

READER'S GUIDE INSTRUMENT 2001

- A. The Financial Services Authority issues the guidance in the Annex to this instrument in the exercise of the power conferred by section 157(1) of the Financial Services and Markets Act 2000 (Guidance).
- B. This instrument shall come into force immediately.
- C. This instrument may be cited as the Reader's Guide Instrument 2001.
- D. Part 1 of the Annex to this instrument may be cited as the Reader's Guide. Part 2 of the Annex to this instrument may be cited as the Reader's Guide Summary.

By order of the Board
21 June 2001

ANNEX

PART 1

READER'S GUIDE

WHAT IS THIS GUIDE?

1. This guide is an introduction to the FSA's Handbook of rules and guidance. It describes the contents of the Handbook; where to find them; and how to make use of them.
2. The guide covers:
 - (1) structure (paragraphs 3 to 17);
 - (2) status of provisions (paragraphs 18 to 31);
 - (3) contents pages (paragraph 32);
 - (4) numbering :
 - pages (paragraphs 33 to 37);
 - contents (paragraphs 38 to 42);
 - (5) cross-references (paragraphs 43 to 45);
 - (6) defined terms (paragraph 46);
 - (7) schedules (paragraphs 47 to 59);
 - (8) glossary of definitions (paragraphs 60 to 64); and
 - (9) index (paragraphs 65 to 68).

STRUCTURE

3. The Handbook is available on the Internet, on CD-ROM and on paper. Its structure and contents, which are the same in each medium, are set out in the table at the end of this guide.
4. Section 153 of the Act requires the FSA to exercise its rule-making powers in writing. The Act describes the document by which the rules are made as a 'rule-making instrument' and imposes a number of requirements, including a requirement to publish it. The FSA will publish all instruments by which provisions in the Handbook are made or amended in full on its website. These fulfil the statutory and other legal requirements for publication, and will be the definitive source for determining what the text was at any particular time for legal purposes (see section 154 of the Act (Verification of rules)).
5. The Handbook as published on CD-ROM and on paper will provide a continuously updated consolidation of the contents of the instruments by which the provisions in the Handbook are made.
6. The Handbook consists of sourcebooks (providing sources of the FSA's requirements and guidance) and manuals (containing processes to be followed). The sourcebooks and manuals are arranged in groups according to their subject matter.
7. Each sourcebook or manual has a reference code of two or more letters. This is usually a contraction or abbreviation of its title, for use in cross-references in the text and in the index. A list of these codes is to be found in the table at the end of this guide.

Prudential sourcebooks

8. To allow more time to achieve satisfactory modernisation and harmonisation, the final, integrated, Prudential sourcebook has been deferred. Meanwhile, the Handbook contains five Interim Prudential sourcebooks:

- | | |
|-------------------------------|------------|
| (1) for banks | IPRU(BANK) |
| (2) for building societies | IPRU(BSOC) |
| (3) for friendly societies | IPRU(FSOC) |
| (4) for insurers | IPRU(INS) |
| (5) for investment businesses | IPRU(INV) |

The prudential categories, which normally determine which of these versions applies to a firm, are explained in Appendix 1 to the Supervision manual (SUP App 1). Each of these sourcebooks continues the existing prudential regime, with changes mainly where the Financial Services and Markets Act 2000 (the Act), and other statutory and international developments, have made a change desirable or essential.

9. Until the integrated Prudential sourcebook comes into force, the prudential provisions for Lloyd's are included in the Lloyd's sourcebook.

Contents of sourcebooks and manuals

10. Each sourcebook or manual has with or in it:

- (1) this guide, or a summary of it;
- (2) a contents page;
- (3) a schedule of transitional provisions (if any); and
- (4) the main text, with any annexes and appendices to it.

In addition:

- (5) schedules of supplementary information (see paragraphs 47 to 59); and
- (6) a glossary of defined terms used, with their definitions (see paragraphs 60 to 64);

are provided (on the Internet, on disk and in hard copy with each module or group of modules as appropriate). An index is also planned.

11. Each sourcebook or manual is divided into chapters. A chapter is divided into sections, and each section is divided into paragraphs.

12. Each paragraph has a regulatory status, indicated by:

- (1) an icon containing a letter ('R' for rule, and so on; see paragraphs 18 to 31); and
- (2) the typeface:
 - (a) Sabon bold 12 point for rules (**R**);
 - (b) Sabon 11 point for directions (**D**);
 - (c) Officina Sans 12 point for Statements of Principle for approved persons (**P**);
 - (d) Officina Sans 11 point for conclusive descriptions of behaviour (**C**);
 - (e) Sabon 12 point for evidential provisions (**E**); and
 - (f) Sabon 10 point for guidance (**G**).

13. Beneath the icon appear:

- (1) the date on which the paragraph came into force; and
- (2) the number of the Handbook release in which the paragraph first appeared in its current form.

14. Each sourcebook or manual, or each chapter or section in it, begins with an application provision. This explains to what types of firm or other person, or to persons carrying on what types of business, the sourcebook or manual, or the chapter or section, applies.

15. After the application provision, each chapter will normally contain a statement of purpose. This explains the objective of the provisions in the chapter: what standards is it intended to uphold? does it reinforce one or more of the Principles for Businesses? does it implement European measures? what result does it aim at? If the subject of the chapter is complicated or detailed, the purpose statement may contain, or be followed by, a table or paragraph mapping the shape and main features of the chapter. Where it may help the reader's understanding, a section too may open with a purpose paragraph.
16. A chapter may have one or more annexes, containing material that supplements the contents of the chapter, but would interrupt the flow of the text if it were included in the chapter itself. The contents of an annex are normally all of one status, shown by an icon, containing the status letter, at the top of the page.
17. A sourcebook or manual may have one or more appendices. These normally relate to the whole sourcebook or manual, or to more than one chapter in it. The contents of an appendix may, like the main text, be of more than one status. This is shown in the same way, by icons.

STATUS OF PROVISIONS

18. The Handbook contains the following types of provision, whose status is indicated by icons containing the letters below. The precise legal status of any particular provision depends upon the terms of the Act and the particular power exercised to create that provision. Schedule 4 lists the powers used to make the various parts of the Handbook (see paragraphs 49 and 56). So what follows is only an introduction.

R

19. The letter R is used to indicate general rules made under section 138 of the Act and specialised rules made under sections 140 to 147 and other powers. (It is not used for evidential provisions (see E, paragraphs 24 to 27).) The legal effect of a rule varies, depending on the power under which it is made, and on the language used in the rule – is it mandatory language or not? Most of the rules in the Handbook create binding obligations on firms (that is, authorised persons). If a firm contravenes such a rule, it may be subject to enforcement action (see ENF) and, in certain circumstances, to an action for damages (see Schedule 5, paragraph 57).
20. The FSA Principles for Businesses are rules. (For the Statements of Principle for approved persons, see P, paragraph 22.)

D

21. The letter D is used to indicate directions and requirements given under various powers conferred by the Act – for example, directions under section 51(3) of the Act about the form and content of applications for Part IV permission. Directions and requirements are binding upon the persons or categories of person to whom they are addressed.

P

22. The letter P is used to indicate the Statements of Principle for approved persons made under section 64 of the Act. The Statements of Principle are binding on approved persons.

C

23. The letter C is used for paragraphs made under section 119(2)(b) of the Act which specify descriptions of behaviour that, in the opinion of the FSA, do not amount to market abuse. These descriptions are conclusive because such behaviour is to be taken, for the purposes of the Act, as not amounting to market abuse (section 122(1)).

E

24. The letter E is used to identify evidential provisions with the characteristics specified in section 149 of the Act. An evidential provision is a rule, but it is not binding in its own right. It always relates to some other binding rule. When it says so, compliance with an evidential provision may be relied on as 'tending to establish compliance' with the rule to which it relates. And when it says so, contravention of an evidential provision may be relied on as 'tending to establish contravention' of the rule to which it relates. An evidential provision of this kind will always say one of these things, and it may say both. Such evidential provisions are thus indicative in nature: they create rebuttable presumptions of compliance with or contravention of the binding rules to which they refer.
25. E is also used for the paragraphs that make up the Code of Practice for Approved Persons (APER 3) made under section 64 of the Act. That code may be relied on so far as it tends to establish whether or not the conduct of an approved person complies with the Statements of Principle for approved persons.
26. E is also used for certain paragraphs in the Code of Market Conduct (MAR 1) made under section 119 of the Act. These paragraphs specify:
 - (1) descriptions of behaviour that, in the opinion of the FSA, amount to market abuse; and
 - (2) factors that, in the opinion of the FSA, are to be taken into account in determining whether or not behaviour amounts to market abuse.
27. These paragraphs of the Code of Market Conduct may be relied on so far as they indicate whether or not particular behaviour should be taken to amount to market abuse (section 122(2) of the Act).

G

28. The letter G is used to indicate guidance given under section 157. The guidance in the Handbook relates to the operation of the Act, the rules in the Handbook and other matters. Guidance may be used to explain the implications of other provisions, to indicate possible means of compliance, to recommend a particular course of action or arrangement, and for other purposes. Whatever guidance is used for, it is not binding on those to whom the Act and rules apply, nor does it have 'evidential' effect. It need not be followed in order to achieve compliance with the relevant rule or other requirement. So a firm cannot incur disciplinary liability merely because it has not followed guidance. Nor is there any presumption that departing from guidance is indicative of a breach of the relevant rule.
29. Guidance is generally designed to throw light on a particular aspect of regulatory requirements, not to be an exhaustive description of firms' obligations. If a person acts in accordance with guidance in the circumstances contemplated by that guidance, then the FSA will proceed on the footing that the person has complied with the aspects of the rule or other requirement to which the guidance relates.
30. Rights conferred on third parties (such as a firm's clients) cannot be affected by guidance given by the FSA. Guidance on rules, the Act or other legislation represents the FSA's view, and does not bind the courts, for example in relation to an action for damages brought by a private person for breach of a rule (see section 150 of the Act (Actions for damages)), or in relation to the enforceability of a contract where there has been a breach of the general prohibition on carrying on a regulated activity in the United Kingdom without authorisation (see sections 26 and 27 of the Act (Enforceability of agreements)). A person may need to seek his own legal advice.
31. G is also used for the FSA's statement of the procedure for giving statutory notices under section 395 of the Act (see DEC), for the various statements of policy regarding use of the FSA's enforcement powers (see ENF), and to indicate the arrangements made by the FSA under paragraph 7 of Schedule 1 to the Act for the investigation of complaints arising in connection with its exercise or non-exercise of its non-legislative functions (see COAF).

CONTENTS PAGES

32. The contents page of each sourcebook or manual lists the chapters, sections, annexes, appendices and schedules in it (without page numbers). To find a section on a particular topic, or any other item, use the electronic links.

NUMBERING: PAGES

33. Page numbers are not important in the Handbook. In the paper version, page numbering starts again at the beginning of each chapter. But each page of a chapter shows:

- (1) the reference code for the sourcebook or manual;
- (2) the number and title of the chapter; and
- (3) the number and title of the section of the chapter.

For example, the first page of Chapter 3 of the Supervision manual shows at the top, on the left 'SUP 3: Auditors' and on the right 'Section 1: Application'. In addition, each page of a chapter shows, at the foot of the page, the number of the last paragraph on the page.

34. Each page of an annex shows, at the top of the page, the reference code, number and title of the chapter to which the annex relates, and the number and status of the annex.
35. Each page of an appendix shows, at the top of the page, the reference code of the sourcebook or manual to which the appendix relates, and the number and title of the appendix.
36. Each page of the Handbook also shows, at the foot of the page, the number, month and year of the release with which the page was published (for example, 'FSA Handbook: Release 03: October 2001').
37. Both the electronic and the paper editions of the Handbook represent the text of the Handbook current at the date of the last release, including all amendments to that date.

NUMBERING: CONTENTS

38. The main text of the Handbook is numbered as follows:

- | | | |
|-------------------|----------|--------------------------|
| (1) chapter | 1 | (2, 3 etc) |
| (2) section | 1.1 | (1.2, 1.3 etc) |
| (3) paragraph | 1.1.1 | (1.1.2, 1.1.3 etc) |
| (4) sub-paragraph | 1.1.1(1) | (1.1.1(2), 1.1.1(3) etc) |

39. Sub-sub-paragraphs are shown by (a), (b), (c) and so on, and sub-sub-sub-paragraphs by (i), (ii), (iii) and so on. For example, the third paragraph of the second section of the first chapter in the Conduct of Business sourcebook, if it were a rule, would be COB 1.2.3R. A sub-sub-paragraph of that paragraph would be COB 1.2.3R(1)(a).
40. When changes are made in the text, if it becomes necessary to add new material between two pieces of existing text, the Handbook numbering will change in the same way as in a statute. For example, if a new paragraph has to be inserted between two existing paragraphs numbered COB 1.2.3R and COB 1.2.4R, the new paragraph will be given the number of the paragraph before it plus the letter A, so that it becomes COB 1.2.3AR.
41. A table in the text is numbered as if it were a paragraph.
42. An illustration in the text, such as a flow-chart, is numbered with the number of the chapter and section in which it appears, followed by the number of the illustration itself. For example, the third illustration in the second section of the first chapter of the Supervision manual would be numbered SUP Fig 1.2.3. If the illustration were in an appendix, it would be numbered according to the number of illustrations in the appendix.

For example, the third illustration in the second appendix to the Enforcement manual would be ENF App 2 Fig 3.

CROSS-REFERENCES

43. In cross-references, and generally, the reference code letters of the sourcebook or manual are given in front of the number, and, if the cross-reference is to a paragraph (or a table or an annex), the letter indicating its status is added at the end. So the first chapter in the Conduct of Business sourcebook is referred to as COB 1; its first section as COB 1.1; and its first paragraph (which is a paragraph of guidance) as COB 1.1.1G.
44. A cross-reference to the annex to COB 1 appears as COB 1 Ann 1G. A cross-reference to an appendix appears, for example, as SUP App 1, and to the first paragraph in that appendix as SUP App 1.1.1G.
45. The index, when referring to an item in a chapter or an appendix, will show the number and regulatory status of the relevant paragraph. When referring to an item in an annex, however, or in a table or illustration, the index will show only the number and status of the annex, table or illustration (not the number of a paragraph within it).

DEFINED TERMS

46. Defined terms used in the text are shown in *italic type*. Where a word or phrase is in italics, its definition can be found in the glossary of defined terms near the end of the sourcebook or manual, or in the consolidated glossary. Where a word or phrase which is shown in italics in one part of the text appears without italics in another part, it is meant to be given, where unitalicised, its ordinary natural meaning. Paragraphs 60 to 64 give more information about the Glossary.

SCHEDULES

47. Each sourcebook or manual contains:
 - (1) a schedule of transitional provisions, immediately after the Contents page;
 - (2) schedules, after the text, of any:
 - (a) record keeping requirements (Schedule 1);
 - (b) notification requirements (Schedule 2);
 - (c) fees and other required payments (Schedule 3);
 - (d) statutory powers exercised by the FSA in making the Handbook (Schedule 4);
 - (e) rights of action for damages (Schedule 5); and
 - (f) rules that can be waived (Schedule 6).
48. Schedules 1 to 3 briefly summarise the contents of the relevant provisions in the sourcebook or manual and cross-refer to them.
49. Schedules 4, 5 and 6 specify the powers the FSA has exercised in making each rule-making instrument (see paragraph 4), summarise the rights of action for damages which attach to many rules, and state which rules can be waived, and under which section of the Act.
50. Where comprehensive schedules may be useful, consolidated versions, drawing together the contents of the schedules from each sourcebook and manual, will be provided.
51. A single consolidated schedule (Schedule 7) provides a check-list of releases for the Handbook as a whole.

Transitional provisions

52. The schedule of Transitional provisions:
- (1) sets out the transitional provisions for the sourcebook or manual (if any);
 - (2) specifies the parts of the sourcebook or manual to which each transitional provision relates, and when those parts commenced; and
 - (3) gives the dates on which each transitional provision:
 - (a) came into force; and
 - (b) expires.

Record keeping requirements

53. Schedule 1 provides a list of the detailed record keeping requirements in the sourcebook or manual and where they are to be found.

Notification requirements

54. Schedule 2 provides a list of the detailed notification requirements in the sourcebook or manual and where they are to be found.

Fees and other required payments

55. Schedule 3 provides a list of any fees and other payments for which a firm may be liable under the sourcebook or manual and where details of them are to be found.

Powers exercised in making the Handbook

56. Schedule 4 specifies the powers given by the Act which the FSA has exercised in making the provisions in the sourcebook or manual.

Rights of action for damages

57. Schedule 5:
- (1) gives guidance (where relevant) on the availability of rights of action to private persons under section 150 of the Act: that rights of action are available on contravention of a rule by an authorised person only; and how 'private person' is defined; and
 - (2) lists the rules in the sourcebook or manual:
 - (a) to which rights of action apply under section 150(1) of the Act;
 - (b) to which rights of action do not apply, in accordance with section 150(2);
 - (c) to which rights of action apply at the suit, not only of a private person, but of a person who is not a private person, in accordance with section 150(3), with a statement to whom the rights have been extended;
 - (d) to which rights of action do not apply because they are not binding on authorised persons, or because they are listing rules or financial resources rules, in accordance with section 150(4).

Rules that can be waived

58. Schedule 6 specifies the rules in the sourcebook or manual (if any) which the FSA has power to waive or modify, and the section of the Act which gives the FSA that power in respect of the rules in question.

Consolidated schedule of releases

59. The purpose of Schedule 7 is to help firms keep track of amendments made to the Handbook since it was first published. It lists by serial number each release issued, its date of publication and its contents. The full text of each release is on the FSA's website at www.fsa.gov.uk.

GLOSSARY OF DEFINITIONS

60. In addition to the links between defined terms and definitions in the electronic versions of the Handbook, each sourcebook or manual has a glossary of definitions. This lists the defined terms used in the sourcebook or manual and gives their meaning. It also contains guidance reminding the reader of the main General provisions for interpreting the Handbook (GEN 2).
61. The provisions in GEN 2:
 - (1) require a purposive interpretation of the rules (GEN 2.2.1R);
 - (2) state the effect of the status letter E (GEN 2.2.3R);
 - (3) state how defined expressions are used (GEN 2.2.7R);
 - (4) confirm that the Interpretation Act 1978 applies throughout the Handbook (GEN 2.2.11R), and explain particular effects of that application (GEN 2.2.12G);
 - (5) state the effect of a cross-reference to Handbook text which has been amended (GEN 2.2.13R); and
 - (6) give the meaning of 'in writing' in the Handbook (GEN 2.2.14R).
62. The introduction to the Glossary summarises the main practical effects of GEN 2. For example, it reminds the reader that an expression with a defined meaning is shown in the Handbook in italics (and not by capital letters); and that the singular includes the plural.
63. A consolidated glossary, drawing together all the defined terms used in the Handbook, will also be found in the Handbook.
64. The Glossary of definitions, including its introduction, is intended to help readers to interpret the Handbook. But readers cannot rely on the Handbook in isolation. If they need to know exactly what is said by and under the Act, they will need to consult the Act itself, and the statutory instruments made under it.

INDEX

65. In addition to the links in the electronic versions of the Handbook, it is planned that each sourcebook or manual will contain an index. The index will warn that it is to help readers, and should not be relied on as comprehensive. It will aim to list alphabetically any significant mention of each of the main subjects of the text and to show where it is to be found.
66. The Handbook system for numbering pages, for numbering the text and for cross-referring is described in paragraphs 33 to 45.
67. Because of this system, references in the index will not be to the page number but to the reference code, number and status of the paragraph (or annex) in question. For example, a reference in the index to the first paragraph in the second section of Chapter 1 of the General provisions (which has the status of guidance) would appear as 'GEN 1.2.1G'.

68. A consolidated index will draw together the contents of the index to each sourcebook and manual.

Contents of the Handbook

	Sourcebook or manual	Reference Code
High Level Standards	Principles for Businesses	PRIN
	Senior management arrangements, Systems and Controls	SYSC
	Threshold Conditions	COND
	Statements of Principle and Code of Practice for Approved Persons	APER
	The Fit and Proper test for Approved Persons	FIT
	General provisions	GEN
Business Standards	5 Interim Prudential sourcebooks	IPRU
	Conduct of Business	COB
	Market conduct, including: Code of market conduct Price stabilising rules Inter-professional conduct	MAR
	Training and Competence	TC
	Money Laundering	ML
Regulatory Processes	Authorisation	AUTH
	Supervision	SUP
	Enforcement	ENF
	Decision making	DEC
Redress	Dispute resolution: Complaints	DISP
	Compensation	COMP
	Complaints against the FSA	COAF

Specialist sourcebooks	Collective Investment Schemes	CIS
	(Later: Credit unions)	(CRED)
	Professional firms	PROF
	Lloyd's	LLD
	(Later: Mortgages)	(MORT)
	Recognised Investment Exchanges and Recognised Clearing Houses	REC
	(Later: United Kingdom Listing Authority)	(UKLA)
Special guides		
Schedules:		
Transitional provisions		
Summary schedules:		
1. Record keeping requirements		
2. Notification requirements		
3. Fees and other required payments		
4. Powers exercised in making the Handbook		
5. Rights of action for damages		
6. Rules that can be waived		
7. Releases		
Glossary of definitions		
Index		

ANNEX

PART 2

Reader's Short Guide

What is the Reader's Guide?

An introduction to the FSA's Handbook of rules and guidance: where to find the contents, and how to use them.

There is a table of Handbook contents with this short version of the Guide.

How is the Handbook published?

The Handbook is on the Internet, CD-ROM and paper, but is the same in each medium. Its modules are arranged in groups by subject matter.

The rule-making instruments, published on the FSA's website, are the definitive source of Handbook text for legal purposes. The text on the CD-ROM, on paper and on the Internet is a continuously updated consolidation of the contents of those instruments.

How is the Handbook published?

Each module:

- has a reference code of two or more letters (see the Handbook contents list);
- has with or in it:
 - (1) the Reader's Guide, or this short version of it;
 - (2) a contents page;
 - (3) a schedule of transitional provisions (if any);
 - (4) the main text, with any annexes and appendices to it;
 - (5) schedules of supplementary information:
 - a schedule of transitional provisions, immediately after the Contents page;
 - schedules, after the text, of any:
 - (a) record keeping requirements (Schedule 1);
 - (b) notification or reporting requirements (Schedule 2);
 - (c) fees and other required payments (Schedule 3);
 - (d) statutory powers exercised by the FSA in making the Handbook (Schedule 4);
 - (e) rights of action for damages (Schedule 5); and
 - (f) rules that can be waived (Schedule 6); and
 - (6) a glossary of definitions, reminding the reader of the main General provisions for interpreting the Handbook (GEN 2) and listing the defined terms used in the module with their meanings;
- is divided into chapters (sub-divided into sections and paragraphs);
- begins (or each chapter or section in it begins) by saying to whom, or to what kind of business, it applies, normally followed by a statement of its purpose.

What is the status of Handbook material?

Each paragraph of the main text of a module has a regulatory status, indicated by:

- (1) an icon containing a letter (such as **R** for rule); and
- (2) the font and type size.

Under the icon are:

- (1) the date the paragraph came into force; and
- (2) the number of the Handbook release in which the paragraph first appeared in its current form.

A module may have one or more appendices, which normally relate to the whole module or to more than one chapter in it. The contents of an appendix may, like the main text, be of more than one status. This is shown in the same way, by icons.

A chapter may have one or more annexes of supplementary material. This is normally all of one status, shown by an icon, containing the status letter, at the top of the page.

The Handbook contains six types of provision. The icon showing the status of each contains one of the following letters:

R	=	rule (The Principles for Businesses are rules.)
D	=	direction
P	=	Statement of Principle for approved persons
C	=	conclusive description of behaviour which does not amount to market abuse
E	=	evidential provision
G	=	guidance

The full Reader's Guide contains a description of each type of status.

How is the Handbook numbered?

Page numbers are not important in the Handbook. But:

- each page of a chapter shows:
 - (1) the reference code for the sourcebook or manual;
 - (2) the number and title of the chapter;
 - (3) the number and title of the section of the chapter;
 - (4) the number, month and year of the release with which the page was published; and
 - (5) the number of the last paragraph on the page;

(so the first page of Chapter 3 of the Supervision manual shows at the top, on the left 'SUP 3: Auditors' and on the right 'Section 1: Application', and at the bottom, for example, on the left 'FSA Handbook: Release 03: October 2001' and on the right '3.1.6')

- each page of an annex shows the reference code, number and title of the chapter to which the annex relates, and the number and status of the annex;
- each page of an appendix shows the reference code of the module to which the appendix relates, and the number and title of the appendix.

The main text of the Handbook is numbered as follows:

chapter	1	(2, 3 etc)
section	1.1	(1.2, 1.3 etc)
paragraph	1.1.1	(1.1.2, 1.1.3 etc)
sub-paragraph	1.1.1(1)	(1.1.1(2), 1.1.1(3) etc)

sub-sub-paragraphs are shown by (a), (b), (c) and so on, and sub-sub-sub-paragraphs by (i), (ii), (iii) and so on;

(for example, the third paragraph of the second section of the first chapter in the Conduct of Business sourcebook, if it were a rule, would be COB 1.2.3R; a sub-sub-paragraph of that paragraph would be COB 1.2.3R(1)(a)).

A table in the text is numbered as if it were a paragraph.

An illustration in the text, such as a flow-chart, is numbered with the number of the chapter and section in which it appears, followed by the number of the illustration itself.

In cross-references, the reference code letters of the module (see the table of Handbook contents) appear in front of the number. In a cross-reference to a paragraph (or a table or an annex), the letter indicating its status is added at the end. So:

- the first chapter in the Conduct of Business sourcebook is COB 1;
- its first section is COB 1.1;
- its first paragraph (if guidance) is COB 1.1.1G;
- its first annex is COB 1 Ann 1G;
- its first appendix would be COB App 1, and the first paragraph in it would be COB App 1.1.1.

How does the Handbook show defined terms?

Defined terms are shown in italic type. Their definitions are in the glossary of defined terms near the end of the module, or in the consolidated glossary of the Handbook.

Where a word or phrase which is shown in italics in one part of the text appears without italics in another part, it is meant to be given, where unitalicised, its ordinary natural meaning.

What consolidated schedules are there in the Handbook?

Where likely to be useful, there are consolidated schedules drawing together the contents of the schedules from each module.

There is also a consolidated schedule of Handbook releases (Schedule 7) to act as a check-list.

Contents of the Handbook

	Sourcebook or manual	Reference Code
High Level Standards	Principles for Businesses	PRIN
	Senior management arrangements, Systems and Controls	SYSC
	Threshold Conditions	COND
	Statements of Principle and Code of Practice for Approved Persons	APER
	The Fit and Proper test for Approved Persons	FIT
	General provisions	GEN
Business Standards	5 Interim Prudential sourcebooks	IPRU
	Conduct of Business	COB
	Market conduct, including: Code of market conduct Price stabilising rules Inter-professional conduct	MAR
	Training and Competence	TC
	Money Laundering	ML
Regulatory Processes	Authorisation	AUTH
	Supervision	SUP
	Enforcement	ENF
	Decision making	DEC
Redress	Dispute resolution: Complaints	DISP
	Compensation	COMP
	Complaints against the FSA	COAF

Specialist sourcebooks	Collective Investment Schemes	CIS
	(Later: Credit unions)	(CRED)
	Professional firms	PROF
	Lloyd's	LLD
	(Later: Mortgages)	(MORT)
	Recognised Investment Exchanges and Recognised Clearing Houses	REC
	(Later: United Kingdom Listing Authority)	(UKLA)
Special guides		
Schedules:		
Transitional provisions		
Summary schedules:		
1. Record keeping requirements		
2. Notification requirements		
3. Fees and other required payments		
4. Powers exercised in making the Handbook		
5. Rights of action for damages		
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Glossary of definitions		
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PRINCIPLES FOR BUSINESSES INSTRUMENT 2001

- A. The Financial Services Authority makes the rules and gives the guidance in the Annex to this instrument ("PRIN") in the exercise of the powers listed in Schedule 4 to PRIN (Powers exercised).
- B. This instrument shall come into force at the beginning of the day on which section 19 (The general prohibition) of the Financial Services and Markets Act 2000 (the "Act") comes into force.
- C. The provisions of the Act relevant to making rules and listed in Schedule 4 to PRIN (Powers exercised) are specified for the purpose of section 153(2) of the Act (Rule-making instruments).
- D. This instrument may be cited as the Principles for Businesses Instrument 2001.
- E. The Annex to this instrument (including its Schedules) may be cited as the Principles for Businesses (or PRIN).

By order of the Board

21 June 2001

ANNEX



Principles for Businesses



Contents

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Transitional provisions

G

- 1 There are no transitional provisions in PRIN. However:
 - (1) GEN contains some technical transitional provisions that apply throughout the Handbook and which are designed to ensure a smooth transition to commencement;
 - (2) COB contains transitional provisions that apply throughout the Handbook relating to the treatment of clients classified by ex-SRO firms and ex-section 43 firms before commencement.

Chapter 1

Introduction



1.1 Application and purpose

Application

- 1.1.1** G_{/1} The *Principles* (see ■ PRIN 2) apply in whole or in part to every *firm*. The application of the *Principles* is modified for *incoming EEA firms*, *incoming Treaty firms* and *UCITS qualifiers*. ■ PRIN 3 (Rules about application) specifies to whom, to what and where the *Principles* apply.

Purpose

- 1.1.2** G_{/1} The *Principles* are a general statement of the fundamental obligations of *firms* under the *regulatory system*. They derive their authority from the FSA's rule-making powers as set out in the *Act* and reflect the *regulatory objectives*.

Accepting deposits, general insurance business and certain long-term insurance business

- 1.1.3** G_{/1} The *Principles* apply with respect to *regulated activities* generally, but, in applying the *Principles* with respect to *accepting deposits*, *general insurance business* and *long-term insurance business* involving *pure protection contracts* or reinsurance contracts, the FSA will proceed only in a *prudential context*. That is to say, in this context, the FSA would not expect to exercise the powers brought into play by a contravention of a *Principle* unless the contravention amounted to a serious or persistent violation which had implications for confidence in the *financial system*, or for the fitness and propriety of the *firm* or for the adequacy of the *firm's* financial resources.

Link to fit and proper standard in the threshold conditions

- 1.1.4** G_{/1} In substance, the *Principles* express the main dimensions of the "fit and proper" standard set for *firms* in *threshold condition 5* (Suitability), although they do not derive their authority from that standard or exhaust its implications. Being ready, willing and organised to abide by the *Principles* is therefore a critical factor in applications for *Part IV permission*, and breaching the *Principles* may call into question whether a *firm* with *Part IV permission* is still fit and proper.

Taking group activities into account

- 1.1.5** G_{/1} *Principles* 3 (Management and control), 4 (Financial prudence) and (in so far as it relates to disclosing to the FSA) 11 (Relations with regulators) take into account the activities of members of a *firm's group*. This does not mean that, for example, inadequacy of a *group* member's risk management systems or resources will automatically lead to a *firm* contravening *Principle* 3 or 4. Rather, the potential impact of a *group* member's activities (and, for example, risk management systems operating on a *group* basis) will be relevant in determining the adequacy of the *firm's* risk management systems or resources respectively.

Standards in markets outside the United Kingdom

- 1.1.6** G_{/1} As set out in ■ PRIN 3.3 (Where?), *Principles* 1 (Integrity), 2 (Skill, care and diligence) and 3 (Management and control) apply to world-wide activities in a *prudential context*. *Principle* 5 (Market conduct) applies to world-wide activities which might have a negative effect on confidence in the *financial system* operating in the *United Kingdom*. In considering whether to take regulatory action under these *Principles* in relation to activities carried on outside the *United Kingdom*, the FSA will take into account the standards expected in the market in which the *firm* is operating. *Principle* 11 (Relations with regulators) applies to world-wide activities; in considering whether to take regulatory action under *Principle* 11 in relation to cooperation with an overseas regulator, the FSA will have regard to the extent of, and limits to, the duties owed by the *firm* to that regulator. (*Principle* 4 (Financial prudence) also applies to world-wide activities.)

Consequences of breaching the Principles

- 1.1.7** G_{/1} Breaching a *Principle* makes a *firm* liable to disciplinary sanctions. In determining whether a *Principle* has been breached it is necessary to look to the standard of conduct required by the *Principle* in question. Under each of the *Principles* the onus will be on the FSA to show that a *firm* has been at fault in some way. What constitutes "fault" varies between different *Principles*. Under *Principle* 1 (Integrity), for example, the FSA would need to demonstrate a lack of integrity in the conduct of a *firm's* business. Under *Principle* 2 (Skill, care and diligence) a *firm* would be in breach if it was shown to have failed to act with due skill, care and diligence in the conduct of its business. Similarly, under *Principle* 3 (Management and control) a *firm* would not be in breach simply because it failed to control or prevent unforeseeable risks; but a breach would occur if the *firm* had failed to take reasonable care to organise and control its affairs responsibly or effectively.
- 1.1.8** G_{/1} The *Principles* are also relevant to the FSA's powers of information-gathering, to vary a *firm's Part IV permission*, and of investigation and intervention, and provide a basis on which the FSA may apply to a court for an *injunction* or restitution order or require a *firm* to make restitution. However, the *Principles* do not give rise to actions for damages by a *private person* (see ■ PRIN 3.4.4 R).
- 1.1.9** G_{/1} Some of the other *rules* and *guidance* in the *Handbook* deal with the bearing of the *Principles* upon particular circumstances. However, since the *Principles* are also designed as a general statement of regulatory requirements applicable in new or unforeseen situations, and in situations in which there is no need for *guidance*, the FSA's other *rules* and *guidance* should not be viewed as exhausting the implications of the *Principles* themselves.

1.2 Clients and the Principles

Characteristics of the client

- 1.2.1** **G**_{/1} *Principles 6 (Customers' interests), 7 (Communications with clients), 8 (Conflicts of interest), 9 (Customers: relationships of trust) and 10 (Clients' assets) impose requirements on firms expressly in relation to their clients or customers. These requirements depend, in part, on the characteristics of the client or customer concerned. This is because what is "due regard" (in Principles 6 and 7), "fairly" (in Principles 6 and 8), "clear, fair and not misleading" (in Principle 7), "reasonable care" (in Principle 9) or "adequate" (in Principle 10) will, of course, depend on those characteristics. For example, the information needs of a general insurance broker will be different from those of a retail general insurance policyholder.*

Approach to client classification

- 1.2.2** **G**_{/1} *Principles 6, 8 and 9 and parts of Principle 7, as qualified by ■ PRIN 3.4.1 R, apply only in relation to customers (that is, clients which are not market counterparties). The approach that a firm needs to take regarding classification of clients into customers and market counterparties will depend on whether the firm is carrying on designated investment business or other activities, as described in ■ PRIN 1.2.3 G and ■ PRIN 1.2.4 G.*

Classification: designated investment business

- 1.2.3** **G**_{/1} ■ COB 4.1.4 R (Requirement to classify) requires a firm to classify a client before conducting designated investment business with or for him, and that classification will be applicable for the purposes of Principles 6, 7, 8 and 9.

Classification: other activities

- 1.2.4** **G**_{/1} In relation to the carrying on of activities other than designated investment business, for example general insurance business or accepting deposits, only ■ COB 4.1.12 R and ■ COB 4.1.13 G (Large intermediate customer classified as a market counterparty) and ■ COB 4.1.14 R (Client classified as a private customer) in ■ COB 4.1 (Client classification) apply (see ■ PRIN 3.4.2 R).

- 1.2.5** **G**_{/1} A firm is therefore not required to classify its clients (because ■ COB 4.1.4 R does not apply) and may choose to comply with Principles 6, 7, 8 and 9 as if all its clients were customers. Alternatively, it may choose to distinguish between market

counterparties and *customers* in complying with those *Principles*. But, in that case, the *firm* would need to classify any *client* treated as a *market counterparty*. In doing this, the requirements in SYSC will apply, including the requirement to establish appropriate systems and controls ■ SYSC 3.1.1 R) and the requirement to make and retain adequate records ■ SYSC 3.2.20 R). In classifying its *market counterparties*, it would be open to such a *firm*, although not obligatory, to permit *intermediate customers* to opt up to *market counterparty* status in accordance with ■ COB 4.1.12 R. It would also have to treat a *market counterparty* as a *customer* if the *firm* had chosen to treat the *client* as a *private customer* in the circumstances set out in ■ COB 4.1.14 R.

1.2.6

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If the *person* with or for whom the *firm* is carrying on an activity is acting through an agent, the ability of the *firm* to treat the agent as its *client* under ■ COB 4.1.5 R (Agent as client) will not be available. For example, if a general *insurer* is effecting a *general insurance contract* through a general insurance broker who is acting as agent for a disclosed *policyholder*, the *policyholder* will be a *client* of the *firm* and the *firm* must comply with the *Principles* accordingly.

Chapter 2

The Principles



2.1 The Principles

2.1.1

R

Table The Principles

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1 Integrity	A <i>firm</i> must conduct its business with integrity.
2 Skill, care and diligence	A <i>firm</i> must conduct its business with due skill, care and diligence.
3 Management and control	A <i>firm</i> must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
4 Financial prudence	A <i>firm</i> must maintain adequate financial resources.
5 Market conduct	A <i>firm</i> must observe proper standards of market conduct.
6 Customers' interests	A <i>firm</i> must pay due regard to the interests of its <i>customers</i> and treat them fairly.
7 Communications with clients	A <i>firm</i> must pay due regard to the information needs of its <i>clients</i> , and communicate information to them in a way which is clear, fair and not misleading.
8 Conflicts of interest	A <i>firm</i> must manage conflicts of interest fairly, both between itself and its <i>customers</i> and between a <i>customer</i> and another <i>client</i> .
9 Customers: relationships of trust	A <i>firm</i> must take reasonable care to ensure the suitability of its advice and discretionary decisions for any <i>customer</i> who is entitled to rely upon its judgment.

<p>10 Clients' assets</p>	<p><i>A firm must arrange adequate protection for clients' assets when it is responsible for them.</i></p>
<p>11 Relations with regulators</p>	<p><i>A firm must deal with its regulators in an open and cooperative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice.</i></p>



Chapter 3

Rules about application



3.1 Who?

- 3.1.1** **R** *PRIN* applies to every *firm*, except that:
- /1
- (1) for an *incoming EEA firm* or an *incoming Treaty firm*, the *Principles* apply only in so far as responsibility for the matter in question is not reserved by a European Community instrument to the *firm's Home State regulator*;
 - (2) for an *incoming EEA firm* which is a *BCD credit institution* without a *top-up permission*, *Principle 4* applies only in relation to the liquidity of a *branch* established in the *United Kingdom*;
 - (3) for an *incoming EEA firm* which has *permission* only for *cross border services* and which does not carry on *regulated activities* in the *United Kingdom*, the *Principles* do not apply;
 - (4) for a *UCITS qualifier*, only *Principles 1, 2, 3, 7 and 9* apply, and only with respect to the activities in **PRIN 3.2.2 R**(Communication and approval of financial promotions).
- 3.1.2** **G** **SYSC App 1** contains *guidance* on the reservation of responsibility to a *Home State regulator* referred to in **PRIN 3.1.1 R (1)**.
- /1
- 3.1.3** **G** **PRIN 3.1.1 R (2)** reflects article 27 of the *Banking Consolidation Directive* which provides that the *Host State regulator* retains responsibility in cooperation with the *Home State regulator* for the supervision of the liquidity of a *branch* of a *BCD credit institution*.
- /1
- 3.1.4** **G** **PRIN 3.1.1 R (3)** puts *incoming EEA firms* on an equal footing with *unauthorised overseas persons* who utilise the overseas persons exclusions in article 72 of the *Regulated Activities Order*.
- /1
- 3.1.5** **G** **PRIN 3.1.1 R (4)** reflects section 266 of the *Act* (Disapplication of rules).
- /1

3.2 What?

3.2.1

R

PRIN applies with respect to the carrying on of:

/1

- (1) *regulated activities*;
- (2) activities that constitute *dealing in investments as principal*, disregarding the exclusion in article 15 of the *Regulated Activities Order* (Absence of holding out etc); and
- (3) *ancillary activities* in relation to *designated investment business*.

3.2.2

R

PRIN also applies with respect to the *communication* and *approval* of *financial promotions* which:

/1

- (1) if *communicated* by an *unauthorised person* without *approval* would contravene section 21(1) of the *Act* (Restrictions on financial promotion); and
- (2) may be *communicated* by a *firm* without contravening section 238(1) of the *Act* (Restrictions on promotion of collective investment schemes).

3.2.3

R

Principles 3, 4 and (in so far as it relates to disclosing to the *FSA*) 11 (and this chapter) also:

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- (1) apply with respect to the carrying on of *unregulated activities* (for *Principle* 3 this is only in a *prudential context*); and
- (2) take into account any activity of other members of a *group* of which the *firm* is a member.

3.3 Where?

3.3.1

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Table Territorial application of the Principles

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Principle	Territorial application
<i>Principles 1, 2 and 3</i>	<p>in a <i>prudential context</i>, apply with respect to activities wherever they are carried on;</p> <p>otherwise, apply with respect to activities carried on from an establishment maintained by the <i>firm</i> (or its <i>appointed representative</i>) in the <i>United Kingdom</i> unless another applicable <i>rule</i> which is relevant to the activity has a wider territorial scope, in which case the <i>Principle</i> applies with that wider scope in relation to the activity described in that <i>rule</i>.</p>
<i>Principle 4</i>	applies with respect to activities wherever they are carried on.
<i>Principle 5</i>	<p>if the activities have, or might reasonably be regarded as likely to have, a negative effect on confidence in the <i>financial system</i> operating in the <i>United Kingdom</i>, applies with respect to activities wherever they are carried on;</p> <p>otherwise, applies with respect to activities carried on from an establishment maintained by the <i>firm</i> (or its <i>appointed representative</i>) in the <i>United Kingdom</i>.</p>
<i>Principles 6, 7, 8, 9 and 10</i>	apply with respect to activities carried on from an establishment maintained by the <i>firm</i> (or its <i>appointed representative</i>) in the <i>United Kingdom</i> unless another applicable <i>rule</i> which is relevant to the activity has a wider territorial scope, in which case the <i>Principle</i> applies with that wider scope in relation to the activity described in that <i>rule</i> .
<i>Principle 11</i>	applies with respect to activities wherever they are carried on.

3.4 General

Clients and the Principles

3.4.1 **R**_{/1} Although *Principle 7* refers to *clients*, the only requirement of *Principle 7* relating to *market counterparties* is that a *firm* must communicate information to *market counterparties* in a way that is not misleading.

3.4.2 **R**_{/1} For the purposes of *PRIN*, the following provisions of **■ COB 4.1** (Client classification) also apply to a *firm* intending to carry on, or carrying on, activities other than *designated investment business*:

- (1) **■ COB 4.1.12 R** and **■ COB 4.1.13 G** (Large intermediate customer classified as a market counterparty); and
- (2) **■ COB 4.1.14 R** (Client classified as a private customer).

3.4.3 **G**_{/1} The whole of **■ COB 4.1** (Client classification) applies to a *firm* intending to conduct, or conducting, *designated investment business* and *ancillary activities* relating to *designated investment business*. Any *client* classifications established in relation to such business will be applicable for the purposes of *Principles 6, 7, 8* and *9*.

Actions for damages

3.4.4 **R**_{/1} A contravention of the *rules* in *PRIN* does not give rise to a right of action by a *private person* under section 150 of the *Act* (and each of those *rules* is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action).

Reference to "regulators" in Principle 11

3.4.5 **R**_{/1} Where *Principle 11* refers to regulators, this means, in addition to the *FSA*, other regulators with recognised jurisdiction in relation to *regulated activities*, whether in the *United Kingdom* or abroad.

Handbook Modules

Schedule1 Record Keeping Requirements

G

- 1 There are no record keeping requirements in PRIN.

Handbook Modules

Schedule2 Notification requirements

G

- 1 The aim of the guidance in the following table is to give the reader a quick over-all view of the relevant requirements for notification and reporting.
- 2 It is not a complete statement of those requirements and should not be relied on as if it were.
- 3 **Table**

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
Principle 11 (PRIN 2.1.1R)	Anything relating to the firm of which the FSA would reasonably expect notice	Appropriate disclosure	Anything relating to the firm of which the FSA would reasonably expect notice	Appropriate

Handbook Modules

Schedule3 Fees and other required payments

G

- 1 There are no requirements for fees or other payments in PRIN.

Handbook Modules

Schedule4 Powers Exercised

G

- 1 The following powers and related provision in the Act have been exercised by the FSA to make the rules in PRIN:
 - (1) Section 138 (General rule -making power)
 - (2) Section 145 (Financial promotion rules)
 - (3) Section 146 (Money laundering rules)
 - (4) Section 150(2) (Actions for damages)
 - (5) Section 156 (General Supplementary powers).

- 2 The following power in the Act has been exercised by the FSA to give the guidance in PRIN:
 - Section 157(1) (Guidance).

Handbook Modules

Schedule5 Rights of action for damages

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- 1 The table below sets out the rules in PRIN contravention of which by an authorised person may be actionable under section 150 of the Act (Actions for damages) by a person who suffers loss as a result of the contravention.
- 2 If a “Yes” appears in the column headed “For private person?”, the rule may be actionable by a “private person” under section 150 (or, in certain circumstances, his fiduciary or representative; see article 6(2) and (3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001 No 2256)). A “Yes” in the column headed “Removed” indicates that the FSA has removed the right of action under section 150(2) of the Act. If so, a reference to the rule in which it is removed is also given.
- 3 The column headed “For other person?” indicates whether the rule may be actionable by a person other than a private person (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of person by whom the rule may be actionable is given.

4 Table

Chapter/ Appendix	Section/ Annex	Paragraph	Right of Action		
			For private person?	Removed?	For other person?
All rules in <i>PRIN</i>			No	Yes PRIN 3.4.4R	No

Handbook Modules

Schedule6 Rules that can be waived

G

- 1 The rules in PRIN can be waived by the FSA under section 148 of the ACT (Modification or waiver of rules).

Principles for Businesses

Derivations

G

There is no table of derivations for *PRIN*.

Principles for Businesses

Destinations

G

There is no table of destinations for *PRIN*.

**SENIOR MANAGEMENT ARRANGEMENTS,
SYSTEMS AND CONTROLS INSTRUMENT 2001**

- A. The Financial Services Authority makes the rules and gives the guidance in the Annex to this instrument ("SYSC") in the exercise of the powers listed in Schedule 4 to SYSC (Powers exercised).
- B. This instrument shall come into force at the beginning of the day on which section 19 (The general prohibition) of the Financial Services and Markets Act 2000 (the "Act") comes into force.
- C. The provisions of the Act relevant to making rules and listed in Schedule 4 to SYSC (Powers exercised) are specified for the purpose of section 153(2) of the Act (Rule-making instruments).
- D. This instrument may be cited as the Senior Management Arrangements, Systems and Controls Instrument 2001.
- E. The Annex to this instrument (including its Schedules) may be cited as Senior Management Arrangements, Systems and Controls (or SYSC).

By order of the Board
21 June 2001

ANNEX



Senior Management Arrangements, Systems and Controls

Contents

Transitional provisions

Text of SYSC:

- 1 Application and purpose
 - 2 Senior management arrangements
 - 3 Systems and controls
- Appendix 1: Matters reserved to a Home State regulator

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Schedule 3: Fees and other required payments

Schedule 4: Powers exercised

Schedule 5: Rights of action for damages

Schedule 6: Rules that can be waived

Derivations

Destinations

Handbook Modules

Transitional provisions

G

- 1 There are no transitional provisions in SYSC. However, GEN contains some technical transitional provisions that apply throughout the Handbook and which are designed to ensure a smooth transition at commencement.

Chapter 1

Application and purpose

1.1 Application

Who?

1.1.1

R

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SYSC applies to every *firm* except that:

- (1) for an *incoming EEA firm* or an *incoming Treaty firm*:
 - (a) ■ SYSC 2.1.1 R and ■ SYSC 2.1.2 G do not apply;
 - (b) ■ SYSC 2.1.3 R to ■ SYSC 2.2.3 G apply, but only in relation to allocation of the function in ■ SYSC 2.1.3 R (2) and only in so far as responsibility for the matter in question is not reserved by a European Community instrument to the *firm's Home State regulator*; and
 - (c) ■ SYSC 3 applies, but only in so far as responsibility for the matter in question is not reserved by a European Community instrument to the *firm's Home State regulator*;
- (2) for an *incoming EEA firm* which has *permission only for cross border services* and which does not carry on *regulated activities* in the *United Kingdom*, SYSC does not apply;
- (3) ■ SYSC 2 does not apply to a *sole trader* as long as he does not employ any *person* who is required to be approved under section 59 of the *Act* (Approval for particular arrangements); and
- (4) for a *UCITS qualifier*:
 - (a) ■ SYSC 2.1.1 R and ■ SYSC 2.1.2 G do not apply;
 - (b) ■ SYSC 2.1.3 R to ■ SYSC 2.2.3 G apply, but only in relation to allocation of the function in ■ SYSC 2.1.3 R (2) and only with respect to the activities in ■ SYSC 1.1.4 R;
 - (c) ■ SYSC 3 applies, but only with respect to the activities in ■ SYSC 1.1.4 R.

1.1.2

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- (1) Question 12 in ■ SYSC 2.1.6 G and ■ SYSC App 1 contain guidance on ■ SYSC 1.1.1R (1)(b) and (c).

- (2) ■ SYSC 1.1.7 R and ■ SYSC 1.1.10 R (Where?) further restrict the territorial application of SYSC for an *incoming EEA firm*, *incoming Treaty firm* or *UCITS qualifier*.
- (3) ■ SYSC 1.1.1R (4) puts *incoming EEA firm* on an equal footing with *unauthorised overseas persons* who utilise the overseas persons exclusions in article 72 of the *Regulated Activities Order*.

What?

1.1.3

R

SYSC applies with respect to the carrying on of:

/1

- (1) *regulated activities*;
- (2) activities that constitute *dealing in investments as principal*, disregarding the exclusion in article 15 of the *Regulated Activities Order* (Absence of holding out etc); and
- (3) *ancillary activities* in relation to *designated investment business*.

1.1.4

R

SYSC also applies with respect to the *communication* and *approval* of *financial promotions* which:

/1

- (1) if *communicated* by an *unauthorised person* without *approval* would contravene section 21(1) of the *Act* (Restrictions on financial promotion); and
- (2) may be *communicated* by a *firm* without contravening section 238(1) of the *Act* (Restrictions on promotion of collective investment schemes).

1.1.5

R

■ SYSC 3 also:

/1

- (1) applies with respect to the carrying on of *unregulated activities* in a *prudential context*; and
- (2) takes into account any activity of other members of a *group* of which the *firm* is a member.

1.1.6

G

■ SYSC 1.1.5 R (2) does not mean that inadequacy of a *group* member's systems and controls will automatically lead to a *firm* contravening, for example, ■ SYSC 3.1.1 R. Rather, the potential impact of a *group* member's activities, including its systems and controls, and any systems and controls that operate on a *group* basis, will be relevant in determining the appropriateness of the *firm's* own systems and controls.

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Where?

1.1.7

R

SYSC applies with respect to activities carried on from an establishment maintained by the *firm* (or its *appointed representative*) in the *United Kingdom* unless another applicable *rule*

/1

which is relevant to the activity has a wider territorial scope, in which case SYSC applies with that wider scope in relation to the activity described in that *rule*.

1.1.8

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An example of the type of *rule* referred to in ■ SYSC 1.1.7 R with a different territorial scope is the *rules* in ■ COB 9.1 (Custody). ■ COB 9.1 applies, for certain *UK firms*, to activities carried on from *branches* in other *EEA States* as well as *UK establishments* ■ COB 1.4.3 R (c) (General application – where?). Therefore, SYSC applies to the *custody* activities described in ■ COB 9.1 carried on from such a *branch* by such a *UK firm*. The *UK firm* must, for example, take reasonable care to establish systems and controls under ■ SYSC 3.1.1 R as are appropriate to those activities carried on from its *EEA branches* as well as from its *UK establishments*.

1.1.9

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SYSC also applies in a *prudential context* to a *UK domestic firm* with respect to activities wherever they are carried on.

1.1.10

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■ SYSC 3 also applies in a *prudential context* to an *overseas firm* (other than an *incoming EEA firm*, *incoming Treaty firm* or *UCITS qualifier*) with respect to activities wherever they are carried on.

1.1.11

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- (1) In considering whether to take regulatory action under SYSC in relation to activities carried on outside the *United Kingdom*, the *FSA* will take into account the standards expected in the market in which the *firm* is operating.
- (2) Most of the *rules* in ■ SYSC 3 are linked to other requirements and standards under the *regulatory system* which have their own territorial limitations so that those *SYSC rules* are similarly limited in scope.

Actions for damages

1.1.12

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A contravention of the *rules* in SYSC does not give rise to a right of action by a *private person* under section 150 of the *Act* (and each of those *rules* is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action).

1.2 Purpose

1.2.1

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The purposes of SYSC are:

- (1) to encourage *firms' directors* and *senior managers* to take appropriate practical responsibility for their *firms'* arrangements on matters likely to be of interest to the *FSA* because they impinge on the *FSA's* functions under the *Act*;
- (2) to increase certainty by amplifying *Principle 3*, under which a *firm* must “take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems”; and
- (3) to encourage *firms* to vest responsibility for effective and responsible organisation in specific *directors* and *senior managers*.

1.2.2

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The main matters, referred to in ■ SYSC 1.2.1 G (1), which are likely to be of interest to the *FSA* are those which relate to confidence in the *financial system*; to the fair treatment of *firms' customers*; to the protection of *consumers*; and to the use of the *financial system* in connection with *financial crime*. The *FSA* is not primarily concerned with risks which threaten only the owners of a financial business except in so far as these risks may have an impact on those matters.

Chapter 2

2

Senior management arrangements

2.1 Apportionment of Responsibilities

2.1.1 **R** ^{/1} A *firm* must take reasonable care to maintain a clear and appropriate apportionment of significant responsibilities among its *directors* and *senior managers* in such a way that:

- (1) it is clear who has which of those responsibilities; and
- (2) the business and affairs of the *firm* can be adequately monitored and controlled by the *directors*, relevant *senior managers* and *governing body* of the *firm*.

2.1.2 **G** ^{/1} The role undertaken by a *non-executive director* will vary from one *firm* to another. For example, the role of a *non-executive director* in a *friendly society* may be more extensive than in other *firms*. Where a *non-executive director* is an *approved person*, for example where the *firm* is a *body corporate*, his responsibility and therefore liability will be limited by the role that he undertakes. Provided that he has personally taken due care in his role, a *non-executive director* would not be held disciplinarily liable either for the failings of the *firm* or for those of individuals within the *firm*. The *non-executive director function*, for the purposes of the *approved persons* regime, is described in ■ SUP 10.

2.1.3 **R** ^{/1} A *firm* must appropriately allocate to one or more individuals, in accordance with ■ SYSC 2.1.4 R, the functions of:

- (1) dealing with the apportionment of responsibilities under ■ SYSC 2.1.1 R; and
- (2) overseeing the establishment and maintenance of systems and controls under ■ SYSC 3.1.1 R.

2.1.4 **R** ^{/1} Table Allocation of functions
This table belongs to ■ SYSC 2.1.3 R

1: Firm type	2: Allocation of both functions must be to the following individual, if any (see Note):	3: Allocation to one or more individuals selected from this column is compulsory if there is no allocation to an individual in column 2, but is otherwise optional and additional:
<p>(1) <i>A firm which is a body corporate and is a member of a group, other than a firm in row (2)</i></p> <p>(2) <i>An incoming EEA firm or incoming Treaty firm (note: only the function in SYSC 2.1.3R(2) must be allocated)</i></p> <p>(3) <i>Any other firm</i></p>	<p>(1) <i>the firm's chief executive (and all of them jointly, if more than one); or</i></p> <p>(2) <i>a director or senior manager responsible for the overall management of:</i></p> <p>(a) <i>the group; or</i></p> <p>(b) <i>a group division within which some or all of the firm's regulated activities fall</i></p> <p>(not applicable)</p> <p><i>the firm's chief executive (and all of them jointly, if more than one)</i></p>	<p><i>the firm's and its group's:</i></p> <p>(1) <i>directors; and</i></p> <p>(2) <i>senior managers</i></p> <p><i>the firm's and its group's:</i></p> <p>(1) <i>directors; and</i></p> <p>(2) <i>senior managers</i></p> <p><i>the firm's and its group's:</i></p> <p>(1) <i>directors; and</i></p> <p>(2) <i>senior managers</i></p>
<p>Note: Column 2 does not require the involvement of the <i>chief executive</i> or other executive <i>director</i> or <i>senior manager</i> in an aspect of corporate governance if that would be contrary to generally accepted principles of good corporate governance.</p>		

2.1.5

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SYSC 2.1.3R and 2.1.4R give a *firm* some flexibility in the individuals to whom the functions may be allocated. It will be common for both the functions to be allocated solely to the *firm's chief executive*. ■ SYSC 2.1.6 G contains further *guidance* on the requirements of ■ SYSC 2.1.3 R and 2.1.4R in a question and answer form.

2.1.6

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Table Frequently asked questions about allocation of functions in ■ SYSC 2.1.3 R
This table belongs to ■ SYSC 2.1.5 G

	Question	Answer
1	Does an individual to whom a function is allocated under SYSC 2.1.3R need to be an <i>approved person</i> ?	<p>An individual to whom a function is allocated under SYSC 2.1.3R will be performing the <i>apportionment and oversight function</i> (CF 8, see SUP 10.7.1R) and an application must be made to the FSA for approval of the individual before the function is performed under section 59 of the Act (Approval for particular arrangements).</p> <p>There are exceptions from this in SUP 10.1 (Approved persons – Application). In particular, an <i>incoming EEA firm</i> is referred to the <i>EEA investment business oversight function</i> (CF 9, see SUP 10.7.6R).</p>
2	If the allocation is to more than one individual, can they perform the functions, or aspects of the functions, separately?	<p>If the functions are allocated to joint <i>chief executives</i> under SYSC 2.1.4R, column 2, they are expected to act jointly.</p> <p>If the functions are allocated to an individual under SYSC 2.1.4R, column 2, in addition to individuals under SYSC 2.1.4R, column 3, the former may normally be expected to perform a leading role in relation to the functions that reflects his position.</p> <p>Otherwise, yes.</p>
3	What is meant by “appropriately allocate” in this context?	<p>The allocation of functions should be compatible with delivering compliance with <i>Principle 3</i>, SYSC 2.1.1R and SYSC 3.1.1R. The FSA considers that allocation to one or two individuals is likely to be appropriate for most <i>firms</i>.</p>
4	If a committee of management governs a <i>firm</i> or <i>group</i> , can the functions be allocated to every member of that committee?	<p>Yes, as long as the allocation remains appropriate (see Question 3).</p> <p>If the <i>firm</i> also has an individual as <i>chief executive</i>, then the functions must be allocated to that individual as well under SYSC 2.1.4R, column 2 (see Question 7).</p>
5	Does the definition of <i>chief executive</i> include the possessor of equivalent responsibilities with another title, such as a managing <i>director</i> or managing <i>partner</i> ?	<p>Yes.</p>

	Question	Answer
6	Is it possible for a <i>firm</i> to have more than one individual as its <i>chief executive</i> ?	Although unusual, some <i>firms</i> may wish the responsibility of a <i>chief executive</i> to be held jointly by more than one individual. In that case, each of them will be a <i>chief executive</i> and the functions must be allocated to all of them under SYSC 2.1.4R, column 2 (see also Questions 2 and 7).
7	If a <i>firm</i> has an individual as <i>chief executive</i> , must the functions be allocated to that individual?	<p>Normally, yes, under SYSC 2.1.4R, column 2.</p> <p>But if the <i>firm</i> is a <i>body corporate</i> and a member of a <i>group</i>, the functions may, instead of to the <i>firm's chief executive</i>, be allocated to a <i>director</i> or <i>senior manager</i> from the <i>group</i> responsible for the overall management of the <i>group</i> or of a relevant <i>group</i> division, so long as this is appropriate (see Question 3). Such individuals will nevertheless require approval by the <i>FSA</i> (see Question 1).</p> <p>If the <i>firm</i> chooses to allocate the functions to a <i>director</i> or <i>senior manager</i> responsible for the overall management of a relevant <i>group</i> division, the <i>FSA</i> would expect that individual to be of a seniority equivalent to or greater than a <i>chief executive</i> of the <i>firm</i> for the allocation to be appropriate.</p>
8	If a <i>firm</i> has a <i>chief executive</i> , can the functions be allocated to other individuals in addition to the <i>chief executive</i> ?	<p>See also Question 14.</p> <p>Yes. SYSC 2.1.4R, column 3, permits a <i>firm</i> to allocate the functions, additionally, to the <i>firm's</i> (or where applicable the <i>group's</i>) <i>directors</i> and <i>senior managers</i> as long as this is appropriate (see Question 3).</p>

	Question	Answer
9	What if a <i>firm</i> does not have a <i>chief executive</i> ?	<p>Normally, the functions must be allocated to one or more individuals selected from the <i>firm's</i> (or where applicable the <i>group's</i>) <i>directors</i> and <i>senior managers</i> under SYSC 2.1.4R, column 3.</p> <p>But if the <i>firm</i>:</p> <p>(1) is a <i>body corporate</i> and a <i>member</i> of a <i>group</i>; and</p> <p>(2) the <i>group</i> has a <i>director</i> or <i>senior manager</i> responsible for the overall management of the <i>group</i> or of a relevant <i>group</i> division;</p> <p>then the functions must be allocated to that individual (together, optionally, with individuals from column 3 if appropriate) under SYSC 2.1.4R, column 2.</p>
10	What do you mean by “ <i>group</i> division within which some or all of the <i>firm's</i> regulated activities fall”?	<p>A “division” in this context should be interpreted by reference to geographical operations, product lines or any other method by which the <i>group's</i> business is divided.</p> <p>If the <i>firm's</i> regulated activities fall within more than one division and the <i>firm</i> does not wish to allocate the functions to its <i>chief executive</i>, the allocation must, under SYSC 2.1.4R, be to:</p> <p>(1) a <i>director</i> or <i>senior manager</i> responsible for the overall management of the <i>group</i>; or</p> <p>(2) a <i>director</i> or <i>senior manager</i> responsible for the overall management of one of those divisions;</p> <p>together, optionally, with individuals from column 3 if appropriate. (See also Questions 7 and 9.)</p>

	Question	Answer
11	<p>How does the requirement to allocate the functions in SYSC 2.1.3R apply to an <i>overseas firm</i> which is not an <i>incoming EEA firm</i>, <i>incoming Treaty firm</i> or <i>UCITS qualifier</i>?</p>	<p>The <i>firm</i> must appropriately allocate those functions to one or more individuals, in accordance with SYSC 2.1.4R, but:</p> <p>(1) The responsibilities that must be apportioned and the systems and controls that must be overseen are those relating to activities carried on from a <i>UK</i> establishment with certain exceptions (see SYSC 1.1.7R). Note that SYSC 1.1.10R does not extend the territorial scope of SYSC 2 for an <i>overseas firm</i>.</p> <p>(2) The <i>chief executive</i> of an <i>overseas firm</i> is the <i>person</i> responsible for the conduct of the <i>firm's</i> business within the <i>United Kingdom</i> (see the definition of "<i>chief executive</i>"). This might, for example, be the manager of the <i>firm's</i> <i>UK</i> establishment, or it might be the <i>chief executive</i> of the <i>firm</i> as a whole, if he has that responsibility.</p> <p>The <i>apportionment and oversight function</i> applies to such a <i>firm</i>, unless it falls within a particular exception from the <i>approved persons</i> regime (see Question 1).</p>

	Question	Answer
12	How does the requirement to allocate the functions in SYSC 2.1.3R apply to an <i>incoming EEA firm</i> or <i>incoming Treaty firm</i> ?	<p>SYSC 1.1.1R(2) and SYSC 1.1.7R restrict the application of SYSC 2.1.3R for such a <i>firm</i>. Accordingly:</p> <p>(1) Such a <i>firm</i> is not required to allocate the function of dealing with apportionment in SYSC 2.1.3R(1).</p> <p>(2) Such a <i>firm</i> is required to allocate the function of oversight in SYSC 2.1.3R(2). However, the systems and controls that must be overseen are those relating to matters which the <i>FSA</i>, as <i>Host State regulator</i>, is entitled to regulate (there is <i>guidance</i> on this in SYSC App 1). Those are primarily, but not exclusively, the systems and controls relating to the conduct of the <i>firm's</i> activities carried on from its <i>UK branch</i>.</p> <p>(3) Such a <i>firm</i> need not allocate the function of oversight to its <i>chief executive</i>; it must allocate it to one or more <i>directors</i> and <i>senior managers</i> of the <i>firm</i> or the <i>firm's group</i> under SYSC 2.1.4R, row (2).</p> <p>(4) An <i>incoming EEA firm</i> which has <i>provision only</i> for <i>cross border services</i> is not required to allocate either function if it does not carry on <i>regulated activities</i> in the <i>United Kingdom</i>; for example if they fall within the overseas persons exclusions in article 72 of the <i>Regulated Activities Order</i>.</p> <p>See also Question 1.</p>

	Question	Answer
13	What about a <i>firm</i> that is a <i>partnership</i> or a <i>limited liability partnership</i> ?	The <i>FSA</i> envisages that most if not all <i>partners</i> or members will be either <i>directors</i> or <i>senior managers</i> , but this will depend on the constitution of the <i>partnership</i> (particularly in the case of a <i>limited partnership</i>) or <i>limited liability partnership</i> . A <i>partnership</i> or <i>limited liability partnership</i> may also have a <i>chief executive</i> (see Question 5). A <i>limited liability partnership</i> is a <i>body corporate</i> and, if a member of a <i>group</i> , will fall within SYSC 2.1.4R, row (1) or (2).
14	What if generally accepted principles of good corporate governance recommend that the <i>chief executive</i> should not be involved in an aspect of corporate governance?	The Note to SYSC 2.1.4R provides that the <i>chief executive</i> or other <i>executive director</i> or <i>senior manager</i> need not be involved in such circumstances. For example, the Combined Code developed by the Committee on Corporate Governance recommends that the board of a listed company should establish an audit committee of non-executive directors to be responsible for oversight of the audit. That aspect of the oversight function may therefore be allocated to the members of such a committee without involving the <i>chief executive</i> . Such individuals may require approval by the <i>FSA</i> in relation to that function (see Question 1).

2.2 Recording the apportionment

- 2.2.1** **R**_{/1} (1) A *firm* must make a record of the arrangements it has made to satisfy ■ SYSC 2.1.1 R (apportionment) and ■ SYSC 2.1.3 R (allocation) and take reasonable care to keep this up to date.
- (2) This record must be retained for six years from the date on which it was superseded by a more up-to-date record.
- 2.2.2** **G**_{/1} (1) A *firm* will be able to comply with ■ SYSC 2.2.1 R by means of records which it keeps for its own purposes provided these records satisfy the requirements of ■ SYSC 2.2.1 R and provided the *firm* takes reasonable care to keep them up to date. Appropriate records might, for this purpose, include organisational charts and diagrams, project management *documents*, job descriptions, committee constitutions and terms of reference provided they show a clear description of the *firm's* major functions.
- (2) *Firms* should record any material change to the arrangements described in ■ SYSC 2.2.1 R as soon as reasonably practicable after that change has been made.
- 2.2.3** **G**_{/1} Where responsibilities have been allocated to more than one individual, the *firm's* record should show clearly how those responsibilities are shared or divided between the individuals concerned.

Chapter 3

Systems and Controls



3.1 Systems and Controls

- 3.1.1** **R** ^{/1} A *firm* must take reasonable care to establish and maintain such systems and controls as are appropriate to its business.
- 3.1.2** **G** ^{/1}
- (1) The nature and extent of the systems and controls which a *firm* will need to maintain under **■ SYSC 3.1.1 R** will depend upon a variety of factors including:
 - (a) the nature, scale and complexity of its business;
 - (b) the diversity of its operations, including geographical diversity;
 - (c) the volume and size of its transactions; and
 - (d) the degree of risk associated with each area of its operation.
 - (2) To enable it to comply with its obligation to maintain appropriate systems and controls, a *firm* should carry out a regular review of them.
 - (3) The areas typically covered by the systems and controls referred to in **■ SYSC 3.1.1 R** are those identified in **■ SYSC 3.2**. Detailed requirements regarding systems and controls relevant to particular business areas or particular types of *firm* are covered elsewhere in the *Handbook*.
- 3.1.3** **G** ^{/1} Where the Combined Code developed by the Committee on Corporate Governance is relevant to a *firm*, the *FSA*, in considering whether the *firm's* obligations under **■ SYSC 3.1.1 R** have been met, will give it due credit for following corresponding provisions in the Code and related guidance.
- 3.1.4** **G** ^{/1} A *firm* has specific responsibilities regarding its *appointed representatives* (see **■ SUP 12**).
- 3.1.5** **G** ^{/1} **■ SYSC 2.1.3 R (2)** prescribes how a *firm* must allocate the function of overseeing the establishment and maintenance of systems and controls described in **■ SYSC 3.1.1 R**.

3.2 Areas covered by systems and controls

Introduction

- 3.2.1** G_{/1} This section covers some of the main issues which a *firm* is expected to consider in establishing and maintaining the systems and controls appropriate to its business, as required by ■ SYSC 3.1.1 R.

Organisation

- 3.2.2** G_{/1} A *firm's* reporting lines should be clear and appropriate having regard to the nature, scale and complexity of its business. These reporting lines, together with clear management responsibilities, should be communicated as appropriate within the *firm*.
- 3.2.3** G_{/1}
- (1) A *firm's governing body* is likely to delegate many functions and tasks for the purpose of carrying out its business. When functions or tasks are delegated, either to *employees* or to *appointed representatives*, appropriate safeguards should be put in place.
 - (2) When there is delegation, a *firm* should assess whether the recipient is suitable to carry out the delegated function or task, taking into account the degree of responsibility involved.
 - (3) The extent and limits of any delegation should be made clear to those concerned.
 - (4) There should be arrangements to supervise delegation, and to monitor the discharge of delegates' functions or tasks.
 - (5) If cause for concern arises through supervision and monitoring or otherwise, there should be appropriate follow-up action at an appropriate level of seniority within the *firm*.
- 3.2.4** G_{/1}
- (1) The *guidance* relevant to delegation within the *firm* is also relevant to external delegation ("outsourcing"). A *firm* cannot contract out its regulatory obligations. So, for example, under *Principle 3* a *firm* should take reasonable care to supervise the discharge of outsourced functions by its contractor.
 - (2) A *firm* should take steps to obtain sufficient information from its contractor to enable it to assess the impact of outsourcing on its systems and controls.
- 3.2.5** G_{/1} Where it is made possible and appropriate by the nature, scale and complexity of its business, a *firm* should segregate the duties of individuals and departments in

such a way as to reduce opportunities for *financial crime* or contravention of requirements and standards under the *regulatory system*. For example, the duties of front-office and back-office staff should be segregated so as to prevent a single individual initiating, processing and controlling transactions.

Compliance

- 3.2.6** **R**_{/1} A *firm* must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the *regulatory system* and for countering the risk that the *firm* might be used to further *financial crime*.
- 3.2.7** **G**_{/1}
- (1) Depending on the nature, scale and complexity of its business, it may be appropriate for a *firm* to have a separate compliance function. The organisation and responsibilities of a compliance function should be documented. A compliance function should be staffed by an appropriate number of competent staff who are sufficiently independent to perform their duties objectively. It should be adequately resourced and should have unrestricted access to the *firm's* relevant records as well as ultimate recourse to its *governing body*.
 - (2) The *regulatory objectives* are defined in section 2 of the *Act* and include “the reduction of *financial crime*”. This objective is more fully described in section 6 of the *Act*. This describes “*financial crime*” as including “any offence involving (a) fraud or dishonesty, (b) misconduct in, or misuse of information relating to, a financial market, or (c) handling the proceeds of crime”.
 - (3) The FSA’s detailed requirements for systems and controls with respect to *money laundering* are set out in the *Money Laundering* sourcebook (*ML*).
- 3.2.8** **R**_{/1}
- (1) A *firm* which carries on *designated investment business* must allocate to a *director* or *senior manager* the function of:
 - (a) having responsibility for oversight of the *firm's* compliance; and
 - (b) reporting to the *governing body* in respect of that responsibility.
 - (2) In ■ SYSC 3.2.8 R (1) “compliance” means compliance with the *rules* in:
 - (a) *COB* (Conduct of Business); and
 - (b) *CIS* (Collective Investment Schemes).
- 3.2.9** **G**_{/1}
- (1) ■ SUP 10.7.8 R uses ■ SYSC 3.2.8 R to describe the *controlled function*, known as the *compliance oversight function*, of acting in the capacity of a *director* or *senior manager* to whom this function is allocated.
 - (2) The *rules* referred to in ■ SYSC 3.2.8 R (2) are the minimum area of focus for the *firm's compliance oversight function*. A *firm* is free to give additional responsibilities to a person performing this function if it wishes.

Risk assessment

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- (1) Depending on the nature, scale and complexity of its business, it may be appropriate for a *firm* to have a separate risk assessment function responsible for assessing the risks that the *firm* faces and advising the *governing body* and *senior managers* on them.
- (2) The organisation and responsibilities of a risk assessment function should be documented. The function should be adequately resourced and staffed by an appropriate number of competent staff who are sufficiently independent to perform their duties objectively.

Management information

3.2.11

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- (1) A *firm's* arrangements should be such as to furnish its *governing body* with the information it needs to play its part in identifying, measuring, managing and controlling risks of regulatory concern. Three factors will be the relevance, reliability and timeliness of that information.
- (2) Risks of regulatory concern are those risks which relate to the fair treatment of the *firm's customers*, to the protection of *consumers*, to confidence in the *financial system*, and to the use of that system in connection with *financial crime*.

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It is the responsibility of the *firm* to decide what information is required, when, and for whom, so that it can organise and control its activities and can comply with its regulatory obligations. The detail and extent of information required will depend on the nature, scale and complexity of the business.

Employees and agents

3.2.13

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A *firm's* systems and controls should enable it to satisfy itself of the suitability of anyone who acts for it.

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- (1) ■ SYSC 3.2.13 G includes assessing an individual's honesty, and competence. This assessment should normally be made at the point of recruitment. An individual's honesty need not normally be revisited unless something happens to make a fresh look appropriate.
- (2) Any assessment of an individual's suitability should take into account the level of responsibility that the individual will assume within the *firm*. The nature of this assessment will generally differ depending upon whether it takes place at the start of the individual's recruitment, at the end of the probationary period (if there is one) or subsequently.
- (3) The FSA's detailed requirements on *firms* with respect to the competence of individuals are in the Training and Competence sourcebook (TC).
- (4) The requirements on *firms* with respect to *approved persons* are in Part V of the *Act* (Performance of regulated activities) and ■ SUP 10.

Audit committee

- 3.2.15** **G**_{/1} Depending on the nature, scale and complexity of its business, it may be appropriate for a *firm* to form an audit committee. An audit committee could typically examine management's process for ensuring the appropriateness and effectiveness of systems and controls, examine the arrangements made by management to ensure compliance with requirements and standards under the *regulatory system*, oversee the functioning of the internal audit function (if applicable) and provide an interface between management and the external auditors. It should have an appropriate number of *non-executive directors* and it should have formal terms of reference.

Internal audit

- 3.2.16** **G**_{/1} Depending on the nature, scale and complexity of its business, it may be appropriate for a *firm* to delegate much of the task of monitoring the appropriateness and effectiveness of its systems and controls to an internal audit function. An internal audit function should have clear responsibilities and reporting lines to an audit committee or appropriate *senior manager*, be adequately resourced and staffed by competent individuals, be independent of the day-to-day activities of the *firm* and have appropriate access to a *firm's* records.

Business strategy

- 3.2.17** **G**_{/1} A *firm* should plan its business appropriately so that it is able to identify, measure, manage and control risks of regulatory concern (see ■ SYSC 3.2.11 G (2)). In some *firms*, depending on the nature, scale and complexity of their business, it may be appropriate to have business plans or strategy plans documented and updated on a regular basis to take account of changes in the business environment.

Remuneration policies

- 3.2.18** **G**_{/1} It is possible that *firms'* remuneration policies will from time to time lead to tensions between the ability of the *firm* to meet the requirements and standards under the *regulatory system* and the personal advantage of those who act for it. Where tensions exist, these should be appropriately managed.

Business continuity

- 3.2.19** **G**_{/1} A *firm* should have in place appropriate arrangements, having regard to the nature, scale and complexity of its business, to ensure that it can continue to function and meet its regulatory obligations in the event of an unforeseen interruption. These arrangements should be regularly updated and tested to ensure their effectiveness.

Records

- 3.2.20** **R**_{/1} (1) A *firm* must take reasonable care to make and retain adequate records of matters and dealings (including accounting records)

which are the subject of requirements and standards under the *regulatory system*.

- (2) Subject to (3) and to any other record-keeping *rule* in the *Handbook*, the records required by (1) or by such other *rule* must be capable of being reproduced in the English language on paper.
- (3) If a *firm's* records relate to business carried on from an establishment in a country or territory outside the *United Kingdom*, an official language of that country or territory may be used instead of the English language as required by (2).

3.2.21

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A *firm* should have appropriate systems and controls in place to fulfil the *firm's* regulatory and statutory obligations with respect to adequacy, access, periods of retention and security of records. The general principle is that records should be retained for as long as is relevant for the purposes for which they are made.

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Detailed record-keeping requirements for different types of *firm* are to be found elsewhere in the *Handbook*. Schedule 1 to the *Handbook* is a consolidated schedule of these requirements.

Appendix 1

1.1 Matters reserved to a Home State regulator (see SYSC 1.1.1 R (1)(b) and SYSC 1.1.1 R (1)(c))

1.1.1 G _{/1} The application of SYSC 2.1.3R to SYSC 2.2.3G and SYSC 3 to an *incoming EEA firm* or *incoming Treaty firm* depends on whether responsibility for the matter in question is reserved to the *firm's Home State regulator*. This appendix contains *guidance* designed to assist such *firms* in understanding the application of those provisions. This appendix is not concerned with the FSA's rights to take enforcement action against an *incoming EEA firm* or an *incoming Treaty firm*, which are covered in the Enforcement manual (ENF), or with the position of a *firm* with a *top-up permission*.

1.1.2 G _{/1} The *Single Market Directives* and the *Treaty* (as interpreted by the European Court of Justice) adopt broadly similar approaches to reserving responsibility to the *Home State regulator*. To summarise, the FSA, as *Host State regulator*, is entitled to impose requirements with respect to activities carried on within the *United Kingdom* if these can be justified in the interests of the "general good" and are imposed in a non-discriminatory way. This general proposition is subject to the following in relation to activities passported under the *Single Market Directives*:

- (1) the *Single Market Directives* expressly reserve responsibility for the prudential supervision of an *ISD investment firm*, *BCD credit institution* or passporting *insurance undertaking* to the *firm's Home State regulator*; accordingly, the FSA, as *Host State regulator*, is entitled to regulate only the conduct of the *firm's* business within the *United Kingdom*;
- (2) article 11 of the *ISD* sets out various rules of conduct which the FSA, as *Host State regulator*, is required to impose on an *ISD investment firm* (including a *BCD credit institution* which is an *ISD investment firm*) in relation to *core investment services* (and, where appropriate, to *non-core investment services*) provided within the *United Kingdom*;
- (3) for a *BCD credit institution*, the FSA, as *Host State regulator*, is jointly responsible with the *Home State regulator* under article 27 of the *Banking Consolidation Directive* for supervision of the liquidity of a *branch* in the *United Kingdom*;
- (4) for an *ISD investment firm* (including a *BCD credit institution* which is an *ISD investment firm*), the protection of clients' money and clients' assets is reserved to the *Home State regulator* under the *ISD*; and
- (5) responsibility for participation in compensation schemes for *BCD credit institutions* and *ISD investment firms* is reserved in most cases to the *Home*

State regulator under the *Deposit Guarantee Directive* and the *Investor Compensation Directive*.

- 1.1.3** G_{/1} It is necessary to refer to the case law of the European Court of Justice to interpret the concept of the “general good”. To summarise, to satisfy the general good test, *Host State* rules must come within a field which has not been harmonised at a Community level, satisfy the general requirements that they pursue an objective of the general good, be non-discriminatory, be objectively necessary, be proportionate to the objective pursued and not already be safeguarded by rules to which the *firm* is subject in its *Home State*.
- 1.1.4** G_{/1} The *FSA* considers that it is entitled, in the interests of the general good, to impose the requirements in SYSC 2.1.3R to SYSC 2.2.3G (in relation to the allocation of the function in SYSC 2.1.3R(2)) and SYSC 3 on an *incoming EEA firm* and an *incoming Treaty firm*; but only in so far as they relate to those categories of matter responsibility for which is not reserved to the *firm's Home State regulator*.
- 1.1.5** G_{/1} Should the *FSA* become aware of anything relating to an *incoming EEA firm* or *incoming Treaty firm* (whether or not relevant to a matter for which responsibility is reserved to the *Home State regulator*), the *FSA* may disclose it to the *Home State regulator* in accordance with any applicable directive and the applicable restrictions in Part XXIII of the *Act* (Public Record, Disclosure of Information and Co-operation).
- 1.1.6** G_{/1} This appendix represents the *FSA's* views, but a *firm* is also advised to consult the relevant European Community instrument and, where necessary, seek legal advice. The views of the European Commission in the banking and insurance sectors are contained in two Commission Interpretative Communications (Nos. 97/C209/04 and C(1999)5046).
- 1.1.7** G_{/1} *AUTH 5 Ann 1G* summarises the application of the *Handbook* to an *incoming EEA firm*. That annex indicates in broad terms, and in relation to such *firms*, those categories of matter which are reserved to a *Home State regulator* and those which the *FSA*, as *Host State regulator*, is entitled to regulate when carried on within the *United Kingdom*.
- 1.1.8** G_{/1} Examples of how the *FSA* considers that SYSC 3 will apply in practice to an *incoming EEA firm* (see SYSC App 1.1.4G) are as follows:
- (1) The interim Prudential sourcebook (insurers) (*IPRU (INS)*) does not apply to an *insurer* which is an *incoming EEA firm*. Similarly, SYSC 3 does not require such a *firm*:
 - (a) to establish systems and controls in relation to financial resources (SYSC 3.1.1R); or
 - (b) to establish systems and controls for compliance with that Interim Prudential sourcebook (SYSC 3.2.6R); or
 - (c) to make and retain records in relation to financial resources (SYSC 3.2.20R).
 - (2) The Conduct of Business sourcebook applies to an *incoming EEA firm*, except that COB 9 (Client asset rules) does not apply with respect to *passported activities*. Similarly, SYSC 3 does require such a *firm*:
 - (a) to establish systems and controls in relation to those aspects of the conduct of its business covered by applicable sections of COB (SYSC 3.1.1R);

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See also Question 12 in SYSC 2.1.6G for guidance on the application of SYSC 2.1.3R(2).

- (b) to establish systems and controls for compliance with the applicable sections of *COB* (SYSC 3.2.6R); and
- (c) to make and retain records in relation to those aspects of the conduct of its business (SYSC 3.2.20R).

Handbook Modules

Schedule1 Record keeping requirements

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- 1 The aim of the guidance in the following table is to give the reader a quick over-all view of the relevant record keeping requirements.
- 2 It is not a complete statement of those requirements and should not be relied on as if it were.
- 3 Table

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
SYSC 2.2.1R	Arrangements made to satisfy SYSC 2.1.1R (apportionment) and SYSC 2.1.3R (allocation)	Those arrangements	On making the arrangements and when they are updated	Six years from the date on which the record is superseded by a more up-to-date record
SYSC 3.2.20R	Matters and dealings (including accounting records) which are the subject of requirements and standards under the <i>regulatory system</i>	Adequate	Adequate time	Adequate

Handbook Modules

Schedule2 Notification requirements

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- 1 There are no notification or reporting requirements in SYSC.

Handbook Modules

Schedule3 Fees and other required payments

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- 1 There are no requirement for fees or other payments in SYSC.

Handbook Modules

Schedule4 Powers exercised

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- 1 The following powers and related provisions in the Act have been exercised by the FSA to make rules in SYSC:
 - (1) Section 138 (General rule-making power)
 - (2) Section 145 (Financial promotion rules)
 - (3) Section 146 (Money laundering rules)
 - (4) Section 150(2) (Actions for damages)
 - (5) Section 156 (General supplementary powers).
- 2 The following power in the Act has been exercised by the FSA to give the guidance in SYSC.
 - Section 157(1) (Guidance).

Handbook Modules

Schedule5 Rights of action for damages

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- 1 The table below sets out the rules in SYSC contravention of which by an authorised person may be actionable under section 150 of the Act (Actions for damages) by a person who suffers loss as a result of the contravention.
- 2 If a “Yes” appears in the column headed “For private person?”, the rule may be actionable by a “private person” under section 150 (or, in certain circumstances, his fiduciary or representative; see article 6(2) and (3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001 No 2256)). A “Yes” in the column headed “Removed” indicates that the FSA has removed the right of action under section 150(2) of the Act. If so, a reference to the rule in which it is removed is also given.
- 3 The column headed “For other person?” indicates whether the rule may be actionable by a person other than a private person (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of person by whom the rule may be actionable is given.
- 4

Table	Actions for damages
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Chapter/ Appendix	Section/ Annex	Paragraph	Right of action under section 150		
			For private person?	Removed?	For other person?
All rules in SYSC			No	Yes SYSC 1.1.12R	No

Handbook Modules

Schedule6 Rules that can be waived

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- 1 The rules in SYSC can be waived by the FSA under section 148 of the Act (Modification or waiver of rules).

Senior Management Arrangements, Systems and Controls

Derivations

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There is no table of derivations for *SYSC*.

Senior Management Arrangements, Systems and Controls

Destinations

G

There is no table of destinations for *SYSC*.

THRESHOLD CONDITIONS INSTRUMENT 2001

- A. The Financial Services Authority gives the guidance in the Annex to this instrument (COND) in the exercise of the power listed in Schedule 4 to COND (Powers exercised).
- B. This instrument shall come into force at the beginning of the first day on which section 40 of the Financial Services and Markets Act 2000 (Application for permission) comes into force for any purpose.
- C. This instrument may be cited as the Threshold Conditions Instrument 2001.
- D. The Annex to this instrument may be cited as the Threshold Conditions (or COND).

By order of the Board
21 June 2001

ANNEX



Threshold Conditions



Contents

Transitional Provisions

Text of COND :

1. Introduction to the Threshold Conditions
2. The Threshold Conditions

Schedule 1: Record keeping requirements

Schedule 2: Notification requirements

Schedule 3: Fees and other required payments*

Schedule 4: Powers exercised

Schedule 5: Rights of action for damages

Schedule 6: Rules that can be waived

Derivations

Destinations

[*These parts of AUTH will be added later]

Handbook Modules

Transitional Provisions

1 G Table

There are no transitional provisions in *COND*. However, *GEN* contains some technical transitional provisions that apply throughout the *Handbook* and which are designed to ensure a smooth transition at *commencement*.

Chapter 1.

Introduction



1.1 Application

Who?

1.1.1

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COND applies to every *firm*, except that:

- (1) for an *incoming EEA firm* or an *incoming Treaty firm* only *threshold conditions* 1, 3, 4 and 5 apply and only in so far as relevant to:
 - (a) an application for a *top-up permission* under Part IV of the *Act* (that is, *permission* to carry on *regulated activities* in addition to those permitted through the *incoming firm's authorisation* under Schedule 3 (EEA Passport Rights) or 4 (Treaty Rights) to the *Act*); and
 - (b) the exercise of the *FSA's own-initiative power* under section 45 of the *Act* (Variation etc on the *FSA's own initiative*) in relation to the *top-up permission*.
- (2) COND also applies to an applicant for *Part IV permission*.

1.1.2

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In COND, '*firm*' includes an applicant for *Part IV permission* unless the context otherwise requires.

What?

1.1.3

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COND applies in relation to all of the *regulated activities* for which a *firm* has, or will have, *permission*, except as stated in COND 1.1.1G(1).

Where?

1.1.4

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COND applies in relation to all of the *regulated activities* wherever they are carried on, except as stated in COND 1.1.1G(1).

1.2 Purpose

1.2.1

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COND gives *guidance* on the *threshold conditions* set out in Schedule 6 to the *Act* (Threshold conditions). The *threshold conditions* represent the minimum conditions which a *firm* is required to satisfy, and continue to satisfy, in order to be given and to retain *Part IV permission*.

Applications for Part IV permission or variation of Part IV permission

1.2.2

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- (1) Under section 41(2) of the *Act* (The threshold conditions), in giving or varying a *Part IV permission* or imposing or varying any *requirement*, the *FSA* must ensure that the *firm* concerned will satisfy, and continue to satisfy, the *threshold conditions* in relation to all of the *regulated activities* for which it has or will have *permission*.
- (2) If, however, the applicant for *permission* is an *incoming firm* seeking *top-up permission*, or variation of *top-up permission*, under Part IV of the *Act* (Permission to carry on regulated activities), then under paragraphs 6 and 7 of Schedule 6 to the *Act*, the *FSA* will have regard only to satisfaction of *threshold conditions* 1, 3, 4 and 5, as relevant to the *regulated activities* for which the applicant has, or will have, *Part IV permission*.

Exercise of the FSA's own-initiative power

1.2.3

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- (1) If, among other things, a *firm* is failing to satisfy any of the *threshold conditions*, or is likely to fail to do so, section 45 of the *Act* (Variation etc. on the *FSA's* own initiative) states that the *FSA* may exercise its *own-initiative power*. Use of the *FSA's* *own-initiative power* is explained in *SUP 7* (Individual requirements), *ENF 3* (Variation of Part IV permission on the *FSA's* own initiative) and *ENF 5* (Cancellation of Part IV permission on the *FSA's* own initiative and withdrawal of authorisation).
- (2) If, when exercising its *own-initiative power* under section 45(1) of the *Act*, the *FSA* varies a *firm's* *permission*, or imposes or varies a *requirement*, then, under section 41(1) of the *Act*, the *FSA* must ensure that the *firm* concerned will satisfy, and continue to satisfy, the *threshold conditions* in relation to all of the *regulated activities* for which it has or will have *permission*. However, section 41(2) of the *Act* states that the duty imposed by section 41(1) of the *Act* does not prevent the *FSA* taking such steps as it considers necessary in relation to a particular *firm* in order to secure its *regulatory objective of consumer protection*.
- (3) The *FSA* can also exercise its *own-initiative power* under section 45 of the *Act* in relation to the *top-up permission* of an *incoming firm*. But this is only on

the grounds that the *incoming firm* is failing, or likely to fail, to satisfy *threshold conditions* 1, 3, 4 or 5 in relation to that *permission*.

Approval of acquisitions or increases of control

1.2.4

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(1) Under section 186(3) of the *Act* (Objection to acquisition of control), in deciding whether the approval requirements for a proposed acquisition or increase of *control* are satisfied, the *FSA* must have regard, in relation to the *control* that the acquirer:

- (a) has over the *firm*; or
- (b) will have over the *firm* if the proposal which has been notified to the *FSA* is carried out;

to its general duty to ensure that the *firm* will continue to satisfy the *threshold conditions*.

(2) The *FSA* must also have regard to the *threshold conditions* in imposing any conditions on its approval of an acquisition or increase of *control* (section 185(2) of the *Act* (Conditions attached to approval)). See *SUP* 11.7.3G (Acquisition or increase of control: procedures).

1.3 General

An overview of the *threshold conditions* is given in COND 1 Ann 1G.

- 1.3.1** **G**_{/1} The *guidance* in COND 2 explains each *threshold condition* in Part I of Schedule 6 (threshold conditions) to the *Act* and how the *FSA* will interpret it in practice. An overview of the *threshold conditions* is given in COND 1 Ann 1G. This *guidance* is not, however, exhaustive and is written in very general terms. A *firm* will need to have regard to the obligation placed upon the *FSA* under section 41 (the *threshold conditions*) of the *Act*; that is, the *FSA* must ensure that the *firm* will satisfy, and continue to satisfy, the *threshold conditions* in relation to each *regulated activity* for which it has, or will have, *permission*.
- 1.3.2** **G**_{/1} (1) The *FSA* will consider whether a *firm* satisfies, and will continue to satisfy, the *threshold conditions* in the context of the size, nature, scale and complexity of the business which the *firm* carries on or will carry on if the relevant application is granted.
- (2) In relation to *threshold conditions* 4 and 5, the *FSA* will consider whether a *firm* is ready, willing and organised to comply, on a continuing basis, with the requirements and standards under the *regulatory system* which apply to the *firm*, or will apply to the *firm*, if it is granted *Part IV permission*, or a variation of its *permission*. These matters will also be considered if the *FSA* is exercising its *own-initiative power* (see COND 1.2.3G). Guidance to *firms* on the implications of this is given under each of those *threshold conditions*.
- 1.3.3** **G**_{/1} Although the *FSA* may consider that a matter is relevant to its assessment of a *firm*, the fact that a matter is disclosed to the *FSA*, for example in an application, does not necessarily mean that the *firm* will fail to satisfy the *threshold conditions*. The *FSA* will consider each matter in relation to the *regulated activities* for which the *firm* has, or will have, *permission*, having regard to the *regulatory objectives* set out in section 2 of the *Act* (The *FSA*'s general duties). A *firm* should disclose each relevant matter but, if it is appropriate to do so, it is encouraged to discuss it with the *FSA*. This will enable the *FSA* to consider fully how material or significant the matter is and how it affects the ability of the *firm* to satisfy, and continue to satisfy, the *threshold conditions* (see also COND 2.3.5G, COND 2.4.4G(3) and COND 2.5.4G(3)).

Statutory quotations

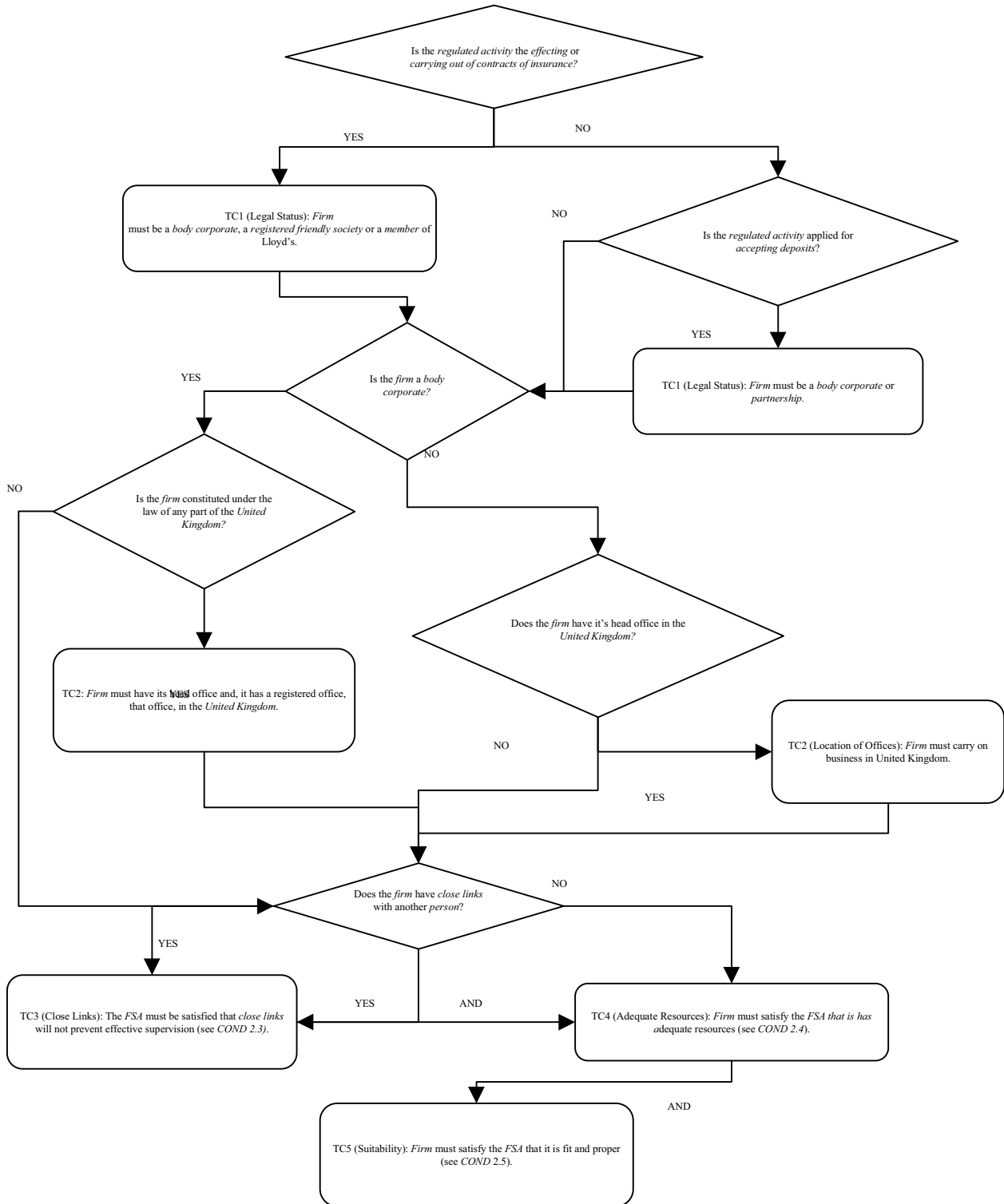
- 1.3.4** **G**_{/1} (1) For ease of reference, the *threshold conditions* in Schedule 6 to the *Act* have been quoted in full in COND 2.

- (2) As these provisions impose obligations, they are printed in bold type. The use of bold type is not intended to indicate that these quotations are *rules* made by the *FSA*.
- (3) Where words have been substituted for the text of these provisions the substitutions are enclosed in square brackets ([]). However, none of the changes made by the *FSA* in these quotations for the purpose of the text in *COND* can supersede or alter the meaning of the statutory provision concerned.

Introduction

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Overview of the threshold conditions (COND 1.3.1G)



Chapter 2.

2.

The threshold conditions

2.1 Threshold condition 1: Legal status

2.1.1 Table Paragraph 1, Schedule 6 to the Act.

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- (1) If the regulated activity concerned is the effecting or carrying out of contracts of insurance the authorised person must be a body corporate, a registered friendly society or a member of Lloyd's.**
- (2) If the person concerned appears to the [FSA] to be seeking to carry on, or to be carrying on, a regulated activity constituting accepting deposits, it must be—**
- (a) a body corporate; or**
 - (b) a partnership.**

2.1.2

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Section 40(1) of the *Act* (Application for permission) allows an application to be made to the *FSA* for *Part IV permission* by an individual, a *body corporate*, a *partnership* or an unincorporated association. However, in the case of the *regulated activities of accepting deposits* and *effecting or carrying out contracts of insurance*, article 1 of the *Banking Consolidation Directive* and article 8(1) of the *First Non-Life Directive* and of the *First Life Directive* place further limits on the legal forms a *firm* may take. The *Act* implements the provisions of the directives and extends some of these limits to *firms* that are outside the scope of the directives.

2.2 Threshold condition 2: Location of offices

2.2.1

Table Paragraph 2, Schedule 6 to the Act.

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- (1) If the person concerned is a body corporate constituted under the law of any part of the United Kingdom –**
- (a) its head office, and**
 - (b) if it has a registered office, that office, must be in the United Kingdom.**
- (2) If the person concerned has its head office in the United Kingdom but is not a body corporate, it must carry on business in the United Kingdom.**

2.2.2

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Threshold condition 2 (Location of offices), implements the requirements of article 6 of the *Post BCCI Directive*, although the *Act* extends this condition to *firms* which are outside the scope of the *Single Market Directives* and the *UCITS Directive*.

2.2.3

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Neither the *Post BCCI Directive* nor the *Act* define what is meant by a *firm's* 'head office'. This is not necessarily the *firm's* place of incorporation or the place where its business is wholly or mainly carried on. Although the *FSA* will judge each application on a case-by-case basis, the key issue in identifying the head office of a *firm* is the location of its central management and control, that is, the location of:

- (1) the *directors* and other senior management, who make decisions relating to the *firm's* central direction, and the material management decisions of the *firm* on a day-to-day basis; and
- (2) the central administrative functions of the *firm* (for example, central compliance, internal audit).

2.3 Threshold condition 3: Close links

2.3.1 Table Paragraph 3, Schedule 6 to the Act.

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- (1) If the person concerned ("A") has close links with another person ("CL"), the [FSA] must be satisfied–**
- (a) that those links are not likely to prevent the [FSA's] effective supervision of A; and**
 - (b) if it appears to the [FSA] that CL is subject to the laws, regulations or administrative provisions of a territory which is not an EEA State ("the foreign provisions"), that neither the foreign provisions, nor any deficiency in their enforcement, would prevent the [FSA's] effective supervision of A.**
- (2) A has close links with CL if:**
- (a) CL is a parent undertaking of A;**
 - (b) CL is a subsidiary undertaking of A;**
 - (c) CL is a parent undertaking of a subsidiary undertaking of A;**
 - (d) CL is a subsidiary undertaking of a parent undertaking of A;**
 - (e) CL owns or controls 20% or more of the voting rights or capital of A; or**
 - (f) A owns or controls 20% or more of the voting rights or capital of CL.**
- (3) "Subsidiary undertaking" includes all the instances mentioned in Article 1(1) and (2) of the Seventh Company Law Directive in which an entity may be a subsidiary of an undertaking.**

2.3.2

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Threshold condition 3 (Close links) implements requirements of the Post BCCI Directive, but the Act extends this condition to firms from outside the EEA and other firms which are outside the scope of the Single Market Directives and the UCITS Directive.

2.3.3

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In assessing this *threshold condition*, factors which the FSA will take into consideration include, among other things, whether:

- (1) it is likely that the FSA will receive adequate information from the *firm*, and those *persons* with whom the *firm* has *close links*, to enable it to determine whether the *firm* is complying with the requirements and standards under the *regulatory system* and to identify and assess the impact on the *regulatory objectives* in section 2 of the *Act* (The FSA's general duties); this will include consideration of whether the *firm* is ready, willing and organised to comply with *Principle 11* (Relations with regulators and the *rules* in *SUP* on the provision of information to the FSA;
- (2) The structure and geographical spread of the *firm*, the *group* to which it belongs and other *persons* with whom the *firm* has *close links*, might hinder the provision of adequate and reliable flows of information to the FSA; factors which may hinder these flows include the fact there may be branches or connected *companies* in territories which supervise *companies* to a different standard or territories with laws which restrict the free flow of information, although the FSA will consider the totality of information available from all sources;

- (3) the *firm* and the *group* to which it belongs are, or will be, subject to supervision on a consolidated basis (consolidated supervision) (for example, if a financial resources requirement is determined for the *group* as a whole); and
- (4) it is possible to assess with confidence the overall financial position of the *group* at any particular time; factors which may make this difficult include lack of audited consolidated accounts for a *group*, if companies in the same *group* as the *firm* have different financial years and accounting dates and if they do not share common auditors.

2.3.4

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When assessing whether the *firm* will satisfy and continue to satisfy this *threshold condition*, the *FSA* will have regard to all relevant matters, whether arising in the *United Kingdom* or elsewhere.

2.3.5

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The *FSA* will take into account relevant matters only in so far as they are significant (see *COND* 1.3.3G). In determining the weight to be given to any relevant matter, the *FSA* will consider its significance in the context of its ability to supervise the *firm* adequately, having regard to the *regulatory objectives* in section 2 of the *Act*. In this context, a series of matters may be significant when taken together, even though each of them in isolation might not give serious cause for concern

Meaning of "parent undertaking" and "subsidiary undertaking"

2.3.6

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- (1) Section 420(1) of the *Act* (Parent and subsidiary undertaking) states that, except in relation to an *incorporated friendly society*, 'parent undertaking' and 'subsidiary undertaking' have the same meaning as in Part VII of the Companies Act 1985 or Part VIII of the Companies (Northern Ireland) Order 1986. These are the cases referred to in *COND* 2.3.7G(1)(a) to (f).
- (2) Section 420(2) of the *Act* supplements these definitions in two ways; these are the cases referred to in *COND* 2.3.7G(1)(g) and (h).
- (3) Paragraph 3(3) of Schedule 6 to the *Act* extends the meaning of 'subsidiary undertaking' for the purposes of *threshold condition* 3 (Close links) to all the cases in articles 1(1) and (2) of the *Seventh Company Law Directive* in which one *undertaking* may be a *subsidiary* of another *undertaking* (see *COND* 2.3.11G).

2.3.7

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- (1) For the purposes of *threshold condition* 3 (Close links) and except in relation to an *incorporated friendly society*, an undertaking is a *parent undertaking* of another *undertaking* (a *subsidiary undertaking*) if any of the following apply to it:
 - (a) it holds a majority of the voting rights in the *subsidiary undertaking*; or
 - (b) it is a member of the *subsidiary undertaking* and has the right to appoint or remove a majority of its board of *directors*; or
 - (c) it has the right to exercise a dominant influence over the *subsidiary undertaking* through:
 - (i) provisions contained in the *subsidiary undertaking's* memorandum or articles; or
 - (ii) a control contract; or

- (d) it is a member of the *subsidiary undertaking* and controls alone, under an agreement with other shareholders or members, a majority of the voting rights in the *subsidiary undertaking*; or
- (e) it has a participating interest (as defined in section 260 of the Companies Act 1985 (Participating interests)) in the *subsidiary undertaking* and:
 - (i) actually exercises a dominant influence over it; or
 - (ii) it and the *subsidiary undertaking* are managed on a unified basis; or
- (f) it is a *parent undertaking* of a *parent undertaking* of the *subsidiary undertaking*; or
- (g) it is an individual and would be a *parent undertaking* if it were an *undertaking*; or
- (h) it is incorporated in or formed under the law of another *EEA State* and is a *parent undertaking* within the meaning of any rule of law in that State for purposes connected with implementation of the *Seventh Company Law Directive*.

(2) A flowchart of COND 2.3.7G(1) is set out in COND 2 Ann 1G.

2.3.8

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- (1) In relation to COND 2.3.7G(1)(b) and (d), an *undertaking* is treated as a member of another *undertaking* if any of its *subsidiary undertakings* is a member of that *undertaking*, or if any shares in that other *undertaking* are held by a *person* acting on behalf of the *undertaking* or any of its *subsidiary undertakings*.
- (2) In relation to COND 2.3.7G(1)(e), a 'participating interest' means an interest held by an *undertaking* in the shares of another *undertaking* which it holds on a long term basis, for the purpose of securing a contribution to its activities by the exercise of control or influence arising from or related to that interest. A holding of 20% or more of the shares of an *undertaking* is presumed to be a participating interest unless the contrary is shown. Examples of interests of a temporary nature which do not constitute participating interests for the purpose of this control relationship include market-makers' holdings in a trading book.
- (3) Section 260(4) of the Companies Act 1985 states that an interest held on behalf of an *undertaking* is treated as held by it. Thus, if the chain of ownership includes a trust, the *FSA* will treat the trustees as legal owners when determining whether it considers there to be a *close link*. The beneficiaries or settlors of a trust (or both) may also come within the scope of these provisions, depending on the terms of the trust. However, the *FSA* will consider each case on its merits.

2.3.9

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The provisions of Schedule 10A to the Companies Act 1985 (Parent and subsidiary undertakings supplementary provisions) explain and supplement the provisions of section 258 in Part VII of the Companies Act 1985 (outlined in COND 2.3.7G(1)(a) to (f)).

2.3.10

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Section 420(3) of the *Act* (Parent and subsidiary undertaking) (supplemented by paragraph 3(3) of Schedule 6 to the *Act*) states that an *incorporated friendly society* is a *parent undertaking* of another *body corporate* (a *subsidiary undertaking*) if it has the following relationship to it:

- (1) it holds a majority of the voting rights in the *subsidiary undertaking*; or
- (2) it is a member of the *subsidiary undertaking* and has the right to appoint or remove a majority of the *subsidiary undertaking's* board of *directors*; or
- (3) it is a member of the *subsidiary undertaking* and controls alone, under an agreement with other shareholders or members, a majority of the voting rights in it.

2.3.11**G**
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For the purposes of this *threshold condition 3* (Close links), an *undertaking* is a *subsidiary undertaking* of another *undertaking* if:

- (1) the other undertaking (its parent) is a member of the *undertaking*;
- (2) a majority of the *undertaking's* board of *directors* who have held office during the financial year and during the preceding financial year have been appointed solely as a result of the exercise of the parent's voting rights; and
- (3) no one else is the *parent undertaking* of the *undertaking* under *COND 2.3.7G(1)(a) to (c)* or *COND 2.3.10G(1) or (2)*.

2.3.12**G**
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The *guidance* in *COND 2.3* is not comprehensive and is not a substitute for consulting the relevant legislation, for example the Companies Act 1985, the Companies (Northern Ireland) Order 1986, the Friendly Societies Act 1992 and the *Seventh Company Law Directive*, or obtaining appropriate professional advice.

2.4 Threshold condition 4: Adequate resources

2.4.1 Table Paragraph 4, Schedule 6 to the Act

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- (1) The resources of the person concerned must, in the opinion of the [FSA], be adequate in relation to the regulated activities that he seeks to carry on, or carries on.**
- (2) In reaching that opinion, the [FSA] may–**
- (a) **take into account the person's membership of a group and any effect which that membership may have; and**
- (b) **have regard to–**
- (i) **the provision he makes and, if he is a member of a group, which other members of the group make in respect of liabilities (including contingent and future liabilities); and**
- (ii) **the means by which he manages and, if he is a member of a group, which other members of the group manage the incidence of risk in connection with his business.**

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- (1) *Threshold condition 4* (Adequate resources), requires the *FSA* to ensure that a *firm* has adequate resources in relation to the specific *regulated activity* or *regulated activities* which it seeks to carry on, or carries on.
- (2) In this context, the *FSA* will interpret the term 'adequate' as meaning sufficient in terms of quantity, quality and availability, and 'resources' as including all financial resources, non-financial resources and means of managing its resources; for example, capital, provisions against liabilities, holdings of or access to cash and other liquid assets, human resources and effective means by which to manage risks.
- (3) High level systems and control requirements are in *SYSC*. Detailed financial resources and systems requirements are in the relevant section of *IPRU*, including specific provisions for particular types of *regulated activity*. The *FSA* will consider whether the *firm* is ready, willing and organised to comply with these requirements when assessing if it has adequate resources for the purposes of this *threshold condition*.

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- (1) When assessing this *threshold condition*, the *FSA* may have regard to any *person* appearing to it to be, or likely to be, in a relevant relationship with the *firm*, in accordance with section 49 of the *Act* (Persons connected with an applicant); for example, a *firm's* *controllers*, its *directors* or *partners*, other *persons* with *close links* to the *firm* (see *COND 2.3*), and other *persons* that exert influence on the *firm* which might pose a risk to the *firm's* satisfaction of the *threshold conditions* and would, therefore, be in a relevant relationship with the *firm*.
- (2) In particular, although it is the *firm* that is being assessed, the *FSA* may take into consideration the impact of other members of the *firm's* *group* on the adequacy of its resources. For example, the *FSA* may assess the consolidated

2.4.4

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- solvency of the *group*. The *FSA*'s approach to the consolidated supervision of a *firm* and its *group* is in the relevant part of *IPRU*.
- (1) When assessing whether a *firm* will satisfy and continue to satisfy *threshold condition 4*, the *FSA* will have regard to all relevant matters, whether arising in the *United Kingdom* or elsewhere.
 - (2) Relevant matters may include but are not limited to:
 - (a) whether there are any indications that the *firm* may have difficulties if the application is granted (see *COND 2.4.6G*), at the time of the grant or in the future, in complying with any of the *FSA*'s prudential *rules* (see the relevant part of *IPRU*);
 - (b) whether there are any indications that the *firm* will not be able to meet its debts as they fall due;
 - (c) whether there are any implications for the adequacy of the *firm*'s resources arising from the history of the *firm*; for example, whether the *firm* has:
 - (i) been adjudged bankrupt; or
 - (ii) entered into liquidation; or
 - (iii) been the subject of a receiving or administration order; or
 - (iv) had a bankruptcy or winding-up petition served on it; or
 - (v) had its estate sequestrated; or
 - (vi) entered into a deed of arrangement or an individual voluntary agreement (or in Scotland, a trust deed) or other composition in favour of its creditors, or is doing so; or
 - (vii) within the last ten years, failed to satisfy a judgment debt under a court order, whether in the *United Kingdom* or elsewhere;
 - (d) whether the *firm* has taken reasonable steps to identify and measure any risks of regulatory concern that it may encounter in conducting its business (see *COND 2.4.6G*) and has installed appropriate systems and controls and appointed appropriate human resources to measure them prudently at all times; see *SYSC 3.1* (Systems and Controls) and *SYSC 3.2* (Areas covered by systems and controls); and
 - (e) whether the *firm* has conducted enquiries into the financial services sector in which it intends to conduct business (see *COND 2.4.6G*) that are sufficient to satisfy itself that:
 - (i) it has access to adequate capital, by reference to the *FSA*'s prudential requirements, to support the business including any losses which may be expected during its start-up period; and
 - (ii) *Client money, deposits, custody assets* and *policyholders'* rights will not be placed at risk if the business fails.
 - (3) In the context of *threshold condition 4* (Adequate resources), the *FSA* will only take into account relevant matters which are material (see *COND 1.3.3G*). The *FSA* will consider the materiality of each relevant matter in relation to the

regulated activities for which the *firm* has, or will have, *permission*, having regard to the *regulatory objectives* in section 2 of the *Act* (The FSA's general duties). It should be noted that a series of matters may be significant when taken together, even if each of them in isolation might not be significant.

- (4) In making its assessment, the *FSA* will consider the individual circumstances of each *firm* on a case-by-case basis.

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In complying with SYSC 3.1.1R (Systems and controls), a *firm* should plan its business appropriately so that it is able to identify, measure and manage the likely risks of regulatory concern it will face (SYSC 3.2.17G (Business strategy)).

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- (1) Any newly-formed *firm* can be susceptible to early difficulties. These difficulties could arise from a lack of relevant expertise and judgment, or from ill-constructed and insufficiently tested business strategies. A *firm* may also be susceptible to difficulties where it substantially changes its business activities.
- (2) As a result, the *FSA* would expect a *firm* which is applying for *Part IV permission*, or a substantial variation of that *permission*, to take adequate steps to satisfy itself and, if relevant, the *FSA* that:
- (a) it has a well constructed business plan or strategy plan for its product or service which demonstrates that it is ready, willing and organised to comply with the relevant requirements in *IPRU* and SYSC that apply to the *regulated activity* it is seeking to carry on;
 - (b) its business plan or strategy plan has been sufficiently tested; and
 - (c) the financial and other resources of the *firm* are commensurate with the likely risks it will face.
- (3) The *FSA* would expect the level of detail in a *firm's* business plan or strategy plan in (2) to be appropriate to the complexity of the *firm's* proposed *regulated activities* and *unregulated activities* and the risks of regulatory concern it is likely to face (see SYSC 3.2.11G (Management information)). General *guidance* on the contents of a business plan is given in the business plan section of the application pack for *Part IV permission*. A *firm* requiring specific *guidance* on the contents and level of detail of its business plan should contact the Corporate Authorisation department (see *AUTH 3: Applications for Part IV permission*), or, if relevant, its usual supervisory contact at the *FSA*, or seek professional assistance.

2.5 Threshold condition 5: Suitability

2.5.1

Table Paragraph 5, Schedule 6 to the Act

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The person concerned must satisfy the [FSA] that he is a fit and proper person having regard to all the circumstances, including–

- (a) his connection with any person;**
- (b) the nature of any regulated activity that he carries on or seeks to carry on; and**
- (c) the need to ensure that his affairs are conducted soundly and prudently.**

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- (1) *Threshold condition 5* (Suitability), requires the *firm* to satisfy the *FSA* that it is 'fit and proper' to have *Part IV permission* having regard to all the circumstances, including its connections with other *persons*, the range and nature of its proposed (or current) *regulated activities* and the overall need to be satisfied that its affairs are and will be conducted soundly and prudently (see also *PRIN* and *SYSC*).
- (2) The *FSA* will also take into consideration anything that could influence a *firm's* continuing ability to satisfy this *threshold condition*. Examples include the *firm's* position within a *UK* or international *group*, information provided by *overseas regulators* about the *firm*, and the *firm's* plans to seek to vary its *Part IV permission* to carry on additional *regulated activities* once it has been granted that *permission* by the *FSA*.

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- (1) The emphasis of this *threshold condition* is on the suitability of the *firm* itself. The suitability of each *person* who performs a *controlled function* will be assessed by the *FSA* under the *approved persons* regime (see *AUTH 6* (Approved persons), *SUP 10* (Approved persons) and *FIT*). In certain circumstances, however, the *FSA* may consider that the *firm* is not suitable because of doubts over the individual or collective suitability of *persons* connected with the *firm*.
- (2) When assessing this *threshold condition* in relation to a *firm*, the *FSA* may have regard to any *person* appearing to it to be, or likely to be, in a relevant relationship with the *firm*, as permitted by section 49 of the *Act* (Persons connected with an applicant) (see *COND 2.4.3G*).

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- (1) When determining whether the *firm* will satisfy and continue to satisfy *threshold condition 5*, the *FSA* will have regard to all relevant matters, whether arising in the *United Kingdom* or elsewhere.
- (2) Relevant matters include, but are not limited to, whether a *firm*:
 - (a) conducts, or will conduct, its business with integrity and in compliance with proper standards;
 - (b) has, or will have, a competent and prudent management; and

(c) can demonstrate that it conducts, or will conduct, its affairs with the exercise of due skill, care and diligence.

(3) The FSA will take into account relevant matters only to the extent that they are significant (see COND 1.3.3G). In determining whether relevant matters are significant to the *firm*, the FSA will consider significance in the context of the suitability of the *firm*, having regard to the *regulatory objectives* in section 2 of the *Act* (The FSA's general duties) a series of matters may be significant when taken together, even if each of them in isolation may not be significant.

(4) In making its assessment, the FSA will, therefore, consider the individual circumstances of each *firm* on a case-by-case basis.

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Where a *firm* is applying for *Part IV permission* or a substantial variation of that *permission*, the guidance in COND 2.4.6G is relevant. For the purpose of *threshold condition 5*, however, the FSA would expect the *firm's* business plan or strategy plan to take into account the interests of *consumers* and demonstrate that it is ready, willing and organised to comply with the relevant requirements in the *Handbook* that apply to the *regulated activity* it is seeking to carry on.

Conducting business with integrity and in compliance with proper standards

2.5.6

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In determining whether a *firm* will satisfy, and continue to satisfy, *threshold condition 5* in respect of conducting its business with integrity and in compliance with proper standards, the relevant matters, as referred to in COND 2.5.4G(2), may include but are not limited to whether:

- (1) the *firm* has been open and co-operative in all its dealings with the FSA and any other regulatory body (see *Principle 11* (Relations with regulators)) and is ready, willing and organised to comply with the requirements and standards under the *regulatory system* and other legal, regulatory and professional obligations; the relevant requirements and standards will depend on the circumstances of each case, including the *regulated activities* which the *firm* has *permission*, or is seeking *permission*, to carry on;
- (2) the *firm* has been convicted, or is connected with a *person* who has been convicted, of any unspent *offence* involving fraud, corruption, perjury, theft, false accounting or other dishonesty, *money laundering*, *market abuse* or *insider dealing*, *offences* under legislation relating to insurance, banking or other financial services, companies, insolvency, consumer credit or consumer protection or any significant tax offence; where relevant, any spent convictions excepted for this purpose under the Rehabilitation of Offenders Act 1974 will be taken into consideration;
- (3) the *firm* has been the subject of, or connected to the subject of, any existing or previous investigation or enforcement proceedings by the FSA, the *Society of Lloyd's* or by other regulatory authorities (including the FSA's predecessors), *clearing houses* or *exchanges*, *professional bodies* or government bodies or agencies; the FSA will, however, take both the nature of the *firm's* involvement in, and the outcome of, any investigation or enforcement proceedings into account in determining whether it is a relevant matter;
- (4) the *firm* has contravened, or is connected with a *person* who has contravened, any provisions of the *Act* or any preceding financial services legislation, the *regulatory system* or the rules, regulations, statements of principles or codes of practice (for example the *Society of Lloyd's* Codes) of other regulatory

authorities (including the *FSA's* predecessors), *clearing houses* or *exchanges*, *professional bodies*, or government bodies or agencies or relevant industry standards (such as the Non-Investment Products Code); the *FSA* will, however, take into account both the status of codes of practice or relevant industry standards and the nature of the contravention (for example, whether a *firm* has flouted or ignored a particular code);

- (5) the *firm*, or a *person* connected with the *firm*, has been refused registration, authorisation, membership or licence to carry out a trade, business or profession or has had that registration, authorisation, membership or licence revoked, withdrawn or terminated, or has been expelled by a regulatory or government body; whether the *FSA* considers such a refusal relevant will depend on the circumstances;
- (6) the *firm* has taken reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system that apply to the *firm* and the *regulated activities* for which it has, or will have, *permission* (see *SYSC 3.2.6R* to *SYSC 3.2.8R* (Compliance));
- (7) the *firm* has put in place procedures which are reasonably designed to:
 - (a) ensure that it has made its *employees* aware of, and compliant with, those requirements and standards under the *regulatory system* that apply to the *firm* and the *regulated activities* for which it has, or will have *permission*;
 - (b) ensure that its *approved persons* (whether or not employed by the *firm*) are aware of those requirements and standards under the *regulatory system* applicable to them;
 - (c) determine that its *employees* are acting in a way compatible with the *firm* adhering to those requirements and standards; and
 - (d) determine that its *approved persons* are adhering to those requirements and standards;
- (8) the *firm* or a *person* connected with the *firm* has been dismissed from employment or a position of trust, fiduciary relationship or similar or has ever been asked to resign from employment in such a position; whether the *FSA* considers a resignation to be relevant will depend on the circumstances, for example if a *firm* is asked to resign in circumstance that cast doubt over its honesty or integrity; and
- (9) the *firm* or a *person* connected with the *firm* has ever been disqualified from acting as a *director*.

Competent and prudent management and exercise of due skill, care and diligence

In determining whether a *firm* will satisfy and continue to satisfy *threshold condition 5* in respect of having competent and prudent management and exercising due skill, care and diligence, relevant matters, as referred to in *COND 2.5.4G(2)*, may include, but are not limited to whether:

- (1) the *governing body* of the *firm* is made up of individuals with an appropriate range of skills and experience to understand, operate and manage the *firm's regulated activities*;
- (2) if appropriate, the *governing body* of the *firm* includes non-executive representation, at a level which is appropriate for the control of the *regulated activities* proposed, for example, as members of an audit committee (see SYSC 3.2.15G (Audit Committee));
- (3) the *governing body* of the *firm* is organised in a way that enables it to address and control the *regulated activities* of the *firm*, including those carried on by *managers* to whom particular functions have been delegated (see SYSC 2.1 (Apportionment of responsibilities) and SYSC 3.2 (Areas covered by systems and controls));
- (4) those *persons* who perform *controlled functions* under certain *arrangements* entered into by the *firm* or its contractors (including *appointed representatives*) act with due skill, care and diligence in carrying out their *controlled function* (see APER 4.2 (Statement of Principle 2) or managing the business for which they are responsible (see APER 4.7 (Statement of Principle 7));
- (5) the *firm* has made arrangements to put in place an adequate system of internal control to comply with the requirements and standards under the *regulatory system* (see SYSC 3.1 (Systems and Controls));
- (6) the *firm* has approached the control of financial and other risk in a prudent manner (for example, by not assuming risks without taking due account of the possible consequences) and has taken reasonable care to ensure that robust information and reporting systems have been developed, tested and properly installed (see SYSC 3.2.10 (Risk assessment));
- (7) the *firm*, or a *person* connected with the *firm*, has been a *director*, *partner* or otherwise concerned in the management of a *company*, *partnership* or other organisation or business that has gone into insolvency, liquidation or administration while having been connected with that organisation or within one year of such a connection;
- (8) the *firm* has developed human resources policies and procedures that are reasonably designed to ensure that it employs only individuals who are honest and committed to high standards of integrity in the conduct of their activities (see, for example, SYSC 3.2.13G (Employees and agents));
- (9) the *firm* has conducted enquiries (for example, through market research or the previous activities of the *firm*) that are sufficient to give it reasonable assurance that it will not be posing unacceptable risks to *consumers* or the *financial system*;
- (10) the *firm* has in place the appropriate *money laundering* prevention systems and training, including identification, record-keeping and internal reporting procedures (see *ML*); and
- (11) where appropriate, the *firm* has appointed auditors and actuaries, who have sufficient experience in the areas of business to be conducted (see SUP 3.4 (Auditors' qualifications) and SUP 4.3.8G to SUP 4.3.13G (Appointed actuary's qualifications)).

2.6 Additional conditions

2.6.1

Table Paragraph 8, Schedule 6 to the Act.

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- (1) If this paragraph applies to the person concerned, he must, for the purposes of such provisions of this Act as may be specified, satisfy specified additional conditions.**
- (2) This paragraph applies to a person who:**
- (a) has his head office outside the EEA; and**
 - (b) appears to the [FSA] to be seeking to carry on a regulated activity relating to insurance business.**

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The application of the *threshold conditions* to *Swiss general insurers* will be the subject of an Order to be made by the Treasury, to recognise the rights of *Swiss general insurance companies* under the *Swiss Treaty Agreement*. This Order will also impose certain additional conditions, required under *the Insurance Directives*, on non-*EEA insurers*. Additional *guidance* will be included in *COND 2* when these orders are made.

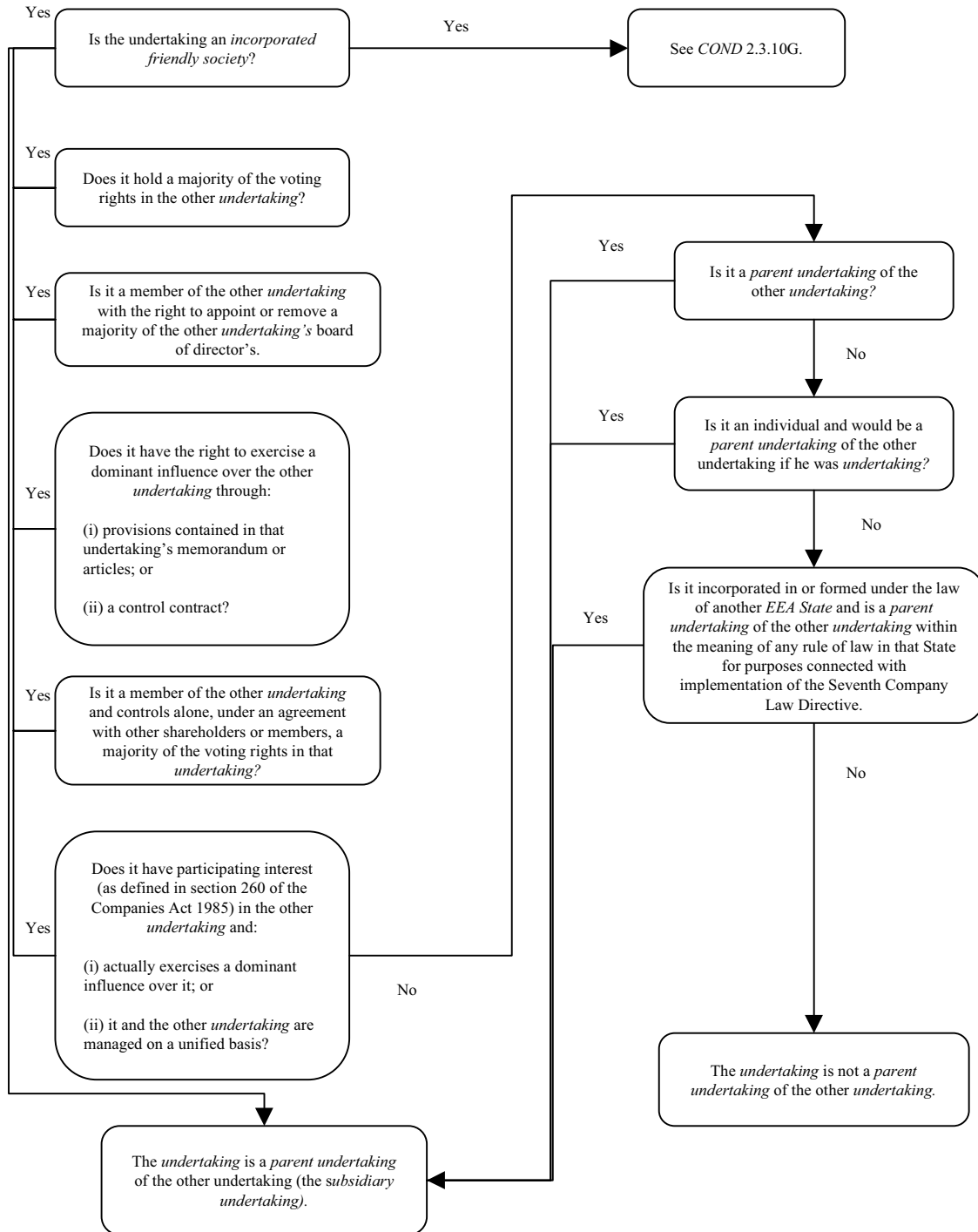
The threshold conditions

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Close Links: is an undertaking the parent undertaking of another undertaking (COND 2.3.7G(2))

COND 2: The threshold conditions

Annex 1 G



Handbook Modules

Schedule1 Record Keeping Requirements

1 G
 Table

There are no record keeping requirements in *COND*.

Handbook Modules

Schedule2 Notification Requirements

1 G
 Table

There are no notification or reporting requirements in *COND*, but *guidance* is given in *COND* 1.3.3G on disclosure to the *FSA* in connection with applications.

Handbook Modules

Schedule3 Fees and other required payments

1 G
 Table

There are no requirements for fees or other payments in *COND*.

Handbook Modules

Schedule4 Powers exercised

1 G
 Table

The following power in the *Act* has been exercised by the *FSA* to give the *guidance* in *COND*:

Section 157(1) (Guidance).

Handbook Modules

Schedule 5 Action for damages for contravention under section 150 of the Act

1 G
 Table

There are no *rules* in *COND*.

Handbook Modules

Schedule6 Rules that can be waived

1 G
 Table

There are no *rules* in *COND*.

Threshold Conditions

Derivations

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There is no table of derivations in *COND*.

Threshold Conditions

Destinations

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There is no table of destinations in *COND*.

**STATEMENTS OF PRINCIPLE AND CODE OF PRACTICE
FOR APPROVED PERSONS INSTRUMENT 2001**

- A. The Financial Services Authority issues the statements and related code of practice and gives the guidance in the Annex to this instrument (“APER”) in the exercise of the powers listed in Schedule 4 to APER (Powers exercised).
- B. This instrument shall come into force at the beginning of the day on which section 19 of the Financial Services and Markets Act 2000 (The general prohibition) comes into force.
- C. This instrument may be cited as the Statements of Principle and Code of Practice for Approved Persons Instrument 2001.
- D. The Annex to this instrument (including its Schedules) may be cited as the Statements of Principle and Code of Practice for Approved Persons (or APER).

By order of the Board
21 June 2001

ANNEX

Statements of Principle and Code of Practice for Approved Persons



Contents

Transitional provisions

Text of APER:

- 1 Application and purpose
- 2 The Statements of Principle for Approved Persons
- 3 Code of Practice for Approved Persons: general
- 4 Code of Practice for Approved Persons: specific

Schedule 1: Record keeping requirements

Schedule 2: Notification requirements

Schedule 3: Fees and other required payments

Schedule 4: Powers exercised

Schedule 5: Rights of action for damages

Schedule 6: Rules that can be waived

Derivations

Destinations

Handbook Modules

Transitional Provisions

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- 1 There are no transitional provisions in APER. However, GEN contains some technical transitional provisions that apply throughout the Handbook and which are designed to ensure a smooth transition at commencement.

Chapter 1

Application and purpose



1.1 Application

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APER applies to *approved persons*.

1.2 Purpose

- 1.2.1** G_{/1} The *Statements of Principle* contained in ■ APER 2 are issued under section 64(1) of the *Act* (Conduct: statements and codes).
- 1.2.2** G_{/1} Section 64(2) of the *Act* states that if the *FSA* issues *Statements of Principle* it must also issue a code of practice for the purpose of helping to determine whether or not a *person's* conduct complies with the *Statements of Principle*. The *Code of Practice for Approved Persons* in ■ APER 3 and ■ APER 4 fulfils this requirement.
- 1.2.3** G_{/1} The *Code of Practice for Approved Persons* sets out descriptions of conduct which, in the opinion of the *FSA*, do not comply with a *Statement of Principle* and, in the case of *Statement of Principle* 3, conduct which tends to show compliance within that statement. The *Code of Practice for Approved Persons* also sets out, in certain cases, factors which, in the opinion of the *FSA*, are to be taken into account in determining whether or not an *approved person's* conduct complies with a *Statement of Principle*. The *guidance* set out in ■ APER 3 and ■ APER 4 does not form part of the *Code of Practice for Approved Persons*.
- 1.2.4** G_{/1} Section 64(11) of the *Act* states that the power to *issue Statements of Principle* and codes of practice includes power to make different provisions in relation to *persons*, cases or circumstances of different descriptions. *Statements of Principle* 1, 2, 3 and 4 apply to all *approved persons*, and *Statements of Principle* 5, 6 and 7 apply to those approved to perform *significant influence functions*.
- 1.2.5** G_{/1} As set out in ■ SUP 10.3.1 R (Arrangements and regulated activities), a function is a *controlled function* only to the extent that it is performed under an *arrangement* entered into by:
- (1) a *firm*; or
 - (2) a contractor of the *firm*;
- in relation to the carrying on by the *firm* of a *regulated activity*.
- 1.2.6** G_{/1} The *Statements of Principle* apply only to the performance of a *controlled function* (that is, to the activities carried on under the *arrangement* described in the *firm's* application for approval).
- 1.2.7** G_{/1} The *FSA* recognises that an *approved person* may be performing functions which are unrelated to *regulated activities* or are otherwise outside the description of a *controlled function*. The fact that a *person* may be approved for one purpose does not have the effect of bringing all his functions within the *controlled function*, nor of making those functions subject to the *Statements of Principle*.
- 1.2.8** G_{/1} The territorial scope of the *approved persons* regime is set out in ■ SUP 10.1 (Application).

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The *Statements of Principle* apply only to the extent that a *person* is performing a *controlled function* for which approval has been sought and granted.

Chapter 2

2

The Statements of Principle for Approved Persons

2.1 The Statement of Principle

2.1.1 **G** /1 ■ APER 2.1.2 P sets out the *Statements of Principle* issued by the FSA to which ■ APER 1.2.1 G refers and to which the provisions of the *Code of Practice for Approved Persons* and *guidance* in ■ APER 3 and ■ APER 4 apply.

2.1.2 **G** /1 Table Statements of Principle issued under section 64 of the Act

Statement of Principle 1

An approved person must act with integrity in carrying out his controlled function.

Statement of Principle 2

An approved person must act with due skill, care and diligence in carrying out his controlled function.

Statement of Principle 3

An approved person must observe proper standards of market conduct in carrying out his controlled function.

Statement of Principle 4

An approved person must deal with the FSA and with other regulators in an open and cooperative way and must disclose appropriately any information of which the FSA would reasonably expect notice.

Statement of Principle 5

An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function is organised so that it can be controlled effectively.

Statement of Principle 6

An *approved person* performing a *significant influence function* must exercise due skill, care and diligence in managing the business of the *firm* for which he is responsible in his *controlled function*.

Statement of Principle 7

An *approved person* performing a *significant influence function* must take reasonable steps to ensure that the business of the *firm* for which he is responsible in his *controlled function* complies with the relevant requirements and standards of the *regulatory system*.

Chapter 3

Code of Practice for Approved Persons: general



3.1 Introduction

- 3.1.1** G_{/1} This *Code of Practice for Approved Persons* is issued under section 64 of the *Act* (Conduct: statements and codes) for the purpose of helping to determine whether or not an *approved person's* conduct complies with a *Statement of Principle*. The code sets out descriptions of conduct which, in the *FSA's* opinion, do not comply with the relevant *Statements of Principle*. The code also sets out certain factors which, in the opinion of the *FSA*, are to be taken into account in determining whether an *approved person's* conduct complies with a particular *Statement of Principle*. The description of conduct, the factors and related provisions are identified in the text by the letter 'E' as explained in paragraph 25 of the Readers Guide.
- 3.1.2** G_{/1} The *Code of Practice for Approved Persons* in issue at the time when any particular conduct takes place may be relied on so far as it tends to establish whether or not that conduct complies with a *Statement of Principle*.
- 3.1.3** G_{/1} The significance of conduct identified in the *Code of Practice for Approved Persons* as tending to establish compliance with or a breach of a *Statement of Principle* will be assessed only after all the circumstances of a particular case have been considered. Account will be taken of the context in which a course of conduct was undertaken, including the precise circumstances of the individual case, the characteristics of the particular *controlled function* and the behaviour to be expected in that function.
- 3.1.4** G_{/1}
- (1) An *approved person* will only be in breach of a *Statement of Principle* where he is personally culpable. Personal culpability arises where an *approved person's* conduct was deliberate or where the *approved person's* standard of conduct was below that which would be reasonable in all the circumstances (see ■ ENF 11.5.3 G (Action against approved persons)).
 - (2) For the avoidance of doubt, the *Statements of Principle* do not extend the duties of *approved persons* beyond those which the *firm* owes in its dealings with *customers* or others.
- 3.1.5** G_{/1} In particular, in determining whether or not an *approved person's* conduct complies with a *Statement of Principle*, the *FSA* will take into account the extent to which an *approved person* has acted in a way that is stated to be in breach of a *Statement of Principle*.
- 3.1.6** G_{/1} The *Code of Practice for Approved Persons* (and in particular the specific examples of behaviour which may be in breach of a generic description of conduct in the code) is not exhaustive of the kind of conduct that may contravene the *Statements of Principle*. The purpose of the code is to help determine whether or not a *person's* conduct complies with a *Statement of Principle*. The code may be supplemented from time to time. The *FSA* will amend the code if there is a risk that unacceptable practice may become prevalent, so as to make clear what conduct

falls below the standards expected of *approved persons* by the *Statements of Principle*.

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Statements of Principle 1 to 4 apply to all *approved persons*. In the *Statements of Principle* and in the *Code of Practice for Approved Persons*, a reference to "his *controlled function*" is a reference to the *controlled function* to which the approval relates. A *person* performing a *significant influence function* is also subject to the additional requirements set out in *Statements of Principle* 5 to 7 in performing that *controlled function*. Those responsible under ■ SYSC 2.1.3 R (Apportionment of responsibilities) for the *firm's* apportionment obligation will be specifically subject to *Statement of Principle* 5 (and see in particular ■ APER 4.5.6 E). In addition, it will be the responsibility of any such *approved person* to oversee that the *firm* has appropriate systems and controls under *Statement of Principle* 7 (and see in particular ■ APER 4.7.3 E).

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In applying *Statements of Principle* 5 to 7, the nature, scale and complexity of the business under management and the role and responsibility of the individual performing a *significant influence function* within the *firm* will be relevant in assessing whether an *approved person's* conduct was reasonable. For example, the smaller and less complex the business, the less detailed and extensive the systems of control need to be. The *FSA* will be of the opinion that an individual performing a *significant influence function* may have breached *Statements of Principle* 5 to 7 only if his conduct was below the standard which would be reasonable in all the circumstances. (See also ■ APER 3.3.1 E (3) to (5))

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UK domestic firms listed on the London Stock Exchange are subject to the Combined Code developed by the Committee on Corporate Governance, whose *internal control* provisions are amplified in the Guidance for Directors issued by the Institute of Chartered Accountants in England and Wales. *FSA-regulated firms* in this category will thus be subject to that code as well as to the requirements and standards of the *regulatory system*. In forming an opinion whether *approved persons* have complied with its requirements, the *FSA* will give due credit for their following corresponding provisions in the Combined Code and related *guidance*.



3.2 Factors relating to all Statements of Principle

3.2.1



In determining whether or not the particular conduct of an *approved person* within his *controlled function* complies with the *Statements of Principle*, the following are factors which, in the opinion of the *FSA*, are to be taken into account:

- (1) whether that conduct relates to activities that are subject to other provisions of the *Handbook*;
- (2) whether that conduct is consistent with the requirements and standards of the *regulatory system* relevant to his *firm*.



3.3 Factors relating to Statements of Principle 5 to 7

3.3.1



In determining whether or not the conduct of an *approved person* performing a *significant influence function* complies with *Statements of Principle 5 to 7*, the following are factors which, in the opinion of the *FSA*, are to be taken into account:

- (1) whether he exercised reasonable care when considering the information available to him;
- (2) whether he reached a reasonable conclusion which he acted on;
- (3) the nature, scale and complexity of the *firm's* business;
- (4) his role and responsibility as an *approved person* performing a *significant influence function*;
- (5) the knowledge he had, or should have had, of regulatory concerns, if any, arising in the business under his control.





Chapter 4

Code of Practice for Approved Persons: specific








4.1 Statement of Principle 1


- 4.1.1**  The *Statement of Principle 1* (see ■ APER 2.1.2 P) is in the following terms: "An *approved person* must act with integrity in carrying out his *controlled function*."
- 4.1.2**  In the opinion of the FSA, conduct of the type described in ■ APER 4.1.3 E, ■ APER 4.1.5 E, ■ APER 4.1.6 E, ■ APER APER 4.1.8 E, ■ APER 4.1.10 E, ■ APER 4.1.12 E or ■ APER 4.1.13 E does not comply with *Statement of Principle 1* ■ APER 2.1.2 P).
- 4.1.3**  Deliberately misleading (or attempting to mislead) by act or omission:
- (1) a *client*; or
 - (2) his *firm* (or its auditors or *appointed actuary*); or
 - (3) the FSA;
- falls within ■ APER 4.1.2 E.
- 4.1.4**  Behaviour of the type referred to in ■ APER 4.1.3 E includes, but is not limited to, deliberately:
- (1) falsifying *documents*;
 - (2) misleading a *client* about the risks of an *investment*;
 - (3) misleading a *client* about the charges or surrender penalties of *investment* products;
 - (4) misleading a *client* about the likely performance of *investment* products by providing inappropriate *projections* of future *investment* returns;
 - (5) misleading a *client* by informing him that products require only a single payment when that is not the case;
 - (6) mismarking the value of *investments* or trading positions;
 - (7) procuring the unjustified alteration of prices on illiquid or *off-exchange* contracts, or both;
 - (8) misleading others within the *firm* about the credit-worthiness of a borrower;



- (9) providing false or inaccurate documentation or information, including details of training, qualifications, past employment record or experience;
- (10) providing false or inaccurate information to the *firm* (or to the *firm's* auditors or *appointed actuary*);
- (11) providing false or inaccurate information to the *FSA*;
- (12) destroying, or causing the destruction of, *documents* (including false documentation), or tapes or their contents, relevant to misleading (or attempting to mislead) a *client*, his *firm*, or the *FSA*;
- (13) failing to disclose dealings where disclosure is required by the *firm's* personal account *dealing rules*;
- (14) misleading others in the *firm* about the nature of risks being accepted.

4.1.5  /1 Deliberately recommending an *investment* to a *customer*, or carrying out a discretionary *transaction* for a *customer* where the *approved person* knows that he is unable to justify its suitability for that *customer*, falls within  APER 4.1.2 E.

4.1.6  /1 Deliberately failing to inform, without reasonable cause:



- (1) a *customer*; or
- (2) his *firm* (or its auditors or *appointed actuary*); or
- (3) the *FSA*;

of the fact that their understanding of a material issue is incorrect, despite being aware of their misunderstanding, falls within  APER 4.1.2 E.


4.1.7  /1 Behaviour of the type referred to in  APER 4.1.6 E includes, but is not limited to, deliberately:


- (1) failing to disclose the existence of falsified *documents*;
- (2) failing to rectify mismarked positions immediately.

4.1.8  /1 Deliberately preparing inaccurate or inappropriate records or returns in connection with a *controlled function*, falls within  APER 4.1.2 E.


4.1.9  /1 Behaviour of the type referred to in  APER 4.1.8 E includes, but is not limited to, deliberately:


- (1) preparing performance reports for transmission to *customers* which are inaccurate or inappropriate (for example, by relying on past performance without appropriate warnings);
- (2) preparing inaccurate training records or inaccurate details of qualifications, past employment record or experience;
- (3) preparing inaccurate trading confirmations, contract notes or other records of *transactions* or holdings of *securities* for a *customer*, whether or not the *customer* is aware of these inaccuracies or has requested such records.

4.1.10  /1 Deliberately misusing the assets or confidential information of a *client* or of his *firm* falls within ■ APER 4.1.2 E.

4.1.11  /1 Behaviour of the type referred to in ■ APER 4.1.10 E includes, but is not limited to, deliberately:






- (1) front running *client* orders;
- (2) carrying out unjustified trading on *client* accounts to generate a benefit (whether direct or indirect) to the *approved person* (that is, churning);
- (3) misappropriating a *client's* assets, including wrongly transferring to personal accounts cash or *securities* belonging to *clients*;
- (4) wrongly using one *client's* funds to settle margin calls or to cover trading losses on another *client's* account or on *firm* accounts;
- (5) using a *client's* funds for purposes other than those for which they were provided;
- (6) retaining a *client's* funds wrongly;
- (7) pledging the assets of a *client* as security or margin in circumstances where the *firm* is not permitted to do so.









4.1.12  /1 Deliberately designing *transactions* so as to disguise breaches of requirements and standards of the *regulatory system* falls within ■ APER 4.1.2 E.

4.1.13  /1 Deliberately failing to disclose the existence of a conflict of interest in connection with dealings with a *client* falls within ■ APER 4.1.2 E.







4.2 Statement of Principle 2

- 4.2.1**  The *Statement of Principle 2* (see ■ APER 2.1.2 P) is in the following terms: "An *approved person* must act with due skill, care and diligence in carrying out his *controlled function*."
- 4.2.2**  In the opinion of the *FSA*, conduct of the type described in ■ APER 4.2.3 E, ■ APER 4.2.5 E, ■ APER 4.2.6 E, ■ APER 4.2.8 E, ■ APER 4.2.10 E, ■ APER 4.2.11 E or ■ APER 4.2.13 E does not comply with *Statement of Principle 2* ■ APER 2.1.2 P).
- 4.2.3**  Failing to inform:
- (1) a *customer*; or
 - (2) his *firm* (or its auditors or *appointed actuary*);
- of material information in circumstances where he was aware, or ought to have been aware, of such information, and of the fact that he should provide it, falls within ■ APER 4.2.2 E.
- 4.2.4**  Behaviour of the type referred to in ■ APER 4.2.3 E includes, but is not limited to:
- (1) failing to explain the risks of an *investment* to a *customer*;
 - (2) failing to disclose to a *customer* details of the charges or surrender penalties of *investment* products;
 - (3) mismarking trading positions;
 - (4) providing inaccurate or inadequate information to a *firm*, its auditors or *appointed actuary*;
 - (5) failing to disclose dealings where disclosure is required by the *firm's* personal account *dealing rules*.
- 4.2.5**  Recommending an *investment* to a *customer*, or carrying out a discretionary *transaction* for a *customer*, where he does not have reasonable grounds to believe that it is suitable for that *customer*, falls within ■ APER 4.2.2 E.

- 4.2.6  /1 Undertaking, recommending or providing advice on *transactions* without a reasonable understanding of the risk exposure of the *transaction* to a *customer* falls within ■ APER 4.2.2 E.
- 4.2.7  /1 *Behaviour* of the type referred to in ■ APER 4.2.6 E includes, but is not limited to, recommending *transactions* in *investments* to a *customer* without a reasonable understanding of the liability (either potential or actual) of that *transaction*.
- 4.2.8  /1 Undertaking *transactions* without a reasonable understanding of the risk exposure of the *transaction* to the *firm* falls within ■ APER 4.2.2 E.
- 4.2.9  /1 *Behaviour* of the type referred to in ■ APER 4.2.8 E includes, but is not limited to, trading on the *firm's* own account without a reasonable understanding of the liability (either potential or actual) of the *transaction*.
- 4.2.10  /1 Failing without good reason to disclose the existence of a conflict of interest in connection with dealings with a *client* falls within ■ APER 4.2.2 E.
- 4.2.11  /1 Failing to provide adequate control over a *client's* assets falls within ■ APER 4.2.2 E.
- 4.2.12  /1 *Behaviour* of the type referred to in ■ APER 4.2.11 E includes, but is not limited to:
- (1) failing to segregate a *client's* assets;
 - (2) failing to process a *client's* payments in a timely manner.
- 4.2.13  /1 Continuing to perform a *controlled function* despite having failed to meet the standards of knowledge and skill set out in the Training and Competence sourcebook (TC) for that *controlled function* falls within ■ APER 4.2.2 E.












4.3 Statement of Principle 3

- 4.3.1  ^{/1} The *Statement of Principle 3* (see ■ APER 2.1.2 P) is in the following terms: "An *approved person* must observe proper standards of market conduct in carrying out his *controlled function*."
- 4.3.2  ^{/1} In many cases the required standard will be set out in ■ MAR 3 (Inter-Professional Conduct) and the *Code of Market Conduct* ■ MAR 1). Market codes and exchange rules will also be relevant.
- 4.3.3  ^{/1} A factor to be taken into account in determining whether or not an *approved person's* conduct complies with this *Statement of Principle* ■ APER 2.1.2 P) is whether he, or his *firm*, has complied with ■ MAR 3 (Inter-Professional Conduct) or the *Code of Market Conduct* ■ MAR 1) or relevant market codes and exchange rules.
- 4.3.4  ^{/1} Compliance with the code or *rules* described in ■ APER 4.3.3 E will tend to show compliance with this *Statement of Principle* ■ APER 2.1.2 P).








4.4 Statement of Principle 4


- 4.4.1**  The *Statement of Principle 4* (see **■** APER 2.1.2 P) is in the following terms: "An *approved person* must deal with the *FSA* and with other regulators in an open and cooperative way and must disclose appropriately any information of which the *FSA* would reasonably expect notice."
- 4.4.2**  For the purpose of this *Statement of Principle* **■** APER 2.1.2 P), regulators in addition to the *FSA* are those which have recognised jurisdiction in relation to *regulated activities* and a power to call for information from the *approved person* in connection with his *controlled function* or (in the case of an individual performing a *significant influence function*) in connection with the business for which he is responsible. This may include an exchange or an *overseas regulator*.
- 4.4.3**  In the opinion of the *FSA*, conduct of the type described in **■** APER 4.4.4 E, **■** APER 4.4.7 E, or **■** APER 4.4.9 E does not comply with *Statement of Principle 4* **■** APER 2.1.2 P).
- 4.4.4**  Failing to report promptly in accordance with his *firm's* internal procedures (or if none exist direct to the *FSA*), information which it would be reasonable to assume would be of material significance to the *FSA*, whether in response to questions or otherwise, falls within **■** APER 4.4.3 E.
- 4.4.5**  There is no duty on an *approved person* to report such information directly to the *FSA* unless he is one of the *approved persons* responsible within the *firm* for reporting matters to the *FSA*. However, if an *approved person* takes steps to influence the decision so as not to report to the *FSA* or acts in a way that is intended to obstruct the reporting of the information to the *FSA*, then the *FSA* will, in respect of that information, view him as being one of those within the *firm* who has taken on responsibility for deciding whether to report that matter to the *FSA*.
- 4.4.6**  In determining whether or not an *approved person's* conduct under **■** APER 4.4.4 E complies with *Statement of Principle 4*, the following are factors which, in the opinion of the *FSA*, are to be taken into account:
- (1) the likely significance to the *FSA* of the information which it was reasonable for the individual to assume;
 - (2) whether the information related to the individual himself or to his *firm*;
 - (3) whether any decision not to report the matter internally was taken after reasonable enquiry and analysis of the situation.


- 4.4.7  /1 Where the *approved person* is, or is one of the *approved persons* who is, responsible within the *firm* for reporting matters to the *FSA*, failing promptly to inform the *FSA* of information of which he is aware and which it would be reasonable to assume would be of material significance to the *FSA*, whether in response to questions or otherwise, falls within ■ APER 4.4.3 E.
- 4.4.8  /1 In determining whether or not an *approved person's* conduct under ■ APER 4.4.7 E complies with *Statement of Principle 4* ■ APER 2.1.2 P), the following are factors which, in the opinion of the *FSA*, are to be taken into account:
- (1) the likely significance of the information to the *FSA* which it was reasonable for the *approved person* to assume;
 - (2) whether any decision not to inform the *FSA* was taken after reasonable enquiry and analysis of the situation.
- 4.4.9  /1 Failing without good reason to:
- (1) inform a regulator of information of which the *approved person* was aware in response to questions from that regulator;
 - (2) attend an interview or answer questions put by a regulator, despite a request or demand having been made;
 - (3) supply a regulator with appropriate *documents* or information when requested or required to do so and within the time limits attaching to that request or requirement;
- falls within ■ APER 4.4.3 E.

4.5 Statement of Principle 5

- 4.5.1**  The *Statement of Principle 5* (see ■ APER 2.1.2 P) is in the following terms: "An *approved person* performing a *significant influence function* must take reasonable steps to ensure that the business of the *firm* for which he is responsible in his *controlled function* is organised so that it can be controlled effectively."
- 4.5.2**  In the opinion of the FSA, conduct of the type described in ■ APER 4.5.3 E, ■ APER 4.5.4 E, ■ APER 4.5.6 E or ■ APER 4.5.8 E does not comply with *Statement of Principle 5* ■ APER 2.1.2 P).
- 4.5.3**  Failing to take reasonable steps to apportion responsibilities for all areas of the business under the *approved person's* control falls within ■ APER 4.5.2 E (see ■ APER 4.5.11 G).
- 4.5.4**  Failing to take reasonable steps to apportion responsibilities clearly amongst those to whom responsibilities have been delegated falls within ■ APER 4.5.2 E (see ■ APER 4.5.11 G).
- 4.5.5**  Behaviour of the type referred to in ■ APER 4.5.4 E includes, but is not limited to:
- (1) implementing confusing or uncertain reporting lines (see ■ APER 4.5.12 G);
 - (2) implementing confusing or uncertain authorisation levels (see ■ APER 4.5.13 G);
 - (3) implementing confusing or uncertain job descriptions and responsibilities (see ■ APER 4.5.13 G).
- 4.5.6**  In the case of an *approved person* who is responsible under ■ SYSC 2.1.3 R (1) for dealing with the apportionment of responsibilities under ■ SYSC 2.1.1 R, failing to take reasonable care to maintain a clear and appropriate apportionment of significant responsibilities among the *firm's directors* and *senior managers* falls within ■ APER 4.5.2 E.
- 4.5.7**  Behaviour of the type referred to in ■ APER 4.5.6 E includes, but is not limited to:
- (1) failing to review regularly the significant responsibilities which the *firm* is required to apportion under ■ APER 2.1.1 R;

(2) failing to act where that review shows that those significant responsibilities have not been clearly apportioned.


4.5.8  /1 Failing to take reasonable steps to ensure that suitable individuals are responsible for those aspects of the business under the control of the individual performing a *significant influence function* falls within ■ APER 4.5.2 E (see ■ APER 4.5.14 G).

4.5.9  /1 Behaviour of the type referred to in ■ APER 4.5.8 E includes, but is not limited to:


(1) failing to review the competence, knowledge, skills and performance of staff to assess their suitability to fulfil their duties, despite evidence that their performance is unacceptable (see ■ APER 4.5.14 G);

(2) giving undue weight to financial performance when considering the suitability or continuing suitability of an individual for a particular role (see ■ APER 4.5.14 G);


(3) allowing managerial vacancies which put at risk compliance with the requirements and standards of the *regulatory system* to remain, without arranging suitable cover for the responsibilities (see ■ APER 4.5.15 G).

4.5.10  /1 Strategy and plans will often dictate the risk which the business is prepared to take on and high level controls will dictate how the business is to be run. If the strategy of the business is to enter high-risk areas, then the degree of control and strength of monitoring reasonably required within the business will be high. In organising the business for which he is responsible, the *approved person* performing a *significant influence function* should bear this in mind.

Apportionment of responsibilities

4.5.11  /1 In order to comply with the obligations of *Statement of Principle 5* (having regard to ■ APER 4.5.3 E and ■ APER 4.5.4 E), the *approved person* performing a *significant influence function* may find it helpful to review whether each area of the business for which he is responsible has been clearly assigned to a particular individual or individuals.

Reporting lines

4.5.12  /1 The organisation of the business and the responsibilities of those within it should be clearly defined (see ■ APER 4.5.5 E (1)). Reporting lines should be clear to staff. Where staff have dual reporting lines there is a greater need to ensure that the responsibility and accountability of each individual line manager is clearly set out and understood.

Authorisation levels and job descriptions

4.5.13 G_{/1} Where members of staff have particular levels of authorisation (see ■ APER 4.5.5 E (2) and ■ APER 4.5.5 E (3)), these should be clearly set out and communicated to staff. It may be appropriate for each member of staff to have a job description of which he is aware.

Suitability of individuals







4.5.14 G_{/1} If an individual’s performance is unsatisfactory, then the appropriate *approved person* (if any) performing a *significant influence function* should review carefully whether to allow that individual to continue in position. In particular, if he is aware of concerns relating to the compliance with requirements and standards of the *regulatory system* (or internal controls) of the individual concerned, or of staff reporting to that individual, the *approved person* performing a *significant influence function* should take care not to give undue weight to the financial performance of the individual or group concerned when considering whether any action should be taken. An adequate investigation of the concerns should be undertaken (including, where appropriate, adherence to internal controls). The *approved person* performing a *significant influence function* should satisfy himself, on reasonable grounds, that the investigation is appropriate, the results are accurate and that the concerns do not pose an unacceptable risk to compliance with the requirements and standards of the *regulatory system* (see in particular *Statement of Principle 6* and ■ APER 4.5.8 E and ■ APER 4.5.9 E (1) and ■ APER 4.5.9E (2)).






Temporary vacancies

4.5.15 G_{/1} In organising the business, the *approved person* performing a *significant influence function* should pay attention to any temporary vacancies which exist (see ■ APER 4.5.9 E (3)). He should take reasonable steps to ensure that suitable cover for responsibilities is arranged. This could include taking on temporary staff or external consultants. The *approved person* performing a *significant influence function* should assess the risk that is posed to compliance with the requirements and standards of the *regulatory system* as a result of the vacancy, and the higher the risk the greater the steps he should take to fill the vacancy. It may be appropriate to limit or suspend the activity if appropriate cover for responsibilities cannot be arranged. To the extent that those vacancies are in respect of one of the *customer functions*, they may only be filled by *persons* approved for that function.



4.6 Statement of Principle 6

- 4.6.1**  The *Statement of Principle 6* (see [■ APER 2.1.2 P](#)) is in the following terms: "An *approved person* performing a *significant influence function* must exercise due skill, care and diligence in managing the business of the *firm* for which he is responsible in his *controlled function*."
- 4.6.2**  In the opinion of the *FSA*, conduct of the type described in [■ APER 4.6.3 E](#), [■ APER 4.6.5 E](#), [■ APER 4.6.6 E](#) or [■ APER 4.6.8 E](#) does not comply with *Statement of Principle 6* [■ APER 2.1.2 P](#)).
- 4.6.3**  Failing to take reasonable steps adequately to inform himself about the affairs of the business for which he is responsible falls within [■ APER 4.6.2 E](#).
- 4.6.4**  Behaviour of the type referred to in [■ APER 4.6.3 E](#) includes, but is not limited to:
- (1) permitting *transactions* without a sufficient understanding of the risks involved;
 - (2) permitting expansion of the business without reasonably assessing the potential risks of that expansion;
 - (3) inadequately monitoring highly profitable *transactions* or business practices or unusual *transactions* or business practices;
 - (4) accepting implausible or unsatisfactory explanations from subordinates without testing the veracity of those explanations;
 - (5) failing to obtain independent, expert opinion where appropriate; (see [■ APER 4.6.12 G](#)).
- 4.6.5**  Delegating the authority for dealing with an issue or a part of the business to an individual or individuals (whether in-house or outside contractors) without reasonable grounds for believing that the delegate had the necessary capacity, competence, knowledge, seniority or skill to deal with the issue or to take authority for dealing with part of the business, falls within [■ APER 4.6.2 E](#) (see [■ APER 4.6.13 G](#)).
- 4.6.6**  Failing to take reasonable steps to maintain an appropriate level of understanding about an issue or part of the business that he has

- delegated to an individual or individuals (whether in-house or outside contractors) falls within ■ APER 4.6.2 E (see ■ APER 4.6.14 G).
- 4.6.7**  /1 Behaviour of the type referred to in ■ APER 4.6.6 E includes but is not limited to:
- (1) disregarding an issue or part of the business once it has been delegated;
 - (2) failing to require adequate reports once the resolution of an issue or management of part of the business has been delegated;
 - (3) accepting implausible or unsatisfactory explanations from delegates without testing their veracity.
- 4.6.8**  /1 Failing to supervise and monitor adequately the individual or individuals (whether in-house or outside contractors) to whom responsibility for dealing with an issue or authority for dealing with a part of the business has been delegated falls within ■ APER 4.6.2 E.
- 4.6.9**  /1 Behaviour of the type referred to in ■ APER 4.6.8 E includes, but is not limited to:
- (1) failing to take personal action where progress is unreasonably slow, or where implausible or unsatisfactory explanations are provided;
 - (2) failing to review the performance of an outside contractor in connection with the delegated issue or business.
- 4.6.10**  /1 In determining whether or not the conduct of an *approved person* performing a *significant influence function* under ■ APER 4.6.5 E, ■ APER 4.6.6 E and ■ APER 4.6.8 E complies with *Statement of Principle 6* (see ■ APER 2.1.2 P), the following are factors which, in the opinion of the FSA, are to be taken into account:
- (1) the competence, knowledge or seniority of the delegate; and
 - (2) the past performance and record of the delegate.
- 4.6.11**  /1 An *approved person* performing a *significant influence function* will not always manage the business on a day-to-day basis himself. The extent to which he does so will depend on a number of factors, including the nature, scale and complexity of the business and his position within it. The larger and more complex the business, the greater the need for clear and effective delegation and reporting lines. The FSA will look to the *approved person* performing a *significant influence function* to take reasonable steps to ensure that systems are in place which result in issues being addressed at the appropriate level. When issues come to his attention, he should deal with them in an appropriate way.

Knowledge about the business

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- (1) It is important for the *approved person* performing a *significant influence function* to understand the business for which he is responsible ■ APER 4.6.4 E). An *approved person* performing a *significant influence function* is unlikely to be an expert in all aspects of a complex financial services business. However, he should understand and inform himself about the business sufficiently to understand the risks of its trading, credit or other business activities.
- (2) It is important for an *approved person* performing a *significant influence function* to understand the risks of expanding the business into new areas and, before approving the expansion, he should investigate and satisfy himself, on reasonable grounds, about the risks, if any, to the business.
- (3) Where unusually profitable business is undertaken, or where the profits are particularly volatile or the business involves funding requirements on the *firm* beyond those reasonably anticipated, he should require explanations from those who report to him. Where those explanations are implausible or unsatisfactory, he should take steps to test the veracity of those explanations.
- (4) Where the *approved person* performing a *significant influence function* is not an expert in a business area, he should consider whether he or those with whom he works have the necessary expertise to provide him with an adequate explanation of issues within that business area. If not he should seek an independent opinion from elsewhere within or outside the *firm*.

Delegation

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- (1) An *approved person* performing a *significant influence function* may delegate the investigation, resolution or management of an issue or authority for dealing with a part of the business to individuals who report to him or to others.
- (2) The *approved person* performing a *significant influence function* should have reasonable grounds for believing that the delegate has the competence, knowledge, skill and time to deal with the issue. For instance, if the compliance department only has sufficient resources to deal with day-to-day issues, it would be unreasonable to delegate to it the resolution of a complex or unusual issue without ensuring it had sufficient capacity to deal with the matter adequately.
- (3) If an issue raises questions of law or interpretation, the *approved person* performing a *significant influence function* may need to take legal advice. If appropriate legal expertise is not available in-house, he may need to consider appointing an appropriate external adviser.
- (4) The FSA recognises that the *approved person* performing a *significant influence function* will have to exercise his own judgment in deciding how issues are dealt with, and that in some cases that judgment will, with the benefit of hindsight, be shown to have been wrong. He will not be in breach of *Statement of Principle 6* unless he fails to exercise due and reasonable consideration before he delegates the resolution of an issue or authority for dealing with a part of the business and fails to reach a reasonable conclusion. If he is in doubt about how to deal with an issue or the seriousness of a particular compliance problem, then, although he cannot delegate to the FSA the responsibility for dealing with the problem or issue, he can speak to the FSA to discuss his approach (see ■ APER 4.6.5 E).

Continuing responsibilities where an issue has been delegated

4.6.14








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Although an *approved person* performing a *significant influence function* may delegate the resolution of an issue, or authority for dealing with a part of the business, he cannot delegate responsibility for it. It is his responsibility to ensure that he receives reports on progress and questions those reports where appropriate. For instance, if progress appears to be slow or if the issue is not being resolved satisfactorily, then the *approved person* performing a *significant influence function* may need to challenge the explanations he receives and take action himself to resolve the problem. This may include increasing the resource applied to it, reassigning the resolution internally or obtaining external advice or assistance. Where an issue raises significant concerns, an *approved person* performing a *significant influence function* should act clearly and decisively. If appropriate, this may be by suspending members of staff or relieving them of all or part of their responsibilities (see ■ APER 4.6.6 E).




4.7 Statement of Principle 7


- 4.7.1  /1 The *Statement of Principle 7* (see ■ [APER 2.1.2 P](#)) is in the following terms: "An *approved person* performing a *significant influence function* must take reasonable steps to ensure that the business of the *firm* for which he is responsible in his *controlled function* complies with the relevant requirements and standards of the *regulatory system*."
- 4.7.2  /1 In the opinion of the *FSA*, conduct of the type described in ■ [APER 4.7.3 E](#), ■ [APER 4.7.4 E](#), ■ [APER 4.7.5 E](#), ■ [APER 4.7.7 E](#), ■ [APER 4.7.9 E](#) or ■ [APER 4.7.10 E](#) does not comply with *Statement of Principle 7* ■ [APER 2.1.2 P](#)).
- 4.7.3  /1 Failing to take reasonable steps to implement (either personally or through a compliance department or other departments) adequate and appropriate systems of control to comply with the relevant requirements and standards of the *regulatory system* in respect of its *regulated activities* falls within ■ [APER 4.7.2 E](#). In the case of an *approved person* who is responsible, under ■ [SYSC 2.1.3 R \(2\)](#), with overseeing the *firm's* obligation under [SYSC 3.1.1R](#), failing to take reasonable care to oversee the establishment and maintenance of appropriate systems and controls falls within ■ [APER 4.7.2 E](#).
- 4.7.4  /1 Failing to take reasonable steps to monitor (either personally or through a compliance department or other departments) compliance with the relevant requirements and standards of the *regulatory system* in respect of its *regulated activities* falls within ■ [APER 4.7.2 E](#) (see ■ [APER 4.7.12 G](#)).
- 4.7.5  /1 Failing to take reasonable steps adequately to inform himself about the reason why significant breaches (whether suspected or actual) of the relevant requirements and standards of the *regulatory system* in respect of its *regulated activities* may have arisen (taking account of the systems and procedures in place) falls within ■ [APER 4.7.2 E](#).
- 4.7.6  /1 Behaviour of the type referred to in ■ [APER 4.7.5 E](#) includes, but is not limited to, failing to investigate what systems or procedures may have failed including, where appropriate, failing to obtain expert opinion on the adequacy of the systems and procedures.
- 4.7.7  /1 Failing to take reasonable steps to ensure that procedures and systems of control are reviewed and, if appropriate, improved, following the identification of significant breaches (whether suspected or actual) of the relevant requirements and standards of the *regulatory system*


relating to its *regulated activities*, falls within ■ APER 4.7.2 E (see ■ APER 4.7.13 G).

4.7.8  Behaviour of the type referred to in ■ APER 4.7.7 E includes, but is not limited to:


- (1) unreasonably failing to implement recommendations for improvements in systems and procedures;
- (2) unreasonably failing to implement recommendations for improvements to systems and procedures in a timely manner.

4.7.9  In the case of the *Money Laundering Reporting Officer*, failing to discharge the responsibilities imposed on him in accordance with chapter 8 of the *Money Laundering* sourcebook (*ML*) falls within ■ APER 4.7.2 E.


4.7.10  In the case of an *approved person* performing a *significant influence function* responsible for compliance under ■ APER 3.2.8 R, failing to take reasonable steps to ensure that appropriate compliance systems and procedures are in place falls within ■ APER 4.7.2 E (see ■ APER 4.7.14 G).

4.7.11  The *FSA* expects an *approved person* performing a *significant influence function* to take reasonable steps both to ensure his *firm's* compliance with the relevant requirements and standards of the *regulatory system* and to ensure that all staff are aware of the need for compliance.

Systems of control

4.7.12  An *approved person* performing a *significant influence function* need not himself put in place the systems of control in his business ■ APER 4.7.4 E). Whether he does this depends on his role and responsibilities. He should, however, take reasonable steps to ensure that the business for which he is responsible has operating procedures and systems which include well-defined steps for complying with the detail of relevant requirements and standards of the *regulatory system* and for ensuring that the business is run prudently. The nature and extent of the systems of control that are required will depend upon the relevant requirements and standards of the *regulatory system*, and the nature, scale and complexity of the business (see ■ APER 3.3.2 E).

Possible breaches of regulatory requirements

4.7.13  Where the *approved person* performing a *significant influence function* becomes aware of actual or suspected problems that involve possible breaches of relevant requirements and standards of the *regulatory system* falling within his area of responsibility, then he should take reasonable steps to ensure that they are dealt with in a timely and appropriate manner ■ APER 4.7.7 E). This may involve an adequate investigation to find out what systems or procedures may have failed and why. He may need to obtain expert opinion on the adequacy and efficacy of the systems and procedures.

Review and improvement of systems and procedures

4.7.14

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Where independent reviews of systems and procedures have been undertaken and result in recommendations for improvement, the *approved person* performing a *significant influence function* should ensure that, unless there are good reasons not to, any reasonable recommendations are implemented in a timely manner ■ APER 4.7.10 E). What is reasonable will depend on the nature of the inadequacy and the cost of the improvement. It will be reasonable for the *approved person* performing a *significant influence function* to carry out a cost benefit analysis when assessing whether the recommendations are reasonable.

Handbook Modules

Schedule1 Record keeping requirements

G

- 1 There are no record keeping requirements in APER.

Handbook Modules

Schedule2 Notification requirements

G

- 1 The aim of the guidance in the following table is to give the reader a quick over-all view of the relevant requirements for notification and reporting.
- 2 It is not a complete statement of those requirements and should not be relied on as if it were.
- 3

Table	Notification requirements
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Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<i>Statement of Principle 4 (APER 2.1.2P)</i>	Any information of which the <i>FSA</i> would reasonably expect notice	Appropriate disclosure	Any information of which the <i>FSA</i> would reasonably expect notice	Appropriate

Handbook Modules

Schedule3 Fees and other required payments

G

- 1 There are no requirements for fees or other payments in APER.

Handbook Modules

Schedule4 Powers exercised

G

- 1 The following powers in the Act have been exercised by the FSA to issue the Statements of Principle and Code of Practice for Approved Persons:

Section 64(1) and (2) (Conduct: statements and codes).

- 2 The following power in the Act has been exercised by the FSA to give the guidance in APER:

Section 157(1) (Guidance).

Handbook Modules

Schedule5 Rights of action for damages

G

- 1 There are no rules in APER.

Handbook Modules

Schedule6 Rules that can be waived

G

- 1 There are no rules in APER.

Statements of Principle and Code of Practice for Approved Persons

Derivations

G

There is no table of derivations for *APER*.

Statements of Principle and Code of Practice for Approved Persons Destinations

G

There is no table of destinations for *APER*.

THE FIT AND PROPER TEST FOR APPROVED PERSONS INSTRUMENT 2001

- A. The Financial Services Authority gives the guidance in the Annex to this instrument (“FIT”) in the exercise of the power listed in Schedule 4 to FIT (Powers exercised).
- B. This instrument shall come into force at the beginning of the first day on which section 40 of the Financial Services and Markets Act 2000 (Application for permission) comes into force for any purpose.
- C. This instrument may be cited as the Fit and Proper Test for Approved Persons Instrument 2001.
- D. The Annex to this instrument (including its Schedules) may be cited as the Fit and Proper Test for Approved Persons (or FIT).

By order of the Board
21 June 2001

ANNEX



The Fit and Proper test for Approved Persons



Contents

Transitional provisions

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1 General

2 Main assessment criteria

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Schedule 2: Notification requirements

Schedule 3: Fees and other required payments

Schedule 4: Powers exercised

Schedule 5: Rights of action for damages

Schedule 6: Rules that can be waived

Derivations

Destinations

Handbook Modules

Transitional provisions

G

- 1 There are no transitional provisions in FIT. However, GEN contains some technical transitional provisions that apply throughout the Handbook and which are designed to ensure a smooth transition at commencement.

Chapter 1

General



1.1 Application and purpose

1.1.1

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FIT applies to:

- (1) a *firm*;
- (2) an applicant for *Part IV permission*;
- (3) and *EEA firm*, a *Treaty firm* or a *UCITS qualifier* that wishes to establish a *branch* into the *United Kingdom* using *EEA rights*, *Treaty rights* or *UCITS directive rights* (see ■ SUP 10.1.12 G and ■ SUP 10.1.13 R), or apply for a *top-up permission* (see ■ SUP 10.1.14 R);
- (4) an *approved person*; and
- (5) a *candidate*.

1.1.2

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The purpose of *FIT* is to set out and describe the criteria that the *FSA* will consider when assessing the fitness and propriety of a *candidate* for a *controlled function* (see generally ■ SUP 10 on *approved persons*). The criteria are also relevant in assessing the continuing fitness and propriety of *approved persons*. The criteria that the *FSA* will consider in relation to an *authorised person* are described in *COND*.

1.2 Introduction

- 1.2.1** G_{/1} Under section 61(1) of the *Act* (Determination of applications), the *FSA* may grant an application for approval made under section 60 (Applications for approval) only if it is satisfied that the *candidate* is fit and proper to perform the *controlled function* to which the application relates.
- 1.2.2** G_{/1} The method of applying for *approved person* status is set out in ■ AUTH 6 and ■ SUP 10.
- 1.2.3** G_{/1} Under section 63(1) of the *Act* (Withdrawal of approval), the *FSA* may withdraw its approval if it considers that the *person* in respect of whom the approval was given is not fit and proper to perform the *controlled function* to which the approval relates.
- 1.2.4** G_{/1} The *Act* does not prescribe the matters which the *FSA* should take into account when determining fitness and propriety. However, section 61(2) states that the *FSA* may have regard (among other things) to whether the *candidate* or *approved person* is competent to carry out a *controlled function*.

1.3 Assessing fitness and propriety

- 1.3.1**  The *FSA* will have regard to a number of factors when assessing the fitness and propriety of a *person* to perform a particular *controlled function*. The most important considerations will be the *person's*:
- (1) honesty, integrity and reputation;
 - (2) competence and capability; and
 - (3) financial soundness.
- 1.3.2**  In assessing fitness and propriety, the *FSA* will also take account of the activities of the *firm* for which the *controlled function* is or is to be performed, the *permission* held by that *firm* and the markets within which it operates.
- 1.3.3**  The criteria listed in **■ FIT 2.1** to **■ FIT 2.3** are *guidance* and will be applied in general terms when the *FSA* is determining a *person's* fitness and propriety. It would be impossible to produce a definitive list of all the matters which would be relevant to a particular determination.
- 1.3.4**  If a matter comes to the *FSA's* attention which suggests that the *person* might not be fit and proper, the *FSA* will take into account how relevant and how important it is.
- 1.3.5**  During the application process, the *FSA* may discuss the assessment of the *candidate's* fitness and propriety informally with the *firm* making the application and may retain any notes of those discussions.

Chapter 2

Main assessment criteria



2.1 Honesty, integrity and reputation

- 2.1.1** G_{/1} In determining a *person's* honesty, integrity and reputation, the *FSA* will have regard to matters including, but not limited to, those set out in ■ FIT 2.1.3 G which may have arisen either in the *United Kingdom* or elsewhere. The *FSA* should be informed of these matters (see ■ SUP 10.13.16 R), but will consider the circumstances only where relevant to the requirements and standards of the *regulatory system*.
- 2.1.2** G_{/1} In considering the matters in ■ FIT 2.1.1 G, the *FSA* will look at whether the *person's* reputation might have an adverse impact upon the *firm* for which the *controlled function* is or is to be performed and at the *person's* responsibilities.
- 2.1.3** G_{/1} The matters referred to in ■ FIT 2.1.1 G to which the *FSA* will have regard include, but are not limited to:
- (1) whether the *person* has been convicted of any criminal offence; this may include, where relevant, any spent convictions under the Rehabilitation of Offenders Act 1974; particular consideration will be given to offences of dishonesty, fraud, financial crime or other offences under legislation relating to banking and financial services, companies, insurance and consumer protection;
 - (2) whether the *person* has been the subject of any adverse finding or any settlement in civil proceedings, particularly in connection with investment or other financial business, misconduct, fraud or the formation or management of a *body corporate*;
 - (3) whether the *person* has been the subject of, or interviewed in the course of, any existing or previous investigation or disciplinary proceedings, by the *FSA*, by other regulatory authorities (including a *previous regulator*), *clearing houses* and exchanges, professional bodies, or government bodies or agencies;
 - (4) whether the *person* is or has been the subject of any proceedings of a disciplinary or criminal nature, or has been notified of any potential proceedings or of any investigation which might lead to those proceedings;
 - (5) whether the *person* has contravened any of the requirements and standards of the *regulatory system* or the equivalent standards or requirements of other regulatory authorities (including a *previous regulator*), *clearing houses* and exchanges, professional bodies, or government bodies or agencies;
 - (6) whether the *person* has been the subject of any justified complaint relating to *regulated activities*;
 - (7) whether the *person* has been involved with a *company*, *partnership* or other organisation that has been refused registration, authorisation, membership or a licence to carry out a trade, business or profession, or has had that registration,

authorisation, membership or licence revoked, withdrawn or terminated, or has been expelled by a regulatory or government body;

- (8) whether, as a result of the removal of the relevant licence, registration or other authority, the *person* has been refused the right to carry on a trade, business or profession requiring a licence, registration or other authority;
- (9) whether the *person* has been a *director*, *partner*, or concerned in the management, of a business that has gone into insolvency, liquidation or administration while the *person* has been connected with that organisation or within one year of that connection;
- (10) whether the *person*, or any business with which the *person* has been involved, has been investigated, disciplined, censured or suspended or criticised by a regulatory or professional body, a court or Tribunal, whether publicly or privately;
- (11) whether the *person* has been dismissed, or asked to resign and resigned, from employment or from a position of trust, fiduciary appointment or similar;
- (12) whether the *person* has ever been disqualified from acting as a *director* or disqualified from acting in any managerial capacity;
- (13) whether, in the past, the *person* has been candid and truthful in all his dealings with any *regulatory body* and whether the *person* demonstrates a readiness and willingness to comply with the requirements and standards of the *regulatory system* and with other legal, regulatory and professional requirements and standards.

2.2 Competence and capability

2.2.1

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In determining a *person's* competence and capability, the *FSA* will have regard to matters including but not limited to:

- (1) whether the *person* satisfies the relevant requirements of the *FSA's* Training and Competence sourcebook (*TC*) in relation to the *controlled function* the *person* performs or is intended to perform;
- (2) whether the *person* has demonstrated by experience and training that the *person* is able, or will be able if approved, to perform the *controlled function*.

2.2.2

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A *person* may have been convicted of, or dismissed or suspended from employment for, drug or alcohol abuses or other abusive acts. This will be considered only in relation to a *person's* continuing ability to perform the particular *controlled function* for which the *person* is or is to be employed.

2.3 Financial soundness

2.3.1

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In determining a *person's* financial soundness, the *FSA* will have regard to any factors including, but not limited to:

- (1) whether the *person* has been the subject of any judgment debt or award, in the *United Kingdom* or elsewhere, that remains outstanding or was not satisfied within a reasonable period;
- (2) whether, in the *United Kingdom* or elsewhere, the *person* has made any arrangements with his creditors, filed for bankruptcy, been adjudged bankrupt, had assets sequestrated, or been involved in proceedings relating to any of these.

2.3.2

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The *FSA* will not normally require the *candidate* to supply a statement of assets or liabilities. The fact that a *person* may be of limited financial means will not, in itself, affect his suitability to perform a *controlled function*.

Handbook Modules

Schedule1 Record keeping requirements

G

- 1 There are no record keeping requirements in FIT.

Handbook Modules

Schedule2 Notification requirements

G

- 1 There are no notification requirements in FIT.

Handbook Modules

Schedule3 Fees and other required payments

G

- 1 There are no requirements for fees or other payments in FIT.

Handbook Modules

Schedule4 Powers exercised

G

- 1 The following power in the Act has been exercised by the FSA to give guidance in FIT:
Section 157(1) (Guidance).

Handbook Modules

Schedule5 Rights of action for damages

G

- 1 There are no rules in FIT.

Handbook Modules

Schedule6 Rules that can be waived

G

- 1 There are no rules in FIT.

The Fit and Proper Test for Approved Persons

Derivations

G

There is no table of derivations for *FIT*.

The Fit and Proper Test for Approved Persons Destinations

G

There is no table of destinations for *FIT*.

GENERAL PROVISIONS AND GLOSSARY INSTRUMENT 2001

- A. The Financial Services Authority makes the provisions in Annex A ("GEN"), other than GEN 2.1.8R, and Annex B (the "Glossary") to this instrument in the exercise of the powers listed in Schedule 4 to GEN (Powers exercised).
- B. This instrument shall come into force immediately, except for GEN 2.1.8R which shall come into force as and when made and brought into force by Financial Ombudsman Service Ltd.
- C. The provisions relevant to making rules and listed in Schedule 4 to GEN (Powers exercised) are specified for the purpose of section 153(2) of the Financial Services and Markets Act 2000 (Rule-making instruments).
- D. This instrument may be cited as the General Provisions and Glossary Instrument 2001.
- E. Annex A to this instrument may be cited as the General provisions (or GEN).
- F. Annex B to this instrument may be cited as the Glossary.

By order of the Board
21 June 2001

ANNEX

PART 1



Contents

Transitional provisions

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- 1 Provisions which apply to all authorised persons
- 2 Interpreting the Handbook
- 3 FSA fees: general provisions *

Schedule 1: Record keeping requirements

Schedule 2: Notification requirements

Schedule 3: Fees and other required payments

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Schedule 6: Rules that can be waived

Derivations

Destinations

[* This chapter of GEN will be added later]

Handbook Modules

Transitional provisions

G

1 Table Transitional Provisions applying across the Handbook

(1) The purpose of these transitional provisions is to assist a smooth transition at *commencement*. They comprise various technical provisions that will apply across the whole *Handbook* and achieve results that most people would probably expect to apply in any event.

(2) These transitional provisions consist of general transitional provisions, which apply at a high level of generality, and more specific transitional provisions in relation to record keeping and *notification rules*.

(3) The more specific transitional provisions relating to record keeping and *notification rules* override the general transitional provisions. Both the general and the more specific transitional provisions do not apply if the context requires otherwise and are subject to any more specific transitional provision elsewhere in the *Handbook* relating to the matter. For example, *COB* contains transitional provisions relating to various matters which are limited in duration and which override these transitional provisions in relation to those matters.

(4) Definitions for these transitional provisions, additional to those in the *Glossary*, are provided at paragraph 17 of the table.

2 Table

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1	Every <i>rule</i> in the <i>Handbook</i> , unless the context otherwise requires and subject to any more specific transitional provision relating to the matter	R	<p><u>Acts under pre-commencement provisions</u></p> <p>Anything done, or having effect as done, under or for the purposes of any pre-commencement provision has effect as if done under or for the purposes of any substantially similar provision in the <i>Handbook</i>.</p>	From commencement of the relevant <i>rule</i> in the <i>Handbook</i>	See schedule of Transitional provisions of the relevant <i>rule</i>
2	Paragraph 1	G	For example, a <i>firm</i> may rely on action to establish the best price, taken shortly before <i>commencement</i> for the purposes of an applicable SRO best execution rule, for the purposes of compliance with COB 7.5.5R(1) (Providing best execution), even if the transaction is <i>executed after commencement</i> .	As paragraph 1	As paragraph 1
3	As paragraph 1	R	<p><u>Achieving compliance before commencement</u></p> <p>Anything done before <i>commencement</i> for the purposes of a provision in the <i>Handbook</i> has effect as if done under that provision.</p>	As paragraph 1	As paragraph 1
4	Paragraph 3	G	For example, a <i>firm</i> may allocate responsibility for apportionment and oversight for the purposes of SYSC 2.1.3R (Apportionment of responsibilities) before <i>commencement</i> , so as to be in compliance at <i>commencement</i> .	As paragraph 1	As paragraph 1

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
5	As paragraph 1	R	<p><u>Series of events</u></p> <p>If the application of any provision in the <i>Handbook</i> is dependent on the occurrence of a series of events, some of which occur before, and some of which occur after, <i>commencement</i>, the provision applies with respect to the events that occur after <i>commencement</i>.</p>	As paragraph 1	As paragraph 1
6	Paragraph 5	G	<p>For example, a <i>firm</i> which executes an aggregated order shortly before <i>commencement</i> must comply with COB 7.7.9R (Requirement for fair allocation) if the allocation occurs after <i>commencement</i>. Transitional provisions in COB may permit the <i>firm</i> to comply with the rules of its <i>previous regulator</i> if it wishes, as an alternative to COB 7.7.9R.</p>	As paragraph 1	As paragraph 1
7	As paragraph 1	R	<p><u>Deemed references to pre-commencement provisions</u></p> <p>Any reference (express or implied) in a provision in the <i>Handbook</i> to a provision of or made under the <i>Act</i> is to be read (so far as the context permits and according to the context) as being or including, in relation to times, circumstances and purposes before <i>commencement</i>, a reference to any substantially similar pre-commencement provision applicable to the <i>firm</i>.</p>	As paragraph 1	As paragraph 1

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
8	Paragraph 7	G	<p>For example, <i>SUP</i> 11.6.4R(1) requires certain <i>firms</i> to notify the <i>FSA</i> when a change in <i>control</i>, previously notified under <i>SUP</i> 11.4.2R, has taken place. Such a <i>firm</i> must notify a change in <i>control</i> that takes place after <i>commencement</i>, even if previously notified under a pre-commencement provision rather than under <i>SUP</i> 11.4.2R (and <i>SUP</i> 11.6.4R(1) is to be read as referring to that pre-commencement provision).</p> <p>Another example is <i>SUP</i> 3.10.6R, which requires an auditor's report on client assets to be provided not more than 53 weeks after the period covered by the previous report on such matters. For the first report after <i>commencement</i>, the period runs from that covered by the report under any substantially similar pre-commencement provision (because of an implied reference to that provision).</p>	As paragraph 1	As paragraph 1

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
9	As paragraph 1	R	<p><u>Time starting before commencement</u></p> <p>If, at <i>commencement</i>, time has begun to run for any purpose under any pre-commencement provision applicable to a <i>firm</i>, then:</p> <p>(1) time will be regarded as having started to run, for the purposes of any substantially similar provision in the <i>Handbook</i>, when it started to run for that other purpose; and</p> <p>(2) the <i>firm</i> will be relieved of its obligation to comply with the relevant pre-commencement provision if and to the extent that it complies with the substantially similar provision as extended by this transitional provision.</p>	As paragraph 1	As paragraph 1
10	Paragraph 9	G	<p>For example, a <i>UK bank</i> was required to submit Form LE2 within 10 business days after its quarter end by the <i>FSA's</i> Guide to Banking Supervisory Policy. If the quarter end fell five days before <i>commencement</i>, the <i>UK bank</i> must still submit the report within 10 <i>business days</i>, but in accordance with <i>SUP</i> 16.7.8R (Financial reports: banks).</p>	As paragraph 1	As paragraph 1

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
11	Every <i>rule</i> in the <i>Handbook</i> requiring a record to be made or retained (see schedule 1), unless the context otherwise requires and subject to any more specific transitional provision relating to the matter	R	<p><u>Record keeping</u></p> <p>A firm will not contravene a rule in the Handbook requiring a record to be made or retained to the extent that the firm:</p> <p>(1) made a record of the matter before commencement in accordance with the rule or with a substantially similar pre-commencement provision applicable to the firm; and</p> <p>(2) retains that record as if the rule was in force when the record was made.</p>	From commencement of the relevant <i>rule</i> in the <i>Handbook</i>	See schedule of Transitional provisions of the relevant <i>rule</i>
12	Paragraph 11	G	This transitional provision makes specific provision, in relation to record keeping, for the matters covered by paragraphs 1 and 3. It is included for clarity and overrides those general transitional provisions.	As paragraph 11	As paragraph 11
13	As paragraph 11	R	A firm must retain a record in accordance with a rule in the Handbook requiring a record of that sort to be retained, if the firm was required to make and retain that record before commencement under a substantially similar pre-commencement provision applicable to the firm.	As paragraph 11	As paragraph 11

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
14	Paragraph 13	G	This transitional provision makes specific provision, in relation to records, for the matters covered by paragraphs 7 and 9. It is included for clarity and overrides those general transitional provisions.	As paragraph 11	As paragraph 11
15	Every <i>notification rule</i> in the <i>Handbook</i> (see schedule 2), unless the context otherwise requires and subject to any more specific transitional provision relating to the matter	R	<p><u>Notification</u></p> <p><i>A firm (or its auditor, appointed actuary or appropriate actuary) will not contravene a notification rule in the Handbook to the extent that notice of the relevant matter was given to the firm's previous regulator before commencement in accordance with:</i></p> <p>(1) the notification rule; or</p> <p>(2) a substantially similar pre-commencement provision applicable to the firm.</p>	From commencement of the relevant rule in the <i>Handbook</i>	See schedule of Transitional provisions of the relevant rule
16	Paragraph 15	G	This transitional provision makes specific provision, in relation to notifications, for the matters covered by paragraphs 1 and 3. It is included for clarity and overrides those general transitional provisions.	As paragraph 15	As paragraph 15

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
17	Paragraphs 1 to 16	R	<p><u>Definitions</u></p> <p>In these transitional provisions:</p> <p>(1) "pre-commencement provision" means a provision repealed or revoked by or under the <i>Act</i> or a rule or guidance of the <i>firm's previous regulator</i>, including (where the context permits) any relevant provision which it replaced before <i>commencement</i>;</p> <p>(2) "substantially similar" means substantially similar in purpose and effect; and</p> <p>(3) a reference to a "provision" in the <i>Handbook</i> means every type of provision, including <i>rules, guidance, provisions in codes</i>, and so on.</p>	As paragraph 1	As paragraph 1
18	Paragraphs 19 to 22	G	<p><u>Application for provisions which are not rules</u></p> <p>The purpose of paragraphs 19 to 22 is to ensure that the transitional provisions in paragraphs 1 to 10 apply throughout the <i>Handbook</i>.</p>	As paragraphs 19 to 22	As paragraphs 19 to 22

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
19	<i>Statements of Principle</i> unless the context otherwise requires and subject to any more specific transitional provision relating to the matter	P	The provisions in paragraphs 1 to 10 apply to every <i>approved person</i> as if the rules in those paragraphs were part of the <i>Statements of Principle</i>.	From commencement of the relevant <i>Statement of Principle</i>	See schedule of Transitional provisions for <i>APER</i>
20	<i>Code of Practice for Approved Persons and Code of Market Conduct</i> unless the context otherwise requires and subject to any more specific transitional provision relating to the matter	E	The provisions paragraphs 1 to 10 apply to every <i>approved person</i> and every person to whom the <i>Code of Market Conduct</i> applies as if the rules in those paragraphs were part of the <i>Code of Practice for Approved Persons</i> and the <i>Code of Market Conduct</i> respectively.	From commencement of the relevant provision of the Code	See schedule of Transitional provisions for <i>APER</i> and <i>MAR</i>

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
21	Directions and requirements in the Handbook (that is, provisions with the status letter "D" in the margin or heading) unless the context otherwise requires and subject to any more specific transitional provision relating to the matter	D	The provisions in paragraphs 1 to 10 apply to every <i>person</i> to whom a direction or requirement in the <i>Handbook</i> applies as if the <i>rules</i> in those paragraphs were part of that direction or requirement.	From commencement of the relevant direction or requirement	See schedule of Transitional provisions of the relevant direction or requirement
22	<i>Guidance</i> (and other provisions with the status letter "G" in the margin or heading) in the <i>Handbook</i> unless the context otherwise requires and subject to any more specific transitional provision relating to the matter	G	The provisions in paragraphs 1 to 10 are also relevant to every <i>person</i> to whom any other <i>guidance</i> (or other provision with the status letter "G" in the margin or heading) in the <i>Handbook</i> is relevant as if the <i>rules</i> in those paragraphs were part of that <i>guidance</i> (or other provision).	From commencement of the relevant provision	See schedule of Transitional provisions of the relevant provision

3 **G** Table Transitional provisions applying to GEN only

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1	<i>GEN 2.2.7R</i>	R	<i>GEN 2.2.7R</i> has effect as if it started with the words "Unless the context indicates otherwise,".	From 21 June 2001 until six months after <i>commencement</i>	21 June 2001

Chapter 1

Provisions which apply to all authorised persons

1.1 Application

1.1.1

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- (1) This chapter applies to every *firm*.
- (2) For a *UCITS qualifier*, this chapter applies only with respect to the *communication* and *approval* of *financial promotions* to which **■ COB 3** (Financial promotion) applies and to the maintenance of facilities to which **■ CIS 17.5** (Facilities in the United Kingdom) applies.

1.1.2

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- GEN 1.1.1 R (2) reflects section 266 of the *Act* (Disapplication of rules).

1.2 Referring to approval by the FSA

- 1.2.1** **G**_{/1} The purpose of **■ GEN 1.2.2 R** is to prevent *clients* being misled about the extent to which the *FSA* has approved a *firm's* affairs.
- 1.2.2** **R**_{/1}
- (1) Unless required to do so under the *regulatory system*, a *firm* must ensure that neither it nor anyone acting on its behalf claims, in a public statement or to a client, expressly or by implication, that its affairs, or any aspect of them, have the approval of the *FSA*.
 - (2) Paragraph (1) does not apply to statements that explain, in a way that is fair, clear and not misleading, that:
 - (a) the *firm* is an *authorised person*;
 - (b) the *firm* has *permission* to carry on a specific activity;
 - (c) an *authorisation order* has been made in relation to an *AUT* or *ICVC*;
 - (d) a *recognised scheme* has that status;
 - (e) the *firm's approved persons* have been approved by the *FSA* for the purposes of section 59 of the *Act* (Approval for particular arrangements);
 - (f) the *firm* has been given express written approval by the *FSA* in respect of a specific aspect of the *firm's* affairs.
 - (3) Paragraph (1) applies with respect to the carrying on of both *regulated activities* and *unregulated activities*.
- 1.2.3** **G**_{/1} **■ GEN 1.2.1 R (2)(f)** is confined to written approval because of the need for clarity as to the scope of any approval given by the *FSA*.

1.3 Emergency

1.3.1 **G**_{/1} The *FSA* recognises that there may be occasions when, because of a particular emergency, a *firm* may be unable to comply with a particular *rule*. The purpose of **■ GEN 1.3.2 R** is to provide appropriate relief from the consequences of contravention of a *rule* in those circumstances.

1.3.2 **R**_{/1} (1) If any emergency arises which:

- (a) could not have been avoided by the *firm* taking all reasonable steps;
- (b) makes it impracticable for a *firm* to comply with a particular *rule*; and
- (c) is outside the control of the *firm*, its *associates* and agents (and of its and their *employees*);

the *firm* will not be in contravention of that *rule* to the extent that, in consequence of the emergency, compliance with that *rule* is impracticable.

(2) Paragraph (1) applies only for so long as:

- (a) the consequences of the emergency continue; and
- (b) the *firm* can demonstrate that it is taking all practicable steps to deal with those consequences, to comply with the *rule*, and to mitigate losses and potential losses to its *clients*.

(3) A *firm* must notify the *FSA* as soon as practicable of the emergency and of the steps it is taking and proposes to take to deal with the consequences of the emergency.

1.3.3 **G**_{/1} A *firm* should continue to keep the *FSA* informed of the steps it is taking under **■ GEN 1.3.2 R** (3), in order to comply with its obligations under *Principle 11* (Relations with regulators).

1.3.4 **G**_{/1} In the context of **■ GEN 1.3.2 R**, an action is not practicable if it involves a *firm* going to unreasonable lengths.

1.3.5 **G**_{/1} **■ GEN 1.3.2 R** operates on the *FSA's rules*. It does not affect the *FSA's* powers to take action against a *firm* in an emergency, based on contravention of other requirements and standards under the *regulatory system*. For example, the *FSA* may exercise its *own-initiative power* in appropriate cases to vary a *firm's Part IV*

permission based on a failure or potential failure to satisfy the *threshold conditions* (see ■ SUP 7 (Applying the FSA's requirements to individual firms) and ■ ENF 4 (Variation of Part IV permission on the FSA's own initiative)).

Chapter 2

2

Interpreting the Handbook

2.1 Application and purpose

Application

- 2.1.1** **G**_{/1} The purpose of ■ GEN 2.1.2 R, ■ GEN 2.1.3 P, ■ GEN 2.1.4 E, ■ GEN 2.1.5 D and ■ GEN 2.1.6 G is to ensure that ■ GEN 2 applies throughout the *Handbook*.
- 2.1.2** **R**_{/1} This chapter applies to every *person* to whom any *rule* in the *Handbook* applies.
- 2.1.3** **P**_{/1} This chapter applies to every *approved person* as if the *rules* in this chapter were part of the *Statements of Principle*.
- 2.1.4** **E**_{/1} This chapter applies to every *approved person* and every *person* to whom the *Code of Market Conduct* applies as if the *rules* in this chapter were part of the *Code of Practice for Approved Persons* and the *Code of Market Conduct* respectively.
- 2.1.5** **D**_{/1} This chapter applies to every *person* to whom a direction or requirement in the *Handbook* (that is, a provision with the status letter “D” in the margin or heading) applies as if the *rules* in this chapter were part of that direction or requirement.
- 2.1.6** **G**_{/1} This chapter is also relevant to every *person* to whom any other *guidance* (or other provision with the status letter “G” in the *margin* or heading) in the *Handbook* is relevant as if the *rules* in this chapter were part of that *guidance* (or other provision).
- 2.1.7** **R**_{/1} Where this chapter refers to a “provision” in the *Handbook*, this means every type of provision, including *rules*, *guidance*, provisions in codes, and so on.
- 2.1.8** **R**_{/1} This chapter applies to all rules made by *FOS Ltd*.
- 2.1.9** **G**_{/1} The effect of ■ GEN 2.1.8 R is that this chapter applies with respect to those provisions in ■ DISP 2 (Jurisdiction of the Financial Ombudsman Service), ■ DISP 3 (Complaint handling procedures of the Financial Ombudsman Service), ■ DISP 4 (Standard terms) and ■ DISP 5 (Financial Ombudsman Service Funding Rules) made by *FOS Ltd*.

Purpose

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The purpose of ■ GEN 2 is to facilitate interpretation of the *Handbook*, in conjunction with the Reader’s Guide.

2.2 Interpreting the Handbook

Purposive interpretation

2.2.1 **R** Every provision in the *Handbook* must be interpreted in the light of its purpose.

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2.2.2 **G** The purpose of any provision in the *Handbook* is to be gathered first and foremost from the text of the provision in question and its context among other relevant provisions. The *guidance* given on the purpose of a provision is intended as an explanation to assist readers of the *Handbook*. As such, *guidance* may assist the reader in assessing the purpose of the provision, but it should not be taken as a complete or definitive explanation of a provision's purpose.

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Evidential provisions

2.2.3 **R** Any *rule* in the *Handbook* which has the status letter "E" in the margin or heading:

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- (1) is to be taken also to provide that contravention of the *rule* does not give rise to any of the consequences provided for by provisions of the *Act* other than section 149 (Evidential provisions); and
- (2) incorporates the status letter "E" in the margin or heading as part of the *rule*.

2.2.4 **G** (1) The *rules* to which section 149 of the *Act* applies ("*evidential provisions*") are identified in the *Handbook* by the status letter "E" in the *margin* or heading.

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- (2) Other provisions in the *Handbook*, although also identified by the status letter "E" in the margin or heading, are actually not *rules* but provisions in codes and ■ GEN 2.2.3 R does not apply to them. These code provisions are ■ GEN 2.1.4 E, and those provisions in the *Code of Practice for Approved Persons* ■ APER 3 and ■ APER 4) and the *Code of Market Conduct* ■ MAR 1) with the status letter "E".

2.2.5 **G** Paragraphs 18 to 31 of the Reader's Guide contain an explanation of the significance of the status letters R, D, P, C, E and G, and include further information on *evidential provisions*.

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Use of defined expressions

- 2.2.6** **G** Expressions with defined meanings appear in italics in the *Handbook*.
- 2.2.7** **R** ^{/1} **In the *Handbook* (except *IPRU*):**
- (1) **an expression in italics which is defined in the *Glossary* has the meaning given there; and**
- (2) **an expression in italics which relates to an expression defined in the *Glossary* must be interpreted accordingly.**
- 2.2.8** **G** ^{/1} Examples of related expressions are:
- (1) “*advice on investments*” and “*advise on investments*”, which should be interpreted by reference to “*advising on investments*”;
- (2) “*closely linked*”, which should be interpreted by reference to “*close links*”;
- (3) “*controls*” and “*controlled*”, which should be interpreted by reference to “*control*”; and
- (4) “*effect*”, as for example in “*effect a life policy*”, which should be interpreted by reference to “*effecting contracts of insurance*”.
- 2.2.9** **G** ^{/1} Unless the context otherwise requires, where italics have not been used, an expression bears its natural meaning (subject to the Interpretation Act 1978; see ■ GEN 2.2.11 R to ■ GEN 2.2.12 G).
- 2.2.10** **G** ^{/1} The Interim Prudential sourcebooks (*IPRU*) have individual arrangements for defined terms and each contains *rules* or *guidance* on its own arrangements. In respect of those sourcebooks, reliance should not be placed on the definitions which appear in the *Glossary* unless otherwise indicated.

Application of the Interpretation Act 1978

- 2.2.11** **R** ^{/1} **The Interpretation Act 1978 applies to the *Handbook*.**
- 2.2.12** **G** ^{/1} The application of the Interpretation Act 1978 to the *Handbook* has the effect, in particular, that:
- (1) expressions in the *Handbook* used in the *Act* have the meanings which they bear in the *Act*, unless the contrary intention appears;
- (2) where reference is made in the *Handbook* to an enactment, it is a reference to that enactment as amended, and includes a reference to that provision as extended or applied by or under any other enactment, unless the contrary intention appears; and
- (3) unless the contrary intention appears:
- (a) words in the *Handbook* importing the masculine gender include the feminine and words importing the feminine gender include the masculine;

- (b) words in the *Handbook* in the singular include the plural and words in the plural include the singular.

Cross-references in the Handbook

- 2.2.13 **R** A reference in the *Handbook* to another provision in the *Handbook* is a reference to that provision as amended from time to time.
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References to writing

- 2.2.14 **R** If a provision in the *Handbook* refers to a communication, notice, agreement or other *document* “in writing” then, unless the contrary intention appears, it means in legible form and capable of being reproduced on paper, irrespective of the medium used. Expressions related to writing must be interpreted accordingly.
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- 2.2.15 **G** ■ GEN 2.2.14 R means that, for example, electronic media may be used to make communications which are required by a provision of the *Handbook* to be “in writing”, unless a contrary intention appears, or the use of electronic media would contravene some other requirement such as the requirement to treat *customers* fairly under *Principle 6*. COB 1.8 (Application to electronic media) contains further *guidance* in respect of electronic communication with or for *customers*. ■ GEN 2.2.14 R does not, however, affect any other legal requirement which may apply in relation to the form or manner of executing a *document* or agreement.
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- 2.2.16 **G** “*Document*” is a defined term in the *Glossary*, the definition of which includes information recorded in any form, including electronic form.
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Activities covered by general rules

- 2.2.17 **R** A general rule (that is a rule made under section 138 of the Act (General rule-making power)) is to be interpreted as:
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- (1) applying to a *firm* with respect to the carrying on of all *regulated activities*, except to the extent that a contrary intention appears; and
 - (2) not applying to a *firm* with respect to the carrying on of *unregulated activities*, unless and then only to the extent that a contrary intention appears.

Continuity of authorised partnerships and unincorporated associations

- 2.2.18 **R** (1) If a *firm*, which is a *partnership* or unincorporated association, is dissolved, any *firm* which succeeds to the business of the dissolved *firm* is to be regarded as the same *firm* for the purposes of the *Handbook*.
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- (2) For the purposes of (1), a *firm* is to be regarded as succeeding to the business of another *firm* only if:
- (a) the *members* of the resulting *firm* are substantially the same as those of the former *firm*; and
 - (b) succession is to the whole or substantially the whole of the business of the former *firm*.
- (3) In (1), "*partnership*" does not include a *partnership* which is constituted under the law of any place outside the *United Kingdom* and is a *body corporate*.

2.2.19

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In principle, it is possible to view a change of *partners* in a *partnership*, or a change in the membership of the unincorporated association, as the formation of a new *partnership* or association. ■ GEN 2.2.18 R reflects section 32 of the *Act* (Partnerships and unincorporated associations), which provides for the continuing *authorisation of partnerships* and unincorporated associations following a change in *partners* or members. ■ GEN 2.2.18 R ensures a similar effect in relation to the status of the *partnership* or unincorporated associations as a "*firm*" or "*authorised person*" for the purposes of the *Handbook*. This continuity does not apply if a *limited liability partnership* succeeds to the business of a dissolved *partnership*; *authorisation of the limited liability partnership* would need to be applied for.

Definition of *designated investment exchange*

2.2.20

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In the *Glossary*, the definition of *designated investment exchange* lists certain investment exchanges. Further information on *designated investment exchanges*, including *guidance* on the addition of an investment exchange to the list, is set out in ■ GEN 2 Ann 1 G.

Designated investment exchanges

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- 1 Table Further information on designated investment exchanges appears on the next page.

Introduction

1. A *designated investment exchange* is an exchange appearing in the list of such exchanges in the *Glossary*.

Benefits of designation

2. Under certain *rules*, *firms* may treat transactions effected on a *designated investment exchange* in the same way as transactions on *RIEs* (for example, see *COB 5 Ann 1 E*, *COB 9.1.35 R* and *COB 7.11*).

Criteria for inclusion in the list of designated investment exchanges

3. Before adding an investment exchange to the list of *designated investment exchanges* in the *Handbook*, the *FSA* will comply with all the requirements imposed by the *Act* in relation to the exercise of its rule-making powers. This will include consulting on the proposed amendment to the list.
4. In considering compatibility of the proposed addition with the *regulatory objectives*, the *FSA* will determine whether the investment exchange provides an appropriate degree of protection for *consumers* having regard in particular to:
 - (1) the relevant law and practice, including the regulatory framework in which the investment exchange operates, in the country or territory in which the investment exchange's head office is situated and any other relevant country or territory; and
 - (2) the rules and practices of the investment exchange.
5. Only investment exchanges which do not carry on a *regulated activity* in the *United Kingdom* and are not *regulated markets* may be added to the list. This is because an investment exchange carrying on a *regulated activity* in the *United Kingdom* will need to apply for recognition as an *RIE*, or *authorisation*, and because a *regulated market* is usually treated in the same way as an *RIE* in the *rules*.

Applications to be added to the list of designated investment exchanges

6. An application to be added to the list should be in writing and delivered to the *FSA* by:
 - (1) post to:
The Financial Services Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS; or
 - (2) leaving the application at that address.
7. In support of the application, an investment exchange should provide information on the questions set out in the table below.

2 Table Designated investment exchange questionnaire

Designated investment exchange questionnaire	
1	In what way are members subject to formal supervision by the exchange or another supervisory or regulatory body? Describe how capital resources of members are monitored on an ongoing basis and how this is related to business done.
2	What powers does the exchange or any other supervisory or regulatory body have to intervene in a member's business in the event of misconduct, financial difficulties or otherwise?
3	What are the clearing arrangements of the exchange? How does the exchange ensure performance of a contract between its members? If relevant, what type of contract guarantee is available?
4	How is price information in respect of contracts effected on the exchange disseminated to investors, particularly those investors in the <i>United Kingdom</i>?
5	What are the exchange's arrangements for reporting and recording of transactions effected on the exchange? Please describe.
6	Does the exchange, or any other supervisory or regulatory body, require members to segregate the money and assets of the member's <i>clients</i> from the money and assets of the member? If so, please describe in outline how this operates. If not, are investors protected in any other way in the event of the insolvency of a member or the exchange?
7	Does the exchange have procedures for the investigation of complaints? Please describe what they are.
8	Does the exchange classify the different contracts traded on it in terms of liquidity? Is it possible to identify certain contracts which are more liquid than others and in which a ready market might be considered to exist?

Handbook Modules

Schedule1 Record keeping requirements

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- 1 There are no record keeping requirements in GEN.

Handbook Modules

Schedule2 Notification requirements

G

- 1 The aim of the guidance in the following table is to give the reader a quick over-all view of the relevant requirements for notification and reporting.
- 2 It is not a complete statement of those requirements and should not be relied on as if it were.
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Table	Notifications requirements
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Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
GEN 1.3.2R	An emergency which makes it impracticable for a <i>firm</i> to comply with a particular <i>rule</i> .	Notification of the emergency and of the steps the <i>firm</i> is taking and proposes to take to deal with its consequences	An emergency which makes it impracticable for a <i>firm</i> to comply with a particular <i>rule</i> .	Notification as soon as practicable

Handbook Modules

Schedule3 Fees and other required payments

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- 1 There are no requirements for fees or other payments in GEN. GEN 3 (FSA fees: general provisions contains general provisions relating to the payment of fees.

Handbook Modules

Schedule4 Powers exercised

G

- 1 The following powers and related provisions in or under the Act have been exercised by the FSA to make rules in GEN:
 - (1) Section 59 (Approval for particular arrangements)
 - (2) Section 118(8) (Market abuse)
 - (3) Section 136(2) (Funding of the legal assistance scheme)
 - (4) Section 138 (General rule-making power)
 - (5) Section 139 (Miscellaneous ancillary matters)
 - (6) Section 140 (Restrictions on managers of authorised unit trust schemes)
 - (7) Section 141 (Insurance business rules)
 - (8) Section 142(2) (Insurance business: regulations supplementing Authority's rules)
 - (9) Section 143 (Endorsements of codes etc)
 - (10) Section 144 (Price stabilising rules)
 - (11) Section 145 (Financial promotion rules)
 - (12) Section 146 (Money laundering rules)
 - (13) Section 147 (Control of information rules)
 - (14) Section 149 (Evidential provisions)
 - (15) Section 150(2) (Actions for damages)
 - (16) Section 156 (General supplementary powers)
 - (17) Section 213 (The compensation scheme)
 - (18) Section 214 (General)
 - (19) Section 215 (Rights of the scheme in relevant person's insolvency)
 - (20) Section 216 (Continuity of long-term insurance policies)
 - (21) Section 217 (Insurers in financial difficulties)

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- (22) Section 218(2)(b) (Annual report)
 - (23) Section 223(1) (Management expenses)
 - (24) Section 226 (Compulsory jurisdiction)
 - (25) Section 229 (Awards)
 - (26) Section 234 (Industry funding)
 - (27) Section 238(5) (Restrictions on promotion)
 - (28) Section 239 (Single property schemes)
 - (29) Section 247 (Trust scheme rules)
 - (30) Section 248 (Scheme particulars rules)
 - (31) Section 278 (Rules as to scheme particulars)
 - (32) Section 283(1) (Facilities and information in the United Kingdom)
 - (33) Section 293 (Notification requirements)
 - (34) Section 295(3) (Notification: overseas investment exchanges and overseas clearing houses)
 - (35) Section 322 (Rules applicable to former underwriting members)
 - (36) Section 332(1) (Rules in relation to persons to whom the general prohibition does not apply)
 - (37) Section 340 (Appointment)
 - (38) Paragraph 17 of Schedule 1 (The Financial Services Authority: Fees)
 - (39) Paragraph 19 of Schedule 3 (EEA Passport Rights: Establishment)
 - (40) Paragraph 20 of Schedule 3 (EEA Passport Rights: Services)
 - (41) Paragraph 7(3) of Schedule 17 (The Ombudsman Scheme: Annual reports)
 - (42) Paragraph 13 of Schedule 17 (Authority's procedural rules)
 - (43) Regulation 6(1) of the OEIC Regulations (FSA rules).
- 2 The following powers and related provisions in the Act have been exercised by the FSA to issue the parts of the codes in GEN:
- (1) Section 64(2) (Conduct: statements and codes)
 - (2) Section 119 (The Code)
 - (3) Section 120 (Provisions included in the Authority's code by reference to the City Code).
- 3 The following powers in the Act have been exercised by the FSA to issue the parts of the statements in GEN:

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- (1) Section 64(1) (Conduct: statements and codes)
 - (2) Section 69 (Statement of policy)
 - (3) Section 124 (Statement of policy)
 - (4) Section 169(9) (Investigations etc in support of overseas regulator)
 - (5) Section 210 (Statements of policy)
 - (6) Section 395(5) (The Authority's procedures).
- 4 The following powers and related provisions in or under the Act have been exercised by the FSA in GEN to direct, require or specify:
- (1) Section 51 (Applications under this Part)
 - (2) Section 60 (Applications for approval)
 - (3) Section 148(3) (Modification or waiver of rules)
 - (4) Section 182 (Notification)
 - (5) Section 242 (Applications for authorisation of unit trust schemes)
 - (6) Section 250(4) and (5) (Modification or waiver of rules)
 - (7) Section 270(6)(b) (Schemes authorised in designated countries or territories)
 - (8) Section 274 (Application for recognition of individual schemes)
 - (9) Section 287 (Application by an investment exchange)
 - (10) Section 288 (Application by a clearing house)
 - (11) Section 294(2) (Modification or waiver of rules)
 - (12) Section 316 (Direction by Authority)
 - (13) Section 317 (The core provisions)
 - (14) Section 318 (Exercise of powers through Council)
 - (15) Regulation 7(3) and (4) of the OEIC Regulations (Modification or waiver of FSA rules)
 - (16) Regulation 12 of the OEIC Regulations (Authorisation).
- 5 The following power in the Act has been exercised by the FSA to make the part of the complaints scheme in GEN:
- Paragraph 7 of Schedule 1 (Arrangements for the investigation of complaints).
- 6 The following power in the Act has been exercised by the FSA to give the other guidance in GEN:
- Section 157(1) (Guidance).

7 In this Schedule, references to GEN include the Glossary.

Handbook Modules

Schedule5 Rights of action for damages

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- 1 The table below sets out the rules in GEN contravention of which by an authorised person may be actionable under section 150 of the Act (Actions for damages) by a person who suffers loss as a result of the contravention.
- 2 If a “Yes” appears in the column headed “For private person?”, the rule may be actionable by a “private person” under section 150 (or, in certain circumstances, his fiduciary or representative; see article 6(2) and (3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001 No 2256)). A “Yes” in the column headed “Removed” indicates that the FSA has removed the right of action under section 150(2) of the Act. If so, a reference to the rule in which it is removed is also given.
- 3 The column headed “For other person?” indicates whether the rule may be actionable by a person other than a private person (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of person by whom the rule may be actionable is given.
- 4

Table	Actions for damages: General provisions
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Chapter/ Appendix	Section/ Annex	Paragraph	Right of action under section 150		
			For private person?	Removed?	For other person?
All rules in <i>GEN</i> with the status letter “E”			No	No	No
<i>GEN</i> 2.1.8 R			No	No	No
All other rules in <i>GEN</i>			Yes	No	No

Handbook Modules

Schedule6 Rules that can be waived

G

- 1 GEN 1.2.2R (Referring to approval by the FSA) can be waived by the FSA under section 148 of the Act (Modification or waiver of rules).
- 2 GEN 2.1.8R is made by FOS Ltd and not by the FSA and cannot be waived by the FSA.
- 3 Every other rule in GEN can be waived by the FSA if, and to the extent that, the rules elsewhere in the Handbook which it modifies or to which it otherwise relates can be waived by the FSA.

General provisions

Derivations

G

There is no table of derivations for *GEN*.

General provisions

Destinations

G

There is no table of destinations for *GEN*.

ANNEX

PART 2

Glossary

G. Guidance on the Glossary

1. The *rules* and *guidance* for interpreting the *Handbook* are to be found in *GEN 2* (Interpreting the Handbook).
2. The *guidance* in the following paragraphs reminds the reader of some practical points for interpreting *Handbook* text.
3. Each sourcebook or manual has a reference code of two or more letters, usually a contraction or abbreviation of its title (for example, *GEN* stands for the General provisions and *COB* for the Conduct of Business sourcebook). The meaning of each of these codes is given in the *Glossary*.
4. Expressions used in the *Handbook* which are defined in the *Glossary* appear in the text in italic type (*GEN 2.2.7R(1)* (Use of defined expressions)). An expression which is not shown in the text in italics has its natural meaning unless the context otherwise requires (*GEN 2.2.9G*).
5. An expression which appears in the text in italics, but is not itself defined in the *Glossary*, should be read in the same sense as the expression to which it relates (for example, "*advice on investments*" and "*advise on investments*" are related to "*advising on investments*", so the reader should refer to the definition of "*advising on investments*" for their meaning). (*GEN 2.2.7R(2)* and *GEN 2.2.8G*).
6. The words "in writing", unless the contrary intention appears, mean in legible form and capable of reproduction on paper; they include electronic communication (*GEN 2.2.14R* (References to writing)).
7. The Interpretation Act 1978 applies to the *Handbook*, so (unless the contrary intention appears):
 - (1) the singular includes the plural, and the plural the singular (*GEN 2.2.12G(3)*);
 - (2) the masculine includes the feminine (*GEN 2.2.12G(3)*);
 - (3) a reference to a statutory provision is a reference to it as amended from time to time (*GEN 2.2.12G(2)*); under *GEN 2.2.13R* (Cross-references in the Handbook) the same applies to a provision in the *Handbook*.
8. Many of the defined expressions in the *Glossary* are used or defined in the *Act* or in a statutory instrument made under it. In these cases, the *Glossary* refers to the statutory provision which is the source of the *Handbook* definition. Where there is a short statutory definition, the *Glossary* sets out the definition in full. Where the statutory definition is long, the *Glossary* gives a summary of it, and states that it is a summary.

Defined expression	Definition
<i>50% controller</i>	a <i>controller</i> in whose case the relevant percentage of shares or <i>voting power</i> is 50% or more.
<i>accepted channel for dissemination of information</i>	(in relation to any <i>prescribed market</i>) an approved channel of communication by which information concerning <i>investments</i> traded on the market is formally disseminated to other market users on a structured and equitable basis.
<i>accepting deposits</i>	the <i>regulated activity</i> , specified in article 5 of the <i>Regulated Activities Order</i> (Accepting deposits), which is in summary: accepting <i>deposits</i> if: <ul style="list-style-type: none"> (a) money received by way of <i>deposit</i> is lent to others; or (b) any other activity of the <i>person</i> accepting the <i>deposit</i> is financed, wholly or to a material extent, out of the capital of or interest on money received by way of <i>deposit</i>.
<i>accident</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph 1 of Part I of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of general insurance), providing fixed pecuniary benefits or benefits in the nature of indemnity (or a combination of both) against risks of the <i>person</i> insured or, in the case of a contract made under section 140, 140A or 140B of the Local Government Act 1972 (or, in Scotland, section 86(1) of the Local Government (Scotland) Act 1973), a <i>person</i> for whose benefit the contract is made: <ul style="list-style-type: none"> (a) sustaining injury as the result of an accident or of an accident of a specified class; or (b) dying as a result of an accident or an accident of a specified class; or (c) becoming incapacitated in consequence of disease or of disease of a specified class; including contracts relating to industrial injury and occupational disease but excluding contracts within paragraph 2 of Part I of Schedule 1 to the <i>Regulated Activities Order</i> (Sickness) and contracts within paragraph IV of Part II of that Schedule (Permanent health).
<i>accounting reference date</i>	(1) (except in <i>CIS</i>): <ul style="list-style-type: none"> (a) (in relation to a <i>company</i> incorporated in the <i>United Kingdom</i> under the Companies Acts) the accounting reference date of that <i>company</i> determined in accordance with section 224 of the Companies Act 1985; (b) (in relation to any other body) the last <i>day</i> of its financial year. (2) (in <i>CIS</i>) the date stated in the most recently published <i>prospectus</i> as the date on which the <i>annual accounting period</i> of the

authorised fund is to end in each year.

<i>accrual interval</i>	(in <i>CIS</i>) (in relation to a <i>manager's</i> periodic charge) the interval specified in the <i>trust deed</i> over which the periodic charge accrues.
<i>accumulation share</i>	a <i>share</i> in respect of which income is credited periodically to capital under <i>CIS</i> 9.2.4R (Annual allocation to accumulation shares or accumulation units) or <i>CIS</i> 9.2.6R (Interim allocations of income).
<i>accumulation unit</i>	a <i>unit</i> in respect of which income is credited periodically to capital under <i>CIS</i> 9.2.4R (Annual allocation to accumulation shares or accumulation units) or <i>CIS</i> 9.2.6R (Interim allocations of income).
<i>ACD</i>	<i>authorised corporate director</i> .
<i>Act</i>	the Financial Services and Markets Act 2000.
<i>acting as the depositary or sole director of an open-ended investment company</i>	the <i>regulated activity</i> , specified in article 51(1)(c) of the <i>Regulated Activities Order</i> (Establishing etc a collective investment scheme), of acting as the depositary or sole director of an <i>open-ended investment company</i> .
<i>acting as trustee of an authorised unit trust scheme</i>	the <i>regulated activity</i> , specified in article 51(1)(b) of the <i>Regulated Activities Order</i> (Establishing etc a collective investment scheme), of acting as a <i>trustee</i> of an <i>authorised unit trust scheme</i> .
<i>actuarial body</i>	the Institute of Actuaries or the Faculty of Actuaries.
<i>actuarial health insurance</i>	the type of insurance defined in <i>LLD</i> 11.4.1R, which is in summary: <i>general insurance business</i> which is <i>sickness</i> insurance and satisfies certain specified conditions.
<i>actuary</i>	a fellow of an <i>actuarial body</i> or (in connection with <i>general insurance business</i>) a Fellow of the Casualty Actuarial Society who is a member of an <i>actuarial body</i> .
<i>actuating purpose</i>	a purpose which motivates or incites a <i>person</i> to act.
<i>additional voluntary contribution</i>	(a) a voluntary contribution paid by a member of an <i>occupational pension scheme</i> under the terms of the scheme or of a separate contract; (b) an additional contribution paid by a member of an <i>occupational pension scheme</i> to which his employer is not a contributor, under which additional benefits are provided to supplement the benefits under another <i>occupational pension scheme</i> of which he is also a member and to which his employer is a contributor.
<i>administrative functions</i>	(a) (in relation to managing <i>investments</i>): (i) arranging settlement; (ii) monitoring and processing corporate actions; (iii) <i>client</i> account administration, liaison and reporting, including valuation and performance measurement; (iv) <i>ISA</i> or <i>PEP</i> administration;

- (v) *investment trust savings scheme* administration;
 - (b) (in relation to *effecting* or *carrying out life policies*):
 - (i) new business administration;
 - (ii) *policy* alterations including surrenders and *policy* loans;
 - (iii) preparing *projections*;
 - (iv) processing claims including pension payments;
 - (v) fund switching;
 - (c) (in relation to the operation of a *stakeholder pension scheme*):
 - (i) new business administration;
 - (ii) receipt of or alteration to contributions;
 - (iii) preparing *projections* and annual statements;
 - (iv) administration of transfers;
 - (v) handling claims, including pension payments;
 - (vi) fund allocation and switching.
- admissible asset* (in *LLD*) an asset that may be taken into account for the purposes of the solvency requirements in *LLD* 11.2.1R in accordance with *LLD* 13.4.1R.
- admission to trading* (in relation to an *investment* and an exchange) the process by which the exchange permits members of the exchange to enter into transactions in that *investment* under and subject to the rules of the exchange.
- adopted packaged product* (in relation to a *firm*) a *stakeholder pension scheme* which is a *packaged product*:
- (a) not produced by the *firm* or in the *firm's marketing group*, but by another producer (whether a *firm* or not); and
 - (b) on which the *firm* is able to advise as a result of a decision taken under *COB* 5.1.4R(1).
- adviser* an individual who is:
- (a) a *financial adviser*; or
 - (b) a *representative*; or
 - (c) an *appointed representative*.
- adviser on syndicate participation at Lloyd's function* *controlled function* CF25 in the *table of controlled functions*, described more fully in *SUP* 10.10.15R.
- advising on investments* the *regulated activity*, specified in article 53 of the *Regulated Activities Order* (Advising on investments), which is in summary: advising a *person* if the advice is:
- (a) given to the *person* in his capacity as an investor or potential investor, or in his capacity as agent for an investor or a potential

	investor; and
	(b) advice on the merits of his doing any of the following (whether as principal or agent):
	(i) <i>buying, selling</i> , subscribing for or underwriting a particular <i>investment</i> which is a designated <i>investment</i> ; or
	(ii) exercising any right conferred by such an <i>investment</i> to <i>buy, sell</i> , subscribe for or underwrite such an <i>investment</i> .
<i>advising on investments (except pension transfers and pension opt-outs)</i>	<i>advising on investments</i> except in respect of <i>pension transfers</i> and <i>pension opt-outs</i> .
<i>advising on pension transfers and pension opt-outs</i>	<i>advising on investments</i> in respect of <i>pension transfers</i> and <i>pension opt-outs</i> .
<i>advising on syndicate participation at Lloyd's</i>	the <i>regulated activity</i> , specified in article 56 of the <i>Regulated Activities Order</i> (Advice on syndicate participation at Lloyd's), of advising a <i>person</i> to become, or continue or cease to be, a member of a particular Lloyd's <i>syndicate</i> .
<i>affected person</i>	(in <i>CIS</i>):
	(a) (in relation to an <i>ICVC</i>):
	(i) the <i>ICVC</i> ;
	(ii) its <i>depository</i> ;
	(iii) a <i>director</i> of the <i>ICVC</i> ;
	(iv) any <i>investment adviser</i> of the <i>ICVC</i> ;
	(v) any <i>associate</i> of any <i>person</i> in (a)(i), (ii), (iii) or (iv);
	(b) (in relation to an <i>AUT</i>):
	(i) the <i>manager</i> ;
	(ii) the <i>trustee</i> ;
	(iii) any <i>investment adviser</i> of the <i>manager</i> ;
	(iv) any <i>associate</i> of any <i>person</i> in (b)(i), (ii) or (iii).
<i>affiliated company</i>	(in relation to a <i>person</i>) an <i>undertaking</i> in the same <i>group</i> as that <i>person</i> .
<i>agreeing to carry on a regulated activity</i>	the <i>regulated activity</i> , specified in article 64 of the <i>Regulated Activities Order</i> (Agreeing to carry on specified kinds of activity), of agreeing to carry on an activity specified in Part II of that Order other than:
	(a) <i>accepting deposits</i> ;
	(b) <i>effecting contracts of insurance</i> ;

	<ul style="list-style-type: none"> (c) <i>carrying out contracts of insurance;</i> (d) <i>establishing, operating or winding up a collective investment scheme;</i> (e) <i>acting as trustee of an authorised unit trust scheme;</i> (f) <i>acting as the depositary or sole director of an open-ended investment company;</i> (g) <i>establishing, operating or winding up a stakeholder pension scheme.</i>
<i>aircraft</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph 5 of Part I of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of general insurance), upon aircraft or upon the machinery, tackle, furniture or equipment of aircraft.
<i>aircraft liability</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph 11 of Part I of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of general insurance), against damage arising out of or in connection with the use of aircraft, including third-party risks and carrier's liability.
<i>allocation period</i>	a single 24-hour period or, with the agreement of each <i>intermediate customer</i> concerned, a period spanning five consecutive <i>business days</i> , during which an aggregated <i>series of transactions</i> may be <i>executed</i> .
<i>ancillary action</i>	action, ancillary to stabilising action, permitted under <i>MAR 2.4.2R</i> .
<i>ancillary activity</i>	an activity which is not a <i>regulated activity</i> but which is: <ul style="list-style-type: none"> (a) carried on in connection with a <i>regulated activity</i>; or (b) held out as being for the purposes of a <i>regulated activity</i>.
<i>announceable information</i>	information which is usually the subject of a public announcement, although not subject to any formal disclosure requirement.
<i>annual accounting period</i>	a period determined in accordance with <i>CIS 9.2.1R</i> (Accounting period).
<i>annual income allocation date</i>	the date in any year stated in the most recently published <i>prospectus</i> as the date on or before which, in respect of each <i>annual accounting period</i> , an allocation of income is to be made.
<i>annual report and accounts</i>	<ul style="list-style-type: none"> (a) (in relation to a <i>company</i> incorporated in the <i>United Kingdom</i>) an annual report and annual accounts as those terms are defined in sections 261(2) and 262(1) of the Companies Act 1985, together with an auditor's report prepared in relation to those accounts under section 235 of the Companies Act 1985; (b) (in relation to any other body) any similar or analogous <i>documents</i> which it is required to prepare whether by its constitution or by the law under which it is established.
<i>APER</i>	the part of the <i>Handbook</i> in High Level Standards which has the title Statements of Principle and Code of Practice for Approved Persons.

applicable provisions the *Host State* rules with which:

- (a) an *incoming EEA firm* is required to comply when carrying on a *permitted activity* through a *branch* or by providing services (as applicable) in the *United Kingdom*, as defined in paragraphs 13(4) and 14(4) of Part II of Schedule 3 to the *Act* (Exercise of passport rights by EEA firms); or
- (b) a *UK firm* is required to comply when conducting business through a *branch* (in accordance with paragraph 19(13) of Part III of Schedule 3 to the *Act* (Exercise of passport rights by UK firms)) or by providing services (as applicable) in another *EEA State*.

applications day the first *day* on which section 40 of the *Act* (Application for permission) comes into force (for any purpose).

appointed actuary an *actuary* appointed under *SUP* 4.3.1R (Appointment by firms).

appointed actuary function *controlled function* CF12 in the *table of controlled functions*, described more fully in *SUP* 10.7.17R.

appointed representative (in accordance with section 39 of the *Act*) a *person* (other than an *authorised person*) who:

- (a) is a party to a contract with an *authorised person* (his *principal*) which:
 - (i) permits or requires him to carry on business of a description prescribed in the *Appointed Representatives Regulations*; and
 - (ii) complies with such requirements as are prescribed in those Regulations; and
- (b) is someone for whose activities in carrying on the whole or part of that business his *principal* has accepted responsibility in writing;

and who is therefore an *exempt person* in relation to any *regulated activity* comprised in the carrying on of that business for which his *principal* has accepted responsibility.

Appointed Representatives Regulations the Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001 (SI 2001/1217).

apportionment and oversight function *controlled function* CF8 in the *table of controlled functions*, described more fully in *SUP* 10.7.1R.

appropriate actuary an *actuary* appointed under *SUP* 4.4.1R (Appointment of an appropriate actuary).

appropriate personal pension a *personal pension policy* or a *personal pension contract* under which contributions are made to a *personal pension scheme* which is an appropriate scheme under section 1(8) of the Social Security Act 1986 or article 3(8) of the Social Security (Northern Ireland) Order 1986.

- appropriate valuer* (in *CIS*) a *person* who complies with the requirements of *CIS* 5.8.5R(7) (Approved immovables).
- approve* (in relation to a *financial promotion*) approve the content of the *financial promotion* for the purposes of section 21 of the *Act* (Restrictions on financial promotion).
- approved bank* (in relation to a bank account opened by a *firm*):
- (a) if the account is opened at a branch in the *United Kingdom*:
 - (i) the Bank of England; or
 - (ii) the central bank of a member state of the *OECD*; or
 - (iii) a *bank*; or
 - (iv) a *building society* which offers, unrestrictedly, banking services; or
 - (v) a bank which is supervised by the central bank or other banking regulator of a member state of the *OECD*; or
 - (b) if the account is opened elsewhere:
 - (i) a bank in (a); or
 - (ii) a *credit institution* established in an *EEA State* other than the *United Kingdom* and duly authorised by the relevant *Home State regulator*; or
 - (iii) a bank which is regulated in the Isle of Man or the Channel Islands; or
 - (c) a bank supervised by the South African Reserve Bank; or
 - (d) any other bank that:
 - (i) is subject to regulation by a national banking regulator;
 - (ii) is required to provide audited accounts;
 - (iii) has minimum net assets of £5 million (or its equivalent in any other currency at the relevant time) and has a surplus revenue over expenditure for the last two financial years; and
 - (iv) has an annual audit report which is not materially qualified.
- approved collateral* any form of security for the discharge of any liability arising from a *contingent liability investment* (other than a guarantee) which:
- (a) (in relation to an *on-exchange* transaction) is acceptable under the rules of the relevant exchange or *clearing house*; and
 - (b) (in relation to an *OTC* transaction) would be acceptable for a similar transaction to the relevant exchange or *clearing house*.
- approved counterparty* an approved counterparty as defined in *IPRU(INS)*.

<i>approved credit institution</i>	an approved credit institution as defined in <i>IPRU(INS)</i> .
<i>approved depositary</i>	any <i>depositary</i> : <ul style="list-style-type: none"> (a) that is subject to regulation by a national <i>regulatory body</i>; (b) that is required to provide audited accounts; (c) that has minimum net assets of £5 million (or its equivalent in any other currency at the relevant time) and has a surplus revenue over expenditure for the last two financial years; and (d) whose latest annual audit report is not materially qualified.
<i>approved derivative</i>	(in <i>CIS</i>) a <i>derivative</i> which is traded or dealt in on an <i>eligible derivatives</i> market.
<i>approved examination</i>	an examination listed in the annexes to <i>TC 2</i> , or an examination which is equivalent in accordance with the <i>Diploma Directives</i> .
<i>approved financial institution</i>	an approved financial institution as defined in <i>IPRU(INS)</i> .
<i>approved immovable</i>	an interest in any land or building which satisfies the conditions in <i>CIS</i> 5.8.5R (Approved immovables).
<i>approved mortgage</i>	(in <i>CIS</i>) a mortgage: <ul style="list-style-type: none"> (a) which the <i>trustee</i> reasonably believes can be discharged on demand or within 28 <i>days</i> by repayment of all the <i>money</i> secured by the mortgage (including, where appropriate, any additional sum provided for under the mortgage); and (b) on which there is not secured any property, whether immediately or contingently, other than the <i>approved immovable</i> in question.
<i>approved person</i>	a <i>person</i> in relation to whom the <i>FSA</i> has given its approval under section 59 of the <i>Act</i> (Approval for particular arrangements) for the performance of a <i>controlled function</i> .
<i>approved security</i>	<ul style="list-style-type: none"> (1) (in <i>CIS</i>) a <i>transferable security</i> that is admitted to <i>official listing</i> in an <i>EEA State</i> or is traded on or under the rules of an <i>eligible securities</i> market (otherwise than by the specific permission of the market authority). (2) (in <i>LLD</i>) any of the following: <ul style="list-style-type: none"> (a) any <i>security</i> issued or guaranteed by, or the repayment of the principal of which, or the interest on which, is guaranteed by, and any loans to or deposits with, any government, public or local authority or nationalised industry or undertaking, which belongs to a <i>Zone A country</i>; (b) any loan to, or deposit with, an <i>approved financial institution</i>;

	(c) any <i>debenture</i> issued before 31 December 1994 by the Agricultural Mortgage Corporation Limited or the Scottish Agricultural Securities Corporation Limited.
<i>arrangement</i>	(as defined in section 59(10) of the <i>Act</i> (Approval for particular arrangements)) any kind of arrangement for the performance of a function of an <i>authorised person</i> ("A") which is entered into by A or any contractor of his with another <i>person</i> , including, in particular, that other <i>person's</i> appointment to an office, his becoming a partner, or his employment (whether under a contract of service or otherwise).
<i>arranger</i>	a <i>person</i> who is <i>arranging (bringing about) deals in investments, making arrangements with a view to transactions in investments, or agreeing to carry on any of those regulated activities.</i>
<i>arranging</i>	(in <i>MAR</i>) <i>arranging (bringing about) deals in investments, making arrangements with a view to transactions in investments or agreeing to carry on any of those regulated activities.</i>
<i>arranging (bringing about) deals in investments</i>	the <i>regulated activity</i> , specified in article 25(1) of the <i>Regulated Activities Order</i> , which is in summary: making arrangements for another <i>person</i> (whether as <i>principal</i> or agent) to <i>buy, sell, subscribe for or underwrite a particular investment</i> which is: <ul style="list-style-type: none"> (a) a <i>designated investment</i>; or (b) the <i>underwriting capacity of a Lloyd's syndicate</i>; or (c) <i>membership of a Lloyd's syndicate</i>; or (d) <i>rights to or interests in investments</i> in (b) or (c).
<i>arranging deals in contracts of insurance written at Lloyd's</i>	the <i>regulated activity</i> , specified in article 58 of the <i>Regulated Activities Order</i> (Arranging deals in contracts of insurance written at Lloyd's), carried on by the <i>Society of Lloyd's</i> of arranging deals in <i>contracts of insurance</i> written at Lloyd's.
<i>arranging safeguarding and administration of assets</i>	that part of <i>safeguarding and administering investments</i> which consists solely of arranging for one or more other <i>persons</i> to carry on both: <ul style="list-style-type: none"> (a) the safeguarding of assets belonging to another; and (b) the administration of those assets.
<i>asset identification rules</i>	(as defined in subsection 142(2) of the <i>Act</i> (Insurance business: regulations supplementing Authority's rules)) <i>rules</i> made by the <i>FSA</i> which require an <i>authorised person</i> who has <i>permission to effect or carry out contracts of insurance</i> to identify assets which belong to him and which are maintained in respect of a particular aspect of his business.
<i>assistance</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph 18 of Part I of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of general insurance), providing either or both of the following benefits: <ul style="list-style-type: none"> (a) assistance (whether in cash or in kind) for <i>persons</i> who get into

	difficulties while travelling, while away from home or while away from their permanent residence;
	(b) assistance (whether in cash or in kind) for <i>persons</i> who get into difficulties otherwise than as in (a).
<i>associate</i>	(in relation to a <i>person</i> ("A")):
	(a) an <i>affiliated company</i> of A;
	(b) an <i>appointed representative</i> of A or of any <i>affiliated company</i> of A;
	(c) any other <i>person</i> whose business or domestic relationship with A or his <i>associate</i> might reasonably be expected to give rise to a community of interest between them which may involve a conflict of interest in dealings with third parties.
<i>associated call option</i>	a right to acquire a particular amount of the <i>relevant security</i> or of any <i>associated security</i> at a future date at a particular <i>price</i> .
<i>associated security</i>	(a) an <i>associated call option</i> ;
	(b) a <i>security</i> of any description:
	(i) which is in all respects uniform with the <i>relevant security</i> ;
	or
	(ii) for which the <i>relevant security</i> may be exchanged or into which it may be converted; or
	(iii) which constitutes a right to obtain delivery of the <i>relevant security</i> ; or
	(iv) which the holder of the <i>relevant security</i> has, through his holding of that <i>security</i> , rights to acquire or to subscribe for; or
	(v) which is issued or guaranteed by the <i>issuer</i> , or by any guarantor, of the <i>relevant security</i> and the prevailing market <i>price</i> of which is, because of similarity with the <i>relevant security</i> in the terms and conditions which attach to each of them respectively, likely to have a material influence on the market <i>price</i> of the <i>relevant security</i> ; or
	(vi) which is a <i>certificate representing a certain security</i> in respect of the <i>relevant security</i> and which is in all material respects uniform with the <i>relevant security</i> in terms of value, size and duration.
<i>AUT</i>	an <i>authorised unit trust scheme</i> .
<i>AUTH</i>	the Authorisation manual.
<i>authorisation</i>	authorisation as an <i>authorised person</i> for the purposes of the <i>Act</i> .
<i>authorisation order</i>	an order made by the <i>FSA</i> :
	(a) in relation to an <i>AUT</i> under section 243 of the <i>Act</i> (Authorisation orders);

	(b) in relation to an <i>ICVC</i> under regulation 14 of the <i>OEIC Regulations</i> (Authorisation);
	as a result of which the <i>AUT</i> becomes authorised or the body becomes incorporated as an <i>ICVC</i> under regulation 3 of the <i>OEIC Regulations</i> (Open-ended investment company).
<i>authorised corporate director</i>	the <i>director</i> of an <i>ICVC</i> who is the authorised corporate <i>director</i> of the <i>ICVC</i> in accordance with <i>CIS</i> 7.2.1R (The directors).
<i>authorised fund</i>	an <i>ICVC</i> or an <i>AUT</i> .
<i>authorised fund manager</i>	an <i>ACD</i> or an <i>authorised unit trust manager</i> .
<i>authorised person</i>	(in accordance with section 31 of the <i>Act</i> (Authorised persons)) one of the following: <ul style="list-style-type: none"> (a) a <i>person</i> who has a <i>Part IV permission</i> to carry on one or more <i>regulated activities</i>; (b) an <i>incoming EEA firm</i>; (c) an <i>incoming Treaty firm</i>; (d) a <i>UCITS qualifier</i>; (e) an <i>ICVC</i>; (f) the <i>Society of Lloyd's</i>. (see also <i>GEN</i> 2.2.18R for the position of an <i>authorised partnership</i> or unincorporated association which is dissolved.)
<i>authorised professional firm</i>	a <i>professional firm</i> which is an <i>authorised person</i> .
<i>authorised UK representative</i>	(in relation to a <i>firm</i>) a <i>person</i> resident in the <i>United Kingdom</i> who is authorised to act generally, and to accept service of any <i>document</i> , on behalf of the <i>firm</i> .
<i>authorised unit trust manager</i>	a <i>manager</i> of an <i>AUT</i> .
<i>authorised unit trust scheme</i>	(as defined in section 237(3) of the <i>Act</i> (Other definitions)) a <i>unit trust scheme</i> which is authorised for the purposes of the <i>Act</i> by an <i>authorisation order</i> .
<i>authorised Voluntary Jurisdiction participant</i>	a participant in the <i>Voluntary Jurisdiction</i> who is an <i>authorised person</i> .
<i>AVC</i>	<i>additional voluntary contribution</i> .
<i>backwardation</i>	a situation in which <i>futures</i> prices are lower than cash prices.
<i>bank</i>	(a) a <i>firm</i> with a <i>Part IV permission</i> which includes <i>accepting deposits</i> , and: <ul style="list-style-type: none"> (i) which is a <i>credit institution</i>; or (ii) whose <i>Part IV permission</i> includes a <i>requirement</i> that it

	comply with <i>IPRU(BANK)</i> ; but which is not a <i>building society</i> , a <i>friendly society</i> or a <i>credit union</i> ;
	(b) an <i>EEA bank</i> .
<i>Banking Consolidation Directive</i>	the Council Directive of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions (No 2000/12/EC).
<i>base currency</i>	(in <i>CIS</i>) the currency specified: (a) in the <i>instrument of incorporation</i> of an <i>ICVC</i> as the currency in which its accounts are to be prepared; or (b) in the <i>trust deed</i> of an <i>AUT</i> as the base currency of the <i>AUT</i> .
<i>BCD</i>	<i>Banking Consolidation Directive</i> .
<i>BCD credit institution</i>	a <i>credit institution</i> that has its registered office (or, if it has no registered office, its head office) in an <i>EEA State</i> , excluding an institution to which the <i>BCD</i> does not apply under article 2(3) of the <i>BCD</i> .
<i>bearer certificate</i>	(in <i>CIS</i>) a certificate or other documentary evidence of title, for which provision is made in the <i>instrument constituting the scheme</i> , which indicates that: (a) the <i>holder</i> of the document is entitled to the <i>units</i> specified in it; and (b) no entry will be made on the <i>register</i> identifying the <i>holder</i> of those <i>units</i> .
<i>bearer form</i>	(in relation to a <i>client's</i> certificate, <i>share</i> transfer or other <i>document</i>) in a form signed by the <i>client</i> so that it enables a <i>designated investment</i> or <i>deposit</i> to which it relates to be sold, transferred, surrendered or dealt with in any other way without the need to obtain further written instructions and allows the <i>firm</i> access to the sale proceeds.
<i>behaviour</i>	any kind of conduct, including action or inaction.
<i>bid price</i>	the <i>price</i> at which a <i>person</i> could sell a <i>unit</i> in a <i>dual-priced AUT</i> or a <i>security</i> .
<i>body corporate</i>	(in accordance with section 417(1) of the <i>Act</i> (Definitions)) any body corporate, including a body corporate constituted under the law of a country or territory outside the <i>United Kingdom</i> .
<i>bonded investment</i>	a <i>designated investment</i> not held by a trustee when acting as a trustee: (a) which, except in the case of a <i>unit</i> , is one of the following: (i) a <i>readily realisable security</i> held for a <i>customer</i> , whether or not held under a discretionary arrangement; or (ii) a <i>designated investment</i> in <i>bearer form</i> ; or (iii) a <i>designated investment</i> held by a <i>nominee company</i> under the control of the <i>firm</i> or a <i>person</i> whom the <i>firm</i>

- controls; or
- (iv) a *designated investment* to which the title is recorded in electronic form;
- (b) which the *firm* may *sell* or procure the sale of without the signature or other action of the *customer* or an independent third party; and
 - (c) where the proceeds of such a sale are or could be payable to the *firm* or its *associate*.
- branch*
- (a) (in relation to a *credit institution*):
 - (i) a place of business which forms a legally dependent part of a *credit institution* and which carries out directly all or some of the transactions inherent in the business of *credit institutions*;
 - (ii) for the purposes of the *Banking Consolidation Directive*, any number of places of business set up in the same *EEA State* by a *credit institution* with headquarters in another *EEA State* are to be regarded as a single *branch*;
 - (b) (in relation to an *investment firm*):
 - (i) a place of business which is a part of an *investment firm*, not being the principal place of business, which has no separate legal personality and which provides *investment services* for which the *investment firm* has been authorised;
 - (ii) for the purposes of the *Investment Services Directive*, all the places of business set up in the same *EEA State* by an *investment firm* with headquarters in another *EEA State* are to be regarded as a single *branch*;
 - (c) (in relation to an *insurance undertaking*) any permanent presence of the *insurance undertaking* in an *EEA State* other than that in which it has its head office is to be regarded as a single *branch*, whether that presence consists of a single office which, or two or more offices each of which:
 - (i) is managed by the *insurance undertaking's* own staff; or
 - (ii) is an agency of the *insurance undertaking*; or
 - (iii) is managed by a *person* who is independent of the *insurance undertaking*, but has permanent authority to act for the *insurance undertaking* as an agency would.
- branded fund* a *life policy* or a *regulated collective investment scheme* other than a *broker fund* which is available as an *investment* only or mainly to the *clients* of a particular *independent intermediary*.
- broker* (in *MAR*) any person when dealing as agent.
- broker fund* (in relation to a fund for which the *firm* is or will be a *broker fund*)

	<p><i>adviser</i>):</p> <ul style="list-style-type: none"> (a) an actual or notional fund of a <i>long-term insurer</i>, which contains or will contain contributions made or to be made by a <i>client</i> or <i>clients</i> of a <i>firm</i> in connection with a <i>life policy</i> or <i>policies</i>; (b) a fund of a <i>collective investment scheme</i>, which contains or will contain cash contributions made or to be made by a <i>client</i> or <i>clients</i> of a <i>firm</i> in connection with the purchase of <i>units</i> in the <i>scheme</i>.
<i>broker fund adviser</i>	<p>a <i>person</i> who has, or whose <i>associate</i> being an <i>authorised person</i> has, an arrangement with a <i>long-term insurer</i>, or with the <i>operator</i> of a <i>regulated collective investment scheme</i> or an <i>unregulated collective investment scheme</i>, under which it is to be expected that the <i>long-term insurer</i> or <i>operator</i> will take into account the advice of that <i>person</i> or his <i>associate</i>:</p> <ul style="list-style-type: none"> (a) in the case of a <i>long-term insurer</i>, on any matter likely to influence the performance of any of the <i>long-term insurer's</i> funds or of any <i>investment</i> issued by the <i>long-term insurer</i> into which cash contributions of that <i>person's customers</i> have been made; (b) in the case of an <i>operator</i>, on the composition of the property of the <i>collective investment scheme</i> into which cash contributions of that <i>person's customers</i> have been made; <p>in this definition, <i>associate</i> includes any <i>authorised person</i> in respect of whose services the first <i>person</i> receives any benefit or reward, either directly or indirectly, in connection with advice of the kind described in (a) and (b) given to a <i>long-term insurer</i> or to a <i>collective investment scheme operator</i>.</p>
<i>building society</i>	(as defined in section 119(1) of the Building Societies Act 1986) a building society incorporated (or deemed to be incorporated) under that Act.
<i>business day</i>	<ul style="list-style-type: none"> (1) (in relation to anything done or to be done in any part of the <i>United Kingdom</i>): <ul style="list-style-type: none"> (a) (except in <i>REC</i>) any <i>day</i> which is not a Saturday or Sunday, Christmas Day, Good Friday or a bank holiday in that part of the <i>United Kingdom</i>; (b) (in <i>REC</i>) (as defined in section 167 of the Companies Act 1989) any <i>day</i> which is not a Saturday or Sunday, Christmas Day, Good Friday or a bank holiday in any part of the <i>United Kingdom</i>. (2) (in relation to anything done or to be done by reference to a market outside the <i>United Kingdom</i>) any <i>day</i> on which that market is normally open for business.
<i>buying</i>	(in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation)) any form of buying, including acquiring for valuable consideration.

<i>byelaw</i>	(in <i>LLD</i>) any Byelaw, direction, regulation, or other instrument made using the powers of the <i>Council</i> under section 6 of Lloyd's Act 1982 (including any regulation ratified by the <i>Council</i> by special resolution) and any condition or requirement made under any such Byelaw, direction, regulation or other instrument.
<i>CAD bank</i>	a <i>bank</i> which uses the <i>Capital Adequacy Directive</i> to measure the capital requirement on its trading book.
<i>cancellation</i>	(in <i>CIS</i>) (in relation to <i>units</i>) a cancellation of a <i>unit</i> by an <i>ICVC</i> or by the <i>trustee</i> of an <i>AUT</i> .
<i>cancellation rules</i>	<i>COB</i> 6.7 (Cancellation and withdrawal).
<i>candidate</i>	a <i>person</i> in respect of whom an application is made for approval under section 59 of the <i>Act</i> (Approval for particular arrangements).
<i>capacity transfer market</i>	any method of transferring capacity in <i>syndicates</i> , including capacity auctions, bilateral arrangements, capacity offers, minority buy-outs and conversion schemes.
<i>capital account</i>	(in <i>CIS</i>) an account relating to the <i>capital property</i> of an <i>authorised fund</i> .
<i>Capital Adequacy Directive</i>	the Council Directive of 15 March 1993 on capital adequacy of investment firms and credit institutions (No 93/6/EEC).
<i>capital at risk</i>	capital at risk as defined in <i>IPRU(INS)</i> 2.5R(7).
<i>capital property</i>	(in <i>CIS</i>) the <i>scheme property</i> , other than <i>income property</i> and any amount for the time being standing to the credit of the <i>distribution account</i> .
<i>capital redemption</i>	(in relation to a <i>class of contract of insurance</i>) capital redemption contracts where effected or carried out by a <i>person</i> who does not carry on a banking business, and otherwise carries on the <i>regulated activity</i> of <i>effecting</i> or <i>carrying out contracts of insurance</i> , as specified in paragraph VI of Part II of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of long-term insurance).
<i>carrying out contracts of insurance</i>	the <i>regulated activity</i> , specified in article 10(2) of the <i>Regulated Activities Order</i> (Effecting and carrying out contracts of insurance), of carrying out a <i>contract of insurance</i> as principal.
<i>cash component</i>	a <i>qualifying investment</i> prescribed in paragraph 8 of the <i>ISA Regulations</i> (Qualifying investments for a cash component).
<i>cash deposit ISA</i>	a <i>cash component</i> of an <i>ISA</i> which does not include the <i>qualifying investments</i> prescribed in paragraphs 8(2)(c), (d), (e) or (f) of the <i>ISA Regulations</i> .
<i>CAT standards</i>	the CAT standards for <i>ISAs</i> prescribed by the Treasury on 22 December 1998.
<i>causing dematerialised instructions to be</i>	the <i>regulated activity</i> , specified in article 45(2) of the <i>Regulated Activities Order</i> , which is in summary: causing dematerialised instructions relating to a <i>security</i> to be sent by means of a relevant system in respect of which an operator is approved under the 1995

<i>sent</i>	<p>Regulations where the <i>person</i> causing them to be sent is a system-participant;</p> <p>in this definition:</p> <p>(a) "the 1995 Regulations" means the Uncertificated Securities Regulations 1995 (SI 1995/3272);</p> <p>(b) "dematerialised instruction", "operator" and "system-participant" have the meaning given by regulation 3 of the 1995 Regulations.</p>
<i>central assets</i>	<p>(in <i>LLD</i>) assets that the <i>Society</i> owns and amounts that <i>members</i> are liable to pay to the <i>Society</i> (or may by resolution of the <i>Council</i> be liable to pay) as contributions to the <i>Central Fund</i> (excluding amounts which, if paid by a <i>member</i>, would cause his assets to fall short (or shorter) of the <i>required amount</i>).</p>
<i>Central Fund</i>	<p>the Central Fund established under Lloyd's Central Fund Byelaw (No 4 of 1986) and the New Central Fund established under Lloyd's New Central Fund Byelaw (No 23 of 1996).</p>
<i>certificate representing certain securities</i>	<p>the <i>investment</i> specified in article 80 of the <i>Regulated Activities Order</i> (Certificates representing certain securities), which is in summary: a certificate or other instrument which confers contractual or property rights (other than rights consisting of <i>options</i>):</p> <p>(a) in respect of any <i>share, debenture, government and public security or warrant</i> held by a <i>person</i> other than the <i>person</i> on whom the rights are conferred by the certificate or instrument; and</p> <p>(b) the transfer of which may be effected without requiring the consent of that <i>person</i>;</p> <p>but excluding any certificate or other instrument which confers rights in respect of two or more <i>investments</i> issued by different <i>persons</i> or in respect of two or more different <i>government and public securities</i> issued by the same <i>person</i>.</p>
<i>CFTC</i>	<p>the Commodity Futures Trading Commission.</p>
<i>charge</i>	<p>any <i>fee</i> or charge made to a <i>client</i> in connection with <i>designated investment business</i>, whether levied by the <i>firm</i> or any other <i>person</i>, including a <i>mark-up or mark-down</i>.</p>
<i>chargeable case</i>	<p>any complaint referred to the <i>Financial Ombudsman Service</i>, apart from those where the <i>Ombudsman</i> considers it apparent from the complaint received, and from any <i>final response</i> which has been issued by the <i>firm</i>, that the complaint should not proceed because:</p> <p>(a) the complainant is not an <i>eligible complainant</i> in accordance with <i>DISP 2</i>; or</p> <p>(b) the complaint does not fall within the jurisdiction of the <i>Financial Ombudsman Service</i> (as described in <i>DISP 2</i>) or falls outside the time limits set out in <i>DISP 2.3</i> (Time limits for referral of complaints to the Financial Ombudsman Service); or</p>

	(c) the <i>Ombudsman</i> considers that the complaint should be dismissed without consideration of its merits under <i>DISP</i> 3.3 (Dismissal of complaints without consideration of the merits); or
	(d) the <i>Ombudsman</i> considers, at any stage, that the complaint should be dismissed under <i>DISP</i> 3.3.1R(2) on the grounds that it is frivolous or vexatious.
<i>chief executive</i>	(1) (in relation to an undertaking whose principal place of business is within the <i>United Kingdom</i>) the <i>person</i> who, alone or jointly with one or more others, is responsible under the immediate authority of the <i>directors</i> for the conduct of the whole of its business.
	(2) (in relation to an undertaking whose principal place of business is outside the <i>United Kingdom</i>) the <i>person</i> who, alone or jointly with one or more others, is responsible for the conduct of its business within the <i>United Kingdom</i> .
<i>chief executive function</i>	<i>controlled function</i> CF3 in the <i>table of controlled functions</i> , described more fully in <i>SUP</i> 10.6.11R.
<i>Chinese wall</i>	an arrangement that requires information held by a <i>person</i> in the course of carrying on one part of its business to be withheld from, or not to be used for, <i>persons</i> with or for whom it acts in the course of carrying on another part of its business.
<i>CIS</i>	the Collective Investment Schemes sourcebook.
<i>claim</i>	(1) (in <i>COMP</i>) a valid claim made in respect of a civil liability owed by a <i>relevant person</i> to the claimant.
	(2) (in <i>LLD</i> , <i>SUP</i> and <i>TC</i>) a claim under a <i>contract of insurance</i> .
<i>class</i>	(1) (in <i>AUTH</i> , <i>IPRU(FSOC)</i> , <i>IPRU(INS)</i> , <i>LLD</i> and <i>SUP</i>) (in relation to a <i>contract of insurance</i>) any class of <i>contract of insurance</i> listed in Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of insurance).
	(2) (in <i>CIS</i>):
	(a) a particular class of <i>units</i> of an <i>authorised fund</i> ; or
	(b) all of the <i>units</i> relating to a single <i>sub-fund</i> ; or
	(c) a particular class of <i>units</i> relating to a single <i>sub-fund</i> .
	(3) (in <i>COB</i>) a particular category or type of <i>packaged product</i> .
<i>class meeting</i>	(in <i>CIS</i>) a separate meeting of <i>holders</i> of a <i>class</i> of <i>units</i> .
<i>clearing firm</i>	a <i>firm</i> which assumes primary responsibility (including legal liability) for the execution and settlement of transactions for <i>clients</i> .
<i>clearing house</i>	a clearing house through which transactions on an exchange may be cleared.
<i>client</i>	(1) (except in <i>ML</i> and <i>PROF</i>) any <i>person</i> with or for whom a <i>firm</i> conducts or intends to conduct <i>designated investment business</i> or any other <i>regulated activity</i> ; and:

- (a) every client is a *customer* or a *market counterparty*;
 - (b) "client" includes:
 - (i) a potential client;
 - (ii) a client of an *appointed representative* of a *firm* with or for whom the *appointed representative* acts or intends to act in the course of business for which the *firm* has accepted responsibility under section 39 of the *Act* (Exemption of appointed representatives);
 - (iii) a *collective investment scheme* even if it does not have separate legal personality;
 - (iv) if a *person* ("C1"), with or for whom the *firm* is conducting or intends to conduct *designated investment business*, is acting as agent for another *person* ("C2"), either C1 or C2 in accordance with COB 4.1.5R (Agent as client);
 - (c) "client" does not include:
 - (i) a trust beneficiary;
 - (ii) a *corporate finance contact*;
 - (iii) a *venture capital contact*.
- (2) (in *ML*) (in relation to a *relevant firm*) any *person* engaged in, or who has had contact with the *relevant firm* with a view to engaging in, any *transaction* with that *relevant firm*:
- (a) on his own behalf; or
 - (b) as agent for or on behalf of another.
- (3) (in *PROF*) (as defined in section 328(8) of the *Act* (Directions in relation to the general prohibition)) (in relation to *members* of a profession providing financial services under Part XX of the *Act* (Provision of Financial Services by Members of the Professions)):
- (a) a *person* who uses, has used or may be contemplating using, any of the services provided by the *member* of a profession in the course of carrying on *exempt regulated activities* (including, where the *member* of the profession is acting in his capacity as a trustee, a *person* who is, has been or may be a beneficiary of the trust); or
 - (b) a *person* who has rights or interests which are derived from, or otherwise attributable to, the use of any such services by other *persons*; or
 - (c) a *person* who has rights or interests which may be adversely affected by the use of any such services by *persons* acting on his behalf or in a fiduciary capacity in relation to him.

<i>client agreement</i>	<i>terms of business</i> which have been signed by the <i>client</i> or to which the <i>client</i> has consented in writing.
<i>client asset rules</i>	COB 9, comprising the <i>custody rules</i> , <i>mandate rules</i> , <i>client money rules</i> , <i>collateral rules</i> and <i>client money distribution rules</i> .
<i>client bank account</i>	(a) an account at a bank which: <ul style="list-style-type: none"> (i) holds the <i>money</i> of one or more <i>clients</i>; (ii) is in the name of the <i>firm</i>; (iii) includes in its title an appropriate description to distinguish the <i>money</i> in the account from the <i>firm's money</i>; and (iv) is a current or a deposit account; or (b) a money market deposit of <i>client money</i> which is identified as being <i>client money</i> .
<i>client money</i>	subject to the <i>client money rules</i> , <i>money</i> of any currency which, in the course of carrying on <i>designated investment business</i> , a <i>firm</i> holds in respect of any <i>investment agreement</i> entered into, or to be entered into, with or for a <i>client</i> , or which a <i>firm</i> treats as <i>client money</i> in accordance with the <i>client money rules</i> .
<i>client money distribution rules</i>	COB 9.5.
<i>client money rules</i>	COB 9.3.
<i>client transaction account</i>	(in relation to a <i>firm</i> and an exchange, <i>clearing house</i> or <i>intermediate broker</i>) an account maintained by the exchange, <i>clearing house</i> or <i>intermediate broker</i> , as the case may be, in respect of transactions in <i>contingent liability investments</i> undertaken by the <i>firm</i> with or for its <i>clients</i> .
<i>close links</i>	(1) (except in SUP 3 (Auditors) and SUP 4 (Actuaries)) (in accordance with paragraph 3(2) of Schedule 6 to the <i>Act</i> (Close links)) the relationship between a <i>person</i> ("A") and another <i>person</i> ("CL") which exists if: <ul style="list-style-type: none"> (a) CL is a <i>parent undertaking</i> of A; or (b) CL is a <i>subsidiary undertaking</i> of A; or (c) CL is a <i>parent undertaking</i> of a <i>subsidiary undertaking</i> of A; or (d) CL is a <i>subsidiary undertaking</i> of a <i>parent undertaking</i> of A; or (e) CL owns or controls 20% or more of the voting rights or capital of A; or (f) A owns or controls 20% or more of the voting rights or capital of CL. (2) (in SUP 3 (Auditors) and SUP 4 (Actuaries)) (in accordance with

section 343(8) of the *Act* (Information given by auditor or actuary to the Authority: persons with close links) the relationship in (1), disregarding (e) and (f).

<i>close out</i>	(in <i>CIS</i> and <i>COB</i>) enter into a further transaction under which the obligation to deliver or receive which arises or may, at the option of the other party to the transaction, arise under the original transaction is offset by an equivalent and opposite obligation or right to receive or deliver.
<i>close relative</i>	(as defined in article 3(1) of the <i>Regulated Activities Order</i> and article 2(1) of the <i>Financial Promotion Order</i>) (in relation to any <i>person</i>): (a) his spouse; (b) his children and step-children, his parents and step-parents, his brothers and sisters and his step-brothers and step-sisters; and (c) the spouse of any <i>person</i> within (b).
<i>closed</i>	(in <i>LLD</i>) (in relation to a <i>syndicate year</i>) closed by <i>reinsurance to close</i> in accordance with <i>byelaws</i> , either into another <i>syndicate year</i> or into an <i>insurer</i> approved by the <i>Council</i> for the purpose.
<i>closed into</i>	(in <i>LLD</i>) (in relation to two <i>syndicate years</i>) closed into another <i>syndicate year</i> by way of a contract of <i>reinsurance to close</i> into that other <i>syndicate year</i> , either directly or through a succession of such contracts.
<i>closing date</i>	the date specified in the earliest relevant <i>public announcement</i> of the <i>offer</i> as the last date for acceptance of the <i>offer</i> , or, if no such date is specified, then the date on which the <i>issuer</i> (or seller) of the <i>securities</i> offered receives any of the proceeds of the <i>offer</i> .
<i>COAF</i>	the part of the <i>Handbook</i> in Redress which has the title Complaints against the FSA.
<i>COB</i>	the Conduct of Business sourcebook.
<i>Code of Market Conduct</i>	the provisions in <i>MAR</i> 1 indicated by an "E" or "C" in the margin or heading, issued by the <i>FSA</i> as required by section 119 of the <i>Act</i> (The Code).
<i>Code of Practice for Approved Persons</i>	the provisions in <i>APER</i> 3 and <i>APER</i> 4 indicated by an "E" in the margin or heading, the purpose of which is to help determine whether or not an <i>approved person's</i> conduct complies with the <i>Statements of Principle</i> and which are issued by the <i>FSA</i> under section 64(2) of the <i>Act</i> (Conduct: statements and codes).
<i>collateral</i>	(1) (in <i>CIS</i>) any form of security, guarantee or indemnity provided by way of security for the discharge of any liability arising from a transaction. (2) (in <i>COB</i>) any of the following: (a) an <i>investment</i> specified in articles 76 to 81 of the <i>Regulated Activities Order</i> ; that is:

- (i) *shares* (article 76);
- (ii) *debentures* (article 77);
- (iii) *government and public securities* (article 78);
- (iv) *warrants* (article 79);
- (v) *certificates representing certain securities* (article 80);
- (vi) *units* (article 81); or
- (b) *money*; or
- (c) a *commodity* warrant (however title is recorded or evidenced);

which belongs to a *client* and which is held or controlled by the *firm* under the terms of a deposit, pledge, charge or other security arrangement.

<i>collateral rules</i>	<i>COB 9.4.</i>
<i>collective insurance</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph VIII of Part II of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of long-term insurance), of a kind referred to in article 1(2)(e) of the <i>First Life Directive</i> ("the operations carried out by insurance companies such as those referred to in Chapter 1, Title 4 of Book IV of the French "Code des assurances").
<i>collective investment scheme</i>	a collective investment scheme, as defined in section 235 of the <i>Act</i> (Collective Investment Schemes), which is in summary: <ul style="list-style-type: none"> (a) any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable <i>persons</i> taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income; and (b) which are not excluded by the Financial Services and Markets Act (Collective Investment Schemes) Order 2001 (SI 2001/1062).
<i>commencement</i>	the beginning of the <i>commencement day</i> .
<i>commencement day</i>	the <i>day</i> on which section 19 of the <i>Act</i> (The general prohibition) comes into force.
<i>commission</i>	any form of commission, including a benefit of any kind, offered or given in connection with <i>designated investment business</i> .
<i>commodity</i>	a physical asset (other than a financial instrument or cash) which is capable of delivery.
<i>commodity future</i>	a <i>future</i> relating to a <i>commodity</i> .

<i>commodity option</i>	an <i>option</i> relating to a <i>commodity</i> .
<i>communicate</i>	(in relation to a <i>financial promotion</i>) (in accordance with section 21(13) of the <i>Act</i> (Restrictions on financial promotion) and article 6(d) of the <i>Financial Promotion Order</i> (Interpretation: communications)) to communicate in any way, including causing a communication to be made or directed.
<i>Community Co-Insurance Directive</i>	the Council Directive of 30 May 1978 on the coordination of laws, regulations and administrative provisions relating to Community co-insurance (No 78/473/EEC).
<i>community co-insurance operation</i>	an operation to which the <i>Community Co-Insurance Directive</i> applies, as modified by article 26 of the <i>Second Non-Life Directive</i> .
<i>COMP</i>	the Compensation sourcebook.
<i>company</i>	any <i>body corporate</i> .
<i>Company Announcements Office</i>	the Company Announcements Office of the London Stock Exchange, the information dissemination provider approved by the <i>UKLA</i> .
<i>compensation scheme</i>	the Financial Services Compensation Scheme established under section 213 of the <i>Act</i> (The compensation scheme) for compensating <i>persons</i> in cases where <i>authorised persons</i> and <i>appointed representatives</i> are unable, or are likely to be unable, to satisfy <i>claims</i> against them.
<i>competent authority</i>	(1) (in relation to admission to an <i>official listing</i>): <ul style="list-style-type: none"> (a) the authority designated under Schedule 8 to the <i>Act</i> (Transfer of functions under Part VI (Official listing)) as responsible for admitting securities to, and for removing securities from, the <i>official list</i>; for the time being, the <i>FSA</i> in its capacity as such; (b) an authority exercising functions corresponding to those in (a) in another <i>EEA State</i>. (2) (in relation to the exercise of an <i>EEA right</i>) a competent authority for the purposes of the relevant <i>Single Market Directive</i> .
<i>complaint</i>	(in <i>COAF</i>) any expression of dissatisfaction about the manner in which the <i>FSA</i> has carried out its statutory functions other than its legislative functions.
<i>Complaints Commissioner</i>	the <i>person</i> appointed by the <i>FSA</i> under <i>COAF</i> 1.3.1G (The Complaints Commissioner) to carry out the functions conferred on him under the <i>complaints scheme</i> .
<i>complaints investigator</i>	(1) (in relation to a <i>UK RIE</i>) the independent <i>person</i> appointed under arrangements referred to in paragraph 9(3) of the Schedule to the <i>Recognition Requirements Regulations</i> to investigate a complaint and to report on the result of his investigation to that <i>RIE</i> and to the complainant. <ul style="list-style-type: none"> (2) (in relation to a <i>UK RCH</i>) the independent <i>person</i> appointed

under arrangements referred to in paragraph 23(3) of the Schedule to the *Recognition Requirements Regulations* to investigate a complaint and to report on the result of his investigation to that *RCH* and to the complainant.

- complaints scheme* the arrangements made by the *FSA* under paragraphs 7 and 8 of Schedule 1 to the *Act* (The Financial Services Authority) for the investigation of *complaints* against the *FSA* arising in connection with the exercise of, or failure to exercise, any of its functions (other than its legislative functions) under the *Act*.
- compliance oversight function* *controlled function* CF10 in the *table of controlled functions*, described more fully in *SUP* 10.7.8R.
- Compulsory Jurisdiction* the jurisdiction of the *Financial Ombudsman Service* to which *firms* are compulsorily subject.
- COND* the part of the *Handbook* in High Level Standards which has the title Threshold Conditions.
- connected company* (in *LLD*) (in relation to a *body corporate*):
- (a) that *body corporate's holding company*;
 - (b) a *subsidiary* of that *body corporate*;
 - (c) a *subsidiary* of the *holding company* of that *body corporate*.
- connected person*
- (1) (in relation to the *FSA's* consideration of an application for, or of whether to vary or cancel, a *Part IV permission*) (in accordance with section 49(1) of the *Act* (Persons connected with an applicant)) any *person* appearing to the *FSA* to be, or likely to be, in a relationship with the applicant or *person* given *permission*, which is relevant.
 - (2) (in relation to the *FSA's* power to gather information under section 165 of the *Act* (Authority's power to require information)) (in accordance with section 165(11) of the *Act*) a *person* who has, or has at any relevant time had, the following relationship with an *authorised person* ("A"):
 - (a) he is a member of A's *group*;
 - (b) he is a *controller* of A;
 - (c) he is a member of a *partnership* of which A is a member;
 - (d) he is or has been an employee of A;
 - (e) if A is a *body corporate*, he is or has been an *officer*, or *manager* or agent of A or of a *parent undertaking* of A;
 - (f) if A is a *partnership*, he is or has been a member, *manager* or agent of A;
 - (g) if A is an unincorporated association of *persons* which is neither a *partnership* nor an unincorporated *friendly society*, he is or has been an *officer*, *manager*, or agent of A;

- (h) if A is a *friendly society*, he is or has been an officer or manager of A ("officer" and "manager" having the same meaning as in section 119(1) of the Friendly Societies Act 1992);
 - (i) if A is a *building society*, he is or has been an officer of A ("officer" having the same meaning as in section 119(1) of the Building Societies Act 1986);
 - (j) if A is an individual, he is or has been an agent of A.
- (3) (in relation to the FSA's powers of investigation under sections 171 and 172 of the *Act* (Powers of persons appointed under section 167; Additional power of persons appointed as a result of section 168(1) or (4))) (in accordance with section 171(4) of the *Act*) a *person* who has, or has at any relevant time had, the following relationship with a *person* under investigation ("P"):
- (a) he has the relationship specified in any of paragraphs (2) (a), (b) or (d) to (j) to P (where references in those paragraphs to A are taken to be references to P);
 - (b) it is a *partnership* of which P is a member;
 - (c) he is the partner, *manager*, employee, agent, *appointed representative*, banker, auditor, actuary or solicitor of:
 - (i) P; or
 - (ii) a *parent undertaking* of P; or
 - (iii) a *subsidiary undertaking* of P; or
 - (iv) a *subsidiary undertaking* of a *parent undertaking* of P; or
 - (v) a *parent undertaking* of a *subsidiary undertaking* of P.

consent notice a notice given by the *FSA* to a *Host State regulator* under paragraph 19(4) (Establishment) of Part III of Schedule 3 to the *Act* (Exercise of Passport Rights by UK firms).

constable a police officer in the *United Kingdom* or a *person* commissioned by the Commissioners of Customs and Excise.

consumer (1) (in relation to the *FSA's* power to make general *rules* (section 138 of the *Act* (General rule-making power))) the approval requirements for *controllers* (section 186 of the *Act* (Objection to acquisition of control)), the publication of notices (section 391 of the *Act* (Publication)) and the exercise of *Treaty rights* (Schedule 4 to the *Act* (Treaty rights))) (as defined in section 138(7) of the *Act* (General rule-making power)) a *person*:

- (a) who uses, has used, or is or may be contemplating using, any of the services provided by:
 - (i) an *authorised person* in carrying on *regulated*

activities; or

- (ii) a *person* acting as an *appointed representative*; or
- (b) who has rights or interests which are derived from, or are otherwise attributable to the use of, any such services by another *person*; or
- (c) who has rights or interests which may be adversely affected by the use of any such services by a *person* acting on his behalf or in a fiduciary capacity in relation to him; or
- (d) (in relation to the *FSA's* power to make general *rules*) a *person* within the extended definition of consumer in article 3 of the Financial Services and Markets Act 2000 (Consequential and Transitional Provisions) (Miscellaneous) Order 2001 (SI 2001/1821) (Application of definition of "consumer" to users of regulated services before commencement);

for the purposes of this definition:

- (A) if an *authorised person* is carrying on a *regulated activity* in his capacity as a trustee, the *persons* who are, have been or may be beneficiaries of the trust are to be treated as *persons* who use, have used or are or may be contemplating using services provided by the *authorised person* in his carrying on of that activity;
- (B) a *person* who deals with an *authorised person* in the course of the *authorised person's* carrying on of a *regulated activity* is to be treated as using services provided by the *authorised person* in carrying on those activities.
- (2) (in relation to the protection of consumers objective (section 5 of the *Act* (The protection of consumers)) and independent inquiries (section 14 of the *Act* (Cases in which the Treasury may arrange independent inquiries))) (as defined in sections 5(3) and 14(5) of the *Act*) a *person*:
 - (a) within (1); or
 - (b) who, in relation to *regulated activities* carried on otherwise than by an *authorised person*, would be a consumer within (1) if the activities were carried on by an *authorised person*.
- (3) (in relation to the establishment and maintenance of the *Consumer Panel* (section 10 of the *Act* (The Consumer Panel))) (as defined in section 10(7) of the *Act*) a *person* within (2) other than an *authorised person*.

consumer credit prohibition

(as defined in section 203(3) of the *Act* (Power to prohibit the carrying on of Consumer Credit Act business)) a prohibition on carrying on, or purporting to carry on, in the *United Kingdom* any Consumer Credit Act business which consists of or includes carrying on one or more

	<i>listed activities or investment services.</i>
<i>Consumer Panel</i>	the panel of <i>persons</i> which section 10 of the <i>Act</i> (The Consumer Panel) requires the <i>FSA</i> to establish and maintain, as part of its arrangements for consultation under section 8, to represent the interests of <i>consumers</i> .
<i>contingent liability investment</i>	a <i>derivative</i> under the terms of which the <i>client</i> will or may be liable to make further payments (other than <i>charges</i> , and whether or not secured by <i>margin</i>) when the transaction falls to be completed or upon the earlier <i>closing out</i> of his position.
<i>contract for differences</i>	the <i>investment</i> , specified in article 85 of the <i>Regulated Activities Order</i> (Contracts for differences etc), which is rights under: <ul style="list-style-type: none"> (a) a contract for differences; or (b) any other contract the purpose or pretended purpose of which is to secure a profit or avoid a loss by reference to fluctuations in: <ul style="list-style-type: none"> (i) the value or price of property of any description; or (ii) an index or other factor designated for that purpose in the contract.
<i>contract of insurance</i>	(1) (in relation to a <i>specified investment</i>) the <i>investment</i> , specified in article 75 of the <i>Regulated Activities Order</i> (Contracts of insurance), which is rights under a contract of insurance in (2). (2) (in relation to a contract) (in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation)) any contract of insurance which is a <i>long-term insurance contract</i> or a <i>general insurance contract</i> , including: <ul style="list-style-type: none"> (a) fidelity bonds, performance bonds, administration bonds, bail bonds, customs bonds or similar contracts of guarantee, where these are: <ul style="list-style-type: none"> (i) effected or carried out by a <i>person</i> not carrying on a banking business; (ii) not effected merely incidentally to some other business carried on by the <i>person</i> effecting them; and (iii) effected in return for the payment of one or more premiums; (b) <i>tontines</i>; (c) <i>capital redemption</i> contracts or <i>pension fund management</i> contracts, where these are effected or carried out by a <i>person</i> who: <ul style="list-style-type: none"> (i) does not carry on a banking business; and (ii) otherwise carries on the <i>regulated activity</i> of <i>effecting</i> or <i>carrying out contracts of insurance</i>; (d) contracts to pay annuities on human life;

- (e) contracts of a kind referred to in article 1(2)(e) of the *First Life Directive* (Collective insurance etc); and
- (f) contracts of a kind referred to in article 1(3) of the *First Life Directive* (Social insurance);

in this definition, "annuities on human life" does not include superannuation allowances and annuities payable out of any fund applicable solely to the relief and maintenance of *persons* engaged, or who have been engaged, in any particular profession, trade or employment, or of the dependants of such *persons*.

<i>contractually based investment</i>	(in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation)): <ul style="list-style-type: none"> (a) a <i>life policy</i>; (b) an <i>option, future or contract for differences</i>; (c) <i>rights to or interests in an investment</i> falling within (a) or (b).
<i>contribution group</i>	one of the groups listed in <i>COMP 13.6.7R</i> which are groups of <i>participant firms</i> which share the costs of funding compensation from <i>claims</i> arising from <i>firms in default</i> which carry on similar business.
<i>control</i>	(in relation to the acquisition, increase or reduction of control of a <i>firm</i>) the relationship between a <i>person</i> and the <i>firm</i> or other <i>undertaking</i> of which the <i>person</i> is a <i>controller</i> .
<i>controlled activity</i>	an activity specified in Part I of Schedule 1 to the <i>Financial Promotion Order</i> (Controlled activities).
<i>controlled agreement</i>	(as defined in section 30 of the <i>Act</i> (Enforceability of agreements resulting from unlawful communications)) an agreement the making or performance of which by either party constitutes a <i>controlled activity</i> .
<i>controlled function</i>	a function, relating to the carrying on of a <i>regulated activity</i> by a <i>firm</i> , which is specified, under section 59 of the <i>Act</i> (Approval for particular arrangements), in the <i>table of controlled functions</i> .
<i>controlled investment</i>	(in accordance with section 21(10) of the <i>Act</i> (Restrictions on financial promotion) and article 4 of the <i>Financial Promotion Order</i> (Definitions of controlled activities and controlled investments)) an <i>investment</i> specified in Part II of Schedule 1 to the <i>Financial Promotion Order</i> (Controlled investments).
<i>controller</i>	(in accordance with section 422 of the <i>Act</i> (Controller)) (in relation to a <i>firm</i> or other <i>undertaking</i> ("A")) a <i>person</i> who falls within any of the following cases; the cases are where the person: <ul style="list-style-type: none"> (a) holds 10% or more of the shares in A; or (b) is able to exercise significant influence over the management of A through his shareholding in A; or (c) holds 10% or more of the shares in a <i>parent undertaking</i> ("P") of A; or (d) is able to exercise significant influence over the management of P

through his shareholding in P; or

- (e) is entitled to exercise, or control the exercise of, 10% or more of the *voting power* in A; or
- (f) is able to exercise significant influence over the management of A through his *voting power* in A; or
- (g) is entitled to exercise, or control the exercise of, 10% or more of the *voting power* in P; or
- (h) is able to exercise significant influence over the management of P through his *voting power* in P;

in this definition:

- (i) "the person" means:
 - (A) the *person*; or
 - (B) any of the *person's* associates; or
 - (C) the *person* and any of his associates;
- (ii) "associate", in relation to a *person* ("H") holding shares in an *undertaking* ("C") or entitled to exercise or control the exercise of *voting power* in relation to another *undertaking* ("D"), means:
 - (A) the spouse of H;
 - (B) a child or stepchild of H (if under 18);
 - (C) the trustee of any settlement under which H has a life interest in possession (or in Scotland a life interest);
 - (D) an *undertaking* of which H is a director;
 - (E) a *person* who is an employee or partner of H;
 - (F) if H is an *undertaking*:
 - (I) a director of H;
 - (II) a *subsidiary undertaking* of H;
 - (III) a director or employee of such a *subsidiary undertaking*; and
 - (G) if H has with any other *person* an agreement or arrangement with respect to the acquisition, holding or disposal of shares or other interests in C or D or under which they undertake to act together in exercising their *voting power* in relation to C or D, that other *person*;
- (iii) "settlement" includes any disposition or arrangement under which property is held on trust (or subject to a comparable obligation);
- (iv) "shares" means:
 - (A) in relation to an *undertaking* with a share capital,

allotted shares;

(B) in relation to an *undertaking* with capital but no share capital, rights to share in the capital of the *undertaking*;

(C) in relation to an *undertaking* without capital, interests:

(I) conferring any right to share in the profits, or liability to contribute to the losses, of the *undertaking*; or

(II) giving rise to any obligation to contribute to the debts or expenses of the *undertaking* in the event of a winding up.

(see also *50% controller*.)

core investment service a service listed in section A of the Annex to the *ISD*, the text of which is set out in Schedule 2 to the *Regulated Activities Order* (Annex to the Investment Services Directive).

core provision (in *LLD*) (as defined in section 316(3) of the *Act* (Direction by Authority)) a provision of the *Act* mentioned in section 317 of the *Act* (The core provisions) which applies to the carrying on of an insurance market activity by a *member*, or the *members* of the *Society* taken together, if the *FSA* so directs.

corporate finance adviser function *controlled function* CF23 in the *table of controlled functions*, described more fully in *SUP* 10.10.13R.

corporate finance advisory firm a *firm* whose *permission* includes a *requirement* that the *firm* must not conduct *designated investment business* other than *corporate finance business*.

corporate finance business (a) *designated investment business* carried on by a *firm* with or for:

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

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

involving any *shares*, share warrants, *debentures* or debenture warrants issued by the *firm*; and

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

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

corporate finance contact

(when a *firm* carries on *designated investment business* with or for a *person* in the course of or as a result of either carrying on *corporate finance business* with or for a *client*, or carrying on *corporate finance business* for the *firm's* own account) that *person* in connection with that *designated investment business* if:

- (a) the *firm* does not behave in a way towards that *person* which might reasonably be expected to lead that *person* to believe that he is being treated as a *client*; and
- (b) the *firm* clearly indicates to that *person* that it:
 - (i) is not acting for him; and
 - (ii) will not be responsible to him for providing protections afforded to *clients* of the *firm* or be advising him on the relevant transaction.

Council

(in *LLD*) the Council constituted by section 3 of Lloyd's Act 1982.

counterparty

(in *LLD*) (in relation to the *Society*, a *syndicate* or *member*):

- (a) any individual; or
- (b) any unincorporated body of *persons*; or
- (c) any *company* which is not a member of a *group*; or
- (d) any *group* of *companies*, excluding any *companies* within the *group* which are *subsidiary undertakings* of the *Society*, a *syndicate* or *member*; or
- (e) any government of a State or any public bodies, local authorities or nationalised industries of a State;

in which the *Society*, a *syndicate* or *member* has made *investments* or against which it has rights under a contract entered into by the *Society*, *syndicate* or *member*.

covered

(in *LLD*) (in relation to a contract) not requiring a significant provision to be made in respect of it.

CRED

the Credit unions sourcebook.

credit

- (1) (except in relation to a *class* of *contract of insurance*) any kind of loan, deferment of repayment of any loan or of interest on any loan, guarantee or indemnity, and any other kind of accommodation or facility in the nature of credit.
- (2) (in relation to a *class* of *contract of insurance*) the *class* of

contract of insurance, specified in paragraph 14 of Part I of Schedule 1 to the *Regulated Activities Order* (Contracts of general insurance), against risks of loss to the *persons* insured arising from the insolvency of debtors of theirs or from the failure (otherwise than through insolvency) of debtors of theirs to pay their debts when due.

<i>credit institution</i>	(as defined in article 1(1) of the <i>BCD</i>) an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account. (see also <i>BCD credit institution</i> .)
<i>credit insurance business</i>	(in <i>LLD</i>) <i>insurance business</i> relating to <i>credit</i> contracts.
<i>credit union</i>	a <i>body corporate</i> registered under the Industrial and Provident Societies Act 1965 as a credit union in accordance with the Credit Unions Act 1979.
<i>CREST</i>	the computer-based system which enables securities to be held and transferred in uncertificated form and which is operated by CRESTCo Limited.
<i>cross border services</i>	(1) (in relation to a <i>UK firm</i>) services provided within an <i>EEA State</i> other than the <i>United Kingdom</i> under the freedom to provide services. (2) (in relation to an <i>incoming EEA firm</i> or an <i>incoming Treaty firm</i>) services provided within the <i>United Kingdom</i> under the freedom to provide services.
<i>cross-transaction</i>	(a) a transaction by which a <i>person</i> matches, at the same price and on the same terms, the <i>buy</i> and <i>sell</i> orders of two or more <i>persons</i> for whom he is acting as agent; (b) a transaction to which only one <i>person</i> is a party, by which he purports to <i>sell</i> to and <i>buy</i> from himself.
<i>currency class share</i>	(in relation to an <i>ICVC</i>) a <i>class</i> of <i>share</i> denominated in a currency that is not the <i>base currency</i> of the <i>ICVC</i> or, if permitted by <i>CIS</i> 2.5.4R(1), denominated in the <i>base currency</i> .
<i>current customer order</i>	(a) a <i>customer order</i> to be <i>executed</i> immediately; (b) a <i>customer order</i> which is to be <i>executed</i> only on fulfilment of a condition, after the condition has been fulfilled.
<i>custodian</i>	(a) an <i>approved bank</i> ; (b) an <i>approved depositary</i> ; (c) a <i>member</i> of a <i>recognised investment exchange</i> or <i>designated investment exchange</i> ; (d) a <i>firm</i> whose <i>permitted activities</i> include <i>safeguarding and administering investments</i> ; (e) a regulated <i>clearing firm</i> ; (f) where it is not feasible to use a <i>custodian</i> in (a) to (e), and there

are reasonable grounds to show that a *person* outside the *United Kingdom*, whose business includes the provision of custodial services, is able to provide such services which are appropriate to the *client* and in the *client's* best interest to use, that *person*.

<i>custody</i>	(in relation to <i>clients'</i> assets) <i>safeguarding and administering investments</i> .
<i>custody asset</i>	(a) a <i>designated investment</i> held for or on behalf of a <i>client</i> ; (b) any other asset which is or may be held with a <i>designated investment</i> held for, or on behalf of, a <i>client</i> .
<i>custody rules</i>	COB 9.1.
<i>customer</i>	(1) (except in COB 3) a <i>client</i> who is not a <i>market counterparty</i> . (2) (in COB 3) a <i>person</i> in (1) or a <i>person</i> who would be such a <i>person</i> if he were a <i>client</i> .
<i>customer function</i>	any of the <i>controlled functions</i> 21 to 27 in the <i>table of controlled functions</i> .
<i>customer order</i>	(a) an order to a <i>firm</i> from a <i>customer</i> to <i>execute</i> a transaction as agent; (b) any other order to a <i>firm</i> from a <i>customer</i> to <i>execute</i> a transaction in circumstances giving rise to duties similar to those arising on an order to <i>execute</i> a transaction as agent; (c) a decision by a <i>firm</i> in the exercise of discretion to <i>execute</i> a transaction with or for a <i>customer</i> .
<i>customer trading function</i>	<i>controlled function</i> CF26 in the <i>table of controlled functions</i> , described more fully in SUP 10.10.16R.
<i>damage to property</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph 9 of Part I of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of general insurance), against loss of or damage to property (other than property to which paragraphs 3 to 7 of that Schedule (<i>Land vehicles, Railway rolling stock, Aircraft, Ships and Goods in transit</i>) relate) due to hail or frost or any other event (such as theft) other than those mentioned in paragraph 8 of that Schedule (<i>Fire and natural forces</i>).
<i>date of allotment</i>	the date on which amounts of the <i>relevant security</i> are allotted to subscribers or purchasers and, where there is an initial or preliminary allotment subject to confirmation, the date of that initial or preliminary allotment.
<i>day</i>	a period of 24 hours beginning at midnight.
<i>deal</i>	a <i>dealing</i> transaction.
<i>dealing</i>	(in accordance with paragraph 2 of Schedule 2 to the <i>Act</i> (Regulated activities)) buying, selling, subscribing for or underwriting <i>investments</i> or offering or agreeing to do so, either as a <i>principal</i> or as an agent, including, in the case of an <i>investment</i> which is a <i>contract of</i>

	<i>insurance</i> , carrying out the contract.
<i>dealing day</i>	(in <i>CIS</i>) the period in each <i>business day</i> (or in each other <i>day</i> when the <i>ACD</i> or <i>operator</i> is open for business) during which the <i>ACD</i> or <i>operator</i> keeps its premises or any of them open to the public or otherwise publicly available for business of any kind.
<i>dealing in investments as agent</i>	the <i>regulated activity</i> , specified in article 21 of the <i>Regulated Activities Order</i> (Dealing in investments as agent), which is in summary: <i>buying</i> , <i>selling</i> , subscribing for or underwriting <i>designated investments</i> as agent.
<i>dealing in investments as principal</i>	the <i>regulated activity</i> , specified in article 14 of the <i>Regulated Activities Order</i> (Dealing in investments as principal), which is in summary: <i>buying</i> , <i>selling</i> , subscribing for or underwriting <i>designated investments</i> as principal.
<i>dealing period</i>	(in <i>CIS</i>) the period between one <i>valuation point</i> and the next.
<i>debenture</i>	the <i>investment</i> , specified in article 77 of the <i>Regulated Activities Order</i> (Instruments creating or acknowledging indebtedness), which is in summary: any of the following which are not <i>government and public securities</i> : <ul style="list-style-type: none"> (a) debentures; (b) debenture stock; (c) loan stock; (d) bonds; (e) certificates of deposit; (f) any other instrument creating or acknowledging indebtedness.
<i>debt security</i>	any of the following: <ul style="list-style-type: none"> (a) a <i>debenture</i>; (b) a <i>government and public security</i>; (c) a <i>warrant</i> which confers a right in respect of an <i>investment</i> in (a) or (b).
<i>DEC</i>	the Decision making manual.
<i>decision notice</i>	a notice issued by the <i>FSA</i> in accordance with section 388 of the <i>Act</i> (Decision notices).
<i>dedicated</i>	(in relation to <i>investments</i> of an <i>authorised fund</i>) intended that the <i>holders</i> should participate in or receive: <ul style="list-style-type: none"> (a) profits or income arising from the acquisition, holding, management or disposal of <i>investments</i> of the relevant description; or (b) sums paid out of profits or income in (a); or (c) other benefits where expressly permitted by a provision in <i>CIS</i>.

<i>default rules</i>	<p>(1) (in relation to a <i>UK RIE</i>) the default rules which it is required to have under paragraph 10 of the Schedule to the <i>Recognition Requirements Regulations</i>.</p> <p>(2) (in relation to a <i>UK RCH</i>) the default rules which it is required to have under paragraph 24 of the Schedule to the <i>Recognition Requirements Regulations</i>.</p>
<i>deferred acquisition costs</i>	deferred acquisition costs as defined in the <i>insurance accounts rules</i> .
<i>defined benefits pension scheme</i>	a <i>pension policy</i> or <i>pension contract</i> under which the only <i>money-purchase benefits</i> are benefits ancillary to other benefits which are not <i>money-purchase benefits</i> .
<i>delivery by value</i>	a transaction type, described as "delivery by value", used to deliver and receive <i>securities</i> within <i>CREST</i> .
<i>deposit</i>	<p>the <i>investment</i>, specified in article 74 and defined in articles 5(2) and 5(3) of the <i>Regulated Activities Order</i>, which is in summary: a sum of money (other than one excluded by any of articles 6 to 9 of the <i>Regulated Activities Order</i>) paid on terms:</p> <p>(a) under which it will be repaid, with or without interest or a premium, and either on demand or at a time or in circumstances agreed by or on behalf of the <i>person</i> making the payment and the <i>person</i> receiving it; and</p> <p>(b) which are not referable to the provision of property (other than currency) or services or the giving of security;</p> <p>in this definition, money is paid on terms which are referable to the provision of property or services or the giving of security if, and only if:</p> <p>(a) it is paid by way of advance or part payment under a contract for the sale, hire or other provision of property or services, and is repayable only in the event that the property or services is or are not in fact sold, hired or otherwise provided; or</p> <p>(b) it is paid by way of security for the performance of a contract or by way of security in respect of loss which may result from the non-performance of a contract; or</p> <p>(c) without prejudice to (b), it is paid by way of security for the delivery up or return of any property, whether in a particular state of repair or otherwise.</p>
<i>Deposit Guarantee Directive</i>	the Council Directive of 13 May 1994 on deposit-guarantee schemes (No 94/19/EC).
<i>deposit-taking firm</i>	a <i>firm</i> which is a <i>bank</i> , <i>building society</i> or <i>credit union</i> .
<i>depository</i>	(a) (in relation to an <i>ICVC</i>) the <i>person</i> to whom is entrusted the safekeeping of all of the <i>scheme property</i> of the <i>ICVC</i> and who has been appointed for this purpose in accordance with regulation 5 (Safekeeping of scheme property by depository) of and

	Schedule 1 (Depositories) to the <i>OEIC Regulations</i> ;
	(b) (in relation to an <i>AUT</i>) the <i>trustee</i> ;
	(c) (in relation to any other <i>unit trust scheme</i>) the <i>person</i> holding the property of the <i>scheme</i> on trust for the <i>participants</i> ;
	(d) (in relation to any other <i>collective investment scheme</i>) any <i>person</i> to whom the property subject to the <i>scheme</i> is entrusted for safekeeping.
<i>derivative</i>	a <i>contract for differences</i> , a <i>future</i> or an <i>option</i> .
<i>designated client bank account</i>	a <i>client bank account</i> with the following characteristics: <ul style="list-style-type: none"> (a) the account holds the money of one or more <i>clients</i>; (b) the account includes in its title the word "designated"; (c) the <i>clients</i> whose <i>money</i> is in the account have each consented in writing to the use of the bank with which the <i>client money</i> is to be held; and (d) in the event of the <i>failure</i> of that bank, the account is not pooled with any other type of account unless a <i>primary pooling event</i> occurs.
<i>designated client fund account</i>	a <i>client bank account</i> with the following characteristics: <ul style="list-style-type: none"> (a) the account holds at least part of the <i>client money</i> of one or more <i>clients</i>, each of whom has consented to that <i>money</i> being held in the same <i>client bank accounts</i> at the same banks (the <i>client money</i> of such <i>clients</i> constituting a designated fund); (b) the account includes in its title the words "designated fund"; and (c) in the event of the <i>failure</i> of a bank with which part of a designated fund is held, each <i>designated client fund account</i> held with the <i>failed</i> bank will form a pool with any other <i>designated client fund account</i> containing part of that same designated fund unless a <i>primary pooling event</i> occurs.
<i>designated investment</i>	a <i>security</i> or a <i>contractually based investment</i> , that is, any of the following <i>investments</i> , specified in Part III of the <i>Regulated Activities Order</i> (Specified Investments): <ul style="list-style-type: none"> (a) <i>life policy</i> (subset of article 75 (Contracts of insurance)); (b) <i>share</i> (article 76); (c) <i>debenture</i> (article 77); (d) <i>government and public security</i> (article 78); (e) <i>warrant</i> (article 79); (f) <i>certificate representing certain securities</i> (article 80); (g) <i>unit</i> (article 81); (h) <i>stakeholder pension scheme</i> (article 82); (i) <i>option</i> (article 83); for the purposes of the <i>permission</i> regime, this

is sub-divided into:

- (i) *option* (excluding a *commodity option* and an *option* on a *commodity future*);
- (ii) *commodity option* and *option* on a *commodity future*;
- (j) *future* (article 84); for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *future* (excluding a *commodity future* and a *rolling spot forex contract*);
 - (ii) *commodity future*;
 - (iii) *rolling spot forex contract*;
- (k) *contract for differences* (article 85); for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *contract for differences* (excluding a *spread bet* and a *rolling spot forex contract*);
 - (ii) *spread bet*;
 - (iii) *rolling spot forex contract*;
- (l) *rights to or interests in investments* in (a) to (k) (article 89).

designated investment business

any of the following activities, specified in Part II of the *Regulated Activities Order* (Specified Activities), which is carried on by way of business:

- (a) *dealing in investments as principal* (article 14), but disregarding the exclusion in article 15 (Absence of holding out etc);
- (b) *dealing in investments as agent* (article 21);
- (c) *arranging (bringing about) deals in investments* (article 25(1)), but only in relation to *designated investments*;
- (d) *making arrangements with a view to transactions in investments* (article 25(2)), but only in relation to *designated investments*;
- (e) *managing investments* (article 37);
- (f) *safeguarding and administering investments* (article 40); for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *safeguarding and administration of assets (without arranging)*;
 - (ii) *arranging safeguarding and administration of assets*;
- (g) *sending dematerialised instructions* (article 45(1));
- (h) *causing dematerialised instructions to be sent* (article 45(2));
- (i) *establishing, operating or winding up a collective investment scheme* (article 51(1)(a)); for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *establishing, operating or winding up a regulated*

- collective investment scheme;*
- (ii) *establishing, operating or winding up an unregulated collective investment scheme;*
- (j) *acting as trustee of an authorised unit trust scheme (article 51(1)(b));*
- (k) *acting as the depositary or sole director of an open-ended investment company (article 51(1)(c));*
- (l) *establishing, operating or winding up a stakeholder pension scheme (article 52);*
- (m) *advising on investments (article 53); for the purposes of the permission regime, this is sub-divided into:*
 - (i) *advising on investments (except pension transfers and pension opt-outs);*
 - (ii) *advising on pension transfers and pension opt-outs;*
- (n) *agreeing to carry on a regulated activity in (a) to (h) and (m) (article 64).*

designated investment exchange

(except in *IPRU*) any of the following investment exchanges:

American Stock Exchange
 Australian Stock Exchange
 Bolsa Mexicana de Valores
 Bourse de Montreal Inc
 Chicago Board of Trade
 Chicago Board Options Exchange
 Chicago Stock Exchange
 Coffee, Sugar and Cocoa Exchange, Inc
 Euronext Amsterdam Commodities Market
 Hong Kong Exchanges and Clearing Limited
 International Securities Market Association
 Johannesburg Stock Exchange
 Kansas City Board of Trade
 Korea Stock Exchange
 MidAmerica Commodity Exchange
 Minneapolis Grain Exchange
 New York Cotton Exchange
 New York Futures Exchange
 New York Stock Exchange
 New Zealand Stock Exchange

	Osaka Securities Exchange
	Pacific Exchange
	Philadelphia Stock Exchange
	Singapore Exchange
	South African Futures Exchange
	Tokyo International Financial Futures Exchange
	Tokyo Stock Exchange
	Toronto Stock Exchange
<i>designated non-member</i>	(in <i>REC</i>) (in relation to a <i>UK RIE</i>) a <i>person</i> in respect of whom action may be taken under the <i>default rules</i> of the <i>RIE</i> but who is not a <i>member</i> of the <i>RIE</i> .
<i>designated professional body</i>	a professional body designated by the Treasury under section 326 of the <i>Act</i> (Designation of professional bodies) for the purposes of Part XX of the <i>Act</i> (Provision of Financial Services by Members of the Professions); as at 21 June 2001 the following professional bodies have been designated in the Financial Services and Markets Act 2000 (Designated Professional Bodies) Order 2001 (SI 2001/1226): <ul style="list-style-type: none"> (a) The Law Society (England and Wales); (b) The Law Society of Scotland; (c) The Law Society of Northern Ireland; (d) The Institute of Chartered Accountants in England and Wales; (e) The Institute of Chartered Accountants of Scotland; (f) The Institute of Chartered Accountants in Ireland; (g) The Association of Chartered Certified Accountants; (h) The Institute of Actuaries.
<i>designated State or territory</i>	any <i>EEA State</i> (other than the <i>United Kingdom</i>), Australia, Canada, Hong Kong, New Zealand, Singapore, South Africa, Switzerland or the USA.
<i>DGD</i>	<i>Deposit Guarantee Directive</i> .
<i>DGD claim</i>	a <i>claim</i> , in relation to a <i>protected deposit</i> , against a <i>BCD credit institution</i> , whether established in the <i>United Kingdom</i> or in another <i>EEA State</i> .
<i>dilution</i>	(in <i>CIS</i>) the amount of <i>dealing</i> costs incurred, or expected to be incurred, by an <i>ICVC</i> or for the account of a <i>single-priced AUT</i> to the extent that these costs may reasonably be expected to result, or have resulted, from the acquisition or disposal of <i>investments</i> by the <i>ICVC</i> or for the account of the <i>single-priced AUT</i> as a consequence (whether or not immediate) of the increase or decrease in the cash resources of the <i>ICVC</i> or <i>single-priced AUT</i> resulting from the <i>issue</i> or <i>cancellation</i> of <i>units</i> over a period;

	for the purposes of this definition, <i>dealing</i> costs include both the costs of <i>dealing</i> in an <i>investment</i> , professional fees incurred, or expected to be incurred, in relation to the acquisition or disposal of <i>approved immovables</i> and, where there is a spread between the <i>buying</i> and <i>selling prices</i> of the <i>investment</i> , the indirect cost resulting from the differences between those <i>prices</i> .
<i>dilution levy</i>	a charge of such amount or at such rate as is determined by an <i>ACD</i> of an <i>ICVC</i> or a <i>manager</i> of a <i>single-priced AUT</i> to be made for the purpose of reducing the effect of <i>dilution</i> .
<i>Diploma Directives</i>	the First and Second Diploma Directives, that is: <ul style="list-style-type: none"> (a) the Council Directive of 21 December 1988 on a general system for the recognition of higher-education diplomas, awarded on completion of professional education and training of at least three years' duration (No 89/48/EEC); (b) the Council Directive of 18 June 1992 on a second general system for the recognition of professional education and training to supplement Directive 89/48/EEC (No 92/51/EEC).
<i>direct offer financial promotion</i>	a <i>non-real time financial promotion</i> which: <ul style="list-style-type: none"> (a) contains: <ul style="list-style-type: none"> (i) an offer by the <i>firm</i> to enter into a <i>controlled agreement</i> with anyone who responds to the <i>financial promotion</i>; or (ii) an invitation to anyone who responds to the <i>financial promotion</i> to make an offer to the <i>firm</i> to enter into a <i>controlled agreement</i>; and (b) specifies the manner of response or includes a form in which any response is to be made (for example by providing a tear-off slip).
<i>directive friendly society</i>	a <i>friendly society</i> other than a <i>non-directive friendly society</i> .
<i>director</i>	(1) (except in <i>CIS</i>) (in relation to any of the following (whether constituted in the <i>United Kingdom</i> or under the law of a country or territory outside it)): <ul style="list-style-type: none"> (a) an unincorporated association; (b) a <i>body corporate</i>; (c) (in <i>SYSC</i> and <i>SUP 10</i> (Approved persons)) a <i>partnership</i>; (d) (in <i>SYSC</i> and <i>SUP 10</i> (Approved persons)) a <i>sole trader</i>; any <i>person</i> appointed to direct its affairs, including a <i>person</i> who is a member of its <i>governing body</i> and (in accordance with section 417(1) of the <i>Act</i>): <ul style="list-style-type: none"> (i) a <i>person</i> occupying in relation to it the position of a director (by whatever name called); and (ii) a <i>person</i> in accordance with whose directions or instructions (not being advice given in a professional

capacity) the directors of that body are accustomed to act.

- (2) (in *CIS*) a director of an *ICVC*, including (in accordance with regulation 2(1) of the *OEIC Regulations*) a *person* occupying in relation to the *ICVC* the position of director, by whatever name called.

<i>director function</i>	<i>controlled function</i> CF1 in the <i>table of controlled functions</i> , described more fully in <i>SUP</i> 10.6.4R.
<i>director of unincorporated association function</i>	<i>controlled function</i> CF5 in the <i>table of controlled functions</i> , described more fully in <i>SUP</i> 10.6.24R.
<i>Disciplinary Tribunal</i>	(in <i>LLD</i>) a Tribunal appointed under Schedule 2 to Lloyd's Disciplinary Committees Byelaw (No 31 of 1996).
<i>disclosable information</i>	any information which has to be disclosed in the market in accordance with any legal or regulatory requirement.
<i>discounting</i>	(in <i>LLD</i>) discounting or deductions to take account of investment income as set out in paragraph 48 of the <i>insurance accounts rules</i> .
<i>DISP</i>	Dispute resolution: the Complaints sourcebook.
<i>distribution account</i>	(in <i>CIS</i>) the account to which the <i>income property</i> of an <i>authorised fund</i> must be transferred as at the end of each <i>annual accounting period</i> under <i>CIS</i> 9.2.3R (Annual allocation of income).
<i>document</i>	any piece of recorded information, including (in accordance with section 417(1) of the <i>Act</i> (Interpretation)) information recorded in any form; in relation to information recorded otherwise than in legible form, references to its production include references to producing a copy of the information in legible form.
<i>document evidencing title</i>	any means of evidencing title whether in documentary form or otherwise.
<i>dual-priced AUT</i>	an <i>AUT</i> that is not a <i>single-priced AUT</i> .
<i>ECA Regulations</i>	the Open-Ended Investment Companies (Investment Companies with Variable Capital) Regulations 1996 (SI 1996/2827).
<i>EEA</i>	the <i>European Economic Area</i> . (see also <i>EEA State</i> .)
<i>EEA authorisation</i>	(in accordance with paragraph 6 of Schedule 3 to the <i>Act</i> (EEA Passport Rights)) authorisation granted to an <i>EEA firm</i> by its <i>Home State regulator</i> for the purpose of the relevant <i>Single Market Directive</i>).
<i>EEA bank</i>	an <i>incoming EEA firm</i> which is a <i>BCD credit institution</i> .
<i>EEA firm</i>	(in accordance with paragraph 5 of Schedule 3 to the <i>Act</i> (EEA Passport Rights)) any of the following, if it does not have its head office in the <i>United Kingdom</i> : (a) an investment firm (as defined in article 1(2) of the <i>Investment</i>

	<p><i>Services Directive</i>) which is authorised (within the meaning of article 3) by its <i>Home State regulator</i>;</p> <p>(b) a <i>credit institution</i> which is authorised (within the meaning of article 1) by its <i>Home State regulator</i>;</p> <p>(c) a financial institution (as defined in article 1 of the <i>Banking Consolidation Directive</i>) which is a subsidiary of the kind mentioned in article 19 and which fulfils the conditions in articles 18 and 19;</p> <p>(d) an <i>undertaking</i> pursuing the activity of direct insurance (within the meaning of article 1 of the <i>First Life Directive</i> or of the <i>First Non-Life Directive</i>) which has received authorisation under article 6 from its <i>Home State regulator</i>.</p>
<i>EEA investment business oversight function</i>	<i>controlled function</i> CF9 in the <i>table of controlled functions</i> , described more fully in SUP 10.7.6R.
<i>EEA regulator</i>	a <i>competent authority</i> for the purposes of any of the <i>Single Market Directives</i> .
<i>EEA right</i>	(in accordance with paragraph 7 of Schedule 3 to the <i>Act</i> (EEA Passport Rights)) the entitlement of a <i>person</i> to establish a <i>branch</i> or provide services in an <i>EEA State</i> other than that in which he has his head office: <p>(a) in accordance with the <i>Treaty</i> as applied in the <i>European Economic Area</i>; and</p> <p>(b) subject to the conditions of the relevant <i>Single Market Directive</i>.</p>
<i>EEA State</i>	(in accordance with paragraph 8 of Schedule 3 to the <i>Act</i> (EEA Passport Rights)) a State which is a contracting party to the agreement on the European Economic Area signed at Oporto on 2 May 1992, as it has effect for the time being; as at 21 June 2001, the following are the <i>EEA States</i> : Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Liechtenstein, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden and the <i>United Kingdom</i> .
<i>effecting contracts of insurance</i>	the <i>regulated activity</i> , specified in article 10(1) of the <i>Regulated Activities Order</i> (<i>Effecting and carrying out contracts of insurance</i>), of effecting a <i>contract of insurance</i> as principal.
<i>EIS</i>	<i>Enterprise Investment Scheme</i> .
<i>EIS fund</i>	an arrangement, specified in paragraph 2 of the Schedule to the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 (SI 2001/1062), which is in summary: an arrangement in relation to <i>EIS shares</i> that would have been a <i>collective investment scheme</i> if the scheme arrangements had not provided that: <p>(a) the <i>operator</i> will, so far as practicable, make investments which, subject to each participant's individual circumstances, qualify for</p>

	relief under Chapter III of Part VII of the Income and Corporation Taxes Act 1988; and
	(b) the minimum subscription to the arrangements by each participant must be not less than £2,000.
<i>EIS managed portfolio</i>	a managed portfolio which is, or is to be, invested wholly or mainly in <i>EIS shares</i> .
<i>EIS manager</i>	(a) (in relation to an <i>EIS managed portfolio</i>) the investment manager; (b) (in relation to an <i>EIS fund</i>) the manager of the fund.
<i>EIS particulars</i>	a <i>document</i> containing particulars of an <i>Enterprise Investment Scheme</i> .
<i>EIS share</i>	a <i>share</i> in respect of which the beneficial owner may, subject to his individual circumstances, be qualified, or has been qualified, for relief under Chapter III of Part VII of the Income and Corporation Taxes Act 1988.
<i>EIS subscription</i>	any <i>money</i> which is subscribed: (a) in the case of an <i>EIS managed portfolio</i> , by the <i>client</i> of the <i>EIS manager</i> whose portfolio it is; (b) in the case of an <i>EIS fund</i> , by the participants in the <i>EIS</i> .
<i>eligible</i>	(in <i>CIS</i>) (in relation to a <i>securities</i> market or a <i>derivatives</i> market) a market that satisfies the requirements of <i>CIS</i> 5.3.3R (Eligible markets requirements).
<i>eligible claimant</i>	a <i>person</i> who is eligible to bring a <i>claim</i> for compensation under <i>COMP</i> 4.2.1R.
<i>eligible complainant</i>	a <i>person</i> eligible to have a complaint considered under the <i>Financial Ombudsman Service</i> , as defined in <i>DISP</i> 2.4 (Who can refer a complaint to the Financial Ombudsman Service).
<i>eligible institution</i>	(in <i>CIS</i>) (a) a <i>BCD credit institution</i> authorised by its <i>Home State regulator</i> ; (b) an <i>ISD investment firm</i> authorised by its <i>Home State regulator</i> .
<i>eligible investment trust</i>	an <i>investment trust</i> that satisfies the requirements of <i>CIS</i> 5.10.4R (Feeder fund investing in a single eligible investment trust).
<i>employee</i>	(1) (for all purposes except those in (2)) an individual: (a) who is employed or appointed by a <i>person</i> in connection with that <i>person's</i> business, whether under a contract of service or for services or otherwise; or (b) whose services, under an arrangement between that <i>person</i> and a third party, are placed at the disposal and under the control of that <i>person</i> ; but excluding an <i>appointed representative</i> of that <i>person</i> .

- (2) (for the purposes of:
- (a) *COB* 7.13 (Personal account dealing);
 - (b) *SUP* 12 (Appointed representatives); and
 - (c) *TC*)
- an individual:
- (i) within (1); or
 - (ii) who is:
 - (A) an *appointed representative* of the *person* referred to in (1); or
 - (B) employed or appointed by an *appointed representative* of that *person*, whether under a contract of service or for services or otherwise, in connection with the business of the *appointed representative* for which that *person* has accepted responsibility.
- endowment assurance* a *life policy* which pays a sum of *money* on the survival of the life assured to a specific date or on his earlier death.
- ENF* the Enforcement manual.
- engage in investment activity* (as defined in section 21(8) of the *Act* (Restrictions on financial promotion)):
- (a) enter or offer to enter into an agreement the making or performance of which by either party constitutes a *controlled activity*; or
 - (b) exercise any rights conferred by a *controlled investment* to acquire, dispose of, underwrite or convert a *controlled investment*.
- entering as provider into a funeral plan contract* the *regulated activity*, specified in article 59 of the *Regulated Activities Order* (Funeral plan contracts) which comes into force on 1 January 2002, of entering as provider into a *funeral plan contract*.
- Enterprise Investment Scheme* an arrangement which is an *EIS managed portfolio* or an *EIS fund*.
- Enterprise Zone Property Unit Trust* an *unregulated collective investment scheme* of which the underlying assets are industrial and commercial buildings in an Enterprise Zone in accordance with section 749(2) of the Finance Act 1980.
- equity stake* (in relation to a *company*) any kind of equity stake in that *company*, including *shares* in it (including non-voting and non-equity *shares*, *debt securities* that are convertible or exchangeable into such *shares*, a call *option* on such *shares* or an in-the-money put *option* on such *shares*, but excluding a *contract for differences* or other *investment* that provides merely an economic exposure to movement in the price of the *company's shares*).
- establishing,* the *regulated activity*, specified in article 51(1)(a) of the *Regulated*

<i>operating or winding up a collective investment scheme</i>	<i>Activities Order</i> (Establishing etc a collective investment scheme), of establishing, operating or winding up a <i>collective investment scheme</i> .
<i>establishing, operating or winding up a regulated collective investment scheme</i>	<i>establishing, operating or winding up a collective investment scheme</i> if the <i>scheme</i> is a <i>regulated collective investment scheme</i> .
<i>establishing, operating or winding up a stakeholder pension scheme</i>	the <i>regulated activity</i> , specified in article 52 of the <i>Regulated Activities Order</i> (Establishing etc a stakeholder pension scheme), of establishing, operating or winding up a <i>stakeholder pension scheme</i> .
<i>establishing, operating or winding up an unregulated collective investment scheme</i>	<i>establishing, operating or winding up a collective investment scheme</i> if the <i>scheme</i> is an <i>unregulated collective investment scheme</i> .
<i>establishment conditions</i>	(in relation to the establishment of a <i>branch</i> in the <i>United Kingdom</i>) the conditions specified in paragraph 13 of Schedule 3 to the <i>Act</i> (EEA Passport Rights), which are that: <ul style="list-style-type: none"> (a) the <i>FSA</i> has received notice ("a consent notice") from the <i>EEA firm's Home State regulator</i> that it has given the <i>EEA firm</i> consent to establish a <i>branch</i> in the <i>United Kingdom</i>; (b) the consent notice: <ul style="list-style-type: none"> (i) is given in accordance with the relevant <i>Single Market Directive</i>; (ii) identifies the activities to which consent relates; and (iii) includes the other information prescribed in the Financial Services and Markets Act 2000 (EEA Passport Rights) Regulations 2001 (SI 2001/1376); and (c) the <i>EEA firm</i> has been informed of the <i>applicable provisions</i> or two <i>months</i> have elapsed beginning with the date when the <i>FSA</i> received the consent notice.
<i>establishment costs</i>	(in <i>DISP</i>) the costs of establishing the <i>Financial Ombudsman Service</i> .
<i>European Economic Area</i>	the area established by the agreement on the European Economic Area signed at Oporto on 2 May 1992 and which consists of the <i>EEA States</i> .
<i>evidential provision</i>	a <i>rule</i> , contravention of which does not give rise to any of the consequences provided for by other provisions of the <i>Act</i> ; and which provides, in accordance with section 149(2) of the <i>Act</i> , that: <ul style="list-style-type: none"> (a) contravention may be relied on as tending to establish contravention of such other <i>rule</i> as may be specified; or (b) compliance may be relied on as tending to establish compliance with such other <i>rule</i> as may be specified; or

	(c) both (a) and (b).
<i>ex-section 43 firm</i>	a <i>firm</i> that was a listed institution, as defined in section 43 of the Financial Services Act 1986, immediately before <i>commencement</i> .
<i>ex-section 43 lead regulated firm</i>	an <i>ex-section 43 firm</i> for which the <i>FSA</i> (in its capacity as the regulatory body under section 43 of the Financial Services Act 1986) was lead regulator for financial supervision purposes, and that was subject to the <i>section 43 capital requirements</i> , immediately before <i>commencement</i> .
<i>excluded material</i>	(in relation to access to <i>FSA</i> material) (as defined in section 394(7) of the <i>Act</i> (Access to Authority material)) material which: <ul style="list-style-type: none"> (a) has been intercepted in obedience to a warrant issued under any enactment relating to the interception of communications; or (b) indicates that such a warrant has been issued or that material has been intercepted in obedience to such a warrant; or (c) is a <i>protected item</i>.
<i>execute</i>	(in relation to a transaction) carry into effect or perform the transaction, whether as <i>principal</i> or as agent, including instructing another <i>person</i> to execute the transaction.
<i>execution-only transaction</i>	a transaction <i>executed</i> by a <i>firm</i> upon the specific instructions of a <i>client</i> where the <i>firm</i> does not give <i>advice on investments</i> relating to the merits of the transaction.
<i>executive procedures</i>	the procedures relating to the giving of <i>warning notices</i> , <i>decision notices</i> and <i>supervisory notices</i> that the <i>FSA</i> proposes to follow in the circumstances specified in <i>DEC 4.1.6G</i> (Decisions to be taken by executive procedures), and that are described in <i>DEC 4.3</i> (Executive procedures for statutory notice decisions and statutory notice associated decisions).
<i>exempt activity</i>	(in relation to a <i>recognised body</i>) any <i>regulated activity</i> in respect of which the body is exempt from the <i>general prohibition</i> as a result of section 285(2) or (3) of the <i>Act</i> (Exemption for recognised investment exchanges and clearing houses).
<i>exempt person</i>	(as defined in section 417(1) of the <i>Act</i> (Definitions)) (in relation to a <i>regulated activity</i>) a <i>person</i> who is exempt from the <i>general prohibition</i> in respect of that activity as a result of: <ul style="list-style-type: none"> (a) the <i>Exemption Order</i>; or (b) being an <i>appointed representative</i>; or (c) section 285(2) or (3) of the <i>Act</i> (Exemption for recognised investment exchanges and clearing houses).
<i>exempt professional firm</i>	a <i>person</i> to whom, under section 327 of the <i>Act</i> , the <i>general prohibition</i> does not apply; guidance is given in <i>PROF 2.2</i> (Exempt regulated activities).
<i>exempt regulated</i>	(as defined in section 325(2) of the <i>Act</i> (Authority's general duty)) a

<i>activity</i>	<i>regulated activity</i> which may, as a result of Part XX of the <i>Act</i> (Provision of Financial Services by Members of the Professions), be carried on by <i>members</i> of a profession which is supervised and regulated by a <i>designated professional body</i> without breaching the <i>general prohibition</i> .
<i>Exemption Order</i>	the Financial Services and Markets Act 2000 (Exemption) Order 2001 (SI 2001/1201).
<i>exposure</i>	(in relation to a <i>firm</i>) the maximum loss which the <i>firm</i> might suffer if: <ul style="list-style-type: none"> (a) a counterparty or a group of connected counterparties fail to meet their obligations; or (b) it realises assets or off-balance sheet positions.
<i>extraordinary resolution</i>	(in <i>CIS</i>) a resolution passed by a majority of not less than three-quarters of the votes validly cast (whether on a show of hands or on a poll) for and against the resolution at a general meeting or (as the case may be) <i>class meeting of holders</i> , of which notice specifying the intention to propose the resolution as an extraordinary resolution has been duly given.
<i>EZPUT</i>	<i>Enterprise Zone Property Unit Trust</i> .
<i>facilities</i>	(in relation to a <i>recognised body</i>) the facilities and services which it provides in the course of carrying on <i>exempt activities</i> .
<i>failure</i>	(in <i>COB 9</i>) the appointment of a liquidator, receiver or administrator, or trustee in bankruptcy, or any equivalent procedure in any relevant jurisdiction.
<i>fee</i>	any payment offered or made by a <i>client</i> to a <i>firm</i> in connection with <i>designated investment business</i> or with any other business of the <i>firm</i> , including (where applicable) any <i>mark-up or mark-down</i> .
<i>feeder fund</i>	an <i>AUT</i> that is a <i>relevant pension scheme</i> and <i>dedicated</i> to units in a single <i>regulated collective investment scheme</i> or to <i>shares</i> or <i>debentures</i> of a single <i>eligible investment trust</i> .
<i>field representative</i>	an <i>appointed representative</i> of the <i>firm</i> , or an <i>employee</i> of the <i>firm</i> (or of its <i>appointed representative</i>), whose normal fixed place of business is not a business address of the <i>firm</i> which appears on the <i>firm's</i> stationery.
<i>final notice</i>	a notice given by the <i>FSA</i> under section 390 of the <i>Act</i> (Final notices).
<i>final response</i>	a response from a <i>firm</i> to a complainant which: <ul style="list-style-type: none"> (a) accepts the complaint, and where appropriate, offers redress; or (b) offers redress without accepting the complaint; or (c) rejects the complaint giving reasons for doing so, and contains information about the right to refer the complaint to the <i>Financial Ombudsman Service</i>.
<i>finance function</i>	<i>controlled function</i> CF13 in the <i>table of controlled functions</i> ,

	described more fully in <i>SUP</i> 10.8.1R.
<i>Financial Action Task Force</i>	the inter-governmental body responsible for developing and promoting policies, both nationally and internationally, to combat money laundering.
<i>financial adviser</i>	an individual appointed by an <i>independent intermediary</i> or by its <i>appointed representative</i> to provide any or all of the following services: <ul style="list-style-type: none"> (a) giving <i>advice on investments</i> to <i>clients</i>; (b) <i>arranging (bringing about) deals in investments</i> or <i>executing transactions</i> involving, in each case, <i>designated investments</i> with or for <i>clients</i>; (c) <i>managing investments</i>; (d) receiving or holding <i>client money</i> or other <i>clients'</i> assets; (e) <i>safeguarding and administering investments</i>.
<i>financial crime</i>	(in accordance with section 6(3) of the <i>Act</i>) any kind of criminal conduct relating to money or to financial services or markets, including any offence involving: <ul style="list-style-type: none"> (a) fraud or dishonesty; or (b) misconduct in, or misuse of information relating to, a financial market; or (c) handling the proceeds of crime; <p>in this definition, "offence" includes an act or omission which would be an offence if it had taken place in the <i>United Kingdom</i>.</p>
<i>Financial Ombudsman Service</i>	the scheme provided under Part XVI of the <i>Act</i> (The Ombudsman Scheme) under which certain disputes may be resolved quickly and with minimum formality by an independent <i>person</i> .
<i>Financial Ombudsman Service Limited</i>	the <i>body corporate</i> established by the <i>FSA</i> under paragraph 2(1) of Schedule 17 to the <i>Act</i> (The Scheme Operator) to administer the <i>Financial Ombudsman Service</i> .
<i>financial promotion</i>	(in accordance with section 21(1) of the <i>Act</i> (Restrictions on financial promotion)) an invitation or inducement to <i>engage in investment activity</i> .
<i>Financial Promotion Order</i>	the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 (SI 2001/1335).
<i>financial promotion rules</i>	<i>COB</i> 3.
<i>Financial Services and Markets Tribunal</i>	the Tribunal established under section 132 of the <i>Act</i> (The Financial Services and Markets Tribunal) and run by the Lord Chancellor's Department.
<i>Financial Services Compensation</i>	the <i>body corporate</i> established by the <i>FSA</i> under section 212 of the <i>Act</i> (The scheme manager) to administer the <i>compensation scheme</i> .

<i>Scheme Limited</i>	
<i>financial system</i>	(as defined in section 3 of the <i>Act</i> (Market confidence)) the financial system operating in the <i>United Kingdom</i> including: <ul style="list-style-type: none"> (a) financial markets and exchanges; (b) <i>regulated activities</i>; and (c) other activities connected with financial markets and exchanges.
<i>financial year</i>	(1) (in <i>DISP</i>) the 12 <i>months</i> ending with 31 March. (2) (in <i>LLD</i>) a calendar year.
<i>fire and natural forces</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph 8 of Part I of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of general insurance), against loss of or damage to property (other than property to which paragraphs 3 to 7 of Part I of Schedule 1 to the <i>Regulated Activities Order</i> (Land vehicles; railway rolling stock; aircraft; ships; goods in transit) relate) due to fire, explosion, storm, natural forces other than storm, nuclear energy or land subsidence.
<i>firm</i>	an <i>authorised person</i> , but not a <i>professional firm</i> unless it is an <i>authorised professional firm</i> . (see also <i>GEN 2.2.18R</i> for the position of an <i>authorised partnership</i> or unincorporated association which is dissolved.)
<i>First Life Directive</i>	the Council Directive of 5 March 1979 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct life assurance (No 79/267/EEC).
<i>First Non-Life Directive</i>	the Council Directive of 24 July 1973 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct insurance other than life insurance (No 73/239/EEC).
<i>FIT</i>	the part of the <i>Handbook</i> in High Level Standards which has the title the Fit and Proper test for Approved Persons.
<i>flat rate benefits business friendly society</i>	a <i>friendly society</i> whose <i>insurance business</i> is restricted to the provision of benefits which vary according to the resources available and in which the contributions of members are determined on a flat rate basis.
<i>former member</i>	(in <i>LLD</i>) a <i>person</i> who has ceased to be a <i>member</i> , whether by resignation or otherwise, in accordance with Lloyd's Act 1982 and any <i>byelaw</i> made under it.
<i>former underwriting member</i>	(as defined in section 324(1) of the <i>Act</i> (Interpretation of Part XIX: Lloyd's)) a <i>person</i> ceasing to be an <i>underwriting member</i> on, or at any time after, 24 December 1996.
<i>forward price</i>	(in relation to <i>units</i>) a <i>price</i> calculated by reference to the <i>valuation point</i> next following the <i>authorised fund manager's</i> agreement to <i>sell</i> or, as the case may be, to <i>redeem</i> the <i>units</i> in question.

<i>FOS Ltd</i>	<i>Financial Ombudsman Service Limited.</i>
<i>free-standing additional voluntary contribution</i>	an <i>additional voluntary contribution</i> to a private <i>pension policy</i> or <i>pension contract</i> separate from but associated with an <i>occupational pension scheme</i> which is an approved arrangement under section 591(2)(h) of the <i>Income and Corporation Taxes Act 1988</i> .
<i>friendly society</i>	an <i>incorporated friendly society</i> or a <i>registered friendly society</i> .
<i>front end loaded</i>	(in relation to an <i>investment</i>) one where deductions for <i>charges</i> and expenses are loaded disproportionately on the early years.
<i>FSA</i>	the Financial Services Authority.
<i>FSA Register</i>	the public record, as required by section 347 of the <i>Act</i> (The public record), of every: <ul style="list-style-type: none"> (a) <i>authorised person</i>; (b) <i>AUT</i>; (c) <i>ICVC</i>; (d) <i>recognised scheme</i>; (e) <i>recognised investment exchange</i>; (f) <i>recognised clearing house</i>; (g) individual to whom a <i>prohibition order</i> relates; (h) <i>approved person</i>; and (i) <i>person</i> within such other class (if any) as the <i>FSA</i> may determine; except as provided by any transitional provisions.
<i>FSAVC</i>	<i>free-standing additional voluntary contribution.</i>
<i>FSCS</i>	<i>Financial Services Compensation Scheme Limited.</i>
<i>fund of funds scheme</i>	an <i>authorised fund dedicated</i> to <i>units</i> in a number of <i>regulated collective investment schemes</i> or <i>sub-funds</i> of one or more <i>regulated collective investment schemes</i> (or both).
<i>funds at Lloyd's</i>	assets of <i>members</i> held by the <i>Society</i> , not being part of their <i>premium trust funds</i> , available to meet the liabilities arising from their <i>insurance business</i> at Lloyd's.
<i>funeral plan contract</i>	the <i>investment</i> , specified in articles 59(2), 60 and 87 of the <i>Regulated Activities Order</i> which come into force on 1 January 2002, which is in summary: rights under a contract under which: <ul style="list-style-type: none"> (a) a <i>person</i> ("the customer") makes one or more payments to another <i>person</i> ("the provider"); and (b) the provider undertakes to provide, or secure that another <i>person</i> provides, a funeral in the <i>United Kingdom</i> for the customer (or some other <i>person</i> who is living at the date when the contract is entered into) on his death; <p>unless, at the time of entering into the contract, the customer and the</p>

	provider intend or expect the funeral to occur within one month;but excluding certain contracts under which sums paid will be applied towards a <i>contract of insurance</i> or will be held on trust.
<i>future</i>	the <i>investment</i> , specified in article 84 of the <i>Regulated Activities Order</i> (Futures), which is in summary: rights under a contract for the sale of a commodity or property of any other description under which delivery is to be made at a future date and at a price agreed on when the contract is made.
<i>future benefit</i>	(in <i>COMP</i>) any benefit, provided by a <i>long-term insurance contract</i> under which a <i>company</i> in liquidation owes obligations, which has not fallen due to be paid before the beginning of the liquidation.
<i>futures and options scheme</i>	an <i>authorised fund dedicated to derivatives</i> (where most or all of the transactions in <i>derivatives</i> are fully covered by cash, <i>securities</i> or <i>derivatives</i>), with or without <i>transferable securities</i> .
<i>geared futures and options scheme</i>	an <i>authorised fund dedicated to derivatives</i> (where most or all of the extent of the <i>investment</i> is limited by the amount of property available to put up as <i>initial outlay</i>), whether with or without <i>transferable securities</i> .
<i>geared securities scheme</i>	a <i>regulated collective investment scheme</i> where the policies which the operator adopts or proposes to adopt mean that, as a result of investment in <i>warrants</i> , movements in prices of <i>units</i> are likely to be amplified significantly.
<i>GEN</i>	the part of the <i>Handbook</i> in High Level Standards which has the title General provisions.
<i>general client bank account</i>	a <i>client bank account</i> that holds <i>client money</i> of one or more <i>clients</i> and which is not: <ul style="list-style-type: none"> (a) a <i>designated client bank account</i>; or (b) a <i>designated client fund account</i>.
<i>general insurance business</i>	the business of <i>effecting</i> or <i>carrying out general insurance contracts</i> .
<i>general insurance business assets</i>	(in <i>LLD</i>) assets of a <i>member</i> that are: <ul style="list-style-type: none"> (a) in a <i>premium trust fund</i> for <i>general insurance business</i>; or (b) <i>funds at Lloyd's</i> that are not <i>long-term insurance business assets</i>.
<i>general insurance business liabilities</i>	liabilities of a <i>member</i> that are not to be left out of account under <i>LLD</i> 12.5.4R, and are not <i>long-term insurance business liabilities</i> .
<i>general insurance business syndicate</i>	a <i>syndicate</i> in which <i>members</i> at Lloyd's carry on <i>general insurance business</i> .
<i>general insurance contract</i>	(in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation: general)) any <i>contract of insurance</i> within Part I of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of general insurance), namely:

	<ul style="list-style-type: none"> (a) <i>accident</i> (paragraph 1); (b) <i>sickness</i> (paragraph 2); (c) <i>land vehicles</i> (paragraph 3); (d) <i>railway rolling stock</i> (paragraph 4); (e) <i>aircraft</i> (paragraph 5); (f) <i>ships</i> (paragraph 6); (g) <i>goods in transit</i> (paragraph 7); (h) <i>fire and natural forces</i> (paragraph 8); (i) <i>damage to property</i> (paragraph 9); (j) <i>motor vehicle liability</i> (paragraph 10); (k) <i>aircraft liability</i> (paragraph 11); (l) <i>liability of ships</i> (paragraph 12); (m) <i>general liability</i> (paragraph 13); (n) <i>credit</i> (paragraph 14); (o) <i>suretyship</i> (paragraph 15); (p) <i>miscellaneous financial loss</i> (paragraph 16); (q) <i>legal expenses</i> (paragraph 17); (r) <i>assistance</i> (paragraph 18).
<i>general levy</i>	(in <i>DISP</i>) the annual fee raised from a <i>firm</i> under the <i>rules</i> to fund a part agreed between the <i>Financial Ombudsman Service</i> and the <i>FSA</i> of the <i>Financial Ombudsman Service's</i> annual budget.
<i>general liability</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph 13 of Part I of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of general insurance), against risks of the <i>persons</i> insured incurring liabilities to third parties, the risks in question not being risks to which paragraph 10 (Motor vehicle liability), 11 (Aircraft liability) or 12 (Liability of ships) of that Schedule relates.
<i>general prohibition</i>	the prohibition imposed by section 19 of the <i>Act</i> (The general prohibition) which states that no <i>person</i> may carry on a <i>regulated activity</i> in the <i>United Kingdom</i> , or purport to do so, unless he is: <ul style="list-style-type: none"> (a) an <i>authorised person</i>; or (b) an <i>exempt person</i>.
<i>general representative</i>	a <i>person</i> resident in the <i>United Kingdom</i> who is authorised to act generally, and to accept service of any <i>document</i> , on behalf of the <i>firm</i> .
<i>global account</i>	the accounts produced under <i>LLD 15.10</i> (The Lloyd's global account).
<i>Glossary</i>	the Glossary giving the meanings of the defined expressions used in

	the <i>Handbook</i> .
<i>goods in transit</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph 7 of Part I of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of general insurance), against loss of or damage to merchandise, baggage and all other goods in transit, irrespective of the form of transport.
<i>governing body</i>	the board of <i>directors</i> , committee of management or other governing body of a <i>firm</i> or <i>recognised body</i> , including, in relation to a <i>sole trader</i> , the <i>sole trader</i> .
<i>governing function</i>	any of the <i>controlled functions</i> 1 to 7 in the <i>table of controlled functions</i> .
<i>government and public security</i>	<p>the <i>investment</i>, specified in article 78 of the <i>Regulated Activities Order</i> (Government and public securities), which is in summary: a loan stock, bond or other instrument creating or acknowledging indebtedness, issued by or on behalf of:</p> <ul style="list-style-type: none"> (a) the government of the <i>United Kingdom</i>; or (b) the Scottish Administration; or (c) the Executive Committee of the Northern Ireland Assembly; or (d) the National Assembly of Wales; or (e) the government of any country or territory outside the <i>United Kingdom</i>; or (f) a local authority in the <i>United Kingdom</i> or elsewhere; or (g) a body the members of which comprise: <ul style="list-style-type: none"> (i) States including the <i>United Kingdom</i> or another <i>EEA State</i>; or (ii) bodies whose members comprise States including the <i>United Kingdom</i> or another <i>EEA State</i>; <p>but excluding:</p> <ul style="list-style-type: none"> (A) the instruments specified in article 77(2)(a) to (d) of the <i>Regulated Activities Order</i>; (B) any instrument creating or acknowledging indebtedness in respect of: <ul style="list-style-type: none"> (I) money received by the Director of Savings as <i>deposits</i> or otherwise in connection with the business of the National Savings Bank; or (II) money raised under the National Loans Act 1968 under the auspices of the Director of Savings or treated as so raised under section 11(3) of the National Debt Act 1972.
<i>gross accumulation share</i>	(in <i>CIS</i>) a <i>share</i> in respect of which income is credited periodically to capital under <i>CIS</i> 9.2.4R (Annual allocation to accumulation shares or

accumulation units) or *CIS* 9.2.6R (Interim allocations of income) but, in accordance with relevant law, without deduction by the *ICVC* of any income tax.

group

(as defined in section 421 of the *Act* (Group)) (in relation to a *person* ("A")) A and any *person* who is:

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

in this definition:

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

(see also *immediate group*.)

group ISA

an *individual savings account* of which the *plan manager* is the *authorised fund manager*, or in the same *group* as the *authorised fund manager*, of the *authorised fund* by reference to *units* in which the *plan register* is being, or is proposed to be, maintained.

group personal equity plan

(as defined in regulation 2 of the Personal Equity Plan Regulations 1989) a general plan:

- (a) of which the *plan manager* is the *authorised fund manager*, or in the same *group* as the *authorised fund manager*, of the *authorised fund* by reference to *units* in which the *plan register* is being, or is proposed to be, maintained; and
- (b) for the account of which there is no holding of *units* in a *collective investment scheme* other than a holding of *units* in one or more *authorised funds* managed by (or, in the case of an *ICVC*, whose *ACD* is) the *plan manager* or a *body corporate* in the same *group* as the *plan manager*.

group personal

a *personal pension scheme* which is available to employees of the

<i>pension scheme</i>	same employer or of employers within a <i>group</i> .
<i>group plan</i>	a <i>group personal equity plan</i> , a <i>group ISA</i> or a <i>group savings plan</i> .
<i>group savings plan</i>	a savings plan: <ul style="list-style-type: none"> (a) of which the <i>plan manager</i> is the <i>authorised fund manager</i>, or in the same <i>group</i> as the <i>authorised fund manager</i>, of the <i>authorised fund</i> by reference to <i>units</i> in which the <i>plan register</i> is being, or is proposed to be, maintained; (b) under which <i>investments</i> are periodically acquired and held by a nominee for the absolute benefit of the respective subscribers to the savings plan; and (c) under which all the <i>investments</i> are <i>units</i> in one or more <i>authorised funds</i> managed by (or, in the case of an <i>ICVC</i>, whose <i>ACD</i> is) the <i>plan manager</i>, or a <i>body corporate</i> in the same <i>group</i> as the <i>plan manager</i>.
<i>guarantee fund</i>	(in relation to an <i>insurer</i>) an amount equal to the greater of one third of the <i>required margin of solvency</i> and the <i>minimum guarantee fund</i> , as set out in <i>IPRU(INS) 2.9R</i> .
<i>guidance</i>	guidance given by the <i>FSA</i> under the <i>Act</i> .
<i>habitual residence</i>	<ul style="list-style-type: none"> (a) if the <i>policyholder</i> is an individual, the address given by the <i>policyholder</i> as his residence if it reasonably appears to be a residential address and there is no evidence to the contrary; (b) if the <i>policyholder</i> is not an individual or a <i>group</i> of individuals, the State in which the <i>policyholder</i> has its place of establishment, or, if it has more than one, its relevant place of establishment; (c) in respect of the variation of a <i>life policy</i>, or the purchase of a <i>pension annuity</i> related to a <i>life policy</i>, unless there is evidence to the contrary, the habitual residence of the <i>policyholder</i> at the date on which the <i>policyholder</i> signed the proposal for the <i>life policy</i>.
<i>half-yearly accounting period</i>	(in <i>CIS</i>) a period determined in accordance with <i>CIS 9.2.1R(6)</i> (Accounting period).
<i>Handbook</i>	the <i>FSA's Handbook</i> of rules and guidance (for a table of contents, see the Reader's Guide).
<i>higher volatility fund</i>	a <i>regulated collective investment scheme</i> which is: <ul style="list-style-type: none"> (a) a <i>geared futures and options scheme</i>, a <i>geared securities scheme</i> or a <i>warrant scheme</i>; (b) a <i>fund of funds scheme</i> of which one or more of the <i>schemes</i> to which it is <i>dedicated</i> falls within (a); or (c) an <i>umbrella scheme</i>, a <i>sub-fund</i> of which, if it were a separate fund, would fall within (a).
<i>historic price</i>	a <i>price</i> calculated by reference to the <i>valuation point</i> immediately preceding the <i>authorised fund manager's</i> agreement to <i>sell</i> or, as the case may be, to <i>redeem</i> the <i>units</i> in question.

<i>holder</i>	<ul style="list-style-type: none"> (a) (in relation to a <i>unit</i> in an <i>authorised fund</i>): <ul style="list-style-type: none"> (i) the <i>shareholder</i>; or (ii) the <i>unitholder</i>; (b) (in relation to a <i>unit</i> in any other <i>collective investment scheme</i>): <ul style="list-style-type: none"> (i) the <i>person</i> who is entered in the <i>register</i> of the <i>scheme</i> as the <i>holder</i> of that <i>unit</i>; or (ii) the bearer of a <i>bearer certificate</i> representing that <i>unit</i>.
<i>holding company</i>	<p>(as defined in section 736(1) of the Companies Act 1985 ("subsidiary", "holding company" and "wholly-owned subsidiary")) (in relation to another <i>body corporate</i> ("S")) a <i>body corporate</i> which:</p> <ul style="list-style-type: none"> (a) holds a majority of the voting rights in S; or (b) is a member of S and has the right to appoint or remove a majority of its board of directors; or (c) is a member of S and controls alone, under an agreement with other shareholders and members, a majority of the voting rights in S.
<i>Holloway sickness policy</i>	a <i>policy</i> offered or effected by a <i>friendly society</i> under the Holloway system.
<i>Home State</i>	<ul style="list-style-type: none"> (1) (in relation to a <i>credit institution</i>) the <i>EEA State</i> in which the <i>credit institution</i> has been authorised in accordance with the <i>Banking Consolidation Directive</i>. (2) (in relation to an <i>investment firm</i>): <ul style="list-style-type: none"> (a) if the <i>investment firm</i> is a natural <i>person</i>, the <i>EEA State</i> in which his head office is situated; (b) if the <i>investment firm</i> is a legal <i>person</i>, the <i>EEA State</i> in which its registered office is situated or, if under its national law it has no registered office, the <i>EEA State</i> in which its head office is situated. (3) (in relation to an <i>insurance undertaking</i> with an <i>EEA right</i>) the <i>EEA State</i> in which the registered office of the <i>insurance undertaking</i> is situated. (4) (in relation to a market) the <i>EEA State</i> in which the registered office of the body which provides trading facilities is situated or, if under its national law it has no registered office, the <i>EEA State</i> in which that body's head office is situated. (5) (in relation to a <i>Treaty firm</i>) the <i>EEA State</i> in which its head office is situated, in accordance with paragraph 1 of Schedule 4 to the <i>Act</i> (Treaty Rights).
<i>Home State authorisation</i>	(as defined in paragraph 3(1)(a) of Schedule 4 to the <i>Act</i> (Treaty Rights)) authorisation of a <i>firm</i> under the law of its <i>Home State</i> to carry on a <i>regulated activity</i> .

<i>Home State regulator</i>	<p>(1) (in relation to an <i>EEA firm</i>) (as defined in paragraph 9 of Schedule 3 to the <i>Act</i> (EEA Passport Rights)) the <i>competent authority</i> (under the relevant <i>Single Market Directive</i>) of an <i>EEA State</i> (other than the <i>United Kingdom</i>) in relation to the <i>EEA firm</i> concerned.</p> <p>(2) (in relation to a <i>UK firm</i>) the <i>FSA</i>.</p> <p>(3) (in relation to a <i>Treaty firm</i>) (as defined in paragraph 1 of Schedule 4 to the <i>Act</i> (Treaty Rights)) the competent authority of the <i>firm's Home State</i> for the purpose of its <i>Home State authorisation</i>.</p>
<i>home territory</i>	(in relation to an <i>overseas investment exchange</i> or an <i>overseas clearing house</i>) the country or territory in which its head office is situated.
<i>Host State</i>	the <i>EEA State</i> in which an <i>EEA firm</i> , a <i>UK firm</i> , or a <i>Treaty firm</i> is exercising an <i>EEA right</i> or <i>Treaty right</i> to establish a <i>branch</i> or provide <i>cross border services</i> .
<i>Host State regulator</i>	<p>(1) (in relation to an <i>EEA firm</i> or a <i>Treaty firm</i> exercising an <i>EEA right</i> or <i>Treaty right</i> in the <i>United Kingdom</i>) the <i>FSA</i>.</p> <p>(2) (in relation to a <i>UK firm</i>) (as defined in paragraph 11 of Schedule 3 to the <i>Act</i> (EEA Passport Rights)) the <i>competent authority</i> (under the relevant <i>Single Market Directive</i>) of an <i>EEA State</i> (other than the <i>United Kingdom</i>) in relation to a <i>UK firm's</i> exercise of <i>EEA rights</i> there.</p>
<i>ICD</i>	<i>Investor Compensation Directive</i> .
<i>ICD claim</i>	<p>a <i>claim</i>:</p> <p>(a) against an <i>ISD investment firm</i> (including a <i>credit institution</i> which is an <i>ISD investment firm</i>), whether established in the <i>United Kingdom</i> or in another <i>EEA State</i>; and</p> <p>(b) in relation to any of the <i>investment services</i> listed in Section A and paragraph 1 of Section C of the Annex to the <i>ISD</i>.</p>
<i>ICVC</i>	<i>investment company with variable capital</i> .
<i>identification evidence</i>	evidence of the type referred to in <i>ML 3.1.3R(1)</i> .
<i>immediate group</i>	<p>(in relation to an <i>authorised person</i>) (as defined in section 148(11) of the <i>Act</i> (Modification or waiver of rules)) :</p> <p>(a) the <i>authorised person</i>;</p> <p>(b) a <i>parent undertaking</i> of the <i>authorised person</i>;</p> <p>(c) a <i>subsidiary undertaking</i> of the <i>authorised person</i>;</p> <p>(d) a <i>subsidiary undertaking</i> of a <i>parent undertaking</i> of the <i>authorised person</i>;</p> <p>(e) a <i>parent undertaking</i> of a <i>subsidiary undertaking</i> of the</p>

	<i>authorised person.</i>
<i>IMRO</i>	the Investment Management Regulatory Organisation Limited.
<i>in default</i>	the status of being in default following a determination made under <i>COMP</i> 6.3.1R.
<i>income account</i>	(in <i>CIS</i>) an account relating to the <i>income property</i> of an <i>authorised fund</i> .
<i>income equalisation</i>	(in relation to a <i>scheme</i>) a capital sum which, in accordance with a power contained in the <i>instrument constituting the scheme</i> , is included in an allocation of income for a <i>unit</i> issued or sold during the accounting period in respect of which that income allocation is made.
<i>income property</i>	all sums considered by an <i>ICVC</i> or by a <i>manager</i> , in each case after consultation with the auditor, to be in the nature of income received or receivable for the account of and in respect of the property of an <i>authorised fund</i> , but excluding any amount for the time being standing to the credit of the <i>distribution account</i> .
<i>income share</i>	a <i>share</i> in respect of which income is allocated periodically to <i>shareholders</i> under <i>CIS</i> 9.2.3R (Annual allocation of income) or <i>CIS</i> 9.2.6R (Interim allocations of income).
<i>income unit</i>	a <i>unit</i> in an <i>AUT</i> which is not an <i>accumulation unit</i> .
<i>income withdrawals</i>	(a) income withdrawals under section 630 of the Income and Corporation Taxes Act 1988; or (b) payments made under interim arrangements in accordance with section 28A of the Pension Schemes Act 1993; in respect of an election to make income withdrawals, a reference to a <i>private customer</i> , an investor or a <i>policyholder</i> includes, after that <i>person's</i> death, his surviving spouse, or anyone who is, at that time, his dependant, or both.
<i>incoming EEA firm</i>	(in accordance with section 193(1)(a) of the <i>Act</i> (Interpretation of this Part)) an <i>EEA firm</i> which is exercising, or has exercised, its right to carry on a <i>regulated activity</i> in the <i>United Kingdom</i> in accordance with Schedule 3 to the <i>Act</i> (EEA Passport Rights).
<i>incoming firm</i>	(in accordance with section 193(1) of the <i>Act</i> (Interpretation of this Part)) an <i>incoming EEA firm</i> or an <i>incoming Treaty firm</i> .
<i>incoming Treaty firm</i>	(in accordance with section 193(1)(b) of the <i>Act</i> (Interpretation of this Part)) a <i>Treaty firm</i> which is exercising, or has exercised, its right to carry on a <i>regulated activity</i> in the <i>United Kingdom</i> in accordance with Schedule 4 to the <i>Act</i> (Treaty rights).
<i>incorporated friendly society</i>	a society incorporated under the Friendly Societies Act 1992.
<i>independent advice</i>	<i>advice on investments</i> , other than in the form of a <i>direct offer financial promotion</i> , given to a <i>customer</i> by an <i>independent intermediary</i> in relation to <i>packaged products</i> .

<i>independent intermediary</i>	a <i>firm</i> acting as an intermediary, but excluding: <ul style="list-style-type: none"> (a) a <i>firm</i> which is a member of a <i>marketing group</i>; (b) a <i>product provider</i> which <i>sells</i> its own <i>packaged products</i>.
<i>individual member</i>	(in <i>LLD</i>) a <i>member</i> , or <i>former member</i> , who is a natural <i>person</i> .
<i>individual pension contract</i>	a <i>pension policy</i> or <i>pension contract</i> under which contributions are paid to: <ul style="list-style-type: none"> (a) a <i>personal pension scheme</i>; or (b) a retirement benefits scheme, approved under section 591(2)(g) of the Income and Corporation Taxes Act 1988, for the provision of relevant benefits by means of an annuity contract made with an insurance company of the employee's choice.
<i>individual savings account</i>	an account which is a scheme of investment satisfying the conditions prescribed in the <i>ISA Regulations</i> .
<i>industrial and provident society</i>	a society registered or deemed to be registered under the Industrial and Provident Societies Act 1965 or the Industrial and Provident Societies Act (Northern Ireland) 1969.
<i>industrial assurance policy</i>	a policy of industrial assurance, as defined in the Industrial Assurance Act 1923.
<i>industry block</i>	(in <i>DISP</i>) a grouping of <i>firms</i> by common business activity for the purposes of calculating the <i>general levy</i> .
<i>initial margin</i>	<ol style="list-style-type: none"> (1) (in <i>CIS</i>) cash or other property deposited in accordance with the rules of a <i>derivatives</i> market. (2) (in <i>COB</i>) the amount which under the rules of the relevant exchange or <i>clearing house</i> the <i>firm</i> or an <i>intermediate broker</i> would be required to deposit in cash as a fidelity deposit in respect of all the <i>client's</i> open positions in <i>marginated transactions</i> at that time, irrespective of any unrealised profit or loss on such positions, on the assumption that those transactions were the only transactions undertaken under the rules of that exchange or that <i>clearing house</i> by the <i>firm</i> or the <i>intermediate broker</i> at that time. (3) (in <i>LLD</i>) (in relation to a <i>derivative</i> contract or <i>quasi-derivative contract</i>) assets which, before or at the time the contract is entered into, are transferred subject to a condition that the assets (or where the assets transferred are <i>securities</i>, equivalent <i>securities</i>) will be returned on completion of that contract.
<i>initial offer</i>	(in <i>CIS</i>) an <i>offer</i> for sale of <i>units</i> in an <i>authorised fund</i> or in a <i>sub-fund</i> (otherwise than in accordance with arrangements of the type described in <i>CIS</i> 5.15.8R(3)(b)(iii) or (c) (Guarantees and indemnities)), where all or part of the consideration paid for the account of the <i>authorised fund</i> for the <i>units</i> is to be used to acquire the initial <i>scheme property</i> of the <i>authorised fund</i> or the initial <i>scheme property</i> attributable to the <i>sub-fund</i> .
<i>initial outlay</i>	(in relation to an <i>authorised fund</i>) the amount which the <i>authorised</i>

	<i>fund</i> is required to provide in order to obtain rights under a transaction in <i>derivatives</i> , excluding any payment or transfer on exercise of rights.
<i>initial price</i>	(in <i>CIS</i>): <ul style="list-style-type: none"> (a) (in relation to a <i>share</i> of an <i>ICVC</i> or a <i>unit</i> in a <i>single-priced AUT</i>) the <i>price</i> to be paid for a <i>unit</i> of any <i>class</i> during the period of the <i>initial offer</i> under <i>CIS</i> 4.2.4R(1) (Issue of units: initial offer); (b) (in relation to a <i>unit</i> in a <i>dual-priced AUT</i>) such amount as may be agreed by the <i>trustee</i> and <i>manager</i> as being the maximum amount, inclusive of the <i>manager's preliminary charge</i>, if any, which may be paid to the <i>manager</i> for <i>units</i> on an <i>initial offer</i>.
<i>injunction</i>	a court order made by the High Court that prohibits a <i>person</i> from doing or continuing to do a certain act or requires a <i>person</i> to carry out a certain act.
<i>insider dealing</i>	the activity described in section 52 of the Criminal Justice Act 1993, which is in summary: <ul style="list-style-type: none"> (a) the offence of which an individual is guilty if he has information as an insider and: <ul style="list-style-type: none"> (i) in the circumstances described in (b), he deals in securities that are price-affected securities in relation to the information; (ii) (A) he encourages another <i>person</i> to deal in securities that are (whether or not that other knows it) price-affected securities in relation to the information, knowing or having reasonable cause to believe that the dealing would take place in the circumstances mentioned in (b); or <ul style="list-style-type: none"> (B) he discloses the information, otherwise than in the proper performance of the functions of his employment, office or profession, to another <i>person</i>; (b) the circumstances referred to in (a) are that the acquisition or disposal in question occurs on a regulated market (identified in an Order made by the Treasury), or that the <i>person</i> dealing relies on a professional intermediary or is himself acting as a professional intermediary.
<i>insolvency order</i>	an administration order, compulsory winding up order, bankruptcy order, or sequestration order.
<i>insolvent</i>	(in <i>ML</i>) insolvent under regulation 13 of the <i>Money Laundering Regulations</i> .
<i>instrument constituting the scheme</i>	<ul style="list-style-type: none"> (a) (in relation to an <i>ICVC</i>) the <i>instrument of incorporation</i>; (b) (in relation to an <i>AUT</i>) the <i>trust deed</i>; (c) (in relation to a <i>collective investment scheme</i> other than an <i>authorised fund</i>) any instrument to which the <i>operator</i> is a party

	setting out any arrangements with any other <i>person</i> relating to any aspect of the operation or management of the <i>scheme</i> .
<i>instrument of incorporation</i>	the instrument of incorporation of an <i>ICVC</i> (as from time to time amended) initially provided to the <i>FSA</i> in accordance with regulation 14(1)(c) of the <i>OEIC regulations</i> .
<i>insurance accounts rules</i>	Schedule 9A to the Companies Act 1985 (Form and content of accounts of insurance companies) and Schedule 9A to the Companies Act (Northern Ireland) Order 1986.
<i>insurance business</i>	the business of <i>effecting or carrying out contracts of insurance</i> .
<i>insurance component</i>	a <i>qualifying investment</i> prescribed in regulation 9 of the <i>ISA Regulations</i> .
<i>Insurance Directives</i>	the <i>First Life Directive</i> , <i>Second Life Directive</i> and <i>Third Life Directive</i> and the <i>First Non-Life Directive</i> , <i>Second Non-Life Directive</i> and <i>Third Non-Life Directive</i> .
<i>insurance market direction</i>	a direction made by the <i>FSA</i> under section 316(1) of the <i>Act</i> (Direction by Authority).
<i>insurance undertaking</i>	an undertaking, whether or not an <i>insurer</i> , which carries on <i>insurance business</i> .
<i>insurer</i>	a <i>firm</i> with <i>permission</i> to <i>effect or carry out contracts of insurance</i> (other than a <i>bank</i>).
<i>inter-professional business</i>	<p>the business of a <i>firm</i>:</p> <p>(a) when it carries on:</p> <p>(i) <i>regulated activities</i>; or</p> <p>(ii) related <i>ancillary activities</i>;</p> <p>to the extent that the <i>regulated activity</i> that the <i>firm</i> is carrying on is:</p> <p>(A) <i>dealing in investments as principal</i>; or</p> <p>(B) <i>dealing in investments as agent</i>; or</p> <p>(C) acting as an <i>arranger</i>; or</p> <p>(D) giving <i>transaction-specific advice</i> or agreeing to do so;</p> <p>but only if that activity is:</p> <p>(I) in or in respect of an <i>inter-professional investment</i>;</p> <p>(II) undertaken with or for a <i>market counterparty</i>; and</p> <p>(III) carried on from an establishment maintained by the <i>firm</i> in the <i>United Kingdom</i>;</p> <p>(b) but excluding the carrying on of the following activities:</p> <p>(i) the <i>approval</i> by a <i>firm</i> of a <i>financial promotion</i>;</p> <p>(ii) activities carried on between <i>operators</i>, or between</p>

	<p><i>operators and depositaries, of the same collective investment scheme (when acting in that capacity);</i></p> <p>(iii) <i>corporate finance business;</i></p> <p>(iv) <i>safeguarding and administering investments and agreeing to carry on that regulated activity.</i></p>
<i>inter-professional investment</i>	<p>any of the following <i>investments</i> specified in Part III of the <i>Regulated Activities Order</i> (Specified investments):</p> <p>(a) <i>share</i> (article 76);</p> <p>(b) <i>debenture</i> (article 77);</p> <p>(c) <i>government and public security</i> (article 78);</p> <p>(d) <i>warrant</i> (article 79);</p> <p>(e) <i>certificate representing certain securities</i> (article 80);</p> <p>(f) <i>option</i> (article 83); for the purposes of the <i>permission</i> regime, this is sub-divided into:</p> <p>(i) <i>option</i> (excluding a <i>commodity option</i> and an <i>option</i> on a <i>commodity future</i>);</p> <p>(ii) <i>commodity option</i> and <i>option</i> on a <i>commodity future</i>;</p> <p>(g) <i>future</i> (article 84); for the purposes of the <i>permission</i> regime, this is sub-divided into:</p> <p>(i) <i>future</i> (excluding a <i>commodity future</i> and a <i>rolling spot forex contract</i>);</p> <p>(ii) <i>commodity future</i>;</p> <p>(iii) <i>rolling spot forex contract</i>;</p> <p>(h) <i>contract for differences</i> (article 85); for the purposes of the <i>permission</i> regime, this is sub-divided into:</p> <p>(i) <i>contract for differences</i> (excluding a <i>spread bet</i> and a <i>rolling spot forex contract</i>);</p> <p>(ii) <i>spread bet</i>;</p> <p>(iii) <i>rolling spot forex contract</i>;</p> <p>(i) <i>rights to or interests in investments</i> in (a) to (h) (article 89).</p>
<i>inter-syndicate reinsurance</i>	<p>reinsurance between one <i>syndicate year</i> and another, not being <i>reinsurance to close</i>.</p>
<i>interdict</i>	<p>a Scottish court order made by the Court of Session that prohibits a <i>person</i> from doing or continuing to do a certain act or requires a <i>person</i> to carry out a certain act.</p>
<i>interested party</i>	<p>(in relation to an application made under section 60 of the <i>Act</i> (Applications for approval)):</p> <p>(a) the <i>firm</i> making the application;</p> <p>(b) the <i>person</i> in respect of whom the application is being made</p>

	("A"); and
	(c) the <i>person</i> by whom A's services are to be retained, if not the <i>firm</i> making the application.
<i>interim accounting period</i>	(in <i>CIS</i>) a period within an <i>annual accounting period</i> in respect of which an allocation of income is to be made.
<i>interim income allocation date</i>	any date specified in the <i>prospectus</i> of an <i>authorised fund</i> as the date on or before which an allocation of income will be made.
<i>intermediaries offer</i>	(for the purposes of the <i>Code of Market Conduct (MAR 1)</i>) a marketing of <i>securities</i> not yet in issue, by means of an <i>offer</i> by, or on behalf of, the <i>issuer</i> to intermediaries for them to allocate to their own clients.
<i>intermediary</i>	(in <i>LLD</i>) a <i>person</i> who in the course of any business or profession invites other <i>persons</i> to make offers or proposals or to take other steps with a view to entering into <i>contracts of insurance</i> , but not a <i>person</i> who publishes such invitations only on behalf of, or to the order of, some other <i>person</i> .
<i>intermediate broker</i>	(in relation to a transaction in a <i>contingent liability investment</i>) any <i>person</i> acting in the capacity of an intermediary through whom the <i>firm</i> undertakes that transaction.
<i>intermediate customer</i>	(1) (except in <i>COB 3</i>) a <i>client</i> who is not a <i>market counterparty</i> and who is: <ul style="list-style-type: none"> (a) a local authority or public authority; (b) a <i>body corporate</i> whose <i>shares</i> have been <i>listed</i> or <i>admitted to trading</i> on any <i>EEA</i> exchange; (c) a <i>body corporate</i> whose <i>shares</i> have been <i>listed</i> or <i>admitted to trading</i> on the primary board of any <i>IOSCO</i> member country official exchange; (d) a <i>body corporate</i> (including a <i>limited liability partnership</i>) which has (or any of whose <i>holding companies</i> or <i>subsidiaries</i> has) (or has had at any time during the previous two years) called up share capital or net assets of at least £5 million (or its equivalent in any other currency at the relevant time); (e) a <i>special purpose vehicle</i>; (f) a <i>partnership</i> or unincorporated association which has (or has had at any time during the previous two years) net assets of at least £5 million (or its equivalent in any other currency at the relevant time) and calculated in the case of a <i>limited partnership</i> without deducting loans owing to any of the <i>partners</i>; (g) a trustee of a trust (other than an <i>occupational pension scheme</i>, <i>SSAS</i> or <i>stakeholder pension scheme</i>) which has (or has had at any time during the previous two years) assets of at least £10 million (or its equivalent in any

other currency at the relevant time) calculated by aggregating the value of the cash and *designated investments* forming part of the trust's assets, but before deducting its liabilities;

- (h) a trustee of an *occupational pension scheme*, *SSAS* or *stakeholder pension scheme* where the trust has (or has had at any time during the previous two years):
 - (i) at least 50 members; and
 - (ii) assets under management of at least £10 million (or its equivalent in any other currency at the relevant time);
- (i) another *firm*, or an *overseas financial services institution*, when, in relation to *designated investment business*, or related *ancillary activities*, conducted with or for that *firm* or institution, that *firm* or institution is an *intermediate customer* in accordance with *COB 4.1.7R* (Classification of another firm or an overseas financial services institution);
- (j) an *unregulated collective investment scheme*;
- (k) a *client* when he is classified as an *intermediate customer* in accordance with *COB 4.1.9R* (Expert private customer classified as intermediate customer);

but excluding:

- (i) a *regulated collective investment scheme*; and
 - (ii) a *client* who would otherwise be an *intermediate customer*, when he is classified in accordance with:
 - (A) *COB 4.1.12R* (Large intermediate customer classified as market counterparty); or
 - (B) (except for the purposes of *DISP*) *COB 4.1.14R* (Client classified as private customer).
- (2) (in *COB 3*) a *person* in (1) or a *person* who would be such a *person* if he were a *client*.

internal audit function

controlled function CF15 in the *table of controlled functions*, described more fully in *SUP 10.8.6R*.

internal controls

the whole system of controls, financial or otherwise, established by the management of a *firm* in order to:

- (a) carry on the business of the *firm* in an orderly and efficient manner;
- (b) ensure adherence to management policies;
- (c) safeguard the assets of the *firm* and other assets for which the *firm* is responsible; and
- (d) secure as far as possible the completeness and accuracy of the

	<i>firm's</i> records (including those necessary to ensure continuous compliance with the requirements or standards under the <i>regulatory system</i> relating to the adequacy of the <i>firm's</i> financial resources).
<i>introducer</i>	an individual appointed by a <i>provider firm</i> or by an <i>appointed representative</i> of such a <i>firm</i> , to carry out in the course of <i>designated investment business</i> either or both of the following activities: <ul style="list-style-type: none"> (a) effecting introductions; (b) distributing <i>non-real time financial promotions</i>.
<i>introducer appointed representative</i>	an <i>appointed representative</i> appointed by a <i>provider firm</i> whose scope of appointment is limited to: <ul style="list-style-type: none"> (a) effecting introductions; and (b) distributing <i>non-real time financial promotions</i>.
<i>introducing broker</i>	a <i>firm</i> which introduces transactions relating to <i>designated investments arranged (brought about)</i> for its <i>clients</i> to a <i>clearing firm</i> .
<i>introductory period</i>	(in <i>MAR 2</i> (Price stabilising rules)) (in relation to <i>stabilising action</i>) the period starting at the time of the first <i>public announcement</i> from which it could reasonably be deduced that the <i>offer</i> was intended to take place in some form and at some time, and ending with the beginning of the <i>stabilising period</i> .
<i>investment</i>	(in accordance with sections 22(4) (The classes of activity and categories of investments) and 397(13) (Miscellaneous offences) of the <i>Act</i>) any investment, including any asset, right or interest.
<i>investment adviser</i>	(in relation to an <i>authorised fund</i>) a <i>person</i> who is retained by an <i>ICVC</i> , its <i>directors</i> or its <i>ACD</i> or by a <i>manager</i> of an <i>AUT</i> under a commercial arrangement which is not a contract of service: <ul style="list-style-type: none"> (a) to supply any of them with advice in relation to the <i>authorised fund</i> as to the merits of investment opportunities or information relevant to the making of judgments about the merits of investment opportunities; or (b) to exercise for any of them any function concerning the management of the <i>scheme property</i>.
<i>investment adviser (trainee) function</i>	<i>controlled function</i> CF22 in the <i>table of controlled functions</i> , described more fully in <i>SUP 10.10.11R</i> .
<i>investment adviser function</i>	<i>controlled function</i> CF21 in the <i>table of controlled functions</i> , described more fully in <i>SUP 10.10.7R</i> .
<i>investment agreement</i>	any agreement the making or performance of which by either party constitutes a <i>regulated activity</i> , but disregarding the exclusions in Part II of the <i>Regulated Activities Order</i> .
<i>investment company with variable capital</i>	a body incorporated under the <i>OEIC Regulations</i> .
<i>investment firm</i>	any legal person the regular occupation or business of which is the

provision of *core investment services* for third parties on a professional basis, as defined in article 1(2) of the *ISD*, and (in relation to a person with his or its head office in an *EEA State*) a *person*, who is not a legal person, included as an *investment firm* by his or its *Home State*.

(see also *ISD investment firm*.)

*investment
management firm*

a *firm* whose *permitted activities* include *designated investment business*, which is not an *authorised professional firm*, *bank*, *building society*, *credit union*, *friendly society*, *ICVC*, *insurer*, *media firm*, *service company*, *incoming EEA firm* (without a *top-up permission*), *incoming Treaty firm* (without a *top-up permission*) or *UCITS qualifier* (without a *top-up permission*), whose *permission* does not include a *requirement* that it comply with *IPRU(INV) 3* or *10* (Securities and futures firms) or *13* (Personal investment firms) and which is within (a), (b) or (c):

- (a) a *firm*:
 - (i) which was a member of *IMRO* immediately before *commencement*; and
 - (ii) which was not, immediately before *commencement*, subject to the financial supervision requirements of the *FSA* (under section 43 of the Financial Services Act 1986), or *PIA* or *SFA* (under lead regulation arrangements);
- (b) a *firm* whose *permission* includes a *requirement* that it comply with *IPRU(INV) 5* (Investment management firms);
- (c) a *firm*:
 - (i) which was given a *Part IV permission* on or after *commencement*, or which was authorised under section 25 of the Financial Services Act 1986 immediately before *commencement* and was not a member of *IMRO*, *PIA* or the *SFA*; and
 - (ii) for which the most substantial part of its gross income, including *commissions*, from the *regulated activities* included in its *Part IV permission* is derived from one or more of the following activities (based, for a *firm* given a *Part IV permission* after *commencement*, on the business plan submitted as part of the *firm's* application for *permission* or, for a *firm* authorised under section 25 of the Financial Services Act 1986, on the *firm's* financial year preceding its *authorisation* under the *Act*):
 - (A) *managing investments* other than for *private customers* or where the assets managed are primarily *derivatives*;
 - (B) *OPS activity*;
 - (C) acting as the *manager* or *trustee* of an *AUT*;

- (D) acting as the *ACD* or *depository* of an *ICVC*;
- (E) *establishing, operating or winding up a collective investment scheme* (other than an *AUT* or *ICVC*);
- (F) *safeguarding and administering investments*.

investment management function controlled function CF27 in the table of controlled functions, described more fully in SUP 10.10.20R.

investment manager a person who, acting only on behalf of a *client*:

- (a) manages *designated investments* in an account or portfolio on a discretionary basis under the terms of a discretionary management agreement; or
- (b) manages *designated investments* in an account or portfolio on a non-discretionary basis under the terms of a *non-discretionary management agreement*.

investment professional (in accordance with article 19(5) of the *Financial Promotion Order*) (in relation to a *financial promotion*):

- (a) an *authorised person*;
- (b) an *exempt person* when the *financial promotion* relates to a *controlled activity* which is a *regulated activity* in relation to which the *person* is exempt;
- (c) any other *person*:
 - (i) whose ordinary activities involve him in carrying on the *controlled activity* to which the *financial promotion* relates for the purposes of a business carried on by him; or
 - (ii) who it is reasonable to expect will carry on that activity for the purposes of a business carried on by him;
- (d) a government, a local authority (whether in the *United Kingdom* or elsewhere) or an international organisation;
- (e) a *person* ("A") who is a *director, officer* or employee of a *person* ("B") falling within any of (a) to (d) where the *financial promotion* is made to A in that capacity and where A's responsibilities when acting in that capacity involve him in the carrying on by B of *controlled activities*.

investment service a *core investment service* or *non-core investment service*.

Investment Services Directive the Council Directive of 10 May 1993 on investment services in the securities field (No 93/22/EEC).

investment transaction a transaction to *buy, sell, subscribe for or underwrite a security* or *contractually based investment*.

investment trust a *company listed* in the *United Kingdom* or another *EEA State* which:

- (a) is approved by the Inland Revenue Commissioners under section 842 of the Income and Corporation Taxes Act 1988 (or, in the

	case of a newly formed <i>company</i> , has declared its intention to conduct its affairs so as to obtain such approval); or
	(b) is resident in an <i>EEA State</i> other than the <i>United Kingdom</i> and would qualify for such approval if resident and <i>listed</i> in the <i>United Kingdom</i> .
<i>investment trust savings scheme</i>	(a) a <i>dealing service</i> (whether or not held within a <i>pension contract</i>) dedicated to the <i>securities</i> of a particular <i>investment trust</i> , or of <i>investment trusts</i> within a particular <i>marketing group</i> ;
	(b) <i>securities</i> to be acquired through an investment trust savings scheme in (a).
<i>Investor Compensation Directive</i>	the Council Directive of 3 March 1997 on investor compensation schemes (No 97/9/EC).
<i>IOSCO</i>	the International Organisation of Securities Commissions.
<i>IPRU</i>	the Interim Prudential sourcebook, comprising <i>IPRU(BANK)</i> , <i>IPRU(BSOC)</i> , <i>IPRU(FSOC)</i> , <i>IPRU(INS)</i> and <i>IPRU(INV)</i> , or according to the context one of these Interim Prudential sourcebooks.
<i>IPRU(BANK)</i>	the Interim Prudential sourcebook for banks.
<i>IPRU(BSOC)</i>	the Interim Prudential sourcebook for building societies.
<i>IPRU(FSOC)</i>	the Interim Prudential sourcebook for friendly societies.
<i>IPRU(INS)</i>	the Interim Prudential sourcebook for insurers.
<i>IPRU(INV)</i>	the Interim Prudential sourcebook for investment businesses.
<i>ISA</i>	an <i>individual savings account</i> .
<i>ISA manager</i>	a <i>person</i> who is approved by the Inland Revenue for the purposes of the <i>ISA Regulations</i> as an account manager.
<i>ISA Regulations</i>	the Individual Savings Account Regulations 1998 (SI 1998/1870).
<i>ISA transfer</i>	a transaction resulting from a decision, made with or without advice from a <i>firm</i> , by a <i>customer</i> who is an individual, to transfer the <i>investments</i> (or their value) held in his existing <i>ISA</i> in favour of another <i>ISA</i> which may or may not be managed by the same <i>ISA manager</i> .
<i>ISD</i>	<i>Investment Services Directive</i> .
<i>ISD investment firm</i>	an <i>investment firm</i> that has its registered office (or, if it has no registered office, its head office) in an <i>EEA State</i> :
	(a) excluding a <i>person</i> to whom the <i>ISD</i> does not apply under article 2(2) of the <i>ISD</i> ; but
	(b) including a <i>BCD credit institution</i> whose <i>Home State authorisation</i> includes a <i>core investment service</i> .
<i>issue</i>	(in relation to <i>units</i>)
	(1) (except in <i>ENF</i>) the issue of new <i>units</i> by the <i>trustee</i> of an <i>AUT</i>

	or by an <i>ICVC</i> ;
	(2) (in <i>ENF</i>)
	(a) an issue in accordance with (1); and
	(b) the sale of <i>units</i> .
<i>issue price</i>	(in relation to the <i>issue</i> of <i>units</i> of a <i>dual-priced AUT</i>) the price for each <i>unit</i> payable by the <i>manager</i> to the <i>trustee</i> on that <i>issue</i> .
<i>issuer</i>	(except in <i>CIS</i>)
	(1) (in relation to any <i>security</i>) (other than a <i>unit</i> in a <i>collective investment scheme</i>) the <i>person</i> by whom it is or is to be issued;
	(2) (in relation to a <i>unit</i> in a <i>collective investment scheme</i>) the <i>operator</i> of the <i>scheme</i> ;
	(3) (in relation to an interest in a limited <i>partnership</i>) the <i>partnership</i> ;
	(4) (in relation to <i>certificates representing certain securities</i>) the <i>person</i> who issued or is to issue the <i>security</i> to which the certificate or other instrument relates.
<i>joint enterprise</i>	(as defined in article 3(1) of the <i>Regulated Activities Order</i> (Interpretation)) an enterprise into which two or more <i>persons</i> ("the participators") enter for commercial purposes related to a business or businesses (other than the business of engaging in a <i>regulated activity</i>) carried on by them; where a participator is a member of a <i>group</i> , each other member of the <i>group</i> is also to be regarded as a participator in the enterprise.
<i>key features</i>	information about a <i>life policy</i> , <i>scheme</i> or <i>stakeholder pension scheme</i> which is required to be produced in the format specified in <i>COB 6.1</i> (Packaged products and ISA disclosure) to <i>COB 6.5</i> (Content of key features and important information: life policies, schemes, cash deposit ISAs and stakeholder pension schemes).
<i>key individual</i>	(in relation to a <i>UK recognised body</i>):
	(a) its chairman or president;
	(b) its <i>chief executive</i> ;
	(c) a member of its <i>governing body</i> ;
	(d) a <i>person</i> who, alone or jointly with one or more others, is responsible under the immediate authority of a <i>person</i> in (a), (b) or (c) or a committee of the <i>governing body</i> for the conduct of any <i>relevant function</i> .
<i>kind of control</i>	(in relation to a <i>firm</i>) (in accordance with section 179(4) of the <i>Act</i> (Acquiring control)):
	(a) <i>control</i> arising as a result of holding shares in the <i>firm</i> ;
	(b) <i>control</i> arising as a result of holding shares in a <i>parent undertaking</i> of the <i>firm</i> ;

	(c) <i>control</i> arising as a result of the entitlement to exercise or control the exercise of <i>voting power</i> in the <i>firm</i> ;
	(d) <i>control</i> arising as a result of the entitlement to exercise or <i>control</i> the exercise of <i>voting power</i> in a <i>parent undertaking</i> of the <i>firm</i> ;
	in this definition, "shares" has the meaning given in the definition of " <i>controller</i> ".
<i>know your business information</i>	(in <i>ML</i>) information which a <i>relevant firm</i> has about: <ul style="list-style-type: none"> (a) the financial circumstances of a <i>client</i> or any <i>person</i> on whose behalf the <i>client</i> has been acting or is acting; and (b) the features of the <i>transactions</i> which the <i>relevant firm</i> has entered into with or for the <i>client</i> (or that <i>person</i>).
<i>land vehicles</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph 3 of Part I of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of general insurance), against loss of or damage to vehicles used on land, including motor vehicles but excluding railway rolling stock.
<i>large company</i>	a <i>body corporate</i> which does not qualify as a small company under section 247 of the Companies Act 1985.
<i>large deal</i>	(in <i>CIS</i>) a <i>transaction</i> (or <i>series of transactions</i> in one <i>dealing period</i>) by any <i>person</i> to <i>buy, sell</i> or exchange <i>units</i> in an <i>authorised fund</i> at a total value of £15,000 or its equivalent in the <i>base currency</i> of the <i>authorised fund</i> , or: <ul style="list-style-type: none"> (a) for the purpose of <i>SDRT provision</i>, such other value; or (b) for all or any other specified purposes, such greater value; as may be specified in the <i>prospectus</i> .
<i>large mutual association</i>	a mutual association or unincorporated association with net assets of more than £1.4 million (or its equivalent in any other currency at the relevant time).
<i>large partnership</i>	a <i>partnership</i> or unincorporated association with net assets of more than £1.4 million (or its equivalent in any other currency at the relevant time).
<i>larger denomination share</i>	any <i>share</i> that is not a <i>smaller denomination share</i> .
<i>lead regulated firm</i>	a <i>firm</i> which is the subject of the financial supervision requirements of an <i>overseas regulator</i> in accordance with an agreement between the <i>FSA</i> and that regulator relating to the financial supervision of <i>firms</i> whose head office is within the country of that regulator.
<i>leading insurer</i>	(in relation to a <i>community co-insurance operation</i>) has the same meaning as in the <i>Community Co-Insurance Directive</i> .
<i>legal expenses</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph 17 of Part I of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of general insurance), against

	risks of loss to the <i>persons</i> insured attributable to their incurring legal expenses (including costs of litigation).
<i>liability of ships</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph 12 of Part I of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of general insurance), against damage arising out of or in connection with the use of vessels on the sea or on inland water, including third party risks and carrier's liability.
<i>liability subject to compulsory insurance</i>	any liability required under any of the following enactments to be covered by insurance or (as the case may be) by insurance or by some other provisions for securing its discharge: <ul style="list-style-type: none"> (a) section 1(4A)(d) of the Riding Establishments Act 1964 (or any corresponding enactment for the time being in force in Northern Ireland); (b) section 1 of the Employers' Liability (Compulsory Insurance) Act 1969 or Article 5 of the Employers' Liability Order (Defective Equipment and Compulsory Insurance) (Northern Ireland) Order 1972; (c) Part VI of the Road Traffic Act 1988 or Part VIII of the Road Traffic (Northern Ireland) Order 1981.
<i>liability to a policyholder</i>	(in relation to a <i>firm carrying out contracts of insurance</i>) any liability or obligation of that <i>firm</i> to, or in respect of, a <i>policyholder</i> , including any liability or obligation arising: <ul style="list-style-type: none"> (a) from the requirement to treat <i>customers</i> fairly under <i>Principle 6</i>, including with respect to <i>policyholders'</i> reasonable expectations; or (b) from a determination of liability by an <i>Ombudsman</i>; or (c) from any requirement to pay compensation under the <i>regulatory system</i>.
<i>life and annuity</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph I of Part II of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of long-term insurance), on human life or a contract to pay annuities on human life, but excluding (in each case) contracts within paragraph III of Part II of that Schedule (Linked long-term).
<i>life policy</i>	(in accordance with the definition of "qualifying contract of insurance" in article 3(1) of the <i>Regulated Activities Order</i>) a <i>long-term insurance contract</i> (which includes a <i>pension policy</i>) other than a reinsurance contract and a <i>pure protection contract</i> .
<i>LIFFE</i>	the London International Financial Futures and Options Exchange.
<i>limitation</i>	a limitation incorporated in a <i>Part IV permission</i> under section 42(7)(a) of the <i>Act</i> (Giving permission) or section 45(4) of the <i>Act</i> (Variation etc on the Authority's own initiative).
<i>limited liability</i>	(a) a <i>body corporate</i> incorporated under the Limited Liability

<i>partnership</i>	Partnerships Act 2000; (b) a <i>body corporate</i> incorporated under legislation having the equivalent effect to the Limited Liability Partnerships Act 2000.
<i>linked benefit</i>	a benefit payable under a <i>life policy</i> or a <i>regulated collective investment scheme</i> the amount of which is determined by reference to: (a) the value of the property of any description (whether specified or not); or (b) fluctuations in the value of any such property; or (c) income from such property; or (d) fluctuations in an index of the value of such property.
<i>linked long-term</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph III of Part II of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of long-term insurance), on human life or contracts to pay annuities on human life where the benefits are wholly or partly to be determined by reference to the value of, or the income from, property of any description (whether or not specified in the contracts) or by reference to fluctuations in, or in an index of, the value of property of any description (whether or not so specified).
<i>listed</i>	(1) (except in <i>LLD</i>) included in an <i>official list</i> . (2) (in <i>LLD</i>) (a) included in an <i>official list</i> ; or (b) in respect of which facilities for <i>dealing</i> on a <i>regulated market</i> have been granted.
<i>listed activity</i>	an activity listed in Annex 1 to the <i>Banking Consolidation Directive</i> .
<i>listed security</i>	any <i>security</i> that is admitted to an <i>official list</i> .
<i>listing rules</i>	the <i>rules</i> made by <i>UKLA</i> governing admission to <i>listing</i> , the continuing obligations of <i>issuers</i> , the enforcement of those obligations and the suspension and cancellation of <i>listing</i> .
<i>LLD</i>	the Lloyd's sourcebook.
<i>Lloyd's actuary</i>	the <i>actuary</i> appointed by the <i>Society</i> under <i>LLD</i> 10.9.1R.
<i>Lloyd's Arbitration Scheme</i>	the Lloyd's Arbitration Scheme (Members and Underwriting Agents Arbitration Scheme) established under Lloyd's Arbitration Scheme (Members and Underwriting Agents Scheme) Byelaw (No 15 of 1992).
<i>Lloyd's Members' Ombudsman</i>	the office of Ombudsman established under Lloyd's Members' Ombudsman Scheme Byelaw (No 13 of 1987).
<i>Lloyd's policy</i>	a <i>contract of insurance</i> written at Lloyd's.
<i>Lloyd's Return</i>	the financial report that the <i>Society</i> is required to submit to the <i>FSA</i> under <i>LLD</i> 15.2.1R.

<i>local</i>	<p>a <i>firm</i> which is a member of a <i>futures</i> and <i>options</i> exchange and whose <i>permission</i> includes a <i>requirement</i> that:</p> <p>(a) the <i>firm</i> will not conduct <i>designated investment business</i> other than:</p> <p style="margin-left: 2em;">(i) <i>dealing</i> for its own account on that <i>futures</i> or <i>options</i> exchange; or</p> <p style="margin-left: 2em;">(ii) <i>dealing</i> for the accounts of other members of the same <i>futures</i> and <i>options</i> exchange; or</p> <p style="margin-left: 2em;">(iii) making a price to other members of the same <i>futures</i> and <i>options</i> exchange; and</p> <p>(b) the performance of the <i>firm's</i> contracts must be guaranteed by and must be the responsibility of one or more of the clearing members of the same <i>futures</i> and <i>options</i> exchange.</p>
<i>long-term insurance business</i>	the business of <i>effecting</i> or <i>carrying out long-term insurance contracts</i> .
<i>long-term insurance business assets</i>	<p>assets of a <i>member</i> that are:</p> <p>(a) in a <i>premium trust fund</i> for <i>long-term insurance business</i>; or</p> <p>(b) <i>funds at Lloyd's</i> that are, for the time being, identified as available to meet <i>long-term insurance business liabilities</i> of the <i>member</i>.</p>
<i>long-term insurance business liabilities</i>	liabilities of a <i>member</i> that are attributable to his <i>long-term insurance business</i> .
<i>long-term insurance business syndicate</i>	a <i>syndicate</i> in which <i>members</i> carry on <i>long-term insurance business</i> .
<i>long-term insurance contract</i>	<p>(in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation: general)) any <i>contract of insurance</i> within Part II of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of long-term insurance), namely:</p> <p>(a) <i>life and annuity</i> (paragraph I);</p> <p>(b) <i>marriage and birth</i> (paragraph II);</p> <p>(c) <i>linked long-term</i> (paragraph III);</p> <p>(d) <i>permanent health</i> (paragraph IV);</p> <p>(e) <i>tontines</i> (paragraph V);</p> <p>(f) <i>capital redemption</i> (paragraph VI);</p> <p>(g) <i>pension fund management</i> (paragraph VII);</p> <p>(g) <i>collective insurance</i> etc (paragraph VIII);</p> <p>(h) <i>social insurance</i> (paragraph IX).</p>
<i>long-term insurer</i>	an <i>insurer</i> with <i>permission</i> to <i>effect</i> or <i>carry out long-term insurance</i>

	<i>contracts.</i>
<i>lower required amount</i>	the lower required amount as defined in <i>LLD</i> 11.2.13R or <i>LLD</i> 11.2.14R.
<i>making arrangements with a view to transactions in investments</i>	<p>the <i>regulated activity</i>, specified in article 25(2) of the <i>Regulated Activities Order</i> (Arranging deals in investments), which is in summary: making arrangements with a view to a <i>person</i> who participates in the arrangements <i>buying, selling</i>, subscribing for or underwriting any of the following <i>investments</i> (whether as <i>principal</i> or agent):</p> <ul style="list-style-type: none"> (a) a <i>designated investment</i>; (b) the <i>underwriting capacity of a Lloyd's syndicate</i>; (c) <i>membership of a Lloyd's syndicate</i>; (d) <i>rights to or interests in investments</i> in (b) or (c).
<i>management accounts</i>	(in relation to a <i>UK recognised body</i>) accounts showing the actual and budgeted income and expenditure of that body over any period.
<i>manager</i>	<ul style="list-style-type: none"> (1) (in relation to an <i>AUT</i>) the <i>firm</i> which is the manager of the <i>AUT</i> in accordance with the <i>trust deed</i>. (2) (as defined in section 423(1) and (2) of the <i>Act</i> (Manager)) (except in relation to a <i>unit trust scheme</i> or a <i>registered friendly society</i>): <ul style="list-style-type: none"> (a) an employee who: <ul style="list-style-type: none"> (i) under the immediate authority of his employer, is responsible, either alone or jointly with one or more other individuals, for the conduct of his employer's business; or (ii) under the immediate authority of his employer or of a <i>person</i> who is a manager in accordance with (i) exercises managerial functions or is responsible for maintaining accounts or other records of his employer; (b) if the employer is not an individual, references in (a) to the authority of the employer are references to the authority: <ul style="list-style-type: none"> (i) in the case of a <i>body corporate</i>, of the directors; (ii) in the case of a <i>partnership</i>, of the partners; and (iii) in the case of an unincorporated association, of its officers or the members of its governing body. (3) (as defined in section 423(3) of the <i>Act</i> (Manager)) (in relation to a <i>body corporate</i>): <ul style="list-style-type: none"> (a) a <i>person</i> (other than an employee of the body) who is appointed by the body to manage any part of its business, including an employee of the <i>body corporate</i> (other than

	<p>the <i>chief executive</i>) who under the immediate authority of a director or <i>chief executive</i> of the <i>body corporate</i> exercises managerial functions or is responsible for maintaining accounts or other records of the <i>body corporate</i>;</p> <p>(b) for the purposes of (a) and in relation to a <i>body corporate</i> whose principal place of business is within the <i>United Kingdom</i>, the <i>chief executive</i> includes only a <i>person</i> who is an employee of the <i>body corporate</i> in accordance with section 417(1) of the <i>Act</i> (Definitions).</p>
<i>managing agent</i>	<p>(as defined in article 3(1) of the <i>Regulated Activities Order</i>) a <i>person</i> who is permitted by the <i>Council</i> in the conduct of his business as an <i>underwriting agent</i> to perform for a <i>member</i> one or more of the following functions:</p> <p>(a) underwriting <i>contracts of insurance</i> at Lloyd's;</p> <p>(b) reinsuring such contracts in whole or in part;</p> <p>(c) paying claims on such contracts.</p>
<i>managing investments</i>	<p>the <i>regulated activity</i>, specified in article 37 of the <i>Regulated Activities Order</i> (Managing investments), which is in summary: managing assets belonging to another <i>person</i> in circumstances which involve the exercise of discretion, if:</p> <p>(a) the assets consist of or include any <i>designated investment</i>; or</p> <p>(b) the arrangements for their management are such that the assets may consist of or include such <i>investments</i>, and either the assets have at any time since 29 April 1988 done so, or the arrangements have at any time (whether before or after that date) been held out as arrangements under which the assets would do so.</p>
<i>managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's</i>	<p>the <i>regulated activity</i>, specified in article 57 of the <i>Regulated Activities Order</i> (Managing the underwriting capacity of a Lloyd's syndicate), of managing the <i>underwriting capacity of a Lloyd's syndicate</i> as a <i>managing agent</i> at Lloyd's.</p>
<i>mandate rules</i>	COB 9.2.
<i>MAR</i>	the Market conduct sourcebook.
<i>margin</i>	<p>(in <i>CIS</i>) cash or other property paid, transferred or deposited under the terms of a <i>derivative</i>; for these purposes cash or property will be treated as having been paid, transferred or deposited if it must be paid, transferred or deposited in order to comply with a requirement imposed by the market on which the contract is made or traded.</p>
<i>margin of solvency</i>	<p>the excess of the value of an <i>insurer's</i> assets over the amount of its liabilities, that value and amount being determined in accordance with <i>IPRU(INS)</i> and <i>IPRU(FSOC)</i>.</p>

- margin* (in *CIS*) any contract in *derivatives*.
- margin* (1) (except in *COB 9.3*) a transaction *executed* by a *firm* with or for a *client* relating to a *future*, *option* or *contract for differences* (or any right to or any interest in such an *investment*) under the terms of which the *client* will or may be liable to provide cash or *collateral* to secure performance of obligations which he may have to perform when the transaction falls to be completed or upon the earlier *closing out* of his position.
- (2) (in *COB 9.3*):
- (a) a transaction within (1); or
- (b) an *option* purchased by a *client*, the terms of which provide that the maximum liability of the *client* in respect of the transaction will be limited to the amount payable as premium.
- mark-up or mark-down* (when a *firm* receives a *customer order* and takes a *principal* position in the relevant *investment* in order to fulfil that *customer order*) any difference between:
- (a) the price at which the *firm* takes a *principal* position in the relevant *investment*; and
- (b) the *price* at which the *firm* *executes* the transaction with its *customer*.
- market abuse* (in accordance with section 118 of the *Act* (Market abuse)) *behaviour* (whether by one *person* alone or by two or more *persons* jointly or in concert):
- (a) which occurs in relation to *qualifying investments* traded on a market to which section 118 of the *Act* applies (see *MAR 1* (Code of market conduct));
- (b) which satisfies any one or more of the conditions set out below: and
- (c) which is likely to be regarded by a *regular user* of that market who is aware of the *behaviour* as a failure on the part of the *person* or *persons* concerned to observe the standard of *behaviour* reasonably expected of a *person* in his or their position in relation to the *market*;
- the conditions are that:
- (i) the *behaviour* is based on information which is not generally available to those using the market but which, if available to a *regular user* of the market, would or would be likely to be regarded by him as relevant when deciding the terms on which transactions in *investments* of the kind in question should be effected;
- (ii) the *behaviour* is likely to give a *regular user* of the market a false or misleading impression as to the supply of, or demand for, or as to the price or value of, *investments* of the kind in question;

- (iii) a *regular user* of the market would, or would be likely to, regard the *behaviour* as *behaviour* which would, or would be likely to, distort the market in *investments* of the kind in question.
- market abuse regime* the regime established under the provisions of Part VIII of the *Act* (Penalties for market abuse).
- market contract* a market contract as described in section 155 of the Companies Act 1989 or article 80 of the Companies (No2) (Northern Ireland) Order 1990 which is in summary:
- (a) a contract entered into by a *member* or *designated non-member* of an *RIE* which is either:
- (i) a contract made on the exchange or an exchange to whose undertaking the exchange has succeeded; or
- (ii) a contract in the making of which the *member* or *designated on-member* was subject to the rules of the exchange or of an exchange to whose undertaking the exchange has succeeded;
- (b) a contract entered into by an *RIE* or *RCH* with one of its *members* for the purpose of enabling the rights and liabilities of that *member* under transactions in *investments* to be settled.
- market counterparty* (1) (except in *COB 3*) a *client* who is:
- (a) a properly constituted government (including a quasi-governmental body or a government agency) of any country or territory;
- (b) a central bank or other national monetary authority of any country or territory;
- (c) a supranational whose members are either countries or central banks or national monetary authorities;
- (d) a State investment body, or a body charged with, or intervening in, the management of the public debt;
- (e) another *firm*, or an *overseas financial services institution*, except in relation to *designated investment business*, and related *ancillary activities*, conducted with or for that *firm* or institution, when that *firm* or institution is an *intermediate customer* in accordance with *COB 4.1.7R* (Classification of another firm or an overseas financial services institution);
- (f) any *associate* of a *firm* (except an *OPS firm*), or of an *overseas financial services institution*, if the *firm* or institution consents;
- (g) a *client* when he is classified as a *market counterparty* in accordance with *COB 4.1.12R* (Large intermediate customer classified as a market counterparty);
- but excluding:

	(A) a <i>collective investment scheme</i> ; and
	(B) (except for the purposes of <i>DISP</i>) a <i>client</i> , who would otherwise be a <i>market counterparty</i> , when he is classified as a <i>private customer</i> in accordance with <i>COB 4.1.14R</i> (Client classified as private customer).
	(2) (in <i>COB 3</i>) a <i>person</i> in (1) and a <i>person</i> who would be such a <i>person</i> if he were a <i>client</i> .
<i>market maker</i>	(in relation to an <i>investment</i>) a <i>person</i> who (otherwise than in his capacity as the <i>operator</i> of a <i>regulated collective investment scheme</i>) holds himself out as able and willing to enter into transactions of sale and purchase in <i>investments</i> of that description at prices determined by him generally and continuously rather than in respect of each particular transaction.
<i>market value</i>	the market value as determined in accordance with <i>United Kingdom</i> generally accepted accounting practice.
<i>marketable investment</i>	<p>(a) an <i>investment</i> which is traded on or under the rules of an exchange;</p> <p>(b) a debt instrument which may be transferred without the consent of the <i>issuer</i> or any other <i>person</i> (including a collateralised mortgage obligation);</p> <p>(c) a <i>commodity</i>;</p> <p>(d) a <i>warrant</i>, <i>option</i>, <i>future</i> or other instrument which entitles the holder to subscribe for or acquire:</p> <p style="padding-left: 2em;">(i) an <i>investment</i> or <i>commodity</i> in (a) to (c); or</p> <p style="padding-left: 2em;">(ii) any currency; or</p> <p style="padding-left: 2em;">(iii) any combination of (i) and (ii);</p> <p>(e) a <i>contract for differences</i> (including interest rate and currency swaps) relating to fluctuations in:</p> <p style="padding-left: 2em;">(i) the value or price of an <i>investment</i> or <i>commodity</i> in (a) to (d); or</p> <p style="padding-left: 2em;">(ii) any currency; or</p> <p style="padding-left: 2em;">(iii) the rate of interest in any currency or any index of such rates; or</p> <p style="padding-left: 2em;">(iv) the level of any index which is derived from the prices of an <i>investment</i> or <i>commodity</i> in (a) to (c); or</p> <p style="padding-left: 2em;">(v) any combination of (i) to (iv);</p> <p>(f) <i>warrants</i>, <i>options</i>, <i>futures</i> or other instruments entitling the holder to obtain the rights of those contracts in (d) or (e);</p> <p>(g) a <i>unit</i> in a <i>regulated collective investment scheme</i>.</p>
<i>marketing</i>	(in <i>CIS</i>) (in relation to marketing <i>units</i> in a <i>regulated collective investment scheme</i> in a particular country or territory):

	<ul style="list-style-type: none"> (a) <i>communicating</i> to a <i>person</i> in that country or territory an invitation or inducement to become, or offer to become, a <i>holder</i> in that <i>authorised fund</i>; (b) <i>giving advice on investments</i> to, or <i>arranging (bringing about) a deal in an investment</i> for a <i>person</i> in that country or territory to become a <i>holder</i> in that <i>authorised fund</i>.
<i>marketing group</i>	<p>a group of <i>persons</i> who:</p> <ul style="list-style-type: none"> (a) are allied together (either formally or informally) for purposes of marketing <i>packaged products</i> of the marketing group; and (b) each of which, if it holds itself out in the <i>United Kingdom</i> as marketing <i>packaged products</i> to <i>private customers</i>, does so only as an <i>investment manager</i> or in relation to <i>packaged products</i> of the marketing group.
<i>marketing group associate</i>	a <i>firm</i> other than a <i>product provider</i> which is a member of a <i>marketing group</i> .
<i>marriage and birth</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph II of Part II of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of long-term insurance), to provide a sum on marriage or on the birth of a child, being contracts expressed to be in effect for a period of more than one year.
<i>material interest</i>	<p>(in <i>COB</i>) (in relation to a transaction) any interest of a material nature, other than:</p> <ul style="list-style-type: none"> (a) disclosable <i>commission</i> on the transaction; (b) goods or services which can reasonably be expected to assist in carrying on <i>designated investment business</i> with or for <i>clients</i> and which are provided or to be provided under a <i>soft commission agreement</i>.
<i>material outsourcing</i>	<i>outsourcing</i> services of such importance that weakness, or failure, of the services would cast serious doubt upon the <i>firm's</i> continuing satisfaction of the <i>threshold conditions</i> or compliance with the <i>Principles</i> .
<i>mathematical reserves</i>	(in <i>LLD</i>) the provision made for a <i>member</i> to cover liabilities (excluding liabilities which have fallen due and liabilities arising from deposit back arrangements) arising under or in connection with <i>long-term insurance contracts</i> .
<i>maxi-ISA</i>	<p>an <i>ISA</i> which includes a <i>stocks and shares component</i> and may also include other <i>qualifying investments</i> such as:</p> <ul style="list-style-type: none"> (a) a <i>cash component</i>; (b) an <i>insurance component</i>; <p>as prescribed in paragraphs 7, 8 and 9 respectively of the <i>ISA Regulations</i>.</p>
<i>media firm</i>	a <i>firm</i> whose only <i>permitted activities</i> are <i>advising on investments</i> and <i>agreeing to carry on that regulated activity</i> , and whose <i>Part IV</i>

	<p><i>permission</i> includes <i>requirements</i> to the effect that the <i>firm</i> must advise:</p> <ul style="list-style-type: none"> (a) only through the media; and (b) without conveying the impression that the advice is particularly suitable for any <i>person</i>, except when it is given in response to a specific request for advice from that <i>person</i>; <p>in this definition, "media" means:</p> <ul style="list-style-type: none"> (i) newspapers, journals, magazines or other periodical publications; (ii) services comprising regularly updated news or information; (iii) services consisting of the broadcast or transmission of television or radio programmes.
<i>member</i>	<ul style="list-style-type: none"> (1) (except in <i>PROF</i>, <i>ENF</i> 18 and <i>REC</i>) a <i>person</i> admitted to membership of the <i>Society</i> or any <i>person</i> by law entitled or bound to administer his affairs. (2) (in <i>PROF</i> and <i>ENF</i> 18) (as defined in section 325(2) of the <i>Act</i> (Authority's general duty)) (in relation to a profession) a <i>person</i> who is entitled to practise that profession and, in practising it, is subject to the rules of the relevant <i>designated professional body</i>, whether or not he is a member of that body. (3) (in <i>REC</i>) (in relation to a <i>recognised body</i>) a <i>person</i> who is entitled, under an arrangement or agreement between him and that body, to use that body's <i>facilities</i>.
<i>member's margin</i>	the amount determined in accordance with <i>LLD</i> 11.3.1R (General insurance business) or <i>LLD</i> 11.3.4R (Long-term insurance business).
<i>members' adviser</i>	a <i>firm</i> whose <i>permission</i> includes <i>advising on syndicate participation at Lloyd's</i> , but which is not an <i>underwriting agent</i> .
<i>members' agent</i>	an <i>underwriting agent</i> who carries on the <i>regulated activity</i> of <i>advising on syndicate participation at Lloyd's</i> .
<i>membership of a Lloyd's syndicate</i>	the <i>investment</i> , specified in article 86(2) of the <i>Regulated Activities Order</i> , which is a <i>person's</i> membership (or prospective membership) of a Lloyd's <i>syndicate</i> .
<i>mini-ISA</i>	<p>an <i>ISA</i> which contains only one of the following <i>qualifying investments</i>:</p> <ul style="list-style-type: none"> (a) a <i>stocks and shares component</i>; (b) a <i>cash component</i>; (c) an <i>insurance component</i>; <p>as prescribed in paragraph 7, 8 or 9 respectively of the <i>ISA Regulations</i>.</p>
<i>minimum guarantee fund</i>	(in <i>LLD</i>) a minimum guarantee fund as defined in <i>IPRU(INS)</i> 2.9.

<i>minimum levy</i>	(in <i>DISP</i>) the fixed minimum <i>general levy</i> payable by a <i>firm</i> .
<i>miscellaneous financial loss</i>	<p>(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i>, specified in paragraph 16 of Part I of Schedule 1 to the <i>Regulated Activities Order</i> (General contracts of insurance), against any of the following risks:</p> <ul style="list-style-type: none"> (a) risks of loss to the <i>persons</i> insured attributable to interruptions of the carrying on of business carried on by them or to reduction of the scope of business so carried on; (b) risks of loss to the <i>persons</i> insured attributable to their incurring unforeseen expense (other than loss such as is covered by contracts within paragraph 18 of Part I of Schedule 1 to the <i>Regulated Activities Order</i> (Assistance)); (c) risks which do not fall within paragraphs (a) or (b) and which are not of such a kind that <i>contracts of insurance</i> against them fall within any other provision of Schedule 1 to the <i>Regulated Activities Order</i>.
<i>misleading statements and practices offence</i>	<p>any of the offences described in section 397 of the <i>Act</i> (Misleading statements and practices), which are in summary:</p> <ul style="list-style-type: none"> (a) the offence of: <ul style="list-style-type: none"> (i) making a statement, promise or forecast, which the <i>person</i> making the statement, promise or forecast knows to be misleading, false or deceptive in a material particular; or (ii) dishonestly concealing any material facts whether in connection with a statement, promise or forecast made by the <i>person</i> concealing the facts or otherwise; or (iii) recklessly making (dishonestly or otherwise) a statement, promise or forecast which is misleading, false or deceptive in a material particular; <p>where the <i>person</i> makes the statement, promise or forecast or conceals the facts for the purpose of inducing, or is reckless as to whether it may induce, another <i>person</i> (whether or not that <i>person</i> is the same <i>person</i> to whom the statement, promise or forecast is made):</p> <ul style="list-style-type: none"> (A) to enter or offer to enter into, or to refrain from entering or offering to enter into, a relevant agreement; or (B) to exercise, or refrain from exercising, any rights conferred by a relevant investment; (b) the offence of doing any act or engaging in any course of conduct which creates a false or misleading impression as to the market in or the price or value of any relevant investments where the act was done or the course of conduct engaged in for the purpose of creating that impression and of thereby inducing another <i>person</i> to acquire, dispose of, subscribe for or underwrite those

investments or to refrain from doing so, or to exercise, or refrain from exercising, any rights conferred by those investments;

in this definition:

"relevant agreement" means an agreement:

- (I) the entering into or performance of which by either party constitutes an activity of a kind specified in an order made by the Treasury or one which falls within a specified class of activity; and
- (II) which relates to a relevant investment;

"relevant investment" means an investment of a kind specified in an order made by the Treasury or one which falls within a class of investment prescribed in regulations made by the Treasury.

<i>mixed remittance</i>	a remittance that is part <i>client money</i> and part other <i>money</i> .
<i>ML</i>	the Money Laundering sourcebook.
<i>MLRO</i>	<i>money laundering reporting officer</i> .
<i>Model Code</i>	the Model Code on directors' dealings in securities set out in the appendix to Chapter 16 of the <i>listing rules</i> .
<i>money</i>	any form of money, including cheques and other payable orders.
<i>money laundering</i>	any act which constitutes an offence under: <ul style="list-style-type: none">(a) section 93A, 93B or 93C of the Criminal Justice Act 1988 (which relate to the handling etc of proceeds of certain criminal conduct); in <i>ML</i> the definition of criminal conduct in section 93A(7) is to be read as:<ul style="list-style-type: none">"(i) conduct which constitutes an offence to which Part VI of that Act (Confiscation of the Proceeds of an Offence) applies; or(ii) conduct which:<ul style="list-style-type: none">(A) would constitute such an offence if it had occurred in England and Wales or (as the case may be) Scotland; and(B) contravenes the law of the country in which it occurred"; or(b) section 49, 50 or 51 of the Drug Trafficking Act 1994 (which relate to the handling etc of the proceeds of drug trafficking); or(c) section 42A or 43 of the Criminal Justice (Scotland) Act 1987 (which relate to the handling etc of proceeds of drug trafficking); or(d) section 11 of the Prevention of Terrorism (Temporary Provisions) Act 1989 (which relate to financial assistance for terrorism); or

- (e) section 14 of the Criminal Justice (International Cooperation) Act 1990 (concealing or transferring proceeds of drug trafficking); or
- (f) article 29 or 30 of the Criminal Justice (Confiscation) (Northern Ireland) Order 1990 (which relate to the handling etc of proceeds of drug trafficking); or
- (g) section 53 or 54 of the Northern Ireland (Emergency Provisions) Act 1991 (which relate to the handling etc of proceeds of terrorist-related activities); or
- (h) any provision, whenever made, which has effect in Northern Ireland and corresponds to any of the provisions mentioned in (a) or (g); or

in any case of an act done otherwise than in England and Wales, Scotland or, as the case may be, Northern Ireland, would constitute such an offence under any of (b) to (h) if done in England and Wales, Scotland or Northern Ireland.

<i>Money Laundering Directive</i>	the Council Directive of 10 June 1991 on the prevention of the use of the financial system for the purpose of money laundering (91/308/EEC).
<i>Money Laundering Regulations</i>	the Money Laundering Regulations 1993 (SI 1993/1933) (see <i>ML</i>).
<i>money laundering reporting function</i>	<i>controlled function</i> CF11 in the <i>table of controlled functions</i> , described more fully in <i>SUP</i> 10.7.13R.
<i>money laundering reporting officer</i>	the individual appointed by a <i>relevant firm</i> in accordance with <i>ML</i> 7.1.
<i>money-market scheme</i>	<p>an <i>authorised fund dedicated</i> to:</p> <ul style="list-style-type: none"> (a) <i>deposits</i>; and (b) <i>debentures</i> which are not <i>transferable securities</i>; <p>whether with or without <i>securities</i> which are <i>transferable securities</i>.</p>
<i>money-market instrument</i>	<p>any of the following <i>investments</i>:</p> <ul style="list-style-type: none"> (a) a <i>debenture</i> which is issued on terms requiring repayment not later than five years from the date of issue; (b) any <i>government and public security</i> which is issued on terms requiring repayment not later than one year or, if issued by a local authority in the <i>United Kingdom</i>, five years from the date of issue; (c) a <i>warrant</i> which entitles the holder to subscribe for an <i>investment</i> within (a) or (b); (d) a <i>certificate representing certain securities or rights to or interests in investments</i> relating, in either case, to an <i>investment</i> within (a) or (b);

- (e) an *option* relating to:
 - (i) an instrument in (a) or (b); or
 - (ii) currency of the *United Kingdom* or of any other country or territory; or
 - (iii) gold or silver;
 - (f) a *future* for the sale of:
 - (i) an instrument in (a) or (b); or
 - (ii) currency of the *United Kingdom* or of any other country or territory; or
 - (iii) gold or silver;
 - (g) a *contract for differences* by reference to fluctuations in:
 - (i) the value or price of any instrument within any of (a) to (f); or
 - (ii) currency of the *United Kingdom* or of any other country or territory; or
 - (iii) the rate of interest on loans in any such currency or any index of such rates;
 - (h) an *option* to acquire or dispose of an instrument within (e), (f) or (g).
- money-purchase benefits* (in relation to an *occupational pension scheme*) benefits the rate or amount of which are calculated by reference to a payment or payments made by a member of the scheme.
- money-purchase occupational scheme* an *occupational pension scheme* which provides *money-purchase benefits*.
- month* (in accordance with the Interpretation Act 1978) a calendar month.
- motor vehicle liability* (in relation to a *class of contract of insurance*) the *class of contract of insurance*, specified in paragraph 10 of Part I of Schedule 1 to the *Regulated Activities Order* (Contracts of general insurance), against damage arising out of or in connection with the use of motor vehicles on land, including third-party risks and carrier's liability.
- name-passing broker* a *person* who *arranges (brings about) deals* between counterparties at mutually acceptable terms and passes their names to each of them to facilitate the conclusion of a transaction.
- national bureau* (in relation to an *EEA State*) a professional organisation which:
 - (a) has been constituted in that State in accordance with Recommendation No 5 adopted on 25 January 1949 by the Road Transport Sub-committee of the Inland Transport Committee of the United Nations Economic Commission for Europe; and
 - (b) groups together *insurance undertakings* which in that State are

	authorised to conduct the business of motor vehicle liability insurance.
<i>national guarantee fund</i>	(in relation to an <i>EEA State</i>) a body which: <ul style="list-style-type: none"> (a) has been set up or authorised in that State in accordance with article 1(4) of Council Directive (84/5/EEC); and (b) provides compensation for damages to property or personal injuries caused by unidentified vehicles for which the insurance obligation provided for in article 1(1) of that Directive has not been satisfied.
<i>NCIS</i>	National Criminal Intelligence Service.
<i>near cash</i>	<i>money, deposits or investments</i> which, in each case, fall within any of the following: <ul style="list-style-type: none"> (a) <i>money</i> which is deposited with an <i>eligible institution</i> in: <ul style="list-style-type: none"> (i) a current account; or (ii) a deposit account, if the <i>money</i> can be withdrawn immediately and without payment of a penalty exceeding seven <i>days'</i> interest calculated at ordinary commercial rates; (b) certificates of deposit issued by an <i>eligible institution</i> if immediately redeemable at the option of the holder; (c) <i>government and public securities</i>, if redeemable at the option of the holder or bound to be redeemed within two years; (d) bills of exchange which are <i>government and public securities</i>; (e) <i>deposits</i> with a <i>local</i> authority of a kind which fall within paragraph 9 of Part II of the First Schedule to the Trustee Investments Act 1961, and equivalent <i>deposits</i> with any <i>local</i> authority in another <i>EEA State</i>, if the <i>money</i> can be withdrawn immediately and without payment of a penalty as described in (a).
<i>net accumulation share</i>	(in relation to an <i>ICVC</i>) a <i>share</i> in respect of which income (net of any tax deducted or accounted for by an <i>ICVC</i>) is credited periodically to capital under <i>CIS</i> 9.2.4R (Annual allocation to accumulation shares or accumulation units) or <i>CIS</i> 9.2.6R (Interim allocations of income).
<i>net central assets</i>	<i>central assets</i> less the liabilities of the <i>Society</i> (excluding the liabilities of <i>members</i>) valued in accordance with <i>LLD</i> 9 to 15.
<i>network</i>	an <i>independent intermediary</i> : <ul style="list-style-type: none"> (a) which has five or more <i>appointed representatives</i>; or (b) whose <i>appointed representatives</i> (being fewer than five) have, between them, 26 or more <i>financial advisers</i>.
<i>nominee company</i>	a <i>body corporate</i> whose business consists solely of acting as a nominee holder of <i>investments</i> or other property.

<i>non-authorised Voluntary Jurisdiction participant</i>	a participant in the <i>Voluntary Jurisdiction</i> who is not a <i>firm</i> .
<i>non-core investment service</i>	a service listed in section C of the Annex to the <i>ISD</i> , the text of which is set out in Schedule 2 to the <i>Regulated Activities Order</i> (Annex to the Investment Services Directive).
<i>non-directive friendly society</i>	<p>(a) a <i>friendly society</i> whose <i>insurance business</i> is restricted to the provision of benefits which vary according to the resources available and in which the contributions of the members are determined on a flat-rate basis;</p> <p>(b) a <i>friendly society</i> whose <i>long-term insurance business</i> is restricted to the provision of benefits for employed and self-employed <i>persons</i> belonging to an undertaking or group of undertakings, or a trade or group of trades, in the event of death or survival or of discontinuance or curtailment of activity (whether or not the commitments arising from such operations are fully covered at all times by mathematical reserves);</p> <p>(c) a <i>friendly society</i> which undertakes to provide benefits solely in the event of death where the amount of such benefits does not exceed the average funeral costs for a single death or where the benefits are provided in kind;</p> <p>(d) a <i>friendly society</i> (carrying on <i>long-term insurance business</i>):</p> <p style="margin-left: 2em;">(i) whose registered rules contain provisions for calling up additional contributions from members or reducing their benefits or claiming assistance from other <i>persons</i> who have undertaken to provide it; and</p> <p style="margin-left: 2em;">(ii) whose annual gross premium income (other than from contracts of reinsurance) has not exceeded euro 500,000 for each of the three preceding financial years;</p> <p>(e) a <i>friendly society</i> (carrying on <i>general insurance business</i>) whose:</p> <p style="margin-left: 2em;">(i) registered rules contain provisions for calling up additional contributions from members or reducing their benefits; and</p> <p style="margin-left: 2em;">(ii) gross premium income (other than from contracts of reinsurance) for the preceding financial year did not exceed euro 1,000,000;</p> <p>(f) a <i>friendly society</i> whose liabilities in respect of <i>general insurance contracts</i> are fully reinsured with or guaranteed by other mutuals (including <i>friendly societies</i>);</p> <p>and in each case whose <i>insurance business</i> is limited to that described in any of (a) to (f).</p>
<i>non-directive insurer</i>	a non-directive insurer as defined in <i>IPRU(INS)</i> .

<i>non-discretionary management agreement</i>	<p>an agreement for the non-discretionary management of <i>investments</i>:</p> <p>(a) under which the <i>firm</i> agrees to conduct a regular review of the suitability of the <i>client's</i> account or portfolio, based on an assessment of the <i>client's</i> requirements; and</p> <p>(b) that sets out the <i>client's</i> investment objectives, investment strategy, and attitude to risk, the intervals at which the portfolio will be reviewed, and the arrangements for consulting the <i>client</i> about proposed investment decisions.</p>
<i>non-EEA bank</i>	a <i>bank</i> which is a <i>body corporate</i> or <i>partnership</i> formed under the law of any country or territory outside the <i>EEA</i> .
<i>non-executive director</i>	a <i>director</i> who has no responsibility for implementing the decisions or the policies of the <i>governing body</i> of a <i>firm</i> .
<i>non-executive director function</i>	<i>controlled function</i> CF2 in the <i>table of controlled functions</i> , described more fully in <i>SUP</i> 10.6.8R.
<i>Non-Exempt Activities Order</i>	the Financial Services and Markets Act 2000 (Professions) (Non-Exempt Activities) Order 2001 (SI 2001/1227).
<i>Non-Life Directives</i>	the <i>First Non-Life Directive</i> , the <i>Second Non-Life Directive</i> and the <i>Third Non-Life Directive</i> .
<i>non-mainstream regulated activity</i>	a <i>regulated activity</i> of an <i>authorised professional firm</i> in relation to which the conditions in <i>PROF</i> 5.2.1R are satisfied.
<i>non-market-price transaction</i>	<p>a transaction where:</p> <p>(a) the <i>dealing</i> rate or price paid by the <i>firm</i> or its <i>client</i> differs from the prevailing market rate or price to a material extent; or</p> <p>(b) the <i>firm</i> or its <i>client</i> otherwise gives materially more or less in value than it receives in return.</p>
<i>non-real time financial promotion</i>	(in accordance with article 7(2) of the <i>Financial Promotion Order</i>) (as more fully described in <i>COB</i> 3.5.5R ("Real time" and "non-real time" financial promotions)) a <i>financial promotion</i> that is not a <i>real time financial promotion</i> .
<i>non-UCITS scheme</i>	an <i>authorised fund</i> that is not a <i>UCITS scheme</i> .
<i>notice of discontinuance</i>	a notice given by the <i>FSA</i> in accordance with section 389 of the <i>Act</i> (Notices of discontinuance) which states that the <i>FSA</i> has decided not to take the action proposed in a <i>warning notice</i> or the action to which a <i>decision notice</i> relates.
<i>notice of intention</i>	a notice of intention to establish a <i>branch</i> in an <i>EEA State</i> given by a <i>UK firm</i> under paragraph 19(2) of Part III of Schedule 3 to the <i>Act</i> (Exercise of passport rights by UK firms).
<i>notification rule</i>	<p>(1) (in relation to a <i>firm</i>) a <i>rule</i> requiring a <i>firm</i> to give the <i>FSA</i> notice of, or information regarding, an event, but excluding:</p> <p>(a) a <i>rule</i> requiring periodic submission of a report; and</p> <p>(b) a <i>rule</i> in the <i>listing rules</i>.</p>

	(2) (in relation to a <i>recognised body</i>) a <i>rule</i> made by the <i>FSA</i> under section 293 of the <i>Act</i> (Notification requirements) or section 295 of the <i>Act</i> (Notification: overseas investment exchanges and overseas clearing houses) requiring a <i>recognised body</i> to give the <i>FSA</i> :
	(a) notice of, and specified information regarding, specified events relating to the body;
	(b) specified information relating to the body at specified times or in respect of specified periods; and
	(c) any other information required to be given by such a <i>rule</i> .
<i>notified point</i>	a point that is within the two hours immediately following a <i>valuation point</i> and is notified in accordance with <i>CIS</i> 4.3.9R(3) (Issue of units to meet authorised fund manager's obligation to sell) or <i>CIS</i> 15.3.4R(4) (Issue of units: manager's instructions).
<i>notional principal</i>	(a) (in relation to a <i>contract for differences</i> which is an index derivative):
	(i) the current mark to market valuation of a <i>contract for differences</i> which resembles a <i>futures</i> contract; or
	(ii) the exercise value of a <i>contract for differences</i> which resembles an <i>option</i> contract;
	(b) (in relation to any other <i>contract for differences</i>) the notional lot size of the contract.
<i>occupational pension scheme</i>	(as specified in article 3(1) of the <i>Regulated Activities Order</i> (Interpretation)) any scheme or arrangement which is comprised in one or more instruments or agreements and which has, or is capable of having, effect in relation to one or more descriptions or categories of employment so as to provide benefits, in the form of pensions or otherwise, payable on termination of service, or on death or retirement, to or in respect of earners with a qualifying service in an employment of any such description or category.
<i>OECD</i>	Organisation for Economic Co-operation and Development.
<i>OEIC</i>	<i>open-ended investment company</i> . (see also <i>ICVC</i> .)
<i>OEIC Regulations</i>	the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228).
<i>off-exchange</i>	(in relation to a transaction in an <i>investment</i>) a transaction which is not <i>on-exchange</i> .
<i>offer</i>	(1) (in <i>MAR</i> 1 (Code of market conduct)) an offer as defined in the <i>Takeover Code</i> . (2) (in <i>MAR</i> 2 (Price stabilising rules)) an offer or an invitation to make an offer and (except in <i>MAR</i> 2.2.3R, <i>MAR</i> 2.4.2R(5) and <i>MAR</i> 2.8.2R(1)(c)) an issue.

<i>offer for cash</i>	an <i>offer</i> which satisfies the conditions set out in <i>MAR 2.1.3R</i> .
<i>offeree</i>	(in <i>MAR 1</i>) an offeree as defined in the <i>Takeover Code</i> .
<i>offeror</i>	(in <i>MAR 1</i>) an offeror as defined in the <i>Takeover Code</i> .
<i>offer price</i>	(1) (except in <i>MAR 2</i> (Price stabilising rules)) the price at which a <i>person</i> could purchase a <i>unit</i> in a <i>dual-priced AUT</i> or a <i>security</i> . (2) (in <i>MAR 2</i>) <i>the specified price</i> at which the <i>relevant security</i> is <i>offered</i> without deducting any <i>selling concession</i> or <i>commission</i> .
<i>officer</i>	(1) (in connection with the exercise of the <i>FSA's</i> power to require information) an officer of the <i>FSA</i> , a member of the <i>FSA's</i> staff or an agent of the <i>FSA</i> . (2) (otherwise) (in relation to a <i>body corporate</i>) (as defined in section 400(5) of the <i>Act</i> (Offences by bodies corporate etc)) a director, member of the committee of management, <i>chief executive</i> , <i>manager</i> , secretary, or other similar officer of the body, or a <i>person</i> purporting to act in that capacity or a <i>controller</i> of the body.
<i>official list</i>	(a) the list maintained by the <i>FSA</i> in accordance with section 74(1) of the <i>Act</i> (The official list) for the purposes of Part VI of the <i>Act</i> (Official Listing); (b) any corresponding list maintained by a <i>competent authority</i> for listing in another <i>EEA State</i> .
<i>oil</i>	mineral oil of any description and petroleum gases, whether in liquid or vapour form, including products and derivatives of oil.
<i>oil collective investment scheme</i>	a <i>collective investment scheme</i> , the property of which consists only of property which is <i>oil</i> or an <i>oil investment</i> or cash awaiting investment.
<i>oil investment</i>	any of the following: (a) a <i>unit</i> in an <i>oil collective investment scheme</i> ; (b) an <i>option</i> to acquire or dispose of an <i>oil investment</i> ; (c) a <i>future</i> where the <i>commodity</i> in question is <i>oil</i> ; (d) a <i>contract for differences</i> where the property in question is <i>oil</i> or an <i>oil investment</i> or the index or other factor in question is linked to or otherwise dependent upon fluctuations in the value or price of <i>oil</i> or any <i>oil investments</i> ; (e) rights to and interests in anything which is an <i>oil investment</i> .
<i>oil market activity</i>	(a) any <i>regulated activity</i> in relation to an <i>oil investment</i> or to <i>oil</i> ; (b) <i>establishing, operating or winding up</i> an <i>oil collective investment scheme</i> .

<i>oil market participant</i>	<p>a <i>firm</i>:</p> <ul style="list-style-type: none"> (a) which carries on <i>oil market activities</i>, which in the <i>United Kingdom</i> are confined to either or both the following: <ul style="list-style-type: none"> (i) the performance of management services for the <i>participants</i> in an <i>oil collective investment scheme</i> in which individuals do not participate, and other <i>oil market activities</i> which are performed in relation to any such <i>oil collective investment scheme</i>; (ii) other <i>oil market activities</i> which: <ul style="list-style-type: none"> (A) are the <i>executing</i> of <i>own-account transactions</i> on any <i>recognised investment exchange</i> or <i>designated investment exchange</i>; or (B) if they are not the <i>executing</i> of transactions on such exchanges, are performed in connection with or for <i>persons</i> who are not individuals; and (b) (except in <i>COB</i>) whose <i>permission</i> includes a <i>requirement</i> that the <i>firm</i> must not carry on any <i>designated investment business</i> other than that in (a).
<i>Ombudsman</i>	a <i>person</i> appointed to the panel of <i>persons</i> maintained by the <i>FOS Ltd</i> to determine complaints, including the Chief Ombudsman.
<i>on-exchange</i>	<ul style="list-style-type: none"> (a) (in relation to a transaction in the <i>United Kingdom</i>) effected by means of the <i>facilities</i> of, or governed by the <i>rules</i> of, an <i>RIE</i> or a <i>regulated market</i>; (b) (in relation to any other transaction) effected by means of the <i>facilities</i> of, or governed by the <i>rules</i> of, an exchange.
<i>one-off transaction</i>	any transaction other than a transaction carried out in the course of an established business relationship formed by a <i>person</i> acting in the course of relevant financial business.
<i>open</i>	in relation to a <i>syndicate year</i> , one which has not been <i>closed</i> .
<i>open to review</i>	<p>(as defined in section 391(8) of the <i>Act</i> (Publication)) (in relation to a <i>supervisory notice</i> which does not take effect immediately or on a specified date) the status of the matter to which the notice relates when:</p> <ul style="list-style-type: none"> (a) the period during which any <i>person</i> may refer a matter to the <i>Tribunal</i> is still running; or (b) the matter has been referred to the <i>Tribunal</i> but has not been dealt with; or (c) the matter has been referred to the <i>Tribunal</i> and dealt with but the period during which an appeal may be brought against the <i>Tribunal's</i> decision is still running; or (d) such an appeal has been brought but has not been determined.
<i>open-ended</i>	(as defined in section 236 of the <i>Act</i> (Open-ended investment

investment company companies)) a *collective investment scheme* which satisfies both the property condition and the investment condition:

- (a) the property condition is that the property belongs beneficially to, and is managed by or on behalf of, a *body corporate* ("BC") having as its purpose the investment of its funds with the aim of:
 - (i) spreading investment risk; and
 - (ii) giving its members the benefit of the results of the management of those funds by or on behalf of that body;
- (b) the investment condition is that, in relation to BC, a reasonable investor would, if he were to participate in the *scheme*:
 - (i) expect that he would be able to realise, within a period appearing to him to be reasonable, his investment in the *scheme* (represented, at any given time, by the value of shares in, or securities of, BC held by him as a *participant* in the *scheme*); and
 - (ii) be satisfied that his investment would be realised on a basis calculated wholly or mainly by reference to the value of property in respect of which the *scheme* makes arrangements.

(see also *investment company with variable capital*.)

open-market option the option to apply:

- (a) the proceeds of a *pension policy* or *pension contract*; or
- (b) the proceeds of a *money-purchase occupational scheme* for a particular occupational scheme member;

to purchase an annuity on the open market from a *long-term insurer*.

operator

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

property of the *investment trust*, to manage the *investment trust savings scheme*.

- (2) (in *ENF*) (in accordance with section 237(2) of the *Act* (Other definitions)):
- (a) (in relation to a *unit trust scheme* with a separate *trustee*) the manager; and
 - (b) (in relation to an *open-ended investment company*) that company.
- OPS activity*
- (a) *managing investments* in a case where the assets managed are:
 - (i) held for the purposes of an *occupational pension scheme*; or
 - (ii) held for the purposes of a *welfare trust* established by a *person* who is, or has been at any time during the last 12 *months*, an *associate* of the *OPS firm*; or
 - (iii) assets of an *OPS collective investment scheme*;
 - (b) any one or more of the following activities undertaken in the course of, or incidental to, the operation of an *occupational pension scheme*, *welfare trust* or *OPS collective investment scheme*:
 - (i) *dealing in investments as principal*;
 - (ii) *dealing in investments as agent*;
 - (iii) *arranging (bringing about) deals in investments*;
 - (iv) *making arrangements with a view to transactions in investments*;
 - (v) *safeguarding and administering investments*;
 - (vi) *advising on investments*;
 - (vii) receiving or holding *client money*.
- OPS collective investment scheme*
- a *collective investment scheme* the contributions to which consist entirely of assets held for an *occupational pension scheme*.
- OPS firm*
- (a) (except in *IPRU(INV)*) a *firm* which:
 - (i) carries on *OPS activity*; and
 - (ii) is one or more of the following:
 - (A) a trustee of the *occupational pension scheme* in question;
 - (B) a *company* owned by the trustees of the *occupational pension scheme* in question;
 - (C) a *company* which is:
 - (I) an employer in relation to the *occupational pension scheme* in question in respect of its employees or former employees or their

	dependants; or
	(II) a <i>company</i> within the <i>group</i> which includes an employer within (I); or
	(III) an administering authority subject to the Local Government Superannuation Regulations 1986; or
	(b) a <i>firm</i> which:
	(i) has satisfied the requirements set out in (a) at any time during the past 12 <i>months</i> ; but
	(ii) is no longer able to comply with those requirements because of a change in the control or ownership of the employer referred to in (a)(ii) during that period.
<i>option</i>	the <i>investment</i> , specified in article 77 of the <i>Regulated Activities Order</i> (Options), which is an option to acquire or dispose of:
	(a) a <i>designated investment</i> (other than an option); or
	(b) currency of the <i>United Kingdom</i> or of any other country or territory; or
	(c) palladium, platinum, gold or silver; or
	(d) an option to acquire or dispose of an option specified in (a), (b) or (c).
<i>organisation</i>	a <i>body corporate</i> , a <i>partnership</i> , a trust or an unincorporated association.
<i>OTC</i>	<i>over the counter</i> .
<i>OTC derivative</i>	a <i>derivative</i> traded solely <i>over the counter</i> .
<i>other personal wealth</i>	(in <i>LLD</i>) assets of an <i>individual member</i> that are neither part of his <i>funds at Lloyd's</i> nor in a <i>premium trust fund</i> .
<i>outsourcing</i>	the use of a <i>person</i> to provide customised services to a <i>firm</i> other than:
	(a) a member of the <i>firm's governing body</i> acting in his capacity as such; or
	(b) an individual employed by a <i>firm</i> under a contract of service.
<i>over the counter</i>	(in relation to a transaction in an <i>investment</i>) not <i>on-exchange</i> .
<i>overseas clearing house</i>	a <i>clearing house</i> which has neither its head office nor its registered office in the <i>United Kingdom</i> .
<i>overseas financial services institution</i>	an institution authorised in an <i>EEA State</i> other than the <i>United Kingdom</i> by a <i>competent authority</i> , or in any other country or territory by a <i>regulatory body</i> which is a member of <i>IOSCO</i> .
<i>overseas firm</i>	a <i>firm</i> which has its registered office (or, if it has no registered office, its head office) outside the <i>United Kingdom</i> .
<i>overseas introducing</i>	a <i>person</i> , who is not an <i>authorised person</i> :

<i>broker</i>	<ul style="list-style-type: none"> (a) who is resident outside the <i>United Kingdom</i>; and (b) who introduces transactions relating to <i>designated investments arranged (brought about)</i> for its <i>clients</i> to a <i>clearing firm</i> in the <i>United Kingdom</i>.
<i>overseas investment exchange</i>	an investment exchange which has neither its head office nor its registered office in the <i>United Kingdom</i> .
<i>overseas long-term insurer</i>	<p>an <i>insurance undertaking</i> which is not an <i>authorised person</i> and which:</p> <ul style="list-style-type: none"> (a) has its head office in an <i>EEA State</i> other than the <i>United Kingdom</i>, and is entitled to carry on <i>long-term insurance business</i> in that <i>EEA State</i>; or (b) has a <i>branch</i> or agency in an <i>EEA State</i> other than the <i>United Kingdom</i> and is entitled to carry on <i>long-term insurance business</i> in that <i>EEA State</i>; or (c) is authorised to effect or carry on <i>long-term insurance business</i> in the Bailiwick of Jersey, the Bailiwick of Guernsey, the Isle of Man, the Commonwealth of Pennsylvania or the State of Iowa; <p>for the purposes of (a) and (b), Gibraltar is to be regarded as if it were an <i>EEA State</i>.</p>
<i>overseas person</i>	<p>(in accordance with article 3(1) of the <i>Regulated Activities Order (Interpretation)</i>) a <i>person</i> who:</p> <ul style="list-style-type: none"> (a) carries on any of the following <i>regulated activities</i>: <ul style="list-style-type: none"> (i) <i>dealing in investments as principal</i>; (ii) <i>dealing in investments as agent</i>; (iii) <i>arranging (bringing about) deals in investments</i>; (iv) <i>making arrangements with a view to transactions in investments</i>; (v) <i>managing investments</i>; (vi) <i>safe custody and administering investments</i>; (vii) <i>sending dematerialised instructions</i>; (viii) <i>causing dematerialised instructions to be sent</i>; (ix) <i>establishing, operating or winding up a collective investment scheme</i>; (x) <i>acting as trustee of an authorised unit trust scheme</i>; (xi) <i>acting as the depositary or sole director of an open-ended investment company</i>; (xii) <i>establishing, operating or winding up a stakeholder pension scheme</i>; (xiii) <i>advising on investments</i>; (xiv) <i>agreeing to carry on those regulated activities</i>,

disregarding the exclusion in article 72 of the *Regulated Activities Order* (Overseas persons); but

- (b) does not carry on any such activities, or offer to do so, from a permanent place of business maintained by him in the *United Kingdom*.

overseas recognised body an *ROIE* or *ROCH*.

overseas regulator (as defined in section 195(3) of the *Act* (Exercise of power in support of overseas regulator)) an authority in a country or territory outside the *United Kingdom*:

- (a) which is a *Home State regulator*; or
- (b) which exercises any of the following functions:
 - (i) a function corresponding to any function of the *FSA* under the *Act*;
 - (ii) a function corresponding to any function exercised by the *FSA* in its capacity as *competent authority* in relation to the listing of securities;
 - (iii) a function corresponding to any function exercised by the Secretary of State under the Companies Act 1985;
 - (iv) a function in connection with the investigation of conduct of the kind prohibited by Part V of the Criminal Justice Act 1993 (Insider Dealing), or with the enforcement of rules (whether or not having the force of law) relating to such conduct;
 - (v) a function prescribed by regulations made for the purposes of section 195(4) of the *Act* (Exercise of powers) which, in the opinion of the Treasury, relates to companies or financial services.

own account order an order which relates to an *own account transaction*.

own account transaction a transaction *executed* by the *firm* for its own benefit or for the benefit of its *associate*.

own funds own funds as described in articles 34 to 39 of the *Banking Consolidation Directive*.

own-initiative power the *FSA's* power under section 45 of the *Act* (Variation etc on the Authority's own initiative) to vary or cancel a *Part IV permission* otherwise than on the application of a *firm*.

packaged product (a) a *life policy*;

- (b) a *unit* in a *regulated collective investment scheme*;
- (c) an interest in an *investment trust savings scheme*;
- (d) a *stakeholder pension scheme*;

whether or not (in the case of (a), (b) or (c)) held within a *PEP* or an

ISA.

parent undertaking (in accordance with section 420 of the *Act* (Parent and subsidiary undertaking) and section 258 of the Companies Act 1985 (Parent and subsidiary undertakings)):

- (a) (in relation to whether an *undertaking*, other than an *incorporated friendly society*, is a parent undertaking) an *undertaking* which has the following relationship to another *undertaking* ("S"):
- (i) it holds a majority of the voting rights in S; or
 - (ii) it is a member of S and has the right to appoint or remove a majority of its board of directors; or
 - (iii) it has the right to exercise a dominant influence over S through:
 - (A) provisions contained in S's memorandum or articles; or
 - (B) a control contract;
 - (iv) it is a member of S and controls alone, under an agreement with other shareholders or members, a majority of the voting rights in S; or
 - (v) it has a participating interest (as defined in section 260 of the Companies Act 1985) (Participating interests) in S; and
 - (A) actually exercises a dominant influence over S; or
 - (B) it and S are managed on a unified basis; or
 - (vi) it is a *parent undertaking* of a *parent undertaking* of S; or
 - (vii) (except in *REC* and *LLD*) he is an individual and would be a *parent undertaking* if he were an *undertaking*; or
 - (viii) (except in *REC* and *LLD*) it is incorporated in or formed under the law of another *EEA State* and is a parent undertaking within the meaning of any rule of law in that State for purposes connected with implementation of the *Seventh Company Law Directive*;

in relation to (ii) and (iv), the *undertaking* will be treated as a member of S if any of its *subsidiary undertakings* is a member of S, or if any shares in S are held by a *person* acting on behalf of the *undertaking* or any of its *subsidiary undertakings*;

the provisions of Schedule 10A to the Companies Act 1985 (Parent and subsidiary undertakings: supplementary provisions) explain the expressions used in and supplement paragraphs (i) to (vi);

- (b) (in relation to whether an *incorporated friendly society* is a parent undertaking) an *incorporated friendly society* which has

the following relationship to a *body corporate* ("S"):

- (i) it holds a majority of the voting rights in S; or
- (ii) it is a member of S and has the right to appoint or remove a majority of S's board of directors; or
- (iii) it is a member of S and controls alone, under an agreement with other shareholders or members, a majority of the voting rights in S; or
- (iv) it is the *parent undertaking* of a *body corporate* which has the relationship in (i), (ii) or (iii) to S.

<i>Part XX exemption</i>	the exemption from the <i>general prohibition</i> conferred on an <i>exempt professional firm</i> by section 327 of the <i>Act</i> (Exemption from the general prohibition).
<i>Part 30 exemption order</i>	an order under regulation 30.10 of the General Regulations under the US Commodity Exchange Act, issued by the Commodity Futures Trading Commission on 15 May 1989, granting a <i>person</i> exemption from the registration requirement contained in Part 30 of those General Regulations.
<i>Part IV permission</i>	(as defined in section 40(4) of the <i>Act</i> (Application for permission)) a <i>permission</i> given by the <i>FSA</i> under Part IV of the <i>Act</i> (Permission to carry on regulated activities), or having effect as if so given.
<i>participant</i>	(in accordance with section 235(2) of the <i>Act</i> (Collective investment schemes)) a <i>person</i> who participates in a <i>collective investment scheme</i> .
<i>participant firm</i>	a <i>firm</i> other than: <ul style="list-style-type: none">(a) an <i>incoming EEA firm</i> which is a <i>BCD credit institution</i> or <i>ISD investment firm</i> and whose <i>permission</i> is confined to <i>cross border services</i>;(b) an <i>incoming EEA firm</i> without <i>top-up cover</i> which is:<ul style="list-style-type: none">(i) a <i>BCD credit institution</i> whose <i>permission</i> to carry on <i>regulated activities</i> from a <i>UK branch</i> is confined to <i>accepting deposits</i>; or(ii) an <i>ISD investment firm</i> (including a <i>credit institution</i> which is an <i>ISD investment firm</i>) whose <i>permission</i> to carry on <i>regulated activities</i> from a <i>UK branch</i> is confined to <i>passport activities</i>;(c) a <i>service company</i>;(d) the <i>Society</i>, in respect of activities included in its <i>permission</i> under section 315(2) of the <i>Act</i> (The Society: authorisation and permission);(e) a <i>member</i>, in respect of <i>effecting</i> or <i>carrying out Lloyd's policies</i>;(f) an <i>underwriting agent</i>, or <i>members' adviser</i>, in respect of <i>advising on syndicate participation at Lloyd's</i> or <i>managing the underwriting capacity of a Lloyd's syndicate as a managing</i>

	<i>agent at Lloyd's;</i>
	(g) an <i>authorised professional firm</i> that is subject to the rules of the Law Society (England and Wales) or the Law Society of Scotland;
	(h) an <i>ICVC</i> ;
	(i) a <i>UCITS qualifier</i> .
<i>participating security</i>	a participating security as defined in regulation 3 of the Uncertificated Securities Regulations 1995 (SI 1995/3272), which enable title to participating securities to be evidenced otherwise than by a certificate and transferred otherwise than by a written instrument.
<i>partner</i>	(in relation to a <i>firm</i> which is a <i>partnership</i>) any <i>person</i> appointed to direct its affairs, including: <ul style="list-style-type: none"> (a) a <i>person</i> occupying the position of a partner (by whatever name called); and (b) a <i>person</i> in accordance with whose directions or instructions (not being advice given in a professional capacity) the partners are accustomed to act.
<i>partner function</i>	<i>controlled function</i> CF4 in the <i>table of controlled functions</i> , described more fully in SUP 10.6.17R.
<i>partnership</i>	(in accordance with section 417(1) of the <i>Act</i> (Definitions)) any partnership, including a partnership constituted under the law of a country or territory outside the <i>United Kingdom</i> , but not including a <i>limited liability partnership</i> .
<i>passported activity</i>	an activity carried on by an <i>EEA firm</i> , or by a <i>UK firm</i> , under an <i>EEA right</i> .
<i>penny share</i>	a <i>readily realisable security</i> in relation to which the bid-offer spread is 10 per cent or more of the offer price, but not: <ul style="list-style-type: none"> (a) a <i>government and public security</i>; or (b) a <i>share</i> in a <i>company</i> quoted on The Financial Times Stock Exchange 100 Index; or (c) a <i>security</i> issued by a <i>company</i> which, at the time that the <i>firm deals</i> or recommends to the <i>client</i> to <i>deal</i> in the <i>investment</i>, has a market capitalisation of £100 million or more (or its equivalent in any other currency at the relevant time).
<i>pension annuity</i>	an <i>investment</i> purchased with the sums derived from the vesting (partial or full) of a <i>pension policy</i> or <i>pension contract</i> , for the purposes of securing the beneficiary's entitlement to immediate or <i>future benefits</i> .
<i>pension buy-out contract</i>	an annuity contract which complies with paragraph (g) of section 591(2) of the Income and Corporation Taxes Act 1988.
<i>pension contract</i>	a contract under which rights to benefits are obtained by the making of contributions to an <i>occupational pension scheme</i> or to a <i>personal</i>

	<i>pension scheme</i> , where the contributions are paid to a <i>regulated collective investment scheme</i> .
<i>pension fund management</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> specified in paragraph VII of Part II of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of long-term insurance) namely: <ul style="list-style-type: none"> (a) <i>pension fund management contracts</i>; and (b) <i>pension fund management contracts</i> which are combined with <i>contracts of insurance</i> covering either conservation of capital or payment of a minimum interest; where effected or carried out by a <i>person</i> who does not carry on a banking business, and otherwise carries on <i>insurance business</i> .
<i>pension fund management contract</i>	(as defined in article 3(1) of the <i>Regulated Activities Order</i> (Interpretation)) a contract to manage the <i>investments</i> of pension funds (other than funds solely for the benefit of the officers or employees of the <i>person</i> effecting or carrying out the contract and their dependants or, in the case of a <i>company</i> , partly for the benefit of officers and employees of its subsidiary or holding company or a subsidiary of its holding company and their dependants; <p>in this definition "subsidiary" and "holding company" mean either <i>subsidiary</i> and <i>holding company</i>, or subsidiary and holding company defined in accordance with article 4 of the Companies (Northern Ireland) Order 1986 (SI 1986) No 1032 (NI 6)) as amended by article 62 of the Companies (No 2) (Northern Ireland) Order 1990 (SI 1990 No 1504 (NI 10)).</p>
<i>pension opt-out</i>	a transaction resulting from a decision made, with or without advice from a <i>firm</i> , by a <i>customer</i> who is an individual, to: <ul style="list-style-type: none"> (a) opt out of an <i>occupational pension scheme</i> of which he is a current member; or (b) decline to become a member of an <i>occupational pension scheme</i> which he is eligible to join or which he will become eligible to join at the end of a waiting period; in favour of a <i>stakeholder pension scheme</i> or a <i>personal pension scheme</i> (including a self-invested <i>personal pension scheme</i>).
<i>pension policy</i>	a contract under which a right to benefits results from contributions made to an <i>occupational pension scheme</i> or to a <i>personal pension scheme</i> , where the contributions are paid to a <i>long-term insurer</i> .
<i>pension scheme</i>	a scheme under which a right to benefits results from contributions made under a <i>pension contract</i> or <i>pension policy</i> .
<i>pension transfer</i>	a transaction resulting from a decision made, with or without advice from a <i>firm</i> , by a <i>customer</i> who is an individual, to transfer deferred benefits from: <ul style="list-style-type: none"> (a) an <i>occupational pension scheme</i>; or (b) an <i>individual pension contract</i> providing fixed or guaranteed

	benefits that replaced similar benefits under a <i>defined benefits pension scheme</i> ;
	to a <i>stakeholder pension scheme</i> or a <i>personal pension scheme</i> (including a self-invested <i>personal pension scheme</i>).
<i>pension transfer specialist</i>	an individual appointed by a <i>firm</i> to check the suitability of a <i>pension transfer</i> or <i>pension opt-out</i> who has passed the required examinations specified in the interim approved examination annexes to <i>TC 2</i> .
<i>pension transfer specialist function</i>	<i>controlled function</i> CF24 in the <i>table of controlled functions</i> , described more fully in <i>SUP 10.10.14R</i> .
<i>PEP</i>	a <i>personal equity plan</i> .
<i>PEP manager</i>	the <i>plan manager</i> of a <i>PEP</i> in accordance with the Personal Equity Plan Regulations 1989.
<i>PEP transfer</i>	a transaction resulting from a decision, made with or without advice from a <i>firm</i> , by a <i>customer</i> who is an individual, to transfer the <i>investments</i> (or their value) held in his existing <i>PEP</i> in favour of another <i>PEP</i> which may or may not be managed by the same <i>PEP manager</i> .
<i>periodic statement</i>	a report which a <i>firm</i> is required to provide to a <i>customer</i> under <i>COB 8.2</i> (Periodic statements).
<i>permanent health</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph IV of Part II of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of long-term insurance), providing specified benefits against risks of persons becoming incapacitated in consequence of sustaining injury as a result of an accident or of an accident of a specified class or of sickness or infirmity, being contracts that: <ul style="list-style-type: none"> (a) are expressed to be in effect for a period of not less than five years, or until the normal retirement age of the persons concerned, or without limit of time; and (b) either are not expressed to be terminable by the insurer, or are expressed to be so terminable only in special circumstances mentioned in the contract.
<i>permission</i>	permission to carry on <i>regulated activities</i> ; that is, any of the following: <ul style="list-style-type: none"> (a) a <i>Part IV permission</i>; (b) the permission that an <i>incoming EEA firm</i> has, under paragraph 4(1) of Schedule 3 to the <i>Act</i> (EEA Passport Rights), on qualifying for <i>authorisation</i> under paragraph 12 of that Schedule; (c) the permission that an <i>incoming Treaty firm</i> has, under paragraph 15(1) of Schedule 4 to the <i>Act</i> (Treaty Rights), on qualifying for <i>authorisation</i> under paragraph 2 of that Schedule; (d) the permission that a <i>UCITS qualifier</i> has, under paragraph 2(1) of Schedule 5 to the <i>Act</i> (Persons concerned in Collective

	Investment Schemes);
	(e) the permission that an <i>ICVC</i> has, under paragraph 2(2) of Schedule 5 to the <i>Act</i> (Persons concerned in Collective Investment Schemes);
	(f) the permission that the <i>Society of Lloyd's</i> has, under section 315(2) of the <i>Act</i> (The Society: authorisation and permission), which is to be treated as a <i>Part IV permission</i> for the purposes of Part IV of the <i>Act</i> (Permission to carry on regulated activities) in accordance with section 315(3) of the <i>Act</i> .
<i>permitted activity</i>	a <i>regulated activity</i> which a <i>firm</i> has <i>permission</i> to carry on.
<i>permitted asset exposure limit</i>	a permitted asset exposure limit as defined in <i>LLD</i> 14.5.17R.
<i>permitted counterparty exposure limit</i>	a permitted counterparty exposure limit as defined in <i>LLD</i> 14.6.1R.
<i>permitted immovable</i>	any immovable which falls within <i>CIS</i> 5.8.4R (Permitted immovable) (excluding, in relation to an <i>ICVC</i> , immovable property that is necessary for the direct pursuit of its business).
<i>permitted third party</i>	a third party who is: <ul style="list-style-type: none"> (a) an <i>authorised person</i>; or (b) an <i>exempt person</i> for whom an <i>authorised person</i> is accepting responsibility; or (c) a <i>person</i> lawfully carrying on a <i>regulated activity</i> in another <i>EEA State</i>.
<i>person</i>	(in accordance with the Interpretation Act 1978) any person, including a body of persons corporate or unincorporate (that is, a natural person, a legal person and, for example, a <i>partnership</i>).
<i>personal account transaction</i>	a transaction for the account of an <i>employee</i> of a <i>firm</i> , or his <i>associate</i> , in a <i>designated investment</i> , other than: <ul style="list-style-type: none"> (a) a transaction in a <i>government and public security</i>; or (b) a transaction in a <i>life policy</i>; or (c) a transaction in a <i>unit</i> in a <i>regulated collective investment scheme</i>; or (d) a discretionary transaction if there is no prior communication with the <i>employee</i> and the discretion is not exercised by the <i>firm</i>.
<i>personal equity plan</i>	a scheme of investment satisfying the conditions prescribed in regulations made by the Treasury under section 333 of the Income and Corporation Taxes Act 1988 (the Personal Equity Plan Regulations 1989).
<i>personal investment firm</i>	a <i>firm</i> whose <i>permitted activities</i> include <i>designated investment business</i> , which is not an <i>authorised professional firm</i> , <i>bank</i> , <i>building society</i> , <i>credit union</i> , <i>friendly society</i> , <i>ICVC</i> , <i>insurer</i> , <i>media firm</i> ,

service company, incoming EEA firm (without a top-up permission), incoming Treaty firm (without a top-up permission) or UCITS qualifier (without a top-up permission), whose permission does not include a requirement that it comply with IPRU(INV) 3 (Securities and futures firms), 5 (Investment management firms) or 10 (Securities and futures firms), and which is within (a), (b) or (c):

- (a) a *firm*:
 - (i) which was a member of *PIA* immediately before *commencement*; and
 - (ii) which was not, immediately before *commencement*, subject to the financial supervision requirements of the *FSA* (under section 43 of the Financial Services Act 1986), or *IMRO* or *SFA* (under lead regulation arrangements);
- (b) a *firm* whose *permission* includes a *requirement* that it comply with *IPRU(INV)* 13 (Personal investment firms);
- (c) a *firm*:
 - (i) which was given a *Part IV permission* after *commencement*, or which was authorised under section 25 of the Financial Services Act 1986 immediately before *commencement* and not a member of *IMRO*, *PIA* or *SFA*; and
 - (ii) for whom the most substantial part of its gross income, including *commissions*, from the *regulated activities* included in its *Part IV permission* is derived from one or more of the following activities (based, for a *firm* given a *Part IV permission* after *commencement*, on the business plan submitted as part of the *firm's* application for *permission* or, for a *firm* authorised under section 25 of the Financial Services Act 1986, on the *firm's* financial year preceding its *authorisation* under the *Act*):
 - (A) *advising on investments, or arranging (bringing about) deals in investments, in relation to packaged products;*
 - (B) *managing investments for private customers.*

<i>personal pension contract</i>	a <i>pension contract</i> under which contributions (single or regular) are paid to a <i>personal pension scheme</i> .
<i>personal pension policy</i>	a <i>pension policy</i> under which contributions (single or regular) are paid to a <i>personal pension scheme</i> .
<i>personal pension scheme</i>	a scheme of investment in accordance with section 630 of the Income and Corporation Taxes Act 1988.
<i>personal recommendation</i>	a recommendation given to a specific <i>person</i> .

<i>PIA</i>	the Personal Investment Authority Limited.
<i>plan investor</i>	a <i>person</i> entered in the <i>plan register</i> under CIS 6.5.4R(7) (Requirement).
<i>plan manager</i>	in relation to: <ul style="list-style-type: none"> (a) a <i>group personal equity plan</i>, the <i>PEP manager</i>; (b) a <i>group ISA</i>, the <i>ISA manager</i>; (c) a <i>group savings plan</i>, the <i>person</i> primarily responsible for that <i>group savings plan</i>.
<i>plan register</i>	<ul style="list-style-type: none"> (1) (in relation to an <i>ICVC</i>) a record of <i>persons</i> who subscribe to a <i>group plan</i> and for whom <i>shares</i> in the <i>ICVC</i> are held for the purposes of the <i>group plan</i> by the <i>plan manager</i> or a nominee (other than a record for the establishment or maintenance of which no payments are to be made out of the <i>scheme property</i>). (2) (in relation to an <i>AUT</i>) a sub-register to the <i>register</i>, which sub-register records <i>persons</i> who subscribe to a <i>group plan</i> and for whom <i>units</i> in the <i>AUT</i> are held for the purposes of the plan by the <i>plan manager</i> or a nominee (other than any sub-register that has not been established and maintained in accordance with CIS 6.5.4R (Requirement) or for the establishment of which no payments are to be made out of the <i>scheme property</i>).
<i>plan shares</i>	<i>shares</i> entered in a <i>plan register</i> under CIS 6.5.4R(7) (Requirement).
<i>plan units</i>	<i>units</i> entered in a <i>plan register</i> under CIS 6.5.4R(12) (Requirement).
<i>plastic card</i>	a card, or a token with an equivalent function, which a <i>customer</i> can use to pay for goods and services, or to obtain cash or both, such as a credit card, charge card, debit card, cash card or electronic purse.
<i>policy</i>	[awaiting Order under section 424(2) of the <i>Act</i> .]
<i>policyholder</i>	[awaiting Order under section 424(2) of the <i>Act</i> .]
<i>POS Regulations</i>	the Public Offers of Securities Regulations 1995 (SI 1995/1537).
<i>post</i>	(in relation to sending a <i>document</i> by post) sending pre-paid by a postal service which seeks to deliver documents by post within the <i>United Kingdom</i> no later than the next working day in all or the majority of cases, and to deliver by post outside the <i>United Kingdom</i> within such a period as is reasonable in all the circumstances.
<i>Post-BCCI Directive</i>	the European Parliament and Council Directive of 29 June 1995 amending certain directives with a view to reinforcing prudential supervision (No 95/26/EC).
<i>post-sale notice</i>	a notice of a right to cancel an <i>investment agreement</i> given under COB 6.7.30R(2) (Giving the customer notice of a right to cancel).
<i>power of intervention</i>	the power conferred on the <i>FSA</i> under section 196 of the <i>Act</i> (The Power of Intervention) to impose a requirement on an <i>incoming firm</i> .
<i>pre-sale notice</i>	a notice of a right to cancel an <i>investment agreement</i> given under COB

6.7.30R(1) (Giving the customer notice of a right to cancel).

- predecessor scheme* any of the following:
- (a) The Office of the Banking Ombudsman;
 - (b) The Office of the Building Societies Ombudsman;
 - (c) The Insurance Ombudsman Bureau;
 - (d) The Office of the Investment Ombudsman;
 - (e) The Personal Investment Authority Ombudsman Bureau;
 - (f) The Personal Insurance Arbitration Service;
 - (g) The Securities and Futures Authority Complaints Bureau and Arbitration Service;
 - (h) The FSA Complaints Unit and Independent Investigator.
- preliminary charge* a charge upon a sale of units by an authorised fund manager whether or not acting as principal.
- premium*
- (1) (in relation to a general insurance contract) the consideration payable under the contract by the policyholder to the insurer.
 - (2) (in relation to a long-term insurance contract) a payment under the contract; (except in SUP 16.8 (Persistency reports from insurers)) a premium is a regular premium if it is one of a series of payments under the contract:
 - (a)
 - (i) which are payable on dates that are certain or ascertainable at the time the contract is made;
 - (ii) which are payable over a period that exceeds one year in length; and
 - (iii) assuming the policy evidencing the contract is not surrendered or otherwise terminated before the premiums fall due, will fall due on those dates without either party to the contract exercising any option under the contract; or
 - (b) of which the first payment is an obligation under the contract, and subsequent payments, calculated according to an agreed formula, are payable over a period which exceeds one year in length under a collateral written arrangement with the insurer or friendly society.
 - (3) (in relation to an option) the total amount which the purchaser of the option is, or may be, required to pay in consideration for the right to exercise the option.
- premium trust fund* a trust fund into which premiums receivable by members are paid in compliance with a trust deed under LLD 10.3 (Carrying of insurance receivables to trust funds).
- prescribed market* a market which has been prescribed by the Treasury in the Prescribed Markets and Qualifying Investments Order (see MAR 1 (Code of

	market conduct)).
<i>Prescribed Markets and Qualifying Investments Order</i>	the Financial Services and Markets Act 2000 (Prescribed Markets and Qualifying Investments) Order 2001 (SI 2001/996).
<i>prescribed pricing basis</i>	(in relation to a <i>derivative</i> contract, or <i>quasi-derivative contract</i>), the pricing basis set out in <i>IPRU(INS)</i> 4.12R(8) (Derivative contracts).
<i>previous regulator</i>	<p>(1) (in relation to a <i>firm</i> which was authorised under the Banking Act 1987 immediately before <i>commencement</i> or which was a European institution (as defined in the Banking Coordination (Second Council Directive) Regulations 1992) immediately before <i>commencement</i>) the <i>FSA</i>.</p> <p>(2) (in relation to a <i>firm</i> which was a <i>building society</i> immediately before <i>commencement</i>) the Building Societies Commission.</p> <p>(3) (in relation to a <i>firm</i> which was a <i>friendly society</i> immediately before <i>commencement</i>) the Friendly Societies Commission.</p> <p>(4) (in relation to a <i>firm</i> authorised under the Insurance Companies Act 1982 immediately before <i>commencement</i>) the Treasury.</p> <p>(5) (in relation to an <i>underwriting agent</i> which obtained the <i>permission</i> relevant to that category under the Financial Services and Markets Act 2000 (Repeals, Transitional Provisions and Savings) Order 2001 (SI 2001/[number to be added later])) the <i>Society of Lloyd's</i>.</p> <p>(6) (in relation to a <i>firm</i> which was authorised, or which was an <i>appointed representative</i>, under the Financial Services Act 1986 immediately before <i>commencement</i> or which was a European investment firm (as defined in the Investment Services Regulations 1995 (SI 1995/3275)) immediately before <i>commencement</i>) any of:</p> <p>(a) <i>IMRO</i>;</p> <p>(b) <i>PIA</i>;</p> <p>(c) <i>SFA</i>;</p> <p>(d) a <i>recognised professional body</i>; and</p> <p>(e) the <i>FSA</i>;</p> <p>if the <i>firm</i> (or, if relevant, its principal for the purposes of section 44 of the Financial Services Act 1986) was subject in carrying on business to the rules, requirements, regulations or guidance of that body.</p> <p>(7) (in relation to an <i>ex-section 43 firm</i>) the <i>FSA</i>.</p>
<i>price</i>	(in relation to a <i>unit</i> in an <i>ICVC</i> or a <i>single-priced AUT</i>) the price of the <i>unit</i> calculated in accordance with <i>CIS</i> 4 (Single pricing and dealing).
<i>price stabilising</i>	the <i>rules</i> made under section 144 of the <i>Act</i> , and appearing in <i>MAR</i> 2.1

<i>rules</i>	to <i>MAR 2.5</i> , together with any other provisions available for their interpretation.
<i>primary pooling event</i>	an event that occurs in the circumstances described in <i>COB 9.5.5R</i> (Failure of the authorised firm: primary pooling event).
<i>PRIN</i>	the part of the <i>Handbook</i> in High Level Standards that has the title Principles for Businesses.
<i>principal</i>	<p>(1) in relation to a <i>person</i>:</p> <p>(a) a <i>person</i> acting on his own account;</p> <p>(b) (if the <i>person</i> is an <i>appointed representative</i>) the <i>authorised person</i> who is party to a contract with the <i>appointed representative</i> resulting in him being exempt under section 39 of the <i>Act</i> (Exemption of appointed representatives).</p> <p>(2) in relation to an <i>option, future</i> or forward contract:</p> <p>(a) (except in the case of an <i>option</i> on a <i>future</i>) the amount of property or the value of the property which must be delivered in order to satisfy settlement of the <i>option, future</i> or forward contract;</p> <p>(b) (in relation to an <i>option</i> on a <i>future</i>) the amount of property or the value of the property which must be delivered in order to satisfy settlement of the <i>future</i>.</p>
<i>Principle</i>	one of the Principles set out in <i>PRIN 2.1.1R</i> (Principles for Businesses).
<i>private customer</i>	<p>(1) (except in <i>COB 3</i>) a <i>client</i> who is not a <i>market counterparty</i> or an <i>intermediate customer</i>, including:</p> <p>(a) an individual who is not a <i>firm</i>;</p> <p>(b) an overseas individual who is not an <i>overseas financial services institution</i>;</p> <p>(c) a <i>regulated collective investment scheme</i>;</p> <p>(d) (except for the purposes of <i>DISP</i>) a <i>client</i> when he is classified as a <i>private customer</i> in accordance with <i>COB 4.1.14R</i> (Client classified as a private customer);</p> <p>but excluding a <i>client</i>, who would otherwise be a <i>private customer</i>, when he is classified as an <i>intermediate customer</i> in accordance with <i>COB 4.1.9R</i> (Expert private customer classified as an intermediate customer).</p> <p>(2) (in <i>COB 3</i>) a <i>person</i> in (1) or a <i>person</i> who would be such a <i>person</i> if he were a <i>client</i>.</p>
<i>private person</i>	<p>(as defined in article 3 of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2000 (SI 2001/2256)):</p> <p>(a) any individual, unless he suffers the loss in question in the</p>

- course of carrying on:
- (i) any *regulated activity*; or
 - (ii) any activity which would be a *regulated activity* apart from any exclusion made by article 72 of the Regulated Activities Order (Overseas persons); and
- (b) any *person* who is not an individual, unless he suffers the loss in question in the course of carrying on business of any kind;

but not including a government, a local authority (in the *United Kingdom* or elsewhere) or an international organisation;

for the purposes of (a), an individual who suffers loss in the course of *effecting or carrying out contracts of insurance written at Lloyd's* is not to be taken to suffer loss in the course of carrying on a *regulated activity*;

in this definition:

- (A) "government" means:
- (I) the government of the *United Kingdom*; or
 - (II) the Scottish Administration; or
 - (III) the Executive Committee of the Northern Ireland Assembly; or
 - (IV) the National Assembly for Wales; or
 - (V) the government of any country or territory outside the *United Kingdom*;
- (B) "international organisation" means any international organisation the members of which include the *United Kingdom* or any other State;
- (C) "local authority", in relation to the *United Kingdom*, means:
- (I) in England and Wales, a local authority as defined in the Local Government Act 1972, the Greater London Authority, the Common Council of the City of London or the Council of the Isles of Scilly;
 - (II) in Scotland, a local authority as defined in the Local Government (Scotland) Act 1973; and
 - (III) in Northern Ireland, a district council as defined in the Local Government Act (Northern Ireland) 1972.

product provider a *firm* which is:

- (a) a *long-term insurer*;
- (b) a *friendly society*;

	(c) the <i>operator</i> of a <i>regulated collective investment scheme</i> or an <i>investment trust savings scheme</i> .
<i>PROF</i>	the Professional firms sourcebook.
<i>professional firm</i>	(in accordance with sections 325(2) (Definition of "members") and 327(2) (Exemption from the general prohibition of the Act) a <i>person</i> which is: <ul style="list-style-type: none"> (a) an individual who is entitled to practise a profession regulated by a <i>designated professional body</i> and in practising it is subject to its rules; or (b) a <i>person</i> (not being an individual) which is managed and controlled by one or more individuals each of whom: <ul style="list-style-type: none"> (i) is entitled to practise a profession regulated by a <i>designated professional body</i>; and (ii) in practising it is subject to the rules of the <i>designated professional body</i>.
<i>prohibition order</i>	an order made by the <i>FSA</i> under section 56 of the <i>Act</i> (Prohibition orders) which prohibits an individual from performing a specified function, any function falling within a specified description or any function.
<i>projection</i>	a projection of the amount of any future benefit payable under a contract or <i>policy</i> , being a benefit the amount of which is not ascertainable under the terms of the contract or <i>policy</i> when the calculation is made.
<i>projection date</i>	the date to which is <i>projection</i> is made.
<i>property enterprise trust</i>	an <i>unregulated collective investment scheme</i> of which the underlying assets are land and buildings.
<i>property investment company</i>	(in <i>CIS</i>) a <i>body corporate</i> , a substantial activity of which relates to <i>permitted immovables</i> (whether by way of investing, dealing in, developing, redeveloping or refurbishing them and whether directly or indirectly).
<i>property related assets</i>	(in <i>CIS</i>): <ul style="list-style-type: none"> (a) <i>shares, debentures</i> or <i>warrants</i> which are issued by a <i>property investment company</i>; (b) <i>certificates representing certain securities</i> which confer rights in respect of an <i>investment</i> within (a).
<i>property scheme</i>	(in <i>CIS</i>) an <i>authorised fund dedicated</i> to <i>permitted immovables</i> and <i>property related assets</i> , whether with or without <i>transferable securities</i> .
<i>prospectus</i>	(in relation to a <i>collective investment scheme</i>) a <i>document</i> containing information about the <i>scheme</i> and complying with the requirements in <i>CIS</i> 3 or <i>CIS</i> 17 applicable to a prospectus of a <i>scheme</i> of the type concerned.

<i>protected claim</i>	a <i>claim</i> which is covered by the <i>compensation scheme</i> , as defined in <i>COMP 5.2.1R</i> .
<i>protected contract of insurance</i>	a <i>contract of insurance</i> which is covered by the <i>compensation scheme</i> , as defined in <i>COMP 5.4.1R</i> .
<i>protected deposit</i>	a <i>deposit</i> which is covered by the <i>compensation scheme</i> , as defined in <i>COMP 5.3.1R</i> .
<i>protected investment business</i>	<i>designated investment business</i> which is covered by the <i>compensation scheme</i> , as defined in <i>COMP 5.5.1R</i> .
<i>protected items</i>	(as defined in section 413 of the <i>Act</i> (Protected items)) communications (and items which they enclose or refer to and which are in the possession of a <i>person</i> entitled to possession of them) between: <ul style="list-style-type: none"> (a) a professional legal adviser and his client or any <i>person</i> representing his client; or (b) a professional legal adviser, his client or any <i>person</i> representing his client and any other <i>person</i>; where the communication or the item is made: <ul style="list-style-type: none"> (i) in connection with the giving of legal advice to the client; or (ii) in connection with, or in contemplation of, legal proceedings and for the purposes of those proceedings; and is not held with the intention of furthering a criminal purpose.
<i>provider firm</i>	a <i>firm</i> that is: <ul style="list-style-type: none"> (a) a <i>product provider</i>; or (b) a <i>marketing group associate</i>.
<i>prudential context</i>	in relation to activities carried on by a <i>firm</i> , the context in which the activities have, or might reasonably be regarded as likely to have, a negative effect on: <ul style="list-style-type: none"> (a) confidence in the <i>financial system</i>; or (b) the ability of the <i>firm</i> to meet either: <ul style="list-style-type: none"> (i) the "fit and proper" test in <i>threshold condition 5</i> (Suitability); or (ii) the applicable requirements and standards under the <i>regulatory system</i> relating to the <i>firm's</i> financial resources.
<i>public announcement</i>	any communication made by or on behalf of the <i>issuer</i> or the <i>stabilising manager</i> being a communication made in circumstances in which it is likely that members of the public will become aware of the communication.
<i>public offer</i>	an offer of <i>securities</i> to the public and described in the <i>POS Regulations</i> .

*published
recommendation*

any publication by or on behalf of a *firm* (including publication by sound broadcasting or television or other electronic means) which contains:

- (a) the results of research into *investments*; or
- (b) analysis of factors likely to influence the future performance of *investments*; or
- (c) advice or recommendations based on those results or analysis, including any communication of which the content is common to a number of communications although worded as if it were a *personal recommendation*.

*pure protection
contract*

a *long-term insurance contract* in respect of which the following conditions are met:

- (a) the benefits under the contract are payable only on death or in respect of incapacity due to injury, sickness or infirmity;
- (b) the contract provides that benefits are payable on death (other than death due to an accident) only where the death occurs within ten years of the date on which the life of the person in question was first insured under the contract, or where the death occurs before that person attains a specified age not exceeding seventy years;
- (c) the contract has no surrender value, or the consideration consists of a single premium and the surrender value does not exceed that premium;
- (d) the contract makes no provision for its conversion or extension in a manner which would result in it ceasing to comply with any of (a), (b) or (c); and
- (e) the contract is not a reinsurance contract.

pure reinsurer

an *insurer* whose *insurance business* is restricted to reinsurance.

qualified valuer

(in relation to any particular type of land in any particular area) a fellow or professional associate of the Royal Institution of Chartered Surveyors, a fellow or associate of the Incorporated Society of Valuers and Auctioneers, or a fellow or associate of the Rating and Valuation Association, who:

- (a) has knowledge of and experience in the valuation of that particular type of land in that particular area; or
- (b) has knowledge of and experience in the valuation of land and has taken advice from a valuer who he is satisfied has knowledge of and experience in the valuation of that particular type of land in that particular area; or
- (c) immediately before 15 June 1981 was recognised as a qualified valuer by approval by the Secretary of State under the Insurance Companies (Valuation of Assets) Regulations 1976.

qualifying investment an *investment* which has been prescribed by the Treasury in the

	<i>Prescribed Markets and Qualifying Investments Order</i> (see <i>MAR 1</i> (Code of market conduct)).
<i>quantification date</i>	the date as at which the liability of the <i>relevant person in default</i> is to be determined under <i>COMP 12.3</i> .
<i>quasi-derivative contract</i>	a contract or asset having the effect of a <i>derivative</i> contract.
<i>railway rolling stock</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph 5 of Part I of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of general insurance), against loss of or damage to railway rolling stock.
<i>RCH</i>	a <i>recognised clearing house</i> .
<i>RDC</i>	<i>Regulatory Decisions Committee</i> .
<i>readily realisable investment</i>	(a) a <i>packaged product</i> ; (b) a <i>readily realisable security</i> .
<i>readily realisable security</i>	(a) a <i>government or public security</i> denominated in the currency of the country of its <i>issuer</i> ; (b) any other <i>security</i> which is: <ul style="list-style-type: none"> (i) admitted to <i>official listing</i> on an exchange in an <i>EEA State</i>; or (ii) regularly traded on or under the rules of such an exchange; or (iii) regularly traded on or under the rules of a <i>recognised investment exchange</i> or (except in relation to <i>unsolicited real time financial promotions</i>) <i>designated investment exchange</i>; (c) a newly issued <i>security</i> which can reasonably be expected to fall within (b) when it begins to be traded.
<i>real time financial promotion</i>	(in accordance with article 7(1) of the <i>Financial Promotion Order</i>) (as more fully described in <i>COB 3.5.5R</i> ("Real time" and "non-real time" financial promotions)) a <i>financial promotion</i> made in the course of a personal visit, telephone conversation or other interactive dialogue.
<i>REC</i>	the Recognised Investment Exchange and Recognised Clearing House sourcebook.
<i>receivable</i>	(in <i>LLD</i>) (in relation to a <i>member</i> , a period and a <i>premium</i>) a <i>premium</i> due to the <i>member</i> in respect of <i>contracts of insurance</i> effected during the period, whether or not the <i>premium</i> is received during that period.
<i>recognised body</i>	an <i>RIE</i> or an <i>RCH</i> .
<i>recognised clearing house</i>	a <i>clearing house</i> which is declared by a <i>recognition order</i> for the time being in force to be a recognised clearing house.
<i>recognised investment exchange</i>	an investment exchange which is declared by a <i>recognition order</i> for the time being in force to be a recognised investment exchange.

<i>recognised overseas clearing house</i>	an <i>overseas clearing house</i> which is declared by a <i>recognition order</i> for the time being in force to be a <i>recognised clearing house</i> .
<i>recognised overseas investment exchange</i>	an <i>overseas investment exchange</i> which is declared by a <i>recognition order</i> for the time being in force to be a <i>recognised investment exchange</i> .
<i>recognised professional body</i>	any of the following professional bodies (which were the recognised professional bodies for the purposes of the Financial Services Act 1986): <ul style="list-style-type: none"> (a) The Law Society (England and Wales); (b) The Law Society of Scotland; (c) The Law Society of Northern Ireland; (d) The Institute of Chartered Accountants in England and Wales; (e) The Institute of Chartered Accountants of Scotland; (f) The Institute of Chartered Accountants in Ireland; (g) The Association of Chartered Certified Accountants; (h) The Institute of Actuaries. (see also <i>designated professional body</i> .)
<i>recognised scheme</i>	a <i>scheme</i> recognised under: <ul style="list-style-type: none"> (a) section 264 of the <i>Act</i> (Schemes constituted in other EEA States); or (b) section 270 of the <i>Act</i> (Schemes authorised in designated countries or territories); or (c) section 272 of the <i>Act</i> (Individually recognised overseas schemes).
<i>recognition order</i>	(in accordance with section 313 of the <i>Act</i> (Interpretation of Part XVIII)) an order made under section 290 or 292 of the <i>Act</i> which declares an investment exchange or <i>clearing house</i> to be a <i>recognised body</i> .
<i>recognition requirement</i>	<ul style="list-style-type: none"> (1) (in relation to a <i>UK RIE</i> or <i>UK RCH</i>) any of the requirements applicable to that body under the <i>Recognition Requirements Regulations</i>. (2) (in relation to a body applying for recognition as a <i>UK RIE</i> or <i>UK RCH</i>) any of the requirements under the <i>Recognition Requirements Regulations</i> which, if its application were successful, would apply to it. (3) (in relation to an <i>ROIE</i> or <i>ROCH</i>, or to an applicant for recognition as an <i>ROIE</i> or <i>ROCH</i>) any of the requirements in section 292(3) of the <i>Act</i> (Overseas investment exchanges and overseas clearing houses).
<i>Recognition Requirements</i>	the Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses)

<i>Regulations</i>	Regulations 2001 (SI 2001/995).
<i>redemption</i>	<p>(1) (except in <i>ENF 17</i> (Collective investment schemes)) (in relation to <i>units</i> in an <i>authorised fund</i>) the purchase of them from their <i>holder</i> by the <i>authorised fund manager</i> acting as a <i>principal</i>.</p> <p>(2) (in <i>ENF 17</i> (Collective investment schemes)) redemption as in (1) but including their cancellation by the <i>trustee</i> of an <i>AUT</i> or by an <i>ICVC</i>.</p>
<i>redemption charge</i>	<p>an amount levied by the <i>operator</i> of a <i>scheme</i> upon the <i>redemption</i> of <i>units</i>, in the case of an <i>authorised fund</i> under:</p> <p>(a) <i>CIS 8.2.7R</i> (Redemption charge: <i>ICVCs</i>); or</p> <p>(b) <i>CIS 8.5.2R</i> (Redemption charge: single-priced <i>AUTs</i>); or</p> <p>(c) <i>CIS 15.4.10R</i> (Redemption charge).</p>
<i>redemption price</i>	the <i>authorised fund manager's price</i> for <i>redemption</i> under <i>CIS 15.4.9R</i> (Redemption price parameters).
<i>register</i>	(in <i>CIS</i>) the register of <i>holders</i> kept under Schedule 3 to the <i>OEIC Regulations</i> or <i>CIS 6.2.1R</i> (Basic requirements) or, in relation to a <i>collective investment scheme</i> that is not an <i>authorised fund</i> , a record of the <i>holders</i> (other than of <i>bearer certificates</i>) of <i>units</i> in it.
<i>registered branch</i>	a branch of a <i>friendly society</i> which is separately registered under the Friendly Societies Act 1974.
<i>registered friendly society</i>	a <i>friendly society</i> registered under section 7(1)(a) of the Friendly Societies Act 1974 or any enactment which it replaced, including any <i>registered branches</i> .
<i>registrar</i>	the <i>person</i> who maintains a <i>register</i> .
<i>regular user</i>	(as defined in section 118(10) of the <i>Act</i> (Market abuse)) a <i>person</i> who is, in relation to a particular market, a reasonable <i>person</i> who regularly deals on that market in <i>investments</i> of the kind in question.
<i>Regulated Activities Order</i>	the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544).
<i>regulated activity</i>	<p>(in accordance with section 22 of the <i>Act</i> (The classes of activity and categories of investment)) any of the following activities specified in Part II of the <i>Regulated Activities Order</i> (Specified Activities):</p> <p>(a) <i>accepting deposits</i> (article 5);</p> <p>(b) <i>effecting contracts of insurance</i> (article 10(1));</p> <p>(c) <i>carrying out contracts of insurance</i> (article 10(2));</p> <p>(d) <i>dealing in investments as principal</i> (article 14);</p> <p>(e) <i>dealing in investments as agent</i> (article 21);</p> <p>(f) <i>arranging (bringing about) deals in investments</i> (article 25(1));</p> <p>(g) <i>making arrangements with a view to transactions in investments</i> (article 25(2));</p>

- (h) *managing investments* (article 37);
- (i) *safeguarding and administering investments* (article 40); for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *safeguarding and administration of assets (without arranging)*;
 - (ii) *arranging safeguarding and administration of assets*;
- (j) *sending dematerialised instructions* (article 45(1));
- (k) *causing dematerialised instructions to be sent* (article 45(2));
- (l) *establishing, operating or winding up a collective investment scheme* (article 51(1)(a)); for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *establishing, operating or winding up a regulated collective investment scheme*;
 - (ii) *establishing, operating or winding up an unregulated collective investment scheme*;
- (m) *acting as trustee of an authorised unit trust scheme* (article 51(1)(b));
- (n) *acting as the depositary or sole director of an open-ended investment company* (article 51(1)(c));
- (o) *establishing, operating or winding up a stakeholder pension scheme* (article 52);
- (p) *advising on investments* (article 57); for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *advising on investments (except pension transfers and pension opt-outs)*;
 - (ii) *advising on pension transfers and pension opt-outs*;
- (q) *advising on syndicate participation at Lloyd's* (article 56);
- (r) *managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's* (article 53);
- (s) *arranging deals in contracts of insurance written at Lloyd's* (article 58);
- (t) *agreeing to carry on a regulated activity* (article 64);

which is carried on by way of business and relates to a *specified investment* or, in the case of (l), (m), (n) and (o), is carried on in relation to property of any kind.

regulated activity
debt

an obligation to pay a sum due and payable under an agreement, the making or performance of which constitutes or is part of a *regulated activity* carried on by an individual who:

- (a) is, or has been, an *authorised person*; or
- (b) is carrying on, or has carried on, a *regulated activity* in

	contravention of the <i>general prohibition</i> .
<i>regulated collective investment scheme</i>	(a) an <i>ICVC</i> ; or (b) an <i>AUT</i> ; or (c) a <i>recognised scheme</i> ; whether or not the <i>units</i> are held within a <i>PEP</i> , <i>ISA</i> , or <i>pension contract</i> .
<i>regulated institution</i>	subject to the requirements of <i>IPRU</i> and as more fully defined in <i>IPRU</i> , an <i>insurance undertaking</i> , <i>credit institution</i> , <i>friendly society</i> or <i>investment firm</i> .
<i>regulated market</i>	(as defined in article 1 of the <i>ISD</i>) a market for the instruments listed in Section B of the Annex to the <i>ISD</i> which: (a) appears on the list of such markets drawn up by the market's <i>Home State</i> as required by article 16 of the <i>ISD</i> ; (b) functions regularly; (c) is characterised by the fact that regulations issued or approved by the competent authorities define the conditions for the operation of the market, the conditions for access to the market and, where Directive 79/279/EEC is applicable, the conditions governing admission to listing imposed in that Directive and, where that Directive is not applicable, the conditions that must be satisfied by a financial instrument before it can effectively be dealt in on the market; and (d) requires compliance with all the reporting and transparency requirements laid down by articles 20 and 21 of the <i>ISD</i> . (see <i>SUP 17 Ann 5G</i> for a list of these markets.)
<i>regulatory body</i>	any authority, body or <i>person</i> having, or who has had, responsibility for the supervision or regulation of any <i>regulated activities</i> or other financial services, whether in the <i>United Kingdom</i> or overseas.
<i>Regulatory Decisions Committee</i>	a committee of the Board of the <i>FSA</i> , described in <i>DEC 4.2</i> (The Regulatory Decisions Committee).
<i>regulatory function</i>	(as defined in section 291 of the <i>Act</i> (Liability in relation to recognised body's regulatory functions)) any function of a <i>recognised body</i> so far as relating to, or to matters arising out of, the obligations to which the body is subject under or by virtue of the <i>Act</i> .
<i>regulatory objectives</i>	(as described in sections 2(2) and 3 to 6 of the <i>Act</i>): (a) market confidence; (b) public awareness; (c) the protection of <i>consumers</i> ; and (d) the reduction of <i>financial crime</i> .
<i>regulatory provisions</i>	(a) (in accordance with section 302 of the <i>Act</i> (Interpretation)) (in relation to an investment exchange or <i>clearing house</i>) the rules of

or any guidance issued by the investment exchange or *clearing house*;

- (b) (in relation to an investment exchange):
 - (i) any arrangements which it has made, or proposes to make, for the provision of clearing services in respect of transactions effected on the exchange; and
 - (ii) if it provides, or proposes to provide, clearing services on exchange, the criteria which it applies, or proposes to apply, when determining to whom it will provide those services;
- (c) (in relation to a *clearing house*):
 - (i) if it makes, or proposes to make, clearing arrangements with an *RIE*, those arrangements; and
 - (ii) if it provides, or proposes to provide, clearing services for *persons* other than *RIEs*, the criteria which it will apply when determining to whom it will provide those services.

regulatory system the arrangements for regulating a *firm* or other *person* in or under the *Act*, including the *threshold conditions*, the *Principles* and other *rules*, the *Statements of Principle*, codes and *guidance*.

reinsurance to close (a) an agreement under which members of a *syndicate* in one *syndicate year* ("the reinsured members") agree with the members of that *syndicate* in a later *syndicate year* or the members of another *syndicate* ("the reinsuring members") that the reinsuring members will discharge, or procure the discharge of, or indemnify the reinsured members against, all known and unknown *insurance business* liabilities of the reinsured members arising out of the *insurance business* carried on by the reinsured members in that *syndicate year*; or

(b) a similar reinsurance agreement or arrangement that has been approved by the *Council* as a reinsurance to close.

related designated investment (in relation to a *designated investment* (the "first investment")) a *designated investment* whose value might reasonably be expected to be directly affected by:

- (a) any fluctuation in the value of the first investment; or
- (b) any *published recommendation* that concerns the first investment.

relevant business (in *DISP*) that part of a *firm's* business which it conducts with private individuals and which is subject to the jurisdiction of the *Financial Ombudsman Service* as provided for under *DISP* 2.6 (To which activities do the rules apply?), measured by reference to the appropriate tariff base for each *industry block*.

relevant charitable scheme an *authorised fund* which is:

- (a) a registered charity; or
- (b) a charitable unit trust scheme under regulation 7(2)(d) of the

- relevant collateral* in relation to a transaction:
- (a) cash;
 - (b) letters of credit and guarantees to the extent of their face value, issued by an *approved bank* which is neither a counterparty nor an *associate* of a counterparty;
 - (c) gold and silver bullion and coinage;
 - (d) *marketable investments*;
 - (e) the performance guarantees issued in support of the securities lending and borrowing programmes of Euroclear and Cedel, in respect only of *exposure* arising from participation in such programmes;
- subject in each case to:
- (i) the *firm* having an unconditional right to apply or realise the relevant collateral for the purpose of repaying a counterparty's obligations;
 - (ii) *marketable investments*:
 - (A) being marked to market daily using the valuation principles in *IPRU(INV)* 3.41(9)R;
 - (B) not being issued by a counterparty nor by an *associate* of a counterparty.
- relevant complaint* (as defined in section 299(2) of the *Act* (Complaints about recognised bodies)) a complaint which the *FSA* considers is relevant to the question of whether a *recognised body* should remain a *recognised body*.
- relevant firm* (in *ML*) a *firm* of the kind described in *ML* 1.1.2R.
- relevant function* (in relation to a *UK recognised body*) an *exempt activity* or a *regulatory function*.
- relevant general insurance contract* (in *COMP*) any *general insurance contract* other than:
- (a) a reinsurance contract;
 - (b) a *Lloyd's policy*;
 - (c) a contract falling within any of the following classes:
 - (i) *aircraft*;
 - (ii) *ships*;
 - (iii) *goods in transit*;
 - (iv) *aircraft liability*;
 - (v) *liability of ships*;
 - (vi) *credit*.

- relevant information* (1) (except in *REC*) (in relation to an *investment*) information which would be likely to be regarded by a *regular user* of the market in question as relevant when deciding the terms on which transactions in that *investment* should be effected.
- (2) (in *REC*) (in relation to an *investment*) information which is relevant to determining the current value of that *investment*.
- relevant office-holder* a relevant office-holder as defined in section 189 of the Companies Act 1989, which is in summary:
- (a) the official receiver;
- (b) (in relation to a company) any *person* acting as its liquidator, provisional liquidator, administrator or administrative receiver;
- (c) (in relation to an individual or a debtor within the Bankruptcy (Scotland) Act 1985) a trustee in bankruptcy, interim receiver of property, or permanent or interim trustee in the sequestration of an estate;
- (d) any *person* acting as administrator of an insolvent estate of a deceased *person*.
- relevant pension scheme* (a) an appropriate scheme for the purposes of section 1(8) of the Social Security Act 1986 or for the purposes of article 3(8) of the Social Security (Northern Ireland) Order 1986; or
- (b) an exempt approved scheme under section 592(1) of the Income and Corporation Taxes Act 1988 to which the employer is not a contributor and which provides benefits additional to those provided by:
- (i) another scheme approved under Chapter 1 of Part XIV of that Act to which the employer is a contributor; or
- (ii) a statutory scheme as defined in section 612(1) of that Act; or
- (iii) a relevant statutory scheme as defined in section 611A(1) of that Act; or
- (c) a *pension scheme* approved under Chapter IV of Part XIV of that Act.
- relevant person* (in *COMP*) a *person* for *claims* against whom the *compensation scheme* provides cover, as defined in *COMP* 6.2.1R.
- relevant product* (in *MAR*) (in accordance with section 118(6) of the *Act* (Market abuse)) (in relation to any *qualifying investment*):
- (a) anything which is the subject matter of that *qualifying investment*;
- (b) an *investment* whose price or value is expressed by reference to the *price* or value of that *qualifying investment*;
- (c) an *investment* whose subject matter is that *qualifying investment*.

<i>relevant regulated activities</i>	(in <i>ML</i>) activities of the kind described in <i>ML</i> 1.1.4R.
<i>relevant security</i>	(in <i>MAR</i>) a <i>security</i> subject to an <i>offer</i> falling within <i>MAR</i> 2.1.3R(1) and (3).
<i>remedial direction</i>	(in accordance with section 308(8) of the <i>Act</i> (Directions by the Treasury)) a direction requiring the <i>FSA</i> : <ul style="list-style-type: none"> (a) to exercise its powers under section 297(2) of the <i>Act</i> to revoke the <i>recognition order</i> for a <i>recognised body</i>; or (b) to exercise its powers under section 296 of the <i>Act</i> by giving such directions to the <i>recognised body</i> concerned as may be specified in the direction.
<i>remuneration</i>	any form of remuneration, including benefits of any kind.
<i>repo</i>	<ul style="list-style-type: none"> (a) an agreement between a seller and buyer for the sale of <i>securities</i>, under which the seller agrees to repurchase the <i>securities</i>, or equivalent <i>securities</i>, at an agreed date and, usually, at a stated price; (b) an agreement between a buyer and seller for the purchase of <i>securities</i>, under which the buyer agrees to resell the <i>securities</i>, or equivalent <i>securities</i>, at an agreed date and, usually, at a stated price.
<i>reportable transaction</i>	a transaction defined in <i>SUP</i> 17.5.1R (Transaction reporting: Reportable transaction).
<i>reporting accountant</i>	an accountant appointed: <ul style="list-style-type: none"> (a) by the <i>FSA</i>; or (b) by a <i>firm</i>, having been nominated or approved by the <i>FSA</i> under section 166 of the <i>Act</i> (Reports by skilled persons); or (c) by an applicant for <i>Part IV permission</i>; to report on one or more aspects of the business of a <i>firm</i> or applicant, such as its financial position, including <i>internal controls</i> and reporting returns.
<i>representative</i>	(in relation to <i>designated investment business</i>) an individual appointed by a <i>provider firm</i> or by an <i>appointed representative</i> of that <i>firm</i> , to carry out either or both of the following activities: <ul style="list-style-type: none"> (a) giving <i>advice on investments</i> to <i>customers</i> on the merits of <i>packaged products offered</i> by that <i>firm</i> (or any other <i>provider firm</i> within the same <i>marketing group</i>); (b) <i>arranging (bringing about) deals in investments</i> in relation to such products.
<i>required amount</i>	(in <i>LLD</i>) for a <i>member</i> , in relation to <i>general insurance business</i> or <i>long-term insurance business</i> , the required amount determined in accordance with <i>LLD</i> 11.2.6R or <i>LLD</i> 11.2.7R.

<i>required function</i>	any of <i>controlled functions</i> 8 to 12 in the <i>table of controlled functions</i> .
<i>required margin of solvency</i>	a <i>margin of solvency</i> required by <i>IPRU(INS)</i> or <i>IPRU(FSOC)</i> .
<i>required minimum margin</i>	for an <i>insurer</i> , the minimum margin required by <i>IPRU(INS)</i> .
<i>requirement</i>	a requirement included in a <i>firm's Part IV permission</i> under section 43 of the <i>Act</i> (Imposition of requirements), section 45(4) of the <i>Act</i> (Variation etc on the Authority's own initiative) or section 46 of the <i>Act</i> (Variation of permission on acquisition of control).
<i>requiring or encouraging</i>	taking or refraining from taking any action which requires or encourages another <i>person</i> to engage in <i>behaviour</i> which, if engaged in by the <i>person</i> requiring or encouraging, would amount to <i>market abuse</i> .
<i>requisite details</i>	the details required under the Financial Services and Markets Act 2000 (EEA Passport Rights) Regulations 2001 (SI 2001/1376) and set out in <i>SUP 13 Ann 1R</i> (Requisite details: branches) and <i>SUP 13 Ann 1R</i> (Requisite details: cross border services).
<i>restricted credit</i>	a loan for which, as a result of an existing arrangement between a supplier and a <i>firm</i> , the <i>customer's</i> application to the <i>firm</i> is submitted through the supplier and the terms of the loan require that it be paid to the supplier for goods or services supplied to the <i>customer</i> , not including loans secured by a charge over land or loans or payments by <i>plastic card</i> (other than a <i>store card</i>).
<i>retirement annuity</i>	an individual <i>pension policy</i> effected by a self-employed <i>person</i> or a <i>person</i> in non-pensionable employment before 1 July 1998 and which is approved under Chapter III, Part XIV of the Income and Corporation Taxes Act 1988.
<i>retirement fund</i>	the amount which will be available, at the date on which the investor retires, for the provision of benefits.
<i>RIE</i>	<i>recognised investment exchange</i> .
<i>rights to or interests in investments</i>	the <i>investment</i> , specified in article 89 of the <i>Regulated Activities Order</i> (Rights to or interests in investments), which is in summary: any right to or interest in any other <i>specified investment</i> , but excluding: <ul style="list-style-type: none"> (a) interests under the trusts of an <i>occupational pension scheme</i>; (b) rights to or interests in a <i>contract of insurance</i> of the kind referred to in paragraph (1)(a) of article 60 of the <i>Regulated Activities Order</i> (Plans covered by insurance or trust arrangements), or interests under a trust of the kind referred to in paragraph 1(b) of article 60 of the <i>Regulated Activities Order</i> (Plans covered by insurance or trust arrangements); (c) any other <i>specified investment</i>.
<i>risk assessment function</i>	<i>controlled function</i> CF14 in the <i>table of controlled functions</i> , described more fully in <i>SUP 10.8.3R</i> .

<i>ROCH</i>	<i>recognised overseas clearing house.</i>
<i>ROIE</i>	<i>recognised overseas investment exchange.</i>
<i>rolling spot forex contract</i>	<p>either of the following:</p> <p>(a) a <i>future</i>, other than a <i>future</i> traded or expressed to be as traded on a <i>recognised investment exchange</i>, where the property which is to be sold under the contract is foreign exchange or sterling; or</p> <p>(b) a <i>contract for differences</i> where the profit is to be secured or loss avoided by reference to fluctuations foreign exchange; and</p> <p>in either case where the contract is entered into for the purpose of speculation.</p>
<i>rule</i>	<p>(in accordance with section 417(1) of the <i>Act</i> (Definitions)) a rule made by the <i>FSA</i> under the <i>Act</i>, including:</p> <p>(a) a <i>Principle</i>; and</p> <p>(b) an <i>evidential provision</i>.</p>
<i>safe custody investment</i>	a <i>designated investment</i> , which is not the property of the <i>firm</i> , but for which the <i>firm</i> , or any <i>nominee company</i> controlled by the <i>firm</i> or by its <i>associate</i> , is accountable; which has been paid for in full by the <i>client</i> ; and which ceases to be a <i>safe custody investment</i> when the <i>firm</i> has disposed of it in accordance with a valid instruction.
<i>safeguarding and administering investments</i>	<p>the <i>regulated activity</i>, specified in article 40 of the <i>Regulated Activities Order</i> (Safeguarding and administering investments), which is in summary: the safeguarding and the administration of assets belonging to another and the administration of those assets, or arranging for one or more other <i>persons</i> to carry on that activity, where:</p> <p>(a) the assets consist of or include any <i>designated investment</i>; or</p> <p>(b) the arrangements for their safeguarding and administration are such that the assets may consist of or include <i>designated investments</i>, and either the assets have at any time since 1 June 1997 done so, or the arrangements have at any time (whether before or after that date) been held out as ones under which <i>designated investments</i> would be safeguarded and administered.</p>
<i>safeguarding and administration of assets (without arranging)</i>	<p>that part of <i>safeguarding and administering investments</i> which consists of both:</p> <p>(a) the safeguarding of assets belonging to another; and</p> <p>(b) the administration of those assets.</p>
<i>sale</i>	(in <i>CIS</i>) (in relation to <i>units</i> in an <i>authorised fund</i>) the sale of <i>units</i> by the <i>authorised fund manager</i> as <i>principal</i> .
<i>salvage right</i>	(in <i>LLD</i>) any right of a <i>member</i> under a <i>contract of insurance</i> (and vested in a <i>premium trust fund</i>) to take possession of and to dispose of property because he has made a payment or has become liable to make a payment in respect of a loss to that property.

<i>SARs</i>	the Rules Governing Substantial Acquisitions of Shares issued on the authority of the <i>Takeover Panel</i> .
<i>scheme</i>	<p>(1) (except in <i>COB</i> and <i>SUP</i>) a <i>collective investment scheme</i>.</p> <p>(2) (in <i>COB</i> and <i>SUP</i>)</p> <ul style="list-style-type: none"> (a) a <i>regulated collective investment scheme</i>; (b) an <i>investment trust</i> where the relevant <i>shares</i> have been or are to be acquired through an <i>investment trust savings scheme</i>; (c) an <i>investment trust</i> where the relevant <i>shares</i> are to be held within an <i>ISA</i> or <i>PEP</i> which promotes one or more specific <i>investment trusts</i>; (d) (in <i>COB</i> 10) in addition to (a), (b) and (c), an <i>unregulated collective investment scheme</i>.
<i>scheme holding</i>	<p>a holding of:</p> <ul style="list-style-type: none"> (a) <i>units</i> in a <i>collective investment scheme</i>; or (b) <i>shares</i> in an <i>investment trust savings scheme</i>.
<i>scheme management activity</i>	the management by an <i>operator</i> of the property held for or within the <i>scheme</i> of which it is the <i>operator</i> , excluding the receiving and holding of <i>client money</i> and <i>safeguarding and administering investments</i> .
<i>scheme of arrangement</i>	<p>(in <i>CIS</i>) an arrangement relating to an <i>authorised fund</i> ("transferor fund") or to a <i>sub-fund</i> of an <i>umbrella scheme</i> ("transferor sub-fund") under which:</p> <ul style="list-style-type: none"> (a) either: <ul style="list-style-type: none"> (i) all or part of the property of the transferor fund, or all or part of the property attributed to the transferor sub-fund, is to become the property of one or more <i>regulated collective investment schemes</i> ("transferee schemes"); or (ii) all or part of the property attributed to the transferor sub-fund is to become part of the property attributed to one or more other <i>sub-funds</i> of the same <i>umbrella scheme</i> ("transferee sub-funds"); and (b) <i>holders</i> of <i>units</i> in the transferor fund or transferor sub-fund, the property of which is being transferred or reattributed under (a), are to receive, in exchange for their respective interests in that property, either: <ul style="list-style-type: none"> (i) <i>units</i> in the transferee scheme or one or more of the transferee schemes, to which the property is transferred; or (ii) <i>units</i> in the transferee sub-fund or one or more of the transferee sub-funds, to which the property is reattributed.

<i>scheme of operations</i>	a scheme which: <ul style="list-style-type: none"> (a) describes the nature of the risks which the <i>insurer</i> is underwriting, or intends to underwrite, and the guiding principles which it intends to follow in reinsuring or covering those risks; and (b) contains the information required under <i>SUP</i> App 2.9.1R (Content of a scheme of operations).
<i>scheme particulars</i>	a <i>document</i> containing information about a <i>regulated collective investment scheme</i> .
<i>scheme property</i>	<ul style="list-style-type: none"> (a) (in relation to an <i>ICVC</i>) the property subject to the <i>collective investment scheme</i> constituted by it; (b) (in relation to an <i>AUT</i>) the <i>capital property</i> and the <i>income property</i>.
<i>SDRT provision</i>	a <i>charge</i> of such amount or at such rate as is determined by the <i>authorised fund manager</i> to be made as a provision for stamp duty reserve tax for which the <i>ICVC</i> may become liable under the Stamp Duty and Stamp Duty Reserve Tax (Open-Ended Investment Companies)(Amendment No.2) Regulations 2000 or the <i>trustee</i> may become liable under Schedule 19 to the Finance Act 1999 in respect of a surrender of <i>units</i> to the <i>authorised fund manager</i> .
<i>Second Life Directive</i>	the Council Directive of 8 November 1990 on the coordination of laws, etc and laying down provisions relating to facilitate the effective exercise of freedom to provide services and amending Directive 79/267/EEC (No 90/619/EEC).
<i>Second Non-Life Directive</i>	the Council Directive of 22 June 1988 on the coordination of laws, etc and laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 73/239/EEC (No 88/357/EEC).
<i>secondary material</i>	(as more fully described in section 394 of the <i>Act</i> (Access to Authority material)) material, other than that which the <i>FSA</i> relied on in reaching its decision, which: <ul style="list-style-type: none"> (a) the <i>FSA</i> considered in reaching its decision; or (b) the <i>FSA</i> obtained in connection with, that is, in the investigation of, the matter in question.
<i>secondary pooling event</i>	an event that occurs in the circumstances described in <i>COB</i> 9.5.14R (Failure of a bank, intermediate broker, settlement agent or OTC counterparty: secondary pooling events).
<i>section 43 capital requirements</i>	the financial supervision requirements of the <i>FSA</i> for the purposes of the listing arrangements made under section 43 of the Financial Services Act 1986.
<i>secured debt</i>	(in <i>LLD</i>) a debt owed to (or an obligation to be fulfilled for the benefit of) a <i>member</i> , secured by an <i>admissible asset</i> .
<i>securities and futures</i>	a <i>firm</i> whose <i>permitted activities</i> include <i>designated investment</i>

firm

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

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

	(d) a <i>firm</i> that is:
	(i) an <i>ex-section 43 firm</i> which was not authorised under the Financial Services Act 1986 immediately before <i>commencement</i> ; or
	(ii) an <i>ex-section 43 lead regulated firm</i> .
<i>securities scheme</i>	an <i>authorised fund dedicated to transferable securities</i> , excluding an <i>authorised fund</i> which is a <i>feeder fund</i> , a <i>fund of funds scheme</i> or a <i>warrant scheme</i> .
<i>security</i>	(in accordance with article 3(1) of the <i>Regulated Activities Order (Interpretation)</i>) any of the following <i>investments</i> specified in that Order:
	(a) <i>share</i> (article 76);
	(b) <i>debenture</i> (article 77);
	(c) <i>government and public security</i> (article 78);
	(d) <i>warrant</i> (article 79);
	(e) <i>certificate representing certain securities</i> (article 80);
	(f) <i>unit</i> (article 81);
	(g) <i>stakeholder pension scheme</i> (article 82);
	(h) <i>rights to or interests in investments</i> in (a) to (g) (article 89).
<i>segregated client</i>	a <i>client</i> whose <i>money</i> must be segregated by the <i>firm</i> under COB 9.3.37R (Segregation).
<i>sell</i>	(in accordance with article 3(1) of the <i>Regulated Activities Order (Interpretation)</i>) (in relation to any <i>investment</i>) sell in any way, including disposing of the <i>investment</i> for valuable consideration; in this definition, "disposing" includes:
	(a) (in relation to an <i>investment</i> consisting of rights under a contract):
	(i) surrendering, assigning or converting those rights; or
	(ii) assuming the corresponding liabilities under the contract;
	(b) (in relation to an <i>investment</i> consisting of rights under other arrangements) assuming the corresponding liabilities under the arrangements; and
	(c) (except in <i>CIS</i>) (in relation to any other <i>investment</i>) issuing or creating the <i>investment</i> or granting the rights or interests of which it consists.
<i>sending dematerialised instructions</i>	the <i>regulated activity</i> , specified in article 45(1) of the <i>Regulated Activities Order</i> , of sending, on behalf of another <i>person</i> , dematerialised instructions relating to a <i>security</i> , where those instructions are sent by means of a relevant system in respect of which an operator is approved under the 1995 Regulations;

	in this definition:
	(a) "the 1995 Regulations" means the Uncertificated Securities Regulations 1995 (SI 1995/3272);
	(b) "dematerialised instruction" and "operator" have the meaning given by regulation 3 of the 1995 Regulations.
<i>senior manager</i>	an individual other than a <i>director</i> :
	(a) who is employed by:
	(i) a <i>firm</i> ; or
	(ii) a <i>body corporate</i> within a <i>group</i> of which the <i>firm</i> is a member;
	(b) to whom the <i>governing body</i> of the <i>firm</i> , or a member of the <i>governing body</i> of the <i>firm</i> , has given responsibility, either alone or jointly with others, for management and supervision;
	(c) who, if the individual is employed by the <i>firm</i> , reports directly to:
	(i) the <i>governing body</i> ; or
	(ii) a member of the <i>governing body</i> ; or
	(iii) the <i>chief executive</i> ; or
	(iv) the head of a significant business unit; and
	(d) who, if the individual is employed by a <i>body corporate</i> within the <i>group</i> , reports directly to a <i>person</i> who is the equivalent of a body or <i>person</i> referred to in (c).
<i>senior staff committee</i>	(in <i>DEC</i>) a committee consisting of senior <i>FSA</i> staff members that is empowered to make <i>statutory notice decisions</i> and <i>statutory notice associated decisions</i> by <i>executive procedures</i> .
<i>series of transactions</i>	a series of transactions <i>executed</i> with a view to achieving one investment decision or objective.
<i>service company</i>	a <i>firm</i> whose only <i>permitted activities</i> are <i>making arrangements with a view to transactions in investments</i> , and <i>agreeing to carry on that regulated activity</i> , and whose <i>Part IV permission</i> :
	(a) incorporates a <i>limitation</i> substantially to the effect that the <i>firm</i> carry on <i>regulated activities</i> only with <i>market counterparties</i> or <i>intermediate customers</i> ; and
	(b) includes <i>requirements</i> substantially to the effect that the <i>firm</i> must not:
	(i) guarantee, or otherwise accept responsibility for, the performance, by a participant in arrangements made by the <i>firm</i> in carrying on <i>regulated activities</i> , of obligations undertaken by that participant in connection with those arrangements; or
	(ii) <i>approve</i> any <i>financial promotion</i> on behalf of any other <i>person</i> or any specified class of <i>persons</i> ; or

	(iii) in carrying on its <i>regulated activities</i> , provide services otherwise than in accordance with <i>documents</i> (of a kind specified in the <i>requirement</i>) provided by the <i>firm</i> to the <i>FSA</i> .
<i>service conditions</i>	(in accordance with paragraph 14 of Schedule 3 to the <i>Act</i> (EEA Passport Rights)) the conditions that: <ul style="list-style-type: none"> (a) the <i>firm</i> has given its <i>Home State regulator</i> notice of its intention to provide services in the <i>United Kingdom</i>; (b) if the <i>firm</i> falls within paragraph (a) or (d) in the definition of "<i>EEA firm</i>", the <i>FSA</i> has received notice from the <i>firm's Home State regulator</i> containing such information as may be prescribed; and (c) if the <i>firm</i> falls within paragraph (d) of that definition, its <i>Home State regulator</i> has informed it that the regulator's notice has been sent to the <i>FSA</i>.
<i>SETS</i>	the Stock Exchange Electronic Trading Service.
<i>settlement agent</i>	a <i>person</i> with or through whom the <i>firm</i> effects settlement of <i>UK-settled</i> or <i>foreign-settled</i> transactions.
<i>Seventh Company Law Directive</i>	the Council Directive of 13 June 1983 on consolidated accounts (No 83/349/EEC).
<i>SFA</i>	the Securities and Futures Authority Limited.
<i>share</i>	(1) (except in <i>CIS</i>) the <i>investment</i> , specified in article 76 of the <i>Regulated Activities Order</i> (Shares etc), which is in summary: a share or stock in the share capital of: <ul style="list-style-type: none"> (a) any <i>body corporate</i> (wherever incorporated); (b) any unincorporated body constituted under the law of a country or territory outside the <i>United Kingdom</i>. (2) (in <i>CIS</i>): <ul style="list-style-type: none"> (a) (in relation to an <i>ICVC</i>) a <i>share</i> in the <i>ICVC</i> (including both <i>smaller denomination shares</i> and <i>larger denomination shares</i>); (b) (otherwise) an <i>investment</i> within (1).
<i>shareholder</i>	(in relation to an <i>ICVC</i> , and subject to <i>CIS</i> 11.2.2R (Special meaning of shareholder)): <ul style="list-style-type: none"> (a) (in relation to a <i>share</i> that is represented by a <i>bearer certificate</i>) the <i>person</i> who holds the certificate; (b) (in relation to a <i>share</i> that is not represented by a <i>bearer certificate</i>) the <i>person</i> whose name is entered on the <i>register</i> in relation to that <i>share</i>.
<i>ships</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph 6 of Part I of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of general insurance), upon

	vessels used on the sea or on inland water, or upon the machinery, tackle, furniture or equipment of such vessels.
<i>shortfall</i>	<p>(1) (in relation to cancellation of an <i>investment agreement</i>) the amount a <i>firm</i> is entitled to charge a <i>customer</i> for the market loss in accordance with <i>COB 6.7.54R</i> to <i>COB 6.7.58R</i> (Shortfall; Exceptions to shortfall).</p> <p>(2) (in relation to <i>client money</i>) the amount by which the <i>client money</i> in a <i>client bank account</i> is insufficient to satisfy the claims of <i>clients</i> in respect of that <i>money</i>, or not immediately available to satisfy such claims.</p>
<i>sickness</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph 2 of Part I of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of general insurance), providing fixed pecuniary benefits or benefits in the nature of indemnity (or a combination of both) against risks of loss to the <i>persons</i> insured attributable to sickness or infirmity, but excluding contracts within paragraph IV of Part II of Schedule 1 to the <i>Regulated Activities Order</i> (Permanent health).
<i>sickness or distressed circumstances contract</i>	any contract in accordance with which benefits are provided for the relief or maintenance of any <i>person</i> during sickness or when in distressed circumstances.
<i>significant influence function</i>	any of the <i>controlled functions</i> 1 to 20 in the <i>table of controlled functions</i> .
<i>significant management (designated investment business) function</i>	<i>controlled function</i> CF16 in the <i>table of controlled functions</i> , described more fully in <i>SUP 10.9.10R</i> .
<i>significant management (financial resources) function</i>	<i>controlled function</i> CF19 in the <i>table of controlled functions</i> , described more fully in <i>SUP 10.9.16R</i> .
<i>significant management (insurance underwriting) function</i>	<i>controlled function</i> CF18 in the <i>table of controlled functions</i> , described more fully in <i>SUP 10.9.14R</i> .
<i>significant management (other business operations) function</i>	<i>controlled function</i> CF17 in the <i>table of controlled functions</i> , described more fully in <i>SUP 10.9.12R</i> .
<i>significant management (settlements) function</i>	<i>controlled function</i> CF20 in the <i>table of controlled functions</i> , described more fully in <i>SUP 10.9.18R</i> .
<i>significant</i>	any of the <i>controlled functions</i> 16 to 20 in the <i>table of controlled</i>

management function functions.

<i>Single Market Directives</i>	(as defined in paragraph 1 of Schedule 3 to the <i>Act</i> (EEA Passport Rights)) the <i>Banking Consolidation Directive</i> , the <i>Insurance Directives</i> and the <i>Investment Services Directive</i> .
<i>single-priced AUT</i>	an <i>AUT</i> for the <i>units</i> of which there is only one <i>price</i> applicable by reference to a <i>valuation point</i> .
<i>skilled person</i>	a <i>person</i> appointed to make a report required by section 166 of the <i>Act</i> (Reports by skilled persons) for provision to the <i>FSA</i> and who must be a <i>person</i> : <ul style="list-style-type: none"> (a) nominated or approved by the <i>FSA</i>; and (b) appearing to the <i>FSA</i> to have the skills necessary to make a report on the matter concerned.
<i>small business</i>	(in <i>COMP</i>) a <i>partnership</i> , <i>body corporate</i> , unincorporated association or mutual association with an annual turnover of less than £1 million (or its equivalent in any other currency at the relevant time).
<i>small friendly society function</i>	<i>controlled function</i> CF6 in the <i>table of controlled functions</i> , described more fully in <i>SUP</i> 10.6.26R.
<i>small personal investment firm</i>	a <i>personal investment firm</i> : <ul style="list-style-type: none"> (a) which is not an <i>ISD investment firm</i>; (b) which is not a <i>network</i>; and (c) which has fewer than 26 <i>financial advisers</i> or <i>representatives</i>.
<i>small self-administered scheme</i>	an <i>occupational pension scheme</i> of a kind described in article 4(4) and 4(5) of the Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001 (SI 2001/1177).
<i>smaller denomination share</i>	a <i>share</i> to which are attached rights in a smaller denomination as provided by regulation 45 of the <i>OEIC regulations</i> .
<i>social insurance</i>	(in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i> , specified in paragraph IX of Part II of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of long-term insurance), of a kind referred to in article 1(3) of the <i>First Life Directive</i> ("operations relating to the length of human life which are prescribed by or provided for in <i>social insurance</i> legislation, when they are effected or managed at their own risk by assurance undertakings in accordance with the laws of an <i>EEA State</i> ").
<i>Society</i>	the society incorporated by Lloyd's Act 1871 by the name of Lloyd's.
<i>Society guarantee fund</i>	(in <i>LLD</i>) the guarantee fund calculated by the <i>Society</i> under <i>LLD</i> 11.5.2R.
<i>Society margin</i>	(in <i>LLD</i>) the margin calculated by the <i>Society</i> under <i>LLD</i> 11.5.1R.
<i>Society's basic market activity</i>	(in accordance with section 315(2)(a) of the <i>Act</i> (The Society: authorisation and permission)) <i>arranging deals in contracts of insurance written at Lloyd's</i> .

<i>Society's regulatory functions</i>	the <i>Society's</i> powers, duties or functions in relation to <i>members</i> or <i>underwriting agents</i> which are or may be exercised for the purposes of supervising or regulating the market at Lloyd's.
<i>Society's secondary market activity</i>	(in accordance with section 315(2)(b) of the <i>Act</i> (The Society: authorisation and permission)) arranging deals in participation in Lloyd's syndicates.
<i>soft commission agreement</i>	an agreement in any form, the terms of which permit a <i>firm</i> to receive certain goods or services from another <i>person</i> in return for transacting <i>designated investment business</i> with or through that other <i>person</i> .
<i>sole trader</i>	an individual who is a <i>firm</i> .
<i>sole trader function</i>	<i>controlled function</i> CF7 in the <i>table of controlled functions</i> , described more fully in SUP 10.6.30R.
<i>solicited real time financial promotion</i>	(in accordance with article 8 of the <i>Financial Promotion Order</i>) (as more fully described in COB 3.10.1R (Meaning of "solicited" and "unsolicited" real time financial promotion)) a <i>real time financial promotion</i> which is solicited, that is, it is made in the course of a personal visit, telephone call or other interactive dialogue if that call, visit or dialogue: <ul style="list-style-type: none"> (a) was initiated by the recipient of the <i>financial promotion</i>; or (b) takes place in response to an express request from the recipient of the <i>financial promotion</i>.
<i>special purpose vehicle</i>	a <i>body corporate</i> whose sole purpose (either generally or when acting in a particular capacity) is to carry out one or more of the following functions: <ul style="list-style-type: none"> (a) issuing <i>designated investments</i>, other than <i>life policies</i>; (b) redeeming or terminating or repurchasing (whether with a view to re-issue or to cancellation) an issue (in whole or part) of <i>designated investments</i>, other than <i>life policies</i>; (c) entering into transactions or terminating transactions involving <i>designated investments</i> in connection with the <i>issue</i>, redemption, termination or re-purchase of <i>designated investments</i>, other than <i>life policies</i>; subject to the special purpose vehicle having been: <ul style="list-style-type: none"> (i) explicitly established for the purpose of securitising assets; and (ii) assessed by a rating agency.
<i>specific non-real time financial promotion</i>	a <i>non-real time financial promotion</i> which identifies and promotes a particular <i>investment</i> or service.
<i>specified investment</i>	any of the following <i>investments</i> specified in Part III of the <i>Regulated Activities Order</i> (Specified Investments): <ul style="list-style-type: none"> (a) <i>deposit</i> (article 74); (b) <i>contract of insurance</i> (article 75); for the purposes of the

permission regime, this is sub-divided into:

- (i) *general insurance contract*;
- (ii) *long-term insurance contract*;

and then further sub-divided into *classes of contract of insurance*;

- (c) *share* (article 76);
- (d) *debenture* (article 77);
- (e) *government and public security* (article 78);
- (f) *warrant* (article 79);
- (g) *certificate representing certain securities* (article 80);
- (h) *unit* (article 81);
- (i) *stakeholder pension scheme* (article 82);
- (j) *option* (article 83); for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *option* (excluding a *commodity option* and an *option* on a *commodity future*);
 - (ii) *commodity option* and an *option* on a *commodity future*;
- (k) *future* (article 84); for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *future* (excluding a *commodity future* and a *rolling spot forex contract*);
 - (ii) *commodity future*;
 - (iii) *rolling spot forex contract*;
- (l) *contract for differences* (article 85); for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *contract for differences* (excluding a *spread bet* and a *rolling spot forex contract*);
 - (ii) *spread bet*;
 - (iii) *rolling spot forex contract*;
- (m) *underwriting capacity of a Lloyd's syndicate* (article 86(1));
- (n) *membership of a Lloyd's syndicate* (article 86(2));
- (o) *rights to or interests in investments* (article 89).

spread bet

a *contract for differences* that is a gaming contract, whether or not section 412 of the *Act* (Gaming contracts) applies to the contract;

in this definition, "gaming" has the meaning given in the Gaming Act 1968, which is in summary: the playing of a game of chance for winnings in money or money's worth, whether any *person* playing the game is at risk of losing any money or money's worth or not.

<i>SSAS</i>	<i>small self-administered scheme.</i>
<i>stabilising action</i>	any action contemplated by <i>MAR 2.2.3R</i> or <i>MAR 2.4.2R</i> .
<i>stabilising manager</i>	the single <i>person</i> responsible for <i>stabilising action</i> under <i>MAR 2</i> (Price stabilising rules).
<i>stabilising period</i>	(in relation to a <i>relevant security</i> and an <i>associated security</i>) the period: <ul style="list-style-type: none"> (a) beginning with the date on which the earliest <i>public announcement</i> of the <i>offer</i> which states the <i>offer price</i> is made; and (b) ending on the <i>thirtieth day</i> after the <i>closing date</i> or, if it is earlier than that <i>day</i>, the <i>sixtieth day</i> after the <i>date of allotment</i>; <p>except that, in relation to a <i>debenture</i> and a <i>government and public security</i>, the period begins with the date on which the earliest <i>public announcement</i> of the <i>offer</i> is made (whether or not that announcement states the <i>offer price</i>).</p>
<i>stabilising price</i>	the initial price (at or below the <i>offer price</i>) up to which the <i>stabilising manager</i> has determined that he may wish to intervene in the market by way of <i>stabilising action</i> ; and if the effect of <i>MAR 2.5.4R</i> is to raise that price above the initial stabilising price, then "stabilising price" thereafter means that new, higher, price.
<i>stakeholder pension scheme</i>	(a) (in relation to a <i>specified investment</i>) the <i>investment</i> specified in article 82 of the <i>Regulated Activities Order</i> (Rights under a stakeholder pension scheme) which is rights under a stakeholder pension scheme in (b); <ul style="list-style-type: none"> (b) (in relation to a scheme) a scheme established in accordance with Part I of the Welfare Reform and Pensions Act 1999 and the Stakeholder Pension Schemes Regulations 2000.
<i>standard terms</i>	(in <i>DISP</i>) the contractual terms made under paragraph 18 of Schedule 17 to the <i>Act</i> (The Ombudsman Scheme), under which <i>VJ participants</i> participate in the <i>Voluntary Jurisdiction</i> .
<i>standing independent valuer</i>	the <i>person</i> appointed as such under <i>CIS 12.3.1R</i> (Standing independent valuer).
<i>Statement of Principle</i>	one of the Statements of Principle issued by the <i>FSA</i> under section 64(1) of the <i>Act</i> (Conduct: Statements and codes) with respect to the conduct of <i>approved persons</i> and set out in <i>APER</i> .
<i>statutory notice</i>	a <i>warning notice</i> , <i>decision notice</i> or <i>supervisory notice</i> .
<i>statutory notice decision</i>	a decision by the <i>FSA</i> on whether or not to give a <i>statutory notice</i> .
<i>statutory notice associated decision</i>	a decision which is made by the <i>FSA</i> and which is associated with a decision to give a <i>statutory notice</i> , including a decision: <ul style="list-style-type: none"> (a) to determine or extend the period for making representations; (b) to determine whether a copy of the <i>statutory notice</i> needs to be

	given to any third party and the period for him to make representations;
	(c) to refuse access to <i>FSA</i> material;
	(d) as to the information which it is appropriate to publish about the matter to which a <i>final notice</i> or an effective <i>supervisory notice</i> relates.
<i>stock lending</i>	the disposal of a <i>designated investment</i> subject to an obligation or right to reacquire the same or a similar <i>designated investment</i> from the same counterparty.
<i>stock lending activity</i>	the activity of undertaking a <i>stock lending</i> transaction.
<i>stocks and shares component</i>	a <i>qualifying investment</i> as prescribed in paragraph 7 of the <i>ISA Regulations</i> .
<i>store card</i>	a card restricted to paying for goods or services from a particular supplier or group of suppliers and where the price of the goods or services is paid directly to the supplier or group of suppliers by the customer or the <i>firm</i> , but excluding a <i>plastic card</i> used to pay for goods or services through a network such as Visa or MasterCard.
<i>sub-fund</i>	(a) (in relation to an <i>umbrella scheme</i>) a separate part of the <i>scheme property</i> of that <i>scheme</i> that is pooled separately;
	(b) (in relation to a <i>collective investment scheme</i> that is not an <i>authorised fund</i>) any part of that <i>scheme</i> that is equivalent to a <i>sub-fund</i> of an <i>umbrella scheme</i> .
<i>subsidiary</i>	(as defined in section 736 of the Companies Act 1985 ("Subsidiary", "holding company" and "wholly-owned subsidiary")) (in relation to another <i>body corporate</i> ("H")) a <i>body corporate</i> of which H is a <i>holding company</i> .
<i>subsidiary undertaking</i>	(1) (except for the purposes of determining whether a <i>person</i> has <i>close links</i> with another <i>person</i>) an <i>undertaking</i> of which another <i>undertaking</i> is its <i>parent undertaking</i> .
	(2) (for the purposes of determining whether a <i>person</i> has <i>close links</i> with another <i>person</i>) (in accordance with section 343(8) of the <i>Act</i> (Information given by auditor or actuary to the FSA) and paragraph 3(3) of Schedule 6 to the <i>Act</i> (Threshold conditions)):
	(a) an <i>undertaking</i> in (1);
	(b) an <i>undertaking</i> ("S") if:
	(i) another <i>undertaking</i> (its parent) is a member of S;
	(ii) a majority of S's board of directors who have held office during the financial year and during the preceding financial year have been appointed solely as a result of the exercise of the parent's voting rights; and
	(iii) no one else is the parent undertaking of S under any of (a) (i) to (iii) or b(i) or (ii) in the definition of

parent undertaking.

- suitability letter* a letter that must be provided to a *customer* under COB 5.3.14R (Requirement for a suitability letter) and that contains the information required by COB 5.3.16R.
- SUP* the Supervision manual.
- supervisory notice* (as defined in section 395(13) of the *Act* (The Authority's procedures)) a notice given by the *FSA* in accordance with section 53(4), (7) or (8)(b); 78(2) or (5); 197(3), (6) or (7)(b); 259(3), (8) or (9)(b); 268(3), (7)(a) or (9)(a) (as a result of subsection (8)(b)); 282(3), (6) or (7)(b); or 321(2) or (5).
- supplementary levy* (in *DISP*) a levy, additional to the *general levy*, for the purposes of recovering the *establishment costs*.
- suretyship* (in relation to a *class of contract of insurance*) the *class of contract of insurance*, specified in paragraph 15 of Part I of Schedule 1 to the *Regulated Activities Order* (Contracts of general insurance), namely:
- (a) a *contract of insurance* against the risks of loss to the *person* insured arising from their having to perform contracts of guarantee entered into by them;
 - (b) fidelity bonds, performance bonds, administration bonds, bail bonds or customs bonds or similar contracts of guarantee where these are:
 - (i) effected or carried out by a *person* not carrying on a banking business;
 - (ii) not effected merely incidentally to some other business carried on by the *person* effecting them; and
 - (iii) effected in return for the payment of one or more premiums.
- surrender value*
- (a) where the contract is a contract of life assurance or a contract for an annuity, the amount (including a nil amount) payable by the *firm* or other body issuing the contract on surrender of the *policy*;
 - (b) where the contract is a *pension contract*, the amount payable on the transfer of the investor's accrued rights under that contract to another *pension contract*;
 - (c) where the contract is a *Holloway sickness policy*, the amount payable by the *firm* on surrender on or before the *projection date* for the *policy*;
 - (d) where the contract is for any other matter, the amount payable by the *firm* on the surrender of the *policy*.
- Swiss general insurance company* a company:
- (a) whose head office is in Switzerland;
 - (b) which has permission in Switzerland (not restricted to reinsurance business) to carry on *general insurance business*; and

	(c) which proposes to establish a <i>branch</i> or agency in the <i>United Kingdom</i> to carry out <i>insurance business</i> which is confined to the classes referred to in article 2 of the <i>Swiss Treaty Agreement</i> and not subject to any of the exceptions referred to in article 3 of the <i>Swiss Treaty Agreement</i> .
<i>Swiss Treaty Agreement</i>	the agreement of 10 October 1989 between the European Economic Community and the Swiss Confederation on direct insurance other than life insurance, approved on behalf of the European Economic Community by the Council Decision of 20 June 1999 (No 91/390/EEC).
<i>syndicate</i>	one or more <i>persons</i> , to whom a particular syndicate number has been assigned by or under the authority of the <i>Council</i> , <i>carrying out</i> or <i>effecting contracts of insurance</i> written at Lloyd's.
<i>syndicate actuary</i>	an <i>actuary</i> appointed to a <i>syndicate</i> as required by LLD 10.9.4R(1).
<i>syndicate year</i>	a year of account of a <i>syndicate</i> .
<i>synthetic cash</i>	a position in a <i>derivative</i> that offsets an exposure in property to the point where that exposure has effectively been neutralised, and the effect of the combined holding of both property and the position in the <i>derivative</i> is the same as if the <i>authorised fund</i> had received or stood to receive the value of the property in cash.
<i>synthetic future</i>	(a) a synthetic bought future, that is, a bought call <i>option</i> coupled with a written put <i>option</i> ; or (b) a synthetic sold future, that is, a bought put <i>option</i> coupled with a written call <i>option</i> ; provided that in either case the two <i>options</i> : (i) are bought and written, whether simultaneously or not, on a single <i>eligible derivatives</i> market; (ii) relate to the same underlying <i>security</i> or other asset; (iii) give the purchasers of the <i>options</i> the same rights of exercise (whether at the same price or not); and (iv) will expire together, if not exercised.
<i>SYSC</i>	the part of the <i>Handbook</i> in High Level Standards which has the title Senior Management Arrangements, Systems and Controls.
<i>systems and controls function</i>	any of <i>controlled functions</i> 13 to 15 in the <i>table of controlled functions</i> .
<i>table of controlled functions</i>	the table of controlled functions in SUP 10.4.5R.
<i>takeover bid</i>	an offer, as the term is used in the <i>Takeover Code</i> , or any other similar conduct governed by that code.
<i>Takeover Code</i>	the City Code on Takeovers and Mergers issued by the <i>Takeover Panel</i> .

<i>takeover or related operation</i>	<ul style="list-style-type: none"> (a) any transaction falling within paragraph 4(b) (Companies and Transactions to which the Code applies) of the introduction to the <i>Takeover Code</i>; (b) any transaction subject to the <i>SARs</i>; (c) any transaction which would have fallen within (a) were it not for the fact that the company which is the subject of the transaction does not satisfy the tests set out in paragraph 4(a) (Companies and Transactions to which the Code applies) of the introduction to the <i>Takeover Code</i> and, for this purpose, an offer for non-voting, non-equity share capital is to be regarded as falling within the <i>Takeover Code</i> even if not required by rule 15 of that Code; (d) any transaction which would have been subject to the <i>SARs</i> but where the shares the subject of the transaction are in a company which does not satisfy the test of residency set out in the second and third paragraphs of Section 2 (Scope) of the Introduction to the <i>SARs</i>; (e) any offer, transaction or arrangement relating to the purchase of <i>securities</i> with a view to establishing or increasing a strategic holding of a <i>person</i>, or of a <i>person</i> together with his <i>associates</i>, in the <i>securities</i> concerned; (f) any transaction or arrangement entered into in contemplation or furtherance of any offer, transaction or arrangement falling within (a) to (e); and (g) any transaction or arrangement entered into by way of defence or protection against any offer, transaction or arrangement falling within (a) to (f) which has taken place or which is contemplated.
<i>Takeover Panel</i>	the Panel on Takeovers and Mergers.
<i>takeover promotion</i>	a <i>financial promotion</i> which is subject to the <i>Takeover Code</i> or has been exempted from complying with the <i>Takeover Code</i> by the rules of that Code or by a ruling of the <i>Takeover Panel</i> .
<i>tax exempt policy</i>	any contract of assurance, offered or issued by a <i>friendly society</i> , which is tax exempt life or endowment business as defined in section 466 (2) of the Income and Corporation Taxes Act 1988.
<i>TC</i>	the Training and Competence sourcebook.
<i>technical provision</i>	(in <i>LLD</i>) a technical provision as defined in the <i>insurance accounts rules</i> .
<i>terms of business</i>	a written statement, supplied to a <i>client</i> , of the terms on which a <i>firm</i> will conduct <i>designated investment business</i> with or for the <i>client</i> .
<i>Third Life Directive</i>	the Council Directive of 10 November 1992 on the coordination of laws, etc, and amending Directives 79/267/EEC and 90/619/EEC (No 92/96/EEC).
<i>Third Non-Life Directive</i>	the Council Directive of 18 June 1992 on the coordination of laws, etc, and amending Directives 73/239/EEC and 88/357/EEC (No

	92/49/EEC).
<i>threshold condition</i>	(in relation to a <i>regulated activity</i>) any of the conditions set out in or under Schedule 6 to the <i>Act</i> (Threshold conditions) (see <i>COND</i>).
<i>tontines</i>	(in relation to a <i>class of contract of insurance</i>) tontines as specified in paragraph V of Part II of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of long-term insurance).
<i>top-up cover</i>	cover provided by the <i>compensation scheme</i> for <i>claims</i> against an <i>incoming EEA firm</i> (which is a <i>BCD credit institution</i> or an <i>ISD investment firm</i>): <ul style="list-style-type: none"> (a) in relation to <i>protected deposits</i>; or (b) in relation to <i>protected investment business</i>; or (c) in relation to both <i>protected deposits</i> and <i>protected investment business</i>; and which is in addition to the cover provided by the <i>firm's Home State</i> compensation scheme.
<i>top-up permission</i>	a <i>Part IV permission</i> given to an <i>incoming EEA firm</i> , an <i>incoming Treaty firm</i> or a <i>UCITS qualifier</i> .
<i>traded life policy</i>	a <i>life policy</i> which is to be or has been assigned for value by the <i>policyholder</i> to another <i>person</i> .
<i>transaction</i>	(in <i>ML</i>) any transaction, including the giving of advice and any other business or service undertaken in the course of carrying on a <i>regulated activity</i> .
<i>transaction report</i>	a report of a <i>reportable transaction</i> which meets the requirements of <i>SUP 17.6.2R</i> (Transaction report: Content).
<i>transaction-specific advice</i>	<i>advice on investments</i> : <ul style="list-style-type: none"> (a) given in connection with dealing or arranging activities carried on by the <i>firm</i> that fall within <i>MAR 3.1.2(2)R</i>(a), (b) or (c); or (b) with a view to carrying on any such activities; with or for the <i>market counterparty</i> to whom the advice is given.
<i>transfer value analysis</i>	an analysis performed to make a comparison between the benefits which are likely (on reasonable assumptions) to be paid under an <i>occupational pension scheme</i> and the benefits afforded by a <i>personal pension contract</i> or a <i>pension buy-out contract</i> .
<i>transferable security</i>	(in <i>CIS</i>) a <i>security</i> that is not an <i>investment</i> excluded by <i>CIS 5.2.9R</i> (Transferable securities).
<i>transitional complaints scheme</i>	the arrangements made by the <i>FSA</i> for the investigation of complaints against the <i>FSA</i> and each of <i>PIA</i> , <i>IMRO</i> and <i>SFA</i> arising in connection with the carrying out of their functions under the Financial Services Act 1986 and the Banking Act 1987.
<i>Treaty</i>	the Treaty establishing the European Community.

<i>Treaty activity</i>	(as defined in section 417(1) of the <i>Act</i> (Definitions)) an activity carried on under a <i>permission</i> obtained in accordance with Schedule 4 to the <i>Act</i> (Treaty Rights).
<i>Treaty firm</i>	(as defined in paragraph 1 of Schedule 4 to the <i>Act</i> (Treaty Rights)) a <i>person</i> : <ul style="list-style-type: none"> (a) whose head office is situated in an <i>EEA State</i> (its "<i>Home State</i>") other than the <i>United Kingdom</i>; and (b) which is recognised under the law of that State as its national.
<i>Treaty right</i>	the entitlement of a <i>Treaty firm</i> to qualify for <i>authorisation</i> under Schedule 4 to the <i>Act</i> (Treaty Rights).
<i>Tribunal</i>	the <i>Financial Services and Markets Tribunal</i> .
<i>trust deed</i>	(in <i>CIS</i>) the deed referred to in <i>CIS</i> 2.2.5R (The trust deed for AUTs), together with any deed expressed to be supplemental to it, made between the <i>manager</i> and the <i>trustee</i> (or, in the case of a <i>recognised scheme</i> that is a <i>unit trust scheme</i> , the <i>instrument constituting the scheme</i> as amended from time to time).
<i>trust scheme rules</i>	<i>rules</i> in <i>CIS</i> made by the <i>FSA</i> under section 247(1) of the <i>Act</i> (Trust scheme rules) in relation to: <ul style="list-style-type: none"> (a) the constitution, management and operation of <i>AUTs</i>; (b) the powers, duties, rights and liabilities of the <i>manager</i> and <i>trustee</i> of any such <i>scheme</i>; (c) the rights and duties of the <i>participants</i> in any such <i>scheme</i>; and (d) the winding up of any such <i>scheme</i>.
<i>trustee</i>	(in accordance with section 237(2) of the <i>Act</i> (Other definitions)) (in relation to a <i>unit trust scheme</i>) the <i>person</i> holding the property in question on trust for the <i>participants</i> .
<i>trustee firm</i>	a <i>firm</i> which is not an <i>OPS firm</i> and which is acting as a: <ul style="list-style-type: none"> (a) trustee; or (b) personal representative.
<i>UCITS Directive</i>	the Council Directive of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (No 85/611/EEC).
<i>UCITS qualifier</i>	a <i>firm</i> which: <ul style="list-style-type: none"> (a) for the time being is an <i>operator</i>, <i>trustee</i> or <i>depository</i> of a <i>scheme</i> which is a <i>recognised scheme</i> under section 264 of the <i>Act</i>; and (b) is an <i>authorised person</i> as a result of paragraph 1(1) of Schedule 5 to the <i>Act</i> (Persons Concerned in Collective Investment Schemes); <p>a reference to a <i>firm</i> as a <i>UCITS qualifier</i> applies in relation to the</p>

	carrying on by the <i>firm</i> of activities for which it has <i>permission</i> in that capacity.
<i>UCITS scheme</i>	an <i>authorised fund</i> which complies with the conditions necessary for it to enjoy the rights conferred by the <i>UCITS Directive</i> .
<i>UK</i>	<i>United Kingdom</i> .
<i>UK bank</i>	a <i>bank</i> which is a <i>body corporate</i> or <i>partnership</i> formed under the law of any part of the <i>United Kingdom</i> .
<i>UK domestic firm</i>	a <i>firm</i> that has its registered office (or, if it has no registered office, its head office) in the <i>United Kingdom</i> .
<i>UK firm</i>	(as defined in paragraph 10 of Schedule 3 to the <i>Act</i> (EEA Passport Rights)) a <i>person</i> whose head office is in the <i>United Kingdom</i> and who has an <i>EEA right</i> to carry on activity in an <i>EEA State</i> other than the <i>United Kingdom</i> .
<i>UK RCH</i>	an <i>RCH</i> that is not an <i>ROCH</i> .
<i>UK recognised body</i>	a <i>UK RIE</i> or <i>UK RCH</i> .
<i>UK RIE</i>	an <i>RIE</i> that is not an <i>ROIE</i> .
<i>UKLA</i>	(1) (except in relation to a part of the <i>Handbook</i>) the <i>FSA</i> acting in its capacity as the <i>competent authority</i> for the purposes of Part VI of the <i>Act</i> (Official Listing). (2) (in relation to a part of the <i>Handbook</i>) the United Kingdom Listing Authority sourcebook.
<i>ultimate parent undertaking</i>	(in relation to an <i>insurer</i>) a <i>parent undertaking</i> of the <i>insurer</i> that is not itself the <i>subsidiary undertaking</i> of another <i>undertaking</i> .
<i>umbrella</i>	(in <i>CIS</i>) a <i>collective investment scheme</i> under which the contributions of the <i>participants</i> in the <i>scheme</i> and the profits or income out of which payments are to be made to them are pooled separately in relation to separate parts of the <i>scheme property</i> .
<i>umbrella scheme</i>	(in <i>CIS</i>) an <i>authorised fund</i> that is an <i>umbrella</i> .
<i>unauthorised person</i>	a <i>person</i> who is not an <i>authorised person</i> .
<i>undertaking</i>	(as defined in section 259 of the Companies Act 1985 (Meaning of "undertaking" and related expressions)): (a) a <i>body corporate</i> or <i>partnership</i> ; or (b) an unincorporated association carrying on a trade or business, with or without a view to profit.
<i>underwriting agent</i>	a <i>firm</i> permitted by the <i>Council</i> to act as an underwriting agent at Lloyd's.
<i>underwriting capacity of a Lloyd's syndicate</i>	the <i>investment</i> , specified in article 86(1) of the <i>Regulated Activities Order</i> , which is the underwriting capacity of a <i>syndicate</i> .
<i>underwriting</i>	a <i>person</i> admitted to the <i>Society</i> as an underwriting member.

<i>member</i>	
<i>unit</i>	the investment, specified in article 81 of the <i>Regulated Activities Order</i> (Units in a collective investment scheme) and defined in section 237(2) of the <i>Act</i> (Other definitions)), which is the right or interest (however described) of the <i>participants</i> in a <i>collective investment scheme</i> ; this includes: <ul style="list-style-type: none"> (a) (in relation to an <i>AUT</i>) a unit representing the rights or interests of the <i>unitholders</i> in the <i>AUT</i>; (b) (in relation to an <i>ICVC</i>) a <i>share</i> in the <i>ICVC</i>.
<i>unit trust scheme</i>	(as defined in section 237(1) of the <i>Act</i> (Other definitions)) a <i>collective investment scheme</i> under which the property in question is held on trust for the <i>participants</i> .
<i>United Kingdom</i>	England and Wales, Scotland and Northern Ireland (but not the Channel Islands or the Isle of Man).
<i>unitholder</i>	(in relation to an <i>AUT</i> , and subject to <i>CIS</i> 11.3.2R (Special meaning of unitholder)): <ul style="list-style-type: none"> (a) (in relation to a <i>unit</i> represented by a <i>bearer certificate</i>) the <i>person</i> who holds the <i>bearer certificate</i>; (b) (in relation to a <i>unit</i> that is not represented by a <i>bearer certificate</i>) the <i>person</i> whose name is entered on the <i>register</i> in relation to that <i>unit</i>.
<i>unitisation</i>	arrangements for a newly formed <i>dual-priced AUT</i> under which: <ul style="list-style-type: none"> (a) the whole or part of the property of a <i>body corporate</i> (or a <i>collective investment scheme</i>) becomes the first property to be held on the trusts of the <i>AUT</i>; and (b) the <i>holders</i> of <i>shares</i> (or <i>units</i>) in the <i>body corporate</i> (or <i>collective investment scheme</i>) being wound up or property of which is being transferred become the first <i>participants</i> in the <i>AUT</i>.
<i>units in existence</i>	(in <i>CIS</i>) (in relation to an <i>AUT</i>) all <i>units</i> which are in issue and any <i>units</i> which the <i>trustee</i> is obliged to <i>issue</i> , less any <i>units</i> which the <i>trustee</i> is obliged to <i>cancel</i> .
<i>unregulated activity</i>	an activity which is not a <i>regulated activity</i> .
<i>unregulated collective investment scheme</i>	a <i>collective investment scheme</i> which is not a <i>regulated collective investment scheme</i> .
<i>unsolicited real time financial promotion</i>	(in accordance with article 8 of the <i>Financial Promotion Order</i>) (as more fully described in <i>COB</i> 3.10.1R (Meaning of "solicited" and "unsolicited" real time financial promotion)) a <i>real time financial promotion</i> which is not a <i>solicited real time financial promotion</i> .
<i>valuation point</i>	(in <i>CIS</i>) a valuation point fixed by the <i>authorised fund manager</i> for the purpose of <i>CIS</i> 4.8.5R (Regular valuation points), <i>CIS</i> 4.8.6R

	(Additional valuation points) or <i>CIS</i> 15.8.3(1) or (2)R (Frequency of valuation).
<i>venture capital business</i>	<p>the business of carrying on any of:</p> <ul style="list-style-type: none"> (a) investing in, <i>advising on investments</i> which are, <i>managing investments</i> which are, <i>arranging (bringing about) transactions</i> in, or <i>making arrangements with a view to transactions in, venture capital investments</i>; (b) <i>advising on investments</i> or <i>managing investments</i> in relation to portfolios, or <i>establishing, operating or winding up collective investment schemes</i>, where the portfolios or <i>collective investment schemes</i> (apart from funds awaiting investment) invest only in <i>venture capital investments</i>; (c) any <i>custody</i> activities provided in connection with the activities in (a) and (b); (d) any related <i>ancillary activities</i>.
<i>venture capital contact</i>	<p>(when a <i>firm</i> carries on <i>designated investment business</i> with or for a <i>person</i> in the course of or as a result of carrying on <i>venture capital business</i>) that <i>person</i> in connection with that <i>designated investment business</i> if:</p> <ul style="list-style-type: none"> (a) the <i>firm</i> does not behave in a way towards that <i>person</i> which might reasonably be expected to lead that <i>person</i> to believe that he is being treated as a <i>client</i>; and (b) the <i>firm</i> clearly indicates to that <i>person</i> that the <i>firm</i>: <ul style="list-style-type: none"> (i) is not acting for him; and (ii) will not be responsible to him for providing protections afforded to <i>clients</i> of the <i>firm</i> or be advising him on the relevant transaction.
<i>venture capital firm</i>	a <i>firm</i> whose <i>permission</i> includes a <i>requirement</i> that it must not conduct <i>designated investment business</i> other than <i>venture capital business</i> .
<i>venture capital investment</i>	<p>a <i>designated investment</i> which, at the time the investment is made, is:</p> <ul style="list-style-type: none"> (a) in a new or developing <i>company</i> or venture; or (b) in a management buy-out or buy-in; or (c) made as a means of financing the investee <i>company</i> or venture and accompanied by a right of consultation, or rights to information, or board representation, or management rights; or (d) acquired with a view to, or in order to, facilitate a transaction falling within (a) to (c).
<i>VJ participant</i>	a <i>person</i> subject to the <i>Voluntary Jurisdiction</i> by contract.
<i>Voluntary Jurisdiction</i>	the jurisdiction of the <i>Financial Ombudsman Service</i> in which <i>persons</i> (whether <i>authorised</i> or <i>unauthorised</i>) participate by contract.

<i>voting power</i>	(in relation to an <i>undertaking</i>) (in accordance with section 422(7) of the <i>Act</i> (Controller)) voting power exercisable at a general meeting of the <i>undertaking</i> or, if the <i>undertaking</i> does not have general meetings at which matters are decided by the exercise of voting rights, the right under the constitution of the <i>undertaking</i> to direct the overall policy of the <i>undertaking</i> or to alter the terms of its constitution.
<i>waiver</i>	a direction waiving or modifying a <i>rule</i> , given by the <i>FSA</i> under sections 148, 250 or 294 of the <i>Act</i> (Waiver or modification of rules) or regulation 7 of the <i>OEIC Regulations</i> (Modification or waiver of <i>FSA</i> rules) (see <i>SUP</i> 8 and <i>REC</i> 3.3).
<i>warning notice</i>	a notice issued by the <i>FSA</i> in accordance with section 387 of the <i>Act</i> (Warning notices).
<i>warrant</i>	<p>(1) (except in <i>CIS</i>) the <i>investment</i>, specified in article 79 of the <i>Regulated Activities Order</i> (Instruments giving entitlements to investments), which is in summary: a warrant or other instrument entitling the holder to subscribe for a <i>share</i>, <i>debenture</i> or <i>government and public security</i>.</p> <p>(2) (in <i>CIS</i>) an <i>investment</i> in (1) and any other <i>transferable security</i> (not being a nil paid or partly paid <i>security</i>) which is:</p> <ul style="list-style-type: none"> (i) <i>listed</i> on an <i>eligible securities</i> market; and (ii) akin to an <i>investment</i> within (1) in that it involves a down payment by the then holder and a right later to surrender the instrument and to pay more <i>money</i> in return for a further <i>transferable security</i>.
<i>warrant scheme</i>	an <i>authorised fund</i> which invests entirely in <i>warrants</i> .
<i>welfare trust</i>	any scheme or arrangement, not being an <i>occupational pension scheme</i> , that is comprised in one or more instruments or agreements and operates as a benevolent fund so as to provide benefits, at the discretion of the trustees and to which the beneficiaries have no contractual rights.
<i>whole life assurance</i>	a <i>contract of insurance</i> which, disregarding any benefit payable on surrender, secures a capital sum only on death or either on death or on disability, but does not include a term assurance.
<i>wholesale market broker</i>	a <i>firm</i> when carrying out the activities of <i>name-passing broker</i> , or acting on a matched principal basis, with or for <i>market counterparties</i> .
<i>Zone A country</i>	any <i>EEA State</i> and any other country which is a full member of the <i>OECD</i> and any country which has concluded special lending arrangements with the International Monetary Fund associated with the Fund's General Arrangements to Borrow.

CONDUCT OF BUSINESS SOURCEBOOK INSTRUMENT 2001

- A. The Financial Services Authority makes the rules and gives the guidance in the Annex to this instrument (“COB”) in the exercise of the powers listed in Schedule 4 to COB (Powers exercised).
- B. This instrument shall come into force at the beginning of the day on which section 19 (The general prohibition) of the Financial Services and Markets Act 2000 (the “Act”) comes into force.
- C. The provisions of the Act relevant to making rules and listed in Schedule 4 to COB (Powers exercised) are specified for the purpose of section 153(2) of the Act (Rule-making instruments).
- D. This instrument may be cited as the Conduct of Business Sourcebook Instrument 2001.
- E. The Annex to this instrument (including its schedules) may be cited as the Conduct of Business sourcebook (or COB).

By order of the Board
21 June 2001

ANNEX



Conduct of Business

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COB TR 1 Transitional Rules for pre-N2 and ex-Section 43 firms

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1.0		Application
1.1		These transitional provisions apply to: <ul style="list-style-type: none"> (a) <i>pre-N2 firms</i>; and (b) <i>ex-section 43 firms</i>.
2.0		Purpose
2.1	G	<p>The <i>FSA</i> is aware that the introduction of <i>COB</i> will impose an additional compliance burden on <i>firms</i>, even when there is an underlying continuity of policy. The <i>FSA</i> wishes to lighten that burden in a manner consistent with its regulatory objectives and the principles of good regulation under the <i>Act</i>. The following <i>rules</i> provide transitional relief which takes three distinct forms:</p> <ul style="list-style-type: none"> (a) extra time provisions (ETPs) which, in practice, give firms additional time after <i>commencement</i>, until 30 June 2002 (note that for <i>ex-section 43 firms</i>, the relief lasts until the expiry of 12 months following <i>commencement</i>), to complete their preparations for the impact of certain provisions in <i>COB</i>; (b) technical timing provisions (TTPs) which give relief from certain provisions in <i>COB</i> that require firms to fulfil obligations to customers at periodic intervals. TTPs postpone the impact of these provisions in <i>COB</i> in relation to periods that span N2; and (c) timeless (saving) provisions (TSPs) which give <i>firms</i> relief for an indefinite period after N2 from certain provisions in <i>COB</i> relating mainly to terms of business and client agreements <i>COB</i> 4.2 and from provisions in the <i>Handbook</i> generally (including <i>COB</i>) relating to client classification. TSPs allow <i>firms</i> to continue to use, or rely upon, documentation or compliance work that was undertaken in accordance with <i>previous regulator</i> rules in relation to existing <i>clients</i> at N2.
2.2	G	If a firm's permitted <i>regulated activities</i> are subject to one or more of the transitional provisions in <i>COB</i> , and were carried on before <i>commencement</i> , those <i>regulated activities</i> should be interpreted, where appropriate, as if they were authorised investment business before <i>commencement</i> .
2.3	G	<i>GEN</i> contains some technical transitional provisions that apply throughout the <i>Handbook</i> and which are designed to ensure a smooth transition at <i>commencement</i> . These include transitional provisions relevant to record keeping and notification rules.
2.4	G	For the avoidance of doubt, <i>TTPs 1, 2 and 3</i> at <i>COB</i> Table TR 2.1 to 2.4 override paragraph 9 (Time starting before commencement) of the technical timing provisions in <i>GEN</i> .
2.5	G	<i>SUP</i> contains transitional provisions, which carry forward written concessions relating to pre- <i>commencement</i> provisions.
3.0		Continuity of contracts

3.1	G	The <i>FSA</i> is sometimes asked whether a <i>firm</i> should re-negotiate contracts to replace references to its authorisation status or regulatory provisions made under predecessor legislation with references to its status or regulatory provisions made under the <i>Act</i> . Clearly, whether a <i>firm</i> should renegotiate its contracts is a matter for the <i>firm</i> , which needs to be considered in the light of the effect of the contractual provision as a whole. As a general rule, unless the <i>FSA</i> has made particular requirements relating to such matters, the <i>FSA</i> would not expect to see this done for regulatory reasons. <i>Firms</i> may wish to consider whether they need appropriate professional advice.
3.2	G	Clearly, the interpretation of contractual provisions is a matter for the courts. However, where a <i>firm</i> continues, as a result of the grandfathering process, to enjoy <i>permission</i> which provides it with authority under the <i>Act</i> to carry on <i>regulated activities</i> substantially similar to the investment business it could carry on under its authorisation under predecessor legislation, the <i>FSA</i> would be surprised if a court were to conclude that updating a contractual provision was necessary to enable it to give effect to the intentions of the parties to the contract.
4.0 Definitions		
4.1	R	<p>In these transitional provisions the following words are to have the meaning given to them below:</p> <p>”<i>corresponding rule</i>” means a <i>rule</i> of the <i>previous regulator</i> of a <i>firm</i> that is substantially similar in purpose and effect to the relevant provision in <i>COB</i>.</p> <p>”<i>section 43 business</i>” means activities in respect of which the <i>firm</i> would have been an exempted person under Section 43 of the Financial Services Act 1986.</p> <p>”<i>pre-N2 firm</i>” means:</p> <p>(a) a <i>firm</i> which immediately before <i>commencement</i> was authorised under the Financial Services Act 1986 to carry on investment business in the <i>United Kingdom</i> by virtue of its membership of:</p> <p>(i) <i>IMRO</i>;</p> <p>(ii) <i>PIA</i>; or</p> <p>(iii) <i>SFA</i>;</p> <p>(b) a <i>firm</i> which immediately before <i>commencement</i> held an authorisation granted directly by the <i>FSA</i> under the Financial Services Act 1986 to carry on investment business in the <i>United Kingdom</i> immediately before <i>commencement</i>; or</p> <p>(c) an <i>employee</i> of such a <i>firm</i> in (a) or (b), including any of its <i>appointed representatives</i> (as defined under section 44 of the Financial Services Act 1986);</p> <p>but does not include:</p> <p>(d) an <i>ex-RPB firm</i>; or</p> <p>(e) an <i>ex-section 43 firm</i> in relation to its section 43 business.</p> <p>”<i>transitional period</i>” means the period starting on <i>commencement</i> and finishing on midnight on 30 June 2002.</p>

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 2 with the labels indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1.0	Extra time provisions				
1.1	ETP1	R	<p>Transitional Relief</p> <p>A pre-N2 firm will not contravene any of the provisions labelled ETP1 in Table COB TR 2 to the extent that, on or after commencement, it is able to demonstrate that it has complied with the corresponding rule of its previous regulator or, where applicable, the relevant former statutory requirement, subject to any modification, wherever appropriate, to take account of the passing of the Act.</p>	<i>commencement to 30 June 2002</i>	<i>commencement</i>
1.2	<p><i>ETPs 1 to 8</i></p> <p><i>TTPs 1 to 3</i></p> <p><i>TSPs 1 to 7</i></p>	G	<p>It is for a <i>pre-N2 firm</i> to satisfy itself that it has complied with the <i>corresponding rule</i> of its <i>previous regulator</i> or, where applicable, the relevant former statutory requirement. In order to benefit from the relief, a <i>firm</i> must ensure that the rule of its <i>previous regulator</i> which it proposes to comply with is substantially similar to the provision in <i>COB</i> to which it relates.</p> <p>For the assistance of <i>firms</i>, the <i>FSA</i> has compiled tables of derivations indicating the rules of a <i>firm's previous regulator</i> that correspond to the provision in <i>COB</i> being transitioned. <i>Firms</i> may wish to refer to these tables but in doing so should understand that they are not intended to be exhaustive and are produced merely as a guide.</p>	<p><i>commencement to 30 June 2002 for ETPs and TTPs;</i></p> <p><i>indefinitely for TSPs</i></p>	<i>commencement</i>

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 2 with the labels indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1.3	<p><i>ETPs 1 to 8</i></p> <p><i>TTPs 1 to 3</i></p> <p><i>TSPs 1 to 7</i></p>	G	<p><i>Firms</i> are advised that should they wish to take advantage of the transitional provisions set out in this section, the onus is on the <i>firm</i> to be able to demonstrate that in any given case it has in fact complied with the <i>corresponding rules</i> of its <i>previous regulator</i> or, as the case may be, the former statutory requirement.</p> <p><i>Firms</i> will have noted from the wording of COB TR11.1R that they should treat the <i>corresponding rules</i> of their <i>previous regulator</i> as modified to the extent necessary to ensure that the provision can operate effectively notwithstanding the enactment of the <i>Act</i>. <i>Firms</i> will need to adopt a common sense approach in interpreting the <i>corresponding rules</i> of their <i>previous regulator</i> and modify them accordingly. For example, references in such rules to a <i>firm's previous regulator</i> should be read as if they referred to the <i>FSA</i>. Other modifications may not be as straightforward, such as where the concept of an indirect <i>customer</i> is not carried forward under the new legislation. In cases of difficulty, <i>firms</i> are encouraged to approach the <i>FSA</i> for its views.</p>	<p><i>commencement</i> to 30 June 2002 for ETPs and TTPs;</p> <p>indefinitely for TSPs</p>	<i>commencement</i>

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 2 with the labels indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1.4	ETP2	R	<p><u>Financial Promotion</u></p> <p><i>A pre-N2 firm will not contravene any of the provisions labelled ETP2 in Table COB TR 2 to the extent that, on or after commencement, it communicates a non-real time financial promotion which, as to its content, complies with the corresponding rules of its previous regulator and which, for that purpose, had been approved by the firm as complying with them before commencement.</i></p>	<i>commencement to 30 June 2002</i>	<i>commencement</i>
1.5	ETP2	G	<p>(1) <i>Firms are reminded that under article 74 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 a financial promotion which has been approved before commencement in accordance with pre-commencement provisions or the financial promotion rules may be communicated by an unauthorised person for one month from commencement.</i></p> <p>(2) <i>Firms should take reasonable steps to avoid communicating a non-real time financial promotion which, through the passage of time, has become misleading. In such circumstances the promotion is unlikely to be in compliance with the rules of its previous regulator.</i></p>	<i>commencement to 30 June 2002</i>	<i>commencement</i>
1.6	ETP3	R	<p><u>Client Classification</u></p> <p>(1) <i>This rule applies only in relation to a client of a pre-N2 firm which the firm had classified as an expert private customer before commencement.</i></p>	<i>commencement to 30 June 2002</i>	<i>commencement</i>

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 2 with the labels indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1.7	ETP3	G	<p>(2) A <i>pre-N2 firm</i> will not contravene any of the provisions labelled <i>ETP3</i> in Table <i>COB TR 2</i> to the extent that, on or after <i>commencement</i>, it complies with (3).</p> <p>(3) For the purpose of <i>COB 4.1</i>, a <i>pre-N2 firm</i> which before <i>commencement</i> has classified a <i>client</i> as an expert private customer in accordance with the <i>corresponding rules</i> of its <i>previous regulator</i>, must treat that <i>client</i> as:</p> <p style="padding-left: 40px;">(a) a <i>private customer</i>; or</p> <p style="padding-left: 40px;">(b) an <i>intermediate customer</i>;</p> <p>from <i>commencement</i> until the date of expiry of the <i>transitional period</i>, by which time it must classify the <i>client</i> in accordance with <i>COB 4.1</i>.</p>	<i>commencement</i> to 30 June 2002	<i>commencement</i>
1.8	ETP4	R	<p>(1) An <i>ex-section 43 firm</i> will not contravene any of the provisions labelled <i>ETP4</i> in Table <i>COB TR 2</i> in relation to its <i>section 43 business</i> to the extent that, on or after <i>commencement</i>, it complies with (2).</p>	<i>commencement</i> to <i>commencement</i> plus 12 months	<i>commencement</i>

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 2 with the labels indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1.9	ETP4	G	<p>(2) For the purposes of COB 4.1, an <i>ex-section 43 firm</i> may treat its <i>client</i> (other than another firm) who was a <i>client</i> of the firm before commencement as a market counterparty in relation to its section 43 business until the date of expiry of the transitional period, by which date it must classify the client in accordance with COB 4.1.</p> <p>An <i>ex-section 43 firm</i> that wishes to take advantage of the transitional relief provided by COB TR1 1.8(1) and (2) should continue to maintain the standard of care set out in paragraphs 31 to 37 of the London Code of Conduct (version June 1999) in relation to each of their clients. For these <i>clients</i>, the FSA will maintain the arbitration procedures set out in paragraph 120 of the London Code of Conduct for disputes arising during the <i>transitional period</i>.</p>	commencement to commencement plus 12 months	commencement
1.10	ETP 5	R	<p>Client Assets</p> <p>For the purposes of any of the provisions labelled ETP5 in Table COB TR 2, the following will apply from commencement until the date of expiry of the transitional period:</p> <p>(a) any reference in COB 9 to an approved bank must be treated as if it were a reference to an institution which satisfied the definition of “approved bank” under the corresponding rules of a firm’s previous regulator; and</p>	commencement to 30 June 2002	commencement

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 2 with the labels indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1.11	ETP6	R	<p>(b) any reference in <i>COB 9</i> to a <i>custodian</i> must be treated as if it were a reference to an institution which satisfied the definition of “custodian” under the <i>corresponding rules</i> of a firm’s <i>previous regulator</i>.</p> <p><u>Client money</u></p> <p>A <i>pre-N2 firm</i> need not comply with any of the provisions labelled <i>ETP6</i> in Table <i>COB TR 2</i> until the date of expiry of the <i>transitional period</i>.</p>	commencement to 30 June 2002	commencement
1.12	ETP7	R	<p><u>Client money</u></p> <p>An <i>ex-section 43 firm</i> need not comply with the provisions labelled <i>ETP7</i> in Table <i>COB TR 2</i> in relation to its section 43 business until the expiry of a period of 12 months following <i>commencement</i>, provided it continues to comply with the requirements of the Grey Paper (version June 1999), as published by the <i>FSA</i>, relating to the segregation of money and other assets belonging to counterparties.</p>	commencement to commencement plus 12 months	commencement
1.13	ETP8	R	<p><u>Information about the firm</u></p> <p>(1) Subject to (2), a <i>pre-N2 firm</i> or an <i>ex-section 43 firm</i> will not contravene any of the provisions labelled <i>ETP8</i> in Table <i>COB TR 2</i> in relation to any written material it has produced before <i>commencement</i> to the extent that, on or after <i>commencement</i>, it is able to demonstrate that it has provided information about itself, in any such material, in accordance with the <i>corresponding rule</i> of its <i>previous regulator</i>.</p>	<p>(<i>pre-N2 firms</i>): commencement to 30 June 2002</p> <p>(<i>ex-section 43 firms</i>): commencement to commencement plus 12 months</p>	commencement

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 2 with the labels indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1.14	<i>ETP8</i>	G	<p>(2) (1) does not apply to a <i>firm</i>'s appointed representative as defined under section 44(2) of the Financial Services Act 1986.</p> <p>The purpose of <i>COB TR2</i> 1.13R is to ensure that the <i>firm</i> does not incur unnecessary costs by having to withdraw or destroy written material produced before <i>commencement</i>. For the avoidance of doubt, where a <i>firm</i> prints a document on or after <i>commencement</i>, from a precedent held in electronic form, <i>ETP8</i> will apply.</p>	<p><i>(pre-N2 firms): commencement to 30 June 2002</i></p> <p><i>(ex-section 43 firms): commencement to commencement plus 12 months</i></p>	<i>commencement</i>
2.0					
2.1	<i>TTP1</i>	R	<p><u>Periodic disclosure of soft commission</u></p> <p>A <i>pre-N2 firm</i> will not contravene any of the provisions labelled <i>TTP1</i> in Table <i>COB TR 2</i> to the extent that it is able to demonstrate that, on or after <i>commencement</i>, it has made periodic disclosure required by <i>COB 2.2.18R</i> (Periodic disclosure), in relation to the period in which <i>commencement</i> falls, in accordance with the <i>corresponding rule</i> of its <i>previous regulator</i>.</p>	<i>commencement to expiry of the relevant period</i>	<i>commencement</i>
2.2	<i>TTP2</i>	R	<p><u>With-profits guides</u></p> <p>A <i>pre-N2 firm</i> will not contravene any of the provisions labelled <i>TTP2</i> in Table <i>COB TR 2</i> to the extent that it is able to demonstrate that, on or after <i>commencement</i>, it has produced, and made available, the with-profits guide required by <i>COB 6.9.4R</i> for the financial year in which <i>commencement</i> falls, in accordance with the <i>corresponding rule</i> of its <i>previous regulator</i>.</p>	<i>commencement to expiry of the relevant period</i>	<i>commencement</i>

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 2 with the labels indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
2.3	TTP3	R	<p>Periodic statements</p> <p>A <i>pre-N2 firm</i> will not contravene any of the provisions labelled TTP3 in Table <i>COB TR 2</i> to the extent that it is able to demonstrate that, on or after <i>commencement</i>, it has provided its <i>customers</i> with a <i>periodic statement</i> required by <i>COB 8.2.4R</i> (Requirement for a periodic statement) for the period in which <i>commencement</i> falls, in accordance with the <i>corresponding rules</i> of its <i>previous regulator</i>.</p>	<i>commencement</i> to expiry of the relevant period	<i>commencement</i>
2.4	<i>TTP1, TTP2 and TTP3</i>	G	<p><i>Firms</i> should note that the technical timing provisions set out at <i>COB TR1 2.1</i> to <i>2.3R</i> operate on a one-off basis. Any future disclosure, with-profits guide or periodic statement relating to a period after the initial period in which <i>commencement</i> falls, will have to be made in accordance with the full requirements of the relevant provision in <i>COB</i> subject, wherever applicable, to the availability of other transitional relief.</p>	<i>commencement</i> to expiry of the relevant period	<i>commencement</i>
3.0	Timeless (saving) provisions				
3.1	TSP1	R	<p><u>Confirmation of compliance and approval</u></p> <p>A <i>pre-N2 firm</i> will not contravene any of the provisions labelled TSP1 in Table <i>COB TR 2</i> to the extent that it is able to demonstrate that, on or after <i>commencement</i>, it has carried out the confirmation exercise referred to in <i>COB 3.6.1R</i> (Confirmation of compliance), for an <i>investment advertisement</i> issued or approved before <i>commencement</i>, in accordance with the <i>corresponding rule</i> of its <i>previous regulator</i>.</p>	indefinitely	<i>commencement</i>

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 2 with the labels indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
3.2	TSP2	R	<p><u>Terms of business and client agreements</u></p> <p>(1) Subject to (2) and (3), a <i>pre-N2 firm</i> will not contravene any of the provisions in Table COB TR 2 labelled TSP2 to the extent that, on or after <i>commencement</i>, it is able to demonstrate that it has continued to use, or rely upon, <i>terms of business</i> (including a <i>client agreement</i>) given to, or made with, a <i>client</i> before the end of the <i>transitional period</i> in accordance with the <i>corresponding rule</i> of its <i>previous regulator</i>.</p> <p>(2) If the basis on which a <i>pre-N2 firm</i> conducts, or proposes to conduct, its <i>designated investment business</i> for a <i>client</i> changes after <i>commencement</i> in a way not contemplated by the original <i>terms of business</i> and where the original <i>terms of business</i> allow the <i>firm</i> to amend its terms without the <i>customer's</i> consent, the <i>firm</i> must provide the <i>client</i> with amended <i>terms of business</i> in accordance with COB 4.2.13R (Amendment of terms of business).</p>	indefinitely	<i>commencement</i>

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 2 with the labels indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
3.3	TSP2	G	<p>(3) A pre-N2 firm must take reasonable steps to ensure that a private customer to whom it has provided terms of business (including a client agreement) before commencement is notified in writing of the matters set out in COB 4.2.15E (2), (21) and (22) as soon as practicable after commencement.</p> <p>(1) <i>Firms</i> should note that COB 4.2 also benefits from an ETP1 as set out in COB TR1 1.1R. The purpose of this is to allow firms additional time, after commencement, to amend their terms of business for new clients taken on after N2.</p> <p>(2) Where a pre-N2 firm has started, but has not concluded, negotiating terms of business with a client before commencement, it may rely on COB TR 3.2(1)R even if the terms of business are not agreed until after commencement.</p> <p>(3) COB TR2 3.2(2)R does not require the firm to provide a client with amended terms of business where the change in the terms was contemplated in the original terms of business.</p> <p>(4) Further to Principle 7 (Communications with clients) of the FSA's Principles for Business, a firm should not refuse a customer's reasonable request for new terms of business to reflect the new regime applicable under the Act.</p>	indefinitely	commencement

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 2 with the labels indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
3.4	TSP3	R	<p><u>Know your customer and suitability</u></p> <p>(1) Subject to (2), a <i>pre-N2 firm</i> will not contravene any of the provisions labelled TSP3 in Table COB TR 2 to the extent that it is able to demonstrate that, on or after <i>commencement</i>, it has continued to use, or rely upon, a record of a <i>private customer's</i> personal and financial circumstances made in accordance with the <i>corresponding rules</i> of its <i>previous regulator</i>, and in doing so has had regard to the guidance set out in COB 5.2.6G.</p> <p>(2) The relief in (1) will apply only so long as there is no relevant change in the <i>customer's</i> personal and financial circumstances.</p>	indefinitely	<i>commencement</i>
3.5	TSP4	R	<p><u>Suitability and customers' understanding of risk</u></p> <p>A <i>pre-N2 firm</i> will not contravene any of the provisions labelled TSP4 in Table COB TR 2 to the extent that it is able to demonstrate that, on or after <i>commencement</i>, it uses, or relies upon, a <i>suitability letter</i> or, as the case may be, a risk warning or disclosure, given to a <i>customer</i> in accordance with the <i>corresponding rule</i> of its <i>previous regulator</i>, in relation to a transaction or <i>series of transactions executed or arranged</i> before the expiry of the <i>transitional period</i>.</p>	indefinitely	<i>commencement</i>

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 2 with the labels indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
3.6	<i>TSP4</i>	G	<i>Firms</i> should note that the requirements in <i>COB 5.2</i> and <i>COB 5.3</i> relating to the production of <i>suitability letters</i> and risk warnings also benefit from an <i>ETP1</i> provision.	indefinitely	<i>commencement</i>
3.7	<i>TSP5</i>	R	<p><u>Scheme documents for an unregulated collective investment scheme</u></p> <p><i>A pre-N2 firm that is an operator will not contravene any of the provisions labelled TSP5 in Table COB TR 2 to the extent that it is able to demonstrate that, on or after commencement, it has continued to use, or rely upon, a scheme document provided to a participant before the expiry of the transitional period, in accordance with the corresponding rule of its previous regulator.</i></p>	indefinitely	<i>commencement</i>
3.8	<i>TSP6</i>	R	<p><u>Notice and consents</u></p> <p><i>A pre-N2 firm will not contravene any of the provisions labelled TSP6 in Table COB TR 2 to the extent that it is able to demonstrate that, on or after commencement, it has continued to use or rely upon a valid notice given to, or valid notice or consent obtained from, a client or counterparty in accordance with the corresponding rule of its previous regulator or, where applicable, the relevant former statutory instrument, in relation to an investment agreement concluded before the expiry of the transitional period.</i></p>	indefinitely	<i>commencement</i>

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 2 with the labels indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
3.9	TSP7	R	<u>Cancellation</u> The Financial Services (Cancellation) Rules 1994 and the Financial Services (Non-Life Cancellation) Rules 1997 continue to apply in respect of investment agreements, as defined in section 44 (9) of the Financial Services Act 1986, entered into before commencement.	indefinitely	<i>commencement</i>
3.10	TSP7	G	COB 6.7 (Cancellation and withdrawal) applies in the case of an investment agreement entered into before commencement but which, on or after that date, is subsequently varied.	indefinitely	<i>commencement</i>

3 Table COB TR 2: Rules benefiting from transitional relief (pre-N2 and ex-section 43 firms)

This Table belongs to ■ COB TR 1.1 to ■ COB TR 3.10

COB Rule	Rule Heading	Label		
		ETP	TTP	TSP
Chapter 2 Rules which apply to all firms conducting designated investment business				
2.2 Inducements and soft commission				
2.2.8R	Requirements when using a soft commission agreement	ETP1		
2.2.12R	Allowable benefits provided under a soft commission agreement	ETP1		
2.2.16R	Prior disclosure	ETP1		
2.2.18R	Periodic disclosure		TTP1	
2.2.20R	Record keeping		TTP1	
Chapter 3 Financial promotion (whole chapter)				
3.6 Confirmation of compliance				
3.6.1R	Confirmation of compliance	ETP1		TSP1
3.6.2R	Withdrawing confirmation	ETP1		TSP1

COB Rule	Rule Heading	Label		
		ETP	TTP	TSP
3.6.5R	Communicating a financial promotion where another firm has confirmed compliance	ETP1		TSP1
3.7	Records	ETP1		
3.8	Form and content of financial promotions	ETP1		
3.9	Direct offer financial promotions	ETP1		
3.10	Unsolicited real time financial promotions			
3.10.1R	Meaning of "solicited" and "unsolicited" real time financial promotion	ETP1		
3.11	Unregulated collective investment schemes			
3.11.4R	Limited disapplication of this chapter	ETP1		
3.12	Communication and approval of financial promotions for an overseas person or an unauthorised person			
3.12.2R	No approval of real time financial promotions	ETP1		
3.12.3R	Approval of financial promotions when not all the rules apply	ETP1		
3.13	Additional requirements for financial promotions for an overseas long-term insurer			
3.13.2R		ETP1		
3.13.3R		ETP1		
Annex 2R	Contents of Enterprise Investment Scheme particulars	ETP1		
Annex 3R	Additional contents of Enterprise Investment Scheme particulars (Private Offer of Enterprise Investment Scheme shares)	ETP1		
Annex 5R	Permitted promotion of unregulated investment schemes	ETP1		
Chapter 4	Accepting customers			
4.1	Client classification	ETP3		
		ETP4		
4.2	Terms of business and client agreements with customers	ETP1		TSP2
Chapter 5	Advising and selling			
5.2	Know your customer			
5.2.5R	Requirement to know your customer	ETP1		TSP3
		ETP6		
5.2.9R	Record keeping: personal and financial circumstances	ETP1		TSP3
		ETP6		
5.2.10R		ETP1		TSP3
		ETP6		
5.3	Suitability			TSP4

COB Rule	Rule Heading	Label		
		ETP	TTP	TSP
5.3.5R	Requirement for suitability generally	ETP1		
5.3.6R	Requirement for suitability: provider firms	ETP1		
5.3.7R		ETP1		
		ETP6		
5.3.9R	Requirement for suitability: independent intermediary	ETP1		
5.3.14R	Requirement for a suitability letter	ETP1		
5.3.19R	Exceptions from requirement to provide a suitability letter	ETP1		
		ETP6		
5.3.20R	Suitability of broker funds	ETP1		
5.3.21R	Suitability of pension transfers and opt-outs	ETP1		
5.3.22R		ETP1		
		ETP6		
5.3.23R		ETP1		
		ETP6		
5.3.24R		ETP1		
5.3.25R		ETP1		
5.3.26R		ETP1		
		ETP6		
5.3.27R		ETP1		
		ETP6		
5.3.28R	Suitability of personal pension schemes: promotions to employees	ETP1		
		ETP6		
5.4	Customers' understanding of risk			TSP4
5.4.3R	Requirement for risk warnings	ETP1		TSP4
5.5	Information about the firm			
5.5.3R	Information required to be disclosed	ETP8		
5.5.7R	Overseas business for UK private customers	ETP8		
5.5.8R	Business conducted from an overseas place of business with overseas customers	ETP8		
5.7	Disclosure of charges, remuneration and commission			
5.7.3R	Disclosure of charges	ETP1		
5.7.5R	Disclosure of remuneration and commission for packaged products	ETP1		
5.7.9R	Exceptions to the disclosure for packaged products	ETP1		
5.7.10R		ETP1		

COB Rule	Rule Heading	Label		
		ETP	TTP	TSP
5.7.15R		ETP1		
	Chapter 6 Product disclosure and the customers' right to cancel or withdraw (whole chapter)	ETP1		TSP7
6.7	Cancellation and withdrawal	ETP1		TSP6
6.9	With-profits guides		TTP2	
	Chapter 7 Dealing and managing			
7.15	Non-market-price transactions			
7.15.3R	Non-market-price transactions	ETP6		
7.15.4R		ETP6		
	Chapter 8 Reporting to customers			
8.1	Confirmation of transactions			
8.1.3R	Requirement to confirm a transaction	ETP1		
8.1.6R	Exceptions to the requirement to despatch a confirmation	ETP1		
8.1.7R		ETP1		
8.1.8R		ETP1		
8.1.11R	When a confirmation may omit certain information	ETP1		
8.1.12R	When a transaction is treated as executed	ETP1		
8.1.14R	Record keeping requirements	ETP1		
8.2	Periodic statements			
8.2.4R	Requirement for a periodic statement	ETP1	TTP3	
8.2.6R	Exceptions from the requirement to provide a periodic statement	ETP1	TTP3	
8.2.9R	Record keeping requirements	ETP1	TTP3	
	Chapter 9 Client assets (whole chapter)	ETP5		
9.1.35		ETP1		TSP4
(3)–(5)R				TSP6
9.1.38R		ETP1		
9.1.40R		ETP1		TSP4
				TSP6
9.1.48R		ETP1		TSP6
9.1.49R		ETP1		TSP2
				TSP6
9.1.51R		ETP1		TSP2
				TSP6

COB Rule	Rule Heading	Label		
		ETP	TTP	TSP
9.1.54R	Risk disclosures	ETP1		TSP4
				TSP6
9.1.57R		ETP1		TSP4
				TSP6
9.1.58R		ETP1		TSP4
				TSP6
9.1.59R	Production and despatch of client statements	ETP1	TTP1	
9.1.60R			TTP1	
9.1.61R			TTP1	
9.1.63R		ETP1		
9.1.64R	Content of client statements	ETP1		
9.1.65R		ETP1		
9.1.69R	Custodian agreement	ETP1		TSP2
9.1.72R	Use of a safe custody investment: by the firm	ETP1		TSP6
9.1.73R	Use of a safe custody investment: by another client	ETP1		TSP6
9.1.74R	Stock lending			TSP2
9.1.78R		ETP1		
9.1.79R		ETP1		TSP6
9.1.80R		ETP1		
9.1.85R	Reconciliation: frequency of reconciliation	ETP1		
9.1.89R		ETP1		
9.1.93R	Reconciliation methods	ETP1		
9.1.94R	Reconciliation discrepancies	ETP1		
9.1.97R	Notification requirement	ETP1		
9.1.98R	Records	ETP1		
9.2 Mandates				
9.2.1R	Application	ETP1		
9.2.5R	General	ETP1		TSP6
9.3 Client money				
9.3.2R		ETP1		TSP6
9.3.9R				TSP6
9.3.11R				TSP6
9.3.53R	Client entitlements	ETP6		
9.3.55R		ETP6		
9.3.56R		ETP6		

COB Rule	Rule Heading	Label		
		ETP	TTP	TSP
9.3.60R	Interest	ETP6		TSP6
9.3.64(2)R		ETP6		
9.3.69R				TSP6
9.3.70R				TSP6
9.3.76R		ETP6		
9.3.80R	Group banks	ETP6		TSP6
9.3.81R		ETP6		TSP6
9.3.82R	Notification and acknowledgement of trust (banks)			TSP6
9.3.84R				TSP6
9.3.86R				TSP6
9.3.89R	Notification and acknowledgement of trust (ex- change, clearing house, intermediate broker or OTC counterparty)	ETP1		TSP6
9.3.90R				TSP6
9.3.95R				TSP6
9.3.97R	Notification to clients: use of an intermediate broker, settlement agent or OTC counterparty outside the United Kingdom			TSP6
9.3.100R		ETP1		
9.3.101R		ETP1		
9.3.105R		ETP1		
9.3.106R		ETP1		
9.3.107R (T)		ETP1		
9.3.108R		ETP1		
9.3.109R		ETP1		
9.3.113R		ETP1		
9.3.114R		ETP1		
9.3.115R	Equity balance	ETP1		
9.3.115R	Margined transaction requirements	ETP1		
9.3.119R	Reduced client money requirement option	ETP1		
9.3.121R	Failure to perform calculations	ETP1		
9.3.122R		ETP1		
9.3.123R	Reconciliation of client money balances: fre- quency of reconciliation	ETP1		
9.3.125R		ETP1		
9.3.135R		ETP6		
9.3.136R		ETP6		

COB Rule	Rule Heading	Label		
		ETP	TTP	TSP
9.5	Client money distribution (whole section)	ETP7		
	Chapter 10 Operators of collective investment schemes			
10.3	Modification of the allocation rule			
10.3.1R		ETP1		
10.6	Scheme documents for an unregulated collective investment scheme			
10.6.2R	Provision of scheme documents to private customers	ETP1		TSP5
10.6.5R		ETP6		TSP5
10.7	Periodic statements for an unregulated collective investment scheme	ETP1	TTP3	
10.7.2R	The requirement to prepare and issue periodic statements	ETP1		
10.7.6R	Record keeping requirements	ETP1		

4

Table COB TR 3: Client Classification Provisions

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies: All rules in the Handbook		Transitional provision	Transitional provision: dates in force	Handbook provision: coming into force
1.0	Timeless (saving) provisions for the Handbook (including COB)				
1.1	Rules in the Handbook unless the contrary intention appears	R	<u>Client Classification</u> (1) This paragraph applies only to a <i>pre-N2 firm</i> and in relation to any person who became a <i>client of the firm</i> before commencement (in this rule referred to as an "existing client").	indefinitely	varies depending on the rule concerned

(1)	(2) Material to which the transitional provision applies: All rules in the Handbook	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
			<p>(2) If a <i>firm</i> before <i>commencement</i> classified an existing <i>client</i>, other than another <i>firm</i>, as a <i>market counterparty</i> in accordance with the rules of its <i>previous regulator</i>, it will not contravene a <i>rule</i> in the <i>Handbook</i> by treating the <i>client</i> as a <i>market counterparty</i>, unless (3) applies.</p> <p>(3) If the <i>client</i> in (2) has been classified as a <i>market counterparty</i> only in relation to a particular transaction or type of transaction, the <i>firm</i> must from <i>commencement</i> classify that <i>client</i> in accordance with <i>COB 4.1</i>.</p> <p>(4) If a <i>firm</i> before <i>commencement</i> classified an existing <i>client</i>, other than another <i>firm</i> or a <i>client</i> within <i>COB TR1 1.6</i>, as a non-private customer in accordance with the rules of its <i>previous regulator</i>, it will not contravene a <i>rule</i> in the <i>Handbook</i> by treating that <i>client</i> as an <i>intermediate customer</i>.</p>		

(1)	(2) Material to which the transitional provision applies: All rules in the Handbook	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
			<p>(5) The <i>firm</i> may, notwithstanding (4), classify the <i>client</i> in (4) as a <i>market counterparty</i> provided the <i>firm</i> complies with COB 4.1.12R(2) (Large intermediate customer classified as a market counterparty).</p> <p>(6) If a <i>firm</i> before commencement classified an existing client, other than another <i>firm</i>, as a <i>private customer</i> in accordance with the rules of its <i>previous regulator</i>, it will not contravene a rule in the Handbook by treating that <i>client</i> as a <i>private customer</i>.</p> <p>(7) The <i>firm</i> may, notwithstanding (6), classify the <i>client</i> in (6) as an <i>intermediate customer</i> provided the <i>firm</i> complies with COB 4.1.9R (Expert private customer classified as an intermediate customer).</p>		

(1)	(2) Material to which the transitional provision applies: All rules in the Handbook	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1.2	Rules in the Handbook unless the contrary intention appears	G	<p>(8) If a firm before commencement classified an existing client, other than another firm, as an ordinary business investor in accordance with the rules of its previous regulator, it will not contravene a rule in the Handbook by treating that client as an intermediate customer.</p> <p>Firms should note that COB TR 3 1.1R does not require them to take positive steps to re-classify clients falling within the scope of the rule at N2 for the purposes of compliance with COB 4.1.4R (Requirement to classify). COB TR 3 1.1R has the effect of automatically re-classifying these clients except as otherwise stated.</p>	indefinitely	varies depending on the rule concerned
1.3	Rules in the Handbook unless the contrary indication appears	G	<p>There are no transitional rules regarding classification by a firm ("F") of a client who is a firm or overseas financial services institution ("C1"). In such cases the effect of COB 4.1.7R is that C1 will be a market counterparty of F, unless COB 4.1.7R(2), (3), (4) or (5) apply. If C1 wishes to be classified as an intermediate customer for inter-professional business from commencement, the requirement for agreement under COB 4.1.7R(2)(c) could, for example, be satisfied if:</p>	indefinitely	varies depending on the rule concerned

(1)	(2) Material to which the transitional provision applies: All rules in the Handbook	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1.4	<i>Rules in the Handbook unless the contrary intention appears.</i>	G	<p>(a) C1 notifies F in writing that it wishes to be classified as an <i>intermediate customer</i> for that purpose and that F's agreement will be implied if F continues to do business with C1 after <i>commencement</i>; and</p> <p>(b) F has not notified C1 in writing that it does not agree to that classification.</p> <p>For the assistance of <i>firms</i>, the FSA has prepared a <i>client</i> classification mapping table, which explains the link between pre-N2 <i>client</i> categories and the <i>client</i> classification in COB. This is to be found in Annex E of the Policy Statement on Transitional Arrangements for the Conduct of Business Sourcebook issued in July 2001.</p>		
1.5	<i>Rules in the Handbook unless the contrary intention appears.</i>	F	<p>If a <i>firm</i> treats a <i>client</i> as a <i>private customer</i>, or as an <i>intermediate customer</i>, or as a <i>market counterparty</i> in accordance with COB TR1 1.6 or COB TR1 1.8, it will not contravene a <i>rule</i> in the <i>Handbook</i> by doing so.</p>		

Handbook Modules

COB TR4 Transitional Rules for ex-RPB firms

1 Table

1.0	Application
1.1	R This section applies to <i>firms</i> who are <i>ex-RPB firms</i> .
2.0	Purpose
2.1	G The <i>FSA</i> is aware that the introduction of <i>COB</i> will impose an additional compliance burden on <i>firms</i> , even where there is an underlying continuity of policy. The <i>FSA</i> wishes to lighten that burden in a manner consistent with its statutory objectives and the principles of good regulation under <i>the Act</i> . Transitional measures are being produced for parts of <i>COB</i> which take three distinct forms. First, <i>firms</i> are in practical terms being given additional time after the <i>commencement day</i> , until 30 November 2002, to complete their preparations for the impact of certain <i>COB</i> rules. Secondly, relief is being given in relation to certain rules that require <i>firms</i> to fulfil obligations to <i>customers</i> at periodic intervals, so as to postpone the impact of the <i>COB</i> provisions in relation to periods that span N2. Thirdly, <i>firms</i> are being given relief for an indefinite period after N2 for certain <i>COB</i> provisions so as to allow <i>firms</i> to continue to use, or rely upon, documentation or compliance work undertaken in accordance with rules of their <i>previous regulator</i> in relation to existing <i>customers</i> at N2.
2.2	G If a <i>firm's</i> permitted <i>regulated activities</i> are subject to one or more of the transitional provisions in <i>COB</i> , and were carried on before <i>commencement</i> , those <i>regulated activities</i> should be interpreted, where appropriate, as if they were authorised investment business before <i>commencement</i> .
2.3	G <i>GEN</i> contains some technical transitional provisions that apply throughout the Handbook and which are designed to ensure a smooth transition at <i>commencement</i> . These include transitional provisions relevant to record keeping and notification rules.
2.4	G For the avoidance of doubt, <i>TTP1</i> at COB TABLE TR4 2.1 overrides paragraph 9 (Time starting before <i>commencement</i>) of the technical timing provisions in <i>GEN</i> .
3.0	Continuity of contracts
3.1	G The <i>FSA</i> is sometimes asked whether a <i>firm</i> should renegotiate contracts to replace references to its authorisation status under predecessor legislation with reference to its status under the <i>Act</i> . Clearly, whether a <i>firm</i> should renegotiate its contracts is a matter for the <i>firm</i> which needs to be considered in the light of the effect of the contractual provision as a whole. As a general rule, however, the <i>FSA</i> would not expect to see this done for regulatory reasons.

3.2	G	Clearly, the interpretation of contractual provisions is a matter for the courts. However, where a <i>firm</i> continues, as a result of the grandfathering process, to enjoy <i>permission</i> which provides it with authority under the <i>Act</i> to carry on <i>regulated activities</i> substantially similar to the investment business it could carry on under its authorisation under predecessor legislation, the <i>FSA</i> does not view it as necessary to update the contractual provisions.
4.0	Definitions	
4.1	R	In these transitional provisions the following words are to have the meaning given to them below: "corresponding rule" means a rule of the previous regulator of a firm that is substantially similar in purpose and effect to the relevant provision in COB. "ex-RPB firm" means a firm which immediately before commencement was authorised under the Financial Services Act 1986 to carry on investment business in the United Kingdom by virtue of a certificate from a recognised professional body under section 16 of the 1986 Act.

2 Table COB Table TR4: COB Transitional Provisions (for ex-RPB firms)

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies: The COB provisions in Table COB TR 5 with the label indicated		Transitional provision	Transitional provision: dates in force	Handbook provision: coming into force
1.0	Extra time provisions				
1.1	ETP1	R	<p><u>Transitional Relief</u></p> <p>An <i>ex-RPB firm</i> will not contravene any of the provisions labelled ETP1 in Table COB TR to the extent that, on or after <i>commencement</i>, it is able to demonstrate that it has complied with the <i>corresponding rule</i> of its <i>previous regulator</i> or, where applicable, the relevant former statutory requirement, subject to any modification, wherever appropriate, to take account of the passing of the <i>Act</i>.</p>	<i>commencement to 30 November 2002</i>	<i>commencement</i>

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 5 with the label indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1.2	<p><i>ETPs 1 to 3 (inclusive)</i></p> <p><i>TTP 1</i></p> <p><i>TSPs 1 to 4 (inclusive)</i></p>	G	<p>It is for an <i>ex-RPB firm</i> to satisfy itself that it has complied with the corresponding rule of its <i>previous regulator</i> or, where applicable, relevant former statutory requirement. In order to benefit from the relief, a <i>firm</i> must ensure that the rule of its <i>previous regulator</i> which it proposes to comply with is substantially similar to the COB provision to which it relates. For the assistance of <i>firms</i> the <i>FSA</i> has compiled tables of derivations indicating the rules of a <i>firm's previous regulator</i> that correspond to the <i>COB</i> provisions being transitioned. <i>Firms</i> may wish to refer to these tables but in doing so should understand that they are not intended as exhaustive and are produced merely by way of a guide. <i>Firms</i> are advised that should they wish to take advantage of the transitional measures set out in this section, the onus is on them to be able to demonstrate that in any given case they have in fact complied with the corresponding rules of their <i>previous regulators</i> or, as the case may be, former statutory requirement.</p>	<p><i>commencement to 30 November 2002 (for ETPs and TTPs)</i></p> <p>Indefinitely (for TSPs)</p>	<p><i>commencement</i></p>

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 5 with the label indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1.3	<p><i>ETPs 1 to 3 (inclusive)</i></p> <p><i>TTP 1</i></p> <p><i>TSPs 1 to 4 (inclusive)</i></p>	G	<p><i>Firms will have noted from the wording of COB TR 1.1 R that they should treat the corresponding rules of their previous regulator as modified to the extent necessary to ensure that the provision can operate effectively notwithstanding the enactment of the Act. Firms will need to adopt a common sense approach in interpreting the corresponding rules of their previous regulator and should modify them accordingly. For example, references in such rules to a firm's previous regulator should be read as if they referred to the FSA. Other modifications may not be as straightforward. In cases of difficulty, firms are encouraged to approach the FSA for its views.</i></p>	<p><i>commencement to 30 November 2002 (for ETPs and TTPs)</i></p> <p><i>Indefinitely (for TSPs)</i></p>	<i>commencement</i>
1.4	ETP2	R	<p><u>Financial Promotion</u></p> <p>(1) An ex-RPB firm will not contravene any of the provisions labelled ETP2 in Table COB TR2 to the extent that, on or after commencement, it communicates a financial promotion which, as to its content, complies with the corresponding rules of its previous regulator and which, for that purpose, had been approved by the firm as complying with them before commencement.</p>	<i>commencement to 30 November 2002</i>	<i>commencement</i>

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 5 with the label indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1.5	ETP2	G	<p>(2) For the purposes of (1), a <i>financial promotion</i> will be treated as <i>approved by an ex-RPB firm</i> for the purposes of section 21 of the <i>Act</i> if, as to its content, it complies with the <i>corresponding rules of the firm's previous regulator</i> and, for that purpose, was <i>approved by the firm</i> as so complying with them before <i>commencement</i>.</p> <p><i>Firms</i> should take reasonable steps to avoid communicating a non-real time <i>financial promotion</i> which, through the passage of time, has become misleading. In such circumstances the promotion is unlikely to be in compliance with the rules of its <i>previous regulator</i>.</p>	<i>commencement to 30 November 2002</i>	<i>commencement</i>
1.6	ETP3	R	<p><u>Information about the firm</u></p> <p>(1) Subject to (2), an ex-RPB firm will not contravene any of the provisions labelled ETP3 in Table COB TR 4 in relation to any written material it has produced before <i>commencement</i> to the extent that, on or after <i>commencement</i>, it is able to demonstrate that it has provided information about itself, in any such material, in accordance with the <i>corresponding rule of its previous regulator</i>.</p> <p>(2) (1) does not apply to a firm's appointed representative as defined under section 44(2) of the Financial Services Act 1986.</p>	<i>commencement to 30 November 2002</i>	<i>commencement</i>

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 5 with the label indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1.7	<i>ETP3</i>	G	The purpose of COB TR 1.6 R is to ensure that the <i>firm</i> does not incur unnecessary costs by having to withdraw or destroy written material produced before <i>commencement</i> . For the avoidance of doubt, where a <i>firm</i> prints a document on or after <i>commencement</i> from a precedent held in electronic form, ETP3 will apply.	<i>commencement to 30 November 2002</i>	
2.0	Technical timing provisions				
2.1	<i>TTP1</i>	R	<u>Periodic statements</u> An <i>ex-RPB</i> firm will not contravene any of the provisions labelled TTP1 in Table COB TR 4 to the extent that, on or after <i>commencement</i>, it is able to demonstrate that it has provided its <i>customers</i> with a periodic statement required by COB 8.2.4 R for the period in which <i>commencement</i> falls, in accordance with the corresponding rules of its previous regulator.	<i>commencement to 30 November 2002</i>	<i>commencement</i>
2.2	<i>TTP1</i>	G	<i>Firms</i> should note that the technical timing provisions set out at COB TR 2.1R operate on a one-off basis. Any future periodic statement relating to a period after the initial period in which <i>commencement</i> falls will have to be made in accordance with the full requirements of the relevant provision in COB.	<i>commencement to 30 November 2002</i>	<i>commencement</i>
3.0	Timeless (saving) provisions				

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 5 with the label indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
3.1	TSP1	R	<p><u>Confirmation of compliance and approval</u></p> <p>An <i>ex-RPB firm</i> will not contravene any of the provisions labelled TSP1 in Table COB TR 4 to the extent that it is able to demonstrate that, on or after <i>commencement</i>, it has carried out the confirmation exercise referred to in COB 3.6.2 R (2), for an <i>investment advertisement</i> issued or approved before <i>commencement</i>, in accordance with the corresponding rule of its previous regulator.</p>	Indefinitely	<i>commencement</i>
3.2	TSP2	R	<p><u>Terms of business and customer agreements</u></p> <p>(1) Subject to (2) and (3), an <i>ex-RPB firm</i> will not contravene any of the provisions in Table COB TR 4 labelled TSP2 to the extent that, on or after <i>commencement</i>, it is able to demonstrate that it has continued to use, or rely upon, <i>terms of business</i> (including a client agreement) given to, or made with, a client in accordance with the corresponding rule of its previous regulator.</p> <p>(2) If the basis on which an <i>ex-RPB firm</i> conducts or proposes to conduct its <i>designated investment business</i> for a client changes after the <i>commencement day</i>, it must provide the <i>client</i> with amended <i>terms of business</i> in accordance with COB 4.2.13R.</p>	Indefinitely	<i>commencement</i>

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 5 with the label indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
3.3	TSP2	G	<p>(3) An <i>ex-RPB firm</i> must take reasonable steps to ensure that a <i>private customer</i> to whom it has provided <i>terms of business</i> (including a <i>client agreement</i>) before commencement is notified in writing of the matters set out in COB 4.2.15E (21) and (22) as soon as practicable after commencement.</p> <p>(1) <i>Firms</i> should note that COB 4.2 also benefits from an <i>ETP1</i> extra-time provision as set out in COB TR 3.1R. The purpose of this is to allow firms additional time, after commencement, to amend their <i>terms of business</i> for new <i>clients</i> taken on after N2.</p> <p>(2) Where an <i>ex-RPB firm</i> has started, but not concluded, negotiating <i>terms of business</i> with a <i>client</i> before commencement, it may rely on COB TR 3.2(1) R even if the <i>terms of business</i> are not agreed until after commencement.</p> <p>(3) COB TR 3.2(2) R does not require the <i>firm</i> to provide a <i>client</i> with amended <i>terms of business</i> where the change in the terms was contemplated in the original <i>terms of business</i>.</p>	Indefinitely	commencement
3.4	TSP3	R	<u>Know your customer and suitability</u>	Indefinitely	commencement

(1)	(2) Material to which the transitional provision applies: The COB provisions in Table COB TR 5 with the label indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
3.5	<i>TSP4</i>	R	<p>(1) Subject to (2), an <i>ex-RPB firm</i> will not contravene any of the provisions labelled TSP3 in Table <i>COB TR2</i> to the extent that it is able to demonstrate that, on or after <i>commencement</i>, it has continued to use, or rely upon, a record of a <i>private customer's</i> personal and financial circumstances made in accordance with the <i>corresponding rules</i> of its <i>previous regulator</i>, and in doing so has had regard to the guidance set out in <i>COB 5.2.6 G</i>.</p> <p>(2) The relief in (1) will only apply so long as there is no relevant change in the <i>customer's</i> personal and financial circumstances.</p> <p><u>Suitability and customers' understanding of risk</u></p> <p>An <i>ex-RPB firm</i> will not contravene any of the provisions labelled TSP4 in Table <i>COB TR2</i> to the extent that, on or after <i>commencement</i>, it uses, or relies upon, a suitability letter or, as the case may be, a risk warning or disclosure, given to a <i>customer</i> in accordance with the corresponding rule of its <i>previous regulator</i>, in relation to a transaction or <i>series of transactions executed or arranged prior to commencement</i>.</p>	Indefinitely	<i>commencement</i>
3.6	<i>TSP4</i>	G	<p><i>Firms</i> should note that the requirements in COB 5.2 and COB 5.3 relating to the production of suitability letters and risk warning also benefit from an <i>ETP1</i> provision.</p>	Indefinitely	<i>commencement</i>

3 Table COB Table TR5: COB rules benefiting from transitional relief for ex-RPB firms
 This Table belongs to COB TR4 1.1R to COB TR4 4.1R

COB Rule	Rule Heading	Assignment		
		ETP	TTP	TSP
CHAPTER 3 FINANCIAL PROMOTION (whole chapter)		ETP1 ETP2		
3.6 Confirmation of compliance and approval				
3.6.1R	Confirmation of compliance	ETP1		TSP1
3.6.2R	Withdrawing confirmation	ETP1		TSP1
3.6.5R	Communicating a financial promotion where another firm has confirmed compliance	ETP1		TSP1
CHAPTER 4 ACCEPTING CUSTOMERS				
4.2 Terms of business and customer agreements		ETP1		TSP2
CHAPTER 5 ADVISING AND SELLING				
5.2 Know your customer		ETP1		TSP3
5.3 Suitability		ETP1		TSP4
5.4 Customers' understanding of risk				
5.4.3R	Requirement for risk warnings	ETP1		TSP4
5.5 Information about the firm		ETP3		
CHAPTER 8 REPORTING TO CUSTOMERS				
8.1 Confirmation of transactions				
8.1.3R	Requirement to confirm a transaction	ETP1		
8.1.6R	Exceptions to the requirements to dispatch a confirmation	ETP1		
8.1.7R		ETP1		
8.1.8R		ETP1		
8.1.11R	When a confirmation may omit certain information	ETP1		
8.1.12R	When a transaction is treated as arranged	ETP1		
8.1.14R	Record keeping requirements	ETP1		
8.2 Periodic statements				
8.2.4R	Requirement for a periodic statement	ETP1	TTP1	
8.2.9R	Record keeping requirements	ETP1	TTP1	
CHAPTER 9 CLIENT ASSETS				
9.1 Custody (whole chapter)		ETP1		
9.1.35				TSP4
(3)–(5)R				
9.1.40R				TSP4

COB Rule	Rule Heading	Assignment		
		ETP	TTP	TSP
9.1.49R	Client agreement			TSP2
9.1.51R				TSP2
9.1.54R	Risk disclosures			TSP4
9.1.57R				TSP4
9.1.58R				TSP4
9.1.69R	Custodian agreement			TSP2
9.1.74R	Stock lending			TSP2

Chapter 1

Application and general provisions



1.1 Application and Purpose

Application

1.1.1

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COB applies to every *firm* (except an *ICVC*) as specified in the remainder of this chapter.

Purpose

1.1.2

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The purpose of this chapter is to set out to whom, for what activities, and within what territorial limits the *rules*, *evidential provisions* and *guidance* in COB apply.



1.2 General application: who?

1.2.1

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COB applies to every *firm*, except that:

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- (1) ■ **COB 9** (Client assets) does not apply to an *incoming EEA firm* with respect to its *passport activities*;
- (2) for a *UCITS qualifier* and a *service company*, only ■ **COB 3** (Financial promotion), and any provision of *COB* incorporated into ■ **COB 3** by reference, applies;
- (3) *COB* does not apply to an *ICVC*; and
- (4) *COB* does not apply to an *authorised professional firm* with respect to its *non-mainstream regulated activities* except for:
 - (a) ■ **COB 2.1** (Clear, fair and not misleading communication);
 - (b) ■ **COB 3** (Financial promotion); and
 - (c) the following provisions of ■ **COB 4.2** (Terms of business and client agreements with customers); ■ **COB 4.2.1** to ■ **COB 4.2.6**, ■ **COB 4.2.9** to ■ **COB 4.2.11** and ■ **COB 4.2.15(26)**.

1.2.2

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A *UCITS qualifier* should be aware of the requirements of ■ **CIS 17.4** (Facilities in the United Kingdom).

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1.2.3

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■ **COB 6.7** (Cancellation and withdrawal) confers rights on *customers* to rescind agreements with, or withdraw offers from, *firms* within a specified period.

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1.2.4

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■ **COB 3** (Financial promotion) is available for nationals of *EEA States* (other than the *United Kingdom*) wishing to take advantage of article 36 of the *Financial Promotion Order*.

/1

1.2.5

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Authorised professional firms should be aware of the following:

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- (1) *PROF 5.2* (Nature of non-mainstream regulated activities);
- (2) ■ **COB 3.1.5** (Authorised professional firms) and the exemption in article 55 of the *Financial Promotion Order* (Communications by members of professions) which applies in relation to *financial promotions* of *authorised professional firms* under ■ **COB 3.5.5(2)** (Exemptions); and
- (3) ■ **COB 4.2.3** which contains *guidance* for *authorised professional firms* on the provision of *terms of business*.



1.3 General application: what?

1.3.1

R

COB applies to *firms* with respect to the carrying on of:

/1

- (1) all *regulated activities* except to the extent that a provision of *COB* provides for a narrower application; and
- (2) *unregulated activities* to the extent specified in any provision of *COB*.

1.3.2

G

- (1) The approach in *COB* is to ensure that each *rule*, or, as appropriate, the *rules* in a section or part of a section, are applied to *firms* in respect of particular *regulated activities* or *unregulated activities* or, in the case of **■ COB 3** (Financial promotion), in relation to particular kinds of promotion.
- (2) Most of *COB* applies in relation to *regulated activities*, conducted by *firms*, which fall within the definition of *designated investment business*. In relation to *deposits*, *pure protection contracts* and *general insurance contracts*, *COB* has only limited application.
- (3) The scope of the *regulated activities* to which *COB* applies is determined by the description of the activity as it is set out in the *Regulated Activities Order*. Accordingly, a *firm* will not generally be subject to *COB* in relation to any aspect of its business activities which fall within an exclusion found in the *Regulated Activities Order*. The definition of *designated investment business* includes, however, activities within the exclusion from *dealing in investments as principal* in article 15 of the *Regulated Activities Order* (Absence of holding out etc).
- (4) *COB* has limited application to Lloyd's related activities as set out in Chapter XIII of Part II of the *Regulated Activities Order*. *Firms* are reminded of the provisions of **■ COB 12** (Lloyd's).
- (5) **■ COB 3** (Financial promotion) applies to a *firm* which *communicates* or *approves a financial promotion*, but see (6);
- (6) *Firms* are reminded that **■ COB 3** (Financial promotion) has limited application to a *firm* carrying on a *takeover or related operation*. (See **■ COB 3.2.4** and **■ COB 3.2.5(7)**)

Application for private customers, intermediate customers and market counterparties

1.3.3

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- (1) In *COB*, the term *customer* refers to *private customers* and *intermediate customers*, but not *market counterparties*. Where relevant, each of the provisions of *COB* makes clear whether it applies to activities carried on with or for *private customers*, *intermediate customers* or both.
- (2) ■ **COB 9 (Client assets)** also applies directly in respect of activities conducted with or for *market counterparties* as well as with or for *customers*. The term *client* is used in that chapter to refer both to *market counterparties* and to *customers*.

Inter-professional business

1.3.4

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Only the following provisions of *COB* apply with respect to the carrying on of *inter-professional business*:

- (1) **this chapter;**
- (2) ■ **COB 2.4 (Chinese walls);**
- (3) ■ **COB 4.1 (Client classification);**
- (4) ■ **COB 7.13 (Personal account dealing).**

1.3.5

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Firms are reminded that the definition of *inter-professional business* does not include:

- (1) the *approval* of a *financial promotion* - ■ **COB 3 (Financial promotion)** has a limited application in this context (see ■ **COB 3.2.4** and ■ **COB 3.2.5 (1)**);
- (2) *safekeeping and administration of assets* and *agreeing to carry on that activity* - ■ **COB 9 (Client assets)** will apply in this context (and will apply to the holding of *money* for *clients* in connection with *inter-professional business*);
- (3) offering, giving, soliciting or accepting inducements for the purpose of or in connection with activities falling within the scope of *COB* ■ **COB 2.2 (Inducements and soft commission)** will apply in this context.



1.4 General application: where?

- 1.4.1 **R** /1 The territorial scope of the application of *COB* to *firms* is set out in **■ COB 1.4.3** except for the application of **■ COB 3** (Financial promotion), which is set out in **■ COB 3.3** (Application: where?).
- 1.4.2 **G** /1 **■ COB 3.3** (Territorial scope) contains *rules* about the territorial scope of **■ COB 3** (Financial promotion).
- 1.4.3 **R** /1 Table This table sets out the application of *COB* with reference to the location of the carrying on of an activity by a firm. This table belongs to **■ COB 1.4.1**.

	Activity	Application of COB
(a)	An activity carried on from an establishment maintained by the <i>firm</i> (or by its <i>appointed representative</i>) in the <i>United Kingdom</i>	<i>COB</i> applies in full
(b)	An activity carried on: <ul style="list-style-type: none"> • otherwise than in (a); and • with or for a <i>client</i> in the <i>United Kingdom</i> 	Where, if the office from which the activity is carried on were a separate <i>person</i> , the activity: <ul style="list-style-type: none"> • would fall within the <i>overseas persons</i> exclusions in article 72 of the <i>Regulated Activities Order</i>; or • would not be regarded as carried on in the <i>United Kingdom</i>; then only the following apply: <ul style="list-style-type: none"> • <i>COB 5.5.7R</i> and <i>COB 5.5.8R</i> (Overseas business);

	Activity	Application of COB
(c)	An activity carried on by a <i>UK firm</i> from a <i>branch</i> in another <i>EEA State</i> under an <i>EEA right</i>	<ul style="list-style-type: none"> • <i>COB 6.5, COB 6.7 and COB 6.8 (Content of key features, Cancellation and withdrawal, Insurance contracts – life and general) but only in relation to long term insurance business carried on with a customer habitually resident in the United Kingdom</i> <p>Otherwise, <i>COB</i> applies in full</p> <p>Only the following apply:</p> <ul style="list-style-type: none"> • for an <i>ISD investment firm (including a credit institution which is an ISD investment firm), COB 9 (Client assets); and</i> • if relevant, the provisions in (b)
(d)	An activity carried on otherwise than in (a), (b) or (c)	<p>Only the following apply;</p> <ul style="list-style-type: none"> • <i>COB 5.5.7 and COB 5.5.8 (Overseas business);</i> • <i>COB 6.5, COB 6.7 and COB 6.8 (Content of key features, Cancellation and withdrawal, Insurance contracts – life and general) but only in relation to long term insurance business carried on with a customer habitually resident in the United Kingdom</i>



1.5 Application to Occupational pension scheme firms (□OPS firms')

1.5.1

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In the case of *OPS activity* undertaken by an *OPS firm*, *COB* applies with the following general modifications:

- (1) references to *customer* are to the *OPS* or *welfare trust*, whichever fits the case, in respect of which the *OPS firm* is acting or intends to act, and with or for the benefit of which the relevant activity is to be carried on; and
- (2) where an *OPS firm* is required by any *rule* in *COB* to provide information to, or obtain consent from, a *customer*, that *firm* must ensure that the information is provided to, or consent obtained from, each of the trustees of the *OPS* or *welfare trust* in respect of which that *firm* is acting, unless the context requires otherwise.



1.6 Application to stock lending activity, corporate finance business and oil market participants

Stock lending activity

1.6.1 **R** In respect of any *stock lending activity* undertaken with or for a
/1 *customer* by a *firm*, only those provisions of COB in ■ COB 1.6.2 apply.

1.6.2 **R** Table Stock lending activity.
/1 This table belongs to ■ COB 1.6.1

COB	Subject
Chapter 1	Application and general provisions
2.1	Clear, fair and not misleading communication
2.2	Inducements and soft commission
2.3	Reliance on others
2.4	Chinese walls
2.5	Exclusion of liability
4.1	Client classification
4.2	Terms of business and client agreements with customers
5.3	Suitability
5.4	Customers' understanding of risk
5.5	Information about the firm
5.7	Disclosure of charges, remuneration and commission
7.1	Conflict of interest and material interest
7.7	Aggregation and allocation
7.8	Realisation of a private customer's assets
7.9	Lending to private customers
7.12	Customer order and execution records
7.13	Personal account dealing
8.1	Confirmation of transactions
Chapter 9	Client assets

Corporate finance business

1.6.3 **R** In respect of any *corporate finance business* undertaken by a *firm*,
/1 only those provisions of COB in ■ COB 1.6.4 apply.

1.6.4 **R** Table Corporate finance business.
/1 This table belongs to ■ COB 1.6.3

COB	Subject
Chapter 1	Application and general provisions
2.1	Clear, fair and not misleading communication
2.2	Inducements and soft commission
2.3	Reliance on others
2.4	Chinese walls
2.5	Exclusion of liability
Chapter 3	Financial promotion
4.1	Client classification
5.3	Suitability
5.4	Customers' understanding of risk
7.1	Conflict of interest and material interest
7.12	Customer order and execution records
7.13	Personal account dealing
Chapter 9	Client assets

1.6.5 **G** *Firms* should, when relevant, make reference to ■ MAR 4 (Endorsement of the
/1 Takeover Code). The effect of this endorsement in ■ MAR 4, is that, should a *firm* to whom the endorsement applies fail to comply with the City Code on Takeovers and Mergers ('*Takeover Code*'), the Rules Governing Substantial Acquisition of Shares ('*SARs*') or rulings or requirements made by the *Takeover Panel*, the *Takeover Panel* can request the *FSA* to take enforcement action against that *firm*.

Oil market participants

1.6.6 **R** In respect of *oil market activity* undertaken by an *oil market*
/1 *participant*, only those provisions of COB in ■ COB 1.6.7 apply.

1.6.7 **R** Table Oil market participants
/1 This table belongs to ■ COB 1.6.6

COB	Subject
Chapter 1	Application and general provisions
2.1	Clear, fair and not misleading communication
2.3	Reliance on others
2.4	Chinese walls
2.5	Exclusion of liability

COB	Subject
Chapter 3	Financial promotion
4.1	Client classification
7.1	Conflict of interest and material interest
7.3	Dealing ahead
8.1	Confirmation of transactions
Chapter 9	Client assets



1.7 Appointed representatives

1.7.1

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- (1) Although COB does not apply directly to a *firm's appointed representatives*, a *firm* will always be responsible for the acts and omissions of its *appointed representatives* in carrying on business for which the *firm* has accepted responsibility (section 39(3) of the *Act*). In determining whether a *firm* has complied with any provision of COB, anything done or omitted by a *firm's appointed representative* (when acting as such) will be treated as having been done or omitted by the *firm* (section 39(4) of the *Act*).
- (2) *Firms* should also refer to ■ SUP 12 (Appointed representatives), which sets out requirements which apply to *firms* using *appointed representatives*.



1.8 Application to electronic media

1.8.1

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■ GEN 2.2.14 (References to writing) has the effect that electronic media may be used to make communications that are required by the *Handbook* to be 'in writing' unless a contrary intention appears.

Additional guidance in respect of electronic communication with or for customers

1.8.2

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For any electronic communication with a *customer*, a *firm* should:

- (1) have in place appropriate arrangements, including contingency plans, to ensure the secure transmission and receipt of the communication; it should also be able to verify the authenticity and integrity of the communication; the arrangements should be proportionate and take into account the different levels of risk in a *firm's* business;
- (2) be able to demonstrate that the *customer* wishes to communicate using this form of media; and
- (3) if entering into an agreement, make it clear to the *customer* that a contractual relationship is created that has legal consequences.

1.8.3

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Firms should note that ■ GEN 2.2.14 does not affect any other legal requirement that may apply in relation to the form or manner of executing a *document* or agreement.

Chapter 2

2

Rules which apply to all
firms conducting
designated investment
business



2.1 Clear, fair and not misleading communication

Application

- 2.1.1** **R**_{/1} (1) This section applies to a *firm* when it communicates information to a *customer* in the course of, or in connection with, its *designated investment business*.
- (2) This section does not apply to a *firm* when it communicates a *financial promotion* in circumstances in which **■ COB 3** (Financial promotion) applies to the *firm*.

Purpose

- 2.1.2** **G**_{/1} The purpose of this section is to restate, in slightly amended form, and as a separate *rule*, the part of *Principle 7* (Communications with clients) that relates to communication of information. This enables a *customer*, who is a *private person*, to bring an action for damages under section 150 of the *Act* to recover loss resulting from a *firm* communicating information, in the course of *designated investment business*, in a way that is not clear or fair, or is misleading.

Clear, fair and not misleading communication

- 2.1.3** **R**_{/1} When a *firm* communicates information to a *customer*, the *firm* must take reasonable steps to communicate in a way which is clear, fair and not misleading.
- 2.1.4** **G**_{/1} When considering the requirements of **■ COB 2.1.3**, a *firm* should have regard to the *customer's* knowledge of the *designated investment business* to which the information relates.
- 2.1.5** **G**_{/1} **■ COB 2.1** embraces all communications with *customers*, for example: *client agreements*, *periodic statements*, financial reports, telephone calls and any correspondence which is not a *financial promotion* to which **■ COB 3** (Financial promotion) applies. *Firms* should note the requirements of **■ COB 3.8.4** relating to *non-real time financial promotions* and **■ COB 3.8.22** relating to *real time financial promotions*.



2.2 Inducements and soft commission

Application

- 2.2.1 **R** This section applies to a *firm* that conducts *designated investment business* with or for a *customer*.
/1

Purpose

- 2.2.2 **G** *Principles* 1 and 6 require a *firm* to conduct its business with integrity, to pay due regard to the interests of its *customers* and to treat them fairly. The purpose of this section is to ensure that a *firm* does not conduct business under arrangements that might give rise to a conflict with its duty to *customers*.
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Prohibition of inducements

- 2.2.3 **R** A *firm* must take reasonable steps to ensure that it, and any *person* acting on its behalf, does not:
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- (1) offer, give, solicit or accept an inducement; or
- (2) direct or refer any actual or potential item of *designated investment business* to another *person* on its own initiative or on the instructions of an *associate*;

if it is likely to conflict to a material extent with any duty that the *firm* owes to its *customers* in connection with *designated investment business* or any duty which such a recipient *firm* owes to its *customers*.

- 2.2.4 **G** The purpose of ■ COB 2.2.3(2) is to prevent the requirement in ■ COB 2.2.3(1) being circumvented by an inducement being given or received by an unregulated *associate*. A *firm* may be able to demonstrate that it could not reasonably have knowledge of an *associate* giving or receiving an inducement. It should not, however, direct business to another *person* on the instruction of an *associate* if this is likely to conflict with the interests of its *customers*.
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Restriction in connection with the sale of packaged products

2.2.5



- (1) A *firm* should not enter into any of the following arrangements with an *independent intermediary* in relation to the sale of a *packaged product* if any *commission* is required to be disclosed to a *customer* under ■ COB 6.2 (Provision of key features):
- (a) volume overrides, if *commission* paid in respect of several transactions is more than a simple multiple of the *commission* payable in respect of one transaction of the same kind;
 - (b) an arrangement to pay *commission* that is increased in excess of the amount disclosed to the *customer*, unless the increase is attributable to an increase in the *premiums* or contributions payable by that *customer*;
 - (c) an agreement to indemnify the payment of *commission* on terms that would or might confer an additional financial benefit on the recipient in the event of the *commission* becoming repayable;
 - (d) an arrangement to pay *commission* other than to the *firm* responsible for the sale, unless:
 - (i) the *firm* responsible for the sale has passed on its right to receive the *commission* to the recipient; or
 - (ii) another *firm* has given *advice on investments* to the same *customer* after the sale; or
 - (iii) the *firm* is a *provider firm*, the recipient is an *independent intermediary* and the *commission* is paid following the sale of a *packaged product* by the *provider firm* in response to a *direct offer financial promotion* communicated by that *firm* to a *customer* of the *independent intermediary*.
- (2) Contravention of (1) may be relied upon as tending to establish contravention of ■ COB 2.2.3.

Packaged products – guidance on indirect benefits

2.2.6



- (1) The FSA will not regard a *firm* as being in contravention of ■ COB 2.2.3 if it gives or receives any of the following indirect benefits, providing they do not conflict with the duties that the recipient owes to his *customer*:
- (a) gifts, hospitality and promotional competition prizes of a reasonable value;
 - (b) business leads channelled toward a particular *independent intermediary* provided that the *independent intermediary* is an *associate* and complies with the requirements of ■ COB 5.3.9 (Requirement for suitability: independent intermediary);

- (c) assistance in conducting the Review of past business in pension transfers and opt-outs.
- (2) A *product provider* may assist an *independent intermediary* to promote its *packaged products* so that the quality of their service to *customers* is enhanced. Such assistance should not be of a kind or value that is likely to impair an *independent intermediary's* ability to act independently, and to give advice on, and recommend, *packaged products* available from the market as a whole. The *independent intermediary* should be mindful of the requirements of ■ COB 5.3.9 (Requirement for suitability: independent intermediary).
- (3) In relation to the sale of *packaged products*, ■ COB 2.2.7 indicates the kind of benefits which, in the FSA's view, a *firm* can give and receive without contravening ■ COB 2.2.3.

2.2.7

G

Table Reasonable indirect benefits – joint marketing exercises
This Table belongs to ■ COB 2.2.6.

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Reasonable indirect benefits	
Joint marketing exercises	
1	A <i>provider firm</i> may provide generic product literature (that is, letterheading, leaflets, forms and envelopes) that is suitable for use and distribution by or on behalf of an <i>independent intermediary</i> if: <ul style="list-style-type: none"> (a) the literature does not feature the <i>independent intermediary's</i> name or features it less prominently than that of the <i>provider firm</i> and is not used to promote the <i>independent intermediary's broker fund</i> service; and (b) the total costs (for example, packaging, posting, mailing lists) of distributing such literature to its <i>customers</i> is borne by the <i>independent intermediary</i>.
2	A <i>provider firm</i> may supply an <i>independent intermediary</i> with 'freepost' envelopes, for forwarding such items as completed applications, medical reports or copy <i>client agreements</i> , when these are made generally available to all <i>independent intermediaries</i> from whom the <i>firm</i> obtains business.
3	A <i>provider firm</i> may supply product specific literature (for example, <i>key features</i> , minimum information, <i>direct offer financial promotions</i>) to an <i>independent intermediary</i> if: <ul style="list-style-type: none"> (a) the literature is not designed to be used to promote the <i>independent intermediary's broker fund</i> service; or (b) the literature does not contain the name of any <i>independent intermediary</i>; or (c) the name of the <i>independent intermediary</i> is only overprinted on the literature and the <i>provider firm's</i> name appears on the literature more prominently than that of the <i>independent intermediary</i>.
4	A <i>provider firm</i> may supply draft articles, news items and <i>financial promotions</i> for publication in an <i>independent intermediary's</i> magazine, only if in each case any costs paid by the <i>provider firm</i> for placing the articles and <i>financial promotions</i> are not more than market rate, and exclude distribution costs. Seminars and conferences
5	A <i>provider firm</i> may take part in a seminar organised by an <i>independent intermediary</i> or a third party and may pay toward the cost of the seminar, if: <ul style="list-style-type: none"> (a) its participation is for a genuine business purpose; (b) the contribution is reasonable and proportionate; and (c) in the case of a seminar organised by a third party, the seminar is open to participation by <i>independent intermediaries</i> generally.

Reasonable indirect benefits	
Joint marketing exercises	
	Technical services and information technology
6	A <i>provider firm</i> may supply a ‘freephone’ link to which it is connected only if it is available to <i>independent intermediaries</i> generally.
7	A <i>provider firm</i> may supply an <i>independent intermediary</i> with any of the following: <ul style="list-style-type: none"> (a) quotations and <i>projections</i> relating to its <i>packaged products</i> and, in relation to specific <i>investment</i> transactions (or for the purpose of any scheme for review of past business), advice on the completion of forms or other <i>documents</i>; (b) access to data processing facilities, or access to data, that is related to the <i>provider firm’s</i> business; (c) access to third party electronic dealing or quotation systems that are related to the <i>provider firm’s</i> business; and (d) software that gives information about the <i>provider firm’s packaged products</i> or which is appropriate to its business (for example, for use in a scheme for review of past business or for producing <i>projections</i> or technical product information).
8	A <i>provider firm</i> may supply a <i>broker fund adviser</i> (and its <i>customer</i>) with a <i>periodic statement</i> relating to the relevant <i>broker fund</i> if the <i>broker fund adviser</i> is unable to supply the <i>periodic statement</i> .
9	A <i>provider firm</i> may supply an <i>independent intermediary</i> with information about sources of mortgage finance.
10	A <i>provider firm</i> may supply an <i>independent intermediary</i> with generic technical information in writing, not necessarily related to the <i>provider firm’s</i> business, when this information: <ul style="list-style-type: none"> (a) is made available generally to <i>independent intermediaries</i>; or (b) <ul style="list-style-type: none"> (i) is of a specialist nature and is made available to a particular class of <i>independent intermediary</i> (that is, one that promotes itself as an expert in the same specialist area); and (ii) states clearly and prominently that it is produced by the <i>provider firm</i>.
	Training
11	A <i>provider firm</i> may provide an <i>independent intermediary</i> with training facilities of any kind (for example, lectures, venue, written material and software) only if these are made available generally to all <i>independent intermediaries</i> .
	Travel and accommodation expenses
12	A <i>provider firm</i> may reimburse an individual <i>independent intermediary’s</i> reasonable travel and accommodation expenses when the <i>independent intermediary</i> : <ul style="list-style-type: none"> (a) participates in market research conducted by or for the <i>provider firm</i>; (b) attends an annual national event of a <i>UK</i> trade association, hosted or co-hosted by the <i>provider firm</i>; (c) participates in the <i>provider firm’s</i> training facilities (see 11); (d) visits the <i>provider firm’s UK</i> office in order to: <ul style="list-style-type: none"> (i) receive information about the <i>provider firm’s</i> administrative systems; or (ii) attend a meeting with the <i>provider firm</i> and an existing or prospective <i>customer</i> of the <i>independent intermediary</i>.

Requirements when using a soft commission agreement

2.2.8

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A *firm* must not deal in investments as agent for a customer, either directly or indirectly, through any broker, under a soft commission agreement, unless:

- (1) the agreement is a written agreement for the supply of goods or services described in ■ COB 2.2.12 which do not take the form of, or include, cash or any other direct financial benefit;
- (2) the broker has agreed to provide best execution to the *firm*;
- (3) the *firm* has taken reasonable steps to ensure that the terms of business and methods by which services will be supplied by the broker do not involve any potential for comparative price disadvantage to the *customer*;
- (4) for transactions in which the broker acts as *principal*, the *firm* has taken reasonable steps to ensure that *commission* paid under the agreement will be sufficient to cover the value of the goods or services to be received and the costs of execution; and
- (5) the *firm* makes adequate prior and periodic disclosure to the *customer* in accordance with ■ COB 2.2.16 and ■ COB 2.2.18.

2.2.9

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When the soft commission broker is part of an 'integrated house', a *firm* may be able to meet the requirements of ■ COB 2.2.8(4) if it is able to monitor the individual transaction prices obtained by the broker, and has taken reasonable steps to ensure that the broker has complied with its best execution obligation. Alternatively, a *firm* should select a soft commission broker who is able to demonstrate independence of action in the market place. This is unlikely to be fulfilled when that broker deals exclusively with one *market maker*.

2.2.10

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When a broker is only partly remunerated by *commission*, in complying with ■ COB 2.2.8(4) a *firm* should take reasonable steps to ensure that the *commission* element that should be disclosed constitutes the greater part of that broker's remuneration. A broker *firm* should also set its multiple at a level which it can demonstrate would generate sufficient *commission* income from softing transactions to cover the costs of the goods and services provided, and the costs of dealing and settling the associated transactions, together with the specialised softing administration. When considering whether the *commission* is sufficient to cover the costs of the services provided, the broker *firm* may have regard to the aggregate number of bargains transacted rather than each individual transaction.

2.2.11

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Although 'commission recapture' and 'directed commission' arrangements are not covered by ■ COB 2.2.8, a *firm* should have regard to the prohibition on inducements in ■ COB 2.2.3.

Allowable benefits provided under a soft commission agreement

2.2.12

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A *firm* may accept goods or services supplied under a soft *commission agreement*, and these goods or services will not constitute an inducement for the purposes of ■ COB 2.2.3, provided that they are

directly relevant to, and are used to assist in, the provision to the *firm's customers* of:

- (1) investment management services;
- (2) advice on dealing in, or on the value of, any *designated investment*;
- (3) *custody* services relating to *designated investments* belonging to, or managed for, *customers*; or
- (4) services relating to the valuation or performance measurement of portfolios.

2.2.13

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Examples of particular goods and services that could be provided under a *soft commission agreement* include, to the extent they would assist in the provision of the services specified in ■ COB 2.2.12:

- (1) research, analysis and advisory services, including those on economic factors and trends;
- (2) market price services;
- (3) electronic trade confirmation systems;
- (4) third party electronic dealing or quotation systems;
- (5) computer hardware associated with specialised computer software or research services;
- (6) dedicated telephone lines;
- (7) seminar fees (if the subject matter is relevant to the provision of the services set out in ■ COB 2.2.12); and
- (8) publications (if the subject matter is relevant to the provision of the services set out in ■ COB 2.2.12).

2.2.14

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Examples of goods and services that the *FSA* does not regard as relevant to the provision of the services specified in ■ COB 2.2.12 include:

- (1) travel, accommodation or entertainment costs, whether or not related to the conduct of *designated investment business*;
- (2) any seminar fees not falling within ■ COB 2.2.13(7);
- (3) any subscription for publications not falling within ■ COB 2.2.13(8)
- (4) office administrative computer software, for example, word processing or accounting programmes;
- (5) computer hardware not associated with specialist computer software;
- (6) membership fees to professional associations;
- (7) purchase or rental of standard office equipment or ancillary facilities;

- (8) *employees' salaries*; and
- (9) *direct money payments*.

2.2.15

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In complying with ■ COB 2.2.8 when a *firm* is able to and does reclaim or offset all or part of the VAT payable on benefits received, the *firm* should ensure that its soft commission account with the broker is charged only with the net amount at the *firm's* effective rate. Disclosure of the value of benefits received, in accordance with ■ COB 2.2.18, should be expressed net of VAT reclaimed, when appropriate.

Prior disclosure

2.2.16

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If a *firm* has information from which it knows, or reasonably ought to know, that another member of its *group* has a *soft commission agreement* with another *person* under which it or that other party *deals* or intends to *deal* for *customers* of the *firm*, the *firm* must, before entering into an *agreement* authorising it to *deal* for a *customer*, either directly or indirectly with or through the agency of the other *person*, inform the *customer* in writing of:

- (1) the existence of the *soft commission agreement*; and
- (2) the *firm's* or, when relevant, its *group's* policy relating to *soft commission agreements*.

2.2.17

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When making the disclosures required by ■ COB 2.2.16, a *firm* should note that:

- (1) it is acceptable to make a general disclosure that *soft commission agreements* are, or may be, in place;
- (2) the requirements apply equally when *deals* are placed directly, and not solely on an agency basis, with a third party (for example, a unit trust manager in the same *group*), that itself is a party to the *soft commission agreement*; and
- (3) the policy statement should explain generally why the *firm* or a member of its *group* might find it necessary or desirable to pay *soft commission*, bearing in mind the practices in the markets in which it does business on behalf of its *customers*.

Periodic disclosure

2.2.18

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If a *firm* has information from which it knows, or reasonably ought to know, that another *member* of its *group* has a *soft commission agreement* with another *person* under which it or that other party *deals* or intends to *deal* for a *customer* of the *firm*, the *firm* must:

- (1) provide each relevant *customer* at least once a year, unless ■ COB 2.2.19 applies, with the following information covering the period since the *firm* last reported to that *customer* or, if no previous report has been made, since the *firm* first dealt for him:

- (a) the percentage paid under *soft commission agreements* of the total *commission* paid by or at the direction of:
 - (i) the *firm*; and
 - (ii) any other member of the *firm's group* which is a party to those agreements;
 - (b) the value (on a cost price basis) of goods or services received by the *firm* under *soft commission agreements*, expressed as a percentage of the total *commission* paid by or at the direction of:
 - (i) the *firm*; or
 - (ii) other members of the *firm's group*;
 - (c) a summary of the goods or services received by the *firm*;
 - (d) a list of the brokers which are parties to the *soft commission agreements*; and
 - (e) the total *commission* paid from the portfolio of that *customer*;
- (2) at least once a year explain to each relevant *customer*, unless ■ COB 2.2.19 applies, the policy of the *firm* relating to *soft commission agreements* for the period up to the submission of the next policy statement (which must not exceed one year) or state that its policy has not changed (this may be included in any periodic report provided under (1), or in a separate document);
- (3) give to a *customer* to whom it is relevant an explanation promptly after any material change in the *firm's* policy relating to *soft commission agreements*, and, if it is the case, confirm to each relevant *customer* that the goods and services received by the *firm* are expected to assist only in the conduct of *designated investment business* with or for other *customers*.

Exceptions

2.2.19

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A *firm* need not make the periodic disclosures required by ■ COB 2.2.18(1) or (2) if:

- (1) the *customer* is habitually resident overseas and has requested the *firm* not to do so; or
- (2) a *firm* has information from which it is reasonable to conclude that the *customer* does not wish to receive this information.

Record keeping

2.2.20

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- (1) A *firm* must make records of the reports sent to its *customers* as required by ■ COB 2.2.18 and retain those records for at least three years from the date on which the *soft commission agreement* to which they relate is terminated.
- (2) A *firm* must make a record of each payment of disclosable *commission*, and must retain that record for a period of at least six years from the date of payment.
- (3) A *firm* must make a record of each benefit given to an *independent intermediary*, and must keep that record for at least six years from the date on which it was given.



2.3 Reliance on others

Application

- 2.3.1 **R** /1 This section applies to a *firm* when it is conducting *designated investment business* or activities in connection with *designated investment business*.

Purpose

- 2.3.2 **G** /1 *Principle 2* requires a *firm* to conduct its business with due skill, care and diligence. This section indicates the extent to which *firms* can meet this requirement by relying on others.

Reliance on others

- 2.3.3 **R** /1 A *firm* will be taken to be in compliance with any *rule* in *COB* that requires a *firm* to obtain information to the extent that the *firm* can show that it was reasonable for the *firm* to rely on information provided to it in writing by another *person*.

- 2.3.4 **E** /1
- (1) In relying on **■** COB 2.3.3, a *firm* should take reasonable steps to establish that the other *person* providing written information is:
 - (a) not connected with the *firm*; and
 - (b) competent to provide the information.
 - (2) Compliance with (1) may be relied on as tending to establish compliance with **■** COB 2.3.3.
 - (3) Contravention of (1) may be relied on as tending to establish contravention of **■** COB 2.3.3.

- 2.3.5 **G** /1 A *firm* may generally rely on any information provided to the *firm* in writing by:
- (1) an unconnected *authorised person*; or
 - (2) a *professional firm*;

2.3.6

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unless the *firm* is aware, or ought reasonably to be aware, of any fact, or facts, that would give reasonable grounds to question the accuracy of any such information.

- (1) Any information which a *rule* in *COB* requires to be sent to a *customer* may be sent to another *person* on the instruction of the *customer*, so long as the recipient is not connected with the *firm*.
- (2) There is no need for a *firm* to send information to a *customer* where it has taken reasonable steps to establish that this has been or will be supplied by another *person*.



2.4 Chinese walls

Application

- 2.4.1 **R** This section applies to a *firm* that conducts *designated investment business*.
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Purpose

- 2.4.2 **G** *Principle 8* (Conflicts of interest) requires a *firm* to manage a conflict of interest fairly, both between itself and its *customers* and between a *customer* and another *client*. One of the methods by which a *firm* may manage conflicts of interest is to establish and maintain internal arrangements restricting the movement of information within the *firm* – *Chinese walls*. The purpose of this section is to set out the circumstances when the *FSA* would consider it appropriate for a *firm* to withhold or not to use information that it would otherwise have to disclose to, or use for the benefit of a *client*.

- 2.4.3 **G** The purpose of **■** COB 2.4.4(1) is also to exercise the *FSA*'s power under section 147 of the *Act* to make control of information rules (see **■** COB 2.4.5 for an explanation of the effect of this).
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Control of information

- 2.4.4 **R** (1) When a *firm* establishes and maintains a *Chinese wall* (that is, an arrangement that requires information held by a *person* in the course of carrying on one part of its business to be withheld from, or not to be used for, *persons* with or for whom it acts in the course of carrying on another part of its business), it may:
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- (a) withhold or not use the information held; and
 - (b) for that purpose, permit *persons* employed in the first part of its business to withhold the information held from those employed in that other part of the business;

but only to the extent that the business of one of those parts involves the carrying on of *designated investment business*.

- (2) Information may also be withheld or not used by a *firm* when this is required by an established arrangement maintained between different parts of the business (of any kind) in the same *group*. This provision does not affect any requirement to transmit or use information that may arise apart from the *rules* in *COB*.
- (3) For the purpose of this rule, 'maintains' includes taking reasonable steps to ensure that the arrangements remain effective and are adequately monitored, and must be interpreted accordingly.
- (4) For the purposes of section 118(8) of the *Act*, behaviour conforming with ■ COB 2.4.4(1) does not amount to market abuse.

Effect of acting in conformity with ■ COB 2.4.4

2.4.5

G

Section 147 of the *Act* enables the *FSA* to make *rules* ("control of information rules") about the disclosure and use of information held by a *firm*. ■ COB 2.4.4(1) is the only control of information rule made by the *FSA*. This means that:

- (1) acting or engaging in conduct in conformity with ■ COB 2.4.4(1) provides a defence against proceedings brought under section 397(2) or (3) of the *Act* (Misleading statements and practices) – see sections 397(4) and (5)(c);
- (2) behaviour conforming with ■ COB 2.4.4(1) does not amount to *market abuse* – see ■ COB 2.4.4(4); and
- (3) acting in conformity with ■ COB 2.4.4(1) provides a defence for a *firm* against *FSA* enforcement action, or an action for damages under section 150 of the *Act*, based on a breach of a relevant requirement to disclose or use information (this is likely to be relevant only for requirements in *PRIN*, *COB* and ■ *MAR* 3 (Inter-professional conduct)). Acting in conformity with ■ COB 2.4.4(2) has a similar effect but only in relation to such a requirement in *COB*.

Attribution of knowledge

2.4.6

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When any of the *COB rules* apply to a *firm* that acts with knowledge, the *firm* will not be taken to act with knowledge for the purposes of that *rule* if none of the relevant individuals involved on behalf of the *firm* acts with that knowledge as a result of arrangements established under ■ COB 2.4.4.

2.4.7

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When a *firm* manages a conflict of interest using the arrangements in ■ COB 2.4.4 which take the form of a *Chinese wall*, individuals on the "other side of the wall" will not be regarded as being in possession of knowledge denied to them as a result of the *Chinese wall*.



2.5 Exclusion of liability

Application

- 2.5.1 **R**
/1 This section applies to a *firm* that makes any written or oral communication to a *customer* in the course of, or in connection with, its *designated investment business*.

Purpose

- 2.5.2 **G**
/1 *Principle 6* (Customers' interests) requires a *firm* to pay due regard to the interests of its *customers* and treat them fairly. A *firm* may not exclude the duties it owes or the liabilities it has to a *customer* under the *Act* or the *regulatory system*. It may exclude other duties and liabilities only if it is reasonable for it to do so.

Limits on the exclusion of liability

- 2.5.3 **R**
/1 A *firm* must not, in any written or oral communication, seek to exclude or restrict, or to rely on any exclusion or restriction of, any duty or liability it may have to a *customer* under the *regulatory system*.
- 2.5.4 **R**
/1 A *firm* must not in any written or oral communication to a *private customer* seek to exclude or restrict, or to rely on any exclusion or restriction of, any duty or liability not referred to in ■ COB 2.5.3 unless it is reasonable for it to do so.

Chapter 3

Financial promotion



3.1 Application: who?

Firms

- 3.1.1** **R** _{/1} This chapter applies to every *firm* (other than an *ICVC*) which *communicates or approves a financial promotion*.
- 3.1.2** **G** _{/1} This chapter applies generally to *firms* in relation to all *financial promotions*. This wide application is however cut back by **■ COB 3.2** (Application: what?) and **■ COB 3.3** (Application: where?) which limit the application of this chapter for:
- (1) *financial promotions* for *deposits, general insurance contracts, pure protection contracts* and reinsurance contracts;
 - (2) *financial promotions* which fall within the scope of the exemptions in the *Financial Promotion Order* or the additional exemptions set out in **■ COB 3.2.5**; and
 - (3) *financial promotions* to *persons* outside the *United Kingdom*.

Appointed representatives

- 3.1.3** **G** _{/1} Under section 39(3) of the *Act*, a *firm* is responsible for *financial promotions communicated* by its *appointed representatives* when acting as such (see **■ COB 1.7** (Approved representatives)).

Nationals of other EEA States

- 3.1.4** **G** _{/1} A national of an *EEA State* (other than the *United Kingdom*) wishing to take advantage of the exemption in article 36 of the *Financial Promotion Order* in relation to any *controlled activity* lawfully carried on by him in that State, should act in conformity with the *rules* in this chapter.
- 3.1.5** **R** _{/1} (1) **■ COB 3** does not apply to an *authorised professional firm* in relation to the *communication of a financial promotion* if the following conditions are satisfied:
- (a) the *firm's* main business must be the practice of its profession (see *IPRU(INV) 2.1.1R(3)*);

- (b) the *financial promotion* must be made for the purposes of and incidental to the promotion or provision by the *firm* of:
 - (i) its professional services; or
 - (ii) its *non-mainstream regulated activities* (see *PROF 5.2*);
and
 - (c) the *financial promotion* must not be *communicated* on behalf of another *person* who would not be able lawfully to *communicate* the *financial promotion* if he were acting in the course of business.
- (2) In (1)(b)(i), "professional services" means services:
- (a) which do not constitute a *regulated activity*; and
 - (b) the provision of which is supervised and regulated by a *designated professional body*.

3.1.6

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Authorised professional firms are reminded that in circumstances in which ■ COB 3 does not apply to the *firm* ■ COB 2.1 (Clear, fair and not misleading communication) may apply.



3.2 Application: what?

What do "communicate", "approve" and "financial promotion" mean?

3.2.1

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- (1) The *rules* in this chapter adopt various concepts from the restriction on *financial promotion* by *unauthorised persons* in section 21(1) of the *Act* (Restrictions on financial promotion). *Guidance* on that restriction is contained in ■ AUTH App [] and that *guidance* will be relevant to interpreting these *rules*. In particular, *guidance* on the meaning of:
 - (a) "communicate" is in ■ AUTH App [] (Communicate);
 - (b) "invitation or inducement" and "engage in investment activity" (two elements which, with "communicate", make up the definition of "financial promotion") is in ■ AUTH App [] (Invitation and inducement) and ■ AUTH App [] (Engage in investment activity).
- (2) *Guidance* on the "approval" of a *financial promotion* is in ■ COB 3.12.1 (Approval of financial promotions).

Media of communication

3.2.2

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- (1) There is no restriction on the media of communication to which this chapter applies. It applies to a *financial promotion communicated* by any means, including by way of printed advertising, radio and television broadcast, a personal visit, a telephone call, an e-mail, the internet and electronic media such as digital and other forms of interactive television and media. Both solicited and unsolicited communications are covered.
- (2) *Financial promotions* may be *communicated* for example, by means of:
 - (a) product brochures;
 - (b) general advertising in magazines, newspapers, radio and television programmes and websites;
 - (c) mailshots (whether distributed by post, facsimile, e-mail or other media);
 - (d) telemarketing activities, such as telephone calls made by call centres;
 - (e) written correspondence, telephone calls and face to face discussions including by *advisers*;

- (f) sales aids which themselves constitute a *financial promotion*;
- (g) presentations to groups of individuals;
- (h) tip-sheets; and
- (i) other publications, which may contain non-*personal recommendations* as to the acquisition, retention or disposal of *investments* of any description.

Financial promotions for deposits and contracts of insurance which are not life policies

3.2.3

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To the extent that a *financial promotion* relates to one or more of the following:

- (1) a *deposit*; or
- (2) a *general insurance contract*, *pure protection contract*, or *reinsurance contract*.

only ■ COB 3.1 to ■ COB 3.5 and ■ COB 3.8.4 to ■ COB 3.8.6 and ■ COB 3.14 apply, unless the *financial promotion* relates to a *cash deposit ISA* in which case ■ COB 3.9.6(1) and ■ COB 3.9.8 also apply.

Exemptions

3.2.4

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This chapter does not apply to a *firm* in relation to a *financial promotion* of a kind listed in ■ COB 3.2.5, except that:

- (1) if the *financial promotion* relates to an *unregulated collective investment scheme*, ■ COB 3.11 (Unregulated collective investment schemes) applies;
- (2) if the *firm approves* the *financial promotion*, the following apply:
 - (a) ■ COB 3.1 to ■ COB 3.5 (Application, General and Purpose).
 - (b) ■ COB 3.8.4(1) (Non-real time financial promotions: fair, clear and not misleading);
 - (c) ■ COB 3.12.1 to ■ COB 3.12.5 (Approval of financial promotions; No approval of real time financial promotions; Approval of financial promotions when not all the rules apply); and
- (3) if the *firm*:
 - (a) *approves a specific non-real time financial promotion* relating to an *investment* or service of an *overseas person*; and

3.2.5

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Table Exemptions
This table belongs to ■ COB 3.2.4

Exemptions

This chapter does not apply to the following:

- (1) **a financial promotion to a market counterparty or an intermediate customer, that is a financial promotion which:**
 - (a) **is made only to recipients who the firm has taken reasonable steps to establish are market counterparties or intermediate customers; or**
 - (b) **may reasonably be regarded as directed only at recipients who are market counterparties or intermediate customers;**

when a person is classified as an *intermediate customer* under **COB 4.1.9R (Expert private customer classified as intermediate customer)**, this exemption applies only for a *financial promotion* that relates to the *designated investments* or *designated investment business* for which he has been so classified;
- (2) **a financial promotion which can lawfully be communicated by an unauthorised communicator without approval;**
- (3) **a financial promotion communicated from outside the United Kingdom which would be exempt under articles 30, 31, 32 or 33 of the Financial Promotion Order (Overseas communicators) if the office from which the financial promotion is communicated were a separate unauthorised person (but see COB 5.5.7R (Overseas business for UK private customers));**
- (4) **a “one off” non-real time financial promotion or a “one off” solicited real time financial promotion; if the conditions set out in (a) to (c) are satisfied, a financial promotion is to be regarded as “one off”; if not, the fact that any one or more of these conditions is met is to be taken into account in determining if a financial promotion is “one off”, but a financial promotion may be regarded as “one off” even if none of the conditions are met; the conditions are that:**
 - (a) **the financial promotion is communicated only to one recipient or only to one group of recipients in the expectation that they would engage in any investment activity jointly;**
 - (b) **the identity of the product or service to which the financial promotion relates has been determined having regard to the particular circumstances of the recipient;**
 - (c) **the financial promotion is not part of an organised marketing campaign;**

Exemptions	
(5)	a <i>financial promotion</i> which contains only one or more of the following: <ul style="list-style-type: none"> (a) the name of the <i>firm</i>; (b) the name of an <i>investment</i>; (c) a contact point (address (including an e-mail address), telephone or facsimile number); (d) a logo; (e) a brief, factual description of the <i>firm's</i> activities; (f) a brief, factual description of the <i>firm's</i> fees; (g) a brief, factual description of the <i>firm's</i> investment products; (h) the price or yields of <i>investments</i> and the <i>charges</i>;
(6)	a personal quotation or illustration form;
(7)	a <i>financial promotion</i> in connection with a <i>takeover or related operation</i> which is subject to the <i>Takeover Code</i> (or exempted from complying with the <i>Takeover Code</i> by the rules of that Code or by a ruling of the <i>Takeover Panel</i>) or to the requirements relating to <i>takeovers or related operations</i> in another <i>EEA State</i> .

Combination of exemptions

- 3.2.6 **R** /1 A *firm* may rely on more than one exemption (and also on ■ COB 3.3.1 (Territorial limitation)) in relation to the same *financial promotion*.

Guidance on the exemptions

- 3.2.7 **G** /1
- (1) Under ■ COB 3.2.5(1) a *financial promotion* which is *communicated* only to *market counterparties* or *intermediate customers* is exempt. See ■ COB 3.5.6 and ■ COB 3.5.7 which amplify this exemption. A *firm* will need to take particular note of the conditions in ■ COB 3.5.7 when designing *financial promotions* for trade publications which may be available also to *private customers*.
 - (2) A table summarising some of the main exemptions contained in the *Financial Promotion Order*, and therefore relevant to ■ COB 3.2.5(2), is in ■ COB 3 Ann 1. *Guidance* on certain exemptions is contained in ■ AUTH App [].
 - (3) In ■ COB 3.2.5:
 - (a) Item (4) reflects the exemption in article 28 of the *Financial Promotion Order* (One off non-real time communications and solicited real time communications), but goes further, exempting such *financial promotions* which relate to *deposits* and all *contracts of insurance*. It exempts, amongst other things, correspondence which is written specifically for a recipient, whether hard copy or e-mail. A *firm* should note, however, that such correspondence will, if *personal recommendations* are made, be

subject to other obligations such as know your customer and suitability requirements ■ COB 5.2 and ■ COB 5.3). It does not exempt *financial promotions communicated* in the form of mass mailshots, which may appear to be items of personalised correspondence but which in fact comprise the same or virtually the same material sent to a number of recipients, without tailoring the material to the circumstances of each recipient. Such mailshots must meet the requirements of this chapter.

- (b) Items (5)(e), (f) and (g) exempt a *financial promotion* made by a *firm* which refers only to its activities in general terms in image advertising. Acceptable examples include 'life and pensions' and 'life assurance and pensions business'. In addition a *firm* may include its name, address and telephone number in accordance with items 5(a) and (c).
- (c) Item (5)(h) exempts *financial promotions* which merely comprise lists of prices published in newspapers, or through the internet, or other electronic media. In addition a *firm* may include its name, address and telephone number in accordance with items (5)(a) and (c).
- (4) A company's annual report and accounts issued in accordance with a requirement of the Companies Act 1985 (or corresponding Northern Ireland or EEA provisions) are exempt under item (2) and article 59 of the *Financial Promotion Order*. But this exemption does not extend to the report and accounts of ICVCs, other types of OEIC, and *unit trust schemes*.
- (5) A *financial promotion* included in a newspaper, magazine or periodical which is printed and published overseas, but which may be brought into the *United Kingdom* and made available to *persons* in the *United Kingdom*, will be exempt provided that the *financial promotion* is not *communicated* to *persons* inside the *United Kingdom* (see ■ COB 3.3).
- (6) This chapter does not apply in relation to a *financial promotion* the *communication* of which by a *firm* would contravene section 238(1) of the *Act* (Restrictions on promotion of unregulated collective investment schemes) (see ■ COB 3.11.4).

Other Handbook rules relevant to financial promotions

3.2.8

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- (1) Firms are reminded that *financial promotions* (including those which are exempt) may be subject to more general *rules* including *Principle 7* (Communications with clients), ■ SYSC 3 (Systems and controls) and ■ COB 2.1.3 (Clear, fair and not misleading communication).
- (2) *Firms* are reminded that if in the course of making a *financial promotion* of any kind an *adviser* (independent or tied) gives specific *advice on investments* to a *private customer* about the suitability of a product for that individual, the *adviser* in giving the advice is subject to the *rules*, as appropriate, on advising and selling in ■ COB 5.
- (3) *Firms* are reminded that this chapter does not apply with respect to the carrying on of *inter-professional business*. This means that a *financial promotion communicated* to a *market counterparty* in connection with certain types of *regulated activities* is exempt from this chapter; instead, ■ MAR 3 (Inter-professional conduct) may be relevant. But that exemption does not apply in relation to the *approval* of a *financial promotion* in the course of *inter-professional business*.



3.3 Application: where?

Territorial scope

3.3.1

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This chapter applies to a *firm* only in relation to:

- (1) the *communication* of a *financial promotion* to a *person* inside the *United Kingdom*; or
- (2) the *communication* of an *unsolicited real time financial promotion* to a *person* outside the *United Kingdom*, unless:
 - (a) it is made from a place outside the *United Kingdom*; and
 - (b) it is made for the purposes of a business which is carried on outside the *United Kingdom* and which is not carried on in the *United Kingdom*; and
- (3) the approval of a *non-real time financial promotion* for *communication* to a *person* inside the *United Kingdom*;

subject to ■ COB 3.3.3.

3.3.2

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- (1) The application under ■ COB 3.3.1 is relevant both when a firm *communicates* a *financial promotion* itself and when a firm *approves* a *non-real time financial promotion* for *communication* by others. But see also ■ COB 3.3.3(2) regarding *approvals*.
- (2) The exemptions in ■ COB 3.2.5 (Application: what?; Exemptions) also incorporate some territorial elements. In particular, the exemption for *financial promotions* originating outside the *United Kingdom* (section 21(3) of the *Act* (Restrictions on financial promotion)) (see ■ COB 3.2.5(2)) and the exemptions for overseas communicators (see ■ COB 3.2.5(3)).

Exceptions to territorial scope

3.3.3

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The following parts of this chapter apply without any territorial limitation:

- (1) ■ COB 3.11 (Unregulated collective investment schemes);

- (2) if a *firm approves a financial promotion*:
- (a) ■ COB 3.1 to ■ COB 3.5 (Application, General and Purpose);
 - (b) ■ COB 3.8.4(1) (Non-real time financial promotions: clear, fair and not misleading);
 - (c) ■ COB 3.12.1 to ■ COB 3.12.5 (Approval of financial promotions; No approval of real time financial promotions; Approval of financial promotions when not all the rules apply).

3.3.4

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There is no need for a *financial promotion* which is indicated in ■ COB 3.3.3 to be outside the territorial scope of the application of this chapter to be *approved* before being *communicated* by an *unauthorised person* (because the restriction in section 21 of the *Act* (Restrictions on financial promotion) does not apply). If a *firm* nevertheless *approves* such a *financial promotion*, it must comply with the *rules* indicated in ■ COB 3.3.3(2). However, a *firm* must not *approve a real time financial promotion* (see ■ COB 3.12.2).

Meaning of "communicated to a person inside or outside the United Kingdom"

3.3.5

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For the purposes of this chapter:

- (1) a *financial promotion* is *communicated* to a *person* outside the *United Kingdom* if it is:
 - (a) made to a *person* who receives it outside the *United Kingdom*; or
 - (b) directed only at *persons* outside the *United Kingdom*; and
- (2) a *financial promotion* is *communicated* to a *person* inside the *United Kingdom* if it is *communicated* to a *person* other than as described in (1);

and see ■ COB 3.5.6 and ■ COB 3.3.6 which amplify this *rule*.

Meaning of "directed only at persons outside the United Kingdom"

3.3.6

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- (1) If the conditions set out in 4(a), (b), (c) and (d) are met, a *financial promotion* directed from a place inside the *United Kingdom* will be regarded as directed only at *persons* outside the *United Kingdom*.
- (2) If the conditions set out in 4(c) and (d) are met a *financial promotion* directed from a place outside the *United Kingdom* will be regarded as directed only at *persons* outside the *United Kingdom*.

- (3) In any other case where one or more of the conditions in 4(a) to (e) is met, that fact will be taken into account in determining whether a *financial promotion* is directed only at *persons* outside the *United Kingdom* (but a *financial promotion* may still be regarded as directed only at *persons* outside the *United Kingdom* even if none of these conditions is met).
- (4) The conditions are that:
- (a) the *financial promotion* is accompanied by an indication that it is directed only at *persons* outside the *United Kingdom*;
 - (b) the *financial promotion* is accompanied by an indication that it must not be acted upon by *persons* in the *United Kingdom*;
 - (c) the *financial promotion* is not referred to in, or directly accessible from, any other *financial promotion* which is made to a *person* or directed at *persons* in the *United Kingdom* by or on behalf of the same *person*;
 - (d) there are in place proper systems and procedures to prevent recipients in the *United Kingdom* (other than those to whom the *financial promotion* might otherwise lawfully have been made) *engaging in the investment activity* to which the *financial promotion* relates with the *person* directing the *financial promotion*, a *close relative* of his or a member of the same *group*;
 - (e) the *financial promotion* is included in:
 - (i) a website, newspaper, journal, magazine or periodical publication which is principally accessed in or intended for a market outside the *United Kingdom*;
 - (ii) a radio or television broadcast or teletext service transmitted principally for reception outside the *United Kingdom*.



3.4 Purpose

3.4.1

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- (1) Section 21(1) of the *Act* (Restrictions on financial promotion) imposes a restriction on the *communication of financial promotions* by *unauthorised persons*. A *person* must not, in the course of business, *communicate* an invitation or inducement to *engage in investment activity* (a *financial promotion*) unless:
 - (a) he is an *authorised person*; or
 - (b) the content of the *financial promotion* is *approved* by an *authorised person*.
- (2) However, the *Financial Promotion Order* exempts from the restriction created by section 21(1) of the *Act* certain types of *financial promotion*.
- (3) Sections 238 and 240 of the *Act* (Restrictions on promotion/approval) impose restrictions on the *communication* and *approval* by *firms* of *financial promotions* relating to *unregulated collective investment schemes*. See further ■ COB 3.11.

3.4.2

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- (1) The purpose of this chapter is to provide *rules* and *guidance* for a *firm* which wishes to *communicate* or *approve* a *financial promotion*. ■ COB 3.5.2 provides a guide to the topics covered in this chapter.
- (2) This chapter amplifies, for activities within its scope:
 - (a) *Principle 6* (Customers' interests) which requires a *firm* to pay due regard to the interests of its *customers* and treat them fairly; and
 - (b) *Principle 7* (Communications with clients) which requires a *firm* to pay due regard to the information needs of its *clients*, and *communicate* information to them in a way which is clear, fair and not misleading.



3.5 General

Topics covered in this chapter

- 3.5.1** G_{/1} This chapter includes some provisions which are applicable to all types of *financial promotion* and others which apply only to specific types. ■ COB 3.5.2 has been provided to help locate the areas of particular relevance to types of *financial promotion*.
- 3.5.2** G_{/1} Table Areas of particular relevance to types of financial promotion. This table belongs to ■ COB 3.5.1

Areas of particular relevance to types of financial promotion

(1)	Provisions applying to all <i>financial promotions</i>	Application – who?	COB 3.1
		Application – what?	COB 3.2
		Application – where?	COB 3.3
		Purpose	COB 3.4
		General	COB 3.5
(2)	Provisions applying only to <i>non-real time financial promotions</i>	Confirmation of compliance	COB 3.6
		Records	COB 3.7
		Form and content of financial promotions: non-real time financial promotions	COB 3.8.2R to COB 3.8.7G
		Form and content of financial promotions: specific non-real time financial promotions	COB 3.8.8R to COB 3.8.20G
(3)	Provisions applying only to <i>real time financial promotions</i>	Form and content of financial promotions: real time financial promotions	COB 3.8.21G to COB 3.8.25G
		Unsolicited real time financial promotions	COB 3.10
(4)	Provisions applying only to certain types of <i>financial promotions</i>	Direct offer financial promotions	COB 3.9
		Unregulated collective investment schemes	COB 3.11

Areas of particular relevance to types of financial promotion

	Communication and approval of financial promotions for an overseas or unauthorised person	COB 3.12
	Additional requirements for financial promotions for an overseas long-term insurer	COB 3.13
	The internet and other electronic media	COB 3.14

Other regulations and guidelines

3.5.3

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A *firm communicating a financial promotion* may also be subject to other regulations and guidelines, outside the remit of the FSA, such as:

- (1) the codes issued from time to time by the Advertising Standards Authority, the Independent Television Commission and the Radio Authority;
- (2) regulations from any *overseas regulator* (where relevant) if the *firm* intends to market from the *United Kingdom* into any other country;
- (3) the *POS Regulations*; and
- (4) the Telecommunications (Data Protection and Privacy) Regulations 1999 (SI 1999/2093).

"Real time" and "non-real time" financial promotions

3.5.4

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This chapter draws a distinction between a *real time* and a *non-real time financial promotion*. Guidance on the meaning of those expressions, which are based on article 7 of the *Financial Promotion Order*, is contained in ■ AUTH App [] (Types of communication).

3.5.5

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- (1) A "*real time financial promotion*" is a *financial promotion* which is *communicated* in the course of a personal visit, telephone conversation or other interactive dialogue.
- (2) A "*non-real time financial promotion*" is a *financial promotion* that is not a *real time financial promotion*. It includes a *financial promotion* made by letter, e-mail or contained in a newspaper, journal, magazine, other periodical publication, website, television or radio programme, or teletext service.
- (3) The following are to be regarded as indications that a *financial promotion* is a *non-real time financial promotion*:
 - (a) the *financial promotion* is *communicated* to more than one *person* in identical terms (save for details of the recipient's identity);

- (b) the *financial promotion is communicated* by way of a system which in the normal course constitutes or creates a record of the communication which is available to the recipient to refer to at a later time;
- (c) the *financial promotion is communicated* by way of a system which in the normal course does not enable or require the recipient to respond immediately to it.

Meaning of “made”, “directed at” and “recipient” in this chapter

3.5.6

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(In accordance with article 6 of the *Financial Promotion Order* (Interpretation: communications)) any reference in this chapter to:

- (1) a communication being made to another *person* is a reference to a communication being addressed, whether verbally or in legible form, to a particular *person* or *persons* (for example, where it is contained in a telephone call or letter);
- (2) a communication being directed at *persons* is a reference to a communication being addressed to *persons* generally (for example where it is contained in a television broadcast or website);
- (3) a “recipient” of a communication is the *person* to whom the communication is made or, in the case of a *non-real time communication* which is directed at *persons* generally, any *person* who reads or hears the communication.

When is a financial promotion “directed only at” certain persons?

3.5.7

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- (1) This *rule* applies for the purposes of determining whether a communication is directed:
 - (a) only at *market counterparties* or *intermediate customers* under ■ COB 3.2.5(1); or
 - (b) in a way that complies with paragraph 2(b) in ■ COB 3 Ann 5.
- (2) If all the conditions set out in (4) are met, a communication is to be regarded as directed as in (1).
- (3) In any other case in which one or more of those conditions are met, that fact is to be taken into account in determining whether the communication is directed as in (1) (but a communication may still be regarded as so directed even if none of the conditions in (4) are met).
- (4) The conditions are that:

- (a) the communication includes an indication of the description of *persons* to whom it is directed and an indication of the fact that the *investment* or service to which it relates is available only to such *persons*;
- (b) the communication includes an indication that *persons* of any other description should not rely upon it;
- (c) there are in place proper systems and procedures to prevent recipients other than *persons* to whom it is directed *engaging in the investment activity*, or participating in the *collective investment scheme*, to which the communication relates with the *person* directing the communication, a *close relative* of his or a member of the same *group*.



3.6 Confirmation of compliance

Confirmation of compliance

- 3.6.1** **R**_{/1} (1) Before a *firm communicates* or *approves a non-real time financial promotion*, it must confirm that the *financial promotion* complies with the *rules* in this chapter.
- (2) A *firm* must arrange for the confirmation exercise in (1) to be carried out by an individual or individuals with appropriate expertise.
- 3.6.2** **G**_{/1} (1) In **■** COB 3.6.1(2) ‘appropriate expertise’ will vary depending on the complexity of the *financial promotion* and the *investment* or service to which it relates. The individuals engaged by a *firm* to confirm the compliance of its *financial promotions* with this chapter may themselves have different levels of expertise and therefore a different level of authority for confirmation depending on the type of *financial promotion* and the *investment* or service involved.
- (2) A *firm* may arrange for a third party with appropriate expertise to carry out the confirmation exercise on the *firm’s* behalf, but the responsibility for the *financial promotion* remains with the *firm*.

Withdrawing confirmation

- 3.6.3** **R**_{/1} If, at any time after it has completed a confirmation exercise in **■** COB 3.6.1(1), a *firm* becomes aware that a *financial promotion* no longer complies with the *rules* in this chapter, it must ensure that the *financial promotion* is withdrawn as soon as is reasonably practicable by:
- (1) ceasing to *communicate* it;
- (2) withdrawing its approval (if applicable); and
- (3) notifying any *person* that the firm knows to be relying on its approval (if applicable) or confirmation (under **■** COB 3.6.5).
- 3.6.4** **G**_{/1} (1) **■** COB 3.6.3 is of particular importance to a *financial promotion*, such as a product brochure, that a *firm* uses over a period of time. It has little application to a *financial promotion* which is of its nature ephemeral, for

example a mobile phone text message. Further, a *financial promotion* which clearly speaks as at a particular date will not cease to comply with the *rules* in this chapter merely because the passage of time has rendered it out-of-date; an example would be a dated analyst's report.

- (2) For compliance with ■ COB 3.6.3, the FSA will expect a *firm* to monitor its relevant *financial promotions* as part of the *firm's* routine compliance monitoring procedures. A *firm* may find it helpful to designate a relevant *financial promotion* with a 'review date', a date at which the *financial promotion* should be checked once more against the *rules* of this chapter. If it is found no longer to meet these requirements it should be withdrawn as soon as is reasonably practicable.
- (3) If at any time a *firm* becomes aware that *private customers* may have been misled by a *financial promotion* it should consider whether *private customers* who have responded to the *financial promotion* should be contacted with a view to explaining the position and offering any appropriate form of redress to those who have suffered financial loss.

Communicating a financial promotion where another firm has confirmed compliance

3.6.5

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A *firm* will not contravene any of the *rules* in this chapter in circumstances where it (*firm* "A") *communicates a non-real time financial promotion* which has been produced by another *person* provided that:

- (1) A takes reasonable care to establish that another *firm* (*firm* "B") has already confirmed the compliance of the *financial promotion* in accordance with ■ COB 3.6.1;
- (2) A takes reasonable care to establish that A communicates the *financial promotion* only to recipients of the type for whom it was intended at the time B carried out the confirmation exercise; and
- (3) so far as A is, or ought reasonably to be, aware:
 - (a) the *financial promotion* has not ceased to be clear, fair and not misleading since that time; and
 - (b) B has not withdrawn the *financial promotion*.



3.7 Records

Requirement to make and retain records

- 3.7.1** **R**
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- (1) A *firm* must make an adequate record of each *non-real time financial promotion* which it has confirmed as complying with the *rules* in this chapter.
- (2) A record in (1) must be retained for the following periods:
- (a) indefinitely in the case of a *financial promotion* relating to a *pension transfer, pension opt-out* or *FSAVC*;
 - (b) six years in the case of a *financial promotion* relating to a *life policy, pension contract* or *stakeholder pension scheme*;
 - (c) three years in any other case.

Content of records

- 3.7.2** **G**
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- In deciding what is an adequate record under **COB 3.7.1**, a *firm* should consider including, or providing reference to, where appropriate matters such as:

- (1) the name of the individual or individuals who confirmed that the *financial promotion* complied with the *rules* in this chapter;
- (2) the date of confirmation and (where appropriate) *approval*;
- (3) details of the medium for which the *financial promotion* was authorised;
- (4) the evidence supporting any material factual statement about an investment matter in the *financial promotion*.

- 3.7.3** **G**
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- (1) A *firm* should also retain a copy of the *financial promotion* as finally published or, if this is not practicable, monitor the published version to verify that it is in substantially the same format as the version which the *firm* confirmed complied with the *rules* in this chapter.

- (2) Records which should be retained include:
- (a) any written *financial promotion* used by a *financial adviser* or *representative*;

- (b) any written material which is used in an organised marketing campaign (including, for example, written mailshots whether sent by e-mail, post, facsimile or other media).
- (3) see ■ COB 3.14.6 for guidance on recording an electronic financial promotion containing market information which is updated continuously.

Form of records

3.7.4

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A record in ■ COB 3.7.1 may be in any form, provided that it is readily accessible for inspection by the FSA.

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3.7.5

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A *firm* may arrange for records to be kept in such form as it chooses, such as hard copy, disk or tape. If the *financial promotion* is not in a written form, the record should represent the actual *financial promotion* as accurately as possible. A record would be "readily accessible" if it were available for inspection within 48 hours of the request being made. ■ SYSC 3.2.20(2) (Records to be capable of reproduction on paper) does not apply to records of *non-real time financial promotions*.

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3.8 Form and content of financial promotions

Application

3.8.1

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This section applies as follows:

- (1) ■ COB 3.8.2 to ■ COB 3.8.20 apply to a *firm* which *communicates* or *approves a non-real time financial promotion*;
- (2) ■ COB 3.8.21 to ■ COB 3.8.25 apply to a *firm* which *communicates a real time financial promotion*.

Non-real time financial promotions: name and contact point

3.8.2

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A *non-real time financial promotion* must contain the name of the *firm* and either an address of the *firm* or a contact point from which an address is available.

3.8.3

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- (1) For the purposes of ■ COB 3.8.2, the name may be a trading name or shortened version of the legal name of the *firm* (although other legislation, for example, the Companies Act 1985, may require a *firm* to include information not required by this *rule*).
- (2) The type of contact point envisaged for a *firm* by ■ COB 3.8.2 is: an e-mail address, or telephone or facsimile number, where a *person* can contact the *firm* for its address.
- (3) Except for a *direct offer financial promotion* (see ■ COB 3.9.6) a *firm* is not required in a *financial promotion* which it *communicates* or *approves* to name the FSA as its regulator. However, to comply with ■ COB 3.8.4, if the *firm* chooses to name the FSA as its regulator and the *financial promotion* refers to matters not regulated by the FSA, it should also make clear that those matters are not regulated by the FSA.

Non-real time financial promotions: clear, fair and not misleading; comparisons

3.8.4

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- (1) A *firm* must be able to show that it has taken reasonable steps to ensure that a *non real-time financial promotion* is clear, fair and not misleading.

- (2) *A non-real time financial promotion* which includes a comparison or contrast must:
- (a) compare *investments* or services meeting the same needs or which are intended for the same purpose;
 - (b) objectively compare one or more material, relevant, verifiable and representative features of those *investments* or services, which may include price;
 - (c) not create confusion in the market place between the *firm* itself (or the *person* whose *financial promotion* it *approves*) and a competitor or between the *firm's* trademarks, trade names, other distinguishing marks, *investments* or services (or those of the *person* whose *financial promotion* it *approves*) and those of a competitor;
 - (d) not discredit or denigrate the trademarks, trade names, other distinguishing marks, *investments*, services, activities or circumstances of a competitor;
 - (e) not take unfair advantage of the reputation of a trademark, trade name or other distinguishing marks of a competitor;
 - (f) not present *investments* or services as imitations or replicas of *investments* or services bearing a protected trademark or trade name; and
 - (g) indicate in a clear and unequivocal way in any comparison referring to a special offer the date on which the offer ends or, where appropriate, that the special offer is subject to the availability of the *investments* and services, and, where the special *offer* has not yet begun, the date of the start of the period during which the special price or other specific conditions shall apply.

3.8.5



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- (1) *A firm* should take reasonable steps to ensure that, for a *non-real time financial promotion*:
- (a) its promotional purpose is not in any way disguised or misrepresented;
 - (b) any statement of fact, promise or prediction is clear, fair and not misleading and discloses any relevant assumptions;
 - (c) any statement of opinion is honestly held and, unless consent is impracticable, given with the consent of the *person* concerned;
 - (d) the facts on which any comparison or contrast is made are verified, or, alternatively, that relevant assumptions are disclosed and that the comparison or contrast is presented in a

- fair and balanced way, which is not misleading and includes all factors which are relevant to the comparison or contrast.
- (e) it does not contain any false indications, in particular as to:
 - (i) the *firm's* independence;
 - (ii) the *firm's* resources and scale of activities; or
 - (iii) the scarcity of any *investment* or service;
 - (f) the design, content or format does not disguise, obscure or diminish the significance of any statement, warning or other matter which the *financial promotion* is required by this chapter to contain;
 - (g) it does not include any reference to approval by the *FSA* or any government body, unless such approval has been obtained in writing from the *FSA* or that body (see also ■ GEN 1.2 (Referring to approval by the *FSA*));
 - (h) it does not omit any matters the omission of which causes the *financial promotion* not to be clear, fair and not misleading; and
 - (i) the accuracy of all material statements of fact in it can be substantiated.
- (2) (a) Compliance with ■ COB 3.8.5 (1) may be relied on as tending to show compliance with ■ COB 3.8.4(1).
 - (b) Contravention of ■ COB 3.8.5(1) may be relied on as tending to show contravention of ■ COB 3.8.4(1).

Non-real time financial promotions: guidance for deposits, general insurance and pure protection policies

3.8.6

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When designing *non-real time financial promotions* relating to *deposits*, *general insurance contracts* or *pure protection contracts* with a view to complying with the general requirements of ■ COB 3.8.4, *firms* may find it helpful to take account of:

- (1) (for *deposits*) the British Bankers' Association/Building Societies Association Code of Conduct for the Advertising of Interest Bearing Accounts;
- (2) (for *general insurance contracts*) the General Insurance Standards Council Code;
- (3) (for *pure protection contracts*) the ABI Life Insurance (Non-Investment Business) Selling Code of Practice.

Non-real time financial promotions: guidance on fair, clear and not misleading

3.8.7

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- (1) It cannot be assumed that recipients necessarily have an understanding of the *investment* or service being promoted. If a *non-real time financial promotion* is specially designed for a targeted collection of recipients who are reasonably believed to have particular knowledge of the *investment* or service being promoted, this fact should be made clear.
- (2) Except in relation to *life policies* providing guaranteed benefits, or *deposits*, the description of an *investment* as ‘guaranteed’ should be used only if there is a legally enforceable arrangement with a third party to meet a claim in full. In such cases sufficient details about the guarantor and the guarantee should be provided before a *person* enters into a transaction relating to the *investment* to enable him to make a fair assessment of the value of the guarantee. A guarantee to the *directors* of a company that issues an *EIS share* is not a guarantee to a *person* invested in the relevant *Enterprise Investment Scheme*.
- (3) The use of any of the following may mean that a *non-real time financial promotion* does not meet the general requirement of ■ COB 3.8.4(1) of being clear, fair and not misleading:
 - (a) a statement such as ‘no initial charges’ or ‘no entry or redemption charges’ where the *bid price* is not the same as the *offer price* (for example there is a spread), unless the statement is suitably qualified with information about the additional costs of investment;
 - (b) the phrase ‘frozen pensions’, which implies that the pension fund will not remain invested and the pension benefits may not be subject to the possibility of an upward revaluation and will not be upgraded in circumstances where this is not the case (the phrase ‘preserved pensions’ is recommended as an alternative);
 - (c) a statement of the amount of authorised share capital of a *company* without the amount of the issued share capital;
 - (d) a statement of the amount of a *company’s* total assets without the amount of its liabilities, or the amount of a *company’s* total costs, or income or turnover, without making clear the period to which the statement relates;
 - (e) an implication that the assets of a whole *group* can be drawn on by a *subsidiary* when this is not the case;
 - (f) a comparison of the performance or the likely performance of an investment in *units* in a *regulated collective investment scheme* with an investment in *units* an *unregulated collective investment scheme*.
- (4) In relation to quotations of opinion:
 - (a) where only part of an opinion is quoted, it should nevertheless be a fair representation;
 - (b) any connection between the holder of the opinion and the *firm* should be made clear.
- (5) *Firms* should note that the “return” on an *investment* is the gain or profit; it does not include the original capital invested.

Specific non-real time financial promotions: general requirements

3.8.8

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A specific non-real time financial promotion must;

- (1) include a fair and adequate description of:
 - (a) the nature of the *investment* or service;
 - (b) the commitment required;
 - (c) the risks involved; and
- (2) if it relates to an *investment* or service of a *person* other than the *firm*, contain the name of that *person*, in addition to the name and address or contact point of the *firm* (see ■ COB 3.8.2).

3.8.9

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- (1) A *specific non-real time financial promotion* should give a fair and balanced indication of the requirements in ■ COB 3.8.8(1)(a) to (c), to meet ■ COB 3.8.4(1).
- (2) The details of the commitment which is required by ■ COB 3.8.8(1)(b) will depend on the nature of the *investment* being promoted. This could be, for example, the minimum amount which can be invested, minimum or maximum period of *investment* or, where it is the case, the fact that it could be some time before a *person* may see a return on his *investment*.
- (3) In giving a fair and adequate explanation of the *investment* or service being promoted *firms* should avoid:
 - (a) accentuating the potential benefits of an *investment* without also giving a fair indication of the risks;
 - (b) failing to describe any benefits under a *life policy* which are not fixed;
 - (c) drawing attention to favourable tax treatment without stating that this might not continue in the future.
- (4) *Guidance* on the application of ■ COB 3.8.4 to the internet and other electronic media is provided in ■ COB 3.14.
- (5) To assist *firms'* compliance with ■ COB 3.8.4(1) in relation to a *specific non-real time financial promotion* further *guidance* on potential problem areas is given in ■ COB 3 Ann 4.

Specific non-real time financial promotions: non-packaged products

3.8.10

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A specific non-real time financial promotion relating to a designated investment other than a packaged product must, when it is the case, and if it is known, disclose if the firm or its associate:

- (1) has or may have a position or holding in the *investment* concerned or in a related *investment*; or

- (2) has or may have a *material interest* in any *investment* concerned, and the nature and extent of that interest; or
- (3) is or may be the only *market maker* where the *financial promotion* is for a *security* (excluding *units* in a *collective investment scheme*); or
- (4) is or may be providing, or has or may have provided within the previous 12 months, significant advice or investment services in relation to the *investment* concerned or a related *investment*.

Specific non-real time financial promotions: past performance

3.8.11

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A *specific non-real time financial promotion* which gives information about the past performance of *specified investments* or of a *firm* must include:

- (1) suitable text:
 - (a) that is specifically designed as suitable for the type of *financial promotion* being promoted and its target audience; and
 - (b) which draws attention to the fact that past performance will not necessarily be repeated; and
- (2) information relating to a relevant and sufficient period of past performance to provide a fair and balanced indication of the performance.

3.8.12

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- (1) The purpose of ■ COB 3.8.11 is to:
 - (a) prevent an *investment* being promoted in such a way as to induce a *person* to believe that any previous periods of favourable performance will necessarily be repeated in the future; and
 - (b) to encourage *firms* to draft warnings which are tailored to fit the design of the *financial promotion* and the audience to which they are primarily directed. Therefore, for example, text used in a warning included in a specialist magazine may not be useful in a *financial promotion* in the popular press.
- (2) Any of the following may mean that a *specific non-real time financial promotion* does not meet the requirement of ■ COB 3.8.4(1) of being clear, fair and not misleading:
 - (a) an unfair comparison with the performance of another type of *investment*;
 - (b) the selection of an inappropriate or irrelevant investment period;
 - (c) the selection of an unreasonably short time period;
 - (d) the selection of inconsistent time periods for a range of funds;

- (e) a comparison with *deposits* without an indication in clear terms, and with equal prominence, that the *investment* does not include the security of capital which is afforded under a *deposit* with a *bank* or *building society*.
- (3) *Firms* need to take special care when presenting euro-based information as new factors should be taken into account in the calculation and/or comparison of the performance of some products. There may be some techniques of presenting past performance data which can no longer be used because when euro conversion is factored into the calculation it produces a misleading result. *Guidance* cannot deal with all the circumstances in which performance data are used, and it is therefore important for *firms* to look at the end result and the context in which the information is presented to ensure it does not breach ■ COB 3.8.4(1) (clear, fair and not misleading).
- (4) Information on the past performance of a conventional with-profits contract may be relevant to a unitised contract to give potential *policyholders* access to information relating to the performance of a contract within the with-profit fund of a *product provider*. Any differences between the two systems and any factors which reduce the relevance of the past performance of the conventional contract, including differences in bonus policy and the level of charges and expenses, should be clearly explained.

3.8.13

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A specific non-real time financial promotion, which refers to past performance of a packaged product, must include information about the performance of the packaged product which covers the previous five years (or the whole period if the packaged product has been offered for less than this), ending with the date on which the firm confirms compliance with the rules in this chapter under ■ COB 3.6.1 (or as near as is reasonably practicable).

3.8.14

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- (1) The information required by ■ COB 3.8.13 should be given on:
 - (a) an offer to bid basis (which should be stated) where there is an actual return or comparison of performance with other *investments*; or
 - (b) an offer to offer, or offer to bid basis (which should be stated) where there is a comparison of performance with an index or with movements in the price of *units*; or
 - (c) a single pricing basis with allowance for charges.
- (2) Where the pricing policy of the *investment* has changed, the prices used to comply with ■ COB 3.8.13 should include such adjustments as are necessary to remove any distortions resulting from the pricing method.
- (3) Where the performance relates to a different *investment* vehicle, any material differences should be stated in the *financial promotion*.

3.8.15

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Information about past performance in a specific non-real time financial promotion must not be presented in such a manner as to suggest that it constitutes a projection illustrating the possible future value of an investment contract or fund.

3.8.16

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In determining whether ■ COB 3.8.15 has been satisfied, the *FSA* will take into account:

- (1) the way in which the information about past performance has been presented;
- (2) how it is positioned in the *financial promotion*;
- (3) the wording which accompanies it.

Paragraph headings, or the positioning of information about past performance and current yields next to each other, can sometimes contribute to an overall impression that past performance and future prospects are linked.

Specific non-real time financial promotions: projections for life policies or schemes

- 3.8.17 **R** ^{/1} *A specific non-real time financial promotion relating to a life policy, or a scheme, and which includes a projection must comply with the detailed projection rules in ■ COB 6.6.*

Specific non-real time financial promotions: projections for EIS shares

- 3.8.18 **R** ^{/1} *A specific non-real time financial promotion must not contain a projection of the possible investment return on a direct or indirect investment in EIS shares.*

Specific non-real time financial promotions: provider firms

- 3.8.19 **R** ^{/1} *A provider firm must ensure that it does not communicate or approve a specific non-real time financial promotion relating to a packaged product unless it discloses in the financial promotion that the firm is only able to give advice on investments to private customers about the packaged products of the firm or of its marketing group and (if it is the case) about adopted packaged products.*

- 3.8.20 **G** ^{/1} *Firms are reminded that ■ COB 3.8.19 does not apply to image advertising (see ■ COB 3.2.5(5) (Exemptions) and ■ COB 3.2.7(3)(b) (Guidance on the exemptions)).*

Real time financial promotions

- 3.8.21 **G** ^{/1} *A firm should note that ■ COB 3.10.3 prevents a firm from communicating an unsolicited real time financial promotion other than an exempt financial promotion (which is outside the scope of this chapter) or where one of ■ COB 3.10.3(1) or (2) applies. Many solicited real time financial promotions will be exempt financial promotions (and, therefore, outside the scope of this chapter). Accordingly, ■ COB 3.8.22 applies only to solicited real time financial promotions which are not exempt financial promotions and to unsolicited real time financial promotions within ■ COB 3.10.3(1) or (2).*

3.8.22

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A *firm* must take reasonable steps to ensure that an individual who makes a *real time financial promotion* on the *firm's* behalf:

- (1) does so in a way which is clear, fair and not misleading;
- (2) does not make any untrue claims;
- (3) makes clear the purpose (or purposes) of the *financial promotion* at the initial point of communication, and identifies himself and the *firm* which he represents;
- (4) if the time and method of communication were not previously agreed by the recipient:
 - (a) checks that the recipient wishes him to proceed;
 - (b) terminates the communication if the recipient does not wish him to proceed (but may ask for another appointment);
 - (c) recognises and respects, promptly, the right of the recipient to:
 - (i) end the communication at any time;
 - (ii) refuse any request for another appointment;
- (5) gives any recipient with whom he arranges an appointment a contact point;
- (6) does not communicate with a *person*:
 - (a) at an unsocial hour, unless the *person* has previously agreed to such a communication;
 - (b) on an unlisted telephone number, unless the *person* has previously agreed to such calls on that number;
- (7) if applicable, acts in conformity with the *rules* in ■ COB 5.1 concerning polarisation and status disclosure.

3.8.23

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In ■ COB 3.8.22(6)(a) an unsocial hour usually means on a Sunday or before 9am or after 9pm on any other *day*. It could also mean other *days* of the week or other times if the *firm* knows that a particular recipient would not wish to be called on that *day* or at that time for reasons of, for example, religious faith or night shift working.

3.8.24

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The requirements of ■ COB 3.8.22:

- (1) apply in respect of all individuals who initiate the communication, including *advisers*, call centre operators and *introducers*;
- (2) apply to all forms of *real time financial promotion*, including face to face and telephone *financial promotion*;

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(3) but do not prevent, for example, a telephone call centre which has received a call from a *person* at an hour generally regarded as unsocial, either responding to that call or asking during the call if the *person* would like details of other investment products.

■ SYSC 3.2.20 (Records) requires a *firm* to take reasonable care to make and retain certain records. For a telemarketing campaign to which ■ COB 3.8.22 applies, those records should include copies of any scripts used.



3.9 Direct offer financial promotions

Application

3.9.1 **R** This section applies to a *firm* which *communicates* or *approves* a *direct offer financial promotion*.
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3.9.2 **G** (1) This section includes provisions which apply to all *direct offer financial promotions* and other provisions which apply only to certain kinds of *direct offer financial promotions*. ■ COB 3.9.3 is intended to help *firms* locate the paragraphs which are relevant to them.
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(2) ■ COB 3.8.2 to ■ COB 3.8.20 also apply to *direct offer financial promotions*.

(3) Material communicated as one package, such as by direct mail, may be regarded as one *financial promotion* for the purposes of this section.

3.9.3 **G** Table Location of the provisions applicable to direct offer financial promotions
/1 This table belongs to ■ COB 3.9.2

(1)	Exemptions for deposits, general insurance contracts, pure protection contracts and reinsurance contracts	COB 3.9.4G
(2)	Prohibited types of direct offer financial promotions	COB 3.9.5R
(3)	Direct offer financial promotions: general requirements	COB 3.9.6R to COB 3.9.7R
(4)	Cash deposit ISAs	COB 3.9.8R
(5)	Electronic media	COB 3.9.9G
(6)	Packaged products	COB 3.9.10R to COB 3.9.11G
(7)	Execution-only dealing service	COB 3.9.12R to COB 3.9.13G
(8)	Potential problem areas	COB 3.9.14 G
(9)	Information to be contained in direct offer financial promotions regarding:	COB 3.9.14G
	(a) investments which can fluctuate in value	COB 3.9.15R
	(b) life policies	COB 3.9.18R

(c)	taxation	COB 3.9.19R to COB 3.9.20R
(d)	cancellation rights	COB 3.9.21R to COB 3.9.22G
(e)	charges for regulated collective investment schemes	COB 3.9.23R
(f)	penny shares	COB 3.9.24R
(g)	branded funds	COB 3.9.25R
(h)	Enterprise Investment Schemes	COB 3.9.26R to COB 3.9.28R
(i)	income withdrawals	COB 3.9.29R

Exemptions

3.9.4

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Firms are reminded that under ■ COB 3.2.3:

- (1) ■ COB 3.9 does not apply to a *direct offer financial promotion* relating to:
 - (a) a *deposit* (except a *cash deposit ISA*); or
 - (b) a *general insurance contract*, *pure protection contract*, or *reinsurance contract*; and
- (2) a *direct offer financial promotion* relating to a *cash deposit ISA* must comply with ■ COB 3.9.6(1) and ■ COB 3.9.8.

Prohibited types of direct offer financial promotion

3.9.5

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(1) A *direct offer financial promotion* must not relate to a *broker fund*.

- (2) A *direct offer financial promotion* must not relate to:
 - (a) an *unregulated collective investment scheme*;
 - (b) a *derivative*; or
 - (c) a *warrant*;

unless the *firm* itself has adequate evidence to suggest that the *investment* may be suitable for the *person* to whom the promotion is *communicated*.

Direct offer financial promotions: general requirements

- 3.9.6 **R** /1
- (1) A *direct offer financial promotion* must contain sufficient information to enable a *person* to make an informed assessment of the *investment* or service to which it relates.
 - (2) In particular, a *direct offer financial promotion* must contain the information set out in ■ COB 3.9.7.

- 3.9.7 **R** /1
- Table Direct offer financial promotions: particular information required
This table belongs to ■ COB 3.9.6(2)

Direct offer financial promotions: particular information required

- (1) A prominent statement that the *firm* which has *communicated* or *approved* the *financial promotion* is regulated or authorised by the *FSA*.
- (2) A prominent statement that, if a *person* has any doubt about the suitability of the agreement which is the subject of the *financial promotion*, he should contact the *firm* for advice (or an independent financial adviser if the *firm* does not offer advice).
- (3) The full name and address of the *person* who is offering the *investment* or service being promoted (and, if different, the full name and address of the *firm communicating*, or *approving*, the *financial promotion*).
- (4) If the *financial promotion* is *communicated* by a *firm* whose *permission* includes a *requirement* that it must not hold *client money*, the name of the *person* to whom payment (if any) should be made.
- (5) Details of the basis or amount of any *charges* and expenses which the *private customer* will or may bear.
- (6) Details of the basis or amount of any *commission* or remuneration which might be payable by the *firm* to another *person*.

Cash deposit ISAs

- 3.9.8 **R** /1
- (1) A *direct offer financial promotion* relating to a *cash deposit ISA* must contain the information required by ■ COB 6.5.42.
 - (2) Paragraph (1) does not apply to a *bank* or *building society* which subscribes to, and includes in the *direct offer financial promotion* the information relating to a *cash deposit ISA* that is suggested in the January 2001 edition of, the Banking Code issued by the British Bankers' Association, the Building Societies Association and the Association for Payment Clearing Services.

Electronic media

- 3.9.9 **G**_{/1} *Guidance*, including information on *direct offer financial promotions* on the internet and other electronic media, is provided in ■ COB 3.14.

Packaged products

- 3.9.10 **R**_{/1} A *direct offer financial promotion* relating to a *packaged product* must contain the information required by ■ COB 6.5 (Contents of key features).

- 3.9.11 **G**_{/1} The information should follow, where possible, the same *order* as *key features*. But adjustments may be made to the order, where this would assist design and understanding of the material.

Execution-only dealing services

- 3.9.12 **R**_{/1} A *direct offer financial promotion* relating to an execution-only dealing service must in particular, if it is the case, contain a clear statement that:
- (1) the *firm's* procedures are such that there may be a delay in the execution of a *customer order*, including the reason for and the normal maximum extent of any such delay;
 - (2) *customer orders* may on occasion be aggregated (in which case the statement must comply with ■ COB 7.7.4).

- 3.9.13 **G**_{/1} The purpose of ■ COB 3.9.12 (1) is to ensure that explanations are given when *firms'* procedures might, for example, involve dealing every hour or at certain times of the *day*. Details of external factors over which the *firm* has no control are not required.

Potential problem areas for direct offer financial promotions.

- 3.9.14 **G**_{/1} To assist *firms'* compliance with ■ COB 3.8.4(1) in relation to a *direct offer financial promotion*, further *guidance* on potential problem areas is given in ■ COB 3 Ann 4.

Investments which can fluctuate in value

- 3.9.15 **R**_{/1} (1) A *direct offer financial promotion* relating to an *investment* which can fluctuate in value, or which offers income distributions which may fluctuate, must make this clear in terms which are likely to be understood by the kind of recipient to whom the *financial promotion* is *communicated*.

- (2) **The explanation given in conformity with (1) must be set out with due prominence and in a print size no smaller than that used in the main text of the *financial promotion*.**

3.9.16

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The FSA will expect the explanation required by ■ COB 3.9.15 to be contained within the main body of the *financial promotion*, and not in small print at the very end. *Firms* which choose to include it in a separate ‘stand-alone’ statement should satisfy themselves on reasonable grounds that this is likely to offer the best prospect of it being seen and read and should record such reasons for the purposes of ■ COB 3.7 (Records).

3.9.17

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Examples of explanations which could meet ■ COB 3.9.15 are:

- (1) ‘You are not certain to make a profit; you may lose money/make a loss’;
- (2) ‘You may not get back the full amount of your investment’;
- (3) (for investment income): ‘The income is not fixed - it can go up or down’;
- (4) (for contingent liabilities): ‘You could lose all the money you invested and you may have to pay more later’;
- (5) (for *higher volatility funds*): ‘This investment may be subject to sudden and large falls in value, you could get back nothing at all’;
- (6) (for property funds):
 - (a) ‘This fund invests in property and land. This can be difficult to sell - so you may not be able to sell/cash in this investment when you want to. We may have to delay acting on your instructions to sell your investment’;
 - (b) ‘The value of property is generally a matter of a valuer’s opinion rather than fact’;
- (7) (for an *Enterprise Investment Scheme*):
 - (a) ‘It may be difficult to sell your investment, or to get accurate information about how much it is worth or how risky it is’;
 - (b) ‘These are unquoted securities which may have more risks than quoted securities or shares’;
 - (c) ‘Investments in unquoted securities may be difficult to sell. Market makers may not be prepared to deal in them. This scheme may invest in private companies and restrictions may apply to the transfer of these private company securities’;
 - (d) ‘Proper information for working out the current value of investments may not be available’;
- (8) (for *property enterprise trusts* and *Enterprise Zone Property Unit Trusts*):
 - (a) ‘The value of the property in these schemes can go down as well as up. The initial price of Enterprise Zone property may be distorted as a result of the tax allowances and other benefits available - it may often be necessary to pay a higher price for this property compared with other property’;
 - (b) ‘There is no established market in this investment’;

- (c) 'This investment is designed to be held for a very long time (normally 25 years). You may have difficulty selling it. You should not invest in this if you may need to sell early';
- (d) 'Do not invest in this investment unless you have carefully thought about whether you can afford it and whether it is right for you';
- (9) (for *non-readily realisable investments*): 'You may have difficulty selling this investment at a reasonable price and, in some circumstances, it may be difficult to sell it at any price. Do not invest in this unless you have carefully thought about whether you can afford it and whether it is right for you';
- (10) (for *front end loaded* contracts): 'We take most of our charges in the early years of this investment. This means that if you withdraw during this time you may lose money/get back less than you invested';
- (11) (for with-profit *life policies*): 'The value of this policy depends on how much profit we make and how we may decide to distribute this profit';
- (12) (for *penny shares*): 'There is an extra risk of losing money when shares are bought in some smaller companies including penny shares. There is a big difference between the buying price and the selling price of these shares. If they have to be sold immediately, you may get back much less than you paid for them. The price may change quickly and it may go down as well as up';
- (13) (for foreign currency denominated *investments*): 'Changes in the rates of exchange between currencies may cause your investment/the income to go down or up';
- (14) (for *investments* where the market is restricted): 'There is only one market maker', and/or 'the only market maker is the communicator of the financial promotion or an associate of the issuer'.

Life policies

3.9.18 **R** *A direct offer financial promotion which relates to a life policy must state:*
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- (1) which benefits (if any) are fixed amounts, and what those amounts are; and
- (2) which benefits are not fixed amounts.

Taxation

3.9.19 **R** *A direct offer financial promotion must include a summary of the taxation of any investment to which it relates and the taxation consequences for investors generally.*
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3.9.20 **R** *A firm must include in a direct offer financial promotion:*
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- (1) a warning that taxation levels, bases and (if relevant) reliefs can change;
- (2) the assumed rate of taxation;
- (3) (where taxation reliefs are mentioned) statements:
 - (a) distinguishing between reliefs which apply directly to investors and anyone else;
 - (b) that the reliefs are the ones which currently apply; and
 - (c) that the value depends upon the circumstances of the investor; and
- (4) where the words ‘free from tax liability’, or similar are used and it is the case, a statement making clear that this describes the benefits when paid to the investor, and a statement with equal prominence that the income is payable out of a fund which has already paid income tax, corporation tax or capital gains tax (whichever applies).

Cancellation rights

3.9.21

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- (1) A *direct offer financial promotion* which relates to an *investment* which is subject to cancellation or withdrawal rights must describe those rights and explain:
 - (a) the length of the cancellation or withdrawal period, and when it will begin;
 - (b) whether cancellation or withdrawal is a legal right or voluntarily conferred;
 - (c) (if it is the case) that there might be a *shortfall*, or, if applicable, a significant *shortfall*, on cancellation.
- (2) A *direct offer financial promotion* which relates to an *EIS* or *non-packaged product*, *ISA* or *PEP* for which no right to withdraw is given under case 8 of column 2, ■ COB 6.7.17, must include the statement required by that provision.

3.9.22

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The description ‘significant *shortfall*’ is appropriate for *higher volatility funds* where a large proportion of the *investment* may be lost during the cancellation period.

Charges for regulated collective investment schemes

- 3.9.23 **R** /1 *A direct offer financial promotion relating to a regulated collective investment scheme must give an adequate explanation of the charging structure and make clear:*
- (1) whether all or part of the *scheme* expenses will be taken out of capital or income; and
 - (2) the likely long-term effect on capital or income.

Penny shares

- 3.9.24 **R** /1 *If an indication of the price of a particular penny share is included in a direct offer financial promotion, the bid-offer spread must also be included (based on the best price available in the relevant market at the time for transactions of the largest bid or offer price of that share).*

Branded funds

- 3.9.25 **R** /1 *A direct offer financial promotion relating to a branded fund must include a statement that the firm responsible for the promotion does not manage the investments in the branded fund, together with the name and address of the manager.*

Enterprise Investment Schemes

- 3.9.26 **R** /1 *A direct offer financial promotion relating to an Enterprise Investment Scheme must contain:*
- (1) the information specified in **■ COB 3 Ann 2**;
 - (2) (a) either a copy of the prospectus; or
(b) if no prospectus is required by the *POS Regulations*, the information specified in **■ COB 3.9.27** relating to each *company* in which the *Enterprise Investment Scheme* manager has a material interest and intends to acquire interests on behalf of the scheme;
 - (3) a prominent statement that applications may only be made and accepted subject to the terms and conditions of the *Enterprise Investment Scheme* particulars and prospectus (if applicable); and
 - (4) a prominent explanation of any right to withdraw (under **■ COB 6.7**) or, where it is the case, that such rights will not apply.

- 3.9.27** G_{/1} To meet the requirements of ■ COB 3.9.26, an *Enterprise Investment Scheme* should include the following information about the company issuing the *EIS shares*:
- (1) assets and liabilities;
 - (2) financial position;
 - (3) profits and losses;
 - (4) prospects; and
 - (5) rights attaching to the *EIS shares*.

- 3.9.28** R_{/1} In addition to the requirements of ■ COB 3.9.26, a *direct offer financial promotion* relating to a private offer of *EIS shares* must include the information specified in ■ COB 3 Ann 3.

Income withdrawal

- 3.9.29** R_{/1} A *direct offer financial promotion* relating to, or offering a facility for, *income withdrawals* must include the following explanations:
- (1) taking withdrawals may erode the capital value of the fund, especially if investment returns are poor and a high level of income is taken; this could result in a lower income when the annuity is eventually purchased;
 - (2) the investment returns may be less than those shown in the illustrations;
 - (3) annuity rates may be at a worse level when annuity purchase eventually takes place; and
 - (4) if the maximum withdrawals permitted by Inland Revenue regulations are to be taken, high *income withdrawals* may not be sustainable during the deferral period.

3.10 Unsolicited real time financial promotions

Meaning of "solicited" and "unsolicited" real time financial promotion

3.10.1

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- (1) *An unsolicited real time financial promotion is a real time financial promotion which is not a solicited real time financial promotion.*
- (2) *A solicited real time financial promotion is a real time financial promotion which is solicited, that is, it is made in the course of a personal visit, telephone call or other interactive dialogue if that call, visit or dialogue:*
 - (a) *was initiated by the recipient of the financial promotion; or*
 - (b) *takes place in response to an express request from the recipient of the financial promotion;*

and it is clear from all the circumstances when the call, visit or dialogue is initiated or requested that during the course of the visit, call or dialogue financial promotions would be made concerning the kind of controlled activities or controlled investment to which the financial promotion relates.
- (3) *In (2), a person is not to be treated as expressly requesting a call, visit or dialogue:*
 - (a) *because he omits to indicate that he does not wish to receive any or any further visits or calls or to engage in any or any further dialogue;*
 - (b) *because he agrees to standard terms that state that such visits, calls or dialogues will take place unless he has signified clearly that, in addition to agreeing to the terms, he is willing for them to take place.*
- (4) *If a real time communication is solicited by a person ("R") it is treated as also having been solicited by any other person to whom it is made at the same time as R if that other person is a close relative of R or is expected to engage in any investment activity jointly with R.*

3.10.2

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■ COB 3.10.1 is based on article 8 of the *Financial Promotion Order*. Guidance on whether a *real time financial promotion* is solicited is contained in ■ AUTH App [] (Types of communication).

Restriction of unsolicited real time financial promotions

3.10.3

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A firm must not make an *unsolicited real time financial promotion* unless:

- (1) the recipient has an established existing customer relationship with the *firm* and the relationship is such that the recipient envisages receiving *unsolicited real time financial promotions*; or
- (2) the *financial promotion* relates to a generally marketable *packaged product* which is not:
 - (a) a *higher volatility fund*; or
 - (b) a *life policy* with a link (including a potential link) to a *higher volatility fund*.

3.10.4

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Firms are reminded of the exemptions in ■ COB 3.2.5; ■ COB 3.10.3 does not prohibit an exempt *unsolicited real time financial promotion*.

3.11 Unregulated collective investment schemes

Introduction

3.11.1

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- (1) Under section 238(1) of the *Act* (Restrictions on promotion), an *authorised person* must not *communicate* an invitation or inducement to participate in an *unregulated collective investment scheme* ("the scheme promotion restriction").
- (2) However, the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (SI 2001/1060) exempts from the scheme promotion restriction certain types of communications relating to *unregulated collective investment schemes*.
- (3) In addition, section 238(5) of the *Act* gives the *FSA* power to make *rules* exempting from the scheme promotion restriction certain promotions relating to *unregulated collective investment schemes*, provided that they are not made to the general public. The purpose of **■ COB 3.11.2** is to make appropriate use of the power which the *FSA* has under section 238(5) of the *Act*.
- (4) Under section 240 of the *Act* (Restriction on approval of promotion), an *authorised person* cannot *approve*, for the purposes of section 21, the content of a communication relating to an *unregulated collective investment scheme* if he would not have been able, under section 238(1), to *communicate* it himself.

Exemptions from the scheme promotion restriction

3.11.2

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A firm may communicate an invitation or inducement to participate in an unregulated collective investment scheme if the communication falls within **■ COB 3 Ann 5.**

3.11.3

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- (1) A *firm* may *communicate* an invitation or inducement to participate in an *unregulated collective investment scheme* only if either:
 - (a) the communication falls within **■ COB 3 Ann 5**; or
 - (b) the communication is exempt from the scheme promotion restriction under the Financial Services and Market Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001.
- (2) *Firms* are reminded that if an invitation or inducement is within **■ COB 3 Ann 5**, then all relevant *rules* in this chapter apply, including in particular **■ COB 3.9.5(2)(a)** (which prohibits the *communication* or *approval of direct offer*

financial promotions relating to *unregulated collective investment schemes* except in specified circumstances).

Limited disapplication of this chapter

3.11.4 **R** This chapter applies only in relation to invitations or inducements
/1 that may be *communicated* by a *firm* without contravening section 238(1) of the *Act*.

3.11.5 **G** The purpose of ■ COB 3.11.4 is to give effect to the limitation of the *FSA's*
/1 rule-making power in section 145(3)(b) of the *Act* (Financial promotion rules).



3.12 Communication and approval of financial promotions for an overseas person or an unauthorised person

Approval of financial promotions

3.12.1

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- (1) Section 21(1) of the *Act* (Restrictions on financial promotion) prohibits an *unauthorised person* from *communicating* a *financial promotion*, in the course of business, unless an exemption applies or the *financial promotion* is *approved* by a *firm*. (An overview of the main exemptions in the *Financial Promotion Order* is in ■ COB 3 Ann 1.)
- (2) Most of the *rules* in this chapter apply when a *firm approves* a *financial promotion* in the same way as when a *firm communicates* a *financial promotion* itself. A *firm* therefore has a similar responsibility for a *financial promotion* that it *approves* as for one that it *communicates*. For example, a *firm* which *approves* a *non-real time financial promotion* must:
 - (a) if ■ COB 3.6.1 applies, confirm that the *financial promotion* complies with the *rules* in this chapter; and
 - (b) if ■ COB 3.8.4(1) applies, be able to show that it has taken reasonable steps to ensure that the *financial promotion* is clear, fair and not misleading.
- (3) A *firm* may also wish to *approve* a *financial promotion* that it *communicates* itself. This would ensure that an *unauthorised person* who then also *communicates* the *financial promotion* to another *person* will not contravene the restriction on *financial promotion* in section 21(1) of the *Act* (Restrictions on financial promotion).
- (4) A *firm* which *approves* a *financial promotion* that is exempt under ■ COB 3.2.5 (Exemptions) or ■ COB 3.3.1 (Application; where?) must still comply with certain *rules* in this chapter (see ■ COB 3.2.4(2) and (3) and ■ COB 3.3.3(2)).

No approval of real time financial promotions

3.12.2

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A firm must not approve a real time financial promotion.

Approval of financial promotions when not all the rules apply

3.12.3 **R** ^{/1} If a *firm approves a financial promotion* in circumstances in which one or more of the *rules* in this chapter, or the prohibition in section 240(1) of the *Act* (Restriction on approval), are expressly disapplied, the *approval* must be given on terms that it is limited to those circumstances.

3.12.4 **G** ^{/1} For example, if a *firm approves a financial promotion* relating to an *unregulated collective investment scheme* under one or more of the exemptions in the table in ■ COB 3 Ann 5, the *approval* must be limited to *communication* of the *financial promotion* to the relevant class of *person* in the left hand column of the table. Similarly, if a *firm approves a financial promotion* for *communication to market counterparties* and *intermediate customers* (see ■ COB 3.2.5(1)), the *approval* must be limited to *communication* to such *persons*.

3.12.5 **G** ^{/1} If an *approval* is limited in accordance with ■ COB 3.12.3, and an *unauthorised person communicates* the *financial promotion* to *persons* not covered by the *approval*, the *unauthorised person* may commit an *offence* under section 21(1) of the *Act* (Restrictions on financial promotion). A *firm* giving a limited *approval* may wish to advise the *unauthorised person* accordingly.

Specific non-real time financial promotions for overseas persons

3.12.6 **R** ^{/1} A *firm* must not *communicate* or *approve* a *specific non-real time financial promotion* which relates to an *investment* or service of an *overseas person*, unless:

- (1) the *financial promotion* makes clear which *firm* has *approved* or *communicated* it and, where relevant, explains:
 - (a) that the *rules* made under the *Act* for the protection of *private customers* do not apply;
 - (b) the extent and level to which the *compensation scheme* will be available, or if the scheme will not be available, a statement to that effect; and
 - (c) if the communicator wishes, the protection or compensation available under another system of regulation; and
- (2) the *firm* has no reason to doubt that the *overseas person* will deal with *private customers* in the *United Kingdom* in an honest and reliable way.

3.12.7 **G** ^{/1} In considering which points are relevant for the purposes of ■ COB 3.12.6(1), the activities, and the associated products or services of the *overseas person* will need to be separately considered.



3.13 Additional requirements for financial promotions for an overseas long-term insurer

3.13.1

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- (1) *A firm must not communicate or approve a financial promotion to enter into a life policy with a person who is not:*
- (a) *an authorised person; or*
 - (b) *an exempt person who is exempt in relation to effecting or carrying out contracts of insurance of the class to which the financial promotion relates; or*
 - (c) *a company which has its head office in an EEA State other than the United Kingdom and which is entitled under the law of that State to carry on there insurance business of the class to which the financial promotion relates; or*
 - (d) *a company which has a branch or agency in an EEA State other than the United Kingdom and is entitled under the law of that State to carry on there insurance business of the class to which the financial promotion relates; or*
 - (e) *a company authorised to carry on insurance business of the class to which the financial promotion relates in any country or territory which is listed in (2).*
- (2) *The countries or territories referred to in (1)(e) are:*
- (a) *the Bailiwick of Guernsey;*
 - (b) *the Isle of Man;*
 - (c) *the Commonwealth of Pennsylvania;*
 - (d) *the State of Iowa; and*
 - (e) *the Bailiwick of Jersey.*
- (3) *For the purposes of (1), Gibraltar shall be regarded as if it were an EEA State.*

- 3.13.2 **R** ^{/1} A *financial promotion* for an *overseas long-term insurer*, which has no establishment in the *United Kingdom*, must include:
- (1) the full name of the *overseas long-term insurer*, the country where it is registered, and, if different, the country where its head office is situated;
 - (2) a prominent statement that ‘holders of policies issued by the company will not be protected by the Financial Services Compensation Scheme if the company becomes unable to meet its liabilities to them’; and,
 - (3) where any trustee, *investment manager* or *United Kingdom* agent of the *overseas long-term insurer* is named which is not independent of the *overseas long-term insurer*, a prominent statement of that fact.

- 3.13.3 **R** ^{/1} A *financial promotion* for an *overseas long-term insurer* which is authorised to carry on *long-term insurance business* in any country or territory listed in ■ COB 3.13.1(2) must also include:
- (1) the full name of any trustee of property of any description which is retained by the *overseas long-term insurer* in respect of the promoted contracts;
 - (2) an indication whether the investment of such property (or any part of it) is managed by the *overseas long-term insurer* or by another *person* and the full name of any *investment manager*;
 - (3) the registered office of any such trustee and of any *investment manager* and of his principal office (if different); and
 - (4) where any *person* in the *United Kingdom* takes, or may take, any steps on behalf of the *overseas long-term insurer* to enter into a promoted contract, the following details about that *person*:
 - (a) the full name of the *overseas long-term insurer*;
 - (b) the registered or head office in the *United Kingdom*; and,
 - (c) if there is more than one such *person*, the principal or main *person* in the *United Kingdom*.

- 3.13.4 **R** ^{/1} If a *financial promotion* relates to a *life policy* with an *overseas long-term insurer* but does not name the *overseas long-term insurer* by giving its full name or its business name:
- (1) it must include the following prominent statement: “This financial promotion relates to an insurance company which does not, and is not authorised to, carry on in any part of the United Kingdom the class of insurance business to which this promotion relates. This means that the management and solvency of the company are not

supervised by the Financial Services Authority. Holders of policies issued by the company will not be protected by the Financial Services Compensation Scheme if the company should become unable to meet its liabilities to them”; and

(2) if it also refers to other *investments* it must make this clear.

3.13.5

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For the purposes of ■ COB 3.13.2(2) and (3) and ■ COB 3.13.4(1) a prominent statement is one that is:

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- (1) made immediately after the full name;
- (2) alongside the full name; or
- (3) where the name is stated more than once, the most prominent or the first if equally prominent.



3.14 The internet and other electronic media

- 3.14.1** G_{/1} This section contains *guidance* on the use of the internet and other electronic media to *communicate financial promotions*. *Firms* are also referred to the *guidance* in ■ COB 1.8.

Approach and general guidance

- 3.14.2** G_{/1} Any material which meets the definition of a *financial promotion*, including any video or moving image material incorporated in any website containing a *financial promotion*, should comply with the *rules* in this chapter. See ■ AUTH App [] for further guidance on *financial promotions* on the internet, including the treatment of hyperlinks and banners.

- 3.14.3** G_{/1} As indicated in ■ COB 3.5.4 for the purposes of the *financial promotion rules*, there are two types of approach to *financial promotions* communicated via the internet and other electronic media:

- (1) *real time financial promotions* where the communication is in the form, for example, of a telephone conversation or other form of interactive dialogue; and
- (2) *non-real time financial promotions*, where the recipient may, for example, choose from reading a description of an *investment* or service, through to the completion of a contract via a *direct offer financial promotion* in a similar way to browsing through a leaflet rack. The *rules* in this chapter relating to hard copy *financial promotions* such as advertisements in magazines or newspapers apply equally to such promotions.

E-mails, material displayed on a website and sound and television broadcasts are *non-real time financial promotions* (see ■ COB 3.5.5).

- 3.14.4** G_{/1}
- (1) Before using the internet, digital or any other form of interactive television or other electronic media to promote its services a *firm* should refer to legislation such as the Data Protection Act 1998 and the Computer Misuse Act 1990, as well as to this chapter.
 - (2) When designing websites and other electronic media, *firms* should be aware of the difficulties that can arise when reproducing certain colours and printing certain types of text. These difficulties could cause problems with the presentation and retrieval of required information. Any *financial promotion* communicated by the internet, digital or other forms of interactive television is subject to the requirements set out in ■ COB 3.6 to ■ COB 3.9 as applicable.

Specific guidance

3.14.5

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- (1) *Key features* and written contractual terms
 - (a) To meet the requirements of ■ COB 3.9.10, a *firm* should make it clear that the information is available to a recipient of the *direct offer financial promotion*, and easily obtainable, before any application is made.
 - (b) It is important that recipients should have the opportunity to view the full text of the relevant *key features*, terms and conditions, customer agreement and any other applicable risk information required by the *rules*.
 - (c) This can be achieved through the use of a hypertext link, as long as it is not hidden away in the body of the text where a recipient could miss it when browsing through the pages.
 - (d) Local printing of information by the user should be allowed, where feasible. *Firms* should endeavour to provide hard copy on request.
- (2) Application forms
 - (a) It is not necessary for access to an application form to be denied until the recipient has read *key features* and other contractual terms, but *firms* should ensure that on the application form, or in the preceding text, they draw attention to the existence of this material and the importance of reading it, as relevant business will be conducted on the basis of the *key features* and written contractual terms.
 - (b) A *financial promotion* may be a *direct offer financial promotion* even if the *firm* is unable to provide a copy of the application form electronically.
- (3) Exemptions

■ COB 3.2.4 (Application: what?: Exemptions) and ■ COB 3.3.1 (Territorial scope) contain exemptions from this chapter which depend on a particular *financial promotion* being made or directed only at certain *persons*. ■ COB 3.5.6 sets out the meaning of "made" and "directed at" in this context. ■ COB 3.5.7 and ■ COB 3.3.6 (respectively) set out various conditions relevant for determining whether a *financial promotion* will be regarded as directed only at such *persons*.
- (4) *Unregulated collective investment schemes*

A *firm* which *communicates* an invitation or inducement to participate in an *unregulated collective investment scheme* by means of a website it may take advantage of the exemptions in ■ COB 3 Ann 5. But if it does so, it must in accordance with that annex design the website to reduce, as far as possible, the risk of participation by *persons* to whom the invitation or inducement may not be promoted (as described in ■ COB 3.11). ■ COB 3.5.7 sets out various conditions relevant for determining whether that test is satisfied.
- (5) The *FSA* website

The *FSA's* website <http://www.fsa.gov.uk> contains a wide range of information including pages of specific relevance to *customers*. *Firms* may, if they wish, include a reference or hyperlink to the *FSA's* site; this will not however, replace any requirements of the *financial promotion rules*.

(6) Record-keeping: continuously updated market information

- COB 3.7.1 requires a *firm* to make and retain an adequate record of a *non-real time financial promotion*. If the *non-real time financial promotion* includes market information that is updated continuously in line with the relevant market, the record will be adequate without recording that information. But see ■ COB 7.12.9 and ■ COB 7.12.10 (Orders received over the Internet) regarding giving a *customer* access to such information in conjunction with the ability to place a *customer order* by relying on such information.

An overview of some of the main exemptions contained in the Financial Promotion Order (G)

1 Table

This annex belongs to COB 3.2.7G(2) and summarises some of the main exemptions in the *Financial Promotion Order*. It is not an exhaustive list, and does not seek to replace the Order itself. The first column contains the article number, and the name of the exemption as set out in the *Financial Promotion Order*, the second column indicates to which type of *financial promotions* the exemption applies (unsolicited real time, solicited real time or non-real time), the third column indicates to which *controlled activities* and *controlled investments* the exemption applies and the final column gives a brief summary of the principal conditions required by the exemption. In all cases, *firms* wishing to use an exemption should consult the Order and in particular take note of the conditions which apply. References to articles are to articles of the *Financial Promotion Order* and to paragraphs are to paragraphs of schedule 1 to the *Financial Promotion Order*.

2 Table

Article no. and name of exemption	Type of promotion: Unsolicited real time, solicited real time, non-real time	Controlled activity/ controlled investment	Other conditions
17 Generic promotions	All	All	Does not identify (directly or indirectly) a <i>person</i> who provides the <i>controlled investment</i> to which the <i>financial promotion</i> relates; and does not identify directly or indirectly any <i>person</i> as a <i>person</i> who carries on a <i>controlled activity</i> in relation to that <i>controlled investment</i> .
18 Mere conduits	All	All	Made by a <i>person</i> who acts as a mere conduit for it.
19 Investment professionals	All	All	Made only to recipients whom the <i>person</i> making the <i>communication</i> believes on reasonable grounds to be <i>investment professionals</i> ; or may reasonably be regarded as directed only at such recipients.
22 Deposits: non-real time communications	<i>Non-real time</i>	Accepting deposits within paragraph 1	Accompanied by information specified in article 22(2).

Article no. and name of exemption	Type of promotion:	Controlled activity/ controlled investment	Other conditions
	Unsolicited real time, solicited real time, non-real time		
23 Deposits: real time communications	<i>Real time</i>	Accepting deposits within paragraph 1	None.
24 Relevant insurance activity: non-real time communications	<i>Non-real time</i>	Effecting and carrying out contracts of insurance within paragraph 2 in relation to <i>contracts of insurance other than life policies</i>	Accompanied by information specified in article 24(2).
26 Relevant insurance activity: real time communications	<i>Real time</i>	Effecting and carrying out contracts of insurance within paragraph 2 in relation to <i>contracts of insurance other than life policies</i>	None.
28 One off non-real time communications and solicited real time communications	<i>Solicited real time</i> <i>Non-real time</i>	Note 1	One off communication.
38 Persons in business of placing promotional material	All	Note 1	Made to a <i>person</i> whose business it is to place, or arrange for the placing of, promotional material provided that it is <i>communicated</i> so that he can place or arrange for placing it.

Article no. and name of exemption	Type of promotion: Unsolicited real time, solicited real time, non-real time	Controlled activity/ controlled investment	Other conditions
40 Participants in certain recognised collective investment schemes	<i>Solicited real time</i> <i>Non-real time</i>	Note 1	Made by a <i>person</i> who is the operator of a scheme recognised under section 270 or 272 of the <i>Act</i> ; and to <i>persons</i> in the <i>United Kingdom</i> who are <i>participants</i> in any such recognised scheme operated by the <i>person</i> making the <i>communication</i> ; and which relates only to such recognised schemes as are operated by that <i>person</i> or to <i>units</i> in such schemes.
48 Certified high net worth individuals	<i>Solicited real time</i> <i>Non-real time</i>	Note 2	(1) Made to a certified high net worth individual (as defined by article 48(2)); and (2) does not invite or induce the recipient to engage in investment activity with the person who signed the certificate of high net worth; and (3) accompanied by an indication of the matters specified by article 48(4).
49 High-net worth companies, unincorporated associations etc	All	Note 1	Either: (1) made only to recipients whom the <i>person</i> making the <i>financial promotion</i> believes on reasonable grounds to be <i>persons</i> to whom the conditions set out in the article apply; or (2) may reasonably be regarded as directed only at such <i>persons</i> .
50 Sophisticated investors	All	Note 1	(1) Made to a certified sophisticated investor (as defined by article 50(1)); (2) does not invite or induce the recipient to engage in investment activity with the <i>person</i> who has signed the certificate; (3) relates only to a description of <i>investment</i> in respect of which that investor is certified; and

Article no. and name of exemption	Type of promotion: Unsolicited real time, solicited real time, non-real time	Controlled activity/ controlled investment	Other conditions
51 Associations of high net worth or sophisticated investors	<i>Solicited real time</i> <i>Non-real time</i>	Note 1	(4) accompanied by an indication of the matters specified by article 50 (3). (1) Made to an association, the membership of which the <i>person</i> making the <i>financial promotion</i> believes on reasonable grounds comprises wholly or predominantly <i>persons</i> who are certified high net worth individuals within article 48, high net worth persons within article 49(2)(a) to (d) and certified sophisticated investors within article 50; and (2) relates only to an <i>investment</i> under the terms of which a <i>person</i> cannot incur a liability or obligation to pay or contribute more than he commits by way of <i>investment</i> .
59 Annual accounts and directors' report	All	Note 3	Made by a <i>body corporate</i> (other than an <i>open-ended investment company</i>) which consists of, or is accompanied by, the whole or any part of the annual accounts, or is accompanied by the <i>directors'</i> report, and complies with the requirements specified by article (59).
62 Sale of body corporate	All	Note 1	(1) Made by a <i>company</i> , a <i>partnership</i> , a single individual or a group of connected individuals; (2) relates to a transaction to acquire or dispose of shares in a <i>company</i> (other than an <i>open-ended investment company</i>) or is entered into for the purposes of such an acquisition or disposal, and (3) either certain conditions are satisfied or the object of the transaction may reasonably be regarded as being the acquisition of day to day control of the affairs of the <i>company</i> .

Article no. and name of exemption	Type of promotion: Unsolicited real time, solicited real time, non-real time	Controlled activity/ controlled investment	Other conditions
67 Promotions required or permitted by market rules	<i>Solicited real time</i> <i>Non-real time</i>	Note 4	<i>Financial promotion</i> is required or permitted to be <i>communicated</i> by the rules of the relevant market, a body which regulates the market, or a body which regulates offers or issues of <i>investments</i> to be traded on such a market.
70 Promotions in connection with listing applications	<i>Solicited real time</i> <i>Non-real time</i>	Note 1	<i>Financial promotion</i> to which <i>listing rules</i> apply.
71–73 Promotions included in listing particulars and prospectuses	<i>Non-real time</i>	Note 1	These articles contain details of exemptions relating to <i>financial promotions</i> included in listing particulars and prospectuses for public offers of listed securities and <i>financial promotions</i> relating to prospectuses for public offers of unlisted securities.

3 Table Notes to ■ COB 3 Ann 1 table 2.

Notes to Annex 1G

Note 1:

References in these notes to paragraphs are to paragraphs of schedule 1 to the *Financial Promotion Order*. The *controlled investments* italicised in these notes are defined in the same way in both the *Financial Promotion Order* and the *Regulated Activities Order*.

- (1) effecting and carrying out contracts of insurance within paragraph 2 in relation to *life policies*;
- (2) dealing in securities and contractually based investments within paragraph 3;
- (3) arranging deals in investments within paragraph 4;
- (4) managing investments within paragraph 5;
- (5) safeguarding and administering investments within paragraph 6;
- (6) advising on investments within paragraph 7;
- (7) advising on syndicate participation at Lloyds within paragraph 8;
- (8) providing funeral plan contracts within paragraph 9;
- (9) agreeing to carry on any of (2) to (8) within paragraph 11

Note 2:

The *controlled activities* specified in Note 1 carried on in relation to one or more of:

- (1) *shares* (paragraph 14) being stock or shares in an unlisted company;

Note 2:

- (2) *debentures* (paragraph 15) acknowledging the indebtedness of an unlisted company;
- (3) *warrants* (paragraph 17) and *certificates representing certain securities* paragraph 18) conferring entitlements or rights with respect to (1) or (2);
- (4) *units* (paragraph 19) in a *collective investment scheme* which invests wholly or predominantly in (1) or (2);
- (5) *options* (paragraph 21) to acquire or dispose of (1), (2) or (3);
- (6) *futures* (paragraph 22) which are a rights under a control for the sale of (1), (2) or (3);
- (7) *contracts for differences* (paragraph 23) which relate to or to fluctuations in the value or price of (1), (2) or (3)

provided that in each case the investor cannot under the terms of the investment incur a liability or obligation to pay or contribute more than he commits by way of investment.

Note 3:

The *controlled activities* specified in Note 1 carried on in relation to one or more of:

- (1) *shares* (paragraph 14)
- (2) *debentures* (paragraph 15)
- (3) *warrants* (paragraph 17) and *certificates representing certain securities* (paragraph 18) so far as relating to (1) or (2)

Note 4:

The *controlled activities* specified in Note 1 carried on in relation to one or more of:

- (1) *shares* (paragraph 14)
- (2) *debentures* (paragraph 15)
- (3) *government and public securities* (paragraph 16)
- (4) *warrants* (paragraph 17)
- (5) *certificates representing certain securities* (paragraph 18)

in each case which is permitted to be traded or dealt in on a relevant market (as defined in article 67(2)).

Contents of Enterprise Investment Scheme particulars (R)

1 This annex forms part of ■ COB 3.9.26R(1).

2 Table

The following statements, to be included with particular prominence:

- (1) that applications may only be made and accepted subject to the terms and conditions of the *EIS particulars*;
- (2) that the applicant is advised not to subscribe to the *Enterprise Investment Scheme* unless he has taken appropriate independent advice;
- (3) the name and business address of:
 - (a) every *person* acting in a professional capacity in relation to the *Enterprise Investment Scheme*;
 - (b) every *person* likely to take part in any decision or recommendation relating to investment of monies subscribed to the *Enterprise Investment Scheme*;
- (4) any arrangements under which any preferential treatment will or may be given in relation to subscription to the *Enterprise Investment Scheme* to particular *persons* or classes of *person* subscribing to the *Enterprise Investment Scheme*;
- (5) the circumstances in which *persons* or particular classes of *person* are excluded from participation in the *Enterprise Investment Scheme* or in any particular investment of *Enterprise Investment Scheme* monies;
- (6) the manner in which shares in companies in which *Enterprise Investment Scheme* monies are to be invested are to be held on behalf of participants in the *Enterprise Investment Scheme* and the manner in which, according to their *Enterprise Investment Scheme* subscriptions, interests in such shares are to be allocated to each participant;
- (7) any arrangements for registering shares in the names of participants in the *Enterprise Investment Scheme* at or after the end of the period during which shares must be held in order to obtain tax relief;
- (8) the circumstances in which a *person's* participation in the *Enterprise Investment Scheme* may be terminated;
- (9) any arrangements for dealing with *Enterprise Investment Scheme* monies which become available as a result of a sale of *Enterprise Investment Scheme* investments by the *EIS manager*;
- (10) whether the *EIS manager* remains free to subscribe for shares, or to hold options to do so, in companies in which the *Enterprise Investment Scheme* funds are invested and, if so, an indication of the price or the formula by which a price is determined at which it may subscribe and the maximum proportion of the ordinary share capital of those companies for which it may subscribe or which may be the subject of options in its favour, or both;

The following statements, to be included with particular prominence:

- (11) whether the *EIS manager* proposes to establish another *Enterprise Investment Scheme* and, if so, whether or not arrangements exist to ensure that the *EIS manager* does not discriminate between one *Enterprise Investment Scheme* and another and, if so, what they are;
- (12) a summary of the fiscal provisions concerning the *Enterprise Investment Scheme*;
- (13) either a description of the arrangements which exist for:
- (a) securing that any *person* who knowingly has a material interest in any decision or recommendation concerning the investment of *Enterprise Investment Scheme* subscriptions which are not subject to independent approval is excluded from participation in the making of that decision or recommendation; and
 - (b) for securing independent approval of decisions and recommendations concerning the investment of *Enterprise Investment Scheme* subscriptions which may be made by *persons* who have a material interest in them;
- or a statement that no such arrangements exist;
- (14) where the arrangements described in (13) above do not cover any of the following interests:
- (a) an interest of the *EIS manager* or of its *associates* arising by way of remuneration in connection with the management or operation of the *Enterprise Investment Scheme* or any other *Enterprise Investment Scheme*;
 - (b) an interest arising from investment of subscriptions of the *Enterprise Investment Scheme* or of any other *Enterprise Investment Scheme* managed by the *EIS manager* or its *associates*;
 - (c) an interest of a *bank* resulting from a loan made by such an institution;
 - (d) an interest arising from the formation by the *EIS manager*, or its *associates*, of a company with a view to an interest in that company being acquired on behalf of an *Enterprise Investment Scheme*, of which it, or its *associates*, is the *scheme manager*;
- a statement that investment may be made despite the existence of such an interest;
- (15) particulars of any material interest or duty of the *EIS manager* which would conflict with the interests of participants in the *Enterprise Investment Scheme* or its duty to those participants;
- (16) any arrangements to enable participants in the *Enterprise Investment Scheme* to notify the *EIS manager* of companies with which they are connected within the meaning of Sections 291, 291A and 291B of the Income and Corporation Taxes Act 1988;
- (17) the investment policies and objectives of the *Enterprise Investment Scheme*;
- (18) the periodic reports made available to participants and how frequently those reports will be made in accordance with the *Enterprise Investment Scheme*.

Additional contents of Enterprise Investment Scheme particulars (Private Offer of Enterprise Investment Scheme Shares) (R)

1 This annex forms part of ■ COB 3.9.28.

2 Table

The following statements are to be included with particular prominence:

- (1) “The [firm][scheme manager][and its directors] [has][have] taken all reasonable care to ensure that all the facts stated in this document are true and accurate in all material respects and that there are no other material facts, or opinions, which have been omitted, which would make any part of this promotion misleading. The [firm][scheme manager][and its directors] accept[s] responsibility accordingly”;
- (2) The name and business address of:
 - (a) the *EIS manager*;
 - (b) the promoter of the *Enterprise Investment Scheme* (if any);
- (3) the opening and closing dates for receipt of *Enterprise Investment Scheme* subscriptions;
- (4) the maximum and minimum sizes, if any for; permitted individual subscriptions to the scheme;
- (5) the arrangements:
 - (a) for the holding of *Enterprise Investment Scheme* subscriptions pending investment;
 - (b) for the return of subscriptions should the *Enterprise Investment Scheme* be over-subscribed or the monies not be accepted for other reasons;
 - (c) for the return of *Enterprise Investment Scheme* subscriptions remaining uninvested at the time when the final investment of the *Enterprise Investment Scheme* has been made or the final date for investment has passed;
- (6) any arrangements for the payment of dividends, if any, to participants in the *Enterprise Investment Scheme*;

Guidance on potential problem areas for financial promotions which identify and promote specific investments and for direct offer financial promotion (G)

1 This annex forms part of ■ COB 3.8.9(5) and ■ COB 3.9.14.

2 Table Contents.

A	AVC Schemes (including FSAVCs)
B	PEP or ISA transfers
C	Corporate bond funds or similar contracts
D	'Guaranteed' products
E	With profit bonds
F	Pensions – phased retirement
G	'High Income' products
H	'Stock market bonds'
I	'Hybrid bonds'
J	Personal pensions and stakeholder pension schemes

3 Table A.

Additional Voluntary Contribution Schemes (including Free Standing Additional Voluntary Contributions)

A financial promotion for an AVC scheme or FSAVC contract should contain a prominent warning that as an alternative:

- (1) (for FSAVC promotions) an AVC exists, and that details can be obtained from the scheme administrator;
- (2) (for AVC promotions) FSAVC contracts are available.

4 Table B.

PEP or ISA transfers

A financial promotion for a PEP or ISA transfer should include details of the likely advantages and disadvantages of transferring an existing PEP or ISA holding, including:

- (1) exit charges and any other costs associated with the transfer;
- (2) initial set up charges;
- (3) transaction details (ie are holdings liquidated or transferred intact, as permitted by the terms and conditions);
- (4) the possibility (and likely effects) of shortfall, following cancellation;
- (5) potential for loss of income or growth, following a rise in the markets, whilst the PEP or ISA transfer remains pending.

5 Table C.

Bond Funds

A firm constructing a financial promotion for corporate bond funds or similar contracts should take account of the following:

(1) Clear description of the risk

Yields offered by bonds often reflect in part the risk rating of the issuer. Investment in such bonds brings an increased risk of default on repayment and this in turn translates into a risk that the capital value of the fund will be affected. Financial promotions for funds which invest in riskier bonds should clearly explain this point to recipients. The prominence and wording of the explanation should reflect both the risk profile of the portfolio held by the fund, and the prominence given to information about the yield on the fund.

(2) Quoting out of date yields

Financial promotions often feature prominently the yield on the fund. In some cases the actual yield being paid at the time the promotion is communicated is materially different to the yield quoted. Owing to lead times, inaccuracies can occur if the market is moving rapidly, but yields several weeks or months out of date are misleading. The promotion should quote the date at which the rate applied. It is unwise for items with a long shelf life to prominently feature a rate which may become invalid.

(3) Funds not fully invested

Yield figures should reflect the overall position of the fund allowing for any monies held in cash. Yields quoted on the assumption that the fund is 100% invested in bonds where a proportion is invested in cash would be misleading.

(4) Running and redemption yields

Whilst the running yield indicates the expected level of current income for investors, managers should take the redemption yield into account when considering how to portray the prospects for future investors. They should also take into account, and explain, any material difference between the two.

(5) Describing the yield and growth prospects

Where it is the case, the fact that both the yield and the capital value of the fund can fluctuate should be disclosed. Firms need to be careful when describing the future yield or growth prospects of a fund. The prominence and tone given to descriptions of future prospects should reflect a reasonable assessment of the fund taking into account eg the redemption yield, whether charges are taken from capital, and the general economic climate.

6 Table D.

Guaranteed products

1. Equal prominence to guaranteed and not guaranteed benefits
 - (a) Firms should give equal prominence to the description of benefits which are guaranteed and of benefits which are not.
 - (b) If the word 'guaranteed' is highlighted, or otherwise emphasised, equal highlighting, or emphasis should be given to the fact that any elements which are 'not guaranteed' are not guaranteed.
 - (c) If the reference to guaranteed income is highlighted in, for example, a 'back to back' scheme combining an annuity which is guaranteed with a five year policy or ISA, the proceeds of which are not guaranteed, the fact that the benefits under the life assurance policy or ISA are not guaranteed must be stated with equal prominence.

2. Past performance

The FTSE index began in 1984 and reference is often made to its performance. Examples of 'back testing' are often given to show that the index has not fallen in any five year period since 1984. The experience may not, however, be representative of current conditions and if so the results are capable of being misunderstood. Including earlier experience may result in a more balanced presentation of risk.

3. Averaging

Contracts are normally based on the assumption that the index being used will rise. The use of the average level of the index will reduce the investment potential of the contract. Where the averaging periods cover more than the last six months of the contract term, it should not be implied that averaging is to protect against falls at the end of the term. It should be made clear that investors benefit only from some of the performance of the index and that one effect of averaging is likely to be to constrain the final level of the index used to calculate benefits.

4. Maximum benefits

These should not be promoted as a particular feature if the economic circumstances required to meet those benefits require investment conditions more favourable than those which would need to prevail to achieve the higher of the growth assumptions specified by the FSA.

7 Table E.

With-profits bonds

1. Particular areas of concern about financial promotion of with profit bonds are:
 - (a) failure to make it clear that a whole life with profits bond is unsuitable as a short term investment;
 - (b) unclear statements as to what factors will determine the cash-in value of the bond;
 - (c) reservation of the right to adjust the value of the contract by means such as Market Value Adjustment Factors without adequately explaining the significance or likelihood of such a procedure;

With-profits bonds

- (d) use of a rate of bonus in a way that implies such a rate will apply;
 - (e) quotation of values based on existing bonus rates to lead recipients to anticipate receiving such amounts;
 - (f) reference to building society accounts in comparison with the bond without adequately explaining the differences between the two types of investment.
2. Quoting a high initial bonus rate may suggest that it is achievable for all investors, whereas for example, the rate may only be available to investors who make a sizeable investment or who make their investment considerably earlier than the closing date. In addition, initial bonus rates are frequently subject to limiting factors, such as:
- (a) establishment charges;
 - (b) monthly policy charges;
 - (c) fund management or investment charges;
 - (d) early surrender penalties or discontinuance charges;
 - (e) market adjustment factors.
- Therefore where applicable firms should not include terms such as ‘guaranteed’, ‘return’ and ‘fixed for the first year’ without making it clear that the bonus rate may not be achievable.

8 Table F.

Pensions – phased retirement

1. Some promotions for phased retirement pensions tend to emphasise the various advantages but do not give adequate risk warnings, some of the important assumptions, or detail potential disadvantages. The following failures are typical:
- (a) not including risk warnings in respect of performance and value of underlying units.
 - (b) not indicating that future annuity rates are not guaranteed and may be higher or lower.
 - (c) not disclosing any information about additional charges linked to the plan.
 - (d) not making any reference to protected rights being deferred to age 65 or 60 (in illustrations of pensions commencing earlier).
 - (e) not indicating how a surviving spouse is provided for.
2. Four particular areas that need to be made clear are:
- (a) Mortality
Compared with a conventional annuity, phased retirement normally provides higher residual sums on death. For survivors to age 75, this can result in a strain, as annuities will not have been purchased at an earlier age. This risk should be made clear.
If a spouse’s pension is to be provided, it needs to be made clear whether each annuity is bought on a joint life basis and whether the annuity is bought on death or at age 75.
If protected rights pensions at age 65 or 60 are to be provided, it needs to be made clear how these are to be provided.
 - (b) Investment

Pensions – phased retirement

The future investment returns on the residual funds and the future immediate annuity rates are unknown. The risk of this to the investor needs to be made clear.

Care needs to be taken to ensure that the impression is not given that postponing the purchase of an annuity will automatically be to the investor's advantage.

(c) Tax

Most of the financial advantage in phased retirement derives from utilising tax free cash sums to provide part of the investors pension payment. Therefore the investor does not have the benefit of the tax free cash sum at retirement, which can be a disadvantage. Any comparison with a conventional annuity should allow for the use of a purchased life annuity purchased with the tax free cash, or include a statement that the effect of the option to use the tax free cash to secure a purchased life annuity has been ignored.

Because the pension will usually constitute most of a investor's income, it will generally be correct to assume basic rate tax. Where the level of income makes it appropriate, higher rate tax may be allowed for; this can be done assuming an average tax rate or taking account of specific tax bands. If tax thresholds are assumed to increase, the rate must be consistent with the investment return assumed and the rate of increase in the target pension.

(d) Expenses

The costs in operating phased retirement are usually higher than for conventional annuities. These costs need to be disclosed, especially as they are relevant to any comparison with a conventional annuity. Particular reference should be made to the level of initial charge and annual management charge on unit-linked funds.

9 Table G.

High income products

1. **Income Term**
If the word 'income' is used, it will be difficult for the promotion to avoid being misleading unless it:
 - (a) is used to indicate payments comprised solely of interest or dividend earnings; or
 - (b) is clearly defined at an early point in the promotion as having a different meaning, and in particular specifies the risk to capital necessary to achieve the payment.
2. **Problem of disclosure of risks**
If the rate of income available is at some capital risk or at the expense of growth, or the income or a portion of it comprises a return of capital, these facts should be clearly explained.
3. **Guaranteed income but not capital**
 - (a) A clear statement should be made where:
 - (i) the relevant benefits are not guaranteed; or
 - (ii) no benefits are guaranteed.
 - (b) If direct or indirect comparison is made with a building society or with other forms of deposit, there should be a prominent statement that the investment does not include the security of capital which is afforded under a deposit with a bank or building society.

High income products

- (c) If any guarantee is given, the guarantor should be named.
 - (d) An equivalent annualised rate of return (for example 8.16% relating to a cash return payable of 8% per annum half yearly) may be quoted if the cash rate is quoted more prominently than the equivalent annualised rate and the nature of the equivalent annualised rate is described.
 - (e) An equivalent gross return (allowing for notional income tax) may be quoted provided that it is:
 - (i) less prominent than the actual cash return; and
 - (ii) stated that tax is not recoverable by investors.
4. High income bonds, high income unit trusts and similar types of collective investment schemes
- (a) Some unit trusts achieve a high income by the use of derivatives such as put and call options. Firms should provide a statement to the effect that the high income is achieved at the expense of most of the potential capital gain.
 - (b) If it is claimed that the downside potential is less than that of a conventional unit trust, it should be made clear with equal prominence that if the fund goes down its potential recovery will be less than that of a conventional unit trust.
 - (c) Where an income figure is shown a clear statement should be made that the income is not guaranteed.

10 Table H.

Stock market bonds

Stock market bonds are those investments which offer returns linked to the price of an index such as the FTSE 100.

(1) Minimum amount payable at the end of the term

The word 'guarantee' is usually used to describe the minimum amount payable at the end of the term. This guarantee is usually provided at some cost to the investor and promotions therefore need to make clear what that cost is and whether it is levied:

- (a) from the start, for example by means of an additional initial charge; or
- (b) only if the guarantee is invoked, for example by reference to an index or other indicator which includes capital growth but excludes investment income.

(2) Potential for Growth

(a) Expressions like 'stock market growth' or 'the growth of the FTSE 100 Index' are frequently used and are potentially misleading if the product will not be investing in all the stocks which make up the index.

(b) Promotion of a product which is linked to growth in the FTSE 100 index should make clear that it does not include an allowance for any return or re-investment of dividend income.

(c) Promotions should therefore make it clear that references to 'stock market growth' exclude any form of income payment.

(3) Amount Invested

Some promotions quote returns in excess of the percentage increase in the FTSE 100 index, without mentioning that 100% of capital is not invested at outset.

(4) Gross returns and tax on underlying fund

Stock market bonds

Promotions showing guaranteed returns against the FTSE 100 index expressed in 'gross' terms are potentially misleading where the underlying funds of the firm concerned are taxable and the returns quoted are therefore unavailable to the investor because he will receive the benefits after tax has been deducted and which he cannot reclaim.

(5) Taxation of investor

The tax treatment in the hands of the investor should be made clear, in particular, whether the return will be treated as income or as capital gains where the investor may be entitled to a tax free exemption limit with the added benefit of indexation.

(6) Early Encashment

(a) The terms for early encashment need to be fully explained.

(b) Despite the minimum amount at the end of the specified term, an appropriate risk warning should be included where the value of the investment can fall if an investor wishes to encash the contract before the end of the term.

11 Table I.

Hybrid bonds

A hybrid bond refers to those life policy investments which combine one investment designed to provide income with another designed to return all or part of the capital. Potential problems with the promotion of 'hybrid bonds' are listed below. These should all be clearly explained, where applicable, in a direct offer financial promotion:

- (1) although the word 'income' is used to describe the regular payments generated from part of the investment, only part of each payment derives from interest earned on that money. The balance consists of a return of the capital itself;
- (2) although payments may be promised at a pre-defined level for a set period, there should be no implication that the original capital is guaranteed to be returned;
- (3) part of the investment is often invested in vehicles which offer opportunities for rapid growth, with risks of loss;
- (4) whilst the larger tranche is typically invested in a unit linked bond, the income producing tranche is given the greater prominence resulting in an unbalanced picture of the investment and the risks.

12 Table J.

Personal pensions and stakeholder pension schemes

Firms promoting personal pension schemes through direct offer financial promotions are reminded of the provisions of *COB 5.3*.

Permitted promotion of unregulated collective investment schemes (R)

1 Table

- 1 This annex forms part of *COB* 3.11.2.
- 2 Where the left hand column in the table refers to promotion to a category of *person*, this means that the invitation or inducement:
 - (a) is made only to recipients who the *firm* has taken reasonable steps to establish are *persons* in that category; or
 - (b) is directed at recipients in a way that may reasonably be regarded as designed to reduce, so far as possible, the risk of participation in the *collective investment scheme* by *persons* who are not in that category;
 and see *COB* 3.5.6 and *COB* 3.5.7 which amplify this paragraph.
- 3 A *firm* may rely on more than one exemption in relation to the same invitation or inducement.

2 Table Permitted promotion of unregulated collective investment schemes

Promotion to:	Promotion of an unregulated collective investment scheme which is:
<p>Category 1 person:</p> <p>(1) a <i>person</i> who is already a <i>participant</i> in an <i>unregulated collective investment scheme</i>;</p> <p>(2) a <i>person</i> who has been, in the last 30 months, a <i>participant</i> in an <i>unregulated collective investment scheme</i>.</p>	<p>A. that <i>collective investment scheme</i>; or</p> <p>B. any other <i>collective investment scheme</i> whose underlying property and risk profile are both ‘substantially similar’ (see Note 1) to those of that <i>collective investment scheme</i>; or</p> <p>C. a <i>collective investment scheme</i> which is intended to absorb or take over the assets of that <i>collective investment scheme</i>; or</p> <p>D. a <i>collective investment scheme</i>, units in which are being offered by its operator as an alternative to cash on the liquidation of that <i>collective investment scheme</i>.</p> <p>Any <i>collective investment scheme</i></p>
<p>Category 2 person:</p> <p>(1) a <i>person</i></p> <p>(a) for whom the <i>firm</i> has taken reasonable steps to ensure that <i>investment</i> in the <i>collective investment scheme</i> is suitable; and</p>	

Promotion to:	Promotion of an unregulated collective investment scheme which is:
<p>(b) who is an ‘established’ or ‘newly accepted’ <i>customer</i> of the <i>firm</i> or of a person in the same <i>group</i> as the <i>firm</i> (see Notes 2 & 3).</p> <p>Category 3 person: a person who is <i>eligible</i> to participate in a <i>scheme</i> constituted under:</p> <ol style="list-style-type: none"> (1) the Church Funds Investment Measure 1958; (2) section 24 of the Charities Act 1993; or (3) section 25 of the Charities Act (Northern Ireland) 1964. <p>Category 4 person:</p> <p>An eligible employee, that is, a <i>person</i> who is:</p> <ol style="list-style-type: none"> (1) an officer, (2) an <i>employee</i>, (3) a former officer or <i>employee</i>, or (4) a member of the immediate family of any of (1)–(3) of an employer which is (or is in the same <i>group</i> as) the <i>firm</i>, or which has accepted responsibility for the activities of the <i>firm</i> in carrying out the <i>designated investment business</i> in question. 	<p>Any such <i>collective investment scheme</i></p> <p>1. A <i>collective investment scheme</i> the instrument constituting which:</p> <p>A. restricts the property of the <i>scheme</i>, apart from cash and <i>near cash</i>, to</p> <ol style="list-style-type: none"> (1) (where the employer is a <i>company</i>) <i>shares in</i> and <i>debentures of company</i> or any other connected <i>company</i> (see Note 4) (2) (in any case), any property, provided that the <i>scheme</i> takes the form of: <ol style="list-style-type: none"> (i) a <i>limited partnership</i>, under the terms of which the employer (or connected <i>company</i>) will be the unlimited <i>partner</i> and the eligible employees will be some or all of the <i>limited partners</i>; or (ii) a trust which the <i>firm</i> reasonably believes not to contain any risk that any eligible employee may be liable to make any further payments (other than <i>charges</i>) for <i>investment transactions</i> earlier entered into, which the eligible employee was not aware of at the time he entered into them; and <p>B. (in a case falling within A(1) above) restricts participation in the <i>scheme</i> to eligible employees, the employer and any connected <i>company</i>.</p>

Promotion to:	Promotion of an unregulated collective investment scheme which is:
<p>Category 5 person A person admitted to membership of the Society of Lloyd's or any person by law entitled or bound to administer his affairs.</p> <p>Category 6 person An exempt person (other than a person exempted only by section 39 of the Act (Exemption of appointed representatives)) if the financial promotion relates to a regulated activity in respect of which the person is exempt from the general prohibition.</p> <p>Category 7 person A market counterparty or an intermediate customer.</p>	<p>2. Any collective investment scheme provided that the participation of eligible employees is to facilitate their co-investment:</p> <p>(i) with one or more <i>companies</i> in the same <i>group</i> as their employer (which may include the employer) and/or</p> <p>(ii) with one or more <i>clients</i> of such a <i>company</i>.</p> <p>irrespective of whether the eligible employees co-invest through a <i>company</i> or a <i>collective investment scheme</i> falling within A(2)(ii) above or a trust under which they or a <i>member</i> of their immediate family is a potential beneficiary.</p> <p>A scheme in the form of a limited partnership which is established for the sole purpose of underwriting insurance business at Lloyd's.</p> <p>Any collective investment scheme</p> <p>Any collective investment scheme</p>

3 Table Notes to the table

Notes to the table

Note 1.

The property of a *collective investment scheme* is 'substantially similar' to that of another *collective investment scheme* if in both cases the objective is to invest in the same one of the following sectors:

- (a) *on-exchange derivatives* or *warrants*;
- (b) *on-exchange* (or quoted) *securities*;
- (c) the property market (whether in *securities* of property companies or in property itself);

Notes to the table

- (d) collectable items of a particular description (such as works of art, antique vehicles, etc);
- (e) artistic productions (such as films, television, opera, theatre or music);
- (f) unlisted *investments* (including unlisted *debt securities*).

The risk profile of a *scheme* will be substantially similar to that of another *scheme* only if there is such similarity in relation to both liquidity and volatility.

Note 2.

A person is an 'established *customer*' of another *person* if he has been and remains an actual *customer* of that *person* in relation to *designated investment business* done with or through that other *person*.

Note 3.

A *person* is a 'newly accepted' *customer* of a *firm* if:

a written agreement relating to *designated investment business* exists between the *customer* and the *firm* (or, if the *customer* is normally resident outside the *United Kingdom*, an oral or written agreement); and

that agreement has been obtained without any contravention of section 238 or 240 of the *Act*, or of any *rule* in *COB* applying to the *firm* or (as far as the *firm* is reasonably aware) any other *authorised person*.

Note 4.

A *company* is 'connected' with another *company* if:

- (a) They are in the same *group*; or
- (b) one *company* is entitled either alone or with another *company* in the same *group*, to exercise or control the exercise of a majority of the voting rights attributable to the share capital, which are exercisable in all circumstances at any general meeting of the other *company* or of its *holding company*.

Chapter 4

Accepting customers



4.1 Client classification

Application

- 4.1.1** **R**_{/1} (1) This section applies to a *firm* intending to conduct, or conducting, *designated investment business*, or *ancillary activities* relating to *designated investment business*.
- (2) For the purposes of *COB* only, the following provisions in **■ COB 4.1** also apply to a *firm* intending to carry on, or carrying on, any other *regulated activity*:
- (a) **■ COB 4.1.12** and **■ COB 4.1.13** (Large intermediate customer classified as a market counterparty); and
- (b) **■ COB 4.1.14** (Client classified as a private customer).

- 4.1.2** **G**_{/1} The *communication* or *approval* of a *financial promotion* relating to *designated investment business*, or a *designated investment*, is an *ancillary activity* relating to *designated investment business* to which this section applies under **■ COB 4.1.1(1)**.

Purpose

- 4.1.3** **G**_{/1} (1) This section requires a *firm* to classify the *persons* with or for whom it intends to carry on *designated investment business*, to achieve appropriate application of the *rules* in *COB* and **■ MAR 3** (Inter-professional conduct). Its purpose is to ensure that *clients* are appropriately categorised so that regulatory protections are focused on those classes of *client* that need them most, while allowing an appropriately ‘light-touch’ approach for *inter-professional business*.
- (2) Some of the *rules* in *COB* relating to activities other than *designated investment business* are disapplied if the activity is carried on with or for a *market counterparty* rather than a *customer*, for example rules in **■ COB 6.8** (Insurance contracts: life and general). For *guidance* on how a *firm* carrying on these other activities may approach *client* classification, see **■ PRIN 1.2.4** (Classification: other activities).

Requirement to classify

4.1.4

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- (1) Before conducting *designated investment business* with or for any *client*, a *firm* must take reasonable steps to establish whether that *client* is a *private customer*, *intermediate customer* or *market counterparty*.
- (2) For the purposes of the *rules* in *COB*, a *firm* must ensure that it treats its *client* in accordance with the classification established under (1), or, where relevant, ■ COB 4.1.7, ■ COB 4.1.9, ■ COB 4.1.12, ■ COB 4.1.14 or ■ COB 4.1.15.

Agent as client

4.1.5

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- (1) If a *firm* ("F") is aware that a *person* ("C1") with or for whom it is conducting *designated investment business*, or related *ancillary activities*, is acting as agent for another *person* ("C2") in relation to that business, C1, and not C2, is the *client* of F in respect of that business, if:
 - (a) C1 is another *firm* or an *overseas financial services institution*; or
 - (b) C1 is any other *person*, provided that avoidance of duties which F would otherwise owe to C2 is not the main purpose of the arrangements between the parties.
- (2) Paragraph (1) does not apply if F has agreed with C1 in writing to treat C2 as its *client*.
- (3) If paragraph (1) does not apply, because of the proviso in (1)(b) or an agreement under (2), C2, and not C1, is the *client* of F in respect of that business.

4.1.6

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Firms are reminded that ■ COB 4.1.5:

- (1) does not relieve them of any obligation under the *Money Laundering* sourcebook relating to C2 (there is a different definition of "*client*" in that sourcebook);
- (2) is not relevant to the question of who is the *firm's* counterparty for the purposes of the Interim Prudential sourcebook; and
- (3) does not relieve them of any obligation the *firm* may owe to C2 under the general law relating to principals and agents; if a *firm* is in any doubt about such obligations, it is advised to take appropriate legal advice.

Classification of another firm or an overseas financial services institution

4.1.7

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- (1) When a *firm* ("F") conducts *designated investment business*, or related *ancillary activities*, with or for:
 - (a) another *firm*; or
 - (b) an *overseas financial services institution*;

("C1"), C1 is a *market counterparty* of F, unless (2), (3), (4) or (5) applies.
- (2) C1 is an *intermediate customer* of F when the activity carried on by F would be *inter-professional business* (if C1 were a *market counterparty*), and:
 - (a) C1 is acting for an underlying *customer* ("C2");
 - (b) C1 has decided that, for the interests of C2 to be properly protected under the applicable *rules* in COB, C1 should benefit from the protections available to *intermediate customers*; and
 - (c) F and C1 have agreed that F should classify C1 as an *intermediate customer* when C1 is acting for C2.
- (3) C1 is an *intermediate customer* of F when the activity carried on would not be *inter-professional business* (if C1 were a *market counterparty*) and:
 - (a) C1 has not indicated that it is acting on its own behalf in relation to that activity; or
 - (b) C1 is a *long-term insurer* acting on behalf of its life fund.
- (4) If C1 is a *regulated collective investment scheme*, C1 is a *private customer* of F.
- (5) If C1 is an *unregulated collective investment scheme*, C1 is an *intermediate customer* of F.

4.1.8

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- (1) Any agreement under ■ COB 4.1.7(2)(c) may be in relation to a particular underlying *customer* of C1's or in relation to all cases in which C1 acts on behalf of its *customers*.
- (2) When deciding whether it should be classified as an *intermediate customer* under ■ COB 4.1.7(2)(b), C1 should have regard to the fact that it will be responsible to C2 for delivering applicable protections under COB (or, if C1 is an *overseas financial services institution*, under any relevant overseas provisions). C1 should also remember that F is entitled to refuse to agree to classify C1 as an *intermediate customer*; and, in such a case, it may be appropriate for C1 to obtain services from a different *firm*.

- (3) C1 is an *intermediate customer* under ■ COB 4.1.7(2) or (3), but remains a *market counterparty* for other purposes. For example, for *designated investment business* which is not *inter-professional business*, C1 is a *market counterparty* for transactions for C1's own account.
- (4) In relation to activities other than *designated investment business*, and related *ancillary activities*, C1 is a *market counterparty* in accordance with the definition of "*market counterparty*".
- (5) When C1 is a *market counterparty*, then only limited parts of COB will apply to F's business with C1. The *Principles* (other than 6, 8 and 9 and most of 7) will also apply, as will ■ MAR 3 (Inter-professional conduct) for *inter-professional business*. See ■ MAR 3 Ann 1 for further *guidance* on the application of the *Principles*, COB and ■ MAR 3 for *inter-professional business*.

Expert private customer classified as an intermediate customer

4.1.9

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- (1) A *firm* may classify a *client* who would otherwise be a *private customer* as an *intermediate customer* if:
 - (a) the *firm* has taken reasonable care to determine that the *client* has sufficient experience and understanding to be classified as an *intermediate customer*; and
 - (b) the *firm*:
 - (i) has given a written warning to the *client* of the protections under the *regulatory system* that he will lose;
 - (ii) has given the *client* sufficient time to consider the implications of being classified as an *intermediate customer*; and
 - (iii) has obtained the *client's* written consent, or is otherwise able to demonstrate that informed consent has been given.
- (2) For the purposes of (1), a *client's* consent to being classified as an *intermediate customer* may be limited to one or more types of:
 - (a) *designated investment*; or
 - (b) *designated investment business*.

4.1.10

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- (1) To take reasonable care to determine that a *client* has sufficient experience and understanding to be classified as an *intermediate customer* for the purposes of ■ COB 4.1.9(1)(a), the *firm* should have regard to:
 - (a) the *client's* knowledge and understanding of the relevant *designated investments* and markets, and of the risks involved;
 - (b) the length of time the *client* has been active in these markets, the frequency of dealings and the extent to which he has relied on the *advice on investments* of the *firm*;

4.1.11



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- (c) the size and nature of transactions that have been undertaken for the *client* in these markets;
 - (d) the *client's* financial standing, which may include an assessment of his net worth or of the value of his portfolio.
- (2) It is likely that a *firm* will need to have regard to more than one of these criteria, or to other criteria, before it can be satisfied that a *client*, who would otherwise be a *private customer*, is eligible to be classified as an *intermediate customer*.
- (1) In the written warning required by ■ COB 4.1.9(1)(b)(i), a *firm* should:
- (a) advise the *client* that he will lose the protection afforded by the following *rules* in *COB* applicable exclusively to *private customers*:
 - (i) ■ COB 3.9 (Direct offer financial promotions), ■ COB 3.12.1 (Communication and approval of financial promotions of an overseas or unauthorised person) and ■ COB 3.13 (Additional requirements for financial promotions for an overseas long-term insurer);
 - (ii) ■ COB 5.4 (Customers' understanding of risk);
 - (iii) ■ COB 5.7 (Disclosure of charges, remuneration and commission);
 - (iv) ■ COB 6.1: (Packaged product and ISA disclosure);
 - (v) ■ COB 7.9 (Lending to private customers);
 - (vi) ■ COB 7.10 (Margin requirements);
 - (vii) ■ COB 7.11 (Non-exchange traded securities);
 - (b) explain any consequences to the *client* in respect of the following *rules* in *COB* which are limited or modified in their application to *intermediate customers*:
 - (i) ■ COB 3 (Financial promotion);
 - (ii) ■ COB 5.1 (Polarisation and status disclosure);
 - (iii) ■ COB 8.1 (Confirmation of transactions);
 - (iv) ■ COB 8.2 (Periodic statements);
 - (c) explain possible consequences to the *client* in respect of the following *rules* in *COB* which are capable of modification in their application to *intermediate customers*:
 - (i) ■ COB 7.5 (Best execution);

- (ii) ■ COB 9.1 (Custody);
 - (iii) ■ COB 9.3 (Client money);
 - (d) warn the *client* that he will also lose the right of access to the *Financial Ombudsman Service*; and
 - (e) warn the *client* that the *firm* may have regard to his expertise when complying with requirements under the *regulatory system* that communications must be clear, fair and not misleading.
- (2) Contravention of any part of ■ COB 4.1.11(1) may be relied upon as tending to establish contravention of ■ COB 4.1.9(1)(b)(i).

Large intermediate customer classified as a market counterparty

4.1.12

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A *firm* may classify a *client* (other than another *firm* or an *overseas financial services institution*) who would otherwise be an *intermediate customer* as a *market counterparty* if:

- (1) the *client* at the time he is classified is one of the following:
 - (a) a *body corporate* (including a *limited liability partnership*) which has (or any of whose *holding companies* or *subsidiaries* has) called up share capital of at least £10 million (or its equivalent in any other currency at the relevant time);
 - (b) a *body corporate* that meets (or any of whose *holding companies* or *subsidiaries* meets) two of the following tests:
 - (i) a balance sheet total of 12.5 million euros (or its equivalent in any other currency at the relevant time);
 - (ii) a net turnover of 25 million euros (or its equivalent in any other currency at the relevant time);
 - (iii) an average number of employees during the year of 250;
 - (c) a local authority or public authority;
 - (d) a *partnership* or unincorporated association which has net assets of at least £10 million (or its equivalent in any other currency at the relevant time) (and calculated, in the case of a limited *partnership*, without deducting loans owing to any of the *partners*);
 - (e) a trustee of a trust (other than an *occupational pension scheme*, *SSAS* or *stakeholder pension scheme*) with assets of at least £10 million (or its equivalent in any other currency), calculated by aggregating the value of the cash and *designated*

- investments* forming part of the trust's assets, but before deducting its liabilities;
- (f) a trustee of an *occupational pension scheme*, *SSAS* or *stakeholder pension scheme* where the trust has (or has had at any time during the previous two years):
- (i) at least 50 members; and
 - (ii) assets under management of not less than £10 million (or its equivalent in any other currency at the relevant time); and
- (2) the *firm* has, before commencing business with the *client* on a *market counterparty* basis:
- (a) advised the *client* in writing that he is being classified as a *market counterparty*;
 - (b) given a written warning to the *client* that he will lose protections under the *regulatory system*;
 - (c) for a *client* falling under (1)(a) or (b):
 - (i) taken reasonable steps to ensure that the written notices required by (2)(a) and (b) have been delivered to a *person* authorised to take such a decision for the *client*; and
 - (ii) not been notified by the *client* that the *client* objects to being classified as a *market counterparty*;
 - (d) for a *client* falling under (1)(c), (d), (e) or (f):
 - (i) taken reasonable steps to ensure that the written notices required by 2(a) and (b) have been delivered to a *person* authorised to take such a decision for the *client*; and
 - (ii) obtained the *client's* written consent or is otherwise able to demonstrate that consent has been given.

4.1.13

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In the written warning required by ■ COB 4.1.12(2)(b), a *firm* should advise a *client* who is classified as a *market counterparty* in accordance with ■ COB 4.1.12 that he will lose all protections applicable to *customers* afforded by the *rules* in COB (other than those in ■ COB 9 (Client assets)) and *Principle 6* (Customers' interests), *Principle 8* (Conflicts of interest) and *Principle 9* (Customers: relationships of trust) and most of *Principle 7* (Communications with clients). (The *firm* should also advise the *client* that, in respect of *inter-professional business* conducted between *market counterparties*, ■ MAR 3 (Inter-professional conduct) applies.)

Client classified as a private customer

4.1.14

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- (1) A *firm* may classify as a *private customer* any *client* (other than a *firm* or an *overseas financial services institution*) who would otherwise be a *market counterparty* or an *intermediate customer*, and must notify any such *client* accordingly.
- (2) A notice under (1) must advise the *client* that he may not necessarily have rights under the *Financial Ombudsman Service* or the *compensation scheme* as a result of such classification.

Review of classification

4.1.15

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- (1) If a *firm* classifies:
 - (a) a *client* as an *intermediate customer* under ■ COB 4.1.9 (Expert private customer classified as an intermediate customer); or
 - (b) a *client* as a *market counterparty* under ■ COB 4.1.12 (Large intermediate customer classified as a market counterparty);

it must review that classification at least annually to ensure that it remains appropriate to the *designated investment business* which the *firm* carries on with or for that *client*, unless (2) applies.
- (2) If a *firm* has not conducted *designated investment business* with or for a *client* during the previous 12 month period, the *firm* may defer the review referred to in (1) until the *firm* next conducts *designated investment business* with or for the *client*.

Record keeping

4.1.16

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- (1) A *firm* must make a record of the classification established for each *client* under ■ COB 4.1.4(1), or, where relevant, under ■ COB 4.1.7, ■ COB 4.1.9, ■ COB 4.1.12, ■ COB 4.1.14 or ■ COB 4.1.15, including sufficient information to support that classification.
- (2) A *firm* must retain the record referred to in (1) for a minimum period after the date on which the *firm* ceases to carry on business with or for that *client*, as follows:
 - (a) indefinitely, if relevant to a *pension transfer*, *pension opt-out* or *FSAVC*;
 - (b) for a period of at least six years, if relevant to a *life policy* or *pension contract*;
 - (c) for a period of at least three years in any other case.



4.2 Terms of business and client agreements with customers

Application

- 4.2.1** **R**_{/1} This section applies to a *firm* intending to conduct or conducting *designated investment business* with or for a specific *customer*, unless the *designated investment business* relates to the type of transaction or *firm* in column A of **COB 4.2.9** and is limited to the type of business specified in the same row in column B.
- 4.2.2** **G**_{/1} This section does not apply to transactions relating to a *cash deposit ISA* held on deposit with a *deposit-taking firm*, since it is not a *designated investment*.
- 4.2.3** **G**_{/1} If an *authorised professional firm* conducts *non-mainstream regulated activity* for a *customer* (whether with or without any other *regulated activity* for the *customer*) then, subject to **COB 4.2.8**, the effect of **COB 1.2.1(4)** is that:
- (1) *terms of business* must be provided; but
 - (2) with respect to the *non-mainstream regulated activity*, the *terms of business* should satisfy **COB 4.2** if it contains the effect of the disclosure in **COB 4.2.15(26)**.

Purpose

- 4.2.4** **G**_{/1} *Principle 7* (Communications with clients) requires a *firm* to pay due regard to the information needs of its *customers*. A *customer* needs to know on what basis a *firm* intends to do business with him. *Terms of business* or a *client agreement* set out the basis on which a *firm* conducts any *designated investment business* with or for the *customer*.

Requirement to provide terms of business to a customer

- 4.2.5** **R**_{/1} (1) A *firm* must provide a *customer* with its *terms of business*, setting out the basis on which *designated investment business* is to be conducted with or for the *customer* within the period specified in (2) or (3).

- (2) A *firm* must, before conducting any *designated investment business* with or for a specific *private customer*, provide him with its *terms of business*, unless the *customer* has made an oral offer to enter into an *investment agreement* relating to an *ISA*, or a *stakeholder pension scheme*, that relates to a *designated investment*, in which case the *terms of business* must be provided to him within five *business days* of the offer.
- (3) If the *customer* is an *intermediate customer*, the *firm* must provide its *terms of business* within a reasonable period of the *firm* beginning to conduct *designated investment business* with or for the *customer*.

4.2.6

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■ COB 4.2.5(2) does not require a *firm* to provide information that, by its nature, is unavailable at the time the *terms of business* are issued. For example, a *firm* will not necessarily know a *private customer's* investment objectives before providing *terms of business*, since it may not be possible to determine the *private customer's* requirements without undertaking know-your-customer checks, as required by ■ COB 5.2. In these circumstances, the *firm* should notify the *private customer* of any relevant information set out in ■ COB 4.2.15 and ■ COB 4.2.16 as soon as practicable after it becomes available.

Requirement to enter into a client agreement with a private customer

4.2.7

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- (1) If a *firm* intends to conduct any of the following *designated investment business* with or for a *private customer*:
 - (a) *managing investments* on a discretionary basis;
 - (b) *designated investment business* relating to a *contingent liability investment*;
 - (c) *stock lending activity*; or
 - (d) *designated investment business* involving underwriting (except in respect of a *life policy*);

its *terms of business* for the *customer* must, unless (2) applies, take the form of a *client agreement*, and the *firm* must not enter into this *client agreement* unless it has taken reasonable care to ensure that the *private customer* has had a proper opportunity to consider the terms.

- (2) A *firm* need not enter into a *client agreement* with a *private customer* if the *private customer* is habitually resident outside the *United Kingdom* and the *firm* has taken reasonable steps to establish that the *private customer* does not wish to enter into a *client agreement*.

4.2.8

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Firms are reminded that, as well as complying with the requirements of ■ COB 4.2.5 and ■ COB 4.2.7, they may also need to comply with the additional requirements relating to disclosure and *client agreements* set out in ■ COB 9 (Client assets).

4.2.9

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Table Designated investment business to which the terms of business and client agreement requirements in this section do not apply.

This table belongs to ■ COB 4.2.1

	Column A	Column B
(1)	<i>Execution-only transactions</i>	Bringing about any <i>execution-only transaction</i> (except a transaction in a <i>contingent liability investment</i> with or for a <i>private customer</i>).
(2)	<i>Direct offer financial promotion</i>	When a <i>customer</i> enters into a transaction as a result of a <i>direct offer financial promotion</i>.
(3)	Advising during preparation of <i>terms of business</i>	Providing <i>advice on investments</i> or information solely for the purpose of preparing <i>terms of business</i> or with a view to providing <i>terms of business</i> or entering into a <i>client agreement</i>.
(4)	<i>Life insurer</i>	Effecting a <i>life policy</i> issued or to be issued by it as <i>principal</i>.
(5)	<i>Operator of a collective investment scheme</i>	Any designated investment business conducted as part of <i>scheme management activity</i>.
(6)	<i>Operator of a collective investment scheme</i>	Any service provided to the <i>trustee</i> or <i>depository</i> of the <i>scheme</i> which is not part of the <i>operator's scheme management activity</i>.
(7)	<i>Operator of a collective investment scheme</i>	The sale or purchase as <i>principal</i> of <i>units</i> in a <i>scheme</i>.
(8)	<i>Trustee or depository</i>	Acting as a <i>trustee</i> of a <i>unit trust</i> or <i>depository</i> of an <i>ICVC</i>.
(9)	<i>Operator of investment trust savings scheme</i>	Bring about a transaction in the <i>shares</i> of any <i>investment trust</i> that is the subject of the <i>scheme</i>.
(10)	<i>Operator of investment trust savings scheme</i>	Any designated investment business conducted as part of its activities as such.
(11)	<i>Supplier of a published recommendation</i>	The supply of a <i>published recommendation</i>.

	Column A	Column B
(12)	<i>Designated investment business performed after termination of terms of business</i>	<i>Designated investment business performed under terms of business that have terminated, but only for the purposes of fulfilling any obligations still outstanding under the terms of business.</i>
(13)	<i>OPS firms who are trustees of an OPS</i>	<i>Any designated investment business carried on by an OPS firm as part of its OPS activity in relation to an occupational pension scheme of which it is the trustee.</i>

Adequate detail

- 4.2.10** **R** ^{/1} A firm must ensure that its *terms of business* (including a *client agreement with a customer*) set out in adequate detail the basis on which *designated investment business* is to be conducted.
- 4.2.11** **E** ^{/1}
- (1) A firm should, in order to provide adequate detail, include in its *terms of business* provided to a *customer*:
 - (a) a provision about each item set out in **■ COB 4.2.15** and **■ COB 4.2.16**, except those the *customer* has requested not to be included; and
 - (b) any further or alternative provisions that the *customer* has asked for and on his own initiative agreed with the *firm*;

to the extent that each such provision is relevant in the circumstances and that it is practicable to provide it.
 - (2) Compliance with (1) may be relied on as tending to establish compliance with **■ COB 4.2.10**.
 - (3) Contravention of (1) may be relied on as tending to establish contravention of **■ COB 4.2.10**.
- 4.2.12** **R** ^{/1} A firm's *terms of business* provided to a *customer* may comprise more than one document, provided that it is clear that collectively they constitute the *terms of business*, and provided the use of several documents does not materially diminish the significance of any information the *firm* is required to give the *customer*, or the ease with which this can be understood.

Amendment of terms of business

4.2.13 **R** /1 If the *terms of business* provided to a *customer* allow a *firm* to amend its terms without the *customer's* consent, the *firm* must give at least ten *business days'* notice to a *customer* before conducting *designated investment business* with or for that *customer* on any amended terms, unless it is impracticable in the circumstances to do so.

4.2.14 **R** /1

(1) A *firm* must make a record of each *terms of business* it provides to a *customer*, and any amendment to them, as soon as the *terms of business* come into force.

(2) A *firm* must retain each record referred to in (1):

- (a) indefinitely, where the *terms of business* relate to a *pension transfer, pension opt-out* or *FSAVC*;
- (b) for six years, where the *terms of business* relate to a *life policy, pension contract* or *stakeholder pension scheme*; and
- (c) for three years in any other case.

(3) For the purposes of (2), the appropriate time period runs in each case from the date on which the *customer* ceases to be a *customer* of the *firm*.

4.2.15 **E** /1 Table Content of terms of business provided to a customer: general requirements
This table belongs to ■ COB 4.2.11.

General requirements	
A <i>firm's terms of business</i> (including a <i>client agreement</i>) provided to a <i>customer</i> should, where relevant, include some provision about:	
(1)	Commencement of the <i>terms of business</i> When and how the <i>terms of business</i> are to come into force.
(2)	Regulator The fact that the <i>firm</i> is regulated or authorised by the <i>FSA</i> .
(3)	Investment objectives The customer's investment objectives.
(4)	Restrictions
(a)	any restrictions on:
(i)	the types of <i>designated investment</i> in which the <i>customer</i> wishes to invest; and
(ii)	the markets on which the <i>customer</i> wishes transactions to be <i>executed</i> ; or
(b)	that there are no such restrictions.

General requirements	
(5)	<p>Services</p> <p>The services the <i>firm</i> will provide.</p>
(6)	<p>Payments for services</p> <p>Details of any payment for services payable by the <i>customer</i> to the <i>firm</i>, including where appropriate:</p> <ul style="list-style-type: none"> (a) the basis of calculation; (b) how it is to be paid and collected; (c) how frequently it is to be paid; <p>whether or not any other payment is receivable by the <i>firm</i> (or to its knowledge by any of its <i>associates</i>) in connection with any transaction <i>executed</i> by the <i>firm</i>, with or for the <i>customer</i>, in addition to or in lieu of any <i>fees</i>.</p>
(7)	<p>Disclosure of polarisation status</p> <p>Where the <i>firm</i> is to transact business in <i>packaged products</i> with <i>private customers</i>, a statement, in accordance with COB 5.1.17R (Disclosure of polarisation status generally) whether <i>advice on investments</i> about <i>packaged products</i> will be:</p> <ul style="list-style-type: none"> (a) independent; or (b) restricted to the <i>packaged products</i> of one <i>product provider</i> or <i>marketing group</i>; or (c) restricted to the <i>packaged products</i> of one <i>product provider</i> or <i>marketing group</i> but inclusive of <i>adopted packaged products</i>; or (d) given for the purposes of managing a portfolio with discretion.
(8)	<p><i>Investment manager</i></p> <p>If the <i>firm</i> is to act as an <i>investment manager</i>:</p> <ul style="list-style-type: none"> (a) the arrangements for giving instructions to the firm and acknowledging those instructions; (b) the initial value of the managed portfolio; (c) the initial composition of the managed portfolio; and (d) the period of account for which statements of the portfolio are to be provided in accordance with COB 8.2.4R (Requirement for a periodic statement) (where <i>periodic statements</i> are required).
(9)	<p>Accounting</p> <p>The arrangements for accounting to the <i>customer</i> for any transaction <i>executed</i> on his behalf.</p>

General requirements	
(10)	<p>Right to withdraw</p> <p>In the case of a non-packaged product ISA or PEP, an explanation of any right to withdraw (see COB 6.7 (Cancellation and withdrawal)) or, if it is the case, a statement that such rights will not apply.</p>
(11)	<p>Unsolicited real time financial promotions</p> <p>In the case of a private customer, the circumstances, if any, in which the firm or its representatives or employees may communicate an unsolicited real time financial promotion to the private customer.</p>
(12)	<p>Acting as a principal</p> <p>That the firm may act as principal in a transaction with the customer, if this is the case.</p>
(13)	<p>Conflict of interest and material interest</p> <p>When a material interest or conflict of interest may or does arise, the manner in which the firm will ensure fair treatment of the customer as required by COB 7.1.3R (Fair treatment).</p>
(14)	<p>Broker fund adviser</p> <p>If the firm acts as a broker fund adviser for a private customer, a statement explaining the nature of the firm's dual role as adviser to the customer and adviser to the life office or operator in question.</p>
(15)	<p>Use of soft commission agreements</p> <p>If the firm is to be authorised under the terms of business to undertake transactions with or through the agency of another person with whom the firm has a soft commission agreement, the prior disclosure required by COB 2.2.16R (Prior disclosure).</p>
(16)	<p>Customer's understanding of risk</p> <p>When a firm chooses to fulfil any of its obligations under COB 5.4.3R (Requirement for risk warnings) in the terms of business in relation to any of the following:</p> <ul style="list-style-type: none"> (a) warrants or derivatives; (b) non-readily realisable investments; (c) penny shares; (d) securities which may be subject to stabilisation; (e) stock lending activity; <p>the relevant risk warning.</p>
(17)	<p>Unregulated collective investment scheme</p> <p>That the services to be provided by the firm will or may include advice on investments relating to, or executing transactions in units in unregulated collective investment schemes, if this is the case.</p>

General requirements	
(18)	<p>Underwriting</p> <p>That the <i>firm</i> may enter into transactions for the <i>customer</i>, either generally or subject to specified limitations, when the <i>customer</i> will incur obligations as an underwriter or sub-underwriter, if this is the case.</p>
(19)	<p>Stock lending</p> <p>In the case of a <i>private customer</i>, that the <i>firm</i> may undertake <i>stock lending activity</i> with or for the <i>private customer</i> (if this is the case), specifying the assets to be lent, the type and value of <i>relevant collateral</i> from the borrower and the method and amount of payment due to the <i>private customer</i> in respect of the lending.</p>
(20)	<p>Right to realise a <i>private customer</i>'s assets</p> <p>The information required by COB 7.8.3R (Contractual rights to realise a private customer's assets), if applicable.</p>
(21)	<p>Complaints procedure</p> <p>How to complain to the <i>firm</i>, and a statement, if relevant, that the <i>customer</i> may subsequently complain directly to the <i>Financial Ombudsman Service</i>.</p>
(22)	<p>Compensation</p> <p>If applicable, an explanation of the compensation arrangements available to <i>customers</i> under the <i>Compensation Scheme</i> if the <i>firm</i> is unable to meet any of its liabilities, or the availability of an explanation describing those arrangements.</p>
(23)	<p>Termination method</p> <p>How the <i>terms of business</i> may be terminated, including a statement:</p> <ul style="list-style-type: none"> (a) that termination will be without prejudice to the completion of transactions already initiated, if this is the case; (b) that the <i>customer</i> may terminate the <i>terms of business</i> by written notice to the <i>firm</i> and when this may take effect; (c) that if the <i>firm</i> has the right to terminate the <i>terms of business</i>, it may do so by notice given to the <i>customer</i>, and specifying the minimum notice period, if any; and (d) of any agreed time after which, or any agreed event upon which, the <i>terms of business</i> will terminate.
(24)	<p>Termination consequences</p> <p>The way in which transactions in progress are to be dealt with upon termination.</p>
(25)	<p>Contracting out of best execution</p> <p>When the obligation to provide best execution can be and is to be waived, a statement:</p> <ul style="list-style-type: none"> (a) that the <i>firm</i> does not owe a duty of best execution; or

General requirements	
(b)	the circumstances in which it does not owe such a duty.
(26)	<p><i>Authorised professional firms</i></p> <p>If the <i>firm</i> is an <i>authorised professional firm</i> and may conduct a <i>non-mainstream regulated activity</i> with or for the <i>customer</i> (whether with or without any other <i>regulated activity</i> for the same <i>customer</i>), an explanation, with respect to that activity, of:</p> <p>(a) how to complain to the <i>firm</i>, where the <i>customer</i> may subsequently complain and the mechanisms that operate in respect of such a subsequent complaint; and</p> <p>(b) what, if any, compensation arrangements are available to the <i>customer</i> if the <i>firm</i> is unable to meet any of its liabilities, or the availability of an explanation describing those arrangements.</p>

4.2.16



Table Content of terms of business provided to a customer: managing investments on a discretionary basis
This table belongs to ■ COB 4.2.11.

Managing investments on a discretionary basis	
Additional contents in respect of discretionary management	
In respect of discretionary management, <i>terms of business</i> (including a <i>client agreement</i>) provided to a <i>customer</i> should, in addition, include some provision about each of:	
(1)	<p>Extent of discretion</p> <p>(a) the extent of the discretion to be exercised by the <i>firm</i>, including any restrictions on:</p> <p>(i) the value of any one <i>investment</i>; and</p> <p>(ii) the proportion of the portfolio which any one <i>investment</i> or any particular kind of <i>investment</i> may constitute; or</p> <p>(b) that there are no such restrictions.</p>
(2)	<p><i>Periodic statements</i></p> <p>(a) The frequency of any <i>periodic statements</i>, except when a <i>periodic statement</i> is not required by COB 8.2.7R (Promptness, suitable intervals and adequate information); and</p> <p>(b) whether those statements will include some measure of performance, and if so, what the basis of that measurement will be.</p>
(3)	<p>Valuation</p> <p>The basis on which assets comprised in the portfolio are to be valued.</p>

Managing investments on a discretionary basis	
(4)	<p>Borrowings</p> <p>That the <i>firm</i> may commit the <i>customer</i> to supplement the funds in the portfolio, including borrowing on his behalf, if this is the case, and, if it may:</p> <ul style="list-style-type: none">(a) the circumstances in which the <i>firm</i> may do so;(b) whether there are any limits on the extent to which the <i>firm</i> may do so and, if so, what those limits are; and(c) any circumstances in which such limits may be exceeded.
(5)	<p>Underwriting commitments</p> <p>If it is the case, that the <i>firm</i> may commit the <i>customer</i> to any obligation to underwrite or sub-underwrite any issue or offer for sale of <i>securities</i>, and:</p> <ul style="list-style-type: none">(a) whether there are any restrictions on the categories of <i>securities</i> which may be underwritten and, if so, what these restrictions are; and(b) whether there are any financial limits on the extent of the underwriting and, if so, what these limits are.

Chapter 5

Advising and selling



5.1 Polarisation and Status Disclosure

Application

- 5.1.1 **R** This section applies to a *firm* which gives *advice on investments* to a *private customer on packaged products* (including *adopted packaged products*), and to a *firm* which is a member of a *marketing group*.

Purpose

- 5.1.2 **G** This section gives support to *Principle 6* (Customers' interests) and *Principle 7* (Communications with clients) which require *firms* to have due regard to the information needs of their *customers* and treat them fairly. When *advice on investments* which are *packaged products* is given it is important that a *private customer* is always clear whether a *firm*, its *advisers* or *representatives*, will act solely in his interests or whether the range of advice offered by the *firm* will be constrained by the nature and number of the *firm's* commercial relationships. Accordingly, the *rules* and *guidance* in **■ COB 5.1** give effect to the regulatory policy of polarisation which, in relation only to advice on *packaged products* requires a *firm* to act either independently for the *private customer*, or to act on a tied basis where advice is restricted to its own products, those of its *marketing group* and *adopted packaged products*. Polarisation does not extend to an *execution-only transaction* or to a *financial promotion* of a *packaged product* which does not contain any *advice on investments*.
- 5.1.3 **G** As well as giving effect to the policy of polarisation, the *rules* and *guidance* in this section require *firms* to take reasonable steps to disclose their polarised status to *private customers* in a clear and timely way.

Adoption of packaged products

- 5.1.4 **R** (1) If a decision is made by a *provider firm* to provide *advice on investments* in accordance with this section, to a *private customer* on a *stakeholder pension scheme* produced by a *person* ("the producer") other than the *firm* (or, where applicable, outside the *marketing group* of the *firm*), then that *stakeholder pension scheme* becomes an *adopted packaged product* of the *firm* (and, where relevant, of all the members of its *marketing group*).

- (2) If a decision under (1) is to be made in respect of the members of a *marketing group*, the *product provider* in the group adopting the product must ensure that the decision is made by a *firm* which is a member of the group and which is selected for that purpose by the *product provider*.
- (3) The *product provider* or, where (2) applies, the selected *firm* must:
- (a) make a record of each decision made under (1), and
 - (b) retain that record throughout the period during which the decision remains in effect, and for a period of six years thereafter.
- (4) If the *product provider's* selection at (2) is changed, then (3)(b) shall have effect in relation to the new *firm* selected as if it had made all the decisions itself.

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A decision to adopt a *packaged product* may relate to a *stakeholder pension scheme* produced by a *person* who is not an *authorised person* if the conditions in ■ COB 3.13.1 (overseas insurance business) are, where applicable, satisfied.

5.1.6

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When *advice on investments* is given by a *provider firm* or its *appointed representative* on an *adopted packaged product*, the *provider firm* is responsible for the advice given. By contrast, the producer is responsible for the relevant terms and conditions of the *adopted packaged product*. It is, however, acceptable for the *provider firm* and the producer to set up arrangements, for example a one-stop shop for customer information and customer complaints handling, under a service level agreement, provided that this still secures for the customers an equivalent standard of service and, if appropriate, redress. Any such arrangements should be made clear to the customer at the advisory stage.

Tied advice by provider firms

5.1.7

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- (1) A *provider firm* must, subject to (2), take reasonable steps to ensure that neither it nor any of its *employees* or *representatives* gives *advice on investments* to a *private customer* about the purchase of a *packaged product* unless the product is:
- (a) issued by the *firm* itself or by another member of its *marketing group*; or
 - (b) an *adopted packaged product*.
- (2) The restriction in (1) does not apply to a *provider firm* when it acts as an *investment manager* but only when it manages *designated investments* on a discretionary basis.

5.1.8

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A *provider firm* must take reasonable steps to ensure that each of its *appointed representatives* complies with the requirements in ■ COB 5.1.7 – ■ COB 5.1.15.

- 5.1.9** G_{/1} ■ COB 5.1.7(1) does not inhibit the sale by a *provider firm* where the sale does not involve the provision of *advice on investments* to a *private customer*. A *provider firm* may act as an intermediary for a transaction in a *packaged product* where that transaction is an *execution-only transaction*.
- 5.1.10** G_{/1} ■ COB 5.1.7(1) applies to *advice on investments* given to *private customers* about the components of an *ISA* which are *packaged products*.
- 5.1.11** R_{/1} A *provider firm* must take reasonable steps to ensure that neither it nor any of its *employees, representatives* or *introducers* says or does, or omits to say or do, anything which might lead a *private customer* reasonably to believe that it is in a position to *advise on investments* or procure *advice on investments* which are *packaged products* other than those of its *marketing group* or its *adopted packaged products*.
- 5.1.12** R_{/1}
- (1) A *provider firm* must, subject to (2), take reasonable steps to ensure that its *representatives* are able to sell with advice each type of *packaged product* that it issues itself, or is issued by a member of its *marketing group*, or is an *adopted packaged product*.
 - (2) A *provider firm* may restrict the type of *packaged product* it authorises a particular *representative* to sell, if:
 - (a) that *representative* is not sufficiently competent to sell certain types of product; and
 - (b) it requires that *representative* to identify instances when another *packaged product* of its own, or of the *marketing group*, or an *adopted packaged product* outside his own restricted range ought to be recommended. The representative must then refer the *private customer* to another *representative* within the *marketing group* who is authorised and competent to sell that product.
- 5.1.13** R_{/1} A *provider firm* must take reasonable steps to ensure that its *representatives*:
- (1) are not likely to be influenced by the structure of their *remuneration* to give unsuitable *advice on investments* to a *private customer*; and
 - (2) do not refer *private customers* to an *independent intermediary* in circumstances which would amount to the provision of an inducement under ■ COB 2.2.3 (Prohibition of inducements).
- 5.1.14** R_{/1} A *firm* which is a *provider firm* must, if it gives *advice on investments* to a *private customer* about an *adopted packaged product*, ensure that it does so only in accordance with arrangements under which the *firm* discloses any charges imposed by the *firm* in excess of those charged by the producer of the *adopted packaged product*.

- 5.1.15 **R** /1 A *firm* giving *advice on investments to private customers* about *adopted packaged products* must ensure that its *private customers* are informed on a timely basis of the arrangements set out in **COB 5.1.14** orally on first contact and subsequently in the *terms of business*.

Independent advice

- 5.1.16 **R** /1
- (1) An *independent intermediary* must act in the best interests of its *private customers* when it gives *advice on investments* which are *packaged products*.
 - (2) An *independent intermediary* must not enter into commercial arrangements with other *persons* which might be likely adversely to affect its ability to provide *advice on packaged products* on an independent basis.
 - (3) An *independent intermediary* must take reasonable steps to ensure that its *appointed representatives* comply with the requirements of (1) and (2).

Disclosure of polarisation status generally

- 5.1.17 **R** /1 A *firm* must ensure that *private customers* are informed on a timely basis whether any *advice on investments* which the *firm* may give on *packaged products* will be:
- (1) independent; or
 - (2) restricted to the *packaged products* of one *product provider* or *marketing group*; or
 - (3) restricted to the *packaged products* of one *product provider* or *marketing group* and the *packaged products* outside the *firm's marketing group* that have been adopted; or
 - (4) given for the purposes of managing a portfolio with discretion.

- 5.1.18 **R** /1 Where a *firm* which is a *provider firm* decides to give *advice on investments* about an *adopted packaged product*, it must take reasonable steps to ensure that any communication with a *private customer*, whether written or oral makes clear that *advice on investments* can be given about *adopted packaged products*.

Disclosure on first contact with a private customer: provider firms

- 5.1.19 **R** /1 A *provider firm* must take reasonable steps to ensure that each of its *introducers* and *representatives*, when first making contact with a

private customer, (including a private customer of its appointed representatives):

- (1) states the name of the *firm* and identifies himself as an *introducer* or *representative* of the *provider firm* or of its *marketing group*; and either
 - (a) makes it clear that the *firm* provides *advice on investments* only about the *packaged products* of the *provider firm* or of its *marketing group*; or
 - (b) makes it clear that the *firm* provides *advice on investments* only about the *packaged products* of the *provider firm* or of its *marketing group* and on its *adopted packaged products*.

Disclosure on first contact with a private customer: independent intermediaries

5.1.20

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An *independent intermediary* must take reasonable steps to ensure that its *financial advisers* (including those of its *appointed representatives*), when first making contact with a *private customer*:

- (1) state the name of the *firm*; and
- (2) make it clear that the *firm* provides *independent advice*.

Disclosure on first contact by electronic means generally

5.1.21

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When the first contact with a *private customer* is carried out by electronic means, the *firm* should ensure that a message specifying the *firm's* polarisation status is prominently displayed at the outset of any presentation or series of screens.

5.1.22

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The message in ■ COB 5.1.21 should be clearly visible and not hidden in some way, for example within other text, by having print size too small to be easily legible or by including it in an area which can be bypassed without giving the *private customer* an opportunity to read it in full.

Disclosure in specific non-real time financial promotions: provider firms

5.1.23

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Provider firms are reminded that ■ COB 3.8.19 (specific non-real time financial promotions: provider firms) requires a *provider firm* to disclose its polarisation status in any *specific non-real time financial promotion* relating to a *packaged product* that it *communicates* or *approves*.



5.2 Know your customer

Application

- 5.2.1 **R** This section applies to a *firm* that:
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- (1) gives a *personal recommendation* concerning a *designated investment* to a *private customer*; or
 - (2) acts as an *investment manager* for a *private customer*; or
 - (3) arranges a *pension opt-out* or *pension transfer* from an *occupational pension scheme* for a *private customer*.
- 5.2.2 **G** A *firm* that arranges an *execution-only transaction* for a *private customer* is not generally required to obtain any personal or financial information about that *customer*, except when the *Money Laundering* sourcebook applies.
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- 5.2.3 **G** When a *firm* provides limited *advice on investments* to a *private customer*, the *firm* should not treat any resulting transaction as an execution-only one.
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Purpose

- 5.2.4 **G** *Principle 9* (Customers: relationships of trust) requires a *firm* to take reasonable care to ensure the suitability of its advice and discretionary decisions. To comply with this, a *firm* should obtain sufficient information about its *private customer* to enable it to meet its responsibility to give suitable advice. A *firm* acting as a discretionary *investment manager* for a *private customer* should also ensure that before acting in the exercise of discretion it has sufficient information about its *private customer* to enable it to act in a way which is suitable for that *private customer*.
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Requirement to know your customer

- 5.2.5 **R** Before a *firm* gives a *personal recommendation* concerning a *designated investment* to a *private customer*, or acts as an *investment manager* for a *private customer*, it must take reasonable steps to ensure that it is in possession of sufficient personal and financial
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information about that *customer* relevant to the services that the *firm* has agreed to provide.

5.2.6 **G**_{/1} A *firm* that advises a *private customer*, or exercises discretion for a *private customer*, on a continuing basis should keep its information about that *customer* under regular review. A *firm* that acts for a *private customer* on an occasional basis should undertake such a review whenever that *customer* seeks *advice*.

5.2.7 **G**_{/1} If a *private customer* declines to provide relevant personal and financial information, a *firm* should not proceed to provide the services described in ■ COB 5.2.5 without promptly advising that *customer* that the lack of such information may affect adversely the quality of the services which it can provide. The *firm* should consider sending written confirmation of that advice.

5.2.8 **G**_{/1} The information to be obtained and enquiries made to satisfy ■ COB 5.2.5 may vary significantly depending on the type of *customer* concerned. ■ COB 5.2.11 provides some *guidance* on the process of collecting personal and financial information.

Record keeping: personal and financial circumstances

5.2.9 **R**_{/1} A *firm* must make and retain a record of a *private customer's* personal and financial circumstances that it has obtained in satisfying ■ COB 5.2.5. The record must be retained for a minimum period after the information is obtained, as follows:

- (1) indefinitely for a record relating to a *pension transfer, pension opt-out or free-standing additional voluntary contribution (FSAVC)*;
- (2) six years for a record relating to a *life policy or pension contract*;
- (3) three years in any other case.

Record keeping: execution-only pension opt-outs and pension transfers

5.2.10 **R**_{/1} When a *firm* arranges a *pension opt-out* or *pension transfer* from an OPS for a *private customer* as an *execution-only transaction*, the *firm* must make and retain a clear record to evidence that no *advice on investments* was supplied to the *private customer*.

5.2.11 **G**_{/1} Table Guidance on the collection of information about a private customer. This table belongs to ■ COB 5.2.8.

Guidance on the collection of personal and financial information about a private customer

- 1 *COB 5.2.5R* does not prescribe the method of obtaining sufficient personal and financial information about a *private customer*. A *firm* may design and use a process suitable for the market in which it transacts business. This process is often described as "fact-finding" and the *document* which records the information is often known as the "fact-find".
- (a) Information collected from a *private customer* should, at a minimum provide an analysis of a *customer's* personal and financial circumstances leading to a clear identification of his needs and priorities so that, combined with attitude to risk, a suitable *investment* can be recommended.
 - (b) A *customer* information record can be electronic or paper based and it should be readily available and accessible at all times.
 - (c) There is no *requirement* under the *regulatory system* to obtain the *private customer's* consent in writing to a *customer* information record. When a *customer* is to give consent in writing to an information record, the request for consent should include a prominent warning advising the *customer* to read the information record in full before giving consent.
 - (d) *Firms* may send a *customer* a copy of the information record as proof of compliance with *COB 5.3.14R* (Suitability letter). Further *guidance* on the contents of *suitability letters* is contained in *COB 5.3.29G*.

Affordability

- 2 In assessing whether a *private customer* can afford an *investment*, due regard should be given to that *customer's* current level of income and expenditure, and any likely *future* changes to his income and expenditure.

Friendly society life policies

- 3 When recommending a *friendly society life policy*, the *premium* of which does not exceed £50 a year or, if the *premiums* are payable weekly, £1 a week, the *firm* should:
- (a) obtain details of the *private customer's* (and his dependants') net income and expenditure; and
 - (b) keep a record of the reasons why the recommended transaction is considered to be suitable for that individual *customer*.



5.3 Suitability

Application

5.3.1

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This section applies to a *firm* when it:

- (1) makes a *personal recommendation* concerning a *designated investment* to a *private customer*; or
- (2) acts as an *investment manager* for a *private customer*; or
- (3) manages the assets of an *occupational pension scheme* (OPS) or a *stakeholder pension scheme*; or
- (4) promotes a *personal pension scheme* by means of a *direct offer financial promotion* to a group of *employees*.

5.3.2

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This section does not apply to a *firm* in respect of a *direct offer financial promotion*, except in respect of a promotion of a *personal pension scheme* under ■ COB 5.3.28.

5.3.3

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Firms are reminded of the requirements of ■ COB 3.9.7(Direct offer financial promotions: general requirements) a *direct offer financial promotion* must make it clear that, if a *private customer* is in any doubt about the suitability of the agreement which is the subject of the promotion, he should contact the *firm*, or an *independent intermediary* if the *firm* does not offer *advice*.

Purpose

5.3.4

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Principle 9 (Customers: relationships of trust) requires a *firm* to take reasonable care to ensure the suitability of its advice and discretionary decisions. The purpose of this section is to amplify this requirement. The nature of the steps *firms* need to take will vary greatly, depending on the needs and priorities of the *private customer*, the type of *investment* or service being offered, and the nature of the relationship between the *firm* and the *private customer* and, in particular, whether the *firm* is giving a *personal recommendation* or acting as a discretionary *investment manager*.

Requirement for suitability generally

5.3.5

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(1) A *firm* must take reasonable steps to ensure that it does not in the course of *designated investment business*:

- (a) make any *personal recommendation* to a *private customer* to buy or sell a *designated investment*; or
- (b) effect a discretionary transaction for a *private customer* (except as in (3));

unless the recommendation or transaction is suitable for the *private customer* having regard to the facts disclosed by him and other relevant facts about the *private customer* of which the *firm* is, or reasonably should be, aware.

(2) A *firm* which acts as an *investment manager* for a *private customer* must take reasonable steps to ensure that the *private customer's* portfolio or account remains suitable, having regard to the facts disclosed by the *private customer* and other relevant facts about the *private customer* of which the *firm* is or reasonably should be aware.

(3) Where, with the agreement of the *private customer*, a *firm* has pooled his funds with those of others with a view to taking common discretionary management decisions, the *firm* must take reasonable steps to ensure that a discretionary transaction is suitable for the fund, having regard to the stated *investment objectives* of the fund.

Requirements for suitability: provider firms

5.3.6

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If a *provider firm* makes a *personal recommendation* to a *private customer* to buy a *packaged product*, it must, unless **■ COB 5.3.8(1)** applies, take reasonable steps to ensure that:

- (1) the recommended *packaged product* is the most suitable (taking account of **■ COB 5.3.8(2)**) of those available from the *marketing group* and the *adopted packaged products* that the *firm* is able to sell; and
- (2) no recommendation is made if there is no suitable *packaged product* available from within the *marketing group* and the *adopted packaged products* that the *firm* is able to sell.

5.3.7

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For the purposes of **■ COB 5.3.6(1)**, a *packaged product* will not be more suitable than another only because it is available at a more favourable price through an alternative distribution channel, or on special terms offered by the *provider firm*, and its availability is restricted.

- 5.3.8** G_{/1} (1) In satisfying ■ COB 5.3.6, a *provider firm* may refer a *private customer* to an *independent intermediary* provided it does so in accordance with ■ COB 2.2 (Inducements and soft commission).
- (2) ■ COB 5.3.6 does not apply to a *provider firm* when it is acting as an *investment manager* but only when it manages designated investments on a discretionary basis.

Requirement for suitability: independent intermediary

- 5.3.9** R_{/1} An *independent intermediary* must not make a *personal recommendation* to a *private customer* to buy:
- (1) a *packaged product* if it ought reasonably to be aware of a generally available *packaged product* which would be more appropriate to the needs and circumstances of the *private customer*; or
- (2) a *packaged product* issued or operated by an *associate* if it ought reasonably to be aware of another generally available *packaged product* which could satisfy the needs and circumstances of the *private customer* as well as the connected *packaged product* (but see ■ COB 5.3.11).

- 5.3.10** R_{/1} ■ COB 5.3.9(2) does not apply to a *firm* acting as an *investment manager*.

- 5.3.11** G_{/1} In complying with the requirements of ■ COB 5.3.9, an *independent intermediary* should have an adequate knowledge of and have regard to the *packaged products* available from the market as a whole.

Requirement for suitability: manager of OPS and stakeholder pension scheme

- 5.3.12** R_{/1} A *firm* that manages the assets of an *occupational pension scheme* or *stakeholder pension scheme* must take reasonable steps to ensure the suitability of specific transactions and of the investment portfolio under management with regard to the *investment* objectives specified in the portfolio mandate.

Requirements for suitability: other specific requirements

- 5.3.13** G_{/1} (1) ■ COB 5.3.20 contains specific *rules* applicable to the suitability of *broker funds*.
- (2) ■ COB 5.3.21 - ■ COB 5.3.27 contain specific *rules* applicable to the suitability of *pension transfers* and *pension opt-outs*.

- (3) ■ COB 5.3.28 contains specific *rules* applicable to the promotion of *personal pension schemes*, including *group personal pension schemes* by means of *direct offer financial promotions*.
- (4) ■ COB 5.3.29 contains *guidance* which is relevant for assessing the suitability of:
 - (a) *pension transfers* and *pension opt-outs*;
 - (b) *personal pension schemes* and *free-standing additional voluntary contributions* (FSAVCs) compared to *stakeholder pension schemes*;
 - (c) hybrid products;
 - (d) *industrial assurance policies*;
 - (e) *income withdrawals*;
 - (f) *ISA* or *PEP transfers*; and
 - (g) contracting out of SERPS.

Requirement for a suitability letter

5.3.14

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If, following a *personal recommendation* by the *firm*, a *private customer*:

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- (1) buys, sells, surrenders, converts, cancels, or suspends *premiums* for or contributions to, a *life policy* or a *stakeholder pension scheme*; or
- (2) elects to make *income withdrawals*; or
- (3) acquires a holding in, or sells all or part of a holding in, a *scheme*; or
- (4) enters into a *pension transfer* or *pension opt-out* from an OPS;

the *firm* must provide the *customer* with a *suitability letter*, within the time period stipulated by ■ COB 5.3.18, unless one of the exceptions in ■ COB 5.3.19 applies.

5.3.15

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A *suitability letter* is not required in respect of a personal recommendation made by a *firm* to buy or sell *shares* or *units* in a *regulated collective investment scheme* when the *firm* is acting as an *investment manager* for a *private customer* (see ■ COB 5.3.19(1)).

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5.3.16

R

The *suitability letter* in ■ COB 5.3.14 must:

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- (1) explain why the *firm* has concluded that the transaction is suitable for the *customer*, having regard to his personal and financial circumstances;

- (2) contain a summary of the main consequences and any possible disadvantages of the transaction;
- (3) (a) in the case of a *personal pension scheme* which is not a *stakeholder pension scheme*, explain the reasons why the *firm* considers the *personal pension scheme* to be at least as suitable as a *stakeholder pension scheme*;
- (b) in the case of an FSAVC
 - (i) if the *customer* has the alternative of a *stakeholder pension scheme*, explain the reasons why the *firm* considers the recommended contract to be at least as suitable as a *stakeholder pension scheme* or as any *additional voluntary contribution* (AVC) or the facility to make additional contributions to the *occupational pension scheme* which may be available; or
 - (ii) if the *customer* does not have the alternative of a *stakeholder pension scheme*, explain the reasons why the *firm* considers the recommended contract to be at least as suitable as any AVC or the facility to make additional contributions to the *occupational pension scheme* which may be available; and
- (4) identify the individual who is authorised by the *firm* to advise on the type of product that has been recommended.

5.3.17

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■ COB 5.3.30 provides *guidance* on the contents of *suitability letters*.

5.3.18

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The *firm* must provide the letter required by ■ COB 5.3.14 to the *customer*:

- (1) in the case of a *life policy* or *stakeholder pension scheme*, where the *cancellation rules* require notification of the right to cancel, no later than the issue of the post-sale notice of the *customer's* right to cancel; or
- (2) in any other case, when or as soon as possible after the transaction is effected.

Exceptions from requirement to provide a suitability letter

5.3.19

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■ COB 5.3.14 does not apply:

- (1) if the *firm* is acting as an *investment manager* for a *private customer* and makes a *personal recommendation* relating to a *regulated collective investment scheme*;

- (2) if the *customer* is habitually resident in another *EEA State* at the time of acknowledging consent to the proposal form to which the *personal recommendation* relates;
- (3) if the *customer* is habitually resident outside the *EEA* and the *customer* is not present in the *United Kingdom* at the time of acknowledging consent to the proposal form to which the *personal recommendation* relates;
- (4) to any *personal recommendation* for a *life policy* sold by a *friendly society* with a *premium* not exceeding £50 a year or, if payable weekly, £1 a week;
- (5) to any *personal recommendation* to increase a regular *premium* to an existing contract; and
- (6) to any *personal recommendation* to invest additional single *premiums* or single contributions to an existing *packaged product* to which a single *premium* or single contribution has previously been paid.

Suitability of broker funds

5.3.20

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A *firm* acting as a *broker fund adviser* for a *private customer* must:

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- (1) take account of the characteristics of the *broker fund*, including the charging arrangements, in total, when assessing the suitability of the arrangements;
- (2) review on a regular basis the *customer's* current *investment* objectives and strategies relative to those at the time of any previous periodic report to the *customer* in accordance with **COB 8.2.4** (Requirement for a periodic statement);
- (3) follow up the review with a recommendation in writing to the *customer*, to be provided at least annually, either to continue with the *investment* or to withdraw, and in either case to supply reasons for the recommendation;
- (4) provide the *customer* with an alternative recommendation if the *broker fund arrangement* is no longer suitable; and
- (5) ensure that any significant change in the *investment* strategy of the fund, where known to the *firm*, is notified to the *customer* in advance together with confirmation why the fund continues to be suitable for the *customer's* circumstances or an alternative recommendation.

Suitability of pension transfers and opt-outs

5.3.21 **R** /1 If a *personal recommendation* about a *pension transfer* or *pension opt-out* is to be made on a *firm's* behalf by an individual who is not one of its *pension transfer specialists*, the *firm* must have established procedures for checking:

- (1) the individual's compliance with the *firm's* procedures;
- (2) the correctness of the application of the *transfer value analysis* system, where applicable; and
- (3) the merits of the proposed transaction and the suitability of the recommendation;

and any such recommendation must be assessed by one of the *firm's* designated *pension transfer specialists* to ensure the procedures have been followed.

5.3.22 **R** /1 (1) A *firm* must ensure that a *transfer value analysis* is carried out in accordance with ■ COB 6.6.87 – ■ COB 6.6.93 (Projections) before it makes any recommendation to a *customer* to transfer out of a *defined benefits pension scheme*.

(2) A copy of the analysis must be delivered with the *key features document* or otherwise provided to the *customer* before he gives consent to the application to transfer.

(3) The *firm* must take reasonable steps to ensure the *customer* understands the analysis, drawing attention to factors which do and do not support the recommendation to transfer.

5.3.23 **R** /1 A *firm* must provide a *projection* of the possible *future* benefits of the proposed *individual pension contract* before it makes any *personal recommendation* to a *customer* to opt out of, or transfer from, an *occupational pension scheme*.

(1) The format and nature of the benefits given in the *projection* must, so far as possible, be the same as those which apply under the *occupational pension scheme* of which the *customer* is, or is *eligible* to become, a member.

(2) If it is not possible for the benefits shown in the *projection* to replicate those of the *occupational pension scheme*, an explanation must be given.

(3) If the *customer* has expressed an interest in changing the structure of his eventual benefits, an additional *projection* may also be prepared on that basis.

5.3.24 **R** /1 A *suitability letter* relating to a *personal recommendation* to opt out of or transfer from an *occupational pension scheme* must include:

5.3.25

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- (1) a summary of the disadvantages as well as the advantages of opting out or transferring; and
- (2) in the case of a *pension opt out*, a financial analysis explaining the decision to opt-out.

If, contrary to the *advice* of the *firm*, a *private customer* instructs the *firm* to arrange a *pension opt-out* or *pension transfer*, the *firm* must:

- (1) make and retain a clear record of the *firm's advice* that the *private customer* should not proceed with the *pension opt-out* or *pension transfer* and the *private customer's* instructions to proceed with the transaction; and
- (2) provide a further confirmation and explanation, in writing, to the *private customer* that the *firm's advice* is that the *private customer* should not proceed with the *pension opt-out* or *pension transfer*.

5.3.26

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- (1) Every six months, a *firm* must notify the *FSA*, in writing, of the number of opt out and transfer transactions within **■ COB 5.3.25** which it has handled during the previous six months; and it must also supply, at quarterly intervals, the following details in respect of the preceding quarter:
 - (a) the number of execution-only *pension opt-outs* or *pension transfers* arranged if they exceed 1% of all the *firm's pension opt-outs* or *pension transfers* arranged during that quarter;
 - (b) the number of *pension opt-outs* and *pension transfers* arranged against the *firm's advice* if they exceed 1% of all the opt outs and transfers arranged by the *firm* during that quarter; and
 - (c) the number of *pension opt outs* and *pension transfers* arranged on a correspondence-only basis if they exceed 1% of all the the opt outs and transfers arranged by the *firm* during that quarter.
- (2) A *firm* must retain records of the notifications required by (1) indefinitely.

5.3.27

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A *firm* must keep separate records for each *private customer* of every *pension transfer*, *pension opt-out* or *free-standing additional voluntary contribution* (FSAVC) which it has arranged, whether advised or not, and retain these records indefinitely.

Suitability of personal pension schemes: promotions to employees

5.3.28 **R** /1 When a *firm* promotes a *personal pension scheme*, including a *group personal pension scheme*, by means of a *direct offer financial promotion* to a group of *employees*, the *firm* must be satisfied on reasonable grounds that the *pension scheme* is likely to be at least as suitable for the majority of the *employees* as a *stakeholder pension scheme*, and must record why it thinks the promotion is justified.

5.3.29 **G** /1 Table Guidance on matters which should be taken into account when assessing the suitability of various personal recommendations. This table belongs to ■ COB 5.3.13(4).

Suitability guidance	
A	Pension Transfers and Pension Opt-outs
1	When advising a <i>customer</i> who is, or is eligible to be, an active member of a <i>defined benefit occupational pension scheme</i> whether he should opt out or transfer, a <i>firm</i> should: <ul style="list-style-type: none"> (a) start by assuming it will not be suitable; and (b) only then consider it to be suitable if it can clearly demonstrate on the evidence available at the time that it is in the <i>customer's</i> best interests.
2	When the <i>firm</i> is recommending a <i>customer</i> to transfer or opt out of any other type of <i>occupational pension scheme</i> , the <i>suitability letter</i> should include: <ul style="list-style-type: none"> (a) a clear explanation why transferring or opting out is more suitable than remaining in the <i>occupational pension scheme</i>; (b) a request for the <i>customer</i> to contact the <i>firm</i> immediately should clarification or further information be needed or if the letter does not match the <i>customer's</i> understanding of why the transfer or opt-out has been recommended; (c) a statement to the effect that the <i>firm</i> has relied on information supplied by the <i>customer</i> and the <i>occupational pension scheme</i>; (d) particularly with <i>pension opt-outs</i>, an arithmetical analysis setting out the financial implications of leaving the <i>scheme</i>;
	Pension Opt-outs only
3.	When advising on a <i>pension opt-out</i> from an <i>occupational pension scheme</i> , a <i>firm</i> should: <ul style="list-style-type: none"> (a) identify all the rights and benefits available to the <i>customer</i> under the <i>occupational pension scheme</i> and carefully consider the effect of replacing them with the very different benefits of a personal pension; the following factors should be taken into account relating to the <i>occupational pension scheme</i>: <ul style="list-style-type: none"> (i) spouse's, dependants' and children's pensions; (ii) early retirement provision, including retirement in ill-health; (iii) revaluation rates both in deferment and payment, and whether they are guaranteed or discretionary (and if discretionary, whether likely to continue); (iv) ancillary benefits (for example, tax-free cash or lump-sum death benefits);

Suitability guidance	
	<ul style="list-style-type: none"> (v) transfer club arrangements, where applicable; (vi) the <i>customer's</i> contribution and the employer's contribution; (vii) benefits on leaving service; (viii) whether or not eligibility for other benefits, such as <i>permanent health</i> insurance, is dependent on being a member of the <i>occupational pension scheme</i>; (ix) the financial security of the <i>occupational pension scheme</i>, by reference (for example) to the last actuarial statement or the most recent <i>trustees'</i> report and accounts; and
	<p>(b) take into account the following additional factors:</p> <ul style="list-style-type: none"> (i) whether or not the employer would contribute to the <i>personal pension scheme</i>; (ii) the charging structure of the personal pension and its impact on transfer values in the early years; (iii) subjective factors relating to the <i>customer's</i> personal circumstances such as: <ul style="list-style-type: none"> – future career plans and earning prospects (including any reasonable likelihood of career progression making better occupational terms available) and intended retirement date; – attitude towards earnings-related compared with <i>money-purchase benefits</i>; – attitude to financial risk and security; – a possible wish to make pension arrangements separate from employment (for example, because the <i>customer</i> is on a short-term non-renewable employment contract or does not expect to stay in his current employment for more than a short period); – any value the <i>customer</i> attaches to personal control; – the <i>customer's</i> cash needs;
	<p>(c) if the <i>customer</i> is about to change, or has just changed, employment, consider the <i>issues</i> in (ii) and (iii) in relation to any <i>scheme</i> of the new employer for which the <i>customer</i> is eligible now, or will become eligible in the near future;</p>
	<p>(d) if the <i>customer</i> is an active or prospective <i>member</i> of a <i>money-purchase occupational scheme</i>, follow 1– 3 to the extent that the factors listed are relevant to such <i>schemes</i> taking particular account of differences in costs and <i>charges</i>.</p>
	<p>Pension Transfers only</p>
4.	<p>(a) Advising a <i>customer</i> on the suitability of transferring deferred benefits from a <i>defined benefit occupational pension scheme</i> requires detailed consideration of the ceding <i>scheme</i> compared to the <i>individual pension contract</i> to which the transfer would take place. A process will be needed which should include procedures:</p> <ul style="list-style-type: none"> (i) for gathering ceding <i>scheme</i> information as detailed in (b);

Suitability guidance	
	<ul style="list-style-type: none"> (ii) to assess the <i>customer's</i> attitude to risk and <i>security</i>; this is relevant not merely to the choice of contract or fund, but also (and more fundamentally) to the initial choice between an <i>occupational pension scheme</i> and an <i>individual pension contract</i>; (iii) to ascertain the <i>customer's</i> career aspirations and desired retirement age and to consider what a realistic retirement age would be, having regard to the size of the transfer value and the extent to which it can be converted into a stream of income before State pension age; (iv) to ascertain whether the <i>customer's</i> new employer (if any) has arrangements to accept transferred benefits, as if so a further analysis may be necessary; (v) enabling the <i>adviser</i> to look at other pension options, if available; (vi) for carrying out a transfer value analysis; (vii) for enabling the <i>customer</i> to receive sufficient, clear information to make an informed <i>investment</i> decision (see (iii)).
(b)	<p>The following information as a minimum will be needed from the ceding <i>scheme</i> in respect of the <i>customer</i>:</p> <ul style="list-style-type: none"> (i) spouse's, dependants' and children's pensions; (ii) early retirement provision, including retirement in ill-health; (iii) transfer value quotation detailing: <ul style="list-style-type: none"> – guarantee period; – pre- and post- April 1988 Guaranteed Minimum Pension and Excesses; – revaluation rates in deferment and payment and whether they are guaranteed or discretionary and if discretionary whether they are likely to continue and how far they are reflected in the transfer value; – tax-free cash arrangements; (iv) lump-sum death benefits; (v) transfer club arrangements, if applicable; (vi) relevant earnings; (vii) period of service; (viii) <i>scheme</i> details (for example benefits, bridging pensions, guarantee periods, position pre- and post- normal retirement date, history of discretionary increases); (ix) whether members' benefits have been equalised for service from 17 May 1990; (x) ill-health benefits; (xi) a consideration of the <i>scheme's</i> financial position and whether the transfer value has been reduced because the <i>scheme</i> is underfunded.
(c)	<p>Relevant items of information about the <i>customer</i> include:</p>

Suitability guidance	
	<ul style="list-style-type: none"> (i) the different risks of <i>personal pension schemes</i> and <i>defined benefit pension schemes</i>; (ii) the impact of fluctuations in annuity rates on the size of the eventual pension; (iii) the impact of <i>protected rights</i> on the planned retirement date; (iv) any changes to the tax-free lump-sum; (v) any reduction in immediate death benefits; (vi) the transfer value analysis including an indication of the rate of growth needed to ensure the investor is no worse off as a result of any transfer; (vii) the position and interests of the <i>customer's</i> spouse and dependants.
	<p>(d) (a) – (c) also apply to prospective <i>money-purchase benefits</i> transfers where appropriate; and additional information concerning the <i>customer</i> should be considered, including:</p> <ul style="list-style-type: none"> (i) the possibility of incurring early transfer penalties and new front-end <i>charges</i>; (ii) how the transfer affects the <i>investment</i> risk; (iii) how the effects of <i>charges</i> and expenses differ between the <i>schemes</i>; (iv) changes to the tax-free cash; (v) any reduction in immediate death benefits.
B.	Personal Pension Schemes and FSAVCs compared to Stakeholder Pension Schemes
1.	A particular feature of the <i>personal pension scheme</i> market is that a potential investor in a <i>personal pension scheme</i> will always have the option of a <i>stakeholder pension scheme</i> and may find that equally suitable for his or her needs.
2.	Both <i>independent intermediaries</i> and <i>representatives</i> will need to undertake the comparison between <i>personal pension schemes</i> and <i>stakeholder pension schemes</i> and, as required by COB 5.3.16R(3), explain in the <i>suitability letter</i> why, if they have recommended a <i>personal pension scheme</i> , it is considered to be at least as suitable.
3.	There are some circumstances where a potential investor in an FSAVC will have the option of a <i>stakeholder pension scheme</i> , in addition to the option of an in-house AVC.
4.	Both <i>independent intermediaries</i> and <i>representatives</i> will need to undertake a comparison between the three options and explain in the <i>suitability letter</i> why, if they have recommended an FSAVC, it is considered to be at least as suitable as a <i>stakeholder pension scheme</i> or the in-house AVC.
5.	If a <i>representative</i> without access to a <i>stakeholder pension scheme</i> makes a comparison with a <i>stakeholder pension scheme</i> , the comparison may be with a <i>stakeholder pension scheme</i> on the minimum product standards unless the <i>representative</i> is or ought to be aware that the <i>customer</i> has access to a <i>stakeholder pension scheme</i> on more advantageous terms.

Suitability guidance	
6.	The <i>guidance</i> in this section of the table applies equally to recommendations for individual and group personal pensions, even though the latter may, in accordance with Regulation 22 of the Stakeholder Pension Scheme Regulations 2000 (SI 2000 No 1403), exempt an employer from having to designate a <i>stakeholder pension scheme</i> for his <i>employees</i> .
7.	<i>Firms</i> are reminded that <i>key features documents</i> for <i>personal pension schemes</i> should signpost the availability of <i>stakeholder pension schemes</i> , as set out in COB 6.5.21G(5).
8.	<i>Firms</i> promoting a <i>personal pension scheme</i> (including a <i>group personal pension scheme</i>) to the <i>employees</i> of a particular employer through <i>direct offer financial promotions</i> are reminded of the provisions of COB 5.3.28R. Accordingly, <i>firms</i> should take reasonable care to ensure that the <i>personal pension scheme</i> is likely to be at least as suitable as a <i>stakeholder pension scheme</i> for the majority of <i>employees</i> to whom the <i>personal pension scheme</i> is being promoted, and that this is adequately evidenced.
C.	Hybrid Products
1.	A ‘hybrid product’ is a product which results from combining a package of products to create one recommended solution. An example is a ‘back to back’ contract which takes a lump sum <i>investment</i> and splits it into two amounts; one part is used to provide income through the purchase of a temporary annuity and the other part is invested in a <i>unit trust</i> or life insurance bond so that by the end of the annuity term the growth may produce the return of the original lump sum invested.
2.	The requirements for suitability and best <i>investment advice</i> apply to all elements of a hybrid product: <ul style="list-style-type: none"> (a) <i>independent intermediaries</i> need to scrutinise ready-made packages from a single <i>product provider</i> to make sure that each element is competitive and that a better solution is not available by combining elements from different providers; (b) simplicity or administrative convenience is not sufficient reason for using one provider for all elements.
D.	Industrial Assurance Policies If an <i>industrial assurance policy</i> is recommended to a <i>customer</i> and a comparable <i>policy</i> (which is not an <i>industrial assurance policy</i>) is available which is at least as suitable, the <i>suitability letter</i> should explain clearly the reasons why the <i>industrial assurance policy</i> is being recommended.
E.	Income Withdrawals When a <i>firm</i> is advising a <i>customer</i> about personal pension fund withdrawals: <ul style="list-style-type: none"> (a) the <i>customer’s</i> personal and financial circumstances should be considered carefully, in particular: <ul style="list-style-type: none"> (i) the <i>customer’s</i> <i>investment</i> objectives, need for tax-free cash and state of health; (ii) current and future income requirements, existing pension assets and the relative importance of the plan, given the <i>customer’s</i> financial circumstances;

Suitability guidance	
	<ul style="list-style-type: none"> (iii) the <i>customer's</i> attitude to risk, ensuring that any discrepancy between his attitude to risk relating to pension fund withdrawals and that in relation to other <i>investments</i> is clearly explained;
	<p>(b) the <i>suitability letter</i> should explain:</p> <ul style="list-style-type: none"> (i) the purpose of the contract for the <i>customer</i>; (ii) the relative importance of the contract, given the <i>customer's</i> financial circumstances; (iii) the <i>customer's</i> attitude to risk; and (iv) the risk factors involved in entering into a pension fund withdrawal, which are: <ul style="list-style-type: none"> – taking withdrawals may erode the capital value of the fund, especially if <i>investment</i> returns are poor and a high level of income is taken; this could result in a lower income when the annuity is eventually purchased; – the <i>investment</i> returns may be less than those shown in the illustrations; – annuity rates may be at a worse level when annuity purchase takes place; – when maximum withdrawals are to be taken, high <i>income withdrawals</i> may not be sustainable during the deferral period.
F.	<p>ISA or PEP Transfers</p> <p>When a <i>firm</i> is advising a <i>customer</i> on whether to transfer existing <i>ISA</i> or <i>PEP</i> holdings, <i>COB</i> 5.2 (Know your <i>customer</i>) and <i>COB</i> 5.3 (Suitability) apply. All the advantages and disadvantages of transferring should be considered. In particular the following information (which is not exhaustive) should be considered and provided to the <i>customer</i>, usually as part of the <i>suitability letter</i>, before the transfer takes place:</p> <ul style="list-style-type: none"> (a) <i>exit charges</i> and any other costs associated with the transfer; (b) initial start-up <i>charges</i>; (c) transaction details (that is, whether holdings are liquidated or transferred intact, as permitted by the terms and conditions); (d) possibility (and likely effects) of <i>shortfall</i>, following cancellation; (e) potential for loss of income or growth, following a rise in markets, while the <i>ISA</i> transfer or <i>PEP transfer</i> remains pending.
G.	<p>Contracting out of SERPS</p> <p>When a <i>firm</i> is advising a <i>customer</i> on whether to contract out of SERPS in favour of an <i>appropriate personal pension</i> or contracted-out <i>money-purchase scheme</i> ('<i>COMP</i>'): </p> <ul style="list-style-type: none"> (a) <i>advisers</i> should give careful consideration to: <ul style="list-style-type: none"> (i) the range of pivotal ages outside which it will generally be in the best interests of <i>customers</i> to remain in SERPS; (ii) the level of earnings below which it may not be in a new <i>customer's</i> interests to contract out; (iii) the minimum length of time for which a <i>customer</i> may benefit from being contracted out;

Suitability guidance	
(b)	factors to be taken into account when making this assessment include:
(i)	<i>customer's</i> age and sex;
(ii)	State pension age for females (where different from males);
(iii)	<i>customer's</i> level and stability of earnings and tax position;
(iv)	<i>customer's</i> career prospects (including the likely period for remaining contracted-out);
(v)	<i>customer's</i> existing pension provision or opportunity to participate in an <i>occupational pension scheme</i> ;
(vi)	potential loss of rights compared to SERPS benefits;
(vii)	terms of the <i>personal pension scheme</i> or contracted out <i>money-purchase scheme</i> with particular reference to the level of <i>charges</i> ;
(viii)	<i>customer's</i> attitude to risk.
(c)	The <i>suitability letter</i> should clearly explain any risks in contracting out.

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Table Guidance on the contents of suitability letters.
This table belongs to ■ COB 5.3.17.

Guidance on the contents of suitability letters	
	Introduction
1.	<i>COB 5.3.14R</i> requires a written explanation of a recommendation relating to a product to be provided to a <i>private customer</i> . This is commonly referred to as 'the <i>suitability letter</i> ' although it does not need to take the form of a letter, for example it might form part of:
(a)	a financial report to the <i>customer</i> (provided that it is prominent); or
(b)	a fact find <i>document</i> (a copy of the whole fact find or just the recommendation section could be given to the <i>customer</i>); if a copy of the fact find or the recommendation section is sent, the copy should be of sufficient quality to be clearly legible.
2.	A <i>suitability letter</i> , to be successful, should explain simply and clearly why the recommendation is viewed as suitable having regard to the <i>customer's</i> :
(a)	personal and financial circumstances;
(b)	needs and priorities identified through the fact finding process;
(c)	attitude to risk in the area of need to which the recommendation relates.
	When a <i>suitability letter</i> is needed
3.	<i>COB 5.3.14R</i> sets out the occasions when a <i>suitability letter</i> is required. <i>COB 5.3.19R</i> sets out the exceptions to this <i>rule</i> . A letter is required in all cases where <i>pension transfers</i> or <i>pension opt-outs</i> are recommended.
	Style and presentation
4.	The style and presentation of a <i>suitability letter</i> is left for <i>firms</i> to decide so that they can design a document which works best for the market in which they transact business. A <i>suitability letter</i> is more likely to be effective if it demonstrates these features:

Guidance on the contents of suitability letters

- (a) personalisation – the more personalised the *suitability letter*, the more effective it is likely to be;
 - (b) simplicity and plain English – when technical terms need to be incorporated, they should be explained if the *customer* is unlikely to understand their meaning;
 - (c) concise and clear messages – lengthy explanations in extensive letters are likely to reduce the effectiveness of the letter with the *customer* disinclined to read it properly.
5. Ideally each *suitability letter* will be different, reflecting the approach of the *adviser*, the *customer's* profile, subjects discussed and the considerations on which the *advice* was based. Some *firms* may wish to introduce a degree of standardisation to *suitability letter* production to aid quality control. When using a standardised approach the *firm* should take the following into account:
- (a) standard paragraphs are best limited to the description of the most common needs and the products which will satisfy those needs;
 - (b) the *firm* should clearly link the *customer's* own needs, priorities and attitude to risk to the product recommended rather than just setting out stock motives that may apply to all *customers*;
 - (c) tick box, pre-printed forms should rarely be used, and when they are it should only be in the simplest and most straightforward *advice* situations.
- Content
6. A *firm* should take the following into account when constructing a *suitability letter*:
- (a) the letter should explain why the *customer's* needs, priorities, attitude to risk and financial situation all combine to make the recommended product suitable for the *customer*. It should not merely state what product is being recommended with no link to the *customer's* personal circumstances;
 - (b) other needs discussed during the factfind process which the *customer* does not wish to consider do not need to be included in the *suitability letter* (although they should be recorded in the factfind); they should be included if they assist in demonstrating why the product recommended is considered suitable;
 - (c) alternative products which were recommended but rejected by the *customer* should be mentioned;
 - (d) only the available options under a contract which have been recommended, whether accepted or rejected, need be mentioned in the letter;
 - (e) *independent intermediaries* should include (the list is not exhaustive) why a particular *product provider* has been recommended; reasons may include product features not available elsewhere, price, service levels, performance track record, *investment* prospects, medical evidence terms, reputation and financial strength.

Signing

Guidance on the contents of suitability letters

7. Each *suitability letter* should be signed by a *person* authorised by the *firm* to advise on the type of product which is being recommended. Ideally this will be the *adviser* who gave the particular *advice* but, if not, both the signatory and the *adviser* should accept responsibility for the letter and the recommendation.

Timing of suitability letters

8. *Suitability letters* should be issued to *customers* at the time that the recommendation is made or as soon as possible afterwards, to allow as much time as possible for the *customer* to consider the recommendation before any cancellation period ends. In any event the letter should be issued no later than the issue of the cancellation notice or, in situations where no cancellation notice will be issued, for example in the case of personal pension *income withdrawals*, before the *transaction* is put into effect.



5.4 Customers' understanding of risk

Application

- 5.4.1 **R** This section applies to a *firm* that conducts *designated investment business* with or for a *private customer*.
/1

Purpose

- 5.4.2 **G** *Principle 7* (Communications with clients) requires a *firm* to pay due regard to the information needs of its *clients* and communicate information to them in a way that is clear, fair and not misleading. *Principle 9* (Customers: relationships of trust) requires a *firm* to take reasonable care to ensure the suitability of its advice and discretionary decisions. The purpose of this section is to ensure that a *firm* takes reasonable steps to ensure that a *private customer* understands the nature of the risks inherent in certain transactions.
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Requirement for risk warnings

- 5.4.3 **R** A *firm* must not:
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- (1) make a *personal recommendation* of a transaction; or
 - (2) act a discretionary *investment manager*; or
 - (3) *arrange (bring about) a deal in a warrant or derivative*; or
 - (4) engage in *stock lending activity*;

with, to or for a *private customer* unless it has taken reasonable steps to ensure that the *private customer* understands the nature of the risks involved.

- 5.4.4 **E** The reasonable steps in ■ COB 5.4.3 should include the steps set out in ■ COB 5.4.6 to ■ COB 5.4.10 in relation to transactions in the following types of *investment* or activity:
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- (1) *warrants and derivatives*;

- (2) *non-readily realisable investments*;
- (3) *penny shares*;
- (4) *securities* subject to stabilisation;
- (5) *stock lending activity*.

5.4.5



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Contravention of ■ COB 5.4.4 may be relied on as tending to establish contravention of ■ COB 5.4.3.

Risk warnings in respect of warrants and derivatives

5.4.6



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- (1) In relation to a transaction in a *warrant* or *derivative*, the *firm* should:
 - (a) provide the *private customer* with the notice in ■ COB 5 Ann 1; and
 - (b) require the *private customer* to acknowledge receipt of the notice and confirm acceptance of its contents, in writing.
- (2) A *firm* need not undertake steps ■ COB 5.4.6(1)(a) and (b) in respect of a *private customer* who is ordinarily resident outside the *United Kingdom*, if it has taken reasonable steps to determine that the *private customer* does not wish to receive the notice.
- (3) The notice in ■ COB 5 Ann 1 (Warrants and derivatives risk warning notice) need not be sent in relation to the realisation of a *warrant* that is already held by the *private customer*, or of a *warrant* attached to another *designated investment*.

Risk warnings in respect of non readily realisable investments

5.4.7



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In relation to a transaction in a *designated investment* that is not a *readily realisable investment*, a *firm* should:

- (1) warn the *private customer* that there is a restricted market for such *designated investments*, and that it may therefore be difficult to *deal* in the *designated investment* or to obtain reliable information about its value; and
- (2) disclose any position knowingly held by the *firm* or any of its *associates* in the *designated investment* or in a *related designated investment*.

Risk warnings in respect of penny shares

5.4.8



In respect of *penny shares*, a *firm* should provide the risk warnings required by ■ COB 3.9.17(12) (Investments that can fluctuate in value).

Risk warnings in respect of securities that may be subject to stabilisation

5.4.9



In respect of *securities* that may be subject to stabilisation, a *firm* should send to the *private customer* the notice in ■ COB 5 Ann 2 (Dealing in securities which may be subject to stabilisation) unless it has taken reasonable steps to establish that the *customer* requires an oral explanation only.

Stock lending activity

5.4.10



A *firm* should not engage in *stock lending activity* with or for a *private customer* unless it has notified him:

- (1) that this may affect his tax position and that he should consult a tax adviser before proceeding; and
- (2) of the consequences of the *stock lending activity*, including what impact it may have on the rights of the holder of the *designated investments* concerned.



5.5 Information about the firm

Application

- 5.5.1 **R** /1 (1) This section applies to a *firm* that conducts *designated investment business* with or for a *private customer*.
- (2) This section does not apply when a *firm communicates* or *approves a financial promotion*.

Purpose

- 5.5.2 **G** /1 *Principle 7* (Communications with clients) requires a *firm* to pay due regard to the information needs of its *clients* and communicate information to them in a way that is clear, fair and not misleading. ■ COB 5.5 aims to ensure that a *firm* provides its *private customers* with adequate information about the *firm*.

Information required to be disclosed

- 5.5.3 **R** /1 When it conducts *designated investment business*, a *firm* must take reasonable steps to ensure that a *private customer* is given adequate information about:
- (1) the identity and business address of the *firm* and any relevant agent of the *firm*;
 - (2) the identity and status, or relationship with the *firm*, of *employees* and other agents with whom the *customer* may have contact; and
 - (3) the fact that the *firm* is regulated or authorised by the *FSA*;
- unless the *private customer* has been given the information on a previous occasion and that information is still up to date.
- 5.5.4 **A** /1 (1) For the purposes of ■ COB 5.5.3, the reasonable steps should include the relevant measures detailed in ■ COB 5.5.5.
- (2) Compliance with (1) may be relied as tending to establish compliance with ■ COB 5.5.3.

5.5.5



(3) Contravention of (1) may be relied as tending to establish contravention of ■ COB 5.5.3.

Table Table of information to be disclosed in written communications.
This table belongs to ■ COB 5.5.4

Written communications	
1.	<p>Any written communication, including stationery, business cards or other business documentation published by the <i>firm</i>, or used by its <i>employees</i>, agents, <i>representatives</i>, <i>financial advisers</i> or <i>introducers</i>, should include:</p> <ul style="list-style-type: none"> (a) the name, business address and telephone number of the <i>firm</i> or of the branch or office of the <i>firm</i> from which the communication originates; (b) the name of the <i>firm's marketing group</i> (if any); (c) the name and status or relationship with the <i>firm</i>, of the individual from whom the communication originates; (d) a statement that the <i>firm</i> is regulated by or authorised by the Financial Services Authority; (e) in the case of a <i>provider firm</i>: <ul style="list-style-type: none"> (i) a statement that the individual using the communication is the <i>representative</i> of, or represents only, the <i>firm</i> or its <i>marketing group</i>; and (ii) a brief description, except in the case of business cards, of the <i>packaged products</i> and services provided by the <i>firm</i> or by members of its <i>marketing group</i> including any <i>adopted packaged products</i> which the <i>firm</i> or any member of the <i>marketing group</i> has adopted; (f) if the communication is by or relates to an <i>introducer</i>, a statement of the <i>introducer's</i> capacity
2.	<p>In the case of a <i>provider firm</i>, when the <i>firm's representative</i> first meets a <i>private customer</i>, the <i>customer</i> should be given the following particulars in writing, which may be in the form of a business card, either before progressing beyond the social preliminaries or as soon as reasonably practicable after a telephone conversation has ended:</p> <ul style="list-style-type: none"> (a) the name, address and telephone number of the <i>representative</i>; (b) the name, business address and telephone number of the <i>firm's</i> branch or office to which the <i>representative</i> reports; (c) the name of the <i>firm's marketing group</i> (if any);

Written communications	
(d)	a statement that the <i>firm</i> is regulated by or authorised by the Financial Services Authority; and
(e)	where relevant a statement that the <i>appointed representative</i> or <i>marketing group associate</i> represents only the specified <i>firm</i> or <i>marketing group</i> together (except in the case of a business card) with a brief description of the <i>packaged products</i> and services provided by that <i>firm</i> or <i>marketing group</i> , indicating which of those he is appointed to sell.

5.5.6

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A *firm* which gives *advice on investments* to a *private customer* about *packaged products* is reminded of the additional disclosure requirements in ■ COB 5.1 (Polarisation and status disclosure).

Overseas business for UK private customers

5.5.7

R

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- (1) A *firm* must not conduct *designated investment business*:
 - (a) from an office of its own (or of any *appointed representative*) outside the *United Kingdom*;
 - (b) with or for a *private customer* who is in the *United Kingdom*;

unless it has, where relevant, made a disclosure in accordance with (2) to the *private customer*.
- (2) The required disclosure in (1) means a written statement making it clear that in some or all respects the *regulatory system* applying, including any compensation arrangements, will be different from that of the *United Kingdom*. The statement may also indicate the protections or compensation available under another system of regulation.
- (3) A *firm* must not make an introduction or make arrangements or give *advice on investments* with a view to another *person* conducting *designated investment business*;
 - (a) from an office outside the *United Kingdom*;
 - (b) with or for a *private customer* (or a person who, if a *client*, would be a *private customer*), who is in the *United Kingdom*;

unless the *firm* has, where relevant, made a disclosure in accordance with (2) and there are no reasonable grounds for the *firm* to doubt that the *private customer* will be dealt with in an honest and reliable way.

Business conducted from an overseas place of business with overseas customers

5.5.8

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- (1) If, in any communication made to a *private customer* outside the *United Kingdom* in connection with *designated investment business* conducted from its (or its *appointed representative's*) office outside the *United Kingdom*, a *firm* indicates that it is an *authorised person*, it must also, where relevant, and with equal prominence, make the disclosure in ■ COB 5.5.7(2).
- (2) A *firm* need not include the disclosure in (1) if it has already made the disclosure in writing to the *private customer* to whom the communication is made.



5.6 Excessive charges

Application

- 5.6.1 **R**
/1 This section applies to a *firm* that makes a *charge* to a *private customer* in the course of, or in connection with its *designated investment business*.

Purpose

- 5.6.2 **G**
/1 *Principle 6* (Customers' interests) requires a *firm* to pay due regard to the interests of its *customers* and treat them fairly. The purpose of this section is to ensure that the *charges* a *firm* makes to its *private customer* are not excessive. The obligation to disclose to a *private customer* the *charges* that a *firm* intends to make are set out in ■ COB 5.7 (Disclosure of charges, remuneration and commission).

Charges to a private customer

- 5.6.3 **R**
/1 A *firm* must ensure that its *charges* to a *private customer* made in connection with the conduct of *designated investment business* are not excessive.
- 5.6.4 **G**
/1 When determining whether a *charge* is excessive, a *firm* should consider:
- (1) the amount of its *charges* for the services or product in question compared with *charges* for similar services or products in the market;
 - (2) the degree to which the *charges* are an abuse of the trust that the *customer* has placed in the *firm*; and
 - (3) the nature and extent of the disclosure of the *charges* to the *private customer*.

Charges in respect of designated investments that are not readily realisable

- 5.6.5 **R**
/1 When a *firm's* *charges* for advising on or managing a *private customer's* assets are dependent on the value of *designated investments* that are not *readily realisable investments*, the valuation of those *designated investments* must be based upon the price likely

to be agreed between a willing buyer and a willing seller dealing at arm's length who are both in possession of all freely available information concerning those investments.

5.6.6

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In appropriate cases it may be necessary for the basis of a valuation referred to in ■ COB 5.6.5 to be confirmed or approved by an independent expert.



5.7 Disclosure of charges, remuneration and commission

Application

- 5.7.1 **R** This section applies to a *firm* that conducts *designated investment business* with or for a *private customer*.
/1

Purpose

- 5.7.2 **G** *Principle 7* (Communications with clients) requires a *firm* to pay due regard to the needs of its *clients* and communicate information to them in a way that is clear, fair and not misleading. The purpose of this section is to ensure that a *private customer* is made aware of the costs to him, directly or indirectly, of financial services, so that he is better able to make informed choices.
/1

Disclosure of charges

- 5.7.3 **R** Before a *firm* conducts *designated investment business* with or for a *private customer*, the *firm* must disclose in writing to that *private customer* the basis or amount of its *charges* for conducting that business and the nature or amount of any other income receivable by it or, to its knowledge, by its *associate* and attributable to that business.
/1
- 5.7.4 **G** A *firm* may make the disclosures required by **■ COB 5.7.3** in its *terms of business*, in a *client agreement*, or in a separate written statement. Disclosure should include any product-related *charges* that are deducted from the *private customer's* investment. If the product is a *packaged product*, product-related *charges* and expenses will be disclosed in the *key features* document or in the minimum information that the *firm* is required to provide to the *private customer* in accordance with **■ COB 6.2** (Provision of key features) and **■ COB 6.4** (Product disclosure: special situations). When a *firm* is a *broker fund adviser*, disclosure should include any *fees* payable to the *firm* or its *associate* in connection with that activity by a *provider firm*.
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Disclosure of remuneration and commission for packaged products

5.7.5

R

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(1) Before effecting a transaction in a *life policy* with or for a *private customer*, and subsequently on request of the *private customer*, a *firm* must disclose to that *private customer*, in cash terms:

- (a) any *remuneration* payable by it or its *associates* to its *employees* or agents; and
- (b) any *remuneration* or *commission* receivable by it, in connection with the transaction;

unless ■ COB 5.7.9 or ■ COB 5.7.10 apply.

(2) Before effecting a transaction in any other *packaged product* with or for a *private customer*, or subsequently on request of the *private customer*, an *independent intermediary* or *product provider* must disclose to that *private customer*, in cash terms:

- (a) any *remuneration* payable by it or its *associates* to its *employees* or agents; and
- (b) any *remuneration* or *commission* receivable by it, in connection with the transaction;

unless ■ COB 5.7.9 or ■ COB 5.7.10 apply.

5.7.6

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In determining the amount to be disclosed as *remuneration* in accordance with ■ COB 5.7.5, a *firm* must put a proper value on the cash payments, benefits and services provided to its *employees* and agents in connection with the transaction.

5.7.7

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For an *adopted packaged product*, ■ COB 5.7.6 includes all cash payments, benefits and services provided by the provider of the *adopted packaged product*.

5.7.8

E

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(1) When determining the value of cash payments, benefits and services under ■ COB 5.7.6, a *provider firm* should follow the provisions of ■ COB 5.7.16.

(2) Compliance with ■ COB 5.7.8(1) may be relied on as tending to establish compliance with ■ COB 5.7.6.

(3) Contravention of ■ COB 5.7.8(1) may be relied on as tending to establish contravention of ■ COB 5.7.6.

Exceptions to the disclosure for packaged products

5.7.9

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■ COB 5.7.5 does not apply if:

- (1) the *firm* is acting as an *investment manager*; or

- (2) the transaction is effected for a *private customer* who is habitually resident overseas; or
- (3) the *packaged product* is a *life policy* and the *private customer* is not present in the *United Kingdom* at the time the application is made.

5.7.10 **R** _{/1} The requirement in **■ COB 5.7.5** to disclose to a *private customer* the amount or value, in cash terms, of *remuneration* or *commission* does not apply if the *firm* provides the *private customer* with example *key features*, in accordance with **■ COB 6.2.7** (Life policies) and **■ COB 6.2.22** (Schemes), provided that the *firm* discloses to the *private customer* the actual amount or value of *remuneration* or *commission* within five *business days* of effecting the transaction.

Guidance on disclosure requirements for packaged products

5.7.11 **G** _{/1} The disclosures required by **■ COB 5.7.5** should be made in a manner that is clear, fair and not misleading, as required by **■ COB 2.1.3** (Clear, fair and not misleading communication), and that indicates the timing of any payment. For example, when a *firm* exchanges its right to future *commission* payments for a lump sum, whether by way of a loan or other commercial arrangement, it should disclose the amount of *commission* receivable by it that has been exchanged for the lump sum.

5.7.12 **G** _{/1} If the precise rate of *remuneration* or value of *commission* is not known in advance, the *firm* should estimate the rate likely to apply to the *employee* or agent in question.

5.7.13 **G** _{/1} The disclosures required by **■ COB 5.7.5** should normally be made in writing. For example, if a specific *key features* document or *projection* is provided to a *private customer*, the required disclosures should either be contained in the *projection* or the *key features* document, or be given to the *private customer* in a separate written statement at the time these *documents* are given to the *private customer*. When a *private customer* does not make a written application to enter into a transaction contemplated by **■ COB 5.7.5**, for example, when the transaction is a telephone *deal* for *units* in a *regulated collective investment scheme*, the *firm* may disclose the amount or value of *remuneration* or *commission* orally. In these circumstances, the *firm* should give written confirmation as soon as possible after the date of the transaction, and in any event within five *business days*. In preparing its written disclosure statement, a *firm* may wish to follow the *guidance* on content and wording set out in **■ COB 5.7.17**.

5.7.14 **G** _{/1} The collection of *premiums* payable under a *life policy* by *introducers* acting as the appointed collecting agents of a *product provider* will not be treated by the *FSA* as a transaction for the purposes of **■ COB 5.7.5**.

5.7.15 **R** _{/1} If the terms of a *packaged product* are varied in circumstances that require the issue of a cancellation notice, a *firm* must disclose to a *private customer* in writing any consequent increase in *remuneration* or *commission* receivable by it in relation to that transaction.

5.7.16 **A** _{/1} Table Calculating remuneration.
This table forms part of **■ COB 5.7.8**.

Calculating remuneration

COB 5.7.8E applies only to a *firm* which is a *provider firm*. This table sets out the basis on which the *firm* should determine the value of cash payments, benefits and services to be disclosed as *remuneration* under *COB 5.7.5R*. Benefits and services, as set out in parts B and C below, need be included only where their value is such that they could not be provided to an *independent intermediary* as an indirect benefit under *COB 2.2.6G* (Packaged products – guidance on indirect benefits) and *COB 2.2.7G* (Reasonable indirect benefits – joint marketing exercises).

Part A: Cash payments

1. These cover all payments by a *firm* to a *representative* in relation to a transaction in a *packaged product*, including:
 - (a) payments to any *employee* or *representative* of the *firm* in respect of the transaction (for example, a manager's override), including any payments from the *firm* to *introducers*;
 - (b) bonus payments made for the achievement of certain sales targets;
 - (c) that element of any payment made in relation to other business which may be considered to result directly or indirectly from the transaction; for example, any extra element of *remuneration* payable on the sale of a mortgage which is to be repaid through an *investment* in a *packaged product*;
 - (d) payments resulting directly from business written in previous years (for example, renewal *remuneration*), which are conditional on the completion of minimum amounts of new business;
 - (e) payments made by an *associate* of the *firm* to an *associate* of the *representative*;
 - (f) salaries and other payments which do not relate directly to any one transaction, provided they are treated similarly to 'benefits' and 'services' (see paragraph 11).
2. In determining the amounts to be included in the calculation, a *firm* should have regard to the following:
 - (a) When the precise rate of *remuneration* is not known in advance (for example, if retrospective volume overrides apply), the *firm* should estimate the rate likely to apply to the *representative* in question. This could, for example, be based on an average rate applicable to particular groupings of *representatives* or on a best estimate for each *representative*. It should never be below any minimum rate applicable to that *representative* or sale.
 - (b) When payments are credited to an 'account' from which periodic withdrawals may be made, the amount included should be that credited to the account whether or not the recipient intends to withdraw it immediately. If a *representative* is able to 'overdraw' an account, all amounts to be credited in respect of a transaction, up to any 'borrowing limit', should be included as if they were credited at the time the transaction was effected.

Calculating remuneration	
(c)	When a payment is made before the <i>firm</i> receives the <i>premium</i> or the investment monies to which it relates (for example, indemnity <i>remuneration</i>), it should be included as being received at the time of payment. If the <i>adviser</i> or the <i>provider firm</i> wishes to explain this arrangement to the <i>customer</i> , he is free to do so, provided this does not detract from the required disclosure.
(d)	When the <i>firm</i> arranges for a lump sum to be paid to a <i>representative</i> through a third party, in exchange for the income stream to which the <i>representative</i> is entitled (for example, a factoring arrangement), the lump sum should be included as if it were a payment from the <i>firm</i> .
(e)	When a <i>firm</i> provides, or arranges for a third party to provide, a loan to a <i>representative</i> , on the security of, or in the expectation of, future payments from the <i>firm</i> , the amounts to be included are the payments to the <i>representative</i> on which the provision of the loan is based, as if they were received at the time the transaction was effected, irrespective of their actual timing.
(f)	When an agent is employed and remunerated by the <i>firm's appointed representative</i> , the payments to be included should be those made by the <i>firm</i> to the <i>appointed representative</i> , not those made by the <i>appointed representative</i> to its own <i>employee</i> .
Part B: Benefits	
3.	These include the cost to the <i>firm</i> of all non-monetary benefits provided by it to a <i>representative</i> . These benefits include any item that could be considered as a benefit or expense under the Income and Corporation Taxes Act 1988 (ICTA). A benefit should be included whether or not the <i>representative</i> is liable to income tax on it and whether it is chargeable to tax.
4.	The type of benefits covered by paragraph 3 include the use of a car, attendance at conferences, subsidised loans, contributions to <i>pension schemes</i> , national insurance contributions, the value of any voucher outside the ICTA definition of benefit or expense, and the value of <i>share options</i> (taking into account any discount on issue and assuming that the <i>shares</i> in question grow at a reasonable rate in line with other <i>investments</i>).
Part C: Services	

Calculating remuneration

5. These include benefits which could not be provided to an *independent intermediary* as an indirect benefit (under *COB 2.2.3R* (Prohibition of inducements) and *COB 2.2.6G* (Packaged products – guidance on indirect benefits)), and which the *intermediary* would therefore have to fund out of its disclosable *commission*. It is not necessary for a *firm* actually to provide services to an *independent intermediary* for it to be able to apply this criterion in relation to its *employees* or agents.
6. The following services should be included:
 - (a) office accommodation and equipment, including telephone, photocopying and fax;
 - (b) loans where a commercial rate of interest is not charged, including *remuneration* advances overdue for repayment;
 - (c) general stationery and mailing or distribution costs;
 - (d) computer hardware and software (except software which specifically relates to the *firm's packaged products*, such as software used in supporting the pensions review process or for producing illustrations, *projections* and product information);
 - (e) clerical and administrative support (except support given in relation to the pensions review process);
 - (f) business insurance cover, including professional indemnity and fidelity guarantee;
 - (g) recruitment;
 - (h) compliance monitoring;
 - (i) *customer* services;
 - (j) business planning services;
 - (k) line management.
7. To put a value on these services, the following costs should be included:
 - (a) all overheads attributable to a particular cost item (for example, the cost of a compliance official);
 - (b) salary costs pro rata where individuals are only engaged part-time on relevant business;
 - (c) rent and associated premises costs at an appropriately reduced rate where the premises are also used for other business activities;
 - (d) only that proportion of the cost of lead generation promotions attributable to the generation of relevant business (but including the placing of any *financial promotion*, and its mailing or provision of access to third party *customers*);
 - (e) only the marginal additional compliance costs of ensuring that *representatives* and their support and training material comply with relevant *rules*;

Calculating remuneration	
	<ul style="list-style-type: none"> (f) the commercial value of a service which is the use of an asset owned by the <i>firm</i> (for example in the case of a property, its full market rent); (g) in respect of <i>appointed representatives</i>, the costs of any promotion in a newspaper or elsewhere and the provision of <i>representative</i>–specific literature in connection with a <i>direct offer financial promotion</i>; (h) in respect of <i>marketing group associates</i> and connected <i>appointed representatives</i>, where the name of the company is included in the <i>direct offer financial promotion</i>, the costs of any promotion in a newspaper or elsewhere and the provision of <i>representative</i>–specific literature in connection with a <i>direct offer financial promotion</i>.
8.	<p>The following costs should be excluded:</p> <ul style="list-style-type: none"> (a) any contributions made by a <i>representative</i> out of his own resources; (b) the cost of corporate awareness advertising; (c) training costs; (d) underwriting, policy administration and claims handling costs; (e) costs of developing and maintaining computer systems for the provision of <i>projections</i> of benefits, <i>customer</i>–specific <i>key features</i> documents or other product information; (f) costs of compensating <i>customers</i>; (g) the costs of head office and branch level management and support, other than payments to <i>managers</i> falling under Part 1, for <i>representatives</i>, where these services could also be provided to an <i>independent intermediary</i>, for example, broker branches and ‘inspectors’; (h) ‘collecting remuneration’ payable in respect of <i>industrial assurance policies</i> or by <i>friendly societies</i>, provided that the amounts excluded do not exceed the genuine costs of <i>premium</i> collection; comparison with the <i>remuneration</i> payable to collectors who are not <i>representatives</i> or with the renewal <i>remuneration</i> payable on ordinary branch business may provide a guide. <p>Part D: Calculation methodology actuarial advice</p>
9.	<p>A <i>long–term insurer</i> or <i>friendly society</i> should take the advice of its <i>appointed actuary</i> (or if does not have one, an <i>actuary</i>) in determining the costs of benefits and services to be included and their apportionment over individual <i>packaged product</i> transactions. Where the <i>firm</i> does not follow its <i>actuary</i>’s advice, it should notify the <i>FSA</i>, giving the reasons for that decision and the alternative assumptions it plans to use.</p> <p>Remuneration scale</p>

Calculating remuneration	
10.	When an identical <i>remuneration</i> scale applies to all <i>representatives</i> (although they might earn differing percentages of it), the same average amount of <i>remuneration</i> (and the value of other benefits and services) in respect of identical transactions may be disclosed, regardless of the percentage of the scale paid to each individual <i>representative</i> . Averaging may be used for <i>representatives</i> on the same scale and <i>employees of marketing group associates</i> , but not <i>appointed representatives</i> . Salary and other non–volume or sales related payments
11.	When a <i>representative</i> receives a salary, or other payment unrelated to volume or <i>sales</i> : (a) this should be amalgamated with the cost of benefits and services; and (b) the total costs should be apportioned over individual transactions in a way that reflects the value of the contract to the <i>firm</i> or to the <i>firm’s marketing group</i> .
Payments to associates	
12.	Where a <i>firm</i> pays <i>remuneration</i> to a <i>marketing group associate</i> , or an <i>appointed representative</i> which is an <i>associate</i> of the <i>firm</i> , it should ensure that the calculation of the sum to be disclosed is the higher of: (a) all payments, benefits and services provided to its <i>representatives</i> , from whatever source, plus an additional allowance for profit of 15% – unless the <i>firm</i> can demonstrate that another figure (higher or lower) is more appropriate; and (b) the <i>remuneration</i> actually paid by the <i>firm</i> , plus the value of services provided.

5.7.17

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Table Remuneration and commission disclosure statements: content and wording.
This table forms part of ■ COB 5.7.13.

Remuneration and commission disclosure statements: content and wording	
A <i>firm</i> may wish to follow the <i>guidance</i> on content and wording in this table when drawing up its written statement of <i>remuneration</i> or <i>commission</i> under COB 5.7.5R.	
Degree of accuracy	
1.	To help the <i>customer</i> understand, the <i>firm</i> may round large amounts of <i>commission</i> or <i>remuneration</i> to three significant figures (that is, where the leading three figures are sufficient to convey the magnitude of the result, for example £122 instead of £122.35). Sample wordings
2.	Examples of appropriate <i>remuneration</i> or <i>commission</i> disclosure wordings, for:

Remuneration and commission disclosure statements: content and wording	
(a)	<i>independent intermediaries</i> and other intermediaries (in a <i>direct offer financial promotion</i> or post-sale information): "For arranging this policy/contract XYZ Ltd will pay commission to IFA Ltd £..."
(b)	<i>representatives</i> employed by an <i>appointed representative</i> : "For arranging this policy/contract XYZ Ltd will pay <i>remuneration</i> and provide services to AR Ltd worth £..."
(c)	<i>representatives</i> employed by an <i>appointed representative</i> (at the point of sale or in a <i>direct offer financial promotion</i>): "For arranging this policy/contract AR Ltd expects to receive <i>remuneration</i> and services from XYZ Ltd worth £..."
(d)	<i>representatives</i> employed directly by the <i>firm</i> (including self-employed sole trader <i>appointed representatives</i>):
(i)	"for arranging this policy/contract I expect to receive <i>remuneration</i> and services from XYZ Ltd worth £...";
(ii)	an acceptable post sale alternative might be: "For arranging this policy XYZ Ltd has provided <i>remuneration</i> and services to your adviser worth £...";
	this type of approach would be suitable either to a salaried or commissioned <i>representative</i> .
3.	The description of the monetary amount (just shown as '£...') in the examples in paragraph 2 will vary according to the incidence and basis of <i>remuneration</i> or <i>commission</i> . Examples of some common cases are:
(a)	indemnified payments (on a monthly payment contract): "£X immediately and £Y each month from the Nth month to the end of the term"
(b)	level basis (on an annual payment whole life contract): "£X each year"; but in the case of a sale by any <i>representative</i> , the provision of benefits and services would probably require instead a statement in the form: "£X immediately and £Y each year thereafter".
(c)	fund related basis:
(i)	using the same rate of growth and the same periods as those in the <i>key features</i> , the example will normally show the <i>commission</i> or <i>remuneration</i> in the first year in which it is paid and the tenth year; or
(ii)	for an <i>investment</i> of £P, "For arranging this <i>policy</i> , XYZ Ltd will pay commission to IFA Ltd of £X, and half a percent of the fund value each year. For example, if your fund was worth £P, we would pay £X per year: if it was worth £2xP, we would pay £Z per year. Commission is paid every six months".
(d)	increasing payment basis: "£X immediately and a variable amount in each year thereafter, being, for example, £Y in the second year and increasing to £Z by the final year".



5.8 Customers introduced to clearing firms by introducing brokers and overseas introducing brokers

Application

- 5.8.1 **G**_{/1} This section should be considered by a *firm* that, in the course of carrying on *designated investment business*, acts as a *clearing firm* to which an *introducing broker* or an *overseas introducing broker* introduces a transaction for its *customer*.

Purpose

- 5.8.2 **G**_{/1} *Principle 1* (Integrity) requires a *firm* to *conduct* its business with integrity and *Principle 6* (Customers' interests) requires a *firm* to pay due regard to the interests of its *customers* and treat them fairly. This section supports and clarifies these requirements in respect of the relationship that exists between a *clearing firm* and a *customer* for whom the *clearing firm* executes and clears business, when the business has been introduced by a third party.

Clearing firms and introducing brokers and overseas introducing brokers

- 5.8.3 **G**_{/1} A *clearing firm* to which an *overseas introducing broker* has introduced a transaction on behalf of its *customer* should ensure that the *customer* is aware of the nature of the services that the *clearing firm* will be providing to that *customer* and that only these services, but not those of the *overseas introducing broker*, will be regulated under the *Act*.
- 5.8.4 **G**_{/1} As a matter of good practice, and preferably before accepting orders, a *clearing firm* should enter into a written contract with the *introducing broker* or *overseas introducing broker* specifying that the *clearing firm* will be responsible for all dealing and settlement obligations to the *customer*. The contract should also specify that the *introducing broker* or *overseas introducing broker* will act as agent for the *customer* in introducing transactions and will be responsible for advising the *customer* or managing his assets (or both).
- 5.8.5 **G**_{/1} A *clearing firm* should, by appropriate disclosures, ensure that the *customer* is aware of the nature of the services to be provided to him by the *clearing firm*.
- 5.8.6 **G**_{/1} When a *clearing firm* knows or suspects that the activities of an *introducing broker* or an *overseas introducing broker* are or may be damaging to its *customers*, it should take reasonable steps to address the situation and, as far as possible, to protect its *customers'* interests.

5.8.7

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When a *clearing firm* operates an omnibus account for an *overseas introducing broker* (that is, an account operated in the name of the *overseas introducing broker* for more than one underlying *client*) a *clearing firm* should:

- (1) establish that the *overseas introducing broker* is authorised in his own country;
- (2) where there is no formal regulatory regime in the *overseas introducing broker's* own country, take reasonable steps to establish that the *overseas introducing broker* is legally empowered to undertake the proposed business to be transacted; and
- (3) have regard to the requirements of *UK law* on *money laundering* and *financial crime*.



5.9 Information about stakeholder pension schemes

Application

- 5.9.1 **R** /1 This section applies to a *firm* that provides information about *stakeholder pension schemes* at a meeting arranged for a group of *employees*.

Requirement

- 5.9.2 **R** /1 When a *firm* provides information about *stakeholder pension schemes* to a group of five or more *employees* at a meeting which has been sponsored by one or more employers, that information must be given by an *adviser* appointed by the *firm* to give *advice* to *private customers* on *packaged products*.

Exception

- 5.9.3 **R** /1 ■ COB 5.9.2 does not apply to a *firm* that provides information about *stakeholder pension schemes* to a group of four or less *employees* at a meeting.

Warrants and derivatives risk warning notice (E)

1 Table This table belongs to ■ COB 5.4.6.

This notice is provided to you, as a private customer, in compliance with the rules of the Financial Services Authority (FSA). Private customers are afforded greater protections under these rules than other customers are and you should ensure that your firm tells you what this will mean to you. This notice cannot disclose all the risks and other significant aspects of warrants* and/or derivative* products such as futures*, options*, and contracts for differences* (* delete as appropriate). You should not deal in these products unless you understand their nature and the extent of your exposure to risk. You should also be satisfied that the product is suitable for you in the light of your circumstances and financial position. Certain strategies, such as a 'spread' position or a 'straddle', may be as risky as a simple 'long' or 'short' position.

Although warrants and/or derivative instruments can be utilised for the management of investment risk, some of these products are unsuitable for many investors. Different instruments involve different levels of exposure to risk and in deciding whether to trade in such instruments you should be aware of the following points. (Include or delete as appropriate).

1. Warrants

A warrant is a time-limited right to subscribe for shares, debentures, loan stock or government securities and is exercisable against the original issuer of the underlying securities. A relatively small movement in the price of the underlying security results in a disproportionately large movement, unfavourable or favourable, in the price of the warrant. The prices of warrants can therefore be volatile.

It is essential for anyone who is considering purchasing warrants to understand that the right to subscribe which a warrant confers is invariably limited in time with the consequence that if the investor fails to exercise this right within the predetermined time-scale then the investment becomes worthless.

You should not buy a warrant unless you are prepared to sustain a total loss of the money you have invested plus any commission or other transaction charges.

Some other instruments are also called warrants but are actually options (for example, a right to acquire securities which is exercisable against someone other than the original issuer of the securities, often called a 'covered warrant').

2. Off-exchange warrant transactions

Transactions in off-exchange warrants may involve greater risk than dealing in exchange traded warrants because there is no exchange market through which to liquidate your position, or to assess the value of the warrant or the exposure to risk. Bid and offer prices need not be quoted, and even where they are, they will be established by dealers in these instruments and consequently it may be difficult to establish what is a fair price.

Your firm must make it clear to you if you are entering into an off-exchange transaction and advise you of any risks involved.

3. Futures

Transactions in futures involve the obligation to make, or to take, delivery of the underlying asset of the contract at a future date, or in some cases to settle the position with cash. They carry a high degree of risk. The 'gearing' or 'leverage' often obtainable in futures trading means that a small deposit or down payment can lead to large losses as well as gains. It also means that a relatively small movement can lead to a proportionately much larger movement in the value of your investment, and this can work against you as well as for you. Futures transactions have a contingent liability, and you should be aware of the implications of this, in particular the margining requirements, which are set out in paragraph 8.

4. Options

There are many different types of options with different characteristics subject to the following conditions.

Buying options:

Buying options involves less risk than selling options because, if the price of the underlying asset moves against you, you can simply allow the option to lapse. The maximum loss is limited to the premium, plus any commission or other transaction charges. However, if you buy a call option on a futures contract and you later exercise the option, you will acquire the future. This will expose you to the risks described under 'futures' and 'contingent liability investment transactions'.

Writing options:

If you write an option, the risk involved is considerably greater than buying options. You may be liable for margin to maintain your position and a loss may be sustained well in excess of the premium received. By writing an option, you accept a legal obligation to purchase or sell the underlying asset if the option is exercised against you, however far the market price has moved away from the exercise price. If you already own the underlying asset which you have contracted to sell (when the options will be known as 'covered call options') the risk is reduced. If you do not own the underlying asset ('uncovered call options') the risk can be unlimited. Only experienced persons should contemplate writing uncovered options, and then only after securing full details of the applicable conditions and potential risk exposure.

Traditional options:

Certain London Stock Exchange member firms under special exchange rules write a particular type of option called a 'traditional option'. These may involve greater risk than other options. Two-way prices are not usually quoted and there is no exchange market on which to close out an open position or to effect an equal and opposite transaction to reverse an open position. It may be difficult to assess its value or for the seller of such an option to manage his exposure to risk.

Certain options markets operate on a margined basis, under which buyers do not pay the full premium on their option at the time they purchase it. In this situation you may subsequently be called upon to pay margin on the option up to the level of your premium. If you fail to do so as required, your position may be closed or liquidated in the same way as a futures position.

5. Contracts for differences

Futures and options contracts can also be referred to as contracts for differences. These can be options and futures on the FTSE 100 index or any other index, as well as currency and interest rate swaps. However, unlike other futures and options, these contracts can only be settled in cash. Investing in a contract for differences carries the same risks as investing in a future or an option and you should be aware of these as set out in paragraphs 3 and 4 respectively. Transactions in contracts for differences may also have a contingent liability and you should be aware of the implications of this as set out in paragraph 8.

6. Off-exchange transactions in derivatives

It may not always be apparent whether or not a particular derivative is arranged on exchange or in an off-exchange derivative transaction. Your firm must make it clear to you if you are entering into an off-exchange derivative transaction.

While some off-exchange markets are highly liquid, transactions in off-exchange or 'non transferable' derivatives may involve greater risk than investing in on-exchange derivatives because there is no exchange market on which to close out an open position. It may be impossible to liquidate an existing position, to assess the value of the position arising from an off-exchange transaction or to assess the exposure to risk. Bid prices and offer prices need not be quoted, and, even where they are, they will be established by dealers in these instruments and consequently it may be difficult to establish what is a fair price.

7. Foreign markets

Foreign markets will involve different risks from the UK markets. In some cases the risks will be greater. On request, your firm must provide an explanation of the relevant risks and protections (if any) which will operate in any foreign markets, including the extent to which it will accept liability for any default of a foreign firm through whom it deals. The potential for profit or loss from transactions on foreign markets or in foreign denominated contracts will be affected by fluctuations in foreign exchange rates.

8. Contingent liability investment transactions

Contingent liability investment transactions, which are margined, require you to make a series of payments against the purchase price, instead of paying the whole purchase price immediately.

If you trade in futures contracts for differences or sell options, you may sustain a total loss of the margin you deposit with your firm to establish or maintain a position. If the market moves against you, you may be called upon to pay substantial additional margin at short notice to maintain the position. If you fail to do so within the time required, your position may be liquidated at a loss and you will be responsible for the resulting deficit. Even if a transaction is not margined, it may still carry an obligation to make further payments in certain circumstances over and above any amount paid when you entered the contract.

Save as specifically provided by the FSA, your firm may only carry out margined or contingent liability transactions with or for you if they are traded on or under the rules of a recognised or designated investment exchange. Contingent liability investment transactions which are not so traded may expose you to substantially greater risks.

9. Limited liability transactions

Before entering into a limited liability transaction, you should obtain from your firm or the firm with whom you are dealing a formal written statement confirming that the extent of your loss liability on each transaction will be limited to an amount agreed by you before you enter into the transaction.

The amount you can lose in limited liability transactions will be less than in other margined transactions, which have no predetermined loss limit. Nevertheless, even though the extent of loss will be subject to the agreed limit, you may sustain the loss in a relatively short time. Your loss may be limited, but the risk of sustaining a total loss to the amount agreed is substantial.

10. Collateral

If you deposit collateral as security with your firm, the way in which it will be treated will vary according to the type of transaction and where it is traded. There could be significant differences in the treatment of your collateral, depending on whether you are trading on a recognised or designated investment exchange, with the rules of that exchange (and the associated clearing house) applying, or trading off-exchange. Deposited collateral may lose its identity as your property once dealings on your behalf are undertaken. Even if your dealings should ultimately prove profitable, you may not get back the same assets which you deposited, and may have to accept payment in cash. You should ascertain from your firm how your collateral will be dealt with.

11. Commissions

Before you begin to trade, you should obtain details of all commissions and other charges for which you will be liable. If any charges are not expressed in money terms (but, for example, as a percentage of contract value), you should obtain a clear and written explanation, including appropriate examples, to establish what such charges are likely to mean in specific money terms. In the case of futures, when commission is charged as a percentage, it will normally be as a percentage of the total contract value, and not simply as a percentage of your initial payment.

12. Suspensions of trading

Under certain trading conditions it may be difficult or impossible to liquidate a position. This may occur, for example, at times of rapid price movement if the price rises or falls in one trading session to such an extent that under the rules of the relevant exchange trading is suspended or restricted. Placing a stop-loss order will not necessarily limit your losses to the intended amounts, because market conditions may make it impossible to execute such an order at the stipulated price.

13. Clearing house protections

On many exchanges, the performance of a transaction by your firm (or third party with whom he is dealing on your behalf) is 'guaranteed' by the exchange or clearing house. However, this guarantee is unlikely in most circumstances to cover you, the customer, and may not protect you if your firm or another party defaults on its obligations to you. On request, your firm must explain any protection provided to you under the clearing guarantee applicable to any on-exchange derivatives in which you are dealing. There is no clearing house for traditional options, nor normally for off-exchange instruments which are not traded under the rules of a recognised or designated investment exchange.

14. Insolvency

Your firm's insolvency or default, or that of any other brokers involved with your transaction, may lead to positions being liquidated or closed out without your consent. In certain circumstances, you may not get back the actual assets which you lodged as collateral and you may have to accept any available payments in cash. On request, your firm must provide an explanation of the extent to which it will accept liability for any insolvency of, or default by, other firms involved with your transactions.

[name of firm]

[on duplicate for signature by private customer]

I/We have read and understood the risk warning set out above.

Date

[Signature of the customer]

[Signature of joint account holder]

Note to firms

Paragraphs 1–10 may be deleted when they relate to particular kinds of business which will not be carried out with or for the customer.

Paragraphs 11–14 are mandatory and may not be deleted.

This notice may be incorporated as part of a two-way customer agreement, but the customer must sign separately that he has read and understood the risk warnings.

Dealing in securities which may be subject to stabilisation (E)

1 Table This table belongs to ■ COB 5.4.9.

This statement complies with the rules of the Financial Services Authority (FSA)

[Name of Firm] or its representatives may, from time to time, recommend transactions in securities to you, or carry out such transactions on your behalf, where the price may have been influenced by measures taken to stabilise it.

You should read the explanation below carefully. This is designed to help you judge whether you wish your funds to be invested at all in such securities and, if you do, whether you wish:

- (1) to be consulted before [Name of Firm] carries out any such transaction on your behalf; or
- (2) to authorise [Name of Firm] to carry out any such transaction on your behalf without first having to consult you.

What is stabilisation?

Stabilisation enables the market price of a security to be maintained artificially during the period when a new issue of securities is sold to the public. Stabilisation may affect not only the price of the new issue but also the price of other securities relating to it.

The FSA allows stabilisation in order to help counter the fact that, when a new issue comes onto the market for the first time, the price can sometimes drop for a time before buyers are found.

Stabilisation is being carried out by a 'stabilisation manager' (normally the firm chiefly responsible for bringing a new issue to market). As long as the stabilising manager follows a strict set of rules, he is entitled to buy back securities that were previously sold to investors or allotted to institutions which have decided not to keep them. The effect of this may be to keep the price at a higher level than it would otherwise be during the period of stabilisation.

The Stabilisation Rules:

- (1) limit the period when a stabilising manager may stabilise a new issue;
 - (2) fix the price at which he may stabilise (in the case of shares and warrants but not bonds); and
 - (3) require him to disclose that he may be stabilising but not that he is actually doing so.
- The fact that a new issue or a related security is being stabilised should not be taken as any indication of the level of interest from investors, nor of the price at which they are prepared to buy the securities.

Chapter 6

Product disclosure and the customer's right to cancel or withdraw



6.1 Packaged product and ISA disclosure

Application

6.1.1

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■ COB 6.1 to ■ COB 6.5 apply to a *firm*:

- (1) which sells, *personally recommends* or *arranges (brings about)* for the sale of a *packaged product* to a *private customer* or to the trustees of an *occupational pension scheme* or to the trustee or operator of a *stakeholder pension scheme*; or
- (2) which manages, sells or *personally recommends* a *cash deposit ISA* for or to a *private customer*; or
- (3) which effects, *personally recommends* or arranges for a variation of a *life policy* for or to a *private customer*; or
- (4) which effects, *personally recommends* or arranges *income withdrawals* for or to a *private customer*.

6.1.2

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- (1) ■ COB 6.2.21 (Exceptions from the requirement to provide key features for life policies) and ■ COB 6.2.24 (Exceptions from the requirement to provide key features for schemes) contain exemptions from the requirement to produce *key features* in relation to *life policies* and *schemes*.
- (2) ■ COB 6.4.3 to ■ COB 6.4.5 and ■ COB 6.4.19 to ■ COB 6.4.20 set out how the *rules* apply where *packaged products* are sold to the trustees of certain *occupational pension schemes* or to the trustees or operators of *stakeholder pension schemes*.

Purpose

6.1.3

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■ COB 6.1 to ■ COB 6.5 amplify *Principle 7* (Communications with clients), which requires a *firm* to pay due regard to the information needs of its *customers*. In the case of *packaged products* there is a special need to ensure that *private customers* are supplied with information which will highlight particular *packaged product* features. This also needs to be achieved in a way which will optimise the *private customer's* ability to make a comparative analysis of different *packaged products*. These *rules* also address a similar information need in relation to *cash deposit ISAs*.

Requirement to produce key features

6.1.4

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- (1) A *product provider* or *stakeholder pension scheme* operator must, for each *packaged product* which it offers produce *key features* which, as to design and content, comply with the requirements of ■ COB 6.1, ■ COB 6.2 and ■ COB 6.5.
- (2) A *firm* to which ■ COB 6.4.13(1) applies must, for each *cash deposit ISA* it offers, produce the information document required by ■ COB 6.5.42 instead of *key features*. That information document must comply with ■ COB 6.1, ■ COB 6.2 and ■ COB 6.5 as to design and content.
- (3) A *firm* must produce *key features* in printed hard copy format and may in addition produce *key features* in an electronic format, unless the *firm* intends to conduct the activities in ■ COB 6.1.1 solely through electronic media, in which case there is no requirement for a printed hard copy.

Quality and production of key features

6.1.5

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A *firm* must ensure that any *key features* or information document it produces is in writing, whether in printed hard copy or in electronic format, and:

- (1) is produced and presented to at least the same quality and standard as the associated sales or marketing material being used by the *firm* to promote the *packaged product* or *cash deposit ISA* to *customers*; and
- (2) is separate from any other material given to the *customer*, unless it is produced for *collective investment schemes* or *stakeholder pension schemes*; in that case it may be included as part of another item of sales or marketing material, but only if the *key features* or information document appears with due prominence.

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Separate in ■ COB 6.1.5(2) means stand-alone for these purposes. Where *key features* are produced in hard copy printed format, *firms* should, in complying with ■ COB 6.1.5, have particular regard to the quality of paper, the type size and the use of colour printing. Where an electronic format is used, the *firm* should pay regard to the design and appearance of the *key features* screens, as compared to other screens being used to promote the product. Where *key features* are permitted to be included within another item, the need for due prominence is unlikely to be satisfied if they are hidden away at the end, or are produced in such small type that their impact on the reader is likely to be materially less than other parts of the document or series of screens.



6.2 Provision of key features

Application

- 6.2.1 **R** ■ COB 6.2 applies to a *firm* in accordance with ■ COB 6.1.1.
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General

- 6.2.2 **R** The *key features* which the rules in ■ COB 6.2 and ■ COB 6.4 require a *firm* to provide to a *private customer* must be provided by the *firm* in writing.
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- 6.2.3 **G** For detailed guidance on electronic provision please refer to ■ COB 1.8 and ■ COB 3.14.
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- 6.2.4 **G** *Firms* are reminded that any *key features* or other information required by ■ COB 6.4 - ■ COB 6.5 is a form of *financial promotion* and therefore the *financial promotion rules* contained in ■ COB 3 apply (subject to the application provisions in ■ COB 3.1 to ■ COB 3.3). The same is true for a document relating to a *cash deposit ISA* produced by a *bank* or *building society* under the Banking Code in place of that required under ■ COB 6.5.42 (see ■ COB 6.4.13(2)).
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- 6.2.5 **G** ■ COB 3.7 requires a *firm* to keep records of *non-real time financial promotions* to *private customers* for certain periods of time. These periods are: indefinitely for a record relevant to a *pension transfer* or *pension opt out*; six years for a record relevant to a *life policy*, *pension contract* or *stakeholder pension scheme*; and three years in any other case.
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Life policies

- 6.2.6 **G** ■ COB 6.2.7 - ■ COB 6.2.18 are disapplied by ■ COB 6.2.21 in relation to certain *customers* resident outside the *United Kingdom*.
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- 6.2.7 **R** When a *firm* sells, *personally recommends* or arranges the sale of a *life policy* to a *private customer*, the *firm* must provide the *private customer* with appropriate *key features* before the *private customer* completes an application for the *policy*, unless ■ COB 6.2.9(2) applies.
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- 6.2.8 **G** Where a *private customer* has responded to a *direct offer financial promotion*, the mailing package or *financial promotion* will have included example-based *key*
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features – there is no requirement to provide a further set of *key features* to such a *private customer* in respect of the same transaction.

6.2.9

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- (1) ■ COB 6.2.7 does not apply to a *product provider* when its *life policy* is sold on the *personal recommendation* of, or arranged to be sold by, an *independent intermediary* or *marketing group associate*.
- (2) ■ COB 6.2.7 does not apply to a *firm* where the *private customer* is to acquire a *life policy* without making a written application, but the *firm* must instead ensure that it gives an adequate oral explanation of the main features of the *policy*, and must give or send the *private customer* appropriate *key features* within five *business days* of the date on which the sale, recommendation or arrangement was made.

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In most cases, *life policies* will be sold through written applications or proposal forms. ■ COB 6.2.9(2) in particular allows personal pensions to be effected or varied quickly at the end of the tax year, when speed might be essential and the transaction is effected by telephone. A 'written' application includes an application by electronic means.

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An adequate oral explanation of the information required by ■ COB 6.2.9(2) should include the following:

- (1) the *policy* type, brand name and issuing *company*;
- (2) the *policy* aims, the *private customer's* commitment and the risk factors;
- (3) a summary of the reasons for any recommendation;
- (4) where it is the case, the fact that *commission* or *remuneration* will be paid to the *adviser* or *representative*; and
- (5) that *key features* will be sent within five *business days*.

Life policies: pre-completion variations

6.2.12

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Where *key features* have already been provided by a *firm* to a *private customer* and the terms for the proposed *life policy* are subsequently altered before the *private customer* completes an application form, the *firm* must ensure that the *private customer* is provided with revised *key features*, unless the alteration is one or more of the following:

- (1) the amount of the *premium* is changed;
- (2) the amount of any *commission* or *remuneration* payable is reduced;
- (3) a rider benefit is added, removed or amended.

6.2.13 G /1 ■ COB 6.2.12 is intended to allow simple changes to be made before a *private customer* commits himself without further *packaged product* disclosure information being provided. Changes in the amount of *premium* alone, of whatever size, will not require revised *key features* if the underlying purpose of the proposed contract is unchanged. So, for example, an increase in the proposed regular *premium* for a *personal pension policy*, will not require revised *key features*; nor will a change in *premium* and sum assured under a mortgage *policy* if the loan has to be increased before the house sale is finalised. However, changes to the type of *packaged product* or the underlying purpose would require revised *key features* – examples being a change from regular to single *premiums* under a *personal pension policy*, or a change from maximum life cover to balanced or standard protection under a flexible whole-life *policy*, with or without a change in *premium*. Revised *key features* would be required where the rate or basis of *commission* or *remuneration* was increased, but not where the amount increased simply because of a change in *premium*.

6.2.14 R /1 Where *key features* have already been provided to a *private customer* by a *firm*, and the terms of the proposed *life policy* are materially altered after the *private customer* completes an application form, the *firm* must ensure that the *private customer* is provided with written details of the change as soon as practicable and offered revised *key features*.

6.2.15 G /1 What constitutes a ‘material change’ requires consideration of the facts in the circumstances of each case. Changes which lead to an increase in the proposed *premium* of 25 per cent or less can be regarded as not material and can be ignored, so long as the underlying *policy* terms and conditions are the same. Other changes to the terms of the proposed contract, such as an increase in the rate or basis of *commission*, a different charges structure or an extension of the *policy* term should be regarded as material.

Variations to existing life policies

6.2.16 R /1 When a policyholder applies to vary a *life policy* issued on or after 1 January 1995 (or is recommended to do so) and the variation of the *policy* gives rise to a right to cancel under ■ COB 6.7.7, a document containing at least the information required by ■ COB 6.5.15 – ■ COB 6.5.19, ■ COB 6.5.23 – ■ COB 6.5.25, ■ COB 6.5.27 - ■ COB 6.5.28 and ■ COB 6.5.38 must be provided to the policyholder by the *firm* personally recommending, arranging or effecting the variation before it is put into effect, unless ■ COB 6.2.19 applies.

6.2.17 G /1 *Key features* were introduced for new *policies* sold from 1 January 1995. *Firms* can meet the requirements of ■ COB 6.2.16 by providing a complete set of new *key features* to the policyholder. If a full *key features* is not provided, then as a minimum the information to be supplied must include the details required by ■ COB 6.5.15 – ■ COB 6.5.19 (An Example), ■ COB 6.5.23 – ■ COB 6.5.25 (Tables), ■ COB 6.5.19 – ■ COB 6.5.28 (Deductions Summary) and ■ COB 6.5.38 (*Commission/Remuneration*). The illustrative figures in the *key features* could relate to just the increase in *premiums* and benefits, or could illustrate a ‘before and after’ situation.

6.2.18 R /1 When a policyholder applies to vary a *policy* issued before 1 January 1995 (or is *personally recommended* to do so) and the variation of

the *policy* gives rise to a right to cancel under ■ COB 6.7.7, information must be given to the policyholder by the *firm* that is *personally recommending*, arranging or effecting the variation before it is put into effect, unless ■ COB 6.2.19 applies. The *firm* must believe on reasonable grounds that the information given is sufficient to enable the policyholder to understand the consequences of the variation.

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- (1) ■ COB 6.2.16 and ■ COB 6.2.18 do not apply to a *product provider* when the variation to its *life policy* is effected on the *personal recommendation* of or arranged by an *independent intermediary* or *marketing group associate*.
- (2) ■ COB 6.2.16 and ■ COB 6.2.18 do not apply to a *firm* where the *private customer* is to vary a *life policy* without making a written application, but the *firm* must instead ensure that it gives an adequate oral explanation of the variation, and must give or send the *private customer* the information required by whichever of ■ COB 6.2.16 or ■ COB 6.2.18 is applicable within five *business days* of the variation being effected.

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The *guidance* in ■ COB 6.2.10 and ■ COB 6.2.11 is also relevant to top-ups to existing *policies* when speed might be essential and the transaction is effected by telephone.

Exception from the requirement to provide key features for life policies

6.2.21

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- There is no requirement for *key features* to be provided for a new *life policy* or a variation to an existing *policy* if, at the time that the *private customer* signs the application; he is *habitually resident*:
- (1) in an *EEA State* other than the *United Kingdom*; or
 - (2) outside the *EEA* and he is not present in the *United Kingdom*.

Schemes

6.2.22

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- When a *firm* sells, *personally recommends* or arranges for the sale of a *scheme* to a *private customer*:
- (1) the *firm* must, unless ■ COB 6.2.24 or ■ COB 6.2.25 applies, provide the *private customer* with *key features* for the *scheme* before he completes an application for the *scheme holding*; or
 - (2) the *firm* may delay the provision of *key features* where a *private customer* is to acquire the *scheme* without making a written application, provided that it gives an adequate oral explanation of the main features of the *scheme holding* to the *private customer* and the *key features* are sent to him within five *business days* of

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the date on which the sale, recommendation or arrangement was made.

- (1) ■ COB 6.2.22 applies not just to new purchases but also to any recommendation or application to transfer the value of a particular fund holding within a *scheme* to a different fund within the same *scheme*.
- (2) Where a *private customer* has responded to a *direct offer financial promotion*, the mailing package or *direct offer financial promotion* should have included example-based *key features* – there is no requirement to provide a further set of *key features* to such a *private customer* in respect of the same transaction.
- (3) An adequate oral explanation of the information required by ■ COB 6.2.22 should include the following:
 - (a) the name of the *scheme*;
 - (b) the *scheme*'s aims, the amount to be invested and the risk factors;
 - (c) the charges that the *customer* will or may bear and their effect on his *investment*;
 - (d) a summary of the reasons for any recommendation;
 - (e) where it is the case, that *commission* or *remuneration* will be paid to the *adviser* or *representative*; and
 - (f) that *key features* will be sent within five *business days*.

Exceptions from the requirement to provide key features for schemes

6.2.24

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A *firm* need not provide *key features* to a *private customer* in respect of a *scheme* if:

- (1) it is a *UK firm* and the obligation arises from business carried on in another *EEA State* under an *EEA right*; or
- (2) at the time he signs the application, the *private customer* is habitually resident outside the *EEA* and is not present in the *United Kingdom*; or
- (3) the *scheme holding* is purchased by a *private customer* on an execution-only basis; or
- (4) the *scheme holding* is purchased on behalf of a *private customer* by an *investment manager* exercising discretion; or
- (5) the sale of the *scheme holding* is arranged or recommended by an *investment manager* who is not exercising discretion and the *private customer* has agreed, either in relation to that specific holding or generally, that *key features* need not be provided; or

- (6) a *private customer* is making a purchase of a *scheme holding* in a fund in which he already has a *scheme holding*:
 - (a) where the terms and conditions, including all charges, are the same as applied at the time of the previous purchase of a *scheme holding* in that fund; and
 - (b) *key features* outlining those terms and conditions were issued to the *private customer* in respect of that previous purchase; or
- (7) a *private customer* is transferring from *accumulation units* to *income units* of the same *scheme* (or vice versa) and has already been supplied with *key features* for that *scheme*.

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- COB 6.2.22 does not apply to a *product provider* when the *scheme holding* is sold on the *personal recommendation* of, or arranged to be sold by, an *independent intermediary* or *marketing group associate*.



6.3 Post-sale confirmation: life policies

Application

- 6.3.1** **R** ^{/1} ■ COB 6.3 applies to a *firm* in accordance with ■ COB 6.1.1.
- 6.3.2** **G** ^{/1} The requirement on *long-term insurers* to issue post-sale confirmation applies only to *life policies* which are *packaged products*. ■ COB 6.3 does not require a *long-term insurer* to issue post-sale confirmation in respect of *schemes*, *pure protection contracts* or *stakeholder pension schemes*.
- 6.3.3** **R** ^{/1} When a *private customer* buys a *life policy* which is a *packaged product* or varies such an existing *life policy*, and the variation gives rise to a right to cancel under ■ COB 6.7.7, the *long-term insurer* must send to, or in the case of an *industrial assurance policy* must either give or send to, the *private customer* the information required in ■ COB 6.5.46, unless ■ COB 6.3.6 applies.
- 6.3.4** **G** ^{/1} Post-sale confirmation can be provided in printed hard copy and sent through the post direct to the *private customer*. For *industrial assurance policies*, the post-sale confirmation may be delivered by the *firm's representative* rather than sent by *post*. When a *private customer* has approached the *firm* or has responded by submitting his application through an electronic medium (such as e-mail or through the Internet), the post-sale confirmation may be provided by the same means. But electronic methods should only be used where the *private customer* expects to communicate in this way (see ■ COB 1.8 (Application to electronic media)).
- 6.3.5** **R** ^{/1} The post-sale confirmation required by ■ COB 6.3.3 must be sent or given to the *private customer* no later than the issue of any *post-sale notice* under the *cancellation rules* or, if no such notice is required, as soon as reasonably practicable after the contract is effected.

Exceptions to post-sale confirmation

- 6.3.6** **R** ^{/1} A *long-term insurer* need not send or give the post-sale confirmation required by ■ COB 6.3.3 when:
- (1) the *long-term insurer* has taken reasonable steps to determine that the *life policy* or variation is purchased or effected on behalf of a *private customer* by an *investment manager* exercising discretion; or

- (2) the *life policy* is purchased by the trustees of an *occupational pension scheme*; or
- (3) the *life policy* is purchased by the trustees or manager of a *stakeholder pension scheme*; or
- (4) a *life policy* issued before 1 January 1995 is being varied; or
- (5) at the time the *private customer* signs the application for the new *life policy* or variation, he is *habitually resident*:
 - (a) in an *EEA State* other than the *United Kingdom*; or
 - (b) outside the *EEA* and he is not present in the *United Kingdom*.



6.4 Product disclosure: special situations

Application

6.4.1 **R** ^{/1} ■ COB 6.4 applies to a *firm* in accordance with ■ COB 6.1.1, in respect of *occupational pension schemes*, self invested personal pensions, *income withdrawals*, *cash deposit ISAs*, *traded life policies* and *stakeholder pension schemes*.

6.4.2 **G** ^{/1} *Firms* are reminded that, under ■ COB 6.2.2, the *key features* required to be provided to a *private customer* under ■ COB 6.4 must be provided by the *firm* in writing. See also ■ COB 6.2.3 - ■ COB 6.2.5.

Occupational pension schemes

6.4.3 **G** ^{/1} ■ COB 6.1 and ■ COB 6.2 apply to a *firm* in respect of the purchase of *packaged products*, whether *life policies* or *schemes*, by the trustees of *money-purchase occupational schemes*. There is no requirement for a *firm* to provide *key features* for *packaged products* sold to trustees of *defined benefit pension schemes*.

6.4.4 **R** ^{/1}

- (1) When a *firm* sells, *personally recommends* or arranges the sale of a new group or master *life policy*, the first in a series of individual *life policies* or the first *units* in a particular *scheme* to or for the trustees of a *money-purchase occupational scheme*, it must provide the trustees with *key features*, in accordance with ■ COB 6.2.7 to ■ COB 6.2.25.
- (2) In ■ COB 6.2 to ■ COB 6.5, for the purposes of (1), the *firm* must treat the trustees as *private customers*.
- (3) In addition to the information to be provided to trustees under ■ COB 6.4.4(1), the *firm* must ensure that *key features* are made available to the trustees to distribute to all scheme members at the outset of the scheme and for subsequent new members.
- (4) The requirement in ■ COB 6.4.4(3) applies to main scheme benefits and to *additional voluntary contributions* where members' benefits are linked to earmarked segments of *life policies* or *schemes*. It does not apply where trustees make pooled investments and make their own arrangements for allocation of

investment returns to determine members' benefits, whether attached to *defined benefit pension schemes* or *money purchase occupational schemes*.

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- (1) The illustrative figures within the *key features* provided under ■ COB 6.4.4(1) can be on an example basis, using a range of representative actual or hypothetical scheme members (covering, for example, different ages, sexes and salaries), so that the trustees can assess the effectiveness of the investment for their pension scheme members.
- (2) The definition of *money-purchase occupational scheme* includes executive pension plans (established for directors, executives and senior employees), *small self-administered schemes* that provide *money-purchase benefits* and *additional voluntary contribution* schemes.
- (3) *Group personal pension schemes* are not *occupational pension schemes* and ■ COB 6.4.4 does not apply to them. *Firms* should therefore provide each *person* who is offered membership of a *group personal pension scheme* with *key features* in accordance with ■ COB 6.1 and ■ COB 6.2. This does not preclude generic *key features* being sent out as part of a *financial promotion*, provided that a post-sale confirmation is issued in accordance with ■ COB 6.3.3.
- (4) The objective of ■ COB 6.4.4(3) is to ensure that prospective scheme members have access to information about the *occupational pension scheme* that could enable comparison with alternative personal *investments*. *Firms* may decide for themselves the format (but not content) of this information. For example, individual sets of *key features* can be supplied or a schedule of details which the trustees or their advisers can assimilate into other pension scheme communications.

Self-invested personal pension schemes

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- (1) **A firm which sells, personally recommends or arranges the sale of a packaged product to or for a member, prospective member or trustees of a self-invested personal pension scheme, must provide key features to that member or trustees, in accordance with ■ COB 6.2.7 to ■ COB 6.2.25.**
- (2) **In ■ COB 6.2 to ■ COB 6.5, for the purposes of (1), members, prospective members and trustees must be treated by the firm as private customers.**

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Investments within a self-invested *personal pension scheme* (a "SIPP") are effected by the trustees on behalf of scheme members. *Key features* should be given to the trustees and to members of SIPPs when *packaged products* (whether *life policies* or *schemes*) are recommended by a *firm* to scheme members or effected by SIPP trustees. Cancellation notices should also be copied to SIPP members in these circumstances, in accordance with ■ COB 6.7.31.

Income withdrawals

6.4.8 **R** ^{/1} When a *firm personally recommends*, arranges or effects *income withdrawals* to or for a *private customer*, the *firm* must provide *key features* to the *customer* before he signs any form of application or authority electing to make those withdrawals, whether that election is made with *advice on investments* or on an execution-only basis, unless ■ COB 6.4.10 to ■ COB 6.4.12 apply.

6.4.9 **R** ^{/1} In relation to an election to make *income withdrawals*, the requirement for the provision of *key features* in:

- (1) ■ COB 6.2.7 also applies when an existing *life policy* is to be endorsed;
- (2) ■ COB 6.2.22 also applies when an existing *scheme holding* is to be used.

6.4.10 **R** ^{/1} In relation to an election to make *income withdrawals*, the requirements of ■ COB 6.4.11 and ■ COB 6.4.12 override the relevant requirement in ■ COB 6.2, where there is conflict.

6.4.11 **R** ^{/1} When a *private customer* makes a series of elections within a period of 12 months to make *income withdrawals*, the *firm* that is *personally recommending*, arranging or effecting the elections may provide one combined set of *key features* for those elections, or may provide separate sets of *key features* for elections which relate to *life policies* and *schemes*.

6.4.12 **R** ^{/1} At intervals no longer than 12 months from the date of an election by a *private customer* to make *income withdrawals*, the relevant *product provider* must:

- (1) provide the *private customer* with such information required by ■ COB 6.6.13 as will enable the *private customer* to review the election; and
- (2) inform the *private customer* how to obtain *advice on investments* in respect of his *income withdrawals*, and that it would be in his best interests to do so.

Cash deposit ISAs

6.4.13 **R** ^{/1} (1) A *firm* that manages, *personally recommends* or sells a *cash deposit ISA* must ensure, in relation to that *cash deposit ISA*, that the *private customer* is provided with the information specified in ■ COB 6.5.42 instead of *key features* before the transaction is entered into.

- (2) Paragraph (1) does not apply to a *firm* if it is a *bank* or *building society* which subscribes to the Banking Code issued by the British Bankers' Association, the Building Societies Association and the Association for Payment Clearing Services.

Traded life policies

- 6.4.14 **R** /1 When a *firm* personally recommends that a *private customer* should purchase a *traded life policy*, it need not provide *key features*, if it instead supplies the information outlined in ■ COB 6.5.44 in writing to the *private customer* before he is asked to complete any form of application or authority giving effect to the purchase of the *traded life policy*.

Stakeholder pension schemes

- 6.4.15 **R** /1 When a *firm* sells, manages, personally recommends or arranges the sale of a *stakeholder pension scheme* to or for a *private customer*, the *firm* must, subject to ■ COB 6.4.18, provide the *private customer* with *key features* before the *private customer* completes an application for the *stakeholder pension scheme*.
- 6.4.16 **R** /1 When a *firm* proposes to deal with a *private customer* on the telephone for the purposes of providing information through a decision tree about *stakeholder pension schemes*, the *firm* may do so only if it has adequate evidence to show that the *private customer* has access to a copy of a decision tree (as specified in ■ COB 6.5.8) during the conversation.
- 6.4.17 **G** /1 ■ COB 6.4.16 is intended to ensure that, where a *firm* takes a *private customer* through the decision tree process by telephone, it takes reasonable care to ensure that the *private customer* has a decision tree in front of him. For example, on first contact *firms* could enquire whether the *private customer* has a decision tree, and if not, send one to him before taking him through the decision tree process during a follow-up telephone call.
- 6.4.18 **R** /1 ■ COB 6.4.15 does not apply to a *stakeholder pension scheme* operator when its *stakeholder pension scheme* is sold on the *personal recommendation* of, or arranged to be sold by, another *firm*.
- 6.4.19 **R** /1 (1) When a *firm* sells, personally recommends or arranges the sale of a new group or master *life policy*, the first in a series of individual *life policies* or the first *units* in a particular *scheme* to the trustees or the operator of a *stakeholder pension scheme*, it must provide the trustees or operator with *key features*, in accordance with ■ COB 6.2.7 to ■ COB 6.2.25.
- (2) In ■ COB 6.2 to ■ COB 6.5, for the purposes of (1), the *firm* must treat trustees and managers as *private customers*.

- 6.4.20** **G**_{/1} The illustrative figures within the *key features* provided under ■ COB 6.4.19 can be on an example basis, using a range of representative actual or hypothetical *scheme* members (covering, for example, different ages, sexes and salaries), so that the *trustees* or operator can assess the effectiveness of the *investment* for *scheme* members.
- 6.4.21** **R**_{/1} When a *firm* provides a *private customer* with information through a decision tree concerning membership of a *stakeholder pension scheme*, but does not give *advice on investments* or make a *personal recommendation*, the *firm* must provide the *private customer* with a written notice in accordance with ■ COB 6.4.22 and ■ COB 6.4.23.
- 6.4.22** **R**_{/1} A written notice required by ■ COB 6.4.21 must be provided by the *firm* no later than the issue of the *post-sale notice* of the *private customer's* right to cancel under the *cancellation rules*.
- 6.4.23** **R**_{/1} The notice in ■ COB 6.4.22 must:
- (1) confirm that no *advice on investment* has been given and that the *private customer* has decided that the *stakeholder pension scheme* is appropriate as a result of the answers he has given to the questions posed in the decision tree; and
 - (2) include a copy of the decision tree indicating the answers which the *private customer* has given.
- 6.4.24** **G**_{/1} After giving information through a decision tree in accordance with ■ COB 6.4.16 and before the *customer* completes the application, a *firm* could satisfy ■ COB 6.4.15 by providing an adequate oral explanation (for example over the telephone in the case of a call-centre) about the main features of the *stakeholder pension scheme* (as outlined in ■ COB 6.2.11). Written *key features* must then be given or sent along with the copy decision tree in accordance with ■ COB 6.4.21 - ■ COB 6.4.23 within five *business days*.



6.5 Content of key features and important information: life policies, schemes, ISA cash deposit components and stakeholder pension schemes

Application

- 6.5.1 **R** ■ COB 6.5 applies in accordance with ■ COB 6.1.1.
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General

- 6.5.2 **R** A *firm* must ensure, unless ■ COB 6.5.3 applies, that:
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- (1) the *key features* it produces for a *packaged product* other than a *stakeholder pension scheme* includes the information required by ■ COB 6.5.11, set out in the order shown divided by appropriate and prominent sub-headings, some of which are prescribed in the *rules*;
 - (2) the information it produces for a *cash deposit ISA* under ■ COB 6.4.13(1) complies with ■ COB 6.5.42;
 - (3) the information document or abbreviated form of *key features* it produces relating to *friendly society tax exempt policies*, *traded life policies*, or *broker funds*, contains the applicable information specified in ■ COB 6.5.43 - ■ COB 6.5.45;
 - (4) the post-sale confirmation document it produces contains the applicable information specified in ■ COB 6.5.46; and
 - (5) the *key features* it produces or issues for a *stakeholder pension scheme*:
 - (a) includes the relevant sub-headings set out at ■ COB 6.5.11, the applicable information specified in ■ COB 6.5.12 – ■ COB 6.5.40 appropriate to those sub-headings; and
 - (b) is, subject to ■ COB 6.5.6, accompanied by or includes the decision trees specified in ■ COB 6.5.8, unless the *stakeholder*

pension scheme is being purchased as a result of a *personal recommendation*.

6.5.3 **R** ^{/1} A *firm* may adapt the prescribed content and format requirements in **■ COB 6.5** only when it can demonstrate that this is necessary to reflect the terms and nature of a particular product.

6.5.4 **G** ^{/1}

(1) Where the *rules* in **■ COB 6.5** do not require the use of prescribed text, *firms* may give the relevant information using their own words and style.

(2) For the purposes of **■ COB 6.5.2(1)**:

(a) a *firm* which offers more than one *scheme* may choose whether to produce separate *key features* for each *scheme* (including a fund or *sub-fund* or *share* class), or to produce a single *key features* to cover a range of funds (provided the differences between those funds are made clear);

(b) where a publication covers more than one *scheme* (for example, in the case of a year book comprising information on all the funds offered by a *unit trust manager*), it might consist of a *key features* section at the beginning giving details common to all the relevant funds (whether *unit trusts*, *ICVCs*, *sub-funds* of an *umbrella scheme* or *share* classes within an *ICVC*), followed by separate pages setting out, for each fund, those items which are specific to it, for example 'Aims', 'Risk Factors' and 'Charges and their Effect'.

Stakeholder pension schemes: decision trees

6.5.5 **G** ^{/1} There is no obligation to supply a decision tree where a *firm* has *personally recommended* a *stakeholder pension scheme* to a *private customer*. *Firms* may wish to supply a copy of any decision tree used as part of the advice process along with the mandatory *suitability letter*.

6.5.6 **R** ^{/1} Where a *firm* knows that a certain decision tree or trees will not be relevant to a *private customer* to whom *key features* are to be given, the *firm* can omit them and include only the relevant decision tree or trees.

6.5.7 **G** ^{/1} There are three versions of the decision trees – for employed persons, the self-employed and those not in employment. The specified introductory text is a required part of each decision tree. *Firms* are permitted to issue one decision tree, consisting of the introductory text and the relevant version of the flowcharts, where the employment status of the *customer* is known. In other circumstances, the introductory text and all three versions of the flowcharts should be included. This *guidance* applies whether decision trees are within the *key features* or are used separately.

6.5.8 **R** ^{/1} Whether a *firm* produces decision trees within or separate from *key features*, unless **■ COB 6.5.9** applies, it must reproduce the text, content and format set out in **■ COB 6 Ann 1**.

6.5.9 **R** ^{/1} The only adaptations a *firm* may make to the decision trees specified in **■ COB 6.5.8** are those suitable to brand the decision tree with the corporate image of the *firm*, to reflect the design of its *stakeholder*

pension scheme promotional material or to reflect the use of interactive delivery.

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- (1) There is a limited scope within ■ COB 6.5.9 to depart from the prescribed decision tree format and content in order to blend in the trees with other promotional materials such as *key features* or internet *financial promotions*. However, the text and general design should follow the prescribed content and format. *Firms* will be aware that the *FSA* publishes its own version of the decision trees for public use: *firms* may consider them as examples of acceptable design.
- (2) Examples of items and formatting where no adaptations should be made include:
 - (a) the text – both content and order – whether in the introduction, the boxes within the flowcharts or any other sections of the decision trees;
 - (b) the use of boxed items within the introductory text;
 - (c) the use of emphasis (*firms* can choose the method of giving emphasis, such as size, bold or italic text);
 - (d) the vertical flow and pagination of the flowcharts within the decision trees;
 - (e) the boxes within the flowchart pages – these should be rectangular and filled with one consistent colour, except that two tints of the base colour may be used to highlight tick boxes and to differentiate columns of figures;
 - (f) the directional arrows linking the boxes within flowchart pages – these should be of one design and the same colour as fills the flowchart boxes.
- (3) Examples of items where adaptations can be made include:
 - (a) the typeface and font size of the text;
 - (b) the pagination of the introductory text and the use of columns;
 - (c) the edging of boxes (for example, use of shadow or rounded corners);
 - (d) the use of background colours, for example, to match corporate colours or product brochures (see (2)(e));
 - (e) separate colour schemes to differentiate between sets of decision trees, for example between employed and self-employed versions;
 - (f) the use of an extra colour to highlight headings within flowchart pages and to identify separate versions of the decision trees;
 - (g) the size of paper used (A4 is recommended, but other sizes are possible, provided that the flowchart pages are clear and legible);
 - (h) where delivery is through an interactive computer-based system, the wording of the introductory text that explains how to use the decision trees.

6.5.11

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Table Table of Information/Applicable provisions
This table belongs to ■ COB 6.5.2(1)

Information	Applicable provisions
Title	COB 6.5.12R
Nature of <i>life policy</i> or <i>scheme</i> or <i>stakeholder pension scheme</i>	COB 6.5.13R – COB 6.5.14G
An example	COB 6.5.15R – COB 6.5.19R
Description of the <i>life policy</i> or <i>scheme</i> or <i>stakeholder pension scheme</i>	COB 6.5.20R
Tables:	
<i>Life policies</i>	COB 6.5.23 – COB 6.5.26R
<i>Schemes</i>	COB 6.5.30 – COB 6.5.32R
Deductions summary:	
<i>Life policies</i>	COB 6.5.27 – COB 6.5.29R
<i>Schemes</i>	COB 6.5.33 – COB 6.5.36G
Commission and remuneration	COB 6.5.38R – COB 6.5.39G
Further information	COB 6.5.40R

Title

6.5.12

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A *firm* must include this heading: 'key features of the [name of *life policy/scheme/stakeholder pension scheme*]'.
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Nature of *life policy* or *scheme* or *stakeholder pension scheme*

6.5.13

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- (1) A *firm* must describe the nature of the *life policy* or *scheme* or *stakeholder pension scheme* under the following headings: 'its aims', 'your commitment', or, 'your investment' (whichever is more appropriate) and 'risk factors'.
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- (2) Under 'risk factors' a *firm* must give a brief description of the factors which may have an adverse effect on performance or are otherwise material to the decision to invest.

6.5.14

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A *firm* might include information on the following under 'risk factors', when relevant:
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- (1) whether the value of the capital and any income from it might fluctuate;
- (2) cancellation issues, including the fact that, if the value of the investment falls before notice of cancellation is given, a full refund of the original investment may not be provided but rather the original amount less the fall in value;
- (3) particular risks, if any, associated with the underlying assets in which the *packaged product* is invested;
- (4) risks associated with the markets in which investments will be made, with particular reference to emerging markets; such risks might include dealing difficulties, settlement and *custody* practices;

- (5) special risks such as capital erosion or constraints on capital growth in the case of funds where charges are deducted from capital, or where buying income or dividend stripping forms part of the investment strategy;
- (6) volatility, in particular with regard to *higher volatility funds* such as *geared futures and options schemes* and *warrant schemes* and the fact that the loss on realisation of the investment could be very high, even equalling the amount originally invested;
- (7) the inclusion of a 'market value adjustment' in respect of with-profits funds, and the risk that, in adverse circumstances, benefits could be reduced;
- (8) potential problems with investment in property in respect of liquidity, and the fact that repurchase or surrender might be delayed during a period when the property is not readily saleable, and that property valuation is a matter of judgement by a valuer;
- (9) in the case of a *broker fund*, whether the *private customer* has the right, or may be required, to transfer out of that fund to any other fund or *scheme* of a *firm*; if so, the name of the fund or *scheme*, the transfer terms and the circumstances in which, and by whom, such a transfer may be required or made;
- (10) the risk that a current favourable situation may not be maintained in future, for example the tax treatment of *ISAs*;
- (11) the fact that if the *private customer* does not maintain contributions he may not meet any target benefit which has been projected and may lose the benefits of any life protection;
- (12) in the case of a new fund, the risk that, if its assumed size is not achieved, the proportion of charges and expenses allocated to the investment may be higher and the value of the investment consequently reduced;
- (13) the fact that there is no guarantee that a *life policy* such as an *endowment assurance* used to repay an interest-only mortgage will produce sufficient funds at the end of the mortgage term and that the amount the investor will have to continue to pay may need to increase to achieve repayment of the loan;
- (14) the fact that with personal pensions there may be penalties if the *private customer* takes the benefits before the stated retirement date;
- (15) in the case of a guaranteed *packaged product*, where it is a possibility, the fact that there may be a capital shortfall at the end of the contract; where there is a fixed regular payment of income, it should be drawn to the attention of the *private customer* that such payments often involve a risk to capital.

An example

6.5.15

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A *firm* must include a *projection*, illustrating how the principal terms of the proposed transaction apply to the *private customer*:

- (1) where the proposed transaction is for a *life policy*; or
- (2) where the proposed transaction is for a *scheme*:

PAGE
18

- (a) and relates to an election to make *income withdrawals*; or
- (b) where the *private customer's* primary objective is to acquire;
 - (i) a specified sum of money on a specified date; or
 - (ii) a specified sum of money on death; or
 - (iii) an annuity of a specified amount payable as from a specified date.

6.5.16 G _{/1} A *projection* may be included for *schemes* where ■ COB 6.5.15(2) does not require one, at a *firm's* discretion.

6.5.17 G _{/1} Where the proposed transaction is for a *stakeholder pension scheme*, a specimen *projection* will have been included in the decision tree. There is no requirement in these *rules* for a personalised *projection* in the *key features* for a *stakeholder pension scheme*. Where *projections* are given for *stakeholder pension schemes* in other circumstances, for example where a scheme member requests a personalised *projection*, they should follow the standard *projection rules* in ■ COB 6.6.

6.5.18 R _{/1} All *projections* included in *key features*, except a specimen *projection* in a decision tree for a *stakeholder pension scheme*, must be calculated in accordance with ■ COB 6.6 (Projections), using the lower, intermediate and higher rates of return in ■ COB 6.6.50, and followed by the appropriate statements from ■ COB 6.6.15.

6.5.19 R _{/1} (1) A *life policy projection* in *key features* must be specific to the *private customer*, calculated on the basis of the *private customer's* age and sex, the sum assured, the *premium* and other principal factors of the proposed *life policy* unless:

- (a) the *life policy* is a single *premium life policy*; or
- (b) the total *premiums* payable do not exceed £120 a year (or £130 a year if the *premiums* are paid every four weeks); or
- (c) the total *premiums* are less than £1,000; or
- (d) the *key features* are part of a *direct offer financial promotion*.

(2) If (1)(a), (b), (c) or (d) applies and no *customer specific projection* is included, a *projection* must be provided which typically represents the type of business which the *firm* conducts (or proposes to conduct) in relation to the *life policy* in question.

(3) A *scheme projection* in *key features* must be based on either:

- (a) the actual amount which the *private customer* is proposing to invest; or

- (b) an amount which typically represents the type of business which the *firm* conducts (or proposes to conduct) in relation to the *scheme* in question;

unless it is for *income withdrawals*, when it must be on the basis of (a).

Description of the life policy or scheme or stakeholder pension scheme

6.5.20

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In addition to ■ COB 6.5.13 and ■ COB 6.5.18, a *firm* must set out in the form of questions and answers a description of the principal terms of the *life policy, scheme, or stakeholder pension scheme*, and any other information necessary to enable the *private customer* to make an informed decision.

6.5.21

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A *firm* should set out the following information:

- (1) for a *life policy* such as an endowment which is being used to repay an interest-only mortgage loan, details of how and when the *private customer* will be notified whether the *life policy* is on target to provide sufficient funds to repay the loan and, if it is not, what options the *private customer* has;
- (2) for a *life policy*, the consequences of making the *life policy* paid up or taking a contribution holiday;
- (3) for an *FSAVC*, a prominent warning that, as an alternative, a scheme *AVC* exists which may offer better terms, details of which can be obtained from the *occupational pension scheme* administrator;
- (4) for a *long-term care insurance* which is based on single *premium* investment bonds -
 - (a) a statement drawing attention to the possible effect on the capital invested where withdrawals are taken to pay for care; this can be communicated by including a standard, non-client-specific, example comparing the effect of *claim* payments on the value of the *life policy*, first assuming no *claims* and then assuming a *claim* beginning at age 80 and lasting for five years; the standard mid rate of return should be used assuming claim payments at the highest benefit level payable under the *life policy*; and
 - (b) information to make the *private customer* aware that he can use *key features* to compare the investment potential of different *product providers' packaged products*, for example *surrender values* at various times and the effect of deductions;
- (5) for a *personal pension scheme*, including a *group personal pension scheme*, a clear and prominent indication of the general availability of *stakeholder pension schemes* and the fact that these might meet the consumer's needs at least as well as the *personal pension scheme* on offer;
- (6) for a *stakeholder pension scheme*, a description of the default investment option offered under regulation 3(5) of the Stakeholder Pension Schemes Regulations 2000.

Tables and deductions summaries for life policies, schemes and stakeholder pension schemes

6.5.22

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- (1) ■ COB 6.5.23 - ■ COB 6.5.29 set out the Tables, Deductions Summary and method of calculating the 'Effect of deductions to date' for *life policies*.
- (2) ■ COB 6.5.30 - ■ COB 6.5.36 set out the Tables, Deductions Summary and method of calculating 'Effect of deductions to date' for *schemes*.
- (3) ■ COB 6.5.37 outlines a simplified illustration of charges for *stakeholder pension schemes*. There is no requirement for the tables of figures or the reduction in yield summary required for *life policies* or *schemes*.

Tables for life policies

6.5.23

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For *life policies* which can have a *surrender value*, a *firm* must include the contents of ■ COB 6.5.24 unless ■ COB 6.5.28 applies.

6.5.24

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Table The early years
This table belongs to ■ COB 6.5.23

The early years

WARNING – if you cash in during the early years you could get back less than you have paid in.

The last two columns assume that investments will grow at [insert the intermediate rate appropriate to the type of *life policy* set out in COB 6.6.50R] a year.

At end of year	Total paid in to date	[Total actual deductions to date]	Effect of deductions to date	What you might get back
	£	£	£	£
1				
2				
3				
4				
5				
The later years				

Notes:

The column headed 'Total actual deductions to date' is optional. If included, it must follow the requirements in COB 6.5.23R – COB 6.5.29R. In the case of a *Holloway sickness policy*, an indication of the total cost of risk benefits expressed as a figure in £s may be given by way of a footnote to the column headed 'Effect of deductions to date'.

6.5.25

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When completing ■ COB 6.5.24, a *firm* must:

- (1) under 'the early years' include figures for the first five years of the *life policy* or, if the *life policy* has a fixed term of less than five years, as many of them as fall before the maturity date;
- (2) under 'the later years' include figures for the tenth and every subsequent fifth year of the term of the *life policy* (or of the contract period as defined in ■ COB 6.6.25 if that is shorter) and for the final year, except in the following cases:
 - (a) for a whole-life *policy*, figures must be included for every tenth year and:
 - (i) the final year, assuming that the *life policy* will continue (unless and until converted to a fixed term) until the insured life (or the youngest insured life) attains the age of 75 years or to a term of ten years if that is later; or
 - (ii) the year in which the projected fund reaches zero if earlier than (i); the consequences of this must be drawn to the *private customer's* attention;
 - (b) in the case of a single *premium life policy* with no fixed term, a term of ten years should be assumed, but figures for a longer term may be shown in addition;
 - (c) for a ten-year *life policy*, the figures for the final year may be included in the 'early years' table;
 - (d) for a *personal pension policy* with *income withdrawals*, there is an option to quote figures for the sixth year and at three-yearly intervals thereafter; and
 - (e) where there is any significant discontinuity in the trend of surrender or transfer values, figures should be given for all the intervening years.
- (3) in the 'Total paid in to date' column, include cumulative totals of *premiums* paid (making adjustment as necessary to take account of any automatic *premium* changes);
- (4) in the 'Total actual deductions to date' and 'Effect of deductions to date' columns, include the cumulative sum of the charges and expenses (as defined in ■ COB 6.6.23) and the cost of any protection benefits expected to be levied against the *life policy*; they must be calculated in accordance with ■ COB 6.5.29;
- (5) in the 'What you might get back' column, include projections of surrender values for the *life policy*:
 - (a) these must be calculated in accordance with ■ COB 6.6.38 (projections of surrender values) assuming the *premium* and

- any other relevant matters given for the purposes of ■ COB 6.5.13 (Nature of *Policy*) and ■ COB 6.5.15 (An Example);
- (b) the *surrender value* of a *premium* on a particular date must be calculated by assuming that any *premium* payable on that date is payable on the following day; and
 - (c) where any *surrender values* are guaranteed they must be provided with a suitably adjusted heading and introductory text;
- (6) where the *life policy* is a personal pension, replace 'What you might get back' with 'What the transfer value might be' and make suitable amendments to the explanatory text; for a *personal pension policy* with *income withdrawals* it must be replaced with 'Open market value';
 - (7) where the *private customer* is entitled to exercise and has chosen, or expressed the intention, to exercise the right to make partial surrenders, include a column headed 'Withdrawals' or, in the case of a personal pension with *income withdrawals*, 'Total income taken'; the sum of withdrawals must be shown;
 - (8) for a personal pension with *income withdrawals*, include a table headed 'What effect will the deductions have?' instead of 'The early years' and 'The later years'; where there is any charge or penalty in calculating the open market value, all the years to which this applies should be given; and
 - (9) in the case of a long-term care insurance *packaged product* based on a single *premium* investment bond, where the standard ten-year table does not illustrate adequately how the charges taken from a *policy* can increase considerably with age:
 - (a) the table must be extended to show figures at ten-year intervals and the year in which the *private customer* attains 100 years or the year the fund is exhausted if earlier; but
 - (b) the standard ten-year figure must be used for the reduction in yield and the accompanying words amended accordingly.

6.5.26

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■ COB 6.5.23 - ■ COB 6.5.25 do not apply to a *life policy* which will never have a *surrender value*; the following warning must be given instead of the tables: 'WARNING – this policy has no cash-in value at any time.'

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Deductions summary for life policies

6.5.27

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The following statements must appear beneath the information required by ■ COB 6.5.23, unless ■ COB 6.5.28 applies:

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- (1) 'What are the deductions for?'
- (2) 'The deductions include [the cost of life cover, sickness benefits,] [commissions/remuneration,] expenses, charges, any surrender penalties and other adjustments.'
- (3) 'The last line in the table shows that over the full term of the policy the effect of the total deductions could amount to £x.'

and then either:

- (4) 'Putting it another way, leaving out the cost of life cover [and sickness benefits] this would have the same effect as bringing investment growth from x% a year down to y% a year.' or
- (5) 'Putting it another way, if the growth rate were to be x%, which is in no way guaranteed, this would have the effect of reducing it to y% a year.'

6.5.28

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The information relating to 'Total actual deductions to date' and 'Effect of deductions to date' in ■ COB 6.5.23, and the information relating to reduction in yield required by ■ COB 6.5.27, do not need to be given for the following categories of *life policy*:

- (1) a without-profits *life policy* of which the benefits, except on surrender or variation, are guaranteed benefits;
- (2) a *life policy* for a term not exceeding five years.

Calculation method for 'effect of deductions to date' for life policies

6.5.29

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In ■ COB 6.5.24 the 'Total actual deductions to date' and the 'Effect of deductions to date' must be calculated for each of the years detailed in ■ COB 6.5.25. These are the amounts of all deductions that are expected to be levied against the assets and *premiums* in respect of charges and expenses (as defined in ■ COB 6.6.23), and surrender penalties, as well as allowance for the cost of risk benefits (defined in ■ COB 6.6.28) to the end of the year. They must be calculated as follows.

- (1) The *premiums* must be accumulated at the intermediate rate prescribed in ■ COB 6.6.49 for the category of *life policy* to which the *key features* relates (the 'prescribed rate'), making no allowance for charges and expenses and other deductions.
- (2) 'Effect of deductions to date' must be derived by subtracting the amount shown in the column 'What you might get back' from *premiums* accumulated in accordance with (1).

- (3) The figures in the column 'Effect of deductions to date' must reflect the charges and expenses accumulated at the prescribed rate. The column headed 'Total actual deductions to date' must show the sum of actual deductions.
- (4) The deductions for each year must be calculated by subtracting from the 'Effect of deductions to date' for that year the 'Effect of deductions to date' for the previous year (if any), increased by the amount of interest for the year calculated at the prescribed rate.
- (5) 'Total actual deductions to date' is the sum of the figures derived in accordance with (4) for the year in question and all previous years; where it is negative, nil must be shown for that year.

Table for schemes

6.5.30

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For *schemes*, a *firm* must include the contents of ■ COB 6.5.31.

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6.5.31

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Table This table belongs to ■ COB 6.5.30

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How will charges and expenses affect my investment?

[Give an indication of the nature and amount or rate of the charges and expenses which the *private customer* will or may bear, including any relevant proportion of *scheme* charges deducted directly from the fund or not directly attributed to the account of the *private customer*. In describing the nature of charges state how the charges will be made, in particular whether they will be taken from capital or income. Include a statement that dealing costs are not included.]

[Give a statement that there is a buying price and a selling price (if that is the case) and that the difference between them is called the 'spread', and an indication of where up-to-date information may be obtained on these prices.]

Their effect on an *investment* of £_____ assuming growth of [insert the intermediate rate appropriate to the type of *scheme* set out in COB 6.6.49R)] a year, is set out below

[Where (except as described in COB 6.5.15R(2)) a *projection* is not a *requirement*, include a statement that the figures are not guaranteed and serve only to demonstrate the effect of charges and expenses on an investment.]

At end of year	Investment to Date	Effect of deductions to date	What you might get back [at the appropriate intermediate rate]
	£	£	£
1			
3			
5			
10			

6.5.32

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When including the contents of ■ COB 6.5.31, a *firm* must replace the wording in brackets as directed by the instructions in those brackets and:

- (1) when the inclusion of a *scheme projection* within *key features* is compulsory in accordance with ■ COB 6.5.15(2), include figures calculated in accordance with ■ COB 6.6 (*projections*):
 - (a) at the end of years 1, 3, 5 and 10 and (optionally) for years 2 and 4;
 - (b) then for each fifth year following the tenth year which falls within the period of the *projection*; and
 - (c) the final year of the *projection*;
- (2) when a *scheme projection* is not required by ■ COB 6.5.15(2) but is included at a *firm's* discretion, include figures at the end of years 5 and 10 and (optionally) for years 1 and 3 or for years 1 to 4, all calculated in accordance with ■ COB 6.6 (*projections*);
- (3) in the 'Investment to date' column, include:
 - (a) the actual amount which the *private customer* is proposing to invest; or
 - (b) an amount which is representative of the type of business which the *firm* conducts (or proposes to conduct) in relation to the contract in question;

but where, under ■ COB 6.5.15(2), a *projection* is included in the *key features*, the amount shown as the 'Investment' must be the same as the amount used as the basis for the projection;
- (4) in the 'Effect of deductions to date' column, include the cumulative sum of charges and expenses (as defined in ■ COB 6.6.23) for each of the years shown, these figures must be calculated in accordance with ■ COB 6.5.35 - Calculation Method for Effect of charges to date;
- (5) in the 'What you might get back' column, include figures taking account of charges and expenses showing what the value might be if the *scheme* were cashed in;
- (6) where the contract is a personal pension, replace 'What you might get back' with 'What the transfer value might be', and make suitable amendments to the explanatory text; for a *personal pension contract* with *income withdrawals* the replacement must be 'Open market value';
- (7) include extra columns in the Table in the following cases:

- (a) where the *private customer* is entitled to exercise and has chosen, or expressed the intention, to exercise the right to make partial withdrawals, an extra column must be included headed 'Withdrawals' or, in the case of a *personal pension contract* with *income withdrawals*, 'Total Income taken'; 'Withdrawals' must include distributions of income;
- (b) where the investment involves periodic redemptions at pre-determined intervals to make payments to the *private customer*, a column headed 'Redemptions' is needed;
- (c) where the investment distributes income and does not involve the automatic reinvestment of this income, a column headed 'Income' must be included;

in (a), (b) and (c) the arithmetic sum of the withdrawals or redemptions or income payments must be stated, on the assumption that these are made throughout on the same basis as contemplated at the time the *projection* was prepared; the method set out in ■ COB 6.6.36 must be used to calculate distributions of income;

- (8) for a *personal pension contract* with *income withdrawals*, include in a table under the heading 'What effect will deductions have?' figures for every third year or every fifth year; where there is any charge or penalty in calculating the open market value, all the years to which this applies must be given;
- (9) include a statement that allowance for tax relief has been made in the calculation where any tax relief available to the *scheme* has been taken into account in the calculation of charges and expenses.

Deductions summary for schemes

6.5.33

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The statements in (1) and (2), or in (1) and (3) must appear beneath the information required by ■ COB 6.5.31:

- (1) 'The last line in the table shows that over [n] years the effect of the total charges and expenses could amount to £x';
- (2) 'Putting it another way, if the growth rate were to be (x)%, which is in no way guaranteed, this would have the effect of reducing it to (y)% a year';
- (3) 'Putting it another way, this would have the same effect as bringing investment growth from (x)% a year down to (y)% a year'.

6.5.34

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- (1) The figure [n] in the prescribed wording in ■ COB 6.5.33 is the number of years in figures given at the bottom of the table, as appropriate for each transaction.
- (2) The 'Investment to date' must be accumulated to the end of [n] years at the relevant rate of return (x)% making full allowance for the charges and expenses (as specified in ■ COB 6.6.23).
- (3) The rate of return (y)% must be found which, if applied (on a compound basis) to the amounts included in the 'Investment to date' column over the [n] years, without making any allowance for the charges and expenses, would produce the same sum as that calculated in (2).

Calculation method for 'effect of charges to date' for schemes

6.5.35

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For each year, figures must be given for the effect of deductions assuming the fund grows in accordance with a relevant rate of return (as defined in ■ COB 6.6.33). These calculations must reflect all deductions (charges and expenses as defined in ■ COB 6.6.23) expected to be levied against the fund and against the *private customer's* investment. The calculations must be made on the basis of the following principles:

- (1) for each year the 'Investment' must be accumulated, at the relevant rate of return (as specified in ■ COB 6.6.33), to the end of each year, making due allowance for the *charges* and expenses;
- (2) for each year the 'Investment' must be accumulated, at the relevant rate of return, to the end of each year, but making no allowance for the charges and expenses;
- (3) the 'Effect of deductions to date' is the amount calculated in (1) subtracted from the amount calculated in (2);
- (4) a rate of return which is lower than the relevant rate of return must be used where the *firm* expects that rate would imply an overstatement of the investment potential; and
- (5) the calculations specified in (1) and (2) must allow for any partial encashment of *units* or *shares* or distributions of income where under the terms of the *scheme* the *private customer* has exercised, or has expressed the intention of exercising, an option to make such encashments or to receive such income or where such encashments or distributions will automatically apply. The allowance must be assumed in accordance with the estimated rate or amount, unless to do so would be inappropriate for that *scheme*.

6.5.36

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■ COB 6.5.35(5) applies, for example, to *money market schemes* and bond funds.

Stakeholder pension schemes

6.5.37

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- (1) The statement in (2) must appear beneath or within the information required by ■ COB 6.5.20.
- (2) "There is an annual *charge* of [y]% of the value of the funds you accumulate. If your fund is valued at £500 throughout the year, this means we deduct [£500 x y/100] that year. If your fund is valued at £7500 throughout the year, we will deduct [£7500 x y/100 that year."

Commission and remuneration for life policies, schemes and stakeholder pension schemes

6.5.38

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- A *firm* must include under the heading 'How much will the advice cost?' either the statement prescribed in (1) or the details required by (2):
- (1) 'Your adviser will give you details about the cost. The amount will depend on the size of the premium and the length of the policy term. It will be paid for out of the deductions [or charges, if more appropriate]'; or
 - (2) (a) The amount or value in cash terms of the commission or remuneration and an indication of the timing of these payments; and
 - (b) a statement that commission or remuneration is paid for out of the deductions [or charges, if more appropriate] and, if applicable, that the amount will depend on the size of the *premium* or contribution and the length of the life policy, scheme or stakeholder pension scheme term.

6.5.39

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In ■ COB 6.5.38(2) the name of the *adviser* to whom the *commission* or *remuneration* is to be paid may be given.

Further information for life policies, schemes, insurance or equity ISAs, PEPs and stakeholder pension schemes

6.5.40

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- A *firm* must include the following information in the *key features*, separately or as part of the information required by ■ COB 6.5.2:
- (1) for *life policies*:
 - (a) a clear indication, in one place, of the nature and amount or rate of any charges or expenses which the *private customer* will or may bear; if charges or expenses are levied in the form of reduced investment, both the method and effect must be clearly explained; in the case of a single *premium* charge for

- mortality or morbidity under *linked benefit policies*, it is sufficient to describe its nature and basis;
- (b) the information that Annex II to the *Third Life Directive* requires to be communicated to policyholders, which is specified in ■ COB 6.5.49; and
 - (c) an explanation how the *private customer* may obtain further information about compensation arrangements and other matters relating to the *life policy*;
- (2) for all *schemes*, an explanation that other information about the *scheme* is available on request and how it may be obtained;
- (3) for *regulated collective investment schemes* and for such *investments* held within a *PEP* or an *ISA*:
- (a) a statement where details of the latest estimated distribution yield and buying and selling prices can be found;
 - (b) in the case of any purchase, how and when the price to be allocated in respect of each payment will be determined;
 - (c) whether certificates will be issued and, if so, when they will be sent;
 - (d) how *units* or *shares* may be redeemed and when payment on *redemption* will be made;
 - (e) the names and addresses of the *scheme manager* or *authorised corporate director*, and the names of the *trustees*, or *depository* (if any);
 - (f) where and how copies of *scheme particulars*, annual and half-yearly reports and accounts and *prospectuses* can be obtained;
 - (g) an explanation of any relevant right to cancel or withdraw, or, where it is the case, that such rights do not apply;
 - (h) how complaints and queries are dealt with and how further details of compensation arrangements (if any) can be obtained;
 - (i) a summary of the *private customer's* potential liability (if any) to income tax and capital gains tax;
 - (j) whether the *private customer* has a choice to reinvest income, where uninvested *money* will be held and whether interest is paid on such *money*;
- (4) for *investment trust savings schemes* and for such *investments* held within a *PEP* or an *ISA*:

- (a) when *shares* will be purchased for the *scheme*, where uninvested *money* will be held and whether interest is paid;
 - (b) where information about the *investment trust share* price, yield, and *premium* and discount information can be obtained;
 - (c) where information about the net asset value and latest dividend can be found;
 - (d) whether the *private customer* has a choice to reinvest income, how it is reinvested, or how it is paid to the *private customer*;
 - (e) details of any nominees with which *shares* are registered;
 - (f) how *shares* can be sold and how the *sale* proceeds are determined;
 - (g) whether applications and payments will be acknowledged and whether contract notes or certificates are issued;
 - (h) whether there will be a statement of account showing details such as number and cost of *shares* and balance of cash;
 - (i) an explanation of any right to withdraw or cancel (as specified in ■ COB 6.7) or, where it is the case, that such rights do not apply;
 - (j) where the *investment trust* report and accounts may be obtained;
 - (k) information about the *manager* and administrator of the *scheme*;
 - (l) the *private customer's* options in the case of items such as rights issues;
 - (m) how to stop investing in or how to leave a *scheme* and the position in respect of the *shares* held;
 - (n) terminations or alterations by the *scheme manager*;
 - (o) taxation details in respect of the *private customer's investment*; and
 - (p) how complaints are dealt with and how further details of compensation arrangements (if any) can be obtained;
- (5) for ISAs with a *life policy* (insurance) or equity (stocks and *shares*) component and PEPs, in addition to (1), (2), (3) or (4):
- (a) a description of the nature of the services which will be provided for the *private customer*;

- (b) for ISAs or ISA components which are stated as satisfying the *CAT standards*:
 - (i) a table comparing the ISA or ISA component with the *CAT standards*;
 - (ii) clarification that satisfying the *CAT standards* does not mean that the *investment* is appropriate for the *private customer* or that there is any guarantee of performance;
 - (c) the fact, if applicable, that an ISA does not meet the *CAT standards* together with any relevant explanation;
 - (d) a statement that the favourable tax treatment of ISAs may not be maintained;
 - (e) how and when statements (if any) will be sent;
 - (f) an explanation how the ISA or plan may be terminated or transferred to another ISA or *PEP manager*; and
 - (g) whether the ISA is a mini-or *maxi-ISA* agreement and an explanation of the differences between the two.
- (6) For *stakeholder pension schemes*, an explanation how complaints are dealt with and how further details of compensation arrangements (if any) can be obtained.

Information requirements for cash deposit ISAs, friendly Society tax-exempt policies, traded life policies and broker funds

6.5.41

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■ COB 6.5.42 does not apply to a *cash deposit ISA* offered by a *bank* or *building society* which subscribes to the Banking Code (see ■ COB 6.4.13(2)).

6.5.42

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If ■ COB 6.4.13(1) applies, for a *cash deposit ISA*, the *private customer* must be given the following minimum information (in accordance with ■ COB 6.4.13) in place of *key features*:

- (1) (a) for the *cash deposit ISA* which is stated as satisfying the *CAT standards*, a comparison with the *CAT standards*; or
- (b) if the *cash deposit ISA* is not stated as satisfying the *CAT standards*, a statement making this clear, together with, if desired, any relevant information;
- (2) a statement making it clear whether the ISA is a mini or a *maxi-ISA* agreement and explaining the differences between the two;
- (3) the minimum amount needed to open an account;

- (4) the maximum yearly *deposit*;
- (5) the interest rate earned, and if and how it may vary;
- (6) the calculation of interest;
- (7) how to make withdrawals and any limits;
- (8) details of the arrangements for the application of the right to cancel;
- (9) the arrangements for handling complaints;
- (10) that the favourable tax treatment may not be maintained;
- (11) that compensation may be available from the Financial Services Compensation Scheme;
- (12) where applicable, that the *firm* cannot accept *money* directly and acts only as agent in arranging the *cash deposit ISA*, identifying the *principal* to whom such *monies* should be made payable, and explaining that the *principal* has accepted responsibility for the activities of the *firm* in relation to the *cash deposit ISA*;
- (13) where a *private customer* can obtain further information about *ISAs* and, if applicable, other products within the *firm's* range; and
- (14) a warning that a *mini-* and *maxi-ISA* may not be opened in the same tax year and that, by opening a mini cash *ISA*, the *customer* will be limiting the amount of tax-free savings in equities that he can make, if he does not already have a mini stocks and shares or insurance *ISA* (not applicable for a TESSA-only *ISA*).

Friendly Society tax exempt policies

6.5.43

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Where a *private customer* buys a *tax-exempt policy* issued by a *friendly society*, or agrees to make additional contributions to such a *policy*, the *firm* may, where there is a right to cancel under ■ COB 6.7 (Cancellation and withdrawal), issue an abbreviated form of *key features* containing only the details of:

- (1) the amount of the contribution;
- (2) the term over which the contribution will be paid;
- (3) material differences between the terms of any increase and those of the existing *policy*; and
- (4) the amount or value in cash terms of the *commission* or *remuneration*.

Traded life policies

- 6.5.44 **R** /1 When *personally recommending* the purchase of a *traded life policy*, a *firm* may provide a *private customer* with the information at ■ COB 6.5.49 in place of *key features* (in accordance with ■ COB 6.4.14).

Broker funds

- 6.5.45 **R** /1 In relation to any fund or *scheme* of which the *firm* is a *broker fund adviser*, at the same time as providing a *private customer* with a *suitability letter* (in accordance with ■ COB 5.3) or before any change in investment objectives or strategies, the *firm* must inform the *private customer* in writing of:
- (1) the investment objectives, and the policies and strategies which are proposed to be followed to achieve those objectives;
 - (2) the relevant published index or other indicator with which comparison of the performance of the fund or *scheme* may fairly be made, which is, in the case of:
 - (a) *life policies* or pension funds:
 - (i) where the *long-term insurer* has its own managed unit-linked life or pension fund, the average performance of that managed fund; or
 - (ii) the average performance of one or more other funds, which are not *broker funds*, into which under the terms of the *policy* the *private customer* may switch, the objectives of which do not conflict with those of the *broker fund*; or
 - (iii) where there is no such fund, the sector average of general managed life or pension funds;
 - (b) *broker unit trusts*, the sector average of *unit trusts* appropriate to the objectives and strategy of the *broker unit trust*;
 - (3) a published index or sector average which the *firm* must identify as appropriate to the investment objectives and strategy of the fund or *scheme* under comparison; and
 - (4) the name of any *person* providing *advice* under the arrangement.

Other information: post-sale confirmation: life policies

- 6.5.46 **R** /1 The post-sale confirmation to be given to *private customers* in accordance with ■ COB 6.3.3 must include:

- (1) the information required by ■ COB 6.5.15 - ■ COB 6.5.19 (an Example), ■ COB 6.5.23 to ■ COB 6.5.28 (Tables and Deductions Summary) and ■ COB 6.5.38 (Commission and Remuneration);
- (2) where the investment has been recommended to a *private customer* by a *representative*, a statement under the heading 'adviser's status' that: 'the person who advised you about this policy represents only [Name of *firm*, or, if appropriate, *marketing group associate*.]'

Third Life Directive annex II: 'information for policyholders'

6.5.47

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- (1) A *firm* to which ■ COB 6.5.40(1)(b) applies must communicate in writing the information prescribed in ■ COB 6.5.49 to the policyholder, before the *policy* is concluded, in an official language of the *EEA State* of the commitment.
- (2) This information may be in another language if the policyholder so requests, and the law of the *EEA State* so permits or the policyholder is free to choose the law applicable.

6.5.48

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The headings and other wordings within ■ COB 6.5.49 follow those used in the European Directives.

6.5.49

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Table Third Life Directive annex II table of 'information for policyholders'
This table belongs to ■ COB 6.5.47

Third Life Directive – 'information for policyholders'

Information about the assurance undertaking

- 1. The name of the *undertaking* and its legal form
- 2. The name of the *EEA State* in which the head office and, where appropriate, the agency or branch concluding the *policy* is situated
- 3. The address of the head office and, where appropriate, of the agency or branch concluding the *policy*

Information about the commitment

- 4. Definition of each benefit and each option
- 5. Term of the *policy*
- 6. Means of terminating the *policy*
- 7. Means of payment of *premiums* and duration of payments
- 8. Means of calculation and distribution of bonuses
- 9. Indication of surrender and paid-up values and the extent to which they are guaranteed

Third Life Directive – 'information for policyholders'

10. Information on the *premiums* for each benefit, both main benefits and supplementary benefits, where appropriate
11. For unit-linked *policies*, definition of the *units* to which the benefits are linked
12. Indication of the nature of the underlying assets for unit-linked *policies*
13. Arrangements for application of the right to cancel
14. General information on the tax arrangements applicable to the type of *policy*
15. The arrangements for handling complaints concerning *policies* by policyholders, lives assured or beneficiaries under *policies*, including, where appropriate, the existence of a complaints body, without prejudice to the right to take legal proceedings.
16. Law applicable to the *policy* where the parties do not have a free choice or, where the parties are free to choose the law applicable, the law the *long-term insurer* proposes to choose.



6.6 Projections

Application

- 6.6.1 **R** /1 ■ COB 6.6 applies to a *firm* in respect of *projections* for *life policies*, *schemes* and *stakeholder pension schemes*.

Purpose

- 6.6.2 **G** /1 ■ COB 6.6 amplifies *Principle 7* (Communications with clients), which requires a *firm* to pay due regard to the information needs of its *clients*, and communicate information to them in a way which is clear, fair and not misleading. A *projection* needs to be carried out on a basis of uniform and consistent rates of investment return so that *firms* do not seek to compete on the basis of wholly speculative forecasts as to the potential value of future benefits. This should ensure that *private customers* purchasing a *life policy*, *scheme* or *stakeholder pension scheme* receive information about possible future returns from their investment in a way which is fair and not misleading.

Content

- 6.6.3 **G** /1 ■ COB 6.6 sets out:
- (1) when these *rules* apply ■ COB 6.6.4 - ■ COB 6.6.7);
 - (2) the information and statements to accompany *projections* ■ COB 6.6.8 - ■ COB 6.6.18);
 - (3) what records must be kept of *projections* issued to *customers* ■ COB 6.6.19);
 - (4) the method of calculating a *projection* ■ COB 6.6.20 - ■ COB 6.6.53);
 - (5) the method of calculating the effect of deductions (the reduction in yield) which must be included within *key features* ■ COB 6.6.54 - ■ COB 6.6.62);
 - (6) the method of calculating charges and expenses relating to *schemes* ■ COB 6.6.63 - ■ COB 6.6.79);
 - (7) assumptions to be used when converting a *retirement fund* into an annuity ■ COB 6.6.80 - ■ COB 6.6.85); and
 - (8) how to produce a *pension transfer* value analysis ■ COB 6.6.86 - ■ COB 6.6.93).

General

- 6.6.4 **R** ^{/1} A *firm* must not provide a *projection* for a *life policy, scheme* or *stakeholder pension scheme* unless the *projection* is calculated and presented in accordance with the *rules* in ■ COB 6.6.

Exceptions

- 6.6.5 **R** ^{/1} The *rules* in ■ COB 6.6 do not apply to a *firm* when it provides a *projection*:
- (1) of the benefits payable under a *defined benefit occupational pension scheme*, unless they are *money-purchase benefits*;
 - (2) issued with a view to determining a maximum contribution allowed by the Inland Revenue, provided the assumptions used in calculating such a contribution are disclosed;
 - (3) if the benefits are fixed and do not depend on an assumption of a future investment return;
 - (4) of a benefit under an existing contract where the date to which the benefit is being projected is not more than six months after the date on which the *projection* is given;
 - (5) contained in a decision tree as specified in ■ COB 6.5.8;
 - (6) of the benefits payable under a *money-purchase occupational scheme* or arrangement if they were calculated and issued in accordance with regulations made under section 113 of the Pensions Schemes Act 1993.

Higher volatility funds

- 6.6.6 **R** ^{/1} A *firm* must not provide a *projection* of possible investment returns or realisable values, or figures or statements which would enable the calculation of such a *projection*, for an investment in a *higher volatility fund*.

Projections issued by independent intermediaries

- 6.6.7 **R** ^{/1} An *independent intermediary* must, in addition to complying with other *rules* in this section, ensure that a *projection* given to a particular *customer* is relevant to that *customer's* circumstances.

Information to accompany projections

6.6.8

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- (1) A *document* containing a *projection* must include the information detailed in ■ COB 6.5 (*Key Features*) under the headings ‘An Example’, ‘Tables’, ‘Deductions Summary’ and ‘Commission and Remuneration’, unless (2) applies.
- (2) The information under the headings ‘Tables’, ‘Deductions Summary’ and ‘Commission and Remuneration’ need not be included in a *projection* issued in respect of:
 - (a) an existing contract; or
 - (b) a *financial promotion* (other than a *direct offer financial promotion*); or
 - (c) an *execution-only transaction* relating to a *scheme*.
- (3) If the *projection* relates to a contract to which regular *premiums* or contributions can be made, the total amount or number of *premiums* or contributions payable over the *projection* term must be made clear.
- (4) Where a *projection* is given which makes allowance for increases in *premiums* or contributions, the *premium* or contribution in the final year must be shown (or, where the rate of possible future increments is based upon rates of growth in a salary or index, details of that salary or index).

Generic projection

6.6.9

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- (1) A *firm* may provide a generic *projection* for illustrative purposes based on a single rate of investment return only in the following circumstances:
 - (a) in a *financial promotion* (other than a *direct offer financial promotion*) which comprises a table (or extracts from a table) published by a newspaper, magazine or other periodical publication, or by the *firm* itself, which compares *illustrative projections* from at least five *product providers*; or
 - (b) where the purpose is to indicate the likely cost of a proposed *transaction*; or
 - (c) to provide an estimate of the additional *premium* or contribution required to achieve a specified target.
- (2) A *firm* which provides a generic *projection* must ensure that:
 - (a) it does not relate solely to an existing contract;

- (b) the rate of return used does not exceed the higher *projection* rate for its class of business;
- (c) where the rate used exceeds the middle rate by more than 0.5 percentage point, a statement is included advising why it is believed reasonable to project at such a high rate of return;
- (d) where the charges and expenses (as described in ■ COB 6.6.23) of the *product provider* are available, they are used, or an estimate is given based on the *firm's* knowledge of the charges and expenses applicable to similar contracts;
- (e) it is accompanied by the written statements contained in ■ COB 6.6.17; and
- (f) *key features* are supplied in accordance with ■ COB 6.1 to ■ COB 6.5 (*Key Features*) if a recommendation is subsequently made.

Pension projections

6.6.10

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For pension targeting, a *firm's* own assumptions as to future rates of return (but not exceeding the higher rate of return as specified in ■ COB 6.6.49), salary increases and inflation must be used to determine the level of contributions. Any allowance for salary increases used in pension targeting must not be less than the rate of return assumed before retirement less 3% per annum.

6.6.11

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A *projection* for an *appropriate personal pension* must, for the purpose of comparison, include a *projection* which:

- (1) is calculated to the *customer's* State retirement age, using real rates of return of x% and y% ('x' and 'y' are the real rates of return referred to in ■ COB 6.6.52), together with a statement of the benefits which the minimum contributions would secure if the *customer* did not take out an *appropriate personal pension*;
- (2) includes, immediately after the comparison, the statement: 'These figures are only meant to give you a rough idea how the value of the pension you might get compares with the benefit you would be giving up under the State Earnings Related Pension Scheme. The statements made after the main illustration also apply to this comparison.';
- (3) aggregates contributions in respect of the current and the next two tax years;
- (4) is followed by the *appropriate personal pension projection* and a description of any differences in:

- (a) presentation, for example, real or monetary rates of return, joint or single life;
- (b) the dates from which the benefits are assumed to be payable;
- (c) the nature of the benefits, for example, index-linked or limited price indexation ('LPI') increases.

6.6.12

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■ COB 6.6.11(1) to (3) require that, where the contract is in respect of contracting-out of the State Earnings Related Pension Scheme, there should be a comparison using real rates of return of the benefits being given up and the relevant contract. ■ COB 6.6.11(4) permits additional *projections* provided that the differences are described.

6.6.13

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A projection for a personal pension or stakeholder pension scheme with income withdrawals:

- (1) **must include:**
 - (a) a statement of the initial amounts of minimum and maximum income as specified in the current tables published by the Government Actuary for *income withdrawals*;
 - (b) a statement of the assumed initial level of income and the assumed basis for future years;
 - (c) a schedule showing under the heading 'WHAT THE BENEFITS MIGHT BE' the amount of income and the fund at each, or every third, anniversary for each of the rates of return specified in ■ COB 6.6.49;
 - (d) a statement of the projected open market values and the amounts of annuity at age 75 or the date at which it is reasonably assumed an annuity will be purchased; and
 - (e) a statement of the amount of annuity that could be secured using an immediate annuity rate available in the market; and
- (2) **must assume that the current rate of gilt-index yield will continue to apply in projecting amounts of minimum and maximum income throughout the term of the *projection*.**

Statements to accompany projections

6.6.14

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- (1) *A document containing a projection must include the appropriate statements set out in ■ COB 6.6.16 – ■ COB 6.6.18.*
- (2) *A statement may be altered if a firm believes on reasonable grounds that it is not wholly appropriate to the contract in question. But the alteration must not reduce the significance or impact of the statement.*

(3) Any statement required to accompany a *projection* must appear adjacent to the projected values and be in a type size no smaller or less prominent than that used for the projected values.

6.6.15 **R** /1 The statements in ■ COB 6.6.16 must accompany each *projection* for a *life policy* or *scheme* as indicated, except a generic *projection* given in accordance with ■ COB 6.6.9 (see ■ COB 6.6.17), or a *protected rights annuity projection* (see ■ COB 6.6.18).

6.6.16 **R** /1 Table Statements to accompany projections of life policies, schemes or stakeholder pension schemes (excluding generic projections and protected rights annuity projections)
This table belongs to ■ COB 6.6.15

Statements to accompany projections of life policies, schemes or stakeholder pension schemes (excluding generic projections and protected rights annuity projections)

1. These figures are only examples and are not guaranteed – they are not minimum or maximum amounts. What you will get back depends on how your investment grows and on the tax treatment of the investment.

2. [You could get back] [your retirement fund could be] more or less than this.

3. All firms use the same rates of growth for projections but their charges vary. [They also use the same rates to show how funds may be converted into pension income].

4. Do not forget that inflation would reduce what you could buy in the future with the amounts shown.

5. [Your pension income will depend on how your investment grows and on interest rates at the time you retire].

6. These rates of return are not necessarily appropriate [for contracts written in] [for units traded in] [for shares traded in] currencies other than sterling.

7. Benefits may also be affected by fluctuations in exchange rates.
Note:

Statement 5 applies to *pension contracts* only and statements 6 and 7 apply to non–sterling *investments* only.

6.6.17 **R** /1 Table Statements to accompany generic projections
This table belongs to ■ COB 6.6.15

Statements to accompany generic projections

These figures are only illustrative.

An assessment of your needs will be confirmed before a recommendation can be made OR Your needs will be confirmed before a recommendation can be made.

Key features, including a projection which is personal to your circumstances, will be provided if a recommendation for an investment product is made.

6.6.18

R

Table Statements to accompany projections for protected rights contracts
This table belongs to ■ COB 6.6.15

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Statements to accompany projections for protected rights contracts

1. These figures are only meant to give you a rough idea of the amount of pension you might get compared with the benefit that you would be giving up under the State Earnings Related Pension scheme.
2. The figures show what might happen if we achieved an investment return of [x%] or [y%] each year on top of the rate of earnings inflation.
3. They are only examples and are not guaranteed – they are not minimum or maximum amounts. What you will get back depends on how your investment grows.
4. You could get back more or less than this.
5. All *firms* use the same rates of growth for projections but their charges vary. They also use the same rates to illustrate how funds may be converted into pension income.
6. Your pension income will depend on how your investment grows and interest rates at the time you retire.

Note:

[x%] and [y%] in statement 2 are the real rates of return used in the *projection* as specified in COB 6.6.51R.

Records

6.6.19

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A *firm* must ensure that a record of a *projection* provided to a *customer* is made and retained, unless it relates to a proposal which does not proceed. The record must be retained for a minimum period of:

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- (1) six years in the case of a record relevant to a *life policy*, *pension contract* or *stakeholder pension scheme*;
- (2) indefinitely in the case of a record relevant to a *pension transfer* or *pension opt-out*;
- (3) three years in any other case.

The calculation of a projection

6.6.20

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■ COB 6.6.21 - ■ COB 6.6.53 set out:

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- (1) definitions of key terms used in the calculation of a *projection* (■ COB 6.6.21);
- (2) the basic approach to be used when calculating a *projection* for *life policies* (■ COB 6.6.34), *Holloway sickness policies* (■ COB 6.6.35), *schemes* (■ COB 6.6.36) and *stakeholder pension schemes* (■ COB 6.6.34);

- (3) Principles which must be taken into account when calculating a *projection* including general Principles which may apply to all *life policies, schemes* and *stakeholder pension schemes* (■ COB 6.6.37 - ■ COB 6.6.38) and specific Principles applicable to certain types of product or features within a product (■ COB 6.6.39 - ■ COB 6.6.46);
- (4) tables containing the rates of return to be used when calculating a *projection* depending on the type of contract being projected (■ COB 6.6.47 – ■ COB 6.6.53).

Key terms used in the calculation of a projection

6.6.21

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The descriptions of defined terms in ■ COB 6.6.22 to ■ COB 6.6.33 apply to all references to those terms in ■ COB 6.6.34 - ■ COB 6.6.78 which detail the method of calculating *projections* and of calculating charges and expenses and the recommended method of calculating *scheme* expenses.

Adjusted premium

6.6.22

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- (1) The adjusted *premium* is the *premium* or contribution payable under the contract during the contract period (defined in ■ COB 6.6.25), disregarding any increases that cannot be quantified at the commencement of the contract (but allowing for any increases which are assumed and disclosed in the *key features*).
- (2) When calculating the amount of *premium* or contribution, a *firm* may deduct:
 - (a) the cost of any rider benefits;
 - (b) any part of a *premium* or contribution which is payable in respect of an exceptional mortality risk.

Charges and expenses

6.6.23

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- (1) For a *scheme* or unit-linked *life policy*, charges and expenses are all explicit charges and expenses the *customer* will or may bear:
 - (a) including:
 - (i) all other deductions and expenses which will or may bear upon the fund (including charges in respect of any *collective investment scheme* or insurance fund in which any funds of the contract in question are invested but excluding dealing costs of the underlying portfolio); and

- (ii) all deductions from the *premium* or contribution payable which do not accrue to the benefit of the *customer* by way of contribution to the value of the benefit;
- (b) having regard to:
 - (i) the principal terms of the contract; and
 - (ii) any tax relief which will be available to the fund or scheme in respect of so much of the fund's or *scheme's* gross expenses as can be properly attributed to the contract.
- (2) For a with-profits contract, or a unit-linked *life policy* where not all charges and expenses are determined in accordance with (1), charges and expenses are such expenses as the *firm* reasonably determines to be appropriate to the contract having regard to:
 - (a) the principal terms of the contract;
 - (b) any tax relief which will be available to the *firm* in respect of so much of the *firm's* gross expenses as can properly be attributed to the contract;
 - (c) any transfers to *shareholders'* funds, or equivalent retentions from established surplus offset by any sustainable rate of transfer of surplus from non-profit business;
 - (d) dealing costs of the underlying portfolio which should be excluded; and
 - (e) any *guidance* published by the Institute of Actuaries or the Faculty of Actuaries (or by both jointly).
- (3) If a contract has explicit charges, it should be assumed that they continue at a rate no less than that at which similar charges are being made at the time when the *projection* or calculation of the effect of the charges is made.

6.6.24

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For the calculation of the effect of deductions in *projections*, charges are all explicit charges adjusted for tax as in ■ COB 6.6.23(1)(b) and expenses are all other deductions. For *stakeholder pension schemes*, charges are all explicit charges and expenses for the underlying *policy* or contract, including any charges levied by the *manager* or trustees of the *stakeholder pension scheme*.

Contract period

6.6.25

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The contract period of a *life policy*, *scheme* or *stakeholder pension scheme* is the period beginning with the commencement of the contract and ending as follows:

- (1) for a contract which contains an option under which benefits may be:
 - (a) payable earlier than the date on which they would be payable if the option were not exercised; and
 - (b) the marketing of which seeks to draw to the attention of *customers* the existence of an option or *surrender value*, so that it is reasonable to infer that the *firm* expects some *customers* to purchase the contract with the intention of exercising the option or surrendering the contract in whole or in part;

on the earliest date on which an option may be exercised or the contract may be surrendered (in whole or in part);
- (2) for a contract which is a *whole life assurance* the *premiums* under which are regular *premiums*:
 - (a) the anniversary of the commencement of the contract which first falls after the seventy-fifth birthday of the *person* whose life is assured under the contract, taking, if there are two or more such *persons*:
 - (i) the older or oldest if the benefits under the contract are payable on the death of the first of them to die; and
 - (ii) the younger or youngest in any other case; or
 - (b) the tenth anniversary of the commencement of the contract;

whichever is the later;
- (3) in the case of an *endowment assurance* or a non-pension deferred annuity, the *premiums* under which are regular *premiums*, on the maturity date;
- (4) in the case of an *endowment assurance* or a non-pension deferred annuity under which the only *premium* payable is a single *premium* and the term of which does not exceed ten years, on the maturity date;
- (5) in the case of a *Holloway sickness policy*, on the latest date on which the *sickness* benefit will cease to be payable;
- (6) in the case of a *pension contract* other than an immediate annuity, on the maturity date or, if the contract provides for annuities at various dates, the latest date at which an annuity may be purchased;

- (7) in the case of an immediate annuity, on the date to which the *customer* is expected to live, calculating the expectancy of life for this purpose by reference to an appropriate mortality basis; and
- (8) for the purpose of this section “maturity date” means:
 - (a) in relation to an endowment type assurance, the date specified in the contract as the maturity date;
 - (b) in relation to a *pension contract* or *stakeholder pension scheme*, the vesting date of the annuity payable under the contract or, if no vesting date for the annuity is specified in the contract, the date specified in relation to the annuity as the retirement date by the *firm* in the *projection* in question, being a date not earlier than the earliest date on which the annuity could vest and not later than the latest such date.

6.6.26 **R** In the case of any contract which falls within both ■ COB 6.6.25(1) and one or more of ■ COB 6.6.25(2) - (7), the contract period must be determined by reference to ■ COB 6.6.25(1).
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6.6.27 **R** In the case of any contract not falling within ■ COB 6.6.25, then:
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- (1) for *schemes*, the contract period will end on the tenth anniversary of the commencement date of the contract; and
- (2) for all other contracts there will be two contract periods, the first ending on the fifth anniversary of the commencement date of the contract, and the second ending on the tenth anniversary of the commencement date.

Cost of risk benefits

6.6.28 **R** Cost of risk benefits means:
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- (1) explicit mortality or morbidity charges (at a level no lower than the current level); or
- (2) the implicit cost or effect of mortality or morbidity appropriate to the class of *customers*;

and risk benefits means all forms of mortality and *sickness* benefits under a contract.

Relevant contribution

6.6.29 **R** The relevant contribution is the actual payment or payments to be made by the *customer*, or a sum which reasonably reflects the
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amounts which the *customer* is proposing to invest, into a *scheme*, except in the case of a protected rights annuity (see ■ COB 6.6.31).

Relevant premium

- 6.6.30 **R** ^{/1} The relevant *premium* is the actual *premium* payable under a *life policy* less an amount equal to the cost of any rider benefit, except in the case of a protected rights annuity (see ■ COB 6.6.31).

Relevant premium or contribution for protected rights annuities

- 6.6.31 **R** ^{/1} The relevant *premium* or contribution in relation to a protected rights annuity is an amount that may reasonably be estimated to be paid by the Secretary of State or the Department of Social Services for Northern Ireland by way of minimum contributions in respect of the *customer* involved.

- 6.6.32 **G** ^{/1} The relevant *premium* or contribution may include amounts in respect of minimum contributions expected to be paid in future years. This applies if the estimate for those years makes allowance for the most recent assumptions published by the Government Actuary in respect of the future years, and these assumptions and the period of any *projection* are made clear.

Relevant rate of return

- 6.6.33 **R** ^{/1} The relevant rate of return is the intermediate *projection rate* appropriate to the category of business as set out in ■ COB 6.6.50 – ■ COB 6.6.52, or the lower rate if ■ COB 6.6.38(1) (Projections of surrender values and transfer values) applies.

Basic calculation method life policy or stakeholder pension scheme calculation

- 6.6.34 **R** ^{/1}
- (1) A *projection* of any future benefit payable under a *life policy* or *stakeholder pension scheme* must be calculated by reference to the relevant *premium* for the *policy* or *stakeholder pension scheme*.
 - (2) The relevant *premium* must be accumulated to the *projection date* at the rate of return for its class of business as detailed in ■ COB 6.6.50 – ■ COB 6.6.52, subject to charges and expenses (as described in ■ COB 6.6.23) and the cost of risk benefits.
 - (3) An allowance must be made where a *customer* has exercised or has expressed the intention to exercise an option to effect a partial surrender of a *policy*.

- (4) Allowance must not be made for *income withdrawals*, surrenders, lapses or early discontinuance, except as in (3).

Holloway sickness policy calculation

6.6.35

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For a *Holloway sickness policy* issued by a *friendly society*, a rate of bonus no greater than that last declared by the *friendly society* must be accumulated, with allowance for applicable charges and expenses (as described in ■ COB 6.6.23) at the rates of return set out in ■ COB 6.6.50 until the *projection date*.

Scheme calculation

6.6.36

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- (1) A *projection* of any future benefit payable under a *scheme* must be calculated by reference to the relevant contribution for the *scheme*.
- (2) The relevant contribution must be accumulated to the *projection date* at the rates of return for the relevant class of business as detailed in ■ COB 6.6.50, subject to charges and expenses (as described in ■ COB 6.6.23).
- (3) An allowance must be made where a *customer* has exercised or expressed the intention to exercise an option under the *scheme* to make withdrawals, either by:
 - (a) encashment of *units*; or
 - (b) distribution of income, which must be calculated using an estimated gross distribution yield, reduced by the rate of tax relevant to the contract; the distribution yield must be rounded to the higher 0.1%.
- (4) No allowance must be made for the distribution of income except as in (3).

General rules applicable to the calculation of projections

6.6.37

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- (1) A *projection* must be rounded down to not more than three significant figures.
- (2) Where the *projection*, other than a *projection* in real terms of a *pension contract* or *stakeholder pension scheme*, is less than the amount guaranteed under the *life policy* or *scheme*, the *projection* must be increased to that guaranteed amount.

- (3) Where a *customer* is entitled, and has expressed the intention, to increase the *premium* or contribution by an amount linked to future salary or other index increases, the relevant *premium* or contribution may be calculated by making allowance for such increases on the same basis as that used for administration charges in ■ COB 6.6.47.

Projections of surrender values and transfer values

6.6.38

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A *projection* of a surrender or transfer value:

- (1) must be given using the intermediate rate of return appropriate to its category of business, unless:
 - (a) the *firm* reasonably expects the rate to overstate the potential of the contract, in which case a lower rate of return must be used and disclosed; or
 - (b) the *customer* so requests, in which case a lower rate of return may be used, and the fact that it has been used must be disclosed;
- (2) must make allowance for partial surrenders of a contract where the contract terms permit this and the *customer* has exercised this option or expressed the intention to do so;
- (3) must allow for the *firm's surrender value* basis and reflect the current approach of the *firm* towards applying penalties on surrender, including less than full credit for accrued terminal bonus, specific penalties or exit charges; and
- (4) for a with-profits contract where bonus rates apply, must ensure that the bonus rates supported by the relevant *premium* are assumed to apply throughout the term of the contract.

Rules specific to products or features of products: annuities

6.6.39

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- (1) Any *projection* of an annuity with one or more years to maturity must show an annuity value based on the higher and lower rates of return as set out in ■ COB 6.6.50 – ■ COB 6.6.52, and make allowance for:
 - (a) mortality and also, in the case of *life policies*, morbidity appropriate to the class of *customers*; and
 - (b) charges and expenses (as described in ■ COB 6.6.23).

6.6.40

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- (2) Any *projection* of an annuity with less than one year to maturity must be calculated using annuity rates no more favourable than the *firm's* current immediate annuity rates.
- (3) Where a *firm* which does not offer annuities *issues a projection* for a contract the proceeds of which are to be applied to the *purchase* of an annuity, the *firm* must use annuity rates no more favourable than those currently being used in the open market for such a *projection*.

In the case of a contract for an immediate annuity:

- (1) the uniform rate of continuous change in annuity supported by the actual *premium* to be paid must be determined for each rate of return with allowance for:
 - (a) mortality appropriate to the class of *customer*; and
 - (b) charges and expenses (as described in ■ COB 6.6.23) on the assumptions used when calculating the *firm's* own annuity rates;
- (2) the rate of continuous change in annuity calculated must then be:
 - (a) applied to the initial annuity under the contract which is the subject of the *projection*; and
 - (b) assumed to be maintained throughout the term of the contract.

Appropriate personal pensions and protected rights annuities

6.6.41

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- (1) The *retirement fund* for a *protected rights annuity* under an *appropriate personal pension scheme* or *stakeholder pension scheme* must be calculated by accumulating the relevant contribution less charges and expenses (as described in ■ COB 6.6.23) at the two relevant rates of return for the period.
 - (a) The period is either:
 - (i) where the relevant contribution is a minimum contribution, from the 1st September following the end of the tax year to which the minimum contribution relates up to the maturity date; or
 - (ii) where the relevant contribution is a transfer value, from the commencement of the contract up to the maturity date.
 - (b) The two relevant rates of return are:

- (i) in the case of a *protected rights annuity projection* issued in accordance with ■ COB 6.6.11(1), the real rate of return in ■ COB 6.6.52;
 - (ii) in the case of any other *protected rights annuity projection*, either the real or monetary lower and higher rates of return in ■ COB 6.6.52.
- (2) The annuity must be calculated by reference to the *retirement fund* using the higher and lower rates of return set out in ■ COB 6.6.51, with allowance for the mortality appropriate to the class of *customers*, charges and expenses and the relevant rate of increase in payment.

Pension contracts or stakeholder pension schemes

6.6.42

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- (1) An additional *projection* may be given for a *pension contract* or *stakeholder pension scheme* where the period to maturity is five years or less. This:
- (a) may be calculated using the intermediate rates of return specified in ■ COB 6.6.51;
 - (b) may use a current annuity rate calculated using a rate of return no higher than the higher rate specified in ■ COB 6.6.51.
- (2) If the *firm* providing the *projection* offers annuities, it must use its own annuity rates.

Single premium contracts

6.6.43

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- A *projection* relating to a series of single *premiums* (other than a *protected rights annuity*) may be a calculation set out as if those *premiums* were regular *premiums*, provided:
- (1) it is not otherwise given on a misleading basis;
 - (2) the *firm* is bound unconditionally, and by express terms of the contract, to accept all single *premiums* which may be paid by the *customer* under the contract.

With-profits endowment business

6.6.44

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- For with-profit *endowment assurance* where the amount of any guaranteed benefit payable on death is not calculated by reference to the total value of the *premiums* paid under the contract before that event:

- (1) the cost of risk benefits must allow for the bonus rate or rates supported by the relevant *premium* (given the basic sum assured for such a *policy* with an appropriate office *premium*) calculated for each rate of return; and
- (2) the rate or rates of bonus must then be applied under the *policy* which is the subject of the *projection* and be assumed to be maintained throughout the term of the *policy*.

With-profits whole life assurance business

6.6.45

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For with-profit *whole life assurance* other than a *policy* the bonuses under which are added to the *surrender value*:

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- (1) the cost of risk benefits must allow for the bonus rate or rates supported by the *premium* (given the basic sum assured for such a *policy* with an appropriate office *premium*) calculated for each rate of return; and
- (2) the rate or rates of bonus must then be applied under the *policy* which is the subject of the *projection* and be assumed to be maintained throughout the term of the *policy*.

Contracts with reviewable administration charges

6.6.46

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In respect of *policies* with reviewable administration charges:

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- (1) a *firm* must make allowance for increases in administration charges which are reviewable at the *firm's* discretion, on a basis which:
 - (a) is fair and reasonable; and
 - (b) takes into account the *firm's* pricing *policy* as regards future levels of administration charges;
- (2) increases must be assumed at the rates in ■ COB 6.6.47 for any contracts where:
 - (a) an administration charge is reviewable by the *firm* (whether or not any increases are contractually linked to an external index); or
 - (b) expenses in respect of future renewal or claims costs are expressed as monetary amounts.

6.6.47

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Table Table of assumed rates of increase for policies with reviewable administration charges
This table belongs to ■ COB 6.6.46

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Basis of review	Assumed rate of increase		
	Lower rate of return	Intermediate rate of return	Higher rate of return
Administration charge reviewed in line with price increases	0.5%	2.5%	4.5%
Administration charge reviewed in line with earnings increases	2%	4%	6%

Contracts with rider benefits or extra premiums for underwriting risks

6.6.48

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In respect of a contract with rider benefits, or where an extra *premium* is being charged for an increased underwriting risk:

- (1) the rider benefit or extra *premium* charged for an impaired life, hazardous pursuit, or on the grounds of occupation, must be taken into account when determining a *projection*;
- (2) if a deduction is made from the actual *premium* for a rider benefit or increased underwriting risk (or both), the sum of the amounts of the relevant *premium* must be quoted with the *projection*; and
- (3) for *policies* with rider benefits, a *firm* may apply the following procedure:
 - (a) if the *policy* is also available without the rider benefit, then the same values must be projected as would be projected for such a *policy* with the *premium* appropriately reduced; and
 - (b) if the contract is available only with one or more rider benefits, the *firm* must deduct a fair estimate of the cost of the extra benefits from the *premium* when determining the *projection*; if a fair estimate cannot be made, a rough estimate (rounded to the next higher 10% of the total *premium* payable by the policyholder) must be deducted.

Rate of return assumptions

6.6.49

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- (1) The appropriate rates of return for the type of contract being projected, taken from ■ COB 6.6.50 – ■ COB 6.6.52, must be used when calculating a *projection*;
- (2) reduced rates of return must be used if the *firm* expects the rates in the tables to overstate the investment potential of a contract;

- (3) reduced rates of return may be used if requested by a *customer*; and
- (4) whenever reduced rates are used, they must be disclosed in the *document* containing the *projection*.

6.6.50

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Table Rate of return assumptions for all schemes, ordinary branch non-pensions, industrial branch, friendly Society, immediate annuity and Holloway sickness policies (all monetary rates of return)
This table belongs to ■ COB 6.6.49

Rate of return assumptions for all schemes, ordinary branch non-pensions, industrial branch, friendly Society, immediate annuity and Holloway sickness policies (all monetary rates of return)

	Lower rate	Intermediate rate	Higher rate
(a) Non-tax-exempt business relating to schemes, ordinary branch non-pensions and industrial branch business	4%	6%	8%
(b) Holloway sickness policies	4%	6%	8%
(c) Tax-exempt business held within an ISA or PEP or by a friendly society, relating to schemes, ordinary branch non-pensions and industrial branch business	5%	7%	9%
(d) immediate annuities	5%	7%	9%

Notes:

In relation to schemes: The monetary rates of return above include any distribution of income. The rates of return may be used for contracts for units denominated in currencies other than sterling unless it is expected they will overstate the investment potential of the contract.

6.6.51

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Table Rate of return assumptions for pension contracts and stakeholder pension schemes excluding contracts for immediate annuities and protected rights annuities issued in accordance with ■ COB 6.6.11(1).
This table belongs to ■ COB 6.6.49

Rate of return assumptions for pension contracts and stakeholder pension schemes excluding contracts for immediate annuities and protected rights annuities issued in accordance with COB 6.6.11R(1)			
	Lower rate	Intermediate rate	Higher rate
(a) in deferment – either monetary or real rates of return may be provided			
Monetary rates of return	5%	7%	9%
Real rates of return	1%	N/A	3%
(b) after vesting – (monetary or real rates as used for period of deferment under a) above)			
Monetary rates of return	4%	6%	8%
For annuities linked to the retail price index	2%	3%	4%
For annuities linked to LPI (limited price indexation)	2%	3.5%	5%

6.6.52

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Table Rate of return assumptions for protected rights annuity projections given in accordance with ■ COB 6.6.11(1)
This table belongs to ■ COB 6.6.49

Rate of return assumptions for protected rights annuity projections given in accordance with COB 6.6.11R(1)			
	Lower rate	Intermediate rate	Higher rate
(a) In deferment:			
for periods in excess of five years – real rates of return	1%	N/A	3%
for periods of five years or less – monetary rates of return	5%	7%	9%
(b) after vesting: – for annuities linked to the retail prices index	2%	3%	4%

6.6.53

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The rates of return in ■ COB 6.6.50 – ■ COB 6.6.52 are assumed to compound annually and allow for inflation.

Calculation of the reduction in yield due to the effect of charges and expenses content

6.6.54

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■ COB 6.6.55 - ■ COB 6.6.62 set out the *rules* to be used when calculating the effect of deductions (the 'reduction in yield') to be provided within *key features* (■ COB 6.5) for all types of *life policies* and *schemes*. ■ COB 6.6.63 - ■ COB 6.6.79 provide *guidance* in assessing the expenses and charges relating to *schemes*.

Basic calculation method of the reduction in yield

6.6.55

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- (1) A *firm* must accumulate the adjusted *premium* to the end of the contract period at the relevant rate of return, making:
 - (a) full allowance for the charges and expenses (as described in ■ COB 6.6.23); and
 - (b) no allowance for charges and expenses.
- (2) A *firm* must then calculate the rate of return which, if applied (on an annual compound basis) to the adjusted *premium* over the contract period, without making any allowance for the charges and expenses, will produce the same sum as that calculated under (1)(a).
- (3) The reduction in yield is the difference between the relevant rate of return and the rate of return found in (2).

6.6.56

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- (1) When a *firm* is calculating a *projection*, charges which relate to benefits for any mortality or morbidity risks, or a proportion of them, must be assumed not to be made:
 - (a) providing the assumption does not produce figures for the effect of charges deductions which suggest that the charges under the contract are lower than they actually are; and
 - (b) only in so far as they are attributable solely to benefits for mortality or morbidity risks, a proper apportionment being made of any composite charges.
- (2) When a charge cannot be apportioned, (1) will not apply, but the *firm* may include in the information required to be given within a *projection* a statement to the effect that the reductions have been calculated without disregarding charges relating to benefits for any mortality or morbidity risks.

Alternative calculation method of the reduction in yield for a life policy

6.6.57

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The following alternative method of calculation of the reduction in yield may be used at a *firm's* discretion for a *life policy*:

- (1) The adjusted *premium* must be accumulated to the end of the contract period at the relevant rate of return, making full allowance for the charges and expenses (as described in ■ COB 6.6.23).
- (2) If the accumulated value will reach zero before the end of the contract period, the accumulation must cease at that stage; subsequent references in this *rule* to the contract period are to be taken where relevant as referring to that shorter calculation period.
- (3) In making this calculation, the total of all charges and expenses not solely attributable to the risk benefits must be assessed separately and accumulated to the end of the contract period at the relevant rate of return.
- (4) The adjusted *premium* must be accumulated to the end of the contract period at the relevant rate of return, making no allowance for charges and expenses.
- (5) The reduction in yield must be calculated in accordance with, ■ COB 6.6.55, but using the shorter calculation period specified in (2), if applicable.

Other provisions

6.6.58

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In the case of a protected rights annuity, the effect of charges and expenses (as described in ■ COB 6.6.23) may be calculated on the assumption that *premiums* will continue to be paid after the first year.

6.6.59

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The reduction in yield or the effect of charges and expenses must be expressed to the nearest tenth of 1%.

Unit-linked contracts with more than one fund

6.6.60

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(1) Where there is more than one fund into which the *premiums* under a unit-linked contract are expected to be paid initially (disregarding any option of the *customer* to require the funds to be changed):

- (a) the effect of charges and expenses must be calculated separately in relation to each such fund;

- (b) unless a representative figure is shown in accordance with (3), each of those reductions in yield must be shown in the information required within *key features*; and
 - (c) a brief explanation of the difference between them may be included.
- (2) If any of the funds referred to in (1) is a unitised with-profits fund, the calculation relating to that fund must be made on the with-profits expenses basis as described in ■ COB 6.6.23(2).
 - (3) If, in the case of any contract, two or more of the calculations of the effect of charges and expenses would produce results which are so similar that one may fairly be regarded as representative of the other or others, only one figure for the effect of charges and expenses need be shown, accompanied by an indication that it is a representative figure.

Regular and single premium contracts

6.6.61

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In the case of any contract where the *premiums* include both a regular and a single *premium*:

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- (1) the reduction in yield should be calculated separately for the regular *premiums* and for the single *premium*; and
- (2) each of those reductions in yield should be shown in the information required in ■ COB 6.5 (Contents of key features) with a brief indication of the difference between them.

Table of specimen values of the reduction in yield

6.6.62

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Where ■ COB 6.6.60 or ■ COB 6.6.61 applies in relation to the calculation of the reduction in yield, either:

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- (1) different tables must be shown with the values calculated separately for each fund or for the regular *premiums* and the single *premiums* (as the case may require); or
- (2) one table may be used, but it must contain those values calculated separately as required by (1), and it must make clear to the *customer* (or any potential *customer* in the case of a *financial promotion*) what the different values refer to.

Charges and expenses disclosure for schemes

- 6.6.63** G_{/1} ■ COB 6.6.65 – ■ COB 6.6.79 set out *rules* and *guidance* on how to calculate charges and expenses (as described in ■ COB 6.6.23) for *schemes*.
- 6.6.64** G_{/1} ■ COB 6.6.65 – ■ COB 6.6.69 provide *rules* and *guidance* for authorised *unit trusts* (and OEICs and *recognised collective investment schemes*) and ■ COB 6.6.70 - ■ COB 6.6.74 *rules* and *guidance* for *investment trust savings schemes*.

Charges and expenses disclosure for authorised unit trusts

- 6.6.65** G_{/1}
- (1) Charges and expenses as described in ■ COB 6.6.23 means ‘all explicit charges and expenses, and includes all other deductions and expenses which will or may bear upon the fund’. The following paragraphs give *guidance* on the assessment and apportionment of expenses.
 - (2) Those expenses that were, or would be, reported in the Annual report and Financial Statement of *authorised unit trust schemes* in accordance with the ‘Statement of Recommended Practice’ (‘SORP’) issued by the *FSA*, will normally provide a suitable starting point for any assessment of the level of charges and expenses. The same principles apply to funds and *schemes* which are not within the scope of the SORP.
 - (3) Where expenses are charged directly against the assets of the fund, it will normally be appropriate to express such expenses as an annual percentage charge against the fund, which is then added to other such charges. An example is a manager’s periodic charge to form an aggregate percentage charge. It is reasonable to round this charge to the nearest 0.05%.
 - (4) Where a *scheme* invests in other *packaged products*, it will be necessary to look through to ensure that all charges and expenses which the *customer* will or may bear are included. Appropriate allowance may be made for any abatement to avoid double charging. If the *product provider* is not required to make expense disclosure in respect of such *packaged products*, the charges and expenses of an equivalent product from another provider should be used. In the case of *investment trusts*, the method in ■ COB 6.6.70(4) should be used.
 - (5) Where the *unit trust* invests in other *unit trusts*, charges and expenses will be based on a reasonable distribution of assets that takes account of the investment philosophy of the *unit trust*.

Representative unit trust

- 6.6.66** G_{/1}
- (1) Where a document refers to investment in a number of trusts, charges and expenses (as described in ■ COB 6.6.23) applicable to the trusts selected by the *customer* should be used. Where this is not practicable, it is permissible to use the charges and expenses of a representative *unit trust*.
 - (2) The representative *unit trust* will normally be the one that is most likely to be selected by the *customers* to whom the material is issued. Where advantage is taken of this option, the *document* should include information which shows the differences if other trusts are selected. The normal presentation will be to show the differences as a reduction of investment return, or as an adjustment to the Table in *key features*. Where the reduction of *investment* return is used,

it will not be necessary to show differences unless the rounded difference is at least 0.1% and the unrounded difference is at least 0.05%.

Types of expenses

6.6.67

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- (1) The following are those expenses and costs of *investment* that *firms* should take into account when making their calculations. The list is not comprehensive. These are in addition to explicit charges.
- (2) Examples of expenses are:
 - (a) registration fees;
 - (b) *safe custody fees*;
 - (c) *trustees' fees*;
 - (d) handling charges;
 - (e) audit fees;
 - (f) regulatory fees and subscriptions;
 - (g) costs of investment management, but excluding dealing costs of the underlying portfolio, and costs associated with routine management and servicing of existing property investments;
 - (h) bid/offer spread in the pricing of *units*.
- (3) The spread in (h) should be on a basis that fairly represents the expected levy of such spread in the *firm's* experience of normal trading conditions.
- (4) The expenses should include allowance for any value added tax which is not recoverable.

Translation to fund level

6.6.68

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- (1) The expenses and explicit charges need to be adjusted for any expected variation in costs from the period of the report to the period relevant to the disclosure expenses if such variation is believed to make a material difference.
- (2) The adjusted expenses should be expressed as a proportion of the relevant fund. For established funds, the relevant fund is the average size of the fund for the period of the report.
- (3) Where the use of the figure calculated as in (2) would be misleading, a fair estimate of the size of the relevant fund which is consistent with the adjusted expenses should be used. The same method should be used in the case of new funds. In determining the reasonable levels of expense to be assumed, account should be taken of the expense attributable to the existing fund which most closely corresponds to it, with proper regard to material differences in cost.

Review of expenses

6.6.69

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The expenses used in calculations must be reviewed whenever material changes in the levels are identified which would mean that the disclosed amounts are misleading. In any event the expenses must be reviewed at least once a year.

Charges and expenses disclosure for investment trust savings schemes charges and expenses

6.6.70

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- (1) Charges and expenses as described in ■ COB 6.6.23 should be taken to include all explicit charges and, in addition, all other deductions and expenses which are not financed from explicit charges. These include deductions and expenses within the *trust*.
- (2) The method is to identify all expenses that will be borne by the *customer*, and these will include not only the cost of acquiring a holding but also the cost of disposing of the investment.
- (3) Where expenses are charged directly against the assets of the *investment trust*, it will normally be appropriate to express the expenses as an annual percentage charge against the trust, which is then added to such charges, for example, a periodic management fee, to form an aggregate percentage charge. It will be reasonable to round to the nearest 0.05%.
- (4) Where an *investment trust* company (A) invests in another *investment trust* company (B), it will be necessary to look through to ensure that all charges or expenses which the *customer* will or may bear are included. Appropriate allowance may be made for any abatement to avoid double charging. Charges and expenses will be based on a reasonable distribution of assets that takes account of the investment philosophy of the *investment trust* company (A). If the *investment trust* company (B) is not required to make expense disclosure in respect of such assets, the charges and expenses of a similar company should be used.

Representative investment trust company

6.6.71

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- (1) Where a document refers to investment in a number of *investment trusts*, charges and expenses (as described in ■ COB 6.6.23) applicable to the trusts selected by the *customer* must be used. Where this is not practical, it is permissible to use the charges and expenses of a representative *investment trust* company.
- (2) The representative *investment trust* company will normally be the one that is most likely to be selected by the *customers* to whom the material is issued. Where advantage is taken of this option, the *document* must include information which shows the differences if other *trusts* are selected. The normal presentation will be to show the differences in the other reduction of investment return, or as an adjustment to the Table in *key features*. Where the reduction of investment return is used, it will not be necessary to show differences unless the rounded difference is at least 0.1% and the unrounded difference is at least 0.05%.

Types of expense

6.6.72

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- (1) Expenses may be incurred either in acquiring or in holding an investment in an *investment trust* company. The list in (2) is not comprehensive and, in respect of other expenses, the list sets out the type of expense that should be included. The report and accounts of the *investment trust* company will normally provide a starting point in assessing the expenses that are charged against the assets of the *investment trust* company. These are in addition to disclosable charges.
- (2) Expenses to be included will be of four main types:
 - (a) deductions levied against the assets of the *investment trust* company;
 - (b) management expenses levied against the assets of the *investment trust* company; these expenses include management fees plus any management costs financed from commission received, directors' fees, pension contributions, non-recurring expenses, all other professional and regulator's fees and subscriptions, rents paid, depreciations, custody fees, audit fees and all other pre-tax expenses (except for interest paid); management expenses include marketing costs, if any;
 - (c) expenses borne by the *customer* in acquiring or disposing of *investment trust* shares; these include adviser's commission (if any), stockbroker dealing commission on purchases and sales, stamp duty and withdrawal charges;
 - (d) investment spread in the pricing of the *investment trust shares*.
- (3) Expenses should include allowance for any value added tax which is not recoverable.
- (4) Expenses in (2)(c) and the spread in (2)(d) should be on bases that fairly represent the expected level of such expenses and spread. Where appropriate, a representative level of expenses and the spread should be used.

Translation to trust level

6.6.73

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- (1) Having identified all the expenses in ■ COB 6.6.72(2), a *firm* needs to express them as rates of charges and expenses (as described in ■ COB 6.6.23) that can be used in *projections* and *key features*.
- (2) The process is as follows.
 - (a) The expenses in ■ COB 6.6.72(2)(a) and (b) should be expressed as a proportion of the overall fund using net asset value: For established companies, the relevant fund is taken to be based on the average size of the *investment trust* company for the period of assessment.
 - (b) The expenses in ■ COB 6.6.72(2)(c) and (d) will usually be expressed as a proportion of the fund based on *share price* or the amount of the *investment*, as appropriate. Some expenses will be a one-off expense or spread and some will be in the form of an annual charge.
 - (c) The rates of charges and expenses calculated under (a) and (b) should be added together. The fact that the calculation at (a) used net asset value

can be ignored as it is assumed that the level of discount or *premium* remains unaltered.

- (3) The charges and expenses will normally be historic and need to be adjusted for any expected variation in the level of costs from the period used in the assessment to the period relevant to the disclosure of the expenses if such variation is believed to make a material difference.
- (4) Where the use of the figure calculated in (3) would be misleading, a fair estimate of the size of the company which is consistent with the adjusted expenses should be used. The same method should be used in the case of new *investment trusts*. In determining the reasonable levels of expense to be assumed, account may be taken of the expenses attributable to the existing *investment trust* which most closely corresponds to it, but with proper regard to any material differences in cost.
- (5) Set-up costs may be amortised over a limited period not normally exceeding five years.

Review of expenses

6.6.74

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The expenses used in calculations must be reviewed whenever material changes in the levels are identified which would mean that the disclosed amounts are misleading. In any event the expenses must be reviewed at least once a year.

Example of the calculation of reduction in investment return

6.6.75

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■ COB 6.6.76 - ■ COB 6.6.78 contain an example which has been prepared to assist understanding of the method of calculating the reduction in investment return. However, the figures should not be regarded as representative or indicative of likely levels of charges and expenses to be expected.

General

6.6.76

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- (1) The reduction in investment return shows the effect of all charges and expenses to the *customer*.
- (2) The rates of investment return allow for all tax and withholding tax for which the *product provider* is responsible. The current rate of tax may be used to calculate the net distribution of income. Where appropriate, the net distributions are offset from the rate of investment return.
- (3) It is not necessary to allow for daily changes so that monthly steps are acceptable.
- (4) The rates of return are assumed to compound annually. The twelfth root is used to calculate the monthly rate. This is different from the fund management charge, where normally one twelfth of the annual rate is deducted monthly.

- (5) The bid/offer spread should be allowed as an initial charge so that subsequent figures are on the basis of the bid price, except where the context requires allowance to be made for the spread.

The parameters

6.6.77

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- (1) Contract details: *unit trust* for a term of 10 years with a single *investment* of £6,000 (SP).
- (2) Distributions: at the rate of 2.4% per annum, distributed as 1.2% of the offer value at the end of each half year.
- (3) Charges:
 - (a) initial charge of 3% of *investment* (IC);
 - (b) fund management charge of 1/12 of 1.25% per month (FMC) on distribution *units*;
 - (c) attributable expenses of 1/12 of 0.25% per month (AE);
 - (d) investment spread of 3% (IS) making total bid/offer spread of 6%.
- (4) Calculation:
 - (a) investment of £6,000 (SP) less (IC+IS) giving an initial bid value of £5,640
 - (b) interest of 6% pa or 0.4868% per month less (FMC + AE) = $1.004868 \times (1 - 0.015/12) - 1 = 0.3612\%$ per month
 - (c) the value after 10 years as shown in ■ COB 6.6.79 is £6,720
 - (d) the internal rate of return necessary to generate £6,720 plus distributions over 120 months from an initial investment of £6,000 is 0.3030% per month or 3.7% per annum
 - (e) one method of creating the table is to use 20 periods of six months, each of which end with the payment of a distribution.
 - (f) after 6 months:
 - (i) the bid value of the fund before the distribution is $6000 \times 0.94 \times (1.003612)^6 = £5,763$
 - (ii) the distribution is $0.012 \times 5763/0.94 = £73$
 - (iii) the fund carried forward is $5763 - 73 = £5,690$
 - (iv) after the end of Year 1, that is, after the second 6 months
 - (v) the bid value of the fund before the distribution is $5690 \times (1.003612)^6 = £5,814$
 - (vi) the distribution is $0.012 \times 5814/0.94 = £74$
 - (vii) the fund carried forward is $5814 - 74 = £5,740$

- (viii) this bid value is disclosed as there is no exit penalty as ‘what you might get back’.
- (g) the ‘effect of deductions’ is calculated from the accumulation of the *investment* with no allowance for charges and expenses but with allowance for income:
 - (i) the accumulated fund after 1 year with no allowance for charges is $[6000 \times (1.004868)^6 - 73] \times (1.004868)^6 - 74 = \text{£}6,210$
 - (ii) the ‘effect of deductions’ is this figure less ‘what you might get back’, that is, $\text{£}6,210 - \text{£}5,740 = \text{£}470$
- (h) this process is continued throughout the term of the table; after 10 years, the accumulated investment at 0.4868% per month with no allowance for charges and expenses but with allowance for the same distributions of income is $\text{£}8,621$; ‘What you might get back’ is $\text{£}6,723$ so ‘effect of deductions’ is the difference or $\text{£}1,898$;
- (i) the deduction in *investment* return is determined by calculating the rate of interest which accumulates the *investment* with no allowance for charges and expenses but with allowance for income to $\text{£}6,723$; this is 0.3030% per month (0.4868% per month gives $\text{£}8,621$); the yearly rate is $(1.00303)^{12} - 1$ or 3.7%.

6.6.78

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In ■ COB 6.6.79 projected amounts are rounded down to three significant figures.

6.6.79

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Table Specimen table of presentation of the effect of charges and expenses
This table belongs to ■ COB 6.6.75

At end of year	Investment to date £	Income to date £	Effect of deductions to date £	What you might get back £
1	6,000	148	470	5,740
3	6,000	451	715	5,940
5	6,000	766	998	6,150
10	6,000	1,600	1,890	6,720

The last line in the table shows that over 10 years the effect of total charges and expenses could amount to $\text{£}1,890$.

Putting it another way, this would have the same effect as bringing the illustrated investment growth from 6.0% a year down to 3.7% a year.

Assumptions for pension annuities

6.6.80

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The formulae shown must be used for calculating the factors for converting a *retirement fund* into an annuity. The formulae in ■ COB 6.6.81 assume that the annuity will be payable monthly in advance for a term certain of *n* years (typically five):

- (1) for an RPI-linked and LPI-linked annuity (excluding a *protected rights annuity*): use Factor (1);

- (2) for an annuity which is static or has fixed rates of escalation: use Factor (2);
- (3) for a spouse's reversionary annuity (excluding a protected rights annuity, and whether or not there is overlap with any guaranteed period under the associated single life annuity): use Factor (3);
- (4) for a pre April 1997 *protected rights annuity*: use Factor (4);
- (5) for a post April 1997 protected annuity: use Factor (5).

6.6.81

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Table Table of formulae for pension annuity factors
This table belongs to ■ Local COBS 6.6.80 and ■ COB 6.6.82

Factor	Formula
(1)	$(1+E)*[\ddot{a}_n^{(12)} + D_{x+n}/D_x * \ddot{a}_{x+n}^{(12)}]$
(2)	$(1+E)*[\ddot{a}_n^{(12)} + D_{x+n}/D_x * \ddot{a}_{x+n}^{(12)}]$
(3)	$(1+E)*[a_{y-x:y}]$
(4)	$(1+E)*[\ddot{a}_f^{(12)} + .045*(a_m - a_{m:f})]$
(5)	$(1+E)*[\ddot{a}_f^{(12)} + 0.50*(a_m - a_{m:f})]$
(6) namely $a_x^{(12)}$	$= a_x + 13/24$
(7) namely $\ddot{a}_{x:t}^{(12)}$	$= 13/24 * \ddot{a}_{x:t} + 11/24 * a_{x:t}$

6.6.82

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- (1) All factors must be rounded to three decimal places before being applied to the *retirement fund*.
- (2) In the formulae the letters a and D have their normal actuarial notation meanings. In formulae for two lives, x is the member and y is the spouse, and for the *protected rights* formulae, f indicates the use of female mortality and m that for males. In addition, a monthly annuity is either Factor (6) or (7).
- (3) For retirement other than on a birthday, the factors must be obtained by linear interpolation on complete months. Where a member is not able (for practical reasons or otherwise) to determine the exact age at retirement, it must be assumed that the exact age at retirement is then the age at the last birthday.
- (4) Where the *projection* is of an annuity after taking a tax-free lump sum, the table must be used with the *retirement fund* reduced by the projected tax-free lump sum before rounding. Any tax-free lump sum illustrated should be rounded to three significant figures, unless the lump sum is equal to the amount of a loan.
- (5) Where a *retirement fund* includes both *protected rights* and *non-protected rights* benefits, the appropriate factors are to be used for each relevant part of the total fund.
- (6) Where *customers* have post April 1997 *protected rights* funds and are not married at retirement, an illustration of single life pensions

may be provided. The factor must be calculated using the same assumptions as formula (5) in ■ COB 6.6.81 but ignoring the reversionary annuity part of the formula.

6.6.83

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In the formulae in ■ COB 6.6.81, the allowance for expenses (E) is:

- (1) for index-linked annuities: 3.5%
- (2) for all other annuities: 4%

6.6.84

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In the formulae in ■ COB 6.6.81, mortality rates must be calculated as follows:

- (1) the mortality table to be used is P80, amounts, with the mortality improvements projected forward to 2010, and with one year deducted from age;
- (2) where there are two lives concerned, for reversionary and for *protected rights annuities*, the husband is normally to be taken as being three years older than his wife; where the *firm* is aware that the wife is more than six years younger than her husband, an exact calculation must be performed using actual ages;
- (3) *protected rights annuities* must be calculated for both sexes on the basis that the member experiences female mortality and the spouse experiences male mortality.

6.6.85

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In the formulae in ■ COB 6.6.81, the mortality functions must be calculated at a rate of interest J, where:

- (1) $J = (1 + I)/(1 + R) - 1$;
- (2) R is the rate of escalation increase appropriate for the *customer* in formulae (2) and (3) in ■ COB 6.6.80; it is 3% for pre-April 1997 *protected rights* benefits in formula (4), and zero otherwise;
- (3) the rate of return assumptions (1) are as set out in the tables in ■ COB 6.6.50 – ■ COB 6.6.52 with real rates of return being used for formulae (1) and (5) in ■ COB 6.6.81 and monetary rates otherwise; and
- (4) different factors will need to be calculated where a *projection* is being prepared on lower and higher rates of return, and where appropriate also the intermediate rate.

Pension transfer value analysis requirements content

6.6.86

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■ COB 6.6.87 - ■ COB 6.6.93 outline how a *pension transfer* value analysis should be prepared. A *pension transfer* value analysis should provide a comparison between the potential benefits available to the *customer* from an *occupational pension*

scheme of which he is a member and the potential benefits that would be available to him under a personal pension or buy-out contract.

Basis of a pension transfer value analysis

6.6.87

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- (1) The basis for the *pension transfer* value analysis must be clear, fair and not misleading.
- (2) The information analysed must include details relevant to the *customer's* circumstances:
 - (a) spouse's, dependants' and children's pensions;
 - (b) early retirement provision, including provision for retirement in ill-health;
 - (c) a transfer value quotation detailing:
 - (i) guarantee period;
 - (ii) pre- and post-April 1988 Guaranteed Minimum Pension and excesses;
 - (iii) revaluation rates both in deferment and payment, and whether they are guaranteed or discretionary;
 - (iv) tax-free cash arrangements;
 - (d) lump sum death benefits;
 - (e) transfer club arrangements, if applicable;
 - (f) relevant earnings;
 - (g) period of service;
 - (h) scheme details (for example, benefits, bridging pensions, guarantee periods, position before and after normal retirement date, history of discretionary increases);
 - (i) whether members' benefits have been equalised for service from 17 May 1990;
 - (j) ill-health benefits.

Required comparisons

6.6.88

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The analysis must contain the following:

- (1) where the period before benefits are assumed to commence is one year or more:
 - (a) a statement of the rates of return, calculated as in ■ COB 6.6.92(2), which would have to be achieved under the transfer contract in order to provide the same level of benefits as those which would be afforded by the *occupational pension scheme* if the *customer* were to retire at normal retirement date ('the Target Benefits');
 - (b) if in the *firm's* opinion early retirement would be materially more favourable to the *customer* than retirement at normal retirement date, a statement of the rates of return, calculated as in ■ COB 6.6.92(2), which would have to be achieved under the transfer contract in order to provide the same pension as that afforded by the *occupational pension scheme*, assuming early retirement at a date on which the *customer* may be expected, or will have the *option*, to retire;
 - (c) a statement of the value of the benefits payable on the death of the *customer*, under the transfer contract and under the *occupational scheme*, on the assumption that the *customer* were to die on the *day* after the date on which the transfer contract is assumed to have commenced; comparisons assuming other dates of death may be included if they are likely to enhance understanding of the differences between the benefits payable under the transfer contract and the *occupational pension scheme*;
- (2) where the period before benefits are assumed to commence is less than one year:
 - (a) a statement of the annuity payable under the transfer contract and of the comparable Target Benefits;
 - (b) where the normal retirement date under the *occupational pension scheme* is not within a year, a statement of the rates of return, calculated as in ■ COB 6.6.92(2), which would have to be achieved under the transfer contract in order to provide the Target Benefits.

6.6.89

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- (1) In all cases (except in a case within ■ COB 6.6.88(2) in respect of the annuity) a statement of the assumptions must be provided which complies with the requirements of ■ COB 6.6.90.

Required assumptions

6.6.90

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- (1) The assumptions in ■ COB 6.6.91 must be made for the purposes of the required calculations, except as envisaged by this *rule*.

- (2) The assumptions may be varied only to incorporate more cautious assumptions.
- (3) If an annuity interest rate different from the *FSA* annuity rate (as described in ■ [COB 6.6.91](#)) is used, it must be the interest rate for annuities in payment provided that it is a multiple of 0.5% per annum and must not exceed the *FSA* annuity rate for zero years to retirement.
- (4) Where the *occupational pension scheme* has a record of discretionary increases in pension, the assumptions must be consistent with the published practice of the trustees, if any, or based on a comparison of the increases granted over the last five years with a published index. It must be assumed that increases will continue, and allowance must be made for continuation by:
 - (a) relying on any statement by the trustees of their practice;
 - (b) comparing recent experience with the increase in the retail *price* index and restricting the future allowance to a maximum of the increase in the retail price index;
 - (c) making a default assumption of limited pension indexation;
 - (d) assessing the likelihood whether such increases will continue to be paid.

Figures may be provided showing the effect of applying a factor representing the likelihood of such continuation.

6.6.91

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Table Assumptions to be made
This table belongs to ■ [COB 6.6.90](#)

Annuity interest rate (“AIR”)	As published by the FSA from time to time [the FSA annuity rate]
Retail prices index	AIR – 3%
Average earnings index (“AEI”) and section 21 orders	AIR – 1.5%
Pre-retirement limited price indexation revaluation	AIR – 3% (maximum 5%)
Post-retirement limited price indexation increases	AIR – 3% (maximum 5%)
Index-linked pensions	AIR – 3%
Note:	
The interest rate in deferment must not be assumed but calculated as required by <i>COB 6.6.92R</i> .	

Method of calculation

6.6.92

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- (1) In calculating the Target Benefits for the purposes of the comparisons required by ■ COB 6.6.88, regard must be had to benefits which commence at different times.
 - (a) Where a benefit becomes payable at a different age from the age at which the Guaranteed Minimum Pension becomes payable, the benefit must be valued from its appropriate commencement date.
 - (b) In the case of pensions payable only for a limited period, an allowance must be made.
- (2) The method of calculating the rate to be used for the purpose of the comparisons required by ■ COB 6.6.88 is:
 - (a) make the assumptions required by ■ COB 6.6.91;
 - (b) on those assumptions, calculate the Target Benefits;
 - (c) calculate, in accordance with ■ COB 6.6.34 - ■ COB 6.6.62 which relate to the calculation of *projections*, the interest rate in deferment necessary to attain a transfer value sufficient to provide benefits equal to the Target Benefits.

Required disclosures

6.6.93

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The analysis must also contain:

- (1) a list of all the main assumptions made for the purposes of the analysis, set out consecutively and with equal prominence;
- (2) a warning as to the differences between the amounts of benefit under the *occupational pension scheme* and the level of benefits under the proposed transfer contract which depends on future investment performance and on interest rates at the time of retirement;
- (3) a description of any differences in the dates on which the pensions become payable, for example in the case of a *protected rights* pension under a *personal pension scheme* which will not become payable until the *customer* attains the State retirement age;
- (4) a warning of any shortfall in the value of the death benefits provided by the transfer contract and, where there is such a *shortfall*, if appropriate, a quotation for provision to make good the shortfall.



6.7 Cancellation and withdrawal

Application

6.7.1

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■ COB 6.7 applies to:

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- (1) a *product provider*;
- (2) an *insurer* which provides *pure protection contracts*;
- (3) an *independent intermediary*, when acting as an *EIS manager*, *ISA manager* or *plan manager*, or when *selling on to a customer units* which the *firm* has bought or redeemed as *principal* for that purpose;
- (4) a *deposit-taking firm*, when acting as *ISA manager* or as the *firm* responsible for holding *deposits* in respect of another *firm's cash deposit ISA*;
- (5) the operator of a *stakeholder pension scheme*.

6.7.2

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The *firms* in ■ COB 6.7.1 (except those in ■ COB 6.7.1(3)) are *product providers*, *insurers*, *deposit-taking firms* or *stakeholder pension scheme* operators, that is, the *firms* responsible for issuing *life policies*, *selling units*, issuing *long-term insurance contracts*, *accepting deposits* for *ISAs*, or acting as operators of *stakeholder pension schemes*.

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6.7.3

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- (1) ■ COB 6.7 specifies the rights which *customers* have either to cancel agreements into which they have entered, or to withdraw any offer before an agreement has commenced.
- (2) ■ COB 6.7.12 specifies those agreements for a *stakeholder pension scheme* which *customers* have a right to cancel.
- (3) ■ COB 6.7.14(1) specifies those agreements for an *EIS*, *ISA* or *PEP* from which *customers* have a right to withdraw.
- (4) ■ COB 6.7.15 specifies those *long-term insurance contracts* which *customers* have a right to cancel and those which they do not.
- (5) A *firm* has the option to replace a post-sale right to cancel certain *pension annuities* with a pre-sale right to withdraw, referred to as "cancellation substitute" (see ■ COB 6.7.14(2)). This option is also available for money purchase and defined benefits (or final salary) *pension transfers*. If a *firm*

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chooses not to offer the cancellation substitute, it has to offer cancellation. The cancellation substitute is available as it is very difficult for post-sale cancellation to work effectively in the case of *pension transfers*, because of the difficulty of putting the *customer* back in his original position.

- (6) ■ COB 6.7.17 specifies those non-life agreements for a *pension contract*, *appropriate personal pension* or *units* in an *AUT* or *ICVC* which *customers* have a right to cancel and those which they do not. It also allows *firms*, for *units* within an *ISA* or *PEP*, to replace cancellation with a pre-sale right to withdraw.
- (7) ■ COB 6.7.20 specifies the cancellation procedure which applies to *cash deposit ISAs*.
- (8) ■ COB 6.7.23 specifies certain variations to existing agreements which *customers* have a right to cancel or right to withdraw.
- (9) ■ COB 6.7.54 to ■ COB 6.7.58 identify *investment agreements* subject to *shortfall* and describe how to calculate *shortfall*.

6.7.4



■ COB 6.7.5 summarises the applicable cancellation and withdrawal rights and the maximum period of reflection. *Firms* should have regard to the detailed *rules* and guidance in all cases, particularly for the detailed exemptions.

6.7.5



Table Cancellable investment agreements.
This table belongs to ■ COB 6.7.4

Cancellable investment agreements			
	Post-sale right to cancel?	Pre-sale right to withdraw?	Maximum period of reflection
A. Agreements where the right arises regardless of whether advice is given.			
<i>appropriate personal pension (APP)</i>	Yes	No	14–30 days ^{2,3}
<i>cash deposit ISA</i>	Yes	No	14 days
<i>life policy</i> (inc. <i>pension policy</i> , <i>pension annuity</i> or within <i>ISA</i>)	Yes ¹	Yes ¹	14 days ^{2,4}
<i>pension contract</i>	Yes ¹	Yes ¹	14 days ^{2,4}
<i>pure protection contract</i>	Yes	No	14 days ²
<i>stakeholder pension scheme (SHP)</i>	Yes	No	14–30 days ^{2,5}
certain variations of existing <i>life policies</i> , <i>pension contracts</i> and <i>SHP</i> 's	Yes ¹	Yes ¹	14–30 days ^{2,6}
B. Agreements where the right arises only if advice is given.			
<i>Units</i> in an <i>AUT</i> or <i>ICVC</i> (within an <i>ISA</i> or <i>PEP</i>)	Yes ⁸	Yes ⁸	14 days for cancellation ² 7 days for withdrawal

Cancellable Investment agreements			
ISA or PEP not mentioned in any row above	No	Yes ⁷	7 days
Units in an AUT or ICVC (outside an ISA or PEP)	Yes	No	14 days ²
EIS	No	Yes ⁷	7 days

Notes:

- For a *pension annuity* or *pension transfer* (and a relevant variation), the *firm* can, in certain circumstances, choose to operate a pre-sale right to withdraw in COB 6.7.19R – known also as the ‘cancellation substitute’ – rather than a post-sale right to cancel (see COB 6.7.14R(2)).
- Assuming the terms of the *firm’s* contract do not give the *customer* a longer period (see COB 6.7.11R).
- 14 days for an APP which is a *pension contract* / 14–30 days for an APP which is a *pension policy*.
- The period is at least 14 days if the cancellation substitute is operated.
- 14–30 days for an SHP which is a *life policy*; 14 days for other SHPs.
- The cancellation period depends on the nature of the existing agreement.
- There is no right to withdraw for a second or subsequent *EIS* or *ISA*, or (for an *EIS* or non-packaged product *ISA* or *PEP*) where the *firm* has previously disclosed to the *customer* that no such rights will apply.
- For *units* in an *AUT* or *ICVC* (within an *ISA* or *PEP*), the *firm* can choose to offer a pre-sale right to withdraw rather than a post-sale right to cancel (see COB 6.7.14R(1)). There is no right to cancel or withdraw for a second or subsequent *ISA*.

Purpose

6.7.6

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■ COB 6.7 reinforces *Principle 6* (Customers’ interests), which requires a *firm* to pay due regard to the interests of its *customers* and treat them fairly. In certain circumstances, *customers* who are entering into an *investment agreement* will be entitled to a period of reflection during which they can decide whether to proceed with their purchase.

Right to cancel

6.7.7

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A *customer*, who is an individual, has a right to cancel:

- (1) an *investment agreement* specified in column 1 of ■ COB 6.7.15 or ■ COB 6.7.17, unless the right to cancel is disapplied or replaced by anything in column 2 of ■ COB 6.7.15 or ■ COB 6.7.17;
- (2) an *investment agreement* for a *stakeholder pension scheme* for which a right to cancel applies under ■ COB 6.7.12;
- (3) an *investment agreement* for a *cash deposit ISA* in accordance with ■ COB 6.7.20;

(4) a variation of a *life policy*, *pension contract* or *stakeholder pension scheme* for which a right to cancel applies under ■ COB 6.7.23.

6.7.8 **R** /1 The trustees of an *occupational pension scheme* or the trustees and managers of a *stakeholder pension scheme* must be treated so far as necessary as an individual *customer* for the purposes of the *cancellation rules*, and acquire the same right to cancel as an individual *customer*.

6.7.9 **G** /1 (1) ■ COB 6.7.8 applies when trustees purchase *life policies* or *schemes* as *investments* of their *pension schemes*. Individual members of *stakeholder pension schemes* have a right to cancel initial membership of the scheme and, in some circumstances, a subsequent variation of their contributions.

(2) A *product provider* or operator of a *stakeholder pension scheme* (see ■ COB 6.7.2) may be unsure whether any of the situations in column 2 of ■ COB 6.7.17 applies to the agreement in question. In such circumstances the *product provider* or operator of a *stakeholder pension scheme* may find it convenient to contract with an intermediary for the provision of documentary evidence needed to confirm the status of *customers*. However, the responsibility for ensuring compliance with the *cancellation rules* remains with the *product provider* or operator of a *stakeholder pension scheme*.

6.7.10 **R** /1 When a *customer* has a right to cancel under ■ COB 6.7.7(1), (2) or (4), that right must (unless ■ COB 6.7.11 applies) be exercised:

- (1) (in the case of a *life policy*) within the shorter of:
- (a) 30 days; or
 - (b) the period (of 14 days or more) specified by the *firm*;
- from the date when the *customer* received a *post-sale notice* from the *firm*;
- (2) (in any other case) within 14 days from the date when the *customer* received a *post-sale notice* from the *firm*.

6.7.11 **R** /1 Where the terms of the *firm's* contract give the *customer* a longer period to cancel (that is, in excess of the 14 or 30 days specified), the *firm* must disclose in the *post-sale notice* the differences between the *customer's* rights under ■ COB 6.7.10 and the terms of the contract, which operate independently.

Right to cancel a stakeholder pension scheme

6.7.12 **R** /1 (1) A *customer*, who is an individual, and who has entered into an *investment agreement* for a *stakeholder pension scheme* has a right to cancel.

- (2) When the *customer* has entered into an *investment agreement* for a *stakeholder pension scheme* involving recurring contributions to that *stakeholder pension scheme*, only the first contribution will attract a right to cancel provided that:
- (a) the intention or option to make regular contributions has been disclosed in advance of the *customer* entering into the *investment agreement*; and
 - (b) the *customer's* intention to make regular contributions is evidenced.

6.7.13

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For the purposes of ■ COB 6.7.12(2)(a), disclosure of the option to make regular contributions may, for example, take place in *key features*. For the purposes of ■ COB 6.7.12(2)(b), an individual *customer's* intention to make regular contributions could, for example, be demonstrated by the establishment of a direct debit mandate or instructions to an employer to deduct regular contributions from salary.

Right to withdraw

6.7.14

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A *customer*, who is an individual, has a right to withdraw an offer to enter into:

- (1) (unless a right to cancel is offered for an *ISA* or *PEP* under ■ COB 6.7.15, ■ COB 6.7.17 or ■ COB 6.7.20 and subject to cases 8 and 9 of column 2 ■ COB 6.7.17) an *EIS*, *ISA* or a *PEP*, following *advice on investments*; the right to withdraw procedures are that the offer made by the *customer* to enter into the agreement cannot be accepted by the *firm* until at least seven days after the offer is made; or
- (2) a *pension annuity* or a *pension transfer* (or a relevant variation), if a right to cancel has been replaced by a right to withdraw under case 4(a) or 7(a) of column 2, ■ COB 6.7.15, case 12 of column 2, ■ COB 6.7.17 or ■ COB 6.7.23(3); the right to withdraw procedures are set out in ■ COB 6.7.19.

6.7.15

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Table Cancellable investment agreements – life
This table belongs to ■ COB 6.7.7(1).

Cancellable investment agreements – life	
Investment agreements for a long-term insurance contract for which an individual customer has:	
Column 1	Column 2
<p>a right to cancel under COB 6.7.7R(1) (subject to column 2)</p> <p>A. Life policy (whether or not held within an ISA – see notes 1, 2 and 3 in COB 6.7.16R) (see COB 6.7.23R regarding variation of an existing life policy).</p> <p>B. Appropriate personal pension which is a pension policy.</p> <p>C. Pure protection contract.</p>	<p>no right to cancel where any one or more of the following cases applies</p> <ol style="list-style-type: none"> 1. Pension fund management policy. 2. Life policy that relates to or is associated with securing benefits under a defined benefits pension scheme. 3. Any life policy for a term of six months or less (unless note 3 in COB 6.7.16R applies). 4. Pension policy funded (wholly or in part) from payments derived from: <ol style="list-style-type: none"> (a) a pension transfer, for which the right to cancel is replaced by the right to withdraw (see COB 6.7.14R(2)), using the cancellation substitute in COB 6.7.19R; or (b) compensation or redress paid by a firm following a review undertaken in relation to a complaint. 5. Traded life policy. 6. Life policy effected by the trustees of an occupational pension scheme or the employer, or the manager or trustees of a stakeholder pension scheme that represents a: <ol style="list-style-type: none"> (a) pension buy-out contract; or (b) purchase of a without-profits deferred pension annuity; or

Cancellable investment agreements – life	
Investment agreements for a long-term insurance contract for which an individual customer has:	
Column 1	Column 2
	<p>(c) <i>defined benefits pension scheme</i> or a <i>single premium payment to any occupational pension scheme with a pooled fund</i> (that is, underlying <i>investments</i> are not earmarked for individual scheme members); or</p> <p>(d) purchase made to insure and secure members' pension benefits under a <i>money-purchase occupational scheme</i> or <i>stakeholder pension scheme</i> (unless it is the master, first or only <i>policy</i>).</p> <p>7. <i>Pension annuity</i> that is:</p> <p>(a) due to commence within a year and a day of the contract, for which the right to cancel is replaced by the right to withdraw (see <i>COB 6.7.14R(2)</i>), using the cancellation substitute in <i>COB 6.7.19R</i>; or</p> <p>(b) funded (wholly or in part) from compensation or redress paid by a <i>firm</i> following a review undertaken in relation to a complaint.</p> <p>8. The <i>customer</i>, at the time he signs the application, is <i>habitually resident</i>:</p> <p>(a) in an <i>EEA State</i> other than the <i>United Kingdom</i> (see note 4 in <i>COB 6.7.16R</i>); or</p>

Cancellable investment agreements – life	
Investment agreements for a long-term insurance contract for which an individual customer has:	
Column 1	Column 2
	<p>(b) outside the <i>EEA</i> and is not present in the <i>United Kingdom</i>.</p> <p>9. <i>Pure protection contract</i> effected by the trustees of an <i>occupational pension scheme</i>, an employer or a <i>partnership</i> to secure benefits for employees or the <i>partners in the partnership</i>.</p>

6.7.16

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Table Notes to cancellable investment agreements - life
This table belongs to ■ COB 6.7.15

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Notes to COB 6.7.15R:
<p>1. Recurring single premium life policy: Under certain conditions, only the first <i>premium</i> in what might be a series of <i>premiums</i> (for example, in the case of a <i>mini-ISA insurance component</i>) attracts cancellation rights under <i>COB 6.7.7R(1)</i>. The conditions are:</p> <p>(a) the option to make a series of single <i>premium</i> payments is disclosed at outset (for example, in <i>key features</i>); and</p> <p>(b) the intention is evidenced (for example, by the <i>customer</i> establishing a direct-debit mandate).</p> <p>2. Multiple agreements: Where a <i>customer</i> enters into a set of <i>investment agreements</i> at the same time (for example, the different components held within a <i>maxi-ISA</i> and with the same <i>firm</i> (or another <i>person</i> in the same <i>marketing group</i> as that <i>firm</i>)), and that set is being purchased to fulfil one investment objective of the <i>customer</i>, the <i>firm</i> may treat the multiple agreements as being one agreement for the purposes of <i>COB 6.7</i>. But if it does so, the <i>firm</i> must ensure that the <i>customer</i> retains a right to cancel each <i>investment agreement</i> separately. See also <i>COB 6.7.37R</i> in relation to a <i>maxi-ISA</i>. This note applies also to a group of <i>contracts of insurance</i>, for example, <i>term assurance</i> contracts which have been established as part of a specific marketing arrangement. Such an arrangement may not have an investment objective.</p> <p>3. A purchaser of a single premium pension policy has a right to cancel where the designated retirement date is within six months of the date of the policy, unless the <i>policy</i> falls within case 1, 4 or 7(b) of column 2.</p> <p>4. For a <i>customer habitually resident</i> in an <i>EEA State</i> other than the <i>United Kingdom</i>, <i>firms</i> are reminded that they may need to apply cancellation in accordance with the requirements in that <i>EEA State</i>.</p>

6.7.17

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Table Cancellable investment agreements – non-life
This table belongs to ■ COB 6.7.7(1) and ■ COB 6.7.14(1)

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Cancellable investment agreements – non-life	
Investment agreements for which an individual customer has:	
Column 1	Column 2
<p>a right to cancel under <i>COB 6.7.7R(1)</i> (subject to column 2).</p> <p>A. <i>Pension contract</i> (see notes 1, 2 and 4 in <i>COB 6.7.18R</i>).</p> <p>B. <i>Appropriate personal pension which is a pension contract</i> (see note 4 in <i>COB 6.7.18R</i>).</p> <p>C. Subscriptions (see notes 1 and 2 in <i>COB 6.7.18R</i>) which can be invested only in <i>units</i> (whether or not held within an <i>ISA</i>, <i>PEP</i> or <i>pension contract</i>) in an <i>AUT</i> or <i>ICVC</i> purchased from the:</p> <p>(a) <i>operator</i>; or</p> <p>(b) <i>its marketing group associate acting as an ISA manager or plan manager</i>.</p>	<p>no right to cancel where any one or more of the following cases applies</p> <ol style="list-style-type: none"> 1. The <i>customer</i> is not a <i>private customer</i>. 2. The agreement is entered into with the <i>firm</i> (and where relevant with any <i>independent intermediary</i>) as an <i>execution-only transaction</i> (unless note 4 in <i>COB 6.7.18R</i> applies). 3. The agreement is entered into through a <i>direct offer financial promotion</i> (unless note 4 in <i>COB 6.7.18R</i> applies). 4. The agreement represents an exchange of <i>units</i> between <i>sub-funds</i>. 5. The agreement represents a <i>defined benefits pension scheme</i>. 6. The agreement is entered into under a <i>customer agreement</i> or during negotiations (which are not <i>ISA</i> or <i>PEP</i> related) intended to lead to a <i>client agreement</i> (unless note 4 in <i>COB 6.7.18R</i> applies). 7. The agreement relates to an <i>ISA</i> or <i>PEP</i> for which the right to cancel is replaced by the right to withdraw (see <i>COB 6.7.14R(1)</i>).

Cancellable investment agreements – non-life	
Investment agreements for which an individual customer has:	
Column 1	Column 2
	<p>8. The agreement relates to an <i>EIS</i> or <i>non-packaged product ISA</i> or <i>PEP</i> and is entered into, following <i>advice on investments</i>, and following an explanation, given to the <i>customer</i> in accordance with <i>COB 3.9.21R(2)</i> (Direct offer financial promotions: Cancellation rights) or <i>COB 4.2.14E(10)</i> (Terms of business and client agreements with customers) in a <i>direct offer financial promotion, terms of business</i>, or given in <i>EIS particulars</i>, that neither of the rights specified in case 7 will apply.</p> <p>9. The agreement entered into is a second or subsequent <i>ISA</i> (or <i>EIS</i>) on substantially the same terms (see note 3 in <i>COB 6.7.18R</i>) as an <i>ISA</i> (or <i>EIS</i>) purchased from the same <i>ISA manager</i> (or <i>EIS manager</i>) in the previous tax year.</p> <p>10. The agreement relates to a change from <i>accumulation units</i> to <i>income units</i> or vice versa, in the same <i>scheme</i>.</p> <p>11. <i>Pension contract</i> funded (wholly or in part) from payments derived from compensation or redress paid by a <i>firm</i> following a review undertaken in relation to a complaint.</p> <p>12. <i>Pension contract</i> funded (wholly or in part) from payments derived from a <i>pension transfer</i> for which a right to cancel is replaced by a right to withdraw) (see <i>COB 6.7.14(2)R</i> using the cancellation substitute in <i>COB 6.7.19R</i>.</p>

Cancellable investment agreements – non-life	
Investment agreements for which an individual customer has:	
Column 1	Column 2
	<p>13.The agreement relates to a <i>recognised collective investment scheme</i> and the agreement is with an <i>operator</i> who is not:</p> <ul style="list-style-type: none"> (a) an <i>authorised person</i>; or (b) carrying on business in the <i>United Kingdom</i>. <p>14.The agreement relates or would relate to exported products, that is to say:</p> <ul style="list-style-type: none"> (a) where the <i>customer</i> is not <i>habitually resident</i> in the <i>United Kingdom</i> at the date of the offer of the agreement; or (b) the <i>firm</i> has reasonable grounds for assuming that no <i>advice on investments</i> about the agreement was provided by anyone carrying on <i>designated investment business</i> in the <i>United Kingdom</i>.

6.7.18

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Table Notes to cancellable investment agreements - non-life
This table belongs to ■ COB 6.7.17

Notes to COB 6.7.17R:
<p>1. Recurring single payment <i>pension contracts</i> and <i>unit savings plans</i>. Under certain conditions, only the first payment in what might be a series of payments attracts cancellation rights under <i>COB 6.7.7R(1)</i>. The conditions are:</p> <ul style="list-style-type: none"> (a) the intention or option to make a series of single payments is disclosed at outset (for example, in <i>key features</i>); and (b) the intention is evidenced (for example, by the <i>customer</i> establishing a direct debit mandate). <p>2. Multiple agreements. Where a <i>customer</i> enters into a set of investment agreements at the same time (for example, regarding different components held within a <i>maxi-ISA</i>) and with the same <i>firm</i> (or another <i>person</i> in the same <i>marketing group</i> as that <i>firm</i>) and that set is being purchased to fulfil one investment objective of the <i>customer</i>, the <i>firm</i> may treat the agreements as being one agreement for the purposes of <i>COB 6.7</i>. But if it does so, the <i>firm</i> must ensure that the <i>customer</i> has a right to cancel each <i>investment agreement</i> separately (see also <i>COB 6.7.37R</i> in relation to <i>maxi-ISA</i>).</p>

Notes to COB 6.7.17R:

3. For example, *mini-* to *mini-ISA* or *maxi-* to *maxi-ISA* would be regarded in this context as ‘on substantially the same terms’.
4. A *customer* has a right to cancel an *appropriate personal pension* or *pension contract* at the outset and on any subsequent agreement for a variation of a *pension contract* (see COB 6.7.23R regarding variation of an existing contract).

6.7.19

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Table Cancellation substitute.
This table belongs to ■ COB 6.7.14(2), cases 4(a) and 7(a) of column 2 to ■ COB 6.7.15 and case 12 of column 2 to ■ COB 6.7.17.

Cancellation substitute

The *customer’s* right to cancel under COB 6.7.7R(1) or (4) is replaced by the right to withdraw only if:

1. the *firm* has supplied (or has reasonably relied upon another *firm* to supply) to the *customer*, at least 14 days before the contract is concluded, a written notice (see note 1) which prominently states:
 - (a) that the *customer* has a period of at least 14 days within which to consider his pension options;
 - (b) the dates at which the period begins and ends (which must be, in the case of a *pension transfer*, before the transfer has been irrevocably effected);
 - (c) the pension options available (for example, the *open-market option* in relation to a *pension annuity*);
 - (d) the steps the *customer* must take in order to exercise a particular pension option;
 - (e) that the *customer* is entitled to *key features* and is advised to check with the *firm* if the *key features* have not been received;
 - (f) the cost of any advice given to the *customer* in relation to the transaction; and
2. the *firm* has taken sufficient steps (or has reasonably relied upon the same *firm* as in 1. to take those steps) to ensure that the *customer* has been informed and made fully aware of the potential advantages and disadvantages of proceeding and has had an opportunity to consider all other possible alternatives.

Note:

1. The notice must be issued separately or feature prominently as part of the application form, *suitability letter* or *key features* supplied to the *customer*.

6.7.20

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Table Cancellation – cash deposit ISA
This table belongs to ■ COB 6.7.7(3)

Cancellation – cash deposit ISA

The *firm* must supply (or may reasonably rely upon another *firm* to supply) to the *customer* before the account is opened, a written notice (see note 1) which prominently states:

- A. that the *customer* has a 14 day period within which to consider whether or not to keep the account open;
- B. the dates at which the 14 day period begins and ends (see note 2);
- C. the options available (see note 3);
- D. how cancellation will operate in circumstances where the account forms part of a *maxi-ISA* which contains other components (see *COB 6.7.37R*);
- E. the steps the *customer* must take to communicate any decision not to proceed with the account (see *COB 6.7.42R* to *6.7.46G*); and
- F. that a *customer* who exercises a right to cancel will not incur any additional charges or be affected by any notice period.

Notes:

- 1. The notice must be issued separately or feature prominently as part of the minimum information or *key features* supplied to the *customer*.
- 2. Unless the *firm* has specified a longer period to the *customer*, the minimum expiry date is the end of the fifteenth day from the date the account was opened.
- 3. A *firm* must either assist the *customer* in switching accounts or re-fund all monies deposited together with interest.

Voluntary provisions

- 6.7.21 **R**
/1 If anything in column 2 of either ■ *COB 6.7.15* or ■ *COB 6.7.17* removes the right to cancel an *investment agreement*, but a *firm* voluntarily gives the *customer* a right to cancel in any event, the *firm* must treat the agreement as if it were cancellable under ■ *COB 6.7.7(1)*.
- 6.7.22 **G**
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 - (1) If the *firm* has any doubt whether the *investment agreement* or the circumstances of its purchase bring the case within any part of ■ *COB 6.7.7(1)*, it should treat the agreement as if it were cancellable.
 - (2) A *firm* that sends a *pre-sale notice* or *post-sale notice* where it is not obliged to do so under ■ *COB 6.7.30* will be taken to have voluntarily granted the *customer* a right to cancel (unless, for the purposes of ■ *COB 6.7.17*, there is a relevant *client agreement* between the *firm* and the *customer*).

Variations

- 6.7.23 **R**
/1 (1) After an increase in regular or single *premiums* or payments (including a *pension transfer*) to a *life policy*, *pension contract* or

stakeholder pension scheme, a *customer*, who is an individual, has a right to cancel (see ■ COB 6.7.7(4)) in the following circumstances unless (2) applies:

- (a) any variation, other than a ‘pre-selected option’ (see ■ COB 6.7.26), providing for substantial increases in *premium* or payment where the increase:
 - (i) is being paid by way of varying the existing agreement; or
 - (ii) will result in a new agreement established on the same terms as the original agreement;

and, in each case, represents an increase on the original *premium* or payments (or the previous highest agreed *premium* or payment) of more than 25% (see ■ COB 6.7.25); or

- (b) any variation, other than a ‘pre-selected option’ (see ■ COB 6.7.26), that results in a new agreement which involves fresh contract terms or imposes additional obligations on the *customer* due to a change in the terms of the original agreement;
 - (c) any variation where the increase represents the proceeds of a *pension transfer*.
- (2) Paragraph (1) does not apply if:
- (a) there would have been no right to cancel the original *investment agreement* under ■ COB 6.7.7(1) had that agreement been entered into on the date of the variation; or
 - (b) the variation arises out of the settlement of a claim for damages or compensation connected with a previous *investment agreement*.

- (3) A *firm* may use the cancellation substitute in ■ COB 6.7.19 in relation to a variation of an *investment agreement* in any case where that substitute would have been available to it had the agreement been entered into on the date of the variation.

6.7.24

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For the avoidance of doubt, a right to cancel in relation to ■ COB 6.7.23(1) applies to the variation and not the original contract.

6.7.25

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In the case of ■ COB 6.7.23(1)(a) and (b), there is no right to cancel where the variation results in an increase in *premium* or payment of 25% or less. For example, if the first *premium* paid by the *customer* (to the same *policy*) was £1,000, the second was £500, and the third was £900, the *customer* would have no right to cancel in relation to the third *premium*. Although £900 is more than 25% greater than £500, it is still below the original *premium* of £1,000. In this case, therefore, the right to cancel would only arise in circumstances where the *premium* was increased to over £1,250 (this being more than 25% of the original *premium*).

6.7.26 G /1 ■ COB 6.7.23(1)(a) and (b) do not apply where the increase results from a ‘pre-selected option’. Increases of this type (for example, index-linked *premiums* or pension contributions that increase or decrease as salary fluctuates) will have been previously disclosed (for example, in the *key features* or ‘terms and conditions’) and agreed with the *customer* at the outset. Any subsequent increases of 25% or more resulting from a ‘pre-selected option’ will not, therefore, attract fresh disclosure or cancellation rights.

Electronic communication relating to cancellation and withdrawal

6.7.27 G /1 For electronic transactions (for example, facsimile, e-mail or Internet) *firms* are referred to the *guidance* in ■ COB 1.8. The *rules* in ■ COB 6.7 permit the *firm* to issue the *pre-sale* or *post-sale notices* and other communications, and to accept notice from *customers* who are exercising the right to cancel or withdraw, by electronic means. However, a *firm* should be able to demonstrate that the *customer* wishes to communicate electronically.

Time deadlines relating to cancellation and withdrawal

6.7.28 R /1 (1) The deadlines in ■ COB 6.7.10, item 1 of ■ COB 6.7.19, item A and note 2 of ■ COB 6.7.20, ■ COB 6.7.34(2) and ■ COB 6.7.48 are based on calendar days (excluding public holidays) and must be calculated by reference to the day after the date on which the agreement is concluded.

(2) In the event of any contingency beyond the *firm* or *customer’s* control which prevents delivery or service of the cancellation notice, the period in question must be counted as public holidays and therefore will not count for the purposes of the time delay.

6.7.29 G /1 For an example of the operation of ■ COB 6.7.28(1), in the case of the eight-day deadline, the *post-sale notice* for an agreement concluded on Wednesday would need to be sent by the *firm* no later than Thursday of the following week.

Giving the customer notice of the right to cancel

6.7.30 R /1 Where there is a right to cancel, under ■ COB 6.7.7(1), (2) or (4), the *firm* which enters into the agreement with the *customer* (also see ■ COB 6.7.31) must give the *customer*, in writing, clear and prominent notice of this right:

- (1) before the agreement is concluded (a ‘*pre-sale notice*’); and
- (2) after the agreement has been concluded (a ‘*post-sale notice*’).

6.7.31 R /1 When the *customer* is a trustee who is reasonably believed by the *firm* to be expected to act on the instructions of the individual beneficiary or purchaser of the *policy* or contract, the *firm* must send a copy of the *post-sale notice* to:

- (1) the trustee; and
- (2) the beneficiary or purchaser;

and must inform the beneficiary or purchaser of the need to give instructions, within the specified cancellation period, to the trustee where the right to cancel is to be exercised.

Pre-sale notices

6.7.32 **R** ^{/1} A *pre-sale notice* must contain at least a summary of the information required in a *post-sale notice*.

6.7.33 **G** ^{/1} The following is an example of the type of summary statement which *firms* could use: ‘You will be able to cancel your [investment]/[contract] during a two-week period after concluding the agreement and receive a refund [in full / less a deduction for shortfall to reflect any fall in the markets in the interim]. You will be told of this right in more detail (including when it begins and ends, and how to exercise it) in documents that we will send you at the relevant time.’

Post-sale notices: general

6.7.34 **R** ^{/1} A *post-sale notice* must be:

- (1) in writing;
- (2) given to the *customer*:
 - (a) (for any *investment agreement* specified in Part II of **■ COB 6.7.57** to which *shortfall* applies), no later than the end of the eighth day; and
 - (b) (in any other case specified in **■ COB 6.7.7**), no later than the end of the fourteenth day;

after the agreement is concluded;
- (3) sufficiently clear, prominent (see **■ COB 6.7.39**) and informative to enable the *customer* to exercise the right to cancel; and
- (4) accompanied by a slip or form (or an electronic equivalent) to enable the *customer* to exercise a right to cancel.

Post-sale notices: method of sending

6.7.35 **R** ^{/1} A *post-sale notice* must be sent by *post*, or electronically, except in the case of an *industrial assurance policy*, when it may, instead, be given to the *customer* by hand.

Post-sale notices: content

6.7.36

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A *post-sale notice* must state:

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- (1) that there is an agreement between the *customer* and the *firm*;
- (2) that there is a right to cancel the agreement;
- (3) the duration of the right to cancel and the date at which the right begins and ends;
- (4) the steps the *customer* must take to cancel the agreement;
- (5) the consequences of cancelling the agreement, including a prominent statement of any *shortfall* (see ■ COB 6.7.54) which the *customer* will have to bear;
- (6) (as a prominent reminder) that the *customer* is entitled to *key features* and is advised to check with the *firm* if the *key features* have not been received (except in the case of *pure protection contracts*); and
- (7) that the *customer's* right to cancel will remain unaffected if any contingency beyond the *customer's* control arises which makes it impracticable for the *customer* to communicate his wish to cancel (see ■ COB 6.7.28).

Post-sale notices: ISAs

6.7.37

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In the case of *ISAs*, a *firm* must ensure that the slip or form in ■ COB 6.7.34(4) will enable the *customer* to indicate whether the entire *ISA* agreement is to be cancelled or just a particular component or product.

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6.7.38

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For example, in the case of a *maxi-ISA*, the *customer*:

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- (1) has to be able to cancel at the component (or underlying product) level and is not compelled to cancel other components (or products);
- (2) needs to know that the effect of cancelling the last component has the effect of cancelling the entire *ISA* agreement and may also (where it is the case) delay the *customer* from entering into another *ISA* agreement until the next tax year.

Prominence of post-sale notice

6.7.39

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To comply with ■ COB 6.7.34(3), where the *post-sale notice* forms part of another document or is one of a number of documents sent to the *customer* at the same time, a *firm* must ensure that the presence of the *post-sale notice* is drawn to the *customer's* attention (see ■ COB 6.7.40).

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- 6.7.40 **G**
/1 Where the *post-sale notice* forms part of a brochure or is included in a pack of documents, the front of the brochure or pack should prominently feature words such as: ‘IMPORTANT: information about your right to cancel this agreement is enclosed’.

Failure to send post-sale notice

- 6.7.41 **R**
/1 If a *firm* does not send a *post-sale notice* when required by these *rules*, the *customer* can cancel the agreement at any time within two years of the agreement and will not be liable for any *shortfall* (see ■ COB 6.7.56(3)).

Exercising the right to cancel

- 6.7.42 **R**
/1 A *customer* who has a right to cancel under ■ COB 6.7.7 may cancel the agreement by serving notice upon the *firm*.

- 6.7.43 **R**
/1 Notice of cancellation is valid if sent by *post* or in any other manner that the *firm* has told the *customer* is acceptable.

Valid notice of cancellation

- 6.7.44 **R**
/1 (1) A notice of cancellation is valid when it is served on the *firm*, its *appointed representative* or on any agent of the *firm* with authority to accept notice on the *firm’s* behalf or otherwise sent.
- (2) A *firm* must treat any notice of cancellation sent by prepaid *post*, or otherwise sent, and valid in accordance with ■ COB 6.7.43 and ■ COB 6.7.44(1), as being served on the date it was *posted* or sent.

- 6.7.45 **G**
/1 The purpose of ■ COB 6.7.44 is to identify the relevant day for determining whether the right to cancel was exercised within the relevant period in ■ COB 6.7.10.

- 6.7.46 **G**
/1 In the event of any dispute, unless there is clear written evidence to the contrary, the *firm* should treat the date cited by the *customer* as being the date when the notice was *posted* or otherwise sent.

Record keeping

- 6.7.47 **R**
/1 Where notice of cancellation or withdrawal has been served on a *firm* (or its *appointed representative* or agent), the *firm* must make and retain records (which include a copy of any receipt of notice issued to the *customer* and the *customer’s* original notice instructions):

- (1) indefinitely in the case of a record relevant to a *pension transfer*, *pension opt-out* or *FSAVC*;

- (2) for a minimum period of:
- (a) six years in the case of a record relevant to a *life policy*, *pension contract* or *stakeholder pension scheme*; and
 - (b) three years in any other case;

and, in each case, the minimum time period runs from the date when the *firm* first became aware that notice of cancellation had been served.

Cancellation notices served out of time

6.7.48 **R** /1 If a *firm* has sent a *post-sale notice*, it need not (unless ■ COB 6.7.11 applies) accept notice of cancellation if it is served later than the period specified for that agreement in ■ COB 6.7.10.

Death of the life assured: cancellation of a pension annuity

6.7.49 **R** /1 A *firm* need not accept notice of cancellation of a *pension annuity* contract if the life (or any of the lives) assured under it has died before notice is given.

Joint policyholders: effecting cancellation of a life policy

6.7.50 **R** /1 In the case of a *life policy*, cancellation by one of several policyholders is valid if that policyholder has the right to cancel, irrespective of whether the policyholder is exercising that right alone or jointly on behalf of all of the policyholders.

Effects of cancellation

6.7.51 **R** /1 By exercising a right to cancel under ■ COB 6.7.7(1), (2) or (4), the *customer* withdraws from the *investment agreement* and:

- (1) the entire agreement; or
- (2) the particular *ISA* component (see ■ COB 6.7.37); or
- (3) the variation alone (see ■ COB 6.7.23(1));

is rescinded.

6.7.52 **R** /1 When a *customer* exercises a right to cancel under ■ COB 6.7.7(1), (2) or (4), the *firm* must pay to the *customer* (or, in the case of a *pension transfer* or *pension annuity*, for the benefit of the *customer*) any

sums which the *customer* has paid to or for the benefit of the *firm* in connection with the agreement (including sums paid by the *customer* to agents of the *firm*) and the *firm* is entitled to receive:

- (1) any property that became the *customer's* under the agreement; plus
- (2) any sum which the *firm* has paid under the agreement; plus
- (3) (subject to ■ COB 6.7.56) any *shortfall* due under ■ COB 6.7.54.

6.7.53 **R** Any sum payable under ■ COB 6.7.52 is owed as a simple contract debt, and any sums payable in respect of the same cancellation may where relevant be set off against each other.
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Shortfall

6.7.54 **R** If a *firm* has sent a *post-sale notice* that satisfies the *rules* in ■ COB 6.7 and the market falls during the cancellation period, subject to ■ COB 6.7.56, the *firm* is entitled under ■ COB 6.7.52(3) to charge the *customer* for the market loss (that is, *shortfall*), calculated in accordance with ■ COB 6.7.58, which the *firm* would incur in cancelling any investment agreement specified in ■ COB 6.7.57.
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Shortfall: worked example

6.7.55 **G** ■ COB 6.7.58 illustrates the process that *firms* need to undertake in order to discover the amount (that is, *shortfall*) by which the purchase price paid by the *customer* is greater than the purchase price prevailing when the *firm* becomes aware that the *customer* has cancelled. EXAMPLE: In the case of dual-priced *investments*, the *shortfall* on cancellation is calculated on an offer-to-offer basis; for example, 1,000 *units* are purchased at an offer *price* of 209.1p and the offer *price* is (or, in the case of a *forward price*, is subsequently ascertained to be) 196.2p as at the time when the *firm* became aware that notice of cancellation had been served by the *customer*. The *shortfall* on cancellation, therefore, is $(209.1 - 196.2) = (12.9p \times 1,000) = \text{£}129$.
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Exceptions to shortfall

6.7.56 **R** A *firm* will have no right to charge a *customer* for any *shortfall* which results from the *customer* having exercised a right to cancel in any of the following circumstances:
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- (1) if the *firm* sends the *pre-sale notice*, or the *post-sale notice*, later than required by the *rules* in ■ COB 6.7 (whether the notice is valid or not);

6.7.57

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Table Investment agreements which are subject to shortfall.
This table belongs to ■ COB 6.7.54

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Investment agreements which are subject to shortfall	
Part I: any investment agreement specified in column 1 of COB 6.7.15R (unless note 1 applies):	
which is:	where the investment agreement is effected as a:
(1) a life policy	(a) single premium life policy; or
(2) a pension policy	(b) single premium pension policy; or
	(c) single premium addition to an existing single or regular premium life policy or pension policy.
Part II: any investment agreement specified in column 1 of COB 6.7.17R (unless note 2 applies):	
which is:	where the investment agreement is effected as:
(1) a pension contract	(a) a single payment arrangement; or
(2) a subscription to invest in an AUT	(b) a single payment addition to an existing single or regular payment pension contract or unit savings plan.
(3) a subscription to invest in an ICVC	
Part III: a single contribution to a stakeholder pension scheme except where the contribution is a recurring contribution or the stakeholder pension scheme has been established at the outset on the basis of regular contributions.	
Notes:	
Shortfall does not apply to any investment agreement which is established at the outset:	
1. on a regular premium basis, or as a recurring single premium life policy or pension policy;	
2. on a regular payment basis, or as a recurring single payment pension contract or unit savings plan.	

6.7.58

R

Table Calculation of shortfall.
This table belongs to ■ COB 6.7.54

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Calculation of shortfall

A *firm* must calculate *shortfall* as at the ‘relevant date’ (see note 1) as follows:

- A. take the actual payment made, whether only or first payment (see note 2);
- B. take the equivalent payment that would have been quoted (see notes 3, 4 and 5) to the same *customer* assuming an identical purchase was made at the ‘relevant date’;
- C. add to the figure at B the amount of any income included in the figure at A (but originally excluded from the figure at B for the purposes of distribution to *customers*); and
- D. deduct the figure at B (as amended by C) from the figure at A; if the resultant figure is zero or negative, there is no *shortfall*.

Notes:

1. The ‘relevant date’ is the date when the *firm* first became aware that notice of cancellation had been served upon it.
2. If the agreement is a variation of a previous agreement (see *COB* 6.7.23R), the *firm* must treat the increase in *premium* as the sum in A.
3. If details of the payments necessary to calculate B (for example, *premium* rates, investment prices or yields etc) are not publicly available (see note 6) at the ‘relevant date’, there is no *shortfall*.
4. If the agreement relates to a *life policy* or *pension annuity* on the life of another, the *firm* must treat the first life assured as the *customer* for the comparison in B.
5. Where the change is yield and not *premium* or price, in order to calculate B the *firm* must convert the change in yield (if an enhancement) into a change in *premium* or price.
6. In the case of a *forward price*, the requirement of public availability is satisfied if both the previous and next relevant prices are published in a national *UK* newspaper).



6.8 Insurance contracts: life and general

Application

6.8.1

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■ COB 6.8 applies to a *firm* which effects or carries out pure protection contracts or general insurance contracts.

Purpose

6.8.2

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- (1) *Principle 7* (Communications with clients) requires a *firm* to pay due regard to the information needs of its *customers*. This section reinforces *Principle 7* by requiring certain information to be provided to a *customer* before a *pure protection contract* or *general insurance contract* is entered into. Certain information must also be provided on an ongoing basis to a *customer* with a *pure protection contract*.
- (2) This section implements certain requirements of the *Third Life and Non-Life Directives*.
- (3) For *general insurance contracts*, *firms* may find it helpful to take account of the GISC code for private customers. The provisions in this section relating to *general insurance contracts* are not intended to exceed the requirements of that code.

Pure protection contracts: Information to be provided before the contract is made.

6.8.3

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A *firm* must ensure that, before entering into a *pure protection contract* with a *customer*, it provides the *customer* with the information specified in ■ COB 6.8.5, unless, at the time of application, the *customer* is *habitually resident*:

- (1) in an *EEA State* other than the *United Kingdom*; or
- (2) outside the *EEA* and he is not present in the *United Kingdom*.

6.8.4

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The information required by ■ COB 6.8.3 must be:

- (1) provided to the *customer* either by the *firm* itself or by an intermediary authorised by the *firm* to act on its behalf; and

(2) in English, unless the *customer* requests it to be, and the *firm* agrees to it being, in another language.

6.8.5

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Table Provision of information for pure protection contracts
This table belongs to ■ COB 6.8.3

Provision of information for pure protection contracts	
(1)	The name and legal form of the <i>firm</i> ;
(2)	the <i>firm's Home State</i> and, where appropriate, the <i>EEA State</i> of the branch through which the contract is to be entered into;
(3)	the address of the <i>firm's</i> head office (and branch, if appropriate);
(4)	a definition of each benefit and option;
(5)	the term of the contract and the means by which it may be terminated;
(6)	the method of paying <i>premiums</i> and the duration of the payments;
(7)	the method of calculating bonuses and the distribution of bonuses (if relevant);
(8)	an indication of <i>surrender value</i> and paid-up value and the extent to which such values are guaranteed (if relevant);
(9)	an indication of the <i>premium</i> for each benefit, whether a main or supplementary benefit;
(10)	in the case of a unit-linked contract, a definition of the units to which benefits are linked and an indication of the nature of the underlying assets;
(11)	the arrangements with respect to the period within which the <i>customer</i> may cancel the contract, as required by COB 6.7;
(12)	the tax arrangements which apply to the contract;
(13)	the arrangements for handling complaints about the contract, whether by the policyholder or by a life assured or beneficiary under the contract;
(14)	any arrangements for providing compensation should the <i>firm</i> be unable to meet its liabilities under the contract;
(15)	a statement whether the <i>firm</i> or <i>customer</i> is entitled to choose the law applicable to the contract and: <ul style="list-style-type: none"> (a) if so, the law which the <i>firm</i> proposes to choose; or (b) if not, the law which will apply.

Pure protection contracts: Information to be provided during the term of the contract

6.8.6

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■ COB 6.8.7 and ■ COB 6.8.8 apply to a *long-term insurer* if the policyholder is in the *United Kingdom* at the time of signing the application for the *pure protection contract*.

- 6.8.7 **R** /1 If during the term of a *pure protection contract* entered into on or after 1 July 1994 there is any proposed change in the information provided under ■ COB 6.8.5 items (1) to (10), the *long-term insurer* must inform the policyholder of the effect of the change before the change is made.
- 6.8.8 **R** /1 If a *pure protection contract* entered into on or after 1 July 1994 provides for the payment of bonuses and the amounts of bonus are unspecified, the *long-term insurer* must, at least once a year coincident with or immediately following the first contract anniversary, either:
- (1) notify the policyholder of the amount of any bonus which has become payable under the contract, and which has not previously been notified under this rule; or
 - (2) give the policyholder sufficient information to enable him to determine the amount of any such bonus.
- 6.8.9 **G** /1 The information under ■ COB 6.8.8(2) could include the total value of the benefits (including bonuses) which have accrued under the contract, the rates of bonus which have been declared since the previous notification or provision of information and a note of the benefits to which those new rates should be applied.
- 6.8.10 **G** /1 Although ■ COB 6.8.8 does not apply to a bonus if the amount is specified in the contract, *long-term insurers* are free to provide the information if they wish.
- General insurance contracts: Information required to be provided before the contract is made**
-
- 6.8.11 **G** /1 ■ COB 6.8.12 and ■ COB 6.8.13 cover information to be provided before the sale of a *general insurance contract*. They contain no requirements for information during the term of the contract.
- 6.8.12 **R** /1 Before entering into a *general insurance contract* with a *customer*, covering a risk situated in the *United Kingdom*, a *firm* must, subject to ■ COB 6.8.13 provide the *customer* with:
- (1) details of its complaints procedure;
 - (2) a statement whether the *firm* or *customer* is entitled to choose the law applicable to the contract and, if so, the law which the *firm* proposes to choose.
- 6.8.13 **R** /1 ■ COB 6.8.12 does not apply if the contract has been submitted to the *firm* on behalf of a *customer* by an intermediary and:
- (1) the intermediary is a member of the General Insurance Standards Council; or
 - (2) the *firm* has taken reasonable steps to determine that the intermediary has provided the information required by ■ COB 6.8.12.

- 6.8.14** G_{/1} Situations for information delivery will differ depending on the channels used. For example, leaflets will be sufficient at point of sale. For telephone sales the information may be given orally but then must be followed up in writing within five *business days* (see ■ COB 6.8.15(2)).

Provision of information

- 6.8.15** R_{/1} (1) When a *firm* provides information in accordance with ■ COB 6.8.3, ■ COB 6.8.7, ■ COB 6.8.8 or ■ COB 6.8.12, it must provide the information in writing, unless (2) applies.
- (2) If the contract is being made by telephone, the *firm* may give the information orally to the *customer*. If the *customer* has committed to the contract, a written version of the required information must be sent to the *customer* within five *business days* of the oral explanation.

- 6.8.16** G_{/1} In relation to electronic notification, *firms* are referred to the *guidance* in ■ COB 1.8.

- 6.8.17** R_{/1} Where a *pure protection contract* or *general insurance contract* is effected jointly, the information required by ■ COB 6.8.3, ■ COB 6.8.7, ■ COB 6.8.8, or ■ COB 6.8.12 may be sent to the first named *customer*.

Record keeping

- 6.8.18** R_{/1} A *firm* must make an adequate record of information provided to a *customer* under ■ COB 6.8 and retain that record for a minimum period after the information is provided of:
- (1) six years in the case of a *pure protection contract*; or
- (2) three years in the case of a *general insurance contract*.



6.9 With-profits guides

Application

6.9.1

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This section applies to a *long-term insurer* which issues with-profits *life policies* and which is:

- (1) a *long-term insurer* other than a *friendly society*; or
- (2) a *directive friendly society* that is carrying on *long-term insurance business* other than just in relation to *industrial assurance policies*; or
- (3) a *friendly society* which issues *Holloway sickness policies* if details of the funds' expenses and asset distribution are not published elsewhere at least annually.

Purpose

6.9.2

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This section is relevant to a *firm's* obligations under *Principle 7* (Communications with clients) which requires a *firm* to pay due regard to the information needs of its *customers*, and communicate with them in a way which is clear, fair and not misleading. In the case of with-profits *life policies*, it is desirable for *customers* and their advisers to have additional information available to them in order to enable them to understand how the *long-term insurer* is likely to take decisions concerning the distribution of profits and the declaration of bonuses.

With-profits guides

6.9.3

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A *firm* must produce a with-profits guide in accordance with **■ COB 6.9.4** and make it available in accordance with **■ COB 6.9.5**.

6.9.4

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A *firm* must:

- (1) not later than six months after its financial year end, produce a separate and self-contained guide for each with-profits fund that it maintains, unless the fund is closed to new policyholders;

- (2) issue a revised guide or a supplement to the guide as soon as reasonably practicable after a change in the circumstances of or affecting the with-profits fund which would cause the guide to become misleading or incomplete;
- (3) ensure that each guide is consistent with the information contained in the annual prudential regulatory returns; and
- (4) ensure that each guide contains the information specified in ■ COB 6.9.6.

6.9.5

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- (1) If asked to supply a copy of a with-profits guide for a fund that it maintains, a *firm* must do so free of charge.
- (2) The guide supplied in accordance with (1) must be the latest version unless a specific earlier version is requested.

Content of with-profits guides

6.9.6

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A with-profits guide must contain the headings, tables and information prescribed in ■ COB 6.9.7 and:

- (1) the lettered sections and the tables in those sections must appear in the order set out in ■ COB 6.9.7 but the information required within each lettered section may be provided in a different order;
- (2) the text prescribed by ■ COB 6.9.7 must be used, but:
 - (a) any text in brackets must be replaced by appropriate text applicable to the *firm* and with-profits fund to which the guide relates; and
 - (b) the text must be modified if the *firm* considers it inappropriate to the fund or the aspects of it being explained;
- (3) a *firm* may omit or alter the lettering and numbering of the headings, sections and paragraphs;
- (4) the guidance notes must not be included; and
- (5) in preparing information for inclusion in the with-profits guide, a *firm* must have regard to any relevant guidance published by the Institute of Actuaries or the Faculty of Actuaries (or both jointly).

6.9.7

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Table Contents of a with-profits guide
This table belongs to ■ COB 6.9.6.

[Name of fund] with-profits guide [date of issue]	
A	<p>Introduction</p> <p>1 All insurance companies, and the larger friendly societies, which market with-profits policies in the United Kingdom, are required to make available a guide containing information about the company or society and its with-profits fund. This is because the benefits under such policies depend in part, and sometimes to a considerable extent, on bonus additions which are made by the company or the society from time to time and which cannot be known in advance. It is therefore important that potential policyholders and their advisers should have access to information about the most important factors influencing such bonuses.</p> <p>2 However, investors are advised that, in comparing a policy marketed by one company or society with other policies, it is unwise to place too much importance on any one factor. An over-all view of all relevant elements will usually give a more realistic comparison: in particular, an examination of the history of a fund over a period of years will usually give a fuller picture than can be obtained from looking at the figures for just one year.</p> <p>3 [The company/society] is satisfied that this guide fairly presents information as at [date] about the company/society¹ and complies with the rules of the Financial Services Authority.</p> <p>4 [If the <i>firm</i> is producing an appendix to the guide referring to an industrial assurance with-profits fund, the <i>firm</i> may include an explanation of the difference between ordinary and <i>industrial assurance business</i>.]</p> <p>Note: 1 – Delete whichever is inapplicable</p>
B	<p>Company information</p> <p>[Under this heading the <i>firm</i> must:</p> <p>a Describe its own constitution and state where it has its registered office;</p> <p>b State whether it is a <i>subsidiary</i> of a <i>United Kingdom</i> company or overseas company and, if so, identify its ultimate <i>holding company</i>;</p> <p>c Describe its principal activities which are relevant to its with-profits business;</p> <p>d in relation to the fund identified at the beginning of the guide, state whether the <i>firm</i> carries on business outside the <i>United Kingdom</i>, and, if so, indicate the importance of that non-<i>United Kingdom</i> business as compared with its total with-profits business.]</p>
C	<p>Factors influencing bonus rates</p>

[Name of fund] with-profits guide [date of issue]

- 1 [Under this heading the *firm* must include an introduction to the following sections of the guide, identifying the main factors which are likely to influence bonus rates of the *firm's* with-profits business including, in particular:
 - a the assets in which the fund is invested;
 - b the effect of inflation;
 - c the effect of taxation;
 - d the effect of surpluses from miscellaneous sources;
 - e the expenses of the fund;
 - f the effect of any liabilities, such as policy guarantees of the fund.]
- 2 [The *firm* must relate the factors to each other, so far as is possible, and should indicate that individual factors will be covered in more detail elsewhere in the guide.]

D Investments

- 1 [Under this heading the *firm* must set out Table 1 which may be modified in accordance with paragraph 3 if the *investments* include a holding in a *collective investment scheme*.]

Table 1 – Investments attributable to with-profits business in the United Kingdom

	[year] %	[year] %	[year] %	[year] %	[year] %
Fixed interest					
Property					
Equity shares					
(i) UK shares ²					
(ii) non-UK shares ³					
(iii) unlisted shares ⁴					
Other investments	100	100	100	100	100

Notes:

- 2 – This entry refers to *shares* which are *UK listed shares*
- 3 – This entry refers to *shares* which are *listed* other than in the *United Kingdom*
- 4 – This entry refers to *shares* which are *not listed*

[Name of fund] with-profits guide [date of issue]	
2	[The information in Table 1 must be based upon the financial information relevant to the fund as at the end of the <i>firm's</i> preceding financial year and for the preceding four years or for so many of those four years as there are figures available, with the most recent on the right. Each entry must be shown as a percentage of the total of the <i>investments</i> in the column in which the entry appears. The <i>firm</i> may show figures for any category of <i>investment</i> referred to in the Table broken down into sub-categories. The assets are to be shown at <i>market value</i> or, if that is not available, the basis of valuation used must be described here.]
3	[The <i>firm</i> may show holdings in <i>collective investment schemes</i> separately from other <i>investments</i> , by including a separate sub-heading for each category of holding in <i>collective investment schemes</i> under a general heading 'Collective investment schemes'. Such holdings must not, in any event, be included under the heading 'Other investments'.]
4	[If 2½% or more of the total of the <i>investments</i> shown in any one column is in one property or in <i>shares</i> in one company, details of that property or shareholding must be given here. This includes holdings in any <i>subsidiary</i> companies of the <i>group</i> to which the <i>firm</i> may belong.]
5	[The <i>firm</i> must describe its investment strategy with respect to its with-profits fund, and explain any significant differences between the figures for one year and those for another. If <i>derivatives</i> have been used, the Table should reflect the economic exposure of the fund.]
6	[In order to explain the relative importance of underlying investment returns, information on rates of return on the assets attributable to with-profits <i>policies</i> may be included, together with an explanation how these have been taken into account in determining bonus policy.]
E	Solvency margins
1	The solvency of companies and societies transacting with-profits business and other long-term business in the United Kingdom is monitored by the FSA. Values for assets and liabilities for the company's/society's total long-term business are shown below. It is the assets in which the funds of the long-term business are invested which are available to meet the liabilities of that business.
2	Because the valuations are not all on the same bases and the liabilities are not all of the same kind, the information in the following table should not be used as a means of direct comparison between companies and societies; these figures are more useful as an indicator of trends in the business.
3	[Under this heading the <i>firm</i> should set out Tables 2A and 2B.]

[Name of fund] with–profits guide [date of issue]					
4	[The information in Table 2A must be based upon the financial information relevant to the fund as at the end of the <i>firm's</i> preceding financial year and for the preceding four years or for so many of those four years as there are figures available, with the most recent on the right in Table 2B.]				
5	[The <i>firm</i> must include a description of the factors influencing the solvency margins, for example the bases of valuations and the effects of the business mix. This description must also explain how those factors affect the margins.]				
	Table 2A – Solvency margins				
			£m		[year] £m
	‘A’ Admissible assets: [shareholders funds] ⁵ unit–linked with–profits remainder				
					[total]
	‘B’ Liabilities: unit–linked with–profits remainder				
					[total]
	‘C’ Required minimum margin ⁶ Excess of ‘A’ over ‘B’ & ‘C’				[difference]
	Table 2B – Solvency margins				
		[year] £m	[year] £m	[year] £m	[year] £m
	‘A’ Admissible assets				
	‘B’ Liabilities				
	Excess of A over B				
	‘C’ Required minimum margin ⁶				
	Excess of A over (B + C)				
	Notes:				
	5 – Delete if inapplicable				
	6 – This item refers to any <i>margin of solvency</i> the <i>firm</i> is required to maintain by law, including any required by any regulatory authority				
F	Bonus and surrender value policy				
	[Under this heading the <i>firm</i> must set out an explanation of:				

[Name of fund] with-profits guide [date of issue]						
a	the basis on which the amount available for distribution to policyholders and shareholders (if any) is to be determined and on the actual level of transfers to shareholders ⁷ ;					
b	the nature of each series of bonuses payable in respect of the with-profits <i>policies</i> currently marketed by the <i>firm</i> (as at the guide date) and the relative importance of each series by including sufficient information to quantify the relative significance of basic benefits, reversionary bonuses and terminal bonuses;					
c	the <i>firm's</i> policy for ensuring fairness of treatment at maturity or earlier surrender, so far as possible, between investors holding <i>policies</i> issued at different times, including the <i>firm's</i> approach to terminal bonuses, stating whether it is subject to frequent change and identifying in particular the factors which might lead to any change in the approach;					
d	the <i>firm's</i> policy concerning the use of the market value adjustment factors whether at maturity or earlier surrender, the description should detail the circumstances in which they have been imposed and indicate when it would be imposed.]					
	Note: 7 – The firms must include here the percentage of declared profits to which with-profits policyholders are entitled under the firm's Articles of Association or other constitution					
G	Expenses					
1	[Under this heading the <i>firm</i> must describe how expenses arise and are charged in relation to with-profits business, and must include an explanation how the level of expenses is affected by the nature of that business and of the assets in which the with-profits fund is invested.]					
2	[Under this heading the <i>firm</i> must set out Table 3 giving the required figures in accordance with paragraph 3.]					
	Table 3					
	Expenses (including commission)⁸ attributable to UK with-profits business					
		[year] £m	[year] £m	[year] £m	[year] £m	[year] £m
	Related to acquisition of business					
	Maintenance					
	Other					
	Total					

[Name of fund] with-profits guide [date of issue]

Note: 8 – Omit references to *commission* if there are no *commission* payments included in the expenses. In calculating what expenses to attribute to with-profits business, the *firm* may use approximations as the *firm* considers appropriate.

3 [The information in Table 3 must be based upon the financial information relevant to the fund as at the end of the *firm*'s preceding financial year and for the preceding four years or for so many of those four years as there are figures available, with the most recent on the right.]

4 [Here the *firm* must outline the method used to attribute expenses to the with-profits business and indicate the effect of changes in growth and composition of any new business.]

H Examples of the effect of expenses implicit in Table 3

1 [The *firm* must here set out Table 4 giving the required figures for the reduction in yield in accordance with paragraphs 2 and 3 below.]

Table 4

Comparative reductions in yields

Year	Endowment assurances		Personal pensions		Single premium with-profits bonds	ISA with-profits bonds
	Term 10 yrs %	Term 25 yrs %	Term 10 yrs %	Term 25 yrs %	Term [] ⁹ yrs %	Term [] ⁹ yrs %
[year] A B						
[year] A B						
[year] A B						
[year] A B						
[year] A B						

Note: 9 – The term to be used is that of the latest bond to be marketed or the terms, if any, when a market value adjustment factor will not be applied, or, if no specific term, 10 years

[Name of fund] with-profits guide [date of issue]	
2	[The information in Table 4 must be based upon the financial information relevant to the fund as at the end of the <i>firm's</i> preceding financial year and for the preceding four years, or for so many of those four years as figures are available, with the most recent at the top.]
3	The reductions in yield shown in this table are consequential on the expenses disclosed in Table 3 above. The figures are given for the last five years ¹⁰ of the fund preceding the date shown at the beginning of this guide. The reductions in yield shown in row A have been calculated taking into account the actual expenses incurred during the year in question ¹¹ , whereas those shown in row B, which are for comparison, are averages of the reduction in yield figures used in <i>key features</i> (relating to contracts of the same class) issued by the [company][society] ¹² during the year in question.
4	The reductions in yield have been calculated on the assumption of a monthly premium of £60.00 ¹³ or a single premium of £10,000 ¹³ . In addition, an allowance for tax has been made in calculating the figures for endowment assurance and with-profits bonds ¹⁴ .
5	[The <i>firm</i> must, in relation to the figures disclosed under this heading:
a	explain any disparity between the two reductions in yield; and
b	describe any allowance for tax which has been made in calculating the reduction in yields.]
6	[The <i>firm</i> may show reductions in yield for other classes of contract in Table 4 if <i>endowment assurances</i> or personal pensions are not representative of the <i>firm's</i> with-profits business, but, if the with-profits business to which the guide refers includes both <i>endowment assurance</i> and personal pensions, reductions in yield for contracts of both those classes must be shown. Figures may be shown only for contracts marketed by the <i>firm</i> during the year in which the guide date falls.]
	Notes:
	10 – In the case of a fund for which there are fewer than five years' figures available, the <i>firm</i> must make appropriate alteration
	11 – The <i>firm</i> must make these calculations in accordance with the <i>projection rules</i> . If there is any discontinuity due to a change in the calculation method, this should be explained in a note to the Table
	12 – Delete whichever is inapplicable

[Name of fund] with–profits guide [date of issue]																											
	<p>13 – If the <i>firm</i> does not write business at this rate, substitute another figure which is not unrepresentative of the <i>firm's</i> with–profits business. In respect of industrial branch endowments, the figure is £4 per week</p> <p>14 – This sentence may be omitted if the fund to which the guide relates is part of the <i>firm's</i> tax–exempt business</p>																										
J	<p>Other factors</p> <p>[Under this heading the <i>firm</i> must describe any other factors not dealt with under any of the preceding headings of the guide which the <i>firm</i> regards as relevant to its with–profits business, commenting on the importance of the different factors.]¹⁵</p> <p>Note: 15 – <i>Firms</i> are to include here a description of the effect of the surpluses from miscellaneous sources or strains from other liabilities on the with–profits business</p>																										
K	<p>Policy proceeds</p> <p>1 [Under this heading the <i>firm</i> must set out the following table, giving the required figures for the contracts in relation to which the reductions in yield were shown under section H, showing, subject to paragraph 5 below, the net return to the <i>policyholder</i> for contracts maturing in the year in which the guide date falls and providing the necessary breakdown.]</p> <p>2 Table 5 shows the rates of investment return per annum implicit in <i>policy</i> proceeds payable at maturity or retirement at age 60 for a male life (based on a monthly <i>premium</i> of £60.00¹³).</p> <p>3 [<i>Firms</i> are encouraged to indicate how the net return to policyholders is split between the return on assets and allocations from miscellaneous sources. It would also be helpful to indicate the likely future potential for allocations from miscellaneous sources.]</p> <p>Table 5 – Examples of results achieved by with–profits policies</p> <table border="1"> <thead> <tr> <th rowspan="2"></th> <th colspan="2">Policy proceeds payable in [year]¹⁶</th> </tr> <tr> <th>Term 10 yrs %</th> <th>Term 25 yrs %</th> </tr> </thead> <tbody> <tr> <td>Endowment assurances¹⁷</td> <td></td> <td></td> </tr> <tr> <td>Net return to policyholder</td> <td></td> <td></td> </tr> <tr> <td>After meeting the following items which are estimated to be:</td> <td></td> <td></td> </tr> <tr> <td>Effect of mortality risks</td> <td></td> <td></td> </tr> <tr> <td>Effect of expenses</td> <td></td> <td></td> </tr> <tr> <td>Personal pensions (at vesting)¹⁷</td> <td></td> <td></td> </tr> <tr> <td>Net return to policyholder</td> <td></td> <td></td> </tr> </tbody> </table>		Policy proceeds payable in [year] ¹⁶		Term 10 yrs %	Term 25 yrs %	Endowment assurances ¹⁷			Net return to policyholder			After meeting the following items which are estimated to be:			Effect of mortality risks			Effect of expenses			Personal pensions (at vesting) ¹⁷			Net return to policyholder		
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[Name of fund] with-profits guide [date of issue]	
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<p>L Conclusion</p>	

[Name of fund] with–profits guide [date of issue]	
1	[Under this heading the <i>firm</i> may provide a summary of the guide.]
2	Much of the format and content of this guide are prescribed. However, there are other factors, such as surrender values, underwriting requirements and the quality and standard of service, which are not dealt with in this guide but which you may consider relevant to the selection of a policy or contract. If you would like more information, [company/society] will be pleased to assist.

Decision trees for stakeholder pension schemes: text, content and format (R)

Decision trees for stakeholder pension schemes: text, content and format

STAKEHOLDER PENSION DECISION TREES

You should read these notes before using the decision trees.

Decision trees provide information and help you to answer the question: “Would a stakeholder pension be a good choice for me as part of my financial planning for retirement?”

What is a stakeholder pension?

A stakeholder pension is a *new private pension*, it's *not a State pension*. You can get a stakeholder pension if you are in employment, a fixed-contract worker, self-employed, or even not working but able to afford contributions. You can get one from a bank, building society, insurance company, investment company, or through a financial adviser.

You pay contributions regularly which are invested to build up your own pension fund. You can also pay lump-sum contributions whenever you like.

When you retire, you use your pension fund to buy an “annuity”. The annuity will pay you a regular income during your retirement. That income will depend on the size of your fund and the annuity rates at the time you take your pension.

You can't withdraw any money from your fund before you take your pension. But when you take your pension you can choose to have up to 25% of your fund as a tax-free lump sum.

What's new about stakeholder pensions?

Stakeholder pensions must meet the standards laid down by the government.

The standards include:

■ **Charges**

Providers of stakeholder pensions usually charge for managing your money. There is an upper limit on this charge. The limit is 1% of the value of your fund each year. The charge is taken from your fund. So if your fund is worth £5,000, a 1% charge would be £50.

■ **Flexibility**

You can contribute regularly or occasionally. It is always best to make regular weekly or monthly contributions but you can change the amount. You can pay in as little as £20, and you can stop paying in without having to pay any penalty and restart later.

If you are employed and your employers provide a stakeholder pension, they may, if you wish, deduct your contributions direct from your pay and put them into your pension fund.

You can take your stakeholder pension with you when you change jobs. You can switch to another stakeholder pension at any time if you want to, without having to pay any charges for the transfer.

■ **Information**

Your stakeholder pension provider must give you regular information about your fund. This will include an annual statement to let you know how much you have paid in and how your fund is growing. It may also include a forecast of how much your pension might be.

Will I get any tax relief?

Everybody who contributes to a stakeholder pension will get tax relief on their contributions.

Under present tax arrangements, for each £1 you pay into your stakeholder pension fund, the Inland Revenue will pay an extra 28p into your fund, even if you don't normally pay income tax.

Example

If you pay in £50 a month, income tax relief will increase your contribution to £64.10.

Anyone can contribute up to £3,600 to a stakeholder pension in any tax year, including basic-rate tax relief. What this means is that you could pay in £2,808 and the income tax relief would increase your contribution to £3,600.

If you are employed or self-employed you might be able to contribute more than £3,600 and still get income tax relief, depending on your age and earnings. For example, up to age 35 you can contribute up to 17.5% of your earnings in any tax year. If you are over 35, there is a scale that allows you to contribute higher percentages of your earnings. The Inland Revenue sets the limits on what you can contribute to a pension scheme.

If you pay income tax at the higher rate you will be able to claim back the extra tax from the Inland Revenue at the end of each tax year.

Won't the State pensions be enough for me to retire on?

To answer this question, you need to think about three things:

BASIC STATE RETIREMENT PENSION

If you have a full national insurance contribution record, you are entitled to the full basic State Retirement Pension. You cannot get your basic State Retirement Pension until you reach State pension age (currently 65 for men and 60 for women).

The government reviews the basic State Retirement Pension every year. The rates applying from April 2001 are shown further on in these notes.

ADDITIONAL STATE PENSION (CURRENTLY SERPS)

Only people in employment qualify for the State Earnings Related Pension Scheme (SERPS). The SERPS pension, payable when you reach State pension age, depends on your earnings while you were in employment and the national insurance contributions you paid. SERPS is paid in addition to the basic State Retirement Pension.

The government plans to change SERPS in 2002 and rename it the State Second Pension. This will give more help than SERPS to the lowest earners, particularly those earning less than about £10,000 a year.

Self-employed people do not qualify for the additional State pension (currently SERPS).

GUARANTEED MINIMUM INCOME AND PENSION CREDIT

The current Minimum Income Guarantee (MIG) is a benefit that helps people with low incomes in retirement. MIG is means-tested. If you apply, the Department of Social Security assesses your income and decides whether you get a top-up. If you qualify for a MIG top-up, or have an income just above the MIG level, you may also qualify for other benefits, such as housing benefit.

The government has announced plans to introduce a new Pension Credit from 2003 that includes a guaranteed minimum income.

THE BASIC STATE RETIREMENT PENSION AND MIG RATES GIVEN HERE ARE THOSE ANNOUNCED BY THE GOVERNMENT ON 8 NOVEMBER 2000 AS APPLYING FROM APRIL 2001.

	Weekly	Monthly equivalent
One person	£72.50	£314.17
Man with dependent wife	£115.90	£502.23
Couples who have <i>both</i> paid full national insurance contribution	£72.50 each	£314.17 each
If you get the full MIG top-up, your income would rise to:		
Single person	£92.15	£399.32
Couple	£140.55	£609.05

How do I get more information on my State pensions?

Rates of State pensions and benefits change every year. These notes can only give you basic information about what is available. Other information you can get:

- A forecast of your State pensions by calling the Retirement Pension Forecasting and Advice Unit (RPFA) on 0191 218 7585 between 9am and 5pm. You can complete an application form over the phone or ask for the forecast form BR19 to be sent to you. Or you can write to:

RPFA
Pensions and Overseas Directorate
Tyneview Park
Whitley Road
Newcastle upon Tyne
NE98 1BA

You can also complete and send the form direct on the Internet at the DSS website, www.dss.gov.uk or send it by post in the normal way.

- There are changes to the State pension age which affect women born on or after 6 April 1950. Women born on or after 6 April 1955 will not get a State pension until age 65. For more information on these changes, see the DSS guide *Pensions for women – Your guide* (PM6).
- The DSS produces a series of guides that give basic information on pensions. You can get copies by calling the Pensions Info-Line on 0845 731 3233. The line is open 24 hours and calls are charged at local rate. A textphone service is available on 0845 604 1210. You can also order copies of these information guides on the Internet at www.dss.gov.uk

Do I need to save more for my retirement?

You need to make your own judgment about whether State retirement pensions and any existing private pensions will be enough for you to live on when you retire.

Ask yourself:

- ***Roughly how much will I need to live on when I retire?***
- ***Is the basic State Retirement Pension likely to be enough for me?***
- ***Will I qualify for an additional pension through SERPS and the State Second Pension?***
- ***Have I got any other private pensions, maybe from previous employers' schemes or from personal pension schemes? If so, how much income will they give me?***

Can I afford to contribute regularly to a stakeholder pension?

Before you answer this question, you should ask yourself:

- ***What are my other financial commitments?***
For example, mortgage repayments, rent, life assurance, and credit cards. Make sure you do your sums before using the decision trees.
- ***Would I be prepared, if necessary, to give up anything so that I can pay into a stakeholder pension?***
- ***Should I be thinking of other things first?***
For example, life assurance protection for me and my family, or building up some "rainy-day" cash savings.

Whatever you decide you can afford, think about increasing your contributions, especially when your earnings rise.

I can't afford to contribute much regularly – won't the MIG make my contributions a waste of money?

The government has said that it intends to ensure that all those who have saved already, or who wish to save in the future, can benefit from those savings when they retire.

To achieve this, the government has announced proposals to introduce a new Pension Credit which will overhaul the current MIG arrangements from 2003.

The proposals are designed to alter the present situation where those who have saved to build up a second pension to add to the basic State retirement pension, might be little or no better off than those who haven't saved.

A lot depends on the final rules for Pension Credit and how it works out in practice. Of course, future governments can change State pensions and benefits at any time and it may be unwise to rely on any particular type or level being available when you retire.

I can't afford to contribute much regularly – so what will I get from my stakeholder pension?

Stakeholder pensions allow contributions as low as £20. But, a regular monthly contribution of £20 will not produce a large pension when you retire. And the older you are when you start saving, the less time there will be for your pension fund to grow to something worthwhile. The tables in the decision trees will give you a fair idea of the pension you could get, depending on your age and contributions.

The figures in the tables, however, are only estimates and are not guaranteed. They are also shown before income tax. When you receive your pension during retirement you may be taxed on it.

The figures are calculated on the following basis:

Before you retire

Your monthly contributions increase in line
with inflation.....2.5% a year
Before charges, your fund grows by.....7% a year
Charges deducted from your fund.....1% of fund a year

When you retire

Annuity rates assume that the investment
return after retirement is.....5.5% a year
(After a 4% charge has been deducted from your fund)

Your pension increases by.....2.5% a year

Your spouse will receive half your pension on your death.

What does contracting-out of the additional State pension (currently SERPS) mean for me?

Everyone in employment is automatically included in SERPS unless they decide to leave it. This is called 'contracting-out'. If you contract-out, you give up any SERPS entitlement and build up a replacement for it in your own private pension arrangement instead. The private pension could be an employer's pension scheme or your own stakeholder pension scheme or other personal pension.

Some employers' occupational pension schemes contract-out all scheme members automatically. Other employers' occupational schemes are 'contracted-in' and the scheme pensions are paid on top of any SERPS pensions. If you are in one of these contracted-in schemes, you can still decide to contract-out.

You can also decide to contract-out if you are not a member of an employer's occupational pension scheme. If you contract-out of SERPS this way, the Inland Revenue will pay a rebate on your national insurance contributions into your private pension fund. The rebate is invested along with your own pension contributions and you build up a replacement pension for the SERPS pension given up.

With stakeholder and other personal pension schemes the government sets the rebate. The rebate is set to give a reasonable chance that the replacement pension will be at least as big as if you had remained in SERPS. There's no guarantee that you'll be better off by contracting-out but generally the younger you are and the more you are earning the more you stand to gain if you do contract-out.

Contracting-out is an important decision and you need to consider all the implications. If you want help with your decision, you should consult a financial adviser. You may have to pay for this help. Or you can ask your stakeholder scheme provider for a comparison of the SERPS pension you'll be giving up and the possible replacement pension you might get from a private arrangement.

Deciding to contract-out in one tax year does not commit you to do the same in later years. In fact, it's a good idea to review your decision regularly. You should do this, for example, when the State Second Pension starts in 2002.

What else do I need to check?

IF YOU ARE EMPLOYED

Employers' pension plans are always worth checking first as they usually provide extra benefits, such as added contributions from your employer or free life assurance.

You need to check:

- ***Does your employer provide a pension plan?***
- ***Are you a member of your employer's pension plan?***
- ***If you are not a member, could you join now or later?***

If your employer does not provide a pension plan for you at the moment, they *may* have to arrange for a stakeholder pension to be available to you by **October 2001**.

- *Ask your employer if it is intended to arrange a new pension plan for staff as it might be better than a private pension you arrange yourself.*
- *Employers might agree to pay the stakeholder annual charge or make payments to your fund on top of your own contributions, but they don't have to.*

IF YOU ARE SELF-EMPLOYED

- *Are you contributing to a pension plan?*

If you have no pension to look forward to except the basic State Retirement Pension, you should consider setting up a personal pension, such as a stakeholder pension.

IF YOU HAVE NO FORM OF PAID EMPLOYMENT

- *Can you afford to contribute to a pension plan?*

You can now set up a new stakeholder pension. You can then benefit from tax relief on your contributions, even if you don't normally pay income tax.

EVERYBODY

Check on the pension plans you have contributed to in the past but no longer pay into today. You need to have some idea of the retirement income you might get from an old pension plan.

To check on the value of old pension plans, look at the most recent benefit statements you have been sent. If you cannot find any statements, contact the pension plan provider, for example the insurance company or the employer that offered the pension to you.

Alternatively, the Pension Schemes Registry provides a free tracing service. It can help you identify pension schemes you have belonged to in the past. To contact the Pensions Scheme Registry, phone them on 0191 225 6393 and ask for a tracing request form or write to them at:

Pension Schemes Registry
PO Box 1NN
Newcastle upon Tyne
NE99 1NN

AND FINALLY

You should consider getting advice if you're not sure that saving in a pension plan is right for you, or if you want to look at other ways of saving and investing for the long term.

If you are not sure what's the best thing for you to do, get help. The decision trees suggest some organisations that might be able to help you.

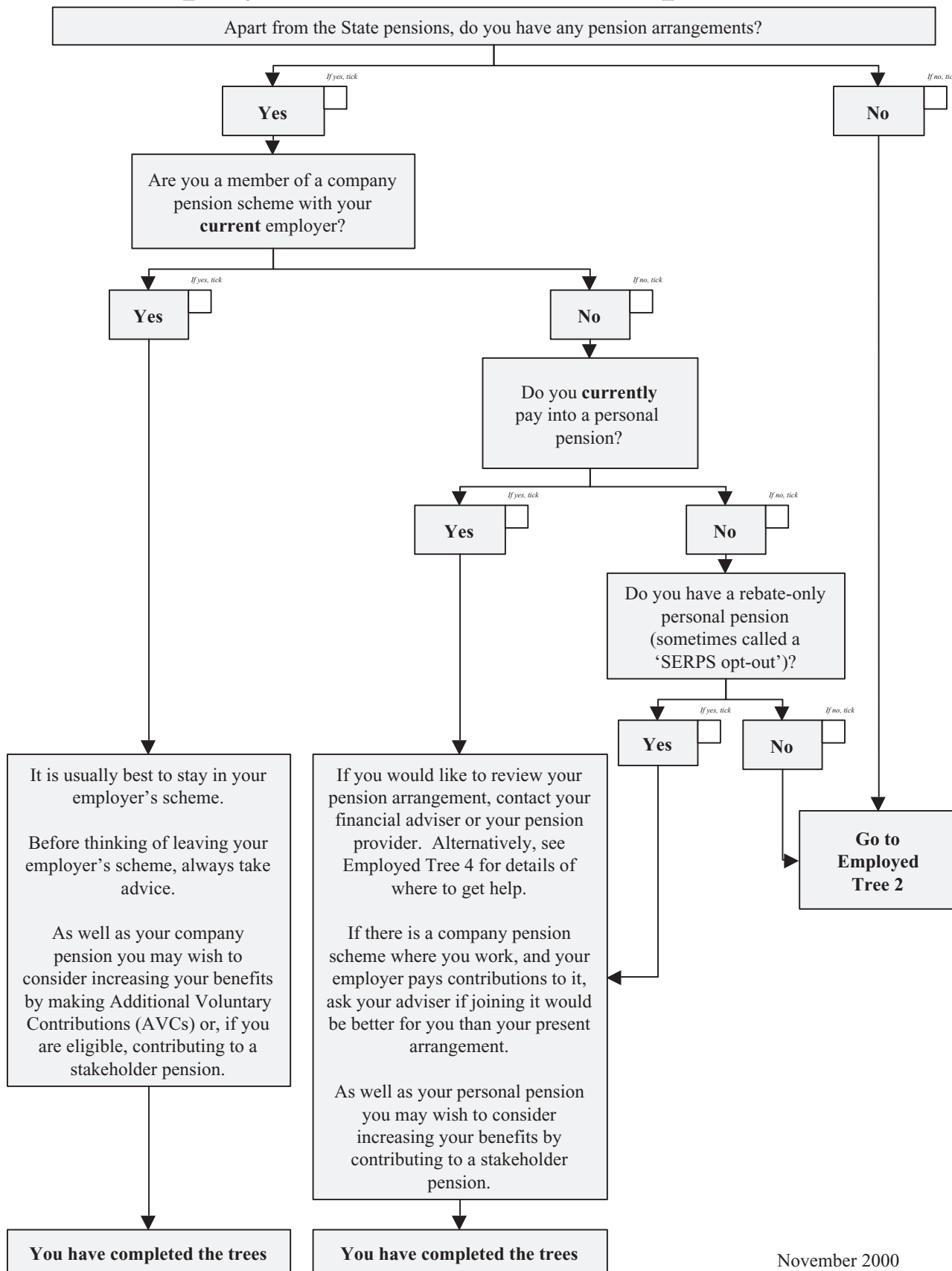
How to use the decision trees

- **These decision trees have been designed to help you decide whether a stakeholder pension would be a good choice for you. Please take the time to read and use them carefully, giving accurate answers to the questions. The decision you take will be your responsibility.**
- **There are three sets of decision trees. Make sure you use the right one. There is a different set of trees for:**
 - **Employed people**
 - **Self-employed people**
 - **People who are not employed**
- **When you are sure you have the right set of trees, start with ‘tree 1’ and work through the questions from the top of the page. Depending on your answers, you may only need to use the first tree or be asked to go to another tree in the set.**
- **Always work from the top of the page and tick the box for each question you answer.**
- **If the tree asks you about your present pension arrangements and you are not sure of the correct answer, find out the right information – don’t guess.**
- **If the tree recommends you take advice, or if you are not sure what is right for you, then you should seek advice. You may have to pay for this advice.**

Some of the information used in these materials comes from sources outside the FSA and PIA. Neither the FSA nor PIA guarantee or warrant the accuracy of the information included in these materials, and does not accept any liability for errors or omissions. Neither the FSA nor PIA shall be liable for any damages arising in contract, tort or otherwise from any action or decision taken as a result of using these materials or any of them.

The decision tree is intended to help you make your own choice about your pension arrangements. It does not give you financial or professional advice and you should not regard it as doing so. You should get help if you require advice.

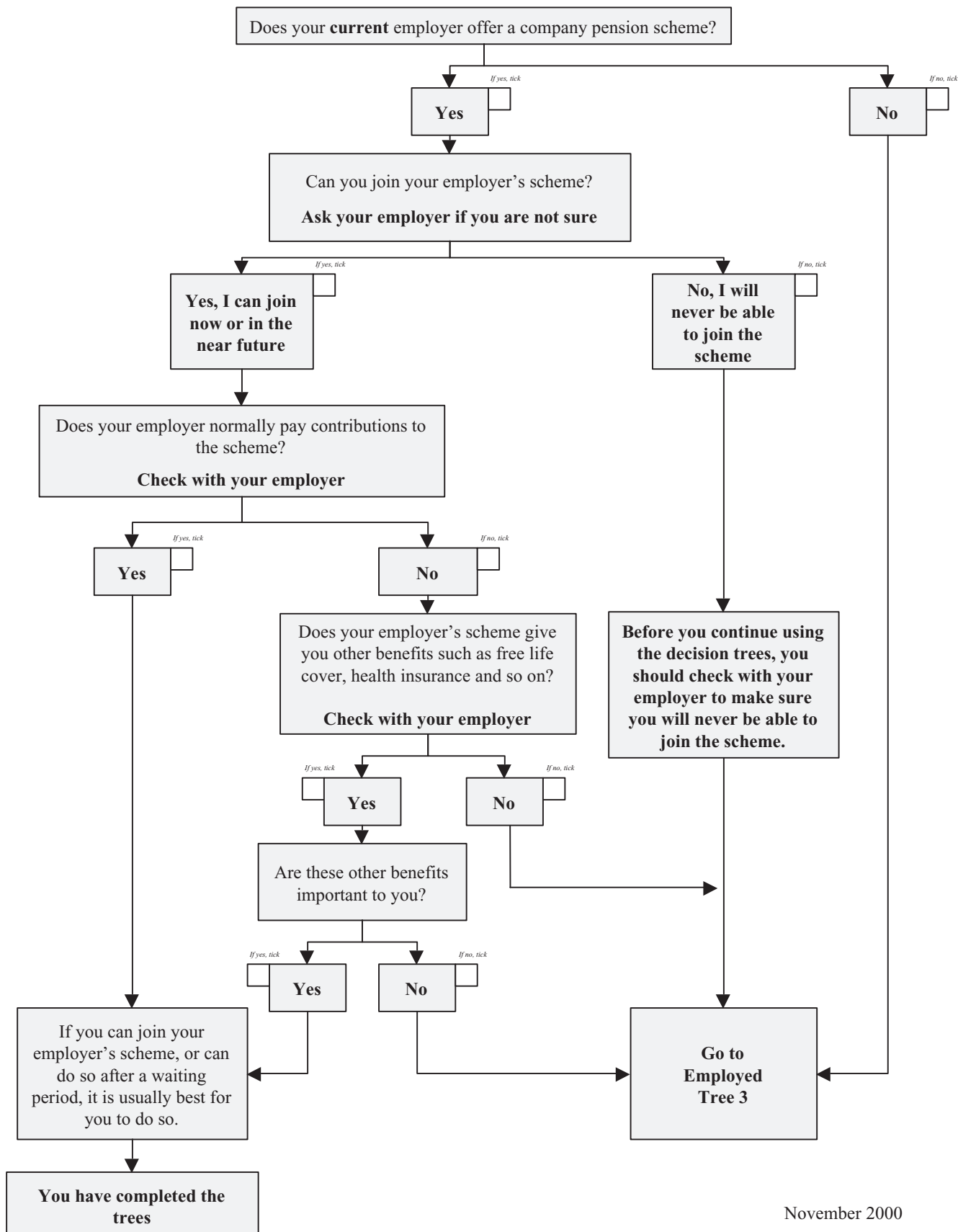
Employed Tree 1 – Current pensions



November 2000

The decision tree is intended to help you make your own choice about your pension arrangements. It does not give you financial or professional advice and you should not regard it as doing so. You should get help if you require advice.

Employed Tree 2 – No current pension



November 2000

The decision tree is intended to help you make your own choice about your pension arrangements. It does not give you financial or professional advice and you should not regard it as doing so. You should get help if you require advice.

Employed Tree 3 – How much should I save towards a pension?

THIS IS AN IMPORTANT DECISION

Most people save every month. It is better if you can keep up your monthly contributions.

The following table shows the **estimated monthly pension**, at today's prices, that you would get for different **regular monthly contributions**. The contribution shown is assumed to **increase each year in line with inflation**. The government will also add tax rebates to increase the actual amounts paid into your stakeholder pension (although all tax breaks are subject to change). The estimated pension figures include this tax rebate. When you retire, your pension will increase in line with inflation.

Remember: these estimates are not guaranteed - you could get more or less than the amounts shown. A stakeholder pension would be on top of any State pensions you are entitled to.

The table gives you an idea of how much you need to pay now - as a regular monthly contribution - to receive the monthly pension you want when you retire. First look down the left-hand column to find the age closest to your age now. Then look across to find the monthly contribution you want to pay and the age at which you want to retire.

Your approximate age now	What you pay per month for the first year (tax rebates will be added to this amount)							
	£20		£50		£100		£200	
	Initial monthly pension if you retire at 65	Initial monthly pension if you retire at 60	Initial monthly pension if you retire at 65	Initial monthly pension if you retire at 60	Initial monthly pension if you retire at 65	Initial monthly pension if you retire at 60	Initial monthly pension if you retire at 65	Initial monthly pension if you retire at 60
20	£154	£108	£386	£272	£772	£544	£1,544	£1,089
25	£124	£86	£310	£215	£620	£431	£1,240	£863
30	£98	£67	£245	£168	£491	£336	£983	£672
35	£76	£50	£191	£127	£382	£254	£765	£509
40	£57	£37	£144	£92	£289	£185	£579	£371
45	£42	£25	£105	£63	£211	£127	£422	£254
50	£28	£15	£72	£38	£144	£77	£289	£155
55	£17	£7	£44	£17	£88	£35	£176	£71
60	£8		£20		£40		£81	

Have you found the level of monthly pension that you need in the table and can you afford the monthly contribution?

If yes, tick

Yes, I've found the pension I need and can afford the monthly contribution

Consider starting a stakeholder pension.
If in doubt seek help from an expert adviser. See Employed Tree 4 for details.

You have completed the trees

If no, tick

No, I can't find the pension I need or I can't afford the contribution

For details of where to get further help,
Go to Employed Tree 4

Nov 2000

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Employed Tree 4 – Where do I go from here?

DO YOU NEED FURTHER HELP?

You may need to get further help, particularly if you are in one or more of the following situations:

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- **You wish to get advice that takes account of all your personal circumstances.**
- **You are not sure how to answer some of the questions in the decision trees.**
- **You are not sure if you are making the right decision.**
- **You feel you cannot afford to save for retirement.**

WHERE TO GET FURTHER HELP

You can get help from a number of sources.

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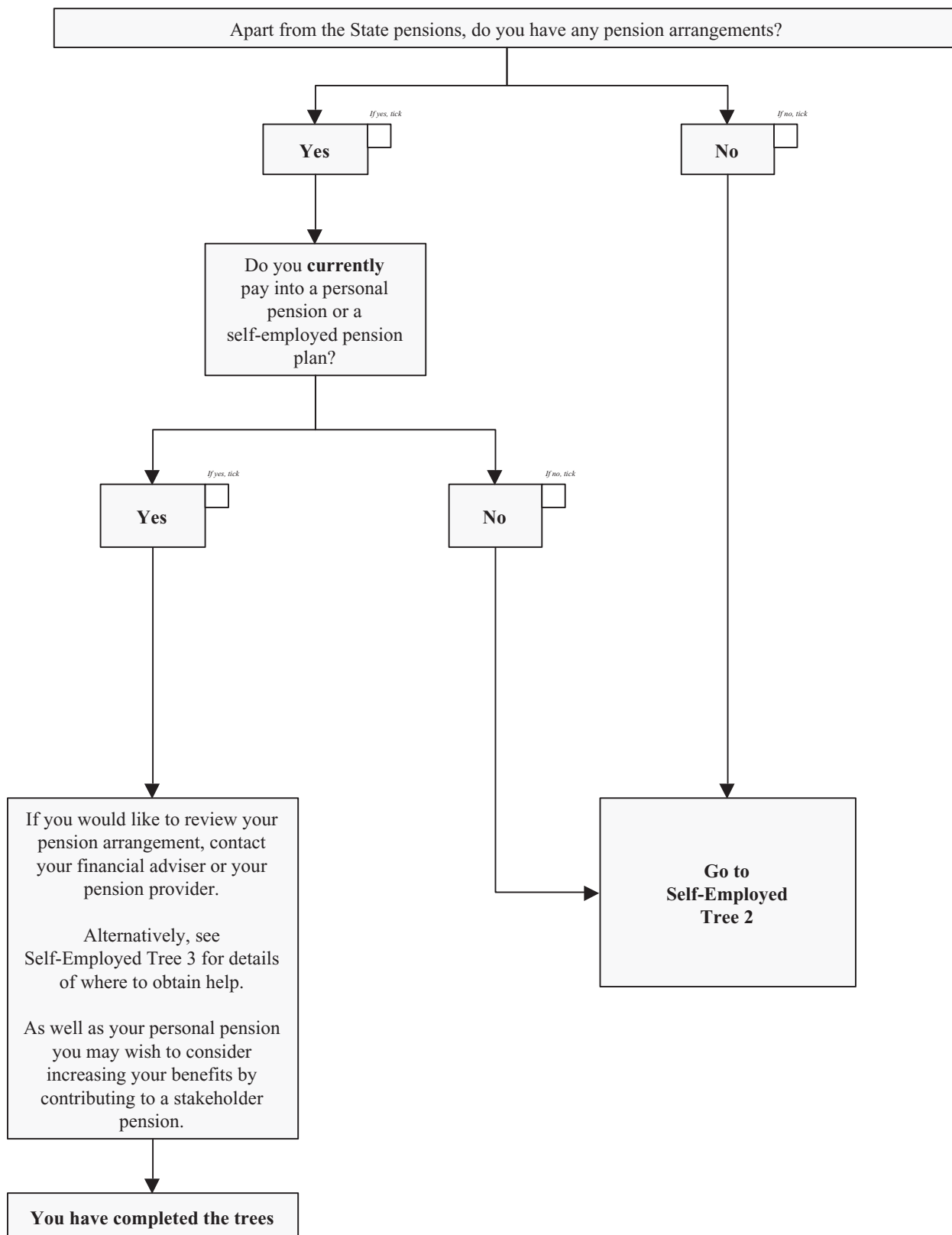
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Self-employed Tree 1 – Current pensions



November 2000

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Self-employed Tree 2 – How much should I save towards a pension?

THIS IS AN IMPORTANT DECISION

Most people save every month. It is better if you can keep up your monthly contributions.

The following table shows the **estimated monthly pension**, at today's prices, that you would get for different **regular monthly contributions**. The contribution shown is assumed to **increase each year in line with inflation**. The government will also add tax rebates to increase the actual amounts paid into your stakeholder pension (although all tax breaks are subject to change). The estimated pension figures include this tax rebate. When you retire, your pension will increase in line with inflation.

Remember: these estimates are not guaranteed - you could get more or less than the amounts shown. A stakeholder pension would be on top of any State pensions you are entitled to.

The table gives you an idea of how much you need to pay now - as a regular monthly contribution - to receive the monthly pension you want when you retire. First look down the left-hand column to find the age closest to your age now. Then look across to find the monthly contribution you want to pay and the age at which you want to retire.

Your approximate age now	What you pay per month for the first year (tax rebates will be added to this amount)							
	£20		£50		£100		£200	
	Initial monthly pension if you retire at 65	Initial monthly pension if you retire at 60	Initial monthly pension if you retire at 65	Initial monthly pension if you retire at 60	Initial monthly pension if you retire at 65	Initial monthly pension if you retire at 60	Initial monthly pension if you retire at 65	Initial monthly pension if you retire at 60
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55	£17	£7	£44	£17	£88	£35	£176	£71
60	£8		£20		£40		£81	

Have you found the level of monthly pension that you need in the table and can you afford the monthly contribution?

If yes, tick

Yes, I've found the pension I need and can afford the monthly contribution

Consider starting a stakeholder pension.

If in doubt seek help from an expert adviser. See Self-Employed Tree 3 for details.

You have completed the trees

If no, tick

No, I can't find the pension I need or I can't afford the contribution

For details of where to get further help, Go to Self-Employed Tree 3

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Self-employed Tree 3 – Where do I go from here?

DO YOU NEED FURTHER HELP?

You may need to get further help, particularly if you are in one or more of the following situations:

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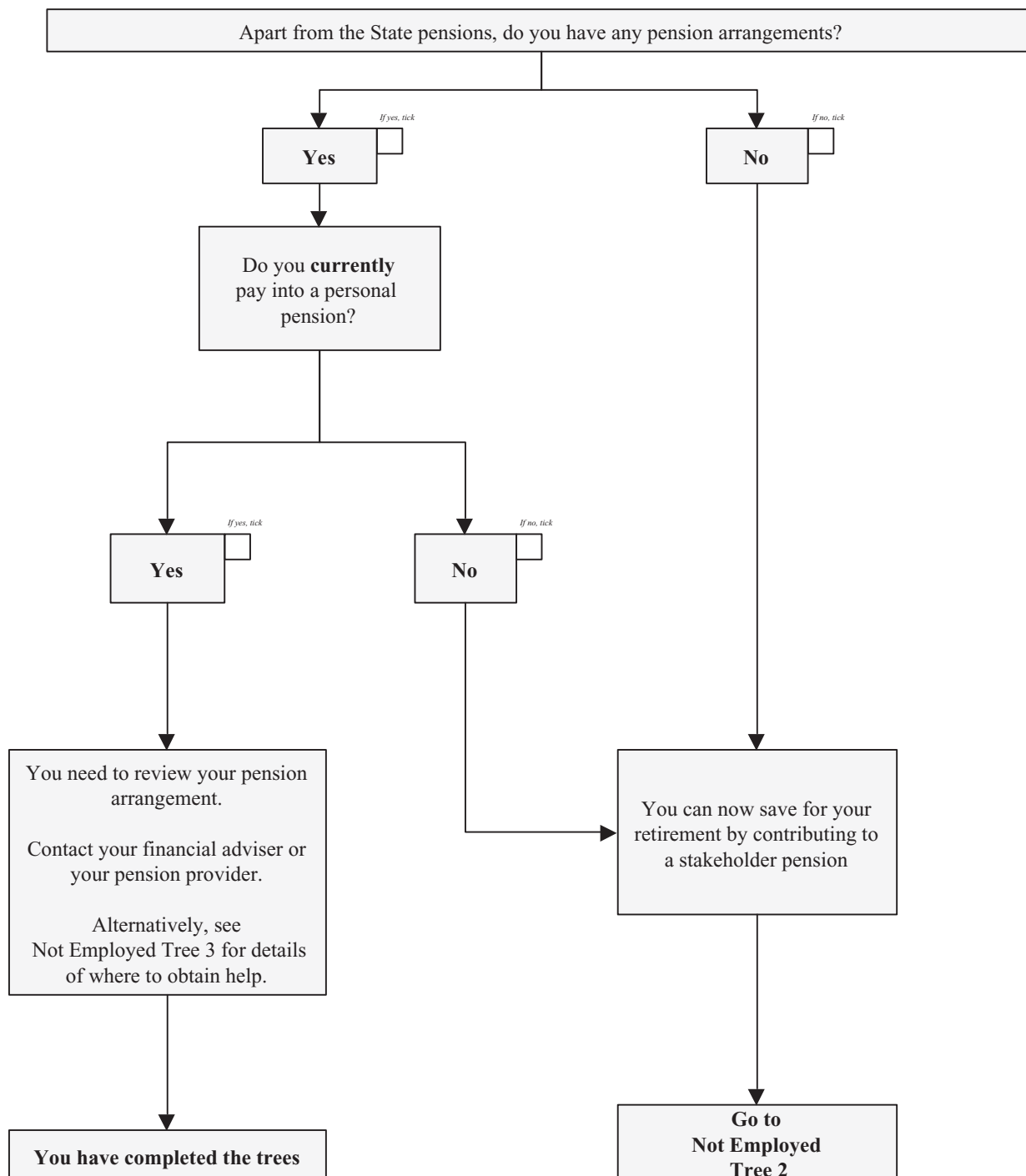
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Not employed Tree 1 – Current pensions



November 2000

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Not employed Tree 2 – How much should I save towards a pension?

THIS IS AN IMPORTANT DECISION

Most people save every month. It is better if you can keep up your monthly contributions.

The following table shows the **estimated monthly pension**, at today's prices, that you would get for different **regular monthly contributions**. The contribution shown is assumed to **increase each year in line with inflation**. The government will also add tax rebates to increase the actual amounts paid into your stakeholder pension (although all tax breaks are subject to change). The estimated pension figures include this tax rebate. When you retire, your pension will increase in line with inflation.

Remember: these estimates are not guaranteed - you could get more or less than the amounts shown. A stakeholder pension would be on top of any State pensions you are entitled to.

The table gives you an idea of how much you need to pay now - as a regular monthly contribution - to receive the monthly pension you want when you retire. First look down the left-hand column to find the age closest to your age now. Then look across to find the monthly contribution you want to pay and the age at which you want to retire.

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Have you found the level of monthly pension that you need in the table and can you afford the monthly contribution?

If yes, tick

Yes, I've found the pension I need and can afford the monthly contribution

If no, tick

No, I can't find the pension I need or I can't afford the contribution

Consider starting a stakeholder pension. If in doubt seek help from an expert adviser. See Not Employed Tree 3 for details.

You have completed the trees

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Not employed Tree 3 – Where do I go from here?

DO YOU NEED FURTHER HELP?

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November 2000

Chapter 7

Dealing and managing



7.1 Conflict of interest and material interest

Application

- 7.1.1 **R** This section applies to a *firm* when it is conducting *designated investment business* with or for a *customer*.
/1

Purpose

- 7.1.2 **G** *Principle 8* (Conflicts of interest) requires a *firm* to manage conflicts of interest fairly. This section aims to ensure that when a *firm* has, or may have, a conflict of interest between itself and its *customer*, or between one *customer* and another *customer*, the *firm* pays due regard to the interests of each *customer* and manages the conflict of interest fairly.
/1

Fair treatment

- 7.1.3 **R** If a *firm* has or may have:
/1
- (1) a *material interest* in a transaction to be entered into with or for a *customer*; or
 - (2) a relationship that gives or may give rise to a conflict of interest in relation to a transaction in (1); or
 - (3) an interest in a transaction that is, or may be, in conflict with the interest of any of the *firm's customers*; or
 - (4) *customers* with conflicting interests in relation to a transaction;
- the *firm* must not knowingly advise, or *deal* in the exercise of discretion, in relation to that transaction unless it takes reasonable steps to ensure fair treatment for the *customer* (see ■ COB 2.4.7 (Attribution of knowledge)).

- 7.1.4 **E** For the purposes of ■ COB 7.1.3, a *firm* may manage a conflict of interest by taking one or more of the following reasonable steps:
/1
- (1) disclosure of an interest to a *customer*;

- (2) relying on a policy of independence;
- (3) establishing internal arrangements (Chinese walls);
- (4) declining to act for a *customer*.

Disclosure of an interest to a *customer*

7.1.5



/1

The following are examples of *material interest* or conflicts of interest that a *firm* should disclose under ■ COB 7.1.4(1):

- (1) *dealing in investments as principal* (unless the *firm* is acting as a *market maker*);
- (2) *dealing in investments as agent* for more than one party;
- (3) a recommendation to buy or sell a *designated investment* in which one of the *firm's customers* has given instructions to buy or sell;
- (4) a recommendation to buy or sell a *designated investment* in which the *firm* has respectively a long or short position;
- (5) acting as a *broker fund adviser*.

7.1.6



/1

In disclosing an interest to a *customer*, a *firm* should:

- (1) disclose to the *customer*, either orally or in writing, any *material interest* or conflict of interest it has, or may have, whether generally or in relation to a specific transaction, before it advises the *customer* about the transaction or before it *deals* on behalf of the *customer* in the exercise of discretion in relation to the transaction; and
- (2) be able to demonstrate that it has taken reasonable steps to ensure that the *customer* does not object to that *material interest* or conflict of interest.

Relying on a policy of independence

7.1.7



/1

When it is not practical for a *firm* to act in accordance with ■ COB 7.1.6, it may demonstrate that it has taken reasonable steps to ensure fair treatment for its *private customers* by relying on a policy of independence. If a *firm* relies on a policy of independence, that policy should:

- (1) require the relevant *employee* to disregard any *material interest* or conflict of interest when advising a *customer* or dealing for a *customer* in the exercise of discretion;
- (2) be recorded in writing by the *firm* and made known to the relevant *employee*;

- (3) be disclosed to a *private customer* stating that the *firm* may have a *material interest* or conflict of interest relating to the transaction or service concerned.

Establishing internal arrangements

- 7.1.8** G_{/1} A *firm* may manage a conflict of interest by establishing and maintaining the arrangements set out in ■ COB 2.4 (Chinese walls).

Declining to act for a customer

- 7.1.9** G_{/1} If a *firm* determines that it is unable to manage a conflict of interest using one of the methods described above, it should decline to act on behalf of the *customer*.

Broker fund advisers

- 7.1.10** R_{/1} In addition to ■ COB 7.1.3, a *broker fund adviser*, acting for a *private customer*, must obtain an acknowledgement from the *private customer* stating that he understands the nature of the *firm's* dual role as adviser to the *private customer* and adviser to the *long-term insurer* or operator of the fund in question.

- 7.1.11** G_{/1} ■ COB 7.1.10 is particularly relevant when any *remuneration* receivable by the *firm* or its *associate*, for acting in that dual capacity, would be greater than it would otherwise be when the *firm* is recommending to the *customer* a *life policy* or *units* in a *regulated collective investment scheme*.



7.2 Churning and switching

Application

- 7.2.1 **R** This section applies to a *firm* that conducts *designated investment business* with or for a *customer*.
/1

Purpose

- 7.2.2 **G** *Principle 6* (Customers' interests) requires a *firm* to pay due regard to the interests of its *customers* and treat them fairly. A *firm* should therefore not "churn" a *customer's* account, that is, enter into transactions with unnecessary frequency having regard to the *customer's* agreed investment strategy. A *firm* should also not switch a *private customer* within or between *packaged products* unnecessarily, having regard to what is suitable for that *customer*. *Firms* are reminded that a *customer's* interests are paramount.

Restrictions on dealing and switching

- 7.2.3 **R** A *firm* must not:
/1
- (1) *deal*, or arrange a *deal*, in the exercise of discretion for any *customer*; or
 - (2) make a *personal recommendation* to a *private customer* to *deal*, or arrange a *deal* that gives effect to such a recommendation; or
 - (3) make or arrange a switch within a *packaged product* or between *packaged products*, in the exercise of discretion for a *private customer*; or
 - (4) make a *personal recommendation* to a *private customer* to switch within a *packaged product* or between *packaged products*, or make or arrange a switch that gives effect to such a recommendation;

unless the *firm* has taken reasonable steps to ensure that the *deal* or switch is in the *customer's* best interests, both when viewed in isolation and when viewed in the context of earlier transactions.



7.3 Dealing ahead

Application

- 7.3.1 **R** This section applies to a *firm* when it or any of its *associates* intends to publish a written recommendation, or a piece of research or analysis, to *customers* that relates to a *designated investment*.

/1

Purpose

- 7.3.2 **G** *Principle 6* (Customers' interests) requires a *firm* to pay due regard to the interests of its *customers* and treat them fairly. *Principle 8* (Conflicts of interest) requires a *firm* to manage conflicts of interests fairly, both between itself and its *customers* and between a *customer* and another *client*. This section aims to ensure that either a *firm* pays due regard to the interests of its *customers* by postponing an *own account transaction* when the *firm* or its *associate* publishes a written recommendation or, when this is not practicable or desirable generally in the interests of the *firm's customer*, that any dealing does not unfairly disadvantage the *customer*.

/1

Requirement to postpone own account transactions

- 7.3.3 **R** If a *firm* or its *associate* intends to publish a written recommendation, or a piece of research or analysis, to *customers* that relates to a *designated investment*, unless **■ COB 7.3.4** applies, the *firm* must:

/1

- (1) not undertake an *own account transaction* in the *designated investment* concerned or any *related designated investment*; and
- (2) take all reasonable steps to ensure that its *associates* do not undertake any transaction in that *designated investment*, or any *related designated investment*;

until the *customers* for whom the publication was principally intended have had (or are likely to have had) a reasonable opportunity to act upon it.

Exceptions

7.3.4

R

/1

■ COB 7.3.3 does not apply if:

- (1) the publication could not reasonably be expected to affect significantly the price of the *designated investment* concerned or any *related designated investment*; or
- (2) the *firm* is a *market maker* in the *designated investment* concerned or in a *related designated investment* and it undertakes the transaction in good faith and in the normal course of market making; or
- (3) the *firm deals* in order to fulfil an unsolicited *customer order*; or
- (4) the *firm* has taken reasonable steps to ensure that it needs to *deal* to fulfil a *customer order* that is likely to result from the publication, and that doing so will not cause the price of the *designated investment* or *related designated investment* that is the subject of the written recommendation, or piece of research or analysis, to move against a *customer's* interest by a material amount; or
- (5) the *firm* or its *associate* discloses in the publication that the *firm* or its *associate* has undertaken or may undertake an *own account transaction* in the *designated investment* concerned or any *related designated investment*.



7.4 Customer order priority

Application

- 7.4.1 **R** This section applies to a *firm* when *executing customer orders in designated investments*.
/1

Purpose

- 7.4.2 **G** *Principle 6* (Customers' interests) requires a *firm* to pay due regard to the interests of its *customers* and to treat them fairly. *Principle 8* (Conflicts of interest) requires a *firm* to manage conflicts of interest fairly. This section is therefore designed to ensure that a *firm* acts fairly in *executing both own account orders and customer orders* and manages any conflict of interest accordingly.
/1

Dealing fairly and in due turn

- 7.4.3 **R** A *firm* must *execute customer orders and own account orders in designated investments* fairly and in due turn.
/1

- 7.4.4 **G** ■ COB 7.4.3 does not preclude a *firm* from, for example:
/1
- (1) *executing*:
 - (a) a prior *own account order* ahead of a subsequent *current customer order* in the same *designated investment* or a *related designated investment*; or
 - (b) a *current customer order* when the *person* dealing for the *customer* neither knew nor ought reasonably to have known of an earlier *unexecuted current customer order*;
 - (2) postponing *execution* of a *current customer order* when the *firm* has taken reasonable steps to ensure that *execution* of another *customer order* ahead of that *customer order* is likely to improve the terms on which the *current customer order* is *executed* (in which case the *firm* should ensure that the *customer* whose *customer order* is being *executed* ahead of that other *customer order* is also being treated fairly);
 - (3) treating the life fund as if it were a *customer* to the extent that the *firm* is an insurance company dealing for the account of its life fund;

- (4) treating the *investment trust* or *scheme* as if it were a *customer* to the extent that the *firm* is dealing for the account of an *investment trust* or a *collective investment scheme* that is a *body corporate*, which in either case is in the same *group* as the *firm*;
- (5) treating an *employee* (or *close relative*) of the *firm* or of its *associate*, or a trustee acting on his behalf, as if he were a *customer*; or
- (6) treating the *firm's occupational pension scheme* as a *customer* to the extent that the *firm* is dealing for the account of its *occupational pension scheme*.

7.4.5

G

/1

■ MAR 1.4.26(c) (Trading information) clarifies that *behaviour* based solely on information about another *person's* intention to *deal* will not constitute *market abuse*. *Firms* are reminded, however, that it may constitute a breach of ■ COB 7.4.3.



7.5 Best execution

Application

- 7.5.1 **R** This section applies to a *firm* when *executing* a *customer order* in a *designated investment*.
/1

Purpose

- 7.5.2 **G** *Principle 2* (Skill, care and diligence) and *Principle 6* (Customers' interests) require a *firm* to act with due skill, care and diligence and to pay due regard to its *customer's* interests. This section sets standards for *firms* when *executing current customer orders* in *designated investments*, particularly in the *securities* and *derivatives* markets, to obtain for *customers* the best price available to the *firm*, given the kind and size of such transactions.
/1

When best execution is owed

- 7.5.3 **R** A *firm* that *executes* a *customer order* in a *designated investment* must provide best execution, unless **■** COB 7.5.4 applies.
/1

Exceptions

- 7.5.4 **R** **■** COB 7.5.3 does not apply in any of the following circumstances:
/1
- (1) the *customer order* is for:
 - (a) the purchase of a *life policy*; or
 - (b) the purchase of or sale of *units* in a *regulated collective investment scheme* from or to the *operator* of that *scheme*;
 - (2) the *firm* has agreed in writing with an *intermediate customer* that it need not owe a duty of best execution to him, unless that *customer* is:
 - (a) the trustee of an *occupational pension scheme* or an *OPS collective investment scheme*; or

- (b) the trustee of any other trust for whom, and to the extent that, the *firm* acts as a *permitted third party* under ■ COB 11.6 (Delegation to a permitted third party); or
- (3) the *firm* relies on another *person* to whom it passes a *customer order* for *execution* to provide best execution, but only if it has taken reasonable care to ensure that he will do so.

Providing best execution

7.5.5



/1

To provide best execution, a *firm* must:

- (1) take reasonable care to ascertain the price which is the best available for the *customer order* in the relevant market at the time for transactions of the kind and size concerned; and
- (2) *execute* the *customer order* at a price which is no less advantageous to the *customer*, unless the *firm* has taken reasonable steps to ensure that it would be in the *customer's* best interests not to do so.

7.5.6



/1

- (1) In order to take reasonable care under ■ COB 7.5.5(1), a *firm*:
 - (a) should disregard any *charges* and *commission* made by it or its agents that are disclosed to the *customer* under ■ COB 5.7 (Disclosure of charges, remuneration and commission);
 - (b) need not have access to competing exchanges, or to all, or a minimum number of, available price sources; but if a *firm* can access prices displayed by different exchanges and trading platforms and make a direct and immediate comparison, it should *execute* the *customer order* at the best price available to the *firm* on such exchanges or trading platforms, if this is in the best interests of the *customer*;
 - (c) should pass on to the *customer* the price at which it *executes* the transaction to meet the *customer order*;
 - (d) should not take a *mark-up* or *mark-down* from the price at which it *executes* the *customer order*; and
 - (e) that is engaged in programme trading should ensure that it applies the duty of care in ■ COB 7.5.5 to each individual transaction.
- (2) In relation to a *customer order* for euro priced *securities* traded on the London Stock Exchange, if the *firm* has decided to *execute* in sterling, the *firm* should take reasonable care to ascertain the best price available in sterling and to *deal* at a price no less advantageous to the *customer*.

- (3) In relation to a *customer order* for *shares* that are traded on *SETS*, a *firm's* obligations under ■ COB 7.5.5 will be satisfied if, subject to ■ COB 7.5.6(1)(b), a *firm executes* the *customer order* through *SETS*.
- (4) If, in relation to a *customer order* for *securities* that are traded on *SETS*, a *firm* does not *execute* the *customer order* through *SETS*, the *firm* should ensure that:
 - (a) when a *customer order* is for normal settlement and is within the size currently displayed on *SETS*, the price obtained at least matches the best bid or offer price available on *SETS*;
 - (b) when a *customer order* is larger than the total of limit orders displayed on the best bid or offer on *SETS*, but there is sufficient depth overall, the price obtained at least matches the weighted average price of all orders for that *security* displayed on *SETS*;
 - (c) when a *customer order* is larger than the totality of orders currently displayed on the best bid or offer on *SETS*, and *execution* at the weighted average price would be impracticable, it uses due skill and care to ascertain the best available price, having regard to the price of recently *executed* transactions of a similar size, any prices or quotes available to it, and to prevailing market conditions;
 - (d) when there are no current bid or offer prices displayed on *SETS*, it refers to the previous best bid or offer prices, and to the latest published trades in the relevant *security*, and uses due skill and care to determine the best price in the light of the information available; and
 - (e) when a *customer order* is subject to a special condition (for example, non-standard settlement), the price should at least match the price available on *SETS*, and that any *charge* and *commission* in respect of the non-standard element is separately and appropriately disclosed to the *customer*.
- (5) Compliance with (1), (2) and (3) may be relied on as tending to establish compliance with ■ COB 7.5.5(1).
- (6) Contravention of (1) or (2) may be relied on as tending to establish contravention of ■ COB 7.5.5(1).
- (7) Compliance with (3) or (4) may be relied upon as tending to establish compliance with ■ COB 7.5.5(2).
- (8) Contravention of (4) may be relied upon as tending to establish contravention of ■ COB 7.5.5(2).

7.5.7

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Disclosure of *charges* and *commission* in relation to non-standard settlement under ■ COB 7.5.6(4)(e) may be made on a contract or confirmation note, or in a separate

written statement to the *customer* before the transaction is *executed*. If the issue of a written statement in advance of the transaction is impracticable, the *firm* may make an oral disclosure to the *customer* provided it discloses the *charges* and *commission* promptly in writing after the transaction is *executed*.

7.5.8

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An example of a circumstance in which a *firm* may, under ■ COB 7.5.5, *execute* a *customer order* at a price which is less advantageous than the best available price is when a *firm* has a continuing relationship with a *customer*, and reasonably expects that it will be able to secure compensating advantages for the *customer* in other transactions that should provide best execution for the *customer* over a period or a *series of transactions*. In such cases, the decision would need to be taken and justified in respect of each separate transaction as it arose.



7.6 Timely execution

Application

- 7.6.1 **R**_{/1} This section applies to a *firm* when it agrees or decides in the exercise of its discretion to *execute a current customer order* in a *designated investment*.

Purpose

- 7.6.2 **G**_{/1} In accordance with *Principle 2* (Skill, care and diligence) and *Principle 6* (Customers' interests), this section requires a *firm* when it agrees or decides in its discretion to *execute a current customer order* to do so with due skill, care and diligence and to act in the best interests of *customers* in selecting the most opportune time to *execute the current customer order*.
- 7.6.3 **G**_{/1} This section applies only to *current customer orders*, as opposed to *customer orders*. A *customer order* that can be *executed* immediately is a *current customer order*. A *customer order* that is to be *executed* on fulfilment of a condition, only becomes a *current customer order* once that condition is satisfied.

Achieving timely execution

- 7.6.4 **R**_{/1} Once a *firm* has agreed or decided in its discretion to *execute a current customer order* in a *designated investment*, it must do so as soon as reasonably practicable unless **■ COB 7.6.5** applies.
- 7.6.5 **R**_{/1} **■ COB 7.6.4** does not apply if a *firm* has taken reasonable steps to ensure that postponing the *execution* of a *current customer order* in a *designated investment* is in the best interests of the *customer*.
- 7.6.6 **G**_{/1} Examples of situations in which a *firm* should take particular care to assess the timing of *execution* of all or part of a *current customer order* include when:
- (1) a *firm* receives a *customer order* outside the normal trading hours of the relevant market or trading platform and intends *executing* that *customer order* on that market or other trading platform;

- (2) a foreseeable improvement in the level of liquidity in the relevant *designated investment* is likely to enhance the terms on which the *firm executes* the *customer order*;
- (3) *executing* the *customer order* as a series of partial *executions* over a period of time is likely to improve the terms on which the *customer order* as a whole is *executed*.

7.6.7

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A *firm* may have reasonable grounds for postponing *execution* of a *current customer order* in the best interests of the *customer*. Examples of this may include when the *deal* is part of an aggregated transaction (see ■ COB 7.7 (Aggregation and allocation)) for:

- (1) one or more *customers*; or
- (2) for the *firm* and one or more *customers* (including all those who would otherwise have priority over any other *person* for whom the *deal* is done);

and the *firm* has taken reasonable steps to ensure that the *deal* will not operate to the disadvantage of any of the *customers* concerned.

7.6.8

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■ COB 7.12 (Customer order and execution records) contains the requirements for recording *customer order* and *execution* details.



7.7 Aggregation and allocation

Application

7.7.1 **R** This section applies to a *firm* when it aggregates a *customer order* with an *own account order*, or with an order from a *market counterparty*, or with another *customer order*, while conducting *designated investment business*.

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Purpose

7.7.2 **G** *Principle 1* (Integrity) requires a *firm* to conduct its business with integrity while *Principle 6* (Customers' interests) requires that *customers* are treated fairly. When a *firm* aggregates and subsequently *executes* an order for *customer, market counterparty* and *own account transactions* collectively, or any combination of them, it should allocate the *designated investments* concerned fairly to all clients.

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Requirement for recorded standards and procedures

7.7.3 **R** When a *firm* aggregates a *customer order* with an *own account order*, or with an order from a *market counterparty*, or with another *customer order*, and subsequently allocates the *designated investments* concerned, it must do so in accordance with a written policy on allocation that is consistently applied and that fulfils the requirements of this section.

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Aggregation

7.7.4 **R** A *firm* may not aggregate a *customer order* with an *own account order*, or with an order from a *market counterparty*, or with another *customer order*, unless:

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- (1) it is likely that the aggregation will not work to the disadvantage of each of the *customers* concerned; and
- (2) it has disclosed either orally or in writing to each *customer* concerned, either specifically or in the *terms of business*, that the

effect of aggregation may work on some occasions to its disadvantage.

Requirement for timely allocation

7.7.5

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When a *firm* has aggregated a *customer order* with an *own account order*, or with an order from a *market counterparty*, or with another *customer order*, and part or all of the aggregated order has been filled, it must promptly allocate the *designated investments* concerned.

7.7.6

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- (1) To allocate promptly, a *firm* that has aggregated an order under ■ COB 7.7.4 should complete the allocation of the *designated investments* concerned within one *business day* of the transaction, subject to (2), (3), (4) and (5).
- (2) The period in (1) is within five *business days* if:
 - (a) only *intermediate customers* are concerned; and
 - (b) each of them has agreed to such an extension.
- (3) The period in (1) is within three *business days* if:
 - (a) the aggregated order relates to one or more *ISAs* or *PEPs*; and
 - (b) the *firm* can show that it is necessary to *execute* those transactions in that way in order to serve its *customer's* best interests.
- (4) All transactions in a *series of transactions*, all of which are *executed* within the one *business day*, may be treated as having been *executed* at the time of the last transaction, so long as a record of the time that each individual transaction was *executed* is made, such as by means of a time stamp.
- (5) If transactions in a *series of transactions* occur over more than one *business day*, then the requirement for timely allocation in ■ COB 7.7.5 (and (1), (2) or (3) as appropriate) will apply separately in relation to each *business day* in which any such transaction is *executed*.
- (6) Compliance with (1) may be relied on as tending to establish compliance with ■ COB 7.7.5.
- (7) Contravention of (1) may be relied on as tending to establish contravention of ■ COB 7.7.5.

7.7.7

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■ COB 8.1.3 (Requirement to confirm transactions) and ■ COB 8.1.5 (Essential details and prompt despatch) allow for a single confirmation to be sent to each

intermediate customer for a *series of transactions* over a period up to and including five *business days*.

7.7.8

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If, for any reason, a *firm* is not able to allocate the *designated investments* concerned promptly, the reason for the delay should be fully documented and recorded by the *firm*.

Requirement for fair allocation

7.7.9

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When a *firm* executes an aggregated order that combines:

- (1) a *customer order* and an *own account order*; or
- (2) a *customer order* and an order from a *market counterparty* (other than an *associate* of the *firm*); or
- (3) a *customer order* and another *customer order*;

in the subsequent allocation it must:

- (4) not give unfair preference to the *firm* or to any of those for whom it dealt; and
- (5) where (1) applies, give priority to satisfying *customer orders*, if the aggregate total of all orders cannot be satisfied, unless it can demonstrate on reasonable grounds that without its own participation it would not have been able to *execute* those orders on such favourable terms, or at all.

7.7.10

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A *firm* may treat the following as a *customer order*:

- (1) a transaction on the account of the life fund of an insurance company, when the insurance company is in the same *group* as the *firm* (or is the *firm*);
- (2) a transaction for the account of an *investment trust* or a *collective investment scheme* that is a *body corporate* in the same *group* as the *firm*;
- (3) a transaction for the account of an *employee* (or a *close relative*) of the *firm* or of its *associate*, or a trustee acting on his behalf, but only when the transaction is undertaken on a pre-established and recorded basis;
- (4) a transaction for the *firm's occupational pension scheme*.

Re-allocation

7.7.11

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A *firm* may undertake a revised allocation of an aggregated order if:

- (1) an error is identified in either the intended basis of allocation or the actual allocation, provided that the *firm* makes a record of the reason for the re-allocation and completes it within one *business day* of the error being identified; or
- (2) the order is only partially *executed* resulting in an uneconomic allocation to some *customers*; in such a case the *firm* must take reasonable steps to ensure that a re-allocation is in the best interests of the *customers* for whom it has dealt; and
- (3) the revised allocation is carried out in accordance with ■ COB 7.7.12.

Price of allocation

7.7.12

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When a *firm* has *executed* an aggregated order or is undertaking a revised allocation as described in ■ COB 7.7.11, then it must allocate that order either at:

- (1) the price paid for each *designated investment* concerned (net of all relevant *fees* and *commissions*); or
- (2) a volume-weighted average of the prices of a *series of transactions*.

7.7.13

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The method of calculating the volume-weighted average price of two transactions in the same *shares* is illustrated as follows:

Transaction 1 – 100 *shares* at £1.00 each

Transaction 2 – 400 *shares* at £2.00 each

Volume-weighted average price = $[(100 \times 1.00) + (400 \times 2.00)] / 500 = £1.80$

Record keeping requirements

7.7.14

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- (1) A *firm* must, on *executing* an aggregated transaction that includes one or more *customer* orders, make a record of:
 - (a) the identity of each *client* concerned;
 - (b) whether the transaction is to be transacted in whole or in part for a discretionary managed investment portfolio and, if in part, the relevant proportions.
- (2) If a *firm* aggregates a number of *client* orders that include one or more *customer* orders, the *firm* must make a record of the intended basis of allocation as soon as is practicable.

(3) If a *firm* aggregates an order for one or more *customers* and itself, the *firm* must make a record of the intended basis of allocation before the transaction is *executed*.

7.7.15

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A *firm* may choose to show the relevant proportions as the number of *shares* (or *units*) for each *client* together with the aggregate number of *shares* (or *units*).

7.7.16

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When allocating an aggregated transaction that includes the *execution* of one or more *customer* orders, a *firm* must make a record of:

- (1) the date and time of the allocation;
- (2) the relevant *designated investment*;
- (3) the identity of each *customer* and *market counterparty* concerned;
- (4) the amount allocated to each respective *customer*, *market counterparty* and to the *firm*; and
- (5) the agreement with each *intermediate customer* to extend the *allocation period* under ■ COB 7.7.6(2)(b).

7.7.17

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A *firm* must make a record of the basis of and reason for any re-allocation made in accordance with ■ COB 7.7.11 at the time of the re-allocation.

7.7.18

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A *firm* must retain the records required by ■ COB 7.7 for a period of at least three years from the date on which the order is allocated or re-allocated.



7.8 Realisation of a private customer's assets

Application

7.8.1 **R** This section applies to a *firm* when it:

^{/1}

- (1) seeks a right; or
- (2) seeks to exercise a right;

to realise a *private customer's* assets in order to discharge an obligation of that *private customer* which arises from *designated investment business* conducted by the *firm*.

Purpose

7.8.2 **G** *Principle 6* (Customers' interests) requires a *firm* to pay due regard to the interests of its *customers* and treat them fairly. This section therefore aims to ensure that a *firm*, where relevant, discloses to a *private customer*, in the *terms of business*, that it may exercise remedies involving the realisation of assets.

^{/1}

Contractual rights to realise a private customer's assets

7.8.3 **R** A *firm* must not realise a *private customer's* assets unless it is legally entitled to do so, and it has either:

^{/1}

- (1) set out in the *terms of business* provided to the *private customer* in accordance with **■ COB 4.2.5** (Requirement to provide terms of business to a customer) (or a *client agreement* entered into in accordance with **■ COB 4.2.7** (Requirement to enter into a client agreement with a private customer)):
 - (a) the action it may take to realise any assets of the *private customer*;
 - (b) the circumstances in which it may do so; and
 - (c) each asset (if relevant) or type or class of asset over which it may exercise the right; or

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- (2) given the *private customer* notice (oral or written) of its intention to exercise its rights at least three *business days* before it does so.



7.9 Lending to private customers

Application

- 7.9.1 **R** ^{/1} This section applies to a *firm* when it lends *money* or grants *credit* to a *private customer* or arranges for any other *person* to do so, in the course of, or in connection with, its *designated investment business*.

Purpose

- 7.9.2 **G** ^{/1} *Principle 6* (Customers' interests) requires a *firm* to pay due regard to the interests of its *customers* and treat them fairly. This section seeks to ensure that a *firm* lends money or grants *credit* to a *private customer* only in appropriate circumstances, and only if the *customer* has given prior consent in full knowledge of any resulting interest and *fees*.

Restrictions on lending to private customers

- 7.9.3 **R** ^{/1} A *firm*, subject to the exceptions in **■ COB 7.9.5**, must not lend *money* or grant *credit* to a *private customer* (or arrange for any other person to do so) in the course of, or in connection with, its *designated investment business* unless:
- (1) the *firm* has made and recorded an assessment of the *private customer's* financial standing, based on information disclosed by the *private customer*;
 - (2) the *firm* has taken reasonable steps to ensure that the arrangements for the loan or *credit* and the amount concerned are suitable, based on the information disclosed by the *private customer*, for the type of *investment agreement* proposed or which the *private customer* is likely to enter into; and
 - (3) the *private customer* has given his prior written consent to both the maximum amount of the loan or *credit* and the amount or basis of any interest or *fees* to be levied in connection with the loan or *credit*.

7.9.4 **G**_{/1} When the provisions of the Consumer Credit Act 1974 apply, the *firm* should ensure that it has an appropriate licence under that Act and that it complies with all that Act's requirements (details are available from the Office of Fair Trading).

Exceptions

7.9.5 **R**_{/1} ■ COB 7.9.3 does not apply when:

- (1) a *firm* settles a *securities* transaction of the *private customer* because he has failed to pay or has paid late; or
- (2) a *firm* covers a margin call made on a *private customer* for a period of no longer than five *business days*.

7.9.6 **G**_{/1} A *firm* should consider whether the circumstances mentioned in ■ COB 7.9.5 give rise to any obligations under the *client money rules* to maintain adequate *client money* resources.

Record keeping requirements

7.9.7 **R**_{/1} A *firm* must make a record of the information about the *private customer's* financial standing upon which the assessment required by ■ COB 7.9.3(1) was made, including the date on which the information was last updated or checked, and retain the record for three years from the date on which the *credit* arrangements ceased.



7.10 Margin requirements

Application

- 7.10.1** **R** _{/1} This section applies to a *firm* which *executes* a transaction in a *contingent liability investment* with or for a *private customer*, in the course of, or in connection with, its *designated investment business*.

Purpose

- 7.10.2** **G** _{/1} *Principle 3* (Management and control) requires a *firm* to have adequate risk management systems, while *Principle 6* (Customers' interests) requires a *firm* to pay due regard to the interests of its *customers* and treat them fairly. This section aims to ensure that a *firm* does not expose itself to unacceptable levels of *credit* risk while managing its *margin requirements*. It also aims to ensure that a *firm* manages a *private customer's* exposure to contingent liabilities by diligently monitoring the *firm's* relevant provision of *credit*.

Provision of margin by a private customer

- 7.10.3** **R** _{/1} (1) A *firm* must obtain from a *private customer* any margin payable, whether at the outset or subsequently, by or to the *firm*, for a transaction in a *contingent liability investment*.
- (2) The minimum margin to be obtained from a *private customer* in accordance with (1) for an *on-exchange* transaction in a *contingent liability investment* is an amount or value equal to the margin requirements of the relevant exchange or *clearing house*.

- 7.10.4** **G** _{/1} Before conducting a transaction with or for a *private customer*, a *firm* should notify the *customer* of:
- (1) the circumstances in which the *customer* may be required to provide any margin;
 - (2) the form in which the margin may be provided;
 - (3) the steps the *firm* may be required or entitled to take if the *customer* fails to provide the required margin, in accordance with **■ COB 7.10.5**, including:

- (a) the fact that the *customer's* failure to provide margin may lead to the *firm* closing out his position after a time limit specified by the *firm*;
- (b) the circumstances in which the *firm* will have the right or duty to close out the *customer's* position; and
- (4) the circumstances, other than failure to provide the required margin, that may lead to the *firm* closing out the *customer's* position without prior reference to him.

Failure to meet a margin call

7.10.5

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A *firm* must close out a *private customer's* open position if that *customer* fails to meet a margin call made for that position for five *business days* following the date on which the obligation to meet the call accrues, unless:

- (1) (a) the *firm* has received confirmation from a relevant third party that the *private customer* has given instructions to pay in full; and
- (b) the *firm* has taken reasonable care to establish that the delay in its receipt is owing to circumstances beyond the *private customer's* control; or
- (2) the *firm* makes a loan or grants *credit* to the *private customer* to enable that *customer* to pay the full amount of the margin call in accordance with the requirements of ■ COB 7.9.3 (Restrictions on lending to private customers).

7.10.6

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In ■ COB 7.10.5(1) (a), a 'relevant' third party includes a party connected with the transaction such as a *clearing firm*.

7.11 Non-exchange traded securities

Application

- 7.11.1 **R** This section applies to a *firm* that conducts *designated investment business* with or for a *private customer* and:
/1
- (1) sells to the *customer* any *security* that is not traded on a *recognised investment exchange*, a *designated investment exchange* or any *regulated market*; and
 - (2) holds itself out as a *market maker* in that *security*.

Purpose

- 7.11.2 **G** This section aims to ensure that a *firm deals* fairly with a *private customer* in
/1 relation to the sale and subsequent purchase of a non-exchange traded *security*.

Requirement for selling non-exchange traded securities to private customers

- 7.11.3 **R** A *firm* must:
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- (1) give written notice to a *private customer*, no later than the time of sale, that:
 - (a) a reasonable price for repurchase of the *security* will be available to the *private customer* for a period, specified in that notice, that must not be less than three months from the date the notice is given; and
 - (b) sale by the *private customer* of the *security* after the end of that period may be difficult due to the nature and possible illiquidity of the *security*; and
 - (2) ensure that a reasonable price is available to the *private customer* for the duration of the period specified in the notice.

7.11.4 G_{/1} In establishing a reasonable price a *firm* should consider factors that are of direct relevance to the particular *security*, for example that a company has announced (unanticipated) substantially increased profits.

7.11.5 G_{/1} Factors that the *firm* took into account when the original sale was done should, if these remain unchanged, be taken into account in the same way when the price is established for the purchase of the *security* back from the *private customer*. *Firms* should take care to ensure that fluctuations in price are not solely or mainly justified by reference to an absence of liquidity, unless this reflects factors that are directly relevant to the particular *security*.



7.12 Customer order and execution records

Application

7.12.1

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This section applies to a *firm* that:

- (1) receives (or, in the exercise of its discretion, decides upon) a *customer order*;
- (2) *executes a customer order*;
- (3) passes a *customer order* to another *person* for *execution*; or
- (4) in addition to (1), (2) or (3), also *executes own account transactions*;

in any *designated investment* other than a *life policy*.

Purpose

7.12.2

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Principle 3 (Management and control) requires a *firm* to take reasonable care to organise and control its affairs responsibly and effectively. This section aims to ensure that a *firm* makes and retains records of *customer orders* and other transactions in the course of adhering to the *customer order execution* requirements in ■ COB 7.4 (Customer order priority), ■ COB 7.5 (Best execution) and ■ COB 7.6 (Timely execution).

Record keeping requirement

7.12.3

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A *firm* must ensure by the establishment and maintenance of appropriate procedures that it promptly records adequate information in relation to the events in ■ COB 7.12.1, including any *own account transactions*.

7.12.4

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- (1) When an event in the left-hand column of ■ COB 7.12.6 occurs, a *firm* should make a record of the matters set out in the right-hand column that relate to that event.

- (2) Compliance with (1) may be relied on as tending to establish compliance with ■ COB 7.12.3.
- (3) Contravention of (1) may be relied on as tending to establish contravention of ■ COB 7.12.3.

7.12.5



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In addition to the information referred to in ■ COB 7.12.4, other information that the *firm* considers prudent should be recorded.

7.12.6



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Table Minimum contents of customer order and execution records
This table belongs to ■ COB 7.12.3

When:		The firm should record:	
(1)	a <i>customer order</i> arises	(a)	the <i>customer's</i> name or other designation and account number;
		(b)	the date and time of: <ul style="list-style-type: none"> (i) receipt by the <i>firm</i> of the <i>customer order</i>; or (ii) the decision by the <i>firm</i> to <i>deal</i>;
(1)	a <i>customer order</i> arises	(c)	the identity of the <i>employee</i> who received the <i>customer order</i> or made the decision in (b)(i) and (ii);
		(d)	<ul style="list-style-type: none"> (i) the <i>designated investment</i> concerned; and (ii) the number of, or total value of, the <i>designated investment</i> (including any price limit);
(1)	a <i>customer order</i> arises	(e)	whether the <i>customer order</i> is for a purchase or sale; and
		(f)	any other instruction received by the <i>firm</i> from the <i>customer</i> with regard to the <i>execution</i> of the <i>customer order</i> (including the nature of the communication, for example, telephone, fax, letter, email).
(2)	the <i>firm</i> executes a transaction	(a)	the name or other designation and account number of the <i>client</i> (if any) for whom the transaction was <i>executed</i> (unless the transaction was an <i>own account transaction</i>);
		(b)	the name of the counterparty, if known to the <i>firm</i> ;
		(c)	the date and if available, the time of the transaction;
		(d)	the identity of the <i>employee</i> executing the transaction;

When:		The firm should record:	
(3)	the <i>firm</i> passes a <i>customer order</i> to another <i>person</i> for <i>execution</i>	(e)	(i) the <i>designated investment</i> concerned; and (ii) the number of, or total value of, the <i>designated investment</i> ;
		(f)	the price and other significant terms (including exchange rate details if relevant);
		(g)	whether the transaction was a purchase or a sale; and
		(h)	whether the <i>firm</i> was acting as <i>principal</i> as well as on behalf of its <i>customer</i> .
		(a)	the name of the <i>person</i> instructed;
		(b)	the terms of the instruction; and
		(c)	the date and time that the instruction was given.

7.12.7 G_{/1} When a *firm* aggregates and subsequently allocates a *customer order* with an *own account transaction* or with another *customer order*, the time and price required to be recorded by ■ COB 7.12.6(2)(c) and (f) will be determined in accordance with the provisions in ■ COB 7.7.5 (Requirement for timely allocation) and ■ COB 7.7.12 (Price of allocation) respectively.

7.12.8 G_{/1} For the purposes of ■ COB 7.12.3, if information is recorded as soon as practicable following receipt or *execution*, then the *FSA* will regard it as having been recorded promptly. When information required to be recorded is supplied to the *firm* by someone else, it should be recorded upon receipt.

Orders received over the Internet

7.12.9 G_{/1} When a *firm* gives a *customer* access to market information, that is updated continuously in line with the relevant market, in conjunction with the ability to place a *customer order* by relying on such market information, and the *customer order* is *executed* automatically upon receipt, the *firm* should record the price, even if only indicative, which the *customer* relied on when placing the *customer order*, as part of the information required to be recorded in accordance with ■ COB 7.12.3.

7.12.10 G_{/1} When a *firm* provides market information as described in ■ COB 7.12.9, and the *customer order* is submitted over the Internet but is not executed automatically upon receipt, the *firm* should record the price displayed on the screen at the time the *customer order* is placed, as part of the information required to be recorded in accordance with ■ COB 7.12.3.

Period of retention

7.12.11

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A *firm* must retain the records referred to in ■ COB 7.12.3 for a period of at least three years after the date of the event in the left-hand column of ■ COB 7.12.6.



7.13 Personal account dealing

Application

7.13.1 **R** This section applies to a *firm* that conducts *designated investment business*.
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7.13.2 **G** This section has been written in accordance with the FSA's responsibilities under articles 10 and 11 of the *Investment Services Directive*. These rules also form part of the conditions applied to *EEA firms* with a *UK branch* office in the interest of the general good under article 17 of the *Investment Services Directive*.
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Purpose

7.13.3 **G** *Principle 3* (Management and control) requires a *firm* to take reasonable care to organise and *control* its affairs responsibly and effectively. *Principle 8* (Conflicts of interest) requires a *firm* to manage conflicts of interest fairly between itself and its *customers*. This section is designed to ensure that a *firm's customers* are not disadvantaged by the personal dealings of the *firm's employees*. *Firms* will, therefore, need to ensure that appropriate controls and monitoring arrangements are implemented and maintained.
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Restrictions on personal account dealing

7.13.4 **R** A *firm* must take reasonable steps to ensure that:
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- (1) a *personal account transaction* in a *designated investment* undertaken by any of its *employees* does not conflict with the *firm's* duties to its *customers* under the *regulatory system*, unless **COB 7.13.6** applies; and
- (2) when it gives permission to an any of its *employees* to undertake a *personal account transaction*, it receives prompt notification of, or is otherwise able to identify, that transaction.

7.13.5 **G** *Firms* should note that an *employee* is defined in the *Glossary* (for the purposes of this section) as meaning not just an individual who is employed or appointed by a *firm* but also an individual who is:
/1

- (1) an *appointed representative* of a *firm*; or

- (2) employed or appointed by an *appointed representative* of a *firm*, whether under a contract of service or services or otherwise.

So, where a *firm* has one or more *appointed representatives*, ■ COB 7.13.4 will apply to the *firm* in relation to, for example, *employees* of its *appointed representative* in exactly the same way as it would were those individuals employed by the *firm* itself.

Exceptions

7.13.6



■ COB 7.13.4 does not apply to:

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- (1) an *employee* who is a *sole trader* whose *regulated activities* consist only of *own account transactions*; or
- (2) an *employee*, if the *firm* has taken reasonable steps to determine that the *employee* will not be involved to any material extent in, or have access to information about, the *firm's designated investment business*.

Reasonable steps

7.13.7



(1) For the purposes of ■ COB 7.13.4, a *firm's* "reasonable steps" should ensure that:

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- (a) the restrictions, and the basis, if any, upon which its *employees* may undertake *personal account transactions*, are set out in a written notice drawn explicitly to the attention of each *employee*, and that the contents of such a notice are made a term of his contract of employment or contract for services;
- (b) the written notice in (1)(a) states that, if an *employee* is precluded from entering into a transaction for his own account, he must not (except in the proper course of his employment):
 - (i) procure any other *person* to enter into such a transaction; or
 - (ii) communicate any information or opinion to any other *person* if he knows, or ought to know, that the *person* will, as a result, enter into such a transaction, or counsel or procure some other *person* to do so; and
- (c) procedures are established and maintained by the *firm* that are appropriate to its business, and that are designed with a view to ensuring that:

- (i) each of its *employees* does not undertake a *personal account transaction* in a *designated investment* unless the *firm* has given its permission in writing to that transaction, or to transactions generally in *designated investments* of that kind;
 - (ii) when the *firm* gives such permission, the requirements in ■ COB 7.13.4(1) and (2) are complied with.
- (2) Compliance with (1) may be relied upon as tending to establish compliance with ■ COB 7.13.4.
- (3) Contravention of (1) may be relied on as tending to establish contravention of ■ COB 7.13.4.

7.13.8 G
/1 A *firm* will be able to identify its *employees' personal account transactions* under ■ COB 7.13.4(2) if it designates its *employees' own accounts* in a way that enables them to be distinguished from other *customers' accounts*.

7.13.9 G
/1 When an *employee* undertakes a *personal account transaction* through a *person* other than the *firm* or its *associate*, a copy of the note confirming details of the transaction issued by that *person* will be sufficient notification for the purposes of ■ COB 7.13.4(1).

7.13.10 G
/1 *Firms* should note that for the purposes of ■ COB 7.13.7(1), while they may look to a third party to make the appropriate arrangements to ensure that the "reasonable steps" referred to in that provision are taken, ultimate responsibility for ensuring that such steps are in fact carried out rests with the *firm*. Therefore a *firm*, which has entered into arrangements with its *appointed representative* under which that *appointed representative* agrees to carry out the steps in ■ COB 7.13.7 (1) (a) and (b) in relation to individuals employed by the *appointed representative*, remains responsible should the *appointed representative* fail, for any reason, to carry out the necessary steps. In relation to ■ COB 7.13.7(1) (c) (i) and (ii), it should be noted that all permissions have to be given by the *firm* itself.

Record keeping requirements

- 7.13.11** R
/1 (1) A *firm* must make a record of:
- (a) the restrictions upon personal account dealing and the basis upon which any permission to *deal* is made;
 - (b) each permission given by it under ■ COB 7.13.4(2);
 - (c) each notification made to it under ■ COB 7.13.4(2);
 - (d) in respect of ■ COB 7.13.6(2), the basis upon which the *firm* has determined that an *employee* will not be involved in, or have access to information about, the *firm's designated investment business*; and

retain these records for the minimum period specified in (2), (3) or (4), as the case may be.

- (2) In relation to a record under (1)(a), the period is three years from the date that the restrictions or basis were communicated to the *employee*.
- (3) In relation to each permission and notification in (1)(b) and (c), the period is three years from the date that the permission or notification was made.
- (4) In relation to a record under (1)(d), the period is three years after the date on which the individual ceases to be an *employee*.

7.13.12

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A *firm's* records under ■ COB 7.13.11(1) should be sufficiently detailed to identify the position in relation to (1)(a) to (d) for each of its *employees*. So where the firm gives permission under (1)(b) to a particular *employee*, as opposed to *employees* generally, an individual record of that permission is required to be made and retained. However, where the *firm's* restrictions on personal account dealing are set out in, for example, a standard booklet which is issued to all its *employees*, it is sufficient for the purposes of (1)(a) for the *firm's* records to show what global restrictions were in place at any given moment in time and it is not necessary for there to be a record of each booklet that was issued to each *employee*.



7.14 Programme trading

Application

- 7.14.1** G_{/1} This section applies to a *firm* when it *executes* a programme trade that includes one or more *designated investments*. The term 'programme trade' is used in this section to describe a single transaction or *series of transactions executed* for the purpose of acquiring or disposing, for a *customer*, of all or part of a portfolio or a large basket of *securities*.

Purpose

- 7.14.2** G_{/1} *Principle 6* (Customers' interests) requires a *firm* to pay due regard to the interests of its *customers* and treat them fairly. This section provides *guidance* on the steps a *firm* should take when *executing* a programme trade, either as *principal* or agent, whenever a *customer* is involved.

Programme trading

- 7.14.3** G_{/1} Before a *firm executes* a programme trade, it should disclose to its *customer* whether it will be acting as a *principal* or agent, unless the *customer* has given prior notification that no such notice is required. A *firm* should not subsequently act in a different capacity from that which is disclosed without the prior consent of the *customer*.
- 7.14.4** G_{/1} A *firm* should ensure that neither it, nor an *associate*, *executes* an *own account transaction* in any *designated investment* included in a programme trade, unless the *firm* has notified the *customer* in advance that it may do this, or can otherwise demonstrate that it has provided fair treatment to the *customer* concerned.
- 7.14.5** G_{/1} **COB 7.5.6(1)(e)** (Providing best execution) provides that a *firm* should ensure that it applies the duty of care in **COB 7.5.5(1)** (Providing best execution) to each individual transaction *executed* as part of a programme trade, subject to the exceptions in **COB 7.5.4** (Exceptions).



7.15 Non-market-price transactions

Application

- 7.15.1 **R** This section applies to a *firm* when it conducts *designated investment business* with or for a *customer*.
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Purpose

- 7.15.2 **G** *Principle 1* (Integrity) requires a *firm* to conduct its business with integrity, whilst *Principle 5* (Market conduct) requires a *firm* to observe proper standards of market conduct. In general, *firms* should undertake transactions at the prevailing market price. Failure to do this may result in a *firm* participating, whether deliberately or unknowingly, in the concealment of a profit or loss, or in the perpetration of a fraud. A *firm* should therefore not enter into a *non-market-price transaction* unless it has taken reasonable steps to ensure that the transaction is not illegal or otherwise for an improper purpose.
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Non-market-price transactions

- 7.15.3 **R** Subject to **■ COB 7.15.4**, a *firm* must not, as agent or *principal*, enter into a *non-market-price transaction* under which it *deals* in a *designated investment* with or for a *customer*, unless it has taken reasonable steps to ensure that the transaction is not being entered into by the *customer* for an improper purpose.
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- 7.15.4 **R** **■ COB 7.15.3** does not apply to a *non-market-price transaction* if it is subject to the rules of a *recognised investment exchange*.
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- 7.15.5 **G** For further *guidance*, *firms* are referred to the corresponding provisions on *non-market-price transactions* set out in **■ MAR 3** (Inter-professional conduct), in particular **■ MAR 3.5.7**(Non-market-price transactions). Although these provisions apply to a *firm's* bilateral dealings with a *market counterparty*, they are also relevant to business conducted with or for *customers*.
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Chapter 8

Reporting to customers



8.1 Confirmation of transactions

Application

- 8.1.1 **R**_{/1} This section applies to a *firm* when it *executes* a sale or purchase of a *designated investment* with or for a *customer*.

Purpose

- 8.1.2 **G**_{/1} *Principle 7* (Communications with clients) requires a *firm* to pay due regard to the information needs of its *customers*. The provisions in **■ COB 8.1** are designed to ensure that *customers* are promptly advised of the essential details of a transaction. *Firms* are obliged to despatch these details, except in certain circumstances when they are supplied by someone else, or at a later date, or if the *customer* waives the right to receive the information.

Requirement to confirm a transaction

- 8.1.3 **R**_{/1} (1) A *firm* must, subject to **■ COB 8.1.6**, despatch to the *customer* a written confirmation recording the essential details of the transaction, and must do so promptly.
- (2) For the purposes of (1), a *firm* may despatch a confirmation to an agent, other than the *firm* or an *associate* of the *firm*, nominated by the *customer* in writing.
- 8.1.4 **G**_{/1} (1) Regarding the electronic provision of a confirmation, see **■ COB 1.8** (Application to electronic media).
- (2) A *firm* may comply with **■ COB 8.1.3(1)** by posting a confirmation on its website, provided that the confirmation is only accessible to the party that placed the order. If the *firm* does this for a *private customer*, it should regularly review the website to ensure that the *customer* has reviewed his confirmations. If the *private customer* has not accessed his confirmation within five days of it being posted on the website, the *firm* should send the confirmation to him either in hard copy or electronically.

Essential details and prompt despatch

8.1.5



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- (1) A *firm* should provide the following essential details of a transaction, to the extent they are relevant:
- (a) the information specified in:
 - (i) ■ COB 8.1.15 for all transactions;
 - (ii) ■ COB 8.1.16 in particular circumstances;
 - (iii) ■ COB 8.1.17 for transactions in *units* in a *regulated collective investment scheme*;
 - (iv) ■ COB 8.1.18 for transactions in *derivatives*;
 - (v) ■ COB 8.1.19 upon the exercise of an *option*; or
 - (b) such information as the *customer* has on his own initiative agreed with the *firm*, or is in accordance with the custom of a non-UK market in which the transaction was arranged; or
 - (c) a copy of a confirmation received by the *firm* from a third party together with any other information provided by the *firm* which, when taken together, satisfies (1)(a).
- (2) To despatch a confirmation promptly, a *firm* should:
- (a) despatch it no later than the *business day* following the *day* the transaction was *executed* (as specified in ■ COB 8.1.12) or within any period specified by the *customer* on his own initiative; or
 - (b) despatch a copy of a confirmation received from a third party together with additional information, if any, to the *customer* as soon as practicable, but in any event no later than the *business day* following receipt; and
 - (c) despatch it at the latest on the *business day* following the *day* the *issue* or *redemption price* was determined, when the *firm* has *issued* or *redeemed units* in a *regulated collective investment scheme*, unless (b) applies.
- (3) Compliance with (1) and (2) may be relied upon as tending to establish compliance with ■ COB 8.1.3.
- (4) Contravention of (1) or (2) may be relied upon as tending to establish contravention of ■ COB 8.1.3.

Exceptions to the requirement to despatch a confirmation

8.1.6



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A *firm* need not despatch a confirmation when:

- (1) the *designated investment* is a *life policy* or a *personal pension contract*; or
- (2) an arrangement is in place for the *customer* to make a series of payments for the purchase of *units* in a *regulated collective investment scheme* or of *shares* in an *investment trust* (including one-off payments made in addition to those in the series); or
- (3) the *firm* has been requested by the *customer* in writing not to supply confirmations, either generally or in specified circumstances (but see ■ COB 8.1.7 and ■ COB 8.1.8); or
- (4) the *firm* is acting as an *investment manager*, or as an *ISA manager* or *plan manager*, and:
 - (a) the *designated investment* is not a *contingent liability investment*;
 - (b) the *firm* has taken reasonable steps to determine that the *customer* does not wish to receive confirmations, either generally or in specified circumstances; and
 - (c) the *firm* complies with ■ COB 8.1.7 or ■ COB 8.1.8; or
- (5) it would duplicate a confirmation containing the essential details of the transaction (other than those that are *firm-specific*) which is to be promptly despatched by someone else.

8.1.7

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A *firm* which is not an *OPS firm* referred to in ■ COB 8.1.8 may rely upon the exceptions in ■ COB 8.1.6(3) or ■ COB 8.1.6(4) only if it provides to the *customer* a *periodic statement* containing the information that would have been contained in a confirmation despatched in accordance with ■ COB 8.1.3 (other than information which has since become irrelevant) relating to the transactions *executed* during the relevant period.

8.1.8

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An *OPS firm* conducting *OPS activity* for an *OPS trustee* which is an *intermediate customer* of the *OPS firm*, and is habitually resident in the *United Kingdom*, may rely upon the exceptions in ■ COB 8.1.6(3) or ■ COB 8.1.6(4) only if it provides a *periodic statement* containing the information required by ■ COB 8.2.10(3)(c).

8.1.9

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The request in ■ COB 8.1.6(3) includes a general request as well as a request made on any specific occasion.

8.1.10

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If the *firm* *executes a series of transactions*, or aggregates orders, it should modify the information to be provided as necessary, to ensure that the confirmation is clear, fair and not misleading, as required by ■ COB 2.1.3.

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When a confirmation may omit certain information

8.1.11

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If:

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- (1) anyone fails to supply information which the *firm* requires for inclusion in a confirmation; or
- (2) the transaction involves a conversion of one currency into another and that conversion has not been made by the *firm*;

the *firm* may omit this information from the confirmation, provided the fact of its omission is stated with an indication that it is to be supplied later (or that it cannot be supplied at all if that is the case). The relevant information must then be supplied to the *customer* promptly after receipt.

When a transaction is treated as executed

8.1.12

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(1) When a *firm* executes a transaction outside normal market hours, the transaction must be treated as *executed* on the following *business day*.

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(2) When a *firm* executes a series of transactions, all the transactions may be treated as *executed* at the time of the last transaction so long as a record of the time that each individual transaction was *executed* is made, for example, by means of a time stamp.

(3) When a *firm* aggregates and then subsequently allocates a *customer order* with an *own account order* or with another *customer order*, the transaction must be treated as *executed* at the time of allocation under ■ COB 7.7.5 (Requirement for timely allocation).

8.1.13

G

Any right of the *customer* to cancel the *designated investment* does not affect the time when the transaction is treated as *executed*.

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Record keeping requirements

8.1.14

R

A *firm* must make a copy of the confirmation information despatched to a *customer* under ■ COB 8.1.3 and retain it for three years from the date of despatch.

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8.1.15

E

Table Content of a confirmation of transaction – general requirements
This table belongs to ■ COB 8.1.5

/1

Content of a confirmation of transaction – general requirements

1. The *firm's* name and address.
2. That the *firm* is regulated or authorised by the Financial Services Authority.
3. If the *firm* (other than the *operator of a regulated collective investment scheme*) executed the transaction as *principal*, that fact.
4. The *customer's* name or other designation and account number.
5. A description of the *designated investment*, including the amount invested.
6. Whether the transaction is a sale or purchase.
7. The *unit price* at which the transaction was *executed*, and, if the *unit price* is averaged including any price set in accordance with COB 7.7.12R (Price of allocation), a statement of that fact.
8. The date of the transaction.
9. Either:
 - (a) the time of the transaction; or
 - (b) a statement that information about the time of the transaction will be supplied on request.
10. The total consideration payable and the date on which it is due.
11. The *remuneration* of the *firm* (other than the *operator of a regulated collective investment scheme* subject to COB 8.1.17E) and that of any *associate* in connection with the transaction, distinguishing:
 - (a) the amount of any *commission* charged; and
 - (b) the basis on which the *commission* has been determined, unless all *commission* charged to the *customer* has already been disclosed to him; and
 - (c) if the *firm* or an *associate* acted as *principal* in *executing* the transaction, and owes a duty of best execution, the amount of any *mark-up* or *mark-down* (unless the firm is the *operator of a regulated collective investment scheme*, in which case CIS 8.5.6(3)R (Exemptions from liability to account for profits) applies.
12. The amount of any *fees*, taxes or duties, unless included in *remuneration* mentioned in 11.

8.1.16



Table Content of a confirmation of transaction – additional content in particular circumstances
This table belongs to ■ COB 8.1.5

Content of a confirmation of transaction – additional content in particular circumstances

If the transaction involves:	The confirmation should state:
1. a conversion of currency;	the rate of exchange obtained;

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6

Content of a confirmation of transaction – additional content in particular circumstances		
2.	a <i>firm</i> receiving any payment or reward from another <i>person</i> in connection with the transaction;	unless a prior written statement to this effect has been made to the <i>customer</i> , the amount or basis of any payment or reward or the fact that this will be made available on request;
3.	the <i>firm</i> being remunerated for acting as an agent for the <i>market counterparty</i> to the transaction as well as acting as agent for the <i>customer</i> ;	that fact;
4.	a right to receive interest on an <i>investment</i> (for example, in relation to a <i>government or public security</i>);	(a) if not part of the transaction price, the amount of interest which the purchaser is entitled to receive; and (b) any part of the total consideration which is specifically attributable to the right in (a);
5.	<i>charges</i> shared with another <i>person</i> (except <i>employees</i>);	unless a prior written statement to this effect has been made to the <i>customer</i> , the amount or basis of any shared <i>charges</i> , or the fact that this will be made available on request;
6.	a <i>security</i> which is not a <i>packaged product</i> or a <i>readily realisable security</i> and the <i>firm</i> acted as a <i>principal</i> in <i>executing</i> the transaction with the <i>customer</i> and there is no calculable <i>mark-up or mark-down</i> ;	how the <i>unit price</i> of the transaction was arrived at;
7.	<i>units</i> in an <i>unregulated collective investment scheme</i> of which the <i>firm</i> or one of its <i>associates</i> is the <i>operator</i> ;	the amount or percentage of the <i>operator's</i> initial <i>charges</i> included in the price of those <i>units</i> ;

Content of a confirmation of transaction – additional content in particular circumstances

8.	the <i>firm's</i> or an <i>associate's remuneration</i> being passed on by the <i>firm</i> to a third party as a reward for introducing the business;	the identity of the third party and the amounts passed on or the fact that details of such arrangements will be made available on request;
9.	any dividend or capitalisation or other right which has been declared, but which has not been paid, allotted or otherwise become effective in respect of the <i>investment</i> , and under the terms of the transaction the benefit of which will not pass to the purchaser.	that fact.

8.1.17



Table Content of a confirmation of a transaction – additional content relating to transactions in units in a regulated collective investment scheme
This table belongs to ■ COB 8.1.5

Content of a confirmation of transaction – additional content relating to transactions in units in a regulated collective investment scheme

1.	If the <i>firm</i> is not the <i>operator</i> and the transaction was <i>executed</i> with the <i>customer</i> by the <i>firm</i> as <i>principal</i> , that fact.	
2.	The name of the <i>scheme</i> and the type and number of <i>units</i> involved.	
3.	The amount of:	
	(a)	the <i>operator's</i> initial <i>charges</i> , if any; and
	(b)	any <i>charges</i> (other than the initial <i>charges</i>) made by the <i>firm</i> to the <i>customer</i> in respect of the transaction and, unless such <i>charges</i> to the <i>customer</i> are made on the same basis, the basis on which the amount of the <i>charges</i> was determined.
4.	A statement that the price at which the transaction has been <i>executed</i> is on an <i>historic price</i> or <i>forward price</i> basis, as the case may be.	

8.1.18



Table Content of a confirmation of a transaction – additional content relating to transactions in derivatives
This table belongs to ■ COB 8.1.5

Content of a confirmation of transaction – additional content relating to transactions in derivatives

1.	The maturity, delivery or expiry date of the <i>derivative</i> .
2.	In the case of an <i>option</i> , a reference to the last exercise date, whether it can be exercised before maturity and the strike price.

Content of a confirmation of transaction – additional content relating to transactions in derivatives

- 3. If the transaction involved, or will involve, the purchase of one currency with another, the rate of exchange involved or a statement that the rate will be supplied when the currency has been purchased, including the maturity or expiry date of any currency hedge, unless the currency hedge is separately reportable under *COB* 8.1.3R.
- 4. If the transaction *closes out* an open *futures* position, all essential details required in respect of each contract comprised in the open position and each contract by which it was *closed out* and the profit or loss to the *customer* arising out of *closing out* that position (a difference account).

8.1.19



Table Content of a confirmation of transaction – additional content on exercise of an option
This table belongs to ■ *COB* 8.1.5

Content of a confirmation of transaction – additional content on exercise of an option (exercise confirmations)

- 1. The date of exercise, and either the time of exercise or that the *customer* will be notified of that time on request.
- 2. Whether the exercise creates a sale or purchase in the underlying asset.
- 3. The strike price of the *option* (for a currency *option*, the rate of exchange will be the same as the strike price) and, if applicable, the total consideration from or to the *customer*.



8.2 Periodic statements

Application

8.2.1

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This section applies to a *firm* when it:

- (1) acts as an *investment manager*, or administers any other account or portfolio which includes *designated investments*, for a *customer*; or
- (2) operates a *customer's* account containing uncovered open positions in a *contingent liability investment*.

8.2.2

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Examples of uncovered open positions include:

- (1) selling a call *option* on an *investment* not held in the portfolio;
- (2) unsettled sales of call *options* on currency in amounts greater than the portfolio's holding of that currency in cash or in *readily realisable securities* denominated in that currency; and
- (3) transactions having the effect of 'selling' an index to an amount greater than the portfolio's holdings of *designated investments* included in that index.

Purpose

8.2.3

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Principle 7 (Communications with clients) requires a *firm* to pay due regard to the information needs of its *customers*. A *firm* should therefore supply the *customer* with a regular statement, on a timely basis, providing information on the *customer's investment* portfolio.


Requirement for a periodic statement

8.2.4


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A *firm* must, promptly and at suitable intervals, provide the *customer* with a written statement containing adequate information on the value and composition of the *customer's* account or portfolio with the *firm*, as at the end of the period covered by the statement, unless **■** COB 8.2.6 applies.

- 8.2.5  For *periodic statements* provided electronically, *firms* are referred to the *guidance* in ■ COB 1.8 (Application to electronic media).


Exceptions from the requirement to provide a periodic statement

- 8.2.6  A *firm* need not:
- (1) provide a *periodic statement*:
 - (a) to a *private customer* habitually resident outside the *United Kingdom*;
 - (b) to an *intermediate customer*, if the *firm* is not an *OPS firm*;
 - (c) to an *intermediate customer* habitually resident outside the *United Kingdom*, if the *firm* is an *OPS firm*;


if the *customer* concerned has so requested or the *firm* has taken reasonable steps to establish that he does not wish to receive it; or

- (2) provide a *periodic statement* if it would duplicate a statement to be provided by someone else.

Promptness, suitable intervals and adequate information

- 8.2.7  (1) In order to comply with ■ COB 8.2.4, a *firm*, other than an *OPS firm* conducting *OPS activity*, should take the steps set out in ■ COB 8.2.10.
- (2) Compliance with (1) may be relied on as tending to establish compliance with ■ COB 8.2.4.
 - (3) Contravention of (1) may be relied on as tending to establish contravention of ■ COB 8.2.4.

OPS firms

- 8.2.8  (1) In order to comply with ■ COB 8.2.4, an *OPS firm* conducting *OPS activity* should:
- (a) comply with ■ COB 8.2.10(1) and (2) and ■ COB 8.2.15 in all circumstances;
 - (b) comply with ■ COB 8.2.10(3)(a) and (b) if the *customer* is a *private customer*; and
 - (c) comply with ■ COB 8.2.10(3)(c) if the *customer* is an *intermediate customer* and the *firm* relies on the exception in ■ COB 8.1.6(3)

or ■ COB 8.1.6(4) from the requirement to provide confirmations.

- (2) Compliance with (1)(a) and, where applicable, (b) and (c) may be relied on as tending to establish compliance with ■ COB 8.2.4.
- (3) Contravention of (1)(a) or, where applicable, (b) or (c) may be relied on as tending to establish contravention of ■ COB 8.2.4.

Record keeping requirements

8.2.9



A *firm* must make a copy of any *periodic statement*, and retain it for three years from the date on which it was provided.

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8.2.10



Table Periodic statements – timing and content
This table belongs to ■ COB 8.2.7

/1

Periodic statements: timing and content			
Promptness	(1)	(a)	A <i>periodic statement</i> should be provided to a <i>private customer</i> within 25 <i>business days</i> after the end of the period to which the statement relates.
		(b)	A <i>periodic statement</i> should be provided to a <i>private customer</i> within 10 <i>business days</i> after the end of the period to which the statement relates if, at the end of that period, the portfolio includes any uncovered open positions in <i>contingent liability investments</i> .
		(c)	A <i>firm</i> whose sole <i>permitted activity</i> is <i>venture capital business</i> should (instead of (a) or (b)) provide a <i>periodic statement</i> to a <i>private customer</i> within 50 <i>business days</i> after the end of the period to which the statement relates.
		(d)	Any <i>periodic statement</i> provided to an <i>intermediate customer</i> should be provided within such period as the <i>intermediate customer</i> has on his own initiative agreed with the <i>firm</i> as adequate.
Suitable intervals	(2)		A <i>periodic statement</i> should be provided:
		(a)	six-monthly, to a <i>private customer</i> or an <i>intermediate customer</i> not subject to (2)(d);
		(b)	once in any other period not exceeding 12 months if the <i>private customer</i> has advised the <i>firm</i> in writing that he wishes to receive less frequent <i>periodic statements</i> than required by (a);

Periodic statements: timing and content	
Adequate information	<p>(c) monthly if the <i>customer's</i> portfolio includes an uncovered open position in a <i>contingent liability investment</i>;</p> <p>(d) at such intervals as an <i>intermediate customer</i> has on his own initiative agreed with the <i>firm</i> as adequate.</p> <p>(3) A <i>periodic statement</i> should contain:</p> <p>(a) (i) the information set out in <i>COB</i> 8.2.11E; (ii) if applicable the additional information in <i>COB</i> 8.2.12E, <i>COB</i> 8.2.13E, <i>COB</i> 8.2.14E and <i>COB</i> 8.2.15E; and (iii) if a <i>firm</i> relies upon the exceptions in <i>COB</i> 8.1.6R(3) or (4) to the requirement to provide confirmations, the information that would have been contained in confirmations complying with 8.1.3R; or</p> <p>(b) information that a <i>private customer</i> habitually resident outside the <i>United Kingdom</i>, or an <i>intermediate customer</i>, has on his own initiative agreed with the <i>firm</i> as adequate; or</p> <p>(c) in the case of an <i>OPS firm</i> subject to <i>COB</i> 8.2.8E(3):</p> <p>(i) the information that would have been contained in a confirmation complying with <i>COB</i> 8.1.3R, relating to the following classes of asset:</p> <p>(a) <i>securities</i> which are not <i>readily realisable securities</i>;</p> <p>(b) <i>derivatives</i>;</p> <p>(c) <i>warrants</i>;</p> <p>(d) land and buildings; and</p> <p>(ii) in relation to all other transactions not included in (i), a summary of the information that would have been contained in a confirmation complying with <i>COB</i> 8.1.3R; this summary should contain sufficient information about the relevant transactions to enable an <i>OPS</i> trustee to determine whether it will be necessary to obtain more detailed information about the relevant transactions. For example, the summary might disclose, for each asset class:</p> <p>(a) the number and value of transactions entered into for the portfolio;</p>

Periodic statements: timing and content				
				(b) any material portfolio changes;
				(c) whether a material number of changes were entered into in relation to a single entity and, if so, which ones;
				(d) the information required by item 11 and 12 of <i>COB</i> 8.1.15E.

8.2.11



Table Periodic statements – general information
This table belongs to ■ *COB* 8.2.10

Periodic statements: general information	
1	<p>Contents and value</p> <p>As at the end of the period covered: the number, description and value of each <i>designated investment</i> held; the amount of cash held; and the total value of the portfolio.</p>
2	<p>Basis of valuation</p> <p>A statement of the basis on which the value of each <i>designated investment</i> has been calculated and, if applicable, a statement that the basis for valuing a particular <i>designated investment</i> has changed since the previous <i>periodic statement</i>. If any <i>designated investments</i> are shown in a currency other than the usual one used for valuation of the portfolio, the relevant currency exchange rates must be shown.</p>

8.2.12



Table Periodic statements – additional information required for a discretionary managed portfolio
This table belongs to ■ *COB* 8.2.10

Periodic statements: additional information required for a discretionary managed portfolio*	
* (except OPS firms conducting OPS activity – see 8.2.15E)	
1	<p>Details of any assets loaned or charged</p> <p>A statement of which <i>investments</i> (if any) were at the closing date loaned to any third party and which <i>investments</i> (if any) were at that date charged to secure borrowings made on behalf of the portfolio; and</p> <p>the aggregate of any interest payments made and income received during the account period in respect of loans or borrowings made during that period.</p>
2	<p>Transactions and changes in composition</p> <p>Particulars of each transaction entered into for the portfolio during the period; and</p> <p>the aggregate of <i>money</i> and particulars of all <i>investments</i> transferred into and out of the portfolio during the period; and</p>

Periodic statements: additional information required for a discretionary managed portfolio*	
* (except OPS firms conducting OPS activity – see 8.2.15E)	
	the aggregate of any interest payments (and, in the case of a <i>cash deposit ISA</i> , the interest rates applied during the period of account), together with the dates of their application and dividends or other benefits received by the <i>firm</i> for the portfolio during that period. The particulars required may be disclosed in separate statements (excluding confirmations of transactions) issued to the <i>customer</i> during the period.
3	<i>Charges and remuneration</i> If not previously advised in writing: (a) a statement of the aggregate <i>charges</i> of the <i>firm</i> and its <i>associates</i> ; and (b) a statement of any <i>remuneration</i> received by the <i>firm</i> or its <i>associates</i> or both from a third party in respect of the transactions entered into, or any other services provided, for the portfolio.
4	<i>CAT standards</i> If the <i>periodic statement</i> relates to an <i>ISA</i> intended to be managed in accordance with <i>CAT standards</i> , a statement whether the relevant <i>CAT standards</i> have been adhered to throughout the period of account.

8.2.13



Table Periodic statements – additional information required for a contingent liability investment
This table belongs to ■ COB 8.2.10

Periodic statements: additional information required for a contingent liability investment	
1	<i>Changes in value</i> The aggregate of <i>money</i> transferred into and out of the portfolio during the valuation period.
2	<i>Open positions</i> In relation to each open position in the account at the end of the account period, the unrealised profit or loss to the <i>customer</i> (before deducting or adding any <i>commission</i> which would be payable on closing out).
3	<i>Closed positions</i> In relation to each transaction <i>executed</i> during the account period to <i>close out</i> a <i>customer's</i> position, the resulting profit or loss to the <i>customer</i> after deducting or adding any <i>commission</i> .
Note: Instead of the specific detail required by item 2 and 3, the statement may show the net profit or loss in respect of the <i>customer's</i> overall position in each contract.	
4	<i>Aggregate of contents</i>

Periodic statements: additional information required for a contingent liability investment

	The aggregate of each of the following in, or relating to, the <i>customer's</i> portfolio at the close of business on the valuation date:
	(a) cash;
	(b) <i>collateral</i> value;
	(c) management <i>fees</i> ; and
	(d) <i>commissions</i> attributable to transactions during the period or a statement that this information has been separately disclosed in writing in earlier statements or confirmations to the <i>customer</i> .
5	<i>Option</i> account valuations in respect of each open <i>option</i> contained in the account on the valuation date stating:
	(a) the <i>share, future, index</i> or other <i>investment</i> involved;
	(b) the trade price and date for the opening transaction, unless the valuation statement follows the statement for the period in which the <i>option</i> was opened;
	(c) the market price of the contract; and
	(d) the exercise price of the contract.
	<i>Option</i> account valuations may show an average trade price and market price in respect of an <i>option</i> series if the <i>customer</i> buys a number of contracts within the same series.

8.2.14



Table Periodic statements – additional information required for a broker fund
This table belongs to ■ COB 8.2.10

Periodic statements: additional information required for a broker fund (to the extent that the firm can reasonably be expected to obtain the information)

1	Significant holdings If any asset is worth more than 5% of the value of the fund, it must be described and its percentage in value stated.
2	Unit-linked <i>life policies</i> (except where a <i>firm</i> is managing a <i>broker fund</i> on behalf of a single <i>customer</i>) If the fund consists of unit-linked <i>life policies</i> , a comparison, over the account period and over the whole life of the fund, of the percentage change in the price of the units in the fund: (a) with the prices of units in the managed unit-linked pension fund of the <i>long-term insurer</i> (if the fund is dedicated to <i>pension policies</i>); or (b) with the prices of units in the managed unit-linked life fund of the <i>long-term insurer</i> (in any other case).
3	Price comparison Unless the <i>firm</i> is managing a <i>broker fund</i> on behalf of a single <i>customer</i> , a comparison of the price of units in the fund or <i>scheme</i> with the published index or sector average stated in the product particulars.

Periodic statements: additional information required for a broker fund (to the extent that the firm can reasonably be expected to obtain the information)

4	<p>Investment objectives and strategies</p> <p>The current investment objectives and strategies including an indication as to whether or not either of these have changed since the previous report.</p>
5	<p>Benefits and rewards</p> <p>The cash value of the benefits and rewards which the <i>broker fund adviser</i> and any <i>associate</i> have received directly or indirectly during the reporting period by way of <i>remuneration</i> which may be shown in aggregate or as applicable to each <i>customer</i> or both.</p>

8.2.15



Table Periodic statements – minimum content required where an OPS firm conducts OPS activity
This table belongs to ■ COB 8.2.10

Periodic statements: information required when an OPS firm conducts OPS activity

1	<p>Investment objectives</p> <p>A statement of any investment objectives governing the mandate of the portfolio of the <i>occupational pension scheme</i> as at the closing and starting date.</p>
2	<p>Details of any assets loaned or charged</p> <p>(a) a summary of any <i>investments</i> that were, at the closing date, lent to a third party and any <i>investments</i> that were at that date charged to secure borrowings made on behalf of the portfolio; and</p> <p>(b) the aggregate of any interest payments made and income received during the account period in respect of loans or borrowings made during that period and a comparison with the previous period.</p>
3	<p>Transactions and changes in composition</p> <p>(a) a summary of the transactions entered into for the portfolio during the period and a comparison with the previous period;</p> <p>(b) the aggregate of <i>money</i> and a summary of all <i>investments</i> transferred into and out of the portfolio during the period; and</p> <p>(c) the aggregate of any interest payments, dividends and other benefits received by the <i>firm</i> for the portfolio during that period and a comparison with the previous period.</p>
4	<p><i>Charges and remuneration</i></p> <p>If not previously advised in writing, a statement for the period of account:</p> <p>(a) of the aggregate <i>charges</i> of the <i>firm</i> and its <i>associates</i>; and</p>

Periodic statements: information required when an OPS firm conducts OPS activity	
	(b) of any <i>remuneration</i> received by the <i>firm</i> or its <i>associates</i> or both from a third party in respect of the transactions entered into, or any other services provided, for the portfolio.
5	<p>Movement in value of portfolio</p> <p>A statement of the difference between the value of the portfolio at the closing date of the period of account and its value at the starting date, having regard, during the period of account, to:</p> <p>(a) the aggregate of assets received from the <i>occupational pension scheme</i> and added to the portfolio;</p> <p>(b) the aggregate of the value of assets transferred, or of amounts paid, to the <i>customer</i>;</p> <p>(c) the aggregate income received on behalf of the <i>customer</i> in respect of the portfolio; and</p> <p>(d) the aggregate of realised and unrealised profits or gains and losses attributable to the assets comprised in the portfolio.</p>

8.2.16

G

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- (1) The items in ■ COB 8.2.15(2) and (3) should contain sufficient information about the relevant transactions to enable an *OPS* trustee to determine whether it will be necessary to obtain more detailed information about the relevant transactions.
- (2) A *firm* may wish to provide more information than is required by ■ COB 8.2.15(5), by distinguishing capital and income. If the statement includes some measure of performance, the basis of measurement should be stated.

Chapter 9

Client assets



9.1 Custody

Application

- 9.1.1** **R** ^{/1} This section (the *custody rules*) apply to a *firm* when it is *safeguarding and administering investments*, subject to **■ COB 9.1.9**.
- 9.1.2** **G** ^{/1} The *regulated activity of safeguarding and administering investments* covers both the *safeguarding and administration of assets (without arranging)* and *arranging the safeguarding and administration of assets*, when those assets are either *safe custody investments* or *custody assets*. A *safe custody investment* is, in summary, a *designated investment* that a *firm* receives or holds on behalf of a *client*. *Custody assets* include *designated investments*, and any other assets that the *firm* holds or may hold in the same portfolio as a *designated investment* held for or on behalf of the *client*.
- 9.1.3** **R** ^{/1} *Firms* must apply the *custody rules* to those *custody assets* which are not *safe custody investments* in a manner appropriate to the nature and value of those *custody assets*.
- 9.1.4** **G** ^{/1} The term '*client*' refers to a *market counterparty*, *intermediate customer* or *private customer*. However, the term '*customer*' does not include a *market counterparty*.
- 9.1.5** **G** ^{/1} In accordance with article 42 of the *Regulated Activities Order*, a *firm* will not be *arranging safeguarding and administration of assets* if it introduces a *client* to a *firm* whose *permitted activities* include the *safeguarding and administration of investments*, or to an *exempt person* acting as such, with a view to that *person*:
- (1) providing a safe custody service in the *United Kingdom*; or
 - (2) arranging for the provision of a safe custody service in the *United Kingdom* by another *person*; and the other *firm*, *exempt person* or other person who is to provide the safe custody service is not in the same *group* as, or remunerated by, the introducing *firm*.
- 9.1.6** **G** ^{/1} *Firms* are reminded that, under **■ COB 1.2.1(1)**, the *custody rules* do not apply to an *incoming EEA firm* with respect to its *passport activities*. The application of the *custody rules* to the activity of a *firm* is also dependent on the location from which the activity is undertaken (see **■ COB 1.4.3**).
- 9.1.7** **G** ^{/1} The *Home State regulator* of an *incoming EEA firm* has regulatory oversight for that *firm's* custody activities; if an *EEA firm* wishes to comply with the *custody rules* it should apply to its *Home State regulator* for permission to do so.

9.1.8 **G**_{/1} The *FSA* has regulatory oversight for a *UK firm's* custody activities in an *EEA Host State*; if a *firm* wishes to comply with an *EEA Host State's* regime for regulating custody activities it should apply to the *FSA* for a *waiver* from the *custody rules*.

9.1.9 **R**_{/1} The *custody rules* do not apply to:

- (1) a *firm* when it safeguards and administers a *designated investment* on behalf of an *affiliated company*, unless:
 - (a) the *firm* has been notified that the *designated investment* belongs to a *client* of the *affiliated company*; or
 - (b) the *affiliated company* is a *client* dealt with at arm's length;
- (2) a *firm*, when it acts as the *operator* of a *regulated collective investment scheme*, in relation to activities carried on for the purpose of, or in connection with, the operation of the *scheme*;
- (3) a *personal investment firm* when it temporarily holds a *designated investment*, other than in *bearer form*, belonging to a *client*, if the *firm*:
 - (a) keeps it secure, records it as belonging to that *client*, and forwards it to the *client* or in accordance with the *client's* instructions, as soon as practicable after receiving it;
 - (b) retains the *designated investment* for no longer than the *firm* has taken reasonable steps to determine is necessary to check for errors and to receive the final *document* in connection with any series of transactions to which the *documents* relate; and
 - (c) makes a record, which must then be retained for a period of 3 years after the record is made, of all the *designated investments* handled in accordance with (3)(a) and (b) together with the details of the *clients* concerned and of any action the *firm* has taken.

9.1.10 **G**_{/1} Administrative convenience alone should not lead a *personal investment firm* to rely on ■ COB 9.1.9(3). *Personal investment firms* should consider what is in the *client's* interest and not rely on ■ COB 9.1.9(3) as a matter of course.

9.1.11 **R**_{/1} A *firm* must accept the same level of responsibility to its *client* for any *nominee company* controlled by the *firm* in respect of any requirements of the *custody rules*.

General purpose

9.1.12 **G**_{/1} *Principle 10* (Clients' assets) requires a *firm* to arrange adequate protection for *clients'* assets when it is responsible for them. As part of these protections, the *custody rules* require a *firm* to take appropriate steps to protect *safe custody investments* for which it is responsible. The *rules* are designed primarily to restrict the commingling of *client* and *firm's* assets and minimise the risk of the *client's safe*

custody investments being used by the *firm* without the *client's* agreement or contrary to the *client's* wishes, or being treated as the *firm's* assets in the event of its insolvency.

Delivery versus payment transactions

9.1.13 **R** *A designated investment need not be treated as a safe custody investment* in respect of a delivery versus payment transaction through a commercial settlement system if it is intended that the *designated investment* is either to be:

- (1) in respect of a *client's* purchase, due to the *client* within one *business day* following the *client's* fulfilment of a payment obligation; or
- (2) in respect of a *client's* sale, due to the *firm* within one *business day* following the fulfilment of a payment obligation;

unless the delivery or payment by the *firm* does not occur by the close of business on the third *business day* following the date of payment or delivery of the *designated investment* by the *client*.

9.1.14 **R** Until a transaction of the type described in **COB 9.1.13** settles, a *firm* may segregate *money* (in accordance with the *client money rules*) instead of the *client's safe custody investment*.

Modification of scope

9.1.15 **G** It is not necessary to apply the full range of the *custody rules* to all types of *firm*. For example, certain *firms* already have extensive obligations imposed on them under the general law with regard to the correct treatment of *client's safe custody investments*. Likewise the full range of the *rules* is not appropriate for a *firm* that only arranges safe custody services for its *clients*. Consequently, the *rules* provide for appropriate differentiation of scope and application of the *rules*.

Trustees and depositaries

9.1.16 **R** When a *trustee firm* or *depository* acts as a *custodian* for a trust or *collective investment scheme* and

- (1) the trust or *scheme* is established by written instrument; and
- (2) the *trustee firm* or *depository* has taken reasonable steps to determine that the relevant law and provisions of the trust instrument or *scheme* constitution will provide protections at least equivalent to the *custody rules* for the trust property or *scheme* property,

the *trustee firm* or *depository* need comply only with the *custody rules* listed in ■ COB 9.1.18.

9.1.17 **G** /1 The reasonable steps referred in ■ COB 9.1.16(2) could include obtaining an appropriate legal opinion to that effect.

9.1.18 **R** /1 Table This table belongs to ■ COB 9.1.16.

Reference	Rule
<i>COB 9.1.1R to 9.1.12G</i>	Application
<i>COB 9.1.16R to 9.1.20G</i>	Trustees and depositories
<i>COB 9.1.28R to 9.1.32R</i>	Segregation
<i>COB 9.1.35R to 9.1.37G</i>	Registration and recording
<i>COB 9.1.40R(2), 9.1.41G and 9.1.42R</i>	Holding
<i>COB 9.1.74R to 9.1.80R</i>	Stocklending
<i>COB 9.1.85R to 9.1.97R</i>	Reconciliation
<i>COB 9.1.98R and 9.1.99R</i>	Records

9.1.19 **R** /1 When a *trustee firm* or *depository* within COB ■ COB 9.1.16 arranges for or delegates the provision of safe custody services by or to another *person*, the *trustee firm* or *depository* must also comply with ■ COB 9.1.43, ■ COB 9.1.48 (Assessment of a custodian), ■ COB 9.1.54 (Risk disclosure) and ■ COB 9.1.69 (Custodian agreement) in addition to the *custody rules* listed in ■ COB 9.1.18.

9.1.20 **G** /1 A *trustee firm* or *depository* that just arranges safeguarding and administration of assets may also take advantage of the exemption in ■ COB 9.1.21R (Arrangers).

Arrangers

9.1.21 **R** /1 Only the *custody rules* in ■ COB 9.1.22 apply to a *firm* when *arranging safeguarding and administration of assets*.

9.1.22 **R** /1 Table This table belongs to ■ COB 9.1.21.

Reference	Rule
<i>COB 9.1.1R to 9.1.12G</i>	Application
<i>COB 9.1.21R to 9.1.22R</i>	Arrangers
<i>COB 9.1.43R, 9.1.46 to 9.1.47G</i>	Assessment of custodian
<i>COB 9.1.54R to 9.1.56G</i>	Risk disclosures
<i>COB 9.1.98R</i>	Records

Depository receipt business

9.1.23 **G**
/1 For *firms* that issue depository receipts, the underlying *security* is held for the benefit of the depository receipt holder. *Clients* for whom depository receipts are held will be known to the *firm* and will have the necessary agreements in place. However, other *persons* who purchase depository receipts in the secondary market will not be known to the *firm* until after they become *clients*. Consequently, *firms* that issue depository receipts will accordingly not be able to comply with certain *custody rules*.

9.1.24 **R**
/1 *Firms* that hold *securities*, which are represented by depository receipts or *documents* which have the characteristics of depository receipts and these receipts or *documents* entitle the holders to all dividends and other rights given by the underlying *securities* held by the *firm*, need not comply with the *rules* listed in **■ COB 9.1.25** in respect of *clients* who acquire the depository receipts in the secondary market:

9.1.25 **R**
/1 Table This table belongs to **■ COB 9.1.24**.

Reference	Rule
COB 9.1.33R	Segregation
COB 9.1.48R	Assessment of custodian
COB 9.1.49R to 9.1.52R	Client agreement
COB 9.1.54R to 9.1.56G	Risk disclosures
COB 9.1.59R to 9.1.63R	Production and despatch of statements
COB 9.1.64R to 9.1.68R	Content of client statements

9.1.26 **R**
/1 When a *firm* arranges *safeguarding and administration of assets* in respect of depository receipts, it need not comply with **■ COB 9.1.54** (risk disclosures) for that business.

Segregation: purpose

9.1.27 **G**
/1 The *rules* governing the segregation, registration or recording, and holding of a *client's safe custody investments* require a clear distinction to be maintained, to the extent practicable, between *safe custody investments* held for the *clients* and those *designated investments* held for the *firm*.

General

9.1.28 **R**
/1 A *firm* must segregate *safe custody investments* from its own *designated investments* except to the extent required by law or permitted by the *custody rules*.

9.1.29 **G**
/1 A *firm* which is a *trustee* is bound in relation to *safe custody investments* by the terms of its trust and applicable law and **■ COB 9.1.28** does not modify those obligations.

9.1.30 **R** ^{/1} A *firm* must ensure that if a *safe custody investment* is recorded in an account with itself, the title of that account makes it clear that the *safe custody investment* belongs to a *client*, and is segregated from the *firm's designated investments*.

9.1.31 **G** ^{/1} ■ COB 9.1.30 refers to the *firm's* own records.

9.1.32 **R** ^{/1} A *firm* must require that if a *safe custody investment* is recorded in an account with a *custodian*, the *custodian* makes it clear in the title of the account that the *safe custody investment* belongs to one or more *clients* of the *firm*.

Affiliated companies

9.1.33 **R** ^{/1} If a *firm* holds a *designated investment* on behalf of an *affiliated company*, it must not hold that *designated investment* in the same account as a *safe custody investment* (of a *client* who is not an *affiliated company*) unless ■ COB 9.1.9(1) (Application) applies, and consequently, the *firm* is applying the *custody rules* to that *investment*.

Registration and recording: purpose

9.1.34 **G** ^{/1} The registration and recording *rules* are designed to safeguard and secure a *client's* entitlement. The *rules* are not in order of priority and *firms* are expected to register and record the legal title of a *safe custody investment* in such a manner as to provide the *client* with appropriate protection.

9.1.35 **R** ^{/1} To the extent practicable, a *firm* must effect appropriate registration or recording of legal title to a *safe custody investment* in the name of:

- (1) the *client* (or where appropriate, the *trustee firm*), unless the *client* is an *authorised person* acting on behalf of its *client*, in which case it may be registered in the name of the *client* of that *authorised person*;
- (2) a *nominee company* which is controlled by:
 - (a) the *firm*;
 - (b) an *affiliated company*;
 - (c) a *recognised investment exchange* or *designated investment exchange*;
 - (d) a *custodian*;
- (3) a *custodian* if:

- (a) the *safe custody investment* is subject to the law or market practice of a jurisdiction outside the *United Kingdom* and the *firm* has taken reasonable steps to determine that it is in the *client's* best interests to register or record it in that way, or that it is not feasible to do otherwise, because of the nature of the applicable law or market practice; and
 - (b) the *firm* has notified the *client* in writing;
- (4) the *firm* if:
- (a) the *safe custody investment* is subject to the law or market practice of a jurisdiction outside the *United Kingdom* and the *firm* has taken reasonable steps to determine that it is in the *client's* best interests to register or record it in that way, or that it is not feasible to do otherwise, because of the nature of the applicable law or market practice; and
 - (b) the *firm* has notified the *client* in accordance with ■ COB 9.1.57 (Risk disclosures) if a *market counterparty* or an *intermediate customer*, or obtained his prior written consent if a *private customer*; or
- (5) any other *person*, in accordance with the *client's* specific written instruction, provided:
- (a) the *firm* complies with ■ COB 9.1.58 (Risk disclosures); and
 - (b) in the case of a *private customer*, the other *person* is not an *associate* of the *firm*.

9.1.36

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If the *client* in ■ COB 9.1.35(1) is an *authorised person* and the *safe custody investments* belong to *clients* of that *authorised person*, it is the responsibility of that *authorised person* to ensure that the registering or recording is appropriate for the *client* concerned.

9.1.37

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A *firm* that applies ■ COB 9.1.35(3) or (4) will be expected to demonstrate that adequate investigations have been made of the market concerned by reference to local sources which may include appropriate legal opinion.

9.1.38

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A *firm* may register or record legal title to its own *designated investment* in the same name as that in which legal title to a *safe custody investment* is registered or recorded, but only if:

- (1) the *firm's designated investments* are separately identified in the *firm's* records from *safe custody investments*; or
- (2) the *firm* registers or records a *safe custody investment* in accordance with ■ COB 9.1.35(4).

Holding: purpose

- 9.1.39** **G**_{/1} The following *rules* are designed to provide an appropriate level of protection for a *safe custody investment* which the *firm* physically holds. A *firm* should ensure that the arrangements for holding any document of title to a *safe custody investment* are appropriate to the value and risk of loss of the *safe custody investments* concerned, and that there are adequate controls designed to safeguard it from damage, misappropriation or other loss.
- 9.1.40** **R**_{/1} A *firm* must hold any document of title to a *safe custody investment* either in the physical possession of the *firm* or:
- (1) for a *private customer*, with a *custodian* in an account designated for *clients' safe custody investments*;
 - (2) for a *market counterparty* or *intermediate customer*, with one or more of the following:
 - (a) a *custodian* in an account designated for *clients' safe custody investments*;
 - (b) any *person* whom the *firm* has taken reasonable steps to determine is a *person* whose business includes the provision of appropriate safe custody services; or
 - (c) subject to **■ COB 9.1.58** (Risk disclosures) in accordance with the *market counterparty's* or *intermediate customer's* specific written instructions.
- 9.1.41** **G**_{/1} In **■ COB 9.1.40** 'reasonable steps' may include on the basis of an appropriate legal opinion obtained by the *firm* or another *person*.
- 9.1.42** **R**_{/1} A *firm* must ensure that any documents of title to *designated investments in bearer form*, belonging to the *firm* and which it holds in its physical possession, are kept separately from any document of title to a *client's safe custody investment in bearer form*.

Assessment of a custodian

- 9.1.43** **R**_{/1} Before a *firm* holds a *safe custody investment* with a *custodian* or arranges registration of a *safe custody investment* through a *custodian*, it must undertake an appropriate risk assessment of that *custodian*.
- 9.1.44** **R**_{/1} Before a *firm* recommends a *custodian* to a *private customer*, it must undertake an appropriate risk assessment of that *custodian*.
- 9.1.45** **G**_{/1} A *firm* that holds *safe custody investments* with a *custodian* or recommends *custodians* to *private customers*, is expected to establish and maintain a system for assessing the appropriateness of its selection of the *custodian* and to assess the continued appointment of that *custodian* periodically as often as is reasonable in the relevant market. In order to comply with **■ SYSC 3.2.20**(Records), the *firm* is

also expected to make and retain a record of the grounds on which it satisfies itself as to the appropriateness of its selection or, following a periodic assessment, continued appropriateness of the *custodian*.

9.1.46

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In undertaking an appropriate risk assessment of the *custodian* in accordance with ■ COB 9.1.43 and ■ COB 9.1.44, *firms* might take into account any or all of the following matters:

- (1) the expertise and market reputation of the *custodian*, and, once a *safe custody investment* has been lodged by the *firm* with the *custodian*, the *custodian's* performance of its services to the *firm*;
- (2) the arrangements for holding and safeguarding an *investment*;
- (3) an appropriate legal opinion as to the protection of *custody assets* in the event of the insolvency of the *custodian*;
- (4) current industry standard reports, for example Financial reporting and auditing group (FRAG) 21 report or its equivalent;
- (5) whether the *custodian* is regulated and by whom;
- (6) the capital or financial resources of the *custodian*;
- (7) the credit rating of the *custodian*;
- (8) any other activities undertaken by the *custodian* and, if relevant, any *affiliated company*.

9.1.47

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In undertaking the risk assessment of a *custodian*, a *firm* should have regard to all relevant circumstances including legal requirements and custodial practices, in the relevant jurisdiction. For example, if the legal requirements of a jurisdiction in which the *firm* proposes to hold a *safe custody investment* with a *custodian*, makes it mandatory to use a particular *custodian* for that purpose, then the *FSA* will regard this fact alone as justifying the use of that *custodian*. If the use of that *custodian* is a matter of custodial practice in that jurisdiction, the *custodian* is likely to be appropriate for that purpose subject to the *firm* checking whether following that practice is appropriate for the *client's* purposes. In both circumstances, the *firm* will still be under a duty to ensure the continued appropriateness of the *custodian*, taking account of the current legal requirements and custodial practice of that jurisdiction.

9.1.48

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Before a *firm* holds a *custody asset* with a *custodian* which is in the same *group* as the *firm*, it must inform the *client* in writing that it intends to do so.

Client agreement

9.1.49

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Before a *firm* provides safe custody services to a *client*, unless ■ COB 9.1.52 applies, the *firm* must notify the *client* as to the appropriate terms and conditions which apply to this service, including, where applicable, those covering:

- (1) registration of the *safe custody investments* if these will not be registered in the *client's* name;

- (2) the extent of the *firm's* liability in the event of a default by a *custodian*, except that a *firm* must accept the same level of responsibility to its *client* for any *nominee company* controlled by the *firm* or by its *affiliated company* as for itself and may not disclaim responsibility for losses arising directly from the fraud, wilful default or negligence of the *firm*;
- (3) the circumstances in which the *firm* may realise a *safe custody investment* held as *collateral* to meet the *client's* liabilities (see ■ COB 7.8) (Realisation of a private customer's assets).
- (4) claiming and receiving dividends, interest payments and other entitlements accruing to the *client*;
- (5) dealing with takeovers, other offers or capital reorganisations and exercising voting, conversion and subscription rights;
- (6) arrangements for the distribution of entitlements to *shares* and any other benefits arising from corporate events, where *clients'* balances have been pooled;
- (7) arrangements for the provision of information to the *client* relating to the *safe custody investment* which the *firm*, or its *nominee company*, holds on behalf of the *client*;
- (8) how often a statement of *custody assets* will be sent to the *client* and the basis on which assets shown on the statement are valued;
- (9) fees and costs for safe custody services to the extent that they are not notified to the *client* elsewhere; and
- (10) if the *firm* intends to pool a *safe custody investment* with that of one or more other *clients*, notification of its intention to the *market counterparty* or *intermediate customer* and if the *client* is a *private customer*, an explanation of the effects of pooling to that *private customer*.

9.1.50

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When explaining the meaning of pooling to a *private customer*, *firms* are expected to advise the *private customer* that:

- (1) individual entitlements may not be identifiable by separate certificates, other physical *documents* or equivalent electronic record; and
- (2) in the event of an unreconcilable shortfall after the *failure* of a *custodian*, *clients* may share in that shortfall in proportion to their original share of the assets in the pool.

9.1.51

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Unless ■ COB 9.1.52 or ■ COB 9.1.53 applies, the *firm* must obtain the written agreement of a *private customer*, or notify a *market counterparty* or an *intermediate customer*, as to:

- (1) the arrangements for the giving and receiving of instructions by or on behalf of the *client* in respect of the safe custody service which

is to be provided, including, if applicable, the arrangements for the giving of authority by the *client* to another *person* and the extent of that authority and any limitation on it; and

- (2) any lien or security interest taken over a *safe custody investment* by the *firm* or a third party, except in respect of any charges relating to the administration or safekeeping of the *safe custody investments*;

9.1.52 **R** ^{/1} A *firm* need not obtain the written agreement or give notice as required by ■ COB 9.1.51, or give notice to a *client* in accordance with ■ COB 9.1.49, if the *firm* has no intention of providing a safe custody service to the *client* but unintentionally holds a *safe custody investment* for the *client* as a result of circumstances that could not reasonably have been foreseen by the *firm*.

9.1.53 **R** ^{/1} A *firm* need not obtain the written agreement of a *private customer*, or give notice to a *market counterparty* or an *intermediate customer*, as required by ■ COB 9.1.51 if:

- (1) the *client* is ordinarily resident outside the *United Kingdom*;
- (2) the *firm* has taken reasonable steps to determine that the *client* does not wish to execute that agreement; and
- (3) the *firm* makes and retains a record of those steps and their results.

Risk disclosures

9.1.54 **R** ^{/1} Before holding or arranging for another *person* or *firm* to hold a *customer's safe custody investment* overseas, a *firm* must notify the *customer* in writing that there may be different settlement, legal and regulatory requirements in overseas jurisdictions from those applying in the *United Kingdom*, or such jurisdiction as is appropriate in the circumstances, and that there may be different practices for the separate identification of *safe custody investments*.

9.1.55 **G** ^{/1} The term "*customer*" does not include a *market counterparty*.

9.1.56 **G** ^{/1} It is intended that the application of ■ COB 9.1.54 be appropriate to the circumstance, so for example, a European *branch* of a *UK firm* which provides services to *customers* in the country where the *branch* is located may adapt the risk disclosure required by ■ COB 9.1.54 to suit the particular circumstances applicable to that *branch* and *customer*.

9.1.57 **R** ^{/1} Before a *firm* registers or records legal title to a *safe custody investment* in the name of the *firm*, it must notify the *client* if a *market counterparty* or an *intermediate customer*, and obtain his prior written consent if the *client* is a *private customer*, that:

- (1) the *safe custody investment* will or may be registered or recorded in the *firm's* name;
- (2) as a result the *safe custody investment* may not be segregated from the *designated investments* of the *firm*; and
- (3) in the event of the *failure* of the *firm*, the *client's* assets may not be as well protected from claims made on behalf of the general creditors of the *firm*.

9.1.58 **R** /1 If a *client* has instructed the *firm* on the holding, registration or recording of a *safe custody investment* under ■ COB 9.1.35(5) (Registration and recording) or ■ COB 9.1.40(2)(c) (Holding) the *firm* must notify the *client* that the consequences of doing so are at the *client's* own risk, unless the *firm* has agreed otherwise.

Production and despatch of client statements

9.1.59 **R** /1 A *firm* must, as often as necessary or as often as agreed with its *client*, but in any event not less frequently than annually, provide to each *client*, or to a representative nominated by the *client* in writing, a statement prepared in accordance with ■ COB 9.1.64 (Content of client statements) unless:

- (1) the account of a *client* for whom a *custody asset* has been held at any time during the *firm's* financial year has been closed; and
- (2) the *firm* has sent the *client* a closing statement which shows that the *firm* no longer holds any *custody asset* for the *client*.

9.1.60 **R** /1 Statements must be provided in accordance with ■ COB 9.1.59 within 25 *business days* of the date as at which the statement is made.

9.1.61 **R** /1 A *firm* may, with the *client's* prior written agreement, retain statements required to be sent to a *client* who is ordinarily resident outside the *United Kingdom*.

9.1.62 **G** /1 The statements referred to in ■ COB 9.1.61 may be retained either electronically or in hard copy. Wherever possible responsibility within a *firm* for such statements should be given to an *employee* or department not otherwise involved with that *client*.

9.1.63 **R** /1 If a *firm* provides a range of safe custody services for a *private customer* which result in statements being generated from more than one system, it must ensure that all the statements in respect of those services are produced as at the same date and despatched within one week of each other, unless each statement makes clear that it relates to a particular service.

Content of client statements

- 9.1.64** **R** ^{/1} All statements produced by or on behalf of a *firm* in accordance with ■ COB 9.1.59 - ■ COB 9.1.61 and ■ COB 9.1.63, must list all *custody assets* held for the *client* for which the *firm* is accountable and:
- (1) identify any *safe custody investment* registered in the *client's* own name separately from those registered in any other name;
 - (2) identify any *custody assets* which are being used as *collateral* or have been pledged to third parties, separately from any other *custody assets*;
 - (3) show the *market value* of any *collateral* held, as at the date of the statement; and
 - (4) for a *private customer*, base the statement on either trade date or settlement date information for cash balances and *safe custody investments* and notify the basis to the *private customer*.
- 9.1.65** **R** ^{/1} A *firm* may include the information required by ■ COB 9.1.64 in any statement provided by the *firm* to the *client* in accordance with ■ COB 8.2 (Periodic statements), or by other separate *documents*, as long as they are prepared in relation to the same date and delivered to the *client* within a reasonable period of one another.
- 9.1.66** **R** ^{/1} A statement under ■ COB 9.1.64 must include *client money* unless this has been included in a statement separately despatched to the *client* within one month before or after the statement date.
- 9.1.67** **G** ^{/1} ■ COB 9.1.66 refers to the *client money* balance as at the statement date for each *client*.
- 9.1.68** **R** ^{/1} A *safe custody investment* need not be included in a statement if a *client* transaction has been carried out within the previous three months and the *firm* does not intend to offer a safe custody service in relation to the *safe custody investment*.

Custodian agreement

- 9.1.69** **R** ^{/1} Before a *firm* holds a *safe custody investment* for or on behalf of a *client* with a *custodian*, it must agree in writing appropriate terms and conditions with the *custodian*, including, where applicable:
- (1) that the title of the account indicates that any *safe custody investment* credited to it does not belong to the *firm* or to an *affiliated company* that is not being treated as an arm's length *client* in accordance with ■ COB 9.1.9(1)(b) (Application));
 - (2) that the *custodian* will hold or record a *safe custody investment* belonging to the *firm's client* (or where the *firm* is a *trustee firm*,

the trustees), separately from any *designated investment* belonging to the *firm* or to the *custodian*;

- (3) that the *custodian* will deliver to the *firm* a statement as at a date or dates specified by the *firm* which details the description and amounts of all the *safe custody investments* credited to the account;
- (4) that the *custodian* will not claim any lien, right of retention or sale over any *safe custody investment* standing to the credit of any account set up in accordance with (1) except:
 - (a) where the *firm* has notified the *custodian* in writing that the *client* has provided written consent; or
 - (b) in respect of any charges relating to the administration or safekeeping of the *safe custody investment*;
- (5) the arrangements for registration or recording of the *safe custody investment* if this will not be registered in the *client's* name;
- (6) that the *custodian* is not to permit withdrawal of any *safe custody investment* from the account except for delivery to the *firm* or on the *firm's* instructions;
- (7) the procedures and authorities for the passing of instructions to or by the *firm*;
- (8) the claiming and receiving of dividends, interest payments and other entitlements accruing to the *client*; and
- (9) the extent of the *custodian's* liability in the event of the loss of a *safe custody investment* caused by the fraud, wilful default or negligence of the *custodian*, or an agent appointed by him.

9.1.70

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Firms should seek to ensure that *custodians* deliver the statement referred to in ■ COB 9.1.69(3) to the *firm* within 20 *business days* of the date of the statement.

9.1.71

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Firms need not include in the custodian agreement, any of the provisions set out in ■ COB 9.1.69 if, for example, the *firm* or *custodian* is unable to comply with the provision on account of legal requirements or custodial practice imposed on or by a securities depository or clearance system.

Use of a safe custody investment: by the firm

9.1.72

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A *firm* must not use a *safe custody investment* for its own account unless the *client*:

- (1) if a *private customer*, has given prior written consent to the *firm*;
or

- (2) if an *intermediate customer* or *market counterparty*, has been notified by the *firm*.

Use of a safe custody investment: by another client

- 9.1.73** **R** ^{/1} A *firm* must not use, for the account of one *client*, the *safe custody investment* of any other *customer*, unless that other *customer*:
- (1) if a *private customer*, has given prior written consent to the *firm*;
or
- (2) if an *intermediate customer*, has been notified by the *firm*.

Stock lending

- 9.1.74** **R** ^{/1} A *firm* must not undertake or otherwise engage in *stock lending activity* with or for a *customer* unless:
- (1) the *firm* has obtained the consent of the *customer*; and
- (2) the *stock lending activity* is subject to appropriate terms and conditions.
- 9.1.75** **E** ^{/1} (1) In the case of a *private customer*, the appropriate terms and conditions referred to in **■ COB 9.1.74(2)** include those specified in **■ COB 4.2.15(19)** (Content of terms of business provided to a customer: stock lending).
- (2) Compliance with (1) may be relied upon as tending to establish compliance with **■ COB 9.1.74(2)**.
- (3) Contravention of (1) may be relied upon as tending to establish contravention of with **■ COB 9.1.74(2)**.
- 9.1.76** **G** ^{/1} *Firms* are reminded that the term "*customer*" does not include *market counterparty*.
- 9.1.77** **G** ^{/1} To the extent that specific instructions are given by the *customer*, they are an important factor in assessing what terms and conditions are appropriate and should, in the absence of a reason not to do so, normally be followed. The specific requirements of the markets in which the lending takes place are another factor to be considered when assessing what terms and conditions are appropriate.
- 9.1.78** **R** ^{/1} If a *safe custody investment* belonging to a *private customer* is used for *stock lending activity*, the *firm* must ensure that:
- (1) *relevant collateral* is provided by the borrower in favour of the *customer*;

- (2) the current realisable value of the *safe custody investment* and of the *relevant collateral* is monitored daily; and
- (3) the *firm* provides *relevant collateral* to make up the difference where the current realisable value of the collateral falls below that of the *safe custody investment*, unless otherwise agreed in writing by the *customer*.

9.1.79

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If *safe custody investments* of more than one *customer* are registered or otherwise held together, none of those *safe custody investments* may be used for a *stock lending activity* unless:

- (1) all of those *customers* have consented to their *safe custody investments* being used for that activity; or
- (2) the *firm* has adequate systems and procedures in place to ensure that only *safe custody investments* belonging to *customers* who have given their consent are used for *stock lending activity*.

9.1.80

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Any cash or *custody assets* held in favour of a *customer* for *stock lending activity* must be held in accordance with the *client money rules* or *custody rules*.

9.1.81

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The *stock lending* requirements in ■ COB 4.2.15(19) also apply to *safe custody investments* held collectively on behalf of a *firm's customers* in any *custody* or settlement system. If the *custody* or settlement system operates an 'automatic' *stock lending* programme, the *firm* should maintain a separate account or be able to demonstrate that it maintains adequate systems to differentiate between the *safe custody investments* of those *customers* who have not consented to *stock lending activity* through that programme from the *designated investments* of those that have consented.

9.1.82

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A *firm* is expected to have documentation in place with borrowing *counterparties* which is adequate and appropriate having regard to the *customers* whose *safe custody investments* are being lent. The terms and conditions of lending should be appropriate to the markets in which lending takes place (for example by reference to the Stock lending and Repo Committee's Stock Borrowing and Lending Code of Guidance), and to the other circumstances of the transaction, in particular, the various types of risk involved in the transaction.

9.1.83

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If a borrower is required to provide collateral (for example, to protect against settlement risk), the *firm* should consider whether it is appropriate to require this collateral be provided in advance of the *stock lending activity*. When making this decision the *firm* should consider all the circumstances of the transaction, including normal practice in the relevant market. The level and type of collateral required should take account of the credit-worthiness of the borrower and the market risks associated with the particular collateral.

9.1.84

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Firms are reminded that dividends (actual or payments in lieu), *stock lending* fees and other payments received for the benefit of a *customer*, belong to the *customer* and should be held in accordance with the *client money rules* or *custody rules* as appropriate.

Reconciliation: frequency of reconciliation

- 9.1.85** **R**_{/1} A *firm* must, as often as is necessary, but no less than every 25 *business days*, perform a reconciliation of its record of *safe custody investments* for which it is accountable but which it does not physically hold, with statements obtained from *custodians*, and in the case of dematerialised *safe custody investments* not held through a *custodian*, statements obtained from the *person* who maintains the record of legal entitlement.
- 9.1.86** **G**_{/1} Information about *client* holdings obtained from, for example *CREST*, in respect of dematerialised *safe custody investments* may be used to comply with **■ COB 9.1.85**.
- 9.1.87** **R**_{/1} If a *firm* is unable to obtain no less than every 25 *business days*, statements of *clients*' entitlement from *unit trust managers*, *operators* of *ICVCs* or administrators of offshore mutual funds, it need perform a reconciliation of the *client's unit trusts*, *ICVCs* and offshore mutual funds holdings only as often as the statements are received but no less than every 6 months.
- 9.1.88** **G**_{/1} When a *firm* relies on **■ COB 9.1.87** the *FSA* will still expect the *firm* to make reasonable efforts to obtain statements on a monthly basis.
- 9.1.89** **R**_{/1} A *firm* must, as often as is necessary, but no less than every 6 months (or twice in a period of 12 months but at least 5 months apart), carry out:
- (1) a count of all *safe custody investments* it physically holds on behalf of *clients* and reconcile the result of that count with its record of *safe custody investments* that it physically holds on behalf of its *clients*; and
 - (2) a reconciliation between the *firm's* record of *client* holdings, and the *firm's* record of the location of *safe custody investments*.
- 9.1.90** **G**_{/1} Whenever possible, a *firm* should ensure that reconciliations are carried out by a *person* (for example an *employee* of the *firm*) who is independent of the production or maintenance of the records to be reconciled.
- 9.1.91** **R**_{/1} A *firm* must perform the reconciliation in **■ COB 9.1.89** as soon as reasonably practicable after the date to which the reconciliation relates.
- 9.1.92** **G**_{/1} *Firms* will normally be expected to perform the reconciliation in **■ COB 9.1.89** within 25 *business days* of the date to which the statements relate.

Reconciliation methods

- 9.1.93** **R**_{/1} The reconciliation referred to in **■ COB 9.1.89** must cover all *safe custody investments* recorded in the *firm's* books and records and those of any *nominee company* which the *firm* uses for the provision

of safe custody services and is controlled by the *firm* or by an *affiliated company*, and must be performed by:

- (1) the ‘total count method’, which requires that all *safe custody investments* be counted and reconciled as at the same date; or
- (2) an alternative reconciliation method (for example the rolling stock method) provided that:
 - (a) all of a particular *safe custody investment* are counted and reconciled as at the same date;
 - (b) all *safe custody investments* are counted and reconciled during a period of six months; and
 - (c) written confirmation is given to the *FSA* from the *firm’s* auditor that the *firm* has in place systems and controls which enable it to adequately perform the alternative method of reconciliation which the *firm* proposes to use.

Reconciliation discrepancies

9.1.94 **R** A *firm* must promptly correct any discrepancies which are revealed, and make good, or provide the equivalent of, any unreconciled shortfall for which there are reasonable grounds for concluding that the *firm* is responsible.

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9.1.95 **G** Items recorded or held within a suspense or error account fall within the scope of discrepancies.

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9.1.96 **G** A *firm* may, where justified, conclude that another *person* is responsible for an irreconcilable shortfall despite the existence of a dispute with that other *person* about the unreconciled item. In those circumstances, the *firm* is not required to make good the shortfall but is expected to take reasonable steps to resolve the position with the other *person*.

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Notification requirement

9.1.97 **R** A *firm* must inform the *FSA* in writing without delay:

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- (1) if it has not complied with, or is unable, in any material respect, to comply with the reconciliation requirements in ■ COB 9.1.85, ■ COB 9.1.87, ■ COB 9.1.89, ■ COB 9.1.91 and ■ COB 9.1.93; or
- (2) if having carried out a reconciliation it is unable, in any material respect, to comply with ■ COB 9.1.94.

Records

9.1.98

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A *firm* must ensure that proper records of the *custody assets* which it holds or receives, or arranges for another to hold or receive, on behalf of the *client*, are made and retained for a period of 3 years after they are made.

9.1.99

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A *firm* that uses a *safe custody investment* in *stock lending activity* must ensure that its records identify which *safe custody investments* are available to be lent, and which have been lent.



9.2 Mandates

Application

9.2.1 **R** ^{/1} This section applies to a *firm* in respect of any written authority from a *client* under which the *firm* may control a *client's* assets or liabilities in the course of, or in connection with, the *firm's designated investment business*.

9.2.2 **G** ^{/1} Mandates or similar authorities for the purpose of **■ COB 9.2.1** include a *firm's* authority over a *client's* safe custody account, for example for *stock lending* purposes, a *firm's* authority over a *client's* bank or building society account including direct debits in favour of the *firm*, and a *firm* holding a *client's* credit card details.

9.2.3 **G** ^{/1} *Firms* are reminded that, under **■ COB 1.2.1(1)**, the *mandate rules* do not apply to an *incoming EEA firm* with respect to its *passport activities*. The application of the *mandate rules* is also dependent on the location from which the activity is undertaken (see **■ COB 1.4.3**).

Purpose

9.2.4 **G** ^{/1} The *mandate rules* apply to those *firms* that control, rather than hold, *clients'* assets or are able to create liabilities in the name of a *client*. These *rules* seek to ensure that *firms* establish and maintain records and internal controls to prevent the misuse of the authority granted by the *client*.

General

9.2.5 **R** ^{/1} A *firm* that holds authorities of the sort referred to in **■ COB 9.2.1**, must establish and maintain adequate records and internal controls in respect of its use of the mandates, which must include:

- (1) an up-to-date list of the authorities and any conditions placed by the *client* or the *firm's* management on the use of them;
- (2) a record of all transactions entered into using the authority and internal controls to ensure that they are within the scope of

authority of the *person* and the *firm* entering into the transaction;
and

- (3) the details of the procedures and authorities for the giving and receiving of instructions under the authority; and
- (4) where the *firm* holds a passbook or similar *documents* belonging to the *client*, internal controls, for the safeguarding (including against loss, unauthorised destruction, theft, fraud or misuse) of any passbook or similar *document* belonging to the *client* held by the *firm*.

9.3 Client money

Application

- 9.3.1** **R** _{/1} This section (the *client money rules*) applies to a *firm* that receives or holds *money* from, or on behalf of, a *client* in the course of, or in connection with, its *designated investment business*, except where ■ COB 9.3.2 otherwise provides.
- 9.3.2** **R** _{/1} The *client money rules* do not apply with respect to:
- (1) the *permitted activities* of a *life office* or a *friendly society*; or
 - (2) coins held on behalf of a *client* if the *firm* and the *client* have agreed that the *money* (or *money* of that type) is to be held by the *firm* for the intrinsic value of the metal which constitutes the coin; or
 - (3) *money* held by a *firm* which is an *approved bank*, but only when held in an account with itself, in which case the *firm* must notify the *client* in writing that:
 - (a) *money* held for that *client* in an account with the *approved bank* will be held by the *firm* as banker and not as trustee (or in Scotland as agent); and
 - (b) as a result, the *money* will not be held in accordance with the *client money rules*; or
 - (4) *money* held by *depositories* which are regulated by ■ COB 11.
- 9.3.3** **G** _{/1} *Firms* are reminded that, under ■ COB 1.2.1(1), the *client money rules* do not apply to an *incoming EEA firm* with respect to its *passported activities*. The application of the *client money rules* to the activity of a *firm* is also dependent on the location from which the activity is undertaken (see ■ COB 1.4.3).
- 9.3.4** **G** _{/1} The *custody rules* will apply when a *firm* holds, for example, gold coins on behalf of the *client* in accordance with ■ COB 9.3.2(2) in the same portfolio as *safe custody investments*.
- 9.3.5** **G** _{/1} A *firm* that is an *approved bank*, and relies on the exemption under ■ COB 9.3.2(3), should be able to account to all of its *clients* for amounts held on their behalf at all times. A bank account opened with the *firm* that is in the name of the *client* would

generally be sufficient. When *money* from *clients* deposited with the *firm* is held in a pooled account, this account should be clearly identified as an account for *clients*. The *firm* should also be able to demonstrate that an amount owed to a specific *client* that is held within the pool can be reconciled with a record showing that individual's *client* balance and is, therefore, identifiable at any time. Similarly, where that *money* is reflected only in a *firm's* bank account with other banks (nostro accounts), the *firm* should be able to reconcile amounts owed to that *client* within a reasonable period of time.

- 9.3.6 **G**_{/1} A *firm* that is an *approved bank* is reminded that ■ COB 9.3.2(3) is not an absolute exemption from the *client money rules*.

General purpose

- 9.3.7 **G**_{/1} *Principle 10* (Clients' assets) requires a *firm* to arrange adequate protection for *clients'* assets when the *firm* is responsible for them. An essential part of that protection is the proper accounting and handling of *client money*. The *client money rules* provide requirements for *firms* that receive or hold *client money*, in whatever form.

Money that is not client money: 'opt outs' for any business (including ISD business)

- 9.3.8 **G**_{/1} The 'opt out' provisions provide a *firm* with the option of allowing an *intermediate customer* or *market counterparty* to choose whether their *money* is subject to the *client money rules*.

- 9.3.9 **R**_{/1} Subject to ■ COB 9.3.11, *money* is not *client money* when a *firm* (other than a *sole trader*) holds that *money* on behalf of, or receives it from, a *market counterparty* or an *intermediate customer* and the *firm* has obtained written acknowledgement from the *market counterparty* or *intermediate customer* that:

- (1) the *money* will not be subject to the protections conferred by the *client money rules*;
- (2) as a consequence, this *money* will not be segregated from the *money* of the *firm* in accordance with the *client money rules* and will be used by the *firm* in the course of its own business; and
- (3) the *market counterparty* or *intermediate customer* will rank only as a general creditor of the *firm*.

'Opt-outs' for non-ISD business

- 9.3.10 **G**_{/1} For a *firm* whose business is not governed by the *ISD*, it is possible to 'opt out' on a one-way basis. However, in the case of certain non-*ISD investment firms* that undertake 'ISD type' business from a *branch* in the *United Kingdom*, article 5 of the *ISD* requires the *FSA* not to treat this business any more favourably than

business of an *ISD investment firm*. Therefore all *ISD* and ‘*ISD* type’ business should comply with the *client money rules* or be ‘opted out’ on a two-way basis.

9.3.11

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Money is not *client money* if a *firm*, in respect of *designated investment business* which is not a *core investment service*, a *non-core investment service* or a *listed activity*:

- (1) holds it on behalf of or receives it from a *market counterparty* who is not an *authorised person* or an *intermediate customer* who is not an *authorised person*; and
- (2) has sent a separate written notice stating the matters set out in ■ COB 9.3.9(1) to (3).

9.3.12

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When a *firm* undertakes a range of business for a *market counterparty* or *intermediate customer* and has separate agreements for each type of business undertaken, the *firm* may treat *client money* held on behalf of the *client* differently for different types of business; for example, a *firm* may, under ■ COB 9.3.9 or ■ COB 9.3.11, elect to segregate *client money* in connection with *securities* transactions and not segregate (by complying with ■ COB 9.3.9 or ■ COB 9.3.11) *money* in connection with *contingent liability investments* for the same *client*.

9.3.13

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When a *firm* transfers *client money* to another *person*, the *firm* must not enter into an agreement under ■ COB 9.3.9 or ■ COB 9.3.11 with that other *person* in relation to that *client money* or represent to that other *person* that the *money* is not *client money*.

9.3.14

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■ COB 9.3.13 prevents a *firm*, when passing *client money* to another *person* under ■ COB 9.3.64 (transfer of assets to a third party), from making use of the ‘opt out’ provisions under ■ COB 9.3.9 or ■ COB 9.3.11.

Money in connection with a “delivery versus payment” transaction

9.3.15

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Money need not be treated as *client money* in respect of a delivery versus payment transaction through a commercial settlement system if it is intended that either:

- (1) in respect of a *client’s* purchase, *money* from a *client* will be due to the *firm* within one *business day* upon the fulfilment of a delivery obligation; or
- (2) in respect of a *client’s* sale, *money* is due to the *client* within one *business day* following the *client’s* fulfilment of a delivery obligation;

unless the delivery or payment by the *firm* does not occur by the close of business on the third *business day* following the date of payment or delivery of the *investments* by the *client*.

9.3.16

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Money need not be treated as *client money* in respect of a delivery versus payment transaction, for the purpose of settling a transaction in relation to *units* in a *regulated collective investment scheme*, if:

- (1) the *firm* receives it from a *client* in relation to the *firm's* obligation to issue *units*, in accordance with *CIS*, unless the *price* of those *units* has not been determined by the close of business on the next *business day*:
 - (a) following the date of the receipt of the *money* from the *client*; or
 - (b) if the *money* was received by an *appointed representative* of the *firm*, in accordance with ■ COB 9.3.49, following the date of receipt at the specified business address of the *firm*; or
- (2) the *money* is held in the course of redeeming *units* where the proceeds of that redemption are paid to a *client* within the time specified in *CIS*; when a *firm* draws a cheque or other payable order within these timeframes the provisions of ■ COB 9.3.135 and ■ COB 9.3.136 will not apply.

Affiliated companies

9.3.17

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Money from an *affiliated company* is not treated as *client money* unless the provisions of ■ COB 9.3.18 apply. This seeks to ensure that *client money* is protected against the potential contagion that may arise on the *failure* of a *firm* which is itself part of a *group* which, if treated as a *client*, would expose the other *clients* of the *firm* to the risks of other parts of the *group*.

9.3.18

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Money is not *client money* if the *firm* holds it on behalf of, or receives it from, an *affiliated company*, unless:


- (1) the *firm* has been notified by the *affiliated company* that the *money* belongs to a *client* of the *affiliated company*; or
- (2) the *affiliated company* is a *client* dealt with at arm's length; or
- (3) the *affiliated company* is a manager of an *occupational pension scheme* or is an overseas company; and
 - (a) the *money* is given to the *firm* in order to carry on *designated investment business* for or on behalf of the *clients* of the *affiliated company*; and
 - (b) the *firm* has been notified by the *affiliated company* that the *money* is to be treated as *client money*.


Money due and payable to the firm

9.3.19


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/1

Money is not *client money* when it becomes properly due and payable to the *firm* for its own account.


- 9.3.20  /1
- (1) For *fees* and *commissions* payable by *customers*, 'due and payable' means:
- (a) they have been accurately calculated and are in accordance with a formula or basis previously disclosed to the *client* by the *firm*; or
 - (b) five *business days* have elapsed since a statement showing the amount of those *fees* and *commissions* has been despatched to the *client*, and the *firm* has taken reasonable steps to ensure that the *client* does not question that sum specified; or
 - (c) the precise amount of the *fees* or *commissions* has been agreed by the *client*, or has been determined by a court, arbitrator or arbiter;
- (2) Compliance with (1) may be relied on as tending to establish compliance with ■ COB 9.3.19;
- (3) Contravention of (1) may be relied on as tending to establish contravention of ■ COB 9.3.19.

9.3.21  /1


Money held as *client money* becomes due and payable to the *firm* or for the *firm's* own account, for example, because the *firm* acted as *principal* in the contract or the *firm*, acting as agent, has itself paid for *securities* in advance of receiving the purchase *money* from its *client*. The circumstances in which it is due and payable will depend on the contractual arrangement between the *firm* and the *client* and on the provisions of ■ COB 9.3.20.

9.3.22  /1

When a *firm* has entered into an arrangement under which *commission* is rebated to a *client*, those rebates should be treated as *client money* when the *firm* has performed its obligations in accordance with the relevant contract. The circumstances in which they become due and payable will depend on the contractual arrangements between the *firm* and the *client*.


9.3.23  /1

When a *client's* obligation or liability, that is secured by that *client's* asset, crystallises, and the *firm* realises the asset in accordance with an agreement entered into between the *client* and the *firm*, the part of the proceeds of the asset to cover such liability that is due and payable to the *firm* is not *client money*. However, any proceeds of sale in excess of the amount owed by the *client* to the *firm* should be paid over to the *client* immediately or be held in accordance with the *client money rules*.

9.3.24  /1

When a *firm* realises *client collateral* to meet liabilities of that *client*, it should do so in accordance with the relevant terms and conditions (see ■ COB 9.1.49 to ■ COB 9.1.53), and for a *private customer*, in accordance with ■ COB 7.8.

Solicitors

9.3.25  /1

An *authorised professional firm* regulated by The Law Society (England and Wales), The Law Society of Scotland or The Law Society of Northern Ireland must comply with the rules of its *designated professional body* as specified in ■ COB 9.3.26, in force at

commencement, and if it does so, it will be deemed to comply with ■ COB 9.3.

9.3.26

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For the purposes of ■ COB 9.3.25 the relevant rules are:

- (1) if regulated by the Law Society (of England and Wales):
 - (a) the Solicitors' Accounts Rules 1998; or
 - (b) where applicable, the Solicitors Overseas Practice Rules 1990;
- (2) if regulated by the Law Society of Scotland, the Solicitors' (Scotland) Accounts Rules 1997 and the Solicitors' (Scotland) Accounts Certificate Rules 1997;
- (3) if regulated by the Law Society of Northern Ireland, the Solicitors' Accounts Regulations 1998.

Trustee firms (other than trustees of unit trust schemes)

9.3.27

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A *trustee firm* must hold any *client money* separate from its own *money* at all times.

9.3.28

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Only the *client money rules* listed in ■ COB 9.3.29 apply to a *trustee firm* in respect of *client money* held in the course of that trustee business.

9.3.29

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Table This table belongs to ■ COB 9.3.28

Reference	Rule
<i>COB 9.3.1R – COB 9.3.7G</i>	Application
<i>COB 9.3.27R – COB 9.3.29R</i>	Trustee firms (other than trustees of unit trust schemes)
<i>COB 9.3.31R – COB 9.3.35G</i>	Requirement
<i>COB 9.3.67G – COB 9.3.74R</i>	a) <i>Client bank accounts</i>
<i>COB 9.3.75G – COB 9.3.79G</i>	b) <i>A firm's selection of a bank</i>
<i>COB 9.3.80R – COB 9.3.81R</i>	Group banks
<i>COB 9.3.123R – COB 9.3.131R</i>	Reconciliation of client money balances

Statutory trust

9.3.30

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Section 139(1) of the *Act* (Miscellaneous ancillary matters) provides that *rules* may make provision which result in *client money* being held by a *firm* on trust (England and Wales and Northern Ireland) or as agent (Scotland only). ■ COB 9.3.31 creates a fiduciary relationship between the *firm* and its *client* under which *client money* is in the legal ownership of the *firm* but remains in the beneficial ownership of the

client. In the event of *failure* of the *firm*, costs relating to the distribution of *client money* may have to be borne by the trust.

Requirement

9.3.31 **R** ^{/1} A *firm* (other than a *firm* acting in accordance with ■ COB 9.3.34) receives and holds *client money* as trustee (or in Scotland as agent) on the following terms:

- (1) for the purposes of and on the terms of the *client money rules* and the *client money distribution rules*;
- (2) subject to (3), for the *clients* for whom that *money* is held, according to their respective interests in it;
- (3) on *failure* of the *firm*, for the payment of the costs properly attributable to the distribution of the *client money* in accordance with (2); and
- (4) after all valid *claims* and costs under (2) and (3) have been met, for the *firm* itself.

9.3.32 **G** ^{/1} A *firm* can hold *client money* in either a *general client bank account* or a *designated client bank account*. A *firm* holds all *client money* in *general client bank accounts* for its *clients* as part of a common pool of *money* so those particular *clients* do not have a claim against a specific sum in a specific account; they only have a claim to the *client money* in general. A *firm* holds *client money* in *designated client bank accounts* for those *clients* that requested their *client money* be part of a specific pool of *money*, so those particular *clients* do have a claim against a specific sum in a specific account; they do not have a claim to the *client money* in general unless a *primary pooling event* occurs. If the *firm* becomes insolvent, and there is (for whatever reason) a *shortfall* in *money* held for a *client* compared with that *client's* entitlements, the available funds will be distributed in accordance with the *client money distribution rules*.

9.3.33 **G** ^{/1} ■ COB 9.3.39 to ■ COB 9.3.41 set out the circumstances in which it is permissible for a *firm* to hold *money*, which would otherwise be *money* belonging to the *firm*, in a *client bank account*.

9.3.34 **R** ^{/1} A *trustee firm*:

- (1) must receive and hold *client money* in accordance with the relevant instrument of trust;
- (2) subject to that, receives and holds *client money* on trust on the terms (or in Scotland on the agency terms) specified in ■ COB 9.3.31.

9.3.35 **G** ^{/1} If a *trustee firm* holds *client money* in accordance with ■ COB 9.3.34(2), the *firm* should follow the provisions in ■ COB 9.3.27 and ■ COB 9.3.28.

Segregation

- 9.3.36** **G**
/1 The purpose of the *client money rules* is to ensure that, unless otherwise permitted, *client money* is kept separate from the *firm's own money*. Segregation, in the event of a *firm's failure*, is important for the effective operation of the statutory trust that is created to protect *client money*. The aim is to clarify the difference between *client money* and general creditors' entitlements in the event of the *failure* of the *firm*.
- 9.3.37** **R**
/1 A *firm* must, except to the extent permitted by the *client money rules*, hold *client money* separate from the *firm's money*.
- 9.3.38** **R**
/1 A *firm* may segregate *client money* in a different currency from that of receipt. If it does so, the *firm* must ensure that the amount held is adjusted each *day* to an amount at least equal to the original currency amount (or the currency in which the *firm* has its liability to its *clients*, if different), translated at the previous day's closing spot exchange rate.
- 9.3.39** **R**
/1 A *firm* must not hold *money* other than *client money* in a *client bank account* unless it is:
- (1) a minimum sum required to open the account, or to keep it open; or
 - (2) *money* temporarily in the account in accordance with ■ COB 9.3.47 (Mixed remittance); or
 - (3) interest credited to the account which exceeds the amount due to *clients* as interest and has not yet been withdrawn by the *firm*.
- 9.3.40** **R**
/1 If it is prudent to do so to ensure that *client money* is protected, a *firm* may pay into a *client bank account* *money* of its own, and that *money* will then become *client money* for the purposes of the *client money rules* and the *client money distribution rules*.
- 9.3.41** **G**
/1 *Firms* are reminded of the requirements of ■ COB 9.3.100 and ■ COB 9.3.101. The *money* paid into the *client bank account* by the *firm*, in accordance with ■ COB 9.3.40, does not lessen the requirement to carry out the daily *client money* calculation.

Payment of client money into a client bank account

- 9.3.42** **R**
/1 A *firm* must segregate *client money* it receives using either:
- (1) the approach detailed in ■ COB 9.3.44 (the 'normal approach'); or
 - (2) the approach detailed in ■ COB 9.3.46 (the 'alternative approach'), subject to:

- (a) written confirmation to the *FSA* from the *firm's* auditor that the *firm* has in place systems and controls which are adequate to enable it to operate the alternative approach effectively; and
- (b) the *firm* appointing a manager responsible for compliance with the *client money rules*.

9.3.43

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The alternative approach is designed for a *firm* that operates in a multi-product, multi-currency environment for which adopting the normal approach would be unduly burdensome and would not achieve the *client* protection objective. Under the alternative approach, *client money* is received into and paid out of a *firm's* own bank accounts; consequently systems and controls that are capable of monitoring the *client money* flows are required, so that the *firm* can perform the daily *client money* calculation accurately. A *firm* that adopts the alternative approach will segregate *client money* into a *client bank account* on a daily basis, after having performed the *client money* calculation to determine what the *client money* requirement was at the close of the previous *business day*.

9.3.44

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If a *firm* receives and segregates *client money*, unless it adopts the alternative approach, it must, subject to ■ COB 9.3.15 and ■ COB 9.3.16, ■ COB 9.3.45, ■ COB 9.3.47, ■ COB 9.3.49 and ■ COB 9.3.55 (delivery versus payment) either:

- (1) pay it as soon as possible, and in any event no later than the next *business day* after receipt, into a *client bank account*; or
- (2) pay it out in accordance with ■ COB 9.3.133.

9.3.45

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If *client money* is received by the *firm* in the form of an automated transfer, the *firm* must take reasonable steps to ensure that:

- (1) the *money* is received directly into a *client bank account*; and
- (2) if *money* is received directly into the *firm's* own account, the *money* is transferred into a *client bank account* no later than the next *business day* after receipt.

9.3.46

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Under the alternative approach, a *firm* receiving and segregating *client money*:

- (1) is required to pay any *money* to or on behalf of *clients* out of its own account;
- (2) is required to perform the segregation calculation contained in ■ COB 9.3.101, adjust the balance held in its *client bank accounts* and then segregate the *money* in the *client bank account* until the calculation is re-performed on the next *business day*;
- (3) is not required to pay *client money* into a *client bank account* in accordance with any of ■ COB 9.3.44(1), ■ COB 9.3.45, ■ COB 9.3.47, ■ COB 9.3.49(1) and (2), ■ COB 9.3.55(1) and (2)(b) and ■ COB 9.3.58(1);
- (4) may receive all *client money* into its own bank account;

- (5) may choose to operate the alternative approach for some types of business (for example overseas equities transactions) and operate the normal approach for other types of business (for example *contingent liability investments*) if the *firm* can demonstrate that its systems and controls are adequate; and
- (6) may use an historic average to account for uncleared cheques in accordance with ■ COB 9.3.103.

Mixed remittance

9.3.47 **R** If a *firm* receives a *mixed remittance* (that is part *client money* and part other *money*), it must:

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- (1) pay the full sum into a *client bank account* in accordance with ■ COB 9.3.44(1); and
- (2) pay the *money* that is not *client money* out of the *client bank account* within one *business day* of the day on which the *firm* would normally expect the remittance to be cleared.

9.3.48 **G** When *money* is due to the *firm* in respect of *fees* and *commissions*, the *firm* should follow the provisions in ■ COB 9.3.20.

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Appointed representatives, field representatives and other agents

9.3.49 **R** A *firm* must establish and maintain procedures to ensure that *client money* received by its *appointed representatives*, *field representatives* or other agents is:

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- (1) paid into a *client bank account* of the *firm* in accordance with ■ COB 9.3.44(1); or
- (2) forwarded to the *firm*, or in the case of a *field representative* forwarded to a specified business address of the *firm*, so as to ensure that the *money* arrives at the specified business address by the close of the third *business day*.

9.3.50 **G** For the purposes of ■ COB 9.3.49(2), the *client money* received on *business day* one should be forwarded to the *firm* or specified business address of the *firm* no later than the next *business day* after receipt (*business day* two) in order for it to reach that *firm* or specified business address by the close of the third *business day*. Procedures requiring the *client money* to be sent to the *firm* or the specified business address of the *firm* by first class post no later than the next *business day* after receipt would meet the requirements of ■ COB 9.3.49(2).

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9.3.51 **R** If *client money* is received in accordance with ■ COB 9.3.49, the *firm* must ensure that its *appointed representative*, *field representative* or other agent keeps *client money* separately identifiable from any other

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money (including that of the *firm*) until the *client money* is paid into a *client bank account* or sent to the *firm*.

9.3.52

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For the purposes of ■ COB 9.3.49 and ■ COB 9.3.51, a *firm* that operates a number of small branches, but handles or accounts for all *client money* centrally, may treat those small branches as *appointed representatives*.

Client entitlements

9.3.53

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A *firm* must take reasonable steps to ensure that it is notified promptly of any receipt of *client money* in the form of *client entitlements*.

9.3.54

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The *firm* should receive regular statements from overseas depositaries used by the *firm*. The frequency of such statements will depend on the volume of business. *Client entitlements* are such things as dividends, coupons and other distributions with similar characteristics.

9.3.55

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When a *firm* receives a *client entitlement* on behalf of a *client*, it must pay any part of it which is *client money*:

- (1) for *client entitlements* received in the *United Kingdom*, into a *client bank account* in accordance with ■ COB 9.3.44(1); or
- (2) for *client entitlements* received outside the *United Kingdom*, into any bank account operated by the *firm*, provided that such *client money* is:
 - (a) paid to, or in accordance with, the instructions of the *client* concerned; or
 - (b) paid into a *client bank account* in accordance with ■ COB 9.3.44(1), as soon as possible but no later than five *business days* after the *firm* is notified of its receipt.

9.3.56

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A *firm* must take reasonable steps to ensure that a *client entitlement*, which is *client money*, is allocated within a reasonable period of time after notification of receipt.

9.3.57

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- (1) A *firm* should allocate *client entitlements* due to the individual *clients* within a period of ten *business days*.
- (2) Compliance with (1) may be relied on as tending to establish compliance with ■ COB 9.3.56.
- (3) Contravention of (1) may be relied on as tending to establish contravention of ■ COB 9.3.56.

Money due to a client from a firm

- 9.3.58 **R**_{/1} If a *firm* is liable to pay *money* to a *client*, it must as soon as possible, and no later than one *business day* after the *money* is due and payable:
- (1) pay it into a *client bank account*, in accordance with ■ COB 9.3.44(1); or
 - (2) pay it to, or to the order of, the *client*.

- 9.3.59 **G**_{/1} *Money* may become due to a *client* in respect of an agreement entered into with, or for, that *client*, in the course of the *firm's* business.

Interest

- 9.3.60 **R**_{/1} Unless a *firm* notifies a *private customer* in writing whether or not interest is to be paid on *client money* and, if so, on what terms and at what frequency, it must pay that *private customer* all interest earned on that *client money*. Any interest due to a *client* will be *client money*.

- 9.3.61 **G**_{/1} If no interest is payable to a *private customer*, that fact should be separately identified in an agreement or notification.

- 9.3.62 **G**_{/1} If a *firm* outlines its policy on its payment of interest under ■ COB 9.3.60, it need not necessarily disclose the actual rates prevailing at any particular time; the *firm* should disclose the terms, for example, LIBOR plus or minus 'x' percent.

Transfer of client money to a third party

- 9.3.63 **G**_{/1} ■ COB 9.3.64 sets out the requirements a *firm* must comply with when it transfers *client money* to another *person* without discharging its fiduciary duty owed to that *client*. Such circumstances arise when, for example, a *firm* passes *client money* to an *intermediate broker* for *contingent liability investments* in the form of initial or variation margin on behalf of a *client*. In these circumstances, the *firm* remains responsible for that *client's* equity balance, as defined in ■ COB 9.3.113, held at the *intermediate broker* until the contract is terminated and all of that *client's* positions at that *broker* closed. If a *firm* wishes to discharge itself from its fiduciary duty, it should do so in accordance with ■ COB 9.3.133.

- 9.3.64 **R**_{/1} A *firm* may allow another *person*, such as an exchange, a *clearing house* or an *intermediate broker*, to hold or control *client money*, but only if:
- (1) the *firm* transfers the *client money*:
 - (a) for the purpose of a transaction for a *client* through or with that *person*; or

- (b) to meet a *client's* obligation to provide collateral for a transaction (for example, an *initial margin* requirement for a *contingent liability investment*); and
- (2) in the case of a *private customer*, that *customer* has been notified that the *client money* may be transferred to the other *person*.

9.3.65 G_{/1} In relation to the notification required by ■ COB 9.3.64(2), there is no need for a *firm* to make a separate disclosure in relation to each transfer made.

9.3.66 G_{/1} A *firm* should not hold excess *client money* in its *client transaction accounts* with *intermediate brokers*, *settlement agents* and *OTC counterparties*; it should be held in a *client bank account*.

Client bank accounts

9.3.67 G_{/1} The *FSA* generally requires a *firm* to place *client money* in a *client bank account* with an *approved bank*.

9.3.68 R_{/1} (1) A *firm* must ensure that, subject to ■ COB 9.3.64 and ■ COB 9.3.74, *client money* is held in a *client bank account* at one or more *approved banks*.

(2) If the *firm* is a *trustee firm*, it must:

(a) hold *client money* in a *client bank account* with an *approved bank* at all times; and

(b) maintain separate *client bank accounts* for each trust.

9.3.69 R_{/1} A *firm* may open one or more *client bank accounts* in the form of a *designated client bank account*. Characteristics of these accounts are that:

(1) the account holds *money* of one or more *clients*;

(2) the account includes in its title the word 'designated';

(3) the *clients* whose *money* is in the account have each consented in writing to the use of the bank with which the *client money* is to be held; and

(4) in the event of the *failure* of that bank, the account is not pooled with any other type of account unless a *primary pooling event* occurs.

9.3.70 R_{/1} A *firm* may open one or more *client bank accounts* in the form of a *designated client fund account*. Characteristics of these accounts are that:

(1) the account holds at least part of the *client money* of one or more *clients*, each of whom has consented to that *money* being held in

the same *client bank accounts* at the same banks (the *client money* of such *clients* constituting a designated fund);

- (2) the account includes in its title the words 'designated fund'; and
- (3) in the event of the *failure* of a bank with which part of a designated fund is held, each *designated client fund account* held with the *failed* bank will form a pool with any other *designated client fund account* containing part of that same designated fund unless a *primary pooling event* occurs.

9.3.71 G _{/1} The *client money distribution rules* set out the provisions of a *primary pooling event* on the *failure* of a *firm*.

9.3.72 G _{/1} The effect of ■ COB 9.3.70 is that a *designated client fund account* may be used for a *client* only where that *client* has consented to the use of that account and all other *designated client fund accounts* which may be pooled with it. A *client* who consents to the use of bank A and bank B should have his *money* held in a different *designated client fund account* at bank B from a *client* who has consented to the use of banks B and C.

9.3.73 G _{/1} A *firm* may operate as many *client bank accounts* as it wishes. When, for example, a *firm* has previously operated a dividend claims bank account and a margined transaction bank account under the Financial Services (Client Money) Regulations 1991 and Financial Services (Client Money) (Supplementary) Regulations 1991, these will be *client bank accounts* for the purposes of the *client money rules*.

9.3.74 R _{/1} A *firm* (other than a *trustee firm*) may hold *client money* with a bank that is not an *approved bank* if all of the following conditions are met:

- (1) the *client money* relates to:
 - (a) the settlement of a transaction, or a *series of transactions*; or
 - (b) the distribution of income;

subject to the law or market practice of a jurisdiction outside the *United Kingdom*;
- (2) because of the applicable law or market practice of that overseas jurisdiction, it is not possible to hold the *client money* in a *client bank account* with an *approved bank*;
- (3) the *firm* holds the *money* with such a bank for no longer than is necessary to effect the transaction, or *series of transactions*;
- (4) the *firm* notifies each relevant *market counterparty* and *intermediate customer* and obtains the prior written consent of each relevant *private customer* that:
 - (a) the *client money* will not be held with an *approved bank*;

- (b) in such circumstances, the legal and regulatory regime applying to the bank with which the *client money* is held will be different from that of the *United Kingdom* and, in the event of a *failure* of the bank, the *client money* may be treated differently from the treatment which would apply if the *client money* were held by an *approved bank* in the *United Kingdom*; and
 - (c) if it is the case, the particular bank has not accepted that it has no right of set off or counterclaim against *client money* held, in respect of any sum owed by the *firm* on any other account held at that bank, as required by ■ COB 9.3.82; and
- (5) the *client money* is held in a designated bank account.

A firm's selection of a bank

- 9.3.75** G_{/1} A *firm* owes a duty of care to a *client* when it decides where to place *client money*. The review required by ■ COB 9.3.76 is intended to ensure that the risks inherent in placing *client money* with the banks are minimised or appropriately diversified by requiring a *firm* to consider carefully the bank or banks with which it chooses to place *client money*.
- 9.3.76** R_{/1} Before a *firm* opens a *client bank account* and as often as is appropriate on a continuing basis (no less than once in each financial year), it must take reasonable steps to establish that the bank is appropriate for that purpose.
- 9.3.77** G_{/1} A *firm* should consider diversifying placements of *client money* with more than one bank where the amounts are, for example, of sufficient size to warrant such diversification.
- 9.3.78** G_{/1} When considering where to place *client money* and to determine the frequency of the appropriateness test under ■ COB 9.3.76, a *firm* should consider taking into account, together with any other relevant matters:
- (1) the capital of the bank;
 - (2) the amount of *client money* placed, as a proportion of the bank's capital and *deposits*;
 - (3) the credit rating of the bank (if available); and
 - (4) to the extent that the information is available, the level of risk in the investment and loan activities undertaken by the bank and its *affiliated companies*.
- 9.3.79** G_{/1} A *firm* will be expected to perform due diligence when opening a *client bank account* with a bank that is authorised by an *EEA regulator*. Any continuing assessment of that bank may be restricted to verification that it remains authorised by an *EEA regulator*.

Group banks

- 9.3.80 **R** /1 Subject to ■ COB 9.3.74(2)(b), a *firm* that holds or intends to hold *client money* with a bank which is in the same *group* as the *firm* must:
- (1) undertake a continuous review in relation to that bank which is at least as rigorous as the review of any bank which is not in the same *group*, in order to ensure that the decision to use a *group* bank is appropriate for the *client* or trust;
 - (2) disclose in writing to its *client* at the outset of the *client* relationship or, if later, not less than 20 *business days* before it begins to hold *client money* of that *client* with that bank:
 - (a) that it is holding or intends to hold *client money* with a bank in the same *group*; and
 - (b) the identity of the bank concerned.

- 9.3.81 **R** /1 If a *client* has notified a *firm* in writing that he does not wish his *money* to be held with a bank in the same *group* as the *firm*, the *firm* must either:
- (1) place that *client money* in a *client bank account* with another bank in accordance with ■ COB 9.3.68; or
 - (2) return that *client money* to, or pay it to the order of, the *client*.

Notification and acknowledgement of trust (banks)

- 9.3.82 **R** /1 When a *firm* opens a *client bank account*, the *firm* must give or have given written notice to the bank requesting the bank to acknowledge to it in writing:
- (1) that all *money* standing to the credit of the account is held by the *firm* as trustee (or if relevant, as agent) and that the bank is not entitled to combine the account with any other account or to exercise any right of set-off or counterclaim against *money* in that account in respect of any sum owed to it on any other account of the *firm*; and
 - (2) that the title of the account sufficiently distinguishes that account from any account containing *money* that belongs to the *firm*, and is in the form requested by the *firm*.

- 9.3.83 **R** /1 In the case of a *client bank account* in the *United Kingdom*, if the bank does not provide the acknowledgement referred to in ■ COB 9.3.82 within 20 *business days* after the *firm* dispatched the notice, the *firm* must withdraw all *money* standing to the credit of the account and

deposit it in a client bank account with another bank as soon as possible.

9.3.84 **R** ^{/1} In the case of a *client bank account* outside the *United Kingdom*, if the bank does not provide the acknowledgement referred to in **■ COB 9.3.82** within 20 *business days* after the *firm* dispatched the notice, the *firm* must notify the *client* of this fact as set out in **■ COB 9.3.90(3)**.

9.3.85 **G** ^{/1} *Firms* are reminded of the provisions of **■ COB 9.3.74(4)**, that sets out the notification and consents required when using a bank that is not an *approved bank*.

Notification and acknowledgement of trust (exchange, clearing house, intermediate broker or OTC counterparty)

9.3.86 **R** ^{/1} A *firm* which undertakes any *contingent liability investment* for *clients* through an exchange, *clearing house*, *intermediate broker* or *OTC counterparty* must, before the *client transaction account* is opened with the exchange, *clearing house*, *intermediate broker* or *OTC counterparty*:

- (1) notify the *person* with whom the account is to be opened that the *firm* is under an obligation to keep *client money* separate from the *firm's own money*, placing *client money* in a *client bank account*;
- (2) instruct the *person* with whom the account is to be opened that any *money* paid to it in respect of that transaction is to be credited to the *firm's client transaction account*; and
- (3) require the *person* with whom the account is to be opened to acknowledge in writing that the *firm's client transaction account* is not to be combined with any other account, nor is any right of set-off to be exercised by that *person* against *money* credited to the *client transaction account* in respect of any sum owed to that *person* on any other account.

9.3.87 **R** ^{/1} If the *intermediate broker* or *OTC counterparty* does not provide the acknowledgement required by **■ COB 9.3.86(3)** within 20 *business days* of the dispatch of the notice and instruction, the *firm* must cease using the *client transaction account* with that *broker* or counterparty and arrange as soon as possible for the transfer or liquidation of any open positions and the repayment of any *money*.

9.3.88 **G** ^{/1} If a *firm* knows or reasonably ought to know that an *intermediate broker* or *OTC counterparty* will not provide the acknowledgement required by **■ COB 9.3.86**, the *firm* should not open a *client transaction account* with that *intermediate broker* or *OTC counterparty*.

9.3.89 **R** ^{/1} If the exchange or *clearing house* does not provide the acknowledgement required by **■ COB 9.3.86(3)** within 20 *business days* of the despatch of the notice and instruction, the *firm* must notify the *client* that a particular exchange or *clearing house* has not accepted

that it has no right of set-off or counterclaim against *money* held in a *client transaction account* in respect of any sum owed on any other account of the *firm*, in that particular case or generally in an agreement entered into between the *firm* and its *client*.

Notification to clients: use of an approved bank outside the United Kingdom

9.3.90

R

^{/1}

A *firm* must not hold *client money* in a *client bank account* outside the *United Kingdom*, unless the *firm* has previously disclosed to the *client* in writing:

- (1) that his *money* may be deposited in a *client bank account* outside the *United Kingdom*;
- (2) that in such circumstances, the legal and regulatory regime applying to the *approved bank* will be different from that of the *United Kingdom* and, in the event of a *failure* of the bank, his *money* may be treated in a different manner from that which would apply if the *client money* was held by a bank in the *United Kingdom*; and
- (3) if it is the case, that a particular bank has not accepted that it has no right of set-off or counterclaim against *money* held in a *client bank account* in respect of any sum owed on any other account of the *firm*, notwithstanding the *firm's* request to the bank as required by ■ COB 9.3.82.

9.3.91

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^{/1}

There is no need for a *firm* to make a separate disclosure under ■ COB 9.3.90(1) and (2) in relation to each jurisdiction.

9.3.92

G

^{/1}

Firms are reminded of the provisions of ■ COB 9.3.74(4), that sets out the notification and consents required when using a bank that is not an *approved bank*.

9.3.93

R

^{/1}

If a *client* has notified a *firm* in writing before entering into a transaction that *client money* is not to be held in a particular jurisdiction, the *firm* must either:

- (1) hold the *client money* in a *client bank account* in a jurisdiction to which the *client* has not objected; or
- (2) return the *client money* to, or to the order of, the *client*.

9.3.94

G

^{/1}

Firms are reminded of the provisions of ■ COB 9.3.74(4), that sets out the notification and consents required when using a bank that is not an *approved bank*.

Notification to clients: use of an intermediate broker, settlement agent or OTC counterparty outside the United Kingdom.

9.3.95

R

/1

A *firm* must not undertake any transaction for a *client* that involves *client money* being passed to an *intermediate broker, settlement agent* or *OTC counterparty* located in a jurisdiction outside the *United Kingdom*, unless the *firm* has previously disclosed in writing to the *client*:

- (1) that his *client money* may be passed to a *person* outside the *United Kingdom*; and
- (2) that, in such circumstances, the legal and regulatory regime applying to the *intermediate broker, settlement agent* or *OTC counterparty* will be different from that of the *United Kingdom* and, in the event of a *failure* of the *intermediate broker, settlement agent* or *OTC counterparty*, this *money* may be treated in a different manner from that which would apply if the *money* was held by an *intermediate broker, settlement agent* or *OTC counterparty* in the *United Kingdom*.

9.3.96

G

/1

There is no need for a *firm* to make a separate disclosure under ■ COB 9.3.95 in relation to each jurisdiction.

9.3.97

R

/1

If a *client* has notified a *firm* before entering into a transaction that he does not wish his *money* to be passed to an *intermediate broker, settlement agent* or *OTC counterparty* located in a particular jurisdiction, the *firm* must either:

- (1) hold the *client money* in a *client bank account* in the *United Kingdom* or a jurisdiction to which the *client* has not objected and pay its own *money* to the *firm's* own account with the broker, agent or counterparty; or
- (2) return the *money* to, or to the order of, the *client*.

Notification to the FSA: failure of a bank, intermediate broker, settlement agent or OTC counterparty

9.3.98

R

/1

On the *failure* of a third party with which *money* is held, a *firm* must notify the *FSA*:

- (1) as soon as it becomes aware of the *failure* of any bank, *intermediate broker, settlement agent, OTC counterparty* or other entity with which it has placed, or to which it has passed, *client money*; and
- (2) as soon as reasonably practical, whether it intends to make good any *shortfall* that has arisen or may arise and of the amounts involved.

Client money calculation

- 9.3.99** G ^{/1} The purpose of the *client money* calculation is:
- (1) for the normal approach, to act as a check that the amount of *client money* that is segregated at banks and third parties is sufficient to meet the *firm's* obligations to its *clients* on a daily basis;
 - (2) for the alternative approach, to calculate the appropriate amount of *client money* to be segregated at banks and third parties which is sufficient to meet a *firm's* obligations to its *clients* on a daily basis.

- 9.3.100** R ^{/1} Each *business day*, a *firm* that adopts the normal approach in accordance with ■ COB 9.3.42 must:
- (1) check whether its *client money* resource, being the aggregate balance on the *firm's client bank accounts*, as at the close of business on the previous *business day*, was at least equal to the *client money* requirement, as defined in ■ COB 9.3.105, as at the close of business on that day; and
 - (2) ensure that:
 - (a) any *shortfall* is paid into a *client bank account* by the close of business on the day the calculation is performed; or
 - (b) any excess is withdrawn within the same time period unless ■ COB 9.3.39 or ■ COB 9.3.40 applies.

- 9.3.101** R ^{/1} Each *business day*, a *firm* that adopts the alternative approach, in accordance with ■ COB 9.3.42, must ensure that its *client money* resource, being the aggregate balance on the *firm's client bank accounts*, as at the close of business on that *business day* is at least equal to the *client money* requirement, as defined in ■ COB 9.3.105, as at the close of business on the previous *business day*.

- 9.3.102** G ^{/1} No excess or *shortfall* should arise when adopting the alternative approach.

- 9.3.103** G ^{/1} If a *firm* is operating under the alternative approach allowed by ■ COB 9.3.42, and draws a cheque on its own bank account, it will be expected to account for those cheques that have not yet cleared under ■ COB 9.3.135 when performing the *client money* calculation in ■ COB 9.3.101. An historic average estimate of uncleared cheques may be used to satisfy this obligation.

- 9.3.104** G ^{/1} For the purposes of ■ COB 9.3.100 and ■ COB 9.3.101, a *firm* should use the values contained in its accounting records, for example its cash book, rather than values contained in statements received from its banks and other third parties.

Client money requirement

- 9.3.105** R ^{/1} Subject to ■ COB 9.3.119, the *client money* requirement is the sum of, for all *clients*:

- (1) the individual *client* balances calculated in accordance with ■ COB 9.3.106, excluding:
 - (a) individual *client* balances which are negative (that is, debtors); and
 - (b) *clients'* equity balances calculated in accordance with ■ COB 9.3.113; and
- (2) the total *contingent liability investment* requirement, which is calculated in accordance with ■ COB 9.3.115.

General transactions

9.3.106 **R** The individual *client* balance for each *client* is calculated in accordance with ■ COB 9.3.107.
/1

9.3.107 **R** Table This table belongs to ■ COB 9.3.106.
/1

Individual client balance calculation		
Free money (no trades) and sale proceeds due to the <i>client</i>:		A
(a)	in respect of <i>principal deals</i> when the <i>client</i> has delivered the <i>designated investments</i>; and	B
(b)	in respect of <i>agency deals</i>, when either:	
(i)	the sale proceeds have been received by the <i>firm</i> and the <i>client</i> has delivered the <i>designated investments</i>; or	C1
(ii)	the <i>firm</i> holds the <i>designated investments</i> for the <i>client</i>; and	C2
the cost of purchases:		
(c)	in respect of <i>principal deals</i>, paid for by the <i>client</i> but the <i>firm</i> has not delivered the <i>designated investments</i> to the <i>client</i>; and	D
(d)	in respect of <i>agency deals</i>, paid for by the <i>client</i> when either:	
(i)	the <i>firm</i> has not remitted the <i>money</i> to, or to the order of, the counterparty; or	E1
(ii)	the <i>designated investments</i> have been received by the <i>firm</i> but have not been delivered to the <i>client</i>;	E2
Less	<i>money</i> owed by the <i>client</i> in respect of unpaid purchases by or for the <i>client</i> if delivery of those <i>designated investments</i> has been made to the <i>client</i>; and	F

Individual client balance calculation	
Proceeds remitted to the <i>client</i> in respect of sales transactions by or for the <i>client</i> if the <i>client</i> has not delivered the <i>designated investments</i> .	G
Individual <i>Client Balance</i> 'X' = (A+B+C1+C2+D+E1+E2)–F–G	X

- 9.3.108 **R** In ■ COB 9.3.106 a *firm* must calculate the individual *client* balance using the contract value of any *client* purchases or sales. _{/1}
- 9.3.109 **R** A *firm* may choose to segregate *designated investments* instead of the value identified in ■ COB 9.3.107 (except E1) if it ensures that the *designated investments* are held in such a manner that the *firm* cannot use them for its own purposes. _{/1}
- 9.3.110 **G** Segregation in the context of ■ COB 9.3.109 can take many forms, including the holding of a *safe custody investment* in a nominee name and the safekeeping of certificates evidencing title in a fire resistant safe. It is not the intention that all the *custody rules* should be applied to *designated investments* held in the course of settlement. _{/1}
- 9.3.111 **G** In calculating its individual *client* balances under ■ COB 9.3.106, a *firm* need not include *money* held in accordance with ■ COB 9.3.15 and ■ COB 9.3.16 (delivery versus payment). _{/1}
- 9.3.112 **G** In calculating its individual *client* balances under ■ COB 9.3.106, a *firm*: _{/1}
- (1) should include dividends received and interest earned and allocated;
 - (2) may deduct outstanding *fees*, calls, rights and interest charges and other amounts owed by the *client* in accordance with ■ COB 9.3.20;
 - (3) need not include *client money* which, under ■ COB 9.3.55(2), is not required to be segregated nor include *client money* forwarded to the *firm*, in accordance with ■ COB 9.3.51, but not received;
 - (4) should take into account any *client money* arising from ■ COB 9.3.129; and
 - (5) should include any unallocated *client money*.

Equity balance

- 9.3.113 **R** A *client's* equity balance is the amount which the *firm* would be liable (ignoring for the purposes of this *rule* any non-cash *collateral* held) to pay to a *client* (or the *client* to the *firm*) in respect of his *margined transactions* if each of his open positions was liquidated at the closing or settlement prices published by the relevant exchange or other appropriate pricing source and his account closed. _{/1}
- 9.3.114 **R** A *firm's* equity balance, whether with an exchange, *intermediate broker* or OTC counterparty, means the amount which the *firm* would be liable to pay to the exchange, *intermediate broker* or OTC counterparty (or vice versa) in respect of the *firm's margined* _{/1}

transactions if each of the open positions of the *firm's clients* was liquidated at the closing or settlement prices published by the relevant exchange or other appropriate pricing source and the *firm's* account with the exchange, *intermediate broker* or *OTC* counterparty is closed.

Margined transaction requirement

9.3.115

R

The total margined transaction requirement is:

/1

- (1) the sum of each of the *client's* equity balances, as defined in ■ COB 9.3.113, which are positive;

Less

- (2) the proportion of any individual negative *client* equity balance which is secured by *approved collateral*; and
- (3) the net aggregate of the *firm's* equity balance (negative balances being deducted from positive balances) on transaction accounts for *customers* with exchanges, *clearing houses*, *intermediate brokers* and *OTC* counterparties.

9.3.116

G

To meet a shortfall that has arisen in respect of the requirement in ■ COB 9.3.105(2), a *firm* may utilise its own *approved collateral* provided it is held on terms specifying when it is to be realised for the benefit of *clients*, it is clearly identifiable from the *firm's* own property and the relevant terms are evidenced in writing by the *firm*. In addition, the proceeds of the sale of that *collateral* should be paid into a *client bank account*.

/1

9.3.117

G

If a *firm's* total *margined transaction* requirement is negative, the *firm* should treat it as zero for the purposes of calculating its *client money* requirement in accordance with ■ COB 9.3.105(2).

/1

9.3.118

G

The terms '*client* equity balance' in ■ COB 9.3.113 and '*firm's* equity balance' in ■ COB 9.3.114 refer to cash values and do not include non-cash *collateral* or other *designated investments* held in respect of a *contingent liability investment*.

/1

Reduced client money requirement option

9.3.119

R

- (1) When, in respect of a *client*, there is a positive individual *client* balance and a negative *client* equity balance, a *firm* may offset the credit against the debit and hence have a reduced individual *client* balance in ■ COB 9.3.106 for that *client*.

/1

- (2) When, in respect of a *client*, there is a negative individual *client* balance and a positive *client* equity balance, a *firm* may offset the credit against the debit and hence have a reduced *client* equity balance in ■ COB 9.3.115 for that *client*.

9.3.120 G _{/1} The effect of ■ COB 9.3.119 is to allow a *firm* to offset, on a *client by client* basis, a negative amount with a positive amount arising out of the calculations in ■ COB 9.3.106 and ■ COB 9.3.115, and, by so doing, reduce the amount the *firm* is required to segregate.

Failure to perform calculations

9.3.121 R _{/1} A *firm* must notify the *FSA* immediately if it is unable to, or does not, perform the daily calculation required by ■ COB 9.3.100 or ■ COB 9.3.101.

9.3.122 R _{/1} A *firm* must notify the *FSA* immediately it becomes aware that it may not be able to make good any *shortfall* identified by ■ COB 9.3.100 by the close of business on the day the calculation is performed.

Reconciliation of client money balances: frequency of reconciliation

9.3.123 R _{/1} A *firm* must perform a reconciliation of the *client money* balances which it holds, or for which it is responsible, as frequently as is necessary to ensure the accuracy of its record of *money* so held, and no less than once in every 25 *business days*.

9.3.124 G _{/1} In determining whether the minimum acceptable frequency is sufficient, a *firm* should consider the risks to which the business is exposed, such as the volume of business, and where and with whom the *client money* is held.

9.3.125 R _{/1} A *firm* must complete the reconciliation of *client money* within ten *business days* of the date to which the reconciliation relates.

Reconciliation method

9.3.126 R _{/1} A *firm* must compare:

- (1) the balance on each *client bank account* as recorded by the *firm* with the balance on that account as set out on the statement or other form of confirmation issued by the bank with which those accounts are held; and
- (2) the balance, currency by currency, on each *client transaction account* as recorded by the *firm*, with the balance on that account as set out in the statement or other form of confirmation issued by the *person* with whom the account is held;

and identify any discrepancies between them.

9.3.127 R _{/1} Any *approved collateral* held in accordance with the *client money rules* must be included within this reconciliation.

Reconciliation discrepancies

- 9.3.128 **R** /1 When any discrepancy arises as a result of the reconciliation carried out under ■ COB 9.3.126, the *firm* must identify the reason for the discrepancy and correct it as soon as possible, unless the discrepancy arises solely as a result of timing differences between the accounting systems of the party providing the statement or confirmation and that of the *firm*.
- 9.3.129 **R** /1 While a *firm* is unable to resolve a difference arising from a reconciliation, and one record or a set of records examined by the *firm* during its reconciliation indicates that there is a need to have a greater amount of *client money* or *approved collateral* than is in fact the case, the *firm* must assume, until the matter is finally resolved, that the record or set of records is accurate and pay its own *money* into a relevant account.
- 9.3.130 **G** /1 Items recorded or held within a suspense or error account fall within the scope of discrepancies.
- 9.3.131 **R** /1 A *firm* must notify the *FSA* as soon as possible if it is unable to comply with any of the requirements of ■ COB 9.3.123, ■ COB 9.3.125, ■ COB 9.3.126, ■ COB 9.3.128 and ■ COB 9.3.129.

Discharge of fiduciary duty

- 9.3.132 **G** /1 The purpose of ■ COB 9.3.133 to ■ COB 9.3.136 is to set out those situations in which a *firm* will have fulfilled its contractual and fiduciary obligations in relation to any *client money* held for or on behalf of its *client*, in relation to the *firm's* ability to require repayment of that *money*.
- 9.3.133 **R** /1 *Money ceases to be client money if it is paid:*
- (1) to the *client*, or a duly authorised representative of the *client*; or
 - (2) to a third party on the instruction of the *client*, unless it is transferred to a third party in the course of effecting a transaction, in accordance with ■ COB 9.3.64; or
 - (3) into a bank account of the *client* (not being an account which is also in the name of the *firm*); or
 - (4) to the *firm* itself, when it is due and payable to the *firm* in accordance with ■ COB 9.3.19 to ■ COB 9.3.24; or
 - (5) to the *firm* itself, when it is an excess in the *client bank account* as set out in ■ COB 9.3.100(2)(b).
- 9.3.134 **G** /1 When a *firm* wishes to transfer *client money* balances to a third party in the course of transferring its business to another *firm*, it should do so in compliance with ■ COB 9.3.133.

9.3.135 **R** ^{/1} When a *firm* draws a cheque or other payable order to discharge its fiduciary duty under ■ COB 9.3.133, it must continue to treat the sum concerned as *client money* until the cheque or order is presented and paid by the bank.

9.3.136 **R** ^{/1} For the purposes of ■ COB 9.3.19, if a *firm* makes a payment to, or on the instructions of, a *client*, from an account other than a *client bank account*, until that payment has cleared, no equivalent sum from a *client bank account* for reimbursement will become due and payable to the *firm*.

Allocated but unclaimed client money

9.3.137 **G** ^{/1} The purpose of ■ COB 9.3.138 is to allow a *firm*, in the normal course of its business, to cease to treat as *client money* any balances, allocated to an individual *client*, when those balances remain unclaimed.

9.3.138 **R** ^{/1} A *firm* may cease to treat as *client money* any unclaimed *client money* balance if it can demonstrate that it has taken reasonable steps to trace the *client* concerned and to return the balance.

9.3.139 **E** ^{/1}

- (1) Reasonable steps should include:
 - (a) entering into a written agreement, in which the *client* consents to the *firm* releasing, after the period of time specified in (b), any *client money* balances, for or on behalf of that *client*, from *client bank accounts*;
 - (b) determining that there has been no movement on the *client's* balance for a period of at least six years (notwithstanding any payments or receipts of charges, interest or similar items);
 - (c) writing to the *client* at the last known address informing the *client* of the *firm's* intention of no longer treating that balance as *client money*, giving the *client* 28 days to make a claim;
 - (d) making and retaining records of all balances released from *client bank accounts*; and
 - (e) undertaking to make good any valid claim against any released balances;
- (2) Compliance with (1) may be relied on as tending to establish compliance with ■ COB 9.3.138;
- (3) Contravention of (1) may be relied on as tending to establish contravention of ■ COB 9.3.138.

9.3.140 **G** ^{/1} When a *firm* gives an undertaking in ■ COB 9.3.139(1)(e), it should make arrangements authorised by the *firm's* relevant *controllers* that are legally enforceable by any *person* with a valid claim to such *money*.

Commodity futures Trading Commission Part 30 exemption order

- 9.3.141 **R** ^{/1} A *firm* with a *Part 30 exemption order* must treat as *client money* the *money* of any US resident investor which is held or received in respect of transactions on non-US exchanges.
- 9.3.142 **R** ^{/1} A *firm* with a *Part 30 exemption order* which also operates an LME bond arrangement for the benefit of US-resident investors, must exclude the *client's* equity balances, as defined in ■ COB 9.3.113, for transactions undertaken on the London Metal Exchange on behalf of those US-resident investors from the calculation required by ■ COB 9.3.115.
- 9.3.143 **R** ^{/1} A *firm* must not reduce the amount of, or cancel a letter of credit issued under, an LME bond arrangement where this will cause the *firm* to be in breach of its *Part 30 exemption order*.
- 9.3.144 **R** ^{/1} A *firm* must notify the *FSA* immediately it arranges the *issue* of an individual letter of *credit* under an LME bond arrangement.

Records

- 9.3.145 **R** ^{/1} A *firm* must ensure that proper records, sufficient to show and explain the *firm's* transactions and commitments in respect of its *client money*, are made and retained for a period of three years after they were made.



9.4 Collateral

Application

- 9.4.1** **R** _{/1} This section applies to a *firm* when it receives or holds assets in connection with an arrangement to secure the obligation of a *client* in the course of, or in connection with, its *designated investment business*.
- 9.4.2** **G** _{/1} *Firms* are reminded that, under **■** COB 1.2.1(1), this section does not apply to an *incoming EEA firm* with respect to its *passport activities*. The application of this section is also dependent on the location from which the activity is undertaken (see **■** COB 1.4.3).
- 9.4.3** **R** _{/1} This section does not apply to a *firm* that has only a bare security interest (without rights to hypothecate) in the *client's* asset. In such circumstances, the *firm* must comply with the *custody rules* or *client money rules* as appropriate.
- 9.4.4** **G** _{/1} For the purpose of this section only, a bare security interest in the *client's* asset gives a *firm* the right to realise the assets only on a *client's* default and without the right to use other than in default.

Purpose

- 9.4.5** **G** _{/1} The purpose of this section is to ensure that an appropriate level of protection is provided for those assets over which a *client* gives a *firm* certain rights. The arrangements covered by this section are those under which the *firm* is given a right to use the asset, and the *firm* treats the asset as if legal title and associated rights to that asset had been transferred to the *firm* subject only to an obligation to return equivalent assets to the *client* upon satisfaction of the *client's* obligation to the *firm*. The rights covered in this section do not include those arrangements by which the *firm* has only a bare security interest in the *client's* asset (in which case the *custody rules* or *client money rules* apply).
- 9.4.6** **G** _{/1} Examples of the arrangements covered by this section include the taking of collateral by a *firm*, under the ISDA English Law (transfer of title) and the New York Law Credit Support Annexes (assuming the right to rehypothecate has not been disapplied).
- 9.4.7** **G** _{/1} This section recognises the need to apply a differing level of regulatory protection to the assets which form the basis of the two different types of arrangement described in **■** COB 9.4.5. Under the bare security interest arrangement, the asset

continues to belong to the *client* until the *firm's* right to realise that asset crystallises (that is, on the *client's* default). But under a "right to use arrangement", the *client* has transferred to the *firm* the legal title and associated rights to the asset, so that when the *firm* exercises its right to treat the asset as its own, the asset ceases to belong to the *client* and in effect becomes the *firm's* asset and is no longer in need of the full range of *client* asset protection. The *firm* may exercise its right to treat the asset as its own by, for example, clearly so identifying the asset in its own books and records.

Requirements

- 9.4.8** R _{/1} A *firm* that receives or holds a *client's* assets under an arrangement to which this section applies and which exercises its right to treat the assets as its own must ensure that it maintains adequate records to enable it to meet any future obligations including the return of equivalent assets to the *client*.
- 9.4.9** G _{/1} If the *firm* has the right to use the *client's* asset under a "right to use arrangement" but has not yet exercised its right to treat the asset as its own, the *client money rules* or the *custody rules* will continue to apply as appropriate until such time as the *firm* exercises its right, at which time ■ COB 9.4.8 will apply.
- 9.4.10** G _{/1} When appropriate, *firms* that enter into the arrangements covered in this section with *private customers* will be expected to identify in the statement of *custody assets* sent to the *client* in accordance with ■ COB 9.1.59 (Production and despatch of client statements) details of the assets which form the basis of the arrangements. Where the *firm* utilises global netting arrangements, a statement of the assets held on this basis will suffice.



9.5 Client money distribution

Application

9.5.1 **R** ^{/1} ■ COB 9.5 (the *client money distribution rules*) applies to a *firm* that holds *client money* which is subject to the *client money rules* when a *primary pooling event* or a *secondary pooling event* occurs.

9.5.2 **G** ^{/1} The *client money distribution rules* have force and effect on any *firm* that holds *client money*. Therefore, they will apply to a *UK branch* of a non-EEA *firm*. In this case the *UK branch* of the *firm* may be treated as if the *branch* itself is a free standing entity subject to the *client money distribution rules*.

Purpose

9.5.3 **G** ^{/1} The *client money distribution rules* seek to facilitate the timely return of *client money* to a *client* in the event of the *failure* of a *firm* or third party at which the *firm* holds *client money*.

Failure of the authorised firm: primary pooling event

9.5.4 **G** ^{/1} A *primary pooling event* triggers a notional pooling of all the *client money*, in every type of *client money* account, and the obligation to distribute it.

9.5.5 **R** ^{/1} A *primary pooling event* occurs:

- (1) on the *failure* of the *firm*; or
- (2) on the vesting of assets in a *trustee* in accordance with an 'assets requirement' imposed under section 46(1)(b) of the *Act*; or
- (3) on the coming into force of a *requirement* for all *client money* held by the *firm*; or
- (4) when the *firm* notifies, or is in breach of its duty to notify, the *FSA*, in accordance with ■ COB 9.3.131, that it is unable correctly to identify and allocate in its records all valid claims arising as a result of a *secondary pooling event*.

9.5.6 **R** ^{/1} ■ COB 9.5.5(4) does not apply so long as:

- (1) the *firm* is taking steps, in consultation with the *FSA*, to establish those records; and
- (2) there are reasonable grounds to conclude that the records will be capable of rectification within a reasonable period.

Pooling and distribution

9.5.7

R

If a *primary pooling event* occurs:

^{/1}

- (1) *client money* held in each *client money* account of the *firm* is treated as pooled; and
- (2) the *firm* must distribute that *client money* in accordance with ■ COB 9.3.31, so that each *client* receives a sum which is rateable to the *client money* entitlement calculated in accordance with ■ COB 9.3.119.

9.5.8

G

A *client's main* claim is for the return of *client money* held in a *client bank account*. A *client* may claim for any *shortfall* against *money* held in a *firm's* own account. For that claim, the client will be an unsecured creditor of the *firm*.

^{/1}

Client money received after the failure of the firm

9.5.9

R

Client money received by the *firm* after a *primary pooling event* must not be pooled with *client money* held in any *client money* account operated by the *firm* at the time of the *primary pooling event*. It must be placed in a *client bank account* that has been opened after that event and must be handled in accordance with the *client money rules*, and returned to the relevant *client* without delay, except to the extent that:

^{/1}

- (1) it is *client money* relating to a transaction that has not settled at the time of the *primary pooling event*; or
- (2) it is *client money* relating to a *client*, for whom the *client money* entitlement, calculated in accordance with ■ COB 9.3.119, shows that *money* is due from the *client* to the *firm* at the time of the *primary pooling event*.

9.5.10

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Client money received after the *primary pooling event* relating to an unsettled transaction should be used to settle that transaction. Examples of such transactions include:

^{/1}

- (1) an equity transaction with a trade date before the date of the *primary pooling event* and a settlement date after the date of the *primary pooling event*; or
- (2) a *contingent liability investment* that is 'open' at the time of the *primary pooling event* and is due to settle after the *primary pooling event*.

- 9.5.11 **R** /1 If a *firm* receives a *mixed remittance* after a *primary pooling event*, it must:
- (1) pay the full sum into the separate *client bank account* opened in accordance with ■ COB 9.5.9; and
 - (2) pay the *money* that is not *client money* out of that *client bank account* into a *firm's* own bank account within one *business day* of the *day* on which the *firm* would normally expect the remittance to be cleared.

- 9.5.12 **G** /1 Whenever possible the *firm* should seek to split a *mixed remittance* before the relevant accounts are credited.

Failure of a bank, intermediate broker, settlement agent or OTC counterparty: secondary pooling events

- 9.5.13 **R** /1 If both a *primary pooling event* and a *secondary pooling event* occur, the provisions of this section relating to a *primary pooling event* apply.

- 9.5.14 **R** /1 A *secondary pooling event* occurs on the *failure* of a third party to which *client money* held by the *firm* has been transferred under ■ COB 9.3.42 or ■ COB 9.3.64.

- 9.5.15 **R** /1 ■ COB 9.5.20 to ■ COB 9.5.32 do not apply if, on the *failure* of the third party, the *firm* repays to its *clients* or pays into a *client bank account*, at an unaffected bank, an amount equal to the amount of *client money* which would have been held if a *shortfall* had not occurred at that third party.

- 9.5.16 **G** /1 When *client money* is transferred to a third party, a *firm* continues to owe a fiduciary duty to the *client*. However, consistent with a fiduciary's responsibility (whether as agent or trustee) for third parties under general law, a *firm* will not be held responsible for a *shortfall* in *client money* caused by a third party *failure* if it has complied with those duties.

- 9.5.17 **G** /1 To comply with its duties the *firm* should show proper care:
- (1) in the selection of a third party; and
 - (2) when monitoring the performance of the third party.

By demonstrating compliance with ■ COB 9.3.76, a *firm* should be able to demonstrate that it has taken reasonable steps to comply with its duties.

Failure of a bank

- 9.5.18 **G** /1 When a bank *fails* and the *firm* decides not to make good the *shortfall* in the amount of *client money* held at that bank, a *secondary pooling event* will occur in accordance with ■ COB 9.5.20. The *firm* would be expected to reflect the *shortfall*

that arises at the *failed* bank in the daily *client money* calculation by reducing the *client money* resource and *client money* requirement accordingly.

9.5.19

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The *client money distribution rules* seek to ensure that *clients* who have previously specified that they are not willing to accept the risk of the bank that has *failed*, and who therefore requested that their *client money* be placed in a *designated client bank account* at a different bank, should not suffer the loss of the bank that has *failed*.

Failure of a bank: pooling

9.5.20

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If a *secondary pooling event* occurs as a result of the *failure* of a bank where one or more *general client bank accounts* are held, then:

- (1) in relation to every *general client bank account* of the *firm*, the provisions of ■ COB 9.5.22 and ■ COB 9.5.27 to ■ COB 9.5.29 will apply;
- (2) in relation to every *designated client bank account* held by the *firm* with the *failed* bank, the provisions of ■ COB 9.5.24 and ■ COB 9.5.27 to ■ COB 9.5.29 will apply;
- (3) in relation to each *designated client fund account* held by the *firm* with the *failed* bank, the provisions of ■ COB 9.5.25 and ■ COB 9.5.27 to ■ COB 9.5.29 will apply;
- (4) any *money* held at a bank, other than the bank that has *failed*, in *designated client bank accounts*, is not pooled with any other *client money*; and
- (5) any *money* held in a *designated client fund account*, no part of which is held by the bank that has *failed*, is not pooled with any other *client money*.

9.5.21

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If a *secondary pooling event* occurs as a result of the *failure* of a bank where one or more *designated client bank accounts* or *designated client fund accounts* are held, then;

- (1) in relation to every *designated client bank account* held by the *firm* with the *failed* bank, the provisions of ■ COB 9.5.24 and ■ COB 9.5.27 to ■ COB 9.5.29 will apply; and
- (2) in relation to each *designated client fund account* held by the *firm* with the *failed* bank, the provisions of ■ COB 9.5.25 and ■ COB 9.5.27 to ■ COB 9.5.29 will apply.

9.5.22

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Money held in each *general client bank account* and *client transaction account* of the *firm* must be treated as pooled and:

- (1) any *shortfall* in *client money* held, or which should have been held, in *general client bank accounts* and *client transaction accounts*, that has arisen as a result of the *failure* of the bank,

must be borne by all the *clients* whose *client money* is held in either a *general client bank account* or *client transaction account* of the *firm*, rateably in accordance with their entitlements;

- (2) a new *client money* entitlement must be calculated for each *client* by the *firm*, to reflect the requirements in (1), and the *firm's* records must be amended to reflect the reduced *client money* entitlement;
- (3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* at the *failed* bank until the *client* is repaid; and
- (4) the *firm* must use the new *client* entitlements, calculated in accordance with (2), when performing the daily *client money* calculation in accordance with ■ COB 9.3.99 to ■ COB 9.3.119.

9.5.23

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The term 'which should have been held' is a reference to the *failed* bank's failure to hold the *client money* at the time of the pooling event.

9.5.24

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For each *client* with a *designated client bank account* held at the *failed* bank:

- (1) any *shortfall* in *client money* held, or which should have been held, in *designated client bank accounts* that has arisen as a result of the *failure*, must be borne by all the *clients* whose *client money* is held in a *designated client bank account* of the *firm* at the *failed* bank, rateably in accordance with their entitlements;
- (2) a new *client money* entitlement must be calculated for each of the relevant *clients* by the *firm*, and the *firm's* records must be amended to reflect the reduced *client money* entitlement;
- (3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* at the *failed* bank until the *client* is repaid; and
- (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), when performing the daily *client money* calculation, in accordance with ■ COB 9.3.99 to ■ COB 9.3.119.

9.5.25

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Money held in each *designated client fund account* with the *failed* bank must be treated as pooled with any other *designated client fund accounts* of the *firm* which contain part of the same designated fund and:

- (1) any *shortfall* in *client money* held, or which should have been held, in *designated client fund accounts* that has arisen as a result of the *failure*, must be borne by each of the *clients* whose *client money* is held in that designated fund, rateably in accordance with their entitlements;

- (2) a new *client* entitlement must be calculated for each *client* by the *firm*, in accordance with (1), and the *firm's* records must be amended to reflect the reduced *client money* entitlement;
- (3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* at the *failed* bank until the *client* is repaid; and
- (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), when performing the daily *client money* calculation in accordance with ■ COB 9.3.99 to ■ COB 9.3.119.

9.5.26

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A *client* whose *money* was held, or which should have been held, in a *designated client bank account* with a bank that has *failed* is not entitled to claim in respect of that *money* against any other *client bank account* or *client transaction account* of the *firm*.

Client money received after the failure of a bank

9.5.27

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Client money received by the *firm* after the *failure* of a bank, that would otherwise have been paid into a *client bank account* at that bank:

- (1) must not be transferred to the *failed* bank unless specifically instructed by the *client* in order to settle an obligation of that *client* to the *failed* bank; and
- (2) must be, subject to (1), placed in a separate *client bank account* that has been opened after the *secondary pooling event* and either:
 - (a) on the written instruction of the *client*, transferred to a bank other than the one that has *failed*; or
 - (b) returned to the *client* as soon as possible.

9.5.28

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If a *firm* receives a *mixed remittance* after the *secondary pooling event* which consists of *client money* that would have been paid into a *general client bank account*, a *designated client bank account* or a *designated client fund account* maintained at the bank that has *failed*, it must:

- (1) pay the full sum into a *client bank account* other than one operated at the bank that has *failed*; and
- (2) pay the *money* that is not *client money* out of that *client bank account* within one *business day* of the day on which the *firm* would normally expect the remittance to be cleared.

9.5.29

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Whenever possible the *firm* should seek to split a *mixed remittance* before the relevant accounts are credited.

**Failure of an intermediate broker, settlement agent or OTC counterparty:
Pooling**

9.5.30 **R** ^{/1} If a *secondary pooling event* occurs as a result of the *failure* of an *intermediate broker, settlement agent* or *OTC counterparty*, then in relation to every *general client bank account* and *client transaction account* of the *firm*, the provisions of **■ COB 9.5.31** and **■ COB 9.5.27** to **■ COB 9.5.29** will apply.

9.5.31 **R** ^{/1} Money held in each *general client bank account* and *client transaction account* of the *firm* must be treated as pooled and:

- (1) any *shortfall* in *client money* held, or which should have been held, in *general client bank accounts* and *client transaction accounts*, that has arisen as a result of the *failure*, must be borne by all the *clients* whose *client money* is held in either a *general client bank account* or a *client transaction account* of the *firm*, rateably in accordance with their entitlements;
- (2) a new *client money* entitlement must be calculated for each *client* by the *firm*, to reflect the requirements of (1), and the *firm's* records must be amended to reflect the reduced *client money* entitlement;
- (3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* at the *failed intermediate broker, settlement agent* or *OTC counterparty* until the *client* is repaid; and
- (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), when performing the daily *client money* calculation, in accordance with **■ COB 9.3.99** to **■ COB 9.3.119**.

**Client money received after the failure of an intermediate broker,
settlement agent or OTC counterparty**

9.5.32 **R** ^{/1} *Client money* received by the *firm* after the *failure* of an *intermediate broker, settlement agent* or *OTC counterparty*, that would otherwise have been paid into a *client transaction account* at that *intermediate broker, settlement agent* or *OTC counterparty*:

- (1) must not be transferred to the *failed* third party unless specifically instructed by the *client* in order to settle an obligation of that *client* to the *failed intermediate broker, settlement agent* or *OTC counterparty*; and
- (2) must be, subject to (1), placed in a separate *client bank account* that has been opened after the *secondary pooling event* and either:

- (a) on the written instruction of the *client*, transferred to a third party other than the one that has *failed*; or
- (b) returned to the *client* as soon as possible.

Notification on the failure of a bank, intermediate broker, settlement agent or OTC counterparty

9.5.33

R

The provisions of ■ COB 9.3.98 apply.

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Chapter 10

Operators of collective investment schemes



10.1 Application

- 10.1.1** **R** (1) ■ COB 10 applies to a *firm* which is an *operator* of a *collective investment scheme* in accordance with ■ COB 10.1.2.
/1
- (2) The right hand column of the table in ■ COB 10.1.2 specifies the sections in ■ COB 10 which apply to the *operator* specified in the left hand column of the table.

10.1.2 **R** Table Application
/1 This table belongs to ■ COB 10.1.1

Application	
Type of firm	Section
<i>Operator of a regulated collective investment scheme in so far as the firm is undertaking scheme management activity.</i>	COB 10.1, 10.2 and 10.3
<i>Operator of an unregulated collective investment scheme in so far as the firm is undertaking scheme management activity.</i>	COB 10.1, 10.2, 10.3, 10.4 and 10.5
<i>Operator of an unregulated collective investment scheme.</i>	COB 10.1, 10.6 and 10.7

10.1.3 **G** The term *operator* includes an *authorised corporate director* of an ICVC.
/1

10.1.4 **G** *Operators* are also required to comply with the other relevant provisions of the *Handbook*. For example:
/1

- (1) The Principles for Business (*PRIN*);
- (2) Senior Management Arrangements, Systems and Controls (*SYSC*);
- (3) an *operator* that *communicates* or *approves* a *financial promotion* relating to a *scheme* is also required to comply with ■ COB 3;
- (4) an *operator* that holds *clients' money* otherwise than as *trustee* of an *unregulated collective investment scheme* is also required to comply with ■ COB 9.3;
- (5) an *operator* that is also the *trustee* of an *unregulated collective investment scheme* is also required to comply with ■ COB 11 in relation to its activity as a *trustee firm*;

- (6) an *operator* of an *authorised unit trust scheme* is also required to comply with the Collective Investment Schemes sourcebook (*CIS*);
- (7) an *operator* of an *ICVC* is also required to comply with the Collective Investment Schemes sourcebook (*CIS*); and
- (8) an *operator* is also required to comply with the Money Laundering sourcebook (*ML*).

Purpose

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The purpose of this chapter is:

- (1) to take into account the existence of other legislation and *rules* that may apply to *operators* (for example, the Collective Investment Schemes sourcebook); to adopt or disapply *rules* from other chapters in *COB*; in this way, conflicts between *rules* and duplication of *rules* are avoided;
- (2) to make a number of general modifications to the operation of the applied *rules* in *COB* in the *operator* context; in general, the ordinary definition of a '*customer*' is modified to mean the '*scheme*'; however, in certain circumstances, such as an obligation to provide certain kinds of information about the *scheme* and its *investments*, the ordinary definition of a '*customer*' is modified to mean a '*participant*' in the *scheme*; and
- (3) to apply a number of *rules* that have been specifically designed to apply to *operators* when undertaking *scheme management activity*.

10.2 Application of general COB rules

Application or modification of general COB rules for operators

- 10.2.1 **R** ^{/1} An *operator* when it is undertaking *scheme management activity*:
- (1) must comply with the *rules* specified in ■ COB 10.2.5 as modified by ■ COB 10.2.3 and in ■ COB 10.2.5;
 - (2) need not comply with any other *rule* in COB; and

- 10.2.2 **G** ^{/1} *Firms* which are operators are reminded that under the *Glossary*:
- (1) every *regulated collective investment scheme* is a *private customer*; and
 - (2) every *unregulated collective investment scheme* is an *intermediate customer*.

General modifications

- 10.2.3 **R** ^{/1} The *rules* specified in ■ COB 10.2.5 apply to an *operator* when it is undertaking *scheme management activity* (unless otherwise expressly provided in this chapter) with the following modifications:
- (1) subject to (3), references to *customer* are to be construed as references to any *scheme* in respect of which the *operator* is acting or intends to act, and with or for the benefit of which the relevant activity is to be carried on;
 - (2) In the case of an *unregulated collective investment scheme*, references to *terms of business* or a *client agreement* are to be construed as references to the scheme documents of an *unregulated collective investment scheme* required by ■ COB 10.6.2; and
 - (3) in the case of an *unregulated collective investment scheme*, when an *operator* is required by the *rules* in COB to provide information to, or obtain consent from, a *customer*, the *operator* must ensure that the information is provided to, or consent obtained from, a *participant* or a potential *participant* in the *scheme* as the case may be.

10.2.4 **G** Terms including the word ‘customer’ such as *customer order* and *current customer order* are to be construed in accordance with ■ COB 10.2.3.
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10.2.5 **R** Table Application of conduct of business rules
This table belongs to ■ COB 10.2.1
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Application of conduct of business rules		
Chapter, Section or Rule	Description	Modifications
1	Application and general provisions	
2.1	Clear, fair and not misleading communication	
2.2	Inducements and soft commission	In the case of a <i>regulated collective investment scheme</i> , COB 2.2.8R(5) and COB 2.2.16R to 2.2.19R do not apply.
2.3	Reliance on others	
2.4	Chinese Walls	
5.3	Suitability	COB 10.4 applies instead of COB 5.3.
7.1	Conflict of interest and material interest	
7.2	Churning and switching	
7.4	Customer order priority	
7.5	Best execution	In the case of an <i>unregulated collective investment scheme</i> , COB 10.5.3R applies instead of COB 7.5.4R in the circumstances set out in COB 10.5.3R.
7.6	Timely execution	
7.7	Aggregation and allocation	COB 10.3.3E applies instead of COB 7.7.6E. COB 10.3.5R applies instead of COB 7.7.14R.
7.12	Customer order and execution records	
10	Operators of collective investment schemes	



10.3 Modification of the allocation rule

- 10.3.1** **R** ^{/1} ■ COB 10.3 applies to an *operator* only when undertaking *scheme management activity*.
- 10.3.2** **G** ^{/1} ■ COB 10.3.3 replaces ■ COB 7.7.6. ■ COB 10.3.3 modifies the general *rule* on the timing of allocation (ie, ■ COB 7.7.5) to take into account the kind of *scheme* in which no *participant* is a *private customer*.
- 10.3.3** **E** ^{/1}
- (1) To allocate promptly, an *operator* which has aggregated an order under ■ COB 7.7.4 should complete the allocation of the *designated investments* concerned within one *business day* of the transaction, subject to (2), (3) and (4).
 - (2) The period in (1) is within five *business days* if:
 - (a) the *scheme* is one in which no *participant* is a *private customer*; or
 - (b) the *scheme* is an *unregulated collective investment scheme* and no current *participant* in the *scheme* was a *private customer* on joining the *scheme* as a *participant*.
 - (3) For the purposes of ■ COB 10.3.3, all transactions in a *series of transactions* all of which are *executed* within one *business day*, may be treated as having been *executed* at the time of the last transaction, so long as a record of the time that each individual transaction was *executed* is made, such as by means of a time stamp.
 - (4) If transactions in a *series of transactions* occur over more than one *business day*, then the requirement in ■ COB 7.7.5 (and (1) or (2) as appropriate) will apply separately in relation to each *business day* in which any transaction is *executed*.
 - (5) Compliance with (1) may be relied on as tending to establish compliance with ■ COB 7.7.5.
 - (6) Contravention of (1) may be relied on as tending to establish contravention of ■ COB 7.7.5.
- 10.3.4** **G** ^{/1} ■ COB 10.3.5 replaces ■ COB 7.7.14. ■ COB 10.3.5 modifies the general *rule* on the record keeping of aggregated transactions (that is, ■ COB 7.7.14) to take into account the fact that an *operator* may act on a proportional basis or otherwise and

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may also act for all *schemes* under its management or for some of the *schemes* under its management.

- (1) **An operator must, on executing an aggregated transaction on behalf of a number of schemes under its management, make a record of:**
 - (a) the identity of the *schemes* concerned; and
 - (b) whether the transaction was *executed* proportionally for these *schemes* under its management generally or that a stated proportion was *executed* for some *schemes* under its management.
- (2) **If an operator aggregates a number of customer orders on behalf of a number of schemes under its management, the operator must make a record of the intended basis of allocation as soon as is practicable.**
- (3) **If an operator aggregates an order for one or more schemes under its management and itself, the operator must make a record of the intended basis of allocation before the transaction is executed.**



10.4 Suitability of the portfolio of an unregulated collective investment scheme

10.4.1 **R** ^{/1} ■ COB 10.4 applies to an *operator* of an *unregulated collective investment scheme* only when undertaking *scheme management activity*.

10.4.2 **G** ^{/1} ■ COB 10.4 adapts ■ COB 5.3 (Suitability) for an *operator* of an *unregulated collective investment scheme*. It requires the *operator* to ensure that its management of the portfolio of the *scheme* is suitable taking into account its investment management objectives. The Collective Investment Schemes sourcebook deals separately with the basis upon which an *operator* of a *regulated collective investment scheme* manages its portfolio.

10.4.3 **R** ^{/1} An *operator* of an *unregulated collective investment scheme* when it is undertaking *scheme management activity* must take reasonable steps to ensure that:

- (1) each transaction undertaken with or for an *unregulated collective investment scheme* under its management; and
- (2) the portfolio for an *unregulated collective investment scheme* under its management;

is suitable for the *scheme*.

10.4.4 **G** ^{/1} For the purposes of ■ COB 10.4.3, an *operator* of an *unregulated collective investment scheme* should have regard to the stated investment objectives of the *scheme*.



10.5 Modification of the best execution rule

- 10.5.1** **R** _{/1} ■ COB 10.5 applies to an *operator* of an *unregulated collective investment scheme* only when undertaking *scheme management activity*.
- 10.5.2** **G** _{/1} ■ COB 10.5.3 modifies the effect of ■ COB 7.5.4. ■ COB 10.5.3 modifies the general *rule* (that is, ■ COB 7.5.4) on the exceptions to the best execution *rule* (that is, ■ COB 7.5.3) to take into account the existence of *unregulated collective investment schemes* in which no *participant* is a *private customer*.
- 10.5.3** **R** _{/1} ■ COB 7.5.3 does not apply:
- (1) in any of the circumstances specified in ■ COB 7.5.4; or
 - (2) in relation to an *unregulated collective investment scheme* whose scheme documents include a statement that best execution does not apply in relation to the *scheme* and in which:
 - (a) no *participant* is a *private customer*; or
 - (b) no current *participant* in the *scheme* was a *private customer* on joining the *scheme* as a *participant*.



10.6 Scheme documents for an unregulated collective investment scheme

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■ COB 10.6.2 fulfils the purpose of the *terms of business* (including the *client agreement*) requirements (see ■ COB 4.2) in the context of an *unregulated collective investment scheme* by application of content requirements in scheme documents. In this way, the scheme documents record the basis on which the *operator* provides investment management services to a *participant* in the *scheme*. The Collective Investment Schemes sourcebook deals separately with the basis upon which an *operator* of a *regulated collective investment scheme* provides investment management services to a *participant* of the *scheme*.

Provision of scheme documents to private customers

10.6.2

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An *operator* of an *unregulated collective investment scheme* must not accept a *private customer* as a *participant* in the *scheme* unless it has taken reasonable steps to offer and, if requested, provide to the potential *participant* scheme documents which adequately describe how the operation of the *scheme* is governed.

Format and content of scheme documents

10.6.3

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An *operator's* scheme documents may consist of any number of *documents* provided that it is clear that collectively they constitute the scheme documents and provided the use of several *documents* in no way diminishes the significance of any of the statements which are required to be given to the potential *participant*.

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■ COB 10.6.4 is intended to ensure that the scheme documents of an *unregulated collective investment scheme* (if they exist) make it clear that if a *participant* is reclassified as a *private customer*, this reclassification will not affect certain *scheme management activities* of the *operator* of the *scheme*. In particular, despite such a reclassification, the *operator* will not be required to comply with ■ COB 7.5.3 (that is, the *best execution rule*) and the requirement in ■ COB 10.3.3(1) to complete the allocation of an aggregated transaction order within one *business day* of the transaction. It should be noted that ■ COB 10.6.5 does not require that scheme documents must be produced for an *unregulated collective investment scheme*.

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Where the *scheme* is an *unregulated collective investment scheme* where no current *participant* in the *scheme* was a *private customer* on joining the *scheme* as a *participant*, the scheme documents must include a statement that:

- (1) explains that if a *participant* is reclassified as a *private customer* subsequent to joining the *scheme* as a *participant*, then the *operator* may continue to treat all *participants* in the *scheme* as though they were not *private customers*; and
- (2) explains that, in respect of an order aggregated under ■ COB 7.7.4, the *operator* may allocate the *designated investments* concerned within five *business days* of the transaction;
- (3) explains that if a *participant* is reclassified as a *private customer* subsequent to joining the *scheme* as a *participant*, then ■ COB 10.5.3 will continue to apply to that *scheme*; and
- (4) explains that, in the event of a reclassification described in (3), the *operator* will not be required to provide best execution under ■ COB 7.5.3 in relation to the *scheme*.

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It should be noted that the *operator* will still have to comply with other COB provisions as a result of the reclassification of a *participant* as a *private customer*: for example, the requirement under ■ COB 10.7.2 to provide *periodic statements* to *participants* who are *private customers* in an *unregulated collective investment scheme*.

Adequate Information

10.6.7



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- (1) In order to provide adequate information in scheme documents under ■ COB 10.6.2, an *operator* should include in the scheme documents required by ■ COB 10.6.2 a provision about each of the items of relevant information set out in ■ COB 10.6.8.
- (2) Compliance with (1) may be relied on as tending to establish compliance with ■ COB 10.6.2.
- (3) Contravention of (1) may be relied on as tending to establish contravention of ■ COB 10.6.2.

10.6.8



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Table Content of scheme documents
This table belongs to ■ COB 10.6.7

Content of scheme documents

The scheme documents should include provision about:

- (1) Regulator
the fact that the *operator* is regulated by or authorised by the *FSA*;
- (2) Services
the nature of the services that the *operator* will provide in relation to the *scheme*;
- (3) Payments for services

Content of scheme documents	
	<p>details of any payment for services payable by the <i>scheme</i> or from the property of the <i>scheme</i> or <i>participants</i> in the <i>scheme</i> to the <i>operator</i>, including where appropriate:</p> <ul style="list-style-type: none"> (a) the basis of calculation; (b) how it is to be paid and collected; (c) how frequently it is to be paid; and (d) whether or not any other payment is receivable by the <i>operator</i> (or to its knowledge by any of its <i>associates</i>) in connection with any transactions effected by the <i>operator</i> with or for the <i>scheme</i>, in addition to or in lieu of any fees;
(4)	<p>Commencement</p> <p>when and how the <i>operator</i> is appointed;</p>
(5)	<p>Accounting</p> <p>the arrangements for accounting to the <i>scheme</i> or <i>participants</i> in the <i>scheme</i> for any transaction effected;</p>
(6)	<p>Termination method</p> <p>how the appointment of the <i>operator</i> may be terminated;</p>
(7)	<p>Complaints procedure</p> <p>how to complain to the <i>operator</i> and a statement that the <i>participants</i> in the <i>scheme</i> may subsequently complain direct to the <i>Financial Ombudsman Service</i>;</p>
(8)	<p>Compensation</p> <p>an explanation of the compensation arrangements available to <i>participants</i> under the <i>Act</i> if the <i>operator</i> is unable to meet any of its liabilities, or the availability of an explanation describing those arrangements;</p>
(9)	<p>Investment objectives</p> <p>the investment objectives for the portfolio of the <i>scheme</i>;</p>
(10)	<p>Restrictions</p> <ul style="list-style-type: none"> (a) any restrictions on: <ul style="list-style-type: none"> (i) the types of <i>investments</i> or property which may be included in the portfolio of the <i>scheme</i>; and (ii) markets on which <i>investments</i> or property may be acquired for the portfolio of the <i>scheme</i>; (iii) the amount or value of any one <i>investment</i> or asset, or on the proportion of the portfolio of the <i>scheme</i> which any one <i>investment</i> or asset or any particular kind of <i>investment</i> or asset may constitute; or (b) that there are no such restrictions;
(11)	<p>Holding of scheme assets</p> <ul style="list-style-type: none"> (a) if it is the case, that the <i>operator</i> will:

Content of scheme documents	
	<ul style="list-style-type: none"> (i) hold <i>money</i> on behalf of the <i>scheme</i> or be the <i>custodian</i> of <i>investments</i> or other property of the <i>scheme</i>; or (ii) arrange for some other <i>person</i> to act in either capacity and, if so, whether that <i>person</i> is an <i>associate</i> of the <i>operator</i> identifying that <i>person</i> and describing the nature of any association; and
(b)	<p>in either case:</p> <ul style="list-style-type: none"> (i) how any <i>money</i> is to be deposited; (ii) the arrangements for recording and separately identifying registrable <i>investments</i> of the <i>scheme</i> and, where the registered holder is the <i>operator's</i> own nominee, that the <i>operator</i> will be responsible for the acts and omissions of that <i>person</i>; (iii) the extent to which the <i>operator</i> accepts liability for any loss of the <i>investments</i> of the <i>scheme</i>; (iv) the extent to which the <i>operator</i> or any other <i>person</i> mentioned in (11)(a)(ii), may hold a lien or security interest over <i>investments</i> of the <i>scheme</i>; (v) where <i>investments</i> of the <i>scheme</i> will be registered collectively in the same name, a statement that the entitlements of the <i>scheme</i> may not be identifiable by separate certificates or other physical documents of title, and that, should the <i>operator</i> default, any shortfall in <i>investments</i> of the <i>scheme</i> registered in that name may be shared proportionately among all <i>schemes</i> and any other <i>customers</i> of the <i>operator</i> whose <i>investments</i> are so registered; (vi) whether or not <i>investments</i> or other property of the <i>scheme</i> can be lent to, or deposited by way of collateral with, a third party and whether or not <i>money</i> can be borrowed on the behalf of the <i>scheme</i> against the security of those <i>investments</i> or property and, if so, the terms upon which they may be lent or deposited; (vii) the arrangements for accounting to the <i>scheme</i> for <i>investments</i> of the <i>scheme</i>; for income received (including any interest on <i>money</i> and any income earned by lending <i>investments</i> or other property) of the <i>scheme</i>; and for rights conferred in respect of <i>investments</i> or other property of the <i>scheme</i>; (viii) the arrangements for determining the exercise of any voting rights conferred by <i>investments</i> of the <i>scheme</i>; and

Content of scheme documents	
	(ix) where <i>investments</i> of the <i>scheme</i> may be held by an eligible <i>custodian</i> outside the <i>United Kingdom</i> , a general statement that different settlement, legal and regulatory requirements, and different practices relating to the segregation of those <i>investments</i> , may apply;
(12)	<p>Clients' money outside the United Kingdom</p> <p>if it is the case, that the <i>operator</i> may hold the <i>money</i> of the <i>scheme</i> in a <i>client bank account</i> outside the <i>United Kingdom</i>;</p>
(13)	<p>Exchange rates</p> <p>if a liability of the <i>scheme</i> in one currency is to be matched by an asset in a different currency, or if the services to be provided to the <i>operator</i> for the <i>scheme</i> may relate to an <i>investment</i> denominated in a currency other than the currency in which the <i>investments</i> of the <i>scheme</i> are valued, a warning that a movement of exchange rates may have a separate effect, unfavourable or favourable, on the gain or loss otherwise made on the <i>investments</i> of the <i>scheme</i>;</p>
(14)	<p>Stabilised investments</p> <p>if it is the case, that the <i>operator</i> is to have the right under the <i>scheme documents</i> to effect transactions in <i>investments</i> the prices of which may be the subject of stabilisation;</p>
(15)	<p>Conflict of interest and material interest</p> <p>if it is the case, that the <i>operator</i> is to have the right under the agreement or <i>instrument constituting the scheme</i> to effect transactions on behalf of the <i>scheme</i> in which the <i>operator</i> has directly or indirectly a material interest (except for an interest arising solely from the participation of the <i>operator</i> as agent for the <i>scheme</i>), or a relationship of any description with another party which may involve a conflict with the <i>operator's</i> duty to the <i>scheme</i>, together with a disclosure of the nature of the interest or relationship;</p>
(16)	<p>Use of soft commission agreements</p> <p>if the <i>operator</i> is to be authorised under the agreement or <i>instrument constituting the scheme</i> to effect transactions with or through the agency of another <i>person</i> with whom the <i>operator</i> has a <i>soft commission agreement</i>, the prior disclosure required by <i>COB 2.2.16R</i>;</p>
(17)	<p>Acting as principal</p> <p>if it is the case, that the <i>operator</i> may act as <i>principal</i> in a transaction with the <i>scheme</i>;</p>
(18)	<p>Stock lending</p> <p>if it is the case, that the <i>operator</i> may undertake <i>stock lending activity</i> with or for the <i>scheme</i> specifying the type of assets of the <i>scheme</i> to be lent, the type and value of <i>relevant collateral</i> from the borrower and the method and amount of payment due to the <i>scheme</i> in respect of the lending;</p>

Content of scheme documents	
(19)	<p>Transactions involving contingent liability investments</p> <ul style="list-style-type: none"> (a) if it is the case, that the agreement or <i>instrument constituting the scheme</i> allows the <i>operator</i> to effect transactions involving <i>contingent liability investments</i> for the account of the portfolio of the <i>scheme</i>; (b) if applicable, whether there are any limits on the amount to be committed by way of margin and, if so, what those limits are; and (c) if applicable, that the <i>operator</i> has the authority to effect transactions involving <i>contingent liability investments</i> otherwise than under the rules of a <i>recognised investment exchange</i> or <i>designated investment exchange</i> and in a contract traded thereon;
(20)	<p>Periodic statements</p> <ul style="list-style-type: none"> (a) the frequency of any <i>periodic statement</i> (this should not be less than once every 12 months under <i>COB 10.7.3E</i>) except where a <i>periodic statement</i> is not required by <i>COB 10.7.5R</i> (Exceptions from the requirement to provide a periodic statement); and (b) whether those statements will include some measure of performance, and, if so, what the basis of that measurement will be;
(21)	<p>Valuation</p> <p>the bases on which assets comprised in the portfolio of the <i>scheme</i> are to be valued;</p>
(22)	<p>Borrowings</p> <p>if it is the case, that the <i>operator</i> may supplement the funds in the portfolio of the <i>scheme</i> and, if it may do so:</p> <ul style="list-style-type: none"> (a) the circumstances in which the <i>operator</i> may do so; (b) whether there are any limits on the extent to which the <i>operator</i> may do so and, if so, what those limits are; and (c) any circumstances in which such limits may be exceeded;
(23)	<p>Underwriting commitments</p> <p>if it is the case, that the <i>operator</i> may for the account of the portfolio of the <i>scheme</i> underwrite or sub-underwrite any issue or offer for sale of <i>securities</i>, and:</p> <ul style="list-style-type: none"> (a) whether there are any restrictions on the categories of <i>securities</i> which may be underwritten and, if so, what these restrictions are; and (b) whether there are any financial limits on the extent of the underwriting and, if so, what these limits are;
(24)	<p>Investments in other collective investment schemes</p>

Content of scheme documents	
	whether or not the portfolio may contain <i>units</i> in a <i>collective investment scheme</i> either operated or advised by the <i>operator</i> or by an <i>associate</i> of the <i>operator</i> or in a <i>collective investment scheme</i> which is not a <i>regulated collective investment scheme</i> ;
(25)	Investments in securities underwritten by the operator whether or not the portfolio may contain <i>securities</i> of which any issue or offer for sale was underwritten, managed or arranged by the <i>operator</i> or by an <i>associate</i> of the <i>operator</i> during the preceding 12 months.



10.7 Periodic statements for an unregulated collective investment scheme

10.7.1 **G**_{/1} ■ COB 10.7 applies in the case of an *operator* of an *unregulated collective investment scheme*. ■ COB 10.7 modifies the general section on *periodic statements* (that is, ■ COB 8.2) to take into account the operation of an *unregulated collective investment scheme*. In this way, an *operator* should send to a *participant* of the *scheme*, on a timely basis, a regular statement providing a valuation of the portfolio of the *scheme* and other details.

The requirement to prepare and issue periodic statements

10.7.2 **R**_{/1} An *operator* of an *unregulated collective investment scheme* must, subject to ■ COB 10.7.5, provide to *participants* in the *scheme*, promptly and at suitable intervals, a written statement which contains adequate information on the value and composition of the portfolio of the *scheme* at the beginning and end of the period of the statement.

Promptness, suitable intervals and adequate information

10.7.3 **E**_{/1}

- (1) An *operator* should act in accordance with the provisions in the right hand column of ■ COB 10.7.7 to fulfil the requirement of ■ COB 10.7.2 indicated in the left hand column against these provisions.
- (2) Compliance with (1) may be relied on as tending to establish compliance with ■ COB 10.7.2.
- (3) Contravention of (1) may be relied on as tending to establish contravention of ■ COB 10.7.2.

10.7.4 **G**_{/1} Regarding the electronic provision of a *periodic statement*, see ■ COB 1.8.

Exceptions from the requirement to provide a periodic statement

10.7.5 **R**_{/1} An *operator* of an *unregulated collective investment scheme* need not provide a *periodic statement*:

- (1) (a) to a *participant* in the *scheme* who is a *private customer* ordinarily resident outside the *United Kingdom*; or

- (b) to a *participant* in the *scheme* who is an *intermediate customer*;
- (1) if the *participant* has so requested or the *operator* has taken reasonable steps to establish that the *participant* does not wish to receive it; or
- (2) if it would duplicate a statement to be provided by someone else.

Record keeping requirements

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An *operator* of an *unregulated collective investment scheme* must make a copy of any *periodic statement* it has provided in accordance with ■ COB 10.7.2 to *participants* in the *scheme*. The record must be retained for a minimum period of three years.

10.7.7



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Table Periodic statements
This table belongs to ■ COB 10.7.3

Periodic statements			
Promptness	(1)	(a)	A <i>periodic statement</i> should be provided within 25 <i>business days</i> after the end of the period to which the statement relates.
		(b)	In the case of: <ul style="list-style-type: none"> (i) a <i>scheme</i> the portfolio of which is comprised exclusively of investment in equity that is not traded or listed on an exchange; or (ii) a <i>scheme</i> which is a <i>property enterprise trust</i>; or (iii) a <i>scheme</i> the portfolio of which is comprised exclusively of investment in equity that is not traded or listed on an exchange and assets which are land and buildings; the <i>operator</i> should provide a <i>periodic statement</i> within 50 <i>business days</i> after the end of the period to which the statement relates.
Suitable intervals	(2)		A <i>periodic statement</i> should be provided at least: <ul style="list-style-type: none"> (a) six-monthly; or (b) once in any other period, not exceeding 12 months, which has been mutually agreed between the <i>operator</i> and the <i>participant</i> in the <i>scheme</i>.
Adequate information	(3)		A <i>periodic statement</i> should contain:

Periodic statements			
	(a)	(i)	the information set out in <i>COB</i> 10.7.9E; and
		(ii)	where the portfolio of the <i>scheme</i> includes uncovered open positions in <i>contingent liability investments</i> , the additional information in <i>COB</i> 10.7.10E; or
	(b)		such information as a <i>participant</i> who is a <i>private customer</i> ordinarily resident outside the <i>United Kingdom</i> , or an <i>intermediate customer</i> , has on his own initiative agreed with the <i>operator</i> as adequate.

10.7.8



Examples of uncovered open positions include:

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- (1) selling a call *option* on an *investment* not held in the portfolio;
- (2) unsettled sales of call *options* on currency in amounts greater than the portfolio's holding of that currency in cash or in *readily realisable investments* denominated in that currency; and
- (3) transactions having the effect of 'selling' an index to an amount greater than the portfolio's holdings of *investments* included in that index.

10.7.9



Table General contents of a periodic statement
This table belongs to ■ *COB* 10.7.7

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General contents of a periodic statement	
1	<p>Contents and value</p> <p>(a) As at the beginning of the account period, the total value of the portfolio of the <i>scheme</i>, being either:</p> <p>(i) the value of the assets comprised in the portfolio on the date as at which the statement provided for the immediately preceding period of account is made up; or</p> <p>(ii) in the case of the first <i>periodic statement</i>, the value of the assets comprised in the portfolio on the date on which the <i>operator</i> assumed responsibility for the management of the portfolio.</p> <p>(b) As at the end of the account period:</p> <p>(i) the number, description and value of each <i>investment</i> held on behalf of the <i>scheme</i>;</p> <p>(ii) the amount of cash held on behalf of the <i>scheme</i>; and</p> <p>(iii) the total value of the portfolio of the <i>scheme</i>.</p>
2	Basis of valuation

General contents of a periodic statement

A statement of the basis on which the value of each *investment* has been calculated and, if applicable, a statement that the basis for valuing a particular *investment* has changed since the previous *periodic statement*. Where any *investments* are shown in a currency other than the usual one used for valuation of the portfolio of the *scheme*, the relevant currency exchange rates must be shown.

3 Details of any assets loaned or charged

- (a) A summary of those *investments* (if any) which were, at the closing date, loaned to any third party and those *investments* (if any) that were at that date charged to secure borrowings made on behalf of the portfolio of the *scheme*; and
- (b) the aggregate of any interest payments made and income received during the account period in respect of loans or borrowings made during the period.

4 Transactions and changes in composition

Except in the case of a portfolio which aims to track the performance of an external index:

- (a) a statement that summarises the transactions entered into for the portfolio of the *scheme* during the period; and
- (b) the aggregate of *money* and a summary of all *investments* transferred into and out of the portfolio of the *scheme* during the period; and
- (c) the aggregate of any interest payments, dividends and other benefits received by the *operator* for the portfolio of the *scheme* during that period.

5 Charges and remuneration

If not previously advised in writing, a statement for the account period:

- (a) of the aggregate *charges* of the *operator* and its *associates*; and
- (b) of any *remuneration* received by the *operator* or its *associates* or both from a third party in respect of the transactions entered into, or any other services provided, for the portfolio of the *scheme*.

6 Movement in value of portfolio

A statement of the difference between the value of the portfolio at the closing date and its value at the starting date of the account period, having regard at least, during the account period, to the following:

- (a) the aggregate of assets received from *participants* of the *scheme* and added to the portfolio of the *scheme*;
- (b) the aggregate of the value of assets transferred, or of amounts paid, to the *scheme*;
- (c) the aggregate income received on behalf of the *scheme* in respect of the portfolio; and

General contents of a periodic statement	
(d)	the aggregate of realised and unrealised profits or gains and losses attributable to the assets comprised in the portfolio of the <i>scheme</i> .
Notes:	
For the purposes of Item 1, where the <i>scheme</i> is a <i>property enterprise trust</i> , it will be sufficient for the <i>periodic statement</i> to disclose the number of properties held in successive valuation bands where this is appropriate to the size and composition of the <i>scheme</i> , rather than the value of each asset in the portfolio. The valuation bands of over £10m, £5–£10m, £2.5–£5m, £1–£2.5m and under £1m would be appropriate, unless an <i>operator</i> could show that different bands were justifiable in the circumstances.	
The statement to be provided under Item 6 is not intended to be an indicator of the performance of the portfolio of the <i>scheme</i> .	
An <i>operator</i> may wish to distinguish capital and income, and thereby provide more information than referred to in this table. If the statement includes some measure of performance, the basis of measurement should be stated.	

10.7.10



Table Contents of a periodic statement in respect of contingent liability investments
This table belongs to ■ COB 10.7.7

Contents of a periodic statement in respect of contingent liability investments	
1	<p>Changes in value</p> <p>The aggregate of <i>money</i> transferred into and out of the portfolio of the <i>scheme</i> during the account period.</p>
2	<p>Open positions</p> <p>In relation to each open position in the portfolio of the <i>scheme</i> at the end of the account period, the unrealised profit or loss to the portfolio of the <i>scheme</i> (before deducting or adding any <i>commission</i> which would be payable on closing out).</p>
3	<p>Closed positions</p> <p>In relation to each transaction effected during the account period to close out a position of the <i>scheme</i>, the resulting profit or loss to the portfolio of the <i>scheme</i> after deducting or adding any <i>commission</i>.</p> <p>(Instead of the specific detail required by Items 2 or 3, the statement may show the net profit or loss in respect of the overall position of the <i>scheme</i> in each contract)</p>
4	<p>Aggregate of contents</p> <p>The aggregate of each of the following in, or relating to, the portfolio of the <i>scheme</i> at the close of business on the valuation date:</p> <ul style="list-style-type: none"> (a) cash; (b) <i>collateral</i> value; (c) management fees; and

Contents of a periodic statement in respect of contingent liability investments

- (d) *commissions* attributable to transactions during the period or a statement that this information has been separately disclosed in writing on earlier statements or confirmations to the *participant*.

5 Option account valuations

In respect of each open *option* comprising the portfolio of the *scheme* on the valuation date:

- (a) the *share, future, index* or other *investment* or asset involved;
- (b) (unless the valuation statement follows the statement for the period in which the *option* was opened) the trade price and date for the opening transaction;
- (c) the market price of the contract; and
- (d) the exercise price of the contract.

Options account valuations may show an average trade price and market price in respect of an *option* series where a number of contracts within the same series have been purchased on behalf of the *scheme*.

Chapter 11

Trustee and depositary activities

11.1 Application

- 11.1.1** **R** ^{/1} This chapter applies to *depositaries* and *trustee firms* when acting as such.
- 11.1.2** **G** ^{/1} The definition of *depositary* includes *trustees* of authorised and unauthorised *unit trust schemes* as well as *depositaries* of ICVCs. The definition of *trustee firm* includes any *firm* carrying on activity as a trustee but not an *OPS firm*. There is overlap between these definitions. A *trustee* of an *authorised unit trust scheme* is both a *trustee firm* and a *depositary*.
- 11.1.3** **G** ^{/1} The definition of *trustee firm* includes a *firm* acting as personal representative.
- 11.1.4** **G** ^{/1} *Firms* are reminded that *trustee firm* may include individuals who require *authorisation* and who are within the definition of *trustee firm*. It also includes *partnerships* where the *partnership* requires *authorisation*.
- 11.1.5** **G** ^{/1} Article 66 of the *Regulated Activities Order* provides exclusions for some trustees, nominees and personal representatives from certain *regulated activities*. This chapter does not apply to a *trustee firm* in respect of an activity which is excluded from being a *regulated activity* carried on by the *trustee firm* under any paragraph in article 66.
- 11.1.6** **G** ^{/1} In COB only the *rules* in ■ COB 1, ■ COB 11 and the *rules* applied by this chapter apply to a *trustee firm* or *depositary*.
- 11.1.7** **G** ^{/1} This chapter does not apply with respect to any *regulated activities* carried on by a *trustee* with a trust beneficiary where the *trustee firm* is not acting as trustee. Such activities would be subject to the *rules* in COB applied otherwise than through this chapter.
- 11.1.8** **G** ^{/1} In respect of *trustee firms*, the *rules*:
- (1) apply in addition to any duties or powers imposed or conferred upon a trustee by the general law;
 - (2) do not qualify or restrict the duties or powers that the general law imposes or confers upon a trustee; *trustee firms* will be under a duty to observe the provisions of their trust instrument; if its provisions conflict with any applicable *rule*, trustees will need to take advice in resolving the conflict.
- 11.1.9** **G** ^{/1} A *depositary* of a *regulated collective investment scheme* is also required to comply with the Collective Investment Schemes sourcebook (CIS).
- 11.1.10** **G** ^{/1} A *depositary* of an ICVC is also required to comply with the OEIC Regulations.

11.1.11

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All *depositories* and *trustee firms* are also required to comply in particular with the Principles for Businesses (*PRIN*), Senior Management Arrangements, Systems and Controls (*SYSC*) and the Money Laundering sourcebook (*ML*).

Purpose

11.1.12

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The purpose of this chapter is to select *rules* to apply to the activities of *trustee firms* and *depositories*. *COB* is modified by this chapter for that purpose. The *rules* in this chapter:

- (1) redefine ‘*customer*’ so that it applies meaningfully in the *trustee firm/depository* context. A *trustee firm*, for example, may be both the *customer* and the *firm*. A requirement to make a disclosure to a *customer* may therefore not be clear when applied to a *trustee firm* – the requirement may be taken to apply to the trustees as a body, or to the trust beneficiaries. In the context of *collective investment schemes* disclosure may appropriately be effected through reports and documentation sent to the *participants*;
- (2) recognise that some *trustee firms* may not be experts in investment; in consequence they should be allowed to delegate regulatory responsibility for compliance with *COB* to other suitable *firms*.
- (3) apply appropriate *rules* to different types of trustee; for example the *rules* in ■ *COB* 11.5.3 are not applied to personal representatives because this would amongst other things require such a *firm* to send out *periodic statements*.
- (4) apply *rules* specifically devised for *trustee firms* or *depositories*; for example, ■ *COB* 11.8 (Proper advice) applies only to *trustee firms*.



11.2 Relationship with the scheme

11.2.1

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Firms which are *depositories* are reminded that, under the *Glossary*:

- (1) every *regulated collective investment scheme* is a *private customer*; and
- (2) every *unregulated collective investment scheme* is an *intermediate customer*.

11.2.2

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^{/1}

Where a *trustee firm* is required by any applicable *rule* in *COB* to provide information to, or obtain consent from, a *customer*, the *trustee firm* must ensure the information is provided to, or consent obtained from all the trustees, or as many trustees as are required by the trust instrument.



11.3 Polarisation

11.3.1

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^{/1}

A *trustee firm* must not arrange the purchase, or recommend the purchase of a *packaged product* unless the *trustee firm* has taken reasonable steps to ensure that that *packaged product* will secure the investment objectives of the trust of which it is trustee at least as well as any other generally available *packaged product* of which it is or reasonably should be aware.



11.4 Depositaries

- 11.4.1 **R** ^{/1} A *depositary* when acting as such:
 - (1) must comply with the *rules* in *COB* specified in ■ *COB* 11.4.3, as modified;
 - (2) need not comply with any other *rule* in *COB*.

- 11.4.2 **G** ^{/1} ■ *COB* 11.4.1 applies to a *trustee firm* which is also a *depositary*. If a *trustee firm* is not a *depositary* then ■ *COB* 11.5 applies instead.

- 11.4.3 **R** ^{/1} Table Rules applicable to depositaries
This table belongs to ■ *COB* 11.4.1.

Chapter	Description	Modifications
1	Application and general provisions	'Customer' means 'trustee' or 'trust' as appropriate. <i>COB</i> 1.5 and <i>COB</i> 1.6 do not apply.
2.1 to 2.4	Rules which apply to all firms	<i>COB</i> 2.2.8R – <i>COB</i> 2.2.20R do not apply. For the <i>depositary</i> of a <i>unit trust scheme</i> , 'customer' means 'trustee' or 'trust' as appropriate. For the <i>depositary</i> of an <i>ICVC</i> , 'customer' means the <i>ICVC</i> . For the <i>depositary</i> of any other <i>collective investment scheme</i> , 'customer' means the <i>scheme</i> .
2.5	Exclusion of liability	For the <i>depositary</i> of a <i>unit trust scheme</i> , 'customer' and 'private customer' mean 'trustee' or 'trust' as appropriate. For the <i>depositary</i> of an <i>ICVC</i> , 'customer' means the <i>ICVC</i> . For the <i>depositary</i> of any other <i>collective investment scheme</i> , 'customer' means the <i>scheme</i> .
3	Financial promotion	

Chapter	Description	Modifications
5.5	Information about the firm	'Customer' and 'private customer' mean 'trustee' or the operator of the collective investment scheme as appropriate.
7.1	Conflict of interest and material interest	'Customer' and 'private customer' mean 'trustee' or 'trust' as appropriate.
7.13	Personal account dealing	'Client' and 'customer' mean 'collective investment scheme'.
9	Client assets	COB 9.3 and COB 9.5 do not apply. Except for COB 9.2, 'client' means 'trustee', 'trust' or 'collective investment scheme' as appropriate. In COB 9.2, 'client' means 'trustee', 'collective investment scheme' or 'collective investment scheme instrument' as appropriate.
10	Operators of collective investment schemes	The chapter does not apply to a depositary of an ICVC. It applies to the trustee of a unit trust scheme only where there is no separate operator, or where and to the extent that the separate operator does not take all day-to-day investment decisions in relation to the scheme.
11	Trustee and depositary activities	

11.5 Trustee firms which are not depositaries

11.5.1

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The only *rules* in COB which apply to a *trustee firm* which is not a *depositary* and when acting as such are as follows:

(1) where the *firm* is:

- (a) a bare *trustee* (or, in Scotland, a nominee) holding *investments* for another *person* and acting on that *person's* instructions;
- (b) a personal representative;
- (c) a trustee acting as trustee of an issue of *debentures* or *government and public securities*:
 - (i) where the issue is made by a *company listed* on a *recognised investment exchange* or on a *designated investment exchange* (or by a wholly-owned *subsidiary* of such a *company*); or
 - (ii) where the issue is made by a government, local authority or public authority; or
 - (iii) where the aggregate amounts issued (under the trust deed or any deed supplemental to it and ignoring any amounts redeemed, repurchased or converted) exceed the sum of £10,000,000, or its equivalent in a foreign currency;

the *rules* in ■ COB 11.5.2, as modified

(2) where the *firm* does not fall within (1), the *rules* in ■ COB 11.5.3 as modified.

11.5.2

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Table Rules applicable to trustee firms which are not depositaries and to which ■ COB 11.5.1(1) applies
This table belongs to ■ COB 11.5.1(1).

Chapter	Description	Modifications
1	Application and general provisions	'Customer' means 'trustee' or 'trust' as appropriate. COB 1.5 and 1.6 do not apply.
2.1	Clear, fair and not misleading communication	'Customer' means 'trustee'
2.2	Inducements and soft commission	'Customer' means 'trustee' or 'trust' as appropriate.
2.3	Reliance on others	'Customer' means 'trustee'.
2.4	Chinese walls	'Customer' and 'client' mean 'trustee' or 'trust' as appropriate.
2.5	Exclusion of liability	'Customer' and 'private customer' mean 'trustee', as appropriate.
3	Financial promotion	
4.1	Client classification	'Client' and 'customer' mean 'trustee' or 'trust' as appropriate.
5.5	Information about the firm	'Customer' and 'private customer' means 'trustee' or 'trust' as appropriate.
7.1	Conflict of interest and material interest	'Customer' means 'trustee' or 'trust' as appropriate.
7.2	Churning and switching	'Customer' means 'trustee' or 'trust' as appropriate.
9.2	Mandates	'Client' means 'trustee', 'trust' or 'trust instrument' as appropriate.
11	Trustee and depositary activities	

11.5.3

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Table Rules applicable to trustee firms which are not depositaries and to which ■ COB 11.5.1(2) applies
This table belongs to ■ COB 11.5.1(2).

Chapter	Description	Modifications
1	Application and general provisions	'Customer' means 'trustee' or 'trust' as appropriate. COB 1.5 and 1.6 do not apply.
2.1	Clear, fair and not misleading communication	'Customer' means 'trustee'

Chapter	Description	Modifications
2.2	Inducements and soft commission	'Customer' means 'trustee' or 'trust' as appropriate.
2.3	Reliance on others	'Customer' means 'trustee'.
2.4	Chinese walls	'Customer' and 'client' mean 'trustee' or 'trust' as appropriate.
2.5	Exclusion of liability	'Customer' and 'private customer' mean 'trustee', as appropriate.
3	Financial promotion	
4.1	Client classification	'Client' and 'customer' mean 'trustee' or 'trust' as appropriate.
5.2	Know your customer	'Customer' and 'private customer' mean trustee or trust as appropriate.
5.3	Suitability	'Customer' and 'private customer' mean 'trustee' or 'trust' as appropriate. <i>COB 5.3.14 – 5.3.19 do not apply to a trustee firm. However a trustee firm must keep appropriate records to show compliance with COB 5.3.</i>
5.4	Customers' understanding of risk	'Customer' and 'private customer' mean 'trustee'.
5.5	Information about the firm	'Customer' and 'private customer' means 'trustee' or 'beneficiary' as appropriate.
7.1	Conflict of interest and material interest	'Customer' and 'Private customer' mean 'trustee', or 'trust' as appropriate.
7.2	Churning and switching	'Customer' means 'trustee' or 'trust' as appropriate.
7.3	Dealing ahead	'Customer' means 'trustee' or 'trust' as appropriate.
7.4	Customer order priority	'Customer' means 'trust'.
7.5	Best execution	'Customer' means 'trustee' or 'trust' as appropriate.
7.6	Timely execution	'Customer' means 'trust'.
7.7	Aggregation and allocation	'Customer' means 'customer' or 'trust' as appropriate.

Chapter	Description	Modifications
7.9	Lending to private customers	'Private customer' means 'beneficiary'.
7.10	Margin requirements	'Customer' and 'private customer' mean 'trustee' or 'trust' as appropriate.
7.12	Customer order and execution records	'Customer' means 'trustee' or 'trust' as appropriate.
7.13	Personal account dealing	'Client' means 'trust'.
7.14	Programme trading	'Customer' means 'trustee' or 'trust' as appropriate.
7.15	Non market price transactions	'Customer' means 'trustee' or 'trust' as appropriate.
8.1	Confirmation of transactions	'Customer' means 'trustee' or 'trust' as appropriate.
8.2	Periodic statements	'Customer' means 'trustee', or 'trust' as appropriate.
9	Client assets	'Client' means 'trustee', 'trust' or 'trust instrument' as appropriate.
11	Trustee and depositary activities	



11.6 Delegation to a permitted third party.

- 11.6.1** **R**
/1 *A trustee firm may not appoint a permitted third party ('PTP') under this rule unless:*

 - (1) *the trustee firm could not reasonably be expected to discharge the responsibility itself.*
 - (2) *the delegation is made in writing which:*
 - (a) *describes in adequate detail the regulated activities to be carried on by the PTP; and*
 - (b) *states that the arrangement is to be regarded as a 'PTP arrangement' for the purposes of this rule;*
 - (3) *the PTP undertakes in writing to the trustee firm to comply with all rules relevant to the regulated activity in question; and*
 - (4) *the PTP is an appropriate person to perform the regulated activity.*
- 11.6.2** **G**
/1 For the purposes of ■ COB 11.6.1(1) *a trustee firm may reasonably be expected to accept responsibility for the PTP's compliance where the trustee firm undertakes substantial trustee business. The PTP rules are intended to be of assistance to smaller trustee firms who are inexperienced in regulated business.*
- 11.6.3** **G**
/1 For the purposes of ■ COB 11.6.1(4), where the PTP has appropriate *permission* enabling him to carry on the *regulated activity* in question, that fact may be taken to indicate that the PTP is an appropriate *person* to perform the *regulated activity*.
- 11.6.4** **R**
/1 When a *trustee firm* has appointed a PTP under ■ COB 11.6.1, the *trustee firm* will not be responsible for compliance by the PTP with any *rules* relating to any *regulated activity* which the PTP carries on for the *trustee firm*.
- 11.6.5** **G**
/1 The effect of ■ COB 11.6.4 is that the *trustee firm* is not liable for the acts or defaults of the PTP in respect of the *regulated activities* concerned.
- 11.6.6** **R**
/1 The *trustee firm* must notify the *FSA* within *14 days* of it delegating any *regulated activity* to a PTP and the notification must include the identity of the PTP.
- 11.6.7** **G**
/1 *Trustee firms* are reminded that '*permitted third party*' is defined as being either: (a) an *authorised person*; (b) an *exempt person* for whom an *authorised person* is

accepting responsibility; or (c) a *person* lawfully carrying on a *regulated activity* in another *EEA State*.

11.6.8

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Trustee firms may delegate to *persons* other than *permitted third parties* under general principles of law and subject to the *FSA's rules*.

11.6.9

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The *rules* permitting use of a PTP do not absolve the *trustee firm* from the need to comply with any restrictions on delegation or the manner of delegation derived from trust law or from the trust instrument. The *rules* do not affect the *trustee firm's* position under the general law, including the law of agency.



11.7 Record Keeping

11.7.1

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(1) A *firm* must make a record of any written delegation to a PTP under ■ COB 11.6.1(1) and of the PTP's undertaking under ■ COB 11.6.1(2) and of any variation of those *documents*.

(2) A record in (1) must be retained for a period ending three years after the date on which the PTP's appointment ceases.

11.7.2

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■ COB 11.7.1 obliges a *trustee firm* to keep records of any variations in the terms of the agreement occurring during the period of the PTP's appointment for three years from the date at which the appointment ends.



11.8 Proper advice

- 11.8.1 **R** ^{/1} *A trustee firm must obtain and consider proper advice whenever it intends to exercise its power of investment, except where there are reasonable grounds for not doing so.*
- 11.8.2 **G** ^{/1} Proper advice is advice from a *person* who is able to give it competently.
- 11.8.3 **G** ^{/1} There is no need to obtain proper advice where there are reasonable grounds not to do so, for example if the *trustee firm* is itself appropriately qualified to make the particular investment decision concerned or if the investment decision could be reasonably considered not to merit obtaining proper advice.
- 11.8.4 **G** ^{/1} ■ COB 11.8 amplifies the requirements of section 6(2) of the Trustee Investments Act 1961 (or section 5 of the Trustee Act 2000 from the date on which that Act enters into force) and trustees' duties at common law.
- 11.8.5 **R** ^{/1} *A trustee firm must follow the proper advice received unless it is reasonable not to do so.*
- 11.8.6 **G** ^{/1} *A trustee firm which finds it necessary to seek proper advice would normally be expected to follow the advice received. However, there may be reasonable grounds to disregard the advice. For example, a trustee firm may be unable to follow proper advice because of restrictions arising from the trust instrument.*
- 11.8.7 **R** ^{/1} *The trustee firm must make records to show compliance with ■ COB 11.8.5 and retain them for three years from the date on which the proper advice is received.*

Chapter 12

Lloyd's



12.1 Application

- 12.1.1** **R** This chapter applies to a *firm* when it carries on any of the following activities:
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- (1) *advising on syndicate participation at Lloyd's or agreeing to carry on that regulated activity;*
 - (2) *managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's or agreeing to carry on that regulated activity;*
 - (3) *carrying on designated investment business in relation to funds at Lloyd's;*
 - (4) *communicating or approving a financial promotion in relation to:*
 - (a) *the underwriting capacity of a Lloyd's syndicate; or*
 - (b) *membership of a Lloyd's syndicate; or*
 - (c) *effecting or carrying out contracts of insurance written at Lloyd's; or*
 - (d) *any of the activities specified in (1) or (3).*
- 12.1.2** **G** *Underwriting agents* should be aware that the *Society's* regulatory requirements remain applicable to them even if these requirements cover similar matters to the applicable COB provisions.
/1
- 12.1.3** **G** This chapter does not affect the application of COB to a *firm* when carrying on activities other than those specified in ■ COB 12.1.1.
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- 12.1.4** **G** The *Society* is itself also required to comply with the requirements of LLD which contains *rules* and *guidance* in respect of areas where COB provisions also have relevance. In particular ■ LLD 4.2.1 places a requirement on the *Society* to make appropriate *byelaws* governing conduct in the *capacity transfer market*. LLD also imposes at ■ LLD 9.2.3 a requirement on the *Society* to comply with the standards of due care and diligence set out in ■ COB 9 in relation to the *custody* of assets that constitute *members' funds*.
/1

Purpose

12.1.5 **G** _{/1} The purpose of this chapter is to protect the interests of *members* or potential *members* and *policyholders* or potential *policyholders*.

12.1.6 **G** _{/1} This chapter provides *rules* that apply to *firms* when carrying on the activities in ■ COB 12.1.1. *Rules* from other chapters are modified for this purpose. These *COB* provisions will apply to the activities of *members' agents*, *members' advisers*, the *Society*, *managing agents* (in some circumstances) and to any other *authorised person* undertaking any of the activities specified in ■ COB 12.1.1.

Rules of general application

- 12.1.7** **R** _{/1}
- (1) When a *firm* is carrying on any of the activities specified in ■ COB 12.1.1(1) and (3), *COB* applies in full, except to the extent disapplied under ■ COB 12.1.14.
 - (2) *COB* does not apply to a *firm* when carrying on the activity specified in ■ COB 12.1.1(2), except as specified in ■ COB 12.1.15.
 - (3) ■ COB 3 applies to a *firm* when carrying on the activity specified in ■ COB 12.1.1(4).

12.1.8 **G** _{/1} *Firms* subject to the *financial promotion rules* under ■ COB 12 are also reminded that *syndicate* business plans may be used in ways that bring them within the definition of a *financial promotion*. In such cases the *financial promotion rules* will apply, in particular ■ COB 3.6 (Confirmation of compliance), ■ COB 3.7 (Records) and ■ COB 3.8 (Form and content of financial promotions).

12.1.9 **G** _{/1} A *firm* which provides advice to a *person* on a transaction in the *capacity transfer market* will be carrying on the activity specified in ■ COB 12.1.1(1) and will be subject to *COB*, as specified in ■ COB 12.1.7(1) in respect of that activity.

12.1.10 **G** _{/1} *COB* does not apply to a *firm* when carrying on the *regulated activity* of *arranging (bringing about) deals in investments* that relate to the *underwriting capacity* of a *Lloyd's syndicate* or *membership of a Lloyd's syndicate*.

12.1.11 **R** _{/1} A *firm* carrying on the activity specified at ■ COB 12.1.1(1) must, in addition to meeting the requirements of ■ COB 5, take reasonable steps to ensure that it does not advise a potential *member* who is a *private customer* to become a *member* of a *syndicate* unless membership of the *Society* itself is suitable for the *private customer* having regard to the facts disclosed by him and other relevant facts about the *private customer* of which the *firm* is or reasonably should be aware.

Definitions and modifications

12.1.12 **R** _{/1} When a *firm* is carrying on activities to which this chapter applies, any reference in *COB* to the term:

- (1) *"designated investment"* is to be taken to include the following *specified investments*:
 - (a) *the underwriting capacity of a Lloyd's syndicate*;
 - (b) *membership of a Lloyd's syndicate*; and
 - (c) *rights to or interests in the specified investments* in (a) or (b);
- (2) *"designated investment business"* is to be taken to include the following *regulated activities*:
 - (a) *advising on syndicate participation at Lloyd's*;
 - (b) *managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's*; and
 - (c) *agreeing to carry on the regulated activities* in (a) or (b).

12.1.13 **R** When a *firm* is carrying on activities to which this chapter applies, any reference in *COB* to the term *customer* is to be taken to refer to a *member* or potential *member* except in the case of ■ *COB* 6.7 to ■ *COB* 6.8 where it refers to a *policyholder* or potential *policyholder*.
/1

12.1.14 **R** Table This table disapplies parts of *COB* to a firm when carrying on the activities to which ■ *COB* 12.1.7(1) relates.
/1

Chapter	Description	Disapplication
4.2	Terms of business and client agreements with customers	<i>COB</i> 4.2.11E and <i>COB</i> 4.2.12R are disapplied.
6	Product disclosure and the customer's right to cancel or withdraw	<i>COB</i> 6 is disapplied.
8.2	Periodic statements	<i>COB</i> 8.2 is disapplied to a <i>firm</i> <i>advising on syndicate participation at Lloyd's</i> . <i>COB</i> 8.2.7E is disapplied to the <i>Society</i> .
9	Client assets	<i>COB</i> 9 is disapplied to the <i>Society</i> .
11	Trustee and depositary activities	<i>COB</i> 11 is disapplied.

12.1.15 **R** Table This table applies *COB* to firms when carrying on the activity to which ■ *COB* 12.1.7(2) relates.
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Chapter	Description	Application
1	Application and general provisions	Applied
2	Rules which apply to all firms conducting designated investment business	Applied
4.1	Client classification	Applied
6.7	Cancellation and withdrawal	Applied
6.8	Insurance contracts – life and general	Applied

12.1.16 G_{/1} The tables at ■ COB 12.1.17 to ■ COB 12.1.21 are provided to help *firms* when carrying on those activities to which this chapter applies locate those *COB rules* that are particularly relevant to their activities. *Firms* should be aware that these tables may not include all *rules* which apply to an individual *firm* as these will vary depending on the *firm's* particular circumstances and that there may be other *COB rules* that apply.

12.1.17 G_{/1} Table Location of rules of general application to firms when carrying on activities to which this chapter applies. This table forms part of ■ COB 12.1.16.

Chapter	Description
<i>COB 1</i>	Application and general provisions
<i>COB 2</i>	Rules which apply to all firms conducting designated investment business
<i>COB 4.1</i>	Client classification

12.1.18 G_{/1} Table Location of rules of particular relevance to a firm when advising on syndicate participation at Lloyd's. This table forms part of ■ COB 12.1.16.

Chapter	Description
<i>COB 4.2.1R to COB 4.2.10R (inclusive), COB 4.2.13R to COB 4.2.14R</i>	Terms of business and customer agreements
<i>COB 5</i>	Advising and selling
<i>COB 7.1</i>	Conflict of interest and material interest

12.1.19 G_{/1} Table Location of rules of particular relevance to a firm when carrying on designated investment business in relation to funds at Lloyd's. This table forms part of ■ COB 12.1.16.

Chapter	Description
<i>COB 4.2.1R to COB 4.2.10R (inclusive), COB 4.2.13R and COB 4.2.14R</i>	Terms of business and customer agreements
<i>COB 7</i>	Dealing and managing

12.1.20

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Table Location of rules of particular relevance to a firm managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's.
This table forms part of ■ COB 12.1.16.

Chapter	Description
COB 8.1	Confirmation of transactions
COB 8.2.1R to COB 8.2.6R (inclusive) and COB 8.2.9R	Periodic statements

12.1.21

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Table Location of rules of particular relevance to a firm when communicating or approving financial promotions in relation to the investments and activities specified at ■ COB 12.1.1(4).
This table forms part of ■ COB 12.1.16.

Chapter	Description
COB 6.7	Cancellation and withdrawal
COB 6.8	Insurance contracts – life and general

Chapter	Description
COB 3	Financial promotion

Handbook Modules

Schedule1 Record keeping requirements

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- 1 The aim of the guidance in the following table is to give the reader a quick overall view of the relevant record keeping requirements.
- 2 It is not a complete statement of those requirements and should not be relied on as if it were.
- 3 **Table**

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
COB 2.2.20R(1)	Periodic reports	Details of soft commission agreements	Date of periodic statement	3 years (from termination of relevant soft commission agreement)
COB 2.2.20R(2)	Disclosable commission	Each payment	Date of payment	6 years
COB 2.2.20R(3)	Indirect benefits given to an independent intermediary	Each benefit	Date from which benefit was conferred	6 years
COB 3.7.1R	Non-real time financial promotion – each: Pension transfer Pension opt-out FSAVC	Name of individual who confirmed compliance or approved the financial promotion. See COB 3.7.2(1) to (4) for other contents	Date of confirmation or approval	Indefinitely
COB 3.7.1R	Non-real time financial promotion – each: Life policy Pension contract Stakeholder pension scheme	Name of individual who confirmed compliance or approved the financial promotion. See COB 3.7.2(1) to (4) for other contents	Date of confirmation or approval	6 years

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
COB 3.7.1R	Non-real time financial promotion – any other case	Name of individual who confirmed compliance or approved the financial promotion. See COB 3.7.2(1) to (4) for other contents	Date of confirmation or approval	3 years
COB 4.1.16R	Classification of each client – if relevant to: Pension transfers Pension opt-outs FSAVCs	Sufficient information to support classification	When the client relationship begins or upon re-classification, to include annual review where necessary	Indefinitely
COB 4.1.16R	Classification of each client – if relevant to: Life policies Pension contracts	Sufficient information to support classification	When the client relationship begins or upon re-classification, to include annual review where necessary	6 years (from end of client relationship)
COB 4.1.16R	Classification of each client – any other case	Sufficient information to support classification	When the client relationship begins or upon re-classification, to include annual review where necessary	3 years (from end of client relationship)
COB 4.2.14R	Terms of business for: Pension transfer Pension opt-out FSAVC	Each term of business provided and any amendments	As soon as in force	Indefinitely
COB 4.2.14R	Terms of business for: Life policy Pension contract Stakeholder pension scheme	Each term of business provided and any amendments	As soon as in force	6 years (from the date on which the customer ceases to be a customer)
COB 4.2.14R	Terms of business: any other case	Each term of business provided and any amendments	As soon as in force	3 years (from the date on which the customer ceases to be a customer)

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
COB 5.1.4R(3)	Adoption of a packaged product	Decision to adopt	On making the decision to adopt	Throughout the period the adoption remains in effect and for 6 years thereafter
COB 5.2.9R	Private customer's details for a pension transfer, pension opt-out, FSAVC	Personal and financial circumstances	On giving advice	Indefinitely
COB 5.2.9R	Private customer's details for a life policy, pension contract	Personal and financial circumstances	On giving advice	6 years
COB 5.2.9R	Private customers details for any other case	Personal and financial circumstances	On giving advice	3 years
COB 5.2.10R	Private customer: Opt out or transfer from an OPS on an execution only basis	Execution only transaction, no investment advice given	Upon execution	
COB 5.3.25R	Private customer instructs a pension opt-out or transfer contrary to advice of firm	Firm's advice to customer and customer instructions to firm to proceed	Upon execution	Indefinitely
COB 5.3.26R(2)	Statistics of pension opt-out or transfer transactions involving private customers	Details of the notification required by COB 5.3.26R(1)	On making the notification	Indefinitely
COB 5.3.27R	Statistics of pension opt-out, pension transfer or FSAVC transactions involving private customers	Separate records per customer	On arranging the transaction	Indefinitely
COB 6.6.19R	Projections relating to a life policy, pension contract or stakeholder pension scheme	A projection provided to a customer	As soon as proposal proceeds	6 years
COB 6.6.19R	Projections relating to a pension transfer or pension opt-out	A projection provided to a customer	As soon as proposal proceeds	Indefinitely

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
COB 6.6.19R	Projections relating to any other case	A projection provided to a customer	As soon as proposal proceeds	3 years
COB 6.7.47R	Cancellation or withdrawal: Pension transfer, opt-out or FSAVC	To include a copy of any receipt of notice issued to the customer and the customer's original notice instructions	Upon notice of cancellation or withdrawal being served to firm, its appointed representative or agent	Indefinitely
COB 6.7.47R	Cancellation or withdrawal: Life policy, pension contract or stakeholder pension scheme	To include a copy of any receipt of notice issued to the customer and the customer's original notice instructions	Upon notice of cancellation or withdrawal being served to firm, its appointed representative or agent	6 years (from the date when the firm became aware that notice of cancellation had been served)
COB 6.7.47R	Cancellation or withdrawal: Any other case	To include a copy of any receipt of notice issued to the customer and the customer's original notice instructions	Upon notice of cancellation or withdrawal being served to firm, its appointed representative or agent	3 years (from the date when the firm became aware that notice of cancellation had been served)
COB 6.8.18R(1)	Firm effecting or carrying out pure protection contracts	Adequate details of information provided	After information provided	6 years
COB 6.8.18R(2)	Firm effecting or carrying out general insurance contracts	Adequate details of information provided	After information provided	3 years
COB 7.7.6E(4)	Allocation of aggregated transactions in a series of transactions all executed within one business day	The time each transaction is made	On executing an aggregated transaction	
COB 7.7.14R(1)	An aggregated transaction that includes a customer order	Identity of each customer; whether transaction is in whole or in part for discretionary managed investment portfolio and any relevant proportions	On executing an aggregated transaction	3 years

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
COB 7.7.14R(2)	Firm aggregating a number of client orders that include a customer order	Intended basis of allocation	As soon as is practicable	3 years
COB 7.7.14R(3)	Aggregation of one or more customer orders and an own account order	Intended basis of allocation	Before the transaction is executed	3 years
COB 7.7.16R	Allocation of an aggregated transaction that includes the execution of a customer order	Date + time of allocation; relevant designated investment; identity of each customer and market counterparty and the amount allocated to each customer and market counterparty; agreement to extend allocation period for intermediate customers under COB 7.7.6E(2)(b)	Date on which the order is allocated	3 years
COB 7.7.17R	Re-allocation	Basis and reason for any re-allocation	At the time of the re-allocation	3 years
COB 7.9.7R	Lending to private customers	Assessment of a private customer's financial standing and the date when the information was last updated/checked	Upon assessment	3 years (from the date on which the credit arrangement ceased)

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
COB 7.12.3R and COB 7.12.6E(1)	Customer orders	Customer's name (or other designation)/ account number; date and time of receipt or decision by the firm to deal; who received the order or made the decision to deal; the designated investment; the number of/total value of the designated investment inc any price limit; whether sale or purchase; any other instructions received; and the nature of the communication of the customer order	When the order arises	3 years (after the date of completion of the transaction)
COB 7.12.3R and COB 7.12.6E(2)	Execution of a transaction by a firm	Name/other designation of client (if any); name of counterparty (if known); date and time of execution; who executed the transaction; the designated investment; number of/ total value of the designated investment; price and other significant terms; whether sale or purchase; whether the firm was acting as principal	When the firm executes a transaction	3 years (after the date of completion of the transaction)
COB 7.12.3R and COB 7.12.6E(3)	The firm instructs another person to deal	Name of the person instructed; terms of instruction and date and time of instruction	When the firm instructs another person to deal	3 years (after the date of completion of the transaction)

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
COB 7.13.11R(1)(a)	Personal account dealing	The restrictions upon pa dealing and the basis upon which any permission to deal is made	Whenever the restrictions are placed and from the date of consent	3 years (from the date that the restrictions or basis were communicated to the employee)
COB 7.13.11R(1)(b)	Personal account dealing	Each permission to deal given by the firm	From the date of consent	3 years (from the date that the permission was given)
COB 7.13.11R(1)(c)	Personal account dealing	Each notification of the transaction made by the employee to the firm	From the date of notification	3 years (from the date that the notification was made)
COB 7.13.11R(1)(d)	Personal account dealing	The basis upon which the firm has determined that an employee will not be involved in, or have access to information about, the firm's designated investment business	On determining the basis	3 years (from the date on which the individual ceases to be an employee)
COB 8.1.14R	Confirmation of transaction	Information provided	On dispatch of confirmation	3 years
COB 8.2.9R	Periodic statements	Copy of any periodic statement	On date on which it is provided	3 years
COB 9.1.9R	A personal investment firm that temporarily holds a client's designated investments	Client details and any action taken by firm		3 years (from the making of the record)
COB 9.1.53R(3)	Safe custody: arrangements for clients ordinarily resident outside the United Kingdom	The steps taken and result under COB 9.1.53R(2)	On determination that client does not wish to execute agreement	

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
COB 9.1.98R	Client custody assets held or received by or on behalf of a client or which the firm has arranged for another to hold or receive	Full details	On receipt	3 years
COB 9.1.99R	Safe custody investments used for stock lending activities	The identity of safe custody investments available to be lent, and those which have been lent	On receipt	3 years
COB 9.2.5R	Adequate records and internal controls in respect of the firm's use of mandates (see COB 9.2.5R(1) to (4))	Up to date list of firm's authorities, all transactions entered into, important client documents held by firm	Maintain current full details	
COB 9.3.145R	Client money	Sufficient records to show and explain firm's transactions and commitments	Maintain current full details	3 years (after records made)
COB 9.5.24R(3)	Client money shortfall	Each client's entitlement to client money shortfall at the failed bank	Maintain up to date records	Until client repaid
COB 9.5.25R(3)	Client money shortfall	Each client's entitlement to client money shortfall at the failed bank	Maintain up to date records	Until client repaid
COB 9.5.31R(3)	Client money shortfall	Each client's entitlement to client money shortfall at the failed intermediate broker, settlement agent or OTC counterparty	Maintain up to date records	Until client repaid
COB 10.3.3E(3)	Allocation of aggregated transactions in a series of transactions all executed within one business day	The time each transaction is made	On executing an aggregated transaction	

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
COB 10.3.5R(1)	Aggregated transaction on behalf of a number of schemes	Identity of schemes concerned, whether transaction was effected proportionally or if a stated proportion was effected for some schemes under its management	On executing an aggregated transaction	
COB 10.3.5R(2)	Aggregated customer orders on behalf of a number of schemes	The intended basis of allocation	As soon as is practicable	
COB 10.3.5R(3)	Aggregated orders of schemes under its management and own account orders	The intended basis of allocation	Before the transaction is executed	
COB 10.7.6R	Periodic statements in relation to unregulated collective investment scheme	Operator to retain copy of any periodic statement it has provided to participants in the scheme	On providing the periodic statement	3 years
COB 11.7.1R	PTP appointment	Details of the written delegation to a PTP, PTP's undertaking under COB 11.6.1R(3) and of any variation in the documentation	On the PTP's appointment	3 years (from date of end of the PTP's appointment)
COB 11.8.7R	Trustee firm following (or rejecting) proper advice in relation to exercise of power of investment	Evidence of compliance with COB 11.8.5R	Date on which proper advice is received	3 years

Handbook Modules

Schedule2 Notification requirements

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1 Table

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
COB 5.3.26R	opt-out and transfer transactions involving private customers	in writing – number of opt-outs and transfer transactions the firm has handled in previous 6 monthly period	6 monthly intervals	as soon as reasonably practicable
COB 5.3.26R	execution only opt-outs and transfer transactions	in writing – number of transactions arranged if they exceed 1% of all the firm's opt-outs or transfers arranged during that quarter	3 month intervals	as soon as reasonably practicable
COB 5.3.26R	opt-outs and transfer transactions	in writing – number of transactions arranged against the firm's advice if they exceed 1% of all the firm's opt-outs or transfers arranged during that quarter	3 month intervals	as soon as reasonably practicable
COB 5.3.26R	opt-outs and transfer transactions	in writing – number of transactions arranged on a correspondence – only basis if they exceed 1% of all the firm's opt-outs and transfers arranged during that quarter	3 month intervals	as soon as reasonably practicable
COB 5.7.16E, paragraph 9	failure to follow actuarial advice	reasons for not following actuarial advice and alternative assumptions the firm plans to use	where a firm does not follow its actuary's advice	as soon as reasonably practicable

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
COB 9.1.97R(1)	non-compliance with reconciliation requirements in COB 9.1.85R, 9.1.87R, 9.1.89R, 9.1.91R, 9.1.93R	reason for non-compliance	non-compliance	immediately
COB 9.1.97R(2)	non-compliance of reconciliation requirements in COB 9.1.94R	reason for non-compliance once reconciliation carried out	non-compliance	immediately
COB 9.3.98R	failure of a third party with which money is held – ie; bank, intermediate broker, settlement agent or OTC counterparty or other entity with which it has placed or to which it has passed client money	full details	when firm becomes aware of the failure of the entity	immediately
COB 9.3.98R	failure of a third party with which money is held – ie; bank, intermediate broker, settlement agent or OTC counterparty or other entity with which it has placed or to which it has passed client money	intentions regarding making good any shortfall that has arisen or may arise, and of the amounts involved	failure of third party with which money is held	as soon as reasonably practical
COB 9.3.121R	daily calculation required by COB 9.3.100R or COB 9.3.101R	inability to perform daily calculation	inability to perform daily calculation	immediately
COB 9.3.122R	daily calculation required by COB 9.3.100R or COB 9.3.101R	inability to make good any shortfall identified by daily calculation	inability to make good any shortfall identified by close of business on the day of calculation	immediately
COB 9.3.131R	requirements detailed in COB 9.3.123R, COB 9.3.125R, COB 9.3.126R, COB 9.3.128R and COB 9.3.129R	inability to comply with any of the requirements	inability to comply with any of the requirements	as soon as possible

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
COB 9.3.144R	LME bond arrangement	issue of an individual letter of credit issued by the firm	upon issue of an individual letter of credit under an LME bond arrangement	immediately
COB 9.5.33R	failure of a third party with which money is held – ie; bank, intermediate broker, settlement agent or OTC counterparty or other entity with which it has placed or to which it has passed client money	full details	when firm becomes aware of the failure of the entity	immediately
COB 9.5.33R	failure of a third party with which money is held – ie; bank, intermediate broker, settlement agent or OTC counterparty	intentions regarding making good any shortfall that has arisen or may arise, and of the amounts involved	failure of third party with which money is held	as soon as reasonably practicable
COB 11.6.6R	delegation of regulated activity by a trustee firm to a PTP	the trustee firm must notify the FSA within 14 days of it first delegating any regulated activity to a PTP and the notification must include the identity of the PTP	upon first delegation of regulated activity	14 days

Handbook Modules

Schedule3 Fees and other required payments

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- 1 There are no requirements for fees or other payments in COB.

Handbook Modules

Schedule4 Powers exercised

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- 1 The following powers in the Act have been exercised by the FSA to make the rules in COB:
- 2 Section 118(8) (Market abuse)
- 3 Section 138 (General rule-making power)
- 4 Section 139(1) and (4) (Miscellaneous ancillary matters)
- 5 Section 145 (Financial promotion rules)
- 6 Section 147 (Control of information rules)
- 7 Section 149 (Evidential provisions)
- 8 Section 156 (General supplementary powers)
- 9 Section 238(5) (Restrictions on promotion)
- 10 Section 247 (Trust scheme rules)
- 11 Regulation 6(1) of The Open-Ended Investment Companies Regulations 2001
- 12 The following powers in the Act have been exercised by the FSA to give the guidance in COB:
- 13 Section 157(1) (Guidance)

Handbook Modules

Schedule5 Rights of actions for damages

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- 1 The table below sets out the rules in COB contravention of which by an authorised person may be actionable under section 150 of the Act (Actions for damages) by a person who suffers loss as a result of the contravention.
- 2 If a “Yes” appears in the column headed “For private person?”, the rule may be actionable by a “private person” under section 150 (or, in certain circumstances, his fiduciary or representative; see article 6(2) and (3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001 No 2256)). A “Yes” in the column headed “Removed” indicates that the FSA has removed the right of action under section 150(2) of the Act. If so, a reference to the rule in which it is removed is also given.
- 3 The column headed “For other person?” indicates whether the rule may be actionable by a person other than a private person (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of person by whom the rule may be actionable is given.

4 Table

Chapter/ Appendix	Section/ Annex	Paragraph	Right of action under section 150			
			For private		For other person?	
			person?	Removed?		
		All rules in COB with the status letter “E”	No	No	No	
		Any rule in COB which prohibits an <i>authorised person</i> from seeking to make provision excluding or restricting any duty or liability	Yes	No	Yes	Any other <i>person</i>
		Any rule in COB which is directed at ensuring that transactions in <i>designated investments</i> are not effected with the benefit of unpublished information that, if made public, would be likely to affect the price of that <i>designated investment</i>	Yes	No	Yes	Any other <i>person</i>
		All other rules in COB	Yes	No	No	

Handbook Modules

Schedule6 Rules that can be waived

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- 1 The rules in COB can be waived by the FSA under sections 148 or 250 of the Act (Modification or waiver of rules) or regulation 7 of the OEIC Regulations (Modification or waiver of FSA rules), except for the following rules:
 - (a) the rules in COB 1 (Application and general provisions) to the extent that those rules apply or modify other rules in COB which may not be waived;
 - (b) the rules in COB 2.1 (Clear, fair and not misleading communication) to the extent that those rules apply or modify other rules in COB which may not be waived;
 - (c) COB 2.4.4R(1) and 2.4.4R(3) (Chinese walls);
 - (d) COB 3.11.2R (Unregulated Collective Investment Schemes);
 - (e) the rules in COB 6.7 (Cancellation and withdrawal) (other than COB 6.7.11R, COB 6.7.21R);
 - (f) COB 9.3.1-2, 9.3.31, 9.3.34 and 9.3.59 (Client money) and COB 9.5 (Client money distribution);
 - (g) the rules in COB 10 (Operators of collective investment schemes) to the extent that those rules apply or modify other rules in COB which may not be waived;
 - (h) the rules in COB 11 (Trustee and depositary activities) to the extent that those rules apply or modify other rules in COB which may not be waived;
 - (i) the rules in COB 12 (Lloyd's) to the extent that those rules apply or modify other rules in COB which may not be waived.

MARKET CONDUCT SOURCEBOOK INSTRUMENT 2001

- A The Financial Services Authority makes the provisions in the Annex to this instrument (“MAR”) in the exercise of the powers listed in Schedule 4 to MAR (Powers exercised).
- B This instrument shall come into force as follows:
- (1) MAR 1 (Code of Market Conduct): at the beginning of the day on which section 123 (Power to impose penalty in cases of market abuse) of the Financial Services and Markets Act 2000 (the “Act”) comes into force;
 - (2) MAR 2 (Price stabilising rules) and MAR 3 (Inter-professional conduct): at the beginning of the day on which section 19 of the Act (The general prohibition) comes into force;
 - (3) paragraphs A to E on this page: immediately.
- C The provisions of the Act relevant to making rules and listed in Schedule 4 to MAR (Powers exercised) are specified for the purpose of section 153(2) of the Act (Rule-making instruments).
- D This instrument may be cited as the Market Conduct Sourcebook Instrument 2001.
- E The Annex to this instrument (including its Schedules) may be cited as the Market conduct sourcebook (or MAR).

By Order of the Board
June 2001

ANNEX



Market conduct



Contents

Transitional provisions

Text of MAR:

- 1 Code of Market Conduct
- 2 Price Stabilising Rules
- 3 Inter-Professional Conduct
- 4 Endorsement of the Takeover Code (Not yet available)

Schedule 1: Record keeping requirements

Schedule 2: Notification requirements

Schedule 3: Fees and other required payments

Schedule 4: Powers exercised

Schedule 5: Rights of action for damages

Schedule 6: Rules that can be waived

Derivations

Destinations

Handbook Modules

Transitional Provisions

1 Table

G GEN contains some technical transitional provisions that apply throughout the *Handbook* and which are designed to ensure a smooth transition at *commencement*. These include transitional provisions relevant to record keeping and *notification rules*.

1) Transitional Provisions for The Code of Market Conduct – (MAR 1)

There are no transitional provisions for *MAR 1* (The Code of Market Conduct).

2) Transitional Provisions for Price stabilising rules (MAR 2)

SUP contains transitional provisions which carry forward into *MAR 2* (Price stabilising rules) written concessions relating to pre-commencement provisions.

2 Table

(1)	(2)	(3)	(4)	(5)	(6)
	Material provision to which transitional provision applies		Transitional provision	Transitional provision: dates in force	Handbook provision: coming into force

1	MAR 2	R	<p>Part 10 of the Financial Services (Conduct of Business) Rules 1990 applies in relation to an <i>offer for cash</i>, instead of MAR 2, if:</p> <p>(1) a <i>public announcement of the offer</i> which stated the <i>offer price</i> has been made before <i>commencement</i>; or</p> <p>(2) the <i>introductory period</i> for the <i>offer</i> started not more than 60 days before <i>commencement</i> and the <i>firm</i> or other <i>person</i> so chooses and makes a written record of that choice before <i>commencement</i>.</p> <p>A record in (2) must be retained for 3 years from the end of the <i>stabilising period</i> for the <i>offer</i>.</p> <p>This transitional provision applies to an offer as defined in the 1990 Rules, and has effect as a <i>price stabilising rule</i>.</p>	<p><i>Commence-</i> <i>ment</i> until the end of the <i>stabilis-</i> <i>ing period</i> for the offer</p>	<p><i>Commence-</i> <i>ment</i></p>
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Chapter 1.

The Code of Market Conduct

1.1 Application

APPLICATION: WHO?

- 1.1.1** G_{/1} The *Code of Market Conduct* ("the Code") is made under section 119 of the *Act* which requires the *FSA* to produce a code giving guidance on what does and does not amount to *market abuse*. This Code is relevant to all *persons* seeking guidance as to whether or not *behaviour* amounts to *market abuse*.

APPLICATION: WHAT?

- 1.1.2** G_{/1} Part VIII of the *Act* (Penalties for market abuse) contains provisions relating to *market abuse* which are described in this Code as the *market abuse regime*.
- 1.1.3** G_{/1} The three tests in the *Act* which must be satisfied in order to establish that *behaviour* (see *MAR* 1.3), whether by one *person* alone or by two or more *persons* jointly or in concert, amounts to *market abuse* are as follows:
- (1) the *behaviour* must occur in relation to a *qualifying investment* traded on a *prescribed market* (see *MAR* 1.11);
 - (2) the *behaviour* must satisfy one or more of the three conditions identified in section 118(2) of the *Act* (Market abuse), the text of which is set out below:
 - (a) "the behaviour is based on information which is not generally available to those using the market but which, if available to a regular user of the market, would or would be likely to be regarded by him as relevant when deciding the terms on which transactions in *investments* of the kind in question should be effected" (section 118(2)(a) of the *Act*) (see *MAR* 1.4);
 - (b) "the behaviour is likely to give a regular user of the market a false or misleading impression as to the supply of, or demand for, or as to the price or value of, investments of the kind in question" (section 118(2)(b) of the *Act*) (see *MAR* 1.5);
 - (c) "a regular user of the market would, or would be likely to, regard the behaviour as behaviour which would, or would be likely to, distort the market in investments of the kind in question" (section 118(2)(c) of the *Act*) (see *MAR* 1.6); and
 - (3) the *behaviour* must be likely to be regarded by a *regular user* of the market as a failure on the part of the *person* concerned to observe the standard of *behaviour* reasonably expected of a *person* in the position of the *person* in question (see *MAR* 1.2).

1.1.4 G_{/1} Under section 123(1) of the *Act*, the FSA has the power either to impose a penalty, or to make a statement to the effect that a *person* has engaged in *market abuse*, if the FSA is satisfied that a *person* ("A"):

- (1) has engaged in *market abuse*; or
- (2) by taking or refraining from taking any action has *required or encouraged* another *person* to engage in *behaviour* which, if engaged in by A, would amount to *market abuse*.

1.1.5 G_{/1} In accordance with section 123(2) of the *Act*, the FSA cannot impose a penalty if there are reasonable grounds for it to be satisfied that a *person*:

- (1) believed on reasonable grounds that his *behaviour* did not amount to *market abuse*; or
- (2) had taken all reasonable precautions and exercised all due diligence to avoid engaging in *market abuse*.

1.1.6 G_{/1} In accordance with section 123(2) of the *Act*, the FSA cannot impose a penalty if there are reasonable grounds for it to be satisfied that a *person*:

- (1) believed on reasonable grounds that his *behaviour* had not *required or encouraged* another *person* to engage in *behaviour* which, if engaged in by the first *person*, would have amounted to *market abuse*; or
- (2) had taken all reasonable precautions and exercised all due diligence to avoid *requiring or encouraging* another *person* to engage in *behaviour*, which, if engaged in by the first *person*, would have amounted to *market abuse* (see ENF 14.5).

APPLICATION: WHERE?

1.1.7 G_{/1} Under section 118(5) of the *Act*, *behaviour* will fall within the scope of the *market abuse regime* if it occurs in relation to *qualifying investments* which are traded on a *prescribed market* which is located in the *United Kingdom* or which is accessible electronically in the *United Kingdom*. (See MAR 1.11 for more detail on *qualifying investments* traded on a *prescribed market*.)

PURPOSE AND EFFECT

1.1.8 G_{/1} The Code gives *guidance* for the purpose of determining whether or not *behaviour* amounts to *market abuse*, in accordance with section 119 of the *Act*.

1.1.9 G_{/1} The Code does not have the effect of modifying or extending any disclosure obligations, including under the *Listing Rules*, the *Takeover Code* and SARs or which apply in relation to any *prescribed market*.




1.1.10 G_{/1} The Code also describes *behaviour* that, in the opinion of the FSA, does not amount to *market abuse*. Section 122(1) of the *Act* (Effect of the code) provides that such *behaviour* is to be taken conclusively, for the purposes of the *Act*, as not amounting to *market abuse*. The relevant sections of the Code are identified by the letter "C" and they are referred to in the Code as "safe harbours". (See MAR

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1.4.20C, MAR 1.4.21C, MAR 1.4.24C, MAR 1.4.26C, MAR 1.4.28C, MAR 1.5.24C, MAR 1.5.25C, MAR 1.5.27C, MAR 1.5.28C and MAR 1.6.19C.)







- 1.1.11** G_{/1} In accordance with section 122(2) of the *Act*, some of the provisions of the Code identified by the letter “E” may be relied upon so far as they describe *behaviour* which, in the opinion of the *FSA*, amounts to *market abuse*. In addition, in accordance with section 119(2)(c) of the *Act*, other provisions in the Code identified by the letter “E” describe factors that, in the opinion of the *FSA*, are to be taken into account in determining whether or not *behaviour* amounts to *market abuse*.
- 1.1.12** G_{/1} Explanatory *guidance* is provided in relation to some provisions of the *Act* and this Code. This *guidance* is indicated by the letter “G”. It does not form part of the Code, but it is *guidance* made under the *FSA*’s general power to give *guidance* as set out in section 157 of the *Act* (Guidance).
- 1.1.13** G_{/1} The Code is not an exhaustive list of all types of *behaviour* which may, or may not, amount to *market abuse*, nor of all the factors to be taken into account in determining whether *behaviour* amounts to *market abuse*. The *FSA* may, subject to appropriate consultation, alter or replace the Code at any time.
- 1.1.14** G_{/1} The *Act* provides certain statutory exceptions in relation to the *market abuse regime* (see MAR 1.7).

1.2 The regular user test

- 1.2.1**  ^{/1} A *regular user* is defined in Section 118(10) of the *Act* as 'in relation to a particular market, a reasonable person who regularly deals on that market in investments of the kind in question.' *Behaviour* will amount to *market abuse* only where it would be likely to be regarded by a *regular user* as a failure on the part of the *person* or *persons* concerned to observe the standard of *behaviour* reasonably expected of a *person* in his or their position in relation to the market.
- 1.2.2**  ^{/1} In determining whether *behaviour* amounts to *market abuse*, it is necessary to consider objectively whether a hypothetical reasonable *person*, familiar with the market in question, would regard the *behaviour* as acceptable in the light of all the relevant circumstances.
- 1.2.3**  ^{/1} In determining whether *behaviour* falls below the standards expected, the *regular user* is likely to consider all the circumstances of the *behaviour*, including:
- (1) the characteristics of the market in question, the *investments* traded on that market, and the users of the market;
 - (2) the rules and regulations of the market in question and any applicable laws. For example, it is likely that it will be relevant to consider the extent to which the *behaviour* is in compliance with the rules of the particular market and if the *person* is based overseas it may be relevant to consider the extent to which the *behaviour* is in compliance with the standards prevailing in that overseas jurisdiction;
 - (3) prevailing market mechanisms, practices and codes of conduct applicable to the market in question;
 - (4) the position of the *person* in question and the standards reasonably to be expected of that *person* at the time of the *behaviour* in the light of that *person's* experience, level of skill and standard of knowledge. For example, the standards which it would be reasonable to expect of a retail investor are likely to differ from those to be expected of an industry professional; and

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(5) the need for market users to conduct their affairs in a manner that does not compromise the fair and efficient operation of the market as a whole or unfairly damage the interests of investors.

- 1.2.4**  _{/1} The *regular user* is likely to consider it relevant, although not determinative, that the *behaviour* conforms with standards that are generally accepted by users of the market. Detailed guidance is given at MAR 1.4 – MAR 1.6 as to the different types of *behaviour* that would not be regarded as acceptable.
- 1.2.5**  _{/1} The statutory definition of market abuse does not require the *person* engaging in the *behaviour* to have intended to abuse the market. Accordingly it is not essential for such an intention or purpose to be present in order for *behaviour* to fall below the objective standards expected. However, in some circumstances the determination of whether *behaviour* falls short of those standards will depend on the purpose of the *person* in question (for example, MAR 1.6.4E). In those circumstances, the *regular user* is likely to consider the purpose of the *person* in question in addition to the other relevant considerations listed at MAR 1.2.3E. This need not be the sole purpose but should be an *actuating purpose*.
- 1.2.6**  _{/1} A mistake is unlikely to fall below the objective standards expected where the *person* in question has taken reasonable care to prevent and detect the occurrence of such mistakes.
- 1.2.7**  _{/1} The objective standard of *behaviour* expected by the *regular user* is likely to vary to some degree across markets according to the characteristics of the market in question and the *investments* concerned. For example, the disclosure standards currently expected in equities markets differ from those expected in *commodities* markets. Consequently, different standards currently apply to the use of non-public information in different markets. Further, the standard expected of a *person* will vary with the experience, level of skill and standard of knowledge that the *regular user* is likely to expect from a *person* in that position. For example, when assessing the standards to be expected of public sector bodies, it is likely that it will be relevant to take into account their statutory and other official functions.
- 1.2.8**  _{/1} It may often be appropriate to take into account the extent to which the *behaviour* is in compliance with other applicable rules including the rules of a *prescribed market*, the *Takeover Code* or *FSA rules*. Compliance with such rules may not be sufficient for the *behaviour* not to amount to *market abuse*, since those rules may not be specifically directed at the types of *behaviour* prohibited by the *Act* or because compliance with those rules is only one consideration among others. Greater weight is likely to be given to compliance with a rule that expressly requires or permits particular *behaviour*. However, this will not in itself be determinative. Similarly, failure to comply with a rule will not of itself create a presumption that there has been *market abuse*. If the *prescribed market* or the *Takeover Panel* has granted a dispensation from, or given guidance in advance on, its rules, this is likely also to be a relevant factor in considering whether the *behaviour* amounts to *market abuse*. As mentioned at ENF 14.9.3G the *FSA* will attach considerable weight to the views of the *Takeover Panel* in interpreting and applying the *Takeover Code* and the *SARs*.
- 1.2.9**  _{/1} Where a *person's behaviour* occurs on an overseas market, but has an impact on a *prescribed market*, the *regular user* is likely to consider that it will be relevant to

- have regard to the local rules, practices and conventions prevailing in the relevant market, and whether or not the *person* is in the *United Kingdom*. However, compliance with such rules will not of itself be determinative.
- 1.2.10** G_{/1} As stated in *MAR 1.2.4E*, it is likely to be relevant to consider whether to take into account the extent to which the *behaviour* conforms with standards that are generally accepted by users of the market, but again this will not in itself be determinative. Such standards will be acceptable where they promote the fair and efficient operation of the market as a whole and do not unfairly damage the interests of investors. In circumstances where there is a range of practices which are generally accepted by users of the market, each practice is to be judged objectively on its own merits.
- 1.2.11** G_{/1} The *FSA* does not anticipate that divergences between standards that are generally accepted by users of the market and the standards expected by the *regular user* will be frequent. In future, the *FSA* may identify a practice which is accepted in the market, but which, in the *FSA*'s opinion, is likely to fall short of the standards expected by the *regular user*. In such cases the *FSA* will consider whether to signal its views on the practice in the form of *guidance* (making use of its power to do so under section 157 of the *Act*), or through some other statement, or by revising the Code, or to take enforcement action. The *FSA* recognises that the former approach will often be more appropriate, and where this is the case the *FSA* will work with relevant market participants and regulatory bodies (including the *RIEs*) to address the causes of concern. However, for those occasions where the appropriate response will be to take enforcement action, the *FSA*'s enforcement policies in relation to *market abuse* as set out at *ENF 14* will be relevant.
- 1.2.12** G_{/1} The *FSA* is satisfied that the *RIE* rulebooks do not permit or require *behaviour* which amounts to *market abuse*.
- 1.2.13** G_{/1} The Code is not exhaustive in its descriptions of *behaviour* that does or does not amount to *market abuse*. In circumstances where a *person* is proposing to undertake an innovative transaction, he should consider it in the light of the guidance provided in sections *MAR 1.4 - MAR 1.6*. It is also open to a *person* to consider seeking *guidance* from the *FSA* in respect of the proposed *behaviour*. Similarly, members of an *RIE* may wish to seek guidance from the relevant exchange on the consistency of the *behaviour* with exchange rules.

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1.3 Behaviour

1.3.1



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The types of *behaviour* which come within the scope of the *market abuse regime* include, but are not limited to, the following:

- (1) *dealing in qualifying investments*;
- (2) *dealing in commodities or investments* which are the subject matter of, or whose price or value is determined by reference to, a *qualifying investment* (in this case, the *commodity* will be a “*relevant product*” in relation to the *qualifying investment*);
- (3) *arranging deals* in respect of *qualifying investments*;
- (4) causing or procuring or *advising* others to *deal in qualifying investments*;
- (5) making statements or representations or otherwise disseminating information which is likely to be regarded by the *regular user* as relevant to determining the terms on which transactions in *qualifying investments* should be effected;
- (6) providing corporate finance advice and conducting corporate finance activities in *qualifying investments*; and
- (7) managing investments which are *qualifying investments* belonging to another.




1.3.2




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Behaviour includes both action and inaction. For example, inaction may amount to *market abuse* in circumstances where a *person* is under a legal or regulatory obligation to make a particular disclosure and fails to do so.

1.4 Misuse of information

- 1.4.1**  Statements in this section to the effect that *behaviour* “amounts to *market abuse*” assume that the test in MAR 1.1.3G(1) has also been met.
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- 1.4.2**  Section 118(2)(a) of the *Act* defines *behaviour* based on misuse of information as:
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”behaviour which is based on information which is not generally available to those using the market but which, if available to a regular user of the market, would or would be likely to be regarded by him as relevant when deciding the terms on which transactions in investments of the kind in question should be effected”.
- 1.4.3**  In all *prescribed markets*, market users rely on the timely dissemination of such *relevant information* as they may reasonably expect to receive. Those who possess *relevant information* ahead of general dissemination should, therefore, refrain from basing their *behaviour* on that information and from *requiring or encouraging* others to engage in *behaviour* until it is disseminated, save in the circumstances set out in MAR 1.4.20C - MAR 1.4.28C. Otherwise, the confidence of market users in the ability of the market to ensure access to such information will be undermined. The extent to which market users may reasonably expect to have access to information differs between different markets. This is explained further below at MAR 1.4.12E to MAR 1.4.16G.

BEHAVIOUR WHICH AMOUNTS TO MARKET ABUSE

- 1.4.4**  *Behaviour* will amount to *market abuse* (unless MAR 1.4.20C - MAR 1.4.28C apply) in that it will be a misuse of information where a *person deals or arranges deals* in any *qualifying investment* or *relevant product* where all four of the following circumstances are present:
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- (1) the *dealing* or *arranging* is based on information. The *person* must be in possession of information and the information must have a material influence on the decision to engage in the *dealing* or *arranging*. The information must be one of the reasons for the *dealing* or *arranging*, but need not be the only reason;

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- (2) the information must be information which is not generally available. Criteria for determining whether information is generally available are set out in MAR 1.4.5E;
- (3) the information must be likely to be regarded by a *regular user* as relevant when deciding the terms on which transactions in the *investments* of the kind in question should be effected. Such information is referred to in this Code as “*relevant information*”. Factors which are to be taken into account when determining whether information is *relevant information* are set out in MAR 1.4.9E to MAR 1.4.11E;
- (4) the information must relate to matters which the *regular user* would reasonably expect to be disclosed to users of the particular *prescribed market*. As explained further below at MAR 1.4.12E and MAR 1.4.13E, this includes both matters which give rise to such an expectation of disclosure or are likely to do so either at the time in question, or in the future.

(A) INFORMATION WHICH IS GENERALLY AVAILABLE (MAR 1.4.4E(2))

1.4.5



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Information is treated as generally available if it can be obtained by research or analysis conducted by or on behalf of users of a market (section 118(7) of the *Act*). In addition, information is to be regarded as generally available where one (or more) of the following is satisfied:


- (1) the information has been disclosed to a *prescribed market* through an *accepted channel for dissemination of information* or otherwise under the rules of that market;
- (2) the information is contained in records which are open to inspection by the public;
- (3) the information has otherwise been made public, including through the Internet, or some other publication, or is derived from information which has been made public;
- (4) the information can be obtained by observation.

1.4.6




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People are free to use information that they have obtained through research, analysis or other legitimate means. Legitimate means include the observation of a public event. Observation of a public event includes any information which is discussed in a public area or can be observed by the public without infringing rights of privacy, property or confidentiality. Such information will be considered generally available. The fact that in practice other users of the market cannot obtain the information because of limitations in their resources, expertise or competence does not mean that the information cannot legitimately be obtained.

1.4.7  /1 Examples of information which might be obtainable through legitimate research include:


- (1) information which is available only overseas and has not been published, or otherwise been made available to the public, in the *United Kingdom*; and
- (2) information which is only available on payment of a fee.

1.4.8  /1 For example, if a train passes a burning factory and a passenger calls his broker using his mobile telephone to *sell shares* in the factory's owner, that passenger will be acting on information which is generally available, since it is information which has been obtained by legitimate means through observation of a public event.


(B) RELEVANT INFORMATION (MAR 1.4.4E(3))

1.4.9  /1 Whether, in a particular case, a particular piece of information would, or would be likely to, be regarded as *relevant information* by the *regular user* will depend on the circumstances of the case. In making such a determination, the *regular user* is likely to consider the extent to which:

- (1) the information is specific and precise;
- (2) the information is material;
- (3) the information is current;
- (4) the information is reliable, including how near the *person* providing the information is, or appears to be, to the original source of that information and the reliability of that source;
- (5) there is other material information which is already generally available to inform users of the market; and
- (6) the information differs from information which is generally available and can therefore be said to be new or fresh information.

1.4.10  /1 In the case of information relating to possible future developments (which do not currently give rise to an expectation of disclosure (MAR 1.4.4E(4)), the following additional factors are to be taken into account when determining the relevance of that information (see example in MAR 1.4.18E):

- (1) whether the information provides, with reasonable certainty, grounds to conclude that the possible future developments will, in fact, occur; and
- (2) the significance those developments would assume for market users given their occurrence.

1.4.11  /1 Examples of *relevant information* include the following:

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- (1) where the *qualifying investment* in question is issued by a *company*, or is a *derivative* relating to a *qualifying investment* issued by a *company*, information concerning the business affairs or prospects of the *company* or a related *company*;
- (2) where the *qualifying investment* is a *derivative* relating to a *commodity*, information or events affecting the deliverable supply of the *commodity*, such as, for example, information as to the business operations of major suppliers; and
- (3) information as to official statistics, and fiscal and monetary policy announcements before they are announced.

(C) INFORMATION WHICH A REGULAR USER WOULD REASONABLY EXPECT TO BE DISCLOSED TO OTHER USERS OF THE MARKET (MAR 1.4.4E(4))

1.4.12



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Information will only fall within MAR 1.4.4E(4) if it is either:

- (1) information which has to be disclosed in accordance with any legal or regulatory requirement (referred to as “*disclosable information*”); or
- (2) information which is routinely the subject of a public announcement although not subject to any formal disclosure requirement (referred to as “*announceable information*”).

1.4.13



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In the case of information relating to possible future developments (MAR 1.4.4E(4) and MAR 1.4.10E), which may lead to a disclosure or an announcement being made, the following additional factor is to be taken into account when determining whether the information is to be treated as *disclosable information* or as *announceable information*, namely whether the information provides, with reasonable certainty, grounds to conclude that the possible future developments will, in fact, occur and accordingly that a disclosure or announcement will, in fact, be made (see example in MAR 1.4.18E).

1.4.14



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Examples of *disclosable information* include:

- (1) information which is required to be disseminated under the *Takeover Code* or *SARs* on, or in relation to, *qualifying investments* traded on a *prescribed market*;
- (2) information relating to *officially listed securities* which is required to be disclosed under the *Listing Rules*;
- (3) information which is required to be disclosed to a *prescribed market* under the rules of an *RIE*.

1.4.15



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Examples of *announceable information* include:

- (1) information which is to be the subject of official announcement by governments, central monetary or fiscal authorities or *regulatory body* (financial or otherwise, including exchanges);
- (2) changes to published credit ratings of *companies* whose *securities* are *qualifying investments* or *relevant products*; and
- (3) changes to the constituents of a *securities* index, where the *securities* are *qualifying investments* or *relevant products*.

1.4.16



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Examples of information that would not be *announceable information* include surveys or research based on information generally available, for example, CBI surveys and MORI opinion polls.

(D) EXAMPLES

1.4.17



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An example of *behaviour* which falls within MAR 1.4.4E occurs where a *person deals*, on a *prescribed market*, in the equities of XYZ plc, a *commodity* producer, based on information concerning that *company* which is not generally available, which is *relevant information* and which is *disclosable* or *announceable information* in relation to the equity market. If the information is also *relevant information* in relation to a *commodity futures* contract traded on a *prescribed market*, *dealing* in that *futures* contract based on the information will amount to *market abuse* only if the information is also *disclosable* or *announceable* in relation to the *commodity futures* market. More generally, where information is required to be disclosed to market A, *dealing or arranging deals* in *qualifying investments* traded on A, or in other related products, based on the information will amount to *market abuse* where this occurs prior to the disclosure being made. Where market A is an equity market, related products will include *derivatives* and other *investments* related to the equity in relation to which the disclosure is to be made. Where the information is also relevant to market B, *dealing or arranging deals* in relation to *qualifying investments* traded on market B, or in other related products, based on the information will only amount to *market abuse* where disclosure obligations exist in relation to market B.

1.4.18




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An example of information which falls within MAR 1.4.4E(4) arises in connection with the obligation of an *officially listed company* to announce any major new developments in its sphere of activity which may lead to substantial movement in the price of its *listed securities*. This could include, for example, entering into a significant contract with a major supplier. In that case, the obligation arises at the time of entering into the contract and disclosure is required to be made without delay. This falls within the category of information set out in MAR 1.4.4E(3) and MAR 1.4.4E(4). However, subject to meeting the tests in MAR 1.4.12E, the information will fall within MAR 1.4.4E(3) and MAR 1.4.4E(4) at an earlier stage: namely at the time


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at which there are grounds to conclude, with reasonable certainty, that the contract will be entered into and that disclosure of the contract will have to be made. Any *dealing* based on that information in the *securities* (or *investments* related to the *securities*) at that earlier stage would amount to *market abuse*.




SAFE HARBOURS

- 1.4.19  /1 MAR 1.4.20C, MAR 1.4.21C, MAR 1.4.24C, MAR 1.4.26C and MAR 1.4.28C each set out descriptions of *behaviour* that does not amount to *market abuse* in that the *behaviour* does not constitute a misuse of information (see MAR 1.4.4E).

(A) DEALING OR ARRANGING REQUIRED FOR OTHER REASONS

- 1.4.20  /1 *Dealing or arranging deals* will not amount to a misuse of information if the *dealing or arranging* was required in order to comply with a legal (including contractual) or regulatory obligation in circumstances where the obligation existed before the *relevant information* was in the *person's* possession.

(B) DEALING OR ARRANGING NOT BASED ON INFORMATION

- 1.4.21  /1 *Dealing or arranging deals* will not amount to a misuse of information if the *person's* possession of *relevant information* that is not generally available did not influence the decision to engage in the *dealing or arranging* in question.
- 1.4.22  /1 It will be presumed for the purposes of MAR 1.4.21C that the *person's* possession of the information in question did not influence his decision to *deal or arrange deals* if:
- (1) the *person* had taken a firm decision to *deal or arrange deals* before the *relevant information* was in the *person's* possession; and
 - (2) the terms on which the *person* had proposed to enter into the transaction(s) did not alter after the receipt of the information.
- 1.4.23  /1 Where a *person* is an *organisation* and where one or more individuals within the *organisation* are in possession of *relevant information*, it will be presumed for the purposes of MAR 1.4.21C that such possession had no influence on the *person's* decision to *deal or arrange deals* if none of the individuals in possession of the information:

- (1) had any involvement in the decision to engage in the *dealing* or *arranging*; or
- (2) behaved in such a way as to influence, directly or indirectly, the decision to engage in the *dealing* or *arranging*; or
- (3) had any contact with those who were involved in the decision to engage in the *dealing* or *arranging* whereby the information could have been transmitted.

1.4.24 P ^{/1} *Relevant information* does not influence the decision to *deal* or *arrange deals* if:

- (1) the information in question was held behind an effective *Chinese wall* and the individual or individuals who *dealt* or *arranged deals* or were on the other side of the *Chinese wall* (see further *COB 2.4*); or
- (2) arrangements equivalent to effective *Chinese walls* had been established and maintained in respect of the information, and the individuals who *dealt* or *arranged deals* did not, therefore, have access to the *relevant information*.

1.4.25 G ^{/1} See also *MAR 1.7.3E(2)* which discusses a further safe harbour in relation to *Chinese walls*.

(C) TRADING INFORMATION

1.4.26 P ^{/1} *Dealing* or *arranging deals* will not amount to a misuse of information solely because it is based on information as to that *person's* intention, or any other *person's* intention, to *deal* or *arrange deals* in relation to any *qualifying investment*, or information concerning transactions that have taken place. However, this safe harbour does not include *dealing* or *arranging deals*:

- (1) based on information as to a possible *takeover bid*;
- (2) based on information relating to new *offers, issues, placements* or other primary market activity.

1.4.27 G ^{/1} While *dealing* or *arranging deals* which is based on trading information will not constitute *market abuse*, it may constitute a breach of *COB 7.4.3R* (*Dealing fairly and in due turn*) or *rules* in *COB 7.13* (*Personal account dealing*) applicable to *firms*. Specifically, *MAR 1.4.26C* does not legitimise the front running of customer orders.

(D) FACILITATION OF TAKEOVER BIDS AND OTHER MARKET OPERATIONS

1.4.28 P ^{/1} *Dealing* or *arranging deals* will not amount to a misuse of information if it is engaged in by a *person* (or someone acting for him) or by another person acting in concert with him in circumstances where:

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- (1) the *dealing* or *arranging deals* was:
 - (a) in connection with the acquisition or disposal of an *equity* or *non-equity stake* in a *company*;
 - (b) engaged in for the sole purpose (see *MAR 1.4.30E*) of making the acquisition or disposal; or
 - (c) where engaged in by a concert party of a person making or potentially making an acquisition or disposal for the sole benefit of that person; and
- (2) the information in question consists of one or more of the following matters:
 - (a) that *investments* of a particular kind have been or are to be acquired or disposed of, or that their acquisition or disposal is under consideration or the subject of negotiation;
 - (b) that *investments* of a particular kind have not been or are not to be acquired or disposed of;
 - (c) the number of *investments* acquired or disposed of, or to be acquired or disposed of, or whose acquisition or disposal is under consideration or the subject of negotiation;
 - (d) the price (or range of prices) at which *investments* have been, or are to be, acquired or disposed of, or the price (or range of prices) at which the *investments* whose acquisition or disposal is under consideration, or the subject of negotiation, may be acquired or disposed of;
 - (e) the identity of the *persons* involved, or likely to be involved, in any capacity in an acquisition or disposal;
 - (f) in the case of a takeover bid any information legitimately obtained by the bidder in relation to the target company.

1.4.29



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For example, in the context of a takeover bid the following instances of *dealing* or *arranging deals* will fall within *MAR 1.4.28C*.

- (1) seeking from holders of *securities* irrevocable undertakings or expressions of support to accept an *offer* to acquire those *securities* (or not to accept such an *offer*);
- (2) making arrangements in connection with an issue of *securities* where those *securities* are to be offered as consideration for the takeover *offer* or to be issued in order to fund the takeover *offer*, including making arrangements for the underwriting or placing of those *securities* and any associated hedging arrangements by underwriters or placees;

- (3) making arrangements to offer cash as consideration for the takeover *offer* as an alternative to *securities* consideration.

1.4.30





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A *person* should not be prevented from acquiring an *equity* or non-*equity stake* in a *company* with a view to pursuing a *takeover bid* or engaging in other forms of market operations simply because he knew that he would be making a bid, and the knowledge amounted to *relevant information*. For example, a bidder (including a potential bidder), and those who act for him and his associates, may *deal* in the target *company's shares* for the purpose of building a stake in the target *company* or take other steps in connection with a proposed takeover, such as seeking irrevocable undertakings from shareholders or making arrangements for an issue of consideration *shares*. However, this does not mean that a bidder may undertake any other type of transaction in the target *company's shares*, or in other *investments* (for example, *contracts for differences* or *securities* of other *companies*) in relation to which the information is *relevant information*. For example, a bidder will be engaging in *market abuse* if he enters into transactions in *qualifying investments* that provide merely an economic exposure to movements in the price of the target *company's shares*. Similarly, those who act for the bidder will engage in *market abuse* if they *deal* for their own benefit in *qualifying investments* or *relevant products* in respect of which information concerning the proposed bid is *relevant information*. (See MAR 1.8.3G, MAR 1.8.7G(2) and MAR 1.8.8G.)


1.5 False or misleading impressions

INTRODUCTION


1.5.1  Statements in this section to the effect that *behaviour* “amounts to *market abuse*” assume that the test in MAR 1.1.3G(1) has also been met.

1.5.2  Section 118(2)(b) of the *Act* defines *behaviour* giving rise to a false or misleading impression as follows:

“behaviour [which] is likely to give a regular user of the market a false or misleading impression as to the supply of, or demand for, or as to the price or value of, investments of the kind in question”.

1.5.3  *Prescribed markets* provide a mechanism by which the price or value of *investments* may be determined according to the market forces of supply and demand. When market users trade on *prescribed markets* they expect the price or value of *investments* and volumes of trading to reflect the proper operation of market forces rather than the outcome of improper conduct by other market users. Improper conduct which gives market users a false or misleading impression results in market users no longer being able to rely on the prices formed in markets or volumes of trading as a basis for their *investment* decisions. This will undermine confidence in the integrity of the *prescribed market* and overall market activity may decrease and transaction costs may rise, or both, to the detriment of market users, including investors.

ELEMENTS OF THE TEST

1.5.4  In order to fall within the false or misleading impressions test:

- (1) the *behaviour* must be likely to give the *regular user* a false or misleading impression. *Behaviour* will amount to *market abuse* if the *behaviour* engaged in is likely to give rise to, or to give an impression of, a price or value or volume of trading which is materially false or misleading; and

- (2) in order to be likely, there must be a real and not fanciful likelihood that the *behaviour* will have such an effect, although the effect need not be more likely than not. The *behaviour* may, or may be likely to, give rise to more than one effect, including the effect in question.

GENERAL FACTORS

1.5.5



Factors that are to be taken into account in determining whether or not *behaviour* is likely to give the *regular user* a false or misleading impression as to the supply of, or the demand for, or the price or value of a *qualifying investment* or *relevant product* include:

- (1) the experience and knowledge of the users of the market in question;
- (2) the structure of the market, including its reporting, notification and transparency requirements;
- (3) the legal and regulatory requirements of the market concerned and accepted market practices;
- (4) the identity and position of the *person* responsible for the *behaviour* which has been observed (if known); and
- (5) the extent and nature of the visibility or disclosure of the *person's* activity.

RELATIONSHIP WITH DISTORTION

1.5.6



In some circumstances, *behaviour* which falls within these descriptions (see MAR 1.5.7E) may also fall within the descriptions of *behaviour* giving rise to a market distortion (see MAR 1.6).

BEHAVIOUR WHICH AMOUNTS TO MARKET ABUSE

1.5.7



MAR 1.5.8E, MAR 1.5.15E, MAR 1.5.18E and MAR 1.5. 21E each set out descriptions of *behaviour* that amount to *market abuse* in that the *behaviour* gives rise, or is likely to give rise, to a false or misleading impression.

(A) ARTIFICIAL TRANSACTIONS

1.5.8



Behaviour will constitute *market abuse* where:

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- (1) a *person* enters into a transaction or series of transactions in a *qualifying investment* or *relevant product*; and
- (2) the principal effect of the transaction or transactions will be, or will be likely to be, to inflate, maintain or depress the apparent supply of, or the apparent demand for, or the apparent price or value of a *qualifying investment* or *relevant product* so that a false or misleading impression is likely to be given to the *regular user*; and
- (3) the *person* knows, or could reasonably be expected to know, that the *principal* effect of the transaction or transactions on the market will be, or will be likely to be, as set out at MAR 1.5.8E(2);

unless the *regular user* would regard:

- (4) the principal rationale for the transaction in question as a legitimate commercial rationale; and
- (5) the way in which the transaction is to be *executed* as proper.

1.5.9



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A transaction which creates a false or misleading impression will not normally be considered to have a legitimate commercial rationale where the purpose behind the transaction was to induce others to trade in, or to position or move the price of, a *qualifying investment* or *relevant product*. This need not be the sole purpose for entering into the transaction or transactions, but must be an *actuating purpose*. Equally, transactions will not automatically be considered to have a legitimate commercial rationale simply because the purpose behind the transaction was to make a profit or avoid a loss (whether directly or indirectly).

1.5.10



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A transaction will be executed in a proper way where it is executed in a way which takes into account the need for the market as a whole to operate fairly and efficiently. The way in which a transaction was executed would be unlikely to be regarded as proper by the *regular user* where a transaction was executed in a particular way with the purpose of creating a false or misleading impression. In most cases the rules of *prescribed markets* include a requirement that transactions be executed in a proper way (for example, rules on reporting and executing *cross-transactions*). Transactions would not necessarily be considered to have been executed in an improper way simply because the way in which they were executed did not disclose the firm's intentions or positions to the market.

1.5.11



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The following factors are to be taken into account when determining whether a *person's behaviour* amounts to *market abuse* as described in MAR 1.5.8E, although the presence of one or more of these factors does not automatically mean the *behaviour* in question amounts to *market abuse*:

- (1) whether the transaction causes or contributes to an increase (or decrease) in the supply of, or the demand for, or the price or value of a *qualifying investment* or *relevant product* and the *person* has an interest in the level of the supply of, or the demand for, or the price or value of the *qualifying investment* or *relevant product*;
- (2) whether the transaction involves the placing of *buy* and *sell* orders at prices higher or lower than the market price, or the placing of *buy* and *sell* orders which increase the volume of trading;
- (3) whether the transaction coincides with a time at or around which the supply of, or the demand for, or the price or value of a *qualifying investment* or *relevant product* is relevant (whether for the market as a whole or the *person* in question) to the calculation of reference prices, settlement prices, and valuations (for example, close of trading, end of quarter);
- (4) whether those involved in the transaction are connected parties;
- (5) whether the transaction causes the market price of the *investment* in question to increase or decrease, following which the market price immediately returns to its previous level;
- (6) whether a *person* places a bid (or offer) which is higher (or lower) than the previous bid (or offer) only to remove the bid (or offer) from the market before it is executed.

1.5.12



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A further factor to be taken into account in determining whether the *behaviour* amounts to *market abuse* as described in MAR 1.5.8E is the extent to which the transaction generally either opens a new position, so creating an exposure to market risk, or closes out a position and so removes market risk. This factor, if present, will tend to suggest that the transaction is likely to have a legitimate commercial rationale and the *behaviour* does not amount to *market abuse* as described in MAR 1.5.8E, subject to the way in which the transaction is executed. Examples of transactions which typically have a legitimate commercial rationale are given at MAR 1.5.24C.

1.5.13



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A *person* has an interest in a *qualifying investment* or *relevant product* where that *person*:

- (1) may directly (including by holding a short position) or indirectly benefit from alterations in its market price; or
- (2) may be rewarded by, or is otherwise in collusion with or connected with, *persons* who may benefit from alterations in the market price of the *qualifying investment*.

1.5.14



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Examples of *behaviour* which might give rise to a false or misleading impression and in respect of which the principal rationale may not be a legitimate commercial rationale include:

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- (1) arrangements for the sale or purchase of a *qualifying investment* or *relevant product* (other than on *repo* or on *stock lending* or borrowing terms) whereby there is no change in beneficial interests or market risk, or the transfer of beneficial interest or market risk is only between *persons* who are acting in concert or collusion;
- (2) a transaction or series of transactions that are designed to conceal the ownership of a *qualifying investment* or *relevant product*, so that disclosure requirements are circumvented by the holding of the *qualifying investment* in the name of a colluding party, such that disclosures are misleading in respect of the true underlying holding of the *security*. These transactions are often structured so that market risk remains with the seller. This does not include nominee holdings;
- (3) a fictitious transaction.

(B) DISSEMINATING INFORMATION

1.5.15



Behaviour will constitute *market abuse* where:

- (1) a *person* disseminates information which is, or if true would be, *relevant information*;
- (2) the *person* knows, or could reasonably be expected to know, that the information disseminated is false or misleading; and
- (3) the *person* disseminates the information in order to create a false or misleading impression (this need not be the sole purpose for disseminating the information, but must be an *actuating purpose*).

1.5.16



A factor to be taken into account in determining the purpose of the *person* in question is whether that *person* has an interest in a *qualifying investment* or *relevant product* (see MAR 1.5.13E) to which the information is relevant. This factor, if present, will tend to suggest that the *person* had disseminated the information in order to create a false or misleading impression. That said, the absence of any such interest does not conclusively demonstrate that the *behaviour* does not amount to *market abuse*.

EXAMPLES

1.5.17



The following is an example of disseminating false or misleading information. A *person* posts information on an Internet bulletin board or chat room which contains false or misleading statements about the takeover of a *company* whose *shares* are *qualifying investments*. The *person* knows that the information is false or

PAGE
22

misleading and he has posted the information in order to create a false or misleading impression.

(C) DISSEMINATION OF INFORMATION THROUGH AN ACCEPTED CHANNEL

1.5.18



Behaviour will constitute *market abuse* where:

- (1) a *person* responsible for the submission of the information to an *accepted channel for the dissemination of information* submits information which is, or if true would be, *relevant information* which is likely to give the *regular user* a false or misleading impression as to the supply of, or the demand for, or the price or value of a *qualifying investment* or *relevant product*; and
- (2) the *person* who submits the information has not taken reasonable care to ensure it is not false or misleading.

1.5.19



There are a number of channels through which information relating to *qualifying investments* which are traded on *prescribed markets* is formally disseminated to other market users. Some information is required to be disseminated through one of these channels, for example, under the rules of the *prescribed market* or the *Listing Rules*. *RIEs* also use these channels to disseminate information about trades which have been *executed* on their markets.

1.5.20



The *FSA* recognises the importance of information disseminated through *accepted channels for the dissemination of information*. Users of such information should be able to rely on the accuracy and integrity of information carried through these channels. It is, therefore, appropriate that those who disseminate information through them, for example, the *company* itself, its *financial advisers* or its public relations advisers, take reasonable care to ensure the information is not inaccurate or misleading. Where they do not, and the information is likely to give rise to a false or misleading impression, they will be regarded as engaging in *behaviour* which amounts to *market abuse*.

(D) COURSE OF CONDUCT

1.5.21



Behaviour will constitute *market abuse* where:

- (1) a *person* engages in a course of conduct, the principal effect of which will be, or is likely to be, to give a false or misleading impression to the *regular user* as to the supply of, or the demand for, or the price or value of a *qualifying investment* or *relevant product*; and
- (2) the *person* knows, or could reasonably be expected to know, that the principal effect of the conduct on the market will be, or is likely to be as set out in MAR 1.5.21E(1);

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unless the *regular user* would regard:

- (3) the principal rationale for the conduct in question as a legitimate commercial rationale (see MAR 1.5.9E) and
- (4) the way in which the conduct is engaged in as proper (see MAR 1.5.10E)

EXAMPLES

1.5.22



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The exact nature of conduct that might give a false or misleading impression will vary according to the characteristics of the market. The following are examples of *behaviour* which might give a false or misleading impression to the *regular user*:

- (1) the movement of physical *commodity* stocks, which might create a misleading impression as to the supply of, or demand for, or price or value of, a *commodity* or the deliverable into a *commodity futures* contract; and
- (2) the movement of an empty cargo ship, which might create a false or misleading impression as to the supply of, or the demand for, or the price or value of a *commodity* or the deliverable into a *commodity futures* contract.

SAFE HARBOURS

1.5.23



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MAR 1.5.24C, MAR 1.5.25C, MAR 1.5.27C and MAR 1.5.28C each set out descriptions of *behaviour* that does not amount to *market abuse* in that the *behaviour* does not give rise to a false or misleading impression (see MAR 1.5.4E).

(A) PERMITTED TRANSACTIONS

1.5.24



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The following examples of *behaviour* will not give rise to a false or misleading impression even though the conditions described in MAR 1.5.8E(1), MAR 1.5.8E(2) and MAR 1.5.8E(3) are satisfied, provided that the conditions in MAR 1.5.8E(4) and MAR 1.5.8E(5) are also satisfied:

- (1) transactions which effect the taking of a position, or the unwinding of a position taken, so as to take legitimate advantage of:
 - (a) differences in the taxation of income or capital returns generated by *investments* or *commodities* (whether such differences arise solely because of the identity of the *person* entitled to receive such income or capital or otherwise); or

- (b) differences in the prices of *investments* or *commodities* as traded in different locations; or
- (2) transactions which effect the lending or borrowing of *qualifying investments* or *commodities* so as to meet an underlying commercial demand for the *investment* or *commodity*.

(B) REQUIRED REPORTING OR DISCLOSURE OF TRANSACTIONS

1.5.25

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Making a report or disclosure will not, of itself, give rise to a false or misleading impression if:

- (1) the report or disclosure was made in accordance with the way specified by any applicable legal or regulatory requirement; and
- (2) the report or disclosure was expressly required or expressly permitted by the *rules* or the rules of a *prescribed market* or the rules of the *Takeover Code* or *SARs* or by any other applicable statute or regulation or the rules of any competent statutory, governmental or regulatory authority.

1.5.26

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Examples of disclosure that is expressly required or expressly permitted include *rule 9.10(j)* of the *Listing Rules*, which permits a *company* to delay certain announcements at its discretion, and section 198 of the Companies Act 1985 which requires disclosure of certain interests in *shares*. See also *MAR 1.7.7C* concerning rules of the *Takeover Code* which relate, among other things, to the timing of announcements and *MAR 1.7.3E(3) - 1.7.3E(4)* concerning the *Listing Rules*.

(C) CHINESE WALLS

1.5.27

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Where a *person* is an *organisation*, that *person* may be aware of information that is not known to all of the individuals within the *organisation*. If an individual within the *organisation* disseminates information which he would know, or could reasonably be expected to know, is false or misleading if he was aware of information held by other individuals within the *organisation*, then that *person* will be taken not to know, or to be reasonably expected to know, that the information disseminated was false or misleading if:

- (1) the other information in question is held behind an effective *Chinese wall* or is restricted using other similarly effective arrangements; and
- (2) there was nothing which was known, or ought reasonably to have been known, to the individual who disseminated the information which should have led him to conclude it was false or misleading.

1.5.28

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For the purposes of *MAR 1.5.27C*, the fact that the *person* did not know, or could not be reasonably expected to know, that the information was false or misleading can be demonstrated by showing that the

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requirements identified in *MAR 1.4.22E* have been satisfied. Where it can be demonstrated that the individual disseminating the information did not know, or could not be reasonably expected to know, that the information was false or misleading, *behaviour* will not fall within the description of *market abuse* set out in *MAR 1.5.15E*.




1.5.29




The circumstances described in *MAR 1.4.23E(1)* to *MAR 1.4.23E(3)* are capable of giving rise to a presumption that the other information in question is held behind an effective *Chinese wall* or is restricted using other similarly effective arrangements.


1.6 Distortion


INTRODUCTION

- 1.6.1**  ^{/1} Statements in this section to the effect that *behaviour* “amounts to *market abuse*” assume that the test in MAR 1.1.3G(1) has also been met.
- 1.6.2**  ^{/1} Section 118(2)(c) of the *Act* defines *behaviour* amounting to distortion as follows:
“a regular user of the market would, or would be likely to, regard the behaviour as behaviour which would, or would be likely to, distort the market in investments of the kind in question.”
- 1.6.3**  ^{/1} The matters in MAR 1.5.3E apply with equal force in connection with *behaviour* which gives rise to market distortion. A *person* may not engage in *behaviour* that interferes with the proper operation of market forces and so with the interplay of proper supply and demand and so has a distorting effect. Distortion undermines confidence in the *prescribed markets* and damages efficiency to the detriment of market users, including investors.


ELEMENTS OF THE TEST

- 1.6.4**  ^{/1} In order to fall within the distortion test:
- (1) the *behaviour* must be such that a *regular user* would, or would be likely to, regard it as *behaviour* which would, or would be likely to, distort the market in the *investment* in question. *Behaviour* will amount to *market abuse* if the *behaviour* engaged in interferes with the proper operation of market forces with the purpose of positioning prices at a distorted level. This need not be the sole purpose of entering into the transaction or transactions, but must be an *actuating purpose*; and
 - (2) in order to be likely, there must be a real and not fanciful likelihood that the *behaviour* will have such an effect, although the effect need not be more likely than not. The *behaviour* may, or may be likely to, give rise to more than one effect, including the effect in question.


1.6.5  /1 It is unlikely that the *behaviour* of market users when trading at times and in sizes most beneficial to them (whether for the purpose of long term *investment* objectives, risk management or short term speculation) and seeking the maximum profit from their *dealings* will of itself amount to distortion. Such *behaviour*, generally speaking, improves the liquidity and efficiency of markets.

1.6.6  /1 It is unlikely that prices in the market which are trading outside their normal range will necessarily be indicative that someone has engaged in *behaviour* with the purpose of positioning prices at a distorted level. High or low prices relative to a trading range can be the result of the proper interplay of supply and demand.


RELATIONSHIP WITH FALSE OR MISLEADING IMPRESSIONS


1.6.7  /1 In some circumstances, *behaviour* which falls within these descriptions (see MAR 1.6.8E) may also fall within the scope of the prohibition against *behaviour* giving rise to a false or misleading impression (see MAR 1.5).

BEHAVIOUR WHICH AMOUNTS TO MARKET ABUSE

1.6.8  /1 MAR 1.6.9E and MAR 1.6.13E each set out descriptions of *behaviour* that amount to *market abuse* in that the *behaviour* gives rise to market distortion.

(A) PRICE POSITIONING

1.6.9  /1 *Behaviour* will constitute *market abuse* where a *person* enters into a transaction, or a series of transactions, with the purpose of positioning the price of a *qualifying investment* or *relevant product* at a distorted level (the purpose need not be the sole purpose for entering into the transaction or transactions, but must be an *actuating purpose*).

1.6.10  /1 It follows that *behaviour* which incorporates a purpose of positioning the price at a distorted level cannot have a legitimate commercial rationale. The Code does not restrict market users trading significant volumes where there is a legitimate purpose for the transaction (for example, index tracking which can involve trading significant volumes on the close) and where the transaction is *executed* in a proper way, that is, a way which takes into account the need for the market as a whole to operate fairly and efficiently. In most cases the rules of *prescribed markets* include a requirement that transactions be *executed* in a proper way (for example, rules on reporting and *executing cross-trades*). Such *behaviour* is unlikely to distort the

market in the *investments* in question, even if it causes the market to move. But trading significant volumes with the purpose of controlling the price of a *qualifying investment* or a *relevant product* and positioning it at a distorted level will amount to *market abuse*.

1.6.11



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The following factors will be taken into account when determining whether a *person* has positioned the price of a *qualifying investment* or *relevant product* at a distorted level, although the presence of one or more of these factors does not automatically mean the market has been distorted:

- (1) the extent to which the timing of the *person's* transaction or transactions coincided with a time at or around which the price of the *qualifying investment* or *relevant product* was relevant (whether for the market as a whole and or the *person* in question) to the calculation of reference prices, settlement prices, and valuations (for example, close of trading, end of quarter);
- (2) the extent to which the *person* had a direct or indirect interest in the price or value of the *qualifying investment* or *relevant product*;
- (3) the volume or size of the *person's* transaction or transactions in relation to reasonable expectations of the depth and liquidity of the market at the time in question;
- (4) the extent to which price, rate or *option* volatility movements, and the volatility of these factors for the *investment* in question occur which are outside their normal intra-day, daily, weekly or monthly range;
- (5) the extent to which the *person's* transaction or transactions caused the market price of the *investment* to increase or decrease, following which the market price returned immediately to its previous level; and
- (6) whether a *person* has successively and consistently increased or decreased his bid, offer or the price he has paid for a *qualifying investment* or *relevant product*.

EXAMPLES

1.6.12



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The following are examples of price positioning at a distorted level:

- (1) a trader simultaneously *buys* and *sells* the same *investment* (that is, trades with himself) to give the appearance of a legitimate transfer of title or risk (or both) at a price outside the normal trading range for the *investment*. The price of the *investment* is relevant to the calculation of the settlement value of an *option*. He does this while holding a position in the *option*. His purpose

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is to position the price of the *investment* at a distorted level, making him a profit or avoiding a loss;

- (2) a trader *buys* a large volume of *commodity futures* (whose price will be relevant to the calculation of the settlement value of a *derivatives* position he holds) just before the close of trading. His purpose is to position the price of the *commodity futures* at a distorted level so as to make a profit from his *derivatives* position;
- (3) a trader holds a short position that will show a profit if a particular *investment*, which is currently a component of an index, falls out of that index. The question of whether the *investment* will fall out of the index depends on the closing price of the *investment*. He places a large *sell* order in this *investment* just before the close of trading. His purpose is to position the price of the *investment* at a distorted level so that the *investment* will drop out of the index so as to make a profit; and
- (4) a fund manager's quarterly performance will improve if the valuation of his portfolio at the end of the quarter in question is higher rather than lower. He places a large order to *buy* relatively illiquid *shares*, which are also components of his portfolio, to be executed at or just before the close. His purpose is to position the price of the *shares* at a distorted level.

(B) ABUSIVE SQUEEZES

1.6.13



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Behaviour will constitute *market abuse* where a *person* engages in an abusive squeeze. That is, where a *person* with:

- (1) a significant influence over the supply of, or demand for, or delivery mechanisms for a *qualifying investment* or *relevant product*; and
- (2) a position (directly or indirectly) in an *investment* under which quantities of the *qualifying investment* or *relevant product* in question are deliverable;

engages in *behaviour* with the purpose of positioning at a distorted level the price at which others have to deliver, take delivery or defer delivery to satisfy their obligations (the purpose need not be the sole purpose of entering into the transaction or transactions, but must be an *actuating purpose*).




1.6.14



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Squeezes occur relatively frequently when the proper interaction of supply and demand leads to market tightness, but this is not of itself abusive. In addition, having a significant influence over the supply of, or demand for, or delivery mechanisms for an *investment*, for example, through ownership, borrowing or reserving the *investment* in question, is not of itself abusive.

PAGE
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- 1.6.15**  /1 An abusive squeeze occurs where a *person* has satisfied the conditions in MAR 1.6.13E, which include positioning the price at a level materially different than the price that would have been determined by the interaction of proper supply and demand at which others have to deliver, take delivery or defer delivery to satisfy their obligations. Abusive squeezes damage liquidity and confidence in *prescribed markets* on a multilateral, not just a bilateral, basis and damage confidence in the delivery mechanisms of *prescribed markets*.
- 1.6.16**  /1 The following factors will be taken into account when determining whether a *person* has engaged in an abusive squeeze. These factors do not impose new obligations on market users. For example, they do not impose an obligation to lend to others where one does not already exist, although *behaviour* is less likely to amount to an abusive squeeze if a *person* is willing to lend the *investment* in question. The factors are as follows:
- (1) the extent to which a *person* is willing to relax his control or other influence in order to help maintain an orderly market, and the price at which he is willing to do so;
 - (2) the extent to which the *person's* activity causes, or risks causing, settlement default by other market users on a multilateral basis and not just a bilateral basis. The more widespread the risk of multilateral settlement default, the more likely that the market has been distorted;
 - (3) the extent to which prices under the delivery mechanisms of the market diverge from the prices for delivery of the *investment* or its equivalent outside those mechanisms. The greater the divergence beyond that to be reasonably expected, the more likely that the market has been distorted; and
 - (4) the extent to which the spot or immediate market compared to the forward market is unusually expensive or inexpensive or the extent to which borrowing rates are unusually expensive or inexpensive.
- 1.6.17**  /1 The effects of an abusive squeeze are likely to be influenced by the extent to which other market users have failed to protect their own interests or fulfil their obligations in a manner consistent with the standards of *behaviour* to be expected of them in that market. The *regular user* is likely to expect other market users to settle their obligations and not to put themselves in a position where, to do so, they have to rely on holders of long positions lending when they may not be inclined to do so and may be under no obligation to do so. For example, where a long position holder has accumulated his position in an open and transparent manner, the *regular user* is likely to expect the short position holders to be aware of the situation and to protect themselves accordingly.

EXAMPLES

1.6.18



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The following is an example of an abusive squeeze. A trader with a long position in bond *futures buys* or borrows a large amount of the cheapest to deliver bonds and either refuses to re-lend these bonds or will only lend them to parties he believes will not re-lend to the market. His purpose is to position the price at which those with short positions have to deliver to satisfy their obligations at a materially higher level, making him a profit.

(C) SAFE HARBOURS


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Behaviour which complies with the London Metal Exchange's document "Market Aberrations: The Way Forward" published in October 1998, which governs the *behaviour* expected of long position holders, will not amount to *market abuse* in that the *behaviour* will not amount to distortion (see MAR 1.6.4E).

1.7 Statutory Exceptions

1.7.1  /1 The *Act* provides statutory exceptions for two types of *behaviour* in relation to the *market abuse regime*. The first relates to *behaviour* which is described in this Code as not amounting to *market abuse* (see MAR 1.1.10G). The second relates to *behaviour* which conforms with an *FSA rule* where that *rule* includes a provision to the effect that *behaviour* conforming with that *rule* does not amount to *market abuse* (section 118(8) of the *Act*). In the Code, specific instances of both these exceptions are referred to as ‘safe harbours’. In addition, the *Act* states that information which can be obtained by research or analysis is to be regarded as generally available (section 118(7) of the *Act*) (see MAR 1.4.5E).







1.7.2  /1 *Behaviour* will be regarded as conforming with an *FSA rule* only if it is required or expressly permitted by that *rule*. In order to fall within this safe harbour, there must be a specific *rule* that either requires or expressly permits a *person* to engage in the *behaviour* in question.





FSA RULES

1.7.3  /1 The *FSA rules* which contain a provision to the effect that *behaviour* conforming with that *rule* does not amount to *market abuse* (section 118(8) of the *Act*) are:

- (1) the *price stabilising rules*; (MAR 2; see MAR 2.1.1R(2));
- (2) a *rule* relating to *Chinese walls* (COB 2.4.4R(1)); see COB 2.4.4R(4) and see also MAR 1.4.21C and MAR 1.5.27C;
- (3) those parts of the *Listing Rules* which relate to the timing, dissemination or availability, content and standard of care applicable to a disclosure, announcement, communication or release of information. These are specified in MAR 1 Annex 1G;
- (4) *rule* 15.1(b) of the *Listing Rules* (in relation to *share* buy-backs).

TAKEOVER CODE AND SARs

- 1.7.4  /1 The FSA exercises in MAR 1.7.7C - MAR 1.7.8C, with the approval of the Treasury, the powers conferred by section 120 of the *Act* (Provisions included in the Authority's code by reference to the City Code), save that any reference made to the SARs is made under section 119 of the *Act* and therefore does not require the approval of the Treasury.
- 1.7.5  /1 These safe harbours apply in relation to *behaviour* likely to give rise to a false or misleading impression as described in MAR 1.5, and *behaviour* which would, or would be likely to, give rise to distortion as described in MAR 1.6, but not in relation to *behaviour* based on the misuse of information as described in MAR 1.4.
- 1.7.6  /1 The FSA is satisfied that the remainder of the *Takeover Code* and SARs do not permit or require *behaviour* which amounts to *market abuse*. Much of the *Takeover Code* and the SARs is not directed specifically at the types of *behaviour* prohibited by the *Act*; for example, many provisions are directed at ensuring that an *offer* or stakebuilding is conducted within an orderly framework or that shareholders in a *company* are treated similarly. Other provisions, such as the rules dealing with the specific content of *offeree* and *offeror* documents, are encompassed within the general content standard in Rule 23 of the *Takeover Code* and have not, therefore, been given a specific safe harbour.
- 1.7.7  /1 *Behaviour* conforming with any of the rules of the *Takeover Code* or SARs in relation to the timing, dissemination or availability, content and standard of care applicable to a disclosure, announcement, communication or release of information, and which rules are specified in MAR 1 Annex 2G, does not of itself amount to *market abuse* in that the *behaviour* does not give rise to a false or misleading impression (MAR 1.5.4E) or distortion (MAR 1.6.4E) in so far as the *behaviour* is expressly required or expressly permitted by the rule in question, but this is subject to MAR 1.7.10E.
- 1.7.8  /1 *Behaviour* conforming with Rule 4.2 of the *Takeover Code* (in relation to restrictions on *dealings* by *offeror* and concert parties) does not of itself amount to *market abuse* in that the *behaviour* does not give rise to a false or misleading impression (MAR 1.5.4E) or distortion (MAR 1.6.4E) in so far as the *behaviour* is expressly required or expressly permitted by that rule, but this is subject to MAR 1.7.10E.
- 1.7.9  /1 An example of how MAR 1.7.7C is intended to work may assist. If the rule in question in the *Takeover Code* is about timing of an announcement, then the protection of MAR 1.7.7C is conferred on the *behaviour* in so far as timing is relevant. However, the method of dissemination, the content and the standard of care will not be protected unless they are respectively in compliance with relevant provisions of the *Takeover Code* or SARs relating to dissemination, content and standard of care.

- 1.7.10**  /1 MAR 1.7.7C and MAR 1.7.8C do not apply in any case where the *behaviour* which conforms with the particular rule of the *Takeover Code* is nonetheless in breach of any General Principle set out at Section B of the *Takeover Code* which is relevant to that rule.
- 1.7.11**  /1 In applying MAR 1.7.7C, the notes for the time being associated with the rules identified in the *Takeover Code* are treated as part of the relevant rule.
- 1.7.12**  /1 Certain provisions of the *Takeover Code* and of the SARs restrict the commercial freedom of a *person* by, for example, restricting the speed at which *shares* can be acquired. However, *behaviour* in compliance with such provisions will not be regarded as giving a false or misleading impression, as such restrictions will be taken into account in assessing whether *behaviour* falls below the standard reasonably to be expected.
- 1.7.13**  /1 In cases where none of the safe harbours in MAR 1.7.7C to MAR 1.7.8C apply, the *regular user* may not necessarily consider that complying with applicable requirements of the *Takeover Code* or the SARs will be sufficient in and of itself to demonstrate that *behaviour* does not amount to *market abuse*. An example may help to explain this. If, for example, a *person* were to comply with Rule 1 of the SARs in building a stake, but his decision to build the stake was based on *relevant information* and none of the safe harbours in MAR 1.4 applied, that *person's behaviour* would be likely to amount to *market abuse*. Nevertheless, the question whether a *person* has complied with relevant provisions of the *Takeover Code* and SARs which do not give a safe harbour may be relevant to a *regular user's* assessment of whether or not that *person's behaviour* has fallen below reasonably expected standards.

1.8 Requiring or encouraging

- 1.8.1** **G**_{/1} Section 123(1)(b) of the *Act* (Power to impose penalties) gives the *FSA* the power to impose a penalty on a *person*, “A”, if it is satisfied that A, “by taking or refraining from taking any action has required or encouraged another person or persons to engage in behaviour which, if engaged in by A, would amount to market abuse”.
- 1.8.2** **G**_{/1} For the purposes of section 123(1)(b), it must be shown:
- (1) that the *behaviour* would have amounted to *market abuse* if carried out by the *person* who *requires or encourages* (to which hypothetical situation the principles set out in this Code will be applied); and
 - (2) that the *person*, by action or inaction, *required or encouraged* another to engage in the *behaviour* in question.
- It is not necessary to show that the *person* who *requires or encourages* has benefited from the action of the *person* who is *required or encouraged*.
- 1.8.3** **G**_{/1} There are many ways in which a *person*, A, may, by taking or refraining from taking any action, *require or encourage* another *person*, B, to engage in *behaviour* which, if engaged in by A, would amount to *market abuse*. Some examples of *behaviour* that might fall within the scope of 123(1)(b) are as follows:
- (1) where a *director* of a *company*, while in possession of information which is both *relevant information* and disclosable *information* (other than trading information) and which is not generally available to market users, instructs an *employee* of that *company* to *deal in qualifying investments* or *relevant products* in respect of which the information is *relevant* and *disclosable information*;
 - (2) where A recommends or advises B to engage in *behaviour* which, if engaged in by A, would amount to *market abuse*.
- 1.8.4** **G**_{/1} Whether a *person’s* taking or refraining from taking action might be regarded as *requiring or encouraging* others will depend on circumstances such as acceptable market practices, the experience, level of skill and standard of knowledge of the *person* concerned, and the control or influence the *person* has in relation to the *person* who engages in the *behaviour* in question.
- 1.8.5** **G**_{/1} However, early or selective disclosure of information which a *regular user* would expect market users to have will generally be presumed to constitute *requiring or encouraging* unless there is a legitimate purpose for making the disclosure, for example, as permitted or required by the rules of a *prescribed market*, the *rules* of the *FSA*, or the rules of the *Takeover Code*. Any such disclosure should be accompanied by a statement at or before the time the information is passed that the information is given in confidence and that the recipient should not base any

behaviour in relation to the *qualifying investment* or *relevant product* which would amount to *market abuse* on the information until after the information is made generally available. Such a statement may be incorporated in the express or implied terms of any contract governing the relationship between the *persons* making and receiving the disclosure. Some examples of disclosure for a legitimate purpose are set out in MAR 1.8.6G.

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The FSA will not regard a *person* as *requiring or encouraging* others to *deal* if he passes information which is *relevant information* and not generally available to:

- (1) his *employees* (or, where appropriate, his fellow *employees* or *employees* of a group or associated *company*) for the purpose of enabling them to perform their functions in circumstances where the possession of the information in question is necessary for the proper performance of those functions; or
- (2) his professional advisers, and or the professional advisers of any *persons* involved or who may be involved in any transaction or *takeover bid* with or involving him, for the purpose of obtaining advice; or
- (3) any *person* with whom he is negotiating, or intends to negotiate, any commercial, financial or *investment* transaction (including prospective underwriters or placees of *securities*) for the purpose of facilitating the proposed transaction; or
- (4) any *person* from whom he is seeking or intends to seek an irrevocable commitment or expression of support in relation to an *offer* which is subject to the *Takeover Code*, for the purpose of obtaining that commitment or expression of support; or
- (5) representatives of his *employees* or trade unions acting on their behalf in fulfilment of a legal obligation; or
- (6) any government department, the Bank of England, the Competition Commission, the *Takeover Panel* or any other statutory or *regulatory body* or authority for the purposes of fulfilling a legal or regulatory obligation or otherwise in connection with the performance of the functions of the body to which the information has been passed.

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In the context of a *takeover bid* (see MAR 1.4.28C - MAR 1.4.30E), a *person*, A, will not be regarded as having *required or encouraged* another *person*, B, to engage in *behaviour* amounting to *market abuse* in circumstances where:

- (1) A is an adviser to B, and B is considering the acquisition or disposal of an *equity* or *non-equity stake*; and
- (2) A advises B to acquire or dispose of an *equity* or *non-equity stake* in the target *company* for the purposes and in the manner specified in MAR 1.4.28C.

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Where the originator of the transaction appears to have engaged in *market abuse* and, in the course of doing so, has acted through an intermediary, the intermediary's *behaviour* will not amount to either *requiring or encouraging* or *market abuse* unless the intermediary knew or ought reasonably to have known that the originator was engaging in *market abuse*.

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There are circumstances where the FSA will regard a *person* as *requiring or encouraging*: for example, where a *person* who has relevant and *disclosable information* about a *company* which is not yet generally available to other market

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users, advises or encourages another to acquire *shares* in that *company*, unless *guidance* suggests that this is acceptable (see for example, MAR 1.8.7G).

A *director* of a *company* or relevant employee (as defined in the *Model Code*) will not be regarded as having *required or encouraged* another *person* to engage in *behaviour* amounting to *market abuse* where the *director* or relevant employee acts in compliance with the requirements in paragraphs 11 and 12 (Dealings by connected parties and investment managers) of the *Model Code*.

1.9 Relationship with criminal law and other regulatory requirements

- 1.9.1** G_{/1} Nothing in the Code makes lawful or permits any activity that contravenes the criminal law or applicable legal or regulatory requirements. In particular, nothing in this Code modifies or affects any other obligations of *persons* who are bound by the *rules*, the rules of a *prescribed market* or other relevant rules, regulations or codes of conduct or good practice. The FSA's policy on individual *guidance* in Chapter 9 of the Supervision manual (*SUP 9*) is relevant to a person seeking *guidance* on the Code.
- 1.9.2** G_{/1} *Persons* will, therefore, need to ensure that, even if their *behaviour* does not amount to *market abuse*, it does not breach:
- (1) any applicable criminal law, for example the *insider dealing* provisions of the Criminal Justice Act 1993 or the provisions relating to misleading statements and practices in section 397 of the *Act*; or
 - (2) any applicable *rules*, for example *Principle 5* of the *Principles for Businesses (PRIN)*, the *Conduct of Business sourcebook (COB)*, and the *Statements of Principle and Code of Practice for Approved Persons (APER)*; or
 - (3) any other legal or regulatory requirements to which they are subject, including the rules and regulations of *RIEs*, the provisions of the *Takeover Code* and the *SARs*, the *Companies Acts*, overseas rules and regulatory requirements.
- 1.9.3** G_{/1} *Principle 5* requires a *firm* to observe proper standards of market conduct. *APER 4.3.1P* requires *approved persons* to observe proper standards of market conduct in carrying out their *controlled function*. There is, therefore, some degree of overlap between *Principle 5* and the *market abuse regime*, and between *APER 4.3.1P* and the *market abuse regime*. However, there are some important differences:
- (1) *Principle 5* and *APER 4.3.1P* apply only to *authorised persons* and to *approved persons*, respectively, whereas the *market abuse regime* applies to all *persons*.
 - (2) the *market abuse regime* applies only to *behaviour* which occurs in relation to *qualifying investments* traded on a *prescribed market*. *Principle 5* applies, in respect of *authorised persons*, in relation to activities wherever conducted, if the activities have or might have a negative effect on confidence in the financial system, and otherwise broadly in relation to activities carried on in the *United Kingdom*. *APER 4.3.1P* applies to the activities of *approved persons* in carrying out their *controlled function* wherever they occur.
 - (3) *Principle 5* and *APER 4.3.1P* are broader in scope than the *market abuse regime*. *Principle 5* and *APER 4.3.1P* are directed generally at all *behaviour* which may fall short of proper standards of market conduct. Accordingly, *behaviour* may fall short of proper standards of market conduct, and therefore

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breach *Principle 5* and *APER 4.3.1P*, even though such *behaviour* does not constitute *market abuse*.

1.10 Statement of policy on penalties

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Section 124 of the *Act* requires the *FSA* to publish a statement of its policy with respect to the imposition and amount of penalties in cases of *market abuse* under section 123 of the *Act*. This statement must include an indication of the circumstances in which the *FSA* is to be expected to regard a *person* as having a reasonable belief that his *behaviour* did not amount to *market abuse* or having taken reasonable precautions and exercised due diligence to avoid engaging in *market abuse*. This statement is contained in *ENF* 14.

1.11 The scope of the market abuse regime

PRESCRIBED MARKETS AND QUALIFYING INVESTMENTS

1.11.1 G_{/1} Section 118(1) of the *Act* defines *market abuse* as *behaviour* which amongst other things:

“occurs in relation to qualifying investments traded on a market to which this section applies”

1.11.2 G_{/1} Section 118(3) allows the Treasury to prescribe markets and *qualifying investments*. This is the purpose of the Financial Services and Markets Act 2000 (Prescribed markets and Qualifying investments) Order 2001. This Order, when read in conjunction with the *Act*, makes certain kinds of *investment* “traded on” *prescribed markets qualifying investments*. Treasury has prescribed all markets established under the rules of a *UK RIE* as markets to which section 118 applies. The following is a list of *UK RIEs* as at 31 May 2001:

COREDEAL Limited

The International Petroleum Exchange of London Limited

Jiway Limited

LIFFE Administration and Management

The London Metal Exchange Limited

London Stock Exchange plc

OM London Exchange Limited

virt-x plc

1.11.3 G_{/1} In the majority of cases, there will be no dispute that an *investment* is “traded on” a *prescribed market*. However, in a small number of cases, for example, where an *investment* has traded in the past but not recently, and where an *investment* has not yet started trading, the answer may be less obvious. To avoid any doubt, the following *investments* would be “traded on” a *prescribed market*:

- (1) *investments* which have not yet traded subject to the rules of a *prescribed market* from the point they start trading subject to the rules of a *prescribed market* (including the first trade);
- (2) *investments* which are currently trading subject to the rules of a *prescribed market*; and

(3) *investments* which have traded in the past and can still be traded subject to the rules of a *prescribed market*.

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The fact that *behaviour* has occurred in relation to an *investment* “traded on” a *prescribed market* is a necessary condition for *market abuse* to have occurred but it is not a sufficient condition. In addition, the *behaviour* must, among other things, satisfy one or more of the three conditions identified in section 118(2). It is difficult to see how these tests could be satisfied where there is no ongoing market on the *prescribed market* in the *qualifying investment*. If there is no ongoing market for a *qualifying investment* on a *prescribed market*, market participants are unlikely to rely on the *prescribed market* for price discovery or price formation. Equally, any trading in such a *qualifying investment* that is not associated with the *prescribed market* is unlikely to damage confidence in the *prescribed market*. The question of whether there is an ongoing market will depend on a number of factors, including how recently and in what volumes the *qualifying investment* has traded. The importance of these factors is likely to vary from market to market.

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An example shows how this *guidance* might be applied. An *investment* has not traded for a long time or only in insignificant volumes but it can still be traded subject to the rules of a *prescribed market*. The *investment* will be “traded on” a *prescribed market* for the purposes of the regime (MAR 1.11.3G). There will probably be no ongoing market in this *investment* since it has not traded for a long time or only in insignificant volumes. For that reason, *behaviour* in this *investment* is unlikely to amount to *market abuse* (MAR 1.11.4G).

BEHAVIOUR OCCURRING IN RELATION TO QUALIFYING INVESTMENTS

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Section 118(1)(a) of the *Act* requires that, in order to amount to *market abuse*, *behaviour* must occur in relation to *qualifying investments* traded on a market to which the section applies. According to section 118(6) of the *Act*:

”the behaviour which is to be regarded as occurring in relation to qualifying investments includes behaviour which:




(a) occurs in relation to anything which is the subject matter, or whose price or value is expressed by reference to the price or value, of those qualifying investments; or

(b) occurs in relation to investments (whether qualifying or not) whose subject matter is those qualifying investments.”

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The definition of *behaviour* in relation to a *qualifying investment* in section 118(6) is not exhaustive. However, there must be a clear relationship between the *behaviour* and a *qualifying investment* for the *behaviour* to be regarded as occurring in relation to a *qualifying investment*. Further, where *behaviour* is engaged in for the purpose of abuse in relation to a *qualifying investment*, it may be regarded as having occurred in relation to a *qualifying investment* even though the *behaviour* is not in a *qualifying investment* or *relevant product* (see MAR 1.11.8E).

- 1.11.8**  /1 The statutory definition of *behaviour* which occurs in relation to *qualifying investments* set out at MAR 1.11.6E includes *behaviour* in relation to other *investments* which are not themselves *qualifying investments*, since such *behaviour* can have a damaging effect on confidence in *prescribed markets* and *qualifying investments*. These related *investments* are referred to in this Code as *relevant products*.
- 1.11.9**  /1 *Behaviour* in the following *relevant products* is caught by section 118(6) of the Act:
- (1) anything that is the subject matter of a *qualifying investment*;
 - (2) anything whose price is expressed by reference to the price of a *qualifying investment*;
 - (3) anything whose price is expressed by reference to the value of a *qualifying investment*;
 - (4) anything whose value is expressed by reference to the price of a *qualifying investment*;
 - (5) anything whose value is expressed by reference to the value of a *qualifying investment*;
 - (6) *investments* (whether *qualifying* or not) whose subject matter is a *qualifying investment*.
- 1.11.10**  /1 Something will be the subject matter of an *investment* or a *qualifying investment* where there is a clear (for example, contractual, documented) relationship between the two: for example, the subject matter specified in the contract specification of an exchange-traded *investment*. Contract specifications for exchange-traded *investments* which are physically settled will specify the deliverable product under the contract. Contract specifications for exchange-traded instruments which are cash-settled will specify the subject matter of the contract by reference to which the settlement price is to be calculated. In relation to *OTC investments*, the subject matter of the *investment* will be specified in the accompanying contractual documentation. The following are examples of the application of the element of subject matter:
- (1) the subject matter of the gilt *futures* contract traded on LIFFE (which is a *qualifying investment*) is those gilts which are deliverable under the terms of the contract (which are *investments*). The gilts are therefore *relevant products*;
 - (2) the subject matter of the FTSE Eurotop 100 index *option* traded on LIFFE (which is a *qualifying investment*) is all the individual *shares* which constitute the index (which are *investments*). The *shares* are all therefore *relevant products*;

- (3) the subject matter of an *OTC option* on a basket of *UK shares* (which is an *investment*) traded on a *prescribed market* is *qualifying investments* and the *OTC option* is therefore a *relevant product*.

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The following are examples of the price and or value relationship between a *qualifying investment* and a *relevant product*:

- (1) the value of a *spread bet* in relation to a basket of *UK shares* traded on a *prescribed market* is expressed by reference to the price of the *shares* (which are *qualifying investments*) and the *spread bet* is therefore a *relevant product*;
- (2) the price of an *OTC contract* in relation to Brent crude is expressed by reference to the price of the Brent crude *futures contract* traded on the IPE (which is a *qualifying investment*) and the *OTC contract* is therefore a *relevant product*;
- (3) the value of a total return swap in relation to a *UK share* traded on a *prescribed market* is expressed by reference to the value (that is the price and any dividend) of the *share* (which is a *qualifying investment*) and the total return swap is therefore a *relevant product*.

Chapter 2

2

Price Stabilising Rules

2.1 Application

APPLICATION: WHO?

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- (1) This chapter applies to every *firm*.
- (2) For the purposes of section 118(8) of the *Act*, *behaviour* (whether by a *firm* or not) conforming with the *price stabilising rules* does not amount to *market abuse*.

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- (1) This chapter is available to any *person*, whether that *person* is a *firm* or not, who wishes to show:
 - (a) that he acted in conformity with the *price stabilising rules* for the purposes of paragraph 5(1) of Schedule 1 to the Criminal Justice Act 1993 (Insider dealing); or
 - (b) that he acted or engaged in conduct in conformity with the *price stabilising rules* for the purposes of section 397(4) or (5)(b) of the *Act* (Misleading statements and practices); or
 - (c) that his *behaviour* conforms with *rules* in accordance with section 118(8) of the *Act* (Market abuse).
- (2) Any *person* concerned with an *offer for cash of securities* might wish to rely on this chapter; there are no legal restrictions on the appointment of *stabilising managers* to whom this chapter may apply. However, the main focus of the chapter is on lead managers when they are contemplating or carrying out an *offer for cash of securities*. Agents appointed by lead managers, on the basis contemplated by this chapter, may also find the chapter especially relevant.

APPLICATION: WHAT?

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- This chapter applies to an *offer for cash*, that is, an *offer of securities*:
- (1) where the *securities* are *investments* falling within paragraphs 76, 77, 78, 79 or 80 of the *Regulated Activities Order*;
 - (2) where the *offer for cash* is to be, is, or has been, made at a specified price payable in sterling or another currency;
 - (3) where those *securities*:

- (a) have been *admitted to trading* (or are the subject of an application for *admission to trading*) on an exchange or other institution included in MAR 2.1.5R; or
 - (b) are, or may be, traded under the rules of the International Securities Markets Association;
- (4) where the total cost of the *securities* subject to the *offer* at the *offer price* is at least £15,000,000 (or its equivalent in another currency); and
- (5) where the *offer* is public in character and is to be, is, or has been subject of a public announcement.

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The effect of MAR 2.1.3R is to include both initial public offers and public offers of additional *securities* to rank alongside *securities* already in issue. An offer is likely to be regarded as public in character where it is made in a prospectus. Other offers that may be regarded as public are offers to a section of the public, placements that are not essentially private and distributions. But the use of the word "offer" and the fact that there has to be a *public announcement* of the *offer* shows that a sale, for example by means of a block trade, of *securities* already in issue is not included.

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Table Exchanges (see MAR 2.1.3R(3))

Application: securities admitted to trading or to be admitted to trading on the following exchanges are within the scope of the price stabilising rules (see MAR 2.1.3R(3)).

A recognised investment exchange

A recognised overseas investment exchange

A regulated market

Other specific exchanges as listed in MAR 2 Ann 1R

APPLICATION: WHERE?

2.1.6

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This chapter:

- (1) so far as it provides a defence for any *person*, has the same territorial application as the provision which is alleged to have been contravened; and
- (2) in its application to a *firm* for purposes other than those falling within (1), applies to the *firm's* business carried on from an establishment in the *United Kingdom*.

2.1.7

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There are specific provisions in MAR 2.8 about action for stabilising purposes in conformity with provisions made by certain overseas authorities. Accordingly action by *persons* not present in the *United Kingdom*, but where the action may have an effect in the *United Kingdom*, may have to be assessed in terms of the general provisions in this chapter, or the specific provisions in MAR 2.8.

- 2.1.8** **G**_{/1} The defences to legal or regulatory procedures referred to in *MAR 2.1.6R (1)* and listed at *MAR 2.1.2G (1)* are conferred by *rules* made under section 144 of the *Act* (price stabilising rules); this means that *MAR 2.6* (Management of stabilisation) and *MAR 2.7* (Recording of action taken), which are made under section 138 of the *Act*, and apply only to *authorised persons*, are not relevant for the purposes of such a defence.
- 2.1.9** **R**_{/1} A contravention of the *price stabilising rules* in *MAR 2* does not give rise to a right of action by a *private person* under section 150 of the *Act* (and each of those *rules* is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action).

2.2 Purpose

2.2.1

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The purpose of this chapter is to provide *rules* permitting, but also regulating, price support for *offers* of equities and bonds, including new issues such as initial public offers and *offers of securities* of the type and class already traded in the market. It prescribes the circumstances in which the *stabilising manager* and others acting for him are permitted to support the prices of the *relevant securities* offered for a limited period after the *offer*. This is to maintain an orderly initial market in the *securities* offered, and potentially therefore to facilitate new *offers* and reduce the costs to enterprises involved in the making of new *offers* of their *securities*. The *stabilising manager* and his agents are allowed to exert upward pressure on the price in the cash market, by all means permitted by the *price stabilising rules*, including by the purchase of *relevant securities* previously sold short. Under the *rules* in this chapter, there can be only one *stabilising manager* in respect of any particular *offer*.

GENERAL EFFECT OF THE RULES

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The general effect of this chapter is to enable the *stabilising manager* of an *offer of securities* to enter into the market personally, or through specially appointed agents, to buy or agree to buy *securities* in order to support (though not to suppress) the market price of the *relevant securities* being *offered*. He will, however, be free to do this only if:

- (1) the *stabilising period* is still running;
- (2) he has taken the necessary preliminary steps envisaged by MAR 2.3 and, if applicable, MAR 2.7 (relating to warning the market of the possibility of *stabilising action*, and records of action taken);
- (3) the price is not already false at the start of the *stabilising period* under MAR 2.3.8R; and
- (4) the limits set by MAR 2.5 as to the maximum price at which *stabilising action* may be taken are not exceeded.

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During the *stabilising period* the *stabilising manager* may do any or all of the following:

- (1) purchase, or agree to purchase, any of the *relevant securities* (or *associated securities*) with a view to supporting the market price of the *relevant securities*; and
- (2) offer or attempt to do anything in (1) with a view to supporting the market price of the *relevant securities*.

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But the *stabilising manager* will not be able to rely on the *price stabilising rules* if, at the time of the relevant act or omission, he knew or should reasonably have known that:

- (1) the market had not been properly informed in accordance with *MAR 2.3.2R(1)* and (2); or
- (2) proper records are obliged to be but have not been or are not being kept in accordance with *MAR 2.3.2R(3)*; or
- (3) the price of any *associated securities* or of the *relevant securities* was already false at the time when the *offer price* was determined in the circumstances described at *MAR 2.3.8R*.

2.3 Preparation before and restrictions upon stabilising action

2.3.1

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Before *stabilising action* is taken, the *stabilising manager* is required (under MAR 2.3.2R) to take, or check that others have taken, proper steps to inform the market (and, so far as relevant, the issuer) that *stabilising action* may be taken and (under MAR 2.3.8R) to verify that the price of any *relevant securities* or *associated securities* is not already false. He must also:

- (1) be satisfied (under MAR 2.3.2R) that proper systems have been set up (where required) for the central recording of any *stabilising action*; and
- (2) (under MAR 2.3.9R) not stabilise shares and certificates associated to bonds, loans, debentures, etc, if one is to be convertible into the other but the terms of conversion have not yet been announced.

2.3.2

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The *stabilising manager* may not take any *stabilising action* in any *relevant securities* or *associated securities* in accordance with this chapter unless he has taken all reasonable steps to satisfy himself that:

- (1) from the beginning of the *introductory period* (or where relevant the period mentioned in MAR 2.3.5E(3)(b)) adequate disclosure is made, in relevant communications issued by or on behalf of the issuer or the *stabilising manager*, of the fact that *stabilising action* may take place in relation to the *offer*;
- (2) any requirement of the relevant exchange (see MAR 2.5.6R note (2)) or other institution on which the *relevant securities* or *associated securities* are or will be traded (see MAR 2.1.3R(3)) to inform it that *stabilising action* in those *securities* may take place during the *stabilising period* has been complied with;
- (3) the *stabilising manager* has established the register required by MAR 2.7.2R(1) (if that paragraph is binding upon him) for recording each *stabilising action* effected by him in the *relevant securities* or *associated securities* and the matters required to be recorded by MAR 2.7.2R(2) in relation to it; and
- (4) where the *offer* relates to an issue of *relevant securities* the issuer has been informed of the existence of the FSA informational guidance (MAR 2 Ann 2G), either in relation to the *offer* in question or to a previous one.

2.3.3



- (1) A *stabilising manager* who is required to comply with MAR 2.3.2R(1) should ensure that the communications there referred to, if they fall within items 1 to 5 of MAR 2.3.4E, contain the words suggested in, or otherwise fairly comply with, any relevant note to that table.
- (2) Compliance with (1) may be relied on as tending to establish compliance with MAR 2.3.2R(1).

2.3.4



Table Communication referring to the offer (see MAR 2.3.2R(1))

Item	Communication	Relevant Notes (See MAR 2.3.5E)
1	Any screen-based statement	1, 2, 3, 5 and 6
2	Press announcement (or other <i>public announcement</i>)	2, 3, 5 and 6
3	Invitation telex (or similar)	2, 5 and 6
4	Preliminary offering circular (or draft prospectus)	4, 5 and 6
5	Final offering circular (or prospectus)	4, 5 and 6

2.3.5



Table Notes to MAR 2.3.4E

(1) Item 1 extends to any statement made by the *stabilising manager* or issuer on screen facilities (whether provided by the *stabilising manager* or not) conveying prices for a purchase or sale of *securities*.

(2) For items 1, 2 and 3, adequate disclosure is given if the communication contains some indication of the fact that the *offer* may be stabilised in accordance with the *price stabilising rules*. The term "stabilisation / FSA" is sufficient for this purpose. During the *introductory period* a reference to the future prospectus or to the prospectus can be used instead if preferred.

(3) Items 1 and 2 apply from the beginning of the shorter of two periods, that is:

(a) the *introductory period*; or

(b) the period beginning 45 days before the day proposed for the issue of the *relevant securities* and ending with the start of the *stabilising period*.

(4) For Items 4 and 5 adequate disclosure is given if the communication contains wording substantially similar to the following:

"In connection with this [issue] [*offer*], [name of *stabilising manager*] [or any *person* acting for him] may over-allot or effect transactions with a view to supporting the market price of [description of *relevant securities* and any *associated securities*] at a level higher than that which might otherwise prevail for a limited period after the issue date. However, there may be no obligation on [name of *stabilising manager*] [or any agent of his] to do this. Such stabilising, if commenced, may be discontinued at any time, and must be brought to an end after a limited period."

(5) Where any communication referred to in items 1 to 5 is not to be issued to or directed at *persons* in the *United Kingdom*, the notice required by those items may be adapted or omitted.

(6) Where any communication referred to in items 1 to 5 is to be issued to or directed at *persons* in the *United Kingdom* and *persons* elsewhere, the notice required by those items may be adapted or omitted so as not to require the *stabilising manager* or any agent of his to commit any breach of any legal rule or requirement in respect of any communication issued to or directed at *persons* outside the *United Kingdom*.

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The requirement in MAR 2.3.2R (1) to make adequate disclosure in communications does not apply to any communication which is not mentioned in table MAR 2.3.4E.

2.3.7

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An FSA consumer factsheet has been prepared which explains to potential investors the significance of the fact that stabilisation may take place in the *relevant securities* offered. The factsheet is available on the FSA's website and may in addition be obtained from the FSA by post, free of charge. The *stabilising manager* acting for the issuer should consider drawing attention to the availability of this factsheet in prospectuses which are aimed at *private customers*.

2.3.8

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- (1) The *stabilising manager* may not take *stabilising action* in any case where:
- (a) there are in existence *associated securities*;
 - (b) at the time when the *offer price* of the *relevant securities* was determined, the market price of the *associated securities* was falsely higher than the true market price; and
 - (c) the *stabilising manager* knew or ought reasonably to have known that the falsity in the market price was attributable in whole or in part to any act or course of conduct on the part of any *person* which was in breach of section 397(2) or (3) of the *Act*.
- (2) The *stabilising manager* may not take *stabilising action* in any case where:
- (a) at the time when the *offer price* of the *relevant securities* was determined, the market price of the *relevant securities* or of rights to them, whether in informal trading or otherwise, was falsely higher than the price which would otherwise have prevailed; and
 - (b) the *stabilising manager* knew or ought reasonably to have known that the falsity in the market price was attributable in whole or in part to any act or course of conduct on the part of any *person* which was in breach of section 397(2) or (3) of the *Act*.

2.3.9

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The *stabilising manager* may not take *stabilising action* in any case where:

- (1) the *relevant securities* fall within article 77 (instruments creating or acknowledging indebtedness), 78 (Government and public securities) or 79 (instruments giving entitlements to investments) of the *Regulated Activities Order*;
- (2) there are, in relation to those *relevant securities*, *associated securities* falling within article 76 (shares, etc) or 80 (certificates representing certain securities) of the *Regulated Activities Order*, into which those *relevant securities* can be converted or to the purchase of which those *relevant securities* give rights; and
- (3) the terms of the conversion, purchase or subscription have not yet been publicly announced.

2.3.10

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The general purpose of MAR 2.3.9R is to place a restriction on stabilising bonds convertible into equities, and warrants for equities, in cases where the terms of the conversion or right to purchase have not yet been settled. Prime examples would be a convertible loan stock of a public limited company, but MAR 2.3.9R also

covers similar cases such as government debt instruments which are convertible into shares, for example a privatisation in the *United Kingdom* or overseas.

2.3.11

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The *stabilising manager* may not take *stabilising action* in any case where:

- (1) he or an *associate* of his has, in connection with the *offer*, an *option* or other right to purchase *relevant securities* from the issuer; and
- (2) that *option* or right may be exercised or relied on after the start of the *introductory period* and during or after the remainder of the *stabilising period*;

unless the existence and principal terms of the *option* or right have been disclosed in the relevant prospectus or offering document or in a *public announcement*.

2.4 Ancillary permitted stabilising action

- 2.4.1** **G** ^{/1} MAR 2.4.2R and 2.4.3R enable the *stabilising manager* to over-allot or go short of *securities*, so as to facilitate his subsequent purchase of them by *stabilising action*; and he may buy or sell on the market in order to close out or liquidate positions established by *stabilising action* or by going short.

PERMITTED ANCILLARY ACTION

- 2.4.2** **R** ^{/1} The *stabilising manager* may, subject to MAR 2.4.3R:
- (1) with a view to supporting the price of the *relevant securities* by action under MAR 2.2.3R:
 - (a) make allotments of a greater number of the *relevant securities* than will be offered; or
 - (b) sell or agree to sell *relevant securities* or *associated securities* so as to establish a short position in them; or
 - (c) achieve a result equivalent to that in (b) by use of *derivatives*; or
 - (2) buy or subscribe for or agree to buy or subscribe for *relevant securities* or *associated securities* in order to close out or liquidate any position established under (1); or
 - (3) sell or agree to sell *relevant securities* or *associated securities* in order to close out or liquidate any position that has been established by *stabilising action*; or
 - (4) achieve a result equivalent to that in (3) by use of *derivatives*; or
 - (5) offer or attempt to do anything permitted by (1)(b) or (c), (2), (3) or (4).

- 2.4.3** **R** ^{/1} MAR 2.4.2R applies only if the *stabilising manager* has reasonable grounds for believing, and does believe, that the requirements in MAR 2.3 have been complied with.

PRICE LIMITS

- 2.4.4 **R**_{/1} *Ancillary action* under MAR 2.4.2R(2) may be taken without regard to the limits on pricing in MAR 2.5.
- 2.4.5 **G**_{/1} Long or short positions can be established either in the cash market or by the use of *derivatives*. The extent to which *derivatives* may be used in *stabilising action* or in *ancillary action* is strictly limited. MAR 2 contemplates the use of *derivatives* only on the “selling” side, that is as permitted *ancillary action*, under MAR 2.4.2R(1)(c) and (4). This is because of the need for market transparency in any purchase transactions and because of the requirements which are applicable to *firms* in MAR 2.7.2R for a single record of *stabilising action* taken.
- 2.4.6 **G**_{/1} MAR 2.4.2R(2) extends to the purchase from the issuer during the *stabilising period*, or shortly after, by exercise of an *option* or other right, of further *securities* not previously allotted.

2.5 Pricing

LIMIT ON PRICING: GENERAL

- 2.5.1** **G**_{/1} The principal purpose of this section is to put an upper limit on the price at which certain *securities* may be stabilised.
- 2.5.2** **G**_{/1} The price limits are broadly similar whether the *stabilising action* is concerned with *relevant securities* or *associated securities* (including call options). However, the price limits do not extend to *debt securities* in the form of bonds, etc., and pricing for them is subject instead to the requirements in MAR 2.2.3R that the *stabilising action* is taken to support the market price.
- 2.5.3** **G**_{/1} The initial *stabilising price* (Price X) cannot exceed the *offer price* (or starting price) (Price Y), and subsequent *stabilising action* must equally be at or below the level of Price X. If there are no sales and purchases which are independent of the *stabilising manager* on both sides on the relevant exchange above Price X, the *stabilising manager* can operate at a price or at prices below Price X, moving up or down in that area as he wishes. But if an independent buyer and seller do a deal on the relevant exchange, at a price (Price Z) between Price X and Price Y, then the *stabilising manager* has a new maximum price (Price Z) instead of Price X.

MAXIMUM PRICES

- 2.5.4** **R**_{/1} (1) No bid may be made or transaction effected in the case of action described in MAR 2.2.3R at a price higher than any relevant price indicated in accordance with MAR 2.5.5R (including any relevant note in MAR 2.5.6R).
- (2) The prohibition in (1) does not apply to *stabilising action* related to *investments* falling within Articles 77 or 78 of the *Regulated Activities Order* (bonds, etc), nor within Article 80 (certificates, etc) that confer rights in respect of any of those *investments*.
- 2.5.5** **R**_{/1} Table Limits on pricing (see MAR 2.5.4R(1))

Time of Action	Column A	Column B	Column C
	<i>Relevant securities (including associated securities which are in all respects uniform with them)</i>	<i>Associated securities (other than associated call options) excluding those in column A</i>	<i>Associated call options</i>
(1) Initial stabilising action	The offer price	The market bid price of the associated securities at the beginning of the stabilising period	The market price of an option at the beginning of the stabilising period
(2) Later, but where there has been a deal at a price above the stabilising price on the relevant exchange	The offer price, or the price at which that deal was done, whichever is the lower	The market bid price in B(1), or the price at which that deal in the associated securities was done, whichever is the lower	The market price in C(1), or the price at which that deal in an option was done, whichever is the lower
(3) Later, but where there has been no deal in (2)	The offer price, or the initial stabilising price, whichever is the lower	The market bid price in B(1), or the initial stabilising price for the associated securities, whichever is the lower	The market price in C(1), or the initial stabilising price of the option, whichever is the lower

2.5.6

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Table

Pricing Notes (see MAR 2.5.5R)

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- (1) Deals done. For the purposes of *MAR 2.5.5R(2)*, a deal done by or on the instructions of the *stabilising manager* does not count.
- (2) Relevant Exchange. For the purposes of *MAR 2.3.2R(2)*, *MAR 2.5.5R(2)* and *MAR 2.5.6R* the relevant exchange means the investment exchange which the *stabilising manager* reasonably believes to be the principal investment exchange on which those *securities*, or as the case may be *options*, are dealt in at the time of the transaction.
- (3) Convertible bonds, etc. For the purposes of *MAR 2.5.5R* and *MAR 2.5.6R* any investment falling within Article 76 and also within Article 77 or 79 of the *Regulated Activities Order* shall be treated as if it fell only within Article 76.
- (4) References in column B of *MAR 2.5.5R* to *associated securities* do not include call *options*.
- (5) Currency fluctuations. Where the price of any *relevant securities* or associated securities on the relevant exchange is in a currency other than the currency of the price of the *securities* to be stabilised, stabilising bids may be made or transactions effected at a price that reflects any change in the relevant rate of exchange; but this does not permit *stabilising action*, in column A of *MAR 2.5.5R*, at a price above the equivalent, in the other currency, of the *offer price* in the currency on the relevant exchange.
- (6) New *securities*: Where there is no market bid price for any *associated securities* (including *associated call options*) at the beginning of the *stabilising period* because those *securities* or *options* are not in existence or capable of being traded at that time, *MAR 2.5.5R* shall be read as if references to the market bid price of the *associated securities* or *options* at the beginning of the *stabilising period* were a reference to the first market bid price of the *associated securities* or *options* during the *stabilising period* of which the *stabilising manager* is, or reasonably should be, aware.

2.6 Management of stabilisation

- 2.6.1** **G**^{/1} The purpose of this section and of section 2.7 is to provide an orderly structure for the management of *stabilising action* even where it is to be carried out on a devolved basis, whether in the *United Kingdom* or elsewhere. The central management has to be in the hands of one *stabilising manager*. If authorised in the *United Kingdom*, the *stabilising manager* has to set up, operate and be legally responsible for a single stabilisation register (MAR 2.7.2R) which must be kept in the *United Kingdom* or be capable of being inspected by the relevant regulators. These sections accordingly build on the base requirement for *authorised persons* at MAR 2.3.2R(3).
- 2.6.2** **R**^{/1} (1) This section, and section MAR 2.7, apply only where the *stabilising manager* is a *firm* or is employed by a *firm*.
- (2) Where the *stabilising manager* is employed by a *firm*, this section and MAR 2.7 shall have effect as if the obligations imposed on the *stabilising manager* were imposed on the *firm*.
- 2.6.3** **R**^{/1} No bid may be made or transaction effected in the course of stabilising action unless the stabilising manager:
- (1) has established the relevant register in compliance with MAR 2.7.2R; and
- (2) is in compliance with the registration requirements in MAR 2.7.2R in respect of all earlier transactions effected in the course of *stabilising action* in connection with the *offer* in question.
- 2.6.4** **R**^{/1} No bid may be made or transaction effected in the course of *stabilising action* except by:
- (1) the *stabilising manager* himself; or
- (2) a *person* appointed by the *stabilising manager* to act as his agent on terms which:
- (a) make the agent responsible to the *stabilising manager*; and
- (b) make the *stabilising manager* as responsible to others for the acts or omissions of the agent as if they had been done or omitted by the *stabilising manager*.

2.6.5

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- (1) The *stabilising manager* may not during the *stabilising period* enter into a transaction as principal in *relevant securities* or *associated securities* with any agent of his appointed under MAR 2.6.4R.
- (2) Paragraph (1) does not apply if, at the time of the transaction, neither the *stabilising manager* nor the agent knew or could reasonably have been expected to know the identity of his counterparty.

2.7 Recording of action taken

2.7.1

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For the application of this section see MAR 2.6.2R.

2.7.2

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- (1) The *stabilising manager* must establish and keep a register in respect of each *offer of securities* covered by this chapter.
- (2) He must ensure that it contains, either in real time or updated overnight (from *business day* to *business day*):
- (a) the names of all agents appointed under MAR 2.6.4R, and details of the terms of the appointment of each;
 - (b) the general parameters (including the initial *stabilising price*) laid down by the *stabilising manager* for his agents and the date and time of their communication, variation or revocation;
 - (c) each transaction effected in the course of *stabilising action* including:
 - (i) the type of *security*;
 - (ii) the unit price;
 - (iii) the size;
 - (iv) the date and time; and
 - (v) details of the counterparty;
 - (d) details of the allotment of *relevant securities* (allottee and amount allotted); and
 - (e) details (so far as known to the *stabilising manager*) of any deal which “counts” as a deal at a price above the then *stabilising price* for the purposes of MAR 2.5.5R(2) (pricing after independent deals).
- (3) The register must be kept in the *United Kingdom*, or else be capable of being brought to, or reconstituted in, the *United Kingdom* within 48 hours of a request for access from anyone entitled to inspect it.

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- (4) If the *register* is not kept in English, it must be capable of being converted into English within the 48 hour period mentioned in (3).
- (1) During the three months from the end of the *stabilising period*, the *stabilising manager* must permit the issuer of the *securities*, on any *business day*, to inspect that part of the register which is kept under MAR 2.7.2R (2) (c) (i) to (iv).
- (2) The obligation in (1) arises only if the *offer* related to an issue of *relevant securities*.

2.7.4

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The register must be retained for a period of at least three years from the date of the end of the *stabilising period*.

2.8 Overseas Stabilisation

2.8.1

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Under sections 144(3) and (6) of the *Act*, the *FSA* may make *rules* which confer a “safe harbour” in respect of one type of market manipulation (section 397(3)) on *persons* who act in conformity with specified provisions of foreign laws. Under that power, the *FSA* “specifies” certain legislative provisions having effect in the United States of America and in Japan. It should be noted that conformity with these provisions may assist in proceedings under section 397(3) but not in proceedings under section 397(2) nor in proceedings under Part V of the Criminal Justice Act 1993 (insider dealing). This is because of the wording of section 144(3).

2.8.2

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(1) A person who, in any place outside the *United Kingdom*, acts or engages in conduct:

- (a) for the purposes of stabilising the price of *investments*; and
- (b) in conformity with the provisions specified in (2) or, as the case may be, in (3); and
- (c) in relation to an offer which is governed by the law of a country (or a state or territory in a country) so specified;

is to be treated for the purposes of section 397(5) of the *Act* (misleading statements and practices) as acting or engaging in conduct for that purpose and in conformity with the *price stabilising rules*.

(2) In relation to the United States of America, the specified provisions are:

Regulation M made by the *Securities and Exchange Commission* (17 CFR 242, # 100-105).

(3) In relation to Japan, the specified provisions are:

- (a) The Securities and Exchange Law of Japan, (Law No 25, April 13 1948), Article 159, paragraphs 3 and 4;
- (b) Cabinet Orders for the Enforcement of the Securities and Exchange Law of Japan (Cabinet Order 321, September 30, 1965), Articles 20 to 26;

- (c) Ministerial Ordinance concerning the Registration of Stabilisation Trading (Ordinance of the Ministry of Finance No 43, June 14, 1971);
 - (d) Ministerial Ordinance concerning rules and otherwise governing the soundness of securities companies (Ordinance of the Ministry of Finance, No 60, November 5, 1965), Article 2.
- (4) A *person* who is treated under (1) as acting or engaging in conduct in conformity with the *price stabilising rules* is also to be treated to an equivalent extent as so acting or engaging for the purposes of MAR 2.1.1R (2) above, and of Part XIV (Disciplinary measures) and Part XXV (Injunctions and Restitution) of the *Act*.
- (5) The provisions in (2) and (3) are specified as they have effect from time to time, so long as this paragraph has effect.

2.8.3

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- (1) The effect of MAR 2.8.2R (4) is to confer a defence in the following classes of cases:
- (a) proceedings under Part VIII of the *Act* in cases of *market abuse*;
 - (b) disciplinary proceedings under Part XIV of the *Act* in cases of a breach of other *price stabilising rules*;
 - (c) proceedings under Part XXV of the *Act* (Injunctions and Restitution) in relation to *market abuse* or a breach of other *price stabilising rules*.
- (2) The *FSA* and, if necessary, the *Financial Services and Markets Tribunal* and the court will need, in such cases, to consider whether, and if so how, the overseas stabilising rule has been complied with or broken in relation to conduct of the kind which otherwise would be proscribed under section 397(3) of the *Act*.

2.8.4

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The provisions in this section are separate and distinct from other provisions in these *rules* which may be relevant to overseas stabilisation whether by *persons* who are authorised in the *United Kingdom* or by other *persons*. In particular, MAR 2.6.4R enables overseas agents appointed by a *UK* authorised *stabilising manager* to obtain the benefit of the *price stabilising rules*.

MAR 2 Ann 1R

- 1 Table List of specified exchanges (This is the list of other specified exchanges referred to in MAR 2.1.5R)

American Stock Exchange (AMEX)
Australian Stock Exchange
Bolsa Mexicana de Valores
Canadian Venture Exchange
Hong Kong Stock Exchange
Johannesburg Stock Exchange
Korea Stock Exchange
Midwest Stock Exchange
Montreal Stock Exchange
New York Stock Exchange (NYSE)
New Zealand Stock Exchange
Osaka Securities Exchange (OSE)
Pacific Stock Exchange
Philadelphia Stock Exchange
Singapore Exchange Securities Trading Limited
Tokyo Stock Exchange (TSE)
Toronto Stock Exchange

MAR 2 Ann 2G

1 Table Information for issuers on stabilisation (see MAR 2.3.2R (4))

1.	Introduction
1.1	This guidance has been produced by the FSA to help issuers identify the information they might seek when engaging underwriters and <i>stabilising managers</i> to manage their new offers for them. <i>Stabilising managers</i> are encouraged by the <i>price stabilising rules</i> to alert issuers to the existence of this guidance.
2	When stabilisation can be used
2.1	It is a common market practice in the <i>United Kingdom</i> for <i>stabilising managers</i> of both debt and equity issues to reserve the right to stabilise offers by including in the offer documentation wording which gives notice that the issue may be stabilised. <i>FSA rules</i> allow the <i>stabilising manager</i> /underwriter to stabilise a new offer, which means that it may purchase securities to support the price: <ol style="list-style-type: none"> 1 where the <i>offer</i> is for cash; 2 where the <i>offer</i> is public and is subject to the rules of an exchange specified under the <i>price stabilising rules</i>; and 3 only for a limited period, (the <i>stabilising period</i>).
3	Common market practice when undertaking stabilisation
3.1	<i>Stabilising action</i> involves supporting the price of <i>securities</i> made in public offers. The <i>stabilising manager</i> undertakes this action by purchasing or agreeing to purchase the relevant <i>securities</i> . Supporting a price may potentially lead to distortions of price signals. For the <i>stabilising manager</i> to obtain the ‘safe harbour’ (effectively a defence against a charge of market manipulation, insider dealing or <i>market abuse</i>) provided by the <i>price stabilising rules</i> , a number of disclosures must be made to the market (see 5 below).

3.2	<p>It is common practice for the <i>stabilising manager</i> to over-allot a new <i>offer</i> as an <i>ancillary action</i> to stabilisation. This leaves the <i>stabilising manager</i> with a net short position in the <i>securities</i>, having pre-sold more than 100% of the issue. When the <i>offer</i> begins to trade in the after-market, if the price does not go above the <i>offer price</i>, the <i>stabilising manager</i> can make purchases of <i>securities</i> in order to close out this short position. The purchases that the <i>stabilising manager</i> makes to close out the position will be part of the <i>price stabilising activity</i>. It is common for the <i>stabilising manager</i> to take out an over-allotment (or Green Shoe) option, so that further <i>securities</i> can be obtained from the issuer at the <i>offer price</i>. Thus, if the price has risen, the <i>stabilising manager</i> can still close out the short position.</p>
4	Use of the Green Shoe unconnected with stabilisation
4.1	<p>It is possible for the <i>stabilising manager</i> to obtain a Green Shoe option that is not intended for the purpose of filling any short position arising from over-allotment. The reason for the option should be explicitly disclosed to the issuer. The issuer may wish to ensure that it understands why the <i>stabilising manager</i> wants a Green Shoe option, and may wish to secure that its agreement specifies the circumstances in which it can be exercised</p>
5	FSA rules and disclosure
5.1	<p>The <i>price stabilising rules</i> require the <i>stabilising manager</i> to make certain disclosures:</p>
1	to the market, providing notification that <i>stabilising action</i> may be taken; and
2	in the prospectus, or offering circular, concerning the existence of an over-allotment or Green shoe option, and the terms on which it has been agreed.
5.2	<p>In addition, where the stabilising manager is an authorised person in the <i>United Kingdom</i>, MAR 2.7.3R gives the issuer certain rights to inspect parts of the register of <i>stabilising action</i> which such a <i>stabilising manager</i> must maintain.</p>
6	Information that issuers may wish to request from the stabilising manager

6.1	<p>When negotiating the terms of agreement for the <i>offer</i>, the parties will no doubt wish to consider how the <i>offer</i> will be managed and what information the issuer might wish to seek from the <i>stabilising manager</i>. In considering what information might be requested, the issuer may wish to arrange for the following:</p>
	<ol style="list-style-type: none"> <li data-bbox="363 510 1256 611">1 information on how the issue is proceeding during the <i>stabilising period</i> (nature of demand, types of investors, etc.); and <li data-bbox="363 611 1256 801">2 information on the level of <i>stabilising activity</i> which is being undertaken (though it may not be desirable, for reasons of confidentiality, for this to be disclosed in any detail until the <i>stabilising period</i> has ended).
6.2	<p>The issuer may also request information on the reasons for the exercise of the right to additional allotment by the <i>stabilising manager</i>. In particular, the issuer may wish to know how far the additional allotment is attributable to:</p> <ol style="list-style-type: none"> <li data-bbox="363 992 1256 1093">1 a need to deliver <i>relevant securities</i> to <i>persons</i> who are unconnected with the <i>stabilising manager</i>; and <li data-bbox="363 1093 1256 1182">2 a need to make good any failures to deliver by other counterparties. <p>The issuer may also wish to consider whether the additional allotment might have led to a profit for the <i>stabilising manager</i>.</p>
6.3	<p>The <i>stabilising manager</i> is not under any obligation to identify the names of individual clients to the issuer.</p>

Chapter 3.

Inter-Professional Conduct

3.



3.1 Application

APPLICATION: WHO?

3.1.1 **R** This chapter applies to every *firm* except:

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- (1) a *service company*;
- (2) a *non-directive friendly society*;
- (3) a *non-directive insurer*;
- (4) a *UCITS qualifier*.

APPLICATION: WHAT?

3.1.2 **R** This chapter applies to a *firm*:

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- (1) when it carries on:
 - (a) *regulated activities*; or
 - (b) related *ancillary activities*;
- (2) to the extent that the *regulated activity* the *firm* is carrying on is:
 - (a) *dealing in investments as principal*; or
 - (b) *dealing in investments as agent*; or
 - (c) acting as an *arranger*; or
 - (d) *giving transaction-specific advice*;
- (3) but only if the activity referred to in (1) and (2) is in or is in respect of an *inter-professional investment* and is undertaken with or for a *market counterparty*.

3.1.3 **R** This chapter does not apply to the carrying on of the following activities:

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- (1) the *approval* by a *firm* of a *financial promotion*; or
- (2) activities carried on between *operators*, or between *operators* and *depositories*, of the same *collective investment scheme* (when acting in that capacity); or
- (3) *corporate finance business*; or
- (4) *Safeguarding* and *administering investments* and agreeing to carry on that *regulated activity*.

APPLICATION: WHERE?

3.1.4

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This chapter applies only with respect to a *firm's* activities carried on from an establishment maintained by the *firm* in the *United Kingdom*.

3.2 Purpose

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The main objective of this chapter (*MAR 3*) is the maintenance of confidence in the *financial system*, although it is also relevant to the *FSA's* other *regulatory objectives* under the *Act*. However, many of its provisions relate to the conduct of bilateral dealings and it seeks to secure good market practice by *firms* undertaking *inter-professional business* in three ways:

- (1) by increasing certainty by explaining how the *Principles* apply to *inter-professional business*, whilst acknowledging that what is required to meet the proper standards of conduct for a *firm* may differ depending on whether or not the *firm* is *dealing* with a *market counterparty* (see *PRIN 1.2.1G* (Characteristics of the client));
- (2) by setting out *rules* for *inter-professional business* in cases when it is not appropriate to rely on the *Principles* alone; and
- (3) by setting out the *FSA's* understanding of certain market practices and conventions; drawing this information together in this way will assist certainty, reduce the scope for disputes and make it easier to resolve disputes that do arise.



3.3 Contents and status of this chapter



3.3.1

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MAR 3 Ann 1G provides *guidance* on the scope of this chapter.

3.3.2

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MAR 3 is not the only chapter of the *Handbook* that applies to *firms* doing *inter-professional business*. *Firms* should always consider what other parts of the *Handbook* may apply to them. A table listing the applicable *Principles* is set out in MAR 3 Ann 2G. The table also sets out the key provisions of *COB* that may also apply to *firms* doing *inter-professional business*, but it should not be read as an exhaustive list. *Firms* should also consider the other provisions of the *Handbook*, especially but not exclusively *ML* and *IPRU*.

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MAR 3 Ann 3G is a statement of what the *FSA* understands to be generally regarded as good *market* practice and conventions in certain areas. It is not *guidance* on *rules*.

3.4 Standards expected of firms when undertaking inter-professional business

3.4.1 **G** This section 3.4 provides *guidance* on the interpretation of the *Principles* and in particular *Principle 1* (Integrity), *Principle 2* (Skill, care and diligence), *Principle 5* (Market conduct) and *Principle 7* (Communications with clients.)
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3.4.2 **G** The *Principles*, as they apply to *inter-professional business*, will be interpreted on the basis that *market counterparties* do not need or expect the level of protection provided to *private customers* or *intermediate customers*. In many respects, inter-professional dealings are mutually self-disciplining. *Market counterparties* have commercial sanctions available if they consider the conduct of someone they conduct business with is unacceptable, and are responsible for their own decisions. These factors are relevant also to the *FSA*'s interpretation of the provisions of this chapter.

SUITABILITY AND ADVICE

3.4.3 **G** The *Principles* do not require a *firm* to assess the suitability of a particular transaction for its *client* once it has established that it is dealing with a *market counterparty*. For example, the *firm* is not obliged to ensure that the *market counterparty* understands the risks involved; nor is it under any duty to provide best *execution* or other *dealing* protections (but see *MAR 3.4.5G* to *MAR 3.4.9G*).
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3.4.4 **G** Similarly, a *firm* is not obliged to give advice to a *market counterparty*. The mere passing of information does not mean the *firm* has assumed responsibility for giving advice. Although *Principle 7* (Communications with clients) requires a *firm* to pay due regard to the information needs of its "*clients*", the only requirement of *Principle 7* relating to *market counterparties* is that a *firm* must communicate information to *market counterparties* in a way that is not misleading. (See *PRIN 3.4.1R*.)
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COMMUNICATION OF INFORMATION

3.4.5 **G** *Principle 7* (Communications with clients) requires that a *firm's* communications with a *market counterparty* should not be misleading. Otherwise, for the reasons explained in *MAR 3.4.4G*, *Principle 7* does not apply to a *firm's* communications with *market counterparties*.
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3.4.6 **G** If a *firm* volunteers information to a *market counterparty*, but no formal advisory arrangement is agreed, the *firm* need not advise a *market counterparty* about the reliability, relevance or importance of that information. Silence on the part of a *firm* does not result in a breach of *Principle 7*, unless, in the circumstances, it results in a *communication* made by a *firm* being misleading.
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- 3.4.7** G_{/1} (1) It is for a *firm* to decide whether it wishes to provide information to a *market counterparty*. If it does so the *firm* is not obliged to keep the *market counterparty* informed of any changes to the information, unless the *firm* has agreed to do so.
- (2) Because the duties owed by a *firm* to a *market counterparty* are limited, it will frequently be the case that there will be no clash between the duties owed by the *firm* to the *market counterparty* and the *firm's* interests. There will in those cases be no requirement on the *firm* to disclose its interests.
- (3) When a *firm* does owe a duty to a *market counterparty* that arises under the general law of contract (see as an example MAR 3.4.8G) it should manage any conflict of interest. This can be achieved by the operation of internal *Chinese Walls* (in accordance with (Chinese Walls) COB 2.4). Otherwise, before it transacts, the *firm* should disclose the nature and extent of any material conflict to the *market counterparty*.
- (4) This paragraph, MAR 3.4.7G, is *guidance* on *Principle 1* (Integrity) and *Principle 5* (Market conduct).

- 3.4.8** G_{/1} The following are examples of where there may be responsibilities that potentially give rise to a duty to disclose material conflicts of interest to the *market counterparty*:
- (1) the *firm* is acting as agent for the *market counterparty*;
- (2) the *firm* has agreed to advise the *market counterparty*;
- (3) the *firm* otherwise owes fiduciary duties to the *market counterparty*.

- 3.4.9** G_{/1} Thus, a *firm* acting as an *arranger* for a *market counterparty*, when the *firm* is an *affiliated company* of the other *principal*, should disclose that relationship to the *market counterparty*.

CLARITY OF ROLE

- 3.4.10** G_{/1} A *firm* should take reasonable steps to ensure that it is clear to the *market counterparty* whether it is acting on its own account, as agent, or as *arranger* before it enters into a transaction. If a *firm* is acting as a *wholesale market broker*, it should indicate what type of *broker* it is, for example *name-passing broker* or *matched principal broker*. This paragraph, MAR 3.4.10G, is *guidance* on *Principle 7* (Communications with clients).

- 3.4.11** G_{/1} If a *firm* has agreed with a *market counterparty* to act in one capacity in a transaction, it should not then act in any other capacity in that *transaction* without the consent of that *market counterparty*. For example, if a *firm* bids to transact on an agency basis, it should not, without consent, execute any part of the trade against its own book.

- 3.4.12** G_{/1} It is not consistent with acting solely as an *arranger* (or *name-passing broker*) to take positions, even fleetingly, or act on a *matched principal basis* in the course of that transaction.

MARKETING INCENTIVES, INDUCEMENTS AND PAYMENTS IN KIND

- 3.4.13** G_{/1} MAR 3.4.14G and MAR 3.4.16G provide *guidance* on the interpretation of the *Principles* and in particular *Principle 1* (Integrity), *Principle 3* (Management and control) and *Principle 5* (Market conduct) as they apply to marketing incentives, inducements and payments in kind.
- 3.4.14** G_{/1} A *firm* should take reasonable steps to ensure that it, or any person acting on its behalf, does not offer, give, solicit or accept an inducement if it is likely to conflict to a material extent with any duty which a recipient *firm* owes to another person. Inducement can include entertainment and soft commissions.
- 3.4.15** G_{/1} If a *firm* gives an inducement and the recipient, although a *market counterparty*, is acting on behalf of *customers*, the *firm* may be subject to the provisions of COB 2.2 (Inducements and soft commission).
- 3.4.16** G_{/1} A *firm* should make and implement appropriate systems, controls and policies consistent with MAR 3.4.14G.

3.5 Transactions at Non-Market Prices

INTRODUCTION

- 3.5.1** **G**_{/1} A *firm* should not enter into a transaction which it knows to be improper, or which it ought reasonably to have realised is improper, whether on its own account or for a third party. *Firms* often do not have the information to be able to assess the reasons why a *market counterparty* is entering into a transaction, but from past experience, a good indication that the purpose may be improper is if the transaction is undertaken at a price other than at the prevailing market price. Failure to use prevailing rates or prices may result in a firm participating, whether deliberately or unknowingly, in the concealment of a profit or loss, or in the perpetration of a fraud. There may, however, be legitimate reasons for entering into transactions at non-market prices, and MAR 3.5.4R requires that a *firm* take reasonable steps to check this.
- 3.5.2** **G**_{/1} *Firms* acting as *arrangers* (or *name-passing brokers*) have a more limited role in the transaction and MAR 3.5.4R and MAR 3.5.7E do not apply to them. Under *Principle 1* (Integrity) and *Principle 5* (Market conduct), a *firm* acting as *arranger* (or *name-passing broker*) should not conclude the arrangement if there is information from which it ought reasonably to conclude that the transaction is improper, whether or not it is at a non-market price. Notwithstanding their limited role, *firms* acting as *arrangers* (or *name-passing brokers*) as well as other *firms* should also comply with obligations upon them arising from ML.
- 3.5.3** **G**_{/1} The *requirements* upon *firms* when conducting *designated investment business* with or for a *customer* are set out in COB 7.15 (Non-market-price transactions).

NON-MARKET-PRICE TRANSACTIONS

- 3.5.4** **R**_{/1} Except where MAR 3.5.6R applies, a *firm* must not enter into, as agent or principal, a *non-market-price transaction* under which it *deals* in an *inter-professional investment* unless it has taken reasonable steps to ascertain that the transaction is not being entered into by the *market counterparty* for an improper purpose (see also MAR 3.5.7E).
- 3.5.5** **R**_{/1} A *firm* must make and retain, for a period of three years, a record of the steps it has taken under MAR 3.5.4R, in relation to each *transaction*.

3.5.6 **R** /1 MAR 3.5.4R does not apply to a *non-market-price transaction* if it is subject to the rules of an *RIE*.

- 3.5.7 **E** /1
- (1) To take reasonable steps as required by MAR 3.5.4R a *firm* should:
- (a) have in place procedures to enable it to identify *non-market-price transactions* (for *guidance* on this, see MAR 3.5.8G to MAR 3.5.12G);
 - (b) have in place, and *approved* by an individual holding a senior position with the *firm*, a policy and procedure for the review (to take place before the *firm* commits itself to that transaction) of the *non-market-price transaction*:
 - (i) by an individual holding a senior position with the *firm*; or
 - (ii) in accordance with (2);and should follow that *policy* and procedure (for *guidance* on this, see MAR 3.5.17G to MAR 3.5.21G);
 - (c) ensure the review considers the reasons for the *transaction* (for *guidance* on this, see MAR 3.5.13G to MAR 3.5.16G); and
 - (d) check whether it has been put on notice that the *transaction* is for an improper purpose.
- (2) A *firm* may have the review in (1)(b) carried out by an individual working for the *firm* who does not hold a senior position in the *firm* if:
- (a) the policy and procedures established under (1) cover such reviews;
 - (b) that policy sets out the categories of transaction that may be reviewed in this way;
 - (c) the transaction falls into one of those categories;
 - (d) the *firm* can demonstrate that these categories of transactions are routinely entered into by *firms* and are so defined that there is a high probability that transactions coming within them will be for proper purposes;
 - (e) the factors defining those categories do not in substance involve any judgment of whether any purpose is improper;
 - (f) the policy provides for matters to be referred to a senior level in appropriate circumstances;

- (g) those approving the policy are satisfied that all those who are eligible under the policy to participate in the review have the appropriate level of skills;
 - (h) the policy has due regard to segregation of responsibilities; and
 - (i) the *firm* keeps under review whether the categories of transaction established under (2) do have the result described in (2)(d).
- (3) Compliance with (1) and, to the degree relevant, (2) may be relied on as tending to show compliance with *MAR* 3.5.4R.
 - (4) Contravention of (1) or, to the degree relevant, (2) may be relied on as tending to show contravention of *MAR* 3.5.4R.

WHETHER A TRANSACTION IS TO BE CONSIDERED A NON-MARKET-PRICE TRANSACTION

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A *non-market-price* transaction is a transaction where:

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- (1) the dealing rate or price paid by the *firm* or its *client* differs from the prevailing market rate or price to a material extent; or
- (2) the *firm* or its *client* otherwise gives materially more or less in value than it receives in return.

3.5.9

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Certain types of transactions or structured transactions are undertaken at non-market rates or prices, but are not necessarily considered to be *non-market-price transactions*. Examples are:

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- (1) a transaction with more than one component, where the individual components are entered into at non-market rates or prices, so long as the sum of the whole transaction produces an overall market rate or price, for example:
 - (a) asset swaps, where the underlying asset is sometimes sold at a non-market price; the fixed cash flows from the asset are then passed back to the seller, also at a non-market rate; where neither the asset trade nor the swap is at a market rate, the overall transaction can be considered to be at the market price where the combination of the two components delivers this result; and
 - (b) other types of swaps, where one or both legs is not on the forward curve (showing implied forward rates or prices), for example when up-front or final payments are involved;
- (2) the purchase and sale of out of the money *options*. The fact that the strike price is away from the market price is not in itself sufficient to give rise to a *non-market-price transaction*; other factors, such as the level of premium, must also be considered;
- (3) in tax-based transactions, a tax gain or liability should be taken into account in order to determine whether it is a *non-market-price transaction*.

3.5.10 G_{/1} Certain circumstances may result in a transaction being undertaken at a price other than the market price, for example:

- (1) the transaction is not for a marketable amount; or
- (2) an order has been carried out over a period of time; or
- (3) a transaction is executed outside normal market hours; or
- (4) a transaction is executed in illiquid markets; or
- (5) a transaction has a non-standard settlement period;

and these circumstances may be relevant in assessing whether the transaction constitutes a *non-market-price transaction*.

3.5.11 G_{/1} The question of whether a transaction is a *non-market-price transaction* is to be judged as at the time it is effected and not with hindsight.

3.5.12 G_{/1} The variation or rolling over of an existing transaction should be regarded as a new transaction for the purposes of MAR 3.5.4.

WHETHER A TRANSACTION IS TO BE CONSIDERED TO BE FOR IMPROPER PURPOSES

3.5.13 G_{/1} Examples of improper purposes for transactions (see MAR 3.5.4R) include:

- (1) the perpetration of a fraud;
- (2) the disguising or concealment of the nature of a transaction or of profits, losses or cashflows;
- (3) transactions which amount to *market abuse*;
- (4) vulnerable transactions under the Insolvency Act 1986; and
- (5) "window dressing", in particular around the year end, to disguise the true financial position of the *person* concerned.

3.5.14 G_{/1} A transaction may be for one or more of the purposes stated in MAR 3.5.13G yet still not be a *non-market-price transaction*. MAR 3.5 should not be taken as qualifying in any way obligations on *firms*, however these arise, regarding these transactions.

3.5.15 G_{/1} When a *non-market price transaction* has more than one component, the assessment of whether or not the transaction is improper should be made by reference to the transaction as a whole. Although the judgment is formed with reference to the whole transaction, a *firm* may conclude that the rationale for one component would cause it to be in breach of MAR 3.5.4R.

3.5.16 G_{/1} A transfer between a *firm* and its nominee or an intra-group transfer for risk management purposes may not be at a market price, but will often be for proper purposes. Where that is so, the *firm* may take part in it. However a *firm* should establish, and act in accordance with, a policy dealing with these transfers, and other intra-group *non-market-price transactions*, and be able to demonstrate that it has considered the consequences of participating in them.

PROCEDURES TO BE TAKEN BY A FIRM

- 3.5.17** G_{/1} The procedures a *firm* has in place to identify *non-market-price transactions* should be appropriate for the types of transaction in question, bearing in mind MAR 3.5.8G to MAR 3.5.12G.
- 3.5.18** G_{/1} When a *firm* proposes to enter into a *non-market-price transaction*, the personnel considering the transaction should:
- (1) consider the justification and rationale of the other parties to the proposed transaction and whether the decision to enter into it was taken by the parties concerned at a senior level, and not by an individual trader or treasurer; and
 - (2) (if the transaction is approved) be satisfied that all the material terms of the *non-market-price transaction* (so far as they affect the *firm*) have been agreed before the transaction is entered into and that they are promptly recorded in accordance with MAR 3.5.7E; material terms are likely to include the amounts each counterparty is to pay and receive and whether any amounts are to be netted against or offset against any amounts due and owing under a separate transaction.
- 3.5.19** G_{/1} The degree of seniority referred to in MAR 3.5.7E(1)(b) may depend on the nature of the transaction.
- 3.5.20** G_{/1} A *firm* operating an electronic matching system should consider implementing appropriate systems to identify potential *non-market-price transactions*. In these circumstances, it may be appropriate for such identification, and appropriate resulting action, to occur after the transaction has taken place.
- 3.5.21** G_{/1} A *firm* may take reasonable steps to ascertain its *market counterparty's* rationale for entering into the transaction, as set out in MAR 3.5.18G, but still be unable to find this out. It is up to the *firm*, having regard to the circumstances, to decide whether it is appropriate to enter into the transaction. One relevant circumstance is whether or not the *market counterparty* is another *firm*, in which case the *firm* is entitled to assume that the other *firm* is acting properly, in the absence of any further information to the contrary.

3.6 Taping

- 3.6.1** G_{/1} (1) This section MAR 3.6 provides *guidance* on the interpretation of the *Principles*, and in particular *Principle 3* (Management and control), as they apply to the capture of certain transactional information and other matters. MAR 3.6 applies only to *inter-professional business* and there are other requirements in the *Handbook* which relate to record-keeping requirements.
- (2) MAR 3.6 also provides additional *guidance* on the record-keeping requirements of SYSC 3.2.20R (Records).
- 3.6.2** G_{/1} MAR 3.6 does not apply:
- (1) to a *firm* acting in the course of carrying on the *regulated activity* of *establishing, operating or winding up a collective investment scheme*; or
- (2) to an *insurer*; or
- (3) in respect of a transaction if the *firm* is subject to record-keeping requirements in *COB* for that transaction.
- 3.6.3** G_{/1} A *firm* should implement appropriate systems and controls with a view to ensuring that the material terms of all transactions to which it is a party, and other material information about such transactions, are promptly and accurately recorded in its books or records. The manner in which this information may be recorded include:
- (1) voice recordings of transactions;
- (2) voice recordings of oral confirmations;
- (3) written trading logs or blotters; and
- (4) automated electronic records.
- 3.6.4** G_{/1} A *firm* acting as an *arranger* (or *name-passing broker*) need record only those terms that are necessary for the *transaction* to be identified in its records or that are otherwise relevant to its role as *arranger* (or *name passing broker*). For example, it would not normally know the payment and settlement instructions.
- 3.6.5** G_{/1} A *firm* should be able to access all records as promptly as necessary. Records should be kept in comprehensible form or should be capable of being promptly so reproduced. The *firm* should make and implement appropriate procedures to avoid unauthorised alteration of its records.
- 3.6.6** G_{/1} If the records identified in MAR 3.6.3G are substituted by written or electronic confirmations produced in accordance with SYSC 3.2.20R (Records), then that confirmation may be an adequate record of the transaction.

- 3.6.7** G_{/1} If a transaction is agreed or arranged through an electronic trading, matching and order-routing system, then the records provided by that system may be an adequate record of the transaction.
- 3.6.8** G_{/1} A *firm* should keep under review whether, and to what extent, to make and retain voice recordings of its front and back office telephone lines used for negotiating, agreeing, arranging and confirming transactions and for the passing of payment instructions. (See also *MAR* 3.6.10G.)
- 3.6.9** G_{/1} If a *firm* undertakes oral confirmations of the transactions it executes or *brings about*, voice recordings of these conversations can constitute an adequate record of that confirmation.
- 3.6.10** G_{/1} In undertaking a review under *MAR* 3.6.8G, it is likely to be a relevant factor that voice recordings:
- (1) provide an immediate record of all transactions and therefore may assist firms in resolving any disputes;
 - (2) may assist a *firm* to identify whether any personnel of the *firm* or of its *market counterparty* are involved in inappropriate behaviour; *market counterparties* may take comfort in knowing that their transactions are immediately recorded and that this provides evidence that can be relied upon; and
 - (3) can provide evidence of the rationale for a particular trading strategy or other aspects of *inter-professional business* and thereby provide protection to the *firm*.
- 3.6.11** G_{/1} A *firm* should make and implement policies on the length of time it keeps tapes. The *FSA* does not expect tapes to be kept for the full period required by the general record-keeping requirement, except where a *firm* relies upon voice recordings to comply with record-keeping requirements, in which case it should retain those recordings in accordance with the relevant requirements. One factor in setting that policy may be the use of tapes to assist the *firm* in resolving any disputes with *market counterparties*.



3.7 Firms acting as Wholesale market brokers and those undertaking transactions through them; provisions concerning brokers and arrangers generally

3.7.1 **G** /1 MAR 3.7 provides *guidance* on the interpretation of the *Principles*, and in particular *Principle 5 (Market conduct)*, as they apply to certain responsibilities of *firms* acting as *wholesale market brokers* and of *persons* undertaking transactions through them. In particular, it covers the passing of names and differences.

3.7.2 **G** /1 The use of various terms for brokers and arrangers are based on the understanding that *name-passing brokers* are, in simple terms, what *arrangers* are called in certain wholesale markets. As such, the terms are virtually interchangeable and in MAR both terms have generally been used for the avoidance of doubt. Similarly, *name-passing brokers* and “matched principal brokers” are both subsets of *wholesale market brokers*. The use of the latter term is intended to reduce confusion.

PASSING OF NAMES

3.7.3 **G** /1 A *firm* acting as a *name-passing broker* should not prematurely divulge the names of the prospective counterparties to each other, for example before both sides display a serious intention to transact. However, as soon as the material terms of a transaction have been agreed, a *firm* acting as a *name-passing broker* should aim to achieve a mutual and immediate exchange of names. When a *market counterparty* name is unacceptable to another, it is quite proper for a *firm* acting as a *name-passing broker* not to divulge by whom the name was refused.

SETTLEMENT OF DIFFERENCES

3.7.4 **R** /1 MAR 3.7.5R to MAR 3.7.8G apply:

- (1) to a *firm* when it acts as a *name-passing broker*; and
- (2) to a *firm* whether acting as *principal* or agent, when its transaction is *brought about* by a *firm* acting as a *name-passing broker*.

3.7.5 **R** /1 (1) If a *firm* acting as a *name-passing broker* compensates a *market counterparty* for a difference, that difference must be settled in *money* (which for these purposes includes payment by discounting, reducing or rebating commission).

(2) A “difference” means (in MAR 3.7.5R to MAR 3.7.8G) any difference between a rate or price quoted by a *firm* acting as a *name-passing broker* and the rate or price at which the transaction is ultimately concluded.

3.7.6 **G**_{/1} When arranging a transaction, a *name-passing broker* is trying to achieve a mutual and immediate exchange of names, based on firm quotation of prices. Inevitably, for non-electronic *arrangers*, there will be occasions when the transaction is not completed at the original price (for instance because a firm price has been hit by another counterparty). The *name-passing broker* is said to have missed the original price when a *market counterparty* accepts a firm quote at that price, but the *name-passing broker* is unable to arrange for the deal to be completed at that price.

3.7.7 **G**_{/1} A *firm* acting as a *name-passing broker* should not ordinarily accept liability for differences and should provide its services on the basis that it does not do so. (This is because accepting liability for differences amounts to taking a position legally and economically, and the *name-passing broker* would not be following MAR 3.4.12G.) A *firm* doing business with a *name-passing broker* should not, in the ordinary course, ask the latter for compensation for differences. However, once a difference has arisen, a *firm* acting as a *name-passing broker* may offer to compensate its *market counterparty* for some or all of the difference to preserve the relationship with the *market counterparty* concerned or for other legitimate commercial reasons. That compensation should be in accordance with MAR 3.7.5R.

3.7.8 **G**_{/1} When a price has been missed, a *firm* acting as principal or agent should generally complete the transaction at the next available price through the *name-passing broker* that has missed the original price. To do otherwise can be prejudicial to the smooth operation of the markets. If the *firm* does not proceed with the transaction, it should first consider whether withdrawing would be likely to affect the market concerned, and should immediately communicate its decision to the *name-passing broker*. The *firm* should not decline to enter into the transaction at the new price if it would breach a reasonable expectation on the part of the *name-passing broker* that it would not do this.

GENERAL PROVISIONS ON WHOLESALE MARKET BROKERS AND ARRANGERS

3.7.9 **G**_{/1} Any payment for broking or arranging services rendered by a *firm*, other than on a matched principal basis, should be in *money* (which for these purposes includes payment by discounting, reducing or rebating commission) unless otherwise agreed in writing between the parties.

3.7.10 **G**_{/1} A *firm* acting as a *wholesale market broker* or *arranger* should not unfairly favour one *market counterparty* client over another. Treatment that would otherwise have been unfair is not unfair if the *market counterparty* concerned has expressly consented to it. The “client” of a *wholesale market broker* or *arranger* means (in MAR 3.7.10G and MAR 3.7.11G) a *person* for whom it is providing its services as *wholesale market broker* or *arranger*.

3.7.11 **G**_{/1} A *firm* should not place an order with a *firm* acting as a *wholesale market broker* or *arranger* if the main purpose is to ascertain either the identity of any client of that *firm*, or information about transactions into which that *client* may be interested in entering. For example, a *firm* that wishes to purchase 1000 bonds should not have a *firm* arrange for the purchase of 100, in order to discover the identity of a *person* willing to sell those bonds, and then transact with that other *person* direct for the other 900.



3.8 Codes of Practice

3.8.1

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/1

The FSA does not endorse individual codes of practice applying to *inter-professional business* (except for the *Takeover Code*) that are in place in some markets. It will, however, take into account the differing standards and practices operating in markets when interpreting the *Principles* as they apply to *inter-professional business*. Further, non-compliance with those codes, or of the Non-Investment Products Code in respect of certain non-authorisable activities, may raise issues such as the integrity or competence of a *firm* which are relevant to the *threshold conditions* (see COND 2.5.6G(4)).

MAR 3 Ann 1G

1 Table Guidance on scope of the code (see MAR 3.3.1G)

1	<p>This chapter, <i>MAR 3</i>, applies to <i>firms</i> in their dealings with <i>market counterparties</i>, as set out in <i>MAR 3.1.2R</i>. When <i>market counterparties</i> have opted to be treated as <i>intermediate customers</i> under <i>COB 4.1.7R</i> (Classification of another firm or an overseas financial services institution), this chapter does not apply. The requirements on <i>firms</i> in such circumstances are those set out in <i>COB</i>. <i>MAR 3</i> does, however, apply to <i>firms</i> in their dealings with <i>intermediate customers</i> who have opted to be treated as <i>market counterparties</i> under <i>COB 4.1.12R</i> (Large intermediate customer described as a market counterparty).</p>
2	<p>This chapter sets out the <i>requirements</i> upon <i>firms</i> in their dealings with <i>market counterparties</i>. The way a <i>firm</i> is assessed under <i>COB 4.1</i> (Client classification) has no bearing on its obligations to assess its own <i>clients</i>.</p>
3	<p>The list of activities in <i>MAR 3.1.2R</i> (Application: What?) is not based on types of <i>permission</i>. It is based on the activities of <i>dealing</i>, <i>arranging</i> and <i>advice on investments</i>. This means, for example, that a <i>firm</i> may be subject to <i>MAR 3</i> if it purchases securities in the course of:</p> <ol style="list-style-type: none"> (1) operating a <i>collective investment scheme</i>; or (2) acting as a life insurance company; or (3) acting as agent for a <i>customer</i>; <p>in making that purchase. This is notwithstanding that the operation of a <i>collective investment scheme</i>, acting as a life insurance company and acting as agent for a customer for a <i>private customer</i> are not activities that are covered by this chapter in their own right.</p>
4	<p><i>MAR 3</i> does not affect the application provisions of the <i>Principles</i> (see <i>PRIN 3</i> (Rules about application)). The purpose of the application provisions of <i>MAR 3</i>, as they apply to the <i>guidance</i> on the <i>Principles</i>, is to explain in what situations <i>MAR 3</i> may be used as <i>guidance</i> for interpreting the <i>Principles</i>. If <i>MAR 3</i> is silent about how the <i>Principles</i> apply to a particular situation, the <i>Principles</i> still apply.</p>
5	<p><i>MAR 3</i> is intended to cover the whole range of <i>inter-professional business</i>. It is not, in general, specifically tailored for particular types of business, nor is it a comprehensive statement of how the <i>Principles</i> apply to <i>inter-professional business</i> in all situations. The <i>guidance</i> on the <i>Principles</i> in <i>MAR 3</i> should be read in the light of other <i>requirements</i> that may be applicable in a particular case. For example, this <i>guidance</i> applies to <i>on-exchange</i> business, and does not take into account specific <i>rules</i> of exchanges.</p>
6	<p>The application provisions in <i>MAR 3.1.2R</i> (Application: What?) mean that <i>corporate finance business</i> will normally be outside the scope of this chapter. However, <i>firms</i> should note that some activities, such as <i>dealing</i>, carried out in connection with <i>corporate finance business</i>, may be subject to this chapter.</p>
7	<p>This chapter does not apply to the <i>approval</i> by <i>firms</i> of a <i>financial promotion</i> (see <i>MAR 3.1.3R</i>); <i>rules</i> and <i>guidance</i> relating to <i>financial promotions</i> are in <i>COB 3</i>. Most <i>financial promotions</i> by <i>unauthorised persons</i> to <i>market counterparty</i> are exempt under the <i>Financial Promotion Order</i>, (for example, article 19 (investment professionals)) so <i>approval</i> should not be required. In addition, the application of <i>COB 3</i> to approval of a <i>financial promotion</i> for communication to a <i>market counterparty</i> is limited (see <i>COB 3.2.4R</i> (2) and <i>COB 3.2.5R</i>(1) (Exemptions)).</p>

- 8 The same transaction may give rise to obligations under this chapter and another sourcebook, such as *COB*. For example, if a *firm* purchases an *inter-professional investment* from a *market counterparty* on behalf of a *customer*, this chapter applies to the relationship between the *firm* and the *market counterparty*. *COB* governs the relationship between the *firm* and the *customer*.
- 9 In some cases, a deal carried out abroad by the firm's overseas branch or by another member of the firm's group may be subject to this chapter if the final booking is to the firm's balance sheet in the United Kingdom. In all cases, the question is whether the activity involves a firm carrying on inter-professional business from an establishment maintained by the firm in the United Kingdom. For the purposes of this discussion, booking does not include doing a deal with a counterparty and transferring it to the United Kingdom balance sheet by an intra-group back-to-back transaction. It is about putting the transaction with the market counterparty directly onto the UK balance sheet.
- (1) In some cases, the transaction involves the *firm* and an overseas affiliate. The overseas affiliate negotiates and arranges the *deal* with the *market counterparty* abroad. However, the actual contract is between the *firm* in the *United Kingdom* and the *market counterparty*. It is likely that this chapter will apply to the *firm*. This is because the firm's entry into the contract amounts to dealing and that dealing is done from an establishment maintained by the *firm* in the *United Kingdom*.
- (2) If the booking is merely an internal accounting exercise, and the transaction has no other *United Kingdom* connection, it is likely that this chapter will not apply. For example, the transaction may be negotiated and *executed* by an overseas branch of the *firm* but booked to the *firm's United Kingdom* balance sheet. If the booking to the *United Kingdom* balance sheet is the only involvement of the *firm* in the *United Kingdom*, it is likely that this chapter will not apply to the *firm*. This is because, even though the *firm* is party to the contract and is carrying out a *dealing* transaction, all the *dealing* activity takes place at the foreign branch. A mere bookkeeping entry in the *United Kingdom*, not involving the counterparty in any way, does not mean that the dealing activity is carried on from an establishment maintained by the firm in the *United Kingdom*. It is carried on from the overseas branch.
- 10 The territorial application of this chapter does not modify those of any other part of the *Handbook*. In particular, *firms* should note the application of *Principle 5* (Market conduct), which applies to activities which have, or might reasonably be regarded as likely to have, a negative effect on confidence in the *financial system*, wherever they are carried on (see *PRIN* 3.3.1R).
- 11 Nothing in this chapter:
- (1) modifies any duty owed by a *firm* to a *private customer* or *intermediate customer* under the provisions of any other part of the *Handbook*; or
- (2) relieves a *firm* of any other obligation to which it may be subject under the general law; or
- (3) should be read as qualifying or modifying the *Code of Market Conduct*, the *Code of Practice for Approved Persons* or the *Statement of Principle*.

MAR 3 Ann 2G

This table lists the Principles that apply to firms carrying on inter-professional business, and also sets out some of the key provisions of COB that apply.

1 Table Other relevant Handbook provisions (see MAR 3.3.2G)

Rule	Description
Principle 1	A <i>firm</i> must conduct its business with integrity.
Principle 2	A <i>firm</i> must conduct its business with due skill, care and diligence.
Principle 3	A <i>firm</i> must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
Principle 4	A <i>firm</i> must maintain adequate financial resources.
Principle 5	A <i>firm</i> must observe proper standards of market conduct.
Principle 7	A <i>firm</i> must <i>communicate</i> information [to its <i>clients</i>] in a way which is not misleading.
Principle 10	A <i>firm</i> must arrange adequate protection for <i>clients'</i> assets when it is responsible for them.
Principle 11	A <i>firm</i> must deal with its regulators in an open and cooperative way, and must disclose to the <i>FSA</i> appropriately anything relating to the <i>firm</i> of which the <i>FSA</i> would reasonably expect notice.
COB 3	Financial promotion (relating to the approval of a financial promotion, see paragraph 7 in <i>MAR 3 Ann 1G</i>)
COB 2.4	Chinese Walls
COB 4.1	Client classification
COB 7.13	Personal Account Dealing
COB 9	Client assets

MAR 3 Ann 3G

1 Table General information on good market practice (see MAR 3.3.3G)

	INTRODUCTION
1	This annex, <i>MAR 3 Ann 3G</i> , is a statement of what the <i>FSA</i> understands to be generally regarded as good market practice and conventions in certain areas. It is not <i>guidance on rules</i> and is issued under section 157(1)(d) of the <i>Act</i> . This annex applies to all kinds of <i>inter-professional business</i> . It will be evident that much of the content is equally applicable to <i>market counterparties</i> as well as <i>firms</i> .
	CONFIDENTIALITY
2	When information is received from a <i>market counterparty</i> under conditions of confidentiality, that confidentiality is likely to be enforceable by the owner of that information. Confidentiality should be respected, subject to regulatory and legal requirements.
3	<i>Firms</i> are reminded that the use of loudspeakers in broking and dealing rooms in close proximity to other lines of communication could result in breaches of confidentiality.
	NEGOTIATION OF TRANSACTIONS
4	It is good practice for a <i>firm</i> to agree expressly all the economic terms of a transaction before it commits itself to the transaction. A <i>firm</i> should negotiate the remaining terms in good faith and try to agree them as soon as possible.
5	It is good practice for a <i>firm</i> to regard itself as bound to transact once the rate or <i>price</i> and any other key commercial terms have been agreed (whether orally or in written form), unless the parties explicitly and unambiguously agree to the contrary.
6	Generally, a <i>firm</i> that regularly uses the services of a <i>firm</i> acting as a <i>name-passing broker</i> should indicate to it the <i>market counterparties</i> with which, and the <i>investments</i> in which, it is not prepared to transact. That indication should not be in a form which would damage or lower the standing or reputation of the <i>market counterparty</i> in the estimation of reasonable <i>market counterparties</i> if they knew of it. A <i>firm</i> which is given an indication should treat it as confidential.
	FIRMNESS OF QUOTATION
7	It is good practice for a <i>firm</i> to follow market conventions regarding quotation, unless it has specifically agreed otherwise with its <i>market counterparty</i> in advance. It should be clear to a <i>market counterparty</i> ;
	(1) whether the quote is firm or not;
	(2) whether the quote is subject to any conditions, and, if it is, what they are;
	(3) for how long the quote remains firm (in fast moving markets, when practicable); and
	(4) whether the quote is firm only for the normal marketable amount (if appropriate, otherwise the <i>firm</i> should state the size of the quote).
8	Express clarification of these matters is not necessary to the extent that the <i>firm</i> quotes in accordance with the relevant market convention or exchange rules (if applicable).

- 9 When a *firm* quotes to a *market counterparty* a firm rate or price (whether through an arranger, or *name-passing broker*, or directly), it is not good practice for the *firm* then to withdraw that quote or, if that quote is accepted during the period for which the quote remains firm, to decline to deal at that rate or price. A *firm* may decline to deal with a *market counterparty* in these circumstances if it was unaware of its identity when the *firm* gave the quote and the name turns out to be unacceptable, for example, on the grounds of credit risk.
- LIMIT ORDERS
- 10 Before a *firm* accepts any limit order from a *market counterparty*, it is good practice to have made and implemented appropriate:
- (1) policies on these orders and in particular the circumstances in which and the terms on which it will accept these orders; and
 - (2) systems and controls for carrying them out.
- 11 A limit order means a stop loss order and any other instruction from a *market counterparty* to execute transactions if rates or prices reach specified levels. These orders may be time limited or may be for an indefinite period.
- OUT OF HOURS/OFFICE DEALING
- 12 It is good practice for *firms* to issue guidelines to their staff on transactions entered into after normal hours or from outside premises, either by mobile phone or any other equipment. The guidelines should cover:
- (1) the type of transactions which may be undertaken in this way;
 - (2) where and with whom these transactions may be executed;
 - (3) permitted limits;
 - (4) how and when these transactions should be booked into and recorded on the front and back office systems; and
 - (5) how and when these transactions are to be confirmed.
- 13 When answering machines are used for instant reporting and recording of all off-premises transactions, they should be installed and located in such a way that reported transactions cannot subsequently be erased without senior management approval.
- 14 The use of mobile phones for business purposes from within the dealing room, except in an emergency, is considered bad practice.
- SETTLEMENT ERRORS
- 15 If a *firm* becomes aware of a settlement error that benefits it at the cost of a *market counterparty*, it is good practice to inform the *market counterparty* promptly and reverse the error.
- 16 If a *firm*, acting as a *broker*, becomes aware that it is holding assets on behalf of a *market counterparty* because of a settlement error which adversely affects that *market counterparty*, it is good practice to inform the *market counterparty* promptly and try to rectify the situation.
- CONFIRMATIONS
- 17 Confirmations provide a useful safeguard against dealing errors and can be a valuable element in the control of the *firm's inter-professional business* and exposures. It is good practice for a *firm* to make available to, or provide to, the *market counterparty* written confirmation of the material terms of a transaction between them, as soon as possible after the transaction has been agreed or executed.
- 18 It is acceptable market practice for the *firm* to agree with its *market counterparty* that only one party need send a confirmation. If a *firm* undertakes this practice to a material extent, it is advisable to identify the legal and other risks involved and address them in the *firm's* risk control policies.

- 19 If there is a standard form of confirmation that applies to a transaction a *firm* enters into, it is good practice to ensure that that form is used, unless there is good reason not to. One example of when there is an applicable standard form confirmation is when the parties enter into the transaction under the terms of a master agreement that provides for an applicable form of confirmation. Another is when it is customary in the market concerned to use a particular form of confirmation for transactions of that kind.
- 20 In general, it is not good practice for confirmations to be issued by or sent to the individual dealer responsible for the transaction. It is good practice to ensure that the dealer concerned is not responsible for checking confirmations unless there are exceptional circumstances. If the dealer is given that responsibility, it is good practice to subject the process to independent monitoring.
- 21 In general, it is good practice for a *firm* which *arranges* a transaction to try to ensure that the parties agree who is to issue a confirmation.
- 22 Some transactions are matched through an electronic matching system that does not provide for the issue of confirmations, but instead makes and retains records of transactions itself. In these cases, it may be appropriate for a *firm* neither to receive nor issue confirmations, provided the system allows for the back offices of users to verify the details of transactions entered into on the system.
- 23 The statements of good practice in paragraphs 17 to 22 do not apply to on-exchange business.

STANDARD SETTLEMENT INSTRUCTIONS

- 24 It is good practice for a *firm* to make and implement appropriate policies on the use of standard settlement instructions (SSIs) to reduce the incidence and size of differences arising from a mistaken settlement of funds. These are especially appropriate when the *firm* has a relationship with a *market counterparty* which suggests there will be regular payment of significant amounts.
- 25 It is good practice to establish SSIs in a secure and verifiable format. A *firm* acting as an *arranger* (or *name-passing broker*) has no responsibility for ensuring that its *market counterparties* have SSIs in place.

MASTER AGREEMENTS

- 26 *Firms* are encouraged to negotiate and execute master agreements. These govern the relationship between the parties and how such a relationship and all transactions under it shall be terminated in the event of one party's default upon a transaction. It is recognised that executed documentation can be and should be used as an efficient risk management tool. *Firms* should consider the benefits of valid close out netting provisions (see *IPRU*).
- 27 If it is the policy of a *firm* to use master agreements, it is good practice to make and implement policies for what transactions should be subject to the terms of which master agreement and have systems and controls for ensuring compliance with that policy. If a *firm* has a policy that transactions should be entered into with a *market counterparty* only after a master agreement has been implemented, it is advisable to have procedures to ensure that any exceptions are agreed at an appropriate level.

COMMISSION/BROKERAGE

- 28 It is good practice for *firms* acting as principals to pay due brokerage bills promptly. Overdue payments can seriously disadvantage *wholesale market brokers*, since overdue payments result, in their treatment by the *FSA* for regulatory purposes, as an increase in their cost of capital.

DISPUTES

- 29 In the event of a dispute between a *firm* and a *market counterparty*, it is preferable for the parties to seek to resolve the issues themselves. If they cannot reach agreement, they should consider the advantages of using established arbitration or mediation services.

Handbook Modules

Transitional Provisions

1 Table

G *GEN* contains some technical transitional provisions that apply throughout the *Handbook* and which are designed to ensure a smooth transition at *commencement*. These include transitional provisions relevant to record keeping and *notification rules*.

1) Transitional Provisions for The Code of Market Conduct – (MAR 1)

There are no transitional provisions for *MAR 1* (The Code of Market Conduct).

2) Transitional Provisions for Price stabilising rules (MAR 2)

SUP contains transitional provisions which carry forward into *MAR 2* (Price stabilising rules) written concessions relating to pre-commencement provisions.

2 Table

(1)	(2)	(3)	(4)	(5)	(6)
	Material provision to which transitional provision applies		Transitional provision	Transitional provision: dates in force	Handbook provision: coming into force

1	MAR 2	R	<p>Part 10 of the Financial Services (Conduct of Business) Rules 1990 applies in relation to an <i>offer for cash</i>, instead of MAR 2, if:</p> <p>(1) a <i>public announcement of the offer</i> which stated the <i>offer price</i> has been made before <i>commencement</i>; or</p> <p>(2) the <i>introductory period</i> for the <i>offer</i> started not more than 60 days before <i>commencement</i> and the <i>firm</i> or other <i>person</i> so chooses and makes a written record of that choice before <i>commencement</i>.</p> <p>A record in (2) must be retained for 3 years from the end of the <i>stabilising period</i> for the <i>offer</i>.</p> <p>This transitional provision applies to an offer as defined in the 1990 Rules, and has effect as a <i>price stabilising rule</i>.</p>	<p><i>Commence-</i> <i>ment</i> until the end of the <i>stabilis-</i> <i>ing period</i> for the offer</p>	<p><i>Commence-</i> <i>ment</i></p>
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Handbook Modules

Schedule1 Record Keeping requirements

1 G
Table

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
MAR 2.7R	Price stabilising action	Full details as noted in MAR 2.7.2R	On initiation of stabilising action	3 years
MAR 3.5.4	Non Market Price Transactions	Details of steps taken in consideration of NMPTs	On considering the transaction	3 years

Handbook Modules

Schedule2 Notification requirements

G

There are no notification requirements in MAR.

Handbook Modules

Schedule3 Fees and other required payments

G

There are no requirements for fees or other payments in MAR.

Handbook Modules

Schedule4 Powers Exercised

1 G
 Table

The following powers in the *Act* have been exercised by the *FSA* to make the *rules* in *MAR*:

- Section 118(8) (Market abuse)
- Section 138 (General rule-making power)
- Section 144 (Price stabilising rules)
- Section 145 (Financial promotion rules)
- Section 149 (Evidential provisions)
- Section 150(2) (actions for damages)
- Section 156 (General supplementary powers)

The following powers in the *Act* have been exercised by the *FSA* to give the *guidance* in *MAR* (including the *guidance* comprising of the *Code of market conduct*):

- Section 119 (The Code)
- Section 120 (Provisions included in the Authority's code by reference to the City Code)
- Section 157(1) (Guidance)

Handbook Modules

Schedule5 Rights of action for damages

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1 Table

1. The table below sets out the *rules* in *MAR* contravention of which by an *authorised person* may be actionable under section 150 of the *Act* (Actions for damages) by a *person* who suffers loss as a result of the contravention.
2. If a "yes" appears in the column headed "For private person?", the *rule* may be actionable by a "*private person*" under section 150 unless a "yes" appears in the column headed "Removed". A "yes" in the column headed "Removed" indicates that the *FSA* has removed the right of action under section 150(2) of the *Act*. If so, a reference to the *rule* in which it is removed is also given.
3. In accordance with the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001/2256), a "*private person*" is:
 - i. any individual, except when acting in the course of carrying on a *regulated activity*; and
 - ii. any *person* who is not an individual, except when acting in the course of carrying on business of any kind;
 but does not include a government, a local authority or an international organisation.
4. The column headed "For other person?" indicates whether the rule is actionable by a *person* other than a *private person*, in accordance with those Regulations. If so, an indication of the type of *person* by whom the *rule* is actionable is given.

2 Table

Chapter / Appendix	Section / Annex	Paragraph	For Private Person?	Removed	For other person?
MAR 1					
(no rules)					

<p>All <i>rules</i> in <i>MAR</i> 2 except <i>MAR</i> 2.3.3E and <i>MAR</i> 2.3.4E <i>MAR</i> 2.3.3E, <i>MAR</i> 2.3.4E and <i>MAR</i> 2.3.5E All <i>rules</i> in <i>MAR</i> 3 except <i>MAR</i> 3.5.7E <i>MAR</i> 3.5.7E</p>			<p>Yes No Yes No</p>	<p>Yes <i>MAR</i> 2.1.9R Yes <i>MAR</i> 3.1.5R</p>	<p>No No No No</p>	
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Handbook Modules

Schedule6 Rules that can be waived

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 Table

The rules in *MAR* can be waived by the FSA under section 148 of the Act (Modification or waiver of rules), except for:

MAR 2.1.1R(2) (Application)

MAR 2.1.9R (Actions for damages)

MAR 3.1.5R (Actions for damages)

MARKET CONDUCT SOURCEBOOK

Derivations

G References to 'LCC' are to the June 1999 edition of the London Code of Conduct published by the FSA

Ch/App	S/Ann	P		Subject	Source	Reference
MAR 1	nil return					
MAR 2 (except MAR 2.7)			R G	Price stabilising rules	FSA rules	Part 10 of the Financial Services (Conduct of Business) Rules 1990
MAR 2.7			R	Access to the stabilisation register	FSA rules	Part 16.17, part 16.18 of the Financial Services (Conduct of Business) Rules 1990 and SFA rules 5-54(5)
MAR 3	4	8	G	Communication of information	LCC	57
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MAR 3	4	11	G	Clarity of role	LCC	24
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MAR 3	4	15	G	Inducements	LCC	61
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MAR 3	5	4	R	NMPTs	LCC	50, 51
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MAR 3	Ann 3	3		Confidentiality	LCC	43
MAR 3	Ann 3	4		Negotiation of transactions	LCC	78

Ch/App	S/Ann	P		Subject	Source	Reference
MAR 3	Ann 3	5		Negotiation of transactions	LCC	78
MAR 3	Ann 3	6		Negotiation of transactions	LCC	81
MAR 3	Ann 3	7		Firmness of quote	LCC	74, 76
MAR 3	Ann 3	8		Firmness of quote	LCC	76
MAR 3	Ann 3	9		Firmness of quote	LCC	73, 77
MAR 3	Ann 3	10		Limit orders	LCC	55
MAR 3	Ann 3	11		Limit orders	LCC	55
MAR 3	Ann 3	12		Out of hours/office dealing	LCC	54
MAR 3	Ann 3	12		Out of hours/office dealing	LCC	54
MAR 3	Ann 3	15		Settlement errors	LCC	117
MAR 3	Ann 3	17		Confirmations	LCC	Intro to para 88
MAR 3	Ann 3	18		Confirmations	LCC	92
MAR 3	Ann 3	19		Confirmations	LCC	Intro to para 88
MAR 3	Ann 3	20		Confirmations	LCC	98
MAR 3	Ann 3	24		SSIs	LCC	100
MAR 3	Ann 3	25		SSIs	LCC	101
MAR 3	Ann 3	26		Master agreements	LCC	Intro to para 107
MAR 3	Ann 3	28		Commission/brokerage	LCC	123
MAR 3	Ann 3	29		Disputes	LCC	9

MARKET CONDUCT SOURCEBOOK

Title of Sources **London Code of Conduct (references are to June 1999 edition)**
Part 10 of the Financial Services (Conduct of Business) Rules 1990

Destinations

G

The *rules* in *MAR* can be *waived* by the *FSA* under section 148 of the *Act* (Modification or waiver of rules), except for:

MAR 2.1.1R(2) (Application)

MAR 2.X.XR (Actions for damages)

MAR 3.1.5R (Actions for damages)

Source reference	Subject	Module	Ch/App	S/Ann	P		
Nil return		MAR	1				
Part 10 of the Financial Services (Conduct of Business) Rules 1990	Price stabilising rules	MAR	2, excluding 2.7			R G	2
Part 16.17, part 16.18 of the Financial Services (Conduct of Business Rules) 1990 and SFA rule 5-54(5)	Access to the stabilisation register	MAR	2.7			R	2.7
9	Disputes	MAR	3	Ann 3	29		
24	Responsibilities	MAR	3	4	11	G	
29	Role of brokers	MAR	3	4	13	G	
41, 42	Confidentiality	MAR	3	Ann 3	2		
43	Confidentiality	MAR	3	Ann 3	3		
48	Taping	MAR	3	6	8	G	
48	Taping	MAR	3	6	10	G	
49	Taping	MAR	3	6	5	R	
49	Taping	MAR	3	6	11	G	
50	NMPTs	MAR	3	5	1	G	
50	NMPTs	MAR	3	5	4	R	
50	NMPTs	MAR	3	5	7	E	
50	NMPTs	MAR	3	5	3	G	
51	NMPTs	MAR	3	5	4	R	
51	NMPTs	MAR	3	5	7	E	
54	Out of hours/office dealings	MAR	3	Ann 3	12		
55	Stop loss orders	MAR	3	Ann 3	10		
56	Personal account dealing	COBS	7	14	4	R	

Source reference	Subject	Module	Ch/App	S/Ann	P		
57	Dealing using a connected broker	MAR	3	4	8	G	
57	Dealing using a connected broker	MAR	3	4	9	G	
61	Entertainment, gifts and gambling	MAR	3	4	15	G	
73	Firmness of quote	MAR	3	Ann 3	9		
74	Firmness of quote	MAR	3	Ann 3	7		
76	Firmness of quote	MAR	3	Ann 3	7		
77	Firmness of quote	MAR	3	Ann 3	9		
78	Concluding a deal	MAR	3	Ann 3	4		
78	Concluding a deal	MAR	3	Ann 3	5		
81	Passing of names	MAR	3	Ann 3	6		
100	Payment instructions	MAR	3	Ann 3	24		
101	Payment instructions	MAR	3	Ann 3	25		
107	Terms and documentation	MAR	3	Ann 3	26		
114	Settlement of differences	MAR	3	7	5	G	
114	Settlement of differences	MAR	3	7	6	R	
114	Settlement of differences	MAR	3	7	7	G	
114	Settlement of differences	MAR	3	7	8	G	
117	Settlement errors	MAR	3	Ann 3	15		
121	Commission/ brokerage	MAR	3	7	9	G	
122	Commission/ brokerage	MAR	3	7	9	G	
123	Commission/ brokerage	MAR	3	Ann 3	28		

Interim Prudential Sourcebook for Banks Instrument 2001

1. The Financial Services Authority makes this instrument on 21 June 2001.

New rules and guidance

2. The Financial Services Authority makes the rules (other than IPRU (BANK) 3.3.15R in chapter GN) and gives the guidance (other than section 7.3 of chapter LM) in Annex A (The Sourcebook) to this instrument.
3. Sections 138, 149 and 156 of the Financial Services and Markets Act 2000 (the "Act") are specified for the purpose of section 153(2) of the Act.

Continued rule

4. The Financial Services Authority designates paragraph 4(4) of Schedule 3 to the Banking Act 1987 (1987 c22), as amended, (the "continued rule") for the purposes of article 4(1) of the Financial Services and Markets Act 2000 (Repeals, Transitional Provisions and Savings) (Rules) Order 2001 (the "Order").
5. The continued rule is to be treated as having effect under section 138 of the Act (General rule making power).
6. The continued rule:
 - (i) is modified so as to be to be interpreted in accordance with, and applies subject to, the general provisions contained in the General Provisions Instrument 2001; and
 - (ii) is modified in accordance with Annex B (Modification of continued rule) to this instrument; and
 - (iii) applies to a bank, except that in the case of an EEA bank with a UK branch paragraph (1) of the continued rule applies only in relation to that branch.
7. In paragraph 6(iii) above, "bank", "EEA bank", "UK" and "branch" have the meanings given in IPRU (BANK) 3.5.1R in chapter GN in Annex A (The Sourcebook) to this instrument.
8. The continued rule (incorporating the modifications made pursuant to paragraph 6(i) and (ii) above) is set out in Annex A (The Sourcebook) to this instrument at IPRU (BANK) 3.3.15R in chapter GN.

Guidance on continued rule

9. The Financial Services Authority gives the guidance (the "guidance on the continued rule") in section 7.3 (Committed facilities) of chapter LM in Annex A (The Sourcebook) to this instrument under section 157 of the Act and article 11 of the Order.

10. The guidance on the continued rule reproduces, with necessary modifications, section 7.3 (Committed facilities) of chapter LM in Volume II of the Guide to Banking Supervisory Policy issued by the Financial Services Authority on 30 September 2000.

Further provisions

11. This instrument shall come into force at the beginning of the day on which section 19 of the Act (the general prohibition) comes into force.
12. This instrument may be cited as the Interim Prudential Sourcebook for Banks Instrument 2001.
13. The provisions in Annex A to this instrument may be cited as the Interim Prudential Sourcebook for Banks.

By order of the Board
21 June 2001

Annex A
The Sourcebook

IPRU (BANK) attached

Annex B

Modification of continued rule

(1) The continued rule (paragraph 4(4) of Schedule 3 to the Banking Act 1987, as amended) is modified as follows:

- (a) Renumber the paragraph as "3.3.15R (1)".
- (b) Delete the words before "maintain" and substitute "*A bank, except an EEA bank which does not have a UK branch, must*".
- (c) Delete the words after "liquidity," and before "fall due" and substitute "taking into account the nature and scale of its business so that it is able to meet its obligations as they".
- (d) Delete the words after "fall due" to the end of the sentence.
- (e) After the end of the paragraph, add:

"(2) In the case of an *EEA bank* with a *UK branch*, (1) applies only in relation to that *branch*."

Annex C

Statement of purpose and compatibility applying to continued rule (IPRU (BANK) 3.3.15R)

Purpose

The purpose of IPRU (BANK) 3.3.15R is to require a firm to maintain a minimum amount of liquidity so that it is able to meet its obligations as they fall due. The FSA believes that making 3.3.15R and requiring firms to comply with it will contribute to meeting the FSA's regulatory objectives of market confidence and the protection of consumers. (Although this rule is not intended to contribute to the regulatory objectives of public awareness and the reduction of financial crime, the FSA believes it is compatible with these two objectives)

Compatibility of continued rule with the FSA's general duties under section 2 of the Act

The FSA believes that making 3.3.15R and so requiring firms to comply with it is compatible with the regulatory objectives of market confidence and the protection of consumers for the following reasons:

Market confidence

3.3.15R aims to ensure that firms maintain adequate liquidity in order to help mitigate the risk that they may be unable to meet their liabilities as they fall due. Compliance with this rule will consequently reduce the risk that the financial system operates in ways which would damage market confidence.

Consumer protection

3.3.15R aims to ensure that firms maintain adequate liquidity in order to help mitigate the risk that they may be unable to meet their liabilities as they fall due. Compliance with this rule will consequently reduce the risk that firms may be unable to meet their commitments to consumers (including depositors) as they fall due.

Principles of good regulation

The FSA's reasons for believing that making 3.3.15R is compatible with its general duty to have regard to the principles in section 2(3) of the Act are set out below.

The need to use its resources in the most efficient and economic way

The FSA believes that the most efficient and economic way to set standards regarding liquidity is to maintain the existing standard for liquidity for firms contained in Schedule 3 of the Banking Act 1987. Continuing existing prudential standards is the approach adopted for the IPRU (BANK) as a whole which preserves continuity for firms pending the introduction of an Integrated Prudential Sourcebook in the medium term.

The responsibilities of those who manage the affairs of authorised persons

3.3.15R is framed in such a way as to leave it to a firm's senior management how best to meet the required standard.

The principle that a burden or restriction should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction

Given that 3.3.15R maintains an existing standard, the FSA does not believe that any cost benefit issues will arise for a firm in maintaining that standard.

The desirability of facilitating innovation in connection with regulated activities

The FSA does not believe that 3.3.15R will restrict the scope of firms' management to develop their regulated activities in an innovative manner.

The international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom

Given that 3.3.15R maintains an existing standard, the FSA does not believe that it will have any impact on the competitive position of the United Kingdom.

The need to minimise the adverse effects on competition that may arise from anything done in the discharge of the FSA's general functions

Given that 3.3.15R maintains an existing standard, the FSA does not believe that it will have an adverse affect on competition.

The desirability of facilitating competition between those who are subject to any form of regulation by the FSA

Given that 3.3.15R maintains an existing standard, the FSA does not believe that it will have any impact on competition between those who are subject to any form of regulation by the FSA.

Compatibility with the duty of the FSA to act in a way which the FSA considers most appropriate for the purpose of meeting its regulatory objectives

The FSA believes that making 3.3.15R is the most appropriate way to meet its objectives because it reflects the importance of firms maintaining adequate liquidity so as to reduce the probability of prudential failure. Also, it gives firms some flexibility over how they choose to meet the standard and therefore gives them a wider choice of risk mitigation techniques.

**THE INTERIM PRUDENTIAL SOURCEBOOK FOR BUILDING SOCIETIES
INSTRUMENT 2001**


Preface

1. The Financial Services Authority makes the rules and gives the guidance in this instrument on 21 June 2001.
2. Sections 138, 149 and 156 of the Financial Services and Markets Act 2000 (the “Act”) are specified for the purpose of section 153(2).
3. This instrument shall come into force at the beginning of the day on which section 19 of the Act (the general prohibition) comes into force.
4. This instrument is to be interpreted in accordance with, and applies subject to, the General Provisions contained in the General Provisions Instrument 2001.
5. This instrument may be cited as the Interim Prudential Sourcebook for Building Societies Instrument 2001.
6. This instrument, excluding the provisions in this preface, may be cited as the Interim Prudential Sourcebook for Building Societies , or IPRU (BSOC).

By order of the Board

21 June 2001

ANNEX



Interim Prudential sourcebook: Building Societies

Financial Services Authority

Final Rules – Building Societies
Volume 1 of 2

Part of:

The Interim Prudential
Sourcebook for
Building Societies

June 2001

IPSB FOR BUILDING SOCIETIES

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Interim Prudential Sourcebook for Building Societies

X. Introductory Chapter

X.1 Introduction

X.1.1 G The rules in this sourcebook are made under section 138 of the Financial Services and Markets Act 2000 (“the Act”) and that section and sections 149 and 156 are specified for the purposes of section 153. The guidance in volume 2 of this sourcebook is given under section 157(1)(b) of the Act.

X.2 Application

X.2.1 R **The Interim Prudential Sourcebook for building societies applies to all firms with permission from the Financial Services Authority to accept deposits which are also building societies as defined in the Building Societies Act 1986 and, in this sourcebook, “society” and “societies” are construed accordingly.**

X.3 Content of this sourcebook

X.3.1 G This sourcebook is divided into two volumes. Volume 1 contains eleven prudential chapters which set out the Financial Services Authority’s prudential standards for societies. Three of the prudential chapters incorporate material drawn from the Interim Prudential Sourcebook for banks and guidance on the presentational style of the bank material can be found in section 4 of chapter GN of that sourcebook. Volume 2 contains five chapters of constitutional guidance: the Financial Services Authority (the “FSA”) inherits from the Building Societies Commission (“the Commission”) a range of functions under the Building Societies Act 1986 (“the 1986 Act”) related to the constitutional aspects of building societies and these chapters give guidance on how the FSA will exercise certain of these functions. The constitutional chapters replace Guidance Notes previously issued by the Commission.

X.4 The Purpose of the Interim Prudential Sourcebook for Building Societies

X.4.1 G The Interim Prudential Sourcebook for building societies sets out the FSA's detailed prudential standards and related notification requirements applying to societies authorised under the Act and covers the constitutional matters referred to above. Other prudential standards applying to societies are set out in the Act and elsewhere in the Handbook: see, for example, the Threshold Conditions (COND), the Principles for Businesses (PRIN) and Senior Management Arrangements, Systems and Controls (SYSC). Other notification requirements are set out in chapter 15 of the Supervision Manual (SUP).

X.4.2 G This sourcebook, together with the separate prudential sourcebook applying to banks, also implements EC directives setting out prudential standards as they apply to credit institutions.

X.4.3 G This sourcebook applies to societies on an interim basis pending the preparation and implementation of a single Prudential Sourcebook applying to all firms regulated by the FSA – termed the Integrated Prudential Sourcebook. In developing the interim sourcebook, the FSA has drawn on the standards which formerly applied to societies authorised under the 1986 Act set out in the Statement of Principles and Prudential Notes issued by the Commission. These standards took the form of the Commission's interpretation of the criteria of prudent management in section 45 of the 1986 Act (which are repealed under the Act). The FSA has expressed some of the content of the former criteria of prudent management as rules in this Interim Prudential Sourcebook, but the majority of the previous material has now been recast as guidance under the Act. A significant amount of material previously published by the Commission has not been carried forward into the Interim Prudential Sourcebook, particularly descriptive, historical and explanatory material. This has been removed because the FSA considers that it is not appropriate material for prudential rules and guidance under the Act, not because the material is in any way incorrect or irrelevant to societies' business. The rules and evidential provisions are distributed throughout the prudential chapters of this sourcebook: rules can be found in paragraphs X.2.1, X.8.2, 1.2.1, 1.2.2, 4.2.1, 4.2.5, 4.2.6, 5.2.1, 5.2.7, 5.2.9, 6.2.1, 6.2.2, 6.2.3, 7.6.2, 7.6.3, 7.7.1,

7.7.3, 8.2.1, 9.2.1, 9.2.7 and 9.2.8. Evidential provisions can be found in paragraphs 5.2.4, 9.2.3 and 9.2.5.

X.4.4 G The approach outlined in X.4.3 has been adopted, after consultation, as appropriate for material drawn from the previous standards of the Commission that will apply on an interim basis only. It is the FSA's intention in developing its final prudential standards (in the Integrated Prudential Sourcebook) to make further use of its rule-making powers to express its detailed prudential standards.

X.4.5 G This sourcebook also sets out both rules and guidance on the information related to prudential standards which societies should notify to the FSA. The FSA needs to be provided with certain information by societies if it is to monitor compliance with its requirements. The rules and guidance in this sourcebook supplement, for societies, the FSA's general notification requirements set out in the Supervision Manual (see SUP 15). In addition to the rules, the following paragraphs contain guidance on matters about which the FSA expects to be notified: 1.5.2, 1.6.4(1), 1.11.1, 1A4.2, 2.9.1, 4.5.8, 7.6.4 and 7.6.5.

X.4.6 G In addition to the rules and guidance applying to societies under the Act, directors and certain staff of all firms are subject to obligations referred to as the Statements of Principle for Approved Persons. The FSA has issued a Code of Practice to help determine whether an Approved Person's conduct has complied with a Statement of Principle. The Statements and the Code of Practice are set out in APER. A society's failure to meet the prudential standards set out in this sourcebook may also be relevant to the FSA's assessment of whether a particular Approved Person has complied with a Statement of Principle.

X.5 Principal Purpose of a building society and funding and lending limits

X.5.1 G Building societies are bound by sections of the 1986 Act which place limitations on certain aspects of their business (particularly sections 5, 6 and 7). The following paragraphs provide guidance on compliance with those sections and the FSA's

powers in relation thereto, replacing guidance previously included in the Commission's Statement of Principles.

X.5.2 G A building society may only be, and continue to be, incorporated under the 1986 Act if its principal office is in the United Kingdom and if it complies with the purpose or principal purpose (section 5(1) of the 1986 Act) of all building societies, namely:

“... that of making loans which are secured on residential property and are funded substantially by its members ...”

This criterion lies at the heart of what it is to be a building society and sets down its defining characteristics. A failure, or projected failure, to comply with the criterion may therefore cast doubt on the society's longer-term commitment to remain as a building society.

X.5.3 G The lending (section 6) and funding (section 7) limits, commonly known as the “nature limits”, are quantitative criteria which help to determine an individual society's compliance with the purpose or principal purpose.

X.5.4 G Compliance with the statutory purpose is not, however, limited to compliance with limits on the composition of the society's assets and liabilities. Societies are involved in activities or provide services which do not of themselves create significant balance sheet assets or liabilities. Such business may still have an impact on a society's compliance with the statutory purpose because of the actual or projected proportion of the society's business made up of those activities.

X.5.5 G In assessing whether a society is complying with the statutory purpose, the FSA will adopt a broadly-based judgement taking all relevant factors, both quantitative and qualitative, into account. As part of that overall assessment, there are two main quantitative indicators. First, the actual and projected proportion of the society's gross income that is, or is intended to be, derived from activities or services that have little or no connection with the making of loans secured on residential property (income from car insurance would, for example be considered unconnected business but income from mortgage and property related insurance and valuation services would, for example, be considered connected with core

lending business). Second, it would take into account the actual and projected proportion of the society's resources (for example, financial assets, capital, senior management and staff) that are, or are intended to be, applied to those other activities or services.

X.5.6 G The FSA expects societies to draw up their corporate and other business plans so as to provide reasonable assurance that they will comply with the statutory purpose and the nature limits. The FSA inherits the Commission's enforcement powers (in sections 36, 36A and 37 of the 1986 Act) in relation to breach of statutory purpose or nature limits.

X.6 The continuing 1986 Act

X.6.1 G Before N2, the main piece of legislation governing building societies and their activities has been the Building Societies Act 1986, as amended, in particular by the Building Societies Act 1997. The 1986 Act fulfilled a number of roles. It established the Commission as the prudential supervisor for societies and gave the Commission certain prudential powers of control, but it also, for example, set out the principal features of a building society and made provision for societies' internal constitutional arrangements and procedures for mergers and transfers of business. Although nearly all of those sections of the 1986 Act which related to prudential supervision have been repealed by or under the Act, a substantial part of the 1986 Act remains in force. For example, all references to the Commission have been removed and any remaining powers of control pass to the FSA (the Commission's powers to make secondary legislation under the remainder of the 1986 Act pass to the Treasury). The constitutional parts of the 1986 Act, however, remain, e.g. principal purpose and nature limits, the obligation to prepare annual accounts, provisions on societies' rules and general governance, membership, meeting and voting arrangements and procedures for mergers and transfers.

X.7 Frequently Used terms

X.7.1 G The following terms are used frequently in the sourcebook and have the meaning described here:

PN	a Prudential Note issued by the Building Societies Commission
section 9A	section 9A of the Building Societies Act 1986, as amended
the Accounts Regulations	the Building Societies (Accounts & Related Provisions) Regulations 1998 (SI 1998/504) as amended
the Act	the Financial Services and Markets Act 2000
the BCD	Directive 2000/12/EC of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions (the “Banking Consolidation Directive”). This directive consolidated most of the EC directives relating to credit institutions into one text. The directives so consolidated include the Own Funds Directive (89/299/EEC), the Solvency Ratio Directive (89/647/EEC), the Large Exposures Directive (92/121/EEC), the 1 st and 2 nd Banking Co-ordination Directives (respectively 77/780/EEC and 89/646/EEC) and the 2 nd Consolidated Supervision Directive (92/30/EEC).
the central office	the department of the FSA carrying out the registration functions transferred from the central office of the Registry of Friendly Societies
the Commission	the Building Societies Commission
the FSA	the Financial Services Authority
the 1986 Act	the Building Societies Act 1986, as amended in particular by the Building Societies Act 1997 and by and under the Financial Services and Markets Act 2000
the 1997 Act	the Building Societies Act 1997

X.8 Schedule of Transitional Provisions

X.8.1 G A number of rules in this Sourcebook require societies to provide copies of policy statements covering various aspects of their business and their corporate plan to the

FSA. These rules replace similar prudential requirements previously imposed by the Commission.

X.8.2 R A society which, before the date of the coming into force of this rule, had provided to the Commission a copy of its current policy statement on each of financial risk management, liquidity, and lending and a copy of its current corporate plan is taken to be in compliance, at that date, with any obligation to submit to the FSA such document contained in, respectively, rules 4.2.5, 5.2.7, 6.2.2, and 9.27.

X.8.3 G X.4.5 refers to particular paragraphs in this Sourcebook which contain guidance on matters about which the FSA expects to be notified or in respect of which it expects to receive certain documents. These matters were previously required to be communicated to the Commission and in some cases (where the communication related to a past event, a proposed change in a society's approach or a situation which is ongoing) notification or documents may already have been given to the Commission before the date on which the guidance set out in this Sourcebook comes into effect. The relevant guidance for these purposes is set out in paragraphs 1.5.2, 1.6.4(1), 1.11.1, 1A.4.2, 2.9.1, 4.5.8, 7.6.4 and 7.6.5. Any society which, before that date, had notified the Commission, or provided documents to the Commission, about a matter referred to in any of those paragraphs, in compliance with the Commission's guidance, is taken to be in compliance, at that date, with the relevant paragraph in this Sourcebook in so far as it relates to the matter in respect of which notification or documents had been received by the Commission.

X 8.4 G In addition , GEN contains some technical transitional provisions that apply throughout the Handbook and which are designed to ensure a smooth transition at commencement (that is ,when section 19 of the Act (the general prohibition) comes in to force) . The Supervision manual (SUP) contains transitional provisions which carry forward written concessions relating to pre-commencement provisions.

Interim Prudential Sourcebook for Building Societies

1 SOLVENCY

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Interim Prudential Sourcebook for Building Societies

1 Solvency

1.1 Introduction

1.1.1 G This chapter replaces PN 1998/1 issued by the Commission. It includes rules and guidance for societies on the Threshold Condition in Schedule 6 paragraph 4(1) of the Act (the resources of a firm must, in the opinion of the FSA, be adequate in relation to the regulated activities it seeks to carry on) – see also COND 2.4 - and on Principle 4 ("a firm must maintain adequate financial resources"). It describes the purpose of capital in a deposit-taking institution and the particular risks faced by building societies. It describes how societies should calculate their solvency ratio for capital adequacy purposes, what funds are eligible for inclusion in own funds and the FSA's methodology for setting Threshold Ratios. It should be read in conjunction with Chapter 2.

1.1.2 G This chapter further explains that the FSA will set each society a Threshold Ratio based on the FSA's assessment of a society's risk profile. Societies are expected to meet their Threshold Ratio at all times on both a consolidated and society only basis. The setting of a Threshold Ratio by the FSA does not absolve the society's board from maintaining such higher capital ratio as it considers prudent for the maintenance and management of the society's business and its future plans.

1.1.3 G Finally this chapter explains how the capital adequacy requirement should be calculated and sets out the FSA's methodology for setting threshold ratios.

1.2 Rules

1.2.1 R A society must maintain adequate capital resources commensurate with the nature and scale of its business and the risks inherent in its business. Where a society has subsidiary undertakings it must also maintain capital resources commensurate with the scale and nature of the activities of the whole group.

1.2.2 R A society must maintain own funds of at least £1m.

1.3 The Purpose of Capital

1.3.1 G The capital of a body corporate is the amount by which the value of its assets exceed its non-capital liabilities. A deposit taking institution needs sufficient capital:

- (1) to maintain itself as a viable going concern, able to overcome either expected or unexpected difficulties (including both squeezes on margins and losses on assets), to exploit opportunities and to sustain its infrastructure;
- (2) to secure, in conjunction with liquidity, its ability to repay deposits (and in a building society, shares) whenever that may be required; and
- (3) to maintain public confidence that the institution will be able to repay such deposits (and shares) in full.

1.4 EU Directives

1.4.1 G The EU has harmonised capital adequacy requirements for credit institutions in the EU by the following principal directives:

- (1) Council Directive of 17 April 1989 on the Own Funds of Credit Institutions (89/299/EEC);
- (2) Council Directive of 18 December 1989 on a Solvency Ratio for Credit Institutions (89/647/EEC).

1.4.2 G In March 2000, these directives, along with the Large Exposures Directive, the 1st and 2nd Banking Co-ordination Directives and the 2nd Consolidated Supervision Directive, were consolidated into a single Directive, known as the Banking Consolidation Directive (2000/12/EC). Elsewhere in this sourcebook, references will be to the consolidated directive (“BCD”).

1.4.3 G A further directive, 93/6/EEC on the capital adequacy of investment firms and credit institutions (the "CAD", not included in the BCD), sets out the capital requirements for credit institutions which have trading books and foreign exchange exposures. Building societies which are on the "Trading Book" approach to Treasury management may engage in those activities (see section 1.18).

1.4.4 G The BCD requires national authorities to ensure that all credit institutions maintain sufficient capital resources in relation to their business to ensure a minimum solvency ratio of 8%. The BCD specifies the types of capital resources whose inclusion is permitted in the calculation of the solvency ratio: those resources are known, collectively, as "own funds". It also sets out the calculation of the solvency ratio as follows:

$$\text{solvency ratio} = \frac{100 \times \Sigma \text{ own funds}}{\Sigma(\text{risk weighted assets} + \text{off balance sheet items})} \geq 8\%$$

i.e. the solvency ratio equals own funds divided by the sum of risk weighted assets and off balance sheet items, expressed as a percentage and should be 8% or more.

1.4.5 G The BCD specifies the minimum risk weights which should be applied to assets in the balance sheet and the "credit conversion factors" to be applied to off balance sheet items, in order to calculate the denominator of the solvency ratio.

1.5 Threshold Ratios

1.5.1 G Each society has been informed of the Threshold Ratio it is expected to maintain. This has been set by the FSA taking account of the nature and inherent risks of that society's business in areas which are not covered or not sufficiently covered by application of risk weighting. The Threshold Ratio should be maintained on both a society only basis and on a group basis reflecting the fact that the subsidiaries are separate legal entities and that the society cannot rely on having access to their capital at all times. In certain circumstances solo consolidation may be agreed; this is further explained in section 1.11. Paragraph 1.5.3 explains the FSA's approach to setting threshold ratios for societies. In every case the FSA

has provided against a society inadvertently breaching the EC 8% minimum. The setting of a Threshold Ratio by the FSA does not absolve boards of societies from the responsibility of maintaining such higher ratios as they consider appropriate for their business and future plans.

1.5.2 G There is no prescribed amount by which the FSA expects a society's capital to exceed that required to meet the threshold but it is the responsibility of the society to plan so it has sufficient capital at all times to avoid breaching its Threshold Ratio. The Board should therefore set and monitor a capital margin above both the society only and the group threshold ratios which management will be expected to observe at all times; societies' systems should be able to demonstrate that this is the case. The FSA should be advised of the margin set and any changes thereto. Subject to the foregoing, the FSA does not object to societies reducing solvency ratios, for example, by repaying excess capital to their members, but it will want to be satisfied that any such reduction is planned and capable of being reversed without undue adverse affect should changes in the economic position of the society or in its risk profile so dictate. Any society that falls below its margin and/or is in danger of breaching its Threshold Ratio should advise the FSA immediately, stating how it proposes to remedy the situation. The projected solvency ratio should feature in all operational and strategic plans and any proposal for a new business venture should take into account any impact on the society's solvency ratio.

1.5.3 G A society's threshold ratio reflects the FSA's assessment of the society's risk profile. The seven factors which go into establishing the threshold ratio are board, management, systems, asset quality (insofar as not adequately covered by minimum risk weights and including MIG arrangements), treasury management (including hedging, funding and liquidity), planning (including the planning and control of new initiatives) and operating performance (including consistency in financial results and vulnerability to external shocks, for example, through geographic concentration). A blank appraisal form currently used to assess societies' risk profile can be found in Annex 1J.

1.5.4 G There are a number of points which have an important bearing on the appraisal process:

- (1) the seven broad factors, and the various criteria underlying those factors, do not carry equal weight amongst themselves or uniformly across societies. The system recognises that some factors and criteria are more important to some societies than others, consequently the threshold ratio is not based on an arithmetical average of criteria and factors but these are weighted by the FSA to the extent appropriate to each society;
- (2) the assessment system recognises that there are other criteria, which may be relevant only to particular societies, and these are also taken into account where they exist;
- (3) whilst some criteria focus on societies' competence in a particular area, others evaluate the risk of particular activities which are not reflected in the asset weighting formula but which exist even in the most competently managed operation;
- (4) societies are assessed in the context of both their past performance and of their current and planned business activities. The process recognises that some societies' business requires less sophisticated systems and less board and managerial expertise than others;
- (5) where societies merge, the merged institution will be the subject of a full new appraisal. The FSA recognises that the threshold ratio which is set on the basis of this appraisal might affect the merger terms and the FSA will be prepared to give an advance indicative ratio, if so requested by the societies involved.

1.5.5 G In setting the ratios the FSA has been careful to review each society's ratio against those of the rest of the building society sector to ensure that societies' ratios are consistent with one another. Both societies and the economic environment in which they operate are constantly evolving and the FSA reviews societies' ratios both individually and across the sector on a regular basis, but it is the FSA's expectation that threshold ratios will be reasonably stable with infrequent changes.

1.6 Own Funds

1.6.1 G The BCD specifies which capital resources can count towards own funds and the extent to which they may do so. Its purpose is to ensure that credit institutions operating under supervisory regimes in different EU member states do not count towards own funds any items not falling within the BCD's list nor include any items to a greater extent than the BCD permits. But not all the items contained in the list are relevant to societies: moreover the BCD gives national authorities discretion whether or not to allow the use of the various constituents of capital listed.

1.6.2 G For building societies, own funds comprise reserves, all other capital resources listed in Annex 1A and minority interests in accordance with section 1.7.

1.6.3 G The BCD distinguishes between those components of own funds, such as reserves and PIBS, which may be included without limit and those to which a limit applies (see also chapter 2). These two categories closely correspond to the categories of core, or Tier 1 capital and supplementary, or Tier 2 capital used in the Basel Accord, and the same terminology is therefore used for convenience in this chapter although it does not feature in the BCD itself.

1.6.4 G Whenever a calculation of own funds is to be made other than at the balance sheet date, the amount of reserves included should be after deduction of any overall losses in the current year:

- (1) where a society does not seek to take credit in its solvency ratio calculation for profits earned in the current year, but simply reports on the basis of its previous year-end reserves, then as a minimum the society should have passed a board resolution, after the close of the second financial quarter, to the effect that the directors have satisfied themselves that no reduction in reserves has been sustained during the first six months of the financial year and a copy of this resolution should be forwarded to the FSA. Should the FSA be concerned about a society's ability to meet its capital requirements the society may be required to

obtain a certificate or opinion from its external auditors that no reduction in reserves has been sustained;

- (2) interim current year profits may be included with reserves, i.e. in Tier 1, but only if they have been verified by the society's external auditors and a report from the auditors that the interim profits have been verified should be provided.

Where a society includes general provisions in its solvency ratio calculation other than at balance sheet date then as a minimum it should have passed a board resolution, after the close of the second financial quarter, to the effect that the directors have satisfied themselves that the general provisions meet the requirements set out in Annex 1A3.1.

1.6.5 G What constitutes verification by external auditors is summarised in Annex 1E. Societies may include interim profits on a quarterly basis, but are not required to do so: some societies whose capital is plentiful may prefer to choose the simpler minimum procedure outlined in paragraph 1.6.4(1). Moreover, the FSA recognises that it will not be practicable for societies or their auditors to complete the verification procedures prior to the deadline for submission of the quarterly returns. For the first, second and third financial quarters societies may include interim profits in their returns, if they so wish, on the understanding that the society will submit the required reports and, where necessary, board resolutions within two months of the quarter end. For the fourth quarter the FSA will rely on the forthcoming audited accounts and accordingly the full year's profits should be included in own funds under Tier 1. The figure shown for reserves in the return for the first quarter should agree with that shown in the annual accounts.

1.7 Minority Interests

1.7.1 G The BCD provides for the inclusion of minority interests when they are credit (negative) items in the capital of a subsidiary undertaking in the calculation of consolidated own funds of a society and these subsidiaries. The FSA believes that building societies should not regard minority shareholdings as having all the properties of their own capital because minority interests cannot absorb the losses of the building society or any other

member of its group and they would not necessarily be available to the building society if the society or subsidiary undertaking were to be wound up.

1.7.2 G Accordingly, minority interests should only be included for the purpose of calculating consolidated own funds, and then only if:

- (1) the total amount of minority interests aggregated with Tier 1 or Tier 2 capital does not exceed 10% of the society's own funds in that category;
- (2) it is clear that the society has effective practical control over the subsidiary undertaking and can pass a special resolution;
- (3) the society owns at least 75% of the equity capital of the subsidiary undertaking.

In determining which elements of minority interests should be integrated into Tier 1 own funds societies should have regard to the characteristics of the subsidiary undertaking's capital. Only those items which are analogous to a society's Tier 1 own funds should be included in Tier 1. The remainder should be assigned to the appropriate category of Tier 2 funds. In this section, references to subsidiaries are to entities which are subsidiaries of the society.

1.8 Deductions

1.8.1 G Societies should make certain deductions from own funds and observe certain restrictions on the inclusion of Tier 2 items. The deductions comprise:

- (1) intangible fixed assets, including goodwill;
- (2) all holdings of capital instruments of other credit or financial institutions (see Annex 1D for definitions);

- (3) all holdings of capital instruments of regulated broker-dealers (subject to CAD or an analogous regime);
- (4) (a) the amount of the capital deficit of any subsidiary undertaking which has such a deficit (only required for society only calculations). The entire deficit should be excluded even if the subsidiary is only partially owned;
- (b) the proportion attributable to outside minority interests in the capital deficit of any subsidiary undertaking which has such a deficit (required for consolidated calculations).

1.8.2 G Societies may be expected to make a deduction from own funds to reflect the existence of a contingent liability which, if called, would create an asset that societies would be required to deduct from own funds.

N B: See section 1.13 for deductions in respect of insurance companies, section 1.14 for MIG captives, section 1.16 for holdings in other institutions, and for possible deductions arising out of securitisation, section 1.15.

1.9 Limits on Tier 2 Capital

1.9.1 G The maximum amount of term subordinated debt which should be counted as own funds within Tier 2 is 50% of Tier 1 capital after deduction of intangible fixed assets. Total Tier 2 capital should not exceed 100% of Tier 1 capital after deduction of intangible fixed assets. Funds eligible for inclusion in Tier 2 capital are defined in Annex 1A.

1.10 Solvency Ratio

1.10.1 G The solvency ratio of any society is determined by the formula set out in paragraph 1.4.4. Societies should calculate their own ratios using the definition of own funds contained in this Chapter and in Annex 1A and the risk weights and credit conversion factors in

Annexes 1B and 1C. The relevant risk weight (a percentage) is applied to the balance sheet value of an asset, or in the case of off balance sheet items, to the nominal value multiplied by the appropriate credit conversion factor. Asset values and values attributed to off balance sheet items should also be determined on a basis consistent with the Accounts Regulations and should be net of any specific provisions. Where a society has subsidiary undertakings, the solvency ratio should be calculated on a consolidated basis. Consolidation should be on the same basis as applies to the society's statutory accounts (i.e. the Accounts Regulations). Where subsidiary undertakings, either singly or in aggregate, have either:

- (1) total gross assets equal to or greater than 1% of the society's assets; or
- (2) income which is equal to or greater than 1% of the society's total income; or
- (3) profits or losses which are equal to or greater than 1% of the society's profits;

the society should also calculate its solvency ratio on a society only basis and both calculations should meet the society's solvency ratio threshold (see Annex 1H for definitions of terms used in (1), (2) and (3)). Societies should report their solvency ratios quarterly in the QFS1 return.

1.10.2 G The percentage weights given in the BCD are minima: the directive explicitly recognises that national authorities may set higher weightings as they see fit. The FSA has decided to do so for securities issued by Zone A or Zone B countries. These are weighted at 10% or 20%, according to residual maturity, as a proxy for interest-rate risk, rather than at 0% as the BCD permits.

1.10.3 G The FSA uses the "mark-to-market" approach for the measurement of off balance sheet risks associated with interest-rate and foreign exchange contracts, and societies are expected to report on this basis. Treatment of off-balance sheet items is shown in Annex 1C.

1.11 Solo Consolidation

1.11.1 G The FSA recognises that for structural reasons societies have historically conducted certain core business through subsidiaries which they might otherwise have preferred to conduct themselves. In such cases the FSA may agree or expect societies to consolidate such subsidiary undertakings when calculating their society only solvency ratio. However, in so doing the FSA may expect the society to deduct a percentage of the subsidiary undertaking's capital from the society's own funds when making the society only solvency ratio calculation. This deduction will reflect the FSA's view of any enhanced risk in opting to conduct the business through a subsidiary rather than the society itself. At the minimum there is a risk that the environment which made the subsidiary route profitable may change leaving the society with a cost to unwind the structure. The FSA will discuss with societies where solo consolidation is considered appropriate or necessary, but see section 1.12. Where solo consolidation occurs societies should confirm annually in writing to the FSA that the solo consolidated subsidiaries continue to meet the criteria under which solo consolidation is agreed and that there has been no change in the type of business conducted by the subsidiary undertaking. Confirmation should be received within two months of the society's year end.

1.12 Mortgage Subsidiaries

1.12.1 G The principle of solo consolidation can be applied not only to capital adequacy but also to large exposures (see Chapter 7 Large Exposures) and although these are two distinct issues the grounds for confusion are much reduced if it is possible and prudent to adopt a common approach in respect of specific subsidiaries or categories of subsidiaries. Provided they comply with certain criteria, mortgage subsidiaries are a suitable category for solo consolidation in respect of both large exposures and capital adequacy. To enable the FSA to make valid comparisons across the building society sector it is important that all mortgage subsidiaries which meet the criteria are treated in a similar manner; however, under the BCD the FSA is required to give its approval to applications from each society individually. All societies which have mortgage subsidiaries which:

- (1) are under the effective day to day control of the society's executives;

- (2) are wholly owned by the society;
- (3) are not subject to the capital requirements of another regulator;
- (4) have no restrictions on winding up and upstreaming capital at any time;

and either:

- (5) have no third party creditors at all (this is not intended to include small administrative creditors such as the electricity bill); or
- (6) are constituted so that the society can substitute itself for the mortgage subsidiary and perform its obligations to third party creditors;

should apply to the FSA to solo consolidate these subsidiaries confirming that they meet the above mentioned criteria.

1.13 Exclusions from Consolidation

1.13.1 G Subject to a limited degree of discretion allowed to the supervisory authorities, the BCD requires building societies to consolidate subsidiary undertakings which are financial or credit institutions (defined in Annex 1D) for the purposes of calculating their solvency ratio. However unless:

- (1) the inclusion of a particular non financial institution or non-credit institution subsidiary undertaking would result in a higher solvency ratio than if it were to be excluded; or
- (2) the FSA specifically requires the subsidiary undertaking to be excluded;

societies should include all their subsidiary undertakings when calculating their solvency ratio. Exclusion is likely where the FSA believes that a subsidiary's inclusion in the

consolidation would be misleading or inappropriate. Life insurance and general insurance companies fall into this category and societies should calculate their solvency ratio after reversing the impact of the investment in, or consolidation of, these subsidiary undertakings. In the society only ratio calculation, the carrying value of the investment should be removed from the weighted asset total, and an equal deduction made from the society's own funds. In the consolidated ratio calculation, the weighted assets of the insurance subsidiary should be removed from the consolidated weighted assets, and the reserves of the subsidiary consolidated into group own funds should be reversed out, including any benefit of the embedded value taken through the group's reserves. The only profits of the subsidiary that may count as group own funds are those that have been distributed to the parent society i.e. as dividends.

1.14 Mortgage Indemnity Insurance Captives

1.14.1 G Societies which own a MIG Captive should include the captive when calculating their consolidated solvency ratio (for rules and guidance on mortgage indemnity insurance, see chapter 8). For the society only solvency ratio the FSA has adopted a composite treatment which recognises both that the capital invested in the captive bears a heavier risk of loss than the generality of investments in subsidiaries, and that the captive bears only the society's own lending risk, albeit in concentrated form, and is not using its capital to "gear up" and assume new external liabilities. Out of the total capital committed to the captive, whether fully paid or not, 25% (or, if greater, the actual capital requirement imposed by the local insurance supervisor) should be deducted from the society's own funds, in the society only calculation. The remainder should be risk-weighted at 100% as if an ordinary investment in a subsidiary.

1.15 Securitisation

1.15.1 G In considering how to treat societies' securitisation transactions, the three key points are:

- (1) whether, and to what extent, to include securitised assets, which have been financed on a limited recourse basis, in the calculation of the society's (or society group's) solvency ratio (subject to their relevant risk weightings);
- (2) whether, and to what extent, to require the deduction from societies' own funds of quasi-capital exposures to securitisation transactions; and
- (3) how to reflect the largely unquantifiable risks that are left with a society after securitisation.

1.15.2 G In order to achieve consistency and simplicity, the FSA deals with these as follows:

- (1) securitisation transactions by, or involving, building societies will be analysed in the same way as similar transactions by, or involving, banks. The FSA will apply the principles and guidance contained in chapter SE of the IPSB for banks, which is set out, with additional guidance for building societies, as chapter 10 of this sourcebook. This will determine whether securitised assets are to be risk weighted and included in the solvency ratio calculation, and whether (and to what extent) quasi-capital exposures, such as first loss provisions or holdings of deeply subordinated notes, are to be deducted from own funds.
- (2) all other risks arising from securitisation will, collectively, be considered in the context of the process of appraisal that leads to the setting or reviewing of an individual society's threshold solvency ratio. Depending on the scale and nature of a society's securitisation activity, this could lead, other things being equal, to an increase in that threshold ratio.

1.15.3 G Some of the risks that securitisation leaves with a society are inherent in most, if not all, existing securitisation structures and are thus unavoidable. Particular examples are the risk from servicing and liability under warranties. But in other respects, particularly in relation to "moral hazard", there is much greater scope for conscious acceptance or avoidance of risk through the selection and adaptation of particular structures.

1.15.4 G While a society may endeavour to avoid the accumulation of such risks, to the extent that risk is accepted and/or is unavoidable, an assessment of the various residual risks will be made by the FSA as part of the appraisal for setting or reviewing the society's threshold solvency ratio. This assessment will reflect the scale and nature of a society's current and planned securitisation programme. It will also cover how the society has addressed the residual risks in the structure(s) it proposes to use. Where, for example, securitisation activity is small-scale relative to the society's asset base, a "clean break" with borrowers has been achieved, the society has good errors and omissions insurance to cover servicing risk, and substantial audit of the pool of assets to be transferred has been carried out, the effect on the solvency threshold ratio is likely to be minimal and there may indeed be no actual change. While recognising that assessment through the solvency threshold appraisal process is less transparent for societies, the FSA considers that much is gained by simplicity and the avoidance of a proliferation of risk weightings or other formulae intended to capture individual, largely unquantifiable, risks.

1.16 Deductions in Respect of Holdings in Other Institutions

1.16.1 G Articles 51.1 and 51.2 of the BCD prohibit a credit institution from having a "qualifying holding" in excess of 15% of its own funds in an undertaking or 60% in several undertakings which are neither credit institutions, financial institutions, nor undertakings which carry on "ancillary banking services".

1.16.2 G A qualifying holding is defined as "a direct or indirect holding in an undertaking which represents 10% or more of the capital or of the voting rights, or which makes it possible to exercise a significant influence over the management of the undertaking in which the holding subsists".

1.16.3 G The Directive gives member states the option not to apply the restrictions to life and general insurance companies and not to apply them in other cases provided they require a deduction from the credit institution's own funds of 100% of the amount in excess of the 15% or 60% limits.

1.16.4 G The FSA has decided not to apply the limits to participation in insurance companies but see section 1.13 for capital treatment in respect of holdings in insurance companies. The FSA has also decided not to apply the limits in other cases but to recommend a 100% deduction from own funds of the amount of the holding in excess of 15%.

1.17 Capital Cost and Pricing

1.17.1 G When acquiring assets societies should consider what effect the profit or cost derived from those assets will have on their solvency ratios. The higher the weighting which an asset carries the greater the capital cost and societies will need to decide whether they can, or should, pass on such cost or accept a lower rate of return.

1.18. Capital Adequacy Directive (CAD)

1.18.1 G Societies on the "Trading" approach to financial risk management (described in chapter 4, Financial Risk Management), under which they can trade securities and maintain unhedged foreign exchange positions within defined limits, should calculate the capital requirements for their trading book and foreign exchange positions separately in accordance with the FSA's guidance to banks (as set out in the IPSB for banks). In moving to the "Trading" approach societies will need to satisfy the FSA that they have the systems to calculate and report their capital position in accordance with the FSA's guidance.

CALCULATION OF "OWN FUNDS"

G

1A.1 Tier 1 Capital

1A.1.1 Reserves as disclosed in the latest year end balance sheet;

plus

cumulative interim profits for the year to date which have been verified by the society's external auditors (see Annex 1E); or

less

cumulative losses (if any) for the year to date.

1A.1.2 Deferred shares which meet the requirements of chapter 2, currently PIBS, and deferred shares which were issued prior to the Building Societies (Deferred Shares) Order 1991 (SI 1991/701) and which met the statutory requirements then in force.

1A.1.3 Tier 1 minority interests in a subsidiary undertaking which meets the requirements of section 1.7.

1A.1.4 Deduct intangible assets from the sum of 1A.1.1, 1A.1.2 and 1A.1.3 to calculate Tier 1 capital.

1A.2 Tier 2 Capital

1A.2.1 Term subordinated debt and undated subordinated debt, which meet the requirements of chapter 2; together with general provisions for bad debt and revaluation reserves.

1A.2.2 Tier 2 minority interests in a subsidiary undertaking which meets the requirements of section 1.7.

1A.3 General Provisions for Bad Debt

1A.3.1 General provisions should be made to cover possible losses, existing at the balance sheet or other reporting date, which have not been specifically identified. As such, they are freely available to the society to be utilised against any actual losses subsequently identified or arising and so conform with Article 35.1(a) of the BCD. But the BCD does not permit the inclusion in "own funds" of a provision which covers identified deterioration in particular assets, whether individual or group. Thus societies should not include the latter type of provision in own funds. Societies may only include general provisions in their solvency ratio calculation to an amount less than or equal to that shown in the society's last audited accounts or the amount provided when interim profits were last verified by the external auditors.

1A.4 Revaluation Reserves

1A.4.1 Societies may include revaluation reserves arising out of the differences between book values and the current market value of property fixed assets but only if:

- (1) the society applies the revaluation method to all of its property fixed assets, or all of its property fixed assets in a designated class and not selectively;
- (2) the values result from regular professional valuations of each property. If not annually, there should be:
 - (a) a rolling programme such that no professional valuation of a property is more than five years old;
 - (b) in the intervening year(s) in which a property is not professionally valued, an interpolation of value by the Board

which takes into account any decline in property values disclosed by valuations of other properties in that year;

- (c) where a society owns less than five properties, none of which are valued during the financial year, the valuation should be determined by the Board on the basis of their knowledge of appropriate property values in the area.

1A.4.2 If a society divides its fixed property assets into classes for the purposes of the valuation then it should advise the FSA of the basis of the division and the valuation policy in respect of each class.

1A.4.3 Any increase in revaluation reserve should be supported by a professional valuation.

1A.4.4 For the purposes of this calculation the revaluation reserve will be the amount standing to the credit of any revaluation reserve in the balance sheet or the amount of any such reserve in the accounting records of the society, for the time being, whichever is the lesser amount.

1A.5 Limits on capital

1A.5.5 Term Subordinated Debt which meets the guidance in chapter 2 may not exceed 50% of Tier 1 constituents minus intangible assets.

1A.5.6 Tier 2 capital resources in aggregate may not be included to an extent greater than 100% of Tier 1 constituents minus intangible assets.

1A.5.7 The total amount of minority interests which may be aggregated with Tier 1 or Tier 2 capital may not exceed 10% of the society's own funds in that category.

1A.6 Own funds

1A.6.1 Gross own funds comprise Tier 1 capital plus Tier 2 capital. From this should be deducted:

- (1) all holdings of capital instruments of other credit or financial institutions, or in regulated broker-dealers (subject to CAD or an analogous regime);
- (2) the amount of capital deficit of any subsidiary undertaking which has such a deficit (for society only calculations);
- (3) the proportion attributable to outside minority interests in the capital deficit of any subsidiary undertaking which has such a deficit (for consolidated calculations);
- (4) any deductions in respect of insurance companies (section 1.13), MIG Captives (section 1.14), holdings in other undertakings (section 1.16) and securitisation (paragraph 1.15.2);

to arrive at "own funds".

1A.6.2 Article 34.2(3) of the BCD allows "funds for general banking risks" to be counted as Tier 1 capital. Such funds are not general provisions for bad debt but are akin to banks' "hidden reserves" and are therefore not applicable to building societies.

RISK ASSET WEIGHTS**G****1B.1 General**

1B.1.1 Risk weights should be applied net of any specific provision. Items subject to deduction from Own Funds should be zero weighted. Assets held by a subsidiary undertaking are weighted on the same basis as if held by the parent society.

1B.2 Assets to be weighted at 0%

1B.2.1 The following assets should be weighted at 0%:

- (1) Bank notes or coinage of any territory or country;
- (2) Deposits with:
 - (a) any Zone A Central Bank (see Annex 1G for Zone A countries);
 - (b) the National Savings Bank;
 - (c) any Zone B Central Bank denominated in local currency and funded by liabilities in the same currency (see Annex 1G for Zone B countries);
- (3) Certificates of Tax Deposit issued by the Treasury;
- (4) National Savings Bonds;
- (5) Loans granted at the society's administered rate and supported by the explicit guarantee of a Zone A central government or central bank.

1B.3 Assets to be weighted at 10%

1B.3.1 The following assets should be weighted at 10%:

- (1) Deposits with any gilt edged market maker or participant in the UK gilt market supervised by a regulatory authority in the EEA provided they are collateralised by assets which, if held directly, would have a weighting of not more than 20%.
- (2) Stock lending rights arising from the lending of securities issued in the UK by HM Government.
- (3) Fixed-rate securities with a residual maturity of one year or less or floating rate securities:
 - (a) issued or guaranteed by a Zone A Central government (including Ginnie Maes);
 - (b) issued or guaranteed by a Zone B Central government denominated in the local currency and funded by liabilities in the same currency;
 - (c) issued or guaranteed by the European Atomic Energy Community, European Coal and Steel Community or European Economic Community.
- (4) Loans either with a maturity of one year or less and granted on a fixed rate basis, or with any maturity and granted at a rate which is periodically reset at least annually against a market rate, and in either case supported by the explicit guarantee of a Zone A central government or central bank.

1B.4 Assets to be weighted at 20%

1B.4.1 The following assets should be weighted at 20%:

- (1) Fixed rate securities, with a residual maturity over 1 year:
 - (a) issued or guaranteed by a Zone A Central government (including Ginnie Maes); or
 - (b) issued or guaranteed by the European Atomic Energy Community, European Coal and Steel Community or European Economic Community.
- (2) Deposits with or securities issued, guaranteed, or (in the case of bills of exchange) accepted by, any Zone A credit institution (see Annex 1G).
- (3) Deposits with, or securities issued, or (in the case of bills of exchange) accepted by any Zone B credit institution (see Annex 1G), with a maturity of one year or less.
- (4) Securities issued by, or loans to, any relevant authority (see Annex 1F for definition) or loans to the Department of Finance and Personnel (Northern Ireland).
- (5) Securities issued by, or loans to, Fannie Maes and Freddie Macs.
- (6) Securities issued or guaranteed by multilateral development banks (International Bank for Reconstruction and Development, International Finance Corporation, Inter-American Development Bank, Asian Development Bank, African Development Bank, Caribbean Development Bank, European Investment Bank, European Bank for Reconstruction and Development, Nordic Investment Bank, Council of Europe Resettlement Fund, European Investment Fund and Inter-American Investment Corporation).

- (7) Cash items in the process of collection.
- (8) Loans with a maturity greater than one year that are either granted on a fixed rate basis, or at a market rate which is periodically reset less frequently than annually and, in either case, supported by the explicit guarantee of a Zone A central government or central bank.
- (9) Loans supported by an unconditional guarantee issued by a Zone A credit institution.
- (10) Loans, with a maturity of one year or less, supported by an unconditional guarantee issued by a Zone B credit institution.
- (11) Loans supported by the unconditional guarantee of a relevant authority (see Annex 1F).

1B.5 Assets to be weighted at 50%

1B.5.1 The following assets should be weighted at 50%:

- (1) Mortgage-backed securities (MBS) issued by special purpose mortgage finance vehicles where the following conditions are met:
 - (a) they are fully secured at all times on a pool of first mortgages on residential property, no part of which is used for non residential purposes, or on loans to Registered Social Landlords which are registered with the Housing Corporation or Scottish Homes or the National Assembly of Wales or the Northern Ireland Department of Social Development, fully secured by a mortgage on a residential property that is:
 - (i) already let, or

- (ii) under development and will be let on condition that the development attracts Social Housing Grant (SHG) and/or other public subsidy on equivalent terms and the loans are fully secured by a charge (but not necessarily a first priority charge) on a residential property owned by Registered Social Landlords which is rented;
- (b) the notes embody an express promise to repay the noteholder;
- (c) the issue documentation contains provisions which would ultimately enable noteholders to initiate legal proceedings directly against the issuer of the MBS. As an example such provisions would allow noteholders to proceed against the issuer where the trustee, having become bound to take steps and/or to proceed against the issuer, fails to do so within a reasonable time and such failure is continuing;
- (d) the documentation contains provisions which would ultimately enable noteholders to acquire the legal title to the security (i.e. the mortgagee's interest in it) and to realise the security in the event of a default by the mortgagor;
- (e) the mortgage loans should not be in default at the time at which they are transferred to the vehicle;
- (f) the vehicle's activities are restricted by its articles of association to mortgage business. The vehicle may also hold assets qualifying for a risk weighting of less than 50%;
- (g) the notes do not absorb more than their pro rata share of losses in the event of arrears or default (see chapter 10 for treatment of junior or B notes).

- (2) Loans to individuals fully and completely secured by a first priority charge on residential property that is (or is to be) occupied by the borrower or is rented.

- (3) Loans to Registered Social Landlords, registered with the Housing Corporation, or Scottish Homes or the National Assembly of Wales or the Northern Ireland Department of Social Development, fully secured by a mortgage on residential property that is:
 - (a) already let; or

 - (b) under development and will be let, on condition that the development attracts Social Housing Grant (SHG) and/or other public subsidy on equivalent terms, of an amount equal to, or greater than, 50% of the approved total scheme cost, the security for which is subordinated to the loan, where the funding body has legally committed itself to the full payment of the subsidy.

- (4) Loans to public universities, fully secured by a mortgage on a residential property that is:
 - (a) already let; or

 - (b) under development and will be let, on condition that the lender is in possession of a certificate, issued by a quantity surveyor or architect appointed by the society, showing that work to the value of 20% of the projected finished end value of the project (excluding cost of land) has been completed, prior to any draw down under the loan; and

 - (c) can readily be sold or let on the non student market.

N.B. For the purposes of paragraphs 1B.5.1(3) and (4), once a property has been let it is not necessary to increase the weighting to 100% during a subsequent temporary void.

1B.6 Assets to be weighted at 100%

1B.6.1 All other assets should be weighted at 100% including:

- (1) Deposits with, or securities issued or (in the case of bills of exchange) accepted by any Zone B credit institution authorised by the competent authorities of a member state of the European Community, with a maturity greater than one year.
- (2) Commercial Paper issued or guaranteed by companies of the types to which Directive 78/660/EEC on the annual accounts of certain types of company (as amended by subsequent acts of accession) applies (that is, public or private companies limited by shares or by guarantee).
- (3) Securities issued by the European Telecommunications Satellite Organisation, International Monetary Fund, and European Company for the Financing of Railway Rolling Stock.
- (4) Other mortgages and MBS.
- (5) Unsecured loans and leasing receivables
- (6) Development and residential property:
 - land acquired
 - development projects
 - rented housing
 - equity interest in shared ownership schemes

- (7) Investments in connected undertakings which are not subsidiary undertakings (except where treated as a deduction from own funds or netted on consolidation)
- (8) Premises, plant, equipment and other fixed assets
- (9) Prepayments, accrued income, sundry debtors etc (except where the asset represents a claim on a counterparty which normally attracts a weighting below 100%, e.g. UK central government (0%), local authorities or credit institutions (20%), in which case it should be weighted accordingly).

1B.7 Repos and Reverse Repos

1B.7.1 Gilt edged securities subject to a repo transaction should be treated as remaining on the balance sheet of the seller throughout the repo period. The weightings for UK Government securities at 10% or 20% (according to residual maturity) apply. A reverse repo should be treated as a collateralised loan and should be weighted on the basis of the collateral (i.e. the gilt) securing the loan at 10% or 20% according to residual maturity for the duration of the transaction.

1B.8 Gilt Strips

1B.8.1 The weighting for gilt strips does not differ from that of traditional holdings in gilt-edged securities (10% or 20% according to residual maturity), but societies should bear in mind that considerable activity in the more sophisticated repos and strips markets will be taken into account and weighed against the expertise available when assessing their threshold solvency ratio.

1B.9 Stock Lending

1B.9.1 Securities held in a liquid asset portfolio and loaned to the market will already be weighted for capital adequacy purposes in accordance with this Annex. A possible additional risk posed by the lending of the security will depend upon whether the

transaction is collateralised. The lending of gilt edged securities, for example, should not attract any additional weighting for counterparty risk because it is fully collateralised under the terms of a stock lending agreement.

1B.9.2 However, stock lending which is not fully collateralised, such as that conducted through the Cedel and Euroclear stock lending programmes, needs to take account of the counterparty risk. As Cedel and Euroclear are both Zone A banks, an additional capital weighting of 20% should be applied.

TREATMENT OF OFF-BALANCE SHEET ITEMS

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1C Classification of Off-Balance Sheet Items (other than items related to interest rates and foreign exchange)

Degree of Risk	Credit Conversion Factor
1C.1 Full Risk <ul style="list-style-type: none"> - Guarantees having the character of credit substitutes, - Acceptances, - Endorsements on bills not bearing the name of another credit institution, - Transactions with recourse, - Irrevocable standby letters of credit having the character of credit substitutes, - Asset sale and repurchase agreements (repos), - Assets purchased under outright forward purchase agreements, - Forward forward deposits, - The unpaid portion of partly-paid shares and securities. 	100%
1C.2 Medium Risk <ul style="list-style-type: none"> - Documentary credits issued and confirmed (see also medium/low risk), 	50%

- Warranties and indemnities (including tender, performance, customs and tax bonds) and guarantees not having the character of credit substitutes,
- Irrevocable standby letters of credit not having the character of credit substitutes,
- Undrawn credit facilities (agreements to lend, purchase securities, provide guarantees or acceptance facilities) with an original maturity of more than one year,
- Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs).

1C.3 Medium/low Risk 20%

- Documentary credits in which underlying shipment acts as collateral and other self-liquidating transactions.

1C.4 Low Risk 0%

- Undrawn credit facilities (agreements to lend, purchase securities, provide guarantees or acceptance facilities) with an original maturity of up to and including one year, or which may be cancelled unconditionally at anytime without notice (including facilities related to cheque guarantee cards, automated teller machine cards, credit cards and mortgage offer letters which are expressly stated to be subject to immediate cancellation).

Each item described in 1C.1 to 1C.4 should be multiplied by the appropriate credit conversion factor and then weighted by the risk weight applicable to the category of the counterparty for an on-balance sheet transaction.

The portion of unpaid capital subscribed to the European Investment Fund should be weighted at 20%.

1C.5 The treatment of off-balance sheet items using the "mark to market" approach.

Societies may, of course, only enter into such contracts permitted by the 1986 Act, guidance in respect of which can be found in chapter 4.

1C.5.1 Method

1C.5.2 Step (a): by attaching current market values to contracts (mark to market) the current replacement cost of all contracts with positive values is obtained. (Societies should consult their external auditors if they require guidance on how to ascertain market values).

1C.5.3 Step (b): to obtain a figure for potential future credit exposure, the notional principal amounts or values underlying a society's aggregate book are multiplied by the following percentages:

Residual maturity	Interest rate contracts	Contracts concerning foreign exchange rates and gold	Contracts concerning equities	Contracts concerning precious metals except gold	Contracts concerning commodities other than precious metals
One year or less	0.0%	1%	6%	7%	10%
Over one year, less than five years	0.5%	5%	8%	7%	12%
Over five years	1.5%	7.5%	10%	8%	15%

1C.5.4 Contracts which do not fall within one of the five categories indicated in this table shall be treated as contracts concerning commodities other than precious metals.

1C.5.5 For contracts with multiple exchanges of principal, the percentages have to be multiplied by the number of remaining payments still to be made according to the contract.

1C.5.6 For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage shall be no lower than 0.5%.

1C.5.7 In the case of single-currency "floating/floating interest rate swaps" only the current replacement cost will be calculated (i.e. no future credit exposure).

1C.5.8 Step (c): the sum of current replacement cost and potential future credit exposure for each contract is multiplied by the risk weighting allocated to the relevant counterparties for on-balance sheet transactions, (except that the 100% weightings shall be replaced by 50% weightings) to give the risk-weighted amount relating to that contract which is to be included in the solvency ratio calculation.

1C.5.9 Societies should ensure that the notional amount to be taken into account is an appropriate yardstick for the risk inherent in the contract. Where, for instance, the contract provides for a multiplication of cashflows, the notional amount should be adjusted in order to take into account the effects of the multiplication on the risk structures of that contract.

1C.5.10 Interest-rate and foreign-exchange contracts traded on recognised exchanges where they are subject to daily margin requirements and foreign exchange contracts with an original maturity of 14 calendar days or less are excluded.

1C.6 Netting

1C.6.1 Societies may treat as reducing risk and therefore as permitting weighting on a net, rather than gross basis:

- (1) bilateral contracts for novation between the society and its counterparty under which mutual claims and obligations are automatically amalgamated in such a way that this novation fixes one single net amount each time novation applies and thus creates a legally binding, single new contract extinguishing former contracts (in the case of foreign exchange transactions a separate single net amount should be fixed for each currency and value date);
- (2) other bilateral netting agreements between the society and its counterparty;

but only under the following conditions;

- (a) the society should have a contractual netting agreement with its counterparty which creates a single legal obligation, covering all included transactions, such that, in the event of a counterparty's failure to perform owing to default, bankruptcy, liquidation or any other similar circumstance, the society would have a claim to receive or an obligation to pay only the net sum of the positive and negative mark-to-market values of included individual transactions;
- (b) the society should have made available to the FSA written and reasoned legal opinions to the effect that, in the event of a legal challenge, the relevant courts and administrative authorities would, in the cases described under (a), find that the society's claims and obligations would be limited to the net sum, as described in (a), under;
 - the law of the jurisdiction in which the counterparty is incorporated and, if a foreign branch of an undertaking is

involved, also under the law of the jurisdiction in which the branch is located;

- the law that governs the individual transactions included;
 - the law that governs any contract or agreement necessary to effect the contractual netting.
- (c) the society should have provided assurances to the FSA that it has set in place procedures for ensuring that the legal validity of its contractual netting is kept under review in the light of possible changes in the relevant laws;
- (d) the society should have provided assurances to the FSA that it has adequate systems to monitor netting. Any society not on the comprehensive or trading approach should produce confirmation from its external auditors that its systems are adequate.

1C.6.2 No contract containing a provision which permits a non-defaulting counterparty to make limited payments only, or no payments at all to the defaulter, even if the defaulter is a net creditor (a 'walkaway' clause) should be recognised as risk reducing.

1C.6.3 The FSA will recognise as risk-reducing contractual-netting agreements covering foreign-exchange contracts with an original maturity of 14 calendar days or less, written options (where these are permitted by section 9A) or similar off-balance-sheet items to which this Annex does not apply because they bear only a negligible or no credit risk. If, depending on the positive or negative market value of these contracts, their inclusion in another netting agreement can result in an increase or decrease of the capital requirements, societies should use a consistent treatment.

1C.6.4 No contractual netting will be recognised as reducing risk until the FSA has confirmed that conditions (b), (c) and (d) above have been met and that it is satisfied that contractual netting is legally valid under the law of each of the relevant jurisdictions.

1C.6.5 Effects of Netting

(1) Contracts for novation

- (a) The single net amounts fixed by contracts for novation, rather than the gross amounts involved, may be weighted. Thus in:

Step (a) the current replacement cost, and in

Step (b) the notional principal amounts or underlying values

may be obtained taking account of the contract for novation.

(2) Other Netting Agreements

- (a) In step (a) the current replacement cost for the contracts included in a netting agreement may be obtained by taking account of the actual hypothetical net replacement cost which results from the agreement; in the case where netting leads to a net obligation for the credit institution calculating the net replacement cost, the current replacement cost is calculated as “0”;

In step (b) the figure for potential future credit exposure for all contracts included in a netting agreement may be reduced according to the following equation:

$$PCE_{\text{red}} = 0.4 * PCE_{\text{gross}} + 0.6 * NGR * PCE_{\text{gross}}$$

Where:

PCE_{red} = the reduced figure for potential future credit exposure for all contracts with a given counterparty included in a legally valid bilateral netting agreement,

PCE_{gross} = the sum of the figures for potential future credit exposure for all contracts with a given counterparty which are included in a legally valid bilateral netting agreement and are calculated by

multiplying their notional principal amounts by the percentages set out in the table in 1C.5.3,

NGR = “net-to-gross ratio”: this should be done as a separate calculation: the quotient of the net replacement cost for all contracts included in a legally valid bilateral netting agreement with a given counterparty (numerator) and the gross replacement cost for all contracts included in a legally valid bilateral netting agreement with that counterparty (denominator).

For the calculation of the potential future credit exposure according to the above formula perfectly matching contracts included in the netting agreement may be taken into account as a single contract with a notional principal equivalent to the net receipts. Perfectly matching contracts are forward foreign exchange contracts or similar contracts in which notional principal is equivalent to cash flows if the cash flows fall due on the same value date and fully or partly in the same currency.

1C.7 Types of Off-Balance Sheet Items to which the treatment in section 1C.5 above is to be applied.

1C.7.1 Interest-rate contracts

- Single-currency interest-rate swaps;
- Basis swaps;
- Forward-rate agreements;
- Interest-rate futures;
- Interest-rate options purchased;
- Other contracts of a similar nature.*

1C.7.2 Foreign-exchange contracts and contracts concerning gold

- Cross-currency interest-rate swaps;

- Forward foreign-exchange contracts;
- Currency futures;
- Currency options purchased;
- Other contracts of a similar nature*
- Contracts concerning gold of a similar nature to the above items*

Contracts of a nature similar to those in points above other than those marked
* concerning other reference items or indices concerning:

- equities,
- precious metals except gold,
- commodities other than precious metals,
- other contracts of a similar nature.

1C.7.3 Where off balance sheet items carry explicit guarantees, they shall be weighted, to the extent of the guarantee as if they had been incurred on behalf of the guarantor rather than the counterparty. Where off balance sheet items are secured by collateral listed in Annex 1B.2.1(1), 1B.3.1(2) or 1B.4.1(3), they shall be weighted, to the extent of the collateral at the weight appropriate to the collateral by which they are secured.

1C.7.4 Societies may apply a 50% weighting to off balance sheet items which are sureties or guarantees having the character of credit substitutes and which are fully guaranteed by mortgages which would themselves attract a 50% weighting provided the guarantor has direct right to such collateral.

**HOLDINGS OF CAPITAL INSTRUMENTS OF OTHER CREDIT AND
FINANCIAL INSTITUTIONS TO BE EXCLUDED FROM "OWN
FUNDS" CALCULATIONS
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1D.1 Definitions

1D.1.1 Capital Instruments Includes without limitation any constituent of own funds (as set out in Article 34 of the BCD) or the equivalent in a financial institution

1D.1.2 Credit Institution An undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account

1D.1.3 Financial Institution An undertaking other than a credit institution the principal activity of which is to acquire holdings or to carry on one or more of the following activities:

- (1) lending
- (2) financial leasing
- (3) money transmission services
- (4) issuing and administering means of payment (e.g. credit cards, travellers cheques and bankers drafts)
- (5) guarantees and commitments

- (6) trading for own account or for account of customers in
 - (a) money market instruments (cheques, bills, CDs etc)
 - (b) foreign exchange
 - (c) financial futures and options
 - (d) exchange and interest rate instruments
 - (e) transferable securities
- (7) participation in securities issues and the provision of services related to such issues
- (8) advice to undertakings on capital structure, industrial strategy and related questions and advice and services relating to mergers and the purchase of undertakings
- (9) money broking
- (10) portfolio management and advice
- (11) safekeeping and administration of securities

INTERIM PROFITS: VERIFICATION PROCEDURES

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1E.1 Verification of Interim Profits by External Auditors

1E.1.1 The FSA interprets "verified" to mean obtaining a reasonable degree of comfort on the accuracy of the reported interim results. For this purpose, the analytical review procedures commonly used by auditors in the normal course of their work can be helpful and a combination of some of them will provide adequate assurance that reported interim profits are of sufficient quality for inclusion in the capital base, provided that the society has complied in all material respects with the valuation principles of the Accounts Regulations.

1E.1.2 The particular procedures which the FSA considers appropriate for this purpose are listed below. A full scope audit is not required, but in situations where the scope of work carried out differs materially from that set out in this chapter, the FSA will expect to be informed by the auditor in his report.

1E.1.3 Verification by auditors should in normal circumstances entail at least the following:

- (1) satisfying themselves that the figures forming the basis of the interim profits have been properly extracted from the underlying accounting records and that the reliability of any major change to the systems, upon which the accounting records are dependent, has been considered;
- (2) reviewing the accounting policies used in calculating the interim profits so as to obtain comfort that they are consistent with those normally adopted by the society in drawing up its annual financial statements and are in accordance with the principles set out in the Accounts Regulations;

- (3) performing analytical procedures on the result to date, including comparisons of actual performance to date with budget and with the results of prior period(s);
- (4) discussing with management the overall performance and financial position of the society;
- (5) obtaining adequate comfort that the implications of current and prospective litigation, all known claims and commitments, and changes in business activities been properly taken into account in arriving at the interim profits;
- (6) following up problem areas of which the auditors are already aware in the course of auditing the society's financial statements;
- (7) enquiring into the adequacy of provisions for bad and doubtful debt.

1E.1.4 The external auditors should submit an opinion to the society on whether the interim results are fairly stated. The text of the report is set out below:

"Dear Sirs

In accordance with your letter of instruction dated [] we have reviewed [name of society's] current year interim profits for the period [] as reported on Form QFS1, a copy of which is attached for identification. Our review, which did not constitute an audit, has been carried out having regard to the FSA's Interim Prudential Sourcebook for building societies Chapter 1.

On the basis of the results of our review, nothing came to our attention to indicate that:

- (1) the interim profits as reported on QFS1 have not been calculated on the basis of the accounting policies adopted by the society in preparing its latest statutory accounts for the year to [];
- (2) those accounting policies differ in any material respects from those required by the Accounts Regulations [except for];
- (3) the interim profits amounting to £[] as so reported are not fairly stated."

DEFINITION OF RELEVANT AUTHORITY

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1F.1 "Relevant authority" means any of the following:

- (1) a local authority;
- (2) any authority all the members of which are appointed or elected by one or more local authorities;
- (3) any authority the majority of the members of which are appointed or elected by one or more local authorities in the United Kingdom, being an authority which by virtue of any enactment has power to issue a precept to a local authority in England and Wales, or a requisition to a local authority in Scotland, or to the expenses of which, by virtue of any enactment, a local authority in the United Kingdom is or can be required to contribute;
- (4) the Receiver for a combined police authority (within the meaning of the Police Act 1964);
- (5) a Passenger Transport Executive within the meaning of section 9(1) of the Transport Act 1968;
- (6) a residuary body within the meaning of section 105(1) of the Local Government Act 1985.

DEFINITIONS OF ZONE A AND ZONE B COUNTRIES

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1G.1 ZONE A:

1G.1.1 Member States of the European Community and all other countries which are full members of the Organisation for Economic Co-operation and Development (OECD) and those countries which have concluded special lending arrangements with the International Monetary Fund (IMF) associated with the Fund's General Arrangements to Borrow (GAB). Any country which reschedules its external sovereign debt is however, precluded from Zone A for a period of 5 years. Zone A countries currently comprise Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany (including pre-unification claims on East Germany), Greece, Hungary, Iceland, Ireland, Italy, Japan, South Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Saudi Arabia, Spain, Sweden, Switzerland, Turkey, United Kingdom and USA.

Note: The Channel Islands, Gibraltar, Bermuda and the Isle of Man should be regarded as Zone A countries for the purposes of calculating a society's solvency ratio.

1G.2 ZONE B:

1G.2.1 All other countries.

Note: A United Kingdom branch of a credit institution which has its head office in a Zone B country is regarded as a Zone B institution even though its United Kingdom branch is authorised by the FSA.

SOCIETY ONLY SOLVENCY RATIO CALCULATIONS DEFINITIONS

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- 1H.1 "Gross assets" - being the sum of ASSETS according to Balance Sheet Format 2 in Schedule 4 of the Companies Act 1985 (or any alternative accounting regulations under which a subsidiary undertaking may be required to prepare its financial statements), which is equivalent to the total of ASSETS according to the Format of Society Balance Sheet under Schedule 2 Part I of the Accounts Regulations.
- 1H.2 "Income" - being the sum of turnover, other operating income, income from shares in group undertakings income from participating interests, income from other fixed asset investments and other interest receivable and similar income according to Profit and Loss Account Format 1 in Schedule 4 of the Companies Act 1985 (or any alternative accounting regulations under which a subsidiary undertaking may be required to prepare its financial statements), which is equivalent to the sum of interest receivable, income from investments, fees and commissions receivable, net profit on financial operations and other operating income according to the Format of Society Income and Expenditure Account under Schedule 1 Part I of the Accounts Regulations.
- 1H.3 "Profit" or "Loss" - being the profit or loss for the financial year according to Profit and Loss Account Formats 1 and 2 in Schedule 4 of the Companies Act 1985 (or any alternative accounting regulations under which a subsidiary undertaking may be required to prepare its financial statements), which is equivalent to profit or loss for the financial year according to the Format of Society Income and Expenditure Account under Schedule 1 Part I of the Accounts Regulations.

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Society Threshold Appraisal Sheet

Date of Appraisal:

Society : Deposit Limit :
 Total Assets : Liquidity Limit :
 Associate : Treasury Approach :
 Manager : External Auditors :

Summary grades	This assessment	Last Consistency Review	Any Subsequent Change & Date
Board Competence			
Management Competence			
Systems			
Asset Quality			
Treasury			
Planning/Diversification			
Operational Risk Profile			

Summary

Grading and Threshold	Threshold Ratio Recommended at this Review	Position at Last Consistency Review	Any Subsequent Change & Date
Overall grade			
Threshold ratio			
Own funds required			
Surplus/(deficit) Own Funds available against required			
Surplus/(deficit) as % of Own Funds available			

A. BOARD COMPETENCE	COMMENTS	GRADE
1. Range of Skills		
2. Range of ages and succession planning		
3. Effectiveness of Chairman		
4. Effectiveness of Non Executives		
5. Summary		

B. MANAGEMENT COMPETENCE	COMMENTS	GRADE
1. Range and depth of skills		
2. Succession planning, reliance on key person		
3. Effectiveness of Chief Executive		
4. Existence of "four eyes" management responsibility		
5. Management and corporate culture, dominance of Chief Executive		
6. Delegation and Control, quality of 2nd Tier Management		
7. Quality of communications with FSA staff and responsiveness to FSA concerns		
8. Summary		

C. SYSTEMS	COMMENTS	GRADE
1. Adequacy of business control systems and their documentation, Delegation of authority, Risk Management, Operational Controls.		
2. Quality of Policy documents: Liquidity, Treasury, Funding, Lending, etc.		
3. Independence, quality and effectiveness of internal and external audit and compliance function.		
4. Adequacy of IT systems, existence of a tested contingency plan		
(i) Ability to maintain and amend software		
(ii) Ability to absorb future upgrades and development costs		
(iii) Computer literacy of Board, Senior Management, and Internal Audit		
5. Quality of management information		
6. Summary		

D. ASSET QUALITY	COMMENTS	GRADE
1. Philosophic approach to risk/ reward in lending		
2. Controls on lending and arrears management and approach to provisioning		
3. Actual levels of mortgage arrears		
4. Extent of large exposures		
5. Mortgage Indemnity cover		
6. Summary		

E. TREASURY	COMMENTS	GRADE
1. Volatility of retail funds/reliance on special products, exposure to large shareholdings.		
2. Level of wholesale funding relative to industry, reliance on short-term deposits		
3. Approach to hedging and level of position risk accepted		
4. Adequacy of Treasury management skills, inc. information output and internal skills		
5. "Quality" of liquidity/observance of minimum 7 day and adjusted net liquidity limits, availability of undrawn committed facilities.		
6. Adequate Senior Management oversight of Treasury		
7. Summary		

F. PLANNING/DIVERSIFICATION	COMMENTS	GRADE
1. Quality of corporate planning		
2. Quality of planning, execution and control of new initiatives (including proper consultation with FSA)		
3. Approach and extent of diversification, impact of diversification mix on overall business.		
4. Level of commitment of management resource to new ventures or subsidiary operations		
5. Availability at NXD level, of specialist expertise to query/challenge management plans/proposals for subsidiaries or new ventures		
6. Significant commitment to new ventures - not easily reversed if unsuccessful		
7. Potential for risks incurred by, or systems failures within subsidiaries (or other diversifications) to cause financial or reputational problems for the parent society.		
8. Reliability of forecasting		
9. Summary		

G. OPERATIONAL RISK PROFILE	COMMENTS	GRADE
1. Geographic concentration		
2. Vulnerability on account of small size		
3. Stability of profit track record		
4. Ability to cover management expenses, in the face of narrowing interest margins, loss of fee income or reduction of profit from other causes.		
5. Adequacy and quality of capital, reliance on Tier 2 and 3, cost of servicing capital, headroom for future issues, timing of repayment or amortisation of Tier 2 and Tier 3 Capital and impact on business.		
6. Risk from service activities not covered in asset risk weighting		
7. Summary		

Interim Prudential Sourcebook for Building Societies

2 ISSUED CAPITAL

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2 Issued Capital

2.1 Introduction

2.1.1 G This chapter replaces PN 1998/2 issued by the Commission. It contains guidance for societies on issued capital to amplify the Threshold Condition set out in Schedule 6, paragraph 4(1) of the Act (the resources of a firm must, in the opinion of the FSA, be adequate in relation to the regulated activities it seeks to carry on) – see also COND 2.4 - and Principle 4 (“a firm must maintain adequate financial resources”). It should be read in conjunction with Chapter 1.

2.1.2 G This chapter is relevant only to those societies that have issued, or propose to issue, capital instruments to supplement their reserves. It explains the terms and conditions on which capital should be issued if it is to count as own funds. It advises prior consultation with the FSA before issuing capital and describes the documentation which societies should submit to the FSA before including the issue as own funds. Capital which was issued prior to N2, and which does not conform with the guidance in this chapter, will continue to count as own funds provided that at the time it was issued it complied with the statutory instruments or Prudential Note in force at that time.

2.2 Types of Issued Capital

2.2.1 G The FSA will recognise PIBS, Undated Subordinated Debt, and Term Subordinated Debt as own funds qualifying for inclusion in the calculation for capital adequacy, provided they conform with the guidance in this chapter.

2.2.2 G The FSA will not recognise as own funds any capital where the issue terms include clauses which would inhibit mergers or transfers in circumstances where the FSA gives a direction under section 42 B (1), (3), or (4) of the 1986 Act.

2.2.3 G The BCD distinguishes between several classes of capital and sets limits on the proportion of the lower classes of capital which may be held in relation to the highest class (the classes are referred to as Tier 1, Tier 2, and Upper Tier 2 capital). Provided they conform to the guidance in this chapter, PIBS count as Tier 1, Undated Subordinated Debt counts as Upper Tier 2 and Term Subordinated Debt counts as Tier 2.

2.3 Rules of the Society

2.3.1 G The rules of the society should, in the event of conflict, take precedence over any separate terms in respect of issued capital. Provisions in such terms of issue purporting to override the society's rules are inconsistent with this, as are provisions purporting to restrict the society's freedom to amend its rules. Societies should also note that for issued capital to count as own funds there should be no provision in the issuing society's rules permitting the write down of shares, other than deferred shares as defined in the Building Societies (Deferred Shares) Order 1991 (SI 1991/701).

2.4 Interest Terms

2.4.1 G The terms of the capital issue may provide for variation of either the rate of interest, or the interest margin over a bench mark market rate during the life of the instrument. But the extent of such variation should be such that it will not create a presumption, at the time of issue, that the society will in practice elect (with the agreement of the FSA) to repay the debt where the terms of issue give the society that option. Accordingly no term should provide for variation in either the interest rate or the margin which is:

- (1) greater than 0.5% p.a. in the first ten years of the issue; or
- (2) greater than 1% p.a. over the whole life of the issue;

whether in a single step, or a series of steps. Any new bench mark should be of a broadly similar type to the previous one and no change in bench mark should take place within five

years of the previous one. Capital may be issued on the basis that the interest rate is capped and/or floored at a specified rate.

2.4.2 G These limits are not intended to set a "market norm" for such variation as that is for societies to negotiate. They can be seen as the maximum level of increase that can be provided for without creating expectations, through the exercise of a repayment option, that the capital will be repaid before maturity or, in the case of permanent instruments, repaid at a certain date.

2.5 Amount Eligible as Own Funds

2.5.1 G Only fully paid up funds, together with premia if any, should be counted as own funds, although deductions for reasonable fees or commission incurred in arranging the issue may be disregarded for this purpose.

2.6 Permanent Interest Bearing Shares

2.6.1 G PIBS are a sub-set of deferred shares which comply both with the Building Societies (Deferred Shares) Order 1991 (SI 1991/701) and the BCD. PIBS are usually listed on the Stock Exchange. To be eligible for inclusion in the calculation for capital adequacy, the PIBS issue should meet the conditions in paragraphs 2.6.2 to 2.6.9.

Permanence

2.6.2 G PIBS are perpetual instruments. Repayment may normally only occur on the winding up of a society, and no other events of default entitling the holders of PIBS to repayment are possible. However, PIBS may be issued on terms which permit the issuing society, in accordance with a board resolution, to repay PIBS but only subject to the prior consent of the FSA (SI 1991/701 Article 3 and Schedule). The decision to repay PIBS should be genuinely at the instance of the society's board. Such consent would only be given if the FSA were satisfied that the remaining capital would be adequate for the society's present and foreseeable future needs. It is unlikely to be given within five years of the issue date.

Subordination

2.6.3 G On winding up PIBS should rank after all types of ordinary (i.e. non-deferred) shares and all other liabilities including subordinated debt.

Waiver of Interest - Non-cumulative

2.6.4 G In order for PIBS to be effective as a protection against running losses, the issue terms should provide that interest payments due on PIBS at a particular date may be reduced or cancelled by the board of the issuing society if the society is, or after the payment would be, in breach of capital adequacy requirements. The issue terms should also provide that no interest is payable on PIBS if the society has cancelled, or failed to pay, interest or dividend upon other shares of any class (other than deferred shares) or deposits with the society. Interest on PIBS so cancelled is non-cumulative. A term of issue may allow a society to issue further PIBS as fully paid by application of reserves to the extent that interest is foregone.

Conversions/Takeovers/Mergers

2.6.5 G The issue terms should provide that, if a society transfers its business to a commercial company, the PIBS will be transformed into undated subordinated debt of the successor company, ranking behind any undated subordinated debt previously issued by the society. The issue terms should provide that the issue should continue to rank as PIBS in the successor society after an amalgamation or transfer of engagements.

Notice to Subscribers

2.6.6 G At the time of issue the attention of subscribers should be drawn to the deferred nature of PIBS and to their exclusion from the deposit sub-scheme of the Financial Services Compensation Scheme and this information should also be shown prominently on any documents of title (SI 1991/701 Article 3 (2)).

Limits

2.6.7 G Not only does the issuing of PIBS directly reduce the endowment effect of reserves but, by increasing the potential to issue Tier 2 capital, it provides scope for reducing the endowment effect still further. The FSA would not expect a society to issue PIBS in excess of 50% of its reserves.

Secondary Market: Stockbrokers

2.6.8 G A stockbroking subsidiary of a society may accept orders for the purchase and sale of the society's PIBS but, to ensure that the society's capital in the form of PIBS is not reduced except with FSA consent, neither the society nor any subsidiary undertaking may trade, buying and reselling on its own account, as opposed to executing client orders.

Retail Issues

2.6.9 G Societies issuing PIBS as retail instruments directly to the public will be expected to take the utmost care that retail investors are made fully aware of the risks of investing in PIBS as opposed to investing in societies' normal investment share accounts. Issues of PIBS, whether retail or not, should be restricted to minimum denominations of not less than £1000.

2.7 Undated Subordinated Debt

2.7.1 G To be eligible for inclusion in the calculation for capital adequacy, any issue of Undated Subordinated Debt should meet the conditions in paragraphs 2.7.2 to 2.7.7.

Permanence

2.7.2 G Undated Subordinated Debt should be permanent. Repayment may normally only occur on the winding up of a society and no other events of default entitling the holders of such debt to repayment are possible. However, undated debt may be issued on terms which permit

the society, in accordance with a board resolution, to repay undated debt, subject to the prior consent of the FSA. The decision to repay the debt should be genuinely at the instance of the society's board. Such consent would only be given if the FSA were satisfied that the remaining capital would be adequate for the society's present, and future foreseeable needs. It is unlikely to be given within the first five years of issue.

Subordination

2.7.3 G In the event of winding up, Undated Subordinated Debt should, together with deferred shares, rank so as to support the solvency of the society. That is to say, the terms of the issue should provide that the claims of a holder of Undated Subordinated Debt, in the winding up of the borrower, shall be limited to such amount as would have been payable if, immediately prior to the commencement of a winding up, the holder held deferred shares of equivalent value instead of subordinated debt. Upon winding up, the holders of Undated Subordinated Debt should rank after all creditors and holders of non-deferred shares, including creditors in respect of term subordinated debt but their claims should, nevertheless, rank ahead of any existing PIBS or other deferred shares in issue by that society.

Interest Deferral

2.7.4 G Interest payments on Undated Subordinated Debt should rank after those on all other deposits, including other types of Subordinated Debt, and all non-deferred shares. The terms of issue should prohibit the payment, or crediting, of interest on Undated Subordinated Debt unless all amounts payable on non-deferred shares, or deposits with the society, in respect of any earlier or concurrent period, have been paid.

2.7.5 G The interest payment due on Undated Subordinated Debt at a particular date may be deferred by the board if, after the payment, the society would otherwise be in breach of capital adequacy requirements. However, such interest need only be deferred, not cancelled, i.e. it may be cumulative. Societies may make a scrip issue of Undated Subordinated Debt in satisfaction of the interest payments.

2.7.6 G The terms of issue should allow for the extreme situation by prohibiting the society from paying interest on Undated Subordinated Debt if the society is insolvent, or would be insolvent, after making the payment.

Conversions/Takeovers/ Mergers

2.7.7 G The issue terms should provide that the loss absorption characteristics of Undated Subordinated Debt will continue as a feature of the corresponding liability of the successor company in the case of transfer of business to a company or the successor society in the case of a merger. In order to preserve, as far as possible, the relative rankings of PIBS-holders and holders of Undated Subordinated Debt through the conversion process, issues of PIBS should become a form of Undated Subordinated Debt on conversion, ranking behind any Undated Subordinated Debt previously issued by the society. This avoids the situation in which, upon conversion, PIBS could have become, say, 10 year term subordinated debt of the successor company and be repaid ahead of undated subordinated debt already in issue by the society. This stipulation was first introduced on 15 April 1994 and may not feature in earlier issues of PIBS.

2.8 Term Subordinated debt

2.8.1 G To be eligible for inclusion in the calculation for capital adequacy, any issue of Term Subordinated Debt should meet the conditions in paragraphs 2.8.2 to 2.8.11.

Subordination

2.8.2 G On winding up, Term Subordinated Debt should rank after all types of ordinary (i.e. non-deferred) shares, and interest due thereon, and other liabilities excluding PIBS and Undated Subordinated Debt.

Maturity

2.8.3 G The original maturity should be not less than five years and one day. Where the debt is drawn down in tranches the minimum term should be calculated from the date of the last draw down.

Amount Eligible as Own Funds

2.8.4 G With a discounted issue it is the amount actually received, not the amount due to be repaid at the end of the term, which counts as own funds.

2.8.5 G Subordinated loan capital in its final four years to maturity should not count in full as part of own funds but should be amortised on a straight line basis by 20% p.a. The debt should be included in the capital base according to the following schedule:

Years to maturity	Amount included in own funds
More than 4	100%
Less than and including 4 but more than 3	80%
Less than and including 3 but more than 2	60%
Less than and including 2 but more than 1	40%
Less than and including 1	20%

2.8.6 G If repayment is by instalments then either:

- (1) the debt is divided into its constituent instalments and during the five years preceding the repayment of any instalment of debt, its contribution to own funds is written down on a straight line basis; or
- (2) where the debt repayment schedule is of equal annual, semi annual, or quarterly instalments over the last three to five years of the debt term, the amounts which may be counted as own funds during the last five years of its term are calculated

by multiplying the principal debt outstanding by the residual term outstanding, and dividing the result by five.

Early Repayment

2.8.7 G There should be no provision allowing early repayment of the debt other than in the event of approval being granted by the FSA. Only a society or its successor may request this approval for repayment.

2.8.8 G Early repayment should not be capable of being triggered by performance conditions, cross-default clauses, negative pledges, or by mergers, or transfers - in circumstances where the FSA gives a direction under section 42 B (1), (3) or (4) of the 1986 Act.

2.8.9 G However, the loan terms may require the borrower to consult the lender(s) and/or trustee about partial transfers of engagements, or transfer of business where the lender(s) or trustee is not satisfied that the successor company will keep its authorisation under the Act.

2.8.10 G The terms may also provide for certain events of default which would allow the lender or his trustee to require early repayment of the loan but only in a winding up/dissolution of a society or in a winding up of its successor. The permitted events of default should be restricted to:

- (1) the commencement of the winding up of the society or its successor;
- (2) the commencement of the dissolution of a society where it is dissolved otherwise than by virtue of any one or more of sections 93(5), 94(10) or 97(9) and 97(10) of the 1986 Act;
- (3) the cancellation of a society's registration under the 1986 Act otherwise than under section 103 (1)(a) of the 1986 Act.

2.8.11 G The FSA would consider any request for early repayment in the light of the projected capital position of the society if repayment were allowed. Approval would only be given where the FSA was satisfied that the society's capital would remain adequate after repayment for the society's existing and proposed business.

2.9 Notification to the FSA

2.9.1 G It is the responsibility of the society's board to satisfy itself that the terms of issue (which include the relevant sections of the society's rules) meet the guidance in this chapter and the 1986 Act: this would normally be on the basis of specialist legal advice. Before including any issued capital in a society's calculation of its solvency ratio for capital adequacy purposes the FSA expects to receive from the society:

- (1) evidence, usually in the form of a certified board minute, that the board has considered the specialist legal advice provided to the society, and that the board is satisfied that the society has the power to make the issue and that the issue will meet the guidance in this chapter;
- (2) a copy of the legal opinion provided to the society which should cover at least the following points:
 - (a) that the society has the power to make the issue (having made the necessary amendments to rules, etc.);
 - (b) that any terms not contained within the society's rules are consistent with the rules;
 - (c) that the terms of the issue (including the terms within the society's rules) comply with the guidance set out in this chapter.

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3 BOARDS AND MANAGEMENT

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3 Boards and Management

3.1 Introduction

3.1.1 G This chapter replaces PN 1998/3 (Boards and Management) and PN 1992/2 (New Business Developments and New Initiatives) published by the Commission. It provides additional guidance for building societies supplemental to other FSA rules and guidance in this area, especially the FSA Statements of Principle for Approved Persons and the Code of Practice (see APER) and the rules and guidance on senior management arrangements (see SYSC).

3.1.2 G It also provides additional guidance on the provisions of Part VII (Management of Building Societies) of the 1986 Act.

3.1.3 G Building societies have a particular constitutional form not shared by the generality of deposit-taking firms regulated by the FSA. They are mutual institutions run for the benefit of their members (i.e. their borrowers and savers). This mutual structure means that a society cannot be owned or controlled by an outside institution or major shareholders. Society boards and management have a special responsibility to protect the interests of their customers through the highest standards of corporate governance.

3.2 Corporate Governance

3.2.1 G As for all firms, the FSA regards the board and senior management as the focus for the accountability of the society for the conduct of its business. Accordingly, the FSA will take into account its assessment of the standards of governance, and board and management competence (relative to the nature, scale and complexity of the society's business), in setting the society's threshold solvency ratio.

3.2.2 G Although societies are not publicly quoted, they should have regard to the Combined Code, developed by the Committee on Corporate Governance for listed companies, when establishing and reviewing their own corporate governance arrangements. A sample Code of Governance is attached as Annex 3A, which is a version of the Combined

Code, adapted for the particular circumstances of building societies. Societies are encouraged to adopt this code to apply principles of good governance practice within their business.

3.3 Fit and Proper

3.3.1 G As set out in SUP, all directors of building societies, including non-executives, will be Approved Persons and thus are expected to meet the “fit and proper” criteria and comply with the Principles for Approved Persons and the Code of Practice.

3.3.2 G Under section 60 of the 1986 Act, directors of building societies are elected by the members, and subsection (4) makes clear that, subject to certain conditions, any natural person is eligible to be elected a director. (Subsection (4A) however provides that a person subject to a prohibition order under section 56(2) of the Act is not eligible.) Members have the right under a society’s rules to nominate candidates and the FSA has no power to intervene in elections for board directors. Where members nominate a candidate, in the FSA’s view it is not open to the board to refuse to accept a candidate’s nomination on the grounds that, in the board’s view, he (or she) is not fit and proper (except, of course, in the limited circumstances of a prohibition order being in force in relation to that person). However, the board should, prior to the election, take such steps as are practicably open to it to establish whether there are any matters concerning the candidate’s fitness and propriety of which the members should be aware in advance of the election. If there are such matters, the board should bring them to the attention of the members. The FSA will not vet candidates for election.

3.3.3 G On election, all directors, whether recommended by the board or nominated by members, have the same status. The FSA would, in the exercise of its responsibilities under the Act concerning the regulation of Approved Persons, apply the requirements for approval equally to all directors upon election (i.e. before the elected individuals can take up controlled functions).

3.4 Other requirements and guidance

3.4.1 G Part VII of the 1986 Act contains requirements relating to the management of building societies. This section contains further guidance on this Part of the 1986 Act and

sets out some factors the FSA will take into account in assessing the adequacy of a society's board and management arrangements for the purposes of setting its threshold solvency ratio.

3.4.2 G Section 58(2) of the 1986 Act requires each building society to have a chairman and this person plays a key role in the strategic direction of the society. The chairman should not have any executive post in the society. This assists in the separation of strategic direction from the day to day running of the business and helps the chairman take an independent view of management performance. It also protects against undue concentration of power.

3.4.3 G Given the mutual status of building societies, a clear majority of directors on a society's board should be non-executive. The appropriate ratio of non-executives to executives will vary with the scale, nature and complexity of the society's business. The board should have an appropriate range of skills and experience to control and direct the society's activities effectively. The composition of the board should be reviewed at regular intervals.

3.4.4 G It will rarely be appropriate or desirable for a chief executive or other executive director to remain as a non-executive board member after his or her retirement.

3.4.5 G The composition of a board should change progressively over time in a planned manner. As societies increasingly innovate in their mainstream business and use wider powers, so they should recognise the need to enhance their overall board and management resources and expertise accordingly. Non-executive directors should not be given the expectation that they will remain on the board, automatically standing for re-election every 3 years, until the retirement age in the society's rules. They should serve for fixed terms, both initially and for any subsequent term.

3.4.6 G Each society is required by section 59(1) of the 1986 Act to have a chief executive. The chief executive plays a key role in the running of the society and has specific responsibilities in SYSC. He or she should be a member of the board.

3.4.7 G Smaller societies may not need as many executives on the board as larger societies, but every society should have at least one executive director on the board.

3.4.8 G Where executives are appointed under formal service contracts, the board should consider carefully the terms of such contracts. It should have regard not only to the need to

attract or retain executives but also to the need to preserve the board's freedom, considering the potential associated costs, to make a change if circumstances so require. A board should consider in particular the period of notice the society must give and the potential liability to the society if it wishes to terminate the contract otherwise than on grounds of misconduct. The objective should be for notice or contract periods to be one year or less.

3.4.9 G Societies are required under the Accounts Regulations to give particulars of the service contracts of directors and chief executives in their annual Report and Accounts. Where there are no such service contracts in existence, societies should say so.

3.4.10 G Each society is required by section 59(2) of the 1986 Act to have a secretary. The secretary plays a key role within the society, with the responsibility of a company secretary to ensure that board procedures are followed and regularly reviewed and to provide guidance on the board's responsibilities and how they should be discharged.

3.4.11 G In assessing the adequacy of society's corporate governance arrangements, the FSA will consider whether the society has established committees of the board appropriate to the scale and nature of its business. Such committees should include at least an audit committee (see Chapter 9 Systems) and may also include an asset and liability committee (ALCO) and a remuneration committee.

3.4.12 G Paragraphs 15.3.7 to 15.3.10 of SUP give guidance on how the FSA will assess compliance with Principle 11 ("A firm must deal with its regulators in an open and co-operative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice"). They indicate that firms should notify the FSA of any "proposed restructuring, reorganisation or business expansion which could have a significant impact on the firm's risk profile or resources". A society entering a new area of activity should ensure that it has appropriate board and management skills properly to manage and control that activity. It is for boards to satisfy themselves on the commercial aspects of any such new venture and to be satisfied that such a venture will not put the society at undue risk, that capital remains adequate and that adequate systems of control have been established.

3.5 Dealings with Directors

3.5.1 G Dealings with directors (and other officers) of societies are subject to restrictions contained in Part VII of the 1986 Act. These include limitations on specified financial transactions, requirements for directors to disclose their interests in any existing or proposed contracts, and the requirement for permitted dealings to be reported. The requirements are concerned with issues of particular sensitivity to a society and its members. In view of this, and the risk of damage to a society's reputation, the board should satisfy itself that there are written procedures and controls in place to ensure compliance with statutory requirements for dealings with directors.

Loans to Directors

3.5.2 G Section 65 of the 1986 Act places restrictions on the loans societies can make to directors or connected persons (as defined in the 1986 Act). Given this, it would be inappropriate for a society simply to follow its usual loan procedures when a loan application is made by a director or a person connected with a director. The responsibility for approving such loans should not rest with staff members, even if the loan could otherwise be decided within staff mandates. A board should ensure that the society has written procedures for dealing with loan applications from directors or persons connected with them and that all directors are familiar with such procedures. They should include consideration by the board or a board committee before approval and should require a review of the proposed terms of a loan, including legal advice, if necessary, to ensure that the loan is allowed by the 1986 Act. Such transactions should take place at arm's length. There should be written procedures to identify applications for director-connected loans.

3.6 Reporting Requirements

3.6.1 G The Accounts Regulations set out specific legal and regulatory requirements about the form and content of the annual report and accounts, summary financial statements, etc., that societies and their directors must produce. A board should present to the members an assessment of the society's position which is balanced (that is, setbacks should be reported as well as successes) and understandable.

3.6.2 G A key principle behind the requirements in the Accounts Regulations is that the members of a society should be given additional disclosure in the annual report and accounts about the interests in the society of directors, the chief executive (on the matter of service contracts) and other officers (on the matter of options to subscribe for share or debentures). The reporting requirements in the Accounts Regulations accordingly include individual directors' remuneration, particulars of service contracts for the directors and chief executive, additional retirement benefits to current and past directors and interests in shares or debentures of connected undertakings. In the interests of transparency, societies should say in their annual report whether they adhere to the sample code of governance in Annex 3A and, if not, in what respects.

Sample Code of Governance

3A.1 G This sample Code of Governance is an adapted version of the Combined Code, which is considered suitable for building societies.

The board

3A.2 G The board should have procedures to ensure that due consideration is given before the appointment of any director or manager to whether the candidate is fit and proper.

3A.3 G The chairman of a building society should not have any executive post in the society.

3A.4 G All directors should bring an independent judgement to bear on issues of strategy, performance, resources (including key appointments) and standards of conduct.

3A.5 G A board should review its composition at appropriate intervals or when considering a major new activity.

3A.6 G A clear majority of directors on a society board should be non-executive.

3A.7 G A society should have at least one executive director on the board.

3A.8 G A non-executive director should serve for specified initial and subsequent terms (if any). Towards the end of each term the board should review whether to recommend re-election.

3A.9 G The chief executive should be a member of the board.

Executive Directors and Other Executives

3A.10 G The terms of an executive's service contract should reflect a reasonable balance between attracting or retaining executives of the requisite calibre and preserving the board's freedom to make a change. The objective should be for notice or contract periods to be one year or less.

Board Procedures

3A.11 G A board should establish a remuneration committee, consisting only of non-executive directors, to develop a general policy, and to make recommendations, on the pay of executive directors.

3A.12 G A board should establish an audit committee of non-executive directors consisting of at least three members.

3A.13 G It is a board's responsibility to ensure that an objective and professional relationship is maintained with the external auditors.

3A.14 G A board should ensure that the society has specific written procedures for the consideration of loan applications by directors or persons connected with them and that all directors are familiar with these procedures.

3A.15 G If a director or any person connected with a director participates in an existing share option scheme, that director should not be allowed to vote on, or to use any discussion to promote, any transaction (such as sale of a subsidiary undertaking) under which that director or connected person would benefit financially.

3A.16 G A board should have a procedure that enables individual directors to obtain independent professional advice at the society's expense for the furtherance of their duties.

3A.17 G Each director should have access to the advice and services of the secretary and any separately appointed compliance officer(s).

Reporting

3A.18 G A board should present a balanced and understandable assessment of the society's position to the members.

3A.19 G Directors should explain their responsibility for preparing the accounts next to a statement by the external auditors about their reporting responsibilities.

3A.20 G Directors should (if it be the case) report that the society is a going concern, with supporting assumptions or qualifications as necessary.

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4 FINANCIAL RISK MANAGEMENT

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4.1 Introduction

4.1.1 G This chapter replaces PN 1998/4, issued by the Commission, and contains rules and guidance for societies on financial risk management, a key part of compliance with Principle 3 (“a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems”).

4.1.2 G This chapter describes the key financial risks to which societies are exposed, explains the statutory restrictions on funding, market making, trading and use of derivative instruments, sets out the framework within which the FSA will supervise the treasury activities of societies, including details of the five “approach” categories (Administered, Matched, Extended, Comprehensive and Trading) applied, and emphasises the respective responsibilities of boards and management for monitoring and controlling financial risks. (Unless otherwise explicitly stated, references in this chapter to “societies” are to society groups, consolidated to include all subsidiary undertakings.)

4.2. Rules

4.2.1 R A society must have an adequate system for managing and containing financial risks to the net worth of its business, and risks to its net income, whether arising from fluctuations in interest or exchange rates or from other factors.

4.2.2 G Societies should have systems and procedures for identifying, monitoring and controlling all material maturity mismatch, interest rate, foreign exchange and similar (e.g. index related) risks, and for reporting exposures to senior management and the board on a regular, and timely, basis. Societies should also have interest margin management systems in place to estimate the expected profitability of new mortgage and savings products, and to project forward the cumulative effect of mortgage incentives and loyalty schemes.

4.2.3 G Societies should have credit limits in place for all counterparties both for placing liquidity and for transacting derivative contracts (further guidance also in Chapter 5 (Liquidity)).

4.2.4 G Societies’ boards should ensure that there are adequate internal controls in place covering

all treasury activities, including appropriate segregation of duties between initiation of a transaction and confirmation/settlement/ accounting for it, such controls to be the subject of regular review by internal auditors with the requisite skills and experience.

4.2.5 R A society must maintain, and submit to the FSA, a board-approved policy statement on financial risk management.

4.2.6 R A society making any significant change to its policy statement on financial risk management must provide the FSA with a copy of the amended statement as soon as possible after it has been adopted.

4.2.7 G Boards have ultimate responsibility for understanding and controlling the degree of risk, by type, which is being taken by their societies. They should approve the general business strategies, including the treasury section of the society's corporate plan, and the risk management policies that control the extent of risk which is taken, and should give clear guidance on the level of risk considered to be acceptable – such strategies and guidance to be reviewed regularly by the board.

4.2.8 G The policy statement establishes guidelines for the society's senior managers on the control of financial risks, including: operational risk; structural risk; funding risk; and counterparty credit (including settlement) risk. Such documents should be consistent with the type of business undertaken by the society and compliant with sections 7 and 9A of the 1986 Act.

4.2.9 G Policy statements should set out the strategic framework for treasury operations, recording the rationale for that framework i.e. why and how treasury activities are expected to support the society's core business, and the "approach" category being followed, derived, where possible, from the results of a financial risk audit. They should clearly state the conditions under which authority is delegated to a board sub-committee, or to management. The documents should establish the operating limits and high level controls that will maintain exposures within levels consistent with the policy, and the procedures/controls on the introduction of new products or activities. Copies of the policy statements should be made available to, and read by, all personnel involved in treasury operations.

4.3 Financial risks

Funding risks

4.3.1 G Building societies' current core business, financing long-term residential mortgages with short-term personal savings, necessarily involves a high degree of maturity transformation, and this constitutes the major financial risk that all societies need to manage.

4.3.2 G Wholesale deposit funding, available from a range of sources, provides a useful supplement to the stocks, and inflows, of personal savings. Wholesale markets typically provide funding at longer and/or more definite maturity, often at advantageous rates, but may concentrate the refinancing risks societies face.

4.3.3 G The particular constitution of building societies means that the scale of deposit funding has a significant impact on the position of investor members. The public perceives building society share accounts to be as secure as (or even more secure than) bank deposits. However, unlike depositors with banks, share account investors are contributories, not creditors, so they rank after deposit funders, including suppliers of wholesale funding. A society which gears itself up significantly with wholesale funds thereby dilutes the security of its share account investors, whilst at the same time increasing its refinancing and liquidity risks.

4.3.4 G Guidance on the management of short-term cashflow mismatches, and the liquidity requirements which flow from such positions, is given in Chapter 5 (Liquidity). Risks arising from the interest basis/structure or currency of the funding are covered later in this chapter.

Structural risks

4.3.5 G Most societies are susceptible to interest rate exposure arising not only as a result of changes (or potential changes) in the general level of interest rates or the relationship between short term and long term rates, but also from divergence of rates for different balance sheet elements ("basis" risk), for example, the risk that it may not be possible to increase administered mortgage rates in line with increases in money market (LIBOR) rates, resulting in a margin squeeze where

funding is LIBOR-based. In this chapter, risks which arise from the different interest rate or currency characteristics of assets and liabilities, and from transactions based on other financial reference rates or indices, are referred to as “structural” risks.

Operational risks

4.3.6 G The extension of building society activities into new forms of funding, liquidity and off balance sheet instruments has dramatically increased the operational risks involved. The documentation, accounting treatment and settlement procedures for such instruments can be highly complex, with significant costs and penalties arising from operational mistakes. Societies involved in these areas of activity need rigorous management procedures and control systems to ensure that robust legal documentation is used, that compliance with market practice is achieved, and that deal recording and settlement systems are effective (with appropriate contingency arrangements in place).

Key risk categories

4.3.7 G The key financial risks which, in order to comply with Rule 4.2.1, societies should manage and control are:

- (1) Maturity mismatch, including the risks:
 - (a) that the society may be unable to refinance term wholesale borrowings on a rollover date due to general market conditions (which may or may not be related to the position of the society itself);
 - (b) associated with the bunching of roll-over dates for wholesale funding or maturities of term retail funding;
 - (c) from concentration on a limited number of funding providers, giving rise to increased dependence particularly on roll-over days; and
 - (d) arising from the prepayment (early redemption) profile of mortgages, and

those inherent in the early withdrawal characteristics of retail savings products (i.e. behavioural v. contractual maturity risks);

(2) Interest rate risk to a society's earnings (most significantly, to its interest margin) and to its economic value (the present value of future cashflows) arising from:

- (a) repricing mismatches, e.g. where, in a rising interest rate environment, liabilities reprice earlier than the assets which they are funding, or, in a falling rate environment, assets reprice earlier than the liabilities funding them (in both cases leaving the society with a reduction in future income); repricing risk is inherent in fixed rate instruments, the market value of which will change with interest rate movements (e.g. Gilts), and unhedged fixed rate retail products (e.g. unhedged fixed rate mortgages funded by variable rate liabilities would yield less margin should the cost of the liabilities increase due to changes in market rates);
- (b) yield curve risk, where unanticipated changes to the shape or slope of the yield curve will cause assets and liabilities to reprice relative to each other - possibly exposing positions which were hedged against a parallel shift in rates only;
- (c) interest basis mismatches, arising from the imperfect correlation of rates on instruments with similar repricing characteristics, e.g. between LIBOR rates and mortgage rates (both of which are variable but are subject to different market forces), or between LIBOR and reference Gilt rates, or between 3 and 12 month LIBOR rates etc. Risk can also arise where the underlying market rate is the same for matching assets and liabilities, but the margin paid relative to the offer rate diverges from the margin received relative to the bid rate;
- (d) balance sheet composition, where an increase in the proportion of assets and liabilities repricing at fixed or variable wholesale market rates implies a

reduced administered rate element in the balance sheet - which will nevertheless have to bear (at least in the short term) the full brunt of any rate changes required in order for a society to widen its margins, if necessary for business or profitability reasons (e.g. in the event of a significant credit deterioration leading to rising provision levels);

- (e) optionality (i.e. explicit/contracted option contracts, such as “caps”, “collars” and “floors”, which confer the right, but not the obligation, to fix an interest rate for an agreed amount and for an agreed period. and embedded/implied options included within products, such as early withdrawal or redemption entitlements), magnifying the effect of other interest rate risks: in particular, societies may be subject to implied optionality in respect of retail savings rates (for which a minimum rate payable - a “floor” - above 0% may need to be assumed), and from prepayment of mortgages/pre-withdrawal of deposits (where the customer may effectively have an “option” which may not be adequately “hedged” by way of early redemption charges); and
 - (f) product pricing, arising particularly where products are not immediately profitable and where longer term payback is dependent upon the achievement of specific cost and/or pricing assumptions.
- (3) Currency risk, arising from the effects of changing exchange rates on unmatched assets and liabilities denominated in different currencies; and
 - (4) Index related risk, arising from the effects of movements in an index of financial assets (e.g. the FTSE 100), or similar reference rate, on unmatched assets or liabilities paying or receiving a return based on that index/rate.

4.3.8 G Societies’ financial risk management policies should also cover:

- (1) Settlement risk: the risk of losses arising from failure to settle transactions accurately, or on a timely basis;

- (2) Counterparty risk: associated with settlement risk, where a counterparty cannot or will not complete a transaction;
- (3) Investment risk: associated with the financial consequences of capital projects including diversification investments; and
- (4) Operational risk: including failure of internal controls or procedures, and the risk arising from errors in legal documentation.

4.4 Statutory restrictions

Funding limit

4.4.1 G Section 7 of the 1986 Act provides that at least 50% of the funds (excluding those qualifying as own funds) of a building society (or, if appropriate, of the society's group) must be raised in the form of shares held by individual members of the society (excluding share accounts held by individuals as bare trustees for corporate bodies).

Structural risk management restrictions

4.4.2 G Section 9A prohibits a society or its subsidiary undertakings (subject to certain defined exemptions) from:

- (1) acting as a market maker in securities, commodities, or currencies;
- (2) trading in commodities or currencies; or
- (3) entering into any transactions involving derivative investments.

4.4.3 G Section 9A contains definitions of the above terms, and societies are directed particularly to section 9A(9) for the purposes of compliance monitoring.

4.4.4 G Section 9A also includes a “purpose” test for entering into derivatives contracts and a “safe harbour” clause for society counterparties stating that any transaction in contravention of the section 9A prohibitions is not, however, thereby invalid and may be enforced against the society.

4.4.5 G The exemptions in section 9A fall into two broad categories:

- (1) those which allow a society or subsidiary undertaking to provide certain retail services to its customers, including:
 - (a) acting as market maker in currency or securities transactions of less than £100,000;
 - (b) trading in currencies (but not commodities) up to a value of £100,000 per transaction;
 - (c) entering into “contracts for differences” in respect of customers who wish to hedge exposures arising from their own loans or deposits with, the society group; or
 - (d) acting as market maker or entering into “derivative investments” in its capacity as manager of a collective investment scheme; and
- (2) those which allow a society or subsidiary undertaking to use “derivative investments” in order to limit the extent to which it, or a connected undertaking, will be affected by changes in interest rates, exchange rates, any index of retail prices, any index of residential property prices, any index of the prices of securities, or the creditworthiness of any borrower(s).

4.4.6 G The Treasury may, by negative resolution order, amend the £100,000 transaction limit and may add factors to, or remove factors from, the list in 4.4.5(2) above. The Treasury may, by affirmative resolution order, make more significant amendments to section 9A.

4.4.7 G Boards should have procedures and controls to ensure that use of section 9A exemptions by their society (and subsidiary undertakings, if any) is within the law. The exemptions permitting transactions of up to £100,000 (as market-maker in currency or securities transactions, or trading currencies) may not be abused by artificially breaking up larger transactions into a number of smaller amounts falling within the £100,000 ceiling (section 9A(8) is the relevant anti-avoidance provision). Compliance with the 1986 Act may be assisted by specifying the purposes and circumstances in which hedging transactions may be undertaken, or derivatives used, both in the financial risk management policy documents and in the internal arrangements for delegation, identifying the specific authority in section 9A. Whatever the hedging policies adopted, and however the control and authorisation arrangements are organised, it is important that they should be accurately and fully documented.

4.5 Supervisory approach

Funding limits

4.5.1 G Whilst the section 7 funding limit is expressed as a minimum of 50% share account funding, societies should, for prudential monitoring purposes, draw up a funding policy which incorporates an internal policy limit based on a maximum level of deposit liabilities (i.e. an inversion of the “nature limit”). In order to avoid any possibility of an inadvertent breach of the 1986 Act, it is expected that such internal limits will be set at levels below the 50% statutory maximum.

4.5.2 G In setting funding limits, the board should consider wholesale and other deposit funding requirements over the period of their society’s current corporate plan, and avoid setting limits at levels where usage is either unplanned or highly unlikely. Where societies have significant levels of offshore deposit funding or commercial deposit funding, boards should set policy sub-limits for these sources (e.g., a society might set an overall deposit liabilities limit of 30%, with sub-limits of 25% for wholesale funding and 10% for offshore funding - the total of the sub-limits exceeding the overall limit only on the basis that both could not be used to their full extent simultaneously).

Supervisory standards for treasury activities

4.5.3 G Under section 5 of the 1986 Act, a society's principal purpose is residential mortgage lending, financed by members' savings, not undertaking, and trading in, financial risk for profit. Societies should therefore adopt a risk-averse approach to maturity mismatch and to structural risk management. A degree of maturity mismatch and structural risk is inherent in normal building society operations, but boards should set risk limits which either:

- (1) ensure that, as far as possible, such exposures are minimised; or
- (2) where interest rate positions are to be taken, restrict potential reductions in income or economic value, estimated under robust stress testing scenarios, to levels which would not compromise the current or future viability of their societies.

4.5.4 G Societies should aim to eliminate, as far as is practicable, all exposures to risk arising from movements in currency exchange rates.

4.5.5 G To comply with rule 4.2.1, a society's system for financial risk management must be **adequate**. The policy statement required under rule 4.2.5 must be appropriate for the society's business needs and the complexity of its existing and proposed treasury activities. The FSA has devised five models, described as supervisory approaches, of increasing sophistication, to assist societies to comply with these rules. The approaches are described as "administered", "matched", "extended", "comprehensive" and "trading". A society that conducts its treasury activities in accordance with the most suitable (for it) of these five models, can readily demonstrate that it complies with rules 4.2.1 and 4.2.5. But these models are neither mandatory nor exhaustive. Guidance on the characteristics of each approach is set out in Annex 4A.

Supervisory discussions on change of approach

4.5.6 G The FSA anticipates that societies will wish to develop further their treasury expertise, and that a change of "approach" may be necessary. In this respect, the "approach" categories should be seen, not as discrete compartments, but rather as stages in the continuous evolution of financial

risk management, with a change of “approach” marking a milestone in that progress. Societies should develop their financial risk management and systems to the level appropriate to support the scale and nature of their business and the FSA will be encouraging societies to enhance their treasury capabilities where this is considered to be necessary.

4.5.7 G Whilst the “approach” benchmarks have no legal significance, the process of moving between approaches provides a useful opportunity for the FSA to review a society's progress, and to satisfy itself that policies, limits and systems are appropriate for the treasury activities planned, and that therefore compliance with rule 4.2.1 is adequately established.

4.5.8 G Any society which wishes to move between approaches should contact the FSA at an early stage. The FSA will wish to be satisfied that the society has the requisite expertise, management information systems, accounting systems and controls before any significant change in the society's treasury activities is implemented.

4.6 Management responsibilities

4.6.1 G Senior management of a society are responsible for:

- (1) ensuring that board policies for managing treasury risk are implemented through the operation of effective:
 - (a) control procedures;
 - (b) risk measurement systems; and
 - (c) risk reporting systems; and
- (2) maintaining clear lines of authority and responsibility for controlling treasury risk, including:
 - (a) recruitment of sufficient personnel (including ensuring adequate cover for sickness and holidays) with appropriate specialist skills and expertise to control and monitor structural risk;

- (b) setting and monitoring appropriate control limits within the board policy levels delegated; and
- (c) maintaining effective internal controls through daily monitoring of treasury activities, and appropriate segregation of duties.

4.7 Risk management systems

4.7.1 G In order to demonstrate compliance with rule 4.2.1, a society should have in place information systems that are capable of:

- (1) measuring the level of maturity mismatch and structural risk inherent in its balance sheet;
- (2) assessing the potential impact of interest rate (and, if applicable, currency exchange rate) changes on its earnings and its economic value;
- (3) reporting accurately, and promptly, on risk positions - to management, to the board and, if requested, to the FSA;
- (4) recording accurately, and on a timely basis, all new transactions and/or cashflows which will affect calculations of structural risk exposures;
- (5) managing the settlement timetable and processes for individual treasury instruments; and
- (6) monitoring credit risk and settlement risk positions incurred with individual and groups of counterparties.

4.7.2 G The scale and scope of the risk measurement system employed should reflect the sophistication of a society's treasury operations, those societies wishing to adopt the

“Comprehensive” or “Trading” approaches requiring more complex techniques to capture different facets of risk.

Control limits

4.7.3 G Control limits confine structural risk positions within levels considered by board and management to be prudent, given the size, complexity and capital needs of the society’s business. Where applicable, limits should also be applied to individual instrument types, asset/liability portfolios, and to separate business activities or subsidiaries. The size of the limits set will be a factor in the FSA’s assessment of the overall risk profile of the society, and thus in the threshold solvency ratio which is set for it.

4.7.4 G The structure of limits should enable the board and management to monitor actual levels of sensitivity, under different pre-defined market index, interest rate and exchange rate scenarios, against the policy specified maxima, to ensure that corrective action can be taken if required.

4.7.5 G The number and type of limits which should be applied will depend upon the relative sophistication of a society’s treasury operations, and further guidance on the FSA’s expectations for each policy approach is set out in Annex 4A.

4.7.6 G Where limits are set as part of the overall board policy, these should be treated as absolute, and therefore no excesses should be tolerated. Any limit exceptions should be reported immediately to executive managers, and the policy should make clear what action is expected of management in such circumstances (including arrangements for informing the board and the FSA of the breach). Limits set by management should similarly be subject to clear guidelines covering the circumstances and periods for which breaches may be permitted (if at all) and the arrangements for notification of exceptions.

Stress testing

4.7.7 G The risk measurement systems put in place should evaluate the impact, on income or economic value as appropriate, of abnormal market conditions. The amount and type of such stress

testing required will depend upon the sophistication of treasury operations undertaken, and the level of risk taken, but where required should be regular and systematic. Boards and management should, periodically, review the extent of such stress testing to ensure that any “worst case” scenarios remain valid. Contingency plans should be in place to deal with the consequences should such scenarios become reality.

Board information reporting

4.7.8 G The FSA attaches considerable importance to the quality, timeliness, and frequency of the management information which the board uses to inform itself of the society's risk positions and to satisfy itself that treasury activities are being undertaken in accordance with its policies and guidelines. Information obtained by the board should not be confined to the current position, but should include regular and systematic stress testing, as described above, which should be taken into account when policies and limits are established or reviewed.

4.8 Counterparty risk

4.8.1 G Counterparty limits should cover:

- (1) full risk exposures (e.g. deposits or marketable instruments);
- (2) market risk exposures (e.g. mark to market positive value of swaps, plus appropriate addition for potential future exposure increases arising from changes in market rates);
and
- (3) settlement risk exposures (e.g. currency deals where amounts are paid out before funds are received).

4.8.2 G Boards should determine the extent to which authority to set counterparty limits is delegated to management, but delegation to a single individual should not be permitted. Personnel with dealing mandates should not be given authority to set new or increased counterparty limits. No dealings should take place with counterparties which do not have a pre-approved limit.

4.8.3 G Limits should be established on the basis of a robust methodology, which should be fully documented and reviewed regularly. For societies with more active treasury operations, a separate credit risk committee with responsibility for preparing a credit policy statement and counterparty list may be appropriate - less active societies may incorporate a section on credit risk within their liquidity policy statements, with appropriate cross-references to other policy and procedures statements. In all cases, the counterparty list and individual limits should be subject to formal credit review at least annually, with interim arrangements in place to add, amend or remove limits as appropriate.

4.8.4 G Where reliance is placed on sources of information or opinion external to both the society and the counterparty (e.g. rating agencies), the nature of the source, and arrangements for ensuring that the information relied upon is kept up to date, should be made explicit in the credit risk policy document and in procedures manuals. Where ratings are reduced (or put on “watch” with “negative implications”), or where a society becomes aware of information on a counterparty which might affect its perceived creditworthiness, it should have systems for reviewing individual counterparty limits and, possibly, suspending/removing individual names from authorised lists in an expeditious manner. Arrangements for obtaining published information on counterparties should also be included in procedures manuals.

4.8.5 G Exposures to counterparties should be monitored on a consolidated basis, aggregating exposures of the society and any subsidiaries (where applicable), and setting total exposure limits for groups of connected counterparties (e.g. a commercial bank and its merchant bank subsidiary). Similarly, country, sector and market concentrations should be monitored continuously against agreed limits.

Large shareholdings and deposits

4.8.6 G Undue dependence on individual funding sources that account for a large proportion of a society’s overall liabilities will involve risk of liquidity problems should those funds be withdrawn or not be available for roll-over. These potential problems apply whether the funds in question are raised from the retail or the wholesale markets.

4.8.7 G A small society is relatively more exposed to this type of risk, and should consider the implications of concentration on individual shareholders or depositors when assessing its liquidity levels and need for committed facilities. In the management of large retail investment accounts, a society should normally avoid:

- (1) obtaining funding from a single shareholder or depositor which exceeds 1% of shares, deposits and loans; and
- (2) allowing the aggregate total of funding, from those single shareholders or depositors which individually represent more than one-quarter of 1% of shares, deposits and loans, to exceed 5% of shares, deposits and loans.

Committed facilities

4.8.8 G A society with high levels of maturing funding, or vulnerability to withdrawal of individual deposits, should consider arranging committed facilities (or to maintain higher than average levels of liquidity). In arranging committed facilities, a society should consider:

- (1) the credit standing and capacity of the provider of the facility;
- (2) the documented basis of the commitment (i.e. is it an unconditional commitment or a “best endeavours” arrangement); and
- (3) the cost/fee structure compared to alternatives.

In extreme cases, there remains a risk that a provider may renege on a contractual commitment to provide funding, or purport to rely on widely drawn “events of default” or “material adverse change” clauses, and face the legal consequences (if any) rather than lend money to a society in difficulties. Societies should not, therefore, become over reliant on committed facilities to plug short term cashflow difficulties.

4.9 Operational risk

General

4.9.1 G Treasury is an area which is particularly vulnerable to losses arising out of errors, fraud, or wilful override of controls in order to “trade out” of loss making positions.

Segregation of duties

4.9.2 G Societies should ensure that, for all transactions undertaken, separate individuals are responsible for agreeing the deal, for preparing settlement instructions and for authorising payments. Societies should aim to ensure that there is complete segregation of duties between:

- (1) dealers,
- (2) those responsible for confirming the deals with counterparties and making and receiving the payments resulting from the deals, and
- (3) those reconciling bank statements.

4.9.3 G In more active treasuries duties should be split between a “front office” (dealing and deal support), a “middle office” (risk management) - essential only for those societies with more complex treasury operations - and a “back office” (confirmation, and settlement), with accounting and payment functions carried out either by the back office, or by a separate finance department. Physical segregation of the dealers from the settlement staff, to ensure that the former have no access to post or fax facilities used for confirmations, should be in place where accommodation and numbers of staff permit.

Reporting lines

4.9.4 G Where treasury activity and personnel numbers are high enough to allow the creation of separate “front” and “back offices”, the reporting line for the latter should be independent of the

former, so as to ensure that no conflicts of interest arise at the next level of management.

4.9.5 G A society adopting the “Comprehensive” or “Trading” approach should ensure that its “middle office” risk management function has clearly defined duties, and reports structural risk exposures directly to senior management and the board. The risk function should be independent of the profit centres of the society.

Remuneration policy

4.9.6 G Whilst it is clearly important that societies should offer salary levels sufficient to attract treasury personnel with the required qualifications and experience, remuneration policies should not encourage individual risk taking at the society’s expense. In particular, bonus schemes for treasury staff should not be based on numbers of transactions or gross income targets.

IT security

4.9.7 G Reliance on computerised dealing, information, treasury management and risk assessment systems renders societies particularly vulnerable to software or hardware failure. In accordance with Chapter 9 (Systems), boards of societies should:

- (1) have in place tested contingency plans for business recovery in the event of unforeseen disaster;
- (2) ensure that treasury IT systems access, both physical and logical, is subject to robust security;
- (3) exercise strong control over the development and modification of treasury IT systems; and
- (4) involve internal audit in reviewing the development or modification of treasury IT systems.

4.10 Independent review and controls

Internal audit

4.10.1 G Each board should ensure that its society's internal audit department has the skills and resources available to undertake an audit of the treasury function. Internal audit should evaluate, on a continuing basis, the adequacy and integrity of the society's controls over maturity mismatch, over the level of structural risk taken and should assess the effectiveness of treasury management procedures.

4.10.2 G Societies with complex treasuries or lacking internal auditors with treasury expertise may outsource treasury audit to an audit firm with the appropriate expertise and experience. The work of outsourced internal audit should be fully integrated into the society's overall audit procedures and plans, with appropriate reporting lines into the audit committee. However, in order to avoid conflicts of interest, internal audit should not be contracted out to the society's own external auditors – even if the function were to be performed by a completely different branch of the audit firm (see also chapter 11 on Outsourcing).

External audit

4.10.3 G The FSA may commission reports on treasury systems from external auditors under section 166 of the Act or from other appropriate skilled persons, whenever a society seeks to broaden the scope of its treasury operations. Societies which move to the “Comprehensive” or “Trading” approaches should carry out a post-implementation review in conjunction with their external auditors or other professional advisers. The FSA may, from time to time, commission an external review of a society's treasury, procedures and controls, in order to satisfy the FSA that these remain adequate and appropriate.

4A.1 Supervisory approach categories

4A.1.1 G This Annex provides guidance on the five models, or supervisory approaches, to financial risk management described in paragraph 4.5.5G. Where societies have subsidiary treasury operations, it is expected that these will fall into the same approach category as that of the parent society. An outline description of each approach is set out below, and a table at the end of this Annex summarises the key features.

4A.2 “Administered” approach

4A.2.1 G Societies in this category are expected to have balance sheets where loan assets and funding liabilities are entirely in Sterling and predominantly (>95%) subject to administered rates. In general, it is anticipated that the “Administered” approach will:

- (1) tend to suit small or very small societies;
- (2) where balance sheet management is typically undertaken by the Chief Executive in conjunction with the board - existence of a specific finance function (and Finance Director) being unlikely.

4A.2.2 G Societies adopting this approach:

- (1) should not offer fixed rate products (defined as repricing more than one year and one day later than the current date) on either side on the balance sheet;
- (2) should have policies limiting the levels of deposit funding to less than 10% of share and deposit liabilities unless a higher limit of up to 35% has been discussed with the FSA to accommodate those societies who take significant commercial deposits but funding from the wholesale markets will be limited to 10% of share and deposit

liabilities;

- (3) will hold a simple range of liquid assets (whether counting as prudential liquidity or not), with marketable fixed rate instruments held only provided that these have a residual maturity of 5 years or less; and
- (4) should place no fixed rate time deposits having a maturity greater than 1 year.

4A.2.3 G Societies adopting the “Administered” approach do not need specific risk management reporting, but the market value of fixed rate investments with maturities of more than one year, as compared to their purchase price, will be monitored by the monthly monitoring returns.

4A.3 “Matched” approach

4A.3.1 G Societies adopting this approach should have balance sheets where assets and liabilities are entirely in Sterling and use hedging contracts (or internal matching of assets and liabilities with similar interest rate and maturity features) to neutralise the risk arising from loans or funding other than at administered rates, on a tranche by tranche, product by product basis. Characteristic of small to medium sized societies, with limited treasury skills or resources, typically the Chief Executive of such societies will be supported by a Finance Director or Finance Manager, and report direct to the board on treasury matters (or through a board sub-committee).

4A.3.2 G Societies adopting this approach should:

- (1) have in place policy statements covering the intention to offer fixed rate (i.e. >1 year to repricing date) products on one or both sides of the balance sheet;
- (2) set limits (as a % of total assets) for fixed rate loan assets and share or deposit liabilities, and for holdings of fixed rate liquid assets (whether counting as prudential liquidity or not);
- (3) set an overall limit for hedging transactions (nominal value of transactions %SDL);

and

- (4) have in place policies limiting the levels of deposit funding to less than 25% of share and deposit liabilities unless a higher limit of up to 35% has been discussed with the FSA to accommodate those societies who take significant commercial deposits but funding from the wholesale markets will be limited to 25% of share and deposit liabilities.

4A.3.3 G The policies of such societies can allow use of standard hedging products for transactions permitted by section 9A, e.g.:

- (1) swaps (including FTSE index swaps);
- (2) Forward Rate Agreements; and
- (3) plain vanilla over the counter (“OTC”) options such as swaptions, caps, collars and floors (options purchased only);

for the purpose only of matching individual products and within the exemptions permitted by section 9A - structural hedging of the whole balance sheet should not be permitted.

4A.3.4 G Risk management for such societies will be achieved internally through:

- (1) matching reports (detailing individual products and the hedging instruments associated with them); and
- (2) gap analysis - for gapping purposes, reserves will need to be treated as having no fixed repricing date, and gap limits should be set at the minimum level required to give flexibility in timing the hedges for individual mortgage and investment products, with some allowance for residual risks (those too small to be economic to hedge) and for holdings of fixed rate liquid assets. Basis risk should be minimised by setting cautious limits for fixed rate and market rate assets and liabilities.

4A.3.5 G Gap monitoring reports should be updated and considered by the board at least monthly. By implication, societies adopting this approach should not be taking an interest rate view for the purposes of determining a hedging strategy.

4A.4 “Extended” approach

4A.4.1 G The principal difference between the “Matched” and the “Extended” approaches lies in the capability to measure and hedge structural risk across the whole balance sheet, including reserves, rather than just hedging individual transactions. The approach will thus allow a society to allocate reserves to specific repricing bands representing a considered view of the characteristics of such reserves and/or the assets deemed to “represent” such reserves, or to manage interest rate gaps as part of a strategy for hedging the endowment effect of interest free reserves against adverse interest rate movements. Risk analysis should also enable it to position its balance sheet to take advantage of a particular interest view. Societies adopting this approach will have the capability to fund in currency and to hold a limited range of currency liquid assets (see Chapter 5, Liquidity), subject to aiming for elimination of all currency exchange mismatch, within an expected maximum limit of 2% of own funds.

4A.4.2 G As a result, a society adopting the “Extended” approach will:

- (1) adopt policies and systems to enable it to undertake the hedging of individual transactions within the context of an overall strategy for structural hedging, based on detailed analysis of its balance sheet; and
- (2) use the output of such analysis to enable it to position its balance sheet to take advantage of a particular interest view.

4A.4.3 G Management of interest risk for such societies will typically be controlled by the board acting through an Assets and Liabilities Committee (ALCO) or equivalent sub-committee, which will normally be responsible for agreeing any interest rate view. Reporting to the ALCO, there will typically be a Treasurer running a small treasury department with appropriate segregation between

dealing and settlement activities.

4A.4.4 G Hedging instruments available to be authorised by the board will be the same as for the “Matched” approach, with the addition of (as far as permitted by section 9A):

- (1) exchange traded futures/options and FTSE (or similar) OTC swaps/options (options to be purchased only); and
- (2) foreign exchange swaps and forward contracts, used to hedge currency funding.

4A.4.5 G Risk management systems should be based on:

- (1) full balance sheet gap analysis;
- (2) possibly supplemented by static simulation.

4A.4.6 G Gap limits could allow leeway for risk positions - to be controlled by sensitivity limits covering potential changes in both earnings and economic value.

4A.4.7 G Basis risk should be controlled through limits on the minimum levels of administered rate assets and liabilities, and limits on the extent of mismatch between LIBOR-based and administered rate balances.

4A.4.8 G Positions should be monitored internally by way of frequent updates (monthly minimum).

4A.5 “Comprehensive” approach

4A.5.1 G The principal differences between the “Extended” and the “Comprehensive” approaches lie in:

- (1) the depth and quality of the risk management systems put in place to monitor and control structural risk;

- (2) the frequency of analysis undertaken; and
- (3) the currencies in which treasury operations would be undertaken.

4A.5.2 G Like the “Extended” approach societies, “Comprehensive” approach societies will manage risk using a board/ALCO/Treasurer reporting structure, but the latter will typically subdivide the treasury department further with a separate “middle office” risk management function, segregated from “front office” (dealing) and “back office” (settlement/accounting).

4A.5.3 G Hedging instruments available for use under agreed board policy will include those for the “Extended” approach plus (as far as permitted by section 9A):

- (1) currency options.

4A.5.4 G Risk analysis should extend beyond static gap/static sensitivity analysis to:

- (1) dynamic simulation (projecting forward balance sheet elements and simulating the impact of different interest rate scenarios);
- (2) possibly duration (modified or dollar, reflecting the change in percentage or money value of positions for a given change in interest rates) for individual portfolio elements, or present value of a basis point move (PVBP) calculations, to highlight sensitivity to non-parallel shifts in the yield curve; and
- (3) possibly value at risk (VaR), using correlation/historic simulation and/or Monte Carlo simulation;

the impact on both earnings and economic value being assessed internally on a very regular basis.

4A.5.5 G Risk positions could reflect an interest view, subject to sensitivity limits set by board/ALCO and incorporating basis risk assessment/control. Foreign exchange mismatch (i.e.

exchange rate exposure) is expected to be limited to less than 2% own funds (within Capital Adequacy Directive de minimis levels).

4A.6 “Trading” approach

4A.6.1 G A category for those societies which wish to take advantage of the ability to trade in securities. Essentially, such societies will adopt the “Comprehensive” approach for the purpose of managing interest risk arising in their “banking books”, but with additional policies, financial instruments, systems and expertise for managing the market risks inherent in running separate “trading books”. Currency positions exceeding 2% of own funds are permitted, but are expected to be subject to overall board limits.

4A.6.2 G Such a society should control the additional market risks through a Market Risk Committee of the board and risk management systems should include complex portfolio management, option pricing and VaR models.

4A.6.3 G Societies adopting this approach will be subject to the Capital Adequacy Directive in respect of their trading books – see Chapter 1 (Solvency).

POLICY APPROACH	RISK MANAGEMENT	RISK ANALYSIS	HEDGING INSTRUMENTS	FUNDING	PRUDENTIAL & OTHER LIQUIDITY	LOAN ASSETS
ADMINISTERED	CE (+FD) & board Dealing/settlement segregation (minimum 2 persons)	None (But, if fixed rate liquid assets held, then mark to market value and sensitivity analysis required)	None	Sterling only Deposit Liabilities < 35%SDL No fixed rate (> 1 Year) provided that funds received from the wholesale market do not exceed 10% SDL	Sterling only No non-marketable > 1 Yr. No marketable > 5 Yrs	No fixed rate (1 Yr. +)
MATCHED	CE/FD (or FM), (ALCO) & board Dealing/settlement segregation (minimum 2 persons)	Matching report & Monthly (minimum) Gap analysis (Reserves NFR) - No structural hedging No Interest View Minimal limits (to cover residual balances + pipeline products only)	Interest rate & FTSE index Swaps/FRAs/ Caps/Collars/ Floors (purchase only)	Sterling only Deposit Liabilities <35%SDL provided that funds received from the wholesale market do not exceed 25% SDL	Sterling only	Limit on fixed rate (1 Yr. +)
EXTENDED	(CE)/FD/Treasurer + ALCO & board Treasury segregation (front office/back office)	Monthly (minimum) Static Gap (& Static Simulation) - Reserves hedged Interest view Sensitivity limits (earnings, economic value & basis risk)) No FX mismatch	Interest Rate & FTSE index Swaps/FRAs/ Caps/Collars/ Floors/Futures/FTSE Options (purchase only) FX Swaps/Forward Contracts Retail derivatives & FX contracts permitted.	Sterling + Currency Minimum level of administered rate liabilities	Sterling + Currency (limited range of currency instruments)	Minimum Level Of administered Rate Assets
COMPREHENSIVE	FD/Treasurer/Risk Manager + ALCO & board Treasury segregation (front office/middle office/back office)	Very frequent Gap (Reserves Hedged)+ Duration/ Simulation/ (VaR.) Sensitivity limits (earnings & economic value) Basis risk limits FX mismatch <2% Own Funds	Interest Rate & FTSE index Swaps/FRAs/ Caps/Collars/ Floors/Futures/FTSE Options Exotic Options FX Swaps/Forward Contracts/ Options Retail derivatives & FX contracts permitted.	Sterling + Currency	Sterling + Currency	Sterling + Currency
TRADING	FD/Treasurer/Risk Manager +/- Market Risk Committee/ ALCO & board Treasury segregation (front office/middle office/back office) + banking book/ trading book	Banking Book: Daily (minimum) Gap (Reserves Hedged)+ Duration/ Simulation/ (VaR) Trading Book: VaR - CAD capability	Interest Rate & FTSE index Swaps/FRAs/ Caps/Collars/ Floors/Futures/FTSE Options/ Exotic Options Retail derivatives/FX permitted. FX Swaps/Forward Contracts/ Options Equity Options	Sterling + Currency	Sterling + Currency	Sterling + Currency

Interim Prudential Sourcebook for Building Societies

5 LIQUIDITY

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5 Liquidity

5.1 Introduction

5.1.1 G This chapter replaces PN 1998/5 issued by the Commission and contains rules and guidance for societies on the management of liquidity. It contains guidance for societies on what is meant by “adequate resources” in the Threshold Condition set out in paragraph 4(1) of Schedule 6 to the Act – see also COND 2.4 - and in Principle 4, in respect of liquidity. The chapter explains the FSA’s approach to liquidity for building societies and provides guidance on factors the FSA will take into account in assessing whether a society meets the rules set out in section 5.2.

5.2 Rules

5.2.1 R A society must maintain adequate liquid resources, including prudential liquidity, appropriate to the scale and nature of its business to enable it to meet its obligations as they fall due.

5.2.2 G “Adequate liquid resources” means of such amount and composition as will at all times enable the society to meet its obligations as they fall due.

5.2.3 G “Prudential liquidity” has the meaning set out in paragraph 5.3.4. A list of assets suitable for inclusion in prudential liquidity is set out in Annex 5A.

- 5.2.4 E**
- (1) A society should keep at least 3.5%SDL in 8 day liquidity.**
 - (2) Contravention of 5.2.4(1) may be relied upon as tending to establish contravention of 5.2.1.**

5.2.5 G “SDL” is defined in paragraph 5.3.2.

5.2.6 G A list of assets acceptable as 8 day liquidity is set out in paragraph 5.4.3.

5.2.7 R A society must maintain, and submit to the FSA, a board-approved policy statement on liquidity.

5.2.8 G Guidance on the content of a liquidity policy statement is set out in paragraphs 5.6.2 to 5.6.4 and in Annex 5B.

5.2.9 R A society making any significant change to its policy statement on liquidity must provide the FSA with a copy of the amended policy statement as soon as possible after it has been adopted.

5.3 The Prudential Regime for Liquidity

5.3.1 G A building society specialises in long-term mortgage lending which is financed mainly by liabilities which are contractually short-term. This feature of societies' business creates maturity mismatches which can give rise to cash flow imbalances. To ensure that it can meet its obligations as they fall due, a society should therefore keep an appropriate amount and mix of liquidity to meet any sudden adverse cash flow; the level of liquidity held should be sufficient to maintain public confidence that the society can meet its commitments.

5.3.2 G The amount of liquid assets held by a society should be expressed as a percentage of its share and deposit liabilities (SDL). For the purposes of this chapter, SDL is defined as the total of share and deposit liabilities, excluding amounts that qualify as own funds but including accrued interest not yet payable. Societies should show the board-approved range for liquidity expressed as a percentage of SDL in their liquidity policy statement.

5.3.3 G Funds borrowed from the wholesale money markets have a specified maturity date on which they have to be repaid or rolled over and thus carry the risk that they will be unable to be refinanced on that maturity date on terms acceptable to the society. Societies should take this risk into account in planning the maturity profile of their prudential liquidity. The same

consideration applies to large positions in retail funds where, for example, fixed-rate bonds or Tessa accounts are due to mature. Societies should not run large exposed funding positions without having sufficient liquidity to re-finance part or all of the position on maturity. An effective maturity diary should be established for both funding and prudential liquidity.

5.3.4 G Liquid assets should be genuinely liquid i.e. they should be capable of being realised at very short notice. Only instruments or assets that are marketable (i.e. realisable in a secondary market) or have three months or less to run to maturity should (subject to the guidance in Annex 5A and in paragraph 5.5.2) be included in the calculation of liquidity for prudential purposes. Societies may hold other assets, but as an investment rather than liquidity (although such assets might still fall within the “liquid assets” heading in the annual accounts, which has no restriction on maturity). The treatment in the annual accounts determines whether an asset is a liquid asset for the purposes of calculating the society’s position in relation to the statutory limit in section 6 of the 1986 Act (the “lending limit”).

5.3.5 G Committed standby facilities form an important element of societies’ funding strategy and can be used to boost liquidity when needed. Societies should ensure that the lines are truly committed and that a diary is kept noting when the lines expire, allowing the facilities to be renewed on a timely basis. Societies not using committed standby facilities should increase their level of liquidity to compensate.

5.4 Short-term Liquidity

5.4.1 G The FSA operates a short-term liquidity regime for building societies from sight to 8 calendar days forward.

5.4.2 G An asset maturing on a non-business day should be regarded as maturing on the succeeding business day.

5.4.3 G The following liquid assets may be counted as short-term liquidity:

- (1) cash, current account balances, Treasury, Local Authority and eligible bank bills;

- (2) deposits with relevant authorities (as defined in Annex 1F), banks and building societies with not more than 8 days' notice, or within 8 days of maturity;
- (3) all gilt-edged securities, subject to discounting according to maturity (see paragraph 5.4.4);
- (4) CDs (banks and building societies) with 3 months or less to maturity, commercial paper with residual maturity up to 1 month.

5.4.4 G All gilt-edged securities can be included within 8 day liquidity, but discounted back to sight according to maturity. Such discounting should help to offset the greater price volatility which can affect gilts at the longer end of the maturity range. The discount factors which should be applied to market value of holdings of gilt-edged securities are as follows:

maturities	maturities	maturities
less than 1 year	1 to 5 years	over 5 years
Zero	5%	10%

5.4.5 G Societies on the “Administered” approach (as described in chapter 4 on Financial Risk Management) should not hold marketable fixed-rate instruments, including gilts, unless their residual maturity is 5 years or less. Where such societies have historic holdings of such investments, they may continue to be counted as prudential liquidity subject to the discount factor for gilt-edged securities.

5.4.6 G Societies with extensive treasury operations and large holdings of gilts will typically mark-to-market their gilt book daily. Societies with less sophisticated treasury operations which hold gilts as liquidity should mark-to-market their holdings at least once a week and more often during times of market volatility. Where such holdings are held as 8 day liquidity, market valuations should be taken daily to obtain an accurate value for purposes of discounting and to establish the amount of prudential liquidity at any given time.

5.4.7 G Societies should not include excessive amounts of inter-society holdings in their 8 day liquidity calculation. Societies should include sub-limits for the 8 day liquidity band within their overall sector limits in the liquidity policy statement.

5.5 Supervisory Approach to Liquidity

5.5.1 G Societies should adopt a risk-averse approach to the management of liquid assets. Societies should ensure that treasury systems and controls are adequate for the scale of activity undertaken and that treasury personnel have appropriate expertise and competence, including dealing, settlement and accounting skills. Chapter 4 suggests that dealings in certain categories of liquid assets should be confined to societies on an advanced approach to financial risk management.

5.5.2 G Annex 5A sets out the range of assets considered appropriate for societies to hold as prudential liquidity although each society should satisfy itself that any particular kind of asset is suitable to its needs. If a society wishes to hold an asset as prudential liquidity that is not listed in Annex 5A, it should consider the following factors:

- (1) the suitability of the asset for the structure of the society's balance sheet, taking into account, inter alia, interest rate risk and any currency risk;
- (2) the marketability of the asset i.e. the "depth" of its liquidity;
- (3) credit risk and market risk (price volatility);
- (4) the adequacy of the society's expertise and systems in the treasury area.

5.6 Board and Management Responsibilities

5.6.1 G Chapter 4 on Financial Risk Management refers to the potential risks to societies of treasury activities. In particular, the size and complexity of some transactions can make them vulnerable to losses and fraud, and the impact of losses on individual transactions in the treasury

area can be significant and immediate. Boards have ultimate responsibility for deciding the degree of risk taken by their societies, including all categories of liquid assets and risks arising from the management of liquidity.

5.6.2 G Rule 5.2.7 requires each society to have a liquidity policy statement. This should be approved by the society's board and be consistent with the society's strategic plan and its financial risk management policy statement.

5.6.3 G Policy statements should set out the board's objectives for liquidity, the limits within which liquidity should be maintained, the range of instruments in which liquidity can be invested and conditions under which authority is exercised. The document should establish the framework for operating limits and high level controls, and should set out the board's policy on credit assessment, ratings and exposure limits. Guidance on the content of liquidity policy statements is set out in Annex 5B.

5.6.4 G A liquidity policy statement should be a working document and personnel in the treasury and settlement areas should be familiar with its contents, as should members of ALCO or Finance Committee. When aspects of the policy or limits become out of date, the policy document should be amended and the revised copy must be sent to the FSA (see rule 5.2.9).

5.6.5 G Boards should establish the objectives for liquidity including meeting obligations as they fall due (including any unexpected adverse cash flow), smoothing out the effect of maturity mismatches and the maintenance of public confidence. The need to earn a return may also be recognised as an objective, although this should be secondary to the security of the assets.

5.6.6 G Boards should decide the principles of remuneration for treasury dealing staff. Large bonuses linked to dealing-related profit targets should be discouraged as they can lead to unacceptable risk-taking on the part of those involved at the expense of the society.

5.6.7 G Management should regularly review the liquid asset portfolio. Some categories of asset are more complex than others and their characteristics (which can involve how the assets are held as well as the assets themselves, for example, securities subject to repo/reverse repo transactions) need to be fully assessed in any review of the portfolio.

5.6.8 G Board policies should be implemented through the operation of effective procedures and controls, risk measurement and reporting systems; senior management should maintain clear lines of authority and responsibility; sufficient personnel with specialist skills - in the settlements as well as in the dealing area - should be recruited; senior managers should have sufficient understanding of treasury operations to be able to carry out their responsibilities without relying exclusively on advice from the treasury team; and delegation of authority should be fully documented in procedures manuals and closely monitored.

5.7 Society-only Approach to Liquidity

5.7.1 G Societies need not calculate liquidity on a group basis for prudential purposes. Each subsidiary undertaking will have its own liquidity requirements reflecting the particular nature of its business and it will not normally be appropriate to combine these with the parent society or with each other. Liquidity held offshore, for example, may be managed with a degree of autonomy and subject to the rules of another regulator. In either case, this can lead to a loss of control and there may be circumstances where liquid assets are not immediately callable overnight. Liquid assets which are held offshore or in a subsidiary undertaking (or both) should be excluded from a society's calculation of its prudential liquidity.

5.8 Outsourcing of Liquidity Management and Brokers' Advice

5.8.1 G In considering whether to outsource a proportion of their liquidity to a fund manager, societies should take into account the guidance on outsourcing in chapter 11 and the following:

- (1) any agreement should be fully supported by legal documentation and societies should take legal advice on the terms and conditions;
- (2) the security of the assets should be no weaker when held to the order of a third party (the fund manager) than when held to the direct order of the society;

- (3) societies should ensure that the safety of the assets is the responsibility of the fund manager while they are under management, including while securities are out for settlement;
- (4) the assets under management should at all times be held in a separate client inventory identifying the society - there should be no credit exposure risk;
- (5) the fund manager should be given the terms and conditions under which it can act; this should include, inter alia, a copy of the society's liquidity policy statement;
- (6) the society should remain in control over policy decisions and be able to monitor the performance of the fund manager against independent benchmarks;
- (7) periodic meetings should be held between the society's senior management and senior management of the fund managers to discuss performance;
- (8) the board of the society should satisfy itself about procedures and controls, including internal audit, to obtain the level of comfort it needs over the operation.

5.8.2 G Most societies take advice from brokers regarding investment of their liquidity. Some, however, enter into a more formal arrangement where securities are delivered to and from the broker and a customer agreement between the broker and the society is completed. If so, societies should differentiate between advice and discretionary fund management. If the society has entered into an agreement involving the provision of advice, it should ensure that no transaction is undertaken without its prior consent. As with discretionary fund management, societies should make certain that all transactions are within the terms of its liquidity policy statement.

Prudential Liquidity

5A.1 G The following list of assets is available to societies for the management of prudential liquidity, according to the society's approach to financial risk management, as set out in chapter 4.

	Administered	Matched	Extended	Comprehensive	Trading
1.1 Bank notes or coinage of any country or territory.	✓	✓	✓	✓	✓
1.2 Deposits with:					
(1) the central bank of any member country of the EEA and of Canada, Japan, Switzerland and the USA (sterling only);	✓	✓	✓	✓	✓
(2) National Savings Bank;	✓	✓	✓	✓	✓
(3) any credit institution authorised by the competent authorities of any member country of the EEA and Switzerland (sterling only);	✓	✓	✓	✓	✓
(4) wholly owned subsidiaries of UK banks and building societies in the Channel Islands and the Isle of Man;	✓	✓	✓	✓	✓
(5) any gilt-edged market maker or participant in the UK gilt market supervised by a regulatory authority in the EEA.	✓	✓	✓	✓	✓

<p>1.3 Loans to:</p> <p>(1) the Department of Finance and Personnel (Northern Ireland);</p> <p>(2) any relevant authority ("relevant authority" is defined in Annex 1F).</p>	✓	✓	✓	✓	✓
<p>1.4 UK Government money market instruments (e.g., Treasury bills) and securities (gilts)</p> <p>(1) up to 5 years residual maturity;</p> <p>(2) over 5 years residual maturity</p>	✓	✓	✓	✓	✓
<p>1.5 Securities issued or fully guaranteed by the government of any other member country of the EEA and of Australia, Canada, Japan, New Zealand, Switzerland and the USA (sterling securities only).</p> <p>(1) either floating rate (of any maturity) or fixed-rate up to 5 years;</p> <p>(2) fixed-rate over 5 years.</p>	✓	✓	✓	✓	✓
<p>1.6 Securities issued, guaranteed or, in the case of bills of exchange, accepted by any credit institution authorised by the competent authorities of any member country of the EEA and Switzerland (sterling securities only).</p> <p>(1) either floating rate (of any maturity) or fixed-rate up to 5 years;</p>	✓	✓	✓	✓	✓

(2) fixed-rate over 5 years.	✘	✓	✓	✓	✓
1.7 Securities issued by any relevant authority (as in 1.3(2)).					
(1) either floating rate (of any maturity) or fixed-rate up to 5 years;	✓	✓	✓	✓	✓
(2) fixed-rate over 5 years.	✘	✓	✓	✓	✓
1.8 National Savings Bonds.	✓	✓	✓	✓	✓
1.9 Foreign currency deposits with:					
(1) the central bank of any member country of the EEA and of Canada, Japan, Switzerland and the USA;	✘	✘	✓	✓	✓
(2) any credit institution authorised by the competent authorities of any member country of the EEA and Switzerland.	✘	✘	✓	✓	✓
1.10 Foreign currency securities issued or fully guaranteed by the government of any member country of the EEA and of Australia, Canada, Japan, New Zealand, Switzerland and the USA (this category does not apply to mortgage backed securities).	✘	✘	✓	✓	✓
1.11 Foreign currency securities issued, guaranteed or, in the case of bills of exchange, accepted by any credit institution authorised by the competent authorities of any member country of the EEA and Switzerland.	✘	✘	✓	✓	✓
1.12 Securities issued by international organisations the capital of which is subscribed in whole or in part by any member state of the EEA (known as “supranationals”).					

(a) securities in sterling	✓	✓	✓	✓	✓
(b) securities in foreign currencies	✗	✗	✓	✓	✓
1.13 Securities in the form of commercial paper (which should be redeemed before the first anniversary of the date of issue) issued or guaranteed by:					
(1) public companies whose registered office is domiciled in the EEA;	✗	✗	✗	✓	✓
(2) by public companies incorporated in Canada, Japan, Switzerland and the USA	✗	✗	✗	✓	✓
1.14 Mortgage backed securities.	✗	✗	✓ ¹	✓	✓
1.15 Stocklending rights arising from the lending of securities issued in the UK by HM Government.	✗	✓	✓	✓	✓
1.16 Gilt repo	✗	✓	✓	✓	✓
1.17 Repo in non-gilt-edged securities.	✗	✗	✗	✓	✓
1.18 Stocklending rights arising from the lending of securities under the rules of any depository or clearing agent.	✗	✗	✗	✓	✓

Note 1: Foreign currency deposits and foreign currency securities:

Societies should aim to hedge or match their foreign currency exposures. Any residual currency position should not exceed 2% of own funds, unless the society is on the Trading approach.

Note 2: Equities, or equity related stocks are excluded as prudential liquidity.

Note 3: Any guarantee should be unconditional in respect of the payment of both principal and of interest on all securities.

Note 4: Non-marketable assets (i.e., items 1.2, 1.3 and 1.9) are restricted to those with three months or less to residual maturity.

¹ STERLING ONLY

Policy Statement on Liquidity

5B.1 Overview

5B.1.1 G This Annex provides guidance on the issues which should be addressed in a liquidity policy statement. The list of issues is not exhaustive and not all points will be relevant to all societies.

5B.2 Policy Statement Contents

5B.2.1 G The introduction section should include:

- (1) Background to the society's approach to liquidity management;
- (2) Ratification process for obtaining board approval, including amendments to the policy statement as well as complete revisions;
- (3) Arrangements for, and frequency of, review (which should be conducted at least on an annual basis).

5B.2.2 G The objectives section should set out the Board's objectives for liquidity (see section 5.6.5 of this chapter).

5B.2.3 G The operational characteristics section should set out the society's business and operational characteristics, which impact on the amount and composition of liquidity, and the intended range for liquidity and liquidity net of mortgage commitments as a percentage of SDL.

5B.2.4 G The risk management section should include:

- (1) Exposure policies, including controls and limits as appropriate, for countries, sectors (with sub-limits for 8 day liquidity) and counterparties, including exposure to brokers;
- (2) The policy adopted for credit ratings, stating the minimum quality acceptable and procedures for ensuring credit ratings are up to date;
- (3) Policy of assessment to be adopted towards sectors that are non-rated, e.g., local authorities;
- (4) Operational and settlement risk, including: framework of board authorisation, delegations and operating limits (including, inter alia, dealer limits, transaction and day limits); deal authorisation, confirmation checking, segregation of duties;
- (5) Limits for pre-approved free of payment (FOP) exposures (NB: all FOP exposures should be pre-approved);
- (6) Procedures and criteria for exceptional overrides in relation to dealing, operational rules, limits and authorisation;
- (7) Policy for liquidity management information and reporting to the board.

5B.2.5 G The maturity structure section should include the policy for maturity mismatch and a “maturity ladder” covering prudential liquidity. This should give a clear view of the maturity pattern of the liquidity portfolio to be followed, showing the maximum proportions of liquidity to be included within each time band.

5B.2.6 G The categories of assets and activities section should set out the society’s policy for the following:

- (1) inter-society holdings;
- (2) repo/reverse repo (both gilt-edged stock and non-gilt-edged securities);

- (3) stocklending;
- (4) mortgage backed securities (including, where applicable, US MBS);
- (5) foreign currency securities and the handling of foreign currency exposures;
- (6) commercial paper.

5B.2.7 G The society's policy for membership and use of any clearing system or depository should be set out clearly, including a section dealing with authorisation and operational controls.

5B.2.8 G Liquidity implications and the role of standby facilities should be included in the policy statement.

5B.2.9 G The role of external professional advisers should be clearly stated, where applicable.

Inter-society Holdings

5C.1 G Societies may hold other societies' liabilities as prudential liquidity. Such holdings may include deposits and holdings of all forms of securities and money market instruments issued by other societies, including commercial paper, but should exclude Permanent Interest Bearing Shares and other forms of issued capital.

5C.2 G A society's aggregate holding of other societies' liabilities should not exceed 5% SDL or £5m whichever is the higher, including liquid assets which, although not counting as prudential liquidity (i.e., deposits with longer than 3 months to run to maturity) are held as other investments and fall within the "liquid assets" heading in the annual accounts. This measure is to be continuous.

5C.3 G The FSA expects societies to invest no more than 20% of their prudential liquidity (up to a limit of 5% SDL or £5m whichever is the higher) in aggregate holdings of other societies' liabilities.

5C.4 G Committed facility agreements with other societies should be reported to the FSA in the MFS1 return (table D2). Only the amount drawn down (lent) will constitute a liquid asset and should be taken into account when calculating the aggregate holding of other societies' liabilities.

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6 LENDING

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6 Lending

6.1 Introduction

6.1.1 G This chapter replaces PN 1998/6 Lending issued by the Commission.

6.1.2 G Building societies remain subject to the statutory nature limit for lending in the 1986 Act. A minimum of 75% of group business assets must be made up of loans fully secured on residential property (calculated by reference to sections 6, 6A and 6B of the 1986 Act). Each society should ensure that its lending policy and associated business control systems will deliver continuing compliance with this nature limit on the basis of proper, consistent classification of the loan assets of the society and its group. Further guidance on the application of this nature limit is given in section 6.6.

Scope of the Chapter

6.1.3 G The FSA's Principle 3 requires a firm to organise and control its affairs responsibly and effectively, with adequate risk management systems. Principle 2 requires a firm to conduct its business with due skill, care and diligence. Experience shows that one of the most common causes for the failure of deposit-taking institutions is a deficiency in systems for controlling lending and credit risk. Accordingly, the principal theme of this chapter is the need for adequate and appropriate systems for controlling and managing risks arising from lending. The chapter also establishes a framework within which the FSA will judge the risk profile of individual societies' lending, in particular for the purpose of setting and reviewing each society's threshold solvency ratio, and for assessing whether the society complies with Principles 2 and 3.

6.1.4 G This chapter also sets out the FSA's views on good practice in a range of areas related to societies' lending, which are drawn from the experience with societies' activities of its

predecessor, the Commission, over a number of business cycles. Nothing in this chapter absolves the board of each society from its responsibility for developing and maintaining prudent controls over lending risk arising from its business activities and future business plans.

6.2 Rules

6.2.1 R A society must have adequate systems for managing and controlling risk arising from lending, including systems for assessing both the adequacy of security for loans and the ability and willingness of borrowers to repay their loans.

6.2.2 R A society must maintain, and submit to the FSA, a board-approved policy statement on lending, which must include plans for the management of arrears, and the procedures for making specific and general provisions against impaired loans.

6.2.3 R A society making any significant change to its policy statement on lending must provide the FSA with a copy of the amended policy statement as soon as possible after it has been adopted.

6.2.4 G Each society's lending policy should be reviewed, by or on behalf of the board, not less than once a year.

6.2.5 G Chapter 1 on Solvency explains, inter alia, the need for adequate capital to support risks that arise from societies' lending activities. That chapter states that the setting of a threshold ratio by the FSA does not absolve society boards from the responsibility to maintain such higher solvency ratio as they consider appropriate for their business and future plans. Societies should hold sufficient capital to support the risks in their lending book and those arising from new lending initiatives. The FSA will take this into account in assessing compliance with Principle 4.

6.3 Principles of Lending

6.3.1 G The basic principles of good lending practice that the FSA will take into account in assessing compliance with the rules in section 6.2 are as follows:-

- (1) lending activities should be within the capabilities, experience and expertise of a society's management and its board;
- (2) risk should be controlled at inception by sound underwriting procedures, exercised by individuals and/or a credit committee skilled in the type of lending mandated to them, or by fully tested credit scoring systems;
- (3) the pricing of loans should take account of the perceived risks;
- (4) adequate controls should be in place to avoid imprudent concentrations of risk in special products, non-traditional areas of lending and higher risk categories in traditional areas of lending;
- (5) adequate procedures should be in place for monitoring the performance of lending related to source, type, and period of origination, and for ensuring that lending experience feeds into the formulation of policy for new lending;
- (6) the frequency and quality of management and board information should be sufficient to monitor and control lending activities effectively;
- (7) commercial loans should be regularly reviewed;
- (8) systems should be in place for early and effective management of arrears cases and for managing the disposal of properties in possession;

- (9) prudent provisioning methodologies should be used and actual provisions regularly reviewed in the light of experience;
- (10) budgetary procedures should be in place to assess and control the effect on current and future profitability of lending at fixed or capped rates, at a fixed margin over a market reference rate and of price incentivised lending;
- (11) systems should be in place to combat mortgage or other loan fraud;
- (12) for subscribing societies, systems should be in place to ensure compliance with the CML Mortgage Code;
- (13) where external advice is required, professional firms of solicitors, accountants, valuers and other types of adviser should have experience in the type of transaction for which they have been instructed.

6.4 Lending Policy Statements

6.4.1 G Rule 6.2.2 requires each society to have a statement of lending policy. Each society's board should determine, subject to the nature limit, the make up of its lending and its appetite for risk and should establish procedures for containing risk within this agreed policy. This section provides guidance on the content of lending policy statements and suggests factors that boards should consider when drawing up such statements.

6.4.2 G The statement should reflect the society's "philosophical" approach to lending, including the degree of risk the society is prepared to take to achieve a desired level of return, as well as more detailed aspects of controlling new lending risk and residual risk in a lending book. The statement should act as guidance to executives in designing new products as well as to staff involved in the underwriting process.

6.4.3 G The following paragraphs set out the broad areas societies should cover in their lending policy statement. Lending markets and the economic circumstances of borrowers, both personal and commercial, are subject to change and new lending risks may arise in the future. So, boards and management should review lending policy not less than once a year to take account of changing circumstances.

6.4.4 G A policy statement can usefully be structured in four parts: overview, organisation, risk management, and individual lending categories. The overview section could set the broad outline of the society's lending strategy, the degree of risk considered acceptable and the arrangements for its regular review. The organisation section could cover how lending is to be managed within the society, setting out which individuals or departments are responsible for which areas of lending or arrears management. The risk management section could describe how lending risk is controlled and monitored (including the use of exposure limits), how experience is to be fed back into policy and emphasise the importance of the borrower's covenant as the primary source of repayment (rather than the value of the security).

6.4.5 G The individual lending categories section could distinguish owner occupied residential lending, other lending secured on property and unsecured lending to individuals, each of which requires a different approach to product design and underwriting (see following table).

6.4.6 G Policies developed at the centre should be implemented properly and consistently across the organisation. The lending policy should be clearly explained to branch staff, including the society's attitude to risk. Ongoing adherence to the policy should be controlled by the lending function and reviewed by internal audit.

OWNER OCCUPIED RESIDENTIAL LENDING	OTHER LENDING SECURED ON PROPERTY	UNSECURED LENDING TO INDIVIDUALS
Property Types and Location	Property types and location	
Loan types and features	Loan types	Loan types
Underwriting procedures	Underwriting procedures	Underwriting procedures
Repayment Sources and methods	Repayment and monitoring	Repayment methods
Pricing Policy	Pricing policy	Pricing policy
Mortgage Indemnity Insurance	Mortgage Indemnity Insurance (if applicable)	
Other Insurance	Other insurance	
Intermediary Introducers	Intermediary introducers	Credit brokers
Valuations	Valuations	

OWNER OCCUPIED RESIDENTIAL LENDING	OTHER LENDING SECURED ON PROPERTY	UNSECURED LENDING TO INDIVIDUALS
Security	Security	
Management Information	Management Information	Management information

6.5 Risk Features of Mortgage Lending

6.5.1 G The Commission's prudential guidance drew attention to the intrinsic "double security" in normal mortgage lending, i.e. the mortgage on a property, which has been professionally valued and the personal covenant of a borrower, whose ability to repay has been assessed carefully. Both elements should be given appropriate weight. This basic principle of mortgage lending is explicitly incorporated into the rule in paragraph 6.2.1. This neither stipulates how the valuation or assessment should be carried out, nor that they should be done in all cases, but the society's policy and procedures should be clearly documented. The extent to which such valuations and assessments for lending are not carried out will be a factor considered by the FSA when assessing a society's threshold solvency ratio.

Covenant of Borrower

6.5.2 G Reliance on gross income multiples alone to measure a personal borrower's ability to repay provides only a limited indication of affordability and therefore of the strength of the borrower's covenant. Extending the assessment to a borrower's net income after fixed commitments will give a more reliable guide to the size of mortgage he or she can realistically service. When assessing affordability, the borrower's vulnerability to an increase in interest rates should also be taken into account.

6.5.3 G Assessing ability to repay is more difficult for personal borrowers who are self-employed, and more complex for commercial borrowers, both of which require skills in analysing financial accounts.

Valuation of Security

6.5.4 G Valuers should have sufficient experience and expertise and should be free from conflicts of interest.

Managing Aggregate Lending Risk

6.5.5 G Societies should be aware of the risk profile of their overall mortgage stock and of their new lending and should consider lessons arising from experience with their non-performing loans and adjust lending policy accordingly. These lessons should also inform general provisioning policies.

6.5.6 G Societies adopting a strategy for growth should have rigorous controls on quality of lending and should take care not to set up unbalanced incentive structures for staff which reward new business volumes without also recognising responsibility for maintaining quality standards. Societies should maintain strict and documented controls over discretionary overrides to lending criteria and scorecard decisions and should monitor the extent to which overrides occur in practice.

6.5.7 G Each society should determine how it controls lending risks and document this clearly in its lending policy statement. The FSA strongly recommends quantitative exposure limits as a way of achieving this. Outlined below are types of lending and aspects of lending risk where exposure limits can be set:

- (1) Non-traditional lending: for example, secured lending to housing associations, lending on private rented properties or personal unsecured lending;
- (2) Lending at higher LTV ratios or higher income multiples (i.e. lower affordability): societies should set an exposure limit for residential mortgage lending at 90%+ LTV;
- (3) New or innovative products and incentivised loans;
- (4) Fixed rate and other non-administered rate products including foreign currency mortgages;
- (5) Large exposures: (see also Chapter 7 on Large Exposures);
- (6) Remortgage business;

- (7) Origination source;
- (8) Geographical spread (larger societies) and out of area lending (regional and local societies);
- (9) Business sector for commercial lending.

6.5.8 G If societies do not use exposure limits for controlling their mix of lending, they should have an alternative method, as effective as exposure limits, for controlling the risks in their lending books. Exposure limits should act as early triggers and should be set for lending periods (e.g. an annual limit) as well as for the lending book as a whole.

Management information

6.5.9 G Societies should produce adequate and focused management information to monitor the performance of new lending and of the whole lending book against the risk parameters set down in the society's lending policy.

Lending to staff or directors

6.5.10 G Societies should have a board-approved policy on staff lending, setting out whether or not the same criteria (e.g. on income or LTV), are used for staff as for other customers, how ability to repay is assessed, what concessionary terms are available and how staff in arrears will be treated. Staff lending on concessionary terms not available to ordinary borrowers should also be the subject of a separate periodic report to the board. Societies must meet the requirements of sections 65 and 68 of the 1986 Act regarding loans to directors and persons connected with directors.

6.6 Lending Nature Limit

6.6.1 G Societies remain subject to the lending nature limit i.e. at least 75% of business assets must be in the form of loans fully secured on residential property. "Business assets" is a convenient, but non-statutory, collective term for a society's total assets (or total group

assets, where appropriate) plus any provision for bad or doubtful debts, less liquid assets, fixed assets, and any long-term insurance funds (see section 6 of the 1986 Act). “Residential property” is defined in section 5(10) of the 1986 Act as “land at least 40 per cent of which is normally used as, or in connection with, one or more dwellings, or has been, is being, or is to be developed or adapted for such use”.

6.6.2 G The Building Societies (Prescribed Equitable Interests) Order 1997 (SI 1997/2693) enables loans secured by any of three kinds of equitable security interests in property to qualify as fully secured on residential property if eligible in all other respects, and therefore count towards the lending nature limit. Loans fully secured on residential property in the European Economic Area (including here, the Channel Islands, the Isle of Man and Gibraltar) qualify for inclusion in the lending nature limit (section 6A(1)(c) of the 1986 Act).

6.7 Non-traditional Lending

6.7.1 G Societies entering into new areas of lending, including lending to business (whether secured on residential property or not) and unsecured personal lending, should:

- (1) enter the new area in a carefully controlled way so that experience can be gained without incurring an unacceptable level of risk during the learning period;
- (2) have the necessary range of skills at management and board levels adequately to assess, manage and monitor the risks that arise;
- (3) have clearly defined and documented systems of control established before entering the new area, including the establishment of new organisational structures, such as a credit committee, where appropriate;
- (4) ensure that they obtain an adequate return on the new business, taking account of the risks;

- (5) employ appropriate professional advisers in the development of the activity, including legal advice on any new loan structures, documentation or security types, and specialist valuers.

Syndicated Lending

6.7.2 G Societies may undertake syndicated lending, secured or unsecured, with one or more other co-participant(s) and whether, if the lending is secured, the security is held jointly or through a trustee. Syndicated loan assets can count towards the lending nature limit as provided in section 6(13) of the 1986 Act.

6.7.3 G Lending policy statements should address the additional risk aspects of syndication, including:

- (1) Limits: societies should set transactional limits for syndicated loans (e.g., size of participation and underwriting commitment) and an overall limit on the total of syndicated loan assets;
- (2) Loan and borrower types;
- (3) Systems and procedures: including experienced staff and access to appropriate professional advice;
- (4) Specialist Documentation;
- (5) Pricing;
- (6) Other parties: societies should consider which other institutions (or category of institutions) are considered as arranger/agent/trustee in a syndicated loan.

6.7.4 G Syndicated lending for market/consortium type credits is a complex activity, requiring special expertise on the part of the lender. The amounts involved may be large compared to normal lending, and the margins can be small for prime borrowers or where there is competition between lenders to acquire the business. There can be significant benefits for

lenders, but the associated risks also need to be considered. Societies should weigh these risks and rewards before deciding whether to put in place the personnel and systems to enable them to participate in the market.

6.8 Arrears Management

6.8.1 G Rule 6.2.2 requires that each society include an arrears management plan within its lending policy statement. Success in managing arrears is based on early contact with borrowers in difficulty and good management information.

6.8.2 G Management information for reporting arrears should be comprehensive so that senior management and the board can monitor trends in arrears cases as they flow through the various bands of severity. A society's arrears position should be reviewed at senior level not less than monthly. The analysis of arrears for traditional mortgage lending should also track the performance of groups of loans which have characteristics in common, such as analysis by product, by cohort of lending, by geographical region, by LTV band, by size of loan, by income criteria, and by source (introducer, branch, mandate holder). Societies with significant exposures to commercial lending should produce a similar analysis by features such as business sector.

6.8.3 G Regular arrears analysis allows societies to identify the characteristics of lending most likely to lead to arrears and societies should regularly review their lending policy statements (and, if applicable, credit scoring systems) to ensure that exposure to those types of loan identified by the arrears analysis as "riskier" is adequately controlled. If the analysis reveals that, for example, loans in the 95%+ LTV band consistently generate arrears significantly worse than average, steps should be taken to minimise the risks from those loans, including the possibility, if arrears are extreme, of ceasing to undertake such business completely.

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7 LARGE EXPOSURES

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7 Large Exposures

7.1 Introduction

7.1.1 G This chapter replaces PN 1998/7 issued by the Commission. It implements the large exposures provisions of the BCD for building societies. It also sets out rules and guidance on monitoring, controlling and reporting of large exposures by societies to the FSA.

7.2 Scope of this Chapter

7.2.1 G The purpose of the large exposures provisions of the BCD is to limit and control the extent to which credit institutions may commit themselves to large exposures to counterparties individually and in aggregate. Large exposures to a single counterparty and to a limited number of counterparties can create concentrations of risk in the balance sheet of a credit institution. It is the responsibility of each society's board to set its own limits for large exposures, within the general framework set by the BCD and the rules and guidance specific to societies contained in this chapter. The limits set out in this chapter are maxima. Each society should set its own prudential limits in order both to avoid the over-concentration of risk referred to above and to allow a margin for manoeuvre so as to ensure that the limits set out in this chapter can never be exceeded. Each society should set its own internal limits at a lower level than the maxima set out in this chapter.

7.2.2 G The large exposures provisions of the BCD cover all commercial asset exposures, liquid asset exposures, off balance sheet items and exposures to connected undertakings. The limits set out in this chapter therefore apply to all these areas. It should be noted that asset exposures where no counterparty is involved are not covered by the BCD (for example, fixed assets).

7.3 Definitions

7.3.1 G Under the terms of the BCD an exposure means any of the assets or off balance sheet items referred to in Article 43 or Annexes II and IV of the BCD respectively, before the application of risk weightings and credit conversion factors. Those items that are relevant to building societies are identified in Annexes 1B and 1C of chapter 1. In the BCD, an exposure to a counterparty or group of connected counterparties is defined as a large exposure where its value is equal to or exceeds 10% of own funds. The calculation of own funds for building societies is explained in chapter 1, particularly in Annex 1A.

7.3.2 G The BCD excludes from the definition of "exposure" the following:

- (1) all elements entirely covered by own funds provided that such own funds are not included in the calculation of the solvency ratio or of other monitoring ratios provided for in Community acts;
- (2) in the case of foreign exchange transactions, exposures incurred in the ordinary course of settlement during the 48 hours following payment;
- (3) in the case of transactions for the purchase or sale of securities, exposures incurred in the ordinary course of settlement during the five working days following payment or delivery of the securities, whichever is the earlier.

7.3.3 G A society considering the use of the option in paragraph 7.3.2(1) should consult the FSA well before it commits itself to a large exposure. The FSA will consider requests from societies wishing to exercise the option on a case by case basis.

7.3.4 G The calculation of the amount attributable to an off-balance sheet exposure follows the methodology established in the BCD and explained in Annex 1C. Full risk items are counted at full nominal value. For interest rate and foreign exchange contracts, the method set out in Annex 1C is to be used, but without any risk weighting by counterparty.

7.3.5 G Exposures are connected where a group of counterparties are connected: a group of connected counterparties is defined in the BCD as:

- (1) "two or more natural or legal persons who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly, has control over the other or others; or
- (2) two or more natural or legal persons between whom there is no relationship of control but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties".

7.3.6 G Control in this context means the relationship between a parent undertaking and a subsidiary undertaking, as defined in Part VII of the Companies Act 1985 or Part VIII of the Companies (Northern Ireland) Order 1986 (which implemented Article 1 of Directive 83/349/EEC), or a similar relationship between any natural or legal person and an undertaking. All individual exposures to the same counterparty or to a group of connected counterparties should be aggregated for the purpose of calculating a large exposure.

7.4 Controls on Large Exposures

7.4.1 G In accordance with the BCD, large exposures of societies which do not have any subsidiary undertakings should be monitored on an unconsolidated basis. Large exposures of societies with subsidiaries should, in general, be monitored on a fully consolidated basis. The basis of consolidation should be that set out in chapter 1. For convenience, the term "supervised group" is used in the following paragraphs to refer to a society and those subsidiaries subject to consolidated supervision, taken together, and in relation to a supervised group "own funds" means the consolidated own funds of the group. Intra-group exposures (i.e. exposures to connected undertakings) are covered separately in paragraphs 7.5.1 to 7.5.3.

7.4.2 G In accordance with the BCD the following limits will apply:

- (1) A society or supervised group should not incur exposure to an individual counterparty or group of connected counterparties in excess of 25% of own funds;
- (2) the aggregate of all large exposures of a society or supervised group should not exceed 800% of own funds; the aggregate of these exposures should not exceed 300% without the FSA's written approval.

7.4.3 G The BCD allows certain exemptions from the limits on large exposures, giving the competent authorities in each Member State the discretion to use these as appropriate. It also allows for certain exposures to be reduced by the application of weighting factors (in effect, partially exempting those exposures). The exemptions which the FSA allows societies are set out in section 7.8.

7.5 Exposures to Connected Undertakings

7.5.1 G The BCD takes a different approach to the control of exposures by a credit institution to counterparties with which it is connected (i.e. typically to other companies in the same group). Under Article 49.2, subject to applicable exemptions, all such exposures, collectively, are subject to a single aggregate limit of 20% of own funds. Building societies, however, have two particular features which are not shared by the generality of credit institutions. First, a building society will always be the parent entity in a group; it cannot be a subsidiary nor form a minor part of a diversified non-financial conglomerate. Second, under the 1986 Act, as originally enacted, building societies were able to carry out certain activities only through subsidiary companies or other associated undertakings. Although subsequent legislation allows activities to be carried out by the parent society which previously had to be carried out by subsidiaries, the FSA anticipates that societies may still wish to carry on certain activities in dedicated subsidiaries. Given this, the FSA applies, in relation to the single aggregate limit of 20% of own funds, an exemption for all exposures to a society's own subsidiaries that are subject to consolidated supervision. At the same time, the FSA limits exposures to individual subsidiaries to 20% of own funds.

7.5.2 G The FSA's approach to consolidated supervision in relation to capital adequacy is set out in chapter 1, including the criteria for excluding a subsidiary undertaking from the calculation of the consolidated solvency ratio. The same approach will apply to the control of large exposures. The limits on a society's exposures to counterparties connected with it are therefore as follows:

- (1) in relation to any single subsidiary undertaking or sub-group of subsidiary undertakings within the supervised group, the society may not incur an exposure in excess of 20% of own funds;
- (2) the aggregate of all exposures of the supervised group to counterparties connected with the society but outside the supervised group may not exceed 20% of own funds;
- (3) large exposures to counterparties connected with the society still count towards the overall limit of 300% of own funds (or 800%, if the FSA agrees as set out in paragraph 7.4.2(2)) unless otherwise exempted.

7.5.3 G The FSA will also allow further partial exemption to societies in respect of exposures of the kind referred to in paragraph 7.5.2(1). This exemption will draw upon the principle of solo consolidation described in section 1.11. An exposure of the kind referred to in paragraph 7.5.2(1) will be exempt from the limits on large exposures in paragraphs 7.5.2(1) to 7.5.2(3) where it is agreed by the FSA that the subsidiary undertaking concerned may be solo consolidated. Subsidiary undertakings which fall into this category will probably be those undertaking core business but where the society has decided for structural reasons to undertake the business through a subsidiary. Section 1.12 sets out the criteria under which the FSA considers applications for solo consolidation for mortgage subsidiaries. In other cases, societies will need to explain on what basis they consider it appropriate or necessary for solo consolidation to be granted. In all cases, the society should specify the maximum exposure that it is planning to incur.

7.6 Reporting and Notification of Large Exposures

7.6.1 G The FSA may require large exposures to be reported quarterly and has included reporting of large exposures on a consolidated basis in Table L of the quarterly return QFS1 for building societies. Table L of QFS1 also collects additional information on off balance sheet exposures.

7.6.2 R A society contemplating a new exposure which will exceed 20% of own funds (or when aggregated with an existing exposure to the same counterparty or group of connected counterparties would exceed 20% of own funds) must give prior notification to the FSA of such exposure, before making any commitment, using the standard reporting form, LEPR1.

7.6.3 R Exposures of between 10% and 20% of own funds must be reported by each society to the FSA. This information should be reported quarterly by means of Table L of QFS1.

7.6.4 G If a society exceeds the 300% aggregate limit (or the 800% limit, if the FSA so agrees), this should be reported immediately to the FSA in writing.

7.6.5 G Societies should also report to the FSA within two months of the end of their financial year:

- (1) confirming that the criteria under which solo consolidation was granted continue to apply. If any do not continue to apply, details of the changed circumstances should be provided;
- (2) confirming that the activities of the subsidiary undertaking(s) continue to be limited to those engaged in at the time that the FSA approved solo consolidation;
- (3) in respect of each case where solo consolidation has been granted, the amount of the current exposure.

7.7 Systems: Rules and Guidance

7.7.1 R Each society must maintain adequate systems and controls which enable it to:

- (1) monitor and control its large exposures in accordance with its large exposures policy (referred to in Rule 7.7.3); and**
- (2) make timely and accurate reports to the FSA on its large exposures.**

7.7.2 G Each society should ensure its internal audit programme covers the system for monitoring and control of large exposures.

7.7.3 R Each society must set out its policy on large exposures as part of its Financial Risk Management, Liquidity and Lending Policy Statements.

7.7.4 G Paragraphs 4.2.5, 4.2.6, 5.2.7, 5.2.9, 6.2.2 and 6.2.3 contain rules about policy statements and rule 7.7.3 should be read in conjunction with those rules.

7.8 Exemptions

7.8.1 G This section sets out the exemptions which the FSA allows to societies. In some cases, the FSA allows partial exemption by applying a weighting to the asset amount. The weighting of asset items means multiplying the asset value in the balance sheet by the percentage weight and including the weighted amount in any calculation of large exposures. This process is distinct from, though having some similarities to, the risk weighting of asset items for solvency ratio purposes and it is important that the two processes, and the respective weightings, are not confused.

7.8.2 G Assets constituting claims on the central government or central banks of Zone A countries are fully exempt. Annex 1G defines Zone A and contains a full list of current Zone A countries. Although the Channel Islands, Gibraltar, Bermuda and the Isle of Man may be

regarded as OECD members for the purpose of calculating a society's solvency ratio they may not be so regarded for large exposure purposes.

7.8.3 G Assets constituting claims carrying the explicit guarantee of the central governments or central banks of the countries set out in paragraph 7.8.2 are fully exempt.

7.8.4 G Other exposures attributable to, or guaranteed by, the central governments or central banks of the countries set out in paragraph 7.8.2 are fully exempt.

7.8.5 G Asset items and other exposures effectively and legally secured by cash deposits with the society or with any subsidiary undertaking of the society which is also a credit institution (defined in the BCD as an undertaking with both a deposit taking and a lending business) are fully exempt. Societies should note that this definition excludes most existing subsidiaries.

7.8.6 G Claims on and exposures to other credit institutions (including to other building societies) are subject to weightings, for the purpose of calculating exposures, as follows:

- (1) Maturity of one year or less: 0% (i.e. fully exempt);
- (2) Subject to prior written agreement from the FSA, societies' derivative exposures to banks, other building societies and investment firms subject to the Capital Adequacy Directive (CAD) (or subject to a regime that the FSA deems to be equivalent to CAD) with a maturity of over one year but under three years: 20% (i.e. partially exempt)

except where the exposure represents the own funds (as defined in the BCD) of the other institution (e.g. subordinated debt), in which case the exemption does not apply.

7.8.7 G Societies should note that the exemptions in paragraph 7.8.6 do not apply to their own subsidiaries, which also happen to be credit institutions or investment firms subject to CAD.

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8 MORTGAGE INDEMNITY INSURANCE

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8 Mortgage Indemnity Insurance

8.1 Introduction

8.1.1 G This chapter replaces PN 1998/8 issued by the Commission and contains rules and guidance for societies on mortgage indemnity insurance. The acronym MIG (Mortgage Indemnity Guarantee) is used throughout, as it is widely understood as shorthand for mortgage indemnity insurance.

8.1.2 G The chapter outlines the types of cover available to societies to protect themselves against the risks of high loan to value (“LTV”) lending. These include the use of a captive insurance company, excess of loss and self-insurance as well as MIG provided by an external insurer, which may be the preferred option for most societies. The chapter sets out factors the FSA will take into account in assessing the adequacy of a society’s policy for protecting itself against high LTV risk and comments briefly on capital adequacy and systems.

8.2 Rules

8.2.1 R A society undertaking any new lending at a high LTV ratio must have an adequate policy in place to provide protection against the greater risks involved with such lending. In this rule, “high LTV” means lending with an LTV ratio in excess of 80%.

8.2.2 G The extent of the protection in place will be a factor in determining the society's threshold solvency ratio. Factors that the FSA will consider in assessing the adequacy of the policy required in 8.2.1 are set out in the guidance in the rest of this chapter.

8.3 Factors the FSA will consider in assessing compliance with rule 8.2.1

8.3.1 G In deciding how to manage risk from high LTV lending, societies should assess the monetary value to them of the types of cover available and consider the risks and benefits associated with each type of cover, including the losses they could bear. They should assess the systems and accounting implications of changes to the type and level of cover provided.

8.3.2 G Societies have a number of options for managing risk from high LTV lending. They may dispense with MIG altogether, in conjunction with a change to lending policy to "re-balance" the risk profile of the society's loan portfolio. They may continue MIG cover on the best terms available or approach alternative MIG insurers, to establish whether cover on better terms than the standard MIG contract is available. They can consider other forms of insurance, such as excess of loss, self-insurance, and use of a captive insurance company.

8.3.3 G Whilst societies should regard the covenant of the borrower as their principal source of repayment, a comfortable margin in the value of the security is of vital importance. Past experience suggests that it would be imprudent to continue with high LTV lending without obtaining some form of additional protection against the risks involved.

8.3.4 G Therefore, societies undertaking high LTV lending that end their MIG cover and put nothing else in its place, should reduce substantially the proportion of new high LTV lending they undertake. If societies in this position decide not to reduce the level of high LTV lending, the FSA will take into account the society's increased risk profile in setting its threshold solvency ratio.

8.3.5 G The remainder of this chapter focuses on the types of protection against high LTV risk which are available.

8.4 Captive Mortgage Indemnity Insurance Companies (MIG Captives)

8.4.1 G The use of a MIG captive can be a sensible way to manage risk from high LTV lending. This section sets out the factors the FSA will take into account when assessing whether the use of a captive by a society meets the requirement in rule 8.2.1.

8.4.2 G A captive is a means of retaining and managing risk, wholly or partially, within the group. A society should first consider whether, and to what extent, it wishes to retain risk before deciding on any particular mechanism for risk retention. It should consider what its objectives are for high LTV risk and then assess how various forms of cover, including a MIG captive, could meet the objectives. Under the standard MIG contract, the lender retains a significant portion of risk and a captive may be a suitable means for managing that risk.

8.4.3 G A captive could take on all or part of the society's mortgage indemnity business. A wholly-owned captive should not provide unlimited MIG cover to its parent society: cover should be capped in some way, perhaps with a limit on claims arising from any one year's lending. The terms of cover provided by the captive to the parent, and the premiums charged, should be reviewed at least annually. Very generous cover may mean that the captive cannot fully meet the claims on it, and if a captive is unable to meet those claims the loss will revert to the society.

8.4.4 G For smaller societies an "association captive", owned by a group of societies, can be suitable for handling their mortgage indemnity risks. There may be practical difficulties involved, for example, the need for each society to be comfortable with the lending policy of its fellow-owners and the need to pool information. Proper oversight is likely to be more difficult when a captive is multi-owned.

8.4.5 G Society MIG captives should normally be wholly-owned by one or more building societies and provide MIG cover only to the owner society/societies (or to respective subsidiaries). Any scheme which envisages wider ownership, writing MIG business for other lenders or other lines of insurance business should address the different risks involved. Such a company would, of course, not be a pure MIG captive and the FSA's capital requirements are likely to reflect this.

8.4.6 G Societies should consider how the captive will set its premiums. A sensible starting point might be the amount paid for the equivalent external MIG cover and information about the society's lending book, and its claims propensity, should be collected to enable the business to be rated accurately in future. Initial assumptions about the size and frequency of claims should be tested against actual experience. If the captive underprices the

cover it may be difficult for the society, because of borrower resistance or competitive pressures, if the captive were to increase premiums later.

8.4.7 G Societies should consider over what period income can prudently be recognised by the captive, having regard to industry good practice for this kind of business and the likely timescale for emergence of claims. Regular reviews should compare the profit earning period chosen with actual claims experience. Societies should undertake detailed financial modelling to show what premium the captive can be expected to receive and what claims will arise for each annual tranche of lending over, say, a 10 year period. This will involve a full analysis of the performance of the society's mortgage book and societies should take the appropriate professional, including actuarial, advice.

8.4.8 G A captive is an appropriate vehicle for carrying normal MIG losses but is unsuitable for bearing exceptional losses over and above the normal level. Societies with or intending to establish MIG captives should obtain reinsurance to cover the risk of exceptional losses. Societies should consider what price the captive can pay for reinsurance and still remain commercially viable. Societies should also assess the terms on which reinsurance cover is offered, especially any restrictions on lending criteria, the financial standing of the reinsurer and its commitment to the MIG market.

8.4.9 G A captive may be exposed to greater risk in its early years of operation and societies should consider additional protection during this period. A captive may, for example, take out financial reinsurance or finite risk insurance to smooth cashflow.

8.4.10 G A captive needs capital to ensure that it can meet claims in all circumstances. In setting capital for a captive, societies should consider whether the captive is robust enough to weather exceptional losses arising from a "severe adverse case". Such a case might include high interest rates, a high level of borrower default and falls in both house prices and turnover - comparable to the worst experience during the period 1989-1992. It would be reasonable to assume that the "severe adverse case" would affect three consecutive years' lending.

8.4.11 G The captive should assess its probable maximum liability to claims at any one time, on each year of lending, based on a "severe adverse case". The residual risk to the captive

from each year of lending can be calculated taking into account this probable maximum liability, capped by reinsurance if used, and offset by the amount built up from net premiums and investment income. This is the “risk gap” for that year of lending. The relevant local insurance supervisors (most captives are located offshore) will impose their own capital requirements, and the FSA expects societies to comply with these. However, societies and their advisers should develop their own methodologies for assessing the prudent level of capital for the captive over and above the regulatory minimum. The FSA will take into account the society’s methodology for setting capital (including the concepts set out above) in assessing the adequacy of a society’s policy for managing high LTV risk.

8.4.12 G A society may either make the full amount of its capital commitment available immediately to the captive as fully paid share capital or keep part of its commitment in reserve. At least the capital requirements of the local insurance supervisor should be met through fully paid share capital. Societies can provide part of the overall capital commitment in the form of issued but uncalled, or partly paid share capital - where the captive is entitled to call for payment at any time and at its sole discretion.

8.4.13 G For solvency ratio purposes, a subsidiary MIG captive should be included in the consolidated calculation in accordance with Chapter 1 (Solvency). In calculating the society only solvency ratio, the FSA has adopted a composite treatment for building societies which recognises both that the capital invested in the captive bears a heavier risk of loss than the generality of investments in subsidiaries, and that the captive bears only the society's own lending risk and is not using its capital to "gear up" and assume new external liabilities. Of the total capital committed to the captive, whether fully paid or not, 25% (or, if greater, the capital requirement of the local insurance supervisor) should be deducted from the society's own funds, in the society-only calculation. The remainder should be risk-weighted at 100% as an investment in a subsidiary.

8.4.14 G Societies should consider where any captive should be domiciled and the choice of location should be made according to clear criteria (including convenience to facilitate effective oversight). Whichever location is chosen, the captive will need to obtain authorisation from the local supervisory authority and the FSA will communicate with that body about any application for authorisation.

8.4.15 G The society should put in place controls to oversee the operation of its captive. The captive should be overseen at a high level within the society and within a department (e.g. finance) independent of the lending/marketing function. The society should consider what regular information the captive should provide to the parent to enable proper oversight.

8.4.16 G The captive managers should meet regularly with the captive's board to discuss issues such as the adequacy of reserves and premium rates. The FSA also expects societies to commission an external review of the performance of the captive including actuarial advice on the same issues, say every two years, with a minimum of every three years.

8.4.17 G Local insurance supervisors have detailed rules about the type of asset which count towards the captive's solvency margin. The captive's investment policy should be clearly documented, specifying acceptable types of instrument and counterparties. The captive's directors should set investment policy rather than the captive managers or fund managers. In the early years of the captive's life, the funds should be invested in a prudent combination of bank/building society deposits, government securities and other high quality securities. The captive may deposit funds with the parent society provided the society meets the criteria specified in the captive's investment policy (although local insurance supervisors are unlikely to permit the captive to deposit 100% of its funds back with the parent).

8.4.18 G Societies may consider arrangements whereby a third party, such as a UK composite insurer, owns a captive insurance company which "rents" underwriting capacity to a society for its own MIG business (known in the market as a "rent-a-captive"). Any society intending to follow this route should consider the basis of the cover and the availability of reinsurance cover and, as a result of these factors, how much risk it retains.

8.4.19 G The activities of society-owned MIG captives may be expanded to enable them to write other business including insurance of other risks incurred by the parent society or another part of the society group and reinsurance of other lines of business originated by the parent society group.

8.4.20 G Where such business is written by society-owned MIG captives, sufficient capital and reserves should be maintained to enable the risk gap for MIG business to be met in full.

For these new lines of business, at least the capital requirements of the local insurance supervisor should be met through fully paid share capital.

8.4.21 G To avoid "double gearing", a society's investment in these new lines of business, and loans of a capital nature to finance such business, should be excluded, in full, when calculating its solvency ratio as set out in Chapter 1 (Solvency).

8.4.22 G Capital and reserves maintained for MIG business should be legally "ring-fenced" from the capital and reserves held to meet new lines of business. Captives should therefore adopt an appropriate and effective legal structure.

8.5 Self-Insurance and Non-Insurance

8.5.1 G Self-insurance is another way of containing high LTV risk. This section sets out the factors that the FSA will have regard to when assessing the adequacy of any policy for managing high LTV risk which uses this approach.

8.5.2 G With self-insurance some or all of the risk is retained by the society and either borrowers are charged a "premium" (e.g. a fee or additional interest) or the society absorbs the cost through self-charging. The FSA will consider either to be a prudent approach, provided charges to borrowers or the level of self-charging is adequate.

8.5.3 G With non-insurance some or all of the risk is retained by the society, but no charge or self-charge is made. In such cases, the society will be deemed to have no protection against the risk associated with high LTV lending and should follow the guidance in paragraph 8.3.4.

8.5.4 G Societies may combine an external MIG policy with self-insurance or non-insurance. This will arise, for example, under the co-insurance arrangements applied by many insurers, where the external MIG covers 80% of the risk but the society retains the remaining 20%. Where a society has a co-insurance arrangement or a cap on claims with their MIG insurers, it should consider what action should be taken in respect of that proportion of the risk it retains.

8.6 Charging for Self-Insurance

8.6.1 G Societies which retain some or all of their MIG risk without using a captive will need a methodology for determining the amount of risk being accepted and the level of charge to borrowers (or self-charging) for carrying that additional risk.

8.6.2 G To assess the level of charge or self-charging required, societies should devise a methodology to assess the relative risk from differing loan products, borrower types and types and location of property. Such a methodology should use historical statistical information evaluated using a range of assumptions (future interest rates, property prices etc). Independent specialist advice (e.g. from a firm of actuaries) is highly desirable.

8.7 Excess of Loss Insurance

8.7.1 G Excess of loss or stop loss insurance is another way of protecting against risks arising from high LTV lending. Such policies meet claims once a certain threshold loss to the society (the excess or deductible) has been reached. They usually have a defined upper limit, after which losses revert to the society, and they may involve an element of co-insurance.

8.8 Mortgage Book Acquisitions

8.8.1 G Societies should also consider the risks arising from high LTV lending where they have acquired the loans through a mortgage book acquisition. Following completion of the transaction, the principles of this chapter should be applied to the portfolio of loans acquired. Societies should also ensure that any captive acquired meets the rule and guidance in this chapter within a reasonable time of the acquisition.

8.9 Capital Adequacy

8.9.1 G As set out in Chapter 1 (Solvency), the FSA will consider the lending policy and the MIG arrangements of each society when reviewing its threshold solvency ratio. The

assessment will focus on the degree of risk accepted or retained by the society rather than the mechanism used to manage the risk.

8.9.2 G However, the FSA considers that the magnitude of risk retained by a society that either self-insures its entire MIG risk on-balance sheet, or places its entire MIG risk with a captive without reinsurance or takes no action to cover the uninsured portion of MIG risk under the standard external contract, is such that, other things being equal, the FSA is likely to raise that society's threshold ratio.

8.10 Systems

8.10.1 G Societies should ensure that their systems are adequate to monitor and control the risks arising from high LTV lending. (Systems should, of course be adequate to monitor and control all lending, but this chapter focuses on high LTV lending). For example, where societies self-insure, they should operate adequate systems for collecting charges from borrowers (or self-charging) and should set up systems to collect data on the performance of the loan book to help them set appropriate charge levels and assess likely future losses. Where any kind of captive arrangement is used, a society's systems should collect data on the performance of the loan book to refine the underwriting, pricing and reserving/reinsurance policies of the captive.

Interim Prudential Sourcebook for Building Societies

9 SYSTEMS

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9 Systems

9.1 Introduction

9.1.1 G This chapter replaces PN 1996/4 issued by the Commission. It contains rules and guidance on societies' systems of business control and accounting records. It supplements, for building societies, Principle 3 and the rules and guidance on senior management arrangements and systems and controls in SYSC, in particular, rule SYSC3.1.1 ("a firm must take reasonable care to establish and maintain such systems and controls as are appropriate to its business").

9.2 Rules and Evidential Provisions

9.2.1 R A society must have, and ensure that its subsidiary undertakings, if any, have, a fully-documented system of control.

9.2.1(1) G The guidance in section 9.4 applies to the society and any subsidiary undertakings, unless the context clearly dictates otherwise. It is recognised that it may be more convenient for systems of control of the society and any subsidiary undertakings to be integrated, rather than maintained separately.

9.2.2 G Guidance on the documentation of systems of control is given in section 9.5.

9.2.3 E (1) A society should have an internal audit function (this may be either in house or outsourced to a third party).

(2) Contravention of 9.2.3(1) may be relied upon as tending to establish contravention of SYSC3.1.1.

9.2.4 G Guidance on internal audit is given in section 9.6 and in SYSC 3.2.16.

9.2.5 E (1) A society should establish an audit committee consisting of at least three members who are also non-executive directors;

- (2) **Contravention of 9.2.5(1) may be relied on as tending to establish contravention of SYSC3.1.1.**

9.2.6 G Guidance on audit committees is given in section 9.7 and in SYSC3.2.15.

9.2.7 R A society must maintain, and submit to the FSA, a board-approved corporate plan.

9.2.8 R A society making any significant change to its corporate plan must provide the FSA with a copy of the amended plan as soon as possible after it has been adopted.

9.2.9 G Guidance on corporate planning systems is given in paragraphs 9.4.13 to 9.4.18.

9.3 Accounting Records and Systems

9.3.1 G A society is required by SYSC3.2.20 to take reasonable care to make and retain adequate records (including accounting records) and should have appropriate systems and controls in place to fulfil its obligations with respect to adequacy, access, periods of retention and security of records.

9.3.2 G Every building society is also required, under section 71(1) and (2) of the 1986 Act, to keep accounting records which:-

- (1) explain the society's transactions;
- (2) disclose, with reasonable accuracy and promptness, the state of the business of the society at any time;
- (3) enable the directors properly to discharge the duties imposed on them by or under the 1986 Act and their functions of direction of the affairs of the society;
- (4) enable the society properly to discharge the duties imposed on it by or under the 1986 Act.

9.3.3 G The records should contain (see section 71(3) of the 1986 Act) entries in respect of all payments and receipts together with descriptions thereof, entries of all

transactions giving rise to, or likely to give rise to, assets or liabilities and a record of the assets and liabilities of the society, in particular of any class relevant to the “nature limits” in sections 6 and 7 of the 1986 Act.

9.3.4 G The main reasons why a building society should maintain adequate accounting and other records are:

- (1) to provide the directors and management of the society with adequate financial and other information to enable them to conduct its business in a prudent manner on a day-to-day basis;
- (2) to safeguard the assets of the society and the interests of investors;
- (3) to assist directors of the society to fulfil their statutory duties in relation to the preparation of annual accounts;
- (4) to provide the directors and management of the society with sufficient timely and accurate information to assist them to submit the information required or requested by the FSA.

9.3.5 G To achieve this, the society’s accounting systems should disclose, in an orderly and integrated way, with reasonable accuracy and promptness, the state of the business at any time. The records should be maintained to enable financial and business information to be extracted promptly, so that directors and management can monitor and control the performance of the business, the state of its affairs and the risks to which it is exposed. The nature of, and frequency with which, information is prepared, its level of detail, and the amount of narrative analysis and explanation, and who should receive it, is for directors and senior management to decide.

9.3.6 G More detailed guidance on accounting records and systems is set out at Annex 9A, which is derived from the FSA’s guidance in the Interim Prudential Sourcebook for banks. References in Annex 9A to “banks”, and where appropriate “companies”, are taken to include building societies.

9.4 Systems of Business Control

9.4.1 G A society should have systems to enable the directors to control the conduct of its business and to control the accounting and other records. To exercise proper control over the business, the directors should understand the underlying business activities, and how they are carried out. Directors should have procedures in place to identify and assess the risks which may arise through the conduct of that business. Control objectives should be set for each area of the business, controls established and maintained which address appropriately the identified risks to ensure the prudent conduct of the business in accordance with the society's policies, and compliance with all relevant laws and regulations and the FSA's rules.

9.4.2 G A society is required by SYSC3.1.1 to take reasonable care to establish and maintain such systems and controls as are appropriate to its business. In addition, SYSC3.2.6 requires a society to take reasonable care to establish and maintain effective systems and controls for compliance with regulatory requirements and standards. More detailed guidance on internal control systems is set out at Annex 9B, which is derived from the FSA's guidance in the Interim Prudential Sourcebook for banks. References in Annex 9B to "banks" are taken to include building societies.

Organisational control systems

9.4.3 G Societies are required by SYSC2.1.1 to take reasonable care to maintain a clear and appropriate apportionment of significant responsibilities among its directors and senior managers. In addition, SYSC2.1.3 requires the apportionment of the responsibilities and establishment and maintenance of systems and controls to be overseen by a senior individual. SYSC2.2.1 requires societies to keep an up-to-date record of such arrangements.

9.4.4 G Societies should have:

- (1) clearly defined organisational arrangements and a defined structure of authorities, mandates and responsibilities, including reporting lines, which distinguish between decisions to be reserved for the board and those to be delegated to board committees, or managers and employees; and
- (2) arrangements for reviewing the compliance with and effectiveness of organisational controls.

9.4.5 G The composition and operation of the board of a society, and the maintenance of a properly defined structure of board committees, are important elements of high level organisational controls (see chapter 3 Boards and Management).

9.4.6 G The directors of a society should ensure that:

- (1) the society's overall organisational arrangements are adequately defined and documented, usually through an organisation manual;
- (2) the society's decision-making processes, including authority limits and responsibilities, are properly defined and documented, usually through operating manuals; and
- (3) compliance with approved authority limits and stipulated segregation of duties is effectively monitored and controlled.

Management information systems

9.4.7 G More detailed guidance on information for management is set out at paragraphs 6-8 in section 3.2.3 of Annex 9A.

9.4.8 G The board and management of a society should satisfy themselves that:

- (1) the information available is sufficient to enable the board to measure, manage and control risks identified in accordance with paragraph 9.4.1;
- (2) the information available is sufficient for a proper assessment of the potential risks for the society and the proper determination of its need for capital and liquidity;
- (3) the information available is sufficiently comprehensive to provide the board with a clear statement of the performance and financial position of the society;
- (4) management information reports are prepared for the board and management on a regular and timely basis, consistent with the dynamics of the business area reported on. Such reports should allow exposure to be monitored against limits and other parameters set by the board;

- (5) actual performance is compared with prior periods and with budgeted performance at least quarterly and that significant variations are highlighted and explained;
- (6) sufficient attention is focused on key factors affecting income and expenditure, including capital expenditure, and that appropriate performance indicators are employed;
- (7) management information is accurately prepared from the underlying accounting and other records and is presented in a clear, consistent and understandable way.

9.4.9 G The form and content of management information should be reviewed regularly. It should be appropriate and relevant to the current business of the society and to market conditions. Such information should include financial information and other matters such as current market conditions and trends, reporting on the control environment and the status of any current control issues, and the extent of achievement of quantitative and qualitative business targets. Information should clearly indicate the extent of future commitments, as well as the current position arising from treasury management operations.

9.4.10 G In forming a view on whether the management information system is sufficiently comprehensive, the board and management of a society should consider whether the information made available to them provides, for both the society and, where applicable, the group, a clear statement of:

- (1) the capital position;
- (2) the liquidity position;
- (3) the exposures arising from treasury management operations, including an analysis of off-balance sheet positions;
- (4) profits and losses, assets and liabilities, and funds flows;
- (5) the profitability of products, services and subsidiary undertakings;
- (6) the balance sheet ratios in relation to the lending and funding limits in sections 6 and 7 of the 1986 Act;

- (7) the society's actual exposure, in those areas where the board has set a limit, compared to that limit.

9.4.11 G The above matters should be compared against limits, ratios and other parameters set by the board and notified to the FSA or other regulatory authorities.

Information for the FSA

9.4.12 G Information reported to the FSA should be accurate and timely. Societies must complete returns in accordance with the FSA's requirements, set out in chapter 16 of the Supervision Manual, and submit them within the specified timetable. Returns should be reviewed prior to their submission to the FSA at a sufficiently senior level. The procedures should check for consistency between different returns, between the various tables in the same return, and between the returns and information prepared for the board.

Planning systems

9.4.13 G A satisfactory planning system should help a society to comply with its regulatory obligations. It is for each society to decide what is an appropriate planning horizon and to maintain and develop planning systems appropriate to its individual circumstances and the changing business environment.

9.4.14 G Rule 9.2.7 requires each society to maintain, and send to the FSA, a corporate plan. This should deal with longer-term strategic issues, should be reviewed and updated annually and should include:

- (1) views on the markets in which the society competes and the society's position in those markets;
- (2) identification of the society's strengths and weaknesses, market and other opportunities open to it, and threats to the society's business;
- (3) a clear enunciation of the society's strategic aims and action to achieve those aims;
- (4) the resource implications of the strategic aims (including information technology, senior management and staff, and financial resources);

- (5) financial projections, including sensitivity analyses.

9.4.15 G A corporate plan should not simply consist of a number of desirable aims, but should set out the process for achieving these and within what timescale. The board should ensure that there are appropriate policies and procedures in place to implement the strategic plan, as well as mechanisms to monitor achievement against the plan so that, if necessary, appropriate corrective action may be taken.

9.4.16 G The planning systems of a society should also set, review and revise short and medium-term financial and other objectives, consistent with the society's longer-term strategic aims.

9.4.17 G The planning, detailed budgeting and financial accounting systems and processes should be integrated to enable outcomes to be monitored against plan, and for the feedback of results into management decisions and into the planning process. Some of the key features of such processes are:

- (1) There should be clearly-defined short, medium and long-term planning systems, with an unambiguous allocation of responsibilities within the organisation for the development, review, approval and implementation of plans, and for subsequent monitoring of performance against them.
- (2) The elements of any plan should be supported by adequate data, obtained from internal and external sources, and by critical analysis.
- (3) A range of possible outcomes should be considered, relating to varying levels of risk and/or uncertainty, and their financial impact on profitability and capital strength assessed.
- (4) Key indicators should be identified against which actual performance will be tracked. Actual data should be prepared on a basis consistent with the plan, to enable proper comparison to be made.

9.4.18 G Comprehensive arrangements, documented in business recovery plans, should be in place to ensure continuity of business in the event of some unforeseen disaster such as a fire or bomb damage. Information technology ("IT") is an extremely important element, and any business recovery plan should include the possibility of major hardware or software

failure. Planning should cover all aspects of a society's business that might be affected, including premises, personnel and external communications. These arrangements should be regularly reviewed and tested to ensure that they work in practice.

Information Technology

9.4.19 G IT is a major feature of any society's business. Mistakes in this area could be very costly to a society, in terms of money, staff resource and market share. The board of a society should be sufficiently knowledgeable and experienced to appreciate the issues involved and be in a position to exercise proper control over IT systems and developments.

9.4.20 G The board and management of a society should address a wide range of IT issues, some of which are set out below:

- (1) The society should have an IT strategy which is consistent with its longer-term strategic aims.
- (2) Procedures should be in place to ensure that a comprehensive evaluation is made of proposed major IT investment and that the technical and business cases for the investment are clearly demonstrated.
- (3) There should be an appropriate allocation of responsibility for IT issues and an organisation structure which is conducive to a strong IT control environment.
- (4) The security of data and systems is of paramount importance. Controls should be in place to minimise the risk of unauthorised physical and logical access, or the loss of data. Such controls should cover not only centralised mainframe processing but also remote terminals and stand-alone or linked PCs.
- (5) The board should exercise strong control over the development and implementation of new or significantly modified systems. Appropriate technical and project management skills are required and boards should consider seeking expert outside assistance.
- (6) Internal audit should have skills and experience to assess the effectiveness of IT controls. Internal audit should be involved in an advisory capacity during

the development of significant new IT systems, to ensure that appropriate controls are in place.

9.5 Documentation of Systems

9.5.1 G Rule 9.2.1 requires a society's system of control to be fully documented. Documents setting out the systems of control should be available to the board at all times. The documentation helps boards to assess if systems are maintained and controls are operating effectively. It also helps those reviewing the systems to ensure that the controls are those that have been authorised, that they are complete and adequate for their purpose. The use of policy statements documenting the society's policy in a particular area (e.g. lending) is an important element of high level controls.

Form of documentation

9.5.2 G The board and management of a society should determine the form of documentation to be adopted. Considerations should including the following:

- (1) It should be comprehensive. It should cover all material aspects of the operations and business of the society.
- (2) It should be integrated. Separate elements of the system should be interrelated and cross-referred so that the system can be viewed as an integrated totality.
- (3) It should identify risks, and the controls and other arrangements established to manage those risks. The controls should be identified and their purpose defined so that their effectiveness can be evaluated and so that the relationship and interdependence with other controls can be established.
- (4) It should attribute responsibility for operating the controls. There should be named persons or posts for each control operation, alternatives in case of absence, and continuity of standards of control during absence.
- (5) It should state how operation of the control is to be evidenced. Evidence would normally require signatures or initials; records and registers; retention of control documents; staff attendance records.

- (6) It should establish a comprehensive and unambiguous control discipline. The instructions should be clear and precise, avoiding expressions in relation to control functions such as “normally” and “if possible”.
- (7) It should be suitable for practical, day to day use. The separate specifications of controls should have a practical role in the review and improvement of systems, for example, through the inspection function.
- (8) It should be up to date. There should be an accurate description of the system that has been established and is operating. When changes are made to the systems the appropriate systems of control need to be both established and documented by the time the changes become operative.
- (9) It should require confirmation of compliance. Managers in branches and other areas of a society’s business are key control points within the overall control system. They should periodically be required to confirm to the board, to the best of their knowledge and belief, compliance with the controls within the system which has been established.

9.5.3 G The content and level of detail required in documentation prepared for directors and senior management may be different from that required in documentation prepared for the use of more junior staff. In the latter case the main purpose of system documentation is typically to guide staff through the clerical and IT procedures. Such material may be detailed and contain only limited coverage of the control procedures applying to the work of that staff member. The board and senior management require a summarised version, with a wider scope and with a greater emphasis on controls. Whatever form of documentation is adopted it should facilitate an understanding of the society’s systems, procedures and controls, at the level appropriate to the user.

9.5.4 G Societies should make explicit the accounting and other controls which are applicable to their systems, in a separate section of a procedures manual or in a separate document devoted to controls.

9.5.5. G Documentation should not be restricted to “lower-level” clerical and authorisation controls applied in transaction processing, but should also cover “high level” supervisory controls and accordingly should deal with:

- (1) powers to be exercised only by the board, and powers delegated to others;
- (2) the purpose, composition and reporting lines of committees of directors and senior management to whom powers or responsibilities are delegated;
- (3) the specific roles, responsibilities and reporting lines of board members, including the Chairman, executive and non-executive directors;
- (4) the timing, form and purpose of meetings of the directors and the mechanism whereby agreed board strategies, policies and decisions are recorded and their implementation monitored.

IT controls

9.5.6 G The documentation of IT controls should be integrated within the overall documentation of a society's system of business control. Operating manuals provided by a IT supplier can form a useful part of a society's procedures documentation but it is less likely that such manuals will be in a form which enables them to comprise part of the control documentation. The criteria set out in paragraph 9.5.2 apply equally to the controls surrounding IT systems.

9.5.7 G There will be a number of key controls performed within the IT and computer programs and a society should ensure that it documents all such controls if reliance is being placed on them.

9.6 Internal Audit

Purpose of internal audit

9.6.1 G The purpose of internal audit is to:

- (1) provide regular appraisal for management and the board as to the overall effectiveness of the control systems, including all proposed changes, and to recommend improvements where considered desirable or necessary;
- (2) determine whether the systems and controls established by management and the board have operated as laid down (in the society's control documentation)

and comply with policies, procedures, laws, regulations and any other relevant requirements;

- (3) assess whether financial and operating information supplied to management and the board is accurate, pertinent, timely and complete.

9.6.2 G Societies should ensure that their internal audit function adequately covers, in addition to detailed operational activities, the following areas:

- (1) Controls to verify the accuracy and completeness of monitoring returns and other information provided to the FSA.
- (2) Controls to ensure compliance with all regulatory requirements.
- (3) Broader management controls, such as the controls over business planning, systems for monitoring and reporting on financial performance and other key business indicators.
- (4) Controls over new areas of business and other initiatives, whether carried out within the society or through subsidiaries or other associated undertakings.
- (5) “High level” controls, including those referred to in section 9.4.

9.6.3 G The board and management of a society should satisfy themselves that the following considerations have been satisfactorily addressed within the context of the scale, range, complexity and pace of development of the society’s business and accounting systems:

- (1) To maintain its objectivity, the internal audit function should be independent of the functions it inspects.
- (2) The internal audit function should have sufficient manpower resources available to it so that it can achieve its agreed objectives.
- (3) Qualifications, experience and training of the individuals performing the internal audit function should be adequate in relation to the objectives.
- (4) The status and reporting relationship of the head of the internal audit function should be sufficient to maintain the independence and objectivity of the function. The head of internal audit should have the right of direct access at

any time to the highest level of management and the board, including in particular the chairman of the audit committee and the chairman of the society.

9.6.4 G Audit committees have a key role to play in controlling the work of the internal audit function and receiving its reports.

Key elements of an internal audit function

9.6.5 G The key elements of a system of internal audit include:

- (1) terms of reference: these should be specified with precision and should include, amongst other matters, scope and objectives of the internal audit function, and reporting requirements. They should be approved by management and the board. Internal auditors will require a wide-ranging access to records and documents, including material prepared for and by the board. They will also need to be empowered to obtain information and explanations from staff at all levels, including directors. The terms of reference should, accordingly, be framed so as to provide such access.
- (2) risk analysis: risks identified and the controls put in place by management to address those risks should be considered in each area of the society's business. In this context risk will be much wider than just the risk of pecuniary loss, or error or mis-statement in the accounting records. Reputational risk and wider operational and business risks should also be considered. The adequacy of the controls should be assessed. Weaknesses in control should be drawn to the attention of the audit committee or the board as specified in the terms of reference. Full consideration should be given to the high level controls in place within the society.
- (3) audit plan: an audit plan should be developed, covering all aspects of the society's business. The audit plan should identify the scope and frequency of work to be carried out in each area. Audit effort should be focused on those areas identified in the risk analysis as higher risk. However, over a set time-frame, all areas should be covered. The plan should be reviewed and approved by the audit committee before work commences.

- (4) detailed programmes: these should set out the specific tests to be performed in each area of the audit plan.
- (5) working papers: adequate working papers should be maintained to record the audit planning and execution, principal findings and follow-up action. They should evidence the individual who performed the programmed work, how it was controlled and supervised, and record the conclusions reached, with cross-referencing to the reports made and action taken.
- (6) system of reporting: the results of the work performed should be reported to the audit committee, or the board, in accordance with the terms of reference. Such reporting should be carried out on a regular, at least quarterly, and timely basis; obviously serious matters should be raised immediately. The reports should briefly describe the area(s) covered, significant matters arising, recommendations and overall conclusions. Procedures should be established to ensure that recommendations have been implemented or non-implemented validly justified.

9.6.6 G The key elements required for a system of inspection are not affected if internal audit services are outsourced, in whole or in part, to an auditing firm. For smaller societies, in particular, this can be a cost-effective way of obtaining the required level of resource, including appropriate technical skills. However, boards of societies which pursue this route should take into account the guidance in chapter 11 on Outsourcing and consider the following issues:

- (1) It is particularly important that clear and comprehensive terms of reference are laid down. These should specify the anticipated total resources to be provided by the audit firm, including total number of man-weeks and staff grades and/or specialisms. The terms of reference should also make clear how, and under what circumstances, the audit firm would be involved in assignments which may not have been specifically contemplated when the annual internal audit plan was drawn up.
- (2) Boards should satisfy themselves that the timing and frequency of visits by the audit firm is appropriate for the level of assurance which the board requires,

and will also enable the audit firm to be fully up to date regarding business, and control, developments.

- (3) Where there is outsourcing of only one particular element of internal audit – for example, computer audit, or audit of the treasury function - such assignments should be fully integrated into the overall internal audit plan.

Reporting and review

9.6.7 G The board should satisfy itself that the internal audit function is being properly carried out. To enable it to review the overall effectiveness of the inspection function it should consider on an annual basis, or more regularly, the following aspects:

- (1) Adequacy of resources, including number, experience and skills of staff within the internal audit function. There may be circumstances, in situations where specific skills are believed to be deficient, when the board considers it appropriate to obtain these skills from an external source. Societies in these circumstances might consider looking to their external auditors. However there is clearly potential for a conflict of interest to arise, regardless of whether the work would be carried out by persons not directly involved in the audit. External auditors should not be involved in this way, except under exceptional circumstances. Societies should discuss such a proposal with the FSA.
- (2) Adequacy and scope of planning and work performed, including the allocation of audit effort to each area of the society's business.
- (3) Frequency, quality and timeliness of reporting on matters arising from the work of the internal audit function.
- (4) Resolution of points and recommendations raised, and reasons for any rejection of major points.
- (5) Review of overall effectiveness of the internal audit function.

9.7 Board Review and Oversight

Audit committees

9.7.1 G Ultimate responsibility for the effective operation of a society's systems of control rests with the society's board of directors. As with any board committee, the audit committee should have clear and full written terms of reference, that make clear its role, responsibilities and reporting lines.

9.7.2 G A society's board should establish an audit committee of non-executive directors consisting of at least 3 members. Executive directors should not be members of the committee. If the society's chairman is an audit committee member, he or she should not chair the committee. The internal auditor should report directly to the committee and it is usual for the chief executive, and other executives as appropriate, to attend by invitation at least part of the committee meetings. The external auditors should have direct access to the committee, with or without executives present, and should attend some, if not all, meetings, particularly those where matters such as the year end accounts, or systems, are being discussed. The matters with which an audit committee might be involved include:

- (1) the adequacy of the society's systems of business control and, in particular, its arrangements for evaluating risks in relation to its existing and future business and related capital requirements;
- (2) the effectiveness of the society's internal audit function, including an assessment of the scope of work performed by internal audit, the nature and timing of internal audit reports and the adequacy of internal audit resources;
- (3) the preparation and supervision of internal audit's plan and programme;
- (4) the receiving of reports from the internal auditor and reporting to the board on the audit plan together with recommendations for improvements;
- (5) the review of the adequacy of management information and other reports made available to the board;
- (6) the review of the annual accounts prior to their approval by the board;
- (7) assessment of the external audit function.

G

3.2 Accounting and other records**3.2.1 Introduction**

3 The scope and nature of the accounting and other records which a bank should have for its business to be conducted in a prudent manner should be commensurate with its needs and particular circumstances. They should have regard to the factors identified in SYSC3.1.2 and to the manner in which the business is structured, organised and managed, and to the nature, and complexity of its transactions and commitments.

4 The accounting and other records should be located where they will best assist management to conduct the business of the bank.

If the accounting and other records are kept overseas (for example at a UK branch's overseas head office) or by another entity (for example, where processing is outsourced), there should be arrangements which allow local management of the bank to have immediate and unrestricted access to them. In addition, reporting accountants should be allowed access.

3.2.2 General

5 The FSA does not believe it is appropriate to prepare a comprehensive list of the accounting and other records which a bank should maintain. However, they should:-

- (a) capture and record on a timely basis and in an orderly fashion, every transaction and commitment which the bank enters into, with sufficient information to explain:
 - (i) its nature and purpose;
 - (ii) any asset or liability, actual or contingent, which respectively arises or may arise from it; and
 - (iii) any income or expenditure, current or deferred, which arises from it;
- (b) provide details, as appropriate, for each transaction and commitment, showing:-
 - (i) the parties, including, in the case of a loan, advance or other credit exposure, whether (and if so to whom) it is sub-participated;
 - (ii) the amount and currency;
 - (iii) the contract, rollover, value and settlement or repayment dates;

- (iv) the contracted interest rates of an interest rate transaction or commitment;
 - (v) the contracted exchange rate of a foreign exchange transaction or commitment;
 - (vi) the contracted commission or fee payable or receivable, together with any other related payment or receipt;
 - (vii) the nature and current estimated value of any security for a loan or other exposure; the physical location and documentary evidence of such security; and
 - (viii) in the case of any borrowing, whether it is subordinated, and if secured, the nature and book value of any asset upon which it is secured;
- (c) be maintained in such a manner that financial and business information can be extracted promptly to enable management to:-
- (i) identify, measure, monitor and control the quality of the bank's assets and safeguard them, including those held as custodian;
 - (ii) identify, measure, monitor and control its exposures by related counterparties across all products;
 - (iii) identify, measure, monitor and control its exposures to liquidity risk, and foreign exchange and other market risks across all products;
 - (iv) monitor the performance of all aspects of its business on an up-to-date basis; and
 - (v) make timely and informed decisions;
- (d) contain details of exposure limits authorised by management which are appropriate to the type, nature and volume of business undertaken;
- (a) These limits should, where relevant, include counterparty, industry sector, country, settlement, liquidity, interest rate mismatch and securities position limits as well as limits on the level of intra-day and overnight trading positions in foreign exchange, futures, options, future (or forward) rate agreements (FRAs) and swaps.
- (e) provide information which can be summarised in such a way as to enable actual exposures to be readily, accurately and regularly measured against these limits;
- (f) contain details of the factors considered, the analysis undertaken and the authorisation or rejection by management of a loan, advance or other credit exposure; and

- (g) provide, on a memorandum basis, details of every transaction entered into in the name of or on behalf of another party on an agency or fiduciary (trustee) basis where it is agreed that the bank itself is not legally or contractually bound by the transaction.

3.2.3 Information for management

- 6 Every bank should prepare information for directors and management so that they can monitor, assess and control the performance of its business, the state of its affairs and the risk to which it is exposed.
 - (a) This information should be prepared on an individual company and, where appropriate, on a consolidated basis.
 - (b) The frequency with which information is prepared, its level of detail and the amount of narrative analysis and explanation will depend upon the level of management to which it is addressed. Some types of information will be needed on a more frequent basis than others and it may be appropriate for some to be presented on a basis of breaches from agreed limits by way of exception reports.
- 7 It is the responsibility of directors and management to decide what information is required and to decide who should receive it. Appropriate management information should be provided to:-
 - (a) persons responsible for exercising managerial functions or for maintaining accounting and other records;
 - (b) executives who, either alone or jointly, are responsible under the immediate authority of the directors for the conduct of the business of the bank; and
 - (c) the directors of the bank.
- 8 This information should be prepared:-
 - (a) to show the state of affairs of the bank;
 - (b) to show the operational results of the business both on a cumulative basis and by discrete period, and to give a comparison with budgets and previous periods;
 - (c) to provide an analysis of assets and liabilities showing how they have been valued;
 - (d) to provide an analysis of its off-balance sheet positions showing how they have been valued;
 - (e) to provide an analysis of income and expenditure showing how it relates to different categories of asset and liability and off-balance sheet positions; and
 - (f) to show the bank's exposure to each type of risk, compared to the relevant limits set by management.

G

3.3 Internal control systems**3.3.1 Introduction**

9 The scope and nature of adequate control systems should take account of the matters covered in SYSC3.1.2 and:

- (a) the amount of control by senior management over day-to-day operations;
- (b) the degree of centralisation and the extent of reliance on information technology.

10 A system of internal control should be designed and operated to provide reasonable assurance that:

- (a) all the bank's revenues accrue to its benefit;
- (b) all expenditure is properly authorised and disbursed;
- (c) all assets are adequately safeguarded;
- (d) all liabilities are recorded;
- (e) all statutory requirements relating to the provision of accounts are complied with and all prudential reporting conditions are adhered to.

3.3.2 Control environment

11 The strength of the control environment is important for banks, as a weak control environment can undermine an otherwise adequate control system.

- (a) A working definition of 'control environment' is provided in Statement of Auditing Standards ('SAS') 300, issued by the Auditing Practices Board:

'Control environment' means the overall attitude, awareness and actions of directors and management regarding internal controls and their importance in the entity. The control environment encompasses the management style, and corporate culture and values shared by all employees'.

12 Factors relevant to the control environment include:

- (a) the importance which is attached to controls by management;
- (b) the way in which staff are assessed and rewarded (including remuneration and bonus schemes as well as promotion policies);

- (c) controls training, and the methods for reviewing control, including internal audit.

3.3.3 *High level controls*

13 High level controls are the controls which are primarily exercised at director and senior manager level, as distinct from the detailed controls, the operation of which is delegated to others. High level controls typically include:

- (a) the setting of strategy and plans. The strategic plan should be documented and consider the external factors that might impact on the business in the near future, for example macro economic factors and competition. The strategic plan should be reviewed annually and is a key document for the production of the annual business plan that will set out how the bank will achieve its goals for the coming year. Some banks may also consider it appropriate to establish trigger points on key indicators to identify adverse trends in the business that would cause the Board to revisit its strategy or business plan. For banks that are part of a larger group, the strategic plan and annual business plan may be produced on an integrated, group-wide basis;
- (b) approval of risk policies;
- (c) establishment and review of the organisational structure;
- (d) the system for delegation;
- (e) review of high level management information;
- (f) maintaining the framework for monitoring and/or periodic review of risk management and detailed control systems and for the implementation of action points following such a review.

The FSA's requirements for adequate internal control systems will apply to high level as well as to detailed control systems.

3.3.4 *The control system: General*

14 The FSA does not believe it is appropriate to prepare a comprehensive list of internal control procedures which would then be applicable to any bank, nor is it possible to prepare a detailed list of particular procedures which should be undertaken, where appropriate, by all banks. Nonetheless, internal control systems should provide reasonable assurance that:-

- (a) the business is planned and conducted in an orderly and prudent manner in adherence to established policies;
- (b) transactions and commitments are entered into in accordance with management's general or specific authority;

- (c) management is able to safeguard the assets and control the liabilities of the business;
- (d) there are measures to minimise the risk of loss from irregularities, fraud and error, and promptly and readily to identify them when they occur;
- (e) the accounting and other records of the business provide complete, accurate and timely information;
- (f) management is able to monitor on a regular and timely basis, among other things, the adequacy of the bank's capital, liquidity, profitability and the quality of its assets;
- (g) management is able to identify, regularly assess and, where appropriate, quantify the risk of loss in the conduct of the business so that:-
 - (i) the risks can be monitored and controlled on a regular and timely basis; and
 - (ii) appropriate provisions can be made for bad and doubtful debts, and for any other exposures both on and off balance sheet;
- (h) management is able to comply with the FSA's reporting rules (that is to complete returns fully and accurately and in accordance with the FSA's reporting instructions, and to submit them on a timely basis); and
- (i) the bank is able to comply with the other notification requirements under the Act.

15 In seeking to secure reasonable assurance that their internal control objectives are achieved, management needs to exercise judgement in determining the scope and nature of the control procedures to be adopted.

- (a) They should also have regard to the cost of establishing and maintaining a control procedure in relation to the benefits, financial or otherwise, that it is expected to provide.

16 It is a responsibility of directors and management to review, monitor and test its systems of internal control on a regular basis in order to assure their effectiveness on a day-to-day basis and their continuing relevance to the business.

- (a) In many banks an internal audit function assists management by providing an independent review of such systems.
- (b) Such a review should be designed to monitor the effectiveness and operation of the systems and to test compliance with daily procedures and controls (see below).

3.3.5 *Control objectives*

17 The scope and nature of the specific control objectives which should be adopted for the business to be conducted in a prudent manner should be commensurate with a bank's needs and particular circumstances, and should have regard to the manner in which the business is structured, organised and managed, to its size and the nature, volume and complexity of its transactions and commitments.

18 It is not appropriate for the FSA to provide an exhaustive and prescriptive list of detailed control requirements which should apply to all banks. However, the FSA considers that each bank should address the following control objectives:-

- (a) Organisational structure: Banks should have documented the high level controls in their organisation which:
 - (i) define allocated responsibilities;
 - (ii) identify lines of reporting for all aspects of the enterprise's operations, including the key controls and giving outline job descriptions for key personnel.
 - (a) The delegation of authority and responsibility should be clearly specified.
- (b) Risk management: A bank should document its risk management framework setting out how the risks in the business are identified, measured, monitored and controlled. At a high level this might be documented in a matrix, setting out the key risks in the business e.g. credit, interest rate etc, key control procedures, the person responsible for monitoring the risk, and the type and frequency of management information to monitor each risk (see below).
- (c) Monitoring procedures: A bank should have procedures in place to ensure that relevant and accurate management information covering the financial state and performance of the bank and the risk exposures which the bank has entered into is provided to appropriate levels of management on a regular and timely basis. Procedures should also be in place which are designed to provide reasonable assurance of compliance with the bank's policies and practices, including any limits on delegated authority referred to above, and with statutory, supervisory and regulatory requirements.
- (d) Segregation of duties: A prime means of control is the separation of those responsibilities or duties which would, if combined, enable one individual to record and process a complete transaction. Segregation of duties reduces the risk of intentional manipulation or error and increases the element of checking.
 - (a) Functions which should be separated include those of authorisation, execution, valuation, reconciliation, custody and recording.
 - (b) In the case of a computer-based accounting system, systems development and daily operations should be separated.

- (c) For smaller banks, segregation of duties can be difficult due to limited number of staff. In such circumstances, the Board should satisfy itself that the bank is not running undue risk and that there are compensating controls in place e.g. frequent review of the area by internal audit and/or executive directors.
- (e) Authorisation and approval: All transactions should require authorisation or approval by an appropriate person and the levels of responsibility should be recorded as prescribed above.
- (f) Completeness and accuracy: Banks should have controls to ensure that all transactions to be recorded and processed have been authorised, are correctly recorded and are accurately processed.
 - (a) Such controls include:
 - (i) checking the arithmetical accuracy of the records,
 - (ii) checking valuations,
 - (iii) the maintenance and checking of totals,
 - (iv) reconciliations,
 - (v) control accounts and trial balances, and
 - (vi) accounting for documents.
- (g) Safeguarding assets: A bank should have controls designed to ensure that access to assets or information is limited to authorised personnel. This includes both direct access and indirect access via documentation to the underlying assets.
 - (a) These controls are of particular importance in the case of valuable, portable or exchangeable assets and assets held as custodian.
- (h) Personnel: There should be procedures to ensure that personnel have capabilities commensurate with their responsibilities. The proper functioning of any system depends on the competence and integrity of those operating it.
 - (a) The qualifications, recruitment and training as well as the innate personal characteristics of the personnel involved are important features to be considered in setting up any control system.

3.3.6 Controls in an Information Technology Environment

19 The information held in electronic form within a bank's information systems is a valuable asset that needs to be protected against unauthorised access and disclosure. It is the responsibility of management to understand the extent to which a bank relies upon electronic information, to assess the value of that information and to establish an appropriate system of controls.

- (a) The control objectives described above apply equally to operations undertaken in both manual and electronic environments, although there are additional risks associated with electronic environments.

- (b) The FSA recognises that this will usually be achieved by a combination of manual and automated controls, the balance of which will vary between banks, reflecting the need for each to address its particular risks in a manner which is cost effective.

20 The types of risk most often associated with the use of information technology in financial systems may be classified as follows:

(a) fraud and theft:

- (a) Access to information and systems can create opportunities for the manipulation of data in order to create or conceal significant financial loss. Additionally, information can be stolen, even without its physical removal or awareness of the fact, which may lead to loss of competitive advantage. Such unauthorised activity can be committed by persons with or without legitimate access rights.

(b) Errors:

- (a) Although they most frequently occur during the manual inputting of data and the development or amendment of software, errors can be introduced at every stage in the life cycle of an information system.

(c) Interruption:

- (a) The components of electronic systems are vulnerable to interruption and failure; without adequate contingency arrangements this can lead to serious operational difficulty and/or financial loss.

(d) misinformation.

- (a) Problems may emerge in systems that have been poorly specified or inaccurately developed. These might become immediately evident, but can also pass undetected for a period during which they could undermine the veracity of supposedly sound information. This is a particular risk in systems where audit trails are poor and the processing of individual transactions difficult to follow.

21 Management should be aware of its responsibility to promote and maintain a climate of security awareness and vigilance throughout the organisation. In particular, it should give consideration to:

- (a) IT security education and training, designed to make all relevant staff aware of the need for, and their role in supporting, good IT security practice and the importance of protecting company assets;
- (b) IT security policy, standards, procedures and responsibilities, designed to ensure that arrangements are adequate and appropriate.

3.3.7 *Money laundering deterrence*

22 It is a requirement of the Money Laundering Regulations 1993 that authorised banks have policies and procedures in place to guard against their business and the financial system being used for the purpose of money laundering. The Joint Money Laundering Steering Group Guidance Notes ('Money Laundering Guidance Notes for the Financial Sector' revised and consolidated by the Joint

Money Laundering Steering Group in June 1997) provide a practical interpretation of the Regulations. The FSA expects banks to adopt policies and procedures in line with those Guidance Notes.

(a) See also the sourcebook on money laundering.

3.3.8 ***Outsourcing***

23 Authorised banks are required to adequately record and control their business. Where a bank has outsourced an aspect of its operations to another part of the group, or to an external supplier, it should ensure that its records and controls adequately cover that business.

24 Banks should put in place procedures for monitoring and controlling the outsourced operations, and for ensuring that the information requirements of the authorised bank's management with respect to the outsourced operations are satisfied (see chapter OS).

Interim Prudential Sourcebook for Building Societies

10 Securitisation

10.1 Introduction

10.1.1 G This chapter contains new guidance for building societies on securitisation. It replaces the consultation draft Prudential Note issued by the Commission in June 1994.

10.1.2 G This chapter consists of the guidance for banks on securitisation (chapter SE of the Interim PSB for banks) as amended by additional guidance specific to building societies set out in paragraph 10.1.3 and in section 10.3 of this chapter.

10.1.3 G Save as mentioned in paragraph 10.1.3(2), all of the guidance in chapter SE of the IPSB for banks applies to building societies, with the following amendments:

- (1) All references to “banks” should be taken to include building societies.
- (2) Section 1.4 (Grandfathering) of chapter SE does not apply to building societies.
- (3) In paragraph 5 in section 4.3 of chapter SE, the reference to “a bank’s minimum (or “trigger”) capital ratio” should be read as “ a building society’s threshold solvency ratio”.
- (4) In paragraph 7 in section 4.4 of chapter SE, the liquidity implications of securitisation transactions will be assessed for societies by reference to chapter 5 (Liquidity) of this IPSB.

10.2 Areas of the bank guidance which are particularly relevant to societies

10.2.1 G Section 3 of chapter SE outlines the various roles that a bank may play in a securitisation transaction. The following paragraphs direct societies to the parts of the bank guidance that are likely to be most relevant to them.

- (1) Societies planning to securitise mortgages currently on their own balance sheets will act as an “originator”, as described in section 3.2.1 of chapter SE.
- (2) Societies will also act as “servicing agents”, as set out in section 3.3.2, where they continue to administer the mortgages after securitisation.
- (3) Societies may undertake some or all of the secondary roles described in section 3.3.3.

10.3 Additional guidance for building societies

10.3.1 G This section sets out additional guidance on securitisation for building societies over and above that set out in chapter SE of the IPSB for banks. These additions arise as a result of the particular constitutional structure of building societies and the provisions of the 1986 Act. The FSA will expect societies, when planning to securitise, to consider these issues and to adopt a policy to deal with them.

Principal Purpose and Nature Limits

10.3.2 G Section 5(1) of the 1986 Act provides that “*a society may be established ... if its purpose or principal purpose is that of making loans which are secured on residential property and are funded substantially by its members*”. The 1986 Act also gives the FSA certain powers of control in respect of a failure to comply with these provisions. A society will therefore need to ensure that any programme of securitisation does not threaten its continued compliance with its principal purpose.

10.3.3 G The principal purpose is a continuing purpose: it is not just viewed at a single point in time. Whether a society is fulfilling its principal purpose depends on what business it is doing on a continuing basis. For example if, for an extended period of time, a society diverted all its new mortgage business to a special purpose vehicle as part of a securitisation programme, it would arguably not be meeting its principal purpose.

10.3.4 G Sections 6 and 7 of the 1986 Act describe, respectively, the “lending” and “funding” limits, together known as the “nature limits”, which are quantitative criteria which help to determine whether an individual society is complying with its principal purpose. Societies should ensure that any programme of securitisation does not threaten compliance with the nature limits. Sections 6(3) and 7(3) of the 1986 Act respectively make clear that only items included in total assets or total liabilities in a society’s accounts count towards the nature limits.

Provisions of section 9A of the 1986 Act

10.3.5 G Paragraph 6 (i) in section 6.3 of chapter SE sets out some additional guidance for banks which play a primary role in securitisation transactions in respect of undertaking swaps. In addition to the guidance in that paragraph, building societies should also ensure that any swaps they undertake comply with section 9A of the 1986 Act.

Membership of the society

10.3.6 G As mutual institutions, societies have a special responsibility to their customers which, in the context of securitisation, the FSA considers should include maximum openness with affected borrowers. The relationship between a society and its borrowers is qualitatively different to that between a bank and its borrowers because society borrowers are members of the society. Because of this, the FSA will expect societies, when planning to securitise, to consider the issue of membership and to adopt a Board policy to deal with it, which should include a strategy for handling the affected borrowing members.

10.3.7 G The membership issue will not arise if a society intending to undertake a securitisation transaction originates mortgages directly into a vehicle, so that the borrower does not become a member of the society in the first place. In these circumstances, the FSA considers that societies should make clear to borrowers, when they take out the loan, that they do not have membership rights.

10.3.8 G Societies should bear in mind that if they securitise mortgages by means of an equitable transfer, paragraph 5(2) of Schedule 2 to the 1986 Act means that the relevant borrowers will still be members of the society.

10.4 Transitional provisions

10.4.1 G Any securitisation transaction undertaken by a society before 20 June 2000, which conformed to the guidance on securitisation issued by the Commission, is grandfathered. Accordingly, such a transaction may be treated for capital purposes as conforming with the guidance set out in this chapter, without the need to restructure the transaction. A society should, however, satisfy itself that any new pool of assets securitised through a grandfathered structure conforms with the guidance in this chapter.

SECURITISATION AND ASSET TRANSFERS

1 INTRODUCTION

1.1 Application

1 This chapter applies to a UK banks acting in a *primary role* in respect of a transfer of a single asset, pool of assets or securitised portfolio. Where a bank does not meet the terms of this policy, it should regard the assets as remaining on the solo and consolidated balance sheet.

See s3.2

- a) Further details on *primary roles* are set out below.
- b) The FSA's policy does not apply to banks incorporated outside the United Kingdom, even if the special purpose vehicle (SPV) is UK-incorporated.

2 Where a UK bank acts in a *secondary role* in respect of a transfer of a single asset, pool of assets or securitised portfolio, this policy only applies in the following circumstances:

- (a) Where the bank also acts in a primary role. If the bank fails to follow this policy, the FSA will regard the assets as being on the solo and consolidated balance sheet; or
- (b) Where the performer of the primary role is a member of the consolidated group. If the bank fails to follow this policy, the FSA will regard the assets as being on the consolidated balance sheet.

See s3.3

- a) Further details on *secondary roles* are set out below.

See ch CS

- b) The details regarding *consolidated groups* are explained in chapter CS.

3 Where a member of the consolidated group acts in a secondary role in respect of a transfer of a single asset, pool of assets or securitised portfolio, this policy will only apply when the UK bank acts in a primary role. Failure to follow the policy would result in the assets being on the consolidated balance sheet.

4 Where the role policy is followed, the capital consequences are explained below.

1.2 Legal Sources

5 For relevant legal sources see the Legal Sources section of the Capital Overview chapter.

1.3 Notification policy

6 A bank should give prior notification to the FSA when it proposes to act in any of the primary roles, either solely or jointly with one or more other parties. This should take place in reasonable time to allow the FSA to consider the proposal and raise any concerns that it may have.

- a) The responsibility for achieving supervisory non-objection to a proposal rests with the bank itself.

1.4 Grandfathering

7 All securitisation transactions completed prior to the 30th December 1999 will be grandfathered.

8 A bank should satisfy itself that a new pool of assets securitised through a grandfathered structure complies with this policy.

1.5 How this chapter is organised

9 Section 2 outlines the principles and objectives that lie behind the FSA's approach to securitisation and asset transfers. Section 3 then explains the various roles that a bank may take within a securitisation. Section 4 highlights the wider implications of the risks to banks that result from securitisation and loan transfers.

Sections 5, 6, 7 & 8 explain the FSA's general policy applicable to a bank acting in a primary role. Section 5 details the methods of transferring risk effectively and the FSA's policy in each case. Section 6 outlines the FSA's policy for all basic asset transfers or securitisations other than on effective transfers. Section 7 details the policy specifically applying to revolving credit securitisations. Section 8 deals with other specialist schemes.

- Sections 9, 10 & 11 outline the policy applying to banks acting in specific secondary roles. Section 9 outlines the policy on the provision of credit enhancement. Section 10 outlines the policy

on the provision of liquidity facilities. Section 11 outlines the policy on dealing and underwriting of asset backed securities.

2 SECURITISATION, ASSET TRANSFERS AND THE FSA'S APPROACH

2.1 Background

2.1.1 General

1 An *asset transfer* occurs where an asset owned by a bank is *sold* to another legal entity. In doing so, a bank may remove the asset from its supervisory balance sheet, where the conditions of this chapter are met.

See s5

- a) *Sold* means the legal and economic methods of transfer discussed in more detail below.

2 *Securitisation* is generally a process by which assets are sold to a *bankruptcy remote special purpose vehicle* (SPV) in return for an immediate cash payment. The cash payment is raised by the SPV issuing debt securities, usually in the form of tradable notes or commercial paper. A bank performing such a transaction may remove the assets from its supervisory balance sheet, where the conditions of this chapter are met.

- a) In a securitisation, the assets are usually transferred to a vehicle existing specifically for the purpose of securitisation called a *special purpose vehicle* (SPV).
- b) A *bankruptcy remote* SPV is an entity that is considered by the rating agencies to be unlikely to be subject to voluntary or involuntary bankruptcy proceedings.
- c) Although securitisable assets may take other forms, they are generally those with associated streams of principal and interest e.g. mortgages, credit cards and corporate loans.

3 Although this policy is primarily concerned with the sale of loans, the policy also applies to the transfer of other forms of assets.

2.1.2 Rationale for Securitisation

4 A bank may undertake a securitisation for a number of reasons. These include:

- portfolio management;
- reducing the need for capital to support assets on the balance sheet;
- risk management;
- enhancing equity return by allowing the redeployment of capital;

- restructuring the balance sheet for reasons connected with large exposures or sectoral concentrations;
- issuing securities as a means of funding with benefits for both cost and diversification of sources; and
- to provide funding of assets when the originator cannot obtain funding on its own part, for example to fund an acquisition.

2.1.3 *The risks involved*

- 5 In the process of transfer, the functions normally carried out by a lending bank are unbundled. Normally, the various risks in a bank's banking book other than credit risk do not warrant special treatment, as the capital needed to cover credit risk helps to protect a bank against these other risks as well. This is no longer the case, however, where the credit risk lies with a third party and a bank solely carries the risks associated with asset administration or promotion.
- 6 Banks should be aware that although this policy is primarily concerned with capital adequacy, operational and reputational risk may also be incurred. For example, in the transfer of a single asset, the originating bank may have difficulty in avoiding close association with the asset; for a pool of assets, the level of association depends upon the structure used and the number of roles performed. The FSA believes that the risks from close association, which may take a variety of forms with a securitisation scheme, can assume material proportions.
- 7 The solution for the FSA has been to implement the policy of "clean break". A bank, once it has securitised assets, should not have any further involvement with those assets except in accordance with the policy in this chapter. This should be the case both explicitly and implicitly i.e. any reputational linkage between the assets of the originator/sponsor should be broken so far as is possible.

2.2 Objectives

- 7 The framework of the FSA's rules is designed to achieve the following objectives, in that:
- (a) asset sales and packaging achieve their intended effect of passing rights and obligations from the seller to the buyer. Ideally, a completely clean break should be achieved;
 - (b) all the parties to the transaction fully understand the responsibilities and risks they have assumed or retained; and
 - (c) any material risks to buyers or sellers are properly treated in the FSA's supervision of banks.
- 8 The FSA believes that these objectives are best achieved by ensuring that a transfer achieves the following:
- (a) the immediate legal separation of the seller from the assets and their new owner (or the effective economic separation in the case of a transfer by sub-participation);
 - (b) as far as possible, the complete economic separation of the seller from the assets and their new owner;
 - (c) presentational or "moral" separation of the seller from the assets and their new owner; and
 - (d) the identification of the retained risks for capital or other coverage purposes.

3 PRIMARY & SECONDARY ROLES

3.1 General

1 This section outlines the various roles that fall within the scope of this policy.

3.2 Primary roles

3.2.1 *Bank as originator*

See s3.2.2(b) 2 A bank acts as an *originator* when it transfers from its balance sheet a single asset, an asset package or assets that are not investment grade third party financial instruments.

- a) The terms *seller* and *originator* are used interchangeably to mean the bank that is seeking to move assets off its own balance sheet. Note that the terms *seller* and *buyer*, for the party taking on the risk, are used throughout this chapter although in a strict legal sense they may be inaccurate where transfer is by way of sub-participation.

3 Where a bank lends to an SPV in order for that SPV to grant a loan to a borrower as though it were the bank, the bank will be regarded as an originator.

- a) This method of lending is known as *remote origination*.
- b) The bank is regarded as the originator as the SPV is creating an asset that is branded by the bank. The bank will incur reputational risk through the association with the product.

3.2.2 *Bank as sponsor or repackager*

4 A bank acts as a *sponsor* or *repackager* when:

(a) As a sponsor, it repackages *third party* assets *directly* into a *conduit scheme* that funds the purchase by an issue of securities.

See s1.1

- a) *Third Party* means parties other than the members of the bank's wider accounting group.
- b) *Directly* means that the assets have never appeared on the bank's balance sheet.
- c) In a *conduit scheme*, the term sponsor is used to describe the bank promoting the securitisation scheme. A sponsor may be connected to the scheme in ways that may open it to "moral" pressures in the same way as an originator.

- d) Where there is more than one originator in the securitisation the SPV is known as a *multi-seller vehicle*.
 - e) The various sellers usually continue to service the assets, carrying out the functions of collection, administration and the pursuit of arrears.
- (b) As a repackager, it sells *investment grade third party financial instruments* via its balance sheet to an SPV that then rebundles them and resells them to investors.
- a) In a *repackaging scheme*, the repackager is *not* the original lender and is therefore subject to fewer limitations than an originator.
 - b) Where the assets are influenced in credit quality by reference to the repackaging bank, the bank will be regarded as an originator.
- See ch TI s9
- c) For a definition of *investment grade* see the Interest Rate position risk chapter. Where the securities to be repackaged are not rated, the bank should be able to demonstrate that the assets are of a comparable quality.
- See ch CB s3.2.2
- d) For the purposes of this paragraph, *financial instruments* are as defined in Section B of the Annex to the ISD.

5 Where a bank repackages assets that are not investment grade third party financial instruments via its balance sheet the bank will be treated as an originator and should comply with the policy relating to that role except where:

- (a) the bank acts as sponsor and originates up to 10% of the total assets into the scheme; or
- (b) the bank acts as repackager and repackages up to 10% of the total assets in the scheme that are either sub-investment grade securities or securities where it has acted as originator.

Banks should apply the originator treatment for assets falling within this exception, albeit without jeopardising the overall treatment for the scheme.

- a) The rule will be applied at the level of the conduit irrespective of any prior SPVs.

3.3 Secondary Roles

3.3.1 *General*

6 A bank acting in a primary role may also carry out one or more of the secondary roles associated with a securitisation or asset transfer. The number and scope of roles carried out by a bank under a securitised structure affect its treatment under the FSA's policy.

7 If a bank is carrying out only one role, it may be acceptable for it to have greater latitude in that role than if it was carrying out several roles, as the FSA considers the totality of a bank's involvement when assessing the completeness of the clean break and any residual risks.

3.3.2 *Servicing agents*

8 A bank acts in the secondary role of *servicing agent* when it administers or services the securitised assets.

- a) The terms *servicer*, *servicing agent* and *administrator* are used interchangeably to describe a bank which carries out an administrative function with regard to a securitisation scheme.

9 Where a bank acts as servicing agent, it should satisfy itself that it does not have a reputational obligation to support any losses incurred by the scheme. If a bank is unable to do so, it should comply with the policy applying to an originator.

- a) A bank acting as servicing agent can run explicit operational and reputational risks as its identification with the assets can mean that its commercial reputation is committed. The extent of the association depends upon the extent of involvement and the sophistication of the underlying borrowers. The FSA is concerned that a bank in this position may give in to pressure to support losses incurred by the investors/buyers to protect its name.

10 Where a bank acts as serving agent, the bank should be able to demonstrate to investors that it has no reputational obligations to support losses by a clear and unambiguous statement in the offering circular in respect of any implied support.

3.3.3 *Other secondary roles*

11 A bank acts in a secondary role when it carries out any of the following functions:

- See s9 (a) the provider of *credit enhancement*;
- a) A *credit enhancement* is provided to an SPV to cover the losses associated with the pool of assets. The level of the enhancement is reflected in the rating given to the notes by a rating agency.
- See s10 (b) the provider of *liquidity facilities*;
- a) *Liquidity facilities* enable SPVs to assure investors of timely payments. These include smoothing timing differences in the payment of interest and principal on pooled assets and ensuring payments to investors in the event of market disruptions.
- See s11 (c) the *underwriter* and *dealer* in securities issued by the SPV;
- a) *Underwriting* is the arrangement under which a bank agrees to buy, before issue, a specified quantity of securities in a new issue on a given date and at a given price if no other purchaser has come forward.
- b) *Dealing* is acting as principal in both the sale and purchase of notes, in the secondary market of an issued security.
- See s10.4.3 (d) the provider of *bridging loans* to the SPV;
- a) A *bridging loan* is a loan made to an SPV, before the issuance of the notes, to cover a mismatch in time between the date of purchase of the underlying assets and the date of issue of the securities.
- See s6.2.2 (i) (e) the counterparty in swap transactions.

4 IMPLICATIONS OF SCHEMES FOR A BANK'S GENERAL RISKS

4.1 Introduction

1 The following sections of this chapter cover banks acting in a primary and secondary role.

2 No consideration of a securitisation or asset transfer can be concerned solely with the technical rules regarding its structure. It also has wider implications for a bank's risks.

3 The extent of the risks for a bank involved in a securitisation or asset transfer vary according to the comparative size of the bank and the assets involved, as well as the complexity of the structure of transfer.

4.2 Systems & Controls

4 The FSA needs to be satisfied that a bank acting in a primary role has adequate systems and controls in place to deal with all aspects of the securitisation taking place.

a) Some of the systems implications may be significant. The arrangements for controlling the securitisation should be carefully assessed and monitored, and be subject to internal audit.

b) Where appropriate, the FSA may use section 166 reports as part of the monitoring of these systems.

4.3 Operational risks

See ch CO

5 The FSA takes into account any significant operational risks not related to balance sheet items when setting a bank's minimum (or "trigger") capital ratio. In exceptional cases it may wish to apply an explicit capital requirement against this sort of risk.

4.4 Liquidity

6 Where assets may eventually return to the bank's balance sheet, there are particular issues for banks' management of their liquidity.

7 Before the FSA allows assets to be treated as off balance sheet, it needs to be satisfied that the bank can deal with the liquidity implications. These should be handled within a bank's normal liquidity management and assessed using the standard maturity mismatch approach or, in those cases where it is relevant, the sterling stock liquidity approach.

- See s7 a) The liquidity treatment of revolving-credit securitisations is dealt with in more detail below.
- See s10.4.2 (d) 8 The FSA may require sponsors or repackagers that report on a mismatch basis to meet mismatch guidelines out to six months. Similarly the FSA may require sponsors or repackagers reporting on a sterling stock basis to submit additional information (on a mismatch basis) covering the bank's liquidity out to six months.
- See ch LM 9 A bank may be required to arrange committed facilities to be drawn down to the extent necessary to fund assets returning to its balance sheet. The requirements governing these committed facilities will generally be consistent with the FSA's liquidity approach.
- a) Likewise the FSA follows its normal approach on the question of the weighting of such committed facilities by the lending bank for capital adequacy purposes.
- b) Since such commitments need to be available in circumstances where a replacement securitisation does not prove possible, they should not include a "material adverse change" condition in relation to the bank.

4.5 Capital planning

- 10 Where assets may eventually return to the bank's balance sheet -such as in a liquidity asset repurchase agreement - there are particular issues for banks' management of its capital. Returning assets could affect the capital adequacy of the bank.
- See s10.4.2 (e) 11 Where assets could return to the balance sheet the FSA may request a bank to submit a plan to take account of the possible return of the assets to the balance sheet.
- a) A plan should detail how the bank intends *either* to sell the assets, sell other assets or to raise the requisite capital.

4.6 Remaining asset base

- 12 The process of securitising a significant portion of a bank's assets may lead to a change in the profile of the assets on its supervisory balance sheet, in terms of both quality and spread. These implications are considered when assessing any securitisation scheme and may need to be discussed with the bank.
- 13 The FSA may impose limits on the extent to which assets may be securitised in terms of total volume and/or the types of assets securitised in comparison to the total asset base.

- a) The FSA may regard assets removed from a bank's balance sheet through securitisation, even where the bank complies with the policy in this chapter, as carrying some residual risk to the originator.

5 BASIS OF THE POLICY: METHODS OF TRANSFER

5.1 Introduction

1 The FSA considers that the method of transfer of an asset can have an important bearing on the risks assumed by buyer and seller since different methods achieve the desired 'clean break' to varying extents.

2 Each of the four methods set out below may be used to make an effective transfer of a loan off the supervisory balance sheet. The considerations raised in each case apply in all forms of securitisation or asset transfer; the policies set out in section 6 and elsewhere are additional to the policy for identifying adequate forms of transfer.

Sections 5.2 to 5.4 give the FSA's position on transfer methods for on-balance sheet items; section 5.6 for assets which are undrawn.

3 Methods of transfer, other than the four described below may be valid, especially with reference to transfers carried out in other jurisdictions. If a bank proposes to rely upon any other method, it should be supported by legal opinion and the prior approval of the FSA should be obtained.

5.2 Novation

4 A transfer of an asset through *novation* is regarded as a clean transfer and the asset may be therefore excluded from the selling bank's capital ratio and added to the buying bank's.

a) In a *novation*, the existing agreement between the originator and the borrower is cancelled and a new agreement between the investor and borrower is substituted. This effectively transfers all the seller's rights and obligations to the buyer.

b) In the FSA's view, the cleanest transfer of risk is achieved by novation.

5.3 Assignment

5 A legal or equitable *assignment*, if properly structured, can also achieve an effective transfer of the seller's rights - but not his obligations - and the remedies available to him to enforce those rights.

a) An *assignment* transfers from seller to buyer all rights to principal and interest. A loan agreement may impose restrictions on assignability and these bind the buyer. Thus if assignment is prohibited without the consent of the borrower, the borrower's consent should be obtained. In any case, there may be difficulties in assigning the benefit of rights other than the right to principal and interest. The buyer's rights may be impaired by any rights of set-off that exist between the borrower and the seller.

- b) The seller retains any outstanding obligations (for example, to advance further funds).

6 A transfer through an *assignment duly notified* to the borrower is regarded as a clean transfer, provided that the buyer has taken reasonable precautions to ensure that his rights under the transfer are not impaired by an intervening right; for example, a right of set-off between seller and borrower.

- a) At a minimum there should be a warranty from the seller that no such right of set-off exists.

7 A *silent assignment* (i.e. where the borrower is not notified) is usually regarded as a clean transfer. This is subject to the following:

- (a) the volume of assets to individual borrowers sold on a silent assignment basis should be subject to appropriate internal controls;
- (b) the seller should keep under careful review the risks that follow on from this position as it remains the lender of record and therefore will be the focal point for pressure from the borrower.
 - a) The additional risks for the seller as lender of record are that he remains subject to requests to reschedule or renegotiate or advance further funds.
 - b) The buyer also faces additional risks because the absence of notice to the borrower removes some legal protection he would otherwise have had. These need to be kept under careful review.

If it is not satisfied on these points, the FSA may disregard a transfer of an asset through a silent assignment in calculating the capital ratio of the seller.

5.4 Declaration of trust

8 A declaration of trust is regarded as a clean transfer of the assets that is equivalent to a silent assignment, subject to the following:

- (a) The policy on silent assignments detailed above is fulfilled in relation to the trust.
- (b) The bank receives a legal opinion confirming that the trust is effective to transfer the beneficial interest.

If it is not satisfied on these points, the FSA may disregard a transfer of an asset through a declaration of trust in calculating the capital ratio of the seller.

5.5 Sub-participation

- 9 Where an asset is funded in whole or in part via a *sub-participation*, the FSA recognises the transfer of credit risk by excluding it (or the relevant part) from the original lender's capital ratio, and including it in the sub-participant's as a claim on the underlying borrower.
- a) Sub-participation does not transfer any of the seller's rights, remedies or obligations against the borrower to the buyer, but is an entirely separate, back-to-back, non-recourse funding arrangement, under which the buyer places funds with the seller in exchange for acquiring a covenant from the latter under which he passes on to the buyer payments under the underlying asset which the borrower makes to him, but the asset itself is not transferred.
 - b) Sub-participation is accepted as meeting the FSA's criteria for effective transfer as, although not transferring in a legal sense the rights of the original lender, an asset sub-participation aims to have the same economic effect.
 - c) The sub-participant may, but is not required to, obtain a charge over the underlying assets. Such a charge would, among other things, allow the sub-participant to report on the basis of the capital charge on the underlying assets.
 - d) The sub-participant also faces additional risks since it assumes an exposure to the borrower, but is also at risk to the seller, because it relies on the seller to pass through funds received from the borrower.

5.6 Undrawn commitments

- 10 Where banks transfer an *undrawn commitment* to lend (or part thereof), the commitment (or part thereof) is excluded from the selling bank's capital ratio only when:
- (a) the transfer is by novation; or
 - (b) the transfer is by an assignment accompanied by a release by the borrower of the seller from its obligations, an assumption by the buyer of the seller's obligations and a formal acknowledgement from the borrower of a transfer of obligations from the seller to the buyer.
 - a) An acknowledged assignment is regarded as amounting to, in substance, a novation and therefore effectively transfers this obligation.

- 11 A transfer by means of silent assignment, declaration of trust or sub-participation does not lead to the exclusion of the commitment from the selling bank's capital ratio. Instead the commitment is regarded as being to the buyer rather than to the potential borrower.

- a) This treatment is adopted because an undrawn commitment is an obligation on the part of a lender, whilst an assignment is a transfer of rights only. As explained further below, the seller will face a credit risk in the event of the failure of the buyer.
- b) Note that undrawn advised facilities are not extinguished through sub-participation.

See chs BC s4 &
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12 The buyer's assumption of a commitment (or part) is included in its capital ratio as a claim on the borrower, irrespective of the method of transfer used.

- a) In the case of an effective transfer of the obligation, this is clearly the necessary corollary, as the risk is no longer being taken into account against the seller.
- b) A form of transfer which does not transfer an undrawn commitment, i.e. under silent assignment or sub-participation, gives the appearance of a double counting of the credit risk since it is taken into account for both the seller and the buyer. This is because there are two, legally separate transactions, even if the intention in entering into them is to achieve a combined effect. There are, therefore, two credit risks.

6 BASIS OF THE POLICY: LIMITING THE ASSOCIATION WITH THE ASSETS

6.1 Scope

1 This section covers the general policy applying to banks acting in a primary role. It covers single assets, parts of assets and the packaging, securitisation and sale of asset pools as well as the transfer of risk under sub-participation agreements.

See s7 & 8

a) This chapter includes guidance applying to specialist schemes for particular asset types, additional to that set out in this section.

See s5

b) This section should be read in conjunction with the sections covering effective forms of transfer; the policy in this section should be met in addition to that in section 5.

2 There are a number of general policies applying to both single asset and asset packages, set out in s6.2, and further general policies for asset package schemes only, set out in s6.3.

3 References to assets in the singular are for convenience only, unless specifically stated.

6.2 Policy relating to all types of assets

4 The following conditions for the transfer of a single asset, part of an asset or package of assets should be met:

(a) The transfer should not contravene the terms and conditions of the underlying asset agreement and all the necessary consents have been obtained;

(b) The performer of the primary role has no residual economic interest in the principal amount of the asset (or that part which has been transferred) and the buyer has no formal recourse to the seller for losses;

a) When a secured asset is transferred and further advances are made by the originator, if these additional advances are to be secured there should be a separate formal agreement with the borrower. A side letter is insufficient for these purposes.

(c) The performer of the primary role has no legal or moral obligation to purchase or repurchase the asset (or fund the repayment of a sub-participation), or any part of it, at any time;

See s6.4

- a) The performer of the primary role may not retain an option to repurchase the assets, except where the loan portfolio has reduced to less than 10% of its maximum value and the option extends only to fully performing assets.
- b) The inclusion of a 'step up' will only be permitted for mortgage securitisations and will be considered on a case by case basis pending a fuller review of the policy. Where a bank can demonstrate that the economic characteristics for the assets that it proposes to securitise are the same as for mortgages, the inclusion of a step up may be considered.
- c) The details regarding the repurchase or purchase of assets are explained below.
- d) An exception to the conditions in this paragraph is where the obligation arises from warranties given in respect of the asset at the time of its transfer, provided that these are not in respect of the future credit-worthiness of the borrower.
 - i) The FSA would not regard this condition as met if warranties were provided by the originator on matters outside its control.
 - ii) Environmental warranties should restrict liability to legislation in force at the time of sale, not at any time in the future otherwise they may be regarded as constituting a warranty on matters outside the originator's control.
- (d) The performer of the primary role can demonstrate, to the satisfaction of the FSA, that it has given notice to the buyer that it is under no legal obligation to repurchase the asset (or fund the repayment of a sub-participation), nor support any losses suffered by the buyer, and that the buyer has acknowledged the absence of obligation;
 - a) Penalty interest imposed at the administrator's option does not constitute a loss caused by borrower default and may therefore be met by the performer of the primary role.
 - b) An SPV has an ongoing credit exposure to the performer of the primary role, because it is dependent on it passing on payments it receives in respect of the securitised assets. A bank may provide a guarantee to the SPV in respect of such an obligation by its subsidiary (if all or part of the assets are originated by the subsidiary) if the effect is only to bring the credit rating of the subsidiary up to that of the parent bank. The commitment by the parent may go no further than commitments the subsidiary could have given itself within the limitations of the FSA's policy.
- (e) The documented terms of the transfer are such that, if the asset is rescheduled or renegotiated, the buyer and not the performer of the primary role would be subject to the rescheduled or renegotiated terms; and

- (f) Where payments are routed through it, the performer of the primary role is under no obligation to remit funds to the buyer unless and until they are received from the borrower.
 - a) Payments voluntarily made by the performer of the primary role to the buyer in anticipation of payments from the borrower should be made on terms under which they can be recovered from the buyer if the borrower fails to perform.

6.3 Additional policy relating to asset packages

- 5 The process of packaging assets together and selling them as a block or pool can compound risks that are often negligible when a single asset is transferred. The commercial reputation of the performer of the primary role is committed because of its close association with the scheme; such a commitment may jeopardise the existence of a clean break and there may be pressure to support any losses of investors.
- 6 When performing a primary role for a package of assets, a bank should meet the following additional conditions, in order to ensure that its role is not seen as being more than acting as an agent, whether or not it retains the servicing role:
 - (a) The FSA expects the performer of the primary role to have evidence available in its records that its legal advisers are satisfied that the terms of the scheme protect it from any liability to investors in the scheme, other than liability for breach of express contractual performance obligations as servicing agent or originator or for breach of warranty made with respect to the assets in conformity with the policy in this chapter, or liability for any other matter wholly within the control of the originator.
 - (b) The FSA expects the performer of the primary role to have evidence available in its records that its auditors are satisfied that the terms of scheme comply with FRS5.
 - (c) The FSA expects the performer of the primary role to confirm in writing to the FSA that it has evidence available in its records that its auditors and legal advisers are satisfied, so far as it is within their professional competence, that the terms of the scheme comply with the FSA's policy.
 - a) Regardless of the bank having obtained opinions from professional advisors and its auditors under the sub-paragraph above, the responsibility for ensuring that the scheme meets these provisions rests with the bank.
 - b) The FSA may request sight of the opinions of the auditors and legal advisers.
 - c) The evidence in the bank's records may be included in a section 166 report.

- (d) The performer of the primary role should be able to demonstrate that it has taken all reasonable precautions to ensure that it is not obliged, nor will feel impelled, to support any losses suffered by the scheme or investors in it.
 - a) This may be met by any offering circular (or other analogous documentation) containing a highly visible, unequivocal statement that the performer of the primary role does not stand behind the issue or the vehicle and will not make good any losses in the portfolio.
 - b) Where an existing funding is part of a proposed securitisation scheme, the FSA may consider that the statement need not be made retrospectively, although it should be inserted in subsequent funding issues.
 - c) The provision of insurance cover by a bank or a subsidiary of the bank against loss, e.g. mortgage indemnity insurance, will be considered on a case by case basis.
- (e) The performer of the primary role may not own any *share capital* or other form of proprietary interest in or control over, either directly or indirectly, any company used as a vehicle for the scheme.
 - a) Where the bank acts in a primary role, this also applies to members of the consolidated group.
 - b) *Share capital* includes for this purpose all classes of ordinary and preference share capital.
- (f) The Board of a company used as vehicle for a scheme should be independent of the performer of the primary role, although may have one director representing it.
 - a) Where the bank acts in a primary role, this also applies to members of the consolidated group.
- (g) The name of a company used as vehicle for a scheme should not include the name of the performer of the primary role nor imply any connection with it.
 - a) Where the bank acts in a primary role, this also applies to members of the consolidated group.
- (h) The performer of the primary role should not bear any of the recurring expenses of the scheme.
 - a) Credit enhancements are considered below.

- b) The failure of the performer of the primary role to charge appropriate fees or other compensation may amount to funding. The agreement should specify fees and, if costs are not covered, should be subject to the approval of the FSA as being at an acceptable level.
- c) If a bank wishes to securitise a mortgage book which includes staff mortgages which are subsidised, such a subsidy will not count as funding the vehicle if paid to the employee; it may do if paid directly to the buyer. The different treatment arises due to the likely events upon default.
- (i) The performer of a primary role may not enter into swap agreements with the SPV that intentionally bear losses.
 - a) However, the bank may enter into interest or exchange rate swap at market prices with the vehicle, either directly or through a third party.
 - b) There should be provision for unintended temporary losses arising from normal administrative procedures, for example delays in changing mortgage rates, to be recovered by the servicing agent as soon as possible;
- (j) The performer of a primary role may not fund a vehicle or scheme (except within the terms of condition (h) above) and in particular may not provide temporary finance to cover cash shortfalls arising from delayed payments or non-performance of loans which it administers.
 - a) This section does not apply to sponsors or repackagers.

6.3.1 *Asset replenishment*

- 7 An originating bank may structure a securitisation scheme to allow for further tranches of assets to be placed into the scheme. It should be able to demonstrate to the FSA that at the time of subsequent transfer:
- (a) the asset quality of the pool is not materially altered by the addition;
 - (b) any change to the quality of the assets remaining with the originating bank is either not material or is acceptable to the FSA;
 - (c) (for revolving credit securitisation only) there is no change in the liquidity implications of the securitisation resulting from the addition; or
 - (d) there are no unacceptable changes to the “moral” risks to the originator signalled by the addition.

- a) The test of material alteration of the quality of asset pool is to be applied to the pool at the time of the proposed addition, not to the quality of the pool at the original securitisation.
- b) A bank may discuss and receive non objection from the FSA for asset replenishment either at the time of each replenishment or once only to establish a framework to apply for several replenishments.

6.4 Repurchasing the assets

6.4.1 *Repurchasing by an originator*

8 An originator should not repurchase the asset securitised from the SPV unless one of the following circumstances apply:

See 6.2.(c)

- (a) The repurchase is for a breach of warranty;
- (b) The repurchase is of fully performing or defaulted assets when the loan portfolio has sunk to less than 10% of the maximum face value of the assets;
 - a) The total size of the pool for these purposes is equal to the maximum total face value of the assets during the life of scheme, prior to the calculation.
 - b) Defaulted assets may be bought back for nominal consideration.
 - c) Repurchases for further advances or product switches from a mortgage pool will be agreed on a case by case basis pending a fuller review of the policy.

Any repurchase should be performed at market prices with no preference of any kind being shown in the terms and is subject to the bank's normal credit approval and review process;

9 A bank may restructure or refinance a securitisation only if the assets remain, at all times, off the balance sheet.

- a) A bank should notify the FSA when wishing to restructure or refinance a securitisation. The restructuring or refinancing will be considered on a case by case basis.

6.4.2 *Repurchasing by a sponsor or repackager*

10 A sponsor may purchase or a repackager may repurchase or purchase the assets from a scheme. At the time of (re)purchase the following conditions should apply:

- (a) The assets are either investment grade or defaulted, in the case of financial instruments, or fully performing or defaulted, for non-financial instruments;

See 6.2.(c)

- a) If the repurchase occurs due to a breach of warranty, the policy in this section need not be followed.
 - b) Defaulted assets may be bought back for nominal consideration.
- (b) The repurchase is performed at market prices with no preference of any kind being shown in the terms and is subject to the bank's normal credit approval and review process.

7 SPECIAL STRUCTURES: REVOLVING CREDITS

7.1 Introduction

1 Compared with other types of securitisation, schemes to securitise *revolving credits* introduce the possibility of increased legal and moral risk. This arises from the complexity of the arrangements, the shared interest of the originating bank and investors, and the eventual reversion in full to the originating bank of the pool of accounts. Additionally, the speed at which assets return to the balance sheet of the originating bank may cause liquidity problems.

2 Although most securitisations to which this policy applies are of credit cards, it is not limited to any particular type of assets but applies whenever the structure has the characteristics described in the above paragraph.

3 If carefully constructed, however, such schemes can result in the originating bank successfully transferring the risk on the share of the pool assets to the investors. This section outlines the conditions that should be met in respect of revolving credit securitisations in order for the assets to be given off-balance sheet treatment for supervisory purposes.

The policy in this section is additional to the general policy set out in section 6 and the conditions for effective transfer in section 5.

- a) The term *revolving credits* refers to loan facilities which permit borrowers to vary the drawn amount within an agreed limit. Repayment may be at the borrower's discretion, subject in some cases to a minimum amount per payment period, or by fixed schedule.
- b) *Securitisation* of such receivables is especially complex because of the nature of the assets as fluctuating and of indefinite maturity.
- c) Typically, schemes insulate investors in the notes from the effects of fluctuating balances by assigning shares in the receivables that are the subject of the securitisation both to the investors (the *investor interest*) and to the originating bank (the *seller interest*). The amount of the investor interest in the outstanding balances normally stays fixed at the amount of their funding (until the notes start to amortise) whereas the amount assigned to the selling bank goes up or down as borrowers make net drawings or repayments.
- d) Schemes are given a fixed maturity by dividing their life into a revolving (or interest-only) period and an amortisation period.
 - i) During the *revolving period*, the investors receive their share of interest payments, but their share of principal repayments by borrowers is reinvested in the pool.

- ii) During the *amortisation period*, the investors' share of principal repayments is used to redeem the securities, with the result that at the end of the scheme the full interest in the outstanding balances has reverted to the originating bank.

7.2 Principles

4 In setting the conditions for off balance sheet treatment of the share of the balances funded by investors, the FSA considers it a fundamental principle that the arrangements for the securitisation should ensure the full sharing of interest, principal, expenses, losses and recoveries on a clear and consistent basis.

- a) This principle implies, among other things, the need for full loss-sharing on the stock of receivables in the pool throughout the revolving period of the securitisation, since the investors' share of the receivables is removed in full from the originating bank's balance sheet for the whole of that period.

5 There is no specific limit on the total volume of outstanding revolving credits that a bank may remove from its balance sheet using securitisations. It is therefore important to ensure:

- (a) that adequate standards apply to the structure of securitisation schemes; and
- (b) that the implications of securitisation for the bank's risks generally are adequately handled.

7.3 Features and treatments

7.3.1 Pooling

6 Schemes typically involve the transfer of a pool of receivables into a trust.

- a) The trust directs the flows on the accounts to the originating bank and to a special purpose vehicle (SPV) according to the proportion of the funding that they are providing.
- b) The SPV in turn directs the flows to the investors who hold the securities.
- c) Schemes usually contain provisions concerning the selection of the original pool of receivables from the assets on the originating bank's balance sheet and the subsequent replenishment, as necessary, of the pool of accounts.

7 These arrangements form the basis of an acceptable structure to allow the share of the balances funded by the SPV to be removed from the originating bank's balance sheet for supervisory purposes.

- 8 A bank may take back the full financing of a pool at the end of the scheme if there is no reason to assume that its performance will have deteriorated in the meantime.
- a) For a scheme to be acceptable, therefore, the FSA needs to be convinced that it contains no features - for example for the substitution of higher-quality accounts into the scheme - as a result of which the performance of the pool systematically favours the investor interest.
 - b) Adequate seasoning of the accounts transferred into the pool - so that they are likely to display the characteristics of fully operational accounts - is usually required; together with the random selection of the assets transferred into the pool, this should normally ensure that investors are not systematically advantaged.
 - c) In addition, the scheme's documentation should ensure that servicing practices are applied consistently to securitised and unsecuritised loans.

7.3.2 *Aggregated and disaggregated*

- 9 Schemes may incorporate one of two main approaches concerning the payments received by the SPV in respect of the pool of accounts transferred:
- Under the *aggregated* approach, the payments received during a period are aggregated and in distributing them shares are applied to that aggregate, treating the receivables as a homogeneous pool.
 - a) The pool of assets is looked upon as though it were one and receipts/advances apportioned between originator and investor.
 - Under the *disaggregated* approach, the amounts paid to investors and the originating bank are linked to particular receivables that they have financed.
 - b) Each advance/receipt is allocated to either the originator or the investor.

Schemes using either approach may be eligible for off balance sheet treatment by the FSA.

7.3.3 *Scheduled amortisation*

- 10 Under the *scheduled amortisation* of the securities, the outstanding balance of receivables reverts to the originating bank after a scheduled date fixed in the terms of the securitisation, in a controlled manner.

The FSA considers that the following conditions should be met by the provision for scheduled amortisation in a scheme:

- (a) There is a need to ensure full loss-sharing on the stock of receivables throughout the revolving period of a securitisation, which has implications for the rate at which schemes may be amortised at the end of that period.
 - a) If an SPV is able to a large extent to derive repayment flows from borrowers who turn over their balances quickly, and relatively little reliance on borrowers who pay only the minimum amount each month, it might be able to make a very rapid exit from the scheme.
 - b) If the borrowers who paid their debts slowly had different risk characteristics from those repaying and renewing credit at a fast rate, this might allow the investors to avoid their full share of losses on the pool at the end of the revolving period.
 - c) The pace of repayment during any set amortisation period should not in normal circumstances be more rapid than would be allowed by straight-line amortisation over the period.
- (b) Amortisations providing for a *clean-up call* - by which an originating bank has the option to buy back the remaining securitised assets - are considered to be acceptable so long as the clean-up can occur only when 10% or less of the receivables at the start of amortisation remain outstanding.
- (c) If the scheme is based on the disaggregated approach, this is an acceptable structure (as long as any assumption that it includes about the length of the amortisation period is reasonable).
 - a) The investor interest is not eliminated until each borrower in whose debts the SPV shares has made sufficient principal payments to cover the balances outstanding at the end of the revolving period - or these have been recognised as in default.
- (d) If the scheme is based on the aggregated approach, this is more complex but may still be acceptable. There is a need to allay the concern that the SPV may be able to exit from the scheme while a substantial proportion of the total amount outstanding at the start of the scheduled amortisation period remains outstanding.
 - a) This may be the result of a scheme in which, after the start of the amortisation period, investors are repaid from a fixed share of the repayments arising from the aggregate gross flows on the accounts, including repayments of new borrowings incurred during the amortisation period.
- (e) For aggregated structures, the originating bank should be able to demonstrate (either on a theoretical basis or on the basis of historical statistics) to the FSA that, by the end of the scheduled amortisation

period, borrowers in the pool should have made sufficient payments to ensure that in aggregate at least 90% of the total debt outstanding at the beginning of the amortisation period will have been repaid or recognised as in default.

- a) Payments are taken to include both principal and interest.

7.3.4 *Early amortisation*

11 *Early amortisation* of the securities provides for the repayment of the investor interest to be brought forward on the occurrence of certain circumstances defined in the terms of the securitisation. Such an occurrence is called a *trigger event*.

12 Various early amortisation triggers have been included in past securitisations, in the United Kingdom and elsewhere. They may be divided into two main kinds: *economic* and *non-economic* triggers.

- (a) *Economic* triggers activate early amortisation because of a deterioration in the performance of the pool of receivables: for example, a fall below a certain level in the yield of the pool net of provisions, interest and other expenses. The FSA considers that *economic* triggers may, therefore, be included only if:
 - (i) there is full sharing of interest, principal, expenses, losses and recoveries on the balances outstanding at the start of the amortisation period, using either the disaggregated approach or the aggregated approach applying the same conditions as outlined in paragraph 10 above; and
 - (ii) that at the point that early amortisation is triggered losses on the pool will have reached a level where the bank will feel able, if necessary and without putting its reputation at risk, to reduce its new lending broadly in line with the amortisation of the investor interest. The bank should be able to demonstrate to the FSA that this is the case.
- a) In some cases, such triggers allow investors to reduce their participation once they begin to experience losses and commit the originating bank to taking back the full financing in these circumstances. Because the FSA is seeking to ensure full loss-sharing, it considers that certain conditions should be met on the inclusion of *economic* triggers if the assets securitised are to be given off balance sheet treatment. The conditions are intended to prevent the inclusion of such triggers providing, in effect, implicit credit support. The aim is to ensure that investors share in losses for as long as these remain unusually high or until the originating bank decides, and feels able, to run down its portfolio in line with the amortisation of the investor interest.

- (b) *Non-economic* early amortisation triggers relate to changes, other than in the performance of the securitised assets, which have significant implications for the securitisation.
- a) Past examples include tax-event and legal-change triggers, triggers relating to the originating bank's material non-performance in its role as servicing agent to the SPV, and triggers relating to the insolvency of the originating bank or SPV.
 - b) In the FSA's view, the presence of these particular types of trigger does not amount to credit support. It therefore considers that such early amortisation triggers may be included in acceptable schemes, and in these limited cases a form of *rapid amortisation* - by which the investor interest may be repaid as fast as is allowed by its share of the inflow of principal payments - may be included.
 - c) The FSA needs to be convinced of the case for allowing any other forms of *non-economic* early amortisation trigger.

7.4 Implications of schemes for a bank's general risks

7.4.1 Context

13 This subsection explains the particular concerns relating to banks involved in revolving credit securitisations. It should be read in conjunction with Section 4 which discusses the implications for securitisations generally; the policy in this section is in addition to that set out in Section 4.

7.4.2 Systems

14 Systems needs are more complex than in other securitisations, because of the active nature of the assets, the consequent need for the identification of loans and payments, and the monitoring of the portfolio's performance.

7.4.3 Liquidity

15 The eventual return in full of the revolving-credit balances to the bank's balance sheet - as a result of either their scheduled or early amortisation - means that such securitisations raise particular issues for originating banks' management of their liquidity.

- a) These liquidity implications should be handled within a bank's normal liquidity management and assessed as under Section 4.4.
- b) In the case of securitisations of credit-card (and similar) receivables, this approach is combined with the FSA's normal liquidity approach for credit cards.

- c) Before the FSA is able to assess whether it is appropriate to treat such assets as off balance sheet, it needs to be satisfied that the bank can deal with these liquidity implications.
- 16 Each scheme should be included in a bank's liquidity management assuming, in normal circumstances, that during its amortisation the bank may be required to find replacement funding for the full amounts previously provided by the investor interest.
- a) This is because it may not be possible to arrange a replacement securitisation, and an across the board withdrawal or reduction of borrowers' facilities would put its reputation at risk.
- b) In each case, the FSA will consider whether an extra margin based on the likely maximum net growth in lending should be added to the funding requirement, and will, if necessary, set this margin in consultation with the bank including whether to include in the funding requirement an estimate based on the likely maximum net growth in lending.
- 17 For scheduled amortisations, before off balance sheet treatment is adopted, a bank should outline how it expects to manage its liquidity. A bank should satisfy the FSA that its liquidity arrangements could cope with the additional need for funding and, where appropriate, that it would build up additional liquid assets for the periods covering amortisation payments.
- a) This should include, at the appropriate maturities, the cash outflows resulting from the scheduled repayments to investors plus any additional growth margin decided on.
- b) The FSA examines banks' proposals to ensure that schemes do not unwind at times and in amounts that would pose difficulties for the bank concerned.
- 18 For early amortisation triggers in a securitisation scheme there are additional complications, since they render uncertain the timing of the potential need for replacement funding.
- (a) For a bank originating a scheme incorporating an early amortisation trigger or triggers, and having it treated as off balance sheet the bank should be able to demonstrate to the FSA that it has adequate funding plans in place to cope with their implications.
- (b) Where schemes include early amortisation triggers, the FSA wherever possible agrees with the originating bank 'warning indicators' that early amortisation might be triggered.
- a) For example, if the scheme allows early amortisation to be triggered after three successive months of negative net yield on the portfolio, a warning indicator might be one month of negative net yield. Following a signal from one of these

warning indicators, the maturity of the scheme will be advanced in the bank's liquidity reporting; in this example, its presumed maturity immediately after the warning indicator would be two months.

- b) For those banks operating using the stock liquidity approach, the FSA where appropriate will seek to agree with the bank the additional liquidity that should be maintained in the event of a signal from a warning indicator.
- (c) Where a scheme includes an early amortisation trigger that does not permit any warning indicator, the originating bank should likewise explain how it would cope with the liquidity implications of its being triggered.

19 There is additional liquidity risk in the case of originators of more than one securitisation with the same early amortisation trigger(s) (whether 'economic' or 'non-economic').

- a) Because the potential liquidity demand on such banks is multiplied if the early amortisation triggers in each can be triggered at the same time, in such cases the FSA needs further reassurance as to the liquidity implications before being able to agree the appropriate off balance sheet treatment of subsequent issues.

20 In order for a bank to satisfy the FSA that it can deal with the liquidity implications of the amortisation of schemes, it may need to arrange committed facilities to be drawn down to the extent necessary to fund receivables returning to its balance sheet.

- a) The policy governing these committed facilities generally is that used elsewhere in the FSA's liquidity approach. Likewise the FSA follows its normal approach on the question of the weighting of such committed facilities for capital adequacy purposes. Since such commitments need to be available in circumstances where a replacement securitisation does not prove possible, they should not include a material adverse change condition in relation to the bank.

7.4.4 Capital

21 For a bank carrying out revolving-credit securitisations amounting to a high percentage of its solo capital base, the FSA monitors and where appropriate discusses with its management the potential capital implications of its involvement in the securitisation market. Consideration here takes account of the size and development of that market.

- a) This is a particular issue where the presence of common early amortisation triggers makes it possible that a significant volume of assets could revert to the bank at the same time, thereby threatening to cause problems both for the bank's liquidity and its capital requirements.

8 OTHER SPECIAL STRUCTURES

8.1 Transfers of receivables arising from the finance of equipment or consumer goods

8.1.1 Introduction

See s2

- 1 The FSA's principal policy objective is to ensure that in any securitisation, all parties fully understand the responsibilities and risks which they assume or retain, and that any material risks to buyers or sellers are properly treated in the supervision of banks.
- 2 The financing of the purchase of equipment or consumer goods (including hire-purchase) can involve particular risks, which it is difficult legally to transfer to a buyer of the receivables, which may adversely affect this objective.
- 3 The policy in this section is additional to the general policy set out in section 5 and 6.

8.1.2 Concerns

- 4 The following concerns are particular to a securitisation of this type of loan:
 - (a) This type of lending can involve lenders in continuing liabilities for the "merchantability" of goods or equipment.
 - (b) If defective goods were to cause personal injury, very substantial costs could arise.
 - (c) In addition to liabilities for the quality of equipment, institutions involved in the finance of equipment hire or leasing may have contractual obligations towards the borrower - for instance to arrange for the servicing or taxation of vehicles.
 - (d) It is difficult legally to transfer these obligations, unless the transfer is done through novation.

8.1.3 The FSA's policy

- 5 The FSA views the following as the necessary steps to address these concerns:
 - (a) The FSA believes that for assets to be viewed as off-balance sheet, sellers should either receive an indemnity from the buyer to cover any liability, or otherwise take steps to minimise the risk of loss (such as taking out insurance to cover the risk).

- a) Lenders against whom claims are made as a result of their liability for the quality of goods or equipment usually have recourse to the manufacturer which, provided the manufacturer has appropriate liability insurance, may limit the risk to the lender. In addition, the FSA has been given to understand that the loss experience of lenders under such claims is historically very small. Nevertheless, the FSA does not view the risk retained by the seller as unimportant.
- (b) In situations where the seller is left with responsibilities of the kind outlined in paragraph 4 above, the FSA has some concern over the position of the buyer (if the buyer is a bank). The FSA reminds buying banks that risks of this nature need careful evaluation. Buyers should satisfy themselves of the seller's competence to fulfil its obligations towards the borrower in a timely manner.
 - a) There is a clear possibility that the borrower will exercise a right to reduce or withhold payments on the loan to reflect his costs - for instance, the cost of repairing the vehicle - if the original lender fails to meet his obligations under the loan agreement.

8.2 Securitisation of a reverse repo

- See s6 6 Where the benefits of a reverse repo are transferred, the transaction is considered to be the securitisation of a single loan. The originator therefore should comply with the policy above for standard schemes.
 - a) A reverse repo is where a bank has bought (or borrowed) trading book securities from a counterparty subject to buyback (or a return clause);
- 7 Whether the securitised loan is considered to be secured or unsecured depends on the structure of the transaction.
 - a) A sub-participation is deemed to be unsecured.
 - b) Where the transactions are through a trust structure (the trust having legal title) it will usually be secured.
- See s7 8 Where the transaction is through a trust structure and the originator retains an interest in the reverse repo, the concerns raised in respect of sharing of interest, principal and losses for revolving schemes should also be addressed by the bank.

9 SECONDARY ROLES: CREDIT ENHANCEMENTS

9.1 Background

See s6.3 (h)

1 The policy on credit enhancements is part of the wider policy on securitisation published by the FSA, and therefore feature in a previous section. Because of their importance and the variety of possible constructions, this section expands upon the basic rules.

9.2 Overview

2 A credit enhancement is an arrangement provided for the SPV that, in form or substance, covers the losses and risks associated with the pool of assets. The level of the enhancement is reflected in the rating given to the notes by a rating agency.

- a) Where a bank demonstrates a pattern of providing (implicit) support, it will be deemed to have provided credit enhancement.
- b) An enhancement can be an integral part of the structure used to manage funds or securitise assets (i.e. driven by cash flow) or may be provided from outside the structure (i.e. provided by the originator or another third party).
- c) Ratings agencies require banks to provide credit enhancement in order to make the paper issued in securitisations more attractive to investors.

3 A bank acting in a primary role may provide credit enhancement to support an SPV (and its investors). The capital charges against the credit risk that should be made are detailed below.

9.3 Structure of credit enhancements

4 A credit enhancement may be structured in a number of forms, examples include:

- (a) A subordinated loan or note facility issued by a bank equal to a maximum amount of credit support being provided.
- (b) Over-collateralisation, where the face value of the assets is greater than the securities issued. The securitisation will amortise more quickly and a buffer is created against losses. On maturity, any residual assets revert to the originator.
 - a) The credit enhancement, for calculating capital requirements, is the over-collateralisation.
- (c) Spread accounts. The interest rate on the assets is usually higher than the coupon on the securities issued, with the difference being

used to cover costs and provide for losses. Utilising all or part of this for credit enhancement purposes means leaving it in the SPV rather than returning it to the originator.

- a) If the funds are to be returned to the originator, the FSA considers that the SPV should not have recourse to the monies thereafter.
- b) The conditions detailed in 9.4 do not apply to credit enhancement in the form of a spread account retained by the SPV.

See ch TI s9

5

Securities issued that are deemed to be investment grade by relevant rating agencies, as defined, are deemed not to constitute credit enhancement if there is already sufficient credit enhancement within the terms of this section.

See 9.6.1

- a) The limitations on the ability to hold such securities are detailed below.

See s11

- b) The limitations on the ability to trade such securities are detailed below.

9.4 Detailed policy

6

Any bank providing credit enhancement should ensure that:

- (a) the facility is limited in amount and duration;
- (b) there is no recourse to the bank beyond the fixed contractual obligations provided for in the facility;
- (c) the SPV and/or investors in a bond issue have the clear right to select an alternative party to provide the facility;
- (d) the facility is documented separately from any other facility provided by the bank;
- (e) the transaction should be undertaken at the initiation of the scheme;
 - a) However, in the event of a scheme having subsequent tranches of assets being placed in to the SPV, within the terms set out above, the credit enhancement can increase at that time, if detailed in the offering circular. The new credit enhancement should not be used to provide, in a disguised way, enhancement for earlier tranches of assets and schemes seeking to be structured in this way should be discussed in advance with the FSA.
- (f) the details of the facility should be disclosed in any offering circular or other appropriate documentation; and
- (g) payment of any fee or other income for the facility is not further subordinated, or subject to deferral or waiver, beyond what is already

explicitly provided for in the applicable order of priority and other payment entitlement provisions.

See s9.6 & 9.7 7 If the above conditions are met, the relevant capital treatment that should be applied is detailed below.

9.5 Definitions of first loss & second loss credit enhancement

9.5.1 General

8 The distinction between the types, *first loss* and *second loss*, is drawn to allow for an understanding of the underlying structure, and for the other implications resulting from this.

9.5.2 Definition of first loss credit enhancement

9 A *first loss facility* represents the first level of financial support to a SPV.

- a) A first loss facility bears, in effect, all of or the bulk of the risk associated with the assets held by a SPV, as part of the process in bringing the paper issued by the SPV to investment grade. Hence the high capital cost.
- b) A payment by a bank to provide cover against losses incurred by an SPV (e.g. to fund a reserve account) or the sale of assets to an SPV for below their book value in the bank's books (where not written down or off against profits) is regarded as a *first-loss facility*.
- c) Capital is not required for *spread accounts* where the funds are held in the SPV.
- d) Additional capital is not required for *over collateralisation* beyond the assets that are effectively written off in providing the margin of assets.

9.5.3 Definition of second loss credit enhancement

10 A *second-loss facility* represents a credit enhancement providing a second (or subsequent) tier of protection to an SPV against potential loss. The share of risk of a second loss facility depends on the coverage provided by any first loss facility. In order to limit the possibility of the second loss facility carrying a disproportionate level of risk, a credit enhancement facility is deemed a second loss facility only if:

- (a) it enjoys the benefit of protection from a substantial first loss facility; and
- (b) it can only be drawn after the first loss facility has been exhausted.

- a) For the purposes of this section, a first-loss facility will be considered substantial where it covers some multiple of historic losses or worst case losses estimated by simulation or other techniques.
- b) A bank providing a second loss facility needs to assess the adequacy of the first loss facility on an arm's length basis in accordance with its normal credit policies. A review of first loss facilities might refer to such factors as:
 - i) the class and quality of the assets held in the SPV;
 - ii) the history of default rates on the assets;
 - iii) the output of any statistical models used by banks to assess expected default rates on the assets; the types of activity permitted the SPV (i.e. whether the risk underlying the credit enhancement facilities extends beyond the asset held);
 - iv) the quality of the parties providing the first loss facility; and
 - v) the opinions or rating letters provided by reputable third parties, such as rating agencies, regarding the adequacy of the first loss protection.
- c) Where a second loss facility provided by a bank would substitute for a first loss facility provided by another party, in the event of that party failing to meet its obligations, the bank should treat the facility it provides as equivalent to a first loss facility.

9.6 Credit enhancements supplied by an originator

9.6.1 *Restrictions upon an originator*

11 An originator should only make a one-off contribution to enhance the credit-worthiness of a vehicle. Any transactions should be funded at the initiation of the scheme and disclosed in the offering circular.

- a) The agent or originator may lend on a long-term subordinated basis to the vehicle only if the loan is made at the outset of the scheme and is repayable only following winding up of the scheme.

See s11

12 An originator may not hold any of the securities issued by the SPV unless it has received a waiver to deal, as detailed below.

- a) Any holdings in excess of the agreed dealing limits will be deducted from capital.

9.6.2 *Treatment for first loss*

- 13 The originating bank may make a choice of either deducting the amount of the credit enhancement from capital or including the assets within their risk weighted asset ratio under normal rules as if there had been no securitisation. The choice should be made at the outset, maintained for the duration of the credit enhancement facility and be advised to the FSA.

9.6.3 *Treatment for second loss*

- 14 An originator providing a second loss facility (in an acceptable form) should deduct the amount of the facility from capital.

9.7 Credit enhancements supplied by a sponsor or repackager

9.7.1 *General*

- 15 Due to the complexity of conduit and repackaging schemes, the definitions of first and second loss facilities may be difficult to apply. In such circumstances, the FSA should be consulted.

- a) For the purposes of this section, the holding of sub-investment grade paper will be deemed to constitute credit enhancement unless there is already sufficient enhancement within the scheme.

9.7.2 *Treatment for first loss*

- 16 First loss credit enhancement facilities provided by a sponsor or repackager should be deducted from capital.

9.7.3 *Treatment for second loss*

- 17 A bank acting as sponsor or repackager which provides a second loss facility, as defined above, may weight the facility as normal, provided that the extent of the bank's involvement is fully and properly explained in any offering circular for the scheme, or is otherwise notified to investors, and it is made unequivocally clear to investors:

- (a) that the bank's responsibilities do not go beyond that which is provided for in the second loss facility in question (as explained in the offering circular); and
- (b) the bank will not support losses beyond the requirements of the second loss facility or generally stand behind the scheme.

10 SECONDARY ROLES: LIQUIDITY FACILITIES

10.1 General

1 *Liquidity facilities* enable SPVs to assure investors of timely payments. These include smoothing timing differences in the payment of interest and principal on pooled assets and ensuring payments to investors in the event of market disruptions. Such facilities can be particularly important where SPVs hold long term assets funded by the issuance of short-term securities.

- a) Ratings agencies require banks to provide liquidity facilities in order to make the paper issued in securitisations more attractive to investors.
- b) The Commercial Paper (CP) markets display some degree of volatility. For example, in the United States, this may cause the \$CP rates to diverge from \$LIBOR from time to time, particularly over the year-end, quarter ends and US tax payment days. SPVs are sometimes therefore set up in such a way that they are not tied to an obligation to fund assets for a full quarter on specific days each quarter so as to avoid such difficult days. A liquidity facility may be key to the flexibility an SPV needs in such circumstances.

10.2 Detailed Policy

2 To guard against the possibility of a facility functioning as a form of credit enhancement, a liquidity facility when provided should satisfy the following conditions:

- (a) the facility is provided on an arm's length basis and is subject to the bank's normal credit review and approval processes;
- (b) the facility may be reduced or terminated should a specified event relating to a deterioration in asset quality occur, e.g. the facility should not be available to be utilised if the assets of the SPV have deteriorated in quality to the extent there is no longer a sufficient level of credit enhancement to cover the amount of any new or existing drawdowns under the facility.
- (c) the facility should be conducted on market terms and conditions;
- (d) the facility is limited in amount and duration;
- (e) there is no recourse to the bank beyond the fixed contractual obligations provided for in the facility;
- (f) the SPV and/or the note trustee representing the investors have the clear right to select an alternative party to provide the facility;

- (g) the facility is documented separately from any other facility provided by the bank;
- (h) payment of any fee or other income for the facility is not further subordinated, or subject to deferral or waiver, beyond what is already explicitly provided for in the applicable order of priority and other payment entitlement provisions;
- (i) the facility may not be drawn for the purposes of credit support;
- (j) the documentation clearly defines the circumstances under which the facility may be drawn and prohibits drawing in any other circumstances;
- (k) the facility will provide for repayment of advances within a reasonable time period;
- (l) funding is provided to (or via) the SPV and not directly to investors;
- (m) proceeds of drawings under the facility cannot be used to provide permanent revolving funding, or be for the express purpose of purchasing underlying assets held by an SPV (although it is permissible for a liquidity facility to be structured as an arrangement in which underlying assets held by the SPV are purchased by the liquidity provider, provided that the assets in question are investment grade);
- (n) funding cannot be used to cover losses recorded by the SPV; and
- (o) drawings under the facility are not subordinated to the interests of investors, except that drawings may be subordinated to other liquidity facilities if a tiered liquidity facilities are used in a scheme. Such subordination should be clearly set out in the offering circular or other appropriate documentation.

3 Failure to satisfy these conditions will cause the facility to be deemed to be serving the economic purpose of a credit enhancement facility and therefore be treated in the same way as a credit enhancement for capital purposes.

- a) The facility may be deemed to be a first or a second loss facility, as appropriate.

10.3 Restrictions on originators

See s6.3

4 An originator should not provide a liquidity facility as it is deemed to be funding. If it does, it is deemed not to have achieved a clean break with

the assets, which will then be considered by the FSA as being on its balance sheet.

- a) The provision of a liquidity facility to cover very short-term timing differences may be considered acceptable. However, there should be no obligation on the bank to make the payment, the vehicle should have sufficient funding to meet any clawback claims and the structure should be covered in the scheme's documentation.
- b) Although originators may not provide a liquidity facility, the workings of the securitisation vehicle may still require one which may, therefore, be provided by a third party bank.

10.4 Restrictions upon sponsors and repackagers

10.4.1 General

See ch BC s4

5 A sponsor or repackager may provide a liquidity facility to a scheme. The facility will be calculated as 100% weighted asset drawn and 0% or 50% undrawn (in the normal way), provided that the extent of the bank's involvement is fully and properly explained in any offering circular for the scheme, or is otherwise notified to investors, and it is made unequivocally clear to investors:

- (a) that the bank's responsibilities do not go beyond that which is provided for in the liquidity facility in question (as explained in the offering circular); and
- (b) the bank will not support losses beyond the requirements of the liquidity facility or generally stand behind the scheme.

6 If these conditions are not met, the bank should treat the scheme as a fully consolidated subsidiary for capital adequacy purposes.

- a) If a bank acting as sponsor is seeking to use the concessionary treatment of section 3.2.2 paragraph 5, (as a partial originator in a multi-seller vehicle, providing a part of the liquidity facility) and fails the tests in this section, then any assets it originates will be considered as remaining on its balance sheet.

10.4.2 Large Exposures

7 Conduits can grow to considerable sizes and consequently a liquidity facility provided by a sponsor or repackager to such a conduit could potentially exceed the bank's large exposures capital base. A bank should only disaggregate facilities where the following general conditions are fulfilled:

- (a) The facilities are provided to separate legal entities;

- See Ch LE s5.2
- (b) The legal entities are not closely related counterparties for large exposure purposes;
- a) The details regarding large exposures are explained in chapter LE.
- See s4.2
- (c) The bank has systems and controls in place to monitor the assets within the conduit;
- a) The need to aggregate the underlying assets involves the use of complex systems and controls. A bank should be able to satisfy the FSA that it is able to control the securitisation properly primarily at notification and through the section 166 process.
- See s4.4
- (d) There are internal systems in place, that have undergone stress testing on mismatch limits, to monitor and/or manage the bank's liquidity out to at least six months; and
- a) It is possible for CP conduits to grow to a significant size. Should there be a disruption to the CP market that requires the drawing of a facility, sizeable funds will be needed to meet the demand. The drawing of these funds may accelerate as each CP fund matures. The sponsor should be able to monitor its liquidity to ensure that it is able to cope with such an effect.
- b) Conduits should manage their CP maturities so that they do not have significant amounts of CP maturing during any one day or week. If the liquidity lines' renewal dates are not concentrated the bank may be less exposed to market disruption as drawing will take place over a longer period of time.
- See s4.5
- (e) The sponsor's capital planning takes account of possible drawings under the facilities i.e. that they are either able to sell the assets, sell other assets or raise the requisite capital. A sponsor should pre-notify the FSA as to how it will provide capital in the event of possible drawings.
- a) If a CP disruption occurs it may result in the sponsor making a large loan or taking a large quantity of assets onto the balance sheet over a short period of time. A sponsor should plan how it will provide capital in the event that this occurs.

8

The FSA considers that it is appropriate for a bank to disaggregate facilities where the following specific conditions are fulfilled:

- (a) For an asset repurchase facility, the exposure to the obligor for each underlying asset held by each special purpose vehicle is aggregated for large exposures purposes with the bank's own exposures to that obligor; or

(b) For a liquidity backstop facility, a bank takes reasonable steps to aggregate, for large exposure purposes, exposures to the obligor of the underlying assets, that represents a significant proportion of the pool, with the bank's own exposure to that obligor.

a) A bank should also take into account any originator, sectoral, country or regional concentrations when providing liquidity to an SPV.

b) A bank should not only aggregate the exposure to the obligors of the underlying assets across the SPVs but also any exposures to closely related counterparties across the SPVs.

See ch LE s9.2.7

10.4.3 Bridging Loans

9 *A bridging loan* is a loan made to a vehicle, prior to the issuance of the notes, to cover a mismatch in time between the date of purchase of the underlying assets and the date of issue of the securities.

a) A sponsor or repackager should not use the practice in this section to establish a remote origination scheme.

See s3.2.1

10 The FSA considers that it is acceptable for a sponsor or repackager to provide a bridging loan to an SPV subject to usual capital and large exposures requirements where the following conditions are met:

(a) The loan is provided at market prices with no preference of any kind being shown in the terms and conditions;

(b) The sponsor or repackager has the senior secured status; and

(c) The term of the loan is limited to three months or less.

a) The maturity of the underlying assets should extend considerably beyond this period.

11 A sponsor or repackager providing a bridging loan for greater than three months should treat the assets as on the balance sheet until the transaction is completed.

a) Assets that are regarded as being on balance sheet for the purposes of this section will be regarded as originated when securitised.

See s3.2.1

11 SECONDARY ROLES: DEALING & UNDERWRITING

11.1 Dealing & underwriting by an originator

1 An originator may underwrite the securities issued by the SPV. The assets will not be regarded as being off balance sheet until 90% of the total issue has been sold to a third party.

- a) The FSA may vary the minimum level of assets that have to be sold to a third party before off balance sheet treatment is considered appropriate.

See s9.6.1

2 Once the assets have been removed from the balance sheet, any holdings in excess of agreed dealing limits should be deducted from capital. The bank should fully comply with the policy on holding the assets, as detailed above, within one month.

3 An originator should not deal in the securities issued by the SPV unless it has discussed its intention with the FSA. The FSA considers that a bank's deals should be limited. Appropriate limits are likely to represent only a small fraction of the total securities issued.

- a) Limit structures should generally be subject to limits specific to individual tiers of securities issued. Limits are likely to be more constraining for trading in securities other than the most senior debt.

See s6.2

- b) It is an accepted role of an originating bank to promote an orderly market in the securities issued by the SPV, but not to the extent that that originator is or appears to be able to support the issue, which would be in contravention of the policy above.

See s9 and Ch TI
s9

- c) The ability to deal in securities is limited to securities deemed to be of investment grade by a relevant rating agency as defined. Securities below investment grade fall within the definition of as credit enhancement as described below.

- d) The policy is not intended to restrict the ability of an SPV to buy back securities it has issued at or below par.

11.2 Dealing & underwriting by a sponsor or repackager

See ch TU

4 A sponsor or repackager may act as underwriter for the securities issued by the SPV subject to the policy in chapter TU.

See s9

- a) At the end of the underwriting concession period any holdings of sub-investment grade paper will be deemed to constitute credit enhancement unless there is already sufficient enhancement within the scheme.

- b) Securities issued that are deemed to be investment grade by relevant rating agencies are deemed not to constitute credit enhancement, provided that there is already sufficient credit enhancement.

5 A sponsor or repackager may act as dealer in the secondary market in the securities issued by the SPV, provided that there is always at least two other third party dealers.

- a) This may be waived where a scheme is small and having multiple dealers is not practicable. However, given that in such schemes, there may more reason for concerns as to liquidity, the sponsor should be able to demonstrate that it is creating an orderly market and not supporting the issue. Banks wishing to follow this approach should obtain the prior approval of the FSA.

Interim Prudential Sourcebook for Building Societies

11 Outsourcing

11.1 Introduction

11.1.1 G This chapter contains new guidance for building societies on outsourcing.

11.1.2 G The rest of this chapter consists of the guidance for banks on outsourcing (taken from chapter OS of the IPSB for banks). This guidance applies in its entirety to building societies with the following amendments and exceptions:

- (1) all references to “banks” should be read as including building societies;
- (2) paragraphs 3(b)(a)(i) and 4 in section 1.1 do not apply to building societies (societies are not currently subject to the RATE process);
- (3) the date referred to in paragraph 8 in section 1.2 is changed from 30 June 1999 to 1 September 2000.

OUTSOURCING

1 INTRODUCTION

1.1 Legal sources

1 Principle 3 of the Principles for Businesses states that a firm must organise and control its affairs effectively which includes having adequate systems and controls (see also the high-level rule in SYSC 3.1.1R). The Threshold Conditions ('Suitability') also includes the need to ensure that a firm conducts its affairs 'soundly and prudently'. Relevant to the meeting of these requirements is a bank's outsourcing arrangements. In considering any outsourcing proposal, a bank should consider whether the outsourcing meets the material outsourcing definition below. Where the proposal meets these criteria, the bank should take into account the system and control implications, including adequate anti-money laundering systems, and the degree to which management control of the task will be relinquished to the supplier. The FSA considers that a bank's management is accountable for the adequacy of systems and controls for the outsourced activity.

See Supervision Manual, chapter 2

2 The FSA has powers under section 165 of the Act to require a bank to provide documents to the FSA which it reasonably requires in connection with the exercise of its functions under the Act. Nevertheless additional steps need to be taken to protect the FSA's access to information in relation to outsourced activities.

3 Material outsourcing is the use of third parties to provide services to a bank which are of such importance to the bank that:

- (a) a weakness or failure in any of the activities outsourced would cast into serious doubt the bank's continuing compliance with the Principles for Business and Threshold Conditions; and
- (b) the outsourcing is by business units which are *significant units*.
 - a) A *significant unit* is one which is covered by the FSA's risk assessment.
 - i) The first step in the FSA's RATE approach is to agree with banks exactly which units are significant: this process is described in paragraphs 26 to 30 (UK banks) and 31 to 33 (overseas banks) of the FSA's June 1998 paper "Risk based approach to supervision of banks".
 - b) The purchase of a standardised service from, for example, Bloombergs or Reuters and the provision of custody arrangements fall outside of the definition of material outsourcing.

- 4 This definition is solely for the purpose of determining the scope of the policy on outsourcing. It is not intended to restrict discussion with the FSA, nor is it intended to limit the issues that the FSA considers as part of the RATE process. A bank should apply its normal tests in deciding which issues should be raised with the FSA.
- 5 If in doubt as to whether a function would be considered material the bank should discuss the definition of material outsourcing with the FSA.
- 6 Although the principles in Section 4 apply to both intra- and extra-group outsourcing, the FSA applies them flexibly where the outsourcing is intra-group or to another regulated entity, particularly where the outsourced activity is a regulated core business function carried out by the supplier for its own purposes, e.g. cheque clearing.

1.2 Application

- 7 The policy set out in this chapter applies to all banks except EEA banks.
- 8 A bank which had outsourcing arrangements in place on 30 June 1999 or which was close to completing outsourcing arrangements on or after this date, is exempt from the application of this policy until the existing contracts become due for renewal. At that time the FSA expects a bank to discuss with it how the bank intends to apply this policy to the renewal of its existing arrangements.

1.3 How this chapter is organised

- 9 Section 2 sets out the basic scope and range of the FSA's approach to outsourcing proposals. Section 3 summarises the main features of the policy.
- 10 Section 4 details the minimum criteria a bank should adopt when it intends to outsource. These range from its due standard of care, to its relationship with the FSA and to its customers.
- 11 Section 5 sets out some points for further consideration regarding the structure of a bank's relationship with the supplier of the outsourced function. It stresses particularly the standards the bank should expect a supplier to meet and how the bank should monitor the relationship. This section does not represent additional minimum criteria, but a bank still needs to have considered the issues raised; the FSA may ask the outsourcing bank what procedures have been put in place to address relevant concerns.
- 12 Section 6 is an appendix setting out the FSA's general approach to *central booking*. It also explains when the FSA regards central booking as a form of material outsourcing for the purposes of sections 2 to 5.

- a) *Central booking* is where the business is carried out in one location or legal entity within a group and booked in the accounting records of another. In some cases, the risks arising from such business may be managed in a third location.

2 THE FSA'S APPROACH TO OUTSOURCING

- 1 Banks frequently decide to outsource aspects of their operations, either to other group companies or to independent third parties. This is sometimes done on grounds of cost, sometimes because the other party can deliver a better service than can be provided in-house, and sometimes a combination of both.
- 2 The FSA recognises that outsourcing can bring significant benefits to banks and their customers. However, the FSA is concerned that when an important function is performed outside a bank, the bank may lose or have reduced control of the outsourced activity. Furthermore, the FSA's ability to exercise its supervisory powers to gather information or to require changes in the way that the outsourced function is carried out may be affected adversely. In addition, there may be some circumstances in which the FSA will need to assess the suitability of the service provider and its key staff. This policy is designed to address these concerns without impeding unduly banks' ability to use outsourcing to further their business objectives.
- 3 The FSA recognises that some of this policy will not be appropriate to intra-group outsourcing. Where a particular principle applies only to outsourcing either solely within or alternatively outside the consolidated group this has been clearly stated. Where there is no such statement it should be assumed that the policy applies to both intra- and extra-group outsourcing.

3 THE MAIN FEATURES OF THE POLICY

This section summarises the main features of the policy applying in relation to outsourcing banks. It should be read in conjunction with section 4 below.

3.1 Informing the FSA

- See s4.1 1 A bank should make the FSA aware, through its normal supervisory channels, of its intention to outsource a task which, materially, either impacts on its systems and controls or affects its risk profile. This should take place in reasonable time to allow the FSA to consider the proposal and to raise any concerns.
- 2 During the course of the outsourcing agreement a bank should make the FSA aware of any material problems encountered with the outsourcing supplier.

3.2 Material outsourcing proposals

- See s4 3 The FSA expects a bank to be able to analyse the impact outsourcing a particular function will have on its overall risk profile and the bank's internal systems and controls.
- See s4.5 4 A bank should ensure that the FSA has access to any information relevant to the outsourced activity reasonably required by the FSA in connection with the exercise of its functions under the Act.
- See s4.6 5 A bank should ensure that its internal and external auditors have access to any relevant information they require to fulfil their responsibilities.

3.3 The FSA's consideration of banks' outsourcing proposals

- See s4.1 6 The FSA will consider a bank's outsourcing proposal and raise any concerns that it has. The FSA is aware of commercial pressures involved in outsourcing contracts and will agree with the bank a suitable timescale for response.

4 PRINCIPLES OF OUTSOURCING

4.1 General

1 A bank should make the FSA aware of a material outsourcing proposal in reasonable time to allow the FSA to consider the potential impact of the proposal on the bank and to raise any concerns. The FSA is aware of commercial pressures involved in outsourcing contracts and will agree with the bank a suitable timescale for response. Once a bank has notified the FSA of a material outsourcing proposal, the FSA will determine the level of its ongoing scrutiny of the process and ask the bank to provide further information accordingly.

See ch GN s3

2 Regardless of whether the outsourcing supplier is inside or outside the group, the FSA holds the bank's management responsible for ensuring that the outsourced function is carried out to a proper standard and that the integrity of the bank's systems and controls is maintained. The FSA would expect a member of the bank's senior management to take responsibility for each material outsourced function; this person should be an approved person (see 3.3.24G).

3 In some limited circumstances it is possible that a person employed by a supplier may be subject to the approved persons requirements under the Act. Further details are given in the Supervision Manual.

- a) The scope and principles of the approved persons requirements are set out in Part V of the Act, the High Level Standards for Business and the Supervision Manual.
- b) Applicants apply to the FSA to become approved persons using Form A in chapter 10 of the Supervision Manual.

4.2 Principles governing a bank's relationship with its supplier

See s5.2

4 A bank should monitor and manage on an ongoing basis its relationship with the supplier so as to seek to ensure the integrity of its systems and controls is maintained.

5 The supplier should be a competent, financially sound firm with good relevant knowledge and expertise. The bank should be able to demonstrate that it has taken proper steps to verify this and that it also has procedures for assessing the supplier's performance on a continuous basis. Additionally, the bank should be able to satisfy the FSA that the supplier is committed for the term of the contract to devoting sufficient, competent resources to providing the service.

- a) Where the supplier is a member of the same group as the bank, the latter is likely to have a greater pre-existing level of knowledge about the former. The level of assessment may therefore be reduced.

6 The agreement between the bank and the supplier should provide that the bank is informed of any developments which may have a material adverse impact on the supplier's ability to meet its obligations. This includes, for example, relevant material control weaknesses identified by the supplier's internal or external auditors. The supplier's auditors do not have a responsibility to report any concerns to the FSA. Nonetheless, the bank should ensure that there is a clear reporting line between the supplier and itself so that any material problems relating to the outsourced activity can be communicated and to enable it (or the FSA) to make any further enquiries of its own into such problems.

- a) Where the supplier operates abroad, the Data Protection Act 1998 sets out legal requirements governing the transfer of data across borders.

7 For outsourcing outside the group there should be a right to terminate the contract in the event that the supplier undergoes a change of ownership or the supplier becomes insolvent or goes into liquidation or receivership.

4.3 Principles covering service level agreements ('SLAs')

See s5.4

8 An *SLA* is a negotiated agreement on the standards of service between the supplier and the end-user (the bank). A bank should always have a written SLA in place with its supplier, where the outsourcing is outside the group. The SLA should also provide for periodic reviews and appropriate remedies should problems arise. Such reviews should allow for the relationship to be amended via the SLA or contract as appropriate, on the basis of performance against specified targets.

- (a) Banks may be asked to submit SLAs to their supervisors.

9 Where the outsourcing is intra-group a SLA may not always be appropriate. This is particularly the case where a service is supplied on a group wide basis. In such circumstances the supplier may wish to provide a statement of the standard of service to be provided to the whole group. This statement may be supported by a wide range of other existing relationship management systems. Where these provide a sufficient performance measurement structure a SLA may not be required.

4.4 Principles affecting contingency planning

See s5.5

10 A bank should have and regularly review contingency plans to enable it to set up new arrangements as quickly as possible, with minimum disruption to business, if the contract is suddenly terminated or the supplier fails. The level of detail in such plans may vary. For example, if there are large

numbers of possible alternative suppliers the outsourcer may simply be able to use one of the alternative supplier(s). However, this may still be a complex and time consuming process and a bank should consider how it would deal with the hand-over process. If, on the other hand, the only option is for the bank to resume the activity itself the plan should be far more detailed.

- a) As the contract with an intra-group supplier is highly unlikely to be terminated through the actions of the supplier, the only significant risk is that the service will be interrupted by another unrelated event. Such events should be covered by the supplier's business continuity plan and therefore a separate contingency plan for the bank may not be appropriate.

4.5 Principles governing supervisors' access to information

11 The contract between the bank and the supplier should ensure that the bank can provide the FSA with any information relating to the outsourced activity that the FSA may require in order to carry out effective supervision, whether the outsourcing is within or without the group, for example, through section 166 reports by a person with relevant professional skill.

12 Where the supplier is based outside the UK, the bank should assess the extent to which the local regulator/regulations may restrict access to information about the outsourced activity.

13 The FSA should be informed if any other regulator raises serious concerns with the bank's proposal to outsource.

4.6 The auditor's role

14 A bank should have processes in place to identify and deal with any weaknesses in the supplier's procedures which could have a material adverse impact on the service provided to the bank. This could include access for the bank's internal and external auditors, independent reports on the supplier and/or monitoring of detailed performance statistics.

15 In line with the FSA's approach to other areas of banking supervision, where internal or external audit raises material problems the bank should alert its supervisor. The bank should also ensure that it has the management capacity to assess and respond to any such concerns so raised.

4.7 Outsourcing internal audit

16 All cases of outsourcing internal audit will be considered material.

- 17 A bank should not outsource its internal audit function to either its skilled persons or its external auditors. A bank should have an internal audit function independent from external audit as this segregation of responsibilities would be compromised if the same firm fulfilled both functions.
- See ch AR s3 18 However, the FSA considers that it may be appropriate for certain internal audit services to be provided by the external auditors/skilled persons where the following conditions are met:
- (a) the work is carried out under the overall supervision and management of the bank's own internal audit staff;
 - (b) ultimate responsibility for the adequacy and effectiveness of internal audit lies with the Head of Internal Audit.
 - (c) the Head of Internal Audit is a senior and experienced individual who is an employee of the bank, or the group of which the bank is a part.
 - (d) the FSA is satisfied that the Head of Internal Audit has satisfactory reporting lines. These lines would typically involve unfettered access to the audit committee or at a minimum a non-executive director.
- 19 A bank wishing to use its external auditor/skilled person to perform any part of internal audit's function should notify the FSA of its intention to do so. It need not, however, notify where individual employees of a bank's external auditors/skilled persons are seconded to work within the internal audit function.
- 20 Where internal audit is outsourced to another firm which is not otherwise involved in the auditing or accounting function of the bank, the independence issue does not arise. Therefore, outsourcing proposals meeting this criterion are assessed in the same way as any other function.

4.8 Principles covering sub-contracting

- 21 The contract should state that if the outsourcing supplier decides to sub-contract further the original outsourcing supplier continues to be contractually liable and the level of service and systems and controls will not deteriorate.
- a) *Sub-contracting* is where the supplier of an outsourced function further contracts out that function to a third party unrelated to the bank or supplier.

5 FURTHER AREAS FOR CONSIDERATION

Banks should have considered the issues raised in this section as the FSA may ask what procedures have been put in place to address these concerns.

5.1 General

- 1 Any voluntary Codes of Conduct adopted by the bank that would have a direct impact on customers could also be observed by the supplier. This step may help to prevent a deterioration in the service received by its customers.

5.2 A bank's relationship with its supplier

5.2.1 General

See s4.2

- 2 The bank may wish to be aware of the material risks to which the supplier is exposed in relation to the service provided to the bank by the supplier and the corresponding control procedures in place. There might also be provision for relevant management information so that problems, such as a deterioration in service, are brought to the attention of the appropriate individuals in the bank at an early stage. The bank may wish to take steps to seek to ensure that it is clear who is accountable at the appropriate level in respect of such problems. One such mechanism may be through establishing clear lines of escalation both within the supplier and the bank.
- 3 It would be prudent for a bank's management to provide adequate resources at appropriately senior levels to ensure that the relationship with the supplier is properly managed and monitored against performance targets.
- 4 Where the outsourcing supplier is in direct contact with the bank's customers, the bank may wish to establish how its customer relations policies will be reflected by the supplier, for example, answering complaints within a certain time period. Such policies could be measured and factored into any consideration of the supplier's performance. This is important to a bank since any material deterioration in customer relations may adversely affect its reputation. This matter has greater significance if the supplier is external to the group since the supplier might have a different culture.

5.2.2 Termination of contract with the supplier

See s4.2

- 5 A bank may wish to make provision in the contract to ensure that it does not lose any work or records which are material to the bank's business and has been carried out by the supplier, should the contract be terminated. In

any case it would be sensible for termination clauses to provide adequate notice for the bank to put in place alternative arrangements.

5.3 Confidentiality

6 Confidentiality may not be a significant issue if the outsourcing is within a bank's group. However, the bank may wish to consider whether the confidentiality constraints below need to be fulfilled.

7 Where a supplier deals with a bank's competitors distinct procedures (such as Chinese Walls) may be advantageous in seeking to ensure that there is no breach of client confidentiality. Where the supplier operates abroad, the Data Protection Act sets out legal requirements governing the transfer of data across borders.

5.4 Service level agreements ('SLAs')

See s4.3

8 In order to ensure that there is no confusion over respective duties banks may wish to clearly define what is to be outsourced in their SLA. Additionally the SLA may incorporate the capacity for change (including technological change) or expansion, set out clearly who is responsible for ensuring that work is completed and incorporate details of the reports that the bank might wish to receive from the supplier and their frequency.

9 Where a supplier provides a service for several banks or the bank has peak periods of service, the bank might wish to seek to ensure that a minimum level of resources will be continuously devoted to provide an agreed level of service.

10 For extra-group outsourcing, the contract may provide the option for regular re-tendering. However, for both intra- and extra-group outsourcing, it may be prudent for the relationship to be reviewed, where and when appropriate, but at least annually to take account of all relevant business and environmental changes and the review may also include a financial strength assessment of the supplier.

11 An agreed standard of service between the supplier and the bank might be particularly relevant in the case of extra-group outsourcing. A bank may wish to consider whether the standard of service operated by the supplier needs to be as high as that operated within the bank. Performance targets might be included within the SLA, along with provision for escalation and termination where the targets are not met.

5.5 Contingency planning

See s4.4

- 12 Daily operations and systems problems, such as temporary disruption/suspension of the service, could be included within a plan although this could be covered in the supplier's own contingency arrangements.
- 13 A bank might wish to ask the supplier for information about its own contingency plans, in order to assess the level of comfort it can draw from these plans and consider the implications for its own contingency planning. Where sufficient comfort cannot be drawn the bank may wish to make alternative contingency arrangements either in-house or through an alternative supplier as appropriate.

6 APPENDIX – CENTRAL BOOKING

Central booking is where the business is carried out in one location or legal entity within a group and booked in the accounting records of another location or legal entity. This general description covers a range of different scenarios, as explained in the remainder of this section: in all cases, the overriding objective is that, however a bank chooses to organise its activities, it must continue to comply with the Principles for Businesses and Threshold Conditions for Authorisation and with its other legal and supervisory obligations, including those relating to the provision of information to the FSA. The FSA expects banks to discuss significant new central booking proposals with their supervisors, in the same way as for any other significant change in its organisational arrangements.

6.1 Central booking between different locations of the bank

1 Banks often record transactions in a different physical location to that in which the business is undertaken. This will never fall within the definition of material outsourcing (because a bank cannot, by definition, outsource to itself). A bank should nevertheless satisfy itself that, wherever the various functions associated with its business are physically carried out, the bank complies with its legal and regulatory obligations including (but not limited to):

- (a) the maintenance of adequate accounting and other records and internal control systems;
- (b) the adequacy of provisions, liquidity and capital (where relevant); and
- (c) the provision of information to the FSA (including periodic reporting such as prudential returns and the notifications on large exposures, controllers and close links, and ad hoc requests for information).

6.2 Central booking between different legal entities

2 A bank should consider both the legal form and the commercial substance of its arrangements with the other entity in order to establish the true nature of the relationship and therefore the procedures which are appropriate to enable the bank to comply with its obligations. The key consideration is the risks to which the bank is exposed as a result of the transactions undertaken and/or its arrangements with the other party.

3 Material outsourcing issues only arises where the bank records, and bears the risk of, business which is initiated by another legal entity in the group acting in the bank's name (so that clients/counterparties believe that they are dealing with the bank's own staff).

- a) In contrast, where another legal entity in the group acts as broker/introducer for example, it provides a discrete service in its own name to both the bank and customers/counterparties.

**THE INTERIM PRUDENTIAL SOURCEBOOK FOR INSURERS
INSTRUMENT 2001**


Introduction

1. The *FSA* makes the rules and guidance in this instrument on 21 June 2001.
2. The provisions of the *Act* listed in Chapter 11 of this instrument are specified for the purpose of section 153(2).
3. This instrument will come into force at the beginning of the day on which section 19 of the *Act* (the general prohibition) comes into force.
4. This instrument is to be interpreted in accordance with, and applies subject to, the general provisions contained in the General Provisions Instrument 2001.
5. This instrument may be cited as the Interim Prudential Sourcebook for Insurers Instrument 2001.
6. This instrument, excluding the provisions in this Introduction, may be cited as the Interim Prudential Sourcebook for Insurers.

By Order of the Board

21 June 2001

ANNEX



Interim Prudential sourcebook: Insurers

**INTERIM PRUDENTIAL
SOURCEBOOK**

INSURERS

VOLUME ONE

RULES

INTERIM PRUDENTIAL SOURCEBOOK FOR INSURERS GUIDANCE

THE PURPOSE OF THE PRUDENTIAL RULES FOR INSURERS AND AN OVERALL DESCRIPTION

1. The prudential rules for an *insurer* are to be seen in the context of the Principles for Businesses. These are high level obligations applying to all authorised persons and are set out in the High Level Standards part of the Handbook (PRIN).
2. So far as an *insurer* is concerned, the Principles for Businesses are particularly relevant to its internal systems and controls. Principle 3, for example, requires a firm to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. Principle 4 requires a firm to maintain adequate financial resources.
3. In addition to the general obligations placed on an *insurer*, certain staff of all authorised persons are subject to a number of high level obligations, referred to as Statements of Principle. The FSA has issued a Code of Practice to help determine whether an approved person's conduct has complied with a Statement of Principle. The Statements and the Code are set out in the High Level Standards part of the Handbook (APER).
4. One of the features of a *contract of insurance* is the long period of risk the contract may cover. The prudential rules for *insurers* seek to protect the *policy holder* against the risk that an *insurer* will fail to meet a valid *claim* as it falls due or to fulfil the reasonable expectations of *policy holders*.
5. The Interim Prudential Sourcebook for Insurers (*IPRU (INS)*) starts by limiting the risks to which an *insurer* may be subject.

Rule 1.3 in Chapter 1 requires that the business of an *insurer* is restricted to *insurance business*.

6. The essence of the more detailed rules in Volume 1 and 2 is the requirement to maintain an appropriate *margin of solvency*, ie the excess of the value of assets over the amount of liabilities. The rules in Chapter 2 set out the *required margins of solvency* for an *insurer* having regard to the type and location of its business.
7. Chapter 3 concerns *long-term insurance business*.
8. The extent to which an asset may be taken into account for prudential purposes, and then the method of valuing it, is determined in accordance with the rules in Chapter 4. It is a fundamental part of the approach to prudential regulation for *insurers* that the rules limit the assets which are ‘admissible’ for solvency purposes and prescribe the methods of valuation.
9. Similarly, the amount of a liability is determined in accordance with the rules in Chapter 5.
10. *General insurers* must keep reserves in respect of certain *classes* of business in accordance with the rules in Chapter 6 in order to maintain solvency during a period of abnormal *claims*. These reserves are known as ‘equalisation reserves’.
11. Special provisions in Chapter 7 require a liability in any particular currency to be matched by assets in that currency. Further provisions relate to the location of assets.
12. Under the rules in Chapter 8, a *non-EEA insurer* must make a *deposit* in the United Kingdom or other *EEA State* and certain other additional rules apply.

13. As part of the continuing supervision of an *insurer*, the rules in Chapter 9 require the *insurer* to prepare certain accounts and statements in accordance with the rules and deposit them with the *FSA*. In addition, an *insurer* must make certain statistical returns.
 14. Chapter 10 contains rules relating to the ‘Insurance Groups Directive’, ie Council Directive 98/78/EC on the supplementary supervision of insurance undertakings in an insurance group.
 15. Chapter 11 contains the definitions used throughout *IPRU (INS)* and some general provisions including provisions relating to actions for damages.
 16. Chapter 12 contain transitional provisions.
 17. The Appendices in Volume 2 are part of the rules.
 18. FSA guidance and letters from the Government Actuary are in Volume 3 of *IPRU (INS)*.
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INTERIM PRUDENTIAL SOURCEBOOK FOR INSURERS

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Chapter 1

APPLICATION RULE AND RESTRICTION OF BUSINESS TO INSURANCE

CONTENTS

Application

1.1 Insurers

1.2 The Society of Lloyd's

Restriction of business to insurance

1.3

Chapter 1

APPLICATION RULE AND RESTRICTION OF BUSINESS TO INSURANCE

Application

Insurers

- 1.1 An *insurer* must comply with *IPRU (INS)* unless it is –
- (a) a *friendly society*¹; or
 - (b) subject to rule 3.6 and 3.7 (application of rules to *linked long-term contracts*), an *EEA insurer* qualifying for authorisation under Schedules 3 or 4 to the *Act*.

The Society of Lloyd's²

- 1.2 No provisions of *IPRU (INS)* apply to the *Society of Lloyd's*, or members of the *Society of Lloyd's* except rules 9.37 and 9.38.

¹ A *friendly society* must comply with *IPRU(FSOC)*.

² *LLD* applies to the *Society*.

Restriction of business to insurance

- 1.3 (1) An *insurer* must not carry on any commercial business in the United Kingdom or elsewhere other than *insurance business* and activities directly arising from that business.

In-house pension funds

- (2) If an *insurer* manages assets of a pension fund solely for the benefit of -
- (a) its 'officers' or 'employees'; or
 - (b) its 'officers' or 'employees' and 'officers' or 'employees' of its *subsidiary* or *holding company* or a *subsidiary* of its *holding company*,

that activity is to be treated as directly arising from the *insurer's insurance business*.

- (3) **Officers** or **employees** include their dependants.
-

Chapter 2

MARGINS OF SOLVENCY

CONTENTS

- 2.1 Basic requirement
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 - 2.8 Long term class V
 - 2.9 Guarantee fund and minimum guarantee fund
 - 2.10 Valuation
-

Chapter 2

MARGINS OF SOLVENCY

Basic Requirement

- 2.1 (1) Every *insurer* –
- (a) whose head office is in the United Kingdom; or
 - (b) whose business in the United Kingdom is restricted to *reinsurance*,
- must maintain a *margin of solvency* in accordance with the rules in this Chapter (the *Margins of Solvency Rules*).
- (2) Subject to rule 2.1(3), every *insurer* whose head office is not in an *EEA State* must maintain –
- (a) a *margin of solvency*; and
 - (b) a *UK margin of solvency*,
- in accordance with the *Margins of Solvency Rules*.
- (3) Rule 2.1(2) does not apply to an insurer if –
- (a) its business in the United Kingdom is restricted to *reinsurance*;
 - (b) it is a *Swiss general insurer*; or
 - (c) rule 8.1(2) applies to it³,
- but a *UK-deposit insurer* must maintain –
- (d) a *margin of solvency*; and
 - (e) an *EEA margin of solvency*,
- in accordance with the *Margins of Solvency Rules*.
- (4) In the case of an *insurer* that carries on both *long-term insurance business* and *general insurance business*, (1), (2) and (3) have effect as if the requirements to maintain -

³ (ie, it is a *UK-deposit insurer* or an *EEA-deposit insurer*)

- (a) a *margin of solvency*;
- (b) a *UK margin of solvency*; and
- (c) an *EEA margin of solvency*,

were requirements to maintain separate margins in respect of the two kinds of business.

- (5) In calculating *UK margin of solvency*, and *EEA margin of solvency*, the amount of the *insurer's* liabilities must be increased by the amount of any reserve maintained under the *Equalisation Reserves Rules*.

Companies supervised in other EEA States and Switzerland

- 2.2 (1) An *insurer* which is -

- (a) an *EEA-deposit insurer*; or
- (b) a *Swiss general insurer*,

must secure that the value of the assets of the business carried on by it in the United Kingdom does not fall below the amount of the liabilities of that business, that value and amount being determined in accordance with the *Valuation of Assets Rules* and the *Determination of Liabilities Rules*.

Long-term and general insurance business

- (2) In the case of an *insurer* that carries on in the United Kingdom both *long-term* and *general insurance business*, (1) has effect separately in relation to the assets and liabilities of the two kinds of business.

Adequacy of assets

- 2.3 (1) A UK *insurer* must secure -

- (a) that its liabilities under *contracts of insurance* entered into by it, other than liabilities in respect of 'linked benefits', are covered by assets of appropriate safety, yield and marketability having regard to the classes of business carried on; and
- (b) without prejudice to the generality of (a), that its investments are appropriately diversified and adequately spread and that excessive

reliance is not placed on investments of any particular category or description.⁴

- (2) A UK *insurer* which has entered into a ‘linked long-term contract’ must secure that, as far as practicable, its liabilities under the contract in respect of ‘linked benefits’ are covered as follows –
- (a) if those benefits are linked to the value of units in an undertaking for collective investments in transferable *securities* or to the value of assets contained in an internal fund, by those units or assets; and
 - (b) if those benefits are linked to a share index or other reference value not mentioned in (a), by units which represent that reference value, or by assets of appropriate safety and marketability which correspond, as nearly as may be, to the assets on which that reference value is based.⁵
- (3) A UK *insurer* which has entered into a ‘linked long term contract’ must also secure that those of its liabilities under the contract in respect of ‘linked benefits’ which are not covered by contracts of *reinsurance* are covered by assets of a description contained in rule 3.7⁶.

- (4) In this rule –

linked benefits, in relation to a *contract of insurance*, means benefits payable to the policy holder which are determined by reference to the value of or the income from property of any description (whether or not specified in the contract) or by reference to fluctuations in, or in an index of, the value of property of any description (whether or not so specified); and

linked long term contract means a *contract of insurance*,

- (a) the effecting of which constitutes the carrying on of *long-term insurance business*; and
 - (b) under which ‘linked benefits’ are payable.
- (5) In (3), ‘linked long term contract’ does not include a contract to manage the investments of pension funds unless it is combined with a *contract of insurance* covering either conservation of capital or payment of a minimum interest.

⁴ For guidance on appropriate diversification, adequate spread and other matters relating to investments, see **Guidance Note P1** (systems and controls over the investments and counterparty exposure of insurers)

⁵ For guidance on the ‘close matching’ test, see paragraph 2 of **Guidance Note 4.4**

⁶ See footnote 5

Determination of margins of solvency

- 2.4 (1) Subject to (2) to (5), the *margin of solvency* to be maintained by an *insurer* must be determined –
- (a) as regards *long-term insurance business*, in accordance with rules 2.5 to 2.8; and
 - (b) as regards *general insurance business*, by taking the greater of the two sums resulting from the application of the two methods of calculation set out in **Appendices 2.1** and **2.2**.
- (2) Where an *insurer* is required to maintain a *UK margin of solvency* or an *EEA margin of solvency* –
- (a) the *UK margin of solvency* must be determined by applying (1), but only to *insurance business* carried on in the United Kingdom; and
 - (b) the *EEA margin of solvency* must be determined by applying (1), but only to *insurance business* carried on in the *EEA States* taken together.
- (3) For a *contract of insurance* (to which rule 11.8(a) applies), the *required margin of solvency* must be determined by taking the aggregate of the results arrived at by applying –
- (a) in the case of so much of the contract as is within any class of *long-term insurance business*, the appropriate method determined by the *Margins of Solvency Rules* for that class; and
 - (b) in the case of so much of the contract as is within *general insurance business class 1* or *2*, the method of calculation set out in **Appendix 2.1** (excluding paragraphs 6, 7 and 8).
- (4) Where an *insurer* carries on *long-term insurance business* and owing to the nature of that business more than one *margin of solvency* is produced in respect of that business by the operation of the *Margins of Solvency Rules*, the margins in question must be aggregated in order to arrive at the *insurer's required margin of solvency*.
- (5) Where an *insurer* carries on both *long-term* and *general insurance business* and is accordingly required to maintain separate *margins of solvency* in respect of the two kinds of business –
- (a) the *Margins of Solvency Rules* apply for determining *the margin of solvency* for each kind of business separately; and
 - (b) assets other than those representing its *long-term insurance fund* or *funds*, if they are not included among the assets covering the liabilities,

and the *margin of solvency* relating to the *insurer's general insurance business*, may be included among the assets taken into account in covering the liabilities and the *margin of solvency for the insurer's long-term insurance business*.

Long term classes I, II, and IX

- 2.5 (1) For *long-term insurance business* of class I, II or IX the *margin of solvency* must be determined by taking the aggregate of the results arrived at by applying the calculation described in (2) (the *first calculation*) and the calculation described in (3), (4), (5) and (6) (the *second calculation*).
- (2) For the *first calculation* –
- (a) a sum equal to 4% of the *mathematical reserves* for *direct insurance business* and *reinsurance* acceptances without any deduction for *reinsurance cessions* must be taken;
 - (b) the amount of the *mathematical reserves* at the end of the *preceding financial year* after the deduction of *reinsurance cessions* must be expressed as a percentage of the amount of those *mathematical reserves* before any such deduction; and
 - (c) the sum mentioned in (a) must be multiplied –
 - (i) where the percentage arrived at under (b) is greater than 85% (or, in the case of a *pure reinsurer*, 50%), by that greater percentage, and
 - (ii) in any other case, by 85% (or, in the case of a *pure reinsurer*, 50%).
- (3) For the *second calculation* –
- (a) subject to (4), (5) and (6), a sum equal to 0.3% of the ‘capital at risk’ for contracts on which the ‘capital at risk’ is not a negative figure must be taken;
 - (b) the amount of the ‘capital at risk’ at the end of the *preceding financial year* for contracts on which the ‘capital at risk’ is not a negative figure, after the deduction of *reinsurance cessions*, must be expressed as a percentage of the amount of that ‘capital at risk’ before any such deduction; and
 - (c) the sum arrived at under (a) must be multiplied –
 - (i) where the percentage arrived at under (b) is greater than 50%, by that greater percentage, and

- (ii) in any other case, by 50%.
- (4) Where, in a case other than that of a *pure reinsurer*, a contract provides for benefits payable only on death within a specified period and is valid for a period of not more than three years from the date when the contract was first made, the percentage to be taken for the purposes of (3)(a) must be 0.1%; and where the period of validity from that date is more than three years but not more than five years, the percentage to be so taken must be 0.15 %.
 - (5) For the purposes of (4), the period of validity of a contract evidencing a *group policy* is the period from the date when the premium rates under the contract were last reviewed for which the premium rates are guaranteed.
 - (6) In the case of *pure reinsurers*, the percentage to be taken for the purposes of paragraph (3)(a) is 0.1%.
 - (7) For the purposes of the *second calculation*, the **capital at risk** is –
 - (a) in any case in which an amount is payable in consequence of death other than a case falling within (b), the amount payable on death; and
 - (b) in any case in which the benefit under the contract in question consists of the making, in consequence of death, of the payment of an annuity, payment of a sum by instalments or any other kind of periodic payments, the present value of that benefit,

less in either case the *mathematical reserves* in respect of the relevant contracts.
 - (8) When the amount of the *mathematical reserves* referred to in (2)(a), or the amount of the ‘capital at risk’ referred to in (3)(a), is calculated for the purposes of determining the *margin of solvency*, the day as on which that amount is calculated must be the same as that as on which the *margin of solvency* is determined; and the *mathematical reserves* referred to in (7) must also be calculated as on that day when the ‘capital at risk’ in question is that referred to in (3)(a), but must be calculated as at the end of the *preceding financial year* when the ‘capital at risk’ in question is that referred to in (3)(b).

Long term classes III, VII and VIII

- 2.6 (1) For *long-term insurance business* of class III, VII or VIII the *margin of solvency* must be determined in accordance with (2) to (5).
- (2) In so far as an *insurer* bears an investment risk, the *first calculation* must be applied.
- (3) In so far as -
 - (a) an *insurer* bears no investment risk;

- (b) the total expired and unexpired term of the relevant contract exceeds five years; and
- (c) the allocation to cover *management expenses* in the relevant contract has a fixed upper limit which is effective as a limit for a period exceeding five years,

the *first calculation* must be applied, but as if rule 2.5(2)(a) contained a reference to 1% instead of 4%.

- (4) If neither (2) nor (3) applies, then, subject to (5), the *required margin of solvency* is zero.
- (5) Where an *insurer* covers a death risk, a sum arrived at by applying the *second calculation* (disregarding rules 2.5(4) and 2.5(5)) must be added to any *margin of solvency*, including a *required margin of solvency* of zero, arrived at under (2), (3) or (4).

Long term classes IV and VI

- 2.7 For *long-term insurance business* of class IV or VI, the *margin of solvency* must be determined by applying the *first calculation*.

Long term class V

- 2.8 For *long-term insurance business* of class V, the *margin of solvency* must be 1% of the assets of the relevant tontine.

Guarantee fund and minimum guarantee fund

- 2.9 (1) An *insurer* must ensure that its *margin of solvency* does not fall below the 'guarantee fund'⁷.
- (2) Subject to (3) and (4), one-third of the *required margin of solvency* constitutes the **guarantee fund**.
- (3) The 'guarantee fund' must not be less than an amount (the **minimum guarantee fund**) arrived at in accordance with **Appendix 2.3**, whether the *required margin of solvency* is greater or less than that amount.
- (4) In the case of *long-term insurance business*, items that are not *implicit items* must be at least large enough to cover either the 'minimum guarantee fund' or 50% of the 'guarantee fund', whichever is the greater.

⁷ SUP requires the submission of a short term plan to the FSA if this rule is breached.

Valuation

- 2.10 (1) Where an *insurer* has assets equal to or in excess of its liabilities, then, in addition to any other applicable rules, (2) to (5) have effect for determining the extent to which the value of the assets exceeds the amount of liabilities in connection with the *margin of solvency*, the *guarantee fund* and the *minimum guarantee fund*.
- (2) Where -
- (a) an *insurer* has issued shares some or all of which are not ‘fully paid’ and the total paid up value of all the *shares* is equal to or greater than one quarter of their nominal value or, in the case of *shares* issued at a premium, of the aggregate of their nominal value and the premium; or
- (b) at least one quarter of the fund of a *mutual* is paid up,
- an amount not greater than half the total value of the amounts unpaid may be taken into account as an asset; and for the purposes of this paragraph a *share* must not be regarded as **fully paid** if there are any amounts due but unpaid on it.
- (3) Notwithstanding rule 5.2(2), where an *insurer* has issued cumulative preference *shares*, liabilities in respect of such *shares* may be left out of account, in aggregate up to 50% of the *required margin of solvency* save that liabilities in respect of *shares* which are redeemable for the purposes of section 159 of the *Companies Act* may be left out of account, in aggregate only up to 25% of the *required margin of solvency*.
- (4) In the case of a *mutual* carrying on *general insurance business*, any claim which the *mutual* has against its members by way of a call for supplementary contributions for a *financial year* must have its full value for that *financial year*, but the value must not exceed the lesser of -
- (a) 50% of the difference between the maximum contributions and the contributions called in, or
- (b) 50% of the *required margin of solvency*.
- (5) The *implicit items* (which relate to future profits, *zillmerising* and hidden reserves) have no value.
-

Chapter 3

LONG-TERM INSURANCE BUSINESS

CONTENTS

Part I - Identification and application of assets and liabilities

- 3.1 Separation of assets and liabilities attributable to long-term insurance business
- 3.2 Application of assets of insurer with long-term insurance business
- 3.3 Allocations to policy holders
- 3.4 Restriction on transactions with connected persons
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Part II - Linked long-term contracts

- 3.6 Application
 - 3.7 Linked long-term contracts
-

Chapter 3

LONG-TERM INSURANCE BUSINESS

Part I

IDENTIFICATION AND APPLICATION OF ASSETS AND LIABILITIES

Separation of assets and liabilities attributable to long-term insurance business

- 3.1 (1) Where an *insurer* carries on *ordinary long-term insurance business* or *industrial assurance business* or both -
- (a) it must maintain a separate account in respect of each kind of business; and
 - (b) the receipts of each kind of business must be entered in the account maintained for that business and must be carried to and form a separate *long-term insurance fund* with an appropriate name.
- (2) An *insurer* which carries on *ordinary long-term insurance business* or *industrial assurance business* must maintain such accounting and other records as are necessary for identifying -
- (a) the assets representing the fund maintained by it under (1)(b) (but without necessarily distinguishing between the funds or funds if more than one); and
 - (b) the liabilities attributable to each kind of business which it carries on.

Application of assets of insurer with long-term insurance business

Limitation on use of assets in long-term insurance fund

- 3.2 (1) Subject to (2) and (4), *long-term insurance business assets* must -
- (a) be applied only for the purposes of its *long-term insurance business*; and
 - (b) not be transferred so as to be available for other purposes of the *insurer* except where the transfer constitutes reimbursement of expenditure borne by other assets (in the same or the *preceding financial year*) in discharging liabilities wholly or partly attributable to *long-term insurance business*.

First exception: the use of excess assets

- (2) Where an *actuarial investigation* shows that the value of the assets mentioned in (1) exceeds the amount of the liabilities attributable to the *long-term insurance business*, the restriction imposed by that rule does not apply to so much of those assets as represents the excess.

Qualification

- (3) (2) does not authorise a transfer or other application of assets by virtue of an *actuarial investigation* at any time after the date when the abstract of the actuary's report of the investigation has been deposited with the *FSA* in accordance with rule 9.6(1).

Second exception: exchanges at fair market value

- (4) Nothing in (1) precludes an *insurer* from exchanging, at fair market value, *long-term insurance business assets* for other assets of the *insurer*.

Further limitation on use of assets in long-term insurance fund

- (5) Money from an insurer's long-term insurance fund must not be used for the purposes of any other business of the insurer notwithstanding any arrangement for its subsequent repayment out of the receipts of that other business.

Restriction in relation to dividends

- (6) A *long-term insurer* must not declare a dividend at any time when the value of the *long-term insurance business assets*, as determined in accordance with the *Valuation of Assets Rules*, is less than the amount of the *long-term insurance business liabilities* determined in accordance with the *Determination of Liabilities Rules*.⁸

Allocations to policy holders

Allocation of established surplus

- 3.3 (1) Where -
- (a) there is an 'established surplus' in which *long-term policy holders* of any category are eligible to participate; and

⁸ Regulations under section 142 of the *Act* may also apply to restrict a *parent undertaking* of an *insurer* from doing anything to lessen the effectiveness of the *Asset Identification Rules*.

- (b) an amount has been allocated to *policy holders* of that category in respect of a previously ‘established surplus’ in which *policy holders* of that category were eligible to participate,

an *insurer* must not by virtue of rule 3.2(2) transfer or otherwise apply assets representing any part of the surplus mentioned in (a) unless the insurer has –

- (i) allocated to *policy holders* of that category in respect of that surplus an amount not less than the ‘relevant minimum’, or
- (ii) complied with the requirements of (3) and made to those policy holders any allocation of which notice is given under (3)(a).
- (2) Subject to (6) and (7), the **relevant minimum** is the amount represented by the formula -

$$\frac{b \times c}{a} - \frac{c}{200}$$

where -

- a* is the last previously ‘established surplus’ in respect of which an amount was allocated to *policy holders* of the category in question;
- b* is the amount so allocated; and
- c* is the surplus referred to in (1)(a).

Requirements where less than the relevant minimum is to be allocated

- (3) The requirements referred to in (1)(ii) are that the *insurer* -
- (a) at least 14 days before publication has given the *FSA* written notice stating that it proposes to make no allocation or an allocation of an amount (specifying it) which is smaller than the ‘relevant minimum’, and a copy of the statement that it proposes to publish in accordance with (b); and
- (b) has published a statement in the London, Edinburgh and Belfast Gazettes and in two national newspapers explaining the allocation it proposes to make to *policy holders* and the reasons for it,

and that a period of not less than 56 days has elapsed since the date, or the last date, on which the *insurer* has published the statement mentioned in (b) as required by that paragraph.

- (4) In this rule, **established surplus** means an excess of assets representing the whole or a particular part of the *long-term insurance fund* or *funds* over the

liabilities, or a particular part of the liabilities, of the *insurer* attributable to that business as shown by an *actuarial investigation*.

Amounts to be treated as allocated to policy holders

- (5) For the purposes of this rule, an amount is allocated to *policy holders* if, and only if -
- (a) bonus payments are made to them; or
 - (b) reversionary bonuses are declared in their favour or a reduction is made in the premiums payable by them,

and the amount of the allocation is, in a case within (a), the amount of the payments and, in a case within (b), the amount of the liabilities assumed by the insurer in consequence of the declaration or reduction.

Bonus payments in anticipation of established surplus

- (6) For the purposes of this rule, the amount of any bonus payments made in anticipation of an ‘established surplus’ is treated as an amount allocated in respect of the next ‘established surplus’ in respect of which an amount is allocated to eligible *policy holders* generally; and for the purposes of (2) the amount of any surplus in respect of which such an allocation is made is treated as increased by the amount of any such payments.

Unappropriated surplus carried forward

- (7) (1) does not authorise the application for purposes other than those mentioned in rule 3.2(1) of assets representing any part of the surplus mentioned in (1)(a) which the *insurer* has decided to carry forward unappropriated; and for the purposes of (2) the amount of any surplus is treated as reduced by any part of it which the *insurer* has decided to carry forward unappropriated.

Eligibility to participate in an established surplus

- (8) For the purposes of (1), *policy holders* are taken to be eligible to participate in an ‘established surplus’ in any case where they would be eligible to participate in a later ‘established surplus’ representing it if it were carried forward unappropriated.

Restriction on transactions with connected persons

- 3.4 (1) A *long-term insurer* must not enter into a transaction to which this rule applies, and must take reasonable steps to ensure that any ‘subordinate company’ does not enter into such a transaction -
- (a) at a time when the aggregate of the value of the assets and the amount of the ‘liabilities’ attributable to such transactions already entered into

by the *insurer* and its ‘subordinate companies’ exceeds 5% of the total amount standing to the credit of the *insurer’s long term insurance funds*; or

- (b) at any other time when the aggregate of the value of those assets and the amount of those ‘liabilities’ would exceed 5% if the transaction were entered into.

Restricted transactions by the insurer

- (2) This rule applies to any transaction entered into by a *long-term insurer* (whether or not itself a ‘subordinate company’ of another *company*), being a transaction under which -
 - (a) a person ‘connected’ with the *insurer* will owe it money;
 - (b) the *insurer* acquires *shares* in a *company* which is a person ‘connected’ with it; or
 - (c) the *insurer* undertakes a ‘liability’ to meet an obligation of a person ‘connected’ with it or to help such a person to meet an obligation,

if the right to receive the money would constitute a ‘long term asset’ of the *insurer*, the acquisition is made out of its *long term insurance funds* or the ‘liability’ would fall to be discharged out of those funds, as the case may be.

Restricted transactions by the subordinate company

- (3) Without prejudice to (2), this rule applies to any transaction entered into by a ‘subordinate company’ of any *long-term insurer*, being a transaction under which -
 - (a) the *insurer* or a person ‘connected’ with it will owe money to the ‘subordinate company’ (not being money owed by the *insurer* which can be properly paid out of its *long term insurance funds*);
 - (b) the ‘subordinate company’ acquires *shares* in the *insurer* or in a company which is a person ‘connected’ with the *insurer*; or
 - (c) the ‘subordinate company’ undertakes a ‘liability’ to meet an obligation of the *insurer* or of a person ‘connected’ with the *insurer* or to help the *insurer* or such a person to meet an obligation,

but where the ‘subordinate company’ is itself a *long-term insurer*, this rule does not by virtue of this paragraph apply to any such transaction if –

- (i) the right to receive the money would constitute a ‘long term asset’ of the ‘subordinate company’,

(ii) the acquisition is made out of its *long-term insurance fund*, or

(iii) the 'liability' would fall to be discharged out of the fund.

(4) In this rule, **subordinate company**, in relation to a *long-term insurer*, means -

(a) a company having *equity share capital* some or all of which is held by the *insurer* as part of its 'long term assets' where the *share capital* so held by the *insurer* -

(i) amounts to more than half in nominal value of that *share capital*, and

(ii) confers on the *insurer* the power to appoint or remove the holders of all or a majority of the directorship of the company whose *share capital* is held and more than one half of the voting power at any general meeting of that company;

(b) a company having *equity share capital* some or all of which is held by another company which is itself a 'subordinate company' of the *insurer* where the *share capital* held by that other company -

(i) amounts to more than half in nominal value of that *share capital*, and

(ii) confers on that other company the power to appoint or remove the holders of all or a majority of the directorship of the company whose *share capital* is held and more than one half of the voting power at any general meeting of that company,

and for the purposes of this paragraph *share capital* held for any person by a nominee (except where that person is concerned only in a fiduciary capacity) must be treated as held by that person, and *share capital* held by a person in a fiduciary capacity or by way of security must be treated as not held by that person.

(5) For the purposes of this rule, a person is **connected** with a *long-term insurer*, if that person is not a 'subordinate company' of the *insurer* but -

(a) controls, or is a partner of a person who controls, the *insurer*;

(b) being a company, is controlled by the *insurer* or by another person who also controls the *insurer*; or

(c) is a *director* of the *insurer* or the wife or husband or a minor 'son' or 'daughter' of such a *director*.

(6) For the purposes of (5), a person **controls** a company if he is -

- (a) a person in accordance with whose directions or instructions the *directors* of the *insurer* or of a company of which it is a *subsidiary* are accustomed to act; or
 - (b) a person who either alone or with any *associate* or *associates* is entitled to exercise, or control the exercise of, 15% or more of the voting power at any general meeting of the *insurer* or of a company of which it is a *subsidiary*.
- (7) For the purposes of this rule, the value of any assets and the amount of any ‘liabilities’ must be determined in accordance with the *Valuation of Assets Rules* and *Determination of Liabilities Rules*.

- (8) In this rule –

liability includes a contingent liability;

long term assets means assets representing the *long-term insurance fund* or *funds*;

son includes step-son, **daughter** includes step-daughter; and

(without prejudice to section 39(6) of the Adoption Act 1976 and section 39(4) of the Adoption (Scotland) Act 1978) in relation to Northern Ireland, **son** includes step-son and adopted son and **daughter** includes step-daughter and adopted daughter.

Arrangements to avoid unfairness between separate insurance funds etc

- 3.5 (1) An *insurer* which carries on *long-term insurance business* in the UK must have adequate arrangements for securing that transactions affecting assets of the *insurer* (other than transactions outside its control) do not operate unfairly between the *long-term insurance fund* or *funds* and the other assets of the *insurer* or, in a case where the *insurer* has more than one ‘identified fund’, between those funds.
- (2) In this rule, **identified fund** means assets representing the *insurer’s* receipts from a particular part of its *long-term insurance business* which can be identified as such by virtue of accounting or other records maintained by the *insurer*.

Adequacy of premiums

- 3.5A (1) Before entering into a *long-term insurance contract*, a *UK insurer* must satisfy itself that the aggregate of –
- (a) the premiums payable under the contract and the income which will be derived from them; and

- (b) any other resources of the *UK insurer* which are available for the purpose, will be sufficient, on reasonable actuarial assumptions, to meet all *commitments* arising under or in connection with the contract.
- (2) A *UK insurer* must not rely on other resources for the purposes of (1) in such a way as to jeopardise its solvency in the long term.

Part II

LINKED LONG-TERM CONTRACTS

Application

- 3.6 (1) Subject to (2), rule 3.7 applies to *linked long-term contracts* for *ordinary long-term insurance business* which are entered into by -
- (a) *insurers* other than *EEA insurers*; and
 - (b) *EEA insurers* in respect of contracts the effecting of which constitutes the carrying on of *ordinary long-term insurance business* in the United Kingdom.
- (2) (1) does not apply to -
- (a) contracts entered into before, or in pursuance of a contract subsisting at, 1 July 1994⁹ to the extent that they provide for benefits to be determined by reference to the value of, or the income from, property of any description or by reference to fluctuations in, or in an index of property of any description, by reference to which benefits were permitted to be determined before that date;
 - (b) contracts entered into by an *insurer* which are *linked long-term contracts* by reason only that the *policy holder* is eligible to participate in any *established surplus*;
 - (c) contracts entered into by an *EEA insurer* which are *linked long-term contracts* by reason only that the *policy holder* is eligible to participate in an excess of assets representing the whole or a particular part of the *long-term insurance fund or funds* over the liabilities, or a particular part of the liabilities, of the *insurer* attributable to that business as determined in accordance with the law of the *EEA State* in which the head office of the *insurer* is situated;

⁹ ie the date that the *1994 Regulations* came into effect.

- (d) subject to rule 3.7(2), contracts to manage the investments of pension funds that are not combined with *contracts of insurance* covering either conservation of capital or payment of a minimum interest; or
 - (e) contracts entered into before 30 June 1995 to the extent that they provide for benefits to be determined by reference to a *collective investment scheme* which was a *listed security* immediately before 1 July 1994.
- (3) Rule 3.7 does not apply in relation to contracts linked to property of the description in paragraph 11(b) of Part I of **Appendix 3.2** entered into before 1 February 1992 except to the extent that the responsibility mentioned in that paragraph extends at least to acts or omissions after that date.
- 3.7 (1) An *insurer* must not contract to provide benefits under any contract to which this rule applies which are determined, either wholly or partly:
- (a) by reference to the value of, or the income from, or fluctuations in the value of, property of any description other than property of any of the descriptions set out in Part I of **Appendix 3.2**; or
 - (b) whether directly or indirectly, by reference to fluctuations in any index of the value of property other than an index set out in Part II of **Appendix 3.2**.
- (2) Benefits payable under contracts referred to in rule 3.6(2)(d) must not be determined, either wholly or partly, by reference to the value of, or the income from, or fluctuations in the value of *derivative contracts* other than *permitted derivative contracts*.
- (3) Benefits payable under any *linked long-term contract* must not be determined by reference to -
- (a) property of any of the descriptions specified in paragraphs 2, 5(b) or 7 of Part I of **Appendix 3.2**, if the value of such property is determined, either wholly or partly, by reference to the value of, or the income from or fluctuations in the value of or fluctuations in the income from, property other than property of the descriptions in Part I of **Appendix 3.2**;
 - (b) property of the description specified in paragraph 2 of Part I of **Appendix 3.2** in excess of 10% of the aggregate *property linked benefits* under the contract;
 - (c) property of the description specified in paragraph 5(b) of Part I of **Appendix 3.2** which in aggregate exceeds 10% of the *property linked benefits*, unless the contract under which the benefits are payable has been marketed in accordance with any legal restrictions which apply to the marketing of the corresponding *collective investment fund*; or

- (d) property of any of the descriptions specified in Part I of **Appendix 3.2** which has the effect of a *derivative contract* other than a *permitted derivative contract*.
-

Chapter 4

VALUATION OF ASSETS

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- 4.1 Application
 - 4.2 Shares in a group undertaking
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Chapter 4

VALUATION OF ASSETS¹⁰

Application¹¹

- 4.1 (1) Subject to (2), the *Valuation of Assets Rules* apply to the determination of the value of assets of *insurers*.
- (2) Where an *insurer* has entered into any contracts providing for the payment of *property linked benefits*, the *Valuation of Assets Rules* do not apply with respect to the determination of the value of the *linked assets* to the extent that they are held to match liabilities in respect of such benefits.
- (3) Any asset to which the *Valuation of Assets Rules* applies (other than cash) for the valuation of which no provision is made in the *Valuation of Assets Rules* must be left out of account for the purposes specified in (1).
- (4) Where in all the circumstances of the case any asset is actually of a lesser value than the amount calculated in accordance with the *Valuation of Assets Rules*, such lesser value must be taken to be the value of the asset.¹²
- (5) For the purposes of (4), in determining whether an asset is of a lesser value than the amount calculated in accordance with the *Valuation of Assets Rules*, regard must be had to the underlying security and, in the case of bonds, *debt securities* and other money and capital market instruments, the credit rating of the *issuer*, including whether the *issuer* belongs to Zone A as defined in Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions and, where the *issuer* is an international organisation, whether it includes at least one *EEA State* among its members.
- (6) Notwithstanding (1) (but subject to the conditions set out in (7)), an *insurer* may, for the purposes of an *actuarial investigation*, elect to assign to any of its assets the value given to the asset in question in the books or other records of the *insurer*.
- (7) The conditions referred to in (6) are that -
- (a) the election does not enable the *insurer* to bring into account any asset for the valuation of which no provision is made in the *Valuation of Assets Rules*; and

¹⁰ For guidance on the *Valuation of Assets Rules*, see **Guidance Note 4.1**

¹¹ For the application of the *Valuation of Assets Rules* to the financial reporting requirements in Chapter 9, see rule 9.10

¹² See Section 4 of **Guidance Note 4.1**

- (b) the value assigned to the aggregate of the assets is not higher than the aggregate of the value of those assets as determined in accordance with rules 4.2 to 4.14.
- (8) Where an *insurer* has entered into a contract for the conversion of currency which satisfies the conditions set out in (9), then for any of the purposes for which the *Valuation of Assets Rules* apply, the *insurer* must treat the conversion as having been made on the *relevant date*.
- (9) The conditions referred to in (8) are that -
- (a) the contract provides -
 - (i) for the conversion into another currency of an amount representing the sale of an asset which has, on the *relevant date*, been sold but not delivered, or
 - (ii) for the purchase of currency for the purpose of settling the purchase of an asset which has, on the *relevant date*, been purchased but not delivered;
 - (b) the conversion is to take place during a period which is -
 - (i) where the contract is in connection with the delivery of a *listed security*, a period commencing on the date of the contract and extending for the usual period of settlement as laid down by the rules of the relevant stock exchange or *regulated market*, or
 - (ii) where the contract is in connection with the delivery of any other asset, a period commencing on the date of the contract and extending for 20 working days thereafter; and
 - (c) the contract is *listed* or has been entered into with an *approved counterparty*.

Shares in a group undertaking

- 4.2 (1) The value of any *shares* held in a *group undertaking* must not exceed:
- (a) where the *shares* held are in an *insurance undertaking* or *insurance holding company* the value, determined in accordance with the *Valuation of Assets Rules* (other than rule 4.14(1)(a) to (c)), of its *surplus assets*;
 - (b) where the *shares* held are not in an *insurance undertaking* or *insurance holding company* the greater of:
 - (i) the value, determined in accordance with *the Valuation of Assets Rules* (other than rule 4.14(1)(a) to (c)) of its *surplus assets*, and

- (ii) the value of those *shares* as determined under rule 4.8.
- (2) The surplus assets of a *group undertaking* are its total assets excluding:
 - (a) the assets that are selected to cover liabilities and, in the case of a *group undertaking* which is an *insurance undertaking*, to cover the *notional required minimum margin*;
 - (b) assets that are interests directly or indirectly held in:
 - (i) the *group undertaking's* own capital (as defined in the relevant regulatory requirements for that undertaking), or
 - (ii) the *insurer's* capital;
 - (c) where the *group undertaking* carries on *long-term insurance business*, profit reserves and future profits;
 - (d) assets which represent either a *long-term insurance fund* or a fund the allocation of which as between *policy holders* and other purposes has yet to be determined;
 - (e) amounts due, or to become due, in respect of *share* capital, or other contributions from members of the *group undertaking*, subscribed or called for but not fully paid up; and
 - (f) assets that cannot effectively be made available or realised to meet losses (if any) arising in the *insurer*, including assets that represent capital not owned, directly or indirectly, by the *insurer*.
- (3) The assets selected in (2)(a) to be excluded from the total assets:
 - (a) where the *group undertaking* is an *insurance undertaking*, must be identified and valued in accordance with *relevant regulatory requirements* as to the value, admissibility, nature, location or matching that apply to the assets available to cover its liabilities (determined under the *relevant regulatory requirements*) and the *notional required minimum margin*;
 - (b) where the *group undertaking* is not an *insurance undertaking*, must be of a value at least equal to the amount of its liabilities, determining that value and that amount in accordance with the *Valuation of Assets Rules* (other than 4.14(1)(a) to (c)) and the *Determination of Liabilities Rules*; and
 - (c) in both cases, must not include:
 - (i) assets falling within (2)(b), or

- (ii) assets falling within (2)(e) where the amount is due, or to become due, from a *group undertaking*.
- (4) For the purposes of (3), the *relevant regulatory requirements* must be treated as if:
- (a) where rule 2.10 (or its equivalent in a *designated state or territory*) applies, the *insurance undertaking* satisfies the condition in rule 2.10(1); and
 - (b) rules 4.14(1)(a) to (c) (or their equivalent in a *designated state or territory*) do not apply.

Debts due or to become due from a group undertaking

- 4.3 The value of any *debt* due, or to become due, from a *group undertaking* must not exceed the amount reasonably expected to be recovered in respect of the *debt* taking into account only the value of:
- (a) the assets identified in 4.2(2)(a); and
 - (b) any *security* held in respect of the *debt*.

Assets sold to or purchased from an approved credit institution or an approved investment firm subject to an agreement for resale or repurchase

- 4.4 (1) Where an *insurer* has sold *securities* to or purchased *securities* from an *approved credit institution* or an *approved investment firm* and such sale or purchase was made subject to an agreement that the *approved credit institution* or *approved investment firm* would, either on demand by the *insurer* or within six months of such sale or purchase, subsequently sell to or purchase from the *insurer* equivalent *securities*, then if at the *relevant date* such subsequent sale or purchase has not taken place and the conditions specified in (2) and either (3) or (4) (as appropriate) are satisfied, the *insurer* -
- (a) must value -
 - (i) *securities* sold by it under such agreement as if such *securities* had been retained by it, and
 - (ii) assets provided by it as consideration for the purchase of *securities* under such agreement as if such consideration had not been provided by it; and
 - (b) must not ascribe a value to -

- (i) any consideration received for the sale of *securities* under such agreement (or any assets purchased by it with such consideration) up to the limit of the value of the *securities* sold, or
 - (ii) any *securities* purchased by it under such agreement (or any assets purchased with the proceeds of the sale of any such *securities*) up to the limit of the consideration (valued in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate to *insurers*) provided by it.
- (2) The condition specified in this paragraph is that where at any time after the sale or purchase of *securities* by the *insurer* under an agreement described in (1) -
 - (a) the amount of the consideration received by the *insurer* for the sale of the *securities* fell below the value of the *securities* sold by it; or
 - (b) the value of the *securities* purchased by the *insurer* fell below the value of the consideration provided by it,

by more than 2.5% of the value of the *securities* sold or purchased, as the case may be, the *insurer* demanded additional consideration whose amount was equal to the shortfall and such demand was complied with before the end of the working day next following the day on which such shortfall occurred.

- (3) The conditions specified in this paragraph are that where the *insurer* purchases *securities* from an *approved credit institution* or an *approved investment firm* and the consideration provided by the *insurer* is other than by way of sale of *securities* -
 - (a) the *securities* purchased are -
 - (i) *approved securities*,
 - (ii) *listed securities*, or
 - (iii) *securities* issued by an *approved credit institution*; and
 - (b) the *securities* purchased -
 - (i) do not include *securities* (other than *approved securities*) issued by the same *counterparty* whose aggregate value amounts to more than 15% of the value of the *securities* purchased, or
 - (ii) in the event that the condition in (b)(i) is not satisfied, do not include *securities* whose value when aggregated with the *insurer's* existing exposure to assets of the same description or

to the same *counterparty* would exceed the appropriate *permitted asset exposure limit* or *permitted counterparty exposure limit* determined in accordance with rule 4.14 and **Appendix 4.2**.

- (4) The conditions specified in this paragraph are that where the *insurer* sells *securities* to an *approved credit institution* or an *approved investment firm* -
- (a) the consideration provided by the *approved credit institution* or *approved investment firm* is -
- (i) cash,
 - (ii) *approved securities*,
 - (iii) *listed securities*,
 - (iv) *securities* issued by an *approved credit institution*,
 - (v) a charge over assets set out in (i) to (iv),
 - (vi) a letter of credit established with an *approved credit institution*, or
 - (vii) a guarantee provided by an *approved credit institution*;
- (b) the consideration does not include -
- (i) except to the extent that the condition in (ii) is satisfied, consideration whose amount when aggregated with the *insurer's* existing *exposure* to assets of the appropriate description or to the relevant *counterparty* would exceed the appropriate *permitted asset exposure limit* or *permitted counterparty exposure limit* determined in accordance with rule 4.14 and **Appendix 4.2**, or
 - (ii) consideration, more than 15% of the aggregate amount of which takes the form of *securities* (other than *approved securities*) issued by, letters of credit established with, guarantees provided by, cash deposited with, a charge over cash deposited with or a charge over *securities* issued by, the same *counterparty*; and
- (c) the consideration to be provided by the *insurer* for the subsequent purchase of *equivalent securities* is -
- (i) where the consideration for the original purchase by the *approved credit institution* or *approved investment firm* was

- (wholly or in part) cash, cash denominated in the same currency, and
- (ii) where the consideration was (wholly or in part) *securities*, *securities* equivalent to the *securities* provided by way of consideration.
- (5) For the purposes of this rule, where the *insurer* has received consideration in respect of any other sale of the kind described in (1), in addition to any other exposure to assets or to a *counterparty* -
- (a) if such consideration takes the form of a letter of credit established with, or a guarantee provided by, an *approved credit institution*, then it must be treated as giving rise to *exposure* to that institution by the amount of the consideration;
- (b) if such consideration takes the form of a charge over *securities*, then it must be treated as giving rise to *exposure to securities* of the same description and to the issuer of those *securities* by the amount of the consideration; and
- (c) if such consideration takes the form of cash deposited with another party for the benefit of the *insurer*, or a charge over cash deposited with another party, then it must be treated as giving rise to *exposure* to that party by the amount of the consideration.
- (6) For the purposes of this rule, the amount of any consideration is -
- (a) where the consideration provided is a letter of credit established with an *approved credit institution*, the lower of the amount made available under the letter of credit and the value of the assets sold;
- (b) where the consideration is a guarantee provided by an *approved credit institution*, the lower of the amount of the guarantee and the value of the assets sold; or
- (c) where the consideration takes the form of assets of the types mentioned in (4)(a)(i) to (iv), or a charge over such assets, the value of the assets determined in accordance with the *Valuation of Assets Rules*.
- (7) Where an *insurer* has entered into a number of agreements described in (1), for the purposes of (3) and (4) of this rule -
- (a) any or all agreements under which the subsequent sale or purchase has not taken place at the *relevant date* may be treated as one agreement; and

- (b) in such case, the 15% limits in (3)(b)(i) and (4)(b)(ii) must be calculated by reference to the aggregate of the value of the *securities* purchased under (3) and the amount of any consideration under (4).

Debts and other rights

- 4.5 (1) The value of any *secured debt* due, or to become due, to an *insurer*, other than a *debt* to which rule 4.3 or (2), (3) or (7) of this rule applies, is -
- (a) in the case of any such *debt* which is due, or will become due, within 12 months of the *relevant date* (including any *debt* which would become due within that period if the *insurer* were to exercise any right to which it is entitled to require payment of it), the amount which can reasonably be expected to be recovered in respect of that *debt* (due account being taken of the nature and quality of the *security* and the terms and conditions for payment); and
 - (b) in the case of any other such *debt*, the amount which would reasonably be paid by way of consideration for an immediate assignment of the *debt* (due account being taken of the nature and quality of the *security* and the terms and conditions for payment).
- (2) Any *debt* due, or to become due, to an *insurer* under a letter of credit must be left out of account for the purposes of the *Valuation of Assets Rules*.
- (3) In the case of *long-term insurance business* carried on by an *insurer*, the value of any *debt* due, or to become due, to the *insurer* which is secured on a *policy* of insurance issued by the *insurer* and which (together with any other *debt* secured on that *policy*) does not exceed the amount payable on a surrender of that *policy* at the *relevant date* must be the amount of that *debt*.
- (4) The value of any *unsecured debt* due, or to become due, to an *insurer*, other than a *debt* to which rule 4.3, (5) or (7) of this rule or rule 4.10 or 4.13 applies, is -
- (a) in the case of any such *debt* which is due, or will become due, within 12 months of the *relevant date* (including any *debt* which would become due within that period if the *insurer* were to exercise any right to which it is entitled to require payment of it), the amount which can reasonably be expected to be recovered in respect of that *debt* (due account being taken of the terms and conditions for payment); and
 - (b) in the case of any other such *debt*, the amount which would reasonably be expected to be paid by way of consideration for an immediate assignment of the *debt* (due account being taken of the terms and conditions for payment).

- (5) Subject to (6), the value of any rights of the *insurer* under a contract of *reinsurance* to which it is a party is the amount which can reasonably be expected to be recovered in respect of those rights.
- (6) (5) does not apply to -
- (a) rights under a contract of *reinsurance* in respect of *long-term insurance business* except to the extent that *debts* are due under such contracts; or
 - (b) *debts* to which rule 4.3 applies which are due or to become due.
- (7) Any *debt* due, or to become due, to the *insurer* -
- (a) from an *intermediary* in respect of money advanced on account of commission to which that *intermediary* is not absolutely entitled at the *relevant date*;
 - (b) in respect of unpaid *share* capital of the *insurer*;
 - (c) from a *company* of which it is a *subsidiary undertaking* where such *debt* is *subordinated debt*; or
 - (d) which is a *debt* to which (8) applies,
- must be left out of account for the purposes of the *Valuation of Assets Rules*.
- (8) For the purposes of (7)(d), this paragraph applies to a *debt* which is a *debt* owed in respect of premiums (due account being taken of rebates, refunds and commissions payable) which is recorded in the *insurer's* accounting records as due and payable and has been outstanding for more than three months.
- (9) In the case of *general insurance business* carried on by an *insurer*, the value of any subrogation rights of the *insurer* is the amount which can reasonably be expected to be recovered by virtue of the exercise of those rights.
- (10) In the case of *general insurance business* carried on by an *insurer*, the value of any *salvage right* of the *insurer* is the amount which can reasonably be expected to be recovered by virtue of the exercise of that right.
- (11) The value of any right to recover assets transferred by way of *initial margin* must be determined -
- (a) where the *initial margin* was a payment in cash, as if there were a *debt* owed to the *insurer* for that amount; and
 - (b) where the *initial margin* took the form of a transfer of *securities*, as if there were a *debt* owed to the *insurer* of an amount equal to the value

of such *securities* as determined in accordance with the *Valuation of Assets Rules*.

- (12) The value of any rights arising under a *derivative contract* to which rule 4.12 does not apply, or under a contract or asset having the effect of a *derivative contract* to which rule 4.12 does not apply, is the value of any right to recover assets transferred by way of *initial margin* together with the value of any other unconditional right to receive a specified amount.
- (13) This rule does not apply to any rights (other than *debts* due) in respect of -
- (a) investments in *group undertakings*;
 - (b) *securities* or beneficial interests in a limited partnership;
 - (c) units or other beneficial interests in a *collective investment scheme*;
 - (d) a *derivative contract*, except as provided under (11) or (12); or
 - (e) a contract or asset which has the effect of a *derivative contract* other than as provided under (11) or (12) or under rule 4.13(4) or (5).

Land

- 4.6 (1) The value given to any land of an *insurer* (other than land held by the *insurer* as security for a *debt* or to which (2) or rule 4.11 applies) must not be greater than the amount which (after deduction of the reasonable expenses of sale) would be realised if the land were sold at a price equal to the most recent *proper valuation* of that land which has been provided to the *insurer*, and any such land of which there is no *proper valuation* must be left out of account for the purposes of the *Valuation of Assets Rules*.
- (2) The value of any interest in land which is determinable upon the death of any person or upon the happening of some other future event or at some future time is the amount which would reasonably be paid by way of consideration for an immediate transfer of it.

Equipment

- 4.7 (1) The value of any computer equipment of an *insurer* -
- (a) in the *financial year* of the *insurer* in which it is purchased, must be not greater than three-quarters of the cost to the *insurer*;
 - (b) in the next *financial year*, must be not greater than one-half of that cost;
 - (c) in the second *financial year* thereafter, must be not greater than one-quarter of that cost; and

- (d) in any subsequent *financial year*, must be left out of account for the purposes of the *Valuation of Assets Rules*.
- (2) The value of any office machinery (other than computer equipment), furniture, motor vehicles and other equipment of an *insurer*, must be, in the *financial year* of the *insurer* in which it is purchased, not greater than one-half of the cost to the *insurer* and must be, in any subsequent *financial year*, left out of account of the purposes of the *Valuation of Asset Rules*.

Securities and beneficial interests in limited partnerships

- 4.8 (1) Subject to (2), this rule applies to the valuation of investments comprising *securities* and beneficial interests in limited partnerships and, for the purposes of (6), **investments** includes loans.
- (2) This rule does not apply to the valuation of *securities* which are -
- (a) *derivative contracts*;
 - (b) [deleted];
 - (c) units or other beneficial interests in *collective investment schemes*, except as provided in rule 4.9(2); or
 - (d) contracts or assets having the effect of *derivative contracts*, except as provided in rule 4.13(4).
- (3) Subject to (5) and (6) and rule 4.13, the value of an investment to which this rule applies is -
- (a) where the investment is transferable and (4) does not apply, the *market value*; and
 - (b) where the investment is transferable and (4) applies, the lower of -
 - (i) the *market value*, and
 - (ii) the amount which would reasonably be expected to be received by way of consideration for an assignment or transfer of the investment at a date not later than 12 months after the *relevant date*, it being assumed that negotiations for the assignment or transfer commenced on the *relevant date* and the assignment or transfer was made other than to the *issuer* or to an *associate* or an associated *company* of the *issuer* or of the *insurer*; and
 - (c) where the investment is not transferable -

- (i) the amount payable on redemption on the *relevant date* or the most recent date before the *relevant date* on which the *issuer* of the investment could have been required to redeem the investment, or
 - (ii) where the investment cannot be redeemed, the amount which would reasonably be paid by way of compensation for the surrender of the interest in the investment.
- (4) This paragraph applies where it is not reasonable to assume that, had negotiations for the assignment or transfer of the investment commenced not more than seven working days before the *relevant date*, the investment could have been assigned or transferred on the *relevant date* for an amount not less than 97.50% of the *market value* other than to the *issuer* or an *associate* or associated *company* of the *issuer* or of the *insurer*.
- (5) (4) is taken not to apply if it applies by reason only that -
- (a) the *listing* of the investment has been temporarily suspended following receipt of price sensitive information by the stock exchange on which the investment is *listed* or the *regulated market* on which facilities for dealing have been granted; or
 - (b) the extent of the holding would prevent an orderly disposal of the investment for an amount equal to or greater than 97.50% of the *market value*.
- (6) Where an *insurer* has made more than one *unlisted* 'investment' (other than a number of 'investments' exclusively comprising loans) and the value of such 'investments' when taken together is greater than the aggregate of the values of each 'investment' valued separately, then such higher value may be ascribed to the 'investments' if it is reasonable to assume that none of the 'investments' would be assigned or transferred separately.

Beneficial interests in collective investment schemes

- 4.9 (1) Subject to (3), this rule applies to holdings of units or other beneficial interests in -
- (a) a scheme falling within the *UCITS Directive*.
 - (b) an authorised unit trust scheme or a recognised scheme within the meaning of Part XVII of the *Act* (not falling within (a)); or
 - (c) any other *collective investment scheme* where -
 - (i) the scheme does not employ *derivative contracts* unless they are contracts to which rule 4.12 applies;

- (ii) the scheme does not employ contracts or assets having the effect of *derivative contracts* unless they have the effect of *derivative contracts* to which rule 4.12 applies; and
 - (iii) the property of the scheme does not include assets other than those for the valuation of which provision is made in the *Valuation of Assets Rules*.
- (2) The value of units or other beneficial interests in a *collective investment scheme* to which this rule applies is -
 - (a) where the *issuer* can be required to purchase the units or other beneficial interests from the holder upon the holder giving notice of one month or less, the price at which the *issuer* would have purchased the units or other beneficial interests on the *relevant date* or the most recent date before the *relevant date* on which it could have been required to make such a purchase; and
 - (b) where the *issuer* cannot be required to purchase the units or other beneficial interests as set out in (a), a value determined in accordance with rule 4.8.
- (3) Other than as provided in rule 4.13(4), this rule does not apply to units or other beneficial interests in a *collective investment scheme* which has the effect of a *derivative contract*.

Deferred acquisition costs

- 4.10 In the case of *general insurance business*, the value of *deferred acquisition costs* is the value as determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate to *insurers*.

Reversionary interests etc.

- 4.11 The value of any *long-term insurance business asset* of an *insurer* consisting of an interest in land which is a remainder, reversionary interest, right of fee subject to a life interest or other future interest, whether vested or contingent, is the amount which would reasonably be paid by way of consideration for an immediate transfer or assignment of it.

Derivative contracts

- 4.12 (1) The value of rights (other than rights to recover assets transferred by way of *initial margin*) under a *derivative contract* to which this rule applies is -
- (a) in the case of a *listed derivative contract*, the *market value*; and

- (b) in the case of an *unlisted derivative contract*, the amount which would reasonably be paid by way of consideration for closing out that contract,

in either case taking into account the *market value* of any assets which, at the *relevant date*, have been transferred by way of *variation margin*¹³.

- (2) This rule applies to an ‘approved derivative contract’ which is ‘covered’ and -
 - (a) which is held in connection with a contract or asset of the type described in (3) for the purposes of reduction of investment risks or efficient portfolio management; or
 - (b) which has the effect of an ‘approved derivative contract’ held in connection with a contract or asset of the type described in (3) for such purposes¹⁴.
- (3) The contract or asset described in this paragraph is either -
 - (a) an ‘approved derivative contract’ or a contract or asset having the effect of an ‘approved derivative contract’ either of which, when taken together with the ‘approved derivative contract’ the rights under which are being valued in accordance with this rule, would have the effect that the *insurer* either holds an asset for the valuation of which provision is made in the *Valuation of Assets Rules* or holds an ‘approved derivative contract’ in connection with such an asset; or
 - (b) an asset for the valuation of which provision is made in the *Valuation of Assets Rules*, being neither a *derivative contract* nor a contract or asset having the effect of a *derivative contract*.
- (4) For the purposes of this rule, an ‘approved derivative contract’ is **covered** if it does not require a ‘significant’ provision to be made in respect of it pursuant to rule 5.3¹⁵.
- (5) For the purposes of determining in accordance with (4) whether a required provision is ‘significant’, regard must be had to the obligations of the *insurer* under the contract and the volatility of the assets identified by the *insurer* as being suitable to cover such obligations; and the required provision in respect of any one *derivative contract* must be treated as **significant** if -
 - (a) the aggregate provision required in respect of all contracts having a similar effect is significant; or

¹³ See Section 8 of **Guidance Note 4.2**

¹⁴ See Section 4 of **Guidance Note 4.2**

¹⁵ See Sections 6 and 9 of **Guidance Note 4.2**

- (b) the aggregate provision required in respect of all contracts with which it is connected is significant.
- (6) In this rule **approved derivative contract** means a *derivative contract* which -
- (a) is *listed* or has been entered into with an *approved counterparty*¹⁶;
 - (b) the *insurer* reasonably believes may be readily closed out¹⁷; and
 - (c) is either a *contract for differences* to which (7) applies, or a *futures contract* or an *option* to which (8) applies.
- (7) This paragraph applies to -
- (a) a *contract for differences* under which the amount payable by either party is calculated solely by reference to fluctuations in any of the following, namely -
 - (i) the value of an asset for the valuation of which provision is made in the *Valuation of Assets Rules*;
 - (ii) the amount of income from such an asset over a defined period;
 - (iii) an index of such assets, being an index in respect of which a *derivative contract* is *listed*; or
 - (iv) a national index of retail prices published by or under the authority of a government of a state belonging to Zone A as defined in the *Banking Co-ordination Directive*.
- or an arithmetic average thereof; and
- (b) a contract under which the amount payable by either party is calculated by reference to the difference between the *market value* and the *amortised value* of any asset for the valuation of which provision is made in the *Valuation of Assets Rules*¹⁸.
- (8) This paragraph applies to a *futures contract* or an *option* which in either case provides for the acquisition or disposal of assets for the valuation of all of which provision is made in the *Valuation of Assets Rules* at a price which is determined by one or more of the following methods -

¹⁶ See Section 3 of **Guidance Note 4.2**

¹⁷ See footnote 16

¹⁸ See Section 7 of **Guidance Note 4.2**

- (a) for each date on which the contract may be completed or the *option* exercised, the price is a fixed amount under the terms of the contract or *option*;
- (b) it is determined by reference to the *market value* or the *amortised value* of an asset for the valuation of which provision is made in the *Valuation of Assets Rules* or the amount of income over a defined period from such an asset; or
- (c) it is determined by reference to an index of the kind mentioned in (7)(a)(iii) or (iv) or an arithmetic average thereof.

Contracts and assets having the effect of derivative contracts

- 4.13 (1) Subject to (3), for the purposes of the *Valuation of Assets Rules*, a contract has the effect of a *derivative contract* if it is a contract (other than a *derivative contract*) which provides, whether upon the exercise of a right by the *insurer* or otherwise -
- (a) for payment (at any time) of amounts which are determined by fluctuations in -
 - (i) the value of property of any description;
 - (ii) an index of the value of property of any description;
 - (iii) income from property of any description; or
 - (iv) an index of income from property of any description;
 - (b) for delivery of an asset other than an asset for the valuation of which provision is made in rule 4.7 to or by the *insurer*; or
 - (c) for the conversion of an asset held by the *insurer* or another party to -
 - (i) an asset of a different type, or
 - (ii) a different asset of the same type.
- (2) Subject to (3), for the purposes of the *Valuation of Assets Rules* an asset has the effect of a *derivative contract* if the asset is an asset (other than an *approved security* or an asset falling within rule 4.9(1)(a)) and the holding of the asset confers contractual rights or imposes contractual obligations to make or accept payment, delivery or conversion as set out in (1)(a) to (c).
- (3) A contract or asset does not have the effect of a *derivative contract* by reason only that -

- (a) it provides for the unconditional delivery of assets, or for the payment for unconditional delivery of assets, such delivery or payment to be made within a period commencing at the date of the contract and extending -
 - (i) in the case of a *listed security*, for the usual period for delivery or payment as determined by the rules of the stock exchange or *regulated market* on which the *securities* are *listed* or facilities for dealing have been granted, or
 - (ii) in any other case, for no more than 20 working days;
 - (b) it is a contract of the type described in rule 4.1(8) in respect of which the conditions set out in rule 4.1(9) have been satisfied; or
 - (c) it is a transaction to which rule 4.4(1) applies.
- (4) Rights in respect of a contract or asset which has the effect of a *derivative contract* to which rule 4.12 applies must -
- (a) where the asset is a *security*, be valued in accordance with rule 4.8;
 - (b) where the asset comprises units or other beneficial interests in a *collective investment scheme*, be valued in accordance with rule 4.9; and
 - (c) where the asset is a *debt* or other right, be valued in accordance with rule 4.5.
- (5) Rights in respect of a contract or asset having the effect of a *derivative contract* to which rule 4.12 does not apply must be valued in accordance with rule 4.5(12).
- (6) For the purposes of determining whether a contract or asset has the effect of a *derivative contract* to which rule 4.12 applies, it must be treated as having the effect of a *derivative contract* which is *listed* or transacted with an *approved counterparty* if it is itself *listed* or so transacted.

Assets to be taken into account only to a specified extent

- 4.14 (1) Subject to (5) and (6), the aggregate value of the assets of an *insurer* as determined in accordance with the *Valuation of Assets Rules* must, for any of the purposes for which the *Valuation of Assets Rules* apply, be reduced by an amount representing the aggregate of -
- (a) the amount by which the *insurer* is exposed to assets of any description in excess of the *permitted asset exposure limit* for assets of that description;

- (b) the amount by which the *insurer* is exposed to a *counterparty* in excess of the *permitted counterparty exposure limit* for such *counterparty*;
- (c) the amount by which the *insurer* has an excess concentration with a number of *counterparties*;
- (d) the value of any assets transferred to or for the benefit of the *insurer* in pursuance of a condition in a *derivative contract* to which rule 4.12(2) does not apply or a related contract; and
- (e) the value of any assets transferred to or for the benefit of the *insurer* in pursuance of a contract having the effect of a *derivative contract* to which rule 4.12(2) does not apply or a related contract,

as determined in accordance with **Appendix 4.2**.

- (2) Where an *insurer* is exposed to assets of any description in excess of the *permitted asset exposure limit* for such assets, the reduction required to be made by (1)(a) must be made -
 - (a) by deducting (as far as possible) the amount of the excess from the assets of that description held by the *insurer*; and
 - (b) where the *insurer* does not hold sufficient assets of that description to eliminate the excess (or does not hold any assets of that description) by making an appropriate deduction from the aggregate value of the assets which the *insurer* would otherwise be permitted to take into account for any of the purposes for which the *Valuation of Assets Rules* apply.
- (3) Where an *insurer* is required to make a reduction in accordance with (1)(b), (c), (d) or (e), the reduction must be made by making a deduction from the aggregate value of the assets which the *insurer* would otherwise be permitted to take into account for any of the purposes for which the *Valuation of Assets Rules* apply.
- (4) Where an *insurer* carrying on *long-term insurance business* has attributed assets partly to a *long-term insurance business fund* and partly to its other assets, any reduction required to be made by this rule must be made in the same proportion as the attribution.
- (5) Assets of an *insurer* comprising -
 - (a) *approved securities* or any interest accrued on them;
 - (b) *debts* to which rule 4.5(3) applies;
 - (c) rights to which rule 4.5(5), (9) or (10) applies;
 - (d) *debts* in respect of premiums;

- (e) moneys due from, or guaranteed by, the government of any state which belongs to Zone A as defined in *Banking Co-ordination Directive*;
- (f) *shares* in or *debts* due or to become due from a *dependant*;
- (g) holdings in a scheme falling within the *UCITS Directive*; or
- (h) *deferred acquisition costs*,

must not be taken into account in any of the calculations described in (1).

- (6) Where an *insurer* has entered into any contracts providing for the payment of *index linked benefits*, the provisions of (1)(a) will not apply to assets of that *insurer* to the extent that they are held to match liabilities in respect of such benefits.

Chapter 5

DETERMINATION OF LIABILITIES

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Chapter 5

DETERMINATION OF LIABILITIES

Application¹⁹

- 5.1 These *Determination of Liabilities Rules* apply with respect to the determination of the amount of liabilities of an *insurer*.

Long-term and general insurance business

- 5.2 (1) Subject to the *Determination of Liabilities Rules*, the amount of liabilities of an *insurer* must be determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for *insurers*.
- (2) In determining under (1) the amount of liabilities of an *insurer*, all contingent and prospective liabilities must be taken into account including all liabilities in respect of cumulative preference *share* capital but excluding other liabilities in respect of *share* capital²⁰.

Provision for adverse changes

- 5.3 (1) An *insurer* which has or may have (following the exercise of any right by the *insurer* or any other party) an obligation to which this rule applies to deliver assets or make a payment must -
- (a) at all times identify the assets held by it which it considers to be the most suitable to cover such obligations; and
- (b) make prudent provision for the effect on ‘the amount of its excess assets’ of adverse variations between the value of the assets identified and the value of the assets which it is or may be obliged to deliver or the amount of the payment which it is or may be obliged to make.²¹
- (2) For the purposes of (1), the *insurer* must take into account all reasonably foreseeable adverse variations and must have particular regard to past volatility in the value of the assets concerned (or assets of a similar nature) and the possibility of adverse changes in such volatility in the future.
- (3) For the purposes of this rule -

¹⁹ For the application of the *Determination of Liabilities Rules* to the financial reporting requirements in Chapter 9, see rule 9.13

²⁰ For guidance on the treatment of certain hybrid capital instruments, see **Guidance Note 2.1**

²¹ For guidance on this rule in respect of derivatives, see paragraph 9.3 of **Guidance Note 4.2**

the amount of its excess assets means the difference between the aggregate value of its assets (other than *linked assets* to the extent that they are held to match *property linked liabilities*), determined in accordance with the *Valuation of Assets Rules*, and the amount of its liabilities (other than *property linked liabilities* or liabilities for which provision is made in accordance with this rule).

- (4) Subject to (5), this rule applies to an obligation -
- (a) under a contract relating to investments of the kinds mentioned in item C under the heading ‘Assets’ in paragraph 9 of Part I of the *insurance accounts rules* (whether such contract constitutes an asset or liability of the *company*);
 - (b) undertaken for the purposes of, or in connection with the making of, investments of the kind mentioned in (a); or
 - (c) under a contract providing for the purchase, sale or exchange of currency.
- (5) This rule does not apply to a contract to the extent that it relates to, or is for the purposes of the making of an investment in, or is in connection with the making of an investment in, land which is to be occupied by the *insurer* and used by the *insurer* for the conduct of its business.

Provision for related undertakings

- 5.3A (1) An *insurer* must make provision in respect of a *related undertaking* that is an *insurance undertaking* or *insurance holding company*:
- (a) where the *related undertaking* is also a *subsidiary undertaking* of the *insurer*, for the whole of any deficit in the assets available to cover liabilities or represent the *notional required minimum margin*; and
 - (b) in any other case, for the *proportionate share* of any such deficit.
- (2) For the purposes of (1), the identification and valuation of assets available to cover liabilities must be determined in accordance with rule 4.2(3), except that any liability which is a *debt* due to the *insurer* need not be valued at more than the value placed on that debt as an asset of the *insurer*.

General insurance business liabilities

- 5.4 The amount of *insurance liabilities* which are *general insurance business liabilities* must be determined in accordance with the provisions of Section D of Chapter II of Part I of the *insurance accounts rules*.

Relevant co-insurance operations: general insurance business

5.5 Where a *relevant insurer* determines the amount of a liability in order to make provision for outstanding claims arising under a *relevant co-insurance operation*, then, if the *leading insurance undertaking* has informed the *relevant insurer* of the amount of the provision made by the *leading insurance undertaking* for such claims, the amount determined by the *relevant insurer* -

- (a) must be at least as great as the amount of the provision made by the *leading insurance undertaking*; or
- (b) in a case where it is not the practice in the United Kingdom to make such provision separately, must be sufficient, when all liabilities are taken into account, to include provision at least as great as that made by the *leading insurance undertaking* for such claims,

due regard being had in either case to the proportion of the risk covered by the *relevant insurer* and by the *leading insurance undertaking* respectively.

Long-term liabilities

5.6 (1) The determination of the amount of *long-term insurance business liabilities* (other than liabilities which have fallen due for payment before the *relevant date*) must -

- (a) be made on actuarial principles having due regard to –
 - (i) the reasonable expectations of *policy holders*, and
 - (ii) any relevant guidance of the Government Actuary²²; and
- (b) make proper provision for all liabilities on prudent assumptions that include appropriate margins for adverse deviation of the relevant factors.

(2) The determination must take account of all prospective liabilities as determined by the policy conditions for each existing contract, taking credit for premiums payable after the relevant date.

(3) Without prejudice to the generality of (1), the amount of the *long-term insurance business liabilities* must be determined in compliance with rules 5.7 to 5.17 and must take into account, inter alia, the following factors -

- (a) all guaranteed benefits, including guaranteed surrender values;

²² See *IPRU (INS)* Volume 3.

- (b) vested, declared or allotted bonuses to which *policy holders* are already either collectively or individually contractually entitled;
- (c) all options available to the *policy holder* under the terms of the contract;
- (cc) discretionary charges and deductions, in so far as they do not exceed the reasonable expectations of *policy holders*;
- (d) expenses, including commissions; and
- (e) any rights under contracts of *reinsurance* in respect of *long-term insurance business*.

Method of calculation

- 5.7 (1) Subject to (2), (3) and (4), the amount of the *long-term insurance business liabilities* must be determined separately for each contract by a prospective calculation.
- (2) A retrospective calculation may be applied to determine the liabilities where a prospective method cannot be applied to a particular type of contract or benefit, or where the *insurer* can demonstrate that the resulting amount of the liabilities would be no lower than would be required by a prudent prospective calculation.
- (3) Appropriate approximations or generalisations may be made where they are likely to provide the same, or a higher, result than individual calculations of the same amount of the liabilities in respect of each contract.
- (4) Where necessary, additional amounts must be set aside on an aggregated basis for general risks which are not individualised.
- (5) The method of calculation of the amount of the liabilities and the assumptions used must not be subject to discontinuities from year to year arising from arbitrary changes and must be such as to recognise the distribution of profits in an appropriate way over the duration of each *policy*.
- (6) The determination of the amount of liabilities for contracts under which the *policy holder* is eligible to participate in any *established surplus* must have regard to the level of the premiums under the contracts, to the assets held in respect of those liabilities, and to the custom and practice of the *insurer* in the manner and timing of the distribution of profits or the granting of discretionary additions, as the case may be.

Avoidance of future valuation strain

- 5.8 The amount of the liability determined in respect of a group of *contracts of insurance* must not be less than such amount as, if the assumptions adopted for

the valuation were to remain unaltered and were fulfilled in practice, would enable liabilities similarly determined at all times in the future to be covered from resources arising solely from the contracts and the assets covering the amount of the liability determined at the current valuation.

Valuation of future premiums

5.9 (1) Where further specified premiums are payable by the *policy holder* under a contract (not being a *linked long-term contract*) under which the *policy holder* is eligible to participate in any *established surplus* and benefits (other than benefits arising from a distribution of profits) are determined from the outset in relation to the total premiums payable under the contract, then, subject to (4) and rule 5.10 -

(a) where the premiums under the contract are at a uniform rate throughout the period for which they are payable, the premiums to be valued must be not greater than such level premiums as, if payable for the same period as the actual premiums under the contract and calculated according to the rates of interest and rates of mortality or disability which are to be employed in calculating the liability under the contract, would have been sufficient at the outset to provide for the benefits under the contract according to the contingencies upon which they are payable, exclusive of any additions for profits, expenses or other charges; and

(b) where the premiums under the contract are not at a uniform rate throughout the period for which they are payable, the premiums to be valued are to be not greater than such premiums as would be determined on the principles set out in (a) modified as appropriate to take account of the variations in the premiums payable by the *policy holder* in each *financial year*,

but a premium to be valued must in no year be greater than the amount of the premium payable by the *policy holder*.

(2) Where the terms of the contract have changed since the contract was first made (the terms of the contract being taken to change for the purposes of this paragraph if the change is indicated in an endorsement on the policy but not if a new policy is issued), then, for the purposes of (1), one of the following assumptions must be made, namely that-

(a) the change from the date it occurred was provided for in the contract when it was made;

(b) the terms of the contract are those which apply from the date of the change except that a single premium is payable, at the date of the change, of an amount equal to the liability under the *policy* immediately before the change, calculated on a basis consistent with

the *Determination of Liabilities Rules* and with the premiums actually payable from the date of the change; or

- (c) the contract is in two parts, the first of which is for the benefits purchased by the actual premiums payable from the date of the change under the *insurer's* scales of premiums at that date, and the second of which is for all other benefits under the *policy* for which no premiums are payable after that date.
- (3) Where under a contract (not being a *linked long-term contract*) the *policy holder* is eligible to participate in any *established surplus*, and -
- (a) each premium paid increases the benefits (other than benefits arising from a distribution of profits) provided under the contract; or
 - (b) the amount of a premium payable in future is not determinable until it comes to be paid,

future premiums and the corresponding liability may be left out of account so long as adequate provision is made against any risk that the increase in the liabilities of the *insurer* resulting from the payment of future premiums might exceed the amount of the premiums.

- (4) An alternative valuation method to that described in (1) to (3) may be used where it can be demonstrated that the alternative method results in reserves no less, in aggregate, than would result from the use of the method described in those paragraphs.

Acquisition expenses

- 5.10 (1) Subject to (3), in order to take account of acquisition expenses, the maximum annual premium to be valued under rule 5.9 may (subject to (2)) be increased by an amount not greater than the equivalent, taken over the whole period of premium payments and calculated according to the rates of interest and rates of mortality or disability employed in valuing the contract, of 3.5% (or the 'defined percentage', if it is lower than 3.5%) of the relevant capital sum under the contract.
- (2) For the purposes of (1), the **defined percentage** is the percentage arrived at by taking (for all contracts of the same type as the contract in question for which an adjustment is made) the average of the percentages of the relevant capital sum under each such contract that represent the acquisition costs incurred which, after allowing for the effects of taxation, might reasonably be expected to be recovered from the premiums payable under the contract.
- (3) The amount of a future premium valued must not exceed the amount of the premium actually payable by the *policy holder*.
- (4) For the purposes of this rule -

- (a) for contracts other than temporary assurances, the relevant capital sum under a contract must be arrived at in accordance with rule 2.12(4); and
- (b) for temporary assurances, the relevant capital sum must be the sum assured on the *relevant date*.

Rates of interest

- 5.11 (1) The rates of interest to be used in calculating the present value of future payments by or to an *insurer* must be no greater than the rates of interest determined from a prudent assessment of the yields on existing assets attributed to the *long-term insurance business* and, to the extent appropriate, the yields which it is expected will be obtained on sums to be invested in the future.
- (2) For the purposes of (1), the assumed yield on an asset attributed to the *long-term insurance business*, before any adjustment to take account of the effect of taxation, must not exceed the yield on that asset calculated in accordance with (3) to (7), reduced by 2.5% of that yield.
- (3) For the purpose of calculating the yield on an asset -
- (a) the asset must be valued in accordance with the *Valuation of Assets Rules*, excluding any provision under which assets may be taken at lower book values for the purposes of any investigation to which rule 9.4 applies; and
 - (b) the future income from any asset required to be taken into account (whether interest, dividends or repayment of capital) must be reduced by a proportion corresponding to such of the excess *exposure* to assets of that description, calculated in accordance with paragraph 12 of Part I of **Appendix 4.2**, as may reasonably be attributed to such assets.
- (4) For *fixed interest securities*, the yield on an asset, subject to (7), is that annual rate of interest which, if used to calculate the present value of future payments of interest before the deduction of tax and the present value of repayments of capital, would result in the sum of those amounts being equal to the value of the asset.
- (5) For variable interest investments (that is to say, investments which are not *fixed interest securities*) that are equity *shares* other than those within (5A) or land, the yield on an asset, subject to (7), is the ratio to the value of the asset of the income before deduction of tax which would be received in the period of 12 months following the *relevant date* on the assumption that the asset will be held throughout that period and that the factors which affect income will remain unchanged. Account must be taken of any changes in those factors

known to have occurred by the *relevant date* and in particular, without prejudice to the generality of the foregoing, of -

- (a) any known changes in the rental income from property or in dividends on equity *shares*;
 - (b) any forecast changes in dividends which have been publicly announced by the *relevant date*;
 - (c) the effect of any alterations in capital structure; and
 - (d) the value (at the most recent date for which it is known at the *relevant date*) of any determinant of the amount of any future interest payment, that value being deemed to remain unaltered for all subsequent dates.
- (5A) For variable interest investments that are equity *shares* in *companies* subject to, or drawing up accounts as if subject to, legislation implementing the *Accounts Directives*, or which draw up a set of accounts in accordance with International Accounting Standards Committee accounting standards or US generally accepted accounting practice, the yield on an asset, subject to (7A), must be the ratio to the value of the asset of-

(a) $A + B$; or

(b) 2 times A,

whichever is lower,

where A = the income which would be received if it were calculated in accordance with (5),

and B = half the excess (if any) of the 'relevant amount' over A, but if B is less than zero, then it is treated as zero.

- (5B) For the purposes of (5A), the **relevant amount** in relation to equity *shares* must be the issuing *company's* profits after taxation from its ordinary activities for the *preceding financial year*, in so far as attributable to those equity *shares*, so however, without prejudice to the generality of the foregoing, that account is taken of the effect of any alterations in capital structure.
- (5C) For the purposes of (5B), the issuing *company's* profits after taxation from its ordinary activities for the *preceding financial year* must be derived from accounts drawn up in accordance with legislation implementing the *Accounts Directives* or, if accounts are not drawn up in accordance with the *Accounts Directives*, from accounts drawn up in accordance with International Accounting Standards Committee accounting standards or US generally accepted accounting practice.

- (5D) Where (5A) applies, and a *company's* accounting period is longer or shorter than a year, the amount of profits or losses for that period must be annualised, and the annualised figure must be used to calculate the yield.
- (6) Subject to (6A), for variable interest investments (that is to say, investments which are not *fixed interest securities*) other than equity *shares* or land, the yield on an asset, subject to (7), is that annual rate of interest which, if used to calculate the present value of future payments of interest, before deduction of tax, and the present value of repayments of capital, where applicable, would result in the sum of these amounts being equal to the value of the asset, on the assumption that -
- (a) the value of any determinant of the amount of the next interest rate payment and capital repayment made during the following 12 months will be the value of that determinant at the most recent date for which it is known at the *relevant date*;
 - (b) the amount of future interest payments and capital repayments will take account, where appropriate, of -
 - (i) the right of either party to have the investment repaid, and
 - (ii) an assumed yield on other comparable investments made in the future not exceeding an amount determined in accordance with (8) to (10); and
 - (c) indices and all other factors which affect future income payments or capital repayments will remain unchanged after the *relevant date*.
- (6A) For investments in *collective investment schemes* given a value as an asset in accordance with rule 4.9, the yield may be determined as the weighted average of the yields (as determined by this rule) on each of the investments held by the *collective investment scheme*.
- (7) In calculating the yield on an asset under this rule -
- (a) if the asset does not consist of equity *shares* or land -
 - (i) a prudent adjustment must be made to exclude that part of the yield estimated to represent compensation for the risk that the income from the asset might not be maintained or that capital repayments might not be received as they fall due, and
 - (ii) in making that adjustment, regard must be had wherever possible to the yields on risk-free investments of a similar term in the same currency; and
 - (b) for assets which are equity *shares* or land, adjustments to yields must be made as appropriate to exclude that part, if any, of the yield from

each 'category of asset' that is needed to compensate for the risk that the aggregate income from that 'category of asset', taking one year with another, might not be maintained: for this purpose, a **category of asset** comprises assets of a similar nature, type and degree of risk.

- (7A) Notwithstanding (7)(b), for equity *shares* within (5A), adjustments to yields must be made as appropriate to exclude that part, if any, of the yield from each 'category of asset' that is needed to compensate for the risk that the aggregate profits earned by a *company* might not be maintained; and for the purposes of this paragraph, **category of asset** has the same meaning as in (7)(b).
- (8) To the extent that it is necessary to make an assumption about the yields which will be obtained on sums to be invested in future, the yield must be determined in accordance with (9) and (10).
- (9) Where the liabilities are denominated in sterling, the yield assumed, before any adjustment to take account of the effect of taxation -
- (a) on any investment to be made more than three years after the *relevant date* must not exceed the lowest of -
 - (i) the 'long-term gilt yield' current on the *relevant date*,
 - (ii) 3% per annum, increased by two thirds of the excess, if any, of the 'long-term gilt yield' current on the *relevant date* over 3% per annum, or
 - (iii) 6.5% per annum,where **the long-term gilt yield** means the annualised equivalent of the 15 year yield for United Kingdom Government fixed-interest securities jointly compiled by the Financial Times, the Institute of Actuaries and the Faculty of Actuaries; and
 - (b) on any investment to be made three years or less after the *relevant date* must not exceed the assumed yield determined under (2) adjusted linearly over the same three years to the yield determined in accordance with (9)(a).
- (10) Where the liabilities are denominated in currencies other than sterling, the yield must be determined on assumptions that are as prudent as those made under (9).
- (11) In no case may a rate of interest determined for the purposes of (1) exceed the adjusted overall yield on assets calculated as the weighted average of the reduced yields on the individual assets arrived at under (2); and when that weighted average is calculated -

- (a) the weight given to each investment must be its value as an asset determined in accordance with the *Valuation of Assets Rules*, excluding any provision under which assets may be taken at lower book values for the purposes of any investigation to which rule 9.4 applies; and
 - (b) except in relation to the rate of interest used in valuing payments of *property linked benefits*, both the yield and the value of any *linked assets* must be omitted from the calculation.
- (12) For the purpose of determining the rates of interest to be used in valuing a particular category of contracts, the assets may, where appropriate, be notionally apportioned between different categories of contracts.

Rates of mortality and disability

- 5.12 The amount of the liability in respect of any category of contract must, where relevant, be determined on the basis of prudent rates of mortality and disability that have regard to the State of the commitment.

Expenses

- 5.13 (1) Provision for expenses, whether implicit or explicit, must be not less than the amount required, on prudent assumptions, to meet the total net cost, after taking account of the effect of taxation, that would be likely to be incurred in fulfilling contracts if the *insurer* were to cease to transact new business 12 months after the *relevant date*.
- (2) The provision mentioned in (1) must have regard to, among other things, the *insurer's* actual expenses in the last 12 months before the *relevant date* and to the effects of inflation on future expenses on prudent assumptions as to the future rates of increase in prices and earnings.

Options

- 5.14 (1) Provision must be made on prudent assumptions to cover any increase in liabilities caused by *policy holders* exercising options under their *contracts of insurance*.
- (2) Where a contract includes an option whereby the *policy holder* could secure a guaranteed cash payment within 12 months following the *relevant date*, the provision for that option must be such as to ensure that the value placed on the contract is not less than the amount required to provide for the payments that would have to be made if the option were exercised.
- (3) Where a contract includes an option whereby the *policy holder* could secure a cash payment but (2) does not apply, the provision for that option must be such as to ensure that, if the assumptions adopted for the valuation of the contract are fulfilled in practice –

- (a) the resulting value (and therefore the provision) is not less than the amount required to provide for the payment which would have to be made if the option were exercised; and
 - (b) the payment when it falls due is covered from resources arising solely from the contract and from the assets covering the amount of the liability determined at the current valuation.
- (4) For the purposes of (3) the amount of a cash payment secured by the exercise of an option is assumed to be –
- (a) in the case of an *accumulating with-profits policy*, the lower of –
 - (i) the amount which would reasonably be expected to be paid if the option were exercised, having regard to the representations of the *insurer*; and
 - (ii) that amount, disregarding all discretionary adjustments; and
 - (b) in the case of any other *policy* to which this rule applies, the amount which would reasonably be expected to be paid if the option were exercised, having regard to the representations of the *insurer*, without taking into account any expectations regarding future distributions of profits or the granting of discretionary additions in respect of an *established surplus* or in anticipation of such additions.

Contracts not to be treated as assets

5.15 No *long-term insurance contract* may be treated as an asset.

No credit for profits from voluntary discontinuance

5.16 No allowance may be made in the valuation for the voluntary discontinuance of any contract if the amount of the liability so determined would, as a result, be reduced.

Nature and term of assets

5.17 The determination of the amount of *long-term insurance business liabilities* must take into account the nature and term of the assets representing those liabilities and the value placed upon them and must include prudent provision against the effects of possible future changes in the value of the assets on -

- (a) the ability of the *insurer* to meet its obligations arising under the for *long-term insurance business contract* as they arise; and
- (b) the adequacy of the assets to meet the liabilities as determined in accordance with rules 5.7 to 5.16.

Chapter 6

GENERAL INSURANCE BUSINESS: EQUALISATION RESERVES

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Chapter 6

GENERAL INSURANCE BUSINESS: EQUALISATION RESERVES

PART I

PRELIMINARY

- 6.1 For the purposes of these *Equalisation Reserves Rules*, business is *accounted for* on an accident year basis in respect of a *financial year* if, in the accounts and statements required to be deposited with the *FSA* pursuant to rule 9.6, it is *accounted for* using **Forms 21, 22 and 23** under the *Accounts and Statements Rules*, and business is *accounted for* on an underwriting year basis if it is *accounted for* using **Forms 24 and 25** specified in those rules.
- 6.2 In the *Equalisation Reserves Rules*, references to a **numbered class** of *general insurance business* are references to the *class*.
- 6.3 For the purposes of the *Equalisation Reserves Rules*, the rate of conversion from the Euro to the pound sterling is the rate applicable on the last day of the preceding October for which the rate was published in the Official Journal of the Communities.

PART II

BUSINESS OTHER THAN CREDIT INSURANCE BUSINESS

Part II application

- 6.4 (1) Subject to (2), this part of the *Equalisation Reserves Rules* applies to the business listed in (3) when it is carried on by an *insurer* -
- (a) whose head office is in the United Kingdom;
 - (b) whose *insurance business* in the United Kingdom is restricted to *reinsurance*; or
 - (c) whose head office is not in an *EEA State*.
- (2) This part of the *Equalisation Reserves Rules* does not apply to any *insurer* which is an *assessable mutual*.
- (3) This part of the *Equalisation Reserves Rules* applies to *general insurance business* falling within any of the following -

- (a) *accounting class 6* and corresponding *proportional reinsurance treaty business categories*;
 - (b) *direct, facultative and proportional reinsurance treaty consequential loss risks*;
 - (c) *accounting classes 3 and 4* and corresponding *reinsurance treaty business categories*;
 - (d) *nuclear risks*; and
 - (e) *non-proportional reinsurance treaty business categories* corresponding to business in *accounting class 6* and *non-proportional reinsurance treaty consequential loss risks*.
- (4) For the purposes of (3), any business falling within (d) is treated as if it did not fall within (a), (b), (c) or (e).

Part II equalisation reserve

- 6.5 (1) Subject to (2), a *Part II insurer* must maintain an *equalisation reserve* in respect of *Part II business* in accordance with rules 6.6 to 6.10.
- (2) Rules 6.6 to 6.10 do not apply to -
- (a) *Part II business* where *net premiums written* in a *financial year* of an *insurer* in respect of all that business are -
 - (i) less than 1,500,000 Euro, or
 - (ii) less than 4% of *net premiums written* in that *financial year* in respect of all its *general insurance business* and less than 2,500,000 Euro,
 and the *insurer* has no *equalisation reserve* to be brought forward from the previous *financial year*; and
 - (b) *Part II business* carried on outside the United Kingdom by an *insurer* whose head office is not in the United Kingdom.

Business groups

- 6.6 (1) For the purposes of applying this part of the *Equalisation Reserves Rules*, a *Part II insurer* must classify its *Part II business* into separate *business groups* comprising -
- (a) *business group A* - business falling within rule 6.4(3)(a);
 - (b) *business group B* - business falling within rule 6.4(3)(b);

- (c) *business group C* - business falling within rule 6.4(3)(c);
 - (d) *business group D* - business falling within rule 6.4(3)(d); and
 - (e) *business group E* - business falling within rule 6.4(3)(e).
- (2) The *insurer* must further divide its *insurance business* falling within each *business group* into business *accounted for* on an accident year basis and business *accounted for* on an underwriting year basis.

Transfers to and from the equalisation reserve

- 6.7 (1) At the end of each *financial year*, a *Part II insurer* must make transfers to the *equalisation reserve* and transfers from the *equalisation reserve* in accordance with (2) to (6).
- (2) The *insurer* must calculate –
- (a) the aggregate value of transfers to be made to the *equalisation reserve* in accordance with Part I of **Appendix 6.1**; and
 - (b) the aggregate value of transfers to be made from the *equalisation reserve* in accordance with Part II of **Appendix 6.1**.
- (3) Subject to (5), if the aggregate value of transfers to be made to the *equalisation reserve* exceeds the aggregate value of transfers to be made from the *equalisation reserve*, the *insurer* must transfer an amount equal to the excess to the *equalisation reserve*.
- (4) Subject to (5), if the aggregate value of transfers to be made from the *equalisation reserve* exceeds the aggregate value of transfers to be made to the *equalisation reserve*, the *insurer* must transfer from the *equalisation reserve* an amount equal to such excess, or the amount of the *equalisation reserve* brought forward from the *previous financial year* (in this rule referred to as the **previous year's equalisation reserve**), whichever is the lower.
- (5) If the value of the ‘previous year’s equalisation reserve’ together with the aggregate value of transfers to be made to the *equalisation reserve*, less the aggregate value of transfers to be made from the *equalisation reserve*, exceeds the *maximum reserve* calculated in accordance with Part III of **Appendix 6.1**, the *insurer* must transfer such an amount as is necessary to make the *equalisation reserve* equal to the *maximum reserve*.

Transfers of business by insurer

- 6.8 (1) If a *Part II insurer* transfers to another body all its rights and obligations under any *general policies* (whether by novation or pursuant to a transfer approved under Part VII of the *Act*), **Appendix 6.1** applies to that *insurer* at the end of

the *financial year* in which such transfer takes place with the following modifications.

- (2) For the purposes of calculating amounts to be transferred to the *equalisation reserve* (pursuant to Part I of **Appendix 6.1**) and the *business group maximum* applicable to the *insurer's* business (pursuant to Part III of that Appendix), *net premiums written* in respect of policies which were the subject of the transfer must be excluded.
- (3) If all the *insurer's* rights and obligations under all *general policies* falling within a *business group* have been transferred, the *business group maximum* for that *business group* is zero.

Transfers of business to insurer

- 6.9
- (1) If a *Part II insurer* acquires from another body (the **transferor**) all the transferor's rights and obligations under any *general policies* (whether by novation or pursuant to a transfer approved under Part VII of the *Act*), **Appendix 6.1** applies to that *insurer* at the end of the *financial year* in which such acquisition takes place with the following modifications.
 - (2) Where consideration payable in respect of the acquisition is *accounted for* by the *insurer* as an adjustment to premiums -
 - (a) for the purposes of calculating amounts to be transferred to the *equalisation reserve* (pursuant to Part I of **Appendix 6.1**) and the *business group maximum* applicable to the *insurer's* business (pursuant to Part III of that Appendix), *net premiums earned* or *net premiums written*, as the case may be, must be adjusted by any amounts in respect of such consideration; and
 - (b) for the purposes of calculating amounts to be transferred from the *equalisation reserve* (pursuant to Part II of **Appendix 6.1**), *net premiums earned* or *net premiums written*, as the case may be, must include any amounts in respect of such consideration.
 - (3) Where consideration payable in respect of the acquisition is *accounted for* by the *insurer* as an adjustment to *claims* -
 - (a) for the purposes of calculating amounts to be transferred from the *equalisation reserve* (pursuant to Part II of **Appendix 6.1**), *net premiums earned* or *net premiums written*, as the case may be, is such amount as would have been calculated had such consideration been *accounted for* by the *insurer* as an adjustment to premiums; and
 - (b) for the purposes of calculating amounts to be transferred from the *equalisation reserve* (pursuant to Part II of **Appendix 6.1**), *net claims incurred* or *net claims paid*, as the case may be, must be calculated as if such adjustment had not been made.

- (4) For the purposes of (2) and (3), consideration payable in respect of the acquisition must be apportioned between *business groups* (and within each *business group* between business *accounted for* on an accident year basis and business *accounted for* on an underwriting year basis) according to the *business groups* within which the *general policies* which are the subject of the acquisition fall.
- (5) For the avoidance of doubt, an adjustment to premiums or *claims* for the purposes of (2) and (3) may, in either case, be by way of addition or deduction, as appropriate.
- (6) In any *financial year* following that of the acquisition, **Appendix 6.1** applies with the following modifications.
- (7) Where any consideration payable in respect of the acquisition was *accounted for* by the *insurer* as an adjustment to premiums, for the purposes of calculating amounts to be transferred from the *equalisation reserve* pursuant to Part II of **Appendix 6.1**, *net premiums earned* must include an appropriate amount in respect of the consideration for the transfer.
- (8) Where consideration payable in respect of the acquisition was *accounted for* by the *insurer* as an adjustment to *claims*, for the purposes of calculating amounts to be transferred from the *equalisation reserve* pursuant to Part II of **Appendix 6.1**, *net premiums earned* must be taken to be such amount as would have been calculated had the consideration been *accounted for* by the *insurer* as an adjustment to premiums.

Transfers from equalisation reserve where net premiums written fall below specified limits

- 6.10 (1) This rule applies to a *Part II insurer* where -
- (a) the *insurer* has carried on *Part II business* for no less than five *financial years* and *net premiums written* in respect of all that business in two or more of the four *financial years* preceding the *financial year in question* are less than the amounts specified in rule 6.5(2)(a)(i) or (ii), as the case may be; or
 - (b) the *insurer* has carried on *Part II business* for less than five *financial years* and the ‘average net premiums written’ in respect of all that business in those years is less than the amounts specified in rule 6.5(2)(a)(i) or (ii), as the case may be;

and the *insurer* has an *equalisation reserve* to be brought forward from the *preceding financial year*, and *net premiums written* in the *last financial year in question* in respect of *Part II business* are less than the amounts specified in rule 6.5(2)(a)(i) or (ii), as the case may be.

- (2) In this rule, **average net premiums written** means the average amount of *net premiums written* in respect of that business in a *financial year* and any *previous financial years* ending on or after 23 December 1996.
- (3) For the purposes of (2), if any of the *financial years* which the *insurer* is required to take into account for the calculation of ‘average net premiums written’ has been validly extended or shortened, the value of *net premiums written* in that *financial year* is the amount represented by the formula -

$$\frac{\text{NPW} \times 365}{d}$$

where –

NPW means *net premiums written* in the *financial year* concerned; and

d means the number of days falling in that *financial year*.

- (4) The *insurer* to which (1) applies must, as at the end of the *financial year in question*, make a transfer from the *equalisation reserve* of such an amount as is necessary to reduce the *equalisation reserve* to zero.

PART III

CREDIT INSURANCE BUSINESS

Part III application

- 6.11 (1) This part of the *Equalisation Reserves Rules* applies to -
- (a) every *UK insurer* which carries on *credit insurance business*; and
 - (b) every *non-EEA insurer* which carries on *credit insurance business* in the United Kingdom.
- (2) This part of the *Equalisation Reserves Rules* does not apply -
- (a) in the case of a *UK insurer*, where the *net premiums written* in any *financial year* in respect of its *credit insurance business* are less than 4% of the total *net premiums written* by it in that *financial year* and less than 2,500,000 Euro; or
 - (b) in the case of a *non-EEA insurer*, where the *net premiums written* in any *financial year* in respect of its *credit insurance business* carried on through a branch in the United Kingdom are less than 4% of the total *net premiums written* by it in that *financial year* in respect of business carried on through that branch and less than 2,500,000 Euro.

Part III equalisation reserve

- 6.12 *A Part III insurer must maintain an equalisation reserve in respect of credit insurance business carried on by the insurer in accordance with **Appendix 6.2**.*
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Chapter 7

CURRENCY MATCHING AND LOCALISATION

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Chapter 7

CURRENCY MATCHING AND LOCALISATION

Matching: general requirement

- 7.1 (1) Where an *insurer's* 'liabilities' in any particular currency exceed 5% of its total 'liabilities', the *insurer* must hold sufficient 'assets in that currency' to cover at least 80% of its 'liabilities' in that currency.
- (2) Where an *insurer* carries on both *long-term* and *general insurance business*, the requirements of (1) apply to the 'assets' and 'liabilities' of each kind of business separately.
- (3) Where a *contract of insurance* expresses any 'liability' in terms of a particular currency, that 'liability' must be regarded as a 'liability' in that currency.
- (4) For the purposes of this chapter -

assets means assets of the kind referred to in rule 4.1(2) (linked assets), and assets valued in accordance with the *Valuation of Assets Rules*;

liabilities means provision by an *insurer* to cover liabilities arising under or in connection with *contracts of insurance* (not being liabilities relating to *insurance business* excluded by rule 7.6); and

references to **assets in a currency** (or similar expressions) are construed as references to 'assets' expressed in or capable of being realised (without exchange risk) in that currency; and an 'asset' is capable of being realised (without exchange risk) in a currency if it is reasonably capable of being realised in that currency without risk that changes in exchange rates would reduce the cover of 'liabilities' in that currency.

Matching: property linked benefits

- 7.2 (1) In so far as the 'liabilities' for *property linked benefits* and *index linked benefits* are covered by the assets which determine the benefits payable under a *linked long term contract*, rule 7.1 does not apply.
- (2) In so far as the 'liabilities' for *property linked benefits* are determined by reference to 'assets in a currency' other than that in which the *insurer's* obligations to the *policy holder* are expressed, those 'liabilities' are for the purposes of rule 7.1 to be treated as 'liabilities' in the first-mentioned currency.

Matching: currency of general business liabilities

- 7.3 (1) The currency of an *insurer's general insurance business liabilities* must, for the purposes of rule 7.1, be determined as follows.
- (2) Where the 'liabilities' are not expressed as 'liabilities' in terms of a particular currency, they must be treated as 'liabilities' in the currency of the country in which the risk is situated or, if the *insurer* on reasonable grounds so decides, in the currency in which the premium payable under the contract is expressed.
- (3) However, the *insurer* may treat its 'liabilities' as 'liabilities' in the currency which it will use in accordance with past experience or, in the absence of such experience, in the currency of the country in which it is established -
- (a) for contracts covering risks falling within *general insurance business classes* 4, 5, 6, 7, 11, 12 and 13 (producer's liability only); and
- (b) for contracts covering risks falling within any other *general insurance business class* where, in accordance with the nature of the risks, the *insurer's* 'liabilities' are 'liabilities' to be provided in a currency other than that which would result from the application of (2).
- (4) Where a *claim* has been notified to an *insurer* and the *insurer's* 'liability' in respect of that *claim* is payable in a currency other than one which would result from the application of the above provisions, the *insurer* must regard its 'liability' as a 'liability' in the currency in which the *insurer* is actually obliged to pay it.
- (5) Where a *claim* is assessed in a currency which is known to the *insurer* in advance but which is different from a currency which would result from the application of the above provisions, the *insurer* may regard its 'liability' as a 'liability' in that currency.

Matching: exception for certain liabilities

- 7.4 An *insurer* need not cover its 'liabilities' by 'assets in a particular currency' if application of the *Currency Matching and Localisation Rules* would result in the *insurer* being obliged to hold 'assets in a currency' amounting to 7% or less of the remainder of its 'assets in other currencies'.

Localisation

- 7.5 (1) Subject to (2), 'assets' held pursuant to rule 7.1 must be held -
- (a) if they cover 'liabilities' in sterling, in any *EEA State*;
- (b) if they cover 'liabilities' in any other currency, in any *EEA State* or in the country of that currency.

- (2) In the case of a *relevant co-insurance operation* and a *relevant insurer*, ‘assets’ held pursuant to rule 7.1 must be held in any *EEA State*.
- (3) For the purpose of applying (1) and (2) to tangible ‘assets’ and ‘assets’ consisting of a claim against a debtor or a *listed* or *unlisted* investment -
 - (a) a tangible ‘asset’ is to be treated as held in the place where it is situated;
 - (b) an ‘asset’ consisting of a claim against a debtor is to be treated as held in any place where it can be enforced by legal action;
 - (c) an ‘asset’ consisting of a *listed* investment is to be treated as held in any place where -
 - (i) there is a stock exchange (of the kind described in paragraph (a) of the definition of *listed*) where it is listed, or
 - (ii) there is a *regulated market* where it is dealt in; and
 - (d) an ‘asset’ consisting of an *unlisted* investment issued by a company is to be treated as held in the place where the head office of that company is situated.

Exclusions from rules 7.1 to 7.5

- 7.6 (1) Nothing in rules 7.1 to 7.5 applies to -
- (a) *insurance business* carried on by a *UK insurer* outside the *EEA States*;
 - (b) *insurance business* carried on by any other *insurer* outside the United Kingdom; or
 - (c) *reinsurance* business (unless it is facultative *reinsurance* written by an *insurer* who also carries on *insurance business* that is not *reinsurance*).
- (2) Nothing in rule 7.5 applies to the *classes* of *general insurance business* in the groups numbered 3 and 4 in Part II of Annex 11.2.

Location of assets representing margin of solvency of non-EEA insurer

- 7.7 Without prejudice to rule 7.5 -
- (a) the ‘assets’ covering a *UK margin of solvency* maintained under rule 2.1(2)(b) by a *non-EEA insurer* which is not a *Swiss general insurer* must be held -

- (i) up to an amount at least equal to the appropriate *guarantee fund* or *minimum guarantee fund* (whichever is the greater), within the United Kingdom, and
 - (ii) as to the remainder, within the *EEA States*; and
 - (b) the ‘assets’ covering an *EEA margin of solvency* maintained under rule 2.1(3)(e) by a *non-EEA insurer* which is not a *Swiss general insurer* must be held -
 - (i) up to an amount at least equal to the appropriate *guarantee fund* or *minimum guarantee fund* (whichever is the greater) within the *EEA States* where the *insurer* carries on *insurance business* (or in any one or more of them), and
 - (ii) as to the remainder, within the *EEA States*.
-

Chapter 8

NON-UK INSURERS

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Part I - Deposits

8.1 Making and amount of deposit

Part II - Location of accounts and records

8.2 Location of accounts and records

Part III – Rules applicable to branches

8.3 - 8.5

Chapter 8

NON-UK INSURERS

Part I

DEPOSITS

Making and amount of deposit

- 8.1 (1) Subject to (2), a *non-EEA insurer* which has permission under the *Act* to carry on *direct insurance business*, other than a *Swiss general insurer*, must make and maintain a deposit in the United Kingdom with an *approved credit institution* which is no less than *the minimum*.
- (2) Where –
- (a) the *insurer* carries on *insurance business* in the United Kingdom and one or more other *EEA States*; and
 - (b) the *FSA* and the appropriate supervisory authority or authorities in the *EEA States* have agreed that this rule should apply,

the *insurer* must make and maintain the deposit with such person as may be agreed between the *FSA* and the other authority or authorities.

Part II

LOCATION OF ACCOUNTS AND RECORDS

- 8.2 A *non-EEA insurer* which is not a *Swiss general insurer* must keep in the United Kingdom proper accounts and records in respect of *insurance business* carried on in the United Kingdom.

Part III

RULES APPLICABLE TO BRANCHES

- 8.3 An *insurer* which has its head office outside the United Kingdom (other than a *pure reinsurer* which has a Treaty right under Schedule 4 to the *Act*, or a *Swiss general insurer*) must appoint and maintain the appointment of a chief executive (who alone or jointly with one or more others, is responsible for the conduct of its business through an establishment in the United Kingdom) and an authorised UK representative (who is resident in the United Kingdom and is authorised to act generally, and to accept service of any document, on behalf of the *insurer* in the United Kingdom).

8.4 A *Swiss general insurer* must appoint and maintain the appointment of an authorised UK representative as described above.

8.5 An *insurer* which has its head office outside the United Kingdom (other than a *pure reinsurer* which has a Treaty right under Schedule 4 to the *Act*) must be entitled to undertake *insurance business* under its national law.

Chapter 9

FINANCIAL REPORTING

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Chapter 9

FINANCIAL REPORTING

Part I

ACCOUNTS AND STATEMENTS

Application

- 9.1 These *Accounts and Statements Rules* apply to every *insurer* other than -
- (a) an *EEA deposit insurer*, in relation to *insurance business* carried on by it outside the United Kingdom; or
 - (b) a *Swiss general insurer*, in relation to *general insurance business* carried on by it outside the United Kingdom.

Interpretation

- 9.2 (1) In rules 9.25 to 9.27, 9.29, 9.30 and 9.32, and in the Appendices relevant to the *Accounts and Statements Rules*, unless the context otherwise requires, words and expressions not defined in *IPRU (INS)* which are used in the *insurance accounts rules* have the same meanings as in those rules.
- (2) In the *Accounts and Statements Rules* –
- (a) any reference to *long-term insurance business* or *general insurance business* is, in relation to an *EEA-deposit insurer*, to *long-term insurance business* or *general insurance business* carried on by it through a branch in the United Kingdom; and
 - (b) any reference to *general insurance business* is, in relation to a *Swiss general insurer*, to *general insurance business* carried on by it through a branch in the United Kingdom,
- and accordingly any reference to, or requirement imposed in respect of, the accounts and balance sheet (including any notes, statements, reports and certificates annexed to them) is to, or imposes a requirement in respect of, *insurance business* carried on through that branch.
- (3) In the *Accounts and Statements Rules*, any reference to *long-term insurance business* or to *general insurance business* is -
- (a) in relation to an *external insurer* (other than a *pure reinsurer*), to its entire *long-term insurance business* or to its entire *general insurance business* and to any *long-term insurance business* or *general insurance business* carried on by it through a branch in the United Kingdom; and

- (b) in relation to a *UK deposit insurer*, to its entire *long-term insurance business* or to its entire *general insurance business* and to any *long-term insurance business* or *general insurance business* carried on by it through a branch in any *EEA State*,

and accordingly any reference to, or requirement imposed in respect of, the accounts and balance sheet (including any notes, statements, reports and certificates annexed to them) relevant to *long-term insurance business* or to *general insurance business* is to, or imposes a requirement in respect of -

- (i) accounts prepared in respect of its entire *long-term insurance business* or entire *general insurance business*; and
- (ii) accounts prepared in respect of the *long-term insurance business* or the *general insurance business* carried on, in the case of an *external insurer*, by the branch in the United Kingdom and, in the case of a *UK deposit insurer*, by the branches in question in the *EEA States* taken together.

(4) In the *Accounts and Statements Rules* –

- (a) any reference to a numbered Form is a reference to the Form so numbered in **Appendices 9.1 to 9.4**; and
- (b) references to a numbered *class* of *insurance business* are references to the *class* so numbered in either **Annex 11.1** or **11.2**.

(5) To the extent there is a contradiction between *SUP 16.3* and the *Accounts and Statements Rules*, the *Accounts and Statements Rules* apply.

Annual accounts and balance sheets

9.3 (1) Subject to (2) and (3), an *insurer* must, with respect to each of its *financial years*, prepare –

- (a) a revenue account for the year;
- (b) a balance sheet as at the end of the year; and
- (c) a *profit and loss account* for the year.

(2) An *insurer* not trading for profit must, with respect to each of its *financial years*, prepare an income and expenditure account for the year.

(3) If a form is required for -

- an account

- a balance sheet
- a note
- a statement
- a report, or
- a certificate attached to any of the above,

the account etc. must be in that form.

- (4) An *insurer's financial year* must be a 12 month period.

Periodic actuarial investigation of long-term insurer

- 9.4 (1) Every *long-term insurer* -

(a) must, once in every period of 12 months, cause an investigation to be made into its financial condition in respect of its *long-term insurance business*, by the person who for the time being is its *appointed actuary* under the rules in *SUP*; and

(b) when such an investigation has been made, or when at any other time an investigation into the financial condition of the *insurer* in respect of its *long-term insurance business* has been made with a view to the distribution of profits, or the results of which are made public, must cause an abstract of the *appointed actuary's* report of the investigation to be made.

- (2) An investigation to which (1)(b) relates must include -

(a) a determination of the liabilities of the *insurer* attributable to its *long-term insurance business*; and

(b) a valuation of any excess over those liabilities of the assets representing the *long-term insurance fund* or *funds* and, where any rights of any long-term *policy holders* to participate in profits relate to particular parts of such a fund, a valuation of any excess of assets over liabilities in respect of each of those parts.

- (3) For the purposes of any investigation to which this rule applies, the value of any assets and the amount of any liabilities must be determined in accordance with the *Valuation of Assets Rules* and the *Determination of Liabilities Rules*.

- (4) The form and contents of any abstract under this rule must be in accordance with the *Accounts and Statements Rules*.

Audit of accounts

- 9.5 (1) The 'accounts and balance sheets' of every *insurer* must be audited in accordance with rule 9.35 by a person qualified in accordance with the rules in *SUP*.

- (2) In (1), the reference to **accounts and balance sheets** includes a reference to any notes or statement or report annexed to them.

Deposit of accounts etc. with the FSA

- 9.6 (1) Every ‘account’, ‘balance sheet’, abstract or statement required by rules 9.3, 9.4 and 9.36A and any report of the auditor of the *insurer* made in pursuance of rules 9.5 or 9.36E must be printed, and the ‘required copies’ must be deposited with the *FSA* within the periods set out in the table below.

<i>financial year ending on or after</i>	deposit period following the <i>financial year end</i>	
	where the deposit is made electronically or under rule 9.36A	otherwise
31 December 2001	4 months	3 months and 15 days
31 December 2002 and following years	3 months	2 months and 15 days

- (2) In (1), the reference to the **required copies** is to -
- (a) five printed copies of the document; or
 - (b) one printed copy of the document and one copy of it in an electronic form which may be readily used or translated by the *FSA*.
- (3) In the case of any document deposited under (1), except an auditor’s report, one of the printed copies, or, as the case may be, the printed copy, of the document must be signed in accordance with rule 9.33.
- (4) In the case of any auditor's report deposited under (1), one of the printed copies, or, as the case may be, the printed copy, of the document must be signed by the auditor.
- (5) If within 24 months of the date of deposit, the *FSA* notifies the *insurer* that a document deposited under (1) appears to it to be inaccurate or incomplete, the *insurer* must consider the matter and within one month of the date of notification it must correct any inaccuracies and make good any omissions and deposit the relevant parts of the documents again.
- (6) There must be deposited with every revenue ‘account’ and ‘balance sheet’ of an *insurer* any report on the affairs of the *insurer* submitted to the shareholders or *policy holders* of the *insurer* in respect of the *financial year* to which the ‘account’ and ‘balance sheet’ relate.
- (7) In this rule, any reference to an **account** or **balance sheet** includes a reference to any note, or statement or report annexed to it by virtue of rule 9.3 and any certificate annexed to it by virtue of rule 9.34.

Right of policy holders to receive copies of deposited documents

9.7 An *insurer* must provide to any person (or the person who has already been provided with a copy under (a)) within 30 days of the date of request (or, in the case of (b), the date of deposit under rule 9.6(5)):

- (a) a copy of any of the documents last deposited by the *insurer* under rule 9.6(1);
- (b) a copy of any document deposited under rule 9.6(5) which corrects or makes good any document provided under (a); and
- (c) a copy of any report deposited with any such document under rule 9.6(6),

where the deposit is made electronically, in the form (whether printed or electronic) requested or, if the deposit is not made electronically, in printed form, but (except in the case of (b)) the *insurer* may make a charge to cover its reasonable costs, including those of printing and postage.

Documents deposited with the FSA

9.8 [deleted]

Documents deposited in Northern Ireland

9.9 [deleted]

Value of assets and amount of liabilities

9.10 Unless otherwise provided in the *Accounts and Statements Rules*, in the documents which an *insurer* is required to prepare in accordance with the *Accounts and Statements Rules* -

- (a) the value or amount given for an asset (other than a *linked asset* not required to be valued in accordance with the *Valuation of Assets Rules* by virtue of rule 4.1.(2)) or a liability of the *insurer* is the value or amount of that asset or liability as determined in accordance with the *Valuation of Assets Rules* and the *Determination of Liabilities Rules* at the end of *the financial year in question*; and
- (b) in the case of a *linked asset* of the *insurer* (other than a *linked asset* required to be valued in accordance with the *Valuation of Assets Rules* by virtue of rule 4.1), the value given is the value of that asset as determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for *insurers*.

Content and form of accounts

- 9.11 Every account, balance sheet, note, statement, report and certificate required to be prepared by an *insurer* pursuant to rule 9.3(1), (2) and (3) (annual accounts and balance sheets) must be prepared in the manner set out in the *Accounts and Statements Rules* and must fairly state the information provided on the basis required by the *Accounts and Statements Rules*.

Balance sheet

- 9.12 (1) The balance sheet required to be prepared by an *insurer* under rule 9.3(1) must comply with the requirements of **Appendix 9.1** and must be in **Forms 9 to 15** and **17** of that Appendix completed (as may be appropriate) as specified in (2) to (8).
- (2) **Form 9** must be completed by every *insurer*, other than a *Swiss general insurer* or an *EEA deposit insurer*.
- (3) **Form 10** must be completed by every *insurer*.
- (4) **Forms 11 and 12** must be completed by every *insurer* which carries on *general insurance business*, other than a *Swiss general insurer* or an *EEA deposit insurer*.
- (5) **Form 13** must be completed (as appropriate) -
- (a) by every *insurer* which carries on *long-term insurance business* in respect of -
- (i) its total *long-term insurance business assets*; and
- (ii) the *long-term insurance business assets* appropriated by it in respect of each *long-term insurance fund* or, where such assets have been appropriated for a group of funds, those assets;
- (b) by every *insurer* in respect of its total assets other than *long-term insurance business assets*;
- (c) by every *external insurer* (other than a *pure reinsurer*) in respect of *long-term insurance business* or *general insurance business* carried on by it through a branch in the United Kingdom in respect of those assets which are -
- (i) deposited under rule 8.1,
- (ii) maintained in the United Kingdom, and
- (iii) maintained in the United Kingdom and the other *EEA States*; and

- (d) by every *UK deposit insurer* in respect of *long-term insurance business* or *general insurance business* carried on by it through branches in the *EEA States* in respect of those assets which are -
 - (i) deposited under rule 8.1,
 - (ii) maintained in the United Kingdom and such other *EEA States* where *insurance business* is carried on, and
 - (iii) maintained in the United Kingdom and the other *EEA States*.
- (6) **Form 14** must be completed by every *long-term insurer* in respect of -
 - (a) its total *long-term insurance business liabilities* and margins; and
 - (b) the *long-term insurance business liabilities* and margins for each *long-term insurance fund* or where *long-term insurance business assets* have been appropriate in respect of a group of funds, for the *group*.
- (7) **Form 15** must be completed by every *insurer* except an *insurer* not trading for profit which carries on only *long-term insurance business*.
- (8) For each **Form 13** which an *insurer* is required to complete under (5)(a) or (b), the *insurer* must complete **Form 17** in respect of the same *insurance business*; except that where in respect of that Form all amounts required to be shown would be zero and no supplementary note would be required, **Form 13** may instead be accompanied by a supplementary note to that effect and **Form 17** may be returned in blank.

Profit and loss account

- 9.13 The *profit and loss account* required to be prepared by every *insurer* under rule 9.3 must comply with the requirements of **Appendix 9.1** and must be in **Form 16**.

Revenue account

- 9.14 The revenue account to be prepared by every *insurer* under rule 9.3 -
- (a) in the case of an *insurer* carrying on *general insurance business*, must comply with the requirements of **Appendix 9.2** and must be in **Form 20** and separate accounts must be prepared in **Form 20** in respect of each *accounting class* as well as a summary account in that Form in respect of the whole of the *general insurance business* carried on by it; and

- (b) in the case of an *insurer* carrying on *long-term insurance business*, must comply with the requirements of **Appendix 9.3** and must be in **Form 40** and -
 - (i) separate accounts must be prepared in **Form 40** in respect of each *long-term insurance fund* maintained by it; and
 - (ii) where there is more than one fund for *ordinary long-term insurance business* or for *industrial assurance business*, the *insurer* must also prepare a summary **Form 40** for *ordinary long-term insurance business* or for *industrial assurance business*, as the case may require.

Additional information on general insurance business (accounting classes and discounting)

- 9.15 (1) Every *insurer* which carries on *general insurance business* must, in accordance with the requirements of **Appendix 9.2**, prepare in respect of each *accounting class* -
- (a) **Forms 21, 22 and 23** for *insurance business accounted for* on an ‘accident year basis’; and
 - (b) **Forms 24 and 25** for *insurance business accounted for* on an ‘underwriting year basis’.
- (2) For the purposes of (1), business must be taken to be *accounted for* on an **underwriting year basis** where it relates to risks -
- (a) which have been reported previously under the *Accounts and Statements Rules* on **Forms 24 and 25**;
 - (b) in respect of which the *claims* outstanding for such *insurance business* are calculated using the method described in paragraph 52 of the *insurance accounts rules*; or
 - (c) which have not previously been reported on any Form under the *Accounts and Statements Rules* and which the *insurer* accounts for on an ‘underwriting year basis’,
- and business not *accounted for* on an ‘underwriting year basis’ is taken to be *accounted for* on an **accident year basis**.
- (3) Every *insurer* which, in respect of any *financial year*, includes in **Form 22** or **25** amounts relating to adjustments for *discounting* must prepare **Form 30** in accordance with the requirements of **Appendix 9.2**.

Business categories for general insurance business (reinsurance treaties accepted)

- 9.16 (1) Every *insurer* which carries on *general insurance business* must, for the purposes of this rule, allocate its *insurance business* falling within *accounting classes* 9, 10 and 11 to separate *insurance business* categories, that is to say -
- (a) accident and health (corresponding *general insurance business classes* 1 (other than '1(p)') and 2);
 - (b) motor (corresponding *general insurance business classes* '1(p)', 3 and 10);
 - (c) aviation (corresponding *general insurance business classes* '1(p)', 5 and 11);
 - (d) marine (corresponding *general insurance business classes* '1(p)', 6 and 12);
 - (e) transport (corresponding *general insurance business class* 7);
 - (f) property (corresponding *general insurance business classes* 4, 8 and 9);
 - (g) third party liability (corresponding *general insurance business class* 13); and
 - (h) miscellaneous and pecuniary loss (corresponding *general insurance business classes* 14, 15, 16, 17 and 18),

where **1(p)** means the effecting or carrying out of *contracts of insurance* against risks of death of, or injury to, passengers which normally fall within *class* 1, to the extent that the *insurer* has elected to attribute such risks to *accounting class* 2, 3 or 4, as appropriate.

- (2) An *insurer* may allocate its business falling within *general insurance business class* 7 (goods in transit) to the aviation and marine *insurance business categories* and not to the transport *insurance business category* and where such allocation is made the aviation and marine *insurance business categories* are referred to as **aviation and transport** and **marine and transport** respectively.
- (3) Instead of allocating all *insurance business* falling within the *classes* of *general insurance business* specified in any of (1)(a) to (h) to the *insurance business category* stated in that sub-paragraph, an *insurer* may allocate such *insurance business* to two or more separate *insurance business categories*, each of which must consist only of *insurance business* which would otherwise fall in the first-mentioned *insurance business category*.
- (4) Where *insurance business* is allocated to *insurance business categories* pursuant to (3), the *insurer* must, in the Forms prepared in accordance with the

requirements of **Appendix 9.2**, refer to each *insurance business category* so created by a name which -

- (a) describes the general nature of the *insurance business* included; and
- (b) distinguishes that category from other *insurance business categories*.

Additional information on general insurance business (reinsurance treaties accepted)

- 9.17 (1) Every *insurer* which carries on *general insurance business* must, in relation to each *insurance business category* to which *insurance business* has been allocated for the purposes of rule 9.16, in accordance with the requirements of **Appendix 9.2** prepare -
- (a) **Forms 26 and 27** for *insurance business* reported on **Forms 21, 22 and 23**; and
 - (b) **Forms 28 and 29** for *insurance business* reported on **Forms 24 and 25**.
- (2) Information relating to *reinsurance* treaties accepted which fall within more than one *insurance business category* for the purpose of (1) must be shown -
- (a) in the Forms prepared for each such *insurance business category* (amounts being apportioned as necessary); or
 - (b) in the Forms prepared for the *insurance business category* within which the greater part of the *insurance business* to which the treaty relates falls,

and an explanation must be given in a supplementary note annexed to the relevant form of the method used in any such apportionment or of the business included in a form which falls outside the *insurance business category* to which that form relates, as the case may require.

- (3) Unless an explanation is given in a supplementary note annexed to **Form 26** or **28** (as appropriate) for the allocation of the information in question to a different *insurance business category* -
- (a) where information relating to a *reinsurance* treaty accepted has been given in respect of any *financial year*, information relating to that treaty must be included in the same *insurance business category* in the *return* prepared in respect of each later *financial year*; and
 - (b) where a *reinsurance* treaty accepted relates to risks which are of a similar description to those to which an earlier treaty (in relation to which information has been given in respect of *previous financial year*) related and covers those risks in similar proportions, information

relating to the first-mentioned *reinsurance* treaty must be included in the same *insurance business category* as information relating to the earlier treaty.

Risk groups for general insurance business

- 9.18 (1) Every *insurer* which carries on *general insurance business* must, in the manner provided in this rule and for the purpose of the Forms specified in rule 9.19, classify the *direct and facultative insurance business* carried on by it in each country into risk groups by reference to *accounting classes* 1 to 8 as appropriate.
- (2) Each risk group classified for the purposes of this rule must comprise risks within an *accounting class* insured by the *insurer* in each country which, in the opinion of the *directors*, are not significantly dissimilar, either by reference to the nature of the objects exposed to such risks or by reference to the nature of the cover against such risks provided by the *insurer*.
- (3) Subject to (4), the *insurer* must classify its risks so that -
- (a) risks are not included in the same risk group where, having regard to the patterns of risk, *claims* incurrence and settlement patterns, it is necessary to group them separately for the purposes of applying statistical methods (within the meaning of paragraph 47(1) of *the insurance accounts rules*) in calculating the provision for *claims* outstanding in accordance with generally accepted accounting practice;
 - (b) *claims-made policies* are not included in the same risk group as *policies* which are not *claims-made policies*;
 - (c) *policies* falling within *general insurance business class* 14, 15, 16, 17 or 18 are not included in the same risk group as *policies* falling within any other of those *general insurance business classes*, except that *policies* falling within *general insurance business class* 14 may be included in the same risk group as *policies* falling within *general insurance business class* 15;
 - (d) *policies* in respect of private motor car risks are not included in the same risk group as *policies* in respect of other risks falling within *accounting class* 2;
 - (e) *policies* in respect of comprehensive private motor car risks are not included in the same risk group as *policies* in respect of non-comprehensive private motor car risks; and
 - (f) *policies* transferred to the *insurer* by way of a transfer under Part VII of the *Act* are not included in the same risk group as other *policies*.

- (4) (3) does not apply in relation to the risk groups mentioned in that paragraph where, in the case of any *financial year* –
- (a) the *gross premiums written* for that year in respect of the risk group are less than 2.5% of the world-wide *gross premiums written* for all *accounting classes* for that year, or £500,000; or
 - (b) the *gross premiums written* for that year in respect of the risk groups in which *policies* would in accordance with that paragraph be included (except the largest) are less than 0.5% of the world-wide *gross premiums written* for all *accounting classes* for that year, or £100,000.
- (5) Subject to (2) to (4), an *insurer* may in respect of any *accounting class* include all *insurance business* carried on by it in any country in any *financial year* as a single risk group.
- (6) Notwithstanding the provisions of (2) to (4), an *insurer* may classify all *insurance business* carried on by it in any country in respect of any *accounting class* in any *financial year* as a single risk group, provided that *gross premiums written* for that year in respect of that *insurance business* are less than –
- (a) 5% of the world-wide *gross premiums written* for all *accounting classes* for that year; or
 - (b) £500,000.
- (7) Notwithstanding the provisions of (1) to (4), no risk groups need be classified by an *insurer* in respect of a country if the *gross premiums written* in respect of *insurance business* falling within *accounting classes* 1 to 8 and carried on in that country are less than –
- (a) 1% of the world-wide *gross premium written* for all *accounting classes* for that year; or
 - (b) £100,000.
- (8) For the purposes of this rule and rule 9.19, *home foreign business* is to be treated as though it were carried on in a different country from other *insurance business* carried on in the United Kingdom.

Additional information on general insurance business (direct and facultative business)

- 9.19 (1) Every *insurer* which carries on *general insurance business* must, with respect to the *financial year in question* and in relation to each country and each risk group (as classified by it under rule 9.18), prepare in accordance with the requirements of **Appendix 9.2** –

- (a) **Form 31** for *direct and facultative insurance business*, other than *insurance business* falling within *accounting class 2*, reported on **Forms 21, 22 and 23**;
 - (b) **Form 32** for *direct and facultative insurance business* falling within *accounting class 2* reported on **Forms 21, 22 and 23**; and
 - (c) **Form 34** for *direct and facultative insurance business* reported on **Forms 24 and 25**.
- (2) Where an *insurer* has reported *insurance business* with respect to any *previous financial year* and relating to a country and a risk group in **Form 31, 32 or 34** pursuant to (1), it must continue to report that *insurance business* for that *financial year* in subsequent *financial years* for the same country and risk group in **Form 31, 32 or 34** (as appropriate).
- (3) Where any of **Forms 31, 32 or 34** has been prepared in respect of the entire *insurance business* of an *insurer*, no separate forms need be prepared -
- (a) in the case of an *external insurer*, in respect of *insurance business* carried on by it through a branch in the United Kingdom; and
 - (b) in the case of a *UK deposit insurer*, in respect of *insurance business* carried on by it through a branch in any *EEA State*.

Additional information on general insurance business (direct and facultative reconciliation business)

- 9.20 (1) Every *insurer* which carries on *general insurance business* must, with respect to the *financial year in question* and in accordance with the requirements of **Appendix 9.2**, prepare -
- (a) **Form 33** for *insurance business* reported on **Forms 21, 22 and 23** but not reported on **Form 31 or 32**; and
 - (b) **Form 35** for *insurance business* reported on **Forms 24 and 25** but not reported on **Form 34**.
- (2) No separate **Form 33** or **35** need be prepared where, in the cases referred to in rule 9.19(3)(a) or (b), no separate **Forms 31, 32 or 34** need be prepared.

Currencies other than sterling

- 9.21 Every *insurer* which, in respect of a *financial year*, prepares a Form under rules 9.17 or 9.19 containing figures in a currency other than sterling must prepare **Form 36** in accordance with the requirements of **Appendix 9.2**.

Additional information on general insurance business (other than credit insurance business)

- 9.22 (1) This rule applies to *Part II business* and *Part III business*.
- (2) A *Part II insurer* and a *Part III insurer* must, in accordance with the requirements of **Appendix 9.2**, prepare -
- (a) **Form 37**;
 - (b) **Form 38** for business reported on **Forms 21, 22 and 23**; and
 - (c) **Form 39** for business reported on **Forms 24 and 25**.

Additional information on long-term insurance business

- 9.23 Every *insurer* which carries on *long-term insurance business* must, in respect of the *financial year in question* and in accordance with the requirements of **Appendix 9.3**, prepare -
- (a) **Forms 41 to 45** in respect of each revenue account prepared separately under rule 9.14(b)(i); and
 - (b) summary **Forms 41 to 44** in respect of each summary **Form 40** prepared under rule 9.14(b)(ii).

Forms to be annexed

- 9.24 The forms prepared pursuant to rules 9.15, 9.17 and 9.19 to 9.23 must be annexed to the documents referred to in rules 9.12, 9.13 and 9.14.

Additional information on general insurance business: major treaty reinsurers

- 9.25 (1) Subject to the provisions of rule 9.28, an *insurer* which carries on *general insurance business* must annex to the documents referred to in rules 9.12, 9.13 and 9.14, and relating to the *financial year in question*, a statement of -
- (a) the ‘full name’²³ of each of its ‘major treaty reinsurers’ and the address of the registered office or of the principal office in the country where it is incorporated (or, in the case of an unincorporated body, of the principal office) of each such *reinsurer*;
 - (b) whether (and, if so, how) the *insurer* was at any time in the *financial year* ‘connected’²⁴ with any such *reinsurer*;

²³ for the meaning of ‘full name’ in this rule, see rule 9.28(4)

²⁴ for the meaning of ‘connected’, in this rule, see rule 9.28(1)

- (c) the amount of the *reinsurance* premiums payable in the *financial year* to each such *reinsurer* in respect of -
 - (i) *general insurance business ceded* under proportional *reinsurance* treaties; and
 - (ii) *general insurance business ceded* under non-proportional *reinsurance* treaties;
- (d) the amount of any *debt* of each such *reinsurer* to the *insurer* in respect of *general insurance business ceded* under *reinsurance* treaties, included at line 75 of **Form 13**;
- (e) the amount of any deposit received from each such *reinsurer* under *reinsurance* treaties as included at line 31 of **Form 15**; and
- (f) the amount of any anticipated recoveries from each such *reinsurer* under *reinsurance* treaties to the extent that such recoveries have been taken into account by the *insurer* in determining the *reinsurers'* share of *technical provisions* in respect of *claims* outstanding as shown at line 61 of **Form 13**; except that, in respect of *claims* incurred but not reported, such recoveries need only be included to the extent that they are in respect of any specific occurrences for which provisions have been allocated by the *insurer*,

or a statement that it has no 'major treaty reinsurer'.

- (2) For the purposes of this rule, a **major treaty reinsurer** of an *insurer* is a another *company* -
 - (a) to which (whether alone or with any *company* which is 'connected'²⁵ with the other *company*) the *insurer* has *ceded general insurance business* under one or more *reinsurance* treaties -
 - (i) in the case of proportional *reinsurance*, for which the total amount of the *reinsurance* premiums payable is equal to not less than 2% of the *gross premiums receivable* by the *insurer* in respect of *general insurance business*, or
 - (ii) in the case of non-proportional *reinsurance*, for which the total amount of the *reinsurance* premiums payable is equal to not less than 5% of the total premiums payable by the *insurer* in respect of all such non-proportional *reinsurance*,

²⁵ For the meaning of 'connected', in this rule, see rule 9.28(1).

in the *financial year in question* or in any of the five *preceding financial years* of the *insurer*; or

- (b) in relation to which (whether alone or with any *company* which is ‘connected’ with the other *company*) the aggregate of the amounts referred to in (1)(d) and (f) exceeds 5% of the *insurer's general insurance business amount*.

Additional information on general insurance business: major facultative reinsurers

9.26 (1) Subject to rule 9.28, an *insurer* which carries on *general insurance business* must annex to the documents referred to in rules 9.12, 9.13 and 9.14, and relating to *the financial year in question*, for each ‘major facultative reinsurance contract’, a statement in respect of each ‘major facultative reinsurer’ of -

- (a) its ‘full name’²⁶ and the address of the registered office or of the principal office in the country where it is incorporated (or, in the case of an unincorporated body, of the principal office);
- (b) whether (and, if so, how) the *insurer* was at any time in the *financial year* ‘connected’ with such *reinsurer*;
- (c) the amount of the *reinsurance* premiums payable in the *financial year*;
- (d) the amount of any *debt* to the *insurer* included at line 75 of **Form 13**;
- (e) the amount of any deposit received as included at line 31 of **Form 15**; and
- (f) the amount of any anticipated recoveries to the extent that such recoveries have been taken into account by the *insurer* in determining the *reinsurers’ share of technical provisions* in respect of *claims* outstanding as shown at line 61 of **Form 13**; except that, in respect of *claims* incurred but not reported, such recoveries need only be included to the extent that they are in respect of any specific occurrences for which provisions have been allocated by the *insurer*,

or a statement that it has no ‘major facultative reinsurer’.

- (2) For the purposes of this rule, a **major facultative reinsurance contract** is a contract under which *general insurance business* has been *ceded* by the *insurer* on a facultative basis -

²⁶ for the meaning of ‘full name’ in this rule, see rule 9.28(4)

- (a) under which the total amount of premiums payable to any *reinsurer* (a **major facultative reinsurer**) is equal to not less than 0.5% of *gross premiums receivable* by the *insurer* in respect of *general insurance business*; or
- (b) in relation to which, in respect of any *reinsurer* (a **major facultative reinsurer**) the aggregate of amounts in (1)(d) and (e) exceeds 1% of the *insurer's general insurance business amount*.

Information on major general insurance business: reinsurance cedants

9.27 (1) Subject to rule 9.28, an *insurer* which carries on *general insurance business* must annex to the documents referred to in rules 9.12, 9.13 and 9.14, and relating to the *financial year in question*, a statement of -

- (a) the 'full name' of each of its 'major cedants' and the address of the registered office or of the principal office in the country where it is incorporated (or, in the case of an unincorporated body, of the principal office) of each such cedant;
- (b) whether (and, if so, how) the *insurer* was at any time in the *financial year* 'connected' with any such cedant;
- (c) the amount of the total of the *gross premiums receivable* in the *financial year* from each such cedant in respect of *general insurance business* accepted under *reinsurance* treaties;
- (d) the amount of any deposit made with any such cedant as included at line 57 of **Form 13**; and
- (e) the amount of any *debt* of each such cedant in respect of *general insurance business* accepted under *reinsurance* treaties, included at line 74 of **Form 13**,

or a statement that it has no 'major cedant'.

(2) For the purposes of this rule, a **major cedant** of an *insurer* is another *company* from which (whether alone or with any *company* which is 'connected' with the other *company*) the *insurer* has accepted *general insurance business* under one or more *reinsurance* treaties for which the *gross premiums receivable* exceed the greater of -

- (a) 5% of the *gross premiums receivable* by the *insurer* in respect of *general insurance business* accepted under *reinsurance* treaties; and
- (b) 2% of the *gross premiums receivable* by the *insurer* in respect of *general insurance business*,

in the *financial year in question* or in any of the three *preceding financial years* of the *insurer*.

Provisions supplemental to rules 9.25 to 9.27

9.28 (1) For the purposes of rules 9.25(1)(b) and (2), 9.26(1)(b) and 9.27(1)(b) and (2), a *company* and another person are **connected** with each other if -

(a) the other person is -

(i) a *subsidiary undertaking* of the *company*,

(ii) a *parent undertaking* of the *company*, or

(iii) a *subsidiary undertaking* of the *parent undertaking* of the *company*; or

(b) one of them is 'controlled' by the other or both are 'controlled' by the same person,

but a *company* is not to be taken to be 'connected' with another person if the *insurer* furnishing the statement does not know and could not upon reasonable enquiry be expected to discover that it is so 'connected' with the other person.

(2) Except as provided in (3), for the purposes of (1)(b), a person is taken to **control** a *company* if he is a person -

(a) in accordance with whose directions or instructions the *directors* of the *company* or of a *company* of which it is a *subsidiary* are accustomed to act; or

(b) who, either alone or with an *associate* is entitled to exercise, or 'control' the exercise of, 15% or more of the voting power at any general meeting of the *company* or of a *company* of which it is a *subsidiary*.

(3) In relation to an *insurer* -

(a) making a statement pursuant to rules 9.25 or 9.26, a *reinsurer* is not to be taken by virtue of (2) to be 'connected' with another *reinsurer*; or

(b) making a statement pursuant to rule 9.27, a cedant is not to be taken by virtue of (2) to be 'connected' with another cedant,

for the purposes of paragraph (2) of rules 9.25, 9.26 or 9.27, as the case may be, unless it is also 'connected' by virtue of (1) with the *insurer* making the statement.

(4) In rules 9.25, 9.26 and 9.27 and in this rule, **full name** means -

- (a) in the case of a company, its corporate name; and
 - (b) in the case of an individual or any unincorporated body, the name under which the individual or body lawfully carries on business.
- (5) The following provisions of **Appendix 9.1** apply for the purposes of rules 9.25, 9.26, and 9.27 -
- (a) paragraphs 4 and 5 (which relate to currencies other than sterling);
 - (b) paragraphs 8(1) and 8(2) (which, among other things, relate to amounts due to the *insurer*); and
 - (c) paragraph 9 (which provides for amounts to be shown to the nearer £1,000).
- (6) Rules 9.25(2), 9.26(1)(a) to (c) and 9.27 apply in relation to the members of the *Society* taken together as they apply in relation to an *insurer* and in relation to the members of the *Society* (1) to (4) of this rule do not apply.

Additional information on derivative contracts

- 9.29 (1) Every *insurer* must, in respect of the *financial year in question*, annex to the documents referred to in rules 9.12, 9.13 and 9.14 a statement comprising a brief description of -
- (a) any investment guidelines operated by the *insurer* for the use of *derivative contracts*;
 - (b) any provision made by such guidelines for the use of contracts under which the *insurer* had a right or obligation to acquire or dispose of assets which was not, at the time when the contract was entered into, reasonably likely to be exercised and, if so, the circumstances in which, pursuant to that provision, such contracts would be used;
 - (c) the extent to which the *insurer* was during the *financial year* a party to any contracts of the kind described in (b);
 - (d) the extent to which any of the amounts recorded in **Form 13** would be changed if assets which the *insurer* had a right or obligation to acquire or dispose of under '*derivative contracts*' outstanding at the end of the *financial year* (being, in the case of *options*, only those *options* which it would have been prudent to assume would be exercised) had been so acquired or disposed of;
 - (e) how different the information provided pursuant to (d) would have been if such *options* as were outstanding at the end of the year had

been exercised in such a way as to change the amounts referred to in that sub-paragraph to the maximum extent;

- (f) how different the information provided pursuant to (d) and (e) would have been if, instead of applying to contracts outstanding at the end of the *financial year*, those rules had applied to ‘*derivative contracts*’ outstanding at such other time during the *financial year* as would have changed the amounts referred to in those rules to the maximum extent;
 - (g) the maximum loss which would be incurred by the *insurer* on the failure by any one other person to fulfil its obligations under ‘*derivative contracts*’ outstanding at the end of the *financial year*, both under existing market conditions and in the event of other foreseeable market conditions, together with an assessment of whether such maximum loss would have been materially different at any other time during the *financial year*;
 - (h) the circumstances surrounding the use of any ‘*derivative contract*’ held at any time during the *financial year* which did not fall within rule 4.12 (2), or (where appropriate) the definition of a *permitted derivative contract*; and
 - (i) the total value of any fixed consideration received by the *insurer* (whether in cash or otherwise) during the *financial year* in return for granting rights under *derivative contracts* and a summary of contracts under which such rights have been granted.
- (2) In this rule, **derivative contract** includes a contract or asset which has the effect of a *derivative contract* within the meaning of rule 4.13 and, for the purposes of (1)(h), such a contract or asset must be treated as falling within rule 4.12 (2), or the definition of *permitted derivative contract*, as appropriate, if it has the effect of a *derivative contract* which would fall within that provision.
- (3) For the purposes of this rule, an *insurer* which is a party to -
- (a) a *contract for differences*; or
 - (b) any other contract which is to be, or may be, settled in cash,

is taken to have a right or obligation to acquire or dispose of the assets underlying the contract.

Additional information on controllers

- 9.30 Every *insurer* with its head office in the United Kingdom must, in respect of the *financial year in question*, annex to the documents referred to in rules 9.12, 9.13 and 9.14 -

- (a) a statement naming each person who, to the knowledge of the *insurer*, has been, at any time during the *financial year*, a *controller* of that *insurer*; and
- (b) in the case of each person so named, a statement of -
 - (i) the percentage of *shares* which, to the knowledge of the *insurer*, he held at the end of the *financial year in question* in the *insurer*, or in another company of which the *insurer* is a *subsidiary undertaking*; and
 - (ii) the percentage of the voting power which, to the knowledge of the *insurer*, he was entitled at the end of the *financial year in question* to exercise, or control the exercise of, at any general meeting of the *insurer*, or another company of which it is a *subsidiary undertaking*,

in each case, either alone or with any *associate* or *associates*.

Periodic actuarial investigation

9.31 Save in relation to (b), for the purposes of rule 9.4 *ordinary long-term insurance business* and *industrial assurance business* must be treated separately and the abstract of the report of the *appointed actuary* on *long-term insurance business* –

- (a) must comply with the requirements of **Appendix 9.4** and must contain the information (together with such of **Forms 46 to 49** and **51 to 58** as may be appropriate) specified in that Appendix; and
- (b) except in the case of an *EEA-deposit insurer*, must also include **Form 60** and, where appropriate, **Form 61**.

Additional information on general insurance business ceded

9.32 An *insurer* which carries on *general insurance business* must annex to the documents referred to in rules 9.12, 9.13 and 9.14, and relating to the *financial year in question*, a statement of the information required by **Appendix 9.5**.

Signature of documents

- 9.33 (1) In respect of any document relating to the *insurance business* of an *insurer*, wherever it may be carried on, the signatories for the purposes of rule 9.6 are -
- (a) in any case -
 - (i) where there are more than two *directors* of the *insurer*, at least two of those *directors* and, where there are not more than two *directors*, all the *directors*, and

- (ii) a chief executive, if any, of the *insurer* or (if there is no chief executive) the secretary, if any; and
 - (b) in the case of an abstract under rule 9.4, the actuary who made the investigation to which the abstract relates.
- (2) In respect of any document relating to *insurance business* carried on through a branch in the United Kingdom by a *Swiss general insurer*, an *EEA deposit insurer* or an *external insurer* or through branches in any *EEA State* (taken together) by a *UK deposit insurer*, the signatories for the purposes of rule 9.6(3) are -
- (a) in any case -
 - (i) the authorised UK representative referred to in rule 8.3 or 8.4, as the case may be, and
 - (ii) the chief executive appointed under rule 8.3 or, in the case of a *Swiss general insurer*, a person who alone or jointly with one of more others, is responsible for the conduct of its *insurance business* through the branch; and
 - (b) in the case of an abstract under rule 9.4, the actuary who made the investigation to which the abstract relates.

Certificates

- 9.34 There must be annexed to the documents referred to in rules 9.12, 9.13 and 9.14 -
- (a) a certificate in accordance with the requirements of Part I of **Appendix 9.6** which must be signed by the persons required by rule 9.33 to sign the documents to which the certificate relates; and
 - (b) in the case of an *insurer* which has at any time during the *financial year in question* carried on *long-term insurance business*, a certificate in accordance with the requirements of Part II of **Appendix 9.6** which must be signed by the *appointed actuary*.

Audit and auditor's report

- 9.35 (1) The documents referred to in rules 9.12, 9.13 and 9.14, and every statement, analysis, report or certificate annexed pursuant to rules 9.24 to 9.27, 9.29 and 9.34(a) must be audited by a person, in accordance with the rules in *SUP*, who must make and annex to those documents a report in accordance with the requirements of Part III of **Appendix 9.6**.
- (2) For the purposes of the *Accounts and Statements Rules* -

- (a) section 237(1), (2) and (3) and section 389A(1) of the *Companies Act* and article 245(1), (2) and (3) and article 397A(1) of the *1986 Order* apply as if -
 - (i) the references to the *profit and loss account* contained in the definition of ‘individual accounts’ in section 226(1) of that Act and article 234(1) of that Order, respectively, included references to the revenue account; and
 - (ii) the auditors of the *insurer* were not under a duty for the purposes of preparing their report to carry out any investigation into information given in **Forms 31, 32 and 34** relating wholly or partly to the number of *claims* notified or the amount of payments made prior to the *financial year* of the *insurer* in which the Insurance Companies (Accounts and Statements) Regulations 1980 first applied; and
- (b) section 389A(3) and (4) of the *Companies Act* and article 397A(3) and (4) of the *1986 Order* apply as if the references in them to a ‘parent company’ were references to the *insurer*.

Information on appointed actuary

- 9.36 (1) Subject to the provisions of this rule, there must be annexed to the documents referred to in rules 9.12, 9.13 and 9.14, with respect to every person who, at any time during the *financial year in question*, was the *appointed actuary* to the *insurer*, a statement of the following information -
- (a) particulars of any *shares* in, or debentures of, ‘the *insurer*’ in which the *appointed* ‘actuary’ was ‘interested’ at any time during that year;
 - (b) particulars of any pecuniary interest of ‘the actuary’ in any transaction between ‘the actuary’ and ‘the *insurer*’ and subsisting at any time during that year or, in the case of transactions of a minor character, a general description of such interests;
 - (c) the aggregate amount of -
 - (i) any remuneration and the value of any other benefits (other than a pension or other future or contingent benefit) under any contract of service of ‘the actuary’ with, or contract for services by ‘the actuary’ to, ‘the *insurer*’, and
 - (ii) any emoluments, pensions or compensation as *director* of the *insurer* which are required by Part I of Schedule 6 to the *Companies Act* or Part I of Schedule 6 to the *1986 Order* to be included in a note to the accounts of ‘the *insurer*’ under section 232 of the *Companies Act* and Article 239 of the *1986 Order*,

receivable by 'the actuary' in respect of any period in that year;
and

- (d) a general description of any other pecuniary benefit (including any pension and other future or contingent benefit) received by 'the actuary' from 'the *insurer*' in that year or receivable by him from 'the *insurer*',

together with the statement specified in (2).

- (2) The statement referred to in (1) is a statement that 'the *insurer*' has made a request to 'the actuary' to furnish to it the particulars specified in that paragraph and identifying any particulars furnished pursuant to that request.
- (3) For the purposes of (1)(a) to (d) -
- (a) references to **the actuary** include reference to -
- (i) the spouse and any minor child (including step-child) of 'the actuary',
- (ii) any person who is a business partner of 'the actuary',
- (iii) any person (other than 'the *insurer*') of which 'the actuary' is an employee, and
- (iv) any person (other than 'the *insurer*') of which 'the actuary' is a *director* or which is 'controlled' by him;
- (b) a person is deemed to be **interested** in *shares* or debentures if he is interested in them according to the rules set out in Part I of Schedule 13 to the *Companies Act* with the addition, in paragraph 11 of that Part of that Schedule, of a reference to a scheme under section 25 of the Charities Act (Northern Ireland) 1964; and
- (c) a person is deemed to have an **interest** or benefit if he has a beneficial interest.
- (4) For the purposes of (1)(a) to (d) and of (3)(a), references to **the insurer** include references to any *body corporate* which is 'the *insurer's* *subsidiary undertaking* or *parent undertaking* and to any other *subsidiary undertaking* of its *parent undertaking*.
- (5) For the purposes of (3), a person is taken to **control** a *body corporate* if he is a person -
- (a) in accordance with whose directions or instructions the *directors* of that *body corporate* or of a *body corporate* of which it is a *subsidiary* are accustomed to act; or

- (b) who, either alone or with any other person falling within (3)(a), is entitled to exercise, or control the exercise of, 15% or more of the voting power at any general meeting of the *body corporate* or of a *body corporate* of which it is a *subsidiary*.

Part II

ACCOUNTS AND STATEMENTS FOR A MARINE MUTUAL

Returns

9.36A Subject to rules 9.36B, 9.36C, 9.36D and 9.36E and **Appendix 9.8**, a *marine mutual* may complete an abbreviated *return* which comprises –

- (1) **Forms 11 and 12**; and
- (2) **Forms M1 to M5 in Appendix 9.8**,

and, if so, rules 9.3 to 9.4, 9.12 to 9.28, 9.31 and 9.32 and 9.34 to 9.36 do not apply.

Information to be annexed to the forms

9.36B A *marine mutual* must annex to the *return* provided under rule 9.36A-

- (1) a description of the significant *reinsurance* arrangements which will be in operation in the *financial year* following the *financial year in question*;
- (2) in respect of *insurance business* ceded by way of non-facultative reinsurance in respect of the *financial year in question* or any *previous financial year* ended on or after 20 February 1998, a statement of –
 - (a) in the case of contracts which are subject to no or a limited number of reinstatements, any contract not previously reported to the *FSA* under which it is anticipated that any such limit will be exhausted by such *claims* (including *claims* incurred, but not reported, in respect of any specific occurrence for which provisions have been allocated);
 - (b) the percentage of cover, if in excess of 10%, and if such information was not included in the *return* of the *marine mutual* for the *previous financial year*, which has been *ceded* to *reinsurers* which have ceased to pay *claims* to their reinsureds in full, whether because of insolvency or for any other reason; and

- (c) if the percentage specified in (b) has increased by more than 10% since the *previous financial year* in which it was included in the *marine mutual's return*, that percentage unless, in the opinion of the *directors*, the likelihood of any *claim* being incurred under that *policy* is minimal;
- (3) a statement concerning:
 - (a) the default rates of members (or adjusted default rates, as the case may be) on the supplementary calls collectable during the *financial year in question* and the two *previous financial years*, respectively; and
 - (b) the total amount of each such call, the *financial year* to which it relates, the amount paid and the amount remaining outstanding; and
 - (4) a copy of the rules of association of the marine mutual in force on the date of deposit of the return, unless there has been no change in a copy of the rules deposited with the return for a previous financial year.

Information to FSA

9.36C

A *marine mutual* which provides a *return* under rule 9.36A must, with effect from the date of its deposit with the *FSA* until the date of deposit of the *return* for the following *financial year*, provide the *FSA* with written notice of:

- (1) any change which is proposed in the rules of association of the *marine mutual*, not less than 14 days before the change is put to a meeting;
- (2) any change which has been made in the rules of association, within 7 days of the change;
- (3) any significant change in the *reinsurance* arrangements, a description of which has been annexed to the *return* in accordance with rule 9.36B(1), within 7 days of the change;
- (4) a fall in tonnage entered by its members of 10% net or more since the end of the *financial year in question*, within 7 days of the *marine mutual* becoming aware of this; and
- (5) whether tonnage entered by its members who have withdrawn from membership or who have defaulted on their obligations has increased so as to exceed 10% or more of total tonnage entered, whether before, on or after the date of deposit of the *return*, within 7 days of the date of deposit or of the *marine mutual* becoming aware of this, whichever is earlier.

Directors' certificate

9.36D *A marine mutual* must annex to the *return* provided under rule 9.36A a *directors' certificate* in accordance with Part II of **Appendix 9.8**.

Auditors' report

9.36E *A marine mutual* must annex to the *return* provided under rule 9.36A an auditors' report in accordance with Part III of **Appendix 9.8**.

Part III

STATISTICAL RULES

Insurance statistics: EEA States

9.37 (1) Every *UK insurer* which in any calendar year –

- (a) carries on *general insurance business* in an *EEA State* other than the United Kingdom through a branch in that State; or
- (b) provides general insurance in such a State through an establishment in the United Kingdom or another *EEA State*,

must prepare in respect of the *direct general insurance business* so carried on by it a statement in **Form 91** (analysis of financial particulars – branches), or the direct general insurance so provided by it a statement in **Form 92** (analysis of financial particulars – provision of insurance), in accordance with the requirements of **Appendix 9.7**.

(2) Every *UK insurer* which in any calendar year –

- (a) carries on *long-term insurance business* in an *EEA State* other than the United Kingdom through a branch in that State; or
- (b) provides long-term insurance in such a State through an establishment in the United Kingdom or another *EEA State*,

must prepare in respect of the *direct long-term insurance business* so carried on by it a statement in **Form 93** (analysis of financial particulars – branches), or the direct long-term insurance so provided by it a statement in **Form 94** (analysis of financial particulars – provision of insurance), in accordance with the requirements of **Appendix 9.7**.

(3) The forms mentioned in (1) and (2) must be prepared separately in respect of each *EEA State* in which the *insurer* carries on the *insurance business* or provides the insurance.

(4) The statements required by this rule must be printed, and three copies must be deposited with the *FSA* within nine months after the end of the calendar year

to which they relate; but if in any case it appears to the *FSA* that the circumstances are such that a longer period than nine months should be allowed, the *FSA* may extend that period by such period not exceeding three months as it thinks fit.

- (5) One of the copies of the statement deposited under (4) must be signed by a *director*, a chief executive or the secretary of the *insurer*.
- (6) Subject to (7), where a *UK insurer* which has notified the *FSA* -
 - (a) in accordance with the rules in *SUP*, of its intention to establish a branch in a *EEA State* other than the United Kingdom; or
 - (b) in accordance with those rules, of its intention to provide insurance in such a State,

does not in any calendar year carry on *insurance business* or, as the case may be, provide insurance in that State, it must send to the *FSA* a notification of that fact within nine months after the end of the calendar year to which the notification relates, signed by a *director*, a chief executive or the secretary of the *insurer*.

- (7) (6) does not apply if the *insurer* has, before the beginning of the calendar year, informed the *FSA*, in accordance with the rules in *SUP*, that it has ceased to carry on *insurance business* or, as the case may be, to provide insurance in the State in question.
- (8) If within 24 months of the date of deposit under (4), the *FSA* notifies the *insurer* that a document deposited appears to it to be inaccurate or incomplete, the *insurer* must consider the matter and within one month of the date of notification it must correct any inaccuracies and make good any omissions and deposit the relevant parts of the documents again.

Application of rule 9.37 to the Society of Lloyd's

- 9.38
- (1) Subject to (2) and (3), rule 9.37 applies in relation to the *Society* as it applies in relation to a *UK insurer*.
 - (2) The information required in the case of the *Society* to be included in the statements referred to in rule 9.37(4), or the notification referred to in rule 9.37(6), is that relating to the members of the *Society* taken together.
 - (3) Any such statements, forms or notification must be signed by the Chairman or a Deputy Chairman, for and on behalf of the Council of Lloyd's.

PART IV

MATERIAL CONNECTED-PARTY TRANSACTIONS

- 9.39 (1) If, during the *financial year in question*, an *insurer* has agreed to, or carried out, a *material connected-party transaction*, it must provide a brief description of that transaction by way of a supplementary note to **Form 20** or **Form 40**.
- (2) The description to be provided in accordance with (1) must state –
- (a) the names of the transacting parties;
 - (b) a description of the relationship between the parties;
 - (c) a description of the transaction;
 - (d) the amounts involved;
 - (e) any other elements of the transaction necessary for an understanding of its effect upon the financial position or performance of the *insurer*; and
 - (f) amounts written off in the period in respect of *debts* due to or from *connected parties*.
- (3) Transactions with the same *connected party* may be disclosed on an aggregated basis unless separate disclosure is needed for a proper understanding of the effect of the transactions upon the financial position or performance of the *insurer*.
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Chapter 10

THE PARENT UNDERTAKING SOLVENCY MARGIN CALCULATION

CONTENTS

Information to be provided

10.1

10.2

Chapter 10

THE PARENT UNDERTAKING SOLVENCY MARGIN CALCULATION

Information to be provided

- 10.1 This chapter applies to an *insurer* (other than a *pure reinsurer*) that is a *subsidiary undertaking* of an *ultimate insurance parent undertaking*.
- 10.2 (1) When it deposits its *return*, an *insurer* must also provide the *FSA* with a declaration of the following information in respect of each member of the *insurance group* (including itself) as at the end of the *financial year in question*:
- (a) the name, location of head office and principal activity;
 - (b) the relationship with each other member of the *insurance group*, including the amounts and descriptions of holdings of *share* capital and voting rights;
 - (c) whether the member of the group is a *subsidiary undertaking* of the *ultimate insurance parent undertaking* and, if different, of the *ultimate EEA insurance parent undertaking*;
 - (d) the *ultimate insurance parent undertaking's proportionate share* of, or if the group member is a *subsidiary undertaking* of that parent the whole of, any deficit in the assets available to cover the group member's liabilities and represent its *notional required minimum margin*;
 - (e) the *ultimate EEA insurance parent undertaking's proportionate share* of, or if the group member is a *subsidiary undertaking* of that parent the whole of, any deficit in the assets available to cover the group member's liabilities and represent its *notional required minimum margin*; and
 - (f) a statement that:
 - (i) the declaration has been properly prepared in accordance with this rule,
 - (ii) proper records have been maintained and adequate information obtained by the *insurer* for the purpose of the declaration required by this rule and the information required by rule 9.39, and
 - (iii) reasonable enquiries have been made by the *insurer* for the purpose of identifying *material connected-party transactions*.

- (2) The declaration required by (1) must also include separate statements in respect of each of the *ultimate insurance parent undertaking* and *ultimate EEA insurance parent undertaking* of:
- (a) the value, as determined in accordance with the *Valuation of Assets Rules* (other than rule 4.14(1)(a) to (c)), of its *surplus assets*;
 - (b) the aggregate of:
 - (i) any deficit in the assets available to cover its liabilities or represent its *notional required minimum margin*, and
 - (ii) the amounts reported in (1)(d) or (e) as applicable (but excluding any amounts that arise from uncovered liabilities to the *parent undertaking* itself);
 - (c) the excess of (b) over (a) (“the aggregate deficit”); and
 - (d) a statement of the reasons why any aggregate deficit has arisen and of any remedial action taken or planned.
- (3) For the purposes of (1) and (2), the amount of any deficit and the identification of *surplus assets* must be determined as though:
- (a) all references in rule 4.2(2)(a), (c), (d), (e) and (3) to the “*group undertaking*” were references to the *ultimate insurance parent undertaking* or *ultimate EEA insurance parent undertaking*, as applicable;
 - (b) rule 4.2(2)(b) was replaced with “assets that are interests directly or indirectly held in the capital of the *ultimate insurance parent undertakings* or *ultimate EEA insurance parent undertakings*, as applicable”; and
 - (c) rule 4.2(2)(f) was replaced with “assets that cannot effectively be made available or realised to make good any deficiency of assets of the *ultimate insurance parent undertakings* or *ultimate EEA insurance parent undertakings*, as applicable”.
- (4) The declaration required by (1) must be signed by the persons described in rule 9.33 (1)(a).

Chapter 11

DEFINITIONS

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Part I - Definitions

- 11.1 Definitions
- 11.2 Definition of controller, etc.

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Chapter 11

DEFINITIONS

PART I

DEFINITIONS

- 11.1 For the purposes of *IPRU (INS)*, the term or phrase in the first column has the meaning given to it in the second column unless the context otherwise requires.

Term or phrase	Definition
<i>1980 Regulations</i>	Insurance Companies (Accounts and Statements) Regulations (S.I. 1980 No. 6)
<i>1981 Regulations</i>	Insurance Companies Regulations 1981 (S.I. 1981 No. 1654)
<i>1982 Act</i>	Insurance Companies Act 1982
<i>1983 Regulations</i>	Insurance Companies Regulations 1983 (S.I. 1983 No. 1811)
<i>1986 Order</i>	Companies (Northern Ireland) Order 1986
<i>1994 Regulations</i>	Insurance Companies Regulations 1994 (S.I. 1994 No. 1516)
<i>1996 Regulations</i>	Insurance Companies (Accounts and Statements) Regulations (S.I. 1996 No. 943)
<i>accounted for</i>	reported pursuant to the <i>Accounts and Statements Rules</i>
<i>accounting class</i>	an accounting class set out in the following table –

Accounting class	Corresponding groups of classes under paragraph 75(3) of the <i>insurance accounts rules</i>	Corresponding <i>general insurance business classes</i>
1 Accident and health	Accident and health	1 (other than 1(p)), 2
2 Motor	motor (third party liability) motor (other classes)	1(p), 10 3
3 Aviation	marine, aviation and transport	1(p), 5, 11
4 Marine		1(p), 6, 12
5 Transport		7
6 Property	fire and other damage to property	4, 8, 9
7 Third party liability	third party liability	13
8 Miscellaneous and pecuniary loss	credit and suretyship, legal expenses, assistance, miscellaneous	14, 15, 16, 17, 18
9 Non-proportional treaty		
10 Proportional treaty		
11 Marine, aviation and transport treaty		

<i>Accounts and Statements Rules</i>	rules 9.1 to 9.36E of Chapter 9
<i>Accounts Directives</i>	Council Directives 78/660/EEC for companies, 91/674/EEC for insurance companies, 86/635/EEC for banks and 83/349/EEC for consolidated accounts
<i>accumulating with-profits policy</i>	a <i>with-profits policy</i> which has a readily identifiable current benefit, whether or not this benefit is currently realisable, which is adjusted by an amount explicitly related to the amount of any premium payment and to which additional benefits are added in respect of participation in profits by additions directly related to the current benefit or a <i>policy</i> with similar characteristics
<i>Act</i>	Financial Services and Markets Act 2000
<i>actuarial investigation</i>	an investigation to which rule 9.4 applies
<i>admissible asset</i>	an asset which is not required by rule 4.1(3) to be left out of account for the purposes specified in rule 4.1(1)
<i>amortised value</i>	the amortised value as determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate to <i>insurers</i>

<i>ancillary risk</i>	<p>(a) in relation to an <i>insurer</i> with permission under the <i>Act</i> to insure a principal risk belonging to one <i>class</i> of <i>general insurance business</i>, means a risk included in another such <i>class</i> which is -</p> <ul style="list-style-type: none"> - connected with the principal risk, - concerned with the object which is covered against the principal risk, and - the subject of the same contract insuring the principal risk; <p>(b) but, the risks included in <i>classes</i> 14, 15 and 17 may not be treated as risks ancillary to other <i>classes</i>;</p> <p>(c) except, the risk included in <i>class</i> 17 (legal expenses insurance) may be regarded as an ancillary risk of <i>class</i> 18 where the conditions laid down in (a) are fulfilled and where the principal risk relates solely to assistance provided for persons who fall into difficulties while travelling, while away from home or while away from their permanent residence or where it concerns disputes or risks arising out of, or in connection with, the use of sea-going vessels</p>
<i>annuities on human life</i>	does not include superannuation allowances and annuities payable out of any fund applicable solely to the relief and maintenance of persons engaged or who have been engaged in any particular profession, trade or employment, or of the dependants of such persons
<i>appointed actuary</i>	the person appointed as actuary to an <i>insurer</i> under the rules in <i>SUP</i>
<i>approved counterparty</i> ²⁷	<p>any of the following -</p> <p>(a) an <i>approved credit institution</i>;</p> <p>(b) a person permitted under the <i>Act</i> to conduct investment business of a kind which includes entering into <i>unlisted derivative contracts</i> as principal; or</p>

²⁷ For guidance, see paragraph 3 of **Guidance Note 4.1**

	(c) in respect of a transaction involving a new issue of <i>securities</i> which are to be <i>listed</i> , the issuer or an <i>approved investment firm</i> acting on behalf of the issuer
<i>approved credit institution</i>	an institution recognised or permitted under the law of an <i>EEA State</i> to carry on any of the activities set out in Annex 1 to the <i>Banking Co-ordination Directive</i>
<i>approved financial institution</i>	any of the following – <ul style="list-style-type: none"> • the European Central Bank • the central bank of an <i>EEA State</i> • the International Bank for Reconstruction and Development • the International Finance Corporation • the International Monetary Fund • the Inter-American Development Bank • the African Development Bank • the Asian Development Bank • the Caribbean Development Bank • the European Investment Bank • the European Community • the European Atomic Energy Community • the European Coal and Steel Community
<i>approved index</i>	(a) an index which is - <ul style="list-style-type: none"> (i) calculated independently, (ii) published at least once every week, (iii) based on constituents, each of which is property falling within paragraphs (1) to (8) or (10) of Part I of Appendix 3.2, and (iv) calculated on a basis which is made available to the public and which includes both the rules for including and excluding constituents and the rules for valuation which must use an arithmetic average of the value of the constituents; <p>(b) a national index of retail prices published by or under the authority of a government of a State belonging to Zone A as defined in the <i>Banking Co-ordination Directive</i>; or</p>

	<p>(c) an index which is -</p> <p>(i) based on constituents, each of which is property falling within paragraphs (1) to (8) or (10) of Part I of Appendix 3.2, and</p> <p>(ii) in respect of which a <i>derivative contract</i> is listed</p>
<i>approved investment firm</i>	an <i>investment firm</i> as defined in the <i>Investment Services Directive</i>
<i>approved securities</i>	<p>any of the following -</p> <p>(a) any <i>securities</i> issued or guaranteed by, or the repayment of the principal of which, or the interest on which is guaranteed by, and any loans to or deposits with, any of the following, namely, any government, public or local authority or nationalised industry or undertaking, which belongs to Zone A as defined in the <i>Banking Co-ordination Directive</i>;</p> <p>(b) any loan to, or deposit with, an <i>approved financial institution</i>; and</p> <p>(c) debentures issued prior to 31 December 1994 by the Agricultural Mortgage Corporation Ltd or the Scottish Agricultural Securities Corporation Ltd</p>
<i>assessable mutual</i>	<p>a mutual association –</p> <p>(a) where the <i>insurance business</i> carried on by the association is limited to the provision of insurance to its members; and</p> <p>(b) whose articles of association, rules or bye laws provide for the calling of additional contributions from members to meet claims</p>
<i>Asset Identification Rules</i>	the rules in Part I of Chapter 3
<i>associate</i>	has the meaning given in rule 11.2
<i>authorised person</i>	a person who is authorised for the purposes of the <i>Act</i>

<i>AUTH</i>	the Authorisation manual
<i>available assets</i>	the excess of an <i>insurer's</i> assets (other than <i>implicit items</i>) over its liabilities, in each case valued in accordance with the <i>Valuation of Assets Rules</i> and the <i>Determination of Liabilities Rules</i> and rule 2.10

<i>Banking Co-ordination Directive</i>	Council Directive of 20 March 2000, relating to the taking up and pursuit of the business of credit institutions (2000/12/EC)
<i>body corporate</i>	includes a body corporate constituted under the law of a country or territory outside the United Kingdom
<i>building society</i>	a building society within the meaning of the Building Societies Act 1986
<i>business amount</i>	<p>(a) for a company carrying on only <i>general insurance business</i>, the <i>general insurance business amount</i>;</p> <p>(b) for a company carrying on only <i>long-term insurance business</i>, the <i>long-term insurance business amount</i>; and</p> <p>(c) for a company carrying on both <i>general insurance business</i> and <i>long-term insurance business</i>, in the case of its <i>general business assets</i>, the <i>general insurance business amount</i> and in the case of its <i>long-term insurance business assets</i>, the <i>long-term insurance business amount</i></p>
<i>business categories</i>	the business categories specified in rule 9.16(1) corresponding to <i>general insurance business classes</i>
<i>business group</i>	a group comprising descriptions of <i>general insurance business</i> determined in accordance with rule 6.6
<i>business group maximum</i>	has the meaning given in Part III of Appendix 6.1

<i>cede and cession</i>	in relation to <i>reinsurance</i> , include retrocede and retrocession
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<i>charges for management</i>	amounts chargeable in respect of the management of an <i>internal linked fund</i> in accordance with the conditions of those <i>contracts of insurance</i> under which <i>property linked benefits</i> are linked to the value of the fund or units of the fund
<i>claim</i>	a <i>claim</i> against an <i>insurer</i> under a <i>contract of insurance</i>
<i>claims-made policy</i>	a contract of liability insurance which provides that no liability is incurred by the <i>insurer</i> in respect of an incident unless - (a) the incident is notified to the <i>insurer</i> (or its agent or representative); and (b) such notification is received by the <i>insurer</i> (or its agent or representative) before the end of a specified period which is no longer than three years following the final date for which cover is provided under the contract
<i>claims management costs</i>	refers to those claims management costs required by the <i>insurance accounts rules</i> (note (4) to the profit and loss account format) to be included in <i>claims</i> incurred other than those which, whether or not incurred through the employment of the <i>insurer's</i> own staff, are directly attributable to particular <i>claims</i>
<i>class</i>	a class of <i>long-term insurance business</i> , listed in Annex 11.1 or a class of <i>general insurance business</i> listed in Annex 11.2
<i>collecting book</i>	includes any book or document held by a <i>collector</i> in which payments of premiums are recorded
<i>collective investment fund</i>	in Appendix 3.2 includes a <i>collective investment scheme</i>
<i>collective investment scheme</i>	has the meaning given in section 235 of the <i>Act</i>
<i>collector</i>	includes every person, howsoever remunerated, who, by himself or by any deputy or substitute, makes house to house visits for the purpose of receiving premiums payable on policies of insurance on human life, or holds any interest in a <i>collecting book</i> , and includes such a deputy or substitute

<i>commission payable</i>	in relation to <i>long-term insurance business</i> , the amounts recorded during a <i>financial year</i> of the <i>insurer</i> as due to <i>intermediaries</i> and <i>cedants</i> in respect of the <i>inception</i> , amendment or renewal of <i>contracts of insurance</i> , whether or not paid during that year
<i>commitment</i>	a commitment represented by <i>insurance business</i> of any of the <i>classes</i> of <i>long-term insurance business</i>
<i>company</i>	(a) for the purposes of the <i>Accounts and Statements Rules</i> means an <i>insurance undertaking</i> ; and (b) for the purposes of the <i>Valuation of Assets Rules</i> and the <i>Determination of Liabilities Rules</i> , includes any <i>body corporate</i>
<i>Companies Act</i>	the Companies Act 1985
<i>connected</i>	a <i>body corporate</i> "A" and another <i>body corporate</i> "B" are connected with each other if: (a) B is a <i>related undertaking</i> of A; (b) B is a <i>participating undertaking</i> in A; or (c) B is a <i>related undertaking</i> of a <i>participating undertaking</i> in A a <i>body corporate</i> "C" and a natural person "D" are connected if D holds a <i>participation</i> in: (d) C or any of its <i>related undertakings</i> ; (e) a <i>participating undertaking</i> in C; or (f) a <i>related undertaking</i> of a <i>participating undertaking</i> in A
<i>connected company</i>	of any <i>company</i> means - (a) that <i>company's holding company</i> ; (b) a <i>subsidiary</i> of that <i>company</i> ; or (c) a <i>subsidiary</i> of the <i>holding company</i> of that <i>company</i>

<i>connected-party transaction</i>	the transfer of assets or liabilities or the performance of services by, to or for a <i>connected</i> person irrespective of whether or not a price is charged
<i>consequential loss risk</i>	risk falling within <i>general insurance business class 16</i> comprising risks of the persons insured sustaining loss attributable to interruptions of the carrying on of business carried on by them or to reduction of the scope of business so carried on
<i>contract for differences</i>	a <i>contract for differences</i> or any other contract the purpose or pretended purpose of which is to secure a profit or avoid a loss by reference to fluctuations in – (a) the value or price of property of any description; or (b) an index or other factor designated for that purpose in the contract
<i>contracts of insurance</i>	includes: (a) fidelity bonds, performance bonds, administration bonds, bail bonds, customs bonds, or similar contracts of guarantee effected in return for the payment of one or more premiums; (b) tontines; (c) when effected or carried out by a body that carries on the business of effecting or carrying out <i>contracts of insurance</i> apart from this paragraph, capital redemption contracts and <i>pension fund management contracts</i> ; (d) contracts to pay <i>annuities on human life</i> ; (e) contracts of a kind referred to in article 1(2)(e) of the <i>First Life Directive</i> ; and (f) contracts of a kind referred to in article 1(3) of the <i>First Life Directive</i>
<i>contractually based investment</i>	(a) right under a <i>qualifying contract of insurance</i> ; (b) any investment of the kind specified by any of articles 83, 84, 85 of the <i>Regulated Activities Order</i> ; or

	(c) any investment of the kind specified by article 89 of the <i>Regulated Activities Order</i> so far as relevant to an investment falling within (a) or (b)
<i>controller</i>	has the meaning given in rule 11.2
<i>counterparty</i>	<p>in relation to an <i>insurer</i> -</p> <p>(a) any one individual;</p> <p>(b) any one unincorporated body of persons;</p> <p>(c) any one <i>company</i> not being a member of a <i>group</i>;</p> <p>(d) any <i>group</i> of <i>companies</i> excluding any <i>companies</i> within the <i>group</i> which are <i>subsidiary undertakings</i> of the <i>insurer</i>; or</p> <p>(e) any government of a State together with all the public bodies, local authorities or nationalised industries of that State,</p> <p>in which the <i>insurer</i> has made investments or against whom it has rights whether in pursuance of a contract entered into by the <i>insurer</i> or otherwise</p>
<i>credit insurance business</i>	<i>Insurance business</i> falling within <i>general insurance business class 14</i> that is not <i>reinsurance</i>
<i>Currency Matching and Localisation Rules</i>	the rules in Chapter 7

<i>dealings with or by a counterparty</i>	see <i>counterparty</i>
<i>debt</i>	includes an obligation to pay a sum of money under a negotiable instrument
<i>debt security</i>	includes bonds, notes, debentures and debenture stock
<i>deferred acquisition costs</i>	those items shown at GII under the heading ‘Assets’ set out in paragraph 9 of Schedule 9A to the <i>Companies Act</i>

<i>dependant</i>	a <i>subsidiary undertaking</i> the value of whose <i>shares</i> is taken to be the value of its <i>surplus assets</i> under rule 4.2
<i>deposit, and depositor</i>	the deposit mentioned in rule 8.1, and depositor means an <i>insurer</i> making (or intending to make) such a deposit
<i>deposit back arrangement</i>	in relation to any contract of <i>reinsurance</i> , means an arrangement whereby an amount is deposited by the <i>reinsurer</i> with the <i>cedant</i>
<i>designated state or territory</i>	any <i>EEA State</i> (other than the United Kingdom), Switzerland, a state in the United States of America, Canada or a province of Canada, Australia, South Africa, Singapore and Hong Kong
<i>derivative contract</i>	a <i>contract for differences</i> , a <i>futures contract</i> or an <i>option</i> and includes a contract under which the amount payable by either party is calculated by reference to the <i>amortised value</i> of any property
<i>Determination of Liabilities Rules</i>	the rules in Chapter 5
<i>direct and facultative</i>	<i>direct insurance business</i> and inwards facultative <i>reinsurance business</i>
<i>direct insurance business</i>	<i>insurance business</i> other than <i>reinsurance business</i>
<i>Directive</i>	see – <i>Investment Services Directive</i> <i>First Life Directive</i> <i>First Non-Life Directive</i> <i>Banking Co-ordination Directive</i> <i>Third Life Directive</i> <i>Third Non-Life Directive</i>
<i>director</i>	in relation to a <i>body corporate</i> , includes - (a) person occupying in relation to it the position of a director (by whatever name called); and (b) a person in accordance with whose directions or instructions (not being advice given in a professional capacity) the directors of that body

	are accustomed to act
<i>discounting</i>	refers to discounting or deductions to take account of investment income within the meaning of paragraph 48 of the <i>insurance accounts rules</i>

<i>EEA-deposit insurer</i>	a <i>non-EEA insurer</i> which has made a <i>deposit</i> in an <i>EEA State</i> (other than the United Kingdom) in accordance with rule 8.1(2)
<i>EEA insurer</i>	an <i>insurer</i> , other than a <i>pure reinsurer</i> or a <i>non-directive insurer</i> , whose head office is in any <i>EEA State</i> except the United Kingdom and which has received authorisation under article 6 of the <i>First Life Directive</i> or the <i>First Non-Life Directive</i> from its home state regulator
<i>EEA insurance parent undertaking</i>	an <i>insurance parent undertaking</i> that has its head office in the United Kingdom or another <i>EEA State</i>
<i>EEA margin of solvency</i>	the <i>margin of solvency</i> of an <i>insurer</i> computed by reference to the assets and liabilities of the business carried on by the <i>insurer</i> in <i>EEA States</i> (taken together) in accordance with rule 2.4(2)(b)
<i>EEA State</i> ²⁸	a State which is a contracting party to the agreement on the European Economic Area signed at Oporto on 2 May 1992 as it has effect for the time being
<i>equalisation reserve</i>	a reserve to be maintained under the <i>Equalisation Reserves Rules</i>
<i>Equalisation Reserves Rules</i>	the rules in Chapter 6
<i>equity share capital</i>	in relation to a <i>company</i> , its issued <i>share capital</i> excluding any part which, neither as respects dividends nor as respects capital, carries any right to participate beyond a specified amount in a distribution
<i>equivalent securities</i>	<i>securities</i> issued by the same <i>issuer</i> being of an identical type and having the same nominal value, description and amount

²⁸ These comprise the 15 EU states (ie the United Kingdom, Portugal, Spain, France, Italy, Ireland, Belgium, Luxembourg, the Netherlands, Denmark, Germany, Greece, Austria, Sweden and Finland) plus Norway, Iceland and Liechtenstein.

<i>established surplus</i>	has the same meaning as in rule 3.3(4)
<i>excess concentration with a number of counterparties</i>	is determined in accordance with paragraph 17 of Appendix 4.2
<i>exposure</i>	(a) in relation to assets, means an amount determined in accordance with rule 4.14 and paragraphs 4 to 11A of Appendix 4.2 ; and (b) in relation to a <i>counterparty</i> , means an amount terminated in accordance with rule 4.14 and paragraphs 13 to 15A of Appendix 4.2
<i>external insurer</i>	an <i>insurer</i> whose head office is outside the United Kingdom, other than an <i>EEA insurer</i> , a <i>Swiss general insurer</i> or an <i>insurer</i> to which rule 8.1(2) applies

<i>facultative business</i>	facultative <i>reinsurance</i> business
<i>financial year</i>	(a) for the purposes of the <i>Equalisation Reserves Rules</i> , a period of account; and (b) for all other purposes, each period at the end of which the balance of the accounts of the <i>insurer</i> is struck or, if no such balance is struck, the calendar year
<i>financial year in question</i>	the <i>financial year</i> which last ended before the date on which accounts and statements (as specified in the <i>Accounts and Statements Rules</i>) of the <i>insurer</i> relating to that <i>financial year</i> are required to be deposited with the <i>FSA</i> pursuant to rule 9.6, and the preceding financial year and previous financial years are construed accordingly
<i>firm</i>	an <i>authorised person</i>
<i>first calculation</i>	in relation to the <i>Margins of Solvency Rules</i> , is the calculation described in rules 2.5(1) and (2)
<i>First Life Directive</i>	Council Directive (79/267/EEC) of 5 March 1979 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct life assurance

<i>First Non-Life Directive</i>	Council Directive (73/239/EEC) of 24 July 1973 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct insurance other than life insurance
<i>fixed interest securities</i>	<i>securities</i> which under their terms of issue provide for fixed amounts of interest
<i>friendly society</i>	an <i>incorporated friendly society</i> or <i>registered friendly society</i>
<i>futures contract</i>	a contract for the sale or delivery of a commodity or property of any other description under which delivery is to be made at a future date and at a price agreed on when the contract is made
<i>future profits</i>	has the meaning given in rule 2.11
<i>FSA</i>	Financial Services Authority

<i>general insurance business</i>	the business of effecting or carrying out <i>general insurance contracts</i>
<i>general insurance business amount</i>	is the higher of – <ul style="list-style-type: none"> (a) the aggregate of the <i>insurer's insurance liabilities</i> (net of <i>reinsurance</i>) in respect of <i>general insurance business</i> and an amount equal to whichever is the greater of 400,000 Euro or 20% of the <i>general premium income</i>; or (b) such other amount as the <i>insurer</i> may select not exceeding the value of its assets (other than <i>long-term insurance business assets</i> and excluding <i>reinsurance recoveries</i>) as determined in accordance with the <i>Valuation of Assets Rules</i>
<i>general insurance business assets, and general insurance business liabilities</i>	respectively assets and liabilities of an <i>insurer</i> which are not <i>long-term insurance business assets</i> or <i>long-term insurance business liabilities</i>
<i>general insurance business class 1(p)</i>	has the meaning given in rule 9.16(1)

<i>general insurance contract</i>	any <i>contract of insurance</i> falling within Part I of Annex 11.2
<i>general insurer</i>	an <i>insurer</i> whose business includes effecting or carrying out <i>general insurance contracts</i>
<i>general policy</i>	a policy evidencing a contract the effecting or carrying out of which constitutes the carrying on of <i>general insurance business</i>
<i>general premium income</i>	in any year, the net amount, after deduction of any premiums payable for <i>reinsurance</i> , of the premiums receivable in that year in respect of all <i>insurance business</i> other than <i>long-term insurance business</i>
<i>gross premiums</i>	in relation to an <i>insurer</i> and a <i>financial year</i> – (a) means premiums after deduction of discounts, refunds and rebates of premium but before deduction of premiums for <i>reinsurance ceded</i> and before deduction of <i>commission payable</i> by the <i>insurer</i> ; and (b) includes premiums receivable by the <i>insurer</i> under <i>reinsurance</i> contracts accepted by the <i>insurer</i>
<i>gross premiums earned</i>	in respect of a <i>financial year</i> means such proportion of <i>gross premiums written</i> as is attributable to risk borne by the <i>insurer</i> during that <i>financial year</i>
<i>gross premiums written</i>	the amounts required by the <i>insurance accounts rules</i> to be shown in the <i>profit and loss account</i> of a <i>company</i> at general business technical account item I.1.(a)
<i>group</i>	has the meaning given in section 262 of the <i>Companies Act</i>
<i>group undertaking</i>	any of: (a) the <i>insurer</i> ; (b) its <i>related undertakings</i> ; (c) its <i>participating undertakings</i> ; and

	(d) the <i>related undertakings</i> of its <i>participating undertakings</i>
<i>guarantee fund</i>	has the meaning given in rule 2.9

<i>holding company</i>	is construed in accordance with section 736 of the <i>Companies Act</i> or Article 4 of the <i>1986 Order</i>
<i>home foreign business</i>	<i>general insurance business</i> written in the United Kingdom primarily relating to risks situated outside the United Kingdom, but excluding <i>insurance business</i> in <i>accounting classes</i> 3, 4 and 5 and <i>insurance business</i> where the risk commences in the United Kingdom
<i>hybrid linked contract</i>	a <i>contract of insurance</i> the effecting of which constitutes the carrying on of <i>long-term insurance business</i> and which contains an option such that at some future time the contract may, according to how such option is exercised, constitute either a <i>linked contract</i> or a <i>non-linked contract</i>
<i>hybrid security</i>	a <i>debt security</i> , other than an <i>approved security</i> , the terms of which provide or have the effect that the holder does not or would not have an unconditional entitlement to payment of interest and repayment of capital in full within 75 years of the <i>relevant date</i>

<i>implicit item</i>	has the meaning given in rule 2.10(5)
<i>incepted</i>	refers to the time when the liability to risk of an <i>insurer</i> under a <i>contract of insurance</i> commenced and, for this purpose, a contract providing continuous cover is deemed to commence on each anniversary date of the contract, and incepting and inception are construed accordingly
<i>incorporated friendly society</i>	a society incorporated under the Friendly Societies Act 1992
<i>index linked benefits</i>	benefits - (a) provided for under a <i>linked long-term contract</i> , and (b) determined by reference to an index of the value

	of property of any description (whether specified in the contract or not)
<i>index linked contract</i>	a <i>linked long-term contract</i> conferring <i>index linked benefits</i>
<i>index linked liabilities</i>	<i>insurance liabilities</i> in respect of <i>index linked benefits</i>
<i>industrial and provident society</i>	a society registered or deemed to be registered under the Industrial and Provident Societies Act 1965 or the Industrial and Provident Societies Act (Northern Ireland) 1969
<i>industrial assurance business</i>	<p>the business of effecting <i>contracts of insurance</i> on human life, premiums in respect of which are received by means of <i>collectors</i>;</p> <p>But such <i>insurance business</i> does not include -</p> <p>(a) <i>contracts of insurance</i>, the premiums in respect of which are payable at intervals of two months or more;</p> <p>(b) <i>contracts of insurance</i>, effected whether before or after the passing of the Industrial Assurance Act 1923 by a society or company established before the date of the passing of that Act which at that date had no <i>contracts of insurance</i> outstanding the premiums on which were payable at intervals of less than one month so long as the society or company continues not to effect any such contracts;</p> <p>(c) <i>contracts of insurance</i> effected before the passing of the Industrial Assurance Act 1923, premiums in respect of which are payable at intervals of one month or more, and which have up to the passing of that Act been treated as part of the business transacted by a branch other than the industrial branch of the society or company; or</p> <p>(d) <i>contracts of insurance</i> for £25 or more effected after the passing of the Industrial Assurance Act 1923, premiums in respect of which are payable at intervals of one month or more, and which are treated as part of the business transacted by a branch other than the industrial branch of the society or company, in cases where the <i>FSA</i></p>

	certifies that the terms and conditions of such contracts are on the whole not less favourable to the assured than those imposed by that Act
<i>initial margin</i>	in respect of a <i>derivative contract</i> or a contract or asset having the effect of a <i>derivative contract</i> ²⁹ , means assets which, before or at the time the contract is entered into, are transferred by the <i>insurer</i> subject to a condition that such assets (or where the assets transferred are <i>securities, equivalent securities</i>) will be returned to the <i>insurer</i> on completion of that contract
<i>insurance accounts rules</i>	Schedule 9A to the <i>Companies Act</i> and Schedule 9A to the <i>1986 Order</i> for the preparation of accounts by <i>insurance undertakings</i>
<i>Insurance Accounts Directive</i>	Council Directive 91/674/EEC of 19 December 1991 on annual accounts and consolidated accounts of insurance undertakings
<i>insurance business</i>	the business of effecting or carrying out <i>contracts of insurance</i> as principal
<i>insurance group</i>	an <i>insurance parent undertaking</i> and its <i>related undertakings</i> that are – (a) <i>insurance undertakings</i> ; or (b) <i>insurance holding companies</i>
<i>insurance holding company</i>	an undertaking whose main business is to acquire and hold <i>participations</i> in <i>subsidiary undertakings</i> , where those <i>subsidiary undertakings</i> are exclusively or mainly <i>insurance undertakings</i>
<i>insurance liabilities</i>	amounts calculated in accordance with the <i>Determination of Liabilities Rules</i> in respect of those items shown at C and D under the heading ‘Liabilities’ set out in paragraph 9 of the <i>insurance accounts rules</i>
<i>insurance parent undertaking</i>	in relation to an <i>insurer</i> , is a <i>parent undertaking</i> of that <i>insurer</i> which is either itself an <i>insurance undertaking</i> or an <i>insurance holding company</i>
<i>insurance undertaking</i>	an undertaking, whether or not an <i>insurer</i> , which carries on <i>insurance business</i>

²⁹ See rule 4.13 for contracts which have the effect of *derivative contracts*

<i>insurer</i>	a <i>firm</i> with permission under the <i>Act</i> to effect or carry out <i>contracts of insurance</i> , other than a bank
<i>intermediary</i>	a person who in the course of any business or profession invites other persons to make offers or proposals or to take other steps with a view to entering into <i>contracts of insurance</i> with an <i>insurer</i> , other than a person who only publishes such invitations on behalf of, or to the order of, some other person
<i>internal linked fund</i>	an account to which an <i>insurer</i> appropriates certain <i>linked assets</i> and which may be sub-divided into units the value of each of which is determined by the <i>insurer</i> by reference to the value of those <i>linked assets</i>
<i>Investment Services Directive</i>	Council Directive of 10 May 1993 on investment services in the securities field (93/22/EEC)
<i>IPRU (INS)</i>	Interim Prudential Sourcebook for Insurers
<i>IPRU (FSOC)</i>	Interim Prudential Sourcebook for Friendly Societies
<i>issuer</i>	in respect of a <i>collective investment scheme</i> , means the manager or operator of the scheme and in respect of an interest in a limited partnership, means the partnership
<i>leading insurance undertaking</i>	in relation to a <i>relevant co-insurance operation</i> , means an <i>insurance undertaking</i> which – <ul style="list-style-type: none"> (a) is recognised as the leading insurance undertaking by the other <i>insurance undertakings</i> involved in the operation; and (b) determines the terms and conditions of insurance for the operation

<i>linked assets</i> ³⁰	in relation to an <i>insurer</i> , <i>long-term insurance business assets</i> of the <i>insurer</i> which are, for the time being, identified in the records of the <i>insurer</i> as being assets by reference to the value of which <i>property linked benefits</i> are to be determined, and non-linked assets is construed accordingly
<i>linked long-term contract</i>	a contract of the kind described in rule 2.3(4), and linked contract and non-linked contract are construed accordingly
<i>listed</i>	in relation to an investment, means that - (a) there has been granted and not withdrawn a listing in respect of that investment on any stock exchange in an <i>EEA State</i> which is a stock exchange within the law of that <i>EEA State</i> ; or (b) facilities for dealing in that investment have been granted on a <i>regulated market</i>
<i>LLD</i>	the Lloyd's Sourcebook
<i>localisation</i>	existence of assets, whether moveable or immovable, in a State
<i>long-term insurance business</i>	the business of effecting or carrying out <i>long-term insurance contracts</i>
<i>long-term insurance business amount</i>	is the higher of - (a) the amount of the <i>insurer's insurance liabilities</i> in respect of <i>long-term insurance business</i> (net of <i>reinsurance ceded</i> and excluding <i>property linked liabilities</i>), together with- (i) the amount of the <i>required margin of solvency</i> (or the amount of the <i>minimum guarantee fund</i> if greater) determined in accordance with rules 2.5 to 2.9 (or, in the case of an <i>insurer</i> whose head office is not in the United Kingdom, that amount

³⁰ For guidance, see paragraph 3 of **Guidance Note 4.1**

	<p>which would apply if its head office were in the United Kingdom) less the amount of any <i>implicit item</i> valued in accordance with a waiver under section 148 of the <i>Act</i>, and</p> <p>(ii) the amount of any <i>deposit-back</i> in connection with a contract of <i>reinsurance</i> in respect of <i>long-term insurance business</i>; or</p> <p>(b) such other amount as the <i>insurer</i> may select not exceeding the value of its assets (other than <i>general insurance business assets</i> and excluding <i>reinsurance recoveries</i> and assets required to match <i>property linked liabilities</i>) in accordance with the <i>Valuation of Assets Rules</i>,</p> <p>except that for the purposes of determining the <i>permitted asset exposure limit</i> under paragraph 2 of Part I of Appendix 4.2, <i>index linked liabilities</i> must also be excluded from (a) and assets required to match such liabilities must be also excluded from (b)</p>
<i>long-term insurance business assets, and long-term insurance business liabilities</i>	respectively assets of an <i>insurer</i> which are, for the time being, identified as representing the <i>long-term insurance fund or funds</i> , and liabilities of an <i>insurer</i> arising under or in connection with its <i>long-term insurance business</i> , including arising from <i>deposit back arrangements</i>
<i>long-term insurance contract</i>	any <i>contract of insurance</i> falling within Annex 11.1
<i>long-term insurance fund</i>	a fund maintained under rule 3.1
<i>long-term insurer</i>	an <i>insurer</i> whose business includes effecting or carrying out <i>long-term insurance contracts</i>
<i>long-term policy holder</i>	a <i>policy holder</i> in respect of a <i>policy</i> the effecting of which by the <i>insurer</i> constituted the carrying on of <i>long-term insurance business</i>
<i>majority shareholder controller</i>	a <i>shareholder controller</i> whose shareholding is such that the <i>insurer</i> is his <i>subsidiary undertaking</i>

<i>management expenses</i>	in relation to <i>long-term insurance business</i> , means all expenses, other than commission, incurred in the administration of an <i>insurer</i> or its business
<i>margin of solvency</i>	is the excess of the value of assets over the amount of liabilities, that value and amount being determined in accordance with the <i>Valuation of Assets Rules</i> and the <i>Determination of Liabilities Rules</i>
<i>Margins of Solvency Rules</i>	the rules in Chapter 2
<i>marine mutual</i>	<p>an <i>insurer</i> -</p> <p>(a) whose <i>insurance business</i> is restricted to the insurance of its members or their <i>associates</i> against loss, damage or liability arising out of marine adventures (including losses on inland waters or any risk incidental to any sea voyage); and</p> <p>(b) whose articles of association, rules or bye laws provide for the calling of additional contributions from, or the reduction of benefits to, the majority of its members, in either case without limit, in order to ensure that the <i>insurer</i> has sufficient financial resources to meet any valid <i>claims</i> as they fall due</p>
<i>market value</i>	the market value as determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate to <i>insurers</i>
<i>material connected-party transaction</i>	<p>a <i>connected-party transaction</i> for which (together with any similar transactions):</p> <p>(a) the price actually paid or received for the transfer of assets or liabilities or the performance of services; or</p> <p>(b) the price which would have been paid or received had that transaction been negotiated at arm's length between unconnected parties,</p> <p>exceeds:</p>

	<p>(c) in the case of an <i>insurer</i> that carries on either <i>general insurance business</i> or <i>long-term insurance business</i>, but not both, 5% of the <i>general insurance business amount</i> or <i>long-term business insurance amount</i>, as applicable; or</p> <p>(d) in the case of an <i>insurer</i> that carries on both types of business either –</p> <p>(i) 5% of the <i>long-term insurance business amount</i> where the transaction is in connection with the <i>insurer's long term business</i>, or</p> <p>(ii) in other cases, 5% of the <i>general insurance business amount</i></p>
<i>mathematical reserves</i>	the provision made by an <i>insurer</i> to cover liabilities (excluding liabilities which have fallen due and liabilities arising from <i>deposit back arrangements</i>) arising under or in connection with <i>long-term insurance contracts</i>
<i>maximum reserve</i>	for the purposes of the <i>Equalisation Reserves Rules</i> , the aggregate value of the <i>business group maxima</i> calculated in accordance with Part III of Appendix 6.1
<i>the minimum</i>	in relation to a <i>deposit</i> , means one-half of the <i>minimum guarantee fund</i> appropriate to the <i>margin of solvency</i> which the <i>insurer</i> is required to maintain under rule 2.1(2)(b) or 2.1(3)(e)
<i>minimum guarantee fund</i>	has the meaning given in rule 2.9
<i>mortgage</i>	in relation to Scotland, means a heritable security within the meaning of section 9(8) of the Conveyancing and Feudal Reform (Scotland) Act 1970
<i>mutual</i>	an <i>insurer</i> which -
	<p>(a) if it is a <i>body corporate</i> has no share capital; or</p> <p>(b) a <i>registered society</i></p>

<i>net claims incurred</i>	in respect of a <i>financial year</i> means <i>claims</i> arising from incidents occurring during that <i>financial year</i> (including direct <i>claims</i> handling expenses), net of <i>reinsurance</i> and other recoveries but excluding <i>claims management costs</i>
<i>net claims paid</i>	in respect of a <i>financial year</i> means <i>claims</i> paid during that <i>financial year</i> (including direct <i>claims</i> handling expenses), net of <i>reinsurance</i> and other recoveries but excluding <i>claims management costs</i> , regardless of whether incidents giving rise to such <i>claims</i> occurred during that <i>financial year</i> or any preceding <i>financial year</i>
<i>net operating expenses</i>	the net amount paid in a <i>financial year</i> in respect of commissions, other acquisition expenses, administrative expenses, <i>reinsurance</i> commissions and profit participations
<i>net premiums earned, and net premiums written</i>	respectively, <i>gross premiums earned</i> , net of <i>reinsurance</i> premiums earned and <i>gross premiums written</i> , net of <i>reinsurance</i> premiums payable under <i>reinsurance ceded</i>
<i>non-directive insurer</i>	<p>(1) an <i>insurer</i> whose <i>insurance business</i> is restricted to the provision of benefits which vary according to the resources available and in which the contributions of the members are determined on a flat-rate basis;</p> <p>(2) an <i>insurer</i> whose <i>long-term insurance business</i> is restricted to the provision of benefits for employed and self-employed persons belonging to an undertaking or group of undertakings, or a trade or group of trades, in the event of death or survival or of discontinuance or curtailment of activity (whether or not the <i>commitments</i> arising from such operations are fully covered at all times by <i>mathematical reserves</i>);</p> <p>(3) an <i>insurer</i> which undertakes to provide benefits solely in the event of death where the amount of such benefits does not exceed the average funeral costs for a single death or where the benefits are provided in kind;</p> <p>(4) a <i>mutual</i> (carrying on <i>long-term insurance business</i>) –</p> <p>(a) whose articles of association contain provisions for calling up additional</p>

	<p>contributions from members or reducing their benefits or claiming assistance from other persons who have undertaken to provide it; and</p> <p>(b) whose annual <i>gross premium</i> income (other than from contracts of <i>reinsurance</i>) has not exceeded 500,000 Euro for each of the <i>financial year in question</i> and the two <i>previous financial years</i>;</p> <p>(5) a <i>mutual</i> (carrying on <i>general insurance business</i>) whose –</p> <p>(a) articles of association contain provisions for calling up additional contributions from members or reducing their benefits;</p> <p>(b) business does not cover liability risks, other than <i>ancillary risks</i>, or credit or suretyship risks;</p> <p>(c) <i>gross premium</i> income (other than from contracts of <i>reinsurance</i>) for the <i>preceding financial year</i> did not exceed 1,000,000 Euro; and</p> <p>(d) members provided at least half of that <i>gross premium</i> income;</p> <p>(6) an <i>insurer</i> whose <i>insurance business</i> (other than <i>reinsurance</i>) is -</p> <p>(a) restricted to the provision of assistance for persons who get into difficulties while travelling, while away from home or while away from their permanent residence;</p> <p>(b) carried out exclusively on a local basis and consists only of benefits in kind; and</p> <p>(c) such that the <i>gross premium</i> income from the provision of assistance in the <i>financial year in question</i> did not exceed 200,000 Euro; or</p> <p>(7) a <i>mutual</i> whose liabilities in respect of <i>general insurance contracts</i> are fully reinsured with or guaranteed by other <i>mutuals</i> (including <i>friendly</i></p>
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	<p><i>societies</i>); and</p> <p>whose <i>insurance business</i> is limited to that described in paragraphs (1) to (6)</p>
<i>non-EEA insurer</i>	an <i>insurer</i> , other than a <i>pure reinsurer</i> , whose head office is not in an <i>EEA State</i>
<i>non-linked assets</i>	see <i>linked assets</i>
<i>non-linked contract</i>	see <i>linked long-term contract</i>
<i>non-profit policy</i>	see <i>with-profits policy</i>
<i>non-proportional reinsurance treaty</i>	see <i>proportional reinsurance treaty</i>
<i>notional required minimum margin</i>	<p>(a) in the case of an <i>insurance undertaking</i> (other than a <i>pure reinsurer</i>) that has its head office in a <i>designated state or territory</i>, the amount of the <i>required minimum margin</i>, or equivalent, under the regulatory requirements of that state or territory;</p> <p>(b) in the case of a <i>pure reinsurer</i> that has its head office in a <i>designated state or territory</i>, the amount that would be the <i>required minimum margin</i>, or equivalent, if the regulatory requirements of that state or territory applicable to undertakings carrying on <i>direct insurance business</i> were applied to the <i>pure reinsurer</i>; and</p> <p>(c) in all other cases, the amount of the <i>required minimum margin</i> that would apply if the <i>insurance undertaking</i> were an <i>insurer</i> with its head office in the United Kingdom (whether it is or not)</p>
<i>nuclear installation</i>	any installation prescribed by the Nuclear Installations Regulations 1971
<i>nuclear matter, and nuclear reactor</i>	have the same meanings as in the Nuclear Installations Act 1965
<i>nuclear risks</i>	risks falling within any <i>class</i> of <i>general insurance business</i> and arising in connection with the construction or use of any <i>nuclear reactor</i> or <i>nuclear installation</i> or

	the carriage of any <i>nuclear matter</i>
<i>option</i>	<p>an option to acquire or dispose of –</p> <p>(a) an investment falling within any of articles 76 to 82 or, so far as relevant to those articles, within article 89 of the <i>Regulated Activities Order</i>;</p> <p>(b) a <i>contractually based investment</i>;</p> <p>(c) currency of the United Kingdom or of any other country or territory;</p> <p>(d) palladium, platinum, gold or silver; or</p> <p>(e) an investment falling within this definition by virtue of (a), (b), (c) or (d),</p> <p>or a <i>warrant</i></p>
<i>ordinary long-term insurance business</i>	<i>long-term insurance business</i> which is not <i>industrial assurance business</i>
<i>parent undertaking</i>	is construed in accordance with section 258 of the <i>Companies Act</i> and article 266 of the <i>1986 Order</i>
<i>participating undertaking</i>	an undertaking which holds a <i>participation</i> in the undertaking in question
<i>participation</i>	<p>(a) the holding of a participating interest within the meaning of section 411(2) of the <i>Act</i>; or</p> <p>(b) the holding, directly or indirectly, of 20% or more of the voting rights or capital</p>
<i>Part II business, and Part III business</i>	the <i>insurance business</i> to which Part II and Part III, respectively, of the <i>Equalisation Reserves Rules</i> applies
<i>Part II insurer, and Part III insurer</i>	an <i>insurer</i> to which <i>Part II</i> and <i>Part III</i> , respectively, of the <i>Equalisation Reserves Rules</i> applies
<i>pension fund management contract</i>	means a contract to manage the investments of pension funds (other than funds solely for the benefit of the officers or employees of the person effecting or carrying out the contract and their dependants or, in the case of a <i>company</i> , partly for the benefit of officers or employees

	and their dependants of its <i>subsidiary</i> or <i>holding company</i> or a <i>subsidiary</i> of its <i>holding company</i>
<i>period of risk</i>	the period for which a <i>contract of insurance</i> provides cover
<i>permanent health contract</i>	a contract falling within <i>class IV</i> of <i>long-term insurance contracts</i>
<i>permitted asset exposure limit</i>	has the meaning given in paragraph 2 of Appendix 4.2
<i>permitted connected property</i>	property of any of the descriptions in paragraphs 1 to 8 or 10 of Part I of Appendix 3.2 , which is not property falling within rule 3.7(3)
<i>permitted counterparty exposure limit</i>	has the meaning set out in paragraph 3 of Appendix 4.2
<i>permitted derivative contract</i>	<p>(1) for the purpose of Appendix 3.2, a <i>derivative contract</i> -</p> <p>(a) which is ‘covered’ and -</p> <p>(i) which is held in connection with ‘property’ for the purposes of reduction of investment risk or efficient portfolio management, or</p> <p>(ii) which has the effect of a <i>permitted derivative contract</i> held in connection with ‘property’ for such purposes; and</p> <p>(b) which satisfies the conditions in rules 4.12(6) to (8) except that the references in rule 4.12 to ‘an asset for the valuation of which provision is made in the <i>Valuation of Assets Rules</i>’ is construed as a reference to <i>permitted connected property</i>;</p> <p>(2) property is -</p> <p>(a) <i>permitted connected property</i>, not being a contract or asset having the effect of a <i>derivative contract</i>; or</p>

	<p>(b) a <i>permitted derivative contract</i> or contract or asset having the effect of a <i>permitted derivative contract</i> either of which when taken together with the <i>permitted derivative contract</i> mentioned in (1), has the effect that the <i>insurer</i> holds either <i>permitted connected property</i> or a <i>permitted derivative contract</i> in connection with such property; and</p> <p>(3) a <i>derivative contract</i> is covered if it would not require a significant provision to be made in respect of it pursuant to rule 5.3 if it were a <i>derivative contract</i> to which the <i>Valuation of Asset Rules</i> applied</p>
<i>permitted securities</i>	<i>securities</i> in which cash under the control of or subject to the order of the Supreme Court may be invested pursuant to the relevant rules of court
<i>policy</i>	<p>(a) in relation to <i>long-term insurance business</i> and <i>industrial assurance business</i>, includes an instrument evidencing a contract to pay an <i>annuity upon human life</i>;</p> <p>(b) in relation to <i>insurance business</i> of any other kind, includes any policy under which there is for the time being an existing liability already accrued or under which a liability may accrue; and</p> <p>(c) in relation to capital redemption <i>insurance business</i>, includes any policy, bond, certificate, receipt or other instrument evidencing the <i>contract of insurance</i> with the <i>insurer</i></p>
<i>policy holder</i>	<p>the person who for the time being is the legal holder of the <i>policy</i> for securing the contract with the <i>insurer</i>, and -</p> <p>(a) in relation to such <i>long-term insurance business</i> or <i>industrial assurance business</i> as consists in the granting of <i>annuities upon human life</i>, includes an annuitant; and</p> <p>(b) in relation to <i>insurance business</i> of any other kind, includes a person to whom, under a <i>policy</i>, a sum is due or a periodic payment is payable</p>

<i>preceding financial year</i>	see <i>financial year in question</i>
<i>previous financial years</i>	see <i>financial year in question</i>
<i>profit and loss account</i>	in relation to an <i>insurer</i> not trading for profit, an income and expenditure account
<i>profit reserves</i>	has the same meaning as <i>future profits</i>
<i>proper valuation</i>	in relation to land, a valuation made by a <i>qualified valuer</i> not more than three years before the <i>relevant date</i> which determined the amount which would be realised at the time of the valuation on an open market sale of the land free from any <i>mortgage</i> or charge
<i>property linked benefits</i>	benefits other than <i>index linked benefits</i> provided for under a <i>linked long-term contract</i>
<i>property linked contract</i>	a <i>linked long-term contract</i> conferring <i>property linked benefits</i>
<i>property linked liabilities</i>	<i>insurance liabilities</i> in respect of <i>property linked benefits</i>
<i>proportionate share</i>	in the case of a <i>related undertaking</i> of an <i>insurer</i> , the percentage holding (directly or indirectly) of the <i>related undertaking</i> capital
<i>proportional reinsurance treaty</i>	<p>(a) a <i>reinsurance</i> treaty under which a pre-determined proportion of each <i>claim</i> payment by the <i>cedant</i> under <i>policies</i> subject to the treaty is recoverable from the <i>reinsurer</i>; and</p> <p>(b) for the purposes of the <i>Accounts and Statements Rules</i>, a <i>reinsurance</i> treaty under which in return for a proportion of the premium a pre-determined proportion of each <i>claim</i> payment by the <i>cedant</i> under <i>policies</i> subject to the treaty is recoverable from the <i>reinsurer</i>, and</p> <p>non-proportional reinsurance treaty is construed accordingly</p>
<i>pure reinsurer</i>	an <i>insurer</i> whose <i>insurance business</i> is as a matter of fact restricted to effecting or carrying out contracts of <i>reinsurance</i>

<i>qualified valuer</i>	<p>in relation to any particular type of land in any particular area, means –</p> <p>(a) a person who is a fellow or professional associate of the Royal Institution of Chartered Surveyors or a fellow or associate of the Incorporated Society of Valuers and Auctioneers or a fellow or associate of the Rating and Valuation Association and either –</p> <p>(i) has knowledge of and experience in the valuation of that particular type of land in that particular area, or</p> <p>(ii) has knowledge of and experience in the valuation of land and has taken advice from a valuer who he is satisfied has knowledge of and experience in the valuation of that particular type of land in that particular area; or</p> <p>(b) a person who conforms with (a)(i) or (ii) and immediately before 15 June 1981 was recognised as a qualified valuer by virtue of an approval by the Secretary of State under the Insurance Companies (Valuation of Assets) Regulations 1976 (and for these purposes an approval given under the Insurance Companies (Valuation of Assets) Regulations 1974 is deemed to have been given under the 1976 Regulations)</p>
<i>qualifying contract of insurance</i>	<p>means a <i>long-term insurance contract</i> which is not</p> <p>(a) a <i>reinsurance contract</i>; or</p> <p>(b) a contract in respect of which the following conditions are met –</p> <p>(i) the benefits under the contract are payable only on death or in respect of incapacity due to injury, sickness or infirmity;</p> <p>(ii) the contract provides that benefits are payable on death (other than death due to an accident) only where the death occurs within ten years of the date on which the life of the person in question was first</p>

	<p>insured under the contract, or where the death occurs before that person attains a specified age not exceeding seventy years;</p> <p>(iii) the contract has no surrender value, or the consideration consists of a single premium and the surrender value does not exceed that premium; and</p> <p>(iv) the contract makes no provision for its conversion or extension in a manner which would result in it ceasing to comply with any of the above conditions</p>
<i>readily realisable</i>	<p>in relation to a <i>listed</i> investment means a <i>listed</i> investment to which rule 4.8(4) either does not apply or applies by reason only that -</p> <p>(a) the listing of the investment has been temporarily suspended following receipt of price sensitive information received by the stock exchange on which the investment is <i>listed</i> or the <i>regulated market</i> on which facilities for dealing have been granted; or</p> <p>(b) the extent of the holding would prevent an orderly disposal of the investment for an amount equal to or greater than 97.5% of market value</p>
<i>receivable</i>	<p>in relation to an <i>insurer</i>, a <i>financial year</i> and a premium, means due to the <i>insurer</i> in respect of <i>contracts of insurance incepted</i> during that <i>financial year</i>, whether or not the premium is received during that <i>financial year</i></p>
<i>recoverable</i>	<p>in relation to an <i>insurer</i> and a <i>financial year</i>, means recorded in the <i>insurer's</i> books as due in that year, whether or not the <i>insurer</i> has received any payment</p>
<i>registered friendly society</i>	<p>a society which is –</p> <p>(a) a friendly society within the meaning of section 7(1)(a) of the Friendly Societies Act 1974; and</p> <p>(b) registered within the meaning of that Act</p>

<i>registered society</i>	a society registered or deemed to be registered under the Industrial and Provident Societies Act 1965 or the Industrial and Provident Societies Act (Northern Ireland) 1969
<i>Regulated Activities Order</i>	Financial Services and Markets Act (Regulated Activities) Order (S.I. 2001 No. 544)
<i>regulated activity</i>	is construed in accordance with the <i>Regulated Activities Order</i>
<i>regulated institution</i>	any of the following – <ul style="list-style-type: none"> (a) an <i>EEA insurer</i> or <i>UK insurer</i>; (b) an <i>approved credit institution</i>; (c) a <i>friendly society</i> which is authorised to carry on <i>insurance business</i>; and (d) an <i>approved investment firm</i>
<i>regulated market</i>	a market which is characterised by - <ul style="list-style-type: none"> (a) regular operation; (b) the fact that regulations issued or approved by the appropriate authority of the state where the market is situated - <ul style="list-style-type: none"> (i) define the conditions for the operation of and access to the market, (ii) define the conditions to be satisfied by a financial instrument in order for it to be effectively dealt in on the market, and (iii) require compliance with reporting and transparency requirements comparable to those laid down in articles 20 and 21 of the <i>Investment Services Directive</i>, and (c) in the case of a market situated outside the <i>EEA States</i>, the fact that the financial instruments dealt in are of a quality comparable to those in a <i>regulated market</i> in the United Kingdom

<i>reinsurance, and reinsurer</i>	include retrocession and retrocessionaire respectively
<i>reinsurance recoveries</i>	amounts in respect of <i>claims</i> receivable by an <i>insurer</i> from a <i>reinsurer</i> under a contract of <i>reinsurance</i>
<i>related company</i>	in relation to an <i>insurer</i> – <ul style="list-style-type: none"> (a) a <i>subsidiary undertaking</i> of the <i>insurer</i>; (b) a company of which the <i>insurer</i> is a <i>subsidiary undertaking</i>; or (c) a <i>subsidiary undertaking</i> of a company of which the <i>insurer</i> is a <i>subsidiary undertaking</i>
<i>related undertaking</i>	an undertaking in which a <i>participation</i> is held by another undertaking or which is a <i>subsidiary undertaking</i>
<i>relevant co-insurance operation</i>	has the meaning given in Appendix 5.1
<i>relevant company</i>	an <i>insurer</i> whose <i>insurance business</i> is restricted to <i>reinsurance</i> of the <i>marine mutual</i> on terms that provide that the <i>marine mutual</i> can cancel the <i>reinsurance</i> arrangements at any time and can require the <i>insurer</i> immediately to transfer its assets and liabilities to the <i>marine mutual</i>
<i>relevant date</i>	in relation to the valuation of any asset for any purpose for which the <i>Valuation of Assets Rules</i> apply, the date when the asset falls to be valued for that purpose and in relation to the determination of any liability for any purpose for which the <i>Determination of Liabilities Rules</i> apply, the date when the liability falls to be determined for that purpose
<i>relevant insurer</i>	in relation to a <i>relevant co-insurance operation</i> , an <i>insurer</i> which is concerned in the operation but is not the <i>leading insurance undertaking</i>
<i>relevant regulatory requirements</i>	for the purposes of (2)(b) and (3)(a): <ul style="list-style-type: none"> (a) in the case of a <i>group undertaking</i> that is an <i>insurance undertaking</i> established in a <i>designated state or territory</i>, at the option of the <i>insurer</i>, either:

	<ul style="list-style-type: none"> (i) the regulatory requirements of that state or territory applicable to an undertaking carrying on <i>direct insurance business</i> (even if it only carries on reinsurance business), or (ii) the requirements referred to in (b); and <p>(b) in the case of any other <i>insurance undertaking</i>, the rules in <i>IPRU (INS)</i> applicable to an <i>insurer</i> with its head office in the United Kingdom (whether or not it is such an <i>insurer</i>)</p>
<i>required margin of solvency</i>	a <i>margin of solvency</i> required by rule 2.1
<i>required minimum margin</i>	the greater of the appropriate <i>required margin of solvency</i> and the amount of the appropriate <i>guarantee fund</i> ; and 'required EEA minimum margin' and 'required United Kingdom minimum margin' are construed accordingly
<i>return</i>	the documents required (taken together) to be deposited under rule 9.6(1)

<i>salvage right</i>	any right of an <i>insurer</i> under a <i>contract of insurance</i> to take possession of and to dispose of property by virtue of the fact that the <i>insurer</i> has made a payment or has become liable to make a payment in respect of a loss under the contract
<i>second calculation</i>	is the calculation described in rule 2(5)(1) and 2.5(3) to (6)
<i>secured debt</i>	<p>(1) a <i>debt</i> owed to (or an obligation to be fulfilled for the benefit of) an <i>insurer</i> to the extent it is -</p> <ul style="list-style-type: none"> (a) secured by - <ul style="list-style-type: none"> (i) a letter of credit established with an <i>approved credit institution</i>, or (ii) a guarantee provided by an <i>approved credit institution</i>, <p>where the sum of the aggregate amount available under all letters of credit established for the</p>

	<p>benefit of the <i>insurer</i> with the same <i>counterparty</i>, the aggregate amount of all guarantees issued for the benefit of the <i>insurer</i> by that <i>counterparty</i> and the amount of any <i>exposure</i> of the <i>insurer</i> to that <i>counterparty</i> does not exceed the <i>permitted counterparty exposure limit</i> for that <i>counterparty</i>; or</p> <p>(b) secured by assets for the valuation of which provision is made in the <i>Valuation of Assets Rules</i> and -</p> <p>(i) the value of such assets (after deducting reasonable expenses of sale and the amount of any other <i>debt</i> or obligation secured by the assets having priority to in ranking equally with the <i>debt</i> or obligation) is sufficient to enable the <i>debt</i> or obligation to be discharged in full,</p> <p>(ii) the value of the assets when aggregated with the <i>insurer's exposure</i> to assets of the same description does not exceed the <i>permitted exposure limit</i> for assets of that description (as calculated under rule 4.14 of Appendix 4.2), and</p> <p>(iii) where the assets give rise to <i>exposure</i> to a <i>counterparty</i>, the exposure of the <i>insurer</i> to that <i>counterparty</i>, when added to the aggregate amount available under all letters of credit established for the benefit of the <i>insurer</i> with that <i>counterparty</i>, and to the aggregate amount of all guarantees issued for the benefit of the <i>insurer</i> by that <i>counterparty</i>, does not exceed the <i>permitted counterparty exposure limit</i> for that <i>counterparty</i>;</p> <p>(2) for the purpose of (1) -</p> <p>(a) the aggregate amount available under letters of credit established with a <i>counterparty</i> must be taken not to exceed</p>
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	<p>the sum of the aggregate amount of all <i>debts</i> and the aggregate value of all obligations in respect of which those letters of credit were established;</p> <p>(b) the aggregate amount of guarantees issued by a <i>counterparty</i> must be taken not to exceed the sum of the aggregate amount of all <i>debts</i> and the aggregate value of all obligations so guaranteed; and</p> <p>(c) assets which are securing any other <i>debt</i> owed to (or obligation to be fulfilled for the benefit of) the <i>insurer</i> must be treated as if they were assets of the <i>insurer</i>;</p> <p>and unsecured debt is construed accordingly</p>
<i>securities</i>	includes <i>shares, debt securities, Treasury Bills, Tax Reserve Certificates and Certificates of Tax Deposit</i>
<i>settlement date</i>	any date on which the fulfilment of an obligation under a <i>derivative contract</i> is or may be required
<i>share</i>	has the meaning given in the <i>Companies Act</i> or the <i>1986 Order</i>
<i>shareholder controller</i>	see rule 11.2 for <i>controller</i>
<i>short term deposit</i>	a sum of money which may be withdrawn at the discretion of the lender without penalty or loss of accrued interest by giving notice of withdrawal of one month or less
<i>Society</i>	the society incorporated by Lloyd's Act 1871 by the name of Lloyd's
<i>Statistical Rules</i>	rules 9.37 to 9.38
<i>Stock Exchange</i>	London Stock Exchange plc
<i>subordinated debt</i>	any <i>debt</i> which, on a winding up of the debtor, ranks for payment after the claims of general creditors and is not to be repaid until the claims of all the general creditors outstanding at the time have been settled

<i>subsidiary</i>	is construed in accordance with section 736 of the <i>Companies Act</i> or Article 4 of the <i>1986 Order</i>
<i>subsidiary undertaking</i>	is construed in accordance with section 258 of the <i>Companies Act</i> or Article 266 of the <i>1986 Order</i>
<i>SUP</i>	Supervision manual
<i>surplus assets</i>	has the meaning given in rule 4.2(2)
<i>Swiss general insurer</i>	a <i>non-EEA insurer</i> which has its head office in Switzerland and which has permission under the <i>Act</i> to effect or carry out <i>general insurance contracts</i> in accordance with the Swiss Treaty Agreement of 10 October 1989

<i>technical provisions</i>	the items required by the <i>insurance accounts rules</i> to be shown in the balance sheet of an <i>insurer</i> at liabilities items C.1 to 6
<i>Third Life Directive</i>	Council Directive of 10 November 1992 on the co-ordination of laws, etc and amending Directives 79/267/EEC and 90/619/EEC (92/96/EEC)
<i>Third Non-Life Directive</i>	Council Directive of 18 June 1992 on the co-ordination of laws, etc, and amending Directives 73/239/EEC and 88/357/EEC (92/49/EEC)
<i>Treasury Bills</i>	includes bills issued by Her Majesty's Government in the United Kingdom and Northern Ireland Treasury Bills

<i>ultimate EEA insurance parent undertaking</i>	an <i>EEA insurance parent undertaking</i> that is not itself the <i>subsidiary undertaking</i> of another <i>EEA insurance parent undertaking</i>
<i>ultimate insurance parent undertaking</i>	an <i>insurance parent undertaking</i> that is not itself the <i>subsidiary undertaking</i> of another <i>insurance parent undertaking</i>
<i>UCITS</i>	is an undertaking for collective investments in transferable <i>securities</i>
<i>UCITS Directive</i>	Council Directive 85/611/EEC of 20 December 1985 on the co-ordination of laws, regulations and administrative provisions relating to undertakings for collective investments in transferable <i>securities</i>

<i>UK-deposit insurer</i>	a <i>non-EEA insurer</i> which has made a <i>deposit</i> in the United Kingdom in accordance with rule 8.1
<i>UK insurer</i>	an <i>insurer</i> , other than a <i>pure reinsurer</i> or a <i>non-directive insurer</i> , whose head office is in the United Kingdom
<i>UK margin of solvency</i>	an <i>insurer's margin of solvency</i> computed by reference to the assets and liabilities of the business carried on by that <i>insurer</i> in the United Kingdom under rule 2.4
<i>unlisted</i>	see <i>listed</i>
<i>unsecured debt</i>	see <i>secured debt</i>

<i>Valuation of Assets Rules</i>	the rules in Chapter 4;
<i>variable interest securities</i>	<i>securities</i> which under their terms of issue provide for variable amounts of interest
<i>variation margin</i>	<p>(a) in respect of a <i>derivative contract</i>, or a contract having the effect of a <i>derivative contract</i>³¹, assets (other than assets transferred by way of <i>initial margin</i>) which, at the <i>relevant date</i>, have been transferred by, to, or for the benefit of the <i>insurer</i> in pursuance of a condition in that contract or a related contract; and</p> <p>(b) in respect of an asset having the effect of a <i>derivative contract</i>, assets which, at the relevant date, have been transferred by, to, or for the benefit of, the <i>insurer</i> in pursuance of a contractual right conferred, or obligation imposed, by the holding of the asset having the effect of a <i>derivative contract</i></p>
<i>warrant</i>	an instrument which falls within article 79 of the <i>Regulated Activities Order</i>

³¹ See rule 4.13

<i>with profits fund</i>	for the purposes of the <i>Accounts and Statements Rules</i> – (a) a <i>long-term insurance fund</i> (or that part of such a fund) in which <i>policy holders</i> are eligible to participate in any <i>established surplus</i> ; and (b) where it is an <i>insurer's</i> usual practice to restrict <i>policy holders' participation</i> in any <i>established surplus</i> to that arising from only a part of the fund (or part fund) falling within (a), that part (or that part of the part fund)
<i>with-profits policy</i>	a contract falling within a <i>class of long-term insurance business</i> which is eligible to participate in any part of any <i>established surplus</i> , and non-profit policy is construed accordingly
<i>zillmerising</i>	in relation to the <i>Margins of Solvency Rules</i> , means the method known by that name for modifying the net premium reserve method of valuing a long-term <i>policy</i> by increasing the part of the future premiums for which credit is taken so as to allow for initial expenses

Controller

- 11.2 (1) For the purpose of *IPRU (INS)*, **controller**, in relation to an undertaking ("A"), means a person who falls within any of the cases in (2).
- (2) The cases are where the 'person' –
- (a) holds 10% or more of the 'shares' in A;
 - (b) is able to exercise significant influence over the management of A by virtue of his shareholding in A;
 - (c) holds 10% or more of the 'shares' in a parent undertaking ("P") of A;
 - (d) is able to exercise significant influence over the management of P by virtue of his shareholding in P;
 - (e) is entitled to exercise, or control the exercise of, 10% or more of the 'voting power' in A;

- (f) is able to exercise significant influence over the management of A by virtue of his 'voting power' in A;
 - (g) is entitled to exercise, or control the exercise of, 10% or more of the 'voting power' in P; or
 - (h) is able to exercise significant influence over the management of P by virtue of his 'voting power' in P.
- (3) In (2) the **person** means –
- (a) the person;
 - (b) any of the person's *associates*; or
 - (c) the person and any of his *associates*.
- (4) **Associate**, in relation to a 'person' ("H") holding '*shares*' in an undertaking ("C") or entitled to exercise or control the exercise of 'voting power' in relation to another undertaking ("D"), means -
- (a) the spouse of H;
 - (b) a child or stepchild of H (if under 18);
 - (c) the trustee of any 'settlement' under which H has a life interest in possession (or in Scotland a life interest);
 - (d) an undertaking of which H is a *director*;
 - (e) a person who is an employee or partner of H;
 - (f) if H is an undertaking-
 - (i) a *director* of H,
 - (ii) a *subsidiary undertaking* of H,
 - (iii) a *director* or employee of such a *subsidiary undertaking*; and
 - (g) if H has with any other person an agreement or arrangement with respect to the acquisition, holding or disposal of '*shares*' or other interests in C or D or under which they undertake to act together in exercising their 'voting power' in relation to C or D, that other person.
- (5) **Settlement**, in (4)(c), includes any disposition or arrangement under which property is held on trust (or subject to a comparable obligation).

- (6) **Shares -**
- (a) in relation to an undertaking with *share* capital, means allotted shares;
 - (b) in relation to an undertaking with capital but no *share* capital, means rights to share in the capital of the undertaking; and
 - (c) in relation to an undertaking without capital, means interests -
 - (i) conferring any right to share in the profits, or liability to contribute to the losses, of the undertaking, or
 - (ii) giving rise to an obligation to contribute to the debts or expenses of the undertaking in the event of a winding up.
- (7) **Voting power**, in relation to an undertaking which does not have general meetings at which matters are decided by the exercise of voting rights, means the right under the constitution of the undertaking to direct the overall policy of the undertaking or alter the terms of its constitution.

PART 2

GENERAL PROVISIONS

Powers under which the rules are made

- 11.3 The rules and guidance in the *IPRU (INS)* are made under the following sections of the *Act* -
- (a) section 138 (general rule making power);
 - (b) section 141 (insurance business rules);
 - (c) section 150(2) (actions for damages);
 - (d) section 156 (general supplementary powers);
 - (e) section 157 (guidance); and
 - (f) section 340 (appointment of auditors and actuaries).

Actions for damages

- 11.4 Section 150(1) of the *Act* does not apply to a contravention of the rules in the *IPRU (INS)*.

Use of definitions

- 11.5 A word which is printed in italics is used in the defined sense.
- 11.6 Unless the context otherwise requires, a word or phrase which is defined in a related enactment bears the same meaning as in that enactment.
- 11.7 Unless the context otherwise requires, a word which is related to a defined word is construed by reference to the defined word.

Supplementary and ancillary provisions

- 11.8 For the purposes of this *IPRU (INS)*:
- (a) a *contract of insurance* is to be treated as falling within **Annex 11.1**, notwithstanding the fact that that it contains supplementary provisions falling within *class 1* or *class 2* of **Annex 11.2** if:
 - (i) its principal object is that of a contract falling within **Annex 11.1**, and

- (ii) it is effected or carried out by an *insurer* who has permission to effect or carry out contracts falling within *class I* of **Annex 11.1**; and
 - (b) a *contract of insurance* whose principal risk falls within any of *classes 1 to 18* of **Annex 11.2** is to be treated as falling within that *class* and no other, notwithstanding the fact that it also covers *ancillary risks*.
-

ANNEX 11.1

CLASSES OF LONG-TERM INSURANCE BUSINESS

Number	Description	Nature of business
I	Life and annuity	Effecting or carrying out <i>contracts of insurance</i> on human life or contracts to pay <i>annuities on human life</i> , but excluding (in each case) contracts within <i>class III</i> .
II	Marriage and birth	Effecting or carrying out <i>contracts of insurance</i> to provide a sum on marriage or on the birth of a child, being contracts expressed to be in effect for a period of more than one year.
III	Linked long term	Effecting or carrying out <i>contracts of insurance</i> on human life or contracts to pay <i>annuities on human life</i> where the benefits are wholly or partly to be determined by reference to the value of, or the income from, property of any description (whether or not specified in the contracts) or by reference to fluctuations in, or in an index of, the value of property of any description (whether or not so specified).
IV	Permanent health	<p>Effecting or carrying out <i>contracts of insurance</i> providing specified benefits against risks of persons becoming incapacitated in consequence of sustaining injury as a result of an accident or of an accident of a specified class or of sickness or infirmity, being contracts that -</p> <p>(a) are expressed to be in effect for a period of not less than five years, or until the normal retirement age for the persons concerned, or without limit of time; and</p> <p>(b) either are not expressed to be terminable by the insurer, or are expressed to be so terminable only in special circumstances mentioned in the contract.</p>
V	Tontines	Effecting or carrying out tontines.

VI	Capital redemption	Effecting or carrying out capital redemption contracts.
VII	Pension fund management	Effecting or carrying out- (a) <i>pension fund management</i> contracts; or (b) contracts of the kind mentioned in (a) that are combined with <i>contracts of insurance</i> covering either conservation of capital or payment of a minimum interest.
VIII	Collective insurance etc	Effecting or carrying out contracts of a kind referred to in Article 1(2)(e) of the <i>First Life Directive</i> .
IX	Social insurance	Effecting or carrying out contracts of a kind referred to in Article 1(3) of the <i>First Life Directive</i> .

ANNEX 11.2

CLASSES, AND GROUPS OF CLASSES, OF GENERAL INSURANCE BUSINESS

Part I

Classes of general insurance business

Number	Description	Nature of business
1	Accident	<p>Effecting or carrying out <i>contracts of insurance</i> providing fixed pecuniary benefits or benefits in the nature of indemnity (or a combination of both) against risks of the person insured or, in the case of a contract made by virtue of section 140, 140A or 140B of the Local Government Act 1972, a person for whose benefit the contract is made -</p> <p>(a) sustaining injury as the result of an accident or of an accident of a specified class, or</p> <p>(b) dying as the result of an accident or of an accident of a specified class, or</p> <p>(c) becoming incapacitated in consequence of disease or of disease of a specified class,</p> <p>inclusive of contracts relating to industrial injury and occupational disease but exclusive of contracts falling within <i>class 2</i> or within <i>class IV</i> in Annex 11.1.</p>
2	Sickness	<p>Effecting or carrying out <i>contracts of insurance</i> providing fixed pecuniary benefits or benefits in the nature of indemnity (or a combination of the two) against risks of loss to the persons insured attributable to sickness or infirmity, but exclusive of contracts falling within <i>class IV</i> in Annex 11.1.</p>
3	Land vehicles	<p>Effecting or carrying out <i>contracts of insurance</i> against loss of or damage to vehicles used on land, including motor vehicles but excluding railway rolling stock.</p>
4	Railway rolling	<p>Effecting or carrying out <i>contracts of insurance</i> against loss of or damage to railway rolling stock.</p>
5	Aircraft	<p>Effecting or carrying out <i>contracts of insurance</i> upon aircraft or upon the machinery, tackle, furniture or equipment of aircraft.</p>

6	Ships	Effecting or carrying out <i>contracts of insurance</i> upon vessels used on the sea or on inland water, or upon the machinery, tackle, furniture or equipment of such vessels.
7	Goods in transit	Effecting or carrying out <i>contracts of insurance</i> against loss of or damage to merchandise, baggage and all other goods in transit, irrespective of the form of transport.
8	Fire and natural forces	Effecting or carrying out <i>contracts of insurance</i> against loss of or damage to property (other than property to which <i>classes 3 to 7</i> above relate) due to fire, explosion, storm, natural forces other than storm, nuclear energy or land subsidence.
9	Damage to property	Effecting or carrying out <i>contracts of insurance</i> against loss of or damage to property (other than property to which <i>classes 3 to 7</i> above relate) due to hail or frost or to any event (such as theft) other than those mentioned in <i>class 8</i> above.
10	Motor vehicle liability	Effecting or carrying out <i>contracts of insurance</i> against damage arising out of or in connection with the use of motor vehicles on land including third-party risks and carrier's liability.
11	Aircraft liability	Effecting or carrying out <i>contracts of insurance</i> against damage arising out of or in connection with the use of aircraft, including third-party risks and carrier's liability.
12	Liability for ships	Effecting or carrying out <i>contracts of insurance</i> against damage arising out of or in connection with the use of vessels on the sea or on inland water, including third-party risks and carrier's liability.
13	General liability	Effecting or carrying out <i>contracts of insurance</i> against risks of the persons insured incurring liabilities to third parties, the risks in question not being risks to which <i>class 10, 11 or 12</i> above relates.
14	Credit	Effecting or carrying out <i>contracts of insurance</i> against risks of loss to the persons insured arising from the insolvency of debtors of theirs or from the failure (otherwise than through insolvency) of debtors of theirs to pay their debts when due.

15	Suretyship	<p>Effecting or carrying out–</p> <p>(a) <i>contracts of insurance</i> against risks of loss to the persons insured arising from their having to perform contracts of guarantee entered into by them;</p> <p>(b) contracts for fidelity bonds, performance bonds, administration bonds, bail bonds or customs bonds or similar contracts of guarantee.</p>
16	Miscellaneous financial loss	<p>Effecting or carrying out <i>contracts of insurance</i> against any of the following risks, namely –</p> <p>(a) risks of loss to the persons insured attributable to interruptions of the carrying on of business carried on by them or to reduction of the scope of business so carried on;</p> <p>(b) risks of loss to the persons insured attributable to their incurring unforeseen expense (other than loss such as is covered by contracts falling within <i>class 18</i>);</p> <p>(c) risks neither falling within (a) or (b) nor being of a kind such that the carrying on of the business of effecting or carrying out <i>contracts of insurance</i> against them constitutes the carrying on of <i>insurance business</i> of some other class.</p>
17	Legal expenses	<p>Effecting or carrying out <i>contracts of insurance</i> against risks of loss to the persons insured attributable to their incurring legal expenses (including costs of litigation).</p>
18	Assistance	<p>Effecting or carrying out <i>contracts of insurance</i> providing either or both of the following benefits, namely –</p> <p>(a) assistance (whether in cash or in kind) for persons who get into difficulties while travelling, while away from home or while away from their permanent residence, or</p> <p>(b) assistance (whether in cash or in kind) for persons who get into difficulties otherwise than as mentioned in paragraph (a) above.</p>

Part II
Groups of classes of general insurance business

Number	Description	Nature of business
1	Accident and health	<i>Classes 1 and 2.</i>
2	Motor	<i>Class 1 (to the extent that the relevant risks are risks of the person insured sustaining injury, or dying, as the result of travelling as a passenger) and classes 3, 7 and 10.</i>
3	Marine and transport	<i>Class 1 (to the said extent) and classes 4, 6, 7 and 12.</i>
4	Aviation	<i>Class 1 (to the said extent) and classes 5, 7 and 11.</i>
5	Fire and other damage to property	<i>Classes 8 and 9.</i>
6	Liability	<i>Classes 10, 11, 12 and 13.</i>
7	Credit and suretyship	<i>Classes 14 and 15.</i>
8	General	<i>All classes.</i>

Chapter 12

TRANSITIONAL ARRANGEMENTS

Guidance:

GEN (the part of the *FSA Handbook* in High Level Standards which has the title General Provisions) contains some technical transitional provisions that apply throughout the Handbook and which are designed to ensure a smooth transition at commencement of the *Act*. These include transitional provisions relevant to record keeping and notification rules.

SUP contains transitional provisions which carry forward written concessions relating to pre-commencement provisions.

**INTERIM PRUDENTIAL
SOURCEBOOK**

INSURERS

VOLUME TWO

APPENDICES TO THE RULES

INTERIM PRUDENTIAL SOURCEBOOK FOR INSURERS

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-

APPENDIX 2.1 (rule 2.4(1)(b))

GENERAL INSURANCE BUSINESS SOLVENCY MARGIN

FIRST METHOD OF CALCULATION (PREMIUM BASIS)

1. The *gross premiums receivable* in respect of the *insurer's* entire *general insurance business* for the *financial year in question* must be aggregated.
2. From the aggregate arrived at under 1 there must be deducted -
 - (a) any taxes included in the *gross premiums receivable*; and
 - (b) any levies that are related to premiums and are recorded in the *insurer's* books as payable in the *financial year in question* in respect of *general insurance business*.
3. The amount arrived at under 2 must be multiplied by 12 and divided by the number of months in the *financial year*.
4. If the amount arrived at under 3 is more than 10 million Euro, it must be divided into two portions, the former consisting of 10 million Euro and the latter comprising the excess.
5. Where there has been a division into two portions pursuant to 4, there must be calculated and added together 18% and 16% of the two portions respectively; and where there has been no such division, there must be calculated 18% of the amount arrived at under 3.
6. In the case of *general insurance business* consisting of health insurance based on actuarial principles, 5 applies with the substitution of 6% for 18% and 5 and one-third % for 16%, but only if all the 'necessary conditions' are satisfied.
7. For the purposes of 6, the **necessary conditions** are -
 - (a) the *gross premiums receivable* are calculated on the basis of sickness tables appropriate to the *insurance business*;
 - (b) the reserves include provision for increasing age;
 - (c) an additional premium is collected in order to set up a safety margin of an appropriate amount;
 - (d) it is not possible for the *insurer* to cancel the contract after the end of the third year of the contract; and

- (e) the contract provides for the possibility of increasing premiums or reducing payments during its currency.
8. Where 6 applies to an *insurer* whose *general insurance business* consists partly of health insurance based on actuarial principles and partly of other business, the procedure provided in 1 to 6 must operate separately for each part of the *general insurance business*, so as to produce a sum under 6 for the health insurance and a sum under 5 for the other business.
9. (1) If the 'provision for *claims* outstanding' at the end of the *preceding financial year* exceeds the provision for *claims* outstanding at the beginning of that year, the amount of the excess must be added to the 'amount of claims paid' in the *preceding financial year*.
- (2) If the 'provision for *claims* outstanding' at the beginning of the *preceding financial year* exceeds the provision for *claims* outstanding at the end of that year, the amount of the excess must be deducted from the 'amount of *claims* paid' in the *preceding financial year*.
10. (1) For the purposes of 9, the **amount of claims paid**, is the amount that is recorded in the *insurer's* books as at the end of the *financial year* -
- (a) in relation to *general insurance business classes* 1 to 17, as paid by the *insurer* (whether or not payment has been effected in that year) in full or partial settlement of the '*claims*' described in (2) and the 'expenses' described in (3); or
- (b) in relation to *general insurance business class* 18, as being the costs borne by the *insurer* (whether or not borne in that year) in respect of the assistance given,
- less (in either case) any 'recoverable' amounts within the meaning of (4).
- (2) The **claims** mentioned in (1) are *claims* under *contracts of insurance* including *claims* relating to business accounted for over a longer period than a *financial year*.
- (3) The **expenses** mentioned in (1) are expenses (such as legal, medical, surveying or engineering costs) which are incurred by the *insurer*, whether through the employment of its own staff or otherwise, and are directly attributable to the settlement of individual *claims*, whether or not the individual *claims* in question are those mentioned in (1).
- (4) **Recoverable** amounts for the purposes of (1) are amounts recoverable by the *insurer*, in respect of the '*claims*' mentioned in (1) or other *claims*, including amounts recoverable by way of salvage, amounts recoverable from third parties and amounts recoverable from other *insurers* but excluding amounts recoverable in respect of *reinsurance ceded* by the *insurer*.

11. (1) For the purposes of 9, the **provision for claims outstanding**, is (subject to the *Valuation of Asset Rules* and *Determination of Liabilities Rules*) the amount set aside by the *insurer* as at the beginning or end of the *financial year* as being an amount likely to be sufficient to meet -
- (a) the '*claims*' described in (2); and
 - (b) the '*expenses*' described in (3),
- less any '*recoverable*' amounts within the meaning of (4).
- (2) The **claims** mentioned in (1) are *claims* under *contracts of insurance* in respect of incidents occurring -
- (a) in the case of an amount set aside as at the beginning of the financial year, before the beginning of that year; and
 - (b) in the case of an amount set aside as at the end of the *financial year*, before the end of that year,
- being *claims* which have not been treated as *claims* paid including *claims* relating to business accounted for over a longer period than a *financial year*, *claims* the amounts of which have not been determined and *claims* arising out of incidents that have not been notified to the *insurer*.
- (3) The **expenses** mentioned in (1) are expenses (such as legal, medical, surveying or engineering costs) which are likely to be incurred by the *insurer*, whether through the employment of its own staff or otherwise, and are directly attributable to the settlement of individual *claims*, whether or not the individual *claims* in question are those mentioned in (1).
- (4) **Recoverable** amounts for the purposes of (1) are amounts estimated by the *insurer* to be recoverable by it in respect of the '*claims*' mentioned in (1), including amounts recoverable by way of salvage, amounts recoverable from third parties and amounts recoverable from other *insurers* but excluding amounts recoverable in respect of *reinsurance ceded* by the *insurer*.
12. From the amount determined under 9(1) or (2) there must be deducted the total sum recoverable in respect of that amount under *reinsurance* contracts *ceded*.
13. The amount determined under 12 must be expressed as a percentage of the amount determined under 9(1) or (2).
14. The sum arrived at under 5 or 6 or the aggregate of the sums arrived at under those paragraphs, as the case may be, must be multiplied -
- (a) where the percentage arrived at under 13 is greater than 50% but not greater than 100%, by the percentage so arrived at;

- (b) where the percentage so arrived at is greater than 100%, by 100%; and
 - (c) in any other case, by 50%.
-

APPENDIX 2.2 (rule 2.4(1)(b))

GENERAL INSURANCE BUSINESS SOLVENCY MARGIN

SECOND METHOD OF CALCULATION (CLAIMS BASIS)

1. In this Appendix **reference period**, in relation to an *insurer*, means either -
 - (a) the *financial year* which last ended and the two *previous financial years*; or
 - (b) the *financial year in question* and the six *previous financial years* if more than one-half of the *gross premiums receivable* in that period were in respect of all or any of the following, namely, storm (as included in *general insurance business class 8*), hail (as included in *general insurance business class 9*), frost (as included in *general insurance business class 9*) and credit (as included in *general insurance business class 14*).
2. If an *insurer* has not been in existence long enough to acquire a ‘reference period’, this Appendix must be treated as giving a lower result than that given by **Appendix 2.1** and does not otherwise apply to the *insurer*.
3.
 - (1) If the ‘provision for *claims* outstanding’ at the end of the ‘reference period’ exceeds the ‘provision for *claims* outstanding’ at the beginning of the ‘reference period’, the amount of the excess must be added to the ‘amount of *claims* paid’ in the ‘reference period’.
 - (2) If the ‘provision for *claims* outstanding’ at the beginning of the ‘reference period’ exceeds the ‘provision for *claims* outstanding’ at the end of the ‘reference period’, the amount of the excess must be deducted from the ‘amount of *claims* paid’ in the ‘reference period’.
 - (3) For the purposes of this paragraph, the expressions **amount of claims paid** and **provision for claims outstanding** have, in relation to a ‘reference period’, the same meaning as they have in paragraph 9 of **Appendix 2.1**.
4. The aggregate obtained under 3(1) or (2) must be divided by the number of months in the ‘reference period’ and multiplied by 12.
5. If the amount arrived at under 4 is more than 7 million Euro, it must be divided into two portions, the former consisting of 7 million Euro and the latter comprising the excess.
6. Where there has been a division into two portions pursuant to 5, there must be calculated and added together 26% and 23% of the two portions respectively; and where there has been no such division, there must be calculated 26% of the amount arrived at under 4.

7. In the case of *general insurance business* consisting of health insurance based on actuarial principles, 6 applies with the substitution of 8 and two-thirds % for 26% and 7 and two-thirds % for 23%, but only if all the 'necessary conditions' are satisfied.
 8. The **necessary conditions** for the purposes of 7 are the same as those set out in paragraph 7 of **Appendix 2.1**.
 9. In a case of the kind mentioned in 8 of **Appendix 2.1**, that paragraph applies (with the necessary modifications) so as to produce separate sums under 6 and 7.
 10. The sum arrived at under 6 or 7 or the aggregate of the sums arrived at under those paragraphs, as the case may be, must be multiplied by the same percentage as is applicable for the purposes of paragraph 14 of **Appendix 2.1**.
-

APPENDIX 2.3 (rule 2.9)

MINIMUM GUARANTEE FUND

Long-term business

1. Subject to 7, the *minimum guarantee fund* for *long-term insurance business* is-
 - (a) in the case of a *pure reinsurer* which -
 - (i) is the wholly-owned *subsidiary* of an *insurer* carrying on *long-term insurance business*, and
 - (ii) carries on only such *reinsurance* business as is *ceded* to it by that *insurer*, 200,000 Euro;
 - (b) in the case of a *mutual*, 600,000 Euro; and
 - (c) in any other case, 800,000 Euro.

General business

2. Subject to 3 to 7, the *minimum guarantee fund* for *general insurance business* is the amount shown in the table below as applicable to the *general insurance business class* for which the *insurer* has permission under the *Act* (or the highest such amount if the *insurer* has permission for more than one *class*).

General Business	Amount
<i>Class 10, 11, 12, 13, 14, or 15</i>	400,000 Euro
<i>Class 1, 2, 3, 4, 5, 6, 7, 8, 16, or 18</i>	300,000 Euro
<i>Class 9 or 17</i>	200,000 Euro

3. In the case where the risks covered fall within *class 14* and where the annual amount of premiums or contributions of the *insurer* due in respect of that *class* for each of the *financial year in question* and two *previous financial years* exceeded 2,500,000 Euro or 4% of the total amount of premiums or contributions receivable by the *insurer*, for the amount of Euro given in the table in 2 there must be substituted the amount of 1,400,000 Euro.
4. Where an *insurer* carrying on *credit insurance business* is required to increase the amount of Euro pursuant to 3, the *insurer* has -
 - (a) a period of three years in which to bring the fund up to 1,000,000 Euro;
 - (b) a period of five years to bring the fund up to 1,200,000 Euro; and
 - (c) a period of seven years to bring the fund up to 1,400,000 Euro,

such periods to run from the date on which the criteria set out in 3 are fulfilled.

5. An *insurer* which has permission limited to part of a *class* is, for the purposes of 2, treated as having permission for the whole of the *class*.
6. In the case of a *mutual*, the *minimum guarantee fund* required by 2 to 5 is reduced by 25%.

Long-term and general insurance business

7. In relation to a *UK margin of solvency* or *EEA margin of solvency* maintained under rule 2.1(2)(b) or (3)(e), the *minimum guarantee fund* for *long-term* or *general insurance business* is one-half of the amount arrived at by applying the provisions of this Appendix.
-

APPENDIX 3.1 (rule 3.3(3)(b))

FORM OF ALLOCATION NOTICE TO POLICY HOLDERS

[Deleted]

APPENDIX 3.2 (rule 3.7)

PERMITTED LINKS

PART I

DESCRIPTIONS OF PROPERTY BY WHICH BENEFITS MAY BE DETERMINED¹

1. *Listed securities* which are *readily realisable*, not being *securities* which are -
 - (a) *approved securities*;
 - (b) loans or deposits of the kinds mentioned in 4 and 7;
 - (c) units or other beneficial interests in a *collective investment fund*; or
 - (d) *derivative contracts*.

2. *Unlisted securities* which are *readily realisable*, not being *securities* which are -
 - (a) *approved securities*;
 - (b) loans or deposits of the kinds mentioned in 4 and 7;
 - (c) units or other beneficial interests in a *collective investment fund*; or
 - (d) *derivative contracts*.

3. Land (including any interest in land) in an *EEA State*, Australia, Canada, the Channel Islands, Gibraltar, Hong Kong, the Isle of Man, New Zealand, the Republic of South Africa, Singapore or the United States of America.

4. Loans -
 - (a) which are fully secured by a *mortgage* or charge on land (or any interest in land) which -
 - (i) is situated in any of the countries referred to in 3, and
 - (ii) in the case of a loan made to a person other than a body corporate, is not used wholly or mainly for domestic purposes; and

¹ See **Guidance Note 4.1** and **Guidance Note 9.1**

- (b) in relation to which the rate of interest and the due dates for the payment of interest and the repayment of principal can be fully ascertained from the terms of any agreement relating to the loan.
5. Units or other beneficial interests in -
- (a) a scheme falling within the *UCITS Directive*; and
 - (b) a *collective investment fund* which satisfies the following conditions -
 - (i) the property of the fund comprises property of any of the descriptions in 1 to 10,
 - (ii) the units are *readily realisable* at a price which represents the net value per unit of the assets and liabilities of the fund, and
 - (iii) the price at which the units may be bought and sold is published regularly.
6. *Approved securities.*
7. Loans to or deposits with an *approved credit institution*, an *approved financial institution* or an *approved investment firm*.
8. Income due, or to become due, in respect of property of any of the descriptions in 1 to 7.
9. *Permitted derivative contracts.*
10. Cash.
11. Units, by whatever name called, in a real or notional fund (not being a scheme or undertaking of a kind mentioned in 5) which is limited to the descriptions of property mentioned above, not being property falling within rule 3.7(3), and which under the contract is to be managed either-
- (a) wholly by the *insurer*; or
 - (b) wholly or to any extent by another person being a person for whose acts and omissions in managing the fund the *insurer* assumes responsibility towards the *policy holder* as if they were the acts or omissions of the *insurer*, and otherwise (if at all) by the *insurer*.

PART II

INDICES BY REFERENCE TO WHICH BENEFITS MAY BE DETERMINED²

1 *An approved index.*

² See **Guidance Note 4.1** and **Guidance Note 9.1**

APPENDIX 4.1 (rule 4.3)

VALUE OF DEPENDANTS

[Deleted]

APPENDIX 4.2 (rule 4.14)

ASSETS TO BE TAKEN INTO ACCOUNT ONLY TO A SPECIFIED EXTENT

PART I

EXCESS EXPOSURE: METHOD OF CALCULATION

1. Unless the context otherwise requires, words and expressions contained in this Appendix have the same meaning as in the *Valuation of Assets Rules* and the *Determination of Liabilities Rules*.
2. The *permitted asset exposure limit* for assets of any of the descriptions in Part II of this Appendix is the percentage of the *business amount* set out immediately following the description. In the case of an asset which is not covered by any of the descriptions in Part II of this Appendix (other than a *derivative contract*), the *permitted asset exposure limit* is nil.
3. The *permitted counterparty exposure limit* is -
 - (a) where the *counterparty* is an individual or an unincorporated body of persons, 5% of the *business amount*;
 - (b) where the *counterparty* is a *counterparty* of the type mentioned in (e) in the definition of *counterparty*, 5% of the *business amount*;
 - (c) where the *counterparty* is a *body corporate* or *group*, each of -
 - (i) 20% of the *business amount* or £2 million, whichever is the larger,
 - (ii) 10% of the *business amount* or such lower amount as the *insurer* may decide where the *exposure* arises other than by reason that *debts* are due or to become due as a result of *short term deposits* made with an *approved credit institution*, and
 - (iii) 5% of the *business amount* where the *exposure* is other than to bodies which are *approved counterparties*.

Calculation of exposure to assets

4. A value must be ascribed to assets of each description which must be an amount determined in accordance with the *Valuation of Assets Rules* or, where the assets are of a description for the valuation of which no provision is made in the *Valuation of Assets Rules*, an amount which would reasonably be paid by way of consideration for an immediate assignment or transfer of such assets. The amount by which the *insurer* is exposed to assets of each

description must be determined by adjusting the value of the assets in accordance with 5 to 11A.

Adjustment in respect of futures contracts

5. The figure arrived at under 4 in respect of assets of each description must be increased or decreased by the value of assets of that description which the *insurer* is deemed to have acquired or disposed of pursuant to a *futures contract*.
6. For the purposes of 5, the *insurer* is deemed to have acquired or disposed of assets pursuant to a *futures contract* if, at the relevant date, it has entered into (and not closed out) a *futures contract* which -
 - (a) provides for the acquisition of assets by that *insurer*;
 - (b) is *listed* and provides for the disposal of assets by the *insurer*; or
 - (c) is not *listed* but provides for the disposal of assets by the *insurer* to an *approved counterparty* and it is prudent to assume that such disposal will take place within one year of the *relevant date*.

Adjustments in respect of options

7. The figure arrived at under 4 to 6 in respect of assets of each description must be increased or decreased by the value of assets of that description which the *insurer* is deemed to have acquired or disposed of pursuant to an *option*.
8. For the purposes of 7, the *insurer* is deemed to have acquired or disposed of assets pursuant to an *option* if, at the *relevant date*, it is a party to an *option* and it is prudent to assume that the *option* will be exercised and the *option* is one which -
 - (a) provides for the acquisition of assets by the *insurer*;
 - (b) is *listed* and provides for the disposal of assets by the *insurer*; or
 - (c) is not *listed* but provides for the disposal of assets by the *insurer* to an *approved counterparty* and it is prudent to assume that such disposal will take place within one year of the *relevant date*.

Adjustments in respect of initial margins

9. The figure arrived at under 4 to 8 in respect of assets of each description must be increased by an amount representing the value of any assets of that description which have been transferred by the *insurer* by way of *initial margin*.

Adjustments in respect of an undiversified contract for differences or a contract or asset having the effect of a derivative contract

10. The amount arrived at in accordance with 4 to 9 must be increased or decreased by an amount representing the value of assets which the *insurer* is deemed to have acquired or disposed of under -
- (a) an undiversified *contract for differences*; or
 - (b) a contract or asset other than a diversified *contract for differences* which has the effect of a *derivative contract*.
11. For the purposes of 10, the *insurer* is deemed to have achieved the effect of such contract by entering into appropriate *futures contracts* or *options*. The assets deemed to be acquired or disposed of must be dealt with in accordance with 5 and 7 respectively.

Adjustment in respect of subsidiary undertakings

- 11A. The amount arrived at under 4 to 11 must be increased by an amount representing the *exposure*, if any, of the *insurer's dependants* to assets of that description, calculating that *exposure* by applying 4 to 11 to each *dependant* as if it were an *insurer* (whether it is or not).

Excess asset exposure

12. The amount by which the *insurer* is exposed to assets of a particular description in excess of the *permitted asset exposure limit* must be calculated by subtracting the *permitted asset exposure limit* for assets of that description from the corresponding amount of the *exposure*, calculated in accordance with 4 to 11A. For this purpose, *exposure* to assets must be excluded to the extent that such *exposure* has caused the recognition of excess *exposure* to assets of a different description. If the figure arrived at is negative, it must be taken to be zero.

Calculation of exposure to a counterparty

13. Subject to 14 to 15A, the value of all investments (determined in accordance with rule 4.8) issued by any one *counterparty* and the value of all rights (determined in accordance with rules 4.5, 4.12 and 4.13) against that *counterparty*, in each case up to the amount of the appropriate *permitted asset exposure limit*, must be aggregated. Where the *counterparty* is an issuer of a *collective investment scheme* falling within rule 4.9 (1)(c), the value of units or other beneficial interest in the *collective investment scheme* must be included.
14. Where an *insurer* has rights in respect of an obligation to be fulfilled by a *counterparty* and -
- (a) the obligation is a secured obligation which -

- (i) is secured by cash deposited with, or a letter of credit established with, or *securities* issued by, or a guarantee provided by, an *approved credit institution* or an *approved financial institution*, and
 - (ii) is due to be fulfilled within 12 months of the *relevant date*; or
- (b) the obligation is a secured obligation which is secured by *listed securities* which are *readily realisable* or by *approved securities* which in either case -
- (i) have been deposited with an *approved credit institution*, an *approved financial institution* or an *approved investment firm*, and
 - (ii) are beneficially owned by the *counterparty* but will not be available for the benefit of creditors generally in the event of the winding-up of the *counterparty*,

the aggregation required by 13 need not include the value of such rights.

15. If the *insurer* has liabilities to the *counterparty* which may be offset against the above mentioned assets in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for *insurers*, then such liabilities may be offset for the purposes of the aggregation required by 13.
- 15A. The amount arrived at in accordance with 13 to 15 must be increased by the amount by which any *dependant* of the *insurer* is *exposed* to the same *counterparty*.

Excess counterparty exposure

16. The amount by which the *insurer* is exposed to a *counterparty* in excess of the *permitted counterparty exposure limit* must be calculated by subtracting from the amount of the *exposure* to such *counterparty* the amount of the *permitted counterparty exposure limit* for such *counterparty*. If the figure arrived at is negative, it must be taken to be zero. If the *insurer* is exposed to a *counterparty* in excess of the *permitted counterparty exposure limit* in more than one of the circumstances set out in 3(c), it must make the deduction required under rule 4.14 (1)(b) only in respect of the circumstances leading to the greatest excess *exposure*.

Excess concentration with a number of counterparties

17. Where there is *exposure* to a *counterparty* of the type mentioned in 3(c)(ii), 40% of the *business amount* must be deducted from the aggregate of such *exposures*. The amount so arrived at is the excess concentration with a number

of counterparties. Where this amount is negative it must be taken to be zero. For the purposes of this paragraph -

- (a) *exposure* to a *counterparty* is to be taken into account only up to the level of the *permitted counterparty exposure limit* for that *counterparty*;
- (b) *exposure* to a *counterparty* is not taken into account if it does not exceed 5% of the *business amount*; and
- (c) *exposure* to a *counterparty* is not taken into account if the corresponding *permitted counterparty exposure limit* does not exceed 5% of the *business amount*.

PART II

DESCRIPTION OF ASSET AND CORRESPONDING BUSINESS AMOUNT

	Description of asset	Percentage of general insurance business amount or long-term insurance business amount
1	A piece of land or a number of pieces of land (or an interest in such pieces of land) to which in the most recent <i>proper valuation</i> of such pieces of land an aggregate value is ascribed which is greater than the value of each of such pieces of land valued separately	5%.
1A	A reversionary interest or a remainder not falling within 1	1%.
2	All <i>debts</i> due or to become due from any one individual (other than an individual who is connected with the <i>insurer</i> within the meaning of rule 3.4(5), being <i>debts</i> which are fully secured on any dwelling or any land appurtenant to it owned or to be purchased by the individual and used or to be used by him for his own residence	1%.
3.	All <i>debts</i> due or to become due from an individual, other than <i>debts</i> specified in 2	0.25%.
4.	All <i>unsecured debts</i> (other than <i>debts</i> arising under the terms of <i>debt securities</i> or <i>debts</i> from a <i>regulated institution</i>) due or to become due from any one <i>counterparty</i> other than an individual, <i>body corporate</i> or group	1%.
5.	All <i>unsecured debts</i> (other than <i>debts</i> arising under the terms of <i>debt securities</i> or <i>debts</i> from a <i>regulated institution</i>) due or to become due from any one <i>company</i> , taken together with all such <i>debts</i> due or to	

- | | | |
|-----|--|-------|
| | become due from a <i>connected company</i> of that <i>company</i> | 1%. |
| 6. | All <i>unsecured debts</i> (other than <i>debts</i> arising under the terms of <i>debt securities</i> or <i>debts</i> from an <i>approved counterparty</i>) due or to become due from any one <i>regulated institution</i> , taken together with all such <i>debts</i> due or to become due from a <i>connected company</i> of that institution | 2.5%. |
| 7. | All <i>debts</i> , other than <i>debts</i> arising under the terms of <i>debt securities</i> , due or to become due from any one <i>counterparty</i> which is not an <i>approved counterparty</i> taken together with all such <i>debts</i> due or to become due from any <i>connected company</i> (other than an <i>approved counterparty</i>) of that <i>counterparty</i> | 5%. |
| 8. | All <i>debts</i> , other than <i>short-term deposits</i> with an <i>approved credit institution</i> or <i>debts</i> arising under the terms of <i>debt securities</i> , due or to become due from any one <i>approved counterparty</i> , taken together with all such <i>debts</i> due or to become due from any <i>connected company</i> of that <i>approved counterparty</i> | 10%. |
| 9. | All <i>debts</i> due or to become due from an <i>approved credit institution</i> (or a <i>connected company</i> of that institution) taken together unless – | |
| | (a) the <i>insurer</i> has notified the <i>FSA</i> that it places deposits with that institution; and | |
| | (b) the total amount of <i>debts</i> due or to become due does not exceed £2 million | 20% |
| 10. | The aggregate of <i>debts</i> of the descriptions in 3, 4 and 5 | 5%. |
| 11. | All investments of a kind which may be valued in accordance with rule 4.8 (other than <i>secured debt securities</i> , <i>debt securities</i> (other than <i>hybrid securities</i>) issued by a | |

regulated institution or investments which are *listed* and *readily realisable*) issued by any one *issuer* taken together with –

- | | | |
|-----|--|-------|
| | (a) all units or other beneficial interests in a <i>collective investment scheme</i> falling within rule 4.9(1)(c) issued by that <i>issuer</i> ; and with | |
| | (b) all investments of the kinds mentioned in this paragraph issued by a <i>connected company</i> of that <i>issuer</i> | 1%. |
| 12. | The aggregate of assets of any of the descriptions in 1A and 11 | 10%. |
| 13. | All <i>shares</i> and hybrid <i>securities</i> issued by any one <i>issuer</i> taken together with all such <i>securities</i> issued by a <i>connected company</i> of that <i>issuer</i> | 2.5%. |
| 14. | All <i>securities</i> issued by any one <i>issuer</i> which is not an <i>approved counterparty</i> taken together with all <i>securities</i> issued by a <i>connected company</i> , other than an <i>approved counterparty</i> , of that <i>issuer</i> | 5%. |
| 15. | All <i>securities</i> issued by any one <i>counterparty</i> | 10%. |
| 16. | All holdings in any one authorised unit trust scheme or recognised scheme | 5%. |
| 17. | All cash | 3%. |
| 18. | All computer equipment | 5%. |
| 19. | All office machinery (other than computer equipment) taken together with all furniture, motor vehicles and other equipment | 2.5%. |

APPENDIX 5.1 (rule 5.5 and *relevant co-insurance operation*)

RELEVANT CO-INSURANCE OPERATIONS

1. An insurance operation is a **relevant co-insurance operation** for the purposes of rule 5.5 if -
 - (a) it is not a *reinsurance* acceptance;
 - (b) it relates to any of the *classes of general insurance business* specified in 2; and
 - (c) it satisfies all the conditions specified in 3.

2. The *classes* referred to in 1(b) are -
 - class 3 (land vehicles),
 - class 4 (railway rolling stock),
 - class 5 (aircraft),
 - class 6 (ships),
 - class 7 (goods in transit),
 - class 8 (fire and natural forces),
 - class 9 (damage to property),
 - class 10 (motor vehicle liability),
 - class 11 (aircraft liability),
 - class 12 (liability for ships),
 - class 13 (general liability), excluding risks which concern damage arising from nuclear sources or from medicinal products,
 - class 14 (credit),
 - class 15 (suretyship), and
 - class 16 (miscellaneous financial loss).

3. The conditions referred to in 1(c) are -
- (a) that the risk is covered by a single contract at an overall premium and for the same period by two or more *insurance undertakings*, each for its own part;
 - (b) that the risk is ‘situated’ (within the meaning of 4 below) within an *EEA State*; and
 - (c) that at least one of the *insurance undertakings* participating in the operation does so through a head office or branch established in an *EEA State* other than that in which the *leading insurance undertaking’s* head office (or if the *leading insurance undertaking* is participating through a branch, that branch) is established.
4. For the purposes of 3(b), a risk is **situated** in an *EEA State* -
- (a) in the case of insurance relating to immovable property, if the property is situated in an *EEA State*;
 - (b) in the case of insurance relating to a registered vessel, aircraft or vehicle (including railway rolling stock), if the vessel, aircraft or vehicle is registered in an *EEA State*; and
 - (c) in any other case, if the *policy holder* is incorporated or has his habitual residence in an *EEA State*.
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APPENDIX 6.1 (rule 6.7)

METHODS OF CALCULATING THE EQUALISATION RESERVE

Part I

Methods of calculating transfers in

1. Amounts to be transferred to the *equalisation reserve* at the end of a *financial year* must be calculated in accordance with 2 to 3.
2. For *insurance business* falling within a *business group*, the amount to be transferred to the *equalisation reserve* is the percentage specified in the table in 3 of *net premiums written* in that *financial year* including adjustments in respect of all previous *financial years* in respect of that business.
3. The table referred to in 2 is as follows.

Business group	Percentage of net premiums written
A	3%
B	3%
C	6%
D	75%
E	11%

Part II

Methods of calculating transfers out

4. Amounts to be transferred from the *equalisation reserve* at the end of a *financial year* must be calculated in accordance with 5 to 10.
5. For *insurance business* falling within a *business group* which is *accounted for* on an accident year basis, the *insurer* must determine the amount (the **abnormal loss**), if any, by which, taking into account any adjustments in respect of previous years' underwriting, *net claims incurred* in that *financial year* in respect of that business exceed the percentage specified in the table contained in 8 of *net premiums earned* in that *financial year* in respect of that business.
6. For *insurance business* falling within a *business group* which is *accounted for* on an underwriting year basis, the *insurer* must determine the amount (the **abnormal loss**), if any, by which *net claims paid* plus the increase (or less the decrease) in the net *technical provisions* (exclusive of any change in *claims handling expenses* and any *equalisation reserve*) in that *financial year* plus adjustments in respect of all *previous financial years* in respect of that business exceed the percentage specified in the table contained in 8 of *net*

premiums written in that *financial year* plus adjustments in respect of all *previous financial years* in respect of that business.

7. For the purposes of 5 and 6, if *net premiums earned* or *net premiums written*, as the case may be, in respect of any business in any *financial year* are negative, their value is deemed to be zero for the purposes of calculating the ‘abnormal loss’ in respect of that business.
8. The table referred to in 5 and 6 is as follows.

Business group	Percentage of net premiums earned/written
A	72.5%
B	72.5%
C	95%
D	25%
E	100%

9. The ‘abnormal loss’ for each *business group accounted for* on an accident year basis and *business group accounted for* on an underwriting year basis must be aggregated and must, subject to 10, be the amount to be transferred from the *equalisation reserve*.
10. If the ‘abnormal loss’ in respect of any *business group* pursuant to 9 exceeds the relevant ‘business group maximum’ at that date, the loss to be aggregated in respect of that *business group* is the ‘business group maximum’.

Part III

Method of calculating business group maximum

11. The maximum reserve applicable to a *business group* (the **business group maximum**) at the end of a *financial year* must be calculated in accordance with 12.
12. (1) The ‘business group maximum’ at the end of a *financial year* is the percentage specified in the following table of ‘average net premiums written’ in respect of that *business group* -

Business group	Percentage of ‘average net premiums written’
A	20%
B	20%
C	40%
D	600%
E	75%

- (2) For the purposes of (1), the **average net premiums written** in respect of a *business group* means -
- (a) in the case of an *insurer* which has carried on business falling within that *business group* for no less than five *financial years*, the average amount of *net premiums written* in respect of that business in a *financial year*, calculated on the basis of the *financial year in question* and the four *previous financial years*;
 - (b) in the case of an *insurer* which has carried on business falling within that *business group* for less than five *financial years*, the average amount of *net premiums written* in respect of that business in a *financial year*, calculated on the basis of the *financial year in question* and any *previous financial years* ending on or after 23 December 1996.
- (3) For the purposes of (2), if any of the *financial years* which the *insurer* is required to take into account for the calculation of 'average net premiums written' has been validly extended or shortened from 12 months, the value of *net premiums written* in that *financial year* is the amount represented by the formula -

$$\frac{\text{NPW} \times 365}{d}$$

where-

NPW means *net premiums written* in the *financial year* concerned; and

d means the number of days falling in that *financial year*.

Method of calculating the maximum reserve

13. The maximum reserve at the end of a *financial year* is the aggregate value of the 'business group maxima' calculated in accordance with 12.

APPENDIX 6.2 (rule 6.12)

METHOD OF CALCULATING THE EQUALISATION RESERVE FOR CREDIT INSURANCE BUSINESS

1. The *insurer* must maintain a credit insurance *equalisation reserve* to which must be charged, at the end of each *financial year*, any ‘technical deficit’ arising in respect of *credit insurance business* during that *financial year*.
 2. Such reserve must at the end of each *financial year* receive 75% of any ‘technical surplus’ arising in respect of *credit insurance business*, subject to a limit of 12% of *net premiums written* during that *financial year* until the reserve has reached 150% of the highest annual amount of *net premiums written* during the *financial year in question* and the four *previous financial years*.
 3. For the purposes of this Appendix, **technical surplus** or **technical deficit** in respect of *credit insurance business* for a *financial year* means -
 - (a) for business which is accounted for on an accident year basis, the amount by which the aggregate of *net premiums earned* and other technical income exceeds, or falls short of, the aggregate of *net claims incurred, claims management costs* and any technical charges; and
 - (b) for business which is accounted for on an underwriting year basis, the amount by which the aggregate of *net premiums written* and other technical income exceeds, or falls short of, *net claims paid* plus the increase (or less the decrease) in the net *technical provisions* (exclusive of any change in the credit insurance *equalisation reserve*) and *net operating expenses*.
 4. In determining any ‘technical surplus’ referred to in 2, the calculation must be made before tax and before any transfer to or from the credit insurance *equalisation reserve*. Investment income is not included in these calculations.
-

APPENDIX 9.1 (rules 9.12 and 9.13)

BALANCE SHEET AND PROFIT AND LOSS ACCOUNT (FORMS 9 TO 17)

Introduction

1. (1) All the forms included in the part of the *return* to which this Appendix relates (**Forms 9 to 17**) are to be laid out as shown in this Appendix, except that the instructions for the completion of the forms need not be reproduced.
- (2) All amounts, descriptions or other text required to be shown as supplementary notes to a form must not be presented on the face of that form, but must be presented as a separate statement. The title of that statement must identify the form to which it relates.

Completion of Forms

2. Where 'source' appears at the head of a column on a form, the information to be included in the preceding columns of a particular line is to be taken from those items in the *return* to which reference is made on that line in the column headed 'source'. No entries are to be made in the column headed 'source'.
3. (1) The *insurer's* registration number to be entered in every form must be the number provided to the *insurer* by the *FSA* (or a predecessor).
- (2) Boxes marked 'GL/UK/CM' must be completed by inserting -
 - (a) 'UK' in the case of a form which is -
 - (i) prepared by *EEA-deposit insurer* in respect of *long-term* or *general insurance business* carried on through a branch in the United Kingdom;
 - (ii) prepared by an *external insurer* (other than a *pure reinsurer*) in respect of *long-term* or *general insurance business* carried on through a branch in the United Kingdom; or
 - (iii) prepared by a *Swiss general insurer* in respect of *general insurance business* carried on through a branch in the United Kingdom;
 - (b) 'CM' in the case of a form which is prepared by a *UK-deposit insurer* in respect of *long-term* or *general insurance business* carried on through branches in the *EEA States* concerned; or
 - (c) 'GL' in any other case.

- (3) Boxes marked 'Period ended' must be completed so as to show, in numerals, the date of the last day of the *financial year in question*.
- (4) No entry should be made in a box which is shaded or is not labelled.
- (5) In the forms 'this financial year' means the *financial year in question*.

Currency

4. The value of any asset or the amount of any liability denominated in a currency other than sterling must be expressed in sterling as if conversion had taken place at the closing middle rate on the last day for which the appropriate rate is available in the financial year to which the asset or liability relates.
5.
 - (1) The amount of any income or expenditure must be expressed in sterling using such bases of conversion as are in accordance with generally accepted accounting practice.
 - (2) The bases of conversion adopted must be stated by way of supplementary note to **Form 16** or, if there is no **Form 16**, by way of supplementary note to **Form 40**.

Presentation of amounts

6. Negative amounts must be shown between round brackets.
7. Where in any form an amount which is shown as brought forward from a previous year differs from the corresponding amount shown as carried forward from that year and the difference is not due solely to the use of a different rate to express other currencies in sterling, an explanation of the reason for the difference must be given by way of a supplementary note to that form.
8.
 - (1) Except to the extent permitted by (2), amounts due to or from the *insurer* must be shown gross.
 - (2) In calculating amounts due to or from the *insurer* -
 - (a) amounts due from any person may, unless expressly provided otherwise, be included net of amounts which are due to that person, provided that such amounts may be set off against each other under generally accepted accounting practice; and
 - (b) amounts due to any person may, unless expressly provided otherwise, be included net of amounts which are due from that person, provided that such amounts may be set off against each other under generally accepted accounting practice.
 - (3) If amounts shown include amounts calculated on the basis set out in (2), a supplementary note to **Form 13** to that effect must be provided.

(4) This paragraph does not apply to **Form 17**.

9. All amounts are to be shown to the nearer £1,000.

Premiums

10. (1) Notwithstanding the requirements of the *insurance accounts rules*, amounts included in **Forms 11** and **12** in respect of -

(a) *gross premiums receivable*;

(b) *claims* paid;

(c) *claims* outstanding; and

(d) *reinsurance* recoveries,

must be determined in accordance with **Appendices 2.1 to 2.3**.

(2) Where any amount included in **Form 11** or **12** pursuant to (1) differs from the aggregate of the corresponding amounts included in **Forms 21, 22, 24** and **25**, there must be stated by way of supplementary note to **Form 11** or **12**, as the case may be -

(a) the amount of such difference; and

(b) an explanation for such difference.

Counterparty exposure

11. (1) There must be given by way of a supplementary note to **Form 13** -

(a) the maximum extent to which, in accordance with any investment guidelines operated by the *insurer*, it was permitted to be exposed to any one *counterparty* during the *financial year in question*;

(b) the maximum extent to which, in accordance with such guidelines, it was permitted to be exposed to any one *counterparty*, other than by way of exposure to an *approved counterparty*, during the *financial year in question*; and

(c) an account of any occasions during the *financial year* on which either of those amounts was exceeded.

(2) In each case where the exposure of the *insurer* to a *counterparty* at the end of the *financial year in question* exceeds 5% of its *long-term business amount* or *general business amount*, as appropriate -

- (a) the amount of that *exposure*; and
- (b) the nature of the assets held which give rise to that *exposure*,

must be stated by way of a supplementary note to **Form 13**.

- (3) There must be stated by way of supplementary note to **Form 13** the aggregate value of any rights to which paragraph 14 of Part I of **Appendix 4.2**.

Provision for adverse changes

- 12. There must be stated by way of supplementary note to **Form 14** or **15** the methods and assumptions used to determine the amount of any provision made pursuant to rule 5.3 or, if there is no such provision, the methods and assumptions used to determine that no provision is required.

Liabilities

- 13. (1) Subject to (3), the following information must be given by way of a supplementary note to **Form 14** or **15** -
 - (a) in the case of any ‘charge’ over assets of the *insurer*, the particulars specified in (2) or a statement that there are no such ‘charges’;
 - (b) the total potential liability, and the amount provided for that liability, to taxation on capital gains which might arise if the *insurer* disposed of its assets, or a statement that there is no such potential liability;
 - (c) a brief description of any other liabilities being contingent liabilities not included in **Form 14** or **15** (other than liabilities arising under an inwards *contract of insurance* or *reinsurance*) including, where practicable, the amounts or estimated amounts of those liabilities, or a statement that there are no such contingent liabilities;
 - (d) a brief description of any guarantee, indemnity or other contractual commitment, effected by the *insurer* other than in the ordinary course of its *insurance business*, in respect of the existing or future liabilities of any *related companies*, including -
 - (i) the maximum liability of the *company* specified in such guarantee, indemnity or contractual commitment or, where no such amount is specified, a statement to that effect,
 - (ii) the amount of any provision made in respect of such liability, and
 - (iii) the amount reported under (c) in respect of such liability,

or a statement that there are no such guarantees, indemnities or contractual commitments; and

- (e) a description of any other uncertainty where such a description is, in the opinion of the directors, necessary for a proper understanding of the financial position of the *insurer*.
- (2) The particulars referred to in (1)(a) are -
- (a) the nature of the ‘charge’, including a brief description of the terms which are relevant to securing the prior claim of any person to assets which are subject to the ‘charge’;
 - (b) for each line in **Form 13**, the amount included in respect of assets which are subject to the ‘charge’; and
 - (c) for each line in **Form 14** or **15**, the amount included in respect of liabilities which are secured by the ‘charge’.
- (3) (1)(a) and (c) may be disregarded by an *insurer* in the case of -
- (a) one or more ‘charges’ over assets which are attributable to either the *long-term* or the *general insurance business assets* and whose aggregate value (as shown on **Form 13**) does not exceed 2.5% of the *long-term* or *general insurance business amount*, as the case may be; or
 - (b) one or more contingent liabilities whose aggregate value does not exceed 2.5% of the *long-term* or *general insurance business amount*, as the case may be.
- (4) (1)(d) may be disregarded by an *insurer* in respect of one or more guarantees, indemnities or contractual commitments where the aggregate of the maximum liabilities specified in such guarantees, indemnities or contractual commitments does not exceed 2.5% of the *long-term* or *general insurance business amount*, as the case may be.
- (5) For the purposes of this paragraph, **charge** includes any arrangement whatsoever, whether contractual or otherwise, which operates to secure the prior claim of any person over general creditors to any assets on a winding up of the *insurer*.

Reconciliation

14. (1) For an *insurer* (other than a *company* incorporated outside the United Kingdom) an explanation must be given by way of supplementary note to **Form 10** reconciling -

- (a) line 99 of **Form 13** (category of assets '1') less line 59 of **Form 15**; and
 - (b) the amount shown under balance sheet item A 'capital and reserves' in the *insurer's* accounts prepared pursuant to the *insurance accounts rules* for the *financial year in question*.
- (2) Where for an *insurer* (other than a *company* incorporated outside the United Kingdom) there are no accounts pursuant to 1(b) (or the accounts have not yet been prepared), this must be stated by way of supplementary note to **Form 10**.

Derivative contracts

15. Any *derivative contract* entered into by an *insurer* -
- (a) the value of which is taken into account for the purposes of calculating benefits payable to *policy holders* under *property linked contracts*; or
 - (b) in order to match its liabilities in respect of the payment of *index linked benefits*,
- must be excluded from **Form 17**.
16. Where, in respect of any *derivative contract* included in **Form 17**, assets have been transferred to or for the benefit of the *insurer* by way of *variation margin* there must be stated by way of supplementary note to **Form 17** -
- (a) the aggregate amount of any liability to repay such assets or equivalent assets;
 - (b) for each line in **Form 13**, the amount included in respect of such assets; and
 - (c) to what extent any amounts included in **Form 13** have taken account of any requirement to repay such assets or equivalent assets.
17. If -
- (a) the aggregate value of rights under contracts or in respect of assets, either of which have the effect of *derivative contracts*, exceeds 2.5% of the aggregate value of assets shown at line 89 of **Form 13**; or
 - (b) the aggregate amount of liabilities under contracts or in respect of assets, either of which have the effect of *derivative contracts*, exceeds 2.5% of the aggregate of the amounts shown in lines 17 to 39 of **Form 14** or lines 31 to 51 of **Form 15**, as appropriate,

the corresponding value, if not zero, must be stated (by way of supplementary note to **Form 17**) for each line in **Form 13, 14** or **15** and paragraph 16 applies to the *insurer* as if such contracts or assets had been included in **Form 17**.

FORMS

[Forms 9 – 17 to follow]

Statement of solvency

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

	Company registration number	GL/UK/CM	Period ended			Units
			day	month	year	
	R9					£000
			As at the end of this financial year	As at the end of the previous year	Source	
			1	2	Form	Line
						Column

GENERAL INSURANCE BUSINESS**Available assets**

Other than long term insurance business assets allocated towards general insurance business required minimum margin	11			See instructions 1 and 2
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Required minimum margin

Required minimum margin for general insurance business	12			12 . 49
Excess (deficiency) of available assets over the required minimum margin (11-12)	13			

LONG TERM INSURANCE BUSINESS**Available assets**

Long term insurance business admissible assets	21			10 . 11
Other than long term insurance business assets allocated towards long term insurance business required minimum margin	22			See instructions 1 and 3
Total mathematical reserves (after distribution of surplus)	23			See instruction 4
Other insurance and non-insurance liabilities	24			See instruction 5
Available assets for long term insurance business required minimum margin (21+22-23-24)	25			

Implicit items admitted under Rule 2.10 [Regulation 23(5) of the Insurance Companies Regulations 1994]

Future profits	31			
Zillmerising	32			
Hidden reserves	33			

Total of available assets and implicit items (25+31+32+33)	34			
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Required minimum margin

Required minimum margin for long term insurance business	41			60 . 69
Explicit required minimum margin (1/6 x 41, or minimum guarantee fund if greater)	42			
Excess (deficiency) of available assets over explicit required minimum margin (25-42)	43			
Excess (deficiency) of available assets and implicit items over the required minimum margin (34-41)	44			

CONTINGENT LIABILITIES

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Quantifiable contingent liabilities in respect of other than long term insurance business as shown in a supplementary note to Form 15	51			See instruction 6
Quantifiable contingent liabilities in respect of long term insurance business as shown in a supplementary note to Form 14	52			See instruction 6

Instructions for completion of Form 9

1. For a composite *insurer*, the whole Form must be completed, with the sum of the entries at lines 11 and 22 being equal to the entry at Form 10 line 29.
2. For an *insurer* transacting only *general insurance business*, only lines 11 to 13 and line 51 must be completed, with the entry at line 11 being equal to the entry at Form 10 line 29.
3. For an *insurer* transacting only *long-term insurance business*, only lines 21 to 52 must be completed, with the entry at line 22 being equal to the entry at Form 10 line 29.
4. The entry at line 23 must be equal to lines 11 and 63 in Form 14.
5. The entry at line 24 must be equal to the sum of lines 12 and 49 in Form 14.
6. The entries at lines 51 and 52 must not include provision for any liability to tax on capital gains referred to in paragraph 13(1)(b) of Appendix 9.1.

Statement of net assets

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Company
registration
number

GL/UK/CM

Period ended
day month year

Units

R10**£000**

		As at the end of this financial year 1	As at the end of the previous year 2	Source		
				Form	Line	Column
Long term insurance business - admissible assets	11			13	89	1
Long term insurance business - liabilities and margins	12			14	59	1

Other than Long term insurance business - admissible assets	21			13	89	1
Other than Long term insurance business - liabilities	22			15	69	1
Net admissible assets (21-22)	23					
Other assets allowed to be taken into account in covering the required minimum margin	Unpaid amounts (including share premium) on partly paid shares	24				
	Supplementary contributions for a mutual carrying on general insurance business	25				
Liabilities allowed to be left out of account in covering the required minimum margin	Subordinated loan capital	26				
	Cumulative preference share capital	27				
Available assets (23 to 27)	29					

Represented by:

Paid up share capital (other than cumulative preference share capital)	51					
Amounts included in lines 24 to 27 above	52					
Amounts representing the balance of net assets	56					
Total (51 to 56) and equal to line 29 above	59					

**Movement of balance of net assets for solvency
purposes - as per line 56**

Balance brought forward at the beginning of the financial year	61			10	56	2
Retained profit/(loss) for the financial year	62			16	59	1
Movement in asset valuation differences	63					See instruction 2
Decrease/(increase) in the provision for adverse changes	64					See instruction 3
Other movements (particulars to be specified by way of supplementary note)	65					
Balance carried forward at the end of the financial year (61 to 65)	69					

Instructions for completion of Form 10

1. Amounts included at lines 24 to 27 must be as determined in accordance with Rule 2.10.
2. Line 63 must be equal to lines 13.92.2 to 13.95.2 less lines 13.92.1 to lines 13.95.1 of the Form for the total other than *long-term insurance business assets* category.
3. Line 64 must be Form 15.61.2 less 15.61.1.

General insurance business : Calculation of required margin of solvency - first method

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

			Company registration number	GL/UK/CM	Period ended			Units
			R11		day	month	year	£000
					This financial year			Previous year
					1			2
Gross premiums receivable			11					
Premium taxes and levies (included in line 11)			12					
Sub-total A (11-12)			13					
Adjusted Sub-total A if financial year is not a 12 month period to produce an annual figure			14					
Division of Sub-total A (or adjusted Sub-total A if appropriate)	Other than health insurance	Up to and including sterling equivalent of 10M EURO x 18/100	15					
		Excess (if any) over 10M EURO x 16/100	16					
	Health insurance	Up to and including sterling equivalent of 10M EURO x 6/100	17					
		Excess (if any) over 10M EURO x 16/300	18					
Sub-total B (15+16+17+18)			19					
Claims paid			21					
Claims outstanding carried forward at the end of the financial year	For insurance business accounted for on an underwriting year basis		22					
	For insurance business accounted for on an accident year basis		23					
Claims outstanding brought forward at the beginning of the financial year	For insurance business accounted for on an underwriting year basis		24					
	For insurance business accounted for on an accident year basis		25					
Sub-total C (21+22+23-(24+25))			29					
Amounts recoverable from reinsurers in respect of claims included in Sub-total C			30					
Sub-total D (29-30)			39					
First result Sub-total B x Sub-total D (or, if ½ is a greater fraction, x ½) Sub-total C			41					

General insurance business : Calculation of required margin of solvency - second method, and statement of required minimum margin

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

		Company registration number	GL/UK/CM	Period ended			Units
				day	month	year	£000
		R12					£000
		1	2	Source			
				Form	Line	Column	
Reference period (No. of financial years) Insert "0" if there is no reference period otherwise insert "3" or "7" <input type="text"/>		11					See instruction 1
Claims paid in reference period		21					
Claims outstanding carried forward at the end of the reference period	For insurance business accounted for on an underwriting year basis	22					
	For insurance business accounted for on an accident year basis	23					
Claims outstanding brought forward at the beginning of the reference period	For insurance business accounted for on an underwriting year basis	24					
	For insurance business accounted for on an accident year basis	25					
Sub-total E (21+22+23-(24+25))		29					
Sub-total F - Conversion of Sub-total E to annual figure (Multiply by 12 and divide by number of months in reference period)		31					
Division of Sub-total F	Other than health insurance	Up to and including sterling equivalent of 7M EURO x 26/100	32				
		Excess (if any) over 7M EURO x 23/100	33				
	Health insurance	Up to and including sterling equivalent of 7M EURO x 26/300	34				
		Excess (if any) over 7M EURO x 23/300	35				
Sub-total G (32 to 35)		39					
Second result $\text{Sub-total G} \times \frac{\text{Sub-total D}}{\text{Sub-total C}}$ (or, if $\frac{1}{2}$ is a greater fraction, $\times \frac{1}{2}$)		41					
First result		42					11 . 41
Required margin of solvency (the higher of lines 41 and 42)		43					
Minimum guarantee fund		44					
Required minimum margin (the higher of lines 43 and 44)		49					

Instruction for completion of Form 12

If the *insurer* has not been in existence long enough to acquire a reference period, lines 21 to 41 must be ignored.

Analysis of admissible assets

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Category of assets

		Company registration number	GL/UK/CM	Period ended			Units	Category of assets
				day	month	year		
		R13					£000	
Investments				As at the end of this financial year		1	As at the end of the previous year	
						2		
Land and buildings				11				
Investments in group undertakings and participating interests	UK insurance business dependants	Shares	21					
		Debt securities issued by, and loans to, dependants	22					
	Other insurance dependants	Shares	23					
		Debt securities issued by, and loans to, dependants	24					
	Non-insurance dependants	Shares	25					
		Debt securities issued by, and loans to, dependants	26					
	Other group undertakings and participating interests	Shares	27					
		Debt securities issued by, and loans to, group undertaking	28					
		Participating interests	29					
		Debt securities issued by, and loans to, undertakings in which the insurer has a participating interest	30					
Total sheet 1 (11 to 30)				39				

Analysis of admissible assets

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Category of assets

		Company registration number	GL/UK/CM	Period ended			Units	Category of assets	
				day	month	year			
		R13					£000		
Investments (continued)				As at the end of this financial year		As at the end of the previous year			
Deposits with ceding undertakings				1		2			
Assets held to cover linked liabilities									
Other financial investments	Equity shares				41				
	Other shares and other variable yield securities				42				
	Holdings in collective investment schemes				43				
	Rights under derivative contracts				44				
	Debt securities and other fixed income securities	Fixed interest	Approved securities		45				
			Other		46				
		Variable interest	Approved securities		47				
			Other		48				
	Participation in investment pools				49				
	Loans secured by mortgages				50				
	Other loans	Loans to public or local authorities and nationalised industries or undertakings				51			
		Loans secured by policies of insurance issued by the insurer				52			
		Other				53			
	Deposits with approved credit institutions and approved financial institutions	Withdrawal subject to a time restriction of one month or less				54			
		Withdrawal subject to a time restriction of more than one month				55			
Other				56					
Deposits with ceding undertakings				57					
Assets held to match linked liabilities	Index linked				58				
	Property linked				59				
Reinsurers' share of technical provisions	Provision for unearned premiums				60				
	Claims outstanding				61				
	Provision for unexpired risks				62				
	Other				63				
Total sheet 2 (41 to 63)				69					

Analysis of admissible assets

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Category of assets	Company registration number	GL/UK/CM	Period ended			Units	Category of assets
			day	month	year		
R13						£000	
Debtors						As at the end of this financial year	As at the end of the previous year
Other assets						1	2
Debtors arising out of direct insurance operations	Policyholders		71				
	Intermediaries		72				
Salvage and subrogation recoveries			73				
Debtors arising out of reinsurance operations	Due from ceding insurers and intermediaries under reinsurance business accepted		74				
	Due from reinsurers and intermediaries under reinsurance contracts ceded		75				
Other debtors	Due from dependants	Due in 12 months or less after the end of the financial year	76				
		Due more than 12 months after the end of the financial year	77				
	Other	Due in 12 months or less after the end of the financial year	78				
		Due more than 12 months after the end of the financial year	79				
Tangible assets			80				
Cash at bank and in hand	Deposits not subject to time restriction on withdrawal, with approved credit institutions and approved financial institutions and local authorities		81				
	Cash in hand		82				
Other assets (particulars to be specified by way of supplementary note)			83				
Prepayments and accrued income	Accrued interest and rent		84				
	Deferred acquisition costs		85				
	Other prepayments and accrued income		86				
Deductions (under rules 4.14(2)(b) and 4.14(3)) [regulations 57(2)(b) and 57(3) of the Insurance Companies Regulation 1994] from the aggregate value of assets			87				
Total sheet 3 (71 to 86 less 87)			88				
Grand total of admissible assets (39+69+88)			89				

Reconciliation to asset values determined in accordance with the shareholder accounts rules

Total admissible assets (as per line 89 above)	91		
Total assets in excess of the admissibility limits of Appendix 4.2, [Schedule 12 of the Insurance Companies Regulations 1994] (as valued in accordance with those Rules before applying admissibility limits)	92		
Solvency margin deduction for insurance dependants	93		
Other differences in the valuation of assets (other than for assets not valued above)	94		
Assets of a type not valued above, (as valued in accordance with the shareholder accounts rules)	95		
Total assets determined in accordance with the shareholder accounts rules (91 to 95)	99		
Amounts included in line 89 attributable to debts due from related insurers, other than those under contracts of insurance or reinsurance	100		

Instructions for completion of Form 13

1. Form 13 must be completed for the total *long-term insurance business assets* of the *insurer* or branch and for each fund or group of funds for which separate assets are appropriated. The words "total *long-term insurance business assets*" or the name of the fund must be shown against the heading "Category of assets". The corresponding code box must contain "10" for the total assets and, in the case of separate funds, code numbers allocated sequentially beginning with code "11".

2. Form 13 must be completed in respect of the total assets of the *insurer* or branch other than any *long-term insurance business assets*. The words "total other than *long-term insurance business assets*" must be shown against the heading "Category of assets", and the corresponding code box must contain "1".

3. (a) In the case of the United Kingdom branch return of an *external insurer* (other than a *pure reinsurer*) Form 13 must be completed for the following categories of assets -

Category	Code - other than <i>long-term insurance business assets</i>	Code - <i>long-term insurance business assets</i>
Assets deposited under rule 8.1	2	6
Assets maintained in the United Kingdom	3	7
Assets maintained in the United Kingdom and the other <i>EEA States</i>	4	8

(b) In the case of an EEA branch of a *UK deposit insurer*, Form 13 must be completed for the following categories of assets -

Category	Code - other than <i>long-term insurance business assets</i>	Code - <i>long-term insurance business assets</i>
Assets deposited under rule 8.1	2	6
Assets maintained in the United Kingdom and the other <i>EEA States</i>	4	8
Assets maintained in the United Kingdom and the <i>EEA States</i> where <i>insurance business</i> is carried on	5	9

4. In lines 11 to 86 -

(a) for the purpose of classifying (but not valuing) assets, headings and descriptions used above, wherever they also occur in the balance sheet format in Schedule 9A to the *Companies Act*, must have the same meaning as in that Schedule,

(b) assets must be valued in accordance with rule 9.10, and

(c) assets of any particular description must be shown after deduction of assets of that description which (for any reason) fall to be left out of account under rule 4.14 (2) (a).

5. The aggregate value of those investments which are:

- (i) *unlisted* investments falling within any of lines 41, 42, 46 or 48 which have been valued in accordance with rule 4.8;
- (ii) *listed* investments falling within any of lines 41, 42, 46 or 48 which have been valued in accordance with rule 4.8 and which are not *ready realisable*;
- (iii) units or other beneficial interests in *collective investment schemes* falling within rule 4.9 (1);
or
- (iv) reversionary interests or remainders in property other than land or buildings,

must be stated by way of a supplementary note to this Form, together with a description of such investments.

- 6. The aggregate value of those investments falling within lines 46 or 48 which are hybrid *securities* are to be stated by way of a supplementary note to this Form.
- 7. Amounts in respect of salvage or subrogation included above other than at line 73 are to be stated by way of a supplementary note.
- 8. The entry at line 85 must be equal to the sum of lines 22.29.3 and lines 25.24.99-99.
- 9. In line 93 "Solvency margin deduction for insurance *subsidiary undertakings*" refers to deductions under rule 4.3(2)(c).
- 10. In line 95 "Assets of a type not valued above" refers to assets left out of account under rule 4.1(3).
- 11. Lines 60 to 63 and 85 relate only to *general insurance business*.
- 12. Lines 60 to 63 and 85 must be left blank for "Category of assets" codes "2", "3", "4" and "5".

Long term insurance business liabilities and margins

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Category of assets

Company
registration
number

GL/UK/CM

Period ended
day month year

Units

Category
of
assets**R14****£000**

		As at the end of this financial year 1	As at the end of the previous year 2	Source
Mathematical reserves, after distribution of surplus		11		See instruction 2
Cash bonuses which had not been paid to policyholders prior to end of the financial year		12		See instruction 3
Balance of surplus/(valuation deficit)		13		See instruction 4
Long term insurance business fund carried forward (11 to 13)		14		See instruction 5
Claims outstanding which had fallen due for payment before the end of the financial year	Gross amount	15		
	Reinsurers' share	16		
	Net (15-16)	17		
Provisions for other risks and charges	Taxation	21		
	Other	22		
Deposits received from reinsurers		23		
Creditors and other liabilities	Arising out of insurance operations	Direct insurance business	31	
		Reinsurance accepted	32	
		Reinsurance ceded	33	
	Debenture loans	Secured	34	
		Unsecured	35	
	Amounts owed to credit institutions		36	
	Other creditors	Taxation	37	
		Other	38	
Accruals and deferred income		39		
Provision for adverse changes (calculated in accordance with rule 5.3) [Regulation 61 of the Insurance Companies Regulations 1994]		41		
Total other insurance and non-insurance liabilities (17 to 41)		49		
Excess of the value of net admissible assets		51		See instruction 6
Total liabilities and margins		59		
Amounts included in line 59 attributable to liabilities to related companies other than those under contracts of insurance or reinsurance		61		
Amounts included in line 59 attributable to liabilities in respect of property linked benefits		62		
Amount of any additional mathematical reserves included in line 51 which have been taken into account in the appointed actuary's certificate		63		See instruction 7

Instructions for completion of Form 14

1. The Form must be completed for the total *long-term insurance business liabilities* and margins of the *insurer* or branch and for each fund or group of funds for which separate assets are appropriated. The words “total *long term insurance business assets*” or the name of the fund must be shown against the heading “Category of assets”. The corresponding code box must be completed with the same entries as were used on the corresponding Form 13.
2. The entry at line 11 must equal the sum of lines 21, 43, 44 and 45 of the appropriate Form or Forms 58.
3. The entry at line 12 must equal line 42 of the appropriate Form or Forms 58.
4. The entry at line 13 must equal line 49 of the appropriate Form or Forms 58.
5. The entry at line 14 must equal line 59 of the appropriate Form or Forms 40.
6. The entry at line 51 must be:
 - (a) the value of the *admissible assets* (as included in line 89 of the appropriate Form 13) representing the *long-term insurance funds*, fund or group of funds to which the Form relates, less
 - (b) the amount of those funds, fund or group of funds, being the sum of the amounts shown at lines 14 and 49.
7. The entry at line 63 must be the amount specified in the *appointed actuary's* certificate in accordance with paragraph 8(a)(ii) of Appendix 9.6, but only insofar as it relates to the fund, funds or group of funds to which this Form 14 relates.

Liabilities (other than long term insurance business)

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Company registration number GL/UK/CM Period ended
 day month year Units

R15							£000
			As at the end of this financial year 1		As at the end of the previous year 2		
Technical provisions (gross amount)	Provision for unearned premiums		11				
	Claims outstanding		12				
	Provision for unexpired risks		13				
	Equalisation provisions	Credit business	14				
		Other than credit business	15				
	Other		16				
Total (11 to 16)		19					
Provisions for other risks and charges	Taxation		21				
	Other		22				
Deposits received from reinsurers			31				
Creditors	Arising out of insurance operations	Direct insurance business	41				
		Reinsurance accepted	42				
		Reinsurance ceded	43				
	Debenture loans	Secured	44				
		Unsecured	45				
	Amounts owed to credit institutions		46				
	Other creditors	Taxation	47				
		Recommended dividend	48				
		Other	49				
Accruals and deferred income			51				
Total (19 to 51)			59				
Provision for adverse changes calculated in accordance with Rule 5.3 [regulation 61 of the Insurance Companies Regulations 1994]			61				
Cumulative preference share capital			62				
Subordinated loan capital			63				
Total (59 to 63)			69				
Amounts included in line 69 attributable to liabilities to related insurers, other than those under contracts of insurance or reinsurance			71				

Instruction for completion of Form 15

1. Amounts in lines 11 to 13 and 16 must be stated gross of *reinsurers'* share.
2. The aggregate amount of any accrued dividend in respect of cumulative preference *shares* issued by the *insurer* must be shown by way of a supplementary note to this Form.
3. Only equalisation provisions that are created as a result of a regulatory requirement are to be included at lines 14 and 15

Profit and loss account (non-technical account)

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

		Company registration number	GL/UK/CM	Period ended			Units
				day	month	year	
		R16					£000
		This financial year	Previous year	Source			
		1	2	Form	Line	Column	
Transfer (to)/from the general insurance business technical account	From Form 20	11		20	.	59	
	Equalisation provisions	12					
Transfer from the long term insurance business revenue account		13		40	.	26	
Investment income	Income	14					
	Value re-adjustments on investments	15					
	Gains on the realisation of investments	16					
Investment charges	Investment management charges, including interest	17					
	Value re-adjustments on investments	18					
	Loss on the realisation of investments	19					
Allocated investment return transferred to the general insurance business technical account		20		20	.	51	
Other income and charges (particulars to be specified by way of supplementary note)		21					
Profit or loss on ordinary activities before tax (11+12+13+14+15+16-17-18-19-20+21)		29					
Tax on profit or loss on ordinary activities		31					
Profit or loss on ordinary activities after tax (29-31)		39					
Extraordinary profit or loss (particulars to be specified by way of supplementary note)		41					
Tax on extraordinary profit or loss		42					
Other taxes not shown under the preceding items		43					
Profit or loss for the financial year (39+41-(42+43))		49					
Dividends (paid and proposed)		51					
Profit or loss retained for the financial year (49-51)		59					

Analysis of derivative contracts

Name of insurer

Global business/UK branch business/EEA branch business

Insurance Business : Long term/Other than long term

Financial year ended

Category of assets

		Company registration number	GL/UK/CM	Period ended			Units	Category of assets
		R17		day	month	year	£000	
Derivative contracts		As at the end of this financial year			As at the end of the previous year			
		Assets 1	Liabilities 2	Assets 3	Liabilities 4			
Futures contracts	Fixed-interest securities	11						
	Equity shares	12						
	Land	13						
	Currencies	14						
	Other	15						
Options	Fixed-interest securities	21						
	Equity shares	22						
	Land	23						
	Currencies	24						
	Other	25						
Contracts for differences	Fixed-interest securities	31						
	Equity shares	32						
	Land	33						
	Currencies	34						
	Other	35						
Adjustments for variation margin		41						
Total (11 to 41)		49						

Instructions for completion of Form 17

1. Form 17 must be completed in respect of the total *general insurance business assets* and in respect of the total *long-term insurance business assets*, if any, of the *insurer* or branch. Form 17 must also be completed for each fund or group of funds referred to in instruction 1 to Form 13.
2. The codes specified in instructions 1 to 3 to Form 13 must be used as appropriate.
3. *Derivative contracts* must be analysed according to the description of assets shown in the second column of Form 17 which represents the principal subject of the contract.
4. *Derivative contracts* must be reported as assets in column 1 of Form 17 if their value to the *insurer* (gross of *variation margin*) is positive and as liabilities in column 2 of Form 17 if their value (gross of *variation margin*) to the *insurer* is negative.
5. All amounts included at lines 11 to 35 of Form 17 in respect of *derivative contracts* must be determined without making any allowance for *variation margin*.
6. Amounts in respect of a *derivative contract* may only be included net of amounts in respect of any other *derivative contract* if -
 - (a) obligations of the *insurer* under the contracts may be set off against each other under generally accepted accounting practice; and
 - (b) such other contract has the effect (in whole or in part) of closing out the obligations of the *insurer* under the first mentioned contract.
7. The effect of any *variation margin* upon amounts included at lines 11 to 35 of Form 17 must be shown at line 41.
8. The entry at 17.49.1 must be included at 13.44.1.
9. The entry at 17.49.2 must be included at 14.47.1 or 15.49.1. as appropriate.
10. Rights to recover assets transferred by way of *initial margin* must not be shown on Form 17.

APPENDIX 9.2 (rules 9.14 to 9.22)

GENERAL INSURANCE BUSINESS: REVENUE ACCOUNT AND ADDITIONAL INFORMATION (FORMS 20 TO 39)

Introduction

1. All the Forms included in the part of the *return* to which this Appendix relates (**Forms 20 to 39**) are to be laid out as shown in this Appendix, except that the instructions to Forms need not be reproduced.
2. The provisions of paragraph 1(2) and paragraphs 2 to 7 of **Appendix 9.1**, unless otherwise provided, also apply for the purposes of this Appendix.

Currency

3. (1) Notwithstanding the provisions of 2, amounts on **Forms 26 to 29** submitted in accordance with rule 9.17 and on **Forms 31, 32 and 34** submitted in accordance with rule 9.19 in respect of business carried on in any country other than the United Kingdom must be shown in the 'currency of the country concerned', except that figures must be shown in sterling in those columns and lines which the forms indicate are always to contain figures expressed in sterling.
- (2) For every currency other than sterling in which amounts are shown on the Forms referred to in (1), an entry must be made on **Form 36** to show the rate used to convert those amounts to sterling for inclusion elsewhere in the *returns*.
- (3) Notwithstanding the provisions of 2, all amounts included in -
 - (a) columns 1, 2, 3 and 11 of **Forms 23, 26 and 27**;
 - (b) columns 3 and 10 of any **Form 31 or 32** prepared in respect of United Kingdom or *home foreign business*; and
 - (c) columns 1 and 8 of any **Form 34** prepared in respect of United Kingdom or *home foreign business*,must be expressed in sterling as if conversion of every 'major currency' had taken place at the closing middle rate on the last day for which the appropriate rate is available in the *financial year in question*.
- (4) For the purposes of (3), a **major currency** is -
 - (a) in the case of any business carried on outside the UK, the currency of the country;

- (b) in the case of any other business, United States dollars, Canadian dollars, Euro and any other currency which the *insurer* elects to treat as a major currency.
 - (5) A *insurer* need not apply (3) to amounts shown in any line of any of the forms mentioned in that sub-paragraph representing an accident year or underwriting year ending before 23 December 1996.
 - (6) For the purposes of (1), the **currency of the country concerned**, in the case of a country participating in the European Economic and Monetary Union means for Forms completed in respect of a *financial year* ending on or after 31 December 1999, the Euro (whether or not the amounts reported on those Forms relate to accident or underwriting years ending on or after 31 December 1999).
4. All amounts shown in sterling must be shown to the nearer £1,000. Amounts in any other currency on **Forms 26 to 29, 31, 32 and 34** must be shown to the nearer 1,000 principal monetary units of that currency except that, where the rate of exchange of the currency in relation to £1 sterling on the last day of the *financial year in question* exceeded 1,000 principal monetary units of that currency, the amounts must be shown to the nearer 1,000,000 principal monetary units and ‘000,000’ must be inserted in the box labelled ‘Monetary units’. In other cases, this box must be completed by inserting ‘000’.
5. Where premiums are written by a *insurer* or *claims* are incurred by it under a *reinsurance* treaty -
- (1) notwithstanding 2 to 4, amounts shown on **Forms 26 to 29** may be shown in sterling, in United States dollars, in Canadian dollars or in Euro; and
 - (2) if in a *financial year* the proportion of *gross premiums written*, or of *claims* incurred by the *insurer* or outstanding from the *insurer*, in any one currency other than sterling, United States dollars or Canadian dollars exceeds 10% of such premiums or *claims* under all such treaties, **Forms 26 to 29** may be prepared in that currency,

and where these provisions have been applied in respect of a *reinsurance* treaty in relation to a *financial year*, those provisions must be applied in the same manner in respect of that treaty in relation to any later *financial year*.

Accounting classes

- 6. (1) *Direct and facultative insurance business* must be included in the *return* in accordance with the *accounting classes*, save that -
 - (a) where a *insurer* only undertakes business in *accounting class* 4 in respect of risks relating to hovercraft, it may include such business in *accounting class* 3 if it also undertakes business in that class;

- (b) an *insurer* may include in *accounting class 5* business covering liability for loss of, or damage to, goods in transit which would otherwise be included in *accounting class 2*, provided that the policy does not cover damage to vehicles except as an *ancillary risk*; and
 - (c) an *insurer* may include in *accounting class 1* business falling within *general insurance business class 1(p)*.
- (2) *Non-proportional treaty reinsurance* business must be included in *accounting class 9* and *proportional treaty reinsurance* must be included in *accounting class 10* save that -
- (a) an *insurer* may include in *accounting class 11* treaty business falling within *general insurance business classes 1(p), 5, 6, 7, 11 and 12*; and
 - (b) a *insurer* must include in *accounting class 9* proportional retrocessions of *non-proportional treaty reinsurance* business.
7. Where an *insurer* includes *insurance business* in another *accounting class* under 6(1) or 6(2)(a), the following information must be stated by way of a supplementary note to **Form 20** -
- (a) the nature of any business included in another *accounting class* pursuant to 6(1) or 6(2)(a); and
 - (b) the reason for such inclusion.
8. Boxes marked 'Accounting class' must be completed so as to show the number of the *accounting class*. '99' must be shown in the case of the summary account in **Form 20**.

Premiums

9. In **Forms 23, 26, 27, 31 and 32** -
- (a) *gross premiums earned* in respect of an accident year must be such proportion of *gross premiums written* as is attributable to risks borne by the *insurer* during that accident year; and
 - (b) the *reinsurers'* share of premiums earned must be attributed to the same accident years as the corresponding *gross premiums earned*, so as to calculate the *net earned premiums* for each accident year.
10. In **Forms 24, 25, 28, 29 and 34** -
- (a) *gross premiums written* in an underwriting year must be the amount of such premiums arising in respect of *contracts of insurance incepted* during that year, whether or not they are received during that year; and

- (b) the *reinsurers'* share of premiums written must be attributed to the same underwriting years as the corresponding *gross premiums written*.
11. For the purposes of 10 and 14, where an *insurer* has acquired *policies* under a transfer approved under Part VII of the *Act* or its predecessor legislation or approved by the competent authority of another *EEA State* under Article 12 of the *Third Non-Life Directive*, the *policies* transferred to the *insurer* must be taken to have *incepted* on the date of such transfer.
12. In all Forms to which this Appendix relates, amounts required to be shown in respect of premiums must be shown before deduction for commissions.

Claims

13. (1) In **Forms 23, 26, 27, 31 and 32**, where an amount or number is required to be shown for *claims* in respect of an accident year, that amount or number must be determined on the basis of *claims* arising from incidents occurring during that accident year.
- (2) For the purposes of (1), an incident giving rise to a claim under a *claims-made policy* is deemed to occur on the earlier of -
- (a) the date on which it is notified in accordance with the terms of that *policy*; or
 - (b) the date on which the period for which cover is provided under that *policy* expires.
- (3) For the purposes of (1), where an *insurer* has assumed, pursuant to a contract, responsibility (whether wholly or in part) for the payment or reimbursement of *claims* made under *policies* effected by another *insurer*, all incidents occurring prior to the date of such contract and giving rise to *claims* under those *policies* are deemed have occurred on the date of such contract.
- (4) In the application of (3), the reference to responsibility assumed by an *insurer* includes responsibility assumed as a *reinsurer* or under a transfer under Part VII of the *Act* or its predecessor legislation or approved by the competent authority of another *EEA State* under Article 12 of the *Third Non-Life Directive*; and in the case of such a transfer the date of the contract is taken to be the date of the transfer.
14. In **Forms 24, 25, 28, 29 and 34**, where an amount is required to be shown for *claims* in respect of a *financial year*, that amount must be determined on the basis of *claims* arising under *contracts of insurance incepted* during that year.
15. In all Forms to which this Appendix relates, amounts required to be shown for *claims* must not include amounts in respect of *claims management costs*.

UK and overseas business

16. (1) For each *accounting class* there must be stated separately for business accounted for on an accident year basis and on an underwriting year basis the following by way of supplementary note to **Form 20** -
- (a) the total *gross premium written* and the amounts attributable to UK and to overseas business; and
 - (b) the *reinsurers'* amount in respect of each of the amounts required to be stated under (a).
- (2) For the purposes of this Appendix, gross premiums written must be shown or included as UK premiums if, in the case of direct or facultative reinsurance, the contract of insurance was effected in the United Kingdom or if, in the case of a reinsurance treaty, the cedant was an insurer having its head office in the United Kingdom or was a member of the *Society*; and 'overseas premiums' must be construed accordingly.

Transfers of general insurance business

17. (1) If, during the *financial year*, *policies* already effected by another *insurer* have been transferred to the *insurer*, an *insurer* must state, in respect of each *accounting class*, the following by way of supplementary note to **Form 23** and **24** -
- (a) the date of the transfer;
 - (b) whether the transfer was approved under Part VII of the *Act* or its predecessor legislation or approved by the competent authority of another *EEA State* under Article 12 of the *Third Non-Life Directive* or was effected by novation;
 - (c) any amounts included in premiums and *claims* in respect of consideration for the transfer;
 - (d) amounts required to be stated under (c) analysed by risk group and business category;
 - (e) the earliest and latest dates upon which the relevant *policies* *incept*; and
 - (f) whether or not any of the *policies* has a duration of longer than 12 months and, if so, the date by which all *policies* will have expired.
- (2) (1) does not apply in respect of any transfer by way of novation unless the amounts mentioned in (1)(c) exceed in aggregate 2.5% of the insurer's gross premium income for the financial year in question.

Unearned premiums

18. In **Forms 21** and **25**, the basis on which unearned premiums are calculated and the reason for adopting this basis must be stated by way of supplementary note.

Provision for unexpired risks

19. (1) The amount included for the provision for unexpired risks in **Form 22** or **25** prepared in respect of an *accounting class* must be determined without taking into account any surplus expected to arise on the unexpired risks falling within other *accounting classes*.
- (2) Where in determining the amount of the overall provision for unexpired risks (line 13 in **Form 15** less line 62 in **Form 13**) credit has been taken for any aggregate surplus expected to arise on the unexpired risks falling in any accounting class, the amount of that credit must be included as a negative amount at line 19 of **Form 22** or line 23 of **Form 25**, as appropriate, for that accounting class.
20. (1) Where the amount included at column 3 line 19 (provision for unexpired risks) in any **Form 22** or at column 99-99 of line 23 (provision for unexpired risks) in any **Form 25** has been determined after taking into account expected investment return, the following must be stated by way of supplementary note-
- (a) the provision for unexpired risks before taking such investment return into account;
- (b) the rates of investment return assumed; and
- (c) the average interval between the end of the *financial year in question* and the date at which *claims* are expected to be settled in cash.

Cessation of business

21. (1) If the *insurer* has effected no 'new *contracts of insurance*' of any one or more *classes of general insurance business* during the *financial year*, the date on which the last 'new contract' of each such *class* was effected must be stated by way of supplementary note to **Form 20**.
- (2) For the purposes of this paragraph and 22, a **new contract of insurance** is any *contract of insurance* effected by the *insurer* other than in fulfilment of its obligations under subsisting *contracts of insurance*.

Claims management costs

22. (1) In **Forms 22** and **24**, the basis used for the determination of amounts for *claims management costs* payable in the *financial year in question* and carried

forward to the following *financial year* must be stated by way of supplementary note.

- (2) If, in respect of any *accounting class* -
 - (a) no amount for *claims management costs* is shown as being carried forward to the following *financial year*; and
 - (b) an amount for net claims is shown as being carried forward to that year,

the reason for anticipating that there will be no *claims management costs* incurred during the following *financial years* must be included in the note required by (1) .

- (3) If, within an *accounting class*, an insurer has ceased to effect 'new *contracts of insurance*' during the *financial year in question*, the basis upon which any additional costs arising as a result of such cessation have been determined or the reason for anticipating that no such additional costs will be incurred must be included in the note required by (1).
- (4) Where the amount in respect of *claims management costs* carried forward and included in any Form 22 or 24 has been determined after taking into account expected investment return, there must be stated by way of supplementary note to that Form 22 or 24 -
 - (a) the rates of investment return assumed; and
 - (b) the average interval between the end of the *financial year in question* and the date by which the *claims management costs* are expected to be expended.

Acquisition costs

23. The basis used for the determination of amounts for acquisition costs (other than commission) payable in the *financial year in question* and carried forward to the next *financial year*, as shown at line 22 of **Form 22** and line 42 of **Form 24**, must be stated by way of a supplementary note to those Forms.

Underwriting year accounting

24. (1) With reference to the *financial year in question* and in respect of each *accounting class*, the following information must be stated by way of supplementary note to **Form 24** -
 - (a) the reason for accounting for such business on an underwriting year basis;

- (b) the basis for distinguishing between such business and any other business falling within the same *accounting class* accounted for on an accident year basis;
 - (c) the accounting policy adopted for determining the provision for *claims* outstanding; and
 - (d) if the information provided in (a) to (c) differs in respect of risks *incepted* in the *financial year in question* from risks of a similar description *incepted* in *previous financial years*, the reason for that difference.
- (2) Where the provision for *claims* outstanding is set in respect of any business using the ‘non-annual method’, the note required by (1)(a) must include the following information -
- (a) the reason for using the ‘non-annual method’;
 - (b) the basis for distinguishing between such business and other business accounted for on an underwriting year basis falling within the same *accounting class*;
 - (c) the normal period for which an underwriting year is left ‘open’ or, if that period differs for different types of business within an *accounting class* -
 - (i) the basis for distinguishing between the types of business,
 - (ii) the normal period for each type, and
 - (d) where an underwriting year is left ‘open’ for longer than the normal period, the reason for not ‘closing the year’.
- (3) For the purposes of this Appendix -
- (a) **non-annual method** refers to the method described by paragraph 52 of the *insurance accounts rules*; and
 - (b) a year is **open** with respect to any business *incepted* during that year if the provision for outstanding *claims* in respect of that business is set using the ‘non-annual method’ and if so set previously has not now been replaced in accordance with the requirements of paragraph 52(4) of the *insurance accounts rules*, and **closed year** and **closing a year** is construed accordingly.

Business managed together

25. (1) For the purposes of **Forms 25** and **29**, risks may be regarded as managed together if -

- (a) they *incept* in the same *financial year* and are accounted for using the ‘non-annual method’; and
 - (b) they may be treated as managed together under generally accepted accounting practice.
- (2) Where any amount is shown on **Form 25** or **29** for the transfer of anticipated surplus, the following must be stated by way of supplementary note to that Form -
- (a) a description of the business in respect of which the anticipated surplus arises and of the business in respect of which the deficit to be offset arises (including in the case of **Form 25** the risk groups or *business categories* into which such business falls); and
 - (b) the reason for treating the business as managed together.

Application of accounting practice

26. (1) Amounts in respect of inwards and outwards *contracts of insurance* must be classified for inclusion in **Forms 20** to **39** according to their economic substance and in accordance with generally accepted accounting practice.
- (2) Where amounts in respect of an inwards or outwards *contract of insurance* have been excluded from the revenue account, the following must be shown by way of supplementary note to **Form 20** -
- (a) a description of the terms of that contract;
 - (b) a description of the accounting treatment adopted and an explanation for adopting that treatment;
 - (c) a statement of the amounts paid and received during the *financial year* under that contract; and
 - (d) a statement of the amounts in respect of that contract included in each Form prepared under this Appendix or **Appendix 9.1**.
- (3) A *insurer* may elect to show the information required by (1) in respect of groups of contracts which were effected in the same *financial year* with substantially the same contract terms and in respect of which the same accounting treatment has been adopted.

Discounting

27. (1) Sheet 2 of **Form 30** need only be completed if the provision for *claims* outstanding being discounted (before deduction for discounting) exceeds 25%

of the total provision for *claims* outstanding (before deduction for discounting).

- (2) Where in accordance with (1) no Sheet 2 is prepared -
 - (a) lines 21 and 29 of Sheet 1 need not be completed; and
 - (b) lines 11 to 20 need only be completed in respect of those currencies for which the provision for *claims* outstanding being discounted (before deduction for discounting) exceeds 25% of the total provision for that currency for *claims* outstanding (before deduction for discounting).
- (3) For the purposes of **Form 30**, a **major currency** is a currency in respect of which the provision for *claims* outstanding (before deduction for discounting) is not less than 10% of the total provision for *claims* outstanding (before deduction for discounting).
- (4) In **Form 30**, the value of an asset or liability which would be treated as an asset or liability in a particular currency for the purposes of rule 7.1 (disregarding rule 7.6(1)) must be shown in that currency.
- (5) The following must be stated by way of supplementary note to **Form 30** -
 - (a) the risk groups and *business categories* where adjustments for discounting have been made; and
 - (b) in respect of each such risk group or *business category* -
 - (i) the methods used in calculating the deduction for discounting,
 - (ii) the rate of interest used for the calculation of present values,
 - (iii) the expected average interval between the date for settlement of *claims* being discounted and the end of the *financial year in question*, and
 - (iv) the criteria adopted for estimating the period that will elapse before *claims* are settled.

Reinsurance

28. Where the *reinsurers'* share of *claims* incurred (as stated in **Form 22** or **25**) includes amounts expected to be recovered from *reinsurers* more than 12 months after the payment of the underlying gross *claims* by the *insurer*, the following must be stated by way of supplementary note to **Form 22** or **25** (as appropriate) -
 - (a) the amount of such recoveries; and

- (b) the accounting treatment which has been adopted in respect of discounting such recoveries.

Risk groups

29. (1) Subject to (2), the name given in **Forms 31, 32 and 34** to a risk group must include a description of the risks within an *accounting class* included in that risk group.
- (2) Where the name required by (1) is not sufficient to identify the nature of the objects exposed to such risks and the nature of the cover provided against such risks, the information must be stated by way of supplementary note.
- (3) Subject to (1), the name given to a risk group must remain the same when that risk group is reported in subsequent *financial years*.

Continuation sheets

30. Continuation sheets to **Forms 31 and 34** need only be prepared in respect of *accounting class 7*.

FORMS

[**Forms 20 – 39** to follow]

General insurance business : Technical account (excluding equalisation provisions)

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

		Company registration number	GL/UK/CM	Period ended			Units	Accounting class/summary		
				day	month	year	£000			
		R20					£000			
Items to be shown net of reinsurance		This financial year			Previous year			Source		
								Form	Line	Column
This year's underwriting (accident year accounting)	Earned premium	11					21 . 19 . 5			
	Claims incurred	12					22 . 17 . 4			
	Claims management costs	13					22 . 18 . 4			
	Adjustment for discounting	14					22 . 52 . 4			
	Increase in provision for unexpired risks	15					22 . 19 . 4			
	Other technical income or charges (particulars to be specified by way of supplementary note)	16								
	Net operating expenses	17					22 . 42 . 4			
	Balance of year's underwriting (11-12-13+14-15+16-17)	19								
Adjustment for prior years' underwriting (accident year accounting)	Earned premium	21					21 . 11 . 5			
	Claims incurred	22					22 . 13 . 4			
	Claims management costs	23					22 . 14 . 4			
	Adjustment for discounting	24					22 . 51 . 4			
	Other technical income or charges (particulars to be specified by way of supplementary note)	25								
	Net operating expenses	26					22 . 41 . 4			
	Balance (21-22-23+24+25-26)	29								
Balance from underwriting year accounting	Per Form 24	31					24. 69. 99-99			
	Other technical income and charges (particulars to be specified by way of supplementary note)	32								
	Total	39								
Balance of all years' underwriting (19+29+39)		49								
Allocated investment return		51								
Transfer to non-technical account (49+51)		59								

General insurance business (accident year accounting) : Analysis of premiums

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Accounting class

Company registration number	GL/UK/CM	Period ended			Units	Accounting class
		day	month	year		
R21					£000	

Premiums receivable during the financial year		Gross premiums written		Reinsurers' share		Net of	
		Earned in previous financial years 1		Earned in previous financial years 3		Earned in previous financial years 5	
In respect of risks incepted in previous financial years		11					
		Earned in this financial year 1	Unearned at end of this financial year 2	Earned in this financial year 3	Unearned at end of this financial year 4	Earned in this financial year 5	Unearned at end of this financial year 6
In respect of risks incepted in previous financial years		12					
In respect of risks incepted in this financial year	For periods of less than 12 months	13					
	For periods of 12 months	14					
	For periods of more than 12 months	15					
Premiums receivable (less rebates and refunds) in previous financial years not earned in those years and brought forward to the financial year		16					
Total (12 to 16)		19					

General insurance business (accident year accounting) : Analysis of claims, expenses and technical provisions

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Accounting class

		Company registration number	GL/UK/CM	Period ended			Units	Accounting class
				day	month	year		
		R22					£000	
			Amount brought forward from previous financial year	Amount payable/receivable in this financial year	Amount carried forward to next financial year	Amount attributable to this financial year		
			1	2	3	4		
Claims incurred in respect of incidents occurring prior to this financial year	Gross amount	11						
	Reinsurers' share	12						
	Net (11-12)	13						
	Claims management costs	14						
Claims incurred in respect of incidents occurring in this financial year	Gross amount	15						
	Reinsurers' share	16						
	Net (15-16)	17						
	Claims management costs	18						
Provision for unexpired risks		19						
Net operating expenses	Commissions	21						
	Other acquisition expenses	22						
	Administrative expenses	23						
	Reinsurance commissions and profit participations	24						
	Total (21+22+23-24)	29						
Adjustments for discounting in respect of the items shown at lines 11 to 18 above	Gross amount	31						
	Reinsurers' share	32						
	Claims management costs	33						
	Total (31-32+33)	39						
Split of line 29	Prior financial years	41						
	This financial year	42						
Split of line 39	Incidents occurring prior to this financial year	51						
	Incidents occurring in this financial year	52						

Instructions for completion of Form 22

1. Amounts included at lines 11 to 18 must be shown undiscounted and related adjustments for discounting must be shown at lines 31 to 39.
2. The values in column 4 are calculated as follows:

for lines 11 to 18 values in columns 2+3-1;
for lines 21 to 29 and lines 41 to 42 values in columns 1+2-3;
for line 19, lines 31 to 39 and lines 51 to 52 values in columns 3-1.
3. Amounts shown at lines 11 to 13, lines 15 to 17 and lines 31 and 32 must exclude amounts in respect of *claims management costs*.

Instructions for completion of Form 23

1. All figures are to be shown net of the *reinsurers'* share.
2. The accident years shown at lines 11 to 20 must correspond to the *financial year in question* and the nine *previous financial years* respectively.
3. Columns 1 to 9 must be shown before deduction for discounting.
4. All amounts shown must exclude *claims management costs*.
5. The percentage shown at column 12 must be the ratio of the columns 3+4+5+6-2 to column 2.
6. The percentage shown at column 13 must be the ratio of columns 1+3+4+5+6 to column 11.
7. $23.29.5 + 23.29.6 = 22.13.3 + 22.17.3$; $23.29.7 + 23.29.8 = 22.13.1$;
 $23.29.10 = 22.31.3 - 22.32.3$; and $23.29.4 = 22.13.2 + 22.17.2$.
8. [deleted]
9. Columns 1, 11 and 13 need not be completed in respect of accident years ended before 23 December 1994.
10. The percentages shown at columns 12 and 13 must be expressed as percentages to one place of decimals.
11. *Insurance business* reported on any Form 33 may be reported on this Form at line 22 and not lines 11 to 21.

Instructions for completion of Form 24

1. The underwriting years shown between the columns headed "29 29" and "99 99" must correspond (in reverse order) to the *financial year in question* and the nine *previous financial years* respectively.
2. Amounts shown in lines 21 to 29 must exclude *claims management costs*.
3. For *accounting classes* 1 to 8 and 10, amounts in respect of underwriting years ended before 23 December 1993 may be included in the prior underwriting years column.
4. The amounts shown at lines 51 to 54 must exclude equalisation provisions.
5. The amounts shown at lines 11 to 49 must be amounts payable or *receivable* during the *financial year in question*.

Instructions for the completion of Form 25

1. The underwriting years shown between the columns headed "29 29" and "99 99" must correspond (in reverse order) to the *financial year in question* and the nine *previous financial years*, respectively.
2. Lines 11 to 15, 19 to 21 and 29 must be completed for open years and lines 11 to 18 and 21 to 29 for closed years.
3. Line 29 must equal line 53 less 54 on Form 24.
4. Lines 11 to 15 must be shown before adjustment for *discounting*.
5. Lines 11 to 14, 16 and 17 must exclude *claims management costs*.
6. For *accounting classes* 1 to 8 and 10, amounts in respect of *financial years* ended before 23 December 1993 may be included in the prior underwriting years column.
7. Amounts may only be included at line 19 in so far as they arise from the offset of anticipated surpluses and deficits on *insurance business* managed together as defined by paragraph 25 of Appendix 9.2.

General insurance business (accident year accounting) : Analysis of net claims and premiums by category for treaty reinsurance

Name of insurer

Accounting class

Global business/UK branch business/EEA branch business

Currency

Financial year ended

Company registration number

GL/UK/CM

Period ended
day month year

Monetary units

Business category

Accounting class

Currency

Category

Accident year ended		1	2	3	4	Claims outstanding carried forward		Claims outstanding brought forward		9	10	11	12	13
Month	Year					Reported (net)	Incurred but not reported (net)	Reported (net)	Incurred but not reported (net)					
		11												
		12												
		13												
		14												
		15												
		16												
		17												
		18												
		19												
		20												
Prior accident years		21												
Reconciliation		22												
Total (11 to 22)		29												

Instructions for completion of Form 26

1. All figures are to be shown net of the *reinsurers'* share.
2. The accident years shown at lines 11 to 20 must correspond to the *financial year in question* and the nine *previous financial years* respectively.
3. Columns 1 to 9 must be shown before deduction for *discounting*.
4. All amounts shown must exclude *claims management costs*.
5. The percentage shown at column 12 must be the ratio of the columns 3+4+5+6-2 to column 2.
6. The percentage shown at column 13 must be the ratio of columns 1+3+4+5+6 to column 11.
7. The aggregate of the sterling equivalent of an entry on Form 26 for all *business categories* within an *accounting class* must equal the corresponding entry on Form 23 for that *accounting class*.
8. The percentages shown at columns 12 and 13 must be expressed as percentages to one place of decimals.
9. The amounts shown in line 21 must be analysed on continuation sheets by accident year.
10. The box marked "Business category" must be completed by inserting one of the letters "a" to "h" according to which of the sub-paragraphs of rule 9.16(1) describes the *business category* to which the Form relates.

Instructions for completion of Form 27

1. All figures must be shown gross of the *reinsurers'* share.
2. The accident years shown at lines 11 to 20 must correspond to the *financial year in question* and the nine *previous financial years* respectively.
3. Columns 1 to 9 are to be shown before deduction for *discounting*.
4. All amounts shown must exclude *claims management costs*.
5. The percentage shown at column 12 must be the ratio of the columns 3+4+5+6-2 to column 2.
6. The percentage shown at column 13 must be the ratio of columns 1+3+4+5+6 to column 11.
7. $27.29.5+27.29.6 = 22.11.3+22.15.3$; $27.29.7+27.29.8 = 22.11.1$;
 $27.29.10 = 22.31.3$; and $27.29.4 = 22.11.2+22.15.2$.
8. The percentages shown at columns 12 and 13 must be expressed as percentages to one place of decimals.
9. The amounts shown in line 21 must be analysed on continuation sheets by accident year.
10. The box marked "Business category" must be completed by inserting one of the letters "a" to "h" according to which of the sub-paragraphs of rule 9.16(1) describes the *business category* to which the Form relates.

Instructions for completion of Form 28

1. The underwriting years shown between the columns headed "29 29" and "99 99" must correspond (in reverse order) to the *financial year in question* and the nine *previous financial years*.
2. Amounts shown in lines 21 to 29 must exclude *claims management costs*.
3. The amounts shown at lines 51 to 54 must exclude equalisation provisions.
4. For *accounting class 10* (other than *business categories* (c) and (d) and such other categories as have been reported previously on Form 29) amounts in respect of underwriting years ended before 23 December 1993 may be included in the prior underwriting years column and (if so) instruction 5 must not apply to such amounts.
5. The amounts shown in the first column must be analysed on continuation sheets by underwriting year (although amounts in respect of underwriting years beginning prior to 1 January 1983 may be shown in aggregate).
6. The box marked "Business category" must be completed by inserting one of the letters "a" to "h" according to which of the sub-paragraphs of rule 9.16(1) describes the *business category* to which the Form relates.
7. The amounts shown at lines 11 to 49 must be amounts payable or *receivable* during the *financial year in question*.

Instructions for completion of Form 29

1. The underwriting years shown between the columns headed "29 29" and "99 99" must correspond (in reverse order) to the *financial year in question* and the nine *previous financial years*, respectively.
2. Lines 11 to 15, 19 to 21 and 29 must be completed for open years and lines 11 to 18 and 21 to 29 for closed years.
3. Line 29 equals line 53 less 54 on Form 28.
4. Lines 11 to 15 must be shown before adjustment for *discounting*.
5. Lines 11 to 14, 16 and 17 must exclude *claims management costs*.
6. For *accounting class 10* (other than *business categories (c)* and *(d)* and such other categories as have been reported previously on Form 29) amounts in respect of underwriting years ended before 23 December 1993 may be included in the prior underwriting years column and (if so) instruction 7 must not apply to such amounts.
7. The amounts shown in the first column must be analysed on continuation sheets by underwriting year (although amounts in respect of underwriting years beginning prior to 1 January 1983 may be shown in aggregate).
8. The box marked "Business category" must be completed by inserting one of the letters "a" to "h" according to which of the sub-paragraphs of rule 9.16(1) describes the *business category* to which the Form relates.
9. Amounts may only be included at line 19 in so far as they arise from the offset of anticipated surpluses and deficits on business managed together (as defined by paragraph 25 of Appendix 9.2).

General insurance business : Expected income and yield from admissible assets covering discounted provisions

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

		Company registration number	GL/UK/CM	Period ended			Units
				day	month	year	
		R30					£000
Type of asset		Value of admissible assets as shown on Form 13	Admissible assets hypothecated to cover the provision for outstanding claims being discounted	Expected income from assets included in column 2			Yield %
		1	2	3			4
Land and buildings		31					
Fixed interest securities	Approved securities	32					
	Other	33					
Variable interest and variable yield securities (excluding items shown at line 36)	Approved securities	34					
	Other	35					
Equity shares and holdings in collective investment schemes		36					
Loans secured by mortgages		37					
All other assets	Producing income	38					
	Not producing income	39					
Total		49					

Instructions for completion of Form 30

1. The entry at-
 - 30.31.1 must equal 13.11.1
 - 30.32.1 must equal 13.45.1 + the appropriate part of 13.84.1
 - 30.33.1 must equal 13.46.1 + the appropriate part of 13.84.1
 - 30.34.1 must equal 13.47.1 + the appropriate part of 13.84.1
 - 30.35.1 must equal 13.42.1 +13.48.1 + the appropriate part of 13.84.1
 - 30.36.1 must equal 13.41.1 +13.43.1
 - 30.37.1 must equal 13.50.1 + the appropriate part of 13.84.1
 - 30.49.1 must equal 13.87.1 +13.89.1 - 13.60.1 - 13.61.1 - 13.62.1 - 13.63.1 – 13.85.1.
2. The hypothecated assets shown in column 2 must not be less than (but need not equal) the provision for outstanding *claims* being discounted (column 6 less column 7 on sheet 1). Where specific assets are not hypothecated to cover the provision for outstanding *claims* being discounted, column 2 equals column 1.
3. The income in column 3 must be the amounts before deduction of tax which would be received in the next *financial year* on the assumption that-
 - (i) the assets are held throughout that year, and
 - (ii) the factors which affect income remain unchanged but account is to be taken of any changes in those factors known to have occurred.
4. The yield in column 4 must be-
 - (i) for *securities* with a redemption value, the rate of interest which, when used to obtain a present value of expected future income or capital payments, gives the current asset value, and
 - (ii) for all other assets the ratio of the income included in column 3 to the value included in column 2,or where appropriate an average of the above weighted by reference to the values included in column 2.
5. The methods and assumptions used in determining the yield in accordance with must be stated by way of supplementary note to this Form.
6. Where a particular asset is required to be taken into account only to a specified extent by the application of admissibility limits, the expected income and capital payments from that asset must be included only to the same extent.
7. The treatment of expected income payments from any asset where such payment is in default must be stated by way of supplementary note to this Form.
8. In column 8 "Unwind in discount in the next *financial year*" refers to the expected reduction in the deduction for the discounting between-
 - (i) that shown at the end of the *financial year in question*, and

- (ii) that expected to be shown at the end of the next *financial year* but in respect of *claims* incurred prior to the end of the *financial year in question*.
9. Columns 4 and 9 to 11 must be expressed as a percentage to one place of decimals.
 10. In the above instructions, income excludes capital gains or losses or value adjustments.
 11. The discount rate in column 11 must be the average rate of interest at which the provisions are being discounted, weighted by the provisions contained in column 6.
 12. The references in the Form to “outstanding claims” and “technical provisions” are to those amounts net of *reinsurance*

Instructions for completion of Form 31

1. All figures must be shown gross of the *reinsurers'* share and before any deduction for *discounting*.
2. The accident years at lines 11 to 20 must correspond to the *financial year in question* and the nine *previous financial years* respectively.
3. All amounts shown must exclude *claims management costs*.
4. The percentage shown at column 11 is the ratio of the sum of columns 3 to 6 to column 10.
5. Columns 10 and 11 need not be completed in respect of accident years ended before 23 December 1994.
6. The percentages shown at column 11 must be expressed as percentages to one place of decimals.
7. For risk groups falling in *accounting class 7*, the amounts shown in line 21 must be analysed by accident year on continuation sheets.
8. Columns 1 and 2 need not be completed in respect of *accounting classes 3, 4 and 5*.

Instructions for completion of Form 32

1. All figures must be shown gross of the *reinsurers'* share and before any deduction for *discounting*.
2. The accident years at lines 11 to 20 must correspond to the *financial year in question* and the nine *previous financial years* respectively.
3. All amounts shown must exclude *claims management costs*.
4. The percentage shown at column 11 must be the ratio of the sum of columns 3 to 6 to column 10.
5. Columns 10 to 13 need not be completed in respect of accident years ended before 23 December 1994.
6. The number of vehicle years insured in any accident year is the aggregate of the product for each *contract of insurance* of the period (being the period during that accident year when the contract was in force) and the number of vehicles insured under the contract. Figures are to be rounded to the nearest thousand-vehicle years only after aggregating component figures.
7. The percentage shown at column 13 must be the ratio of the sum of columns 1 and 2 to the product of 1000 and column 12.
8. The percentages shown at columns 11 and 13 must be expressed as percentages to one place of decimals.

General insurance business (accident year accounting) : Reconciliation of gross claims and premiums for direct insurance and facultative reinsurance

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Company registration number	GL/UK/CM	Period ended			Units
R33		day	month	year	£000

Accounting class	Claims paid in this financial year	Gross claims outstanding carried forward		Gross claims outstanding brought forward		Balance for this financial year (1+2+3-4-5)	Gross earned premiums
		Reported	Incurred but not reported	Reported	Incurred but not reported		
	1	2	3	4	5	6	7
Accident and health	11						
Motor	12						
Aviation	13						
Marine	14						
Transport	15						
Property	16						
Third party liability	17						
Miscellaneous and pecuniary loss	18						

Instructions for completion of Form 33

1. All figures must be shown gross of the *reinsurers'* share and before any deduction for *discounting*.
2. All amounts shown must exclude *claims management costs*.
3. Only business accounted on an accident year basis but not reported on Forms 31 or 32 is to be included on this Form.
4. "Gross earned *premiums*" refers to all amounts reported in column 1 of lines 11 to 19 of Form 20, but only to the extent such *premiums* have not been reported in Forms 31 or 32.

Instructions for completion of Form 34

1. All figures must be shown gross of the *reinsurers'* share and before any deduction for *discounting*.
2. The underwriting years at lines 11 to 20 must correspond to the *financial year in question* and the nine *previous financial years* respectively.
3. All amounts shown must exclude *claims management costs*.
4. The percentage shown at column 9 must be the ratio of the sum of columns 1 to 4 to column 8.
5. Columns 8 and 9 need not be completed in respect of *financial years* ended before 23 December 1994.
6. The percentages shown at column 9 must be expressed as percentages to one place of decimals.
7. For risk groups falling in *accounting class 7*, the amounts shown in line 21 must be analysed by underwriting year on continuation sheets.

General insurance business (underwriting year accounting) : Reconciliation of gross claims and premiums for direct insurance and facultative reinsurance

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Company
registration
number

GL/UK/CM

Period ended
day month year

Units

R35							£000
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Accounting class	Gross claims paid in this financial year	Gross claims outstanding carried forward		Gross claims outstanding brought forward		Balance for this financial year (1+2+3-4-5)	Gross written premiums
		Reported	Incurred but not reported	Reported	Incurred but not reported		
	1	2	3	4	5	6	7
Accident and health	11						
Motor	12						
Aviation	13						
Marine	14						
Transport	15						
Property	16						
Third party liability	17						
Miscellaneous and pecuniary loss	18						

Instructions for completion of Form 35

1. All figures must be shown gross of the *reinsurers'* share and before any deduction for *discounting*.
2. All amounts shown must exclude *claims management costs*.
3. Only business accounted on an underwriting year basis but not reported on Form 34 must be included on this Form.
4. "Gross written *premiums*" refers to all amounts reported in column 99-99 of line 11 of Form 24, but only to the extent such *premiums* have not been reported in Form 34.

Instructions for completion of Form 36

1. Where any of Forms 26 to 29 or 31, 32 or 34 contains a figure in a currency other than sterling the rate of conversion of those figures into sterling must be stated in column 1 to this Form.
2. Where the rate of conversion differs according to whether it applies to income and expenditure items, or asset and liability items, the former rate must be used.

Equalisation provisions

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

			Company registration number	GL/UK/CM	Period ended			Units
			R37		day	month	year	£000
	Business group A (property) 1	Business group B (business interruption) 2	Business group C (marine and aviation) 3	Business group D (nuclear) 4	Business group E (non-proportional treaty) 5	All business groups 6	Credit insurance business 7	
Calculation of the maximum provision								
Total net premiums written in the previous 4 years	11							
Net premiums written in the current year	12							
Maximum provision	13							

Calculation of the transfer to/from the provision

Equalisation provision brought forward	21							
Transfers in	22							
Total abnormal loss	23							
Provisional transfers out	24							
Excess of provisional transfer out over fund available	25							
Provisional amount carried forward (21+22-24+25)	26							
Excess, if any, of 26 over 13	27							
Equalisation provision carried forward (26-27)	28							
Transfer in/(out) for financial year (28-21)	29							

Instructions for completion of Form 37

1. Lines 11 & 12, columns 1 to 5, must include net written premium from the Form 21 (accident year *insurance business*) and/or Form 24 (underwriting year *insurance business*) that in whole or in part covers each *business group*.
2. Only premium for *financial years* covered by the scheme may be included in lines 11 & 12, columns 1 to 5 (see Appendix 6.1, Part 111). Adjustments in respect of prior years must be included at line 12.
3. Any *insurance business* that has been transferred must be excluded from lines 11 & 12, columns 1 to 5 (see rules 6.8 and 6.9).
4. Line 13, columns 1 to 5 must show the maximum provision for each *business group* calculated in accordance with Appendix 6.1. If *insurance business* in a group has been written for less than 5 years, the average of the qualifying years must be used.
5. If all rights and obligations in a *business group* have been transferred, line 13 columns 1 to 5 must be left blank at the appropriate column.
6. Line 22, columns 1 to 5 must be calculated by multiplying the figure at line 12 for each *business group* by the % in paragraph 3 of Part 1 of Appendix 6.1.
7. Line 23 must be, for each *business group*, the total of abnormal losses, if any, brought forward from Forms 38 and 39, line 19. These must be entered in the same columns as they were on Forms 38 and 39.
8. The transfer out for each *business group* at line 24, columns 1 to 5 must not exceed the line 13 maximum provision for that group.
9. The sum of columns 1 to 5 of lines 13, 22 and 24 must be entered in column 6 of the relevant line.
10. In the first year of the scheme, line 21 column 6 must be left blank. In subsequent years this figure must be brought forward from the previous year's figure (normally the figure at Form 15, line 15). Only equalisation provisions required by the *Equalisation Reserves Rules* may be included.
11. The calculations for lines 25 to 29, column 6 must be carried out and the net transfer in or out for the year must be entered at Form 16, line 12, and the provision carried forward entered at Form 15, line 15.
12. Line 13, column 7 must be 150% of the highest annual amount of net premiums written in the last 5 years.
13. Line 21, column 7 must equal the statutory credit equalisation provision, if any, brought forward from the previous year at Form 15, line 14.
14. Line 22, column 7 must be 75% of the technical surplus, if any, brought forward from Forms 38 and/or 39, line 29, subject to a limit of 12% of line 12.
15. Line 24, column 7 must equal the technical deficit, if any, brought forward from Forms 38 and/or 39, line 29.

16. The calculations for lines 25 to 29, column 7 must be carried out and the net transfer in or out for the year must be entered at Form 16, line 12, and the provision carried forward entered at Form 15, line 14.

Equalisation provisions technical account : Accident year accounting

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

	Company registration number	GL/UK/CM	Period ended			Units
			day	month	year	
	R38					£000
	Business group A (property)	Business group B (business interruption)	Business group C (marine and aviation)	Business group D (nuclear)	Business group E (non-proportional treaty)	
	1	2	3	4	5	
Other than credit business						
Net premiums earned	11					
Claims incurred net of reinsurance	12					
Trigger claims value	13					
Abnormal loss	19					
Trigger claims ratio	72.5%	72.5%	95%	25%	100%	

Credit business

Net premiums earned	21	
Claims incurred net of reinsurance	22	
Claims management costs	23	
Net operating expenditure	24	
Technical surplus/(deficit) (21-22-23-24)	29	

Instructions for completion of Form 38

1. Apart from *credit insurance business*, any *insurance business* transferred to an *insurer* by novation or under Part VII of the *Act* (or the *1982 Act*) must be accounted for in accordance with rule 6.9.
2. The entries at line 11 must be derived from Form 21, that in whole or in part covers the *business group*, at line 11, column 5 and line 19, column 5.
3. The entries at line 12 must be derived from Form 22, that in whole or part covers the *business group*, at line 13 and 17, column 4.
4. The entries at line 13 must be line 11 (or nil if line 11 is negative) multiplied by the trigger *claims* ratio for the *business group*.
5. For each *business group* the entry at line 19 must be the amount, if any, by which the entry at line 12 for that *business group* exceeds the entry at line 13. If the entry at line 12 does not exceed the entry at line 13, line 19 must be left blank.
6. The entry at line 21 must be derived from Form 21 for *accounting class 8*, at line 11, column 5 and line 19, column 5, to include only *insurance business* in *general insurance business class 14*.
7. The entry at line 22 must be derived from Form 22 for *accounting class 8*, at lines 13 and 17, column 4, to include only *insurance business* in *general insurance business class 14*.
8. The entry at line 23 must be derived from Form 22 for *accounting class 8*, at lines 14 and 18, column 4, to include only *insurance business* in *general insurance business class 14*.
9. The entry at line 24 must be derived from Form 22 for *accounting class 8*, at lines 19 and 29, column 4, to include only *insurance business* in *general insurance business class 14*.

Equalisation provisions technical account : Underwriting year accounting

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Company registration number	GL/UK/CM	Period ended			Units
R39		day	month	year	£000

		Business group A (property)	Business group B (business interruption)	Business group C (marine and aviation)	Business group D (nuclear)	Business group E (non-proportional treaty)
		1	2	3	4	5
Other than credit business						
Net premiums written	11					
Claims net of reinsurance	12					
Trigger claims value	13					
Abnormal loss	19					
Trigger claims ratio		72.5%	72.5%	95%	25%	100%

Credit business

Net premiums written	21	
Claims net of reinsurance	22	
Claims management costs	23	
Net operating expenditure	24	
Technical surplus/(deficit) (21-22-23-24)	29	

Instructions for completion of Form 39

1. Apart from *credit insurance business*, any *insurance business* transferred to an insurer by novation or under Part VII of the *Act* (or the *1982 Act*) must be accounted for in accordance with rule 6.9.
2. The entries at line 11 must be derived from Form 24, that in whole or in part covers the *business group*, at line 19, column 99-99.
3. The entries at line 12 must be derived from column 99-99 of Forms 24 and 24, that in whole or part covers the *business group*, as follows:

line 29 on Form 24 plus line 29 less line 15 less line 24 on Form 25 less line 29 plus line 15 plus line 24 on Form 25 for the *preceding financial year*.
4. The entries at line 13 must be line 11 (or nil if line 11 is negative) multiplied by the trigger *claims* ratio for the *business group*.
5. For each *business group* the entry at line 19 must be the amount, if any, by which the entry at line 12 for that *business group* exceeds the entry at line 13. If the entry at line 12 does not exceed the entry at line 13, line 19 must be left blank.
6. The entry at line 21 must be derived from Form 24 for *accounting class* 8, at line 19, column 99-99, to include only *insurance business* in *general insurance business class* 14.
7. The entry at line 22 must be derived from Form 24 for *accounting class* 8, at line 29, column 99-99, plus line 53, column 99-99 less line 51, column 99-99, to include only *insurance business* in *general insurance business class* 14.
8. The entry at line 23 must be derived from Form 24 for *accounting class* 8, at line 39, column 99-99, to include only *insurance business* in *general insurance business class* 14.
9. The entry at line 24 must be derived from Form 24 for *accounting class* 8, at line 49 column 99-99, to include only *insurance business* in *general insurance business class* 14.

APPENDIX 9.3 (rule 9.14 and 9.23)

LONG-TERM INSURANCE BUSINESS REVENUE ACCOUNT AND ADDITIONAL INFORMATION (FORMS 40 TO 45)

1. All the Forms included in the part of the *return* to which this Appendix relates (**Forms 40 to 45**) are to be laid out as shown in this Appendix, except that the instructions to Forms need not be reproduced.
2. The provisions of paragraph 1(2) and paragraphs 3 to 7 of **Appendix 9.1** must, unless otherwise provided, also apply for the purposes of this Appendix. All amounts must be shown in sterling to the nearer £1,000 except valuation unit prices which must be shown to the same level as required under **Appendix 9.4**. Percentages must be shown to two decimal places.
3. For the purposes of this Appendix, a contract is to be regarded as a **UK contract** if, in the case of *direct or facultative reinsurance* accepted, the contract was effected in the United Kingdom or if, in the case of a *reinsurance treaty*, the *cedant* was a *insurer* having its head office in the United Kingdom or was a member of the *Society*; and **overseas contracts** is to be construed accordingly.
4.
 - (1) Where a *insurer* maintains more than one *long-term insurance business fund*, there must be stated by way of a supplementary note to **Form 40** the principles and methods applied to apportioning the investment income, increase or decrease in the value of assets brought into account, expenses and taxation between the different funds.
 - (2) Boxes marked 'No. of Fund/Summary' must be completed by the inclusion of a discrete number to identify each fund or, if the Form relates to a part of the fund, the fund of which it is part. Where there is only one fund for *ordinary long-term insurance business* or for *industrial assurance business*, as the case may be, the number '1' must be shown in the box marked 'No. of Fund/Summary'. Where the Form is a summary Form, the number '99' must be inserted in that box. Boxes marked 'No. of Part of Fund' must show a discrete number for each part of a fund or the figure '0' if the Form is a statement of the whole fund.

5. Where arrangements have been made for the provision of management services to an *insurer* by another *company* (whether an *insurer* or not) -
- (a) the *insurer* receiving the services must state, by way of a supplementary note to **Form 40**; and
 - (b) the *company* (if an *insurer*) providing the services must state, by way of a supplementary note to **Form 40**,

that the arrangements have been in force in the *financial year* and naming the parties to them.

FORMS

[**Forms 40 – 45** to follow]

Long term insurance business : Revenue account

Name of insurer

Global business/UK branch business/EEA branch business

Ordinary insurance business/Industrial insurance business

Financial year ended

Name and number of fund/Summary

	Company registration number	GL/UK/CM	Period ended			Units	OB/IB	No of fund/ Summary	No of part of Fund
			day	month	year				
R40						£000			
Items to be shown net of reinsurance ceded							The financial year 1	Previous year 2	
Earned premiums						11			
Investment income receivable before deduction of tax						12			
Increase (decrease) in the value of non-linked assets brought into account						13			
Increase (decrease) in the value of linked assets						14			
Other income						15			
Total income (11 to 15)						19			
Claims incurred						21			
Expenses payable						22			
Interest payable before deduction of tax						23			
Taxation						24			
Other expenditure						25			
Transfer to (from) non technical account						26			
Total expenditure (21 to 26)						29			
Increase (decrease) in fund in financial year (19-29)						39			
Fund brought forward						49			
Fund carried forward (39+49)						59			

Instructions for completion of Form 40

1. The entry at 40.11.1 must be equal to the sum of 41.19.3 and 41.29.3, the entry at 40.21.1 must be equal to 42.59.3, and the entry at 40.22.1 must be equal to 41.49.3
2. Any item of income which cannot properly be allocated to lines 11, 12, 13 or 14 must be entered in line 15, and similarly, any item of expenditure which cannot properly be allocated to lines 21, 22, 23 or 24 must be entered in line 25. Particulars of such items must be specified in a supplementary note.
3. Where an *insurer* decides to allocate to the *long-term insurance business* the whole or any part of investment income and/or net capital gains arising from assets not attributable to its *long-term insurance business*, the amounts in question must be shown as a transfer in line 26 and particulars must be specified in a supplementary note.
4. Where a transfer is made to the non-technical account, the entry at line 26 must show amounts which have been included in line 47 of Form 58. Transfers from or to other funds must be included in line 15 or 25, with transfers to reserves associated with a transfer of contracts from one fund to another specified in a supplementary note.
5. The entry at line 12 must exclude value re-adjustments on investments and gains on the realisation of investments, which must be shown in lines 13 or 14 as appropriate.
6. The entry at line 11 must exclude any change in the provision for unearned premiums.
7. The entry at line 21 must exclude *claims management costs*, which must be included in line 22, and any change in the provision for *claims*.

Long term insurance business : Analysis of premiums and expenses

Name of insurer

Global business/UK branch business/EEA branch business

Ordinary insurance business/Industrial insurance business

Financial year ended

Name and number of fund/Summary

		Company registration number	GL/UK/CM	Period ended			Units	OB/IB	No of fund/Summary	No of part of Fund
				day	month	year				
		R41					£000			
				Gross	Payable to or recoverable from reinsurers	Net of reinsurance (1-2)				
				1	2	3				
Earned premiums in the financial year	Life assurance and general annuity contracts	Single premium	11							
		Regular premium	12							
	Pension business contracts	Single premium	13							
		Regular premium	14							
	Permanent health contracts	Single premium	15							
		Regular premium	16							
	Other contracts	Single premium	17							
		Regular premium	18							
	Total premiums	Single premium	19							
		Regular premium	29							
Total premiums at lines 19 and 29 attributable to	UK contracts	31								
	Overseas contracts	32								
Expenses payable in the financial year	Commission payable in connection with acquisition of business		41							
	Other commission payable		42							
	Management expenses in connection with acquisition of business		43							
	Management expenses in connection with maintenance of business		44							
	Other management expenses		45							
	Total expenses (41 to 45)		49							
	Total expenses at line 49 attributable to	UK contracts	51							
Overseas contracts		52								

Instructions for completion of Form 41

1. Lines 11, 13, 15, 17 and 19 must include all single premium amounts where there is no expectation of continuing premiums being paid at regular intervals.
2. Lines 12, 14, 16, 18 and 29 must include premiums payable at regular intervals during the *policy* year, including repeated or recurrent single premiums where the level of premium is defined.

Long term insurance business : Analysis of claims

Name of company

Global business/UK branch business/EEA branch business

Ordinary insurance business/Industrial insurance business

Financial year ended

Name and number of fund/Summary

		Company registration number	GL/UK/CM	Period ended			Units	OB/IB	No of fund/Summary	No of part of Fund
				day	month	year				
		R42					£000			
Claims incurred in the financial year				Gross		Recoverable from reinsurers		Net of reinsurance (1-2)		
				1		2		3		
Life assurance and annuity contracts	On death	11								
	By way of lump sums on maturity	12								
	By way of annuity payments	13								
	By way of payments arising from other insured events	14								
	On surrender or partial surrender	15								
	Total life assurance and annuity claims (11 to 15)	19								
Pension business contracts	On death	21								
	By way of lump sums on vesting	22								
	By way of vested annuity payments	23								
	On surrender or partial surrender	24								
	Total pension business claims (21 to 24)	29								
Permanent health contracts	By way of lump sums	31								
	By way of periodical payments	32								
	Total permanent health claims (31+32)	39								
Other contracts	By way of lump sums	41								
	By way of periodical payments	42								
	Total claims (41+42)	49								
Total claims (19+29+39+49)		59								
Total claims at line 59 attributable to	UK contracts	61								
	Overseas contracts	62								

Instruction for completion of Form 42

In the case of *industrial assurance business*, *claims* incurred on survival in respect of periodical endowment benefits must be shown in line 15.

Long term insurance business : Summarised balance sheet for internal linked funds

Name of insurer

Global business/UK branch business/EEA branch business

Ordinary insurance business/Industrial insurance business

Financial year ended

Name and number of fund/Summary

Company registration number

GL/UK/CM

Period ended
day month year

Units

OB/IB

No of fund/ Summary

No of part of Fund

Name of fund	Directly held assets	Investment in other internal linked funds of the insurer	Total assets (2+3)	Provision for tax on unrealised capital gains	Secured and unsecured loans	Other liabilities	Net asset value (4-5-6-7)
1	2	3	4	5	6	7	8
Total							

Instructions for completion of Form 43

1. The basis on which the assets have been valued must be stated in a supplementary note.
2. The aggregate value of rights (gross of *variation margin*) and the aggregate amount of liabilities (gross of *variation margin*) under *derivative contracts* (or in respect of contracts or assets which have the effect of a *derivative contract*) must each be stated in a supplementary note. The corresponding figures net of *variation margin* must also be stated. For this purpose, rights and liabilities must not be set off against one another unless
 - (i) such rights and liabilities may be set off against each other in accordance with generally accepted accounting practice, and
 - (ii) such set off results (in whole or in part) from the closing out of obligations under a contract.
3. Where there is a liability to repay *variation margin* and there are no arrangements for netting of amounts outstanding or the arrangements would not permit the accounting of such amounts on a net basis in accordance with generally accepted accounting practice, it must be so stated in a supplementary note.
4. The total of the net asset value in column 8 less the total of column 3 must equal line 59 of Form 44.

Long term insurance business : Aggregate revenue account for internal linked funds

Name of insurer

Global business/UK branch business/EEA branch business

Ordinary insurance business/Industrial insurance business

Financial year ended

Name and number of fund/Summary

	Company registration number	GL/UK/CM	Period ended			Units	OB/IB	No of fund/ Summary	No of part of Fund
			day	month	year				
R44						£000			
Value of total creation of units						11			
Investment income attributable to the funds before deduction of tax						12			
Increase (decrease) in the value of investments in the financial year						13			
Other income						14			
Total income (11 to 14)						19			
Value of total cancellation of units						21			
Charges for management						22			
Charges in respect of tax on investment income						23			
Taxation on realised capital gains						24			
Increase (decrease) in amount set aside for tax on capital gains not yet realised						25			
Other expenditure						26			
Total expenditure (21 to 26)						29			
Increase (decrease) in funds in financial year (19-29)						39			
Internal linked funds brought forward						49			
Internal linked funds carried forward (39+49)						59			

Instructions for completion of Form 44

1. Double counting of items arising from cross investment between *internal linked funds* must be eliminated.
2. Any item of income which cannot properly be allocated to lines 11, 12, or 13 must be entered in line 14, and similarly, any item of expenditure which cannot properly be allocated to lines 21, 22, 23, 24 or 25 must be entered in line 26. Particulars of such items must be specified in a supplementary note.
3. The gross value of units created must be shown in line 11. The gross value of units cancelled must be shown in line 21.

Instructions for completion of Form 45

1. Column 3 must show the provisions for tax on unrealised capital gains as a percentage of the taxable unrealised capital gain. Similarly, column 4 must show the provisions for tax on realised capital gains as a percentage of the taxable realised capital gain.
2. The liquidity percentage shown in column 5 must be the sum of the values of *approved securities*, short-term deposits and cash held by the fund, less any liabilities included in column 6 or 7 of Form 43, shown as a percentage of the net asset value in column 8 of Form 43.
3. Where there is more than one series of units for any *internal linked* fund the valuation price of each series of unit must be given in column 6 together with the name of that series of unit.

APPENDIX 9.4 (rule 9.31)

ABSTRACT OF VALUATION REPORT PREPARED BY APPOINTED ACTUARY (FORMS 46 TO 61)

All the Forms included in the part of the *return* to which this Appendix relates (**Forms 46 to 49, 51 to 58, 60 and 61**) are to be laid out as shown in the Appendix, except that the instructions to Forms need not be reproduced.

For the purposes of this Appendix -

- (a) the **report period** means the period from the date to which the previous investigation under rule 9.4 or its predecessor legislation related to the 'valuation date' (as defined in 1);
- (b) the provisions of paragraph 1(2) and paragraphs 3 to 7 of **Appendix 9.1** and paragraph 3 of **Appendix 9.3** must, unless otherwise provided, apply; and
- (c) boxes marked 'UK/OS' must be completed by the insertion of 'UK' for 'UK contracts' and 'OS' for 'overseas contracts'.

All amounts in the Forms must be shown in sterling to the nearer £1,000 except valuation unit prices which must be shown to the level used in the valuation. Yields must be shown as percentages to two decimal places.

The following information must be given, the answers being numbered to accord with the numbers of the corresponding paragraphs of this Appendix.

- 1. The date to which the actuarial investigation relates namely, the **valuation date**.
- 2. The date to which the previous investigation under rule 9.4 related.
- 3. A statement that the valuation has been made in conformity with rule 5.6 or, where this was not the case, such qualification, amplification or explanation as necessary.
- 4. (1) Subject to (2), for each category of *non-linked contract* which -

- (a) comprises *accumulating with-profits policies*, a full description of the benefits, including -
 - (i) the circumstances in which, and the method by which, an adjustment to the identifiable current benefit attributable to a *policy* could be made on the payment of any *claim*, including by full or partial surrender, or upon the determination of the amount of any charges deducted under the *policy* together with a description of the *insurer's* policy and past practice in this regard,
 - (ii) where the discounted value of the liability in respect of current benefits including vested bonuses shown in column 12 of **Form 52** is less than the full amount of the current benefit shown in column 11 and the discounted value assumes the exercise of any discretionary adjustments of the type referred to in (a)(i), a general description of such adjustments made during the 'report period',
 - (iii) any guaranteed investment returns or bonus rates,
 - (iv) any guaranteed surrender values, and
 - (v) any material options;
- (b) comprises *policies* (other than those included in (a)) which provide for benefits to be determined on the basis of interest accrued (at a rate to be determined from time to time) in respect of premiums paid, a full description of the benefits, including -
 - (i) the method used to calculate surrender values,
 - (ii) any guaranteed investment returns,
 - (iii) rates of interest applied during the 'report period',
 - (iv) any guaranteed surrender values, and
 - (v) any material options;

- (c) does not fall within (a) or (b), and which is not sufficiently described by the entry in column 1 of **Form 51**, a full description of the benefits, including any premium rate guarantees and material options.
- (2) Information required under (1) need not be provided for any category of contract -
- (a) where no contracts were effected by the *insurer* during the ‘report period’; and
 - (b) which has been included in **Form 51** or **Form 52** under the miscellaneous headings specified in instruction 8 (vi) or 8 (x) to **Forms 51, 52, 53** and **54**.
5. (1) Subject to (3), for each category of *linked contract* -
- (a) the name given to that category;
 - (b) the type of contract, classified according to the categories set out in instructions 3 to 8 of the instructions for completion of Forms 51, 52, 53 and 54;
 - (c) a statement of the frequency of premiums;
 - (d) a brief description of the benefits under the contract, including any eligibility to participate in profits, any guarantees and any material options;
 - (e) details of any guaranteed investment returns;
 - (f) a description of the way in which the *insurer* recovers out of *policies* its costs (including acquisition expenses and commission, renewal expenses and commission and the costs attributable to the provision of *policy* benefits). Where the *policy* provides for the allocation of units, the annual rate of any management charges must be given. Where the amount of premiums deemed to be invested after allowing for the effect of any charges is greater than the amount of the premiums, an explanation must be given;
 - (g) details of any restrictions on increases in charges;
 - (h) the method used to calculate surrender or transfer values;

- (i) whether benefits are (or may be) determined (whether wholly or in part) by reference to the value of an *internal linked fund*, or to the value of assets or an index. Where the link is to the value of assets or an index, those assets or that index must be specified and details of the relationship between their value and benefits payable to *policy holders* must be given;
- (j) a brief description of any other features of the contract not disclosed above which are material to the method and basis of valuation;
- (k) whether the contract was open to new business in the year to the 'valuation date'; and
- (l) any increases in the rates of charges applied generally to contracts during the 'report period', including charges for the provision of *policy* benefits met by the cancellation of units nationally allocated to contracts,

but where the terms and conditions and the method and basis for determining the amount of the *long-term insurance business liabilities* are not materially different for a number of categories of contract, only one description need be given pursuant to this paragraph, provided that the name of each such category is given in the *insurer's* response to (a).

- (2) For each category of *linked contract* which contains a with-profits option, the information required by 4(1)(a) must also be given.
- (3) Information required under (1)(a) to (k) and (2) need not be provided for any category of contract -
 - (a) where no contracts were effected by the *insurer* during the 'report period'; and
 - (b) which has been included under the miscellaneous heading in **Form 53** or **54**.
- (4) A description of the method, or if there is more than one method of the methods and the types of unit to which each applies, used for the creation and cancellation of units in internal linked funds and determining unit prices for the allocation of units to, and the cancellation of units from, policies.

- (5) A description of the method, or if there is more than one method of the methods and the types of unit to which each applies, used to determine the provision for tax on realised and unrealised capital gains and the percentage or percentages of these gains deducted or provided for during the 'report period'.
 - (6) Wherever units of the type referred to in paragraph 5 of Part I of **Appendix 3.2** are held by an *internal linked fund*, or where *property linked benefits* are linked to such units, the rate of discount, commission or other allowance made to the *insurer* on the purchase, sale or holding of units and the extent to which the *policy holder* benefits from such discount, commission or other allowance.
6. (1) The general principles and methods adopted in the valuation, including specific reference to the following -
- (a) the method by which account has been taken of *derivative contracts* or contracts or assets having the effect of *derivative contracts* in the determination of the amount of the *long-term insurance business liabilities*;
 - (b) the method by which due regard has been given to the reasonable expectations of *policy holders*, as required by rule 5.6, and by which account has been taken of the custom and practice of the insurer in the manner and timing of the distribution of profits or the grant of discretionary additions over the duration of each *policy*, as required by rule 5.7(6);
 - (c) where the net premium method has been used, whether and to what extent it has been modified, for what purposes any such modification has been made and whether any modifications on account of *zillmerising* conform to rule 5.10;
 - (d) whether any negative reserves arose and the steps taken to ensure that no *contract of insurance* was treated as an asset, as required by rule 5.15;
 - (e) whether any specific reserve has been made for future bonuses and, if so, at what rate or rates;
 - (f) the basis of the provision made for any prospective liability to taxation on unrealised capital gains;

- (g) in the case of *linked contracts* and contracts falling within 4(1)(a) and (b), the basis of the reserve made for any investment performance guarantees; and
 - (h) the basis of the reserve made for any guarantees and options (other than investment performance guarantees included in (g)).
- (2) For the purposes of this paragraph, where, in determining the provisions referred to in (f) or the reserves referred to in 7(7) or (8), account has been taken of the fact that the fund has been brought into **Form 58** at book value in accordance with rule 4.1(6), that fact must be stated.
7. (1) Unless shown in **Forms 51, 52, 53 and 54**, the rates of interest and tables of mortality and morbidity assumed in the valuation of each category of contract.
- (2) If the tables used have not been published, full details of the rates of mortality or morbidity used.
- (3) A general description of how the tables of mortality and morbidity assumed in the valuation of the various categories of contract have regard to the State of the *commitment*.
- (4) Details of any allowance made for future reductions in the rates of mortality in the tables of mortality assumed in the valuation of annuity contracts.
- (5) Details of any allowance made, and the amount of any reserve held, for any possible detrimental impact of significant changes in the incidence of disease or developments in medical science on the mortality and morbidity experience of the company in the tables of mortality and morbidity assumed in the valuation of contracts.
- (6) A description of all the scenarios of future changes in the value of assets which have been tested in order to take account of the nature (including currency) and terms of the assets held in determining the amount of the *long-term insurance business liabilities* in accordance with rule 5.17 identifying that scenario which produces the most onerous requirement (whether or not a reserve is required).
- (7) The amount of any reserve made pursuant to rule 5.17(a), together with a brief description of the method used and assumptions made to calculate any such reserve.

- (8) In respect of that scenario described under (6) which produces the most onerous requirement (whether or not a reserve is required), the amount of any reserve made pursuant to rule 5.17(b), together with -
- (a) a description of the changed assumptions made (other than the changed interest rate stated in **Form 57**) in calculating such requirement;
 - (b) a brief description of the method used to calculate such requirement; and
 - (c) resulting from the application of such changed assumptions -
 - (i) the change in the aggregate amount of the *long-term insurance business liabilities*, and
 - (ii) the aggregate amount by which the assets allocated to match such liabilities in the scenario have changed in value from the amount of those assets shown in **Form 13**.
- (9) A general description of how the rates of interest assumed in the valuation of the various categories of contract with liabilities denominated in currencies other than sterling have taken into account the currency of the liabilities.

8. In respect of *non-linked contracts* -

- (a) where appropriate, the proportion of the office premiums explicitly or implicitly reserved for expenses and profits for each type of insurance (as shown in column 8 of **Form 51** or column 10 of **Form 52**);
- (b) the method by which a reserve has been made for expenses after premiums have ceased or where no future premiums are payable or where the method of valuation does not take credit for future premiums as an asset;
- (c) where a prospective method of valuation has not been used, details of the tests made of the adequacy of the method used;
- (d) where, in valuing contracts falling within the circumstances described in rule 5.9(1), future premiums brought into account are not in accordance with that rule, such additional information as is necessary to demonstrate whether the *mathematical reserves* determined in the aggregate for each of the main categories of contract are greater than

an amount for each such category calculated in accordance with rules 5.8 to 5.17,

except that where the *mathematical reserves* (after deduction of *reinsurance cessions*) determined in the aggregate for all categories of contracts referred to in (d) represent less than 5% of the total *mathematical reserves* (after deduction of *reinsurance cessions*) for all *non-linked contracts*, it is sufficient for the actuary to state that the *mathematical reserves* for each such category of contracts are not less than the *mathematical reserves* that would be determined on a net premium reserving basis which, in that case, must be specified by the actuary in the abstract.

9. For each category of *linked contract* -
 - (a) all assumptions made in calculating the valuation net liability in columns 12 and 13 of **Forms 53** and **54**; and
 - (b) where an explicit reserve has not been made for meeting the expenses likely to be incurred in future in fulfilling the existing contracts on the basis of specific assumptions in regard to the relevant factors, details of the basis used in testing the adequacy of the reserves to satisfy rule 5.13(1).
10.
 - (1) The assumed levels of inflation of expenses and the bases used in the valuation to allow for such future inflation.
 - (2) The aggregate amount, grossed up for taxation where appropriate, arising during the 12 months after the 'valuation date' from implicit and explicit reserves made in the valuation to meet expenses in fulfilling contracts in force at the 'valuation date', and a general description of the sources of such amounts.
 - (3) The method and basis of calculation of the requirement (whether or not a reserve is required) in respect of the expenses of continuing to transact new business during the 12 months following the 'valuation date' and the amount of the reserve so calculated.
 - (4) The method and basis of calculation of the requirement (whether or not a reserve is required) to provide for the costs of closure to new business, if the *insurer* were to cease to transact new business 12 months after the 'valuation date' and the amount of the reserve so calculated.

11. (1) A schedule of the sum of the *mathematical reserves* (other than liabilities for *property linked benefits*) and the liabilities in respect of the deposits received from *reinsurers* as shown in **Form 14**, analysed by reference to the currencies in which the liabilities are expressed to be payable, together with the value of the assets, analysed by reference to currency, which match such liabilities.
- (2) In the schedule required by (1), liabilities totalling up to 2% of the total required to be analysed may be grouped together as ‘other currencies’, and the assets matching those liabilities need not be analysed provided that the proportion of such liabilities which are matched by assets in the same currency is stated.
12. (1) For *long-term insurance business ceded* on a facultative basis to a *reinsurer* who is not authorised to carry on *insurance business* in the United Kingdom at any time during the ‘report period’ -
 - (a) the aggregate of premiums payable by the insurer to all such reinsurers (sub-divided according to financial years, if appropriate) and the aggregate amount deposited at the ‘valuation date’ under any deposit back arrangement; and
 - (b) the amount of any such premiums payable by the insurer to any reinsurer which is a connected company of the insurer and the aggregate amount deposited at the ‘valuation date’ under any deposit back arrangement.
- (2) For each treaty of *reinsurance* where the *insurer* is the *cedant* and under which business is in force at the ‘valuation date’ -
 - (a) the name of the *reinsurer*;
 - (b) whether the *reinsurer* is authorised to carry on insurance business in the United Kingdom;
 - (c) whether the *reinsurer* is a *connected company* of the *insurer*;
 - (d) an indication of the nature and extent of the cover given under the treaty;
 - (e) the premiums payable by the *insurer* under the treaty during the ‘report period’;

- (f) the amount deposited at the 'valuation date' in respect of the treaty under any *deposit back arrangements*;
 - (g) the extent to which provision has been made for any liability of the insurer to refund any amounts of *reinsurance* commission in the event of lapses or surrender of the contract; and
 - (h) whether the treaty is closed to new business.
- (3) For each 'financing arrangement' -
- (a) the amount of any undischarged obligation of the insurer and a brief description of the conditions for the discharge of such obligation; and
 - (b) a description of how, if at all, all such undischarged obligations have been taken into account in the valuation.
- (4) In this paragraph -
- (a) **financing arrangement** means any contract entered into by the *insurer*, in respect of *contracts of insurance* effected by the *insurer*, which has the effect of increasing the amount of assets included at line 34 of **Form 9**, representing assets of the insurer which are available to meet its *required minimum margin* for *long-term insurance business*, and which includes terms for -
 - (i) the transfer of assets to the *insurer* or the creation of a debt to the *insurer* (or both), and
 - (ii) either an obligation for the *insurer* to return (with or without interest) some or all of such assets or a provision for the diminution of such *debt*, in each case, in specified circumstances; and
 - (b) paragraphs (1), (2) and (3)(a) of rule 9.32 (which relate to connected persons) have effect for the purposes of this paragraph as they have effect for the purposes of those rules.

13. (1) Subject to (2), for each *with-profits fund*³, except where such information is provided elsewhere in the *return* –
- (a) a revenue account in the format of **Form 40** with a supplementary note stating the amount, if any, of investment income relating to *linked assets* included in line 12; and
 - (b) a statement of liabilities and margins in the format of **Form 14** with a supplementary note stating the amount, if any, of the increase or decrease, as the case may be, in the value of *non-linked assets*.
- (2) Where the amount (or part of the amount) of any increase or decrease in *non-linked assets* has yet to be allocated between *with-profits funds* or between one or more *with-profits funds* and other purposes, the information required by (1)(b) in aggregate for that amount or part amount, with a supplementary note which:
- (a) identifies the *with-profits funds* to which the information relates;
 - (b) provides the information in lines 11 to 49 of **Form 14** separately in respect of each *with-profits fund*; and
 - (c) without prejudice to 14(2), describes the basis upon which increases or decreases in the value of *non-linked assets* are, or will be, allocated between the *with-profits funds* or between the *with-profits funds* and other purposes.
14. (1) The principles on which the distribution of profits among *policy holders* and shareholders is based as described in any or all of the following documents -
- (a) the constitution of the *insurer*;
 - (b) board resolutions of the *insurer*;
 - (c) any policy issued by the *insurer*;
 - (d) any advertisement issued by or on behalf of the *insurer*;

³ *With-profits fund* includes subfunds (whether notional or real).

- (e) any document required to be issued by the *FSA* or any regulatory body recognised under the *Act*; and
 - (f) any other relevant document.
- (2) For each *with-profits fund*, a description of the *insurer's* policy and (insofar as it may be relevant to *policy holders' reasonable expectations*) its past practice as to:
- (a) how the *with-profits fund* is defined, which assets, liabilities, income and expense are allocated to it and how the amounts of such assets, liabilities, income and expense are determined;
 - (b) whether any non-profits *insurance business*, or any profit on it, is attributed to the *with-profits fund* and, if so, the nature and volume of such business;
 - (c) how assets within the *with-profits fund* are invested;
 - (d) the level of surplus or free reserves to be maintained in the *with-profits fund*; and
 - (e) the relationship between the performance of the *with-profits fund* and discretionary benefits allocated to *policy holders* including:
 - (i) whether an asset share methodology, or equivalent methodology, is used or is to be used and, if so, how asset shares are calculated (including whether and how investment income, increases or decreases in the value of investments or other assets, expenses, miscellaneous surpluses and deficits, taxation and other items of income and expense are attributed to asset shares) and how they relate to the benefits actually allocated to *policy holders*,
 - (ii) an indication of how, under different scenarios as to the performance of the fund, discretionary benefits are to be smoothed from period to period,
 - (iii) the pattern of allocation of discretionary benefits over the life of a *with-profits policy*, including the balance between annual and terminal bonuses and how *policies* are treated on surrender or on the exercise of options under the contract,

- (iv) how fairness is maintained between different categories of *policy* and different categories of *policy holder* and between *policy holders* collectively and the *insurer* itself, and
 - (v) any other factors which are material to the allocation of discretionary benefits to *policy holders*; and
 - (f) the principles followed by the *insurer* in setting actual proportions of profits distributed to *policy holders* and shareholders.
- (3) A description of the methods used in order to ensure that the aims described in (2) are achieved.
- (4) Subject to (5), if different principles or bonus policies apply to different categories of *with-profits policies* issued by the *insurer*, the information in (1) to (3) must be given in respect of each category.
- (5) Categories of *with-profits policies* which, apart from this paragraph 14(5), would require separate information in accordance with (4) need only be listed under this paragraph 14(5), and the information in (1) to (3) need not be supplied, provided that -
- (a) the aggregate amount of *established surplus* allocated to *policy holders* in all such categories is less than 10% of the aggregate amount of *established surplus* allocated to all *policy holders* (as reported at line 46 of **Form 58**);
 - (b) the amount of *established surplus* allocated to *policy holders* in any one such category is less than 5% of the aggregate amount of *established surplus* allocated to all *policy holders* (as reported at line 46 of **Form 58**); and
 - (c) none of the categories was introduced during the ‘report period’.
15. (1) Particulars of the bonus allocated to each category of contract, including the basis of calculation and the circumstances and the form in which the bonus is payable, together with -
- (a) where the rates of bonus allocated depend on the original term of the contract or on the period of years a contract has been in force,

specimen rates at 5 year intervals of original term or duration, as the case may be;

- (b) where the rates of bonus allocated depend on the age of the life assured, specimen rates at 10 year intervals of age;
- (c) where the rates of bonus allocated depend on the date of each previous premium payment, specimen rates at 5 year intervals of time since the premium was paid, and for premiums paid in each of the 5 years ending with the report period; and
- (d) in all other cases, full details of the rates of bonus allocated,

but where the rates of bonus allocated depend on a formula or a series of formulae, then the formula or formulae must be listed instead of the specimen rates, and wherever appropriate, rates of bonus must be expressed as a fraction of the attribute of the contract to which they are related, e.g. as rates per £1,000 of the sum assured and existing bonuses.

- (2) Information required under (1) need not be provided for any category of contract -
 - (a) where, no contracts were effected by the *insurer* during the ‘report period’; and
 - (b) which has been included under the miscellaneous heading in **Forms 51, 52, 53 and 54.**

16. A statement of the practice regarding any bonus payments (in addition to those for which the *insurer* has become contractually liable) to be made on *claims* arising in the period up to the next *actuarial investigation*, including the basis of calculation and the form in which the bonus is payable, together with -

- (a) where the rates of bonus depend on the original term of the contract or on the period of years a contract has been in force, specimen rates at 5 year intervals of original term or duration, as the case may be;
- (b) where the rates of bonus depend on the age of the life assured, specimen rates at 10 year intervals of age;
- (c) where the rates of bonus depend on the date of each previous premium payment, specimen rates at 5 year intervals of time since the premium

was paid, and for premiums paid in each of the 5 years ending with the report period; and

(d) in all other cases, full details of the rates of bonus,

but where the rates of bonus depend on a formula or a series of formulae, then the formula or formulae must be listed instead of the specimen rates, and wherever appropriate, rates of bonus are to be expressed as a fraction of the attribute of the contract to which they are related, e.g. as rates per £1,000 of the sum assured and existing bonuses.

17. Separate statements in the form set out in **Forms 46** and **46A** summarising changes in ordinary *long-term insurance business* and *industrial insurance business* for all non-group contracts. For group contracts only the number of contracts in force at the end of the 'report period' must be given in a supplementary note to the appropriate statement.
18. Separate statements in the form set out in **Forms 47** and **47A** showing an analysis of new *ordinary long-term insurance business* and *industrial insurance business*.
19.
 - (1) Separate statements of *long-term insurance business assets* (other than assets held to match *property linked* or *index linked liabilities*) in the form set out in **Forms 48** and **49** in respect of each fund or group of funds for which separate assets are appropriated.
 - (2) A brief description of the extent to which any of the amounts recorded in **Form 48** would be changed if assets which the *insurer* had a right or obligation to acquire or dispose of under *derivative contracts* or contracts having the effect of *derivative contracts* outstanding at the end of the *financial year* (being, in the case of *options*, only those *options* which it would have been prudent to assume would be exercised) had been so acquired or disposed of.
 - (3) A brief description of how different the information provided pursuant to (2) would have been if such *options* as were outstanding at the end of the year had been exercised in such a way as to change the amounts referred to in that paragraph to the maximum extent.
 - (4) A brief description of how different the information provided pursuant to (2) and (3) would have been if, instead of applying to contracts outstanding at the end of the *financial year*, those provisions had applied to *derivative contracts*

outstanding at such other time during the *financial year* as would have changed the amounts referred to in those provisions to the maximum extent.

20. (1) Separate statements in the form set out in **Forms 51, 52, 53** and **54** and separate analyses of unit liabilities in the form set out in **Forms 55** and **56** in respect of each separate fund or part of a fund for which a surplus is determined under rule 9.4.
 - (2) The analyses of unit liabilities must also include the liabilities in respect of any amounts deposited with the *insurer* under a *deposit back arrangement* which are either unit liabilities in respect of *property linked benefits* or investment liabilities in respect of *index linked benefits*.
 - (3) In the event that the liability for a specific fund link is wholly reinsured so that entries in columns 8 and 9 of **Form 55** are omitted in accordance with paragraph 7 of the instructions for the completion of that form a statement, if such be the case, to the effect that the provisions of rule 7.2 have been complied with in accordance with any published guidance in relation to the liabilities so reinsured.
21. (1) Separate statements in the form set out in **Form 57** for each fund or group of funds for which separate assets are appropriated in respect of all *long-term insurance business liabilities* except -
 - (a) unit liabilities in respect of *property linked benefits* as shown in column 12 of **Form 53**;
 - (b) investment liabilities in respect of *index linked benefits* as shown in column 12 of **Form 54**;
 - (c) any reserve in respect of provisions made for tax on unrealised capital gains in arriving at the valuation price of *internal linked funds*; and
 - (d) the liabilities in respect of any amounts deposited with the *insurer* under a *deposit back arrangement* which are either unit liabilities in respect of *property linked benefits* or investment liabilities in respect of *index linked benefits*.
- (2) A general description of the method by which the yield on assets other than equity *shares* and land was adjusted in accordance with rule 5.11(7).

- (3) For assets which are equity *shares* or land, a description of the categories into which such assets were divided for the purposes of rule 5.11(7), together with the method and basis by which the yield on such assets was adjusted in accordance with that rule.
22. Separate statements of the results of the valuation in the form set out in **Form 58** in respect of each separate fund or part of a fund for which a surplus is determined under rule 9.4.
23. (1) A statement of the *required minimum margin* for *long-term insurance business* in the form set out in **Form 60** and of the *required margin of solvency* for supplementary accident and sickness insurance in the form set out in **Form 61**.
- (2) If the gross annual office premiums for supplementary accident and sickness insurance in force on the ‘valuation date’ do not exceed 1% of the gross annual office premiums in force on that date for all *long-term insurance business*, **Form 61** need not be completed as long as it can be stated that the entry in line 10 of **Form 60** exceeds the amount that would be obtained if **Form 61** were to be completed. In this circumstance, the method of estimating the entry in line 10 of **Form 60**, together with a statement of the gross annual office premiums in force at the ‘valuation date’ in respect of supplementary accident and sickness insurance, must be given.)

FORMS

[Forms 46 – 61 to follow]

Instructions for completion of Form 46

1. Information must be gross of *reinsurance ceded* and must be provided separately for United Kingdom *insurance business* and overseas *insurance business*, and in each case for *non-linked* and *linked contracts*.
2. The box marked NL/LN must be completed by the insertion "LN" for a *linked contract*, and "NL" for a *non-linked contract*, as defined in rule 10.1.
3. The figures for annual premiums must include repeated or recurrent single premiums where the level of premium is defined.
4. For *hybrid linked contracts*, movements between linked and non-linked business must be shown in lines 13 and 27 as appropriate.
5. Only *claims* payments which result in the termination of a contract providing cover for other insured events may be shown in line 22.

Long term business : Summary of changes in industrial assurance business

Name of insurer

Global business

United Kingdom business/Northern Ireland business

Financial year ended

		Company registration number	Period ended			Units	UK/NI
			day	month	year		
		R46A				£000	
		Paying			Paid up		
		No of policies	Annual premiums		No of policies		
		1	2		3		
In force at beginning of year		11					
Taken up during year	Weekly business	12					
	Monthly business	13					
Converted to paid-up policies during year		14					
Total 'on'		19					
Discontinued during year by	Deaths	21					
	Maturities	22					
	Surrenders for cash	23					
	Terminations by return of premiums	24					
	Conversions to paid-up policies for full sums assured	25					
	Conversions to paid-up policies for reduced sums assured	26					
Forfeitures without grant of paid-up policy or cash surrender		27					
Total 'off'		29					
In force at end of year		31					

Instructions for completion of Form 46A

1. Separate forms must be prepared in respect of *insurance business* carried on in the United Kingdom and in Northern Ireland but information about the numbers of *policies* in force at the beginning and at the end of the year need not be given in respect of *insurance business* carried on in Northern Ireland.
2. The box marked UK/NI must be completed by the insertion of "UK" for *insurance business* carried on in the United Kingdom, and "NI" for *insurance business* carried on in Northern Ireland.
3. *Policies* discontinued by return of premiums on the death of the assured must be included in line 21 and not in line 24.
4. Paid-up *policies* which are written off must be included in line 21 in the case of whole life *policies* and line 22 in the case of endowments.

Long term insurance business : Analysis of new ordinary long term business

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Company registration number	GL/UK/CM	Period ended			Units
		day	month	year	
R47					£000

Type of insurance 1	Single premium contracts			Regular premium contracts		
	No of contracts 2	Premiums 3	Sums assured, annuities per annum or other measures of benefit 4	No of contracts 5	Annual premiums 6	Sums assured, annuities per annum or other measures of benefit 7

Instructions for completion of Form 47

1. New *insurance business* must be shown gross of *reinsurance ceded* and must include increases to premiums on existing *policies*, and in dealing with such increases, columns 2 and 5 must be left blank.
2. Single premium contracts must consist of those contracts under which there is no expectation of continuing premiums being paid at regular intervals. Additional single premiums paid in respect of existing individual contracts must be included.
3. Regular premium contracts must include those contracts under which premiums are payable at regular intervals during the *policy* year, including repeated or recurrent single premiums where the level of premium is defined.
4. Information must be shown separately and totalled within each section in the sequence specified below:
 - (i) United Kingdom *direct insurance business*,
 - (ii) United Kingdom *reinsurance* accepted,
 - (iii) overseas *direct insurance business*, and
 - (iv) overseas *reinsurance* accepted.
5. The information must be shown separately and totalled within each type of *insurance business* in the sequence specified below:
 - (i) life assurance and general annuity business,
 - (ii) pension business,
 - (iii) permanent health business, and
 - (iv) other business.
6. The information is to be further analysed and sub-totalled in the sequence specified below:
 - (i) *accumulating with-profits policies*,
 - (ii) non-linked *with-profits policies*,
 - (iii) non-linked *non-profits policies*,
 - (iv) *index linked contracts*, and
 - (v) other *linked contracts*.

and where a *policy* falls within more than one of the above categories, it must be placed in the first appropriate category.

7. Within each sub-division required under 5 and 6, the appropriate types of insurance from the following list are to be shown separately:
- (i) whole life assurance,
 - (ii) endowment assurance,
 - (iii) pure endowment assurance,
 - (iv) term assurance,
 - (v) other assurance (to be specified),
 - (vi) deferred annuity,
 - (vii) annuity in payment,
 - (viii) other annuity (to be specified),
 - (ix) permanent health insurance,
 - (x) capital redemption assurance,
 - (xi) annuity certain,
 - (xii) group pension,
 - (xiii) group life,
 - (xiv) group permanent health, and
 - (xv) other group (to be specified).
8. In the case of group contracts, the information must relate to new contracts and increments under existing contracts. The amount of the increment under an existing contract is the increase in the annual premium shown in Form 51, 52, 53 or 54 as appropriate, over the previous level shown in those Forms. Decreases in any year for an existing contract must be ignored.

Long term insurance business : Analysis of new industrial assurance business

Name of insurer

Global business

United Kingdom business/ Northern Ireland business

Financial year ended

		Company registration number	Period ended			Units	UK/NI
			day	month	year	£000	
		R47A					
		Whole life (including joint life)	Endowment assurance (including joint life)	(See instruction 2)	Other tables		
		1	2	3	4		
Number of new assurances	Weekly business	11					
	Monthly business	12					
Sums assured	Weekly business	13					
	Monthly business	14					
Annual premiums	Weekly business	15					
	Monthly business	16					

Instructions for completion of Form 47A

1. Separate forms must be prepared in respect of *insurance business* carried on in the United Kingdom and in Northern Ireland. The box marked UK/NI must be completed by the insertion "UK" for *insurance business* carried on in the United Kingdom, and "NI" for *insurance business* carried on in Northern Ireland.
2. If any table other than those shown in columns 1 and 2 (e.g. a table providing for recurring payments) is of a significant amount, details must be given in column 3 with an appropriate heading. In the case of a table including a recurring payment, the sum assured on death before the date of the first recurring payment must be shown against 'Sums assured' and the amount of the recurring payment must be shown separately in brackets.

Long term insurance business : Expected income from admissible assets not held to match liabilities in respect of linked benefits

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Category of assets

		Company registration number	GL/UK/CM	Period ended			Units	Category of assets
				day	month	year		
		R48					£000	
Type of asset			Value of admissible assets as shown on Form 13 1	Expected income from admissible assets 2	Yield % 3			
Land and buildings		11						
Fixed interest securities	Approved securities	12						
	Other	13						
Variable interest and variable yield securities (excluding items shown at line 16)	Approved securities	14						
	Other	15						
Equity shares and holdings in collective investment schemes		16						
Loans secured by mortgages		17						
All other assets	Producing income	18						
	Not producing income	19						
Total (11 to 19)		29						

Instructions for completion of Form 48

1. Where Form 13 is for the same fund or group of funds the entry at
48.11.1 must equal 13.11.1
48.12.1 must equal 13.45.1 + the appropriate part of 13.84.1
48.13.1 must equal 13.46.1 + the appropriate part of 13.84.1
48.14.1 must equal 13.47.1 + the appropriate part of 13.84.1
48.15.1 must equal 13.42.1 + 13.48.1 + the appropriate part of 13.84.1
48.16.1 must equal 13.41.1 + 13.43.1
48.17.1 must equal 13.50.1 + the appropriate part of 13.84.1
48.29.1 must equal 13.87.1 + 13.89.1 - 13.58.1 - 13.59.1.
2. The word "total" or the name of the fund must be shown against the heading "Category of assets". The corresponding code box must contain "10" for the total assets and, in the case of separate funds, code numbers corresponding to those allocated on completion of Form 13.
3. The appropriate part of the entry at 13.84.1 to be included in lines 12 to 15 of this form must be that part which represents accrued interest on assets included in the relevant line of this form. The amounts so included in each line must be stated in a supplementary note.
4. The expected income must be the amounts before deduction of tax which would be received in the next *financial year* on the assumption that the assets will be held throughout the year and that the factors which affect income will remain unchanged, but account must be taken of any changes in those factors known to have occurred by the *relevant date* (in particular changes of the type (a), (b), (c) or (d) denoted in rule 5.11(5)). The expected income shown in this Form must be that determined before any adjustments considered necessary because of rule 5.11(7).
5. Where a particular asset is required to be taken into account only to a specified extent by the application of the admissibility limits, the expected income from that asset must be included only to the same extent.
6. The treatment of the expected income from any asset where the payment of interest is in default and the amount of interest involved must be stated in a supplementary note.
7. The entries at 48.12.3, 48.13.3, 48.14.3 and 48.15.3 must be equal to 49.19.2, 49.29.2, 49.19.5 and 49.29.5 respectively. The yields to be inserted in column 3 for other categories of asset must be the running yields determined in accordance with rules 5.11(3) to (6A). The entry at 48.29.3 must be the weighted average of the yields in column 3, where the weight given to each asset is the value of that asset applicable for entry into column 1. Assets not producing income must be included in the calculation.
8. Where the yield in column 3 for a type of asset shown in line 17, 18 or 19 above (assumed to be zero for assets in line 19) is significantly different from the weighted average of the yields for each asset of that type determined in accordance with rule 5.11(6), then the latter yield figure must be shown in a supplementary note. For this purpose, the weighted average of the yields means an average yield weighted by the value of each asset of that type as entered in column 1.

9. Where an entry at 13.87.1 has resulted from excess exposure to a *counterparty* or excess concentration with a number of *counterparties*, the aggregate value of the assets of the *insurer* giving rise to *exposure* to such *counterparties* must be stated in a supplementary note, together with the expected income from those assets.

Long term insurance business : Analysis of admissible fixed interest and variable interest and variable yield securities not held to match liabilities in respect of linked benefits

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Category of assets

Company registration number	GL/UK/CM	Period ended			Units	Category of assets
		day	month	year		
R49					£000	

Redemption period in years		Value of admissible assets as shown on Form 13 1	Gross redemption yield % 2	Value of admissible higher yielding assets 3		Value of admissible assets as shown on Form 13 4	Gross redemption yield % 5	Value of admissible higher yielding assets 6
One year or less	11				Variable interest and variable yield approved securities excluding equities			
More than one year but not more than five years	12							
More than five years but not more than ten years	13							
More than ten years but not more than fifteen years	14							
More than fifteen years but not more than twenty years	15							
More than twenty years but not more than twenty five years	16							
More than twenty five years	17							
Irredeemable	18							
Total (11 to 18)	19							
One year or less	21				Other fixed interest securities			
More than one year but not more than five years	22							
More than five years but not more than ten years	23							
More than ten years but not more than fifteen years	24							
More than fifteen years but not more than twenty years	25							
More than twenty years but not more than twenty five years	26							
More than twenty five years	27							
Irredeemable	28							
Total (21 to 28)	29							

Instructions for completion of Form 49

1. The word "total" or the name of the fund must be shown against the heading "Category of assets". The corresponding code box must contain "10" for the total assets and, in the case of separate funds, code numbers corresponding to those allocated on completion of Form 13.
2. The gross redemption yield in columns 2 and 5 for each asset must be calculated as in rule 5.11(3), (4) and (6), leaving out of account any adjustment considered necessary because of rule 5.11(7). Where a number of assets with different gross redemption yields are held, the weighted average gross redemption yield must be calculated using as weights the value of the asset applicable for entry into columns 1 and 4 respectively.
3. The value of higher yielding *admissible assets* to be shown in columns 3 and 6 must be the value of *admissible assets* shown in Form 13 where the gross redemption yield on those assets exceeds the gross redemption yield shown in columns 2 and 5 respectively by at least 1.5%.
4. Where *securities* may be redeemed over a period at the option of the guarantor or the issuer, they must be classified on the assumption that they will be redeemed at the latest possible date or, if it is assumed that they will be redeemed at any earlier date, a supplementary note must be provided explaining what assumption has been made.
5. The entries at 49.19.1, 49.19.2, 49.19.4, 49.19.5, 49.29.1, 49.29.2, 49.29.4 and 49.29.5 must be equal to the values at 48.12.1, 48.12.3, 48.14.1, 48.14.3, 48.13.1, 48.13.3, 48.15.1 and 48.15.3 respectively.
6. The entries at 49.19.2, 49.19.5, 49.29.2 and 49.29.5 must be the weighted average of the yields in columns 2 and 5 as appropriate for lines 11 to 18 and 21 to 28 respectively, where the weight given to each yield is the value shown in columns 1 and 4 respectively.

Instructions for completion of Forms 51, 52, 53 and 54

1. Separate valuation summaries must be completed in respect of each separate fund or part of a fund for which a surplus is determined. The name of the fund or part of a fund is to be shown against the heading "Category of surplus". The corresponding code box must contain code numbers allocated sequentially beginning with code "11".
2. Separate totals for column 5 on Form 51 and columns 5, 6, and 7 on Forms 52, 53 and 54 must be shown for sums assured, for annuities per annum and for other measures of benefit.
3. Information must be shown separately and totalled for each of the following:
 - (i) United Kingdom *insurance business*, and
 - (ii) overseas *insurance business*.
4. The information must be shown on separate pages and totalled for each type of *insurance business* in the sequence specified below:
 - (i) life assurance and general annuity *insurance business*,
 - (ii) pension *insurance business*,
 - (iii) permanent health *insurance business*, and
 - (iv) other *insurance business*.
5. The box marked "Type of business" must be completed by the insertion of "L&GA", "Pens", "PHI" or "Other" respectively for each of the types (i), (ii), (iii) and (iv) specified above.
6. The information is to be further analysed and sub-totalled for:
 - (i) *direct insurance business*,
 - (ii) *reinsurance* accepted, and
 - (iii) *reinsurance ceded*,and totals net of *reinsurance ceded* must also be shown, but where any information to be provided in accordance with (iii) duplicates any information required to be provided in accordance with 7, 8 and 9 in respect of (i) or (ii), then for the purpose of (iii), the total of the *reinsurance ceded* may be shown in respect of the duplicated information.
7. The information must be further analysed and sub-totalled within each basis of participation in profits in the sequence specified below:
 - (i) *with-profits policies*, and
 - (ii) *non-profit policies*.

8. Within each subdivision required under 4, 6 and 7 the appropriate types of insurance from the following list must be shown separately:

- (i) whole life assurance,
- (ii) endowment insurance,
- (iii) pure endowment insurance,
- (iv) term assurance,
- (v) other assurance (to be specified),
- (vi) miscellaneous assurance,
- (vii) deferred annuity,
- (viii) annuity in payment,
- (ix) other annuity (to be specified),
- (x) miscellaneous annuity,
- (xi) permanent health insurance,
- (xii) capital redemption assurance,
- (xiii) annuity certain,
- (xiv) group pension,
- (xv) group life,
- (xvi) group permanent health, and
- (xvii) other group (to be specified),

and particulars must also be shown of any supplementary provisions within *general insurance business class 1* or *2* which by virtue of the Authorisation Manuary are to be taken to be included in *long-term insurance business* of any *class* (Supplementary and sickness insurance - see Form 61).

9. A further sub-division into each separate category of contract is required as follows:

Forms 51 and 52 - each category of contract which is valued on a different valuation basis;

Form 53 - each category of contract which provides different guarantees or options, and each category of unit link. For the purpose of determining the category of the unit link, all authorised unit trusts must be considered to be one category and all internal linked funds must be considered to be one category.

Form 54 - each category of contract which provides different guarantees or options and each category of index. Where the link is to a proportion of an index, each different proportion must be treated as a different category.

10. Any contract which consists of a combination of different types of insurance, as described in 8, must be treated as a number of separate contracts each dealing with one of the different types of insurance so combined and the amount by which the total number of contracts shown in column 4 of any valuation summary exceeds the actual number of contracts to which that valuation summary relates must be stated in a supplementary note.
11. For *linked contracts* with both *property linked* and *index linked benefits*, each benefit must be shown on Form 53 or 54 as appropriate, and a note must be attached describing the manner in which details relating to the number of contracts and the amounts of benefits, premiums and other liabilities have been treated. Where the number of contracts is overstated in aggregate, the amount of the overstatement must be stated in a supplementary note.
12. For *linked contracts* which are also *accumulating with-profits policies*, that part of the benefits which are with-profits must be shown on Form 52 and the remainder of the benefits on Form 53 and/or 54 as appropriate, and a note must be attached describing the manner in which details relating to the number of contracts, and the amounts of benefits, premiums and other liabilities have been treated. Where the number of contracts is overstated in aggregate, the amount of the overstatement must be stated in a supplementary note.
13. Reserves calculated on an aggregate basis (including reserves for taxation on capital gains, for investment performance guarantees or other special reserves) or adjustments must be shown on separate lines in the *mathematical reserves* column and the particulars of such reserves or adjustments must be specified.
14. Contracts the nature of which or the method of valuation of which makes it impossible or inappropriate to give the information in the exact form required by Forms 51, 52, 53 or 54, must be shown on a separate valuation summary with appropriately modified column headings and the reason for the modification stated in a supplementary note.
- 14A. Where a net premium method of valuation is not used for contracts reported on **Form 51** then, notwithstanding 14 –
 - (a) columns 7 and 8 must be left blank;
 - (b) if the method used does not separately identify suitable values to be entered in columns 9 and 10, then the total amount of *mathematical reserves* must be entered in columns 9 and 12, and columns 10 and 11 must be left blank; and
 - (c) if the method used does separately identify suitable values to be entered in columns 9 and 10, then the entry in column 11 must be the amount entered in column 10 less the amount reserved for future expenses, so that the amount in column 12 equals the amount in column 9 less the amount in column 11.

15. Contracts of any description may be grouped together under any "miscellaneous" heading as long as the *mathematical reserves* for *insurance business* shown under all such headings in any one valuation summary do not exceed 5% of the total *mathematical reserves* for all *insurance business* shown in that valuation summary.

Long term insurance business : Analysis of units in internal linked funds and direct holdings of assets matching liabilities in respect of property linked benefits

Name of insurer

Global business/UK branch business/EEA branch business

United Kingdom business/Overseas business

Financial year ended

Category of surplus

Internal linked fund/Directly held assets

Name of fund link or directly held asset	Name of unit type	Valuation price per unit or asset	Total actual number of units in force or directly held assets	Value of total actual units in force or directly held assets	Value of actual units held by other internal linked funds	Value of directly held assets and actual units in force excluding those held by other internal linked funds (5-6)	Value of units or directly held assets deemed allocated to contracts		Value of surplus units or directly held assets (7-8+9)																									
							Gross	Reinsurance ceded																										
							8	9																										
				<table border="1"> <tr> <td>Company registration number</td> <td>GL/UK/CM</td> <td colspan="3">Period ended</td> <td>Units</td> <td>UK/OS</td> <td>Category of surplus</td> <td>IL/DH</td> </tr> <tr> <td></td> <td></td> <td>day</td> <td>month</td> <td>year</td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td>R55</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td>£000</td> <td></td> <td></td> </tr> </table>			Company registration number	GL/UK/CM	Period ended			Units	UK/OS	Category of surplus	IL/DH			day	month	year					R55						£000			
Company registration number	GL/UK/CM	Period ended			Units	UK/OS	Category of surplus	IL/DH																										
		day	month	year																														
R55						£000																												
1	2	3	4	5	6	7	8	9	10																									

Instructions for completion of Form 55

1. The box marked "category of surplus" must be completed in accordance with paragraph 1 of the instructions for completion of Forms 51, 52, 53 and 54.
2. Separate forms must be prepared in respect of *internal linked funds* and directly held assets. The box marked IL/DH must be completed by the insertion of "IL" for *internal linked funds* and "DH" for directly held assets.
3. A separate line must be used for each asset to which benefits are linked and each different type of unit of each *internal linked fund*. Columns 5, 6, 7, 8, 9 and 10 must be sub-totalled for each fund link and totalled for all links.
4. The aggregate of the total figures shown for column 8 (excluding any amount shown in column 8 pursuant to 8) and 9 in each Form prepared in respect of a separate fund or part of a fund must equal the appropriate figure shown as the total of column 12 of Form 53.
5. For links to directly held assets, column 6 must not be used.
6. For *internal linked funds*, the total of column 5 must equal the total of column 8 of the summarised Form 43, and the total of column 6 must equal the total of column 3 of the summarised Form 43.
7. Where the liability shown in column 11 of Form 53 for a specific fund link is wholly *reinsured* with an *insurer*, so that the entries in columns 8 and 9 of this Form would otherwise be identical, the entries in respect of that fund link must be aggregated and shown on a separate line with the name of fund link to be shown in column 1 as "wholly *reinsured*".
8. Any amounts included in this analysis in accordance with paragraph 20 of Appendix 9.4, being unit liabilities in respect of *property linked benefits* deposited with the *insurer* under a *deposit back arrangement*, must, for each *internal linked fund* or directly held asset, be shown in column 8 on a separate line with the name of unit type to be shown in column 2 as "amounts deposited back".

Long term insurance business : Analysis of assets and liabilities matching investment liabilities in respect of index linked benefits

Name of insurer

Global business/UK branch business/EEA branch business

United Kingdom business/Overseas business

Financial year ended

Category of surplus

Company registration number	GL/UK/CM	Period ended			Units	UK/OS	Category of surplus
		day	month	year			
R56					£000		

Type of assets and liabilities	Name of index link	Value of assets or liabilities	Gross derivative value
	1	2	3
Total assets			
Total liabilities			
Net total assets			

Instructions for completion of Form 56

1. The box marked "category of surplus" must be completed in accordance with paragraph 1 of the instructions for completion of Forms 51, 52, 53 and 54.
2. Assets and liabilities in column 2 must be listed individually except that where a group of assets of similar type is held which is intended to mirror the performance of an index, a description of the type of assets held may be given. Liabilities must be shown between round brackets and must be fully described.
3. A separate sub-total of assets and liabilities must be used for each index link and for each combination of assets and liabilities matching the *insurer's* liability under any *deposit back arrangement*. Links to different percentages of an index must be treated as different index links.
4. For each index link, the sub-totalled values in column 2 (excluding those held in respect of any *deposit back arrangement*) must match the appropriate entries in column 12 of Form 54 net of *reinsurance ceded*.
5. Assets and liabilities arising from *derivative contracts* (or contracts or assets which have the effect of a *derivative contract*) must be shown separately. Amounts must be shown net of *variation margin* in column 2 and gross of *variation margin* in column 3. Rights to recover assets transferred by way of *initial margin* must not be shown on Form 56.
6. Where there is a liability to repay *variation margin* and there are no arrangements for netting of amounts outstanding or the arrangements would not permit the accounting of such amounts on a net basis in accordance with generally accepted accounting practice, it must be so stated in a supplementary note.
7. Any provision for adverse changes must be determined in accordance with rule 5.3 and shown in a supplementary note.

Instructions for completion of Form 57

1. The word “total” or the name of the fund must be shown against the heading “Category of assets”. The corresponding code box must contain “10” for the total assets and, in the case of separate funds, code numbers corresponding to those allocated on completion of Form 13.
2. Separate Forms must be prepared for sterling and non-sterling liabilities. The box marked “Stg/NonStg” must be completed by the insertion of “Stg” for Sterling liabilities and “NonStg” for non-sterling liabilities.
3. Separate Forms are required for with profit and non-profit contracts within the following types of business:
 - (i) life assurance and annuity business,
 - (ii) pension business,
 - (iii) permanent health business, and
 - (iv) other business.
4. The box marked “L&GA/Pens/PHI/Other” must be completed by the insertion of “L&GA”, “Pens”, “PHI” or “Other” respectively for each of the types (i), (ii), (iii) and (iv) specified above. The box marked “WP/NP” must be completed by the insertion of “WP” for *with-profits policies* or “NP” for *non-profit policies*.
5. Separate Forms must be prepared for each rate of interest used in the valuation in pursuance of rule 5.11(12) and may include all contracts valued at the same rate, subject to 2 and 3. Contracts valued at a lower rate of interest but subject to the same apportionment of assets may also be included as long as the rationale for such inclusion is given in a supplementary note. Each of the valuation rates of interest used must be itemised against the heading “Valuation rate(s) of interest”. The highest valuation rate of interest used must be shown in line 31 or 32 as appropriate and in the code box headed “Valuation rate of interest”.
6. The Forms specified above must exclude the liabilities described in paragraph 21(1) (a) to (d) of Appendix 9.4 and must cover at least 90% of the remaining *long-term insurance business liabilities*.

The balance of the remaining *long-term insurance business liabilities* must be shown in a separate Form in which lines 31 and 32 must be left blank, and details of the contracts covered by the Form must be given in a supplementary note. The word “balance” must be shown against the heading “Valuation rate(s) of interest” and the corresponding code box must contain “98”.
7. A summary of all the separate Forms must be produced as a separate Form in which lines 31 and 32 must be left blank. The word “total” must be shown against the heading “Valuation rate(s) of interest”, and the corresponding code box must contain “99”.
8. The risk adjusted yield in columns 2 and 6 for each asset included in column 1 and 5 respectively must be that calculated as in rules 5.11 (3) to (6), taking account of any adjustment considered necessary because of rule 5.11(7). Where a number of assets with different risk adjusted yields are held, the weighted average risk adjusted yield must be calculated using as weights the value of the asset applicable for entry into columns 2 and 6.

9. The value of each asset included in column 1 must be the value attributed to it in Form 13 and the assets must be grouped according to paragraph 1 of the instructions for completion of Form 48 including adjustments in respect of accrued interest.
10. Where the valuation has been carried out at a net rate or rates of interest, the figure in line 31 must be the net rate grossed up at the corresponding effective rate of tax in respect of the highest valuation rate of interest used in the Form.
11. The *mathematical reserve* in line 33 must include any increase in reserve resulting from the bonus declaration for the year and must be net of reinsurance *ceded*.
12. The entries shown in columns 3, 4, 5 and 6 must be those applicable to the scenario described in the answer to paragraph 7(8) of Appendix 2.2. The entries in column 3 must be the value of the assets shown in column 1 according to the changed assumptions of that scenario. The entries in column 4 must be the value of assets on the changed assumptions for each type of asset notionally re-allocated to cover the *mathematical reserve* or other liability, net of *reinsurance*, in the resilience scenario. The entries in column 5 must equal the sum of the entries in columns 3 and 4.
13. The entries in line 29, column 1 must equal the entries in line 33, column 1. The entries in line 29, column 5 must not be less than the entries in line 33, column 5.

Long term insurance business : Valuation result and distribution of surplus

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Company
registration
number

GL/UK/CM

Period ended
day month year

Units

Category
of surplus

Category of surplus

R58

£000

Valuation result	Fund carried forward		11	
	Bonus payments made to policyholders in anticipation of a surplus		12	
	Transfers out of fund/ parts of fund	Transfer to non-technical account	13	
		Transfer to other funds/parts of funds	14	
	Net transfer out of funds/parts of funds (13+14)		15	
	Total (11+12+15)		16	
	Mathematical reserves for accumulating with profit policies		17	
	Mathematical reserves for other non linked contracts		18	
	Mathematical reserves for property linked contracts		19	
	Mathematical reserves for index linked contracts		20	
	Total (17 to 20)		21	
Surplus including contingency and other reserves held towards the solvency margin (deficiency) (16-21)		29		
Composition of surplus	Balance of surplus brought forward unappropriated from last valuation		31	
	Transfers into fund/part of fund	Transfer from non-technical account	32	
		Transfer from other funds/parts of fund	33	
	Net transfer into fund/part of fund (32+33)		34	
	Surplus arising since the last valuation		35	
Total (31+34+35)		39		
Distribution of surplus	Bonus payments made to policyholders in anticipation of a surplus		41	
	Allocated to policyholders by way of	Cash bonuses	42	
		Reversionary bonuses	43	
		Other bonuses	44	
		Premium reductions	45	
	Total allocated to policyholders (41 to 45)		46	
	Net transfer out of fund/part of fund		47	
	Total distributed surplus (46+47)		48	
Balance of surplus (including contingency and other reserves held towards the solvency margin) carried forward unappropriated		49		
Total (48+49)		59		
Percentage of distributed surplus allocated to policyholders of fund/part of fund			61	
Corresponding percentage at three immediately previous valuations	Latest	(year of valuation)	62	
	Earlier	(year of valuation)	63	
	Earliest	(year of valuation)	64	

Instructions for completion of Form 58

1. Separate statements must be completed in respect of each separate fund or part of a fund for which a surplus is determined. The name of the fund or part of a fund must be shown against the heading "Category of surplus". The corresponding code box must contain code numbers allocated in accordance with paragraph 1 of the instructions for completion of Forms 51, 52, 53 and 54.

The entry at line 11 must be equal to the entry at line 59 in Form 40 for the relevant fund or part of fund.

2. Where interim, mortuary or terminal bonuses are determined in advance of a valuation and are paid in anticipation of surplus arising at the valuation, the amounts of such bonus actually paid in the period up to the *relevant date* must be entered in lines 12 and 41. To the extent that it is the practice of the *insurer* to make special provision for the cost of such bonuses payable on future claims out of surplus arising at a valuation, such amounts must be treated as amounts allocated to *policy holders* at the valuation in question and included in line 44, and the actual amounts paid must not appear at lines 12 and 41 at future valuations. An appropriate supplementary note must identify the various items where necessary.
3. Where *policies* have been transferred from one fund/part of fund to another, the associated transfer of reserves must not be included as a "transfer" in this Form. Where any other transfer has been made, only one positive figure must be inserted in either line 15 or line 34 (depending on the direction of the net transfer) leaving the other line blank. Corresponding entries must be made in either the block comprising lines 13 and 14 or the block comprising lines 32 and 33, as appropriate.
4. Where the entry in line 14 or line 33 represents more than one transaction, each transfer must be separately identified in a supplementary note.
5. Line 61 is line 46 expressed as a percentage of line 48.
6. For each fund/part of fund, the entry at line 18 must equal the total liabilities shown in column 12 of Form 51, and the entries at lines 17, 19 and 20 must equal the total liabilities shown in column 15 of Forms 52, 53 and 54 respectively.
7. The figure at lines 39 and 59 must equal the figure at line 29.
8. The figure at line 47 must equal the figure at line 15.

Instructions for completion of Form 60

1. The appropriate factors must be as specified in rules 2.5(2)(a) and 2.6(3) and (4).
2. For a *pure reinsurer*, the factor of 0.85 is replaced by 0.50.
3. Capital at risk must be shown after distribution of surplus.
4. Line 39 equals line 32 x [line 21 x 0.1% + line 22 x 0.15% + line 23 x 0.3%] for *classes* I, II and IX or line 32 x line 29 x 0.3% for *class* III, VII and VIII.
5. Any additional *mathematical reserves* referred to in the supplementary note to Form 14 (made in accordance with paragraph 4 of the instructions for completion of that Form) must be included at columns 11 or 12, as appropriate.
6. For *class* V business, the amount of the *required margin of solvency* must be stated in a supplementary note to the Form and must be included in line 51.

Supplementary accident and sickness insurance : Calculation of required margin of solvency

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

		Company registration number	GL/UK/CM	Period ended			Units
				day	month	year	
		R61					£000
				This financial year		Previous year	
				1		2	
Gross premiums written		11					
Premium taxes and levies (included in line 11)		12					
Sub-total A (11-12)		19					
Adjusted Sub-total A if financial year is not a 12 month period to produce an annual figure		21					
Division of Sub-total A (or adjusted Sub-total A if appropriate)	18% of amounts up to sterling equivalent of 10M EURO	22					
	16% of excess (if any) over 10M EURO	23					
Sub-total B (22+23)		29					
Claims paid		31					
Claims outstanding carried forward at end of this financial year		32					
Claims outstanding brought forward at beginning of this financial year		33					
Sub-total C (31+32-33)		39					
Amounts recoverable from reinsurers in respect of claims included in sub-total C		41					
Sub-total D (39-41)		49					
Required margin of solvency for supplementary accident and sickness insurance: Sub-total B x <u>Sub-total D</u> (or, if 0.5 is greater, x 0.5) Sub-total C		59					

Instruction for completion of Form 61

"Supplementary accident and sickness insurance" means insurance falling within *general insurance business classes 1 (Accident) and 2 (Sickness)* which is supplementary to *long-term insurance business* and for which a Part IV permission is not required (see *AUTH*).

APPENDIX 9.5 (rule 9.32)

GENERAL INSURANCE BUSINESS ADDITIONAL INFORMATION ON BUSINESS CEDED

For the purposes of rule 9.35, an *insurer* which carries on *general insurance business* must, in respect of the *financial year in question*, prepare a statement of the following information.

1. Subject to 2, for each *contract of insurance* entered into or modified during the *financial year in question* under which *general insurance business* has been *ceded* by the *insurer* on a non-facultative basis, the *insurer* must prepare a statement of -
 - (a) the type of business covered by reference to risk groups or *business categories*, as appropriate, and if only part of a risk group or *business category* is covered, a description of that part;
 - (b) the type of cover, including such details of the terms and conditions of the contract as are necessary for a proper understanding of the nature of the cover;
 - (c) details of any limits on cover as are necessary for a proper understanding of the contract, including any event limits, limits on the amount of business *ceded*, limits on the number of reinstatements and aggregate limits; and
 - (d) the period of cover.
2. Where a contract of *reinsurance* has been modified during the *financial year in question* -
 - (a) no information need be supplied pursuant to 1 in respect of a contract of reinsurance which was entered into before the beginning of the *financial year* of the *insurer* to which the Insurance Companies (Accounts and Statements) Regulations 1996 first applied; and
 - (b) in any other case, the information to be supplied pursuant to 1 must be limited to any changes to the information previously supplied pursuant to that paragraph or its predecessor legislation in respect of that contract.

3. For every contract reported pursuant to 1, whether in the *return* for the *financial year in question* or any previous *return*, the *insurer* must also prepare, if relevant, a statement of -
 - (a) in the case of contracts which are subject to no or a limited number of reinstatements, any contract not previously reported pursuant to this provision (or its predecessor) under which it is anticipated that such limit will be exhausted by claims (including claims incurred, but not reported, in respect of any specific occurrence for which provisions have been allocated);
 - (b) the percentage of cover, if in excess of 10% and if such information has not already been included in the return of the insurer for any previous financial year, which has been ceded to reinsurers which have ceased to pay claims to their reinsureds in full, whether because of insolvency or for any other reason; and
 - (c) if the percentage specified in (b) has increased by more than 10 percentage points since the previous financial year in which it was included in the insurer's return, a statement of that percentage unless, in the opinion of the directors, the likelihood of any claim being incurred under that policy is minimal.

4.
 - (1) For each *business category* or risk group, or part thereof, in respect of which separate non-facultative *reinsurance* cover has been obtained, the *insurer* must prepare a statement of the 'maximum net probable loss' to the *insurer* from any one *contract of insurance* effected by it and from all such contracts taken together.
 - (2) For the purposes of (1), the **maximum net probable loss** is the maximum loss (net of *reinsurance*) arising from any one incident, or any one series of incidents from the same originating cause, which -
 - (a) the *directors*, at the time they decided upon the *reinsurance* cover in respect of the *financial year in question*, reasonably contemplated to be of a type which might take place during that *financial year*; or
 - (b) has actually occurred during the *financial year in question*.
 - (3) The disclosure required by (1) must be given in respect of all *business categories*, risk groups, or parts thereof, of the *insurance business* carried on by the *insurer* whether or not the *insurer* has purchased any *reinsurance* cover

for that *business category*, risk group, or part thereof, and in (2) deciding upon the *reinsurance* cover includes deciding not to obtain any *reinsurance* cover.

5. For each *accounting class* and separately for contracts of facultative and non-facultative *reinsurance ceded* in respect of the *financial year in question* (as shown on **Forms 21** and **24**), the amount of the *reinsurers'* share of *gross premiums* must be stated.
-

APPENDIX 9.6 (rules 9.34 and 9.35)

CERTIFICATES BY DIRECTORS AND ACTUARY AND REPORT OF THE AUDITORS

Part I

Certificate by directors etc.

1. Subject to 7, the certificate required by rule 9.34(a) must state -
 - (a) in relation to the part of the *return* comprising **Forms 9 to 17, 20 to 45** (including the supplementary notes) and the statements required by rules 9.25 to 9.27, 9.29, 9.30 and 9.32 that -
 - (i) the *return* has been prepared in accordance with the *Accounts and Statements Rules*,
 - (ii) proper accounting records have been maintained and adequate information has been obtained by the *insurer*, and
 - (iii) appropriate systems and controls have been established and maintained by the *insurer* over its transactions and records;
 - (b) that reasonable enquiries have been made by the *insurer* for the purpose of determining whether any person and any *body corporate* are connected for the purposes of rules 9.25, 9.26 and 9.27;
 - (c) that in respect of the *insurer's* business which is not excluded by rule 7.6, the assets held throughout the *financial year in question* enabled the *insurer* to comply with rules 7.1 to 7.5 (matching and localisation); and
 - (d) in relation to the statement required by rule 9.36 -
 - (i) that for the purpose of preparing the statement, proper accounts and records have been maintained, and
 - (ii) that the information given has been ascertained in conformity with that rule.

2. Subject to 7, the certificate required by rule 9.34(a) must also, in the case of a *insurer* which is required by 2.1 to maintain a *margin of solvency*, *EEA margin of solvency* or *UK margin of solvency*, state that the required margin has been so maintained throughout the *financial year in question*.
3. Subject to 7, the certificate required by rule 9.34(a) must also state, separately in respect of *long-term insurance business* and of *general insurance business* -
 - (a) in the case of -
 - (i) an *EEA deposit insurer*, that the value of the *admissible assets* of the *long-term insurance business* or of the general insurance business carried on by the *insurer* through a branch in the United Kingdom was maintained throughout the *financial year in question* at not less than the amount of the liabilities of that business, and
 - (ii) a *Swiss general insurer*, that the value of the *admissible assets* of the *general insurance business* carried on by the insurer through a branch in the United Kingdom was maintained throughout the *financial year in question* at not less than the amount of the liabilities of that business;
 - (b) in the case of an *external insurer* (other than a *pure reinsurer*) -
 - (i) that the *insurer* has kept throughout the *financial year in question* *admissible assets* representing the required United Kingdom *guarantee fund* within the United Kingdom, and has kept *admissible assets* representing any remainder up to the *UK margin of solvency* within the *EEA States*, and
 - (ii) that the *deposit* has been maintained throughout that year at a level equal to at least 'the minimum' as set out in rule 8.2; and
 - (c) in the case of a *UK deposit insurer* -
 - (i) that the *insurer* has kept throughout the *financial year in question* *admissible assets* representing the required EEA *guarantee fund* within the *EEA States* concerned and has kept *admissible assets* representing any remainder up to the *EEA margin of solvency* within the *EEA States*, and

- (ii) that the *deposit* has been maintained throughout that year at a level equal to at least 'the minimum' as set out in rule 8.2.

4. Subject to 7, if the *insurer* carries on *long-term insurance business*, the certificate required by rule 9.34(a) must also state -

- (a) except in the case of a *insurer* which has no shareholders and carries on no business whatsoever other than *long-term insurance business*, that the requirements of rules 3.1 to 3.4 have been complied with and in particular that, subject to the provisions of rule 3.2(2) to (4) and rule 3.3, assets attributable to *long-term insurance business*, the income arising therefrom, the proceeds of any realisation of such assets and any other income or proceeds allocated to the *long-term insurance business fund or funds* have not been applied otherwise than for the purpose of the *long-term insurance business*;
- (b) that any amount payable from or receivable by the *long-term insurance business fund or funds* in respect of services rendered by or to any other business carried on by the *insurer* or by a person who, for the purposes of rule 3.4, is connected with it or is a *subsidiary undertaking* of it has been determined and where appropriate apportioned on terms which are believed to be no less than fair to that fund or those funds, and any exchange of assets representing such fund or funds for other assets of the *insurer* has been made at fair *market value*;
- (c) that all guarantees given by the *insurer* of the performance by a *related company* which would fall to be met by any *long-term insurance business fund* have been disclosed in the *return*, and that the fund or funds on which each such guarantee would fall has been identified in the *return*;
- (d) in respect of any *internal linked fund or funds* maintained by an *insurer*, that the investment policy and practice of the *insurer* was during the *financial year in question* consistent with any representations made to *policy holders* or potential *policy holders* of the *insurer*;
- (e) in the case of a *insurer* having its head office in the United Kingdom, a *pure reinsurer*, a *UK deposit insurer* or an *external insurer*, being a *insurer* which has financial, commercial or administrative links with any other *insurer* carrying on *insurance business*, that the *return* in respect of *long-term insurance business* is not distorted by agreements

between the *insurers* concerned or by any arrangements which could affect the apportionment of expenses and income; and

(f) in the case of a *insurer* to which rule 3.5 applies, that the *insurer* has complied with the requirements of that rule.

5. Subject to 7, where the *directors* are satisfied that -

(a) the systems and controls established and maintained by the *insurer* in respect of its business complied, at the end of the *financial year in question*, with any relevant guidance⁴ and it is reasonable to believe that those systems and controls continued so to comply subsequently and will continue so to comply in future; or

(b) the *return* has been prepared in accordance with any relevant guidance⁵,

it must be so stated, by listing such guidance, in the certificate required by rule 9.34(a).

6. Except in the case of a *insurer* whose head office is in an *EEA State* or a *Swiss general insurer*, the certificate required by rule 9.34(a) must also, subject to 7, state that proper accounting records have been maintained in the United Kingdom in respect of *insurance business* carried on through a branch in the United Kingdom.

7. (1) Where, in the opinion of those signing the certificate, the circumstances are such that any of the statements required by 1 to 6 cannot truthfully be made, the relevant statements must be omitted.

(2) Where, by virtue of (1), any statements have been omitted from the certificate, this fact must be stated in a note to the certificate.

⁴ See **Guidance Notes P1 and P2** and **Guidance Notes** for Insurance and Retail products (issued by the Joint Money Laundering Steering Group)

⁵ See **Guidance Notes 4.1, 4.2 and 9.1**

Part II

Certificate by appointed actuary

8. The certificate required by rule 9.34(b) to be signed by the *appointed actuary* -
- (a) must state -
 - (i) if such be the case, that in the *appointed actuary's* opinion proper records have been kept by the *insurer* adequate for the purpose of the valuation of the liabilities of its *long-term insurance business*,
 - (ii) if such be the case, that the sum of the *mathematical reserves* and the deposits received from *reinsurers* as shown in **Form 14**, together, if the case so requires, with an amount specified in the certificate (being part of the excess of the value of the *admissible assets* representing the *long-term insurance business funds* over the amount of those funds shown in **Form 14**), constitute proper provision at the end of the *financial year in question* for the *long-term insurance business liabilities* (including all liabilities arising from *deposit back arrangements*, but excluding other liabilities which had fallen due before the end of the *financial year*) including any increase in those liabilities arising from a distribution of surplus as a result of an actuarial investigation as at that date into the financial condition of the *long-term insurance business*,
 - (iii) if such be the case, that, for the purposes of (ii), the liabilities have been assessed in accordance with the *Determination of Liabilities Rules* in the context of assets valued in accordance with the *Valuation of Assets Rules*, as shown in **Form 13**;
 - (iv) by way of a list, the professional guidance that has been complied with; and
 - (v) if such be the case, that in the *appointed actuary's* opinion premiums for contracts entered into during the *financial year* and the income earned thereon are sufficient, on reasonable actuarial assumptions, and taking into account the other financial resources of the *insurer* that are available for the

purpose, to enable the *insurer* to meet its commitments in respect of those contracts and, in particular, to establish adequate *mathematical reserves*; and

- (b) must state the amount of the *required minimum margin*, *required EEA minimum margin* or *required United Kingdom minimum margin*, as the case may be, applicable to the *insurer's long-term insurance business* immediately following the end of *the financial year in question* (including any amounts resulting from any increase in liabilities arising from a distribution of surplus as a result of the investigation into the financial condition of the *long-term insurance business*).

9. If the *appointed actuary* considers it necessary, such qualification, amplification or explanation as may be appropriate must be added to the certificate.

Part III

Auditors' report

10. (1) The report required by rule 9.35 must, in addition to any statement required by section 237(2) and (3) of the *Companies Act* or article 245(2) and (3) of the *1986 Order* as applied by rule 9.35 state -
- (a) in the auditors' opinion, whether **Forms 9 to 17, 20 to 45** (including the supplementary notes) and information furnished pursuant to rules 9.25 to 9.27 and 9.29 have been properly prepared in accordance with the provisions of the *Accounts and Statements Rules*;
 - (b) in the auditors' opinion, and according to the information and explanations they have received -
 - (i) whether the certificate required to be signed in accordance with rule 9.34(a), otherwise than in relation to statements to which (2) relates, has been properly prepared in accordance with the *Accounts and Statements Rules*, and
 - (ii) subject to 11, whether it was or was not unreasonable for the persons giving the certificate to have made the statements in it (other than statements to which (2) relates); and
 - (c) the extent to which, in giving their opinion, the auditors have relied -

- (i) in the case of an *insurer* carrying on *long-term insurance business*, on the certificate of the actuary given in accordance with the requirements of Part II of this Appendix with respect to the *mathematical reserves* and *required minimum margin*, required *EEA minimum margin* or required *United Kingdom minimum margin*, as the case may be, of the *insurer*; and
 - (ii) in the case of an *insurer* including *implicit items* on **Form 9**, on the identity and value of any *implicit items* as they have been admitted in accordance with rule 2.10.
 - (2) The statements to which this sub-paragraph relates are those required by -
 - (a) rules 9.30, 9.32 and 9.36;
 - (b) 4(d); and
 - (c) 5 but only in so far as it relates to relevant guidance which relates to controls with respect to money laundering.
 - 11. To the extent that the information and explanations they have received do not allow the auditors to express an opinion on whether it was or was not unreasonable for the persons giving the certificate required to be signed in accordance with rule 9.34(a) to have made the statement required by 5, the auditors must add to their report such qualification, amplification or explanation as may be appropriate.
 - 12. Where the auditors refer in their report or in any note attached to it to any uncertainty, the report must state whether, in the auditors' opinion, that uncertainty is material to determining whether the *insurer* has available assets in excess of its *required minimum margin*, *required EEA minimum margin* or *required UK minimum margin*, as the case may be.
-

APPENDIX 9.7 (rule 9.37)

**INSURANCE STATISTICS: OTHER EEA STATES
(FORMS 91 TO 94)**

The statements to be provided under rules 9.37 and 9.38 must be given in the form set out in **Forms 91 to 94**.

Instruction for completion of Form 91

The box described as "EEA State in which branch is situated" must be completed by inserting the appropriate Code from the *FSA* list of "Country Codes".

General insurance business : Analysis of financial particulars - provision of services

Name of insurer

EEA State in which risk is situated

Company registration number	<u>Calendar year ended</u> day month year	Units	EEA State in which risk is situated
F92	31 12	£000	

Groups of Classes							
Accident and sickness 1	Land vehicles, goods in transit and motor vehicle liability (carrier's liability only) 2	Motor vehicle liability (excluding carrier's liability) 3	Fire and other damage to property 4	Aviation, marine and transport 5	General liability 6	Credit and suretyship 7	Other classes 8

Gross premiums written in calendar year	11							
Cost of gross claims paid in calendar year	12							
Cost of gross commission attributable to premiums shown at line 11	13							

Instructions for completion of Form 92

1. The box described as "EEA State in which risk is situated" must be completed by inserting the appropriate Code from the *FSA* list of "Country Codes".
2. Gross commission attributable equals gross commission paid in the *financial year in question* plus gross commission brought forward less gross commission carried forward.

Instructions for completion of Form 93

1. The box described as "EEA State in which branch is situated" must be completed by inserting the appropriate Code from the *FSA* list of "Country Codes".
2. The headings used in this Form are taken from the Companies Act 1985 (Insurance Companies Accounts) Regulations 1993 (S.I. 1993/3246).

Long term insurance business : Analysis of financial particulars - provision of services

Name of insurer

EEA State of commitment

Company registration number	Calendar year ended			Units	EEA State of commitment
	day	month	year		
F94	31	12		£000	

Authorisation classes								
I	II	III	IV	V	VI	VII	VIII	IX
Life and annuity	Marriage and birth	Linked long term	Permanent health	Tontines	Capital redemption	Pension fund management	Collective insurance etc.	Social insurance
1	2	3	4	5	6	7	8	9

Gross premiums receivable for services business in calendar year	11								
--	-----------	--	--	--	--	--	--	--	--

Instruction for completion of Form 94

The box described as "*EEA State of commitment*" must be completed by inserting the appropriate Code from the *FSA* list of "Country Codes".

APPENDIX 9.8 (rule 9.36A)

MARINE MUTUALS: ITEMS TO BE DISREGARDED, DIRECTORS' CERTIFICATES AND AUDITORS REPORTS

Part 1

Items to be disregarded

1. In completing the Forms required under rule 9.36A, a *marine mutual* must disregard *reinsurance* arrangements with any *relevant company* and must treat income and expenditure and assets and liabilities of any *relevant company* as, respectively, income and expenditure and assets and liabilities of the *marine mutual*.

Part II

Directors' certificates

2. Subject to 4, every *return* provided by a *marine mutual* under rule 9.36A must include a certificate signed by the persons required by rule 9.33 to sign the documents to which the certificate relates –
 - (a) confirming that –
 - (i) the *return* has been prepared in accordance with the *Accounts and Statements Rules*,
 - (ii) proper accounting records have been maintained and adequate information on which to base the *return* has been obtained,
 - (iii) appropriate systems and controls have been established and maintained by the *marine mutual* with respect to its transactions and records,
 - (iv) the value or amount given for an asset or liability of the *marine mutual* has been determined in accordance with the *Valuation of Assets Rules* and the *Determination of Liabilities Rules*,
 - (v) in respect of the *marine mutual's insurance business* not excluded by rule 7.6, throughout the *financial year in question*

- the *marine mutual* complied with rules 7.1 to 7.5 (currency matching and localisation),
- (vi) the *marine mutual* maintained the *required margin of solvency* throughout the *financial year in question*,
 - (vii) each member of the *marine mutual* which is subject to them has accepted those parts of the *marine mutual's* rules which oblige members to pay their share of any supplementary calls for the year and of calls to meet the *required minimum margin* (including any sum needed to make good failure by other members to pay calls made on them), and
 - (viii) the *marine mutual* is empowered to make supplementary calls on its members which, if met, would produce sufficient assets to meet the *required minimum margin*; and
- (b) giving information about the number of –
- (i) members of the *marine mutual* which are not reinsured members,
 - (ii) fixed premium members (on which supplementary calls may not be made),
 - (iii) reinsured members (that is, members whose *contract of insurance* with the *marine mutual* is a contract of *reinsurance*), and
 - (iv) the tonnage of shipping attributable to each of the above classes of members, taken separately, and covered by the *marine mutual* at the end of the *financial year in question*.

3. Subject to 4, where the *directors* are satisfied that –

- (a) the systems and controls established and maintained by the *marine mutual* in respect of its *insurance business* complied, at the end of the *financial year in question*, with the relevant guidance in Guidance Notes P.1 and P.2 and it is reasonable to believe that those systems and controls continue so to comply and will continue so to comply in future; or

- (b) the *return* has been prepared in accordance with the relevant guidance in Guidance Note 9.1,

it must be so stated in the certificate.

- 4. (1) Where, in the opinion of the *directors*, the circumstances are such that any of the matters specified in 2 and 3 cannot be confirmed or provided, the relevant statements or information must be omitted.
- (2) Where any statements or information have been omitted from the certificate in accordance with (1), this fact must be explained in a note to the certificate.

Part III

Auditor's reports

- 5. Every *marine mutual* must procure an auditor's report, pursuant to *SUP*, stating whether, in the auditors' opinion –
 - (a) the Forms, information and statements required have been properly prepared in accordance with the *Accounts and Statements Rules*;
 - (b) where the auditors refer in their report or in any note to any uncertainty, that uncertainty is material to determining whether the *marine mutual* has *available assets* in excess of its *required minimum margin, required EEA minimum margin, or required UK minimum margin*, as the case may be; and
 - (c) subject to 6, it was or was not reasonable for the persons giving the *directors'* certificate to have made the statements in it.
- 6. Where the information or explanations given to the auditors is insufficient to allow them to be able to express an opinion on the reasonableness of the statements made in the *directors'* certificate, the report must include such qualification, amplification or explanation as may be appropriate.

Forms M1 to M5 follow

Marine mutuals : Revenue account

Name of insurer

Financial year ended

Company
registration
numberPeriod ended
day month yearUnits
(See instruction 1)

M1

			This financial year 1	Previous year 2	Source	
Income	Gross income from contributions etc	11				
	Reinsurance premiums paid	12				
	Net income from contributions and premiums	13				
	Investments	Income before tax	14			
		Value re-adjustments on investments	15			
		Gains on realisation of investments	16			
	Other income	17			See instruction 2	
Total (13 to 17)	19					
Expenditure	Claims paid	21				
	Reinsurance recoveries received	22				
	Net claims paid (21-22)	23				
	Claims outstanding carried forward	24				
	Claims outstanding brought forward	25				
	Increase (decrease) in claims outstanding (24-25)	26				
	Unexpended contributions and unearned premiums (if any) and any amounts set aside for unexpired risks carried forward	27			See instruction 3	
	Unexpended contributions and unearned premiums (if any) and any amounts set aside for unexpired risks brought forward	28			See instruction 3	
	Increase (decrease) in unexpended contributions and unearned premiums (if any) and any additional amounts set aside for unexpired risks (27-28)	29			See instruction 3	
	Administrative expenses	30				
	Acquisition costs including commission	31				
	Taxation	32				
Other expenditure	33			See instruction 4		
Total (23+26+29 to 33)	39					
Surplus/deficit of income over expenditure (19-39)	49					

Instructions for completion of Form M1

1. Units must in £, £000, US\$, or US\$000 as appropriate.
2. Particulars of other income shown in line 17 must be stated in a supplementary note.
3. Unexpended contributions, unearned premiums, etc shown in lines 27, 28 or 29 must be recorded net of *reinsurance* and deferred acquisition costs.
4. Particulars of other expenditure shown in line 33 must be stated in a supplementary note.

Form M2

Marine mutuals : Statement of solvency

Name of insurer

Financial year ended

	Company registration number	Period ended			Units		
		day	month	year	(See instruction 1)		
	M2						
	As at the end of the financial year	As at the end of the previous financial year	Source				
	1	2	Form	Line	Column		

ASSETS

Admissible assets	11			M3	. 89
Calls approved by the Board but unmade at the end of the financial year	12				
Total (11+12)	19				

LIABILITIES

Unexpended contributions and unearned premiums and any additional amounts set aside for unexpired risks, gross of reinsurance and deferred acquisition costs	21			See instruction 2	
Gross provision for outstanding claims	22			See instruction 3	
Creditors	23				
Taxation	24				
Other liabilities	25			See instruction 4	
Total (21 to 25)	29				

REQUIRED MINIMUM MARGIN

Net admissible assets (19-29)	31				
Calls unapproved by the Board at the end of the financial year	32			See instruction 5	
Available net assets (31+32)	33				
Required minimum margin	34				
Excess (deficiency) of available net assets over the required minimum margin (33-34)	39				

Instructions for completion of Form M2

1. Units must be the same as those used in Form M1.
2. The amount shown at line 21 must equal the sum of M1.27+M3.60+M3.62+M3.85.
3. The amount shown at line 22 must equal the sum of M4.29.8+M4.29.9 for all marine *classes*.
4. Details of the amount shown in line 25 must be stated in a supplementary note.
5. The amounts shown at line 32 must not exceed 50% of the amounts shown at line 34.

Marine mutuals : Analysis of admissible assets

Name of insurer

Financial year ended

M3	Company registration number			Period ended			Units (See instruction 1)
	day	month	year				

Investments			As at the end of this financial year 1	As at the end of the previous year 2
Land and buildings			11	
Investments in group undertakings and participating interests	UK insurance dependants	Shares	21	
		Debt securities issued by, and loans to, dependants	22	
	Other insurance dependants	Shares	23	
		Debt securities issued by, and loans to, dependants	24	
	Non-insurance dependants	Shares	25	
		Debt securities issued by, and loans to, dependants	26	
	Other group undertakings and participating interests	Shares	27	
		Debt securities issued by, and loans to, group undertaking	28	
		Participating interests	29	
		Debt securities issued by, and loans to, undertakings in which the insurer has a participating interest	30	
Total sheet 1 (11 to 30)			39	

Marine mutuals : Analysis of admissible assets

Name of company

Financial year ended

Company
registration
number

Period ended
day month year

Units
(See instruction 1)

M3					
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Investments (continued)			As at the end of this financial year 1	As at the end of the previous year 2	
Deposits with ceding undertakings					
Assets held to cover linked liabilities					
Other financial investments	Equity shares		41		
	Other shares and other variable yield securities		42		
	Holdings in collective investment schemes		43		
	Rights under derivative contracts		44		
	Debt securities and other fixed income securities	Fixed interest	Approved securities	45	
			Other	46	
		Variable interest	Approved securities	47	
			Other	48	
	Participation in investment pools		49		
	Loans secured by mortgages		50		
	Other loans	Loans to public or local authorities and nationalised industries or undertakings		51	
		Loans secured by policies of insurance issued by the company		52	
		Other		53	
	Deposits with approved credit institutions and approved financial institutions	Withdrawal subject to a time restriction of one month or less		54	
		Withdrawal subject to a time restriction of more than one month		55	
	Other		56		
Deposits with ceding undertakings			57		
Assets held to match linked liabilities	Index linked		58		
	Property linked		59		
Reinsurers' share of technical provisions	Provision for unearned premiums		60		
	Claims outstanding		61		
	Provision for unexpired risks		62		
	Other		63		
Total sheet 2 (41 to 63)			69		

Marine mutuals : Analysis of admissible assets

Name of insurer

Financial year ended

Company
registration
number

Period ended
day month year

Units
(See instruction 1)

M3					
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Debtors Other assets		As at the end of this financial year 1	As at the end of the previous year 2
Debtors arising out of direct insurance operations	Policyholders	71	
	Intermediaries	72	
Salvage and subrogation recoveries		73	
Debtors arising out of reinsurance operations	Due from ceding insurers and intermediaries under reinsurance business accepted	74	
	Due from reinsurers and intermediaries under reinsurance contracts ceded	75	
Other debtors	Due from dependants	Due in 12 months or less after the end of the financial year	76
		Due more than 12 months after the end of the financial year	77
	Other	Due in 12 months or less after the end of the financial year	78
		Due more than 12 months after the end of the financial year	79
Tangible assets		80	
Cash at bank and in hand	Deposits not subject to time restriction on withdrawal, with approved credit institutions and approved financial institutions and local authorities	81	
	Cash in hand	82	
Other assets (particulars to be specified by way of supplementary note)		83	
Prepayments and accrued income	Accrued interest and rent	84	
	Deferred acquisition costs	85	
	Other prepayments and accrued income	86	
Deductions (under Rules 4.14(2)(b) and 4.14(3) [Regulations 57(2)(b) and 57(3) of the Insurance Companies Regulations 1994]) from the aggregate value of assets		87	
Total sheet 3 (71 to 86 less 87)		88	
Grand total of admissible assets (39+69+88)		89	

Reconciliation to asset values determined in accordance with the shareholder accounts rules

Total admissible assets (as per line 89 above)	91	
Total assets in excess of the admissibility limits of Appendix 4.2 [Schedule 12 of the Insurance Companies Regulations 1994], (as valued in accordance with those [Rules] before applying admissibility limits)	92	
Solvency margin deduction for insurance dependants	93	
Other differences in the valuation of assets (other than for assets not valued above)	94	
Assets of a type not valued above, (as valued in accordance with the shareholder accounts rules)	95	
Total assets determined in accordance with the shareholder accounts rules (91 to 95)	99	

Amounts included in line 89 attributable to debts due from related companies, other than those under contracts of insurance or reinsurance	100	
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Instructions for completion of Form M3

1. Units must be the same as those used in Form M1.
2. In lines 11 to 85 -
 - (a) for the purpose of classifying (but not valuing) assets, headings and descriptions used above, wherever they also occur in the balance sheet format in the *insurance accounts rules*, have the same meaning as in those rules,
 - (b) assets must be valued in accordance with rule 9.10; and
 - (c) assets of any particular description must be shown after deduction of assets of that description which (for any reason) fall to be left out of account under rule 4.14(2).
3. The aggregate value of those investments which are:
 - (a) *unlisted* investments falling within any of lines 41, 42, 46 or 48 which have been valued in accordance with rule 4.8;
 - (b) *listed* investments falling within any of lines 41, 42, 46 or 48 which have been valued in accordance with rule 4.8 and which are not *readily realisable*;
 - (c) units or other beneficial interests in *collective investment schemes* falling within paragraph (c) of rule 4.9(1); or
 - (d) reversionary interests or remainders in property other than land or buildings, must be stated by way of a supplementary note to this Form, together with a description of such investments.
4. The aggregate value of those investments falling within lines 46 or 48 which are *hybrid securities* must be stated by way of a supplementary note to this Form.
5. Amounts in respect of salvage or subrogation included above other than at line 73 must be stated by way of a supplementary note to this Form.
6. In line 93 "Solvency margin deduction for insurance *dependants*" refers to deductions under rule 4.3(2)(c).
7. In line 95 "Assets of a type not valued above" refers to assets left out of account under rule 4.1(3).

Instructions for completion of Form M4

1. Separate Forms must be completed for each *class* of *insurance business*. The relevant description below must be entered against the 'Marine class' heading and the corresponding *class* code entered in the M4 box.

<u>Code</u>	<u>Description</u>
01	Protection and Indemnity
02	Hull and Machinery
03	Freight Demurrage and Defence
04	War risks
05	Strikes
06	Other - nature of business to be detailed in a supplementary note.

2. Units must be the same as those used in Form M1.
3. The *financial year in question* must be stated at line 11 and *preceding financial years* must be listed in reverse chronological order in lines 12 to 25.

Marine mutuals : Analysis of derivative contracts

Name of insurer

Financial year ended

Company
registration
numberPeriod ended
day month yearUnits
(See instruction 1)

M5

Derivative contracts			As at the end of this financial year		As at the end of the previous year	
			Assets 1	Liabilities 2	Assets 3	Liabilities 4
Futures contracts	Fixed-interest securities	11				
	Equity shares	12				
	Land	13				
	Currencies	14				
	Other	15				
Options	Fixed-interest securities	21				
	Equity shares	22				
	Land	23				
	Currencies	24				
	Other	25				
Contracts for differences	Fixed-interest securities	31				
	Equity shares	32				
	Land	33				
	Currencies	34				
	Other	35				
Adjustments for variation margin		41				
Total (11 to 41)		49				

Instructions for completion of Form M5

1. Units must be the same as those used in Form M1.
2. *Derivative contracts* must be analysed according to the description of assets shown in the second column of Form M5 which represents the principal subject of the contract.
3. *Derivative contracts* must be reported as assets in column 1 of Form M5 if their value to the *marine mutual* (gross of *variation margin*) is positive and as liabilities in column 2 of Form M5 if their value to the *marine mutual* (gross of *variation margin*) is negative.
4. All amounts included at lines 11 to 35 of Form M5 in respect of *derivative contracts* are to be determined without making any allowance for *variation margin*.
5. Amounts in respect of a *derivative contract* may only be included net of amounts in respect of any other *derivative contract* if -
 - (a) obligations of the *marine mutual* under the contracts may be set off against each other under generally accepted accounting practice; and
 - (b) such other contract has the effect (in whole or in part) of closing out the obligations of the *marine mutual* under the first mentioned contract.
6. The effect of any *variation margin* upon amounts included at lines 11 to 35 of Form M5 must be shown at line 41.
7. The entry at M5.49.1 must be shown at M3.44.1.
8. The entry at M5.49.2 must be included at M2.23.1.
9. Rights to recover assets transferred by way of *initial margin* must not be shown on Form M5.

**INTERIM PRUDENTIAL
SOURCEBOOK**

INSURERS

VOLUME THREE

GUIDANCE

INTERIM PRUDENTIAL SOURCEBOOK FOR INSURERS

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GUIDANCE NOTE P.1

SYSTEMS AND CONTROLS OVER THE INVESTMENTS (AND COUNTERPARTY EXPOSURE) OF INSURERS WITH PARTICULAR REFERENCE TO THE USE OF DERIVATIVES

Introduction

1. The Principles for Businesses set out the fundamental obligations of a firm. They apply to every regulated firm, not just an *insurer*.
2. Principle 3 requires a firm to organise its affairs effectively. This will, among other things, include keeping adequate and orderly records of its business and internal organisation.
3. This Guidance is designed to assist the *insurer* in complying with this requirement.
4. The Guidance is relevant for purposes of the certificates required to be given by the *directors* and *appointed actuary* and the report to be given by the auditor under rules 9.34 and 9.35 and **Appendix 9.6**.

Investment strategy

5. Suitable controls and management information systems should be in place to enable the *insurer* to implement an appropriate investment strategy. Such a strategy should have due regard to the following -
 - the implications of rule 1.3, insofar as that rule is relevant to the matters covered by this Guidance

(For example, trading in financial instruments for speculative purposes would not necessarily be considered to be investment activity directly arising from the *insurance business* and would therefore risk being in breach of rule 1.3.)
 - the requirements in rule 3.2 concerning the application of assets held in the *long-term insurance fund*
 - the requirements in rule 2.3 concerning the suitability and spread of assets covering *insurance liabilities*, the need for appropriate diversification of assets and the need for close matching of *linked assets* and liabilities

(For example, depending on an *insurer's* financial position, gearing of a fund might easily be inconsistent with the obligations under rule 2.3.)
 - the requirements of the Currency Matching and Localisation Rules
 - any guidance on any of the above topics issued by the *FSA*.

6. Overall responsibility for the determination, implementation and monitoring of such a strategy rests with the board of *directors*.
7. In the case of an *insurer* carrying on *long-term insurance business*, the board should be aware of the responsibilities of the *appointed actuary*, in particular the duty to advise (in accordance with actuarial guidance note GN1) about an appropriate investment policy for the *long term insurance fund* of a *long-term insurer*, and should ensure that the actuary is in a position to discharge those responsibilities.

Controls over exposures

8. Notwithstanding the admissibility limits in **Appendix 4.2**, appropriate procedures should be in place for assessing the credit-worthiness of *counterparties* to whom the *insurer* is significantly exposed and for setting lower internal limits (than those in **Appendix 4.2**) where prudence dictates such a course. This applies in particular to potential exposure to *reinsurers* which is not covered by **Appendix 4.2**.
9. Notwithstanding the admissibility limits in **Appendix 4.2**, appropriate procedures should be in place for setting prudent limits for the *insurer's* aggregate exposure to certain categories of asset. Such limits should take account of the requirements of rule 2.3(1) concerning the suitability of assets to cover *insurance liabilities*. They may take account of the level of the *insurer's* free assets bearing in mind the possibility that such assets might in future be needed to cover *insurance liabilities* or the *required minimum margin* of solvency.
10. Systems should be in place to allow the *insurer* to monitor its aggregate *exposure* to different categories of asset (paying particular attention to the different kinds of instrument under which *exposure* can arise) or to particular *counterparties* relative to the limits set under the procedures described in paragraphs 8 and 9. The issue of monitoring *exposure to counterparties* is developed in **Annex A**.
11. Systems should be in place to ensure that the assets of linked *long-term insurance funds* of the *insurer* comply fully with rules 2.3(2) & (3) and with rule 3.7.

The investment managers

12. The investment strategy should be reflected in clear terms of reference from the *insurer* to its investment managers who should be qualified and competent to carry out their assigned task and whose remuneration package should be consonant with that strategy. The work of the managers should be monitored sufficiently closely to ensure that the *insurer's* strategy is being followed and that the systems mentioned above are effective. These points apply equally where an external manager is used for this purpose, where a separate legal entity within the insurance *group* is used (in either of which cases the *FSA* would expect there to be a formal agreement between the two parties) or where the managers are internal. The issues are developed in **Annex B**.

Use of derivatives and other complex investment instruments

13. Managers should ensure that controls over derivatives and other complex investment instruments have been implemented and are adequate to ensure that risks are properly assessed, regularly reviewed in the light of changing market conditions and experience and consistent with the overall investment strategy. This area is developed in **Annex C**.

Resources allocated

14. Resources allocated to the tasks mentioned above should be appropriate, both in quantity and quality, for ensuring that the controls are effective at all times. This applies particularly in respect of the matters covered in paragraph 13.

Reports to the Board

15. In order to satisfy themselves that investment activity is carried out in accordance with the approved strategy and that adequate controls are in place, the board of *directors* should receive reports at an appropriate frequency with appropriate details as to the investment activities and controls.

Further guidance

16. If you would like to discuss any of the matters raised above further, please contact the *FSA* as set out below -

Insurers: please contact your supervisor.

Other interested parties: please contact –

Insurance Technical Risk
Prudential Standards Division
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Telephone: 020 7676 9596

Annex A (paragraph 10)

Monitoring of aggregate exposures

- A1 ‘Aggregate exposure’ means the amount against which the asset admissibility limits are applied. The limits are expressed as percentages of the *long-term* or *general insurance business amounts* as appropriate. These limits represent maximum amounts which can be valued for solvency purposes; it will often be prudent for

insurers to set internally lower limits in order to comply with the general provisions on suitability of assets.

A2 The asset admissibility limits include some aggregate limits e.g. there is a maximum limit of 10% excluding bank deposits (20% if deposits are included) of the *long-term* or *general insurance business amounts* with any one *counterparty* or *connected company* of that *counterparty* from whatever source. In other words *exposure* needs to be accumulated for -

- all types of investment and other activities of the *insurer* e.g. all derivatives transactions, stock lending, bank deposits and other loans;
- all operations of the *insurer* i.e. including overseas branches. *Exposure* through *subsidiary* operations will also need to be accumulated within these limits where the assets of that *subsidiary* are valued on a look through basis. The explicit limits do not, however apply to exposures generated through a parent or fellow *subsidiary* of the *insurer*. Where the *insurer* has diverse investment operations, then it may be appropriate to set 'local' limits which, even if aggregated, would still fall within the permitted overall limits; and
- all dealings with the *counterparty* concerned or any of its *connected companies*. *Insurers* will therefore need to find out if any of their *counterparties* have *connected companies* and make sure that they are kept informed of any changes to the status of existing *counterparties*. Financial services regulators have required such information for some time and most *counterparties* should be able readily to provide the necessary information.

A3 When assessing the *counterparty exposure*, only the amounts actually owing to the *insurer* need to be considered. For example, derivatives transactions with brokers would be based on the market value of the contract not the nominal value (which would be a much greater amount). *Exposure* could be further reduced by any margin arrangement. Aggregate *exposure* will normally initially be assessed on a gross basis (i.e. total amounts due to the *insurer* from the *counterparty* concerned). But the application of generally accepted accounting practice may allow this to be reduced by amounts which the *insurer* owes the *counterparty* where there is a legal right of set-off.

Credit exposure to reinsurers

A4 Although there are no quantitative limits in the rules for *reinsurance recoveries*, *insurers* should still have regard to their accumulated credit *exposure* to individual *reinsurers*. (In this context *exposure* normally means *debts* due from the *reinsurer* plus anticipated recoveries on outstanding *claims* and IBNR). The *FSA* would not consider an *insurer* to be soundly and prudently managed if it controlled its investment activities but, in the context of its total assets, had unacceptable levels of *exposure* to any one *reinsurer*. In this context, *exposure* would not only relate to the amounts for which credit has been taken in the *insurer's* accounts but would also take into account how the *insurer* was planning to meet its future liabilities. The assessment of what is an 'acceptable' level of exposure to a particular *reinsurer* may

take into account the security provided by any collateral arrangements such as letters of credit and deposits-back as well as the credit worthiness of the *reinsurer* itself.

Insurance groups

- A5 As noted above the detailed admissibility limits generally apply at an *insurer* level rather than for an insurance *group* as a whole. For its own prudential management reasons, *group* management may still wish to ensure that the basic principles apply across the *group*. Monitoring of *exposures* to individual *counterparties* etc. will obviously be more difficult for *groups* but it could be possible to use the “local limits” approach suggested for branches.

Annex B (paragraph 12)

Controls over investment managers

- B1 Where investment management is contracted out to a third party, the *directors* of the *insurer* must nevertheless satisfy themselves that the appropriate controls are in place and are effective. This applies not only where the entire function is contracted out but also where only a specialist element such as derivatives trading is carried out by a third party. The *directors* should ensure in the latter cases in particular that the effects of their own in-house activities are considered in conjunction with the contracted out activities when monitoring aggregate *exposures* to certain types of investment and/or *counterparty*. (It should be noted that the *counterparty* limits apply to the *insurer's* share of investments only, not to the entire portfolio of the investment manager).
- B2 In determining what are appropriate and effective controls the *FSA* would normally expect the *insurer*, at a minimum, to focus on the following areas -
- There should be a clear contract which sets out the parameters in which investment managers may operate. It is unlikely that managers' “standard” contract will be sufficient for this purpose. The *FSA* would expect tailoring to reflect the legislative constraints (e.g. admissibility limits, permitted links), any investment limits set by the *insurer* and more generally the *insurer's* specific circumstances. For example “to invest in whatever the manager considers appropriate” is not good enough. Apart from any specific limits the parameters need to strike an appropriate balance between risk and reward, taking due account of the nature of the *insurer's insurance liabilities* and (as appropriate) the interests and reasonable expectations of its *policy holders*.
 - The extent of reporting by managers should be sufficient to enable the *insurer* to assess whether or not actual operations are in line with the *insurer's* strategy, and in particular meets the risk/reward criteria. Reporting should also provide sufficient information for the *insurer* to check how close it is to relevant asset admissibility limits (or to its own limits if lower).

- Additional more detailed monitoring of managers' operations may be appropriate in certain circumstances.
- If an investment manager is to hold funds on behalf of the *insurer* or to be a *counterparty* to certain investment transactions, then the extent of capitalisation and form of regulation of the manager will need to be taken into account. These considerations will need to be regularly reassessed e.g. manager A may be suitable if placing £10m of business but not for £100m. Similar considerations will also apply where the *insurer* alters its investment strategy and moves into newer forms of investment activity for which the existing investment manager may have little or no experience.

B3 In addition any new corporate manager appointed by the *insurer* must be notified to the *FSA* under the approved persons regime. Third party investment managers are normally notifiable and will need to pass the appropriate fit and proper tests.

Annex C (paragraph 13)

Controls over derivatives

- C1 Directors of an *insurer* should take all reasonable steps (taking account of the nature and scale of use of derivatives) to satisfy themselves that managers -
- fully understand the nature of derivatives trading being undertaken by the organisation and the related risks, and where relevant, are suitably qualified and competent to transact the range and type of transactions being undertaken and understand the nature of the exposures (including both *counterparty* and market risk) which their use will create;
 - have documented clearly the objectives and policies for the use of *derivatives contracts* and monitor, (including the carrying out of compliance audits) to ensure that their use is in line with those objectives and policies. Managers should ensure policy is sufficiently clear and precise to ensure that new types of instrument are not dealt in without due prior consideration. They should also define any associated limits on exposures or volumes that are considered appropriate;
 - have given due regard, in particular, to uncovered transactions (which may be undertaken only in relation to assets which do not match *technical provisions*) in the context of the above controls so that in no circumstances is the *required minimum margin* of solvency endangered nor, in the case of *insurers* carrying on *long-term insurance business*, are *policy holders'* reasonable expectations adversely affected. Systems are needed which are adequate to prevent exposure to unacceptable exceptionally volatile risks and to monitor transactions on a frequency commensurate with volatility and risk (in general terms). The systems should trigger a strategy to hedge or close out

a transaction whenever adverse movements or events threaten a significant worsening of the *insurer's* solvency position;

- have ensured that those who have responsibility for the control of derivatives investment, are sufficiently independent of the day-to-day operators to ensure effective control;
- are capable of analysing and monitoring the risk of all transactions undertaken by the organisation individually and in aggregate (including interest rate risk, foreign exchange risk fraud, error, unauthorised access to confidential information and other operational risks);
- have ensured that the systems cope adequately with the volumes and volatility of transactions undertaken. In particular, the front office systems should not receive the most attention and funding to the detriment of the accounting systems;
- are provided regularly with statistics and information (appropriately summarised) on the trading volumes of *derivatives contracts* by type of product including regular reports of all off-balance sheet transactions, contingencies and commitments;
- are satisfied that sufficient systems and controls relevant to derivative products have been put in place, including independent agreement and reconciliation of positions, independent checking of prices, agreement of managers' profits to accounting profit, appropriate authorisation where dealing limits have been exceeded, etc.; and
- have tested adequately and approved valuation models which are used to value open positions and *derivative contracts* and that amendments to their programmes are controlled. Such models should include an appropriate test of the robustness of the portfolio to stress in changing investment conditions.

C2 In satisfying themselves on the above points, the *directors* collectively should have sufficient expertise to understand the important issues.

GUIDANCE NOTE P.2

SYSTEMS AND CONTROLS OVER GENERAL BUSINESS CLAIMS PROVISIONS

Introduction

1. The Principles for Businesses set out the fundamental obligations of a firm. They apply to all regulated firms, not just an *insurer*.
2. Principle 3 requires a firm to organise its affairs effectively. This includes keeping adequate and orderly records of its business and internal organisation.
3. This Guidance is designed to assist the *insurer* in complying with this requirement.
4. This Guidance is relevant for purposes of the certificates required to be given by the *directors* and *appointed actuary* and the report to be given by the auditor under rules 9.34 and 9.35 and **Appendix 9.6**.

Scope of Guidance

5. This Guidance has been prepared for *insurers* (and *reinsurers*) on the systems and controls which should be in place in order to ensure that the amounts set aside for *claims* handling expenses and *claims* outstanding are appropriately established, properly recorded and effectively monitored.
6. The Guidance has been structured in two parts: ‘Claims handling’ covers the systems and controls over the recording and processing of notified *claims* incurred and the associated costs of handling *claims*, whilst ‘Claims outstanding’ addresses the setting of the technical ‘*claims* provision’.
7. In this Guidance -

***claims* provision** or **provision for *claims* outstanding** means the amount provided in the *insurer’s Returns* to cover the estimated ultimate cost of settling *claims* (including *claims* incurred but not reported and *claims* handling expenses) arising out of events which have occurred by the end of the accounting period, less amounts already paid in respect of those *claims*;

case estimate means an estimate made of an appropriate provision for an individual *claim* outstanding based on information relevant to that *claim*; and

statistical estimate means an estimate made of an appropriate provision for a group of *claims* outstanding, based on information relevant to the group.

8. Certain parts of the Guidance have been amplified by referring to the ‘Areas for senior management to consider...’ points set out in **Annex B and C**. These annexes have been included for illustrative purposes only and the points raised in them should not be taken as exhaustive.

9. The Guidance should be read in conjunction with the explanatory note attached as **Annex A**.

Part I Claims handling

Suitable controls, systems and procedures should be in place to ensure adequate and accurate information is appropriately and promptly recorded to enable a proper assessment to be made of the ultimate cost of all <i>claims</i> or potential <i>claims</i> .

Systems

10. Appropriate and effective systems and controls should be in place to allow the *insurer* to record and monitor its financial liability to *policy holders* in respect of *claims* arising out of *contracts of insurance*.
11. In determining what are ‘appropriate and effective systems’, the *FSA* would normally expect an *insurer* to consider the areas summarised in **Annex B**.

Resources

12. Resources allocated to the *claims* handling function should be appropriate, both in quality and quantity, for ensuring that the systems and controls are effective at all times.
13. Managers should regularly monitor the pertinent indicators of resource pressure (for example, backlogs, inactive files, missed deadlines from the diary, inaccuracies in ‘case estimates’ or ‘statistical estimates’, late or inappropriate amendments to estimates).
14. If external resources are used, managers should take such steps as are reasonable and appropriate to satisfy themselves that the resource is of the appropriate quality, experience and competence.
15. The *insurer* should maintain adequate supervision and control over any external resources used to assist the *claims* handling function.

Function autonomy

16. The *claims* handling department should maintain regular liaison with other key functions within the *insurer*.
17. Notwithstanding paragraph 16, the managers should ensure that the extent of the segregation of functions is appropriate for the nature and size of the business.

(For example, whilst it is necessary for the *claims* handling department (including the reserving function) to have a certain degree of contact with the underwriters, the two groups must maintain a suitable level of independence from each other.)

Data

18. Appropriate systems should be in place to satisfy managers that data are complete and accurate and are being correctly recorded on a timely basis.
19. Considerations which managers should take into account when assessing the suitability of data collection include, but are not limited to, the items listed in **Annex C**.

Part II Provision for claims outstanding

Managers should maintain appropriate systems controls and procedures to ensure that the 'provision for *claims* outstanding' is, at all times, sufficient to cover any liabilities that have been or will be incurred on *contracts of insurance* as far as can be reasonably foreseen.

Resources

20. Resources utilised for the purposes of setting and monitoring the 'provision for *claims* outstanding' should be appropriate, both in terms of skill and experience.
21. In satisfying themselves that resources of appropriate skill and experience are employed in respect of paragraph 20, managers should consider the following points -
 - the value of using appropriately qualified, experienced and proven loss reserving specialists (such as actuaries with general insurance experience);
 - if any part of the process of setting '*claims* provision' is delegated to an external loss reserving specialist, appropriate procedures should be in place to ensure that the specialist selected possesses the appropriate level of skill and experience;
 - it is essential that the individuals responsible for carrying out the calculations to determine the 'provision for *claims* outstanding' are sufficiently familiar with the nature, complexity and size of the business; and
 - managers should ensure the necessary information (gathered, for example, by regular liaison with underwriters, *intermediaries* and *reinsurers*) is available for the determination of the 'provision for *claims* outstanding'.

Data

22. Suitable controls should be in place to ensure that the data used in determining the 'provision for *claims* outstanding' are extracted from the underlying records accurately and to the necessary level of detail.

(In this regard, the level of detail should be sufficient to ensure that the data available to managers in their assessment of 'claims provisions' covers the whole of its insurance liabilities and exposures)

23. Considerations which managers should take into account when assessing the suitability of the data analysis include, but are not limited to, the items listed in **Annex C**.
24. If the *insurer* makes use of an external resource to assist in the process of estimating the 'provision for *claims* outstanding', suitable controls should be in place to ensure that the source data used by the external resource are complete and suitable and procedures should be in place to ensure that the results received from the third party can be relied upon and are reported in the correct format to the necessary level of detail.

Estimation methods

25. Appropriate methods should be applied in estimating the 'provision for *claims* outstanding'.
26. Regard should be given to relevant judicial developments, changes in legislation and economic assumptions.
27. Managers should not be limited to just one estimation method but should consider using one or more alternative approaches before selecting those which may be regarded as most appropriate to the nature of the business.
28. The frequency with which a comparison of estimation methods should be undertaken depends on the type of business and the adequacy of the methods in use, as evidenced by the run-off performance or other pertinent factors.
29. Efforts should be made to identify and understand the reasons for any significant differences between the results from the different approaches.
30. Suitable systems and controls should be in place to ensure that the selected approaches are applied accurately and on a consistent basis.
31. Procedures should be in place to review and monitor, on a regular basis, the out-turn of provisions made in prior years for *claims* outstanding.
32. Evaluation of the out-turn should normally be carried out by line of business and by accident year or underwriting year. The out-turn of the element within the 'claims provisions' which relates to *claims* handling expenses (both direct and indirect) should be monitored separately.

Function autonomy

33. The individuals responsible for setting 'provision for *claims* outstanding' should maintain regular liaison with other key functions within the *insurer*.

34. The work of those responsible for setting ‘provision for *claims* outstanding’ should be subject to regular review by senior management independent from the underwriting function.

Reinsurance

35. Suitable systems should be in place to ensure that *reinsurance recoveries* are identified and appropriately recorded on a timely basis.
36. Procedures should be in place to allow managers to evaluate and monitor the application (and hence the effect) of the *reinsurance* programme to the gross ‘provision for *claims* outstanding’ (including *claims* incurred but not reported).
37. Appropriate systems should be in place to evaluate and monitor the *insurer’s* credit risk exposure to individual *reinsurers*.
38. Managers should update the provision for *reinsurance* bad and doubtful *debts* on a regular basis.

Annex A (paragraph 9)

EXPLANATORY NOTE

- A1 Other *technical provisions*, namely the provision for unearned premiums, the unexpired risk provision and equalisation provisions are not specifically covered by this Guidance, although much of the Guidance deals with issues which are generic to all *technical provisions*.
- A2 The Guidance recognises that the systems and controls required for the *claims* handling function will not be the same as those required for the function of setting the ‘provision for *claims* outstanding’. Whilst the two areas are strongly interrelated, the Guidance is structured to reflect the different management control considerations that apply, recognising that effective controls are required in both areas in order to form the necessary base from which appropriate provisions can be established and reported.
- A3 The Guidance is not intended to define the controls which all *general insurers* must employ, nor is it intended to be prescriptive. Rather, it is a matter for the *directors* to be satisfied that the *insurer’s* control environment is appropriate for the business that it operates. Control objectives can be attained in many different ways, depending on the size and nature of the business. It is the responsibility of the senior management to ensure that adequate resources are available to meet the control objectives.
- A4 Accordingly, the aim of the Guidance is to provide an overview of the key control systems and procedures. This should then enable management to evaluate the *insurer’s* existing control environment in conjunction with the Guidance in order to identify whether there are any worthwhile areas for enhancement.

- A5 The Guidance has been prepared to assist *directors* of *insurers* (and *reinsurers*), their auditors and others who may be concerned in the setting of *general insurance business claims* provisions for the purposes of both the supervisory Returns and the statutory shareholder accounts.
- A6 The *insurer's* usual *FSA* supervisor will be pleased to provide additional assistance.
- A7 For the preparation of the *return*, the *insurer* must value its *technical provisions* in accordance with the *Determination of Liabilities Rules*. Generally, the *general insurance business liabilities* for such *Returns* will be valued under the same rules that apply to the *technical provisions* disclosed in the shareholder accounts.
- A8 This Guidance does not seek to discuss or comment on the advantages of any one *claims* estimation method when compared to another. The appropriateness of an *insurer's* methods in establishing 'provisions for *claims* outstanding' should be assessed by whether the methods used have yielded or are expected to yield an appropriate level of provisions for that *insurer*.

Annex B (paragraph 11)

AREAS FOR SENIOR MANAGEMENT TO CONSIDER WHEN ESTABLISHING APPROPRIATE AND EFFECTIVE CLAIMS HANDLING SYSTEMS AND PROCEDURES

In establishing and maintaining effective *claims* handling systems and procedures senior managers' considerations should include, but not be limited to, the items set out below.

- B1 Appropriate systems and controls should be in place to ensure that all liabilities or potential liabilities notified to the *insurer* are recorded promptly and accurately. Accordingly, the systems and controls in place should ensure that a proper record is established for each notified *claim*.
- B2 Suitable systems should be in place to identify and quantify, for the key *claims* handling procedures, the effects of processing backlogs and to ensure that appropriate corrective action is taken.
- B3 Suitable controls should be maintained to ensure that '*claims* estimates' and 'statistical estimates' are appropriately made on a consistent basis and are properly categorised.
- B4 Regular reviews of the out-turn of the '*claims* estimates' and 'statistical estimates' should be carried out to check for inconsistencies and to ensure that procedures remain appropriate. The reviews should include the use of statistical techniques to

compare the estimates with the eventual cost of settling the *claims*, after deducting the amounts already paid at the time the estimates were made.

- B5 Appropriate systems and procedures should be in place to ensure that *claim* files without activity are reviewed on a regular basis. For example, the use of a ‘diary’ system should identify areas of inactivity, thereby prompting the *claims* handler to examine the file and reassess the priority of the action required.
- B6 Appropriate systems and procedures should be in place to assess the validity of notified *claims* by reference to the underlying *contracts* of *insurance* and *reinsurance* treaties.
- B7 Suitable systems and procedures should be in place to accommodate the use of suitable experts such as loss adjusters, lawyers, accountants, etc. as and when appropriate.
- B8 There should be suitable systems and procedures in place to identify and deal with any large *claims*, including systems to ensure that senior management are involved in the processing of large *claims* from the outset.

Annex C (paragraph 19)

AREAS FOR SENIOR MANAGEMENT TO CONSIDER WHEN ASSESSING THE SUITABILITY OF DATA COLLECTION AND ANALYSIS USED IN DETERMINING THE PROVISION FOR CLAIMS OUTSTANDING

Senior managers should consider the accuracy and completeness of data collection and recording. In the context of utilising data to determine the ‘provision for *claims* outstanding’, the *FSA* would expect an *insurer’s* senior managers’ considerations to include, but not be limited to, the items set out below.

General matters

- C1 Data requirements should be established, having regard to -
- the size of the business,
 - the nature of the business written,
 - the level of business written in foreign currencies,
 - the specific requirements of the users (e.g. the *actuary*),
 - the data sources available,
 - the homogeneity of the groups.

Data for the assessment of the insurer's claims experience

C2 Data should be capable of assisting the *insurer* to assess -

- the type of *claims* experienced,
- the settlement patterns and changes in them,
- the *reinsurance* arrangements,
- *claims* frequency,
- *claims* severity,
- incidence of large *claims*,
- origin of each '*claims* estimate',
- third party recoverables,
- special issues (e.g. requirements for catastrophe data or latent claim data),
- the effect of portfolio transfers and commutations of business.

Data for the assessment of the insurer's claims exposure

C3 Data should be in a format to enable the *insurer* to be provided with -

- the appropriate exposure base for each *class* of business,
 - an appropriate analysis of changes in premium levels,
 - an appropriate analysis of changes in *policy* terms,
 - an appropriate analysis of the effect of specific loss scenarios.
-

GUIDANCE NOTE 2.1

HYBRID CAPITAL: ADMISSIBILITY FOR SOLVENCY

What is this Guidance about?

1. The *FSA* may, by waiver or modification of the rules, allow *insurers* to count the value of certain types of hybrid capital instruments which they issue towards a proportion of their *required margin of solvency*.
2. This Guidance describes the type of instruments that will be eligible for such treatment, the procedure to be followed, the admissibility limits which will apply and the terms which such instruments should meet in order to qualify. These terms are not to be regarded as definitive.
3. Restrictions on cumulative preference share capital under rule 2.10 are not dealt with in this Guidance.

What is hybrid capital?

4. Hybrid capital is essentially loan capital. However, unlike an ordinary loan, the instrument contains conditions which, inter alia, remove some of the lender's usual rights. These conditions allow the loan to be treated like the proceeds from the issue of *shares* for regulatory purposes. Some forms of hybrid capital are closer in nature to *shares* than others.
5. The *Third Life* and *Third Non Life Directive* allow the value of four types of hybrid capital to count as cover for the *required margin of solvency*. They are the following -
 - subordinated members' accounts (in the case of a *mutual*);
 - dated subordinated loan capital;
 - perpetual subordinated loan capital; and
 - perpetual *securities* with defined characteristics.
6. These instruments are not, however, the equivalent of ordinary *share* capital. The *FSA's* main concern is that *insurers* should have sufficient risk capital to meet unexpected pressures on the *insurance business*. The *FSA* will view applications to count loan capital as part of their solvency margin in this light.

What is the procedure?

7. Under the rules, hybrid capital instruments cannot count for the purpose of covering the *required solvency margin* of *insurers* because they give rise to liabilities

offsetting the value of the funds raised. However, the *FSA* does have the discretion to vary the terms of the requirement by making a direction for waiver or modification under section 148 of the *Act*.

8. *Insurers* may apply under SUP for a direction. The application should enclose the following documentation -
- terms and conditions of agreement/instrument/issue (in draft if necessary);
 - copies of any prospectus or offer document or other promotional literature (in draft if necessary);
 - copy of the memorandum and articles or rules of the *insurer* indicating the provisions catering for the issue of *securities* or a legal opinion confirming the *insurer's* right to issue the *securities*.

How long will the process take?

9. As long as the documentation is complete it should normally be possible to deal with straightforward applications in around a month. However, *insurers* should discuss their application with the *FSA* well in advance.

What will the section 148 waiver or modification do?

Solvency margin

10. Under the *Margins of Solvency Rules*, funds raised from the issue of loan capital do not count toward the *required margin of solvency* because the value of the money received would be offset by a corresponding liability to repay the loan with interest. The section 148 direction would probably vary the terms of the *Determination of Liabilities Rules* (specifically rule 5.2) to provide that the liability to repay the value of the loan capital may be excluded. This exclusion would be limited to a value determined by calculating a proportion of the *required margin of solvency* (see paragraphs 17 and 27).

Accounts and Statements Rules

11. The Forms under the *Accounts and Statements Rules* already permit the proceeds of hybrid capital issues to be shown as assets counting towards the *required margin of solvency*.

Valuation of Assets Rules

12. The following would probably not be affected by a waiver or modification. The *Valuation of Assets Rules* contain three rules concerning the holding of hybrid capital. The first is to treat as inadmissible any holding of a parent *insurer's* hybrid capital by a *subsidiary*. This mirrors the position which is achieved by virtue of section 23 of the *Companies Act* in relation to *share* capital. Second, holdings of *listed* hybrid capital are treated as *listed* debentures and subject to the restrictions

that apply to them. Third, holdings of *unlisted* hybrid capital are subject to an admissibility limit.

What terms must the instruments contain?

13. The instruments must at a minimum be compatible with the provisions in Article 16(1) of the *First Non-Life Directive* and Article 18(1) of the *First Life Directive* as appropriate.
14. Indent 1 of Article 16(1) sets out the terms relevant for subordinated members' accounts (relevant only to *mutuals* and referred to in this Guidance as the '**member's account**'). Indent 7 of the same article specifies the minimum conditions for subordinated loan capital; indent 8 defines the basic terms for the perpetual security. The latter two forms of hybrid capital can be issued by all *insurers*. The terms of Article 18(1) are identical in this respect.

Subordinated members' account

15. The subordinated 'member's account' is a loan made by a member of a *mutual* which can be remunerated under certain specified conditions. The conditions are -
 - the subordination should be to all the creditors of the *insurer*;
 - no payments (interest) may be made to members if this would cause the *required margin of solvency* to be breached; and
 - the *FSA* must be notified at least one month in advance of any proposed payment, other than for the individual termination of membership (capital or capital and interest), and because, during the notice period, the *FSA* may act to prohibit any such payment the contract should accommodate this.
16. The 'member's account' is intended to be part of the core capital of the *mutual*, available to meet losses in much the same way as the effective initial fund. Subject to the above, it can count in full towards the *required margin of solvency*. The account is analogous to the perpetual security, the details of which are set out below and the *FSA* will apply the same criteria. Other forms of hybrid capital may not be as acceptable as subordinated 'members' accounts'.

Other hybrid capital instruments

Extent of subordination

17. The instruments should have the effect that in the event of the winding up of an *insurer* the capital and interest accrued but not paid (including any deferred interest) must be subordinate to the claims of all other creditors. The note holders would rank after all other creditors but before the members in any distribution. In the case of a *mutual*, the note holders would rank after members in their capacity as *policy holders*.

18. The Insolvency Act 1986 does not provide for the ranking of subordinated creditors in the event of a winding-up. However, there are at least two well established methods by which creditors can voluntarily subordinate their rights to other creditors. The first is to establish a trust in favour of other creditors. The second is for the amounts payable to the note holder to attract the status of a contingent *debt* so that on a winding up of the *insurer* the required degree of subordination would be achieved.
19. Other methods of subordination may be acceptable, including structural subordinations, provided they satisfy the conditions in paragraph 15. Note holders should not be able to gain any enhancement of their rights through such methods.
20. It should also not be possible to defeat the subordination by applying rights of set off. This will be relevant where the issuer and purchaser do business, each from time to time holding money due to the other. Under English law agreements to waive rights of set off are effective against the parties, but set off is mandatory upon winding up of an *insurer*. The position in other legal jurisdictions varies. In either case where set off is or may be an issue, the *FSA* will probably require evidence that the subordination cannot be undermined.
21. The subordination provisions should also take into account the need to protect the position of with-profits *policy holders* of *long-term insurers*. With-profits funds will include sums being accrued to meet future bonuses to *policy holders*. Such funds are customarily held in the *long-term insurance fund* on which, upon liquidation, other creditors and also shareholders may have a claim.
22. Accordingly, the *FSA* requests that the relevant documentation satisfies the following two requirements. The first is that the loan (capital and interest) should not constitute a liability attributable to the *long-term insurance fund* of an *insurer*. The rights of the note holder should be met from assets held outside the *long-term insurance fund*, including any distribution of a surplus from the fund under rule 3.3. This is to ensure that, as the *insurer* is trading, the position of the with-profits *policy holder* is fully protected.
23. Second, the documentation should have the effect that the rights of the lender are subordinated to all other creditors of the *insurer* in the event of a winding up. This should, in particular, secure that the note holder's claims on the assets of the *insurer* are to be subordinated to the liabilities assessed in respect of all *long-term insurance business policies*, including any amounts payable to reflect the value of bonuses to meet the reasonable expectations of with-profit *policy holders*.
24. The responsibility for achieving effective subordination lies with the *insurer*. Applicants are recommended to seek legal advice from those with relevant expertise in this field since the effectiveness of the subordination provisions will depend on an accurate understanding of the relevant law.

Limits and solvency margin

Limits

25. As far as hybrid capital is concerned, *insurers* will probably be permitted to count the value of loan capital instruments (the aggregate value of all such instruments) as cover for solvency up to 50% of their *required margin of solvency*. Within this overall limit, the value of term stocks (in aggregate) may count for a maximum of 25% of the *required margin of solvency*. An issue the value of which is in excess of this is unlikely to be permitted to count for the purposes of solvency and should continue to be treated as liabilities under the *Determination of Liabilities Rules*.
26. The above should apply in respect of the *long-term* and *general insurance business* of a composite *insurer*, the limits applying to each margin separately where the funds are applied exclusively for the benefit of one or other type of business. Where such an *insurer* wishes to apply the funds raised to its business as a whole (*general* and *long-term insurance business*), the limits set out in the previous paragraph may be permitted to apply to the aggregate of the required margins for both types of business.
27. In either case, it should be noted that in a winding up the liabilities of the *long-term* and *general insurance business* should be discharged separately. It is the applicant's responsibility to ensure that the records of the *insurer* enable the liabilities attributed to a particular type of business to be accurately identified.

Solvency margin condition

28. In addition to notice requirements allowing the *FSA* to prevent early repayment should this imperil the solvency of the *insurer*, directions under section 148 will probably require the non-payment of interest and capital if payment, or any other event, would result in breach of the *required margin of solvency*. For these purposes the treatment of subordinated *debt* and other perpetual *securities* is different.

Subordinated debt

29. In order to provide the *insurer* with a breathing space to recapitalise, subordinated *debt* agreements should provide that the right to petition for winding up of the *insurer* is exercisable only on the day following the second anniversary of default in the payment of interest and/or capital unless the presentation of a petition arises from some other default.

Perpetual securities

30. The terms of perpetual *securities* should provide for the deferment of interest and capital payments on the loan where the *required margin of solvency* is breached in a manner which will not give rise to a winding up. They should also provide for the security holders to bear losses in the same way as a shareholder if the *insurer* is in financial difficulties. This can be achieved, for example, by providing for conversion of the *debt* to ordinary *share* capital or for payments of principal and unpaid interest, in whole or part, to be cancelled in order to allow the *insurer* to continue in business. The trigger for the loss-bearing provisions would be breach of the *required margin of solvency*.

Maturity and early repayment

Maturity

31. If term subordinated *debt* is to count as capital, it should have a maturity of at least five years. The *debt* may be repaid in equal amounts during the last five years of the loan, in which case the amount allowed to count as cover for the *required margin of solvency* will proportionately reduce. Alternatively, the *debt* may be paid back in full on the maturity date and may count in full until that date. In the latter case, the *FSA* will require to be notified no later than one year before maturity. Since the *FSA* may act to prohibit repayments, the contract should provide for this.
32. Perpetual subordinated *debt* containing provisions triggering the determination of a date for repayment may be acceptable, but the *FSA* will probably require at least five years notice. Where such notice is to be given the *FSA* will also require to be informed.
33. Perpetual *securities* should not be repaid other than at the behest of the issuer and the *FSA* will require to be notified.

Early repayment

34. Where early repayment of hybrid capital is in prospect, *an insurer* should write to its supervisor at the *FSA* with an explanation showing how the *required margin of solvency* is to be maintained.
35. Insurers should not make agreements which provide for early repayment triggered by performance conditions, cross-default clauses, negative pledges, or other restrictive conditions. This is not intended to constrain the right of subordinated debt note holders to petition for winding up if there is default in the payment of interest or capital on the due dates (except in the case set out in paragraph 30).

Conversion

36. Where, as in the above example, there is provision for conversion from loan to *share* capital, the *insurer* should ensure that it has adequate authorised *share* capital to accommodate the change. It will also be necessary in these circumstances for the *FSA* to apply its 'fit and proper' checks, if upon conversion the note holder would become a *controller*. It would be appropriate for this to be acknowledged in the agreement. Where the lender could become a *controller*, the relevant provisions of the Act and the rules will apply.

Transfers / mergers

37. It is common when an *insurer* gets into severe financial difficulties to try and arrange a transfer of portfolio to, or a takeover by, another *insurer* to safeguard the position of *policy holders*. *Insurers* should not agree to any restriction which would inhibit or prevent this.

Denomination of debt

38. Issues may be denominated in sterling or a foreign currency. However, in the case of foreign currency issues, *insurers* should be able to demonstrate to the *FSA* how the foreign currency *debt* would be serviced, or alternatively what hedging arrangements exist to reduce the currency risk. Where capital is raised for foreign operations, the *FSA* would expect sufficient income to be generated in the relevant foreign currency to service the commitments under the loan capital agreement.

Interest

39. The basis on which the capital attracts interest should be clearly stated in the agreement. In the case of subordinated loan capital, where payment of interest or capital is suspended, the agreement may provide for the unpaid interest to accumulate. However, the agreement should not permit further penal interest charges to attach as a result of the suspension.
40. Loan capital instruments with a fixed or stepped rate and those with a floating rate are acceptable as cover for the *required margin of solvency*. Floating rates should be expressed in terms of a reference point, for example, the rates from time to time prevailing in the inter-bank market or rates applicable to government securities.
41. Where there is provision for variation of the rates applicable, the extent of this variation should not be such as to induce repayment of the loan by the issuer of the capital.

Accordingly, any provision allowing -

- (a) an increase in fixed interest rates; or
- (b) an increase in any margin on the floating rate (the margin over and above the reference point by which the rate is determined)

which exceeds a maximum of

- (i) 1% in aggregate over five years; or
- (ii) 2% in aggregate without limit of time,

is unlikely to be approved.

42. These figures are not intended to create market norms, merely to act as a guide to indicate the extent of variation which would not be regarded as unusual. In practice, the interest basis will need to be carefully considered in the light of the type of instrument and the principle in paragraph 41.

Disclosure

43. The documentation relating to the issue should explain the key features of the instruments so that small or retail investors in particular are aware of the nature of their investment and the risks associated with the purchase. The listing requirements of the stock exchange may be sufficient to meet the point, as may compliance with disclosure rules under the *Act*. Where the stock is not quoted and the *Act* does not apply, the *FSA* should be consulted about disclosure to potential purchasers if the issue is priced to enable small investors to participate.

Amendments to agreements

44. No amendment to any agreement or instrument governing the issue of a hybrid capital instrument should be possible without 30 days' prior notice in writing to the *FSA* and the recognition that the *FSA* might take steps to prevent such amendments.

Applicable law

45. Agreements may be governed by any law where the required subordination can be given effect. Where a foreign law is to govern the agreement, evidence of the effectiveness of the subordination should accompany the application.
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GUIDANCE FOR INSURERS AND AUDITORS ON THE VALUATION OF ASSETS RULES

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 - D Regulated markets - factors to be considered

1. INTRODUCTION

- 1.1 This Guidance relates to the *Valuation of Assets Rules*. It has been prepared to assist *directors* of *insurers*, their auditors, and others who may be concerned in the application of the legislation relevant to the valuation and admissibility of assets of *insurers* for the purposes of demonstrating coverage of the technical reserve and the *required solvency margin*.
- 1.2 It is not intended to be prescriptive and cannot be regarded as a substitute for reading the rules themselves and taking professional advice. An *insurer* should contact its usual *FSA* supervisor if there are any areas which it would like to discuss further.
- 1.3 The Guidance deals with the valuation and admissibility of assets belonging to the *insurers* (through either direct ownership or through beneficial interests) and do not necessarily address how these items should be reported in the *FSA Returns*.
- 1.4 This Guidance may be relevant for the purposes of the *directors'* certificate required under paragraph 5 of **Appendix 9.6**.

2. OVERVIEW OF THE RULES

- 2.1 The basic approach of the *Valuation of Assets Rules* is as follows.

Step One

Determine how the asset is to be defined under the rules since a number of definitions are specific to the rules.

Step Two

Once the asset has been defined, apply a series of rules, based on prudent valuation methods which approximate to the value which would be realised in an orderly run-off. The valuation methods will in many cases differ from that used for *Companies Act* accounts which are drawn up on the basis that the company is a going concern. If there is no valuation rule explicitly mentioned in the rules for a particular asset (e.g. for gold), a nil value must be ascribed.

Step Three

The Valuation of Assets Rules provide the appropriate value which can be assigned to an asset. The admissibility rules then determine how much of this value (if any) can be included within the solvency margin calculation. The admissibility rules supply a 'menu-style' set of instructions which detail the admissibility restrictions which apply on the *exposure* to each asset, investment, or *counterparty*. This particular area can be intricate and consequently section 5 is dedicated to providing additional guidance.

This admissibility limits approach is complemented by the general principle of rule 2.3 which requires *insurers* to cover their liabilities with assets with adequate

diversification and of appropriate safety, yield and marketability. Compliance with the admissibility limits does not necessarily mean automatic compliance with rule 2.3 - the *Valuation of Assets Rules* are in addition to the general principle of rule 2.3.

- 2.2 Some aspects of the *Determination of Liabilities Rules* are also relevant to the *Valuation of Assets Rules* - primarily in relation to derivative instruments which are capable of being either an asset or a liability. For property *linked assets* (see paragraph 3.10) none of the *Valuation of Assets Rules* apply - since the liability to *policy holders* is matched by whatever value is placed on the *linked assets*. Instead there are restrictions on what investments linked funds can make – see **Guidance Note 4.4**.

Modification or waivers

- 2.3 At times, strict application of the rules may produce an unintentionally harsh result for an individual *insurer*. Where this occurs, the *FSA* will consider an application for a waiver under section 148 of the *Act* to modify the application of the *Valuation of Assets Rules*. There is no guarantee that such a waiver will be given and it is likely to be given only on a temporary basis and with conditions attached. Where the *Valuation of Assets Rules* implement the requirements of the EC Directives, the *FSA* may be unable to give a direction except ‘in exceptional circumstances, temporarily and under a proper reasoned decision’. Any concession granted under the *1982 Act* may no longer be valid and if an *insurer* wishes to rely on such a concession it should contact the *FSA* supervisor at the earliest opportunity to discuss the position. It is not open to the *insurer* to ignore or to modify the application of the rules to suit its own circumstances otherwise than in accordance with such a waiver.

3. DEFINITIONS AND GENERAL INTERPRETATION

- 3.1 Rule 11.1 lists most of the definitions which are used in the *Valuation of Assets Rules*. In a number of cases, the asset definitions in rule 11.1 may not strictly accord with market parlance. Care must therefore be taken to ensure that the asset is correctly defined under the *Valuation of Assets Rules* since this may have an important impact on the valuation and/or admissibility of the asset. Attention is drawn in particular to the following items.

Approved/regulated institutions

- 3.2 There are definitions for a number of different types of institution and admissibility limits grade the level of *debt* that can be accumulated with any one institution according to the type of institution. The definitions are normally expressed in terms of criteria and in many cases guidance can be gained by referring to lists published periodically by the *FSA* to determine what category applies to a particular institution. The different types of institution in order of credit ‘grading’ are:

approved financial institutions - are listed in rule 11.1 and are largely European central banks.

approved securities - are limited to government *securities* and deposits with approved financial institutions. Only *securities* backed by governments/public authorities of countries classified as Zone A are included. *Debt securities* issued by certain supra-national authorities are also included. Zone A countries are all countries which are full members of OECD, together with those countries which have concluded special lending arrangements with the International Monetary Fund associated with the General Agreement to Borrow. A current list of these countries can be obtained from the FSA (Banking Supervision). It follows that government *securities* from non Zone A countries are therefore subject to the general *debt* rules.

approved credit institutions - are essentially banks and building societies authorised under the Banking Consolidation Directive 2000/12/EC. Note that an *approved credit institution* is also an *approved counterparty* and also a *regulated institution*. The FSA regularly publishes a list of banks authorised in the UK. This list includes UK branches of non-EEA banks which have been authorised directly by the FSA and institutions authorised by other *EEA States* but which have a branch in the UK. It does not, however, include institutions authorised by other *EEA States* which do not operate in the UK but which are nevertheless *approved credit institutions* for the purposes of the *Valuation of Assets Rules*. The European Commission from time to time publishes a full list of all credit institutions authorised under the Directive but in practice this tends to be out of date. It is advisable to contact the competent authority in the *EEA State* concerned for the latest list.

approved counterparties - are *approved credit institutions* plus certain investment firms authorised to engage in wholesale market activities or derivatives transactions. A list of *approved credit institutions* can be obtained from the FSA. For the purposes of calculating aggregate *exposure* for the admissibility limits, the term *counterparty* has been given its own definition. This is dealt with in more detail within section 5.

regulated institutions - are *approved credit institutions* plus all *insurance undertakings* authorised in the EEA (including *friendly societies*) and *approved investment firms*. As a general rule, the vast majority of *approved counterparties* will also fall within the definition of a *regulated institution*.

approved investment firms - are those firms regulated under the *Investment Services Directive*.

Listed securities

- 3.3 Investments are *listed* if they are either officially listed on an EEA stock exchange or the investments have the facility to be traded on a *regulated market*.
- 3.4 The definition of a *regulated market* is expressed in terms of criteria which must be satisfied and it is for the *directors* and auditors to satisfy themselves that these criteria have been met. The key factors which the FSA considers relevant for *insurers* to take into account when considering what is a *regulated market* are set out in **Annex D**.

- 3.5 If an investment falls within the definition of *listed* in rule 11.1 but is, in practice, rarely traded then it is likely that the *insurer* will need to consider whether the investment is *readily realisable*. If a *listed* investment is not *readily realisable*, it must be treated as though it were *unlisted*.
- 3.6 The aim is to distinguish between *securities* which can be disposed of at a price reasonably close to the *market value* from those which are so rarely traded that they are likely to be disposed of at a discount to the quoted market price. Dealings will therefore need to be frequent enough to be able to satisfy this aim. These principles are discussed in section 4.

Hybrid securities

- 3.7 Those *debt securities*, other than *approved securities*, which are akin to equity and are characterised by being either irredeemable or subject to long period repayment terms may fall within the definition of *hybrid securities*.
- 3.8 If this is the case, the *insurer's* holding of such *debt securities* will be treated under the valuation and admissibility rules in the same way as a holding in equity *shares*.
- 3.9 *Subordinated debt securities* may fall within the definition of *hybrid securities*. Because of the nature of a *subordinated debt*, the *debt* will not be entitled to be repaid until all claims from the general creditors have been settled. Since, therefore, the holder of *subordinated debt security* does not possess an unconditional right to payment, *subordinated debt securities* may fall within the definition of *hybrid security*.

Linked assets

- 3.10 The definition of *linked assets* refers only to assets held by an *insurer* and identified in its records as assets by reference to which *property linked benefits* are to be determined (the term 'property' in this context is wider than just land and buildings); it does not refer to assets held to cover *index-linked benefits*. The *Valuation of Assets Rules* allow index linked assets to be treated as *non-linked assets*, although they will be exempt from some of the admissibility limits by virtue of rule 4.14(6). Further guidance on the difference between *index linked contracts* and *property linked contracts* is contained in **Guidance Note 4.4**.

Stock lending and repo

- 3.11 Stock lending and repo transactions are treated on the same footing. Further details of the basic principles and treatment are set out in section 4.

Miscellaneous

- 3.12 In addition to the definitions given in rule 11.1 there are some general points on interpretation. The Interpretation Act 1978 applies to the interpretation of the rules. This means, inter alia, that unless the context requires otherwise -

- (a) any expression in the rules which is also used in the *Act* is to be read in the same sense;
- (b) words in the singular include the plural and words in the plural include the singular;
- (c) ‘land’ includes buildings and other structures, land covered with water, and any estate, interest (such as a lease or option), easement, servitude or right in or over land; and
- (d) ‘person’ includes a body of persons corporate or unincorporate.

4. VALUATION RULES

General principles

- 4.1 Unless a specific valuation rule applies (other than cash which is assigned its face value), no value can be given. In this context, ‘cash’ refers to cash in hand i.e. notes and coins. Cash deposited at a bank is treated under the *Valuation of Assets Rules* as a *debt* due from the bank. It therefore follows that in the case of admissibility limit restrictions, the *counterparty* exposure to the bank will be the aggregate of the cash deposits together with other investments in that bank (see section 5).
- 4.2 Examples of assets which have no value under the *Valuation of Assets Rules* include gold and other commodities, goodwill, expected allocations to shareholders from future life fund surpluses and tax credits recoverable only against tax on future profits (although a deferred tax credit resulting from a short term timing difference which will reverse in the near future may be recognised by way of offset against a current tax liability).
- 4.3 There are two types of valuation rule: those that require an asset to be valued at a certain amount (e.g. a *listed* security valued at its *market value*); and those which specify that the value must be not greater than a certain amount (e.g. land is valued at an amount not greater than the most recent *proper valuation*).

Overriding rule

- 4.4 In all cases there is an overriding rule for all valuations (rule 4.1(4)) which requires that a lesser value must be taken if, in all circumstances of the case, the value required by the rules is unlikely to be realisable. When determining whether or not a lesser value should be taken, regard must be taken to the underlying security of the asset and if a *debt*, the credit standing of the *counterparty*.

Post balance sheet events

- 4.5 In normal circumstances, although not strictly necessary, the *FSA return* for an *insurer* is based on the information included in the *Companies Act* accounts which the *directors* have approved and which the auditor has reported on at a particular date. If, however, there has been a post balance sheet event before the date on which

the *FSA return* is signed which is of such significance that it materially affects the view shown by the *return*, then the *return* should be adjusted and the reasons for the adjustment disclosed in the notes to the *return*. This will apply in cases where either the value of assets or liabilities of the *insurer* are affected.

- 4.6 The extent of the post balance sheet review required between finalisation of the statutory accounts and *Returns* will be a matter of judgement but the *FSA* considers that the general principles contained in SSAP 17 should be applied. Where a post balance sheet *general insurance business liability* is identified, the *FSA* may accept an additional amount to be disclosed as a one line entry on the balance sheet form of the *FSA return* (with appropriate explanation in the notes) without an adjustment to all the detailed analysis Forms.

[paragraphs 4.7, 4.8, 4.9, 4.10, 4.11 and 4.12 deleted]

Debts, deposits and other rights

- 4.13 This is a complex area which requires a three step approach to *debt*, deposits and other rights.
- Firstly, the type of *debt* and other right must be categorised under one of the definitions within rule 11.1.
 - Secondly, the *debt* and other rights must be valued - the rules to be applied are given in rule 4.5.
 - Thirdly, the admissibility rules set out in rule 4.14 and **Appendix 4.2** must be applied in order to determine the amount which can be taken into account for solvency purposes.

The key elements of the rules are described below. For additional guidance, illustrative examples are given in **Annex A**.

What is a debt?

- 4.14 The term *debt* covers a wide variety of rights which are *debts* although not always recognised as such. Such items may include accrued interest and rents receivable. For the purpose of the admissibility limits certain *debts* are given a higher admissibility limit than others. This is dealt with in greater detail in section 5.

Off-set

- 4.15 The valuation and admissibility limits relating to *debts*, including *reinsurers'* share of the technical account, would normally be considered on a gross basis unless any legally enforceable right of set-off existed. For example, *debts* due from one *counterparty* would normally be valued gross of any amounts due by the *insurer* to that *counterparty*. To the extent that rule 5.2 (valuation of liabilities under generally accepted accounting practice) applies, further guidance can be obtained from Financial Reporting Standard No. 5 ('FRS 5') issued by the Accounting Standards

Board in April 1994. The key tests which should be satisfied before assets and liabilities can be offset are set out in paragraph 29 of FRS 5 which may be summarised as follows:

- (a) the *insurer* and the *counterparty* owe each other determinable monetary amounts which are denominated in the same currency or readily convertible;
- (b) the *insurer* has the ability to insist on net settlement and can enforce a net settlement in all situations of default by the *counterparty*; and
- (c) the ability to insist on net settlement is assured beyond doubt and can survive the insolvency of the other party.

Consequently *debts* will not normally be able to be off-set against claims or other provisions. In particular, in relation to derivatives, the provisions for adverse changes cannot be off-set against *debts* due from an *approved counterparty* since the provision for adverse changes is not a determinable amount owed to the other party (i.e. fails test (a)). Note should also be taken of the offset reporting rules in the *Accounts and Statements Rules* - these requirements are not affected by the *Valuation of Assets Rules*. In this respect, therefore, the reporting requirements for the *FSA return* are applied independently after the *Valuation of Assets Rules* have been applied.

Basic valuation rule

- 4.16 The *Valuation of Assets Rules* apply similar valuation rules for both *secured* and *unsecured debts*. The rules differ only by the fact that for *secured debts*, due account must be taken of the quality and nature of the security. The *Valuation of Assets Rules* then apply, differently, depending on the timing of the *debt* as shown in the following chart. The definition of a *secured debt* is discussed in more detail in paragraphs 4.28 to 4.35.

Length of debt	Valuation rule
Due within 12 months	Amount that can reasonably be expected to be recovered
Due in more than 12 months	Immediate assignment value

- 4.17 ‘Immediate assignment’ value does not necessarily mean that there must be a specific buyer for the *debt* identified but that it would be possible to find someone to assign the *debt* to immediately. It also means that in valuing the *debt*, account should be taken of the time value of money which reflects the term of the *debt*, interest rates, status of the borrower and any other relevant conditions. *Unlisted, unsecured* deep discount or zero coupon bonds will certainly need to be discounted in order to arrive at a realistic assignment value.

Reinsurance recoveries/debts

- 4.18 Rules 4.5(5) and (6) distinguish between differing types of *reinsurance recoveries* for *long-term insurance business*. The distinction is made between *debts* actually due at the *relevant date* (which will include, in the main, *reinsurance recoveries* due against liabilities which have already been discharged by the *insurer*) and rights to future recoveries under long-term contracts of *reinsurance*.
- 4.19 The rules for amounts due or to become due under contracts of *reinsurance* can be summarised as follows.

Type of right under a contract of reinsurance	Valuation rule	Admissibility
Rights under a long-term contract of <i>reinsurance</i> which are not <i>debts</i> which have crystallised as being due at the relevant date	The amount of the right is offset against the related liabilities (provided this is standard actuarial treatment). Thus, the liability will be reduced by the amount of the rights	100% (since admissibility limits do not apply to liabilities)
Rights/ <i>debts</i> due from a <i>group undertaking</i>	Rule 4.2(4)	<i>Group undertaking</i> rules apply (rule 4.3)
Rights under a contract of <i>reinsurance</i> (others)	Rule 4.5(5)	100% (rule 4.14(5))

Other debts

- 4.20 Aside from *reinsurance recoveries*, there are a number of exceptions to the basic rule. The main types of exemptions are described in the table below which indicates where the relevant rules are to be found in the *Valuation of Assets Rules*.

Type of debt	Valuation rule	Comment
Amounts due under a letter of credit	Nil value (rule 4.5(2))	This is essentially a double counting provision (i.e. any underlying <i>debt</i> which is secured by a LOC is admissible but credit may not also be taken for the LOC in addition to the underlying <i>debt</i>).
Any <i>debt</i> secured on a long-term insurance <i>policy</i> issued by the <i>insurer</i> .	If fully secured, the amount of the <i>debt</i> (rule 4.5(3))	If not fully secured, usual <i>debt</i> rules will apply. The <i>secured</i> element of the <i>debt</i> remains within the secured <i>debt</i> rules.
Advance commission to intermediaries (contingent asset)	Nil value (rule 4.5(7))	This relates primarily to contingent commission advanced in relation to the sale of long-term insurance <i>policies</i> before such commission has actually been fully earned.
Unpaid <i>share</i> capital	Nil value (rule 4.5(7))	See paragraph 4.21
<i>Subordinated debt</i> due from an undertaking of which it is a <i>group undertaking</i>	Nil value (rule 4.5(6))	See paragraph 4.22
Premium <i>debts</i> more than 3 months overdue	Nil value (rule 4.5(7) and (8))	See paragraph 4.24
Premium <i>debts</i> (other)	The amount expected to be recovered (rule 4.5(1) and (4))	100% admissible (rule 4.14(5))
Quasi-derivatives	Depends on the circumstances	See paragraph 4.26

Unpaid share capital

- 4.21 Rule 4.5(7)(b) requires any *debt* due in respect of unpaid *share* capital of the *insurer* to be left out of account. There are circumstances under rule 2.10 where an *insurer* which has issued partly paid *shares* is able to count one-half of the unpaid amount towards its solvency requirements, provided that the admissible value of the *insurer's* other assets is at least equal to its liabilities. The relevant conditions which need to be met are principally that at least one-quarter of the nominal value and *share* premium has been paid up.

Subordinated debt

- 4.22 *Subordinated debt* is defined in rule 11.1, and is any *debt* that ranks after general creditors, in the event of a winding up of the debtor, and that is not to be repaid until the *claims* of those general creditors have been settled. There is, however, an express provision in rule 4.5(7) which prohibits an *insurer* from assigning a value to such *subordinated debt* if issued by its holding company.
- 4.23 For admissibility purposes, *subordinated debt* falls within the definition of *hybrid security* and will therefore benefit from the same admissibility limits as investments in equity *share* capital.

Premium debtors and the 'three month rule' - applies to all premium debts

- 4.24 The three month rule applies to all premium *debts* whether in relation to *direct insurance business* or inwards *reinsurance* business. *Debts* in relation to outwards *reinsurance* (i.e. essentially *reinsurance recoveries*) are not caught by these premium *debt* rules.
- 4.25 Under the *Valuation of Assets Rules*, any premiums which have been recorded in the *insurer's* records as due and payable and have been outstanding for more than three months can have no value for solvency purposes. The key to determining valuation is to establish when the clock starts running for the purpose of the 'three month' test. In general the due date will run from the time the *insurer* books the *debt* as due and therefore the three month period will run from after the expiry of any agreed credit terms. For example, in the case of an instalment premium, an instalment not due until six months time will only fail the 'three month' test if it has still not been paid within nine months (i.e. three months from the date it is due). In relation to London market bureaux business, a *debt* would normally be considered to be due from the bureau settlement date for the particular transaction concerned, i.e. the *debt* would not need to be linked back to the original signing date of the *policy* each time there is a subsequent treaty statement or premium adjustment. In all cases, the *FSA* would expect the *insurer* to be able to demonstrate clearly from its records when the *debt* is actually due for payment. If an *insurer* has recorded a *debt* but simply not yet made any effort to collect then it cannot claim that the amount is therefore not yet payable. Similarly it is unlikely that an *insurer* would be considered to have fulfilled the requirements if it were to grant extended credit terms beyond those needed for

normal commercial purposes (especially if granted to a *connected company*) in order to extend the admissibility of its premium *debts*.

Quasi-derivatives

- 4.26 Except in limited circumstances (which are described in paragraph 4.90), contracts having the effect of *derivative contracts* (e.g. where the principal is repayable in full and it is simply the coupon which is linked to an unapproved index) are given a nil value. However, any 'true debt' element which is receivable under an unconditional right can be assigned a value using the normal *debt* rules.

Amounts due from the long-term insurance fund

- 4.27 The rules do not specifically cover balances due between the *long-term insurance fund* and shareholders' funds or between separate *long-term insurance funds* maintained by an *insurer*. Given the requirement for separate identification of the *long-term insurance fund* by rules 3.1 to 3.5, such balances do arise in practice and may feature in the shareholders' accounts. There is a difficulty in reflecting these in the *return* since the *long-term insurance fund* is not a separate legal entity and, legally speaking, there is not a 'debt' that can be valued under the rules. The *FSA's* view is that the allocation of assets between the *long-term insurance funds* and shareholders' funds should be made to ensure that no such 'interfund' balances exist.

Secured debts

- 4.28 The *Valuation of Assets Rules* make the distinction between *secured* and *unsecured debts*. Moreover, the rules allow a *debt* to be split into a secured element and an unsecured element and the two parts are able to be treated separately when applying the *Valuation of Assets Rules* and the admissibility rules. The *Valuation of Assets Rules* do not expressly distinguish between types of *security* (e.g. floating or fixed) but instead set out the criteria against which each type of *security* should be assessed to determine whether it allows the *debt* to rank as 'secured' under the *Valuation of Assets Rules*.
- 4.29 The extent to which a *debt* is to be regarded as 'secured' is set out in the definition of *secured debt* in rule 11.1.
- 4.30 A *debt* is treated as secured only to the extent that it is secured by -
- (1) a letter of credit established with an *approved credit institution*Ⓞ;
 - (2) a guarantee provided by an *approved credit institution*Ⓞ; or
 - (3) assets which are of a value which is sufficient to allow the *debt* to be discharged in full (provided the assets can themselves be valued under the *Valuation of Assets Rules* and provided that the exposure to that class of assets does not exceed the permitted *exposure* limits once the assets providing security have been aggregated with the other exposures to that class of assets).

① as long as the LOC/guarantee does not cause a breach of the *permitted counterparty exposure limit*.

- 4.31 In the case of 4.30 (1) and (2), the letter of credit or guarantee can only count as security to the extent that the *counterparty exposure* to the credit institution does not exceed the permitted limits once the letter of credit or guarantee has been aggregated with the other *exposures*.
- 4.32 The *Valuation of Assets Rules* are broadly the same for both *secured* and *unsecured debts* (paragraph 4.16) - the only difference being that for *secured debt*, due account should be taken of the quality and nature of the security. The main difference in treatment between *secured* and *unsecured debts* is in relation to the admissibility limits which are discussed further in section 5.
- 4.33 When assessing *counterparty exposure* to credit institutions which have provided guarantees to act as security, the *FSA* would expect *insurers* to bear in mind their potential *counterparty exposure* to that credit institution in the context of rule 2.3 (the requirement to have assets appropriately spread).
- 4.34 A letter of credit is normally different in economic terms from a guarantee since under a LOC scheme, the credit institution operating the scheme is in effect ensuring that the debtor will honour the *debt* by holding assets which belong to the debtor and only permitting them to be released to the benefit of the *insurer* in settling the *debt* due. This is quite different from the credit institution acting as guarantor of the amount due. When looking at *counterparty exposure*, if letters of credit are involved, *insurers* will need to look at the legal structure of their own arrangements in each case but, in general, the *FSA* would not expect amounts due under LOCs operating as described above to be included within the overall *counterparty exposure* for the credit institution operating the scheme. An exception to this generality is that when assessing whether a LOC can count as security for a *debt* rule 11.1 states that the *counterparty exposure* to the credit institution should be taken into account (paragraph 4.31 refers).
- 4.35 The *secured debt* rules can be difficult to interpret and hence some worked examples of how *secured debts* are valued is given in **Annex A**.

Stock lending and repo transactions

- 4.36 The rules permit stock lending transaction and repos to be treated on the same footing.

Basic principles

- 4.37 The overall principle which is applied to ‘approved’ stock lending and repos is to ‘look through’ the transaction. That is, provided certain conditions are met, values are ascribed to the stock lent as though it were still retained by the *insurer*, but no value is ascribed to the collateral ‘transferred in’. This principle is detailed in rule 4.4(1).

4.38 In summary, the transaction must be with an *approved credit institution* or an *approved investment firm* and the maturity period must not exceed six months or must be ‘on demand’. Finally, the transaction must satisfy the conditions set out in rule 4.4(2) together with those set out in -

- (a) rule 4.4(3) (which caters for *securities* purchased); or
- (b) rule 4.4(4) (which caters for *securities* sold or lent).

Many of the conditions in rule 4.4 relate to the nature and quantum of the collateral. The *Valuation of Assets Rules* operate in a significantly smoother fashion if the *insurer* has ensured that its transactions are appropriately collateralised and can benefit from the ‘look through’ approach. Since it is assumed that the vast majority of *insurers* will carry out stock lending and repo transactions with appropriate collateral, it is not proposed to offer detailed guidance of the calculations required if an arrangement has collateral which fails the conditions within rule 4.4. Insurers should be aware, however, that if the collateral is such that the conditions in rule 4.4 fail, and the look through approach is not permitted, the *insurer* will then have to endure a number of additional calculations in order to apply the *Valuation of Assets Rules* using first principles (i.e. would treat the outward and reverse transactions as futures contracts, requiring therefore that account be taken of *counterparty exposure* etc.).

The conditions set out in rule 4.4(2)

4.39 The conditions described in rule 4.4 broadly require the collateral to maintain a value which does not fall below 97.5% of the value of the stock sold. If the value does fall through this level, additional collateral is required by the end of the next working day to bring it back up to the 100% level.

The conditions set out in rule 4.4(3)

4.40 If, under the agreement, it is the *insurer* which has purchased the *securities*, using consideration which is other than by way of a sale of *securities*, then the conditions which must be met to allow the ‘look through’ approach are set out in rule 4.4(3) and are as follows:

- (a) the *securities* purchased must be gilts, *listed securities* or *securities* issued by an *approved credit institution*; and
- (b) the *securities* purchased must satisfy extra conditions (see 4.41).

4.41 For the ‘look through’ approach to apply where an *insurer* purchases *securities*, it is a condition that the *securities* purchased must not include -

- (a) *securities* issued by the same *counterparty*, the aggregate value of which exceeds 15% of the value of the total package of *securities* purchased,

or, if (a) is not satisfied,

- (b) *securities* which, if aggregated with the *insurer's* existing other holdings, would cause a breach of the relevant admissibility limits.

These conditions do not apply if the assets transferred to the *insurer* are gilts or other types of *approved securities*.

The conditions set out in the rules at 4.4(4)

4.42 If, on the other hand, it is the *insurer* which has sold securities to an *approved credit institution* or an *approved investment firm*, then the conditions in rule 4.4(4) apply as follows -

- (a) the 'consideration' received must be of a certain nature;
- (b) the 'consideration' (unless in the form of gilts or cash) received must satisfy extra conditions;
- (c) if cash was received as collateral, then cash must be returned in the same currency; and
- (d) if *securities* were offered as collateral, then *equivalent securities* must be returned.

Consideration in this context comprises –

- *securities* (other than gilts and other *approved securities* issued by,
- letters of credit established with,
- guarantees provided by,
- cash held with,
- a charge over cash held with,
- a charge over *securities* issued by,

the same *counterparty*.

4.43 For the 'look through' approach to apply where an *insurer* sells *securities*, the conditions require that the 'collateral' received must not include -

- (a) 'consideration' which causes *exposure* to the same *counterparty* to exceed 15% of the value of the total package of the 'collateral',

or, if (a) is not satisfied

- (b) 'consideration' which, if aggregated with the *insurer's* existing other holdings, would cause a breach in the relevant admissibility limits.

The conditions would not, in practice, apply if the 'collateral' received by the *insurer* is gilts or other types of *approved securities*.

Look through approach for stock purchased

- 4.44 If the conditions are met, the *insurer* should value the ‘consideration’ as if such consideration had been retained by it. At the same time, no value is to be given to the stock ‘purchased’, except to the extent that the stock is non-returnable and represents payment for services rendered.

Look through approach for stock sold

- 4.45 Under similar ‘look through’ principles, providing the conditions are satisfied, the *insurer* should value the stock sold as if such stock had been retained by it. At the same time, no value is to be given to the collateral which the *insurer* received as part of the transaction, except to the extent that the assets received as 'collateral' are non-returnable and represent payment for services rendered.

Admissibility implications

- 4.46 Those assets to which a value can be given (see 4.44 and 4.45) will be included within the *insurer's exposure* to assets of the same description. At the same time, if the conditions are satisfied, there will be no *counterparty exposure* to the assignee by virtue of the fact that no value may be given to the assets received by the *insurer*.
- 4.47 Rule 4.4(7) allows *insurers* to adopt a pragmatic approach where the *insurer* has entered into a number of stock lending or repo transactions. It allows the agreements which are yet to mature at the *relevant date* to be aggregated and treated (for the purposes of testing the conditions also set out in rules 4.4(3) and (4)) as though they were one agreement. In practical terms, therefore, when an *insurer* assesses whether the collateral causes a breach of any of the permitted *exposure* limits, it can look at all such collateral collectively.

What if the conditions are not met?

- 4.48 In such instances, the transaction should be assessed using first principles. In the majority of cases, stock lending and repo transactions will be a series of *futures contracts* and should be treated under the *Valuation of Assets Rules* and admissibility rules accordingly. This will undoubtedly require a number of additional calculations to be carried out (the section on futures and options contracts in section 5 may also be relevant). The purpose of the conditions set out in rule 4.4 is to provide a simple, pragmatic treatment for the preferred types of stock lending and repo transactions.

What if the *insurer* reinvests the collateral?

- 4.49 In certain instances, it may be considered commercially advantageous to reinvest the ‘collateral’ received when the *insurer* has ‘sold’ *securities* under a stock lending or repo transaction. If the conditions set out in rules 4.4(2) and (4) are satisfied, then the ‘look through’ approach applies not only to the original collateral, but also to any assets which have been acquired as a result of the reinvestment. In other words, the original collateral, or any assets purchased by it, are given a nil value.

- 4.50 However, in such circumstances, the *insurer* must consider the effects of rule 5.3(1)(b) which caters for imprudent reinvestment of collateral received under a stock lending or repo transaction. The rule requires the *insurer* to provide for, as an additional liability, any adverse variations (taken in the context of the overall level of assets party to this and similar transactions) which may occur between the value of the original assets received as collateral and the assets it has acquired upon reinvestment of the collateral.
- 4.51 Rule 5.3(1)(b) is reliant on the *insurer* being able to earmark assets to match the obligation it has taken on under the transaction – under rule 5.3(1)(a). For pragmatic reasons, it is reasonable for an *insurer* to have regard to the overall availability of the assets of the description in question before carrying out the earmarking process. For example, if the *insurer* were to identify cash as a suitable asset to cover its obligation, and if the *insurer* had an abundance of cash reserves elsewhere, it would be unnecessary for the *insurer* to earmark specific pound notes and coins for the purpose of rule 5.3(1)(a).

FSA return reporting

- 4.52 For the purposes of the *FSA Returns*, the asset sold or lent will be reported in the line of **Form 13** appropriate to the asset to which title has been transferred, and not as a *debt*. This is consistent with existing practice for most *insurers*.

Land and buildings

- 4.53 Rule 4.6 requires that land is valued on the basis of the most recent *proper valuation* after deduction of reasonable expenses of sale. If there has been no *proper valuation*, the land has a nil value. By virtue of the Interpretation Act 1978 'land' includes any interest in land such as a lease or option and also includes buildings, but does not include a remainder or a reversionary interest which in the case of *long-term insurers*, must be valued under rule 4.11 and will have no value for *general insurers*. It does not include debts secured on land.
- 4.54 The definitions of *proper valuation* and *qualified valuer* in rule 11.1 are extremely important. The former makes clear that any *mortgage* or charge is to be excluded from consideration; it is not the equity of redemption which is to be valued as might have been thought to be the case without this specific reference. If the *insurer* has used a valuer who does not hold one of the specified qualifications, then the land will have a nil value unless specific exemptions have been granted under a section 148 direction.
- 4.55 It is a condition of a *proper valuation* that the valuation is made not more than three years earlier by a *qualified valuer*. This is, however, a 'no greater than' provision. If circumstances likely to affect the realisable value have become less favourable since such a valuation was made, or if there is any other adverse consideration arising from a qualification in the valuer's report (for example calling for other professional advice), an appropriate lower value must be taken. Where a property has been acquired at open *market value* after obtaining a professional valuation, this valuation is likely to be adequate for the purposes of rule 4.6.

- 4.56 Valuation of buildings should normally be under the Royal Institute of Chartered Surveyors (RICS) guidelines for the valuation of properties of *insurers*. The deduction for reasonable expenses of sale, which the RICS guidance recommends that the valuer leaves to the *insurer* to assess, may need to include relocation costs where the *insurer* occupies its own premises.
- 4.57 Where the *insurer* or a *related company* occupies the property, then the valuation should be on a vacant possession basis, not sale and lease back, unless a lower value is more appropriate. This rule applies to the situation where the *general insurer* occupies a building owned by the *long term insurance fund* of a *related company*.
- 4.58 Where a number of pieces of land are valued together they may attract a collective admissibility limit under paragraph 1 of Part II of **Appendix 4.2**
- 4.59 Rule 4.6(2) provides that the amount of any interest in land which is determinable upon a future event (including the death of any person) is the immediate transfer value of the interest.

Equipment

- 4.60 Rule 4.7 provides for the rapid write off of all forms of operating equipment. This is a 'not greater than' rule and so a faster rate of write down should be used if that is considered reasonable for particular items of equipment. Such a circumstance may arise if, for example, an *insurer's* computer equipment has become outmoded because of technological developments and would, therefore, have little realisable value.
- 4.61 There is no definition of computer equipment in rule 11.1, but in practice the *FSA* considers it appropriate to continue with the general practice that computer hardware would be included, but not computer software.
- 4.62 Rule 4.7 only applies to equipment owned by the *insurer* and leased assets would have to be left out of account. In the interests of consistency, there is no need in these circumstances to provide for the accounting liability in respect of future finance lease payments which would appear in the shareholder accounts by virtue of SSAP 21. However, where the present value of future lease payment commitments exceeds the value of the assets (valued under the appropriate *Valuation of Assets Rules*), then the net liability (or the cost of breaking the lease if lower) should be included as a liability for the purposes of assessing solvency.

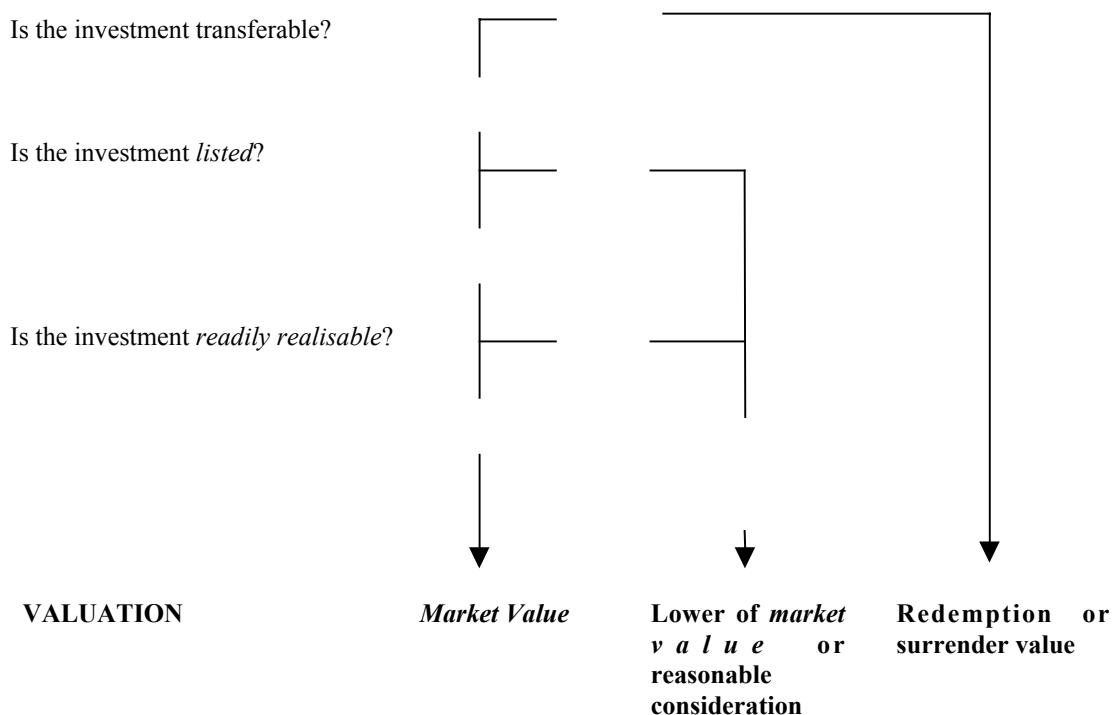
Securities and beneficial interests in limited partnerships

Overview

- 4.63 All *securities* and all beneficial interests in limited partnerships are valued under rule 4.8. There are three exceptions: interests in *collective investment schemes*, *derivative contracts* and contracts having the effect of derivative contracts must be valued using their own more specific rules 4.9, 4.12 and 4.13 respectively.

- 4.64 The same valuation rules apply regardless of whether the security is *listed* or *unlisted*. However, there is a distinction between *listed* and *unlisted securities* in the admissibility rules. The admissibility rules are described in section 5.
- 4.65 The question as to whether *securities* are *readily realisable* has a direct impact on both the valuation rule and the admissibility rule.
- 4.66 *Readily realisable securities* include those which it would be reasonable to assume that, had they been sold at the *relevant date*, the selling price would have been at least 97.5% or more of the *market value*. *Readily realisable securities* are subject to different valuation and admissibility rules. The underlying principles are further explained in paragraphs 4.73 to 4.77.
- 4.67 Rule 4.8 itself does not allow a lower valuation than that required. Consequently, there is no option to show an amount other than that under the rules in the *returns*. As with all valuations, this is subject to the application required of the ‘overriding rule’ in rule 4.1(4) (see 4.4). In addition, the valuation must be under UK GAAP which, in itself, allows the necessary degree of flexibility when valuing *securities*. *Directors* must, however, be able to support and justify the valuation methods used to the *insurer's* auditors.

Summary of the Valuation of Assets Rules



Unlisted investments

- 4.68 The *insurer* must value *unlisted securities* under UK GAAP. The *insurer's* auditor is responsible for forming an opinion on whether the methodologies used in valuing

unlisted investments fall within the scope of UK GAAP and give an appropriate estimation of the investment's value.

4.69 When estimating the value of *unlisted securities*, matters for consideration should include the following.

- For bonds: comparison with a range of similar *securities*, or obtain an independent quotation from an investment firm; and
- For equities and other investment interests: have regard to the valuation guidelines given by the British Venture Capital Association document, 'Guidelines for the Valuation and Disclosure of Venture Capital Portfolios', or obtain an independent quotation from an investment firm.

Consideration should also be given to the average price at which the *unlisted securities* were traded at the *relevant date*, if it is the case that a market exists for such investments.

4.70 The *Valuation of Assets Rules* are not intended to require an *insurer* to assign a 'forced sale' valuation to such *securities*. This may be particularly relevant when assessing the value under rule 4.8(3)(b)(ii).

Listed investments

4.71 Rule 4.8 caters for *listed debt securities* (including local authority capital issues and *listed Eurobonds*) and *listed shares*.

4.72 Other *listed* investments are assigned the *market value* as determined under UK GAAP, except for *securities* (*listed* or *unlisted*) which have the effect of an inadmissible *derivative contract* (in which case the valuation issues are discussed below). Similarly, it follows that fixed interest redeemable investments should also be shown at their *market value* as determined by UK GAAP and hence may not be valued on an amortisation basis.

Investments which are readily realisable

4.73 Rule 4.8(4) requires the *insurer* to assess whether it would have been able to sell the investment at the ascribed value. The *security* would fail the *readily realisable* test if it is reasonable to assume that, if the investment had been sold at the *relevant date*, the maximum selling price which could have been achieved would not be sufficiently close to the ascribed value.

4.74 In order to determine whether the investment is *readily realisable*, the *insurer* should first assign the *market value* (i.e. the value ascribed using UK GAAP) to the *security*. The *insurer* should then be in a position to be able to demonstrate to its auditors that the investment could have been sold or transferred under an orderly arms' length sale at the *relevant date* (having had 7 days to negotiate the sale), at a selling price which is not less than 97.5% of the ascribed value.

- 4.75 If the *insurer* is unable so to demonstrate, then the investment will not be considered *readily realisable* and it will be treated under the admissibility rules as though it were *unlisted* (see the summary rules table above). This then has the knock on effect that *listed* but not *readily realisable* investments are included, together with *unlisted securities*, within the aggregate limit in paragraph 12 of Part II of **Appendix 4.2**. This is in contrast to the treatment of *readily realisable listed* investments, where there are no aggregate limits.
- 4.76 The rules allow certain investments which may, on the face of it, otherwise fail the test in rule 4.8(4), nonetheless still to be classed as *readily realisable*. An investment does not fail the *readily realisable* test if (but only if) it failed the requirements of rule 4.8(4) owing to either -
- (a) a temporary suspension of the listing; or
 - (b) the size of the holding being so large that it would not be possible to carry out an orderly arms' length sale on the *relevant date* of that entire holding at the ascribed value.

Non-transferable securities

- 4.77 Any investment, regardless of whether it is *listed* or *unlisted*, which is not transferable will be assigned a value which would be payable on surrender or redemption of the investment at the *relevant date*. In this regard, the 'transferable test' is not intended to define investments which are 'not readily transferable'. Instead, the intention is to make a distinction for those *securities* where there is a prohibition on any transfer.

Traded debt securities ('Eurobonds')

- 4.78 The term '*listed debt securities*' includes all *debt securities* in respect of which there has been granted and not withdrawn a listing on any stock exchange in an *EEA State* and includes all *debt securities* which have been granted a trading facility on a *regulated market*. *Debt securities* are catered for under rule 4.8.

Other commercial paper

- 4.79 Commercial paper which is not *listed* will be treated as an *unlisted debt security* and will be valued under rule 4.8. The admissibility limits which cater for *debt securities* are described in section 5. Since the valuation rule ascribes *market value* to such items, it is possible for the value of the commercial paper to be stated inclusive of accrued interest.

Valuation rules - unit trusts and other collective investment schemes

- 4.80 Rule 4.9 describes the characteristics of those *collective investment schemes* which can be given a value. Provided the criteria are satisfied, the holding/beneficial interest in the scheme can be valued and admitted for solvency margin purposes. All *UCITS* are incorporated within rule 4.9.

- 4.81 The valuation of *collective investment schemes* where the *issuer* cannot be required to buy back the units is determined by applying the provisions set out in rule 4.8.
- 4.82 The admissibility rules distinguish between *collective investment schemes* recognised under the *UCITS Directive* (which are admissible without restriction) and other authorised/recognised schemes (which are admissible up to 5% of the business amount).
- 4.83 Schemes which are not authorised, or are not recognised by the *FSA*, can be ascribed a value provided certain conditions are met. The admissibility limit for such schemes is 1% of the *business amount*.

Derivatives

- 4.84 Rule 4.13 defines the criteria which apply for a contract to be treated under the *Valuation of Assets Rules* as though it were a *derivative contract*. Rule 4.13 is intended to catch investments which, although they may not have the legal form of a *derivative contract*, nevertheless have the effect of or operate in the same manner as a derivative. Both those contracts which are derivatives and those which have the effect of *derivative contracts* are to be treated on an equal footing.
- 4.85 Rule 4.12 defines an ‘approved derivative contract’ for purposes of the rule. Only such a contract can be given a value for solvency purposes. A contract which gives rise to a liability (whether ‘approved’ or not) must be valued under UK GAAP, under rule 5.2.
- 4.86 (1) The conditions which must all be satisfied in order for the contract to be treated as an ‘approved derivative contract’ are -
- (a) the contract can be readily closed out;
 - (b) the contract is *listed* or if OTC (‘Over The Counter’) is with an *approved counterparty*;
 - (c) the investment is for the purpose of efficient portfolio management or a reduction in investment risks;
 - (d) the contract is held in connection with assets which are themselves admissible under the *Valuation of Assets Rules* for the purposes set out in (c);
 - (e) the contract is covered - i.e. the *insurer* will have, as far as can reasonably be foreseen, appropriate assets at the settlement date to be able to fulfil its obligations under the *derivative contract*;
 - (f) the contract must satisfy the ‘in connection with’ test;
 - (g) the contract must use a prescribed pricing basis.

- (2) The rights to recover the *initial margin* are now catered for under rule 4.5.
- 4.87 A *derivative contract* would not be ‘covered’ if, under rule 5.3, it would require a significant provision to be made. Although it is a matter ultimately for the *directors* to agree with their auditors, the *FSA* takes the view that the term ‘significant provision’ should be taken in the context of the value of the contract - not in the context of the fund within which the contract is used.
- 4.88 *Listed derivative contracts* are valued at their *market value*; the valuation for *unlisted* contracts remains as before, being the amount which would reasonably be paid for closing out the contract. The value of both *listed* and *unlisted derivative contracts* must be reduced by any amounts which have already been received by the *insurer* under the contract, for example by way of a *variation margin*.
- 4.89 Rule 5.3 should also be considered when valuing *derivative contracts* to determine whether an additional liability should be made in respect of a provision for adverse changes.
- 4.90 Whilst the above paragraphs provide an overview of the derivatives rules within the *Valuation of Assets Rules*, fuller guidance on the valuation and admissibility of derivatives is given in Guidance Note 4.2 ‘The use of *derivative contracts* in insurance funds’. This more detailed guidance should be referred to when seeking to value *derivative contracts* for solvency margin purposes.
- 4.91 Rule 4.13 sets out the valuation rules for contracts or assets which have the effect of *derivative contracts*. In essence, such contracts or assets are valued at *market value*. Those which have the effect of inadmissible *derivative contracts* have a nil value, except in respect of an unconditional right to receive a specified amount. Such an amount is treated as a *debt* and valued accordingly.

Implicit items: future profits

- 4.92 (1) *Insurers* may apply for a waiver from rule 2.10 so that the *implicit item* relating to future profits may be valued at not more than 50% of the full amount of future profits.
- (2) For the purposes of (1), the full amount of future profits is the estimated annual profit multiplied by a factor which, as closely as possible, represents the average number of years remaining to run on *policies*, but does not exceed 10.
- (3) For the purposes of (2) -
- (a) the estimated annual profit is one-fifth of the profits made in *long-term insurance business* over a period of five years (the **relevant period**) ending on the last day of the most recent *financial year* for which a valuation under rule 9.4 has been carried out, substantial items of an exceptional nature being excluded; and

- (b) the average number of years remaining to run on *policies* is calculated-
- (i) by multiplying the number of years to run on each *policy* by the actuarial value of the benefits payable under the *policy*, adding together the products so obtained and dividing the total by the aggregate of the actuarial values of the benefits payable under all the *policies*, or
 - (ii) by an approximation to this method of calculation suitable to the circumstances of the case, including, where appropriate, an approximation involving the grouping of contracts,

appropriate allowance being made in either case for premature termination of contracts.

- (4) For the purposes of (3)(a) -
- (a) where a valuation under rule 9.4 has been carried out annually in relation to the 'relevant period', the profits made in *long-term insurance business* for any particular year of the 'relevant period' is the surplus (if any) arising in the *long-term insurance fund* since the last such valuation, and the profit so made for that period is the aggregate of those surpluses less any deficiencies in the *long-term insurance fund* during that period;
 - (b) where an *insurer* has carried on *long-term insurance business* throughout the 'relevant period' but valuations under rule 9.4 have not been made annually in that period, the profits so made for that period are the aggregate of surpluses arising in the *long-term insurance fund* since the last valuation preceding the 'relevant period' less any deficiencies in the *long-term insurance fund* since that last valuation, except that the surplus or deficiency arising in the period ending with the first valuation within the 'relevant period' is proportionately reduced to allow for any period of time falling outside the relevant period; and
 - (c) where an *insurer* has not carried on *long-term insurance business* throughout the 'relevant period', the profits made in *long-term insurance business* for the 'relevant period' are the aggregate of any surpluses arising in the *long-term insurance fund* during that part of the 'relevant period' for which *long-term insurance business* was carried on less any deficiencies in the *long-term insurance fund* during that part of that period.

Implicit items: zillmerising

- 4.93 (1) *Insurers* may apply for a waiver from rule 2.10 so that, where *zillmerising* is appropriate, but either is not practised or is at a rate less than the loading for acquisition costs included in the premium, then, subject to (6), the *implicit item* relating to *zillmerising* may be valued at an amount not exceeding the difference between -
- (a) the *non-zillmerised* or partially *zillmerised* figure for *mathematical reserves* maintained by the *insurer*; and
 - (b) a figure for *mathematical reserves* (not less than those required by the *Determination of Liabilities Rules*) *zillmerised* at a rate equal to the loading for acquisition costs included or allowed for in the premium.
- (2) Where *zillmerising* is not practised, then, subject to (6), the value given by (1) (less any amount relating to temporary assurances) may not exceed 3.5% of the aggregate of the difference between -
- (a) the ‘relevant capital sums’ for *long-term insurance business* activities; and
 - (b) the *mathematical reserves* (excluding *mathematical reserves* for temporary assurances).
- (3) Where *zillmerising* is practised but is at a rate less than the loading for acquisition costs, then, subject to (6), the value given by (1) (less any amount relating to temporary assurances) together with the difference between the partially *zillmerised mathematical reserves* and the *non-zillmerised mathematical reserves* may not exceed 3.5% of the aggregate of the difference between -
- (a) the ‘relevant capital sums’ of *long-term insurance business* activities; and
 - (b) the *mathematical reserves* (excluding *mathematical reserves* for temporary assurances).
- (4) In (2) and (3), **relevant capital sums** means -
- (a) for whole life assurances, the sum assured;
 - (b) for *policies* where a sum is payable on maturity (including *policies* where a sum is also payable on earlier death), the sum payable on maturity;
 - (c) for deferred annuities, the capitalised value of the annuity at the vesting date (or the cash option if it is greater);

- (d) for capital redemption contracts, the sums payable at the end of the contract period; and
- (e) for *linked long-term contracts*, notwithstanding (a) to (d), the lesser of -
 - (i) the amount for the time being payable on death, and
 - (ii) the aggregate of the value for the time being of the units allocated to the contract (or, where entitlement is not denoted by means of units, the value for the time being of any other measure of entitlement under the contract equivalent to units) and the total amount of the premiums remaining to be paid during such of the term of the contract as is appropriate for *zillmerising* or, if such premiums are payable beyond the age of seventy-five, until that age,

excluding in all cases any vested reversionary bonus and any capital sums for temporary assurances.

- (5) Where, under the contract relating to any such business as is mentioned in (4), the payment of premiums is to stop before the sum assured becomes due, then, notwithstanding (4), **relevant capital sums** in (1) to (3) means the *mathematical reserves* appropriate for that contract at the end of the premium-paying term.
- (6) For the purposes of this guidance -
 - (a) reserves for vested reversionary bonuses will not be regarded as *mathematical reserves*; and
 - (b) the result given by (1), (2) or (3) will be reduced by the amount of any undepreciated acquisition costs brought into account as an asset.

Implicit items: hidden reserves

- 4.94 *Insurers* may apply for a waiver of rule 2.10 so that the *implicit item* relating to hidden reserves, if it consists of hidden reserves resulting from the underestimation of assets and overestimation of liabilities (other than *mathematical reserves*), may, in so far as the hidden reserves in question are not of an exceptional nature, be given its full value.

5. ADMISSIBILITY LIMITS

General principles

- 5.1 The admissibility rules are contained in rule 4.14 and **Appendix 4.2** and cover STEP THREE referred to in paragraph 2.1 of this Guidance, that of encouraging *insurers*

to maintain a prudent spread of investments. This is achieved in Part II of **Appendix 4.2** by tabulating percentages of defined yardsticks which represent the maximum value for a particular asset or category of assets that may be taken into account for solvency purposes. Rule 4.14(5) sets out the exemptions from the admissibility rules for certain assets and rule 4.14(6) sets out the special considerations that apply to index linked assets. In essence, if an asset falls within one of the exemptions catered for in rule 4.14(5), then it is fully admissible without restriction. Paragraph 5.25 provides a list of such assets.

- 5.2 An *insurer* is not prohibited from holding a greater amount of a particular asset, but it will receive no credit for the excess holding in determining whether it has complied with solvency requirements. While this may not be unduly significant for a *insurer* with a substantial excess of available assets over the *required minimum margin*, an *insurer* with less of a cushion will need to be careful to ensure that undue concentrations in particular assets do not lead to statutory solvency requirements being breached.
- 5.3 **Appendix 4.2** promotes the concept of aggregate *exposure* to particular assets or classes of assets. The limits are graded so that more restrictive treatment is applied to assets which are subject to higher risks and/or have lower security (both in terms of collateral provided and status of the *counterparty*). The rules relating to *counterparty exposure* place restrictions on large *exposures* to any particular *counterparty* or any of its *connected companies*. Both aggregate *exposure* and *counterparty exposure* are discussed more fully below.
- 5.4 The limits relate to amounts determined by calculating the ascribed percentages of the *general business amount* and the *long-term insurance business amount*. An *insurer* carrying on only *general insurance business* will restrict all its assets by reference to the *general business amount* and a *insurer* carrying on only *long-term insurance business* will restrict all its *non-linked assets*, whether shareholder or *policy holder*, by reference to the *long-term insurance business amount*. A composite will restrict its *long-term insurance business assets* by reference to the *long-term insurance business amount* and its other than *long-term insurance business assets* by reference to the *general business amount*.
- 5.5 If an *insurer* only undertakes *long-term insurance business* and has assets which are partly attributable to both the *policy holders* and the shareholders, then any reduction because of admissibility restrictions must be made to the *long-term insurance business assets* in the same proportion as the attribution to the *policy holders* under rule 4.14(4). Similarly, the same principle applies if an *insurer* has more than one *long-term insurance fund* for which assets are separately appropriated and a reduction is required that will affect more than one fund.
- 5.6 The calculations of *general business amount* and *long-term insurance business amount* are discussed in 5.48 to 5.50. The broad principle is that the *general business amount/long-term insurance business amount* approximates to the higher of the net technical liabilities plus a notional solvency margin or net admissible assets.

Calculation of admissible assets

- 5.7 The admissibility rules adopt a menu-style approach. Firstly the assets are required to be valued in accordance with the *Valuation of Assets Rules* and secondly, a series of admissibility adjustments is applied in turn. Rule 4.14(1) provides the framework for the necessary admissibility adjustments and can be summarised as follows.

STEP	GUIDANCE/RULE	AMOUNT
Value the assets in accordance with the <i>Valuation of Assets Rules</i>	Section 4 of this Guidance Note	Gross amount
Deduct excess of the permitted asset exposure	Rule 4.14(1)(a). See paragraph 5.18 - 5.21 of this Guidance Note	(A)
Deduct excess of the permitted <i>counterparty</i> exposure	Rule 4.14(1)(b). See paragraph 5.22 - 5.27 of this Guidance Note	(B)
Deduct excess of the permitted concentration with a number of <i>counterparties</i>	Rule 4.14(4)(1)(c). See paragraph 5.28 - 5.29 of this Guidance Note	(C)
Deduct an amount representing the value of assets transferred by way of an inadmissible <i>derivative contract</i>	Rule 4.14(4)(1)(d)&(e). See paragraph 5.30 of this Guidance Note	(D)
		Admissible amount

For reporting purposes, the difference between the ‘gross amount’ and the ‘admissible amount’ (being the total amount by which the assets exceeded the admissibility limits in **Appendix 4.2**) is separately disclosed in **Form 13** of the *FSA return*.

- 5.8 The adjustments, in the main, are as a result of excess *exposure* to any one particular asset class or any one *counterparty*. The concept of ‘aggregate *exposure*’ has been introduced to take into account the fact that *insurers* can be exposed to movements in the value of assets other than those which it actually held at the relevant date e.g. where it has entered into a *derivative contract* or where it has taken a particular asset as security for a *debt*.
- 5.9 The admissibility rules operate in order that the amounts which are able to be counted toward the solvency margin calculation are restricted if there is too much concentration toward one particular type of asset or one particular *counterparty*.
- 5.10 The approach to admissibility restrictions is first to set out the rules to allow the *insurer* to calculate its *exposure* to assets or *exposure* to *counterparties* and secondly to define what the ‘excess *exposure*’ should be.

Calculation of exposure to assets

- 5.11 The aggregate *exposure* to assets of a particular description is determined by applying the calculation now included in Part I of **Appendix 4.2**. The calculation is laid out in menu style format which applies as follows.

Aggregate exposure to assets are -

- (1) assets held directly; plus or minus
 - (2) assets which the *insurer* is treated as having acquired or disposed of under *futures contracts*; plus or minus
 - (3) assets which the *insurer* is treated as having acquired or disposed of under *options*; plus or minus
 - (4) assets which the *insurer* is treated as having acquired or disposed of under other *derivative contracts* (other than *futures contracts* and *options* already taken into account above); plus
 - (5) assets which have been transferred by the *insurer* by way of an *initial margin* (under a *derivatives contract*); plus
 - (6) assets which have been taken as security for a *debt*.
- 5.12 Item (6) is not referred to in **Appendix 4.2** itself, but nevertheless must be taken into account when calculating the ‘aggregate *exposure*’ when assessing whether a *debt* is ‘*secured*’ (see paragraph 1(b)(ii) of the definition of *secured debt* in rule 10.1). The worked examples in **Annex A** provide additional guidance on how this operates in practice.
- 5.13 Paragraphs 4.36 to 4.52 describe those stock lending and repo transactions which do not have to be taken into account for aggregate *counterparty exposure* calculations.

Futures and options contracts

- 5.14 The underlying principle for *futures contracts* and *options* is that, provided certain conditions are met, for the purposes of aggregate *exposure* calculations the *insurer* is deemed to have already acquired or disposed of the asset as at the relevant date. Part 1 of **Appendix 4.2** sets out these conditions. In brief, (on the assumption that these conditions are met) the treatment is as follows:
- (a) If the contract provides for the acquisition of assets, the *insurer* is deemed to have already acquired them at the *relevant date*.
 - (b) If the contract provides for the disposal of assets, the *insurer* will be deemed to have already disposed of them at the *relevant date* only if -

- (i) the contract is *listed*, or
- (ii) the contract is not *listed* but provides for the disposal of the assets by the *insurer* to an *approved counterparty* within one year of the *relevant date*.

For *options*, if it appears prudent to assume that the *insurer* will exercise the option, the *insurer* will be deemed to have exercised the *option* at the *relevant date*. (Note that ‘prudent to assume’ should be a considerably stiffer test than a simple balance of probabilities). If the *insurer* is deemed to have exercised the *option*, (a) and (b) will apply.

- 5.15 The principles for the treatment of *futures* can be applied to stock lending or repo transactions which are not able to benefit from the look through approach. The guidance on ‘stock lending and repo transactions’ in section 4 refers.
- 5.16 As *derivative contracts* are part of the aggregate *exposure* calculation, it is possible for the admissibility reduction which is required for a particular class of asset will be larger than the value of the assets which are actually held. In such cases, rule 4.14(2) provides that the necessary reduction is first applied to the assets actually held and any ‘unutilised’ part of the reduction will be applied as a deduction against ‘other assets’. For reporting purposes, a separate line is included in **Form 13** of the *FSA return* for such a deduction. Example 2 in 5.47 illustrates this point.
- 5.17 **Guidance Note 4.2** provides additional guidance relating to *derivative contracts* and should be referred to when valuing *derivative contracts* under the *Valuation of Assets Rules*. The adjustments in relation to stock lending and *secured debts* are discussed in section 4.

Excess of the permitted asset exposure

- 5.18 Once the total aggregate *exposure* to an asset type has been calculated, the *insurer* must restrict the amount which can count toward solvency margin calculations. The restriction is any amount over and above the *permitted asset exposure limit*. The *permitted asset exposure limit* is determined by multiplying the *business amount* by the relevant percentage, as found in the table set out in Part II of **Appendix 4.2**. If an asset is not covered by Part II of **Appendix 4.2**, then unless it falls within one of the exemptions rule 4.14(5), its *permitted asset exposure limit* is nil.
- 5.19 The calculation to determine the ‘*excess asset exposure*’ is –

$$(A) = (\text{total exposure to assets of that description}) - (\text{permitted asset exposure limit})$$

If the figure arrived at is negative then it is taken to be zero (i.e. the excess is nil).

- 5.20 It is possible for an asset to interact with more than one admissibility restriction (e.g. the asset could be a preference share issued by an *approved counterparty*, hence paragraphs 11, 12 and 15 of Part II of **Appendix 4.2** interact). In such cases, the lower admissibility limit bites first. The reduction required by the first limit is taken

into account when calculating the excess *exposure* in applying the second limit. In other words, if an asset has already been partly disallowed by virtue of one limit, only the admissible element needs to be considered when applying a second limit. This approach is set out in paragraph 12, Part I of **Appendix 4.2**.

- 5.21 In circumstances where the *insurer* does not hold sufficient assets of that description to eliminate the excess, a deduction is made against 'other assets' as described under 5.16.

Calculation of exposure to a counterparty

- 5.22 *Exposure* to any one *counterparty* (when taken together with its *connected companies*) also falls under the admissibility restrictions.
- 5.23 The rules require the value of all investments in, *debts* due from and rights against a *counterparty* to be aggregated in order to calculate the *counterparty exposure*. The values which are entered into the *counterparty exposure* calculation are the amounts arrived at after taking account of the permitted asset *exposure* rules, thus avoiding 'double counting' of the admissibility limits.
- 5.24 Certain secured obligations, which may include stock lending and repo transactions, are permitted to be excluded from the aggregation calculation, provided certain conditions are met. The conditions, which relate to the nature of the security given, are set out in paragraph 14 of Part I of **Appendix 4.2**.
- 5.25 Not all assets are subject to admissibility restrictions. Rule 4.14(5) lists those assets which are permitted without limit -
- (a) *approved securities* or interest accrued on them (the definition of *approved securities* should be considered),
 - (b) *debts* due under *reinsurance* contracts,
 - (c) *salvage rights*,
 - (d) subrogations *recoverable*,
 - (e) premium *debts*,
 - (f) amounts due from public bodies of any state in Zone A,
 - (g) for *long-term insurance business*, *debts* due, which are secured by a *policy* of insurance,
 - (h) *general insurance deferred acquisition costs*
 - (i) *UCITS*, and
 - (j) *shares* in, or *debts* due from, a *dependant*.

Hence, such assets are left out of the calculation for *counterparty exposure*.

Calculation of permitted counterparty exposure limit

- 5.26 The definition of *permitted counterparty exposure limit*, is set out in paragraph 3 of Part I of **Appendix 4.2**. The table below provides an illustrative guide as to how the definition operates. As a rule of thumb, the lower limit will always bite first, so the higher limit does not apply.

	Permitted counterparty exposure	Explanation
Unincorporated body of persons	5%	Paragraph 3(a) applies
Individual	5%	Paragraph 3(a) applies
Non Zone A public body	5%	Paragraph 3(b) applies
Manufacturing company	5%	Paragraph 3(c)(iii) bites first
<i>Approved counterparty</i>	10%	Paragraph 3(c)(iii) does not apply Paragraph 3(c)(ii) bites
<i>Approved credit institution</i> – excluding deposits	10%	Paragraph 3(c)(iii) does not apply Paragraph 3(c) (ii) bites
<i>Approved credit institution</i> – including deposits	20% or £2 million, whichever is higher	Paragraph 3(c)(iii) does not apply Paragraph 3(c)(ii) does not apply to the deposit element Paragraph 3(c)(i) bites on the aggregate of the deposit coupled with the other assets

Excess of the permitted counterparty exposure

- 5.27 The calculation to determine the excess *counterparty exposure* is -:

(B) = (total *exposure to counterparty*) - (*permitted counterparty exposure*).

If the figure arrived at is negative, it is taken to be zero (i.e. the excess is nil).

Excess concentration with a number of counterparties

- 5.28 The calculation to determine the *excess concentration with a number of counterparties* can be described as -

(C) = (sum of all the *exposures* which exceed 5% of the *business amount*) - (40% of the *business amount*).

If the figure arrived at is negative, it is taken to be zero (i.e. the excess is nil).

- 5.29 Owing to the restrictions of paragraph 3 of Part I of **Appendix 4.2**, it is only *exposures to approved counterparties* which are able to exceed 5% of the *business amount*, but can be no more than 10%. The rules place an aggregate limit of 40% of the *business amount* on those *exposures to approved counterparties* which exceed 5%, but are not greater than 10% of the *business amount*. If the *counterparty exposure* is less than 5% of the *business amount*, then it will not form part of the *excess concentration with a number of counterparties* calculation. i.e. there is no aggregation limit for *counterparty exposures* of 5% or less.

Assets transferred by way of an unapproved derivative contract

- 5.30 Rules 4.14(1)(d) and (e) define the scope for the necessary deduction of such amounts from the value as determined under the *Valuation of Assets Rules*. **Guidance Note 4.2** includes a number of worked examples which illustrate the operation of the admissibility limits when the *insurer* is party to *derivative contracts*.

Operation of the limits

- 5.31 The limits are set out in Part II of **Appendix 4.2**. There are some important points to note.
- (1) Some aggregate limits apply so that in many cases more than one limit may apply - both an individual limit, e.g. an *exposure* to ABC shares, and an aggregate limit e.g. all *unlisted securities* combined.
 - (2) The *debt* limits have been 'graded' so that the higher the limits that apply the greater the security or liquidity of the *debt*. Security in this context refers to the status of the *counterparty* concerned as well as to any physical collateral arrangements in place.
- 5.32 The aggregate limits take two forms: first as a limit on the total permitted in a particular category of assets and second as a limit on *exposure* to a single *counterparty* and any of its *connected companies* from whatever source.
- 5.33 Given the complexity of some of the limits, it is important to consider each paragraph of **Appendix 4.2** in turn. Note that all percentages relate to percentage of the *general insurance business amount* or *long-term insurance business amount*. The admissibility of *debts* is particularly complex and the flowchart in **Annex B** summarises the different limits which apply. In addition some worked examples on the valuation and admissibility of *debts* are given in **Annex A**. Each paragraph operates on a stand alone basis and consequently more than one paragraph may apply in any one instance. If a particular asset falls within the limits of more than one paragraph, all the limits will need to be applied and in practice, therefore, the lower limit will bite first.

- 5.34 An asset must be expressly described within Part II of **Appendix 4.2** otherwise the asset is inadmissible. This does not apply to any of the asset types which are 100% admissible by virtue of their exclusion from **Appendix 4.2** under the provisions of rule 4.14(5).

Paragraph 1 - land, 5%

- 5.35 This restricts any single piece of land to 5%. This restriction also extends to a number of pieces of land or buildings close enough to each other to be considered as one investment. Adjacent sub-leases of parts of the same building would not normally fall to be considered as separate pieces of land. Adjacent pieces of land would normally be considered separately only for the purposes of assessing the impact of the admissibility restrictions where there is a clear and distinct difference in land usage.

Paragraph 2 - individual mortgage debts, 1%

- 5.36 This paragraph relates to *debts* due from individuals which are secured by land or buildings used as that individual's own residence. The individual concerned must not fall within the definition of a 'connected' person in 3.4(5) i.e. must not be a *controller* or *director* of the *company* (or related to a *director*).

Paragraphs 3 to 8 - debts; individual limits, 10% - 0.25%

- 5.37 **Annex B** provides a decision tree which gives further guidance through the various admissibility paragraphs of **Appendix 4.2** which affect *debts*. The table below summarises the position in respect of admissibility for a number of example *debts*.

Type of debt	Admissibility limit for each individual issuer	Aggregate exposure to debt of this type, for all issuers
1. Sovereign or supranational issuer	No limit (rule 4.14(5))	None
2. Fully secured debt due from an approved counterparty	10% (paragraph 8 of Part II of Appendix 4.2)	None
3. Fully secured debt – other	5% (paragraph 7 of Part II of Appendix 4.2)	None
4. Unsecured debt due from an approved counterparty, including regulated institutions which are approved counterparties	10% (paragraph 8 of Part II of Appendix 4.2)	None
5. Unsecured debt due from a regulated institution, which is not an approved counterparty	2.50% (paragraph 6 of Part II of Appendix 4.2)	None

6. <i>Unsecured debt</i> from any one unincorporated body	1% (paragraph 4 of Part II of Appendix 4.2)	5% (paragraph 10 of Part II of Appendix 4.2)
7. <i>Unsecured debt</i> – other	1% (paragraph 5 of Part II of Appendix 4.2)	5% (paragraph 10 of Part II of Appendix 4.2)
8. <i>Debt</i> due from an individual (other than those under paragraph 2 of Part II of Appendix 4.2)	0.25% (paragraph 3 of Part II of Appendix 4.2)	5% (paragraph 10 of Part II of Appendix 4.2)

When looking at whether a *debt* is *secured* or *unsecured*, the definition allows a partially secured *debt* to be split into two elements: a fully secured element and the remainder (which is not covered by the security) to be treated as unsecured. Consequently, the fully secured element will be able to take advantage of the higher admissibility limits which usually apply to *secured debts*. *Debt securities* are excluded from the limits in paragraphs 4-10 of Part II of **Appendix 4**. These are dealt with in paragraphs 14 and 15 of Part II of **Appendix 4.2** which are described below. Reference should also be made to the exclusions in rule 4.14(5) which have the effect of allowing 100% admissibility for those asset types listed within that rule.

Approved counterparty or regulated institution?

The *FSA* is not aware of any *approved counterparties* which do not also fall under the definition of a *regulated institution*. In practice, therefore *unsecured debts* due from *approved counterparties* will generally be exempt from paragraphs 4 to 7, Part II **Appendix 4.2**. Clearly, however, if there are any such bodies which whilst being an *approved counterparty* do not qualify as being a *regulated institution*, then the lower limit will apply. Similarly, if an *approved counterparty* is an individual, then paragraphs 2 and 3 of Part II **Appendix 4.2** would apply first.

Paragraph 10 - unsecured debts; aggregate limit, 5%

- 5.38 This paragraph applies an aggregate 5% limit to *unsecured debts* due from *companies*, individuals or unincorporated bodies of persons. *Debts* due from a *regulated institution* and all *debt securities* are excluded from this aggregate limit.

Paragraph 9 - deposits and debts with approved credit institutions, 20% or £2 million

- 5.39 This paragraph covers all *debts* including monies held in *short term deposit* accounts that are held with any one credit institution and any of its *connected companies*. This is in contrast to paragraph 8 of Part II of **Appendix 4.2** which excludes amounts which are *short term deposits* and applies a 10% limit to all other *debts* (other than *debt securities*) due from any one *approved counterparty*. The definition of *short term deposit* is sufficiently flexible to allow a deposit to pass the ‘no penalties’ test if

it is ascribed a value for solvency purposes which is net of any redemption penalties which are incurred if notice for withdrawal is one month or less.

Paragraph 11 - unlisted (or listed but not readily realisable) investments, unit trusts, 1%

Paragraph 12 - aggregate limit, 10%

5.40 Paragraph 11 applies a limit of 1% to investments in any one body made up of the asset types described in paragraph 11 and 11(a).

Paragraph 11, which excludes *secured debt securities*, applies the limit of 1% exposure to any one body of investments which fall within the valuation rules set out in rule 4.8 other than *listed* and *readily realisable* investments, which are excluded from this paragraph. In other words, paragraph 11 covers -

- (a) *shares* in the *insurer* and any of its *connected companies* (other than *shares* in an open ended investment company);
- (b) *unsecured debt securities*; and
- (c) beneficial interests in a limited partnership.

Paragraph 11(a) places a 1% limit on units in a *collective investment scheme* (which fall under the valuation rule described in rule 4.9) which are managed by that *insurer* and any of its *connected companies*. Such *collective investment schemes* are those where the scheme only includes assets which can be ascribed a value under the *Valuation of Assets Rules* and does not employ unapproved *derivatives contracts*.

Paragraph 11(b) is required in order to extend the limits in paragraphs 11 and 11(a) to *connected companies* of the body.

Paragraph 12 applies an overall aggregate limit of 10% to total investments of types described in paragraph 11.

Paragraph 13 - shares and hybrid securities, 2.5%

5.41 The table below summarises the position.

Type of Hybrid	Admissibility limit for each individual issuer (and any of its connected companies)	Aggregate exposure to hybrid securities of this type, for all issuers
<i>Listed preference shares</i>	2.5% (paragraph 13 of Part II of Appendix 4.2)	None
<i>Unlisted or listed but not readily realisable preference shares</i>	1% (paragraph 11 of Part II of Appendix 4.2)	10% (paragraph 12 of Part II of Appendix 4.2)

<i>Listed hybrid securities (other) (including subordinated debt)</i>	2.5% (paragraph 13 of Part II of Appendix 4.2)	None
<i>Unlisted or listed but not readily realisable, hybrid securities (other) (including subordinated debt)</i>	1% (paragraph 11 of Part II of Appendix 4.2)	10% (paragraph 12 of Part II of Appendix 4.2)

Paragraph 14 - all securities - other, 5%

- 5.42 Paragraphs 14 and 15 are applicable to all *securities* including *debt securities*. Paragraph 14 applies the aggregate limit for all *securities* (whether equity, preference *shares* or *debt securities*) in any one *insurer* or any of its *connected companies*. Investments in *approved counterparties* are excluded and are caught instead by paragraph 15 of Part II of **Appendix 4.2**.

Paragraph 15 - all securities issued by any one counterparty, 10%

- 5.43 Paragraph 15 applies to *approved counterparties (issuers* which are not approved counterparties are caught by paragraph 14 of Part II of **Appendix 4.2** first). The rule applies an aggregate limit for all security types (whether equity, preference *shares* or *debt securities*) issued by any one *counterparty*. Total *exposure* by way of *securities* to any one *approved counterparty* is limited to 10%.

The table below summarises the position.

	Type of bond	Admissibility limit for each individual issuer	Aggregate exposure to bonds of this type, for all issuers
1	Sovereign or supranational <i>issuer</i>	No limit (rule 4.14(5))	None
2	Fully secured bonds issued by an <i>approved counterparty</i> (either <i>listed</i> or <i>unlisted</i>)	10% (paragraph 15 of Part II of Appendix 4.2)	None
3	Fully secured bonds – other (either <i>listed</i> or <i>unlisted</i>)	5% (paragraph 14 of Part II of Appendix 4.2)	None
4	Unsecured <i>listed</i> bonds issued by an <i>approved counterparty</i>	10% (paragraph 15 of Part II of Appendix 4.2)	None
5	Unsecured <i>listed</i> bonds (other)	5% (paragraph 14 of Part II of Appendix 4.2)	None

6	Unsecured <i>unlisted</i> (or <i>listed</i> but not <i>readily realisable</i>) bonds	1% (paragraph 11 of Part II of Appendix 4.2)	10% (paragraph 12 of Part II of Appendix 4.2)
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Paragraph 16 - unit trusts, 5%

- 5.44 This paragraph limits holdings in any single authorised unit trust scheme or recognised scheme to 5%. *Collective investment schemes* recognised under the *UCITS Directive* are allowed 100% admissibility by virtue of rule 4.14(5).

Paragraph 17- cash 3%

- 5.45 This limit relates to pure cash in hand i.e. money held at a bank is not subject to this 3% limit.

Paragraphs 18 and 19 - equipment, 2.5% - 5%

- 5.46 These paragraphs set limits of 5% for computer equipment and 2.5% for other office equipment.

Aggregate exposure - illustrative examples

- 5.47 This paragraph contains three examples of the treatment of aggregate *exposures*.

Example 1

Insurer 1 holds £500 of equity *shares* in ABC, a *listed company* which is not an *approved counterparty*, has £750 of *listed debentures* in that *company*; has £200 of equity *shares* which it has 'transferred' under a stock lending agreement; and has entered into a *futures contract* to sell 500 *shares* in ABC in three months time at a price of £1 (the current price of the equity being 75p). The *general insurance business amount* of the *insurer* is £10,000. The *insurer's* aggregate *exposure* to ABC is as follows.

Description	Equities £	Debts £	Exposure to ABC £	Reason
actual holding of equity	500			
holding lent under stock loan	200			
<i>shares</i> due to be sold 500 @ 75p	(375)			Note 1
total <i>exposure</i> : ABC equity <i>shares</i>	325		325	
<i>listed debentures</i>		750	750	

Admissibility restrictions

Paragraph 13, 2.5% <i>general insurance business amount</i> for <i>shares</i>	(75)		(75)	
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Paragraph 14, 5% <i>general insurance business amount</i> for <i>debt securities</i>	(250)	(250)	
Paragraph 14, 5% <i>general insurance business amount</i> for all <i>securities</i> in any one <i>counterparty</i>	(250)	(250)	Note 2
Admissible elements	<u>---</u> <u>250</u>	<u>---</u> <u>250</u>	<u>---</u> <u>500</u>

Note 1

In determining the aggregate *exposure*, *exposure* to numbers of *shares* under *derivative contracts* is converted to a monetary amount by reference to the current *market value* of those *shares*. The actual monetary value of the *derivative contract* itself is not relevant for these purposes as in many cases it will be negligible compared to quantum by which it alters the *insurer's* economic exposure to certain assets.

Note 2

This deduction can be made against the equities or the debentures - it would make no difference to the overall level of the admissible elements. In this example, the deduction is against the debentures.

Example 2

Insurer 2 holds £200 of *listed equity shares* in DEF and has entered into a *futures contract* to buy 800 *shares* in DEF in two months time at a price of 50p. The current *share price* is 60p. The *insurer's general insurance business amount* is £10,000. The *insurer's aggregate exposure* to DEF is as follows.

	£	Reason
Actual holding	200	
<i>shares</i> due to be bought 800 @ 60p	<u>480</u>	Note 1
Total <i>exposure</i> DEF <i>equity shares</i>	680	
Admissibility restrictions		
Paragraph 13, 2.5% <i>general insurance business amount</i> for <i>shares</i>	<u>(430)</u>	Note 2
Admissible elements	<u>250</u>	

Note 1

As with Example 1, in determining the aggregate *exposure*, *exposure* to numbers of *shares* under *derivative contracts* is converted to a monetary amount by reference to the current *market value* of those *shares*.

Note 2

In this case the inadmissible element is greater than the value of the *shares* actually held. Rule 4.14(2)(b) therefore applies. This requires that the equity asset admissibility is written down to nil, but the remaining restriction (£230) should be deducted from the aggregate value of the other assets. It is not necessary to try and allocate this further deduction against any one particular class of asset and

therefore an additional line in Form 13 ('deduction for inadmissible items') has been introduced specifically for disclosure of such items.

Example 3

Insurer 3 has *unsecured debts* due from the following corporate bodies, none of which is a *regulated institution*.

X - £250, Y - £150, Z - £200.

It also has *unsecured debts* due from 25 different individuals of £50 each. The *general insurance business amount* of the *insurer* is £10,000. The maximum *exposure* for these *debts* is as follows.

	£	Reason
<i>debt</i> from X	250	
<i>debt</i> from Y	150	
<i>debt</i> from Z	200	
<i>debts</i> from individuals	<u>1,250</u>	25 @ £50 each
Total of <i>unsecured debts</i>	1,850	

Admissibility restrictions

Paragraph 5, 1% <i>general insurance business amount</i> for X <i>debt</i>	(150)	
Paragraph 5, 1% <i>general insurance business amount</i> for Y <i>debt</i>	(50)	
Paragraph 5, 1% <i>general insurance business amount</i> for Z <i>debt</i>	(100)	
Paragraph 3, 0.25% <i>general insurance business amount</i> for <i>debts</i> from individuals	(625)	25 @ £25 each
Sub-total	925	
Paragraph 6, 5% <i>general business amount</i> for the aggregate of all <i>unsecured debts</i>	(425)	
Admissible elements	<u>500</u>	

Calculation of the general insurance business amount/long-term insurance business amount

- 5.48 The bases for calculating the general insurance and long-term insurance business and units are given in the definitions in rule 11.1.

An *insurer* which prepares a UK branch *return* may base the amounts for the UK branch *return* on its global figures (since the definitions of *general insurance business amount/long-term insurance business amount* refer to liabilities 'of the *insurer*').

General insurance business amount

5.49 The *general insurance business amount* is calculated as the higher of:

EITHER:

1. The *insurer's* technical liabilities (i.e. amounts calculated in accordance with the rules in respect of items C and D of the shareholder accounts, net of *reinsurance*),

PLUS

2. the greater of -
 - 400,000 Euros, and
 - 20% of the *general premium income*.

General premium income for the purposes of the *general insurance business amount* represents, in effect, written accounted premiums gross of commission but net of *reinsurance*.

OR:

A higher amount not exceeding the net admissible assets determined in accordance with the *valuation of assets rules*.

Long-term business amount

5.50 The *long-term insurance business amount* is calculated as the higher of:

EITHER:

1. The *insurer's* technical liabilities (i.e. amounts calculated in accordance with the rules in respect of items C and D of the shareholder accounts, net of *reinsurance*)¹,

PLUS

2. the amount of any deposit back under a contract of long-term *reinsurance*,

¹ when calculating the *permitted asset exposure limit*, exclude linked liabilities and when calculating the *permitted counterparty exposure limits* or the *excess concentration with a number of counterparties*, exclude *property linked liabilities*.

PLUS

3. the *margin of solvency* (or *minimum guarantee fund* if greater) which the *insurer* –
 - (a) if its head office is in the United Kingdom, is required to maintain, or
 - (b) if its head office is elsewhere would be required to maintain if its head office were in the United Kingdom,

MINUS

4. any *implicit item* valued in accordance with a waiver under section 148 of the Act (see paragraphs 4.92).

OR:

A higher amount not exceeding the net admissible assets determined in accordance with the *Valuation of assets rules*.

Annex A

RULES FOR VALUATION OF DEBTS

The valuation and admissibility of *debts* under the *Valuation of Assets Rules* are addressed in sections 4 and 5. This annex illustrates the basic rules with a few worked examples. For simplicity all examples below use the GBA as the yardstick by which to compare the admissibility limit but the examples could apply equally where the LTBA is to be used. In addition, all examples assume that the *approved counterparties* are also *regulated institutions*.

Example 1 Operation of overall counterparty exposure limits

Facts

An *insurer* has an *unsecured debt* of £450m due from Y which is an *approved credit institution*. The *insurer* also has *short term deposits* with Y of £1,200m, *listed equity shares* in Y of £475m and rights under *derivative contracts* due from Y of £400m. The *insurer's* GBA is £10,000m and there are no other assets except Government bonds (which are not subject to any **Appendix 4.2** limits).

Application of the rules

The first stage is to identify and apply the individual admissibility limits which impact each separate asset and then to look to the aggregate limits for that class of asset. In this example, the relevant limits are:

Unsecured debt

Following the steps set out in the flowchart in Annex B, this is not a *listed* debenture but is an *unsecured debt* due from an *approved counterparty*. Hence, as seen from the table in paragraph 5.26 of this Guidance, the individual limit is 10% of GBA (**Appendix 4.2** Pt II, para 8).

Deposits – **Appendix 4.2** Pt II Para 9, 20% of GBA (subject to minimum £2 million)

Listed equity shares – **Appendix 4.2** Pt II Para 13, 2.5% of GBA

Rights under derivative contracts – No specific limit within **Appendix 4.2** Pt II, but are for inclusion within the aggregate *counterparty exposure* calculation in **Appendix 4.2** Pt II.

In tabular format, the admissibility limits can be described as follows.

	£m
<i>Unsecured debt</i> from Y	450
<i>Listed shares</i> in Y *	475
Rights under <i>derivative contracts</i> due from Y	<u>400</u>
	1,325
Admissibility restrictions (individual)	
Para 13, 2.5% (two and a half) GBA for <i>shares</i>	(225)
Total <i>counterparty exposure</i> to Y excluding deposits	1,100
Admissibility restrictions (counterparty)	
Appendix 4.2 , Pt I, Para 3(c)(ii)	<u>(100)</u> Note 1
	1,000
Deposits with Y	1,200
<i>Counterparty exposure</i> to Y, including deposits	2,200
Admissibility restrictions (counterparty)	
Appendix 4.2 , Pt I, Para 3(c)(i)	(200) Note 1
Admissible assets	<u>2,000</u>

Note 1

Although there is an individual limit of 20% GBA for deposits, when coupled with the other assets the *counterparty exposure* to Y reaches 2,200. It is necessary therefore to look to **Appendix 4.2** Para I, and paras 3(c)(i), (ii) and (iii).

- Sub-para 3(c)(iii) is excluded because the *exposure* is to an *approved counterparty*.
- Sub-para 3(c)(ii) applies *exposure* to all asset types, but excluding deposits with *approved credit institutions*. The allowed *exposure* under sub-para 3(c)(ii) is 10%. The deposits are caught under sub-para 4(c)(i).
- Sub-para 3(c)(i) applies to *exposure* from all sources (including, therefore, the deposits) to any *body corporate* or group and allows maximum *exposure* of 20% GBA.

Consequently, the permitted *exposure* to Y is 20% GBA made up in this example of 10% deposits and 10% all other assets.

Example 2 Unsecured debts

Facts

An *insurer* has a *general insurance business amount* of £10,000 and the following *unsecured debts*:

£250 due from A which is a chemical company;
£150 due from B which is a retail company;
£300 due from C which is a UK authorised insurance company;
£1,275 due from D which is an *approved counterparty*;
£280 due from E which is due from a manufacturing company.

Application of the rules

The first stage (STEP ONE- para 2.1 of this Guidance) is to categorise the *debts* under the definitions in the rules. The flow chart in Annex B provides additional help. The *debts* are therefore categorised as follows:

A, B, E *unsecured, unlisted debts* from *companies* which are not *regulated institutions* or *approved counterparties*.

C *unsecured, unlisted debt* from a *regulated institution* which is not an *approved counterparty*

D *unsecured, unlisted debt* from an *approved counterparty*

Section 5 of this Guidance assists in identifying the relevant admissibility limits. In tabular form, the result can be described as follows:

	£
<i>Debt</i> from A	250
<i>Debt</i> from B	150
<i>Debt</i> from C	300
<i>Debt</i> from D	1,275
<i>Debt</i> from E	<u>280</u>
	2,255

Admissibility restrictions (individual)

Para 5, 1% GBA – A	(150)
Para 5, 1% GBA - B	(50)
Para 6, 2.5% GBA – C	(50)
Para 8, 10% GBA - D	(275)
Para 5, 1% GBA - E	<u>(180)</u>
	1,550

The aggregate limit which applies to all *unsecured debts* (other than *debts* due from a *regulated institution* or *approved counterparty*) is 5% GBA (**Appendix 4.2**, Pt II, Para 7) but it does not bite in this example.

Example 3 - secured debts (secured by assets)

Facts

An *insurer* has a *debt* due from ABC plc (a chemical company) of £550 which is fully secured by land. There are no other charges on the land concerned and the *insurer* itself also owns £200 of the same piece of land. The *insurer* also has *listed debentures* in ABC plc of £450 and *listed shares* of £325. The *insurer* does not have any other 'large counterparties' and its GBA is £10,000.

Application of the rules

STEP ONE, determine what definition applies, i.e. does the *debt* fall within the definition of *secured debt* in rule 10.1:

rule at 10.1	Not a <i>secured debt</i>
para (1)(b)(i) of the definition	condition satisfied, since land security is of a value which is sufficient to discharge the <i>debt</i> in full
para (1)(b)(ii) of the definition	aggregate <i>exposure</i> to this piece of land is £750. This exceeds the permitted limit of £500 (5% GBA) for any one piece of land. Hence, £250 of the land offered for security cannot count as 'security' for the purposes of the <i>Valuation of Assets Rules</i> since it would breach the permitted <i>exposure</i> limit.

The *debt* from ABC plc can be split into two elements, being £300 secured, £250 unsecured.

In tabular form, the admissibility can be described as follows:

	£	
<i>Unsecured</i> element of the <i>debt</i>	250	
<i>Secured</i> element of the <i>debt</i>	300	
Listed shares in ABC	325	
Listed debentures in ABC	<u>450</u>	
	1,325	
Admissibility restrictions (assets)		
Para 5, 1% GBA, <i>unsecured debts</i>	(150)	
Para 7, 5% GBA for all <i>debts</i>	(-) Note 1	
Para 13, 2.5% GBA for <i>shares</i>	(75)	
Para 14, 5% GBA for debentures and <i>shares</i> combined	(200) Note 2	
	<u>900</u>	
Admissibility restrictions (counterparty)	<u>(400)</u>	Note 3
Admissible amount	500	

NOTE 1

Although total *debts* are £550, the *unsecured* element has already been restricted by £150. This leaves £400 of the *debt* to be considered under **Appendix 4.2**, Pt II, para 7 and hence there is no further restriction since £400 < 5% GBA.

NOTE 2

Similarly, although the 'gross' value of the *shares* and debentures combined is £775, the *shares* have already been restricted by £75. Hence, this leaves a potential admissible combined amount of £700 to be considered under paragraph 14. The 5% GBA maximum of para 14 equates to £500 and so a further restriction of £200 is necessary.

NOTE 3

An *insurer* which is not an *approved counterparty* is not permitted to raise the admissible *exposure* to a *counterparty* from 5% (**Appendix 4.2** Pt I Para 3(c)(iii)) to 10%. See paragraph 5.28 of this Guidance.

In this example, therefore, since ABC plc is not an *approved counterparty* the admissibility limit is 5% GBA, i.e. £500 - hence a further restriction of £400 is required.

What if ABC plc was an *approved counterparty* instead?

If, in the example above, ABC plc is an *approved counterparty*, then the *permitted counterparty exposure limit* to such a *counterparty* would be 10%. Such large *exposures* to *approved counterparties* are caught by the aggregate limit of 40% of the *business amount*.

In this example, we have assumed there are no other large *counterparties* and hence the aggregate restrictions of **Appendix 4.2** Pt I, para 17 would not apply.

The admissibility limit for *approved counterparties* is 10% GBA, i.e. £1,000 - hence the exposure of £900m would not require any further restriction.

Example 4 - secured debts (secured by bank guarantee)

Facts

The same as example 3 above, but instead of the ABC plc debt being secured by land, it is secured by a guarantee from Bank Z. The *insurer* also has *exposure* to Bank Z in the form of deposits of £900m, *listed shares* in Z £350 and *debts* due from Z of £400m. The *insurer* has no other large *counterparties* apart from Z and ABC plc.

Application of the rules

Exposure to ABC plc

In this example, the *debt* will be fully secured since it falls within para (1)(a)(ii) of the definition of *secured debt*.

In tabular form, the *exposure* to ABC plc can be seen as:

	£ m	
<i>Secured debt</i> from ABC	550	
<i>Listed shares</i> in ABC	325	
<i>Listed debentures</i> in ABC	<u>450</u>	
Total <i>exposure</i> to ABC	1325	
Admissibility restrictions (assets)		
Para 7, 5% GBA for all <i>debts</i>	(50)	
Para 13, 2.5% GBA for <i>shares</i>	(75)	As in 3 above
Para 14, 5% GBA for debentures and <i>shares</i> combined	<u>(200)</u>	As in 3 above
	1,000	
Admissibility restrictions (<i>counterparty</i>)	(500)	
Admissible element of <i>exposure</i> to ABC	<u>500</u>	

ABC is not an *approved counterparty* and the *counterparty exposure limit* is therefore 5% of the *business amount*. Hence a restriction of £500m applies.

Exposure to Bank Z

In addition the *insurer* also has *exposure* to the bank Z as follows:

	£ m	
<i>Debts</i> due from Z	400	
<i>Listed shares</i> in Z	<u>350</u>	
	750	
Admissibility restrictions (assets)		
Para 13, 2.5% GBA for <i>shares</i>	<u>(100)</u>	
sub-total of <i>admissible assets</i>	650	
Guarantee supporting the <i>debt</i> from ABC	<u>550</u>	
Total <i>counterparty exposure</i> to Z excluding deposits admissibility restrictions (<i>counterparty</i>)	1,200 (200)	Note 1
Deposits with Z	<u>900</u>	
Total <i>counterparty exposure</i> to Z including deposits	1,900	Note 2

Note 1

Appendix 4.2, Pt I, para 3(c)(ii) applies *exposure* limits to all asset types, but excluding deposits with *approved credit institutions*. The allowed *exposure* under para 3(c)(ii) is 10% GBA (since the bank is an *approved counterparty*) and therefore a restriction to non-deposit *exposures* of £200m is required.

Note 2

With deposits, the admissible *exposure* to an *approved credit institution* can be 20% of the *business amount* **Appendix 4.2**, Pt I, para 9. In this example, this equates to £2,000m and so no further restriction is required.

Example 5 - stock lending and secured debts

Facts

An *insurer* engages in stock lending activities with *counterparty* X using a variety of collateral arrangements. The *insurer* also has the following investments:

debts due from Bank Y of £400, *listed shares* of £100 in Bank Y; *listed shares* in PQR plc of £125.

Counterparty X falls within the definition of an *approved investment firm*.
The GBA is £10,000.

There are five different stock lending arrangements. In cases where the *insurer* has lent stock, for the purposes of rule 4.4(4)(b)(ii) the collateral provided for all of the *insurer's* stock lending arrangements can be taken together when assessing whether each individual item of collateral breaks the '15%' test outlined in rule 4.4(b)(ii). If the collateral fails the '15%' test then the *insurer* looks to rule 4.4(4)(b)(i) to see whether the collateral, when aggregated to the *insurer's* existing *exposures*, would cause a breach in the admissibility limits.

In this example, unless stated otherwise, it is assumed that each piece of collateral satisfies the conditions of rule 4.4(4)(b)(i).

- (a) £250 of mixed equities (with no single large holding) are lent to Broker X. Broker X supplies cash collateral equal in value to the *shares* 'lent'.

Rule 4.4(2) is satisfied since the collateral equals the value of the stock 'lent'. Rule 4.4(4)(a) is satisfied since the collateral is cash; rule 4.4(4)(b)(i) is satisfied, since it is assumed that the cash received would not cause the *insurer* to breach its *exposure* to cash or to deposits with *approved credit institutions*. Hence, rule 4.4(1) dictates that there is no need to include the collateral in the aggregate *exposure* calculations - i.e. the 'look through' approach can be applied. The mixed equities 'lent' should be treated as though they were still retained by the *insurer*.

- (b) £150 of gilts are lent to X and secured by a 'pool' of gilts under a DBV (delivery by value) arrangement whereby the value of the pool is topped up daily to reflect price movement and the value of the collateral exceeds the value of the stock lent by a small margin to cater for intra day movements.

Rule 4.4(2) is satisfied since the collateral equals the value of the stock 'lent'. Rule 4.4(4)(b)(ii) is satisfied since the collateral is mixed (with no single large holding) and is in the form of *approved securities* (sub-para (4)(a)). Rule 4.4(1) dictates that the 'look through approach' is taken.

- (c) £175 of mixed equities are lent to X for a letter of credit.

Rule 4.4(2) is satisfied since the collateral equals the value of the stock 'lent'. Rule 4.4(4)(a) may apply (depending on whether the letter of credit is established with an *approved credit institution*); rule 4.4(4)(b)(i) is assumed to be satisfied (the *insurer* needs to aggregate the collateral with its own holding to see if any of the collateral breaches any permitted *exposure* limits). Hence, the 'look through' approach can be applied.

- (d) £150 of debentures are lent to X for a bank guarantee from Bank Y.

Rule 4.4(2)(a) is satisfied since the collateral equals the value of the stock 'lent'. Rule 4.4(4)(a) is satisfied; rule 4.4(4)(b)(i) is assumed to be satisfied (the *insurer* needs to aggregate the collateral with its own holding to see if any of the collateral breaches any permitted *exposure* limits). Hence, the 'look through' approach can be applied.

(e) £100 of mixed equities are lent to X for collateral of *listed shares* in PQR plc.

Rule 4.4(2) is satisfied since the collateral equals the value of the stock 'lent'. Rule 4.4(4)(a) is satisfied. Rule 4.4(4)(b)(i) is satisfied, since the collateral of £100 if added to the *insurer's* own holding of £125 does not cause a breach in the allowed limit of 2.5% GBA (£2507). Hence, the 'look through' approach can be applied.

Aggregation of collateral with the *insurer's* own holdings

Counterparty X

For the conditions in rule 4.4(4)(b)(i) to be satisfied, the *insurer* must not be *exposed to counterparty X* in excess of the *permitted counterparty exposure*. In this example, the *exposure to X* can be seen as:

	£
Stock lent:	
(a)	250
(b)	150
(c)	175
(d)	150
(e)	<u>100</u>
Total <i>counterparty exposure to X</i>	825

If the *counterparty exposure* had exceeded 10% GBA (i.e. £1,000), the *insurer* would be required to treat those transactions which cause the excess to occur, under first principles (i.e. as though the arrangements were a series of *futures contracts*). This would, of course, involve a significant number of additional calculations because of the need to apply other asset valuation and admissibility limit rules.

Bank Y

Similarly, the *exposure to Bank Y* will need to be calculated to see whether any of the collateral fails the conditions of rule 4.4(4)(b)(i). The *exposure to Y* can be seen as:

£	
<i>Debts due from Y directly</i>	400
Guarantee given as security for stock loan with Broker X	150
<i>Listed shares in Y directly</i>	<u>100</u>
Total <i>counterparty exposure to Y</i>	650

In this example, the *exposure to Bank Y* is within the 10% GBA limit and hence the collateral (i.e. the guarantee) satisfies rule 4.4(4)(b)(i).

ADMISSIBILITY OF DEBTS, OTHER THAN DEBT SECURITIES

Counterparty Description

		<p>— Paragraphs 3 and 10 apply 0.25% individual, 5% aggregate</p>
		<p>— Paragraphs 4, 10 and 7 apply 1% individual, 5% aggregate for unsecured 5% individual for all debts (secured and unsecured taken together)</p>
		<p>— Paragraphs 5, 10 and 7 apply 1% individual, 5% aggregate for unsecured 5% individual for all debts (secured and unsecured taken together)</p>
		<p>— Paragraphs 6 and 7 apply 1% individual, 5% aggregate for unsecured 5% individual for all debts (secured and unsecured taken together)</p>
		<p>— Paragraphs 8 applies 5% individual for all debts (secured and unsecured taken together)</p>

[Annex C deleted]

What is a regulated market for the purposes of the definition of listed in the Valuation of Assets Rules?

1. The definition of *regulated market* is broadly based on the definition in the *Third Life and Third Non-Life Directives* which in turn draws on the definition used in the *Investment Services Directive* (ISD). It may be necessary in cases of doubt to refer directly to the ISD. The definition of *regulated market* feeds into the definition of *listed* as explained in section 3 of this Guidance.
2. There is no official list of *regulated markets*. Instead the *directors* (and auditors) must be satisfied that the criteria set out in the definition have been met.

Definition

3. The key characteristics of a *regulated market*:
 - (a) regular operation;
 - (b) regulations have been issued or approved by the appropriate authority of the state where the market is situated which:
 - (i) define the conditions of operation and access to the market,
 - (ii) define the conditions to be satisfied for an investment to be effectively dealt in on the market, and
 - (iii) require compliance with reporting and transparency requirements comparable to those laid down in articles 20 and 21 of the ISD;
 - (c) for markets situated outside the *EEA*, the investment dealt in on the market should be of a quality comparable to those in a *regulated market* in the UK.
4. In particular, the following areas are considered to be important.

Liquidity

5. The *directors* should have regard to the overall liquidity of the market or exchange; whether *securities* and/or derivatives can be bought and sold in a reasonable time, at best execution and in adequate amounts; and the procedures and restrictions (if any) on the repatriations of funds to the UK.

Regulated

6. The market or exchange must be subject to supervision by an authority which should be a statutory body, an agency of a national or state Government, a department of such Government, or another body designated for the purpose by one of these. Additionally, *directors* will need to take into account:

- (a) the degree to which members of the market/exchange and the supervising body, and in particular whether that supervision includes capital adequacy requirements;
- (b) the powers of the market/exchange and the supervision body to intervene in members' business in the event of misconduct, financial difficulties or otherwise, including the power to reject applicants terminate membership and de-list a security;
- (c) the initial listing standards and ongoing supervision of securities trade on the markets/exchange including the publications of prospectuses and audited financial statements;
- (d) requirements concerning the issue of contract notes (or their equivalents);
- (e) whether the clearance and settlement arrangements normally used for transactions on the market/exchange are prompt and secure;
- (f) the risk of loss in the event of insolvency of a member of the market/exchange;
- (g) how the market/exchange investigates and deals with complaints.

Reporting and transparency requirements

Directors will need to consider:

- (a) the everyday availability of current information about securities, derivatives, quotations, transactions, prices and spreads;
- (b) whether there is a requirement for trade reporting to the market/exchange or other supervisory body of the *securities/derivatives* which the *insurer* intends to buy.

Recognised

7. The market/exchange must be recognised or registered as a market/exchange and/or self regulatory organisation by an authority which should be a statutory body, or an agency of a national or state Government, a department of such Government or another body designated for the purpose by one of these.

Operating regularly

8. The market/exchange must have regular trading hours during which the investments listed or admitted to dealing on that market may be dealt in. Additionally *directors* will need to take into account:

- (a) the availability and timing of price and volume information and the way it is distributed; and
- (b) in respect of *securities*, the degree to which and the speed at which companies listed on the market/exchange must release price sensitive information, and the medium through which that information is distributed.

Open to the public

9. Investments listed or admitted to dealing on the market exchange must be freely available for trading by the public directly, or through members of the market/exchange, during normal trading hours. Additionally, *directors* will need to take into account the extent to which overseas investors are permitted to hold *securities* listed on the market/exchange.
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USE OF DERIVATIVE CONTRACTS IN INSURANCE FUNDS

1. **Introduction**

1.1 This Guidance discusses valuation issues surrounding the use of *derivative contracts* in those funds of an *insurer* which are subject to the *Valuation of Assets Rules*. It is therefore relevant to the statutory solvency valuation of all the ‘other than long-term insurance business’ funds of a general business or composite insurer and of the long-term non-linked and index-linked funds of a long-term or composite insurer. Many of the same principles are relevant to the use of derivatives in property-linked funds, which is also covered in this Guidance. It is not relevant to valuation for the purposes of published accounts.

1.2 In accordance with the traditional UK approach, there is no restriction (except in linked funds) on the *derivative contracts* which *insurers* may transact (subject to over-riding conditions such as the need for *insurers* to be managed in accordance with the *FSA*’s principles for business (where most of the criteria of sound and prudent management now rest). However, the *Valuation of Assets Rules* do set out:

- (a) rules to be satisfied before a derivative which is an asset to the *insurer* may be given an admissible value;
- (b) the valuation rule in the event that the conditions at (a) are satisfied;
- (c) the rule for the determination of the liability under any *derivative contract* which, at the moment, is a liability to the *insurer*;
- (d) rules for determining the effect of derivative contracts on the admissibility of holdings in the underlying assets;
- (e) a rule requiring recognition of a contingent liability in any case where a derivative contract is not strictly covered by the underlying assets.

1.3 Rules of the nature of (a), (b) and (c) above are familiar from the *Valuation of Assets Rules* for other kinds of transaction. Item (d) is needed because the policy is to restrict the admissibility of economic exposure to specific assets. Depending on the nature of the contract, derivatives can increase, decrease or cancel the economic exposure of *insurers* to the underlying assets.

1.4 Item (e) is needed because some derivatives can change rapidly from being an asset to being a liability; moreover, in some cases the liability can be theoretically unlimited. If an *insurer* uses such derivatives without proper cover, it could rapidly use up not only its free assets but also eat into its

required minimum margin of solvency. For prudential reasons, therefore, it is necessary for the company to recognise an appropriate contingent liability in respect of contracts which are not properly covered, even in cases where they are currently an asset to the insurer. Rule 5.3 establishes this obligation (the 'provision for adverse changes').

What kind of derivatives?

- 1.5 Rule 4.12 refers to *options, futures contracts and contracts for differences*. *FSA's* view is that these terms cover all current basic types of derivative instrument. For example, swaps fall under *contracts for differences*; *warrants* fall under the extended definition for insurance purposes of *options*.
- 1.6 Rule 4.1 provides that forward currency contracts are not to be treated as derivatives, where they are for the purpose of settling the sale or purchase of an asset and are to be effected within a short period defined in that regulation.
- 1.7 The rules described below are relevant also to instruments which take some other legal form but which have characteristics of derivatives. The issues are discussed in Section 10.

The status of the guidance

- 1.8 This guidance, in particular the examples throughout this Guidance, is intended to illustrate the *FSA's* view of how the above conditions are to be interpreted in practice. (The *FSA* view is not of course definitive; that would be available only from the courts.) Many of the examples address the conditions set out in paragraph 2.1 (or 2.3) below. However, they tend to deal with only one or two of those conditions without reference to whether the other conditions are satisfied.
- 1.9 None of the examples carries the *FSA's* 'seal of approval'. Whether or not they are sensible courses of action depends heavily on the circumstances of the *insurer*. Moreover, there may be other equally acceptable - or even preferable - ways of achieving the same objective.
- 1.10 Finally, although several of the examples illustrate traps for the unwary, it is inevitable that there are other traps which have not been illustrated in this Guidance. There can be no substitute for testing any proposed course of action against the 'first principles' set out in paragraphs 2.1 or 2.3 below.

2. Conditions governing admissibility; conditions governing use of derivatives in linked funds

Admissibility of derivatives which are assets of the insurer

2.1 Derivative instruments which, at the time of the valuation, are an asset to the *insurer* may be given an admissible value only if they satisfy the seven conditions set out below:

- (a) are for the purposes of reduction of investment risks or efficient portfolio management – rule 4.12(2);
- (b) satisfy the ‘in connection with’ test – rule 4.12(2) and (3);
- (c) are covered – rule 4.12(2) and (4);
- (d) are listed on a *regulated market* or transacted with an *approved counterparty* - rule 4.12(6)(a);
- (e) are capable of being readily closed out – rule 4.12(6)(b);
- (f) are based on underlying assets which are themselves admissible, an index of such assets or an official index of retail prices – rule 4.12(7) and (8);
- (g) have a prescribed pricing basis – rule 4.12(8).

2.2 Failure to satisfy any one of these conditions means that the contract has no admissible value. On the other hand, where a *derivative contract* is currently a liability to the *insurer*, that liability must be recognised whether or not the above conditions are satisfied.

Linked funds

2.3 Use of derivatives in linked funds (whether currently an asset or a liability to the *insurer*) is permitted only if all the conditions below are satisfied. These are very similar to those summarised in paragraph 2.1, the only significant difference being at condition (f). The derivatives:

- (a) should be for the purposes of reduction of investment risks or efficient portfolio management
- (b) should satisfy the ‘in connection with’ test
- (c) should be covered
- (d) are listed on a *regulated market* or transacted with an *approved counterparty*
- (e) are capable of being readily closed out
- (f) are based on underlying assets which are themselves permitted links, an index of such assets or an official index of retail prices

(g) have a prescribed pricing basis.

3. **Liquidity**

Regulated markets and approved counterparties

3.1 The purpose of conditions (d) and (e) of paragraph 2.1 is to ensure that the *derivative contract* is acceptably liquid. Rule 4.12(6)(a) refers to a *listed contract*, which (by tracking through the definitions is seen to require that the contract is *listed* on a *regulated market*. This is not likely to be problematical in practice. A main derivatives exchange of a developed country is likely to qualify as a *regulated market* although *insurers* are responsible for satisfying themselves on this point.

3.2 The descriptions of *approved counterparties* (banks and investment firms authorised in the UK and other *EEA States*) are set out in the Valuation of Assets Rules. In the case of UK *counterparties*, current lists can be obtained from the *FSA*. There are one or two traps for the unwary here. For example, a *subsidiary* of an authorised bank or investment firm would not count as an *approved counterparty* unless it was itself an authorised bank or investment firm. Where a derivatives transaction was arranged with the head office of a non-EEA bank (as opposed to a transaction arranged through an authorised branch in an *EEA State*), the bank would not necessarily qualify as an *approved counterparty* for the purpose of that transaction. Last, we do not believe it is possible for an *EEA insurance undertaking* to satisfy the definition of *approved counterparty* because of a restriction in the *First Life and Non-Life Insurance Directives* (reflected in the UK in rule 1.3). To the extent that this is so, derivative transactions between two *insurers* or between two funds of the same *insurer* would not satisfy the *approved counterparty* test. However, there is nothing to prevent a non-insurance *subsidiary* of an *EEA insurer* from qualifying as an *approved counterparty*.

Capable of being readily closed out

3.3 Rule 4.12(6)(b) sets a test that the *insurer* reasonably believes that the contract may be readily closed out. The appropriate interpretation of ‘readily’ is that the *insurer* cannot reasonably foresee any circumstances in which it would need to close out part or all of the contract at a few days notice and would not be able to do so. ‘Readily’ may therefore mean very different things, depending on the nature of the contract.

Example A

An insurer has sold a 12 month OTC Turkish Lira forward to hedge the currency risk in its Turkish equity portfolio.

It will need to be able to close out the forward at short notice if it decides subsequently to disinvest in Turkey. To regard this contract as capable of being readily closed out, it must satisfy itself either that there is adequate liquidity on the foreign exchange market for Turkish Lira or that it would be able to close out the original transaction with an *approved counterparty* (not necessarily the one who transacted the original forward) at short notice.

Example B

An insurer has bought an index-linked contract for differences to match exactly its policy holder liability (apart from death benefit) under a group of 5-year index-linked bonds. The terms of the contract are such that, on early surrender, the benefits are limited to whatever can reasonably be realised for the underlying assets, less reasonable expenses.

In such circumstances, it is entirely reasonable to arrange for partial realisation to pay death claims and early surrenders once a month, say, so as to minimise realisation expenses. An agreement with an *approved counterparty* to this effect would certainly satisfy the 'may be readily closed out' test.

4. **Reduction of investment risks; efficient portfolio management**

4.1 The *FSA* does not propose to try to distinguish absolutely between the two terms; in practice, they overlap. Since they are alternative components of the set of conditions summarised in paragraph 2.1, it is not necessary to decide whether a particular transaction is consistent with one of these terms rather than the other. Provided that a transaction is for the purposes either of reduction of investment risks or efficient portfolio management, condition (a) of paragraph 2.1 is satisfied. (In particular, a particular case may not be justifiable as efficient portfolio management but qualify as reduction of risks; or vice versa.)

4.2 ***Reduction of investment risks*** is to be interpreted broadly. To qualify, a transaction must achieve the following:

- (a) in any case where a group of assets is 'earmarked' to match specific *policy holder* benefits where the *policy holder* bears an investment risk (notably in the case of linked liabilities), there must either be:
 - (i) a reduction in the risks to the *insurer* of mismatching of those assets and liabilities, while having a neutral or beneficial effect on the investment risks of the *policy holder*; or
 - (ii) a reduction in the investment risks of the *policy holder*, while having a neutral or beneficial effect on the risks to the *insurer* of mismatching
- (b) in any case where there is no such earmarking of assets, it must reduce the risks to the *insurer* of mismatching between its assets and liabilities at large.

4.3 In either case, exactly what constitutes a reduction in risks is not very straightforward. Most *derivative contracts* will leave the *insurer* worse off than if the contract had not been transacted under some foreseeable circumstances. (For example, a purchased *option* might bring benefits to the *insurer*; or it might expire worthless, leaving it worse off than if it had not transacted the *option*.) If the *FSA* were to insist that a contract aimed at

reduction of risks could never leave the *insurer* or *policy holder* worse off, practically nothing would qualify. In practice *FSA* takes a much less extreme view. A contract which brings benefits (to *insurer* or *policy holder*, as appropriate) under some circumstances while having adverse consequences under other circumstances can be said to be reducing investment risks if:

- (a) any adverse consequences of the contract are unforeseeable; or
- (b) the extent of any adverse consequences is insignificant, in particular:
 - (i) small; and
 - (ii) reasonable, given the benefits resulting under other circumstances

4.4 It is also worth stating the obverse of the conclusion in the previous paragraph. A *derivative contract* which has any significant adverse consequences on investment risks cannot qualify as reduction of investment risks. It is not a case of balancing the advantages and the disadvantages; rather, there must be no significant disadvantages. Having said that, *derivative contracts* which change the investment risks without necessarily reducing them may qualify as efficient portfolio management in some circumstances.

Example C

An insurer, wishing to improve matching between its assets and liabilities decides to shift the economic balance of part of its portfolio from equities to gilts. To achieve a rapid switch of exposure, it decides to retain the equities, to sell a FTSE-100 future and to buy a gilt future. Both futures are margined daily, thereby minimising the insurer's exposure to its counterparty.

The purpose of the FTSE future is to reduce exposure to equities. Adverse consequences could only arise from this if there was a serious possibility that the fortunes of the *insurer's* equity portfolio would depart significantly from those of FTSE. Similarly, the purpose of the gilt future is to buy exposure to gilts of a particular term. The mean term of the *insurer's* liabilities might be different, in which case there would be a risk that gilts of that term might behave significantly differently from the gilt future.

Drawing on the criteria in paragraphs 4.2 and 4.3, this transaction could indeed be taken to 'reduce risks' over the short to medium term in circumstances where the congruence between portfolio and future (and between mean terms of the gilt future and the *insurance liabilities*) was good. (In the longer term, repeated costs of rolling over the futures might make such an assessment problematical.) Moreover, if the intention was to hold the futures only for a short time, to give the *insurer* the opportunity to decide which equities to sell and gilts to buy, it is most unlikely that there would be any problem about justifying a 'reduction of risks', even where congruence was not at a particularly high level.

Example D

An insurer, fully invested at present, believes that equity prices will rise. It decides to anticipate future cash inflows (for example, receipt of dividends declared but not yet distributed) by purchasing an index call option, due to expire after the relevant cash will have been received.

Once the dividends had been received, it would clearly be acceptable for the *insurer* to invest the receipts in equities immediately. Use of the *option* anticipates such a future risk profile while giving the *insurer* the option not to invest if the market does not behave as expected. This can be regarded as reduction of risks.

However, where the *insurer* significantly gears the fund (for example, where the amount of cash notionally required to ensure rights can be exercised is significantly in excess of a prudent estimate of the aggregate of cash currently available and net cash inflows), the adverse risk consequences are clearly inconsistent with reduction of risks.

Example E

An insurer, has a portfolio of short and medium-dated fixed interest securities, backing a set of liabilities with a longer average maturity date. In order to improve matching of its assets and liabilities, it decides to purchase a Long Gilt exchange-traded future with the intention of rolling over the future on each settlement date for the foreseeable future.

At first sight, this transaction appears to be gearing the fund. However, short-dated fixed interest *securities* behave rather like cash so that the gearing effect should not be significant. It is perfectly possible that this transaction could justify treatment as reduction of investment risks.

In principle, adverse risk consequences arise from the retention of exposure to short-dated stocks (as opposed to realisation for cash) and any mismatch between the characteristics of the security underlying the gilt future and those of the ideal security for matching purposes. It might be possible to reduce the first element of this risk by selling a short or medium gilt OTC forward.

Example F

An insurer wishes to hedge a sectoral portfolio of UK stocks in a linked fund. It cannot find a suitable sectoral hedging instrument and therefore decides to use a FTSE-based put option.

Assuming (taking into account the historical record) there was good reason to expect a rough correlation between the performance of the sectoral portfolio and FTSE, use of a FTSE option to hedge such a portfolio is consistent with reduction of investment risks. The downside for the *policy holder* is that the option expires worthless at a time when the sectoral portfolio had declined in value (i.e. that FTSE and the sectoral performance move in opposite directions). If it happens, the fund will only be worse off (compared with the alternative strategy of doing nothing) to the extent of the cost of the option. But, under the above assumptions, this is relatively unlikely, the costs are relatively small and outweighed by the benefits from the *option* in the event of any significant downside in the equity values generally. This instrument therefore passes the tests in paragraph 4.3.

A *futures contract*, rather than an *option*, might also be used to protect the fund under the above circumstances and it is possible that this would qualify as reduction of investment risks. However, this requires rather better prospects of correlation between the relative performances of FTSE and the portfolio than is necessary to justify use of an *option* in this

context (because the downside is considerably more severe). Even where a *futures contract* can not be justified as reducing risks, it may be possible to justify using one for efficient portfolio management. See Example G.

4.5 The concept of efficient portfolio management is related to the question of how an *insurer* manages its assets so as to fulfil its prudent adopted investment strategy. When assessing whether a transaction caused a reduction of investment risks, the appropriate comparison was with a ‘do nothing’ strategy. But when considering efficient portfolio management, the right comparison is with a non-derivative strategy having broadly the same economic effect. The fact that a derivative transaction increases asset risk (i.e. the risk that the value of the portfolio will drop) does not necessarily prevent it from being regarded as for the purposes of efficient portfolio management. The same increase in asset risk might well have been achievable by trading in the underlying assets. However, a *derivative contract* which gives rise to a significant adverse consequence which could not result from a prudent strategy of investing in or disinvesting from (as the case may require) the assets underlying the transaction can never be consistent with efficient portfolio management. It follows that use of derivatives which has the effect of significantly gearing the total investment return on the fund is incompatible with efficient portfolio management.

4.6 Subject to the over-riding condition that there must be no reasonably foreseeable significant adverse risk consequences arising from the use of derivatives (as opposed to arising from investing in or disinvesting from the underlying assets), we believe that a transaction is consistent with efficient portfolio management if, under normal circumstances, it will assist the *insurer* to make progress towards its investment objectives:

- (a) more quickly; and/or
- (b) more easily; and/or
- (c) more efficiently; and/or
- (d) more cheaply; and/or
- (e) more flexibly

than can be achieved without the use of a transaction of that nature.

4.7 Where there are no material benefits from using derivatives other than saving of tax, the question arises whether this is sufficient for the efficient portfolio management test to be satisfied. From the point of view of the *insurer*, its future tax position is not completely under its control and there is always a theoretical possibility that instruments which attract favourable tax treatment today may be adversely treated next year. Nevertheless, some tax changes are more foreseeable than others. Provided that it is not reasonable to foresee that a tax advantage might be removed (or even reversed) with retrospective

effect, it can legitimately be invoked to justify efficient portfolio management.

4.8

In assessing whether an adverse risk consequence arises, the *insurer's* investment risk position must be considered in all cases. Further, in any case where a group of assets is earmarked to match specific *policy holder* benefits where the *policy holder* bears an investment risk (notably in the case of linked liabilities), the consequences of the use of derivatives on the asset risk of the earmarked assets must also be taken into account.

Example G

An insurer judges that the UK equity market is going to drop significantly. To reduce exposure to the market immediately (and to minimise transaction costs if its view changes subsequently), it sells a daily-margined exchange-traded FTSE future with principal equal to the value of a significant part of its well-diversified portfolio.

This is an example of efficient portfolio management provided that the *insurer's* portfolio is reasonably congruent with the equities making up FTSE. The comparison to be made here is with the strategy of selling the appropriate part of its portfolio (in contrast to Example F). The only circumstances in which the *insurer* will be worse off than under the alternative strategy arise when FTSE rises (giving rise to a loss on the index future) at the same time as the value of the *insurer's* equity portfolio falls. If congruence is good, the chances of a significant adverse effect on asset values resulting from the use of derivatives can be regarded as unforeseeable.

Even if congruence between portfolio and FTSE was good, a fund manager pursuing such a strategy would not necessarily be immune from criticism. By purchasing an *option* rather than selling a future, he could have protected his portfolio while leaving himself in a position to benefit from (unexpected) growth in the index.

Which is the better strategy - or indeed, whether either strategy is appropriate - can only be a matter for professional judgement in the light of the circumstances of the *insurer* and the tests for efficient portfolio management set out in paragraph 4.6.

Example H

An insurer, currently with mainly fixed-interest investments, wishes to gain exposure to the equity market. It decides to retain its fixed interest income while achieving exposure to the capital gain potential of equities, at the same time saving transaction costs. It proceeds by selling a gilt future while buying a FTSE future.

This is consistent with efficient portfolio management, provided that there is good reason to believe that fluctuations in the market value of the fixed interest portfolio, would be well-correlated with fluctuations in the price of the relevant gilts underlying the future. Otherwise, the transaction might give rise to adverse risk consequences, of a size which is inconsistent with efficient portfolio management. This is particularly the case if the position were to be retained over a considerable period.

Example I

An insurer sees the opportunity to generate additional income (over money market deposit rates) by purchasing a basket of FTSE 100 stocks and selling FTSE futures at above 'fair value'.

Occasionally there is an opportunity to generate income through risk-free arbitrage of this kind, even after taking expenses and tax into account. Provided that the basket of stocks was congruent with FTSE, this would constitute efficient portfolio management.

Example J

An insurer is fully invested in equities, apart from a cash balance of around £1m which it expects to stay roughly constant for the foreseeable future. Seeking additional equity exposure, it transacts a contract for differences under which it would receive the product of £1m and 150% of any percentage rise in FTSE above the level current on the day of the transaction; it would pay the product of £1m and 150% of any fall in FTSE.

This kind of geared risk profile cannot be achieved by buying or selling the underlying stocks. Under no circumstances can it be regarded as efficient portfolio management.

Example K

An insurer buys call options relating to stocks whose current value represents a significant proportion of the value of the insurer's fund. The options are mainly well out-of-the-money.

We would normally regard purchase of out-of-the-money call *options* (which, under normal circumstances, would be likely to expire worthless) as being speculative in nature. Although there might occasionally be a big gain, most of the time the premium will be lost. Accordingly, such use of derivatives will lead to increased volatility in fund performance; if significant, it is inconsistent with efficient portfolio management.

In contrast, it is easy to see that covered out-of-the-money put *options* can be used for 'reduction of investment risks', for example to provide portfolio protection (but see Example L).

Example L

An insurer has the practice of transacting a derivative which has the effect of providing 'portfolio insurance' for a short period over its financial year-end (but, as a general rule, not at other times of the year).

It is quite possible that this is an example of grossly inappropriate portfolio management. The question to be asked is why the portfolio should need protection only around the year-end. Unless there is a satisfactory answer, the transaction is unlikely to count as either reduction of risks or efficient portfolio management.

4.9

One further dimension to risk needs to be considered, namely whether it arises from the possibility of market movements or of failure of a *counterparty* to honour its obligations. The *FSA* regard a contract which decreased market risk but gave rise to a significant increase in *counterparty* risk as having adverse risk consequences and therefore inconsistent with either reduction of investment risks or efficient portfolio management. What is significant in this context is a matter for professional judgement in the light

of the circumstances of the *insurer*. But, as a guide, the *FSA* would normally regard a contract which, under reasonably foreseeable circumstances, would increase the *insurer's exposure* to a *counterparty* to somewhere near the prescribed admissibility limit (or the company's own limit, where lower) as giving rise to a significant increase in *counterparty* risk and therefore having adverse risk consequences. In a linked fund, admissibility limits are irrelevant; it will probably be necessary for the *insurer* to set its own benchmarks as to significance, which may reasonably vary to some extent according to the investment objectives of the fund.

Example M

An insurer wishes its funds to gain exposure to the Japanese stock-market but is content to track the Nikkei index rather than attempt to out-perform it by stock selection. It therefore buys a Nikkei future and covers it with a short-notice deposit of appropriate size. Every 3 months, it simply rolls over the future.

This kind of use of derivatives has traditionally not been allowable for UK unit trusts categorised as *securities* funds. With one caveat however, the economic effect should be extremely close to that of an outright purchase of the stocks underlying the index, in the appropriate proportions.

However, the caveat is important. Unless the contract is margined regularly (probably at least weekly), the *insurer* would expect to build up a significant volume of *counterparty* risk as the index rises. This in itself would be sufficient to fall outside the terms of efficient portfolio management. But provided that the *counterparty* risk and the costs of rollover are kept to an insignificant level, there is no reason why such an arrangement cannot fall within the interpretation of efficient portfolio management set out in paragraph 4.6.

The continuing nature of the test

4.10

A derivative which initially satisfies the efficient portfolio management or reduction of risks tests will not necessarily continue to do so. This is particularly the case with derivatives which are some way out of the ordinary. A derivative which fails the test cannot be admissible (or a permitted link) even if it passed the test at the outset. This possibility should be kept under review.

Example N

An insurer buys a barrier option to protect its UK equity portfolio at a time when FT-SE 100 is at 3000. The barrier is set at 2400; no amount is payable unless FT-SE has fallen through the barrier at some point. Thereafter, the option behaves as a standard option.

It is possible that this kind of *option* would satisfy the reduction of risks test at the time it was transacted. For example, it could be a method whereby a life *insurer* is able to satisfy the resilience test. However, if FT-SE falls close to the barrier, the instrument becomes a highly speculative one. It now has a significant market value although the exercise value remains at nil for the time being. Retention of the *option* becomes a gamble as to whether the index will fall through the barrier or not and would no longer be consistent either with reduction of risks or efficient portfolio management. (Nor, incidentally, would it pass the 'in connection with' test at this stage - see paragraph 4.19.) At this point, the admissible value is nil and a *insurer* wishing to protect its portfolio for solvency purposes would need to close out the *option* (and conceivably, although not necessarily, purchase another barrier

option with a lower barrier).

The 'in connection with' test

- 4.11 As a general rule, free-standing derivatives are inadmissible. The usual requirement is that a derivative must be used 'in connection with' an asset of a different type for the purposes of efficient portfolio management or reduction of investment risks. However, under rules 4.12(2) and 4.12(3), free-standing derivatives or combinations thereof can be admissible provided that they satisfy certain conditions. We refer to the alternative tests jointly as the 'in connection with' test. An analogous test applies in linked funds.
- 4.12 The following combinations also pass the 'in connection with' test, provided that they are used for the purposes of efficient portfolio management or reduction of investment risks:
- (a) a derivative which has the effect of an *approved derivative contract* used in connection with an *admissible asset* (or permitted link) for such purposes
 - (b) a combination of derivatives which synthesise an *admissible asset* (or permitted link)
 - (c) a combination of derivatives which synthesise the combination of an *admissible asset* (or permitted link) and an *approved derivative contract*
- 4.13 In each of the above cases, although the drafting of rule 4.12 (or **Appendix 3.2**) is not explicit on this point, a derivative, an *admissible asset* or a permitted link is to be read as covering one or more instruments in each case.
- 4.14 An *admissible asset* must be admissible in its own right. A chain of connected derivatives (other than a combination which falls within conditions (b) or (c) of paragraph 4.12) pass the 'in connection with' test if the first derivative in the chain is used in connection with some other kind of admissible instrument. For example, see Example Y below.
- 4.15 The 'in connection with' test is part of the barrier to admissibility for speculative derivative instruments. The connection must be for the purposes of efficient portfolio management or reduction in investment risks, not merely incidental to it. This leads to two corollaries, one obvious, the other perhaps less so.
- 4.16 The first corollary is that there must be a relevant asset to be connected to. The derivative in Example O below fails the in connection with test.

Example O

An insurer buys a listed put option on a particular stock or index, without holding either the relevant stock (or, if appropriate, basket of stocks) or an appropriate future or call option.

There is no asset of the fund with which this *option* can be connected for the relevant purposes. Therefore, even though the degree of ‘speculation’ is limited to the initial cost of the *option*, no admissible value can be given to such an asset.

Example P

An insurer buys an index call option whose exercise index level is approximately equal to the current level of the index.

It is perfectly legitimate to regard a purchased call option on an individual asset as being used in connection with cash or other *readily realisable* assets which would enable the *option* to be exercised. Moreover, provided that the underlying asset was one that the fund could reasonably hold, then (as illustrated in Example F) the transaction should qualify as being for the purposes of reduction of investment risks unless it gave rise to significant adverse risk consequences (see paragraph 4.3). By analogy, an index call *option* could certainly be regarded as being used in connection with sufficient cash or ‘near-cash’ (see paragraph 6.12) to allow the underlying stocks to be purchased at the exercise price.

However, taking this example to an extreme, if a fund invested in purchased call *options* to the extent that the cash or ‘near-cash’ in the fund fell significantly short of the amounts notionally needed to exercise the *options*, this would not be consistent with efficient portfolio management. (‘Significantly’ should be interpreted here in the context of the size of the fund. But a number of such transactions may be individually insignificant but nevertheless significant in aggregate.) Such use of derivatives would certainly give rise to significant adverse risk consequences (i.e. gearing). This applies even though an index call *option* would normally be cash-settled, there being no intention to purchase the assets underlying the index.

- 4.17 The above examples might be interpreted as illustrating a rule that the combination of call *options* plus cash satisfies the ‘in connection with’ test while the combination of put *options* plus cash fails it. However, this is not invariably the case.

Example Q

An insurer purchases an index call option with a (variable) exercise price struck at $(2L-K)$ where K is the index level at the time of purchase of the *option* and L is the index level at the time the *option* is exercised. It has sufficient cash in its fund to notionally exercise the *option*.

This *option* is constructed to have the same payoff as a conventional put option with price struck at K. The conclusion is as in Example O therefore; any connection with the cash in the fund is incidental to the purposes of reduction of risks or efficient portfolio management and the *option* is inadmissible.

- 4.18 The second corollary mentioned in paragraph 4.15 is that the value of the derivative must be small at the time the transaction is initiated by comparison with the value of the asset it is connected with. (Moreover, there must be a reasonable possibility that it will remain small.) Otherwise, where the value

of the derivative is very likely to become too large compared to the value of the connected asset, the connection is incidental to the purposes of efficient portfolio management, rather than for those purposes.

- 4.19 This issue does not commonly arise when using derivatives for hedging or shifting the balance of a portfolio. However, it would arise in the case of a derivative whose value is capable of fluctuating strongly and to a considerable size compared to the value of the underlying asset (for instance, the barrier *option* in Example N). The issue can also arise when derivatives are used to give a precise match to guaranteed benefits. It is considered further in paragraph 10.

5. **Admissibility of underlying assets; underlying assets a permitted link**

- 5.1 Under the *Valuation of Assets Rules*, a *derivative contract* based on a category of asset which is not admissible can never have an admissible value. For example, gold is not considered to be a suitable asset to cover insurance liabilities. By the same token, it would be anomalous if an *insurer* were able to assign an admissible value to an *option* or future on gold.

- 5.2 The *FSA* will not entertain any request for a waiver where derivatives based on inadmissible assets are purchased in pursuance of a general investment strategy. However, there might be special cases where holdings of derivatives based on inadmissible assets represent a sensible method of hedging assets covering a specific liability or, more generally, of managing the company's liabilities. Under such circumstances, the *FSA* would be prepared to consider granting a waiver to allow such derivatives to be admitted.

- 5.3 Very similar considerations apply in linked funds. A derivative cannot be a permitted link unless it is wholly based on property, or indices, which are themselves permitted links.

6. **Cover**

- 6.1 The penultimate condition which must be satisfied by an *insurer* who wishes to value a derivative as an asset is that the transaction must be covered by assets which have been earmarked for the purpose. The *Valuation of Assets Rules* allow reasonable flexibility as to which assets may be considered to provide cover.

- 6.2 In order to satisfy the cover condition in the *Valuation of Assets Rules* the *insurer* must be sure that it is not exposing itself to any significant basis risk. That is to say, there is no reasonably foreseeable possibility that it will suffer a significant loss as the result of acquiring or realising investments in order to satisfy its obligations under the *derivative contract*.

- 6.3 Where, at the present time, the *insurer* holds the assets due to be delivered under the contract (and expects to continue to hold them until delivery date), the *FSA* will say that the contract is strictly covered. Similarly, other

derivative contracts which will deliver (or would deliver following exercise of an *option* by the *insurer*) the appropriate assets before the exercise date of the former contract can also constitute strict cover.

- 6.4 Digressing temporarily from asset admissibility, there is another important angle to cover which applies whether a derivative is currently an asset or a liability to the *insurer* and, if the former, whether it is admissible or not. A contract which is not covered or covered only approximately will give rise to the requirement to make a provision for adverse changes, as discussed in paragraph 9. Indeed, the formal cover requirement set out in 4.12(4) is that a significant provision for adverse changes is not required in respect of the contract.
- 6.5 A contract which is strictly covered cannot give rise to a provision for adverse changes. A contract which is covered but not strictly covered must logically give rise to such a provision. But in many practical cases, the provision is likely to be immaterial.
- 6.6 To sum up, the *Valuation of Assets Rules* do not require an admissible derivative to be strictly covered; but they do require it to be covered reasonably strictly. And a derivative which is not covered reasonably strictly and therefore inadmissible, will certainly give rise to a provision for adverse changes.
- 6.7 It follows from the above that the question of cover does not arise in respect of contracts which can never impose obligations on the *insurer* (e.g. purchased *options*, *warrants*). On the other hand, contracts where the liability is potentially unlimited can be covered only by an appropriate holding of the corresponding assets. Finally, as illustrated in Example O, the ‘in connection with’ test (and, indeed, the other conditions set out in paragraph 2.1) remain relevant even where the question of cover does not arise.

Cover and basis risk

- 6.8 It is not always practicable to arrange for a contract to be strictly covered. However, we do not propose to set numerical limits governing whether the basis risk is to be regarded as significant. In determining this for a particular case, we would expect the insurer to have regard to:
- (a) the size of the transaction. A relatively large basis risk (expressed as a percentage of the value of the underlying assets) would constitute a breach of the cover requirement where the value of the notional principal is sizeable; it may be acceptable if the value of the notional principal is a very small percentage of the value of the fund.
 - (b) aggregation of risks. The basis risk on a particular transaction may not be significant; but when aggregated with that on a number of other similar transactions, it can become so.

- (c) inherent volatility of the fund. A particular quantum of basis risk is more likely to be regarded as significant in the context of a fund with reasonably stable investment performance than in one which is rather volatile in nature (e.g. a long-term linked Hong Kong Fund). The test is whether the derivative itself adds significantly to the existing investment risk.
- (d) the fact that basis risk is, of its nature, very volatile.

‘Unforeseeable’ circumstances?

- 6.9 It is impossible to give general guidance as to what is foreseeable. But a few considerations may help. In assessing what might happen to the value of any assets, an *insurer* is entitled to have regard to market experience in recent years. It is certainly not ‘unforeseeable’ that a certain security might become virtually worthless. However, a huge general decline in asset values might legitimately be regarded as ‘unforeseeable’.
- 6.10 Similarly, an *insurer* would be expected to make an exceptionally prudent assessment of its cash outflows in the period before the settlement date of a *derivatives contract* before concluding that it had sufficient cash to cover its liabilities. It would be far from ‘unforeseeable’ that its best estimate of cash outflows would be exceeded in practice.

Other pre-requisites for cover?

- 6.11 In assessing cover, the *insurer* must obviously first allow for all assets which will be needed to meet a prudent estimate of all other liabilities which will be due for settlement before delivery date. Moreover, assets which are earmarked for a different purpose must not be counted as cover for a derivatives transaction. Examples of the latter would be assets earmarked for repayment of a *debt* or to provide cover for another derivatives transaction.

Example R – suitability for covering for a commitment to deliver a fixed amount of cash (The following list is not intended to be exhaustive.)

Acceptable as strict cover

Cash already paid to the *counterparty* by way of initial margin

A *derivatives contract* guaranteed to deliver to the *insurer* sufficient cash to cover its liabilities (e.g. a sold future may cover a bought future)

A holding guaranteed to deliver income of the right magnitude at the right times to cover payment obligations (e.g. an interest rate swap is covered by the appropriate underlying holding)

Cash or ‘near-cash’

May be acceptable as partial cover, subject to the magnitude of the basis risk

A holding in gilts, other than those which count as near-cash

A well-diversified portfolio of *readily realisable* equities

Unacceptable, even as partial cover

Borrowed assets

Assets covering another derivatives transaction

Assets providing security for a *debt*

Dividends due before delivery date but not yet declared

A portfolio of *securities* which is not well diversified or containing significant holdings of *securities* not readily realisable in the short term

Debts (including anticipated tax recoveries), other than those which count as 'near-cash'

Example S

An insurer with a portfolio of US equities wishes to remain exposed to the US market for the next 3 months. It wishes to protect itself against the risk of the dollar weakening and considers it unlikely that it will strengthen. It decides to sell a dollar future (i.e. dollars sold to buy sterling) to the current value of half of its US equity portfolio, for settlement in 3 months time.

Provided that the portfolio of equities is well-diversified and *readily realisable*, it may be possible to consider it to be covering the future, despite the fact that it is at first sight not obviously appropriate for the purpose. The following argument justifies this treatment.

Leaving aside movements in the US market, the *insurer* can never suffer a cash loss as a result of movements in the exchange rate. If the dollar falls, the gain in the forward currency contract matches the fall (in sterling terms) of half the equity portfolio. If the dollar rises, the reverse is true. Under the latter circumstances, the *insurer* might need to sell some of his equity portfolio (which would have appreciated in value in sterling terms) in order to meet his obligation to supply dollars under the forward currency contract. Because the portfolio has been assumed to be well-diversified, this should not be a problem. The same assumption could not necessarily be made of a holding of equities traded on a market which was often turbulent.

There is nevertheless basis risk associated with this contract reflecting the eventuality that the dollar might strengthen and the US equities fall in value over the period. The *insurer* would have to consider whether this risk was significant, bearing in mind the tests in paragraph 6.8, before classifying this transaction as 'covered'.

Similar considerations apply if the *insurer* decides to hedge the currency risk on the whole of its portfolio, rather than just half of it. However, in the latter case, there is in principle a considerable risk that the portfolio could fall in value, leaving the insurer 'over-hedged'. Assuming this reached levels which could not be regarded as insignificant, the currency hedge could neither be regarded as for the purposes of reduction of investment risks nor efficient portfolio management under the interpretation of Section 4. But naturally, in assessing the risks, the *insurer* would be entitled to place due weight on any systems it had in place to close out any 'excess hedging' beyond insignificant levels, as it arose.

Example T – suitability for covering a commitment to deliver physical assets (or cash to the value of those assets).

(The following list is not intended to be exhaustive.)

Acceptable as strict cover

A holding of the assets in question

A *derivatives contract* guaranteed to deliver to the *insurer* sufficient assets to cover its liabilities (e.g. a bought future can cover a written call *option*)

May be acceptable as partial cover, subject to the magnitude of the basis risk

Cash or ‘near-cash’

A holding in gilts

A well-diversified portfolio of *readily realisable* equities

Unacceptable, even as partial cover

Borrowed assets

Assets covering another derivatives transaction

Assets providing security for a *debt*

Dividends due before delivery date but not yet declared

A portfolio of *securities* which is not well diversified or containing significant holdings of *securities* which are not readily realisable

Debts (including anticipated tax recoveries) other than those which count as ‘near-cash’

Example U

An insurer has purchased an index put option to hedge its entire holding of Japanese equities. It has the opportunity to sell some of those assets at a favourable price. It proposes to retain the whole of the option contract.

Purchased *options* do not require cover. However, the other conditions in paragraph 2.1 remain relevant. In particular, the ‘in connection with’ test remains relevant. After the asset sale, part of the *option* is no longer in connection with any relevant assets.

By analogy with Example O, the ‘excess’ part of the *option* cannot be an *admissible asset*. The remaining part would be admissible provided of course that it passed the appropriate tests in the first place.

Example V

An insurer has sold an index future which is covered by an appropriate holding of assets. It has the opportunity to sell some of those assets at a favourable price. It proposes to retain the whole of the futures contract.

The asset sale will partly uncover the future, unless the *insurer* simultaneously tops up the cover by earmarking other suitable assets. Where the *insurer* does not hold such suitable assets, it can regard the *derivatives contract* as being split in two for asset valuation

purposes. One part would definitely not be covered; the other part could be if the basis risk remained insignificant. Obviously, this would require that the remaining assets were reasonably representative of the index.

‘Near-cash’?

6.12 ‘Near-cash’ means cash which is reasonably certain to be received by the *insurer* before delivery date or assets which could, with reasonable certainty, be converted into a known amount of cash before delivery date, at the *insurer's* discretion. The principal examples are:

- (a) Amounts deposited with or loaned to authorised banks and building societies which are redeemable before delivery date (including a prudent estimate of interest due before delivery date)
- (b) *Approved securities* which can be redeemed before delivery date (including a prudent estimate of interest due in the meantime)
- (c) Dividends declared but not yet paid
- (d) An exceptionally prudent estimate of net cash inflows expected before delivery date. (A prudent estimate of the net position may of course be negative! In that case, the *insurer* would be obliged to regard that as a prospective liability, to be taken into account as described in paragraph 6.11.)

Example W

An insurer has sold a FTSE-100 future.

On the delivery date, it will receive cash if the original index level price is greater than the market price; otherwise it will have to pay cash. Because of the basis risk, it is not possible to cover this contract substantially with cash or ‘near-cash’. For example, if the value of the contract was £1m per 100 index points, at least several £m in addition to the cover of the underlying principal (depending partly on the length of the interval before delivery date) of cash or ‘near-cash’ would be needed as cover before the *insurer* could be reasonably certain that this would not be completely eroded by a sharp rise in FTSE. It is most unlikely that this could be regarded as an insignificant basis risk. In passing, it is also most unlikely that this could be justified as reduction of investment risks or efficient portfolio management.

The contract could expediently be covered by a well-diversified portfolio of *securities* making up the FTSE index (the primary cover) of approximately the right value (i.e. the market value of the basket of FTSE *securities* underlying the transaction), together with a secondary holding in cash or ‘near-cash’ equal to the provision for adverse changes (see Section 9), if any. If the performance of the actual portfolio can reasonably be assumed to be closely correlated with that of FTSE, the basis risk is likely to be minimal.

However, if the covering *securities* providing the primary cover were to be replaced by ones which were either:

- (a) not well diversified; or
- (b) not well-matched to the FTSE-100 index; or

(c) of insufficient value to provide full cover

the basis risk could be substantial. If so, the contract could no longer be regarded as covered.

Example X

An insurer wishes to rebalance his portfolio by selling UK equities and buying US equities. He wishes to change market exposure immediately but to give himself time to realise his UK holdings and select appropriate US holdings. He sells a FTSE future, buys a dollar future from an approved counterparty and an S&P future, all for settlement on the same date and all to the value of the UK equity portfolio.

The S&P future is covered by the dollar future. Assuming that the portfolio of equities is a well-diversified selection of stocks making up FTSE-100, the proceeds of the sale plus the balance on the FTSE future should in aggregate realise approximately enough to cover the obligation to deliver sterling under the dollar future. The amount will be insufficient to the extent that the actual stocks underperform between the current date and the date of realisation, relative to FTSE-100. Provided that the basis risk was insignificant, then the equity portfolio, taken together with an appropriate holding in cash or 'near-cash' (to allow for the mismatch between the portfolio and the index) would cover this contract.

It is also instructive to consider the 'in connection with' test. Use of the currency forward and the index futures appears to be consistent with efficient portfolio management. The FTSE future is clearly being used 'in connection with' the UK equity portfolio. But the natural interpretation is that the currency forward is used in connection with the FTSE future and the S&P future in connection with the currency forward. In the situation above, if the FTSE future is covered, it becomes an *admissible asset*. So the currency forward is used 'in connection with' an *admissible asset*; it is itself admissible. The same argument works for the S&P future.

Example Y

Same situation as in Example X except that the various contracts are not all due for settlement on the same date.

The analysis is very similar to that of Example X. The basis risk would also include the risk of adverse movements in currencies and/or indices between the settlement dates of the various contracts. Obviously, the size of this additional risk will depend on the intervals between settlement dates and the perceived volatility of indices, equity portfolio and exchange rates. Nevertheless, it is by no means out of the question that these derivatives could be regarded as covered.

Cover Fallacies

6.13

The following are illustrative examples of fallacies.

Example Z

I have sold an index future which is currently showing a slight profit to me on the basis of current market value. It does not require cover.

WRONG! It may in future show a considerable loss. It is difficult to arrange for strict cover because of small changes in the composition of the index from time to time. An appropriate diversified selection of the assets underlying the index is however likely to be regarded as covering this transaction, depending of course on the size of the basis risk.

Example AA

Earmarking of assets of sufficient current value to cover the basis risk will always ensure that the relevant derivative contract is covered

WRONG! The assets may not be suitable (e.g. because of volatility or non-realisability) for cover. And of course, if the basis risk is significant, the contract cannot be regarded as being covered.

Example BB

A margined contract is automatically covered.

WRONG! Margining guarantees only that the *insurer* can cover adverse market movements to date. It confers no assurance that it will be able to cover any foreseeable future market movement.

Example CC

I have entered into an OTC arrangement for 3 months whereby I sold an index futures contract on day 1. On each subsequent day, I am committed to closing out my futures position and simultaneously re-selling another index future for the original end-date at the close-out price. (In view of the nature of the arrangement, my counterparty has offered extremely favourable terms on dealing costs!) The basis risk for any pair of sale and purchase contracts is small and the contract therefore requires minimal cover.

WRONG! No doubt, little will go wrong with this arrangement from one typical day to the next. But over a period, a lot could go wrong with it. Having regard to the point in paragraph 6.8 on 'aggregation of risks', it is clear that the contract requires cover as if a normal 3 month index future had been sold.

Cover for derivatives in linked funds

- 6.14 Although the drafting of the *Valuation of Assets Rules* makes it hard going to verify this fact, there is in practice no difference in the nature of the cover criterion, whether a derivative is used 'in connection with' *linked* or *non-linked assets*. That is to say, a derivative covered by assets of a linked fund would be covered if the fund were a non-linked one; and vice versa. (However, a derivative in a linked fund is of course legally required to be covered, unlike a derivative in a non-linked fund.)

7. **The pricing basis**

- 7.1 The final condition to be satisfied by an admissible (or permitted) derivative is that it satisfies the prescribed pricing basis. This is usually unproblematic. Assets acquired or disposed of under *options* or *futures contracts* are normally transferred at a fixed price, specified at the time the contract is transacted. Nevertheless, more exotic price structures do occur. The *Valuation of Assets Rules* allow considerable (but not total) flexibility. The paragraphs below cover the conditions to be satisfied by *admissible assets*. The conditions for *permitted derivative contracts* in property-linked funds are equivalent.

- 7.2 Under rule 4.12(7), amounts payable under an admissible contract for differences may be calculated by reference to the value of any *admissible asset* or income from any *admissible asset*. Contracts based on an index of such asset values or income are equally acceptable. So are contracts based on the difference between current and *amortised value*, provided that there is a generally accepted accounting practice for determining the *amortised value* of the asset in question. Finally, contracts based on fluctuations in a national index of retail prices for any Zone A country (in particular the RPI) pass the test.
- 7.3 Rule 4.12(8) prescribes the pricing methods allowable for an admissible *option* or *futures contract*. The exercise or contract price may be fixed (the traditional approach) or may be determined by reference to any of the quantities mentioned in the previous paragraph or by any combination of these.
- 7.4 The most significant exclusions from the above prescribed pricing bases are where a contract value, or buying or selling price of an asset, is determined partly by reference to:
- (a) an inadmissible asset; or
 - (b) the *amortised value* of an asset where there is no generally accepted accounting practice (for insurance companies) for the determination of such *amortised value*.

Example DD

A company transacts an option to buy listed shares in ABC plc at a price which is related to the price of (listed) DEF shares on the exercise date.

This satisfies the pricing basis requirements set out in rule 4.12(8). Of course, it still needs to satisfy all the other requirements of rule 4.12 before it could be given an admissible value. The 'capable of being readily closed out' and 'efficient portfolio management or reduction of risks' tests would undoubtedly need particularly careful justification.

8. **The valuation rule for derivatives which are assets**

- 8.1 The basic rule set out in rule 4.12 is that derivatives which satisfy the conditions described in paragraph 2.1 above shall be valued at current value, taking into account any amounts paid or transferred to the *insurer*, whether by way of *variation margin* or otherwise. Current value is defined to be market value, in the case of a *listed* derivative, or close-out value in the case of an OTC derivative. Under this rule, fully-margined derivatives clearly have a value of zero; the intrinsic value of the contract is represented either by a deposit in the margin account or by assets already transferred to the *insurer* by the *counterparty*.
- 8.2 It might appear at first sight, therefore, that full credit can be taken for any fully-margined *derivative contract*, irrespective of whether it satisfies the conditions summarised in paragraph 2.1. This is not the case. Margining (or

collateralisation) cannot legitimise a *derivative contract* which would not otherwise have an admissible value. Rule 4.14(1) provides that *admissible assets* equal in value to any such margin paid or transferred to the *insurer* must be left out of account if the margin is in respect of a *derivative contract* which does not satisfy all the conditions described in paragraph 2.1. Therefore, although the *insurer* has received assets equal to the intrinsic value of the contract, it is required to leave an equal value of assets out of account. In effect, the net benefit of having transacted the *derivative contract* is nil, for the purposes of statutory valuation.

8.3 Notwithstanding the above strictures, we do of course encourage *insurers* to margin (or collateralise) their contracts wherever appropriate as a means of reducing credit exposure of the fund to the *insurer's counterparty*.

9. **Liabilities arising from derivative contracts**

9.1 The starting point is that a derivative which is currently a liability to the *insurer* (leaving aside the effect of any margin which has already been paid, received or transferred) should be valued at its current value. In the case of an exchange-traded derivative, this is its market value; in any other case, it is what the *insurer* would reasonably expect to pay to close out all its obligations under the contract. This applies irrespective of whether or not the conditions summarised in paragraph 2.1 apply.

9.2 Moreover, as noted in paragraph 2.3, no derivative (whether currently an asset or a liability) may be used in a property-linked fund unless all the conditions of that paragraph apply.

Example EE

An insurer with a well-diversified portfolio of FTSE stocks in a linked fund believes that UK equity prices are likely to fall in the foreseeable future but recover in the medium term. It decides to sell a FTSE-100 call option (adequately covered by its portfolio - see Section 6).

This is a somewhat problematical case. Particularly careful justification will be needed before written *options* can be taken to be for the purposes of reduction of risks or efficient portfolio management.

Suppose, for example that the *insurer's* investment strategy is to reduce exposure to FTSE stocks. When assessing whether selling an *option* counts as efficient portfolio management, it is necessary to consider the non-derivative alternative, in this case to sell the relevant stocks. If the index in fact rises above the strike level, the *insurer* will effectively lose any gain above that level. However, that is irrelevant to the current discussion; the *insurer* would clearly also have given up the gain if it had sold the stocks.

If the index falls below the strike level, the *option* will expire worthless. The *insurer* will therefore benefit from the *option* premium but will nevertheless still be exposed to severe falls in the stocks. In the terms of paragraph 4.8, this is an adverse risk consequence of the derivative strategy. If the transaction is to count as efficient portfolio management, the *insurer* would need to be convinced that the adverse risk consequence was insignificant; in other words, that the risk of the market falling sufficiently far that the *insurer* was left significantly worse off than by selling the stocks could be neglected. This could only be

resolved on a case by case basis, taking into account the volatility of the market, the price of the *option*, the difference between initial market and *option* strike levels and respective tax considerations.

The above gives an analysis for one particular investment strategy; it might be quite different for any other strategy.

Provision for adverse changes

9.3

In addition, where a contract is not strictly covered, the *insurer* must make an appropriate provision for adverse changes under the terms of rule 5.3. This applies to any contract that:

- (a) may give rise to an obligation on the *insurer*, irrespective of whether it is an asset or a liability at the current time; and
- (b) where an adverse change would affect the level of free assets of the *insurer*.

Example FF

An insurer has sold a call option on a stock which it does not hold. On a best estimate basis, it has just sufficient assets in its fund to allow it to buy the stock necessary to perform the obligation.

This contract is not covered and could not therefore be used in a linked fund. It is perfectly foreseeable that the value of the assets in its fund or those underlying the derivative will change to the extent that the *insurer* needs more than its best estimate in order to perform its obligations under the contract. A provision for adverse changes will be needed.

In passing, it is also clear that such a transaction gives rise to significant adverse consequences in the investment risk profile of the portfolio. Under the condition described in paragraph 4.6 above, it could not be regarded as being consistent with efficient portfolio management. Nor, clearly, does it satisfy the 'in connection with' test.

Example GG

An insurer considers selling a put option on an equity holding which, if exercised, will require it to pay £1m for the holding. It currently has a cash balance of £0.5m but expects a net cash outflow, apart from new premium income, of £0.3m. However, due to estimating uncertainties, such net cash outflow might be as high as £0.6m. Taking account of new premium inflows, can this contract be regarded as covered?

Prudence requires the most pessimistic assumption for net outflows, namely £0.6m. This gives rise to a cash shortfall of £0.1m, leaving aside the cash needed to cover the *option*. It follows that new premium inflows would have to be at least £1.1m, on an exceptionally prudent assumption, for the contract to be regarded as covered.

A provision for adverse changes would be required in respect of the uncovered part of the contract.

9.4

The provision must be sufficiently large to cover the basis risk. It follows that a contract which is covered, but not strictly covered requires, in principle, a provision for adverse changes to be established. However, in many practical circumstances, such provision may be immaterial.

- 9.5 The starting point for assessment of the provision is a comparison between the assets underlying the *derivative contract* and the assets notionally attributed by the company to meet its liabilities (including prospective or contingent liabilities) under the contract. For this purpose, it is necessary to identify particular assets of the relevant fund (the ‘identified assets’) as being available to meet liabilities under the contract in question.
- 9.6 Where the contract is not strictly covered, the *insurer* should consider the potential variation between the value of the assets underlying the *derivative contract* and the ‘identified assets’. This will lead to an assessment of the potential liability which could arise from the lack of strict cover. Such variation may of course arise either from general market movements (e.g. if gilts are attributed against an equity index future) or of specific stock value changes (e.g. if a small number of stocks are attributed against an equity index future).
- 9.7 It will be necessary to take account of the potential volatility of each block of assets, including the possibility that prices of the blocks will move in different directions. The assessment would be based initially on historical volatility but would also have regard to the possibility that volatility might be different in future.
- 9.8 The level of provision may also depend on the insurer’s techniques for monitoring (and, where appropriate, hedging or closing out transactions so as to reduce exposure) and the frequency with which *exposures* are monitored by senior management. However, a general intention to manage the *exposure* as the need is perceived to arise is not sufficient to obviate the need for, or even reduce, a provision.
- 9.9 As a general rule, we would expect *insurer’s* to set provisions on bases which are at least as prudent as the following:
- (a) in the case of a derivative based on a broadly-based equity index:
 - (i) that a 25% adverse movement in the index occurs in the near future; and
 - (ii) the possibility of a greater adverse movement should be allowed for, to the extent that this is consistent with the historical record or, otherwise, where it would be imprudent to ignore the possibility;
 - (b) in the case of a derivative whose value depends significantly on the value of a small number of assets, the assumptions in (a) will be insufficiently prudent. Conversely, the assumptions in (a) may be too severe in other cases. (For example, a 25% adverse movement in a short gilt index might be considered extremely unlikely);

- (c) analogous assumptions should be made in respect of the attributed assets (see paragraph 9.5);
- (d) the effect of adverse changes to the value of the derivative and the attributed assets should be compounded (on a probabilistic rather than arithmetical basis), assessing the (positive or negative) correlation between the two variables in a very prudent manner. For example, in the case of long-dated gilts attributed against an equity future, independent 25% adverse movements should be assumed.

The provision for adverse changes and linked funds

- 9.10 A provision for adverse changes ought not to arise in the case of derivatives used in property-linked funds. A contract which was strictly covered would not give rise to a provision in any case. And a contract which was not covered would be illegal in a property-linked fund.
- 9.11 But perhaps the most common case relates to a contract which is covered but not strictly covered. By virtue of condition (b) of paragraph 9.3, a provision cannot arise for such a contract in a linked fund because its fortunes have no effect on the level of the free assets (since any change in its value is matched by an equal change in the total linked benefits payable to *policy holders*). By contrast, as noted in paragraph 6.5, a derivative in a non-linked fund which was covered but not strictly covered would in principle require a provision. Therefore, although the criteria for determining whether a contract is covered (or strictly covered) do not differ between linked and non-linked funds, the consequences of the absence of strict cover do differ between the two cases.

Responsibility for calculation of the provision

- 9.12 Responsibility for calculation of the provision rests with the directors. Even in a *long-term insurer*, it is not one of the long-term liabilities. As with the remaining ‘other than *long-term insurance business*’ liabilities, it will be liable to review by the auditors. However, for *derivative contracts* transacted ‘in connection with’ assets of the *long-term insurance fund*, it will often be appropriate for the *appointed actuary* to take account of the provision in his assessment of the long-term liabilities under rule 5.17, in accordance with professional guidance notes.

Overlap with the Resilience Test

- 9.13 Under some circumstances, there may be an element of overlap between the provision for adverse changes and the provision required in respect of *long-term insurance business* under rule 5.17. Double-counting of the provision is however unnecessary! To the extent that the provision for adverse changes relates to general market movements (as opposed to movements in one or two specific holdings), it may be notionally released in calculating (subsequently) the provision required under rule 5.17.

10. **Quasi-derivatives**

10.1 Certain more traditional types of instrument acquired in the normal course of trading (for example, convertible stocks and partly-paid *shares*), as well as traditional types of practice such as sub-underwriting, have the characteristics of derivatives. In addition, derivatives also exist in securitised form. To illustrate the latter point, there is little difference between investing in a bond whose maturity value is determined according to the level of some market index and transacting a *contract for differences* based on that index (especially if, in practice, it is unforeseeable that the notional principal representing the investment could be eaten away completely by adverse market movements). This section considers how all these ‘quasi-derivatives’ are dealt with by the *Valuation of Assets Rules* and what are the practical implications.

10.2 The aim of rule 4.13 is to make the treatment of ‘quasi-derivatives’ more transparent. Essentially (and with certain defined exceptions), a contract or asset is to be treated as having the effect of a *derivative contract* if it embeds an *option* or obligation to acquire, dispose of or convert an asset or provides for payments akin to those which would be made under a *contract for differences*.

Example HH

Examples of instruments which ‘have the effect of a derivative contract’

- (a) Partly-paid *shares*
- (b) An agreement to underwrite or sub-underwrite a *share* issue
- (c) Bonds convertible to equity
- (d) Stock lending and REPO agreements which do not satisfy the conditions set out in paragraphs (2) and (3) (or (4)) of rule 4.4
- (e) Instruments which provide an income (or maturity value) set by reference to fluctuations in the value of some specified asset or by reference to fluctuations in an index
- (f) *Futures contracts* and *options* funds

Examples of instruments which do not ‘have the effect of a derivative contract’

- (a) *Shares* (unless the rights conferred by the shareholding are such that the income or maturity value is partly or wholly determined by reference to the value of some specified asset or index)
- (b) Gilts issued by a state in Zone A
- (c) Holdings in *collective investment schemes* which fall under the *UCITS Directive*
- (d) Stock lending and REPO transactions which satisfy the conditions set out in paragraphs (2) and (3) (or (4)) of rule 4.4
- (e) Contracts for sale or purchase of assets (i.e. *securities*, land) within a defined period (the normal settlement period for on-exchange transactions in the case of *listed securities* and 20 working days in other cases)
- (f) Contracts for conversion of currency in connection with sale or purchase contracts of the type mentioned in the previous bullet point
- (g) Contracts for sale or purchase of equipment.

N.B. Neither of the above lists should be taken as exhaustive!

- 10.3 An asset having the effect of a *derivative contract* is an *admissible asset* if the corresponding (hypothetical) *derivative contract* would satisfy the conditions set out in paragraph 2.1. It is a permitted link if the corresponding hypothetical *derivative contract* would satisfy the conditions set out in paragraph 2.3.

Example II

A company buys an unlisted bond issued by a manufacturing company, whose maturity value is determined according to the value of FT-SE 100 on the maturity date.

This is not an *admissible asset* or permitted link. It has the effect of a *contract for differences* (of an admissible class) used in connection with a loan. But it is neither *listed* nor transacted with an *approved counterparty*. However, a similar product transacted with an *approved counterparty* would be admissible provided that the efficient portfolio management and reduction of risks criteria could be justified.

- 10.4 Where the conditions of paragraph 2.1 are satisfied, the value of the ‘quasi-derivative’ is, as usual, the current value (i.e. the market value in the case of a listed asset). Where the conditions are not satisfied, the ‘quasi-derivative’ has no value except in respect of any payments whose value is guaranteed. By virtue of rule 4.13(4), such payments are to be given an assignment value, as if they were *debts*.

Example JJ

A company buys a bond whose maturity value is equal to the product of

- (i) the issue price; and**
- (ii) the ratio of the price of gold on maturity and the price of gold at issue,**

with a guarantee that the maturity value will not be less than the issue price.

This product has the same economic effect as a *debt* (to repay the issue price) plus a *contract for differences* based on the gold price. The latter would not be admissible (since gold is not an *admissible asset*). Therefore the value of this instrument for solvency purposes would be the limited to the assignment value of a *debt* to repay the issue price.

- 10.5 The above examples are perhaps a little exotic. With more commonly met examples (such as listed convertibles, partly-paid *shares*, sub-underwriting), there will not usually be a problem over justifying that the conditions of paragraphs 2.1 or 2.3 are satisfied. Clearly, however, cases need to be examined on their merits. Where such instruments are used to an abnormal extent, in particular where they give rise to a significant level of gearing of the fund, there must be grave doubts as to whether this is consistent with efficient portfolio management. If not, they could only be valued in accordance with the rule in rule 4.13(4) described in paragraph 10.4.

Example KK

A company holds a listed convertible bond giving it the right to convert to a specified number of equity shares of the issuer during a specified period.

This is clearly an asset having the effect of a *derivative contract*, in accordance with rule 4.13(1)(c). It is equivalent to a vanilla bond held in connection with a pair of *options*, one to sell the bond and the other to buy equity, the *options* being exercisable either as a pair or not at all. The test set by rule 4.13(4) is whether the hypothetical *options* would satisfy the conditions set out in rule 4.12(2). It is easy to see that they would do so, provided that they were consistent with reduction of investment risks or efficient portfolio management. We would expect this to be justifiable in normal circumstances.

- 10.6 Where the embedded derivative could place the *insurer* under a liability to take some action, the question of a provision for adverse changes arises. Traditional practices do not appear inherently very likely to give rise to a material provision, however, although each case must be considered on its merits.

Example LL

An insurer sub-underwrites a new share issue.

The insurer has effectively granted the underwriter an *option* to sell a number of *shares* at an agreed price. Provided there is sufficient cash or 'near-cash' in the fund to cover the whole of the purchase, if the underwriter should exercise its *option*, a provision for adverse changes is not required. This is separate from the question of whether the *insurer* should make a prudent provision for the contingent liability it has taken on.

Structured products and the 'in connection with' and 'efficient portfolio management' tests

- 10.7 Instruments which are hybrid in form between loan and derivative, sometimes referred to as structured products, are commonly free-standing instruments, not used in connection with anything. Nevertheless, they may satisfy the 'in connection with' test, by virtue of rule 4.12(2)(b). They satisfy the test provided that once they have been notionally separated into bond element and derivative element, the latter can be considered as held 'in connection with' the former (for the purposes of reduction of investment risks or efficient portfolio management).
- 10.8 Such structured products are often used to provide a precise match to the *policy holder* benefits promised under long-term products such as guaranteed income or equity bonds. There is a tendency for these products to become ever more exotic, to the extent that it is rather difficult to decompose them hypothetically into a combination of basic instruments such as loans and options having the same economic effect. Nevertheless, this must in principle be done in order to ensure that the 'in connection with' and other tests are being observed. This is sometimes not very easy!

10.9

It is sometimes argued that a product which provides a precise match to the *policy holder* liabilities automatically satisfies the reduction of risks test. This is a fallacy. Precise matching may well be essential, in order to satisfy rule 2.3. However, as paragraph 4.8 above sets out, the impact of the use of a derivative structure on the *policy holder* risk must also be considered. If the effect of the derivative element is adversely to affect some aspect of the risk to *policy holders* in a significant way, that would cause the product to fail both the efficient portfolio management and reduction of risks tests.

Example MM

A company offers a guaranteed income bond which offers 11% income on the amount invested per annum for 5 years. The bond has a minimum maturity value of 20% of the original investment (less initial charge), when FTSE falls by 5% or more over 5 years. It Returns the original investment (less initial charge) if FTSE ends the 5 year period at or above its opening value. Between these two limits, the maturity value varies pro rata to the fall in FTSE. The insurer purchases a structured product which matches its policy holder liability closely.

The analysis should in principle be carried out on the structured product purchased by the insurance company rather than the *policy holder* benefit structure. In practice it may not matter much.

Clearly, the purchased structured product can be separated notionally into loan and derivative components. However, the derivative component cannot be regarded as reducing investment risks. Even though it allows the *insurer* to match its *policy holder* liability precisely, it certainly cannot be said to have a broadly neutral effect on the investment risks of *policy holders*. If the index falls slightly (unlikely on the basis of its past record, but far from inconceivable), the *policy holder* will be considerably worse off than if he had invested in the assets underlying the index.

Moreover, since the derivative component increases asset risk to the *policy holder*, it cannot be regarded as being for the purposes of efficient portfolio management.

Such a derivative would be inadmissible. A derivative having similar characteristics in a long-term linked fund would be illegal.

10.10

Notwithstanding the instrument illustrated in Example MM, rather similar instruments can be admissible (or permitted in a long-term linked fund). To assess this, the following steps are appropriate:

Step 1 - Identify a broadly comparable non-derivative investment strategy

As discussed above, the investment will not satisfy the efficient portfolio management or reduction of investment risks tests if it gives rise to a significant increase in the *policy holder's* risk. It is therefore appropriate to consider how the *insurer* might have constructed a broadly similar investment strategy without using derivatives. The *policy holder's* risk can then be compared for the derivative and benchmark non-derivative strategy.

Step 2 – Compare the risks inherent in the two strategies

The task here is to identify instances in which the derivative strategy under-performs the non-derivative strategy. It is quite likely to be the case that sometimes one out-performs, sometimes the other but that neither is clearly 'better' than the other. However, that is irrelevant. The test set out in paragraph 4.6 requires that any underperformance by the

derivative strategy should be either insignificant or not reasonably foreseeable.

In making the comparison of risks, it will usually be appropriate to consider how the strategies would have performed historically. However, it will hardly ever be appropriate to argue that because one strategy would have out-performed another historically, the risks of underperformance in the future can be ignored. As a general rule, historical data may be used to calibrate a statistical model of future performance. But where the future values of model parameters can reasonably be expected to be different from their historical counterparts, suitably cautious assumptions should be made.

Step 3 - Identify any reasons why the comparison is unfair to the derivatives strategy and whether such unfairness is the main reason for comparative under-performance

One popular technique is for derivatives strategies to incorporate a minimum performance guarantee, using some kind of embedded *option*. Such a guarantee cannot be provided free and will therefore give rise to some degree of under-performance. Its effect should in principle be stripped out before making the comparison above.

10.11 Bearing in mind the practical difficulties mentioned above, we would not object to a structured product which provides a precise match to *policy holder* liabilities being deemed to satisfy the 'in connection with' and efficient portfolio management tests provided that:

- (a) the analysis above has been carried out; and
- (b) either:
 - (i) any underperformance by the derivative strategy is either insignificant or not reasonably foreseeable;
 - or:
 - (ii) significant underperformance by the derivative strategy occurs only at levels of total investment return well above the risk-free rate and arises wholly or mainly as a result of the incorporation of a guarantee (or some similar benefit) amongst the benefits provided by the derivative strategy;

10.12 In making a comparison above between the performance of derivative and non-derivative strategies, it is always the total return to the *insurer* (after making appropriate allowance for tax and reasonable investment management expenses) which should be considered. If part or all of the investment risks under either strategy are assumed by the *insurer*, then it is the appropriate product allowance which the *insurer* would make to cover those risks which would be taken into account.

10.13 The above method of analysis relies on an assessment of the significance of underperformance. It is difficult to be very precise about what is significant. But under prevailing investment conditions, we would certainly regard a 20 percentage point underperformance over a 5-year term as significant in circumstances where the total return on the non-derivative strategy is at levels up to the risk-free rate. Under the same conditions, a 5%

underperformance could not reasonably be regarded as significant. Moreover, at very high levels of return, it might be reasonable to deem an underperformance above 20 percentage points to be insignificant.

Example NN

An insurer issues a 5 year stock-market bond linked to FT-SE 100, offering the following return on the initial investment (after deduction of initial charge):

If the index stays constant or falls, the initial investment will be reduced by the percentage fall in the index, except that the maturity value is guaranteed not to be less than 80% of the initial investment.

If the index rises by up to 100%, the initial investment will be increased by the product of the percentage rise in the index and 110%.

If the index rises by more than 100%, the maturity value will be 210% of the initial investment.

The insurer transacts a structured product with an approved counterparty which exactly matches these terms.

Where the index falls or rises by up to 100%, this product clearly satisfies condition (b)(i) of paragraph 10.11. Since a 100% rise over 5 years is significantly in excess of the risk free rate of return, the capping at 210% easily satisfies condition (b)(ii).

10.14 The conditions described in paragraph 10.11 are not intended to be an absolute requirement. Other structures may be admissible (or permitted) provided it can be shown from first principles that they satisfy the various tests.

11. **The effect of derivatives on admissibility of the underlying holdings**

11.1 As explained in **Guidance Note 4.1** on asset valuation, the approach in the *Valuation of Assets Rules* is to limit aggregate *exposure* to certain types of asset for solvency purposes, rather than to limit holdings in those assets. Where a *insurer's* aggregate *exposure* exceeds the prescribed limit, excess assets have to be left out of account. (**Guidance Note 4.1** covers the mechanics of this.) In principle, derivatives may have the effect of increasing or decreasing exposure to underlying assets; their effect must obviously be taken into account in assessing the aggregate *exposure*.

11.2 However, the *Valuation of Assets Rules* provide that it is unnecessary to consider changes in *exposure* resulting from *contracts for differences* based on well-diversified indices (e.g. FTSE futures). It would be most unlikely that such contracts could have a significant effect on underlying *exposure* to particular assets (e.g. to specific equities).

11.3 Rule 4.14 provides that, for the purposes of computing aggregate exposure:

- (A) where a *derivative contract* places an *insurer* under an obligation to buy certain assets, it is deemed to have bought those assets

- (B) where a *derivative contract* places an *insurer* under an obligation to sell certain assets, the sale is deemed to have taken place only if the contract is *listed* or if the sale is due within 12 months to an *approved counterparty*
- (C) where a contract gives the *insurer* an *option* or could oblige it to buy certain assets, it is deemed to have bought them if it is prudent to assume that they will be bought
- (D) where a contract gives the *insurer* an *option* or could oblige it to sell certain assets, it is deemed to have sold them only if the sale is due within 12 months to an *approved counterparty* and if it is prudent to assume that they will be sold
- (E) a *contract for differences* (other than one based on a well-diversified index) or a contract or asset having the effect of a *derivative contract* is treated in the same way as an appropriate combination of *options* or *futures contracts* having equivalent economic effect

11.4

The treatment of *futures contracts* is fairly straightforward. However, the treatment of *options* is more complex. One issue surrounds when it is prudent to assume something for the purposes of cases (C) and (D) above. The point here is that prudence has to be construed in the context of limiting aggregate *exposure*. Where the situation is unclear, it will be more prudent to assume higher *exposure* than lower *exposure*. Therefore for the purposes of Case C, it will generally be prudent to assume that the *option* to buy has been exercised. The only exception would be where the *option* was so far out of the money that it was clear that it would not be exercised. Similarly, for Case D, it will generally be prudent to assume that the *option* to sell would not be exercised. The only exception would be where the *option* was so far in the money that it was very unlikely that it would not be exercised.

Example OO

An insurer transacts a contract for differences with an approved counterparty under which it receives (pays) £1000 for every £1 rise (fall) in the value of ABC shares and also receives (pays) £1000 for every £1 rise (fall) in XYZ shares above the strike levels of:

ABC shares - £2.50
XYZ shares - £3.50

with the rise being determined on the basis of the market price in 6 months time.

Any payment by the insurer will be limited to a maximum reached when the share prices fall to

ABC shares - £2.00
XYZ shares - £3.00

The current share prices are:

ABC shares - £1.75

XYZ shares - £1.00

The analysis gets a little tortuous and can most conveniently be considered by imagining that the *insurer* had transacted two separate *contracts for differences*, one in respect of ABC *shares* and one in respect of XYZ *shares*. These are considered in Examples PP and QQ below.

The conclusion is that the effect of the *contract for differences* is to increase the current aggregate *exposure* of the *insurer* to ABC by £1750; there would be no increase in the *insurer's* aggregate *exposure* to XYZ.

Example PP – Company ABC – see Example OO for details

This contract has the same economic effect as the following combination:

- (a) a *futures contract* to purchase the *shares* (today) at the strike price (£2.50)
- (b) a (purchased) *option* to sell those *shares* at £2.00 per share to an *approved counterparty*
- (c) an agreement to sell the *shares* in 6 months time at the then current price, assuming that the *option* at (b) has not been exercised

Drawing on the considerations in paragraph 11.4, the *insurer* has to take into account the effect of hypothetical contracts (a) and (b) above for the purposes of computing current aggregate *exposure*. However, for the purposes of computing aggregate *exposure*, contract (c) is to be disregarded.

Therefore, under Case A of paragraph 11.3, it is necessary to assume that the shares have been purchased. On the other hand, if the conditions set out in Case D are satisfied, it may be possible to regard them as being subsequently sold. The hypothetical *option* (b) is due for exercise within 12 months with an *approved counterparty*. It therefore satisfies the first leg of the test in Case D. On the other hand, it would not be 'prudent to assume' that the *option* to sell the ABC *shares* would be exercised. The *share* price might easily recover above the exercise price of £2.

The conclusion, therefore, is that the effect of the *contract for differences* is to increase the *insurer's* aggregate *exposure* to ABC *shares* by £1750, the current value of 1000 *shares*.

Example QQ – Company XYZ - see Example OO for details

This contract has the same economic effect as the following combination:

- (a) a *futures contract* to purchase the *shares* (today) at the strike price (£3.50)
- (b) a (purchased) *option* to sell those *shares* at £3.00 per share to an *approved counterparty*
- (c) an agreement to sell the *shares* in 6 months time at the then current price, assuming that the *option* at (b) has not been exercised.

As in Example PP, the *insurer* is deemed to have bought the *shares*. Under normal circumstances, it would seem very unlikely that the market price of XYZ *shares* would exceed the exercise price on maturity of the contract. Therefore it would be 'prudent to assume' that the *option* to sell the XYZ *shares* would be exercised. For the purposes of

Case D, such *shares* would be assumed to be sold. The contract does not give rise to any aggregate *exposure* to XYZ *shares*.

- 11.5 It is not possible, simply to leave an asset out of account. All assets have to be assessed as to their effect on aggregate *exposure*. However, where an *insurer* holds an *option*, it is obviously not possible for it to be worse off than if he simply discarded the *option*!

Example RR

An insurer, with holdings in the equity of ABC company to the extent of 1% of its Business Amount, purchases a call option on the same equity in respect of a holding equivalent to 4% of its Business Amount. The exercise price is close to the current market price of the equity.

Case C of paragraph 11.3 applies. Suppose for a moment that the *option* has to be deemed to have been exercised. Under Case C, the exercise date of the *option* is not relevant. The *insurer* would be deemed to have bought the assets.

The aggregate *exposure* to ABC would therefore be 5%. 2.5% would be inadmissible. The *insurer* must leave out of account not only its 1% holding in ABC but also a further 1.5% of assets which would otherwise be admissible. Although the *option* would have a value, it would be unlikely to exceed the value of assets which would be admissible in the absence of the *option* but which are now to be left out of account on the grounds of excess aggregate exposure to ABC. In other words, the *insurer* holds an asset - which can never turn into a liability - which leaves it worse off than if it did not hold that asset!

Clearly, for the purposes of computing aggregate *exposure*, it cannot be sensible - let alone prudent - to assume that the *option* will be exercised in full. On the other hand, bearing in mind the argument in paragraph 11.4, it would certainly be prudent to assume that *exposure* is increased. The solution is to assume that the *option* is exercised in part, to the extent that the admissibility position is no less favourable than if the *insurer* simply disregarded the *option*. Following this analysis, the aggregate *exposure* in this example would be slightly in excess of 2.5%, the excess being equal to the current value of the entire *option*. The value of the *option* would be cancelled out by the value of the *admissible assets* left out of account.

Example SS

Same as Example RR, except that insurer has written a put option (rather than purchased a call option)

The analysis is more straightforward than Example RR. Again Case C of paragraph 11.3 applies. However, in this case, it is clearly prudent to assume that the *option* will be exercised. The aggregate *exposure* to ABC would be 5%. The *insurer* must leave out of account not only its 1% holding in ABC but also a further 1.5% of assets which would otherwise be admissible.

The effect on admissibility of closing out a derivative contract

- 11.6 While the closing out of a *derivative contract* eliminates the market risk associated with that contract, it does not of itself eliminate the credit risk to the original *counterparty*. In general therefore, closure will cancel the impact of the derivative on aggregate *exposure* to the underlying assets. But the *insurer's* aggregate *exposure* to the original *counterparty* will not be affected by closure.

11.7 Even where a contract is closed out with the original *counterparty*, the credit risk can not necessarily be taken to be eliminated. This will only be achieved if the closing-out transaction is drawn up in such a way as to provide for the legal right of offset between amounts due under the two contracts.

GUIDANCE NOTE 4.4

LINKED CONTRACTS

1. Introduction

- 1.1 The purpose of this guidance is to offer guidance on the interpretation of Chapter 3 Part II dealing with *linked long-term contracts of insurance*. [Deleted]
- 1.2 A linked long-term contract is one under which benefits are determined partly or wholly by reference to the value of specified assets or indices, such benefits being known as linked benefits. A contract offering both linked and non-linked benefits is a *linked contract*. All long-term *class III* (see **Annex 11.1**) contracts are therefore *linked contracts* as are some *class VII* contracts. But these are not the only ones. *Class IV* and *class VI* contracts may each offer linked benefits, as interpreted above, as may certain contracts commonly (but incorrectly) classified as *class I*. (This is discussed further in paragraphs 2.14 to 2.17.) Such contracts are therefore also linked contracts.
- 1.3 Linked benefits may be determined only by reference to the so-called ‘permitted links’, as set out in Part I (assets) and Part II (indices) of **Appendix 3.2**. In addition, the ‘permitted links’ must, where relevant, satisfy the conditions set out in rule 3.7. Frequently, the links are to the assets of an ‘internal linked fund’. However, this guidance is relevant whether or not the assets are maintained in such a fund.
- 1.4 This guidance applies to all *linked contracts*, whatever the *class* of business. However, the bulk of the ‘permitted links’ rules (described in sections 5 and 6 below) do not apply to linked *class VII* business (i.e. pensions fund management business); but the ‘permitted derivatives’ rules described in section 7 apply to all *linked contracts*.
- 1.5 The guidance is not intended to be a complete description of the rules governing *linked contracts*. Rather, it concentrates on those aspects which are relatively new or potentially problematical.
- 1.6 [Deleted]
- 1.7 The *FSA* expects an *insurer’s* systems and controls to pay due regard to this guidance. In particular it will be relevant to the responsibilities of the *appointed actuary* of the *insurer*. Furthermore, if a *insurer* were to choose to act in contravention of the guidance, we would expect it, as a matter of prudent management, to discuss the matter with us beforehand.

2 **Close Matching**

2.1 An *insurer* must hold assets whose value matches their unit liability as closely as possible. The corresponding provisions in Chapter 2 of the *Third Life Directive* were drafted with the intention of prohibiting mismatching of the reserves in respect of linked benefits. This ‘close matching’ test applies both to *property-linked* and *index-linked* (the ‘unit liability’) contracts. It applies to all *linked contracts* irrespective of whether they constitute contracts in the nature of investments.

2.2 As a general rule, where the benefits are linked to the value of certain assets, a *insurer* is not permitted to hold different assets and cover the mismatching risk by means of a reserve. However, in certain circumstances, it is permissible for the *insurer* to hold assets other than any which determine the unit liability provided that they are ‘assets of appropriate safety and marketability’ whose value matches those of the unit liability ‘as nearly as may be’. This arises commonly in the case of *index-linked contracts* and also where the unit liability is partly or wholly reinsured.

2.3 Moreover, the ‘close-matching’ test does not prevent surplus assets being kept within a linked fund (but see paragraph 3.6). Temporary and unplanned small shortfalls of assets which match the unit liability are also permitted provided that a satisfactory mismatching reserve is held.

Reinsurance of the unit liability

2.4 The rules do not explicitly restrict *reinsurance* of the unit liability under *linked contracts*. Nevertheless, certain restrictions flow implicitly from the ‘close matching’ requirement discussed above. The following paragraphs discuss 3 aspects of this requirement - ‘appropriate safety’ (paragraphs 2.5 to 2.10), ‘as nearly as may be’ (paragraph 2.11) and ‘appropriate marketability’ (paragraph 2.12).

‘Appropriate safety’

2.5 The right to receive reimbursement of the unit liability under a *reinsurance* contract cannot automatically be considered to be an asset ‘of appropriate safety’ because of the risk, however small, that the *reinsurer* will default. In particular, The *FSA* would not usually accept that a *reinsurance* contract from a *reinsurer* not supervised by an *EEA State* provided appropriate safety in this context, in the absence of additional guarantees such as the examples in paragraphs 2.6 and 2.7.

Deposit-back

2.6 It is clear that where the direct *insurer* arranges for *deposit-back* of the *reinsurance* premium and the contract is such that it has the legal right to retain the assets in the event of a *reinsurance* default, the required close matching can be achieved.

Reinsurance contract guaranteed by third party

- 2.7 As an alternative to *deposit-back*, the *reinsurer* may secure a third party guarantee from an *approved credit institution* which will enable the direct *insurer* to have recourse to that party in the event of a default by the *reinsurer*. This may satisfy the ‘appropriate safety’ test provided that the credit-worthiness of the guarantor is satisfactory and provided that the terms of the guarantee are such that there is no likelihood that the direct *insurer* would have any difficulty in obtaining reimbursement from the guarantor if it were needed. The *FSA* would not accept that a guarantee from anything other than an *approved credit institution* would provide ‘appropriate safety’.

Reinsurance business regulated in UK

- 2.8 The *FSA* would be prepared to accept that a *reinsurance* contract issued by UK-regulated *reinsurer* usually provides ‘appropriate safety’ for these purposes without any additional safeguards. This is not to say that such a contract can always be regarded as providing appropriate safety. If an *insurer* has good reason to doubt the credit-worthiness of the *reinsurer* in question, such a contract cannot provide appropriate safety without additional safeguards such as those mentioned above.

Reinsurance business established outside the UK

- 2.9 Outside the UK, practices as to the supervision of *reinsurance* vary considerably amongst *EEA States*. In particular, our understanding is that *pure reinsurers* are rarely subject to supervision outside the UK. The fact that the *reinsurer* is supervised (probably by virtue of writing *direct insurance business*) may provide some comfort. But unless it is clear that the financial security of the *reinsurer* is beyond reasonable doubt, we believe that some additional security (such as those mentioned in paragraphs 2.6 and 2.7 above) is necessary in order to satisfy the ‘appropriate safety’ test.

Reinsurance within the group

- 2.10 The *FSA* is not prepared to accept that the fact that the reinsurer is a member of the same group as the *insurer* of itself provides ‘appropriate safety’ in all circumstances. However, many of the common situations have been covered above. Additionally, where the *reinsurer* is a regulated subsidiary of the ceding *insurer*, it may be possible to satisfy the ‘appropriate safety’ test even without additional security.

‘As nearly as maybe’

- 2.11 In order to satisfy this requirement, the terms of the *reinsurance* contract must be such that the direct *insurer* would be able to call for reimbursement under the *reinsurance* contract whenever it was under an obligation to pay

benefits to the *policy holder* (including non-discretionary benefits on early surrender).

‘Appropriate marketability’

2.12 The condition in paragraph 2.11, together with ‘appropriate safety’, is also sufficient to ensure that the marketability is ‘appropriate’ in the particular case of *reinsurance*. However, in other cases it could not be assumed that assets which matched the liability ‘as nearly as may be’ were necessarily of ‘appropriate marketability’. Each case needs to be looked at on its merits.

2.13 *Insurers* should review all their arrangements for *reinsurance* of linked liabilities to determine whether or not they satisfy the ‘close matching’ test. The *FSA* is happy to give guidance on individual cases. If in doubt, it is recommended that the *insurer* discusses the situation with their supervisor, as there is a risk that they will be in breach of 2.3.

Linked contracts not in the nature of investments

2.14 By virtue of the interpretation of a *linked contract* in paragraph 1.2, a contract may be regarded as ‘linked’ even if it is not in the nature of an investment. For example, a *permanent health contract* which provides disability benefits in payment which are guaranteed to rise in line with the RPI would be an (*index*) *linked contract* and the close-matching rule described above would apply to the reserves held in respect of those benefits. The same applies for an RPI-linked pension or annuity in payment. (Indeed, these are *class III* contracts notwithstanding the fact that *insurers* may have traditionally reported such business as *class I*.)

2.15 The ‘close-matching’ rule described above applies to matching of all linked benefits. Therefore, in the examples quoted in the previous paragraph, the *technical provisions* covering, respectively, the RPI-linked PHI benefits in payment and the RPI-linked annuity payments must be closely-matched by appropriate *RPI-linked assets*. While the issue is not entirely free from doubt, The *FSA* considers that the reserves covering any of the following general types of benefit are subject to the close-matching rule:

- all linked benefits under *class III* contracts
- all linked benefits under any other *class* (principally but not exclusively *class VII*) of contract in the nature of an investment
- all linked benefits in payment under any *class* of contract

Under this interpretation, the reserves in respect of other types of linked benefit (for example, RPI-linked term assurance) are not covered by the ‘close matching’ rule. We would nevertheless expect *insurers* to maintain appropriate assets to cover such benefits.

2.16 There is an apparent practical problem in that *insurers* may not monitor on a continuous basis what their liabilities in respect of linked benefits in payment. How do they satisfy the ‘close-matching’ rule in practice? In such cases, we would expect that *insurers* will:

- re-assess their liabilities regularly (once per quarter may be sufficient depending on how quickly the book of business is evolving)
- hold an appropriate portfolio of index-linked instruments which provides a close match against the liabilities, as most recently assessed

2.17 For the avoidance of doubt, it may be helpful to refer here to the *FSA* reporting regime for *linked contracts*. Life assurance and annuity contracts which confer linked benefits (whether or not they also confer non-linked benefits) are correctly classified as *class III* business and should all be so reported in the *FSA returns* (albeit that many *insurers* have traditionally reported RPI-linked insurance and annuities as *class I*). All *permanent health contracts* and capital redemption contracts are however *classes IV* and *VI* respectively, whether or not they are linked. The disclosures specific to *linked contracts* (for example, paragraph 5 of **Appendix 9.4**) should be made for all *linked contracts*, not merely for those in the nature of ‘investments’.

3 The Valuation of Assets Rules

3.1 Where the benefits under a linked policy are determined by reference to the value of specific assets, those (‘property linked’) assets are exempt from the *Valuation of Assets Rules*. The corresponding unit liability does not count towards the *long-term insurance business amount*.

3.2 Where the benefits are determined by reference to an index, the index linked assets are subject to the *Valuation of Assets Rules*. However, index linked assets are only partly subject to the diversification rules imposed by virtue of rule 4.14 and **Appendix 4.2**. The *permitted asset exposure limits* set out in Part II of **Appendix 4.2** do not apply to index linked assets, but the *permitted counterparty exposure limits* do apply.

3.3 The corresponding unit liability counts towards the *long-term business amount*, but only for the purpose of assessing compliance with the *counterparty exposure limits*. There are, therefore, 2 versions of the *long-term business amount*, depending on whether compliance with the *permitted asset exposure limits* or compliance with the *counterparty exposure limits* is being assessed.

3.4 Where an *insurer* holds assets in connection with a *property linked benefit* but in excess of those required to match the unit liability, the excess assets are not property linked assets. They are therefore subject to the *Valuation of Assets Rules* for the purposes of assessing solvency (but not for assessing the amount of the unit liabilities). Similarly, excess holdings of assets over

index-linked liabilities lose their exemption from the majority of **Appendix 4.2**.

- 3.5 Material excesses (such as where an *insurer* holds its otherwise non-linked equity portfolio as excess assets in its equity-linked fund) would need to be revalued in accordance with the *Valuation of Asset Rules*. (The revaluation is on the proportionate holdings the excess represents and can be performed on an approximate basis if the linked fund is broadly invested.) A material excess is one which satisfies either of the following tests:
- (i) the value of the assets of the fund materially exceeds the unit liability of that fund; or
 - (ii) the total excess is material in the context of the *long-term business amount*
- 3.6 Notwithstanding the comments above, an *insurer* will commonly hold *linked assets* whose value exceeds the amount of the unit liability. Where a fund has current liabilities, other than to *policy holders*, the unit liability will be determined by the value of the *linked assets*, net of the current liabilities. The difference here is that the *insurer* needs the additional assets in order to match the unit liability. They are not ‘excess’ assets. Circumstances where this arises include the following:
- (a) *Debts* are due to brokers in respect of *linked assets* which have been purchased but where settlement has not yet taken place.
 - (b) The main *linked asset* is a derivative structure which has been collateralised by means of a loan which is re-invested by the *insurer* in money market instruments. In such a case, the money market instruments might or might not be *linked assets*, depending on how the contract with the *policy holder* had been constructed.
- 3.7 Where the *insurer* holds assets whose value mirrors that of a permitted index, it may not be immediately clear whether the assets are to be treated as property linked or index linked for the purposes of applying the rules. This is a point of some significance since the *Valuation of Assets Rules* apply in the second case, but not in the first.
- 3.8 There is a simple rule for determining this question. If the *insurer* bears the whole risk of *counterparty* default (so that *policy holder* benefits are wholly, determined by the performance of the index) then the assets are index linked. If, however, the contract is such that the benefits would be reduced (from those which would be calculated by reference to the index) to reflect part or all of the reduction in the value of the *linked assets* resulting from any *counterparty* default, then the assets are property linked.
- 3.9 The *insurer* may have more assets than are necessary to cover the *linked benefits* (for example, excess assets in an *internal linked fund*). As noted in

paragraph 3.6, there is an 'excess' only where the total assets net of current liabilities (for example, borrowing by an internal fund, *debts* due to brokers) exceeds the unit liability to *policy holders*.

4 **The required solvency margin**

4.1 If the *insurer* bears any type of investment risk, the *required solvency margin* is covered by rule 2.6(2). If it bears no investment risk, the appropriate rules are 2.6(3) and 2.6(4). Instances of an investment risk which the *insurer* may bear include:

- (a) the risk that a *counterparty* to a *derivative contract* may default on its obligations, or
- (b) the risk that a *reinsurer* may default on its obligations to *reinsure* the unit liability.

4.2 Where there is an investment risk, rule 2.6(2) applies only to that part of the linked liabilities which give rise to the investment risk. For example, where part of the linked liabilities is reinsured and an investment risk thereby arises, the 4% solvency margin applies only to the *reinsured* part of the liabilities.

4.3 As noted in section 3, the *insurer* always bears an investment risk in the case of *index linked contracts* (even if only a *counterparty* risk). In the case of *property linked contracts*, the *insurer* may or may not bear an investment risk, depending on the construction of the contract and the nature of any *reinsurance* arrangements.

4.4 The term 'bears an investment risk' is not defined in the rules. The point is of practical significance when considering whether an investment risk can arise for the *insurer* as a result of reinsuring the linked liability or from a stock-lending agreement.

4.5 As regards *reinsurance*, the *FSA* accepts that the techniques for satisfying close-matching set out in section 2 would also go a long way towards ensuring that no investment risk arises for the purposes of rule 2.6. In particular, barring special circumstances, the *FSA* accepts that the *insurer's* investment risk could be disregarded in the following circumstances.

- (a) *deposit-back* or guarantee by *approved credit institution*, as discussed in paragraphs 2.6 and 2.7; or
- (b) - *reinsurer* regulated in *EEA State*;
- no reason to suspect the security of the *reinsurer*;
- precise matching between unit liability and liabilities under the *reinsurance* contract; and

- the *reinsurer* itself holds assets which pass the close-matching test in respect of its liabilities under the relevant contract.

For the avoidance of doubt, the *FSA* regards the above conditions as sufficient conditions, rather than necessary conditions. Other sets of conditions may also be sufficient in particular circumstances.

- 4.6 The *FSA* considers that where stock-lending satisfies the close-matching requirements, as discussed in paragraphs 8.5 to 8.11 below, the *insurer's* investment risk can be disregarded for solvency purposes. Nevertheless, there can clearly be rare circumstances where the *counterparty's* likelihood of honouring a stock-lending agreement is called into question sometime after the agreement comes into effect, even though the 'appropriate safety' test had been satisfied originally. In such a case, the 4% solvency margin would apply.

5 **Property to which benefits may be linked**

- 5.1 This section describes the list of permitted links.

Transferable securities (other than derivatives) paragraphs 1&2 of Appendix 3.2

- 5.2 *Securities* are categorised as to whether they are:

- *listed* or *unlisted*; and
- *readily realisable* or not,

in both cases, as defined for the purposes of the *Valuation of Assets Rules*.

- 5.3 *Securities* which are *listed* and *readily realisable* may be held in a linked fund without limit. Those which are *unlisted* may be held up to the limit of 10% of the unit liability of the fund, provided that they are *readily realisable*. **Guidance Note 4.1** on the *Valuation of Assets Rules* gives more detail on how the *listed* and *readily realisable* criteria are to be interpreted.

- 5.4 In practice, the *FSA* may make a section 148 waiver allowing the use of *securities* which are not *readily realisable*, particularly within the context of a *collective investment fund* investing in such assets (see paragraph 5.6 below), provided that the *insurer* is able to satisfy us:

- that the liquidity of the linked fund investing in such assets will be satisfactory; and
- that there is some reasonable basis for pricing units, given that such investments are not *readily realisable*.

Collective investment funds - paragraph 5 of Appendix 3.2

5.5 A wide category of *collective investment fund* may qualify as permitted links. The term is not explicitly defined although it goes wider than *collective investment schemes*. The rules cover 2 categories of fund:

- schemes (whether in the form of unit trusts or open-ended investment company) which meet the requirements to be a *UCITS* (irrespective of whether they have applied for and been granted the ‘single passport’), as set out in the *UCITS Directive*: and
- other *collective investment funds* which satisfy certain additional requirements.

5.6 The additional requirements to be satisfied by non-*UCITS* funds are:

- they invest in assets all of which are themselves permitted links;
- the holdings may be readily sold to or purchased from the managers at a price which represents net *asset* value;
- the sale or purchase price is published regularly; and
- the *linked contracts* have been marketed in accordance with any restrictions which apply to the marketing of the *collective investment funds* unless such funds represent less than 10% of the unit liability under the *linked contracts*.

Funds which are listed but not permitted (or recognised) under the Financial Services and Markets Act

5.7 All authorised or recognised unit trusts fall under one or other of the criteria of paragraph 5.5 above. However, the criteria of paragraph 5.6 go wider than that and include *collective investment schemes* which are regulated offshore but which are not ‘recognised unit trusts’. Some of those schemes originally qualified as permitted links by virtue of being listed on an EC stock exchange. However, they are very unlikely to meet the definition of *readily realisable* even if *listed*. Therefore such schemes need to qualify under the criteria of paragraph 5.5 to retain their status as permitted links (without limit). (They may of course be eligible to be treated as *listed securities*, not *readily realisable*. In this case, they would be permitted links, subject to the 10% limit described in paragraph 5.3.)

Linked funds of another insurer

5.8 The *FSA* believe that a linked fund of another *insurer* would usually qualify under paragraph 5(b) of **Appendix 3.2**. This is of practical significance since a number of *insurers* offer ‘self-invested’ plans where the *policy holder* makes his own investment arrangements. Some may wish to expose

themselves to the investment performance of an *insurer* other than the plan provider.

- 5.9 However, there is a potential problem in this area. Except where the contract between *policy holder* and first *insurer* is a *class VII* managed pension contract, the *FSA*'s considers that the second *insurer* would be in breach of rule 1.3 if it accepted such funds for investment; such activity is neither *insurance business* nor an activity directly arising from that business. (This issue does not however arise if the first *insurer* reinsures the investment liability to the second *insurer* under a *contract of insurance*.)

Debts - paragraph 7 of Appendix 3.2

- 5.10 Not all *debts* are permitted links. Nevertheless, loans to investment firms may be assets of a linked fund.

Derivatives and quasi-derivatives – Rule 3.7

- 5.11 *Derivative contracts* may be used in linked funds, subject to the special considerations described later in section 7. Contracts or assets which have the effect of a *derivative contract* may be used only if the corresponding (hypothetical) *derivative contract* would be a permitted link. Guidance on the types of contract which are considered to have the effect of a *derivative contract* is given in **Guidance Note 4.2** dealing with derivatives.

Broker funds - paragraph 11 of Appendix 3.2

- 5.12 *Collective investment funds* managed by *intermediaries* and accessible only through the medium of a linked life policy ('broker funds') are unlikely to satisfy the requirements described in paragraph 5.5. Nevertheless, these can still be permitted links by virtue of paragraph 11 of **Appendix 3.2** which sets a condition that the *insurer* must accept responsibility for errors and omissions of the *intermediary* towards the *policy holder*. The 'look-through' requirement described in paragraph 5.13 has now been applied to these funds.

Look-through – Rule 3.7

- 5.13 A look-through rule applies to *securities* (other than those which are *listed* and *readily realisable*), to *collective investment funds* (including broker funds) and to *debts* due from *approved credit institutions* and *investment firm* to determine whether the link is permissible. However, *collective investment funds* 'falling within the *UCITS Directive*' are exempt from look-through.

Bank accounts with returns linked to an external reference value

- 5.14 It is not permitted to link to an account at a bank, for example whose balance varied by reference to the value of assets which were not themselves permitted links.

Collective investment funds investing in non-permitted link.

- 5.15 Similarly, it is illegal to link to *collective investment funds* (other than *UCITS*) which invest in property which would not itself be a permitted link. One such example would be where a unit trust (other than a *UCITS*) invested directly in gold or other commodities.

Funds ‘falling within the UCITS Directive’

- 5.16 The *FSA* take the view that this phrase (which occurs in paragraph 5(a) of **Appendix 3.2** and which determines whether or not look-through is necessary) refers to those schemes which fulfil the minimum requirements set out in that Directive to receive the ‘single passport’, whether or not they have applied for that status. The *FSA* takes the view that all UK-authorized funds classified as *securities* funds ‘fall within’ the Directive and all others fall outside.

Futures and Options Funds (FOFs)

- 5.17 FOFs are subject to the look-through requirement. A particular issue concerns the use of derivatives within a FOF. Provided this is consistent with the interpretation of efficient portfolio management or reduction of investment risks set out in **Guidance Note 4.2** (and satisfies all the other conditions which apply to *permitted derivative contracts*), this would not prevent a FOF from being a permitted link. Geared futures and *options* funds (GFOFs) seem very unlikely in practice to satisfy those conditions and therefore to be a permitted link.

Transitional provisions in respect of linked contracts issued before July 1994

- 5.18 In the limited number of cases where the *1994 Regulations* forbid linkage to an *asset* or an index which was a permitted link under the *1981 Regulations*, that linkage may nevertheless continue in respect of contracts entered into before 1 July 1994 or in pursuance of a contract subsisting at 1 July 1994.

6 Permitted indices for linked contracts

- 6.1 There is no approval of any specific stock market indices; the rules set out criteria which an index must satisfy in order to be a permitted link.
- 6.2 Equity indices on the basis of which index *options* or futures are traded on a regulated market qualify by virtue of sub-paragraph (c) of the definition of *approved index* in rule 11.1. The main indices of other significant stock markets will satisfy the conditions of sub-paragraph (a). While linkage to a matched basket of equities can give a roughly comparable effect to linkage to other indices which do not satisfy the above-mentioned criteria, it would be a

breach of the permitted links rules to determine benefits by reference to such an index itself, rather than by reference to the actual equities.

- 6.3 The UK Retail Prices Index and analogous indices in other Zone A states are permitted indices. The correct classification of RPI-linked investment contracts, such as annuities, is *class III* rather than *class I*, notwithstanding the traditional view that they belonged in *class I*. (Naturally, such contracts are also required to be reported as *linked contracts* in the *FSA returns*.)

7. **Special consideration regarding the use of derivatives (and quasi-derivatives) in linked funds**

- 7.1 Derivative instruments are permitted links only if they satisfy each of the seven conditions set out below:

- (a) are listed or transacted with an *approved counterparty*
- (b) are capable of being readily closed out
- (c) are for the purposes of reduction of investment risks or efficient portfolio management
- (d) satisfy the ‘in connection with’ test
- (e) are based on underlying assets which are themselves permitted links
- (f) are covered
- (g) satisfy the prescribed pricing basis.

- 7.2 The conditions are very similar to those which determine whether or not a derivative in a non-linked fund is an *admissible asset*. Guidance can be found in **Guidance Note 4.2**. There is however one significant difference between the use of derivatives in linked and non-linked funds. Use in a linked fund of a derivative which did not satisfy the conditions in paragraph 7.1 above would be a breach of rule 3.7.

Margining and collateralisation

- 7.3 We encourage *insurers* to margin or collateralise their *derivative contracts* wherever appropriate as a means of reducing credit *exposure* of the fund to the *insurer’s counterparty*. (Indeed, in some cases this may be a necessary pre-requisite for a contract to count as reduction of risks or efficient portfolio management.) However, margining cannot under any circumstances legitimise the use of a contract which is not a *permitted derivative contract* and whose use in linked funds is, therefore, a breach of the rules.

- 7.4 The use of *derivative contracts* in linked funds, falling within the category of *permitted derivative contracts*, is a permitted link. However, the use of

margined *derivative contracts* in linked fund. is not permitted, unless such contracts are *permitted derivative contracts*.

Warrants

7.5 *Warrants* are *options* and, as such, are covered by the general rules on derivatives described above. However, some fund managers have habitually used *warrants* to a fairly limited extent, without necessarily having sufficient cash in the fund to exercise the *warrant*. They have asked whether this practice may continue.

7.6 On the assumption that the terms of the *warrant* can never place the holder under an obligation to exercise, the cover requirement does not apply. However all the remaining conditions mentioned in paragraph 7.1 need to be considered. In particular, excessive use of *warrants* to gear the fund would fail the 'efficient portfolio management' test. We do not propose to lay down hard and fast rules. But a small single-figure percentage of the net assets of the fund invested in *warrants* which were in the money or not too far out of it seem most unlikely to raise any concerns about breach of that test. Even *warrants* which were a long way 'out of the money' could satisfy this test if issued free.

Quasi-derivatives

7.7 A further condition is imposed on permitted links in respect of instruments which have the equivalent effect to *derivative contracts*. Such instruments, of whatever legal form, may now be permitted links only if the effect is equivalent to that of a *permitted derivative contract*. Thus, for example, an instrument which had the effect of a highly geared *derivative contract*, whose use was not consistent with efficient portfolio management, could not be a permitted link even if it took some other legal form - say, that of a *listed security*.

7.8 Some *securities* (for example equity *shares* in gold mining companies) have a rather similar effect to *derivative contracts*. The question has arisen whether such *shares* 'have the effect of' a gold future; the trading price of the *shares* will be fairly highly correlated with the price of gold. It is clear, however, that these *shares* do not satisfy the criteria in the rules for 'assets which have the effect of a *derivative contract*'. This is the right result. Their effect may be similar to that of a derivative. But it is not equivalent since the *share* price would also be expected to depend significantly on factors internal to the company.

8 Special considerations regarding the use of stock-lending and repo agreements in linked funds

8.1 Neither stock loans nor REPO transactions are explicit permitted links. It is therefore appropriate to consider how such instruments may be used in linked

funds and what issues arise. The first point to consider is what are the permitted links. The following analysis assumes that:

- At time 1, the assets of the linked funds are listed *securities*.
- At time 2, the *securities* have been sold pursuant to a REPO agreement. As part of that agreement, a forward contract has been transacted with the same *counterparty* for repurchase of the *securities*. A commission has been negotiated to be paid by the *counterparty*.
- At time 3, the *securities* have been repurchased and the linked fund has also benefited from the commission.

In reality, there would of course be other assets in the linked fund.

8.2 There are two variants, described in below. For either variant, a very similar analysis can be carried out to deal with other analogous transactions. such as:

- traditional stock-lending agreement where collateral (e.g. letter of credit, CREST DBV, charge over assets) is offered rather than cash to effect the outward transaction; or
- agreement where the commission is accounted for by way of adjustment to the purchase or repurchase price and not paid separately.

The Two variants

Variant A: Fund follows the fortunes of the REPO

Time period	Link	Close match
1	<i>Securities</i>	Perfect match
2	Cash + bought future + accrued income	Perfect match
3	<i>Securities</i> and income	Perfect match

Variant B: Link always to 'permanent' assets of the fund

Time period	Link	Close match
1	<i>Securities</i>	Perfect match
2	Cash + bought future + accrued income	Perfect match

3	<i>Securities + income</i>	Perfect match

Analysis of Variant A: Fund ‘follows the fortunes’ of the REPO or stock loan

- 8.3 Variant A implies that the investment risk (of loss on the REPO) is borne by the fund. It is permissible only if the undertaking of REPO transactions is consistent with the policy conditions and with the stated investment philosophy of the fund; and if the forward (for repurchase) constitutes a *permitted derivative contract*. The *FSA* believes that the conditions necessary to justify the latter status are likely to be satisfied in practice although it is the responsibility of the *insurer* either to lay down appropriate general conditions which provide the necessary justification or else to verify on a case by case basis.

Analysis of Variant B: Link always to ‘permanent’ assets of the fund

- 8.4 Variant B implies that the investment risk of the transaction is borne, partly or wholly, outside the linked fund. Since, during period 2, the *insurer* no longer holds the assets to which the *policy holders'* benefits are linked, the question arises of whether the ‘close-matching’ test discussed in section 2 is satisfied.
- 8.5 We do not believe that it is likely to be difficult to justify satisfying the close-matching test for traditional forms of stock-lending (or similar REPO), provided that accepted best practices are followed. Under the standard types of stock-lending agreement, the loans are made to institutions which are regulated by the *FSA*. Moreover, they are fully collateralised either by *securities* which are not unduly volatile (relative to movements in the value of *securities* being lent), or by a guarantee from an *approved credit institution*. Further, they are returnable at very short notice. Provided that stock-lending meets these conditions, we believe that the assets held by the *insurer* are capable of satisfying the ‘close-matching’ test. Where loans are made to institutions not subject to regulation by the *FSA*, *insurers* should satisfy themselves that the arrangements provide equivalent safety in all respects to that inherent in stock-lending to *regulated institutions*.
- 8.6 However, collateral whose value may diverge sharply from the value of the stock lent (e.g. a package of volatile equities as collateral for gilts), as a result of normal market fluctuations during the lifetime of the loan, should not be accepted. Some divergence in value between stock lent and collateral is to be expected. Regular (e.g. daily) adjustment of the collateral in line with market movements will of course mitigate this problem considerably. Moreover, collateral should be *readily realisable*. Otherwise, the assets covering the liability (that is, the promise to repay under the stock-lending agreement) cannot be considered to be ‘assets of appropriate safety and marketability’.

- 8.7 As a general rule, collateral should be diversified, using the test at rule 4.4(4)(b)(ii) ('not more than 15% exposure of the collateral to any one issuer or group') as a benchmark. The diversification test may be performed on the aggregate of collateral received by the fund, rather than separately for each deal. It must in principle be performed separately for each fund (although a *insurer* might reasonably choose to pro-rate its collateral across a number of funds).
- 8.8 In the UK, the gilt REPO market is fairly new. REPO arrangements for other *securities* may also in due course be commonly used in parallel with stock-lending. In principle, the rules on *linked contracts* should provide a level playing field for stock-lending and REPO arrangements. The considerations outlined in the previous four paragraphs for stock-lending should apply to REPO also. However, a few points are worth highlighting.

Fixed period stock-lending and REPO

- 8.9 We understand that fixed term asset exchanges are likely to be more common in the REPO market than the 'return on demand' arrangements which are usual in current stock-lending agreements. Assets which have been REPO'd to another party for a matter of weeks or months can, in isolation, hardly be considered to be 'of appropriate marketability' (from the point of view of the linked fund) during that period.
- 8.10 It is legitimate to take a view on marketability in the context of the total investments of that type. For example, a fixed interest fund which REPO'd 5% of its medium term gilts for a fixed period of 3 months but had no other REPO or stock-lending arrangements in place might reasonably be regarded as containing 'appropriately marketable' *securities*; while this could not be said if the corresponding percentage were 25%. Each case will need to be considered on its merits. But the general principle is that fixed period REPO or stock-lending arrangements of more than a few days needs special justification.

Covered transactions

- 8.11 Another point which stands out to a greater extent for REPO than for stock-lending (although the principle applies equally) is that the transaction must be covered (at least to the extent prescribed in rule 4.4 in respect of transactions covered by the *Valuation of Assets Rules*) at all times. Otherwise, the assets of the fund fail the 'as nearly as may be' and 'appropriate safety' tests. The considerations are very much the same as those for covered derivatives transactions, discussed in **Guidance Note 4.2**. Clearly, a *insurer* which receives cash in exchange for a gilt REPO is permitted to invest that cash. But it may only make investments which are guaranteed (barring unforeseeable circumstances) to deliver approximately enough cash to repurchase the gilts in accordance with the REPO agreement. Deposits at credit institutions or short-term fixed interest securities issued by

organisations of good credit standing seem easily the most likely investments to satisfy the 'as nearly as may be' and 'appropriate safety' tests in these particular circumstances.

Stock-lending/REPO and policy holders' reasonable expectations

- 8.12 For either variant, it is of course necessary to ensure that *policy holders'* reasonable expectations must be satisfied. The extent to which the long-term fund or the linked *policy holders* bear the investment risk of a *counterparty* default must be transparent. (Admittedly, this risk should usually be a very limited one in the case of stock-lending or REPO transactions which comply with the guidance above.) Where the linked *policy holders* bear the whole of the investment risk (assuming this to be consistent with the investment philosophy of the fund), they should receive the whole of the recompense (net of appropriate fees and expenses). Even where the whole of the risk of *counterparty* default is being borne outside the fund, it is appropriate for the linked fund to receive a significant portion of the net recompense. This is because the *linked assets* have been earmarked for the benefit of the linked *policy holders*, albeit that they are not legally ring-fenced; fairness demands that the linked *policy holders* receive a reasonable share of any profits deriving from their use. Finally, under no circumstances could any part of the profits (as opposed to payment of fees or reimbursement of expenses) from stock-lending or REPO transactions on long-term assets be credited outside the *insurer's* long-term fund. In the *FSA's* view, this would represent a clear breach of rule 3.2.

9 Diversification of assets

Explicit diversification requirements

- 9.1 As a general rule, there is no requirement for diversification of assets in linked funds. There are some explicit exceptions, however. *Securities* which are unlisted may not account in aggregate for more than 10% of the *linked benefits* under a contract. A similar percentage limit applies to holdings in *collective investment schemes* other than:

- those qualified to be *UCITS*; or
- those which have been marketed to the *policy holder* in accordance with the marketing rules which apply to the *collective investment schemes* in question.

Implicit diversification requirements derived from marketing material

- 9.2 There are also some important implicit requirements for diversification, derived from the wording of the marketing material used. In assessing any possible breach of *policy holders'* reasonable expectations in this area, the *FSA* would of course pay attention to the letter of the wording. But it would equally pay due regard to its sense.

9.3 For example, a *insurer* offers a *linked contract* which is designed to deliver income of 7% per annum net. Inspection of the marketing material reveals the following statement, which is given reasonable prominence:

‘The fund will be invested in assets offered by major financial institutions. In the unlikely event that one of these institutions defaults on its obligations, you may receive less than promised above.’

9.4 We consider that such wording, in particular the use of the phrase ‘major financial institutions’ conveys an expectation of a reasonable level of diversification. One *counterparty* would be completely unacceptable in this case. It would be even less acceptable if that *counterparty* turned out to be a *connected company* of the *insurer*, however major a financial institution that *connected company* happened to be.

Counterparty exposure and derivatives

9.5 There may also be an implicit requirement for diversification of *counterparty exposure* arising from the use of derivatives, in particular where derivatives are used to provide a precise match to the *promised policy holder* benefits. The situation is not entirely straightforward as not all *linked contracts* which use derivatives to provide precise matching need the *counterparty* risk to be diversified (although this may still be a sensible course in some cases, even if not absolutely required by the rules). To distinguish between the cases, it is necessary to go back to the first principles governing use of derivatives in linked funds set out in **Guidance Note 4.2**.

9.6 As set out in paragraph 7.1 above derivatives may be permitted links only if they satisfy a number of conditions, including the rule that they must be used only for the purposes of reduction of investment risks or efficient portfolio management. According to that interpretation, if the use of derivatives brings with it any significant additional risk, such use is incompatible with ‘reduction of risks’ or ‘efficient portfolio management’, even if other risks are reduced.

9.7 A significant risk is one where there is a reasonably foreseeable risk of significant loss, either to the *insurer* or to the *policy holder*. It follows from this that:

- where a *insurer* uses derivatives to match benefits under *index linked contracts*, *counterparty* risk diversification is necessary only to ensure that the matching derivatives are fully admissible and to ensure that the *insurer’s* solvency position is not significantly affected.
- where a concentration of *counterparty* risk is inherent in (or usual for) the type of contract in question and use of derivatives gives rise to

essentially the same *counterparty* risk, *counterparty* risk diversification is not required.

- 9.8 Where there is significant *counterparty* exposure, an assessment must be carried out of whether or not it is the use of derivatives which gives rise to such *exposure*. For a *property linked contract*, ‘significance’ is to be viewed in the context of the size of the linked fund (i.e. the effect of a *counterparty* failure on the *policy holder* benefits). The threshold of significance will vary according to the nature of the contract.
- 9.9 A fund where the benefits are linked to the performance of the FTSE index would not (if invested in the equities themselves) have built up *counterparty exposures* beyond a few per cent of the value of the fund, determined by the market capitalisation of the biggest companies contributing to the index. Where derivatives are used to replicate the index, *counterparty exposure* of a similar size (say 5% of the value of the fund) would therefore be regarded as significant.
- 9.10 At the other extreme, a *insurer* might offer a ‘ABC Bank fixed interest plus’ fund, offering (assuming that ABC Bank meets its obligations in full) something close to the market rate for fixed interest contracts, together with, small participation in the upside of equity markets. Such a contract would probably rely on use of derivatives. In substance, the benefits are very close to an ‘ABC Bank fixed interest fund’ which would, of course, be a perfectly acceptable property linked fund, even without any diversification of *counterparty exposure*, if properly explained to prospective *policy holders*. In the case of such a ‘fixed interest plus’ fund, therefore, although there is concentration of *counterparty risk exposure*, it is reasonable to conclude the use of derivatives is incidental to this concentration.
- 9.11 The following assessment procedure appears to be a practical one for assessing whether the derivatives have given rise to significant *counterparty* risk:
- First, consider how the benefits could be provided if derivatives were not used and what would be the resulting *counterparty exposure*.
 - In cases where the precise benefit structure can be achieved only with derivatives, consider the *counterparty exposure* (in the absence of derivatives) under broadly equivalent benefit structures provided without use of derivatives. (Such a broadly equivalent structure must exist or else there is no real prospect of satisfying the ‘efficient portfolio management’ or ‘reduction of risks’ tests.)
 - Finally, compare the *counterparty exposure* in the ‘with derivatives’ and ‘without derivatives’ cases. It will be apparent whether use of derivatives has given rise to significant additional *counterparty exposure* or whether such exposure would exist without derivatives:

9.12 Examples of contracts where the use of derivatives does - or does not - give rise to significant *counterparty* risk are at paragraphs 9.9 and 9.10 above. In practice, structures intermediate between these two extremes are common; some of the *counterparty* risk concentration may be inherent in the benefit structure while use of derivatives gives rise to additional concentration of risk. While it would be theoretically possible to attempt to apportion the risk between these two causes, we do not recommend this as a practical procedure. Nor would we welcome the opportunity of giving an opinion on particular cases. In such cases, the *FSA* suggests that the *insurer* takes the view that the whole of the *counterparty* risk needs to be diversified.

9.13 Although the above paragraph recommends erring on the side of *counterparty* risk diversification, this still does not mean that risk diversification is necessary for all contracts which use derivatives for precise matching. We suggest the following rule of thumb. A contract may be considered to be a 'fixed interest contract' if the benefits approximate to the benefits which would be receivable if the fund invested in appropriate fixed interest *securities*. 'Fixed interest contracts' which use derivatives will therefore not require *counterparty exposure* reduction techniques under the 'derivatives rules' - although such techniques may be necessary for other reasons, for example to reflect what the *policy holder* has been told, or not told, about the nature of the risks.

9.14 In the absence of special justification, contracts

- which use derivatives; and
- where (in the absence of *counterparty exposure* reduction techniques) it is reasonably foreseeable that the return will be less than that of 'fixed interest contracts'

will require such techniques. In this context:

- 'approximate to' means that the gross redemption yield will not be more than 1 percentage point less, as far as can reasonably be foreseen, than the rate for a fund which invests in appropriate fixed interest *securities*
- 'benefits receivable' need only be considered at maturity date for a fixed period bond but need to be considered on any day where switches are permitted from the respective linked fund to another fund
- 'appropriate fixed interest securities' would be *securities* issued by sovereign or supra-national issuer, denominated in the appropriate currency and of similar term to the length of the contract.

Management of risk concentrations

- 9.15 Where derivatives naturally give rise to a *counterparty exposure* which is significant (in the above terms), this must be managed appropriately to allow the 'efficient portfolio management' test to be satisfied. There are various techniques for this, including margining and collateralisation. However, these techniques are effective for these purposes only if they achieve:
- substantial risk diversification; or
 - transfer of *counterparty* risk from the original *counterparty* to a 'risk free' sovereign or supranational issuer (e.g. collateralisation by UK gilts).
- 9.16 In this context, 'substantial risk diversification' means that the additional *counterparty* risk arising from use of derivatives must be reduced as far as practicable. Residual *counterparty exposure*, after risk diversification, to the extent of 20% of the value of the fund could be acceptable but:
- only just acceptable; and
 - acceptable only if it would be unduly onerous to reduce it further.
- 9.17 It would be reasonable to take into account the size of the fund in assessing whether or not a further reduction in maximum *counterparty exposure* was unduly onerous; but a small fund is not entitled to ignore the 20% limit on the grounds that its small size means that diversification poses severe practical problems.
- 9.18 For example, consider a contract where derivatives are used to give a precise match to the benefits promised, and
- where the contract was not a 'fixed interest contract', in the terms mentioned in paragraph 9.14 above;
 - where use of derivatives unarguably gives rise to significant *counterparty* risk concentration: and
 - where, on reasonable assumptions, the maximum single *counterparty exposure* was expected to be between 40% and 60% of the net value of the fund and other *counterparty exposures* would be insignificant.

As noted in paragraph 9.12 above, the *FSA* would not encourage *insurers* to attempt to attribute the single *counterparty exposure* between 'caused by derivatives' and 'not caused by derivatives'. Further, the *FSA* believes that it will not usually be unduly onerous to arrange for margining and spread the margined amounts amongst *securities* issued by 4 or 5 different issuers. That should mean that the maximum *counterparty* concentration arising from derivatives would not be expected to exceed 12% of the value of the fund.

Fallacies

- 9.19 It has been argued that the ‘efficient portfolio management’ test is automatically satisfied if the *policy holder* has been told that there will be significant *counterparty exposure* as a result of the use of derivatives. This is fallacious. The test is an independent one and therefore does not depend on what the *policy holder* has or has not been told. (By analogy, the fact that a *policy holder* may have been told that his benefits will be linked to the price of gold does not make gold a permitted link)
- 9.20 It has also been argued that there would normally be 100% exposure to a particular *counterparty* in the case of a property linked deposit fund; and that therefore 100% exposure to a banking group in the case of a property linked fund which uses derivative structures to give equity-like performance is equally acceptable. This is also fallacious. Derivatives are required to satisfy the above-mentioned tests. The requirements derive from the *Third Life Directive* and cannot be waived.
- 9.21 Further, it has been argued that where the *counterparty* has a high credit rating, there is no need to consider the *counterparty* risk. Again, this is a fallacy. The mathematical expectation of loss is not the key determinant of ‘risk’ to be taken into account here. Even though a highly-rated *counterparty* is most unlikely to fail, if the linked fund is substantially or completely exposed to that *counterparty*, the effect on *policy holder* benefits will be catastrophic. While it would be perfectly reasonable to use credit rating to decide which *counterparties* to deal with and for the purpose of setting maximum *exposure* limits, it is not reasonable to disregard the risk completely. A sensible spread of *exposure* amongst *counterparties* of acceptably high rating will strike a reasonable balance between the competing objectives of maintaining *counterparty* quality and keeping the consequences of a single catastrophic failure within acceptable bounds.
- 9.22 There are two other points worth mentioning. First, *counterparty exposure* reduction does not necessarily mean ‘removal’. It is acceptable to have some *counterparty exposure* to the derivatives *counterparty*. Second, *counterparty exposure* reduction does not mean ‘transfer’. Arranging for margin (or collateral), only to invest it wholly in the *securities* of one particular issuer no more achieves efficient portfolio management or reduction of investment risks than leaving the contract unmargined.

Counterparty exposure arising from use of derivatives in asset management

- 9.23 High concentrations of *counterparty exposure* do not usually arise from the traditional use of derivatives in *asset* management, for example:
- to effect an immediate switch of *exposure* from one asset *class* to another: or

- to hedge a position with an exchange traded *option*.

Even if a major portion of the fund's assets is being switched or hedged, the transaction is normally fairly short-term in nature which limits the scope for large *exposures* to build up. However, the principle is the same as that discussed above. A significant *exposure*, interpreted as in paragraph 9.16 above, would be inconsistent with efficient portfolio management

Counterparty exposure in property linked contracts and the ‘reduction of risks’ test

9.24 The *FSA* considers that significant *counterparty exposure* was inconsistent with the ‘permitted links rules’ where derivatives are being used for efficient portfolio management of equity-type assets. However, where a derivative is genuinely being used to reduce risks, a significant *counterparty exposure* could easily arise if the adverse event insured against actually comes to pass. Although this *counterparty* risk would not exist but for the use of derivatives, the fund will be no worse off than if the derivative had not been transacted. In such cases, there is no absolute requirement to diversify the *counterparty* risk in advance. However, we would consider that some diversification mechanism (such as margining) is a normal prudent practice. And to the extent that the derivative underpins some *non-linked benefit* offered under the contract (such as a guarantee of investment performance), it would be essential.

9.25 While it is sometimes not very clear whether a contract is for the purposes of efficient portfolio management or reduction of risks, the *FSA* is clear that use of derivatives which introduces new risks does not fall into either category. Thus, for example, an asset structure which provides:

- performance in line with FT-SE 100, apart from
- a floor on performance if FT-SE falls, and
- concentrated *exposure* to the derivatives *counterparty*

is not justifiable under these headings, except as a small component of a diversified fund. Although market risk is being reduced, this does not provide justification for the significant increase in *counterparty* risk (compared with ‘traditional’ investment in a basket of equities) to be overlooked.

Counterparty exposure and index-linked or non-linked contracts

9.26 The remarks in the preceding paragraphs apply mainly to *counterparty exposure* in the context of property linked funds. Where a ‘guaranteed’ or similar product is arranged as an *index-linked* or *non-linked contract*, the significance of any *counterparty exposure* has to be viewed in the context of the totality of the *non-linked assets*. An *insurer* should, as a matter of course,

have a policy on the maximum acceptable *counterparty exposure* for any *counterparty* it deals with. Provided this is a prudent limit, in the context of the considerations mentioned in paragraph 9.7 above, *counterparty exposure* is unlikely to give rise to failure of the ‘efficient portfolio management’ or ‘reduction of risks’ tests.

10 **Non permitted links**

10.1 From time to time, an *insurer* may find that a linked fund contains assets which are not permitted links, either as a result of unforeseeable circumstances or of error on the part of the fund manager. The rules set an absolute requirement. Such an occurrence represents a breach of the rules if it affects the *policy holder* benefits

10.2 It would not be safe for an *insurer* to plan to have a holding of 9.9% in *unlisted securities* when normal market movement could easily lead to a breach of the 10% limit.

10.3 Nevertheless, if such an event happens, it must be managed. If it does the *FSA* would expect the *insurer* to take the following steps:

- (a) where such a breach occurs as a result of unforeseeable circumstances, it must be repaired without delay; and
- (b) where a breach has occurred whose possibility was reasonably foreseeable or which was not (for whatever reason) repaired without delay, and if such breach has led to a reduction in the net assets of the fund and it was reasonably foreseeable that this could be the result, the notion of fairness to customers demands that the *insurer* should make good the loss: and
- (c) inform the *FSA* and the *insurer's* auditors of the breach and the steps it proposes to take (except where the circumstances described below apply).

10.4 The only cases which the *FSA* is unlikely to need to consider are where all the following conditions are satisfied:

- (a) the financial effect of the breach is minimal;
- (b) the breach is a ‘one-off’ event and far from likely to recur;
- (c) it casts no doubt on the integrity of the company's control system.

In particular, where the breach showed a failure of the *insurer's* control systems, the *FSA* would wish to consider whether appropriate repairs to those systems had been put in place, even where the financial effect of the breach was indeed negligible. As a general rule, we would expect *insurers* and

auditors to err on the side of informing us, except where it is beyond doubt that all the above criteria are satisfied.

GUIDANCE NOTE 9.1

PREPARATION OF RETURNS

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1. THE STATUTORY REQUIREMENT TO PREPARE RETURNS

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1. THE STATUTORY REQUIREMENT TO PREPARE RETURNS

The basic requirement

- 1.1 The *returns* must be prepared by, with certain exceptions, all *insurers* to which rule 9.1 applies, whether established within or outside the United Kingdom, which carry on business within the United Kingdom.

The regulatory basis of the return

- 1.2 The outline content of the *returns* is laid down by three rules:
- (a) rule 9.3 requires the *insurer* to prepare a profit and loss account, revenue account and balance sheet, together with notes, statements and reports and certificates annexed thereto;
 - (b) rule 9.4 requires the *insurer* to provide an abstract of the annual investigation of the *appointed actuary*; and
 - (c) rule 9.5 requires the *insurer* to obtain an auditor's report.

Deposit of returns with the FSA

- 1.3 (1) Rule 9.6(1) requires that every document prepared under rules 9.3, 9.4 or 9.5 be printed and five copies be deposited with the *FSA* within 2 – 4 months of the end of the period to which the documents relate. Rule 9.6(1) sets out which time limits apply. The *FSA* requests that one of the unsigned copies is left unbound held together with a treasury tag in the top left-hand corner. An *insurer* which opts for electronic submission (see below) has slightly larger filing deadlines and need only deposit one printed copy, which should be a bound, signed copy.
- (2) Rule 9.6(3) requires that one copy of every document (other than the auditor's report) be signed by the person or persons specified under rule 9.33. Rule 9.6(4) requires that one copy of the auditors' report be signed. Further guidance on the signature of *returns* is given in section 4.
- (3) [Deleted]
- (4) An *insurer* wishing to deposit *returns* electronically may do so. A separate document 'Electronic Submission of *returns* - Technical Specification' details the format in which an electronic *return* may be presented. The document described in 1.4(3) details the validation rules which must be applied at source in the generation of the *return*. There are software packages commercially available for the generation of the *returns*. It is likely that a *return* generated using such a package will be acceptable to the *FSA*. An *insurer* wishing to use another package or bespoke software will

need to satisfy the *FSA* that the technical specification referred to above is met in full. *Insurers* considering electronic submission should apply to -

Philip Hays-Nowak
Insurance Firms Division
The Financial Services Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

Tel: 020 7676 9604
Fax: 020 7676 9605
E-mail: philip.hays-nowak@fsa.gov.uk

Inaccurate or incomplete returns

- 1.4 (1) Under rule 9.6(5) the *FSA* may notify the *insurer* at any time within 24 months of the date of deposit if any document deposited under rule 9.6(1) appears to it to be inaccurate or incomplete, with a view to the correction of any inaccuracies and making good any omissions.
- (2) Under rule 9.6(5) the *FSA* may draw attention to an apparent inaccuracy or incompleteness and ask for an explanation or it may also ask for the inaccurate or missing documents to be (re) submitted. In either case, the *insurer* should consider the points raised and respond within one month of the date of notification either explaining why there is not in fact any inaccuracy or incompleteness, or (re) submitting the inaccurate or missing documents.
- (3) The validation of *returns* by the *FSA* takes place at two levels. First, certain absolute relationships are expected always subject to any modifications or waivers of rules under section 148 of the *Act* to be present between data items in the *return* (and between those items and the data items in the previous *return*). Secondly, the reasonableness of the data items is reviewed. This includes comparing data with other published sources such as the *Companies Act* accounts, to test its consistency and completeness. A listing (in the form of a systems specification) of the absolute relationships which are validated is available on request from the *FSA* (see 1.3 (4)).

Other documents to be deposited with the returns

- 1.5 (1) Rule 9.6(6) requires that an *insurer* deposit with its *return* any report on the affairs of the *insurer* submitted to the shareholders or *policyholders* of the *insurer* in respect of the *financial year* to which the *return* relates. This includes, but is not limited to, the report and accounts of the *insurer* prepared under the *insurance accounts rules* (or in the case of an overseas *insurer* prepared under section 700 of the *Companies Act*).

- (2) [Deleted]

Insurance fees

- 1.6 No later than when depositing the *returns* and other documents referred to above, an *insurer* should separately send a completed insurance fees form to the address shown on the form and, where a fee is due, a cheque in payment. The insurance fees form should be returned even if it only evidences that no fees are payable.

Disclosure of the returns and other documents deposited with the FSA

- 1.7 (1) The *returns* and the documents deposited with them are publicised in two ways:
- (a) First, under rule 9.7(1) an *insurer* must send a copy to any *policy holder* who requests it, and
 - (b) Second, the *FSA* will deposit with the Registrar of Companies the *returns* and other documents deposited with it. The documents deposited with the registrar of companies are available for public inspection.
- (2) Under section 148 of the *Act* the *FSA* may on the application or with the consent of an *insurer* direct that the above requirements do not apply or are to apply with such modifications as are specified in the direction.
- (3) It is anticipated that such a direction will only be given in exceptional circumstances, e.g. where disclosure would reveal that an *insurer* had significant trading links with two states at war with each other and would thereby seriously prejudice its ability to continue to trade in one or both of those states.

Modification or waiver of rules under section 148 of the Act

- 1.8 (1) As indicated above, under section 148 of the *Act*, the *FSA* may, on the application or with the consent of an *insurer*, direct that all or any prudential rules for *insurers* are not to apply to an *insurer*, or are to apply as modified. A direction under this section need not be confined to the preparation of the *returns*.
- (2) An *insurer* which wishes to apply for a modification or waiver should do so in accordance with *SUP* 8. The application should identify the circumstances which the *insurer* considers justify the granting of a modification or waiver. It is important that an application is made as early as possible, preferably as soon as the circumstances which justify it are known to have arisen.

2. THE TYPES OF RETURN

An overview

2.1 There are three basic types of *return*:

- (a) a global *return* which reports the entire worldwide business of the *insurer*;
- (b) a UK branch *return* which reports only the business carried on through a branch in the United Kingdom; and
- (c) an EEA branches *return* which reports the entire business carried on through all branches in *EEA States* (including the UK).

The detailed requirements

2.2 (1) The following table summarises the types of *return* which *insurers* are required to prepare.

Type of company	Location of Head Office		
	United Kingdom	An <i>EEA State</i> (other than U.K.)	Rest of the World ⁽¹⁾
<i>Pure reinsurer</i>	Global <i>return</i>	Global <i>return</i>	Global <i>return</i>
<i>UK- deposit insurer</i>			Global <i>return</i> and EEA branches <i>return</i>
<i>EEA-deposit Insurer</i>			UK branch <i>return</i>
All other <i>insurers</i>	Global <i>return</i>	Exempt	Global <i>return</i> and UK branch <i>return</i> .

(1) Special rules apply for Switzerland. A *Swiss general insurer* reports as for an *insurer* with its head office in the EEA. Other Swiss companies' report as for companies with their head office in the 'rest of the world'.

(2) The above table summarises the requirements of rule 9.2.

3. INTERPRETATION OF THE RULES

Definitions

Unless the context otherwise requires, words and expressions in any form (including the instructions to any form), or in any rule requiring a statement to be annexed to the forms, are to have the same meaning as applies in rule 9.2.

3.1 (1) [Deleted]

Valuation of assets and liabilities

3.2 (1) Rule 9.10 requires that, unless otherwise more specifically provided, *assets* (other than *linked assets*) and liabilities included in any document in the *return* should be valued using the *Valuation of Assets Rules*.

(2) *Linked assets*, to the extent that they are held to match liabilities in respect of *property linked benefits*, should be valued in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for *insurers*.

Requirement to state information fairly

3.3 Rule 9.11 requires that every revenue account, profit and loss account, balance sheet, note, statement, report and certificate required to be prepared under rule 9.3 be prepared in the manner specified and fairly state the information provided on the basis of the rules. This is a closely analogous requirement to the 'true and fair' concept for *Companies Act* accounts. As with that concept it includes the concept of materiality where properly applied.

4. CONVENTIONS FOR THE COMPLETION OF ALL FORMS

Scope

4.1 (1) The accounting rules and conventions described in this chapter apply (except where the contrary is explicitly stated) to all documents in the *return* other than the forms, notes, statements and certificates required under, **Appendices 9.4, 9.5 and 9.6**.

(2) The accounting rules and many of the conventions for preparing the *return* which are presented in this chapter derive from paragraphs 1 to 17 of **Appendix 9.1**. The other conventions although not directly arising from the rules are merely cosmetic and are requested to facilitate the *FSA's* processing of the *returns*.

Completion of forms

Signature of forms

- 4.2 (1) The first form in the *return* (normally **Form 9** or **Form 10**) should be signed. If the *return* consists of more than one bound volume then the front form of each volume should be signed. Where space does not allow the signatures to be affixed to the foot of this form a covering sheet should be used. The covering sheet should have the same header information as **Form 9** or **Form 10** as the case may be and should be entitled ‘Covering sheet to **Form 9**’, or ‘**Form 10**’ as the case may be.
- (2) A global *return* should be signed by at least two *directors* and the chief executive. If there is only one *director*, he or she and the chief executive should sign. If there is no chief executive, or if there is only one *director* (other than the chief executive), the secretary must also sign. A UK branch *return* or EEA branches *returns* must be signed by the *authorised UK representative* and the branch ‘Chief Executive’. See rule 9.33.

Use of own forms

- (3) An *insurer* may either submit its *return* on forms printed by the *FSA* or print its own forms. However in the latter case it should make sure that they are laid out exactly as the forms in the relevant appendices. *Insurers* wishing to print their own forms are requested to contact their normal supervisory contact at the *FSA*. In general, the *FSA* will accept *returns* produced using a recognised forms generation package. Where an *insurer* is using a bespoke software application, it will be requested to send specimen blank forms to the *FSA* well before it intends to use them.

Headings

- (4) After the heading ‘Name of company’ the full registered name of the *insurer* should be given without abbreviation.
- (5) In the heading ‘Global business/UK branch business/EEA branch business’ all except one of the three alternatives should be deleted according to whether the form is part of a global *return*, UK branch *return* or EEA branches *returns* (see paragraph two).
- (6) The heading ‘Financial year ended’ should be followed by the date of the last day of the *financial year* written in the style ‘dd-month-yy’, e.g. ‘31 December 1996’.
- (7) The ‘company registration box’ should be completed with the number originally used for submission of *returns* under the *1983 Regulations*. An *insurer* making a *return* for the first time should use the full registration number given by the Cardiff, Edinburgh or Belfast Registrar of Companies. If the *insurer* does not have such a number it should agree a suitable number

with the *FSA*. An overseas *insurer* should use its F-series number issued by the Registrar of Companies.

- (8) The 'GL/UK/CM' should be completed with one of the three alternatives according to whether the form is part of a global *return*, UK branch *return* or EEA branches *returns* (see paragraph two).
- (9) The 'Period ended' box should be completed so as to show, in numerals, the date of the last day of the *financial year* to which the *return* relates. The 'month' box should always be completed with a two-digit number, incorporating a leading zero where necessary.

Typewritten entries

- (10) The *FSA* prefers typewritten entries to hand-written ones, but there should be not more than 5 characters per centimetre or 12 per inch.

Other text

- (11) No text or figures should be included in any box in a form or anywhere else on the face of the form other than as required by the rules. In particular no entries should be made:
 - (a) in any unused line or column on **Forms 26 to 29, 31, 32 and 34** after the last accident year or underwriting year required to be reported,
 - (b) in any column headed 'Source', and
 - (c) in any shaded box.

Currency

- 4.3 (1) All forms (other than some of the **Forms 26 to 29 and 31, 32 and 34**) are to be completed in sterling with:
 - (a) assets and liabilities converted at the *financial year* end exchange rate, and
 - (b) income and expenditure converted using such bases of conversion as are in accordance with generally accepted accounting practice.
- (2) Accounting practice allows several alternative accounting bases for the translation of income and expenditure. The *FSA* expects companies to choose the same basis as it uses in its *Companies Act* accounts. Where the *Companies Act* accounts are drawn up in a currency other than Sterling it is acceptable for the *insurer* also to maintain the underlying records upon which the *return* is based, in that currency and to translate those currency amounts into Sterling at the rate ruling at the year end.

- (3) The above conversion rules do not apply to certain entries on **Forms 23, 26, 27, 31, 32 and 34**. The rules for these forms are explained in chapter ten.

Presentation of amounts

- 4.4 (1) Negative amounts should be shown between round brackets. A minus sign or 'DR' should not be used.
- (2) All sterling amounts in the forms (except valuation prices on **Form 45**) should be shown in units of £1000 rounded to the nearest £1000. This is required even if particular figures are so large or small that under normal accounting conventions it would be deemed inappropriate. If the entry in any box to be rounded is less than £500 that box should be left blank. The entry '0' should not be used.
- (3) Amounts required to be shown denominated in foreign currency in a form should be shown in units of 1000 (of the principal monetary unit of that currency) rounded to the nearest 1000, and the entry '000' should be made in the 'units' box of that form. However if the £ to principal monetary unit exchange rate at the year end was in excess of 1000, amounts should be shown in units of 1,000,000 and '000,000' should be inserted in the 'currency' box.
- (4) Figures which are totals of other figures (whether or not on the same form) should be rounded after totalling the unrounded detail figures.

Comparative amounts and brought forward figures

- 4.5 (1) Columns are included on **Forms 9 to 17, 20 and 40** for the disclosure of comparative amounts for the previous *financial year*. These amounts should be reported as stated in the previous *return* (after any correction under rule 9.6(5) - see 1.4), but without restatement for any prior year adjustment even where such restatement is permitted under generally accepted accounting practice.
- (2) Other than to reflect exchange rate reconversion, brought forward figures on the detailed *general insurance business (Forms 21 to 39)* should not, as a general rule, be restated as this destroys the continuity of the historical data triangles which the *FSA* derives from these forms. However the *FSA* recognises that in exceptional cases, e.g. the correction of a fundamental error, restatement for other reasons may be desirable. The *FSA* requests *insurers* that wish to restate amounts (other than to reflect exchange rate reconversion), to discuss the proposed restatement with their usual supervisory contact at the *FSA* prior to submitting their *return*.
- (3) Where any brought forward amount is restated (other than to reflect exchange rate reconversion) the reason for the restatement should be given in a supplementary note to the form upon which the brought forward amount appears. (See **Appendix 9.1**, paragraph 7).

- (4) Special difficulties with brought forward and comparative figures arise for an established overseas *insurer* newly authorised in the UK by the *FSA* and preparing its first global *return*. Such an *insurer* may wish to seek guidance from its normal supervisory contact at the *FSA*.

Supplementary notes

- 4.6 (1) Supplementary notes should not be shown on the face of a form, but should be shown on a separate sheet or sheets of paper. The notes for all forms should be bound together toward the end of the *return* (but before the certificates) and should not be interleaved with the forms to which they relate.
- (2) The requirements to prepare supplementary notes are variously located in the actual text of the rules, the appendices to the rules and in the instructions to the forms. However in each case the requirement to prepare the note identifies the form to which it is to relate.
- (3) In the guidance for each form (under **Appendices 9.1 to 9.3 and 9.8**) a complete list of the required supplementary notes is provided. Each note in the list is given a unique reference code. The first two digits of the code are the number of the form and the final two digits the number of the note. For example the 5th note in the list for **Form 13** is coded '1305'.
- (4) Each supplementary note included in the *return* should be given a title which identifies the form or forms to which it relates. In respect of forms prepared under **Appendices 9.1 to 9.3 and 9.8** this should be done by including the code as the first element in the title. For example the title for note 1601 might be:

'1601 Basis of conversion of foreign currency'

If there is more than one form of the same number (e.g. **Forms 24** for several *accounting classes*) only one title of the above type need be used to cover all such forms.

- (5) Where an *insurer* wishes to include an extra note (beyond those required under the rules) it should identify the form to which it relates and give the note the next unused sequential code number for that form. For example the rules specify seventeen coded notes for **Form 13** which are respectively coded 1301 to 1317. If an extra note is to be added it should be coded 1318. The code 1318 should be used even if for the particular *insurer* there is no note 1317 (because the circumstances in which that note is required do not arise for that *insurer*).
- (6) Where the rules require a form to be submitted, but all entries (including comparatives) would be blank, that form may be omitted provided that a note coded FF00 (where FF is the form number) is included stating that this is

why the form has been omitted. This note is not needed where a form is omitted because the rules do not require it. For example a non-life *insurer* is not required to submit Life **Forms 40 to 45** and so does not need supplementary notes 4000 etc.

- (7) Two or more supplementary notes should not be combined as a single text with a single title except where this avoids unnecessary repetition or leads to a clearer explanation. Where two or more supplementary notes are combined the codes of all the notes should be listed at the beginning of combined title.
- (8) Some supplementary notes are always required whenever the form to which the note refers is required. Others are only required on an exception reporting basis. The detailed guidance below on each supplementary note brings out this distinction.

5. **FORMS 9 TO 17: STATEMENT OF SOLVENCY, BALANCE SHEET AND NON-TECHNICAL ACCOUNT**

Statement of Solvency (Form 9)

Completion of the form

- 5.1 (1) **Form 9** is to be prepared by every *insurer* other than an *EEA insurer*, a *Swiss general insurer* or a *EEA-deposit insurer* - see rule 9.12.
- (2) **Form 9** shows separately for *general insurance business* and *long-term insurance business*:
 - (a) the *required minimum margin of solvency*,
 - (b) the available assets,
 - (c) any *implicit items* (for *long-term insurance business*), and
 - (d) any contingent liabilities.
- (3) The entries on **Form 9**, other than for *implicit items*, derive from other forms within the *return*.
 - (a) The *general insurance business required margin of solvency* derives from **Forms 11** and **12** and the *long-term insurance business required margin of solvency* from **Form 60**.
 - (b) The available assets derive from **Form 10**. A composite *insurer* may apportion part of its 'other than long-term insurance business - available assets' (line 29 on **Form 10**) to count against the *required minimum margin* for its *long-term insurance business* provided that

such assets are in excess of the amount needed to match its *general insurance business required margin of solvency* - see rule 2.4(5)(b).

- (c) The *long-term insurance business liabilities* derive from **Form 14**.
 - (d) The contingent liabilities for *general insurance business* and *long-term insurance business* derive from supplementary notes to **Forms 15** and **14** respectively.
- (4) *Implicit items* are certain special types of asset, i.e. future profits, *Zillmerising* and hidden reserves, specified in rule 2.10. They may be counted against an *insurer's required margin of solvency* but only if, and to the extent, specifically allowed by an order issued by the *FSA* under section 148 of the *Act*. An *insurer* wishing to count such items against its solvency requirement should apply its normal supervisory contact in to the *FSA* for the appropriate order.

Supplementary notes

Two supplementary notes may be required to this form: -

- (a) Where a direction under section 148 of the *Act* has been issued disapplying or modifying any of the provisions of *Accounts and Statements Rules*, a note to **Form 9** explaining the effect of the order is usually required. The requirement for such a note would be specified in the direction itself. [Code 0901].
- (b) Where a direction under section 148 of the *Act* has been issued to an *insurer* permitting it to take into account *implicit items* on *long-term insurance business*, that order may specify that a note is to be included in the *return* explaining such items. That note should be included as a note to **Form 9**. [Code 0902].

Statement of net assets (Form 10)

Completion of the form

- 5.2 (1) **Form 10** is to be prepared by all *insurers* – see rule 9.12(3).
- (2) Lines 11 and 12 are to be completed only by an *insurer* carrying on *long-term insurance business* and respectively derive from **Forms 13** and **14**. An *insurer* which carries on *long-term insurance business* is required by rule 3.1 to maintain a separate fund for that business. Line 11 shows the value of the *admissible assets* in that fund. Lines 11 and 12 should equal each other.
- (3) All other lines on **Form 10** must be completed by every *insurer*, other than a mutual without share capital (or subordinated loan capital) which only carries on *long-term insurance business*. Line 56 is to be completed with the balancing figure so as to ensure that line 59 equals line 29.

- (4) Line 23 shows the net *admissible assets*, i.e. *admissible assets* less liabilities. Lines 24 and 25 show two types of *asset* which may not be taken into account in determining the net *admissible assets* but which, provided that net *admissible assets* are not negative, may (to a limited extent) be added to net *admissible assets* for the purpose of determining whether the *insurer* meets its *required margin of solvency*. Similarly lines 26 and 27 show two types of liability which are taken into account in net *admissible assets* but which, provided that net *admissible assets* are not negative, may (to a limited extent) be added-back for the purpose of determining whether the *insurer* meets its *required margin of solvency*. Thus where line 23 is negative no amounts may be included at lines 24 to 27. See rule 2.10 for the detailed rules applicable to these types of assets and liabilities.
- (5) Line 51 should include the share premium account.

Reconciliation of balance of net assets brought forward and carried forward

- (6) Line 61 to 69 reconcile the balance of net assets, (line 56), brought forward and carried forward. For these purposes the brought forward amount shown at line 61 should not be restated for any reason, even for exchange differences.
- (7) The three most frequent reasons for a movement in the net assets are listed respectively at lines 62 to 64. They are:
- (a) the retained profit or loss for the *financial year* - sourced from **Form 16**;
 - (b) movements in the difference between the value of assets (other than long term assets) under the *FSA* valuation rules and under the GAAP valuation rules - sourced from **Form 13**; and
 - (c) a decrease or increase in the provision for adverse changes (which is a provision made for *FSA* purposes, but which does not arise under GAAP) - sourced from **Form 15**.
- (8) Movements in the net assets which are not attributable to the three reasons given in (7) should be included at line 65 and explained by way of supplementary note to the form. [Code 1002].
- (9) The retained profit or loss (line 62) is sourced from **Form 16** and, therefore, is for other than *long-term insurance business* determined in accordance with the same generally accepted accounting practice ('GAAP') as apply in UK *Companies Act* accounts. The *long-term insurance business* retained profit departs from GAAP in that it is based on the 'statutory' method of reporting, not the 'modified statutory' method.
- (10) The annex to this chapter gives two examples of this reconciliation.

Reconciliation of net assets to the accounts

- (11) In addition to the reconciliation in (9), which appears on the face of **Form 10**, a further reconciliation is required by way of supplementary note to the form. This takes net assets as per the *return* and reconciles them to net assets as they appear in the shareholder accounts. This reconciliation is required for every *insurer* which is not incorporated outside the UK, and which in consequence has to prepare *Companies Act* accounts in accordance with the *insurance accounts rules*. See paragraph 14 of **Appendix 9.1**.
- (12) For purposes of the reconciliation in (11), net assets as per the *return* should be taken not from **Form 10**, but by netting assets taken from line 99 of the **Form 13** (for the category of assets ‘1’) and liabilities from line 59 of **Form 15**. The net assets as per the *Companies Act* accounts should be the amount shown under balance sheet item A ‘capital and reserves’.
- (13) The reason for taking assets and liabilities from these sources within the Annual *return* is to eliminate from the reconciliation differences due to the dissimilar asset and liability valuation rules as between the *return* and *Companies Act* accounts. Lines 91 to 99 of **Form 13** reconcile the valuation of assets as per the *return* rules and as per the *Companies Act* accounts rules. Line 99 shows the value after that reconciliation, i.e. the value as per the *Companies Act* accounts rules. Similarly line 59 of **Form 15** shows liabilities sub-totalled excluding items which do not appear as liabilities in the *Companies Act* accounts, e.g. the provisions for adverse changes etc.
- (14) As a result, the reconciliation in (11) only needs to deal with differences which arise for other reasons. Such differences would include the following:
 - (a) the value of net assets within the *long-term insurance business* fund. This is included in the net assets taken from the *Companies Act* accounts (item A ‘capital and reserves’) but is not included in net assets as sourced from **Form 13** (category of assets ‘1’) and **Form 15**; and
 - (b) The amount of any subordinated loan capital. This is not deducted as a liability in the net assets as sourced, inter alia, from line 59 of **Form 15**, but is deducted as a liability in the net assets as sourced from the *Companies Act* accounts (item A ‘capital and reserves’).
- (15) Other than as noted in (14), *insurers* should only rarely have any differences to report under this reconciliation; e.g. where there is a material adjusting post-balance sheet event which occurs after the date of sign off of the *Companies Act* accounts but before the date of sign off of the *returns*.
- (16) Where for any reason an *insurer* (other than one incorporated outside the UK) either does not prepare or has not yet prepared its *Companies Act* accounts, a statement that this is the case must be included in the

supplementary note instead of the above reconciliation. The reason why accounts have not been prepared, (e.g. because they are drawn up to different year ends from the *return*), should also be stated.

- (17) The annex to this guidance gives an example of this reconciliation.

Supplementary notes

- (18) Three supplementary notes are specified -
- (a) the supplementary note described in (11) to (17) - see paragraph 14 of **Appendix 9.1**; [Code 1001]
 - (b) particulars of any other movements shown at line 65; and [Code 1002]
 - (c) particulars of any direction under section 148 of the *Act* allowing subordinated loan capital not to be treated as a liability for the purposes of determining whether the *insurer* holds net assets which match its *required margin of solvency* - the requirement for this note will be specified in the direction itself. [Code 1003]

Calculation of required margin of solvency (Forms 11 and 12)

The margins of solvency

- 5.3 (1) **Forms 11 and 12** must be completed by every *insurer* which carries on *general insurance business*, other than an *EEA insurer*, a *Swiss general insurer* or an *EEA-deposit insurer* – see rule 9.12(4).
- (2) All *insurers* (subject to certain exceptions described below) are required to maintain a *required margin of solvency* throughout the *financial year*. **Forms 11 and 12** in the *global return* show the calculation of this *required margin of solvency* in respect of *general insurance business*.
- (3) For an *insurer* (other than a *pure reinsurer*) with its head office outside the UK this *required margin of solvency* relates to its entire worldwide business. Such an *insurer* (unless an *UK deposit insurer*) must also maintain a UK *required margin of solvency* in respect of its business carried on in the United Kingdom. **Forms 11 and 12** in the *UK branch return* show the calculation of the UK *required margin of solvency* in respect of *general insurance business*. A *UK deposit insurer* must also maintain an EEA *required margin of solvency* in respect of its business carried on within *EEA States*. **Forms 11 and 12** in the *EEA branches return* show the calculation of the EEA *required margin of solvency* in respect of *general insurance business*.
- (4) The exceptions in (2) are *EEA insurers*, *Swiss general insurers* and *EEA-deposit insurers*. They are excluded (under UK law) from the requirement to

maintain any of the above types of *required margin of solvency*. This is because they are subject to equivalent solvency rules imposed by their home state or by another *EEA State*. These *insurers* are not required to complete forms **Forms 11** and **12**.

- (5) The text on the face of the forms only presents in outline the method of calculation of the *general insurance business* margins of solvency. The detailed rules for the calculation are to be found in **Appendices 2.1 to 2.3**, to which companies preparing these forms should refer. The forms should be interpreted in the light of these rules - see paragraph 10(1) of **Appendix 9.1**.

Margins of Solvency

- (6) The *Margin of Solvency Rules* lay down that the margins of solvency are to be calculated as the highest result from the application of three alternative methods. These are the premium basis, the claims basis and the *minimum guarantee fund*. The first method is shown on **Form 11** and the latter two methods together with the comparison of all three methods are shown on **Form 12**.

Form 11: the first method (i.e. the premium basis)

- (7) Line 11: determine the **gross premium receivable** in the *financial year*.
- (a) ‘gross premium’ means premiums after deduction of discounts, refunds and rebates of premium and before deduction of premiums for *reinsurance* ceded and of commission payable. It includes premiums receivable from *reinsurance* contracts accepted by the *insurer*. In effect, this has the same meaning (subject to one important exception described in (d)) as *gross premiums written* as it occurs in the other forms in the *return*.
- (b) the amount of gross premium to be taken is limited by the words ‘receivable’ and means recorded in the company's books as due to the *insurer* in respect of risks incepted in the *financial year*. Policies transferred to an *insurer* under Part VII of the *Act* (or a transfer under the equivalent law of another *EEA State*) should be considered to be incepted on the date of transfer.
- (c) as a result subject to the exception described in (d), gross premiums receivable may be treated as being the same as that portion of *gross premiums written* which is in respect of risks incepted in the *financial year*. This may be derived from the other forms in the *return* as follows: take the sum of the entries in columns 1 and 2 for lines 13 to 15 on all **Forms 21** and of the entry at line 11 for the current underwriting year on all **Forms 24**. In algebraic notation this is: $\Sigma (21.13.1 + 21.13.2 + 21.14.1 + 21.14.2 + 21.15.1 + 21.15.2)$ for all **Forms 21** + $\Sigma 24.11.(mm-yy)$ for all **Forms 24**; where mm-yy is the current *financial year*.

- (d) the exception in (c) occurs where premiums receivable are excluded from *gross premiums written* as shown in **Forms 21 and 24** by virtue of the rule in paragraph 26 of **Appendix 9.2**. This says that amounts in respect of inwards and outwards *contracts of insurance* must be classified for inclusion in **Forms 20 to 39** according to their economic substance in accordance with generally accepted accounting practice. This, in effect, means that the accounting treatment for so-called financial reinsurances is to be the same in these *return* forms as in the *Companies Act* accounts. This is explained more fully in 8.2.2. The point to note here is that even where, under this rule, the consideration receivable under a *contract of insurance* is not classified as *gross premiums written* for the purposes of those *FSA* forms, it must be included as premiums receivable on **Form 11**. The **Form 11** premiums receivable should include all consideration receivable in respect of contracts which constitute carrying on *insurance business* under the *Act*, and which therefore require authorisation.
- (8) Line 12: deduct premium taxes and levies, but only to the extent that: (i) in the case of taxes they are included in premiums and (ii) in respect of levies they are related to premiums and are recorded in the *insurer's* books as payable in the last preceding *financial year* in respect of *general insurance business* - see paragraph 2 of **Appendix 2.1**. Under generally accepted accounting practice the UK Insurance Premium Tax is excluded from the amount shown for premiums. It should not, therefore, be deducted at line 12 on the form. The anticipated Financial Services Compensation Scheme levy in respect of business written during the year may be deducted, but only to the extent that a provision for that anticipated liability has been established.
- (9) Line 14: adjust the sub-total derived from the above to an annual figure if the *financial year* runs for more or less than 12 months.
- (10) Lines 15 to 19: (i) analyse the amount arrived at in line 14 between other and health insurance based on actuarial principles; (ii) in the case of each amount, if appropriate, divide into two portions of 10 million Euros and the excess over 10 million such units and (iii) apply the appropriate percentages (18, 16, 6 or $5\frac{1}{3}$, as the case may be) to the totals arrived at, and add together the resultant sums to determine the *Sub-total B* - see paragraphs 4 to 8 of **Appendix 2.1**. The *FSA* will advise, if requested, whether business carried on under a particular policy falls within the definition of health insurance based on actuarial principles. The £/Euro rate of exchange to be used is that prevailing at the previous 31 October and is advised to *insurers* each year in an *FSA* market letter.
- (11) Lines 21 to 29: Determine (i) gross *claims paid* in the *financial year*; (ii) gross *claims outstanding* carried forward; and (iii) gross *claims outstanding* brought forward. Determine the gross claims incurred, *Sub-total C*, as (i) plus (ii) less (iii).

- (a) *claims* paid and *claims* outstanding are defined in detail by paragraphs 10 to 11 of **Appendix 2.1**. In essence they refer to the amounts recorded in the *insurer's* books as -
- (i) paid in full or partial settlement of or set aside as likely to be sufficient to meet *claims* under *contracts of insurance*; or as
 - (ii) expenses incurred or set aside as likely to be incurred which are directly attributable to the settlement of individual *claims*; less
 - (iii) related salvage recoveries, recoveries from third parties and recoveries from other *insurers* (but not *reinsurance* recoveries).
- (b) the definition of *claims* outstanding includes the provision for *claims* incurred but not reported.
- (c) although the rules are not expressed in these terms, the definitions in (11) of *claims* paid and *claims* outstanding are equivalent (subject to one important exception described in (f)) to the corresponding amounts included in **Forms 22** and **25**, but excluding the *claims* management costs.
- (d) for *claims* paid, the equivalent amount is the sum of the amounts at lines 11 and 15 in column 2 in all **Forms 22** and of the amounts line 21 of the total column in all **Forms 24**. In algebraic notation this is: $\Sigma (22.11.2 + 22.15.2)$ for all **Forms 22** + $\Sigma 24.21.(99-99)$ for all **Forms 24**.
- (e) for *claims* outstanding, the equivalent amount is the sum of the amounts at lines 11 and 15 in column 3 in all **Forms 22** and of the amounts lines 11 and 13 of the total column in all **Forms 25**. In algebraic notation this is: $\Sigma (22.11.3 + 22.15.3)$ for all **Forms 22** + $\{25.11.(99-99) + 25.13.(99-99)\}$ for all **Forms 24**. (NB. for an *insurer* which discounts its *claims* outstanding this requires that the undiscounted provision be taken.) If necessary the brought forward amount (here and on **Form 12**) should be restated as undiscounted.
- (f) the exception referred to in (c) arises for the same reason as described in 7(d). Amounts are classified for inclusion in **Forms 22**, **24** and **25** according to their economic substance in accordance with generally accepted accounting practice. However in **Forms 11** and **12** *claims* paid and *claims* outstanding should include all amounts paid or set aside for *claims* under contracts which constitute carrying on *insurance business* under the *Act*, and which therefore require authorisation, even where such amount are not classified as *claims* paid under generally accepted accounting practice.

- (12) Lines 30 to 39 :determine the net claims incurred, *Sub-total D*, by deducting from the gross *claims* incurred, *Sub-total C*, the total sum recoverable in respect of that amount under *reinsurance* contracts ceded, see paragraph 12 of **Appendix 2.1**. Line 30 should only include amounts classified for inclusion as *reinsurance* in **Forms 22, 24 and 25** according to their economic substance in accordance with generally accepted accounting practice except that where gross premium has been included in line 11 only by virtue of 11(1), all *reinsurance* of that gross premium (whatever its economic substance) may be included in *Sub-total C*.
- (13) Line 41 :determine the *first result* by multiplying the *Sub-total B* by the ratio of the *Sub-total D* to the *Sub-total C*, (or if that fraction is less than one half, by one half; or if the fraction is more than one, by one). See paragraph 13 and 14 of **Appendix 2.1**.

Form 12: the second (i.e. the claims basis)

- (14) Determine the reference period. If an *insurer* has not been in existence long enough to acquire a reference period this should be indicated by entering a zero at the box in line 11 and lines 21 to 41 ignored. For the majority of *insurers* the reference period will be the last three *financial years*. See paragraphs 1 and 2 of **Appendix 2.2**.
- (15) Establish the amount of claims incurred in a similar way to that explained in (11), but related throughout to the reference period rather than to the *financial year*. For example where the reference period is the last three *financial years* the *claims* incurred should be derived (using the formulae described in (11)) from the amounts reported in the *returns* for those last three years - see paragraph 3 of **Appendix 2.2**. However it is acceptable to restate amounts of *claims* incurred for currency movements.
- (16) Reduce the sum derived to an annual figure by multiplying by 12 and dividing by the number of months in the reference period.
- (17) Lines 32 to 39: (i) analyse *Sub-total F* between other and health insurance based on actuarial principles ; (ii) in the case of each amount, if appropriate, divide into two portions of 7 million Euros and the excess over 7 million Euros and (iii) apply the appropriate percentages (26, 23, 8.66 or 7.66, as the case may be) to the totals arrived at and add together the resultant sums to determine *Sub-total G* - see paragraphs 5 to 9 **Appendix 2.2**. The definition of health business and the £/Euro rate are the same as apply in (10).
- (18) Line 41: determine the *second result* by multiplying *Sub-total G* by the ratio of *Sub-total D* to *Sub-total C*, (or if that fraction is less than one half, by one half; or if the fraction is more than one, by one). See paragraphs 13 and 14 of **Appendix 2.1**.

Form 12: the third method (i.e. the minimum guarantee fund)

- (19) The amount of the *minimum guarantee fund* (line 44 on **Form 12**) is calculated by reference to the classes of business for which the *insurer* has permission under the *Act* – see **Appendix 2.3**. In most cases, it will be 400,000 Euros translated to sterling.

Supplementary notes

- (20) Two supplementary notes are specified.
- (a) if any of the brought forward amounts differs from the corresponding carried forward amounts in the previous *return* the reason should be stated - see **Appendix 9.1**; [Codes 1101 and 1201]
- (b) if any of the amounts included in either **Form 11** or **12** differ from the corresponding amounts in **Forms 21** to **25**, the amount of difference and the reason for it should be stated - see paragraph 10 of **Appendix 9.1**. The expected correspondence between amounts in **Forms 11 & 12** and in **Forms 21** to **25** and the reasons why they might differ are explained in (7) and (11). [Codes 1102 and 1202]

Analysis of admissible assets (Form 13)

Different types of Form 13

- 5.4 (1) **Form 13** is to be prepared by every *insurer* for one or more categories of assets – see rule 9.12(5).
- (a) every *insurer*, (other than a *mutual* without *share* capital which only carries on *long-term insurance business*), must prepare a **Form 13** for its total other than long term assets; and
- (b) every *insurer* which carries on *long-term insurance business* is to prepare a **Form 13** for its total *long-term insurance business assets*.
- (2) The *long-term insurance business* assets are the assets required by rule 3.1 to be maintained in the separate fund for *long-term insurance business*. Where separate assets within the rule 3.1 fund are appropriated for separate long term funds or groups of funds, (other than *internal linked funds*), additional **Forms 13** should be completed in respect of each such fund or group of funds.
- (3) An *external insurer*, (other than a *pure reinsurer*), and a *UK- deposit insurer* must complete certain additional forms. These are described in instruction 3 to **Form 13**.

- (4) The different **Forms 13** are identified by the entry in the ‘category of assets’ box in the heading. A list of codes to be used in the completion of that box is given in the instructions to **Form 13**.

Completion of the form

- (5) **Form 13** consists of three parts.
- (a) lines 11 to 89 provide a ‘line by line’ analysis of the assets valued in accordance with the rule 9.10.
- (b) lines 91 to 99 provide a reconciliation of the total assets as valued in accordance with rule 9.10 and as valued in accordance with the *Companies Act* accounts rules.
- (c) line 100 discloses the value of the *debts* due from related companies, other than those under *contracts of insurance or reinsurance*.
- (6) The classifications used in lines 11 to 89 are based on those used in the balance sheet format in Schedule 9A of the *Companies Act*, i.e. those which are required to be used in the preparation of the *Companies Act* accounts. In many cases, however, a single item in the *Companies Act* format is subdivided. The subdivisions typically reflect distinctions between types of assets found in the *Valuation of Assets Rules*.
- (7) Lines 11 to 89 refer to the descriptions used in the *Companies Act* accounts balance sheet format solely for the purposes of indicating how assets are to be classified, i.e. to show at which line they are to be included. The *Companies Act* valuation rules are not to be followed. Assets at lines 11 to 89 are instead to be valued in accordance with rule 9.10 - see instruction 4 to the form. Reference should also be made to **Guidance Note 4.1**.
- (8) Rule 9.10 provides that:
- (a) assets (other than referred to in (b)) are to be valued in accordance with the *Valuation of Assets Rules*, and
- (b) assets matching *property linked benefits* are to be valued in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for *insurers*. See (12) below.
- (9) Lines 11 to 86 show asset values after deductions for excesses over *permitted asset exposure limits* - see rule 4.14. Where such a deduction relates to assets included at more than one line of **Form 13** it should be apportioned pro rata. Negative amounts should not be shown at lines 11 to 86. If a deduction is more than the value of the assets to which it relates the excess element of the deduction should be shown at line 87, as also should

deductions for excesses over permitted *counterparty* limits and for excess concentrations over a number of *counterparties*. See rule 4.14(3).

- (10) Where the value of any asset is denominated in a currency other than sterling it is to be converted into sterling using the year end closing middle rate - see paragraph 4 of **Appendix 9.1**.
- (11) The amount of any asset in **Form 13** should be shown gross of any set-off against any corresponding liability (which liability should be shown on **Forms 14** or **15** as appropriate). The only exception to this is where:
 - (a) amounts are owed from and to the same person; and
 - (b) such netting is permitted under generally accepted accounting principles. See in particular FRS5.

In (a), 'person' refers not only to individuals but also to *corporate bodies* and unincorporated associations.

- (12) The guidance in (10) usually prevents the set-off of amounts due from and to the same broker/*intermediary* unless they relate to the same client of the broker/*intermediary*. This is because typically such amounts are in law owed from and to not the broker/*intermediary* but the client. The broker/*intermediary* merely acts as a collecting agent.
- (13) Lines 54 and 55: Deposits with *approved credit institutions* and *approved financial institutions* should only show relevant deposits subject to a time restriction on withdrawal. Such *deposits* not subject to such a time restriction should be shown at line 81. In the analysis between lines 54 and 55, (withdrawal subject to a time restriction of one month or less and withdrawal subject to a time restriction of more than one month), the time restriction is to be measured relative to the date of the end of the *financial year* and not, if different, the date on which the *deposits* were originally made.
- (14) Lines 58 and 59 together show the assets held to match linked liabilities. This expression has the same meaning as in the *Companies Act* accounts and the items to be classified for inclusion under these lines should be the same as those included under the heading of the same name in the *Companies Act* accounts. However the valuation of the items to be included is not necessarily the same. The *Valuation of Asset Rules* apply to all items included at these lines other than those exempted by rule 4.1(2). This only exempts *linked assets* (to the extent they are held in compliance with rule 2.3) which match liabilities in respect of *property linked benefits*.
- (15) The *FSA* doubts whether either the heading in the *Companies Act* accounts or at lines 58 and 59 on **Form 13** is apt to include assets backing surplus units in *internal linked funds*. However where such assets are included under this heading in the *Companies Act* accounts they should also be included at lines

58 and 59 on **Form 13**. NB, as such surplus assets are not exempted by rule 4.1(2), they must be valued in accordance with the *Valuation of Assets Rules*). See also 15.7(10). The *FSA* is also aware that *insurers* adopt different treatments in their *Companies Act* accounts for *index linked liabilities* backed by a derivative. Some include the derivative, any margining loan back (as a deduction) and the investments arising from the margining loan in 'assets covering linked liabilities'. Others only include some of these items under that heading and, perhaps, include the margining loan back as a liability. The *FSA* doubts whether all of these treatments necessarily always conform to GAAP, e.g. showing assets net of the margining loan is not permissible where there is no legal right of set-off. However where an *insurer* has adopted a treatment in its *Companies Act* accounts (and so implicitly come to the view the treatment accords with GAAP) it should adopt the same treatment in the *returns*.

- (16) Line 73 (salvage and subrogation recoveries) should only be used for such recoveries which fall to be classified as debtors arising from insurance operations. Occasionally some salvage or subrogation recoveries may be classified under other headings in the *Companies Act* accounts in which case the same heading should be used in **Form 13**, but a supplementary note [Code 1303] is required. If salvage and subrogation recoveries are shown in the *Companies Act* accounts as a deduction from liabilities rather than as an asset, the same treatment should be adopted in the *returns*. That is, line 73 should be left blank and the amount of liabilities shown on **Form 14** should be shown net of the salvage and subrogation recoveries.
- (17) Line 80 should include leased tangible assets that are held under a finance lease and are brought into account as an asset in the *Companies Act* accounts in accordance with Statement of Standard Accounting Practice 21.
- (18) Line 83 'Other assets' refers to the balance sheet heading in the *Companies Act* accounts of 'Other assets – other' (item Fv. in the balance sheet format in Schedule 9A to the *Companies Act*). It should not be used for any other type of asset and even where used for an asset falling under the *Companies Act* account Fv. heading it should show only the admissible value, if any.
- (19) Lines 91 to 99 reconcile the *admissible assets* to the total assets determined in accordance with the *Companies Act* accounts rules. For guidance on the distinction between the different types or reconciling item (lines 92 to 95) - see examples 1 to 3 in **Annex A**. This reconciliation must be completed by all *insurers* whether or not they prepare *Companies Act* accounts. In this reconciliation a particular problem is caused by those assets which the *Companies Act* permits to be shown either as assets or as a deduction from liabilities. The main classes of such assets are-
 - (a) the *reinsurers'* share of *technical provisions*; and
 - (b) the *deferred acquisition costs*.

- (20) For *general insurance business* these assets, to the extent admissible, should always be shown at lines 60 to 63 and 85 respectively. Further, the total shown at line 99 (assets determined in accordance with shareholder accounts rules) should always include such assets, even where they are actually shown as a deduction from liabilities in the *Companies Act* accounts. For *long-term insurance business* these assets should never be shown at lines 60 to 63 and 85 and should never be included in the total at line 99, even where they are shown as an asset in the shareholder accounts. In the category of assets **Forms 3 to 5** lines 60 to 63 (*reinsurers' share of technical provisions*) and line 85 (*deferred acquisition costs*) should be left blank. There is no requirement to maintain such assets either within the UK or any *EEA States*.
- (21) Apart from the assets in (19), an item should be classified as an asset or a deduction from liabilities on **Form 13** (line 99) and **Forms 14/15** in the same way as in the *Companies Act* accounts. The same applies to the classification of an item as a liability or a deduction from assets. Different methods of grossing up should be avoided. For the treatment of leased assets see (17).
- (22) The *insurance accounts rules* allow for some investments to be valued either at current value or at amortised cost. An *insurer* which does not prepare *Companies Act* accounts should choose the current value method for disclosure at line 99 on **Form 13**. Any other *insurer* should choose the same method for line 99 on **Form 13** as it chooses for its *Companies Act* accounts.
- (23) Asset valuation differences arising in respect of shares in, or *debts* due or to become due from, *dependants* should be included:
- (a) at line 92 in so far as they arise from the application of admissibility limits to the assets of that *dependant*;
 - (b) at line 93 in so far as they arise from a solvency margin deduction made either because that *dependant* is itself an *insurer* or because (directly or indirectly) it has invested in another *dependant* which is an *insurer*; and
 - (c) at line 94 in respect of any other causes of differences.

Line 95 should not be used for differences arising in respect of *shares* in, or *debts* due or to become due from, *dependants*. Such *shares* or *debts* are not themselves 'assets of type not valued', and this is still true even if the *dependants* themselves invest in assets of a type not valued.

Supplementary notes

- (24) There are nine specified supplementary notes. Each note, other than the note in (c), should be given separately for *long-term insurance business* and other than *long-term insurance business*, (i.e. separately for the category of assets '1' and '10' **Forms 13**). Further separate disclosure for category of assets

'2' to '5' or '11' onwards is not needed. The notes are coded 1301 to 1307, 1314 & 1315 for other than *long-term insurance business* and 1308 to 1313, 1316 & 1317 for *long-term insurance business*:

- (a) the aggregate value of (i) *unlisted* investments, (ii) certain *listed* investments, (iii) units or beneficial interests in certain *collective investment schemes* and (iv) reversionary interests or remainders in property other than land or buildings, together with a description of the assets in question - see instruction 5 to the form; [Codes 1301 and 1308]
- (b) the aggregate value of hybrid *securities* - see instruction 6 to the form; [Codes 1302 and 1309]
- (c) the amounts of any non-debtor salvage or subrogation recoveries - see instruction 7 to the form; [Code 1303];
- (d) a statement that amounts have been set off to the extent permitted by generally accepted accounting principles (if this option has been exercised) - see paragraph 8 of **Appendix 9.1**; [Code 1304 and 1310]
- (e) the maximum *counterparty* limit permitted by the *insurer's* investment guidelines (and any separate limit for *counterparties* other than *approved counterparties*) together with an account of any breaches during the year of those limits - see paragraph 11(1) of **Appendix 9.1**; [Code 1305 and code 1311]
- (f) the amount and nature of the exposure at the year end to large *counterparties* (i.e. greater than 5% of the *general insurance business* or *long-term insurance business* amounts) - see paragraph 11(2) of **Appendix 9.1**; [Code 1306 and 1312]
- (g) the aggregate value of certain fully secured rights - see paragraph 11(3) of **Appendix 9.1**; [Code 1307 and 1313]
- (h) the amount of any tangible leased assets should be included at line 80 even though not required by the rules; and [Code 1314 and 1316]
- (i) particulars of any other assets included at line 83 - see the face of the form. [Code 1315 and 1317].

Note 1

- (25) A single figure with a simple description will suffice. For example: 'The insurer held £xm in unlisted securities and £ym in unregulated collective investment schemes, almost all of which was of the latter type'. The assets covered by this note are those which count towards the 10% *permitted asset exposure limit* at paragraph 12 of Part II of **Appendix 4.2**. For detailed

descriptions of the type of assets to be included, see the *Valuation of Assets Rules*.

Note 2

- (26) A single aggregate figure is sufficient disclosure. This should only include salvage and subrogation rights (other than shown at line 73) brought into account under the valuation rule in rule 4.5(10). The exercise of salvage rights which have resulted in the *insurer* acquiring an asset which is admissible in its own right, (e.g. land and buildings received by a direct mortgage indemnity insurer), need not be included.

Note 3

- (27) The amounts set off do not need to be disclosed in this note.

Note 4

- (28) The precise content of this account of any breach is not specified in the rules. However the *FSA* expects it typically at least to include an estimate of the amount of the excess and the reasons why it was permitted to arise. The requirement to give an account of any breaches during the year should not be read as implying that real-time monitoring of the exposures is necessary. Rather, the frequency of the monitoring should be appropriate to the make-up of the investment portfolio.
- (29) For the purposes of making the disclosures required by supplementary notes 1305, 1306, 1311 and 1312, *counterparty* has the same meaning as in paragraph 1 of **Appendix 4.2**. Also, the amount of any *counterparty exposure* should be calculated using the rules laid down in paragraphs 13 to 15 of that appendix, except that asset values should not be limited to the amounts of any permitted asset limits. The amount of any *counterparty exposure* should be stated before deduction of any excess *counterparty exposure* or excess concentration with a number of *counterparties*.
- (30) Assets excluded from the scope of the *counterparty exposure* rules may also be disregarded for the purposes of these supplementary notes disclosure. This excludes -
- (a) linked assets held to match *property linked liabilities*; and
 - (b) assets of the type listed in rule 4.14(5). For a list of such *asset* types see paragraph 5.25 of **Guidance Note 4.1**.

Note 5

- (31) The limit of 5% of the *long-term insurance business* amount should be used for *counterparty exposures* which arise from the *long-term insurance business assets* and such other than *long-term insurance business assets* as

are allocated toward the *long-term insurance business required minimum margin* (see line 22 of **Form 9**). This does not apply to a composite *insurer* which must use the *general insurance business amount* for such assets. The limit of 5% of the *general insurance business* amount should be used for all other *counterparty exposures*.

- (32) 29 and 30 also apply to this note.

Note 6

- (33) This disclosure covers those secured assets which are exempted from counting towards the appropriate permitted *counterparty exposure* limit by virtue of paragraph 14 of Part I of **Appendix 4.2**. (NB By no means all secured assets are so exempted). Secured assets which are exempted from the limit by virtue of some other provision, (e.g. rule 4.4 in relation to stock-lending collateral), should not be included. A single aggregate figure is sufficient disclosure.

Note 7

- (35) cf. (17).

Note 8

- (36) cf. (18).

Long term business liabilities and margins (Form 14)

Completion of the form

- 5.5 (1) **Form 14** should be completed by every *insurer* which carries on *long-term insurance business* in respect of:
- (a) its total *long-term insurance business liabilities* and margins; and
 - (b) the *long-term insurance business liabilities* and margins for each separate *long-term insurance business fund* or group of funds for which separate assets have been appropriated (see rule 9.12(b)).
- (2) The effect of item (1)(b) is that a separate **Form 14** is required for each fund or group of funds whenever a separate **Form 13** is required for that fund or group of funds - see 5.4(2). The category of assets box in the header of **Form 14** is to be completed with the same codes as are used for the corresponding box in the header of **Form 13**, except that there are no **Forms 14** required which correspond to the **Form 13** category of assets 1 to 9.
- (3) **Form 14** shows the liabilities and margins in respect of *long-term insurance business*. It is helpful to consider these under three separate headings:

- (a) the liabilities, (lines 11, 12 and 15 to 49);
- (b) the margins, (lines 13 and 51); and
- (c) the footnote to the form, (lines 61 to 63).

Liabilities

- (4) There are three basic types of liability which fall to be disclosed:
 - (a) *long-term insurance business liabilities* not yet fallen due, (lines 11, 12 and 23);
 - (b) accounting liabilities including *long-term insurance business liabilities* which had fallen due, (lines 15 to 22 and 31 to 39); and
 - (c) the provision for adverse changes, (line 41).

Different rules apply for determining the amount of each of these types of liability. *Long-term insurance business liabilities* (other than liabilities which had fallen due for payment before the *relevant date*) are determined on actuarial principles and the accounting liabilities are determined using generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for insurance companies - see the *Determination of Liability Rules*. In effect accounting liabilities are to be determined for inclusion in **Form 14**, (lines 15 to 22 and 31 to 39), in the same way as for *Companies Act* accounts. However if the *Companies Act* accounts are signed off earlier or later than the *returns* differences may still arise despite the application of the same rules. This might be due to, say, the occurrence of an adjusting post-balance sheet event in the intervening period. It is important to identify whether a liability falls to be determined under the actuarial or accounting rules as they may produce very different results.

- (5) *Long-term insurance business liabilities* are liabilities arising under or in connection with contracts for *long-term insurance business*, including liabilities arising from *deposit back arrangements*. Liabilities from *deposit back arrangements* (line 23) should be determined on actuarial principles in accordance with rules 5.6 to 5.17. They include the amount of the *deposit* (as disclosed under paragraph 12(2)(f) in the Abstract of Valuation Report prepared by the *appointed actuary* – **Appendix 9.4**) together with any additional provision which the *appointed actuary* considers to be required in accordance with actuarial principles. *Mathematical reserves* are defined so as to include all long term liabilities (other than those fallen due) with the exception of liabilities arising from *deposit back arrangements*. They are shown, other than for cash bonuses, at line 11 and, for cash bonuses, at line 12. The amounts shown are taken from the *appointed actuary's* valuation as recorded in **Form 58** - see instructions 2 and 3 to **Form 14** - and include any increases resulting from the allocation of bonuses to *policyholders* as a result of the valuation. Subject to one exception, the accounting liabilities (lines 15

to 22 and 31 to 39) should not include any amounts in respect of *technical provisions* and the fund for future appropriations which appear in *Companies Act* accounts as these are already, to the extent necessary, taken into account in setting the *mathematical reserves*. The exception is *claims* outstanding which had fallen due for payment at or prior to the *financial year end* - see lines 15 to 17 on **Form 14**.

- (6) The *FSA* interprets liabilities arising under or in connection with contracts for *long-term insurance business* to include liabilities arising under reinsurances of those contracts for *long-term insurance business*. This includes liabilities under financial reinsurances and by extension, even liabilities under non-reinsurance financing arrangements, provided the liability under the financing arrangement is closely linked to the performance of contracts for *long-term insurance business*. Therefore liabilities under financial reinsurances and such analogous financing arrangements - subject to the exception of liabilities which had fallen due - are to be determined under actuarial principles. This is important as the crystallisation of such liabilities is often - although not invariably - linked to the emergence of future profits. Future profits are not in themselves an asset admissible to match liabilities and may not be included on **Form 13**, (lines 11 to 89). However, provided the reinsurance or financing liability is repayable - as a matter of legal form and economic substance - only upon the emergence of the future profit, actuarial principles may sometimes allow the future profit to be taken into account in determining the amount of the liability. Accounting rules do not permit this treatment. They prohibit the offset of an asset against a liability except where they are amounts due to and from the same person and also impose other conditions - see Financial Reporting Standard 5.
- (7) The provision for adverse changes is an extra provision in addition to that which would be required under either actuarial or accounting principles. It arises when an investment (or transaction associated with an investment) will, or may, give rise to a liability in future and the company does not have the appropriate assets to cover that liability. (Most commonly, but not exclusively, this issue arises in respect of *derivative contracts*.) The provision is to be determined in accordance with rule 5.3.

Margins

- (8) The margins are the amounts by which the net *admissible asset* value of any *long-term insurance business fund* exceeds the *mathematical reserves* and cash bonuses for that fund. The margins are to be calculated in two stages as follows:
- (a) firstly, the amount of the *long-term insurance business fund* as per **Form 40** is compared with the *mathematical reserves* including cash bonuses (lines 11 and 12 on **Form 14**). The amounts of any excess/(deficit) is to be shown at line 13; and

- (b) secondly, the net *admissible asset* value of the long term fund - being the assets as per line 89 on **Form 13** less the liabilities as per line 49 on **Form 14** - is to be compared with the value of the long term fund as per **Form 40**. The amount of any excess is to be shown at line 51. An excess may only arise in those cases where the *insurer* has chosen to report its *long-term insurance business funds* on **Form 40** at a value other than the value of net *admissible asset*, e.g. using book costs for asset values. It is not permissible to report the fund at a value on **Form 40** which is higher than the value of net *admissible assets*. Therefore a deficit should never need to be shown at line 51.

The footnotes to the form

- (9) Lines 61 and 62 to the form show respectively the amounts included in the total liabilities and margins which is attributable to:
- (a) liabilities to related companies, other than those under *contracts of insurance*; and
- (b) liabilities in respect of *property linked benefits*.
- (10) The scope (but not the value) of the line 62 disclosure corresponds to *technical provisions* in the shareholder accounts (i.e. headings C and D in the balance sheet format in Schedule 9A to the *Companies Act*), but only in so far as they relate to *property linked benefits*. Line 62 shows the amounts of those liability items shown at heading C and D in the *Companies Act* accounts, but evaluates them using the **Form 14** valuation rules and not (where different) the *Companies Act* rules. The **Form 14** valuation rules are discussed at (4) to (7) above. NB. The effect of this guidance is that line 62 shows the amount of the *property linked liabilities* which are excluded from the calculation of the *long-term insurance business amount* for the purpose of applying *counterparty* limits - cf. paragraph 2 of **Appendix 4.2**.
- (11) Line 63 requires an *insurer* to disclose whether any part of the amount shown at line 51 represents an amount taken into account by the actuary to support the *mathematical reserves* (as shown in **Form 58**) in giving his certificate. This issue arises because the assets shown on **Form 9**, which are sourced from **Form 13**, are shown at their admissible value even where the *long-term insurance business fund* is maintained and brought into account in the **Appendix 9.4** report on the basis of lower book values. In such circumstances the *mathematical reserves* shown in **Form 58** may not always constitute an appropriate assessment of the liabilities for the purposes of comparison with the assets stated at admissible value. For this reason in certifying the long term liabilities as required under Part II of **Appendix 9.6**, the actuary may find it necessary in some circumstances to make an addition to the *mathematical reserves* on the **Appendix 9.4** basis shown at line 11 of **Form 14**.

Supplementary notes

- (12) Two supplementary notes are specified:
- (a) the methods and assumptions used to determine the amount of any provision for adverse changes (as shown at line 41 of the form), or if there is no such provision the methods and assumptions used to determine that no provision is required, should be stated - see paragraph 12 of **Appendix 9.1**. [Code 1401]
 - (b) specified details should be stated of (i) any charges over assets, (ii) potential capital gains tax liability, (iii) contingent liabilities, (iv) guarantees, indemnities or other contractual commitments effected other than in the ordinary course of *insurance business* and in respect of related companies, and (v) any other fundamental uncertainty - see paragraph 13(1) of **Appendix 9.1**. [Code 1402]. This note is to be given in respect of *long-term insurance business assets and liabilities*. A similar note (code 1502) is to be given in respect of other than *long-term insurance business assets and liabilities*. The guidance given for that note under 5.6(16) to (30) also applies here.

Liabilities - other than long term business (Form 15)

Completion of the form

- 5.6 (1) **Form 15** should be completed by all *insurers* except an *insurer* not trading for profit (i.e. a *mutual*) carrying on only *long-term insurance business* - see rule 9.12(7).
- (2) **Form 15** shows all liabilities of the *insurer* other than *long-term insurance business liabilities*, which are shown instead on **Form 14**.
- (3) **Form 15** consists of three parts:
- (a) lines 11 to 59 provide a line by line analysis of the liabilities (other than share capital and reserves and exclusively *long-term insurance business* items) corresponding to the balance sheet format in Schedule 9A of the *Companies Act*, i.e. the format required to be used in the preparation of the *Companies Act* accounts. In a few cases, however, a single item in that format is subdivided in **Form 15**;
 - (b) lines 61 to 63 list three further items of liability - (i) the provision for adverse changes, (ii) cumulative preference *share* capital and (iii) subordinated loan capital; and
 - (c) line 71 discloses the value (as included in the above items) of the liabilities to related companies, other than those under *contracts of insurance* or *reinsurance*.

Determination of liabilities

Lines 11 to 59

- (4) The liabilities at lines 11 to 59 should be valued in accordance with the *Determination of Liabilities Rules*, the main provision of which is rule 5.2 which provides that:
- (a) the amount of liabilities of an *insurer* must be determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for *insurers*; and
 - (b) in determining under (a) the amount of liabilities of an *insurer*, all contingent and prospective liabilities must be taken into account including all liabilities in respect of cumulative preference *share* capital but excluding other liabilities in respect of *share* capital.
- (5) (4)(b) above does not require that the amount of every prospective and contingent liability be set equal to the full extent of its nominal value regardless of the remoteness of the contingency it represents. The requirement is merely that all prospective and contingent liabilities be taken into account, i.e. considered. The amount of every liability whether present, prospective or contingent should be set as required under (4)(a) in accordance with generally accepted accounting concepts.
- (6) The requirement in (4)(a) that generally accepted accounting concepts be used means, in effect, that the liabilities at lines 11 to 59 are to be valued for the *returns* in the same way as for the *Companies Act* accounts. For *technical provisions* this is indeed explicitly stated by rule 5.4, which refers to the rules in Section D of Chapter II of Schedule 9A to the *Companies Act*.
- (7) However, (6) does not mean that the value shown for such liabilities in the *return* will always necessarily be the same as that shown in the *Companies Act* accounts. Exceptionally differences may occur if the *return* and *Companies Act* accounts are either:
- (a) drawn up to different balance sheet dates; or
 - (b) even if drawn up to the same balance sheet date, signed off at different dates.
- (8) In the (7)(b) case it is possible that a material adjusting post-balance sheet event may have occurred between the date of the sign off of the *Companies Act* accounts and the date of the sign off of the *return* (or vice versa).
- (9) The *technical provision* for *claims* outstanding (line 12) should be shown before or after reduction for anticipated salvage and subrogation recoveries

according to the treatment adopted in preparing **Form 13**. See 5.4(16), but compare the possibly different treatment in the technical account, **Forms 20 to 39** - see 8.2(6).

Lines 61 to 63

- (10) The provision for adverse changes (line 61) is an extra provision which arises when an investment (or transaction associated with an investment) will, or may, give rise to a liability in future and the *insurer* does not have the appropriate assets to cover that liability. (Most commonly, but not exclusively, this issue arises in respect of *derivative contracts*). The provision is in addition to any liability which would be required to be provided in accordance with generally accepted accounting practice. It is required to be determined in accordance with rule 5.3.
- (11) *Share* capital is not normally to be considered a liability for the purposes of completing the *return* - see rule 5.2(2). The only exception (see rule 2.10(3)) is cumulative preference *share* capital, but this exception is in turn subject to a partial exception as explained in (12) and (13).
- (12) In determining whether an *insurer* has assets in excess of its liabilities, the full nominal value (plus any premium on redemption if redeemable) of all cumulative preference share capital is to be counted as a liability. If the assets exceed liabilities then part (sometimes all) of the liability from the preference *share* capital may be disregarded in determining whether the net assets exceed the *required margin of solvency*.
- (13) In **Form 15** (line 62) the full value of cumulative preference *share* capital is to be shown, i.e. the value to be used in determining whether the *insurer* has assets in excess of liabilities. This full value then forms part of the total liabilities which are taken from **Form 15** to **Form 10** where they are compared with the total assets taken from **Form 13**. If assets exceed liabilities the part of the liability for preference share capital which may be disregarded in determining whether the net assets exceed the required margin of solvency, is added back as an adjustment to net assets on **Form 10**. No adjustment is to be made on **Form 15**. See 5.2(6), concerning **Form 10**, for further guidance.
- (14) Subordinated loan capital is to be valued according to rule 5.2, i.e. in accordance with generally accepted accounting concepts. Where a *insurer* has been granted a direction under section 148 of the *Act* permitting it to disregard all or part of the liability for its subordinated loan capital in determining whether its net assets exceed its required minimum margin, the adjustment for the amount to be disregarded is to be made solely on **Form 10** and not on **Form 15**. (The reason for this treatment of the add-back is the same as that described above for the add-back in respect of preference *share* capital).

Supplementary notes

- (15) Three supplementary notes are specified:
- (a) the methods and assumptions used to determine the amount of any provision for adverse changes (as shown at line 51 of the form), or if there is no such provision, the methods and assumptions used to determine that no provision is required, should be stated - see paragraph 12 of **Appendix 9.1**. [Code 1501]
 - (b) specified details should be stated of (i) any charges over assets, (ii) potential capital gains tax liability, (iii) contingent liabilities, (iv) guarantees, indemnities or other contractual commitments, effected other than in the ordinary course of *insurance business*, in respect of related companies, and (v) any other fundamental uncertainty - see paragraph 13(1) of **Appendix 9.1**. Guidance is given in (16) to (30) on each of the items (i) to (v) to be included in this note and in the corresponding note [Code 1403] to **Form 14**, (see 5.5(12)); and [Code 1502]
 - (c) the aggregate amount of any accrued dividend on any cumulative preference *share* capital issued by the *insurer* should be stated - see instruction 2 to **Form 15**. [Code 1503]

Guidance on Note 1502

- (16) Where for any of the items 15(b)(i) to (v) there is no charge, potential capital gains tax liability, contingent liability, guarantee etc., or fundamental uncertainty to report this should be stated.

Item (15)(b)(i)

- (17) The details to be disclosed of any charge over assets are:
- (a) the nature of the charge, including a brief description of the terms which are relevant to securing the prior claim of any person to assets which are subject to the charge;
 - (b) for each line in **Form 13**, the amount included in respect of assets which are subject to the charge; and
 - (c) for each line in **Form 14** or **15**, the amount included in respect of liabilities which are secured by the charge.
- (18) ‘Charge’ is given a wide definition - see paragraph 13(5) of **Appendix 9.1**. It includes not merely formal charges over assets which are registered under the *Companies Act* but also any arrangement whatsoever, whether contractual or otherwise, which operates to secure the prior claim of any

person to any assets in preference to the general creditors on a winding up of the *insurer*. Amongst other items 4 includes:

- (a) arrangements whereby assets of the *insurer* are placed in trust for the prior benefit of only some creditors;
 - (b) assets held as collateral by creditors or by issuers of letters of credit;
 - (c) fixed and floating charges; and
 - (d) equivalent arrangements under the laws of overseas countries.
- (19) It also, in principle, applies to set offs, i.e. where a person owed amounts by the *insurer* may in a winding up set off amounts owed by it to the *insurer*. However, in practice where the *insurer* has accounted for set offs in accordance with generally accepted accounting practice, the assets shown in **Form 13** will already be net of such set offs and so no disclosure under this note will be needed. Amounts due to preferential creditors (e.g. PAYE) need not be disclosed.
- (20) A charge should be disclosed even where it only serves to secure the prior claim of a contingent or potential creditor which has not resulted in any provision for liability in either **Forms 14** or **15**.
- (21) (15)(b)(i) refers to any charge, thus in principle requiring separate disclosure of each arrangement which falls within the definition of a charge. However, where clarity or brevity require, it is acceptable to disclose in aggregate charges which arise from the same related series of transactions, or charges which are of the same nature and have substantially the same relevant terms.
- (22) The disclosure of charges is subject to a de minimis exemption. One or more charges need not be disclosed, provided that the aggregate value (as show on **Form 13**) of all the assets subject to the non-disclosed charges does not exceed 2.5% of the *general insurance business amount* or *long-term insurance business amount*, as appropriate.

Item (15)(b)(ii)

- (23) The total potential liability should be calculated on the basis of a hypothetical disposal of all assets immediately after the year end. It should include liability to foreign taxes on capital gains.

Item (15)(b)(iii)

- (24) Financial Reporting Standard 12 (FRS 12) defines a contingency as a condition which exists at the balance sheet date where the outcome will be confirmed only on the occurrence or non-occurrence of one or more uncertain future events. A contingent liability is a loss dependent on a contingency. FRS 12 distinguishes between contingent liabilities which are

probable or remote. A remote contingent liability need not be disclosed in this note.

- (25) 'Inward' in the expression 'inward *contracts of insurance and reinsurance*' is intended to exclude from the exemption contracts of *reinsurance* where the reporting *insurer* is the reinsured.
- (26) The disclosure of contingent liabilities is subject to a de minimis exemption. One or more contingent liabilities need not be disclosed provided that the aggregate value of the non-disclosed contingent liabilities does not exceed 2.5% of the *general insurance business amount* or *long-term insurance business amount*, as appropriate.

Item (15)(b)(iv)

- (27) *Related company* is defined as:
 - (a) a *dependant* of the *insurer*;
 - (b) a company of which the *insurer* is a *dependant*; or
 - (c) a *dependant* of a company of which the *insurer* is a *dependant*-
- (28) In the *FSA's* view, a guarantee, indemnity or other contractual commitment should not be considered as given other than in the ordinary course of an *insurer's* business where guarantees, indemnities or other contractual commitments on substantially the same terms and conditions are not regularly given to non-related entities in similar circumstances. An example of a contractual commitment which need not be disclosed might be where a motor *insurer* insures the motor car fleet of a related company using the same underwriting principles as it uses for its other fleet business.
- (29) 15(b)(iv) refers to (i) 'maximum liability ... specified in such guarantee, indemnity or contractual commitment', (ii) 'amount of provision' and (iii) 'amount reported under (15)(b)(iii), (i.e. reported as a contingent liability). The distinction between these three items may be illustrated by an example.

An *insurer* guarantees the bank overdraft of its two fellow subsidiaries up to an aggregate of £100,000. At the year end:

- (a) fellow subsidiary A is insolvent and has an overdraft of £5000; and
- (b) fellow subsidiary B is believed (on the balance of probabilities) to be solvent and has an overdraft of £10,000.

A provision of £5000 (in respect of A) would be made in **Form 15** and a contingent liability of £10,000 (in respect of B) would be included in the disclosure under (15)(b)(iii).

The disclosure under (15)(b)(iv) would then be:

- (i) maximum liability specified in the guarantee = £100,000;
- (ii) provision = £5,000; and
- (iii) contingent liability = £10,000;

together, of course, with a brief description of the terms and circumstances of the guarantee, including the identity of the person to whom the guarantee is given and of the persons in respect of whom it was given and of the relationship with the latter (and, if applicable, with the former).

Item (15)(b)(v)

- (30) This is intended to cause to be disclosed the circumstances of any uncertainty which is of a fundamental nature. Note that, unlike (15)(b)(iii), this does not exclude uncertainties arising from inward *contracts of insurance* or *reinsurance*.

Profit and loss account (non-technical account) (Form 16)

Completion of the form

- 5.7
- (1) **Form 16** should be completed by all *insurers* - see rule 9.13. However, for a *mutual insurer* carrying on only *long-term insurance business*, the form usually will include no entries. Where this is the case for both the current and previous *financial year*, the blank form may be omitted provided the supplementary note [Code 1600] under 4.6(6) is included in the *return*.
 - (2) The headings used on **Form 16** are based on those used in the 'Profit and Loss Account - Non Technical Account' format in Schedule 9A of the *Companies Act* (i.e. the format to be used in preparing *Companies Act* accounts) and, except where referenced to other Forms, the amounts included under those headings should be determined using the same rules as apply for the *Companies Act* accounts.
 - (3) One such exception occurs at line 13 (Transfer from the *long-term insurance business* revenue account) which is referenced to **Form 40**. As a result, for *long-term insurance business* **Form 16** presents a profit for the *financial year* determined on the statutory basis and not the modified statutory basis.
 - (4) Unrealised gains and losses on investments (other than for investments in the long term fund) should be included in their entirety at lines 15 and 18, even if different accounting treatment is adopted in the *Companies Act* accounts. Unrealised gains and losses should be measured by reference to the value included for the investment at line 99 on **Form 13**, i.e. the *Companies Act* accounts value. An *insurer* which includes investments at amortised cost at

line 99 on **Form 13** (see 5.4(22)) should show the unrealised gain and loss relative to that amortised cost not to current *market value*.

Supplementary notes

- (5) Four supplementary notes are specified:
- (a) the bases of conversion adopted in respect of foreign currency for income and expenditure should be stated - see paragraph 5(2) of **Appendix 9.1**; [Code 1601]
 - (b) in addition to (a), where any brought forward amounts on any Form are restated due to currency reconversion this fact should be briefly stated in a supplementary note to **Form 16**. A simple statement of this fact is all that is needed, e.g. 'Some of the brought forward amounts shown in the forms xx to xx have been restated from the corresponding carried forward amounts included in the previous years *return* due to the reconversion of foreign currency amounts at a different rate of exchange'. No further details need be given. This note is required to facilitate the *FSA's* computerised validation of the *return*; [Code 1602]
 - (c) particulars of any amounts included at lines 21 on **Forms 16** should be stated - see the face of **Form 16**; and [Code 1603]
 - (d) particulars of any amounts included at lines 41 on **Forms 16** should be stated - see the face of **Form 16**. [Code 1604]

Analysis of derivative contracts (Form 17)

- 5.8 (1) A **Form 17** should be submitted for each category of assets for which a **Form 13** is submitted (other than categories of assets '2' to '9') - see rule 9.12(5) and instruction 1 to the **Form**.
- (2) The paragraphs below consider the following points:
- (a) which derivatives need to be entered on the form;
 - (b) what needs to be recorded in respect of the amounts of margin paid or received;
 - (c) what reconciliation there is to other forms; and
 - (d) what approach is needed for instruments which are required, under the *Asset Valuation Rules*, to be treated as derivatives even though they may have some other legal form (i.e. quasi-derivatives or contracts or assets having the effect of a *derivative contract*).

- (3) Derivatives used for the purpose of matching *index linked* or *property linked liabilities* are not to be recorded on **Form 17**. (These are covered on **Forms 55** or **56**.) However, to the extent that the *insurer* holds *derivative contracts* in connection with *linked contracts*, but additional to the amounts necessary to match linked liabilities, these should be recorded on **Form 17**. For example, if an *insurer* has transacted a tranche of derivatives to match linked liabilities in the expectation of selling a particular volume of linked business, but where the actual volume fell short of expectations, the excess would be recorded on **Form 17**. Similarly, if an *insurer* retains excess derivatives no longer necessary for matching purposes (for example, as a result of policy surrenders), these would also be recorded on **Form 17**.
- (4) Quasi-derivatives are not recorded on the face of **Form 17**, but are required to be shown as a supplementary note [Code 1702] - see (25) and (26).
- (5) Where a provision for adverse changes is required in accordance with rule 5.3, no adjustment is to be made on **Form 17** to the value of the derivative which gave rise to the provision. The provision itself is to be shown on **Form 14** or **15**, as appropriate.

Instructions to the Form

- (6) *Instruction 1*: A **Form 17** should be completed for the other than long term assets and the long term assets separately. Each *long-term insurance business fund* separately accounted for by a separate **Form 13** should also have a **Form 17** completed - see instruction 1 to the Form. A sub fund whose accounting details are only given as part of **Appendix 9.4** should be covered by a commentary in that Appendix.
- (7) *Instruction 2*: The same codes should be used for the category of assets header box on **Form 17** as on the corresponding **Form 13**.
- (8) *Instruction 3*: Analysis is by the principal underlying asset. When there is a mixture of asset types, the derivative should be split if it is sensible to do so, if not then it should be categorised under the most significant asset type.
- (9) *Instruction 4*: Derivatives are to be assigned to the assets and liabilities columns according to whether the gross position is an asset or a liability and irrespective of the net position after margin.
- (10) *Instruction 5*: The asset values to be shown are gross of any *variation margins* received (or, unusually, paid) - i.e. assuming such margin has been reversed. The asset values are to be as determined under the *Asset Valuation Rules*, i.e. before the further liability under rule 5.3 (which of course can apply to an uncovered asset). **Form 17** does not, therefore, deal with economic exposure to various asset classes (as for example, in a 'LIFFE-style' presentation). This issue is dealt with in the supplementary information provided in accordance with rule 2.10.

- (11) *Instruction 6*: Netting of derivative positions may be permissible for the purpose of completing **Form 17**, provided it would be permissible under generally accepted accounting practice. However, there are additional pre-conditions to netting. Within a **Form 17**, derivatives which partly or wholly offset one another (for example, a bought future and a sold future on the same index) cannot be netted to one net asset or liability figure unless there is a legal right of set off with the *counterparty* concerned, or between the *counterparties* concerned. Where the derivatives are with the same *counterparty* and legal set off applies, but the derivatives are not symmetrical, i.e. they do not cancel or part cancel out a given position, then gross figures should be shown. Where a legal right of set off applies, but the derivatives have to be reported on separate **Forms 17**, they should be shown gross in each form.
- (12) *Instruction 7*: The aggregate amount of *variation margin* then to be offset is to be shown at line 41.
- (13) *Instruction 8*: The assets shown at line 49, column 1 should be included at line 44 in **Form 13**. Where line 49, column 1 also includes deductions for applicable margins these should be included either in **Forms 14** or **15** as liabilities or in **Form 13** as deductions from assets according to the same accounting treatment as is adopted in the *Companies Act* accounts, (or if there are no such accounts according to generally accepted accounting practice). Other general buffer or good faith margins paid out (*initial margins*) should appear on **Form 13**, probably on line 78.
- (14) *Instruction 9*: Similarly the liabilities shown at line 49, column 2 should be in **Form 14** (if long term) or **Form 15** (if other than long term) at lines 38 and 49 respectively. Also deductions for applicable margins which are included at line 49, column 2 should be included in **Form 13**, or **14/15** according to the same accounting treatment as adopted in the *Companies Act* accounts (or if there are no such accounts, according to generally accepted accounting practice).
- (15) *Instruction 10*: No entry is to be made on **Form 17** in respect of *initial margin* paid or received.

Further points on margins

- (16) The *variation margin* received for assets acts as an offset to the value of the derivative that flows through to **Form 13**, and such margin then needs to be categorised itself in **Form 13**, probably under *deposits* if the margin payment is deposited with the *insurer's* bankers. *Initial margins* should however appear in **Form 13**, normally line 78, i.e. unsecured amounts due to the *insurer*, unless the *insurer* has more unusually received initial margin and so the amount is due to a creditor. It should be noted that the definition of *variation margin* may be wider than a market understanding as it includes all collateral arrangements. It is this wider definition which should be applied in completion of **Form 17**.

- (17) In the unusual situation of a *variation margin* payment to the broker on a asset, then such an amount should appear on **Form 17** as a positive entry at line 41, and thus an appropriate increase to the asset.
- (18) Liabilities follow the normal accounting rules of rule 5.2. Again, the inclusion of all *variation margins* is necessary, even if this makes the resultant entry on **Forms 14** of **15**, as appropriate, become negative. The offset of margins paid against the amount of the liability means no further entries are needed, as the net entry at line 47 of **Forms 14** or **15** encapsulates the offset of the derivative liability and the sums put up in surety for such liability. In the unusual case of amounts received from the broker on a liability such amount should appear in **Form 17** as a positive entry at line 41, thus an appropriate increase to the liability.
- (19) Asset and liability margin payments must be accounted for separately. Margin is that actually received as cash or *securities* from a broker or paid to a broker. Amounts due to be paid by either party, or amounts held in an account at the broker, where the *insurer* has no legal rights over such account, are not transferred margin and should not be presented as such. **Form 17** must demonstrate the margins actually received into the possession of the *insurer* or released by the *insurer*. Thus, at any reporting date, even daily margined contracts may be a day behind as the margin process is not instantaneous.
- (20) Margin received or paid to different *counterparties* cannot be offset under any circumstances, even where the *counterparties* are *connected companies*. Similarly, margin paid to and received from a single *counterparty* cannot be offset, where no legal right of offset applies. Thus one over-margined asset cannot have its deduction for margin on **Form 17** reduced to allow the reduction of a **Form 17** margin on an over-margined liability, unless legal rights of offset apply.
- (21) Margin must mean the amounts transferred back and forth under the terms of the derivative. Only amounts closely connected to the derivative under a formal agreement that has legal rights of offset between the margin payment and the settlement of the derivative should be included, and not other deposits from or with the *counterparty*.
- (22) Where margin payment is by pledges of assets, such as short gilts, then the same approach should be followed. Unconditional granting of title to a broker will mean the asset can no longer be recorded as that of the *insurer*, and has been replaced by a *debt* due from the broker.

Supplementary notes

- (23) Two supplementary notes are specified in paragraphs 16 and 17 of **Appendix 9.1**, covering treatment of variation margin [Code 1701] and use of quasi-derivatives [Code 1702].

Note 1

- (24) This note (see paragraph 16 of **Appendix 9.1**) needs three separate items, as follows:
- (a) the aggregate amount of an excess *variation margin* which has been received by the *insurer*, the excess being due to market movements which have subsequently been partly or wholly reversed;
 - (b) how *variation margin* received is distributed amongst the different lines of **Form 13**;
 - (c) the extent to which the amount recorded in any line of **Form 13** has been reduced to reflect the liability to repay any excess referred to above.

Note 2

- (25) A further supplementary note is prescribed covering quasi-derivatives - see paragraph 17 of **Appendix 9.1**. These are exempt from special disclosure, provided that, in aggregate, they are below the 'materiality threshold' set out in paragraph 17. Separate thresholds apply for assets and liabilities and are to be calculated prior to any adjustment for *variation margin*.
- (26) For quasi-derivatives which are assets, the test at paragraph 17 of **Appendix 9.1** is whether the aggregate value of all such quasi-derivatives exceeds 2.5% of the total **Form 13** asset value (i.e. for the *long-term insurance business fund* or a *long-term insurance business* sub fund the *non linked, property linked* and *index linked* assets totalled at line 89 of the particular **Form 13**). No attempt should be made to value the derivative component of a quasi-derivative separately and apply the materiality test to that component; the test should be applied to the value of the instrument as a single entity.
- (27) For quasi-derivatives that are liabilities, the test of disclosure is in some ways more demanding, being whether the aggregate liability of all such quasi-derivatives would exceed 2.5% of the non insurance liabilities of **Forms 15** or the relevant **Form 14**, as appropriate. Any provision under rule 5.3 would count towards this aggregate liability, even where it arises from a quasi-derivative that is currently an asset.
- (28) If the holdings are sufficiently significant to trigger disclosure, then the (non-zero) amounts contributed by quasi-derivatives to each line in **Forms 13, 14** and **15** should be stated. In addition, the information specified under Note 1 is also required in respect of such contracts.
- (29) Leaving aside quasi-derivatives used for the purpose of matching linked liabilities, it would be a little unusual for quasi-derivatives to be subject to margining arrangements. In any event, the *Valuation of Assets Rules* and

Determination of Liabilities Rules make no provision for valuation of quasi-derivatives net of value of margin (or collateral) and the appropriate values for the purposes of this disclosure are therefore the gross asset or liability values. Any margins paid or received should appear in **Forms 13, 14** or **15** as debtor or creditor items.

- (30) An example of the disclosure required when the materiality test is passed is as follows:

‘A FTSE-linked bond with embedded option to achieve a guaranteed maturity value of £10m was included in line 48 of **Form 13**. The current value of the bond is £11m. The bond is not margined and was held for the full year.’

Examples

- (31) A number of illustrative examples of completion of **Form 17** are given in **Annex B**.

ANNEX A TO PARAGRAPH 5

Examples of the completion of the reconciliation at the foot of Forms 10 and 13

5.A.1 Example one: the reconciliation on Form 13

In this example an *insurer* shows the following assets in its *Companies Act* accounts.

<i>Assets</i>	<u>1996</u>	<u>1995</u>
Shares in UK insurance subsidiary	1000	1000
Cash at bank	2000	1500
Gold	100	-
	<hr/> 3100	<hr/> 2500

In preparing **Form 13** of its *return* the *insurer* must revalue its assets using the valuation rules. Let us say the revised values are as follows.

Balance sheet: Assets	<u>1996</u>	<u>1995</u>
<i>Investment in insurance dependant</i>		
Basic 'look through' value	900	800
Disallowed under admissibility rules	(100)	(100)
Solvency margin deduction	(200)	(200)
	<u>600</u>	<u>500</u>
<i>Cash at bank</i>		
Valuation	2000	1500
Disallowed under admissibility rules	(200)	(100)
	<u>1800</u>	<u>1400</u>
<i>Gold</i>		
	nil	nil

Form 13 should be prepared with the following entries.

Form 13		<u>1996</u>	<u>1995</u>
UK insurance <i>dependants</i> - shares	21	600	500
Cash at bank - <i>deposits</i>	82	1800	1400
Grand total of <i>admissible assets</i>	89	<u>2400</u>	<u>1900</u>
Reconciliation			
Total - as per line 89 above	91	2400	1900
Total assets in excess of admissibility limits ⁽¹⁾	92	300	200
Solvency margin deduction ⁽²⁾	93	200	200
Other differences ⁽⁴⁾	94	100	200
Assets of a type not valued above ⁽³⁾	95	100	-
Total assets determined in accordance with the shareholder accounts rules	99	<u>3100</u>	<u>2500</u>

Explanations of the above

- (1) 300 = 100 + 200; being the amounts shown above as disallowable under the admissibility limits respectively for the investment in *dependant* (100) and the cash at bank (200).
- (2) This is the solvency margin deduction for the insurance *dependant*.

- (3) This is the value of the gold as per the *Companies Act* accounts. There is no valuation rule, and hence nil value, for gold under the rules.
- (4) This is the total of all other valuation differences not dealt with at lines 92, 93 or 95. In this examples there is only one such difference: that is the difference between the *Companies Act* accounts value of the insurance *dependant* (£1000) and the basic 'look through' value (£900).

5.A.2 Example two: the reconciliation on Form 10 for a general business company

In this example an *insurer* has the same assets as in example one above and shows the following amounts for liabilities in its *Companies Act* accounts.

Balance sheet: liabilities	<u>1996</u>	<u>1995</u>
<i>Share capital</i>	1000	1000
Profit and loss account	1000	700
	<hr/>	<hr/>
	2000	1700
<i>Technical provisions</i>	1000	700
Creditors	100	100
	<hr/>	<hr/>
	3100	2500

The *insurer's* **Form 13** is as in example one above and its **Form 10** as follows.

Form 10⁽¹⁾	<u>1996</u>	<u>1995</u>
Other than Ltb - <i>admissible assets</i> ⁽²⁾	21 2400	1900
Other than Ltb - liabilities ⁽³⁾	22 1,100	800
Available assets	29 <hr/> 1300	<hr/> 1100
Represented by		
Paid up <i>share</i> capital	51 1000	1000
Balance of net assets ⁽⁴⁾	56 300	100
Total - equal to line 29 above	59 <hr/> 1300	<hr/> 1100
Movement of balance of net assets		
Balance brought forward	61 100	50 ⁽⁶⁾
Retained profit	62 300	50 ⁽⁶⁾
Movement in asset valuation difference ⁽⁵⁾	63 (100)	
Balance carried forward as per line 56	69 <hr/> 300	<hr/> 100

Explanations of the above

- (1) Blank lines have been omitted.
- (2) This is taken from line 89 in **Form 13** - see example one above.
- (3) This is *technical provisions* (1000) plus creditors (100).
- (4) This is the balancing figure.
- (5) This is the difference for lines 92 to 95 on **Forms 13** between the comparative amounts, (200 + 200 + 200) and the present year amounts (300 + 200 + 100 + 100) – 5.A.1, example one.
- (6) The comparative amounts at lines 61 and 62 are illustrative only. They cannot be derived from the other data given in this example.

5.A.3 Example three: the reconciliation on Form 10 for a long-term insurance business company

In this example an *insurer* shows the following amounts in its *Companies Act* accounts.

Assets	<u>1996</u>	<u>1995</u>
Investments	1000	1200
Cash	800	400
<i>Deferred acquisition costs</i>	40	20
	1840	1620
<i>Share capital</i>	100	100
Profit & loss account	350	220
Fund for future appropriations	700	600
<i>Technical provisions</i>	490	400
Creditors	200	300
	1840	1620

The profit and loss account for 1996 shows a transfer to the Fund for Future Appropriations of 100 and a retained profit of 130. In the *return* the following items are shown on **Forms 13 to 16**.

Form 13		<i>Long-term Insurance Business</i>		<i>Other than long-term insurance business</i>	
		<u>1996</u>	<u>1995</u>	<u>1996</u>	<u>1995</u>
Equity shares	41	600	650	200	250
Cash at bank - <i>deposits</i>	81	700	300	100	105
Grand total of <i>admissible assets</i>	89	1300	950	300	355
Excess of admissibility limits	92	100	150	100	145
Total assets determined in accordance with the shareholder accounts rules ⁽¹⁾	99	1400	1100	400	500

(1) This amount should not include *long-term insurance business deferred acquisition costs* -see 5.4(20).

Form 14 (part)		<u>1996</u>	<u>1995</u>
<i>Mathematical reserve</i>	11	507	404
Balance of long term funds	13	193	156
		700	560
Creditors etc.	49	150	100
Excess assets etc.	51	450	290
Total	59	1300	950

Form 15 (part)		<u>1996</u>	<u>1995</u>
Total liabilities	59	50	200
Provision for adverse changes	61	18	12
Total	69	68	212

Form 16 (part)		<u>1996</u>	<u>1995</u>
line 59 - retained profit		50	100

Form 10 should now be completed as follows.

Form 10		<u>1996</u>	<u>1995⁽⁵⁾</u>
<i>Long term insurance business - assets</i>	11	1300	950
<i>Long term insurance business - liabilities</i>	12	1300	950
Other than LTB - assets	21	300	355
Other than LTB - liabilities	22	68	212
Available assets	29	232	143
Paid up <i>share</i> capital	51	100	100
Balance of net assets	56	132	43
	59	232	143
Balance of net assets - b/f	61	43	73
Retained profit ⁽¹⁾	62	50	100
Movement in asset valuation differences ⁽²⁾	63	45	(90)
Increase in provision for adverse changes ⁽³⁾	64	(6)	(40)
Other movements ⁽⁴⁾	65	-	-
Balance of net assets - c/f	69	132	43

<u>1002 Reconciliation to shareholder accounts</u>	<u>1996</u>	<u>1995</u>
	<u>£'000</u>	<u>£'000</u>
<u>Net assets as per return</u>		
line 99 on Form 13 (OLTB)	400	500
line 59 on Form 15	(50)	200
	<u>350</u>	<u>300</u>
<u>Capital and reserves as per shareholder accounts</u>	<u>450</u>	<u>320</u>
Difference due to assets retained in the <i>long-term insurance business fund</i> in excess of the fund for future appropriations ⁽⁶⁾	<u>100</u>	<u>20</u>

Explanations of the above.

- (1) This is the retained profit as per **Form 16**.
- (2) This is the difference for lines 92 to 95 on **Forms 13** between the comparative amounts, (145) and the present year amounts (100).
- (3) This the increase in the provision for adverse changes as shown on **Form 15** only.
- (4) This is the balancing figure, i.e. the differences not shown at the other lines.
- (5) The comparative amounts at lines 61 to 69 of **Form 10** are illustrative only. They cannot be derived from the other data given in this example.
- (6) This is taken from the *Companies Act* accounts as follows: value of assets in the *long-term insurance business fund* (1400 + 40) less *long-term insurance business technical provisions* (490) less *long-term insurance business creditors* (150) less fund for future appropriations (700).

ANNEX B TO PARAGRAPH 5

Examples of completion of Forms 13, 14, 15 and 17 in respect of derivative holdings

5.B.1 Introduction to the examples

- (1) The examples introduced below illustrate the inter-relationship between **Forms 13, 14 (or 15) and 17**. Some relate to illustrative examples described in **Guidance Note 4.2**. The derivatives used in the examples are described in section 5.B.2.
- (2) The examples can be summarised as follows.

Example 1 - Derivatives used to rebalance portfolio (much as example C in **Guidance Note 4.2** but reversed to illustrate treatment of assets). *Initial margin* not accounted for on **Form 17**.

Example 2 - Treatment of simple derivative (*option*) which is a liability. Illustration that, in accordance with instruction 4 to **Form 17** (see 5.8(9)), negative assets or liabilities can arise as a result of margining.

Example 3 - Two equity futures and a currency forward (as example X in **Guidance Note 4.2**).

Example 4 - Direct asset, derivative and both inadmissible asset and rule 5.3 items (as example SS in **Guidance Note 4.2**, amended slightly to allow inadmissibility offset). Provision for adverse changes also required.

Example 5 - Range of direct assets and derivative with *counterparty* inadmissibility. The asset inadmissibility has been ignored to avoid making the example overly complex.

Example 6 - Sterling to DM interest rate swap. Illustrates provision for adverse changes on uncovered swap.

5.B.2 Derivatives used in the examples

- (1) These are defined here so that the examples can refer to the instruments involved in a more abbreviated form. The example defines whether the derivative is bought or sold.

Futures

- (2) A traded long gilt *futures contracts* from 7/12/94 for settlement March 1995 at a price then of 101 15/32. This was valued at 31/12/94 at 100 23/32 (after 100 15/32 on 30/12/94) giving a liability per bought contract of £50,000 times 24/32ths or £375.
The *initial margin* was £1000 per contract and *variation margin* of £500 per contract had been paid to date.

- (3) A currency forward for US dollars for settlement in March 1995. This was valued at 31/12/94 at a 3 month rate of exchange of 0.6393 when the cash market was 0.6391, taken (for simplicity of illustration) as a liability of £(0.6393-0.6391) per \$1,000,000 purchase or £200

Options

- (4) A traded BP call *option* at 420p from 7/12/94 for expiry by April 1995. This was valued at 25p at 31/12/94 (after 26p at 30/12/94) and thus 25p x 1000 or £250 per contract. *Initial margin* as writer £1000 and *variation margin* of £50 paid to date.
- (5) A traded BP put *option* at 420p from 7/12/94 for expiry by April 1995. This was valued at 14p at 31/12/94 (after 13p at 30/12/94) and thus 14p x 1000 or £140 per contract. *Initial margin* as writer £1000 and no *variation margin* to date.
- (6) A traded FTSE 100 call *option* at 3100 from 7/12/94 for expiry by June 1995. This was valued at 143 at 31/12/94 (after 145 at 30/12/94) and thus

143 x £10 or £1430 per contract. *Initial margin* as writer £1000 and *variation margin* to date of £1450.

Contracts for differences

- (7) A traded FTSE 100 future from 7/12/94 for settlement March 1995 at a price then of 3036. This was valued at 31/12/94 at 3092 (cash market 3065.5) after 3077 on 30/12/94 and thus $(3092-3036) \times £25$ or £1400 per contract. The *initial margin* was £2000 per contract and *variation margin* of £1025 per contract had been paid to date.
- (8) A traded S&P 500 future from 7/12/94 for settlement March 1995 at a price then of 457.0. This was valued at 31/12/94 at 461.35 (cash market 459.27) after 464.6 on 30/12/94 and thus $(461.35-457.0) \times \$500$ or \$2175 per contract. The maintenance margin was \$1500 per contract and had been topped up by \$4000 per contract to date.
- (9) A swap of sterling to DM short interest rates on £30m of sterling, expiring May 1995. This was valued at a liability of £500,000 at 31/12/94.

5.B.3 Example one: much as example C in **Guidance Note 4.2**

100 bought Traded FTSE 100 *future contracts*, total asset £140,000

150 sold Traded Long Gilt *future contracts*, total asset £56,250

Total margin £97,500 on FTSE 100 future with broker, £200,000 paid to broker as *initial margin* and £102,500 received from broker as *variation margin*.

Total margin £75,000 on Long Gilt with broker, £150,000 paid to broker as *initial margin* and £75,000 received from broker as *variation margin*.

Initial margin taken to line 56 of **Form 13**, receipt of *variation margin* assumed on deposit, thus line 54 of **Form 13**.

FORM 14 (part)		
<i>Long-term insurance business liabilities and margins</i>	As at the end of the <i>financial year</i>	
Other Creditors	38	
Provision for adverse changes	41	
TOTAL	59	

FORM 13 (part)		
<i>Admissible Assets</i>	As at the end of the <i>financial year</i>	
Equity shares	41	
Rights under <i>Derivative Contracts</i>	44	19
<i>Deposits less than 1 month</i>	54	177
<i>Deposits more than 1 month</i>	55	
Other financial Investments - Other	56	350
TOTAL	99	546

FORM 17				
<i>Derivative Contracts</i>			As at the end of the <i>financial year</i>	
			Assets	Liabilities
<i>Futures Contracts</i>	Fixed Interest	11	56	
	Equity Shares	12		
<i>Options</i>	Land	13		
	Currencies	14		
	Other	15		
	Fixed Interest	21		
	Equity Shares	22		
	Land	23		
	Currencies	24		
<i>Contracts for differences</i>	Other	25		
	Fixed Interest	31		
	Equity Shares	32	140	
	Land	33		
	Currencies	34		
	Other	35		
Adjustment for margins		41	(177)	
TOTAL (11 to 42)		51	19	

5.B.4 Example two

100 sold Traded FTSE 100 call <i>options</i> contracts of liability £143,000
Total margin £245,000 on FTSE 100 <i>option</i> with broker, £100,000 paid to broker as initial and £145,000 paid to broker as <i>variation margin</i> .

FORM 14 (part)		
<i>Long-term insurance business liabilities and margins</i>	As at the end of the <i>financial year</i>	
Other Creditors	38	(2)
Provision for Adverse changes	41	
TOTAL	59	(2)

FORM 13 (part)		
<i>Admissible Assets</i>	As at the end of the <i>financial year</i>	
Equity shares	41	
Rights under <i>Derivative Contracts</i>	44	
<i>Deposits less than 1 month</i>	54	
<i>Deposits more than 1 month</i>	55	
Other financial Investments - Other	56	100
TOTAL	99	100

FORM 17			As at the end of the <i>financial year</i>	
<i>Derivative Contracts</i>			Assets	Liabilities
<i>Futures Contracts</i>	Fixed interest	11		
	Equity shares	12		
	Land	13		
	Currencies	14		
	Other	15		
<i>Options</i>	Fixed interest	21		
	Equity shares	22		143
	Land	23		
	Currencies	24		
	Other	25		
<i>Contracts For Differences</i>	Fixed interest	31		
	Equity shares	32		
	Land	33		
	Currencies	34		
	Other	35		
Adjustment for margins		41		(145)
TOTAL (11 to 42)			51	(2)

5.B.5 Example three - as example X in **Guidance Note 4.2**

100 sold Traded FTSE 100 *future contracts* of total liability £140,000
 Bought Currency Forward for US Dollar for £7,750,000 of total liability £2425
 60 bought Traded S&P 500 *future contracts* valued at £130,500 or £83,403

All contracts due to complete in 3 months time

Total margin £302,500 on FTSE 100 future with broker, £200,000 paid to broker as initial, and £102,500 paid to broker as *variation margin*.

No margin on currency forward.

Total margin \$90,000 on S&P 500 future with broker, \$90,000 paid to broker as initial only. Value at 31/12/94 £57,519.

FORM 14 (part)		
<i>Long-term insurance business liabilities and margins</i>	As at the end of the <i>financial year</i>	
Other Creditors	38	40
Provision for Adverse changes	41	
TOTAL	59	40

FORM 13 (part)		
<i>Admissible Assets</i>	As at the end of the <i>financial year</i>	
Equity shares	41	
Rights under <i>Derivative Contracts</i>	44	83
<i>Deposits less than 1 month</i>	54	
<i>Deposits more than 1 month</i>	55	
Other financial Investments - other	76	258 (i.e.200 plus 58)
TOTAL	99	341

FORM 17				
<i>Derivative Contracts</i>			As at the end of the <i>financial year</i>	
			Assets	Liabilities
<i>Futures Contracts</i>	Fixed interest	11		
	Equity shares	12		
	Land	13		
	Currencies	14		2
	Other	15		
<i>Options</i>	Fixed interest	21		
	Equity shares	22		
	Land	23		
	Currencies	24		
	Other	25		
<i>Contracts For Differences</i>	Fixed interest	31		
	Equity shares	32	83	140
	Land	33		
	Currencies	34		
	Other	35		
Adjustment for margins		41		(102)
TOTAL (11 to 42)		51	83	40

5.B.6 Example four - much as example SS in Guidance Note 4.2

400,000 holding of BP *shares* at 425.5p per share, total asset £1,702,000.

3000 written traded BP put *option* at 420p, valued at £420,000 liability.

Total margin £3,000,000 on traded *option*, all initial.

General insurance business Amount (GBA) £400m. 2.5% of GBA equals £10m and total *exposure* is to 3.4m *shares* worth £14,467,000. Inadmissible asset is thus £4,467,000, with first offset to direct equity holding and balance to line 87 of **Form 13**.

Rule 5.3 liability taken as say 50% fall in price i.e. $(4.255 \times 50\% - 4.20) \times 1000 \times 3000$ thus £6,217,500, less any rule 5.2 liability (i.e. £420,000), less any relief from inadmissibility that such a fall would cause (£3,616,000 - see below) therefore £2,181,500 provision.

The inadmissibility offset and provision for adverse changes are calculated as follows

£000s	Year end 50% fall		
Margin deposit	3000	3000	
Direct <i>shares</i>	1702	851	
Put <i>option</i>	(420)	(6218)	
Inadmissibility deduction	(4467)	-	3.4m <i>shares</i> worth under 2.5%
Total	(185)	(2367)	difference i.e. £ 2181.5k is minimum rule 5.3 amount

FORM 15 (part)		
Liabilities (other than long-term insurance business)	As at the end of the financial year	
Other Creditors	49	420
Provision for adverse changes	61	2182
TOTAL	69	2602

FORM 13 (part)		
Admissible assets	As at the end of the Financial Year	
Equity shares	41	0 (i.e. 1702 less 1702)
Rights under derivative contracts	44	
Deposits less than 1 month	54	
Deposits more than 1 month	55	
Other financial investments - other	56	3000
Deduction for inadmissible assets	87	(2765)
TOTAL	99	235

FORM 17				
Derivative Contracts			As at the end of the financial year	
			Assets	Liabilities
Futures Contracts	Fixed interest	11		
	Equity shares	12		
	Land	13		
	Currencies	14		
	Other	15		
Options	Fixed interest	21		
	Equity shares	22		420
	Land	23		
	Currencies	24		
	Other	25		
Contracts For Differences	Fixed interest	31		
	Equity shares	32		
	Land	33		
	Currencies	34		
	Other	35		
Adjustment for margins		41		
TOTAL (11 to 42)			51	420

5.B.7 Example five

£450,000 debt due from XYZ stockbrokers.
£1,200,000 deposit with XYZ Bank (an approved credit institution) on a 15 month fixed term.
£250,000 worth of shares in XYZ Holdings.
2000 BP traded call options at 420p with XYZ Market makers (an approved counterparty) worth £500,000 but offset by £100,000 received from broker as variation margin and put on deposit with a non XYZ bank.

General insurance business amount is £20,000,000.

Total inadmissible by counterparty limits is £300,000. (None of above exposures are via short-term deposits, therefore 10% counterparty exposure limit applies.) Inadmissibility of exposure to BP shares (via call options) ignored for simplicity.

FORM 15 (part)		
Liabilities (other than long-term insurance business)		As at the end of the financial year
Other Creditors	49	
Provision for adverse changes	61	
TOTAL	69	

FORM 13 (part)		
Admissible assets		As at the end of the Financial Year
Equity shares	41	250
Rights under derivative contracts	44	400
Deposits less than 1 month	54	100
Deposits more than 1 month	55	1200
Other financial investments - other	56	450
Deduction for counterparty exposure	87	(300)
TOTAL	99	2100

FORM 17				
Derivative Contracts			As at the end of the financial year	
			Assets	Liabilities
<i>Futures Contracts</i>	Fixed interest	11		
	Equity shares	12		
	Land	13		
	Currencies	14		
	Other	15		
<i>Options</i>	Fixed interest	21		
	Equity shares	22	500	
	Land	23		
	Currencies	24		
	Other	25		
<i>Contracts For Differences</i>	Fixed interest	31		
	Equity shares	32		
	Land	33		
	Currencies	34		
	Other	35		
Adjustment for margins		41	(100)	
TOTAL (11 to 42)		51	400	

5.B.8 Example six

£30m swap of sterling to DM short interest rates, total liability £500,000.

Provision for rule 5.3 taken as if interest rate margin between sterling and DM widens by 2%, as contract uncovered. Provision £250,000.

FORM 14 (part)		
<i>Long-term insurance business liabilities and margins</i>	As at the end of the <i>financial year</i>	
Other Creditors	38	500
Provision for adverse changes	41	250
TOTAL	59	750

FORM 13 (part)		
<i>Admissible assets</i>	As at the end of the <i>financial year</i>	
Equity <i>shares</i>	41	
Rights under <i>derivative contracts</i>	44	
<i>Deposits</i> less than 1 month	54	
<i>Deposits</i> more than 1 month	55	
Other financial investments - other	56	
TOTAL	99	

FORM 17				
<i>Derivative Contracts</i>			As at the end of the <i>financial year</i>	
			Assets	Liabilities
<i>Futures Contracts</i>	Fixed interest	11		
	Equity <i>shares</i>	12		
	Land	13		
	Currencies	14		
	Other	15		
<i>Options</i>	Fixed interest	21		
	Equity <i>shares</i>	22		
	Land	23		
	Currencies	24		
	Other	25		
<i>Contracts For Differences</i>	Fixed interest	31		
	Equity <i>shares</i>	32		
	Land	33		
	Currencies	34	500	
	Other	35		
Adjustment for margins		41		
TOTAL (11 to 42)		51	500	

6. THE RULE 9.29 STATEMENT: DERIVATIVES

Scope of the statement

- 6.1 (1) Every *insurer* is required to make a rule 9.29 statement, whether or not it used derivatives in the year in question. For this purpose, derivatives is defined by the rule to include not only contracts which have the legal form of a *derivative contract* but also the quasi-derivatives defined in rule 4.13 of the *Valuation of Assets Rules*. The latter category includes a number of instruments which are in common use and which have certain characteristics of a derivative, such as partly-paid *shares* and convertible bonds. It is likely, therefore, that many *insurers* will have something of substance to say in their statement, even though they would not normally consider themselves to be users of derivatives.
- (2) For those *insurers* whose policy and practice is to use neither derivatives nor quasi-derivatives, a short statement to this effect is all that is necessary.

Contents of the statement

- 6.2 (1) Rule 9.29 calls for a brief description of certain details of the use of derivatives. There is no subtlety about the use of the term brief description. What is needed is a description which is just long enough to give the reader a reasonable flavour of the use of derivatives, including certain key points concerning use of derivatives to effect significant switches in the balance of portfolio, or use of unusual or exotic derivatives. The detailed requirements of the statement are set out in (2) to (4), referenced by the sub-paragraphs of rule 9.29(1).

- (2) (a) any investment guidelines ... for the use of *derivative contracts*

The *insurer's* policy needs to be explained, even if that policy is not to use derivatives. (In this context it is worth remembering that forward currency derivatives are not derivatives for the purposes of the rules if they satisfy the requirements of rule 4.1(9). A statement that derivatives are only used to match policy liabilities is, however, too brief and a fuller description of the criteria used must be given.

- (3) (b) ... guidelines ... for the use of contracts ... not ... reasonably likely to be exercised

The *insurer* must state whether such contracts are allowable under its guidelines. Thus the restriction of the use of derivatives to those bought and sold to deal at prices close to the market price of the underlying asset at outset would allow a negative reply to this question. Conversely, if the guidelines allow the practice, for example, of selling *options* out of the money, or purchasing barrier *options*, neither of which were expected to be called, this would need detailing together with its purpose. Where such contracts have been entered into in the year, or subsisted over the year, then a brief description is required under (3) of the size (in economic exposure) of the contracts and the approximate market movement that would trigger them.

- (4) (d) ... amounts recorded in **Form 13**

Insurers may find a LIFFE style report the most suitable to present the changes to **Form 13**, i.e. a presentation of the current **Form 13** by broad asset class amended by the impact of futures on economic exposure. The prudence required in the context of *options* is not the same as that when considering the inadmissibility limits of rule 4.14 where the maximum exposure to an asset is in question. *Options* that are currently expected to be exercised should be assumed to be exercised. This would normally follow the value of the *option* at the accounting date: if of high value then exercise is likely but if close to valueless then exercise is unlikely. Further information is required under (6) only if the impact of derivatives in amending economic exposure has been materially different at other times of

the year, not merely if the overall economic *exposure* of the *insurer* has been different.

(5) (e) ... to the maximum extent

Under (4) the expected changes to exposure should be stated. Under (5) same information as (4) is required but assuming that derivatives are exercised against the *insurer*, so as to create the largest changes in the economic exposures of the *insurer* in its major asset classes. While derivative positions that net out, or can be used to net out exposures, will not contribute to this presentation, any other optional derivative positions should be assumed to be exercised so as to create the most extreme exposures potentially possible.

(6) (f) how different other time of the financial year ... maximum extent

This requires the analysis of (4) and (5) to be tested for other points of the year. Where a more significant position occurred other than at the *financial year* end the position then needs to be described. As noted above for the test under (4) the *insurer* must look for times when the use of derivatives to amend economic exposure has been significantly different at other times of the year, not when the direct exposure of the *insurer* has been different. For the test under (5) the purpose is to gauge whether during the year the *insurer's* use of more exotic or obscure derivatives has been greater than at the *financial year* end. The description may thus need to refer to several different times during the year where there was significant activity that was different in nature.

(7) (g) maximum loss:

The requirement for the maximum exposure to a *counterparty* failure at the year end requires this to be tested as well in the event of other foreseeable market conditions. This means a test of individual *counterparty exposure* (not just the *counterparty* giving the maximum *exposure* at the accounting date) under typical market movements and the current margining arrangements. If this gives a higher figure (perhaps due to infrequent margining) then this higher figure should be stated.

(8) (h) ... does not fall within rule 4.12(2) .. or ... paragraph 15:

Structured products that fail the test in rule 4.13(4), and are thus valued purely as unconditional *debt* under the terms of rule 4.13(5), should be described under this section. (To save correspondence, the value assigned to such assets in the relevant **Form 13** should be stated). Other derivatives that are not permitted (or admissible) derivatives held in the internal property linked funds, the rest of the *long-term insurance business fund*, or the other than *long-term insurance business fund* must also be described here.

- (9) (i) ... fixed consideration:

A note is required of what fixed sums have been earned by the *insurer* (for example, premiums received by the *insurer* for selling *options*), and a summary of the contracts involved over the period of the *returns* (not merely those in force at the year end).

7. THE RULE 9.30 STATEMENT: SHAREHOLDER CONTROLLERS

- 7.1 (1) The rule 9.30 statement is required from every *insurer* with its Head Office in the UK other than a *pure reinsurer* or a *non-directive insurer*.
- (2) Rule 9.30 imposes substantially the same requirements as SUP 16.4 and if a statement under rule 9.30 is filed as part of an *insurer's return*, a separate statement need not be filed under SUP 16.4.

8. ACCIDENT YEAR AND UNDERWRITING YEAR ACCOUNTING

The basic rule

- 8.1 (1) The basic rule is that an *insurer* may choose whether to account for its business on an accident year basis or an underwriting year basis. This choice may be made separately for each *accounting class* and, indeed, separately for any clearly definable part of an *accounting class*.
- (2) Where risks are accounted for on an accident year or underwriting year basis the run-off of those risks should continue to be accounted for on the same basis. The *insurer* remains free, however, to account for the renewals of such business on either basis.
- (3) Run off of risks should be reported on the underwriting year basis. The run off of risks previously reported on the annual accounting Forms (21 to 23) should now be reported on the accident year basis.
- (4) In section 8.3 below it is explained that under the rules there is no direct link between the basis of reporting (i.e. underwriting year or accident year) and the method of profit recognition (i.e. annual or non-annual). As is explained more fully below an *insurer* may change its basis of profit recognition, even for risks previously reported, from non-annual to annual. However even where it makes such a change it must continue to report the run-off of such risks on an underwriting year basis.

Accounting for premiums, claims and expenses

The accounting rules

- 8.2 (1) The amounts shown in the *return* for:
- (a) 'gross premiums written', 'reinsurers' share', 'earned premiums' etc.;

- (b) 'claims outstanding', 'claims incurred', 'gross amount', 'reinsurers' share' etc;
- (c) 'provision for unearned premiums', 'provision for unexpired risks', 'deferred acquisition costs'; and
- (d) 'net operating expenses', 'acquisition costs', 'administrative expenses' and 'reinsurance commissions and profit participations'

should be determined:

- (e) using the same rules as apply for the preparation of *Companies Act* accounts (see rule 3(2)(b) which aligns definitions with those in shareholder accounts rules, i.e. Schedule 9A of the *Companies Act*); and
 - (f) in accordance with generally accepted accounting practice (see, for example, paragraph 26(1) of **Appendix 9.2**).
- (2) In particular contracts of financial (re)insurance whether inward or outward should be classified for inclusion in the forms in accordance with Financial Reporting Standard 5 'Reporting the Substance of Transactions' and the statement 'FRAG 35/94: The Application of FRS 5 to Non-Life Insurance Transactions'. Thus where the consideration receivable and payable for transactions which have the legal form of *contracts of insurance* or *reinsurance* would not be accounted for as premiums and *claims* in the preparation of *Companies Act* accounts they should not be included as premiums and *claims* in **Forms 20 to 39**. Instead they should be accounted for in the *return* using the same principles as are applied in the preparation of *Companies Act* accounts. (But see 5.3(7) and 5.3(11) for the different treatment in **Forms 11 and 12**).
- (3) An exception to (1) (i.e. the alignment of definitions with those in Schedule 9A to the *Companies Act*) is that claims amounts shown in the forms should exclude:
- (a) *claims management costs*, and
 - (b) adjustments for discounting.

Some forms exclude these items altogether and other forms provide for their separate disclosure. See paragraph 15 to **Appendix 9.2** and the instructions to the forms themselves.

- (4) Another exception is that the rules for *Companies Act* accounts analyse net operating expenses into (i) acquisition costs; (ii) administrative expenses; and (iii) *reinsurers* commissions and profit participations, whereas the forms sub-analyse the first item into commissions and 'other acquisition expenses'.

- (5) *Claims management costs* are basically those overhead costs of the *claims* department (or of the out-sourced provider of the claims management function) which are required to be included in the amount for incurred *claims* shown in the *Companies Act* accounts.
- (6) In **Forms 20-39**, (as in the technical account in the *Companies Act* accounts) *claims* incurred include any reduction for salvage and subrogation recoveries. (cf. the different treatment in the balance sheet - see 5.6(9)).
- (7) Paragraphs 9 to 14 of **Appendix 9.2** lay down rules as to how premiums and *claims* are to be allocated to accident years and underwriting years. These paragraphs are explained in (8) to (11) and (12) to (13).

Accident year accounting

- (8) For accident year accounting, premium is allocated to accident years on the basis of when it is earned and *claims* are allocated on the basis of when the incident which gives rise to the claim occurred. Special rules apply for (i) *claims-made policies*; and (ii) the *reinsurance* (or transfer under Part VIII of the *Act* or equivalent transfer under the laws of another *EEA State*) of policies covering incidents which had already occurred at the time of the *reinsurance* (or transfer). These are explained below.
- (9) An incident giving rise to a loss under a *claims-made policy* is deemed to occur on the earlier of date of notification or the last date of the period for which cover is provided. The latter of the two alternative dates would usually only be relevant if the *claims-made policy* is not renewed and if upon non-renewal the policy allows a sunset period, (i.e. a period during which claims relating to events which took place prior to the end of the cover period may still be notified).
- (10) Where an *insurer* reinsures, (or receives by way of transfer under Part VII of the *Act* or equivalent EEA transfer), policies covering incidents which had already occurred prior to the date of the contract of *reinsurance* (or of the transfer), all such incidents are deemed to occur at that date.
- (11) Net operating expenses should be allocated to accident years so as to match the premium earned and *claims* incurred to which they relate. Usually this will result in the bulk of administrative expenses being allocated to the youngest accident year. Note that administrative expenses do not include the overhead expenses of running the *claims* department. These are included in *claims management costs*.

Underwriting year accounting

- (12) For underwriting year accounting premiums, and *claims* are allocated to underwriting years on the basis of when policies incept. For these purposes:

- (a) a policy providing continuous cover is deemed to incept on each anniversary of the policy; and
 - (b) policies received by way of a transfer under Part VII of the *Act* (or equivalent transfer under the laws of another *EEA State*) are deemed to incept on the date of the transfer.
- (13) Net operating expenses should be allocated to underwriting years so as to match the premium earned and *claims* incurred to which they relate. Usually this will result in the administrative expenses being allocated to the youngest underwriting year except to the extent that it represents the adjustment for under- or over-provisions of such expenses in the prior years. Note that administrative expenses do not include the overhead expenses of running the claims department. These are included in *claims management costs*.

The annual and non-annual methods

- 8.3
- (1) The annual and non-annual methods refer to the way in which profit is recognised. Under the annual method the profit (and losses) on business written during the *financial year* is recognised at the end of that *financial year* by setting up provisions for outstanding *claims*, unearned premiums and unexpired risk provisions and by deferring an appropriate portion of acquisition costs.
 - (2) Under the non-annual method (sometimes referred to as fund accounting) the recognition of profits (but not losses) is deferred for one, two or three years after the end of the *financial year* in which business incepts. During the period of the deferral the *technical provision* for such business is the excess of premiums written over claims and expenses (increased where necessary to the extent of any losses expected to arise on such business). At the end of the deferral period this *technical provision* is replaced by a *technical provision* determined under the same rules as apply for the annual method, (i.e. a *technical provision* which consists of provisions for outstanding *claims*, unearned premiums and unexpired risk provisions), and by the deferral of an appropriate portion of acquisition costs. The choice of the deferral period should usually be consistent from year to year, but may differ from one type of business to another.
 - (3) The detailed rules for the non-annual method are to be found in paragraphs 51 and 52 of Schedule 9A of the *Companies Act*. Note: Schedule 9A *Companies Act* as such strictly only applies to the preparation of *Companies Act* accounts. However rule 5.4 requires that the *insurance accounts rules* on the valuation of *general insurance business liabilities* should be followed for *FSA* solvency purposes. Also of relevance is the ABI SORP in so far as it is a statement of generally accepted accounting concepts, bases and policies, or other generally accepted methods appropriate for *insurers*. See rule 5.2, which requires such generally accepted concepts etc. to be followed for *FSA* solvency purposes.

The relationship between the reporting basis and method of profit recognition

- 8.4 (1) An *insurer* which wishes to apply the annual method may report that business on either the accident year forms or the underwriting year forms. However if it wishes to apply the non-annual method it must report such business on the underwriting year forms. This relationship is summarised by the table which follows below.

<i>Reporting basis</i>	<i>Profit recognition method</i>
Underwriting year basis	Annual method, or Non-annual method
Accident year basis	Annual method

The non-annual method - ‘closed’ and ‘open’ years

- 8.5 (1) Business to which the non-annual method of profit recognition is applied is classified into open and closed underwriting years.
- (2) As already described in 8.3, under the non-annual basis a *technical provision* is originally set up as the excess of premiums written over *claims* paid and expenses (increased where necessary to the extent of any losses expected to arise on such business). At the end of the deferral period this *technical provision* is replaced by one determined on the same basis as applies under the annual method. An underwriting year is termed closed with respect to any business if the replacement of the *technical provision* has been made in respect of that business, otherwise it is termed open.
- (3) Significantly less disclosure is required on the underwriting year forms for open years than for closed years. See, for example, instruction 2 to **Form 25**. Business reported on the underwriting year forms, but to which the annual method has been applied, are subject to the same level of disclosure on those forms as applies for closed years business.
- (4) The *technical provision* for an open year for an *accounting class* is the fund represented by:
- + premiums written (net)
 - claims paid (net)
 - expenses incurred

- (5) Any excess, over the fund, of present and future liabilities from business incepting in that year falling in that accounting class is termed a deficit. Any excess of the fund, over the present and future liabilities from business incepting in that year falling in that accounting class is termed a surplus.
- (6) A deficit on any open year for any *accounting class* must be dealt with by either:
 - (a) offsetting the deficit against surpluses arising on business falling in other accounting classes which is managed together with the business giving rise to the deficit; and/or
 - (b) increasing the *technical provision*.
- (7) Business may only be regarded as managed together if it:
 - (a) is accounted for on an underwriting year basis;
 - (b) incepts in the same accounting year; and
 - (c) may be regarded as managed together under generally accepted accounting practice.

This definition of managed together is given in paragraph 25 of **Appendix 9.2**.

Conversion from the non-annual to the annual method

- 8.6
- (1) An *insurer* which has previously reported business on a non-annual basis (on accounting year forms) which wishes to convert to an annual basis may do so in one of two ways. It may either:
 - (a) continue to report that business (including new business and renewals) on the underwriting year forms, but close all underwriting years including the youngest year; or
 - (b) report new business and renewals on the accident year forms, but continue to report old business (i.e. risks incepting prior to the current year) on the underwriting year forms and close all underwriting years on those forms.
 - (2) An *insurer* may not transfer business previously reported on underwriting year forms (as opposed to renewals of such business) to the accident year forms. The basic rule is that when any risks are reported on either underwriting year or accident year forms the run-off of those risks must continue to be reported on the same forms.

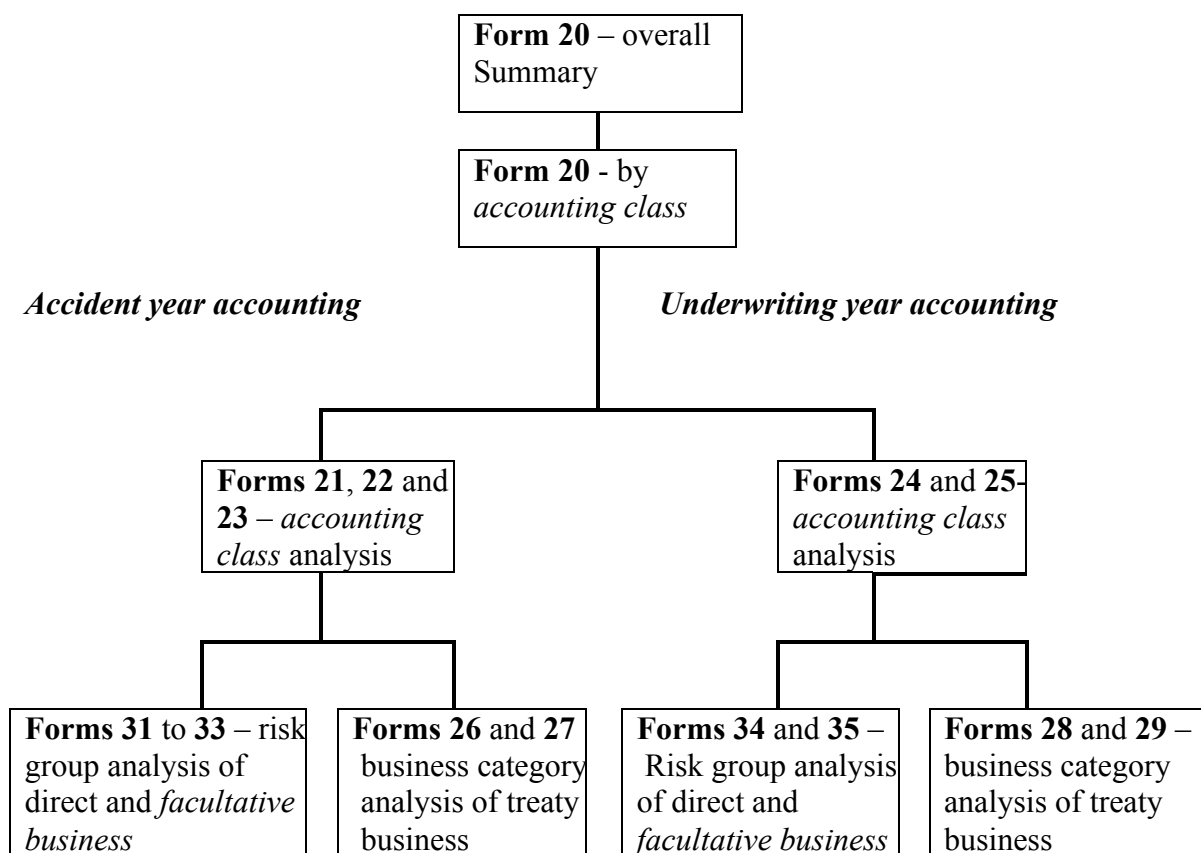
Supplementary note disclosure

- 8.7 (1) Paragraph 24 of **Appendix 9.2** requires that the following be stated by way of supplementary note, [Code 2402], to **Form 24** in respect of each *accounting class* which (in whole or in part) is reported on the underwriting year forms:
- (a) the reason for accounting for such business on an underwriting year basis;
 - (b) the basis for distinguishing such business and any other business falling within the same *accounting class* accounted for on an accident year basis; and
 - (c) the accounting policy adopted for determining the provision for *claims* outstanding (i.e. the annual method or the non-annual method).
- (2) The above information need only be given in respect of risks incepted during the *financial year*. However if the information differs from that which applies for risks of a similar description incepting in the previous *financial year* the difference should be described and the reason for it given.
- (3) If the non-annual method is disclosed as the accounting policy adopted the following should also be stated in the supplementary note [Code 2402]:
- (a) the reason for using the non-annual method;
 - (b) the basis for distinguishing between such business and other business in the same *accounting class* reported on the underwriting year forms; and
 - (c) the normal period for which an underwriting year is left open, or if that period differs for different types of business within an *accounting class*:
 - (i) the basis of distinguishing between different types of business; and
 - (ii) the normal period for each type; and
 - (d) where an underwriting year is left open for longer than the normal period the reason for not closing the year.

9. **ACCOUNTING CLASSES, BUSINESS CATEGORIES AND RISK GROUPS**

An overview of the forms

- 9.1 (1) Reporting of *general insurance business* in the *return* forms takes place separately for business accounted for on an accident year basis and on an underwriting year basis and for each at three levels of detail:
- (a) a summary level,
 - (b) an *accounting class* level, and
 - (c) a sub-*accounting class* level.
- (2) The sub-*accounting class* divisions of business are referred to as ‘risk groups’ for *direct insurance business* and facultative *reinsurance business*; and as ‘business categories’ for treaty business.
- (3) The reporting of business within the *return* is summarised by the following diagram:



For simplicity the equalisation reserve **Forms (37 to 39)**, the discounting **Form (30)** and the currency rates **Form (36)** have been omitted.

Accounting classes

- 9.2 (1) As already noted above the division of *general insurance business* in the *returns* takes place in two stages. First business is divided into *accounting classes* and then each *accounting class* is further sub-divided into either risk groups (in respect of direct insurance and facultative *reinsurance*) or business categories (in respect of treaty *reinsurance* business).
- (2) There are eight direct and facultative *accounting classes* and three treaty *accounting classes*. The following table summarises the definition.

Accounting classes for direct insurance and facultative reinsurance	1	accident and health
	2	Motor
	3	Aviation
	4	Marine
	5	Transport
	6	Property
	7	third party liability
	8	Miscellaneous and pecuniary Loss
Accounting classes for treaty reinsurance	9	non-proportional treaty
	10	proportional treaty
	11	marine, aviation and transport (MAT) treaty

- (3) The *accounting classes* (other than the special case of accounting class 11 which is explained in (6) correspond closely to those used in the rules. The only differences are that:
- (a) death or injury to passengers may now be included in either *accounting class* 1 or split across *accounting classes* 2, 3 and 4 (see (4)); and
 - (b) inwards proportional retrocessions of non-proportional treaty *reinsurance* should be included in accounting class 9.
- (4) There is some flexibility to include the following items in a different *accounting class* from that which would be required by the above table:
- (a) hovercraft business;
 - (b) liability for loss of, or damage to, goods in transit;

- (c) death or injury to passengers.
- (5) Refer to paragraph 6 of **Appendix 9.2** for the detailed rules. A supplementary note to **Form 20** is required if this option is used. It should state the nature of the business included in a different *accounting class* and the reason for such inclusion. The nature of business included in a different *accounting class* should be consistent from year to year.
- (6) *Accounting class* 11 calls for special comment. The basic rule is that all treaty business should be included as either proportional (in *accounting class* 10) or non-proportional (in *accounting class* 9). No business is thus included in *accounting class* 11. However because not all *insurers* were required under the *1983 Regulations* to split MAT business between proportional and non-proportional, the *FSA* recognises that not all necessarily have the accounting records to enable them to do so now as required by the basic rule. In consequence the rules allow an alternative to the basic rule. An *insurer* may choose to include (some or all) of its MAT treaty business in *accounting class* 11, but if it does so it must state in a supplementary note the nature of the business so included and the reason for the inclusion. The nature of business included in *accounting class* 11 should (subject to comments in 9.3) be consistent from year to year. An *insurer* should apply the basic rule wherever its accounting records contain the necessary information to allow it to do so. Where records only enable the basic rule to be used with effect from a particular underwriting or accident year, it should be applied with effect from that year rather than reporting all business in class 11.

Business categories

- 9.3 (1) Rule 9.16 requires an *insurer* to allocate the business within each treaty accounting class (i.e. 9, 10 and 11) into business categories. The following table gives the eight standard business categories.

	Standard business categories
(a)	accident and health
(b)	Motor
(c)	Aviation
(d)	Marine
(e)	Transport
(f)	Property
(g)	third party liability
(h)	Miscellaneous and pecuniary loss

Category (e) may be omitted and transport treaty business allocated instead to categories (c) and (d), in which case these categories are renamed respectively aviation and transport and marine and transport.

- (2) An *insurer* may adopt the standard business categories or its own bespoke categories. However if it adopts its own bespoke categories these must be

subdivisions of the standard categories. Each bespoke category must be given a name which identifies the general nature of the business included within it and distinguishes it from any other categories used (whether bespoke or standard).

- (3) It should be noted that it is not possible for *accounting class* 11, if used, to include any business other than that which falls within business categories (c), (d) and (e).
- (4) Special rules apply for treaty *reinsurances* accepted which fall within more than one business category. Amounts (i.e. premiums, claims etc.) in respect of such a treaty should be either:
 - (a) apportioned between business categories; or
 - (b) allocated to the business category within which the greater part of the business to which the treaty relates falls; and

an explanation must be given (in a supplementary note to **Forms 26 to 29**):

- (c) in case (a) of the method used in any such apportionment; and
 - (d) in case (b) of the (nature) of the business allocated other than to the business categories to which it strictly relates.
- (5) Once the apportionment or allocation in (4) has been made for a particular *reinsurance* treaty, amounts reported in future *returns* in respect of that treaty should be apportioned or allocated in the same manner, unless an explanation for a different treatment is given (in a supplementary note to **Forms 26 to 29**).
- (6) Where a later treaty *reinsurance* is accepted which relates to risks which are of a similar description to those to which the earlier treaty related, the method of apportionment or allocation for the latter treaty should be the same as for the earlier treaty unless an explanation for a different treatment is given (in a supplementary note to **Forms 26 to 29**).

Risk groups

Overview

- 9.4 (1) Rule 9.18 requires an *insurer* to classify its direct and *facultative business* into risk groups. This must be done separately for each country in which business is carried on with respect to each *accounting class* (i.e. classes 1 to 8). The classification of business into risk groups thus takes place in three stages as follows:
 - (a) first business is classified by country;

- (b) then the business for each country is classified in the *accounting classes*; and
- (c) finally each *accounting class* within each country is classified into risk groups.

Each of these stages is subject to de minimis limits under (9).

- (2) The classification of business into risk groups takes place every year with respect to business on-risk/incepted in that *financial year*, and once classified the risk groups remain fixed for that *financial year* for reporting in all subsequent the *returns*. Risk groups classified under the rules for *financial years* ended before 23 December 1996 should continue to be used for reporting business in those *financial years*.
- (3) Business classified into risk groups is reported (by country by *accounting class* by risk group) on **Forms 31 & 32** and **Form 34** (respectively for accident year and underwriting year accounting).

Classification by country

Carrying on *insurance business*

- (4) Business is classified by country according to where it is carried on. *Insurance business* is defined as the 'effecting or carrying out of *contracts of insurance* etc.'. The country where business is carried on thus depends upon where this activity takes place and not necessarily upon the location of the risks covered by the insurance, (but see the comments below on home and *home foreign business*). An *insurer* therefore usually only carries on business in a country if it has a branch, agency or other establishment located in that country.
- (5) For the purposes of classifying risk groups 'home' and '*home foreign*' are treated as two separate countries. An example of where the risk commences in the U.K. but primarily relates to outside the U.K. is an overseas construction risk, where the contractor is a UK firm. Subject to these exclusions, *home foreign business* includes business written on a services basis (under the EEA single passport) into other *EEA State*.

The country-level de minimis limit

- (6) If *gross premiums written* for direct and *facultative business* carried on in a country is less than 1% of the worldwide *gross premiums written* for all business (i.e. direct and facultative and treaty) risk groups need not be classified for that business.
- (7) The aggregate for all countries of such small country business is reported on **Forms 33** and **35** (respectively for accident year and underwriting year accounting).

Classification by accounting class within each country

- (8) The accounting classes have already been described in 9.2. However it should be noted that only the accounting classes 1 to 8 are relevant. *Accounting classes* 9 to 11 relate exclusively to treaty business.

The *accounting class* within a country de minimis limit

- (9) If the *gross premium* written for any *accounting class* within any country is less than:
- (a) 5% of the worldwide *gross premiums written* for all business (i.e. direct and facultative and treaty); or
 - (b) £500,000

the *insurer* may ignore the detailed rules under (10) to (17) for the classification of the business in that *accounting class* within that country into risk groups, but may instead classify all of that business as a single risk group. This single risk group should be given the name 'total'.

Classification into risk groups by accounting class within each country

- (10) These rules consist of two parts: a basic rule and a list of supplementary requirements. The supplementary requirements (but not the basic rule) are subject to a de minimis limit.

The basic rule

- (11) The basic rule is that each risk group should comprise risks which in the opinion of the *directors*, are not significantly dissimilar, either:
- (a) by reference to the nature of the objects exposed to such risks; or
 - (b) by reference to the nature of the cover given against such risks.
- (12) As an example of (11)(a), the *FSA* would normally not expect Marine Hull risks and Marine Liability risks to be considered objects so similar in nature as to be reported in the same risk group. As an example of (11)(b), the *FSA* would normally not expect ground-up direct property risks and high-layer facultative risks to be considered covers so similar in nature as to be reported in the same risk group.
- (13) However, the *FSA* recognises that *directors* would have regard to the size and relative size of business involved when considering any division into risk groups. In the examples in (12), if the total Marine Liability element is very small (either in absolute terms or relative to the class) or the total of the higher-layer facultative risks is very small, the *FSA* would not expect a

separate risk group. Similarly, a miscellaneous risk group could be acceptable but only if it is small by comparison with the rest of the class.

- (14) As further instances, the *FSA* would not normally expect to see significant amounts of: commercial and personal lines business appearing in the same property risk group; professional indemnity / D&O and public / products business appearing in the same liability risk group; domestic mortgage indemnity and other guarantee business appearing in the same pecuniary loss risk group. Overall, the *FSA* looks to *directors* to provide a sufficient but sensible breakdown which allows the ordinary reader to understand the nature of, and the analyst to review the details of, the *insurer's* business.

The supplementary requirements:

- (15) The supplementary requirements are as follows.
- (a) risks may not be included in the same risk group where, having regard to the patterns of risk, claims incurrence and settlement patterns, it is necessary to group them separately for the purposes of applying statistical methods in calculating the provision for *claims* outstanding in accordance with generally accepted accounting practice. In effect this means that where two or more types of risk are sufficiently dissimilar to require the data for each type to be separately identified for the purposes of calculating the provision for *claims* outstanding, each type should be classified in a separate risk group;
 - (b) *claims-made policies* may not be included in the same risk group as non *claims-made policies*. A *claims-made policy* is defined basically as a liability insurance policy which requires a loss incident to be notified either during the policy period or up to three years thereafter;
 - (c) policies for (i) credit and suretyship; (ii) legal expenses; (iii) assistance; and (iv) miscellaneous should not be included in the same risk group. These four categories make up *accounting class 8*;
 - (d) private motor car risks should not be included in the same risk group as other motor risks;
 - (e) comprehensive private motor car risks should not be included in the same risk group as non-comprehensive private motor car risks; and
 - (f) policies transferred to the company (under Part VII of the *Act*, or equivalent legislation of another *EEA State*) should not be included in the same risk group as other policies.

The de minimis limit for the supplementary requirements

- (16) Two or more sets of risks/policies which would be required by any of the supplementary requirements in (15) to be classified as separate risk groups may be combined provided that either:
- (a) the *gross premium written* for all business (i.e. *direct*, facultative and treaty) from the resulting risk group is less than 2.5% of total worldwide *gross premiums written* or than £500,000; or
 - (b) the *gross premium written* for all business (i.e. *direct*, facultative and treaty) from each of the sets being combined (other than the largest) is less than 0.5% of total worldwide *gross premiums written* or than £100,000.
- (17) It should be noted that the above de minimis limit only applies to exempt *insurers* from compliance with the supplementary requirements in (15) and not the basic rule, in (11) to (14). The de minimis limit cannot, therefore, be used to create a large miscellaneous risk group - see the comments in (3) to (5).

10. FORMS 20 TO 36: THE GENERAL BUSINESS TECHNICAL ACCOUNT

Form 20

Completion of the form

- 10.1 (1) **Form 20** should be prepared separately for each *accounting class* (where any business falling in that *accounting class* has been carried on) and also in summary. The entry '99' should be inserted in the *accounting class* box for the summary form.
- (2) **Form 20** presents the '*General insurance business: technical account*' (excluding equalisation provisions). It consists of four parts:
- (a) a technical account for this accident year (lines 11 to 19);
 - (b) a technical account for prior accident years (lines 21 to 29);
 - (c) the balance from underwriting year accounting (line 31 to 39); and
 - (d) the investment return allocated to the technical account (line 51).
- (3) The two accident year technical accounts only relate to business accounted for on an accident year basis. **Form 24** presents the technical account for underwriting year business and it is from this that the balance at line 31 derives.
- (4) The items in the two accident year technical accounts derive from **Form 21** (earned premiums) and **Form 22** (claims, expenses etc.). The only item

which does not derive from other forms is 'Other technical income or charges' (lines 16 and 25). If any amount is entered in these lines particulars must be stated in a supplementary note [Code 2005].

- (5) Line 32 of the form accommodates other technical income and charges arising from business accounted for on an underwriting year basis. NB. such other income and charges should not be included on **Form 24**. As for lines 16 and 25 (see (4)) a supplementary note [Code 2006] is needed.
- (6) The allocated investment income (line 51) is linked to line 20 of **Form 16**. The allocation, if any, should be the same as in the *Companies Act* accounts.

Supplementary notes

- (7) Six notes are specified:
 - (a) where a *insurer* exercises any of the options (described in 9.2(4) to (5)) to report business in a different *accounting class* it should state (i) the nature of the business it has included in that different *accounting class*; and (ii) the reason for such inclusion - see paragraph 7 of **Appendix 9.2**. [Code 2001]
 - (b) for each *accounting class* an *insurer* should state separately for business accounted for on an accident year basis and on an underwriting basis the split of (i) total *gross premium written*; and (ii) *reinsurers'* share of *gross premium written* between business attributable to the UK and to overseas business - see paragraph 16 of **Appendix 9.2**. For these purposes *direct and facultative* business is UK business if the contract was made in the UK and treaty *reinsurance* is UK if the *cedant* has its head office in the UK or is a member of the *Society*; [Code 2002]
 - (c) if an *insurer* has effected no new *contracts of insurance* of any one or more classes for which it is authorised during the *financial year*; it should state the date on which the last new contract of each such class was effected - see paragraph 21 of **Appendix 9.2**. A new contract is any contract other than one effected in fulfilment of an obligation under an already existing *contract of insurance*; [Code 2003]
 - (d) as already explained in 8.2(2), both inwards and outward *contracts of (re)insurance* should be classified for inclusion in the forms in accordance with generally accepted accounting practice. Extensive note disclosure is required where this leads to inwards or outwards *contracts of (re)insurance* not being reported as such on the forms (i.e. because although they fall within the legal definition of a *contract of insurance* or *reinsurance* they do not fall within the GAAP definition). See paragraph 26 of **Appendix 9.2** for details of the disclosure to be given; [Code 2004]

- (e) particulars should be stated of any amounts included at lines 16 or 25 ('accident year accounting - other technical income or charges') - see the text on those lines of the form; and [Code 2005]
- (f) particulars should be stated of any amounts included in line 32 ('underwriting year accounting - other technical income or charges') - see the text of that line of the form. [Code 2006].

Form 21

Completion of the form

- 10.2 (1) **Form 21** should be prepared separately for each *accounting class* (where any business falling in that *accounting class* has been carried on). The form presents an analysis of premiums for business accounted for on an accident year basis.
- (2) Lines 13 to 15 of the **Form 21** should include premiums actually received prior to the *financial year*, but relating to risks incepted in the *financial year* and exclude premiums received during the *financial year*, but relating to risks incepting after the end of the *financial year*. In **Forms 13** and **15** the accounting treatment adopted for premiums received in respect of risks incepting in future *financial years* should be the same as that adopted in the shareholder accounts or, if there are no shareholder accounts, should be in accordance with generally accepted accounting practice. If this results in different amounts for the provision for unearned premium (either gross or the *reinsurers' share*) being shown in **Forms 13** or **15** as compared to **Form 21**, the difference should be identified and explained in a supplementary note, [Code 2103].

Supplementary notes

- (3) Three notes are specified:
- (a) the reason should be stated for any difference in the unearned premiums brought forward and the corresponding amount carried forward from the previous year (i.e. if 21.16.1 + 21.16.2 does not equal 21.19.2 in the previous *return* or 21.16.3 + 21.16.4 does not equal 21.19.4 in the previous *return*) - see paragraph 7 of **Appendix 9.1**; and [Code 2101]
 - (b) the basis upon which the provision for unearned premium is calculated and the reason for adopting that basis should be stated - see paragraph 18 of **Appendix 9.2**. The reason stated should include an explanation of any change in the basis from previous *financial years*. [Code 2102]
 - (c) the supplementary note referred to in 10.2(2). [Code 2103]

Form 22

Completion of the form

- 10.3 (1) **Form 22** should be prepared separately for each *accounting class* (where any business falling in that *accounting class* has been carried on). The form presents an analysis of *claims*, expenses and *technical provisions* for business accounted for on an accident year basis.
- (2) The rules for the allocation of premiums, *claims* and expenses to accident years are explained in section nine. Business which is shown as reconciliation business on **Form 23**, see 10.4(5), should be also be split between the prior *financial years* and this *financial year* headings in this form. However where such amounts are not material it is acceptable to include them in their entirety under 'prior to this financial year'.
- (3) The amount included for the provision for unexpired risks (at line 19) in the **Form 22** for any *accounting class* should be determined without taking into account any surplus expected to arise on the unexpired risks falling within other *accounting classes*.
- (4) However, in determining the total provision for unexpired risks (which is disclosed in **Form 15** at line 13 and in **Form 13** at line 62), deficits and surpluses in different *accounting classes* may be offset (to the extent permitted by generally accepted accounting practice). Any surplus for an *accounting class* thus offset against deficits in other *accounting classes* should, to the extent it relates to business accounted for on an accident year basis, be shown as a negative provision at line 19 on the **Form 22** for that *accounting class*.
- (5) Lines 41 and 42 show the split of operating expenses between prior *financial years* and this *financial year*. Special care should be taken when completing column 1 – 'amount brought forward from previous financial years'. The entry at column 1 for line 42 should equal the sum of the entries at column 3 in the previous years' *return* for lines 41 and 42. The entry at column 1 for line 41 should ordinarily be nil, i.e. it should be left blank. This is because the split at lines 41 and 42, column 4, is used (on **Form 20**) to match expenses against earned premiums.

Supplementary notes

- (6) Six notes are specified:
- (a) if any of the brought forward amounts differs from the corresponding carried forward amounts in the previous *return* the reason should be stated - see paragraph 7 of **Appendix 9.1**; [Code 2201]
- (b) the basis for determining the *claims management expenses* payable and carried forward should be stated - see paragraph 22(1) of

Appendix 9.2. The the payable part of the disclosure, amongst other items, should include an explanation of how overheads are allocated as between *claim management expenses* and net operating expenses. If there are no *claims management expenses* carried forward but there are *claims* outstanding carried forward, the reason for believing these outstanding *claims* can be run-off without incurring *claims management expenses* should be stated - see paragraph 22(2) of **Appendix 9.2.** If the *insurer* has, for any *accounting class*, ceased during the *financial year* to effect new contracts, the basis upon which any additional costs (payable or carried forward) from such cessation have been determined, or the reason for believing there are no such additional costs should be stated - see paragraph 22(3) of **Appendix 9.2;** [Code 2202]

- (c) where, for any *accounting class*, investment income has been taken into account in determining the *claims management costs* carried forward, an *insurer* should state for each such class (i) the rates of interest used; and (ii) the average interval to the date at which the carried forward costs are expected to be expended - see paragraph 22(4) of **Appendix 9.2;** [Code 2203]
- (d) the basis for determining acquisition expenses (other than commission) payable and carried forward should be stated - see paragraph 23 of **Appendix 9.2.** The payable part of the disclosure, amongst other items, should include an explanation of how overheads are allocated as between other acquisition expenses, and the other components of net operating expenses especially administrative expenses. The *FSA* expects the carried forward part of the disclosure should include an explanation of how the appropriate proportion of acquisition expenses (other than commission) to match the unearned premium carried forward was determined; [Code 2204]
- (e) where, for any *accounting class*, the provision for unexpired risks has been determined after taking investment income into account, an *insurer* should state for each such class (i) the provision before taking investment income into account; (ii) the rates of interest used; and (iii) the average interval to the date at which claims are expected to be settled in cash - see paragraph 20 of **Appendix 9.2.** This note should be present even if, as a result of taking investment income into account, the provision for unexpired risks is nil; and [Code 2205]
- (f) where, for any *accounting class*, the *reinsurer's* share of *claims* incurred includes amounts expected to be recovered from reinsurers more than 12 months after the payment of the underlying gross *claims*, there should be stated for that class (i) the amount of such recoveries; and (ii) the accounting treatment which has been adopted in respect of discounting such recoveries - see paragraph 28 of **Appendix 9.2.** [Code 2206]

Form 23

Completion of the form

- 10.4 (1) **Form 23** should be prepared separately for each *accounting class* (where any business falling in that *accounting class* has been carried on). The form presents an analysis of by accident year of net *claims* and premiums. It consists of three parts:
- (a) the last ten accident years (lines 11 to 20);
 - (b) the reconciliation business (line 22); and
 - (c) the prior accident years (line 21).
- (2) The rules for the allocation of premiums, *claims* and expenses to accident years are explained in chapter eight. Reconciliation business is not allocated to accident years but shown at line 22.
- (3) The amount of earned premium shown at column 11 for each accident year should be updated each *financial year* end to take account of over- or under-estimates of premium for that accident year.
- (4) Reconciliation business is any business which falls below the country de minimis limit in the classification of risk groups (see 9.4(7)) and any business which was reported as reconciliation business under the *1983 Regulations*. The reconciliation business should be reported at line 22 net of the *reinsurers'* share.
- (5) Special rules apply for the re-conversion of the premiums and *claims* amounts in columns 1, 2, 3 and 11 of **Form 23**. All amounts denominated in a major currency should be reconverted into sterling using the exchange rate ruling at the end of the current *financial year*. Amounts denominated in a non-major currency need not be re-converted (although they may be if the *insurer* wishes). Where a claim or premium amount is not reconverted it should be reported at the exchange rate which ruled for the *financial year* in which it first arose.
- (6) A major currency is:
- (a) for business carried on in any overseas country (i.e. by a branch, agency or other establishment in that country), the currency of that country; and
 - (b) for all other business Euros, United States dollars, Canadian dollars and any other currency the *insurer* wishes to treat as a major currency.

Supplementary notes

- (7) Two notes are specified:
- (a) if any of the brought forward amounts differs from the corresponding carried forward amounts in the previous *return* the reason should be stated - see paragraph 7 of **Appendix 9.1**; [Code 2301]
 - (b) if during the *financial year* business is transferred (under Part VII of the *Act* or under the equivalent legislation of another *EEA State*) to the *insurer*, certain specified details of that business must be stated - see paragraph 17 of **Appendix 9.2**. [Code 2302]

Form 24

Completion of the form

- 10.5 (1) **Form 24** should be prepared separately for each *accounting class* (where any business falling in that *accounting class* has been carried on). The form reconciles the *technical provisions* brought forward to that carried forward with premiums, *claims*, expenses and profits/losses as the reconciling items.
- (2) The column headings (between columns 29-29 and 99-99) should be completed respectively from right to left with the dates of the end of this *financial year* and of each of the nine preceding *financial years*.
- (3) A transitional concession applies for all *accounting classes* except 9 and 11. Amounts for underwriting years ended before 23 December 1993 may be included in the prior years column. (If this is done the end-date for such years should not be entered in the column headings.) *Insurers* should only take advantage of this concession to the extent that full completion of the form is impracticable, (e.g. full completion of **Form 24** for class 10 would not be impracticable where business of that class was previously reported on the **Form 29**).
- (4) Business reported as reconciliation business on **Form 35** should be reported on this form (net of the *reinsurers'* share) analysed by underwriting year.
- (5) All premium amounts at lines 11 and 12 should be shown gross of commission.
- (6) Net operating expenses (lines 41 to 49) should not include the increase or decrease in *deferred acquisition costs*, ('DAC'). Instead the DAC brought forward and carried forward should be included respectively at lines 51/52 and 53/54. DAC is part of the fund - see line 24 on **Form 25**.
- (7) For an open underwriting year line 54 ('Technical provisions - carried forward - adjustment for discounting') should show the extent to which future investment Return has been taken into account in deciding whether

and, if so, by how much to increase the fund (i.e. premiums written less *claims* and expenses) to make it sufficient to meet all present and future obligations attributable to the underwriting year, i.e. the amount shown at line 53 ('Technical provisions - carried forward – undiscounted') should be the fund augmented by the full amount needed to make it sufficient to meet all such obligations without taking future investment return into account.

- (8) The amount shown at line 54 for an open year should be included as one of the component items included in the balance shown at line 20 on **Form 25**, even if that results in a negative amount at that line. Lines 16 to 18 on this form should not include amounts for open underwriting years.

Supplementary notes

- (9) Six notes are specified:
- (a) if any of the brought forward amounts differs from the corresponding carried forward amounts in the previous *return* the reason should be stated - see paragraph 7 of **Appendix 9.1**; [Code 2401]
 - (b) certain specified details of the reporting basis and basis of profit recognition should be stated - see paragraph 24 of **Appendix 9.2**. Guidance is given in 8.7; [Code 2402]
 - (c) if during the *financial year* business is transferred (under Part VII of the *Act* or under the equivalent legislation of another *EEA State*) to the *insurer*, certain specified details of that business must be stated - see paragraph 17 of **Appendix 9.2**; [Code 2403]
 - (d) the basis for determining the *claims management costs* payable and carried forward should be stated - see paragraph 22 of **Appendix 9.2**. The payable part of the disclosure, amongst other items, should include an explanation of how overheads are allocated as between *claims management costs* and net operating expenses. If there are no *claims management costs* carried forward but there are *claims* outstanding carried forward, the reason for believing these outstanding *claims* can be run-off without incurring *claims management costs* should be stated. If the *insurer* has for any *accounting class* ceased during the *financial year* to effect new contracts, the basis upon which any additional costs (payable or carried forward) from such cessation have been determined, or the reason for believing there are no such additional costs, should be stated; [Code 2404]
 - (e) where, for any *accounting class*, investment income has been taken into account in determining the *claims management costs* carried forward, an *insurer* should state for each such class (i) the rates of interest used; and (ii) the average interval to the date at which the

carried forward costs are expected to be expended - see paragraph 22(4) of **Appendix 9.2**; [Code 2405]

- (f) the basis for determining acquisition expenses (other than commission) payable and carried forward should be stated - see paragraph 23 of **Appendix 9.2**. The payable part of the disclosure, amongst other items, should include an explanation of how overheads are allocated as between other acquisition expenses and the other components of net operating expenses, especially administrative expenses. The carried forward part of the disclosure should include an explanation of how the appropriate proportion of acquisition expenses (other than commission) to match the unearned premium carried forward was determined. [Code 2406]

Form 25

Completion of the form

- 10.6 (1) **Form 25** should be prepared separately for each *accounting class* (where any business falling in that *accounting class* has been carried on). The form analyses the *technical provisions* carried forward.
- (2) The guidance given in 10.5 the completion of **Form 24** also applies for this form.
- (3) The extent to which the form is to be completed differs for open and closed years - see instruction 2 to the form. For this purpose business accounted for under the annual method should be regarded as closed year business. See also 8.5 for further guidance. For open years, line 21 should equal line 29, which should equal line 53 less line 54 on **form 24**. The balancing figure required to achieve this should be entered at line 20.
- (4) Line 20 'Balance of fund' should not be confused with the undeclared profit on an open year. It includes such profit (if any), but also includes all other elements of the fund not shown separately for open years, i.e. the items listed at lines 16 to 18 and 22 to 25 which are not used for open years.
- (5) Lines 13 and 14 refer for both open and closed years to 'claims incurred but not reported'. For closed years this does not include provisions for *claims* not incurred, i.e. *claims* expected to be incurred after the end of the *financial year*. For closed years such yet-to-be-incurred expected claims are provided against by the provisions for unearned premiums and unexpired risks, (lines 23 and 24). For open years such yet-to-be-incurred expected *claims* may either be included at lines 13 and 14 or included as one of the elements represented by the balance of the fund, (line 20). For both open and closed years lines 13 and 14 require the analysis of 'claims incurred but not reported' between the 'gross amount' and 'reinsurer's share'. Where this analysis is not provided, e.g. by reporting the net amount as if it were the

gross amount, the form has not been properly prepared in accordance with the rules.

- (6) the offset of surpluses and deficits on open years from business managed together should be shown at line 19. A surplus on the underwriting year which is to be offset against deficit(s) arising elsewhere should be shown as a positive amount. A deficit on the underwriting year which is to be offset against surplus(es) arising elsewhere is to be shown as a negative amount. See 8.5 for further guidance.
- (7) For closed years, the amount included for the provision for unexpired risks (at line 23) in the **Form 25** for any *accounting class* should be determined without taking into account any surplus expected to arise on the unexpired risks falling within other *accounting classes*.
- (8) However, in determining the total provision for unexpired risks (which is disclosed in **Form 15** at line 13 and in **Form 13** at line 62), deficits and surpluses in different *accounting classes* may be offset (to the extent permitted by generally accepted accounting practice). Any surplus for an *accounting class* thus offset against deficits in other *accounting classes* should, to the extent it relates to business accounted for on an underwriting year basis, be shown as a negative provision at line 23 on the **Form 25** for that *accounting class*.

Supplementary notes

- (9) Five notes are specified:
 - (a) the basis upon which the provision for unearned premium is calculated and the reason for adopting that basis should be stated - see paragraph 18 of **Appendix 9.2**. The reason stated should include an explanation of any change in the basis from previous *financial years*; [Code 2501]
 - (b) where, for any *accounting class*, the provision for unexpired risks has been determined after taking investment income into account, an *insurer* should state for each such class (i) the provision before taking investment income into account; (ii) the rates of interest used; and (iii) the average interval to the date at which *claims* are expected to be settled in cash. The note should be present even if as a result of taking investment income into account the provision for unexpired risks is nil - see paragraph 20 of **Appendix 9.2**.
 - (c) where, for any *accounting class*, the *reinsurers'* share of *claims* incurred includes amounts expected to be recovered from reinsurers more than 12 months after the payment of the underlying gross *claims*, there should be stated for that class (i) the amount of such recoveries; and (ii) the accounting treatment which has been adopted

in respect of discounting such recoveries - see paragraph 28 of **Appendix 9.2**; [Code 2503]

- (d) where a surplus for offset is shown at line 19, the following should be stated:
 - (i) a description of the business in respect of which the anticipated surplus and of the business in respect of which the anticipated deficit to be offset arise (including identification of the risk groups or business categories into which the business falls); and
 - (ii) the reason for treating the business as managed together. (See paragraph 25(2) of **Appendix 9.2**; and [Code 2504])
- (e) particulars of any amounts included at lines 25 on **Forms 25** should be stated - see the face of **Form 25**. [Code 2505]

Forms 26 and 27

Completion of the forms

- 10.7 (1) **Forms 26 and 27** present an analysis by business category of the business reported on **Forms 23** for the treaty *accounting classes* 9 to 11. The format of **Forms 26** is identical to the format of **Form 23** except for:
- (a) the inclusion in the heading of a business category and a currency box; and
 - (b) the use of a continuation sheet; and
- the format of **Form 27** is identical to that of **Form 26** except that it is to be completed gross of the *reinsurers'* share, whereas **Form 26** is to be completed net. The guidance given in 10.4 on the completion of **Form 23** also applies to these forms – see 10.4(4) to 10.4(7).
- (2) **Forms 26 and 27** should be completed separately for each business category of each treaty *accounting class* (where any business is carried on in that business category for that *accounting class*). The entries in any box on all **Form 26** for any *accounting class* should in aggregate (converted into sterling where necessary) equal the corresponding entry on **Form 23** for that *accounting class*.
 - (3) An *insurer* may prepare a single **Forms 26 and 27** for business carried on in all currencies (with all amounts converted into sterling). Alternatively it may prepare separate forms in any one or more of:
 - (a) sterling;

- (b) United States dollars;
 - (c) Canadian dollars;
 - (d) Euros; or
 - (e) any other currency where the *gross premiums or claims* incurred for the business carried on in that currency exceeds 10% of the total for all treaty business.
- (4) Business transacted in a currency for which no separate form is prepared should be included in the sterling form (converted into sterling) unless the *insurer* considers it more appropriate to include it in the form for another currency (converted into that currency). The reporting of treaties on separate currency forms should be consistent from year to year. See paragraph 5 of **Appendix 9.2**.
- (5) The amount of earned premium shown at column 11 for each accident year should be updated each *financial year* end to take account of over- or under-estimates of premium for that accident year.
- (6) The category box in the heading should be completed with one of the letters a to h according to the table in 9.3(1). If any of these standard categories is divided into bespoke business categories (see 9.3(2)) these bespoke categories should be distinguished by inserting the numbers 1, 2, 3 etc. after this letter. (For example if the standard business category c is divided into four bespoke categories, the heading entry for each of these should be respectively c1, c2, c3 and c4). The currency box in the heading should be completed with the country code for that currency, (see the **Annex** to this paragraph for these codes).
- (7) The category names to be used in the title lines to the form are described in 9.3(1). A bespoke category should be given a name which:
- (a) describes the general nature of the business included; and
 - (b) distinguishes it from other business categories.

Supplementary notes

- (8) Five notes are specified:
- (a) if any of the brought forward amounts differs from the corresponding carried forward amounts in the previous *return* the reason should be stated - see paragraph 7 of **Appendix 9.1**; [Code 2601]
 - (b) the basis of allocating or apportioning *reinsurance* treaties accepted which fall within more than one business categories should be stated-see rule 9.17(2). Further guidance is given in 9.3(5); [Code 2602]

- (c) where the allocation or apportionment to business categories of any *reinsurance* treaties accepted which have previously been reported differs from that adopted previously, an explanation of the nature of the change and the reasons for it should be given - see rule 9.17(3)(a). Further guidance is given in 9.3(6) to 9.3(7) above; [Code 2603]
- (d) where the allocation or apportionment to business categories of any *reinsurance* treaties accepted differs from that adopted previously for *reinsurance* treaties relating to similar risks, an explanation of the nature of the change and the reasons for it should be given - see rule 9.17(3)(a). Further guidance is given in 9.3(6) to 9.3(7); [Code 2604]

Forms 28 and 29

Completion of the forms

- 10.8 (1) **Forms 28 and 29** present an analysis by business category of the business reported on **Form 24** and **25** for the treaty *accounting classes* 9 to 11. The formats of **Forms 28** and **29** are identical respectively to the formats of **Forms 24** and **25** except for:
- (a) the inclusion in the heading of a business category and a currency box, and
 - (b) the use of a continuation sheet; and
- the guidance given above on the completion of the headings of those forms also applies to these forms - see 10.5(2).**
- (2) **Forms 28** and **29** should be completed separately for each business category of each treaty *accounting class* (where any business is carried on in that business category for that *accounting class*). The entries in any box on all **Forms 28** and **29** for any *accounting class* should in aggregate (converted into sterling where necessary) equal the corresponding entry on **Forms 24** and **25** for that *accounting class*.
 - (3) The guidance given in 10.7(3) to (6) on the completion of **Forms 26** and **27** also applies to these forms.
 - (4) A transitional concession applies for proportional treaty business (*accounting class* 10) which was not previously reported on the *1983 Regulations Form 29*, either because it did not fall in the MAT business categories or because it was not the subject of a direction under section 148 of the *Act*. Amounts for underwriting years ended before 23 December 1993 may be included in the prior years column and need not be analysed on the continuation sheet. (If this is done only post-1993 year-end dates should be entered in the column headings).

- (5) All premium amounts at lines 11 and 12 should be shown gross of commissions.
- (6) For an open underwriting year, line 54 of **Form 28** ('Technical provisions - carried forward - adjustment for discounting') should show the extent to which future investment return has been taken into account in deciding whether and, if so, by how much to increase the fund (i.e. premiums written less *claims* and expenses) to make it sufficient to meet all present and future obligations attributable to the underwriting year, i.e. the amount shown at line 53 ('Technical provisions - carried forward – undiscounted') should be the fund augmented by the full amount needed to make it sufficient to meet all such obligations without taking future investment return into account.
- (7) The amount shown at line 54 for an open year should be included as one of the component items in the balance shown at line 20 on **Form 29**, even if that results in a negative amount at that line. Lines 16 to 18 on this form should not include amounts for open underwriting years.

Supplementary notes

- (8) Six notes are specified:
 - (a) the first five are the same as described in 10.7(8) for **Forms 26** and **27**, but are in respect of treaty business accounted for on an underwriting basis; and [Codes 2801 to 2805]
 - (b) where a surplus for offset is shown at line 19 of **Form 29**, the following should be stated:
 - (i) a description of the business in respect of which the anticipated surplus and of the business in respect of which the anticipated deficit to be offset arise (including identification of the risk groups or business categories into which the business falls); and
 - (ii) the reason for treating the business as managed together. See paragraph 25(2) of **Appendix 9.2**. [Code 2901]

Form 30

Completion of the form

- 10.9 (1) **Form 30** consists of two sheets. The form should be completed whenever an amount for adjustment for discounting is included in any **Form 22** or **25** - see rule 9.15 and also paragraph 27 of **Appendix 9.2**. However de minimis rules (explained) apply for the completion of sheet 2 and parts of sheet 1.
- (2) Sheet 1 calls for an analysis of assets and liabilities etc. by major currency. A major currency is any currency in respect of which the 'provision for

claims outstanding' (before deduction for *discounting*) is not less than 10% of the total provision for *claims* outstanding (before deduction for *discounting*). In terms of the form each major currency line should have a column 6 entry which is not less than 10% of the column 6 total.

- (3) In sheet 1 of **Form 30**, assets and liabilities should be allocated to particular currencies using, basically, the same rules as apply for the purpose of the matching and localisation requirements. However, for the purpose of completing **Form 30** the rules should be applied to all the assets and liabilities of the *insurer*, (including assets and liabilities in respect of business to which the obligation to match and localise assets does not apply). Rules 7.1(5) and 7.3(2) to 7.3(5) apply.
- (4) Instructions 1 to 4 (and 6 & 10) respectively explain the entries to be made in columns 1 to 4 of sheets 1 and 2. Two points will be noted here:
 - (a) The reference in column 2 to hypothecated assets should not be read as imposing any requirement on *insurers* to hypothecate particular assets to particular liabilities. It merely allows *insurers* who have chosen so to hypothecate to report this on the form. *Insurers* which do not hypothecate should include all assets in column 2, (i.e. column 2 will equal column 1);
 - (b) the expected income and yield to be shown at columns 3 and 4 are to relate only to those assets included in column 2; and
 - (c) the *admissible assets* shown at column 1 are the total *admissible assets*, but excluding the *reinsurers'* share of *technical provisions*, and *deferred acquisition costs*.
- (5) In sheet 1:
 - (a) column 5 should show all *technical provisions*, i.e. including the provisions for unearned premiums and unexpired risks;
 - (b) columns 5 to 7 are to be completed net of *reinsurance*. Column 5 should include all *technical provisions* except the *equalisation reserve* (as there is no rule by which the latter may be allocated across currencies). Columns 6 and 7 ('Provision for claims outstanding being discounted') should include any provisions for *claims management costs* which are being discounted;
 - (c) column 8 should show the unwind of the discount in the next *financial year* calculated in accordance with instruction 8; and
 - (d) column 11 should show the average rate calculated in accordance with instruction 11.

- (6) An example of the calculation of the unwind of the discount in the next *financial year* is given below:

An *insurer* has claims outstanding (including IBNR) of £250k at the end of 1996 which it estimates it will pay as follows -

31.5.97 £150k

31.5.98 £100k

Its discount rate of interest is 5% and so in the 1996 *return* it presents the following amounts in columns 6 and 7 of **Form 30** -

Claims outstanding -

before deduction for *discounting* £250k

deduction for *discounting* £10k

where the latter figure is calculated as -

$$£9.7k = £250k - £150k/(1.05)^{5/12} + £100k/(1.05)^{(1+5/12)}.$$

The unwind of the discount in the next *financial year* is then calculated as follows -

- (a) estimate the expected *claims* outstanding at the 1997 year end (using the same assumptions as are used to estimate the actual claims outstanding at the 1996 year end) but only in respect of accident/underwriting years 1996 and prior.

$$\text{Expected } \textit{claims} \text{ outstanding at 1997 in} \\ \text{respect of accident years 1996 and prior} = \quad \underline{£100k}$$

- (b) estimate the deduction for *discounting* at the 1997 year end (using the same assumptions as are used to estimate the actual deduction for *discounting* at the 1996 year end) but only in respect of accident/underwriting years 1996 and prior.

$$\text{Expected deduction for } \textit{discounting} \text{ at 1997 in} \\ \text{respect of accident years 1996 and prior} = £100k - £100k/(1.05)^{5/12} \\ = \quad \underline{£2.0k}$$

- (c) then subtract the expected deduction for *discounting* at 1997 (as calculated in (b) above) from the actual deduction for *discounting* at 1996 as follows.

'Unwind of discount in the next financial year' = £9.7k - £2.0k = £7.7k = £8k (rounded)

Supplementary note

- (7) Three supplementary notes are specified:
- (a) the methods and assumptions used in determining the yield in accordance with instruction 4 to the form should be stated - see instruction 5; [Code 3001]
 - (b) the treatment of expected income payment (in arriving at the amounts shown at columns 3 and 4) from any asset where such payment is in default should be stated – see instruction 7; and [Code 3002]
 - (c) a note should state the risk groups and business categories where an adjustment for *discounting* has been made and, for each such risk group or business category:
 - (i) the method used in calculating the deduction for *discounting*;
 - (ii) the rate of interest used;
 - (iv) the expected average interval between the date of settlement for *claims* being discounted and the end of the *financial year*; and
 - (v) the criteria adopted for estimating the period that will elapse before *claims* are settled. See paragraph 27(5) of **Appendix 9.2**. [Code 3003]

Forms 31, 32 and 34

Completion of the forms

- 10.10 (1) **Forms 31, 32 and 34** provide the risk group analysis of the gross *claims* and *gross premiums* information for the business (see the diagram in 9.1(3)). **Forms 31** and **32** are used for accident year business, whilst **Form 34** is used for underwriting year business.
- (2) Separate **Forms 31, 32 and 34** are not needed for a UK branch *return* or EEA branches *returns* where a global *return* including these forms is being submitted.
- (3) **Form 31** should be prepared separately for each risk group in each country for all *direct and facultative accounting classes* (other than the *direct and facultative motor class 2*). **Form 32** should be prepared separately for each risk group in each country for *accounting class 2*. **Form 34** should be

prepared separately for each risk group in each country for all *direct and facultative accounting classes*. See rule 9.19.

- (4) The classification of business into risk groups is explained in 9.
- (5) The three forms are similar in format. **Form 32** only differs from **Form 31** by the inclusion of a column 12 (vehicle years) and column 13 (*claims* frequency). **Form 31** only differs from **Form 34** by the inclusion of columns 1 and 2 (*claims* numbers). However instruction 7 to **Form 31** provides that *claims* numbers need not be reported for marine, aviation and transport business reported on that form.
- (6) The *claims* numbers on **Forms 31** and **32** only relate to reported *claims* outstanding. Estimates of *claims* numbers for IBNR are not required. Column 1 of **Forms 31** and **32** show the cumulative *claims* numbers only for *claims* settled at some cost and column 2 the *claims* numbers of reported *claims* outstanding. Where a *claim* was previously reported as closed at some cost but is subsequently reopened, it remains one *claim*. If necessary it should be transferred from column 1 and included in the *claims* number in column 2.
- (7) The amounts shown for *gross premium* for each accident/underwriting year in column 10 on **Forms 31** and **32** and in column 8 on **Form 34** should be updated each *financial year* end to take account of over- or under- estimates of premiums for that year.
- (8) The instructions to the forms also provide that:
 - (a) all figures are to be shown gross of *reinsurers'* shares, before any deduction for *discounting* and exclusive of any *claims management costs*; and
 - (b) all percentages are to be expressed to one place of decimals.
- (9) Instruction 6 to **Form 32** explains how vehicle years are to be calculated. The percentages shown in that form for the *claims* frequency, (column 13), should be calculated as the ratio of (column 1 + column 2) to (1000 x column 12).
- (10) On all forms the accident/underwriting year end dates inserted at lines 11 to 20 should be the year end dates of the current *financial year* and the 9 previous *financial years*.
- (11) **Forms 31** and **34** have continuation sheets. These are only to be used for risk groups falling into *accounting class 7* (third-party liability). The continuation sheets analyse the amounts shown at line 21 (prior accident/underwriting years) and should be prepared where any amount is shown at this line.

- (12) On all **Forms 31, 32 and 34** the risk group name shown (in the titles lines to the Forms) should include a description of the risks within the *accounting class* included in that risk group - see paragraph 29(1) to **Appendix 9.2**. This requires, amongst other things, that the description should be sufficient to distinguish the risk group from other risk groups for the same country falling in the same *accounting class*.

Supplementary notes

- (13) Two supplementary notes are specified:
- (a) if any of the brought forward amounts differs from the corresponding carried forward amounts in the previous *return*, the reason should be stated - see paragraph 7 of **Appendix 9.1**; and [Code 3101, 3201 or 3401]
 - (b) if for any risk group the name given to it (see 10.10(10)) is not sufficient to identify, for the business included in that risk group, the nature of the objects exposed to risks and the nature of the cover provided against such risk, this information should be stated in a supplementary note - see paragraph 29(2) of **Appendix 9.2**. [Code 3102, 3202 or 3402]

Forms 33 and 35

Completion of the forms

- 10.11 (1) If the *insurer* has any reconciliation business then it should complete **Form 33** (for accident years) and **Form 35** (for underwriting years) - see rule 9.20. Separate **Forms 33** and **35** are not needed for a UK branch *return* or EEA branches *returns* where a global *return* including these forms is being submitted.
- (2) In (1), Reconciliation business is any direct and facultative business not classified into risk groups and so not reported on **Forms 31, 32 and 34**. It arises from two sources:
- (a) small country business - see 9.4(6) to (7); and
 - (b) business which was reported on reconciliation forms under the *1983 Regulations*.
- (3) Only one **Form 33** and one **Form 35** should to be prepared covering all *accounting classes*.
- (4) The instructions to the forms also provide that all figures are to be shown gross of *reinsurers'* shares, before any deduction for *discounting* and exclusive of any *claims management costs*.

Supplementary notes

- (5) Only one supplementary note is specified. If any of the brought forward amounts differs from the corresponding carried forward amounts in the previous *return* the reason should be stated - see paragraph 7 of **Appendix 9.1**. [Code 3301 or 3501]

Form 36

- 10.12 (1) **Form 36** should be prepared whenever any of the business category **Forms (26 to 29)** or the risk group **Forms (31 to 35)** is prepared in a foreign currency. **Form 36** reports the rates of exchange used for the conversion of amounts reported on those forms in foreign currency for inclusion in other forms in sterling. Where a different rate is used for premiums and *claims* incurred/paid/ earned during the year than for *claims* outstanding at the year end, the former rate should be stated. Where more than one such rate is used during the year the average rate should be stated.
- (2) The country codes are listed in the **Annex**.
- (3) There are no supplementary notes specified to this form.

ANNEX

COUNTRY	CODE
Afghanistan	QS
Albania	CE
Algeria	KA
Andorra	CG
Angola	MT
Anguilla	GY
Antigua And Barbuda	GP
Argentina	JA
Armenia	RB
Aruba	GM
Australia	EA
Austria	BL
Azerbaijan	RC
Bahamas	GD
Bahrain	PN
Bangladesh	QA
Barbados	GA
Belarus	RD
Belgium	BD
Belize	HH
Benin	LK

Bermuda	GE
Bhutan	QX
Bolivia	JL
Bosnia and Herzegovina	CH
Botswana	MG
Brazil	JC
Brunei	QY
Bulgaria	CD
Burkina Faso	LL
Burundi	MW
Cambodia	QU
Cameroon	MV
Canada	FA
Cape Verde	LM
Central African Republic	MY
Chad	NA
Channel Islands	BA
Chile	JB
China (Taiwan)	QQ
China, Peoples Rep.Of	QJ
Colombia	JD
Comoros	MX
Conga, Democratic Republic of	MM
Congo (Republic of)	MU
Costa Rica	HF
Croatia	CJ
Cuba	GJ
Curacao	GL
Cyprus	DA
Czech Republic	CP
Denmark	BE
Djibouti	NB
Dominica	GR
Dominican Republic	GF
Ecuador	JF
Egypt	KE
El Salvador	HB
England	AC
Equatorial Guinea	NC
Eritrea	NK
Estonia	RE
Ethiopia	MP
European Currencies, Weighted Average Of	CZ
European Currency Unit	CY
Fiji	EC
Finland	BR
France	BF
French Guiana	JK
Gabon	ND

Gambia,The	LA
Georgia	RF
Germany	BK
Ghana	LB
Gibraltar	DB
Grand Cayman Islands	GW
Greece	BN
Grenada	GQ
Guam	RW
Guatemala	HD
Guinea	LN
Guinea-Bissau	LP
Guyana	JH
Haiti	GK
Home Foreign-United Kingdom	AB
Honduras	HC
Hong Kong	QE
Hungary	CC
Iceland	BU
India	QB
Indonesia	QM
Iran	PB
Iraq	PJ
Irish Republic	BC
Isle Of Man	BB
Israel	PC
Italy	BG
Ivory Coast	LH
Jamaica	GB
Japan	QK
Jordan	PL
Kazakhstan	RG
Kenya	MA
Kiribati	ED
Kirjhzia (alternate name for Kyrgystan)	RV
Korea, South	QR
Korea,North	QP
Kuwait	PD
Kyrgyzstan	RV
Laos	RT
Latvia	RJ
Lebanon	PE
Lesotho	MH
Liberia	LG
Libya	KD
Liechtenstein	CK
Lithuania	RK
Luxembourg	BH
Macedonia	BZ

Madagascar	MS
Malawi	MD
Malaysia	QF
Maldives	RU
Mali	LE
Malta	DC
Marshall Islands	EM
Mauritania	LS
Mauritius	ML
Mexico	HA
Micronesia	EN
Moldova	RL
Monaco	CF
Mongolia	RM
Monserrat	GS
Morocco	KB
Mozambique	MR
Myanmar	QH
Namibia	NE
Nauru	EE
Nepal	QT
Netherlands	BJ
Netherlands Antilles	GX
New Zealand	EB
Nicaragua	HE
Niger	NF
Nigeria	LC
Northern Ireland	AF
Norway	BS
Oman	PP
Pakistan	QC
Palau	EP
Panama	HG
Papua New Guinea	EF
Paraguay	JM
Peru	JG
Philippines	QL
Poland	BV
Portugal	BP
Puerto Rico	GG
Qatar	PG
Romania	BW
Russia	RN
Rwanda	NG
San Marino	CL
Sao Tome And Principle	LQ
Saudi Arabia	PF
Scotland	AE
Senegal	LJ

Seychelles	NH
Sierra Leone	LD
Singapore	QG
Slovakia	CQ
Slovenia	CM
Solomon Islands	EG
Somalia	MQ
South Africa	MK
Spain	BQ
Sri Lanka	QZ
St Helena And Dependencies	NJ
St Kitts-Nevis	GT
St Lucia	GV
St Martin	GN
St Vincent and The Grenadines	GU
Sudan	MN
Surinam	JJ
Swaziland	MJ
Sweden	BT
Switzerland	BM
Syria	PK
Tahiti	QV
Tajikistan	RP
Tanzania	MC
Thailand	QN
Togo	LR
Tonga	EH
Trinidad And Tobago	GC
Tunisia	KC
Turkey	PA
Turkmenistan	RQ
Turks & Caicos Islands	GZ
Tuvalu	EJ
Uganda	MB
Ukraine	RR
United Arab Emirates	PH
United Kingdom	AA
Uruguay	JN
USA	FB
Uzbekistan	RS
Vanuatu	EK
Vatican City	CN
Venezuela	JE
Vietnam	QW
Virgin Islands	GH
Wales	AD
Western Samoa	EL
Yemen, South	PM
Yugoslavia	BY

Zambia
Zimbabwe

ME
MF

11. FORMS 37 TO 39: EQUALISATION RESERVES

Introduction

- 11.1 (1) The *Equalisation Reserves Rules* require *insurers* to keep two *equalisation reserves*. One for credit business, and one for those writing property, consequential loss, marine, aviation and nuclear business, referred to collectively as ‘other than credit business’.
- (2) This guidance seeks to explain the rules in areas that are thought likely to be helpful to those responsible for the calculation and audit of *equalisation reserves*.
- (3) This guidance does not deal with tax matters.
- (4) Each of **Forms 37 to 39** is used for both types of *equalisation reserves* (i.e. credit and other than credit), but since the rules for credit and other than credit are different, the guidance is divided into two parts dealing with each of them separately. Sections 11.2 to 11.3 cover the other than credit *equalisation reserves*, and sections 11.4 to 11.5 cover the *equalisation reserves* for credit business.
- (5) All the *returns* from *insurers* carrying on *general insurance business* in the categories prescribed by the *Equalisation Reserves Rules* should include the *equalisation reserve* forms, or a note explaining why they are not included. The note should be prepared in accordance with instructions for supplementary notes under 4.6(6).

Rules governing the Equalisation Reserves Rules: other than credit insurance business

Application

- 11.2 (1) The *Equalisation Reserves Rules* apply to every *insurer*:
- (a) whose head office is in the UK;
 - (b) whose business in the UK is restricted to *reinsurance*; or
 - (c) whose head office is not in an *EEA State*.
- (2) *Assessable mutuals* are excluded from the requirement.
- (3) Business carried on outside the United Kingdom by an *insurer* whose head office is not in the United Kingdom (rule 6.5(2)(b) is also excluded from the requirement.

Coverage

- (4) This is detailed in rule 6.4(3). The business for which *equalisation reserves* are required is set out in five sub-paragraphs. Rule 6.6 requires *insurers* to classify this business into five *business groups*. These are set out in the table in (10).
- (5) *Business group A* – ‘Property’ should be straightforward. In most cases the only business that will be needed to be removed from that reported for *accounting class 6* is any nuclear business. The *direct and facultative* business should be that reported for *accounting class 6* on **Forms 21/22** or **24/25**. The proportional treaty business should be that reported for *accounting class 10*, business category (f), on **Forms 26/27** or **28/29**.
- (6) *Business group B* - Consequential loss is less straightforward in that it will generally comprise only part of *accounting class 8*. Consequential loss risks are defined in the interpretation section of the *Equalisation Reserves Rules*. This covers the risks described at *class 16 (a)* of **Annex 11.2** and it may also be helpful to refer to this. Any nuclear business needs to be removed. The *direct and facultative* business should be a part of that reported for *accounting class 8*. The proportional treaty business should be part of business category (h) that is reported on **Form 26/27** or **28/29** as a break down of *class 10*.
- (7) *Business group C* – ‘Marine and aviation’ covers all relevant *direct and facultative* and treaty business. The group does not include transport business and any nuclear business should be removed. The *direct and facultative* business should be that reported for *accounting classes 3* and *4*. The treaty business will be derived from business categories (c) and (d) for *accounting classes 9, 10* and *11*.
- (8) *Business group D* - The nuclear *business group*, includes both liability and damage business that comes within the definitions in the interpretation section of the *Equalisation and Reserves Rules*. The scope of the description goes beyond the business written by the British Insurers (Atomic Energy) Committee pool, but participants in that pool are expected to be able to include all that business. Liability should be part of *accounting class 7*. Damage should be mainly from *accounting classes 6, 9* and *10*. Some MAT business may need to be included.
- (9) *Business group E* – ‘Non-proportional treaty’ covers property and consequential loss business except such nuclear business which should be included in group D. The property business should be that reported on **Form 26/27** or **28/29** for *accounting class 9*, business category (f). The consequential loss business should be part of business category (h) that is reported on **Form 26/27** or **28/29** as a break down of *accounting class 9*.

(10) The guidance in (4) to (9) is summarised in the following table:

Business Group	Description
Property	<i>Direct and facultative - accounting class 6.</i> Proportional treaty - <i>accounting class 10</i> , business category (f) 'property'.
Consequential loss	<i>Direct and facultative - part of accounting class 8</i> Proportional treaty – <i>accounting class 10</i> , part of business category (h) 'miscellaneous and pecuniary loss'.
Marine and aviation	<i>Direct and facultative - accounting classes 3 and 4.</i> Treaty – <i>accounting classes 9, 10 and 11</i> -business categories (c) and (d) NB Transport is excluded.
Nuclear	<i>Nuclear risks</i> Both damage and liability business. Nuclear business needs to be removed from the other <i>business groups</i> .
Non-proportional treaty property and consequential Loss	Treaty – <i>accounting class 9</i> , business categories (f) 'property' and part of (h) 'miscellaneous and pecuniary loss'.

De minimis rules

- (11) De minimis rules apply in two sets of circumstances. First where an *insurer* has never had an *equalisation reserve*. Secondly where an *insurer* has been required to set up an *equalisation reserve* in previous years, but where the level of business in the current year has dropped below the level where a transfer in is required. The rules that apply in these circumstances are set out in rules 6.5 and 6.10 of the *Equalisation Reserves Rules*.
- (12) Rule 6.5 provides that these rules do not apply to *insurers* who do not already have an *equalisation reserve* if in respect of all other than credit business net premiums written in a *financial year* are:
- (a) less than 1,500,000 Euros; or
 - (b) less than 4% of all its *general insurance business* and less than 2,500,000 Euros.

- (13) Rule 6.10 sets out rules where an *insurer* has an *equalisation reserve* to bring forward, but where the net premiums written in the *financial year* being reported on are less than the limits at 12(a) and (b). The calculation varies according to the number of years an *insurer* has been writing the business. Where a five year reference period is available, the number of years where the *insurer* has been below the thresholds is used. Where less than five years is available, the average net premium is used. In both cases *financial years* may need to be adjusted to 365 day periods. These calculations will produce a result indicating that either the reserve should be carried forward or be reduced to zero.
- (14) If the rule 6.10 reserve calculations result in a reduction of the reserve to zero, line 13 of **Form 37** should be left blank. This will result in the carried forward also being blank.

Treatment of business transfers

- (15) Rules 6.8 and 6.9 of the *Equalisation Reserves Rules* apply respectively to the transferor and transferee of a transfer under Part VII of the *Act*.
- (16) Rule 6.8 requires that the transferor should not include any of the business that has been transferred in *business group maximum* calculations, and that, if all rights and obligations have been transferred, the *business group maximum* at **Form 37**, line 13 should become zero.
- (17) Rules 6.9(1) to 6.9(5) apply to transferees at the end of the year in which the transfer takes place. The prescribed treatment varies according to whether such business is accounted for as an adjustment to premiums or *claims*.
- (18) Rules 6.9(6) to 6.9(8) provide guidance for subsequent years. Appropriate amounts should be included in net premiums.

Completion of Forms 37 to 39 for other than credit insurance business

Form 37

- 11.3 (1) Columns 1 to 6 of this form should be used for other than *credit insurance business*.
- (2) **Form 37** presents the net premiums written, the maximum size of the reserve, the *equalisation reserve* brought and carried forward and transfers to or from it. It consists of two parts:
- (a) calculation of the maximum provision; and
- (b) calculation of the transfer to/from the provision.
- (3) The net premium (i.e. the premium, net of *reinsurance* but gross of commission) for each of the *business groups*, for which business has been

written, should be entered in columns 1 to 5 of line 12 for the current year. These figures include previously unbooked premiums adjustments relating to risks incepted in prior *financial years*.

- (4) The total for the previous four years, or for such years as are available for inclusion, (this applies to all companies during the first four years of the rules, or where the company has recently commenced writing business in a *business group*), should be entered in line 11. *Financial years* ending before 23 December 1996 should not be brought into the calculation. (See *Equalisation Reserves Rules*, **Appendix 6.1**, Part II, paragraph 12(2)).
- (5) The maximum provision can be calculated as the sum of lines 11 and 12 divided by the number of years premiums these figures reflect and multiplying by the percentages shown in the *Equalisation Reserves Rules*, **Appendix 6.1**, Part III. The products of these calculations should be entered in line 13 and then added together and the total entered in line 13 column 6.
- (6) The figure at line 21, column 6, should be available from the previous year's *return*, unless it is the first year of the scheme or a *insurer* has newly commenced writing business covered by the rules, in which case the line should be left blank. Line 22, columns 1 to 5, can be calculated by multiplying the figure in the same column at line 12 by the percentage specified in the *Equalisation Reserves Rules*, **Appendix 6.1**, Part I. Line 22, column 6, is the sum of columns 1 to 5.
- (7) Line 23, columns 1 to 5, derives from the same *business groups* at either **Form 38** line 19 or **Form 39** line 19, according to whether accident year or underwriting year accounting is being used, or possibly the sum of both. Line 24, columns 1 to 5, will be the same as line 23, unless for a *business group* considered in isolation the figure at line 23 is higher than that at line 13. If this is the case for any *business group*, the provisional transfer out will be the maximum reserve figure at line 13. Columns 1 to 5 should be added together and the sum entered in column 6.
- (8) The rest of the calculation only uses column 6. Lines 25 to 29 show the transfer for the year and the *equalisation reserve* carried forward. Line 25 limits any transfer out to the sum available. Line 27 limits the *equalisation reserve* carried forward to the maximum allowable reserve.
- (9) Line 29 should carry forward to **Form 16**, line 12 and line 28 to **Form 15**, line 15. NB, the amounts in **Form 16**, line 12 and **Form 15**, line 15 may also include any non-UK statutory *equalisation reserves* which the *insurer* has been required by overseas law to set up in respect of its overseas operations.
- (10) Instructions 1 to 11 to the form provide guidance for its completion.

Form 38: accident year accounting

- (11) Lines 11 to 19 should be used for other than credit business covered by the *Equalisation Reserves Rules*. Separate calculations are made for each *business group*.
- (12) The form presents the abnormal loss, if any, for business accounted for on an accident year basis.
- (13) The coverage of the five *business groups* is explained in 11.4.
- (14) The net premium includes previously unbooked premium adjustments (i.e. amounts at **Form 21**, line 11, column 5). It should be noted that *claims* incurred excludes *claims management costs* i.e. those *claims management costs* required by the shareholder accounts rules (note (4) to the profit and loss account format) to be included in *claims* incurred other than those which, whether or not incurred through the employment of the *insurer's* own staff, are directly attributable to particular *claims*.
- (15) Lines 13 and 19 are simple arithmetical calculations explained in the instructions to the form.
- (16) Care needs to be taken to comply with the rules for transferred business, particularly in the year of transfer. See rules 6.8 and 6.9.
- (17) Instructions 1 to 5 on the reverse of the form provide guidance for its completion.

Form 39: underwriting year accounting

- (18) Lines 11 to 19 should be used for other than *credit insurance business* covered by the *Equalisation Reserves Rules*. Separate calculations should be made for each *business group*.
- (19) The form presents the abnormal loss, if any, for business accounted for on an underwriting year basis.
- (20) The coverage of the five *business groups* is explained in 11.2(4) to (10).
- (21) The net premium written derives from the total column on **Form 24** (line 19) and, therefore, includes previously unbooked premium adjustments from prior underwriting years.
- (22) The amount shown for 'claims, net of reinsurance', line 12 instruction 3 in **Form 39**, is derived from the amounts shown in **Forms 24 & 25**, but excluding *claims management costs* and *deferred acquisition costs*.
- (23) Lines 13 and 19 are simple arithmetical calculations explained in the instructions to the form.

- (24) Care needs to be taken to comply with the rules for transferred business, particularly in the year of transfer. See rules 6.8 and 6.9 of the *Equalisation Reserves Rules*.
- (25) Instructions 1 to 5 on the reverse of the form provide guidance for its completion.

The Equalisation Reserves Rules: credit insurance business

Application

- 11.4 (1) The *Equalisation Reserves Rules* for *credit insurance business* apply to:
- (a) every *UK insurer* which carries on *credit insurance business*; and
 - (b) every *non-EEA insurer* which carries on *credit insurance business* in the United Kingdom.

De minimis

- (2) Where net written premiums are less than 4% of total net premiums in a *financial year* and less than 2,500,000 Euros a *credit insurance equalisation reserve* need not be kept. See Part III of the *Equalisation Reserves Rules*.

Completion of Forms 37 to 39 for credit insurance business

Form 37

- 11.5 (1) Column 7 of this form should be used for *credit insurance business* where any *non-reinsurance* business falling within *class 14*, including mortgage indemnity business, (above the limits noted in 11.4(3)), has been carried on.
- (2) **Form 37** presents the net premiums written in the year, the maximum size of the reserve, the *equalisation reserve* brought and carried forward and transfers to or from it. It consists of two parts:
- (a) calculation of the maximum provision; and
 - (b) calculation of the transfer to/from the provision.
- (3) The maximum provision cannot be calculated from the information on the form. The rules require that this be 1.5 times the highest net premiums written during the previous 5 years.
- (4) The figure at line 21 should be available from the previous year's *return*. Lines 22 and 24 derive from either **Form 38** or **Form 39**, according to whether underwriting year or accident year accounting is being used, or just possibly both. Two tests must be applied to the technical surplus brought

forward to complete line 22. It must be limited to 75% of the surplus, or 12% of line 12, net premiums written for the year, whichever is the lower.

- (5) Lines 25 to 29 enable the presentation of the transfer for the year and the *equalisation reserve* carried forward. These figures should carry forward to **Form 16**, line 12 and **Form 15**, line 14.
- (6) Instructions 12 to 16 on the reverse of the form provide guidance for its completion.

Form 38

- (7) Lines 21 to 29 should be used for *credit insurance business*.
- (8) **Form 38** presents the technical surplus for *credit insurance business* that has been *accounted for* on an accident year basis.
- (9) *Equalisation Reserves Rules, Appendix 6.2*, section 4 specifies that in determining any technical surplus the calculation must be made before tax and before any transfer to or from the credit insurance *equalisation reserve*. Investment income should not be included in these calculations.
- (10) Where there are technical income or charges for items not specified on the form, for example movements in the provision for unexpired risks, these should be accommodated by adjusting line 24.
- (11) Instructions 6 to 9 on the reverse of the form provide guidance for its completion.

Form 39

- (12) Lines 21 to 29 should be used for *credit insurance business*.
- (13) **Form 39** presents the technical surplus for *credit insurance business* that has been *accounted for* on an underwriting year basis.
- (14) *Equalisation Reserves Rules, Appendix 6.2*, section 4 specifies that in determining any technical surplus the calculation is to be made before tax and before any transfer to or from the credit insurance *equalisation reserve*. Investment income must not be included in these calculations.
- (15) Where there are technical income or provisions for items not specified on the form, these should be accommodated by adjusting line 24.
- (16) Instructions 6 to 9 on the reverse of the form provide guidance for its completion.

12. **THE RULE 9.25, 9.26 AND 9.27 STATEMENTS: MAJOR TREATY REINSURERS, MAJOR FACULTATIVE REINSURERS AND MAJOR CEDANTS**

Major treaty reinsurers

- 12.1 (1) Rule 9.25(1) requires every *insurer* which carries on *general insurance business* to prepare a statement of its major treaty *reinsurers*. The items to be included in that statement are listed in rule 9.25(1). The statement is intended to inform the reader of the *returns* of the *insurer's exposure* to particular treaty *reinsurers* where they are material.
- (2) Rule 9.25(2) lays down two tests for identifying major treaty *reinsurers*:
- (a) a premium *ceded* limit; and
 - (b) a *debt* plus anticipated recoveries limit.
- (3) A major treaty *reinsurer* is any *reinsurer* which either exceeds the 'premium *ceded*' limit in the current or any of the five immediately preceding *financial years*, or exceeds the '*debt* plus anticipated recoveries' limit at the current year end. The limits are applied in aggregate, (i.e. to the sum of all amounts from all treaties ceded to that *reinsurer*), except that the 'premium *ceded*' limit is applied separately for, and differs for, proportional and non-proportional treaty aggregates.
- (4) The 'premium *ceded*' limits are:
- (a) for proportional treaty *reinsurance* 2% of total worldwide *gross premiums written* of the *insurer* or branch;
 - (b) for non-proportional treaty *reinsurance* 5% of the total premium payable in respect of all non-proportional *reinsurance*.
- (5) The '*debt* plus anticipated recoveries' limit is 5% of the *insurer's general insurance business* amount. (Paragraph 5.49 of **Guidance Note 4.1** explains how the *general insurance business* amount is calculated.) The '*debt* plus anticipated recoveries' which are compared with this limit should include the amount of any *debt* due or *reinsurance* recovery anticipated from the *reinsurance* in respect of treaty *reinsurance ceded*, but only to the extent that they are taken into account in **Form 13** (lines 61 and 75), i.e. net of any specific bad or doubtful *debt* provision. Further the anticipated recoveries need only be included to the extent they arise from the *reinsurer's* share of the gross provision for:
- (a) notified outstanding *claims*; and

- (b) *claims* incurred but not reported arising from specific occurrences to which provisions have been allocated.
- (6) The latter category is intended to refer to situations where the *insurer* is aware that a catastrophe event (e.g. hurricane, earthquake etc.) has occurred and sets up a specific IBNR reserve for that catastrophe.
- (7) If two or more *reinsurers* are connected to each other, the ‘premium *ceded*’ and ‘*debt* plus anticipated recoveries’ limits should be compared to their total business. If either limit is exceeded all the connected *reinsurers* should be considered major treaty *reinsurers* and the items referred to in rule 9.25(1) listed separately for each.

Major facultative reinsurers

- 12.2 (1) Rule 9.26 requires every *insurer* which carries on *general insurance business* to prepare a statement of its major facultative *reinsurers*. The items to be included in that statement are listed in rule 9.26(1). The statement is intended to inform the reader of the *returns* of the *insurer’s* exposure to particular facultative *reinsurers* where they are material.
- (2) The definition of major facultative *reinsurer* and the items to be included in the statement are similar to those in 12.1 for the major treaty *reinsurers*. The differences are explained below.
- (3) The ‘premium *ceded*’ and ‘*debt* plus anticipated recoveries’ limits are applied separately for each facultative *reinsurance* contract. The items to be stated for the major facultative *reinsurer* need only be in respect of the major facultative *reinsurance* contract (and, if there is more than one major facultative *reinsurance* contract for that *reinsurer*, should be stated separately for each). Other (smaller) facultative *reinsurances* of the same *reinsurer* may be ignored.
- (4) The ‘premium *ceded*’ limit is 0.5% of total *gross premiums written*. The *debt* plus anticipated recoveries limit is 1% of the *general insurance business amount*. A major facultative *reinsurance* is a facultative *reinsurance* which exceeds either limit in the current *financial year*. Note unlike for treaty *reinsurance* there is no reference back to the five *preceding financial years* in applying the ‘premium *ceded*’ limit. Nor are connected *reinsurers* aggregated in applying either limit.

Major cedants

- 12.3 (1) Rule 9.27 requires every *insurer* which carries on *general insurance business* to prepare a statement of its major *cedants*. The items to be included in that statement are listed in rule 9.27(1). The statement is intended to inform the reader of the *returns* of the major sources of the *insurer’s* inward treaty *reinsurance* business.

- (2) A major *cedant* is any *insurer* from which the *gross premiums written* in respect of the total business accepted under treaty *reinsurances* exceeds the greater of:
- (a) 5% of the total *gross premiums written* under all treaty *reinsurances* accepted; or
 - (b) 2% of *gross premium written* from all sources;
- for the current or any of the three immediately *preceding financial years*.
- (3) If two or more cedants are connected to each other, the above limits should be compared to their total business. If either limit is exceeded all the connected cedants should be considered major cedants and the items referred to in (1) separately listed for each.

Connected companies

- 12.4 (1) Rule 9.28 defines when *insurers* should be regarded as connected for the purposes of rules 9.25 to 9.27. The need to define ‘connected’ arises in two contexts:
- (a) firstly, as explained in 12.1 and 12.3, in identifying major treaty *reinsurers* and major cedants, *reinsurers* connected to each other and cedants connected to each other are respectively grouped; and
 - (b) secondly, one of the items to be disclosed in respect of each major treaty *reinsurer*, major facultative *reinsurer* and major cedant is whether (and, if so, how) it is connected to the *insurer*.
- (2) The test of connectedness differs somewhat for uses in 12.4(1)(a) and (b). In both uses a person (i.e. individual or *body corporate*) and a *body corporate* are considered connected if the person is:
- (a) a *subsidiary undertaking* of the *body corporate*;
 - (b) a *parent undertaking* of the *body corporate*; or
 - (c) a *subsidiary undertaking* of a *parent undertaking* of the *body corporate*.
- (3) In the use in 12.4(1)(b), a person and *body corporate* would also be considered connected if one of them is controlled by the other or they are both controlled by the same person. For these purposes a special definition of control applies - see rule 9.28(2) and (3) which define ‘control’ for these purposes.

- (4) Both the above definitions of ‘connected’ are subject to the exception that a person and a *body corporate* are not to be considered connected if the reporting *insurer*:
- (a) does not know; and
 - (b) could not upon reasonable enquiry be expected to find out that the connection exists.
- (5) Other than in the exceptional circumstance, the reporting *insurer* should know of any connections between its *reinsurers* (or cedants) and itself or *insurers* with which it is connected. However, the *insurer* making the *return* may not in all cases be aware of connections between its *reinsurers* (or cedants) where they are not in turn connected to the *insurer*. In order to comply with the requirement to make reasonable enquiry, it will suffice for the *insurer* making the *return* to refer to the latest available published accounts or recognised industry reference document (provided that, in all cases, the source to which reference is made has been published within twelve months of the end of the *financial year* to which the *return* relates). Alternatively the *insurer* may request any or all of its *reinsurers* (or cedants) to provide details of their connected *insurers*. If no information is available from acceptable published material, or obtained in response to a specific approach to a *reinsurer* (or cedant), in the usual case, the obligation to make a reasonable enquiry will have been satisfied. However, possible breaches of the rules will be considered case by case.
- (6) The rules covered by the guidance in (1) to (5) do not apply in respect of *reinsurers* who are members of the *Society*. For the purposes of preparing the rules 9.25, 9.26 and 9.27 statements, all members of *Lloyd's* are taken as a whole.

Nil returns

- 12.5 (1) Where there are no disclosable major treaty *reinsurers*, major facultative *reinsurances* or major cedants, statement under rules 9.25, 9.26 and 9.27 should state that this is the case.

13. THE RULE 9.32/APPENDIX 9.5 STATEMENT: BUSINESS CEDED

Overview

- 13.1 The statement required under **Appendix 9.5** should be prepared by all *insurers* which carry on *general insurance business*. The statement is intended to give an overview of the *insurer's* outward non-facultative *reinsurance* protections. Its minimum contents are prescribed in paragraphs 1 to 5 of **Appendix 9.5**, which provide as follows.

Paragraphs 1 & 2

- 13.2 (1) Paragraph 1 requires a description to be given for each outward non-facultative *reinsurance* contract entered into, or modified, during the *financial year*. The description includes:
- (a) type of business covered by reference to risk groups;
 - (b) type of cover; and
 - (c) policy limits.
- (2) Refer to the text of paragraph 1 in **Appendix 9.5** for a fuller description of the disclosure required.
- (3) A contract is modified when the terms of the original contract are altered by mutual agreement of the parties. The exercise by one party to the contract of an option (e.g. to extend cover) which the other party has no right to refuse is not a modification. The existence of the option should be included, if material to an understanding of the policy, in the 'type of cover' description given at the time when the policy was originally effected.
- (4) Information on contracts modified during the *financial year* need only be given if, and to the extent that, the modification renders the information originally disclosed either inaccurate or materially incomplete. Modifications of contracts originally entered into prior to the first *financial year* covered by the new *returns* need not be reported.
- (5) The lay-out and presentation of the information required by **Appendix 9.5**, paragraph 1 is at the discretion of the *insurers* provided that is fairly presented (see rule 9.11), legible and complete. In particular the information may be presented, wholly or in part, in the form of a table or chart. However, information on *reinsurances* which cover the same type of business for similar periods of cover should be laid out together.

Paragraph 3(a)

- 13.3 (1) This sub-paragraph requires extra disclosure for outward *reinsurance* contracts which are subject to no, or a finite number of, reinstatements. Where it is anticipated that *claims* arising from incidents which occurred during or prior to the *financial year* will fully exhaust the *reinsurance* (including all reinstatements) this should be disclosed.
- (2) Any *reinsurance* reported under **Appendix 9.5**, paragraph 1, whether in the present or previous *returns* should be disclosed. The disclosure need only be given once, i.e. if a particular *reinsurance* is reported under paragraph 3(a) it need not be so reported under that paragraph in subsequent *returns*.

Paragraphs 3(b) & (c)

- 13.4 (1) These sub-paragraphs require extra disclosure where *reinsurers* representing a 10% or more participation in any *reinsurance* have ceased to pay *claims* to their reinsureds in full. This refers to where a *reinsurer* ceases to pay *claims* in full, as they fall due, to all or substantially all of its reinsureds. It does not require that the *reinsurer* should have actually refused to pay (in full) the particular *insurer* preparing the *return*. Nor does it include situations where the *reinsurer* is refusing to pay that particular *insurer* (e.g. due to a dispute) but is continuing to pay the general body of its reinsureds.
- (2) The cessation of *claims* payment in full, referred to in (1), would typically arise where the *reinsurer* is in liquidation, provisional liquidation, or is paying less than 100% of claims under the provisions of a scheme of arrangement, (or is subject to similar insolvency processes under the laws of foreign countries). However it would also include situations where the *reinsurer* was operating a *claims*-moratorium outside the protection of a formal insolvency legal process.
- (3) Under these sub-paragraphs of **Appendix 9.5** any *reinsurance* reported under **Appendix 9.5** paragraph 1 whether in the present or previous *returns* should be disclosed.
- (4) The disclosure in (3) should identify the *reinsurance* contract and state the participation in that *reinsurance* represented by *reinsurers* which have ceased to pay *claims* in full, but it is not necessary to name those *reinsurers*. Once this disclosure has been made for a particular reinsurance contract it need not be repeated in subsequent *returns* unless, due to further reinsurers ceasing to pay *claims* in full, the percentage has increased by more than ten percentage points.
- (5) The percentage to be disclosed is the full percentage participation for a *reinsurer* even if that *reinsurer* is still making partial payments on *claims*. For example if ABC Reinsurance Co. has a 10% line on a *reinsurance* policy and ABC is now paying *claims* at 60 pence in the pound, the full 10% should be disclosed. The fact that 60 pence on the pound on that 10% participation, is still being paid may also be disclosed, but there is no requirement to do so.

Paragraph 4

- 13.5 (1) This paragraph requires disclosure of the *insurer's* maximum probable loss (net of *reinsurance*) from:
- (a) any one contract; and
 - (b) all contracts taken together.
- (2) Sub-paragraph 4(2) in **Appendix 9.5** defines 'maximum net probable loss' (MPL). It, amongst other things, refers to any one incident or series of

incidents arising from the same originating cause. This wording is intended to require the aggregation of losses from a single incident or series of incidents for reporting of MPL's where they would have to be aggregated for the purpose of making recoveries on the company's (higher layers) *reinsurance*. It is self-evident that all contracts taken together MPL cannot be less than the any one contract MPL. It is also self-evident that both must be non-zero or both zero.

- (3) The disclosure is required separately for each risk group or business category, or part thereof in respect of which separate non-facultative *reinsurance* cover has been obtained. The disclosure is required for a risk group or business category even if no *reinsurance* has been obtained for that risk group or business category.
- (4) The practice (adopted by some companies for the 1997 *returns*) of showing a separate MPL for every non-facultative *reinsurance* policy is not correct and often led to nonsensical disclosures. One, and one only, MPL on each of the bases any one contract effected by the company and all contracts taken together, should be disclosed for each group, business category or part thereof as described in (2). This MPL should be net of all reinsurance protecting the risk group, business category or part thereof.
- (5) The MPL should not be confused with the deductible or retention on the company's lowest level of *reinsurance* protection. It may only equal that amount where (i) the maximum probable gross loss is not expected to exceed the *reinsurance* protection; (ii) the *reinsurance* protection is fully placed, i.e. no *co-reinsurance*; and (iii) recovery from the *reinsurance* protection does not result in liability for additional premiums.

Paragraph 5

13.6 This paragraph requires that the split of *reinsurance* premiums (as shown on **Forms 21** and **24**) for each *accounting class* between facultative and non-facultative *reinsurance* be disclosed.

14. **FORMS 40 TO 45: THE LONG TERM BUSINESS REVENUE ACCOUNT**

Form 40

Different types of Form 40

- 14.1 (1) **Form 40** presents a revenue account for *long-term insurance business*. It should be prepared separately for each *long-term insurance business fund* maintained by the *insurer*. If there is more than one such fund for either *ordinary* or industrial *long-term insurance business* a summary **Form 40** for *ordinary* or industrial *long-term insurance business* (as the case may be) should be prepared. See rule 9.14(b).

- (2) The separate **Forms 40** for different funds and for the summary are distinguished by the entry in the heading box 'No. of Fund/Summary'. Paragraph 4(2) of **Appendix 9.3** specifies how this is to be completed.
- (3) For each with-profits fund paragraph 13 of **Appendix 9.4** requires that the *appointed actuary* include in his/her valuation report:
 - (a) a revenue account for each such sub-fund in the format of **Form 40** with a supplementary note stating the amount, if any, of investment income relating to linked assets included in line 12; and
 - (b) a statement of liabilities and margins in the format of Form 14 with a supplementary note stating the amount, if any, of the increase or decrease, as the case may be, in the value of non-linked assets;

where this information is not provided elsewhere.

- (3A) where the amount of the increase or decrease in non-linked assets has yet to be allocated, paragraph 13.(2) of Appendix 9.4 requires enhanced disclosure in Form 14 and the notes to Form 14.
- (4) It has been the practice of some *insurers* to provide:
 - (a) **Forms 40** for each sub-fund; and
 - (b) the description of principles etc. as a supplementary note to those forms;

within the **Appendix 9.3** part of the *return*, which is signed off by the *directors* and is subject to audit. Where this is the case the *insurer* should also prepare a **Form 40** for the whole fund. The **Forms 40** for the sub-funds should be distinguished by the entry in the heading box 'No. of part of fund'. Paragraph 4(2) of **Appendix 9.3** specifies how this is to be completed.

Relationships with other forms and between different Forms 40

- (5) The amounts included in the form for earned premiums, *claims* incurred and expenses payable are to be derived from **Forms 41** and **Form 42** in accordance with instruction 1.
- (6) Where an *insurer* decides to allocate to the *long-term insurance business* the whole or any part of investment income and/or net capital gains arising from assets not attributable to its *long-term insurance business*, both the income and any associated investment management charges, must first be included in the non-technical account (**Form 16**), with the amount to be allocated to the *long-term insurance business* shown as a transfer at line 13 of **Form 16**, line 26 of **Form 40** and in **Form 58**. See instruction 3.

- (7) The amount shown for transfers to the non-technical account (line 26) should agree with the equivalent amount disclosed at line 47 on **Form 58** - see instruction 4. However, if there is a net transfer into the fund, the entry at line 26 will be negative, and by virtue of instruction 3 to **Form 58** there will be a positive entry in line 34, lines 15 and 47 remaining blank.
- (8) The amount of any transfer to and from other funds should be included in the **Form 40** of the transferee and transferor funds respectively at line 15 and line 25 - see instruction 4.

Completion of the form

- (9) The instructions to the form specify the rules for its completion. These rules differ in several respects from those which are used in the preparation of the *Companies Act* accounts. The following table identifies for each line in the form the most closely corresponding items from *long-term insurance business* technical account specified in the *Companies Act* and describes some major differences between the accounting rules for those items and for **Form 40**.

Line in Form 40	Item(s) in the technical Account	Major points of difference in accounting treatment
<u>Line 11</u> - Earned premiums	<u>II.1</u> Earned premiums	In preparing the technical account the company may choose whether or not to include the change in the provision for unearned premiums under this item. In Form 40 only the latter treatment is acceptable, i.e. the change in unearned premiums must be excluded. This is also by far the more commonly used of the two permitted treatments in the technical account.
<u>Line 12</u> – Investment income receivable before deduction of tax	<u>II.2</u> Investment income, (but excluding items <u>II.2</u> .(c) and (d) - see below).	The items II.2(c) and (d) under the heading investment income in the technical account refer to value re-adjustments and realised gains on investments. In Form 40 no amounts for gains or loss on investments should be included in investment income. The treatment in the <i>returns</i> of tax borne on franked investment income should be consistent with guidance issued for the <i>Companies Act</i> accounts by the Accounting Standards Board and the Association of British Insurers.

Line in Form 40	Item(s) in the technical account	Major points of difference in accounting treatment
<p><u>Line 13</u> – Increase (decrease) in the value of <i>non-linked assets</i>, brought into account</p> <p><u>Line 14</u> – increase (decrease) in the value of <i>linked assets</i></p>	<p><u>II.2.(c)</u> Investment income - value readjustments on investments</p> <p><u>II.2(d)</u> Investment income - gains on realisation of investments</p> <p><u>II.3</u> Unrealised gains on investments</p> <p><u>II.9(b)</u> Investment expenses and charges - value readjustments on investments</p> <p><u>II.9(c)</u> Investment expenses and charges – losses on realisation of investments</p> <p><u>II.10</u> Unrealised losses on investments</p>	<p>(1) The technical account includes <u>all</u> investment gains and losses (realised and unrealised). In Form 40 such gains and losses (other than in respect of <i>linked assets</i>) are only included to the extent they are brought into account. Form 40 includes all gains and losses in respect of <i>linked assets</i>.</p> <p>(2) In Form 40 the increase/(decrease) in value shown includes the changes in the valuation differences shown at lines 92 to 95 of Form 13 (for <i>long-term insurance business assets</i>).</p>
<p><u>Line 15</u> – Other Income</p>	<p><u>II.4</u> Other technical income, net of <i>reinsurance</i></p>	
<p><u>Line 21</u> - <i>Claims</i> incurred</p>	<p><u>II.5</u> <i>Claims</i> incurred, net of <i>reinsurance</i></p> <p><u>II.7</u> Bonuses and rebates, net of <i>reinsurance</i> but only to the extent that they are cash bonuses (which do not therefore increase technical reserves).</p>	<p>(1) In the technical account <i>claims</i> incurred includes <i>claims management costs</i>. In Form 40 these are to be included under expenses payable not <i>claims</i> incurred.</p> <p>(2) In the technical account <i>claims</i> incurred includes the change in the provision for <i>claims</i> outstanding. In Form 40 this change (except to the extent it relates that part of the provision not included in <i>mathematical reserves</i>) is not to be included as it is already taken into account in the movement of the fund shown at line 39. The <i>mathematical reserves</i> take into account outstanding <i>claims</i> except where they have already fallen due at the valuation date.</p>

Line in Form 40	Item(s) in the technical account	Major points of difference in Accounting treatment
<u>Line 22</u> – Expenses payable	<i>Claims management costs</i> included in item <u>II.5</u> above. <u>II.8</u> Net operating expenses <u>II.9(a)</u> Investment expenses and charges – investment management expenses, including interest	(1) In the technical account net operating expenses are adjusted to take account of the change in the amount carried forward for <i>deferred acquisition costs</i> . In Form 40 all acquisition expenses incurred during the year should be included at line 22 and no amounts should be carried forward. (2) Any interest payable included in net operating expenses in the technical account should be included in Form 40 at line 23 not line 22.
<u>Line 23</u> - Interest payable before deduction of tax	Interest included in item <u>II.9(a)</u> above. Interest included in item <u>II.8</u> above.	
<u>Line 24</u> – Taxation	<u>II.12</u> Tax attributable to <i>long-term insurance business</i>	
<u>Line 25</u> – Other Expenditure	<u>II.11</u> Other technical charges, net of <i>reinsurance</i>	

<p><u>Line 26</u> – Transfer to (from) non-technical account</p>	<p><u>II.12</u> Allocated investment return transferred to (from) the non-technical account</p> <p><u>II.13</u> Balance on the technical account - <i>long-term insurance business</i></p>	<p>The main reasons for differences between the amounts transferred to the non-technical account and the technical account are typically -</p> <p>(1) the deferral in the technical account of acquisition expenses;</p> <p>(2) the transfer in the technical account of amounts to or from the fund for future appropriations;</p> <p>(3) valuation differences as between <i>mathematical reserves</i> in the <i>return</i> and <i>technical provisions</i> in the technical account; and</p> <p>(4) investment gains not brought into account in Form 40.</p>
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Line in Form 40	Item(s) in the technical account	Major points of difference in accounting treatment
<p><u>Line 39</u> – Increase in fund in <i>financial year</i></p>	<p><u>II.7</u> Bonuses and rebates, net of <i>reinsurance</i> but only to the extent that they increase the <i>technical provisions</i></p> <p><u>II.6</u> Change in other <i>technical provisions</i>, net of <i>reinsurance</i>, not shown under other headings</p> <p><u>II.12a</u> Transfers to or from the fund for future appropriations</p>	<p>These items are not directly comparable as different valuation rules apply in the <i>returns</i> and <i>Companies Act</i> accounts.</p>

Supplementary notes

- (10) Eight supplementary notes are specified to **Form 40**:
- (a) if any of the brought forward amounts differs from the corresponding carried forward amounts in the previous *return* the reason should be stated - see paragraph 7 of **Appendix 9.1**; [Code 4001]

- (b) particulars of the amounts included at lines 15 and 25 for other income and other expenditure should be stated - see instruction 2 to the form; [Code 4002]
- (c) particulars of the amount of any investment income and/or net capital gains allocation included at line 26 in **Form 40** should be stated - see instruction 3 to the form (and also 14.1(11)); [Code 4003]
- (d) a specification of any transfer of reserves associated with a transfer of contracts from one fund to another should be stated - see instruction 4 to the form; [Code 4004]
- (e) unless already stated in a note to **Form 16**, the bases of conversion adopted in respect of foreign currency for income and expenditure should be stated - see paragraph 5(2) of **Appendix 9.1**; [Code 4005]
- (f) where a *insurer* maintains more than one *long-term insurance business* fund, it should state the principles and methods applied to apportioning the investment income, the increase or decrease in the value of assets brought into account, expenses and taxation between the different fund - see paragraph 4(1) of **Appendix 9.3**; [Code 4006]
- (g) [Deleted]
- (i) where arrangements have been in force during the *financial year* for the provision either by or to the *insurer* of management services, this fact should be stated together with the name of the other party (to whom or from whom such services were provided or received) - see paragraph 5 of **Appendix 9.3**. This statement is only needed where a substantial part of the day-to-day administration of an *insurer* is undertaken by another company or vice versa. Note that where the arrangement is between two *insurers*, the directors will need to consider very carefully the form of their certificate under **Appendix 9.6**, Part I paragraph 4(e). [Code 4008]

Forms 41 to 45

Completion of the forms

- 14.2 (1) **Forms 41 to 45** should be prepared separately for each fund and sub-fund for which a **Form 40** is prepared and also (except for **Form 45**) in summary where a summary **Form 40** is prepared - see rule 9.23. These forms supplement **Forms 40**. **Form 41** provides an analysis of premiums and expenses, **Form 42** of *claims*, **Form 43** a summarised balance sheet for *internal linked funds*, **Form 44** an aggregate revenue account for *internal linked funds* and **Form 45** supplementary information on *internal linked funds*.

- (2) Instruction 2 to **Form 41** provides for the reporting of repeated or recurrent single premium business as regular premium business. The purpose of this is to differentiate business which may be expected to produce an ongoing premium income for the *insurer* (regular premium) from business which is one-off in nature (single premium). It is typical of regular premium business that the office will issue a renewal notice for the expected amount of premium, albeit that the policyholder may have a contractual right to pay a different amount, or nothing at all. Another characteristic might be that premium collection is by a direct debit or other payment order. Contracts set up to receive minimum contributions from the Department of Social Security should be treated as single premiums. This differentiation between single and regular premiums used in **Form 41** should also be used in **Form 46** and **Form 47**, and the total single premiums on **Form 41** should equal that for **Form 47** - see 15.6(2).
- (3) The instructions to the forms provide, amongst other items, for:
- (a) the reporting of industrial assurance *claims* incurred on survival in respect of periodical benefits as surrenders (**Form 42**);
 - (b) the reporting of *derivative contracts* (**Form 43**);
 - (c) the elimination of cross-investment between *internal linked funds* (**Form 44**);
 - (d) the separate disclosure of gross units created and gross units cancelled in *internal linked funds* (**Form 44**) so that turnover can be monitored. Each day's movements may be netted or recorded as two separate entries, one positive and one negative, as is administratively convenient; the total net positive and negative movements will be recorded on lines 11 or 21 as appropriate; and
 - (e) the method of disclosure of the provision for capital gains tax on unrealised and realised capital gains in *internal linked funds* and of the valuation price of units in *internal linked funds* (**Form 45**).
- (4) In addition to the above the following points should be noted:
- (a) the differentiation between UK contracts and overseas contracts (**Forms 41** and **42**) must be in accordance with paragraph 3 to **Appendix 9.3**. The definition does not correspond with the definitions of overseas life assurance business for Inland Revenue purposes;
 - (b) the earned premiums shown in **Form 41** should include that part of the premium which was or will be recoverable from the Inland Revenue;

- (c) the expenses shown in **Form 41** should be those which relate only to the company's *long-term insurance business*. Those relating to the company's other business cannot, by virtue of rule 3.2(1)(a) (subject to the exception in rule 3.2(1)(b), be paid out of the long term funds and must therefore be shown in the *general insurance business* technical account (**Form 20**) or the non-technical account (**Form 16**);
- (d) In dividing management expenses between lines 43, 44 and 45 of **Form 41**:
 - (i) costs of a non-recurring nature, such as those incurred in developing new systems, new premises, or the costs of corporate restructuring, should normally be reported in line 45;
 - (ii) the costs incurred in writing new business (or in obtaining incremental (but not indexed) premiums on existing business), such as underwriting, policy issue, setting up (or amending) records and the maintenance and development of the sales and marketing organisation should be reported at line 43; and
 - (iii) the balancing item will be expenses related to the ongoing costs throughout the year of maintaining the business in force (including any investment management costs) and should be reported in line 44; and
- (e) commission payable to employees of the *insurer* whose job is to sell policies should be included under management expenses (lines 43 and 44 of **Form 41**). On the other hand any commission payable to employees who sell policies on a casual basis should be included under Commission (lines 41 and 42) along with that paid to other *intermediaries* and to cedants;
- (f) all assets held within *internal linked funds* must be included in **Form 43**, even if their value exceeds the amount at the unit liability, cf. paragraph 3.6 of **Guidance Note 4.4**. Note: the *Valuation of Assets Rules* apply in full to these excess assets (see rule 4.1(2));
- (g) The figures shown in column 2 of **Form 45** shall be those appropriate at the end of the *financial year*, net of any indexation allowances. Each percentage shown in column 3 shall be the appropriate figure shown in column 5 of **Form 43** expressed as a percentage of the appropriate figure in column 2 of **Form 45**; and
- (h) The figures shown in column 4 of **Form 45** shall be the total deductions made from each fund for the *financial year* in respect of tax on realised capital gains (as included in line 24 of **Form 44**) expressed as a percentage of the taxable net realised capital gains arising in the period.

Supplementary notes

- (5) Three supplementary notes to **Form 43** are specified:
- (a) the basis on which assets have been valued should be stated - see instruction 1; [Code 4301]
 - (b) the aggregate value of rights and liabilities, both gross and net of *variation margin*, under *derivative contracts* should be stated - see instruction 2; and [Code 4302]
 - (c) certain specified details on the netting of the liability to repay *variation margin on derivative contracts* (and contracts having the effect of *derivative contracts*) should be stated - see instruction 3. [Code 4303]
- (6) Two supplementary notes to **Form 44** are specified:
- (a) if any of the brought forward amounts differs from the corresponding carried forward amounts in the previous *return* the reason should be stated - see paragraph 7 of **Appendix 9.1**; and [Code 4401]
 - (b) particulars of items reported as other income or other expenditure on **Form 44** should be stated - see instruction 2. [Code 4402]

15. **FORMS 46 TO 61: THE ABSTRACT OF THE ACTUARIAL VALUATION**

Overview

- 15.1 (1) **Appendix 9.4** prescribes the format of the abstract of the report of the *appointed actuary* on his investigation into the financial condition of the *long-term insurance business*, required under rule 9.4.
- (2) The preamble to **Appendix 9.4** provides for certain provisions to be applied to the report from **Appendix 9.1** and **Appendix 9.3**. These include the requirement that supplementary notes to forms shall be separate statements and not footnotes, the method for completing the identification boxes on the forms, the treatment of currencies other than sterling, negative numbers within round brackets, dealing with differences between brought forward numbers and last year's *return*, and the definition of UK and overseas contracts. More information on these can be found in the notes relating to the relevant appendix. The *appointed actuary* should note that throughout the appendix and in these notes, references to 'surrender' should be taken to include all similar expressions, including transfer as applied to pension contracts. The preamble also requires that the answers provided by the *appointed actuary* be numbered to accord with the numbers of the

corresponding paragraphs. This instructions is also intended to apply to the numbering of the sub-paragraphs.

- (3) Paragraph 3 of **Appendix 9.4** refers to the requirement that the valuation is conducted so that the liabilities conform to rule 5.6. Sufficient information should be provided within the report to enable the *FSA* to form a view, and in particular that the reserves meet each of the minimum standards required under rules 5.7 to 5.17 of those rules. It is not normally necessary to supply detailed supporting information, except where otherwise stated in these notes or in the rules.
- (4) The preamble to **Appendix 9.4** also defines the report period in terms of the period since the last investigation under rule 9.4. Paragraph 2 also requires the date of this last investigation to be given. This relates to any investigation under the section, which includes any interim valuation for publication or distribution of profits which has been fully dealt with under the requirements, but does not apply to any informal valuation, nor normally to one produced pursuant to an actuarial investigation required by the *FSA* under its own initiative powers.
- (5) Certain paragraphs of **Appendix 9.4** relate exclusively to *non-linked contracts* (e.g. paragraph 4), some are related exclusively to *linked contracts* (e.g. paragraph 5), while others relate to both types of contract. The definition of a *linked contract* includes any contract under which linked benefits as defined rule 2.3(4) are provided. This includes a number of types of contract not traditionally regarded as linked (e.g. RPI-linked annuities) - see **Guidance Note 4.4** for further guidance. Except where there are specific requirements to do otherwise, a contract with both linked and non linked benefits is to be treated as a *linked contract*.

Paragraph 4 - non-linked contracts

- 15.2 (1) Paragraph 4 of **Appendix 9.4** requires specific information to be given in respect of two types of *non linked contract. Accumulating with profits policies* which are to be reported under sub-paragraph (1)(a) of **Appendix 9.4**. Broadly speaking these are policies of the type sometimes known as unitised with-profits, but the definition is slightly broader. First, it is not necessary that the benefits are in any way ‘unitised’ for the definition to apply. In particular, any with profits deposit administration contract would normally fall within this definition. Further, most recurrent single premium with profits contracts are also likely to fall within this definition. It is not considered that a traditional single premium with profits policy falls within this definition where the guaranteed benefit is fully expressed in terms of the amount payable at maturity if that sum is not explicitly related to the premiums, and more importantly to any additional premiums which may be allowed under the contract. Contracts where there is doubt should be reported under this heading.

- (2) Sub-paragraph 4(1)(a)(i) of **Appendix 9.4** requires the description of all deductions from the current benefit used in determining values under the policy. This will include all charges fixed under the policy, as well as any discretionary charges permitted. In particular, where there is a provision for a 'market value adjustment' or a similar deduction, this should be disclosed in terms of when it might apply. This does not refer to when it is in practice being applied.
- (3) Sub-paragraph 4(1)(a)(ii) of **Appendix 9.4** requires the description of how any discretionary adjustments such as are covered in (i) have been applied if the determination of the *mathematical reserves* (excluding any reserves under rule 5.17 including a resilience reserve) has taken credit for these adjustments. Where there are powers to vary an adjustment which is laid down in the policy (as may be the case with initial or capital units), but the *insurer* has not exercised its discretion to vary these adjustments from the levels prescribed in the policy, this need not be considered as triggering this sub-paragraph. Where any discretion has been exercised in respect of a charge taken credit for in the valuation, or where the charge is provided for but no level is specified in the policy, then it is necessary to describe all such discretionary charges levied in the report period.
- (4) Paragraph 4 of **Appendix 9.4** also requires specific information in respect of a further class under sub-paragraph (1)(b) of **Appendix 9.4** which is intended to include policies of the type known as deposit administration, unless they are with profits policies, which should be included under (a). Sub-paragraph (1)(c) of **Appendix 9.4** covers any other types of non linked policy not covered under (a) or (b) which require amplification of the entry in **Form 51**. This will include any contracts which have any supplementary guarantees or options which the *appointed actuary* considers to be significant.
- (5) All sections of paragraph 4 of **Appendix 9.4** require information to be supplied on any material options. 'Options' should be interpreted widely, though it is for the *appointed actuary* to decide what is material. An option to surrender on guaranteed terms, or to convert on guaranteed terms to another form of benefit, or to increase benefits without evidence of health, should generally be considered material. Guarantees on interest rates include both fixed guarantees and guarantees which may be related to some external reference rate. Guaranteed surrender values may similarly be guaranteed by amount or by reference to some formula.
- (6) Sub-paragraph (2) of **Appendix 9.4** provides an exemption from the disclosure requirements of sub-paragraph (1) but only where both of conditions (a) and (b) are satisfied.

Paragraph 5 - linked contracts

- 15.3 (1) Paragraph 5 of **Appendix 9.4** provides for information to be supplied on *linked contracts*. Similar considerations to those described in 15.2, and in particular 15.2(5), in relation to paragraph 8 of **Appendix 9.4** apply also to

this paragraph. Paragraph 5.2 of **Appendix 9.4** requires any with profits option to be reported as under paragraph 4(1)(a) of **Appendix 9.4**.

- (2) Paragraph 5(4) of **Appendix 9.4** requires the disclosure of the methods used in creating and cancelling units and in their allocation to and de-allocation from policies. This requirement should include information on the basis of valuation of assets and how it is selected (for example, offer basis for net creations of units and bid basis for net cancellations), including the timing of the asset valuation used in respect of such operations in relation to the time at which both the operation is decided upon and effected. When at any one time different pricing bases may apply to different policies, then details of the circumstances which give rise to the difference should be provided. Where assets are units in *collective investment schemes* or similar assets, particular reference should be made to precisely what price is used, and the relationship between the last opportunity to deal at that price and the time of the valuation. In summary, the *FSA* should be provided with sufficient information to demonstrate that incoming, outgoing and continuing *policyholders* are treated equitably. It will be acceptable for reference to be made to compliance with published guidance to the extent that such guidance covers the above issues.
- (3) The information under paragraph 5(5) of **Appendix 9.4** should include the treatment of any tax on notional realisations where provision for these is made under the Taxes Acts. In particular, reference should be made to whether the liability for such tax, when it falls due, is retained within an internal fund, or has been transferred out of that fund in exchange for a tax deduction. The rate of such tax deduction should be stated.

Paragraphs 6 to 12 - bases, principles, methods etc.

- 15.4 (1) When providing the information on the general principles and methods adopted in the valuation under paragraph 6 of **Appendix 9.4**, the *appointed actuary* should provide sufficient explanation to enable the *FSA* to take a view, in relation to the issues specifically referred to in paragraph 6(1), on the adequacy of the reserving basis in relation to rules 5.6 to 5.17. Where the *appointed actuary* has not undertaken any specific tests implicit in the points raised in paragraph 6, as he considers the margins in his basis are already sufficiently large to meet each of the minimum requirements of rules 5.7 to 5.17 and of rule 5.6, he should indicate this either directly or indirectly; he should, however, justify his basis if it is not self-evident that there are sufficient margins. The *appointed actuary* should include broad details of the type of investigations he has conducted to meet the requirements of professional guidance in respect of sub-paragraph (1)(b) of **Appendix 9.4**.
- (2) Rule 5.17 requires the *appointed actuary* to take into account the nature and term of the assets and the value at which these have been brought into account when determining the appropriate provision against the effects of possible future changes in the value of the assets on their adequacy to meet the liabilities. If the assets in **Appendix 9.4** are brought in at book values

below the values in accordance with **Form 13**, and in determining the provision under this rule the *appointed actuary* has had regard to this fact, paragraph 6(2) of **Appendix 9.4** requires a statement to this effect. This applies also when the basis of the provision made for any prospective liability for tax on unrealised capital gains is determined in the context of assets taken at their book value rather than their **Form 13** value.

- (3) Paragraph 7(3) of **Appendix 9.4** requires reference to how the tables of mortality and morbidity assumed have regard to the State of commitment. This is a reflection of the requirements of the *Third Life Directive*, and if the *appointed actuary* has determined that the degree of variation of mortality or morbidity between states does not give rise to a material effect in the valuation, it is sufficient for this to be stated.
- (4) Paragraph 7(4) of **Appendix 9.4** requires details of any allowance made for future reductions in the rates of mortality in tables used in valuing annuities. Many such tables have a built-in allowance, and it is not necessary for the *appointed actuary* to give explicit details of this allowance if the table is in common usage in the United Kingdom. To the extent that the *appointed actuary* has determined to make additional allowance to that intrinsic to such a table, he should give details. This includes the making of an adjustment to the table which is intended to allow for future reductions, but does not include any adjustment made in respect of reductions already evidenced at the *relevant date*.
- (5) Paragraph 7(5) of **Appendix 9.4** will include any allowance made for the effects of the Human Immuno-Deficiency Viruses, but is not necessarily limited to those viruses. It does not require the *appointed actuary* to make an allowance for any particular change, but to disclose any allowance he may have made.
- (6) Paragraphs 7(6), (7) and (8) of **Appendix 9.4** cover the requirements of rule 5.17. Paragraph 7(6) requires only a description of the various scenarios tested and identification of the most onerous of those scenarios. It does not require the results of such scenarios to be stated. It should be noted that currency variations are included in this requirement.
- (7) It is not always straight-forward to divide the reserve under rule 5.17(a) from that under rule 5.17(b). Reserves under rule 5.17(b) will often exceed those under rule 5.17(a), particularly where there is a significant volume of with-profits business, and in this case, if the conditions giving rise to the envisaged change in the value of assets embrace those tested under rule 5.17(a), it is sufficient to state this in paragraph 7(7) of **Appendix 9.4**. However, it is not necessarily the case that the most onerous conditions under rule 5.17(b) allow for all the effects under rule 5.17(a), and the response to paragraph 7(7) of **Appendix 9.4** must make clear to what extent the reserve under rule 5.17(b) is taken into account.

- (8) The information required under paragraph 7(8) of **Appendix 9.4** is only in respect of that scenario tested which gives rise to the greatest requirement, but it applies even if the reserve required is zero. If no scenario gives rise to an additional reserve, the most onerous scenario is that which allows the smallest reduction in reserves, whilst the basis remains consistent with the rules. Sub-paragraph (8)(a) of **Appendix 9.4** requires any changes in assumptions, excepting only the interest rate, to be described. This includes, for example, the introduction of a zillmer adjustment within that permitted in the rules, the application of any adjustment to accumulating with profits policies reserves to reflect discretionary charges on surrender, the reduction of bonuses allowed for in the valuation, or any other change in assumptions whether explicit or implicit. Sub-paragraph (8)(b) requires a description of the method used in determining the requirement. This should only to be sufficiently detailed to enable the *FSA* to understand the techniques employed, any changes in the hypothecation of assets to liabilities, assumed changes in the exercise of discretion, and other changes outside the valuation basis or otherwise.
- (9) The additional information to be provided in paragraph 8(d) of **Appendix 9.4** (where the contracts do not fall within the circumstances of the proviso) must be sufficient to constitute the required demonstration. The information could take several different forms. For example the requirement would usually be met if the results of a net premium valuation for each of the relevant main categories of contract in the format of **Form 51** or **52** were given, specifying the valuation rates of interest and mortality used, the zillmer adjustment and any other relevant information. Where a full net premium valuation has not been made, the requirement could be met by a comparison of specimen reserves for each of the main categories of contracts for various ages and durations on the basis used by the *appointed actuary* in his report and on an appropriate net premium basis (specifying particulars of the basis as above) together with information about the distribution of the business in the form of appropriate weightings. In principle a method of demonstration which involved sampling could also be acceptable.
- (10) The information to be supplied in paragraph 9 of **Appendix 9.4** should normally include the expenses of administration per policy for each policy type, the rate of future inflation, and the rate of unit price growth (both gross and net of any relevant taxation, but before management charges) assumed in the valuation/test and the extent to which account has been taken of any increases in management charges, including those increasing with reference to a published index, which are allowed under the terms of the policy. Other parameters will normally include the mortality and morbidity rates and the rate of interest earned on sterling reserves assumed in the valuation/test.
- (11) Paragraph 10 of **Appendix 9.4** is intended to identify the contribution towards future management expenses derived from the assumptions made by the *appointed actuary* in the valuation basis for meeting future expenses. It is a request for statements of the actual results of applying the valuation basis. Thus sub-paragraph (1) requires a description of the rates of inflation

assumed and how inflation is allowed for in the valuation. Sub-paragraph (2) calls for the aggregate amount of expense contributions over the first year, with a general description of the sources, whether they be differences between net premiums and office premiums, or explicit allowances in the basis. Where with profits business valued on a net premium basis is concerned, it is not necessary to determine a precise split between the amount set aside for expenses and that for future bonuses. It is sufficient for the *appointed actuary* to describe the amount he considers appropriate to set aside for expenses on the basis of information readily available at the time. There should be a correlation between the amount disclosed by the *appointed actuary* and the figure included in line 44 of **Form 41**.

- (12) Sub-paragraph 10(3), of **Appendix 9.4** requires a description of the method and details of the basis used to calculate whether there is a need for a reserve in respect of continuing to write new business. This will require general statements as to the levels of business assumed for this purpose (perhaps in relation to that written the previous year), and broad assumptions as to costs (such as stating that he has assumed the continuation of the previous year's costs plus inflation, or by stating that he has used company budgets), product terms (such as stating the *appointed actuary* has assumed the continuation of the products on offer at the *relevant date*, or that he has reflected changes made after the *relevant date* but before the date of the certificate) etc. It does not require identification of explicit items in monetary terms, nor details of the precise assumptions. This is similarly true of sub-paragraph 10(4), where for example the *appointed actuary* might disclose that redundancy costs have been taken into account, if such be the case, or the costs of terminating management agreements, but not the amount of such costs.
- (13) Paragraph 11 of **Appendix 9.4** is a requirement to identify the extent of currency matching. The requirement is driven from the liabilities, and requires the liabilities included within the actuarial certificate (which includes liabilities in respect of deposits received from *reinsurers*), but excluding property-linked liabilities, to be analysed by currency. The assets reported as matching these liabilities, which should correspond with those reported for the same liabilities in other matching schedules within the *returns*, are similarly to be analysed by currency. The de minimis exemption for 2% of the liabilities is intended to avoid unnecessary detail for small exposures, but the degree of mismatching still needs to be given. This mismatching should be taken as the sum of all liabilities reported in the other currencies heading matched by assets in other currencies divided by the total liabilities under that heading. This figure should be given as a percentage and to the nearest whole number.
- (14) The information on *reinsurance* required under paragraph 12 of **Appendix 9.4** is largely self explanatory. It is acceptable for the *appointed actuary* to aggregate arrangements with a single reinsurer that are similar in nature. The requirements under paragraph 12(3) relate to both facultative and treaty *reinsurance*. The definition of a financing arrangement is intended to be wide and may include arrangements with non-insurance companies. It is

likely that many original terms *reinsurances* with advanced commissions will constitute financing arrangements. Financing arrangements cease to be such once all elements of the financing have been repaid, earned or otherwise reduced to zero. The *appointed actuary* should exercise reasonable discretion in reporting under this heading, particularly in relation to *facultative business*. It is acceptable where the financing arises from facultative *reinsurances* under a common overall agreement as to the general terms, for a grouped figure to be provided for the agreement, rather than for each contract.

Paragraphs 13 to 16 - profit distribution

- 15.5 (1) Where, in accordance with paragraph 13 of **Appendix 9.4**, a revenue account for a particular part of a *long-term insurance business* fund is included in the abstract of the *appointed actuary's* report, analyses of premiums, expenses and claims in the format of **Forms 41** and **42** are not required. The *appointed actuary* should provide information on the principles and methods applied in apportioning various items in any such revenue account included in **Appendix 9.4**, and in any revenue account of a with-profit sub-fund which is given in **Appendix 9.3** where the principles and methods of apportionment are not disclosed in that Appendix.
- (2) Paragraph 14 of **Appendix 9.4** is intended to supply sufficient information to enable the *FSA* to understand the criteria used in setting bonus rates. Sub-paragraph 14(1) is a widened version of the previous requirement. It is important the information which is derived from each of the sources is identified, and if the various sources differ in any respect, the information must be identified by source. In this context 'advertisement' has a wide meaning, and should include any sales and marketing literature. The references to policies issued by the *insurer*, and to advertisements, should be taken to mean any policy still in force, or any advertisement issued in a period from which with profits policies are still in force. It is not necessary to refer to policies which no longer exist. Sub-paragraphs 14(2) and (3) are intended to describe in broad terms how the bonus scales are arrived at. Although an answer that the distributions are based upon asset shares might be acceptable, it is necessary to indicate the approach to smoothing which it is intended to apply, the particular application to deaths and maturities, and the extent to which any 'charges' on asset shares are applied to maintain equity between classes or generations. The descriptions of the method should include any items excluded from or charged to any asset shares if that is the basic method.

Paragraphs 17 to 19 - Forms 46 to 49

- 15.6 (1) In **Forms 46, 46A, 47** and **47A**, the term 'annual premiums' refers to the total amount of premium payable, under the terms of the contract, each year. In **Forms 46** and **47** any contract which consists of a combination of different types of insurance (as defined by instruction 5 to **Form 47**) is to be treated as a number of separate contracts each dealing with one of the

different types of business so combined. The amounts by which the total number of contracts shown on each of the forms exceed the total number of contracts to which the forms relate should be stated by way of a supplementary note. In determining whether or not a contract consists of a combination of different types of business, the *appointed actuary* should exercise his discretion in interpreting differences in the same way as for **Forms 51 to 54**. Where the information given in **Forms 51 to 54**, together with any additional information required by Instruction 10 regarding the number of contracts does not enable a reconciliation to be made with the information supplied in **Form 46**, an explanation should be given. The instruction in respect of *hybrid linked contracts* should be interpreted in accordance with the definition in rule 10.1. In **Form 47**, any contract which falls within more than one of the categories described in instruction 6 shall be shown only once, in the most appropriate category.

- (2) Attention is drawn to the instructions to **Forms 46 and 47** in respect of regular premium and recurrent single premium contracts, and in respect of increases to existing contracts. It is essential that consistent treatment of individual contracts is adopted between **Forms 46 and 47**, and that all new business is reported under some heading within **Form 47**. Contracts set up to receive minimum contributions from the Department of Social Security should be treated as single premium business. Additional single premiums paid in respect of existing individual contracts should be shown separately from new business in **Form 47**. In **Form 47**, a single premium contract where there is a likelihood that there will be future premiums, but which do not meet the definition of regular premium contracts because their level of premiums is not defined, should be considered as not having an expectation of continuing premiums at regular intervals, and therefore be included within the single premium categories. (See also 14.2(2)).
- (3) In **Forms 48 and 49** the element of accrued interest or income in respect of any *asset* is required to be allocated to that *asset* class. Thus any accrued income on a government stock shall be reported under *approved securities*, and not under other assets. The yields required should be calculated with the value of the stock including this accrued interest or income element, but with full credit for the whole interest payment being taken in the expected receipts. Separate forms should be produced if and only if funds have assets separately appropriated. The treatment of tax borne on franked investment income should be consistent with guidance issued by the Accounting Standards Board and the Association of British Insurers. A supplementary note to the forms is needed where for any *asset* the payment of interest is in arrears. It should state the treatment of expected income from any such *asset* and the amount of the interest involved. See paragraph 6 to **Form 48**.
- (4) The required statements in respect of derivatives under paragraph 19 of **Appendix 9.4** the *appointed actuary* should follow the same principles as are described in 6 in respect of *asset* values. It is not generally necessary to quantify the changes in yields on **Form 48** which would arise. A broad description would normally suffice, unless the options concerned have the

effect of locking in particular yields not immediately identifiable from the description. Where, and to the extent that, the information provided by the *insurer* under rule 9.29 is sufficiently complete to answer this requirement, it is sufficient for the *appointed actuary* to refer to that information in the *return*.

Paragraph 20 - Forms 51 to 56

- 15.7
- (1) The aggregate of the amounts standing to the credit of *policy holders'* accounts should be shown in column 5 of **Form 51** for non-linked, non profit deposit administration schemes, and should be distinguished from any other measures of benefit shown in that column for such contracts.
 - (2) In **Forms 51** to **54**, wherever different rates of interest are used, the results should be shown separately.
 - (3) In **Forms 53** and **54**, if discounting applies to any type of contract, then columns 11 and 12 must be completed for all contracts. Column 12 may be left blank only if there is no discounting at all for that valuation summary. In **Form 53**, details of units which are discounted at different rates of interest (e.g. capital and accumulation units) should be shown separately.
 - (4) Where a *linked contract* includes *non-linked benefits* except where there are *accumulating with profits* benefits, these should be shown separately on whichever of **Forms 53** or **54** includes the *linked benefits*. Where *accumulating with profits* benefits are included, the treatment should follow instruction 12, and other *non linked benefits* may be included with either the *linked or accumulating with profits* benefits, provided the treatment is disclosed in the note required under instruction 12.
 - (5) Within **Forms 51** to **54** it is required to report separately under instruction 10 combinations of different types of insurance. The *Appointed actuary* is required to determine when such different types of insurance are present in one contract. If he considers that such separate reporting would be misleading, or would not materially alter the amounts reported under each type of insurance, due to the trivial nature of one or more types of insurance in a contract, this would be an indication that there may not, in practice, be more than one type of insurance present. This is not likely to be the case, however, where supplementary benefits of a different class of business under Annex 10.1 to Chapter 10 of the rules are concerned. For this purpose, it should be noted that non linked benefits under a *linked contract* still fall within class III.
 - (6) Risk premium *reinsurance* may be aggregated, separately for, and shown as a separate class in **Forms 51**, **52**, **53** and **54** respectively. Where risk premium *reinsurance* applies to a contract which is split between forms, the risk premium *reinsurance* should be reported on the same form as the benefits to which it applies. Where it is not possible to do this, the reason shall be given in a supplementary note, and the treatment shall be described.

- (7) Note the proviso to instruction 6 to **Forms 51-54**, which allows duplicate data on *reassurance ceded* to be aggregated. A similar easing of reporting requirements is provided by instruction 7 to **Form 55** in respect of unit liabilities wholly *reinsured*. However in this case paragraph 20(3) requires a statement that rule 7.2 has been complied with.
- (8) Valuation summaries for sub-funds for which surpluses are required to be determined under rule 9.4, and valuation summaries for non-linked, *accumulating with profits*, property linked and index linked business should be treated as separate for the purpose of Instruction 15 for the completion of **Forms 51 to 54**.
- (9) The relationships between **Forms 55 and 56** and the related items in **Appendices 9.1 and 9.3** are important. Considering first **Form 55** (property linked), **Form 13** line 59 which shows assets matching linked liabilities does not necessarily include the assets backing the surplus units in **Form 55**. See 5.4(15). Where the reconciliation between the amounts shown in **Form 55** and line 59 of **Form 13** is not readily apparent it should be described in a supplementary note to **Form 55**. Also, **Form 55** should, where appropriate, correspond with the assets in **Form 43**, which includes all assets in an internal fund, and reconciliation with that form should be readily apparent.
- (10) Similarly for **Form 56** (index-linked) the assets shown do not necessarily correspond with those shown in line 58 of **Form 13**. See 5.4(15). Where the reconciliation between the amounts shown in **Form 56** and line 58 of **Form 13** is not readily apparent it should be described in a supplementary note. Note, also, that **Form 56** represents holdings of assets, not liabilities, and that the long-term liability represented by the *mathematical reserve* on **Form 54** should not be entered on the form. **Form 56** recognises that index-linked liabilities will often be matched by derivative or quasi-derivative instruments, the nature of which may contain elements both of asset and of liability and this is reflected in the heading to the form and in column 2.
- (11) For both **Forms 55 and 56** the *appointed actuary* should include a note of any circumstances which make the natural relationships break down (e.g. particular tax treatments).
- (12) Where unit liabilities are reassured and deposited back with the ceding *insurer*, the amounts deposited back are to be treated in accordance with paragraph 20(2) of **Appendix 9.4** in all respects as though they are unit liabilities.

Paragraph 21 - Form 57

- 15.8 (1) Paragraph 21 of **Appendix 9.4** refers to **Form 57** and requires the forms submitted to cover all long term liabilities except unit liabilities in respect of property and *index-linked benefits*, CGT reserves and unit liabilities deposited back for *linked contracts*. The intention of the form is to identify

suitable blocks of assets which can notionally be allocated to cover each block of liabilities. Note that there is no provision that the form must include all of the non-linked assets in **Form 13**. However, the assets covering any resilience or mis-matching reserve (rule 6.17) should be included, generally on the balance form provided under instruction 6. For each form completed, the total assets for the valuation entered at line 29, column 1 should be equal to the liability entered at line 33, column 1.

- (2) An analysis of the same assets and liabilities in (1) is also required under the most onerous scenario identified by the *appointed actuary* in sub-paragraph 7(6) of **Appendix 9.4**. Column 3 re-values the assets included in column 1 on the assumptions of the resilience scenario; column 4 shows the value of any assets notionally re-allocated to the block of liabilities in order that they are still covered under the resilience scenario; and columns 5 and 6 show the new re-allocation in total. For each form completed, the total assets for the valuation entered at line 29, column 5 should be equal to or greater than the liability entered at line 33, column 5. In most circumstances, one would expect the assets allocated to the resilience reserve and included on the balance form under the valuation to be re-allocated so that this liability and its matching assets disappear from the balance form under the resilience scenario.
- (3) The instructions to **Form 57** require separate forms to be prepared among other reasons for each rate of interest used in the valuation. However, in respect of Instruction 5, where a contract or group of contracts is valued at a lower rate of interest to reflect an implicit margin for expenses described in the abstract, or to reflect an implicit provision for future bonuses, then they may be amalgamated with contracts valued at the higher rate without such implicit margins, and reported as if valued at the higher rate. Where this has been done, a supplementary note should record this. Instruction 5 also provides for contracts valued at a lower rate of interest to be grouped together with those at a higher rate, provided that the rationale for doing so is explained in a note. Note, however, that it is not acceptable to combine the separate forms required by instructions 2 and 3. Where more than one form is provided for a particular rate of interest, a supplementary note should identify the contracts included in each form. The totals under the resilience scenario recorded in column 5 shall be those under the scenario which is most onerous and is the subject of paragraph 7(8) (see 15.4(6)).
- (4) In relation to the risk adjustments disclosed in answering paragraph 21 of **Appendix 9.4**, it is not necessary to disclose these for individual assets, nor to provide any individual justifications for the adjustment. The *appointed actuary* should supply such justification to the *FSA* if it is not clear the basis upon which the adjustment was determined.

Paragraph 22 - Form 58

- 15.9 (1) When an *insurer* records a transfer to the non-technical account or to another fund or part of the fund in a revenue account (**Form 40**) for a particular

period, the amount of which has been derived from a valuation completed at the end of that period, that transfer should be shown in 58.13 or 58.14 as appropriate so that the true surplus appears in 58.29.

- (2) Where an *insurer* decides to allocate to the *long-term insurance business* the whole or any part of the investment income and/or net capital gains arising from assets not attributable to its *long-term insurance business*, the allocation should be included in **Form 58** as a transfer from the non-technical account (see 14.1(6)). This transfer should be included in either lines 13 and 15, or 32 and 34, depending on whether there is an overall net transfer out of or into the fund (or part of the fund) respectively (see Instruction 3 for the completion of **Form 58**).
- (3) Where, under rule 9.4(2)(b) a surplus is determined for a part of a fund where the rights of any policyholders to participate in profits relates to that sub-fund, paragraph 22 of **Appendix 9.4** requires a company to provide a **Form 58** both in respect of the sub-fund and the fund of which it is a part.
- (4) In general, line 61 of **Form 58** corresponds to the proportion which has to satisfy the criteria laid down in rule 3.3 but this will not always be so. For example, where the with-profits *policyholders* are entitled to, say, 90% of the profits from the with-profit business but are also eligible to share in the profits arising on the non-profit business on a discretionary basis, line 61 would be relevant for the purpose of rule 3.3 (which relates to 'eligibility') only in the **Form 58** for the long term fund as a whole and not in the **Form 58** for the sub-fund.
- (5) The surplus shown in **Form 58**, in keeping with the definition, represents the excess of the amount of the fund over the liabilities, but the wording in lines 29 and 49 is intended to make it clear that the surplus is not to be regarded as synonymous with disposable profits. The solvency margin requirements implementing the *First Life Directive* make it imperative for a clear distinction to be drawn between the liabilities and the margins available to count towards an *insurer's* solvency margin. The surplus should not include any part of the *mathematical reserves* which the *appointed actuary* considers are required to constitute the proper provision envisaged by rule 5.6 (these should be included in **Forms 51 to 54** as appropriate), but it may include contingency and other reserves held which count towards the solvency margin.

Paragraph 23 - Forms 60 to 61

- 15.10 (1) **Forms 60 and 61** set out the calculation of the *required minimum margin* (i.e. the greater of the *required margin of solvency* and the *minimum guarantee fund*) for *long-term insurance business*. The legislation provides for a solvency margin in respect of an *insurer's long-term insurance business* as a whole and where more than one *long-term insurance business* fund is maintained the information in **Forms 60 and 61** will relate to all funds combined, including industrial business where this is transacted. Provision is

made for the *mathematical reserves* and the calculation of the solvency margin to be shown separately for the main classes of *long-term insurance business* and, for the purposes of reconciliation, *mathematical reserves* attracting a nil rate of solvency margin are to be included. *Class III* includes contracts where the benefits are partially linked to investment funds or indices and any reserves for non-linked benefits under such contracts, including those relating to *accumulating with profits* benefits, should be included under *Class III* business in the appropriate column in **Form 60**. The presence of non-linked benefits, including *accumulating with-profits* benefits, does not generally alter the appropriate column for linked benefits.

- (2) In **Form 60**, line 51 should equal the figure in line 59 of **Form 61**, together with any class V margin included in the note under instruction 6.
- (3) Where cash bonuses have been allocated to *policyholders* and are due to be paid, they are in the nature a current liability. As such they should not be included in the amount of *mathematical reserves* included in **Form 60**. No factor need to be applied to cash bonuses in calculating the *required margin of solvency*.

16. THE RULE 9.36 STATEMENT: INFORMATION ON THE APPOINTED ACTUARY

- 16.1 (1) Rule 9.36 calls for a statement of the information specified in rule 9.36(1)(a) to (d). The *insurer* is required to make a further statement that it has asked the *appointed actuary* to provide it with the particulars set out in the subparagraphs and to identify in the statement the information which has been so provided. The *insurer* must supplement these particulars if there is further information of which it is aware additional to that provided by the *appointed actuary*.
- (2) Rule 9.36 (1)(a) and (b) refer to ‘particulars’ but this word is not defined in the rule. In the case of investments, the particulars should include at least a general description of the investments, the name of the holder of the investment, the nominal or principal amount outstanding and, where applicable, the rate of interest and terms of repayment. In the case of a life policy or policies, it will usually be sufficient to show total annual premiums. In the case of transactions of a minor character falling under rule 9.36(1)(b), a general description should be given and full particulars are not required.
- (3) As a result of rule 9.36(3)(a) the particulars which have to be given apply not only to the interests of or amounts paid to the actuary but also to other person specified in that rule. It is worth noting, however, that rule 9.36(4) provides for the reporting *insurer* and other *insurers* within the same group to be treated as one for the purpose of rule 9.36(3)(a). The effect of the words in parenthesis in rule 9.36(3)(a)(iii) and (iv), taken with rule 9.36(4), is that payments made to the reporting *insurer* and to companies related to it will be excluded from the disclosure requirement.

- (4) Rule 9.36(3)(b) and (c) set out the circumstances in which a person shall be deemed to have an interest or benefit for the purpose of the rule. Rule 9.36(5) describes the circumstances in which a person shall be taken to control a *body corporate* for the purpose of rule 9.36(3).
- (5) The information required by rule 9.36 should be given in respect of each person who was the *appointed actuary* at any time during the *financial year*. Also it is good practice to give the information in respect of the person who prepared the **Appendix 9.4** report for the *financial year*, even if he or she was only appointed as actuary after the year end. It is also good practice to name each *appointed actuary* especially if more than one is referred to in the rule 9.36 disclosure.

17. **CERTIFICATES BY DIRECTORS AND ACTUARY AND REPORT OF AUDITORS**

Certificate by the directors etc.

- 17.1 (1) Part I of **Appendix 9.6** specifies the statements to be included in the *directors'* certificate. These vary according to the type of *insurer* and the types of business which it writes.
- (2) Where in the opinion of those signing the certificate, the circumstances are such that any of the statements required by paragraphs 1 to 6 of **Appendix 9.6** cannot truthfully be made, the relevant statements shall be omitted, (see paragraph 7(1) of **Appendix 9.6**). Where any statements have been omitted, this fact shall be stated in a note, (see paragraph 7(2) of **Appendix 9.6**) and reasons given.
- (3) For *insurers* which fall within the circumstances of the first half of paragraph 4(e) of Part I of **Appendix 9.6**, the *directors* will need to consider carefully whether the *returns* are distorted by any management services agreements - for example, where a parent *insurer* subsidises its *subsidiary* in its infancy.
- (4) Paragraph 5 of Part 1 of **Appendix 9.6** covers *directors'* certificates in respect of two types of published guidance - systems of control and preparation of *returns* guidance. The *FSA* will circulate from time to time a list of the published guidance which it considers relevant for this purpose.
- (5) In order to certify compliance with systems of control guidance, it is necessary for the *directors* to be satisfied that the control system was in place at the end of the *financial year* in question and that it was reasonable to believe that the systems continued to be in place after that date and will continue to be in place for the foreseeable future. In this instance the beliefs which the *directors* hold at the time of signature of the *returns* are the relevant ones. For example, if the system was believed to be in place at the end of the *financial year* in question, had clearly - but unexpectedly - failed shortly afterwards and was once again believed to be in place at the time of signature of the *returns*, the certificate could not properly be given.

- (6) As to the standard of compliance required, the *FSA* recognises that absolute assurance is most unlikely to be achieved. By way of illustration, an isolated human error would not of itself be considered a failure of the system provided that the system is capable of recognising and rectifying the error swiftly. Frequent or repeated errors would however cast doubts on the integrity of the system.
- (7) A list of the guidance complied with is sufficient. Where only part of a published guidance note is complied with, it is acceptable to claim compliance with that part. Where *directors* do not know or cannot satisfy themselves whether guidance has been complied with, such guidance should be omitted from the list. It is not necessary to state which guidance has not been complied with except in rare cases when no published guidance has been complied with (in which case the negative disclosure referred to in (2) comes into play).

The actuary's certificate

- 17.2
- (1) Part II of **Appendix 9.6** sets out the statements to be included in the *appointed actuary's* certificate.
 - (2) The rule in SUP 4.3.9 lays down that an *actuary* must be a Fellow of the Institute of Actuaries or the Faculty of Actuaries and have the required skill and experience to perform his functions under the regulatory system.
 - (3) Where an overseas *insurer* wishes to appoint an *actuary* with an overseas actuarial qualification, the *FSA* will consider the issue of a direction under section 148 of the *Act* permitting this in appropriate cases.
 - (4) If an *insurer* appoints a firm of consulting actuaries, each of the partners in the firm must possess the prescribed qualifications. Where an individual member of a firm is appointed only that individual need be qualified.

The auditors' report

- 17.3
- (1) Rule 9.35 specifies the scope of the audit. The contents of the auditors' report are set out in Part III of **Appendix 9.6**. The rules on auditors' qualifications are found in SUP 3.4.
 - (2) The Auditing Practices Board issues separate guidance notes specifically for auditors of *insurers* and auditors should refer to these.
 - (3) The parts of the *return* which are subject to audit are:
 - (a) **Forms 9 to 17, and 20 to 45;**
 - (b) the statements furnished under rules 9.25, 9.26, 9.27 and 9.29.

- (4) The unaudited parts of the *return* are:
- (a) the statements furnished under rules 9.30, 9.31 and 9.36;
 - (b) the information provided in accordance with **Appendix 9.4** (including **Forms 46 to 61**);
 - (c) the certificate of the *appointed actuary* prepared under Part II of **Appendix 9.6**.
- (5) The auditors are also required to report on whether the *directors'* certificate except for paragraph 4(d) of the certificate and, in so far it relates to published guidance which relates to controls with respect to money laundering, except for paragraph 5 of the certificate. The auditor's report must state whether the certificate has been properly prepared in accordance with the rules and whether or not it was unreasonable for the persons giving that certificate to have made the statements contained in it. Paragraph 11 provides that to the extent the information and explanations the auditors have received do not allow them to express this opinion they should add to their report such qualification, amplification or explanation as may be appropriate.
- (6) It is appropriate for compliance with most, but not necessarily all, relevant published guidance to be subject to the audit opinion described above. When, periodically, a list of relevant published guidance is circulated (see 17.1), the *FSA* will make clear whether or not it would normally expect an audit opinion in respect of compliance with that guidance. Where audit of compliance with a guidance note is inappropriate (or has not been carried out for some reason), the auditor would be expected to invoke paragraph 11 of **Appendix 9.6** to record the fact.
- (7) Paragraph 10(c) of **Appendix 9.6** provides for the auditors to state the extent to which, in giving their opinion, they have relied on the *appointed actuary's* certificate with respect to the *mathematical reserves* and *required minimum margins* and on a direction by the *FSA* under section 148 of the *Act* for the identity and value of any *implicit items* which are admitted.
- (8) **Forms 31** and **34** relating to years of origin prior to 1981 will contain figures which include information about claims notified and payments made prior to the *1980 Regulations* coming into force. Such information was not subject to audit under those rules and the relevant figures are excluded from audit under the *1983 Regulations* and this exemption was carried forward in the *1996 Regulations* and subsequently the Interim Prudential Sourcebook by rule 9.35(2)(a). This is now only relevant to **Forms 31** and **34** for *accounting class 7*, as these forms for the other *accounting classes* have a ten-year cut off.
- (9) Paragraph 12 of **Appendix 9.6** provides that where the auditors refer in their report or in any note attached thereto to any uncertainty, the report shall also state whether in the auditor's opinion that uncertainty is material to

determining whether the *insurer* has available assets over the appropriate solvency margin. This paragraph should not be read as requiring the auditors to refer to an uncertainty. It merely provides that if they do so an additional opinion is required. An uncertainty should be treated as material for these purposes if, upon the crystallisation of so much of the uncertainty as is not remote, the required level of available assets would not be met.

18. STATISTICAL RETURNS: FORMS 91 TO 94

Background

- 18.1 (1) **Forms 91 to 94** do not form part of the *returns* but constitute a separate return which must be deposited with the *FSA*, ('the statistical return').
- (2) The statistical return reports *insurance business* transacted by a *UK insurer* in other *EEA States* either through a branch in that country or on a services basis into that country from an establishment in the UK or another *EEA State*.
- (3) *UK insurers* who wish to establish a branch in or provide services into another *EEA State* must make the requisite notification to the *FSA* under *AUTH*.

The requirement to deposit Forms 91 to 94

- 18.2 (1) The requirement to prepare and deposit **Forms 91 to 94** is set out in rule 9.37.
- (2) A *UK insurer* which in any calendar year:
- (a) carries on *general insurance business* in an *EEA State* (other than the UK) through a branch in that state should prepare **Form 91**;
 - (b) provides general insurance in an *EEA State* (other than the UK) through an establishment in the UK or in another *EEA State* should prepare **Form 92**;
 - (c) carries on *long-term insurance business* in an *EEA State* (other than the UK) through a branch in that state should prepare **Form 93**; or
 - (d) provides long term insurance in an *EEA State* (other than the UK) through an establishment in the UK or in another *EEA State* should prepare **Form 94**.
- (3) The forms in (1) should be prepared separately in respect of each *EEA State* in which the *insurer* carries on business or provides insurance.
- (4) The forms in (1) relate to calendar years not necessarily *financial years*. Three copies of each form (where required) should be deposited with *FSA*

within nine months of the end of each calendar year. One of the copies should be signed by a *director*, chief executive or secretary of the *insurer*.

- (5) Where the *insurer* has made a notification of its intention to establish a branch in an *EEA State* or to provide insurance in an *EEA State* (see 18.1(3)) but does not in any calendar year carry on *insurance business* or provide insurance in that *EEA state*, it should send notification of that fact to the *FSA* within nine months of the end of each calendar year signed by a *director*, chief executive or secretary of the *insurer*.
- (6) **Forms 91 to 94** are not subject to audit.
- (7) No direction under section 148 of the *Act* may be granted modifying or exempting *insurers* from the requirement to deposit **Forms 91 to 94**.

Inaccurate or incomplete returns

- 18.3 (1) Rule 9.37 requires the *FSA* to consider the **Forms 91 to 94** or notification deposited under that rule and, if any such document appears to it to be inaccurate or incomplete, to communicate with the company with a view to the correction of any such inaccuracies and the supply of deficiencies.
- (2) The procedure is similar to that described in 1.4 above for the *returns* and the listing of validation rules described in that paragraph as available upon request includes **Forms 91 to 94**.

Conventions for completing the Forms

- 18.4 (1) The conventions described in 4 for the *return* forms should also be applied to the preparation of these forms, (other than in respect of signature of the *returns* for which see 18.2(4)).
- (2) The box in the heading entitled '*EEA State* in which branch is situated' or '*EEA State* in which risk is situated' should be completed with the country code of that *EEA State* to which the form relates. See the **Annex** to paragraph 10 for these codes.

Accounting rules

- 18.5 The forms variously call for amounts in respect of premiums, *claims*, commissions etc. in respect of the branch or services business in the *EEA State* to which they relate. These amounts should be determined using the same accounting rules as are applied in the preparation of the *returns*.

19. **TREATMENT OF INDIVIDUAL SAVINGS ACCOUNT ('ISA') BUSINESS**

19.1 **Forms 41 and 42**

Earned premiums and *claims* arising from ISA business should be included under 'Other contracts' in **Forms 41 and 42** respectively. The extent to which an entry under 'Other contracts' is attributable to ISA business should be disclosed separately by way of a supplementary note. [Codes 4101 and 4201]

19.2 **Forms 46, 47, 51 to 54 and 57**

ISA business should be included under 'Other business' in **Forms 46, 47, 51 to 54 and 57**. The extent to which an entry under 'Other business' is attributable to ISA business should be disclosed separately by way of a supplementary note.

GUIDANCE NOTE 9.2 (rule 9.3)

**ACCOUNTS AND STATEMENTS FOR A MARINE MUTUAL COMPANY
(FORMS M1 TO M5)**

[Deleted]

GUIDANCE: FSA 'DEAR DIRECTOR' LETTERS

DD1

USE OF DERIVATIVES - LINKED PRODUCTS

The following is the text of a letter dated 3 July 1998 from Martin Roberts, Director, Insurance to all companies authorised by the Treasury to carry on long-term business.

1 Victoria Street
London SW1H 0ET

Enquiries 0171-270 4558
Fax 0171-215 0244

Direct line

Our ref

Your ref

The Managing Director
All companies authorised by the Treasury
to carry on long-term business

3 July, 1998

Dear Managing Director

USE OF DERIVATIVES - LINKED PRODUCTS

I am writing to remind you of the position of current legislation and guidance notes on the use of derivatives by insurance companies, and to set out the Treasury's view in respect of linked insurance (usually single premium) products backed by these instruments. If your company offers, or is intending to offer, such products then the issues covered in this letter will need your personal attention or that of one of your senior board colleagues; but, in any case, please pass a copy to the Appointed Actuary and to the auditors of the company.

Derivatives and the Legislation

Current UK legislation requires that for a derivative to be given an admissible value or to be a permitted link in the case of index-linked or property-linked business respectively it must be possible to demonstrate that, amongst other things, it is being used in connection with a contract or asset for the purposes of "efficient portfolio management" or "reduction of investment risks". The main guidance note on the use of derivatives, Prudential Note 1995/3, provides guidance and illustrative examples on how these conditions are to be interpreted in practice and, in particular, makes clear that an investment strategy using derivatives will not satisfy the efficient portfolio management or reduction in risk criteria if it gives rise to a significant increase in risk to the policyholder. The test of how this should be assessed is introduced in Section 4.5 of the Note and expanded upon in Section 10.10 et seq., namely that the derivative strategy must be "benchmarked" against a broadly comparable non-derivative investment strategy.

This guidance is still in place and it is the Treasury's view that the above test remains fundamental. It follows, therefore, that we consider where a non derivative strategy that has broadly the same economic effect cannot be identified it will not be possible to demonstrate that the derivative strategy has met the criteria of efficient portfolio management. Similarly, it will not be possible to satisfy the reduction in risks test where there is no non-derivative strategy against which changes in risk can be assessed. A derivative used under such a scenario to back an index-linked product could therefore be given no admissible value (bar that which may be possible under Regulation 48 of

the Insurance Companies Regulations 1994, as amended), and in a property-linked product would be illegal.

The Case of Multi-Index Bonds

The appropriate comparison with what constitutes a broadly equivalent non-derivative strategy can be a complex issue, and may not always be straightforward to implement in practice. Nevertheless the task must be done, and it is a cause of concern to us that in the development of the recent generations of what are usually termed guaranteed equity or income bonds, where policyholder benefits are determined by the performance of two or more equity indices and which are backed by derivatives, the above test does not appear to have been given the prominence it requires when determining whether the regulatory criteria have been met.

As set out in the examples contained in Prudential Note 1995/3, the test in the case of products based upon a single stockmarket index involves a comparison of the derivative strategy with the, transparently similar, non-derivative alternative of direct investment in the assets underlying that index. However this transparency fails away in the case of multi-index bonds, and the Treasury are unable to see how for such products a comparable non-derivative strategy having *broadly the same economic effect* can either be identified, or used to demonstrate an insignificant under performance by the derivative strategy. This latter point is of particular relevance to products where the benefits are linked to "the worse performance" of two or more indices. It is germane to this view that we do not consider it feasible to seek to satisfy the regulatory requirements through comparison with a non-derivative strategy that would, in practice, mimic a derivatives strategy. It should be noted that the above concerns do not extend to bonds where the benefits reflect simple weighted averages of two or more indices which clearly could be replicated by similarly weighted direct holdings in the underlying assets.

As I have already stressed, failure to meet the criteria of efficient portfolio management or reduction in risks renders the use of a derivative non-compliant with the Regulations. Companies which are holding derivatives to back the above multi-index linked products should therefore contact their normal supervisor without delay to discuss how the position is to be regularised.

Yours sincerely

Martin Roberts
Director, Insurance
Room 5.C. 19

OTHER MATERIAL: 'DEAR APPOINTED ACTUARY' LETTERS

DAA8

RECOMMENDED AIDS RESERVING POLICY AND RESILIENCE TEST

The following is the text of a letter dated 29 October 1996 from the Government Actuary to Appointed Actuaries.

29 October 1996

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FROM THE
GOVERNMENT ACTUARY
CHRIS DAYKIN
CB Hon DSc MA FIA F55 ASA

Dear Appointed Actuary

RECOMMENDED AIDS RESERVING POLICY

Emerging experience has shown the AIDS epidemic to be of less significance for mortality in the UK than had originally been feared. Nonetheless, it remains the case that there are still a material number of deaths occurring as a result of infection by HIV, and that this number is expected to continue to rise over the next few years. The insured population has seen lower levels of AIDS-related mortality than the general population, but it is not necessarily the case that deaths in future years will be as concentrated in groups which are underrepresented in the insured population.

Taking these factors into account, and bearing in mind that actuaries are required to provide on a prudent basis for adverse deviations in mortality experience in their normal mortality assumptions, it now seems appropriate to revise the advice previously issued to Appointed Actuaries.

For traditional with-profits business, and for those types of unit-linked or accumulating with-profits policy where mortality charges can be varied within a relatively short timescale (say less than two years), it will often be sufficient to allow for the possible impact of AIDS within the actuary's margin for adverse deviations, and not to hold an explicit reserve. This may also be true for classes where an explicit allowance is unnecessary due to insensitivity of the reserves to the mortality assumption.

For classes where mortality or morbidity risk is of more critical importance, it still seems appropriate to make an explicit provision in the reserving basis. It is likely that for most companies an allowance for deaths from HIV and AIDS at a level of about one-third of basis R6A of Bulletin No 5 of the AIDS Working Party will be sufficient (or about one-sixth of basis R). GAD will normally expect to see evidence of reserving for AIDS mortality at this level, but will not insist on maintenance of the additional mortality at the peak level in years after it has been reached.

RESILIENCE TEST

There has been some doubt expressed as to the intended treatment of property under the resilience test. For the avoidance of doubt, I would confirm that the GAD expect the assumed fall in property values to be 20% in those scenarios where equities are assumed to fall by 25%, and a fall of 10% in the scenario where equities fall by 10%.

Where a life insurance company has material holdings of index-linked gilts, the existing three tests should be modified to include a component for changes in real yields on index-linked gilts as follows:

In test (1) a fall in real yields on indexed gilts of 25% (e.g. from 4% to 3%)

In test (2) a rise in real yields on indexed gilts of 10% (e.g. from 4% to 4.4%)

In test (3) a rise in real yields on indexed gilts of 25% (e.g. from 4% to 5%)

Yours sincerely

A handwritten signature in black ink, appearing to read 'C D Daykin', written in a cursive style.

C D DAYKIN

OTHER MATERIAL: DEAR APPOINTED ACTUARY LETTERS

DAA9

PENSIONS REVIEW: RESERVING FOR GUARANTEES

The following is the text of a letter dated 29 May 1997 from the Government Actuary to Appointed Actuaries.

29 May 1997

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FROM THE
GOVERNMENT ACTUARY
CHRIS DAYKIN
CB Hon DSc MA FIA F55 ASA

Dear Appointed Actuary

Pensions Review: Reserving for Guarantees

Several insurance companies have indicated that they would like to consider guaranteeing pension benefits linked to individuals' salaries, in the event that they will not be able to secure reinstatement of service within the relevant occupational pension scheme. I understand that S113/PIA will require such a guarantee to incorporate an undertaking to pursue reinstatement where it is possible, along the lines set out in the SIB Guidance of October 1994 and November 1996. For those investors whose scheme will not allow reinstatement, the guarantees could be structured in several different ways, from replicating the benefits forgone to broad financial correspondence for the key benefits.

The Securities and Investments Board have published criteria which proposals have to meet in order to satisfy the regulators that investors' interests are being adequately and fairly addressed. They require that guarantees should provide pension and other benefits corresponding in value to the benefits of the occupational pension scheme. Approval to the provision of guarantees must be given by the appropriate regulator. In addition reserves for any guarantees must meet the required insurance company solvency requirements. If approval is given, the result will be the creation of longterm insurance liabilities to the Third Life Directive and the relevant UK legislation, with the particular requirement to establish prudential reserves. Accordingly, the result may be considerably higher than the cash equivalent of pension benefits on a GN 11 basis. As these liabilities will not have fallen due, they must be valued by the Appointed Actuary within the mathematical reserves. The annex to this letter sets out the views of the GAD on the required reserving standard for these salary-linked guarantees, issued as a response to the need to compensate for mis-sold personal pensions. Similar considerations, omitting only the allowances for salary progression, -apply where the guarantees are linked to national average earnings. Guarantees linked to RPI or LPI raise no new issues for life office reserving and are not covered in the annex.

Initially, the full information required to set up reserves on an individual basis may not be readily available. In addition, it may take considerable time to obtain and verify that

information. The SIB and PIA consider that, if issuing an offer to guarantee equivalent benefits is, accepted as a satisfactory precursor to seeking reinstatement. then the process of making an offer need not be delayed on an individual basis until the quote for reinstatement is available. Where reinstatement is discovered not to be available, the guarantee to provide corresponding benefits, if accepted, remains in effect. However, where companies accept that investors have been disadvantaged, even in advance of performing a loss assessment, the issuing of offers to guarantee benefit will be seen as a way to overcoming delays in making offers of redress caused by data collection, as well as delays caused by seeking reinstatement.

The Third Life Directive permits reserving on an aggregate basis, providing that the total reserves are at least equal to the total of the individual reserves. If the individual reserves cannot be calculated because the required information is not available, it is incumbent on the Appointed Actuary to make prudent assumptions about the missing information. That would be in addition to the level of prudence normally required. Appointed Actuaries should keep the GAD informed of their approach to these additional reserves.

Further, because some measure of current salary is such a key parameter in these arrangements, no insurance company should be committed to an offer to guarantee a benefit unless that information has been obtained from the investor.

Insurance companies must continue to seek missing information. As relevant information is received, the Appointed Actuary will be able to review the level of the additional reserves. In order to monitor the development of the reserves throughout the duration of the guarantee, the Appointed Actuary will need information about any relevant changes which will affect the level of guarantee (e.g. salary rises). If such information, or any other information required by the Actuary, is not obtained, the Actuary must once again make prudent assumptions. It is understood that SIB/PIA require that once a guarantee has been given to an individual, such guarantee would not lapse if continuing information were not forthcoming.

Please note that these guidelines are relevant only to the special situation arising from the pensions review. They do not indicate any change of view on the inappropriateness of insurance companies entering into contracts linked to salary, earnings or indices thereof.

Yours sincerely



C D Daykin

0597-09

Reserving For Guarantees Arising From Mis-selling of Personal Pensions

1 This note should be read in conjunction with the Dear Appointed Actuary letter of 29 May 1997.

2. Assumptions of a Continuing PP Policy

Whenever there is a guarantee there will also be a continuation of the insurance policy previously entered into. The conversion of the existing policy into one which mirrors the pension scheme exactly is not an acceptable option. The SIB require that the guarantee must be in the form of a legally binding and enforceable contract between the life office and the investor. The DTI considers that this contract will either be separate and additional to, or possibly an amendment of the PP contract, which will in any case remain in force. DTI need to see the form of the additional contract although the responsibility for ensuring that it meets the needs of investor protection lies with the financial services regulator.

The life office should take steps to avoid the personal pension being invested in very volatile unit-linked funds, and as far as possible require it to be switched to with profits, or at least a less volatile unit-linked fund. Otherwise there will be very significant mismatching and resilience issues to address, including a perverse incentive for the policyholder to take exceptional risks, secure in the knowledge that the downside is met by the guarantee.

3. **Proposed Reserving Principles**

3.1 General Basis

It should be assumed that salary inflation (excluding increases arising from promotion, performance or scale increases) will be at 2% a year above the inflation rate as measured by increases in the RPI.

3.2 Deriving the Value of Liabilities - Method 1

3.2.1 Implicit allowance for inflation as measured by increases in the RPI should be made by using a net discount rate, determined according to paragraph 3.2.3 below.

Explicit allowance for salary inflation in excess of increases in the RPI should be made according to paragraphs 3.2.2 and 3.5

3.2.2 The liabilities would be determined assuming an effective salary inflation rate of 2½% (being the 2% differential in paragraph 3.1 above plus an allowance for possible underperformance of assets and for prudence) together with a further allowance for salary progression (discussed in paragraph 3.5 below). The liabilities would be discounted at the modified net interest rate derived in paragraph 3.2.3.

3.2.3 It should be assumed that:-

- (a) The RPI remains constant for the purposes of determining regulation 69 yields on RPI linked assets - as provided in paragraph (6) to that regulation.
- (b) Equity shares, and those land assets where such an assumption is appropriate, are assumed to be linked to RPI for the most of this exercise only.
- (c) The effective yield on fixed interest investments, or on any other investments which do not carry a prospect of capital appreciation related to inflation, should be reduced by an implicit inflation rate so calculated as a *mismatching adjustment*. The required implicit rate of RPI increase is to be taken as the difference between the yield on the FTSE Actuaries 15 year medium coupon gilt index and the FTSE Actuaries over 5 year (inflation 5% per annum) index-linked gilt yield.
- (d) Risk adjustments would then be made in the normal way, and the yield reduced by 2½% in accordance with regulation 69(2).

3.3 Deriving The Value of Liabilities - Method 2

3.3.1 The Appointed Actuary may elect to use the full yield determined in accordance with regulation 69, in which case the salary inflation rate would need to be assumed to be the implicit inflation rate derived in paragraph 3.2.3(c) above, plus at least 3%, being the 2% differential in paragraph 3.1 above plus a 1% allowance for possible underperformance of assets. It would still be necessary to allow for salary progression as set out in paragraph 3.5.

3.4 **Resilience Test**

Resilience tests, whether Method 1 or 2 is adopted, would be carried out in a standard way by applying the scenario to the assets prior to carrying out the chosen steps. The implicit inflation rate in paragraph 12.3(c) would be recalculated by adjusting the indices in a natural manner consistent with the assumptions for assets. In particular this will allow for mismatching approaching retirement.

3.5 **Allowing for salary progression**

3.5.1 The Future

Appropriate allowance should be made for future salary increases arising from promotion, performance or scale increases. The assumptions should have regard to any relevant and available published scales, and to age and occupation. The Appointed Actuary may assume that the basic salary assumption contains a sufficient margin for prudence to cover this area as well, and therefore adopt a "best" estimate approach for this element of the basis.

3.5.2 Data

To ensure the reasonableness of the reserve, the Appointed Actuary should obtain data, normally annually if possible (although triennial data adjusted for inflation is acceptable), to update current salaries and nature of employment

3.6 Other points

3.6.1 Future interest rates

Assumptions about future interest rates, including any implicit in future annuity rate assumptions, must accord with regulation 69(8/9). Where an assumption as to the future yield on index-linked gilts is required, this should not exceed 3% a real.

Resilience tests should incorporate changes in the regulation 69(8/9) yield.

3.6.2 Marital status

For prudence, all persons should be assumed to have a qualifying spouse at the date of death if before retirement. It should also be assumed that all members are married at the date of retirement, but that no re-marriage will take place after the later death of a spouse.

3.6.3 Leaving service

No assumptions should be made in respect of savings from future withdrawals from service.

3.6.4 Mortality

Mortality assumptions need to make prudent allowance for future improvements.

3.6.5. Expenses

When setting overall expense reserves, the Appointed Actuary will need to take into account the additional costs of administering these guarantees.

3.6.6. Unit-linked business

For unit-linked business the reserve for the guaranteed pension benefit (and associated expenses) should be determined along the lines described above, with the assets underlying the relevant unit fund(s) determining the yield for discounting in accordance with paragraph 3.2.3 or 3.3.1. Allowance for a resilience test should be made in accordance with 3.4, again based on the assets underlying the unit fund(s). In order to be consistent with the rest of the basis, allowance for inflation of renewal expenses should be made at the rate of 2% pa., rather than at the rate used when assessing the standard non-unit reserve.

The above calculations will produce a reserve for the guaranteed benefits. There will also be a unit and non-unit reserve calculated for the contract in the normal way. The additional reserve required is the difference between the reserve for the guaranteed benefit and the sum of the standard unit and non-unit reserves, subject to a minimum of zero.

3.6.7 Resilience effects on the associated personal pension

When assessing the liabilities, particular care is required to ensure that the effect of resilience scenarios on the associated personal pension liability, are taken into account. This may mean that, in a resilience scenario, two 'hits' are suffered. The assets backing* the guarantee fall in value, but also the cost of the guarantee rises from the diminution of the value of the personal pension policy, whether this is unit-linked or with profit.

3.6.8 Special benefit rules

Some schemes have special features, which can increase the liability, or make identification of a closed-off liability difficult. These include the public sector schemes which allow re-entrants to restore their preserved rights based upon current salary, and others which provide a boost to pensions after a given number of years' reckonable service.

3.6.9 Negative Reserves

In accordance with regulation 73, the reserve for the guarantee must be non-negative.

Government Actuary's Department 27 May 1997

0597-09

OTHER MATERIAL: 'DEAR APPOINTED ACTUARY' LETTERS

DAA11

RESERVING FOR GUARANTEED ANNUITY OPTIONS

The following is the text of a letter dated 13 January 1999 from the Government Actuary to Appointed Actuaries.

GOVERNMENT
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FROM THE
GOVERNMENT ACTUARY
CHRIS DAYKIN
CB Hon DSc MA FIA F55 ASA

13 January, 1999

The Appointed Actuary
All insurance companies authorised to
carry on long-term business

Dear Appointed Actuary

RESERVING FOR GUARANTEED ANNUITY OPTIONS

Further to Martin Roberts' letter of 18 December regarding the costs of guaranteed annuity options in the context of policyholders' reasonable expectations, he has agreed that it would be helpful if I were to provide some guidance to Appointed Actuaries of companies on the advice I have given him on the application of the existing reserving requirements in respect of contracts containing a guaranteed annuity.

2. I consider that Part IX of the Insurance Companies Regulations 1994 (ICR 1994) requires a life office to calculate its liabilities (and hence to reserve) on the basis of all the benefits offered under the contract. Regulation 64 of the Regulations requires long-term liabilities to be determined "on actuarial principles", and to "make proper provision for all liabilities on prudent assumptions". Regulation 64(2) makes clear that the determination must "take account of all prospective liabilities as determined by the policy conditions".

3. Contracts providing for a guaranteed annuity typically take two main forms either:

- a contract to provide an annuity with an option to secure a cash fund; or

- a contract to provide a cash fund with the option to convert the benefits into an annuity at a guaranteed rate.

4. I would expect the reserving requirements to be very similar (if not identical) irrespective of whether the guaranteed annuity is the principal benefit under the contract or only an option. This is on the basis that in substance a policyholder will be entitled to the same choice of benefits irrespective of which is the principal benefit and which is the option.

5. In my view it is clear that, where a contract provides for a guaranteed level of annuity, then the effect of Part IX of the ICR 1994 is to require the company to reserve fully for its liabilities to provide annuity benefits to the value guaranteed under the contract. In addition it will be necessary to reserve fully in respect of any facility for policyholders to select an alternative form of benefits.

6. In assessing the extent of these liabilities, the company will need to make a prudent assessment of the extent to which any options are likely to be exercised. In this context I consider that, where the cost of meeting the guaranteed annuity benefits at maturity is significantly greater than the value of any alternative benefits, prudence will require the company to reserve for the contract at a level close to the full value of the guaranteed annuity. In general it would not in my view be prudent to assume that policyholders will choose a benefit form that is of significantly lower nominal value to them, although some limited allowance (of a few percentage points of the reserve) could in some cases be made for a reduction in the liability on the grounds of the additional flexibility or other perceived advantages to policyholders of any alternative benefits.

7. Where the levels of terminal bonus are to be adjusted with the aim of bringing the value of the guaranteed annuity option closer to the value of the alternative benefits, there might at first sight appear to be some room for argument that it was not necessary to reserve on the assumption that almost all policyholders will take the guaranteed annuity benefit. However, it needs to be remembered that, although the benefits formally "guaranteed" under the alternative form of benefit may be lower than those under the guaranteed annuity option, the company's discretion in setting the value of terminal bonus applied to the alternative benefit is limited as a result of the existence of the guaranteed annuity. It is likely that close to 100% of policyholders will exercise the annuity guarantee unless the company maintains terminal bonus at a level which ensures that the value to the policyholder of the alternative benefit is at least equal to the value of the guaranteed annuity. Accordingly, this constraint will need to be reflected in the valuation assumptions made about either the proportion of policyholders opting for the alternative benefit or the value of that alternative benefit. Consequently any reduction in the reserves held by the insurer by more than a few percentage points below the full value of the guaranteed annuity for this reason would require very careful justification by the actuary.

8. I am aware that many policyholders have in the past exercised their right to take up to 25% of the benefits of their pension policy in the form of a tax free lump sum. However, I would not consider it prudent to use past experience alone in this regard as a basis for reducing the percentage of benefits assumed to be taken in guaranteed annuity form. In my view there is a significant risk that there may be a marked change in policyholder practice if policyholders and their advisers view annuity guarantees as valuable and something that

should be utilised to the full. For instance, there is the possibility that in future individuals with more than one pension policy will seek to maximise their benefits by exercising in full any guaranteed annuity option and only taking cash from those policies that do not carry a guarantee. In addition any further increase in the value of the annuity benefits relative to cash has the potential to lead to a significantly greater take up of annuity guarantees. As a result I would only consider it prudent to make significant allowance for a proportion of available policy proceeds to be taken as cash, to the extent that policyholders are obliged to take some of the benefits as cash. Where policyholders are not obliged to take some benefits in cash, then the principles described in the above two paragraphs of this letter would apply.

9. In addition to holding mathematical reserves to cover their liabilities for annuity guarantees, companies will need to assess the extent to which a resilience reserve is required. I expect companies to apply the recommended resilience tests and other general advice in my letter (DAA6) of 30 September 1993 (as amended slightly in my letter of 24 November 1998 - DAM0) in determining the need for a resilience reserve. The need to hold substantial mathematical reserves to cover guaranteed annuity options would not in my view be a sound argument for reducing the stringency of the resilience test applied.

10. The level of reserves established for guaranteed annuity options is likely to be one of the features of companies' 1998 annual returns which FSA and GAD will want to review particularly closely. It should be remembered that Schedule 4 of the Insurance Companies (Accounts and Statements) Regulations 1996 requires the actuary's report in the annual returns to include detailed information about the contracts written.

11. In particular, paragraphs 4(1) and 5(1) of the Schedule require the provision of a description of the benefits of the contracts written, including any material options. I would expect such a description to provide an indication of the form of any annuity guarantee offered. In addition, in accordance with paragraph 6(1)(h), actuaries should provide a description of the way in which reserves for any annuity guarantees and options have been determined (including an indication of the interest rate and mortality assumptions used). I would also expect that, in accordance with Instruction 9 to forms 51-54, categories of contracts containing annuity guarantees would be shown separately in those forms.

12. The annual returns should include sufficient information for the FSA and GAD to make an assessment of the extent of the guarantees offered, the reserving basis adopted by the company and hence the scope for guaranteed annuity options to impact on the financial position of the company.

13. The above is my considered view and is without prejudice to any decision of the courts which may affect it.

Yours sincerely



C D Daykin
Government Actuary

OTHER MATERIAL: 'DEAR APPOINTED ACTUARY' LETTERS

DAA13

RESERVING FOR GUARANTEED ANNUITY OPTIONS

The following is the text of a letter dated 22 December 1999 from the Government Actuary to Appointed Actuaries.

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FROM THE
GOVERNMENT ACTUARY
CHRIS DAYKIN
CB Hon DSc MA FIA F55 ASA

22 December 1999

Dear Appointed Actuary

RESERVING FOR GUARANTEED ANNUITY OPTIONS

As you will recall, I wrote to you and other Appointed Actuaries on 13 January this year regarding the application of the reserving requirements in Part IX of the Insurance Companies Regulations 1994 in respect of contracts containing a guaranteed deferred annuity and a cash or other alternative.

Having now reviewed, at least provisionally, the majority of companies' 1998 annual returns, it is apparent that some aspects of this guidance have been interpreted in a variety of ways. It is clearly important that there should be consistency in the approach taken, and therefore the FSA has concluded that it would be helpful if I were to provide some further clarification on the reserving standards that would normally be expected to be seen in future HNTIFSA returns.

In my view, in determining the reserve for a contract containing a guaranteed annuity it would not generally be prudent to assume that policyholders will choose a benefit form that is of significantly lower nominal value to them than the guaranteed annuity. I indicated previously that I would expect any allowance for the reduction in the liability on the basis of policyholders making such choices to be limited to "a few percentage points" of the reserve. I would like to clarify that I was referring here to the total aggregate allowance that might prudently be made for all other benefit forms (whether cash or other forms of annuity) and that in my view an allowance in excess of 5% would not be considered to represent "a few percentage points".

There may be considered to be a stronger case for making an allowance for policyholders choosing to take a proportion of their benefits in the form of a tax free cash lump sum. However, I would not consider it prudent to assume that more than 20% of policyholders exercised the option to take the maximum cash lump sum permitted under the terms of the

contract. In the case of most pension contracts, such an assumption would equate with a 5% reduction in reserve, the maximum aggregate allowance indicated above as likely to be accepted as prudent.

I am also reviewing the level of disclosure made by each company in their 1998 annual returns regarding the assumptions made to determine the level of reserve for contracts containing a guaranteed annuity. For the avoidance of any doubt, we would expect to see full disclosure of the proportions of policyholders assumed to take any available guaranteed annuity, along with the underlying mortality and interest rate assumptions. I should also add in this context that we would expect to see prudent allowance made for future mortality improvement both before and after the assumed retirement date, taking proper account of the recommendations in the latest CMI reports.

Yours sincerely

A handwritten signature in black ink, appearing to read 'C D Daykin', with a horizontal line underneath the name.

C D DAYKIN

OTHER MATERIAL: 'DEAR APPOINTED ACTUARY' LETTERS

DAA14

RESILIENCE TEST

The following is the text of a letter dated 15 May 2000 from the Government Actuary to Appointed Actuaries.

Other Material: ‘Dear Appointed Actuary’ Letter DAA14 on Resilience Testing (replacing DAA6 and DAA12) issued by the Government Actuary

Your reference:

Our reference: DAA14

15 May 2000

Dear Appointed Actuary

Resilience Test

The revisions to the Insurance Companies Regulations 1994 made by HM Treasury recently include a revised formula for determining the yield on investment made more than three years in the future, with consequent effects on shorter term assumptions. This reintroduces a prudent margin on future investment assumptions, but has the effect of making the linkage of the future investment assumption to current yields more dynamic than applied in the past. Three scenarios were originally promulgated in my letter of 30 September 1993 and were amended most recently in DAA12 dated 30 September 1999. Two of these, in the context of the new regulation, now appear unnecessarily severe in their effects, given that the new regulations do allow for the effect of a sustained reduction in long-term interest rates.

I have, therefore, discussed with the Financial Services Authority revisions to the resilience test which FSA and GAD consider appropriate for current conditions. These revisions will apply from the date of coming into force of the amendment regulations.

For with profits offices, and others where it might be appropriate to do so, we consider the three scenarios which should constitute our benchmark to be:

- (1) a combination of
 - (i) a fall in the value of equities of 10%;
 - (ii) for fixed interest securities
 - (a) of less than five years outstanding term to redemption, and for short term deposits, a fall in the risk free yield of 20%
 - (b) for fixed interest securities of fifteen or more years outstanding term to redemption, a fall in the risk free yield of 10%
 - (c) for fixed interest securities of more than five but less than fifteen years outstanding term to redemption, a fall in the risk free yield of $(25 - \{\text{outstanding term in years and part years}\})\%$
- (iii) a fall in property values of 10%

- (iv) a fall in the real yields on indexed gilts of 25% (e.g. from 2% to 1.5%)
- (2) a combination of
 - (i) a fall in the value of equities of the greater of
 - (a) 25%, subject to the fall being restricted to such as would not produce a P/E ratio on the FTSE Actuaries All Share Index lower than 75% of the inverse of the long term gilt yield (as defined in regulation 69(9)) before the assumed fall in paragraph (ii), and
 - (b) 10%
 - (ii) for fixed interest securities
 - (a) a fall in the yields on risk free securities of less than five years outstanding term to redemption and on short-term deposits to the level which is calculated under regulation 69(9) for future investments (or remain constant if already at or below this level),
 - (b) the yields on risk free securities of at least fifteen years duration remaining constant,
 - (c) a fall in the yields on risk free securities of more than five but less than fifteen years outstanding term to redemption to levels obtained by interpolating between the figures given by (a) above and the 15 year gilt index yield (or remain constant if already at or below this level),
 - (iii) a fall in property values of 20%, and
 - (iv) a rise in the real yields on indexed gilts of 10% (e.g. from 2% to 2.2%)
- (3) a combination of
 - (i) a fall in the value of equities of 25%,
 - (ii) a rise in the risk free fixed interest yields of 3 percentage points,
 - (iii) a fall in property values of 20%, and
 - (iv) a rise in the real yields on indexed gilts of 1 percentage point.

For those fixed interest securities which are not risk free, we would expect actuaries to assume the yield differential to risk free does not reduce in a resilience test.

As mentioned in my 1993 letter, appointed actuaries should also consider the possibility of more extreme financial conditions in the future, and the extent to which the solvency margin

would be sufficient to enable the office to meet its liabilities in such circumstances. Cash flow analyses should also be carried out on prudent assumptions.

The tests can be appropriately modified for other situations, in a similar way to that in my 1993 letter. As I indicated in my letters of November 1998 and September 1999, I do not consider it is appropriate to include in the test any component which, taken overall, serves to reduce the prudential effect of the test. For example, the actuary to an office which has only unit linked business, some of which carries a guaranteed annuity rate, should not necessarily assume equity values fall in applying tests for lower interest rates. Indeed actuaries to such offices should consider their resilience to a rise in equity values combined with falling interest rates.

In arriving at these benchmarks, we have been mindful of the existence of the current professional working party, and have endeavoured not to anticipate their possible recommendations. This has led us to maintain for the time being the core features of the previous tests, whilst introducing appropriate modifications in the context of the revised regulation.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Chris Daykin', with a horizontal line underneath the name.

Chris Daykin

**INTERIM PRUDENTIAL SOURCEBOOK
FOR INVESTMENT BUSINESSES INSTRUMENT 2001**

Preface

1. The Financial Services Authority makes, gives, issues and designates the provisions in this instrument.
2. The provisions of the Financial Services and Markets Act 2000 (the "Act") relevant to the making of rules and listed in the Schedule to this instrument entitled "Powers exercised" are specified for the purpose of section 153(2).
3. This instrument shall come into force at the beginning of the day on which section 19 of the Act (the general prohibition) comes into force.
4. This instrument may be cited as the Interim Prudential Sourcebook for Investment Businesses Instrument 2001.
5. The provisions set out in Annex C may be cited as the Interim Prudential sourcebook for investment businesses, or IPRU(INV).

By order of the Board, 21 June 2001

Schedule

Part A – Powers exercised: New Provisions

1. The following powers in the *Act* have been exercised by the *FSA* to make the *rules* in *IPRU(INV)* other than those referred to in Part B (Powers Exercised: Continued Provisions):
 - (a) Section 138 (General rule-making power)
 - (b) Section 149 (Evidential provisions)
 - (c) Section 156 (General supplementary powers)
2. The following powers in the *Act* have been exercised by the *FSA* to give the *guidance* in *IPRU(INV)* other than *guidance* referred to in Part B (Powers Exercised: Continued Provisions):

Section 157(1) (Guidance)
3. The following powers in the *Act* have been exercised by the *FSA* to make the *directions* in *IPRU(INV)*:

Section 318 (Exercise of powers through Council)

Part B – Powers Exercised: Continued Provisions

4. The powers in articles 4(1) of the The Financial Services and Markets Act 2000 (Transitional Provisions and Savings) (Rules) Order 2001 have been exercised by the *FSA* to designate the provisions identified in the tables in Annex A as they are in force at the date of this instrument (the "continued provisions").
5. The powers in article 11(1) of the The Financial Services and Markets Act 2000 (Transitional Provisions and Savings) (Rules) Order 2001 and section 157(1) of the *Act* have been exercised by the *FSA* to give the *guidance* on the continued provisions reproduced in *IPRU(INV)*.
6. The continued provisions are applicable to:
 - (a) *securities and futures firms* (as defined by the Glossary annexed to the General Provisions Instrument 2001) to the extent that they were provisions made by the Securities and Futures Authority Limited and appearing as part of its rulebook;
 - (b) *investment management firms* (as defined by the Glossary annexed to the General Provisions Instrument 2001) to the extent that they were provisions made by the Investment Management Regulatory Organisation Limited and appearing as part of its rulebook;
 - (c) *personal investment firms* (as defined by the Glossary annexed to the General Provisions Instrument 2001) to the extent that they were provisions made by the Personal Investment Authority Limited and appearing as part of its rulebook;

and are modified:

- (1) so as to be interpreted in accordance with and to apply subject to the General provisions contained in the General Provisions Instrument 2001;
- (2) in the manner identified in the tables in Annex A.

The continued provisions are to be treated as having effect under section 138 of the Act (General rule making power).

Part C – Rules that can be waived

7. All of the *rules* in IPRU(INV) can be *waived* using the powers exercisable under section 148 of the *Act*.
8. The directions in IPRU(INV) cannot be *waived*.

ANNEX A

[The Continued Provisions]

Provisions made by the Securities and Futures Authority Limited and appearing as part of its rulebook		
Designated Provision	Modifications	
	Changes in text	Where the designated provision (as modified) appears in IPRU(INV)
1-11(1)(d)	Delete the words "the <i>Financial Rules</i> but only in respect of" and substitute "This chapter does not apply to an <i>oil market participant</i> unless"	3-1A
3-10 and guidance	In 3-10(2)(a), delete "a member of SFA" and replace with "regulated by the <i>FSA</i> or a predecessor regulator" In 3-10(2)(c) delete "required by SFA"; delete "a member of SFA" and replace with "regulated by the <i>FSA</i> or a predecessor regulator"; delete " <i>rules of SFA</i> " and replace with "rules of the <i>FSA</i> "	3-10
3-11	Delete 3-11(1)(a) In 3-11(1)(c) delete "(a) or"	3-11
3-12	Delete 3-12(3)	3-12
3-13	In 3-13(1)(d) delete "SFA" and replace with "the <i>FSA</i> " In 3-13(4)(a) delete "SFA" and replace with "the <i>FSA</i> "	3-13
10-10 and guidance	In 10-10(2)(a), delete "a member of SFA" and replace with "regulated by the <i>FSA</i> or a predecessor regulator" In 10-10(2)(c) delete "required by SFA"; delete "a member of SFA" and replace with "regulated by the <i>FSA</i> or a predecessor regulator"; delete " <i>rules of SFA</i> " and replace with "rules of the <i>FSA</i> " In 10-10(3) delete "SFA" and replace with "the <i>FSA</i> "; delete paragraphs (f) to (l)	10-10
10-11	None	10-11
10-12	None	10-12
Appendix 20	In the heading delete the footnote; delete "rules" and replace with "rule"; delete "and 10-11(4)"	IPRU(INV) 3 Appendix 20

	<p>In paragraph 1 delete "rules" and replace with "rule"; delete "and 10-11(4)"</p> <p>In paragraph 4 delete "(see rules 3-41(3) and 10-41(3))"</p> <p>In paragraph 6(a) delete "member of SFA" and replace with "<i>firm</i>"</p> <p>In paragraph 6(b) delete "This is consistent with the concept of a "dormant" <i>customer</i> in paragraph 4 of the guidance to the <i>safekeeping rules</i>."</p> <p>In paragraph 9 delete "rules" and replace with "rule"; delete "and 10-11(4)"</p> <p>In paragraph 10 delete "SFA" in the first line; delete "Rules 3-11(3) and 10-11 only require" and replace with "Rule 3-11(3) only requires"; delete "SFA agreed that"</p> <p>In paragraph 11 delete "Rules 3-11(3) and 10-11(6) require" and replace with "rule 3-11(3) requires"; delete "SFA"; delete "rules 3-11(1)(d) and 10-11(4)" and replace with "rule 3-11(1)(d)"</p> <p>In paragraph 12 delete "for SFA"</p>	
Appendix 20	<p>In the heading delete the footnote; delete "rules" and replace with "rule"; delete "3-11(1)(d) and"</p> <p>In paragraph 1 delete "rules" and replace with "rule"; delete "3-11(1)(d) and"</p> <p>In paragraph 4 delete "(see rules 3-41(3) and 10-41(3))"</p> <p>In paragraph 6(a) delete "member of SFA" and replace with "<i>firm</i>"</p> <p>In paragraph 6(b) delete "This is consistent with the concept of a "dormant" <i>customer</i> in paragraph 4 of the guidance to the <i>safekeeping rules</i>."</p> <p>In paragraph 9 delete "rules" and replace with "rule"; delete "and 3-11(1)(d) and"</p> <p>In paragraph 10 delete "SFA" in the first line; delete "Rules 3-11(3) and 10-11 only require" and replace with "Rule 10-11 only requires"; delete "SFA agreed that"</p> <p>In paragraph 11 delete "Rules 3-11(3) and 10-11(6) require" and replace with "rule 10-11(6) requires"; delete "SFA"; delete "rules 3-11(1)(d) and 10-11(4)" and replace with "rule 10-11(4)"</p>	IPRU(INV) 10 Appendix 20

	In paragraph 12 delete "for SFA"	
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Provisions made by the Investment Management Regulatory Organisation Limited And appearing as part of its rulebook (in section 3 of Chapter V)		
Designated Provision	Modifications	
	Changes in text	Where the designated provision (as modified) appears in IPRU(INV)
3.1(1)	(1) In line 2 and in both sub-paragraphs (c) (i) and (ii) delete “IMRO” and replace with “the <i>FSA</i> ”. (2) In line 3 insert “must” immediately after “records”, and delete the initial word “must” in sub-paragraphs (a), (b) and (c).	5.3.1(1)
3.1(1)	Convert the Note at the end of the rule into a separate guidance provision.	5.3.1(2)
3.1(3)	(1) In paragraph (c), line 2 delete “Client Money Regulations” and replace with “ <i>client money rules</i> ”. (2) Convert the Note at the end of the rule into a separate guidance provision. (3) In line 2 of the Note delete “Regulations 4.03 to 4.06 of the Financial Services (Client Money) Regulations 1991” and replace with “ <i>COB 9.3</i> ”.	5.3.1(4) 5.3.1(5)
3.1(4)	In line 1 delete “Rules 3.(1) to (3)” and replace with “rule 5.3.1(1) to (4)”.	5.3.1(6)

Provisions made by the Personal Investment Authority Limited and appearing as part of its rulebook		
Designated Provision	Modifications	
	Changes in text	Where the designated provision (as modified) appears in IPRU(INV)
5.1.1(1)	Delete "A <i>Member</i> must" and replace with "A <i>firm</i> must take reasonable steps to ensure that it" Delete "the Rule Book" and replace with "this chapter"	13.1.10
5.1.1(3)	Delete " <i>Member</i> " and replace with " <i>firm</i> " throughout Delete "The accounting records of a <i>Member</i> in <i>Category 1, 2, or 3</i> must be kept up to date and must" and replace with "A <i>firm</i> must ensure that its records are being kept up to date and" In paragraph (3)(a) delete "disclose" and replace with "show" In paragraph (3)(c)(ii) delete "PIA's" and replace with "the relevant"	13.1.12
5.1.3	Delete " <i>Member</i> " and replace with " <i>firm</i> " throughout Delete "PIA" and replace with "the <i>FSA</i> " throughout In paragraph (1)(b) delete "(unless they are taped records required by PIA's Rules)" and delete "or to a <i>customer</i> or his <i>agent</i> in accordance with Rule 5.1.6" In paragraph (2) delete "Where the <i>Member</i> " and replace with "If a <i>firm</i> "; delete "of its <i>relevant business</i> "; delete "in writing, in such form and at such times as PIA may require" and replace with "in accordance with the provisions of SUP 15" In paragraph (4) delete "a particular <i>customer</i> or group of <i>customers</i> or to a <i>particular transaction</i> or <i>group of transactions</i> " and replace with "financial resource requirements"	13.1.14
5.1.4	Delete " <i>Member</i> " and replace with " <i>firm</i> "	13.1.15

5.1.5	Delete " <i>Member</i> " and replace with " <i>firm</i> "	13.1.16
5.1.7 (1)	Delete "(1) Subject to (2) below, (a)" Delete " <i>a Member</i> " and replace with " <i>A firm</i> " Delete (i) Delete "(ii) (if not)" Delete "these Rules" and replace with "the <i>rules</i> or the rules of a <i>previous regulator</i> " Delete (b)	13.1.17
TABLE 5 (second paragraph)	In the first sentence, delete "however, Members" and replace with " <i>firms</i> " Delete the second sentence In the third sentence, delete "without delay"; delete "of the nature and extent"; and delete "Member's current business, the competence of its staff and (where PIA is its prudential regulator) its" and replace with " <i>firm's</i> " Delete the final sentence	13.1.11 13.1.13

ANNEX B

[Statement of Purpose and Compatibility for Continued Provisions]

The purpose of the continued provisions is to supplement the requirements of the new provisions contained in IPRU(INV) that a firm must maintain adequate financial resources, taking into account the nature and scale of its business. The continued provisions provide for accounting records to be kept by firms, and for the continuation of an existing provision relating to firms involved in the oil markets.

Statement of compatibility with the FSA's regulatory objectives

The FSA considers that including the continued provisions in the IPRU(INV) will contribute to meeting two of the FSA's regulatory objectives – maintaining market confidence and consumer protection. In particular they will contribute to the reduction of the risk of investment business firms being unable to meet their liabilities and their commitments to investors and counterparties as they fall due. Although the continued provisions are not intended to contribute to the regulatory objectives of increasing public awareness and reducing financial crime, the FSA believes them to be compatible with those objectives.

Market confidence

IPRU(INV) (including the continued provisions) sets out standards relating to minimum financial resources, risk management and notifications. The continued provisions set out standards relating to accounting records to be kept by firms. Requiring firms to meet these standards will reduce the risk that firms are unable to meet their commitments as they fall due.

Consumer Protection

As with the market confidence objective, requiring firms to meet prudential standards and to keep appropriate accounting records will reduce the risk that firms are unable to meet their commitments, including their commitments to consumers, as they fall due. Inadequate financial resources relative to the scale and nature of a firm's commitments or inadequate systems and controls expose an investment firm to the risk of failure, for example in stressed market conditions, leading to potential loss to customers as well as disruption to the market. Prudential standards, where complied with fully, do not eliminate the risk of such failure but can reduce the likelihood of failure or minimise the adverse consequences for customers where a failure does occur. The FSA has had regard to the matters set out in section 5(2) of the Act, but they are not directly relevant to the continued provisions.

How the continued provisions are most appropriate for meeting the regulatory objectives

IPRU(INV) is based on the prudential standards set out in the legislation, rulebooks and other material of the previous regulators. For the reasons described above its provisions (including those of the continued provisions) will contribute to meeting at least two of the regulatory objectives. The continued provisions add to the carry forward of existing regulatory standards. The FSA considers that this particular approach is the most appropriate way of meeting the objectives at this stage (i.e. when the new legislation takes effect) because:

- ◇ it builds on existing regulators' approaches to setting standards for the same risks; and
- ◇ it is consistent with enabling us to introduce a new set of standards covering all market sectors over the medium term, leaving adequate time for the preparation and implementation of such standards and taking account as far as possible of recent international developments in the area of prudential standards.

Principles of good regulation

Section 2(3) of the Act sets out various principles to which the FSA must have regard in exercising its general functions. The FSA's reasons for believing that making the provisions of IPRU(INV) are compatible with these principles are set out below.

The need to use its resources in the most efficient and economic way

IPRU(INV) essentially carries forward the prudential standards contained in various legislation and rulebooks for firms previously regulated by IMRO, PIA, SFA and FSA (formerly SIB), professional firms, wholesale market brokers and non-bank principals.

An alternative approach would have been to introduce an Integrated Prudential Sourcebook at N2. However, we took the view that the most appropriate approach would be to introduce such a sourcebook in the medium term and that the market, firms and the FSA would be best served by preserving continuity for firms through the carry forward of existing standards.

For this reason, we believe that the most efficient and economic way to set standards regarding accounting records and for oil market participants is to maintain the existing standards contained in the continued provisions.

The responsibilities of those who manage the affairs of authorised persons

Nothing in IPRU(INV) or the continued provisions removes from the senior management of firms the obligation to run their businesses in a sound and prudent way.

The principle that a burden or restriction...should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction

Given that the continued provisions maintain an existing standard, we do not believe that any cost benefit issues will arise for a firm in maintaining that standard. As explained above, we believe that carrying forward the continued provisions is a proportionate approach at this stage.

The desirability of facilitating innovation in connection with regulated activities

The continued provisions will not restrict the scope of management to develop their regulated activities in an innovative manner, provided they meet the business standards set out in other parts of the Handbook.

The international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom

Given that the continued provisions maintain an existing standard, we do not believe that they will have any impact on the competitive position of the United Kingdom.

The need to minimise the adverse affects on competition that may arise from any exercise of its general functions

Although the continued rules carry forward existing differences in the regulatory regimes of the previous regulators, we believe that any adverse effects on competition are small and are outweighed by the advantages of maintaining the existing standards as explained above.

The desirability of facilitating competition between those who are subject to any form of regulation by the Authority

The FSA intends to consult on an integrated approach to setting prudential standards in the near future, which should lead to a harmonisation of standards. As explained above, we believe that until those integrated standards are ready, the most appropriate approach is to maintain the existing standards.

ANNEX C



Interim Prudential sourcebook: Investment businesses

The Interim Prudential Sourcebook for Investment Businesses

Contents

Chapter

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| 1 | Application and General Provisions |
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| 3 | Securities and Futures Firms which are not Investment Firms |
| 4 | Lloyd's Firms |
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| 13 | Personal Investment Firms |

INTERIM PRUDENTIAL SOURCEBOOK FOR INVESTMENT BUSINESSES

1 Chapter 1: Application and General Provisions

1.1 PURPOSE

- 1.1.1 G The Interim Prudential Sourcebook for Investment Businesses (*IPRU (INV)*) sets out the detailed financial resources and prudential standards which the *FSA* applies to certain *firms* on an interim basis pending the introduction of a single prudential sourcebook applying to all *firms* regulated by the *FSA* – (the Integrated Prudential Sourcebook).
- 1.1.2 G The *rules* and *guidance* in this sourcebook will assist the *FSA* to meet the statutory objectives of protecting consumers and maintaining market confidence. This sourcebook does so by setting minimal capital and other risk management standards thereby mitigating the possibility that *firms* will be unable to meet their liabilities and commitments to *consumers* and counterparties.
- 1.1.3 G The general scheme of this sourcebook is, wherever appropriate, to apply the financial and other prudential standards which applied to a *firm* immediately prior to it becoming authorised by the *FSA* under the *Act*. For convenience, the chapter numbers adopted in this sourcebook correspond with those of the rulebooks of *previous regulators*.
- 1.1.4 G This sourcebook does not apply to *banks, building societies, insurers, the Society of Lloyd's* (except in relation to *underwriting agents*), *friendly societies* and certain other categories of *firm* and *members' advisers*.
- 1.1.5 G On becoming authorised by the *FSA* a *firm* will have to comply with the particular chapter of this sourcebook appropriate to its business. The *firm* will be able to seek guidance on this during the authorisation procedure. If subsequently, the business for which a *firm* has *permission* changes it may be necessary for it to comply with a different set of financial resources requirements. *Firms* will be able to discuss this aspect with the *FSA* during the application process.
- 1.1.6 G The *Supervision manual* sets out provisions relating to the periodic reporting and notification of financial information to the *FSA* or to the auditing of accounts. However, this sourcebook contains a few additional notification requirements (*notification rules*) arising out of EU Directives.

1.2 APPLICATION

- 1.2.1 R The Glossary annexed to the General Provisions Instrument 20001 applies to this chapter (*IPRU(INV) 1*), *IPRU(INV) 2*, *IPRU(INV) 4* and *IPRU(INV) 6*.
- 1.2.2 R (1) *IPRU (INV)* applies to:
- (a) a *members' adviser*;
 - (b) an *investment management firm*;
 - (c) a *personal investment firm*;
 - (d) an *authorised professional firm*;
 - (e) a *securities and futures firm*;
 - (f) a *service company*; and
 - (g) the *Society of Lloyd's* (in relation to *underwriting agents*).
- (2) *IPRU (INV)* does not apply to:
- (a) a *lead regulated firm*; or
 - (b) a *media firm*;
- (3) The definitions in the *Glossary* (which is applicable to the *Handbook* generally) apply to this chapter.
- 1.2.3 G For the avoidance of doubt, *IPRU (INV)* does not apply to any of the following:
- (a) a *bank*; or
 - (b) a *building society*; or
 - (c) a *friendly society*; or
 - (d) an *ICVC*; or
 - (e) an *incoming EEA firm* or an *incoming Treaty firm* which does not have a *top up permission*; or
 - (f) an *insurer*; or
 - (g) a *UCITS* qualifier.

OBLIGATION TO COMPLY

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

1.2.5 R Table

This table belongs to *IPRU (INV)* 1.2.3R

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

CAPITAL SUBSTITUTES: TRANSITIONAL PROVISION

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

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

(2) For the purposes of this *rule* "relevant funds" are funds provided to the *firm* under the terms of

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

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

2 Chapter 2: Professional firms

2.1 Application

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

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

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

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

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

<p>(iv) dealing or arranging deals in securities or derivatives, other than inter-professional investments; or</p> <p>(v) the provision of clearing services as a clearing firm; or</p> <p>(vi) spread betting;</p>	
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2.1.5 G An *authorised professional firm* will be an *ISD investment firm* if its business activities include the provision of a *core investment service* for a third party. An *authorised professional firm* will not however be an *ISD investment firm* if it falls within one of the exclusions contained in paragraph 2 of Article 2 of the directive. Paragraph 2(c) of Article 2 provides an exclusion for an *authorised professional firm* which provides *core investment services* in an incidental manner in the course of a professional activity (provided that activity is regulated by the *firm's designated professional body*).

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

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

2.2 Financial Resources Requirements

2.2.1 R (1) **A *firm* must be able to meet its liabilities as they fall due.**

(2) **In complying with (1) a *firm* may use any assets which are available to meet any of its liabilities.**

2.2.2 G *Firms* are reminded that:

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

2.3 Professional Indemnity Insurance

- 2.3.1 R A *firm* must effect and maintain at all times adequate professional indemnity insurance cover for all the business activities which it carries on, or for which it is responsible.
- 2.3.2 E (1) To effect and maintain adequate professional indemnity insurance cover a *firm* should obtain cover which is at least equivalent to the requirements of its *designated professional body* which were in force immediately before *commencement*.
- (2) Compliance with (1) may be relied upon by the *FSA* as tending to establish compliance with *IPRU (INV)* 2.3.1.
- (3) Contravention of (1) may be relied upon by the *FSA* as tending to establish contravention of *IPRU (INV)* 2.3.1.

2.4 Bonding Requirement for Accountants

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

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

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

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

Content of records

3-10(3)

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

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

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

3-11 Reconciliation of firm's balances

Reconciliation

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

Circularisation

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

Response to requests

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

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

3-12 Risk management and internal control

Exposure limits

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

Management information

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

3-13 Nature, accessibility and retention of records

Nature of records

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

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

Audit trail

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

Prompt access

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

Retention of records

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

Security of records

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

Valuation of positions *

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

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

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

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

Broad scope firms

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

Arrangers

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

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

Corporate finance advisory firms

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

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

Advisers and locals/traded options market makers

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

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

Derivative fund managers

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

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

Dematerialised instruction transmitters

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

3-61 THE BASIC COMPUTATION

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

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

R Table 3-61. The basic financial resources calculation

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

- 3-62** Tangible net worth
- Calculation
- 3-62(1)** R **A firm must calculate its *tangible net worth* in accordance with table 3-61, subject to (2), (3) and (4) below.**
- Redeemable shares
- 3-62(2)** R **A firm may include redeemable *share* capital as part of *tangible net worth* only if:**
- (a) **the firm's memorandum and articles of association or a shareholders' agreement contain provisions that:**
 - (i) **redemption may not occur if the firm's financial resources after redemption would be less than or equal to 120% of its financial resources requirement;**
 - (ii) **dividends may not be paid if the firm's financial resources after payment would be less than or equal to 120% of its financial resources requirement; and**
 - (iii) **in the case of a shareholder's agreement, any assignee of the shares is subject to the provisions of the agreement; and**
 - (b) **the firm, before issuing any preference shares, notifies the FSA of its intention to do so.**
- Notice of redemption
- 3-62(3)** R **A firm must provide the FSA with six months' written notice of redemption of any of its redeemable shares.**
- Approved reserves
- 3-62(4)** R **A firm may not include reserves other than retained profits as part of *tangible net worth*.**
- G **A firm that wishes to include other reserves will need to apply for a modification or waiver of this rule.**

3-63 Eligible capital substitutes

Calculation

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

Approved eligible capital substitutes

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

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

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

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

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

Approved lenders

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

(a) the *firm's controller*;

(b) a *regulated banking institution*;

(c) an *approved person*; or

(d) a *regulated financial institution*.

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

Notice of repayment and termination

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

Amounts repayable within three months

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

Limit on eligible capital substitutes

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

Limit on approved bank bonds

- 3-63(7) R** **The total of approved bank bonds which a firm may treat as an eligible capital substitute must not exceed:**
- (a) 30% of the base requirement; and**
 - (b) CRR on exchange-traded-margined-transactions plus concentrated risk to one counterparty arising from exchange-traded-margined-transactions calculated under rules 3-173A and 3-175.**

Limit on approved undertakings

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

Approved undertakings

- 3-63(9) R** **A firm may treat an undertaking as an eligible capital substitute only if the provider of the undertaking is:**
- (a) a regulated banking institution; or**
 - (b) a regulated financial institution;**

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

PRIMARY REQUIREMENT

Definition of primary requirement - General rule

- 3-70 R A *firm's primary requirement* is the sum of:
- (a) the base requirement calculated in accordance with rule 3-71;
 - (b) the total liquidity adjustment calculated in accordance with rule 3-75;
 - (c) charged assets calculated in accordance with rule 3-76;
 - (d) *contingent liabilities* calculated in accordance with rule 3-77; and
 - (e) deficiencies in *subsidiaries* calculated in accordance with rule 3-78;

Base requirement - General rule

- 3-71 R A *firm's base requirement* is the highest of:
- (a) the absolute minimum requirement, calculated in accordance with rule 3-72;
 - (b) the expenditure requirement, calculated in accordance with rule 3-73; or
 - (c) the volume of business requirement, calculated in accordance with rule 3-74.

Absolute minimum requirement - General rule

- 3-72 R A *firm's absolute minimum requirement* is:
- (a) for an *arranger*: £10,000;
 - (b) for a *financial bookmaker*: £50,000;
 - (c) for an *agency broker*: £50,000;
 - (d) for a *firm* which handles *client money* and assets relating to *margined transactions* and segregates all *money* received from clients as *client money*: £50,000;
 - (e) for a *non clearing floor member*: £50,000;

(f) for a *broad scope firm* other than one within (b) to (e) above: £100,000; or

(g) for a *dematerialised instruction transmitter*: £50,000.

3-73 Expenditure requirement

General rule

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

(a) for an *investment manager* or an *introducing broker* who is not responsible for its *counterparties'* performance or a *venture capital firm* which is an *arranger* or a *model A clearing firm* or a *dematerialised instruction transmitter*: 6/52nds of relevant *annual expenditure*; or

(b) for any other *firm*: 1/4 of relevant *annual expenditure*.

Calculation of relevant annual expenditure

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

(a) its total revenue; and

(b) any loss before taxation;

less the aggregate of the following items:

(c) profit before taxation;

(d) *bonuses*;

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

(f) paid *commissions shared*, other than to *employees*, *directors*, half commission men or *appointed representatives* of the *firm*;

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

(h) interest payable to *counterparties*;

(i) interest payable on borrowings to finance the *firm's investment business* and *associated business*; and

- (j) **exceptional or extraordinary items**, provided that it first notify the *FSA* in writing of the nature and amount of the item(s) concerned.

Absence of audited annual financial statements

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

Adjustments to relevant annual expenditure

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

Application

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

Marginised transactions

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

Initial margin

- 3-74(3) R A counterparty's initial margin for the purposes of (2) above is the sum of the following amounts:**
- (a) in respect of exchange traded transactions, the counterparty's initial margin requirement; and**
 - (b) in respect of OTC transactions, the amount of margin that the counterparty is required by the firm to deposit.**

3-75 Liquidity adjustment

General rule

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

Intangible assets

- 3-75(2) R The liquidity adjustment for intangible assets is nil (these must be deducted from capital to arrive at tangible net worth under 3-62).**

Tangible fixed assets

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

Land and buildings used as security for non recourse loans

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

Land and buildings used as security for other loans

- 3-75(5) R The liquidity adjustment for land or buildings used as security for loans other than non recourse loans is the difference between the net book value of the land or building and the lower of:**
- (a) 85% of a professional valuation of the land and buildings (which must have been carried out in the last two years); or**
 - (b) the principal outstanding,**

except where both (a) and (b) are higher than the net book value in which case there is no liquidity adjustment.

Physical stocks

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

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

Investments in connected companies

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

Other investments

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

Prepayments

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

Debtors arising from investment business or dealing activities

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

Other debtors

- 3-75(11) R** The liquidity adjustment for debtors other than debtors arising from *investment business or dealing activities* is the balance sheet value of the debtor, except that there is no liquidity adjustment in the following circumstances:
- (a) amounts due from *connected companies* which are *adequately secured* and are repayable within 90 days;
 - (b) unsecured amounts due at the request of the *firm* from a *connected company* which is a *regulated banking institution* within 90 days;
 - (c) unsecured amounts due at the request of the *firm* from a *connected company* which is a *regulated financial institution* within seven days;
 - (d) having given prior written notice to the *FSA*, unsecured amounts receivable at the request of the *firm* from a *connected company* within seven days under an *approved treasury arrangement*, up to a maximum of the *firm's* excess of *financial resources* over its *financial resources requirement* before taking into account the *approved treasury arrangement*;
 - (e) amounts receivable in respect of cash dividends declared by either *exchange traded companies* or *authorised persons* which have been outstanding for 30 days or less from the date the dividends were due to be paid;
 - (f) amounts accrued or receivable in respect of interest on *marketable investments* which have been outstanding for 30 days or less from the date the interest was due to be paid;
 - (g) amounts receivable on U.K. value added tax which have been outstanding for 30 days or less from the date that the value added tax return was due to be received by HM Customs & Excise; and
 - (h) amounts receivable on taxation other than U.K. value added tax which have been agreed with the appropriate tax authorities and have been outstanding for 30 days or less from the date that the amounts were due to be received.

Cash deposits

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

Other assets

- 3-75(13) R** The liquidity adjustment for assets other than those specifically stated above is the balance sheet value of the asset concerned.

Charged assets - General rule

- 3-76 R** A *firm* must calculate the *primary requirement* for charged assets as the aggregate balance sheet value of each asset of the *firm* over which a third party has the right of *sale* or retention on default by the *firm* except:

- (a) to the extent of any liability of the *firm* plus a reasonable margin in respect of the charged asset; or
- (b) where the asset is collateral for a transaction which is subject to the *CRR* rules.

Contingent liabilities - General rule

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

Deficiencies in subsidiaries - General rule

- 3-78 R** A *firm* must calculate the *primary requirement* for deficiencies in *subsidiaries* as an amount equal to any deficiency in shareholders' funds at any time of a *subsidiary* of the *firm* except to the extent that:

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

POSITION RISK REQUIREMENT

3-80 GENERAL PRINCIPLES OF PRR

Application

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

Obligation to calculate PRR *

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

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

Frequency of calculation

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

Marking to market

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

Marketable investments

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

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

Non marketable investments

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

Instruments for which no PRA has been specified

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

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

Group hedging arrangements

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

Alternative treatments

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

Simpler approach to PRR calculation

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

TABLE 3-80(9)

Position risk requirement - simpler approach

C: Stock positions in *physical commodities*

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

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

F: Other investments

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

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

Models approach to PRR calculation

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

FOREIGN CURRENCY EXPOSURES AND FOREIGN CURRENCY DERIVATIVES METHODS

Summary of foreign currency exposures and derivatives methods

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

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

General rule

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

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

Dual currency bonds

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

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

Determining the currency of investments

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

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

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

Risk assessment models

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

Obligatory use of foreign currency derivatives method

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

Optional use of foreign currency derivatives method

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

Obligatory use of foreign currency exposures method

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

Calculation of “in the money”

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

3-153 Foreign currency derivatives method

Exchange traded futures and options

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

OTC foreign currency options

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

3-154 Foreign currency exposure method

Application

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

Calculation of PRR

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

Calculation of net open position

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

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

COMMODITIES METHOD

Types of positions to be included in the commodities method

3-166

General rule

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

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

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

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

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

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

- (i) they are in the same currency;
- (ii) the interest rates are within 15 basis points;

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

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

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

3-167 Simplified approach

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

3-168 Maturity ladder approach

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

Table 3-168

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

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

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

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

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

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

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

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

Extended maturity ladder approach

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

Table 3-169

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

Models approach

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

3-169B Options

Proprietary options pricing models

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

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

No models

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

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

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

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

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

COUNTERPARTY RISK REQUIREMENT

3-170 GENERAL PRINCIPLES OF CRR

Application

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

General rule

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

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

Rules

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

Frequency of calculation

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

Negative amounts

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

Instruments for which no CRR has been specified

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

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

(a) the whole; or

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

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

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

Provisions

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

Connected companies

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

Basis of valuation

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

Acceptable collateral

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

Nil weighted counterparty exposures

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

Netting

- 3-170 (11) R** **A firm which has offsetting exposures in similar types of transactions with a counterparty may offset these in accordance with rules 3-171(2A), 3-173(2A), 3-173A(3), 3-176(3), 3-180(2A), 3-181(1) and 3-182(4A) when calculating CRR if it has a contractual netting agreement with that counterparty, which:**
- (a) covers the transactions which the firm is seeking to net;**
 - (b) creates a single obligation in each currency or a single overall obligation to pay (or receive) a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances;**
 - (c) does not include a walkaway clause;**
 - (d) is supported by written and reasoned independent legal opinions to the effect that, in the event of a legal challenge, the relevant courts would find the firm's exposure to be the single net amount mentioned in (b) above.**

G Legal opinions should relate to:

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

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

3-171 Cash against documents transactions

General rule

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

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

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

Counterparty exposure calculation

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

Netting

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

Sub-total

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

3-173 Free deliveries of physical commodities and securities

General rule

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

Free delivery value calculation

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

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

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

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

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

Netting

**3-173
(2A)**

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

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

provided that:

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

Partners and connected persons

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

Sub-total

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

3-173A Derivative transactions

General rule

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

Counterparty exposure

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

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

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

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

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

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

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

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

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

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

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

Netting

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

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

provided that:

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

Table 3-173A(3)

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

CRR percentages

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

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

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

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

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

Exposures to locals

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

Sums due for payment or owed on closed out derivative transactions

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

- (a) the *firm* has offset the amount owed against variation margin payable in accordance with (3)(e) above; or
- (b) the *firm* has offset the amount owed against a negative “A” in accordance with (3)(f) above,

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

Equivalent contracts

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

Regulated connected companies

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

Sub-total

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

3-175 Concentrated risk to one counterparty

General rule

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

Table 3-175(1) - Concentrated risk percentages

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

Use of approved bank bonds

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

Sub-total

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

- 3-176** Repurchase and reverse repurchase, securities lending and borrowing and sale and buy back agreements

Repurchase, securities lending and sale and buy back agreements

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

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

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

Reverse repurchase, securities borrowing and buy and sale back agreements

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

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

Type of security purchased or borrowed		CRR
1	For all transactions where the <i>firm</i> has in its possession a “written agreement” evidencing the transaction, in accordance with rule 3-176(5)	
a)	<i>qualifying debt securities</i>	The amount paid or collateral given for the <i>securities</i> less 105% of the current “mark to market value” of the <i>securities</i> received (see note), if the net figure is positive
b)	<i>other securities or physical commodities</i>	The amount paid or collateral given for the <i>securities</i> or <i>physical commodities</i> less 110% of the current “mark to market value” of the <i>securities</i> or <i>physical commodities</i> received (see note), if the net figure is positive

2	Where a <i>firm</i> does not have in its possession a “written agreement” evidencing the transaction, in accordance with rule 3-176(5)	The appropriate requirements from 1 plus the market value of the <i>securities</i> or <i>physical commodities</i> multiplied by the appropriate <i>PRA</i>
Note: the <i>securities</i> or <i>physical commodities</i> received can be included only where they are held under the control of the <i>firm</i> or where they were delivered into the control of the <i>firm</i> upon initiation of the agreement.		

Netting

3-176(3) R A *firm* may reduce the *CRR* by netting where it has more than one exposure to an individual *counterparty* provided that it has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11) as follows:

- (a) in the case of *sale and buy back, repurchase* or *securities* or *physical commodities* lending agreements (Table 3-176(1)), a *firm* may reduce the *CRR* by the excess of the total value of collateral received, including accrued interest, over the “mark to market” value of any other *sale and buy back, repurchase* or *securities* or *physical commodities* lending agreements with the same *counterparty*;
- (b) in the case of *sale and buy back, reverse repurchase* or *securities* or *physical commodities* borrowing agreements (Table 3-176(2)), a *firm* may reduce the *CRR* by the excess of the “mark to market value” over the total value of collateral given, including accrued interest, of any other of *buy and sale back, reverse repurchase* or *securities* or *physical commodities* borrowing agreements with the same *counterparty*; and
- (c) to the extent that an excess has not been used under (a) or (b) above to reduce the *CRR*, a *firm* may use an excess on a *sale and buy back, repurchase* or *securities* or *physical commodities* lending agreement respectively to reduce the *CRR* on a *buy and sale back, reverse repurchase* or *securities* or *physical commodities* borrowing agreement and vice versa provided the agreements are with the same *counterparty*.

Margin percentages

- 3-176(4) R** A *firm* may opt to calculate the *CRR* using the lower collateral rate (105%) in order to avoid undue complication.
- “Written agreement”
- 3-176(5) R** For the purpose of this rule and rule 3-177(2), a “written agreement” must, whether in a general agreement or in respect of specific occasions, include the following elements:
- (a) the names of the persons involved;
 - (b) the type and quantity of *securities* or *physical commodities* subject to the *reverse repurchase, securities or physical commodities* borrowing, or *buy and sale back agreement*;
 - (c) the type and quantity of collateral;
 - (d) the commencement date of the *reverse repurchase, securities or physical commodities* borrowing or *buy and sale back agreement*;
 - (e) the completion date of the *reverse repurchase, securities or physical commodities* borrowing or *buy and sale back agreement*, where appropriate;
 - (f) interest or fee arrangements, where appropriate;
 - (g) arrangements for adjustments in the amount or type of *securities* or *physical commodities* to be returned, if appropriate;
 - (h) arrangements for the calling of margin, if appropriate; and
 - (i) agreements for completion,
- except that having given prior written notice to the *FSA*, a *firm* may disregard certain of the “written agreement” requirements where it can show there are adequate *internal controls* to evidence the arrangements.
- “Mark to market value”
- 3-176(6) R** For the purposes of this rule, the current “mark to market value” of *securities* and the value of cash lodged must include accrued interest.

Daily valuation

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

Settlement failure and pre deliveries

- 3-176(8) R Where:**
- (a) simultaneous delivery of securities or physical commodities and collateral cannot be confirmed immediately due to settlement failure, or**
 - (b) a firm has delivered collateral or securities or physical commodities prior to the receipt of securities or physical commodities or collateral,**
- the firm is not required to calculate a CRR for three business days from the date of payment or delivery by the firm.**

Additional acceptable collateral

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

Exclusions

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

Sub-total

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

- 3-177 Money brokers
- Application
- 3-177(1) R This rule applies to *money brokers*.
- Lending money
- 3-177(2) R When a *money broker* is lending money it must calculate a 100% *CRR* except to the extent that it holds *acceptable collateral*; except where the broker does not have a “written agreement” in accordance with rule 3-176(5) between the *firm* and *counterparty* specifying, inter alia, the interest rate on the loan and stating that the loan is repayable on demand or for a term no longer than 30 days, when the *CRR* is 100% of the amount outstanding.
- Lending and borrowing securities etc
- 3-177(3) R For all *reverse repurchase* and *repurchase agreements*, *securities borrowing* and *lending* agreements and *buy and sale back* and *sale and buy back agreements* other than where *securities* are lent or sold or borrowed or purchased through an approved payments system, a *money broker* must calculate an additional *CRR* of 0.5% applied to the value of all *securities* transferred.
- Sub-total
- 3-177(5) R The sum of the amounts calculated in accordance with (2) and (3) above is the *firm’s* total *CRR* for *money brokers*.
- 3-178 Options purchased for a counterparty
- Single premium options
- 3-178(1) R Where a *firm* has purchased a single premium *option* on behalf of a *counterparty* and the *counterparty* has not paid the full *option* premium cost by three *business days* after trade date, a *firm* must calculate a *CRR* as the amount by which the *option* premium owed to the *firm* exceeds the market value of the *option* or *acceptable collateral*.
- Traditional options
- 3-178(2) R Where a *firm* has purchased a *traditional option* for its own account or a *counterparty* and paid the *option* premium, it must calculate a *CRR* equal to the value of the *option* premium.

Sub-total

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

3-180 Qualifying and other deposits

General rule

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

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

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

Timing

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

Netting

3-180 (2A) R A *firm* may reduce the value of the deposit by an amount owed by the *firm* to a *counterparty* before it multiplies the residual exposure by the appropriate percentage in Table 3-180(1) provided that:

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

Sub-total

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

3-181 Loans to counterparties

General rule

3-181(1) R A *firm* must calculate a 100% *CRR* on the amount by which a loan to a *counterparty* is not:

(a) secured by *acceptable collateral*; or

(b) offset against amounts owed by the *firm* to the *counterparty* where the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11).

Sub-total

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

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

Nil CRR items

3-182(1) R The following receivables arising out of *investment business* or *investment dealing activities* do not require a *CRR* at any time:

(a) any debt not covered elsewhere in the *CRR* rules to the extent that it is *adequately secured*;

(b) amounts in respect of 30 day items specified in (3) below which have been outstanding for less than 30 days from the date on which they were first recorded on the *firm's* balance sheet; and

(c) accrued income for interest on *marketable investments*, except where it has been outstanding for more than 30 days after the date that the interest was due to be received.

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

3-182(2) R (a) Where management or other fees are owed to a *firm* in respect of international underwriting or stabilisation activities, the *firm* must calculate full *CRR* on any amounts remaining unpaid 30 days after they first appeared on the *firm's* balance sheet.

- (b) **A firm acting as stabilising manager must also calculate a CRR equal to 100% of any income accrued as a result of net profit on stabilising activities while the stabilising account remains open.**

CRR on 30 day items

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

100% CRR items

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

Netting

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

Sub-total

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

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

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

Note: If a defined term does not appear in the glossary below, the definition appearing in the Glossary annexed to the General Provisions Instrument 2001 applies.

<i>acceptable collateral</i>	means any of the following items of collateral provided to a <i>firm</i> by a <i>counterparty</i> - <ul style="list-style-type: none">(a) cash;(b) letters of credit and guarantees to the extent of their face value, issued by a <i>regulated banking institution</i> which is not the <i>counterparty</i> nor an <i>associate</i> of the <i>counterparty</i>;(c) letters of credit and guarantees to the extent of their face value, issued by a bank which is not a <i>regulated banking institution</i> (not being the <i>counterparty</i>, an <i>associate</i> of the <i>counterparty</i> nor an <i>affiliated company</i>) which has been accepted under the <i>firm's ACMP</i>;(d) gold and silver bullion and coinage; and(e) <i>marketable investments</i>, to which the following conditions apply - <ul style="list-style-type: none">(i) the <i>firm</i> must have an unconditional right to apply or realise the <i>acceptable collateral</i> for the purpose of repaying the <i>counterparty's</i> obligations;(ii) <i>marketable investments</i> must -<ul style="list-style-type: none">(aa) be <i>marked to market</i> daily using the valuation principles in rule 3-41(9);(bb) not be issued by the <i>counterparty</i> nor by an <i>associate</i> of the <i>counterparty</i>; and(cc) be discounted by 8% (before allowances for hedging or diversification); and(iii) each item of <i>acceptable collateral</i> must be discounted by 5% if it is denominated in a different currency to the <i>counterparty's</i> obligation;
<i>ACMP</i>	means, subject to rule 3-300, a credit management policy and procedures according with the principles discussed in Appendix 56 ;
<i>Act</i>	means the Financial Services and Markets Act 2000;
<i>adequately secured</i>	means secured by cash or by <i>marketable investments</i> - <ul style="list-style-type: none">(a) in respect of which the firm has an unconditional right to apply or realise for the purpose of repaying the <i>counterparty's</i> obligations to the <i>firm</i>;(b) which, in the case of <i>marketable investments</i>, are <i>marked to market</i> daily by the <i>firm</i> using the valuation principles in

	rule 3-41(9);
	(c) with, in the case of <i>marketable investments</i> , a marked to market value not lower than the current value of that obligation after being discounted -
	(i) by 8% (before allowances for hedging or diversification); and
	(ii) at an additional 5% if it is denominated in a different currency to the obligation; and
	(d) which, in the case of <i>marketable investments</i> , must not be issued by the <i>counterparty</i> nor by an <i>associate</i> of the <i>counterparty</i> ;
<i>adviser</i>	means a <i>firm</i> which -
	(a) has <i>counterparties</i> who are investors or potential investors;
	(b) restricts its <i>investment business</i> to activities within article 53 (advising on investments) of <i>the Regulated Activities Order</i> ;
	(c) does not hold, receive or control money or property belonging to another person, nor has a mandate over a <i>customer's</i> bank account;
	(d) does not introduce its <i>counterparties</i> to other persons as its main business; and
	(e) does not deal as principal or <i>agent</i> in <i>investments</i> or <i>physical commodities</i> ;
<i>affiliated company</i>	in relation to a <i>firm</i> , means any <i>body corporate</i> controlled by the <i>firm</i> , any parent company of the <i>firm</i> , and any <i>body corporate</i> controlled by a parent company of the <i>firm</i> ;
<i>agency broker</i>	means a <i>broad scope firm</i> which deals as principal only on an incidental basis;
<i>agent</i>	in relation to a person, means any person (including an <i>employee</i>) who acts on that person's behalf;
<i>allotment date</i>	means the date on which allotments are first made in respect of the <i>securities</i> being offered;
<i>annual accounting reference date</i>	means the date as at which the <i>audited annual financial statements</i> are prepared as initially notified by the <i>firm</i> to the <i>FSA</i> or as subsequently notified under rule 3-31 for all other purposes and which may not be more than 55 weeks since the previous <i>annual accounting reference date</i> or, if applicable, the date on which the <i>firm</i> commenced trading;
<i>appointed representative</i>	(in accordance with section 39 of the <i>Act</i>) means a person (other than an <i>authorised person</i>) who:
	(a) is a party to a contract with an <i>authorised person</i> (his

principal) which:

- (i) permits or requires him to carry on business of a description prescribed in the Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001 (SI 2001/1217); and
 - (ii) complies with the requirements prescribed in those Regulations; and
- (b) is someone for whose activities in carrying on the whole or part of that business his principal has accepted responsibility in writing;

approved bank

(in relation to a bank account opened by a *firm*) means:

- (a) if the account is opened at a branch in the *United Kingdom*:
- (i) the Bank of England; or
 - (ii) the central bank of a member state of the *OECD*; or
 - (iii) a *bank*; or
 - (iv) a *building society* which offers, unrestrictedly, banking services; or
 - (v) a bank which is supervised by the central bank or other banking regulator of a member state of the *OECD*; or
- (b) if the account is opened elsewhere:
- (i) a bank in (a); or
 - (ii) a *credit institution* established in an *EEA State* other than the United Kingdom and duly authorised by the relevant *Home State regulator*; or
 - (iii) a bank which is regulated in the Isle of Man or the Channel Islands; or
- (c) a bank supervised by the South African Reserve Bank; or
- (d) any other bank that:
- (i) is subject to regulation by a national banking regulator;
 - (ii) is required to provide audited accounts;
 - (iii) has minimum net assets of £5 million (or its equivalent in any other currency at the relevant time) and has a surplus revenue over expenditure for the last two financial years; and
 - (iv) has an annual audit report which is not materially qualified;

approved bank bond

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

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

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

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

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

arranger means a *firm* -

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

	<i>customer's</i> bank account;
<i>associate</i>	in relation to a person ("A"), means - <ul style="list-style-type: none"> (a) an undertaking in the same <i>group</i> as A; (b) an <i>appointed representative</i> of A or of any undertaking in the same <i>group</i> as A; and (c) any other person whose business or domestic relationship with A or its <i>associate</i> might reasonably be expected to give rise to a community of interest between them which may involve a conflict of interest in dealings with third parties;
<i>associated business</i>	means business which is carried on in connection with <i>investment business</i> ;
<i>audited annual financial statements</i>	means statements drawn up in accordance with Schedule 4 to the Companies Act 1985 as at the <i>firm's annual accounting reference date</i> together with an <i>auditor's report</i> thereon;
<i>auditor's report</i>	means a report drawn up in the format required by the <i>Supervision manual</i> which a <i>firm</i> must submit to the <i>FSA</i> in conjunction with the <i>firm's audited annual financial statements</i> ;
<i>authorised person</i>	means (in accordance section 31 of the <i>Act</i> (Authorised persons)), one of the following: <ul style="list-style-type: none"> (a) a <i>person</i> who has a <i>Part IV permission</i> to carry on one or more <i>regulated activities</i>; (b) an <i>incoming EEA firm</i>; (c) an incoming <i>Treaty firm</i>; (d) a <i>UCITS qualifier</i>; (e) an <i>ICVC</i>; (f) the <i>Society of Lloyd's</i>;
<i>authorised unit trust scheme</i>	means a <i>collective investment scheme</i> authorised for the purposes of the <i>Act</i> ;
<i>bank</i>	means: <ul style="list-style-type: none"> (a) a <i>firm</i> with a <i>Part IV permission</i> which includes <i>accepting deposits</i>: <ul style="list-style-type: none"> (i) which is a <i>credit institution</i>; or (ii) whose <i>Part IV permission</i> includes a <i>requirement</i> that it comply with IPRU(BANK); <p style="margin-left: 40px;">but which is not a <i>building society</i>, a <i>friendly society</i> or a <i>credit union</i>; or</p> (b) an <i>EEA bank</i>;
<i>body corporate</i>	means (in accordance with section 417(1)(Definitions))any body corporate, including a body corporate constituted under the law of

<i>bonus</i>	a country or territory outside the United Kingdom, of the Act; means that part of the remuneration paid by a firm to its <i>employees</i> (including <i>directors</i>) which is: (a) not a <i>profit share</i> ; and (b) awarded by management entirely on a discretionary basis, to the extent that it does not exceed the profit for the financial year of the <i>firm</i> before accounting for such bonus;
<i>bought deal</i>	means an <i>offering</i> where a <i>firm</i> on its own gives an outright binding commitment to the issuer or seller to purchase or subscribe for the <i>securities</i> to be offered;
<i>broad scope firm</i>	means any <i>firm</i> which is not an <i>adviser</i> , an <i>arranger</i> or a <i>local</i> ;
<i>business day</i>	means any day, except Saturday, Sunday, bank holidays and public holidays (not being bank holidays);
<i>buy and sale back agreement</i>	see <i>reverse repurchase agreement</i> ;
<i>call option</i>	means an <i>option</i> to buy an <i>investment</i> , other instrument, foreign currency or <i>physical commodity</i> at a given price on or before a given date;
<i>cap</i>	means an agreement in respect of a borrowing under which a <i>counterparty</i> contracts to pay any interest costs arising as a result of an increase in rates above an agreed rate: the effect being to provide protection to the holder against a rise above that agreed rate;
<i>category D firm</i>	means a <i>firm</i> , the only <i>core investment service</i> for which it has <i>permission</i> is receiving and transmitting on behalf of investors orders in relation to one or more of the instruments listed in Section B of the Annex to the ISD, and whose <i>permission</i> is subject to a <i>limitation</i> or <i>requirement</i> preventing it from holding <i>client money</i> or <i>clients' assets</i> and for that reason may not at any time place itself in debit with its <i>clients</i> , which benefits from the freedom of establishment or to provide services under Articles 14 or 15 of the <i>ISD</i> ;
<i>certificate of deposit</i>	means a negotiable or non-negotiable certificate issued by a bank;
<i>clearing firm</i>	means a <i>firm</i> which accepts primary responsibility (including legal liability) for the settlement of transactions for <i>counterparties</i> ;
<i>clearing house</i>	means a clearing house through which transactions on an <i>exchange</i> may be cleared;
<i>client</i>	means any <i>person</i> with or for whom a <i>firm</i> conducts or intends to conduct <i>designated investment business</i> or any other <i>regulated activity</i> ; and: (a) every client is a <i>customer</i> or a <i>market counterparty</i> ;

- (b) "client" includes:
 - (i) a potential client;
 - (ii) a client of an *appointed representative* of a *firm* with or for whom the *appointed representative* acts or intends to act in the course of business for which the *firm* has accepted responsibility under section 39 of the *Act* (Exemption of appointed representatives);
 - (iii) a *collective investment scheme* even if it does not have separate legal personality;
 - (iv) if a *person* ("C1"), with or for whom the *firm* is conducting or intends to conduct *designated investment business*, is acting as agent for another *person* ("C2"), either C1 or C2 in accordance with COB 4.1.5R (Agent as client);
- (c) "client" does not include:
 - (i) a trust beneficiary;
 - (ii) a *corporate finance contact*;
 - (iii) a *venture capital contact*.

<i>client money</i>	subject to the <i>client money rules</i> , means <i>money</i> of any currency which, in the course of carrying on <i>designated investment business</i> , a <i>firm</i> holds in respect of any <i>investment agreement</i> entered into, or to be entered into, with or for a <i>client</i> , or which a <i>firm</i> treats as <i>client money</i> in accordance with the <i>client money rules</i> ;
<i>client money rules</i>	means COB 9.3;
<i>close relative</i>	in relation to a person, means the person's spouse, his children and step-children, his parents and step-parents, his brothers and sisters and his step-brothers and step-sisters;
<i>closing date</i>	means the date on which payment for the <i>securities</i> is due to be made to the issuer or seller, or, if payment is made in instalments, payment of the first instalment;
<i>collective investment scheme</i>	means a collective investment scheme, as defined in section 235 of the <i>Act</i> (Collective Investment Schemes), which is in summary: <ul style="list-style-type: none"> (a) any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable <i>persons</i> taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income; and (b) which are not excluded by the Financial Services and Markets Act (Collective Investment Schemes) Order 2001

	(SI 2001/1062);
<i>commissions shared</i>	means that part of the remuneration paid by a <i>firm</i> which is determined on the basis of the number, size or profitability of individual deals carried out;
<i>connected company</i>	and “ <i>connected credit institution</i> ” mean, in relation to a <i>firm</i> which: <ul style="list-style-type: none"> (a) is a <i>body corporate</i>, a <i>body corporate</i> or <i>credit institution</i> satisfying any of the following conditions - <ul style="list-style-type: none"> (i) the same person is the <i>controller</i> of each <i>body corporate</i> or <i>credit institution</i>; (ii) if a group of two or more persons are <i>controllers</i> of each <i>body corporate</i> or <i>credit institution</i> and the group either consists of the same persons or could be regarded as consisting of the same persons by treating a member of either group as replaced by - <ul style="list-style-type: none"> (aa) that member’s <i>close relative</i>; (bb) a person with whom that member is in partnership; or (cc) a <i>body corporate</i> of which the member is an officer; or (iii) both <i>bodies corporate</i> are members of the same group; or (b) is not a <i>body corporate</i>, a <i>body corporate</i> or <i>credit institution</i> which is controlled - <ul style="list-style-type: none"> (i) by the <i>firm</i>; (ii) by a <i>partner</i> in the <i>firm</i>; (iii) by a <i>close relative</i> of a <i>partner</i> in the <i>firm</i> or, if the <i>firm</i> is a <i>sole trader</i>, by a <i>close relative</i> of the <i>sole trader</i>; or (iv) collectively by any of the <i>partners</i> in the <i>firm</i> or their <i>close relatives</i>;
<i>connected credit institution</i>	see “ <i>connected company</i> ”;
<i>connected person</i>	has the same meaning as given in section 346 of the Companies Act 1985 and a person described therein as being connected with a <i>director</i> will similarly be deemed to be connected with a <i>partner</i> of a <i>firm</i> ;
<i>contingency</i>	means a future event the outcome of which is uncertain;
<i>contingent liability</i>	means a liability dependent upon the occurrence or non-occurrence of one or more uncertain future events;
<i>contract for differences</i>	means (as specified in article 85 of the Regulated Activities

Order (Contracts for differences etc)), rights under:

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

controller

means -

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

and “*control*” shall be construed accordingly;

convertible

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

core investment service

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

corporate finance advisory firm

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

corporate finance business

means –

- (a) *designated investment business* carried on by a *firm* with or for:

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

principal for its own account where such business:

- (i) is in the course of, or arises out of, activities undertaken in accordance with (a); and
 - (ii) does not involve transactions with or for, or *advice on investments* to, any other *person* who is a *private customer* in respect of such business;
- (c) *designated investment business* carried on by a *firm* as *principal* for its own account if such business:
- (i) is in the course of, or arises out of:
 - (A) the *offer*, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, *shares*, share warrants, *debentures* or debenture warrants issued by the *firm*, or any related matter; or
 - (B) a proposed or actual *takeover or related operation* by or on behalf of the *firm*, or involving *shares*, share warrants, *debentures* or debenture warrants issued by the *firm*; or
 - (C) a merger, de-merger, reorganisation or reconstruction involving any *shares*, share warrants, *debentures* or debenture warrants issued by the *firm*; and
 - (ii) does not involve giving *advice on investments* to any *person* who is a *private customer*;

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

<i>counterparty</i>	means any person with or for whom a <i>firm</i> carries on, or intends to carry on, any <i>regulated business</i> or <i>associated business</i> ;
<i>credit institution</i>	means an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account;
<i>CRR</i>	means the counterparty risk requirement, as calculated 3-170 to 3-182;
<i>customer</i>	means a <i>client</i> who is not a <i>market counterparty</i> ;
<i>dealing activities</i>	means all <i>dealing activities</i> as <i>principal</i> or <i>agent</i> in <i>investments</i> and <i>physical commodities</i> ;
<i>debenture</i>	means the investment specified in article 77 of the Regulated Activities Order (Instruments creating or acknowledging indebtedness), which is in summary: any of the following which are not <i>government and public securities</i> : <ul style="list-style-type: none">(a) debentures;

	(b) debenture stock;
	(c) loan stock;
	(d) bonds;
	(e) certificates of deposit;
	(f) any other instruments creating or acknowledging indebtedness;
<i>dematerialised instruction transmitter</i>	means a firm - (a) which restricts its <i>investment business</i> to activities within article 45 (sending dematerialised instructions) of the Regulated Activities Order; and (b) which does not hold or receive money or property belonging to another person nor has a mandate over another person's bank account;
<i>derivatives</i>	means <i>options, futures and contracts for differences</i> ;
<i>derivative fund manager</i>	means an <i>arranger</i> - (a) whose <i>investment business</i> consists of discretionary management of funds which are invested predominately in <i>derivatives</i> ; and (b) whose income is not related to the volume of business transacted on behalf of the funds managed by him;
<i>designated investment exchange</i>	means any investment exchange which is listed as such in Appendix 33 ;
<i>director</i>	in relation to a <i>body corporate</i> includes - (a) any person occupying the position of <i>director</i> by whatever name called; (b) any person in accordance with whose directions or instructions (not being advice given in a professional capacity) the <i>directors</i> are accustomed to act; or (c) in the case of an <i>overseas firm</i> , any person who occupies a position analogous to that of a <i>director</i> of a company registered under the Companies Act 1985;
<i>documents of title</i>	means documents of title and documents evidencing title to <i>investments</i> and commodities;
<i>domestic offering</i>	means an <i>offering</i> or a tranche of an <i>offering</i> which is directed primarily to investors in the United Kingdom and which uses methods normal in the United Kingdom domestic capital markets;
<i>dual currency bonds</i>	means debt securities, the issue price and coupon of which are fixed in one currency whilst the redemption value is fixed in a different currency;
EEA	means the area established by the agreement on the European Economic Area signed at Oporto on 2 May 1992 and which

	consists of the <i>EEA States</i> ;
<i>EEA State</i>	means (in accordance with paragraph 8 of Schedule 3 to the Act (EEA Passport Rights)) a State which is a contracting party to the agreement on the European Economic Area signed at Oporto on 2 May 1992, as it has effect for the time being; as at 21 June 2001, the following are the <i>EEA States</i> : Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Liechtenstein, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden and the United Kingdom;
<i>eligible capital substitute</i>	means a subordinated loan, <i>approved bank bond</i> or approved undertaking which a <i>firm</i> may treat as an <i>eligible capital substitute</i> in accordance with rule 3-63;
<i>employee</i>	in relation to any person, means an individual - <ul style="list-style-type: none"> (a) who is employed by that person under a contract of service, a contract for services, or any other contract under which the individual will provide services to the person; (b) who is a <i>director</i> of the person where the person is a <i>body corporate</i>; (c) who is a <i>partner</i> of the person where the person is a partnership; (d) who, where the person is an unincorporated association, is a member of its governing body, the secretary or treasurer; or (e) whose services are, under an arrangement between the person and a third party, placed at the disposal and under the control of the person;
<i>equity balance</i>	means - <ul style="list-style-type: none"> (a) a <i>counterparty's equity balance</i>; or (b) a <i>firm's equity balance</i>;
<i>European Communities</i>	means Euratom (European Atomic Energy Community), the European Coal and Steel Community and the European Economic Community;
<i>exceptional items</i>	means those items which derive from events or transactions within the ordinary activities of the business of a <i>firm</i> and which are both material and not expected to recur frequently or regularly;
<i>exchange</i>	means a <i>recognised investment exchange</i> (as defined in the Act) or <i>designated investment exchange</i> ; *
<i>exchange traded</i>	means an <i>investment</i> which is traded or listed <i>on exchange</i> or on an <i>approved exchange</i> ; or an <i>offering</i> where an investment pari

* For the list of designated investment exchanges, see **Appendix 33**

	passu to that being offered is traded or listed <i>on exchange</i> or on an <i>approved exchange</i> ;
<i>exchange-traded-margined-transaction</i>	means a <i>margined transaction</i> effected by a <i>firm</i> under the rules of an <i>exchange</i> or an <i>approved exchange</i> or <i>clearing house</i> ;
<i>extraordinary items</i>	means those items which derive from events or transactions outside the ordinary activities of the business of a <i>firm</i> and which are both material and not expected to recur frequently or regularly;
<i>financial bookmaker</i>	means a <i>firm</i> which conducts only spread-betting business;
<i>financial reporting statement</i>	means the periodic financial and other reporting statements required to be provided to the <i>FSA</i> under the provisions of Chapter 16 of the <i>Supervision manual</i> ;
<i>financial resources</i>	means the sum of the <i>firm's tangible net worth</i> and <i>eligible capital substitutes</i> ;
<i>financial resources requirement</i>	means the sum of the <i>firm's primary requirement, PRR</i> and <i>CRR</i> ;
<i>financial rules</i>	means the financial rules in Chapter 3 of the <i>FSA's Interim Prudential Sourcebook for Investment Businesses (IPRU(INV)3)</i> ;
<i>firm</i>	means an <i>authorised person</i> ;
<i>floor</i>	means an agreement in respect of a deposit under which a <i>counterparty</i> contracts to pay any lost income arising as a result of a fall in rates below an agreed rate: the effect being to provide protection to the holder against a fall below that agreed interest rate;
<i>foreign currency derivatives method</i>	means the method of calculating <i>PRR</i> under rule 3-153;
<i>foreign currency exposures method</i>	means the method of calculating <i>PRR</i> under rule 3-154;
<i>forward</i>	means a <i>security</i> which is transacted for a settlement date beyond that which would normally apply in the market concerned, and where that forward settlement date is not yet passed;
<i>FRA</i>	means <i>forward rate agreement</i> , i.e. an agreement in which two parties agree on the payment by one party to another of an amount of interest based on an agreed interest rate for a specified period from a specified settlement date applied to an agreed principal amount; no commitment is made by either party to lend or borrow the principal amount; their exposure is only the interest difference between the agreed and actual rates at settlement;
<i>free delivery</i>	means - <ul style="list-style-type: none"> (a) the delivery of <i>securities</i> or <i>physical commodities</i> which takes place before the seller receives payment; or (b) payment made in settlement of a credit balance arising

from a sale on behalf of, or a purchase from a counterparty in respect of which the *securities* are undelivered;

FRN means floating rate note, i.e. all debt *securities* which pay interest at a rate which varies in response to general interest rates (including floating rate collateralised mortgage obligations);

FSA means the Financial Services Authority;

future means the investment, specified in article 84 of the Regulated Activities Order (Futures), which is, in summary: rights under a contract for the sale or delivery of a commodity or property of any other description under which delivery is to be made at a future date and at a price agreed on when the contract is made;

geared futures and options fund means an *authorised fund* dedicated to *derivatives* (where most or all of the extent of investment is limited by the amount of property available to be put up as initial outlay), whether with or without *transferable securities*;

government & public securities means the *investment*, specified in article 78 of the *Regulated Activities Order* (Government and public securities), which is in summary: a loan stock, bond or other instrument creating or acknowledging indebtedness, issued by or on behalf of any of the following:

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

but excluding:

- (A) the instruments specified in article 77(2)(a) to (d) of the *Regulated Activities Order*;
- (B) any instrument creating or acknowledging

indebtedness in respect of:

- (I) money received by the Director of Savings as *deposits* or otherwise in connection with the business of the National Savings Bank; or
- (II) money raised under the National Loans Act 1968 under the auspices of the Director of Savings or treated as so raised under section 11(3) of the National Debt Act 1972;

group

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

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

in this definition:

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

holding company

has the meaning given to it in section 736 of the Companies Act 1985;

in the money

means, in relation to *call options* and *warrants*, that the exercise price is less than the current *mark to market* value of the *underlying instrument* and, in relation to *put options*, that the current *mark to market* value is less than the exercise price;

incoming EEA firm

means (in accordance with section 193(1)(a) of the Act (Interpretation of this Part)) an *EEA firm* which is exercising, or

has exercised, its right to carry on a *regulated activity* in the *United Kingdom* in accordance with Schedule 3 to the *Act* (EEA Passport Rights).

initial margin requirement

means the total amount which under the rules of the relevant *exchange* or *exchanges* or *clearing house* or *clearing houses* the *firm* or an *intermediate broker* would be required to deposit in cash as a fidelity deposit in respect of all the *client's* open positions in *margined transactions* at that time, irrespective of any unrealised profit or loss on such positions, on the assumption that those transactions were the only transactions undertaken under the rules of that *exchange* or those *exchanges* or that *clearing house* or those *clearing houses* by the *firm* or the *intermediate broker* at that time;

intermediate broker

in relation to a *margined transaction*, means any person through whom the *firm* undertakes that transaction;

intermediate customer

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

- (a) a local authority or public authority;
- (b) a *body corporate* whose *shares* have been *listed* or *admitted to trading* on any *EEA* exchange;
- (c) a *body corporate* whose *shares* have been *listed* or *admitted to trading* on the primary board of any *IOSCO* member country official exchange;
- (d) a *body corporate* (including a *limited liability partnership*) which has (or any of whose *holding companies* or *subsidiaries* has) (or has had at any time during the previous two years) called up share capital or net assets of at least £5 million (or its equivalent in any other currency at the relevant time);
- (e) a *special purpose vehicle*;
- (f) a *partnership* or unincorporated association which has (or has had at any time during the previous two years) net assets of at least £5 million (or its equivalent in any other currency at the relevant time) and calculated in the case of a limited *partnership* without deducting loans owing to any of the *partners*;
- (g) a trustee of a trust (other than an *occupational pension scheme*, *SSAS* or *stakeholder pension scheme*) which has (or has had at any time during the previous two years) assets of at least £10 million (or its equivalent in any other currency at the relevant time) calculated by aggregating the value of the cash and *designated investments* forming part of the trust's assets, but before deducting its liabilities;
- (h) a trustee of an *occupational pension scheme*, *SSAS* or *stakeholder pension scheme* where the trust has

(or has had at any time during the previous two years):

- (i) at least 50 members; and
 - (ii) assets under management of at least £10 million (or its equivalent in any other currency at the relevant time);
- (i) another *firm*, or an *overseas financial services institution*, when, in relation to *designated investment business*, or related *ancillary activities*, conducted with or for that *firm* or institution, that *firm* or institution is an *intermediate customer* in accordance with COB 4.1.7R (Classification of another firm or an overseas financial services institution);
 - (j) an *unregulated collective investment scheme*;
 - (k) a *client* when he is classified as an *intermediate customer* in accordance with COB 4.1.9R (Expert private customer classified as intermediate customer);

but excluding:

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

internal controls

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

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

international offering

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

inter-professional

for the purposes of *repurchase*, *reverse repurchase*, *sale and buy back* and *buy and sale back agreements* means an

agreement with a counterparty which is one of the following -

- (a) a *Zone A credit institution*;
- (b) an *investment firm*;
- (c) a *recognised third country investment firm*;
- (d) a *recognised exchange*;
- (e) a *recognised clearing house*;

introducing broker

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

investment

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

- (a) life policies (subset of article 75);
- (b) shares (article 76);
- (c) debentures (that is, instruments creating or acknowledging indebtedness) (article 77);
- (d) government and public securities (article 78);
- (e) warrants (that is, instruments giving entitlement to investments) (article 79);
- (f) certificates representing certain securities (article 80);
- (g) units (article 81);
- (h) stakeholder pension scheme (article 82);
- (i) options (article 83);
- (j) futures (article 84);
- (k) contracts for differences (article 85);
- (l) rights to or interests in an investment within (a) to (k) (article 89);¹

investment agreement

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

investment business

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

- (a) dealing in investments as principal (article 14), but disregarding the exclusion in article 15 (Absence of holding out etc);

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

- (b) dealing in investments as agent (article 21);
- (c) arranging deals in investments for another person (article 25(1)) but only in relation to *investments*;
- (d) making arrangements for deals in investments (article 25(2)) but only in relation to *investments*;
- (e) managing investments (article 37);
- (f) safeguarding and administration of assets (article 40);
- (g) sending dematerialised instructions (article 45(1));
- (h) causing dematerialised instructions to be sent (article 45(2));
- (i) establishing, operating or winding up a collective investment scheme (article 51(1)(a));
- (j) acting as trustee of an authorised unit trust scheme (article 51(1)(b));
- (k) acting as the depository or sole director of an open-ended investment company (article 51(1)(c));
- (l) advising on investments (article 53);
- (m) agreeing to carry on the activities in (a) to (h) and (l) (article 64);²

investment firm means any legal or natural person established in the *EEA*, the regular occupation or business of which is the provision of core *investment services* for third parties on a professional basis, in accordance with the *ISD*, excluding any person to whom the *ISD* does not apply by virtue of the provisions of paragraph 2 of article 2 of that directive;

investment manager means a person who, acting only on behalf of a *customer*, either -

- (a) manages an account or portfolio in the exercise of discretion; or
- (b) has accepted responsibility on a continuing basis for advising on the composition of the account or portfolio;

investment services means -

- (a) activities undertaken in the course of carrying on investment business; and
- (b) activities undertaken in connection with an ISA where those activities do not constitute investment business;

ISA means an account which is a scheme of investment satisfying the conditions prescribed by the Individual Savings Account Regulations;

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

<i>launch</i>	means the time when any announcement, specifying the issuer or the guarantor of and indicating the final <i>pricing terms</i> of the <i>offering</i> is made for the first time to the public or the press or any <i>exchange</i> or <i>approved exchange</i> or information service;
<i>local</i>	means a <i>firm</i> which is a member of a futures and options exchange and whose <i>permission</i> includes a <i>requirement</i> that: <ul style="list-style-type: none"> (a) the <i>firm</i> will not conduct <i>designated investment business</i> other than: <ul style="list-style-type: none"> (i) <i>dealing</i> for its own account on that futures and options exchange; (ii) <i>dealing</i> for the accounts of other members of the same futures and options exchange; or (iii) making a price to other members of the same futures and options exchange; and (b) the performance of the <i>firm's</i> contracts must be guaranteed by and must be the responsibility of one or more of the clearing members of the same futures and options exchange;
<i>margined transaction</i>	means a transaction effected by a <i>firm</i> with or for a <i>customer</i> relating to an <i>investment</i> of any description referred to in articles 83, 84 and 85 of the Regulated Activities Order (or any right or any interest in such an <i>investment</i>) under the terms of which the <i>customer</i> will or may be liable to make a deposit in cash or collateral to secure performance of obligations which he may have to perform when the transaction falls to be completed or upon the earlier closing out of his position;
<i>mark to market</i>	means to value an <i>investment</i> at its current market value in accordance with rule 3-41(9);
<i>market counterparty</i>	means a <i>client</i> who is: <ul style="list-style-type: none"> (a) a properly constituted government (including a quasi-governmental body or a government agency) of any given country or territory; (b) a central bank or other national monetary authority of any country or territory; (c) a supranational whose members are either countries or central banks or national monetary authorities; (d) a State investment body, or a body charged with, or intervening in, the management of the public debt; (e) another <i>firm</i>, or an <i>overseas financial services institution</i>, except in relation to <i>designated investment business</i>, and related <i>ancillary activities</i>, conducted with or for that <i>firm</i> or institution, when that <i>firm</i> or institution is an <i>intermediate customer</i> in accordance with COB 4.1.7R (Classification of another firm or an

overseas financial services institution);

- (f) any *associate* of a *firm* (except an *OPS firm*), or of an *overseas financial services institution*, if the *firm* or institution consents;
- (g) a *client* when he is classified as a *market counterparty* in accordance with COB 4.1.12R (Large intermediate customer classified as a market counterparty);

but excluding:

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

marketable investment means -

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

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

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

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

designated investment exchange, other than to enable the *firm* to fulfil the orders of *clients*; or

(B) if they are not the executing of transactions on such exchanges, are performed in connection with or for persons who are not individuals; and

(b) whose *permission* includes a *requirement* that the *firm* must not carry on any *investment business* other than that in (a);

open-priced deal

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

operator

means:

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

option

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

- (a) a security or contractually based investment (other than an option);
- (b) currency of the United Kingdom or of any other country or territory;
- (c) palladium, platinum, gold or silver; or
- (d) an option to acquire or dispose of an option specified in (a), (b) or (c);

OTC

means over the counter, i.e. in relation to any *investment*, an *investment* which is not traded or listed *on exchange* or an

	<i>approved exchange</i> ;
<i>out of the money</i>	means those <i>options</i> and <i>warrants</i> which are not <i>in the money</i> ;
<i>packaged products</i>	means a <i>life policy</i> or a unit in a <i>regulated collective investment scheme</i> ;
<i>pari passu security</i>	means a <i>security</i> which is the same as another <i>security</i> , except only in respect of payment, entitlement to initial dividend and the nature of <i>documents of title</i> ;
<i>passport institution</i>	means an <i>incoming EEA firm</i> ;
<i>perfectly matching contracts</i>	mean certain <i>OTC derivatives</i> contracts which are included in a legally binding netting agreement that are equal and exact opposites and perfectly matching in all material respects;
<i>permission</i>	permission to carry on <i>regulated activities</i> ; that is, any of the following: <ul style="list-style-type: none"> (a) a <i>Part IV permission</i>; (b) the permission that an <i>incoming EEA firm</i> has, under paragraph 15(1) of Schedule 3 to the <i>Act</i> (EEA Passport Rights), on qualifying for <i>authorisation</i> under paragraph 12 of that Schedule; (c) the permission that an <i>incoming Treaty firm</i> has, under paragraph 4(1) of Schedule 4 to the <i>Act</i> (Treaty Rights), on qualifying for <i>authorisation</i> under paragraph 2 of that Schedule; (d) the permission that a <i>UCITS qualifier</i> has, under paragraph 2(1) of Schedule 5 to the <i>Act</i> (Persons concerned in Collective Investment Schemes); (e) the permission that an <i>ICVC</i> has, under paragraph 2(2) of Schedule 5 to the <i>Act</i> (Persons concerned in Collective Investment Schemes); (f) the permission that the <i>Society of Lloyd's</i> has, under section 315(2) of the <i>Act</i> (The Society: authorisation and permission), which is to be treated as a <i>Part IV permission</i> for the purposes of Part IV of the <i>Act</i> (Permission to carry on regulated activities) in accordance with section 315(3) of the <i>Act</i>;
<i>physical commodities method</i>	means the method of calculating <i>PRR</i> under rules 3-166 to 3-169B;
<i>physical commodity</i>	means the actual commodity, <i>documents of title</i> to actual commodities or shipping documents conveying title to actual commodities;
<i>PRA</i>	means percentage risk addition, i.e. a percentage to be applied to the value of positions in investments held by the firm to determine its <i>PRR</i> ;

<i>preference security</i>	means a <i>share</i> with rights, in respect of capital or dividends, superior to those of ordinary equity;
<i>pre-priced deal</i>	means an <i>international offering</i> other than a <i>bought deal</i> all the <i>pricing terms</i> of which have been fixed;
<i>pricing terms</i>	means, in relation to an <i>offering</i> , the amount of currency, maturity, <i>offering price</i> , rate of or means of calculating interest and any prices at which <i>securities</i> may be redeemed or converted or exchanged into other <i>securities</i> ;
<i>primary requirement</i>	is the primary requirement calculated in accordance with Table 3-61;
<i>private customer</i>	means a <i>client</i> who is not a <i>market counterparty</i> or an <i>intermediate customer</i> , including: <ul style="list-style-type: none"> (a) an individual who is not a <i>firm</i>; (b) an overseas individual who is not an <i>overseas financial services institution</i>; (c) a <i>regulated collective investment scheme</i>; (d) a <i>client</i> when he is classified as a <i>private customer</i> in accordance with COB 4.1.14R (Client classified as a private customer); <p style="margin-left: 40px;">but excluding a <i>client</i>, who would otherwise be a <i>private customer</i>, when he is classified as an <i>intermediate customer</i> in accordance with COB 4.1.9R (Expert private customer classified as an intermediate customer);</p>
<i>profit share</i>	means an appropriation of profit before tax on a predetermined basis for the benefit of management or <i>employees</i> ;
<i>property fund</i>	means a scheme dedicated to permitted immovables and property related assets, whether with or without other transferable securities;
<i>PRR</i>	means the position risk requirement of a firm as calculated in accordance with rules 3-80 to 3-169B;
<i>put option</i>	means an <i>option</i> to sell an <i>investment</i> , other instrument, foreign currency or <i>physical commodity</i> at a given price on or before a given date;
<i>qualifying debt security</i>	means a <i>debt security</i> which: <ul style="list-style-type: none"> (1) (a) represents or evidences indebtedness; (b) is a <i>marketable investment</i>; (c) if it or “equivalent debt” is rated by a “relevant agency” (and there has been no announcement that the rating will be cancelled) - <ul style="list-style-type: none"> (i) the <i>security</i> or the “equivalent debt” is so rated at or higher than the level indicated in the table in Appendix 34;

- (ii) there has been no announcement that the rating will be down-graded below the level so indicated; and
 - (iii) the *firm* has no reasonable cause to believe that another “relevant agency” has rated the security or “equivalent debt” below the level so indicated; and
- (d) if neither it nor any “equivalent debt” is rated by a “relevant agency” (or there has been an announcement that such a rating will be cancelled), it satisfies one or more of the following -
- (i) it is issued or guaranteed by or is subject to the full faith and credit of a sovereign government or province or state thereof (or a corporation over 75% owned by such sovereign government, or province or state), which is a member of the *OECD* and the government, province, state or corporation has not defaulted, or entered into any rescheduling or similar arrangement, or announced the intention of so doing, in respect of itself or its agency’s debt within the last five years;
 - (ii) it is issued or guaranteed by a *supranational organisation*;
 - (iii) it is issued or guaranteed by a corporation (not being a bank, for which see (iv) below) the ordinary *shares* of which are included within the following categories -
 - (aa) UK : constituents of the FT All Share Index;
 - (bb) Japan : constituents of the First Section of the Tokyo Stock Exchange;
 - (cc) USA: constituents of the NYSE, AMEX or NASDAQ NMS; or
 - (dd) countries listed below: the constituents of the FT-Actuaries World Indices in respect thereof;
 - Australia
 - Belgium
 - Canada
 - Denmark
 - France
 - Germany

Hong Kong
Italy
Netherlands
Norway
Singapore
Spain
Sweden
Switzerland

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

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

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

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

(a) in respect of any *security* of, or guaranteed by, any issuer or guarantor, “equivalent debt” means any debt which ranks *pari passu* with, or subordinate to, the *security* or (as the case may be) the guarantee; and

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

qualifying deposit

means a deposit which is one of the following -

(a) balance on current account with an *approved bank*;

(b) money on deposit with an *approved bank*, United Kingdom local authority, member of the Finance Houses Association, *stock exchange moneybroker*, *regulated clearing firm*, the National Savings Bank, *exchange*, *approved exchange* or *approved depository* which may be withdrawn within three months;

(c) money on deposit with an *approved bank* directly related to a transaction creating an offsetting liability for the *firm* or subject to an agreement with the bank allowing its use as

	collateral for a loan that may be withdrawn within three months, which relates to a liability of the same maturity and arises out of a transaction;
	(d) amount evidenced by a certificate of tax deposit;
	(e) amount evidenced by a <i>certificate of deposit</i> issued by a <i>regulated banking institution</i> which matures within three months; or
	(f) deposit of cash by way of margin with an <i>exchange</i> , <i>approved exchange</i> , <i>clearing house</i> or <i>intermediate broker</i> ;
<i>recognised exchange</i>	means an exchange listed as such in Appendix 57 ;
<i>recognised investment exchange</i>	means an investment exchange which is declared by a <i>recognition order</i> for the time being in force to be a <i>recognised investment exchange</i> ;
<i>recognised scheme</i>	means a <i>collective investment scheme</i> recognised under Chapter V of Part XVII of the Act;
<i>recognised third country investment firm</i>	means an undertaking which, if it was established within the <i>EEA</i> , would be covered by the definition of <i>investment firm</i> , and which is subject to the prudential rules of one of the regulators in Appendix 59 ;
<i>Regulated Activities Order</i>	means the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544);
<i>regulated banking institution</i>	means any banking institution which has paid up share capital and reserves of over £5,000,000 as shown by its latest published audited accounts, and which is authorised by the <i>FSA</i> or supervised by the central bank or other regulatory authority of a member state of the <i>OECD</i> in which the bank is incorporated;
<i>regulated business</i>	means <i>investment business</i> which is - <ul style="list-style-type: none"> (a) business carried on from a permanent place of business maintained by a <i>firm</i> (or its <i>appointed representative</i>) in the United Kingdom; and (b) other business carried on with or for <i>customers</i> in the United Kingdom, unless that business is - <ul style="list-style-type: none"> (i) business carried on from an office of a <i>firm</i> outside the United Kingdom which, if that office were a separate person, would fall within the overseas persons exclusions set out in article 72 of the Regulated Activities Order; or (ii) business of an <i>appointed representative</i> of the <i>firm</i> which is not carried on in the United Kingdom;
<i>regulated clearing firm</i>	means a <i>clearing firm</i> which is an <i>authorised person</i> ;
<i>regulated collective investment scheme</i>	means an <i>authorised unit trust scheme</i> , including an <i>ICVC</i> , or a <i>recognised scheme</i> ;

<i>regulated financial institution</i>	<p>means a <i>firm</i>, or an institution which is authorised to conduct <i>investment business</i> involving the execution of transactions on <i>exchanges</i> or on <i>securities</i> or <i>derivatives exchanges</i> by one or more of the following regulators -</p> <p>(a) any regulator of <i>investment business</i> in any member state of the European Community (other than the United Kingdom) established by law in that state; or</p> <p>(b) a body referred to in Part 1 of Appendix 35;</p> <p>provided, in the case of any such institution that the <i>firm</i> has no reason to suppose that the institution is in breach, in any material respect, of the rules enforceable by the relevant regulator;</p>
<i>relevant annual expenditure</i>	means the relevant annual expenditure of a <i>firm</i> calculated in accordance with rule 3-73;
<i>reporting accountant</i>	<p>means an accountant appointed:</p> <p>(a) by the <i>FSA</i>; or</p> <p>(b) by a <i>firm</i>, having been nominated or approved by the <i>FSA</i> under section 166 of the <i>Act</i> (Reports by skilled persons);</p> <p>to report on one or more aspects of the financial position of the <i>firm</i>, including <i>internal controls</i> and reporting returns;</p>
<i>reporting statement</i>	<p>means any one or more of the following types of report as required by the <i>Supervision manual</i>:</p> <p>(a) <i>audited annual financial statements</i>;</p> <p>(b) <i>annual reporting statement</i>;</p> <p>(c) <i>auditor's report</i>;</p> <p>(d) internal control letter;</p> <p>(e) quarterly reporting statement;</p> <p>(f) position risk reporting statement;</p> <p>(g) counterparty risk reporting statement;</p> <p>(h) annual reconciliation;</p> <p>(i) monthly reporting statement; and</p> <p>(j) the audited accounts of a <i>subsidiary</i> of the <i>firm</i>;</p>
<i>repurchase agreement</i>	(and <i>sale and buy back agreement</i>) means an agreement for the sale of <i>securities</i> or <i>physical commodities</i> subject to a commitment to repurchase from the same person the same or similar <i>securities</i> or <i>physical commodities</i> ;
<i>requirement</i>	means a requirement included in a <i>firm's Part IV permission</i> under section 43 of the <i>Act</i> (Imposition of requirements), section 45(4) of the <i>Act</i> (Variation etc on the Authority's own initiative) or section 46 of the <i>Act</i> (Variation of permission on acquisition of <i>control</i>);

<i>reverse repurchase agreement</i>	(and “ <i>buy and sale back agreement</i> ”) means an agreement for the purchase of <i>securities or physical commodities</i> subject to a commitment to resell to the same person the same or similar <i>securities or physical commodities</i> ;
<i>sale</i>	includes any disposal for valuable consideration;
<i>sale and buy back agreement</i>	see <i>repurchase agreement</i> ;
<i>scheme management activity</i>	means the management by an <i>operator</i> of a <i>collective investment scheme</i> of the property held for or within a <i>collective investment scheme</i> of which it is the <i>operator</i> and includes the management of the property of an <i>open-ended investment company</i> by the company itself as its <i>operator</i> but excludes the management of an <i>open-ended investment company</i> by another person as its <i>operator</i> (and excludes in all cases activities relating to transactions in units, <i>shares</i> or interests in the <i>collective investment scheme</i>);
<i>securities and futures firm</i>	means a <i>firm</i> whose <i>permitted activities</i> include <i>designated investment business</i> , which is not an <i>authorised professional firm, bank, building society, credit union, friendly society, ICVC, insurer, media firm, service company, incoming EEA firm</i> (without a <i>top-up permission</i>), <i>incoming Treaty firm</i> (without a <i>top-up permission</i>) or <i>UCITS qualifier</i> , whose <i>permission</i> does not include a <i>requirement</i> that it comply with <i>IPRU(INV) 5</i> (Investment management firms) or 13 (Personal investment firms), and which is within (a), (b), (c) or (d): <ul style="list-style-type: none"> (a) a <i>firm</i> (other than one falling within (d)): <ul style="list-style-type: none"> (i) which was a member of <i>SFA</i> immediately before <i>commencement</i>; and (ii) which was not, immediately before <i>commencement</i>, subject to the financial supervision requirements of the <i>FSA</i> (under section 43 of the Financial Services Act 1986), <i>PIA</i> or <i>IMRO</i> under lead regulation arrangements; (b) a <i>firm</i> whose <i>permission</i> includes a <i>requirement</i> that it comply with <i>IPRU(INV) 3</i> or 10 (Securities and futures firms); (c) a <i>firm</i>: <ul style="list-style-type: none"> (i) which was given a <i>Part IV permission</i> after <i>commencement</i>, or which was authorised under section 25 of the Financial Services Act 1986 immediately before <i>commencement</i> and not a member of <i>IMRO, PIA</i> or <i>SFA</i>; and (ii) for whom the most substantial part of its gross income, including <i>commissions</i>, from the <i>regulated activities</i> included in its <i>Part IV permission</i> is derived from one or more of the following activities (based,

for a *firm* given a *Part IV permission* after *commencement*, on the business plan submitted as part of the *firm's* application or, for a *firm* authorised under section 25 of the Financial Services Act 1986, on the *firm's* financial year preceding its *authorisation* under the Act):

- (A) an activity carried on as a member of an exchange;
 - (B) making a market in *securities* or *derivatives*;
 - (C) *corporate finance business*;
 - (D) *dealing*, or *arranging (bringing about) deals in investments*, in *securities* or *derivatives*;
 - (E) the provision of clearing services as a *clearing firm*;
 - (F) *managing investments*, where those *investments* are primarily *derivatives*; and
 - (G) activities relating to *spread bets*;
- (d) a *firm* that is:
- (i) an *ex-section 43 firm* which was not authorised under the Financial Services Act 1986 immediately before *commencement*; or
 - (ii) an *ex-section 43 lead regulated firm*;

security

means, as defined in article 3(1) of the Regulated Activities Order, any of the following investments specified in that Order:

- (a) shares (article 76);
- (b) debentures (that is, instruments creating or acknowledging indebtedness) (article 77);
- (c) government and public securities (article 78);
- (d) warrants (that is, instruments giving entitlement to investments) (article 79);
- (e) certificates representing certain securities (article 80);
- (f) units (article 81); and
- (g) stakeholder pension scheme (article 82); and
- (h) rights to or interests in investments in (a) to (g) (article 89);

settlement day

means the day on which under the recognised practice of an *exchange* or *approved exchange*, bargains are contracted for settlement; and in the case of bargains not transacted on an *exchange* or *approved exchange*, or entered into for forward settlement, 20 days from the date of the transaction, or, if earlier, the contractual due date;

<i>share</i>	means the investment, specified in article 76 of the Regulated Activities Order (Shares etc), which is, in summary: a share or stock in the share capital of: (a) any <i>body corporate</i> (wherever incorporated); (b) any unincorporated body constituted under the law of a country or territory outside the United Kingdom;
<i>sole trader</i>	means a <i>firm</i> which is not a <i>body corporate</i> and not a <i>partnership</i> ;
<i>stock exchange moneybroker</i>	is a <i>moneybroker</i> which is an <i>authorised person</i> and acts as an intermediary in the gilt market;
<i>subsidiary</i>	has the meaning given to it in section 736 of the Companies Act 1985;
<i>supervisory authority</i>	in relation to another member state, means an authority in that state which has regulatory functions in relation to one or more listed activities, <i>core investment services</i> or <i>non-core investment services</i> ;
<i>supranational organisation</i>	means any organisation referred to in Part 2 of Appendix 35 ;
<i>swap</i>	means a transaction in which two <i>counterparties</i> agree to exchange streams of payments over time according to a predetermined basis;
<i>Takeover Code</i>	means the City Code on Takeovers and Mergers and the Rules Governing Substantial Acquisitions of Shares published by the Takeover Panel;
<i>takeover or related operation</i>	means: (a) any offer to which the <i>Takeover Code</i> applies and any transaction or arrangement which is of such a nature that the <i>Takeover Code</i> would have applied to it had it concerned a company whose shares are listed under Part VI of the <i>Act</i> and whose head office and place of central management are in the United Kingdom; (b) any offer, transaction or arrangement relating to the purchase of <i>securities</i> with a view to establishing or increasing a strategic holding of a person, or of a person together with his <i>associates</i> in the <i>securities</i> concerned; (c) any transaction or arrangement entered into in contemplation or furtherance of any offer, transaction or arrangement falling within (a) or (b) above; and (d) any transaction or arrangement entered into by way of defence or protection against any offer, transaction or arrangement falling within (a), (b) or (c) above which has taken place or which is contemplated;
<i>Takeover Panel</i>	means the Panel on Takeovers and Mergers;
<i>tangible net worth</i>	is the tangible net worth of a <i>firm</i> calculated in accordance with

	rule 3-62;
<i>tender offer</i>	means an unconditional offer as a principal to buy <i>securities</i> ;
<i>total PRR</i>	means the sum of all the amounts calculated as a <i>PRR</i> under rules 3-80 to 3-169B;
<i>traditional option</i>	means any <i>option</i> arranged but not traded under the rules of the London Stock Exchange;
<i>trust beneficiary</i>	means a beneficiary under a trust (not being the settlor) who benefits from the performance by a <i>firm</i> as trustee of <i>investment services</i> relating to the management of the trust assets;
<i>underwriting</i>	means a commitment to take up <i>securities</i> where others do not acquire or retain them;
<i>underwriting price</i>	means the price at which the <i>firm</i> is committed to take up the securities or the price at which it is committed to do so if required under the <i>underwriting</i> commitment less any commissions or discounts paid or allowed in connection with the transaction, except to the extent that the <i>firm</i> has taken credit for them in its accounts;
<i>unregulated collective investment scheme</i>	means a <i>collective investment scheme</i> which is not a <i>regulated collective investment scheme</i> ;
<i>variable rate note</i>	means a debt <i>security</i> with the characteristics of an <i>FRN</i> except that the margin with respect to the index rate of interest is subject to variation depending on periodic negotiations;
<i>variation margin requirement</i>	means in relation to a <i>counterparty</i> the value of any amounts which the <i>firm</i> or <i>intermediate broker</i> would be required to pay under the rules of an <i>exchange</i> , <i>approved exchange</i> or <i>clearing house</i> to meet any <i>marked to market</i> losses occurring on contracts undertaken for that <i>counterparty</i> at that time on the assumption that those transactions were the only transactions undertaken on the <i>exchange</i> , <i>approved exchange</i> or <i>clearing house</i> by the <i>firm</i> or <i>intermediate broker</i> at that time;
<i>venture capital business</i>	means the business of: <ul style="list-style-type: none"> (a) investing in, advising on, managing or arranging transactions in <i>venture capital investments</i>; or (b) advising, managing or operating portfolios or <i>collective investment schemes</i> which (apart from funds awaiting investment) invest only in <i>venture capital investments</i>; (c) any <i>custody</i> activities provided in connection with the activities in (a) and (b); or (d) any related ancillary activities;
<i>venture capital firm</i>	means a <i>firm</i> whose <i>permission</i> includes a <i>requirement</i> that it must not conduct <i>investment business</i> other than <i>venture capital business</i> ;
<i>venture capital</i>	means an <i>investment</i> which, at the time the investment is made,

<i>investment</i>	<p>is:</p> <ul style="list-style-type: none"> (a) in a new or developing company or venture; or (b) in a management buy-out or buy-in; or (c) made as a means of financing the investee company or venture and accompanied by a right of consultation, or rights to information, or board representation, or management rights; or (d) acquired with a view to, or in order to facilitate, a transaction falling within (a) to (c);
<i>venture capital schemes</i>	means a scheme for providing capital to a <i>body corporate</i> whose equity is not traded or listed on an <i>exchange</i> ;
<i>walkaway clause</i>	means a provision which permits a non-defaulting counterparty to make only limited payments, or no payment at all, to the estate of the defaulter, even if the defaulter is a net creditor;
<i>warrant</i>	means the investment specified in article 79 of the Regulated Activities Order (Instruments giving entitlement to investments), which is, in summary: a warrant or other instrument entitling the holder to subscribe for a share, debenture or government and public security;
<i>warrant fund</i>	means a scheme which is dedicated to <i>transferable securities</i> except that it is permitted to invest entirely in <i>warrants</i> ;
<i>zone A</i>	means any country which is a full member of the <i>OECD</i> or has concluded special lending arrangements with the IMF associated with the IMF's General Arrangements to Borrow, provided it has not rescheduled its external sovereign debt to official or commercial bank creditors in the previous five years (Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany (including any pre-unification claims on East Germany), Greece, Hungary, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Portugal, Saudi Arabia, South Korea, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States, the Channel Islands, Gibraltar, Bermuda and the Isle of Man); and
<i>zone B</i>	means any country not in <i>Zone A</i> .

Appendix 20

GUIDANCE NOTES ON RECONCILIATION OF FIRM'S BALANCES WITH A COUNTERPARTY WHICH IS A MEMBER OF AN EXCHANGE (rule 3-11(1)(d))

Introduction

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

Scope

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

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

Timing

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

The obligation on firms

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

Appendix 21

GUIDANCE NOTES ON THE VALUATION OF POSITIONS

(rule 3-41(9))

Introduction

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

General principles

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

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

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

Appendix 33 (exchanges)

LIST OF RECOGNISED INVESTMENT, DESIGNATED INVESTMENT AND APPROVED EXCHANGES

1 Recognised investment exchanges

UK

The International Petroleum Exchange of London Ltd (IPE)
The London International Financial Futures and Options Exchange
The London Metal Exchange Ltd (LME)
The London Stock Exchange
OM London Exchange
virt-x
COREDEAL Limited
Jiway Limited

Overseas

The Cantor Financial Futures Exchange (CFFE)
The Chicago Board of Trade (CBOT)
The Chicago Mercantile Exchange (CME)
Eurex Zurich
The National Association of Securities Dealers Incorporated (NASDAQ)
The New York Mercantile Exchange (NYMEX)
The New Zealand Futures and Options Exchange (NZFOE)
The Swiss Exchange (SWX)
The Sydney Futures Exchange Ltd
Wareterminbörse Hannover

2 Designated investment exchanges

American Stock Exchange
Amsterdam Pork and Potato Terminal Market
Amsterdam Futures Clearing House (NLKKAS)
Australian Stock Exchange
Bolsa Mexicana de Valores
Chicago Board of Trade
Chicago Board Options Exchange
Chicago Mercantile Exchange
Coffee, Sugar and Cocoa Exchange, Inc
Commodity Exchange, Inc
Copenhagen Stock Exchange (including FUTOP)
DTB Deutsche Terminbörse

European Options Exchange
Financiele Termijnmarkt Amsterdam
Finnish Options Market
Hong Kong Futures Exchange
Hong Kong Stock Exchange
International Securities Market Association
Irish Futures & Options Exchange (IFOX)
Johannesburg Stock Exchange
Kansas City Board of Trade
Korea Stock Exchange
Marché à Terme International de France
Marché des Options Négociables de Paris (MONEP)
MEFF Renta Fija
MEFF Renta Variable
MidAmerica Commodity Exchange
Midwest Stock Exchange
Minneapolis Grain Exchange
Montreal Stock Exchange
New York Cotton Exchange (including the Citrus Associates of the New York Cotton Exchange)
New York Futures Exchange
New York Mercantile Exchange
New York Stock Exchange
New Zealand Futures Exchange
New Zealand Stock Exchange
OM Stockholm AB
Osaka Securities Exchange
Pacific Stock Exchange
Paris Stock Exchange
Philadelphia Board of Trade
Philadelphia Stock Exchange
Singapore International Monetary Exchange
Singapore Stock Exchange
South African Futures Exchange (SAFEX)
Swiss Options and Financial Futures Exchange
Sydney Futures Exchange
Tokyo International Financial Futures Exchange (TIFFE)
Tokyo Stock Exchange
Toronto Futures Exchange
Toronto Stock Exchange
Vancouver Stock Exchange

3 Approved exchanges

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

Antwerp (Effectenbeursvennootschap van Antwerpen)
Amsterdam Stock Exchange (Amsterdamse Effectenbeurs)
Asociacion de Intermediarios de Activos Financieros (Spanish Bond Market)
Athens Stock Exchange (ASE)

Barcelona Stock Exchange (Bolsa de Valores de Barcelona)
Basle Stock Exchange (Basler Börse)
Belgian Futures & Options Exchange (BELFOX)
Berlin Stock Exchange (Berliner Börse)
Bergen Stock Exchange (Bergen Bors)
Bilbao Stock Exchange (Bolsa de Valores de Bilbao)
Bologna Stock Exchange (Borsa Valori de Bologna)
Bolsa de Mercadorios & Futures (BM&F)
Bordeaux (Bourse de Bordeaux)
Boston Stock Exchange
Bovespa (The São Paulo Stock Exchange)
Bremen Stock Exchange (Bremer Wertpapierbörse)
Brussels Stock Exchange (Société de la Bourse des Valeurs Mobilières) /(Effecten Beursvennootschap van Brussel)
BVRJ (The Rio de Janeiro Stock Exchange)

Cincinnati Stock Exchange
Copenhagen Stock Exchange (Kobenhavns Fondsbors)

Dusseldorf Stock Exchange (Rheinisch-Westfälische Börse zu Düsseldorf)

Florence Stock Exchange (Borsa Valori di Firenze)

Frankfurt Stock Exchange (Frankfurter Wertpapierbörse)

Fukuoka Stock Exchange

Geneva Stock Exchange (Bourse de Genève)
Genoa Stock Exchange (Borsa Valori di Genova)

Hamburg Stock Exchange (Hanseatische Wertpapier Börse Hamburg)
Hannover (Niedersächsische Börse zu Hannover)
Helsinki Stock Exchange (Helsingin Arvopaperipörssi Osuuskunta)

Kuala Lumpur Stock Exchange

Lille (Bourse de Lille)
Lyon (Bourse de Lyon)
Lisbon Stock Exchange (Bolsa de Valores de Lisboa)
Luxembourg Stock Exchange (Société de la Bourse de Luxembourg SA)

Madrid Stock Exchange (Bolsa de Valores de Madrid)
Marseille (Bourse de Marseille)
Mercato Italiano Futures (MIF)
Mid West Stock Exchange
Milan Stock Exchange (Borsa Valori de Milano)
Munich Stock Exchange (Bayerische Börse in München)

Nagoya Stock Exchange
Nancy (Bourse de Nancy)
Nantes (Bourse de Nantes)
Naples Stock Exchange (Borsa Valori di Napoli)
New Zealand Stock Exchange

Oporto Stock Exchange (Bolsa de Valores do Porto)
Oslo Stock Exchange (Oslo Bors)

Palermo Stock Exchange (Borsa Valori di Palermo)

Rome Stock Exchange (Borsa Valori di Roma)

Stockholm Stock Exchange (Stockholm Fondbörs)
Stuttgart Stock Exchange (Baden-Württembergische Wertpapierbörse zu Stuttgart)

Taiwan
Tel Aviv Stock Exchange
The Stock Exchange of Thailand
Trieste Stock Exchange (Borsa Valori di Trieste)
Trondheim Stock Exchange (Trondheims Bors)
Turin Stock Exchange (Borsa Valori de Torino)

Valencia Stock Exchange (Bolsa de Valores de Valencia)
Venice Stock Exchange (Borsa Valori de Venezia)
Vienna Stock Exchange

Zurich Stock Exchange (Zürcher Börse)

Appendix 34 (“qualifying debt security”) RELEVANT AGENCY

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

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

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

LIST OF REGULATED FINANCIAL INSTITUTIONS AND SUPRANATIONAL ORGANISATIONS

PART 1

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

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

PART 2

List Of Supranational Organisations

The African Development Bank;
The Asian Development Bank;
The Bank for International Settlements;
The Caribbean Development Bank;
The Council of Europe;
Euratom (The European Atomic Energy Community);
Eurofina (The European Company for Financing of Railroad Rolling Stock);
The European Bank for Reconstruction and Development;
The European Coal and Steel Community;
The European Economic Community;
The European Investment Bank;
The Inter-American Development Bank;
The International Bank for Reconstruction and Development (World Bank);
The International Finance Corporation;
The International Monetary Fund;
The Nordic Investment Bank.

Appendix 37 (rule 3-177)

GUIDANCE NOTES FOR MONEY BROKERS

Application Of The Counterparty Risk Requirement

Introduction

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

Calculation of 0.5% additional CRR

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

Approved payments systems

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

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

Collateral

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

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

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

1 Introduction

This Appendix contains detailed guidance to the following rules–

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

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

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

4 Definition

A soft commission agreement means–

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

5 Description

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

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

7 Existing difference in accounting policies

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

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

9 Expenditure and balances receivable

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

10 Required treatment

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

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

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

12 Income and balances payable

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

13 Required treatment

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

14 Expenditure requirement

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

15 Required treatment

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

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

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

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

18 Legally enforceable contracts

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

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

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

Introduction

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

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

Appendix 56

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

Introduction

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

Objective

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

Scope

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

Background

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

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

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

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

General principles

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

Role of senior management

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

Procedures

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

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

Documentation

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

Collateral and margin

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

Measurement and monitoring of exposures

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

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

Additional Guidance on the FSA's Assessment of ACMPs

Preamble

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

A definition of credit and the measurement of credit risk

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

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

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

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

The decision to grant credit

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

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

- What are the qualifications of any Credit Committee's members to make the decisions required of them?
- Independence of Committee from profit centres
- Recording of Approvals

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

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

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

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

Cover sheet detailing proposed credit.

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

Financial information on proposed counterparty.

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

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

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

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

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

The monitoring of credit exposure

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

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

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

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

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

Computer systems

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

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

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

Reporting

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

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

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

Credit Risk Management/Control

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

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

Documentation

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

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

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

Basic documentation to be obtained from all counterparties might include

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

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

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

Other areas for consideration could include:

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

Ongoing review of credit risk

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

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

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

Documentation of credit policies and procedures and customer files

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

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

- press cuttings
- copies of data input documents

Appendix 57

List Of Exchanges And Clearing Houses Recognised for the purposes of IPRU(INV)3

The following lists are not lists of the Recognised Investment Exchanges and the Recognised Clearing Houses to which the RIE and RCH Sourcebook (REC) applies. Inclusion of an exchange or clearing house in the following lists does not imply its recognition under Part XVIII of the Financial Services and Markets Act 2000. The following lists of exchanges and clearing houses are solely for the purposes of IPRU(INV)3.

1 Exchanges recognised for the purposes of IPRU(INV)3

American Stock Exchange LLC
Amsterdam Exchanges (AEX)
AmStock Exchange of Lower Saxony Hannover (Niedersächsische Börse zu Hannover)
Athens Stock Exchange (ASE) - Thessaloniki Stock Exchange Centre (TSEC)
Australian Stock Exchange Ltd.
Baden-Wurtemberg Stock Exchange Stuttgart (Bayrische Börse)
Barcelona Stock Exchange (La Bolsa de Valores de Barcelona)
Bavarian Stock Exchange Munich (Bayrische Börse)
Belgian Futures and Options Exchange (BELFOX)
Berlin Stock Exchange (Berliner Wertpapierbörse)
Bilbao Stock Exchange (Bolsa de Bilbao)
Bourse de Montréal
Bremen Stock Exchange (Bremer Wertpapierbörse)
Canadian Venture Exchange
Chicago Board of Trade
Chicago Mercantile Exchange
Chicago Board Options Exchange Inc.
Copenhagen Stock Exchange (Københavns Fondsbørs)
Deutsche Börse AG
Eurex Deutschland
Eurex Zurich
Euronext Amsterdam NV
Euronext Brussels Ltd.
Euronext Paris SA
Frankfurt Stock Exchange (Frankfurter Wertpapierbörse)
Hanseatic Stock Exchange Hamburg (Hanseatische Wertpapierbörse Hamburg)
Helsinki Exchanges

Hong Kong Exchanges and Clearing
International Petroleum Exchange of London Ltd.
Irish Stock Exchange
Italian Exchange
Bolsa de Valores de Lisboa e Porto (BVLP)
London International Financial Futures and Options Exchange (LIFFE)
London Metal Exchange Ltd.
London Stock Exchange Ltd.
Luxembourg Stock Exchange (Société de la Bourse de Luxembourg SA)
Madrid Stock Exchange (La Bolsa de Valores de Madrid)
Marché à Terme International de France (MATIF)
MEFF Renta Variable
Mercado AIAF de Renta Fija, SA
Mercato Italiano Derivati (IDEM)
Mercato Italiano Futures (MIF)
Nagoya Stock Exchange
The Nasdaq Stock Exchange
New York Mercantile Exchange
New York Stock Exchange Inc.
OM London
OM Stockholm Exchange
Osaka Securities Exchanges
The Oslo Stock Exchange (Oslo Bors)
Pacific Stock Exchange
Rhine-Westphalian Stock Exchange Dusseldorf (Rheinisch-Westfälische Börse zu Düsseldorf)
Singapore Exchange
Stockholm Stock Exchange (Stockholms Fondbörs AB)
Sydney Futures Exchange
Tokyo Stock Exchange
Tokyo international Financial Futures Exchange
The Toronto Stock Exchange
Valencia Stock Exchange (La Bolsa de Valores de Valencia)
Wiener Borse AG

2 Clearing Houses recognised for the purposes of IPRU(INV)3

ASX Settlement and Transfer Corporation Pty Ltd (ASTC)
Austrian Kontroll Bank (OKB)
Board of Trade Clearing Corporation

Cassa di Compensazione e Garanzia S.p.A (CCG)
Commodity Clearing Corporation
The Emerging Markets Clearing Corporation
European Options Clearing Corporation Holding BV (EOCC)
Guarantee Fund for Danish Options and Futures (Garantifonden for Danske Optioner OG Futures (FUTOP)
Kansas City Board of Trade Clearing Corporation
Hong Kong Futures Exchange Clearing Corporation Ltd
Hong Kong Securities Clearing Company Ltd
London Clearing House (LCH)
Norwegian Futures & Options Clearing House (Norsk Opsjonssentral A.S.)
N.V. Nederlandse Liquidatiekas (NLKKAS)
OM Stockholm AB (OM)
Options Clearing Corporation
Options Clearing House Pty Ltd (OCH)
OTOB Clearing Bank AG (OTOB)
Société de Compensation des Marchés Conditionnels (SCMC)
Sydney Futures Exchange Clearing House (SFECH Ltd)
TNS Clearing Pty Ltd (TNSC)

Appendix 59
LIST OF REGULATORS FOR THE PURPOSES OF THE
DEFINITION OF RECOGNISED THIRD COUNTRY INVESTMENT
FIRMS

Country	Regulator
Australia	Australian Stock Exchange Sydney Futures Exchange
Canada	Alberta Stock Exchange Montreal Exchange Toronto Stock Exchange Vancouver Stock Exchange Investment Dealers Association of Canada
Hong Kong	Hong Kong Monetary Authority Hong Kong Securities and Futures Commission
Japan	Ministry of Finance
Singapore	Monetary Authority of Singapore Stock Exchange of Singapore
South Africa	Bond Exchange of South Africa Johannesburg Stock Exchange South African Futures Exchange
United States	Securities and Exchange Commission Commodity and Futures Trading Commission

4. Chapter 4: Lloyd's firms

4.1 APPLICATION

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

4.2 PURPOSE

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

4.3 SPECIFICATION OF OBJECTIVE

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

4.4 FINANCIAL RESOURCE REQUIREMENTS

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

(b) that *underwriting agent* met the applicable financial resource requirements at the end of the financial year to which the report relates; and

(c) the *Society* is not aware of any matters likely to be of material concern to the *FSA* relating to that *underwriting agent's* compliance with financial resource requirements during the year to which the report relates, or arising from the attachments referred to in (a); or

(2) if the *Society* is unable to give any of the confirmations required under *IPRU(INV)* 4.4.5D (1)(a), (b) or (c), set out in each case the reasons why it is unable to give that confirmation.

4.4.6 R A *members' adviser* must comply with the requirements of *IPRU(INV)* 3-60(3) and 3-62.

4.5 ACCOUNTING RECORDS

4.5.1 D The *Society* must maintain appropriate and effective arrangements to require *underwriting agents* to meet the obligation to keep and preserve accounting records, set out in Lloyd's Underwriting Agents Byelaw (No 4 of 1984), Section III, paragraph 53B, as it is in force immediately before *commencement*.

4.5.2 R A *members' adviser* must comply with the requirements of *IPRU(INV)* 3-10 to 3-14.

Interim Prudential Requirements for Former IMRO Firms

5 CHAPTER 5: FINANCIAL RESOURCES

5.1.1 APPLICATION

APPLICATION OF CHAPTER 5

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

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

	ISD Firms	OPS Firms (see Note 1 below)	Non-OPS Life Offices and Non-OPS Local Authorities	Individuals admitted to membership collectively
Financial resources rules				
5.2.1(1) to 5.2.7(5)	Yes	No	No	Yes
Accounting records rules				
5.3.1(1) to 5.3.1(6)	Yes	Yes	Yes	Yes
Financial notification rules				
5.5.1(1)	Yes	No	No	No
Consolidated supervision rules				
5.7.1(1) to 5.7.1(4)	Yes	No	No	Yes

	Individuals whose sole investment business is giving investment advice to institutional or corporate investors	Firms subject to "lead regulator arrangements"	All other Firms
Financial resources rules			
5.2.1(1) to 5.2.7(5)	No	No (see Note 2 below)	Yes
Accounting records rules			
5.3.1(1) to 5.3.1(6)	Yes	Yes	Yes
Financial notification rules			
5.5.1(1)	No	No	No
Consolidated supervision rules			
5.7.1(1) to 5.7.1(4)	No	No	Yes
Note 1. <i>Firms</i> are referred to the specific compliance reports for <i>OPS firms</i> required by Chapter 16 of the Supervision Manual.			
Note 2. A <i>firm</i> subject to "lead regulator arrangements" whereby a body other than <i>the FSA</i> is responsible for its financial regulation shall comply with the corresponding financial resources rules and financial returns rules of that body, and a breach of such rules shall be treated as a breach of the rules of <i>the FSA</i> .			

INTERPRETATION

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

5.2.1 GENERAL REQUIREMENT

ADEQUACY OF FINANCIAL RESOURCES

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

BASIC REQUIREMENT

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

FINANCIAL RESOURCES

- 5.2.1(3) R A firm's financial resources means:
- (a) its *own funds*, if the *firm* is subject to an *own funds requirement* under rule 5.2.3(2); or
 - (b) its *liquid capital*, if the *firm* is subject to a *liquid capital requirement* under paragraph (a) of rule 5.2.3(1); or
 - (c) where the *firm* is an *ISD firm* subject to an *own funds requirement* and a *liquid capital requirement* under paragraph (b) of rule 5.2.3(1), its *own funds* and its *liquid capital*; or
 - (d) where the *firm* is an *ISD firm* and a trustee of an *authorised unit trust scheme* subject to paragraph (c) of rule 5.2.3(1), its *own funds* or its *liquid capital*.

5.2.2 FINANCIAL RESOURCES

OWN FUNDS

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

LIQUID CAPITAL

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

5.2.3 FINANCIAL RESOURCES REQUIREMENT

DETERMINATION OF REQUIREMENT

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

EXCEPTIONS FROM THE LIQUID CAPITAL REQUIREMENT

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

OWN FUNDS REQUIREMENT

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

LIQUID CAPITAL REQUIREMENT

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

TOTAL CAPITAL REQUIREMENT

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

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

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

5.2.4 ANNUAL AUDITED EXPENDITURE

DETERMINATION

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

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

(ix) foreign exchange losses; or

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

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

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

5.2.5 QUALIFYING SUBORDINATED LOANS

CHARACTERISTICS OF LONG TERM QUALIFYING SUBORDINATED LOANS

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

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

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

(c) either:

(i) the minimum original maturity of the loan is 5 years; or

(ii) the loan does not have a minimum or fixed maturity but requires 5 years notice of repayment.

AMOUNT ALLOWABLE IN THE CALCULATION OF OWN FUNDS

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

REQUIREMENTS APPLICABLE TO SHORT-TERM QUALIFYING SUBORDINATED LOANS

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

FORM OF QUALIFYING SUBORDINATED LOAN AGREEMENT

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

CONDITIONS APPLICABLE TO QUALIFYING SUBORDINATED LOANS

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

REQUIREMENTS ON A FIRM IN RELATION TO QUALIFYING SUBORDINATED LOANS

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

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

5.2.6 QUALIFYING PROPERTY AND QUALIFYING UNDERTAKINGS

QUALIFYING PROPERTY AND QUALIFYING AMOUNT DEFINED

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

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

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

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

Qualifying amount is the lowest of:

- (a) $85\% \times £200,000 = £170,000$
- (b) $85\% \times £100,000 = £85,000$
- (c) $£70,000 - £5,000 = £65,000$

i.e. £65,000

QUALIFYING UNDERTAKINGS

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

5.2.7 LARGE EXPOSURES

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

GENERAL REQUIREMENT

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

LARGE EXPOSURE LIMITS

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

EXCEPTION TO THE LARGE EXPOSURE LIMITS

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

TRANSITIONAL ARRANGEMENTS

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

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

**PART I
METHOD OF CALCULATION**

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

Financial resources	Category	Part II Para
Tier 1		
(1) Paid-up share capital (excluding preference shares)	A	2
(2) Share premium account		
(3) Audited reserves		
(4) Non-cumulative preference shares		
Less: (5) Investments in own shares	B	
(6) Intangible assets		3
(7) Material current year losses		4
(8) Material holdings in credit and financial institutions		5
Tier 1 capital = (A-B)	C	
Plus: TIER 2		1
(9) Revaluation reserves	D	
(10) Fixed term cumulative preference share capital		1(a)
(11) Long-term Qualifying Subordinated Loans		1(a); 6

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

PART II DETAILED REQUIREMENTS	
1 Ratios (Items 10, 11 and 15)	<p>(a) For a <i>firm</i> which is an <i>ISD firm</i>, in calculating <i>own funds</i>, the following restriction applies:</p> <p style="padding-left: 40px;">the total of fixed term cumulative preference shares (item 10) and long-term <i>qualifying subordinated loans</i> (item 11) that may be included in Tier 2 capital is limited to 50 per cent of Tier 1 capital. (But see sub-paragraph (b)(ii) below.)</p> <p>(b) For a <i>firm</i> which is an <i>ISD firm</i>, in calculating <i>liquid capital</i>:</p> <p style="padding-left: 40px;">(i) Tier 2 capital must not exceed 100 per cent of Tier 1 capital;</p> <p style="padding-left: 40px;">(ii) capital which would otherwise qualify as Tier 2 capital but for the operation of paragraphs 1(a) and 1(b)(i) may be treated as Tier 3 capital subject to sub-paragraph (iii) below; and</p>

	<p>(iii) the total of the excess of Tier 2 capital so treated as Tier 3 capital and short-term <i>qualifying subordinated loans</i> (item 15) may not exceed 250 per cent of an amount equal to Tier 1 capital less the <i>other assets requirements</i> calculated in accordance with Table 5.2.3(5)(e).</p> <p>(c) A <i>firm</i> which is not an <i>ISD firm</i> and which is subject to a <i>liquid capital requirement</i> under rule 5.2.3(1)(a) may take into account <i>qualifying subordinated loans</i> in the calculation of <i>liquid capital</i> up to a maximum of 400% of its Tier 1 capital.</p>
<p>2 Non corporate entities</p>	<p>(a) In the case of partnerships or sole traders, the following terms should be substituted, as appropriate, for items 1 to 4 in Tier 1 capital:</p> <p>(i) partners' capital accounts (excluding loan capital);</p> <p>(ii) partners' current accounts (excluding unaudited profits and loan capital);</p> <p>(iii) proprietors' account (or other term used to signify the sole trader's capital but excluding unaudited profits).</p> <p>(b) Loans other than <i>qualifying subordinated loans</i> shown within partners' or proprietors' accounts must be classified as Tier 2 capital under item 12.</p>
<p>3 Intangible assets (Item 6)</p>	<p>Intangible assets comprise:</p> <p>(a) formation expenses to the extent that these are treated as an asset in the <i>firm's</i> accounts;</p> <p>(b) goodwill, to the extent that it is treated as an asset in the <i>firm's</i> accounts; and</p> <p>(c) other assets treated as intangibles in the <i>firm's</i> accounts.</p>
<p>4. Material current year losses (Item 7)</p>	<p>Losses in current year operating figures must be deducted when calculating Tier 1 capital if such losses are material. For this purpose profits and losses must be calculated quarterly or monthly, as appropriate. If this calculation reveals a net loss it shall only be deemed to be material for the purposes of this Table if it exceeds 10 per cent of the <i>firm's</i> Tier 1 capital.</p>

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

Note

Non-trading book interim profits may only be included in Tier 1 of the calculation if they have been independently verified by the *firm's* external auditors.

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

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

A *firm* wishing to include interim profits in Tier 1 capital in a *financial return* should submit to *the FSA* with the *financial return* a verification report signed by its external auditor which states whether the interim results are fairly stated.

Profits on the sale of capital items or arising from other activities which are not directly related to the *investment business* of the *firm* may also be included within the calculation of *liquid capital* if they can be separately verified by the *firm's* auditors. In such a case, such profits can form part of the *firm's* Tier 1 capital as audited profits.

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

- (g) physical stocks (except where subject to the *position risk requirement* as set out in Table 5.2.3(5)(b); and
- (h) prepayments to the extent that the period of prepayment exceeds six weeks in the case of a *firm* subject to the *6/52 expenditure based requirement* or thirteen weeks in the case of a *firm* subject to the *13/52 expenditure based requirement* or where a *firm* is required to meet the requirement in rule 5.2.3(4)(c)(i).

11 *qualifying property*
(Item 17)

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

Table 5.2.3(3)(b) OWN FUNDS REQUIREMENT

**PART I
DETERMINATION OF REQUIREMENT**

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

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

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

PART II
OWN FUNDS TRANSITIONAL PROVISIONS

- 1 Subject to paragraph 4 below, an *ISD firm's own funds requirement* may be set at a lower level than the appropriate amount in paragraph 1 of Part I if such *firm*:
- (a) was authorised before 1 July 1995;
 - (b) was permitted by the Investment Management Regulatory Organisation at the commencement date of these *rules* to calculate its *own funds requirement* in accordance with the own funds transitional provisions of that Organisation; and
 - (c) complies with the requirements of paragraph 2 below.
- 2 (a) A *firm* to which this Part applies must at the end of each six-month period calculate the average daily level of its *own funds* for the six-month period preceding the date of calculation.
- (b) The *firm* must report (an "*own funds return*") each such calculation to *the FSA* by the date for submission of its *quarterly return* due next after the date to which the calculation is made.
- (c) The highest level calculated by the *firm* before 1 January 1996 is the *firm's* first reference level for the purposes of this Part.
- (d) Each time that the *firm's* six-monthly calculation results in a level higher than any preceding it, that higher level becomes its relevant level for the purposes of this Part.
- 3 The *own funds* of a *firm* to which this Part applies must not fall below its reference level.

- 4 This Part will cease to apply to a *firm* if:
- (a) its *own funds* equal or exceed the applicable level specified in Part I; or
 - (b) it has a change of *controller*, except a change of control resulting from:
 - (i) the first transfer by inheritance after 31 December 1995 (in this case the *firm* must comply with Part 1 from the tenth anniversary of the date of the transfer);
 - (ii) a change in the composition of the *firm* which is a partnership, if at least one partner who was a partner on 31 December 1995 remains in the partnership (in this case the *firm* must comply with Part I by 31 December 2005); or
 - (iii) a merger of two or more *firms* subject to the Capital Adequacy Directive (No. 93/6/EEC), where the merged *firm* does not have the appropriate minimum level of initial capital (in this case, the reference level will become the *firm's* total of *own funds* at the time of the merger).

Table 5.2.3(5)(a) EXPENDITURE BASED REQUIREMENT

**PART I
CALCULATION OF REQUIREMENT**

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

**PART II
FRACTIONS**

- 1 The fraction is 6/52 where:
- (a) the *firm* is an *authorised unit trust manager*; or
 - (b) the *firm* acts only as an *authorised corporate director* of an *ICVC*; or
 - (c) the *firm* is an *investment manager* (including the *operator* of an *unregulated collective investment scheme* in relation to which the *firm* carries on the activity of an *investment manager*), unless paragraph 2 applies.
- 2 The fraction is 13/52 where the *firm* is an *investment manager* as in paragraph 1(c) above, or is a *custodian*, and the *firm* either:
- (a) itself holds *customers' monies* or assets; or
 - (b) procures the appointment as *custodian* of its *customers' monies* or assets of an *associate* of the *firm* which is not an *approved bank*.

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

Table 5.2.3(5)(b) POSITION RISK REQUIREMENT

**PART I
CALCULATION OF REQUIREMENT**

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

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

**PART II
WEIGHTINGS**

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

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

F Determination of disallowed value of units

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

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

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

Equities:

USA, Japan, Canada 5%

Europe 6%

Far East and other 10%

Note

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

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

Note

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

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

1 Receivables

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

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

A = the amount of the sum due; and

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

Note

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

Note

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

2 Delivery of cash against documents

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

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

SP = agreed settlement price;

MV = current market value;

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

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

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

for reverse repos/stock borrowing:

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

6 otc derivatives

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

CRR = A x RF, where

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

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

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

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

Table 5.2.3(5)(c)(i)

COUNTERPARTY RISK FACTOR – CASH SETTLEMENTS

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

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

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

Table 5.2.3(5)(c)(iii)

OTC DERIVATIVES CALCULATION OF CREDIT EQUIVALENT AMOUNT

- A** By attaching current market values to contracts (marking to market), obtain the current replacement cost of all contracts with positive values.
- B** To obtain a figure for potential future credit exposure, the notional principal amounts or values underlying the *firm's* aggregate positions are multiplied by the following percentages:

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

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

Note

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

Table 5.2.3(5)(d) FOREIGN EXCHANGE REQUIREMENT

Calculation of Requirement

- (1) A firm's foreign exchange requirement is determined by calculating the excess of its foreign exchange position (FEP) above 2 per cent of its own funds and multiplying this excess by 8 per cent.
- (2) The FEP is the greater of:
 - (a) the total in the reporting currency of the net short positions in each currency other than the reporting currency; and
 - (b) the total in the reporting currency of the net long positions in each currency other than the reporting currency;

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

Note

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

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

EXCHANGE POSITION FOR HEDGING PURPOSES

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

Table 5.2.3(5)(e) OTHER ASSETS REQUIREMENT

**PART I
CALCULATION OF REQUIREMENT**

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

A = AV x RF where

A = the amount of the requirement;

AV = the current asset value; and

RF = the appropriate risk factor derived from Part II of this Table.

**PART II
RISK FACTORS**

Assets and Off-Balance Sheet Items	Risk Factor
---	--------------------

Assets

Cash at bank and in hand and equivalent items Assets secured by acceptable collateral including deposits and certificates of deposit with lending institutions	NIL
---	-----

Amount due from trustees of authorised unit trusts	NIL
---	-----

Note

This only applies to *firms* who are *authorised unit trust managers*.

Other receivables due from or explicitly guaranteed by or deposits with <i>category a</i> <i>bodies</i>	NIL
---	-----

Other receivables due from or explicitly guaranteed by or deposits with <i>category b</i> <i>bodies</i>	1.6%
---	------

Pre-payments and accrued income (See paragraph 10 of Part II of Table 5.2.2(1))	8%
All other assets	8%
OFF-BALANCE SHEET ITEMS	
Full Risk Items e.g.	
Charges granted against assets	8% x counterparty weight (see Table 5.2.3(5)(c)(ii))
Guarantees given	
Medium Risk Items e.g.	
Undrawn credit facilities granted by the <i>firm</i> with an original maturity of more than one year	4% x counterparty weight (see Table 5.2.3(5)(c)(ii))
Low Risk Items e.g.	
Undrawn credit facilities granted by the <i>firm</i> with an original maturity of one year or less	Nil

Note

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

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

5.3.1 RECORDS

RECORDING REQUIREMENTS

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

FIRM'S OWN TRANSACTIONS

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

CUSTOMERS' ACCOUNTING RECORDS

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

- (4) disclose the assets and liabilities of a *firm's customers* individually and collectively, to the extent that they are managed by the *firm*;
- (5) record all *customers' assets* (including *customer investments*) in the possession of the *firm* or of another person who is holding such assets for, or to the order of, the *firm*, showing the location of the assets, their beneficial owner and the extent to which they are subject to any charge of which the *firm* has been notified.

5.3.1(5) G The requirement to maintain adequate records of movements and holdings of *client money* and any interest paid on *client money* balances, are set out in COB 9.3.

RETENTION OF ACCOUNTING RECORDS

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

5.5.1 FINANCIAL NOTIFICATION

NOTIFICATION REQUIREMENTS FOR ISD FIRMS

5.5.1(1) R An *ISD firm* must notify *the FSA* in writing as soon as it has reason to believe that any of the following has occurred:

- (a) a counterparty in a repo or reverse repo transaction or a securities lending or borrowing transaction has defaulted; or
- (b) the *firm* is in breach of the requirement to maintain *own funds* in excess of its *own funds requirement*; or
- (c) it is in breach of the large exposures limits set out in rule 5.2.7(3).

5.7.1 CONSOLIDATED SUPERVISION

APPLICATION OF CONSOLIDATION

5.7.1(1) R A *firm* will be subject to *consolidated supervision* by *the FSA* unless rule 5.7.1(2) or (3) applies.

CASES WHERE CONSOLIDATED SUPERVISION BY *THE FSA* WILL NOT APPLY

- 5.7.1(2) R A *firm* will not be subject to consolidated supervision where either of the following conditions are fulfilled:
- (a) the *financial resources rules* do not apply to the *firm* by virtue of Table 5.1.1(1)(a); or
 - (b) the *firm* is included in the supervision on a consolidated basis of the group of which it is a member by another *competent authority*.
- 5.7.1(3) R A *firm* will not be subject to consolidated supervision if:
- (a) each member of the group which is an *ISD firm* or a *European investment firm*:
 - (i) is subject either to a *liquid capital requirement* in accordance with rule 5.2.3(1), or to an equivalent capital regime;
 - (ii) complies with its *financial resources requirement* and the *large exposures* requirements set out in rules 5.2.7(2) to (5), or with the equivalent rules of its regulator; and
 - (iii) has systems to monitor and control the sources of capital and funding of all other *financial institutions* within the group;
 - (b) each member of the group which is regulated by *the FSA* notifies *the FSA* of any serious risks that could undermine the financial stability of the group, and follows any corrective action required by *the FSA*; and
 - (c) the *firm* has applied for and obtained from *the FSA* a waiver from rule 5.7.1(1).

OBLIGATION TO PROVIDE INFORMATION

- 5.7.1(4) R A *firm* which is subject to rule 5.7.1(1) must provide such information as is required to enable *the FSA* to assess the risks to which the *firm* may be subject as a member of the group of which it is a member.

APPENDIX 1 (INTERPRETATION)

GLOSSARY OF TERMS FOR CHAPTER 5 (FORMER IMRO FIRMS)

The following words or terms throughout Chapter 5 are to have the meanings given to them below if not inconsistent with the subject or context. If a defined term does not appear in the Chapter 5 glossary below, the definition appearing in the Glossary annexed to the General Provisions Instrument 2001 ("the *Glossary*") applies.

Term	Meaning
<i>accepting deposits</i>	means the <i>regulated activity</i> , specified in article 5 of the <i>Regulated Activities Order (Accepting deposits)</i> , which is in summary: <i>accepting deposits</i> if: (a) money received by way of <i>deposit</i> is lent to others; or (b) any other activity of the person accepting the <i>deposit</i> is financed, wholly or to a material extent, out of the capital of or interest on money received by way of <i>deposit</i> .
<i>accounting reference date</i>	means: (a) the date to which a <i>firm's</i> accounts are prepared in order to comply with the <i>Companies Act</i> or, in the case of a <i>firm</i> not subject to the <i>Companies Act</i> , the equivalent date selected by the <i>firm</i> ; and (b) in the case of an <i>OPS firm</i> which is not subject to the <i>Companies Act</i> , the date to which the accounts of the <i>OPS</i> in respect of which the <i>firm</i> acts are prepared.
<i>Act</i>	means the Financial Services and Markets Act 2000.
<i>advice or advising on investments</i>	means the <i>regulated activity</i> , specified in article 53 of the <i>Regulated Activities Order (Advising on investments)</i> , which is in summary: advising a person if the advice is (a) given to the person in his capacity as an investor or potential investor, or in his capacity as agent for an investor or a potential investor; and (b) advice on the merits of his doing any of the following (whether as principal or agent): (i) buying, selling, subscribing for or underwriting a particular <i>investment</i> which is a <i>designated investment</i> , or (ii) exercising any right conferred by such an <i>investment</i> to buy, sell, subscribe for or underwrite such an <i>investment</i> .
<i>admission procedures</i>	means the procedures set out in the Authorisation Manual together with any other procedures which the <i>Board</i> resolves, either generally or in relation to any specific case, should apply to the admission of <i>firms</i> and the admission of <i>approved persons</i> .
<i>ancillary activity</i>	means an activity that is not a <i>regulated activity</i> but is: (a) carried on in connection with a <i>regulated activity</i> ; or (b) held out as being for the purposes of a <i>regulated activity</i> .
<i>annual accounts</i>	means accounts prepared to comply with the <i>Companies Act</i> or other statutory obligations.
<i>annual audited expenditure</i>	has the meaning given in rule 5.2.4(1) (Determination).
<i>annual financial return</i>	means the return referred to in the Supervision Manual.
<i>appointed representative</i>	(in accordance with section 39 of the <i>Act</i>) a <i>person</i> (other than an <i>authorised person</i>) who: (a) is a party to a contract with an <i>authorised person</i> (his <i>principal</i>) which: (i) permits or requires him to carry on business of a description prescribed in the Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001 (SI

2001/1217); and

(ii) complies with such requirements as are prescribed in those Regulations; and

(b) is someone for whose activities in carrying on the whole or part of that business his *principal* has accepted responsibility in writing;

and who is therefore an *exempt person* in relation to any *regulated activity* comprised in the carrying on of that business for which his *principal* has accepted responsibility.

approved bank

(in relation to a bank account opened by a *firm*):

(a) if the account is opened at a branch in the *United Kingdom*:

(i) the Bank of England; or

(ii) the central bank of a member state of the *OECD*; or

(iii) a *bank*; or

(iv) a *building Society* which offers, unrestrictedly, banking services; or

(v) a bank which is supervised by the central bank or other banking regulator of a member state of the *OECD*; or

(b) if the account is opened elsewhere:

(i) a bank in (a); or

(ii) a *credit institution* established in an *EEA* state other than the *United Kingdom* and duly authorised by the relevant *Home State regulator*; or

(iii) a bank which is regulated in the Isle of Man or the Channel Islands; or

(c) a bank supervised by the South African Reserve Bank; or

(d) any other bank that:

(i) is subject to regulation by a national banking regulator;

(ii) is required to provide audited accounts;

(iii) has minimum net assets of £5million (or its equivalent in any other currency at the relevant time) and has a surplus revenue over expenditure for the last two financial years; and

(iv) has an annual audit report which is not materially qualified.

approved person

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

associate

in relation to person ("A"), means:

(a) an undertaking in the same *group* as A;

(b) an *appointed representative* of A or of any undertaking in the same *group* as A; and

(c) any other person whose business or domestic relationship with A or its *associate* might reasonably be expected to give rise to a community of interest between them which may involve a conflict of interest in dealings with third parties.

authorised corporate director

means the *director* of an *ICVC* who is the authorised corporate director of the *ICVC* in accordance with CIS 7.2.1R (The directors).

authorised person

as defined in section 31 of the *Act* (*Authorised persons*), means one of the following persons authorised for the purposes of the *Act*:

(a) a person who has a Part IV permission to carry on one or more *regulated activities*;

(b) an *EEA firm* qualifying for authorisation in accordance with Schedule 3 to the *Act* (*EEA Passport Rights*);

(c) an *incoming Treaty firm*;

	(d) a <i>UCITS qualifier</i> ;
	(e) an <i>ICVC</i> ;
	(f) a person who is otherwise authorised by a provision of, or made under the <i>Act</i> .
<i>authorised unit trust manager</i>	means the manager of an <i>authorised unit trust scheme</i> .
<i>authorised unit trust scheme</i>	(as defined in section 237(3) of the <i>Act</i> (Other definitions)), means a <i>unit trust scheme</i> which is authorised for the purposes of the <i>Act</i> by an authorisation order.
<i>best execution</i>	in relation to the effecting of a transaction, means the effecting of that transaction in compliance with COB 7.5.
<i>Board</i>	means the board of <i>directors</i> of <i>FSA</i> or any duly authorised committee of such board.
<i>body corporate</i>	means any body corporate, including a body corporate constituted under the law of a country or territory outside the <i>United Kingdom</i> , in accordance with section 417(1) (Definitions) of the <i>Act</i> .
<i>branch</i>	means: <ul style="list-style-type: none"> (a) in relation to a <i>credit institution</i>, a place of business which forms a legally dependent part of a <i>credit institution</i> and which carries out directly all or some of the transactions inherent in the business of <i>credit institutions</i>; (b) in relation to an <i>investment firm</i>, a place of business which is a part of an <i>investment firm</i>, not being the principal place of business, which has no separate legal personality and which provides <i>investment services</i> for which the <i>investment firm</i> has been authorised; (c) for the purposes of the <i>ISD</i>, all the places of business set up in the same <i>member state</i> by an <i>investment firm</i> with headquarters in another <i>member state</i> are to be regarded as a single <i>branch</i>.
<i>category a body</i>	means: <ul style="list-style-type: none"> (a) the government or central bank of a <i>zone a country</i>; or (b) the European Communities; or (c) the government or central bank of any other country, provided the receivable in question is denominated in that country's national currency.
<i>category b body</i>	means: <ul style="list-style-type: none"> (a) the <i>EIB</i> or a multi-lateral development bank; or (b) the regional government or local authority of a <i>zone a country</i>; or (c) an <i>investment firm</i> or <i>credit institution</i> authorised in a <i>zone a country</i>; or (d) a <i>recognised clearing house</i> or <i>exchange</i>; or (e) an <i>investment firm</i> or <i>credit institution</i> authorised in any other country, which applies a financial supervision regime at least equivalent to the Capital Adequacy Directive (No. 93/6/EEC).
<i>certificates representing securities or</i>	the <i>investment</i> specified in article 80 of the <i>Regulated Activities Order</i> (Certificates representing certain securities), which is, in summary: a certificate or other instrument which confers contractual or property rights (other than rights consisting of options):
<i>certificates representing certain securities</i>	(a) in respect of any share, debenture, <i>government and public security</i> or warrant) held by a <i>person</i> other than the person on whom the rights are conferred by the certificate or instrument; and <ul style="list-style-type: none"> (b) the transfer of which may be effected without requiring the consent of that person; but excluding any certificate or other instrument which confers rights in respect of two or more <i>investments</i> issued by different persons or in respect of two or more different <i>government and public securities</i> issued by the same person.
<i>chief executive</i>	means:

	(a) (in relation to a <i>firm</i> whose principal place of business is within the United Kingdom) the person who, alone or jointly with one or more others, is responsible under the immediate authority of the <i>directors</i> for the conduct of the whole of its business;
	(b) (in relation to a <i>firm</i> whose principal place of business is outside the United Kingdom) the person who, alone or jointly with one or more others, is responsible for the conduct of its business within the United Kingdom.
<i>client money</i>	means, subject to the <i>Client Money Rules</i> , money of any currency which, in the course of carrying on <i>designated investment business</i> , a <i>firm</i> holds in respect of any <i>investment agreement</i> entered into, or to be entered into, with or for a client or which a <i>firm</i> treats as <i>client money</i> in accordance with the <i>Client Money Rules</i> .
<i>Client Money Rules</i>	COB 9.3.
<i>close relative</i>	as defined in article 3(1) of the <i>Regulated Activities Order</i> (in relation to any person) means: <ul style="list-style-type: none"> (a) his spouse; (b) his children and step-children, his parents and step-parents, his brothers and sisters and his step-brothers and step-sisters; and (c) the spouse of any person within (b).
<i>collective investment scheme (CIS)</i>	a collective investment scheme, as defined in section 235 of the <i>Act</i> (Collective Investment Schemes), which is in summary: <ul style="list-style-type: none"> (a) any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income; and (b) which are not excluded by the Financial Services and Markets Act (Collective Investment Schemes) Order 2001 (SI 2001/1062).
<i>Companies Act</i>	means the Companies Acts 1985 to 1989 and their equivalent in Northern Ireland.
<i>company</i>	means a <i>body corporate</i> or an unincorporated association and, where the context permits, includes a partnership.
<i>competent authority</i>	means, in relation to a <i>member state</i> , an authority designated by that state to carry out the supervisory functions provided for in the <i>ISD</i> or the Second Banking Co-ordination Directive (Council Directive 89/646/EEC).
<i>compliance officer</i>	means the individual from time to time appointed by a <i>firm</i> as responsible for compliance matters.
<i>connected company and connected credit institution</i>	means, in relation to a <i>firm</i> which: <ul style="list-style-type: none"> (a) is a <i>body corporate</i>, a <i>body corporate</i> or <i>credit institution</i> satisfying any of the following conditions: <ul style="list-style-type: none"> (i) the same person is the <i>controller</i> of each <i>body corporate</i> or <i>credit institution</i>; or (ii) if a <i>group</i> of two or more persons are <i>controllers</i> of each <i>body corporate</i> or <i>credit institution</i>, the <i>group</i> either consists of the same persons or could be regarded as consisting of the same persons by treating a member of either <i>group</i> as replaced by: <ul style="list-style-type: none"> (A) that member's <i>close relative</i>; or (B) a person with whom the member is in partnership; or (C) a <i>body corporate</i> of which the member is an officer; or (iii) both <i>bodies corporate</i> are members of the same <i>group</i>; or (b) is not a <i>body corporate</i> or <i>credit institution</i> which is controlled: <ul style="list-style-type: none"> (i) by the <i>firm</i>; or

- (ii) by a partner in the *firm*; or
- (iii) by a *close relative* or partner in the *firm* or, if the *firm* is a sole trader, by a *close relative* of the sole trader; or
- (iv) collectively by any of the partners in the *firm* or their *close relatives*.

consolidated supervision means, in relation to a *firm* which is a member of a *group*, the application of Chapter 5 of the Interim Prudential Sourcebook to:

- (a) that *firm* on a solo basis; and
- (b) that *firm* and any other member of that *group* of which the *firm* is a member on a consolidated basis.

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

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

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

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

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

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

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

and in this definition

(A) "person" means:

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

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

- (a) the spouse of H
- (b) a child or stepchild of H (if under 18);
- (c) the trustee of any settlement under which H has a life interest in possession (or in Scotland a life interest);

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

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

corporate finance business means:

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

the interests of another person with or for whom the *firm*, or another *authorised person* or *overseas person*, is undertaking business as specified in (a)(i),(ii),(iii) or (iv), by himself undertaking all or part of any transactions involved in such business;

- (vi) any person undertaking business with or for a person as specified in (a)(i), (ii), (iii), (iv) or (v) in respect of activities described in those sub-paragraphs;
- (b) *designated investment business* carried on by a *firm* as a *principal* for its own account where such *business*:
 - (i) is in the course of, or arises out of, activities undertaken in accordance with (a); and
 - (ii) does not involve transactions with or for, or *advice* to, any other person who is a *private customer* in respect of such business;
- (c) *designated investment business* carried on by a *firm* as *principal* for its own account if such *business*:
 - (i) is in the course of, or arises out of:
 - (A) the offer, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, shares, share warrants, *debentures* or debenture warrants issued by the *firm*, or any related matter; or
 - (B) a proposed or actual *takeover or related operation* by or on behalf of the *firm*, or involving shares, share warrants, *debentures* or debenture warrants issued by the *firm*; or
 - (C) a merger, de-merger, reorganisation or reconstruction involving any shares, share warrants, *debentures* or debenture warrants issued by the *firm*; and
 - (ii) does not involve giving *advice on investments* to any person who is a *private customer*; in this definition, “share warrants” and “debenture warrants” means any *warrant* which relates to shares in the *firm* concerned or, as the case may be, *debentures* issued by the *firm*.

counterparty means any person with or for whom a *firm* carries on *regulated business* or an *ancillary activity*.

counterparty risk requirement has the meaning given in Table 5.2.3(5)(c) (Counterparty risk requirement).

credit institution (as defined in article 1(1) of the Banking Consolidation Directive No. 2000/12/EEC) means an undertaking whose business is to receive *deposits* or other repayable funds from the public and to grant credits for its own account.

custodian means:

- (a) an *approved bank*;
- (b) an approved *depository*;
- (c) a member of a *recognised investment exchange* or *designated investment exchange*;
- (d) a *firm* which is permitted by the *FSA* to conduct safekeeping and administration of *investments*;
- (e) a regulated clearing *firm*;
- (f) where it is not feasible to use a *custodian* in (a) to (e), and there are reasonable grounds to show that a person outside the *United Kingdom*, whose business includes the provision of custodial services, is able to provide such services which are appropriate to the client and in the client's best interest to use, that person.

custody in relation to clients' assets, means safekeeping and administration of *investments*.

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

customer investment means an *investment*, or a document of title or a certificate or other record evidencing title to an *investment*, (other than an *investment* falling within articles 83, 84 and 85 of the *RAO*) which is legally or beneficially owned by a *customer* of a *firm*.

<i>customer transaction</i>	does not include an <i>own account transaction</i> .
<i>debenture</i>	means the investment specified in article 77 of the <i>Regulated Activities Order</i> (Instruments creating or acknowledging indebtedness), which is in summary: any of the following which are not <i>government and public securities</i> : <ul style="list-style-type: none"> (a) debentures; (b) debenture stock; (c) loan stock; (d) bonds; (e) certificates of deposit; (f) any other instruments creating or acknowledging indebtedness.
<i>deposit</i>	means the investment, specified in article 74 and defined in articles 5(2) and 5(3) of the <i>Regulated Activities Order</i> , which is, in summary: a sum of money (other than one excluded by any of articles 6 to 9 of the <i>Regulated Activities Order</i>) paid on terms: <ul style="list-style-type: none"> (a) under which it will be repaid, with or without interest or a premium, and either on demand or at a time or in circumstances agreed by or on behalf of the person making the payment and the person receiving it; and (b) which are not referable to the provision of property (other than currency) or services or the giving of security; <p>in this definition, money is paid on terms which are referable to the provision of property or services or the giving of security if, and only if:</p> <ul style="list-style-type: none"> (a) it is paid by way of advance or part payment under a contract for the sale, hire or other provision of property or services, and is repayable only in the event that the property or services is or are not in fact sold, hired or otherwise provided; or (b) it is paid by way of security for the performance of a contract or by way of security in respect of loss which may result from the non-performance of a contract; or (c) without prejudice to (b), it is paid by way of security for the delivery up or return of any property, whether in a particular state of repair or otherwise.
<i>depository</i>	<ul style="list-style-type: none"> (1) (in relation to an <i>ICVC</i>) the <i>person</i> to whom is entrusted the safekeeping of all of the <i>scheme property</i> of the <i>ICVC</i> and who has been appointed for this purpose in accordance with regulation 5 (Safekeeping of scheme property by depository) of and Schedule 1 (Depositaries) to the <i>OEIC Regulations</i>. (2) (in relation to an <i>AUT</i>) the <i>trustee</i>. (3) (in relation to any other <i>unit trust scheme</i>) the <i>person</i> holding the property of the <i>scheme</i> on trust for the <i>participants</i>. (4) (in relation to any other <i>collective investment scheme</i>) any <i>person</i> to whom the property subject to the <i>scheme</i> is entrusted for safekeeping.
<i>designated investment</i>	see the meaning given to the term in the <i>Glossary</i>
<i>designated investment business</i>	see the meaning given to the term in the <i>Glossary</i>

<i>designated investment exchange</i>	see the meaning given to the term in the <i>Glossary</i>
<i>director</i>	<p>means, in relation to the following (whether constituted in the <i>United Kingdom</i> or under the law of a country or territory outside it):</p> <p>(a) an unincorporated association;</p> <p>(b) a <i>body corporate</i>;</p> <p>any person appointed to direct its affairs, including a person who is a member of its governing body and (in accordance with section 417(1) of the Act):</p> <p>(i) a person occupying in relation to it the position of a director (by whatever name called) and</p> <p>(ii) a person in accordance with whose directions or instructions (not being advice given in a professional capacity) the directors of that body are accustomed to act.</p>
<i>EEA</i>	means the European Economic Area.
<i>EEA firm</i>	<p>(in accordance with paragraph 5 of Schedule 3 to the Act (EEA Passport Rights)): means any of the following, if it does not have its head office in the <i>United Kingdom</i>:</p> <p>(a) an <i>investment firm</i> (as defined in Article 1(2) of the <i>Investment Services Directive</i>) which is authorised (within the meaning of article 3) by its <i>Home State regulator</i>;</p> <p>(b) a <i>credit institution</i> which is authorised (within the meaning of article 1) by its <i>Home State regulator</i>;</p> <p>(c) a financial institution (as defined in Article 1 of the Banking Consolidation Directive (No. 2000/12/EEC)) which is a subsidiary of the kind mentioned in article 19 and which fulfils the conditions in articles 18 and 19;</p> <p>(d) an undertaking pursuing the activity of direct insurance (within the meaning of Article 1 of the First Life Directive (No. 79/267/EEC) or of the First Non-Life Directive (No. 73/239/EEC)) which has received authorisation under article 6 from its <i>Home State regulator</i>.</p>
<i>EEA right</i>	<p>(in accordance with paragraph 7 of Schedule 3 to the Act (EEA Passport Rights)): means the entitlement of a person to establish a <i>branch</i>, or provide services in an <i>EEA State</i> other than that in which he has his head office –</p> <p>(a) in accordance with the Treaty as applied in the <i>EEA</i>; and</p> <p>(b) subject to the conditions of the relevant Single Market Directives.</p>
<i>EEA State</i>	<p>(in accordance with paragraph 8 of Schedule 3 to the <i>Act</i> (EEA Passport Rights)) a State which is a contracting party to the agreement on the European Economic Area signed at Oporto on 2 May 1992, as it has effect for the time being; as at 21 June 2001, the following are the <i>EEA States</i>: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Liechtenstein, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden and the <i>United Kingdom</i>.</p>
<i>EIB</i>	means the European Investment Bank.
<i>European investment firm</i>	<p>means an <i>incoming EEA firm</i>.</p> <p>Note: A <i>European investment firm</i> is not necessarily a <i>firm</i> for the purposes of the <i>rules</i>.</p>
<i>exempt exposure</i>	<p>means an exposure:</p> <p>(a) to or guaranteed by a central government or central bank of a <i>zone a country</i>; or</p> <p>(b) to or guaranteed by the European Communities; or</p> <p>(c) to a central government or central bank of a <i>zone b country</i> denominated in the national currency of the third party; or</p> <p>(d) secured by securities issued by a central government or central bank of a <i>zone a country</i>, or</p>

- by the European Communities; or
- (e) secured by cash deposited with the *firm* or its *connected credit institution*; or
- (f) secured by certificates of deposit issued by the *firm* or its *connected credit institution* and deposited with one of them; or
- (g) to a *connected company* provided that the *group* is supervised on a consolidated basis in accordance with the Second Consolidated Supervision Directive and the consolidation requirements of the Capital Adequacy Directive (No. 93/6/EEC); or
- (h) with a maturity of one year or less to a *credit institution*, *investment firm*, *recognised third country investment firm*, and *recognised clearing houses* and *recognised investment exchanges* in financial instruments, not constituting their *financial resources*; or
- (i) connected with foreign exchange transactions, incurred in the ordinary course of settlement during the 48 hours following payment; or
- (j) in connection with transactions for the purchase or sale of securities incurred in the ordinary course of settlement during the five working days following payment or delivery of the securities; or
- (k) which is a bill of trade, with a maturity of less than one year, accepted by a *credit institution*; or
- (l) secured by marketable securities provided that such collateral exceeds the market value of the *exposure* by 150 per cent in the case of transactions relating to shares and by 50 per cent in relation to debt securities issued by a *credit institution*, a *member state* regional or local authority, the *EIB*, the *IBRD*, the *IFC*, the *IADB*, the Asian and African Development Banks, the Council of Europe Resettlement Fund, the Nordic Investment Bank and the Caribbean Development Bank.

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

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

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

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

exposure means any of the following:

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

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

financial institution means an undertaking other than a *credit institution*, the principal activity of which is to acquire holdings or to carry on one or more of the activities listed in points 2 to 12 in the Annex to the Second Banking Co-ordination Directive (89/646/EEC).

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

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

<i>requirement</i>	
<i>financial resources rules</i>	has the meaning given in rules 5.2.1 to 5.2.7.
<i>financial return</i>	means <i>annual financial return, quarterly financial return or monthly financial return</i> as the case may be.
<i>firm</i>	means an <i>authorised person</i> .
<i>foreign exchange position</i>	has the meaning given in Table 5.2.3(5)(d) (Foreign exchange requirement).
<i>friendly society</i>	see the meaning given to the term in the <i>Glossary</i> .
<i>FSA</i>	means the Financial Services Authority.
<i>general prohibition</i>	the prohibition imposed by section 19 of the <i>Act</i> (The general prohibition) which states that no <i>person</i> may carry on a <i>regulated activity</i> in the <i>United Kingdom</i> , or purport to do so, unless he is: <ul style="list-style-type: none"> (a) an <i>authorised person</i>; or (b) an <i>exempt person</i>.
<i>Glossary</i>	means the Glossary giving the meanings of the defined expressions used in the Handbook.
<i>government and public security</i>	the <i>investment</i> , specified in article 78 of the <i>Regulated Activities Order (Government and public securities)</i> which is in summary: a loan stock, bond or other instrument creating or acknowledging indebtedness, issued by or on behalf of any of the following: <ul style="list-style-type: none"> (a) the government of the <i>United Kingdom</i>; or (b) the Scottish Administration; or (c) the Executive Committee of the Northern Ireland Assembly; or (d) the National Assembly of Wales; or (e) the government of any country or territory outside the <i>United Kingdom</i>; or (f) a local authority in the <i>United Kingdom</i> or elsewhere; or (g) a body the members of which comprise: <ul style="list-style-type: none"> (i) states including the <i>United Kingdom</i> or another <i>EEA State</i>; or (ii) bodies whose members comprise states including the <i>United Kingdom</i> or another <i>EEA State</i>; but excluding: <ul style="list-style-type: none"> (a) the instruments specified in article 77(2)(a) to (d) of the <i>Regulated Activities Order</i>; (b) any instrument creating or acknowledging indebtedness in respect of: <ul style="list-style-type: none"> (i) money received by the Director of Savings as <i>deposits</i> or otherwise in connection with the business of the National Savings Bank; or (ii) money raised under the National Loans Act 1968 under the auspices of the Director of Savings or treated as so raised under section 11(3) of the National Debt Act 1972.
<i>group</i>	see the meaning given to the term in the <i>Glossary</i>
<i>holding company</i>	(as defined in sub-section 736(1) of the Companies Act 1985) (in relation to another body corporate ("S")), means a body corporate which: <ul style="list-style-type: none"> (a) holds a majority of the voting rights in S; or (b) is a member of S and has the right to appoint or remove a majority of its board of directors; or (c) is a member of S and controls alone, under an agreement with other shareholders and members, a majority of the voting rights in S.
<i>Home State</i>	means:

- (a) if the *investment firm* is a natural person, the *EEA State* in which its head office is situated;
- (b) if the *investment firm* is a legal person, the *EEA State* in which the registered office is situated or, if under its national law it has no registered office, the *EEA State* in which its head office is situated.

<i>Home State regulator</i>	means: <ul style="list-style-type: none"> (a) (in relation to an <i>EEA firm</i>) (as defined in paragraph 9 of Schedule 3 to the <i>Act</i> (EEA Passport Rights)) the <i>competent authority</i> (under the relevant <i>Single Market Directive</i>) of an <i>EEA State</i> (other than the <i>United Kingdom</i>) in relation to the <i>EEA firm</i> concerned. (b) (in relation to a <i>UK firm</i>) the <i>FSA</i>. (c) (in relation to a <i>Treaty firm</i>) (as defined in paragraph 1 of Schedule 4 to the <i>Act</i> (Treaty Rights)) the competent authority of the <i>firm's Home State</i> for the purpose of its <i>Home State</i> authorisation.
<i>Host State</i>	means the <i>EEA State</i> in which an <i>EEA firm</i> , a <i>UK firm</i> or a <i>Treaty firm</i> is exercising rights to establish a <i>branch</i> or provide cross-border services.
<i>IADB</i>	means the Inter-American Development Bank.
<i>IBRD</i>	means the International Bank for Reconstruction and Development.
<i>ICVC</i>	means a UK corporate fund which is an ICVC, as defined in the <i>Glossary</i> ..
<i>(investment company with variable capital)</i>	
<i>IFC</i>	means the International Finance Corporation.
<i>incoming EEA firm</i>	see the meaning given to the term in the <i>Glossary</i>
<i>investigation</i>	means an investigation authorised pursuant to the Enforcement Manual.
<i>investment</i>	means a <i>designated investment</i> .
<i>investment agreement</i>	means any agreement the making or performance of which by either party constitutes a <i>regulated activity</i> , but disregarding the exclusions in Part II of the <i>Regulated Activities Order</i> .
<i>investment business</i>	means <i>designated investment business</i> .
<i>investment firm</i>	see the meaning given to the term in the <i>Glossary</i> Note: An <i>investment firm</i> is not necessarily a <i>firm</i> for the purposes of the rules.
<i>investment management firm</i>	see the meaning given to the term in the <i>Glossary</i>
<i>investment manager</i>	means a person who, acting only on behalf of a <i>customer</i> , either: <ul style="list-style-type: none"> (a) manages an account or portfolio in the exercise of discretion; or (b) has accepted responsibility on a continuing basis for advising on the composition of the account or portfolio.
<i>investment services</i>	means activities undertaken in the course of carrying on <i>designated investment business</i> or undertaken as an <i>ISA manager</i> .
<i>investment trust</i>	means a <i>company</i> listed in the <i>United Kingdom</i> or another <i>EEA State</i> which is: <ul style="list-style-type: none"> (a) approved by the Inland Revenue Commissioners under section 842 of the Income and Corporation Taxes Act 1988 (or, in the case of a newly formed <i>company</i>, has declared its intention to conduct its affairs so as to obtain such approval); or (b) resident in another <i>member state</i> and would qualify for such approval if resident and listed in the <i>United Kingdom</i>.
<i>investment trust</i>	means a dealing service (whether or not held within a <i>pension contract</i>) dedicated to the securities

<i>savings scheme</i>	of a particular <i>investment trust</i> or of <i>investment trusts</i> within a particular <i>marketing group</i> , and references to an <i>investment trust savings scheme</i> include references to securities to be acquired through that scheme.
<i>ISA</i>	means an individual savings account within the meaning of the Individual Savings Account Regulations 1998 (SI 1998/1870).
<i>ISA cash deposit</i>	means a cash deposit within Regulation 8 of the Individual Savings Account Regulations 1998 (SI 1998/1870) which is held within a cash component ISA.
<i>ISA manager</i>	means a person who is approved by the Inland Revenue Commissioners for the purposes of the Individual Savings Account Regulations 1998 (SI 1998/1870) as an account manager.
<i>ISD or Investment Services Directive</i>	means the Council Directive of 10 May 1993 on investment services in the securities field (No. 93/22/EEC).
<i>ISD firm</i>	means a <i>firm</i> which is a <i>UK authorised investment firm</i> .
<i>ISD investment services</i>	means <i>core investment services</i> and <i>non-core investment services</i> .
<i>life policy</i>	(in accordance with the definition of "qualifying contract of insurance" in article 3(1) of the <i>Regulated Activities Order</i>) means a <i>long-term insurance contract</i> (which includes a pension policy) other than a reinsurance contract and a pure protection contract.
<i>liquid capital</i>	has the meaning given in rule 5.2.2(2) and Table 5.2.2(1)(Calculation of own funds and liquid capital).
<i>liquid capital requirement</i>	has the meaning given in rule 5.2.3(4) (a) to (c) (Liquid capital requirement).
<i>long term insurance contract</i>	means, in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation: general), any contract of insurance within Part II of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of long term insurance), namely: <ul style="list-style-type: none"> (a) Life and Annuity (paragraph I); (b) Marriage and birth (paragraph II); (c) Linked long term (paragraph III); (d) Permanent health (paragraph IV); (e) Tontines (paragraph V); (f) Capital redemption (paragraph VI); (g) Pension fund management (paragraph VII) (h) Collective insurance etc (paragraph VIII); (i) Social insurance (paragraph IX).
<i>marketable investment</i>	means: <ul style="list-style-type: none"> (a) an <i>investment</i> which is traded on or under the rules of an exchange; (b) a debt instrument which may be transferred without the consent of the issuer or any other person (including a collateralised mortgage obligation); (c) a commodity; (d) a <i>warrant</i>, option, future or other instrument which entitles the holder to subscribe for or acquire: <ul style="list-style-type: none"> (i) an <i>investment</i> or commodity in (a) to (c); or (ii) any currency; or (iii) any combination of (i) and (ii); (e) a contract for differences (including interest rate and currency swaps) relating to fluctuations in:

	(i) the value or price of an <i>investment</i> or commodity in (a) to (d); or
	(ii) any currency; or
	(iii) the rate of interest in any currency or any index of such rates; or
	(iv) the level of any index which is derived from the prices of an <i>investment</i> or commodity in (a) to (c); or
	(v) any combination of (i) to (iv);
	(f) <i>warrants</i> , options, futures or other instruments entitling the holder to obtain the rights of those contracts in (d) or (e);
	(g) a <i>unit</i> in a <i>regulated collective investment scheme</i> .
<i>market maker</i>	see the meaning given to the term in the <i>Glossary</i>
<i>marketing group</i>	means a group of persons: <ul style="list-style-type: none"> (a) who are allied together (either formally or informally) for the purposes of marketing <i>packaged products</i> of the group; and (b) each of whom, if it holds itself out in the UK as marketing any <i>packaged products</i> to <i>private customers</i>, does so only as an <i>investment manager</i> or in relation to those of the <i>marketing group</i>.
<i>member state</i>	means a member state of the <i>EEA</i> .
<i>monthly financial return</i>	means the return referred to in the Supervision Manual.
<i>non-core investment service</i>	means a service listed in Section C of the Annex to the ISD.
<i>non-private customer</i>	means an <i>intermediate customer</i> .
<i>operator</i>	means: <ul style="list-style-type: none"> (a) (in relation to an <i>AUT</i>) the <i>manager</i>; (b) (in relation to an <i>ICVC</i>) that <i>company</i> or, if applicable, the <i>authorised corporate director</i>; (c) (in relation to any other <i>collective investment scheme</i> that is a <i>unit trust scheme</i> with a separate <i>trustee</i>) any person who, under the trust deed establishing the <i>scheme</i>, is responsible for the management of the property held for or within the <i>scheme</i>; (d) (in relation to any other <i>collective investment scheme</i> that is an <i>open-ended investment company</i>) that <i>company</i> or, if applicable any <i>person</i> who, under the constitution or founding arrangements of the <i>scheme</i>, is responsible for the management of the property held for or within the <i>scheme</i>; (e) (in relation to an <i>investment trust savings scheme</i>) any <i>person</i> appointed, by those responsible for managing the property of the <i>investment trust</i>, to manage the <i>investment trust savings scheme</i>.
<i>OPS or occupational pension scheme</i>	means any scheme or arrangement which is comprised in one or more instruments or agreements and which has, or is capable of having, effect in relation to one or more descriptions or categories of employment so as to provide benefits, in the form of pensions or otherwise, payable on termination of service, or on death or retirement, to or respect of earners with qualifying service in an employment of any such description or category.
<i>OPS activity</i>	see the meaning given to the term in the <i>Glossary</i>
<i>OPS firm</i>	see the meaning given to the term in the <i>Glossary</i>
<i>ordinary business investor</i>	means: <ul style="list-style-type: none"> (a) a government, local authority or international organisation; (b) a <i>company</i> or partnership which satisfies (or which has satisfied at any time during the

previous two years) any of the following size requirements:

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

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

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

otc derivative means interest rate and foreign exchange contracts covered by Annex II to the Solvency Ratio Directive and off balance sheet contracts based on equities which are not traded on a *recognised* or *designated investment exchange* or other exchange where they are subject to daily margin requirements, excluding any foreign exchange contract with an original maturity of 14 calendar days or less.

other assets requirement has the meaning given in Table 5.2.3(5) (e) (Other assets requirement).

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

own account transaction means a transaction executed by the *firm* for its own benefit or for the benefit of its *associate*.

own funds has the meaning given in rule 5.2.2(1) (Own funds) and Table 5.2.2(1) (Calculation of own funds and liquid capital).

own funds requirement has the meaning given in rule 5.2.3(3) (a) and (b) (Own funds requirement).

own funds return see paragraph 2(b) of Part II of Table 5.2.3(3)(b) (Own funds requirement).
Note: Copies of this return are available on request from *FSA* (Own funds requirement).

own funds transitional provisions means the provisions of Part II of Table 5.2.3(3)(b) (Own funds requirement).

packaged product means:

- (a) a *life policy*;
- (b) a unit in a *regulated collective investment scheme*;
- (c) an interest in an *investment trust savings scheme*;
- (d) a stakeholder pension scheme;

whether or not (in the case of (a), (b) or (c)) held within a *PEP* or an *ISA*.

<i>partially exempt exposures</i>	means an <i>exposure</i> which may be reduced: <ul style="list-style-type: none"> (a) by 50 per cent in the case of low or medium risk off balance sheet items including documentary credits in which an underlying shipment acts as collateral, undrawn credit facilities with an original maturity of up to and including one year which may be cancelled unconditionally at any time without notice including agreements to lend, purchase securities, provide guarantees or acceptance facilities; (b) by 80 per cent in the case of <i>exposures</i> to or guaranteed by EC regional or local authorities; (c) for an <i>exposure</i> in a financial instrument to a <i>credit institution</i>, <i>investment firm</i>, <i>recognised third country investment firm</i>, and a <i>recognised clearing house</i> or <i>recognised investment exchange</i>, either <ul style="list-style-type: none"> (i) by 80 per cent if it has a maturity of more than one but not more than three years; or (ii) by 50 per cent (for marketable debt instruments only – 100 per cent otherwise) if it has a maturity of more than three years.
<i>pension contract</i>	means a contract under which rights to benefits are obtained by the making of contributions to an <i>occupational pension scheme</i> or to a personal pension scheme, where the contributions are paid to a <i>regulated collective investment scheme</i> .
<i>PEP</i>	means a Personal Equity Plan within the meaning of the Personal Equity Plan Regulations 1989 (SI 1989/469)
<i>permission</i>	(in accordance with section 20(1) of the <i>Act</i>) permission: <ul style="list-style-type: none"> (a) given by the <i>FSA</i> under Part IV of the <i>Act</i> (Permission to carry on regulated activities); or (b) resulting from any other provision of the <i>Act</i>; to carry on <i>regulated activities</i> in the <i>United Kingdom</i> .
<i>permitted business</i>	means <i>regulated activity</i> which a <i>firm</i> has <i>permission</i> to carry on.
<i>permitted third party</i> or <i>PTP</i>	means a third party who is: <ul style="list-style-type: none"> (a) an <i>authorised person</i>; or (b) an <i>exempt</i> person for whom an <i>authorised person</i> is accepting responsibility; or (c) a person lawfully carrying on a <i>regulated activity</i> in another <i>EEA State</i>.
<i>plan investment</i>	means an <i>investment</i> included in a <i>PEP</i> or in any <i>ISA</i> component.
<i>position risk requirement</i>	has the meaning given in Table 5.2.3(5)(b) (Position risk requirement).
<i>powers of intervention</i>	means <i>FSA</i> 's powers to impose prohibitions and restrictions in accordance with the <i>Act</i> .
<i>prescribed subordinated loan agreement</i>	means the subordinated loan agreement prescribed by the <i>FSA</i> for the purposes of rule 5.2.5(4).
<i>principal</i>	means a person acting on his own account.
<i>qualifying amount</i>	has the meaning given in the Supervision Manual.
<i>qualifying capital instrument</i>	means that part of a <i>firm</i> 's capital which is a security of indeterminate duration, or other instrument, that fulfils the following conditions: <ul style="list-style-type: none"> (a) it may not be reimbursed on the bearer's initiative or without the prior agreement of <i>FSA</i>; (b) the debt agreement must provide for the <i>firm</i> to have the option of deferring the payment of interest on the debt; (c) the lender's claims on the <i>firm</i> must be wholly subordinated to those of all non-subordinated creditors; (d) the documents governing the issue of the securities must provide

	for debt and unpaid interest to be such as to absorb losses, whilst leaving the <i>firm</i> in a position to continue trading; and
	(e) only fully paid-up amounts shall be taken into account.
<i>qualifying capital item</i>	means that part of a <i>firm</i> 's capital which has the following characteristics: <ul style="list-style-type: none"> (a) it is freely available to the <i>firm</i> to cover normal banking or other risks where revenue or capital losses have not yet been identified; (b) its existence is disclosed in internal accounting records; and (c) its amount is determined by the management of the <i>firm</i> and verified by independent auditors, and is made known to, and is monitored by, <i>FSA</i>. <p>Note: Verification by internal auditors will suffice until such time as EU provisions making external auditing mandatory have been implemented.</p>
<i>qualifying property</i>	has the meaning given in rule 5.2.6(1) (Qualifying property and qualifying amount defined).
<i>qualifying subordinated loan</i>	has the meaning given in rule 5.2.5 (1) to (7) (Qualifying subordinated loans).
<i>qualifying undertaking</i>	has the meaning given in rule 5.2.6(3) (Qualifying undertakings).
<i>quarterly financial return</i>	means the return referred to in the Supervision Manual.
<i>RAO or Regulated Activities Order</i>	means the Financial Services and Markets Act (Regulated Activities) Order 2001 (SI 2001/544).
<i>readily realisable investment</i>	means a unit in a <i>regulated collective investment scheme</i> , a <i>life policy</i> or any <i>marketable investment</i> other than one which is traded on or under the rules of a <i>recognised</i> or <i>designated investment exchange</i> so irregularly or infrequently: <ul style="list-style-type: none"> (a) that it cannot be certain that a price for that <i>investment</i> will be quoted at all times; or (b) that it may be difficult to effect transactions at any price which may be quoted.
<i>recognised clearing house</i>	means a clearing house which is declared by a recognition order made under section 290 or 292 of the <i>Act</i> for the time being in force to be a recognised clearing house.
<i>recognised investment exchange</i>	means an investment exchange which is declared by a recognition order made under section 290 or 292 of the <i>Act</i> for the time being in force to be a recognised investment exchange.
<i>recognised overseas clearing house</i>	means an <i>overseas clearing house</i> which is declared by a recognition order made under section 290 or 292 of the <i>Act</i> for the time being in force to be a <i>recognised clearing house</i> .
<i>recognised overseas investment exchange</i>	means an <i>overseas investment exchange</i> which is declared by a recognition order made under section 290 or 292 of the <i>Act</i> for the time being in force to be a <i>recognised investment exchange</i> .
<i>recognised scheme</i>	means a scheme recognised under: <ul style="list-style-type: none"> (a) section 264 of the <i>Act</i> (Schemes constituted in other EEA States); (b) section 270 of the <i>Act</i> (Schemes authorised in designated countries or territories); or (c) section 272 of the <i>Act</i> (Individually recognised overseas schemes).
<i>recognised third country investment firm</i>	means an <i>investment firm</i> which is authorised in a country other than a <i>member state</i> and which is subject to and complies with prudential rules equivalent to the requirements of the Capital Adequacy Directive ((No. 93/6/EEC). <p>Note: A <i>recognised third country investment firm</i> is not necessarily a <i>firm</i> for the purposes of the</p>

rules.

Note: A list of the non-EEA regulators which are approved by FSA for the purposes of recognising *recognised third country investment firms* under the Capital Adequacy Directive is available on request from the FSA.

<i>redemption</i>	in relation to units in an <i>ICVC</i> or an <i>authorised unit trust scheme</i> , means the purchase of them from their holder by the authorised fund manager acting as a <i>principal</i> .
<i>registered individual</i>	means an <i>approved person</i> .
<i>registrable activity</i>	in relation to a <i>firm</i> , means any one of the following: (a) holding the post of <i>director</i> or <i>chief executive</i> ; (b) acting as an <i>investment manager</i> in the course of the <i>permitted business</i> of the <i>firm</i> ; (c) acting in a senior capacity with responsibility either alone or jointly with one or more other individuals for the management, supervision and control of a part of the <i>firm's permitted business</i> (including the <i>compliance officer</i> and the <i>finance officer</i>); (d) procuring or endeavoring to procure other persons to enter into <i>investment agreements</i> , or giving advice to persons with whom he deals about entering into <i>investment agreements</i> or exercising rights conferred by <i>investments</i> , in the course of the <i>permitted business</i> of the <i>firm</i> ; (e) committing the <i>firm</i> or its <i>customers</i> in market dealings or in transactions in <i>securities</i> or in other <i>investments</i> in the course of the <i>firm's permitted business</i> .
<i>registrar</i>	means, in relation to any friendly society or to any self-regulating organisation for friendly societies which has applied for, or been granted, a recognition order made by him, the Chief Registrar of Friendly Societies or, as the case may be, the Registrar of Friendly Societies for Northern Ireland.
<i>regulated activity</i>	see the meaning given to the term in the <i>Glossary</i>
<i>regulated business</i>	means <i>designated investment business</i> .
<i>regulated collective investment scheme</i>	means: (a) an <i>ICVC</i> ; (b) an <i>authorised unit trust scheme</i> ; or (c) a <i>recognised scheme</i> ; whether or not the units are held within a <i>PEP</i> , <i>ISA</i> , or <i>pension contract</i> .
<i>regulated friendly society</i>	means, as respects <i>investment business</i> carried on for or in connection with any of the purposes mentioned in Schedule 1 to the Friendly Societies Act 1974, or, as the case may be, to the Friendly Societies Act (Northern Ireland) 1970, means a society which is a friendly society within the meaning of section 7(1)(a) of the Friendly Societies Act 1974 and is registered within the meaning of that Act or is a friendly society within the meaning of section 1(1)(a) of the Friendly Societies Act (Northern Ireland) 1970 and is registered or deemed to be registered under that Act; and (a) under its rules, has its registered office at a place situated in Great Britain or, as the case may be, Northern Ireland; and (b) carries on <i>investment business</i> in the UK.
<i>relevant foreign exchange items</i>	means: (a) all assets less liabilities, including accrued interest, denominated in the currency (all investments at market or realisable value); (b) any currency future, at the nominal value of the contract; (c) any forward contract for the purchase or sale of the currency, at the contract value, including any future exchange of principal

	associated with currency swaps;
	(d) any foreign currency options at the net delta (or delta-based) equivalent of the total book of such options;
	(e) any non-currency option, at market value;
	(f) any irrevocable guarantee;
	(g) any other off-balance sheet commitment to purchase or sell an asset denominated in that currency.
<i>reporting currency</i>	means the currency in which the <i>firm</i> 's books of account are maintained.
<i>rule or rules</i>	in accordance with section 417(1) of the <i>Act</i> (Definitions), means a rule made by the <i>FSA</i> under the <i>Act</i> , including: <ul style="list-style-type: none"> (a) a Principle; and (b) an evidential provision.
<i>SARs</i>	means the Rules Governing Substantial Acquisition of Shares issued on the authority of the Takeover Panel.
<i>scheme</i>	means a <i>collective investment scheme</i> .
<i>small business investor</i>	means: <ul style="list-style-type: none"> (a) a <i>company</i> or partnership; or (b) a <i>trustee</i> acting for a trust; which does not satisfy a size requirement enabling the <i>company</i> , partnership or <i>trustee</i> to be treated as an <i>ordinary business investor</i> .
<i>sole trader</i>	means an individual who is a <i>firm</i> .
<i>specified trustee business</i>	1. means any <i>investment business</i> carried on in the UK by a <i>trustee firm</i> , but excluding each of the following activities: <ul style="list-style-type: none"> (a) Dealing or arranging deals in investments <ul style="list-style-type: none"> (i) where the deal is transacted or arranged by a <i>trustee firm</i> with or through a <i>PTP</i>; or (ii) where the dealing or arranging is done in the course of, or is incidental to, an activity of management falling within paragraph (b) below; or (iii) where the trust is a <i>unit trust scheme</i> and the deal is or the arrangements are made with a view to either an issue or sale of units in such a <i>scheme</i> to, or a redemption or repurchase or conversion of such units or a dealing in investments for such a <i>scheme</i> carried out by with or through, the <i>operator</i> or on the instructions of the <i>operator</i>; or (iv) where the <i>trustee firm</i>, being a bare trustee (or, in Scotland, a nominee) holding <i>investments</i> for another person, is acting on that person's instructions; or (v) where any arrangements do not or would not bring about the transaction in question. (b) Managing Investments <ul style="list-style-type: none"> (i) where the <i>trustee firm</i> has no general authority to effect transactions in <i>investments</i> at discretion; or (ii) if and to the extent that all day-to-day decisions in relation to the management of the <i>investments</i> or any discrete part

of the *investments* are or are to be taken by a *PTP*; or

- (iii) if and to the extent that investment decisions in relation to the *investments* or any discrete part of the *investments* are or are to be taken substantially in accordance with the advice given by a *PTP*; or
 - (iv) where the *trustee firm* is a personal representative or executor and is acting in that capacity; or
 - (v) where the trust is a *unit trust scheme* and all day-to-day investment decisions in the carrying on of that activity are or are to be taken by the *operator* of the *scheme*.
- (c) **Investment advice**
- (i) where the relevant advice:
 - (A) does not recommend the entry into any investment transaction or the exercise of any right conferred by any *investment* to acquire, dispose of, underwrite or convert such an *investment*; and
 - (B) is accompanied by a recommendation that independent advice be obtained; or
 - (ii) if and to the extent that the relevant advice is in substance the advice of a *PTP*; or
 - (iii) where the relevant advice is given by the *trustee firm* acting in the capacity of personal representative or executor.
- (d) **Establishing, operating or winding up a collective investment scheme including acting as trustee of an authorised unit trust scheme** but only to the extent that such activities do not otherwise constitute *specified trustee business*.
- (e) **Any trustee activity undertaken as trustee of an issue of debentures or government or public securities**
- (i) where the issue is made by a company listed on a *recognised investment exchange* or on a *designated investment exchange* (or by a wholly-owned subsidiary of such a company); or
 - (ii) where the issue is listed or traded either on a *recognised investment exchange* or on a *designated investment exchange* or on the Société de la Bourse de Luxembourg; or
 - (iii) where the issue is made by a government, local authority or international organisation; or
 - (iv) where the aggregate amounts issued (pursuant to the trust deed or any deed supplemental thereto and ignoring any amounts redeemed, repurchased or converted) exceed the sum of £10,000,000.

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

- (a) a transaction is entered into through a person if that person:
 - (i) enters into it as agent; or
 - (ii) arranges for it to be entered into as principal or agent by another person and the arrangements are such that they bring about the transaction in question;

- (b) **investment transaction** means a transaction to purchase, sell, subscribe for or underwrite a particular investment and “investment decision” means a decision relating to an investment transaction;
- (c) **debentures** means any securities falling within article 77 of the *RAO*;
- (d) **government or public securities** means any securities falling within article 78) of the *RAO*;
- (e) *government, local authority or international organisation* means:
 - (i) the government of the *United Kingdom*, of Northern Ireland, or of any country or territory outside the United Kingdom;
 - (ii) a local authority in the *United Kingdom* or Anywhere; or
 - (iii) an international organisation the members of which include the *United Kingdom* or another *EEA State*.
- (f) in determining the size of an issue of debentures or government or public securities made in a currency other than sterling, the amount of the issue shall be converted into sterling at the exchange rate prevailing in London on the date of issue.

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

subsidiary means, as defined in section 736 of the Companies Act 1985, (in relation to another body corporate ("H")), a body corporate of which H is a *holding company*.

Takeover Code means the City Code on Takeovers and Mergers issued by the Takeover Panel.

takeover or related operation means:

- (a) any transaction falling within paragraph 4(b) (Companies and Transactions to which the Code applies) of the introduction to the *Takeover Code*;
- (b) any transaction subject to the *SARs*;
- (c) any transaction which would have fallen within (a) were it not for the fact that the company which is the subject of the transaction does not satisfy the tests set out in paragraph 4(a) (Companies and Transactions to which the *Code* applies) of the introduction to the *Takeover Code* and, for this purpose, an offer for non-voting, non-equity share capital is to be regarded as falling within the *Takeover Code* even if not required by rule 15 of that Code;
- (d) any transaction which would have been subject to the *SARs* but where the shares the subject of the transaction are in a company which does not satisfy the test of residency set out in the second and third paragraphs of Section 2 Scope of the Introduction to the *SARs*;
- (e) any offer, transaction or arrangement relating to the purchase of securities with a view to establishing or increasing a strategic holding of a person, or of a person together with his associates in the securities concerned;
- (f) any transaction or arrangement entered into in contemplation or furtherance of any offer, transaction or arrangement falling within (a) to (e); and
- (g) any transaction or arrangement entered into by way of defence or protection against any offer, transaction or arrangement falling within (a) to (f) which has taken place or which is contemplated.

total capital requirement has the meaning given in rule 5.2.3(5) (Total capital requirement).

trading book in relation to a *firm*'s business or *exposures*, means:

- (a) its proprietary positions in financial instruments:
 - (i) which are held for resale and/or are taken on by the *firm* with the intention of benefiting in the short term from actual and/or expected differences between their buying and selling prices or from other price or interest-rate variations;
 - (ii) arising from matched principal broking;

	(iii) taken in order to hedge other elements of the <i>trading book</i> ;
	(b) <i>exposures</i> due to unsettled securities transactions, free deliveries, <i>OTC derivative</i> instruments, repurchase agreements and securities lending transactions based on securities included in (a)(i) to (iii) above, reverse repurchase agreements and securities borrowing transactions based on securities included in (a)(i) to (iii) above; and
	(c) fees, commission, interest and dividends, and margin on exchange-traded derivatives which are directly related to the items included in (a) and (b) above.
<i>trust beneficiary</i>	means a beneficiary under a trust (not being the settlor) who benefits from the performance by a <i>firm</i> as <i>trustee</i> of <i>investment services</i> relating to the management of the trust assets (in accordance with section 2372 of the <i>Act</i> (Other definitions)).
<i>trustee</i>	(in accordance with section 237(2) of the <i>Act</i> (Other definitions) (in relation to a unit trust scheme) the person holding the property in question on trust for the participants.
<i>trustee activity</i>	means, in relation to a <i>firm</i> , any activity undertaken in the course of or incidental to the exercise of any of its powers, or the performance of any of its duties, when acting in its capacity as a trustee.
<i>trustee firm</i>	means a <i>firm</i> which is not an <i>OPS firm</i> and which is acting as: <ul style="list-style-type: none"> (a) a <i>trustee</i>; or (b) a personal representative.
<i>UCITS qualifier</i>	see the meaning given to the term in the <i>Glossary</i>
<i>UK authorised investment firm</i>	means an <i>investment firm</i> . Note: A <i>UK authorised investment firm</i> is not necessarily a <i>firm</i> for the purposes of the <i>rules</i> .
<i>United Kingdom (UK)</i>	means England and Wales, Scotland and Northern Ireland, but not the Channel Islands or Isle of Man.
<i>unit trust manager</i>	means the manager of a <i>unit trust scheme</i> .
<i>unit trust scheme</i>	(as defined in section 237(1) of the <i>Act</i> (Other definitions)) means a <i>collective investment scheme</i> under which the property in question is held on trust for the participants.
<i>units</i>	means the rights or interests (however described) of the participants in a <i>collective investment scheme</i> .
<i>unregulated collective investment scheme</i>	means a <i>collective investment scheme</i> which is not a <i>regulated collective investment scheme</i> .
<i>venture capital investment</i>	means a <i>designated investment</i> which, at the time the investment is made, is: <ul style="list-style-type: none"> (a) in a new or developing company or venture; (b) in a management buy-out or buy-in; (c) made as a means of financing the investee company or venture and accompanied by a right of consultation, or rights to information, or board representation, or management rights; or (d) acquired with a view to, or in order to facilitate, a transaction falling within (a) to (c).
<i>warrant</i>	means the investment specified in article 79 of the <i>Regulated Activities Order</i> (Instruments giving entitlement to <i>investments</i>), which is, in summary: a <i>warrant</i> or other instrument entitling the holder to subscribe for a share, <i>debenture</i> or government and public security.
<i>zone a country</i>	means a country which is a member of the <i>OECD</i> , or which has negotiated special lending arrangements with the IMF. Note: Countries which currently fall within this definition are Australia, Austria, Belgium,

Bermuda, Canada, Denmark, Finland, France, Germany, Gibraltar, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, The Netherlands, New Zealand, Norway, Portugal, Saudi Arabia, Spain, Sweden, Switzerland, Turkey, UK, Channel Islands, Isle of Man and United States.

Note: For the purpose of determining whether a bank is in a *zone a* or *zone b country*, the place of incorporation is the relevant factor to be considered rather than the location of the branch.

zone b country means a country which is not a *zone a country*.

6 Chapter 6: Service Companies

6.1 APPLICATION

6.1.1 R This chapter applies to *service companies*.

FINANCIAL RESOURCES REQUIREMENTS

6.1.2 R (1) A *service company* must be able to meet its liabilities as they fall due.

(2) In complying with (1) a *firm* may use any assets which are available to meet any of its liabilities.

10 Chapter 10: Financial resources for Securities and Futures Firms which are Investment Firms

10-A R The definitions in the glossary at Appendix 1 apply to this chapter.

APPLICATION

10-B R This chapter applies to a *securities and futures firm* which is an *investment firm* and to a *category D firm*.

G Consequently this chapter does not apply to *lead regulated firms* and *passported institutions* (without a top-up permission).

10-10 Keeping of records

Records to be up-to-date

10-10(1) R A *firm* must keep records in accordance with rules 10-10 to 10-12 on a continual basis so that at all times records are up-to-date or able to be brought up-to-date within a reasonable time.

Adequacy of records

10-10(2) R A *firm* must keep records in such a manner that they are sufficient to show and explain the *firm's* transactions and commitments (whether effected on its own behalf or on behalf of others) and in particular so that these records:

- (a) disclose with reasonable accuracy the financial position of the firm at any point in time within the previous six years when the firm was authorised by the *FSA* or a predecessor regulator;**
- (b) demonstrate whether or not the *firm* is or was at that time complying with its *financial resources requirement*; and**
- (c) enable the *firm* to prepare within a reasonable time any *financial reporting statement* as at the close of business of any date within the previous six years when the *firm* was authorised by the *FSA* or a predecessor regulator, and such that the statement complies with the requirements of the rules of the *FSA*.**

Content of records

10-10(3) A firm must ensure that its records contain as a minimum:

Financial

- (a) entries from day to day of all sums of money received and expended by the *firm* whether on its behalf or on behalf of others, and the matters in respect of which the receipt and expenditure takes place;**
- (b) a record of all income and expenditure of the *firm* explaining its nature;**
- (c) a record of all assets and liabilities of the *firm* including any commitments or *contingent liabilities*;**
- (d) entries from day to day of all purchases and sales of *investments* by the *firm* distinguishing those which are made by the *firm* on its own account and those which are made by or on behalf of others;**
- (e) any working papers necessary to show the preparation of any *reporting statement* or any other periodic return to the *FSA*;**

Risk management

- (m) details of exposure limits for trading positions and counterparty credit limits which are appropriate to the type, nature and volume of business undertaken, in such a way that they are capable of being summarised to enable actual exposures to be measured readily and regularly against these limits;**
- (n) management information records maintained in a manner such that they disclose, or are capable of disclosing, in a prompt and appropriate fashion, the financial and business information which will enable the *firm's* management to:**
 - (i) identify, quantify, *control* and manage the *firm's* risk exposures;**
 - (ii) make timely and informed decisions;**
 - (iii) monitor the performance of all aspects of the *firm's* business on an up-to-date basis;**
 - (iv) monitor the quality of the *firm's* assets; and**

- (v) **safeguard the assets of the *firm*, including assets for which the *firm* is accountable belonging to other persons.**

G The FSA does not consider it possible to prepare an exhaustive and prescriptive list of record keeping requirements applicable to all *firms*. The detailed requirements will vary according to the manner in which the business is structured, organised and managed; its size; and the nature, volume and complexity of its transactions and commitments.

Reconciliation of firm's balances

10-11

Reconciliation

- 10-11(1) R **A *firm* must reconcile all balances with banks or building societies (other than a client bank account subject to the Client Money Rules) as recorded by the *firm* to the balance on the statement issued by the bank or building society and must correct any difference forthwith, unless it arises solely as a result of identified differences in timing between the records of the *firm* and the bank or building society.**
- 10-11(2) R **A *firm* must reconcile all balances and positions with *exchanges*, *clearing houses* and *intermediate brokers* as recorded by the *firm* to the balance or position on a statement or circularisation obtained by the *firm* from the *exchange* etc and must correct any differences by agreement with the *exchange* etc on a timely basis.**
- 10-11(3) R **A *firm* must perform *reconciliations* under (1) and (2) above as frequently as is appropriate for the volume of transactions on the accounts and in any event not less than once every five weeks.**
- 10-11(4) R **A *firm* must reconcile all balances and *securities* positions with each counterparty which is a member of an *exchange* as recorded by the *firm* to the balance or position on a statement or circularisation obtained by the *firm* from the counterparty except to the extent that the balances and *securities* positions due to and from the counterparty have been agreed by other means, and must correct any differences by agreement with the counterparty on a timely basis*.**
- 10-11(5) R **A *firm* must perform *reconciliations* under (4) above as frequently as is appropriate for the volume of transactions on the accounts and in any event not less than once every year.**

* For guidance notes on the *reconciliation* of a *firm's* balances with a *counterparty* which is a member of an *exchange*, see Appendix 20

Response to requests

- 10-11(6) R **A *firm* must use its best endeavours to respond within one month of receipt to any circularisation from another *firm* requesting confirmation of outstanding balances.**

10-12 Nature, accessibility and retention of records

Nature of records

- 10-12(1) R **A *firm* may keep a record in any form provided that the record can be reproduced promptly in hard printed form in English.**

- 10-12(2) R **Where all the records relating to a counterparty are not kept together, a *firm* must ensure that each location where documents relating to that counterparty are retained contains an indication that other records relating to that counterparty exist and how access to them can be obtained.**

- 10-12(3) R **A *firm* may accept and rely on records supplied by a third party so long as those records are capable of being and are reconciled with records held by the *firm*.**

Audit trail

- 10-12(4) R **A *firm* must record the information required by rules 10-10 to 10-13 in such a way as to enable a particular transaction to be identified at any time and traced through the accounting systems of the *firm*, in particular in such a manner as to enable early identification of aggregated transactions and of the particular items which have contributed to those aggregated transactions.**

10-12(5) R Retention of records

- (a) **A *firm* must ensure that all records relating to the current year are arranged, filed and indexed so as to permit prompt access to any particular record.**
- (b) **During the most recent year, a *firm* must keep these records either at a place where the *firm* carries on business or in such a manner that they can be produced at such a place within 24 hours of their being requested and thereafter, within 48 hours.**
- (c) **A *firm* must keep all records required by rules 10-10 to 10-12 for a period of six years after the date on which they are first made or prepared.**

Security of records

- 10-12(6) R** **A firm must have adequate procedures for the maintenance, security, privacy and preservation of records, working papers and other documents of title belonging to the firm or others so that they are reasonably safeguarded against loss, unauthorised access, alteration or destruction.**

Notification requirements for category A, B and C firms

Application

- 10-32(1) R** **This rule applies only to category A, B and C firms.**

Counterparty default on a repurchase transaction etc.

- 10-32(2) R** **A firm must notify the FSA as soon as it has reason to believe that a counterparty with which it has entered into a repurchase, reverse repurchase, securities or physical commodities lending, securities or physical commodities borrowing, sale and buy back or buy and sale back agreement has defaulted on its obligations.**

Large exposures

- 10-32(3) R** **Subject to (7) below, a firm must notify the FSA of the following:**
- (a) at the end of each quarter, all large exposures which have occurred during the preceding quarter, stating the amount of the highest large exposure and the name of the third parties concerned;**
 - (b) as soon as it has reason to believe that it is or will be in breach of the limits specified in rule 10-193, stating the amount and cause of the exposure and the name of the third parties concerned, together with details of the steps which it is taking, or has taken to remedy or prevent the breach.**
- 10-32(5) R** **Subject to (7) below, a firm must notify the FSA:**
- (a) at the end of each quarter, all group large exposures which have occurred during the preceding quarter, stating the amount of the highest large exposure and the third parties involved;**

- (b) as soon as it has reason to believe that it is or will be in breach of the limits specified in rule 10-193, stating the amount and cause of the *exposure* and the name of the third parties involved, together with details of the steps which it is taking, or has taken to remedy or prevent the breach.

10-32(6) R A *firm* which is subject to the waiver from consolidated supervision in accordance with rule 10-204 is exempt from (5) above.

10-32(7) R A *firm* is not required to notify the *FSA* of the following:

- (a) *large exposures* to or guaranteed by *Zone A* central governments and central banks and by the *European Communities*; and
- (b) *large exposures* secured by *securities* issued by *Zone A* central governments and central banks and by the *European Communities*.

Repurchase and reverse repurchase, securities or physical commodities lending and borrowing and sale and buy back agreements

10-41(7) R Where a *firm* has entered into a *repurchase, reverse repurchase, securities or physical commodities* lending, *securities or physical commodities* borrowing, *sale and buy back, or buy and sale back agreement* (whether or not *undocumented*), it must:

- (c) *mark to market* the cash borrowed or lent; except that if the residual maturity of the transaction is less than one month, a *firm* may instead provide for accrued interest on the amount borrowed or lent;

10-41 (7A) R (a) Cash borrowed or lent under a *repurchase or reverse repurchase agreement*, or under any similar agreement in which cash is lent or borrowed against security and at a fixed interest rate, as well as *trading book* deposits and cash borrowings, must be included in the interest rate method as outlined in Rule 10-101(14) and (15).

- (b) If less than one month remains until maturity, a *firm* may choose to omit such transactions from its *PRR* calculations.

Valuation of positions*

- 10-41(9) R** A *firm* must value both *trading book* positions and *non-trading book investment* positions on a prudent and consistent basis, as well as having regard to the liquidity of the instrument concerned and any special factors which may adversely affect the closure of the position, and must adopt the following general policies:
- (a) a position must be valued at its close out price (close out price means that a long position shall be valued at current bid price and a short position at current offer price); where firm two way prices are not available a *firm* must value its position in accordance with the notes to this rule; *
 - (b) where a *firm* has been granted a modification or waiver by the *FSA* to use a risk assessment model in the calculation of its *PRR* on *options* positions (as described in the guidance at 10-82(4) and 10-101(2)), it may value its *options* using the values derived from the model;
 - (c) where a *firm* does not use a model as described in (b) above and prices are not published for its *options* positions, it must determine the *mark to market* value of standard European and American *options* as follows:
 - (i) for purchased *options*, the *mark to market* value must be the *in the money* amount multiplied by the quantity underlying the *option*;
 - (ii) for written *options*, the *mark to market* value must be the sum of:
 - (aa) the *in the money* amount multiplied by the quantity underlying the *option*; and
 - (bb) the initial premium received for the *option*;
- G If a written *option* was *in the money* at the time the contract was written, *in the money* amount in (aa) may be taken to be the current *in the money* amount less the *in the money* amount at the time the contract was written.
- (d) a *firm* must calculate the value of a *swap* contract or an *FRA* having regard to the net present value of the *future* cash flows of the contract, using current interest rates relevant to the periods in which the cash flows will arise.

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

(e) in the case of interest rate swaps, currency swaps and FRAs, a firm may limit the bid/offer valuation required under (a) above to its net position.

- G The FSA does not consider it appropriate to lay down a precise formula for calculating the value of swaps and FRAs. However, it will expect a firm to employ a valuation formula which accords with generally accepted market practice.

Instruments of non-standard form

- 10- 41(10) G If a firm holds a position in an instrument that is not of a standard form, it should seek guidance from the FSA about the valuation treatment which it will apply to that instrument.

Initial Capital and Financial Resources

10-60 FIRMS TO WHICH RULES 10-61 TO 10-204 APPLY

Category A, B and C firms

10-60(1) R Rules 10-61 to 10-204 apply to a *category A, B or C firm*.

Category D firms

10-60(2) R Rules 10-61 to 10-176 apply to a *category D firm*, except that a *corporate finance advisory firm* which is a *category D firm* must instead comply with rules 3-60(3), 3-62, 10-61 and 10-63.

10-61 INITIAL CAPITAL

General rule

10-61(1) R A *firm* must:

- (a) on authorisation, hold *initial capital*, calculated in accordance with Table 10-61(1)A below, in excess of its *initial capital* requirement as detailed in (8) below; and**
- (b) at all times, maintain *own funds*, calculated in accordance with Table 10-61(1)B below, in excess of its *initial capital* requirement as detailed in (8) below.**

R TABLE 10-61(1)A - Initial capital

the sum of - ordinary share capital non cumulative preference share capital share premium account reserves excluding revaluation reserves audited retained earnings externally verified interim net profits or current account partners' capital account
<i>initial capital</i>

R TABLE 10-61(1)B - Own funds

the sum of - ordinary share capital non cumulative preference share capital share premium account reserves excluding revaluation reserves audited retained earnings externally verified interim net profits or current account partners' capital account	
<i>initial capital</i>	(A)
the sum of - investments in own shares intangible assets material interim year net losses	(B)
$A - B = \textit{original own funds}$	(C)
the sum of - non fixed term cumulative preference shares fixed term cumulative preference shares non fixed term long term subordinated loans fixed term long term subordinated loans revaluation reserves	(D)
<i>material holdings in credit and financial institutions</i>	(E)
$C + D - E = \textit{own funds}$	(F)

Preference share capital

10-61(2) R A firm may include preference share capital in financial resources only if:

- (a) there is an agreement between the firm and the holders of those shares which provides that redemption of the shares may not take place, if after such redemption the firm would be in breach of rule 10-62(1); and**
- (b) the firm notifies the FSA in writing before issuing any preference shares of its intention to do so.**

Non cumulative preference share capital

- 10-61(3) R A firm may include preference *share capital* in *initial capital* only where the dividends are not cumulative.**

Externally verified interim net profits or current account

- 10-61(4) R A firm may include interim net profits or current account when calculating *initial capital* to the extent that they have been:**
- (a) verified by the *firm's* external auditor; and**
 - (b) a copy of his opinion thereon, drawn up in accordance with the relevant requirements of Appendix 58, has been submitted to the *FSA*,**

and are net of any foreseeable charge, dividend or proprietor's drawings.

Intangible assets

- 10-61(5) R A firm must deduct from *initial capital*, when calculating *original own funds*, the full balance sheet value of intangible assets including goodwill, capitalised development costs, licences, exchange seats held as part of its trading requirement, trademark and similar rights etc.**

Material interim losses

- 10-61(6) R A firm must deduct from *initial capital* when calculating *original own funds* all material unaudited interim losses arising from its *trading book* and *non-trading book* business which exceed 10% of its *initial capital*.**

Material holdings in credit and financial institutions

- 10-61(7) R A firm must deduct the full value of its *material holdings* in *credit* or *financial institutions*, in accordance with Table 10-61(1)B, unless:**
- (a) the *firm* has been granted a waiver from rules 10-200 to 10-203, in which case it must:**
 - (i) deduct in full from *original own funds* those *material holdings* in *credit* or *financial institutions* which would have been included in the scope of consolidation in accordance with rule 10-200(3) if the waiver had not been granted; and**

- (ii) deduct in full as an *illiquid asset* any *material holding* in a *credit* or *financial institution* which would not have been included in the scope of consolidation, unless it is included in the *firm's trading book*, in which case the *firm* may treat it under the *PRR* rules; or
- (b) the *firm* has notified the *FSA* in writing that it intends to calculate its *financial resources* in accordance with Table 10-62(2)C, in which case it must deduct in full as an *illiquid asset* any *material holding* in a *credit* or *financial institution*, unless it is included in the *firm's trading book*, in which case the *firm* may treat it under the *PRR* rules; or
- (c) the *material holding* is a *trading book* position, in which case the *firm* must deduct in accordance with Table 10-61(1)B the full value of that proportion of the holding which exceeds 10% of the *firm's own funds*, and that segment of the *material holding* which falls below the 10% of *own funds* threshold may instead be treated in accordance with the *PRR* rules.

Initial capital requirement

10-61(8) R A *firm's initial capital* requirement must be:

- (a) for a *category A firm* : euro 730,000;
- (b) for a *category B firm* : euro 125,000;
- (c) for a *category C firm* : euro 50,000; or
- (d) for a *category D firm* : euro 50,000.

10-62 FINANCIAL RESOURCES

General rule

10-62(1) R A firm must, at all times, maintain *financial resources* in excess of its *financial resources requirement* as detailed in rule 10-70 below.

Calculation of financial resources

10-62(2) R A firm must calculate its *financial resources* in accordance with Table 10-62(2)A below, unless:

(a) it has been granted a waiver from rules 10-200 to 10-203, in which case it must calculate *financial resources* in accordance with Table 10-62(2)B; or

(b) the *firm* has notified the *FSA* in writing that it intends to calculate its *financial resources* in accordance with Table 10-62(2)C.

G The *FSA* expects a *firm* to calculate *financial resources* on a consistent basis and only change the version which it follows in exceptional circumstances. A *firm* that wishes to change the basis of calculation should inform the *FSA* in writing of its reasons for changing the basis for its calculation of *financial resources*.

R TABLE 10-62(2)A - Financial resources - version I

the sum of - ordinary share capital non cumulative preference share capital share premium account reserves excluding revaluation reserves audited retained earnings externally verified interim net profits or current account partners' capital account	
<i>initial capital</i>	(A)
the sum of - <i>investments</i> in own shares intangible assets material interim net losses	(B)
A - B = <i>original own funds</i>	(C)
the sum of - non fixed term cumulative preference shares fixed term cumulative preference shares non fixed term long term subordinated loans fixed term long term subordinated loans revaluation reserve	(D)
the sum of - liquidity adjustments charged assets <i>contingent liabilities</i> deficiencies in <i>subsidiaries</i>	(E)
the sum of - short term subordinated loan net interim <i>trading book</i> profit & loss partners' interim <i>trading book</i> current account	(F)
<i>material holdings</i> in <i>credit</i> and <i>financial institutions</i>	(G)
C + D - E + F -G = <i>financial resources</i>	

R TABLE 10-62(2)B - Financial resources - version II

the sum of - ordinary share capital non cumulative preference share capital share premium account reserves excluding revaluation reserves audited retained earnings externally verified interim net profits or current account partners' capital account	
<i>initial capital</i>	(A)
the sum of - <i>investments</i> in own shares intangible assets material interim net losses	(B)
$A - B =$ <i>original own funds</i>	(C)
<i>material holdings</i> in <i>credit</i> and <i>financial institutions</i> included in the scope of consolidation	(D)
the sum of - non fixed term cumulative preference shares fixed term cumulative preference shares non fixed term long term subordinated loans fixed term long term subordinated loans revaluation reserve	(E)
the sum of - liquidity adjustment on other <i>non-trading book</i> assets charged assets <i>contingent liabilities</i> deficiencies in <i>subsidiaries</i>	(F)
the sum of - short term subordinated loan net interim <i>trading book</i> profit & loss partners' interim <i>trading book</i> current account	(G)
<i>material holdings</i> in <i>credit</i> and <i>financial institutions</i>	(H)
liquidity adjustment on <i>illiquid assets</i>	(I)
$C - D + E - F + G - H - I =$ <i>financial resources</i>	

R TABLE 10-62(2)C - Financial resources - version II.2

the sum of - ordinary share capital non cumulative preference share capital share premium account reserves excluding revaluation reserves audited retained earnings externally verified interim net profits or current account partners' capital account	
<i>initial capital</i>	(A)
the sum of - <i>investments</i> in own shares intangible assets material interim net losses	(B)
A - B = <i>original own funds</i>	(C)
the sum of - non fixed term cumulative preference shares fixed term cumulative preference shares non fixed term long term subordinated loans fixed term long term subordinated loans revaluation reserve	(D)
the sum of - liquidity adjustment on other <i>non-trading book</i> assets charged assets <i>contingent liabilities</i> deficiencies in <i>subsidiaries</i>	(E)
the sum of - short term subordinated loan net interim <i>trading book</i> profit & loss partners' interim <i>trading book</i> current account	(F)
<i>non-trading book material holdings</i> in <i>credit and financial institutions</i>	(G)
liquidity adjustment on <i>illiquid assets</i>	(H)
C + D - E + F - G - H = <i>financial resources</i>	

10-63 SUBORDINATED LOAN

Calculation

10-63(1) R A firm may take into account subordinated loan capital in its *financial resources* in accordance with Tables 10-62(2)A, B and C subject to (2) to (12) below.

Approved of subordinated loans

10-63(2) R A firm may include a subordinated loan in its *financial resources* only:

- (a) if it is drawn up in accordance with the standard forms obtained from the FSA;**
- (b) if it is signed by authorised signatories of all the parties; and**
- (c) to the extent that it is paid up by the lender.**

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

G A *firm* may, under the provisions of IPRU(INV) 1.2.5R continue to include a subordinated loan in its *financial resources* if it was entitled to do so immediately prior to the *specified day*, and the other conditions set out in IPRU(INV) 1.2.5R are met.

Approved lenders

10-63(3) R A firm may treat a subordinated loan as part of *financial resources* only if the lender is:

- (a) the *firm's controller*;**
- (b) a *credit institution*;**
- (c) an *approved person*; or**
- (d) an *EEA or recognised third country investment firm*.**

G If the *firm* wishes to treat as part of its *financial resources* a subordinated loan from a person not within the above categories, it will need to seek a modification or waiver from the FSA.

Type of subordinated loan

10-63(4) R A firm's subordinated loans must be classified as one or other of the following:

- (a) long term subordinated loan; or**
- (b) short term subordinated loan.**

Long term subordinated loan

- 10-63(5) R A firm's long term subordinated loan must have an original maturity of at least five years.**

Repayment of long term subordinated loan

- 10-63(6) R A firm must not (except in accordance with the terms of the loan):**
- (a) repay, prepay or terminate a long term subordinated loan before the agreed repayment date unless it has provided the FSA with at least five years' written notice; and**
 - (b) make any payment of interest if after such action the firm's financial resources will fall below 120% of its financial resources requirement.**

Amounts repayable within five years

- 10-63(7) R A firm must reduce the extent to which the long term subordinated loan may contribute to its financial resources on a straight line basis over the last five years of its life.**

Short term subordinated loan

- 10-63(8) R A firm's short term subordinated loan must have an original maturity of at least two years.**

Repayment of short term subordinated loan

- 10-63(9) R A firm must not (except in accordance with the terms of the loan):**
- (a) repay, prepay or terminate a short term subordinated loan before the agreed repayment date; and**
 - (b) make any payment of interest or principal if after such action the firm's financial resources will fall below 120% of its financial resources requirement.**

- 10-63 (9A) R If a firm has a surplus of long term subordinated loan, which it may not include in its financial resources, because it would breach the gearing limits in rule 10-63(10) and (11), it may substitute such surplus long term subordinated loan in place of short term subordinated loan in accordance with Tables 10-62(2)A and B, provided that it continues to comply with the gearing limits in rules 10-63(12).**

Limits on subordinated loans, cumulative preference shares and revaluation reserves

- 10-63 (10)** R **The total amount of long term subordinated loan, cumulative preference shares and revaluation reserves which a *firm* may take into account in its *financial resources* must not exceed 100% of *original own funds* as specified in Table 10-62(2)A, B or C as appropriate.**
- 10-63 (11)** R **The total amount of fixed term long term subordinated loan and fixed term cumulative preference shares which a *firm* may take into account in its *financial resources* must not exceed 50% of *original own funds* in Table 10-62(2)A, B or C as appropriate.**
- 10-63 (12)** R **The total amount of short term subordinated loan (including any surplus long term subordinated loan) which a *firm* may take into account in its *financial resources* must not exceed:**
- (a) for a *firm* which calculates its *financial resources* in accordance with Table 10-62(2)A, 200% of the *original own funds* left after the items calculated as line “E” in Table 10-62(2)A have been deducted;**
 - (b) for a *firm* which calculates its *financial resources* in accordance with Table 10-62(2)B, 250% of *original own funds* left after the items calculated as lines “D” and “F” in Table 10-62(2)B have been deducted; or**
 - (c) for a *firm* which calculates its *financial resources* in accordance with Table 10-62(2)C, 250% of *original own funds* left after the items calculated as line “E” in Table 10-62(2)C have been deducted.**
- G In respect of (a) above, a *firm* may use the items of capital listed in “D” in Table 10-62(2)A to cover the items in line “E” before it uses *original own funds* to cover the items in line “E”.
- G In respect of (b) above, a *firm* which has been granted a waiver from rules 10-200 to 10-203 may use the items of capital listed in “E” in Table 10-62(2)B to cover the items in line “F” before it uses *original own funds* to cover the items in line “F”.
- G In respect of (c) above, any other *firm* which the *FSA* has agreed may calculate its *financial resources* in accordance with Table 10-62(2)C may use the items of capital listed in “D” in Table 10-62(2)C to cover the items in “E” before it uses *original own funds* to cover the items in line “E”.

10-64 LIQUIDITY ADJUSTMENT

General rule

10-64(1) R A *firm's* liquidity adjustment for its assets must be calculated -

- (a) for *illiquid assets*, other than commodities, in accordance with rule 10-65; and
- (b) for other *non-trading book* assets, other than commodities, in accordance with rule 10-66;
- (c) for all commodities in accordance with rule 10-166 (commodities method) and rule 10-170 (CRR).

Intangible assets

10-64(2) R The liquidity adjustment for intangible assets is nil (these must be deducted from *initial capital* to arrive at *original own funds* in accordance with rule 10-61(5)).

Debtors arising from trading book business

10-64(3) R Debtors arising from *trading book* business have no liquidity adjustment but instead are subject to the *CRR* rules.

Netting

10-64(4) R A *firm* which has offsetting exposures in similar types of transactions with a counterparty may offset these in accordance with rules 10-65(13) and 10-66(6) when calculating its liquidity adjustment if it has a contractual netting agreement with that counterparty, which:

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

G Legal opinions should relate to:

- (a) the law of the jurisdictions in which the counterparty is organised;

- (b) the law of the jurisdiction in which any branch involved is located;
 - (c) the law that governs the agreement and, if different, the law that governs individual transactions pursuant to it; and
 - (d) the law that governs the legal status of the counterparty who is entering into transactions of the type which the *firm* is seeking to net.
- G Where a *firm* uses a standard netting agreement and the netting/set-off clauses therein follow the form of that standard agreement, provided a legal opinion has already been obtained on the standard agreement which addresses the capacity of counterparties of the type with which the *firm* wishes to contract, that may be relied upon.
- G Legal opinions on netting agreements should be obtained from independent legal advisers with sufficient expertise and experience in this area of law. Opinions from in-house counsel will not be acceptable.
- G Where the regulator of the counterparty is not satisfied that the netting agreement is enforceable under its laws, the netting agreement cannot be relied upon regardless of the opinions obtained by the *firm*.
- G A *firm* may not net balance sheet payables and receivables arising from derivative transactions in the *non-trading book* against other exposures arising in the *non-trading book*.
- G A *firm* wishing to net counterparty balances in the *non-trading book* against counterparty balances in the *trading book* should apply to the FSA for relevant modification or waivers.

10-65 LIQUIDITY ADJUSTMENT ON ILLIQUID ASSETS

General rule

- 10-65(1) R A *firm's* total liquidity adjustment on its *illiquid assets* is the sum of the amounts calculated in accordance with (2) to (12) below, applying either:**
- (a) 8% multiplied by the appropriate counterparty weight* (where applicable), for *firms* who calculate their *financial resources* in accordance with Table 10-62(2)A; or**
 - (b) 100%, for *firms* who calculate their *financial resources* in accordance with Table 10-62(2)B or C.**

* for details of counterparty weights see **Appendix 47**

Tangible fixed assets

- 10-65(2) R** The liquidity adjustment for tangible fixed assets is either 8% or 100% of the total net book value of such assets, except that where a *firm* calculates its *financial resources* in accordance with Table 10-62(2)B or C it may calculate the liquidity adjustment for land and buildings used as security for *non recourse loans* or other loans in accordance with (3) and (4) below.

Land and buildings used as security for non recourse loans

- 10-65(3) R** The liquidity adjustment for land and buildings used as security for a *non recourse loan* is the difference between the net book value of the land or building and the loan principal outstanding, except where the loan principal outstanding is higher than the net book value in which case there is no liquidity adjustment.

Land and buildings used as security for other loans

- 10-65(4) R** The liquidity adjustment for land and buildings used as security for loans other than *non recourse loans* is the difference between the net book value of the land or building and the lower of:
- (a) 85% of a professional valuation of the land and buildings (which must have been carried out in the last two years); and
 - (b) the principal outstanding,

except where both (a) and (b) are higher than the net book value in which case there is no liquidity adjustment.

Physical stocks

- 10-65(5) R** The liquidity adjustment for physical stocks is either 8% or 100% of the balance sheet value of such stocks, except for stock positions in physical commodities associated with the *firm's investment business*, which are subject to the *PRR* rules, in which case there is no liquidity adjustment.

Investments in credit institutions and financial institutions

- 10-65(6) R** The liquidity adjustment for an *investment* in either a *credit institution* or *financial institution*, which may be included in the *own funds* of that institution is either 8% multiplied by the appropriate counterparty weight* applicable to the issuer of the *investment* or 100% of the balance sheet value of the *investment*, except where the *investment* is:
- (a) a *material holding* in a *credit institution* or *financial institution*, in which case it must be treated in accordance with (12) below; or
 - (b) not a *material holding* and is included in the *firm's trading book*, in which case there is no liquidity adjustment but such an *investment* must be subject to the *PRR* rules.

Other investments

- 10-65(7) R** The liquidity adjustment for other *investments* is either 8% multiplied by the appropriate counterparty weight* applicable to the issuer of the *investment* or 100% of the balance sheet value of the *investment*, except where:
- (a) the *investment* is included in the *firm's trading book*, in which case there is no liquidity adjustment but such an *investment* must be subject to the *PRR* rules; or
 - (b) the *investment* is suspended, in which case the *firm* must calculate a liquidity adjustment of 100% of the value of the *investment*.

Other debtors

- 10-65(8) R** The liquidity adjustment for debtors other than debtors arising from *trading book* business, where the debt is not due to be repaid within 90 days, is either 8% multiplied by the appropriate counterparty weight*, or 100% of the balance sheet value of the debtor, except that there is no liquidity adjustment for amounts due which are secured by *acceptable collateral*.

* for details of counterparty weights see **Appendix 47**

Other cash deposits

- 10-65(9) R** The liquidity adjustment for a cash deposit other than a *qualifying deposit* is either 8% multiplied by the appropriate counterparty weight*, or 100% of the balance sheet value of the deposit, except that there is no liquidity adjustment for amounts due which are secured by *acceptable collateral*.

Loans

- 10-65 (10) R** The liquidity adjustment for a loan granted by a *firm* which is not due to be repaid within 90 days is either 8% multiplied by the appropriate counterparty weight*, or 100% of the balance sheet value, except that there is no liquidity adjustment for amounts due which are secured by *acceptable collateral*.

Other assets

- 10-65 (11) R** The liquidity adjustment for assets other than those specifically stated above where the asset is not due to be repaid within 90 days, is either 8% multiplied by the appropriate counterparty weight*, or 100% of the balance sheet value, except that there is no liquidity adjustment for amounts due which are secured by *acceptable collateral*.

Material holdings in credit and financial institutions

- 10-65 (12) R** The liquidity adjustment for a *material holding* in either a *credit* or *financial institution* is:
- (a) for a *firm* which calculates its *financial resources* in accordance with Table 10-62(2)A: zero, such an *investment* must be deducted in accordance with Table 10-61(1)B;
 - (b) for a *firm* which has been granted a waiver from rules 10-200 to 10-203: 100%, unless it is:
 - (i) a *material holding* in a *credit* or *financial institution* which would have been included in the scope of consolidation in accordance with rule 10-200(3) if the waiver had not been granted, in which case it must be deducted in full from *original own funds*; or
 - (ii) is included in the *firm's trading book*, in which case the *firm* may treat it under the *PRR* rules; or

* for details of counterparty weights see Appendix 47

- (c) for a *firm* which calculates its *financial resources* in accordance with Table 10-62(2)C: 100%, unless the holding is included in the *firm's trading book*, in which case the *firm* may treat it under the *PRR* rules.

Netting

- 10-65 (13) R A *firm* may offset positive and negative counterparty exposures, calculated in accordance with (8), (9) and (10) above, before it multiplies the residual exposure by the appropriate percentage provided that:
- (a) the exposures arise on transactions with the same counterparty; and
 - (b) the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 10-64(4).

10-66 LIQUIDITY ADJUSTMENT ON OTHER NON-TRADING BOOK ASSETS

General rule

- 10-66(1) R A *firm's* total liquidity adjustment on its other *non-trading book* assets which are not *illiquid assets* is the sum of amounts specified as liquidity adjustments below.

Qualifying deposits

- 10-66(2) R The liquidity adjustment for a *non-trading book qualifying deposit* is 8% of the balance sheet value of the deposit multiplied by the appropriate counterparty weight*, except that there is no liquidity adjustment for amounts due which are secured by *acceptable collateral*.

Loans

- 10-66(3) R The liquidity adjustment for a loan granted by a *firm* which is due to be repaid within 90 days is 8% of the balance sheet value multiplied by the appropriate counterparty weight*, except that there is no liquidity adjustment for amounts due which are secured by *acceptable collateral*.

Prepayments

- 10-66(4) R The liquidity adjustment for a prepayment is 8% of the balance sheet value of that prepayment, multiplied by the counterparty weight* appropriate to the third party to whom it has been made, except that there is no liquidity adjustment for amounts due which are secured by *acceptable collateral*.

Other assets

- 10-66(5) R** The liquidity adjustment for *non-trading book* assets other than those specifically stated above where the asset is due to be repaid within 90 days, is 8% of the balance sheet value multiplied by the appropriate counterparty weight*, except that there is no liquidity adjustment for amounts due which are secured by *acceptable collateral*.

Netting

- 10-66(6) R** A *firm* may offset positive and negative counterparty exposures, calculated in accordance with (2), (3) and (4) above, before it multiplies the residual exposure by the appropriate percentage provided that:
- (a) the exposures arise on transactions with the same counterparty; and
 - (b) the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 10-64(4).

CHARGED ASSETS

General rule

- 10-67 R** A *firm* must calculate the requirement for charged assets as 8% of the aggregate balance sheet value of each asset of the *firm* over which a third party has the right of sale or retention on default by the *firm* multiplied by the appropriate counterparty weight*, except:
- (a) to the extent of any liability of the *firm* plus a reasonable margin in respect of the charged asset;
 - (b) where the asset is collateral for a transaction which is subject to the *CRR* rules;
 - (c) to the extent that the *firm* has calculated a liquidity adjustment or *PRR* in respect of the charged asset.
- G If the *firm* wishes to apply a different approach it will need to seek a modification or waiver from this rule from the *FSA*.

* for details of counterparty weights, see **Appendix 47**

CONTINGENT LIABILITIES

General rule

- 10-68 R** A *firm* must calculate a requirement for each of its contingent liabilities arising from *non-trading book* activities as 8% of the value of the *contingent liability* multiplied by the appropriate counterparty weight* except:
- (a) to the extent of any liability of the *firm* plus a reasonable margin in respect of the *contingent liability*; or
 - (b) where the *contingent liability* is collateral for a transaction which is subject to the *CRR* rules.
- G If the *firm* wishes to apply a different approach it will need to seek a modification or waiver from this rule from the *FSA*.

DEFICIENCIES IN SUBSIDIARIES

General rule

- 10-69 R** A *firm* must calculate the requirement for deficiencies in *subsidiaries* as an amount equal to 100% of any deficiency in shareholders' funds at any time of a *subsidiary* of the *firm* except to the extent that:
- (a) provision has already been made by the *firm*; or
 - (b) the *firm* has already calculated a liquidity adjustment or *CRR* because the deficiency arises or partially arises out of a liability of the *subsidiary* to the *firm*.

Financial resources requirement

CALCULATION OF FINANCIAL RESOURCES REQUIREMENT

10-70 R A firm's financial resources requirement is the sum of:

- (a) the primary requirement; and
- (b) the secondary requirement.

PRIMARY REQUIREMENT

10-71 R A firm's primary requirement is the higher of:

- (a) the sum of its *PRR*, *FER*, *CRR*, *LER* and base requirement (calculated in accordance with rule 10-72); or
- (b) the *firm's initial capital* requirement for a *category A, B, C or D firm*, calculated in accordance with 10-61(8).

BASE REQUIREMENT

10-72 R A firm's base requirement must be calculated in accordance with the following formula:

$$\text{base requirement} = \text{expenditure requirement} \times \left[\frac{\text{expenditure requirement}}{PRR + FER + CRR + LER + \text{expenditure requirement}} \right]$$

10-73 EXPENDITURE REQUIREMENT

General rule

10-73(1) R A firm's expenditure requirement must be:

- (a) for a *category D firm* which is not responsible for its counterparties' performance: 6/52nds of its relevant annual expenditure calculated in accordance with (2) to (4) below; or
- (b) for any other *firm*: 1/4 of its relevant annual expenditure calculated in accordance with (2) to (4) below.

Calculation of relevant annual expenditure

10-73(2) R Subject to (3) and (4) below, a *firm* must calculate its relevant annual expenditure with reference to the *firm's* most recent *audited annual financial statements* submitted to the *FSA*, as follows:

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

less the aggregate of the following items:

- (c) profit before taxation;
- (d) *bonuses* paid out of the relevant year's profits and not guaranteed;
- (e) *profit shares* and other appropriations of profit, except for fixed or guaranteed remuneration which is payable even if the *firm* makes a loss for the year;
- (f) paid *commissions shared*, other than to *employees, directors, half commission men or appointed representatives* of the *firm*;
- (g) fees, brokerage and other charges paid to clearing houses, *clearing firms*, exchanges, and *intermediate brokers* for the purposes of executing, registering or clearing transactions;
- (h) interest payable to counterparties;
- (i) interest payable on borrowings to finance the *firm's investment business and associated business*; and
- (j) *exceptional items*, provided that the *firm* first notifies the *FSA* in writing of the nature and amount of the *exceptional items*; and
- (k) losses arising on the translation of foreign currency balances.

Absence of audited annual financial statements

- 10-73(3) R** If a *firm* does not have *audited annual financial statements*, it must:
- (a) where it has just commenced trading or has not been authorised long enough to have submitted *audited annual financial statements* to the *FSA* (or to the *FSA's* predecessor), base its relevant annual expenditure on budgeted or other accounts which it submitted to the *FSA* (or to the *FSA's* predecessor) as part of the *firm's* application; or
 - (b) where its accounts do not represent a 12 month period, calculate relevant annual expenditure on a proportionate basis.

Adjusting relevant annual expenditure

- 10-73(4) R** A *firm* must adjust its relevant annual expenditure where:
- (a) there has been a significant change in the circumstances or activities of the *firm*; or
 - (b) the *firm* has a material proportion of its expenditure incurred on its behalf by third parties and such expenditure is not fully recharged to the *firm*.

G FSA would for example consider an application to vary a *firm's* permitted activity as a significant change.

G The FSA would consider 10% of a *firm's* expenditure incurred on its behalf by third parties to be material for the purposes of 10-73(4)R.

G If a *firm* is in any doubt, it should always seek guidance from the FSA

10-74 SECONDARY REQUIREMENT

General rule

- 10-74(1) R** A *firm* must include a secondary requirement in accordance with (2), (3) and (4) below.

Illiquid assets

- 10-74(2) R** A *firm* which calculates its *financial resources* in accordance with Table 10-62(2)A must calculate a secondary requirement as the higher of:
- (a) an amount equal to 92% of the excess of total *illiquid assets* over 25% of *initial capital* plus interim profit and loss account; and

- (b) an amount equal to 92% of the value of any individual *illiquid asset* which has a value greater than 10% of the *firm's initial capital* plus interim profit and loss account.

Risk profile

- 10-74(3) R A *firm* must include in its secondary requirement any amount specified in any *requirement* to cover an unusual risk profile.

Operational risks

- 10-74(4) R A *firm* must include in its secondary requirement any amount specified in any *requirement* to cover the inadequate management of operational risk to which a *firm* is exposed.

- G In assessing whether to impose a *requirement* on a *firm* to cover *illiquid assets*, risk profile or operational risks, the *FSA* will consider various criteria. Further detailed guidance is set out in Appendix 48.

POSITION RISK REQUIREMENT

10-80

General principles of PRR

Application

10-80
(1)

R ***A firm must calculate a PRR in respect of all trading book and physical commodities and physical commodities derivatives items.***

Obligation to calculate PRR

10-80
(2)

R ***A firm must calculate a minimum PRR in respect of any position according to one of the methods available under the rules below but may calculate a higher PRR in any other way at its option, provided it is able to demonstrate that, in all circumstances, the calculation being employed does give rise to a higher PRR for the position.***

G *A firm that wishes to use its internal model to calculate PRR in respect of all, or some, of its positions should apply for a modification or waiver from the relevant rules from the FSA.*

G *Further guidance on the criteria which such models must meet, and the review process, can be obtained from the FSA.*

Frequency of calculation

10-80
(3)

R ***A firm must be able to monitor its total PRR on an intra-day basis, and, before executing any trade, must be able to re-calculate PRR to the level of detail necessary to ensure that the firm's financial resources requirement does not exceed the firm's financial resources.***

Marking to market

10-80(4)

R ***A firm must mark to market its positions, whether or not on the balance sheet, in accordance with rule 10-41(9) at least once every business day and more frequently as appropriate.***

Non trading book items

10-80(5)

R ***Positions in instruments which are non-trading book items must be treated under rule 10-65.***

Instruments for which no PRR treatment has been specified

- 10-80(6)** **R** **Where the *firm* has a position in an instrument for which no *PRR* treatment has been specified, it must calculate a *PRR* of an appropriate percentage of the current *mark to market* value of the position and the *firm* must immediately notify the *FSA* of the details of the instrument, the *PRR* calculated and the reasons for the calculation.**

Instruments of non standard form

- 10-80(7)** **R** **Where an instrument is not of a standard form, the *firm* must calculate a *PRR* of an appropriate percentage of the current *mark to market* value of the position and the *firm* must immediately notify the *FSA* of the details of the instrument, the *PRR* calculated and the reasons for the calculation.**

- 10-80(7A) **E** (1) In 10-80(6) and 10-80(7) “an appropriate percentage” is:
- (a) 100%; or
 - (b) a percentage which takes account of the characteristics of the instrument concerned and of discussions with the *FSA* or a predecessor regulator.
- (2) Compliance with (1) may be relied on as tending to establish compliance with 10-80(6) or 10-80(7) as appropriate.
- (3) Contravention of (1) may be relied on as tending to establish contravention of 10-80(6) or 10-80(7) as appropriate.
- G** The methodologies which have been developed assume instruments with standard characteristics. There are many examples, however, of instruments which, although based on a standard contract, contain structural features which make the rules, as stated, inappropriate.

Alternative treatments

- 10-80(8)** **R** **Where a *firm* has the alternative of treating a position under two or more different methods or treatments within methods, it must treat the position under one of those methods.**

EQUITY METHOD

10-81 Types of positions to be included in the equity method

Securities

10-81(1) R **A firm must apply the equity method to the following *trading book* positions (whether or not *forward* positions):**

- (a) a share;
- (b) a *convertible preference security* (the interest rate method must be applied to a *non-convertible preference security*);
- (c) a depository receipt; and
- (d) a *convertible debt security*;

except for:

- (e) an offering of an equity, to the extent that the issuing market method applies;
- (f) an equity position hedging an *option or company issued warrant*, where the equity is of a type suitable for delivery, and up to a maximum of the extent to which the nominal amount of the equity is matched by the nominal amount of the equity underlying the *option or company issued warrant*, which may at the discretion of the *firm* be treated under rule 10-93(2);
- (g) a suspended stock, which must be treated in accordance with rule 10-65(7)(b);
- (h) a *convertible*, which may at the discretion of the *firm* be treated under the interest rate method subject to (2) below;
- (i) a *tender offer* as principal on an equity, which must be treated as an *OTC option* under rule 10-93(4); and
- (j) a *material holding* in a *credit or financial institution* which must be treated in accordance with rule 10-61(7).

Convertibles

10-81(2) R (a) **A firm must apply the equity method to any *convertible* if:**

- (i) less than three months remain to the first date at which conversion may take place (or less than one year until the next date if the first date has passed); and

- (ii) the *convertible* is trading at a “premium” of less than 10%.
- (b) “Premium” is the current *mark to market* value of the *convertible* less the current *mark to market* value of the underlying equity, expressed as a percentage of the current *mark to market* value of the underlying equity.
- (c) A *firm* may apply the equity method or the interest rate method to any *convertible* which is not subject to (a) above.

Equity swaps

- 10-81(3)
- R
 - (a) Where a *firm* has a position in an equity swap, the *firm* must divide the position into an interest rate leg, which must be treated under (b) below, and an equity leg, which must be treated under (c) below.
 - (b) The interest rate leg must be included in the interest rate method as a bond with characteristics determined in accordance with the provisions for interest rate swaps under rule 10-101(10).
 - (c) Where the *firm* pays (or receives) an amount which is based on the change in value of an equity, basket of equities or equity index, the *firm* must apply the equity method to the equity leg as a notional short (or long) position in the more appropriate of:
 - (i) an OTC *future* on an equity, basket of equities or equity index; or
 - (ii) an OTC *option* on an equity, basket of equities or equity index,

and must apply either the equity *derivatives* method or the equity method to the position, according to the provisions of those methods.
 - G Provided that an equity swap includes an interest rate leg treated under (b) above as well as an equity leg treated under (c) above, then *firms* are not required to calculate an interest rate add-on for the equity leg.

Optional inclusion of equity derivatives

10-
81(4)

R A *firm* may apply the equity method to the following equity *derivative* or *company issued warrant* positions:

- (a) an *exchange* traded or OTC *future* on an equity, basket of equities or equity index;
- (b) an *exchange* traded, OTC or traditional *option* on an equity, basket of equities, or narrow-based equity index provided the *option* is *in the money* by at least the equity method 1 *PRA* appropriate to the underlying instrument, shown in Appendix 49;
- (c) an *exchange* traded or OTC *option* on a broad-based equity index, provided the *option* is at least 8% *in the money*;
- (d) a position in a *company issued warrant* which is *in the money* by at least the equity method 1 *PRA* appropriate to the underlying equity, shown in Appendix 49;
- (e) a synthetic long or short position in an equity, basket of equities or equity index, which may be treated as a *future* on that instrument, provided that:
 - (i) the synthetic long consists of a long call *option* and a short put *option* on the same underlying instrument with the same maturity dates and strike prices; and
 - (ii) the synthetic short position consists of a short call *option* and a long put *option* on the same underlying instrument with the same maturity dates and strike prices; and
 - (iii) if the *options* do not entitle the holder to dividends, the *firm* must be able to demonstrate that the underlying instrument is unlikely to go ex-dividend over the *option* period;

G (f) A *firm* that wishes to apply this method to the notional positions arising from risk assessment models for *options* should apply for the relevant modification or waivers from the *FSA*.

G (g) A *firm* that wishes to apply this method to any other equity *derivative* should apply for the relevant modification or waivers from the *FSA*.

10-82 **CALCULATION OF EQUITY EQUIVALENT POSITIONS**

General rule

- 10-82 (1)** **R** **(a)** **Provided the *firm* is permitted, and has chosen, to apply the equity method to an equity *derivative*, a *convertible*, or a *company issued warrant*, it must derive an equity equivalent position in accordance with this rule.**
- (b)** **Where a *firm* includes an actual or notional position arising from a *forward*, *future* or *option* on an equity, basket of equities, equity index or *company issued warrant*, in equity method 1, 2, 3 or 4 an additional *PRR* must be calculated in accordance with rule 10-86 to cover the interest rate risk.**

Convertibles

- 10-82(2)** **R** **(a)** **The equity equivalent position is the *mark to market* value of the equity underlying the *convertible*.**
- (b)** **Where a *firm* treats a *convertible* under the equity method, an adjustment shall be made to the *PRR* which shall be:**
- (i) an addition equal to any loss on conversion; or**
- (ii) a deduction equal to any profit on conversion, subject to a maximum deduction which would reduce the *PRR* of the net position of all underlying and equivalent positions to zero.**

Options on equities

- 10-82(3)** **R** **Subject to (4) below, a *firm* must take the equity equivalent position of an *option* on an equity to be the *mark to market* value of the underlying equity.**

Options on equities, baskets of equities and equity indices treated under risk assessment models

- 10-82(4) **G** **A *firm* that wishes to use a risk assessment model in respect of its equity and equity index *options* to calculate equity equivalent positions which may be included in the equity method will need to seek the appropriate modification or waivers from the *FSA*.**
- G** **The *FSA* will consider an application for a modification or waiver provided the model forms part of the day to day management supervision of the *firm's options* business and meets other criteria. Further guidance on the criteria for the review of such models can be obtained from the *FSA*.**

Futures and options on a single country equity basket or index

- 10-82(5) R **A firm must treat the *mark to market* value of a notional equity portfolio underlying a basket of equities or equity index, where the constituent equities are from one country, as either:**

- (a) a single equity equivalent position; or
- (b) notional positions in the constituent equities.

Futures and options on a multiple country equity basket or index

- 10-82(6) R **A firm must split the *mark to market* value of a notional equity portfolio underlying a basket of equities or equity index whose constituents are from more than one country into either:**

- (a) a number of single equity equivalent positions, one for each of the countries which is represented in the index, in the proportion of that country's representation in the index; or
- (b) notional positions in all the constituent equities.

- G Where a *firm* chooses to treat a basket of equities or equity index as a single equity equivalent position, rather than breaking it down into the constituent stocks, it should apply the *PRA* for a single stock of the appropriate category unless the number and nature of the constituent equities are such that the basket or index is broad-based and will behave as "the market". In such circumstances the position will attract zero specific risk. Where a *firm* is in any doubt it should apply the single stock weight and consult the *FSA*.

Options

- 10-82(7) R **A firm must treat a purchased call *option* or written put *option* as a long equity equivalent position and a purchased put *option* or written call *option* as a short equity equivalent position.**

Company issued warrants

- 10-82(8) R **Subject to (9) below, a firm must derive the equity equivalent position of a position in a *company issued warrant* as the *mark to market* value of the underlying equity.**

Equity warrant alternative method

- 10-82(9) G A *firm* which is a significant dealer in *company issued warrants* may use an alternative method to calculate *PRR*, the details of which are available from the *FSA* on request, provided it obtains the relevant modification or waivers from the *FSA*.

- G If it grants approval, the *FSA* would generally expect a *firm*:
- (a) consistently to hold positions in not less than 100 *company issued warrant* issues of the country for which the *firm* wishes to apply the method; and

(b) to have a well diversified *company issued warrant* book, such that no single trading position amounts to 10% or more of the relevant book and the largest 20 issues do not exceed 60% of the relevant book by *mark to market* value.

G However, the *FSA* will consider relaxing these numbers if it is satisfied that they would be excessive in relation to the total number of traded *company issued warrant* issues of a particular country and that the *firm's* business is spread over a sufficient number of issues to justify the use of the alternative method.

10-83 NETTING OF EQUITY AND EQUITY EQUIVALENT POSITIONS BEFORE APPLYING THE EQUITY METHOD

Netting of positions

10-83(1) R A *firm* may net a long against a short position only where the positions are in the same actual instrument (including equity equivalent positions arising from *convertibles, derivatives* and *company issued warrants* in respect of that instrument).

Netting of tranches

10-83(2) R A *firm* may net a long position in one tranche of a *security* against a short position in another tranche of the same *security* only where the relevant tranches:

(a) rank pari passu in all respects; and

(b) become fungible within 180 days and thereafter the *securities* of one tranche can be delivered in settlement of the other tranche.

10-84 CATEGORISATION OF EQUITY POSITIONS

General rule

10-84(1) R A *firm* must separate its equity and equity equivalent positions included in the equity method by country.

Depository receipts

10-84(2) R A *firm* must allocate a share represented by a depository receipt to the same country as the underlying share.

10-85 **CALCULATION OF PRR UNDER THE EQUITY METHOD**

General rule

10-85(1) **R** **A *firm* which is permitted to apply the equity method to a position may choose whether to apply equity method 1, 2, 3 or 4 to that position, except that:**

- (a) a *firm* may apply equity method 2, 3 or 4 only to those positions in a country portfolio which individually do not exceed 20% of the gross value of that country portfolio; and**
- (b) where a position exceeds 20% of the gross value of the country portfolio, the amount up to 20% may be treated under equity method 2, 3 or 4 but the excess amount shall be restricted to equity method 1; and**
- (c) a *firm* may apply only one of equity methods 2 and 3; and**
- (d) a *firm* may apply equity method 4 only to portfolios in qualifying countries.**

Total equity method PRR

10-85(2) **R** **A *firm* must calculate the equity method *PRR* as the sum of:**

- (a) the *PRR* for positions for which equity method 1 is used; and**
- (b) the *PRR* for positions for which equity method 2 is used; and**
- (c) the *PRR* for positions for which equity method 3 is used; and**
- (d) the *PRR* for positions for which equity method 4 is used; and**
- (e) the interest rate add-on for *derivatives*.**

10-86 **CALCULATION OF INTEREST RATE ADD-ON FOR DERIVATIVES**

10-86(1) **R** **Where a *firm* includes an actual or notional position in an “equity derivative” in the equity method, an additional *PRR* must be calculated to cover the interest rate risk, using one of the methods described in this rule.**

10-86(2) **R** **An “equity derivative” is a *forward, future, option or company issued warrant* on an equity, basket of equities, or equity index.**

10-86(3) R The add-on to cover interest rate risk must be calculated before any netting which is permitted under rule 10-83.

Basic method

10-86(4) R A *firm* must calculate the interest rate risk of each underlying instrument for each expiry date separately, as follows:

- (a) multiply the *mark to market* value of the position in the notional equity or equity portfolio underlying the *derivative* contract by the percentage in the table below; and
- (b) where the amount calculated in (a) is negative, the sign must be reversed; and
- (c) the results must be aggregated to form the total interest rate add-on.

R TABLE 10-86(4)

Time to expiry	Percentage
0-3 months	0.20
3-6 months	0.40
6-12 months	0.70
1-2 years	1.25
2-3 years	1.75
3-4 years	2.25
4-5 years	2.75
over 5 years	3.75

Alternative method

- 10-86(5)** **R** **For each position in an “equity derivative”, a *firm* must include in its interest rate method calculations a notional government bond, in accordance with rule 10-101(12).**

Modelling method

- 10-86(6)** **G** *A firm* that wishes to use another method of calculating the interest rate risk of “equity derivatives” will need to seek the relevant modification or waivers from this rule from the FSA; in general, a modification or waiver permitting a *firm* to use another method will only be given where a *firm* has been granted a modification or waiver permitting use of a risk assessment model in respect of “equity derivatives”.

10-87 **EQUITY METHOD 1**

Method

- 10-87(1)** **R** **A *firm* must calculate the *PRR* for each country as the aggregate of the *mark to market* value of the positions multiplied by the equity method 1 *PRA* appropriate for the country, as shown in Appendix 49.**

Total

- 10-87(2)** **R** **A *firm* must sum the results for each country to arrive at the *PRR* for positions for which equity method 1 is used.**

10-88 **EQUITY METHOD 2**

- 10-88(1)** **R** **A *firm* must calculate the equity method 2 *PRR* on a country by country basis as the sum of the specific risk and the general market risk, as set out in (2) to (4) below.**

Specific risk

- 10-88(2)** **R** **For each country, the equity method 2 specific risk *PRR* is calculated as the aggregate of the *mark to market* value of positions treated under equity method 2 multiplied by the appropriate specific risk *PRA* shown in Appendix 49.**

General market risk

- 10-88(3)** **R** **For each country, a *firm* must calculate the equity method 2 general market risk *PRR* in the following way:**
- (a) each position shall be multiplied by the appropriate general market risk *PRA* shown in Appendix 49;**
 - (b) the results in (a) shall be netted; and**
 - (c) where the amount in (b) is negative, the sign must be reversed.**

Total

- 10-88(4)** **R** **A *firm* must sum the results for each country portfolio to arrive at the *PRR* for positions for which equity method 2 is used.**

10-89 **EQUITY METHOD 3**

- 10-89(1)** **R** **Where a *firm* chooses to use equity method 3 it must calculate the equity method 3 *PRR* as the higher of:**
- (a) calculation 1 - the result of applying rules (2) to (7) below; and**
 - (b) calculation 2 - the result of applying rules (8) to (10) below.**

Calculation 1

- 10-89(2)** **R** **(a) A *firm* must allocate positions on the basis of the categories set out in Appendix 50, calculate a *PRR* in respect of each country portfolio separately, and aggregate the results.**
- (b) A *firm* must calculate the *PRR* for a country portfolio as:**

$$\left[\begin{array}{c} \text{aggregate long} \\ \text{positions} \end{array} + \begin{array}{c} \text{aggregate short} \\ \text{positions} \end{array} \right] \times \text{Column 1 } \mathbf{PRA} \text{ in Appendix 50}$$

unless the country portfolio is an “eligible country portfolio”, as defined below, in which case the *firm* must calculate the *PRR* for that country portfolio as:

$$\frac{\sqrt{\text{(basic risk x liquidity adjustment factor)}}}{100}$$

(c) Notwithstanding (a) and (b) above, a *firm* may calculate the *PRR* in respect of a UK, US or Japan “eligible country portfolio” as:

$$\frac{\sqrt{\text{(modified basic risk x modified liquidity adjustment factor)}}}{100}$$

G No benefit will be derived under (c) unless the *firm* has “eligible country portfolios” in at least two of the three countries mentioned.

Eligible country portfolio

10-89(3)

- R (a) A *firm* may only include in an “eligible country portfolio” positions in those categories of equity which have a figure in columns 2 and 3 of Appendix 50.
- (b) An “eligible country portfolio” means:
- (i) a UK, US or Japan country portfolio which contains at least 10 long or 10 short positions; or
 - (ii) for any other country listed in section D of Appendix 50, a portfolio of equities which:
 - (aa) comprises constituents of the FT-Actuaries World Indices; and
 - (bb) contains at least 5 long or 5 short positions.

Basic risk calculation

10-89(4)

- R (a) Calculate the square of the net *mark to market* value (i.e. long positions less short positions) of the “eligible country portfolio”.
- (b) Multiply the figure in (a) above by the appropriate figure in column 3 of Appendix 50.
- (c) Calculate the square of the value of each position, excluding positions arising from broad-based equity index contracts, and total the squared amounts for each country.

- (d) Multiply the total calculated under (c) above by the appropriate figure shown in column 2 of Appendix 50 and add the figure calculated in (b) to obtain the basic risk of the “eligible country portfolio”.

Liquidity adjustment factor

10-89(5)

- R** A firm must calculate the liquidity adjustment factor for the UK, US and Japan country portfolios as follows (for other “eligible country portfolios” the liquidity adjustment factor is 1):
- (a) calculate the aggregate *mark to market* value (i.e. long positions plus short positions) of each category and the aggregate *mark to market* value of the “eligible country portfolio”;
- (b) calculate in respect of the relevant aggregate *mark to market* values the following proportions:
- A the constituents of the FT-SE 100 Index category portfolio as a proportion of the UK “eligible country portfolio”;
- B the FT All-Share Index category, excluding FT-SE 100 stocks, as a proportion of the UK “eligible country portfolio”;
- C the constituents of the Nikkei 225 Index category portfolio as a proportion of the Japan “eligible country portfolio”; and
- D the constituents of the Standard & Poor’s 500 Index category portfolio as a proportion of the US “eligible-country portfolio”;
- (c) for each of the US and Japan “eligible country portfolios”, the liquidity adjustment factor is the result of the following calculation performed separately for each country (the reference to “proportion” is as calculated in (b) above):

$$\frac{6}{(\text{proportion} \times 4) + 2}$$

- (d) for the UK “eligible country portfolio”, the liquidity adjustment factor is calculated as:

$$\frac{6}{(\text{proportion A} \times 4) + 2 + \text{proportion B}}$$

Modified basic risk calculation

- 10-89(6)** **R** (a) For each “eligible country portfolio” calculate the basic risk of the portfolio as in (4) above and add the figures for such portfolios together.
- (b) Calculate the net *mark to market* value (i.e. long positions less short positions) for each “eligible country portfolio”, and multiply the net *mark to market* value for pairs of countries by each other, and then by the factor shown below (there will be one pair where two countries are included and three pairs where three countries are included).

TABLE 10-89(6)

Net mark to market values relating to	Factor
UK & US	17
UK & Japan	11
US & Japan	11

- (c) The modified basic risk figure is the total of the figure calculated under (a) above and the those calculated in (b) above.

Modified liquidity adjustment factor

- 10-89(7)** **R** **A firm must calculate the modified liquidity adjustment factor for UK, US and Japan “eligible country portfolios” as follows:**
- (a) calculate the total of the aggregate *mark to market* values (i.e. long positions plus short positions) of all “eligible country portfolios” to obtain the aggregate *mark to market* value;
- (b) calculate the aggregate *mark to market* values of each of the following portfolios as a proportion of the amount calculated in (a) above:
- A** the portfolio comprising the FT-SE 100 Index category portfolio, the Nikkei 225 Index category portfolio and the Standard & Poor’s 500 Index category portfolio; and
- B** the FT All-Share Index category portfolio, excluding FT-SE 100 stocks;
- (c) the modified liquidity adjustment factor is:

$$(\text{proportion A} \times 4) + 2 + \text{proportion B}$$

Calculation 2

- 10-89(8)** **R** **A firm must calculate the equity method 3 PRR on a country by country basis as the sum of the specific risk and the general market risk, as set out in (9) and (10) below, and sum the results across all countries.**

Specific risk

- 10-89(9)** **R** **For each country, the equity method 3 specific risk PRR is calculated as the aggregate of the *mark to market* value of positions treated under equity method 3 multiplied by the appropriate specific risk PRA shown in Appendix 49.**

General market risk

- 10-89(10)** **R** **(a) For each country, the equity method 3 general market risk PRR is calculated as the net *mark to market* value of the portfolio multiplied by 8%; and**
- (b) where the amount in (a) is negative, the sign must be reversed.**

10-90 **EQUITY METHOD 4**

- 10-90(1)** **R** **A firm must calculate the equity method 4 PRR as the sum of the specific risk and the general market risk, as set out in (2) to (5) below.**

Specific risk

- 10-90(2)** **R** **For each qualifying country portfolio, the equity method 4 specific risk PRR is calculated as the aggregate of the *mark to market* value of positions treated under equity method 4 multiplied by the appropriate specific risk PRA shown in Appendix 49.**

General market risk

10-90(3) R **A firm must calculate the equity method 4 general market risk *PRR* as the sum of:**

- (a) the *PRR* for the combined general market risk; and**
- (b) the *PRR* for the residual general market risk.**

Combined general market risk

10-90(4) R **A firm must calculate the combined general market risk as follows:**

- (a) for each country, multiply the net *mark to market* value of the portfolio by 8% to obtain the risk-weighted position; and**
- (b) subject to the criteria listed in (i) to (iii) below, calculate a combined general market risk *PRR* for these portfolios as:**

$$\sqrt{\omega_i^2 + \omega_j^2 + \omega_k^2 + \Lambda + \omega_m^2}$$

where each ω_i represents the risk-weighted position for a single country portfolio; provided that:

- (i) the calculation includes at least four qualifying country portfolios;**
- (ii) the risk-weighted position of each country portfolio does not exceed 30% of the total of the risk-weighted positions in the calculation; and**
- (iii) the sum of the risk-weighted positions equals 0 (i.e., $\Sigma\omega = 0$), where overall long positions in a country portfolio have a positive sign and overall short positions have a negative sign.**

Residual general market risk

10-90(5) R **For all risk-weighted positions in a country portfolio not included in the calculation in (4) above, a firm must calculate the combined general market risk as the aggregate of the risk-weighted positions.**

TREATMENT OF EQUITY DERIVATIVES OUTSIDE THE EQUITY METHOD

Types of positions to be included under the equity derivatives method

- 10-91 R** **A firm must apply the equity derivatives method to a position of any of the following types, except to the extent that the firm is required, or is permitted and chooses, to apply the equity method to the position:**
- (a) a *future* or *option* on an equity, basket of equities or equity index;**
 - (b) a *tender offer* on an equity, which must be treated as a written *option* on the equity under 10-93(4) below;**
 - (c) an equity position hedging an *option* or *company issued warrant* on that equity (provided the equity is of a type suitable to satisfy delivery), up to a maximum of the extent to which the nominal amount of the equity is matched by the nominal amount of the equity underlying the *option* or *company issued warrant*;**
 - (d) an equity leg of an equity *swap* based on the change in value of an equity, a basket of equities or an equity index; and**
 - (e) a *company issued warrant*.**

Total equity derivatives method PRR

- 10-92 R** **A firm must calculate the total equity derivatives method PRR as the sum of:**
- (a) the PRR for positions for which the hedging method is used;**
 - (b) the PRR for positions for which the margin requirement method is used;**
 - (c) the PRR for positions for which the basic method is used; and**
 - (d) the interest rate add-on for derivatives.**

10-93 Alternative methods

Summary of alternative methods

- 10-93(1) R** **A firm must apply one of the methods outlined in the following table:**

TABLE 10-93(1) - Equity derivative positions: alternative methods

1	<p>Hedging method</p> <p>(a) In respect of an equity hedging an <i>option</i> or <i>company issued warrant</i> on that equity, a <i>firm</i> may choose to apply the hedging method under (2) below to the equity and the related <i>option</i> or <i>company issued warrant</i> to the extent that the nominal amount of the equity underlying the <i>option</i> or <i>company issued warrant</i> matches the nominal amount of the equity.</p> <p>(b) To the extent that the nominal amount of the equity exceeds the nominal amount of the equity underlying the <i>option</i> or <i>company issued warrant</i>, a <i>firm</i> must apply the equity method</p>
2	<p>Margin requirement method</p> <p>Where an exchange listed in Appendix 51 has a positive initial margin requirement, a <i>firm</i> may apply the margin requirement method under (3) below to any <i>derivative</i> traded on that exchange.</p>
3	<p>Basic method</p> <p>Where a <i>firm</i> is not permitted, or chooses not to apply any other available method, it must treat equity <i>derivatives</i> under the basic method, as set out in (4) below.</p>

Hedging method

- 10-93(2) R **When using the hedging method for an equity hedging an *option* or *company issued warrant* on that equity, a *firm* must calculate the *PRR* for the equity position and the *option* or *company issued warrant* position in accordance with the provisions of Appendix 52.**

Margin requirement method

- 10-93(3) R (a) **A *firm* may apply the margin requirement method to a *derivative* which is traded on an exchange listed in Appendix 51, provided that the exchange charges a positive initial margin requirement.**
- (b) **When using the margin requirement method for an exchange traded *derivative* on an equity or equity index, a *firm* must:**
- (i) **take 100% of the initial margin requirement of the exchange; and**
- (ii) **multiply the result by the factor shown in Appendix 51.**
- (c) **Where the exchange calculates the margin requirement on an overall basis, or offsets *futures* and *options* in the margin calculation, this may be taken into account.**

Basic method

- 10-93(4) R When using the basic method for a *future, option or company issued warrant* on an equity, basket of equities or equity index, a *firm* must calculate the *PRR* as:
- (a) a purchased *option* or a long *company issued warrant* position: the *PRR* must be the equity equivalent position multiplied by the appropriate *PRA*, but the result may be limited to the *mark to market* value of the *option or company issued warrant*;
 - (b) a written *option*: the *PRR* must be the equity equivalent position underlying the *option* multiplied by the appropriate *PRA*, reduced by any excess of the exercise value over the *mark to market* value of the underlying instrument in the case of a call *option* or vice versa for a put *option*, but limited to nil if it would otherwise be negative;
 - (c) a short *company issued warrant* position: the *mark to market* value of the equity underlying the *company issued warrant* multiplied by the equity method 1 *PRA* for the underlying equity; and
 - (d) an OTC *future* or an equity or equity index: the *PRR* must be the equity equivalent position multiplied by the appropriate *PRA*.

Calculation of equity equivalent positions

- 10-93(5) R A *firm* must derive the amount of the equity equivalent position as follows:
- (a) a *future or option* on an equity index: the *mark to market* value of the underlying contract;
 - (b) an *option* on an equity: the *mark to market* value of the underlying equity; and
 - (c) an equity *swap*: the nominal value of the equity *swap*.

Appropriate *PRA* for basic method

- 10-93(6) R A *firm* must determine the appropriate *PRA* for the basic method as follows:
- (a) a *future, option or swap* on a single stock: the *PRA* is the equity method 1 *PRA* applicable to the underlying instrument;
 - (b) a *future, option or swap* on a basket of equities or narrow-based equity index: the *PRA* is the equity method 1 *PRA* applicable to an appropriate equity position; and

(c) a *future, option* or *swap* on a broad-based equity index: the *PRA* is 8%.

10-94 Calculation of interest rate add-on for derivatives

10-94(1) R Where a *firm* includes an actual or notional position in an “equity derivative” in the equity derivatives method an additional *PRR* must be calculated to cover the interest rate risk, using one of the methods described in this rule.

10-94(2) R An “equity derivative” is a *forward, future, option* or *company issued warrant* on an equity, basket of equities, or equity index.

Basic method

10-94(3) R A *firm* must calculate the interest rate risk of each underlying instrument for each expiry date separately, as follows:

- (a) multiply the *mark to market* value of the position in the notional equity or equity portfolio underlying the *derivative* contract by the percentage in the table below;
- (b) where the amount calculated in (a) is negative, its sign should be reversed; and
- (c) the results must be aggregated to form the total interest rate add-on.

R Table 10-94(3)

Time to expiry	Percentage
0-3 months	0.20
3-6 months	0.40
6-12 months	0.70
1-2 years	1.25
2-3 years	1.75
3-4 years	2.25
4-5 years	2.75
over 5 years	3.75

Alternative method

- 10-94(4) R For each position in an “equity derivative”, a *firm* must include in its interest rate method calculations a notional government bond, in accordance with rule 10-101(12).**

Modelling method

- 10-94(5) G *A firm* that wishes to use another method of calculating the interest rate risk of “equity derivatives” will need to seek a modification or waiver from this rule from the *FSA*; in general, a modification or waiver permitting use of another method will only be given where a *firm* has been granted a modification or waiver permitting use of a risk assessment model in respect of “equity derivatives”.

INTEREST RATE METHOD

- 10-100** Types of positions to be included in the interest rate method

Securities, cash borrowings, qualifying deposits, and repurchase and similar agreements

- 10-100 (1) R A *firm* must apply the interest rate method to the following *trading book* positions (whether or not *forward* positions):**

- (a) a debt security;**
- (b) a non-convertible preference security;**

- (c) an interest rate exposure embedded in a financial instrument; and
- (d) a cash borrowing or a *qualifying deposit*, whether secured or unsecured,

except for:

- (e) an offering of debt *securities*, to the extent that the issuing market method applies;
- (f) a *qualifying debt security* hedging an *option* or *company issued warrant*, where the *qualifying debt security* is of a type suitable for delivery to satisfy the *option* or *warrant*, and up to a maximum of the extent to which the nominal amount of the debt is matched by the nominal amount of the debt underlying the *option* or *warrant*, which may at the discretion of the *firm* be treated under rule 10-111(2);
- (g) a *tender offer* as principal on a debt *security*, which must be treated as an *OTC option* under the interest rate *derivatives* method;
- (h) a cash borrowing or *qualifying deposit*, whether secured or unsecured, with a residual maturity of less than one month, which may be treated in accordance with rule 10-41(7)(c); and
- (i) a *material holding* in a *credit* or *financial institution* which must be treated in accordance with rule 10-61(7).

- G The 'residual maturity' may be determined with reference to the time of the next interest rate fixing, if this is earlier than the repayment date.

Convertibles

- 10-100 (2) R A *firm* may apply the interest rate method to a *convertible* only where permitted to do so under rule 10-81(2).

Dual currency bonds

- 10-100 (4) R A *firm* must derive two positions in respect of a dual currency bond as follows:
 - (a) a debt *security* denominated in the currency in which the dual currency bond is issued which must be treated under the interest rate method; and
 - (b) a *forward* contract for the purchase of the redemption currency which must be treated under rule 10-101(11) below, and is also subject to a foreign exchange requirement.

Obligatory inclusion of debt and interest rate derivatives

- 10-100 (5) R** **A firm must apply the interest rate method to a position in the following interest rate *derivatives*:**
- (a) an *OTC future* which relates to a notional or actual *qualifying debt security* or interest rate;**
 - (b) an *FRA* or other *contract for differences* (including *swaps* other than *equity swaps*) whose values are based on generally available interest rates;**
 - (c) a forward foreign exchange position (see rule 10-101(11));**
 - (d) a currency future; and**
 - (e) an interest rate leg of an *equity swap* (see rule 10-81(3)).**

Optional inclusion of debt and interest rate derivatives

- 10-100 (6) R** **A firm may apply the interest rate method to a position in the following interest rate *derivatives*:**
- (a) an exchange traded *future* which relates to an interest rate or to a notional or actual *debt security*;**
 - (b) an exchange traded *option* which relates to a notional or actual *debt security* or an interest rate, or to an exchange traded *future* which would meet the requirements of (a) above, provided the contract is *in the money* by more than the appropriate *PRA*;**
 - (c) an *OTC option* which relates to a notional or actual *qualifying debt security* or an interest rate, or to an exchange traded *future* which meets the requirements of (a) above, provided the contract is *in the money* by more than the appropriate *PRA*;**
 - (d) an *option* on a *swap* provided the *option* is *in the money* by more than the *PRA* on a *government security* in the relevant currency with maturity equal to the length of the *swap*;**
 - (e) a *company issued warrant* which relates to a *qualifying debt security*, provided the *warrant* is *in the money* by more than the appropriate *PRA*;**
 - (f) a synthetic long or short position in a *debt security*, which may be treated as a *future* on that instrument, provided that:
 - (i) the synthetic long consists of a long call *option* and a short put *option* on the same underlying instrument with the same maturity dates and strike prices; and****

(ii) **the synthetic short position consists of a short call *option* and a long put *option* on the same underlying instrument with the same maturity dates and strike prices.**

- G (g) A *firm* that wishes to include the notional positions arising from risk assessment models for *swaps* or *options* (see rule 10-101(2)) will need to seek the relevant modification or waivers from the *FSA*.

Optional inclusion of interest rate component of equity derivatives

10-100 (7) R A *firm* may apply the interest rate method to calculate the interest rate risk *PRR* on its positions in equity *derivatives*.

Appropriate *PRA*

10-100 (8) R A *firm* must determine the appropriate *PRA* in (6) above using the following principles:

- (a) **in the case of an *option* or a *future* or a *company issued warrant* on an actual or notional debt *security*, the appropriate *PRA* is the sum of the specific risk *PRA* and the maturity-based general market risk *PRA* attributable to the underlying debt *security*;**
- (b) **in the case of an *option* on a *future*, where the *future* relates to an actual or notional debt *security*, the appropriate *PRA* is the sum of the specific risk *PRA* and the maturity-based general market risk *PRA* attributable to that debt *security*; and where the *future* relates to an interest rate, the appropriate *PRA* is the sum of the specific risk *PRA* and the maturity-based general market risk *PRA* attributable to a government *security* of the same currency and maturity as the notional deposit underlying the contract.**

10-101 Calculation of debt equivalent positions for derivatives

General rule

10-101 (1) R Provided the *firm* is permitted to apply the interest rate method to an interest rate *derivative*, it must use this rule to derive the debt equivalent amount in accordance with 10-101(3) to 10-101(15).

Risk assessment models

10-101 (2) G A *firm* may seek a modification or waiver from 10-101(1) from the *FSA* to permit the *firm* to use a risk assessment model in respect of its *swaps*, *FRAs*, *caps* and *floors*, *options* on *swaps* or debt *options* to calculate debt equivalent positions which may be included in the interest rate method, provided the model forms part of the day to day management supervision of the *firm's* business and meets other criteria

- G Further guidance on the criteria for the review of such models can be obtained from the *FSA*.

Options on debt securities

10-101 R An *option* on a debt *security* or interest rate must be included in the interest rate method:

(3)

- (a)** in the case of an *option* on a debt *security*, as a position in that debt *security*, with a value equal to the *mark to market* value of the underlying *security*; and
- (b)** in the case of an *option* on an interest rate, as a position in a zero coupon government *security*, with value equal to the quantity underlying the *option*, and maturity equal to the sum of the time to expiry of the *option* and the length of the period for which the interest rate is fixed;

and which:

- (c)** must be a long debt equivalent position in the case of a purchased call *option* or a written put *option*; and
- (d)** must be a short debt equivalent position in the case of a purchased put *option* or a written call *option*.

Futures on interest rates

10-101 R For each position in a *future* on an interest rate, a *firm* must include in the interest rate method a notional long debt equivalent position and a notional short debt equivalent position in a zero coupon government *security* with the following maturities:

(4)

- (a)** where the *firm* has fixed the rate of interest it will pay at some time in the future (for example, it “sells” an interest rate *future* or “buys” an *FRA*):
 - (i)** the notional short position has a maturity equal to the time to expiry of the *future* plus the maturity of the borrowing period; and
 - (ii)** the notional long position has a maturity equal to the time to expiry of the *future*; and
- (b)** where the *firm* has fixed the rate of interest it will receive at some time in the future:
 - (i)** the notional short position has a maturity equal to the time to expiry of the *future*; and
 - (ii)** the notional long position has a maturity equal to the time to expiry of the *future* plus the maturity of the deposit period.

Options on futures on interest rates

- 10-101 (5) R** **An *option* on a *future* on an interest rate must be included in the interest rate method as a position in the *future*, as described in (4) above.**

Forwards and futures on debt securities

- 10-101 (6) R** **For each position in a *forward* or *future* on a debt security, a firm must include in the interest rate method a notional long debt equivalent and a notional short debt equivalent position of a type and maturity as follows:**

(a) where the *firm* has bought the *future*:

- (i) a long position in the underlying security, or where the contract is satisfied by delivery of a range of securities, the cheapest to deliver; and**
- (ii) a short position in a zero coupon government security with maturity equal to the time to expiry of the *futures* contract; and**

(b) where the *firm* has sold the *future*:

- (i) a short position in the underlying security, or where the contract is satisfied by delivery of a range of securities, any deliverable security; and**
- (ii) a long position in a zero coupon government security with maturity equal to the time to expiry of the *futures* contract.**

Options on futures on debt securities

- 10-101 (7) R** **An *option* on a *future* on a debt security must be included in the interest rate method as a position in the *future*, as set out in (6) above.**

Futures and options based on an index of prices

- 10-101 (8) R** **Where the settlement amount of a *future* or *option* is based on an index of the prices of a range of notional or actual debt securities, the *firm* must treat the contract as the notional position in the longest of these securities.**

Options on interest rate and currency swaps

- 10-101 (9) R** **For a position in an *option* on an interest rate or currency swap, a firm must apply the interest rate method to a notional position in a government security with a maturity equal to that of the swap, which:**

- (a) must be a short position if on exercise the *firm* is committed to pay fixed rate interest and a long position if the *firm* is entitled to receive fixed rate interest;
- (b) has a coupon equal to that rate of interest; and
- (c) has a value equal to the principal amount of the *swap*.

Interest rate and currency swaps

- 10-101 (10) R** Where a *firm* enters into an interest rate or currency *swap*, it must treat each leg of the *swap* as a notional position in a government *security* in the currency concerned, which:
- (a) must be a long position if the *firm* is receiving interest and a short position if the *firm* is paying interest,
 - (b) has maturity:
 - (i) in the case where the *firm* is paying or receiving fixed rate interest, equal to the length of the *swap*; and
 - (ii) in the case where the *firm* is paying or receiving floating rate interest, equal to the period remaining to the next interest rate reset date; and
 - (c) has a coupon equal to the rate of interest payable or receivable on the leg.

Forward foreign exchange and currency futures

- 10-101 (11) R** Where a *firm* enters into a forward foreign exchange or currency futures contract, it must treat the position for the purpose of calculating interest rate risk as two notional zero coupon government *securities* in the currencies concerned, which:
- (a) must be a long position for the currency purchased and a short position for the currency sold; and
 - (b) must have a maturity date equal to the settlement date of the contract.
- G Forward foreign exchange positions and currency futures must also be included in a *firm*'s calculation of its *FER*.

Equity Derivatives

- 10-101 (12) R** (a) Where a *firm* has chosen to use the interest rate method to calculate the interest rate risk on an “equity derivative”, it must create for each position a notional position in a zero coupon government security in the currency concerned with value equal to the *mark to market* value of the notional equity position underlying the contract which:
- (i) must be a short position if the notional equity position underlying the contract is a long position and a long position if the notional equity position underlying the contract is a short position; and
 - (ii) has maturity equal to the expiry of the “equity derivative” contract.
- (b) An “equity derivative” is a *forward, future, option or company issued warrant* on an equity, basket of equities, or equity index.

Offerings of debt securities

- 10-101 (13) R** Where a *firm* has chosen to use the interest rate method to calculate the general market risk *PRR* on an offering of debt *securities* in accordance with rule 10-133(4), it must include its net commitment as a long position in the *security* concerned.

Cash legs of repurchase and similar agreements

- 10-101 (14) R** (a) For each forward cash leg of a “repurchase or similar agreement”, a *firm* must include in the interest rate method a notional debt equivalent position in a government *security* in an amount equal to the *mark to market* value of the cash position, with maturity equal to the maturity date under the agreement and a sign as follows:
- (i) where the forward leg represents a purchase of the underlying *security or physical commodity*, a short position; and
 - (ii) where the forward leg represents a sale of the underlying *security or physical commodity*, a long position.
- (b) “Repurchase or similar agreement” means a *repurchase, reverse repurchase, securities or physical commodities lending, securities or physical commodities borrowing, sale and buy back, buy and sale back, undocumented sale and buy back, or undocumented buy and sale back agreement*.

- G The coupon attributable to the debt equivalent position should be determined by the number of payments remaining: if the next interest payment date coincides with the maturity date, the coupon should be zero; otherwise, the coupon on the debt equivalent position should be the same as the interest rate on the underlying agreement.

Cash borrowings and qualifying deposits

- 10-101 (15) R** **A cash borrowing or *qualifying deposit* must be included in the interest rate method as a notional debt equivalent position in a zero coupon government *security*, whose value is equal to the *mark to market* value of the relevant position, whose maturity coincides with that of the earlier of the next interest rate fixing date and the maturity of the borrowing or deposit, and which must be:**

- (a) a long position in the case of a *qualifying deposit*; and
- (b) a short position in the case of a cash borrowing.

10-102 Netting

Netting of positions

- 10-102 (1) R** **Subject to (3) and (4) below, a *firm* may net a long against a short position only where the positions are in the same actual instrument (including debt equivalent positions arising from *convertibles*, *derivatives* and *company issued warrants* in respect of that instrument).**

Netting of tranches

- 10-102 (2) R** **A *firm* may net a long position in one tranche of a *security* against a short position in another tranche of the same *security* only where the relevant tranches:**

- (a) rank *pari passu* in all respects; and
- (b) become fungible within 180 days and thereafter the *securities* of one tranche can be delivered in settlement of the other tranche.

Netting of notional securities arising from swaps, FRAs, futures and options on interest rates and debt securities, cash borrowings, qualifying deposits, the cash legs of repurchase or similar agreements, forward foreign exchange and foreign currency futures

- 10-102 R (3)**
- (a) A firm may net notional long and short government securities arising from swaps, FRAs, futures and options on interest rates and debt securities, cash borrowings, qualifying deposits, the cash legs of “repurchase or similar agreements”, forward foreign exchange and foreign currency futures against each other, provided:**
- (i) they are in the same currency;**
 - (ii) the interest rates are within 15 basis points;**
 - (iii) (aa) if the maturity dates are less than one month, the dates are the same;**
 - (bb) if the maturity dates are between one month and one year, the dates are within seven days of each other; or**
 - (cc) if the maturity dates are over one year, the dates are within 30 days of each other;**
 - (iv) for a cash borrowing, the next interest rate refix date is within two years and repayment is within two years; and**
 - (v) for a qualifying deposit, the next interest rate refix date is within three months.**
- (b) In respect of a cash borrowing or qualifying deposit, the maturity date is the earlier of the repayment date and the next interest rate refix date.**
- (c) “Repurchase or similar agreement” means a repurchase, reverse repurchase, securities or physical commodities lending, securities or physical commodities borrowing, sale and buy back, buy and sale back, undocumented sale and buy back, or undocumented buy and sale back agreement.**

Netting of notional securities arising from futures, options and options on futures which may be satisfied by delivery of a range of securities

- 10-102 (4) R** **A firm may apply one of the following netting procedures to notional securities arising from futures, options and options on futures which may be satisfied by delivery of a range of securities:**
- (a) a firm may include the contract as though it were a position in the security which is the cheapest to deliver and thereby may net a short (or long) notional position in the cheapest to deliver against a long (or short) actual position in the cheapest to deliver; or**
 - (b) if the future or option gives rise to a short debt equivalent position, a firm may include the contract as though it were a position in any deliverable security and may net the short notional position against a long actual position in the same deliverable security, but only up to 90% of the common amount, with residual amounts being treated as separate positions within the interest rate method.**

Options on swaps

- 10-102 (5) R** **A firm must not net a debt equivalent position arising from an option on a swap against any other notional or actual position in a government security.**

Options on futures based on debt instruments

- 10-102 (6) R** **A firm may apply the same netting to a debt equivalent position arising from an option on a future based on a debt instrument as is permitted for the underlying contract.**

- 10-103** Categorisation of interest rate positions

General rule

- 10-103 (1) R** **A firm must separate its debt and debt equivalent positions included in the interest method by currency.**

Maturity bands

- 10-103 (2) R** **A firm must allocate each position to a maturity band by reference to the period remaining to:**
- (a) final maturity; or**

(b) the next call or next put date, where the *mark to market* value of the debt *security* is greater than the call value or lower than the put value respectively.

G Floating rate instruments should be allocated to maturity bands based on the time remaining to redetermination of the coupon.

10-104 Application of the interest rate method

General rule

10-104 (1) R A firm must calculate the *PRR* for each individual currency as the specific risk plus the general market risk and must aggregate the results for each currency to arrive at the total interest rate method *PRR*.

Specific risk

10-104 (2) R A firm must assign each net position to the appropriate category in Appendix 53 and apply the percentage shown to arrive at the specific risk for the position.

G The appropriate category for a floating rate instrument should be determined with reference to its maturity date.

G Where a *firm* uses the interest rate method for the purpose of calculating its general market risk *PRR* on a position in an offering of debt *securities*, the specific risk *PRR* should be calculated according to the issuing market method (rule 10-133(4)).

General market risk

10-104 (3) R (a) A firm may choose to apply the maturity-based approach or the duration-based approach in order to calculate the general market risk, but must apply the chosen method, by currency, on a consistent basis.

(b) Where a firm applies the maturity-based approach, it may choose to treat a position under method 1 or method 2.

10-105 Maturity-based approach method 1

Calculation

10-105 R A firm must calculate for each category
(1)

$$\left[\begin{array}{l} \text{aggregate} \\ \text{long} \\ \text{positions} \end{array} \right] + \left[\begin{array}{l} \text{aggregate} \\ \text{short} \\ \text{positions} \end{array} \right] \times \text{maturity-based general} \\ \text{market risk PRA for} \\ \text{category}$$

Total

10-105 R A firm must sum the results for each category to arrive at the general
(2) **market risk for positions treated under the maturity-based approach**
method 1.

10-106 Maturity-based approach method 2

Method

10-106 R A firm must apply the following procedures separately to each
(1) **currency portfolio and must then sum the resultant figures to arrive at**
the general market risk for the maturity-based approach method 2.

Price index linked debt securities

10-106 R Where a firm chooses to calculate the PRR for price index linked debt
(2) **securities with over one year to maturity under the maturity-based**
approach method 2, this must form a calculation separate from other
debt securities.

Calculation

- 10-106 R (a) Categorise positions into bands and zones on the basis of**
(3) **maturity and coupon, as set out in Appendix 53.**
- (b) Multiply the gross long and gross short positions in each**
maturity band within each category by the maturity-based
general market risk PRA for that band and that category as set
out in Appendix 53 to arrive at risk-weighted positions.

(c) Match the risk-weighted long positions against the risk-weighted short positions, as permitted in A to D below, according to the procedure described in (d) and (e) below:

A the same maturity band;

B the same zone;

C adjacent zones; and

D non-adjacent zones.

(d) Multiply one side of the common amount of the matched positions by the appropriate maturity-based matching factor set out in Appendix 53 and aggregate all the results.

(e) Aggregate all the unmatched amounts and add to the total in (d) above to arrive at the general market risk calculated under the maturity-based approach method 2 for the currency.

10-107 Duration-based approach

Method

10-107 (1) R A firm must apply the following procedures separately to each currency portfolio and must then aggregate the resultant figures to arrive at the general market risk for the duration-based approach.

Calculation

10-107 (2) R (a) Categorise all debt and debt equivalent positions into zones, as shown in the table below, on the basis of the modified duration of each instrument.

(b) Calculate the duration-weighted position of each instrument by multiplying its market value by its modified duration and by the assumed interest rate change shown in the following table (where qualifying currencies are defined in Appendix 53).

TABLE 10-107(2)(b) - Duration-based general market risk PRAs

Zone	Modified duration (in years)	Assumed interest rate change for qualifying currencies	Assumed interest rate change for other currencies
One	0-1	1%	2%
Two	1-3.6	0.85%	1.7%
Three	more than 3.6	0.7%	1.4%

(c) Match the duration-weighted long positions against the duration-weighted short positions, as permitted in A to C below, according to the procedure described in (d) and (e) below:

- A the same zone;
- B adjacent zones;
- C zone 1 and zone 3.

(d) Multiply one side of the common amount of the matched positions by the percentages shown in the following table and aggregate all the results:

TABLE 10-107(2)(d) - Duration-based general market risk matching factors

	<i>Matching factor</i>
Positions in the same zone	2%
Positions in adjacent zones	40%
Positions spanning zones 1 and 3	150%

(e) Aggregate all the unmatched amounts and add to the amount calculated under (d) above to arrive at the general market risk calculated under the duration-based approach.

TREATMENT OF INTEREST RATE DERIVATIVES OUTSIDE THE INTEREST RATE METHOD

10-110 Types of positions to be included under the interest rate derivatives method

General rule

10-110 (1) R A *firm* must apply the interest rate *derivatives* method to a position in the following debt *securities* or interest rate *derivatives*, except to the extent that the *firm* is required, or is permitted and chooses, to apply the interest rate method to the position:

- (a) an OTC *future* on a debt *security*;
- (b) an exchange traded *future*;
- (c) an *option* on a debt *security*;

- (d) an *option* on:
 - (i) a *future* on a debt security; and
 - (ii) an interest rate *future*;
- (e) an *option* on a *swap*;
- (f) a *tender offer* on a debt security, which must be treated as an OTC written *option* on the debt security;
- (g) a *qualifying debt security* hedging an *option* on:
 - (i) that *qualifying debt security*; or
 - (ii) a *future* on that *qualifying debt security*

(provided the debt security is of a type suitable to satisfy delivery of an *option* of the type held), up to a maximum of the extent to which the nominal amount of the debt security is matched by the nominal amount of the debt security underlying the *option*;
- (h) a *cap* or *floor*; and
- (i) a *company issued warrant* on a debt security.

G The *firm* may apply for a modification or waiver from the *FSA* to use a risk assessment model for its *caps* and *floors* (see 10-101(2)).

Netting

- 10-110 (2) R A *firm* must not net long and short positions except:
- (a) a position in a purchased interest rate *derivative* may be netted with a written interest rate *derivative* only where the characteristics of the two *derivatives* are identical in all respects; and
 - (b) a *firm* may net a purchased *cap* (or *floor*) against a written *cap* (or *floor*) provided they expire within 30 days of each other and all other terms are identical (*caps* may not be netted against *floors*).

10-111 Alternative methods

Summary of alternative methods

10-111 (1) R A *firm* must apply one of the methods outlined in the following table:

R TABLE 10-111(1) - Interest rate derivative positions: alternative methods

1	<p>Hedging method</p> <p>(a) In respect of a <i>qualifying debt security</i> hedging an <i>option</i> or <i>company issued warrant</i> on that <i>security</i> a <i>firm</i> may choose to apply the hedging method under 10-111(2) below to the <i>qualifying debt security</i> and the related <i>option</i> or <i>warrant</i> to the extent that the nominal amount of the debt <i>security</i> underlying the <i>option</i> or <i>company issued warrant</i> matches the nominal amount of the debt <i>security</i>.</p> <p>(b) To the extent that the nominal amount of the debt <i>security</i> exceeds the nominal amount of the debt <i>security</i> underlying the <i>option</i> or <i>warrant</i>, a <i>firm</i> must apply the interest rate method.</p>
2	<p>Margin requirement method</p> <p>Where an exchange listed in Appendix 51 has a positive initial margin requirement, a <i>firm</i> may apply the margin requirement method under 10-111(3) below to any <i>derivative</i> traded on that exchange.</p>
3	<p>Basic method</p> <p>Where a <i>firm</i> is not permitted, or chooses not to apply any other available method, it must treat interest rate <i>derivative</i> positions under the basic method, as set out in 10-111(4) below.</p>

Hedging method

- 10-111 (2) R** When using the hedging method for a *qualifying debt security* hedging an *option* or *company issued warrant* on that *security*, a *firm* must calculate the *PRR* for the debt *security* position and the *option* or *warrant* position in accordance with the provisions of Appendix 54.

Margin requirement method

- 10-111 (3) R**
- (a) A *firm* may apply the margin requirement method to a *derivative* which is traded on an exchange listed in Appendix 51, provided that the exchange charges a positive initial margin requirement.
- (b) When using the margin requirement method for an exchange traded interest rate *derivative*, a *firm* must:
- (i) Take 100% of the initial margin requirement of the exchange; and
- (ii) Multiply the result by the factor shown in Appendix 51.
- (c) Where the exchange calculates the margin requirement on an overall basis, or offsets *futures* and *options* in the margin calculation, this may be taken into account.

Basic method

- 10-111 (4) R** When using the basic method for a debt *derivative*, a *firm* must calculate the *PRR* for debt equivalent positions as follows:
- (a) a purchased *option* or long *company issued warrant* position: the *PRR* must be the *mark to market* value of the position underlying the *option* or *warrant* multiplied by the appropriate *PRA*, but the result may be limited to the *mark to market* value of the *option* or *warrant*;
 - (b) a written *option*: the *PRR* must be the *mark to market* value of the position underlying the *option* multiplied by the appropriate *PRA*, reduced by any excess of the exercise value over the *mark to market* value of the underlying instrument in the case of a call *option* or vice versa for a put *option*, but limited to nil if it would otherwise be negative;
 - (c) a short *company issued warrant*: the *PRR* must be the *mark to market* value of the bond underlying the *warrant* multiplied by the appropriate *PRA*;
 - (d) an OTC *future* on a debt *security*: the *PRR* must be the *mark to market* value of the *future* multiplied by the appropriate *PRA*;
 - (e) a *cap* or *floor*: the *PRR* must be the notional or actual amount underlying the contract multiplied by the appropriate *PRA*, but in the case of a long position the result may be limited to the *mark to market* value of the *cap* or *floor*.

Appropriate *PRA* for basic method

- 10-111 (5) R** A *firm* must determine the appropriate *PRA* for the basic method for interest rate *derivatives* as follows:
- (a) a *future* on a debt *security*: the *PRA* is the sum of the specific risk *PRA* and the maturity-based general market risk *PRA* applicable to the debt *security*, as set out in Appendix 53;
 - (b) an *option* or *company issued warrant* on a debt *security* or an *option* on a *future* on a debt *security*: the *PRA* is the sum of the specific risk *PRA* and the maturity-based general market risk *PRA* applicable to the debt *security*, with a maturity equal to the time to expiry of the *option*, as set out in Appendix 53;

- (c) an *option* on an interest rate or an interest rate *future*: the *PRA* is the sum of the specific risk *PRA* and the maturity-based general market risk *PRA* applicable to a zero coupon government *security* in the currency concerned with a maturity equal to the sum of the time to expiry of the contract and the length of the period on which the settlement amount of the contract is calculated, as set out in Appendix 53;
- (d) an *option* on a *swap*: the *PRA* is the sum of the specific risk *PRA* and the maturity-based general market risk *PRA* applicable to a zero coupon government *security* in the currency concerned with a maturity equal to the length of the *swap*;
- (e) a *cap* or *floor*: the *PRA* is the sum of the specific risk *PRA* and the maturity-based general market risk *PRA* applicable to a zero coupon government *security* in the currency concerned with a maturity equal to the remaining period of the *cap* or *floor*.

Collective investment schemes

- 10-120 **A firm must calculate the *PRR* for a position in a *collective investment scheme* as the *mark to market* value of the *firm's* aggregate position multiplied by:**
- (a) 16% in the case of an *eligible collective investment scheme*; and
 - (b) 100% in the case of any other *collective investment scheme*.

ISSUING MARKET METHOD

- 10-130 Application of issuing market method
- 10-130 R **A firm may apply the issuing market method only where, in respect of new *securities* or *securities* which are new to the market, the *firm*:**
- (1) (a) has given a commitment to an issuer to purchase, underwrite or distribute those *securities*; or
 - (b) is a member of the syndicate for the underwriting or distribution of those *securities*.
- 10-130 R **Where a *firm* is permitted, but chooses not to apply the issuing market method to a commitment, a *PRR* must be computed in respect of the net commitment under another permitted rule from the date of commencement of the commitment.**
- (2)

10-131 Types of position to be included under the issuing market method

General rule

10-131 (1) R **A *firm* which applies the issuing market method must apply it to:**

- (a) any commitment to an issuer of *securities* to purchase underwrite or distribute new *securities* and *securities* which are new to the market;**
- (b) any sub-underwriting commitment obtained by the *firm* from others; and**
- (c) any allotment, purchase or sale of the *securities* in respect of which the *firm* has given a commitment under (a) or (b) above.**

Timing

10-131 (2) R **Where a *firm* is permitted and chooses to apply the issuing market method, a *PRR* must be calculated from the date of the commencement of the commitment until six days after “working day zero”, where “working day zero” is:**

- (a) in respect of a bond issue and other issues which utilise similar underwriting processes, the later of the allotment date and the *payment date*;**
- (b) in respect of a UK domestic equity issue and other issues which utilise similar underwriting processes, the later of the subscription date and the announcement of allocations; and**
- (c) in the case of a rights issue, the first day after the subscription period has ended; and**

thereafter the *firm* must calculate *PRR* for any remaining position under other permitted methods.

G For Large exposures Monitoring (LEM) only, reporting will be from the date of the commencement of the commitment, rather than “working day zero”.

Existing securities which are exchange traded

10-131 (3) R **A *firm* may apply the issuing market method to a commitment to purchase existing *securities* which are exchange traded only if:**

- (a) the *firm* first notifies the *FSA* in writing; and**
- (b) the purchase of existing *securities* has the characteristics of an offering of new *securities* which are new to the market, by reference to:**

- (i) the extent of the publicity;
- (ii) the method of distribution;
- (iii) how widely the offering is to be made; and
- (iv) the type of documentation to be used,

in which case the seller of the *securities* for the purposes of this rule shall be treated as an issuer.

10-132 Net commitment

Calculation of net commitment

10-132 R (1) **A *firm's* net commitment is the amount of the gross commitment adjusted for:**

- (a) underwriting or sub-underwriting commitments obtained from others;
- (b) purchases and sales of the *securities*; and
- (c) allocations granted or received.

Calculation of LER

10-132 R (2) **Where a *firm* treats an underwriting commitment under the issuing market method, the net position shall be included in the calculation of *LER* from “working day zero”. For equities underwritten using the issuing market method, the method 1 *PRA* is required (10-133(1)), as detailed in Appendix 49. The *PRA* includes both specific and general risk. The general risk should be deducted from the *PRA* to give specific risk weightings for *LER* purposes.**

10-133 Calculation of PRR

General rule - equities

10-133 R (1) **The *PRR* for an issue of equities under the issuing market method shall be calculated as the net commitment multiplied by the equity method 1 *PRA* discounted by the percentage in Table 10-133(5).**

General rule - debt securities

10-133 R (2) **A *firm* may calculate the *PRR* for an issue of debt *securities* using either the basic method or the hybrid method, except that only one method may be applied to each issue.**

Basic method

- 10-133 (3) R** The *PRR* for an issue of debt *securities* under the issuing market method shall be calculated as the net commitment multiplied by the sum of the specific risk *PRA*, discounted by the percentage in Table 10-133(5), and the full maturity-based general market risk *PRA*.

Hybrid method

- 10-133 (4) R**
- (a) For the purpose of calculating general market risk *PRR*, a *firm* must include the net commitment in the interest rate method; and
 - (b) the specific risk *PRR* must be calculated as the net commitment multiplied by the appropriate specific risk *PRA*, discounted by the percentage in Table 10-133(5).

- 10-133 (5) R** TABLE 10-133(5) - Discount percentages for issuing market method

Time band	Bond issues and similar	Domestic equity issues, rights issues and similar
	Specific risk	Specific risk and general market risk
From initial commitment until "Working day zero"	100%	90%
Working day one	90%	90%
Working day two	75%	75%
Working day three	75%	75%
Working day four	50%	50%
Working day five	25%	25%
After working day five	Issuing market method no longer applies	

FOREIGN EXCHANGE REQUIREMENT

Summary of FER

10-150 R A *firm* must calculate an *FER* where it has any asset or liability or any off-balance sheet contract which is denominated in, or gives rise to an exposure in, a currency other than the currency of its books of account. For the purposes of *FER*, gold should be treated as another currency.

10-151 Types of exposures to be included in the FER

General rule

10-151 (1) R A *firm* must calculate an *FER* for the following positions, identifying each currency separately, including the currency of its books of account:

- (a) any currency *future* at the nominal value of the contract;
- (b) any *forward* contract for the purchase or sale, at the contract value, including any future exchange of principal associated with cross-currency *swaps*;
- (c) any currency *option*;
- (d) irrevocable guarantees, and similar instruments, which are certain to be called;
- (e) any future income or expense which is:
 - (i) known but not yet accrued; and
 - (ii) fully hedged by forward foreign exchange transactions; and
 - (iii) details of which are notified to the *FSA* in writing;
- (f) any other balance sheet asset or liability; and
- (g) any other off-balance sheet commitment to purchase or sell an asset denominated in that currency;

except that:

- (h) a *firm* may exclude from its *FER* calculation any positions that are of a non-trading or structural nature, and have been deliberately entered into in order to hedge against the effect of adverse exchange rate movements on the value of:

- (i) the *firm's* capital; or
- (ii) items that the *firm* has deducted in full when calculating its *financial resources requirement*, or that are subject to a 100% capital requirement under the *PRR* or *CRR* rules,

provided that the *firm* has provided details of these positions in writing to the *FSA*.

- G The interest rate risk of forward foreign exchange and currency futures contracts must be calculated in accordance with the interest rate method.

Dual currency bonds

- 10-151 (2) R In respect of a dual currency bond, a *firm* must calculate an *FER* on a notional forward contract with a deemed settlement date equal to the maturity of the bond:

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

Determining the currency of investments

- 10-151 (3) R For the purposes of determining the currency in which a position is denominated, a *firm* must apply the following principles:

- (a) where the price of an instrument is quoted in only one currency, a position in that instrument must be treated as an asset or liability in that currency;
- (b) where the price of an instrument is quoted in more than one currency, a position in that instrument must be treated as an asset or liability in the currency in which the *firm* accounts for the instrument;
- (c) notwithstanding (a) and (b) above, a position in an American depository receipt or similar form of instrument must be treated as a position, translated at current spot rate, in the currency of the underlying instrument; and
- (d) where a position is denominated in or gives rise to an exposure in a composite currency, it may be decomposed into the constituent currencies according to the quotas in force.

10-152 Treatment of foreign exchange options

Risk assessment models

- 10-152(1) G A *firm* may, seek a modification or waiver from the *FSA* to use a risk assessment model in respect of its foreign exchange *options* to derive notional *forward* foreign exchange positions, provided the model forms part of the day to day management supervision of the *firm's options* business and meets other criteria.
- G Further guidance on the criteria for the review of such models can be obtained from the *FSA*.

10-152 (1A) R A *firm* must apply either Method 1 or Method 2 to a foreign exchange option.

Method 1

10-152 (2) R A *firm* must calculate the *FER* of a foreign exchange option as 8% of the nominal value of the contract, adjusted as follows:

- (a) a purchased *option*: the *FER* may be restricted to the *mark to market* value of the *option*; and
- (b) a written *option*: the *FER* may be reduced (but to no less than zero) by any excess of the exercise value over the *mark to market* value for a call *option*, or vice versa for a put *option*.

Method 2

- 10-152 (3) R (a) A *firm* must include currency positions arising from foreign exchange options in the *FER* method if the option is at least 8% in the money, in which case the resulting currency positions must be based on the nominal amount of the contract valued at current spot rates.**
- (b) A *firm* must compute, in respect of a foreign exchange option which is less than 8% in the money, currency positions based on the nominal amount of the contract valued at current spot rates; and
- (i) Where such a currency position would increase the net open position in that currency, the position must be included in the *FER* method; and
- (ii) Where such a currency position would decrease the net open position in that currency, the position must not be included in the *FER* method.

Calculation of in the money

- 10-152 (4) R** For the purposes of this rule, a *firm* must determine the extent to which the *option* contract is “*in the money*” by reference to the difference between the exercise price and the current forward rate for the final date on which the *option* may be exercised.

10-153 FER method

Calculation of net open position

- 10-153 (1) R** A *firm* must calculate a net open position for all currencies excluding the currency of the *firm*'s books of account, and must translate them to the reporting currency using the prevailing spot rates.

Calculation of FER

10-153 (2) R A *firm* must use the *FER* method 1.

- G A *firm* wishing to use an internal model will need to seek a modification or waiver from this rule.

FER method 1

10-153 (3) R A *firm* must calculate the *FER* under the *FER* method 1 as 8% of the higher of:

(a) the aggregate of the net open long positions in each currency;
and

(b) the aggregate of the net open short positions in each currency.

10-153(4) G A *firm* may seek a modification or waiver to use its internal model to calculate *FER* in respect of all, or some, of its positions.

- G Further guidance on the criteria which such models must meet, and the review process, can be obtained from the *FSA*.

Currency pairs subject to binding inter-governmental agreements

10-153(5) G A *firm* may seek a modification or waiver from the *FSA* to use an alternative method to calculate *FER* on its matched positions in currency pairs that are subject to legally binding inter-governmental agreements limiting their variation relative to each other.

- G Details of the method are available from the *FSA* on request.

COMMODITIES METHOD

Types of positions to be included in the commodities method

- 10-166** General rule
- 10-166(1)** **R** **A firm must calculate PRR on all positions in commodities in accordance with one of the four approaches set out in rules 10-167 to 10-169A. All spot, physical trading, derivative and other off balance sheet items whose price is affected by changes in commodities prices must be included in the calculation.**
- G** In general, a commodity is a physical product which is or can be traded on the secondary market. Commodities include precious metals (except gold, which is to be treated as a foreign currency), agricultural products, minerals and base metals, oil and other energy products.
- 10-166(2)** **R** **A firm must calculate the PRR for each commodity separately, except that:**
- (a) different sub-categories of the same commodity that are deliverable against each other may be treated together; and**
- (b) commodities which are close substitutes for each other, and whose price movements over a minimum period of one year can be shown by the firm to exhibit a stable and reliable correlation of at least 0.9, may be treated together.**
- G** The onus is on the firm to show that the correlation referred to in (b) above exists on a continuing basis.
- 10-166(3)** **R** **Positions which are purely stock financing may be omitted from the calculation of PRR on commodities positions under rule 10-166 and treated instead under the interest rate method (rule 10-102(3)(a)).**
- G** Stock financing is defined under the Capital Adequacy Directive. Where physical stock has been sold forward, the cost of funding must be locked in until the date of the forward sale.
- 10-167** Simplified approach
- 10-167(1)** **R** **All positions in commodities or commodity derivatives must be expressed in terms of the standard unit of measurement for that commodity (such as tonnes, barrels or kilos).**
- 10-167(2)** **R** **A firm must multiply the position in each commodity by the current spot price for the commodity converted to the firm's reporting currency at current spot rates, and calculate the PRR as the sum of:**
- (a) the overall net position multiplied by 15%; and**
- (b) the gross position multiplied by 3%.**

10-167(3) R **A firm must sum the results for each commodity to arrive at the total PRR for positions treated under the simplified approach.**

10-168 Maturity ladder approach

10-168(1) R **All positions in each commodity or commodity derivatives must be expressed in terms of the standard unit of measurement for that commodity (such as tonnes, barrels or kilos) or in terms of value. A firm must allocate net positions on any given day to the appropriate maturity band in the table below. Physical stock must be assigned to the first band.**

Table 10-168

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

10-168(2) R **A firm may then offset long and short positions within and between maturity bands in accordance with the following:**

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

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

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

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

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

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

Extended maturity ladder approach

10-169 R Until 31 December 2006 a *firm* may adopt the same approach as that outlined under rule 10-168(2), but apply the rates in the table below, if the *firm*:

- (a) undertakes significant commodities business, and
- (b) has a diversified commodities portfolio.

Table 10-169

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

Models approach

- 10-169A G A *firm* may seek a modification or waiver from the *FSA* to use a VaR model as the basis for calculating the *PRR* on its commodity positions.
- G The *FSA* will grant a modification or waiver permitting the use of a VaR model only where a number of qualitative and quantitative standards are met. In assessing the VaR model the *FSA* will have regard to the matters set out in chapter TV of IPRU(BANK).

- 10-169B Options
- Proprietary options pricing models
- 10-169B (1) G A *firm* may seek a modification or waiver from the *FSA* permitting it to use its proprietary *options* pricing model to calculate the *PRR* on *options* positions and their related hedges. The application for a modification or waiver may request that the *firm* be permitted to include an *option* in the maturity ladder approach.
- G A *firm* may propose any methodology that it believes will capture spread, carry and outright risks and that reflects its own day-to-day risk management. A *firm* is strongly advised to contact the *FSA* at the earliest point if it is considering introducing a model or adapting an existing one.
- No models
- 10-169B (2) R **A *firm* may include an *option* in the maturity ladder approach, the extended maturity ladder approach or the simplified approach only if it is in-the-money by more than the appropriate outright rate. Such *options* must be included as a position in the underlying commodity, of an amount equal to the “tonnage” underlying the *option* (long or short as appropriate), and with a maturity equal to the expiry date of the spot, forward or futures contract underlying the *option*.**
- 10-169B (3) R **An *option* which does not satisfy the condition in rule 10-169B(2) attracts a *PRR* in accordance with the following:**
- (a) **In the case of a purchased *option*, the *PRR* must be the *mark to market* value of the full position underlying the *option* multiplied by the appropriate outright rate, but the result may be limited to the *mark to market* value of the *option*.**
- (b) **In the case of a written *option*, the *PRR* must be the *mark to market* value of the full position underlying the *option* multiplied by the appropriate outright rate, reduced by the out-of-the-money amount. The *PRR* must be limited to zero if the calculation results in a negative number.**
- G The out-of-the-money amount is any excess of the exercise value over the *mark to market* value of the underlying commodity in the case of a *call option*, or vice versa for a *put option*.

Counterparty Risk Requirement

10-170 General principles of CRR

General rule

10-170 (1) R **A firm must calculate its total CRR on counterparty exposures arising from its *trading book* business and its *physical commodities* business as the sum of all the amounts calculated in accordance with the rules referred to in the table below.**

R **TABLE 10-170(1) - Counterparty risk requirement**

Rules	
10-171	Cash against documents transactions
10-172	Free deliveries of physical commodities and securities
10-173	Repurchase and reverse repurchase, securities lending and borrowing and sale and buy back agreements
10-174	Derivative transactions
10-175	Other amounts owed to a firm arising out of trading book business
10-176	Trading book deposits

10-170 (2) R **A firm must calculate CRR on a counterparty exposure arising from the *trading book* of another undertaking which the firm has guaranteed as a counterparty exposure of the firm itself.**

Frequency of calculation

10-170 (3) R **A firm:**

- (a) must calculate its CRR at least once each *business day*;
- (b) must, before executing any transaction, be able to re-calculate CRR to the level of detail necessary to ensure that the firm's *financial resources requirement* does not exceed the firm's *financial resources*; and
- (c) may for the purposes of the relevant calculations, use prices of *investments* and *physical commodities* as at the close of business on the previous day.

Negative amounts

- 10-170 (4)** R **A *firm* must not include any *CRR* if it is a negative amount.**

Instruments for which no *CRR* has been specified

- 10-170 (5)** R **Where a *firm* is in doubt as to the classification of an item for the purposes of *CRR*, it must add to its *CRR* an appropriate part of the counterparty exposure on the item concerned, and must immediately notify the *FSA* of the instrument or transaction, the counterparty and the treatment the *firm* adopts.**

Instruments of non standard form

- 10-170 (6)** R **Where an instrument is not of a standard form, a *firm* must add to its *CRR* an appropriate part of the counterparty exposure on the item concerned, and must immediately notify *the FSA* of the instrument or transaction, the counterparty and the treatment the *firm* adopts.**

- G The methodologies which have been developed assume instruments with standard characteristics. There are many examples, however, of instruments which, although based on a standard contract, contain structural features which make the rules, as stated, inappropriate. Examples of such instruments are (i) path dependent and other exotic *options*, (ii) *swaps* with cash flows subject to a multiplier, (iii) *securities* with embedded *options*. In such circumstances a *firm* should consult the *FSA*. Where a *firm* is in any doubt, it should always seek guidance from the *FSA*.

- 10-170(6A) E (1) In 10-170(5) or 10-170(6) “an appropriate part” is:
- (a) the whole; or
 - (b) a proportion which takes account of the characteristics of the transaction and the counterparty concerned, and of discussions with the *FSA* or a predecessor regulator.
- (2) Compliance with (1) may be relied on as tending to establish compliance with 10-170(5) or 10-170(6) as appropriate.
- (3) Contravention of (1) may be relied on as tending to establish contravention of 10-170(5) or 10-170(6) as appropriate.

Provisions

- 10-170 (7)** R **A *firm* may reduce the counterparty exposure on which its *CRR* is calculated to the extent that it makes provision for a counterparty balance.**

Connected companies

- 10-170 (8)** **R** **For the avoidance of doubt, a *firm* must calculate a *CRR* as appropriate on counterparty exposures to or from *connected companies*.**

Basis of valuation

- 10-170 (9)** **R** **For the purposes of valuing instruments and *physical commodities* at *mark to market* value in the calculation of *CRR*, a *firm* must be consistent in the basis it chooses and may use either mid market value or bid and offer prices (as appropriate).**

Netting

- 10-170 (10)** **R** **A *firm* which has offsetting exposures in similar types of transactions with a counterparty may offset these in accordance with rules 10-171(4), 10-172 (5), 10-173(10), 10-174(6) and 10-175(4) when calculating *CRR* if it has a contractual netting agreement with that counterparty, which:**

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

G Legal opinions should relate to:

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

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

10-171 Cash against documents transactions

General rule

10-171 (1) R **A *firm* which enters into a transaction on a cash against documents basis must calculate the counterparty exposure for transactions still unsettled 5 *business days* after *settlement day* as set out in (3) below and must then multiply this by the appropriate percentage set out in the table below to calculate a *CRR* for each separate unsettled transaction.**

R **TABLE 10-171(1) – Percentage to be applied to the counterparty exposure**

Business days after settlement day	Percentage
0-4	Nil
5-15	8%
16-30	50%
31-45	75%
46 or more	100%

Collateral

10-171 (2) R **A *firm* may reduce the counterparty exposure on which its *CRR* is calculated to the extent that it holds *acceptable collateral* to cover that exposure.**

Counterparty exposure

- 10-171 (3)** R (a) Where a *firm* has neither delivered *securities* or *physical commodities* nor received payment when purchasing *securities* or *physical commodities* for, or selling *securities* or *physical commodities* to, a counterparty, the positive counterparty exposure is the excess of the contract value over the market value of the *securities* or *physical commodities*.
- (b) Where a *firm* has neither received *securities* or *physical commodities* nor made payment when selling *securities* or *physical commodities* for, or purchasing *securities* or *physical commodities* from, a counterparty, the positive counterparty exposure is the excess of the market value over the contract value of the *securities* or *physical commodities*.

Netting

- 10-171 (4)** R A *firm* may offset positive and negative counterparty exposures, calculated in accordance with (3) above, before it multiplies the residual exposure by the appropriate percentage in Table 10-171(1) provided that:
- (a) the exposures arise on transactions with the same counterparty; and
- (b) the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 10-170(10).

Sub-total

- 10-171 (5)** R The sum of the amounts calculated in accordance with (1) to (4) above is the *firm's* total *CRR* for cash against documents transactions.

10-172 Free deliveries of physical commodities and securities

General rule

- 10-172 (1)** R When a *firm* makes delivery to a counterparty of *physical commodities* or *securities* without receiving payment or pays for *physical commodities* or *securities* without receiving the *physical commodities* or *securities*, the *firm* must calculate *CRR* for each such *free delivery* in accordance with (2), to (6) below.

Collateral

10-172 (2) R **A firm may:**

- (a) reduce the counterparty exposure on which its *CRR* is calculated to the extent that it holds *acceptable collateral* to cover that exposure; and
- (b) where it does not have an *ACMP*, may continue to multiply the counterparty exposure by 8% multiplied by the counterparty weight, to the extent that the *firm* holds *adequate collateral* to cover that exposure.

Counterparty exposure

10-172 (3) R **A firm must calculate the counterparty exposure for each *free delivery* as set out below and multiply this amount by the appropriate percentage in Table 10-172(2) as follows:**

- (a) if the *firm* has delivered *physical commodities* or *securities* to a counterparty and has not received payment, the counterparty exposure is the full amount due to the *firm* (i.e. the contract value);
- (b) if the *firm* has made payment to a counterparty for *physical commodities* or *securities* and not received them, the counterparty exposure is the *mark to market* value of the *physical commodities* or *securities* respectively.

R TABLE 10-172(3) - Percentage to be applied to counterparty exposures relating to free deliveries

Nature of counterparty to whom counterparty exposure exists	Business days since delivery			
	0-15	16-30	31-45	46 or more
A counterparty granted a credit line under an <i>ACMP</i>	8% x counterparty weight.			
A counterparty not granted a credit line under an <i>ACMP</i>	8% x counterparty weight*	50% x counterparty weight*	75% x counterparty weight*	100%

Cross border deliveries

- 10-172 (4) R** If settlement of the transaction is effected across a national border, the *firm* will be granted a window of one *business day* from the time of payment or delivery, during which the appropriate percentage will be zero.

Netting

- 10-172 (5) R** A *firm* may reduce the counterparty exposure for a transaction calculated in accordance with (2) above, before it multiplies the residual exposure by the appropriate percentage in Table 10-172(2), by:
- (a) the value of any free payment received from the counterparty; or
 - (b) the contract value of any *physical commodities or securities* received free from the counterparty,

provided that:

* for details of counterparty weights see **Appendix 47**

- (c) the exposures arise on transactions with the same counterparty; and
- (d) the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 10-170(10).

Sub-total

10-172 (6) R The sum of the amounts calculated in accordance with (2) to (5) above is the *firm's* total *CRR* for *free deliveries of physical commodities and securities*.

10-173 Repurchase and reverse repurchase, securities or physical commodities lending and borrowing and sale and buy back agreements
General rule

10-173 (1) R Where a *firm* has entered into any *repurchase, reverse repurchase, securities or physical commodities lending, securities or physical commodities borrowing, sale and buy back or buy and sale back agreement, undocumented sale and buy back or undocumented buy and sale back agreement*, it must calculate a *CRR* for each such agreement in accordance with (2) to (11) below.

Counterparty exposure

10-173 (2) R The counterparty exposure for:

- (a) any *repurchase, securities or physical commodities lending or sale and buy back or undocumented sale and buy back agreement* in respect of *securities or physical commodities* is the excess of the *mark to market* value of the *securities or physical commodities* over the value of *adequate collateral* under the agreement, if the net figure is positive; and
- (b) any *reverse repurchase, securities or physical commodities borrowing buy and sale back or undocumented buy and sale back agreement* in respect of *securities or physical commodities* is the excess of the amount paid or collateral given for the *securities or physical commodities* over the *mark to market* value of the *securities or physical commodities* received under the agreement, if the net figure is positive.

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

Percentages

- 10-173 (3)** R **A firm must calculate CRR:**
- (a) where the counterparty is granted a credit line under an *ACMP* as 8% multiplied by the counterparty weight*, multiplied by the counterparty exposure; and
 - (b) where the counterparty is not granted a credit line under an *ACMP* as 8% multiplied by the counterparty weight*, multiplied by the counterparty exposure except where the counterparty exposure is greater than:
 - (i) 5% of the value of the *securities* where the *securities* are *qualifying debt securities*; or
 - (ii) 10% of the value of the *securities* or *physical commodities* where they are any other *securities* or *physical commodities*,
- in which case the *firm* must in addition calculate a *CRR* of 100% of the excess of the counterparty exposure over these limits.

Additional CRR

- 10-173 (4)** R **Where a firm has entered into an *undocumented buy and sale back agreement* or an *undocumented sale and buy back agreement*, it must calculate an additional *CRR* equal to the *CRR* calculated in accordance with (3) above.**

Margin percentages

- 10-173 (5)** R **A firm may opt to calculate the *CRR* in (3)(b) above using the lower margin percentage (5%) in order to avoid undue complication.**

Mark to market value

- 10-173 (7)** R **For the purposes of this rule, the current *mark to market* value of *securities* and the value of cash lodged must include accrued interest.**

Daily valuation

- 10-173 (8)** R **A firm must *mark to market* collateral and *securities* or *physical commodities* lent or sold, or borrowed or purchased, at least daily.**

* for details of counterparty weights, see **Appendix 47**

Additional adequate collateral

- 10-173 (9)** R Where the *firm* has called for additional *adequate collateral* from the other party to the agreement and the counterparty exposure exceeds the margin limits in (3)(b) above, a *firm* may calculate a *CRR* as if the margin limit had not been exceeded for no more than one *business day*.

Netting

- 10-173 (10)** R Where a *firm* has a portfolio of *repurchase, reverse repurchase, securities or physical commodities* lending, *securities or physical commodities* borrowing, *sale and buy back* and *buy and sale back agreements* which it has entered into with the same counterparty, it may calculate the counterparty exposure on those transactions as the total of all *securities or physical commodities* and cash lent or given as collateral to the counterparty less the total of all *securities or physical commodities* and cash received from the counterparty, provided that the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 10-170(10).

Sub-total

- 10-173 (11)** R The sum of the amounts calculated in accordance with this rule is the total *CRR* for *repurchase and reverse repurchase, securities or physical commodities* lending and borrowing *sale and buy back* and *undocumented sale and buy back agreements*.

10-174 Derivative transactions

General rule

- 10-174 (1)** R A *firm* must calculate for each *derivative* transaction a *CRR* by multiplying the counterparty exposure calculated in accordance with (2) and (3) below, by the appropriate percentage in Table 10-174(5) below.

Collateral

- 10-174 (2)** R A *firm* may:
- (a) reduce the counterparty exposure on which its *CRR* is calculated to the extent that it holds *acceptable collateral* to cover that exposure; and

- (b) where it does not have an *ACMP*, may continue to multiply the counterparty exposure by 8% multiplied by the counterparty weight, to the extent that the *firm* holds *adequate collateral* to cover that exposure.

Counterparty exposure

- 10-174 (3)** **R** **A *firm* must calculate the counterparty exposure on *derivative* transactions in accordance with either (a), (b) or (c) below:**
- (a) where a counterparty has not fully paid a *margin requirement* on a *derivative* transaction listed on an *exchange* or cleared through a clearing house, or met it through the deposit of *acceptable collateral* not otherwise used, a *firm* must calculate the counterparty exposure as the shortfall;
 - (b) where a *firm* sells or writes an *option* to a counterparty or buys an *option* on behalf of a counterparty and the counterparty has not paid the full *option* premium, or met it through the deposit of *acceptable collateral* not otherwise used, it must calculate the counterparty exposure as the uncovered premium on the transaction; or
 - (c) a *firm* must calculate the counterparty exposure arising from a *derivative* transaction other than a written or sold *option* or a *derivative* transaction listed on an *exchange* or cleared through a clearing house, as the credit equivalent amount calculated in accordance with Table 10-174(3), not covered by the deposit of *acceptable collateral* not otherwise used.

R Table 10-174(3A) – Method of calculating credit equivalent amount

Type of derivative transaction	Credit equivalent amount	
	If A is positive	If A is negative
Interest rate swaps: single currency		
(a) floating rate swapped against floating rate	A	nil
(b) fixed rate swapped against floating rate:		
- under one year to maturity	A	nil
- over one year to five years	A + 0.5% of N	0.5% of N
- over five years	A + 1.5% of N	1.5% of N
Cross-currency interest rate swaps		
- under one year to maturity	A + 1% of N	1% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
Other interest rate contracts*		
- under one year to maturity	A	nil
- over one year to five years	A + 0.5% of N	0.5% of N
- over five years	A + 1.5% of N	1.5% of N
Foreign exchange and gold contracts*		
- exchange rate contracts with an original maturity of 14 days or less	nil	nil
- under one year to maturity	A + 1% of N	1% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
Equity contracts*		
- under one year to maturity	A + 6% of N	6% of N
- over one year to five years	A + 8% of N	8% of N
- over five years	A + 10% of N	10% of N
Precious metal (not gold) contracts*		
- under one year to maturity	A + 7% of N	7% of N
- over one year to five years	A + 7% of N	7% of N
- over five years	A + 8% of N	8% of N
Commodity contracts*		
- under one year to maturity	A + 10% of N	10% of N
- over one year to five years	A + 12% of N	12% of N
- over five years	A + 15% of N	15% of N

Notes

* *FRAs, swaps, futures, purchased options, and other contracts for differences*

A = the replacement cost of the contract

N = the notional or actual principal amount or value underlying the contract

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

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

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

If a firm uses the extended maturity ladder approach to calculate PRR under rule 10-169, it may use Table 10-174(3B).

R Table 10-174(3B) – Method of calculating credit equivalent amount for commodities

Type of derivative transaction*	Credit equivalent amount	
	If A is positive	If A is negative
Precious metals (except gold)		
- under one year to maturity	A + 2% of N	2% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
Base metals		
- under one year to maturity	A + 2.5% of N	2.5% of N
- over one year to five years	A + 4% of N	4% of N
- over five years	A + 8% of N	8% of N
Softs (agricultural)		
- under one year to maturity	A + 3% of N	3% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 9% of N	9% of N
Other commodity		
- under one year to maturity	A + 4% of N	4% of N
- over one year to five years	A + 6% of N	6% of N
- over five years	A + 10% of N	10% of N
Notes		
<p><i>FRAs, swaps, futures, purchased options, and other contracts for differences</i></p> <p>A = the replacement cost of the contract</p> <p>N = the notional or actual principal amount or value underlying the contract</p> <p>For contracts with multiple exchanges of principal, the % of N has to be multiplied by the remaining number of payments still to be made according to the contract.</p> <p>In the case of a derivative referenced on a bond which satisfies the criteria for a <i>qualifying debt security</i>, the %N applicable to interest rate derivatives may be utilised to calculate the credit equivalent amount. For a derivative referenced on a 'non-qualifying' bond, the credit equivalent amount must be calculated with reference to the %N applicable to equity derivatives.</p> <p>For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage is no lower than 0.5%.</p>		

Sums due for payment or owed on closed out derivative transactions

10-174 (4) R When a counterparty has not fully met amounts owed to a *firm* arising out of losses on closed out *derivative* transactions through the deposit of *acceptable collateral* not otherwise used, or has not fully settled amounts owed in respect of periodic or final settlement of transactions, a *firm* must calculate *CRR* equal to the unpaid loss multiplied by the appropriate percentage from the Table 10-174(5) below.

10-174 (4A) R In the case of a failed FX transaction (whether originally contracted for *forward* settlement, or undertaken in the spot market) where the *firm* has released funds to its counterparty, but has not received the funds in the alternative currency, the *CRR* must be calculated as the gross value of the funds not received, multiplied by the appropriate percentage from Table 10-174(5) below.

CRR percentages

10-174 (5) R A *firm* must multiply the counterparty exposure by the appropriate percentage from the table below, but:

- (a) may opt to calculate *CRR* using the highest available credit percentage in the table below in order to avoid undue complication; and
- (b) may reduce the counterparty weight applicable to counterparty exposures calculated in accordance with (3)(c) above to 50%, where the counterparty would normally attract a counterparty weight of 100% in accordance with Appendix 47.

R TABLE 10-174(5) - CRR percentages

Type of Contract	Nature of counterparty to whom counterparty exposure exists	Business days after counterparty exposure first occurred	
		0 - 5	6 or more
Failed FX Transaction	Any	8% x counterparty weight*	100%
Other	A counterparty granted a credit line under an <i>ACMP</i>	8% x counterparty weight*	
	A counterparty not granted a credit line under an <i>ACMP</i>	8% x counterparty weight*	100%

Netting

10-174 (6) R A firm may offset counterparty exposures arising on *derivative* transactions calculated in accordance with (2), (3) and (4) above before it multiplies the residual exposure by the appropriate *CRR* percentage as follows:

- (a) variation margin payable to a counterparty against an initial *margin requirement* or variation *margin requirement* receivable from a counterparty;
- (b) variation margin payable to a counterparty against a positive “A” as calculated in accordance with Table 10-174(3A);
- (c) a negative “A” as calculated in accordance with Table 10-174(3A) against an initial *margin requirement* or variation *margin requirement* receivable from a counterparty;
- (d) a negative “A” against a positive “A” in each case as calculated in accordance with Table 10-174(3A);
- (e) loss on a closed out *derivative* transaction which has not been settled against variation margin payable to a counterparty;
- (f) loss on a closed out *derivative* transaction which has not been settled against negative “A” calculated in accordance with Table 10-174(3A);

* for details of counterparty weights, see Appendix 47

- (g) profit on a closed out *derivative* transaction which has not been settled against an initial *margin requirement* or variation *margin requirement* receivable from a counterparty;
- (h) profit on a closed out *derivative* transaction which has not been settled against a loss on a closed out *derivative* transaction;
- (i) profit on a closed out *derivative* transaction which has not been settled against a positive “A” as calculated in accordance with Table 10-174(3A);
- (j) premium receivable in respect of written *options* against variation margin payable, initial margin payable or a closed out profit payable to the counterparty or a negative “A” as calculated in accordance with Table 10-174(3A);
- (k) where the *firm* has received the premium due for a written *option*, a negative “A” (the replacement cost) for the written *option* against a positive “A” in each case as calculated in accordance with Table 10-174(3A); or
- (l) in the case of *perfectly matched contracts* these may be treated as a single contract with a notional principal equivalent to the net receipts; or
- (m) where transactions are subject to (3)(c) above, the potential future credit exposures (PFCE) on transactions with the same counterparty (i.e. % o N) may be netted in accordance with Table 10-174(6) below,

provided that:

- (i) the exposures arise on transactions with the same counterparty; and
- (ii) the *firm* has a written agreement, supported by a legal opinion obtained in accordance with rule 10-170(10).

Table 10-174(6)

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

Equivalent contracts

- 10-174 (7) R** Rule 10-174(3)(c) also applies to contracts, which, although they are listed on an exchange are fully dependent upon the issuer for performance (e.g. covered warrants).

Sub-total

- 10-174 (8) R** The sum of the amounts calculated in accordance with this rule is the *firm's CRR for derivative transactions*.

- 10-175** Other amounts owed to a firm arising out of trading book business

General rule

- 10-175 (1) R** A *firm* must calculate for each other amount owed arising out of *trading book* business a *CRR* by multiplying the counterparty exposure by the appropriate percentage in Table 10-175(4).

Collateral

- 10-175 (2) R** A *firm* may:
- (a) reduce the counterparty exposure on which its *CRR* is calculated to the extent that it holds *acceptable collateral*, to cover that exposure; and
 - (b) where it does not have an *ACMP*, may continue to multiply the counterparty exposure by 8% multiplied by the counterparty weight, to the extent that the *firm* holds *adequate collateral* to cover that exposure.

Counterparty exposure

- 10-175 (3) R** The counterparty exposure for an other amount owed to a *firm* arising out of *trading book* business is the balance sheet value.

CRR percentages

- 10-175 (4) R** A *firm* must multiply the counterparty exposure by the appropriate percentage from the table below, except that accrued interest or accrued dividends on *trading book investments* shall be subject to a **CRR of 8%** multiplied by the counterparty weight until the counterparty exposure has been outstanding for more than 15 *business days* after the date that it was due to be received, after which the percentage will increase in accordance with Table 10-175(4).

R TABLE 10-175(4) - CRR percentages

Nature of counterparty to whom counterparty exposure exists	Business days after counterparty exposure first recorded in accounts			
	0-15	16-30	31-45	46 or more
A counterparty granted a credit line under an <i>ACMP</i>	8% x counterparty weight*			
A counterparty not granted a credit line under an <i>ACMP</i>	8% x counterparty weight*	50% x counterparty weight*	75% x counterparty weight*	100%

Netting

- 10-175 (5) R** A *firm* may reduce the value of the amounts owed to the *firm* by an amount owed by the *firm* to a counterparty before it multiplies this by 100% provided that:
- (a) the exposures arise with the same counterparty; and
 - (b) the *firm* has a written agreement supported by a legal opinion obtained, in accordance with rule 10-170(10).

* For details of counterparty weights, see Appendix 47

Sub-total

- 10-175 (6) R** **The sum of the amounts calculated in accordance with this rule is the *CRR* for other amounts owed to a *firm* arising out of *trading book* business.**

Trading book qualifying deposits

- 10-176 R** **A *firm* must calculate a *CRR* for a *trading book qualifying deposit* as 8% of the value of the deposit multiplied by the appropriate counterparty weight, except that there is no *CRR* for deposits which are secured by *acceptable collateral*.**

LARGE EXPOSURES REQUIREMENT

10-190 General principles of LER

Application

10-190 (1) R **A *firm* must comply with rules 10-190 to 10-195 on both a solo and consolidated basis, except that a *firm* with a waiver from consolidated supervision in accordance with rule 10-204 or which is exempt under rule 10-200(2), must comply with rules 10-190 to 10-195 on a solo basis only and also with rule 10-196.**

General rule

10-190 (2) R **A *firm* must calculate its total *LER* on all *exposures* to third parties and *groups of connected third parties* arising from its *trading book* and *non-trading book* business, in accordance with rules 10-190 to 10-195, excluding:**

- (a) ***exposures* connected with foreign *exchange* transactions incurred in the ordinary course of settlement during the two *business days* following due payment date; and**
- (b) ***exposures* in connection with transactions for the purchase or sale of *securities* incurred in the ordinary course of settlement during the five *business days* following and including due payment date or due delivery of the *securities*, where neither cash nor *securities* have been delivered.**

Frequency of calculation

10-190 (3) R **A *firm* must be able to calculate its *LER* at least once each day and before executing any transaction be able to re-calculate it to the level of detail necessary to ensure that the *firm's financial resources requirement* does not exceed the *firm's financial resources*.**

Exposures to connected third parties

10-190 (4) R ***Exposures* to a *group of connected third parties* must be aggregated and treated as if they are a single *exposure*.**

Trustee

10-190 (5) R **Transactions entered into by a *firm* as trustee are excluded from the scope of *LER*.**

10-191 Types of exposure

General

10-191 (1) R For the purposes of rules 10-190 to 10-195 and 10-32(3) to (7), “*exposure*” includes any *trading book issuer exposure*, *trading book counterparty exposure* and *non-trading book exposure*, except where explicitly exempt elsewhere in those rules.

G A transaction could result in both issuer and a counterparty *exposure*.

Trading book issuer exposure

10-191 (2) R A *trading book issuer exposure* is the market value of the net long position, taking account of all actual and notional long and short positions, in either debt or equity instruments including any underlying *derivatives*, *convertibles* and *warrants* issued by a third party which are held in the *firm’s trading book*.

10-191 (3) R A *trading book issuer exposure* for a *derivative* should be determined with reference to the underlying notional *securities* position in accordance with (a) to (j) below.

Futures, forwards and FRAs

(a) A *future* or *forward* on a government *security* or an interest rate does not generate an issuer *exposure*.

(b) An *FRA* does not generate an issuer *exposure*.

(c) A *future* or *forward* on a corporate debt *security* or individual equity is treated as an *exposure* to the underlying issuer.

Interest rate, foreign currency and equity swaps

(d) An interest rate or currency *swap* does not generate an issuer *exposure*.

(e) An interest rate leg of an equity *swap* does not generate an issuer *exposure*.

(f) Where the equity leg of an equity *swap* is based on the change in value of an individual equity, it is treated as an *exposure* to the issuer of the equity.

Indices/baskets

(g) Where a *future* on an index, an equity *swap* based on an index or basket of *securities*, or any other index-linked *derivative* is broken down into its constituents by a *firm* for the purposes of calculating *PRR*, an issuer *exposure* is generated for each underlying constituent position.

G Any issuer *exposure* to a *credit* or *financial institution* which arises as a result of rule 10-191(3)(g) should be included within the calculation required under rule 10-61(7), (*material holdings* in credit and *financial institutions*).

(h) Where a *future* on an index, an equity *swap* based on an index or basket of *securities*, or any other index-linked *derivative* is not broken down into its constituents by a *firm* for the purposes of calculating *PRR*, the basket or index position does not generate an issuer *exposure*.

Options

(i) An *option* or *warrant* on an individual corporate debt *security* or equity that is *in the money* must be treated as an *exposure*, at the full value of the underlying (i.e. at a delta of 1), to the issuer of the underlying instrument, unless the *firm* has an approved model in which case the *firm* may use the delta-weighted value of the underlying generated by the model.

(j) An *out of the money option* or *warrant* must not be treated as an *exposure*.

Trading book counterparty exposure

10-191 (4) R A *trading book counterparty exposure* is calculated in accordance with rules 10-170 to 10-176 before applying the appropriate *CRR* percentage.

Calculation of net counterparty exposure

10-191 (5) R Where, in accordance with rules 10-170 to 10-176, net counterparty *exposures* are used for the purposes of calculating *CRR*, the net *exposure* may be used for rules 10-190 to 10-196 and rule 10-32(3) to (7), and the maturity of the net *exposure* is deemed to be the same as that of the underlying positive *exposure* with the longest maturity.

Non-trading book exposure

- 10-191 (6)** R (a) The *non-trading book* counterparty exposure of a firm is the amount at risk, before applying counterparty weights, arising from the *non-trading book* assets calculated in accordance with rules 10-65 to 10-69.
- (b) The *non-trading book* issuer risk is the full market value of the underlying exposure.

10-192 Exposures exempt from LER

Exempt exposures

- 10-192 (1)** R A firm may exclude the following from its LER calculation and the limits set out in rule 10-193:
- (a) exposures to or guaranteed by Zone A central governments or central banks;
 - (b) exposures to or guaranteed by the European Communities;
 - (c) exposures to Zone B central governments or central banks denominated in the national currency of the third party;
 - (d) exposures secured by securities issued by Zone A central governments or central banks, the European Communities or an EEA regional government or local authority which represents no higher a risk than its central government;
 - (e) exposures secured by cash deposited with the firm or its connected credit institution;
 - (f) exposures secured by CDs issued by the firm or its connected credit institution and deposited with one of them;
 - (g) if the firm first notifies the FSA in writing, exposures to the firm's parent, subsidiaries and other subsidiaries of its parent, provided that these entities are subject to consolidated supervision in accordance with rules 10-200 to 10-203;
 - (h) exposures with a residual maturity of one year or less to counterparties which are not connected companies and which are credit institutions, investment firms, recognised third country investment firms, recognised clearing houses and recognised exchanges on which financial instruments are traded, not constituting their own funds;

- (i) asset items constituting claims on and other *exposures* to those institutions which are not *credit institutions* but which are regulated institutions operating in the inter-bank and public debt markets, with a maturity of one year or less, and secured with *acceptable collateral*;
- (j) *exposures* secured by *securities*, provided that:
 - (i) the *securities* were not issued by the *firm* or a member of its group;
 - (ii) the *securities* were not issued by the third party to which the *exposure* arises;
 - (iii) the *securities* are *marked to market*;
 - (iv) the *securities* are traded on a stock exchange or are freely transferable with prices regularly quoted in trading between market professionals;
 - (v) the *mark to market* value of the *securities* is at least 200% of the value of the *exposure* secured except that where the *securities* are:
 - (aa) *shares*, the *mark to market* value of the *securities* must be at least 250% of the value of the *exposure* secured; and
 - (bb) debt *securities* issued by a *credit institution* (which do not constitute its *financial resources*), *EEA* regional government or local authority which does not represent the same risk as its central government, a *multilateral development bank*, the *mark to market* value of the *securities* must be at least 150% of the value of the *exposure* secured;
- (k) *material holdings* in *credit institutions* and *financial institutions* which have been deducted from *financial resources* in accordance with rule 10-61(7);
- (l) *exposures* where the *firm* has already incurred a 100% *PRR*, *CRR* or liquidity adjustment.
- (m) *exposures* consisting of debt securities to *multilateral development banks*;

(n) if the *firm* first notifies the *FSA* in writing, *exposures* with a residual maturity of one year or less to counterparties which are connected to the *firm* and which are *credit institutions, investment firms, recognised third country investment firms, recognised clearing houses* and *recognised exchanges* on which *financial instruments* are traded, not constituting their *own funds*.

G Any part of an *exposure* that is partially covered by collateral, as defined in rules 10-192(1)(d), (e), (f) and (j), is exempt from *LER*.

Optional exemption

10-192 (2) R Where a *firm* has *exposures* to unconnected *credit institutions, investment firms, recognised third country investment firms, recognised clearing houses*, and *recognised exchanges* on which *financial instruments* are traded, not constituting those third parties' *own funds*, it may elect either to:

- (a) disregard exemption 10-192(1)(h) above and exclude 80% of all such *exposures* regardless of maturity; or
- (b) exclude all *exposures* with a maturity of one year or less, 80% of those *exposures* with a maturity of between one and three years and, in the case of marketable debt *securities*, 50% of those *exposures* with a maturity of more than three years.
- (c) if the *firm* first notifies the *FSA* in writing, the election in (a) or (b) above may be made with regard to *exposures* to counterparties which are connected to the *firm* and which are *credit institutions, investment firms, recognised third country investment firms, recognised clearing houses*, and *recognised exchanges* on which *financial instruments* are traded, not constituting those third parties' *own funds*.

G A *firm* should be consistent across all products in its application of (a) and (b) above.

Partially exempt exposures

- 10-192 (3)** **R** **A firm may reduce the exposures in its LER calculation as follows:**
- (a)** **to the extent that an exposure to a counterparty is unconditionally guaranteed by a third party or parent, a firm may treat that part of the exposure as having been incurred to the third party or parent rather than to the counterparty, having given prior written notice to the FSA;**
 - (b)** **by 80%, exposures to or guaranteed by an EEA regional or local authority;**
 - (c)** **undrawn credit facilities to the extent that an agreement has been concluded with the third party or group of connected third parties under which the exposure may be incurred only where it will not cause the firm to exceed the LER limits.**
- G** The exempt exposures detailed in rule 10-192 do not apply to the quarterly reporting of large exposures (see SUP 16).
- 10-193** Limits for trading book and non-trading book exposures
- 10-193 (1)** **R** **A firm's non-trading book large exposures must not individually exceed 25% of own funds as specified in Table 10-61(1)B.**
- 10-193 (2)** **R** **A firm's non-trading book large exposure to any third party connected to the firm, which is not exempt under rule 10-192(1)(g), must not exceed 20% of own funds as specified in Table 10-61(1)B, unless the firm has notified the FSA under rule 10-32(3)(b).**
- 10-193 (3)** **R** **A firm's aggregate non-trading book large exposures must not exceed 800% of own funds.**
- G** A firm's trading book large exposures may individually exceed 25% of financial resources provided that all non-trading book large exposures to the same third party are within the limits set out in (1) and (2) above.

Transitional Provisions

- 10-193 (4)** R **A firm must ensure that, after 31 December 1995, all *non-trading book exposures* entered into before and outstanding at 5 February 1993 which exceed the limits laid down in (1), (2) and (3) above do not exceed their respective values at 5 February 1993 and may be continued until the contractual maturity where the *firm* is legally bound.**
- 10-193 (5)** R **The excess over 25% of *own funds* of any *exposure* subject to the transitional arrangements in (4) above must be included in “D” under rules 10-194(3) and 10-195 below.**
- G In applying rules 10-194(3) and 10-195, a *firm’s excess exposures* under (5) above should be ranked by counterparty weighting, with any *LER* applied to the liquidity adjustment for that *exposure* multiplied by 200% under rule 10-194(3)(d) or by the appropriate percentage in Table 10-194(3) under rule 10-194(3)(e).
- 10-194** Calculation of *LER*
- Method
- 10-194 (1)** R **A firm must apply the following procedures for each *large exposure* which exceeds 25% of *own funds* and must then sum the resultant *LERs* to arrive at its total *LER*.**
- Calculation
- 10-194 (2)** R **For each third party or *group of connected third parties*, a firm must calculate:**
- (a) the total *non-trading book exposure* (R);
 - (b) the total *trading book exposure* (S); and
 - (c) the sum of the total *non-trading book* and *trading book exposures* (T).
- 10-194 (3)** R **Where the value of “R” is less than 25% of the value of *own funds*, the value of “T” may exceed 25% of the value of *financial resources*, subject to an *LER* calculated in accordance with (a) to (e) below:**
- (a) calculate the excess of “T” over 25% of the value of *financial resources*, known as “D”;

- (b) rank the *trading book exposures* in “T” on the basis of the specific risk weighting in the case of positions, discounted by the appropriate percentage from table 10-133(5) in respect of underwriting positions, and the composite *CRR* percentage in the case of counterparty *exposures*, in descending order;
- (c) sum the *trading book exposures* in “T”, starting with the *exposure* attracting the highest specific risk weighting or composite *CRR* percentage, until the sum equals the excess “D”;
- (d) if an excess “D” has persisted for 10 *business days* or less, irrespective of the age of the constituent *exposures*, the *LER* must be 200% of the aggregate of specific risk requirements and *CRR* applicable to those *exposures* forming the excess “D”, in accordance with (b) and (c) above; and
- (e) if an excess “D” has persisted for more than 10 *business days*, irrespective of the age of the constituent *exposures*:
 - (i) allocate the constituent *exposures* forming the excess “D”, in ascending order of specific risk weighting or composite *CRR* percentage, to the appropriate row in the table below, so that the positions with the highest specific risk or composite *CRR* percentage receive the highest percentage charge; and
 - (ii) calculate the *LER* as the product of the specific risk requirement or *CRR* for the *exposure* multiplied by the appropriate percentage.

R TABLE 10-194(3) [see Guidance below]

Excess “D” as a percentage of financial resources	Percentage
up to 40	200
40 to 60	300
60 to 80	400
80 to 100	500
100 to 250	600
> 250	900

- G The composite *CRR* percentage should be calculated with reference to the actual percentage used to determine *CRR* in accordance with *CRR* rules, i.e. 8% multiplied by the appropriate counterparty weight in most cases.

10-195 Limits for an excess “D”

10-195 (1) R Where an excess “D” has persisted for 10 *business days* or less, the *trading book exposure* must not exceed 500% of *financial resources*.

10-195 (2) R The aggregate of a *firm’s* excess “Ds”, each of which have persisted for more than 10 *business days*, must not exceed 600% of *financial resources*.

Exposures monitoring for firms exempt from consolidated supervision

10-196 R A *firm* which is exempt from consolidated supervision in accordance with rule 10-204 must either:

(a) have in place an *ACMP* which enables the *firm* to monitor its *exposures* on a group wide basis; or

(b) report to the *FSA* all group *large exposures* at the end of each quarter.

Consolidated Supervision

10-200 GENERAL PRINCIPLES OF CONSOLIDATED SUPERVISION

Scope

10-200 (1) R **A firm must at all times ensure that its group maintains externally generated group *financial resources* in excess of its group *financial resources requirement*, unless otherwise permitted under rule 10-204.**

Consolidating Supervisor

10-200 (2) R **A firm is exempt from (1) above when the FSA is not the consolidating supervisor for the firm's group.**

G The FSA will notify the firm if it is not the consolidating supervisor for the group.

Constituents of a Group

10-200 (3) R **For the purposes of (1) above, a firm's group must include the following:**

- (a) **any EEA subsidiary of the firm which is a credit institution, investment firm or financial institution;**
- (b) **any EEA participation of the firm which is a credit institution, investment firm or financial institution;**
- (c) **any EEA parent which is a financial holding company;**
- (d) **any EEA credit institution, investment firm or financial institution which is a subsidiary or participation of the firm's EEA parent which is a financial holding company.**

10-200 (4) G The FSA may exercise its powers (whether through imposing a *requirement* or by using its general information gathering powers) to obtain information about the structure of a firm's group including the position of the entities listed in (a) to (f) below:

- (a) any of the firm's *subsidiaries* or *participations* which are incorporated or have their head offices outside the EEA;
- (b) any of the firm's *subsidiaries* or *participations* which are not *credit institutions, investment firms* or *financial institutions*;
- (c) the firm's *parent* if it is incorporated or has its head office outside of the EEA;
- (d) the firm's *parent* if it is not a *financial holding company*;
- (e) any of the *parent's* other *subsidiaries* or *participations* which are incorporated or have their head offices outside the EEA; and

- (f) any of the *parent's* other *subsidiaries* or *participations* which are not *credit institutions, investment firms* or *financial institutions*.

Exemptions

- 10-200 (5) R** A *firm* may, having first notified the *FSA* in writing, exclude from its group, the following:
- (a) any *subsidiary* or *participation*, the total assets of which are less than the lower of euro 10 million or 1% of the total assets of the *firm*; and
 - (b) any *subsidiary, participation* or *EEA parent* the inclusion of which within the group would lead to a misleading or inappropriate consolidation,
- provided that in aggregate the total assets of such *subsidiaries* and *participations* would still satisfy (a) above.

Additional Information

- 10-200 (6) G The *FSA* may require a firm to provide information about the position in the group of any undertaking excluded from the consolidated group in 10-200(5)R.

- 10-200 (7) R** Where a *firm's parent* is a *mixed activity holding company*, the *firm* must provide a copy of the holding company's *audited annual financial statement* and details of its group structure.

GROUP FINANCIAL RESOURCES

- 10-201 R** A *firm* must calculate the externally generated *financial resources* of its group as the sum of:
- (a) the *financial resources* of the most senior undertaking in the group calculated in accordance with Table 10-62(2)A, except *material holdings* in *credit institutions* and *financial institutions* in the group and deficiencies in *subsidiaries* need not be deducted; and
 - (b) for each *subsidiary* or *participation*, the group's share of the *financial resources* of the *subsidiary* or *participation*, calculated in accordance with Table 10-62(2)A, which was not provided by undertakings within the group subject to consolidated supervision, provided that:
 - (i) these *financial resources* are freely transferable and suitable for the purposes of covering the group's *financial resources requirement*; or
 - (ii) if not, they are limited to the value of the *subsidiary's* or *participation's financial resources requirement* from which they originate.

- 10-202** **GROUP FINANCIAL RESOURCES REQUIREMENT**
- 10-202** **R** **A *firm* must calculate the group *financial resources requirement* as**
(1) **the aggregate of the *financial resources requirements* of the *firm* and**
 any constituents of its group determined in accordance with rules 10-
 200(3), (4) and (5) and the consolidated *LER*.
- 10-202** **R** **The *financial resources requirement* of any *subsidiary* or *participation***
(2) **of the *firm* or its *parent* shall be the higher of:**
- (a) the *subsidiary* or *participation's* local regulatory capital**
 requirement, excluding any *large exposure* capital charges; and
- (b) any requirement imposed on the *firm's* or *parent's* *subsidiary* or**
 ***participation* determined in accordance with rule 10-202(4).**
- 10-202** **R** **The *financial resources requirement* of the most senior undertaking**
(3) **within the group shall be its local regulatory capital requirement, if**
 any, excluding any *large exposure* capital charges.
- 10-202** **R** **Where a *firm* has a *parent*, *subsidiary* or *participation* which is not**
(4) **subject to local regulatory capital requirements, it must include in the**
 group *financial resources requirement* any alternative requirement
 calculated on the business of that *parent*, *subsidiary* or *participation*,
 or the group's *investment* in that *subsidiary* or *participation*, which is
 imposed on it by a *requirement*.
- G The *FSA* envisages imposing such a *requirement* where, for example, a *firm* has an
 unregulated *subsidiary* which deals in OTC *derivatives*, and the *investment* in that
 subsidiary would not constitute an accurate measurement of the risk to the group.
- 10-202 (5) G Where a *firm* has a *parent*, *subsidiary* or *participation* which is subject to local regulatory
 capital requirements, it may seek a modification or waiver permitting it to adopt an
 alternative methodology of determining the group's *financial resources requirement*.
- G The *FSA* only envisages a modification or waiver under this rule in exceptional
 circumstances, for example to permit line-by-line consolidation of a group to determine its
 financial resources requirement.

INTRA-GROUP OFFSETS AND NETTING

- 10-203 R** If a group's *financial resources*, calculated in accordance with rule 10-201, do not exceed the group's *financial resources requirement*, calculated in accordance with rule 10-202, the *firm may* take into account:
- (a) the benefits of netting intra-group counterparty *exposures*;
 - (b) offsetting positions, for the purposes of rules 10-80 to 10-153, held by different group companies; and
 - (c) the group's *share* of capital surpluses in *subsidiaries* not subject to local regulatory capital requirements,
- provided that:
- (d) the *firm* can ensure that the group has sufficient *financial resources* to cover its *financial resources requirements* at all times between *consolidated reporting statements*;
 - (e) there is satisfactory allocation of capital within the group;
 - (f) the regulatory, legal and contractual framework is sufficient to guarantee mutual financial support within the group;
 - (g) such intra-group benefits are only recognised where no regulations exist in the country of incorporation of the entity which might significantly affect the transfer of funds within the group.

EXEMPTION FROM CONSOLIDATED SUPERVISION

- 10-204 R** A *firm* need not apply rules 10-200 to 10-203 to the *firm's* group if:
- (a) there are no *credit institutions* in the group;
 - (b) all *investment firms* within the group:
 - (i) calculate *financial resources* in accordance with Table 10-62(2)B;
 - (ii) deduct *material holdings in credit institutions and financial institutions* in accordance with rule 10-61(7); and
 - (iii) comply with rule 10-70, with local regulatory capital provisions implementing the Capital Adequacy Directive, or rules with equivalent effect;
 - (c) the *firm* complies with rule 10-196;

- (d) the *firm's* group has in place systems to monitor and control the sources of capital and funding of all other *investment firms* and *financial institutions* in the group; and**
- (e) the *firm* first notifies the *FSA* in writing that it intends to rely upon this rule.**

- 10-300 ACMPs
- 10-300 (1) R **A firm may only use an ACMP for the purposes of rules 10-170 to 10-176 if:**
- (a) **the policies and procedures making up the proposed ACMP are at all times adequate and appropriate to the firm and its business; and**
 - (b) **the firm gives to the FSA at least three months' notice in writing of its intention to use an ACMP for the purposes of these rules.**
- 10-300 (2) R **The notice referred to in (1)(b) above must include all relevant details of the policies and procedures making up the proposed ACMP.**
- 10-300 (3) R **The notice referred to in (1)(b) is not required if the firm was permitted under the relevant requirements of a predecessor regulator, as they were in force immediately prior to the specified day, to use the proposed ACMP for the purposes of those requirements.**
- 10-300(4) E
- (a) A firm's policies and procedures should take full account of the principles described in **Appendix 56**.
 - (b) Compliance with 10-300(4)(a) may be relied on as tending to establish compliance with 10-300(1)(a).
 - (c) Contravention of 10-300(4)(a) may be relied on as tending to establish contravention of 10-300(1)(a).
- G On receipt of notice under (1)(b) the FSA is likely to review the policies and procedures proposed by the firm and the degree to which they take full and appropriate account of the matters described in **Appendix 56**. The FSA's review will take account of the context in which the policies and procedures are to operate and the relevant circumstances of the firm. The FSA will indicate to the firm its views on the adequacy and appropriateness of the proposals in the light of its review and may make recommendations of improvements.
- G The FSA may make a further review of the policies and procedures making up an ACMP at any time after their implementation for the purposes of these rules as part of its supervision of the firm. Any review after implementation will broadly follow the lines described above.

APPENDIX 1 – GLOSSARY OF TERMS FOR IPRU(INV) 10

Note: If a defined term does not appear in the glossary below, the definition appearing in the Glossary annexed to the General Provisions Instrument 2001 applies.

acceptable collateral	means any of the following items of collateral provided to a <i>firm</i> by a <i>counterparty</i> : (a) cash; (b) gold and silver bullion and coinage; (c) certificates of deposit issued by and lodged with the <i>firm</i> ; (d) securities issued by <i>Zone A</i> central governments and <i>Zone A</i> central banks; and (e) <i>securities</i> issued by the <i>European Communities</i> , to which the following conditions apply: (i) the <i>firm</i> must have an unconditional right to apply or realise the <i>acceptable collateral</i> for the purpose of repaying the counterparty's obligations to the <i>firm</i> ; and (ii) <i>securities</i> must be <i>marked to market</i> daily using the valuation principles in rule 10-41(9);
ACMP	means, subject to rule 10-300, a credit management policy and procedures according with the principles discussed in Appendix 56 ;
Act	means the Financial Services and Markets Act 2000;
<i>adequate collateral</i>	means any of the following items of collateral provided to a <i>firm</i> by a counterparty: (a) cash; (b) standby letters of credit and unconditional, irrevocable first on demand guarantees to the extent of their face value, issued by a <i>Zone A credit institution</i> which is not the counterparty nor an <i>associate</i> of the counterparty, and which is not an <i>affiliated company</i> , <i>associate</i> or a <i>controller</i> of the <i>firm</i> ; (c) standby letters of credit and unconditional, irrevocable first on demand guarantees to the extent of their face value, issued by a bank which is not a <i>Zone A credit institution</i> (not being the counterparty nor an <i>associate</i> of the counterparty) which has been accepted under the <i>firm's ACMP</i> and which is not an <i>affiliated company</i> , <i>associate</i> or a <i>controller</i> of the <i>firm</i> ; (d) <i>certificates of deposit</i> ; (e) gold and silver bullion and coinage;

- (f) *securities*;
- (g) *physical commodities*; and
- (h) the performance guarantees issued in support of the securities lending and borrowing programmes of Euroclear and Cedel, in respect only of exposure arising from participation in such programmes,

to which the following conditions apply -

- (i) the *firm* must have an unconditional right to apply or realise the collateral for the purpose of repaying the counterparty's obligations to the *firm*; and
- (ii) *securities* must -
 - (aa) be *marked to market* daily using the valuation principles in rule 10-41(9); and
 - (bb) not be issued by the counterparty nor by an *associate* of the counterparty;

<i>affiliated company</i>	in relation to a <i>firm</i> , means any <i>body corporate</i> controlled by the <i>firm</i> , any parent company of the <i>firm</i> , and any <i>body corporate</i> controlled by a parent company of the <i>firm</i> ;
<i>annual accounting reference date</i>	means the date as at which the <i>audited annual financial statements</i> are prepared as initially notified by the <i>firm</i> to the <i>FSA</i> or as subsequently notified under rule 10-31 and which may not be more than 55 weeks since the previous <i>annual accounting reference date</i> or, if applicable, the date on which the <i>firm</i> commenced trading;
<i>appointed representative</i>	means (in accordance with section 39 of the <i>Act</i>) a person (other than an <i>authorised person</i>) who: <ul style="list-style-type: none"> (a) is a party to a contract with an <i>authorised person</i> (his principal) which: <ul style="list-style-type: none"> (i) permits or requires him to carry on business of a description prescribed in the Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001 (SI 2001/1217); and (ii) complies with the requirements prescribed in those Regulations; and (b) is someone for whose activities in carrying on the whole or part of that business his principal has accepted responsibility in writing;
<i>approved bank</i>	(in relation to a bank account opened by a <i>firm</i>) means: <ul style="list-style-type: none"> (a) if the account is opened at a branch in the <i>United Kingdom</i>: <ul style="list-style-type: none"> (i) the Bank of England; or (ii) the central bank of a member state of the <i>OECD</i>; or

- (iii) a *bank*; or
 - (iv) a *building Society* which offers, unrestrictedly, banking services; or
 - (v) a bank which is supervised by the central bank or other banking regulator of a member state of the *OECD*; or
- (b) if the account is opened elsewhere:
- (i) a bank in (a); or
 - (ii) a *credit institution* established in an *EEA State* other than the *United Kingdom* and duly authorised by the relevant *Home State regulator*; or
 - (iii) a bank which is regulated in the Isle of Man or the Channel Islands; or
- (c) a bank supervised by the South African Reserve Bank; or
- (d) any other bank that:
- (i) is subject to regulation by a national banking regulator;
 - (ii) is required to provide audited accounts;
 - (iii) has minimum net assets of £5 million (or its equivalent in any other currency at the relevant time) and has a surplus revenue over expenditure for the last two financial years; and
 - (iv) has an annual audit report which is not materially qualified;

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

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

<i>approved person</i>	means a <i>person</i> in relation to whom the <i>FSA</i> has given its approval under section 59 of the <i>Act</i> (Approval for particular arrangements) for the performance of a <i>controlled function</i> ;
<i>arranger</i>	means a <i>firm</i> - <ul style="list-style-type: none"> (a) whose sole <i>investment business</i> consists of activities within the following articles of the Regulated Activities Order - <ul style="list-style-type: none"> (i) articles 14 (dealing in investments as principal) or 21 (dealing in investments as agent) if - <ul style="list-style-type: none"> (aa) the <i>firm</i> is a <i>venture capital firm</i>; or (bb) the activity is own account business which would be excluded from being <i>investment business</i> by the provisions of article 16 of the Regulated Activities Order but for the fact that the firm is an <i>authorised person</i>; or (ii) article 25(1) (arranging deals in investments); (iii) article 37 (managing investments); and (iv) article 53 (advising on investments); (b) whose <i>permission</i> is subject to a <i>limitation</i> or <i>requirement</i> preventing it from holding money or property belonging to other persons nor has a mandate over a <i>customer's</i> bank account;
<i>associate</i>	in relation to a person ("A"), means - <ul style="list-style-type: none"> (a) an undertaking in the same <i>group</i> as A; (b) an <i>appointed representative</i> of A or of any undertaking in the same <i>group</i> as A; and (c) any other person whose business or domestic relationship with A or its <i>associate</i> might reasonably be expected to give rise to a community of interest between them which may involve a conflict of interest in dealings with third parties;
<i>associated business</i>	means business which is carried on in connection with <i>investment business</i> ;
<i>audited annual financial statements</i>	means statements drawn up in accordance with Schedule 4 to the Companies Act 1985 as at the <i>firm's annual accounting reference date</i> together with an <i>auditor's report</i> thereon;
<i>auditor's report</i>	means a report drawn up in the format specified in the <i>Supervision manual</i> which a <i>firm</i> must submit to the <i>FSA</i> in conjunction with the <i>firm's audited annual financial statements</i> ;
<i>authorised person</i>	means (in accordance section 31 of the <i>Act</i> (Authorised persons)), one of the following: <ul style="list-style-type: none"> (a) a <i>person</i> who has a <i>Part IV permission</i> to carry on one or more <i>regulated activities</i>;

	<ul style="list-style-type: none"> (b) an <i>incoming EEA firm</i>; (c) an <i>incoming Treaty firm</i>; (d) a <i>UCITS qualifier</i>; (e) an <i>ICVC</i>; (f) the <i>Society of Lloyd's</i>;
<i>basic PRA</i>	means for equities the equity method 1 <i>PRAs</i> in Appendix 49; and for interest rate instruments, the sum of the specific risk <i>PRA</i> and the maturity-based general market risk <i>PRAs</i> in Appendix 53;
<i>body corporate</i>	means (in accordance with section 417(1) (Definitions)) any body corporate, including a body corporate constituted under the law of a country or territory outside the United Kingdom, of the <i>Act</i> ;
<i>bonus</i>	means that part of the remuneration paid by a <i>firm</i> to its <i>employees</i> (including <i>directors</i>) which is - <ul style="list-style-type: none"> (a) not a <i>profit share</i>; and (b) awarded by management entirely on a discretionary basis, to the extent that it does not exceed the profit for the financial year of the <i>firm</i> before accounting for such bonus;
<i>business day</i>	means any day, except Saturday, Sunday, bank holidays and public holidays (not being bank holidays);
<i>buy and sale back agreement</i>	see <i>reverse repurchase agreement</i> ;
<i>call options</i>	means an <i>option</i> to buy an <i>investment</i> , other instrument, foreign currency or <i>physical commodity</i> at a given price on or before a given date;
<i>cap</i>	means an agreement in respect of a borrowing under which a <i>counterparty</i> contracts to pay any interest costs arising as a result of an increase in rates above an agreed rate: the effect being to provide protection to the holder against a rise above that agreed rate;
<i>category A firm</i>	means a <i>firm</i> which has <i>permission</i> to provide any <i>core investment service</i> and which is not a <i>category B, C or D firm</i> ;
<i>category B firm</i>	means a <i>firm</i> which - <ul style="list-style-type: none"> (a) has <i>permission</i> to provide any of the following <i>core investment services</i> - <ul style="list-style-type: none"> (i) receiving and transmitting orders; (ii) executing orders; (iii) managing <i>investments</i> on a discretionary basis; and (iv) dealing as principal, but only holding positions as a result of its failure to match investors' orders precisely; and

	(aa) such positions are incidental and provisional in nature and strictly limited to the time required to carry out the transaction in question; and
	(bb) the total market value of all such positions does not exceed 15% of the <i>firm's initial capital</i> ; and
	(b) holds <i>client money</i> or <i>clients' assets</i> ; or
	(c) is a <i>custodian</i> ;
<i>category C firm</i>	means a <i>firm</i> which -
	(a) has <i>permission</i> to provide any of the following core investment services -
	(i) receiving and transmitting;
	(ii) managing <i>investments</i> on a discretionary basis; and
	(iii) executing orders on an agency basis; and
	(b) whose <i>permission</i> is subject to a <i>limitation</i> or <i>requirement</i> preventing it from holding <i>client money</i> or <i>clients' assets</i> ;
<i>category D firm</i>	means a <i>firm</i> , the only <i>core investment service</i> for which it has <i>permission</i> is receiving and transmitting on behalf of investors orders in relation to one or more of the instruments listed in Section B of the Annex to the <i>ISD</i> , and whose <i>permission</i> is subject to a <i>limitation</i> or <i>requirement</i> preventing it from holding <i>client money</i> or <i>clients' assets</i> and for that reason may not at any time place itself in debit with its <i>clients</i> , which benefits from the freedom of establishment or to provide services under Articles 14 or 15 of the <i>ISD</i> ;
<i>certificate of deposit</i>	means a negotiable or non-negotiable certificate issued by a bank;
<i>clearing firm</i>	means a firm which accepts primary responsibility (including legal liability) for the settlement of transactions for counterparties;
<i>client</i>	means any <i>person</i> with or for whom a <i>firm</i> conducts or intends to conduct <i>designated investment business</i> or any other <i>regulated activity</i> ; and:
	(a) every client is a <i>customer</i> or a <i>market counterparty</i> ;
	(b) "client" includes:
	(i) a potential client;
	(ii) a client of an <i>appointed representative</i> of a <i>firm</i> with or for whom the <i>appointed representative</i> acts or intends to act in the course of business for which the <i>firm</i> has accepted responsibility under section 39 of the <i>Act</i> (Exemption of appointed representatives);
	(iii) a <i>collective investment scheme</i> even if it does not have separate legal personality;

(iv) if a *person* (“C1”), with or for whom the *firm* is conducting or intends to conduct *designated investment business*, is acting as agent for another *person* (“C2”), either C1 or C2 in accordance with COB 4.1.5R (Agent as client);

(c) "client" does not include:

(i) a trust beneficiary;

(ii) a *corporate finance contact*;

(iii) a *venture capital contact*;

client money subject to the *client money rules*, means *money* of any currency which, in the course of carrying on *designated investment business*, a *firm* holds in respect of any *investment agreement* entered into, or to be entered into, with or for a *client*, or which a *firm* treats as *client money* in accordance with the *client money rules*;

client money rules means COB 9.3;

collective investment scheme means a collective investment scheme, as defined in section 235 of the *Act* (Collective Investment Schemes), which is in summary:

- (a) any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable *persons* taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income; and
- (b) which are not excluded by the Financial Services and Markets Act (Collective Investment Schemes) Order 2001 (SI 2001/1062);

commissions shared means that part of the remuneration paid by a *firm* which is determined on the basis of the number, size or profitability of individual deals carried out;

company issued warrant means a right (but not an obligation) to buy a *security* or other instrument at an agreed price or on an agreed basis, from the issuer of the *security* or instrument;

connected company (and “*connected credit institution*”) mean, in relation to a *firm* which -

- (a) is a *body corporate*, a *body corporate* or *credit institution* satisfying any of the following conditions -
- (i) the same person is the *controller* of each *body corporate* or *credit institution*;
- (ii) if a group of two or more persons are *controllers* of each *body corporate* or *credit institution* and the group

either consists of the same persons or could be regarded as consisting of the same persons by treating a member of either group as replaced by -

- (aa) that member's *close relative*;
 - (bb) a person with whom that member is in partnership;
or
 - (cc) a *body corporate* of which the member is an officer; or
- (iii) both *body corporates* are members of the same group;
or
- (b) is not a *body corporate*, a *body corporate* or *credit institution* which is controlled -
- (i) by the *firm*;
 - (ii) by a *partner* in the *firm*;
 - (iii) by a *close relative* of a *partner* in the *firm* or, if the *firm* is a *sole trader*, by a *close relative* of the *sole trader*, or
 - (iv) collectively by any of the *partners* in the *firm* or their *close relatives*;

connected credit institution

see "*connected company*";

consolidated reporting statement

means a statement drawn up in accordance with the requirements for consolidated reporting in the *Supervision manual* and prepared as at the date(s) required by the *Supervision manual*;

contingency

means a future event the outcome of which is uncertain;

contingent liability

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

contract for differences

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

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

controller

means -

- (a) in relation to a *body corporate* -
 - (i) a person, who alone or with any *associate* or *associates*, has a direct or indirect holding in the *body*

corporate which represents 10% or more of the capital or of the voting rights; and

- (ii) any person who has a direct or indirect holding in the *body corporate* which makes it possible to exercise a significant influence over the management of the *body corporate*; and

(b) in relation to an unincorporated association -

- (i) any person in accordance with whose directions or instructions the officers of the association are accustomed to act (but disregarding advice given in a professional capacity);
- (ii) any person who is entitled to exercise, or control the exercise of, 10% or more of the voting power at any general meeting of the association; and
- (iii) any person who has a direct or indirect holding in the association which makes it possible to exercise a significant influence over the management of the association;

and “*control*” shall be construed accordingly;

convertible

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

core investment service

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

corporate finance advisory firm

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

corporate finance business

means:

- (a) *designated investment business* carried on by a *firm* with or for:
 - (i) any *issuer*, holder or owner of *designated investments*, if that business relates to the *offer*, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, those *investments*, or any related matter;
 - (ii) any *market counterparty* or *intermediate customer*, or other *body corporate*, *partnership* or supranational organisation, if that business relates to the manner in which, or the terms on which, or the *persons* by whom, any business, activities or undertakings relating to it, or any *associate*, are to be financed, structured, managed, controlled, regulated or reported upon;
 - (iii) any *person* in connection with:

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

	<p>related matter; or</p> <p>(B) a proposed or actual <i>takeover or related operation</i> by or on behalf of the <i>firm</i>, or involving <i>shares</i>, share warrants, <i>debentures</i> or debenture warrants issued by the <i>firm</i>; or</p> <p>(C) a merger, de-merger, reorganisation or reconstruction involving any <i>shares</i>, share warrants, <i>debentures</i> or debenture warrants issued by the <i>firm</i>; and</p> <p>(ii) does not involve giving <i>advice on investments</i> to any <i>person</i> who is a <i>private customer</i>,</p>
	<p>in this definition, “share warrants” and “debenture warrants” mean any <i>warrants</i> which relate to <i>shares</i> in the <i>firm</i> concerned or, as the case may be, <i>debentures</i> issued by the <i>firm</i>;</p>
<i>credit institution</i>	means an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account;
<i>CRR</i>	means the counterparty risk requirement, as calculated under rules 10-170 to 10-175;
<i>custodian</i>	means a <i>firm</i> which has <i>permission</i> to safeguard and administer assets belonging to another, in accordance with article 40 of the Regulated Activities Order;
<i>customer</i>	means a <i>client</i> who is not a <i>market counterparty</i> ;
<i>debenture</i>	<p>means the investment specified in article 77 of the Regulated Activities Order (Instruments creating or acknowledging indebtedness), which is in summary: any of the following which are not <i>government and public securities</i>:</p> <p>(a) debentures;</p> <p>(b) debenture stock;</p> <p>(c) loan stock;</p> <p>(d) bonds;</p> <p>(e) certificates of deposit;</p> <p>(f) any other instruments creating or acknowledging indebtedness;</p>
<i>derivatives</i>	means <i>options, futures</i> and <i>contracts for differences</i> ;
<i>designated investment exchange</i>	means any investment exchange listed as such in Appendix 33 ;
<i>director</i>	<p>in relation to a <i>body corporate</i> includes -</p> <p>(a) any person occupying the position of <i>director</i> by whatever name called;</p>

- (b) any person in accordance with whose directions or instructions (not being advice given in a professional capacity) the *directors* are accustomed to act; or
- (c) in the case of an *overseas firm*, any person who occupies a position analogous to that of a *director* of a company registered under the Companies Act 1985;

documents of title means documents of title and documents evidencing title to *investments* and commodities;

EEA means the area established by the agreement on the European Economic Area signed at Oporto on 2 May 1992 and which consists of the *EEA States*;

EEA State (in accordance with paragraph 8 of Schedule 3 to the *Act* (EEA Passport Rights)) means a State which is a contracting party to the agreement on the European Economic Area signed at Oporto on 2 May 1992, as it has effect for the time being; as at 21 June 2001, the following are the *EEA States*: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Liechtenstein, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden and the United Kingdom;

eligible collective investment scheme means -

- (a) a *regulated collective investment scheme*; or
- (b) a scheme, authorised in another state within the *EEA*, which complies with the requirements of the European Community directive on Undertakings for Collective Investment in Transferable Securities (UCITS - 85/611/EEC);

employee in relation to any person, means an individual -

- (a) who is employed by that person under a contract of service, a contract for services, or any other contract under which the individual will provide services to the person;
- (b) who is a *director* of the person where the person is a *body corporate*;
- (c) who is a *partner* of the person where the person is a partnership;
- (d) who, where the person is an unincorporated association, is a member of its governing body, the secretary or treasurer; or
- (e) whose services are, under an arrangement between the person and a third party, placed at the disposal and under the control of the person;

European business means business carried on in or into a *member state* in accordance with *ISD* or *BCD*;

European Communities means Euratom (European Atomic Energy Community), the European Coal and Steel Community and the European Economic Community;

<i>exceptional items</i>	means those items which derive from events or transactions within the ordinary activities of the business of a <i>firm</i> and which are both material and not expected to recur frequently or regularly;
<i>exchange</i>	means a <i>recognised investment exchange</i> (as defined in the Act) or <i>designated investment exchange</i> ; *
<i>exposure</i>	means for the purposes of rules 10-190 to 10-195 and 10-32(3) to (7), the amount at risk to a <i>firm</i> determined in accordance with rule 10-191;
<i>FER</i>	means the foreign exchange requirement of a <i>firm</i> as calculated in accordance with rules 10-150 to 10-153;
<i>financial holding company</i>	means a <i>financial institution</i> the <i>subsidiary</i> undertakings of which are either exclusively or mainly <i>credit institutions</i> , <i>investment firms</i> and <i>financial institutions</i> , one of which at least is a <i>credit institution</i> or an <i>investment firm</i> ;
<i>financial institution</i>	means an undertaking other than a <i>credit institution</i> , the principal activity of which is to acquire holdings or to carry on a <i>listed activity</i> ;
<i>financial instrument</i>	means any of the following - <ul style="list-style-type: none"> (a) a transferable <i>security</i>; (b) a unit in a <i>collective investment scheme</i>; (c) a money market instrument; (d) a financial <i>future</i> contract, including an equivalent cash settled instrument; (e) an <i>FRA</i>; (f) an interest rate, currency or equity <i>swap</i>; (g) an <i>option</i> to acquire or dispose of any of the above instruments, including an equivalent cash-settled instrument;
<i>financial reporting statement</i>	means the periodic financial and other reporting statements required to be provided to the <i>FSA</i> under the provisions of Chapter 16 of the <i>Supervision manual</i> ;
<i>financial resources</i>	means the financial resources of the <i>firm</i> calculated in accordance with rule 10-62(2)A or, if permitted, in accordance with rule 10-62(2)B;
<i>financial resources requirement</i>	means the financial resources requirement of the <i>firm</i> calculated in accordance with rule 10-70;
<i>firm</i>	means an <i>authorised person</i> ;

* For the list of designated investment exchanges, see **Appendix 33**

<i>floor</i>	means an agreement in respect of a deposit under which a counterparty contracts to pay any lost income arising as a result of a fall in rates below an agreed rate: the effect being to provide protection to the holder against a fall below that agreed interest rate;
<i>forward</i>	means a <i>security</i> which is transacted for a settlement date beyond that which would normally apply in the market concerned, and where that forward settlement date is not yet passed;
<i>FRA</i>	means <i>forward</i> rate agreement, i.e. an agreement in which two parties agree on the payment by one party to another of an amount of interest based on an agreed interest rate for a specified period from a specified settlement date applied to an agreed principal amount; no commitment is made by either party to lend or borrow the principal amount; their exposure is only the interest difference between the agreed and actual rates at settlement;
<i>free delivery</i>	means - <ul style="list-style-type: none"> (a) the delivery of <i>securities</i> or <i>physical commodities</i> which takes place before the seller receives payment; or (b) payment made in settlement of a credit balance arising from a sale on behalf of, or a purchase from a counterparty in respect of which the <i>securities</i> are undelivered;
<i>FSA</i>	means The Financial Services Authority;
<i>FSA authorised business</i>	means any activity within the <i>permissions</i> granted to a <i>firm</i> under the <i>Act</i> ;
<i>future</i>	means the investment, specified in article 84 of the Regulated Activities Order (Futures), which is, in summary: rights under a contract for the sale or delivery of a commodity or property of any other description under which delivery is to be made at a future date and at a price agreed on when the contract is made;
<i>government and public securities</i>	means the <i>investment</i> , specified in article 78 of the <i>Regulated Activities Order</i> (Government and public securities), which is in summary: a loan stock, bond or other instrument creating or acknowledging indebtedness, issued by or on behalf of any of the following: <ul style="list-style-type: none"> (a) the government of the United Kingdom; or (b) the Scottish Administration; or (c) the Executive Committee of the Northern Ireland Assembly; or (d) the National Assembly of Wales; or (e) the government of any country or territory outside the United

Kingdom; or

- (f) a local authority in the United Kingdom or elsewhere; or
- (g) a body the members of which comprise:
 - (i) states including the United Kingdom or another *EEA State*; or
 - (ii) bodies whose members comprise states including the United Kingdom or another *EEA State*;

but excluding:

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

group

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

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

in this definition:

- (i) "participating interest" has the same meaning as in Part VII of the Companies Act 1985 or Part VIII of the Companies

(Northern Ireland) Order 1986; but also includes an interest held by an individual which would be a participating interest for the purposes of those provisions if he were an undertaking;

- (ii) "associated undertaking" has the meaning given in section 119(1) of the Building Societies Act 1986;

group of connected third parties

means a close relationship where -

- (a) two or more entities in a close relationship constitute a single risk because one of them, directly or indirectly, has control over the other or others as defined in section 258 of the Companies Act 1985, or a similar relationship between any natural or legal person and an undertaking; or
- (b) two or more entities between whom there is no relationship of control as defined in (a) but who are to be regarded as constituting a single risk, are so interconnected that the financial soundness of one would be affected by the financial soundness of the other or others;

illiquid asset

means any one of the following -

- (a) a tangible fixed asset except to the extent that land and buildings are used as security for loans;
- (b) physical stocks except for positions in *physical commodities* which are subject to a *PRR*;
- (c) an *investment* in a *credit institution* or *financial institution* which may be included in the *own funds* of that institution, unless it -
- (i) is a *material holding* and is treated in accordance with rule 10-61(8); or
- (ii) is not a *material holding* and is included in the *firm's trading book* and subject to a *PRR*;
- (d) an *investment* in an undertaking other than a *credit institution* or *financial institution* unless it is part of the *firm's trading book* and is subject to a *PRR*;
- (e) a non *qualifying deposit*; or
- (f) a loan or other amount due except where it is due to be repaid within 90 days;

in the money

means, in relation to *call options* and *warrants*, that the exercise price is less than the current *mark to market* value of the *underlying instrument* and, in relation to *put options*, that the current *mark to market* value is less than the exercise price;

incoming EEA firm

(in accordance with section 193(1)(a) of the *Act* (Interpretation of this Part)) means an *EEA firm* which is exercising, or has exercised, its right to carry on a *regulated activity* in the *United Kingdom* in accordance with Schedule 3 to the *Act* (*EEA*

	Passport Rights);
<i>initial capital</i>	means the initial capital of a <i>firm</i> calculated in accordance with Table 10-61(1)A;
<i>inter-professional</i>	for the purposes of <i>repurchase</i> , <i>reverse repurchase</i> , <i>sale and buy back</i> and <i>buy and sale back agreements</i> means an agreement with a counterparty which is one of the following - <ul style="list-style-type: none"> (a) a <i>Zone A credit institution</i>; (b) an <i>investment firm</i>; (c) a <i>recognised third country investment firm</i>; (d) a <i>recognised exchange</i>; (e) a <i>recognised clearing house</i>;
<i>intermediate broker</i>	in relation to a <i>marginised transaction</i> , means any person through whom the <i>firm</i> undertakes that transaction;
<i>intermediate customer</i>	means a <i>client</i> who is not a <i>market counterparty</i> and who is: <ul style="list-style-type: none"> (a) a local authority or public authority; (b) a <i>body corporate</i> whose <i>shares</i> have been <i>listed</i> or <i>admitted to trading</i> on any <i>EEA</i> exchange; (c) a <i>body corporate</i> whose <i>shares</i> have been <i>listed</i> or <i>admitted to trading</i> on the primary board of any <i>IOSCO</i> member country official exchange; (d) a <i>body corporate</i> (including a <i>limited liability partnership</i>) which has (or any of whose <i>holding companies</i> or <i>subsidiaries</i> has) (or has had at any time during the previous two years) called up share capital or net assets of at least £5 million (or its equivalent in any other currency at the relevant time); (e) a <i>special purpose vehicle</i>; (f) a <i>partnership</i> or unincorporated association which has (or has had at any time during the previous two years) net assets of at least £5 million (or its equivalent in any other currency at the relevant time) and calculated in the case of a limited <i>partnership</i> without deducting loans owing to any of the <i>partners</i>; (g) a trustee of a trust (other than an <i>occupational pension scheme</i>, <i>SSAS</i> or <i>stakeholder pension scheme</i>) which has (or has had at any time during the previous two years) assets of at least £10 million (or its equivalent in any other currency at the relevant time) calculated by aggregating the value of the cash and <i>designated investments</i> forming part of the trust's assets, but before deducting its liabilities; (h) a trustee of an <i>occupational pension scheme</i>, <i>SSAS</i> or <i>stakeholder pension scheme</i> where the trust has

(or has had at any time during the previous two years):

- (i) at least 50 members; and
 - (ii) assets under management of at least £10 million (or its equivalent in any other currency at the relevant time);
- (i) another *firm*, or an *overseas financial services institution*, when, in relation to *designated investment business*, or related *ancillary activities*, conducted with or for that *firm* or institution, that *firm* or institution is an *intermediate customer* in accordance with COB 4.1.7R (Classification of another firm or an overseas financial services institution);
 - (j) an *unregulated collective investment scheme*;
 - (k) a *client* when he is classified as an *intermediate customer* in accordance with COB 4.1.9R (Expert private customer classified as intermediate customer);

but excluding:

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

investment

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

- (a) life policies (subset of article 75);
- (b) shares (article 76);
- (c) debentures (that is, instruments creating or acknowledging indebtedness) (article 77);
- (d) government and public securities (article 78);
- (e) warrants (that is, instruments giving entitlement to investments) (article 79);
- (f) certificates representing certain securities (article 80);
- (g) units (article 81);
- (h) stakeholder pension scheme (article 82);
- (i) options (article 83);
- (j) futures (article 84);

- (k) contracts for differences (article 85);
- (l) rights to or interests in an investment within (a) to (k) (article 89);¹

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

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

- (a) dealing in investments as principal (article 14), but disregarding the exclusion in article 15 (Absence of holding out etc);
- (b) dealing in investments as agent (article 21);
- (c) arranging deals in investments for another person (article 25(1)) but only in relation to *investments*;
- (d) making arrangements for deals in investments (article 25(2)) but only in relation to *investments*;
- (e) managing investments (article 37);
- (f) safeguarding and administration of assets (article 40);
- (g) sending dematerialised instructions (article 45(1));
- (h) causing dematerialised instructions to be sent (article 45(2));
- (i) establishing, operating or winding up a collective investment scheme (article 51(1)(a));
- (j) acting as trustee of an authorised unit trust scheme (article 51(1)(a));
- (k) acting as the depositary or sole director of an open-ended investment company (article 48(3));
- (l) advising on investments (article 49); for the purposes of the permission regime, this is sub-divided into:
 - (i) advising on investments (except on pension transfer and pension opt outs);
 - (ii) advice on pension transfers and opt outs;
- (m) agreeing to carry on the activities in (a) to (h) and (l) (article 64);²

investment firm means any legal or natural person established in the *EEA*, the regular occupation or business of which is the provision of *core investment services* for third parties on a professional basis, in

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

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

	accordance with the <i>ISD</i> , excluding -
	(a) any person to whom the <i>ISD</i> does not apply by virtue of the provisions of paragraph 2 of article 2 of that directive;
	(b) a <i>credit institution</i> , a <i>local</i> or a <i>category D firm</i> ;
<i>investment services</i>	means -
	(a) activities undertaken in the course of carrying on <i>investment business</i> ; and
	(b) activities undertaken in connection with an <i>ISA</i> where those activities do not constitute <i>investment business</i> ;
<i>ISD</i>	means the Council Directive on investment services in the securities field (Directive No. 93/22/EEC);
<i>large exposure</i>	means -
	(a) in relation to <i>non-trading book exposures</i> , an <i>exposure</i> or number of <i>exposures</i> to a third party or <i>group of connected third parties</i> which exceed 10% of a <i>firm's own funds</i> ; and
	(b) in relation to the aggregate of <i>non-trading book</i> and <i>trading book exposures</i> , an <i>exposure</i> or number of <i>exposures</i> to a <i>third party</i> or <i>group of connected third parties</i> which exceed 10% of a <i>firm's financial resources</i> ;
<i>lead regulated firm</i>	means a <i>firm</i> which is subject to the financial regulations of another regulator under a lead regulation arrangement to which the <i>FSA</i> is a party, directly or indirectly;
<i>LER</i>	means the <i>large exposures requirement</i> of a <i>firm</i> as calculated in accordance with rules 10-190 to 10-194;
<i>listed activities</i>	means a listed activity within the meaning of the <i>BCD</i> , i.e. one or more of the following activities -
	(a) lending;
	(b) financial leasing;
	(c) money transmission services;
	(d) issuing and administering means of payment;
	(e) guarantees and commitments;
	(f) trading for own account or for the account of customers in money market instruments (cheques, bill, CDs, etc);
	(g) foreign exchange;
	(h) financial <i>futures</i> and <i>options</i> ;
	(i) exchange and interest rate instruments; or
	(j) transferable <i>securities</i> ;
	(k) <i>participation</i> in share issues and the provision of services related to such issues;

- (l) corporate finance advice;
- (m) moneybroking;
- (n) portfolio management and advice; or
- (o) safekeeping and administration of securities;

local

means a *firm* which is a member of a *futures* and *options* exchange and whose *permission* includes a *requirement* that:

- (a) the *firm* will not conduct *designated investment business* other than:
 - (i) *dealing* for its own account on that *futures* or *options* exchange;
 - (ii) *dealing* for the accounts of other members of the same *futures* and *options* exchange; or
 - (iii) making a price to other members of the same *futures* and *options* exchange; and
- (b) the performance of the *firm's* contracts must be guaranteed by and must be the responsibility of one or more of the clearing members of the same *futures* and *options* exchange;

margin requirement

means, in relation to a counterparty, the value of any amounts which the *firm* or *intermediate broker* would be required to pay under the rules of an exchange or clearing house to -

- (a) meet any *marked to market* losses occurring on contracts undertaken for that counterparty at that time; or
- (b) as an initial margin fidelity deposit in respect of all the counterparty's open positions at that time,

on the assumption that those transactions were the only transactions undertaken on the exchange or clearing house by the *firm* or *intermediate broker* at that time;

margin transaction

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

mark to market

means to value an *investment* at its current market value in accordance with rule 10-41(9);

market counterparty

means a *client* who is:

- (a) a properly constituted government (including a quasi-governmental body or a government agency) of any given country or territory;

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

but excluding:

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

marketable investment means -

- (a) an *investment* which is traded on or under the rules of an *exchange* or an *approved exchange*;
- (b) a debt instrument which may be transferred without the consent of the issuer or any other person (including a collateralised mortgage obligation);
- (c) a *physical commodity*;
- (d) a *warrant*, *option*, *future* or other instrument which entitles the holder to subscribe for or acquire -
 - (i) an *investment* or *physical commodity* which falls under (a) to (c) above;
 - (ii) any currency; or
 - (iii) any combination of (i) and (ii) above;
- (e) a *contract for differences* (including interest rate and currency *swaps*) relating to fluctuations in -
 - (i) the value or price of an *investment* or *physical commodity* in (a) to (d) above;

	<ul style="list-style-type: none"> (ii) any currency; (iii) the rate of interest in any currency or any index of such rates; (iv) the level of any index which is derived from the prices of an <i>investment</i> or <i>physical commodity</i> in (a) to (c) above; or (v) any combination of (i) to (iv) above;
	(f) <i>warrants, options, futures</i> or other instruments entitling the holder to obtain the rights of those contracts in (d) or (e) above; and
	(g) a unit in a <i>regulated collective investment scheme</i> ;
<i>material holding</i>	means a holding of -
	(a) ordinary share capital and non cumulative preference share capital; or
	(b) subordinated loan and non fixed term cumulative preference share capital,
	in a <i>credit institution</i> or a <i>financial institution</i> where -
	(i) (a) or (b) above exceed 10% of the share capital plus share premium of the issuer; or
	(ii) the aggregate of (a) and (b) above exceeds 10% of the <i>firm's own funds</i> , before deducting these holdings;
<i>member state</i>	means a country in the European Economic Area;
<i>mixed activity holding company</i>	means a <i>parent</i> undertaking, other than a <i>financial holding company</i> , an <i>investment firm</i> or a <i>credit institution</i> , the <i>subsidiaries</i> of which include at least one <i>investment firm</i> or <i>credit institution</i> ;
<i>multilateral development bank</i>	means African Development Bank, Asian Development Bank, Caribbean Development Bank, Council of Europe Resettlement Fund, European Bank for Reconstruction and Development, European Investment Bank, Inter-American Development Bank, International Finance Corporation, International Bank for Reconstruction and Development (IBRD) and Nordic Investment Bank (NIB);
<i>non recourse loan</i>	means a loan to a <i>firm</i> secured on specific land or buildings, under the terms of which the lender has no claim on the other assets of the <i>firm</i> nor on assets for which the <i>firm</i> is accountable in any circumstances (including a winding up);
<i>non-core investment services</i>	means a service listed in Section C of the Annex to the ISD;
<i>non-trading book</i>	in relation to a <i>firm's</i> business or exposures, means any position, counterparty exposure or balance sheet item not falling within the definition of <i>trading book</i> excluding its <i>physical commodities</i> and

	<i>physical commodities derivatives</i> business;
<i>OECD</i>	means Organisation for Economic Co-operation and Development;
<i>oil</i>	means mineral oil of any description and petroleum gases, whether in liquid or vapour form, and includes products and derivatives of oil;
<i>oil collective investment scheme</i>	means a <i>collective investment scheme</i> , the property of which consists only of property which is <i>oil</i> or an <i>oil investment</i> or cash awaiting investment;
<i>oil investment</i>	means any of the following: <ul style="list-style-type: none"> (a) a unit in an <i>oil collective investment scheme</i>; (b) a <i>future</i> where the commodity in question is <i>oil</i>; (c) a <i>contract for differences</i> where the property in question is <i>oil</i> or an <i>oil investment</i> or the index or other factor in question is linked to or otherwise dependent upon fluctuations in the value or price of <i>oil</i> or any <i>oil investment</i>; (d) rights to and interests in anything which is an <i>oil investment</i>; (e) an option to acquire or dispose of an investment in (a) to (d);
<i>oil market investment activities</i>	means any <i>regulated activity</i> in relation to an <i>oil investment</i> or to <i>oil</i> ;
<i>oil market participant</i>	means a <i>firm</i> which: <ul style="list-style-type: none"> (a) carries on <i>oil market investment activities</i>, which in the United Kingdom are confined to either or both the following: <ul style="list-style-type: none"> (i) the performance of management services for the participants in an <i>oil collective investment scheme</i> in which individuals do not participate, and other <i>oil market investment activities</i> which are performed in relation to any such <i>oil collective investment scheme</i>; (ii) other <i>oil market investment activities</i> which: <ul style="list-style-type: none"> (A) are the executing of transactions on any <i>recognised investment exchange</i> or <i>designated investment exchange</i>, other than to enable the <i>firm</i> to fulfil the orders of <i>clients</i>; or (B) if they are not the executing of transactions on such exchanges, are performed in connection with or for persons who are not individuals; and

- (b) whose *permission* includes a *requirement* that the *firm* must not carry on any *investment business* other than that in (a);

operator

means:

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

option

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

- (a) a security or contractually based investment (other than an option);
- (b) currency of the United Kingdom or of any other country or territory;
- (c) palladium, platinum, gold or silver; or
- (d) an option to acquire or dispose of an option specified in (a), (b) or (c);

original own funds

means the original own funds of a *firm* calculated in accordance with Table 10-62(2) A or B;

OTC

means over the counter, i.e. in relation to any *investment*, an *investment* which is not traded or listed *on exchange* or an *approved exchange*;

out of the money

means those *options* and *warrants* which are not *in the money*;

own funds

means the own funds of a *firm* calculated in accordance with Table 10-61(1)B;

parent

means any parent undertaking as defined in section 258 of the Companies Act 1985 or paragraph 14 of Financial Reporting Standard No.2, and any undertaking which effectively exercises a

	dominant influence over another undertaking;
<i>participation</i>	means a holding either direct or indirect of 20% or more of the voting rights or capital of another undertaking;
<i>partner</i>	see “ <i>registered partner</i> ”;
<i>passport institution</i>	means a <i>firm</i> which is an <i>incoming EEA firm</i> ;
<i>passport investment business</i>	means the carrying on by a <i>passport institution</i> , within or into the United Kingdom in accordance with Schedule 3 to the Act, of - (a) one or more <i>listed activities</i> ; or (b) one or more of the <i>core investment services</i> ; or (c) one or more of the <i>non-core investment services</i> conducted in conjunction with one or more <i>core investment services</i> ; in relation to which a <i>supervisory authority</i> in its home state has regulatory functions;
<i>payment date</i>	means the date on which payment for the <i>securities</i> is due to be made to the issuer or seller, or, if payment is made in instalments, payment of the first instalment;
<i>perfectly matching contracts</i>	mean certain <i>OTC derivatives</i> contracts which are included in a legally binding netting agreement that are equal and exact opposites and perfectly matching in all material respects;
<i>permission</i>	means a <i>permission</i> given by the <i>FSA</i> under Part IV of the <i>Act</i> (Permission to carry on regulated activities), or resulting from any other provision of the <i>Act</i> , to carry on <i>regulated activities</i> in the United Kingdom;
<i>physical commodities method</i>	means the method of calculating <i>PRR</i> under rules 10-166 to 10-169B;
<i>physical commodity</i>	means the actual commodity, <i>documents of title</i> to actual commodities or shipping documents conveying title to actual commodities;
<i>PRA</i>	means percentage risk addition, i.e. a percentage to be applied to the value of positions in <i>investments</i> held by the <i>firm</i> to determine its <i>PRR</i> ;
<i>preference securities</i>	means a <i>share</i> with rights, in respect of capital or dividends, superior to those of ordinary equity;
<i>profit shares</i>	means an appropriation of profit before tax on a predetermined basis for the benefit of management or <i>employees</i> ;
<i>PRR</i>	means the position risk requirement of a <i>firm</i> as calculated in accordance with rules 10-80 to 10-169B;
<i>put option</i>	means an <i>option</i> to sell an <i>investment</i> , other instrument, foreign currency or <i>physical commodity</i> at a given price on or before a

given date;

qualifying debt security means a debt *security* which -

- (1) (a) is, or has an “equivalent debt” which is, rated by a “relevant agency” at, or higher than, the level indicated in the Table in **Appendix 34** and -
 - (i) there has been no announcement that the rating will be down-graded below the level so indicated; and
 - (ii) the *firm* has no reasonable cause to believe that another “relevant agency” has rated the *security* or “equivalent debt” below the level so indicated;
- (b) is issued or fully guaranteed by -
 - (i) a *Zone A* central government or central bank;
 - (ii) a *Zone B* central government or central bank, provided that the *security* is denominated in its national currency;
 - (iii) a *Zone A* public sector entity which represents no higher a risk than its central government;
 - (iv) a *Zone A credit institution*, provided that the *security* represents senior debt of the issuer;
 - (v) a *Zone B credit institution*, provided that the *security* has a maturity of one year or less and is not part of the issuer’s *own funds*;
 - (vi) an *investment firm* or *recognised third country investment firm*;
 - (vii) one of the following organisations -
 - The African Development Bank;
 - The Asian Development Bank;
 - The Bank for International Settlements;
 - The Caribbean Development Bank;
 - The Council of Europe;
 - Euratom (European Atomic Energy Community);
 - Eurofina (European Company for Financing of Railroad Rolling Stock);
 - The European Bank for Reconstruction and Development;
 - The European Coal and Steel Community;
 - The European Economic Community;
 - The European Investment Bank;
 - The Inter-American Development Bank;
 - The International Bank for Reconstruction and Development (World Bank);
 - The International Finance Corporation;
 - The International Monetary Fund;

The Nordic Investment Bank;

- (c) is collateralised by *securities* issued by a *Zone A* central government, *Zone A* central bank or one of the institutions listed in (a)(vii) above; or
 - (d) is issued or fully guaranteed by a company whose equity satisfies the criteria set out in section 5(b) of **Appendix 49**; and
- (2) for the purposes of (1) above -
- (a) the issuer or guarantor of the *security* is not in default as to any payment on any other *security* issued or guaranteed by it;
 - (b) in respect of any *security* of, or guaranteed by, any issuer or guarantor, “equivalent debt” means any debt which ranks *pari passu* with, or subordinated to, the *security* or (as the case may be) the guarantee; and
 - (c) in relation to any issuer or guarantor, a “relevant agency” means one of the agencies names in **Appendix 34** by reference to the category of issue or guarantor;

qualifying deposit

means a deposit which is one of the following -

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

Regulated Activities Order

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

recognised clearing house

means a clearing house listed as such in **Appendix 57**;

<i>recognised exchange</i>	means an exchange listed as such in Appendix 57 ;
<i>recognised investment exchange</i>	means an investment exchange which is declared by a <i>recognition order</i> for the time being in force to be a recognised investment exchange;
<i>recognised scheme</i>	means a <i>collective investment scheme</i> recognised under Chapter V of Part XVI of the <i>Act</i> ;
<i>recognised third country investment firm</i>	means an undertaking which, if it was established within the <i>EEA</i> , would be covered by the definition of <i>investment firm</i> , and which is subject to the prudential rules of one of the regulators in Appendix 59 ;
<i>reconciliation</i>	means the identification and explanation of individual items of difference between two sets of records, but does not include the processing of necessary adjustments;
<i>registered partner</i>	means a partner of any partnership (including any partnership constituted under the law of a country or territory outside the United Kingdom) which carries on <i>investment business</i> as a <i>firm</i> and who is an <i>approved person</i> ;
<i>regulated banking institution</i>	means any banking institution which has paid up share capital and reserves of over £5,000,000 as shown by its latest published audited accounts, and which is authorised by the <i>FSA</i> or supervised by the central bank or other regulatory authority of a member state of the <i>OECD</i> in which the bank is incorporated;
<i>regulated business</i>	means <i>investment business</i> which is - <ul style="list-style-type: none"> (a) business carried on from a permanent place of business maintained by a <i>firm</i> (or its <i>appointed representative</i>) in the United Kingdom; and (b) other business carried on with or for <i>customers</i> in the United Kingdom, unless that business is - <ul style="list-style-type: none"> (i) business carried on from an office of a <i>firm</i> outside the United Kingdom which, if that office were a separate person, would fall within the overseas persons exclusions set out in article 72 of the Regulated Activities Order; or (ii) business of an <i>appointed representative</i> of the <i>firm</i> which is not carried on in the United Kingdom;
<i>regulated collective investment scheme</i>	means: <ul style="list-style-type: none"> (a) an <i>ICVC</i>; or (b) an <i>AUT</i>; or (c) a <i>recognised scheme</i>; whether or not the <i>units</i> are held within a <i>PEP</i> , <i>ISA</i> , or <i>pension contract</i> ;

<i>reporting statement</i>	<p>means any one or more of the following types of report as required by the <i>Supervision manual</i>:</p> <ul style="list-style-type: none"> (a) <i>audited annual financial statements</i>; (b) <i>annual reporting statement</i>; (c) <i>auditor's report</i>; (d) internal control letter; (e) quarterly reporting statement; (f) position risk reporting statement; (g) counterparty risk reporting statement; (h) annual reconciliation; (i) monthly reporting statement; and (j) the audited accounts of a subsidiary of the firm;
<i>repurchase agreement</i>	<p>(and "<i>sale and buy back agreement</i>") means an agreement for the sale of <i>securities</i> or <i>physical commodities</i> subject to a commitment to repurchase from the same person the same or similar <i>securities</i> or <i>physical commodities</i>, which meets either (a), (b), (c) and (e) or (a), (c), (d) and (e) of the following requirements -</p> <ul style="list-style-type: none"> (a) the <i>securities</i> or <i>physical commodities</i> and collateral are <i>marked to market</i> daily; (b) the collateral may be adjusted in order to take account of material changes in the value of the <i>securities</i> or collateral; (c) the agreement provides for the claims of the <i>firm</i> (<i>securities</i> or <i>physical commodities</i>) to be immediately set off against the claims of the counterparty (collateral); (d) the agreement is an <i>inter-professional</i> one; and (e) such agreements are confined to their accepted and appropriate use, and are not artificial transactions, (especially those not of a short term nature);
<i>requirement</i>	<p>means a requirement included in a <i>firm's Part IV permission</i> under section 43 of the <i>Act</i> (Imposition of requirements), section 45(4) of the <i>Act</i> (Variation etc on the Authority's own initiative) or section 46 of the <i>Act</i> (Variation of permission on acquisition of control);</p>
<i>reverse repurchase agreement</i>	<p>(and "<i>buy and sale back agreement</i>") means an agreement for the purchase of <i>securities</i> or <i>physical commodities</i> subject to a commitment to resell to the same person the same or similar <i>securities</i> or <i>physical commodities</i> which meets either (a), (b), (c) and (e) or (a), (c), (d) and (e) of the following requirements -</p> <ul style="list-style-type: none"> (a) the <i>securities</i>, or <i>physical commodities</i>, and collateral are <i>marked to market</i> daily;

- (b) the collateral may be adjusted in order to take account of material changes in the value of the *securities*, or *physical commodities*, or collateral;
- (c) the agreement provides for the claims of the *firm* (collateral) to be immediately set off against the claims of the counterparty (*securities* or *physical commodities*);
- (d) the agreement is an *inter-professional* one; and
- (e) such agreements are confined to their accepted and appropriate use, and are not artificial transactions, (especially those not of a short term nature);

sale and buy back agreement

see *repurchase agreement*;

securities and futures firm

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

- (a) a *firm* (other than one falling within (d)):
 - (i) which was a member of *SFA* immediately before *commencement*; and
 - (ii) which was not, immediately before *commencement*, subject to the financial supervision requirements of the *FSA* (under section 43 of the Financial Services Act 1986), *PIA* or *IMRO* under lead regulation arrangements;
- (b) a *firm* whose *permission* includes a *requirement* that it comply with *IPRU(INV) 3* or 10 (Securities and futures firms);
- (c) a *firm*:
 - (i) which was given a *Part IV permission* after *commencement*, or which was authorised under section 25 of the Financial Services Act 1986 immediately before *commencement* and not a member of *IMRO*, *PIA* or *SFA*; and
 - (ii) for whom the most substantial part of its gross income, including *commissions*, from the *regulated activities* included in its *Part IV permission* is derived from one or more of the following activities (based, for a *firm* given a *Part IV permission* after *commencement*, on the business plan submitted as part of the *firm's* application or, for a *firm* authorised

under section 25 of the Financial Services Act 1986, on the *firm's* financial year preceding its *authorisation* under the Act):

- (A) an activity carried on as a member of an exchange;
 - (B) making a market in *securities* or *derivatives*;
 - (C) *corporate finance business*;
 - (D) *dealing*, or *arranging (bringing about) deals in investments*, in *securities* or *derivatives*;
 - (E) the provision of clearing services as a *clearing firm*;
 - (F) *managing investments*, where those *investments* are primarily *derivatives*; and
 - (G) activities relating to *spread bets*;
- (d) a *firm* that is:
- (i) an *ex-section 43 firm* which was not authorised under the Financial Services Act 1986 immediately before *commencement*; or
 - (ii) an *ex-section 43 lead regulated firm*;

security

means, as defined in article 3(1) of the Regulated Activities Order, any of the following investments specified in that Order:

- (a) shares (article 76);
- (b) debentures (that is, instruments creating or acknowledging indebtedness) (article 77);
- (c) government and public securities (article 78);
- (d) warrants (that is, instruments giving entitlement to investments) (article 79);
- (e) certificates representing certain securities (article 80);
- (f) units (article 81);
- (g) stakeholder pension schemes (article 82); and
- (h) rights to or interests in investments in (a) to (g) (article 89);

settlement day

means the day on which -

- (a) under the recognised practice of an exchange bargains are contracted for settlement; and
- (b) in the case of bargains not transacted on an exchange or entered into for forward settlement, 20 days from the date of the transaction, or, if earlier, the contractual due date;

share

means the investment, specified in article 76 of the Regulated Activities Order (Shares etc), which is, in summary: a share or stock in the share capital of:

	(a) any <i>body corporate</i> (wherever incorporated);
	(b) any unincorporated body constituted under the law of a country or territory outside the United Kingdom;
<i>sole trader</i>	means a <i>firm</i> which is not a <i>body corporate</i> and not a <i>partnership</i> ;
<i>stock exchange moneybroker</i>	is a moneybroker which is an <i>authorised person</i> and acts as an intermediary in the gilt market;
<i>subsidiary</i>	has the meaning given to it in section 736 of the Companies Act 1985;
<i>supervisory authority</i>	in relation to another <i>member state</i> , means an authority in that state which has regulatory functions in relation to one or more <i>listed activities, core investment services</i> or <i>non-core investment services</i> ;
<i>supranational organisation</i>	means any organisation referred to in Part 2 of Appendix 35 ;
<i>swap</i>	means a transaction in which two counterparties agree to exchange streams of payments over time according to a predetermined basis;
<i>Takeover Code</i>	means the City Code on Takeovers and Mergers and the Rules Governing Substantial Acquisitions of Shares published by the Takeover Panel;
<i>takeover or related operation</i>	means - <ul style="list-style-type: none"> (a) any offer to which the <i>Takeover Code</i> applies and any transaction or arrangement which is of such a nature that the <i>Takeover Code</i> would have applied to it had it concerned a company whose shares are listed under Part VI of the <i>Act</i> and whose head office and place of central management are in the United Kingdom; (b) any offer, transaction or arrangement relating to the purchase of <i>securities</i> with a view to establishing or increasing a strategic holding of a person, or of a person together with his <i>associates</i> in the <i>securities</i> concerned; (c) any transaction or arrangement entered into in contemplation or furtherance of any offer, transaction or arrangement falling within (a) or (b) above; and (d) any transaction or arrangement entered into by way of defence or protection against any offer, transaction or arrangement falling within (a), (b) or (c) above which has taken place or which is contemplated;
<i>Takeover Panel</i>	means the Panel on Takeovers and Mergers;
<i>tender offer</i>	means an unconditional offer as a principal to buy <i>securities</i> ;

<i>trading book</i>	<p>in relation to a <i>firm's</i> business or exposures, means its -</p> <ul style="list-style-type: none"> (a) proprietary positions in <i>financial instruments, physical commodities</i> and commodity <i>derivatives</i> which are held for resale and/or are taken on by the <i>firm</i> with the intention of benefiting in the short term from actual and/or expected differences between their buying and selling prices, or from other price or interest-rate variations; (b) positions in <i>financial instruments, physical commodities</i> and commodity <i>derivatives</i> arising from matched principal broking; (c) positions taken in order to hedge other elements of the <i>trading book</i>; (d) exposures due to unsettled <i>securities</i> or <i>physical commodities</i> transactions, free deliveries, derivative transactions, <i>repurchase, sale and buy back</i> and <i>securities</i> and <i>physical commodities</i> lending agreements based on <i>securities</i> or <i>physical commodities</i> included in (a) to (c) above, <i>reverse repurchase, buy and sale back</i> and <i>securities</i> borrowing and <i>physical commodities</i> borrowing agreements based on <i>securities</i> or <i>physical commodities</i> included in (a) to (c) above; and (e) fees, commissions, interest and dividends which are directly related to the items included in (a) to (d) above;
<i>trust beneficiary</i>	means a beneficiary under a trust (not being the settlor) who benefits from the performance by a <i>firm</i> as trustee of investment services relating to the management of the trust assets;
<i>undocumented buy and sale back agreement</i>	means an agreement for the purchase of <i>securities</i> or <i>physical commodities</i> subject to a commitment to resell to the same person the same or similar <i>securities</i> or <i>physical commodities</i> , where the agreement does not meet all of the necessary requirements for a <i>buy and sale back agreement, reverse repurchase, or securities</i> borrowing or <i>physical commodities</i> borrowing agreement;
<i>undocumented sale and buy back agreement</i>	means an agreement for the sale of <i>securities</i> or <i>physical commodities</i> subject to a commitment to repurchase from the same person the same or similar <i>securities</i> or <i>physical commodities</i> , where the agreement does not meet all of the necessary requirements for a <i>sale and buy back agreement, repurchase, or securities</i> lending or <i>physical commodities</i> lending agreement;
<i>venture capital business</i>	<p>means the business of:</p> <ul style="list-style-type: none"> (a) investing in, advising on, managing or arranging transactions in <i>venture capital investments</i>; or (b) advising, managing or operating portfolios or <i>collective investment schemes</i> which (apart from funds awaiting

	investment) invest only in <i>venture capital investments</i> ;
	(c) any <i>custody</i> activities provided in connection with the activities in (a) and (b); or
	(d) any related ancillary activities;
<i>venture capital firm</i>	means a <i>firm</i> whose <i>permission</i> includes a requirement that it must not conduct <i>investment business</i> other than <i>venture capital business</i> ;
<i>venture capital investment</i>	means an <i>investment</i> which, at the time the investment is made, is:
	(a) in a new or developing company or venture; or
	(b) in a management buy-out or buy-in; or
	(c) made as a means of financing the investee company or venture and accompanied by a right of consultation, or rights to information, or board representation, or management rights; or
	(d) acquired with a view to, or in order to facilitate, a transaction falling within (a) to (c);
<i>venture capital schemes</i>	means a scheme for providing capital to a <i>body corporate</i> whose equity is not traded or listed on an <i>exchange</i> ;
<i>walkaway clause</i>	means a provision which permits a non-defaulting counterparty to make only limited payments, or no payment at all, to the estate of the defaulter, even if the defaulter is a net creditor;
<i>warrant</i>	means the investment specified in article 79 of the Regulated Activities Order (Instruments giving entitlement to investments), which is, in summary: a warrant or other instrument entitling the holder to subscribe for a share, debenture or government and public security;
<i>Zone A</i>	means any country which is a full member of the <i>OECD</i> or has concluded special lending arrangements with the IMF associated with the IMF's General Arrangements to Borrow, provided it has not rescheduled its external sovereign debt to official or commercial bank creditors in the previous five years (Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany (including any pre-unification claims on East Germany), Greece, Hungary, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Portugal, Saudi Arabia, South Korea, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States, the Channel Islands, Gibraltar, Bermuda and the Isle of Man); and
<i>Zone B</i>	means any country not in <i>Zone A</i> .

Appendix 20

GUIDANCE NOTES ON RECONCILIATION OF FIRM'S BALANCES WITH A COUNTERPARTY WHICH IS A MEMBER OF AN EXCHANGE (rule 10-11(4))

Introduction

- 1 The purpose of this guidance is to state how under rule 10-11(4) the reconciliation process with counterparties which are also members of exchanges should be performed.

Scope

- 2 The reconciliation to be performed with counterparties should cover all outstanding balances and *securities* positions with such counterparties from all sources except to the extent that the components of such balances and *securities* positions have been agreed by other means. Agreement by other means shall include (but is not to be limited to) those which have been—
 - (a) matched or cleared through an exchange, clearing house or clearing system; or
 - (b) verified by dispatch to or receipt from the counterparty of a confirmation or statement. Such verification should have been evidenced in writing or by electronic media.
- 3 The reconciliation should cover all remaining outstanding items including, for example, fee-based items, dividends where these are on the *firm's* balance sheet, coupons, amounts arising under *OTC* contracts, *repurchase* and *reverse repurchase agreements* and *securities* lending and borrowing.
- 4 The items to be included should be all those past trade date which is consistent with *trade date accounting*.
- 5 Where necessary a *firm* should initially circularise a list of all relevant open items as set out above rather than a net balance. A *firm* should identify the assumptions made by them in ascertaining which balances (or types of balances) have been included in the reconciliation. A *firm* should also identify where the balances or *securities* positions with a counterparty arise from different accounts operated by them with that counterparty.
- 6 The scope of the rule is intended to cover nil balances although these may be covered on a sample basis only. They are included because discrepancies in such balances may only come to light as being incorrectly stated on the performance of a circularisation. However, reconciliations of nil balances do not need to be performed where—
 - (a) the counterparty is also a *firm*; or
 - (b) there has been no outstanding balance with the counterparty at any point during the year.

Timing

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

The obligation on firms

- 9 Where a *firm* receives a statement from a *counterparty* during the year, the recipient *firm* is not also required by virtue of rule 10-11(4) to send a further statement to that counterparty in the same year.
- 10 A recipient of a circularisation request from another *firm* must use its best endeavours to respond. Notwithstanding paragraphs 7 and 8 above, this obligation will apply even if this request is received more frequently than once a year from the same counterparty or is wider in scope than required by paragraphs 2 to 6 above (for example, by also covering balances which have already been agreed by other means). Rule 10-11 only requires that specific balances be covered. This is intended as a minimum requirement and not necessarily as the norm. If a *firm* need not reply to a request more than once a year or which covered balances of a wider scope, *firms* would be discouraged from requesting such reconciliations.
- 11 Rule 10-11(6) requires a *firm* to respond, within one month of receipt, to a circularisation request received from another *firm*. The one month response period should also be observed in relation to circularisation requests received under rule 10-11(4).
- 12 It is not considered necessary to issue detailed guidance for the procedure to be adopted in cases where the recipient does not reply to a circularisation request sent by a *firm*. It is intended that a *firm* need only take reasonable steps to obtain any such reply. However, before a *firm* has taken such steps, it should not assume that the circularisation is agreed merely due to the absence of a reply from the counterparts.

Appendix 21

NOTES ON THE VALUATION OF POSITIONS

(rule 10-41(9))

Introduction

- 1 Rule 10-41(9) states that a position must be valued at its close out price, where close out price means that a long position should be valued at current bid price and a short position at current offer price. In addition, rule 10-41(9) states that a *firm* must value a position on a prudent and consistent basis, and have regard to the liquidity of the instrument concerned and any special factors that may adversely affect the closure of the position.
- 2 The following paragraphs give general indications to *firms* on the appropriate valuation methodology. However, it is emphasised that prudence should be the overriding influence in the valuation exercise and that, where uncertainty exists as to the most appropriate price, the *firm* should use that price which gives the most conservative valuation.

General principles

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

Appendix 33 (exchanges)

LIST OF RECOGNISED INVESTMENT, DESIGNATED INVESTMENT AND APPROVED EXCHANGES

1 Recognised investment exchanges

UK

The International Petroleum Exchange of London Ltd (IPE)
The London International Financial Futures and Options Exchange
The London Metal Exchange Ltd (LME)
The London Stock Exchange
OM London Exchange
virt-x
COREDEAL Limited
Jiway Limited

Overseas

The Cantor Financial Futures Exchange (CFFE)
The Chicago Board of Trade (CBOT)
The Chicago Mercantile Exchange (CME)
Eurex Zurich
The National Association of Securities Dealers Incorporated (NASDAQ)
The New York Mercantile Exchange (NYMEX)
The New Zealand Futures and Options Exchange (NZFOE)
The Swiss Exchange (SWX)
The Sydney Futures Exchange Ltd
Wareterminbörse Hannover

2 Designated investment exchanges

American Stock Exchange
Amsterdam Pork and Potato Terminal Market
Amsterdam Futures Clearing House (NLKKAS)
Australian Stock Exchange
Bolsa Mexicana de Valores
Chicago Board of Trade
Chicago Board Options Exchange
Chicago Mercantile Exchange
Coffee, Sugar and Cocoa Exchange, Inc
Commodity Exchange, Inc
Copenhagen Stock Exchange (including FUTOP)
DTB Deutsche Terminbörse

European Options Exchange
Financiele Termijnmarkt Amsterdam
Finnish Options Market
Hong Kong Futures Exchange
Hong Kong Stock Exchange
International Securities Market Association
Irish Futures & Options Exchange (IFOX)
Johannesburg Stock Exchange
Kansas City Board of Trade
Korea Stock Exchange
Marché à Terme International de France
Marché des Options Négociables de Paris (MONEP)
MEFF Renta Fija
MEFF Renta Variable
MidAmerica Commodity Exchange
Midwest Stock Exchange
Minneapolis Grain Exchange
Montreal Stock Exchange
New York Cotton Exchange (including the Citrus Associates of the New York Cotton Exchange)
New York Futures Exchange
New York Mercantile Exchange
New York Stock Exchange
New Zealand Futures Exchange
New Zealand Stock Exchange
OM Stockholm AB
Osaka Securities Exchange
Pacific Stock Exchange
Paris Stock Exchange
Philadelphia Board of Trade
Philadelphia Stock Exchange
Singapore International Monetary Exchange
Singapore Stock Exchange
South African Futures Exchange (SAFEX)
Swiss Options and Financial Futures Exchange
Sydney Futures Exchange
Tokyo International Financial Futures Exchange (TIFFE)
Tokyo Stock Exchange
Toronto Futures Exchange
Toronto Stock Exchange
Vancouver Stock Exchange

3 Approved exchanges

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

Antwerp (Effectenbeursvennootschap van Antwerpen)
Amsterdam Stock Exchange (Amsterdamse Effectenbeurs)
Asociacion de Intermediarios de Activos Financieros (Spanish Bond Market)
Athens Stock Exchange (ASE)

Barcelona Stock Exchange (Bolsa de Valores de Barcelona)
Basle Stock Exchange (Basler Börse)
Belgian Futures & Options Exchange (BELFOX)
Berlin Stock Exchange (Berliner Börse)
Bergen Stock Exchange (Bergen Bors)
Bilbao Stock Exchange (Bolsa de Valores de Bilbao)
Bologna Stock Exchange (Borsa Valori de Bologna)
Bolsa de Mercadorios & Futures (BM&F)
Bordeaux (Bourse de Bordeaux)
Boston Stock Exchange
Bovespa (The São Paulo Stock Exchange)
Bremen Stock Exchange (Bremer Wertpapierbörse)
Brussels Stock Exchange (Société de la Bourse des Valeurs Mobilières) /(Effecten Beursvennootschap van Brussel)
BVRJ (The Rio de Janeiro Stock Exchange)

Cincinnati Stock Exchange
Copenhagen Stock Exchange (Kobenhavns Fondsbors)

Dusseldorf Stock Exchange (Rheinisch-Westfälische Börse zu Düsseldorf)

Florence Stock Exchange (Borsa Valori di Firenze)

Frankfurt Stock Exchange (Frankfurter Wertpapierbörse)

Fukuoka Stock Exchange

Geneva Stock Exchange (Bourse de Genève)
Genoa Stock Exchange (Borsa Valori di Genova)

Hamburg Stock Exchange (Hanseatische Wertpapier Börse Hamburg)
Hannover (Niedersächsische Börse zu Hannover)
Helsinki Stock Exchange (Helsingin Arvopaperipörssi Osuuskunta)

Kuala Lumpur Stock Exchange

Lille (Bourse de Lille)
Lyon (Bourse de Lyon)
Lisbon Stock Exchange (Bolsa de Valores de Lisboa)
Luxembourg Stock Exchange (Société de la Bourse de Luxembourg SA)

Madrid Stock Exchange (Bolsa de Valores de Madrid)
Marseille (Bourse de Marseille)
Mercato Italiano Futures (MIF)
Mid West Stock Exchange
Milan Stock Exchange (Borsa Valori de Milano)
Munich Stock Exchange (Bayerische Börse in München)

Nagoya Stock Exchange
Nancy (Bourse de Nancy)
Nantes (Bourse de Nantes)
Naples Stock Exchange (Borsa Valori di Napoli)
New Zealand Stock Exchange

Oporto Stock Exchange (Bolsa de Valores do Porto)
Oslo Stock Exchange (Oslo Bors)

Palermo Stock Exchange (Borsa Valori di Palermo)

Rome Stock Exchange (Borsa Valori di Roma)

Stockholm Stock Exchange (Stockholm Fondbörs)
Stuttgart Stock Exchange (Baden-Württembergische Wertpapierbörse zu Stuttgart)

Taiwan
Tel Aviv Stock Exchange
The Stock Exchange of Thailand
Trieste Stock Exchange (Borsa Valori di Trieste)
Trondheim Stock Exchange (Trondheims Bors)
Turin Stock Exchange (Borsa Valori de Torino)

Valencia Stock Exchange (Bolsa de Valores de Valencia)
Venice Stock Exchange (Borsa Valori de Venezia)
Vienna Stock Exchange

Zurich Stock Exchange (Zürcher Börse)

Appendix 34 (“qualifying debt security”) RELEVANT AGENCY

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

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

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

LIST OF REGULATED FINANCIAL INSTITUTIONS AND SUPRANATIONAL ORGANISATIONS

PART 1

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

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

PART 2

List Of Supranational Organisations

The African Development Bank;
The Asian Development Bank;
The Bank for International Settlements;
The Caribbean Development Bank;
The Council of Europe;
Euratom (The European Atomic Energy Community);
Eurofina (The European Company for Financing of Railroad Rolling Stock);
The European Bank for Reconstruction and Development;
The European Coal and Steel Community;
The European Economic Community;
The European Investment Bank;
The Inter-American Development Bank;
The International Bank for Reconstruction and Development (World Bank);
The International Finance Corporation;
The International Monetary Fund;
The Nordic Investment Bank.

Appendix 43

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

(rules 10-73 and 10-175)

1 Introduction

This Appendix contains detailed guidance to the following rules—

Rules	
10-73	Expenditure requirement
10-175	<i>CRR</i> on other amount owed to a <i>firm</i> arising out of <i>trading book</i> business.

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

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

4 Definition

A soft commission agreement means—

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

5 Description

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

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

7 Existing difference in accounting policies

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

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

9 Expenditure and balances receivable

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

10 Required treatment

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

- 11 Notwithstanding the above, expenditure may be capitalised (as an asset) in the balance sheet of the company which incurred the expenditure, **only where this amount is recoverable under a legally enforceable contract**

(see paragraph 18 below). Where such expenditure is capitalised it will be subject to rule 10-175.

12 Income and balances payable

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

13 Required treatment

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

14 Expenditure requirement

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

15 Required treatment

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

16 The reasoning behind this treatment is that the expenditure of a *firm* participating in soft commission arrangements is similar to shared commissions and can, therefore, be treated as though it were shared commissions under rule 10-73(2)(f), except to the extent that such expenses are irrecoverable, i.e. except where there is no enforceable legal agreement.

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

may decide to include all expenditure in the expenditure requirement regardless of source.

18 Legally enforceable contracts

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

Appendix 47

Counterparty Weights To Be Applied In Calculating Liquidity Adjustment And CRR

(rules 10-64 to 10-68, and 10-172 to 10-176)

This Appendix details the appropriate *counterparty* weights to be applied when calculating a liquidity adjustment in accordance with rules 10-64, 10-65 and 10-66, a requirement on a charged asset in accordance with rule 10-67 or a requirement on a *contingent liability* in accordance with rule 10-68 and the *CRR* percentages applicable in the calculation of a *firm's CRR* in accordance with rules 10-172 to 10-176.

Type of counterparty	Counterparty weight
claims on, or explicitly guaranteed by, or collateralised with <i>securities</i> issued by: <ul style="list-style-type: none"> - the central government or central bank of a <i>Zone A</i> country; - the <i>European Communities</i>; or - any other government or central bank, provided the <i>exposure</i> is denominated in that country's national currency. 	NIL
claims on discount houses, gilt-edged <i>market makers</i> , institutions with a <i>money</i> market dealing relationship with the Bank of England and those <i>Stock Exchange money brokers</i> which operate in the gilt-edged market, where the claims are secured on gilts, UK Treasury bills, eligible <i>local</i> authority and eligible bank bills, or London CDs	10%
claims on, or explicitly guaranteed by: <ul style="list-style-type: none"> - a <i>multilateral development bank</i>; - the regional government or <i>local</i> authority of a <i>Zone A</i> country; - a <i>Zone A credit institution</i>; - a <i>recognised clearing house</i> or <i>recognised exchange</i>; - a recognised third country or <i>EEA investment firm</i>; - a <i>Zone B credit institution</i>, provided the <i>exposure</i> has a maturity of one year or less. 	20%
any other <i>counterparty</i>	100%

Guidance

The guarantee should be explicit and be legally enforceable by the *firm* and should prevent a *firm's* capital from becoming deficient as a result of experiencing a loss on such an exposure. The exposure must be retained on the *firm's* balance sheet.

Appendix 48

SECURITIES AND FUTURES FIRMS: GUIDANCE NOTES ON THE SECONDARY REQUIREMENT

1. Illiquid assets

As set out in rule 10-74, firms are required to calculate a secondary requirement on illiquid assets in certain circumstances.

The *FSA* may consider lowering the level of this part of the secondary requirement in steps, if a *firm* can demonstrate, for example:

- (a) that the fixed assets concerned are readily realisable or can be used as *collateral* against which additional liquid funds can be raised; and
- (b) that the risks arising from its loans are well diversified, are partially or fully secured to the *FSA's* satisfaction, or loans are granted only in accordance with formal credit assessment procedures.

Other factors which the *FSA* may take into account will include:

- (a) whether the assets are core to the firm's ongoing business and therefore their ready realisation will be inhibited;
- (b) the relationship between the balance sheet value and market value of the assets;
- (c) the nature of *counterparties* concerned where relevant;
- (d) the number of individual *illiquid assets* greater in value than 10% of *initial capital* plus interim year's profit and loss; and the size of the excess of total *illiquid assets* over 25% of *initial capital* plus interim profit and loss.

2. Discretionary secondary requirement

A firm may be required to include at the *FSA's* discretion (by the imposition of a *requirement*) a secondary requirement as part of its financial resources requirement. In setting a secondary requirement, the *FSA* will take into account whether a firm meets the following criteria.

Liquidity management

The *FSA* will consider whether a *firm* can demonstrate that it has procedures to manage its current and future cashflows and capital requirements and planned routes to obtain additional capital.

The factors which the *FSA* may take into account the following when evaluating a *firm's* ability to satisfy this criterion include:

- (a) the frequency and detail with which cashflow forecasting is performed;
- (b) the ability to monitor the mismatch of cashflows, in particular the effect of individual transactions on a *firm's* liquidity;
- (c) the availability of banking facilities;
- (d) the existence of excess capital in *group* companies or the financial standing of the *firm's controllers* or both; and
- (e) the *firm's* gearing ratio.

Management

A *firm* must be able to demonstrate that, given the nature and size of its business, effective management control is exercised.

In considering this criterion, the factors that the *FSA* may take into account include:

- (a) the level of product awareness and managerial experience of senior management;
- (b) the number and location of senior managers in the context of the type and size of *firm*;
- (c) where appropriate, the independence of senior management, including the possible existence of an internal audit function;
- (d) the extent to which senior management monitors and controls the day to day activities of the *firm* including, for example, the setting and monitoring of limits governing credit and market exposures;
- (e) the integrity and attitude towards regulation of senior management; and
- (f) the existence of clearly defined business strategy laid down by the *firm's* senior management and the extent to which this has been communicated to the appropriate staff, including, for example, consideration of products, markets, *client* base, staffing and systems.

Systems and control

Taking into account the size of the *firm*, the diversity of its business activities, the volume, size and frequency of transactions and the degree of risk arising therefrom, a *firm* must be able to demonstrate that it has established and maintained effective systems and methods of internal control.

In considering this criterion, the factors that the *FSA* may take into account include:

- (a) the existence of standard operating procedures laid down by management and adhered to by staff governing the way in which businesses are performed, who may commit the *firm*, the methods for recording and processing transactions and the production of management information;

- (b) how frequently these operating procedures are reviewed to ensure that they continue to address the activities of the *firm*;
- (c) the existence of risk management systems which, based on the nature, size and complexity of the business, measure the risks incurred in all their activities including market, credit, operational and legal risks and include control mechanisms to alert management where risks become unacceptably high e.g. exception reports;
- (d) whether staff are sufficient in number, have appropriate experience, skill levels and specialised knowledge to manage the risks of processing, reporting and controlling the business undertaken.
- (e) the existence of management information which allows management to determine whether the *firm* is meeting its strategic plans, budget, forecasts etc.
- (f) the degree of centralisation of control procedures and systems;
- (g) the *firm's* commitment to staff training;
- (h) where appropriate, the effective use of an internal audit function;
- (i) the existence of an independent review procedure to assess the risks arising from new and ongoing business activities;
- (j) the frequency of external verification of data held relating to, for example prices, debtors, creditors, balances with depositories and clearing houses;
- (k) the existence of documented systems specifications;
- (l) the existence of adequate and tested back-up facilities and disaster recovery plans;
- (m) the availability of maintenance and programming expertise;
- (n) the age, degree of automation and integration of a *firm's* systems and the ability of a *firm's* systems to process additional data; and
- (o) the existence of insurance cover appropriate to the *firm's* activities.

Appendix 49 - Equity PRAs

1 Equity method 1 PRAs

Category	PRAs
Single stocks in qualifying countries (see 6 below)	12%
Other single stocks	16%
Broad-based equity indices which are not broken down into constituent stocks	8%

Guidance

Equity method 1 PRA includes both specific risk and general market risk. When calculating the LER for positions treated under the issuing market method, 8% should be deducted from the equity method 1 PRA to obtain the appropriate specific risk weighting.

2 Specific risk PRAs for equity method 2

Category	Specific risk PRAs
Single stocks in qualifying countries(see 6 below)	4% unless the position fulfils the criteria set out below (paragraph 5) in which case 2%
Other single stocks	8%
Broad-based equity indices which are not broken down into constituent stocks	0%

3 Specific risk PRAs for equity methods 3 and 4

Category	Specific risk PRAs
Single stocks	4% unless the position fulfils the criteria set out below (paragraph 5) in which case 2%
Broad-based equity indices which are not broken down into constituent stocks	0%

Guidance

For the purposes of Tables 1, 2 and 3 above, a broad-based index is one in which the number and nature of the constituent equities are such that the index will behave as "the market". Where a *firm* is in any doubt it should apply the single stock weights and consult the *FSA*.

4 General market risk PRAs

Category	General market risk PRAs
Single stocks in qualifying countries (see 6 below)	8%
Other single stocks	8%
Broad-based equity indices	8%

5 Criteria for applying 2% specific risk

A firm may only apply a 2% specific risk PRA in the following circumstances–

- (a) the position must be eligible to be treated under equity method 2;
- (b) the position must be–
 - (i) a constituent of an index shown in the table below; or
 - (ii) a constituent of the FT-Actuaries World Indices in a qualifying country; or
 - (iii) a stock of a UK incorporated company, traded on the London Stock Exchange, has at least six registered market makers and has a Normal Market Size (NMS) of at least 5,000 shares; and
- (c)
 - (i) the position may not exceed 10% of the gross value of the country portfolio; and
 - (ii) the total gross value of all positions comprising between 5% and 10% of the gross value of the country portfolio must not exceed 50% of the gross value of the country portfolio.

Table of constituent indices

Country	Index
Australia	All Ordinaries
Belgium	BEL 20
Canada	TSE 35
France	CAC 40
Germany	DAX
Italy	MIB 30
Japan	Nikkei 225
Netherlands	EOE
Spain	IBEX 35
Sweden	OMX
Switzerland	SMI
UK	FTSE 100
UK	FTSE Mid 250
US	S&P 500

6 Qualifying countries for equity method

Qualifying countries for the equity method are–

Australia	Ireland
Austria	Italy
Belgium	Japan
Canada	Luxembourg
Denmark	Netherlands
Finland	Portugal
France	Spain
Germany	Sweden
Greece	Switzerland
Hong Kong	UK
	USA

Appendix 50 –

Equity PRAs For Equity Method 3 - Alternative 2 - Calculation 1

CATEGORY		1 (%)	2	3
A	UK AND IRELAND			
	Constituents of the FT-SE 100 Index	10.5	]	27
	Other constituents of the FT All-Share Index	15.0	] 86	
	Other equities with a normal market size	18.0]	
	Other UK and Irish equities	25.0	n/a	
B	JAPAN			
	Constituents of the Nikkei 225 Index	10.5	]	26
	Other constituents of the First Section of the Tokyo Stock Exchange	18.0	] 88	
	Other Japanese equities	25.0	n/a	
C	USA			
	Constituents of Standard and Poors 500 Index	11.5	]	23
	Other constituents of the NYSE, AMEX and NASDAQ NMS	20.0	] 94	
	Other US equities	25.0	n/a	
D	CONSTITUENTS OF THE FT-ACTUARIES WORLD INDICES			
	Australia	21.0	292	72
	Belgium	12.0	75	43
	Canada	17.0	198	31
	Denmark	16.5	157	45
	France	15.5	161	64
	Germany	12.0	92	69
	Hong Kong	22.0	180	121
	Italy	16.5	137	84
	Netherlands	13.0	116	61
	Norway	17.0	179	102
	Singapore	16.0	123	107
	Spain	17.5	170	120
	Sweden	15.5	149	58
	Switzerland	10.0	60	49
E	OTHER EQUITIES	30.0	n/a	n/a

Appendix 51

List of Exchanges for Margin Requirement Method

Where a *firm* is applying the *margin requirement* method, the multiplication factors in the table below must be used.

Exchange	Multiplication Factor
Australian Stock Exchange	4
Belgian Futures and Options Exchange	2
Chicago Board Options Exchange	3
Chicago Board of Trade	6
Chicago Mercantile Exchange	6
Commodity Exchange Inc	5
Copenhagen Stock Exchange (including FUTOP)	2
DTB Deutsche Terminborse	3
European Options Exchange	3
FINEX	8
Finnish Options Market	3
Hong Kong Futures Exchange	3
IDEM (Italian Derivatives Market)	4
Irish Futures and Options Exchange	2
Kansas City Board of Trade	4
Korea Stock Exchange	2
London International Financial Futures and Options Exchange	4
Marché des Options Négociables de Paris	2
Marché à Terme International de France	2
Meff Renta Fija	2
Meff Renta Variable	2
MidAmerica Commodity Exchange	7
MIF (Mercato Italiano Futures)	2
Montreal Stock Exchange	4
Nagoya Stock Exchange	2
New Zealand Futures Exchange	4
OM Stockholm	2
OMLX London	2
Osaka Securities Exchange	2

Oslo Stock Exchange	2
Philadelphia Stock Exchange	8
Sao Paulo Stock Exchange	2
Singapore International Monetary Exchange	4
South African Futures Exchange	3
Swiss Options and Financial Futures Exchange	2
Sydney Futures Exchange	4
Tokyo International Financial Futures Exchange	4
Tokyo Stock Exchange	2
Toronto Futures Exchange	4
Vancouver Stock Exchange	4
ANY OTHER EXCHANGE NOT LISTED ABOVE	15

Appendix 52

Options And Warrants On Equities - The Hedging Method Of Calculating PRR

The table below must be used where a *firm* applies the hedging method to an equity hedging an *option* or *company issued warrant* on that equity.

	<i>Option position</i>	<i>In the money by more than P%</i>	<i>In the money by less than P%</i>	<i>Out of the money</i>
Long in security	Long put	zero	Wp	X
	Short call	Y	Y	Z
Short in security	Long call	zero	Wc	X
	Short put	Y	Y	Z
Key				
P%	The <i>equity method 1 PRA</i> %			
Wp	[(P%- 100%) x equity position valued at the exercise price] + <i>mark to market</i> value of equity position			
Wc	[(100% + P%) x equity position valued at the exercise price] - <i>mark to market</i> value of equity position			
X	The <i>mark to market</i> value of the equity position multiplied by the <i>equity method 1 PRA</i> in Appendix 49			
Y	The <i>mark to market</i> value of the equity position multiplied by the <i>equity method 1 PRA</i> in Appendix 49 . This result may be reduced by the <i>mark to market</i> value of the <i>option</i> or <i>warrant</i> , subject to a maximum reduction to zero			
Z	The hedging method is no longer permitted - other permitted methods must be used for both the <i>option</i> or <i>warrant</i> and the equities			

Appendix 53

Interest Rate PRAs

1 Specific risk PRAs

<i>Issuer</i>	Maturity	Specific risk PRA (%)
An <i>issue</i> of, or fully guaranteed by, a <i>Zone A</i> central government or central bank	any	0
An <i>issue</i> of, or fully guaranteed by, a <i>Zone B</i> central government or central bank denominated in the domestic currency	0-12 m	0
An <i>issue</i> collateralised by claims on or <i>securities</i> of a <i>Zone A</i> central government or central bank, or the <i>European Communities</i> ; or An <i>issue</i> of the <i>European Communities</i>	any	0.125
Other <i>qualifying debt securities</i>	0-6 m	0.25
	6-24 m	1.00
	Over 24 m	1.60
Any other <i>issuer</i>	any	8

2 Maturity-based general market risk PRAs

Zone	Maturity Band		PRA(%)	
	Coupon 3% or more	Coupon less than 3%	Qualifying currencies (see 4 below)	Other currencies
One	0 - 1 m	0 - 1 m	0.00	0.00
	1 - 3 m	1 - 3 m	0.20	0.40
	3 - 6 m	3 - 6 m	0.40	0.80
	6 - 12 m	6 - 12 m	0.70	1.40
Two	1 - 2 yr	1 - 1.9 yr	1.25	2.50
	2 - 3 yr	1.9 - 2.8 yr	1.75	3.50
	3 - 4 yr	2.8 - 3.6 yr	2.25	4.50
Three	4 - 5 yr	3.6 - 4.3 yr	2.75	5.50
	5 - 7 yr	4.3 - 5.7 yr	3.25	6.50
	7 - 10 yr	5.7 - 7.3 yr	3.75	7.50
	10 - 15 yr	7.3 - 9.3 yr	4.50	9.00
	15 - 20 yr	9.3 - 10.6 yr	5.25	10.50
	over 20 yr	10.6 - 12 yr	6.00	12.00
		12 - 20 yr	8.00	16.00
over 20 yr	over 20 yr	12.50	25.00	

3 Maturity-based matching factors

	Matching factor
Same maturity band	10%
Zone 1	40%
Zone 2	30%
Zone 3	30%
Adjacent Zones	40%
Zone 1 and Zone 3	150%

4 Qualifying currencies for interest rate method

The qualifying currencies for the interest rate method are–

Austria	euro	Italy	euro
Belgium	euro	Japan	(Yen)
Canada	(Dollar)	Luxembourg	euro
Denmark	(Krone)	Netherlands	euro
euro		Portugal	euro
Finland	euro	Spain	euro
France	euro	Sweden	(Krona)
Germany	euro	Switzerland	(Franc)
Greece	(Drachma)	UK	(Sterling)
Ireland	euro	US	(Dollar)

Appendix 54

Options And Warrants On Qualifying Debt Securities - The Hedging Method Of Calculating PRR

The table below must be used to calculate the *PRR* where a *firm* applies the hedging method to a *qualifying debt security* hedging an *option* or *bond warrant* on that *security*.

	Option position	In the money by more than P%	In the money by less than P%	Out of the money
Long in security	Long put Short call	zero Y	Wp Y	X Z
Short in security	Long call Short put	zero Y	Wc Y	X Z
Key				
P%	The sum of the specific risk <i>PRA</i> and the maturity-based general <i>market risk PRA</i> for the debt <i>security</i> .			
Wp	[(P%- 100%) x debt position valued at the exercise price]+ <i>mark to market</i> value of debt position			
Wc	[(100% + P%) x debt position valued at the exercise price] - <i>mark to market</i> value of debt position			
X	The <i>mark to market</i> value of the debt position multiplied by the sum of the specific risk <i>PRA</i> and maturity-based general <i>market risk PRA</i> in Appendix 53			
Y	The <i>mark to market</i> value of the debt position multiplied by the sum of the specific risk <i>PRA</i> and maturity-based general <i>market risk PRA</i> in Appendix 53 . This result may be reduced by the <i>mark to market</i> value of the <i>option</i> or <i>bond warrant</i> , subject to a maximum reduction to zero.			
Z	The hedging method is no longer permitted - other permitted methods must be used for both the <i>option</i> or <i>bond warrant</i> and the debt <i>securities</i> .			

Appendix 55

Guidance Notes On The Application Of Adequate Collateral Or Acceptable Collateral To Reduce Counterparty Exposures

Introduction

- 1 The purpose of this note is to give guidance to *firms* on how *collateral* received from *counterparties* may be applied to reduce *exposures* to *counterparties* on which *CRR* and liquidity adjustments are calculated.

Types of collateral

- 2 The *FSA* recognises two different definitions of *collateral*–
 - (a) *acceptable collateral*, which is a fairly limited definition and includes only cash, gold and silver bullion, certificates of deposit issued by and lodged with the *firm*, *securities* issued by *Zone A* central governments, *Zone A* central banks and the *European Communities*; and
 - (b) *adequate collateral*, which is a much broader definition and includes as well as the types of *collateral* listed in (a) above, *shares*, *Talisman short-term certificates*, letters of credit and guarantees.

Status and value of collateral

- 3 In order that a *firm* may rely on collateral to reduce *exposures* to *counterparties*, it must meet certain criteria, i.e. the *firm* must have an unconditional right to apply or realise the *collateral* for the purposes of repaying the *counterparty's* obligations to the *firm*; and in the case of *adequate collateral*, it may not be issued by the *counterparty*. *Collateral* should be accurately valued, in particular collateral in the form of *securities* must be marked to market daily using the same principles as used for valuing positions (rule 10-41).

Application of collateral

- 4 *Acceptable collateral* may be used to reduce an *exposure* arising under any of rules 10-65, 10-66 and 10-170 to 10-176. Any uncovered *exposure* will then be subject to the relevant liquidity adjustment or *CRR* percentage.
- 5 *Adequate collateral* may be applied to *counterparty exposures* in two different ways. If the *counterparty exposure* arises on a transaction subject to rule 10-173 (repurchase and reverse repurchase, *securities* lending and borrowing and *sale and buy back agreements*), only that part of the *exposure* left uncovered will be subject to the relevant *CRR* percentage. If the *counterparty exposure* arises on a transaction, subject to rules 10-172 (*free deliveries of securities*), 10-174 (*derivative* transactions) or 10-175 (other amounts owed to a *firm* arising out of *trading book* business), the part of the *counterparty exposure* covered by *adequate collateral* will be subject to a maximum 8%

CRR percentage, while the part of the *counterparty exposure* left uncovered will be subject to the *CRR* percentage detailed in the relevant rule.

Appendix 56

Guide To Adequate Credit Management Policy (ACMP) (rules 10-172 to 10-175, 10-300 and "ACMP")

Introduction

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

Objective

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

Scope

- 3 The guidance applies to any *firm* which wishes to:
 - (a) take advantage of the lower *CRR* percentages (by which counterparty exposures must be multiplied); and
 - (b) have its *ACMP* taken into account in the determination of the appropriate level of its secondary requirement.
- 4 Before a firm may use the lower percentages in calculating *CRR* and in preparing its financial reporting statements, it must meet the requirements set by 10-300. The *ACMP* and its operation will be reviewed periodically by the *FSA* and, where it is no longer operating effectively, the firm may be in breach of those requirements.

Background

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

- 7 The prime components of a sound credit risk management process are:
- the definition by a *firm* of what constitutes a credit exposure/risk and is therefore covered by the *firm's ACMP*;
 - a comprehensive credit risk measurement approach;
 - the existence of guidelines and other parameters used to determine credit limits and govern the level and types of risk taken; together with
 - a strong management information system for controlling, monitoring and reporting exposures.

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

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

General principles

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

Role of senior management

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

Procedures

- (b) whether there are clearly established lines of responsibility and levels of authority for:
- the granting of credit to a counterparty;
 - extending its permitted use to cover risk arising on a product new to the counterparty;
 - increasing existing credit facilities; and
 - the monitoring and controlling of all credit risk;
- (c) the extent to which the functions of granting, measuring, monitoring and controlling credit risk are managed independently of the front office

with a direct reporting line to the senior management ultimately responsible for credit risk management;

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

Documentation

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

Collateral and margin

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

Measurement and monitoring of exposures

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

Additional Guidance on the FSA's Assessment of ACMPs

Preamble

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

A definition of credit and the measurement of credit risk

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

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

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

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

The decision to grant credit

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

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

- Independence of Committee from profit centres
- Recording of Approvals

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

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

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

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

Cover sheet detailing proposed credit.

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

Financial information on proposed counterparty.

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

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

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

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

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

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

The monitoring of credit exposure

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

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

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

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

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

Computer systems

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

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

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

Reporting

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

- Excess reports/Exception reports
- Exposure reports

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

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

Credit Risk Management/Control

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

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

Documentation

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

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

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

Basic documentation to be obtained from all counterparties might include

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

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

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

Other areas for consideration could include:

- Prompt execution of documentation
- Monitoring response to documents sent out
- Chasing where no response
- Reporting missing documentation to senior management

- Proper execution
- Secure storage of documentation
- Regular review of documentation held

Ongoing review of credit risk

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

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

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

Documentation of credit policies and procedures and customer files

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

- Credit Procedures manuals and the context in which they are used
- Internal Board Minutes showing delegated authority
- Credit Committee Minutes
- Operations manuals
- Training material for staff
- Internal memorandum detailing credit policy
- Customer Credit files, to contain

- credit analysis information
- copies of decisions to grant credit
- copies of relevant documentation
- press cuttings
- copies of data input documents

Appendix 57

List Of Exchanges And Clearing Houses Recognised For The Purposes Of IPRU(INV)10

The following lists are not lists of the Recognised Investment Exchanges and the Recognised Clearing Houses to which the RIE and RCH Sourcebook (REC) applies. Inclusion of an exchange or clearing house in the following list does not imply its recognition under Part XVIII of the Financial Services and Markets Act 2000. The following lists of exchanges and clearing houses are solely for the purposes of IPRU(INV)10.

1 Exchanges recognised for the purposes of IPRU(INV)10

American Stock Exchange LLC
Amsterdam Exchanges (AEX)
AmStock Exchange of Lower Saxony Hannover (Niedersächsische Börse zu Hannover)
Athens Stock Exchange (ASE) - Thessaloniki Stock Exchange Centre (TSEC)
Australian Stock Exchange Ltd.
Baden-Wurtemberg Stock Exchange Stuttgart (Bayrische Börse)
Barcelona Stock Exchange (La Bolsa de Valores de Barcelona)
Bavarian Stock Exchange Munich (Bayrische Börse)
Belgian Futures and Options Exchange (BELFOX)
Berlin Stock Exchange (Berliner Wertpapierbörse)
Bilbao Stock Exchange (Bolsa de Bilbao)
Bourse de Montréal
Bremen Stock Exchange (Bremer Wertpapierbörse)
Canadian Venture Exchange
Chicago Board of Trade
Chicago Mercantile Exchange
Chicago Board Options Exchange Inc.
Copenhagen Stock Exchange (Københavns Fondsbørs)
Deutsche Börse AG
Eurex Deutschland
Eurex Zurich
Euronext Amsterdam NV
Euronext Brussels Ltd.
Euronext Paris SA
Frankfurt Stock Exchange (Frankfurter Wertpapierbörse)
Hanseatic Stock Exchange Hamburg (Hanseatische Wertpapierbörse Hamburg)
Helsinki Exchanges
Hong Kong Exchanges and Clearing
International Petroleum Exchange of London Ltd.

Irish Stock Exchange
Italian Exchange
Bolsa de Valores de Lisboa e Porto (BVLP)
London International Financial Futures and Options Exchange (LIFFE)
London Metal Exchange Ltd.
London Stock Exchange Ltd.
Luxembourg Stock Exchange (Société de la Bourse de Luxembourg SA)
Madrid Stock Exchange (La Bolsa de Valores de Madrid)
Marché à Terme International de France (MATIF)
MEFF Renta Variable
Mercado AIAF de Renta Fija, SA
Mercato Italiano Derivati (IDEM)
Mercato Italiano Futures (MIF)
Nagoya Stock Exchange
The Nasdaq Stock Exchange
New York Mercantile Exchange
New York Stock Exchange Inc.
OM London
OM Stockholm Exchange
Osaka Securities Exchanges
The Oslo Stock Exchange (Oslo Bors)
Pacific Stock Exchange
Rhine-Westphalian Stock Exchange Dusseldorf (Rheinisch-Westfälische Börse zu Düsseldorf)
Singapore Exchange
Stockholm Stock Exchange (Stockholms Fondbörs AB)
Sydney Futures Exchange
Tokyo Stock Exchange
Tokyo international Financial Futures Exchange
The Toronto Stock Exchange
Valencia Stock Exchange (La Bolsa de Valores de Valencia)
Wiener Borse AG

2 Clearing Houses recognised for the purposes of IPRU(INV)10

ASX Settlement and Transfer Corporation Pty Ltd (ASTC)
Austrian Kontroll Bank (OKB)
Board of Trade Clearing Corporation
Cassa di Compensazione e Garanzia S.p.A (CCG)
Commodity Clearing Corporation

The Emerging Markets Clearing Corporation
European Options Clearing Corporation Holding BV (EOCC)
Guarantee Fund for Danish Options and Futures (Garantifonden for Danske Optioner OG
Futures (FUTOP)

Kansas City Board of Trade Clearing Corporation
Hong Kong Futures Exchange Clearing Corporation Ltd
Hong Kong Securities Clearing Company Ltd
London Clearing House (LCH)
Norwegian Futures & Options Clearing House (Norsk Opsjonssentral A.S.)
N.V. Nederlandse Liquidatiekas (NLKKAS)
OM Stockholm AB (OM)
Options Clearing Corporation
Options Clearing House Pty Ltd (OCH)
OTOB Clearing Bank AG (OTOB)
Société de Compensation des Marchés Conditionnels (SCMC)
Sydney Futures Exchange Clearing House (SFECH Ltd)
TNS Clearing Pty Ltd (TNSC)

Appendix 58

VERIFICATION OF INTERIM PROFITS BY EXTERNAL AUDITORS

Introduction

- 1 The purpose of this note is to give guidance to *firms* on the required level of verification of interim profits by external auditors before a *firm* may include such profits in its *initial capital*.

Eligibility for inclusion in initial capital

- 2 Interim profits must have been verified as being fairly stated by an external auditor. The external auditor should normally undertake at least the following -
 - (a) satisfy himself that the figures forming the basis of the interim profits have been properly extracted from the underlying accounting records;
 - (b) review the accounting policies used in calculating the interim profits so as to obtain comfort that they are consistent with those normally adopted by the institution in drawing up its annual financial statements and are in accordance with the principles required under the provisions of the Supervision Manual;
 - (c) perform analytical procedures on the result to date, including comparisons of actual performance to date with budget and with the results of prior period(s);
 - (d) discuss with management the overall performance and financial position of the institution;
 - (e) obtain adequate comfort that the implications of current and prospective litigation, all known claims and commitments, changes in business activities and provisioning for bad and doubtful debts have been properly taken into account in arriving at the interim profits; and
 - (f) follow up problem areas of which the auditors are already aware in the course of auditing the institution's financial statements.

Submission of an interim profits verification report

- 3
 - (a) A *firm* must submit to the *FSA* a verification report signed by its external auditor which states whether the interim results are fairly stated before it may include the interim profits in its *initial capital*.
 - (b) In the normal course of events, wording in the form of a 'negative assurance' will be considered by the *FSA* to be adequate, reflecting the fact that the scope of the verification process is less than that of a full audit of a

firm's results. However, where the *FSA* has significant prudential concerns about a *firm*, it reserves the right to require an *auditor's report* giving 'positive assurance' before the *firm* may include the interim profits in its *initial capital*.

- (c) A standard form of words for 'negative assurance' purposes is available from the *FSA* on request.

Appendix 59
LIST OF REGULATORS FOR THE PURPOSES OF THE
DEFINITION OF RECOGNISED THIRD COUNTRY INVESTMENT
FIRMS

Country	Regulator
Australia	Australian Stock Exchange Sydney Futures Exchange
Canada	Alberta Stock Exchange Montreal Exchange Toronto Stock Exchange Vancouver Stock Exchange Investment Dealers Association of Canada
Hong Kong	Hong Kong Monetary Authority Hong Kong Securities and Futures Commission
Japan	Ministry of Finance
Singapore	Monetary Authority of Singapore Stock Exchange of Singapore
South Africa	Bond Exchange of South Africa Johannesburg Stock Exchange South African Futures Exchange
United States	Securities and Exchange Commission Commodity and Futures Trading Commission

Chapter 13: Financial Resource Requirements for Personal Investment Firms

13.1 APPLICATION

- 13.1.1 R (1) This chapter applies to a *firm* which is a *personal investment firm*.
- (2) Sections 13.1 to 13.8 apply to a *personal investment firm* which is a *Category A firm*.
- (3) Section 13.1 and sections 13.9 to 13.12 apply to a *personal investment firm* which is a *Category B firm*.
- (4) The definitions in the Glossary at Appendix 13(1) apply to this chapter.
- 13.1.1A G *Firms* are reminded that a *media firm* is not a *personal investment firm*.

GENERAL REQUIREMENTS

13.1.2 A *firm* must:

- (1) have and maintain at all times financial resources of the kinds and amounts specified in, and calculated in accordance with, the *rules* of this chapter; and
- (2) be able to meet its liabilities as they fall due.

13.1.3 R A *firm* must effect and maintain at all times adequate professional indemnity insurance cover for all the business activities which it carries on, or for which it is responsible unless *rule* 13.1.4 applies.

13.1.4 R The following *firms* are not required to effect or maintain professional indemnity insurance:

- (1) members of the same *marketing group* as any of the *firms* specified in (a) and (b);
- (a) *banks, building societies, insurance companies and friendly societies*;
- (b) *firms* with stock market capitalisation at all times of more than £50m;

where there exists between that *firm* and a *firm* specified in (a) or (b) a written agreement that in the event of it becoming insolvent the *firm* specified in (a) or (b) will satisfy any outstanding liabilities which it may have arising out of claims made by *private customers* in relation to *regulated activities*.

- (2) **subsidiaries of any of the firms specified in (1)(a) or (b), where there exists between the subsidiary and its parent or ultimate holding company a written agreement that in the event of it becoming insolvent its parent or ultimate holding company will satisfy any outstanding liabilities which it may have arising out of claims made by private customers in relation to regulated activities.**

- 13.1.5 E (1) To effect and maintain adequate professional indemnity insurance cover a *firm* should obtain insurance cover which is at least equivalent to the provisions set out in appendix 13(2)E and incorporate the requirements set out in (2).
- (2) The professional indemnity insurance *policy* should incorporate terms which make provision for the following:
- (a) legal liability in consequence of any negligence in the exercise and conduct of the *firm's* business by the *firm* and/or by others on behalf of the *firm*;
 - (b) the required minimum limit of indemnity for an *independent intermediary* or *marketing group associate* as set out in (c) or (d) as applicable:
 - (c) any one claim basis, 3 times relevant income subject to a minimum limit of £100,000 any one claim; or aggregate basis, 3 times relevant income subject to a minimum limit of £500,000 in the aggregate;
 - (d) the overall limit of cover in (c) and (d) need not exceed £3,000,000 on any one claim or aggregate basis unless the *firm* is a *Network* in which case such cover need not exceed £5,000,000;
 - (e) the relevant income for an *independent intermediary* or *marketing group associate* means all income paid or payable which is commission, brokerage or fees arising from the Assured's professional business activities covered under the *policy* whether *regulated activities* or not for the last accounting year prior to inception or renewal of the *policy* or as per the business plan for new applicants;

- (f) cover must be arranged in respect of an *appointed representative's designated investment business* for which a *firm* is responsible and the limit of indemnity must be calculated accordingly;
 - (g) the limit of indemnity for *product providers* is £3,000,000 minimum;
 - (h) legal defence costs must be covered in addition to the minimum limit of indemnity referred to above unless the limit of indemnity is on an aggregate basis. This additional cover is limited to defence costs and not, for example, the *firm's* own expenses incurred in defending or establishing claims;
 - (i) full retroactive cover in respect of claims arising from work carried out in the past;
 - (j) the excess is not to exceed the greater of £5,000 or 3% of relevant income;
 - (k) PIA Ombudsman and *Ombudsman awards*;
 - (l) dishonesty of *employees* including *appointed representatives* and principals of *appointed representatives*;
 - (m) libel and slander;
 - (n) loss of documents (liability and costs and expenses incurred in replacing, restoring or reconstructing);
 - (o) self-employed or contract hire persons engaged in the insured's business are deemed to be *employees* of the insured;
 - (p) indemnity to *employees*, former *employees* and/or consultants.
- (3) compliance with (1) may be relied upon as tending to establish compliance with 13.1.5.
- (4) contravention of (1) may be relied upon as tending to establish contravention of 13.1.5.

- 13.1.6 G (1) *firms* may insure with any insurer which is authorised to transact professional indemnity insurance in the *United Kingdom*;
- (2) *firms* should seek advice from their broker on renewal of their professional indemnity insurance cover and to check that their broker is in possession of appendix 13(2)E and the requirements of 13.1.6E.

NOTIFICATION REQUIREMENTS

- 13.1.7 G *Rule* 13.1.9 is a *notification rule* and is in addition to any notification requirements in the Supervision Manual (Sup 15).
- 13.1.8 G *Firms* are reminded to comply with SUP 15.7 (Form and method of notification) when notifying the *FSA* in accordance with *rule* 13.1.9.
- 13.1.9 R **A firm must notify the FSA immediately it becomes aware, or has information which reasonably suggests, that any of the matters in Table 13.1(1) has occurred, may have occurred or may occur in the foreseeable future.**

Table 13.1(1)

This table forms part of 13.1.9

NOTIFIABLE EVENTS	
1.	<i>professional indemnity insurance</i> cover, required in accordance with <i>rule</i> 13.1.3, being refused or cancelled;
2.	in respect of a <i>Category A firm</i> complying with section 13.3: <ul style="list-style-type: none"> (a) <i>own funds</i> falling below the applicable reference level; (b) <i>own funds</i> reaching the applicable € level specified in <i>rule</i> 13.3.1;

- (c) change of control causing loss of eligibility for that alternative test;
- 3. *Category A firms*;
 - (a) exposures to other *undertakings* in the *firm's group* exceeding in aggregate 20 per cent of *own funds*;
 - (b) a *large exposure* exceeding 25 per cent of *own funds*;
 - (c) aggregate *large exposures* exceeding 800 per cent of *own funds*;
 - (d) continuation of a *large exposure* in accordance with *rule 13.6.2D*;
 - (e) default by a counterparty in a stock repurchase or reverse repurchase agreement or a *securities* lending or borrowing transaction;
 - (f) exceeding the limits specified in *rule 13.6.2* and complying instead with table 13.6.2(2);

RECORD KEEPING REQUIREMENTS

- 13.1.10 R **A firm must take reasonable steps to ensure that it:**
- (1) **keeps records which are sufficient to show at any time that it has complied with the requirements of this chapter; and**
 - (2) **establish procedures and controls to ensure that those records are made promptly and accurately and, where appropriate, brought up-to-date at regular and frequent intervals.**

- 13.1.11 G When establishing record keeping systems *firms* are expected to bear in mind the advantage of records which will enable them to demonstrate easily their compliance with the *rules* and the effectiveness of their own procedures and controls.
- 13.1.12 R **A *firm* must ensure that its records are kept up-to-date and:**
- (1) **show with reasonable accuracy at any time the *firm's* financial position at that time;**
 - (2) **enable the *firm* to demonstrate its continuing compliance with the applicable financial resource requirements; and:**
 - (3) **provide the information needed to enable**
 - (a) **the *firm* to prepare the financial statements and reports required by or under the *rules*; and**
 - (b) **any auditor required to report on the *firm's* financial statement to form an opinion on them in accordance with the relevant requirements.**
- 13.1.13 G Records should be capable of presenting a clear picture of the *firm's* financial viability.
- 13.1.14 R (1) **A *firm* may hold its records in any form but it must**
- (a) **keep them in English and up-to-date, and**
 - (b) **be able to produce them promptly at its business premises on paper at the *FSA's* request.**
- (2) **If a *firm* retains records away from the place or places at which it conducts business, it must notify the *FSA* in accordance with the provisions of SUP 15 of the address and telephone number of the place or places at which they are kept.**
- (3) **The *firm* must keep its records in such a way that**
- (a) **any particular record is promptly accessible, and**
 - (b) **any particular transaction is clearly shown, easily traceable through the *firm's* accounting records and sufficiently explained.**

- (4) If the *firm* does not keep all records relating to financial resource requirements in one place, the *firm* must ensure that there is a clear indication that this is the case and provide accessible and adequate means of tracing all relevant records.

RELIANCE ON THIRD PARTIES

- 13.1.15 R A *firm* may rely on records provided by a third party provided that the *firm* reconciles those records with its own.

SECURITY

- 13.1.16 R A *firm* must take reasonable steps to protect its records at all times against loss, unauthorised access, alteration or destruction.

RETENTION OF RECORDS

- 13.1.17 R A *firm* must retain any record required by the *rules* or the rules of a *previous regulator* for a period of six years after the time the record is made.

13.2 Financial Resources Tests

- 13.2.1 R A *Category A firm* must meet:
- (1) Financial Resources Test 1 (the *Own funds Test*) calculated in accordance with section 13.3;
 - (2) Financial Resources Test 1A (the *Adjusted Net current assets Test*) calculated in accordance with section 13.4; and
 - (3) Financial Resources Test 2 (the *Expenditure-based Test*) calculated in accordance with section 13.5.
- 13.2.2 G Where a *Category A firm* deals as principal or as agent (as distinct from arranging transactions) in any of the following financial instruments, namely *units in collective investment schemes, securities or traded options* and other *derivatives*, the “trading book” provisions of section 13.8 are relevant to the *Category A firm*.
- 13.2.3 G Table 13A is a summary of the financial resources test for *Category A firm*.

Table 13.A

This table forms part of guidance 13.2.3

SUMMARY OF FINANCIAL RESOURCES FOR CATEGORY A FIRMS				
Type of firm	Financial Resources Test 1 <i>Own funds Test</i>	Financial Resources Test 1A <i>Adjusted net current assets Test</i>	Financial Resources Test 2 <i>Expenditure-based Test</i>	Rule/section references
Category A1 (including any Network in this category)	*€730,000	Adjusted <i>net current assets</i> of £1	Financial resources equal to the highest of 13/52 of Relevant Annual Expenditure or £400 per <i>adviser</i> or £10,000	13.3.1(1) 13.3.2 13.4 13.5.1 and 13.5.1A and 13.5.2 to 13.5.4A
Category A2 which is permitted to carry on the activity of managing investments or to delegate such activity to an investment firm	*€125,000	Adjusted <i>net current assets</i> of £1	Financial resources equal to the higher of 13/52 of Relevant Annual Expenditure or £400 per <i>adviser</i>	13.3.1(2) 13.3.2 13.4 13.5.1 and 1B and 13.5.2 to 13.5.4A
Category A2 with 26+ advisers	*€125,000	Adjusted <i>net current assets</i> of £1	Financial resources equal to the highest of 8/52 of Relevant Annual Expenditure or 13/52 of Relevant Annual Expenditure without <i>special adjustments</i> or £400 per <i>adviser</i>	13.3.1(2) 13.3.2 13.4 13.5.1C and 13.5.2 to 13.5.4A

Category A2 with 1-25 advisers	*€125,000	Adjusted <i>net current assets</i> of £1	Financial resources equal to the highest of 4/52 of Relevant Annual Expenditure or 13/52 of Relevant Annual Expenditure without <i>special adjustments</i> or £400 per <i>adviser</i>	13.3.1(2) 13.3.2 13.4 13.5.1C to D and 13.5.2 to 13.5.4A
Category A3 which is permitted to carry on the activity of managing investments or to delegate such activity to an investment firm	*€50,000	Adjusted <i>net current assets</i> of £1	Financial resources equal to the highest of 8/52 of Relevant Annual Expenditure or 13/52 of Relevant Annual Expenditure without <i>special adjustments</i> or £400 per <i>adviser</i>	13.3.1(3) 13.3.2 13.4 13.5.1C to D and 13.5.2 to 13.5.4A

Category A3 which is not permitted to carry on the activity of managing investments or to delegate such activity to an investment firm	*€50,000	Adjusted <i>net current assets</i> of £1	Financial resources equal to the highest of 4/52 of Relevant Annual Expenditure or 13/52 of Relevant Annual Expenditure without <i>special adjustments</i> or £400 per <i>adviser</i>	13.3.1(3) 13.3.2 13.4 13.5.1C to D and 13.5.2 to 13.5.4A
Network in Category A2	*€125,000	Adjusted net current assets of £1	Financial resources equal to the higher of 13/52 of Relevant Annual Expenditure or £400 per <i>adviser</i>	13.3.1(2) 13.3.2 13.4 13.5.1 to 1B and 13.5.2 to 13.5.4A
Network in Category A3	*€50,000	Adjusted net current assets of £1	Financial resources equal to the higher of 13/52 of Relevant Annual Expenditure or £400 per <i>adviser</i>	13.3.1(3) 13.3.2 13.4 13.5.1 to 1B and 13.5.2 to 13.5.4A
* Or the <i>firm's</i> highest reference level, in accordance with <i>rules</i> 13.3.3 to 3B				

13.3 Financial Resources Test 1 - Own funds

REQUIREMENT

13.3.1 R Unless *rules 13.3.3 to 3B* apply, a *Category A firm's own funds* must at all times be at least:

(1) for a *Category A1 firm*: €730,000; or

(2) for a *Category A2 firm*: €125,000; or

(3) for a *Category A3 firm*: €50,000.

13.3.1A G These resources may be denominated in sterling but, for the purposes of this test, must be translated into Euros (€) at the current official conversion rate (published daily in the national press).

CALCULATION OF OWN FUNDS

13.3.2 R A *Category A firm's own funds* must be calculated in accordance with tables 13.3.2(1) and (2).

Table 13.3.2(1)

This table forms part of *rule 13.3.2*

FINANCIAL RESOURCES TEST 1 - OWN FUNDS		
Companies		Sole Traders; Partnerships
(1) Paid up ordinary <i>share</i> capital	A	Balances on proprietor's or partners'
(2) <i>Share</i> premium account		(5) capital accounts
(3) Audited reserves (excluding revaluation reserves) and <i>verified</i> interim net profits		(6) current accounts (to the extent that the profits are audited and the interim net profits are <i>verified</i>)
(4) Non-cumulative preference <i>shares</i> (if not redeemable by shareholders within 5 years)		
Initial Capital (applicants for authorisation)		

less	B	less
(7) <i>Investments in own shares</i>		(8) Intangible assets
(8) Intangible assets		(9) <i>Material current year losses</i>
(9) <i>Material current year losses</i>		(10) <i>Material holdings in credit and financial institutions</i>
(10) <i>Material holdings in credit and financial institutions</i>		(11) Excess of current year drawings over current year profits
Original <i>own funds</i> (A minus B)		
C		
(12) Revaluation reserves	D	(12) Revaluation reserves
(13) Cumulative preference <i>share capital</i> (if not redeemable by shareholders within 5 years)		(14) Long-term subordinated loans
(14) Long-term subordinated loans		
(15) Preference <i>share capital</i> (if not redeemable by shareholders within 2 years) and <i>debt capital</i>		
Own <i>funds</i> (C plus D)		
(<i>firms</i>)		

Table 13.3.2(2)

This table forms part of *rule 13.3.2*

OWN FUNDS - RESTRICTIONS
(1) An applicant for authorisation must use only Initial Capital (items (1) to (4) or (5) and (6)) in calculating its resources to meet Financial Resources Test 1.
After obtaining authorisation a <i>firm</i> may use <i>Own funds</i> (items (1) to (15)) for that calculation.
(2) The admissible amount of items (12) to (15) must not be greater than 100% of Original <i>Own funds</i> .
(3) The admissible amount of items (13) and (14) must not be greater than 50% of Original <i>Own funds</i> .

Alternative to Financial Resources Test 1

- 13.3.3 R (1) **If a *Category A firm* was in existence before 1 July 1995 and cannot meet Financial Resources Test 1, it must comply instead with *rules 13.3.3 to 3B*.**
- (2) **At the end of each six-month period, beginning on 24 March 1993 or on the date on which the *Category A firm* came into existence if later, the *firm* must calculate the average daily level of its *own funds* in accordance with *rule 13.3.2* for the six months preceding the date of calculation.**
- (3) **A *Category A firm* must report each such calculation to the *FSA* by the date for submission of its quarterly return due next after the date to which the calculation is made.**
- (4) **The highest level calculated before 1 January 1996 is a *Category A firm's* first reference level for the purposes of the requirement in *rule 13.3.3A*.**
- (5) **Each time that a *Category A firm's* six-monthly calculation results in a level higher than any preceding it, that higher level becomes its reference level for the purposes of the requirement in *rule 13.3.3A*.**

- 13.3.3A R **A Category A firm's own funds must not fall below its reference level.**
- 13.3.3B R **Rules 13.3.3 and 13.3.3A will cease to apply to a Category A firm if its own funds reach the applicable level specified in rule 13.3.1 or if it undergoes a change of control, except a change of control resulting from:**
- (1) **the first transfer by inheritance after 31 December 1995 (in this case the firm must comply with rule 13.3.1 from the tenth anniversary of the date of the transfer);**
 - (2) **a change in the composition of the firm which is a partnership if at least one partner who was a partner on 31 December 1995 remains in the partnership (in this case the firm must comply with rule 13.3.1 from the date on which the last such partner left the partnership or died, or from 31 December 2005 if sooner).**

13.4 Financial Resources Test 1A - Adjusted net current assets

- 13.4.1 R **A Category A firm must adjust its net current assets as follows:**
- (1) **exclude assets which cannot be realised or recovered within twelve months;**
 - (2) **exclude amounts receivable from connected persons to the extent that they are not properly secured, except amounts that are deposits referred to at item (11) in Part I of table 13.5.4(1) or at item (11) in Part I of table 13.5.4(2);**
 - (3) **value investments at current market value, using the bid price for a net long position in an investment and the offer price for a net short position in an investment.**
- 13.4.2 R **A Category A firm must at all times have adjusted net current assets of at least £1.**

13.5 Financial Resources Test 2 – Expenditure-based Requirement

REQUIREMENT

- 13.5.1 R A *Category A firm* specified in *rules* 13.5.1A to 13.5.1B must have at all times financial resources which equal or exceed the amount specified in the applicable *rules*.
- 13.5.1A R A *Category A1 firm*, including a *Network*, must have financial resources calculated in accordance with whichever of (1), (2) or (3) produces the highest amount:
- (1) 13/52 of its relevant annual expenditure, calculated in accordance with *rules* 13.5.2; or
 - (2) an amount equal to £400 multiplied by the number of its *advisers*; or
 - (3) £10,000.
- 13.5.1B R A *Category A2 firm* which is permitted to carry on the activity of *managing investments* or to delegate such activity to an *investment firm*, or a *Network* in *Category A2* or *A3*, must have financial resources calculated in accordance with whichever of (1), or (2) produces the higher amount:
- (1) 13/52 of its relevant annual expenditure, calculated in accordance with *rule* 13.5.2; or
 - (2) an amount equal to £400 multiplied by the number of its *advisers*.
- 13.5.1C R (1) A *Category A2 firm* with more than 25 *advisers* which is not a *Network* and is not permitted to carry on the activity of *managing investments* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3), (4) or (5) produces the highest amount.
- (2) A *Category A3 firm* which is permitted to carry on the activity of *managing investments* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3), (4) or (5) produces the highest amount.
 - (3) Financial resources which taking into account all the *special adjustments* amount to 8/52 of its relevant annual expenditure, calculated in accordance with *rule* 13.5.2; or

- (4) financial resources which disregarding all the *special adjustments* amount to 13/52 of its relevant annual expenditure, calculated in accordance with *rule 13.5.2*; or
- (5) financial resources taking into account all the *special adjustments* of an amount equal to £400 multiplied by the number of its *advisers*.

- 13.5.1D R
- (1) **A Category A2 firm with fewer than 26 advisers which is not a Network and is not permitted to carry on the activity of managing investments or to delegate such activity to an investment firm must have financial resources calculated in accordance with whichever of (3), (4) or (5) produces the highest amount.**
 - (2) **A Category A3 firm which is not permitted to carry on the activity of managing investments or to delegate such activity to an investment firm must have financial resources calculated in accordance with whichever of (3), (4) or (5) produces the highest amount.**
 - (3) **Financial resources which taking into account all the *special adjustments* amount to 4/52 of its relevant annual expenditure calculated in accordance with *rules 13.5.2*; or**
 - (4) **financial resources which disregarding all the *special adjustments* amount to 13/52 of its relevant annual expenditure, calculated in accordance with *rules 13.5.2*; or**
 - (5) **financial resources taking into account all the *special adjustments* of an amount equal to £400 multiplied by the number of its *advisers*.**

CALCULATION OF RELEVANT ANNUAL EXPENDITURE

- 13.5.2 R
- A Category A firm must calculate its relevant annual expenditure by reference to the amount described as total expenditure in its most recently prepared set of *annual financial statements*. If those statements were for a period other than 12 months, the amounts in the *firm's* profit and loss account must be adjusted proportionately.**

Where a *Category A firm* has just begun trading or has not been authorised long enough to submit such statements, the *firm* must calculate its relevant annual expenditure on the basis of forecast or other appropriate accounts submitted to the *FSA*.

A *Category A firm* may, subject to *rule 13.5.3*, deduct from its total expenditure the items set out in table 13.5.2.

Table 13.5.2

This table forms part of *rule 13.5.2*

DEDUCTIONS FROM EXPENDITURE	
(a)	Staff bonuses (except to the extent that they are guaranteed);
(b)	<i>employees' and directors' shares</i> in profits (except to the extent that the amount is guaranteed);
(c)	other appropriations of profits;
(d)	shared commissions paid which are directly related to commissions received;
(e)	interest charges in respect of borrowing made to finance the acquisition of its <i>readily realisable investments</i> ;
(f)	interest paid to <i>clients</i> on <i>client money</i> ;
(g)	interest paid to <i>counterparties</i> ;
(h)	fees, brokerage and other charges paid to <i>recognised clearing houses, exchanges and intermediate brokers</i> for the purposes of executing, registering or clearing transactions;
(i)	foreign exchange losses;
(j)	a <i>firm</i> must not deduct any exceptional expenditure.

- 13.5.2A G (1) Salaries of *directors* or partners are not eligible for deduction, except to the extent that they can be demonstrated to be non-fixed costs of the *firm*.
- (2) The deduction in item (c) is intended to cover forms of remuneration, other than those set out in (b), that are not fixed or guaranteed.

ADJUSTMENTS TO CALCULATION OF RELEVANT ANNUAL EXPENDITURE

- 13.5.3 R **A *firm* must ensure that the expenditure base properly reflects the ongoing annual operating costs of the *firm* by having proper regard to its circumstances when deciding whether to include or exclude any item of expenditure or to make any other adjustment to the calculation of relevant annual expenditure.**
- 13.5.3A G In *rule* 13.5.3 the FSA would expect a *firm* to take proper account of the effect of, for example, the ongoing annual operating costs of the *firm* being met by another party, or of a significant change in the structure of the *firm's* business during the year.

CALCULATION OF FINANCIAL RESOURCES TO MEET TESTS 1, 1A OR 2

- 13.5.4 R **A *Category A firm* must be able to calculate its financial resources at any time on the basis of the balance sheet it could draw up at that time. For this purpose:**
- (1) **a *Category A1 firm* must adjust the assets in the balance sheet as specified in table 13.5.4(1)) and include the liabilities after making the adjustments specified in table 13.5.4(1).**
 - (2) **a *Category A2 or A3 firm*, must adjust the assets in the balance sheet as specified in table 13.5.4(2) and include the liabilities after making the adjustments specified in table 13.5.4(2).**
- 13.5.4A R **A *Category A firm* must be able to identify separately any trading book items as indicated in *rule* 13.8 and any *special adjustments*.**

<p>(4) Debtors relating to Unsettled Securities Transactions – Cash against Documents</p>	<p>Include debtors where a <i>firm</i> has entered into a transaction in <i>securities</i> or <i>units in collective investment schemes</i> on a cash against documents basis and the transaction remains unsettled, after deducting an amount calculated by</p> <p>(a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>market value</i> where that difference is not in the <i>firm's</i> favour, and</p> <p>(b) multiplying that difference by the applicable percentage specified in table 13.5.4B</p>	<p>A Counterparty Risk Adjustment</p>
<p>(5) Debtors relating to Unsettled Securities Transactions - Free Deliveries</p>	<p>If a <i>firm</i> has delivered <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them, or paid for such <i>investments</i> before receiving certificates of good title for them, and not more than 3 days have passed since delivery, include debtors after deducting an amount calculated by</p> <p>(a) (i) (if a <i>firm</i> has delivered them) computing the full amount due to a <i>firm</i> under the contract;</p> <p>(ii) (if a <i>firm</i> has paid for them) computing their current <i>market value</i>; and</p> <p>(b) multiplying the amount or value at (a) by the applicable percentage specified in table 13.5.4C</p>	<p>A Counterparty Risk Adjustment</p>

	Exclude debtors if more than 3 days have passed since delivery.	An Illiquid Adjustment
(6) <i>Regulated collective investment schemes</i>	<p>Include an amount owing in respect of a transaction in <i>units</i> in a <i>regulated collective investment scheme</i> only</p> <p>(a) if the amount has been due and unpaid for 30 days or less after the settlement date of the transaction to which it relates, and</p> <p>(b) after discounting that amount by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude amounts that have been due and unpaid for more than 30 days.</p>	<p>A Counterparty Risk Adjustment</p> <p>An Illiquid Adjustment</p>
(7) Debts of <i>group or connected companies</i>	Exclude in full unless otherwise allowed by the items in this table.	An Illiquid Adjustment
(8) Debtors	<p>Include amounts owing only in respect of</p> <p>(a) (i) commission;</p> <p>(ii) <i>investment management fees</i>;</p> <p>(iii) other fees earned in connection with the <i>firm's investment business</i>;</p> <p>which are due from other authorised or <i>EEA firms, recognised investment exchanges or recognised clearing houses</i> and have been due and unpaid for 30 days or less;</p> <p>(b) (i) <i>investment management fees</i>; or</p> <p>(ii) pensions administration</p> <p>which have been due from the <i>firm's</i> customers and unpaid for 30 days or less;</p> <p>after discounting the amounts in (a) and (b) by the applicable percentage specified in table 13.5.4C.</p>	A Counterparty Risk Adjustment

	<p>Exclude amounts that have been due and unpaid for more than 30 days.</p> <p>All other debtors must be deducted in full.</p>	An Illiquid Adjustment
(9) Prepayments	<p>Include the amount of prepayments which relate to goods or services to be received or performed within 90 days, after discounting the amount by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude the amount of prepayments relating to more than 90 days.</p>	<p>A Counterparty Risk Adjustment</p> <p>An Illiquid Adjustment</p>
(10) Accrued income	<p>Include accrued income not yet due and receivable in respect of fees earned in the performance of <i>investment management</i> services that is receivable within 90 days, after discounting the amount by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude accrued income receivable after 90 days.</p>	<p>A Counterparty Risk Adjustment</p> <p>An Illiquid Adjustment</p>
(11) <i>Deposits</i>	<p>Include amounts in respect of</p> <ul style="list-style-type: none"> (a) cash and balances on current accounts and on <i>deposit</i> accounts with an <i>approved bank</i> or National Savings Bank which can be withdrawn within 90 days; (b) money on <i>deposit</i> with a UK local authority which can be withdrawn within 90 days; (c) money <i>deposited</i> and evidenced by a certificate of tax <i>deposit</i>. <p>Exclude amounts which can only be withdrawn after 90 days.</p>	An Illiquid Adjustment

(12) Other amounts due from Government bodies or local authorities	<p>Include other amounts due from UK Government bodies or local authorities if they are agreed and due within 30 days, after discounting the amounts by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude amounts that are not due to be paid within 30 days.</p>	<p>A Counterparty Risk Adjustment</p> <p>An Illiquid Adjustment</p>
(13) All other assets	Exclude in full.	An Illiquid Adjustment
Where applicable - <i>Large exposures</i>	Deduct an amount calculated in accordance with 13.6.2	A <i>Large exposure</i> Adjustment

TABLE 13.5.4(1) PART II

This table forms part of *rule 13.5.4*

FIRMS IN CATEGORY A1		
LIABILITY	CALCULATION	TYPE OF ADJUSTMENT
(14) Secured Liabilities	<p>Include in full, except the amount of the liabilities secured by a charge on land and buildings which may be reduced by the smallest of the following amounts:</p> <p>(a) the aggregate amount of the <i>firm's</i> secured liabilities which are due more than one year after the balance sheet date;</p> <p>(b) (if the land and buildings have been valued by an independent professional valuer within the past 18 months) 85% of the amount certified by the valuer as their <i>market value</i>;</p> <p>(c) 85% of the net book value of land and buildings.</p>	An Illiquid Adjustment
(15) Subordinated loans	<p>Include in full, except any long term or short term subordinated loan in the standard form prescribed by the <i>FSA</i> which may be treated as capital up to the limits specified in <i>SUP 16</i>.</p>	
(16) Commission on indemnity terms from the sale of <i>life policies</i> or <i>pension contracts</i>	<p>Include as a liability a provision for repayment, in the event that premiums cease within the indemnity period, which must equal or exceed 2.5% of the commissions the <i>firm</i> has received on indemnity terms during the previous twelve months. This provision must be reasonable having regard to the <i>firm's</i> circumstances and, in particular, its previous lapse ratio.</p>	An Illiquid Adjustment
(17) Investments (Short Positions)	<p>Include a <i>net short position</i></p> <p>(a) valued at its <i>offer price</i>, and</p> <p>(b) increased by the applicable percentage specified in table 13.5.4A</p>	A Position Risk Adjustment

(18) Deficiency in <i>subsidiary</i>	Include as a liability the amount by which the liabilities of any <i>subsidiary</i> (excluding its capital and reserves) exceed its tangible assets. This requirement applies only to the extent that the <i>firm</i> has not already made such a provision elsewhere in its financial statements.	An Illiquid Adjustment
(19) Liability for tax	Include as a liability a provision for taxation on the whole of the profits of the <i>firm's</i> business up to its balance sheet date.	An Illiquid Adjustment
(20) Creditors relating to Unsettled Securities Transactions - Cash against Documents	<p>Include creditors where a <i>firm</i> has entered into a transaction in <i>securities</i> or <i>units in collective investment schemes</i> as agent on a cash against documents basis, and the transaction remains unsettled, after adding an amount calculated by</p> <p>(a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>market value</i>, and</p> <p>(b) multiplying that exposure by the applicable percentage specified in table 13.5.4B.</p>	A Counterparty Risk Adjustment
(21) Creditors relating to Unsettled Securities Transactions - Free Deliveries	<p>Include an amount for creditors where (acting as agent) a <i>firm</i> has delivered certificates of title for <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them, or where (acting as principal) a <i>firm</i> has bought such <i>investments</i> before receiving certificates of good title for them, after adding an amount calculated by</p> <p>(a) (i) (if a <i>firm</i> has paid for them but not received certificates of good title for them) computing their current <i>market value</i>;</p> <p>(ii) (if a <i>firm</i> has delivered the certificates without receiving payment for them) computing the full amount due to the <i>firm</i> under the contract for sale; and</p> <p>(b) multiplying that value or amount by the applicable percentage specified in table 13.5.4C.</p>	A Counterparty Risk Adjustment

(22) <i>Over the counter derivatives</i>	<p>Include as a liability an amount for its positions in such <i>derivatives</i> calculated by</p> <p>(a) computing the credit equivalent of those positions in accordance with table 13.5.4D, and</p> <p>(b) increasing that credit equivalent by the applicable percentage specified in table 13.5.4C,</p> <p>(in addition to making an adjustment in accordance with item (17) of this table and (in respect of bought <i>OTC</i> equity <i>options</i> and covered <i>warrants</i>) in accordance with item (25)).</p>	A Counterparty Risk Adjustment
(23) Contingent Liabilities	A <i>firm</i> must include a provision for any contingent liabilities which exist at the <i>firm's</i> balance sheet date that must be made.	An Illiquid Adjustment
(24) Preference Shares	Include as a liability any amounts in excess of the amounts which may be treated as financial resources specified in table 13.3.2(2) and <i>SUP</i> 16.	
(25) <i>Net open foreign currency position</i>	Include as a liability an amount in respect of the <i>firm's</i> foreign exchange risk calculated in accordance with table 13.5.4E.	A Foreign Exchange Risk Adjustment
(26) All other liabilities	Include in full.	

TABLE 13.5.4(2) PART I

This table forms part of *rule 13.5.4*

FIRMS IN CATEGORY A2 AND A3		
ASSETS	CALCULATION	TYPE OF ADJUSTMENT
(1) Land and Buildings	Exclude in full. (A loan secured by a charge on land and buildings may be deducted from liabilities in accordance with item (14) of Part II of this table.	An Illiquid Adjustment
(2) <i>Investments</i>	Exclude in full the value of <i>shares</i> in <i>connected companies</i> . Include any <i>net long position</i> in any fixed or current asset investment (a) valued at its current <i>bid price</i> (or, in the case of a with profits <i>life policy</i> , at its surrender value), and (b) discounted by the applicable percentage specified in table 13.5.4A.	An Illiquid Adjustment A Position Risk Adjustment
(3) <i>Investments</i> subject to Repurchase, Reverse Repurchase, Stock Borrowing or Stock Lending transactions	Include <i>investments</i> for which the <i>firm</i> has entered as principal into a repurchase, reverse repurchase, stock borrowing or stock lending transaction, after making (I) a deduction in accordance with item (2), and (II) a deduction calculated by (a) computing the <i>firm's</i> exposure (the difference between the <i>market value</i> of the <i>securities</i> and the loan or collateral (including accrued interest) where that difference is not in the <i>firm's</i> favour, after adjusting for any excess collateral), and (b) multiplying that exposure by the applicable percentage in table 13.5.4C.	A Position Risk Adjustment A Counterparty Risk Adjustment

<p>(4) Debtors relating to Unsettled Securities Transactions - Cash against Documents</p>	<p>Include debtors where the <i>firm</i> has entered into a transaction in <i>securities</i> or <i>units in collective investment schemes</i> as agent on a cash against documents basis and the transaction remains unsettled, after deducting an amount calculated by</p> <p>(a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>market value</i> where that difference is not in the <i>firm's</i> favour, and</p> <p>(b) multiplying that difference by the applicable percentage specified in table 13.5.4B.</p>	<p>A Counterparty Risk Adjustment</p>
<p>(5) Debtors relating to Unsettled Securities Transactions - Free Deliveries</p>	<p>Where the <i>firm</i> has delivered <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them, or paid for such <i>investments</i> before receiving certificates of good title for them, and not more than 3 days have passed since delivery, include debtors after deducting an amount calculated by</p> <p>(a) (i) (where the <i>firm</i> has delivered them) computing the full amount due to a <i>firm</i> under the contract;</p> <p>(ii) (where the <i>firm</i> has paid for them) computing their current <i>market value</i>; and</p> <p>(b) multiplying the amount or value at (a) by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude debtors if more than 3 days have passed since delivery.</p>	<p>A Counterparty Risk Adjustment</p> <p>An Illiquid Adjustment</p>

(6) <i>Regulated collective investment schemes</i>	<p>Include an amount owing in respect of a transaction in <i>units</i> in a <i>regulated collective investment scheme</i> only</p> <p>(a) if the amount has been due and unpaid for less than 90 days after the settlement date of the transaction to which it relates, and</p> <p>(b) after discounting that amount by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude amounts that have been due and unpaid for more than 90 days.</p>	<p>A Counterparty Risk Adjustment</p> <p>An Illiquid Adjustment</p>
(7) Debts of <i>group</i> or <i>connected companies</i>	<p>Include an amount due from <i>group</i> or <i>connected companies</i> (which does not relate to trade debts)</p> <p>(a) where the <i>firm</i> has no reason to doubt that it will be repaid in full on demand, and</p> <p>(b) after discounting the amount by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude an amount that the <i>firm</i> has reason to doubt will be repaid in full on demand.</p>	<p>A Counterparty Risk Adjustment</p> <p>An Illiquid Adjustment</p>
(8) Debtors	<p>Include amounts due from debtors (including <i>group</i> or <i>connected companies</i>) which have been due and unpaid for less than 90 days, after discounting the amount by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude amounts that have been due and unpaid for more than 90 days.</p>	<p>A Counterparty Risk Adjustment</p> <p>An Illiquid Adjustment</p>

(9) Prepayments	<p>Include the amount of prepayments which relate to goods or services to be received or performed within 90 days, after discounting the amount by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude the amount of prepayments relating to more than 90 days.</p>	<p>A Counterparty Risk Adjustment</p> <p>An Illiquid Adjustment</p>
(10) Accrued income	<p>Include accrued income, including any such income not yet due and receivable in respect of fees earned in the performance of <i>investment management</i> services that is receivable within 90 days, after discounting the amount by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude accrued income receivable after 90 days.</p>	<p>A Counterparty Risk Adjustment</p> <p>An Illiquid Adjustment</p>
(11) <i>Deposits</i>	<p>Include amounts in respect of</p> <p>(a) cash and balances on current accounts and on <i>deposit</i> accounts with an <i>approved bank</i> or National Savings Bank which can be withdrawn within 90 days;</p> <p>(b) money on <i>deposit</i> with a UK local authority which can be withdrawn within 90 days;</p> <p>(c) money <i>deposited</i> and evidenced by a certificate of tax <i>deposit</i>.</p> <p>Exclude amounts which can only be withdrawn after 90 days.</p>	<p>An Illiquid Adjustment</p>
(12) Other amounts due from Government bodies or local authorities	<p>Include other amounts due from UK Government bodies or local authorities if they are agreed and due within 90 days, after discounting the amounts by the applicable percentage specified in table 13.5.4C.</p>	<p>A Counterparty Risk Adjustment</p>

	Exclude amounts that are not due to be paid within 90 days.	An Illiquid Adjustment
(13) All other assets	Exclude in full.	An Illiquid Adjustment
Where applicable - <i>Large exposures</i>	Deduct an amount calculated in accordance with <i>rule 13.6.2.</i>	<i>A Large exposure</i> Adjustment

TABLE 13.5.4(2) PART II

This table forms part of *rule 13.5.4*

FIRMS IN CATEGORY A2 AND A3		
LIABILITY	CALCULATION	TYPE OF ADJUSTMENT
(14) Secured Liabilities	<p>Include in full, except the amount of the liabilities secured by a charge on land and buildings which may be reduced by the smallest of the following amounts:</p> <p>(a) the aggregate amount of the <i>firm's</i> secured liabilities which are due more than one year after the balance sheet date;</p> <p>(b) (if the land and buildings have been valued by an independent professional valuer within the past 18 months) 85% of the amount certified by the valuer as their <i>market value</i>; and</p> <p>(c) 85% of the net book value of land and buildings.</p>	An Illiquid Adjustment
(15) Subordinated loans	Include in full except any long term or short term subordinated loan in the standard form prescribed by the <i>FSA</i> which may be treated as capital up to the limits specified in <i>SUP 16</i> .	

(16) Commission on indemnity terms from the sale of <i>life policies</i> or <i>pension contracts</i>	Include as a liability a provision for repayment, in the event that premiums cease within the indemnity period, which must equal or exceed 2.5% of the commissions the <i>firm</i> has received on indemnity terms during the previous twelve months. This provision must be reasonable having regard to the <i>firm's</i> circumstances and, in particular, its previous lapse ratio.	An Illiquid Adjustment
(17) <i>Investments</i> (Short Positions)	Include a <i>net short position</i> (a) valued at its <i>offer price</i> , and (b) increased by the applicable percentage specified in table 13.5.4A.	A Position Risk Adjustment
(18) Deficiency in <i>subsidiary</i>	Include as a liability the amount by which the liabilities of any <i>subsidiary</i> (excluding its capital and reserves) exceed its tangible assets. This requirement applies only to the extent that the <i>firm</i> has not already made such a provision elsewhere in its financial statements.	An Illiquid Adjustment
(19) Liability for tax	Include as a liability a provision for taxation on the whole of the profits of its business up to its balance sheet date.	An Illiquid Adjustment
(20) Creditors relating to Unsettled <i>Securities</i> Transactions Cash against Documents	Include creditors where a <i>firm</i> has entered into a transaction in <i>securities</i> or <i>units in collective investment schemes</i> as agent on a cash against documents basis, and the transaction remains unsettled, after adding an amount calculated by (a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>market value</i> , and (b) multiplying that exposure by the applicable percentage specified in table 13.5.4B.	A Counterparty Risk Adjustment

(21) Creditors relating to Unsettled Securities Transactions Free Deliveries	Include an amount for creditors where (acting as agent) the <i>firm</i> has delivered certificates of title for <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them, or where the <i>firm</i> has bought such <i>investments</i> before receiving certificates of good title for them, after adding an amount calculated by	A Counterparty Risk Adjustment
	(a) (i) (where the <i>firm</i> has paid for them but not received certificates of good title for them) computing their current <i>market value</i> ; (ii) (where the <i>firm</i> has delivered the certificates without receiving payment for them) computing the full amount due to a <i>firm</i> under the contract for sale; and (b) multiplying that exposure by the applicable percentage specified in table 13.5.4C.	
(22) <i>Over the counter derivatives</i>	Include as a liability an amount for its positions in such <i>derivatives</i> calculated by (a) computing the credit equivalent of those positions in accordance with table 13.5.4D, and (b) increasing that credit equivalent by the applicable percentage specified in table 13.5.4C, (in addition to making an adjustment in accordance with item (17) of this table and (in respect of bought <i>OTC</i> equity <i>options</i> and covered <i>warrants</i>) in accordance with item (25)).	A Counterparty Risk Adjustment
(23) Contingent Liabilities	A <i>firm</i> must include a provision for any contingent liabilities which exist at its balance sheet date that must be made.	An Illiquid Adjustment
(24) Preference Shares	Include as a liability any amounts in excess of the amounts which may be treated as financial resources specified in table 13.3.2(2) and <i>SUP</i> 16.	

(25) <i>Net open foreign currency position</i>	Include as a liability an amount in respect of its foreign exchange risk calculated in accordance with table 13.5.4E.	A Foreign Exchange Risk Adjustment
(26) All other liabilities	Include in full.	

TABLE 13.5.4A

This table forms part of *rule 13.5.4*

POSITION RISK			
The percentages in the table are applied to the <i>market value</i> (unless otherwise stated) of gross positions, i.e. both longs and shorts in each category; netting and offsetting are prohibited. The long or short position in a particular investment is the net of any long or short positions held in that same investment.			
INVESTMENT	DISCOUNT		
A. Debt		Maturity	
Central Government	0-2 years 2%	2-5 years 5%	>5 years 13%
<i>Qualifying debt security:</i>			
- fixed rate	8%	8%	15%
- floating rate	10%	10%	15%
<i>Non-qualifying debt security:</i>			
- fixed rate	10%	20%	30%
- floating rate	30%	30%	30%
B. Equities			
- <i>exchange traded</i>	25%		
- other	100%		

C. Derivatives	
- <i>exchange traded futures</i>	4 x initial margin requirement
- <i>OTC futures</i>	Apply the appropriate percentage shown in A and B to the <i>market value</i> of the underlying position
- <i>Purchased options</i>	Apply the appropriate percentage shown in A and B to the <i>market value</i> of the underlying position but the result may be limited to the <i>market value</i> of the option
- <i>Contracts for differences</i>	20% of the <i>market value</i> of the contract
D. Other Investments	
- <i>Units in regulated collective investment schemes</i>	25%
- <i>units in higher volatility funds or property funds</i>	50%
- <i>with profit life policies</i>	20% of surrender value
- <i>other</i>	100%

TABLE 13.5.4B

This table forms part of *rule 13.5.4*

UNSETTLED SECURITIES TRANSACTIONS	
Number of <i>business days</i> after due settlement date	Percentage
0 – 4	0
5 – 15	8
16 – 30	50
31 – 45	75
46 or more	100

TABLE 13.5.4C**This table forms part of rule 13.5.4**

COUNTERPARTY RISK	
Type of Counterparty	Deducti on
A counterparty which is, or the contract of which is, explicitly guaranteed by: <ul style="list-style-type: none"> - the government or central bank of the <i>United Kingdom</i> or another <i>Zone A country</i>; or - the <i>European Economic Area</i>; or - any other government or central bank, provided the exposure is denominated in that country's national currency. 	NIL
A counterparty which is, or the contract of which is, explicitly guaranteed by: <ul style="list-style-type: none"> - a local authority or regional government in the <i>United Kingdom</i> or another <i>Zone A country</i>; or - a <i>credit institution</i> authorised in the <i>United Kingdom</i> or another <i>Zone A country</i>; or - a recognised <i>clearing house</i> or recognised investment exchange; or - an <i>investment firm</i> or a comparable undertaking regulated by a <i>recognised third country</i>. 	1.6%
Any other counterparty	8%

TABLE 13.5.4D**This table forms part of rule 13.5.4**

OVER THE COUNTER DERIVATIVES		
a. By attaching current <i>market values</i> to contracts (marking to market), obtain the current replacement cost of all contracts with positive values.		
b. To obtain a figure for potential future credit exposure (except in the case of single currency “floating/floating interest rate swaps” in which only the current replacement costs will be calculated), multiply the notional principal amounts or values underlying the <i>firm's</i> aggregate positions by the following percentages:		
Residual Maturity	Interest Rate Contracts	Foreign Exchange Contracts
One year or less	Nil	1%
More than 1 year	0.5%	5%
c. The credit equivalent is the sum of current replacement cost and potential future credit exposure.		

TABLE 13.5.4E**This table forms part of rule 13.5.4**

FOREIGN EXCHANGE RISK
(a) A <i>firm</i> must deduct a foreign exchange risk requirement for all the following items which are denominated in a foreign currency:
(i) all assets and liabilities, including accrued interest, denominated in the currency (all <i>investments</i> at market or realisable value);
(ii) any currency future, at the nominal value of the contract;
(iii) any forward contract for the purchase or sale of the currency, at the contract value, including any future exchange of principal associated with currency swaps;
(iv) any foreign currency <i>options</i> at the net delta (or delta-based) equivalent of the total book of such <i>options</i> ;

- (v) any non-currency option, at *market value*;
- (vi) any irrevocable guarantee;
- (vii) any other off-balance sheet commitment to purchase or sell an asset denominated in that currency.

(b) The requirement must be calculated as follows:

- (i) using the spot rate, convert the *net long position* and *net short position* in each foreign currency into the currency in which its *annual financial statements* are reported;
- (ii) total the *net open long positions* and the *net open short positions*;
- (iii) the higher of (i) and (ii) above is the *firm's net open foreign currency position*;
- (iv) multiply the *firm's net open foreign currency position* by 10%.

(c) A *firm* may not include any future income or expense not yet accrued but fully hedged (subject to deduction of an appropriate risk requirement).

SUBORDINATED LOANS

13.5.5 R **A *Category A firm* may treat a subordinated loan as a financial resource, as specified in table 13.3.2(1), and subject to *rule 13.5.5C*, if the long term or short term subordinated loan is eligible for such treatment in accordance with *rule 13.5.5A* or B as applicable.**

13.5.5A R **A long term subordinated loan is eligible for such treatment if:**

- (1) **it is fully paid up;**
- (2) **it has an original maturity of at least five years, or where it has no fixed term, it is subject to five years' notice of repayment;**
- (3) **repayment, prepayment or termination is only permitted under the loan agreement:**
 - (a) **on maturity, or on expiration of the period of notice, if after such payment or termination a *firm* meets 120% of its financial resource requirement; or**
 - (b) **on winding up after the claims of all other creditors and all outstanding debts have been settled;**

- (4) the amount used in the calculation of its financial resources is reduced on a straight line basis over the last five years of its term;
- (5) it is in the standard form prescribed by the *FSA* for long term subordinated loans.

13.5.5B R A short term subordinated loan is eligible for such treatment if:

- (1) it is fully paid up;
- (2) it has an original maturity of at least two years, or where it has no fixed term, it is subject to two years' notice of repayment;
- (3) payment of interest is not permitted under the loan agreement unless after such payment a *firm* meets 120% of its financial resources requirement;
- (4) repayment, prepayment or termination is only permitted under the loan agreement:
 - (a) on maturity, or on expiration of the period of notice, if after such payment or termination a *firm* meets 120% of its financial requirement; or
 - (b) on winding up after the claims of all other creditors and outstanding debts have been settled;
- (5) it is in the standard form prescribed by the *FSA* for short term subordinated loans.

13.5.5C R The total amount of long term or short term subordinated loans that a *Category A firm* may include in the calculation of its financial resources is restricted as stipulated in table 13.3.2(2) and in *SUP 16*.

13.6 Large exposures

- 13.6.1 R **A large exposure exists where a *Category A firm* is owed a debt by, or are otherwise exposed to, another person, or to two or more *affiliated persons*, and that exposure equals or exceeds 10% of its own funds.**

REQUIREMENTS

- 13.6.2 R **Subject to rules 13.6.2A to D a *Category A firm* must ensure that at all times**
- (1) **no large exposure exceeds 25% of its own funds;**
 - (2) **where a firm is exposed to one or more of its holding company, its subsidiary, or a subsidiary or group of subsidiaries of its holding company, the aggregate of those exposures does not exceed 20% of the firm's own funds;**
 - (3) **the aggregate of the firm's large exposures does not exceed 800% of its own funds.**
- 13.6.2A R **A *Category A firm* may exclude from its calculations under rule 13.6.2 an exempt exposure in table 13.6.2(1).**
- 13.6.2B R **A *Category A firm* may not exclude any exposure covered by any excess of its financial resources over its expenditure based requirement as specified in rules 13.5.1 to 1D.**
- 13.6.2C R **A *Category A firm* may exceed the limits specified in rule 13.6.2 if**
- (1) **the limits in rule 13.6.2 are exceeded only by exposures relating to its trading book as indicated in rule 13.8.2;**
 - (2) **it provides additional financial resources in accordance with table 13.6.2(2) including the Special Limits set out at the foot of table 13.6.2(2); and**
 - (3) **it notifies the FSA immediately in accordance with SUP 15.7 (Form and method of notification).**
- 13.6.2D R **Where a *Category A firm* was legally bound to a large exposure on or before 5 February 1993, the firm may continue it until its contractual maturity provided that the firm has notified the FSA in accordance with SUP 15.7 (Form and method of notification) of such continuation.**

Table 13.6.2(1)**This table forms part of rule 13.6.2**

EXEMPT EXPOSURES	Exempt Percentage
(1) Any illiquid asset which is deducted in full in the calculation of its financial resources.	100
(2) Exposures connected with foreign exchange transactions, incurred in the ordinary course of settlement during the 48 hours following payment.	100
(3) Exposures in connection with transactions for the purchase or sale of <i>securities</i> incurred in the ordinary course of settlement during the five <i>business days</i> following payment or delivery of the <i>securities</i> , whichever is the earlier.	100
(4) Exposures to <i>Zone A</i> central governments or central <i>banks</i> .	100
(5) Exposures to the <i>European Economic Area</i> .	100
(6) Exposures guaranteed by <i>Zone A</i> central governments, central <i>banks</i> or the <i>European Economic Area</i> .	100
(7) Exposures secured by <i>securities</i> issued by <i>Zone A</i> central governments, central <i>banks</i> or the <i>European Economic Area</i> .	100
(8) Exposures secured by cash <i>deposits</i> placed with the lending institution.	100

(9) Exposures secured by certificates of <i>deposit</i> issued by the <i>firm</i> .	100
(10) Exposures to <i>Zone B</i> central governments or central <i>banks</i> denominated in the national currency of the borrower.	100
(11) Connected exposures, e.g. <i>group</i> treasury arrangements, provided that the <i>group</i> is supervised on a consolidated basis in accordance with the <i>FSA</i> 's requirements for consolidated supervision.	100
(12) Bills of trade with a maturity of less than one year accepted by a <i>credit institution</i> .	100
(13) Exposures secured by marketable <i>securities</i> provided that the <i>bid price</i> of the collateral exceeds the exposure as follows: <ul style="list-style-type: none"> - <i>shares</i>: 150% excess; - <i>qualifying debt securities</i>: 50% excess; - in all other cases: 100% excess 	100
(14) Cash balances held with <i>approved banks</i> (provided they can be withdrawn within 90 days).	100
(15) Exposures in financial instruments to <i>credit institutions</i> , <i>investment firms</i> , comparable <i>undertakings</i> regulated by recognised third countries, <i>recognised clearing houses</i> and <i>recognised investment exchanges</i> as follows: <ul style="list-style-type: none"> - exposures with a maturity of one year or less; - exposures with a maturity of more than one but not more than three years; <p>(in the case of marketable debt instruments) exposures with a maturity of more than three years.</p>	100 80 50
(16) Exposures to, or guaranteed by, State regional or local authorities.	80
(17) All low or medium risk off-balance sheet items (e.g. note issuance facilities).	50

CALCULATION OF FINANCIAL RESOURCES TO MEET TESTS 1, 1A OR 2

Table 13.6.2(2)

This table forms part of *rule 13.6.2*

CALCULATION OF ADDITIONAL FINANCIAL RESOURCES	
Note:	The restrictions to using this calculation set out in <i>rule 13.6.2C</i>
1.	Calculate <ol style="list-style-type: none">the <i>firm's</i> total non-trading book exposures (N);the <i>firm's</i> total trading book exposures (T);the sum of N and T (NT).
2.	Calculate the amount by which NT exceeds 25% of the value of the <i>firm's</i> financial resources (the excess - X).
3.	Rank the trading book exposures in NT in descending order: <ol style="list-style-type: none">in the case of positions, in accordance with the position risk discounts specified in table 13.5.4(1) or (2);in the case of counterparty exposures, in accordance with the counterparty risk deductions specified in table 13.5.4C.
4.	Sum r the trading book exposures in NT, starting with the exposure attracting the highest position isk discount or counterparty risk deduction, until the sum equals X.
5.	<ol style="list-style-type: none">If an excess (X) has lasted for no more than 10 days (disregarding the age of the exposures constituting that excess),<p>the additional requirement is 200% of the aggregate of the position risk adjustments and counterparty risk adjustments, as shown in <i>SUP 16</i> applicable to the exposures constituting the excess (X);</p>if an excess (X) has lasted for more than 10 days (disregarding the age of the exposures constituting that excess),<ol style="list-style-type: none">allocate the exposures making up that excess, in ascending order of position risk discount or counterparty risk deduction, to the appropriate row in the Schedule below, so that the highest discount or deduction is matched with the highest percentage; andcalculate the additional requirement by multiplying the position risk adjustment or counterparty risk adjustment, as shown in <i>SUP 16</i>, by the percentage specified in column 2 of the Schedule.

Excess (X) as a Percentage of Financial Resources 1	Percentage 2
up to 40	200
40 - 60	300
60 - 80	400
80 - 100	500
100 - 250	600
over 250	900
Special Limits	
<ul style="list-style-type: none"> - (where an excess has lasted for 10 days or less) the excess must not exceed 500% of the <i>firm's own funds</i>; - (where any excess has lasted for the <i>firm's own funds</i>). 	

13.7 Consolidated Supervision of Group Companies

APPLICATION

- 13.7.1 R **A *Category A firm* which is a member of a *group* must comply with this section.**
- 13.7.1A G Excessive risks or financial deficiencies in other parts of its *group* may damage the financial viability of a *Category A firm*. Rules requiring regular reports enable the *FSA* to gather information so that it can watch for such weaknesses in a *group* and, if necessary, call for protective or remedial action.

REQUIREMENTS

- 13.7.2 R **A *Category A firm* must provide to the *FSA* information about itself and other members of its *group* relevant to the formation of a complete picture of the *group*, its structure and organisation and the risks to which the *firm* may be subject as a member of that *group*.**
- 13.7.2A R **A *Category A firm* must ensure that it and other members of its *group* apply the provisions of this chapter on a consolidated basis unless:**
- (1) **the *group* is subject to the consolidated supervision requirements imposed by the *FSA rules* in another chapter or sourcebook; or**
 - (2) **the *FSA* is not the consolidating supervisor for the *firm's group*.**

- 13.7.2B R **A *Category A firm* must, where it is exposed to undue risk in consequence of its membership of a *group*, provide against, reduce or eliminate that risk.**

13.8 Trading Book

- 13.8.1 G The “trading book” is a term generally used in the context of *credit institutions*, such as *banks*, but now extended to other *investment firms*. It separates their longer term lending, *deposit-taking* and investment activities (in the case of *banks* their “banking book”) from their shorter term trading activities in financial instruments such as *shares*, *units in collective investment schemes* and *traded options* (their “trading book”).
- 13.8.2 R **Where a *Category A firm* has a trading book, it must include only trading book items for the purposes of its financial resource calculations.**
- 13.8.3 G The following table 13.8(1) shows what items are classifiable as “trading book” items and what items cannot be so classified.

Table 13.8(1)

This table forms part of rule 13.8.2

Trading Book Items	Non-trading Book Items
(1) Proprietary positions in financial instruments which are held for resale and/or taken on with the intention of benefiting in the short-term from market fluctuations	(1) Foreign exchange exposures arising from net spot and forward forex positions (unless they are <i>investments</i> as defined in the Glossary)
(2) Positions in financial instruments arising from matched principal broking	(2) Receivables which are not directly related to items included in the trading book, such as fees, commission, interest or dividends
(3) Positions taken on specifically to hedge other elements of the trading book	(3) Illiquid assets

(4) Exposures relating to unsettled <i>securities</i> transactions which are either free deliveries or cash against documents transactions	(4) Other balance sheet or off balance sheet items (including long term <i>investments</i> held by <i>firms</i>).
(5) Exposures relating to <i>Over the counter derivative</i> instruments	
(6) Exposures relating to repurchase or reverse repurchase agreements or stock borrowing or lending transactions which are based on <i>securities</i> included in the trading book	
(7) Receivables which are directly related to items included in the trading book such as fees, commission, interest, dividends or margin on exchange traded <i>derivatives</i>	

13.9 Financial Resources Tests for Category B firms

13.9.1 R A *Category B firm* must meet:

- (1) **financial Resources Test 1 (the *Own funds* Test) calculated in accordance with section 13.10;**
- (2) **Financial Resources Test 1A (the *Adjusted Net current assets* Test) calculated in accordance with section 13.11, unless the *firm* is a *low resource firm* which is not permitted to carry on the activity of *managing investments* in respect of portfolios containing only *life policies*; and**
- (3) **Financial Resources Test 2 (the *Expenditure-based* Test) calculated in accordance with section 13.12 unless the *firm* is a *low resource firm*.**

13.9.1A G Table 13B is a summary of the financial resources test for a *Category B firm*.

Table 13B This table forms part of rule 13.9.1

SUMMARY OF FINANCIAL RESOURCES FOR CATEGORY B FIRMS				
Type of firm	Financial Resources Test 1 <i>Own funds</i> Test	Financial Resources Test 1A Adjusted <i>Net current assets</i> Test	Financial Resources Test 2 Expenditure-based Test	Rule/section References
<i>Category B1</i> (including any <i>Network</i> in this category)	£10,000	Adjusted <i>net current assets</i> of £1	Liquid capital equal to the highest of 13/52 of relevant annual expenditure or £400 per adviser or £10,000	13.10 13.11 13.12.1C 13.12.2 to 13.12.5A 0
Category B2 which is permitted to carry on the activity of <i>investment management</i> in respect of portfolios containing only <i>life policies</i> or to delegate such activity to an <i>investment firm</i>	£10,000	Adjusted <i>net current assets</i> of £1	Adjusted capital equal to the higher of 13/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1D 13.12.2 to 13.12.5A
Category B2 with 26+ advisers	£10,000	Adjusted <i>net current assets</i> of £1	Adjusted capital equal to the higher of 8/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1E 13.12.2 to 13.12.5A
Category B2 with 1-25 advisers	£10,000	Adjusted <i>net current assets</i> of £1	Adjusted capital equal to the higher of 4/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1F 13.12.2 to 13.12.5A

Category B3 which is permitted to carry on the activity of <i>managing investments in</i> respect of portfolios containing only <i>life policies</i> or to delegate such activity to an <i>investment firm</i>	£10,000	Adjusted <i>net current assets</i> of £1	Adjusted capital equal to the higher of 8/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1E 13.12.2 to 13.12.5A
Category B3 with 26+ advisers	£10,000	Adjusted <i>net current assets</i> of £1	Adjusted capital equal to the higher of 4/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1E 13.12.2 to 13.12.5A
Category B3 with 1 - 25 advisers	£10,000	N/A	N/A	13.10
<i>Network</i> in Category B2 or B3	£10,000	Adjusted <i>net current assets</i> of £1	Adjusted capital equal to the higher of 13/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1D 13.12.2 to 13.12.5A

13.10 Financial Resources Test 1- Own funds Requirement

REQUIREMENT

13.10.1 R **A *Category B* firm's own funds must at all times be at least £10,000.**

CALCULATION

13.10.2 R **A *Category B* firm's own funds must be calculated in accordance with table 13.10(2).**

Table 13.10(2).

This table forms part of *rule 13.10.2*

<i>OWN FUNDS</i>	
Companies	Sole Traders: Partnerships
Paid-up <i>share</i> capital (excluding preference <i>shares</i> redeemable by shareholders within 2 years) <i>Share</i> premium account Audited retained profits and <i>verified</i> interim net profits Revaluation reserves Short-term subordinated loans <i>Debt capital</i>	Balances on proprietor's or partners' capital accounts current accounts Revaluation reserves Short-term subordinated loans
less Intangible assets Material current year losses	less Intangible assets Material current year losses Excess of current year drawings over current year profits

13.10.2A R **Where a *Category B* firm is a sole trader or a partnership:**

- (1) it can use (to the extent necessary to make up any shortfall in the required resources) any of its personal assets (not being needed to meet liabilities arising from its personal activities and any business activities not regulated by the *FSA*);
- (2) the *firm's* total financial resources, from whatever source, must at all times be sufficient to cover its total liabilities.

- 13.10.3 R (1) Where a *Category B3 firm* with 1-25 advisers has a facility under the *PASS Loan Agreement Scheme* it may make an adjustment in its *own funds* calculation in accordance with (2).
- (2) a *firm* in (1) can regard as additional to its *own funds* the lower of either:
- (a) the amount of the loan facility agreed (less any loan repayments already made and less the amount of the facility withdrawn or lapsed); or
 - (b) the amount of the *firm's* provision for redress (net of any professional indemnity insurance recoverable) at the relevant *annual accounting reference date*.

13.11 Financial Resources Test 1A - Adjusted net current assets

APPLICATION

- 13.11.1 R This section does not apply to a *low resource firm*.

REQUIREMENT

- 13.11.2 R A *Category B firm* must adjust its *net current assets* as follows:
- (1) exclude assets which cannot be realised or recovered within twelve months;
 - (2) exclude amounts receivable from *connected persons* to the extent that they are not *properly secured*, except amounts that are *deposits* referred to in item (11) of table 13.12.3(1) or item (11) in table 13.12.3(2);

- (3) value *investments* at current *market value*, using the *bid price* for a *net long position* in an investment and the *offer price* for a *net short position* in an investment.

13.11.3 R A *Category B firm* must at all times have adjusted *net current assets* of at least £1.

13.12 Financial Resources Test 2 - Expenditure-based Requirement

APPLICATION

13.12.1A R This section does not apply to a *low resource firm*.

REQUIREMENT

13.12.1B R A *Category B firm* must have at all times financial resources calculated in accordance with *rules 13.12.2 to 13.12.5A* which equal or exceed the amount specified in *rules 13.12.1B to F* as applicable.

13.12.1C R A *Category B1 firm*, including a *Network* must have financial resources calculated in accordance with whichever of (1), (2) or (3) produces the higher amount.

(1) 13/52 of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D; or

(2) an amount equal to £400 multiplied by the number of its *advisers*; or

(3) £10,000;

13.12.1D R (1) A *Category B2 firm* which is permitted to carry on the activity of *investment management* in respect of portfolios containing only *life policies* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.

(2) A *Network* in *Category B2* or *B3* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.

- (3) **13/52** of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D; or
- (4) an amount equal to £400 multiplied by the number of its *advisers*.

13.12.1E R (1) **A *Category B2 firm* with more than 25 *advisers* which is not a *Network* and is not permitted to carry on the activity of *managing investments* in respect of portfolios containing only *life policies* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.**

(2) **A *Category B3 firm* which is permitted to carry on the activity of *investment management* in respect of portfolios containing only *life policies* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.**

(3) **8/52** of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D; or

(4) an amount equal to £400 multiplied by the number of its *advisers*.

13.12.1F R (1) **A *Category B2 firm* with fewer than 26 *advisers* which is not a *Network* and is not permitted to carry on the activity of *managing investments* in respect of portfolios containing only *life policies* or to delegate such activity of *investment management* to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.**

(2) **A *Category B3 firm* which is not permitted to carry on the activity of *investment management* in respect of portfolios containing only *life policies* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.**

(3) **4/52** of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D; or

(4) an amount equal to £400 multiplied by the number of its *advisers*.

CALCULATION OF RELEVANT ANNUAL EXPENDITURE

- 13.12.2 R **A *Category B* firm must calculate its relevant annual expenditure by reference to the amount described as total expenditure in its most recently prepared set of *annual financial statements*. If those statements were for a period other than 12 months, the amounts in its profit and loss account must be adjusted proportionately.**
- 13.12.2A R **Where a *Category B* firm has just begun trading or have not been authorised long enough to submit such statements the *firm* must calculate its relevant annual expenditure on the basis of forecast or other appropriate accounts submitted to the *FSA*.**
- 13.12.2B R **A *Category B* firm may deduct from its relevant annual expenditure items (a) to (f) set out in table 13.12.2, unless the *firm* is a *Category B1* firm, in which case it may not deduct item (e).**

Table 13.12.2

This table forms part of rule 13.12.2

DEDUCTIONS FROM EXPENDITURE	
(a)	staff bonuses;
(b)	<i>employees' and directors' shares</i> in profits;
(c)	interest charges in respect of borrowing made to finance the acquisition of its <i>readily realisable investments</i> ;
(d)	shared commissions paid which are directly related to commissions received;
(e)	emoluments of <i>directors</i> , partners or a sole trader;
(f)	a <i>firm</i> must not deduct any exceptional expenditure.

ADJUSTMENTS TO CALCULATION OF RELEVANT ANNUAL EXPENDITURE

- 13.12.2C R **A *firm* must ensure that the expenditure base properly reflects the ongoing annual operating costs of the *firm* by having proper regard to its circumstances when deciding whether to include or exclude any item of expenditure or to make any other adjustment to the calculation of relevant annual expenditure.**
- 13.12.2D G In *rule* 13.12.2C the FSA would expect a *firm* to take proper account of the effect of, for example, the ongoing annual operating costs of the *firm* being met by another party, or of a significant change in the structure of the *firm's* business during the year.

CALCULATION OF FINANCIAL RESOURCES TO MEET TESTS 1, 1A OR 2

- 13.12.3 R (1) **This *rule* does not apply to a *low resource firm*;**
- (2) **A *Category B firm* must be able to calculate its financial resources at any time on the basis of the balance sheet the *firm* could draw up at that time. For this purpose:**
- (a) **a *Category B1 firm* must adjust the assets in the balance sheet as specified in Part I of table 13.12.3(1) and include the liabilities after making the adjustments specified in Part II of table 13.12.3(1);**
- (b) **a *Category B2 or B3 firm* to which 13.12 applies must adjust the assets in the balance sheet as specified in Part I of table 13.12.3(2) and include the liabilities after making the adjustments specified in Part II of table 13.12.3(2).**

Table 13.12.3(1) Part I

This table forms part of *rule 13.12.3*

<i>FIRMS CATEGORY B1</i>	
CALCULATION OF ASSETS	
ASSETS	ADJUSTMENTS
(1) Land and Buildings	Exclude in full. (A loan secured by a charge on land and buildings may be deducted from liabilities in accordance with item (14) of Part II of this table.)
(2) <i>Investments</i>	<p>Include any <i>net long position</i> in any fixed or current asset investment (including <i>shares</i> in any connected company)</p> <p>(a) valued at its current <i>bid price</i> (or, in the case of a with-profits <i>life policy</i>, at its surrender value), and</p> <p>(b) discounted by the applicable percentage specified in table 13.12.3A.</p> <p><i>A firm</i> which acts as a market-maker in second-hand <i>life policies</i> must comply with the relevant requirements in respect of second-hand <i>life policies</i> held by the <i>firm</i> and include such a <i>policy</i>.</p> <p>(a) valued at its surrender value at the date on which the <i>firm</i> acquired it, or its latest available surrender value if different.</p> <p>(b) where a life office whose <i>policy</i> is held by the <i>firm</i> has altered adversely the basis on which it calculates surrender values, the <i>firm</i> must revise its valuation of the second-hand <i>policy</i> as soon as practicable after becoming aware of the alteration.</p>
(3) <i>Investments</i> subject to Repurchase, Reverse Repurchase, Stock Borrowing or Stock Lending transactions	Include <i>investments</i> for which the <i>firm</i> has entered as principal into a repurchase, reverse repurchase, stock borrowing or stock lending transaction on its own behalf, after making (I) a deduction in accordance with item (2), and (II) a deduction calculated by computing its exposure (the difference between the <i>market value</i> of the <i>securities</i> and the loan or collateral (including accrued interest) where that difference is not in the <i>firm's</i> favour, after adjusting for any excess collateral).

<p>(4) Debtors relating to Unsettled <i>Securities</i> Transactions Cash against Documents</p>	<p>Include debtors where the <i>firm</i> has entered into a transaction on its own behalf in <i>securities</i> or <i>units in collective investment schemes</i> on a cash against documents basis, and the transaction remains unsettled, after deducting an amount calculated by</p> <p>(a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>bid price</i> where that difference is not in the <i>firm's</i> favour, and</p> <p>(b) multiplying that difference by the applicable percentage specified in table 13.12.3B.</p>
<p>(5) Debtors relating to Unsettled <i>Securities</i> Transactions Free Deliveries</p>	<p>(a) Include the full amount due to the <i>firm</i> from debtors if a <i>firm</i> has delivered <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them, or paid for such <i>investments</i> before receiving certificates of good title for them, so long as not more than three days have passed since delivery</p> <p>(b) If more than three days have passed since delivery, exclude in full.</p>
<p>(6) <i>Regulated collective investment schemes</i></p>	<p>Include an amount owing in respect of a transaction in <i>units</i> in a <i>regulated collective investment scheme</i> only if the amount has been due and unpaid for 30 days or less after the settlement date of the transaction to which it relates.</p>
<p>(7) Loans secured on <i>investments</i></p>	<p>If the <i>firm</i> holds client title documents as security for</p> <p>(a) the repayment of money it has lent; or</p> <p>(b) money due to the <i>firm</i> in connection with the purchase for or sale to another person of those <i>investments</i>, which the <i>firm</i> has for genuine commercial reasons agreed to postpone,</p> <p>the <i>firm</i> may include as an asset the lower of the following:</p> <p>(i) the total amount due;</p> <p>(ii) the <i>market value</i> of the <i>investments</i> multiplied by the appropriate rates set out in table 13.12.3A.</p>

(8) Trade debtors	<p>Include amounts owing only in respect of</p> <p>(a) (i) commission;</p> <p>(ii) <i>investment management</i> fees;</p> <p>(iii) other fees earned in connection with the <i>firm's investment business</i>,</p> <p>which are due from other authorised or <i>EEA firms, recognised investment exchanges</i> or <i>recognised clearing houses</i> and have been due and unpaid for 30 days or less;</p> <p>(b) (i) <i>investment management</i> fees; or</p> <p>(ii) pensions administration which have been due from its customers and unpaid for 30 days or less.</p> <p>(c) All other trade debtors must be deducted in full.</p>
(9) Prepayments	<p>Include prepayments which relate to goods or services to be received or performed within 90 days.</p>
(10) Accrued income	<p>(a) Accrued income relating to <i>investment management</i> fees not yet due and payable may be included if the fees relate to services provided within the previous six months.</p> <p>(b) Other accrued income may be included if it relates to interest on marketable debt instruments or on <i>deposits</i> included in item (11).</p>
(11) <i>Deposits</i>	<p>The following may be included:</p> <p>(a) cash and balances on current accounts and on <i>deposit</i> accounts with an <i>approved bank</i> or National Savings Bank which can be withdrawn within 90 days;</p> <p>(b) money on <i>deposit</i> with a UK local authority which can be withdrawn within 90 days;</p> <p>(c) money <i>deposited</i> and evidenced by a certificate of tax <i>deposit</i>.</p>

(12) Other Debts	<p>(a) Amounts owing in respect of</p> <ul style="list-style-type: none"> (i) interest on <i>investments</i>; (ii) repayments of marketable debt instruments at maturity or call; (iii) dividends declared by authorised or not <i>EEA firms</i> or by companies in respect of <i>shares</i> listed on a recognised or designated investment exchange; <p>which have been due and unpaid for 30 days or less may be included.</p> <p>(b) Other amounts due from UK government bodies may be included if they are agreed and due within 30 days.</p>
(13) All other assets	Exclude in full.

Table 13.12.3(1) Part II

This table forms part of **rule 13.12.3**

FIRMS IN CATEGORY B1	
CALCULATION OF LIABILITIES	
LIABILITIES	ADJUSTMENTS
(14) Secured Liabilities	<p>Include in full, except the amount of the liabilities secured by a charge on land and buildings which may be reduced by the smallest of the following amounts:</p> <ul style="list-style-type: none"> (a) the aggregate amount of the <i>firm's</i> secured liabilities which are due more than one year after the balance sheet date; (b) (if the land and buildings have been valued by an independent professional valuer within the past 18 months) 85% of the amount certified by the valuer as their <i>market value</i>; (c) 85% of the net book value of the land and buildings.
(15) Subordinated loans	Include in full, except any short-term subordinated loan in the standard form prescribed by the <i>FSA</i> which may be treated as capital up to the limits specified in <i>rules</i> 13.12.5 and 13.12.5A.

(16) Commission on indemnity terms from the sale of <i>life policies</i> or <i>pension contracts</i>	Include as a liability a provision for repayment, in the event that premiums cease within the indemnity period, which must equal or exceed 2.5% of the commissions the <i>firm</i> has received on indemnity terms during the previous twelve months. This provision must be reasonable having regard to its circumstances and, in particular, its previous lapse ratio.
(17) Short Positions	Include a <i>net short position</i> (a) valued at its <i>offer price</i> and (b) increased using the applicable percentage rate in table 13.12.3A.
(18) Deficiency in <i>subsidiary</i>	Include as a liability the amount by which the liabilities of any <i>subsidiary</i> (excluding its capital and reserves) exceed its tangible assets. This requirement applies only to the extent that the <i>firm</i> has not already made such a provision elsewhere in its financial statements.
(19) Liability for tax	Include as a liability a provision for taxation on the whole of the profits of the <i>firm's</i> business up to its balance sheet date.
(20) Creditors relating to Unsettled <i>Securities</i> Transactions -Cash against Documents	Include creditors where the <i>firm</i> has entered into a transaction on its own behalf in <i>securities</i> or <i>units in collective investment schemes</i> on a cash against documents basis, and the transaction remains unsettled, after adding an amount calculated by (a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>market value</i> where that difference is not in the <i>firm's</i> favour, and (b) multiplying that difference by the applicable percentage specified in table 13.12.3B.
(21) Creditors relating to Unsettled <i>Securities</i> Transactions -Free Deliveries	Include an amount for creditors where (acting on the <i>firm's</i> own behalf) the <i>firm</i> has delivered certificates of title for <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them, or where a <i>firm</i> has bought such <i>investments</i> before receiving certificates of good title for them, as follows: (a) (if the <i>firm</i> has paid for them and not more than 3 days have passed since the payment was made) include in full: (b) (if more than 3 days have passed since the payment was made) include the full value of the <i>securities</i> at their current <i>offer price</i> .

(22) <i>Over the counter derivatives</i>	If the <i>firm</i> holds positions in <i>derivatives</i> on its own behalf must (a) make the adjustment in item (17) of this table, and (b) deduct the credit equivalent of those positions computed in accordance with table 13.12.3C. In addition, bought <i>OTC options</i> and covered <i>warrants</i> will be subject to table 13.12.3D.
(23) Contingent Liabilities	A <i>firm</i> must include a provision for any contingent liabilities which exist at its balance sheet date that must be made.
(24) Redeemable Preference Shares	Include as a liability any redeemable preference <i>shares</i> which fall due within two years. If <i>shares</i> are not redeemable by the shareholder within 2 years, they must be treated in accordance with rules 13.12.5 and 13.12.5A.
(25) Foreign currency risk	If the <i>firm</i> holds positions on its own behalf in foreign currencies or has assets or liabilities denominated in foreign currencies, the <i>firm</i> must calculate a provision to cover the risk in accordance with table 13.12.3D and include the amount as a liability
(26) All other liabilities	Include in full.

Table 13.12.3(2) Part I

This table forms part of **rule 13.12.3**

FIRMS IN CATEGORIES B2 AND B3 (except low resource firms)	
CALCULATION OF ASSETS	
ASSETS	ADJUSTMENTS
(1) Land and buildings	Include land and buildings which are not subject to any charge only if they have been valued either (a) at 60% of their net book value, or (b) (if valued by an independent professional valuer within the past three years) at 60% of the amount certified by the valuer to be the <i>market value</i> .

(2) Motor vehicles	<p>(a) Include motor vehicles acquired less than 12 months ago valued at 50% of their cost</p> <p>(b) Include motor vehicles acquired within the past 24 months (but more than 12 months ago) valued at 25% of their cost</p> <p>(c) Exclude in full any other motor vehicles.</p>
(3) <i>Investments</i>	<p>Include any <i>net long position</i> in any fixed or current asset investment (including <i>shares</i> in any connected company) valued at its current <i>bid price</i> (or, in the case of a with profits <i>life policy</i>, at its surrender value) and discounted by the applicable percentage specified in table 13.12.3A.</p>
(4) Debtors relating to Unsettled Securities Transactions Cash against Documents	<p>Include debtors where a <i>firm</i> has entered into a transaction on its own behalf in <i>securities</i> or <i>units in collective investment schemes</i> on a cash against documents basis and the transaction remains unsettled after deducting an amount calculated by</p> <p>(a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>bid price</i> where that difference is not in the <i>firm's</i> favour and</p> <p>(b) multiplying that difference by the applicable percentage specified in table 13.12.3B.</p>
(5) Debtors relating to Unsettled Securities Transactions Free Deliveries	<p>(a) Where the <i>firm</i> has delivered <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them or paid for such <i>investments</i> before receiving certificates of good title for them include the full amount due to a <i>firm</i> from debtors so long as not more than 3 days have passed since delivery.</p> <p>(b) Exclude in full if more than 3 days have passed since delivery.</p>
(6) <i>Regulated collective investment schemes</i>	<p>Include an amount owing in respect of a transaction in <i>units</i> in a <i>regulated collective investment scheme</i> only if the amount has been due and unpaid for not more than 90 days after the settlement date of the transaction to which it relates.</p>
(7) Debts of <i>group</i> or <i>connected companies</i>	<p>Include amounts due from <i>group</i> or <i>connected companies</i> (which do not relate to trade debts) where a <i>firm</i> has no reason to doubt that repayment will be made in full on demand.</p>

(8) Trade debtors	Include amounts due from trade debtors (including <i>group</i> or <i>connected companies</i>) which have been due and unpaid for less than 90 days.
(9) Prepayments	Include prepayments which relate to goods or services to be received or performed within 90 days.
(10) Accrued income	(a) Include accrued income not yet due and payable in respect of fees earned in the performance of <i>investment management</i> services that is receivable within six months. (b) Include any other accrued income receivable within 90 days.
(11) <i>Deposits</i>	Include amounts in respect of (a) cash and balances on current accounts and on <i>deposit</i> accounts with an <i>approved bank</i> or National Savings Bank which can be withdrawn within 90 days; (b) money on <i>deposit</i> with a UK local authority which can be withdrawn within 90 days; (c) money <i>deposited</i> and evidenced by a certificate of tax <i>deposit</i> .
(12) Other amounts due from Government bodies or local authorities	Include other amounts due from UK Government bodies or local authorities if they are agreed and due within 90 days.
(13) All other assets	Exclude in full.

Table 13.12.3(2) Part II

This table forms part of *rule 13.12.3*

FIRMS IN CATEGORIES B2 AND B3 (except low resource firms)	
CALCULATION OF LIABILITIES	
LIABILITIES	CALCULATIONS
(14) Secured Liabilities	<p>Include in full, except the amount of the liabilities secured by a charge on land and buildings which may be reduced as follows:</p> <p>(a) If the liabilities secured exceed 85% of the value of the land and buildings, then the excess is treated as a liability;</p> <p>(b) If the land and buildings have been valued by an independent professional valuer within the past three years, the value of the land and buildings is the amount certified by the valuer as their <i>market value</i>; otherwise it is their net book value.</p> <p>(If 60% of the value of the land and buildings which are subject to a charge exceeds the liabilities secured, then the amount of that excess may be treated as an asset.)</p>
(15) Subordinated loans	<p>Include in full, except any short term subordinated loan in the standard form prescribed by the <i>FSA</i> for such loans which may be treated as capital up to the limits specified in <i>rules 13.12.5 and 13.12.5A</i>.</p>
(16) Commission on indemnity terms from the sale of <i>life policies</i> or <i>pension contracts</i>	<p>Include as a liability a provision for repayment, in the event that premiums cease within the indemnity period, which must equal or exceed 2.5% of the commissions the <i>firm</i> has received on indemnity terms during the previous twelve months. This provision must be reasonable having regard to its circumstances and, in particular, its previous lapse ratio.</p>
(17) Short Positions	<p>Include a <i>net short position</i></p> <p>(a) valued at its <i>offer price</i>, and</p> <p>(b) increased using the applicable percentage rate in table 13.12.3A.</p>

(18) Deficiency in <i>subsidiary</i>	Include as a liability the amount by which the liabilities of any <i>subsidiary</i> (excluding its capital and reserves) exceed its tangible assets. This requirement applies only to the extent that the <i>firm</i> has not already made such a provision elsewhere in its financial statements.
(19) Liability for tax	Include as a liability a provision for taxation on the whole of the profits of its business up to its balance sheet date.
(20) Unsettled <i>Securities</i> Transactions - Cash against Documents	<p>Include creditors where the <i>firm</i> has entered into a transaction on its behalf in <i>securities</i> or <i>units in collective investment schemes</i> on a cash against documents basis, and the transaction remains unsettled, after adding an amount calculated by</p> <p>(a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>market value</i>, and</p> <p>(b) multiplying that difference by the applicable percentage specified in table 13.12.3B.</p>
(21) Creditors relating to Unsettled <i>Securities</i> Transactions - Free Deliveries	<p>Include an amount for creditors where (acting on its behalf) the <i>firm</i> has delivered certificates of title for <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them, or where the <i>firm</i> has bought such <i>investments</i> before receiving certificates of good title for them, as follows:</p> <p>(a) (if the <i>firm</i> has paid for them and not more than 3 days have passed since the payment was made) include in full;</p> <p>(b) (if more than 3 days have passed since the payment was made) include the full value of the <i>securities</i> at the current <i>offer price</i>.</p>
(22) <i>Over the counter derivatives</i>	Include as a liability an amount for any positions the <i>firm</i> holds on its own behalf in such <i>derivatives</i> calculated by computing the credit equivalent of those positions in accordance with table 13.12.3C. In addition, bought <i>OTC derivatives</i> and covered <i>warrants</i> will be subject to table 13.12.3D.
(23) Contingent Liabilities	A <i>firm</i> must include a provision for any contingent liabilities which exist at its balance sheet date that must be made.

(24) Long term liabilities	Include as a liability any amount which falls due more than 3 years from the balance sheet date and is due to <i>connected persons</i> , in accordance with <i>rules</i> 13.12.5 and 13.12.5A.
(25) Redeemable Preference Shares	Include as a liability any redeemable preference <i>shares</i> which fall due within two years. If <i>shares</i> are not redeemable by the shareholder within two years, they must be treated in accordance with <i>rules</i> 13.12.5 and 13.12.5A.
(26) <i>Net open foreign currency position</i>	A <i>firm</i> must calculate its foreign exchange risk requirement in accordance with table 13.12.3D and include the amount as a liability.
(27) All other liabilities	Include in full.

TABLE 13.12.3A

This table forms part of *rule* 13.12.3

DISCOUNTS FOR INVESTMENTS	
The percentages in the table are applied to the <i>market value</i> (unless otherwise stated) or gross positions, i.e. both longs and shorts in each category; netting and offsetting are prohibited. The long or short position in a particular investment is the net of any long or short positions held in that same investment.	
Investment	Discount
A. Debt	
UK Government or local authority stocks:	
- with less than one year to final redemption	2%
- with more than one year but less than five years to final redemption	5%
- with five years or more to final redemption	10%
Debt security:	
- debt instruments issued or accepted by an <i>approved bank</i> with less than 90 days to final redemption	2%

-	other debt instruments which are <i>marketable investments</i> with less than one year to final redemption	5%
-	other debt instruments which are <i>marketable investments</i> with less than five years to final redemption	10%
-	other debt instruments which are <i>marketable investments</i>	15%
-	floating rate notes which are <i>marketable investments</i> :	
-	with no more than 20 years to final redemption	5%
-	with more than 20 years to final redemption	10%
B.	Equities	
-	other <i>investments</i> listed on a recognised or designated investment exchange	25%
-	<i>shares</i> traded on a recognised or designated investment exchange	35%
-	other <i>shares</i> for which there is a <i>market maker</i> in the UK	35%
C.	<i>Derivatives</i>	
-	<i>exchange traded futures</i>	4 x initial margin requirement
-	<i>OTC futures</i>	Apply the appropriate percentage shown in A and B to the <i>market value</i> of the underlying position
-	Purchased <i>options</i>	Apply the appropriate percentage shown in A and B to the <i>market value</i> of the underlying position but the result may be limited to the <i>market value</i> of the option
-	<i>Contracts for differences</i>	20% of the <i>market value</i> of the contract

D.	<i>Other Investments</i>		
-	<i>Unit linked bonds and units in authorised unit trust schemes (other than higher volatility funds and property funds) or regulated collective investment schemes</i>	25%	
-	<i>units in higher volatility funds and property funds</i>	50%	
-	<i>with profit life policies (only applicable to firms other than traded life policy market makers)</i>	20%	of the surrender value of the policy
-	<i>shares in subsidiary companies and shares which are not readily realisable securities in connected companies</i>	100%	
-	<i>traded endowment policies:</i>		
	<i>where a traded life policy is held for resale by a firm which is a traded life policy market maker:</i>		
	(a) <i>for 3 months or less</i>	0%	of the surrender value of the policy
	(b) <i>for more than 3 months</i>	10%	of the surrender value of the policy
	<i>when a traded life policy is held by a firm which is a traded life policy market maker for investment</i>	10%	of the surrender value of the policy
-	<i>other</i>	100%	

TABLE 13.12.3B**This table forms part of rule 13.12.3**

UNSETTLED SECURITIES TRANSACTIONS		
Number of <i>business days</i> after due settlement date	A %	B %
0 – 15	0	0
16 – 30	25	0
31 – 45	50	25
46 – 60	75	50
61 or more	100	75
over 90	100	100
<p>Note 1 Column A applies to a transaction in a debt or debt-related instrument (unless the debt instrument is settled through the appropriate UK settlement system), and</p> <p>Note 2 Column B applies in all other cases (and, in particular, applies to equity and equity-related instruments).</p>		

TABLE 13.12.3C**This table forms part of rule 13.12.3**

OVER THE COUNTER DERIVATIVES		
a. By attaching current <i>market values</i> to contracts (marking to market), obtain the current replacement cost of all contracts with positive values.		
b. To obtain a figure for potential future credit exposure (except in the case of single currency “floating/floating interest rate swaps” in which only the current replacement costs will be calculated), the notional principal amounts or values underlying the <i>firm's</i> aggregate positions are multiplied by the following percentages:		
Residual Maturity	Interest Rate Contracts	Foreign Exchange Contracts
One year or less	Nil	1%
More than 1 year	0.5%	5%
c. The credit equivalent is the sum of current replacement cost and potential future credit exposure.		

TABLE 13.12.3D

This table forms part of rule 13.12.3

FOREIGN EXCHANGE RISK	
(a)	<p>A <i>firm</i> must deduct a foreign exchange risk requirement for all the following items which are denominated in a foreign currency:</p> <ul style="list-style-type: none">(i) all assets and liabilities, including accrued interest, denominated in the currency (all <i>investments</i> at market or realisable value);(ii) any currency future, at the nominal value of the contract;(iii) any forward contract for the purchase or sale of the currency, at the contract value, including any future exchange of principal associated with currency swaps;(iv) any foreign currency <i>options</i> at the net delta (or delta-based) equivalent of the total book of such <i>options</i>;(v) any non-currency option, at <i>market value</i>;(vi) any irrevocable guarantee;(vii) any other off-balance sheet commitment to purchase or sell an asset denominated in that currency.
(b)	<p>The requirement must be calculated as follows:</p> <ul style="list-style-type: none">(i) using the spot rate, convert the <i>net long position</i> and <i>net short position</i> in each foreign currency into the currency in which the <i>firm's annual financial statements</i> are reported;(ii) total the <i>net open long positions</i> and the <i>net open short positions</i>;(iii) the higher of (i) and (ii) above is its <i>net open foreign currency position</i>;(iv) multiply its <i>net open foreign currency position</i> by 10%;

- (c) A *firm* may not include any future income or expense not yet accrued but fully hedged (subject to deduction of an appropriate risk requirement).

SHORT TERM SUBORDINATED LOANS

- 13.12.4 R A *Category B firm* may treat subordinated loan as a financial resource, as specified in *rules 13.12.5 to 5A*, if the short term subordinated loan is eligible for such treatment in accordance with *rule 13.12.4A*;
- 13.12.4A R A short term subordinated loan is eligible for such treatment if:
- (1) it has an original maturity of at least two years or, if it has no fixed term, it is subject to two years' notice of repayment;
 - (2) payment of interest is not permitted under the loan agreement unless after such payment a *firm* meet 120% of its financial resource requirement;
 - (3) repayment, prepayment or termination is only permitted under the loan agreement
 - (a) on maturity, or on expiration of the period of notice, if after such payment or termination a *firm* meets 120% of its financial resources requirement; or
 - (b) on winding up after the claims of all other creditors and all outstanding debts have been settled;
 - (4) it is in the standard form for short term subordinated loans prescribed by the *FSA*.

RESTRICTIONS

- 13.12.5 R A *Category B firm* must calculate:
- (1) the aggregate amount of its short term subordinated loans, its preference *shares* which are not redeemable within two years, and for a *Category B firm* other than a *Category B1 firm* its long term liabilities which are not secured on its assets, if they do not fall due more than three years from the balance sheet date, and are not due to *connected persons*;
 - (2) the amount of the *firm's* total capital and reserves excluding preference *share* capital, less the amount of its intangible assets, multiplied by 400%.

APPENDIX 13 (1)

Defined terms for Chapter 13

If a defined term does not appear in the glossary below, the definition in the Glossary annexed to the General Provisions Instrument 2001 applies

50% controller	a <i>controller</i> in whose case the relevant percentage of shares or <i>voting power</i> is 50% or more.
accepting deposits	the <i>regulated activity</i> , specified in article 5 of the <i>Regulated Activities Order</i> (Accepting deposits), which is in summary: accepting deposits if: (a) money received by way of <i>deposit</i> is lent to others; or (b) any other activity of the <i>person</i> accepting the <i>deposit</i> is financed, wholly or to a material extent, out of the capital of or interest on money received by way of <i>deposit</i> .
Act	the Financial Services and Markets Act 2000.
adviser	an individual who is: (a) a <i>financial adviser</i> ; or (b) a <i>representative</i> ; or (c) an <i>appointed representative</i> .
advising on investments	the <i>regulated activity</i> , specified in article 53 of the <i>Regulated Activities Order</i> (Advising on investments), which is in summary: advising a <i>person</i> if the advice is: (a) given to the <i>person</i> in his capacity as an investor or potential investor, or in his capacity as agent for an investor or a potential investor; and (b) advice on the merits of his doing any of the following (whether as principal or agent): (i) <i>buying, selling, subscribing for or underwriting a particular investment which is a security or a contractually based investment, or</i> (ii) exercising any right conferred by such an <i>investment</i> to <i>buy, sell, subscribe for or underwrite such an investment</i> .
affiliated company	in relation to a <i>person</i> , an <i>undertaking</i> in the same <i>group</i> as that <i>person</i> .
affiliated persons	(a) persons who constitute a single risk because one of them has direct or indirect control over the other or others; (b) other persons who are so interconnected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties;
allocation period	a single 24-hour period or, with the agreement of each <i>intermediate customer</i> concerned, a period spanning five consecutive <i>business days</i> , during which an aggregated <i>series of transactions</i> , to achieve one investment decision or objective, may be <i>executed</i> .
ancillary activity	an activity that is not a <i>regulated activity</i> but is: (a) carried on in connection with a <i>regulated activity</i> ; or

(b) held out as being for the purposes of a *regulated activity*.

annual accounting reference date	the date to which a corporate <i>firm's</i> accounts are prepared for the purposes of the Companies Acts, or, where the <i>firm</i> is not subject to the Companies Acts, the equivalent date chosen by the <i>firm</i> and notified to the <i>FSA</i> ;
annual financial statement	the financial statements in respect of the year ending on the <i>firm's annual accounting reference date</i> ;
appointed representative	<p>(in accordance with section 39 of the <i>Act</i>) a <i>person</i> (other than an <i>authorised person</i>) who:</p> <p>(a) is a party to a contract with an <i>authorised person</i> (his <i>principal</i>) which:</p> <ul style="list-style-type: none">(i) permits or requires him to carry on business of a description prescribed in the Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001 (SI 2001/1217); and(ii) complies with such requirements as are prescribed in those Regulations; and <p>(b) is someone for whose activities in carrying on the whole or part of that business his <i>principal</i> has accepted responsibility in writing;</p> <p>and who is therefore an <i>exempt person</i> in relation to any <i>regulated activity</i> comprised in the carrying on of that business for which his <i>principal</i> has accepted responsibility.</p>
appropriate personal pension	a <i>personal pension policy</i> or a <i>personal pension contract</i> under which contributions are made to a <i>personal pension scheme</i> which is an appropriate scheme under section 1(8) of the Social Security Act 1986 or article 3(8) of the Social Security (Northern Ireland) Order 1986.
approved bank	<p>(in relation to a bank account opened by a <i>firm</i>):</p> <p>(a) if the account is opened at a branch in the <i>United Kingdom</i>:</p> <ul style="list-style-type: none">(i) the Bank of England; or(ii) the central bank of a member state of the <i>OECD</i>; or(iii) a <i>bank</i>; or(iv) a <i>building Society</i> which offers, unrestrictedly, banking services; or(v) a bank which is supervised by the central bank or other banking regulator of a member state of the <i>OECD</i>; or <p>(b) if the account is opened elsewhere:</p> <ul style="list-style-type: none">(i) a bank in (a); or(ii) a <i>credit institution</i> established in an <i>EEA</i> State other than the <i>United Kingdom</i> and duly authorised by the relevant <i>Home State regulator</i>; or(iii) a bank which is regulated in the Isle of Man or the Channel Islands; or <p>(c) a bank supervised by the South African Reserve Bank; or</p> <p>(d) any other bank that:</p> <ul style="list-style-type: none">(i) is subject to regulation by a national banking regulator;(ii) is required to provide audited accounts;

	(iii) has minimum net assets of £5million (or its equivalent in any other currency at the relevant time) and has a surplus revenue over expenditure for the last two financial years; and
	(iv) has an annual audit report which is not materially qualified.
approved collateral	any form of security for the discharge of any liability arising from a <i>contingent liability investment</i> (other than a guarantee) which: <ul style="list-style-type: none"> (a) (in relation to an <i>on-exchange</i> transaction) is acceptable under the rules of the relevant exchange or <i>clearing house</i>; and (b) (in relation to an <i>OTC</i> transaction) would be acceptable for a similar transaction to the relevant exchange or <i>clearing house</i>.
approved depositary	any <i>depository</i> that: <ul style="list-style-type: none"> (a) is subject to regulation by a national <i>regulatory body</i>; (b) is required to provide audited accounts; (c) has minimum net assets of £5 million (or its equivalent in any other currency at the relevant time) and has a surplus revenue over expenditure for the last two financial years; and (d) has an annual audit report which is not materially qualified.
arranging (bringing about) deals in investments	the <i>regulated activity</i> , specified in article 25(1) of the <i>Regulated Activities Order</i> , which is, in summary: making arrangements for another <i>person</i> (whether as <i>principal</i> or agent) to <i>buy, sell, subscribe for or underwrite</i> a particular <i>investment</i> which is: <ul style="list-style-type: none"> (a) a <i>designated investment</i>; or (b) the <i>underwriting capacity of a Lloyd's syndicate</i>; or (c) <i>membership of a Lloyd's syndicate</i>; or (d) rights to or interests in <i>investments</i> in (b) or (c).
associate	(in relation to a <i>person</i> ("A")): <ul style="list-style-type: none"> (a) an <i>affiliated company</i> of A; (b) an <i>appointed representative</i> of A or of any <i>affiliated company</i> of A; (c) any other <i>person</i> whose business or domestic relationship with A or his <i>associate</i> might reasonably be expected to give rise to a community of interest between them which may involve a conflict of interest in dealings with third parties.
AUT	an <i>authorised unit trust scheme</i> .
authorised corporate director	the <i>director</i> of an <i>ICVC</i> who is the authorised corporate director of the <i>ICVC</i> in accordance with <i>CIS 7.2.1R</i> (The directors).
authorised fund	an <i>ICVC</i> or an <i>AUT</i> .
authorised person	(in accordance with section 31 of the <i>Act</i> (Authorised persons)) one of the following: <ul style="list-style-type: none"> (a) a <i>person</i> who has a <i>Part IV permission</i> to carry on one or more <i>regulated activities</i>; (b) an <i>incoming EEA firm</i>; (c) an <i>incoming Treaty firm</i>; (d) a <i>UCITS qualifier</i>; (e) an <i>ICVC</i>.

	(f) the <i>Society of Lloyds</i>
authorised unit trust scheme	(as defined in section 237(3) of the <i>Act</i> (Other definitions)) a <i>unit trust scheme</i> which is authorised for the purposes of the <i>Act</i> by an <i>authorisation order</i> .
bank	(1) a <i>firm</i> with a <i>Part IV permission</i> which includes <i>accepting deposits</i> , and: <ul style="list-style-type: none"> (a) which is a <i>credit institution</i>; or (b) whose <i>Part IV permission</i> includes a <i>requirement</i> that it comply with <i>IPRU(BANK)</i>; but which is not a <i>building society</i> , a <i>friendly society</i> or a <i>credit union</i> ;
	(2) an <i>EEA bank</i> .
bearer form	(in relation to a <i>client's certificate</i> , <i>share transfer</i> or other <i>document</i>) in a form signed by the <i>client</i> so that it enables a <i>designated investment</i> or <i>deposit</i> to which it relates to be sold, transferred, surrendered or dealt with in any other way without the need to obtain further written instructions and allowing the <i>firm</i> access to the sale proceeds.
bid price	the <i>price</i> at which a <i>person</i> could sell a <i>unit</i> in a <i>dual-priced AUT</i> or a <i>security</i> .
body corporate	(in accordance with section 417(1) of the <i>Act</i> (Definitions)) any body corporate, including a body corporate constituted under the law of a country or territory outside the <i>United Kingdom</i> .
bonded investment	a <i>designated investment</i> not held by a <i>trustee</i> when acting as a <i>trustee</i> : <ul style="list-style-type: none"> (i) which the <i>firm</i> may <i>sell</i> or procure the sale of without the signature or other action of the <i>customer</i> or an independent third party; (ii) where the proceeds of such a sale are or could be payable to the <i>firm</i> or a <i>connected person</i>; and (iii) which, other than in the case of a <i>unit</i> in a <i>collective investment scheme</i>, is one of the following: <ul style="list-style-type: none"> (a) a <i>readily realisable security</i> held for a <i>customer</i> whether or not held under a discretionary arrangement; or (b) a bearer <i>designated investment</i>; or (c) a <i>designated investment</i> held by a <i>nominee company</i> under the <i>control</i> of the <i>firm</i> or a <i>person</i> whom the <i>firm</i> controls; or a <i>designated investment</i> to which the title is recorded in electronic form
branch	(a) in relation to a <i>credit institution</i> : <ul style="list-style-type: none"> (i) a place of business which forms a legally dependent part of a <i>credit institution</i> and which carries out directly all or some of the transactions inherent in the business of <i>credit institutions</i>; (ii) for the purposes of the <i>Banking Consolidation Directive</i>, any number of places of business set up in the same <i>EEA State</i> by a <i>credit institution</i> with headquarters in another <i>EEA State</i> are to be regarded as a single <i>branch</i>; (b) in relation to an <i>investment firm</i> , <ul style="list-style-type: none"> (i) a place of business which is a part of an <i>investment firm</i>, not being the principal place of business, which has no separate legal personality and which provides <i>investment services</i> for which the <i>investment firm</i> has been authorised; (ii) for the purposes of the <i>Investment Services Directive</i>, all the places of business set up in the same <i>EEA State</i> by an <i>investment firm</i> with

	headquarters in another <i>EEA State</i> are to be regarded as a single <i>branch</i> ;
	(c) in relation to an <i>insurance undertaking</i> , any permanent presence of the <i>insurance undertaking</i> in an <i>EEA State</i> other than that in which it has its head office is to be regarded as a single <i>branch</i> , whether that presence consists of a single office which, or two or more offices each of which: <ul style="list-style-type: none"> (i) is managed by the <i>insurance undertaking's</i> own staff; or (ii) is an agency of the <i>insurance undertaking</i>; or (iii) is managed by a <i>person</i> who is independent of the <i>insurance undertaking</i>, but has permanent authority to <i>act</i> for the <i>insurance undertaking</i> as an agency would.
broker fund	(in relation to a fund for which the <i>firm</i> is or will be a <i>broker fund adviser</i>): <ul style="list-style-type: none"> (a) an actual or notional fund of a <i>long-term insurer</i>, which contains or will contain contributions made or to be made by a <i>client</i> or <i>clients</i> of a <i>firm</i> in connection with a <i>life policy</i> or <i>policies</i>; (b) a fund of a <i>collective investment scheme</i>, which contains or will contain cash contributions made or to be made by a <i>client</i> or <i>clients</i> of a <i>firm</i> in connection with the purchase of <i>units</i> in the <i>scheme</i>.
broker fund adviser	a <i>person</i> who has, or whose <i>associate</i> being an <i>authorised person</i> has, an arrangement with a <i>long-term insurer</i> , or with the <i>operator</i> of a <i>regulated collective investment scheme</i> or an <i>unregulated collective investment scheme</i> , under which it is to be expected that the <i>long-term insurer</i> or <i>operator</i> will take into account the advice of that <i>person</i> or his <i>associate</i> : <ul style="list-style-type: none"> (a) in the case of a <i>long-term insurer</i>, on any matter likely to influence the performance of any of the <i>long-term insurer's</i> funds or of any <i>investment</i> issued by the <i>long-term insurer</i> into which cash contributions of that <i>person's customers</i> have been made; (b) in the case of an <i>operator</i>, on the composition of the property of the <i>collective investment scheme</i> into which cash contributions of that <i>person's customers</i> have been made; <p>in this definition, <i>associate</i> includes any <i>authorised person</i> in respect of whose services the first <i>person</i> receives any benefit or reward, either directly or indirectly, in connection with advice of the kind described in (a) and (b) given to a <i>long-term insurer</i> or to a <i>collective investment scheme operator</i>.</p>
building society	(as defined in section 119(1) of the Building Societies Act 1986) a building society incorporated (or deemed to be incorporated) under that Act.
business day	(1) (in relation to anything done or to be done in any part of the <i>United Kingdom</i>): <ul style="list-style-type: none"> (a) (except in REC) any <i>day</i> which is not a Saturday or Sunday, Christmas Day, Good Friday or a bank holiday in that part of the <i>United Kingdom</i>; (b) (in REC) (as defined in section 167 of the Companies Act 1989) any <i>day</i> which is not a Saturday or Sunday, Christmas Day, Good Friday or a bank holiday in any part of the <i>United Kingdom</i>. (2) (in relation to anything done or to be done by reference to a market outside the <i>United Kingdom</i>) <p>any <i>day</i> on which that market is normally open for business.</p>
buying	(in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation general)) any form of buying, including acquiring for valuable consideration.

Category A firm	a <i>personal investment firm</i> which is an <i>ISD firm</i> ;
Category A1 firm	a <i>Category A firm</i> whose <i>permission</i> includes <i>dealing in investments as principal</i> ;
Category A2 firm	a <i>Category A firm</i> whose <i>permission</i> does not include <i>dealing in investments as principal</i> ;
Category A3 firm	a <i>Category A firm</i> whose <i>permission</i> includes only <i>arranging transactions in investments, advising on investments</i> and, if applicable <i>managing investments</i>
Category B firm	a <i>personal investment firm</i> , other than a <i>Category A firm</i> ;
Category B1 firm	a <i>Category B firm</i> whose <i>permission</i> includes <i>dealing in investments as principal</i> ;
Category B2 firm	a <i>Category B firm</i> whose <i>permission</i> does not include <i>dealing as principal</i> ;
Category B3 firm	a <i>Category B firm</i> whose <i>permission</i> includes only <i>arranging transactions in life policies</i> and other insurance contracts, <i>advising on investments</i> and receiving and transmitting, on behalf of investors, orders in relation to <i>securities</i> and <i>units in collective investment schemes</i> ;
charge	any <i>fee</i> or charge made to a <i>client</i> in connection with <i>designated investment business</i> , whether levied by the <i>firm</i> or any other <i>person</i> , including a <i>mark-up</i> or <i>mark-down</i> .
clearing firm	a <i>firm</i> which assumes primary responsibility (including legal liability) for the <i>execution</i> and settlement of transactions for <i>clients</i> .
clearing house	a clearing house through which transactions on an exchange may be cleared.
client	any <i>person</i> with or for whom a <i>firm</i> conducts or intends to conduct <i>designated investment business</i> or any other <i>regulated activity</i> ; and: <ul style="list-style-type: none"> (a) every client is a <i>customer</i> or a <i>market counterparty</i>; (b) "client" includes: <ul style="list-style-type: none"> (i) a potential client; (ii) a client of an <i>appointed representative</i> of a <i>firm</i> with or for whom the <i>appointed representative</i> acts or intends to act, in the course of business for which the <i>firm</i> has accepted responsibility under section 39 of the <i>Act</i> (Exemption of appointed representatives); (iii) a <i>collective investment scheme</i> even if it does not have separate legal personality; (iv) if a <i>person</i> ("C1"), with or for whom the <i>firm</i> is conducting or intends to conduct <i>designated investment business</i>, is acting as agent for another <i>person</i> ("C2"), either C1 or C2 in accordance with COB 4.1.5R (Agent as client); (c) "client" does not include: <ul style="list-style-type: none"> (i) a trust beneficiary; (ii) a <i>corporate finance contact</i>; <p>a <i>venture capital contact</i>.</p>
client agreement	<i>terms of business</i> which have been signed by the <i>client</i> or to which the <i>client</i> has consented in writing.
client asset rules	COB 9, including the <i>custody rules, client money rules, mandate rules</i> and <i>collateral rules</i> .

client bank account	<p>(a) an account at a bank which:</p> <ul style="list-style-type: none"> (i) holds the <i>money</i> of one or more <i>clients</i>; (ii) is in the name of the <i>firm</i>; (iii) includes in its title an appropriate description to distinguish the <i>money</i> in the account from the <i>firm's money</i>; and (iv) is a current or a deposit account; or <p>(b) a money market deposit of <i>client money</i> which is identified as being <i>client money</i>.</p>
client money	subject to the <i>client money rules</i> , <i>money</i> of any currency which, in the course of carrying on <i>designated investment business</i> , a <i>firm</i> holds in respect of any <i>investment agreement</i> entered into, or to be entered into, with or for a <i>client</i> , or which a <i>firm</i> treats as <i>client money</i> in accordance with the <i>client money rules</i> .
client money distribution rules	COB 9.5.
client money rules	COB 9.3.
client transaction account	(in relation to a <i>firm</i> and an exchange or <i>clearing house</i> or an <i>intermediate broker</i>) an account maintained by the exchange, <i>clearing house</i> or the <i>intermediate broker</i> , as the case may be, in respect of contingent liability <i>transactions</i> undertaken by the <i>firm</i> with or for its <i>clients</i> .
close relative	<p>(as defined in article 3(1) of the <i>Regulated Activities Order</i>) (in relation to any <i>person</i>):</p> <ul style="list-style-type: none"> (a) his spouse; (b) his children and step-children, his parents and step-parents, his brothers and sisters and his step-brothers and step-sisters; and (c) the spouse of any <i>person</i> within (b).
collateral	<p>any of the following:</p> <ul style="list-style-type: none"> (a) an <i>investment</i> specified in articles 76 to 81 of the <i>Regulated Activities Order</i>, that is: <ul style="list-style-type: none"> (i) <i>shares</i> (article 76); (ii) <i>debentures</i> (article 77); (iii) <i>government and public securities</i> (article 78); (iv) <i>warrants</i> (article 79); (v) <i>certificates representing certain securities</i> (article 80); (vi) <i>units</i> (article 81); <p>or</p> <ul style="list-style-type: none"> (b) <i>money</i>; or (c) a <i>commodity warrant</i> (however title is recorded or evidenced); <p>which belongs to a <i>client</i> and which is held or controlled by the <i>firm</i> under the terms of a deposit, pledge, charge or other security arrangement.</p>
collective investment scheme	<p>a collective investment scheme, as defined in section 235 of the <i>Act</i> (Collective Investment Schemes), which is in summary:</p> <ul style="list-style-type: none"> (a) any arrangements with respect to property of any description, including <i>money</i>, the purpose or effect of which is to enable <i>persons</i> taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising

from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income; and

(b) which are not excluded by the Financial Services and Markets Act (Collective Investment Schemes) Order 2001 (SI 2001/1062).

commencement	the beginning of the <i>commencement day</i> .
commencement day	the <i>day</i> on which section 19 of the <i>Act</i> (The general prohibition) comes into force.
commission	any form of commission, including a benefit of any kind, offered or given in connection with <i>designated investment business</i> .
commodity	a physical asset (other than a financial instrument or cash) which is capable of delivery.
company	any <i>body corporate</i> .
connected person	<p>(1) (in relation to the FSA's consideration of an application for, or of whether to vary or cancel, a <i>Part IV permission</i>) any <i>person</i> appearing to the FSA to be, or likely to be, in a relationship with the applicant or <i>person</i> given <i>permission</i>, which is relevant, in accordance with section 49(1) of the <i>Act</i> (Persons connected with an applicant);</p> <p>(2) (in relation to the FSA's powers to gather information under section 165 of the <i>Act</i> (Authority's power to require information)) (as defined in section 165(11) of the <i>Act</i>) a <i>person</i> which has or has at any relevant time had the following relationship to an <i>authorised person</i> (A):</p> <ul style="list-style-type: none"> (a) it is a member of A's <i>group</i>; (b) it is a <i>controller</i> of A; (c) it is a member of a <i>partnership</i> of which A is a member; (d) it is or has been an employee of A; (e) if A is a <i>company</i> it is or has been: <ul style="list-style-type: none"> (i) an officer or manager of A or of a <i>parent undertaking</i> of A; or (ii) an agent of A or of a <i>parent undertaking</i> of A; (f) if A is a <i>partnership</i>, it is or has been a member, manager, or agent of A; (g) if A is an unincorporated association of <i>persons</i> which is neither a <i>partnership</i> nor an unincorporated <i>friendly society</i>, it is or has been an officer, manager, or agent of A; (h) if A is a <i>friendly society</i>, it is or has been an officer or manager of A as defined in section 119(1) of the Friendly Societies Act 1992; (i) if A is a <i>building society</i>, it is or has been an officer of A as defined in section 119(1) of the Building Societies Act 1986; (j) if A is an individual, it is or has been an agent of A; <p>(3) (in relation to the FSA's powers of investigation under section 171 and 172 of the <i>Act</i>) (Powers of persons appointed under section 167; Additional power of persons appointed as a result of section 168(1) or (4)) (as defined in section 171(4) of the <i>Act</i>) a <i>person</i> which has or has at any relevant time had the following relationship to a person under investigation (P):</p> <ul style="list-style-type: none"> (a) it has the relationship specified in any of paragraphs (2) (a) to (j) inclusive to P (where references in those paragraphs to A are taken to be references to P);

	<ul style="list-style-type: none"> (b) it is a partnership of which A is a member; (c) it is the partner, manager, employee, agent, <i>appointed representative</i>, banker, auditor, actuary or solicitor of: <ul style="list-style-type: none"> (i) A; (ii) a <i>parent undertaking</i> of A; (iii) a <i>subsidiary undertaking</i> of A; (iv) a <i>subsidiary undertaking</i> of a <i>parent undertaking</i> of A; or (v) a <i>parent undertaking</i> of a <i>subsidiary undertaking</i> of A.
contingent liability investment	a <i>derivative</i> under the terms of which the <i>client</i> will or may be liable to make further payments (other than <i>charges</i> , and whether or not secured by <i>margin</i>) when the transaction falls to be completed or upon the earlier <i>closing out</i> of his position.
contract for differences	<p>(as specified in article 85 of the <i>Regulated Activities Order</i> (Contracts for differences etc)) rights under:</p> <ul style="list-style-type: none"> (a) a contract for differences; or (b) any other contract the purpose or pretended purpose of which is to secure a profit or avoid a loss by reference to fluctuations in: <ul style="list-style-type: none"> (i) the value or price of property of any description; or (ii) an index or other factor designated for that purpose in the contract.
contract of insurance	<ul style="list-style-type: none"> (1) (in relation to a <i>specified investment</i>) the <i>investment</i> specified in article 75 of the <i>Regulated Activities Order</i> (Contracts of insurance) which is rights under a contract of insurance). (2) (in relation to a contract) (in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation: general)) any contract of insurance which is a <i>long-term insurance contract</i> or a <i>general insurance contract</i>, including: <ul style="list-style-type: none"> (a) fidelity bonds, performance bonds, administration bonds, bail bonds, customs bonds or similar contracts of guarantee, where these are: <ul style="list-style-type: none"> (i) effected or carried out by a <i>person</i> not carrying on a banking business; (ii) not effected merely incidentally to some other business carried on by the <i>person</i> effecting them; and (iii) effected in return for the payment of one or more premiums.; (b) <i>tontines</i>; (c) <i>capital redemption</i> contracts, pension fund management contracts, where these are effected or carried out by a <i>person</i> who: <ul style="list-style-type: none"> (i) does not carry on a banking business; and (ii) otherwise carries on a <i>regulated activity</i> of the kind specified by article 10 of the <i>Regulated Activities Order</i> (Effecting and carrying out contracts of insurance); (d) contracts to pay annuities on human life; (e) contracts of a kind referred to in article 1(2)(e) of the <i>First Life Directive</i> (Collective insurance etc); and (f) contracts of a kind referred to in article 1(3) of the <i>First Life Directive</i> (Social insurance).

in this definition, "annuities on human life" does not include superannuation allowances and annuities payable out of any fund applicable solely to the relief and maintenance of *persons* engaged or who have been engaged, in any particular profession, trade or employment, or of the dependants of such *persons*.

contractually based investment	(in accordance with article 3 of the <i>Regulated Activities Order</i> (Interpretation: general)): <ul style="list-style-type: none">(a) rights under a <i>life policy</i>;(b) an <i>option, future or contract for differences</i>;(c) <i>rights to or interests in an investment</i> falling within (a) or (b).
control	(in relation to the acquisition, increase or reduction of control of a <i>firm</i>) the relationship between a <i>person</i> and the <i>firm</i> or other <i>undertaking</i> of which the <i>person</i> is a <i>controller</i> .
controlled activity	an activity specified in Part 1 of Schedule 1 to the <i>Financial Promotion Order</i> (Controlled activities).
controller	(as defined in section 422 of the <i>Act</i> (Controller)) (in relation to a <i>firm</i> or other <i>undertaking</i> ("A")) a person (see I) who: <ul style="list-style-type: none">(a) holds 10 % or more of the shares in A; or(b) is able to exercise significant influence over the management of A through his shareholding in A; or(c) holds 10 % or more of the shares in a <i>parent undertaking</i> ("P") of A; or(d) is able to exercise significant influence over the management of P through his shareholding in P; or(e) is entitled to exercise, or control the exercise of, 10 % or more of the <i>voting power</i> in A; or(f) is able to exercise significant influence over the management of A through his <i>voting power</i> in A; or(g) is entitled to exercise, or control the exercise of, 10 % or more of the <i>voting power</i> in P; or(h) is able to exercise significant influence over the management of P through his <i>voting power</i> in P; in this definition: <ul style="list-style-type: none">(A) "<i>person</i>" means:<ul style="list-style-type: none">(i) the <i>person</i>;(ii) any of the <i>person's</i> associates; or(iii) the <i>person</i> and any of his associates;(B) "<i>associate</i>", in relation to a <i>person</i> ("H") holding shares in an <i>undertaking</i> ("C") or entitled to exercise or control the exercise of <i>voting power</i> in relation to another <i>undertaking</i> ("D"), means:<ul style="list-style-type: none">(a) the spouse of H;(b) a child or stepchild of H (if under 18);(c) the trustee of any settlement under which H has a life interest in possession (or in Scotland a life interest);(d) an <i>undertaking</i> of which H is a director;

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

(see also *50% controller*)

corporate finance
business

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

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

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

credit	<ul style="list-style-type: none"> (1) (except in relation to a <i>class of contract of insurance</i>) any kind of loan, deferment of repayment of any loan or of interest on any loan, guarantee or indemnity, and any other kind of accommodation or <i>facility</i> in the nature of <i>credit</i>. (2) (in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i>, specified in paragraph 14 of Part I of Schedule 1 to the <i>Regulated Activities Order (Contracts of general insurance)</i>, against risks of loss to the <i>persons</i> insured arising from the insolvency of debtors of theirs or from the failure (otherwise than through insolvency) of debtors of theirs to pay their debts when due.
credit institution	(as defined in article 1(1) of the <i>BCD</i>) an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account. (See also <i>BCD credit institution</i> .)
custody asset	<ul style="list-style-type: none"> (a) a <i>designated investment</i> held for or on behalf of a <i>client</i>; (b) any other asset which is or may be held with a <i>designated investment</i> held for, or on behalf of, a <i>client</i>.

custody rules	COB 9.1.
customer	(1) (except in COB 3) a <i>client</i> who is not a <i>market counterparty</i> . (2) (in COB 3) a <i>person</i> in (1) or a <i>person</i> who would be such a <i>person</i> if he was a <i>client</i> .
deal	a <i>dealing</i> transaction.
dealing	(in accordance with paragraph 2 of Schedule 2 to the <i>Act</i> (Regulated activities)) buying, selling, subscribing for or underwriting <i>investments</i> or offering or agreeing to do so, either as a <i>principal</i> or as an agent, including, in the case of an <i>investment</i> which is a <i>contract of insurance</i> , carrying out the contract.
debenture	the <i>investment</i> specified in article 77 of the <i>Regulated Activities Order</i> (Instruments creating or acknowledging indebtedness), which is in summary: any of the following which are not <i>government and public securities</i> : (a) debentures; (b) debenture stock; (c) loan stock; (d) bonds; (e) certificates of deposit; (f) any other instrument creating or acknowledging indebtedness.
debt capital	a <i>security</i> of indeterminate duration or other instrument the debt agreement for which provides that (a) it may not be reimbursed on the holder's initiative; (b) the borrower has the <i>option</i> of deferring the payment of interest on the debt; (c) the lender's claims on the borrower must be wholly subordinated to those of all non-subordinated creditors; (d) debt and unpaid interest should be such as to absorb losses, whilst leaving the borrower in a <i>position</i> to continue trading; and which is fully paid-up;
deposit	the <i>investment</i> , specified in article 74 and defined in articles 5(2) and 5(3) of the <i>Regulated Activities Order</i> , which is, in summary: a sum of money (other than one excluded by any of articles 6 to 9 of the <i>Regulated Activities Order</i>) paid on terms: (a) under which it will be repaid, with or without interest or a premium, and either on demand or at a time or in circumstances agreed by or on behalf of the <i>person</i> making the payment and the <i>person</i> receiving it; and (b) which are not referable to the provision of property (other than currency) or services or the giving of security; in this definition, money is paid on terms which are referable to the provision of property or services or the giving of security if, and only if: (a) it is paid by way of advance or part payment under a contract for the sale, hire or other provision of property or services, and is repayable only in the event that the property or services is or are not in fact sold, hired or otherwise provided; (b) it is paid by way of security for the performance of a contract or by way of security in respect of loss which may result from the non-performance of a contract; or

	(c) without prejudice to (b), it is paid by way of security for the delivery up or return of any property, whether in a particular state of repair or otherwise.
deposit-taking firm	a <i>firm</i> which is a <i>bank, building society or credit union</i> .
depository	(1) (in relation to an <i>ICVC</i>) the <i>person</i> to whom is entrusted the safekeeping of all of the <i>scheme property</i> of the <i>ICVC</i> and who has been appointed for this purpose in accordance with regulation 5 (Safekeeping of scheme property by depository) of and Schedule 1 (Depositaries) to the <i>OEIC Regulations</i> . (2) (in relation to an <i>AUT</i>) the <i>trustee</i> . (3) (in relation to any other <i>unit trust scheme</i>) the <i>person</i> holding the property of the <i>scheme</i> on trust for the <i>participants</i> . (4) (in relation to any other <i>collective investment scheme</i>) any <i>person</i> to whom the property subject to the <i>scheme</i> is entrusted for safekeeping.
derivative	a <i>contract for differences, a future or an option</i> .
designated investment	a <i>security or contractually-based investment</i> that is any of the following <i>investments</i> specified in Part III of the <i>Regulated Activities Order</i> (Specified Investments): (a) <i>life policy</i> (subset of article 75 (Contracts of insurance)); (b) <i>share</i> (article 76); (c) <i>debenture</i> (article 77); (d) <i>government and public security</i> (article 78); (e) <i>warrant</i> (article 79); (f) <i>certificate representing a certain security</i> (article 80); (g) <i>unit</i> (article 81); (h) <i>stakeholder pension scheme</i> (article 82); (i) <i>option</i> (article 83); (for the purposes of the <i>permission</i> regime, this is sub-divided into: (i) <i>option</i> (excluding a <i>commodity option</i> and an <i>option on a commodity future</i>); (ii) <i>commodity option</i> and an <i>option on a commodity future</i>); (j) <i>future</i> (article 84); (for the purposes of the <i>permission</i> regime, this is sub-divided into: (i) <i>future</i> (excluding a <i>commodity future</i> and a <i>rolling spot forex contract</i>); (ii) <i>commodity future</i> ; (iii) <i>rolling spot forex contract</i> ; (k) <i>contract for differences</i> (article 85); (for the purposes of the <i>permission</i> regime, this is sub-divided into: (i) <i>contract for differences</i> (excluding a <i>spread bet</i> and a <i>rolling spot forex contract</i>); (ii) <i>spread bet</i> ; (iii) <i>rolling spot forex contract</i> ; (l) <i>rights to or interests in investments</i> in (a) to (k) (article 89).
designated investment	any of the following activities specified in Part II of the <i>Regulated Activities Order</i> (Specified Activities) which is carried on by way of business:

business	<ul style="list-style-type: none"> (a) <i>dealing in investments as principal</i> (article 14), but disregarding the exclusion in article 15 (Absence of holding out etc); (b) <i>dealing in investments as agent</i> (article 21); (c) <i>arranging (bringing about) deals in investments</i> (article 25(1)), but only in relation to <i>designated investments</i>; (d) <i>making arrangements with a view to transactions in investments</i> (article 25(2)), but only in relation to <i>designated investments</i>; (e) <i>managing investments</i> (article 37); (f) <i>safeguarding and administering investments</i> (article 40); (for the purposes of the <i>permission</i> regime, this is sub-divided into: <ul style="list-style-type: none"> (i) <i>safeguarding and administration of assets (without arranging)</i>; (ii) <i>arranging safeguarding and administration of assets</i>; (g) <i>sending dematerialised instructions</i> (article 45(1)); (h) <i>causing dematerialised instructions to be sent</i> (article 45(2)); (i) <i>establishing, operating or winding up a collective investment scheme</i> (article 51(1)(a)); for the purposes of the <i>permission</i> regime, this is sub-divided into: <ul style="list-style-type: none"> (i) <i>establishing, operating or winding up a regulated collective investment scheme</i>; (ii) <i>establishing, operating or winding up an unregulated collective investment scheme</i>; (j) <i>acting as trustee of an authorised unit trust scheme</i> (article 51(1)(b)); (k) <i>acting as the depositary or sole director of an open-ended investment company</i> (article 51(1)(c)); (l) <i>establishing, operating or winding up a stakeholder pension scheme</i> (article 52); (m) <i>advising on investments</i> (article 53); for the purposes of the <i>permission</i> regime, this is sub-divided into: <ul style="list-style-type: none"> (i) <i>advising on investments (except pension transfers and pension opt-outs)</i>; (ii) <i>advising on pension transfers and pension opt-outs</i>; (n) <i>agreeing to carry on a regulated activity</i> in (a) to (h) and (m) (article 64).
designated investment exchange	any investment exchange appearing in the list at <i>IPRU(INV) 3 App 33, Part 2</i> .
EEA firm	<p>(in accordance with paragraph 5 of Schedule 3 to the <i>Act</i> (EEA Passport Rights)) any of the following, if it does not have its head office in the <i>United Kingdom</i>:</p> <ul style="list-style-type: none"> (a) an investment firm (as defined in article 1(2) of the <i>Investment Services Directive</i>) which is authorised (within the meaning of article 3) by its <i>Home State regulator</i>; (b) a <i>credit institution</i> which is authorised (within the meaning of article 1) by its <i>Home State regulator</i>; (c) a financial institution (as defined in article 1 of the <i>Banking Consolidation Directive</i>) which is a subsidiary of the kind mentioned in article 19 and which fulfils the conditions in articles 18 and 19; (d) an <i>undertaking</i> pursuing the activity of direct insurance (within the

	meaning of article 1 of the <i>First Life Directive</i> or of the <i>First Non-Life Directive</i>) which has received authorisation under article 6 from its <i>Home State regulator</i> .
EEA right	(in accordance with paragraph 7 of Schedule 3 to the <i>Act</i> (EEA Passport Rights)) the entitlement of a <i>person</i> to establish a <i>branch</i> or provide services in an <i>EEA State</i> other than that in which he has his head office: (a) in accordance with the <i>Treaty</i> as applied in the <i>European Economic Area</i> ; and (b) subject to the conditions of the relevant <i>Single Market Directive</i> .
EEA State	(in accordance with paragraph 8 of Schedule 3 to the <i>Act</i> (EEA Passport Rights)) a State which is a contracting party to the agreement on the European Economic Area signed at Oporto on 2 May 1992, as it has effect for the time being; as at 21 June 2001, the following are the <i>EEA States</i> : Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Liechtenstein, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden and the <i>United Kingdom</i> .
European Economic Area	the area established by the agreement on the European Economic Area signed at Oporto on 2 May 1992 and which consists of the <i>EEA States</i> .
evidential provision	a <i>rule</i> , contravention of which does not give rise to any of the consequences provided for by other provisions of the <i>Act</i> ; and which provides, in accordance with section 149(2) of the <i>Act</i> , that: (a) contravention may be relied on as tending to establish contravention of such other <i>rule</i> as may be specified; or (b) compliance may be relied on as tending to establish compliance with such other <i>rule</i> as may be specified; or (c) both (a) and (b).
exchange	a <i>recognised investment exchange</i> or <i>designated investment exchange</i> ;
exchange traded	listed or traded on a <i>recognised</i> or <i>designated investment exchange</i>
exempt person	(as defined in section 417(1) of the <i>Act</i> (Definitions)) (in relation to a <i>regulated activity</i>): a <i>person</i> who is exempt from the <i>general prohibition</i> in respect of that activity as a result of: (a) the <i>Exemption Order</i> ; or (b) being an <i>appointed representative</i> ; or (c) section 285(2) or (3) of the <i>Act</i> (Exemption for recognised investment exchanges and clearing houses).
Exemption Order	the Financial Services and Markets Act 2000 (Exemption) Order 2001 (SI 2001/1201).
exit charge	an amount levied by the <i>operator</i> of a <i>scheme</i> , together with any other expenses incurred, upon the redemption of <i>units</i> .
exposure	(in relation to a <i>firm</i>) the maximum loss which the <i>firm</i> might suffer if: (a) a counterparty or a <i>group</i> of connected counterparties fails to meet its obligations; or (b) the <i>firm</i> realises assets or off-balance sheet positions.
fee	any payment offered or made by a <i>client</i> to a <i>firm</i> in connection with <i>designated investment business</i> or with any other business of the <i>firm</i> , including (where applicable) any <i>mark-up</i> or <i>mark-down</i> .
financial adviser	an individual appointed by an <i>independent intermediary</i> or by its <i>appointed</i>

representative to provide any or all of the following services:

- (a) giving *advice on investments* to *clients*;
- (b) *arranging (bringing about) deals in investments* or *executing* transactions involving, in each case, *designated investments* with or for *clients*;
- (c) *managing investments*;
- (d) receiving or holding *client money* or other *client* assets;
- (e) *safeguarding and administering investments*.

financial institution	an <i>undertaking</i> , other than a <i>credit</i> institution, of which the <i>principal</i> activity is to acquire holdings or to carry on one or more of the activities listed in the annex to 2BCD;
Financial Ombudsman Service Limited	the <i>body corporate</i> established by the FSA under paragraph 2(1) of Schedule 17 to the Act (The Scheme Operator) to administer the <i>Financial Ombudsman Service</i> .
firm	an <i>authorised person</i> , but not a <i>professional firm</i> unless it is an authorised <i>professional firm</i> .
First Life Directive	the Council Directive of 5 March 1979 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct life assurance (No 79/267/EEC).
forward price	(in relation to <i>units</i>), a <i>price</i> calculated by reference to the <i>valuation point</i> next following the <i>authorised fund manager's</i> agreement to <i>sell</i> or, as the case may be, to <i>redeem</i> the <i>units</i> in question.
friendly society	an <i>incorporated friendly society</i> or a <i>registered friendly society</i> .
FSA	the Financial Services Authority.
future	the <i>investment</i> , specified in article 84 of the <i>Regulated Activities Order</i> (Futures), which is, in summary: rights under a contract for the sale of a <i>commodity</i> or property of any other description under which delivery is to be made at a future date and at a price agreed on when the contract is made.
geared futures and options scheme	an <i>authorised fund dedicated to derivatives</i> (where most or all of the extent of the <i>investment</i> is limited by the amount of property available to put up as <i>initial outlay</i>), whether with or without <i>transferable securities</i> .
government and public security	the <i>investment</i> , specified in article 78 of the <i>Regulated Activities Order</i> (Government and public securities) which is in summary: a loan stock, bond or other instruments creating or acknowledging indebtedness, issued by or on behalf of any of the following: <ul style="list-style-type: none">(a) the government of the <i>United Kingdom</i>; or(b) the Scottish Administration; or(c) the Executive Committee of the Northern Ireland Assembly; or(d) the National Assembly of Wales; or(e) the government of any country or territory outside the <i>United Kingdom</i>; or(f) a local authority in the <i>United Kingdom</i> or elsewhere; or(g) a body the members of which comprise:<ul style="list-style-type: none">(i) states including the <i>United Kingdom</i> or another <i>EEA State</i>; or(ii) bodies whose members comprise states including the <i>United Kingdom</i> or another <i>EEA State</i>; but excluding: <ul style="list-style-type: none">(A) the instruments specified in article 77(2)(a) to (d) of the <i>Regulated</i>

Activities Order;

- (B) any instrument creating or acknowledging indebtedness in respect of:
- (I) money received by the Director of Savings as *deposits* or otherwise in connection with the business of the National Savings Bank; or
 - (II) money raised under the National Loans Act 1968 under the auspices of the *Director* of Savings or treated as so raised under section 11(3) of the National Debt Act 1972.

group

(as defined in section 421 of the *Act* (Group)) (in relation to a *person* ("A")) A and any *person* who is:

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

in this definition:

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

(see also *immediate group*)

guidance

guidance given by the FSA under the *Act*.

habitual residence

- (a) if the *policyholder* is an individual, the address given by the *policyholder* as his residence if it reasonably appears to be a residential address and there is no evidence to the contrary;
- (b) if the *policyholder* is not an individual or a *group* of individuals, the State in which the *policyholder* has its place of establishment, or, if it has more than one, its relevant place of establishment;
- (c) in respect of the variation of a *life policy*, or the purchase of a *pension annuity* related to a *life policy*, unless there is evidence to the contrary, the habitual residence of the *policyholder* at the date on which the *policyholder* signed the proposal for the *life policy*.

higher volatility fund

a *regulated collective investment scheme* which is:

- (a) a *geared futures and options scheme*, a *geared securities scheme* or a *warrant scheme*;
- (b) a *fund of funds scheme* of which one or more of the *schemes* to which it is *dedicated* falls within (a); or
- (c) an *umbrella scheme*, a *sub-fund* of which, if it were a separate fund, would fall within (a).

holding company	(as defined in section 736(1) of the <i>Companies Act 1985</i> ("Subsidiary", "holding company" and "wholly-owned subsidiary)) (in relation to another <i>body corporate</i> ("S")) a <i>body corporate</i> which: <ul style="list-style-type: none"> (a) holds a majority of the voting rights in S; or (b) is a member of S and has the right to appoint or remove a majority of its board of directors; or (c) is a member of S and controls alone, under an agreement with other shareholders and members, a majority of the voting rights in S.
incoming EEA firm	(in accordance with section 193(1)(a) of the <i>Act</i>) an <i>EEA firm</i> which is exercising, or has exercised, its right to carry on a <i>regulated activity</i> in the <i>United Kingdom</i> in accordance with Schedule 3 to the <i>Act</i> (EEA Passport Rights).
incoming Treaty firm	(in accordance with section 193(1)(b) of the <i>Act</i> (interpretation of this Part)) a <i>Treaty firm</i> which is exercising, or has exercised, its right to carry on a <i>regulated activity</i> in the <i>United Kingdom</i> in accordance with Schedule 4 to the <i>Act</i> (Treaty rights).
incorporated friendly society	a society incorporated under the Friendly Societies Act 1992.
independent intermediary	a <i>firm</i> acting as an intermediary but excluding: <ul style="list-style-type: none"> (a) a <i>firm</i> which is a member of a <i>marketing group</i>; (b) a <i>product provider</i> which <i>sells</i> its own <i>packaged products</i>.
industrial assurance policy	a <i>policy</i> of industrial assurance, as defined in the Industrial Assurance Act 1923.
initial margin	the amount which under the rules of the relevant exchange or <i>clearing house</i> the <i>firm</i> or an <i>intermediate broker</i> would be required to deposit in cash as a fidelity deposit in respect of all the <i>client's</i> open positions in <i>margined transactions</i> at that time, irrespective of any unrealised profit or loss on such positions, on the assumption that those transactions were the only transactions undertaken under the rules of that exchange or that <i>clearing house</i> by the <i>firm</i> or the <i>intermediate broker</i> at that time.
insurance business	the business of <i>effecting</i> or <i>carrying out contracts of insurance</i> .
Insurance Directives	the <i>First Life Directive</i> , <i>Second Life Directive</i> and <i>Third Life Directive</i> and the <i>First Non-Life Directive</i> , <i>Second Non-Life Directive</i> and <i>Third Non-Life Directive</i> .
insurance undertaking	an undertaking, whether or not an <i>insurer</i> , which carries on <i>insurance business</i> .
insurer	a <i>firm</i> with <i>permission</i> to <i>effect</i> or <i>carry out contracts of insurance</i> (other than a <i>bank</i>).
intermediate broker	(in relation to a transaction in a <i>contingent liability investment</i>) any <i>person</i> acting in the capacity of an intermediary through whom the <i>firm</i> undertakes that transaction.
intermediate customer	a <i>client</i> who is not a <i>market counterparty</i> and who is: <ul style="list-style-type: none"> (a) a local authority or public authority; (b) a <i>body corporate</i> whose <i>shares</i> have been <i>listed</i> or <i>admitted to trading</i> on any <i>EEA</i> exchange; (c) a <i>body corporate</i> whose <i>shares</i> have been <i>listed</i> or <i>admitted to trading</i> on the primary board of any <i>IOSCO</i> member country official exchange; (d) a <i>body corporate</i> (including a <i>limited liability partnership</i>) which has (or

any of whose *holding companies* or *subsidiaries* has) (or has had at any time during the previous two years) called up share capital or net assets of at least £5 million (or its equivalent in any other currency at the relevant time);

- (e) a *special purpose vehicle*;
- (f) a *partnership* or unincorporated association which has (or has had at any time during the previous two years) net assets of at least £5 million (or its equivalent in any other currency at the relevant time) and calculated in the case of a limited *partnership* without deducting loans owing to any of the *partners*;
- (g) a trustee of a trust (other than an *occupational pension scheme*, *SSAS* or *stakeholder pension scheme*) which has (or has had at any time during the previous two years) assets of at least £10 million (or its equivalent in any other currency at the relevant time) calculated by aggregating the value of the cash and *designated investments* forming part of the trust's assets, but before deducting its liabilities;
- (h) a trustee of an *occupational pension scheme*, *SSAS* or *stakeholder pension scheme* where the trust has (or has had at any time during the previous two years):
 - (i) at least 50 members; and
 - (ii) assets under management of at least £10 million (or its equivalent in any other currency at the relevant time);
- (i) another *firm*, or an *overseas financial services institution*, when, in relation to *designated investment business*, or related *ancillary activities*, conducted with or for that *firm* or institution, that *firm* or institution is an *intermediate customer* in accordance with *COB 4.1.7R* (Classification of another firm or an overseas financial services institution);
- (j) an *unregulated collective investment scheme*;
- (k) a *client* when he is classified as an *intermediate customer* in accordance with *COB 4.1.9R* (Expert private customer classified as intermediate customer);

but excluding:

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

introducer	an individual appointed by a <i>provider firm</i> or by an <i>appointed representative</i> of such a <i>firm</i> , to carry out in the course of <i>designated investment business</i> either or both of the following activities: <ul style="list-style-type: none">(a) effecting introductions;(b) distributing <i>non-real time financial promotions</i>.
investment	(in accordance with sections 22(4) and 397(13) (Miscellaneous offences) of the <i>Act</i>) any investment, including any asset, right or interest.
investment company with variable capital	a body incorporated under the <i>OEIC Regulations</i> .

investment firm	any legal person the regular occupation or business of which is the provision of <i>core investment services</i> for third parties on a professional basis, as defined in article 1(2) of the <i>ISD</i> , and in relation to a person with his head office in an <i>EEA State</i> a <i>person</i> , who is not a legal person, included as an <i>investment firm</i> by his or its <i>Home State</i> . (See also <i>ISD investment firm</i> .)
investment management firm	<p>a <i>firm</i> whose <i>permitted activities</i> include <i>designated investment business</i>, which is not a <i>bank</i>, <i>building society</i>, <i>credit union</i>, <i>friendly society</i>, <i>ICVC</i>, <i>insurer</i>, <i>media firm</i>, <i>authorised professional firm</i>, <i>service company</i>, <i>incoming EEA firm</i> (without a <i>top-up permission</i>), <i>incoming Treaty firm</i> (without a <i>top-up permission</i>) or <i>UCITS qualifier</i> (without a <i>top up permission</i>), whose <i>permission</i> does not include a <i>requirement</i> that it comply with <i>IPRU(INV) 3</i> or <i>10</i> (Securities and futures firms) or <i>13</i> (Personal investment firms) and which is within (a), (b) or (c):</p> <p>(a) a <i>firm</i>:</p> <ul style="list-style-type: none"> (i) which was a member of <i>IMRO</i> immediately before <i>commencement</i>; and (ii) which was not, immediately before <i>commencement</i>, subject to the financial supervision requirements of the <i>FSA</i> (under section 43 of the Financial Services Act 1986), <i>PIA</i> or <i>SFA</i> under lead regulation arrangements; <p>(b) a <i>firm</i> whose <i>permission</i> includes a <i>requirement</i> that it comply with <i>IPRU(INV) 5</i> (Investment management firms);</p> <p>(c) a <i>firm</i>:</p> <ul style="list-style-type: none"> (i) which was given a <i>Part IV permission</i> on or after <i>commencement</i>, or which was authorised under section 25 of the Financial Services Act 1986 immediately before <i>commencement</i> and was not a member of <i>IMRO</i>, <i>PIA</i> or the <i>SFA</i>; and (ii) for whom the most substantial part of its gross income, including <i>commissions</i>, from the <i>regulated activities</i> included in its <i>Part IV permission</i> is derived from one or more of the following activities (based, for a <i>firm</i> given a <i>Part IV permission</i> after <i>commencement</i>, on the business plan submitted as part of the <i>firm's</i> application or, for a <i>firm</i> authorised under section 25 of the Financial Services Act 1986, on the <i>firm's financial year</i> preceding its <i>authorisation</i> under the <i>Act</i>): <ul style="list-style-type: none"> (A) <i>managing investments</i> other than for <i>private customers</i> or where the assets managed are primarily <i>derivatives</i>; (B) <i>OPS activity</i>; (C) acting as the <i>manager</i> or <i>trustee</i> of an <i>AUT</i>; (D) acting as the <i>ACD</i> or <i>depository</i> of an <i>ICVC</i>; (E) <i>establishing, operating or winding up a collective investment scheme</i> (other than an <i>AUT</i> or <i>ICVC</i>); and (F) <i>safeguarding and administering investments</i>.
investment manager	<p>a <i>person</i> who, acting only on behalf of a <i>client</i>:</p> <ul style="list-style-type: none"> (a) manages <i>designated investments</i> in an account or portfolio on a discretionary basis under the terms of a discretionary management agreement; or (b) manages <i>designated investments</i> in an account or portfolio on a non-discretionary basis under the terms of a <i>non-discretionary management agreement</i>.

investment service	a <i>core investment service</i> or <i>non-core investment service</i> .
Investment Services Directive	the Council Directive of 10 May 1993 on investment services in the securities field (No 93/22/EEC).
investment trust	a <i>company listed</i> in the <i>United Kingdom</i> or another <i>EEA State</i> which: <ul style="list-style-type: none"> (a) is approved by the Inland Revenue Commissioners under section 842 of the Income and Corporation Taxes Act 1988 (or, in the case of a newly formed <i>company</i>, has declared its intention to conduct its affairs so as to obtain such approval); or (b) is resident in an <i>EEA State</i> other than the <i>United Kingdom</i> and would qualify for such approval if resident and <i>listed</i> in the <i>United Kingdom</i>.
investment trust savings scheme	(a) a <i>dealing</i> service (whether or not held within a <i>pension contract</i>) dedicated to the <i>securities</i> of a particular <i>investment trust</i> , or of <i>investment trusts</i> within a particular <i>marketing group</i> ; (b) <i>securities</i> to be acquired through an investment trust savings scheme in (a).
IPRU(INV)	the Interim Prudential sourcebook for investment businesses.
ISD investment firm	an <i>investment firm</i> that has its registered office (or, if it has no registered office, its head office) in an <i>EEA State</i> : <ul style="list-style-type: none"> (a) excluding a <i>person</i> to whom the <i>ISD</i> does not apply under article 2(2) of the <i>ISD</i>; but (b) including a <i>BCD credit institution</i> whose <i>Home State authorisation</i> includes a <i>core investment service</i>.
large exposure	any <i>exposure</i> to another <i>person</i> , or to two or more <i>affiliated persons</i> , which equals or exceeds 10 per cent. of the <i>firm's</i> own funds;
lead regulated firm	a <i>firm</i> which is the subject of the financial supervision requirements of an <i>overseas regulator</i> in accordance with an agreement between the <i>FSA</i> and that regulator relating to the financial supervision of <i>firms</i> whose head office is within the country of that regulator.
life policy	(in accordance with the definition of "qualifying contract of insurance" in article 3(1) of the <i>Regulated Activities Order</i>) a <i>long-term insurance contract</i> (which includes a <i>pension policy</i>) other than a reinsurance contract and a <i>pure protection contract</i> .
linked benefit	a benefit payable under a <i>life policy</i> or a <i>regulated collective investment scheme</i> the amount of which is determined by reference to: <ul style="list-style-type: none"> (a) the value of the property of any description (whether specified or not); or (b) fluctuations in the value of any such property; or (c) income from such property; or (d) fluctuations in an index of the value of such property.
listed activity	an activity listed in Annex 1 to the <i>Banking Consolidation Directive</i> .
Listing Rules	the <i>rules</i> made by the <i>UKLA</i> governing admission to <i>listing</i> , the continuing obligations of <i>issuers</i> , the enforcement of those obligations and the suspension and cancellation of <i>listing</i> .
long-term insurance contract	(in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation: general)) any <i>contract of insurance</i> within Part II of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of long-term insurance), namely: <ul style="list-style-type: none"> (a) <i>life and annuity</i> (paragraph I);

	<ul style="list-style-type: none"> (b) <i>marriage and birth</i> (paragraph II); (c) <i>linked long-term</i> (paragraph III); (d) <i>permanent health</i> (paragraph IV); (e) <i>tontines</i> (paragraph V); (f) <i>capital redemption</i> (paragraph VI); (g) <i>pension fund management</i> (paragraph VII); (h) <i>collective insurance</i> etc (paragraph VIII); (i) <i>social insurance</i> (paragraph IX).
long-term insurer	an <i>insurer</i> with <i>permission</i> to <i>effect</i> or <i>carry out long-term insurance contracts</i> .
low resource firm	a <i>Category B3 firm</i> which is not a <i>network</i> , has fewer than 26 <i>financial advisers</i> or <i>representatives</i> and is not <i>permitted</i> to carry on discretionary portfolio management or to delegate such activities to an <i>investment firm</i> ;
making arrangements with a view to transactions in investments	<p>the <i>regulated activity</i>, specified in article 25(2) of the <i>Regulated Activities Order</i> (Arranging deals in investments), which is, in summary: making arrangements with a view to a <i>person</i> who participates in the arrangements <i>buying, selling, subscribing for or underwriting</i> any of the following <i>investments</i> (whether as <i>principal</i> or agent):</p> <ul style="list-style-type: none"> (a) a <i>designated investment</i>; (b) the <i>underwriting capacity of a Lloyd's syndicate</i>; (c) <i>membership of a Lloyd's syndicate</i>; (d) <i>rights to or interests in investments</i> in (b) or (c).
managing investments	<p>the <i>regulated activity</i>, specified in article 37 of the <i>Regulated Activities Order</i> (Managing investments), which is, in summary: managing assets belonging to another <i>person</i> in circumstances which involve the exercise of discretion if:</p> <ul style="list-style-type: none"> (a) the assets consist of or include any <i>designated investment</i>; or (b) the arrangements for their management are such that the assets may consist of or include such <i>investments</i>, and either the assets have at any time since 29 April 1988 done so, or the arrangements have at any time (whether before or after that date) been held out as arrangements under which the assets would do so.
market maker	(in relation to an <i>investment</i>) a <i>person</i> who (otherwise than in his capacity as the <i>operator of a regulated collective investment scheme</i>) holds himself out as able and willing to enter into transactions of sale and purchase in <i>investments</i> of that description at prices determined by him generally and continuously rather than in respect of each particular transaction.
market value	the market value as determined in accordance with <i>United Kingdom</i> generally accepted accounting practice.
marketable debt instrument	a <i>debt instrument</i> which is a <i>marketable investment</i> ;
marketable investment	<ul style="list-style-type: none"> (a) an <i>investment</i> which is traded on or under the rules of an exchange; (b) a debt instrument which may be transferred without the consent of the <i>issuer</i> or any other <i>person</i> (including a collateralised mortgage obligation); (c) a <i>commodity</i>; (d) a <i>warrant, option, future</i> or other instrument which entitles the holder to subscribe for or acquire:

- (i) an *investment* or *commodity* in (a) to (c); or
 - (ii) any currency; or
 - (iii) any combination of (i) and (ii);
- (e) a *contract for differences* (including interest rate and currency swaps) relating to fluctuations in:
- (i) the value or price of an *investment* or *commodity* in (a) to (d); or
 - (ii) any currency; or
 - (iii) the rate of interest in any currency or any index of such rates; or
 - (iv) the level of any index which is derived from the prices of an *investment* or *commodity* in (a) to (c); or
 - (v) any combination of (i) to (iv);
- (f) *warrants, options, futures* or other instruments entitling the holder to obtain the rights of those contracts in (d) or (e);
- (g) a *unit* in a *regulated collective investment scheme*.

market maker (in relation to an *investment*), a *person* who (otherwise than in his capacity as the *operator* of a *regulated collective investment scheme*) holds himself out as able and willing to enter into transactions of sale and purchase in *investments* of that description at prices determined by him generally and continuously rather than in respect of each particular transaction.

marketing group a group of *persons* who:

- (a) are allied together (either formally or informally) for purposes of marketing *packaged products* of the marketing group; and
- (b) each of whom, if it holds itself out in the *United Kingdom* as marketing *packaged products* to *private customers*, does so only as an *investment manager* or in relation to *packaged products* of the marketing group.

marketing group associate a *firm* other than a *product provider* which is a member of a *marketing group*.

material current year losses losses of an amount equal to 10 per cent or more of the amount by which the own funds of an *undertaking* exceed the own funds needed to meet financial resources test 1 as prescribed in chapter 13;

money-market instrument any of the following *investments*:

- (a) a *debenture* which is issued on terms requiring repayment not later than five years from the date of issue;
- (b) any *government and public security* which is issued on terms requiring repayment not later than one year or, if issued by a local authority in the *United Kingdom*, five years from the date of *issue*;
- (c) a *warrant* which entitles the holder to subscribe for an *investment* within (a) or (b);
- (d) a *certificate representing certain securities* or *rights to or interests in investments* relating, in either case, to an *investment* within (a) or (b);
- (e) an *option* relating to:
 - (i) an instrument in (a) or (b); or
 - (ii) currency of the *United Kingdom* or of any other country or territory; or
 - (iii) gold or silver;
- (f) a *future* for the sale of:

	(i) an instrument in (a) or (b); or
	(ii) currency of the <i>United Kingdom</i> or of any other country or territory; or
	(iii) gold or silver;
	(g) a <i>contract for differences</i> by reference to fluctuations in:
	(i) the value or price of any instrument within any of (a) to (f); or
	(ii) currency of the <i>United Kingdom</i> or of any other country or territory; or
	(iii) the rate of interest on loans in any such currency or any index of such rates;
	(h) an <i>option</i> to acquire or dispose of an instrument within (e),(f) or (g).
money-purchase benefits	(in relation to an <i>occupational pension scheme</i>) benefits the rate or amount of which are calculated by reference to a payment or payments made by a member of the scheme.
net current assets	the total, at a particular date, of all assets which are not intended for use on a continuing basis in the <i>firm's</i> business (i.e. current assets), less all the liabilities payable within 12 months of that date
net long position	the situation in which a <i>firm</i> holds or will hold more <i>units in a investment</i> than it has contracted to <i>sell</i> or, in respect of <i>options</i> , where it has bought rights which exceed rights sold;
net open foreign currency position	a <i>firm's net long position</i> or <i>net short position</i> , whichever is the higher, in a currency other than that in which the <i>firm's</i> books of account are maintained, calculated in accordance with the appropriate <i>rules</i> in chapter 13;
net short position	the situation in which a <i>firm</i> has contracted to <i>sell</i> more of an <i>investment</i> than it holds or will hold or, in respect of <i>options</i> , where it has sold rights which exceed the rights bought;
network	an <i>independent intermediary</i> : (a) which has five or more <i>appointed representatives</i> ; or (b) whose <i>appointed representatives</i> (being fewer than five) have, between them, 26 or more <i>financial advisers</i> .
nominee company	a <i>body corporate</i> whose business consists solely of acting as a nominee holder of <i>investments</i> or other property.
occupational pension scheme	(as specified in article 3(1) of the <i>Regulated Activities Order</i> (Interpretation: general)) any scheme or arrangement which is comprised in one or more instruments or agreements and which has, or is capable of having, effect in relation to one or more descriptions or categories of employment so as to provide benefits, in the form of pensions or otherwise, payable on termination of service, or on death or retirement, to or in respect of earners with a qualifying service in an employment of any such description or category.
OEIC	<i>open-ended investment company</i> . (see also <i>ICVC</i>).
offer price	the price at which a <i>person</i> could purchase or <i>unit</i> in a dual priced <i>AUT</i> or a <i>security</i> .
Ombudsman	a <i>person</i> appointed to the panel of <i>persons</i> maintained by the <i>FOS Ltd</i> to determine complaints, including the Chief Ombudsman.
on-exchange	(a) (in relation to a transaction in the <i>United Kingdom</i>) effected by means of the <i>facilities</i> of, or governed by the <i>rules</i> of, an <i>RIE</i> or a <i>regulated</i>

	<i>market.</i>
	(b) (in relation to any other transaction) effected by means of the <i>facilities</i> of, or governed by the rules of, an exchange.
open-ended investment company	(as defined in section 236 of the <i>Act</i> (Open-ended investment companies)), a <i>collective investment scheme</i> which satisfies both the property condition and the investment condition: <ul style="list-style-type: none"> (a) the property condition is that the property belongs beneficially to, and is managed by or on behalf of, a body corporate ("BC") having as its purpose the investment of its funds with the aim of: <ul style="list-style-type: none"> (i) spreading investment risk; and (ii) giving its members the benefit of the results of the management of those funds by or on behalf of that body; (b) the investment condition is that, in relation to BC, a reasonable investor would, if he were to participate in the <i>scheme</i>: <ul style="list-style-type: none"> (i) expect that he would be able to realise, within a period appearing to him to be reasonable, his investment in the <i>scheme</i> (represented, at any given time, by the value of shares in, or securities of, BC held by him as a <i>participant</i> in the <i>scheme</i>); and (ii) be satisfied that his investment would be realised on a basis calculated wholly or mainly by reference to the value of property in respect of which the <i>scheme</i> makes arrangements. <p>(see also <i>investment company with variable capital</i>)</p>
open-market option	the option to apply: <ul style="list-style-type: none"> (a) the proceeds of a <i>pension policy</i> or <i>pension contract</i>; or (b) the proceeds of a <i>money-purchase occupational scheme</i> for a particular occupational scheme member; <p>to purchase an annuity on the open market from a <i>life office</i>.</p>
option	the <i>investment</i> specified in article 77 of the <i>Regulated Activities Order</i> (Options), which is an option to acquire or dispose of: <ul style="list-style-type: none"> (a) a <i>designated investment</i> (other than an option); (b) currency of the <i>United Kingdom</i> or of any other country or territory; (c) palladium, platinum, gold or silver; or (d) an option to acquire or dispose of an option specified in (a), (b) or (c).
OTC	<i>over the counter.</i>
over the counter	(in relation to a transaction in an <i>investment</i>) not <i>on-exchange</i> .
overseas firm	a <i>firm</i> which has its <i>registered</i> office (or, if it has no <i>registered</i> office, its head office) outside the <i>United Kingdom</i> .
overseas introducing broker	a <i>person</i> , who is not an <i>authorised person</i> : <ul style="list-style-type: none"> (a) who is resident outside the <i>United Kingdom</i>; and (b) who introduces transactions relating to <i>designated investments arranged (brought about)</i> for its <i>clients</i> to a <i>clearing firm</i> in the <i>United Kingdom</i>.
overseas person	(in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation: general)) a <i>person</i> who: <ul style="list-style-type: none"> (a) carries on any of the following <i>regulated activities</i>:

	<ul style="list-style-type: none"> (i) <i>dealing in investments as principal;</i> (ii) <i>dealing in investments as agent;</i> (iii) <i>arranging (bringing about) deals in investments;</i> (iv) <i>making arrangements with a view to transactions in investments;</i> (v) <i>managing investments;</i> (vi) <i>safe custody and administering investments;</i> (vii) <i>sending dematerialised instructions;</i> (viii) <i>causing dematerialised instructions to be sent;</i> (ix) <i>establishing, operating or winding up a collective investment scheme;</i> (x) <i>acting as trustee of an authorised unit trust scheme;</i> (xi) <i>acting as the depositary or sole director of an open-ended investment company;</i> (xii) <i>establishing, operating or winding up a stakeholder pension scheme;</i> (xiii) <i>advising on investments;</i> (xiv) <i>agreeing to carry on those regulated activities, disregarding the exclusion in article 72 of the Regulated Activities Order (Overseas persons); but</i>
	(b) does not carry on any such activities, or offer to do so, from a permanent place of business maintained by him in the <i>United Kingdom</i> .
overseas regulator	(as defined in section 195(3) of the <i>Act</i> (Exercise of power in support of overseas regulator)) an authority in a country or territory outside the <i>United Kingdom</i> : <ul style="list-style-type: none"> (a) which is a <i>Home State regulator</i>; or (b) which exercises any of the following functions: <ul style="list-style-type: none"> (i) a function corresponding to any function of the <i>FSA</i> under the <i>Act</i>; (ii) a function corresponding to any function exercised by the <i>FSA</i> in its capacity as <i>competent authority</i> in relation to the listing of securities; (iii) a function corresponding to any function exercised by the Secretary of State under the Companies Act 1985; (iv) a function in connection with the investigation of conduct of the kind prohibited by Part V of the Criminal Justice Act 1993 (Insider Dealing), or with the enforcement of rules (whether or not having the force of law) relating to such conduct; (v) a function prescribed by regulations made for the purposes of section 195(4) of the <i>Act</i> (Exercise of powers) which, in the opinion of the Treasury, relates to companies or financial services.
own account order	an order which relates to an <i>own account transaction</i> .
own account transaction	a transaction <i>executed</i> by the <i>firm</i> for its own benefit or for the benefit of its <i>associate</i> .
packaged product	<ul style="list-style-type: none"> (a) a <i>life policy</i>; (b) a <i>unit</i> in a <i>regulated collective investment scheme</i>; (c) an interest in an <i>investment trust savings scheme</i>; (d) a <i>stakeholder pension scheme</i>;

whether or not (in the case of (a), (b) or (c)) held within a *PEP* or an *ISA*.

parent undertaking

(in accordance with section 420 of the *Act* (Parent and subsidiary undertaking) and section 258 of the Companies Act 1985 (Parent and subsidiary undertakings)):

- (1) (in relation to whether an *undertaking* (other than an *incorporated friendly society* is a parent undertaking) an *undertaking* which has the following relationship to another *undertaking* ("S")):
 - (a) it holds a majority of the voting rights in S; or
 - (b) it is a member of S and has the right to appoint or remove a majority of its board of directors; or
 - (c) it has the right to exercise a dominant influence over S through:
 - (i) provisions contained in S's memorandum or articles; or
 - (ii) a control contract;
 - (d) it is a member of S and controls alone, under an agreement with other shareholders or members, a majority of the voting rights in S; or
 - (e) it has a participating interest (as defined in section 260 of the Companies Act 1985) (Participating interests) in S; and
 - (i) actually exercises a dominant influence over S; or
 - (ii) it and S are managed on a unified basis; or
 - (f) it is a *parent undertaking* of a *parent undertaking* of S;
 - (g) (except in *REC* and *LLD*) it is an individual and would be a *parent undertaking* if it were an *undertaking*; or
 - (h) (except in *REC* and *LLD*) it is incorporated in or formed under the law of another *EEA State* and is a parent undertaking within the meaning of any rule of law in that State for purposes connected with implementation of the *Seventh Company Law Directive*;

in relation to (b) and (d), the *undertaking* will be treated as a member of S if any of its *subsidiary undertakings* is a member of S, or if any shares in S are held by a person acting on behalf of the *undertaking* or any of its *subsidiary undertakings*;

the provisions of Schedule 10A to the Companies Act 1985 (Parent and subsidiary undertakings: supplementary provisions) explain the expressions used in and supplement paragraphs (a) to (f);

- (2) (in relation to whether an *incorporated friendly society* is a *parent undertaking*) an *incorporated friendly society* which has the following relationship to a *body corporate* ("S")):
 - (a) it holds a majority of the voting rights in S; or
 - (b) it is a *member* of S and has the right to appoint or remove a majority of S's board of directors; or
 - (c) it is a member of S and controls alone, under an agreement with other shareholders or members, a majority of the voting rights in S.
 - (d) it is the parent undertaking of a body corporate which has the relationship in (a), (b) or (c) to S..

penny share

a *readily realisable security* in relation to which the bid-offer spread is 10 per cent or more of the offer price, but not:

	(a) a <i>government and public security</i> ; or
	(b) a <i>share</i> in a <i>company</i> quoted on The Financial Times Stock Exchange 100 Index; or
	(c) a <i>security</i> issued by a <i>company</i> which, at the time that the <i>firm deals</i> or recommends to the <i>client</i> to <i>deal</i> in the <i>investment</i> , has a market capitalisation of £100 million or more (or its equivalent in any other currency at the relevant time).
pension annuity	an <i>investment</i> purchased with the sums derived from the vesting (partial or full) of a <i>pension policy</i> or <i>pension contract</i> , for the purposes of securing the beneficiary's entitlement to immediate or <i>future benefits</i> .
pension buy-out contract	an annuity contract which complies with paragraph (g) of section 591(2) of the Income and Corporation Taxes Act 1988.
pension contract	a contract under which rights to benefits are obtained by the making of contributions to an <i>occupational pension scheme</i> or to a <i>personal pension scheme</i> , where the contributions are paid to a <i>regulated collective investment scheme</i> .
pension opt-out	a transaction resulting from a decision made, with or without advice from a <i>firm</i> , by a <i>customer</i> who is an individual, to: <ul style="list-style-type: none"> (a) opt out of an <i>occupational pension scheme</i> of which he is a current member; or (b) decline to become a member of an <i>occupational pension scheme</i> which he is eligible to join or which he will become eligible to join at the end of a waiting period; in favour of a <i>stakeholder pension scheme</i> or a <i>personal pension scheme</i> (including a self-invested <i>personal pension scheme</i>).
pension policy	a contract under which a right to benefits results from contributions made to an <i>occupational pension scheme</i> or to a <i>personal pension scheme</i> , where the contributions are paid to a <i>long-term insurer</i> .
pension scheme	a scheme under which a right to benefits results from contributions made under a <i>pension contract</i> or <i>pension policy</i> .
pension transfer	a transaction resulting from a decision made, with or without advice from a <i>firm</i> , by a <i>customer</i> who is an individual, to transfer deferred benefits from: <ul style="list-style-type: none"> (a) an <i>occupational pension scheme</i>; or (b) an <i>individual pension contract</i> providing fixed or guaranteed benefits that replaced similar benefits under a <i>defined benefits pension scheme</i>; to a <i>stakeholder pension scheme</i> or a <i>personal pension scheme</i> (including a self-invested <i>personal pension scheme</i>).
PEP	a <i>personal equity plan</i> .
PEP manager	the <i>plan manager</i> of a <i>PEP</i> .
PEP transfer	a transaction resulting from a decision, made with or without advice from a <i>firm</i> , by a <i>customer</i> who is an individual, to transfer the <i>investments</i> (or their value) held in his existing <i>PEP</i> in favour of another <i>PEP</i> which may or may not be managed by the same <i>PEP manager</i> .
permitted activity	a <i>regulated activity</i> which a <i>firm</i> has <i>permission</i> to carry on.
permitted third party	a third party who is: <ul style="list-style-type: none"> (a) an <i>authorised person</i>; or (b) an <i>exempt person</i> for whom an <i>authorised person</i> is accepting

	responsibility; or
	(c) a <i>person</i> lawfully carrying on a <i>regulated activity</i> in another <i>EEA State</i> .
person	(in accordance with the Interpretation Act 1978) any person, including a body of persons corporate or unincorporate (that is, a natural person, a legal person, and, for example, a <i>partnership</i>).
personal equity plan	a scheme of investment satisfying the conditions prescribed in regulations made by the Treasury under section 333 of the Income and Corporation Taxes Act 1988 (the Personal Equity Plan Regulations 1989).
personal investment firm	a <i>firm</i> whose <i>permitted activities</i> include <i>designated investment business</i> , which is not an <i>authorised professional firm</i> , <i>bank</i> , <i>building society</i> , <i>credit union</i> , <i>friendly society</i> , <i>ICVC</i> , <i>insurer</i> , <i>media firm</i> , <i>service company</i> , <i>incoming EEA firm</i> (without a <i>top-up permission</i>), <i>incoming Treaty firm</i> (without a <i>top-up permission</i>) or <i>UCITS qualifier</i> , whose <i>permission</i> does not include a <i>requirement</i> that it comply with <i>IPRU(INV) 3</i> (Securities and futures firms), 5 (Investment management firms) or 10 (Securities and futures firms), and which is within (a), (b) or (c): (a) a <i>firm</i> : (i) which was a member of <i>PIA</i> immediately before <i>commencement</i> ; and (ii) which was not, immediately <i>before commencement</i> , <i>subject to the financial supervision</i> requirements of the <i>FSA</i> (under section 43 of the Financial Services Act 1986), <i>IMRO</i> or <i>SFA</i> under lead regulation arrangements; (b) a <i>firm</i> whose <i>permission</i> includes a <i>requirement</i> that it comply with <i>IPRU(INV) 13</i> (Personal investment firms); (c) a <i>firm</i> : (i) which was given a <i>Part IV permission</i> after <i>commencement</i> , or which was authorised under section 25 of the Financial Services Act 1986 immediately before <i>commencement</i> and not a member of <i>IMRO</i> , <i>PIA</i> or <i>SFA</i> ; and (ii) for whom the most substantial part of its gross income, including <i>commissions</i> , from the <i>regulated activities</i> included in its <i>Part IV permission</i> is derived from one or more of the following activities (based, for a <i>firm</i> given a <i>Part IV permission</i> after <i>commencement</i> , on the business plan submitted as part of the <i>firm's</i> application or, for a <i>firm</i> authorised under section 25 of the Financial Services Act 1986, on the <i>firm's financial year</i> preceding its <i>authorisation</i> under the Act): (A) <i>advising on investments</i> , or <i>arranging (bringing about) deals in investments</i> , in relation to <i>packaged products</i> ; and (B) <i>managing investments</i> for <i>private customers</i> .
personal pension contract	a <i>pension contract</i> under which contributions (single or regular) are paid to a <i>personal pension scheme</i> .
personal pension policy	a <i>pension policy</i> under which contributions (single or regular) are paid to a <i>personal pension scheme</i> .
personal pension scheme	a scheme of investment in accordance with section 630 of the Income and Corporation Taxes Act 1988.
PIA	the Personal Investment Authority Limited.
plan manager	in relation to: (a) a <i>group personal equity plan</i> , the plan manager of that plan in

	accordance with the Personal Equity Plan Regulations 1989;
	(b) a <i>group ISA</i> , the <i>ISA manager</i> ;
	(c) a <i>group savings plan</i> , the <i>person</i> primarily responsible for that <i>group savings plan</i> .
premium	<p>(1) (in relation to a <i>general insurance contract</i>) the consideration payable under the contract by the <i>policyholder</i> to the <i>insurer</i>.</p> <p>(2) (in relation to a <i>long-term insurance contract</i>) a payment under the contract (except in SUP 16.8 (Persistency reports from insurers)); a premium is a regular premium if it is one of a series of payments under the contract:</p> <p>(a) (i) which are payable on dates that are certain or ascertainable at the time the contract is made;</p> <p>(ii) which are payable over a period that exceeds one year in length; and</p> <p>(iii) assuming the <i>policy</i> evidencing the contract is not surrendered or otherwise terminated before the <i>premiums</i> fall due, will fall due on those dates without either party to the contract exercising any <i>option</i> under the contract; or</p> <p>(b) of which the first payment is an obligation under the contract, and subsequent payments, calculated according to an agreed formula, are payable over a period which exceeds one year in length under a collateral written arrangement with the <i>insurer</i> or <i>friendly society</i>.</p> <p>(3) (in relation to an <i>option</i>) the total amount which the purchaser of the <i>option</i> is, or may be, required to pay in consideration for the right to exercise the <i>option</i>.</p>
previous regulator	<p>(1) (in relation to a <i>firm</i> which was authorised under the Banking Act 1987 immediately before <i>commencement</i> or which was a European institution (as defined in the Banking Coordination (Second Council Directive) Regulations 1992) immediately before <i>commencement</i>) the <i>FSA</i>.</p> <p>(2) (in relation to a <i>firm</i> which was a <i>building society</i> immediately before <i>commencement</i>) the Building Societies Commission.</p> <p>(3) (in relation to a <i>firm</i> which was a <i>friendly society</i> immediately before <i>commencement</i>) the Friendly Societies Commission.</p> <p>(4) (in relation to a <i>firm</i> authorised under the Insurance Companies Act 1982 immediately before <i>commencement</i>) the Treasury.</p> <p>(5) (in relation to an <i>underwriting agent</i> which obtained the <i>permission</i> relevant to that category under the Financial Services and Markets Act 2000 (Repeals, Transitional Provisions and Savings) Order 2001 (SI 2001/xxx)) the <i>Society of Lloyd's</i>.</p> <p>(6) (in relation to a <i>firm</i> which was authorised, or which was an <i>appointed representative</i>, under the Financial Services Act 1986 immediately before <i>commencement</i> or which was a European investment firm (as defined in the Investment Services Regulations 1995 (SI 1995/3275)) immediately before <i>commencement</i>) any of:</p> <p>(a) <i>IMRO</i>;</p> <p>(b) <i>PIA</i>;</p> <p>(c) <i>SFA</i>;</p> <p>(d) a <i>recognised professional body</i>; and</p> <p>(e) the <i>FSA</i>.</p>

	if the <i>firm</i> (or, if relevant, its principal for the purposes of section 44 of the Financial Services Act 1986) was subject in carrying on business to the rules, requirements, regulations or guidance of that body;
	(7) (in relation to an <i>ex-section 43 firm</i>) the <i>FSA</i> .
principal	<p>(1) in relation to a <i>person</i>:</p> <p>(a) a <i>person</i> acting on his own account;</p> <p>(b) (if the <i>person</i> is an <i>appointed representative</i>) the <i>authorised person</i> who is party to a contract with the <i>appointed representative</i> resulting in him being exempt under section 39 of the <i>Act</i> (Exemption of appointed representatives).</p> <p>(2) in relation to an <i>option, future</i> or forward contract:</p> <p>(a) (except in the case of an <i>option</i> on a <i>future</i>) the amount of property or the value of the property which must be delivered in order to satisfy settlement of the <i>option, future</i> or forward contract;</p> <p>(b) (in relation to an <i>option</i> on a <i>future</i>) the amount of property or the value of the property which must be delivered in order to satisfy settlement of the <i>future</i>.</p>
private customer	<p>a <i>client</i> who is not a <i>market counterparty</i> or an <i>intermediate customer</i>, including:</p> <p>(a) an individual who is not a <i>firm</i>;</p> <p>(b) an overseas individual who is not an <i>overseas financial services institution</i>;</p> <p>(c) a <i>regulated collective investment scheme</i>;</p> <p>(d) (except for the purposes of <i>DISP</i>) a <i>client</i> when he is classified as a <i>private customer</i> in accordance with COB 4.1.14R (Client classified as a private customer);</p> <p>but excluding a <i>client</i>, who would otherwise be a <i>private customer</i>, when he is classified as an <i>intermediate customer</i> in accordance with COB 4.1.9R (Expert private customer classified as an intermediate customer).</p>
product provider	<p>a <i>firm</i> which is:</p> <p>(a) a <i>long-term insurer</i>;</p> <p>(b) a <i>friendly Society</i>;</p> <p>(c) the <i>operator</i> of a <i>regulated collective investment scheme</i> or an <i>investment trust savings scheme</i>.</p>
professional fees	<i>Fees, commissions</i> and other receipts receivable in respect of legal, accountancy or actuarial <i>services</i> provide to <i>clients</i> but, excluding any items receivable in respect of <i>regulated activities</i> .
professional firm	<p>a <i>person</i> which is:</p> <p>(a) an individual who is entitled to practice a profession regulated by a <i>designated professional body</i> and in practising it is subject to its rules; or</p> <p>(b) a <i>person</i> (not being an individual) which is managed and controlled by one or more individuals each of whom:</p> <p>(i) is entitled to practice a profession regulated by a <i>designated professional body</i>; and</p> <p>(ii) in practising it is subject to the rules of the <i>designated professional body</i>.</p>
properly secured	fully secured by a first <i>charge</i> in favour of the <i>firm</i> on land and buildings, or

	on a <i>readily realisable investment</i> where the <i>firm</i> has in its possession or under its <i>control</i> a document of title or a document evidencing title to that <i>investment</i> ;
property enterprise trust	an <i>unregulated collective investment scheme</i> of which the underlying assets are land and buildings.
property fund	(a) a <i>regulated collective investment scheme</i> dedicated to land and interests in land; (b) a fund of funds of which one or more of the funds to which it is dedicated falls within (a); (c) a constituent part of an umbrella fund which, if it were a separate fund, would fall within (a);
provider firm	a <i>firm</i> ; that is: (a) a <i>product provider</i> ; or (b) a <i>marketing group associate</i> .
public offer	an offer of <i>securities</i> to the public and described in the <i>POS Regulations</i> .
pure protection contract	a <i>long-term insurance contract</i> in respect of which the following conditions are met: (a) the benefits under the contract are payable only on death or in respect of incapacity due to injury, sickness or infirmity; (b) the contract provides that benefits are payable on death (other than death due to an accident) only where the death occurs within ten years of the date on which the life of the person in question was first insured under the contract, or where the death occurs before that person attains a specified age not exceeding seventy years; (c) the contract has no <i>surrender value</i> , or the consideration consists of a single <i>premium</i> and the <i>surrender value</i> does not exceed that <i>premium</i> ; (d) the contract makes no provision for its conversion or extension in a manner which would result in it ceasing to comply with any of (a), (b) or (c); and (e) the contract is not a reinsurance contract.
qualifying debt security	a <i>debt security</i> (a) issued or explicitly guaranteed by (i) a Zone A central government or central <i>bank</i> ; (ii) a Zone B central government or central <i>bank</i> , provided that the <i>security</i> is denominated in its national currency; (iii) a local authority or regional government of the <i>United Kingdom</i> or another <i>Zone A country</i> ; (iv) one of the following: The African Development Bank; The Asian Development Bank; The Caribbean Development Bank; The Council of Europe; The European Bank for Reconstruction and Development; The European Investment Bank; The Inter-American Development Bank;

	The International Bank for Reconstruction and Development (World Bank);
	The International Finance Corporation;
	The Nordic Investment Bank;
	(b) issued by an <i>investment firm</i> or a comparable <i>undertaking regulated by a recognised third country</i> which is listed on a <i>regulated market</i> or a <i>recognised investment exchange</i> ;
qualifying investment	an <i>investment</i> which has been prescribed by the Treasury in the <i>Prescribed markets and Qualifying investments Order</i> (see <i>MAR 1</i> (Code of market conduct)).
readily realisable security	(a) a <i>government or public security</i> denominated in the currency of the country of its <i>issuer</i> ;
	(b) any other <i>security</i> which is:
	(i) admitted to <i>official</i> listing on an exchange in an <i>EEA State</i> ; or
	(ii) regularly traded on or under the rules of such an exchange; or
	(iii) regularly traded on or under the rules of a <i>recognised investment exchange</i> or (except in relation to <i>unsolicited real time financial promotions</i>) <i>designated investment exchange</i> ;
	(c) a newly issued <i>security</i> which can reasonably be expected to fall within (b) when it begins to be traded.
recognised clearing house	a <i>clearing house</i> which is declared by a <i>recognition order</i> for the time being in force to be a recognised clearing house.
recognised investment exchange	an investment exchange which is declared by a <i>recognition order</i> for the time being in force to be a recognised investment exchange.
Regulated Activities Order	the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 SI 2001/544.
regulated activity	(in accordance with section 22 of the <i>Act</i> (The classes of activity and categories of investment)) any of the following activities specified in Part II of the <i>Regulated Activities Order</i> (Specified Activities):
	(a) <i>accepting deposits</i> (article 5);
	(b) <i>effecting contracts of insurance</i> (article 10(1));
	(c) <i>carrying out contracts of insurance</i> (article 10(2));
	(d) <i>dealing in investments as principal</i> (article 14);
	(e) <i>dealing in investments as agent</i> (article 21);
	(f) <i>arranging (bringing about) deals in investments</i> (article 25(1));
	(g) <i>making arrangements with a view to transactions in investments</i> (article 25(2));
	(h) <i>managing investments</i> (article 37);
	(i) <i>safeguarding and administering investments</i> (article 40); (for the purposes of the <i>permission</i> regime, this is sub-divided into:
	(i) <i>safeguarding and administration of assets (without arranging)</i> ;
	(ii) <i>arranging safeguarding and administration of assets</i>);
	(j) <i>sending dematerialised instructions</i> (article 45(1));
	(k) <i>causing dematerialised instructions to be sent</i> (article 45(2));

- (l) *establishing, operating or winding up a collective investment scheme* (article 51(1)(a)); (for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *establishing, operating or winding up a regulated collective investment scheme*);
 - (ii) *establishing, operating or winding up an unregulated collective investment scheme*;
- (m) *acting as trustee of an authorised unit trust scheme* (article 51(1)(b));
- (n) *acting as the depositary or sole director of an open-ended investment company* (article 51(1)(c));
- (o) *establishing, operating or winding up a stakeholder pension scheme* (article 52);
- (p) *advising on investments* (article 53); (for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *advising on investments (except pension transfers and pension opt-outs)*;
 - (ii) *advising on pension transfers and pension opt-outs*;
- (q) *advising on syndicate participation at Lloyd's* (article 56);
- (r) *managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's* (article 53);
- (s) *arranging deals in contracts of insurance written at Lloyd's* (article 58);
- (t) *agreeing to carry on a regulated activity* (article 64);

which is carried on by way of business and either relates to a *specified investment*, or in the case of (l), (m), (n) and (o), is carried on in relation to property of any kind..

regulated collective investment scheme

- (a) an *ICVC*;
- (b) an *AUT*; or
- (c) a *recognised scheme*;

whether or not the *units* are held within a *PEP*, *ISA*, or *pension contract*.

regulated market

(as defined in article 1 of the *ISD*) a market for the instruments listed in Section B of the Annex to the *ISD* which:

- (a) appears on the list of such markets drawn up by the market's *Home State* as required by article 16 of the *ISD*;
- (b) functions regularly;
- (c) is characterised by the fact that regulations issued or approved by the competent authorities define the conditions for the operation of the market, the conditions for access to the market and, where Directive 79/279/EEC is applicable, the conditions governing admission to listing imposed in that Directive and, where that Directive is not applicable, the conditions that must be satisfied by a financial instrument before it can effectively be dealt in on the market; and
- (d) requires compliance with all the reporting and transparency requirements laid down by articles 20 and 21 of the *ISD*.

(see *SUP 17 Ann 5G* for a list of these markets)

related designated investment

(in relation to a *designated investment* (the "first investment")) a *designated investment* (the related designated investment) whose value might reasonably be expected to be directly affected by:

	(a) any fluctuation in the value of the first investment; or (b) any <i>published recommendation</i> that concerns the first investment.
relevant collateral	in relation to a transaction: (a) cash; (b) letters of credit and guarantees to the extent of their face value, issued by an <i>approved bank</i> which is neither a counterparty nor an <i>associate</i> of a counterparty; (c) gold and silver bullion and coinage; (d) <i>marketable investments</i> ; (e) the performance guarantees issued in support of the securities lending and borrowing programmes of Euroclear and Cedel, in respect only of <i>exposure</i> arising from participation in such programmes; subject to: (i) the <i>firm</i> having an unconditional right to apply or realise the <i>relevant collateral</i> for the purpose of repaying a counterparty's obligations; (ii) <i>marketable investments</i> : (A) being marked to market daily using the valuation <i>principles</i> in <i>IPRU(INV) 3.41(9)R</i> ; (B) not being issued by a counterparty nor by an <i>associate</i> of a counterparty.
representative	(in relation to <i>designated investment business</i>) an individual appointed by a <i>provider firm</i> or by an <i>appointed representative</i> of that <i>firm</i> , to carry out either or both of the following activities: (a) giving <i>advice on investments</i> to <i>customers</i> on the merits of <i>packaged products offered</i> by that <i>firm</i> (or any other <i>provider firm</i> within the same <i>marketing group</i>); (b) <i>arranging (bringing about) deals in investments</i> in relation to such products.
retirement fund	the amount which will be available, at the date on which the investor retires, for the provision of benefits.
rule	(in accordance with section 417(1) of the <i>Act</i> (Definitions)) a rule made by the <i>FSA</i> under the <i>Act</i> , including: (a) a <i>Principle</i> ; and (b) an <i>evidential provision</i> .
safe custody investments	a <i>designated investment</i> , which is not the property of the <i>firm</i> , but for which the <i>firm</i> , or any <i>nominee company</i> controlled by the <i>firm</i> or by its <i>associate</i> , is accountable; which has been paid for in full by the <i>client</i> ; and which ceases to be a <i>safe custody investment</i> when the <i>firm</i> has disposed of it in accordance with a valid instruction.
scheme holding	a holding of: (a) <i>units</i> in a <i>collective investment scheme</i> ; or (b) <i>shares</i> in an <i>investment trust savings scheme</i> .
scheme particulars	a <i>document</i> containing information about a <i>regulated collective investment scheme</i> .
securities and futures firm	a <i>firm</i> whose <i>permitted activities</i> include <i>designated investment business</i> , which is not an <i>authorised professional firm</i> , <i>bank</i> , <i>building society</i> , <i>credit union</i> , <i>friendly society</i> , <i>ICVC</i> , <i>insurer</i> , <i>media firm</i> , <i>service company</i> , <i>incoming</i>

EEA firm (without a top-up permission), incoming Treaty firm (without a top-up permission) or UCITS qualifier, whose permission does not include a requirement that it comply with IPRU(INV) 5 (Investment management firms) or 13 (Personal investment firms), and which is within (a), (b), (c) or (d):

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

security

(in accordance with article 3(1) of the *Regulated Activities Order* (Interpretation)) any of the following *investments* specified in that Order:

- (a) *share* (article 76);
- (b) *debenture* (article 77);
- (c) *government and public security* (article 78);
- (d) *warrant* (article 79);
- (e) *certificate representing certain securities* (article 80);
- (f) *unit* (article 81);

	(g) <i>stakeholder pension scheme</i> (article 82);
	(h) <i>rights to or interests in investments</i> in (a) to (g) (article 89).
sell	(in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation)), in relation to any <i>investment</i> , sell in any way, including disposing of the <i>investment</i> for valuable consideration; in this definition, "disposing" includes: (a) (in relation to an <i>investment</i> consisting of rights under a contract): (i) surrendering, assigning or converting those rights; or (ii) assuming the corresponding liabilities under the contract; (b) (in relation to an <i>investment</i> consisting of rights under other arrangements) assuming the corresponding liabilities under the arrangements; and (c) (except in <i>CIS</i>) (in relation to any other <i>investment</i>) issuing or creating the <i>investment</i> or granting the rights or interests of which it consists.
series of transactions	a series of transactions executed with a view to achieving one investment decision or objective.
service company	a <i>firm</i> whose only <i>permitted activities</i> are <i>making arrangements with a view to transactions in investments</i> , and <i>agreeing to carry on that regulated activity</i> , and whose <i>Part IV permission</i> : (a) incorporates a <i>limitation</i> substantially to the effect that the <i>firm</i> carry on <i>regulated activities</i> only with <i>market counterparties</i> or <i>intermediate customers</i> ; and (b) includes <i>requirements</i> substantially to the effect that the <i>firm</i> must not: (i) guarantee, or otherwise accept responsibility for, the performance, by a participant in arrangements made by the <i>firm</i> in carrying on <i>regulated activities</i> , of obligations undertaken by that participant in connection with those arrangements; or (ii) <i>approve any financial promotion</i> on behalf of any other <i>person</i> or any specified class of <i>persons</i> ; or (iii) in carrying on its <i>regulated activities</i> , provide services otherwise than in accordance with <i>documents</i> (of a kind specified in the <i>requirement</i>) provided by the <i>firm</i> to the <i>FSA</i> .
share	(1) the <i>investment</i> , specified in article 76 of the <i>Regulated Activities Order</i> (Shares etc), which is, in summary: a share or stock in the share capital of: (a) any <i>body corporate</i> (wherever incorporated); (b) any unincorporated body constituted under the law of a country or territory outside the <i>United Kingdom</i> .
small self-administered scheme	an <i>occupational pension scheme</i> of a kind described in article 4(4) and 4(5) of the Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001 (SI 2001/1177).
sole trader	an individual who is a <i>firm</i> .
special adjustment	a <i>position</i> risk adjustment, counterparty risk adjustment, foreign <i>exchange</i> adjustment, and any <i>large exposure</i> adjustment in accordance with chapter 13;
specified investment	any of the following <i>investments</i> specified in Part III of the <i>Regulated Activities Order</i> (Specified Investments):

- (a) *deposit* (article 74);
- (b) *contract of insurance* (article 75); (for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *general insurance contract*;
 - (ii) *long-term insurance contract*;
 and then further sub-divided into classes of *contract of insurance*);
- (c) *share* (article 76);
- (d) *debenture* (article 77);
- (e) *government and public security* (article 78);
- (f) *warrant* (article 79);
- (g) *certificate representing certain securities* (article 80);
- (h) *unit* (article 81);
- (i) *stakeholder pension scheme* (article 82);
- (j) *option* (article 83); (for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *option* (excluding a *commodity option* and an *option on a commodity future*);
 - (ii) *commodity option* and an *option on a commodity future*);
- (k) *future* (article 84); (for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *future* (excluding a *commodity future* and a *rolling spot forex contract*);
 - (ii) *commodity future*);
 - (iii) *rolling spot forex contract*;
- (l) *contract for differences* (article 85); (for the purposes of the *permission* regime this is sub-divided into:
 - (i) *contract for differences* (excluding a *spread bet* and a *rolling spot forex contract*);
 - (ii) *spread bet*;
 - (iii) *rolling spot forex contract*);
- (m) *underwriting capacity of a Lloyd's syndicate* (article 86(1));
- (n) *membership of a Lloyd's syndicate* (article 86(2));
- (o) *rights to or interests in investments* (article 89).

subsidiary (as defined in section 736 of the Companies Act 1985) (in relation to another *body corporate* ("H")) a *body corporate* of which H is a *holding company*.

- surrender value
- (a) where the contract is a contract of life assurance or a contract for an annuity, the amount (including a nil amount) payable by the *firm* or other body issuing the contract on surrender of the *policy*;
 - (b) where the contract is a *pension contract*, the amount payable on the transfer of the investor's accrued rights under that contract to another *pension contract*;
 - (c) where the contract is a *Holloway sickness policy*, the amount payable by the *firm* on surrender on or before the *projection date* for the *policy*;
 - (d) where the contract is for any other matter, the amount payable by the

	<i>firm</i> on the surrender of the <i>policy</i> .
tax exempt policy	any contract of assurance, offered or issued by a <i>friendly society</i> , which is tax exempt life or endowment business as defined in section 466 (2) of the Income and Corporation Taxes Act 1988.
traded life policy	a <i>life policy</i> which is to be or has been assigned for value by the <i>policyholder</i> to another <i>person</i> .
traded option	(a) <i>investments</i> falling within article 77 of the RAO which relate to <ul style="list-style-type: none"> (i) <i>shares</i>, or (ii) <i>debt instruments</i>, or (b) <i>investments</i> falling within article 79 of the RAO which are <i>options</i> on equity indices, <p>provided that those <i>investments</i> are traded on, or under the <i>rules</i> of, a <i>recognised</i> or <i>designated investment exchange</i>;</p>
unauthorised person	a <i>person</i> who is not an <i>authorised person</i> .
undertaking	(as defined in section 259 of the Companies Act 1985 (Meaning of undertaking and related expressions)): <ul style="list-style-type: none"> (a) a <i>body corporate</i> or <i>partnership</i>; or (b) an unincorporated association carrying on a trade or business, with or without a view to profit.
unit	an <i>investment</i> (as specified in article 81 of the <i>Regulated Activities Order</i>) (Units in a collective investment scheme) and defined in section 237(2) of the <i>Act</i> (Other definitions) which is the right or interest (however described) of the <i>participants</i> in a <i>collective investment scheme</i> ; this includes: <ul style="list-style-type: none"> (a) (in relation to an <i>AUT</i>) <p>a unit representing the rights or interests of the <i>unitholders</i> in the <i>AUT</i>;</p> (b) (in relation to an <i>ICVC</i>) <p>a <i>share</i> in the <i>ICVC</i>.</p>
unit trust scheme	(as defined in section 237(1) of the <i>Act</i> (Other definitions)) a <i>collective investment scheme</i> under which the property in question is held on trust for the <i>participants</i> .
unregulated collective investment scheme	a <i>collective investment scheme</i> which is not a <i>regulated collective investment scheme</i> .
verified	(where interim net profits are to be included in Financial Resources Test 1 (own funds) checked by an external auditor who has undertaken at least to <ul style="list-style-type: none"> (a) satisfy himself that the figures forming the basis of the interim profits have been properly extracted from the underlying accounting records, (b) review the accounting <i>policies</i> used in calculating the interim profits so as to obtain comfort that they are consistent with those normally adopted by the <i>firm</i> in drawing up its <i>annual financial statements</i> and are in accordance with the accounting principles set out in chapter 13, (c) perform analytical procedures on the result to date, including comparisons of actual performance to date with budget and with the results of prior period(s), (d) discuss with management the overall performance and financial <i>position</i> of the <i>firm</i>,

obtain adequate comfort that the implications of current and prospective litigation, all known claims and commitments, changes in business activities and provisioning for bad and doubtful debts have been properly taken into account in arriving at the interim profits, and

follow up problem areas of which he is already aware in the course of auditing the *firm's* financial statements,

a copy of whose report asserting that the interim net profits are reasonably stated has been submitted to the *FSA*;

warrant the *investment* specified in article 79 of the *Regulated Activities Order* (Instruments giving entitlements to investments), which is, in summary: a warrant or other instrument entitling the holder to subscribe for a *share*, *debenture* or *government and public security*.

whole life assurance a *contract of insurance* which, disregarding any benefit payable on surrender, secures a capital sum only on death or either on death or on disability, but does not include a term assurance.

Zone A country all *EEA States* and all other countries which are full members of the *OECD* and those countries which have concluded special lending arrangements with the International Monetary Fund associated with the Fund's General Arrangements to Borrow.

APPENDIX 13 (2)E

PROFESSIONAL INDEMNITY INSURANCE PROVISIONS

E The policy terms and additional clauses set out below form part of rule 13.1.6E and have the status of evidential provisions.

Professional Indemnity Insurance Terms

SECTION 1 - BASIS OF INSURANCE CONTRACT

Note: Various words and phrases have a standard meaning within this policy and such definitions and interpretations are as set out in Section 6. Headings and notes are for information purposes only and are not to be construed as part of the policy wording.

1.1 Insuring Clause

In consideration of the Assured having agreed to pay the premium shown in the Schedule, Underwriters agree, subject to the terms, conditions and exclusions of this policy, to indemnify the Assured, up to the Limit of Indemnity, for any claim for compensation and/or damages (including claimant's costs and expenses) first made against the Assured and notified to Underwriters during the Period of this Policy which the Assured may become legally liable to pay in consequence of any Negligence in the exercise and conduct of the Assured's Professional Business by the Assured and/or by others on behalf of the Assured.

1.2 Defence Costs in Addition

Underwriters will also indemnify the Assured for Defence Costs (see 6.6) where such costs have been incurred with Underwriters' consent. Such Defence Costs are payable in addition to the Limit of Indemnity unless the Limit of Indemnity shown in the Schedule is in the aggregate.

In the event that a settlement is made with any party in excess of the amount of the Limit of Indemnity, Underwriters' liability in respect of Defence Costs shall be in the same proportion that the Limit of Indemnity bears to the sum which would be eligible for payment but for the restriction of the Limit of Indemnity.

SECTION 2 - EXTENSIONS

Unless endorsed to the contrary and subject otherwise to the policy terms, conditions and exclusions the following extensions are given:

2.1 Loss of or Damage to Documents

In the event of physical loss of or damage to documents suffered during the Period of this Policy the Assured is indemnified for reasonable and necessary costs and expenses incurred in replacing, restoring or reconstituting any Documents which are the property of the Assured or in the care, custody or control of the Assured or for which the Assured is responsible.

2.1.1 Liability for Loss of Documents

This policy is extended to indemnify the Assured for any liability other than the costs and expenses referred to in Extension 2.1, which may arise in consequence of the physical loss of or damage suffered to any Document referred to in Extension 2.1.

2.2 Self Employed Persons Extension

The Assured is indemnified for any Negligence in consequence of the use of self employed or contract hire persons in connection with the Assured's Professional Business. The use of such persons need not be disclosed to Underwriters. For the purpose of this policy such persons are deemed to be employees of the Assured.

2.3 Indemnity to Employees, Former Employees and/or Consultants

Employees or former employees of the Assured are indemnified in respect of any claim made against them during the Period of this Policy in consequence of any Negligence in the exercise and conduct of the Assured's Professional Business.

Former partners, former directors or former employees of the Assured who have continued as consultants to the Assured and such persons who were formerly consultants to the Assured are indemnified in respect of any claim made against them during the Period of this Policy in consequence of any Negligence in the exercise and conduct of the Assured's Professional Business.

2.4 Libel and Slander

The Assured is indemnified for all sums which the Assured may become legally liable to pay in respect of claims made upon them during the Period of this Policy in direct consequence of any libel, slander or defamation uttered by the Assured in the exercise and conduct of the Assured's Professional Business.

2.5 Dishonesty of Employees

The Assured is indemnified for any claim brought about or contributed to, by the dishonest, fraudulent, criminal or malicious act or omission of any person at any time employed by the Assured who is not a Partner or Director.

SECTION 3 - CLAIMS CONDITIONS

The following claims conditions and the more general conditions listed under Section 4 apply to this policy:

- 3.1 All conditions contained in Section 3 are deemed to be conditions precedent to liability.

Discovery of a Claim or Circumstance

- 3.2 (a) If during the Period of this Policy the Assured shall receive any claim, the Assured shall give notice (see 3.3) to Underwriters as soon as practicable, but in any event not later than expiry of the Period of this Policy.
- (b) If during the Period of this Policy the Assured becomes aware of any Circumstance which may give rise to a claim, the Assured shall give notice (see 3.3) to Underwriters of such Circumstance as soon as practicable, but in any event not later than expiry of the Period of this Policy.

Underwriters agree that any such Circumstance notified to them during the Period of this Policy and which subsequently gives rise to a claim after expiry of this policy shall be deemed to be a claim first made during the Period of this Policy.

Notice

- 3.3 Notwithstanding Clause 3.2 if the Assured becomes aware of a claim or discovers any Circumstance and is unable, due to any reasonable cause, to give notice during the Period of this Policy, Underwriters will accept such notice up to 15 days after expiry of this policy, provided always that the matter which is being notified first came to the Assured's attention during the Period of this Policy.

Conduct of Claims

- 3.4 In the event of a claim or the discovery of any Circumstance, the Assured shall not admit liability and no admission, offer, promise or payment shall be made by the Assured without Underwriters' consent.
- 3.5 Following notification of a claim or notification of any Circumstance, Underwriters shall be entitled if they so desire to take over and conduct in the name of the Assured the investigation, defence or settlement of any such matter. The Assured shall give all such assistance as Underwriters may reasonably require.

Notwithstanding the provisions of the preceding paragraph, if the Assured and Underwriters cannot agree a common course of action with regard to the contesting of any legal proceedings (whether defence or prosecution), the dispute will be resolved by the operation of Clause 4.3.

SECTION 4 - GENERAL CONDITIONS

The following conditions apply to this policy:

4.1 Other Insurance

If at the time any claim arises under this policy the Assured is, or but for the existence of this policy, would be entitled to indemnity under any other policy or policies, Underwriters shall not be liable except in respect of any sum in excess of the amount which is or which would have been payable under such other policy or policies.

4.2 Subrogation

If any payment is made under the terms of this policy, the Assured grants to Underwriters all rights of recovery against any parties from whom a recovery may be made. However, Underwriters agree to waive any rights of recovery against any employee or consultant or former employee or former consultant of the Assured unless liability has resulted in whole or part from any act or omission on the part of such persons which is dishonest, fraudulent, criminal or malicious.

4.3 Policy Disputes

This contract is governed by English Law. Any dispute or difference between the Assured and Underwriters arising from this policy shall be referred to Queen's Counsel of the English Bar, to be mutually agreed between Underwriters and the Assured or any other party as may be mutually agreed. In the event of disagreement regarding the appointment, the Chairman of the Bar Council shall appoint a suitable party.

The findings of the agreed or appointed party shall be binding on Underwriters and the Assured, and the costs of such an exercise shall be allocated by the agreed or appointed party on a fair and equitable basis.

4.4 Claim Settlements

The Underwriters may at any time pay to the Assured in connection with any claims or series of claims under this Policy the Limit of Indemnity (less any sums already paid) or any lesser sum for which such claims can be settled and upon such payment the Underwriters shall not be under any further liability in respect of such claims except for costs and expenses incurred prior to such payment.

If a payment exceeding the Limit of Indemnity has to be made to dispose of a claim the liability of the Underwriters to pay all costs fees and expenses in connection therewith shall be limited to such of the said costs and expenses as the Limit of Indemnity bears to the amount paid to dispose of a claim.

SECTION 5 - EXCLUSIONS

5.1 This policy shall not indemnify the Assured in respect of the following:

(a) Excess

The amount of the Excess shown in the Schedule or in any extension as appropriate.

Defence costs referred to in Clause 1.2 shall not be the subject of any Excess.

(b) Liability involving Transport or Property owned by the Assured

Any claim against the Assured arising solely and directly out of the ownership, possession or use by or on behalf of the Assured of any aircraft, watercraft, hovercraft, motor vehicle or trailer or any buildings, premises or land or that part of any building leased, occupied or rented by the Assured or any property of the Assured.

(c) Liability arising out of Employment

Any claim arising out of injury, disease, illness or death of any employee under a contract of service with the Assured or any claim arising out of any dispute between the Assured and any present or former employee or any person who has been offered employment with the Assured, being brought under or relating to the Employment Protection Act 1975 or equivalent legislation in countries other than England.

(d) Supply of Goods

Any claim against the Assured arising out of the supply of any goods by the Assured or products manufactured, constructed, altered, repaired, treated, sold, supplied or distributed by the Assured.

This exclusion shall not apply to project models or displays.

The exercise and conduct of the Assured's Professional Business shall not be excluded by this exclusion even where the exercise and conduct of such Professional Business is held to be a "product" or "goods" in consequence of the Consumer Protection Act 1987 or equivalent legislation in countries other than England.

(e) Fraud, Dishonesty or Criminal Act

Any claim directly or indirectly contributed to or caused by any act or omission of any partner or director of the Assured which is dishonest, fraudulent, criminal or malicious.

(f) Controlling Interest Exclusion Clause

Any claim made against the Assured by either:

(i) any interest in which the Assured exercises a controlling interest

or

(ii) any entity exercising a controlling interest over the Assured by virtue of their having a financial or executive interest in the operation of the Assured

unless such claim is made against the Assured for an indemnity or contribution in respect of a claim made by another party against:

(a) the said entity in which the Assured exercises such a controlling interest

or

(b) the said entity exercising such a controlling interest in the operation of the Assured

and arises out of the exercise and conduct of the Assured's Professional Business

(g) Nuclear Risks Exclusion

Loss or destruction of or damage to any property whatsoever or any loss or expense whatsoever resulting or arising therefrom or any consequential loss or any legal liability of whatsoever nature directly or indirectly caused by or contributed to by or arising from:

(i) Ionizing radiations or contamination by radioactivity from any nuclear fuel or from any nuclear waste from the combustion of nuclear fuel

(ii) The radioactive, toxic, explosive or other hazardous properties of any explosive nuclear assembly or nuclear component thereof.

(h) War Risks Exclusion

In respect of extension 2.1 only, any consequence of war including a terrorist act initiated by hostile parties, invasion, act of foreign enemy, hostilities (whether war be declared or not), civil war, rebellion, revolution, insurrection or military or usurped power.

(i) Jurisdiction Exclusion

Any claim brought in the courts of countries (or the enforcement of a judgment found against the Assured) outside the geographical limits referred to in the Schedule.

(j) Punitive, Penal or Exemplary Damages

Punitive, penal or exemplary damages where such can be identified separately within any award of a court.

(k) Loss of Documents - Magnetic or Electrical Media

Any claim arising from the physical loss of or damage to Documents which are stored on magnetic or electrical media unless such Documents are duplicated on magnetic or electrical media with the intention that in the event of loss or damage the duplicate can be used as the basis for restoring the Documents to their original status.

(l) Pollution

Any claim directly from pollution.

(m) Directors' and Officers' Liability

Any claim arising from those liabilities consequent upon being a director, officer or trustee of the Assured as (opposed to those duties and functions carried out in furtherance of the Assured's Professional Business) or from the acceptance of any directorship or trusteeship in any other company not forming part of the Practice.

SECTION 6 - DEFINITIONS AND INTERPRETATIONS

- 6.1 The following words and phrases are used in this policy. In certain instances the words may be used in their plural or singular form. Whenever they appear they are deemed to have the meaning set out below:

6.2 Assured

Shall mean:

(a) (i) The Practice

(ii) The present or future partners and present or future directors of the Practice.

(iii) Former partners and former directors of the Practice in respect of claims made during the Period of this policy but arising out of the exercise and conduct of the Assured's Professional Business during the period whilst they were receiving salary or financial benefit from the Practice.

(b) the estate, heirs, executors and assignees in bankruptcy of those parties mentioned in 6.2 (a).

6.3 The Practice

Shall mean the professional practice(s) whether corporate, sole trader or partnership named as the Assured in the Schedule including any predecessors in business.

The definition also includes practice(s) or business(es) for which the Assured is legally liable in consequence of the acquisition of such practice(s) or business(es) prior to inception of this policy provided Underwriters have been notified in writing of the existence of such other practice(s) or business(es) and Underwriters have agreed to insure such entities.

Any office of the Practice as defined is included within the definition unless expressly stated otherwise.

6.4 Professional Business

Shall mean the business activities which are listed in the Schedule.

Where the Assured is liable for a sub-consultant or sub-contractor or responsible for the liability of a joint venture or consortium the definition of Professional Business is extended to include the other professional activities of the sub-consultant, sub-contractor or joint venture or consortium for which the Assured is liable.

In addition, the definition of Professional Business is extended to include personal appointments of any party falling within the definition of the Assured provided the fees, if any, for such activities are credited to the Practice and such activities are related directly or indirectly to the activities listed in the Schedule and the individual is qualified or experienced to carry out such work.

6.5 Limit of Indemnity

Shall mean the sum shown in the Schedule which is available to indemnify the Assured in respect of each claim provided always that where more than one claim arises from the same original cause all such claims shall be deemed to be one claim and only one limit of indemnity shall be payable in respect of the aggregate of all such claims.

6.6 Defence Costs

Shall mean all costs and expenses incurred in the investigation, defence or settlement of any claim or potential claim and/or the cost of representation at any enquiry or other proceedings which have a direct or indirect relevance to the investigation, defence or settlement of any matter notified under the terms of this policy.

6.7 Excess

Shall mean the first amount of each claim which is payable by the Assured. Where, however, a series of claims is made during the Period of this Policy which arises from the same original cause then only one single excess shall apply in respect of all claims resulting from that original cause.

6.8 Geographical Limits

Shall mean the geographical limits referred to in the Schedule.

6.9 Period of this Policy

Shall mean the period shown in the Schedule plus any extension to the period which may be granted by Underwriters.

6.10 Documents

Shall mean deeds, wills, agreements, records, written or printed books, letters, certificates or written or printed documents and/or forms of any nature whatsoever and shall include computer software and systems records (electronic data shall be deemed to be physical property for the purposes of this policy). The definition excludes bearer bonds, coupons, bank or currency notes or other negotiable paper.

6.11 Circumstance

Shall mean information or circumstances of which the Assured is aware which suggests that a claim may be made against the Assured which the Assured may become legally liable to pay and which arises out of the exercise and conduct of the Assured's Professional Business.

6.12 Underwriters

Shall mean those insurance companies or Lloyd's syndicates subscribing to this policy and detailed in the attachment to this policy.

6.13 Negligence

Shall mean a negligent act and/or a negligent error and/or a negligent omission and/or a negligent commission.

Schedule

Policy form:

Policy No.:

- 1 The Assured:
- 2 Principal address:
- 3 Professional Business:

and as more fully declared in the proposal form(s) referred to below and any accompanying information submitted with the proposal form(s)

- 4 Period of this Policy: From:
To: both days inclusive
- 5 Limit of Indemnity: £ each claim
- 6 Excess: £ each claim
- 7 Geographical Worldwide but excluding United States of America or Canada
- 8 Premium: £
- 9 Date(s) of proposal form(s):

This contract is based on the proposal form(s) the date(s) of which are listed above and supporting documentation (if any) accompanying the proposal form(s).

- 10 Endorsement reference(s) (if any):

Additional Clauses

1 COMPLIANCE CLAUSE

This Policy is designed to provide the minimum insurance requirements in accordance with the rules of the Financial Services Authority ('FSA'). However, for the avoidance of doubt in any dispute in connection with the terms, conditions, exclusions and limitations of this Policy it is specifically understood and agreed that the minimum insurance requirements as set out in the FSA rules shall take precedence over any terms, conditions, exclusions or limitations contained herein which are less favourable to the Insured.

2 OMBUDSMAN EXTENSION

In accordance with and subject to the terms, conditions, exclusions, limitations and provisions contained in the Policy, the Insurers agree to indemnify the Assured in respect of their liability to meet any award made against them by:

- (1) the Ombudsman appointed by the Personal Investment Authority Ombudsman Bureau Limited (the "Bureau"), subject to such Ombudsman operating within the Ombudsman's Terms of Reference (a copy of which has been lodged with Insurers) as issued by the Council of the Personal Investment Authority Bureau; and
- (2) the Ombudsman appointed by The FSA, subject to such Ombudsman operating within the compulsory jurisdiction rules (a copy of which has been lodged with Insurers),

arising from any claim(s)/complaint(s) made against the Assured during the period of this Policy.

3 IBRC COMPLIANCE CLAUSE

(If a firm is also a member of the IBRC, it should ensure the inclusion of this clause)

1. It is understood and agreed that this Policy of Insurance is deemed to be taken out pursuant to the Insurance Brokers Registration Council (Indemnity Insurance and Grants Scheme) Rules 1987 (as amended).

2. This policy is extended, subject otherwise to its terms, conditions and exclusions, to indemnify the Assured in respect of losses sustained by them in consequence of any dishonest or fraudulent act or omission committed or omitted by any employee or former employee of the Assured in the conduct and execution of the Assured's professional business.
3. It is understood and agreed that this Policy is extended to comply with the Insurance Brokers Registration Council (Indemnity Insurance and Grants Scheme) Rules 1987 (as amended). However, for the avoidance of doubt, in any dispute in connection with the terms, conditions, exclusions and limitations of this Policy it is specifically understood and agreed that the Insurance Brokers Registration Council (Indemnity Insurance and Grants Scheme) Rules 1987 (as amended) shall take precedence over any terms, conditions, exclusions or limitations contained herein which are less favourable to the Assured.
4. Notwithstanding any policy terms, conditions or exclusions to the contrary, this Policy shall indemnify the Assured in respect of claims made or losses sustained by Parent Company and/or Subsidiary or Associated Companies or any employee or former employee, Director or former Director, or such persons who have continued as Consultants thereof, arising out of the exercise and conduct of the Assured's professional business.
5. It is further understood and agreed that this Policy is extended, subject otherwise to its terms, conditions and exclusions, to indemnify Parent Company and/or Subsidiary or Associated Companies or any employee of or Director of, or Consultant to Parent Company and/or Subsidiary or Associated Companies in respect of claims made against or losses sustained by them arising out of the exercise and conduct of the Assured's professional business.

For the avoidance of doubt employees of or Directors of, or Consultants to Parent Company and/or Subsidiary or Associated Companies shall be deemed to be employees of the Assured in respect of business introduced by them to the Assured.

6. Insuring Clause

This Policy is extended, subject otherwise to its terms, conditions and exclusions, to indemnify:

- (a) at the Assured's election, various persons or firms who are acting as or who have at any time acted as, Sub-Contractors or Agents or Consultants to the Assured.

- (b) the estate, heirs, executors of those parties mentioned in the first paragraph of Extension 2.3 of the policy wording.

in respect of claims or losses which arise out of the exercise and conduct of the Assured's professional business during the period such persons are or were employed or engaged by the Assured.

4 YEAR 2000 EXCLUSION

Cover may exclude any claim, loss, liability or expense caused by or arising directly or indirectly from or in any way relating to any Computer System, whether or not property of the Assured, not being Year 2000 Compliant.

ANNEX D

[Required Forms]

Interim Prudential Sourcebook for Investment Businesses: Required Forms

[To be printed with FSA logo background]

These forms are the required forms referred to in IPRU(INV) and are listed below (a short contents list appears at the beginning of each section of the annex):

IPRU(INV) Chapter	FORM
2	Professional Firms
	2.1 Bond
3	Securities and Futures Firms which are not Investment Firms (former SFA Non-ISD Firms)
	3.1 Approved Form of Subordinated Loan Agreement
	3.2 Form of Deed of Termination
	3.3 Form of Deed of Variation
	3.4 Form of Guarantor Undertaking
	3.5 Guidance Notes
5	Investment Management Firms (former IMRO Firms)
	5.1 Prescribed Subordinated Loan Agreement
	5.2 Prescribed Approved Undertaking
10	Securities and Futures Firms which are Investment Firms (former SFA ISD Firms)
	10.1 Long Term Subordinated Loan Agreement
	10.2 Short Term Subordinated Loan Agreement
	10.3 Form of Deed of Termination
	10.4 Form of Deed of Variation
	10.5 Form of Guarantor Undertaking
	10.6 Long Term Consolidated Supervision Sub-Loan Agreement
	10.7 Short Term Consolidated Supervision Sub-Loan Agreement
	10.8 Guidance Notes
13	Personal Investment Firms (Former PIA Firms)
	13.1 Form of subordinated loan (with guidance notes)

2. Professional Firms

Form
2.1 Form of Bond

Page
2

**FORM OF BOND FOR PROFESSIONAL FIRMS
(SEE IPRU (INV) 2)**

BY THIS BOND AS A DEED WE [] of [] (“the Principal”) and [] of [] (“the Surety”) as witnessed by its common seal (so that the Surety whose seal is affixed below shall alone be bound) are jointly and severally bound upon the terms and conditions herein set out to [] (“the Trustee”) in the sum of £[] ([sum in words]) or such other sum as may from time to time be agreed between the Surety and the Principal (“the Penalty Sum”).

WHEREAS:-

- (1) The Trustee has consented to enter into this bond as trustee and to hold the rights and benefits under this bond upon trust for any Customer of the Principal in accordance with the terms of this bond.**
- (2) The Surety at the request of the Principal has agreed to be bound in the Penalty Sum upon the terms and conditions hereinafter contained.**

NOW THIS DEED WITNESSES as follows:-

- (1) For the purposes of this bond a claim shall arise if the following conditions are satisfied:-**
 - a. the Scheme has determined the Principal to be in default;**
 - b. the Trustee has determined to pay compensation to an eligible claimant whose claim is in respect of a Civil Liability incurred by the Principal in connection with its carrying on of Regulated Activities; and**
 - c. the claim in question relates to a Loss.**
- (2) The Surety and the Principal are held and firmly bound to the Trustee for the payment of any sum arising out of any claim under the provisions of Clause 1 hereof to the extent that any such claim exceeds the sum of fifty thousand pounds (£50,000) provided that the aggregate of any such sum or sums does not exceed the Penalty Sum.**
- (3) The Trustee hereby declares that it holds all its rights and benefits under this bond upon trust for the Customers in respect of whom or for which such claim or claims were made absolutely.**
- (4) The Trustee shall, insofar as it may lawfully do so, notify the Surety of any claim or Matter of which the Trustee is aware which may give rise to any claim hereunder such notice to be addressed to the Surety in writing at its address set out above or to such other address as may have been notified to the Trustee in writing by the Surety and any such information which the Trustee**

shall when serving such notice designate as confidential shall be held and retained by the Surety in confidence.

- (5) Payment of any sum to the Trustee in respect of any claim shall be due thirty (30) days after the giving of notice thereof pursuant to Clause 4 hereof the Surety shall pay any such sum or sums on demand.
- (6) The Surety may give written notice to the Trustee sent by recorded delivery service to the address set out above or such other address as the Trustee shall from time to time advise in writing (and serving a copy of such notice upon the Principal) terminating its liability under this bond which liability shall accordingly cease sixty (60) days after receipt by the Trustee in writing of such notice (“the Termination Date”) save in respect of any claim rising out of anything notified by the Trustee to the Surety pursuant to Clause 4 prior to or within the period of six months after the Termination Date.
- (7) Notwithstanding the Release or Discharge of the Principal the Surety shall remain liable in respect of any claim arising during the period in which this bond was in force or which shall be made within six months of the Termination Date.
- (8) The Principal and its executors administrators or representatives whosoever jointly and severally agree and covenant with the Surety and the Trustee as follows:-

 - a. That they shall and will from time to time and notwithstanding the Release or Discharge of the Principal indemnify the Surety and its successors and assigns from and against all claims losses costs and expenses which the Surety shall or otherwise might at any time sustain or be put to under or by virtue of this bond.
 - b. That the Principal is a Professional Firm which has Permission under the Act to carry on Regulated Activities and will give notice forthwith to the Surety in writing if it shall cease to have such Permission or if it shall become aware of any Matter which might give rise to it being declared in default by the Scheme.
 - c. That the Principal will calculate the Penalty Sum that may be required under this bond from time to time so as to ensure that it complies with the Rules.
 - d. That the persons named herein are duly authorised for an on behalf of the Principal to execute this bond in the manner appearing below.
 - e. That the Trustee is irrevocably authorised to provide such information to the Surety as it shall think fit or as may be required for the purpose of making any claim and the Surety is irrevocably authorised to provide such information to the Trustee in relation to the obligations of the Principal secured by this bond as it shall think fit.

f. That the Principal will duly and promptly pay the annual premium due in respect of this bond.

(9) In this bond words and expressions having capitalised initial letters shall have the meanings set out in this bond and where not so defined shall have the meanings set out in the Glossary annexed to the General Provisions Instrument 2001 and as the same may hereafter be varied amended or supplemented from time to time

“the Act” means the Financial Services and Markets Act 2000 or any amendment or re-enactment of the provisions thereof;

“Civil Liability” means a civil liability as defined in the Scheme Regulations;

“Customer” means a customer as defined in the Scheme Regulations;

“Loss” means a loss which has been the subject of a valid claim determined by the Scheme in respect of which the amount of the Civil Liability is in excess of £50,000;

“Matter” means any proceedings initiated under the Act against the Principal in relation to its Regulated Activities;

“the Principal” means the Professional Firm named herein and includes each of the partners thereof where applicable;

“Release or Discharge” means the release of the Principal in relation to the termination of any Authorisation under the provisions of the Act;

“Scheme” means the Financial Services Compensation Scheme;

“Scheme Regulations” means the Financial Services Compensation Scheme Regulations.

Save where the context otherwise requires words and expressions used herein and in the Act shall bear the meaning given to them in the singular shall include the plural.

**IN WITNESS THEREOF the Principal acting by*
and*
as their duly authorised representatives and the Surety have executed and delivered
this bond as a deed this day of**

EXECUTED AND DELIVERED AS A DEED by

Witness

Signature

Occupation

Address

.....

EXECUTED AND DELIVERED AS A DEED by

Witness

Signature

Occupation

Address

.....

*** Where appropriate this bond should be executed by the compliance partner
 and the partner with overall responsibility for the Principal's Regulated
 Activities**

3. Securities and Futures Firms which are not Investment Firms (former SFA Non-ISD Firms)

Form		Page
3.1	Approved Form of Subordinated Loan Agreement	2
3.2	Form of Deed of Termination	17
3.3	Form of Deed of Variation	19
3.4	Form of Guarantor Undertaking	21
3.5	Guidance Notes	23
3.6	Form of Approved Bank Bond (with power of attorney)	31
3.7	Approved Form of Undertaking	34

3.1 Approved Form of Subordinated Loan Agreement

A. Front Page

THIS AGREEMENT is made on the date set out in the Variable Terms (as set out in **Schedule 1** to this Agreement) and is to be effective on that date unless a different effective date is set out in those terms

BETWEEN -

- (1) **the Lender** (as defined in the Standard Terms set out in **Schedule 2** to this Agreement),
- (2) **the Borrower** (as defined in the Standard Terms), and
- (3) **The Financial Services Authority Limited** whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS.

WHEREAS the Borrower wishes to use the Loan, or each Advance under the Facility (as those expressions are defined in the Standard Terms) as an eligible capital substitute in accordance with the FSA's rule IPRU(INV) 3-63 and has fully disclosed to the FSA the circumstances giving rise to the Loan or Facility and the effective subordination of the Loan and each Advance.

IT IS AGREED THAT this Agreement shall comprise the Variable Terms set out in **Schedule 1** to this Agreement and the Standard Terms set out in **Schedule 2** to this Agreement.

This Agreement is executed by the parties the day and year indicated in the Variable Terms.

Schedule 1

B. Variable Terms

1. Date of Agreement	
2. Effective Date	
3. Lender	
4. Address of Lender	
5. Borrower	
6. Address of Borrower	

7. **The Loan or Facility**

With reference to paragraph 2 of the Standard Terms,

--

8. **Interest**

With reference to paragraph 3 of the Standard Terms, interest shall be calculated and paid as follows -

--

9. **Repayment**

With reference to paragraph 4(2) of the Standard Terms and subject always to paragraphs 4(3) (restrictions on repayment) and 5 (subordination) of the Standard Terms, the terms for repayment are -

--	--

10. **Additional terms**

With reference to paragraph 11 of the Standard Terms, the additional terms to this Agreement are -

--	--

10. Additional terms (contd)

--	--

11. Jurisdiction

With reference to paragraph 16 of the Standard Terms, the person(s) indicated below is (are) appointed as agents for service of process -

(a) by the Lender -

--

of

--

(b) by the Borrower -

--

of

--

Schedule 2

C. Standard Terms

Interpretation

1 (1) In this Agreement -

“Advance” means, where this Agreement is for a loan facility, an amount drawn or to be drawn down by the Borrower or otherwise made available by the Lender under this Agreement as that amount may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“Borrower” means the person identified as such in the Variable Terms and includes its permitted successors and assigns and, where the Borrower is a partnership, each Partner;

“Business Day” means any day except Saturday, Sunday or a bank or public holiday in England;

“Effective Date” means the date on which this Agreement is to take effect being the date of this Agreement unless otherwise stated in the Variable Terms;

“Excluded Liabilities” means Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in the Insolvency of the Borrower;

“Facility” means the loan facility referred to in paragraph 2(2);

“Financial Resources” has the meaning given in the Financial Rules;

“Financial Resources Requirement” has the meaning given it in the Financial Rules;

“Financial Rules” means the rules in IPRU(INV) 3 in the FSA handbook;

“Insolvency” means and includes liquidation, winding up, bankruptcy, sequestration, administration, rehabilitation and dissolution (whichever term may apply to the Borrower) or the equivalent in any other jurisdiction to which the Borrower may be subject;

“Insolvency Officer” means and includes any person duly appointed to administer and distribute assets of the Borrower in the course of the Borrower’s Insolvency;

- 1 (1) **“Lender”** means the person identified as such in the Variable Terms and includes its permitted successors and assigns;

“Liabilities” means all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever);

“Loan” means the indebtedness of the Borrower to the Lender referred to in paragraph 2(1) as that indebtedness may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“Partner” means, where the Borrower is a partnership, each and every partner of the Borrower as a partner and as an individual (see also paragraph 8);

“Senior Liabilities” means all Liabilities except the Subordinated Liabilities and Excluded Liabilities;

“Subordinated Liabilities” means all Liabilities to the Lender in respect of the Loan or each Advance made under this Agreement and all interest payable thereon.

“the FSA” means The Financial Services Authority Limited whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS; and

- (2) Any reference to any rules of the FSA is a reference to them as in force from time to time.
- (3) Reference to any gender includes a reference to all other genders.
- (4) Reference to a paragraph is to a paragraph of these Standard Terms, unless otherwise indicated.

The Loan or Facility

- 2 (1) Where as indicated in the Variable Terms this Agreement is for a loan, the Borrower hereby acknowledges its indebtedness to the Lender in the sum mentioned in the Variable Terms as an unsecured loan upon and subject to the terms and conditions of this Agreement.
- (2) Where, as indicated in the Variable Terms this Agreement is for a loan facility -
- (a) the maximum aggregate principal amount of each Advance outstanding at any time under the Facility shall not exceed the maximum amount specified in the Variable Terms or such other amount as may be agreed between the Borrower and the Lender from time to time;
- (b) the Facility will be available until the last available date specified in the Variable Terms; and

- 2** (2) (c) any specific terms dealing with the mechanics of drawdown are contained in the Variable Terms.
- (3) The Lender and the Borrower undertake to provide the FSA, immediately upon request, with details in writing of all principal and interest in respect of the Loan or each Advance outstanding for the time being and all payments of any amount made in the period specified by the FSA in the request.

Interest

- 3** Subject to the provisions of paragraphs 4 and 5, until repayment of the Loan or each Advance in full, the Borrower will pay to the Lender interest on the Loan or each Advance (or on any part or parts of it or them for the time being outstanding under this Agreement) calculated and payable in the manner set out in the Variable Terms.

Repayment

- 4** (1) The provisions of this paragraph are subject in all respects to the provisions of paragraph 5 (subordination).
- (2) The terms concerning repayment are set out in the Variable Terms but are subject to paragraph 4(3).
- (3) (a) Unless the FSA otherwise permits, no repayment or prepayment of the Loan or any Advance may be made, in whole or in part, until five Business Days have elapsed from the FSA confirming in writing to the Borrower receipt of the Borrower's written notice of his intention to do so, except that -
- (i) where, immediately after repayment or prepayment, the Borrower's Financial Resources would be less than or equal to 120% of its Financial Resources Requirement, the prior written approval of the FSA shall be obtained before any repayment or prepayment;
 - (ii) any notice under this sub-paragraph or the terms referred to in sub-paragraph (2) above shall be ineffective if -
 - (aa) the Insolvency of the Borrower commences before the date on which such notice expires; or
 - (bb) the FSA notifies the Borrower orally or in writing of its refusal to consent to such repayment or prepayment by the time such notice period expires.
- (b) Payments of interest at a rate not exceeding the rate provided for in paragraph 3 may be made without notice to or consent of the FSA, except that where -
- (i) immediately after payment, the Borrower's Financial Resources would be less than or equal to 120% of its Financial Resources Requirement; or

- 4 (3) (b) (ii) before payment, the Insolvency of the Borrower commences,
no such payment may be made without the prior written approval of the FSA.
- (4) If in respect of the Loan or any Advance default is made for a period of -
- (a) seven days or more in the payment of any principal due, or
 - (b) 14 days or more in the payment of any interest due,
- the Lender may, at its discretion and after taking such preliminary steps or actions as may be necessary, enforce payment by instituting proceedings for the Insolvency of the Borrower after giving seven Business Day's prior written notice to the FSA of its intention to do so.
- (5) Subject to (6) below, the Lender may at its discretion, subject as provided in this Agreement, institute proceedings for the Insolvency of the Borrower to enforce any obligation, condition or provision binding on the Borrower under this Agreement (other than any obligation for the payment of principal moneys or interest in respect the Loan or any Advance) PROVIDED THAT the Borrower shall not by virtue of the institution of any such proceedings for the Insolvency of the Borrower be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.
- (6) The Lender may only institute proceedings for the Insolvency of the Borrower to enforce the obligations referred to in (5) above if -
- (a) a default under those obligations is not remedied to the satisfaction of the Lender within 60 days after notice of such default has been given to the Borrower by the Lender requiring such default to be remedied;
 - (b) the Lender has taken all preliminary steps or actions required to be taken by it prior to the institution of such proceedings; and
 - (c) the Lender has given seven Business Days' prior written notice to the FSA of its intention to institute such proceedings.
- (7) No remedy against the Borrower other than as specifically provided by this paragraph 4 shall be available to the Lender whether for the recovery of amounts owing under this Agreement or in respect of any breach by the Borrower of any of its obligations under this Agreement.

Subordination

- 5 (1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon -
- (a) (if an order has not been made or an effective resolution passed for the Insolvency of the Borrower and, being a partnership, the Borrower has not been dissolved) the Borrower being in compliance with not less than 120% of its Financial Resources Requirement immediately after payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that -
 - (i) paragraph 4(3) has been complied with; and
 - (ii) the Borrower could make such payment and still be in compliance with such Financial Resources Requirement;
 - (b) (if an order has been made or effective resolution passed for the Insolvency of the Borrower or, if a partnership, the Borrower is to be dissolved) the Borrower being “solvent” at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be “solvent”.
- (2) For the purposes of sub-paragraph (1)(b) above, the Borrower shall be “solvent” if it is able to pay its debts (other than the Subordinated Liabilities) in full disregarding -
- (a) obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and
 - (b) the Excluded Liabilities.
- (3) Interest will continue to accrue at the rate specified pursuant to paragraph 3 on any payment which does not become payable under this paragraph 5.
- (4) For the purposes of sub-paragraph (1)(b) above, a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to the FSA, shall in the absence of proven error be treated and accepted by the FSA, the Lender and the Borrower as correct and sufficient evidence of the Borrower’s solvency or Insolvency.

- 5** (5) Subject to the provisions of sub-paragraphs (6), (7) and (8) below, if the Lender shall receive from the Borrower payment of any sum in respect of the Subordinated Liabilities -
- (a) when any of the terms and conditions referred to in sub-paragraph (1) above is not satisfied, or
 - (b) where such payment is prohibited under paragraph 4(3),
- the payment of such sum shall be void for all purposes.
- (6) Any sum referred to in sub-paragraph (5) above shall be received by the Lender upon trust to return it to the Borrower.
- (7) Any sum so returned shall then be treated for the purposes of the Borrower's obligations hereunder as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower hereunder.
- (8) A request to the Lender for return of any sum referred to in sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.

Representations and undertakings of Borrower

- 6** From and after the date of this Agreement (or the Effective Date if earlier), the Borrower shall not without the prior written consent of the FSA -
- (a) secure all or any part of the Subordinated Liabilities;
 - (b) redeem, purchase or otherwise acquire any of the Subordinated Liabilities;
 - (c) amend any document evidencing or providing for the Subordinated Liabilities;
 - (d) repay any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
 - (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected; or
 - (f) arrange or permit any contract of suretyship (or similar agreement) relating to its liabilities under this Agreement to be entered into, and

other than as disclosed in writing to the FSA, the Borrower represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Representations and undertakings of Lender

- 7** From and after the date of this Agreement (or the Effective Date if earlier), the Lender shall not without the prior written consent of the FSA -
- (a) assign, transfer, dispose of or encumber the whole or any part of the Subordinated Liabilities or purport to do so in favour of any person;
 - (b) purport to retain or set off at any time any amount payable by it to the Borrower against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement, and the Lender shall immediately pay an amount equal to any retention or set off in breach of this provision to the Borrower and such retention or set off shall be deemed not to have occurred;
 - (c) amend or waive the terms of any document evidencing or providing for the Subordinated Liabilities;
 - (d) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
 - (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected; or
 - (f) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities, and the Lender shall, upon obtaining or enforcing any security, guarantee or indemnity notwithstanding this undertaking, hold the same (and any proceeds thereof) on trust for the Borrower, and

other than as disclosed in writing to the FSA, the Lender represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Borrower being a partnership

- 8** Where the Borrower is a partnership -
- (a) this Agreement shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Borrower by the retirement of the present Partners or any of them or the assumption of new Partners or by a change of name PROVIDED THAT -
 - (i) a retired Partner shall continue to be liable for the payment of all sums due under this Agreement and implementation of all other obligations in this Agreement until the Lender and the remaining Partner(s) shall agree in writing to release a retired Partner from those obligations and the FSA has agreed in writing to the release; and

- 8 (a) (ii) in the event of a new Partner being assumed as a partner of the Borrower the other Partners shall procure that said assumed Partner shall become bound to the Lender as a party to this Agreement and shall execute such addendum hereto as the Lender and the FSA may consider necessary;
- (b) the obligations and undertakings of the Borrower under this Agreement shall bind the Borrower and the Partners jointly and severally.

Partial invalidity

- 9 If any of the provisions of this Agreement is or becomes invalid, illegal or unenforceable under any law, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired.

the FSA and indemnity

- 10 the FSA shall not, by virtue of being a party to this Agreement, be taken to be a trustee for, or have any obligations to, any person to whom some or all of the Senior Liabilities are owed. Each of the Lender and Borrower shall on demand indemnify the FSA against all claims, losses, costs, expenses and other liabilities made against or incurred by the FSA as a consequence of it being a party to, or taking action under this Agreement.

Additional terms

- 11 Any additional terms agreed between the parties are set out in the Variable Terms provided that, if there is any inconsistency between the Variable Terms and the Standard Terms, the Standard Terms shall prevail.

Entire agreement

- 12 This Agreement forms the entire agreement as to the Subordinated Liabilities. If there are any other terms relating to the Subordinated Liabilities existing at the date hereof and not comprised in this Agreement such terms shall be of no further force and effect.

Amendments

- 13 Any amendments to this Agreement made or purported to be made without the consent of the FSA shall be void.

Notices to the FSA

- 14** A notice given to the FSA under this Agreement shall have no effect, and time shall not start to run in connection with that notice, until the FSA has given to the sender written confirmation of its receipt.

Law

- 15** This Agreement is governed by English law.

Jurisdiction

- 16** For the benefit of the FSA solely, each of the Borrower and the Lender irrevocably submits to the jurisdiction of the English Courts and, to the extent that it does not have a place of business within the jurisdiction, appoints the process agent specified in the Variable Terms as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that non-exclusivity prejudices the submission to the jurisdiction.

Approved Form Of Subordinated Loan Agreement

D. Signature Page

The Common Seal of
THE FINANCIAL SERVICES
AUTHORITY LIMITED
was hereunto affixed in the presence of

.....
(Authorised signatory)

.....
(Authorised signatory)

3.2 FORM OF DEED OF TERMINATION

THIS DEED OF TERMINATION is made on the day of 20.....

BETWEEN -

- (1) * [insert full name of Lender] (registered in [England] number *) whose registered office is at * (“the **Lender**”).
- (2) * [insert full name of Borrower] (registered in [England] number *) whose registered office is at * (“the **Borrower**”).
- (3) **The Financial Services Authority Limited** (registered in England number 1920623) whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS (“the **FSA**”).

WHEREAS -

A subordinated loan agreement was entered in between the Lender (1); the Borrower (2); and the FSA (3) on [date] (“the Agreement”) pursuant to which the Lender agreed to make available to the Borrower a [Loan/Facility] of up to [£]. [insert brief details of any Variations] The parties to the Agreement now wish to terminate the Agreement.

IT IS AGREED THAT -

1. The Agreement shall be deemed terminated [in accordance with its terms] with effect from [the date of this Deed of Termination/insert relevant future date]. All obligations and liabilities arising before that date shall remain continuing.
2. This Deed is governed by English Law.

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

.....

Signed
Director

Signed
Director/Secretary

Executed as a deed by [full name of Borrower]

.....

Signed
Director

Signed
Director/Secretary

The Common Seal of THE FINANCIAL
SERVICES AUTHORITY LIMITED
was hereunto affixed in the
presence of

Signed
Authorised Signatory

Signed
Authorised Signatory

3.3 FORM OF DEED OF VARIATION

THIS DEED OF VARIATION is made on the day of 20.....

BETWEEN -

- (1) * [insert full name of Lender] (registered in [England] number *) whose registered office is at * (“the **Lender**”);
- (2) * [insert full name of Borrower] (registered in [England] number *) whose registered office is at * (“the **Borrower**”); and
- (3) **The Financial Services Authority Limited** (registered in England number 1920623) whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS (“the **FSA**”).

WHEREAS -

A subordinated loan agreement was entered into between the Lender (1); the Borrower (2); and the FSA (3) on [date] (“the Agreement”) pursuant to which the Lender agreed to make available to the Borrower a (Loan/Facility) of up to [£].

The parties to the Agreement now wish to vary the Agreement to [insert brief details].

IT IS AGREED THAT -

1. The Agreement shall be deemed varied [, in accordance with its terms,] from [the date of this Deed of Variation/insert relevant future date] so that: [insert additional clauses/details of amended clauses].

[to the extent that any term of the Agreement is inconsistent with their terms and conditions contained in the Approved Form, the terms and conditions in the Approved Form shall prevail (provided that for the purposes of this clause 1, in clauses 11 and 12 of the Approved Form, the expressions “Variable Terms” and “Agreement” shall be deemed to include references to the Agreement and this Deed)*

2. All other terms and conditions of the Agreement remain unchanged.
3. This Deed is governed by English Law.

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

.....

Signed
Director

Signed
Director/Secretary

Executed as a deed by [full name of Borrower]

.....

Signed
Director

Signed
Director/Secretary

The Common Seal of THE FINANCIAL
SERVICES AUTHORITY LIMITED
was hereunto affixed in the
presence of

Signed
Authorised Signatory

Signed
Authorised Signatory

3.4 FORM OF GUARANTOR UNDERTAKING

This undertaking is entered into the [] day of [] 20[]

BETWEEN:-

- (1) [] (the “Guarantor”) of []; and
- (2) **The Financial Services Authority Limited** (“the FSA”) whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS.

WHEREAS:-

- (A) By a subordinated loan agreement (the “Loan Agreement”) [made on]/[of even date] between [] (the “Lender”), [] (the “Borrower”) and the FSA, the Lender made available to the Borrower a loan [facility] on the terms and conditions contained in the Loan Agreement.
- (B) By a guarantee (the “Guarantee”) made [of even date] between the Guarantor and the Lender, the Guarantor guaranteed the obligations of the Borrower to the Lender under the Loan Agreement on the terms and conditions contained in the Guarantee.

IT IS HEREBY AGREED as follows:-

- 1 The Guarantor hereby undertakes and confirms to the FSA that all and any rights which the Guarantor may have against the Borrower in respect of the Guarantee (whether by subrogation or otherwise howsoever) shall be subordinated on the same terms and conditions (mutatis mutandis) set out in the Loan Agreement (as amended from time to time) and further undertakes and confirms that the Guarantor will be bound by the terms of the Loan Agreement as if the Guarantor were a party to it in place of the Lender.
- 2 This undertaking is governed by English law.

IN WITNESS whereof this deed has been executed by the parties on the date first above written.

Executed as a Deed by
[]

Witness:.....

Witness’s Name:

Witness’s Address:

.....

The Common Seal of
The Financial Services Authority Limited
was hereunto affixed in the presence of:

.....
Authorised Signatory

.....
Authorised Signatory

3.5 Guidance Notes on Completion of Agreements

A GENERAL

Introduction

1. These Notes are designed to accompany the Approved Forms of Subordinated Loan Agreement, each of which is in four parts: the front page, the Variable Terms in Schedule 1, the Standard Terms in Schedule 2 and the signature page. The parties will need to set out details of themselves and the transaction in the Variable Terms and complete the signature page. The front page and the Standard Terms should remain unaltered.
2. All communications with the FSA regarding the proposed Agreement should in the first instance be via the firm's inspector.

ISD/Non-ISD

3. Firms are advised to ensure that the appropriate form of ISD (Chap.10)/non-ISD (Chap.3) subordinated loan agreement is used. This is, of course, dependent on the firm's authorisation categorisation. Should the firm's categorisation be changing from ISD to non-ISD (or vice versa), this should be discussed with the firm's inspector as it is likely that any subordinated loan agreement in place will have to be revised.

Preparation of the Agreement

4. (a) The form containing the Variable Terms may be completed or re-typed according to preference.

(b) Rather than re-type the Standard Terms (Schedule 2), firms should simply **photocopy Schedule 2 of the FSA precedent (or print it from the website) and include it as part of the original Agreement**. This avoids the need for the FSA to have to proof read the Standard Terms in each case which means that the FSA can process the Agreement more speedily and, of course, saves work for the firm in having to re-type the document.

Approval

5. (a) Firms should submit the proposed agreements to the FSA in **draft form** for its approval, marked for the attention of the appropriate inspector. If this practice is followed, any change required by the FSA can be effected without the firm and the lender having to re-execute the documents.

(b) When considering whether to approve the proposed agreement, the FSA will rely on a full disclosure to it of the circumstances giving rise to the giving of the loan or facility and its effective subordination. Attention is drawn in

particular to paragraphs 6 and 7 of the Standard Terms (representations and undertakings).

Financial Rule IPRU(INV) 3-63

6. Firms are referred to rule IPRU(INV) 3-63 on the use of subordinated loans, including restrictions on approved lenders, repayment provisions and gearing limits.

B NOTES ON VARIABLE TERMS

Dates

7. Paragraph 1: The **Date of the Agreement** should be left blank by the firm. This Date will be completed by the FSA when it ultimately executes the agreement.

Paragraph 2: If the **Effective Date of the Agreement** is to be different from the Date of the Agreement, care should be taken to record this in paragraph 2. Where this is the case, the Effective Date will normally be expected to be later than the Date of the Agreement. If the Effective Date is to be a date prior to the date of the Agreement (for example because the loan was drawn down before the Agreement was put in place), the firm will be expected to provide a reasonable explanation to the FSA as to why it was not possible to document the loan more promptly.

Addresses

8. Paragraphs 4 and 6: The address given should be the firm's registered office or equivalent.

Partnerships

9. Paragraph 5: Where the Borrower is a partnership, insert "See Additional Terms, paragraph 10() below" and in paragraph 10 of Schedule 1, insert the names and addresses of each of the partners.

The Loan or Facility

10. Paragraph 7: Check that paragraph 2 of the Standard Terms accurately reflects the intentions of the parties.

11. Suggested wording for a loan is:

"This is an agreement for the Loan of £[]."

12. Suggested wording for a facility is:

"This is an agreement for a Facility under which the Lender is committed to make Advances in pounds sterling to the Borrower up to a maximum amount of £[] until the last available date of the Facility being [.....(date)].

The terms (if any) agreed between the parties on the mechanics of drawdown are as follows - ". *

* For example, the parties may wish to provide that:

“Advances may be drawdown in integral multiples of £100,000.”.

Interest

13. Paragraph 8: the FSA will be concerned if an excessive rate of interest compared with the market rate is charged. Broadly speaking a rate of interest will be regarded by the FSA as excessive if it is not a commercial one. Compound interest is not acceptable.

Repayment

14. Irrespective of the form of agreement being used, the specified notice period runs from the date of drawdown and, therefore, where a loan is in the form of a facility, each advance must be for a minimum of the required period.
15. Repayment clauses have given rise to confusion in the past. Sample wordings are set out below.
16. Under rule IPRU(INV) 3-63(5) (which is only relevant in relation to non-ISD firms), an amount repayable within three months of the effective date of the loan or advance is only acceptable as an eligible capital substitute in the absence of a waiver. A notice period of less than three months will accordingly require a waiver which will not normally be given. In many cases the most convenient approach is to provide for repayment on the expiry of three months written notice, such notice to be given to the FSA as well as to the other party to the agreement.
17. Paragraph 9: Examples of suggested wordings for either a fixed repayment date or repayment on notice for a non-ISD form are as follows:
- (a) "The Borrower shall repay [the Loan/each Advance made to it] on the date which falls three months after the date of drawdown of the [Loan/relevant Advance]."
 - (b) "The Borrower shall repay [the Loan/each Advance made to it] three months after the date on which:
 - (a) the Borrower gives written notice to the Lender and to the FSA; or

(b) the Lender gives written notice to the Borrower and to the FSA."

Note: either (a) or (b) above by itself is sufficient.

(c) "[The Loan / Each Advance made to the Borrower] shall be repayable on the date specified by notice in writing given by the Lender to the Borrower and to the FSA or notice in writing given by the Borrower to the Lender and to the FSA, in either case that date being not less than three months after the date on which the notice is given."

Additional terms

18. Paragraph 10: Additional terms may be agreed between the borrower and lender such as those relating to -

- representations and warranties
- provision of financial and other information
- covenants
- costs and expenses
- taxes and increased costs
- mechanics of payment
- notices
- termination provisions.

However, they should not be inconsistent with the Agreement or the FSA rules. For example, any terms dealing with additional payments by the borrower (eg to compensate for taxes or increased costs) should be subject to the FSA's prior written consent. Covenants and additional representations and warranties should not be inconsistent with the existing representations and warranties in paragraphs 6 and 7 of the Standard Terms. Similarly, any notices clause should take into account paragraph 14 of the Standard Terms (notices to the FSA of no effect until receipt confirmed). Any inconsistency between the Variable Terms and the Standard Terms is resolved in favour of the Standard Terms (paragraph 11 of the Standard Terms).

The lender and borrower should note that the action which can be taken by the lender in response to any breach of representation, warranty or covenant by the borrower is considerably constrained by paragraphs 4 and 5 of the Standard Terms. Therefore the value to the lender of including additional representations, warranties or covenants is very limited.

19. See also note 9 above for the situation where the borrower is a partnership and notes 24 -25 below for additional terms relating to law and jurisdiction.

Law and jurisdiction

20. If the borrower or lender is resident in another jurisdiction and does not have a branch office within the United Kingdom, paragraph 11 of the Variable Terms should be completed.
21. The borrower should not be appointed agent for service of process on the lender in case a dispute arises between them.

C NOTES ON STANDARD TERMS

Representations and undertakings

22. Paragraphs 6(f) and 7(f): Before giving its consent, the FSA will need to be satisfied that the guarantor or other provider of security has waived its right of subrogation against the borrower until all Senior Liabilities of the borrower have been paid in full. A form of deed for this purpose is available from the FSA.
23. On the effect of other terms relating to the subordinated liabilities not contained in this Agreement, see also paragraph 12 of the Standard Terms.
24. Paragraphs 15 and 16: See Notes 24-25 above.

D SIGNATURE PAGE

Arrangements for execution post FSA approval

25. (a) **Three identical original Agreements** (i.e. the front page, the two Schedules and the signature page, each copy stapled or otherwise bound together) should be prepared for signature. Firms and lenders may use any of the execution forms set out in Notes 34-35 below.
- (b) *Leaving the date of the Agreement in the Variable Terms blank*, the lender and borrower should execute the three original Agreements, initial any manuscript amendments and forward them to the appropriate FSA inspector so that they may be executed by the FSA.
- (c) The Date of the Agreement in paragraph 2 of the Variable Terms will be filled in by the FSA as the last party to sign the Agreement.

E DEEDS OF VARIATION/ DEEDS OF TERMINATION

- 26. Firms are advised to ensure that the appropriate standard form is used. These forms are available from the FSA on request.
- 27. The recitals to the deed should refer to the amount of the loan/ each advance and where applicable, briefly summarise the effect of any previous variation of the agreement and of variation of the original agreement which is currently proposed.
- 28. A variation or termination of a subordinated loan agreement can only be effected by the execution of a further deed. In particular, this means that the formalities for executing a deed (see note 34-36 below) must be observed for all deeds of variation or termination and that all parties to the original agreement must also be parties to the subsequent deed of variation or termination. Only the forms set out at Notes 35(1) and (2) or 36(2) below are appropriate for execution as a deed.
- 29. A deed of variation will be required where the parties wish to change the terms of a subordinated loan agreement eg. where the amount of the loan or advance is to be increased. A deed of termination is needed where the parties wish to bring to terminate an agreement that is in place before it would otherwise come to an end. This could occur, for example, where the firm wants to substitute a new lender. Please note that where a subordinated loan agreement is terminated in this way, all obligations and liabilities of the parties arising before the date of termination remain in effect.

F Execution

- 30. In the case of English companies, reference is made to sections 36 and 36A of the Companies Act 1985 under which a company may contract
 - under its common seal
 - through any person acting under its authority, express or implied,and a document signed by a director and the secretary of the company or by two directors and expressed to be executed by the company as a deed has the same effect as if executed under the common seal of the company.

31. Suggested wordings for English companies are:

(1) THE COMMON SEAL OF

[]
was hereunto affixed
in the presence of

.....
Director

.....
Director/secretary

OR

(2) EXECUTED as a deed

by

.....

Director

.....

Director/secretary

(3) SIGNED for and on behalf of
[]

by

.....

Authorised signatory

(4) SIGNED for and on behalf of
[]

by

.....

Director

.....

Director/secretary

32. Suggested wording for individuals is –

(1) SIGNED by []
in the presence of -

.....

Signature of witness

.....

Name of witness

.....

Address of witness

.....

.....

OR

- (2) EXECUTED as a deed by []
in the presence of -

Signature of witness

Name of witness

Address of witness
.....

33. In the case of overseas companies or partnerships, appropriate wording should be used. If necessary, firms should obtain legal advice from lawyers qualified in the relevant jurisdiction.

Execution by the FSA

34. The three original Agreements will then be executed by the FSA. Two of the executed Agreements will be returned to the firm. The third will be retained by the FSA for safekeeping.

FORM OF APPROVED BANK BOND

"A"

1. This Bond is issued by [] of [] ("the Bank") for the benefit of [] ("the Firm").
2. The Bank hereby IRREVOCABLY AND UNCONDITIONALLY undertakes to the Firm that forthwith upon receipt of a notice of demand in the form referred to in paragraph 3 of this Bond it shall pay to the Firm the sum of £[] ("the Bonded Amount").
3. The notice of demand referred to in paragraph 2 of this Bond is a notice duly executed by The Financial Services Authority Limited ("the FSA") on behalf of the Firm (pursuant to the power of attorney executed contemporaneously herewith) which :-
 - (i) is deposited at any time during the currency of this Bond at the address of the Bank set out in paragraph 1 of this Bond (or such other address as may be notified by the Bank in writing to the FSA for this purpose from time to time);
 - (ii) demands payment in full of the Bonded Amount; and
 - (iii) certifies that the Firm is in default of its financial resources requirement as determined in accordance with the rules in IPRU(INV) 3 in the FSA handbook ("the Financial Rules") as in force at the relevant time. The Bank shall not be entitled to inquire into or require proof of the facts stated in the notice of demand which, as between the Bank, the FSA and the Firm, shall be conclusive.
4. The Bank shall have no recourse to the assets of the Firm in respect of the Bonded Amount and no other person shall have recourse to the assets of the Firm in respect of the Bonded Amount until payment in respect of all present and future sums, liabilities and obligations payable or owing by the Firm (whether actual or contingent, jointly or severally or otherwise howsoever) has been made in full to all other creditors.
5. The Bank may not terminate the Bond unless -
 - (i) the Firm will have financial resources equal to at least 120% of its financial resources requirement as determined in accordance with the Financial Rules of the FSA as in force at the relevant time immediately after termination of the Bond; or
 - (ii) the Bank is authorised by the FSA to terminate the Bond.
6. This Bond will not be terminated before the date specified in paragraph 8 below through any act or default of the Firm or otherwise.
7. This Bond shall not be affected by any change in:-
 - (i) the constitution of the Bank or the Firm; or
 - (ii) the provisions of the Financial Rules of the FSA.

8. This Bond shall remain valid from the date of its issue until [] [and the Bank[and the Firm] hereby irrevocably submit to the non exclusive jurisdiction of the English courts and irrevocably appoint [] as agents for the service of process in the said jurisdiction].*
9. This Bond shall be governed by and construed and take effect in all respects in accordance with English law.

EXECUTED as a deed this [] day of [] 20[].

THE COMMON SEAL of)
 [Bank])
 was hereunto affixed)
 in the presence of:-)

* Words in square brackets only necessary if the Bank or the Firm is incorporated outside the U.K.

POWER OF ATTORNEY

BY THIS POWER OF ATTORNEY given on the [] day of [] a company [incorporated in the United Kingdom] having its registered office at [] ("the Company") appoints The Financial Services Authority Limited ("the FSA") whose registered office is 25 The North Colonnade, Canary Wharf, London, E14 5HS to be the true and lawful attorney of the Company for the following purpose:-

By way of security for the obligation of the Company to maintain sufficient financial resources as required by the rules in IPRU(INV) 3 of the FSA handbook as in force from time to time to demand payment on behalf of the Company of the sums payable pursuant to the terms of the Approved Bank Bond (annexed hereto marked "A") in the manner prescribed by the terms of such Approved Bank Bond.

The Company declares the authority hereby conferred to be irrevocable as long as the Company shall remain authorised to conduct investment business in the United Kingdom by the FSA.

The authority hereby conferred may be exercised on behalf of the FSA by any one of its officers or employees duly authorised in that regard by a resolution of the FSA's Board or a duly authorised committee thereof.

This Power of Attorney shall be governed by and construed and take effect in all respects in accordance with English law.

IN WITNESS WHEREOF this deed has been duly executed by the Company and it is intended to be and is hereby delivered the day and year first above written.

THE COMMON SEAL of)
[Company])
was hereunto affixed)
in the presence of:-)

3.7 APPROVED FORM OF UNDERTAKING

THIS UNDERTAKING is entered into the [] day of [] 20[] BETWEEN:

- (1) [] of [] ("the Covenantor");
- (2) THE FINANCIAL SERVICES AUTHORITY LIMITED ("the FSA") whose registered office is 25 The North Colonnade, Canary Wharf, London, E14 5HS; and
- (3) [] of [] ("the Principal") [and [] of [], [] of [], and [] of []] the individual partners of the Principal as such partners and as individuals ** [+].

WHEREAS:

- (A) The Principal is authorised to carry on one or more regulated activities in the United Kingdom (as defined under the Financial Services and Markets Act 2000) by the FSA.
- (B) The Principal is required pursuant to the Financial Rules to maintain a Financial Resources Requirement (and the FSA has agreed that such Financial Resources Requirement may in part be represented by one or more undertakings in the form hereof to the extent that any undertaking(s) will not exceed the excess of 30% of the Principal's Base Requirement over the value of any Approved Bank Bond.
- (C) The Principal has requested the Covenantor to give an undertaking to the FSA for the purposes of the Principal's Financial Resources Requirement which the Covenantor has agreed to do.

NOW IT IS HEREBY AGREED AND DECLARED as follows:

1. Definitions

In this Undertaking:

"Base Requirement" has the meaning given in the Financial Rules;

"Business Day" means a day on which The International Stock Exchange of the United Kingdom Limited is open for business;

"Excluded Liabilities" means Liabilities which are expressed to be and in the opinion of the Insolvency Officer of the Principal [or, where relevant, the Insolvency Officer of a Partner**], do, rank junior to the Subordinated Liabilities in the insolvency of the Principal;

"Financial Resources" has the meaning given in the Financial Rules;

"Financial Resources Requirement" has the meaning given in the Financial Rules;

"the Financial Rules" means the rules in IPRU(INV) 3 of the FSA handbook;

"Insolvency" means and includes liquidation, winding up, bankruptcy and sequestration, administration, rehabilitation and dissolution (whichever term may apply to the Principal) or the equivalent in any other jurisdiction to which the Principal may be subject;

"Insolvency Officer" means and includes any person duly appointed to administer and distribute assets of the Principal in the course of the Principal's insolvency;

"Liabilities" means all present and future sums, liabilities and obligations payable or owing by the Principal [or any Partner**] (whether actual or contingent, jointly or severally or otherwise howsoever);

["Partner" means an individual partner of the Principal**];

"Senior Liabilities" means all Liabilities except all Liabilities in respect of any sums paid to the Principal under the terms of this Undertaking and Excluded Liabilities;

"Subordinated Liabilities" means all Liabilities to the Covenantor in respect of repayment of any sums paid to the Principal under the terms of this Undertaking.

Any reference to any rules of the FSA is a reference to them as already amended and includes a reference to any revoked rules which may be remade with or without amendments, and to any future rules and/or amendments of them.

2. In consideration of the FSA agreeing to take this Undertaking into account for the purpose of determining compliance by the Principal with its Financial Resources Requirement the Covenantor with intent to bind its successors and assigns and any body corporate with which it may amalgamate or merge HEREBY UNDERTAKES with and to the FSA and the Principal that at any time after the occurrence of any Event of Default specified in paragraph 6 hereof ("Event of Default") and notwithstanding that any other Event of Default may have occurred prior thereto the Covenantor will on demand in writing made upon it by the FSA accompanied by a certificate of the FSA as referred to in paragraph 9 hereof ("the Certificate") pay to the Principal or as the case may be the FSA (as determined in accordance with paragraph 3 below) the sum of £[] ("the Specified Amount").
3. In the case of an Event of Default falling within any of sub-paragraphs (1)(a), (1)(b) or (1)(c) of paragraph 6 below the sum to be paid pursuant to paragraph 2 above shall be paid to the FSA to be used at its discretion for any lawful purpose of the FSA , and in the case of an Event of Default falling within sub-paragraph (1)(d) of paragraph 6 below the sum to be paid pursuant to paragraph 2 above shall be paid to the Principal.
4. The liability of the Covenantor hereunder shall not be affected or discharged and the Covenantor shall not be released from its obligations hereunder by any act, omission, matter or thing whatsoever whereby, if the Covenantor was treated as a surety, guarantor or cautioner for the Principal, its liability would or might have been so affected or discharged or it might have been so released.
5. the FSA may without notification to or the consent of the Covenantor and without affecting or discharging the Covenantor's liability hereunder or releasing the Covenantor from its obligations hereunder from time to time waive or omit or fail to exercise or delay exercising its rights hereunder in respect of any Event of Default and any such waiver, omission, failure or delay shall not prejudice or affect the FSA 's rights hereunder in respect of that Event of Default (except in the case of a waiver) or any other or further Event of Default (whether or not of the same kind).
6. (1) The following shall be Events of Default for the purposes hereof:
 - (a) the Principal is deemed to be insolvent (as determined in accordance with sub-paragraph (2) below);

- (b) the Principal is unable or admits its inability to pay its debts as they fall due or makes a general assignment for the benefit of, or a compensation with, its creditors;
- (c) an encumbrancer takes possession or a receiver, judicial factor, or similar officer is appointed over all or any part of the undertaking or assets of the Principal;
- (d) the Principal shall in the bona fide opinion of the FSA have failed to maintain an excess of Financial Resources over its Financial Resources Requirement and in the bona fide opinion of the FSA shall not have remedied the same within seven days after being required by the FSA to restore the deficiency.

[(2) The Principal is deemed to become insolvent:

- (a) on the making of a winding-up order against it; or
- (b) on the passing of a resolution for a voluntary winding up in a case in which no statutory declaration has been made under Section 89 of the Insolvency Act 1986 or Article 534 of the Companies (Northern Ireland) Order 1986; or
- (c) on the holding of a creditors meeting summoned under Section 95 of that Act or Article 54 of that Order; or
- (d) on the appointment of an administrator for it under Section 9 of that Act; or
- (e) the occurrence of an event corresponding as nearly as may be to any of those mentioned in sub-paragraphs (a) to (d) above in any other jurisdiction to which the Principal may be subject.*]

[(2) The Principal is deemed to become insolvent:

- (a) in England and Wales on the making of a winding-up order against it under any provision of the Insolvency Act 1986 as applied by an order under Section 420 of that Act; or
- (b) in Scotland, on the making of an award of sequestration on the estate of the partnership; or
- (c) in Northern Ireland, on the making of an adjudication of bankruptcy against any one of the partners; or
- (d) elsewhere on the occurrence of an event corresponding as nearly as may be to any of those mentioned above in this sub-paragraph.**]

[(2) The Principal is deemed to become insolvent if:

- (a) in England and Wales, a bankruptcy order is made against him; or in Scotland, an award of sequestration is made on his estate; or
- (b) in Scotland, and award of sequestration is made on his estate; or
- (c) in Northern Ireland, an adjudication of bankruptcy is made against him; or

- (d) elsewhere than in the United Kingdom, there occurs in relation to him any event corresponding to those mentioned above in this paragraph. *
* *]

7. This Undertaking shall be a continuing undertaking and shall apply irrespective of, and shall not be affected or discharged by, any matter relating to the compliance at any time by the Principal with its Financial Resources Requirement and in particular (but without limitation) the fact (if such be the case) that the Principal at any time complies or is able to comply with the Financial Resources Requirement without making use of this Undertaking or taking the same into account for the purposes of its Financial Resources Requirement.
8. This Undertaking shall apply in relation to any Event of Default occurring at or before the close of business on the earliest (if any) to occur of the following dates ("the Termination Date"):
- (a) if the Covenantor gives the FSA not less than six months' written notice of its desire to terminate this Undertaking with effect from the date (being a date falling on or after the second anniversary of the date hereof) specified therein, such specified date;
 - (b) if the FSA and the Covenantor agree in writing to terminate this Undertaking with effect from the date specified in such agreement, such specified date; and
 - (c) if this Undertaking shall cease with effect from any day to be eligible to represent (in whole or in part) the Financial Resources Requirement to be maintained by the Principal pursuant to the Financial Rules, the date falling two business days after such day:

provided that no demand may be made upon the Covenantor hereunder later than midnight on the thirtieth business day after the Termination Date.

9. (a) In any demand proceedings or otherwise under this Undertaking the occurrence of any Event of Default shall be conclusively proved by a certificate signed by a duly authorised signatory of the FSA which shall specify the Event of Default which has occurred and to which the certificate relates and shall give brief particulars thereof.
- (b) If the FSA requires the Principal to remedy a breach of its Financial Resources Requirement as referred to in paragraph 6(1)(d) hereof, it shall notify the Covenantor thereof as soon as reasonably practicable thereafter.
10. A demand shall be duly made upon the Covenantor hereunder if it is signed by a duly authorised signatory of the FSA (accompanied by evidence reasonably satisfactory to the Covenantor of the signatory's authority) and is addressed to the Covenantor at its registered office [principal place of business in the United Kingdom] and posted by first-class mail and (if it has not been received prior thereto) the Covenantor shall be taken to have received such demand forty-eight hours after it is posted.
11. (1) The rights of the Covenantor to repayment of any sums paid to the Principal or, as the case may be, reimbursement by the Principal of any sums paid to the FSA under the terms of this Undertaking are subordinated to the Senior Liabilities and accordingly repayment of any such sums is conditional upon:
- (a) (if an order has not been made or an effective resolution passed for the insolvency of the Principal) the Principal being in compliance with its Financial Resources Requirement prevailing at the time of payment by the Principal, and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that, subject to sub-paragraph (2) below, the Principal could make such payment

and still be in compliance with such Financial Resources Requirement immediately thereafter;

(b) (if an order has been made or effective resolution passed for the insolvency of the Principal) [or if the Principal shall be dissolved**] the Principal being solvent at the time of payment by the Principal, and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Principal could make such payment and still be solvent immediately thereafter. For the purposes of this sub-paragraph, the Principal shall be solvent if it is able to pay its debts in full and in determining whether the Principal is solvent there shall be disregarded obligations which are not payable or capable of being established or determined in the insolvency of the Principal and the Excluded Liabilities.

- (2) No payment of the Subordinated Liabilities shall be made at any time pursuant to sub-paragraph (1)(a) above unless:
- (a) the Principal has given to the FSA prior written notification that it proposes to make such payment; and
 - (b) the FSA has notified the Principal in writing that it consents to such proposed payment.

The Principal shall give or procure that there are given to the FSA such information and auditor's certificate in relation to such proposed payment as the FSA may require.

- (3) For the purposes of sub-paragraph (1)(b) above a report given at any relevant time as to the solvency of the Principal by its Insolvency Officer, in form and substance acceptable to the FSA, shall in the absence of proven error be treated and accepted by the FSA, the Covenantor and the Principal as correct and sufficient evidence thereof.
- (4) If the Covenantor shall receive from the Principal [or any Partner**] payment of any sum in respect of the Subordinated Liabilities when any of the terms and conditions referred to in sub-paragraphs (1) or (2) above is not satisfied the payment of such sum shall be void for all purposes and [such sums shall be received by the Covenantor upon trust to return the same to the Principal+++] [the Covenantor shall at any time thereafter be bound to return such sum to the Principal or, as the case may be, its Insolvency Officer+] (and any sums so returned shall then be treated for the purposes of the Principal's obligations hereunder as if they had not been paid by the Principal and its original payment shall be deemed not to have discharged any of the obligations of the Principal hereunder). A request to the Covenantor for return of any sum under the foregoing provisions of this sub-paragraph (4) shall be in writing and shall be made by or on behalf of the Principal or, as the case may be, its Insolvency Officer.

12. The Covenantor will not without the prior written consent of the FSA :

- (i) assign or purport to assign to any person the whole or any part of the Subordinated Liabilities;
- (ii) purport to retain or set off at any time any amount payable by it to the Principal [or any Partner* *] against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities

would be permitted at such time by this Undertaking; amend any document evidencing or providing for the Subordinated Liabilities;

- (iii) amend any document evidencing or providing for the Subordinated Liabilities;
 - (iv) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Undertaking;
 - (v) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected;
 - (vi) take any security from any person for all or any part of the Subordinated Liabilities, and the Covenantor shall, upon obtaining security in breach of this Undertaking, hold the same [on trust for+++][as agent of and for the benefit of+] the Principal.
13. The Covenantor acknowledges that the FSA would seek to enforce any breach of the undertaking of the Covenantor contained in Clause 2 hereof by seeking an order for specific performance thereof and the Covenantor acknowledges that an order for specific performance would be the remedy appropriate to be granted to the FSA for such a breach.
14. This Undertaking forms the entire agreement as to the agreement of the Covenantor to provide an undertaking in relation to the Principal's Financial Resources Requirement. If there are any other terms relating thereto existing at the date hereof and not comprised in this Undertaking such terms shall be of no further force and effect. No variation of or amendment to this Undertaking shall be of any effect unless it is in writing subscribed by all the parties hereto. Any amendment to this Undertaking made or purported to be made without the consent of the FSA shall be void.
- [15. This Undertaking shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Principal by the retirement of the present partners or [either] [any] of them or the assumption of new partners or by a change of name it being provided that:
- (a) A retired partner shall continue to be liable for the payment of all sums due hereunder and implementation of all other obligations herein contained until such time as the Bank and the remaining partner[s] shall agree in writing to release a retired partner from such obligations; and
 - (b) In the event of a new partner being assumed as a partner of the Principal the other partners shall procure that said assumed partner shall become bound to the Covenantor as a party to these presents and shall execute such addendum hereto as the Covenantor and the FSA may consider necessary. **] +]
- [16. The Principal and the Partners hereby acknowledge to the Covenantor and the FSA that subject to the foregoing provisions of the Agreement they will be jointly and severally liable to the Covenantor for any sum paid by the Covenantor hereunder and that irrespective of whether such sum was paid by the Covenantor to the Principal or to the FSA . **] +]
17. This Undertaking is governed by [English law+++++] [the law of Scotland+] [Northern Irish law+++++] [, and for the benefit of the FSA solely the Covenantor irrevocably submits to the jurisdiction of the [English Courts+++++] [Court of Session, Scotland+] [Northern Irish Courts+++++] and appoints [] as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive

except to the extent that such non-exclusivity prejudices the submission to such jurisdiction].

Notes:

- (1) To be executed by the Covenantor under seal - other parties to execute either under seal or under hand.
- (2) Words in brackets throughout this document marked with a single asterisk are for use where the Principal is a corporation, those marked with a double asterisk are for use where the Principal is a partnership, and those marked with a triple asterisk where the Principal is an individual.
- (3) Words in brackets marked with a single cross are for use where the agreement is governed by Scottish law, with two crosses where the agreement is governed by either Scottish or Northern Irish law, three crosses where it is governed by either English or Northern Irish law, four crosses where it is governed by Northern Irish law and five crosses where it is governed by English law. Thus, for instance, words marked ++* * would be for use where the Borrower is a partnership and the agreement is governed by either Scottish or Northern Irish law.
- (4) Words in brackets in paragraph 17 above only required where either the Covenantor or the Principal (or both) are not incorporated in any part of the United Kingdom.

5 Investment Management Firms (former IMRO Firms)

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PRESCRIBED SUBORDINATED LOAN AGREEMENT

THIS SUBORDINATED LOAN AGREEMENT is made the ____ day of ____ 20 ____ between:

- (1) [____] of [____] (“the Lender” which term includes its permitted successors and assigns);
- (2) [____] of [____] (“the Borrower” which term includes its permitted successors and assigns).

WHEREAS

- (A) The Borrower is [has applied to be] regulated by FSA.
- (B) The Borrower is required to maintain financial resources to meet the provisions of Chapter 5 of the Interim Prudential Sourcebook as they apply to the Borrower at any particular time.
- (C) The Lender has agreed to lend [has lent] to the Borrower an amount as set out herein upon and subject to the terms and conditions contained in this Agreement.

NOW IT IS HEREBY AGREED as follows:

1. Definitions In this Agreement:
 - “Business Day”
means a day on which banks are open for all banking business in London;
 - “FSA”
means the Financial Services Authority;
 - “Interest Amount”
in respect of an Interest Period means the amount of interest payable in respect of such Interest Period calculated by applying the Rate of Interest in respect of such Interest Period to the average amount (calculated on a daily basis) of the principal of the Loan (together with any interest due but unpaid) outstanding during such Interest Period and multiplying the resulting sum by a fraction of which the numerator is equal to the actual number of days in the Interest Period concerned and the denominator is equal to 365;

“Interest Payment Date”
means [] and [] in each year;

“Interest Period”
means the period starting on the day following an Interest Payment Date and ending on the next following Interest Payment Date provided that the First Interest Period shall commence on the date hereof and end on the next following Interest Payment Date;

“Interim Prudential Sourcebook”
means the Interim Prudential Sourcebook for Investment Businesses made by the FSA;

“LIBOR”
in respect of an Interest Period means the rate determined by such London clearing bank as the Lender and Borrower shall agree to be the arithmetic mean (rounded to the nearest 1/16 of one per cent) of the offered quotations for 6 months sterling deposits in the London inter bank market at 11.00am (London time) on the Business Day prior to the commencement of such Interest Period;

“Loan”
means the Principal Amount (as defined in Clause 2) together with interest accrued thereon as may be outstanding from time to time;

“Rate of Interest”
in respect of an Interest Period means an amount expressed as a percentage per annum equal to the sum of LIBOR in respect of such Interest Period (expressed as a percentage per annum) and [] per cent per annum;

“Senior Creditors”

means all such persons who are:

- (a) unsubordinated creditors of the Borrower; or
- (b) subordinated creditors of the Borrower other than those whose claims are expressed to rank and do rank, pari passu with or junior to the claims of the Lender hereunder.

Clause headings in this Agreement are inserted for ease of reference only and shall not affect the construction of this Agreement.

2. The Loan

(a) The Lender [hereby agrees to advance]/[has on [] advanced] to the Borrower by way of loan the principal amount of [] (the “Principal Amount”) upon and subject to the terms and conditions contained in this Agreement.

[(b) [Upon signature hereof]/[On []] the Lender shall pay, or procure the payment of, the Principal Amount to the Borrower in freely available funds at its account number [] with [] bank.]

3. Interest

(a) Subject to the provisions of Clause 7 of this Agreement:

- (i) the Borrower will until repayment of the Loan in full pay to the Lender interest on the Loan or on any part or parts thereof for the time being remaining due hereunder in accordance with a written notice given by the Lender to the Borrower;
- (ii) on each Interest Payment Date the Borrower shall pay to the Lender the Interest Amount in respect of the Interest Period ending on such Interest Payment Date;

provided that at no time during the continuance of this Agreement shall the Rate of Interest exceed an annual rate of 5 per cent above LIBOR.

		(b) No payment on account of interest shall be made at any time to the extent that such payment would cause the Borrower to be in breach of rule 5.2.1(1) of Chapter 5 of the Interim Prudential Sourcebook (or any equivalent Rule for the time being in force). Any amount of interest whose payment is deferred under this provision shall be paid when and to the extent that the Borrower would not be in breach of rule 5.2.1(1) of the Interim Prudential Sourcebook after such payment. [The Agreement may make provision for interest on interest.]
4.	Early Repayment	<p>Subject to the provisions of Clause 7 of this Agreement the Borrower may make an early repayment of the whole or any part of the Loan provided that:</p> <p>(a) the written consent of FSA to such repayment is first obtained by the Borrower;</p> <p>(b) the Borrower must give to the Lender not less than one Business Day's prior notice of its intention to make such repayment, specifying the amount thereof and the date on which it is to be made (such notice to be ineffective if the winding up of the Borrower commences before the date on which such notice expires); and</p> <p>(c) the Borrower shall simultaneously pay all interest accrued to the date of repayment.</p>
5.	Repayment of the Loan	<p>Subject to the provisions of Clause 7 of this Agreement the Loan shall be repayable upon the expiry of [] months' written notice given by the Lender to the Borrower provided that:</p> <p>(a) such notice shall expire on a day falling after [five] [two] years from the date of [drawdown] [hereof]; and</p> <p>(b) the prior written consent of FSA to the repayment has first been obtained by the Borrower and not withdrawn; but</p> <p>(c) such notice shall cease to have effect if the winding up of the Borrower commences before the date on which such notice expires.</p>
6.	Event of Default	<p>Subject to the provisions of Clauses 7 and 10 of this Agreement:</p> <p>(a) if default is made for a period of five Business Days or more in the payment of any of the principal amount of the Loan [or for a period of 15 Business Days or more in the payment of any of the interest due in respect of the Loan] the Lender may, after taking such preliminary steps or actions as may be necessary, institute proceedings to wind up the Borrower;</p>

(b) if an order is made or an effective resolution is passed for the winding up of the Borrower, the Loan shall forthwith become repayable.

7. Subordination

Notwithstanding the provisions of Clauses 4, 5 and 6 of this Agreement, the rights of the Lender in respect of the Loan are subordinated in all respects to the rights of Senior Creditors in respect of amounts outstanding to them payable by the Borrower ("Senior Liabilities") and accordingly payment of any amount (whether in respect of principal, interest or otherwise and whether by way of repayment or prepayment) of the Loan shall be in all respects conditional upon compliance with the provisions below:

(a) The written consent of FSA to such payment is first obtained by the Borrower.

(b) (i) If at any time or from time to time an order has been made or an effective resolution passed for the winding up of the Borrower, then any payment of any amount (whether in respect of principal, interest or otherwise and whether by way of repayment or prepayment) of the Loan which under any other Clause of this Agreement would fall due for payment whilst the Borrower was insolvent or in insolvent liquidation will not fall so due, and instead such payment will become due for payment only if and when and to the extent that the Borrower could make such payment in whole or in part and still be solvent (whether or not it was in liquidation) thereafter. [Interest pursuant to Clause 3 hereof will continue to accrue on each and every such payment which is suspended under this Clause. Any payment suspended under this Clause but ultimately made will be made according to the amount of principal or interest (as the case may be) due to the Lender and in the event of both principal and interest being so suspended, payment will be made on account of principal before any payment is made on account of interest, but such alteration in order of payment will not prejudice the right of the Lender (which the Borrower acknowledges and confirms) to receive, subject to this Clause 7(b)(i) the full amount to which it would have been entitled if monies from time to time available for payment had been applied instead on account of interest before principal].

(ii) For the purposes of Clause 7(a) and (b) the Borrower may, and will whenever requested by the Lender whilst any payment remains suspended, procure a report or opinion by its auditors or (if it is in liquidation) by its liquidator as to whether or not the Borrower would be solvent at any time in any circumstances or whether or to what extent any payment in respect of the Loan could be made without infringing the provisions of this Sub-Clause and in the absence of proven error such report or opinion shall be treated and accepted by the Borrower and the Lender as correct and sufficient evidence of such fact.

(iii) Nothing in this Clause shall prevent the Lender from presenting or supporting any petition to wind up the Borrower, and the Borrower shall not put forward or rely on the provisions of this Clause as a ground for opposing any petition presented or supported by the Lender.

8. Payments

Subject to the provisions of Clause 7 of this Agreement:

- (a) all payments to be made by the Borrower hereunder shall be made in immediately available funds before [] on the date on which payment is due in such manner as the Lender may from time to time direct;
- (b) if any sum becomes due for payment pursuant to this Agreement on a day which is not a Business Day, such payment shall be made on the next succeeding Business Day and interest shall be adjusted accordingly;
- (c) all sums payable by the Borrower hereunder shall be paid in full without set off or counter claim and free and clear of and without deduction or withholding for or on account of any present or future taxes, duties or other charges. If any payment shall be subject to any such tax or if the Borrower shall be required by law to make any such deduction or withholding, the Borrower will pay such tax, will ensure that such payment, deduction or withholding, will not exceed the minimum legal liability therefore and will simultaneously pay to the Lender such additional amounts as will result in the Lender receiving a net amount equal to the full amount which the Lender would have received had no such payment, deduction or withholding been required.

9. Regulatory Consent	<p>The Lender will not without the prior written consent of FSA:</p> <ul style="list-style-type: none"> (a) assign or purport to assign to any person this Agreement or the whole or any part of its rights against the Borrower in respect of the Loan; (b) purport to retain or set off at any time any amount of the Loan against any amount otherwise payable by it to the Borrower except to the extent that payment of such amount of the Loan would be permitted at such time by this Agreement; (c) amend or waive or concur in amending or waiving the terms of this Agreement; (d) attempt to obtain repayment of the whole or any part of the Loan otherwise than in accordance with the terms of this Agreement; (e) take or omit to take any action whereby the subordination of the Loan or any part thereof as provided for in Clause 7 of this Agreement might be terminated, impaired or adversely affected; or (f) take any security from any person for all or any part of the Loan and so that the Lender shall, upon obtaining security in breach of this Clause, hold the same on trust for the Borrower.
10. Sole Remedy	<p>The Lender shall not be entitled to any remedy against the Borrower in respect of any default by the Borrower in repayment or prepayment of the Loan, or to enforce any other term of this Agreement, other than to institute proceedings to wind up the Borrower, provided always that the Borrower shall not, by the institution of such proceedings, become or be obliged to pay any sums or sum sooner than the same would otherwise have been payable by it pursuant to this Agreement.</p>
11. Trust	<p>Any amounts paid by the Borrower or received or recovered by the Lender or any security taken from any person in respect of the Loan in breach of the provisions of this Agreement and any distributions of any kind or character in respect of the Loan received or recovered by the Lender otherwise than in accordance with the provisions of this Agreement shall be held on trust by the Lender to return the same to the Borrower, or where applicable, the liquidator or other similar such officer.</p>

12.	Entire Agreement	The Borrower and the Lender acknowledge that this Agreement forms the entire agreement relating to the Loan. If there are any other terms relating to the Loan existing at the date hereof and not comprised in this Agreement such terms shall be of no further force and effect.
13.	Continuing Obligations	The obligations of the Borrower and Lender hereunder shall be continuing obligations and shall be and remain fully effective until the repayment of the Loan in full in accordance with the provisions of this Agreement.
14.	Governing Law	This Agreement shall be governed by and construed in accordance with the laws of England and each of the parties hereby irrevocably submits to the non-exclusive jurisdiction of the Courts of England and Wales, Scotland and Northern Ireland.
15.	Notices	<p>Any notice of demand to be given or made hereunder may be delivered by hand or sent by first class registered or pre-paid post to the recipient at the address first above mentioned or such other address as it shall last notify to each of the other parties hereto. Such notice shall be deemed to have been received:</p> <p>(a) if delivered by hand, on the day of delivery;</p> <p>(b) if sent by first class registered or pre-paid post three days after the date of despatch (as to which the sender's certificate shall be conclusive).</p>
16.	Counterparts	<p>This Agreement may be executed in any number of counterparts and by the different parties hereto on separate counterparts, each of which when so executed and delivered shall be an original, but all the counterparts shall together constitute one and the same instrument.</p> <p>IN WITNESS whereof the parties hereto have executed this Agreement as a deed the day and date first above written.</p>

Notes for Prescribed Subordinated Loan Agreement

These notes accompany the *prescribed subordinated loan agreement* and are intended to assist those who are or propose to be regulated by FSA. These notes relate solely to the mechanical drafting aspects of the prescribed agreement.

These notes refer to the Clauses in the order in which they appear in the prescribed agreement.

1. Parties Complete the name, registered number and registered office of the Lender and the Borrower.
2. Loan The Specimen Agreement provides for two alternative ways of advancing the Loan:
 - (a) one advance on the date of the Agreement; or
 - (b) one advance at a date other than the date of the Agreement.Firms are requested to specify clearly the date of the advance.
3. Interest The maximum rate of interest is 5 per cent above LIBOR. However, if a fixed rate of interest is charged, the Interest Rate must not exceed 5 per cent above LIBOR on the date the Loan is first taken out.

If the Loan is to be free of interest:

 - (a) Clause 3 should be deleted and replaced by the words "The Loan shall be interest-free"; and
 - (b) the definitions of "Interest Amount", "Interest Payment Date", "Interest Period", LIBOR and "Rate of Interest" should be deleted and consequential changes should be made to Clauses 4(c), 6(a), 7(preamble), 7(b)(i), and 8(b) accordingly.
4. Repayment The specified date of repayment must not be less than two years after:
 - (a) the date of the Agreement; or
 - (b) where the principal amount was advanced after the date of the Agreement, the date the principal amount was advanced.

5.	Execution	The date of the Agreement is the date on which execution of the Agreement by all parties is completed. Execution must accord with the laws and regulations governing the execution of documents in the jurisdiction of the Firm's principal place of business (e.g. a company whose principal place of business is in the UK must observe the requirements of Section 130 of the Companies Act 1989).
6.	Number of copies of Agreements	Three copies of the Agreement should be executed by both the Lender and the Borrower and forwarded to FSA. FSA will retain one original Agreement and return the other two copies to the Firm.

PRESCRIBED QUALIFYING UNDERTAKING

THIS UNDERTAKING IS ENTERED INTO

THE DAY OF 20 BETWEEN

- (1) [] of [] (“the Bank” or “Holding Company”)
- (2) FINANCIAL SERVICES AUTHORITY whose registered office is at 25 The North Colonnade, Canary Wharf, London E14 5HS (“FSA”) and
- (3) [] of [] (“the Principal”)

WHEREAS

- (A) The Principal is regulated by FSA
- (B) The Principal is required to maintain financial resources to meet the provisions of Chapter 5 of the Interim Prudential Sourcebook as they apply to the Principal and FSA has agreed that the Financial Resources Requirement may in part be represented by one or more undertakings in the form hereof
- (C) The Principal has requested the Bank or Holding Company to give an undertaking to FSA for the purposes of the Principal’s Financial Resources Requirement which the Bank or Holding Company has agreed to do

NOW THESE PRESENT WITNESS and it is hereby agreed and declared as follows:

1. In this Undertaking:

“Business Day”

means a day on which the Bank or Holding Company is open for business;

“Excluded Liabilities”

means Liabilities which are expressed to be and in the opinion of the liquidator of the Principal, do, rank junior to the Subordinated Liabilities in such liquidation;

“Financial Resources Requirement”

means the amount of liquid capital which the Principal is, pursuant to the Rules, required to maintain at any particular time;

“Interim Prudential Sourcebook”

means the Interim Prudential Sourcebook for Investment Businesses made by the FSA;

“Liabilities”

means all present and future sums, liabilities and obligations payable or owing by the Principal (whether actual or contingent, jointly or severally or otherwise howsoever);

“Senior Liabilities”

means all Liabilities except all Liabilities in respect of any sums paid to the Principal under the terms of this Undertaking and Excluded Liabilities;

“Subordinated Liabilities”

means all Liabilities of the Principal to the Bank or Holding Company in respect of repayment of any sums paid to the Principal under the terms of this Undertaking;

“the Rules”

means the Rules of FSA from time to time;

the term “liquid capital”

has the meaning ascribed to it in the Rules;

any reference to an enactment is a reference to it as already amended and includes a reference to any repealed enactment which it may re-enact, with or without amendments, and to any future re-enactment and/or amendment of it.

2. (a) In consideration of FSA agreeing to take this Undertaking into account for the purpose of determining compliance by the Principal with its Financial Resources Requirement the Bank or Holding Company with intent to bind its successors and assigns and any body corporate with which it may amalgamate or merge HEREBY UNDERTAKES with and to FSA and the Principal that at any time after the occurrence of any Event of Default specified in paragraph 5 hereof (“Event of Default”) and notwithstanding that any other Event of Default may have occurred prior thereto the Bank or Holding Company will on demand in writing made upon it by FSA accompanied by a certificate of FSA as referred to in paragraph 8 hereof (“the Certificate”) pay to the Principal the sum of £[] (“the Specified Amount”).
- (b) The Bank or Holding Company shall pay the Specified Amount to such account of the Principal as FSA may specify.
3. The liability of the Bank or Holding Company hereunder shall not be affected or discharged and the Bank or Holding Company shall not be released from its obligations hereunder by any act, omission, matter or thing whatsoever whereby, if the Bank or Holding Company was treated as a surety or guarantor for the Principal, its liability would or might have been so affected or discharged or it might have been so released.
4. FSA may without notification to or the consent of the Bank or Holding Company and without affecting or discharging the Bank’s or the Holding Company’s liability hereunder or releasing the Bank or Holding Company from its obligations hereunder from time to time waive or omit or fail to exercise or delay exercising its rights hereunder in respect of any Event of Default and any such waiver, omission, failure or delay shall not prejudice or affect FSA’s rights hereunder in respect of that Event of Default (except in the case of a waiver) or any other or further Event of Default (whether or not of the same kind).

5. The following shall be Events of Default for the purposes hereof:
- (a) the Principal is deemed to be unable to pay its debts in accordance with Section 123 of the Insolvency Act 1986;
 - (b) the Principal is unable or admits its inability to pay its debts as they fall due or makes a general assignment for the benefit of, or a composition with, its creditors;
 - (c) an encumbrancer takes possession, or a receiver, administrator or similar officer is appointed, of all or any part of the undertaking or assets of the Principal;
 - (d) the Principal shall in the opinion of FSA be in breach of its Financial Resources Requirement and in the opinion of FSA shall not have remedied such breach within 5 Business Days after being required by FSA to restore the deficiency.
6. This Undertaking shall be a continuing undertaking and shall apply irrespective of, and shall not be affected or discharged by, any matter relating to the compliance at any time by the Principal with its Financial Resources Requirement and in particular (but without limitation) the fact (if such be the case) that the Principal at any time complies or is able to comply with the Financial Resources Requirement without making use of this Undertaking or taking the same into account for the purposes of its Financial Resources Requirement.
7. This Undertaking shall apply in relation to any Event of Default occurring at or before the close of business on the earliest (if any) to occur of the following dates (“the Termination Date”):
- (a) if the Bank or Holding Company gives FSA not less than six months’ written notice of its desire to terminate this Undertaking with effect from the date (being a date falling on or after the second anniversary of the date hereof) specified therein, such specified date;
 - (b) if FSA and the Bank or Holding Company agree in writing to terminate this Undertaking with effect from the date specified in such agreement, such specified date; and
 - (c) if this Undertaking shall cease with effect from any day to be eligible to represent (in whole or in part) the Financial Resources Requirement to be maintained by the Principal pursuant to the Rules, the date falling two Business Days after such day.
- Provided that no demand may be made upon the Bank or Holding Company hereunder later than midnight on the thirtieth Business Day after the Termination Date.
8. (a) In any demand proceedings or otherwise under this Undertaking the occurrence of any Event of Default shall be conclusively proved by a certificate signed by a duly authorised signatory of FSA which shall specify the Event of Default which has occurred and to which the certificate relates and shall give brief particulars thereof.
- (b) If FSA requires the Principal to remedy a breach of its Financial Resources Requirement as referred to in paragraph 5(d) hereof, it shall notify the Bank or Holding Company thereof as soon as reasonably practicable thereafter.

- 9.** A demand shall be duly made upon the Bank or Holding Company hereunder if it is signed by a duly authorised signatory of FSA (accompanied by evidence reasonably satisfactory to the Bank or Holding Company of the signatory's authority) and is addressed to the Bank or Holding Company at its registered office [principal place of business in the UK] and posted by first class mail and (if it has not been received prior thereto) the Bank or Holding Company shall be taken to have received such demand forty-eight hours after it is posted.
- 10. (a)** The rights of the Bank or Holding Company to repayment of any sums paid to the Principal under the terms of this Undertaking are subordinated to the Senior Liabilities and accordingly repayment of any such sums is conditional upon:
- (i) (if an order has not been made or an effective resolution passed for the winding up of the Principal) the Principal being in compliance with its Financial Resources Requirement prevailing at the time of payment by the Principal and no such payment which would otherwise fall due will fall so due except to the extent that, subject to sub-paragraph (b) below, the Principal could make such payment and still be in compliance with such Financial Resources Requirement immediately thereafter;
 - (ii) (if an order has been made or effective resolution passed for the winding up of the Principal) the Principal being solvent at the time of payment by the Principal and accordingly no such payment which would otherwise fall due for payment will fall due except to the extent that the Principal could make such payment and still be solvent immediately thereafter. For the purposes of this sub-paragraph, the Principal shall be solvent if it is able to pay its debts in full and in determining whether the Principal is solvent for the purposes of this sub-paragraph there shall be disregarded obligations which are not payable or capable of being established or determined in the winding up of the Principal and the Excluded Liabilities.
- (b) No payment of the Subordinated Liabilities shall be made at any time pursuant to sub-paragraph (a)(i) above unless:
- (i) the Principal has given to FSA prior written notification that it proposes to make such payment; and
 - (ii) FSA has notified the Principal in writing that it consents to such proposed payment.
- The Principal shall give or procure that there are given to FSA such information and auditor's certificate in relation to such proposed payment as FSA may require.
- (c) For the purposes of sub-paragraph (a)(ii) above a report given at any relevant time as to the solvency of the Principal by its liquidator, in form and substance acceptable to FSA, shall in the absence of proven error be treated and accepted by FSA, the Bank or Holding Company and the Principal as correct and sufficient evidence thereof.

(d) If the Bank or Holding Company shall receive from the Principal payment of any sum in respect of the Subordinated Liabilities when any of the terms and conditions referred to in sub-paragraphs (a) or (b) above is not satisfied the payment of such sum shall be void for all purposes and such sums shall be received by the Bank or Holding Company upon trust to return the same to the Principal and the Bank or Holding Company shall at any time thereafter be bound to return such sum to the Principal or, as the case may be, its liquidator (and any sums so returned shall then be treated for the purposes of the Principal's obligations hereunder as if they had not been paid by the Principal and its original payment shall be deemed not to have discharged any of the obligations of the Principal hereunder). A request to the Bank or Holding Company for return of any sum under the foregoing provisions of this sub-paragraph (d) shall be in writing and shall be made by or on behalf of the Principal or, as the case may be, its liquidator.

11. The Bank or Holding Company will not without the prior written consent of FSA:

- (i) assign or purport to assign to any person the whole or any part of the Subordinated Liabilities;
- (ii) purport to retain or set-off at any time any amount payable by it to the Principal against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Undertaking;
- (iii) amend any document evidencing or providing for the Subordinated Liabilities;
- (iv) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Undertaking;
- (v) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected;
- (vi) take any security from any person for all or any part of the Subordinated Liabilities, and the Bank or Holding Company shall, upon obtaining security in breach of this undertaking, hold the same on trust for the Principal.

12. The Bank or Holding Company acknowledges that FSA would seek to enforce any breach of the Undertaking of the Bank or Holding Company contained in Clause 2 hereof by seeking an order for specific performance thereof and the Bank or Holding Company acknowledges that an order for specific performance would be the remedy appropriate to be granted to FSA for such a breach.

13. This Undertaking forms the entire Agreement as to the agreement of the Bank or Holding Company to provide an undertaking in relation to the Principal's Financial Resources Requirement. If there are any other terms relating thereto existing at the date hereof and not comprised in this Undertaking such terms shall be of no further force and effect. No variation of or amendment to this Undertaking shall be of any effect unless it is in writing subscribed by all the parties hereto. Any amendment to this Undertaking made or purported to be made without the consent of FSA shall be void.

14. This Undertaking is governed by English law [and for the benefit of FSA solely the Bank or Holding Company irrevocably submits to the jurisdiction of the Courts of England and Wales, Scotland and Northern Ireland and appoints [] as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that such non-exclusivity prejudices the submission to such jurisdiction].

(1) To be executed by the Bank or Holding Company under seal—other parties to execute either under seal or under hand.

(2) Words in brackets in 9 and 14 above are required only where either the Bank or Holding Company or the Principal (or both) are not incorporated in any part of the UK.

(3) Where the Principal is not a company, the provisions of the Undertaking shall (in agreement with FSA) be amended as appropriate to reflect the legal status of the Principal.

10 Securities and Futures Firms which are Investment Firms (former SFA ISD Firms)

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10.1 Approved Form of Long-Term Subordinated Loan Agreement

A. Front Page

THIS AGREEMENT is made on the date set out in the Variable Terms (as set out in **Schedule 1** to this Agreement) and is to be effective on that date unless a different effective date is set out in those terms

BETWEEN -

- (1) **the Lender** (as defined in the Standard Terms set out in **Schedule 2** to this Agreement),
- (2) **the Borrower** (as defined in the Standard Terms), and
- (3) **The Financial Services Authority Limited** whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS.

WHEREAS the Borrower wishes to use the Loan, or each Advance under the Facility (as those expressions are defined in the Standard Terms) in accordance with FSA rule IPRU(INV) 10-63 and has fully disclosed to the FSA the circumstances giving rise to the Loan or Facility and the effective Subordination of the Loan and each Advance.

IT IS AGREED THAT this Agreement shall comprise the Variable Terms set out in **Schedule 1** to this Agreement and the Standard Terms set out in **Schedule 2** to this Agreement.

This Agreement is executed by the parties the day and year indicated in the Variable Terms.

Schedule 1

B. Variable Terms

1. Date of Agreement	
2. Effective Date	
3. Lender	
4. Address of Lender	
5. Borrower	
6. Address of Borrower	

7. **The Loan or Facility**

With reference to paragraph 2 of the Standard Terms,

--

8. **Interest**

With reference to paragraph 3 of the Standard Terms, interest shall be calculated and paid as follows -

--

9. Repayment

With reference to paragraph 4(2) of the Standard Terms and subject always to paragraphs 4(3) (restrictions on repayment) and 5 (subordination) of the Standard Terms, the terms for repayment are -

[Empty rectangular box for repayment terms]

Notes to paragraph 9 -

1. The repayment date for the Loan must be one or more of -
 - a date not less than five years from the date of drawdown,
 - a date not less than five years from the Borrower giving notice in writing to the Lender and the FSA, or
 - a date not less than five years from the Lender giving notice in writing to the Borrower and the FSA.
2. Where this Agreement is for a loan facility each Advance must be treated separately and have a repayment date not less than five years from the date of drawdown, or be subject to not less than five years' notice or have and be subject to both.

10. **Additional terms**

With reference to paragraph 11 of the Standard Terms, the additional terms to this Agreement are -

Empty rectangular box for additional terms.

11. Jurisdiction

With reference to paragraph 16 of the Standard Terms, the person(s) indicated below is (are) appointed as agents for service of process -

(a) by the Lender -

--

of

--

(b) by the Borrower -

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of

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Schedule 2

C. Standard Terms

Interpretation

1 (1) In this Agreement -

“Advance” means, where this Agreement is for a loan facility, an amount drawn or to be drawn down by the Borrower or otherwise made available by the Lender under this Agreement as that amount may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“Borrower” means the person identified as such in the Variable Terms and includes its permitted successors and assigns and, where the Borrower is a partnership, each Partner;

“Business Day” means any day except Saturday, Sunday or a bank or public holiday in England;

“Effective Date” means the date on which this Agreement is to take effect being the date of this Agreement unless otherwise stated in the Variable Terms;

“Excluded Liabilities” means Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in any Insolvency of the Borrower;

“Facility” means the loan facility referred to in paragraph 2(2);

“Financial Resources” has the meaning given in the Financial Rules;

“Financial Resources Requirement” has the meaning given it in the Financial Rules;

“Financial Rules” means the rules in IPRU(INV) 10 in the FSA handbook;

“Insolvency” means and includes liquidation, winding up, bankruptcy, sequestration, administration, rehabilitation and dissolution (whichever term may apply to the Borrower) or the equivalent in any other jurisdiction to which the Borrower may be subject;

“Insolvency Officer” means and includes any person duly appointed to administer and distribute assets of the Borrower in the course of the Borrower’s Insolvency;

- 1 (1) **“Lender”** means the person identified as such in the Variable Terms and includes its permitted successors and assigns;

“Liabilities” means all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever);

“Loan” means the indebtedness of the Borrower to the Lender referred to in paragraph 2(1) as that indebtedness may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“Partner” means, where the Borrower is a partnership, each and every partner of the Borrower as a partner and as an individual (see also paragraph 8);

“Senior Liabilities” means all Liabilities except the Subordinated Liabilities and Excluded Liabilities;

“Subordinated Liabilities” means all Liabilities to the Lender in respect of the Loan or each Advance made under this Agreement and all interest payable thereon.

“the FSA” means The Financial Services Authority Limited whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS; and

- (2) Any reference to any rules of the FSA is a reference to them as in force from time to time.
- (3) Reference to any gender includes a reference to all other genders.
- (4) Reference to a paragraph is to a paragraph of these Standard Terms, unless otherwise indicated.

The Loan or Facility

- 2 (1) Where as indicated in the Variable Terms this Agreement is for a loan, the Borrower hereby acknowledges its indebtedness to the Lender in the sum mentioned in the Variable Terms as an unsecured loan upon and subject to the terms and conditions of this Agreement.
- (2) Where, as indicated in the Variable Terms this Agreement is for a loan facility -
- (a) the maximum aggregate principal amount of each Advance outstanding at any time under the Facility shall not exceed the maximum amount specified in the Variable Terms or such other amount as may be agreed between the Borrower and the Lender from time to time;
- (b) the Facility will be available until the last available date specified in the Variable Terms; and

- 2** (2) (c) any specific terms dealing with the mechanics of drawdown are contained in the Variable Terms.
- (3) The Lender and the Borrower undertake to provide the FSA, immediately upon request, with details in writing of all principal and interest in respect of the Loan or each Advance outstanding for the time being and all payments of any amount made in the period specified by the FSA in the request.

Interest

- 3** Subject to the provisions of paragraphs 4 and 5, until repayment of the Loan or each Advance in full, the Borrower will pay to the Lender interest on the Loan or each Advance (or on any part or parts of it or them for the time being outstanding under this Agreement) calculated and payable in the manner set out in the Variable Terms.

Repayment

- 4** (1) The provisions of this paragraph are subject in all respects to the provisions of paragraph 5(subordination).
- (2) The terms concerning repayment are set out in the Variable Terms but are subject to paragraph 4(3).
- (3) (a) Except where the FSA otherwise permits, no repayment or prepayment of the Loan or any Advance may be made, in whole or in part, before the relevant repayment date provided for in paragraph 9 of the Variable Terms.
- (b) At the request of the Borrower, the FSA may permit the early repayment or prepayment of the Loan or any Advance, in whole or in part, only where, immediately after such repayment or prepayment, the Borrower's Financial Resources would be greater than 100% of its Financial Resources Requirement.
- (c) Payments of interest at a rate not exceeding the rate provided for in paragraph 3 may be made without notice to or consent of the FSA, except that where -
- (i) immediately after payment, the Borrower's Financial Resources would be less than or equal to 120% of its Financial Resources Requirement; or
- (ii) before payment, the Insolvency of the Borrower commences,
- no such payment may be made without the prior written consent of the FSA.
- (4) If in respect of the Loan or any Advance default is made for a period of -
- (a) seven days or more in the payment of any principal due, or
- (b) 14 days or more in the payment of any interest due,

- 4 (4) the Lender may, at its discretion and after taking such preliminary steps or actions as may be necessary, enforce payment by instituting proceedings for the Insolvency of the Borrower after giving seven Business Day's prior written notice to the FSA of its intention to do so.
- (5) Subject to (6) below, the Lender may at its discretion, subject as provided in this Agreement, institute proceedings for the Insolvency of the Borrower to enforce any obligation, condition or provision binding on the Borrower under this Agreement (other than any obligation for the payment of principal moneys or interest in respect of the Loan or any Advance) PROVIDED THAT the Borrower shall not by virtue of the institution of any such proceedings for the Insolvency of the Borrower be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.
- (6) The Lender may only institute proceedings for the Insolvency of the Borrower to enforce the obligations referred to in (5) above if -
- (a) a default under those obligations is not remedied to the satisfaction of the Lender within 60 days after notice of such default has been given to the Borrower by the Lender requiring such default to be remedied;
 - (b) the Lender has taken all preliminary steps or actions required to be taken by it prior to the institution of such proceedings; and
 - (c) the Lender has given seven Business Days' prior written notice to the FSA of its intention to institute such proceedings.
- (7) No remedy against the Borrower other than as specifically provided by this paragraph 4 shall be available to the Lender whether for the recovery of amounts owing under this Agreement or in respect of any breach by the Borrower of any of its obligations under this Agreement.

Subordination

- 5 (1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon -
- (a) (if an order has not been made or an effective resolution passed for the Insolvency of the Borrower and, being a partnership, the Borrower has not been dissolved) the Borrower being in compliance with not less than 120% of its Financial Resources Requirement immediately after payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that -
 - (i) paragraph 4(3) has been complied with; and

- 5 (1) (a) (ii) the Borrower could make such payment and still be in compliance with such Financial Resources Requirement; and
- (b) the Borrower being “solvent” at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be “solvent”.
- (2) For the purposes of sub-paragraph (1)(b) above, the Borrower shall be “solvent” if it is able to pay its Liabilities (other than the Subordinated Liabilities) in full disregarding -
- (a) obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and
- (b) the Excluded Liabilities.
- (3) Interest will continue to accrue at the rate specified pursuant to paragraph 3 on any payment which does not become payable under this paragraph 5.
- (4) For the purposes of sub-paragraph (1)(b) above, a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to the FSA, shall in the absence of proven error be treated and accepted by the FSA, the Lender and the Borrower as correct and sufficient evidence of the Borrower’s solvency or Insolvency.
- (5) Subject to the provisions of sub-paragraphs (6), (7) and (8) below, if the Lender shall receive from the Borrower payment of any sum in respect of the Subordinated Liabilities -
- (a) when any of the terms and conditions referred to in sub-paragraph (1) above is not satisfied, or
- (b) where such payment is prohibited under paragraph 4(3),
- the payment of such sum shall be void for all purposes.
- (6) Any sum referred to in sub-paragraph (5) above shall be received by the Lender upon trust to return it to the Borrower.
- (7) Any sum so returned shall then be treated for the purposes of the Borrower’s obligations hereunder as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower hereunder.
- (8) A request to the Lender for return of any sum referred to in sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.

Representations and undertakings of Borrower

6 From and after the date of this Agreement (or the Effective Date if earlier), the Borrower shall not without the prior written consent of the FSA -

- (a) secure all or any part of the Subordinated Liabilities;
- (b) redeem, purchase or otherwise acquire any of the Subordinated Liabilities;
- (c) amend any document evidencing or providing for the Subordinated Liabilities;
- (d) repay any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
- (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected; or
- (f) arrange or permit any contract of suretyship (or similar agreement) relating to its liabilities under this Agreement to be entered into, and

other than as disclosed in writing to the FSA, the Borrower represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Representations and undertakings of Lender

7 From and after the date of this Agreement (or the Effective Date if earlier), the Lender shall not without the prior written consent of the FSA -

- (a) assign, transfer, dispose of or encumber the whole or any part of the Subordinated Liabilities or purport to do so in favour of any person;
- (b) purport to retain or set off at any time any amount payable by it to the Borrower against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement, and the Lender shall immediately pay an amount equal to any retention or set off in breach of this provision to the Borrower and such retention or set off shall be deemed not to have occurred;
- (c) amend or waive the terms of any document evidencing or providing for the Subordinated Liabilities;
- (d) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
- (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected; or

- 7 (f) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities, and the Lender shall, upon obtaining or enforcing any security, guarantee or indemnity notwithstanding this undertaking, hold the same (and any proceeds thereof) on trust for the Borrower, and

other than as disclosed in writing to the FSA, the Lender represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Borrower being a partnership

- 8 Where the Borrower is a partnership -

- (a) this Agreement shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Borrower by the retirement of the present Partners or any of them or the assumption of new Partners or by a change of name PROVIDED THAT -

- (i) a retired Partner shall continue to be liable for the payment of all sums due under this Agreement and implementation of all other obligations in this Agreement until the Lender and the remaining Partner(s) shall agree in writing to release a retired Partner from those obligations and the FSA has agreed in writing to the release; and

- (ii) in the event of a new Partner being assumed as a partner of the Borrower the other Partners shall procure that said assumed Partner shall become bound to the Lender as a party to this Agreement and shall execute such addendum hereto as the Lender and the FSA may consider necessary;

- (b) the obligations and undertakings of the Borrower under this Agreement shall bind the Borrower and the Partners jointly and severally.

Partial invalidity

- 9 If any of the provisions of this Agreement is or becomes invalid, illegal or unenforceable under any law, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired.

the FSA and indemnity

- 10 the FSA shall not, by virtue of being a party to this Agreement, be taken to be a trustee or other fiduciary for, or have any obligations to, any person to whom some or all of the Senior Liabilities are owed. Each of the Lender and Borrower shall on demand indemnify the FSA against all claims, losses, costs, expenses and other liabilities made against or incurred by the FSA as a consequence of it being a party to, or taking action under this Agreement.

Additional terms

- 11** Any additional terms agreed between the parties are set out in the Variable Terms provided that, if there is any inconsistency between the Variable Terms and the Standard Terms, the Standard Terms shall prevail.

Entire agreement

- 12** This Agreement forms the entire agreement as to the Subordinated Liabilities. If there are any other terms relating to the Subordinated Liabilities existing at the date hereof and not comprised in this Agreement such terms shall be of no further force and effect.

Amendments

- 13** Any amendments to this Agreement made or purported to be made without the consent of the FSA shall be void.

Notices to the FSA

- 14** A notice given to the FSA under this Agreement shall have no effect, and time shall not start to run in connection with that notice, until the FSA has given to the sender written confirmation of its receipt.

Law

- 15** This Agreement is governed by English law.

Jurisdiction

- 16** For the benefit of the FSA solely, each of the Borrower and the Lender irrevocably submits to the jurisdiction of the English Courts and, to the extent that it does not have a place of business within the jurisdiction, appoints the process agent specified in the Variable Terms as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that non-exclusivity prejudices the submission to the jurisdiction.

Approved Form Of Subordinated Loan Agreement

D. Signature Page

The Common Seal of
THE FINANCIAL SERVICES
AUTHORITY LIMITED
was hereunto affixed in the presence of

.....
(Authorised signatory)

.....
(Authorised signatory)

10.2 Approved Form of Short-Term Subordinated Loan Agreement

A. Front Page

THIS AGREEMENT is made on the date set out in the Variable Terms (as set out in **Schedule 1** to this Agreement) and is to be effective on that date unless a different effective date is set out in those terms

BETWEEN -

- (1) **the Lender** (as defined in the Standard Terms set out in **Schedule 2** to this Agreement),
- (2) **the Borrower** (as defined in the Standard Terms), and
- (3) **The Financial Services Authority Limited** whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS.

WHEREAS the Borrower wishes to use the Loan, or each Advance under the Facility (as those expressions are defined in the Standard Terms) in accordance with FSA rule IPRU(INV) 10-63 and has fully disclosed to the FSA the circumstances giving rise to the Loan or Facility and the effective subordination of the Loan and each Advance.

IT IS AGREED THAT this Agreement shall comprise the Variable Terms set out in **Schedule 1** to this Agreement and the Standard Terms set out in **Schedule 2** to this Agreement.

This Agreement is executed by the parties the day and year indicated in the Variable Terms.

Schedule 1

B. Variable Terms

1. Date of Agreement	
2. Effective Date	
3. Lender	
4. Address of Lender	
5. Borrower	
6. Address of Borrower	

7. **The Loan or Facility**

With reference to paragraph 2 of the Standard Terms,

--

8. **Interest**

With reference to paragraph 3 of the Standard Terms, interest shall be calculated and paid as follows -

--

9. Repayment

With reference to paragraph 4(2) of the Standard Terms and subject always to paragraphs 4(3) (restrictions on repayment) and 5 (subordination) of the Standard Terms, the terms for repayment are -



Notes to paragraph 9.

1. The repayment date for the Loan must be one or more of -
 - a date not less than two years from the date of drawdown,
 - a date not less than two years from the Lender giving notice in writing to the Borrower and the FSA, or
 - a date not less than two years from the Borrower giving notice in writing to the Lender and the FSA.
2. Where the Agreement is for a loan facility each Advance must be treated separately and have a repayment date not less than two years from the date of drawdown, or be subject to not less than two years' notice or have and be subject to both.

10. **Additional terms**

With reference to paragraph 11 of the Standard Terms, the additional terms to this Agreement are -

[Empty rectangular box for additional terms]

11. Jurisdiction

With reference to paragraph 16 of the Standard Terms, the person(s) indicated below is (are) appointed as agents for service of process -

(a) by the Lender -

--

of

--

(b) by the Borrower -

--

of

--

Schedule 2

C. Standard Terms

Interpretation

1 (1) In this Agreement -

“Advance” means, where this Agreement is for a loan facility, an amount drawn or to be drawn down by the Borrower or otherwise made available by the Lender under this Agreement as that amount may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“Borrower” means the person identified as such in the Variable Terms and includes its permitted successors and assigns and, where the Borrower is a partnership, each Partner;

“Business Day” means any day except Saturday, Sunday or a bank or public holiday in England;

“Effective Date” means the date on which this Agreement is to take effect being the date of this Agreement unless otherwise stated in the Variable Terms;

“Excluded Liabilities” means Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in any Insolvency of the Borrower;

“Facility” means the loan facility referred to in paragraph 2(2);

“Financial Resources” has the meaning given in the Financial Rules;

“Financial Resources Requirement” has the meaning given it in the Financial Rules;

“Financial Rules” means the rules in IPRU(INV) 10 of the FSA handbook;

“Insolvency” means and includes liquidation, winding up, bankruptcy, sequestration, administration, rehabilitation and dissolution (whichever term may apply to the Borrower) or the equivalent in any other jurisdiction to which the Borrower may be subject;

“Insolvency Officer” means and includes any person duly appointed to administer and distribute assets of the Borrower in the course of the Borrower’s Insolvency;

- 1 (1) **“Lender”** means the person identified as such in the Variable Terms and includes its permitted successors and assigns;

“Liabilities” means all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever);

“Loan” means the indebtedness of the Borrower to the Lender referred to in paragraph 2(1) as that indebtedness may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“Partner” means, where the Borrower is a partnership, each and every partner of the Borrower as a partner and as an individual (see also paragraph 8);

“Senior Liabilities” means all Liabilities except the Subordinated Liabilities and Excluded Liabilities;

“Subordinated Liabilities” means all Liabilities to the Lender in respect of the Loan or each Advance made under this Agreement and all interest payable thereon.

“the FSA” means The Financial Services Authority Limited whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS; and

- (2) Any reference to any rules of the FSA is a reference to them as in force from time to time.
- (3) Reference to any gender includes a reference to all other genders.
- (4) Reference to a paragraph is to a paragraph of these Standard Terms, unless otherwise indicated.

The Loan or Facility

- 2 (1) Where as indicated in the Variable Terms this Agreement is for a loan, the Borrower hereby acknowledges its indebtedness to the Lender in the sum mentioned in the Variable Terms as an unsecured loan upon and subject to the terms and conditions of this Agreement.

- (2) Where, as indicated in the Variable Terms this Agreement is for a loan facility -

(a) the maximum aggregate principal amount of each Advance outstanding at any time under the Facility shall not exceed the maximum amount specified in the Variable Terms or such other amount as may be agreed between the Borrower and the Lender from time to time;

(b) the Facility will be available until the last available date specified in the Variable Terms; and

- 2 (2) (c) any specific terms dealing with the mechanics of drawdown are contained in the Variable Terms.
- (3) The Lender and the Borrower undertake to provide the FSA, immediately upon request, with details in writing of all principal and interest in respect of the Loan or each Advance outstanding for the time being and all payments of any amount made in the period specified by the FSA in the request.

Interest

- 3 Subject to the provisions of paragraphs 4 and 5, until repayment of the Loan or each Advance in full, the Borrower will pay to the Lender interest on the Loan or each Advance (or on any part or parts of it or them for the time being outstanding under this Agreement) calculated and payable in the manner set out in the Variable Terms.

Repayment

- 4 (1) The provisions of this paragraph are subject in all respects to the provisions of paragraph 5(subordination).
- (2) The terms concerning repayment are set out in the Variable Terms but are subject to paragraph 4(3).
- (3) (a) Except where the FSA otherwise permits, no repayment, or prepayment of the Loan or any Advance may be made, in whole or in part, before the relevant repayment date provided for in paragraph 9 of the Variable Terms.
- (b) the FSA may permit the early repayment or prepayment of the Loan or any Advance, in whole or in part, only where, immediately after such repayment or prepayment, the Borrower's Financial Resources would be greater than 100% of its Financial Resources Requirement.
- (c) Payments of interest at a rate not exceeding the rate provided for in paragraph 3 may be made without notice to or consent of the FSA, except that where -
 - (i) immediately after payment, the Borrower's Financial Resources would be less than or equal to 120% of its Financial Resources Requirement; or
 - (ii) before payment, the Insolvency of the Borrower commences,no such payment may be made without the prior written consent of the FSA.
- (4) If in respect of the Loan or any Advance default is made for a period of -
 - (a) seven days or more in the payment of any principal due, or
 - (b) 14 days or more in the payment of any interest due,

- 4 (4) the Lender may, at its discretion and after taking such preliminary steps or actions as may be necessary, enforce payment by instituting proceedings for the Insolvency of the Borrower after giving seven Business Day's prior written notice to the FSA of its intention to do so.
- (5) Subject to (6) below, the Lender may at its discretion, subject as provided in this Agreement, institute proceedings for the Insolvency of the Borrower to enforce any obligation, condition or provision binding on the Borrower under this Agreement (other than any obligation for the payment of principal moneys or interest in respect of the Loan or any Advance) PROVIDED THAT the Borrower shall not by virtue of the institution of any such proceedings for the Insolvency of the Borrower be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.
- (6) The Lender may only institute proceedings for the Insolvency of the Borrower to enforce the obligations referred to in (5) above if -
- (a) a default under those obligations is not remedied to the satisfaction of the Lender within 60 days after notice of such default has been given to the Borrower by the Lender requiring such default to be remedied;
 - (b) the Lender has taken all preliminary steps or actions required to be taken by it prior to the institution of such proceedings; and
 - (c) the Lender has given seven Business Days' prior written notice to the FSA of its intention to institute such proceedings.
- (7) No remedy against the Borrower other than as specifically provided by this paragraph 4 shall be available to the Lender whether for the recovery of amounts owing under this Agreement or in respect of any breach by the Borrower of any of its obligations under this Agreement.

Subordination

- 5 (1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon -
- (a) (if an order has not been made or an effective resolution passed for the Insolvency of the Borrower and, being a partnership, the Borrower has not been dissolved) the Borrower being in compliance with not less than 120% of its Financial Resources Requirement immediately after payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that -
 - (i) paragraph 4(3) has been complied with; and

- 5 (1) (a) (ii) the Borrower could make such payment and still be in compliance with such Financial Resources Requirement; and
- (b) the Borrower being “solvent” at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be “solvent”.
- (2) For the purposes of sub-paragraph (1)(b) above, the Borrower shall be “solvent” if it is able to pay its Liabilities (other than the Subordinated Liabilities) in full disregarding -
- (a) obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and
- (b) the Excluded Liabilities.
- (3) Interest will continue to accrue at the rate specified pursuant to paragraph 3 on any payment which does not become payable under this paragraph 5.
- (4) For the purposes of sub-paragraph (1)(b) above, a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to the FSA, shall in the absence of proven error be treated and accepted by the FSA, the Lender and the Borrower as correct and sufficient evidence of the Borrower’s solvency or Insolvency.
- (5) Subject to the provisions of sub-paragraphs (6), (7) and (8) below, if the Lender shall receive from the Borrower payment of any sum in respect of the Subordinated Liabilities -
- (a) when any of the terms and conditions referred to in sub-paragraph (1) above is not satisfied, or
- (b) where such payment is prohibited under paragraph 4(3),
- the payment of such sum shall be void for all purposes.
- (6) Any sum referred to in sub-paragraph (5) above shall be received by the Lender upon trust to return it to the Borrower.
- (7) Any sum so returned shall then be treated for the purposes of the Borrower’s obligations hereunder as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower hereunder.
- (8) A request to the Lender for return of any sum referred to in sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.

Representations and undertakings of Borrower

- 6** From and after the date of this Agreement (or the Effective Date if earlier), the Borrower shall not without the prior written consent of the FSA -
- (a) secure all or any part of the Subordinated Liabilities;
 - (b) redeem, purchase or otherwise acquire any of the Subordinated Liabilities;
 - (c) amend any document evidencing or providing for the Subordinated Liabilities;
 - (d) repay any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
 - (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected; or
 - (f) arrange or permit any contract of suretyship (or similar agreement) relating to its liabilities under this Agreement to be entered into, and

other than as disclosed in writing to the FSA, the Borrower represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Representations and undertakings of Lender

- 7** From and after the date of this Agreement (or the Effective Date if earlier), the Lender shall not without the prior written consent of the FSA -
- (a) assign, transfer, dispose of or encumber the whole or any part of the Subordinated Liabilities or purport to do so in favour of any person;
 - (b) purport to retain or set off at any time any amount payable by it to the Borrower against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement, and the Lender shall immediately pay an amount equal to any retention or set off in breach of this provision to the Borrower and such retention or set off shall be deemed not to have occurred;
 - (c) amend or waive the terms of any document evidencing or providing for the Subordinated Liabilities;
 - (d) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
 - (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected; or

- 7 (f) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities, and the Lender shall, upon obtaining or enforcing any security, guarantee or indemnity notwithstanding this undertaking, hold the same (and any proceeds thereof) on trust for the Borrower, and

other than as disclosed in writing to the FSA, the Lender represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Borrower being a partnership

- 8 Where the Borrower is a partnership -

- (a) this Agreement shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Borrower by the retirement of the present Partners or any of them or the assumption of new Partners or by a change of name PROVIDED THAT -

- (i) a retired Partner shall continue to be liable for the payment of all sums due under this Agreement and implementation of all other obligations in this Agreement until the Lender and the remaining Partner(s) shall agree in writing to release a retired Partner from those obligations and the FSA has agreed in writing to the release; and

- (ii) in the event of a new Partner being assumed as a partner of the Borrower the other Partners shall procure that said assumed Partner shall become bound to the Lender as a party to this Agreement and shall execute such addendum hereto as the Lender and the FSA may consider necessary;

- (b) the obligations and undertakings of the Borrower under this Agreement shall bind the Borrower and the Partners jointly and severally.

Partial invalidity

- 9 If any of the provisions of this Agreement is or becomes invalid, illegal or unenforceable under any law, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired.

The FSA and indemnity

- 10 the FSA shall not, by virtue of being a party to this Agreement, be taken to be a trustee or other fiduciary for, or have any obligations to, any person to whom some or all of the Senior Liabilities are owed. Each of the Lender and Borrower shall on demand indemnify the FSA against all claims, losses, costs, expenses and other liabilities made against or incurred by the FSA as a consequence of it being a party to, or taking action under this Agreement.

Additional terms

- 11** Any additional terms agreed between the parties are set out in the Variable Terms provided that, if there is any inconsistency between the Variable Terms and the Standard Terms, the Standard Terms shall prevail.

Entire agreement

- 12** This Agreement forms the entire agreement as to the Subordinated Liabilities. If there are any other terms relating to the Subordinated Liabilities existing at the date hereof and not comprised in this Agreement such terms shall be of no further force and effect.

Amendments

- 13** Any amendments to this Agreement made or purported to be made without the consent of the FSA shall be void.

Notices to the FSA

- 14** A notice given to the FSA under this Agreement shall have no effect, and time shall not start to run in connection with that notice, until the FSA has given to the sender written confirmation of its receipt.

Law

- 15** This Agreement is governed by English law.

Jurisdiction

- 16** For the benefit of the FSA solely, each of the Borrower and the Lender irrevocably submits to the jurisdiction of the English Courts and, to the extent that it does not have a place of business within the jurisdiction, appoints the process agent specified in the Variable Terms as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that non-exclusivity prejudices the submission to the jurisdiction.

Approved Form Of Subordinated Loan Agreement

D. Signature Page

The Common Seal of
THE FINANCIAL SERVICES
AUTHORITY LIMITED
was hereunto affixed in the presence of

.....
(Authorised signatory)

.....
(Authorised signatory)

10.3 FORM OF DEED OF TERMINATION

THIS DEED OF TERMINATION is made on the day of 20....

BETWEEN -

- (1) * [insert full name of Lender] (registered in [England] number *) whose registered office is at * (“the **Lender**”).
- (2) * [insert full name of Borrower] (registered in [England] number *) whose registered office is at * (“the **Borrower**”).
- (3) **The Financial Services Authority Limited** (registered in England number 1920623) whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS (“the **FSA**”).

WHEREAS -

A subordinated loan agreement was entered in between the Lender (1); the Borrower (2); and the FSA (3) on [date] (“the Agreement”) pursuant to which the Lender agreed to make available to the Borrower a [Loan/Facility] of up to [£]. [insert brief details of any Variations] The parties to the Agreement now wish to terminate the Agreement.

IT IS AGREED THAT -

- 1. The Agreement shall be deemed terminated [in accordance with its terms] with effect from [the date of this Deed of Termination/insert relevant future date]. All obligations and liabilities arising before that date shall remain continuing.
- 2. This Deed is governed by English Law.

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

.....

Signed
Director

Signed
Director/Secretary

Executed as a deed by [full name of Borrower]

.....

Signed
Director

Signed
Director/Secretary

The Common Seal of THE FINANCIAL
SERVICES AUTHORITY LIMITED
was hereunto affixed in the
presence of

Signed
Authorised Signatory

Signed
Authorised Signatory

10.4 FORM OF DEED OF VARIATION

THIS DEED OF VARIATION is made on the day of 2.....

BETWEEN -

- (1) * [insert full name of Lender] (registered in [England] number *) whose registered office is at * (“the **Lender**”);
- (2) * [insert full name of Borrower] (registered in [England] number *) whose registered office is at * (“the **Borrower**”); and
- (3) **The Financial Services Authority Limited** (registered in England number 1920623) whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS (“the **FSA**”).

WHEREAS -

A subordinated loan agreement was entered into between the Lender (1); the Borrower (2); and the FSA (3) on [date] 199 (“the Agreement”) pursuant to which the Lender agreed to make available to the Borrower a (Loan/Facility) of up to [£].

The parties to the Agreement now wish to vary the Agreement to [insert brief details].

IT IS AGREED THAT -

1. The Agreement shall be deemed varied [, in accordance with its terms,] from [the date of this Deed of Variation/insert relevant future date] so that:

[insert additional clauses/details of amended clauses].

to the extent that any term of the Agreement is inconsistent with their terms and conditions contained in the Approved Form, the terms and conditions in the Approved Form shall prevail (provided that for the purposes of this clause 1, in clauses 11 and 12 of the Approved Form, the expressions “Variable Terms” and “Agreement” shall be deemed to include references to the Agreement and this Deed.

2. All other terms and conditions of the Agreement remain unchanged.
3. This Deed is governed by English Law.

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

.....

Signed
Director

Signed
Director/Secretary

Executed as a deed by [full name of Borrower]

.....

Signed
Director

Signed
Director/Secretary

The Common Seal of THE FINANCIAL
SERVICES AUTHORITY LIMITED
was hereunto affixed in the
presence of

Signed
Authorised Signatory

Signed
Authorised Signatory

10.5 FORM OF GUARANTOR UNDERTAKING

This undertaking is entered into the [] day of [] 20[]

BETWEEN:-

- (1) [] (the "Guarantor") of []; and
- (2) **The Financial Services Authority Limited** ("the FSA") whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS.

WHEREAS:-

- (A) By a subordinated loan agreement (the "Loan Agreement") made [of even date] between [] (the "Lender"), [] (the "Borrower") and the FSA, the Lender made available to the Borrower a loan [facility] on the terms and conditions contained in the Loan Agreement.
- (B) By a guarantee (the "Guarantee") made [of even date] between the Guarantor and the Lender, the Guarantor guaranteed the obligations of the Borrower to the Lender under the Loan Agreement on the terms and conditions contained in the Guarantee.

IT IS HEREBY AGREED as follows:-

- 1 The Guarantor hereby undertakes and confirms to the FSA that all and any rights which the Guarantor may have against the Borrower in respect of the Guarantee (whether by subrogation or otherwise howsoever) shall be subordinated on the same terms and conditions (mutatis mutandis) set out in the Loan Agreement (as amended from time to time) and further undertakes and confirms that the Guarantor will be bound by the terms of the Loan Agreement as if the Guarantor were a party to it in place of the Lender.
- 2 This undertaking is governed by English law.

IN WITNESS whereof this deed has been executed by the parties on the date first above written.

Executed as a Deed by
[]

Witness:.....

Witness's Name:

Witness's Address:

.....

The Common Seal of
The Financial Services Authority Limited
was hereunto affixed in the presence of:

.....
Authorised Signatory

.....
Authorised Signatory

10.6 Approved Form of Long-Term Subordinated Loan Agreement for the purposes of Consolidated Supervision

A. Front Page

THIS AGREEMENT is made on the date set out in the Variable Terms (as set out in **Schedule 1** to this Agreement) and is to be effective on that date unless a different effective date is set out in those terms

BETWEEN -

- (1) **the Lender** (as defined in the Standard Terms set out in **Schedule 2** to this Agreement) and
- (2) **the Borrower** (as defined in the Standard Terms)

WHEREAS the Borrower wishes the Loan to qualify as Financial Resources contributing to its Financial Resources Requirement, (as those expressions are defined in the Standard Terms) and has fully disclosed to the FSA the circumstances giving rise to the Loan or Facility and the effective subordination of the Loan.

IT IS AGREED THAT this Agreement shall comprise the Variable Terms set out in **Schedule 1** to this Agreement and the Standard Terms set out in **Schedule 2** to this Agreement.

This Agreement is executed by the parties the day and year indicated in the Variable Terms.

Schedule 1

B. Variable Terms

1. Date of Agreement	
2. Effective Date	
3. Lender	
4. Address of Lender	
5. Borrower	
6. Address of Borrower	

7. **The Loan or Facility**

With reference to paragraph 2 of the Standard Terms,

--

8. **Interest**

With reference to paragraph 3 of the Standard Terms, interest shall be calculated and paid as follows -

--

9. Repayment

With reference to paragraph 4(2) of the Standard Terms and subject always to paragraphs 4(3) (restrictions on repayment) and 5 (subordination) of the Standard Terms, the terms for repayment are -

Notes to paragraph 9.

1. The repayment date for the Loan must be one or more of -
 - a date not less than five years from the date of drawdown,
 - a date not less than five years from the Lender giving notice in writing to the Borrower and the FSA, or
 - a date not less than five years from the Borrower giving notice in writing to the Lender and the FSA.
2. Where the Agreement is for a loan facility each Advance must be treated separately and have a repayment date not less than five years from the date of drawdown, or be subject to not less than five years' notice or have and be subject to both.

10. **Additional terms**

With reference to paragraph 11 of the Standard Terms, the additional terms to this Agreement are -

[Empty rectangular box for additional terms]

11. Jurisdiction

With reference to paragraph 16 of the Standard Terms, the person(s) indicated below is (are) appointed as agents for service of process -

(a) by the Lender -

of

(b) by the Borrower -

of

Schedule 2

C. Standard Terms

Interpretation

1 (1) In this Agreement -

“Advance” means, where this Agreement is for a loan facility, an amount drawn or to be drawn down by the Borrower or otherwise made available by the Lender under this Agreement as that amount may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“Borrower” means the person identified as such in the Variable Terms and includes its permitted successors and assigns and, where the Borrower is a partnership, each Partner;

“Business Day” means any day except Saturday, Sunday or a bank or public holiday in England;

“Effective Date” means the date on which this Agreement is to take effect being the date of this Agreement unless otherwise stated in the Variable Terms;

“Excluded Liabilities” means Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in any Insolvency of the Borrower;

“Facility” means the loan facility referred to in paragraph 2(2);

“Financial Resources”; means the financial resources which apply to the Borrower as calculated under rule 10-200(1) of the Financial Rules and are notifiable to the Borrower via its subsidiaries regulated by the FSA from time to time;

“Financial Resources Requirement” means the financial resources requirement which applies to the Borrower as calculated under rule 10-200(1) of the Financial Rules and are notifiable to the Borrower via its subsidiaries regulated by the FSA from time to time;

“Financial Rules” means the rules in IPRU(INV) 10 in the FSA handbook;

“Insolvency” means and includes liquidation, winding up, bankruptcy, sequestration, administration, rehabilitation and dissolution (whichever term may apply to the Borrower) or the equivalent in any other jurisdiction to which the Borrower may be subject;

“Insolvency Officer” means and includes any person duly appointed to administer and distribute assets of the Borrower in the course of the Borrower’s Insolvency;

- 1 (1) **“Lender”** means the person identified as such in the Variable Terms and includes its permitted successors and assigns;

“Liabilities” means all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever);

“Loan” means the indebtedness of the Borrower to the Lender referred to in paragraph 2(1) as that indebtedness may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“Partner” means, where the Borrower is a partnership, each and every partner of the Borrower as a partner and as an individual (see also paragraph 8);

“Senior Liabilities” means all Liabilities except the Subordinated Liabilities and Excluded Liabilities;

“Subordinated Liabilities” means all Liabilities to the Lender in respect of the Loan or each Advance made under this Agreement and all interest payable thereon.

“the FSA” means The Financial Services Authority Limited whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS; and

- (2) Any reference to any rules of the FSA is a reference to them as in force from time to time.
- (3) Reference to any gender includes a reference to all other genders.
- (4) Reference to a paragraph is to a paragraph of these Standard Terms, unless otherwise indicated.

The Loan or Facility

- 2 (1) Where as indicated in the Variable Terms this Agreement is for a loan, the Borrower hereby acknowledges its indebtedness to the Lender in the sum mentioned in the Variable Terms as an unsecured loan upon and subject to the terms and conditions of this Agreement.
- (2) Where, as indicated in the Variable Terms this Agreement is for a loan facility -
- (a) the maximum aggregate principal amount of each Advance outstanding at any time under the Facility shall not exceed the maximum amount specified in the Variable Terms or such other amount as may be agreed between the Borrower and the Lender from time to time;
- (b) the Facility will be available until the last available date specified in the Variable Terms; and

- 2** (2) (c) any specific terms dealing with the mechanics of drawdown are contained in the Variable Terms.
- (3) The Lender and the Borrower undertake to provide the FSA, immediately upon request, with details in writing of all principal and interest in respect of the Loan or each Advance outstanding for the time being and all payments of any amount made in the period specified by the FSA in the request.

Interest

- 3** Subject to the provisions of paragraphs 4 and 5, until repayment of the Loan or each Advance in full, the Borrower will pay to the Lender interest on the Loan or each Advance (or on any part or parts of it or them for the time being outstanding under this Agreement) calculated and payable in the manner set out in the Variable Terms.

Repayment

- 4** (1) The provisions of this paragraph are subject in all respects to the provisions of paragraph 5(subordination).
- (2) The terms concerning repayment are set out in the Variable Terms but are subject to paragraph 4(3).
- (3) (a) Except where the FSA otherwise permits, no repayment, or prepayment of the Loan or any Advance may be made, in whole or in part, before the relevant repayment date provided for in paragraph 9 of the Variable Terms.
- (b) the FSA may permit the early repayment or prepayment of the Loan or any Advance, in whole or in part, only where, immediately after such repayment or prepayment, the Borrower's Financial Resources would be greater than 100% of its Financial Resources Requirement.
- (c) Payments of interest at a rate not exceeding the rate provided for in paragraph 3 may be made without notice to or consent of the FSA, except that where -
- (i) immediately after payment, the Borrower's Financial Resources would be less than or equal to 100% of its Financial Resources Requirement; or
- (ii) before payment, the Insolvency of the Borrower commences,
- no such payment may be made without the prior written consent of the FSA.
- (4) If in respect of the Loan or any Advance default is made for a period of -
- (a) seven days or more in the payment of any principal due, or
- (b) 14 days or more in the payment of any interest due,

- 4** (4) the Lender may, at its discretion and after taking such preliminary steps or actions as may be necessary, enforce payment by instituting proceedings for the Insolvency of the Borrower after giving seven Business Day's prior written notice to the FSA of its intention to do so.
- (5) Subject to (6) below, the Lender may at its discretion, subject as provided in this Agreement, institute proceedings for the Insolvency of the Borrower to enforce any obligation, condition or provision binding on the Borrower under this Agreement (other than any obligation for the payment of principal moneys or interest in respect of the Loan or any Advance) PROVIDED THAT the Borrower shall not by virtue of the institution of any such proceedings for the Insolvency of the Borrower be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.
- (6) The Lender may only institute proceedings for the Insolvency of the Borrower to enforce the obligations referred to in (5) above if -
- (a) a default under those obligations is not remedied to the satisfaction of the Lender within 60 days after notice of such default has been given to the Borrower by the Lender requiring such default to be remedied;
 - (b) the Lender has taken all preliminary steps or actions required to be taken by it prior to the institution of such proceedings; and
 - (c) the Lender has given seven Business Days' prior written notice to the FSA of its intention to institute such proceedings.
- (7) No remedy against the Borrower other than as specifically provided by this paragraph 4 shall be available to the Lender whether for the recovery of amounts owing under this Agreement or in respect of any breach by the Borrower of any of its obligations under this Agreement.

Subordination

- 5** (1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon -
- (a) (if an order has not been made or an effective resolution passed for the Insolvency of the Borrower and, being a partnership, the Borrower has not been dissolved) the Borrower being in compliance with not less than 100% of its Financial Resources Requirement immediately after payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that -
 - (i) paragraph 4(3) has been complied with; and

- 5 (1) (a) (ii) the Borrower could make such payment and still be in compliance with such Financial Resources Requirement; and
- (b) the Borrower being “solvent” at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be “solvent”.
- (2) For the purposes of sub-paragraph (1)(b) above, the Borrower shall be “solvent” if it is able to pay its Liabilities (other than the Subordinated Liabilities) in full disregarding -
- (a) obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and
- (b) the Excluded Liabilities.
- (3) Interest will continue to accrue at the rate specified pursuant to paragraph 3 on any payment which does not become payable under this paragraph 5.
- (4) For the purposes of sub-paragraph (1)(b) above, a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to the FSA, shall in the absence of proven error be treated and accepted by the FSA, the Lender and the Borrower as correct and sufficient evidence of the Borrower’s solvency or Insolvency.
- (5) Subject to the provisions of sub-paragraphs (6), (7) and (8) below, if the Lender shall receive from the Borrower payment of any sum in respect of the Subordinated Liabilities -
- (a) when any of the terms and conditions referred to in sub-paragraph (1) above is not satisfied, or
- (b) where such payment is prohibited under paragraph 4(3),
- the payment of such sum shall be void for all purposes.
- (6) Any sum referred to in sub-paragraph (5) above shall be received by the Lender upon trust to return it to the Borrower.
- (7) Any sum so returned shall then be treated for the purposes of the Borrower’s obligations hereunder as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower hereunder.
- (8) A request to the Lender for return of any sum referred to in sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.

Representations and undertakings of Borrower

6 From and after the date of this Agreement (or the Effective Date if earlier), the Borrower shall not without the prior written consent of the FSA -

- (a) secure all or any part of the Subordinated Liabilities;
- (b) redeem, purchase or otherwise acquire any of the Subordinated Liabilities;
- (c) amend any document evidencing or providing for the Subordinated Liabilities;
- (d) repay any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
- (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected; or
- (f) arrange or permit any contract of suretyship (or similar agreement) relating to its liabilities under this Agreement to be entered into, and

other than as disclosed in writing to the FSA, the Borrower represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Representations and undertakings of Lender

7 From and after the date of this Agreement (or the Effective Date if earlier), the Lender shall not without the prior written consent of the FSA -

- (a) assign, transfer, dispose of or encumber the whole or any part of the Subordinated Liabilities or purport to do so in favour of any person;
- (b) purport to retain or set off at any time any amount payable by it to the Borrower against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement, and the Lender shall immediately pay an amount equal to any retention or set off in breach of this provision to the Borrower and such retention or set off shall be deemed not to have occurred;
- (c) amend or waive the terms of any document evidencing or providing for the Subordinated Liabilities;
- (d) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
- (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected; or

- 7 (f) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities, and the Lender shall, upon obtaining or enforcing any security, guarantee or indemnity notwithstanding this undertaking, hold the same (and any proceeds thereof) on trust for the Borrower, and

other than as disclosed in writing to the FSA, the Lender represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Borrower being a partnership

- 8 Where the Borrower is a partnership -

- (a) this Agreement shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Borrower by the retirement of the present Partners or any of them or the assumption of new Partners or by a change of name PROVIDED THAT -

- (i) a retired Partner shall continue to be liable for the payment of all sums due under this Agreement and implementation of all other obligations in this Agreement until the Lender and the remaining Partner(s) shall agree in writing to release a retired Partner from those obligations and the FSA has agreed in writing to the release; and

- (ii) in the event of a new Partner being assumed as a partner of the Borrower the other Partners shall procure that said assumed Partner shall become bound to the Lender as a party to this Agreement and shall execute such addendum hereto as the Lender and the FSA may consider necessary;

- (b) the obligations and undertakings of the Borrower under this Agreement shall bind the Borrower and the Partners jointly and severally.

Partial invalidity

- 9 If any of the provisions of this Agreement is or becomes invalid, illegal or unenforceable under any law, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired.

The FSA and indemnity

- 10 The FSA shall not be taken to be a trustee or other fiduciary for, or have any obligations to, any person to whom some or all of the Senior Liabilities are owed. Each of the Lender and Borrower shall on demand indemnify the FSA against all claims, losses, costs, expenses and other liabilities made against or incurred by the FSA as a consequence of it taking action for breach of this Agreement.

Additional terms

- 11** Any additional terms agreed between the parties are set out in the Variable Terms provided that, if there is any inconsistency between the Variable Terms and the Standard Terms, the Standard Terms shall prevail.

Entire agreement

- 12** This Agreement forms the entire agreement as to the Subordinated Liabilities. If there are any other terms relating to the Subordinated Liabilities existing at the date hereof and not comprised in this Agreement such terms shall be of no further force and effect.

Amendments

- 13** Any amendments to this Agreement made or purported to be made without the consent of the FSA shall be void.

Notices to the FSA

- 14** A notice given to the FSA under this Agreement shall have no effect, and time shall not start to run in connection with that notice, until the FSA has given to the sender written confirmation of its receipt.

Law

- 15** This Agreement is governed by English law.

Jurisdiction

- 16** For the benefit of the FSA solely, each of the Borrower and the Lender irrevocably submits to the jurisdiction of the English Courts and, to the extent that it does not have a place of business within the jurisdiction, appoints the process agent specified in the Variable Terms as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that non-exclusivity prejudices the submission to the jurisdiction.

Approved Form Of Subordinated Loan Agreement

D. Signature Page

10.7 Approved Form of Short-Term Subordinated Loan Agreement for the purposes of Consolidated Supervision

A. Front Page

THIS AGREEMENT is made on the date set out in the Variable Terms (as set out in **Schedule 1** to this Agreement) and is to be effective on that date unless a different effective date is set out in those terms

BETWEEN -

- (1) **the Lender** (as defined in the Standard Terms set out in **Schedule 2** to this Agreement), and
- (2) **the Borrower** (as defined in the Standard Terms)

WHEREAS the Borrower wishes the Loan to qualify as Financial Resources contributing to its Financial Resources Requirement, (as those expressions are defined in the Standard Terms) and has fully disclosed to the FSA the circumstances giving rise to the Loan or Facility and the effective subordination of the Loan.

IT IS AGREED THAT this Agreement shall comprise the Variable Terms set out in **Schedule 1** to this Agreement and the Standard Terms set out in **Schedule 2** to this Agreement.

This Agreement is executed by the parties the day and year indicated in the Variable Terms.

Schedule 1

B. Variable Terms

1. Date of Agreement	
2. Effective Date	
3. Lender	
4. Address of Lender	
5. Borrower	
6. Address of Borrower	

7. **The Loan or Facility**

With reference to paragraph 2 of the Standard Terms,

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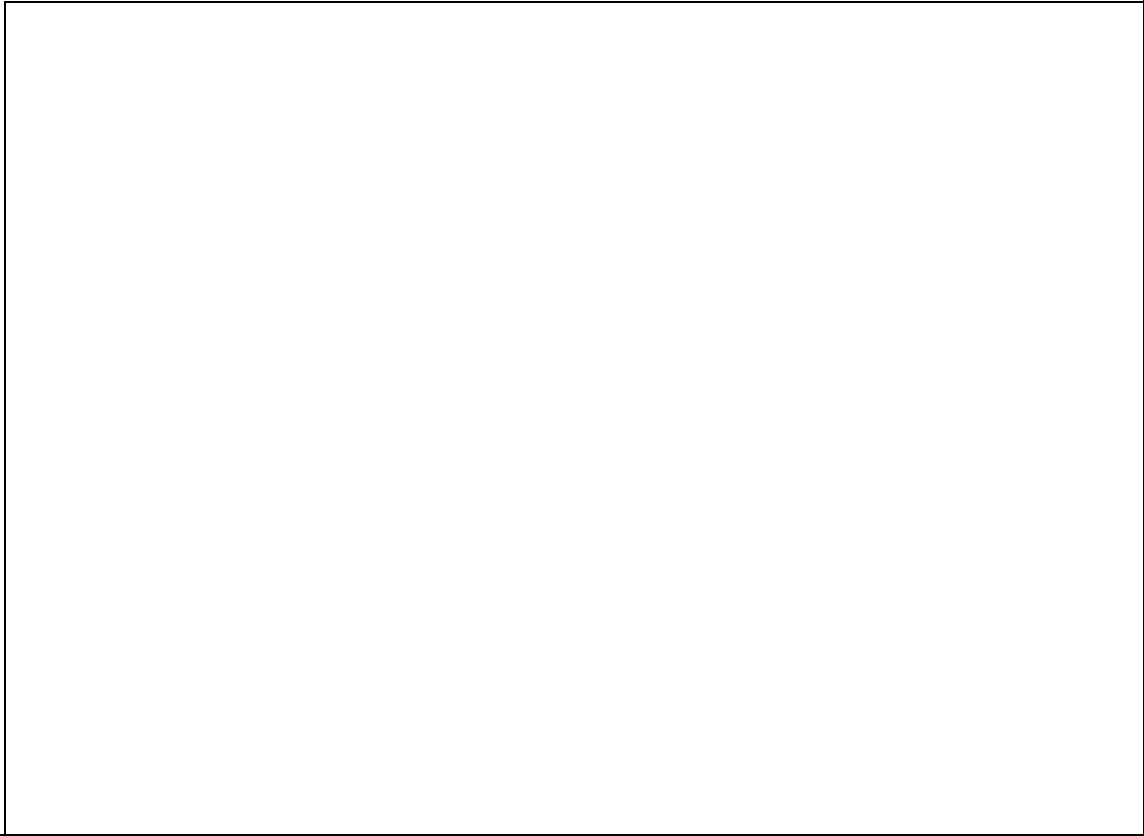
8. **Interest**

With reference to paragraph 3 of the Standard Terms, interest shall be calculated and paid as follows -

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9. **Repayment**

With reference to paragraph 4(2) of the Standard Terms and subject always to paragraphs 4(3) (restrictions on repayment) and 5 (subordination) of the Standard Terms, the terms for repayment are -



Notes to paragraph 9.

1. The repayment date for the Loan must be one or more of -
 - a date not less than two years from the date of drawdown,
 - a date not less than two years from the Lender giving notice in writing to the Borrower and the FSA, or
 - a date not less than two years from the Borrower giving notice in writing to the Lender and the FSA.
2. Where the Agreement is for a loan facility each Advance must be treated separately and have a repayment date not less than two years from the date of drawdown, or be subject to not less than two years' notice or have and be subject to both.

10. **Additional terms**

With reference to paragraph 11 of the Standard Terms, the additional terms to this Agreement are -

[Empty rectangular box for additional terms]

11. Jurisdiction

With reference to paragraph 16 of the Standard Terms, the person(s) indicated below is (are) appointed as agents for service of process -

(a) by the Lender -

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of

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(b) by the Borrower -

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of

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Schedule 2

C. Standard Terms

Interpretation

1 (1) In this Agreement -

“**Advance**” means, where this Agreement is for a loan facility, an amount drawn or to be drawn down by the Borrower or otherwise made available by the Lender under this Agreement as that amount may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“**Borrower**” means the person identified as such in the Variable Terms and includes its permitted successors and assigns and, where the Borrower is a partnership, each Partner;

“**Business Day**” means any day except Saturday, Sunday or a bank or public holiday in England;

“**Effective Date**” means the date on which this Agreement is to take effect being the date of this Agreement unless otherwise stated in the Variable Terms;

“**Excluded Liabilities**” means Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in any Insolvency of the Borrower;

“**Facility**” means the loan facility referred to in paragraph 2(2);

“**Financial Resources**” means the financial resources which apply to the Borrower as calculated under rule 10-200(1) of the Financial Rules and are notifiable to the Borrower via its subsidiaries regulated by the FSA from time to time;

“**Financial Resources Requirement**” means the financial resources requirement which applies to the Borrower as calculated under rule 10-200(1) of the Financial Rules and are notifiable to the Borrower via its subsidiaries regulated by the FSA from time to time.

“**Financial Rules**” means the rules in IPRU(INV) 10 of the FSA handbook;

“**Insolvency**” means and includes liquidation, winding up, bankruptcy, sequestration, administration, rehabilitation and dissolution (whichever term may apply to the Borrower) or the equivalent in any other jurisdiction to which the Borrower may be subject;

“**Insolvency Officer**” means and includes any **person** duly appointed to administer and distribute assets of the Borrower in the course of the Borrower’s Insolvency;

- 1 (1) **“Lender”** means the person identified as such in the **Variable** Terms and includes its permitted successors and assigns;

“Liabilities” means all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever);

“Loan” means the indebtedness of the Borrower to the Lender referred to in paragraph 2(1) as that indebtedness may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“Partner” means, where the Borrower is a partnership, each and every partner of the Borrower as a partner and as an individual (see also paragraph 8);

“Senior Liabilities” means all Liabilities except the Subordinated Liabilities and Excluded Liabilities;

“Subordinated Liabilities” means all Liabilities to the Lender in respect of the Loan or each Advance made under this Agreement and all interest payable thereon.

“the FSA” means The Financial Services Authority Limited whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS; and

- (2) Any reference to any rules of the FSA is a reference to them as in force from time to time.
- (3) Reference to any gender includes a reference to all other genders.
- (4) Reference to a paragraph is to a paragraph of these Standard Terms, unless otherwise indicated.

The Loan or Facility

- 2 (1) Where as indicated in the Variable Terms this Agreement is for a loan, the Borrower hereby acknowledges its indebtedness to the Lender in the sum mentioned in the Variable Terms as an unsecured loan upon and subject to the terms and conditions of this Agreement.
- (2) Where, as indicated in the Variable Terms this Agreement is for a loan facility -
- (a) the maximum aggregate principal amount of each Advance outstanding at any time under the Facility shall not exceed the maximum amount specified in the Variable Terms or such other amount as may be agreed between the Borrower and the Lender from time to time;
- (b) the Facility will be available until the last available date specified in the Variable Terms; and

- 2** (2) (c) any specific terms dealing with the mechanics of drawdown are contained in the Variable Terms.
- (3) The Lender and the Borrower undertake to provide the FSA, immediately upon request, with details in writing of all principal and interest in respect of the Loan or each Advance outstanding for the time being and all payments of any amount made in the period specified by the FSA in the request.

Interest

- 3** Subject to the provisions of paragraphs 4 and 5, until repayment of the Loan or each Advance in full, the Borrower will pay to the Lender interest on the Loan or each Advance (or on any part or parts of it or them for the time being outstanding under this Agreement) calculated and payable in the manner set out in the Variable Terms.

Repayment

- 4** (1) The provisions of this paragraph are subject in all respects to the provisions of paragraph 5(subordination).
- (2) The terms concerning repayment are set out in the Variable Terms but are subject to paragraph 4(3).
- (3) (a) Except where the FSA otherwise permits, no repayment, or prepayment of the Loan or any Advance may be made, in whole or in part, before the relevant repayment date provided for in paragraph 9 of the Variable Terms.
- (b) the FSA may permit the early repayment or prepayment of the Loan or any Advance, in whole or in part, only where, immediately after such repayment or prepayment, the Borrower's Financial Resources would be greater than 100% of its Financial Resources Requirement.
- (c) Payments of interest at a rate not exceeding the rate provided for in paragraph 3 may be made without notice to or consent of the FSA, except that where -
- (i) immediately after payment, the Borrower's Financial Resources would be less than or equal to 100% of its Financial Resources Requirement; or
- (ii) before payment, the Insolvency of the Borrower commences,
- no such payment may be made without the prior written consent of the FSA.
- (4) If in respect of the Loan or any Advance default is made for a period of -
- (a) seven days or more in the payment of any principal due, or
- (b) 14 days or more in the payment of any interest due,

- 4** (4) the Lender may, at its discretion and after taking such preliminary steps or actions as may be necessary, enforce payment by instituting proceedings for the Insolvency of the Borrower after giving seven Business Day's prior written notice to the FSA of its intention to do so.
- (5) Subject to (6) below, the Lender may at its discretion, subject as provided in this Agreement, institute proceedings for the Insolvency of the Borrower to enforce any obligation, condition or provision binding on the Borrower under this Agreement (other than any obligation for the payment of principal moneys or interest in respect of the Loan or any Advance) PROVIDED THAT the Borrower shall not by virtue of the institution of any such proceedings for the Insolvency of the Borrower be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.
- (6) The Lender may only institute proceedings for the Insolvency of the Borrower to enforce the obligations referred to in (5) above if -
- (a) a default under those obligations is not remedied to the satisfaction of the Lender within 60 days after notice of such default has been given to the Borrower by the Lender requiring such default to be remedied;
 - (b) the Lender has taken all preliminary steps or actions required to be taken by it prior to the institution of such proceedings; and
 - (c) the Lender has given seven Business Days' prior written notice to the FSA of its intention to institute such proceedings.
- (7) No remedy against the Borrower other than as specifically provided by this paragraph 4 shall be available to the Lender whether for the recovery of amounts owing under this Agreement or in respect of any breach by the Borrower of any of its obligations under this Agreement.

Subordination

- 5** (1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon -
- (a) (if an order has not been made or an effective resolution passed for the Insolvency of the Borrower and, being a partnership, the Borrower has not been dissolved) the Borrower being in compliance with not less than 100% of its Financial Resources Requirement immediately after payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that -
 - (i) paragraph 4(3) has been complied with; and

- 5** (1) (a) (ii) the Borrower could make such payment and still be in compliance with such Financial Resources Requirement; and
- the Borrower being “solvent” at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be “solvent”.
- (2) For the purposes of sub-paragraph (1)(b) above, the Borrower shall be “solvent” if it is able to pay its Liabilities (other than the Subordinated Liabilities) in full disregarding -
- (a) obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and
- (b) the Excluded Liabilities.
- (3) Interest will continue to accrue at the rate specified pursuant to paragraph 3 on any payment which does not become payable under this paragraph 5.
- (4) For the purposes of sub-paragraph (1)(b) above, a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to the FSA, shall in the absence of proven error be treated and accepted by the FSA, the Lender and the Borrower as correct and sufficient evidence of the Borrower’s solvency or Insolvency.
- (5) Subject to the provisions of sub-paragraphs (6), (7) and (8) below, if the Lender shall receive from the Borrower payment of any sum in respect of the Subordinated Liabilities -
- (a) when any of the terms and conditions referred to in sub-paragraph (1) above is not satisfied, or
- (b) where such payment is prohibited under paragraph 4(3),
- the payment of such sum shall be void for all purposes.
- (6) Any sum referred to in sub-paragraph (5) above shall be received by the Lender upon trust to return it to the Borrower.
- (7) Any sum so returned shall then be treated for the purposes of the Borrower’s obligations hereunder as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower hereunder.

- 5** (8) A request to the Lender for return of any sum referred to in sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.

Representations and undertakings of Borrower

- 6** From and after the date of this Agreement (or the Effective Date if earlier), the Borrower shall not without the prior written consent of the FSA -

- (a) secure all or any part of the Subordinated Liabilities;
- (b) redeem, purchase or otherwise acquire any of the Subordinated Liabilities;
- (c) amend any document evidencing or providing for the Subordinated Liabilities;
- (d) repay any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
- (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected; or
- (f) arrange or permit any contract of suretyship (or similar agreement) relating to its liabilities under this Agreement to be entered into, and

other than as disclosed in writing to the FSA, the Borrower represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Representations and undertakings of Lender

- 7** From and after the date of this Agreement (or the Effective Date if earlier), the Lender shall not without the prior written consent of the FSA -

- (a) assign, transfer, dispose of or encumber the whole or any part of the Subordinated Liabilities or purport to do so in favour of any person;
- (b) purport to retain or set off at any time any amount payable by it to the Borrower against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement, and the Lender shall immediately pay an amount equal to any retention or set off in breach of this provision to the Borrower and such retention or set off shall be deemed not to have occurred;
- (c) amend or waive the terms of any document evidencing or providing for the Subordinated Liabilities;
- (d) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;

- 7 (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected; or
- (f) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities, and the Lender shall, upon obtaining or enforcing any security, guarantee or indemnity notwithstanding this undertaking, hold the same (and any proceeds thereof) on trust for the Borrower, and

other than as disclosed in writing to the FSA, the Lender represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Borrower being a partnership

8 Where the Borrower is a partnership -

- (a) this Agreement shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Borrower by the retirement of the present Partners or any of them or the assumption of new Partners or by a change of name PROVIDED THAT -
- (i) a retired Partner shall continue to be liable for the payment of all sums due under this Agreement and implementation of all other obligations in this Agreement until the Lender and the remaining Partner(s) shall agree in writing to release a retired Partner from those obligations and the FSA has agreed in writing to the release; and
- (ii) in the event of a new Partner being assumed as a partner of the Borrower the other Partners shall procure that said assumed Partner shall become bound to the Lender as a party to this Agreement and shall execute such addendum hereto as the Lender and the FSA may consider necessary;
- (b) the obligations and undertakings of the Borrower under this Agreement shall bind the Borrower and the Partners jointly and severally.

Partial invalidity

- 9 If any of the provisions of this Agreement is or becomes invalid, illegal or unenforceable under any law, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired.

The FSA and indemnity

- 10** The FSA shall not be taken to be a trustee or other fiduciary for, or have any obligations to, any person to whom some or all of the Senior Liabilities are owed. Each of the Lender and Borrower shall on demand indemnify the FSA against all claims, losses, costs, expenses and other liabilities made against or incurred by the FSA as a consequence of it taking action for breach of this Agreement.

Additional terms

- 11** Any additional terms agreed between the parties are set out in the Variable Terms provided that, if there is any inconsistency between the Variable Terms and the Standard Terms, the Standard Terms shall prevail.

Entire agreement

- 12** This Agreement forms the entire agreement as to the Subordinated Liabilities. If there are any other terms relating to the Subordinated Liabilities existing at the date hereof and not comprised in this Agreement such terms shall be of no further force and effect.

Amendments

- 13** Any amendments to this Agreement made or purported to be made without the consent of the FSA shall be void.

Notices to the FSA

- 14** A notice given to the FSA under this Agreement shall have no effect, and time shall not start to run in connection with that notice, until the FSA has given to the sender written confirmation of its receipt.

Law

- 15** This Agreement is governed by English law.

Jurisdiction

- 16** For the benefit of the FSA solely, each of the Borrower and the Lender irrevocably submits to the jurisdiction of the English Courts and, to the extent that it does not have a place of business within the jurisdiction, appoints the process agent specified in the Variable Terms as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that non-exclusivity prejudices the submission to the jurisdiction.

Approved Form Of Subordinated Loan Agreement

D. Signature Page

10.8 Guidance Notes on Completion of Agreements

A GENERAL

Introduction

1. These Notes are designed to accompany the Approved Forms of Subordinated Loan Agreement, each of which is in four parts: the front page, the Variable Terms in Schedule 1, the Standard Terms in Schedule 2 and the signature page. The parties will need to set out details of themselves and the transaction in the Variable Terms and complete the signature page. The front page and the Standard Terms should remain unaltered.
2. All communications with the FSA regarding the proposed Agreement should in the first instance be via the firm's inspector.

ISD/Non-ISD

3. Firms are advised to ensure that the appropriate form of ISD (Chap.10)/non-ISD (Chap.3) subordinated loan agreement is used. This is, of course, dependent on the firm's authorisation categorisation. Should the firm's categorisation be changing from ISD to non-ISD (or vice versa), this should be discussed with the firm's inspector as it is likely that any subordinated loan agreement in place will have to be revised. Subordinated loan agreements for ISD firms are further classified as either short-term or long-term - this turns on whether the loan is to have an original maturity period of at least 2 or 5 years.

Preparation of the Agreement

4. (a) The form containing the Variable Terms may be completed or re-typed according to preference.
(b) Rather than re-type the Standard Terms (Schedule 2), firms should simply **photocopy Schedule 2 of the FSA precedent or print it from the website and include it as part of the original Agreement**. This avoids the need for the FSA to have to proof read the Standard Terms in each case which means that the FSA can process the Agreement more speedily and, of course, saves work for the firm in having to re-type the document.

Approval

5. (a) Firms should submit the proposed agreements to the FSA in **draft form** for its approval, marked for the attention of the appropriate inspector. If this practice is followed, any change required by the FSA can be effected without the firm and the lender having to re-execute the documents.
(b) When considering whether to approve the proposed agreement, the FSA will rely on a full disclosure to it of the circumstances giving rise to the

giving of the loan or facility and its effective subordination. Attention is drawn in particular to paragraphs 6 and 7 of the Standard Terms (representations and undertakings).

Financial Rules IPRU(INV) 10-63

6. Firms are referred to rule IPRU(INV) 10-63 on the use of subordinated loans, including restrictions on approved lenders, repayment provisions and gearing limits.

B NOTES ON VARIABLE TERMS

Dates

7. Paragraph 1: The **Date of the Agreement** should be left blank by the firm. This Date will be completed by the FSA when it ultimately executes the agreement.

Paragraph 2: If the **Effective Date of the Agreement** is to be different from the Date of the Agreement, care should be taken to record this in paragraph 2. Where this is the case, the Effective Date will normally be expected to be later than the Date of the Agreement. If the Effective Date is to be a date prior to the date of the Agreement (for example because the loan was drawn down before the Agreement was put in place), the firm will be expected to provide a reasonable explanation to the FSA as to why it was not possible to document the loan more promptly.

Addresses

8. Paragraphs 4 and 6: The address given should be the firm's registered office or equivalent.

Partnerships

9. Paragraph 5: Where the Borrower is a partnership, insert "See Additional Terms, paragraph 10() below" and in paragraph 10 of Schedule 1, insert the names and addresses of each of the partners.

The Loan or Facility

10. Paragraph 7: Check that paragraph 2 of the Standard Terms accurately reflects the intentions of the parties.

11. Suggested wording for a loan is:

"This is an agreement for the Loan of £[]."

12. Suggested wording for a facility is:

"This is an agreement for a Facility under which the Lender is committed to make Advances in pounds sterling to the Borrower up to a maximum amount of £[] until the last available date of the Facility being [.....(date)].

The terms (if any) agreed between the parties on the mechanics of drawdown are as follows - ". *

* For example, the parties may wish to provide that:

“Advances may be drawdown in integral multiples of £100,000.”.

Interest

13. Paragraph 8: the FSA will be concerned if an excessive rate of interest compared with the market rate is charged. Broadly speaking a rate of interest will be regarded by the FSA as excessive if it is not a commercial one. Compound interest is not acceptable.

Repayment

14. Irrespective of the form of agreement being used, the specified notice period runs from the date of drawdown and, therefore, where a loan is in the form of a facility, each advance must be for a minimum of the required period.

15. Repayment clauses have given rise to confusion in the past. The wording of such clauses will differ depending on whether an ISD long-term, an ISD short-term or a non-ISD form is being used. Sample wordings for each of these forms of agreement are set out below.

ISD: Long-term form

16 Firms are advised that for an ISD long-term form the repayment date must be a specified date not less than 5 years from one or more of:

- the date of drawdown;
- the borrower giving notice in writing to the lender and the FSA; or
- the lender giving notice in writing to the borrower and the FSA.

17. Paragraph 9: Examples of suggested wordings for either a fixed repayment date or repayment on notice for a long-term form are as follows:

(a) "The Borrower shall repay [the Loan/each Advance made to it] on the [date which falls five years after the date] [fifth anniversary]of drawdown of the [Loan/relevant Advance]."

(b) "The Borrower shall repay [the Loan/each Advance made to it] five years after the date on which:

(a) the Borrower gives written notice to the Lender and to the FSA; or

(b) the Lender gives written notice to the Borrower and to the FSA."

Note: either (a) or (b) above by itself is sufficient.

- (c) "[The Loan / Each Advance made to the Borrower] shall be repayable on the date specified by notice in writing given by the Lender to the Borrower and to the FSA or notice in writing given by the Borrower to the Lender and to the FSA, in either case that date being not less than five years after the date on which the notice is given."

ISD: Short-term form

18 For short-term agreements the applicable repayment period is at least two years, rather than five years as required for a long-term form, but otherwise the requirements are as above.

19 Paragraph 9: Examples of suggested wordings for either a fixed repayment date or repayment on notice for a short-term form are as follows:

(a) "The Borrower shall repay [the Loan/each Advance made to it] on the [date which falls two years after the date] [second anniversary] of drawdown of the [Loan/relevant Advance]."

(b) "The Borrower shall repay [the Loan/each Advance made to it] two years after the date on which:

(a) the Borrower gives written notice to the Lender and to the FSA; or

(b) the Lender gives written notice to the Borrower and to the FSA."

Note: either (a) or (b) above by itself is sufficient.

- (c) "[The Loan / Each Advance made to the Borrower] shall be repayable on the date specified by notice in writing given by the Lender to the Borrower and to the FSA or notice in writing given by the Borrower to the Lender and to the FSA, in either case that date being not less than two years after the date on which the notice is given."

Additional terms

20. Paragraph 10: Additional terms may be agreed between the borrower and lender such as those relating to -

- representations and warranties
- provision of financial and other information
- covenants
- costs and expenses

- taxes and increased costs
- mechanics of payment
- notices
- termination provisions.

However, they should not be inconsistent with the Agreement or the FSA rules. For example, any terms dealing with additional payments by the borrower (eg to compensate for taxes or increased costs) should be subject to the FSA's prior written consent. Covenants and additional representations and warranties should not be inconsistent with the existing representations and warranties in paragraphs 6 and 7 of the Standard Terms. Similarly, any notices clause should take into account paragraph 14 of the Standard Terms (notices to the FSA of no effect until receipt confirmed). Any inconsistency between the Variable Terms and the Standard Terms is resolved in favour of the Standard Terms (paragraph 11 of the Standard Terms).

21. The lender and borrower should note that the action which can be taken by the lender in response to any breach of representation, warranty or covenant by the borrower is considerably constrained by paragraphs 4 and 5 of the Standard Terms. Therefore the value to the lender of including additional representations, warranties or covenants is very limited.
22. See also note 9 above for the situation where the borrower is a partnership and notes 24 -25 below for additional terms relating to law and jurisdiction.

Law and jurisdiction

23. If the borrower or lender is resident in another jurisdiction and does not have a branch office within the United Kingdom, paragraph 11 of the Variable Terms should be completed.
24. The borrower should not be appointed agent for service of process on the lender in case a dispute arises between them.

C NOTES ON STANDARD TERMS

Representations and undertakings

25. Paragraphs 6(f) and 7(f): Before giving its consent, the FSA will need to be satisfied that the guarantor or other provider of security has waived its right of subrogation against the borrower until all Senior Liabilities of the borrower have been paid in full. A form of deed for this purpose is available from the FSA.
26. On the effect of other terms relating to the subordinated liabilities not contained in this Agreement, see also paragraph 12 of the Standard Terms.
27. Paragraphs 15 and 16: See Notes 24-25 above.

D SIGNATURE PAGE

Arrangements for execution post the FSA approval

28. (a) **Three identical original Agreements** (i.e. the front page, the two Schedules and the signature page, each copy stapled or otherwise bound together) should be prepared for signature. Firms and lenders may use any of the execution forms set out in Notes 34-35 below.
- (b) *Leaving the date of the Agreement in the Variable Terms blank*, the lender and borrower should execute the three original Agreements, initial any manuscript amendments and forward them to the appropriate the FSA inspector so that they may be executed by the FSA.
- (c) The Date of the Agreement in paragraph 2 of the Variable Terms will be filled in by the FSA as the last party to sign the Agreement.

E DEEDS OF VARIATION/ DEEDS OF TERMINATION

30. Firms are advised to ensure that the appropriate standard the FSA form is used. These forms are available from the FSA on request.
31. The recitals to the deed should refer to the amount of the loan/ each advance and where applicable, briefly summarise the effect of any previous variation of the agreement and of variation of the original agreement which is currently proposed.
32. A variation or termination of a subordinated loan agreement can only be effected by the execution of a further deed. In particular, this means that the formalities for executing a deed (see note 34-36 below) must be observed for all deeds of variation or termination and that all parties to the original agreement must also be parties to the subsequent deed of variation or termination. Only the forms set out at Notes 35(1) and (2) or 36(2) below are appropriate for execution as a deed.
33. A deed of variation will be required where the parties wish to change the terms of a subordinated loan agreement eg. where the amount of the loan or advance is to be increased. A deed of termination is needed where the parties wish to bring to terminate an agreement that is in place before it would otherwise come to an end. This could occur, for example, where the firm wants to substitute a new lender. Please note that where a subordinated loan agreement is terminated in this way, all obligations and liabilities of the parties arising before the date of termination remain in effect.

F Execution

34. In the case of English companies, reference is made to sections 36 and 36A of the Companies Act 1985 under which a company may contract

- under its common seal
- through any person acting under its authority, express or implied,

and a document signed by a director and the secretary of the company or by two directors and expressed to be executed by the company as a deed has the same effect as if executed under the common seal of the company.

35. Suggested wordings for English companies are:

(1) THE COMMON SEAL OF

[]
was hereunto affixed
in the presence of

.....
Director

.....
Director/secretary

OR

(2) EXECUTED as a deed

by

.....
Director

.....
Director/secretary

(3) SIGNED for and on behalf of

[]

by

.....
Authorised signatory

(4) SIGNED for and on behalf of

[]

by

.....
Director

.....
Director/secretary

**13 Personal Investment Firms
(former PIA firms)**

Form
13.1 Form of subordinated loan (with guidance notes)

Page
2

13.1 FORM OF SUBORDINATED LOAN AGREEMENT FOR PERSONAL INVESTMENT FIRMS (SEE IPRU (INV) 13)

NOTES FOR COMPLETION OF THIS DOCUMENT

This subordinated loan Agreement is to be used for injecting additional funds into a firm on a semi-permanent basis. This loan should normally be made in cash. You should speak to FSA before completing the Agreement if you intend to make the loan by a transfer or assignment of assets.

- (1) *This is the standard form prescribed by FSA for long term or short term subordinated loans. A long term subordinated loan must have an original maturity of at least five years or, where it has no fixed term, be subject to five years' notice of repayment; a short term subordinated loan must have an original maturity of at least two years or, where it has no fixed term, be subject to five years' notice of repayment. Delete from the heading and from paragraph 4(2) (Repayment of the Loan) whichever period in brackets is not relevant.*
- (2) *In paragraph 2, you should insert the Effective Date of the Loan, that is, the date on which the Lender will make the advance, if this differs from the date of the Agreement.*
- (3) *Words in brackets marked with a double asterisk ** are for use where the Borrower is a partnership.*

Governing Law

Number of crosses	Governing Law
+	Scottish
++	Scottish or Northern Irish
+++	English or Northern Irish
++++	Northern Irish
+++++	English

*Example: Words marked ++** will be for use where the Borrower is a partnership and the Agreement is governed by either Scottish or Northern Irish law.*

- (4) *Words in round brackets in paragraph 10 are only required where either the Lender or Borrower (or both) is not incorporated in any part of the United Kingdom.*
- (5) *You should speak to FSA before changing or amending this standard form (for example, by adding provisions relating to the terms of the Loan to be made to the Borrower by the Lender). FSA reserves the right to make a charge for considering any non-standard agreement.*

BETWEEN:-

- (1) [] of
[]
(the “Lender” which term includes its permitted successors and assigns);
- (2) [] of
[]
(the “Borrower” which term includes its permitted successors and assigns); [and
[] of
[],
[] of
[] and
[] of
[]
the individual partners of the Borrower as such partners and as individuals +**] and
- (3) The FINANCIAL SERVICES AUTHORITY LTD (“FSA”) whose registered office is at 25 North Colonnade, Canary Wharf, London, E14 5HS.

IT IS AGREED AS FOLLOWS:-

1. DEFINITIONS

In this agreement:-

“**Effective Date**” means the date on which this Agreement is to take effect being the date of the Agreement unless otherwise stated in paragraph 2;

“**Excluded Liabilities**” means Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do rank junior to the Subordinated Liabilities in any Insolvency of the Borrower;

“**Financial Resource Requirement**” means 120 per cent. of the minimum amount of financial resources which the Borrower is required by FSA to maintain at any particular time in compliance with the Rules in chapter 13 of the Interim Prudential Sourcebook (“IPRU (INV)”) and any provisions amending or replacing them;

“**Insolvency**” means and includes liquidation, winding up, bankruptcy, sequestration, administration or dissolution (whichever term may apply to the Borrower) or the equivalent in any other jurisdiction to which the Borrower may be subject;

“**Insolvency Officer**” means and includes any person duly appointed to administer and distribute assets of the Borrower in the course of the Borrower’s Insolvency;

“**Liabilities**” means all present and future sums, liabilities and obligations payable or owing by the Borrower [or any Partner **] (whether actual or contingent, jointly or severally or otherwise howsoever);

“**Loan**” means the indebtedness of the Borrower to the Lender referred to in paragraph 2 as that indebtedness may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

[“**Partner**” means an individual partner of the Borrower**];

“**Rules**” means the Rules of FSA from time to time in force;

“**Senior Liabilities**” means all Liabilities except the Subordinated Liabilities and Excluded Liabilities;

“**Subordinated Liabilities**” means all Liabilities to the Lender in respect of the Loan and all interest payable thereon.

2. LOAN

The Borrower hereby acknowledges its indebtedness to the Lender in the sum of [] as an unsecured loan upon and subject to the terms and conditions of this Agreement.

[Note: This paragraph may be adapted to reflect the actual basis on which the unsecured Loan arises and, if applicable, how it is to be drawn down. Members are requested to specify clearly the Effective Date of the Loan if it will differ from the date of the Agreement.]

3. INTEREST

Subject to the provisions of paragraphs 4 and 5, until repayment of the Loan in full the Borrower will [the Borrower and the partners hereby bind and oblige themselves jointly and severally to +**] pay to the Lender interest on the Loan or on any part or parts of it for the time being remaining due under this Agreement such interest to be calculated and to be payable as provided below.

[Enter details of interest calculations and manner and time of payments. The rate of interest is not to exceed an annual rate of five per cent. above the London Inter-Bank Offered Rate for deposits of the currency in question for the relevant interest period or (where a fixed rate of interest is charged) give per cent. per annum above such rate at the date the Loan is first taken out.]

4. REPAYMENT OF THE LOAN

- (1) The provisions of this paragraph are subject to the provisions of paragraph 5.
- (2) Except where the Borrower has obtained FSA’s prior written consent and that consent has not been withdrawn, **no** repayment or prepayment of the Loan shall be made, in whole or in part, earlier than a date:
 - (a) not less than [five years] [two years] from the date on which the Loan was first made; or

- (b) not less than [five years] [two years] from the date on which the Borrower gave notice in writing to the Lender and FSA, or
 - (c) not less than [five years] [two years] from the date on which the Lender gave notice in writing to the Borrower and FSA.
- (3) If default is made for a period of 7 days or more in the payment of any principal due in respect of the Loan or for a period of 14 days or more in the payment of any interest due in respect of the Loan the Lender may, in order to enforce payment, at its discretion and after taking such preliminary steps as may be necessary and after notifying FSA, institute proceedings for the Insolvency of the Borrower [or the Insolvency of all or any Partners**]. If an order is made or an effective resolution is passed for the winding up of the Borrower, the Loan shall become repayable.
- (4) The Lender may at its discretion, subject to the provisions which follow, institute proceedings for the Insolvency of the Borrower [or the Insolvency of all or any Partners**] to enforce any obligation, condition or provision binding on the Borrower [or on all or any Partners**+] under this Agreement (other than any obligation for the payment of principal moneys or interest in respect of the Loan) provided that the borrower [or any Partner**] shall not by virtue of the institution of any such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it. The Lender may only institute such proceedings to enforce the obligations referred to above if (i) the default is not remedied to the satisfaction of the Lender within 60 days after notice of such default is not remedied to the satisfaction of the Lender within 60 days after notice of such default has been given to the Borrower by the Lender (with a copy to FSA) requiring the default to be remedied and (ii) the Lender has taken all preliminary steps required to be taken by it prior to the institution of such proceedings.
- (5) No remedy against the Borrower [or any Partner**] other than as specifically provided by this paragraph shall be available to the Lender whether for the recovery of amounts owing under this Agreement or in respect of any breach by the Borrower [or any Partners**] of any of its obligations under this Agreement.

5. SUBORDINATION

- (1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount whether principal (by way of repayment or prepayment), interest or otherwise, of the Subordinated Liabilities is conditional upon:-
 - (a) (if an order has **not** been made or an effective resolution passed for the Insolvency of the Borrower) the Borrower being in compliance with its Financial Resource Requirement prevailing at the time of payment by the Borrower; and accordingly no such amount which would otherwise

fall due for payment shall be payable except to the extent that repayment under paragraph 4(2) above is permitted and the Borrower could make such payment and still be in compliance with its Financial Resource Requirement immediately thereafter; and

- (b) (if an order has been made or an effective resolution has been passed for the Insolvency of the Borrower [or if the Borrower shall be dissolved**]) the Borrower being solvent at the time of payment by the Borrower; and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be solvent immediately thereafter. For the purposes of this sub-paragraph, the Borrower shall be solvent if it is able to pay its debts in full and in determining whether the Borrower is solvent for the purposes of this sub-paragraph there shall be disregarded obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower.
- (2) (a) No payment of the Subordinated Liabilities (other than in respect of interest) shall be made at any time under sub-paragraph (1) above unless the Borrower has obtained FSA's prior written consent to such payment and that consent has not been withdrawn.
 - (b) The Borrower shall give or ensure that there are given to FSA such information and auditor's certificate in relation to the proposed payment as FSA may require.
- (3) Payments of interest at a rate not exceeding the rate provided in paragraph 3 may be made to the extent permitted by sub-paragraph (1) above without prior notification to FSA.
 - (4) For the purposes of sub-paragraph (1)(b) above a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to FSA, shall in the absence of proven error be treated and accepted by FSA, the Lender and the Borrower as correct and sufficient evidence of the Borrower's solvency.
 - (5) If the Lender shall receive from the Borrower [or any Partner**] payment of any sum in respect of the Subordinated Liabilities where repayment is prohibited under paragraph 4(2) or when any of the terms and conditions referred to in sub-paragraphs (1) or (2) above is not satisfied the payment of such sum shall be void for all purposes and [any such sum shall be received by the Lender upon trust to return the same to the Borrower+++] [the Lender shall at any time thereafter be bound to return such sum to the Borrower, or, as the case may be, its Insolvency Officer+] (and any sum so returned shall then be treated for the purposes of the Borrower's obligations under this Agreement as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower). A request to the Lender for return of any sum under the foregoing provisions of this sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.

6. UNDERTAKINGS OF BORROWER

From and after the date of this Agreement (or the Effective Date if earlier), the Borrower will not [and no Partner will**] without the prior written consent of FSA:-

- (1) secure all or any part of the Subordinated Liabilities;
- (2) redeem, purchase or otherwise acquire any of the Subordinated Liabilities;
- (3) amend any document evidencing or providing for the Subordinated Liabilities;
- (4) repay any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
- (5) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected.

7. DOCUMENTATION

This Agreement forms the entire agreement as to the Subordinated Liabilities. If there are any other terms relating to the Subordinated Liabilities existing at the date of this Agreement and not comprised in it such terms shall be of no further force and effect. No variation of or amendment to this Agreement shall be of any effect unless it is in writing signed by all the parties. Any amendment to this Agreement made or purported to be made without the consent of FSA shall be void.

8. UNDERTAKINGS OF LENDER

The Lender will not without the prior written consent of FSA:-

- (1) assign or purport to assign to any person the whole or any part of the Subordinated Liabilities;
- (2) purport to retain or set-off at any time any amount payable by it to the Borrower [or any Partner**] against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement, and the Lender shall immediately pay an amount equal to any retention or set-off in breach of this provision to the Borrower and such retention or set-off shall be deemed not to have occurred;
- (3) amend or waive the terms of any document evidencing or providing for the Subordinated Liabilities;
- (4) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;

- (5) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected;
- (6) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities, and the Lender shall, upon obtaining security, guarantee or indemnity in breach of this undertaking, hold the same [on trust for +++] [as agent of and for the benefit of ++] the Borrower.

[Note: Before giving its consent to a transaction falling under paragraph 8(6), FSA will need to be satisfied that the provider of security has waived his rights of subrogation against the Borrower until all Senior Liabilities of the Borrower have been paid in full.]

9. This Agreement shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Borrower by the retirement of the present partners or [either] [any] of them or the assumption of new Partners or by a change of name it being provided that:-
 - (a) a retired Partner shall continue to be liable for the payment of all sums due under this Agreement and implementation of all other obligation contained in it until such time as the Lender and the remaining Partner[s] shall agree in writing to release a retired Partner from such obligations and FSA has given its written consent to the release; and
 - (b) in the event of a new partner being assumed as a Partner of the Borrower the other partners shall procure that the said assumed Partner shall become bound to the Lender as a party to this Agreement and shall execute such addendum to it as the Lender and FSA may consider necessary.

The obligations and undertakings of the Borrower under this Agreement shall bind the Borrower and the Partners jointly and severally. **+]

10. LAW [AND JURISDICTION]

This Agreement is governed by [English law +++++] [the law of Scotland +] [the law of Northern Ireland +++++] and, for the benefit of FSA solely, each of the Borrower and the Lender irrevocably submits to the jurisdiction of the [English Courts +++++] [Court of Session, Scotland +] [Northern Irish Courts +++++] (and, to the extent that it does not have a place of business within this jurisdiction, appoints [*name and address of agent for service*] as agent for receipt of service of process in such courts). Such jurisdiction shall be non-exclusive except to the extent that such non-exclusivity prejudices the submission to such jurisdiction.

IN WITNESS whereof the parties hereto have duly executed this Agreement as a Deed the day and year first above written.

(EXECUTED AS A DEED and DELIVERED by
(the Lender
(and signed by:

Director

Director/Secretary

or

(SIGNED and DELIVERED as a DEED
by the individual partners of the Lender
(as such partners and as individuals
(in the presence of:

or

SIGNED and DELIVERED as a DEED by
the Lender (*if an individual*)
in the presence of:

(EXECUTED AS A DEED and DELIVERED by
(the Borrower
(and signed by:

Director

Director/Secretary

or

(SIGNED and DELIVERED as a DEED
(by the individual partners or the Borrower
(as such partners and as individuals
(in the presence of:

or

*SIGNED and DELIVERED as a DEED by
the Borrower (if an individual)
in the presence of:*

(EXECUTED AS A DEED and DELIVERED by
(the FINANCIAL SERVICES AUTHORITY Ltd
(and signed by:

Director

Director/Secretary

Dated this day of 20

BETWEEN

the Lender

and

the Borrower

and

The FINANCIAL SERVICES AUTHORITY LTD

**SUBORDINATED
LOAN AGREEMENT**

TRAINING AND COMPETENCE SOURCEBOOK INSTRUMENT 2001

- A. The Financial Services Authority makes the rules and gives the guidance in the Annex to this instrument ("TC") in the exercise of the powers listed in Schedule 4 to TC (Powers exercised).
- B. This instrument shall come into force at the beginning of the day on which section 19 (The general prohibition) of the Financial Services and Markets Act 2000 (the "Act") comes into force.
- C. The provisions of the Act relevant to making rules and listed in Schedule 4 to TC (Powers exercised) are specified for the purpose of section 153(2) of the Act (Rule-making powers).
- D. This instrument may be cited as the Training and Competence Sourcebook Instrument 2001.
- E. The Annex to this instrument (including its Schedules) may be cited as the Training and Competence sourcebook (or TC).

By order of the Board
21 June 2001

ANNEX



Training and Competence



Contents

Transitional provisions

Text of TC:

- 1 Commitments
- 2 Rules and guidance

Schedule 1: Record keeping requirements

Schedule 2: Notification requirements

Schedule 3: Fees and other required payments

Schedule 4: Powers exercised

Schedule 5: Rights of action for damages

Schedule 6: Rules that can be waived

Derivations

Destinations

Handbook Modules

Training and Competence Sourcebook

1 Table Transitional Provisions

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1	TC 2.4.1 R (1) and (2) TC 2.4.5 R, TC 2.7.5 R	R	<p>(1) This transitional provision applies in respect of an <i>employee</i> of a <i>firm</i> employed at <i>commencement</i> if the <i>employee</i> had, before <i>commencement</i>, been assessed as competent by a <i>firm</i> in accordance with the applicable rules of its <i>previous regulator</i>.</p> <p>(2) A <i>firm</i> may for the purposes of TC 2.4.1 R (1) and (2), TC 2.4.5 R and TC 2.7.5 R assess an <i>employee</i> described in (1) as competent to engage in or oversee an activity, or act as supervisor, (without the assessment required by TC 2.4.5 R (1) or TC 2.7.5 R (2) and without requiring the <i>employee</i> to pass an <i>approved examination</i> under TC 2.4.5 R (2) or TC 2.7.5 R (1)), but only if the activity or role for that <i>employee</i> after <i>commencement</i> is the same or substantially the same as that in respect of which the <i>employee</i> had been assessed as competent before <i>commencement</i>.</p> <p>(3) If a <i>firm</i> has assessed an <i>employee</i> as competent under (1) and (2), any other <i>firm</i> which subsequently employs the individual may also assess him as competent on the same basis provided that:</p> <p>(a) the activity which the <i>employee</i> engages in or oversees (or the role of the supervisor) continues to be the same, or substantially the same, as that in respect of which the <i>employee</i> had been previously assessed as competent; and</p>	From <i>comm – commencement</i>	<i>Commencement</i>

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
2	TC 2.4.1 R (1) and (2), TC 2.4.5 R (2)	R	<p>(b) the individual has not experienced any significant break of employment since the previous assessment.</p> <p>(1) This transitional provision applies to a <i>firm</i> which at <i>commencement</i> employed individuals who engage in or oversee an activity but which was not, in respect of those <i>employees</i>, required by the rules of its <i>previous regulator</i> to comply with any specific training and competence requirements.</p> <p>(2) A <i>firm</i> in (1) may, during the 12-month period beginning at <i>commencement</i>, assess an <i>employee</i> as competent (without requiring the individual to pass an <i>approved examination</i> under TC 2.4.5 R (2), but with the assessment required by TC 2.4.5 R (1)) but only in respect of the activities which the individual was able to engage in or oversee before <i>commencement</i>.</p> <p>(3) If a <i>firm</i> has assessed an <i>employee</i> as competent under (1) and (2), any other <i>firm</i> which subsequently employs the individual may also assess that individual as competent on the same basis provided that:</p> <p>(a) the activity which the <i>employee</i> engages in or oversees continues to be the same, or substantially the same, as that in respect of which the <i>employee</i> had been previously assessed as competent; and</p> <p>(b) the individual has not experienced any significant break of employment since the previous assessment.</p>	<p>From <i>commencement</i> for 12 months</p> <p>From <i>commencement</i> for 12 months</p>	<p><i>Commencement</i></p> <p><i>Commencement</i></p>
3	Paragraph 2 above	G	<p>(1) <i>Firms</i> are reminded that they should make and retain records of:</p> <p>(a) the criteria applied in assessing competence; and</p> <p>(b) how and when the competence decision was arrived at.</p>	From <i>commencement</i>	<i>Commencement</i>

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
4	TC 2.5.1 R (1) and (2)	R	(1) A firm which, immediately before commencement, was required to comply with specific training and competence requirements imposed by its previous regulator, may, in respect of the individuals employed before commencement, comply with the requirements of TC 2.5.1 R (1) and (2) by ensuring that those individuals pass the relevant approved examinations within the time limits imposed by its previous regulator.	From commencement	Commencement
5	TC 2 TC Rules and guidance in TC referring to "customer" or "private customer"	R G G	(1) [A further transitional provision has been consulted on in respect of firms currently subject to the s43 regime and will be added later.] <u>General transitional provisions</u> GEN contains some technical transitional provisions that apply throughout the Handbook and which are designed to ensure a smooth transition at commencement. These include transitional provisions relevant to record keeping. <u>Pre-commencement written concessions</u> SUP contains transitional provisions which carry forward written concessions relating to pre-commencement provisions. <u>Client classification</u> COB contains some transitional provisions relating to the treatment of clients classified by ex-SRO firms and ex-section 43 firms before commencement.	From commencement for 24 months From commencement From commencement for 12 months	Commencement Commencement Commencement

Chapter 1.

Commitments

1.1 Application and purpose

Who?

- 1.1.1** G_{/1} The *guidance* in this chapter lists some general, high level, commitments which every *firm* should make and fulfil, except that:
- (1) for an *incoming EEA firm* or an *incoming Treaty firm*, this chapter applies only in so far as responsibility for any matter it covers is not reserved by a European Community instrument to the *firm's Home State regulator*; and
 - (2) this chapter applies to a *UCITS qualifier* only in so far as it is relevant to the manner in which a *firm communicates* or *approves a financial promotion*.

Where?

- 1.1.2** G_{/1} The *guidance* in this chapter is addressed to *firms* wherever their activities may be carried on.

Why?

- 1.1.3** G_{/1} *Principle 3* requires *firms* to take reasonable care to organise and control their affairs responsibly and effectively. This includes making proper arrangements for any *employee* associated with a *regulated activity* carried on by the *firm* to achieve, maintain and enhance competence.
- 1.1.4** G_{/1} *Principle 3* is amplified in *SYSC*. A *firm* must take reasonable care to establish and maintain such systems and controls as are appropriate to its business (*SYSC 3.1.1 R*) ■ *SYSC 3.1.1 R*. Also, a *firm's* systems and controls should enable it to satisfy itself of the suitability of anyone who acts for it (*SYSC 3.2.13 G*) ■ *SYSC 3.2.13 G*. This would include the competence of the individual for the role.
- 1.1.5** G_{/1} Under *threshold condition 5* (Suitability), *firms* are required to satisfy the *FSA* that they are fit and proper *persons* having regard to all the circumstances including, amongst other things, the nature of the *regulated activity* the *firm* carries on or is seeking to carry on and the need to ensure that the *firm's* affairs are conducted soundly and prudently. This involves an assessment of the competence of management and staff as a whole. The suitability of a member of staff who performs a *controlled function* is assessed under *FIT*.
- 1.1.6** G_{/1} Section 59 of the *Act* (Approval) requires *firms* to take reasonable care to ensure that no *person* performs a *controlled function* without approval from the *FSA*.

Before it can grant an application for approval, the *FSA* must be satisfied that the *person* is fit and proper. Under section 61 of the *Act* (Determination of applications) the fit and proper test for those requiring such approval includes assessing qualifications, training and competence.

1.1.7

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Where there are no specific training and competence requirements for a *controlled function*, the commitments in *TC 1.2* apply. Where there are specific training and competence requirements for a *controlled function* (the *investment adviser function*, for example), the *rules* and *guidance* in *TC 2* apply, as well as the commitments. This is because the *controlled functions* cover a wider range of activities than the activities specified in *TC 2*. Also, there are some *rules* in *TC 2* for activities which are not *controlled functions* (the overseers of *administrative functions*, for example).

1.1.8

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The purpose of this sourcebook is to define the standards which *firms* should achieve. The *FSA* expects *firms* to make their own arrangements to meet these standards.

1.2 Commitments

1.2.1

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The *firm's* commitments to training and competence should be that:

- (1) its *employees* are competent;
- (2) its *employees* remain competent for the work they do;
- (3) its *employees* are appropriately supervised;
- (4) its *employees'* competence is regularly reviewed; and
- (5) the level of competence is appropriate to the nature of the business.

Chapter 2.

2.

Rules and Guidance



2.1 Application: who? where? and what?

Who?

- 2.1.1 **R** /1 (1) This chapter applies, subject to (2), to every *firm* to the extent indicated in TC 2.1.4 R, except that:
- (a) for an *incoming EEA firm* or an *incoming Treaty firm*, this chapter applies only in so far as responsibility for any matter it covers is not reserved by a European Community instrument to the *firm's Home State regulator*; and
 - (b) this chapter applies to a *UCITS qualifier* only in so far as it is relevant to the manner in which a *firm communicates* or *approves a financial promotion*.
- (2) This chapter does not apply to an *authorised professional firm* with respect to its *non-mainstream regulated activities*, see PROF 5.2.

Where?

- 2.1.2 **R** /1 (1) This chapter applies to a *UK domestic firm* in respect of its *employees* who engage in or oversee activities (to the extent indicated in TC 2.1.4 R) wherever they are carried on.
- (2) This chapter applies to an *overseas firm* in respect of its *employees* who engage in or oversee activities (to the extent indicated in TC 2.1.4 R) from an establishment maintained by the *firm* (or its *appointed representative*) in the *United Kingdom*.

What?

2.1.3 **G** /1 The table in TC 2.1.4 R sets out the activities to which TC 2 applies.

2.1.4 **R** /1 Table Activities to which TC 2 applies.

	Activity	Extent of Application
<p>1. <i>Employees engaging in:</i></p>	<p><u>Advising and dealing</u></p> <p>(a) <i>advising on investments which are, and dealing with or for clients in, securities (other than stakeholder pension schemes or broker funds) and derivatives;</i></p> <p>(b) <i>advising on investments which are, and dealing with or for clients in, securities (other than stakeholder pension schemes or broker funds) only;</i></p> <p>(c) <i>advising on investments which are, and dealing with or for clients in, derivatives only;</i></p> <p><u>Managing</u></p> <p>(d) <i>managing investments;</i></p> <p>(e) <i>managing investments in relation to venture capital investments only;</i></p> <p><u>Advising (without dealing)</u></p> <p>(f) <i>advising on investments which are packaged products (other than broker funds or as in (g) or (h));</i></p> <p>(g) <i>advising on investments which are friendly society tax exempt policies only;</i></p>	<p>If the activity is carried on with or for a <i>private customer</i>, whole of TC 2 applies. If the activity is carried on with or for an <i>intermediate customer</i> or a <i>market counterparty</i> only TC 2.4, 2.5, 2.6 and 2.8 apply.</p>

	Activity	Extent of Application
	<p><i>(h) advising on investments which are packaged products (where the employee sells only life policies issued by a friendly society and is not reasonably expected to receive remuneration of more than £1,000 a year in respect of such sales);</i></p> <p><i>(i) advising on investments in the course of corporate finance business only;</i></p> <p><i>(j) advising on investments which are (but not dealing in) securities (other than stakeholder pension schemes or broker funds) and derivatives;</i></p> <p><i>(k) advising on investments which are (but not dealing in) securities (other than stakeholder pension schemes or broker funds) only;</i></p> <p><i>(l) advising on investments which are (but not dealing in) derivatives only;</i></p> <p><i>(m) the activity of a broker fund adviser;</i></p> <p><i>(n) advising on syndicate participation at Lloyd's;</i></p> <p><i>(o) the activity of a pension transfer specialist.</i></p>	

	Activity	Extent of Application
2. <i>Employees overseeing on a day-to-day basis:</i>	<ul style="list-style-type: none"> (a) <i>operating, or acting as a trustee or depositary of, a collective investment scheme;</i> (b) <i>safeguarding and administering investments or holding of client money;</i> (c) <i>the following administrative functions in relation to managing investments:</i> <ul style="list-style-type: none"> (i) <i>arranging settlement;</i> (ii) <i>monitoring and processing corporate actions;</i> (iii) <i>client account administration, liaison and reporting, including valuation and performance measurement;</i> (iv) <i>ISA or PEP administration;</i> (v) <i>investment trust savings scheme administration;</i> 	Whole of TC 2 applies except TC 2.7 (Supervising).

2.

	Activity	Extent of Application
	<p>(d) the following <i>administrative functions</i> in relation to the <i>effecting or carrying out of life policies</i>:</p> <ul style="list-style-type: none"> (i) new business administration; (ii) <i>policy</i> alterations, including surrenders and <i>policy</i> loans; (iii) preparing <i>projections</i>; (iv) processing <i>claims</i>, including pension payments; (v) fund switching; <p>(e) taking <i>private customers</i> through decision trees in connection with a <i>stakeholder pension scheme</i>;</p> <p>(f) the following <i>administrative functions</i> in relation to the operation of a <i>stakeholder pension scheme</i>:</p> <ul style="list-style-type: none"> (i) new business administration; (ii) receipt of or alteration to contributions; (iii) preparing <i>projections</i> and annual statements; (iv) administration of transfers; (v) handling <i>claims</i>, including pension payments; (vi) fund allocation and switching. 	

Actions for damages

2.1.5

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A contravention of the *rules* in *TC* does not give rise to a right of action by a *private person* under section 150 of the *Act* (and each of

those *rules* is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action).

2.

2.2 Recruitment

- 2.2.1** **R** _{/1} If a *firm* intends to recruit an individual with a view to that individual engaging in or overseeing an activity with or for *private customers*, the *firm* must as part of its recruitment procedures:
- (1) take into account the knowledge and skills of the individual in relation to the knowledge and skills required for the role; and
 - (2) take reasonable steps to obtain sufficient information about the individual's previous relevant activities and training.
- 2.2.2** **G** _{/1} The *firm* should take reasonable steps to obtain information about the knowledge and skills of the individual in *TC 2.2.1 R*, including any *approved examination* passes, from a suitable source within a reasonable time.

2.3 Training

2.3.1

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If a *firm's employees* engage in or oversee an activity with or for *private customers*, the *firm* must:

- (1) at intervals appropriate to the circumstances, determine the training needs of those *employees* and organise appropriate training to address these needs; and
- (2) ensure that training is timely, planned, appropriately structured and evaluated.

2.3.2

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In the case of a new *employee* or an *employee* new to an activity, the *firm* should determine the *employee's* training needs before the *employee* engages in or oversees any activity.

2.3.3

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- (1) Training should take into account the knowledge and skills necessary to fulfil the role.
- (2) A *firm* should ensure that training remains effective and up to date.
- (3) Training should take into account changes in the market and to products, legislation and regulation.
- (4) A *firm* should use methods of meeting training needs that are appropriate to the activity and to the *employee's* circumstances and role.

2.4 Attaining competence

- 2.4.1** **R** ^{/1} A *firm* must not permit an *employee* to engage in or oversee an activity unless:
- (1) the *employee* has been assessed as competent in that activity in accordance with TC 2.4.5 R; or
 - (2) the *employee* engages in or oversees the activity while under appropriate supervision; or
 - (3) the *employee* has been assessed in accordance with TC 2.4.5 R as competent to engage in or oversee a particular activity, but then engages in or oversees in a different activity, then the *employee* is appropriately supervised until assessed as competent in that new activity.
- 2.4.2** **R** ^{/1} A *firm* which permits an *employee* to engage in an activity with or for a *private customer* under supervision must ensure that:
- (1) the *employee* has first passed the relevant regulatory module of an appropriate *approved examination*; and
 - (2) the *firm* has satisfied itself that the *employee* has an adequate level of knowledge and skills to act with or for *private customers* while under supervision.
- 2.4.3** **G** ^{/1} In TC 2.4.2 R (2) an adequate level of application of knowledge and skills includes:
- (1) specific knowledge of the *firm's* relevant systems and procedures, and of the kinds of *designated investment business* carried on by the *firm* and any other members of its *marketing group*; and
 - (2) appropriate skills in analysing *private customers'* needs and circumstances when applying relevant knowledge.
- 2.4.4** **R** ^{/1} If a *firm* permits an *employee* under supervision to engage in:
- (1) *advising on investments* which are, and *dealing with or for clients in, securities* (other than *stakeholder pension schemes* or *broker funds*), *derivatives* or both such *securities* and *derivatives*; or
 - (2) the activity of a *broker fund adviser*; or

- (3) *advising on syndicate participation at Lloyd's*; or
- (4) the activity of a *pension transfer specialist*;

the *firm* must ensure that the *employee* has first passed the appropriate *approved examination* before permitting the *employee* to engage in the relevant activity.

Assessing competence

2.4.5

R

A *firm* must not assess an *employee* as competent to engage in or oversee an activity unless the *employee*:

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- (1) has been assessed as competent to apply the knowledge and skills necessary to engage in or oversee the activity without supervision; and
- (2) has passed each module of the appropriate *approved examination* specified in the annexes to TC 2.

2.4.6

G

A *firm* should ensure that its assessments take into account:

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- (1) technical knowledge and its application;
- (2) skills and their application; and
- (3) changes in the market and to products, legislation and regulation.

2.4.7

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A *firm* should use methods of assessment that are appropriate to the activity and to the *employee's* role.

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2.4.8

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A *firm* should ensure that its *employees* are aware how its training and competence arrangements apply to their individual roles.

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2.4.9

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A *firm* should, for the purposes of TC 2.8.1 R (Record keeping), make and retain records of:

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- (1) the criteria applied in assessing competence; and
- (2) how and when the competence decision was arrived at.

2.5 Approved examinations

Time limits

- 2.5.1** **R** /1 (1) A *firm* must ensure that an *employee* under supervision passes the appropriate *approved examination* within the time specified in the annexes to TC 2 and, for this purpose, a *firm* must record the date on which the *employee* began engaging in or overseeing the relevant activity.
- (2) For the purposes of calculating the time spent by an *employee* under supervision, a *firm* must:
- (a) aggregate periods of time spent engaging in or overseeing the activity during different periods of employment;
 - (b) disregard any period of 60 *business days* or more during which the *employee* is continuously absent from engaging in or overseeing the activity.
- (3) A *firm* must ensure that any *employee* who does not pass the *approved examination* within the specified time:
- (a) ceases to engage in or oversee the activity; and
 - (b) does not resume the activity or oversee the activity without first passing the *approved examination*.
- 2.5.2** **G** /1 A *firm* should, for the purposes of TC 2.8.1 R (Record keeping), make and retain records of the time limits within which the *approved examination* has been passed.

Advising and dealing: restarting the activity

- 2.5.3** **R** /1 A *firm* must ensure that an *employee* does not recommence engaging in the activity of *advising on investments* which are, and *dealing* with or for *clients* in, *securities* (other than *stakeholder pension schemes* or *broker funds*), *derivatives* or both such *securities* and *derivatives* if:
- (1) the *employee* has not engaged in that activity for 12 months; and

- (2) two years have elapsed since the *employee* passed an appropriate *approved examination* for that activity;

unless the *firm* can demonstrate that the *employee* has sufficient experience and has kept his technical and regulatory knowledge up to date. If the *firm* cannot do so it must require the *employee* to pass the appropriate *approved examination*.

2.5.4

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A *firm* may regard an *employee* described in TC 2.5.3 R as having sufficient experience if the *firm* has determined that the individual has had at least three years' relevant experience in the past five years.

Exemption from the approved examination

2.5.5

R

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- (1) Except as described in (2), if a *firm* is satisfied that an *employee*:

- (a) has at least three years' up-to-date relevant experience in the activity in question obtained while employed outside the *United Kingdom*;
- (b) had not previously been required to comply fully with the relevant examination requirements as stipulated in TC 2.4.5 R (2); and
- (c) has passed the relevant regulatory module of an *approved examination*;

then the requirement to have passed each module of the appropriate *approved examination* in TC 2.4.5 R (2) does not apply for that *employee*.

- (2) TC 2.5.5 R (1) does not apply for an *employee* engaging in the following activities:
- (a) *advising on investments* which are *packaged products*, if that advice is given to *private customers*;
 - (b) the activity of a *broker fund adviser*;
 - (c) *advising on syndicate participation at Lloyd's*;
 - (d) the activity of a *pension transfer specialist*.

2.5.6

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A *firm* should, for the purposes of TC 2.8.1 R (Record keeping), make and retain records of the criteria governing its decision to apply TC 2.5.5 R to an *employee*.

European and other overseas examinations

2.5.7

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The annexes to TC 2 give details of the extent to which European and other overseas-based examinations are appropriate for an activity. In addition, the

definition of *approved examination* includes an examination which is equivalent in accordance with the *Diploma Directives*.

2.6 Maintaining competence

- 2.6.1** **R** ^{/1} A *firm* must have appropriate arrangements in place to ensure that an *employee* who has been assessed as competent to engage in or oversee an activity maintains competence.
- 2.6.2** **G** ^{/1} A *firm* should ensure that maintaining competence for an *employee* takes into account:
- (1) technical knowledge and its application;
 - (2) skills – their application and development; and
 - (3) changes in the market and to products, legislation and regulation.
- 2.6.3** **G** ^{/1} A *firm* should maintain systems for monitoring an *employee's* competence.
- 2.6.4** **G** ^{/1} A *firm* should, for the purposes of TC 2.8.1 R (Record keeping), make and retain records of:
- (1) the criteria applied in assessing continuing competence; and
 - (2) how the *employee* continues to be competent.

2.7 Supervising

Supervising employees not yet assessed as competent

2.7.1 **R** ^{/1} If a *firm's* employees engage in an activity with or for *private customers*, the *firm* must ensure that if an *employee* has not yet been assessed as competent, but is permitted in accordance with TC 2.4.2 R to engage in a particular activity under supervision, the *employee* is appropriately supervised until assessed as competent in that activity.

2.7.2 **G** ^{/1}

- (1) A *firm* should have arrangements in place to ensure that levels of supervision are appropriate in relation to an *employee's* ability to apply the necessary knowledge and skills.
- (2) A *firm* should ensure that an *employee* who is being supervised undergoes, as appropriate:
 - (a) review and assessment of work;
 - (b) individual coaching and assessment of performance, for example, role-play and accompanied *private customer* visits.

Supervising employees assessed as competent

2.7.3 **R** ^{/1} A *firm* must have *arrangements* in place to ensure that an *employee* who has been assessed as competent is appropriately supervised.

2.7.4 **G** ^{/1} Appropriate supervision will vary according to the competence of the *employee* and is likely to be less intense once competence has been attained.

Supervisors of employees advising private customers on packaged products

2.7.5 **R** ^{/1} If an *employee* is engaging in the activity of giving advice on *investments* which are *packaged products* to *private customers*, the *firm* must ensure that the individual supervising that *employee*:

- (1) has passed an appropriate *approved examination*; and

- (2) **has the technical knowledge, assessment skills and coaching skills to act as supervisor, before acting as supervisor, and that this competence is maintained.**

Supervising: record keeping

2.7.6**G**
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A *firm* should, for the purposes of TC 2.8.1 R (Record keeping), make and retain records of:

- (1) the criteria applied in deciding the level of supervision required in respect of its *employees*; and
- (2) how the supervision of its *employees* is carried out.

2.8 Record keeping

2.8.1

R

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- (1) A *firm* must make appropriate records to demonstrate compliance with the *rules* in this chapter.
- (2) The records in (1) must be retained by the *firm* for at least three years after cessation of an *employee's* appointment with the *firm*, except for the records of *pension transfer specialists*, which must be retained indefinitely.

Annex 1R The interim approved examinations referred to in TC 2

Table 1 **TC 2.1.4 R (1) (a) *Employees engaging in advising on investments which are, and dealing with or for clients in, securities (other than stakeholder pension schemes or broker funds) and derivatives***

Examination that must be passed before starting the activity		
K E Y	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory module
1	Associateship - must include a pass in the Investment paper	Chartered Institute of Bankers
1	Associateship – must include a pass in the Investment paper	Chartered Institute of Bankers in Scotland
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	SFA Futures and Options Representative Examination plus Securities Representative Examination – Part 2	Securities Institute
1	SFA Securities and Financial Derivatives Representative Examination	Securities Institute
1	SFA Securities Representative plus Financial Derivatives Module	Securities Institute
2	Chartered Financial Analyst	Association for Investment Management and Research
2	Examination	NIBE – SVV – the Dutch Institute for the banking, insurance and stockbroking industry
2	Module B(ii), Securities and Portfolio Management	Law Society of England and Wales
2	Ordinary and Senior Certificate	South African Institute of Financial Markets
2	Registered Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification – Class 1	Japanese Banking Association
2	Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification – Type 1	Japanese Securities Dealers Association
2	Secondary Examination	Analyst Association of Japan
3	SFA Registered Persons Examination - Section 1 (Regulation)	Securities Institute

Table 2 TC 2.1.4 R (1) (b) *Employees engaging in advising on investments which are, and dealing with or for clients in, securities (other than stakeholder pension schemes or broker funds) only*

Examination that must be passed before starting the activity		
K E Y	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory module
1	Associateship - must include a pass in the Investment paper	Chartered Institute of Bankers
1	Associateship - must include a pass in the Investment paper	Chartered Institute of Bankers in Scotland
1	Diploma (including a pass in Regulation and Compliance paper)	Securities Institute
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	SFA Securities and Financial Derivatives Representative Examination	Securities Institute
1	SFA Securities Representative Examination	Securities Institute
2	Canadian Securities course plus Conduct and Practices Handbook	Canadian Securities Institute
2	Certificate	New Zealand Stock Exchange
2	Certificate in Financial Markets	Securities Institute of Australia
2	Certified European Financial Analyst	EFFAS Societies with accredited examinations
2	Chartered Financial Analyst (Level 1)	Association for Investment Management and Research
2	Diploma	Association of Belgian Financial Analysts
2	Diploma	The Swiss Stock Exchange
2	Diploma of Financial Markets	Securities Institute of Australia
2	Dealers Representative Examination	Singapore Exchange
2	Elementary, Intermediate and International Capital Markets courses	Korea Securities Training Institute
2	Examination	NIBE – SVV – the Dutch Institute for the banking, insurance and stockbroking industry
2	Examination	The French Society of Investment Analysts
2	General Certification Programme	ISMA/University of Reading
2	International Capital Markets Qualification (ICMQ) (including the Fixed Interest and Bond Markets Module)	Securities Institute/South African Institute of Financial Markets
2	Irish Registered Representatives Examination	Irish Stock Exchange/Dublin City

Examination that must be passed before starting the activity		
		University
2	Membership Examinations	Johannesburg Stock Exchange
2	Module B(ii), Securities and Portfolio Management	Law Society of England and Wales
2	Ordinary and Senior Certificate	South African Institute of Financial Markets
2	Promotore Finanziario Examination	Italian Exchange
2	Registered Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification – Class 1	Japanese Banking Association
2	Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification – Type 1	Japanese Securities Dealers Association
2	Secondary Examination	Analyst Association of Japan
2	Series 7 - General Securities Representatives Examination	National Association of Securities Dealers
2	Trainee Dealers Representatives examination	Kuala Lumpur Stock Exchange
3	SFA Registered Persons Examination - Section 1 (Regulation)	Securities Institute

Table 3 TC 2.1.4 R (1) (c) Employees engaging in advising on investments which are, and dealing with or for clients in, derivatives only

Examination that must be passed before starting the activity		
K E Y	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory module
1	Associateship - must include a pass in the Investment paper	Chartered Institute of Bankers
1	Associateship - must include a pass in the Investment paper	Chartered Institute of Bankers in Scotland
1	Diploma (including Regulation and Compliance paper and Financial Derivatives paper)	Securities Institute
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	SFA Securities and Financial Derivatives Representative Examination	Securities Institute
1	SFA Futures and Options Representative Examination	Securities Institute
2	ACI Diploma	ACI
2	Chartered Financial Analyst	Association for Investment

Examination that must be passed before starting the activity		
		Management and Research
2	Derivatives Fundamentals course and Futures/Options Licensing course	Canadian Securities Institute
2	Diploma including passes in both the Australian Futures Trading and Options Trading papers	Securities Institute of Australia
2	Examination	NIBE – SVV – the Dutch Institute for the banking, insurance and stockbroking industry
2	Examination	Norwegian Society of Financial Analysts
2	Financial Derivatives paper of Diploma	Securities Institute
2	International Capital Markets Qualification (ICMQ) including passes in Futures, Options and other Derivative Products paper	Securities Institute/South African Institute of Financial Markets
2	Module B(ii), Securities and Portfolio Management	Law Society of England and Wales
2	Ordinary and Senior Certificate	South African Institute of Financial Markets
2	Registered Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification – Class 1	Japanese Banking Association
2	Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification – Type 1	Japanese Securities Dealers Association
2	Registered Representatives Examination	Sydney Futures Exchange
2	Secondary Examination	Analyst Association of Japan
2	Series 3 - National Commodity Futures Examination	National Futures Association
2	Singapore Exchange Futures Trading Test	Singapore Institute of Banking and Finance
3	SFA Registered Persons Examination - Section 1 (Regulation)	Securities Institute

Annex 2R The interim approved examinations referred to in TC 2

Table 1 TC 2.1.4 R (1) (d) *Employees engaging in managing investments*

Examination that must be passed within 30 months of starting the activity		
KEY	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory modules

Examination that must be passed within 30 months of starting the activity		
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	Diploma (including Regulation and Compliance, Investment Analysis and either Fund Management or Private Client Investment Advice and Management papers)	Securities Institute
1	Fellow or Associate must include Investment paper E (post - May 1992 syllabus)	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Certificate in Investment Management (at least three papers passed by examination)	Society of Investment Analysts in Ireland
2	Certified European Financial Analyst	EFFAS Societies with accredited examinations
2	Chartered Financial Analyst (Level 1)	Association for Investment Management and Research
2	Chartered Member	Securities Analysts' Association of Japan
2	Investment Management Asset Allocation Qualification	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Investment Practice version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Module B(ii), Securities and Portfolio Management	Law Society of England and Wales
2	Ordinary and Senior Certificates	South African Institute of Financial Markets
3	SFA Registered Persons Examination – Section 1 (Regulation)	Securities Institute
3	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research

Table 2 TC 2.1.4 R (1) (e) Employees engaging in managing investments in relation to venture capital investments only

Examination that must be passed within 30 months of starting the activity		
K E Y	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory modules

Examination that must be passed within 30 months of starting the activity		
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	Diploma (including Regulation and Compliance, Investment Analysis and either Fund Management or Private Client Investment Advice and Management papers)	Securities Institute
1	Fellow or Associate must include Investment paper E (post - May 1992 syllabus)	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Certificate in Investment Management (at least three papers passed by examination)	Society of Investment Analysts in Ireland
2	Certified Diploma in Accounting and Finance	Association of Chartered Certified Accountants
2	Certified European Financial Analyst	EFFAS Societies with accredited examinations
2	Chartered Financial Analyst (Level 1)	Association for Investment Management and Research
2	Chartered Member	Securities Analysts' Association of Japan
2	Diploma – Corporate Finance paper	Securities Institute
2	Investment Management Asset Allocation Qualification	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Investment Practice version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Module B(ii), Securities and Portfolio Management	Law Society of England and Wales
2	Ordinary and Senior Certificates	South African Institute of Financial Markets
2	SFA Corporate Finance Representative Examination	Securities Institute
2	Professional qualification which provides the particular discipline relevant to their responsibilities in relation to venture capital investments	
3	SFA Registered Persons Examination – Section 1 (Regulation)	Securities Institute
3	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research

Annex 3R The interim approved examinations referred to in TC 2

Table 1 *TC 2.1.4 R (1) (f) Employees engaging in advising on investments which are packaged products (other than broker funds or as in (g) or (h))*

Examination that must be passed within two years of starting the activity		
K E Y	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory modules
1	Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Associateship (post-August 1994 syllabus)	Chartered Institute of Bankers in Scotland
1	Certificate for Financial Advisers	Chartered Institute of Bankers
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	Diploma (including Private Client Investment Advice and Management paper)	Securities Institute
1	Fellow or Associate (life and pensions route only)	Chartered Insurance Institute
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Financial Planning Certificate	Chartered Insurance Institute
1	Initial Test of Competence	Institute of Chartered Accountants in England and Wales
1	Investment Advice Certificate	Securities Institute
1	Investment Paper (post-August - 1994 syllabus)	Chartered Institute of Bankers in Scotland
2	Investment paper from the Associateship	Chartered Institute of Bankers
2	Investment paper (pre - August 1994 syllabus)	Chartered Institute of Bankers in Scotland
2	Investment Planning Paper 2	Institute of Bankers in Ireland
2	Module B(i), Retail Branded/Packaged Products	Law Society of England and Wales
3	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
3	Certificate in Investment Planning – Paper 1	Chartered Institute of Bankers in Scotland
3	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
3	Investment Advice Certificate – Paper 1	Securities Institute

Table 2 TC 2.1.4 R (1) (g) Employees engaging in advising on investments which are friendly society tax exempt policies only

Examination that must be passed within two years of starting the activity		
Interim approved examinations which meet the requirements of TC 2.4.5 R (2)		
1	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
1	Certificate in Investment Planning – Paper 1	Chartered Institute of Bankers in Scotland
1	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
1	Investment Advice Certificate – Paper 1	Securities Institute

Table 3 TC 2.1.4 R (1) (h) Employees engaging in advising on investments which are packaged products (where the employee sells only life policies issued by a friendly society and is not reasonably expected to receive remuneration of more than £1,000 a year in respect of such sales)

No examination requirement

Table 4 TC 2.1.4 R (1) (i) Employees engaging in advising on investments in the course of corporate finance business only

Examination that must be passed within two years of starting the activity		
K E Y	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory modules
1	Diploma (including Regulation and Compliance, Investment Analysis and Fund Management)	Securities Institute
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	SFA Corporate Finance Representative Examination	Securities Institute
1	SFA Securities Representatives Examination	Securities Institute

Examination that must be passed within two years of starting the activity		
1	SFA Securities and Financial Derivatives Representative Examination	Securities Institute
2	Diploma – Corporate Finance paper	Securities Institute
2	Examination	NIBE – SVV – the Dutch Institute for the banking, insurance and stockbroking industry
2	Module B(ii), Securities and Portfolio Management	Law Society of England and Wales
2	Ordinary and Senior Certificates	South African Institute of Financial Markets
2	Registered Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification - Type 1	Japanese Securities Dealers Association
2	Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification - Class 1	Japanese Bankers Association
2	Secondary Examination	Analyst Association of Japan
3	SFA Registered Persons Examination – Section 1 (Regulation)	Securities Institute
3	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research

Table 5 *TC 2.1.4 R (1) (j) Employees engaging in advising on investments which are (but not dealing in) securities (other than stakeholder pension schemes or broker funds) and derivatives. For employees engaging in advising in relation to venture capital investments only – see Annex 2R, Table 2.*

Examination that must be passed within two years of starting the activity		
KEY	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory modules
1	Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Associate or Fellow (life and pensions route only)	Chartered Insurance Institute
1	Certificate for Financial Advisers	Chartered Institute of Bankers
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	Diploma (including Regulation and Compliance, Investment Analysis and either Fund Management or Private Client Investment Advice and Management papers)	Securities Institute

Examination that must be passed within two years of starting the activity		
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Financial Planning Certificate	Chartered Insurance Institute
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Investment Advice Certificate	Securities Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Investment paper (post - August 1994 syllabus)	Chartered Institute of Bankers in Scotland
1	SFA Futures and Options Representative Examination plus Securities Representative Examination – Part 2	Securities Institute
1	SFA Securities and Financial Derivatives Representative Examination	Securities Institute
1	SFA Securities Representative Examination plus Financial Derivatives Module	Securities Institute
2	Chartered Financial Analyst	Association for Investment Management and Research
2	Examination	NIBE – SVV – the Dutch Institute for the banking, insurance and stockbroking industry
2	Investment paper from the Associateship	Chartered Institute of Bankers
2	Investment paper (pre-August 1994 syllabus)	Chartered Institute of Bankers in Scotland
2	Investment Planning – Paper 2	Institute of Bankers in Ireland
2	Module B(ii), Securities and Portfolio Management	Law Society of England and Wales
2	Ordinary and Senior Certificates	South African Institute of Financial Markets
2	Registered Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification - Type 1	Japanese Securities Dealers Association
2	Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification – Class 1	Japanese Bankers Association
2	Secondary Examination	Analyst Association of Japan
3	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
3	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
3	Investment Advice Certificate – Paper 1	Securities Institute
3	SFA Registered Persons Examination – Section 1 (Regulation)	Securities Institute
3	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment

Examination that must be passed within two years of starting the activity	
	Management and Research

Table 6 TC 2.1.4 R (1) (k) Employees engaging in advising on investments which are (but not dealing in) securities (other than stakeholder pension schemes or broker funds) only. For employees engaging in advising in relation to venture capital investments only – see Annex 2R, Table 2.

Examination that must be passed within two years of starting the activity		
K E Y	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory module
1	Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Associate or Fellow (life and pensions route only)	Chartered Insurance Institute
1	Certificate for Financial Advisers	Chartered Institute of Bankers
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	Diploma (including Regulation and Compliance, Investment Analysis and either Fund Management or Private Client Investment Advice and Management papers)	Securities Institute
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Financial Planning Certificate	Chartered Insurance Institute
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Initial Test of Competence	Institute of Chartered Accountants in England and Wales
1	Investment Advice Certificate	Securities Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Investment paper (post - August 1994 syllabus)	Chartered Institute of Bankers in Scotland
1	SFA Securities and Financial Derivatives Representative Examination	Securities Institute
1	SFA Securities Representative Examination	Securities Institute
2	Canadian Securities course plus Conduct and Practices Handbook	Canadian Securities Institute
2	Certificate	New Zealand Stock Exchange
2	Certificate in Financial Markets	Securities Institute of Australia
2	Certified European Financial Analyst	EFFAS Societies with accredited examinations
2	Chartered Financial Analyst (Level 1)	Association for Investment

Examination that must be passed within two years of starting the activity		
		Management and Research
2	Dealers Representative Examinations	Singapore Exchange
2	Diploma	Association of Belgium Financial Analysts
2	Diploma of Financial Markets	Securities Institute of Australia
2	Elementary, Intermediate and International Capital Markets course	Korea Securities Training Institute
2	Examination	NIBE – SVV – the Dutch Institute for the banking, insurance and stockbroking industry
2	Examination	French Society of Investment Analysts
2	General Certification Programme	ISMA/University of Reading
2	Investment paper from the Associateship	Chartered Institute of Bankers
2	Investment paper (pre-August 1994 syllabus)	Chartered Institute of Bankers in Scotland
2	Investment Planning – Paper 2	Institute of Bankers in Ireland
2	International Capital Markets Qualification (including the Fixed Interest and Bond Markets Module)	Securities Institute/South African Institute of Financial Markets
2	Membership Examination	Johannesburg Stock Exchange
2	Module B(ii), Securities and Portfolio Management	Law Society of England and Wales
2	Ordinary and Senior Certificates	South African Institute of Financial Markets
2	Promotore Finanziano Examination	Italian Exchange
2	Registered Representatives Examination	Irish Stock Exchange/Dublin City University
2	Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification - Class1	Japanese Bankers Association
2	Registered Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification - Type 1	Japanese Securities Dealers Association
2	Secondary Examination	Analyst Association of Japan
2	Series 7 – General Securities Representative Examination	National Association of Securities Dealers
2	Trainee Dealers Representative Examination	Kuala Lumpur Stock Exchange
3	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
3	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
3	Investment Advice Certificate – Paper 1	Securities Institute
3	SFA Registered Persons Examination - Section 1 (Regulation)	Securities Institute
3	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Management and Research

Table 7 TC 2.1.4 R (1) (I) Employees engaging in advising on investments which are (but not dealing in) derivatives only

Examination that must be passed within two years of starting the activity		
K	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
E	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
Y	3	UK regulatory module
1	Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Associate or Fellow (life and pensions route only)	Chartered Insurance Institute
1	Certificate for Financial Advisers	Chartered Institute of Bankers
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	Diploma (including Regulation and Compliance, Investment Analysis and either Fund Management or Private Client Investment Advice and Management papers)	Securities Institute
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Financial Planning Certificate	Chartered Insurance Institute
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Investment Advice Certificate	Securities Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Investment paper (post - August 1994 syllabus)	Chartered Institute of Bankers in Scotland
1	SFA Securities and Financial Derivatives Representative Examination	Securities Institute
1	SFA Futures and Options Representative Examination	Securities Institute
2	ACI Diploma	ACI
2	Chartered Financial Analyst	Association for Investment Management and Research
2	Derivatives Fundamentals course and Futures/Options Licensing course	Canadian Securities Institute
2	Diploma including passes in both the Australian Futures Trading and Options Trading papers	Securities Institute of Australia
2	Examination	NIBE – SVV – the Dutch Institute for the banking, insurance and stockbroking industry
2	Examination	Norwegian Society of Financial Analysts

Examination that must be passed within two years of starting the activity		
2	International Capital Markets Qualification (ICMQ) including a pass in Futures, Options and other Derivative Products paper	Securities Institute/South African Institute of Financial Markets
2	Investment paper from the Associateship	Chartered Institute of Bankers
2	Investment paper (pre-August 1994 syllabus)	Chartered Institute of Bankers in Scotland
2	Investment Planning – Paper 2	Institute of Bankers in Ireland
2	Module B(ii), Securities and Portfolio Management	Law Society of England and Wales
2	Ordinary and Senior Certificates	South African Institute of Financial Markets
2	Registered Representatives Examination	Sydney Futures Exchange
2	Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification – Class 1	Japanese Bankers Association
2	Registered Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification - Type 1	Japanese Securities Dealers Association
2	Secondary Examination	Analyst Association of Japan
2	Series 3 – Futures Representative Examination	National Futures Association
2	Singapore Exchange Futures Trading Test	Singapore Institute of Banking and Finance
3	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
3	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
3	Investment Advice Certificate – Paper 1	Securities Institute
3	SFA Registered Persons Examination - Section 1 (Regulation)	Securities Institute
3	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Management and Research

Annex 4R The interim approved examinations referred to in TC 2

Table 1 TC 2.1.4 R (1) (m) *Employees* engaging in the activity of a *broker fund adviser*

Examination that must be passed before starting the activity

Examination that must be passed before starting the activity		
K E Y	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory modules
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Investment Management Asset Allocation Qualification	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
3	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
3	Certificate in Investment Planning – Paper 1	Chartered Institute of Bankers in Scotland
3	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
3	Investment Advice Certificate – Paper 1	Securities Institute
3	Regulation and Compliance paper of Diploma	Securities Institute
3	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research

Table 2 *TC 2.1.4 R (1) (n) Employees engaging in advising on syndicate participation at Lloyd's*

Examination that must be passed before starting the activity	
Interim approved examinations which meet the requirements of TC 2.4.5 R (2)	
Lloyd's Introductory Test	Lloyd's
Lloyd's Market Certificate	Lloyd's/Chartered Insurance Institute

Table 3 *TC 2.1.4 R (1) (o) Employees engaging in the activity of a pension transfer specialist*

Examination that must be passed before starting the activity	
Interim approved examinations which meet the requirements of TC 2.4.5 R (2)	
Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
Fellow or Associate by examination	Pensions Management Institute
Fellow or Associate including three pensions-related subjects as confirmed by the examining body	Chartered Insurance Institute
G60 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
Pensions paper of Professional Investment Certificate	Chartered Institute of Bankers

Annex 5R The interim approved examinations referred to in TC 2

Table 1 ***TC 2.1.4 R (2) (a) Employees overseeing on a day-to-day basis operating, or acting as a trustee or depositary of, a collective investment scheme***

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity		
	Stage 1 Industry awareness	
	Stage 2 Regulatory knowledge	
	Stage 3 Knowledge relevant to the role	
1	Certificate for Financial Advisers - Paper 1	Chartered Institute of Bankers
1	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	Company Secretarial Practice and Share Registration Practice (including the Regulatory module within the examination)	Institute of Chartered Secretaries and Administrators
1	Diploma	Securities Institute
1	Diploma - International Operations Management paper	Securities Institute
1	Diploma – Operations Management paper	Securities Institute
1	Fellow, Member or Associate	Chartered Institute of Bankers in Scotland
1	Fellow or Associate	Association of Corporate Treasurers
1	Fellow or Associate	Association of Chartered Certified Accountants
1	Fellow or Associate	Chartered Institute of Bankers
1	Fellow or Associate	Chartered Institute of Bankers in Ireland
1	Fellow or Associate	Chartered Institute of Management Accountants
1	Fellow or Associate	Chartered Institute of Public Finance Accountants
1	Fellow or Associate	Chartered Insurance Institute
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate	Institute of Chartered Accountants in England and Wales
1	Fellow or Associate	Institute of Chartered Accountants in Ireland

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

1	Fellow or Associate	Institute of Chartered Accountants in Scotland
1	Fellow or Associate	Institute of Chartered Secretaries and Administrators
1	Fellow or Associate	Pensions Management Institute
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Financial Planning Certificate - Paper 1	Chartered Insurance Institute
1	Investment Administration Qualification – Introduction to Securities and Investment module	Securities Institute
1	Investment Advice Certificate - Paper 1	Securities Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Member	Association of Accounting Technicians
1	SFA Registered Persons Examination	Securities Institute
1	Solicitor	Law Society of England and Wales/Law Society of Scotland/Law Society of Northern Ireland
2	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
2	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
2	Certificate in Company Secretarial Practice and Share Registration Practice (including the Regulatory module within the examination)	Institute of Chartered Secretaries and Administrators
2	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
2	Diploma – International Operations Management paper	Securities Institute
2	Diploma – Operations Management paper	Securities Institute
2	Diploma – Regulation and Compliance paper	Securities Institute
2	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
2	Investment Advice Certificate – Paper 1	Securities Institute
2	Investment Administration Qualification – Regulatory Environment module	Securities Institute
2	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Investment Regulation and Practice paper of the Associate Examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	SFA Futures and Options Representative Examination	Securities Institute
2	SFA Securities and Financial Derivatives Representative Examination	Securities Institute
2	SFA Securities Representative Examination	Securities Institute

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

2	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
3	Certificate in Company Secretarial Practice and Share Registration Practice (including the Regulatory module within the examination)	Institute of Chartered Secretaries and Administrators
3	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
3	Diploma - International Operations Management paper	Securities Institute
3	Diploma – Operations Management paper	Securities Institute
3	Investment Administration Management Award	Association of Unit Trusts and Investment Funds
3	Investment Administration Qualification – CREST Settlement module	Securities Institute
3	Investment Administration Qualification – Derivatives Operations/Exchange – Traded Derivative Administration module	Securities Institute
3	Investment Administration Qualification – Global Custody module	Securities Institute
3	Investment Administration Qualification – ISA Administration module	Securities Institute
3	Investment Administration Qualification – OEIC Administration module	Securities Institute
3	Investment Administration Qualification – PEP Administration module	Securities Institute
3	Investment Administration Qualification – Unit Trust Administration module	Securities Institute
3	A firm may use alternative methods of assessing the required level of knowledge and understanding at stage 3 only where the firm can demonstrate that none of the above examinations are appropriate.	

Annex 6R The interim approved examinations referred to in TC 2

Table 1 TC 2.1.4 R (2) (b) *Employees overseeing on a day-to-day basis safeguarding and administering investments or holding of client money*

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

Stage 1	Industry awareness	
Stage 2	Regulatory knowledge	
Stage 3	Knowledge relevant to the role	
1	Certificate for Financial Advisers - Paper 1	Chartered Institute of Bankers
1	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	Company Secretarial Practice and Share Registration Practice (including the Regulatory module within the examination)	Institute of Chartered Secretaries and Administrators
1	Diploma	Securities Institute
1	Diploma – International Operations Management paper	Securities Institute
1	Diploma – Operations Management paper	Securities Institute
1	Fellow, Member or Associate	Chartered Institute of Bankers in Scotland
1	Fellow or Associate	Association of Chartered Certified Accountants
1	Fellow or Associate	Association of Corporate Treasurers
1	Fellow or Associate	Chartered Institute of Bankers
1	Fellow or Associate	Chartered Institute of Bankers in Ireland
1	Fellow or Associate	Chartered Institute of Management Accountants
1	Fellow or Associate	Chartered Institute of Public Finance Accountants
1	Fellow or Associate	Chartered Insurance Institute
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate	Institute of Chartered Accountants in England and Wales
1	Fellow or Associate	Institute of Chartered Accountants in Ireland
1	Fellow or Associate	Institute of Chartered Accountants in Scotland
1	Fellow or Associate	Institute of Chartered Secretaries and Administrators
1	Fellow or Associate	Pensions Management Institute
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
1	Investment Administration Qualification – Introduction to Securities and Investment module	Securities Institute
1	Investment Advice Certificate – Paper 1	Securities Institute

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Member	Association of Accounting Technicians
1	SFA Registered Persons Examination	Securities Institute
1	Solicitor	Law Society of England and Wales/Law Society of Scotland/Law Society of Northern Ireland
2	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
2	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
2	Certificate in Company Secretarial Practice and Share Registration Practice (including the Regulatory module within the examination)	Institute of Chartered Secretaries and Administrators
2	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
2	Diploma – International Operations Management paper	Securities Institute
2	Diploma – Operations Management paper	Securities Institute
2	Diploma – Regulation and Compliance paper	Securities Institute
2	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
2	Investment Advice Certificate – Paper 1	Securities Institute
2	Investment Administration Qualification – Regulatory Environment module	Securities Institute
2	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Investment Regulation and Practice paper of the Associate Examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	SFA Futures and Options Representative Examination	Securities Institute
2	SFA Securities and Financial Derivatives Representative Examination	Securities Institute
2	SFA Securities Representative Examination	Securities Institute
2	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
3	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
3	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
3	Certificate in Company Secretarial Practice and Share Registration Practice (including the Regulatory module within the examination)	Institute of Chartered Secretaries and Administrators
3	Diploma - International Operations Management paper	Securities Institute
3	Diploma – Operations Management paper	Securities Institute
3	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
3	Investments Administration Management Award	Association of Unit Trusts and

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity		
		Investment Funds
3	Investment Administration Qualification – CREST Settlement module	Securities Institute
3	Investment Administration Qualification – Derivatives Operations/Exchange – Traded Derivative Administration module	Securities Institute
3	Investment Administration Qualification – Global Custody module	Securities Institute
3	Investment Administration Qualification – ISA Administration module	Securities Institute
3	Investment Administration Qualification – OEIC Administration module	Securities Institute
3	Investment Administration Qualification – PEP Administration module	Securities Institute
3	Investment Administration Qualification – Unit Trust Administration module	Securities Institute
3	Investment Advice Certificate – Paper 1	Securities Institute
3	A firm may use alternative methods of assessing the required level of knowledge and understanding at stage 3 only where the firm can demonstrate that none of the above examinations are appropriate.	

Annex 7R The interim approved examinations referred to in TC 2

Table 1 ***TC 2.1.4 R (2) (c) Employees overseeing on a day-to-day basis the following administrative functions in relation to managing investments:***

- (i) arranging settlement;
- (ii) monitoring and processing corporate actions;
- (iii) *client* account administration, liaison and reporting, including valuation and performance measurement;
- (iv) *ISA* or *PEP* administration;
- (v) *investment trust savings scheme* administration

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity	
Stage 1	Industry awareness
Stage 2	Regulatory knowledge
Stage 3	Knowledge relevant to the role

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

1	Certificate for Financial Advisers - Paper 1	Chartered Institute of Bankers
1	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	Company Secretarial Practice and Share Registration Practice (including the Regulatory module within the examination)	Institute of Chartered Secretaries and Administrators
1	Diploma	Securities Institute
1	Diploma - International Operations Management paper	Securities Institute
1	Diploma – Operations Management paper	Securities Institute
1	Fellow, Member or Associate	Chartered Institute of Bankers in Scotland
1	Fellow or Associate	Association of Chartered Certified Accountants
1	Fellow or Associate	Association of Corporate Treasurers
1	Fellow or Associate	Chartered Institute of Bankers
1	Fellow or Associate	Chartered Institute of Bankers in Ireland
1	Fellow or Associate	Chartered Institute of Management Accountants
1	Fellow or Associate	Chartered Institute of Public Finance Accountants
1	Fellow or Associate	Chartered Insurance Institute
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate	Institute of Chartered Accountants in England and Wales
1	Fellow or Associate	Institute of Chartered Accountants in Ireland
1	Fellow or Associate	Institute of Chartered Accountants in Scotland
1	Fellow or Associate	Institute of Chartered Secretaries and Administrators
1	Fellow or Associate	Pensions Management Institute
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Financial Planning Certificate - Paper 1	Chartered Insurance Institute
1	Investment Administration Qualification - Introduction to Securities and Investment module	Securities Institute
1	Investment Advice Certificate - Paper 1	Securities Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Member	Association of Accounting Technicians

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

1	SFA Registered Persons Examination	Securities Institute
1	Solicitor	Law Society of England and Wales/Law Society of Scotland/Law Society of Northern Ireland
2	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
2	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
2	Certificate in Company Secretarial Practice and Share Registration Practice (including the Regulatory module within the examination)	Institute of Chartered Secretaries and Administrators
2	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
2	Diploma – International Operations Management paper	Securities Institute
2	Diploma – Operations Management paper	Securities Institute
2	Diploma – Regulation and Compliance paper	Securities Institute
2	Financial Planning Certificate - Paper 1	Chartered Insurance Institute
2	Investment Administration Qualification - Regulatory Environment module	Securities Institute
2	Investment Advice Certificate - Paper 1	Securities Institute
2	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Investment Regulation and Practice paper of the Associate Examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	SFA Futures and Options Representative Examination	Securities Institute
2	SFA Securities and Financial Derivatives Representative Examination	Securities Institute
2	SFA Securities Representative Examination	Securities Institute
2	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
3	Certificate in Company Secretarial Practice and Share Registration Practice (including the Regulatory module within the examination)	Institute of Chartered Secretaries and Administrators
3	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
3	Diploma – International Operations Management paper	Securities Institute
3	Diploma – Operations Management paper	Securities Institute
3	Investment Administration Management Award	Association of Unit Trusts and Investment Funds
3	Investment Administration Qualification – CREST Settlement module	Securities Institute
3	Investment Administration Qualification – Derivatives Operations/Exchange – Traded Derivative Administration module	Securities Institute

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

3	Investment Administration Qualification – Global Custody module	Securities Institute
3	Investment Administration Qualification – ISA Administration module	Securities Institute
3	Investment Administration Qualification – OEIC Administration module	Securities Institute
3	Investment Administration Qualification – PEP Administration module	Securities Institute
3	Investment Administration Qualification – Unit Trust Administration module	Securities Institute
3	A firm may use alternative methods of assessing the required level of knowledge and understanding at stage 3 only where the firm can demonstrate that none of the above examinations are appropriate.	

Annex 8R The interim approved examinations referred to in TC 2

Table 1 **TC 2.1.4 R (2) (d) Employees overseeing on a day-to-day basis the following *administrative functions* in relation to the *effecting or carrying out of life policies*:**

- (i) new business administration;
- (ii) *policy* alterations including surrenders and *policy* loans;
- (iii) preparing *projections*;
- (iv) processing *claims*, including pension payments;
- (v) fund switching

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

Stage 1 Industry awareness		
Stage 2 Regulatory knowledge		
Stage 3 Knowledge relevant to the role		
1	Certificate for Financial Advisers - Paper 1	Chartered Institute of Bankers
1	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	Certificate of Insurance Practice	Chartered Insurance Institute
1	Fellow, Member or Associate	Chartered Institute of Bankers in

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

		Scotland
1	Fellow or Associate	Association of Chartered Certified Accountants
1	Fellow or Associate	Association of Corporate Treasurers
1	Fellow or Associate	Chartered Institute of Bankers
1	Fellow or Associate	Chartered Institute of Bankers in Ireland
1	Fellow or Associate	Chartered Institute of Management Accountants
1	Fellow or Associate	Chartered Institute of Public Finance Accountants
1	Fellow or Associate	Chartered Insurance Institute
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate	Institute of Chartered Accountants in England and Wales
1	Fellow or Associate	Institute of Chartered Accountants in Ireland
1	Fellow or Associate	Institute of Chartered Accountants in Scotland
1	Fellow or Associate	Institute of Chartered Secretaries and Administrators
1	Fellow or Associate	Pensions Management Institute
1	Fellow or Associate by examination	United Society of Investment Professionals/Institute of Investment Management and Research
1	Financial Planning Certificate - Paper 1	Chartered Insurance Institute
1	Investment Administration Qualification - Introduction to Securities and Investment module	Securities Institute
1	Investment Advice Certificate - Paper 1	Securities Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Member	Association of Accounting Technicians
1	SFA Registered Persons Examination	Securities Institute
1	Solicitor	Law Society of England and Wales/Law Society of Scotland/Law Society of Northern Ireland
2	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
2	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
2	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
2	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
2	Investment Administration Qualification – Regulatory Environment module	Securities Institute
2	Investment Advice Certificate – Paper 1	Securities Institute

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

3	Certificate for Financial Advisers – Paper 2	Chartered Institute of Bankers
3	Certificate of Insurance Practice (life or pensions route)	Chartered Insurance Institute
3	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
3	Fellow or Associate (by examination)	Pensions Management Institute
3	Fellow or Associate (life and pensions route only)	Chartered Insurance Institute
3	Financial Planning Certificate – Paper 2	Chartered Insurance Institute
3	Initial Test of Competence	Institute of Chartered Accountants in England and Wales
3	Investment Advice Certificate - Paper 2	Securities Institute
3	Life assurance (735)	Chartered Insurance Institute
3	Life office administration	Chartered Insurance Institute
3	Module B(i), Retail Branded/Packaged Products	Law Society of England and Wales
3	Pensions administration	Chartered Insurance Institute
3	Pensions law, taxation and administration (740)	Chartered Insurance Institute
3	A firm may use alternative methods of assessing the required level of knowledge and understanding at stage 3 only where the firm can demonstrate that none of the above examinations are appropriate.	

Annex 9R The interim approved examinations referred to in TC 2

Table 1 *TC 2.1.4 R (2) (e) Employees overseeing on a day-to-day basis taking private customers through decision trees in connection with a stakeholder pension scheme*

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity		
Stage 1 Industry awareness		
Stage 2 Regulatory knowledge		
Stage 3 Knowledge relevant to the role		
1	Certificate for Financial Advisers - Paper 1	Chartered Institute of Bankers
1	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	Fellow, Member or Associate	Chartered Institute of Bankers in

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

		Scotland
1	Fellow or Associate	Association of Chartered Certified Accountants
1	Fellow or Associate	Association of Corporate Treasurers
1	Fellow or Associate	Chartered Institute of Bankers
1	Fellow or Associate	Chartered Institute of Bankers in Ireland
1	Fellow or Associate	Chartered Institute of Management Accountants
1	Fellow or Associate	Chartered Institute of Public Finance Accountants
1	Fellow or Associate	Chartered Insurance Institute
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate	Institute of Chartered Accountants in England and Wales
1	Fellow or Associate	Institute of Chartered Accountants in Ireland
1	Fellow or Associate	Institute of Chartered Accountants in Scotland
1	Fellow or Associate	Institute of Chartered Secretaries and Administrators
1	Fellow or Associate	Pensions Management Institute
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Financial Planning Certificate - Paper 1	Chartered Insurance Institute
1	Investment Administration Qualification - Introduction to Securities and Investment module	Securities Institute
1	Investment Advice Certificate - Paper 1	Securities Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Member	Association of Accounting Technicians
1	Solicitor	Law Society of England and Wales/Law Society of Scotland/Law Society of Northern Ireland
2	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
2	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
2	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
2	Investment Advice Certificate – Paper 1	Securities Institute
3	Certificate for Financial Advisers – Paper 2	Chartered Institute of Bankers
3	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
3	Fellow or Associate (by examination)	Pensions Management Institute

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

3	Fellow or Associate (pensions route)	Chartered Insurance Institute
3	Financial Planning Certificate – Paper 2	Chartered Insurance Institute
3	Initial Test of Competence	Institute of Chartered Accountants in England and Wales
3	Investment Advice Certificate - Paper 2	Securities Institute
3	Module B(i), Retail Branded/Packaged Products	Law Society of England and Wales
3	A firm may use alternative methods of assessing the required level of knowledge and understanding at stage 3 only where the firm can demonstrate that none of the above examinations are appropriate.	

Annex 10R The interim approved examinations referred to in TC 2

Table 1 *TC 2.1.4 R (2) (f) Employees overseeing on a day-to-day basis the following administrative functions in relation to the operation of a stakeholder pension scheme:*

- (i) new business administration;
- (ii) receipt of or alteration to contributions;
- (iii) preparing *projections* and annual statements;
- (iv) administration of transfers;
- (v) handling claims, including pension payments;
- (vi) fund allocation and switching

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity		
	Stage 1 Industry awareness	
	Stage 2 Regulatory knowledge	
	Stage 3 Knowledge relevant to the role	
1	Certificate for Financial Advisers - Paper 1	Chartered Institute of Bankers
1	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	Fellow, Member or Associate	Chartered Institute of Bankers in Scotland
1	Fellow or Associate	Association of Chartered Certified Accountants
1	Fellow or Associate	Association of Corporate Treasurers
1	Fellow or Associate	Chartered Institute of Bankers
1	Fellow or Associate	Chartered Institute of Bankers in Ireland
1	Fellow or Associate	Chartered Institute of Management Accountants
1	Fellow or Associate	Chartered Institute of Public Finance Accountants
1	Fellow or Associate	Chartered Insurance Institute
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate	Institute of Chartered Accountants in England and Wales
1	Fellow or Associate	Institute of Chartered Accountants in Ireland
1	Fellow or Associate	Institute of Chartered Accountants in Scotland

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

1	Fellow or Associate	Institute of Chartered Secretaries and Administrators
1	Fellow or Associate	Pensions Management Institute
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Financial Planning Certificate - Paper 1	Chartered Insurance Institute
1	Investment Administration Qualification - Introduction to Securities and Investment module	Securities Institute
1	Investment Advice Certificate - Paper 1	Securities Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Member	Association of Accounting Technicians
1	Solicitor	Law Society of England and Wales/Law Society of Scotland/Law Society of Northern Ireland
2	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
2	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
2	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
2	Investment Advice - Certificate – Paper 1	Securities Institute
3	Associate or Fellow	Faculty of Actuaries/Institute of Actuaries
3	Certificate for Financial Advisers – Paper 2	Chartered Institute of Bankers
3	Certificate of Insurance Practice (pensions route)	Chartered Insurance Institute
3	Fellow or Associate (by examination)	Pensions Management Institute
3	Fellow or Associate (pensions route)	Chartered Insurance Institute
3	Financial Planning Certificate – Paper 2	Chartered Insurance Institute
3	Initial Test of Competence	Institute of Chartered Accountants in England and Wales
3	Investment Advice Certificate - Paper 2	Securities Institute
3	Module B(i), Retail Branded/Packaged Products	Law Society of England and Wales
3	Pensions administration	Chartered Insurance Institute
3	Pensions law, taxation and administration (740)	Chartered Insurance Institute
3	A firm may use alternative methods of assessing the required level of knowledge and understanding at stage 3 only where the firm can demonstrate that none of the above examinations are appropriate.	

Handbook Modules

Schedule1 Record keeping requirements

- 1 The aim of the guidance in the following table is to give the reader a quick over-all view of the relevant record keeping requirements.
- 2 It is not a complete statement of those requirements and should not be relied on as if it were.
- 3 In the table, "PTS" means pension transfer specialist.
- 4

Table	Record keeping requirements
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Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
TC 2.4.9 G	Attaining Competence	Data on competence	On a continuing basis	Employment plus 3 years. For PTS indefinite
TC 2.5.1 R	Approved examinations	Examination time limits	When <i>employee</i> begins in the activity	Employment plus 3 years or for PTS indefinite
TC 2.5.2 G	Approved examinations	Examination passes and dates and other relevant data such as periods of absence	Duration of time limits for that activity	Employment plus 3 years or for PTS indefinite
TC 2.5.6 G	Approved examinations – regulatory module only	Criteria for application of TC 2.5.5 R to the <i>employee</i>	At the time of the application of the <i>rule</i>	Employment plus 3 years or for PTS indefinite
TC 2.6.4 G	Maintaining Competence	Criteria for and application of assessment	On a continuing basis after competence	Employment plus 3 years or for PTS indefinite

TC 2.7.6 G	Supervising and monitoring	Criteria in deciding level of supervision and how it is carried out	When the <i>employee</i> begins in the activity and on an ongoing basis	Employment plus 3 years or for PTS indefinite
TC 2.8.1 R (1)	Compliance with sourcebook	Data on competence, relevant to compliance with the sourcebook	When the <i>employee</i> begins in the activity and on a continuing basis	Employment plus 3 years or for PTS indefinite

Handbook Modules

Schedule2 Notification requirements

- 1 G – There are no notification or reporting requirements in TC.

Handbook Modules

Schedule3 Fees and other required payments

- 1 G – There are no requirements for fees or other payments in TC.

Handbook Modules

Schedule4 Powers exercised

- 1 G – The following powers and related provisions in the Act have been exercised to make the rules in TC:
 - (1) Section 138 (General rule making power)
 - (2) Section 150(2) (Actions for damages)
 - (3) Section 156 (General supplementary powers)
- 2 The following power in the Act has been exercised by the FSA to give the guidance in TC:
 - (1) Section 157(1) (Guidance)

Handbook Modules

Schedule5 Rights of action for damages

- 1 The table below sets out the rules in TC contravention of which by an authorised person may be actionable under section 150 of the Act (Actions for damages) by a person who suffers loss as a result of the contravention.
- 2 If a "Yes" appears in the column headed "For private person?", the rule may be actionable by a "private person" under section 150 (or, in certain circumstances, his fiduciary or representative). A "Yes" in the column headed "Removed" indicates that the FSA has removed the right of action under section 150(2) of the Act. If so, a reference to the rule in which it is removed is also given.
- 3 The column headed "For other person?" indicates whether the rule is actionable by a person other than a private person (or his fiduciary or representative). If so, an indication of the type of person by whom the rule is actionable is given.
- 4 **Table** Actions for damages: Training and Competence sourcebook

Chapter/ Appendix	Section/ Annex	Paragraph	Right of action under section 150			
			For private person	Removed	For other person	
	<i>Rules in TC 2</i>		No	Yes <i>TC</i> 2.1.5 R	No	

Handbook Modules

Schedule6 Rules that can be waived

- 1 G - The rules in TC can be waived by the FSA under section 148 of the Act (Modification or waiver of rules).

Training and Competence sourcebook

Derivations

G (1) Derivations: IMRO

1. The aim of the *guidance* in the following table is to give the reader a guide to the derivation of the text.
2. It is not a complete statement of the derivation and should not be relied on as if it were.

Ch/App	S/Ann	P		Subject	Source	Reference
1	1	1	G	(1) Application – who?	IMRO	Ch I R 3.2 (1) (c) Ch II Section 12
1	1	2	G	Application – where?	IMRO	Ch I Section 3.2
1	1	3	G	Purpose- Principle 3	IMRO	Ch I R 1.1 (1) 9
1	1	4	G	Principle 3	IMRO	Ch I R 1.1 (1) 9
1	1	5	G	Threshold Conditions for authorisation	IMRO	Ch VII R 1.2 (1) Ch VII Table 1.2 (1) (1)
1	1	6	G	Fit and proper test	IMRO	Ch VII R 1.2 (1) Ch VII Table 1.2 (1) (1) Ch VII Annex A
1	1	8	G	Standards	IMRO	Ch I R 1.1 (1) 9
1	2	1	G	(1) The firm's Commitments to training and competence	IMRO	Ch I R 1.1 (1) 9
1	2	1	G	(2) The firm's Commitments to training and competence	IMRO	Ch I R 1.1 (1) 9
1	2	1	G	(3) The firm's Commitments to training and competence	IMRO	Ch I R 1.1 (1) 9
1	2	1	G	(4) The firm's Commitments to training and competence	IMRO	Ch I R 1.1 (1) 9
1	2	1	G	(5) The firm's Commitments to training and competence	IMRO	Ch I R 1.1 (1) 9
2	1	1	R	(1) (a) Territorial scope	IMRO	Ch I R 3.2 (1) (c) Ch II Section 12
2	1	3	R	Territorial scope	IMRO	Ch I R 3.2 (1) (a) (b)
2	1	4	R	Scope – activities	IMRO	Ch IV R 1.1 (10) (a)
2	1	4	R	(1) (d) Managing investments	IMRO	Ch IV R 1.1 (10) (a)
2	1	4	R	(1) (e) Managing investments in relation to venture capital investments only	IMRO	Ch IV R 1.1 (10) (a)

Ch/App	S/Ann	P		Subject	Source	Reference
2	1	4	R	(1) (f) Advising on investments which are packaged products (other than broker funds)	IMRO	Ch IV R 1.1 (10) (a)
2	1	4	R	(1) (i) Advising on investments in the course of corporate finance business	IMRO	Ch IV R 1.1 (10) (a)
2	1	4	R	(1) (j) Advising on investments which are (but not dealing in) securities (other than stakeholder pension schemes or broker funds) and derivatives	IMRO	Ch IV R 1.1 (10) (a)
2	1	4	R	(1) (k) Advising on investments which are (but not dealing in) securities (other than stakeholder pension schemes or broker funds) only	IMRO	Ch IV R 1.1 (10) (a)
2	1	4	R	(1) (l) Advising on investments which are (but not dealing in) derivatives only	IMRO	Ch IV R 1.1 (10) (a)
2	1	4	R	(1) (m) Activities of a broker fund adviser	IMRO	Ch IV R 1.1 (10) (a)
2	1	4	R	2 (a) Overseeing operating, or acting as a trustee or depository of, a collective investment scheme	IMRO	Ch IV R 1.1 (10) (a) Definitions – A - Administration Functions, (f)
2	1	4	R	2 (b) Overseeing safeguarding and administering investments or holding of client money	IMRO	Ch IV R 1.1 (10) (a) Definitions – A - Administration Functions, (a) to (e), (g)
2	1	4	R	2 (c) Overseeing administrative functions in relation to managing investments	IMRO	Ch IV R 1.1 (10) (a) Definitions – A – Administration Functions. (a) to (e), (g)
2	1	4	R	2 (f) Overseeing administrative functions in relation to operation of a stakeholder pension scheme	IMRO	Ch IV R 1.1 (10) (a) Definitions – A – Administration Functions, (h)
2	2	1	R	(1) Recruitment	IMRO	Ch IV App 1.1 (10) 1
2	2	1	R	(2) Recruitment	IMRO	Ch IV App 1.1 (10) 1
2	2	2	G	Recruitment procedures	IMRO	Ch IV App 1.1 (10) 1
2	3	1	R	(1) Training needs	IMRO	Ch IV R 1.1 (10) (a) Ch IV App 1.1 (10) 3, 4

Ch/App	S/Ann	P			Subject	Source	Reference
2	3	1	R	(2)	Planning training	IMRO	Ch IV R 1.1 (10) (a) Ch IV App 1.1 (10) 3, 4
2	3	2	G		Determining training need	IMRO	Ch IV App 1.1 (10) 3
2	3	3	G	(1)	Training guidance	IMRO	Ch IV App 1.1 (10) 4
2	3	3	G	(2)	Training guidance	IMRO	Ch IV App 1.1 (10) 4
2	3	3	R	(3)	Training guidance	IMRO	Ch IV App 1.1 (10) 4
2	3	3	R	(4)	Training guidance	IMRO	Ch IV App 1.1 (10) 4
2	4	1	R	(1)	Attaining competence	IMRO	Ch IV R 1.1 (10) (a) (b) (i) Ch IV App 1.1 (10) 5 (a)
2	4	1	R	(2)	Attaining competence	IMRO	Ch IV App 1.1 (10) 5 (a)
2	4	1	R	(3)	Supervision of a transferee until assessed as competent in new activity	IMRO	Ch IV App 1.1 (10) 3 (b)
2	4	2	R	(1)	Employee under supervision	IMRO	Ch IV R 1.1 (10) (a), (b), (i) Ch IV App 1.1 (10) 5 (a)
2	4	2	R	(2)	Employee under supervision	IMRO	Ch IV R 1.1 (10) (a)
2	4	3	G	(1)	Knowledge/skills for employees under supervision	IMRO	Ch IV App 1.1 (10) 4, 4 (a), 4 (b)
2	4	3	G	(2)	Knowledge/skills for employees under supervision	IMRO	Ch IV App 1.1 (10) 4, 4 (a), 4 (b)
2	4	5	R	(1)	Assessing competence	IMRO	Ch IV R 1.1 (10) (a) (b) (i)
2	4	5	R	(2)	Assessing competence	IMRO	Ch IV R 1.1 (10) (b) (i)
2	4	6	G	(1)	Assessments	IMRO	Ch IV App 1.1 (10) 8
2	4	6	G	(2)	Assessments	IMRO	Ch IV App 1.1 (10) 8
2	4	6	G	(3)	Assessments	IMRO	Ch IV App 1.1 (10) 8
2	4	7	G		Assessment methods	IMRO	Ch IV App 1.1 (10) 8
2	4	8	G		Awareness of employees re Training and Competence arrangements	IMRO	Ch IV App 1.1 (10) 2
2	4	9	G	(1)	Record keeping for assessing competence	IMRO	Ch IV App 1.1 (10) 7 Ch IV R 1.6 (2) Ch IV Table 1.6 (2) III 1
2	4	9	G	(2)	Record keeping for assessing competence	IMRO	Ch IV App 1.1 (10) 7 Ch IV R 1.6 (2) Ch IV Table 1.6 (2) III 1
2	5	1	R	(1)	Approved examinations and time limits	IMRO	Ch IV R 1.1 (10) (b) (i)
2	5	1	R	(2) (a)	Time limits	IMRO	Ch IV R 1.1 (10) (b) (i) Ch IV App 1.1 (10) 4
2	5	1	R	(2) (b)	Time limits	IMRO	Ch IV R 1.1 (10) (b) (i)
2	5	1	R	(3) (a)	Failure to keep to time limits	IMRO	Ch IV R 1.1 (10) (b) (i)
2	5	1	R	(3) (b)	Failure to keep to time limits	IMRO	Ch IV R 1.1 (10) (b) (i)

Ch/App	S/Ann	P		Subject	Source	Reference	
2	5	5	R	(1)	Exemption from full examination requirement for employees transferred in from outside UK	IMRO	Ch IV R 1.1 (10) (b) (ii)
2	5	5	R	(1) (a)	Holding of sufficient up-to-date and relevant experience gained outside UK	IMRO	Ch IV R 1.1 (10) (b) (ii)
2	5	5	R	(1) (b)	Not previously having been fully subject to relevant examination requirements	IMRO	Ch IV R 1.1 (10) (b) (ii)
2	5	5	R	(1) (c)	Need to pass regulatory module	IMRO	Ch IV R 1.1 (10) (b) (ii)
2	5	6	G		Record keeping in relation to 2.5.5 R	IMRO	Ch IV App 1.1 (10) 7, 7 (a) Ch IV R 1.6 (2) Ch IV Table 1.6 (2) III 1
2	5	7	G		Overseas examinations	IMRO	Ch IV R 1.1 (10) (b) (ii) Examinations and Exemptions schedule
2	6	1	R		Maintaining competence	IMRO	Ch IV App 1.1 (10) 6
2	6	2	G	(1)	Arrangements for maintaining competence	IMRO	Ch IV App 1.1 (10) 6
2	6	2	G	(2)	Arrangements for maintaining competence	IMRO	Ch IV App 1.1 (10) 6
2	6	2	G	(3)	Arrangements for maintaining competence	IMRO	Ch IV App 1.1 (10) 6
2	6	3	G		Monitoring competence	IMRO	Ch IV App 1.1 (10) 6
2	6	4	G	(1)	Record keeping for monitoring competence	IMRO	Ch IV App 1.1 (10) 7, 7 (b) Ch IV R 1.6 (2) Ch IV Table 1.6 (2), III, 1
2	6	4	G	(2)	Record keeping monitoring competence	IMRO	Ch IV App 1.1 (10) 7, 7 (b) Ch IV R 1.6 (2) Ch IV Table 1.6 (2), III, 1
2	7	1	R		Supervising employees before competence	IMRO	Ch IV R 1.1 (10) (a) Ch IV App 1.1 (10) 5 (a) (b)
2	7	2	G	(1)	Supervision arrangements before competence	IMRO	Ch IV App 1.1 (10) 5 (a) (b)
2	7	2	G	(2) (a)	Supervision arrangements before competence	IMRO	Ch IV 1.1 (10) (a)
2	7	2	G	(2) (b)	Supervision arrangements before competence	IMRO	Ch IV App 1.1 (10) 5 (a) (b)
2	7	3	R		Supervision arrangements after competence	IMRO	Ch IV App 1.1 (10) 6

Ch/App	S/Ann	P			Subject	Source	Reference
2	7	6	G	(1)	Record Keeping on the level of Supervision	IMRO	Ch IV App 1.1 (10) 7 Ch IV R 1.6 (2) Ch IV Table 1.6 (2), III, 1
2	7	6	G	(2)	Record keeping on how supervision is carried out	IMRO	Ch IV App 1.1 (10) 7 Ch IV R 1.6 (2) Ch IV Table 1.6 (2), III, 1
2	8	1	R	(1)	Record keeping	IMRO	Ch IV App 1.1 (10) 7 Ch IV R 1.6 (2) Ch IV Table 1.6 (2), III, 1
2	8	1	R	(2)	Record keeping	IMRO	Ch IV App 1.1 (10) 7 Ch IV R 1.6 (2) Ch IV Table 1.6 (2), III, 1

G (2) Derivations : PIA

Ch/App	S/Ann	P			Subject	Source	Reference
1	1	1	G	(1)	Application – who?	PIA	1.3.1 (3) (d)
1	1	1	G	(2)	Application - who?	PIA	1.3.1 (3) 1. Schedule 2
1	1	2	G		Application – where?	PIA	1.1.1
1	1	3	G		Purpose- Principle 3	PIA	The Principles 9
1	1	4	G		Principle 3	PIA	The Principles 9
1	1	5	G		Threshold conditions for authorisation	PIA	The Principles 9
1	1	6	G		Fit and proper test	PIA	2.1.1
1	1	8	G		Standards	PIA	The Principles 9
1	2	1	G	(1)	The firm's Commitments to training and competence	PIA	The Principles 9
1	2	1	G	(2)	The firm's Commitments to training and competence	PIA	The Principles 9
1	2	1	G	(3)	The firm's Commitments to training and competence	PIA	The Principles 9
1	2	1	G	(4)	The firm's Commitments to training and competence	PIA	The Principles 9
1	2	1	G	(5)	The firm's Commitments to training and competence	PIA	The Principles 9
2	1	1	R	(1) (a)	Territorial scope	PIA	1. Schedule 2
2	1	2	R	(1) (2)	Territorial scope	PIA	1.3.1
2	1	4	R		Scope – activities	PIA	1.1.1
2	1	4	R	(1) (a)	Advising on investments and dealing for clients in securities and derivatives	PIA	1.1.2 (1) (a) (d) 1.1.2 (3)
2	1	4	R	(1) (b)	Advising on investments and dealing for clients in securities	PIA	1.1.2 (1) (a)
2	1	4	R	(1) (c)	Advising on investments and dealing for clients in derivatives	PIA	1.1.2 (1) (d)
2	1	4	R	(1) (d)	Managing investments	PIA	1.1.2 (1) (d)
2	1	4	R	(1) (f)	Advising on packaged products	PIA	1.1.2 (1) (c)
2	1	4	R	(1) (g)	Advising on friendly society tax exempt policies	PIA	1.1.2 (1)
2	1	4	R	(1) (h)	Advising on packaged products (friendly society £1,000 exemption)	PIA	1.1.2 (1)
2	1	4	R	(1) (i)	Corporate finance business	PIA	1.1.2 (2) (a)
2	1	4	R	(1) (j)	Advising on securities and derivatives	PIA	1.1.2 (1) (a) (d)
2	1	4	R	(1) (k)	Advising on securities	PIA	1.1.2 (1) (a)
2	1	4	R	(1) (l)	Advising on derivatives	PIA	1.1.2 (1) (d)
2	1	4	R	(1) (m)	Broker fund adviser	PIA	1.1.2 (1)
2	1	4	R	(1) (n)	Advising on syndicate participation at Lloyd's	PIA	1.1.2 (1)
2	1	4	R	(1) (o)	Pension transfer specialist	PIA	1.1.2 (1)
2	1	5	R		Actions for damages	PIA	Statement of Principle – Introduction – Para 3

Ch/App	S/Ann	P			Subject	Source	Reference
2	2	1	R	(1)	Recruitment	PIA	2.1.1 (a) (i) 2.6.3 (1) 2.6.6 (2) T&C Guidance (1998) 3.1.3
2	2	1	R	(2)	Recruitment	PIA	2.6.3 (1) 2.6.6 (2) RU 50
2	2	2	G		Recruitment procedures	PIA	2.1.1 (2) (b) 2.6.6 (2) RU 50
2	3	1	R	(1)	Training needs	PIA	2.6.1 (1) 2.6.2
2	3	1	R	(2)	Planning training	PIA	2.6.1 (1) 2.6.2
2	3	2	G		Determining training need	PIA	2.6.4 (1)
2	3	3	G	(1)	Training guidance	PIA	2.6.4 (1) (b) 2.6.5 (1)
2	3	3	G	(2)	Training guidance	PIA	2.6.4 (1) (b) 2.6.5 (1) T&C Guidance (1998) 3.1.4.1
2	3	3	G	(3)	Training guidance	PIA	2.6.4 (1) 2.6.5 (1) T&C Guidance (1998) 3.1.4.1
2	3	3	G	(4)	Training guidance	PIA	2.6.4 (1) (b) 2.6.5 (1) T&C Guidance (1998) 3.1.4.1
2	4	1	R	(1)	Attaining competence	PIA	2.6.4 (2) (d)
2	4	1	R	(2)	Attaining competence	PIA	2.6.4 (2) (b)
2	4	2	R	(1)	Employee under supervision	PIA	2.6.4 (2) (c)
2	4	2	R	(2)	Employee under supervision	PIA	2.6.4 (1) (b)
2	4	3	G	(1)	Knowledge/skills for employees under supervision	PIA	2.6.4 (1) (b)
2	4	3	G	(2)	Knowledge/skills for employees under supervision	PIA	2.6.4 (1) (c)
2	4	4	R	(3)	Approved examination - broker fund adviser	PIA	2.6.9 (2)
2	4	4	R	(4)	Approved examination - pension transfer specialist	PIA	2.6.9 (2)
2	4	5	R	(1)	Assessing competence	PIA	2.6.5 (3) (b)
2	4	5	R	(2)	Assessing competence	PIA	2.6.5 (4) (a)
2	4	6	G	(1)	Assessments	PIA	2.6.5 (3) (b)
2	4	6	G	(2)	Assessments	PIA	2.6.5 (3) (b)
2	4	6	G	(3)	Assessments	PIA	T&C Guidance (1998) 3.1.5.3
2	4	7	G		Assessment methods	PIA	2.6.5 (3) (b)
2	4	8	G		Employee awareness of Training and Competence scheme	PIA	7.1.1
2	4	9	G	(1)	Record keeping for assessing competence	PIA	Table 5 IV
2	4	9	G	(2)	Record keeping for assessing competence	PIA	Table 5 IV

Ch/App	S/Ann	P			Subject	Source	Reference
2	5	1	R	(1)	Approved examinations and time limits	PIA	2.6.5 (3) (a) Table 5 IV
2	5	1	R	(3) (a)	Failure to keep to time limits	PIA	2.6.7
2	5	1	R	(3) (b)	Failure to keep to time limits	PIA	2.6.7
2	5	2	G		Record keeping on time limits	PIA	Table 5 IV
2	5	6	G		Record keeping in relation to 2.5.5 R	PIA	Table 5 IV
2	6	1	R		Maintaining competence	PIA	2.6.8
2	6	2	G	(1)	Arrangements for maintaining competence	PIA	2.6.8 (2) (b)
2	6	2	G	(2)	Arrangements for maintaining competence	PIA	2.6.8 (2) (b)
2	6	2	G	(3)	Arrangements for maintaining competence	PIA	2.6.8 (2) (b)
2	6	3	G		Monitoring competence	PIA	2.6.8 (2) (c) (i)
2	6	4	G	(1)	Record keeping for monitoring competence	PIA	2.6.8 (2) (b) 2.6.10
2	6	4	G	(2)	Record keeping for monitoring competence	PIA	2.6.8 (2) (b) 2.6.10
2	7	1	R		Supervising	PIA	2.6.4 (2) (b) 2.6.5 (2)
2	7	2	G	(1)	Supervision arrangements	PIA	2.6.5 (2)
2	7	2	G	(2) (a)	Supervision arrangements	PIA	2.6.4 (2) (d) 2.6.5 (3) (b)
2	7	2	G	(2) (b)	Supervision arrangements	PIA	2.6.5 (1)
2	7	3	R		Supervising and monitoring	PIA	2.6.8 (2) (a)
2	7	4	G		Appropriate supervision	PIA	T&C Guidance (1998) 4.2.2
2	7	5	R	(1) and (2)	Supervisors/private customers/package products	PIA	2.6.11 (1) (2)
2	7	6	G	(1)	The level of supervision	PIA	Table 5 IV
2	7	6	G	(2)	Record keeping on how supervision is carried out	PIA	Table 5 IV
2	8	1	R	(1)	Record keeping - making	PIA	5.1.1
2	8	1	R	(2)	Record keeping - retaining	PIA	5.1.7

G (3) Derivations: SFA

Ch/App	S/Ann	P			Subject	Source	Reference
1	1	1	G	(1)	Application – who?	SFA	R 1.2 R 1.14
1	1	2	G		Application – where?	SFA	R 1.2
1	1	3	G		Principle 3	SFA	Statement of Principles – The Principles - 9
1	1	4	G		Principle 3	SFA	Statement of Principles – The Principles - 9
1	1	5	G		Threshold Conditions for authorisation	SFA	R 2.2
1	1	6	G		Fit and proper test	SFA	R 2.2
1	1	7	G		Approved persons and controlled function	SFA	R 2.37 BN 162, P 11
1	1	8	G		Standards	SFA	Statement of Principles – The Principles - 9
1	2	1	G	(1)	The firm's Commitments to training and competence	SFA	Statement of Principles – The Principles - 9
1	2	1	G	(2)	The firm's Commitments to training and competence	SFA	Statement of Principles – The Principles - 9
1	2	1	G	(3)	The firm's Commitments to training and competence	SFA	Statement of Principles – The Principles - 9
1	2	1	G	(4)	The firm's Commitments to training and competence	SFA	Statement of Principles – The Principles - 9
1	2	1	G	(5)	The firm's Commitments to training and competence	SFA	Statement of Principles – The Principles - 9
2	1	1	R	(1) (a)	Territorial scope – who?	SFA	R 1.2 R 1.14
2	1	2	R		Territorial scope – where?	SFA	R 1.2
2	1	3	G		Scope	SFA	R 2.25
2	1	4	R		Scope – activities	SFA	R 2.25
2	1	4	R	1 (a)	Advising on investments which are, and dealing with or for clients in, securities (other than stakeholder pension schemes or broker funds) and derivatives	SFA	R 2.25 (1) (c)

Ch/App	S/Ann	P		Subject	Source	Reference
2	1	4	R	1 (b)	Advising on investments which are, and dealing with or for clients in securities (other than stakeholder pension schemes or broker funds) only	R 2.25 (1) (c)
2	1	4	R	1 (c)	Advising on investments which are, and dealing with or for clients in, derivatives only	R 2.25 (1) (c)
2	1	4	R	1 (d)	Managing investments	R 2.25 (1) (a)
2	1	4	R	1 (e)	Managing investments in relation to venture capital investments only	R 2.25 (1) (a)
2	1	4	R	1 (f)	Advising on investments which are packaged products (other than broker funds)	R 2.25 (1) (c)
2	1	4	R	1 (i)	Advising on investments in the course of corporate finance business	R 2.25 (1) (c)
2	1	4	R	1 (j)	Advising (without dealing) on investments which are securities (other than stakeholder pension schemes and broker funds) and derivatives	R 2.25 (1) (c)
2	1	4	R	1 (k)	Advising (without dealing) on investments which are securities (other than stakeholder pension schemes or broker funds) only	R 2.25 (1) (c)
2	1	4	R	1 (l)	Advising (without dealing) on investments which are derivatives only	R 2.25 (1) (c)
2	2	1	R	(1)	Recruitment	Guidance before R 5.51
2	2	1	R	(2)	Recruitment	Guidance before R 5.51
2	2	2	G		Recruitment procedures	Guidance before R 5.51
2	3	1	R	(1)	Training needs	BN 162 P 12, 14, 17
2	3	1	R	(2)	Planning training	BN 162 P 14
2	3	2	G		Determining training needs	BN 162 P 12,19,20,21,22,23
2	3	3	G	(1)	Training guidance	BN 162 P 12,14,15,23
2	3	3	G	(2)	Training guidance	BN 162 P 12,14,15
2	3	3	R	(3)	Training guidance	BN 162 P 12,14,15
2	3	3	R	(4)	Training guidance	BN 162 P 12,14,15,23
2	4	1	R	(1)	Attaining competence	BN 162 P 11

Ch/App	S/Ann	P			Subject	Source	Reference
2	4	1	R	(2)	Supervision prior to attaining competence	SFA	BN 162 P 11
2	4	1	R	(3)	Supervision of transferee until assessed as competent in new activity	SFA	BN 162 P 23
2	4	2	R	(1)	Employee under supervision	SFA	R 2.37 BN 162, P 20
2	4	2	R	(2)	Employee under supervision	SFA	BN 162 P 11,19,20,21,22,23
2	4	3	G	(1)	Knowledge/skills for employees under supervision	SFA	BN 162 P 11,12,23
2	4	3	G	(2)	Knowledge/skills for employees under supervision	SFA	BN 162 P 11,12
2	4	4	R	(1)	Approved examination – advising and dealing for clients in securities or derivatives	SFA	R 2.37 BN 162, P 20
2	4	5	R	(1)	Assessing competence	SFA	BN 162 P 11
2	4	5	R	(2)	Assessing competence	SFA	R 2.37,38,40 BN 162 P 11
2	4	6	G	(1)	Assessments	SFA	BN 162 P 11
2	4	6	G	(2)	Assessments	SFA	BN 162 P 11
2	4	6	G	(3)	Assessments	SFA	BN 162 P 11
2	4	7	G		Assessment methods	SFA	BN 162 P 11
2	4	9	G	(1)	Record keeping for assessing competence	SFA	R 5.54 (1)
2	4	9	G	(2)	Record keeping for assessing competence	SFA	R 5.54 (1)
2	5	1	R	(1)	Approved examinations and time limits	SFA	R 2.37, 40
2	5	1	R	(2) (a)	Time limits	SFA	R 2.37, 40
2	5	1	R	(2) (b)	Time limits	SFA	R 2.37, 40
2	5	1	R	(3) (a)	Failure to keep to time limits	SFA	R 2.37, 40
2	5	1	R	(3) (b)	Failure to keep to time limits	SFA	R 2.37, 40
2	5	2	G		Record keeping on time limits	SFA	R 5.54 (I)
2	5	3	R	(1)	Examination pass validity	SFA	R 2.41 Examination Exemption Guidance Notes P 2.4, 4.3
2	5	3	R	(2)	Examination pass validity	SFA	R 2.41 Examination Exemption Guidance Notes P 2.4, 4.3
2	5	4	G		Examination pass validity	SFA	Examination Exemption Guidance Notes P 2.4, 4.3

Ch/App	S/Ann	P		Subject	Source	Reference
2	5	5	R	(1)	Exemption from full examination requirement for employees transferred from outside the UK	SFA R 2.37, 38, 39, 40 Examination Exemption Guidance Notes P 2.1 (i), 3.1, 4.1 (i)
2	5	5	R	(1) (a)	Holding of sufficient up-to-date and relevant experience gained outside the UK	SFA R 2.37, 38, 39, 40 Examination Exemption Guidance Notes P 2.1 (i), 3.1, 4.1 (i)
2	5	5	R	(1) (b)	Not having previously been fully subject to relevant examination requirements	SFA R 2.37, 38, 39, 40 Examination Exemption Guidance Notes P 2.1 (i), 3.1, 4.1 (i)
2	5	5	R	(1) (c)	Need to pass regulatory module	SFA R 2.37, 38, 39, 40 Examination Exemption Guidance Notes P 2.1 (i), 3.1, 4.1 (i)
2	5	6	G		Record keeping in relation to 2.5.5 R	SFA R 5.54 (1)
2	5	7	G		Overseas examinations	SFA Examination Exemption Guidance Notes P 8.1, Note 2 (i) (iii) (iv)
2	6	1	R		Maintaining competence	SFA BN 162 P 15, 24
2	6	2	G	(1)	Arrangements for maintaining competence	SFA BN 162 P 24 (i)
2	6	2	G	(2)	Arrangements for maintaining competence	SFA BN 162 P 24 (i)
2	6	2	G	(3)	Arrangements for maintaining competence	SFA BN 162 P 24 (ii)
2	6	3	G		Monitoring competence	SFA BN 162 P 24 (i)
2	6	4	G	(1)	Record keeping for monitoring competence	SFA R 5.54 (1)
2	6	4	G	(2)	Record keeping monitoring competence	SFA R 5,54 (1)
2	7	1	R		Supervising employees before competence	SFA BN 162 P 19,23
2	7	2	G	(1)	Supervision arrangements before competence	SFA BN 162 P 19,23
2	7	2	G	(2) (a)	Supervision arrangements before competence	SFA BN 162 P 19,23
2	7	2	G	(2) (b)	Supervision arrangements before competence	SFA BN 162 P 19,23
2	7	3	R		Supervision of employees assessed as competent	SFA BN 162 P 14,15,17,22
2	7	6	G	(1)	Record keeping on the level of supervision	SFA R 5.54 (1)

Ch/App	S/Ann	P			Subject	Source	Reference
2	7	6	G	(2)	Record keeping on how supervision is carried out	SFA	R 5.54 (1)
2	8	1	R	(1)	Record keeping	SFA	R 5.54 (1) (3)
2	8	1	R	(2)	Record keeping	SFA	R 5.54 (1) (3)

Training and Competence sourcebook

Destinations

G (1) Destinations: IMRO

1. The aim of the *guidance* in the following table is to give the reader a guide to the destination of relevant text.
2. It is not a complete statement of the destination and should not be relied on as if it were.

Source reference	Subject	Module	Ch/App	S/Ann	P	
Ch I R 1.1 (1) 9	Principle 9	TC	1	1	3	G
Ch I R 1.1 (1) 9	Principle 9	TC	1	1	4	G
Ch I R 1.1 (1) 9	Principle 9	TC	1	2	1	G (1) (2) (3) (4) (5)
Ch IV R 1.1 (10) (a)	Training and Competence —scope - requirement to be adequately trained and properly supervised	TC	2	1	4	R 1 (d) (e) (f) (i) (j) (k) (l) (m)
Ch IV R 1.1 (10) (a)	Training and Competence —scope - requirement to be adequately trained and properly supervised	TC	2	1	4	R 2 (a) (b) (c) (f)
Ch IV R 1.1 (10) (a)	Training and Competence —scope - requirement to be adequately trained and properly supervised	TC	2	3	1	R (1) (2)
Ch IV R 1.1 (10) (a)	Training and Competence —scope - requirement to be adequately trained and properly supervised	TC	2	3	2	G
Ch IV R 1.1 (10) (a)	Training and Competence —scope - requirement to be adequately trained and properly supervised	TC	2	3	3	G (1) (2) (3) (4)
Ch IV R 1.1 (10) (a)	Training and Competence —scope - requirement to be adequately trained and properly supervised	TC	2	4	1	R (1) (2) (3)

Source reference	Subject	Module	Ch/App	S/Ann	P		
Ch IV R 1.1 (10) (a)	Training and Competence —scope - requirement to be adequately trained and properly supervised	TC	2	4	2	R	(1) (2)
Ch IV R 1.1 (10) (a)	Training and Competence —scope - requirement to be adequately trained and properly supervised	TC	2	4	5	R	(1)
Ch IV R 1.1 (10) (a)	Training and Competence —scope - requirement to be adequately trained and properly supervised	TC	2	7	1	R	
Ch IV R 1.1 (10) (a)	Training and Competence —scope - requirement to be adequately trained and properly supervised	TC	2	7	2	G	(2)
Ch IV R 1.1 (10) (b) (i)	Threshold Competence – requirement to pass examination and be assessed	TC	2	4	1	R	(1)
Ch IV R 1.1 (10) (b) (i)	Threshold Competence – requirement to pass examination and be assessed	TC	2	4	2	R	(1) (2)
Ch IV R 1.1 (10) (b) (i)	Threshold Competence – requirement to pass examination and be assessed	TC	2	4	3	G	(1) (2)
Ch IV R 1.1. (10) (b) (i)	Threshold Competence – requirement to pass examination and be assessed	TC	2	4	5	R	(1) (2)
Ch IV R 1.1 (10) (b) (i)	Threshold Competence – requirement to pass examination and be assessed	TC	2	5	1	R	(1) (3) (a) (b)
Ch IV R 1.1 (10) (b) (ii)	IMRO's criteria for exemption from examination requirement	TC	2	5	5	R	(1) (a) (b) (c) (2)
Ch IV R 1.1 (10) (b) (ii)	IMRO's criteria for exemption from examination requirement	TC	2	5	7	G	

Source reference	Subject	Module	Ch/App	S/Ann	P	
Ch IV App 1.1 (10) 1 (a)	Recruitment	TC	2	2	1	R (1) (2)
Ch IV App 1.1 (10) 1 (a)	Recruitment	TC	2	2	2	G
Ch IV App 1.1 (10) 1 (b)	Recruitment	TC	2	2	1	R (1) (2)
Ch IV App 1.1 (10) 1 (b)	Recruitment	TC	2	2	2	G
Ch IV App 1.1 (10) 2	Identification of employees within T&C scope	TC	2	1	4	R (1) (d) (e) (f) (i) (j) (k) (l) (m)
Ch IV App 1.1 (10) 2	Identification of employees within T&C scope	TC	2	1	4	R (2) (a) (b) (c) (f)
Ch IV App 1.1 (10) 2	Identification of employees within T&C scope	TC	2	4	8	G
Ch IV App 1.1 (10) 3 (a)	Induction training	TC	2	3	1	R (1) (2)
Ch IV App 1.1 (10) 3 (a)	Induction training	TC	2	3	2	G
Ch IV App 1.1 (10) 3 (a)	Induction training	TC	2	3	3	G (1) (2) (3) (4)
Ch IV App 1.1 (10) 3 (b)	Training for transferees	TC	2	3	1	R (1) (2)
Ch IV App 1.1 (10) 3 (b)	Training for transferees	TC	2	3	2	G
Ch IV App 1.1 (10) 3 (b)	Training for transferees	TC	2	3	3	G (1) (2) (3) (4)
Ch IV App 1.1 (10) 3 (b)	Training for transferees	TC	2	4	1	R (1) (2) (3)
Ch IV App 1.1 (10) 4	Training Programme for trainees	TC	2	3	1	R (1) (2)
Ch IV App 1.1 (10) 4	Training Programme for trainees	TC	2	3	2	G
Ch IV App 1.1 (10) 4	Training Programme for trainees	TC	2	3	3	G (1) (2) (3) (4)
Ch IV App 1.1 (10) 4 (a)	Training Programme for trainees	TC	2	3	3	G (1) (2) (3) (4)
Ch IV App 1.1 (10) 4 (a)	Training Programme for trainees	TC	2	4	3	G (1)
Ch IV App 1.1 (10) 4 (b)	Training Programme for trainees	TC	2	3	3	G (1) (2) (3) (4)
Ch IV App 1.1 (10) 4 (b)	Training Programme for trainees	TC	2	4	3	G (2)
Ch IV App 1.1 (10) 5 (a)	Supervision and Assessment	TC	2	4	1	R (1) (2)
Ch IV App 1.1 (10) 5 (a)	Supervision and Assessment	TC	2	4	2	R (1) (2)
Ch IV App 1.1 (10) 5 (a)	Supervision and Assessment	TC	2	4	5	R (1) (2)
Ch IV App 1.1 (10) 5 (a)	Supervision and Assessment	TC	2	4	6	G (1) (2) (3)
Ch IV App 1.1 (10) 5 (b)	Supervision and Assessment	TC	2	4	1	R (1) (2)

Source reference	Subject	Module	Ch/App	S/Ann	P		
Ch IV App 1.1 (10) 5 (b)	Supervision and Assessment	TC	2	4	2	R	(1) (2)
Ch IV App 1.1 (10) 5 (b)	Supervision and Assessment	TC	2	4	5	R	(1) (2)
Ch IV App 1.1 (10) 5 (c) (i)	Supervision and Assessment	TC	2	4	1	R	(1) (2)
Ch IV App 1.1 (10) 5 (c) (i)	Supervision and Assessment	TC	2	4	2	R	(1) (2)
Ch IV App 1.1 (10) 5 (c) (i)	Supervision and Assessment	TC	2	4	5	R	(1) (2)
Ch IV App 1.1 (10) 6	Continuing competence and updating of knowledge	TC	2	6	1	R	
Ch IV App 1.1 (10) 6	Continuing competence and updating of knowledge	TC	2	6	2	G	(1) (2) (3)
Ch IV App 1.1 (10) 6	Continuing competence and updating of knowledge	TC	2	6	3	G	
Ch IV App 1.1 (10) 7	Records	TC	2	4	9	G	(1) (2)
Ch IV App 1.1 (10) 7	Records	TC	2	5	6	G	
Ch IV App 1.1 (10) 7	Records	TC	2	6	4	G	(1) (2)
Ch IV App 1.1 (10) 7	Records	TC	2	7	6	G	(1) (2)
Ch IV App 1.1 (10) 7	Records	TC	2	8	1	R	(1) (2)
Ch IV App 1.1 (10) 7 (a)	Records	TC	2	5	6	G	
Ch IV App 1.1 (10) 7 (b)	Records	TC	2	4	9	G	(1) (2)
Ch IV App 1.1 (10) 7 (b)	Records	TC	2	6	4	G	(1) (2)
Ch IV App 1.1 (10) 7 (b)	Records	TC	2	7	6	G	(1) (2)
Ch IV App 1.1 (10) 8	Existing staff and experienced new recruits -methods of assessment	TC	2	4	6	G	(1) (2) (3)
Ch IV App 1.1 (10) 8	Existing staff and experienced new recruits - methods of assessment	TC	2	4	7	G	
Ch IV R 1.6 (2)	Records to be kept	TC	2	4	9	G	(1) (2)
Ch IV R 1.6 (2)	Records to be kept	TC	2	5	2	G	
Ch IV R 1.6 (2)	Records to be kept	TC	2	5	6	G	
Ch IV R 1.6 (2)	Records to be kept	TC	2	6	4	G	(1) (2)
Ch IV R 1.6 (2)	Records to be kept	TC	2	7	6	G	(1) (2)
Ch IV R 1.6 (2)	Records to be kept	TC	2	8	1	R	(1) (2)
Ch IV Table 1.6 (2), III, 1	Records to be kept	TC	2	4	9	G	(1) (2)
Ch IV Table 1.6 (2), III, 1	Records to be kept	TC	2	5	2	G	
Ch IV Table 1.6 (2), III, 1	Records to be kept	TC	2	5	6	G	

Source reference	Subject	Module	Ch/App	S/Ann	P		
Ch IV Table 1.6 (2), III, 1	Records to be kept	TC	2	6	4	G	(1) (2)
Ch IV Table 1.6 (2), III, 1	Records to be kept	TC	2	7	6	G	(1) (2)
Ch IV Table 1.6 (2), III, 1	Records to be kept	TC	2	8	1	R	(1) (2)
Examinations and Exemptions Schedule	IMRO's criteria for exemption from examination requirements	TC	2	4	5	R	(2)
Examinations and Exemptions Schedule	IMRO's criteria for exemption from examination requirements	TC	2	5	5	R	(1) (a) (b) (c) (2)
Examinations and Exemptions Schedule	IMRO's criteria for exemption from examination requirements	TC	2	5	6	G	
Definitions – A – Administration Functions (a)	custody of client's money and assets	TC	2	1	4	R	2 (b)
Definitions – A – Administration Functions (b)	arranging settlement	TC	2	1	4	R	2 (c) (i)
Definitions – A – Administration Functions (c)	monitoring and processing corporate actions and income	TC	2	1	4	R	2 (c) (ii)
Definitions – A – Administration Functions (d)	client administration liaison and reporting, including valuation and performance measurement	TC	2	1	4	R	2 (c) (iii)
Definitions – A – Administration Functions (e)	PEP administration	TC	2	1	4	R	2 (c) (iv)
Definitions – A – Administration Functions (f)	Collective Investment Scheme administration	TC	2	1	4	R	2 (a)
Definitions – A – Administration Functions (g)	Investment Trust Savings Scheme administration	TC	2	1	4	R	2 (c) (v)
Definitions – A – Administrative Functions (h)	Stakeholder Pension Scheme administration	TC	2	1	4	R	2 (f)

G (2) Destinations : PIA

Source reference	Subject	Module	Ch/App	S/Ann	P		
Statements of Principle - Introduction - Para 3	Rights of action	TC	2	1	5	R	
The Principles 9	Internal organisation	TC	1	1	3	G	
The Principles 9	Internal organisation	TC	1	1	4	G	
The Principles 9	Internal organisation	TC	1	1	5	G	
The Principles 9	Internal organisation	TC	1	1	8	G	
The Principles 9	Internal organisation	TC	1	2	1	G	(1) (2) (3) (4) (5)
1.1.1	Eligibility	TC	1	1	2	G	
1.1.1	Eligibility	TC	2	1	4	R	
1.1.2 (1)	Scope of regulation by PIA	TC	2	1	4	R	1 (g) (h) (j) (k) (l) (m) (n) (o)
1.1.2 (1) (a)	Scope of regulation by PIA	TC	2	1	4	R	1 (a) (b) (d)
1.1.2 (1) (c)	Scope of regulation by PIA	TC	2	1	4	R	(1) (f)
1.1.2 (1) (d)	Scope of regulation by PIA	TC	2	1	4	R	1 (c) (d)
1.1.2 (2) (a)	Scope of regulation by PIA	TC	2	1	4	R	1 (i)
1.1.2 (3)	Scope of regulation by PIA	TC	2	1	4	R	1 (a) (d)
1.3.1	European Members	TC	2	1	2	R	(1) (2)
1.3.1 (3) (d)	European Members	TC	1	1	1	G	(1) (2)
1 Schedule 2	UCITS operators	TC	1	1	1	G	(2)
1 Schedule 2	UCITS operators	TC	2	1	1	R	(1) (a)
2.1.1	Investment staff to be fit and proper	TC	1	1	6	G	
2.1.1 (a) (i)	Investment staff to be fit and proper	TC	2	2	1	R	(1)
2.1.1 (2) (b)	Investment staff to be fit and proper	TC	2	2	2	G	
2.6.1 (1)	Training and Competence Programme required	TC	2	3	1	R	(2)
2.6.2	Training and Competence scheme required	TC	2	3	1	R	(2)
2.6.3 (1)	Classification of DIs – experience	TC	2	2	1	R	(1)
2.6.3 (2)	Classification of DIs–activity	TC	2	2	1	R	(1) (2)
2.6.3 (3)	Classification of DIs– supervisor	TC	2	7	1	R	
2.6.4 (1) (b)	New entrants – Stage 1	TC	2	3	3	G	(1) (2) (4)
2.6.4 (1) (b)	New entrants – Stage 1	TC	2	4	2	R	(2)
2.6.4 (1) (c)	New entrants – Stage 1	TC	2	4	3	G	(1) (2)
2.6.4 (2) (b)	New entrants – Stage 1	TC	2	4	1	R	(1) (2)

Source reference	Subject	Module	Ch/App	S/Ann	P		
2.6.4 (2) (b)	New entrants – Stage 1	TC	2	7	1	R	
2.6.4 (2) (d)	New entrants – Stage 1	TC	2	4	1	G	(1) (2)
2.6.4 (2) (d)	New entrants – Stage 1	TC	2	4	3	R	(2)
2.6.4 (2) (d)	New entrants – Stage 1	TC	2	7	2	G	(2) (a) (b)
2.6.5(1)	New entrants – Stage 2	TC	2	7	1	R	
2.6.5(2)	New entrants – Stage 2	TC	2	4	6	G	(1) (2)
2.6.5 (3) (a)	New entrants – Stage 2	TC	2	5	1	R	(1)
2.6.5 (3) (b)	New entrants – Stage 2	TC	2	4	5	R	(1)
2.6.5 (3) (b)	New entrants – Stage 2	TC	2	4	6	G	(1) (2)
2.6.5 (3) (b)	New entrants – Stage 2	TC	2	4	7	G	
2.6.5(4)	New entrants – Stage 2	TC	2	4	5	R	(2)
2.6.6	Experienced new entrants	TC	2	4	5	R	(1) (2)
2.6.6 (2)	Experienced new entrants	TC	2	2	1	R	(1) (2)
2.6.6 (2)	Experienced new entrants	TC	2	2	2	G	
2.6.7	Unsuccessful entrants	TC	2	5	1	R	(3) (a) (b)
2.6.8 (1)	Competent designated individuals	TC	2	6	1	R	
2.6.8 (2)	Continuing supervision	TC	2	6	1	R	
2.6.8 (2)	Continuing supervision	TC	2	6	2	G	(1) (2) (3)
2.6.8 (2)	Continuing supervision	TC	2	6	3	G	
2.6.8 (2) (a)	Continuing supervision	TC	2	7	3	R	
2.6.8 (2) (b)	Continuing supervision	TC	2	6	4	G	(1) (2)
2.6.9 (2)	CDI with particular expertise	TC	2	4	4	R	(3) (4)
2.6.10	Record of achievement	TC	2	6	4	G	(1) (2)
2.6.11 (1)	Supervisors	TC	2	7	5	R	(1) (2)
2.6.11 (2)	Supervisors	TC	2	7	5	R	(1) (2)
5.1.1	Record keeping requirements	TC	2	8	1	R	(1)
5.1.7	Retention of records	TC	2	8	1	R	(2)
Table 5 IV	Record keeping	TC	2	4	9	G	(1) (2)
Table 5 IV	Record keeping	TC	2	5	1	R	(1)
Table 5 IV	Record keeping	TC	2	5	2	G	
Table 5 IV	Record keeping	TC	2	5	6	G	

Source reference	Subject	Module	Ch/App	S/Ann	P	
Table 5 IV	Record keeping	TC	2	7	6	G (1) (2)
7.1.1		TC	2	4	8	G
T&C Guidance 1998 3.1.3	Recruitment	TC	2	2	1	R (1)
T&C Guidance 1998 3.1.4.1	Recruitment	TC	2	3	3	G (2) (3) (4)
T&C Guidance 1998 3.1.5.3	Completion of Stage Two	TC	2	4	6	G (3)
T&C Guidance 1998 4.2.2	Continuing supervision	TC	2	7	4	G
RU 50	Recruitment	TC	2	2	1	R (2)
RU 50	Recruitment	TC	2	2	2	G

G (3) Destinations: SFA

Source reference	Subject	Module	Ch/App	S/Ann	P		
Statement of Principles	Principle 9	TC	1	1	3	G	
Statement of Principles	Principle 9	TC	1	1	4	G	
Statement of Principles	Principle 9	TC	1	1	8	G	
Statement of Principles	Principle 9	TC	1	2	1	G	(1)(2)(3)(4)(5)
R2.25 (1) (a)	Registered Representatives – Managing investments	TC	2	1	4	R	1(d) (e)
R2.25 (1) (c)	Registered Representatives – advice on investments	TC	2	1	4	R	1(a)(b)(c)(f)(i)(j)(k)(l)
R2.37	Registered Representatives – qualification requirements	TC	2	4	5	R	(2)
R2.37	Registered Representatives – qualification requirements	TC	2	5	1	R	(1)
R2.37	Registered Representatives – qualification requirements	TC	2	5	1	R	(2)(a)(b)
R2.37	Registered Representatives – qualification requirements	TC	2	5	1	R	(3)(a)(b)
R2.37	Registered Representatives – qualification requirements	TC	2	5	5	R	(1)(a)(b)(c)(2)
R2.38	Registered Representatives – exemption via overseas qualifications	TC	2	4	5	R	(2)
R2.38	Registered Representatives – exemption via overseas qualification	TC	2	5	5	R	(1)(a)(b)(c)(2)
R2.39	Registered Representatives – exemption through experience	TC	2	5	5	R	(1)(a)(b)(c) (2)
R2.40(a)	Other registered persons carrying out Registered Representative activities	TC	2	1	4	R	1(d)(e)

Source reference	Subject	Module	Ch/App	S/Ann	P		
R2.40(a)	Other registered persons carrying out Registered Representative activities	TC	2	4	5	R	(2)
R2.40(c)	Other registered persons carrying out Registered Representative activities	TC	2	1	4	R	1(a)(b)(c)(f)(i)(j)(k)(l)
R2.40(c)	Other registered persons carrying out Registered Representative activities	TC	2	4	5	R	(2)
R2.41	Examination pass validity	TC	2	5	3	R	(1)(2)
R2.41	Examination pass validity	TC	2	5	4	G	
Guidance before 5.51	Recruitment	TC	2	2	1	R	(1)(2)
Guidance before 5.51	Recruitment	TC	2	2	2	G	
R5.54(1)	Record keeping	TC	2	4	9	G	(1)(2)
R5.54(1)	Record keeping	TC	2	5	2	G	
R5.54(1)	Record keeping	TC	2	5	6	G	
R5.54(1)	Record keeping	TC	2	6	4	G	(1)(2)
R5.54(1)	Record keeping	TC	2	7	6	G	(1)(2)
R5.54(1)	Record keeping	TC	2	8	1	R	(1)(2)
R5.54(3)	Record keeping	TC	2	8	1	R	(1)(2)
BN162 P11	Need for competence	TC	2	4	1	R	(1)(2)(3)
BN162 P11	Need for competence	TC	2	4	2	R	(1)(2)
BN162 P11	Need for competence	TC	2	4	3	G	(1)(2)
BN162 P11	Need for competence	TC	2	4	5	R	(1)(2)
BN162 P11	Need for competence	TC	2	4	6	G	(1)(2)(3)
BN162 P11	Need for competence	TC	2	4	7	G	
BN162 P12	Adequate training to ensure competence	TC	2	3	1	R	(1)
BN162 P12	Adequate training to ensure competence	TC	2	3	2	G	
BN162 P12	Adequate training to ensure competence	TC	2	3	3	G	(2)(3)(4)
BN162 P12	Adequate training to ensure competence	TC	2	4	3	G	(1)(2)

Source reference	Subject	Module	Ch/App	S/Ann	P		
BN162 P14	Training on knowledge and skills to enable competence to be achieved	TC	2	3	1	R	(1)(2)
BN162 P14	Training on knowledge and skills to enable competence to be achieved	TC	2	3	3	G	(1)(2)
BN162 P15	Obligations on firms to decide how to ensure registered representatives are and remain competent	TC	2	3	3	R	(3)(4)
BN162 P15	Obligations on firms to decide how to ensure registered representatives are and remain competent	TC	2	6	1	R	
BN162 P15	Obligations on firms to decide how to ensure registered representatives are and remain competent	TC	2	6	2	G	(1)(2)(3)
BN162 P17	Continuing training	TC	2	3	1	R	(1)
BN162 P17	Continuing training	TC	2	7	3	R	
BN162 P19	Employees new to industry – need for initial training and supervision	TC	2	3	2	R	
BN162 P19	Employees new to industry – need for initial training and supervision	TC	2	4	2	R	(1)(2)
BN162 P19	Employees new to industry – need for initial training and supervision	TC	2	7	1	R	
BN162 P19	Employees new to industry – need for initial training and supervision	TC	2	7	1	R	

Source reference	Subject	Module	Ch/App	S/Ann	P		
BN162 P19	Employees new to industry – need for initial training and supervision	TC	2	7	2	G	(1)(2)(a)(b)
BN162 P20	Training of new inexperienced staff	TC	2	3	2	G	
BN162 P20	Training of new inexperienced staff	TC	2	4	2	R	(1)(2)
BN162 P20	Training of new inexperienced staff	TC	2	4	4	R	(1)
BN162 P21	Firms to decide content of knowledge, skills and on the job training	TC	2	3	2	G	
BN162 P21	Firms to decide content of knowledge, skills and on the job training	TC	2	4	2	R	(2)
BN162 P22	Need for new inexperienced staff to receive adequate training and supervision	TC	2	3	2	G	
BN162 P22	Need for new inexperienced staff to receive adequate training and supervision	TC	2	4	2	R	(2)
BN162 P22	Need for new inexperienced staff to receive adequate training and supervision	TC	2	7	1	R	
BN162 P23	Need for appropriate induction training for new experienced Registered Representatives and where necessary, initial supervision	TC	2	3	2	G	

Source reference	Subject	Module	Ch/App	S/Ann	P		
BN162 P23	Need for appropriate induction training for new experienced Registered Representatives and where necessary, initial supervision	TC	2	3	3	G	(1)(4)
BN162 P23	Need for appropriate induction training for new experienced Registered Representatives and where necessary, initial supervision	TC	2	4	2	R	(2)
BN162 P23	Need for appropriate induction training for new experienced Registered Representatives and where necessary, initial supervision	TC	2	4	3	G	(1)
BN162 P23	Need for appropriate induction training for new experienced Registered Representatives and where necessary, initial supervision	TC	2	7	1	R	
BN162 P23	Need for appropriate induction training for new experienced Registered Representatives and where necessary, initial supervision	TC	2	7	2	G	(1)(2)
BN162 P24	Continuing professional education	TC	2	6	1	R	
BN162 P24	Continuing professional education	TC	2	6	2	G	(1)(2)(3)

Source reference	Subject	Module	Ch/App	S/Ann	P		
BN162 P24	Continuing professional education	TC	2	6	3	G	
Examination Exemption Guidance Notes P2.1(i)	Exemption from the Securities Representatives Examination	TC	2	5	5	R	(1)(a)(b)(c)
Examination Exemption Guidance Notes P2.1(ii)	Exemption from the Securities Representatives Examination	TC	2	4	5	R	(2)
Examination Exemption Guidance Notes P2.1(ii)	Exemption from the Securities Representatives Examination	TC	2	5	1	R	(1)
Examination Exemption Guidance Notes P2.3	Exemption from the Securities Representatives Examination	TC	2	4	5	R	(2)
Examination Exemption Guidance Notes P2.3	Exemption from the Securities Representatives Examination	TC	2	5	1	R	(1)
Examination Exemption Guidance Notes P2.4	Exemption from the Securities Representatives Examination	TC	2	5	3	R	(1)(2)
Examination Exemption Guidance Notes P2.4	Exemption from the Securities Representatives Examination	TC	2	5	4	G	
Examination Exemption Guidance Notes P3.1	Exemption from the Corporate Finance Representatives Examination	TC	2	4	5	R	(2)
Examination Exemption Guidance Notes P4.1(i)	Exemption from the Futures and Options Representative Examination	TC	2	5	5	R	(1)(a)(b)(c)
Examination Exemption Guidance Notes P4.1(ii)	Exemption from the Futures and Options Representative Examination	TC	2	4	5	R	(1)
Examination Exemption Guidance Notes P4.1(ii)	Exemption from the Futures and Options Representative Examination	TC	2	5	1	R	(1)
Examination Exemption Guidance Notes P4.2	Exemption from the Futures and Options Representative Examination	TC	2	4	5	R	(2)

Source reference	Subject	Module	Ch/App	S/Ann	P	
Examination Exemption Guidance Notes P4.2	Exemption from the Futures and Options Representative Examination	TC	2	5	1	R (1)
Examination Exemption Guidance Notes P4.3	Exemption from the Futures and Options Representative Examination	TC	2	5	3	R (1)(2)
Examination Exemption Guidance Notes P4.3	Exemption from the Futures and Options Representative Examination	TC	2	5	4	G
Examination Exemption Guidance Notes P6.1	Exemption from the Securities and Financial Derivatives Examination	TC	2	5	5	R (1)(a)(b)(c)
Examination Exemption Guidance Notes P7.1	The Register of SFA Life Assurance and Pension Representatives	TC	2	4	5	R (2)
Examination Exemption Guidance Notes P7.1	The Register of SFA Life Assurance and Pension Representatives	TC	2	5	1	R (1)
Examination Exemption Guidance Notes P8.1	Examination Exemptions for Employees of European Institutions	TC	2	5	5	R (1)(a)(b)(c)
Examination Exemption Guidance Notes P8.1	Examination Exemptions for Employees of European Institutions	TC	2	5	6	G

MONEY LAUNDERING SOURCEBOOK INSTRUMENT 2001

- A. The Financial Services Authority makes the rules and gives the guidance in the Annex to this instrument ("ML") in the exercise of the powers listed in Schedule 4 to ML (Powers exercised).
- B. This instrument shall come into force at the beginning of the day on which section 19 (The general prohibition) of the Financial Services and Markets Act 2000 (the "Act") comes into force.
- C. The provisions of the Act relevant to making rules and listed in Schedule 4 to ML (Powers exercised) are specified for the purpose of section 153(2) of the Act (Rule-making instruments).
- D. This instrument may be cited as the Money Laundering Sourcebook Instrument 2001.
- E. The Annex to this instrument (including its Schedules) may be cited as the Money Laundering sourcebook (or ML).

By order of the Board
21 June 2001

ANNEX



Contents

Transitional provisions

Text of ML:

- 1 Application and purpose
- 2 General money laundering duties
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Schedule

1 Table Transitional Provisions

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook-provision: coming into force
1	ML 2.1.1R ML 7.1.5R	R	<p>(1) Paragraph (2) applies where, immediately before the <i>commencement</i>, there is in a <i>relevant firm</i> an individual who was appointed by the <i>relevant firm</i> before that date to act for it in connection with its responsibilities in relation to money laundering.</p> <p>(2) If, on <i>commencement</i>, the individual in (1) is approved to perform the <i>money laundering function</i>, nothing in <i>ML 2.1.1R</i> or <i>ML 7.1.5R</i> requires the <i>relevant firm</i> to reappoint that individual as its <i>MLRO</i>.</p>	From <i>commencement</i>	<i>Commencement</i>
2	ML 3	R	Where, immediately before <i>commencement</i> , a <i>relevant firm</i> already has an established client relationship with any person, nothing in <i>ML 3</i> requires the <i>relevant firm</i> to establish the identity of that <i>client</i> .	From <i>commencement</i>	<i>Commencement</i>
	ML	G	<p>General transitional provisions</p> <p><i>GEN</i> contains some technical transitional provisions that apply throughout the <i>Handbook</i> and which are designed to ensure a smooth transition at <i>commencement</i>. These include transitional provisions relevant to record keeping.</p>	From <i>commencement</i>	<i>Commencement</i>

Chapter 1

Application and Purpose

1.1 Application

- 1.1.1** **R** /1 (1) This sourcebook applies to every *relevant firm* (see *ML 1.1.2 R*) with respect to its *relevant regulated activities* (see *ML 1.1.4 R*), but there are special provisions in *ML 8.1 R* and *ML 8.2 R* for *sole traders* with no *employees* and *authorised professional firms*.
- (2) Some provisions also relate to the *money laundering reporting officer* of a *relevant firm* in his capacity as an *approved person* (see *ML 7.1*).

Who?

- 1.1.2** **R** /1 (1) In this sourcebook, "*relevant firm*" means every *firm*, except:
- (a) a *firm* whose only *regulated activities* are those specified in *ML 1.1.4 R* (1) to (4);
- (b) a *UCITS qualifier*.
- (2) An *incoming firm* is a *relevant firm*, but only to the extent that it is conducting activities from an establishment in the *United Kingdom*.

- 1.1.3** **G** /1 The scope of this sourcebook is very wide. It includes all *firms* except those within the limited exception for *firms* concerned only with certain insurance activities and *UCITS qualifiers* (see *ML 1.1.2 R*). In this respect, the chapter follows article 1 of the *Money Laundering Directive* (No91/308/EEC). The scope extends to *incoming firms* (such as branches of institutions established elsewhere in the *EEA*), except those providing only *cross border services* in the *United Kingdom*. This is because the *Directive* is designed to apply on a "*Host State*" basis.

What?

- 1.1.4** **R** /1 In this sourcebook, "*relevant regulated activities*" means any *regulated activity* apart from:
- (1) *general insurance business*;
- (2) *long-term insurance business* which is outside the *First Life Directive* (and is not otherwise a *relevant regulated activity*);

- (3) business relating to contracts which are within the *Regulated Activities Order* only because they fall within paragraph (e) of the definition of "contract of insurance" in article 3 of that Order (see the *Glossary*); and
- (4) (a) arranging, by the *Society of Lloyd's*, of deals in *general insurance contracts* written at Lloyd's; and
 - (b) *managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyds.*

Where?

1.1.5

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This sourcebook applies only in relation to activities carried on from an establishment maintained by the *firm* (or its *appointed representative*) in the *United Kingdom*.

1.2 Purpose

- 1.2.1** **G**_{/1} The purpose of this sourcebook is to require *relevant firms* to have effective anti-*money laundering* systems and controls, in order to reduce the opportunities for *money laundering* in relation to *relevant firms*. It is also to require *relevant firms* to ensure that *approved persons* exercise appropriate responsibilities in relation to these anti-*money laundering* systems and controls.
- 1.2.2** **G**_{/1} Section 2 of the *Act* (The Authority's general duties) sets out the *regulatory objectives* of promoting market confidence and public awareness, protecting *consumers* and reducing *financial crime*. The reduction of *financial crime* objective is the most important to this sourcebook. One aspect of the reduction of *financial crime* objective is the risk of the businesses of *relevant firms* being used in connection with offences which involve handling the proceeds of crime. It follows that an effective and proportionate regulatory regime is important in reducing the extent to which it is possible for the businesses carried on by *relevant firms* to be used for *money laundering*. These *rules* and compliance with them will also help the *FSA* to meet the objective of maintaining market confidence, by reducing the risks posed to the financial community by *money laundering*. As to the public awareness objective, this sourcebook is designed to assist *relevant firms* and, through them, the public at large, to be better informed about the safeguards for the *financial system* provided by effective anti-*money laundering* systems and controls. *Consumers* are better protected if *relevant firms* are able to protect themselves against criminal activity and to record the steps they have taken for that purpose.
- 1.2.3** **G**_{/1} This sourcebook provides support, in relation to *money laundering*, for certain other parts of the *Handbook*, mainly:
- (1) the *Principles (PRIN)*, especially *PRIN 3*;
 - (2) the *Statements of Principles and Code of Practice for Approved Persons (APER)*, in particular *Statements of Principle 2* and *7*;
 - (3) *Senior Management Arrangements, Systems and Controls (SYSC)*, in particular *SYSC 3*; and
 - (4) the *Training and Competence sourcebook (TC)*.
- 1.2.4** **G**_{/1} This sourcebook relates to regulatory requirements, as opposed to requirements imposed by the criminal law. It is therefore not relevant regulatory or supervisory *guidance* for the purposes of regulation 5(3) of the *Money Laundering Regulations*.

Chapter 2

2

General money laundering duties



2.1 Duty to have arrangements and to appoint a money laundering reporting officer

2.1.1 **R** ^{/1} A *relevant firm* must set up and operate arrangements, including the appointment of a *money laundering reporting officer (MLRO)* in accordance with the duty in *ML 7*, which are designed to ensure that it, and any *appointed representatives* that act on its behalf, are able to comply, and do comply, with the *rules* in this sourcebook.

2.1.2 **G** ^{/1} The duties of the *MLRO* are set out in full in *ML 7*. The *MLRO* is responsible for the oversight of the *relevant firm's* anti-money laundering activities and is the key *person* in the *relevant firm's* implementation of anti-money laundering strategies and policies.

2.1.3 **G** ^{/1} If a *relevant firm* permits or requires an *appointed representative* to carry on particular *relevant regulated activities* on its behalf, the *relevant firm's* duty to comply with this sourcebook and the *MLRO's* duties set out in *ML 7* also apply to the activities of those *appointed representatives*.

Chapter 3

Identification of the client



3.1 The duty

Purpose and meaning of "client"

3.1.1

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The purpose of this chapter is to ensure that *relevant firms* carry out the identification of *clients*. The chapter also makes clear that *relevant firms* must not, in general, carry out *relevant regulated activities*, or agree to do so, for a *client* or potential *client* unless the *relevant firm* has taken reasonable steps to check that *client's* identity. In this sourcebook "client" is defined differently from elsewhere in the *Handbook* and *relevant firms* should take care to ensure that they use the correct definition. There are special provisions in this chapter for cases where the *person* with whom the *relevant firm* has contact is acting for another. Broadly, the *relevant firm* has to enquire into the identity of both *persons*, unless a relevant exemption enables it to focus solely on the *person* it is actually in contact with.

Meaning of "transaction"

3.1.2

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"Transaction" in this sourcebook includes the giving of advice, and thus has a wide meaning throughout this sourcebook. Certain sorts of *transaction* are exempted from these requirements. These include cases where the *transaction* is of relatively small value or the *person* has been vouched for by another *person* who can be relied on to have carried out these checks himself. But the various exemptions from the requirement are all subject to the overriding condition that there is nothing in place to put the *relevant firm* on enquiry ("knowledge or suspicion") in the *money laundering* context.

Identification of the client: the duty

3.1.3

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- (1) **A *relevant firm* must take reasonable steps to find out who its *client* is by obtaining sufficient evidence of the identity of any *client* who comes into contact with the *relevant firm* to be able to show that the *client* is who he claims to be.**
- (2) **If the *client* with whom a *relevant firm* has contact is, or appears to be, acting on behalf of another, the obligation in (1) is to obtain sufficient evidence of both their identities.**
- (3) **This *rule* is subject to the exceptions in *ML* 3.2.**

3.1.4

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In assessing a *relevant firm's* compliance with its duty to identify a *client* in accordance with *ML* 3.1.3 R, the *FSA* will have regard to the *relevant firm's*

compliance with the Joint Money Laundering Steering Group's Guidance Notes for the Financial Sector and with the *guidance* on financial exclusion in *ML 3.1.5 G*.

Financial exclusion

- 3.1.5** **G**_{/1} The *guidance* in *ML 3.1.5 G* to *ML 3.1.7 G* aims to help *relevant firms* ensure that, where people cannot reasonably be expected to produce detailed evidence of identity, they are not denied access to financial services. Although a *relevant firm* must always take reasonable steps to check who its *client* is, *relevant firms* will sometimes be approached by *clients* who are at a disadvantage, or who otherwise cannot reasonably be expected to produce detailed evidence that helps to confirm identity. An example could be where a *person* does not have a passport or driving licence, and whose name does not appear on utility bills.
- 3.1.6** **G**_{/1} If a *relevant firm* has reasonable grounds to conclude that an individual *client* is not able to produce detailed evidence of his identity and cannot reasonably be expected to do so, the *relevant firm* may accept as identification evidence a letter or statement from a *person* in a position of responsibility who knows the *client* that tends to show that the *client* is who he says he is, and to confirm his permanent address if he has one.
- 3.1.7** **G**_{/1} Examples of *persons* in a position of responsibility include solicitors, doctors, ministers of religion, teachers, hostel managers and social workers.

Identification of the client: timing

- 3.1.8** **R**_{/1} (1) A *relevant firm* must comply with the obligation in *ML 3.1.3 R (1)* as soon as reasonably practicable after it has contact with a *client* with a view to:
- (a) agreeing with the *client* to carry out an initial *transaction*; or
 - (b) reaching an understanding (whether binding or not) with the *client* that it may carry out future transactions.
- (2) If the *client* does not supply evidence of identity within the time scale in (1), the *relevant firm* must:
- (a) discontinue any *regulated activity* it is conducting for him; and
 - (b) bring to an end any understanding it has reached with him;
- unless in either case the *relevant firm* has informed the National Criminal Intelligence Service (NCIS).
- 3.1.9** **R**_{/1} Nothing in *ML 3.1.8. R (2)* requires a *relevant firm* to continue with a *transaction* which conflicts with its obligations, if any, in relation to rights of a third party.

3.2 The exceptions

3.2.1

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(1) This section sets out circumstances in which:

- (a) the duty in *ML 3.1.3 R (1)* (Identification of the client: the duty) need not be complied with; or
- (b) the *relevant firm* is entitled to regard the evidence it has as sufficient evidence;

but none of the *rules* in this section applies if the *relevant firm* knows or suspects, in accordance with (2), that the *client* or the *person* on whose behalf he is or appears to be acting is engaged in *money laundering*.

(2) The *relevant firm* is taken to have the knowledge or suspicion referred to in (1) if any member of the staff handling the *transaction* or potential *transaction* or managerially responsible for it has the knowledge or suspicion.

When the duty to identify does not apply

3.2.2

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The duty in *ML 3.1.3 R (1)* (Identification of the client: the duty) does not apply if:

- (1) the *client* is also a *credit institution* or financial institution covered by the *Money Laundering Directive*; or
- (2) the *transaction* is:
 - (a) a one-off *transaction* with a value of less than euro 15,000; or
 - (b) is one of a number of *transactions* which are related and, when taken together, have a value of less than euro 15,000; or
- (3) with a view to carrying out a one-off *transaction*, the *client* is introduced to the *relevant firm* by a *person* who has given the *relevant firm* a written assurance that in all such cases he obtains and records identification evidence, and:

- (a) the *person* who has given the written assurance is covered by the *Money Laundering Directive*; or
- (b) the *person* is subject to regulatory oversight exercised by a relevant overseas regulatory authority (see *ML 3.2.7 R*), and to legislation at least equivalent to that required by the *Money Laundering Directive*; or
- (4) the proceeds of a one-off *transaction*;
 - (a) are to be payable to the *client* but are then to be invested on his behalf;
 - (b) are to be the subject of a record; and
 - (c) can thereafter only be reinvested on his behalf or paid directly to him; or
- (5) when the *transaction* concerns a *long-term insurance contract*:
 - (a) taken out in connection with a *pension scheme* relating to the *client's* employment or occupation, if the *policy* contains no surrender clause and cannot be used as security for a loan; or
 - (b) where the *premium* is a single payment of no more than euro 2,500; or
 - (c) where the *premium* payments do not exceed euro 1,000 in any calendar year.

3.2.3

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A *relevant firm* is expected to take reasonable steps to determine whether or not the *client* falls within the exceptions in *ML 3.2.2 R* (1) and *ML 3.2.2 R* (3)(b).

When evidence of identify may be regarded as sufficient

3.2.4

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A *relevant firm* may regard evidence as sufficient evidence for the purposes of *ML 3.1.3 R* (Identification of the client: the duty) if it establishes that:

- (1) the relevant payment for the *transaction* was made or is to be made from the *client's* account held at an institution which is:
 - (a) a *relevant firm* with *permission* to accept *deposits*; or
 - (b) an *incoming relevant firm* which is a *credit institution*; or
 - (c) a *credit institution*;
- (2) the payment has been or will be sent or confirmed by post or electronically;

- (3) it was or is reasonable for the payment to be sent or confirmed in that way; and
- (4) the payment is not made to open an account from which onward payment may be made to someone other than the *client*.

3.2.5

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A *relevant firm* may regard evidence as sufficient for the purposes of ML 3.1.3 R (Identification of the client: the duty) if it establishes that the *client*:

- (1) is bound by this sourcebook or by the *Money Laundering Regulations* or is otherwise covered by the *Money Laundering Directive*; or
- (2) is acting on behalf of another *person*, and has given a written assurance that he has obtained and recorded evidence of the identity of the *person* on whose behalf he is acting, and is subject to regulatory oversight exercised by a relevant overseas regulatory authority (see ML 3.2.7 R) and to legislation at least equivalent to that required by the *Money Laundering Directive*.

3.2.6

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A *relevant firm* is expected to take reasonable steps to determine whether or not the *client* falls within the exemption in ML 3.2.5 R (2).

Relevant overseas regulatory authorities

3.2.7

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An overseas regulatory authority is relevant for the purposes of ML 3.2.2 R (3)(b) and ML 3.2.5 R (2) if it falls within section 82 of the Companies Act 1989 (Request for assistance by overseas regulatory authority), in so far as it exercises the kind of regulatory functions described in that section.

Chapter 4

Reporting



4.1 Internal reporting

4.1.1

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This section deals with the reporting to the *firm's MLRO* of knowledge or suspicions within the *relevant firm* about *money laundering*.

4.1.2

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- (1) **A *relevant firm* must take reasonable steps to ensure that any member of staff who handles, or is managerially responsible for handling, *transactions* which may involve *money laundering* makes a report promptly to the *MLRO* if he knows or suspects that a *client*, or the *person* on whose behalf the *client* is acting, is engaged in *money laundering*.**
- (2) **The steps to be taken under (1) include establishing and maintaining arrangements for disciplining any member of staff who fails, without reasonable excuse, to make a report of the kind envisaged in this section.**

4.1.3

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A *relevant firm* may wish to set up internal systems that allow its staff to consult with their line manager before sending a report to the *MLRO*. If a *relevant firm* sets up such systems, it should ensure that they are not used to prevent reports reaching the *MLRO* whenever staff have stated that they have knowledge or suspicion that a *transaction* may involve *money laundering*.



4.2 MLRO access to know your business information

4.2.1

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(1) A *relevant firm* must take reasonable steps to give its *MLRO*, or any *person* to whom the *MLRO*'s duties have been delegated, access to any *know your business information* it has.

(2) *Know your business information* in (1) is information about:

- (a) the financial circumstances of a *client* or any *person* on whose behalf the *client* has been acting or is acting; and
- (b) the features of the *transactions* which the *relevant firm* has entered into with or for the *client* (or that *person*).

4.2.2

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In order to do his job properly, the *MLRO* has to decide whether to make a report to *NCIS*. In most cases, before taking the decision to make a report, the *MLRO* is likely to need access to a *relevant firm's know your business information*.

4.2.3

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A *relevant firm* is not required to increase the amount of information it gathers and keeps about its *clients* in the normal course of its business. Rather, a *relevant firm* should use its existing *client* information effectively by making such information readily available to its *MLRO*.

4.3 External reporting

4.3.1

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The purpose of this section is to ensure that reports made to the *MLRO* are considered and that, where appropriate, a report is made available to *NCIS*. The duty to make external reports is one of the functions that some *groups* or larger *relevant firms* may decide can be delegated by their *MLRO* to suitably qualified staff, as described in *ML 7.1.3 G*.

4.3.2

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A *relevant firm* must take reasonable steps to ensure that any report required by *ML 4.1.2 R (1)*(Internal reporting) is considered by the *MLRO*, or his duly authorised delegate, and that if, having considered the report and any relevant *know your business information* to which he has sought access, the *MLRO*, or his duly authorised delegate, suspects that a *person* has been engaged in *money laundering*, he reports promptly to *NCIS*.

4.3.3

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- (1) To take reasonable steps as required by *ML 4.3.2 R*, the *relevant firm* should:
 - (a) require the *MLRO* to consider a report under *ML 4.1.2 R (1)* in the light of all relevant information accessible to or reasonably obtainable by the *MLRO*;
 - (b) permit the *MLRO* to have access to any information, including *know your business information*, in the *relevant firm's* possession which could be relevant; and
 - (c) ensure that where the *MLRO*, or his duly authorised delegate, suspects that a *person* has been engaged in *money laundering*, he makes a report which is not subject to the consent or approval of any other *person*.
- (2) Contravention of (1) may be relied on as tending to establish contravention of *ML 4.3.2 R*.
- (3) Compliance with (1) may be relied on as tending to establish compliance with *ML 4.3.2 R*.

4.3.4

R
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A *sole trader* with no *employees* who knows or suspects that a *client* of his, or the *person* on whose behalf the *client* is acting, is or has been engaged in *money laundering* must make a report promptly to *NCIS*.

Chapter 5

Using national and international findings on material deficiencies



5.1 Government and Financial Action Task Force findings

5.1.1 **G**^{/1} The purpose of this chapter is to enable government and *Financial Action Task Force* findings of inadequacy, concerning the approach to *money laundering* of individual countries or jurisdictions, to be brought to bear on *relevant firms'* decisions and arrangements.

5.1.2 **R**^{/1} (1) *A relevant firm* must take reasonable steps whenever this *rule* applies to ensure that it:

- (a) obtains; and
- (b) makes proper use of;

any government or *Financial Action Task Force* findings of the kind referred to in *ML 5.1.3 R*.

(2) "Proper use" in (1) includes:

- (a) applying the information in the circumstances envisaged by *ML 3.2.2 R (3)(b)* (introduction of client for one-off transaction) or *ML 3.2.5 R (2)* (introduction by client of a person on whose behalf he is acting);
- (b) applying the information whenever first obtained to *know your business information*;
- (c) Disseminating the information in the course of dealing with awareness and training under *ML 6*.

5.1.3 **R**^{/1} The findings in *ML 5.1.2 R (1)* are any published notices:

- (1) which are issued:
 - (a) by the government of the *United Kingdom*, or any government department in the *United Kingdom*; or
 - (b) by the *Financial Action Task Force*; and
- (2) which contain a finding or other conclusion on the part of the government or a government department or the *Financial Action Task Force*:

- (a) that it has examined the arrangements for restraining *money laundering* in a particular State or jurisdiction other than the *United Kingdom*; and
- (b) that it has found those arrangements to be materially deficient in comparison with one or more of the relevant, internationally accepted, standards, including any recommendations published by the *Financial Action Task Force*, required of or recommended to States and jurisdictions.

5.1.4

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^{/1}

In order to assist *relevant firms*, the FSA will, from time to time, publish any government, government department or *Financial Action Task Force* findings, of the kind referred to in *ML 5.1.3 R*, on the FSA website (www.fsa.gov.uk). All *relevant firms* should check this information regularly to ensure that they keep up to date with current findings.

Chapter 6

Awareness of and training for staff





6.1 Purpose

6.1.1

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^{/1}

The purpose of this chapter is to ensure that staff in *relevant firms* are:

- (1) made aware of; and
- (2) given regular training about;

what is expected of them in relation to prevention of *money laundering*, and what the consequences are for the *relevant firm* and for them if they fall short of that expectation.

6.2 Awareness

- 6.2.1** **R** ^{/1} A *relevant firm* must take reasonable steps to ensure that staff who handle, or are managerially responsible for the handling of, *transactions* which may involve *money laundering* are aware of:
- (1) their responsibilities under the *relevant firm's* arrangements made under this sourcebook, including those for obtaining sufficient evidence of identity, recognising and reporting knowledge or suspicion of *money laundering* and use of findings of material deficiencies;
 - (2) the identity and responsibilities of the *MLRO*;
 - (3) the law relating to *money laundering*, including *the Money Laundering Regulations* and this sourcebook; and
 - (4) the potential effect, on the *relevant firm*, on its *employees* and its *clients*, of any breach of that law.
- 6.2.2** **E** ^{/1} (1) A *relevant firm* should provide information, whether recorded in writing or otherwise, which:
- (a) covers the matters in *ML 6.2.1 R*;
 - (b) is brought to the attention of any member of staff who starts to work in any capacity within a *relevant firm* which is covered by this sourcebook; and
 - (c) remains available to that *person* so long as he works for that *relevant firm* in that capacity.
- (2) Contravention of (1) may be relied on as tending to establish contravention of *ML 6.2.1 R*.
- (3) Compliance with (1) may be relied on as tending to establish compliance with *ML 6.2.1 R*.
- 6.2.3** **G** ^{/1} Staff need to have an awareness of anti-*money laundering* legislation in the *United Kingdom*, including a clear understanding of their own potential criminal liability.
- 6.2.4** **G** ^{/1} Staff are likely to need information about the ways in which their *clients'* involvement in *money laundering* may affect bank and other accounts and other assets, in particular if a *relevant firm* decides it is unable to process *transactions*,

because of the risk of committing a *money laundering* offence. They are also likely to need information about the ways in which the *relevant firm* may itself be at risk if (without the consent of *NCIS*) it processes *transactions* which involve the proceeds of crime.

6.3 Training

6.3.1

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A *relevant firm* must take reasonable care to provide appropriate anti-*money laundering* training for its staff who handle, or are managerially responsible for the handling of, *transactions* which may involve *money laundering*.

6.3.2

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- (1) In taking reasonable care for the purposes of *ML* 6.3.1 R, the *relevant firm* should provide training which:
- (a) deals with the law on *money laundering*, and the responsibilities of staff under the *relevant firm's* arrangements;
 - (b) is applicable to all staff who handle, or are managerially responsible for the handling of, *transactions* which may involve *money laundering* (see *ML* 6.2.1 R); and
 - (c) takes place with sufficient frequency to ensure that within any period of 24 months it is given to substantially all of the staff referred to in (b).
- (2) Contravention of (1) may be relied on as tending to establish contravention with *ML* 6.3.1 R.
- (3) Compliance with (1) may be relied on as tending to establish compliance of *ML* 6.3.1 R.

6.3.3

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These requirements do not preclude a rolling programme of training, under which training on different subjects takes place on different dates.

Chapter 7

The money laundering reporting officer and other arrangements

7.1 The money laundering reporting officer

MLRO: approval by the FSA and role

7.1.1

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A *relevant firm* has to appoint an individual as its *MLRO* (see *ML 7.1.5 R*). Under section 59 of the *Act*, the function of acting in the capacity of the *MLRO* has been specified as a *controlled function* (see *SUP 10.1.13 R*). As a consequence, any individual invited to perform that function must be individually approved by the *FSA*, on the application of the *relevant firm*, before performing the function. The job of the *MLRO* is to act as the focal point within the *relevant firm* for the oversight of all activity relating to anti-money laundering. He needs to be senior, to be free to act on his own authority and to be informed of any relevant knowledge or suspicion in the *relevant firm*. In turn he has to pass on issues to *NCIS* as he thinks appropriate. He can be expected to liaise with *NCIS* on any question whether to proceed with a *transaction* in the circumstances.

Firms within a group

7.1.2

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If a *relevant firm* is part of a *group*, it may choose to appoint as its *MLRO* an individual who performs that function for another *relevant firm* within the *group*.

Delegation by the MLRO to others

7.1.3

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If a *relevant firm* that is a member of a *group* chooses the approach in *ML 7.1.2 G*, it may wish to permit the *MLRO* to delegate anti-money laundering duties to other suitably qualified individuals within the *relevant firm*. Similarly some *relevant firms*, particularly those with a number of branches or offices in different locations, may wish to permit the *MLRO* to delegate such duties within the *relevant firm*. Where anti-money laundering tasks are delegated by a *relevant firm's MLRO*, the *FSA* will expect the *MLRO* to take ultimate managerial responsibility for ensuring that the duties imposed on the *MLRO* by this sourcebook are complied with. The responsibilities to be discharged by the *MLRO* are set out in *ML 7.1.11 R*.

MLRO as "appropriate person" under Money Laundering Regulations

7.1.4

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If convenient, a *relevant firm* may decide that the same *person* can carry out the responsibilities of the *MLRO* and of the "appropriate person" under the *Money Laundering Regulations*. "Appropriate person", under those Regulations, means a *person* appointed to handle the internal and external reporting required by the Regulations (see Regulation 14).

Duty to appoint MLRO

7.1.5 **R** ^{/1} *A relevant firm* must appoint an individual as its *MLRO* and operate arrangements that are designed to ensure that it and the *MLRO* comply with the relevant obligations of this chapter.

7.1.6 **R** ^{/1} When a *relevant firm* appoints an individual to be its *MLRO*, it must choose someone who is *employed* within the *relevant firm*, or within another *relevant firm* in the same *group*, whether as part of its governing body, management or staff.

Qualifications and resources of MLRO

7.1.7 **R** ^{/1} So that he can carry out his *controlled function* effectively, a *relevant firm* must ensure that its *MLRO*:

- (1) has a sufficient level of seniority within the *relevant firm*; and
- (2) has sufficient resources, including sufficient time and (if necessary) support staff.

7.1.8 **G** ^{/1} "Sufficient resources" should include arrangements to apply in any temporary absence of the *MLRO*, who should take reasonable steps to ensure the adequacy of such arrangements. An individual who performs the role of *MLRO* for a period of less than 12 weeks in a consecutive 12 month period does not need approval by the *FSA* (see *SUP* 10.5.5 R (periods of less than 12 weeks)).

7.1.9 **R** ^{/1} *A relevant firm* must ensure that its *MLRO* is able to:

- (1) monitor the day-to-day operation of its *anti-money laundering* policies; and
- (2) respond promptly to any reasonable request for information made by the *FSA*.

7.1.10 **E** ^{/1} (1) *A relevant firm* should ensure that its *MLRO* is based in the *United Kingdom*.

(2) Contravention of (1) may be relied on as tending to establish contravention of *ML* 7.1.9 R

Responsibilities of the MLRO

7.1.11 **R** ^{/1} *A relevant firm* must make its *MLRO* responsible for:

- (1) receiving internal reports under *ML* 4.1;
- (2) taking reasonable steps to access any relevant *know your business information*;

- (3) making external reports to *NCIS* under *ML 4.2*;
- (4) obtaining and using national and international findings under *ML 5*;
- (5) taking reasonable steps to establish and maintain adequate arrangements for awareness and training (whether by himself or someone else) under *ML 6*; and
- (6) making annual reports to the *relevant firm's* senior management under *ML 7.2*.

7.1.12

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APER 4.7.2 E and *APER 4.7.9 E* make provisions about the conduct of the *MLRO*, to help determine whether the *MLRO's* conduct complies with *Statement of Principle 7* concerning the conduct expected of the *MLRO* as an *approved person*.

Duty to appoint MLRO when position vacant

7.1.13

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If the position of *MLRO* falls vacant, the *relevant firm* must appoint another individual as its *MLRO*.

7.1.14

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The obligation on a *relevant firm* to appoint an *MLRO* is in *ML 2.1.1 R*. That provision is limited to *relevant firms* and does not apply:

- (1) if the *relevant firm* is a *sole trader* with no *employees*; or
- (2) if the *relevant firm* is an *incoming firm* which is only providing *cross border services* (as opposed to operating through an established *branch*) in the *United Kingdom*.



7.2 Compliance monitoring

7.2.1



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SYSC 3.2.6 R (Compliance) requires a *relevant firm* to take reasonable care to establish and maintain appropriate systems and *controls* for compliance with its regulatory obligations and to counter the risk that it might be used to further *financial crime*. This section amplifies this requirement.

7.2.2



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(1) A *relevant firm* should establish and maintain arrangements under SYSC 3.2.6 R which include requirements that:

- (a) at least once in each calendar year, the *relevant firm* commission a report from its *MLRO* which:
 - (i) assesses the *relevant firm's* compliance with this sourcebook;
 - (ii) indicates, in particular, the way in which new findings under *ML 5* (Using national and international findings) have been used during the year; and
 - (iii) gives the number of reports made in accordance with *ML 4.1* (Internal reporting) by staff of the *relevant firm*, dealing separately, if appropriate, with different parts of the *relevant firm's* business;
- (b) the *relevant firm's* senior management consider the report; and
- (c) they take any necessary action to remedy deficiencies identified by the report.

(2) Contravention of (1) may be relied on as tending to establish contravention of SYSC 3.2.6 R.

7.2.3



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Figures for internal reports should be broken down, if appropriate, in the *MLRO's* report. The purpose of the report is to enable a *relevant firm's* senior management to assess whether internal reports are being made whenever required by *ML 4.1.2 R*, and that an overall figure which seems satisfactory does not conceal inadequate reporting in a particular part of the *relevant firm's* business. *Relevant firms* will need to use their judgement how the *MLRO* should be required to break down the figures in order to achieve this aim.

7.3 Record keeping arrangements

7.3.1 **G**_{/1} SYSC 3.2.20 R (Records) requires a *relevant firm* to take reasonable care to make and retain adequate records (including accounting records). This section amplifies this requirement.

7.3.2 **R**_{/1} (1) A *relevant firm* must make and retain, for the periods specified in (2), the following records:

- (a) in relation to evidence of identity:
 - (i) a copy of the evidence of identity obtained under *ML 3*; or
 - (ii) a record of where a copy of the evidence of identity can be obtained; or
 - (iii) when it is not reasonably practicable to comply with (i) or (ii), a record of how the details of the evidence of identity can be obtained; andwhen it has concluded it should treat a *client* as financially excluded *ML 3.1.5 G* to *ML 3.1.7 G* (Financial exclusion), a record of the reasons for doing so;
- (b) a record containing details of every *transaction* carried out by the *relevant firm* with or for the *client* in the course of *regulated activity*;
- (c) when a *relevant firm's client* has become *insolvent*, and it has taken steps to recover all or part of a debt owed to it by the *client*, a record of the grounds and those steps;
- (d) records of action taken under *ML 4.1* (Internal reporting) and *ML 4.3* (External reporting); and
- (e) when an *MLRO* has considered information or other matter concerning knowledge or suspicion that another *person* has engaged in *money laundering*, but has not made a report to *NCIS* under *ML 4.3*, a record of that information or other matter.

(2) The specified periods are:

- (a) in relation to evidence of identity, five years from the end of the *relevant firm's* relationship with the *client*;
 - (b) in relation to *transactions* within (1)(b), five years from the date when the *transaction* was completed;
 - (c) in relation to (1)(c), five years from the date of the insolvency; and
 - (d) in any other case, five years from the obtaining of the information or the creation of the record.
- (3) '*Transaction*' in (2) does not include advice given to a *client* unless such advice is followed by a *transaction* with monetary value.

7.3.3

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Records kept under SYSC 3.2.20 R should include the dates when anti-*money laundering* training was given, the nature of the training, and the names of the staff who received training; and (in relation to anti-*money laundering* monitoring) reports by the *MLRO* made in accordance with *ML* 4.3, and records of consideration of those reports and of any action taken as a consequence.

Chapter 8

Sole traders and authorised professional firms



8.1 Application of this sourcebook

Sole traders

8.1.1 **R** The only provisions of this sourcebook which apply to a *sole trader* with no *employees* are those specified in ML 8.1.2.
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8.1.2 **R** Table Application to certain sole traders (see ML 8.1.1 R)
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Chapter	Subject matter	Parts applicable to a sole trader with no employees
ML 1	Application and purpose	The whole chapter
ML 2	The general money laundering duties	The whole chapter
ML 3	Identification of the client	The whole chapter
ML 4	Reporting	Only ML 4.3.4R applies
ML 5	Findings of deficiencies	The whole chapter
ML 6	Awareness and training	The whole chapter except ML 6.2.1(2)R
ML 7	The MLRO and other arrangements	Only ML 7.2 Except 7.2.2E(1)(a) and (b) and (2) ML 7.3 Except 7.3.2E(1)(d) and (e)
ML 8	Sole traders and authorised professional firms	The whole chapter

Authorised professional firms

8.1.3 **R** This sourcebook does not apply to *authorised professional firms* when carrying on *non-mainstream regulated activities*.
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Handbook Modules

Schedule1 Record keeping requirements G

- 1 The aim of the guidance in the following table is to give the reader a quick over-all view of the relevant record keeping requirements.
- 2 It is not a complete statement of those requirements and should not be relied on as if it were.
- 3

Table	Record keeping requirements
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Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
<i>ML 7.3.2 R (1)(a)</i>	Customer identification	Full details of evidence of identity	As soon as reasonably practicable after first contact	5 years from end of relationship with <i>client</i>
<i>ML 7.3.2 R (1)(b)</i>	<i>Transactions</i>	Full details	On effecting the transaction	5 years from the date when the <i>transaction</i> was completed
<i>ML 7.3.2 R (1)(c)</i>	<i>Insolvent client</i>	Grounds for insolvency and details of steps taken to recover the debt	When firm becomes aware of event and takes steps	5 years from date of insolvency
<i>ML 7.3.2 R (1)(d)</i>	Internal and external reporting	Full details of actions taken	Once actions have been taken	5 years from the creation of the record
<i>ML 7.3.2 R (1)(e)</i>	Information not acted upon	Full details of information considered by the <i>MLRO</i> but not made an external report	Once decision not to report has been made	5 years from the obtaining of the information

Handbook Modules

Schedule2 Notification requirements G

- 1 There are no requirements to notify or report to the FSA in ML.

Handbook Modules

Schedule3 Fees and other required payments G

- 1 There are no requirements for fees or other payments in ML.

Handbook Modules

Schedule4 Powers exercised G

- 1 The following powers and related provisions in the Act have been exercised by the FSA to make the rules in ML:
 - (a) Section 138 (General rule making power)
 - (b) Section 146 (Money laundering rules)
 - (c) Section 149 (Evidential provisions)
 - (d) Section 156 (General supplementary powers)
- 2 The following power in the Act has been exercised by the FSA to give the guidance in ML:
 - (a) Section 157(1) (Guidance)

Handbook Modules

Schedule5 Rights of action for damages G

- 1 The table below sets out the rules in ML contravention of which by an authorised person may be actionable under section 150 of the Act (Actions for damages) by a person who suffers loss as a result of the contravention.
- 2 If a "Yes" appears in the column headed "For private person?", the rule may be actionable by a "private person" under section 150 (or, in certain circumstances, his fiduciary or representative; see article 6(2) and (3)(c) of the Financial Services and Markets Act 2000 (rights of Action) Regulations 2001 (SI 2001 No 2256)). A "Yes" in the column headed "Removed" indicates that the FSA has removed the right action under section 150(2) of the Act. If so, a reference to the rule in which it is removed is also given.
- 3 The Column headed "For other person?" indicates whether the rule may be actionable by a person other than a private person (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of person by whom the rule may be actionable is given.
- 4 Table Actions for damages: Money Laundering Sourcebook

Chapter/ Appendix	Section/ Annex	Paragraph	Right of action under s150			
			For			For other Person?
			Private person?	Removed		
<i>Rules in ML with the status letter "R"</i>			Yes	No		No
<i>Rules in ML with the status letter "E"</i>			No	No		No

Handbook Modules

Schedule6 Rules that can be waived G

- 1 The rules in ML can be waived by the FSA under section 148 of the Act (Modifications or waiver of rules).

Handbook Modules

Schedule1 Derivations G

- 1 There is no table of derivations for ML.

Handbook Modules

Schedule1 Destinations G

- 1 There is no table of destinations for ML.

AUTHORISATION MANUAL INSTRUMENT 2001

- A. The Financial Services Authority gives the guidance and makes the directions and requirements in the Annex to this instrument (“AUTH”) in the exercise of the powers listed in Schedule 4 to AUTH.
- B. This instrument shall come into force at the beginning of the first day on which section 40 of the Financial Services and Markets Act 2000 (Application for permission) comes into force for any purpose.
- C. This instrument may be cited as the Authorisation Manual Instrument 2001.
- D. The Annex to this instrument (including its schedules) may be cited as the Authorisation manual (or AUTH).

By order of the Board
21 June 2001

ANNEX



Authorisation

Contents

Transitional Provisions

Text of AUTH:

1. Introduction to the Authorisation Manual
2. Authorisation and regulated activities
3. Applications for Part IV permission
4. Fees*
5. Qualifying for authorisation*
6. Approved persons
7. Periodical publications, new services and broadcasts: applicants for certification*
8. Determining applications

Appendix X: Perimeter Guidance*

Schedule 1: Record keeping requirements

Schedule 2: Notification requirements

Schedule 3: Fees and other required payments*

Schedule 4: Powers exercised

Schedule 5: Rights of action for damages

Schedule 6: Rules that can be waived

Derivations

Destinations

[*These parts of AUTH will be added later]

Handbook Modules

Transitional Provisions

1 **G** Table

There are no transitional provisions in *AUTH*.

GEN contains transitional provisions that apply throughout the *Handbook*.

Chapter 1.

Introduction to the Authorisation manual

1.1 Application and purpose

Application

1.1.1

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This manual applies to:

- (1) a *person* which is considering carrying on activities in the *United Kingdom* which may fall within the scope of the *Act* and is seeking *guidance* on whether it needs to be an *authorised person*;
- (2) a *person* which seeks to become an *authorised person* under the *Act* and which is, or is considering, applying to the *FSA* for *Part IV permission* to carry on *regulated activities* in the *United Kingdom*;
- (3) an *EEA firm*, a *Treaty firm* or a *UCITS qualifier* that wishes to establish a *branch* or provide *cross-border services* into the *United Kingdom* using *EEA rights*, *Treaty rights* or *UCITS Directive rights*, or apply for a *top-up permission*;
- (4) a *candidate* for approval under Part V of the *Act*, but only in respect of *AUTH 6* (Approved persons), which is of general relevance, and *AUTH 8* (Determining applications); and
- (5) *persons* generally.

Purpose

1.1.2

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The purpose of:

- (1) *authorisation* is to allow only *persons* which satisfy the necessary conditions (relating, for example, to adequate resources and suitability – see *COND*) to engage in a *regulated activity*; and
- (2) approval of *persons* (generally individuals) is to seek to ensure that only fit and proper *persons* perform *controlled functions* in the financial services industry.

1.1.3

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The purpose of this manual is to give *guidance* about:

- (1) the circumstances in which *authorisation* is required, or *exempt person* status is available, including *guidance* on the activities which are regulated under the *Act* and the exclusions which are available; see *AUTH 2* (Authorisation and regulated activities);

- (2) the procedures by which a *person* can apply for, or obtain, *permission* under the *Act* to carry on these *regulated activities* and become an *authorised person* and any fees payable; see *AUTH 3* (Applications for Part IV permission), *AUTH 5* (Qualifying for authorisation under the Act) and *AUTH 4* (Fees [to be added later]).
- (3) the procedures by which a *person* seeking to become an *authorised person* can obtain approval for *persons* to perform *controlled functions* under the *approved persons* regime; see *AUTH 6* (Approved persons); and
- (4) the *FSA*'s powers in relation to *authorisation* and how it will use them (see *AUTH 3* and *AUTH 5*), including a summary of how applications will be determined; see *AUTH 8* (Determining applications).

1.2 Introduction

- 1.2.1** G_{/1} (1) The Financial Services and Markets Act 2000 (the *Act*) is the *UK* legislation under which *bodies corporate, partnerships*, individuals and unincorporated associations are permitted by the *FSA* to carry on various financial activities which are subject to regulation (referred to as *regulated activities*).
- (2) The activities which are *regulated activities* are specified in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the *Regulated Activities Order*): for example, *accepting deposits, managing investments, effecting contracts of insurance, dealing in investments as agent*. In general terms, a *regulated activity* is an activity, specified in the Order, carried on in relation to one or more of the *investments* specified in the Order. *AUTH 2* gives further *guidance* on *regulated activities* and *specified investments*.
- 1.2.2** G_{/1} In order to carry on a *regulated activity* in the *United Kingdom*, or even "purport to do so", section 19 of the *Act* (The general prohibition) provides that a *person* must be either *authorised* under the *Act* (an *authorised person*) or exempt from its provisions (an *exempt person*). In this context, a "*person*" includes both a legal *person*, for example a *body corporate*, and a natural *person*, that is, an individual.
- 1.2.3** G_{/1} *Exempt persons* are *persons* falling within the following groups:
- (1) an *appointed representative*;
- (2) a *person*, or class of *persons*, specified in secondary legislation; for example, the Bank of England is specified in the Financial Services and Markets Act 2000 (Exemption) Order 2001 (the *Exemption Order*);
- (3) a *recognised investment exchange* or a *recognised clearing house* (for more information on being a recognised body see *REC*).
- Further information on *exempt persons* is given in *AUTH 2.10*.
- 1.2.4** G_{/1} *Members* of the *Society of Lloyd's* are not required to obtain *authorisation* to carry out certain insurance market activities unless so directed by the *FSA* (see *AUTH 2.10.9G*). In addition, certain *professional firms* (solicitors, accountants and actuaries) are allowed under Part XX of the *Act* (Provision of Financial Services by Members of the Professions) to carry on certain *regulated activities* without *authorisation* subject to their complying with specified conditions (see *AUTH 2.10.12G* and *PROF*).
- 1.2.5** G_{/1} Before any *person* carries on in the *United Kingdom*, by way of business, activities that are *regulated activities*, it will generally need to be an *authorised person* (see *AUTH 2.2*). There are two main kinds of *authorised person* under the *Act*: a *person* who is *authorised* because it has a *Part IV permission* (see *AUTH 1.2.5G(2)*) and a *person* which qualifies for *authorisation* (see *AUTH 1.2.5G(1)*).

It is important that a *person* considering carrying on a *regulated activity* in the *United Kingdom* determines which type of *authorisation* is required.

- (1) A *person* from another *EEA State* which is authorised in its *Home State* may be entitled to establish a *branch* in, or provide *cross border services* into, the *United Kingdom* under the *Single Market Directives*, the *Treaty* or the *UCITS Directive* (this is often known as *passporting*). The process by which that *person* can qualify for *authorisation* under Schedules 3, 4 and 5 to the *Act* is described in *AUTH 5*.
- (2) Other *persons* wishing to carry on *regulated activities* in the *United Kingdom* must obtain *permission* from the *FSA* under Part IV of the *Act* (this is known as *Part IV permission*). Such *persons* will become *authorised persons* if the *FSA* gives them *permission*. *AUTH 1.6* outlines the process of applying for *Part IV permission*; the formal elements are described in more detail in *AUTH 3*. At the same time, the applicant will need to apply for certain *persons* to become *approved persons* (see *AUTH 6*).

1.3 The Authorisation manual

- 1.3.1** G_{/1} (1) The Authorisation manual (*AUTH*), the Supervision manual (*SUP*), the Enforcement manual (*ENF*) and the Decision making manual (*DEC*) form the Regulatory Processes part of the *Handbook*.
- (2) *AUTH* sets out the relationships between the *FSA* and applicants for *Part IV permission* and *persons* wishing to exercise *EEA rights*, *Treaty rights* or *UCITS Directive* rights. *SUP* sets out the relationship between the *FSA* and *authorised persons* (referred to in the *Handbook* as *firms*). As a general rule, material that is of continuing relevance after *authorisation* is in *SUP*.
- (3) *ENF* describes the *FSA*'s enforcement powers under the *Act* and sets out its policies for using these powers.
- (4) *DEC* is principally concerned with, and sets out, the *FSA*'s decision making procedures for decisions that involve the giving of *statutory notices*.
- 1.3.2** G_{/1} The procedures for applying for *Part IV permission*, for approval of a *person* under section 59 of the *Act* and for qualifying for *authorisation* under Schedules 3, 4 and 5 to the *Act* are derived from the *Act*. *AUTH* gives *guidance* on the *Act* and the *FSA*'s procedures. It also contains directions to applicants on the manner of making applications (see *AUTH* 3.9.3D and *AUTH* 6.3.2D) and *rules* on fees (see *AUTH* 4 [to be added later]).
- 1.3.3** G_{/1} (1) A Reader's Guide gives an introduction to the *Handbook* and is a key navigational aid for *Handbook* users. The guide explains the format, layout and workings of the *Handbook*, including the status and definitions of its components such as directions, *rules* and *guidance* (see paragraphs 18 to 31 of the Guide).
- (2) We recommend that readers consult this Guide before or while reading *AUTH*. In particular, readers may find it helpful to refer to the sections of the Guide that explain structure (paragraphs 3 to 13 of the Guide), the status of provisions (paragraphs 14 to 27 of the Guide) and cross-references (paragraphs 40 to 42 of the Guide).
- 1.3.4** G_{/1} (1) The *Act*, and the secondary legislation made under the *Act*, is complex. Although *AUTH* gives *guidance* to those considering or seeking *authorisation*, it does not aim to be exhaustive.
- (2) References have been made to relevant provisions in the *Act* or secondary legislation. However, since reproducing an entire statutory provision would sometimes require a lengthy quotation, or considerable further explanation, many provisions of the *Act*, or secondary legislation made under the *Act*, are summarised. For the precise details of the legislation, readers of the manual should, therefore, refer to the *Act* and the secondary legislation itself, as well as the manual.

(3) The *Act* and the Explanatory Notes are available from the Stationery Office (the *Act*, ISBN 0-10-540800-X, £21.70; and the Explanatory Notes, ISBN 0-10-560800-9, £14.50). Secondary legislation made by the Treasury under the *Act* can be obtained from the Stationery Office or can be accessed through the Treasury’s website (www.hm-treasury.gov.uk).

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Guidance on the *Act* or secondary legislation made under the *Act* represents the FSA’s view and does not bind the Courts. In the event of any discrepancy between the manual and the *Act* or that secondary legislation, the provisions of the *Act* or the secondary legislation prevail. It remains each *person’s* responsibility to ensure that, at all times, his activities comply with the *Act* and with other relevant provisions (including general requirements such as company law or consumer credit) and to take all necessary steps to satisfy himself of this, including where necessary by seeking his own legal advice.

1.3.6

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AUTH uses words and phrases that have specific meanings in the *Handbook* or in legislation; these may be different from, or more precise than, their usual dictionary meanings. Defined terms used in the text of the *Handbook* are shown in italics (see paragraph 43 of the Reader’s Guide). For the meanings of defined terms used in *AUTH*, see the *Glossary* (either the extracts at the end of *AUTH* or the consolidated *Glossary* near the end of the *Handbook*). It is essential that readers refer to these definitions.

1.3.7

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AUTH 1.3.9G summarises *AUTH*. Readers should note that in a cross-reference, as explained in paragraph 40 of the Reader’s Guide, the code letters of the manual or sourcebook immediately precede the chapter number. For example, *AUTH* 1 is the first chapter of the Authorisation manual.

1.3.8

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The FSA is keen to encourage an interactive *authorisation* process. With this in mind, *AUTH* gives specific contact points in the FSA from which an applicant can get help with questions about its application. To help readers, the contact points are listed at *AUTH* 1.9.2G.

1.3.9

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Table Summary of *AUTH*
This table belongs to *AUTH* 1.3.7G

Chapter:	Applicable to:	On:
<i>AUTH</i> 2: Authorisation and regulated activities	a <i>person</i> wishing to find out whether it needs to be <i>authorised</i> (or is an <i>exempt person</i>).	the <i>Act</i> , the <i>Regulated Activities Order</i> and the <i>Exemption Order</i> .
<i>AUTH</i> 3: Applications for Part IV permission	an applicant for <i>Part IV permission</i> .	how the FSA will exercise the powers granted to it in Part IV of the <i>Act</i> to determine and, if appropriate, grant an application for <i>Part IV permission</i> .
<i>AUTH</i> 4: Fees [to be added later]	an applicant for <i>Part IV permission</i> .	the fees the FSA will levy on applicants for <i>Part IV permission</i> .
<i>AUTH</i> 5: Qualifying for authorisation under the Act [to be added later]	1. an <i>EEA firm</i> wishing to exercise its <i>EEA right</i> and establish a <i>branch</i> in, or provide <i>cross border services</i> into, the <i>United Kingdom</i> ;	how an <i>EEA firm</i> , a <i>Treaty firm</i> or a <i>UCITS qualifier</i> can qualify for <i>authorisation</i> under the <i>Act</i> .

Chapter:	Applicable to:	On:
AUTH 6: Approved persons	<ol style="list-style-type: none"> 2. a <i>Treaty firm</i> wishing to exercise its <i>Treaty rights</i>; 3. a prospective <i>UCITS qualifier</i>. 1. an applicant for <i>Part IV permission</i> seeking approval for a person to perform a <i>controlled function</i> under <i>arrangements</i> to be entered into by the <i>firm</i> or its contractors (including <i>appointed representatives</i>); 2. a <i>candidate</i>. <p>Note: <i>EEA firms, Treaty firms</i> and <i>UCITS qualifiers</i> should refer to <i>SUP 10.1 (Application)</i>.</p>	<ol style="list-style-type: none"> 1. the <i>controlled functions</i> that the <i>FSA</i> has specified; and. 2. how the <i>FSA</i> will exercise the powers given to it in Part V of the <i>Act</i> to require <i>firms</i> to obtain prior <i>approval</i> for <i>persons</i> who will perform <i>controlled functions</i>.
AUTH 7: [to be added later]		
AUTH 8: Determining applications	<ol style="list-style-type: none"> 1. applicants for <i>Part IV permission</i> generally; 2. an <i>EEA firm</i> or a <i>Treaty firm</i> that has submitted an application for approval of a <i>person</i> under the <i>approved persons regime</i>; 3. a <i>candidate</i>. 	<ol style="list-style-type: none"> 1. the procedures which the <i>FSA</i> will follow when granting an application; and 2. a summary of the <i>FSA's</i> decision making procedures for: <ol style="list-style-type: none"> (a) refusing, or proposing to refuse, an application for <i>Part IV permission</i> or an application for approval under the <i>approved persons regime</i>; or (b) granting, or proposing to grant, an application for <i>Part IV permission</i> subject to <i>limitations</i> or <i>requirements</i> not applied for or with a narrower description of <i>regulated activity</i> than that to which the application relates.



1.4 The FSA's approach to applications for Part IV permission: an overview

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- (1) Under the *Act*, there is a single process for applications for *Part IV permission*. However, the amount of detailed information that an applicant will have to submit as part of its application will be related to the risks posed to the FSA's *regulatory objectives* by the *regulated activities* and any *unregulated activities* that the applicant intends to carry on. Thus the information requested will depend on, and be proportional to, the nature of the application.
- (2) This proportionality is reflected in the design of the application pack. Although all applicants have to complete certain standard sections, other sections of the pack are specific to certain types of business such as *insurance business*. In completing the relevant sections of the pack, the level of detailed information an applicant will be required to provide varies according to the nature of the application. Thus, for example, the FSA will require an applicant which seeks to carry on low-risk *designated investment business* activities to submit, among other things, a business plan and other information which is proportional and relevant to the applicant's size and the scope of its proposed business.

1.4.2

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- (1) To gain, and retain, the status of an *authorised person*, an applicant must satisfy and continue to satisfy certain minimum requirements, laid down in the *Act*. These are known as *threshold conditions* and further *guidance* is given in *AUTH 3.8* and *COND*.
- (2) The FSA will assess each application against the *threshold conditions*. During this assessment, the FSA may require further information from applicants to address any concerns. If an applicant can satisfy the *threshold conditions* in part only, the FSA may impose a *limitation* or a *requirement* on the *Part IV permission* applied for to enable the applicant to satisfy the *threshold conditions*.

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- (1) An applicant for *Part IV permission* will be expected to demonstrate to the FSA that it is ready, willing and organised to comply, and continue to comply, with the regulatory obligations that are relevant to the *regulated activities* it seeks *Part IV permission* to carry on.
- (2) To do this, an applicant will need to familiarise itself with the relevant *Principles*, other *rules* and *guidance* that apply to the *regulated activities* it proposes to carry on. *AUTH* is designed as a guide, but it cannot alone equip applicants with all the detail of the regulatory obligations for a proposed business. Such detail is in the other parts of the *Handbook*.

The FSA's approach to risk assessment

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- (1) Alongside the assessment of the *threshold conditions*, described in *AUTH* 1.4.2G(2), the *FSA* will operate its risk assessment process. This process enables the *FSA* to be proportional in its procedures, both in terms of the information which it seeks from an applicant and in the allocation of its own resources. The outcome of this process will help determine the relationship the *FSA* will seek to have with the applicant if it gives it *Part IV permission*.
- (2) The process will include assessing the risks posed by the applicant against a number of probability and impact factors. The probability factors relate to the likelihood of an event happening, and the impact factors indicate the scale and significance of the problem if it occurred. For further details of the process see *SUP* 1.3 (The *FSA*'s risk based approach to supervision). The *FSA* intends to communicate the outcome of its risk assessment to the *firm* (see *SUP* 1.3.10G).



1.5 Understanding the requirements and standards of the regulatory system

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The requirements and standards of the regulatory system, with which an *authorised person* must comply, vary depending on both the nature of the *firm* and the *regulated activities* it has *permission* to carry on. As part of preparing an application for *Part IV permission*, an applicant will need to familiarise itself with the *rules*, regulations and standards that would apply to the business it proposes to carry on. An applicant will then have to demonstrate how it proposes to comply, for example, with the high level systems and controls requirements in SYSC and, where relevant, the applicable rules in COB. *EEA firms*, *Treaty firms* or *UCITS qualifiers* which qualify for *authorisation* should also familiarise themselves with the relevant regulatory obligations before carrying on *regulated activities* in the *United Kingdom*.

1.5.2

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- (1) An *EEA firm* will be informed of any relevant regulatory obligations (known as *applicable provisions*) by the *FSA* or, in the case of an *EEA firm* which is an *insurer*, its *Home State regulator*, as part of the process of qualifying for *authorisation*.
- (2) An applicant for *Part IV permission* should consult the notes to the application pack. They cross-refer to relevant parts of the *Handbook*, and this will help applicants to respond to certain questions.

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As a general guide, all applicants for *Part IV permission* should be familiar with the *threshold conditions* (*COND*) and the *Principles for Businesses* (*PRIN*) in the High Level Standards part of the *Handbook*. To complete an application for *Part IV permission*, an applicant will also need to have regard to the following matters:

- (1) Prudential requirements:
 - (a) the high level requirement for adequate resources, which is applicable to all *firms*, described in *COND*; and
 - (b) the detailed prudential requirements in the interim Prudential sourcebooks (collectively referred to as *IPRU*) in the Business Standards part of the *Handbook*. There are five sourcebooks that apply, respectively, to *banks* (*IPRU(BANK)*), *building societies* (*IPRU(BSOC)*), *friendly societies* (*IPRU(FSOC)*), *insurance companies* (*IPRU(INS)*) and *investment business firms* (*IPRU(INV)*). *Guidance* is given to applicants in *AUTH 3 Ann 2G* on determining which prudential category, and which sourcebook of *IPRU*, will apply.

An applicant will need to confirm that it will have adequate resources in place to meet the applicable requirements.

- (2) Systems, controls and internal arrangements:

- (a) the high level requirement for all *firms* to maintain adequate resources (including systems and human resources) described in *COND* and the high level standards for all *firms* in Senior management arrangements, systems and controls (*SYSC*); and
- (b) the detailed requirements, many of which are *regulated activity* specific, in the sourcebooks in the Business Standards part of the *Handbook*; for example, in *IPRU*, the Training and Competence sourcebook (*TC*), the Money Laundering sourcebook (*ML*) and Conduct of Business sourcebook (*COB*); and the reporting requirements for *firms* in *SUP 16* (Reporting requirements) and *SUP 17* (Transaction reporting).

Before the *FSA* gives a *Part IV permission*, an applicant will need to confirm that it will have the necessary systems and controls in place.

(3) *Approved persons*:

- (a) the high level standards contained in the Fit and Proper test for approved persons (*FIT*) and the Statements of Principle and Code of Practice for Approved Persons (*APER*); and
- (b) the detailed *rules* about *controlled functions* and other matters in *SUP 10* (Approved persons).

An applicant will need to identify the *persons* that will require approval from the *FSA* in conjunction with its application for *permission*. This approval is required before a *person* may perform a *controlled function*.

(4) Other regulatory obligations:

- (a) the detailed regulatory obligations that apply to certain types of *firm* or *regulated activity* in *COB*, the Market Conduct sourcebook (*MAR*) and *SUP*;
- (b) the obligations in Dispute resolution: Complaints (*DISP*) and Compensation (*COMP*); and
- (c) the specialist sourcebooks or special guides included in the *Handbook* such as, for example, those for *collective investment schemes*, exempt *professional firms*, the market at Lloyd's and market *service companies*.

1.5.4



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A table of contents of the *Handbook* is at the end of the Reader's Guide.



1.6 Applying for Part IV permission: overview of the process

1.6.1 G_{/1} The formal procedures for applying for *Part IV permission* are described in *AUTH 3*. The application process is, however, interactive and includes discussions and, in some circumstances, an initial meeting with a potential applicant before it submits a completed application form. This section, therefore, outlines how the application process is likely to proceed in practice.

- 1.6.2** G_{/1}
- (1) Although the *FSA* does not require all applicants to appoint professional advisers to help with the application process, reports from professionals will be required in respect of some applications for *Part IV permission* (see *AUTH 3.9.16G* and *AUTH 3.9.17G*).
 - (2) In addition, a potential applicant should consider at an early stage whether, given the nature of the proposed business it is seeking to carry on and its own experience, it is appropriate to seek professional advice in connection with its application. For example, an applicant may need to seek professional advice from lawyers, auditors or reporting accountants, consultants, *actuaries* or its *professional body*, before making a formal application to the *FSA*.
 - (3) *SUP 9* (Individual guidance) describes how a *person* may apply to the *FSA* for individual *guidance* which relates to its own particular circumstances or plans. Applicants should note, in particular, *SUP 9.2.5G*, which states that the *FSA* will expect a *person* to have taken reasonable steps to research and analyse a topic before approaching the *FSA* for individual *guidance*. *SUP 9.2.5G* also cautions that the *FSA* should not be viewed as a first port of call, except where only the *FSA* can give *guidance*.

1.6.3 G_{/1} Before beginning discussions with the *FSA*, an applicant for *Part IV permission* should have completed its business planning to determine what activities it proposes to undertake and the resources it will need to do so.

- 1.6.4** G_{/1}
- (1) An applicant should also have determined and established the appropriate legal entity through which the proposed activities are to be conducted - that is, whether it wishes to trade on its own account, or establish:
 - (a) a *body corporate* – for example, a limited *company*, which can be public or private and limited by shares or by guarantee, or a *friendly society*; or
 - (b) a *partnership*; or
 - (c) an unincorporated association; or
 - (d) a *UK branch*.
 - (2) A *limited liability partnership* (regardless of the jurisdiction of incorporation) is a *body corporate* and does not fall within the definition of *partnership*, except

in relation to *SUP 10* (Approved persons). Most limited liability partners will be either *directors* or *senior managers*, but this will depend on the constitution of the *limited liability partnership*.

- 1.6.5** G_{/1} The legal status of an *insurer* and an applicant which seeks to carry on the *regulated activity* of *accepting deposits* is specified by *threshold condition 1* (Legal status) (see *COND 2.1*).
- 1.6.6** G_{/1} The first stage in the application process is to establish whether the proposed business will carry on *regulated activities* requiring *permission* under Part IV of the *Act* (Permission to carry on regulated activities). *AUTH 2* gives a high-level guide to the activities that are regulated under the *Act* and those that are excluded (but this is not a substitute for consulting the legislation itself); further queries may be referred to the *FSA's* Authorisation Enquiries team (see *AUTH 1.9.2G*).
- 1.6.7** G_{/1} Once an applicant has determined that it needs to apply for *Part IV permission*, it should begin to gather the information needed for the formal application. At this stage, applicants are encouraged to begin discussion with the *FSA's* Corporate Authorisation department about their plans and the application (see *AUTH 1.9*).
- 1.6.8** G_{/1} The *FSA's* application pack (that is, the set of forms for an application for *Part IV permission*, and the notes for their completion) and *approved persons* forms are available from the *FSA* website or by contacting the Corporate Authorisation department (see *AUTH 1.9.2G*).
- 1.6.9** G_{/1} Among other things, the applicant will need to:
- (1) determine the precise scope of the *permission* it wishes to apply for; this should include the *regulated activities* (the specified activities and the *specified investments* in respect of which the activities are carried on: see *AUTH 2 Ann 2G*) and any *limitations* and *requirements* the applicant wishes to apply for to refine the scope of the *regulated activities*; an example includes a *limitation* on the types of *client* it wishes to carry on business with or a *requirement* not to hold or control *client money*;
 - (2) determine whether it needs to apply to the *Society of Lloyd's* for admission to the register of *underwriting agents* or to any other bodies; the timing of these applications should be included in the applicant's plans;
 - (3) determine which prudential category (and, if relevant, sub-category) will apply, and therefore its minimum regulatory financial requirements;
 - (4) determine the rules in the *Handbook* which will apply to the activities it proposes to carry on, and take all reasonable steps to ensure that it is ready, willing and organised to comply with those *rules*;
 - (5) determine the systems and controls necessary both to support its activities and to comply with the relevant *rules*, and have plans to implement and test these systems before the *FSA* determines its application;
 - (6) prepare a business plan setting out the planned activities (and related risks), budget and resources (human, systems and capital);
 - (7) determine which *persons* will fall under the *FSA's* *approved persons* regime and apply for the necessary approval; and
 - (8) obtain any auditors' or *reporting accountants'* reports that are required to support its application or have been requested by the *FSA*; the auditors or other

professionals should be involved early in the process to ensure that the planned work on the application will be sufficient to enable them to provide any opinions required.

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- (1) It is in the interests of the applicant and the *FSA* that the application pack, when submitted, should be fully completed and address any areas of potential regulatory concern.
- (2) If an applicant’s plans are complex (for example, if they include *insurance business, accepting deposits* or certain types of *designated investment business*), high risk or innovative (for example, if they raise new or unusual issues), then the *FSA* would expect to be in discussion with the applicant while the applicant is developing the material needed for the formal application.
- (3) Where appropriate - for example in an application for *Part IV permission* including *insurance business* or *accepting deposits* - *FSA* staff may, by agreement with the applicant, arrange a pre-application meeting or discuss aspects of the applicant’s draft business plan or other relevant documents while the application is being prepared. This will help the *FSA* develop its knowledge of the applicant and the proposed business.

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In addition, all applicants are encouraged to take the opportunity to discuss particular issues with the *FSA* as they arise, with a view to tackling them before submitting the completed application pack. Applicants are also advised to review the application pack before submission and check that they have provided adequate responses to all questions (that is, responses appropriate to the scope and scale of their activities and the risks they may pose to *consumers*).

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After receiving the application pack, the *FSA* will begin its formal process of consideration. The *FSA* Corporate Authorisation and Individual Vetting and Registration teams will review the application pack and *approved persons* regime forms respectively. During this process, the *FSA* may ask for additional information and is likely to meet the applicant’s management and visit its premises before determining the application.

1.7 Appointed representatives

1.7.1 **G** /1 An applicant for *Part IV permission*, an *EEA firm* or *Treaty firm* which is seeking to carry on *designated investment business* may wish to consider appointing an *appointed representative* if they become *authorised*.

1.7.2 **G** /1

- (1) An *appointed representative* is a *person* who, as a result of satisfying conditions in section 39 of the *Act* (Exemption of appointed representatives) is an *exempt person* in respect of certain business which it carries on for an *authorised person*. The *Act* states that a *person* who is an *authorised person* cannot also be an *appointed representative*.
- (2) The business for which an *appointed representative* may be exempt is specified in the *Appointed Representatives Regulations*. The business which an *appointed representative* carries on for a *firm* must fall within the scope of the *firm's own permission*.
- (3) *SUP 12 (Appointed representatives)* contains *guidance* on the conditions in the *Act*, the *Appointed Representatives Regulations* and the *FSA's rules and guidance* which apply to a *firm* which is appointed or has appointed an *appointed representative*. An applicant for *Part IV permission* can notify the *FSA* of the *persons* it wishes to appoint as *appointed representatives* in the application pack.



1.8 What other general guidance is available from the FSA?

- 1.8.1** **G**_{/1} It will not always be clear to a *person* whether or not its prospective business activities will be such that it requires *authorisation*. The *FSA* has established an Authorisation Enquiries team to help in such cases.
- 1.8.2** **G**_{/1} The Authorisation Enquiries team gives assistance by:
- (1) producing *guidance* for *persons* who wish to find out whether they need to be *authorised* (see *AUTH* 2);
 - (2) publishing *guidance* about areas where *persons* may have difficulty deciding whether or not *authorisation* or exemption is needed (this is included in *AUTH* App X [to be added at later date]); and
 - (3) responding to oral and written enquiries from applicants, prospective applicants, *EEA firms*, *Treaty firms* or prospective *UCITS qualifiers* (or their professional advisers) about their particular position under the *Act*.
- 1.8.3** **G**_{/1} The Authorisation Enquiries team also handles enquiries about *financial promotions*. Under the *Act*, the communication of a *financial promotion* by an *unauthorised person* is prohibited, unless its contents have been approved by an *authorised person*, or an exemption applies.
- 1.8.4** **G**_{/1} As well as being included as an appendix to *AUTH*, copies of all current *guidance* issued by Authorisation Enquiries are available separately from the *FSA* website at www.fsa.gov.uk or through the *FSA*'s Publications Enquiries department on 020 7676 3298. The Authorisation Enquiries team will be pleased to clarify or discuss any aspects of the *guidance* in more detail.
- 1.8.5** **G**_{/1} The *FSA* will review its *guidance* from time to time and may need to amend or withdraw published or written *guidance* in the light of changing circumstances, developing business practices, or case law. For the status of guidance issued by the *FSA*, see paragraphs 25 to 28 in the Reader's Guide.



1.9 Next steps?

1.9.1 G /1 To find out where next to look in the Authorisation manual, see *AUTH* 1 Ann 1G. To find out who to contact at the *FSA* see *AUTH* 1.9.2G.

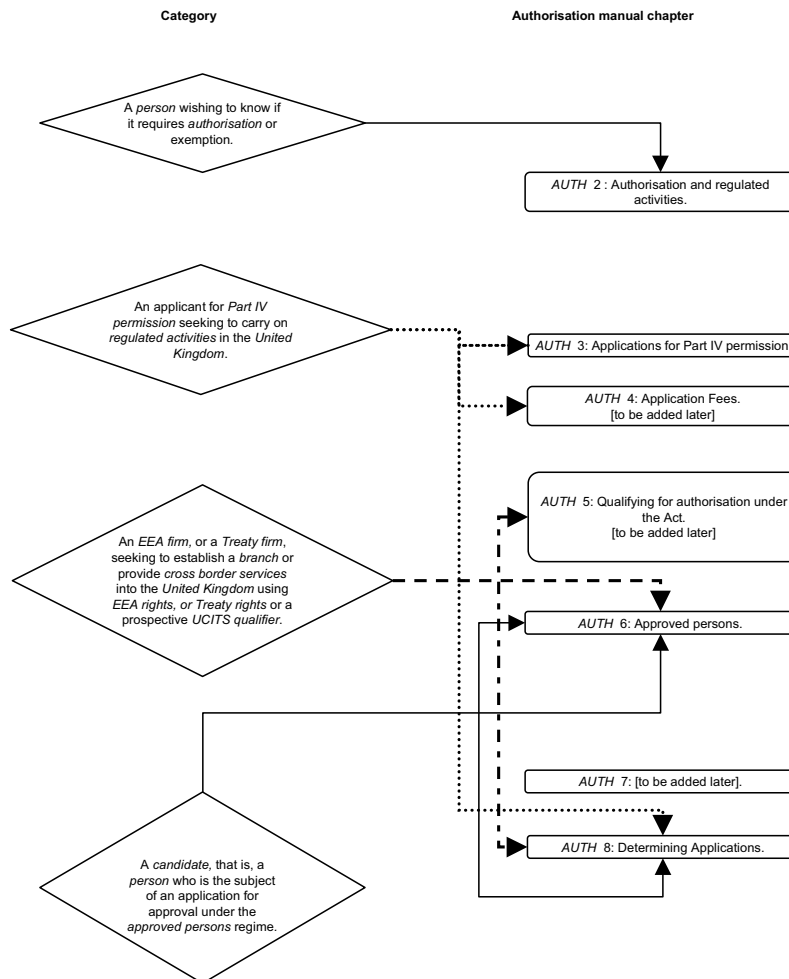
1.9.2 G /1 Table Who to contact at the *FSA*
This table belongs to *AUTH* 1.9.1G

FSA dept.	For advice on:	Contact details:
Authorisation Enquiries	The <i>authorisation</i> aspects of the <i>Act</i> and relevant secondary legislation made under the <i>Act</i> (for example, the <i>Regulated Activities Order</i>)	Authorisation Enquiries The Financial Services Authority 25 The North Colonnade Canary Wharf London E14 5HS Telephone: 020 7676 1000
Corporate Authorisation	Applications for <i>Part IV permission</i>	Corporate Authorisation The Financial Services Authority 25 The North Colonnade Canary Wharf London E14 5HS Telephone: 020 7676 1000 email: corporate.authorisation@fsa.gov.uk
Passport Notification Unit	Passporting notifications (into or out of the <i>United Kingdom</i>)	Passport Notification Unit The Financial Services Authority 25 The North Colonnade Canary Wharf London E14 5HS Telephone: 020 7676 1000 email: passport.notifications@fsa.gov.uk
Individual Vetting and Approval	Applications for approval of <i>persons</i> under the <i>approved persons</i> regime	Individual Vetting and Approval The Financial Services Authority 25 The North Colonnade Canary Wharf London E14 5HS Telephone: 020 7676 0019 Fax: 020 7676 0017 email: iva@fsa.gov.uk

Introduction to the Authorisation Manual

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Where to next?



Chapter 2

2

Authorisation and regulated activities



2.1 Application and purpose

Application

2.1.1

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This chapter is relevant to any *person* who needs to know what activities fall within the scope of the *Act*.

Purpose

2.1.2

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The purpose of this chapter is to provide *guidance*:

- (1) to *unauthorised persons* who wish to find out whether they need to be *authorised* and, if so, what *regulated activities* their *permission* needs to include;
- (2) to *authorised persons* who may have questions about the scope of their existing *permission*.

2.2 Introduction

- 2.2.1** **G**_{/1} Under section 23 of the *Act* (Contravention of the general prohibition), a *person* commits a criminal offence if he carries on activities in breach of the *general prohibition* in section 19 of the *Act* (The general prohibition) (see *AUTH* 1.2.2G). Although a *person* who commits the criminal offence is subject to a maximum of two years imprisonment and an unlimited fine, it is a defence for a *person* to show that he took all reasonable precautions and exercised all due diligence to avoid committing the offence.
- 2.2.2** **G**_{/1} Another consequence of a breach of the *general prohibition* is that certain agreements could be unenforceable (see sections 26 to 29 of the *Act*). This applies to agreements entered into by *persons* who are in breach of the general prohibition. It also applies to any agreement entered into by an *authorised person* if the agreement is made as a result of the activities of a *person* who is in breach of the *general prohibition*.
- 2.2.3** **G**_{/1} Any *person* who is concerned that his proposed activities may require *authorisation* will need to consider the following questions (these questions are a summary of the issues to be considered and have been reproduced, in slightly fuller form in the decision tree in *AUTH* 2 Ann 1G):
- (1) Will I be carrying on my activities by way of business (see *AUTH* 2.3)?
 - (2) Will I be managing the assets of an *occupational pension scheme* (see *AUTH* 2.3.2G(3))?
 - (3) If the answer is 'Yes' to (1) or (2), will my activities involve *specified investments* in any way (see *AUTH* 2.6)?
 - (4) If so, will my activities be, or include, *regulated activities* (see *AUTH* 2.7)?
 - (5) If so, will I be carrying them on in the *United Kingdom* (see *AUTH* 2.4)?
 - (6) If so, will my activities be excluded (see *AUTH* 2.8 and *AUTH* 2.9)?
 - (7) If not, will I be exempt (see *AUTH* 2.10.5G to 2.10.8G)?
 - (8) If not, am I allowed to carry on *regulated activities* without *authorisation* (see *AUTH* 2.10.9G to 2.10.16G)?
 - (9) If not, do I benefit from the few provisions of the *Act* that *authorise* me without a *permission* under Part IV of the *Act* (see *AUTH* 1 2.4G(1))?
 - (10) If not, what is the scope of the *Part IV permission* that I need to seek from the *FSA* (see *AUTH* 2, Ann 2G and *AUTH* 3)?

2.2.4

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The rest of this chapter provides a high level guide through the questions set out in *AUTH 2.2.3G*. It aims to give an overall picture but in doing so it necessarily relies on the reader referring to statutory provisions to fill in the detail (which can be extensive).

2.2.5

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The process of applying for *Part IV permission* is described in *AUTH 3*. But a list of the activities for which *permission* may be given is annexed to this chapter (see *AUTH 2 Ann 2G*). You may find this helpful in providing an overview of the activities that are regulated. The list is included here because, with some exceptions, the investments and activities for which *permission* may be given are the same as the investments and activities specified in the *Regulated Activities Order*. The exceptions (which are explained in *AUTH 3.4* and *3.5*) involve distinctions being drawn within each of several activities and investments so specified. This creates a few additional categories for which *permission* must be sought.

2.3 The Business element

2.3.1 **G** Under section 22 of the *Act* (Regulated activities), for an activity to be a *regulated activity* it must be carried on 'by way of business'.
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2.3.2 **G** There is power in the *Act* for the Treasury to change the meaning of the business element by including or excluding certain things. They have exercised this power (see the Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001 SI No 1177). The result is that the business element differs depending on the activity in question. This in part reflects certain differences in the nature of the activities:

- (1) The activity of *accepting deposits* will not be regarded as carried on by way of business by a *person* if he does not hold himself out as *accepting deposits* on a day-to-day basis and if the *deposits* he accepts are accepted only on particular occasions. In determining whether *deposits* are accepted only on particular occasions, the frequency of the occasions and any distinguishing characteristics must be taken into account.
- (2) Except for the trustees of *occupational pension schemes* (for which special provision is made (see *AUTH 2.3.2(3)G*)), the business element is not to be regarded as satisfied for any of the *regulated activities* carried on in relation to *securities* or *contractually based investments* (or for those *regulated activities* carried on in relation to 'any property') unless a *person* carries on the business of engaging in one or more of the activities. This is a narrower test than that of carrying on *regulated activities* by way of business (as required by section 22 of the *Act*), as it requires the *regulated activities* to represent the carrying on of a business in their own right.
- (3) A *person* managing assets on a discretionary basis while acting as trustee of an *occupational pension scheme* may in certain circumstances be regarded as acting by way of business even if he would not, in the ordinary meaning of the phrase, be regarded as doing so. The Financial Services and Markets Act (Carrying on Regulated Activities by Way of Business) Order 2001 contains some exceptions from this (see article 4).
- (4) The business element for all other *regulated activities* is that the activities are carried on by way of business. This applies to the activities of *effecting* or *carrying out contracts of insurance*, certain activities relating to the Lloyd's market and, in the future, *entering as provider into a funeral plan contract* and activities relating to regulated mortgage contracts (see *AUTH 2.7.18* and *AUTH 2.7.20G* respectively).

2.3.3 **G** Whether or not an activity is carried on by way of business is ultimately a question of judgment that takes account of several factors (none of which is likely to be conclusive). These include the degree of continuity, the existence of a commercial element, the scale of the activity and the proportion which the activity bears to other activities carried on by the same *person* but which are not regulated. The

nature of the particular *regulated activity* that is carried on will also be relevant to the factual analysis.



2.4 Link between activities and the United Kingdom

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Section 19 of the *Act* (The general prohibition) provides that the requirement to be *authorised* under the *Act* only applies in relation to activities that are carried on 'in the *United Kingdom*'. In many cases it will be quite straightforward to identify where an activity is carried on. But when there is a cross border element, for example because a client is outside the *United Kingdom* or because some other element of the activity happens outside the *United Kingdom*, the question may arise as to where the activity is carried on.

2.4.2

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Even with a cross border element a *person* may still be carrying on an activity 'in the *United Kingdom*'. For example, a *person* who is situated in the *United Kingdom* and who is *safeguarding and administering investments* will be carrying on activities in the *United Kingdom* even though his client may be overseas.

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Section 418 of the *Act* (Carrying on regulated activities in the United Kingdom) takes this one step further. It extends the meaning that 'in the *United Kingdom*' would ordinarily have by setting out four additional cases. The *Act* states that, in these four cases, a *person* who is carrying on a *regulated activity* but who would not otherwise be regarded as carrying on the activity in the *United Kingdom* is, for the purposes of the *Act*, to be regarded as carrying on the activity in the *United Kingdom*.

- (1) The first case is where a *UK-based person* carries on a *regulated activity* in another *EEA State* in exercise of rights under a *Single Market Directive*.
- (2) The second case consists of the *marketing* in another *EEA State* of a *UK-based collective investment scheme* by the *scheme's manager* where the *scheme* in question is one to which the *UCITS Directive* applies.
- (3) The third case is where a *regulated activity* is carried on by a *UK-based person* and the day-to-day management of the activity is the responsibility of an establishment in the *United Kingdom*.
- (4) The fourth case is where a *regulated activity* is carried on by a *person* who is not based in the *United Kingdom* but is carried on from an establishment in the *United Kingdom*. This might occur when each of the stages that make up a *regulated activity* (such as *managing investments*) takes place in different countries. For example, a *person's* management is in country A, the assets are held by a nominee in country B, all transactions take place in country B or country C but all decisions about what to do with the investments are taken from an office in the *United Kingdom*. Given that the investments are held, and all dealings in them take place, outside the *United Kingdom* there may otherwise be a question as to where the *regulated activity* of *managing investments* is taking place. For the purposes of the *Act*, it is carried on in the *United Kingdom*.

- 2.4.4 **G**_{/1} The application of the third and fourth cases will depend on how the activities carried on from the *UK* establishment are set up and operated.
- 2.4.5 **G**_{/1} A *person* who is based outside the *United Kingdom* but who sets up an establishment in the *United Kingdom* must therefore consider the following matters. First, he must not, unless he is *authorised*, carry on *regulated activities* in the *United Kingdom*. Second, unless he is *authorised*, the day-to-day management of the carrying on of the *regulated activity* must not be the responsibility of the *UK* establishment. This may, for example, affect those *UK* establishments that in the context of *deposit-taking* activities were, before the *commencement* of the *Act*, treated as representative offices of overseas institutions. Such institutions will need to seek *authorisation* if the responsibility for the day to day management of the accepting of *deposits* by them outside the *United Kingdom* is nevertheless effectively that of their *UK* establishment. Third, such a *person* will need to ensure that he does not contravene other provisions of the *Act* that apply to *persons* who are not *authorised*. These include the controls on *financial promotion* (section 21 of the *Act* (Financial promotion)), and on giving the impression that a *person* is *authorised* (section 24).
- 2.4.6 **G**_{/1} A *person* based outside the *United Kingdom* may also be carrying on activities in the *United Kingdom* even if he does not have a place of business maintained by him in the *United Kingdom* (for example, by means of the internet or other telecommunications system or by occasional visits). In that case, it will be relevant to consider whether what he is doing satisfies the business test as it applies in relation to the activities in question. In addition, he may be able to rely on the exclusions from certain *regulated activities* that apply in relation to *overseas persons* (see *AUTH 2.9.15G*).

2.5 Investments and activities: general

2.5.1 **G**_{/1} In addition to the requirements as to the business test and the link to the *United Kingdom*, two other essential elements must be present before a *person* needs *authorisation* under the *Act*. The first is that the investments must come within the scope of the system of regulation under the *Act* (see *AUTH* 2.6). The second is that the activities, carried on in relation to those *specified investments*, are regulated under the *Act* (see *AUTH* 2.7). Both investments and activities are defined in the *Regulated Activities Order* made by the Treasury under section 22 of the *Act*.

2.5.2 **G**_{/1} The *Regulated Activities Order* contains exclusions. Exclusions may exist in relation to both the element of investment and the element of activity. Each should therefore be checked carefully. The exclusions that relate to *specified investments* are considered in *AUTH* 2.6, together with the outline of the *specified investments*. The exclusions that relate to activities are considered separately from the outline of activities (see *AUTH* 2.8 and *AUTH* 2.9).

Modification of certain exclusions as a result of Investment Services Directive

2.5.3 **G**_{/1} The application of certain of the exclusions considered in *AUTH* 2.8 and *AUTH* 2.9 is modified in relation to *persons* who are subject to the *Investment Services Directive*. The reasons for this and the consequences of it are explained in *AUTH* 2.5.4G.

2.5.4 **G**_{/1} It remains the Government's responsibility to ensure the proper implementation of the *Investment Services Directive*. In this *Directive*, *persons* (called '*investment firms*') who are caught by the *Directive* must be brought within the scope of regulation under the *Act*. An *investment firm* is any *person* whose ordinary business involves the provision to third parties on a professional basis of *core investment services* (these services are described in the extract from the *Directive* in Schedule 2 to the *Regulated Activities Order*). The *Investment Services Directive* does not apply in the circumstances described in the extract from the *Directive* in Schedule 3 to the *Regulated Activities Order*. A *person* will need to consider whether he is an *investment firm* to which the *Directive* applies, having due regard to the provisions in Schedule 3 to the *Regulated Activities Order*.

2.5.5 **G**_{/1} For *persons* who are *investment firms*, the activities that must be caught by the *Regulated Activities Order* are those that are caught by the *Investment Services Directive*. To achieve this result, some of the exclusions in the *Order* (that will apply to *persons* who are not caught by the *Directive*) have been made unavailable to *investment firms*. Article 4(4) of the *Regulated Activities Order* identifies four exclusions that must be disregarded. These relate to the exclusions concerned with the absence of holding out (see *AUTH* 2.8.4(1)G), sale of goods (see *AUTH*

2.9.7G), groups and joint enterprises (see *AUTH 2.9.9G*) and sale of a *body corporate* (see *AUTH 2.9.11G*).

2.6 Specified investments: a broad outline

- 2.6.1** G_{/1} The following paragraphs describe the various *specified investments*, taking due account of any exclusion that applies.

Deposits

- 2.6.2** G_{/1} A *deposit* is defined in article 5(2) of the *Regulated Activities Order*. This focuses on a sum of *money* paid by one *person* to another on terms that it will be repaid when a specified event occurs (for example, a demand is made).

- 2.6.3** G_{/1} Certain transactions are excluded. The definition of *deposit* itself excludes money paid in connection with certain transactions such as advance payments for the provision of goods or services and sums paid to secure the performance of a contract. The circumstances in which payments are excluded from the definition itself are exhaustively stated in article 5(3) of the *Regulated Activities Order*. In addition, there is a separate exclusion in article 9 of the Order for sums that are received as consideration for the issue of specified *debt securities*.

- 2.6.4** G_{/1} In addition, several separate exclusions focus on the identity of the *person* paying the *money* or the *person* receiving it (or both).
- (1) Payments by certain *persons* are excluded if they are made by specified *persons* (such as local authorities or national, or supranational, bodies) or by *persons* acting in the course of a business consisting wholly or partly of lending money.
 - (2) Exclusions apply for sums paid between certain *persons* who are linked in a specified way (such as *group companies* or *close relatives*).
 - (3) Exclusions apply to sums received by *persons* acting for specified purposes. This covers sums received by a practising solicitor acting in the course of his profession or by *authorised* or *exempt persons* carrying on one of a specified range of *regulated activities* and acting within the scope of their *permission* or exemption.

Rights under a contract of insurance

- 2.6.5** G_{/1} *Contract of insurance* is defined to include certain things that might not be considered a *contract of insurance* at common law. Examples of such additions include *capital redemption* contracts or contracts to pay annuities on human life.

- 2.6.6** G_{/1} There are two main sorts of *contracts of insurance*. These are *general insurance contracts* and *long-term insurance contracts*. The *Regulated Activities Order* provides that, in certain specified circumstances, a contract is to be treated as a

long-term insurance contract notwithstanding that it contains supplementary provisions that might also be regarded as relating to a *general insurance contract* (see article 3(3)).

2.6.7 G_{/1} The *Regulated Activities Order* uses a further term in relation to *long-term insurance contracts* in order to identify those contracts under which rights are treated as *contractually based investments*. These contracts are described as 'qualifying contracts of insurance' (referred to as *life policies* in the *Handbook*). This term does not cover *long-term insurance contracts* which are contracts of reinsurance or, if specified conditions are met, contracts under which benefits are payable only on death or incapacity.

2.6.8 G_{/1} Certain arrangements in relation to funeral plans are specifically excluded from being *contracts of insurance* if they would otherwise be so. The exclusion applies to arrangements that fall within the definition of a *funeral plan contract* (see *AUTH 2.6.26G*) as well as arrangements that are excluded from the *regulated activity of entering as provider into funeral plan contracts* (see *AUTH 2.8.14G*).

Shares etc

2.6.9 G_{/1} *Shares* are defined in the *Regulated Activities Order* as shares or stock in a wide range of entities; that is, any *body corporate* wherever incorporated and unincorporated bodies formed under the law of a country other than the *United Kingdom*. They include deferred shares issued by *building societies* as well as transferable shares in *industrial and provident societies*, *credit unions* and equivalent *EEA* bodies. These shares are transferable and negotiable in a way similar to other shares or stock and are treated as such for the purposes of defining *regulated activities*. They are specifically mentioned as being within the *specified investment* category of *shares* because other types of share issued by these mutual bodies are not transferable and are expressly excluded (see *AUTH 2.6.10G*).

2.6.10 G_{/1} The following are excluded from the *specified investment* category of *shares*. Shares or stock in all *open-ended investment companies* are excluded from being treated in this particular category (but see *AUTH 2.6.17G*). Exclusions from this category also apply to shares or stock in the share capital of certain mutuals or in equivalent *EEA* bodies. This takes out *building society* or *credit union* accounts and non-transferable shares in *industrial and provident societies*. These may nevertheless be *specified investments* in another category (such as *deposits* in the case of *building society* accounts).

Debt instruments

2.6.11 G_{/1} Two categories of *specified investments* relating to debt instruments are dealt with under this heading. They broadly split into private debt and public sector debt.

- (1) The first category of 'instruments creating or acknowledging indebtedness' (defined in article 77 of the *Regulated Activities Order* and referred to in the *Handbook* as *debentures*) expressly refers to a range of *instruments* such as *debentures*, bonds and loan stock and contains a catch-all reference to 'any other instrument creating or acknowledging indebtedness.'
- (2) The second category (defined in article 78 of the *Regulated Activities Order* and referred to in the *Handbook* as *government and public securities*) refers to loan stock, bonds and other instruments creating or acknowledging

indebtedness which are issued by or on behalf of any government, the assemblies for Scotland, Wales or Northern Ireland, a local authority or an international organisation.

An instrument cannot fall within both categories of *specified investments* relating to debt instruments. 'Instrument' is defined to include any record whether or not in the form of a document (see article 3(1) of the *Regulated Activities Order*).

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Certain instruments are excluded from both these categories of *specified investments*. These include trade bills, specified banking documents (such as cheques and banknotes though not bills of exchange accepted by a banker) and *contracts of insurance*. There is a further exclusion from this category of *specified investment* dealing with public debt for National Savings deposits and products.

Warrants

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The category of *specified investment* of instruments giving entitlements to investments (referred to in the *Handbook* as *warrants*) covers warrants and other instruments which confer an entitlement to subscribe for *shares, debentures* and *government and public securities*. This is one of several categories of *specified investments* that are expressed in terms of the rights they confer in relation to other categories of *specified investment*. The rights conferred must be rights to 'subscribe' for the relevant investments. This means that they are rights to acquire the investments directly from the *issuer* of the investments and by way of the *issue* of new investments (rather than by purchasing investments that have already been issued).

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To keep clear distinctions between the different *specified investment* categories, instruments giving entitlements to investments are not to be regarded as *options, futures* or *contracts for differences*.

Certificates representing securities

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The *specified investment* category of *certificates representing certain securities* covers certificates or other instruments which confer rights in relation to *shares* and *debt securities*. It includes depositary receipts.

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There is an exclusion for any instrument that would otherwise fall within the *specified investment* category of *units* in a *collective investment scheme*. But the exclusion does not apply where the underlying investments covered by the certificate are issued by the same (non-public sector) *issuer* or constitute a single issue of public sector debt (such as a single issue of gilts). Certificates or other instruments conferring rights in respect of investments in these two cases continue to be treated as *certificates representing certain securities*.

Units

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The *specified investment* category of *units* in a *collective investment scheme* includes *units* in a *unit trust scheme, shares* in *open-ended investment companies* and rights in respect of most limited partnerships. *Shares* in or *securities* of an *open-ended investment company* are treated differently from *shares* in other *companies*. They are excluded from the *specified investment* category of *shares*.

This does not mean that they are not investments but simply that they are uniformly treated in the same way as *units* in other forms of *collective investment scheme*. The effect is that an *open-ended investment company* will, in issuing its *shares*, be subject to the restrictions on promotion of *collective investment schemes* in section 238 of the *Act* (rather than to restrictions, such as those in the Public Offers of Securities Regulations 1995, that apply to other forms of body corporate). For exclusions from the restrictions on the provisions of *collective investment schemes*, see the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 SI No 1060.

- 2.6.18** G_{/1} There are no exclusions in the *Regulated Activities Order* for this *specified investment* category. This is because '*collective investment scheme*' is defined in section 235 of the *Act* (Collective investment schemes) for the purposes of the *Act* generally. But there is a separate power to provide for exemptions from that definition and the Treasury have exercised it (see the Financial Services and Markets (Collective Investment Schemes) Order 2001 SI No 1062). The result is that *units* in certain arrangements are excluded from being *collective investment schemes* (for example, closed-ended *bodies corporate*, franchise arrangements, timeshare schemes).

Rights under a stakeholder pension scheme

- 2.6.19** G_{/1} A *stakeholder pension scheme* is defined in section 1 of the Welfare Reform and Pensions Act 1999. Regulations made under that section set out detailed rules under which such schemes will operate (see the Stakeholder Pension Scheme Regulations 2000). Schemes must be registered with the Occupational Pensions Regulatory Authority and approved by the Board of the Inland Revenue. Rights under such schemes are *specified investments* for the purposes of the *Regulated Activities Order*. There are no exclusions in the Order.

Options

- 2.6.20** G_{/1} The *specified investment* category of *options* is limited to *options* to acquire or dispose of *securities* or *contractually based investments*, currency and certain precious metals and *options* to acquire or dispose of such *options*. *Options to buy* or *sell* other types of *commodity* will only fall within this *specified investment* category if they are *options to buy* or *sell futures*, or *options to buy* or *sell contracts for differences*, which are based on other *commodities*. But *options to buy* or *sell* other types of *commodity* may be *contracts for differences* (see AUTH 2.6.23G).

Futures

- 2.6.21** G_{/1} *Futures* is the name given to rights under a contract for the *sale* of a *commodity*, or of property of any other description, under which delivery is to be made at a future date and at a price agreed on when the contract is made.

- 2.6.22** G_{/1} The key issue in determining whether something is an investment in this category for the purposes of the *Regulated Activities Order* is whether the contract is made for investment purposes rather than commercial purposes. Contracts which are made for commercial purposes are excluded from this *specified investment*

category and the *Regulated Activities Order* contains several tests as to when that is, or is not, the case (some are conclusive, others only indicative).

Contracts for differences

2.6.23 G_{/1} The *specified investment* category of *contracts for differences* covers rights under *contracts for differences* and rights under other contracts whose purpose or pretended purpose is to secure a profit or avoid a loss by reference to fluctuations in certain factors. In addition to fluctuations in the value or price of property of any description or in an index, those factors also include fluctuations in any 'other factor designated in the contract'. This catches a wide range of factors. All contracts in this category are cash-settled instruments (as opposed to being settled by way of delivering something other than cash). Many would be unenforceable as gaming contracts were it not for section 412 of the Act (Gaming contracts). Examples of things that count as *specified investments* under this category are *spread bets* and interest rate swaps.

2.6.24 G_{/1} There are a number of exclusions. These include a case where the parties intend that the profit is to be secured or the loss to be avoided by taking delivery of property. This avoids overlap with the *specified investment* categories of *options* and *futures*. Also excluded are index-linked *deposits* and rights under certain contracts connected with the National Savings Bank or National Savings products. There is also provision to ensure that the *specified investment* category of *contracts for differences* does not include rights under *life policies*.

Lloyd's investments

2.6.25 G_{/1} Two types of *specified investment* are relevant. These are the *underwriting capacity of a Lloyd's syndicate* and a *person's membership of a Lloyd's syndicate*. There are no exclusions from these *specified investment* categories.

Rights under a funeral plan

2.6.26 G_{/1} Rights under a *funeral plan contract* are the rights to a funeral obtained by a *person* who pays for the funeral before the death of the *person* whose funeral it will be. This will be a *specified investment* with effect from 1 January 2002.

Rights under a regulated mortgage contract

2.6.27 G_{/1} Regulated mortgage contracts will be *specified investments* with effect from the date nine months following the date on which section 19 of the *Act* comes into force.

Rights to or interests in investments

2.6.28 G_{/1} Rights to, or interests in, all the *specified investments* in AUTH 2.6 (except rights to, or interests in, rights under a regulated mortgage contract) are themselves treated as *specified investments*. The effect is that an activity carried on in relation

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to rights or interests derived from any of those *investments* is also a *regulated activity* if the activity would be regulated if carried on in relation to the investment itself.

There are several things that are not covered by this category (other than rights to, or interests in, rights under a mortgage contract). Anything that is covered by any other *specified investment* category is excluded, as are interests under the trusts of an *occupational pension scheme*. Finally, where a contract is excluded from the scope of the *regulated activity* of *entering as provider into a funeral plan contract* (see *AUTH 2.8.14G*), then rights to, or interests in, the *contracts of insurance* or interests under the trusts, to which the *contracts* relate are also excluded from this *specified investment* category.

2.7 Activities : a broad outline

- 2.7.1** **G**_{/1} The following paragraphs describe the various specified activities. The exclusions relating to activities are dealt with in *AUTH 2.8* and *AUTH 2.9*.

Accepting deposits

- 2.7.2** **G**_{/1} Whether or not *accepting deposits* is a *regulated activity* depends on the use to which the money is put. The activity is caught if money received by way of *deposit* is lent to others or if any other activity of the *person* accepting the *deposit* is financed wholly (or to a material extent) out of the capital of, or interest on, money received by way of *deposit*.

Effecting or carrying out contracts of insurance as principal

- 2.7.3** **G**_{/1} The activities of *effecting a contract of insurance* or *carrying out a contract of insurance* are separate *regulated activities*, each requiring *authorisation*. But this only applies where they are carried on by a *person* who is acting as principal. This means that the activities of agents, such as loss adjusters, will not constitute this *regulated activity*. The activities of some agents may, however, constitute other *regulated activities*; for example, brokers arranging *long-term insurance contracts* may be caught as carrying on the *regulated activity* of *arranging (bringing about) deals in contractually based investments* (see *AUTH 2.7.7G*).

- 2.7.4** **G**_{/1} In addition, other activities carried on in relation to rights under certain *long-term insurance contracts* are regulated (see *AUTH 2.7.5G* to *2.7.10G*, *AUTH 2.7.15G* and *AUTH 2.7.16G*). This is because such rights are classified as *contractually based investments*.

Dealing in investments (as principal or agent)

- 2.7.5** **G**_{/1} In relation to *securities* or *life policies* (or rights or interests in either), *dealing as principal* is only a *regulated activity* if certain conditions are satisfied (see *AUTH 2.8.4G(1)*).

- 2.7.6** **G**_{/1} Both the activities of *dealing in investments as principal* and *dealing in investments as agent* are defined in terms of '*buying, selling, subscribing for or underwriting securities* or *contractually based investments* (except rights under a *funeral plan contract*). Because of the different nature of the *specified investments* in relation to which these activities are carried on, '*buying*' and '*selling*' are defined terms that have an extended meaning. For example, some of the *specified investments* listed in *AUTH 2.6* are particular things that can be bought and *sold* in the ordinary

meaning of the words. Others fall outside the ordinary meaning of 'buy' and 'sell' because their transfer involves an assumption of a potential liability under a bilateral contract (*contracts for differences* are an example of this). To deal with the possible range of circumstances, 'buying' is defined in the *Regulated Activities Order* to include acquiring for valuable consideration. 'Selling' is defined to include disposing for valuable consideration and 'disposing' is itself given a specified meaning that covers a range of possible transactions according to the nature of the investment being transferred (including, for example, surrendering a life insurance contract).

Arranging deals in investments

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Arranging applies to arrangements that relate to *securities, contractually based investments* and the *underwriting capacity of a Lloyd's syndicate or membership of a Lloyd's syndicate*. Arrangements relating to rights to or interests in any of these *specified investments* are also caught. Arranging is made up of two distinct *regulated activities*. Both are aimed at the *person* who agrees with another *person* that he will procure a third *person* to *buy, sell, subscribe for or underwrite* the relevant *specified investments*.

- (1) The first activity is 'making arrangements for another *person* to *buy, sell, subscribe for or underwrite* a particular investment'. This activity is referred to in the *Handbook* as *making arrangements with a view to transactions in investments*. It is aimed at arrangements that would have the direct effect that a transaction is concluded (that is, arrangements that bring it about).
- (2) The second activity is 'making arrangements with a view to a *person* who participates in the arrangements *buying, selling, subscribing for or underwriting investments*'. This activity is referred to in the *Handbook* as *arranging (bringing about) deals in investments*. It is aimed at cases where it may be said that the transaction is 'brought about' directly by the parties to it but where this happens in a context set up by a third party specifically with a view to the conclusion by others of transactions through the use of that third party's facilities. This will catch the activities of *persons* such as exchanges, *clearing houses* and *service companies* (for example, *persons* who provide *communication facilities* for the routing of orders or the negotiation of transactions). A *person* may be carrying on this *regulated activity* even if he is only providing part of the facilities necessary before a transaction is brought about.

Managing investments

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The *regulated activity of managing investments* includes several elements.

- (1) First, a *person* must exercise discretion. Non-discretionary portfolio management (where the manager *buys and sells, as principal or agent, on the instructions of some other person*) is not caught by this activity, although it may be caught by a different *regulated activity* such as the activity of *dealing in investments as principal or dealing in investments as agent*. The discretion must be exercised in relation to the composition of the portfolio under management and not in relation to some other function (such as proxy voting) carried on by the manager.

- (2) Second, the property that is managed must belong beneficially to another *person*. This excludes from the *regulated activity* the management by a *person* of his own property. But discretionary management of assets by a *person* acting in his capacity as trustee will be caught even though he is the legal owner of the assets.
- (3) Third, the property that is managed must consist of (or include) *securities* or *contractually based investments*. Alternatively, discretionary management will generally be caught if it is possible that the property could consist of or include such *securities* or investments. This is the case even if there never has been any investment in *securities* or *contractually-based investments*, as long as there have been representations that there would be.

Safeguarding and administering investments

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The activity of *safeguarding and administering investments* belonging to another is regulated, as is providing a service under which a *person* undertakes to arrange on a continuing basis for others actually to carry out the safeguarding and administering. In each case, both the elements of safeguarding and administering must be present before a *person* will be said to carry on the activity.

- (1) Safeguarding is acting as custodian of the property, for example, holding any documents evidencing the investments such as the share certificate (although it is worth noting that there is express provision that an uncertificated investment may be safeguarded and administered).
- (2) Administration covers services provided to the owner or manager of the property, such as settlement of sale transactions relating to an investment, dealing with income arising from the investment and carrying out corporate actions such as voting. The nature of administration services must be such that the custodian has no discretion (otherwise he is likely to be caught by the *regulated activity of managing investments* (see AUTH 2.7.8G)).

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The property that is safeguarded and administered must belong beneficially to another *person*. It must consist of (or include) *securities* or *contractually based investments*. Alternatively, safeguarding and administration will generally be caught if it is possible that the property could consist of (or include) such *securities* or investments. This is the case even if the property in question has never consisted of (or included) such *securities* or investments, as long as there have been representations that it would do.

Sending dematerialised instructions

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The *regulated activities* relating to *sending dematerialised instructions* relate to the operation of the system for electronic transfer of title to certain securities set up by the Uncertificated Securities Regulations 1995 (and currently operated by CREST). Sending instructions on behalf of another is a *regulated activity*, as is causing such instructions to be sent if the *person* causing the sending is a system-participant, as defined in those Regulations. A system-participant is the *person* who has the computer and network connection to CREST.

Establishing etc collective investment schemes

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The *regulated activities* carried on in relation to a *collective investment scheme* generally are the *establishing, operating or winding up a collective investment scheme*. Acting as the *depository* and acting as sole director of an *open-ended investment company* are also separate *regulated activities*. In all these cases, the activities are regulated where the schemes themselves are authorised schemes for the purposes of the UK product regulation regime under Part XVII of the *Act* (Collective investment schemes) as well as where the schemes are unregulated schemes.

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In addition, express provision is included in the *Regulated Activities Order* to make *acting as trustee of an authorised unit trust scheme* into a *regulated activity*. The full picture for authorised schemes (that is, schemes that can be promoted to the public) is as follows:

- (1) *Acting as trustee of an authorised unit trust scheme* is expressly included as a *regulated activity*.
- (2) *Acting as depository of an open-ended investment company* that is authorised under regulations made under section 262 of the *Act* (Open-ended investment companies), is a *regulated activity*.
- (3) Acting as a sole director of such a company is a *regulated activity*.
- (4) Managing an *authorised unit trust scheme* will amount to operating the scheme and so will be a *regulated activity*. A *person* acting as *manager* is also likely to be carrying on other *regulated activities* (such as *dealing* (see AUTH 2.7.5G) or *managing investments* (see AUTH 2.7.8G)).
- (5) An *open-ended investment company* will, once it is authorised under regulations made under section 262 of the *Act*, become an *authorised person* in its own right under Schedule 5 to the *Act* (Persons concerned in Collective Investment Schemes). Under ordinary principles, a company operates itself and an *authorised open-ended investment company* will be operating the *collective investment scheme* constituted by the *company*. It is not required to go through a separate process of *authorisation* as a *person* because it has already undergone the process of product *authorisation*.
- (6) *Operators, trustees or depositories of UCITS schemes* constituted in other *EEA States* are also *authorised persons* under Schedule 5 of the *Act* if those *schemes* qualify as recognised *collective investment schemes* for the purposes of section 264 of the *Act*.

Establishing etc stakeholder pension schemes

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The *regulated activities* carried on in relation to *stakeholder pension schemes* are the *establishment, operating or winding up of a stakeholder pension scheme*. Managers of such schemes will require *authorisation* as they will be operating the schemes.

Advising on investments

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The activity of *advising on investments* falls to be regulated only if it applies to *securities* and *contractually based investments*. It does not, for example, include giving advice about *deposits*, rights under a *general insurance contract* or rights under a regulated mortgage contract or about things that are not *specified investments* for the purposes of the *Regulated Activities Order* (such as interests under the trusts of an *occupational pension scheme*). Giving a *person* generic advice about *specified investments* (for example, invest in Japan rather than Europe) is not a *regulated activity* nor is giving information as opposed to advice (for example, listings or company news). However, the context in which something is communicated may affect its character; for example, if a *person* gives information on share price against the background that, when he does so, that will be a good time to sell, then this will constitute *advice*.

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The *advice* must also be given to someone who holds *specified investments* or is a prospective investor (including trustees, nominees or discretionary fund managers). This requirement excludes advice given to a *person* who receives it in another capacity. An example of this might be a tax professional to whom advice is given to inform the practice of his profession or advice given to an employer for the purposes of setting up a *group personal pension scheme*.

Lloyd's activities

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Certain activities carried on in connection with business at Lloyd's will be regulated. In addition to those already mentioned (*arranging deals* in the *underwriting capacity of a Lloyd's syndicate* or *membership of a Lloyd's syndicate*), there are three other *regulated activities* as follows.

- (1) *Managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's* is a *regulated activity*. 'Managing agent' is defined in article 3(1) of the *Regulated Activities Order*.
- (2) *Advising on syndicate participation at Lloyd's*, that is advising a *person* to become, or continue or cease to be, a member of a particular *syndicate* is also caught. Giving *advice* about *syndicate* participation (such as how members should use their capital within the market and arrange their *syndicate* participation) is a separate *regulated activity* to that of providing advice in relation to *securities* and *contractually based investments* (see AUTH 2.7.15G). Appropriate *permission* will be needed.
- (3) *Arranging deals in contracts of insurance written at Lloyd's* is also a *regulated activity* for the *Society of Lloyd's* itself.

Entering funeral plan contracts

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Entering as provider into a funeral plan contract is a *regulated activity*. The 'provider' is the *person* to whom the pre-payments are made and who undertakes to provide, or secure the provision of, the funeral at some future point. He may be the funeral director or a third party who arranges for another *person* to provide the funeral. Certain types of *funeral plan contract* are excluded (see AUTH 2.8.14G). This will be a *regulated activity* with effect from 1 January 2002.

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In addition, other activities carried on in relation to rights under certain *funeral plan contracts* are regulated (see *AUTH 2.7.5G* to *2.7.11G* and *AUTH 2.7.15G* and *2.7.16G*). This is because such rights are classified as *contractually based investments*.

Activities in respect of regulated mortgage contracts

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Entering into, and administering, a regulated mortgage contract will become *regulated activities* from the date nine months following the date on which section 19 of the *Act* comes into force. These activities have not been included in Table 1 of *AUTH 2 Ann 2G*.

Agreeing

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Agreeing to carry on most *regulated activities* is itself a *regulated activity*. But this is not the case if the underlying activities to which agreement relates are those of *accepting deposits*, *effecting* or *carrying out contracts of insurance* or carrying on any of the activities that are regulated in relation to *collective investment schemes* and *stakeholder pension schemes*. A person will need to make sure that he has appropriate *authorisation* at the stage of agreement and before he actually carries on the underlying activity (such as the *dealing* or arranging).



2.8 Exclusions applicable to particular regulated activities

2.8.1 **G**_{/1} Most *regulated activities* are subject to exclusions that are set out in the *Regulated Activities Order* directly following each activity.

Accepting deposits

2.8.2 **G**_{/1} No exclusions operate directly on the activity of *accepting deposits*. But, in addition to the situations that are excluded from being '*deposits*' (see *AUTH 2.6.2G* to *AUTH 2.6.4G*), several *persons* are *exempt persons* in relation to the *regulated activity* of *accepting deposits* (see *AUTH 2.10.8G(2)*).

Effecting and carrying out contracts of insurance

2.8.3 **G**_{/1} The following activities are excluded from both the *regulated activities* of *effecting* and *carrying out contracts of insurance*.

- (1) In specified circumstances, the activities of an *EEA firm* when participating in a Community co-insurance operation are excluded. A Community co-insurance operation is defined in the *Community Co-insurance Directive*.
- (2) Activities that are carried out in connection with the provision of on-the-spot accident or breakdown assistance for cars and other vehicles (such as repairs, vehicle retrieval, delivery of parts or fuel) are excluded.

Dealing in investments as principal

2.8.4 **G**_{/1} The *regulated activity* of *dealing in investments as principal* applies to specified transactions relating to any *security* or to any *contractually based investment* (apart from rights under *funeral plan contracts* or rights to or interests in such contracts). The activity is cut back by exclusions as follows.

- (1) Of particular significance is the exclusion in article 15 of the *Regulated Activities Order*. This applies where *dealing in investments as principal* involves entering into transactions relating to any *security* or assigning rights under a *life policy* (or rights or interests in such a contract). In effect, it superimposes an additional condition that must be met before a *person's* activities become *regulated activities*. The additional condition is that a *person* must hold himself out as making a market in the relevant *specified investments* or as being in the business of dealing in them, or he must regularly solicit members of the public with the purpose of inducing them to *deal*. This

exclusion does not apply to dealing activities that relate to any *contractually based investment* except the assigning of rights under a *life policy*.

- (2) Entering into a transaction relating to a *contractually based investment* is not regulated if the transaction is entered into by an *unauthorised person* and it takes place in either of the following circumstances (a transaction entered into by an *authorised person* would be caught). The first set of circumstances is where the *person* with whom the *unauthorised person* deals is either an *authorised person* or an *exempt person* who is acting in the course of a business comprising a *regulated activity* in relation to which he is exempt. The second set of circumstances is where the *unauthorised person* enters into a transaction through a non-UK office (which could be his own) and he deals with or through a *person* who is based outside the *United Kingdom*. This non-UK *person* must be someone who, as his ordinary business, carries on any of the activities relating to *securities* or *contractually based investments* that are generally treated as *regulated activities*.
- (3) A *person* (for example, a bank) who provides another *person* with finance for any purpose can accept an instrument acknowledging the debt (and as security for it) without risk of *dealing as principal* as a result.
- (4) A *company* does not *deal* as principal by issuing certain *securities* in itself.
- (5) Risk-management activities involving *options*, *futures* and *contracts for differences* will not require *authorisation* if specified conditions are met. The conditions include the *company's* business consisting mainly of *unregulated activities* and the sole or main purpose of the risk management activities being to limit the impact on that business of certain kinds of identifiable risk.
- (6) A *person* will not be treated as carrying on the activity of *dealing in investments as principal* if, in specified circumstances (outlined in AUTH 2.9), he enters as principal into a transaction:
 - (a) while acting as bare trustee (or, in Scotland, as nominee);
 - (b) in connection with the sale of goods or supply of services;
 - (c) that takes place between members of a *group* or *joint enterprise*;
 - (d) in connection with the sale of a *body corporate*;
 - (e) in connection with an employee share scheme;
 - (f) as an *overseas person*.

Dealing in investments as agent

2.8.5

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The *regulated activity* of *dealing in investments as agent* applies to specified transactions relating to any *security* or to any *contractually based investment* (apart from rights under *funeral plan contracts* or rights to or interests in such contracts). In addition, the activity is cut back by exclusions as follows.

- (1) An exclusion applies to transactions entered into by an agent who is not an *authorised person* which depend on him dealing with (or through) an *authorised person*. There are certain conditions which must be satisfied for the exclusion to apply. These are that the agent must not give any relevant advice

on the transaction and that he must not receive any remuneration from the transaction unless account is made to his client.

- (2) There is an exclusion for risk-management transactions where the agent is dealing on behalf of a *group* company or a co-participant in a *joint enterprise*.
- (3) In addition, exclusions apply in specified circumstances (outlined in *AUTH* 2.9) where a *person* enters as agent into a transaction:
 - (a) in connection with the carrying on of a profession or of a business not otherwise consisting of *regulated activities*;
 - (b) in connection with the sale of goods or supply of services;
 - (c) that takes place between members of a *group* or *joint enterprise*;
 - (d) in connection with the sale of a *body corporate*;
 - (e) in connection with an employee share scheme;
 - (f) as an *overseas person*.

Arranging deals in investments

2.8.6

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The exclusions in relation to the *regulated activities* of arranging are of particular relevance in the context of raising corporate finance. Many of the exclusions outlined below relate to both the elements of the activity; that is, *arranging (bringing about) deals in investments* (under article 25(1) of the *Regulated Activities Order*) and *making arrangements with a view to transactions in investments* (under article 25(2) of the *Regulated Activities Order*). But several exclusions relate only to one of those activities.

- (1) Arrangements that do not or would not bring about the investment transaction to which the arrangements relate are excluded from article 25(1) only. A *person* will bring about an investment transaction only if his involvement in the chain of events leading to a transaction is of sufficient importance that without that involvement the transaction would not take place. This will require something more than the mere giving of advice (although giving such *advice* may be the *regulated activity* of *advising on investments*).
- (2) Simply providing the means by which parties to a transaction (or possible transaction) are able to communicate with each other is excluded from article 25(2) only. This will ensure that *persons* such as internet service providers or telecommunications networks are excluded if all they do is provide communication facilities (and these would otherwise be considered to be arrangements made with a view to the participants entering into transactions). If a *person* makes arrangements that go beyond providing the means of communication, and add value to what is provided, he will lose the benefit of this exclusion.
- (3) Arranging investment transactions to which the *arranger* is to be a party is excluded from both article 25(1) and (2). The main purpose is to ensure that a *person* is not regarded as arranging *deals* for another when the transaction in question is one to which he intends to be a party. As a result, a *person* cannot both be engaging in a dealing activity (as principal or agent) and arranging *deals* for another as regards any particular transaction.

- (4) An unauthorised *person* who arranges investment transactions, with a view to a transaction between a third party and an *authorised person*, is excluded from article 25(1) and (2) if specified conditions as to advice and remuneration are satisfied. For example, the exclusion is dependent on the third party not receiving any *advice* on the transactions from the unauthorised *person* making the arrangements.
- (5) Arranging investment transactions in connection with lending on the security of insurance policies is excluded, in specified circumstances, from article 25(1) and (2).
- (6) Making arrangements for finance (in whatever form) to be supplied to a *person* by a third party is excluded from article 25(1) and (2) if the finance is given in exchange for an instrument acknowledging the debt. This mirrors the exclusion from *dealing in investments as principal* in similar circumstances (see *AUTH* 2.8.4(3)G).
- (7) Arrangements the only purpose of which is to provide finance to enable *persons* to enter into investment transactions are excluded from article 25(2) only. There is no equivalent exemption from article 25(1). But arrangements for the provision of finance will only be caught by that provision if the arrangements actually bring about the transaction.
- (8) Making arrangements under which *clients* will be introduced to third parties who will provide independent services (consisting of *advice* or the exercise of discretion in relation to certain investments) is excluded from article 25(2) only. The *person* to whom the introduction is made must be of a specified standing (including that of an *authorised person*).
- (9) A *company's* arrangements for issuing specified securities in itself are excluded from both article 25(1) and (2).
- (10) A body carrying out international securities business of a specified type can apply to the Treasury for approval as an international securities self-regulating organisation (ISSRO). Arrangements made in order to carry out the functions of an ISSRO are excluded from article 25(1) and (2). The exclusion applies whether the arrangements are made by the ISSRO or by a *person* acting on its behalf.
- (11) The following exclusions from both article 25(1) and (2) (outlined in *AUTH* 2.9) apply in specified circumstances where a *person* makes arrangements:
 - (a) while acting as trustee or personal representative;
 - (b) in connection with the carrying on of a profession or of a business not otherwise consisting of *regulated activities*;
 - (c) in connection with the sale of goods or supply of services;
 - (d) in connection with certain transactions by a *group* member or by a participator in a *joint enterprise*;
 - (e) in connection with the sale of a *body corporate*;
 - (f) in connection with an employee share scheme;
 - (g) as an *overseas person*.

Managing investments

2.8.7

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The activities of *persons* appointed under a power of attorney are excluded from the *regulated activity* of *managing investments*, if specified conditions are satisfied. In addition, the following exclusions (outlined in *AUTH 2.9*) apply in specified circumstances where a *person* manages assets:

- (1) while acting as trustee or personal representative;
- (2) in connection with the sale of goods or supply of services;
- (3) that belong to a *group* member or participator in a *joint enterprise*.

Safeguarding and administering investments

2.8.8

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The exclusions from the *regulated activity* of *safeguarding and administering investments* are as follows.

- (1) Safeguarding and administration activities carried on by one *person* are excluded if a specified third party undertakes a responsibility for the assets which is no less onerous than it would have if he were doing the safeguarding and administration himself. The effect of this is that an *authorised person* with *permission* to carry on this *regulated activity* (or in certain circumstances an *exempt person*) can delegate all or part of the activities without the delegate needing to be *authorised* and without loss of protection to the owner of the assets.
- (2) Introductions to an *authorised person*, or to an *exempt person* acting within the scope of his exemption and in the course of a business, are excluded from that aspect of this *regulated activity* which consists of *arranging safeguarding and administration of assets* by another *person* (see *AUTH 2.7.9G*).
- (3) Certain specified activities (such as currency conversion and document handling) are excluded from being the administration of investments. A *person* who safeguards and administers assets will not be carrying on *regulated activities* if these are the only administration activities in which he engages. This is because a *person* must be carrying on both the activity of safeguarding and that of administration, or be arranging for both to be carried on by another, before he requires *authorisation* (see *AUTH 2.7.9G*).
- (4) The following exclusions (outlined in *AUTH 2.9*) apply in specified circumstances where a *person* safeguards and administers assets (or arranges for another to do so):
 - (a) while acting as trustee or personal representative;
 - (b) in connection with the carrying on of a profession or of a business not otherwise consisting of *regulated activities*;
 - (c) in connection with the sale of goods or supply of services;
 - (d) which belong to a *group* member or participator in a *joint enterprise*;
 - (e) in connection with an employee share scheme.

Sending dematerialised instructions

2.8.9

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Exclusions from the *regulated activity of sending dematerialised instructions* apply in relation to certain types of instructions sent in the operation of the system set up by the Uncertificated Securities Regulations 1995. The various exclusions relate to the roles played by participating issuers, settlement *banks* and network providers (such as internet service providers) and to instructions sent in connection with takeover offers (as long as specified conditions are met). In addition, the following exclusions (outlined in *AUTH 2.9*) apply in specified circumstances where a *person* sends dematerialised instructions:

- (1) while acting as trustee or personal representative;
- (2) on behalf of a *group* member.

Establishing etc collective investment schemes

2.8.10

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There are no exclusions from the range of activities specified as being regulated in relation to *collective investment schemes*. The key issue here is whether or not what is being done relates to something that is a *collective investment scheme*. Exclusions exist in relation to that issue (see *AUTH 2.6.18G*).

Establishing etc stakeholder pension schemes

2.8.11

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There are no exclusions from the range of activities specified as being regulated in relation to *stakeholder pension schemes*.

Advising on investments

2.8.12

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In certain circumstances, advice that takes the form of a regularly updated news or information service and advice which is given in one of a range of different media (for example, newspaper or television) is excluded from the regulated activity of *advising on investments* (see *AUTH 7* [to be added later]). In addition, the following exclusions (outlined in *AUTH 2.9*) apply in specified circumstances where a *person* gives advice:

- (1) while acting as trustee or personal representative;
- (2) in connection with the carrying on of a profession or of a business not otherwise consisting of *regulated activities*;
- (3) in connection with the sale of goods or supply of services;
- (4) to a *group* member or participator in a *joint enterprise*;
- (5) in connection with the sale of a *body corporate*;
- (6) as an *overseas person*.

Lloyd’s activities

2.8.13

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There are no exclusions from the *regulated activities* that relate expressly to business carried on at Lloyd’s except to the extent that such activities are caught by the *regulated activity* of arranging deals (see AUTH 2.7.7G and AUTH 2.8.6G).

Entering funeral plan contracts

2.8.14

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Entering as provider into a funeral plan contract is not treated as a *regulated activity* where:

- (1) the contract is one under which the sums received from the customer will be applied towards a *contract of insurance* on the life of the *person* whose funeral is to be provided or be held on trust for the purpose of providing a funeral; in each case certain specified conditions must be met for the exclusion to apply;
- (2) the customer and the provider intend or expect that the funeral will be provided within one *month* of the contract being entered into;
- (3) the contract is entered into before 1 January 2002.

Agreeing

2.8.15

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A *person* who agrees to carry on certain other *regulated activities* (which is itself a *regulated activity* – see AUTH 2.7.21G) does not require *authorisation* where the *person* concerned is an *overseas person* and the agreement is reached as a result of a legitimate approach (see AUTH 2.9.12G). For this exclusion to apply, the agreement must be one to arrange deals, *manage investments*, *safeguard and administer investments* or *send dematerialised instructions*.

2.8.16

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To the extent that an exclusion applies in relation to a *regulated activity*, then ‘agreeing’ to carry on an activity falling within the exclusion will not be a *regulated activity*. This is the effect of article 4(3) of the *Regulated Activities Order*.

2.9 Additional exclusions for activities relating to securities and contractually based investments

2.9.1 **G**_{/1} The various exclusions outlined below deal with a range of different circumstances. Each set of circumstances has some application to several *regulated activities* relating to *securities* or *contractually based investments*. They have no effect in relation to the separate *regulated activities* of *accepting deposits*, *effecting or carrying out contracts of insurance*, *advising on syndicate participation at Lloyd's*, *managing the underwriting capacity of a Lloyd's syndicate as managing agent at Lloyd's*, *entering as provider into a funeral plan contract* or any *regulated activities* relating to regulated mortgage contracts. Within each set of circumstances, the *Regulated Activities Order* (see Chapter XVII of Part II of the Order) makes separate provision for each *regulated activity* affected. This is necessary because each exclusion has to be tailored to reflect the different nature of the *regulated activity* involved and the different language required (for example, some activities directly involve entering into transactions while others relate to the provision of services).

2.9.2 **G**_{/1} The exclusions grouped together in the *Regulated Activities Order* are described below in this chapter in general terms. The exact terms of each exclusion will need to be considered by any *person* who is considering whether they need *authorisation*. Each description is accompanied by an indication of which *regulated activities* are affected.

Trustees, nominees or personal representatives

2.9.3 **G**_{/1} This group of exclusions applies, in specified circumstances, to the *regulated activities* of:

- (1) *dealing in investments as principal*;
- (2) *arranging (bringing about) deals in investments* and *making arrangements enabling or facilitating transactions in investments*;
- (3) *managing investments*;
- (4) *safeguarding and administering investments*;
- (5) *sending dematerialised instructions*; and
- (6) *advising on investments*.

2.9.4 **G**_{/1} A *person* carrying on certain *regulated activities* does not require *authorisation* in specified circumstances if he is acting in a representative capacity. The representative capacities covered by the exclusions depend on the *regulated activity*

concerned but, in most cases, the focus is on *persons* who are acting as trustee or personal representative. In broad terms, the exclusions apply to specified transactions, or activities, that are part of the discharge of his general obligations by the trustee or representative when he is acting as such. Many of the exclusions require that the trustee or representative must not hold himself out as providing services consisting of the *regulated activity* in question. In addition, he must not receive remuneration that is additional to any he receives for acting in the representative capacity (although a *person* is not to be regarded as receiving additional remuneration merely because his remuneration as trustee or representative is calculated by reference to time spent).

Professions or business not involving regulated activities

2.9.5 G /1 This group of exclusions applies, in specified circumstances, to the *regulated activities* of:

- (1) *dealing in investments as agent;*
- (2) *arranging (bringing about) deals in investments and making arrangements enabling or facilitating transactions in investments;*
- (3) *safeguarding and administering investments;* and
- (4) *advising on investments.*

2.9.6 G /1 The exclusions apply where the *regulated activity* is carried out in the course of a profession or business which does not otherwise consist of *regulated activities*. However, activities are only excluded to the extent that they may reasonably be regarded as a necessary part of the other services provided in the course of the profession or business. The exclusion does not apply if separate remuneration is received in respect of any regulated activity that is carried on. (See separate guidance for *authorised professional firms* in PROF).

Sale of goods and supply of services

2.9.7 G /1 This group of exclusions applies, in specified circumstances, to the *regulated activities* of:

- (1) *dealing in investments as principal;*
- (2) *dealing in investments as agent;*
- (3) *arranging (bringing about) deals in investments and making arrangements enabling or facilitating transactions in investments;*
- (4) *managing investments;*
- (5) *safeguarding and administering investments;* and
- (6) *advising on investments.*

2.9.8 G /1 Broadly speaking, the exclusions focus on cases where the main business of a *person* is to sell goods or supply services but where certain activities may have to be carried on for the purposes of that business which would otherwise be *regulated*

activities. The exclusions are not available where the customer to whom goods are sold or services are supplied is an individual. They are also not available where what is at issue is a transaction entered into, or service provided, in relation to rights under a *life policy* or *units* in a *collective investment scheme* (or rights to, or interests in, either).

Group and joint enterprises

2.9.9

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This group of exclusions applies, in specified circumstances, to the *regulated activities* of:

- (1) *dealing in investments as principal*;
- (2) *dealing in investments as agent*;
- (3) *arranging (bringing about) deals in investments and making arrangements enabling or facilitating transactions in investments*;
- (4) *managing investments*;
- (5) *safeguarding and administering investments*;
- (6) *sending dematerialised instructions*; and
- (7) *advising on investments*.

2.9.10

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These exclusions apply to intra-group dealings and activities and to dealings or activities involving participators in a *joint enterprise* which take place for the purposes of, or in connection with, the enterprise. The general principle here is that, as long as activities that would otherwise be *regulated activities* take place wholly within a *group* of companies, then there is no need for *authorisation*. The same principle applies to dealings or activities that take place wholly within a *joint enterprise* entered into for commercial purposes related to the participators' unregulated business.

Sale of body corporate

2.9.11

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This group of exclusions applies, in specified circumstances, to the *regulated activities* of:

- (1) *dealing in investments as principal*;
- (2) *dealing in investments as agent*;
- (3) *arranging (bringing about) deals in investments and making arrangements enabling or facilitating transactions in investments*;
- (4) *advising on investments*.

2.9.12

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The exclusions only apply where the object of the transaction may reasonably be regarded as being the acquisition of day-to-day control of the affairs of a *body corporate*. Whether or not day-to-day control is at stake is a question of fact based on an objective test. The *Regulated Activities Order* contains a non-exhaustive list of circumstances in which the day-to-day control requirement will be regarded as

satisfied. These include the case where it is the acquisition or disposal of at least 50 per cent of the voting shares in the *body corporate* that is at issue. Certain additional requirements must also be satisfied. These exclusions do not have effect in relation to shares in an *open-ended investment company*.

Employee share schemes

2.9.13

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This group of exclusions applies, in specified circumstance, to the *regulated activities* of:

- (1) *dealing in investments as principal;*
- (2) *dealing in investments as agent;*
- (3) *arranging (bringing about) deals in investments and making arrangements enabling or facilitating transactions in investments;*
- (4) *safeguarding and administering investments.*

2.9.14

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In broad terms, the exclusions apply to activities which further an employee share scheme, or are carried on in operation of such a scheme. They apply to activities carried on by the *company* whose securities or debentures (which are given an extended meaning for this exclusion) are the subject of the scheme. They also apply to activities of any *company* in the same *group* or of any trustee who holds certain types of securities or debentures under the scheme.

Overseas persons

2.9.15

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This group of exclusions applies, in specified circumstances, to the *regulated activities* of:

- (1) *dealing in investments as principal;*
- (2) *dealing in investments as agent;*
- (3) *arranging (bringing about) deals in investments and making arrangements enabling or facilitating transactions in investments;*
- (4) *advising on investments;*
- (5) *agreeing to carry on the regulated activities of managing investments, arranging, safeguarding and administering investments or sending dematerialised instructions.*

2.9.16

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An *overseas person* is defined as a *person* who carries on what would be *regulated activities* (including any activity that is excluded from being a *regulated activity*) but who does not do so, or offer to do so, from a permanent place of business maintained by him in the *United Kingdom*. Where a *person* does not have a permanent place of business in the *United Kingdom*, he will not, in any event, need to rely on these exclusions unless what he does is regarded as carried on in the *United Kingdom* (see AUTH 2.4).

2.9.17

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The exclusions are available in the two broad cases set out below. For some *regulated activities*, the exclusions apply in each case. In others, they apply in only one:

- (1) The first case is where the nature of the *regulated activity* requires the direct involvement of another *person* and that *person* is *authorised* or exempt (and acting within the scope of his exemption). For example, this might occur where the *person* with whom an *overseas person* deals is an *authorised person* or where the arrangements he makes are for transactions to be entered into by such a *person*;
- (2) The second case is where a particular *regulated activity* is carried on as a result of what is termed a 'legitimate approach'. An approach to an *overseas person* that has not been solicited by him in any way, or has been solicited in a way that does not contravene the restrictions on *financial promotion* in section 21 of the *Act*, is a legitimate approach. An approach that is made by him in a way that does not contravene section 21 of the *Act* is also a legitimate approach. In such circumstances, the *overseas person* can, without requiring *authorisation*, enter into deals with (or on behalf of) a *person* in the *United Kingdom*, give advice in the *United Kingdom* or enter into agreements in the *United Kingdom* to carry on certain *regulated activities*. The exemptions to the *financial promotion* restrictions made by the Treasury under section 21 of the *Act* will be relevant to the question of whether those restrictions have been contravened (see separate *guidance* on *financial promotion* in AUTH App X [to be added later]).



2.10 Persons carrying on regulated activities who do not need authorisation

2.10.1 **G**_{/1} There are various provisions that disapply the *general prohibition* from specific *persons* in relation to the carrying on by them of particular *regulated activities*. There is, however, no general provision for *persons* to apply for an exemption.

2.10.2 **G**_{/1} *Persons* may be exempted from the *general prohibition* in relation to one or more particular *regulated activities*. The extent of any exemption may also be limited to specified circumstances (such as where another *person* who is *authorised* and has relevant *permission* has accepted responsibility for the *regulated activities* in question) or subject to specified conditions (such as a requirement that the activity is not carried on for pecuniary gain).

2.10.3 **G**_{/1} The *Act* provides that *appointed representatives* (see AUTH 2.10.5G), *recognised investment exchanges* and *recognised clearing houses* (see AUTH 2.10.6G) and certain other *persons* exempt under miscellaneous provisions (see AUTH 2.10.7G) are *exempt persons*. Members of Lloyd’s and members of the professions are not ‘*exempt persons*’ as such, but the *general prohibition* in section 19 of the *Act* only applies to them in certain circumstances. The distinction is significant in relation to various provisions (such as those in the *Regulated Activities Order*) that apply only to transactions and other activities that involve *exempt persons*.

2.10.4 **G**_{/1} *Appointed representatives* and the *persons* exempt under miscellaneous provisions cannot be exempt in relation to some *regulated activities* and *authorised* in relation to others. If a *person* is already *authorised*, and proposes to carry on additional *regulated activities* in respect of which he would otherwise be exempt as an *appointed representative* or under miscellaneous provisions, he must seek an extension to his existing *permission* to cover those additional activities. A *person* in either of these categories who would otherwise be exempt in relation to particular activities will, if he becomes *authorised*, no longer be able to rely on the exemption.

Appointed representatives

2.10.5 **G**_{/1} A *person* is exempt if he is an *appointed representative* of an *authorised person*. See SUP 12.

Recognised Investment Exchanges and Recognised Clearing Houses

2.10.6 **G**_{/1} Investment exchanges and *clearing houses* can apply for recognition under Part XVIII of the *Act* (Recognised investment exchanges and clearing houses). See REC.

Particular exempt persons

- 2.10.7** G_{/1} Various named *persons* are exempted by Order made by the Treasury under section 38 of the *Act* from the need to obtain *authorisation*. Some of the exemptions are subject to restrictions as to the circumstances in which they apply. For example, a *person* is only exempt when acting in a particular capacity or for particular purposes.
- 2.10.8** G_{/1} The exemptions apply so as to confer *exemption on persons* from the *general prohibition* in respect of four distinct categories of regulated activities.
- (1) The first category is carrying on any *regulated activity*, apart from effecting or *carrying out contracts of insurance* (or agreeing to do so). *Exempt persons* here are generally supranational bodies of which the *United Kingdom* or another *EEA State* is a member.
 - (2) The second category is the *regulated activity of accepting deposits*. *Exempt persons* here include municipal banks, local authorities, charities and *industrial and provident societies*.
 - (3) The third category is carrying on any of those *regulated activities* relating to *securities* or *contractually based investments* or to 'any property' (or agreeing to do so). *Exempt persons* here include *persons* whose activities are subject to a certain degree of control or oversight by the Government.
 - (4) The fourth category is carrying on one or more specified *regulated activities* (or agreeing to do so). *Exempt persons* here cover a range of different *persons*.

Members of Lloyd's

- 2.10.9** G_{/1} Several activities carried on in connection with business at Lloyd's are *regulated activities* in respect of which *authorisation* must be obtained. These include the *regulated activities* of *advising on syndicate participation at Lloyd's* or *managing the underwriting capacity of Lloyd's syndicate as a managing agent at Lloyd's* or *arranging(bringing about) deals in investments* or *making arrangements with a view to transactions in investments* for another in relation to such participation or underwriting capacity.
- 2.10.10** G_{/1} But under section 316 of the *Act* (Direction by the FSA) the *general prohibition* does not apply to a *person* who is a *member* of the *Society of Lloyd's* unless the FSA has made a direction that it should apply. The *general prohibition* is disapplied in relation to any *regulated activity* carried on by a *member* relating to *contracts of insurance* written at Lloyd's. Directions can be made by the FSA in relation to individual *members* or the *members* of the *Society of Lloyd's* taken together. Alternatively, instead of being required to obtain *authorisation*, a *member* of the *Society of Lloyd's* may, as a result of a direction under section 316 of the *Act*, become subject to specific provisions of the *Act* even though he is not an *authorised person*.
- 2.10.11** G_{/1} A *person* who ceased to be an *underwriting member* at any time on or after 24 December 1996 may, without *authorisation*, *carry out contracts of insurance* he has underwritten at Lloyd's. But this is subject to any requirements or *rules* that the FSA may impose under sections 320 to 322 of the *Act* (Former underwriting members).

Members of the professions

2.10.12 G_{/1} The *general prohibition* does not in certain circumstances apply to a *person* providing professional services that are supervised and regulated by a professional body designated by the Treasury under section 326 of the *Act* (Designation of professional bodies) (see *PROF*). Certain of the exclusions from *regulated activities* outlined in *AUTH 2.8* and *AUTH 2.9* will be relevant to members of *designated professional bodies*. The regime outlined below applies only where no exclusion applies and a *person* will be carrying on a *regulated activity*.

2.10.13 G_{/1} Such a *person* may carry on *regulated activities* if the conditions outlined below are met, that is the *person*:

- (1) is not affected by an order or direction made by the *FSA* under section 328 or 329 of the *Act* (Directions and orders in relation to the general prohibition) which has the effect of re-imposing the *general prohibition* in any particular case.
- (2) is, or is controlled by, a member of a profession.
- (3) does not receive any pecuniary reward or other advantage from the *regulated activities* which is given to him by any *person* other than his client (or if he does, he must account to his client for it).
- (4) provides any service in the course of carrying on the *regulated activities* in a manner which is incidental to the provision of professional services.
- (5) carries on only those *regulated activities* which are permitted by the rules of the professional body or in respect of which they are an *exempt person*.
- (6) is not an *authorised person*.

2.10.14 G_{/1} The *regulated activities* that may be carried on in this way are restricted by an Order made by the Treasury under section 327(6) of the *Act* (Exemption from the general prohibition). Accordingly, under that section, a *person* may not by way of business carry on any of the following activities without *authorisation*:

- (1) *accepting deposits*;
- (2) *effecting or carrying out contracts of insurance*;
- (3) *dealing in investments as principal*;
- (4) *establishing, operating or winding up a collective investment scheme*;
- (5) *establishing, operating or winding up a stakeholder pension scheme*;
- (6) *managing the underwriting capacity of a Lloyd’s syndicate as a managing agent at Lloyd’s*;
- (7) *entering as provider into funeral plan contracts*;
- (8) entering into regulated mortgage contracts as lender or administering such contracts;
- (9) agreeing to do certain of the above activities.

2.10.15 G_{/1} In addition, there are restrictions on carrying on (or agreeing to carry on) certain other *regulated activities*. These relate to *managing investments*, *advising on investments* and *advising on syndicate participation at Lloyd's*.

2.10.16 G_{/1} A *person* carrying on *regulated activities* under the regime for members of the professions will be subject to rules made by the professional body designated by the Treasury. Such bodies are obliged to make rules governing the carrying on by their members of those *regulated activities* that they are able to carry on without *authorisation* under the *Act*.



2.11 What to do now ?

2.11.1

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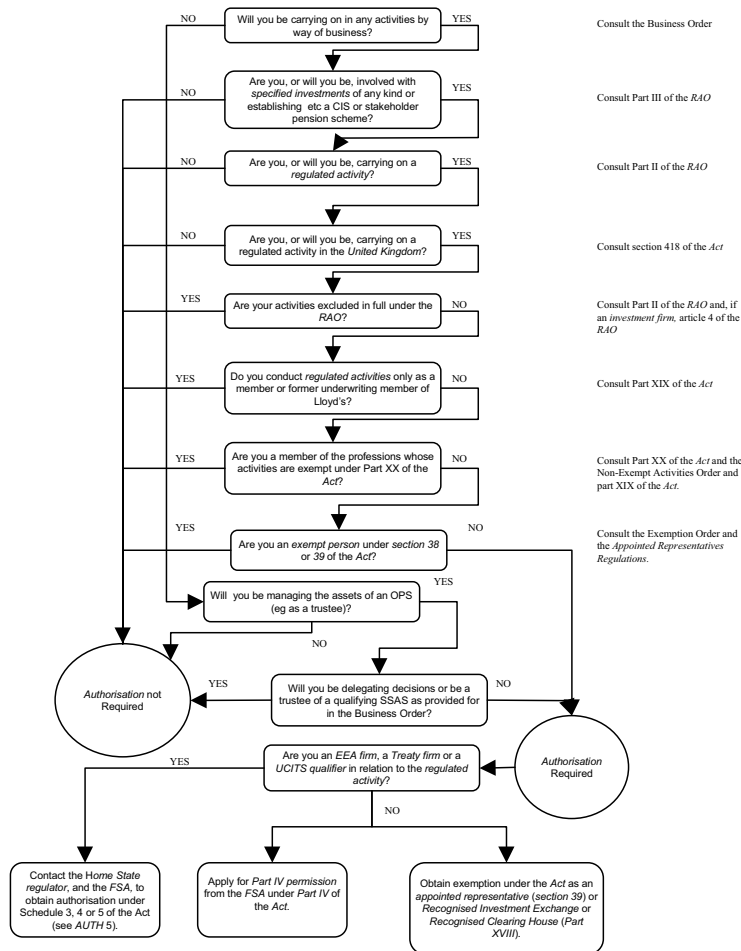
^{/1}

Any *person* who concludes or is advised that he will need to make an application for *Part IV permission* should look at *AUTH 2 Ann 2G* to determine the categories of *specified investment* and *regulated activities* that are relevant to the next step and should then refer to *AUTH 3* for details of the application process.

Authorisation and regulated activities

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Do you need authorisation?



Regulated activities and the permission regime

G

1 Table

1.1 G Table 1 is designed to relate the *permission* regime to *regulated activities*. Section 42(6) of *Act* gives the *FSA* the power to describe the *regulated activity* or *regulated activities* for which it gives *permission* in such manner as the *FSA* considers appropriate. Table 1 details how the *FSA* has chosen to describe the *regulated activities* and *specified investments* for the purposes of the *permission* regime.

1.2 G In an application for *Part IV permission*, an applicant will need to state the *regulated activities* it requires *permission* to carry on. This will involve an applicant identifying the *regulated activities* and the *specified investments* associated with those activities for which it requires *Part IV permission*.

1.3 G Part II of the *Regulated Activities Order* (Specified activities) specifies the activities for the purposes of section 22 of the *Act*. This section states that an activity is a *regulated activity* if it is an activity of a specified kind which is carried on by way of business and:

- (1) relates to an *investment* of a specified kind; or
- (2) in the case of an activity specified for the purposes of section 22(1)(b) of the *Act*, is carried on in relation to property of any kind.

Part III of the *Regulated Activities Order* (Specified investments) specifies the *investments* referred to at *AUTH 2 Ann 2, 1.23(1)*.

1.4 G Column 1 of Table 1 lists the *regulated activities* and column 2 lists the associated *specified investments*. Descriptions of some categories of *specified investments* are expanded in Tables 2 and 3. There are notes to all three tables which provide further explanation where appropriate.

1.5 G A reference to an article in the tables in *AUTH 2 Ann 2G* is to the relevant article in the *Regulated Activities Order*.

2 Table

Table 1: Regulated Activities [See note 1 to Table 1]

Regulated Activity	Specified Investment in relation to which the regulated activity (in the corresponding section of column one) may be carried on
(a) <i>accepting deposits</i> (article 5)	<i>deposit</i> (article 74)
Insurance business	
(b) <i>effecting contracts of insurance</i> (article 10(1))	<i>contract of insurance</i> (article 75) [Expanded in Table 2]
(c) <i>carrying out contracts of insurance</i> (article 10(2))	
Designated investment business	

Regulated Activity	Specified Investment in relation to which the regulated activity (in the corresponding section of column one) may be carried on
(d) <i>dealing in investments as principal</i> (article 14) [see note 2 to Table 1]	<i>security</i> [Expanded in Table 3]; OR
(e) <i>dealing in investments as agent</i> (article 21) [see note 2 to Table 1]	<i>contractually based investment</i> [Expanded in Table 3]
(f) <i>arranging (bringing about) deals in investments</i> (article 25(1)) [also see Lloyd's market section]	
(g) <i>making arrangements with a view to transactions in investments</i> (article 25(2)) [also see Lloyd's market section]	
(h) <i>managing investments</i> (article 37) [see note 3 to Table 1]	
(i) <i>safeguarding and administering investments</i> (article 40) [see note 3 Table 1]	
For the purposes of the <i>permission</i> regime, this <i>regulated activity</i> is subdivided into:	
(i) <i>safeguarding and administration of assets (without arranging);</i>	
(ii) <i>arranging safeguarding and administration of assets</i>	
(j) <i>advising on investments</i> (article 53)	
For the purposes of the <i>permission</i> regime, this <i>regulated activity</i> is subdivided into:	
(i) <i>advising on investments (except pension transfers and pension opt-outs);</i>	
(ii) <i>advising on pension transfers and pension opt-outs</i> [see note 4 to Table 1]	
(k) <i>sending dematerialised instructions</i> (article 45(1))	<i>security</i> [Expanded in Table 3]
(l) <i>causing dematerialised instructions to be sent</i> (article 45(2))	
(m) <i>establishing, operating or winding up a collective investment scheme</i> (article 51(1)(a))	[see note 5 to Table 1]
For the purposes of the <i>permission</i> regime, this <i>regulated activity</i> is subdivided into:	
(i) <i>establishing, operating or winding up a regulated collective investment scheme;</i>	
(ii) <i>establishing, operating or winding up an unregulated collective investment scheme</i>	
(n) <i>acting as trustee of an authorised unit trust scheme</i> (article 51(1)(b))	
(o) <i>acting as the depositary or sole director of an open-ended investment company</i> (article 51(1)(c))	
(p) <i>establishing, operating or winding up a stakeholder pension scheme</i> (article 52)	
The Lloyd's market [see note 6 to Table 1]	

Regulated Activity	Specified Investment in relation to which the regulated activity (in the corresponding section of column one) may be carried on
(q) <i>advising on syndicate participation at Lloyd's</i> (article 56)	<i>membership of a Lloyd's syndicate</i> (article 86(2))
(r) <i>managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's</i> (article 57)	<i>underwriting capacity of a Lloyd's syndicate</i> (article 86(1))
(s) <i>arranging (bringing about) deals in investments</i> (article 25(1))	<i>underwriting capacity of a Lloyd's syndicate</i> (article 86(1))
(t) <i>making arrangements with a view to transactions in investments</i> (article 25(2))	<i>membership of a Lloyd's syndicate</i> (article 86(2)) <i>rights to or interests in investments</i> (article 89) in so far as they relate to either of the above categories of <i>specified investment</i>
Funeral plan providers [a regulated activity with effect from 1 January 2002]	
(u) <i>entering as provider into a funeral plan contract</i> (article 59)	<i>funeral plan contract</i> (article 87)

3 Table

Notes to Table 1

Note 1:

In addition to the *regulated activities* listed in Table 1, article 64 of the *Regulated Activities Order* specifies that *agreeing to carry on a regulated activity* is itself a *regulated activity* in relation to any other *regulated activity* other than:

- *accepting deposits* (article 5);
- *effecting and carrying out contracts of insurance* (article 10);
- *establishing, operating or winding up a collective investment scheme* (article 51(a));
- *acting as trustee of an authorised unit trust scheme* (article 51(1)(b));
- *acting as the sole depository or sole director of an open-ended investment company* (article 51(1)(c)); and
- *establishing, operating or winding up a stakeholder pension scheme* (article 52).

Permission to carry on the activity of *agreeing to carry on a regulated activity* will be given automatically by the FSA in relation to those other *regulated activities* for which an applicant is given *permission* (other than those activities in articles 5, 10, 51 and 52 detailed above).

Note 2:

For the purposes of the *regulated activities* of *dealing in investments as principal* (article 14) and *dealing in investments as agent* (article 21), the definition of *contractually based investments* [expanded in Table 3] excludes a *funeral plan contract* (article 87) and rights to or interests in *funeral plan contracts*.

Note 3:

The *regulated activities* of *managing investments* (article 37) and *safeguarding and administering investments* (article 40) may apply in relation to any assets, in particular circumstances, if the assets being managed or safeguarded and administered include, or may include, any *security* or *contractually based investment*.

Note 4:

For the purposes of the *permission* regime, the activity in (j)(ii) of *advising on pension transfers and pension opt-outs* is carried on in respect of the following *specified investments*:

- *unit* (article 81);
- *stakeholder pension scheme* (article 82); and
- *life policy* (as defined in article 3(1)).

Note 5:

Article 4(2) of the *Regulated Activities Order* specifies the activities (m) to (p) for the purposes of section 22(1)(b) of the *Act*. That is, these activities will be *regulated activities* if carried on in relation to any property and are not expressed as relating to a *specified investment*.

Note 6:

Section 315 of the *Act* (The Society: authorisation and permission) states that the *Society of Lloyd's* has *permission* to carry on the *regulated activities* referred to in that section, one of which is specified in article 58 of the *Regulated Activities Order*. This *permission* is unique to the *Society of Lloyd's*.

4 Table**Table 2: Contracts of insurance**

Contract of insurance (article 75 of the RAO)

(a) *general insurance contract* (Part I of Schedule 1 to the *Regulated Activities Order*)

(b) *long-term insurance contract* (Part II of Schedule 1 to the *Regulated Activities Order*)

Number	<i>Accident</i> (paragraph 1)	<i>life and annuity</i> (paragraph I)
1	<i>Sickness</i> (paragraph 2)	<i>marriage and birth</i> (paragraph II)
2	<i>Land vehicles</i> (paragraph 3)	<i>linked long-term</i> (paragraph III)
3	<i>Railway rolling stock</i> (paragraph 4)	<i>permanent health</i> (paragraph IV)
4	<i>Aircraft</i> (paragraph 5)	<i>tontines</i> (paragraph V)
5	<i>Ships</i> (paragraph 6)	<i>capital redemption</i> (paragraph VI)
6	<i>Goods in transit</i> (paragraph 7)	<i>pension fund management</i> (paragraph VII)
7	<i>fire and natural forces</i> (paragraph 8)	<i>collective insurance</i> (paragraph VIII)
8	<i>damage to property</i> (paragraph 9)	<i>social insurance</i> (paragraph IX)
9	<i>motor vehicle liability</i> (paragraph 10)	
10	<i>aircraft liability</i> (paragraph 11)	
11	<i>liability of ships</i> (paragraph 12)	
12	<i>general liability</i> (paragraph 13)	
13	<i>credit</i> (paragraph 14)	
14	<i>suretyship</i> (paragraph 15)	
15	<i>miscellaneous financial loss</i> (paragraph 16)	
16	<i>legal expenses</i> (paragraph 17)	
17	<i>assistance</i> (paragraph 18)	
18		
Notes to Table 2		
Note 1		
See <i>IPRU(INS)</i> Ann 10.2, Part II for the groups of <i>classes of general insurance business</i> from the Annex to the <i>First Non-Life Directive</i> .		

5 Table

Table 3: Securities and contractually based investments	
Security (article 3(1)) <i>share</i> (article 76) <i>debenture</i> (article 77) <i>government and public security</i> (article 78) <i>warrant</i> (article 79) <i>certificate representing certain security</i> (article 80) <i>unit</i> (article 81) <i>stakeholder pension scheme</i> (article 82) <i>rights to or interests in investments</i> (article 89) in so far as they relate to any of the above categories of <i>security</i>	Contractually based investment (article 3(1)) <i>option</i> (article 83) For the purposes of the <i>permission</i> regime, <i>option</i> is subdivided into: <ul style="list-style-type: none"> • <i>option</i> (excluding a <i>commodity option</i> and an <i>option</i> on a <i>commodity future</i>); • <i>commodity option</i> and <i>option</i> on a <i>commodity future</i>. <i>future</i> (article 84) For the purposes of the <i>permission</i> regime, <i>future</i> is subdivided into: <ul style="list-style-type: none"> • <i>future</i> (excluding a <i>commodity future</i> and a <i>rolling spot forex contract</i>); • <i>commodity future</i>; • <i>rolling spot forex contract</i>. <i>contract for differences</i> (article 85) For the purposes of the <i>permission</i> regime, <i>contract for differences</i> is subdivided into: <ul style="list-style-type: none"> • <i>contract for differences</i> (excluding a <i>spread bet</i> and a <i>rolling spot forex contract</i>); • <i>spread bet</i>; • <i>rolling spot forex contract</i>. <i>life policy</i> (article 3(1)) <i>funeral plan contract</i> (article 87) [from 1 January 2002] <i>rights to or interests in investments</i> (article 89) in so far as they relate to any of the above categories of <i>contractually based investment</i> .

Notes to Table 3

Note 1:

Security and *contractually based investment* are not, in themselves, *specified investments* but are defined as including a number of *specified investments* as set out in Table 3.

Note 2:

For the purposes of the *regulated activities* of *dealing in investments as principal* (article 14) and *dealing in investments as agent* (article 21), the definition of *contractually based investments* excludes a *funeral plan contract* (article 87) and rights to or interests in *funeral plan contracts*.

Chapter 3

Applications for Part IV permission





3.1 Application and purpose

Application

3.1.1

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This chapter applies to:

- (1) an individual, a *body corporate* (including a *branch* of a *body corporate*), a *partnership* or an unincorporated association which is not an *authorised person* and which wishes to apply for *Part IV permission* to carry on *regulated activities* in the *United Kingdom*;
- (2) an *EEA firm* or a *Treaty firm* seeking to carry on *regulated activities* in the *United Kingdom* other than through the exercise of an *EEA right* or *Treaty right*;
- (3) an *EEA firm*, *Treaty firm* or *UCITS qualifier* wishing to apply for a *top-up permission* to carry on any *regulated activity*.

Purpose

3.1.2

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This chapter gives *guidance* to applicants on how the *FSA* will exercise the powers granted to it in Part IV of the *Act* (Permission to carry on regulated activities) to determine an application and give *Part IV permission*. In particular, the chapter gives *guidance* on:

- (1) *permission* under Part IV of the *Act*;
- (2) the procedures, under section 51 of the *Act* (Application under this Part), for making an application to the *FSA* for *Part IV permission*;
- (3) when and how the *FSA* will determine applications under section 52 of the *Act* (Determination of applications); and
- (4) when and how a *person* becomes *authorised* under the *Act*.



3.2 Introduction

3.2.1

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- (1) With certain exceptions (for example, *EEA firms*), a *person* wanting to carry on any one or more *regulated activities* must apply to the *FSA* for *Part IV permission*. If the *FSA* gives an applicant such *permission*, the applicant will become an *authorised person*.
- (2) *Authorisation* gives a *firm* the ability to carry on *regulated activities* without breaching the *general prohibition* and incurring criminal liability (see *AUTH 2.2.1G*). A *firm* may, however, be subject to regulatory action if it does not have the necessary *Part IV permission* for each *regulated activity* it carries on (see *AUTH 3.3.3G*).






3.2.2

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AUTH 3 Ann 1G gives an overview of the application process from receipt of the application by the *FSA*.



3.3 When is Part IV permission required and what does it contain?

- 3.3.1**  _{/1} A *person* will, broadly speaking, be treated as carrying on a *regulated activity* in the *United Kingdom* (and so, under section 20(1), need *permission*), where it is carried on in the circumstances described in AUTH 2.4 (Link between activities and the United Kingdom). A *Part IV permission* under Part IV of the *Act* is required before the person carries on *regulated activities* unless the *person* has *permission* resulting from any other provisions in the *Act* (see AUTH 2.10 (Persons carrying on regulated activities who do not need authorisation)).
- 3.3.2**  _{/1} Under section 20(1) of the *Act* (Requirement for permission), a *firm* must not carry on a *regulated activity* in the *United Kingdom* (or purport to do so) otherwise than in accordance with its *permission*.
- 3.3.3**  _{/1} Following a successful application to the *FSA*, an applicant will be given *Part IV permission*. The *Part IV permission* will specify all or some of the following elements:
- (1) a description of the activities the *firm* can carry on (see AUTH 3.4), including any *limitations* (see AUTH 3.6);
 - (2) the *specified investments* involved (see AUTH 3.5); and
 - (3) if appropriate, *requirements* (see AUTH 3.7).
- 3.3.4**  _{/1}
- (1) Section 42(6) of the *Act* (Giving permission) requires the *FSA* to describe the *regulated activities* for which a *firm* is given *Part IV permission*; this description may include *limitations* (see AUTH 3.6). The *Part IV permission* may also include *requirements* (see AUTH 3.7).
 - (2) After being given *Part IV permission*, a *firm* can apply at any time to have a *limitation* or a *requirement* varied or removed, following the procedures in SUP 6 (Application to vary or cancel Part IV permission).
- 3.3.5**  _{/1} Under section 51(3) of the *Act*, an application for *permission* must be made in such manner as the *FSA* directs (see AUTH 3.9.3D).

3.4 Activities

3.4.1

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- (1) The activities for which an applicant may apply for *Part IV permission* are listed in *AUTH 2 Ann 2G* (Regulated activities and the permission regime). The *FSA* has described these activities in the same way as *regulated activities* are specified in the *Regulated Activities Order* (see *AUTH 2.7* to *AUTH 2.8*) but with three sub-divisions.
- (2) The sub-divisions are that:
 - (a) *advising on pension transfers and pension opt outs* is a separate category from advising on other *investments*; this distinction has been made because *pension transfers* and *pension opt-outs* are considered to be transactions which are high risk to *consumers* and it is appropriate to differentiate advice on them from other forms of advice;
 - (b) *establishing, operating and winding up a collective investment scheme* has been sub-divided to distinguish *regulated collective investment schemes* from unregulated ones; this is because of the different regulatory requirements and risk characteristics of the two types of *scheme*; and
 - (c) *safeguarding and administering investments* has been divided into *safeguarding and administration of assets (without arranging)* and *arranging safeguarding and administration of assets*; this is because some *firms* arrange the provision of safe custody for *clients* instead of providing the facilities themselves.

3.4.2

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It should be noted that some combinations of *regulated activities* are restricted by other legislation, such as the *UCITS Directive* and the *Insurance Directives*. In addition, applicants seeking to carry on specified activities in certain business areas, for example, *ISA* management, will be required to demonstrate that they satisfy additional regulatory obligations. Details of these restrictions and obligations are in *AUTH 3.11* to *AUTH 3.17*.

3.4.3

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If an applicant is uncertain whether the *FSA* will give *Part IV permission* for a particular combination of activities, it should seek professional advice and discuss the matter with the *FSA* before making a formal application for *Part IV permission*. These discussions with the *FSA* will not be part of the formal application process.



3.5 Specified investments

3.5.1

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The *specified investments* for which an applicant may apply for *Part IV permission* are listed in *AUTH 2 Ann 2G*. In general, the *FSA* has described these *specified investments* in a way that mirrors the activities specified in the *Regulated Activities Order* (see *AUTH 2.6*). The *FSA* has, however, sub-divided certain *specified investments* in the *Regulated Activities Order* to distinguish those investments which, among other things, are considered to have significantly different risk profiles. These are:

- (1) *commodity futures* and *commodity options* and *options on commodity futures*, which have been distinguished from other *futures* and *options*;
- (2) *spread bets*, which have been distinguished from other *contracts for differences*; and
- (3) *rolling spot forex contracts*, which have been distinguished from other *contracts for differences* and *futures*.

3.6 Limitations

- 3.6.1** **G**_{/1} The FSA may include appropriate *limitations* in a description of the *regulated activities* in a *Part IV permission*.
- 3.6.2** **G**_{/1} Generally speaking, a *limitation* limits, in some way, a particular *regulated activity*. Unlike *requirements* (see AUTH 3.7), each *limitation* is specific to a particular *regulated activity* (either to the *specified activity*, the *specified investments* or both). This is why the *Act* refers to a *limitation* being incorporated within the actual description of the *regulated activity*.
- 3.6.3** **G**_{/1} As part of its application for *Part IV permission*, an applicant may wish to apply for certain *limitations* (details of which are given in the application pack). Alternatively, the FSA may impose a *limitation* where it considers it appropriate after reviewing the application. Examples of *limitations* which may be applied for or imposed include:
- (1) a limit on the types of *client* that a *firm* may deal with; this would be used either where an applicant's business plan makes it clear that it only intends to provide services for specific types of *clients* (for example, see AUTH 3.6.4G) or where the FSA wishes to limit the types of *clients* a *firm* can deal with; or
 - (2) a limit on the number of *clients* with whom a *firm* may carry on a particular *regulated activity* during, for example, an initial period of operation; this might be used where, for example, a *firm's* systems are not yet adequate to be able to process a high volume of transactions; or
 - (3) a limit on the types of *specified investments* that a *firm* can deal in; this would be used either where an applicant's business plan makes it clear that it only intends to provide services in respect of certain *specified investments* or where the FSA wishes to limit the categories of *specified investments* a *firm* can deal with; or
 - (4) a limit on the type of *insurance business* which a *firm* may carry on in connection with certain categories of *specified investments* for which *Part IV permission* may be granted; for example, a *limitation* specifying that only reinsurance business may be carried on in relation to certain *specified investments*; [note that for direct *insurance business*, the *Insurance Directives* restrict the ability of the FSA to impose *limitations* on an individual *class* of *specified investment*].
- 3.6.4** **G**_{/1} (1) In relation to the carrying on of *designated investment business* (and related *ancillary activities*, including *communication* and *approval* of related *financial promotions*), COB 4.1.4R (Requirement to classify) requires a *firm* to classify a *client* before conducting *designated investment business* with him or for him and that classification is relevant to the application of *Principles* 6,7,8 and 9. The classification of *clients* is used to apply appropriately differentiated market conduct and conduct of business provisions based on the expertise of the

different *clients*. An applicant may, therefore, wish to apply to carry on *designated investment business* in respect of one or more of the following classifications:

- (a) *private customer*;
 - (b) *intermediate customer*;
 - (c) *market counterparty*.
- (2) In practice, a *firm* may be permitted to carry on *regulated activities* that fall within the definition of *designated investment business* with one, or more, of these *client* categories.
- (3) As explained in *PRIN 1.2.4G*, a *firm* carrying on business other than *designated investment business* may choose to distinguish between *customers* and *market counterparties* in complying with the *Principles*. An applicant may, therefore, wish to apply to carry on business only with *market counterparties*.

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If, after reviewing an application, the *FSA* proposes to impose a *limitation*, the applicant will be advised formally (that is, the applicant will be sent a *warning notice*) and given an opportunity to make representations before the *FSA* reaches a final decision. For an overview of how the *FSA* determines applications and a summary of the *FSA*'s decision-making procedures, see *AUTH 8* (Determining applications).

3.6.6**G**
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After the *FSA* gives a *Part IV permission*, a *firm* can apply at any time to vary that *Part IV permission*, including any *limitation*, following the procedures set out in *SUP 6*.

3.7 Requirements

3.7.1

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- (1) Section 43 of the Act (Imposition of requirements) gives the *FSA* power to include any *requirements* in a *Part IV permission* that it considers appropriate. A *requirement* may be imposed on a *firm* to:
 - (a) take a particular action; or
 - (b) refrain from taking a particular action.
- (2) The *requirement* may extend to activities which are not *regulated activities* (for example, see *AUTH* 3.7.6G(3)) and the *FSA* may set a time at which the *requirement* expires.
- (3) As part of its application for *Part IV permission*, an applicant may wish to apply for certain *requirements* (details of which are given in the application pack).

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Generally speaking, a *requirement* will either be unrelated to the performance of *regulated activities* (for example, a *requirement* that relates to reporting) or will relate to all, or a number of, the *regulated activities* which an applicant wishes to carry on. This can be contrasted with a *limitation*, which is specific to one particular *regulated activity* (either to the *specified activity*, the *specified investments* or both), as in *AUTH* 3.6.

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- (1) *Requirements* can, among other things, be used by the *FSA* to control the performance of certain business activities which are not in themselves *regulated activities*; although in many cases a *firm* will require *permission* for a combination of *regulated activities* before the business activity can be carried on. The business activities controlled in this way are those which, in the interests of *consumer* protection, have certain minimum standards, for example in respect of the systems and controls required to meet regulatory or other obligations (for example, see the *client money rules* in *COB* 9.3).
- (2) As a result, applicants will be asked to specify as part of their application whether or not they wish to carry on business activities that include:
 - (a) the holding or controlling of *client money*; or
 - (b) *ISA* or *PEP* management; or
 - (c) operating an *investment trust savings scheme*; or
 - (d) management of a *broker fund*.
- (3) As part of demonstrating that it can satisfy and continue to satisfy the *threshold conditions* in respect of the *regulated activities* it wishes to carry on, an applicant will be expected to demonstrate that it is ready, willing and

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- organised to satisfy, and continue to satisfy, any relevant regulatory obligations that would apply to any business activities it wishes to carry on (for example, COB 9.3 (Client money)). An applicant that does not wish to engage in these activities should apply for a *requirement* to exclude performance of these activities from the scope of its *Part IV permission*.
- (1) A *requirement* can also be used by the FSA to define the scope of a number of *regulated* activities carried on by a *firm* so that a particular differentiated regulatory regime applies. Examples of such regimes include those for *locals*, *venture capital firms*, *corporate finance advisory firms* and *service companies*. Where this is relevant, an applicant may wish to apply for *Part IV permission* which includes a *requirement* defining the scope of each of its *regulated activities*.
 - (2) As an example, an applicant wishing to act as a *corporate finance advisory firm* may be given *Part IV permission* to carry on the activities of *advising on investments* and *arranging (bringing about) deals in investments*, subject to a *requirement* that the *firm* carries on these activities only within the definition of a *corporate finance advisory firm*.
 - (3) As part of the application pack, an applicant will be asked whether it wishes to apply for a *requirement* to define the scope of its *Part IV permission*. An applicant that applies for *Part IV permission* with a *requirement* to reduce the scope of that *permission* will only be required to demonstrate to the FSA that it is able to satisfy, and continue to satisfy, the *threshold conditions* in respect of the reduced scope.

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As part of the application process, an applicant will need to determine which prudential category it falls into and, in some cases, which sub-category (see AUTH 3.8.5G). In some cases, a *requirement* may form part of the description of such a category or sub-category, in which case the applicant may wish to apply for *Part IV permission* subject to appropriate *requirements*. The FSA may also impose a *requirement* on a *firm* to require it to comply with certain financial requirements (see SUP 7.4 (Individual requirements)).

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Examples of *requirements* which may be applied by the FSA in particular circumstances, include:

- (1) a *requirement*, imposed under section 48 of the Act (Prohibitions and restrictions), that a *firm* given *Part IV permission* obtain the approval of the FSA before payment of a dividend; or
- (2) a *requirement* to submit financial returns more often than normal, for example during the *firm's* first *months* or years of business; or
- (3) a *requirement* to submit audited financial accounts of a parent company; or
- (4) a *requirement*, on the *permission* of an *insurer*, to carry on only reinsurance business; or
- (5) a *requirement* to submit periodic independent compliance reviews, performed by an appropriate *person*, during the first *months* or years of business.

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If, after reviewing an application, the FSA proposes to impose a *requirement*, the applicant will be advised formally (that is, the applicant will be sent a *warning notice*) and given an opportunity to make representations before the FSA reaches a final decision. For an overview of how the FSA determines applications and a summary of the FSA's decision making procedures, see AUTH 8.

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Following the giving of a *Part IV permission*, a *firm* can apply, at any time, to vary that *Part IV permission*, including any *requirement* or *limitation*, following the procedures in *SUP 6*.



3.8 The threshold conditions and financial resources

The threshold conditions

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- (1) Under section 41(2) of the *Act* (The threshold conditions), the *FSA* is required, in giving *Part IV permission* or imposing any *requirement*, to ensure that the applicant satisfies, and will continue to satisfy, the *threshold conditions* in relation to all the *regulated activities* for which it has or will have *permission*. The *threshold conditions* are in Schedule 6 to the *Act*.
- (2) The *FSA* has provided *guidance* on the *threshold conditions* in *COND*. This guidance is not exhaustive and is written at a high level of generality as satisfaction of the *threshold conditions* is considered on a case-by-case basis, in relation to each *regulated activity* an applicant is seeking to carry on.

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- (1) There are five *threshold conditions* applying to a *firm* with *Part IV permission*:
 - (a) *threshold condition 1* (Legal status) sets out the legal status that the applicant must have if it wishes to carry on certain *regulated activities*;
 - (b) *threshold condition 2* (Location of offices) provides that:
 - (i) a *body corporate* constituted under the law of any part of the *United Kingdom* must have its head office and, if it has one, its registered office, in the *United Kingdom*; and
 - (ii) a non body corporate with its head office in the *United Kingdom* must carry on business in the *United Kingdom*;
 - (c) *threshold condition 3* (Close links) relates to the effect of close links on supervisability;
 - (d) *threshold condition 4* (Adequate resources) relates to the adequacy of an applicant's resources;
 - (e) *threshold condition 5* (Suitability) relates to the suitability of the applicant.
- (2) The last three *threshold conditions* enable the *FSA* to assess the applicant in the light of the activities it wishes to carry on and, in particular, make it clear that suitability to carry on one *regulated activity* does not mean that the applicant is suitable to carry on all *regulated activities*.
- (3) An *incoming firm* applying for a *top-up permission* must also satisfy the *threshold conditions* with the exception of *threshold condition 2* (Location of

offices): see *COND* 1.1 (Application) and paragraphs 6 and 7 of Schedule 6 to the *Act*.

- (4) The application of the *threshold conditions* to *Swiss general insurance companies* will be varied by an Order made by the Treasury under paragraph 8 of Schedule 6 to the *Act*.

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The *FSA*, in making a determination whether an applicant satisfies and will continue to satisfy the *threshold conditions* under section 41(2) of the *Act*, will consider whether an applicant can demonstrate that it is ready, willing and organised so as to enable it to comply with the specific regulatory obligations that will apply to the applicant if it is given *Part IV permission* to carry on the *regulated activities* referred to in its application.

Financial resources

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- (1) As part of its application, an applicant will be required to demonstrate that it has adequate financial resources to meet the financial resources requirement for its prudential category.
- (2) The *Single Market Directives* and the *Capital Adequacy Directive* set out minimum financial requirements for all *firms* which carry on banking, insurance or investment services within the scope of the *Single Market Directives*, that is, most *firms* that are *credit institutions*, *financial institutions*, *insurance undertakings* or *investment firms* as defined in these Directives. These requirements are reflected in the relevant *IPRU* for each type of *firm*.

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- (1) An applicant will need to determine its prudential category and, in some cases, its sub-category. The application pack and *AUTH* 3 Ann 2G give further details.
- (2) In determining its prudential sub-category, an applicant may need to consider whether it falls under the scope of a *Single Market Directive*, for example whether it will be an *investment firm* as defined in the *ISD*.
- (3) However, an applicant which falls outside the *Single Market Directives* will not have a right to passport into the *EEA* and will be subject to separate prudential requirements.

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An applicant in the prudential category of *bank* or *insurer* should note that the *FSA* will give it individual guidance on its likely capital requirements; for example, the trigger ratios for a *bank* (see *IPRU(BANK)* CO 4.1.1 (Trigger ratios)) or the capitalisation or solvency margin of an *insurer* (see *IPRU(INS)* 2 (Margins of solvency)) during pre-application discussions (see *AUTH* 3.9.2G).

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Applicants should note that the prudential category and, where relevant, sub-category, not only determines which provisions in the relevant *IPRU* will apply, but which provisions on auditors, financial reporting and transaction reporting in the *SUP* will apply.

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An applicant that is a member of a *group* should note that the *FSA* may take into consideration the impact of other members of the *group* on the adequacy of its resources (see the relevant *IPRU*).



3.9 Procedures in relation to applications for Part IV permission

Pre-application meetings

- 3.9.1** G_{/1} All applicants for *Part IV permission* are encouraged to contact the Corporate Authorisation department of the FSA to discuss their application before they send in an application form.
- 3.9.2** G_{/1}
- (1) If an applicant’s plans are complex (for example, including *insurance business* or *accepting deposits* and some *designated investment business*), high risk or innovative (for example, raising new or unusual issues), the FSA will expect the applicant to discuss its plans with them before submitting an application for *Part IV permission*.
 - (2) FSA staff will be available to attend a pre-application meeting with such applicants to discuss the application and any issues or problem areas. If appropriate, for example in the case of an application to carry on *insurance business* or *accepting deposits*, FSA staff may, by agreement with the applicant discuss aspects of the application during its preparation, for example, the applicant’s draft business plan or other relevant documentation. If relevant, FSA staff will discuss likely capital and, where relevant, liquidity ratios with the applicant to enable the applicant to prepare capital adequacy projections.
 - (3) Applicants should note that:
 - (a) a pre-application meeting is not a substitute for an applicant obtaining any professional assistance;
 - (b) a pre-application meeting is to give informal assistance to applicants (as set out in *AUTH 3.9.2G*). A meeting might, for example, be used to help an applicant prepare its formal application for *Part IV permission* and to identify and address issues or problem areas at an early stage before time and costs are incurred in preparing a complete application. This assistance is not part of the application process outlined in the rest of *AUTH 3.9*.
 - (c) the submission of an incomplete application will start the formal application process, including the time limits for determination of incomplete applications (see *AUTH 3.9.31G*) and the requirements for a fee (see *AUTH 3.9.4G(1)*).

The application for permission

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- (1) An applicant for *Part IV permission*, except in so far as the *FSA* may direct in an individual case, must apply in writing in the manner directed, and with the information required, in the application pack provided by the *FSA*.
- (2) The application for *Part IV permission* must be:
 - (a) given to a member of, or addressed for the attention of, the Corporate Authorisation department; and
 - (b) delivered to the *FSA* by one of the methods in (3).
- (3) The application may be delivered by:
 - (a) post to the address in (4);
 - (b) leaving the application at the address in (4) and obtaining a time-stamped receipt; or
 - (c) hand delivery to a member of the Corporate Authorisation department.
- (4) The address for applications is: The Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.
- (5) Until the application has been determined, an applicant which submits an application for *Part IV permission* must inform the *FSA* of any significant change to the information given in the application immediately it becomes aware of the change.

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- (1) An application should be accompanied by the application fee set by the *FSA* (see *AUTH* 4 [to be added]).
- (2) The application pack and accompanying guidance notes are available on www.fsa.gov.uk or from the Corporate Authorisation department of the *FSA*. To contact the Corporate Authorisation department:
 - (a) telephone on 020 7676 1000; or
 - (b) write to the Corporate Authorisation department at the address in *AUTH* 3.9.3D(4); or
 - (c) email corporate.authorisation@fsa.gov.uk.

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The application pack is made up of several sections and the ones which need to be completed will depend on the category of applicant. For example, the insurance sections will contain different application questions according to the type of applicant (for example, matters needing to be addressed vary for overseas applicants and *Swiss general insurance companies*). In addition, applicants will need to submit forms for *approved persons* (see *AUTH* 6 (Approved persons)) and *controllers* as part of the pack (see *AUTH* 3.9.24G).

Information to be supplied to the FSA

- 3.9.6** G_{/1} Under section 51(1)(b) of the *Act*, an application for *Part IV permission* must give an address in the *United Kingdom* for service of any document required by the *Act*.
- 3.9.7** G_{/1} The application forms ask for general information about the applicant, its intended activities and any proposed or current *unregulated activities*. They also ask for details of how the applicant plans to comply with the *FSA's* regulatory obligations relating to the activities it seeks *Part IV permission* to carry on. The forms contain notes on completion and details of how the *FSA* can help.
- 3.9.8** G_{/1} In addition to the information in the application pack, the *FSA* may require the applicant to provide such further information as it reasonably considers necessary to enable it to determine the application, and to verify it as the *FSA* directs. This may include the provision of documents. The *FSA* may request such additional information during a pre-application meeting or after reviewing a submitted application pack. Should the *FSA* require further information on reviewing an application pack, the applicant will be advised in writing as early as possible.
- 3.9.9** G_{/1} The *FSA* will assess the applicant having regard to the *regulatory objectives* and will, therefore, be proportional in its procedures, including in the information which it seeks from applicants (see *AUTH* 1.4.4G). Thus the nature of the information and documents requested by the *FSA*, either in the application pack or subsequently, will be proportional to the nature of the business the applicant intends to carry on. For example, a small company seeking to carry on low risk business will be required to submit a business plan and other information relevant to its size and the scope of the proposed business. Information which is requested from applicants as part of the application pack includes but is not limited to the following.
- (1) A business plan which describes the *regulated activities* and any *unregulated activities* (except where not permitted, for example see *AUTH* 3.12.2G) which the applicant proposes to carry on, the management and organisational structure of the applicant and details of any proposed outsourcing arrangements. The level of detail required in the business plan will be appropriate to the risks to *consumers* arising from the proposed *regulated* and *unregulated activities*. For an applicant seeking to carry on *insurance business*, the business plan should include a *scheme of operations* in accordance with *SUP* App 2 (Insurer and friendly societies: schemes of operation).
 - (2) Appropriately analysed financial budget and projections which demonstrate that the applicant expects to comply with the relevant financial resources requirements appropriate to the applicant's prudential category (and in some cases sub-category).
 - (3) Details of systems to be used (which do not have to be in place at the time of initial application), compliance procedures and documentation.
 - (4) Details of the individuals to be involved in running the proposed business (such as *directors*, *partners* and members of the *governing body*, all of whom will be performing *controlled functions*) and any *connected persons* (see *AUTH* 3.9.23G). *AUTH* 6 gives *guidance* on the *approved person* regime and the procedures for approval.
- 3.9.10** G_{/1} (1) The application pack should be accompanied by such other information as the applicant reasonably considers the *FSA* should be aware of for the purposes of determining the application. Any relevant supporting documentation should also be enclosed. The guidance notes to the application pack give further

details about information to be provided by applicants, to enable them to answer the questions.

- (2) In certain circumstances, the interests of the *customers* of an applicant would be significantly affected by the death or incapacity of an individual within the applicant. If this is the case, the applicant will be required to provide information on its arrangements to protect the interests of *customers* in that event. Examples include arrangements to enable urgent transactions to be carried out and unfinished transactions to be completed. The information should include the name and address, and such other details as the *FSA* may reasonably require, of an *authorised person* with whom arrangements have been made for the protection of *customers*. The guidance notes to the application pack give further details.

3.9.11 G_{/1} The application forms also require a statement from one or more members of the applicant’s *governing body* confirming, to the best of their knowledge, the completeness and accuracy of information supplied.

3.9.12 G_{/1} Applicants should be aware that there may be a delay in processing applications if the information given to the *FSA* is inaccurate or incomplete; for example, if the business plan for an applicant does not describe in adequate detail the *regulated activities* for which the applicant seeks *Part IV permission*. Applicants should discuss any problems with the Corporate Authorisation department before submitting the application or, if necessary, consider seeking appropriate professional advice.

3.9.13 G_{/1} At any time after receiving an application and before determining it, the *FSA* may give notice to the applicant to require it to provide additional information or documents. The circumstances of each application will determine what additional information or procedures are appropriate.

3.9.14 G_{/1} While applicants will often wish to discuss applications with the Corporate Authorisation department during the application process; similarly, the *FSA* will often need to discuss and clarify information that has been submitted within the application pack. The exchange of information during the application process is viewed as important by the *FSA*, since the final decision about an application needs to be based on as complete a picture of the application as possible.

3.9.15 G_{/1} In addition, in considering the application, the *FSA* may:

- (1) carry out any enquiries which it considers appropriate, for example, discussions with other regulators or exchanges;
- (2) ask the applicant, or any specified representative of the applicant, to attend meetings at the *FSA* to give further information and explain any matter the *FSA* considers relevant to the application;
- (3) require any information given by the applicant to be verified in such a way as the *FSA* may specify (for example, see *AUTH 3.9.16G*);
- (4) take into account any information which it considers appropriate in relation to the application, for example any *unregulated activities* which the applicant carries on or proposes to carry on;
- (5) visit the premises which the applicant intends to use as its place of business.

Reports from third parties

- 3.9.16** **G**_{/1} Under section 51(6) of the *Act*, the *FSA* may require the applicant to verify information provided in such a way as the *FSA* directs. Thus, as part of the application, the *FSA* may require the applicant to provide, at its own expense, a report by an auditor, *reporting accountant*, actuary or other qualified person approved by the *FSA*. The report may be on such aspects of the information provided, or to be provided, by the applicant as the *FSA* may specify.
- 3.9.17** **G**_{/1} Applicants seeking to carry on *long-term insurance business* are also required to provide a certificate from an *actuary* confirming the appropriateness of the projections for the *long-term insurance business* and, in particular, the adequacy of premium rates and technical provisions and *margin of solvency* and how quickly capital strains from effecting new business will be overcome.
- 3.9.18** **D**_{/1} If an applicant appoints a *reporting accountant* other than its own auditor to report on an application for *Part IV permission*, the applicant is directed to take reasonable steps to ensure that the *reporting accountant* satisfies the qualification and independence tests, as relevant, in *SUP 3.4* (Auditor’s qualifications) and *SUP 3.5* (Auditor’s independence).
- 3.9.19** **D**_{/1} If an applicant appoints an *actuary*, other than an *appointed actuary*, to report on an application for *Part IV permission*, the applicant is directed to take reasonable steps to ensure that the *actuary* satisfies the qualification tests in *SUP 4.3.8* (Appointed actuaries’ qualifications).
- 3.9.20** **G**_{/1} Occasionally, the *FSA* may identify a need for an independent report on specific areas of an application; for example, a report from the auditors of an applicant seeking to carry on *regulated activities* which include *accepting deposits* where the applicant’s business plan is innovative, complex or raises concerns as a result of matrix management. Such reports will usually be discussed and agreed with the applicant as part of the pre-application meeting (see *AUTH 3.9.2G*).

Applications to other bodies

- 3.9.21** **G**_{/1} In addition to applying to the *FSA* for *Part IV permission*:

 - (1) an applicant which will need permission from the *Council* of the *Society* of Lloyd’s to conduct business as *underwriting agents* should apply for that permission at the same time as its application to the *FSA*; and
 - (2) an applicant should also determine whether it needs to apply to any other bodies, for example, to any exchanges or to other bodies for membership, the Office of Fair Trading for a consumer credit licence or to court for licences such as a gaming licence; the applicant should check when any such applications should be made.

Connected persons

- 3.9.22** **G**_{/1} (1) Under section 49 of the *Act* (Persons connected with an application), in considering an application for *Part IV permission*, the *FSA* may have regard to any *person* appearing to it to be, or likely to be, in a relationship with the applicant which is relevant.

- (2) A *person* in, or likely to be in, a relationship with an applicant which is relevant is known as a *connected person*. The *FSA* will assess whether a particular relationship is relevant in the light of the particular circumstances of each application. Examples of *persons* who might be considered connected with an applicant include, but are not limited to:
 - (a) a *controller* of the applicant; or
 - (b) an applicant's *directors, partners* or members of its *governing body*; or
 - (c) a *company* in the same *group* as the applicant; or
 - (d) a *person* with whom the applicant intends to enter into a material outsourcing agreement; or
 - (e) any other *person* who may exert influence on the applicant which might pose a risk to the applicant satisfying or continuing to satisfy the *threshold conditions*.

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As a result, as part of the application process, the *FSA* may request information about any other *person* who the *FSA* determines is in a relationship with an applicant which is relevant. The *FSA* may request information from the applicant on *persons* who are *connected persons* or are likely to become *connected persons* under any proposed transactions or relationships.

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- (1) As part of the application process, the *FSA* may request information on an applicant's *controllers, directors, partners* or members of its *governing body*. The *FSA* will assess whether:
 - (a) the applicant's *controller* is a fit and proper *person* to have *control* over the *firm*;
 - (b) the applicant's *directors, partners* and members of the *governing body* who will be performing *controlled functions* are fit and proper *persons* to be granted approval under the *approved persons* regime (see *AUTH* 6).
- (2) An applicant (other than a *Swiss general insurance company* seeking to establish an agency or *branch* in the *United Kingdom* or an *EEA firm*, or a *Treaty firm* in the circumstances set out in *AUTH* 3.1.1(2) and (3)) will be required to provide the following information about its *controllers*:
 - (a) in the case of a *controller* who is not an *authorised person*, the information required in Controllers Form A (*SUP* 11 Ann 4D) and one or more of Controllers Form B (*SUP* 11 Ann 5D) in accordance with *SUP* 11.3.8D and *SUP* 11.3.9D; or
 - (b) in all other cases, the information required in Controllers Form A, sections 1, 5 and 6 (*SUP* 11 Ann 4D).

Commencing regulated activities

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- (1) If *Part IV permission* is given, the *FSA* will expect a *firm* to commence its *regulated activity* in line with its current business plan. Applicants should take this into consideration when determining when to make an application to the *FSA*.

- (2) Applicants should be aware that the *FSA* may exercise its *own-initiative powers* to vary or cancel a *Part IV permission* once granted if they do not:
 - (a) commence a *regulated activity* for which they have *Part IV permission* within a period of at least twelve months from the date the *permission* was given; or
 - (b) carry on a *regulated activity* for which they have *Part IV permission* for a period of at least twelve months (irrespective of the date of the grant of *permission*).
- (3) If *FSA* considers that it may be appropriate to exercise its *own-initiative powers* to vary or cancel a *firm's Part IV permission*, *FSA* staff will discuss the proposed action with the *firm* and ascertain the *firm's* reasons for not commencing or carrying on the *regulated activities* concerned. Applicants are advised to discuss any problems about commencing a *regulated activity* with the Corporate Authorisation department.

When will the FSA grant an application for Part IV permission?

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- (1) The *FSA* will assess the information provided in the application process. As noted in *AUTH* 3.8.1G, the *FSA* is required, by section 41(2) of the *Act*, to ensure that an applicant will satisfy, and continue to satisfy, the *threshold conditions* in relation to all the *regulated activities* for which the applicant is seeking *Part IV permission*. However, section 41(3) of the *Act* states that the *FSA's* duty under section 41(2) of the *Act* does not prevent it, having regard to that duty, from taking such steps as it considers necessary in relation to a particular applicant, to secure the *consumer protection* objective.
- (2) As part of the assessment of whether an applicant satisfies and will continue to satisfy the *threshold conditions*, the *FSA* will consider whether the applicant is ready, willing and organised to comply with the regulatory requirements to which it will be subject if it is granted *Part IV permission* to carry on the *regulated activities* referred to in its application.
- (3) The *FSA* will give *Part IV permission* in respect of some categories of *regulated activity* only if the applicant can meet specific requirements. For example, *Part IV permission* including *advising on pension transfers* and *pension opt-outs* will only be granted to applicants that will have *persons* (or individuals) qualified to advise in this area.

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As noted in *AUTH* 3.6 and *AUTH* 3.7, the *FSA* may decide to grant an application for *Part IV permission* including appropriate *limitations* or *requirements*. Where the *FSA* imposes *limitations* or *requirements* on a *Part IV permission* that were not applied for by the applicant, their precise nature will depend on the circumstances of each application. During the application process, the *FSA* will discuss with applicants any *limitations* or *requirements* it is considering imposing but which they have not applied for. The applicant may ask the *FSA* to reconsider its preliminary views on any such *limitations* or *requirements* in the course of the application process.

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In some cases, the *FSA* would be minded to grant an application for *Part IV permission* as long as certain conditions are fulfilled. As an example, the *FSA* may advise an applicant that it is minded to grant its application subject to the applicant providing proof that its share capital or its required financial resources are in place or that it has satisfied an outstanding element of its business plan. *Part IV*

permission will not, however, be given until the *FSA* is content that its conditions have been satisfied by the applicant and, as a result, the applicant satisfies the *threshold conditions*. Applicants are welcome to discuss with the Corporate Authorisation department the circumstances in which the *FSA* may be prepared to determine an application subject to such conditions.

Other powers relating to the scope of Part IV permission

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- (1) In determining an application for *Part IV permission*, the *FSA* may:
 - (a) specify a narrower or wider description of *regulated activity* than that for which *Part IV permission* was originally sought; or
 - (b) give *Part IV permission* for a *regulated activity* which was not originally applied for.
- (2) Occasionally, the *FSA* expects to use its power to give *Part IV permission* for an applicant to carry on a *regulated activity* for which it did not originally apply. This might happen when, as a result of correspondence and discussion with an applicant, it becomes clear that it needs *Part IV permission* to carry on different categories of activities or activities relating to different categories of *specified investments* than those it had originally applied for.
- (3) The *Insurance Directives* set out minimum information requirements for an application for *authorisation* which include information on the *specified investments* the applicant proposes to deal in. If these requirements are not met, the *FSA* may not be able to use the power described in *AUTH* 3.9.29G(1)(b).

How long will an application take?

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- (1) Under Part IV of the *Act*, the *FSA* has six months from the date of receipt of a completed application to make its determination.
- (2) When the *FSA* receives an application which is incomplete, that is, when information or documents required to be submitted as part of the application are not provided, Part IV of the *Act* requires the *FSA* to determine that incomplete application, in any event, within twelve months of the initial receipt of the application.
- (3) Within these time limits, however, length of the process will relate directly to the complexity of the application. The *FSA* publishes standard response times on its web site at www.fsa.gov.uk, setting out how long the application process is expected to take in practice, and, from time to time, the *FSA* publishes its performance against these times.
- (4) Unless it considers it is appropriate to do so, the *FSA* will not grant an application for *Part IV permission* until it has had the opportunity to review all the information and documents which it has requested in connection with the application (whether as part of the application or at a later date).

How will FSA make the decision?

3.9.31

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AUTH 8 (Determining applications) gives an overview of how the *FSA* will determine an application. The *FSA*'s decision making procedures are in *DEC* and include the procedures the *FSA* will follow if it proposes to refuse an application for *Part IV permission* or grant an application subject to *limitations* or *requirements* not applied for.

Withdrawal of applications

3.9.32

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An applicant may withdraw its application at any time before the application is granted or refused by giving written notice to the *FSA*. This written notice should be signed by a *person* with appropriate authority to bind the applicant.

Authorised status

3.9.33

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- (1) The *Act* states that an applicant which does not qualify for automatic *authorisation* by, or under, the *Act*, becomes *authorised* automatically if the *FSA* grants it *Part IV permission*.
- (2) When the *FSA* grants an application for *Part IV permission*, it will inform the applicant by written notice, stating the date on which the *permission* takes effect.



3.10 The FSA register

3.10.1

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- (1) Section 347 of the *Act* (The record of authorised persons etc) requires the *FSA* to maintain a public record containing certain details about all *firms*, including information as to the services they hold themselves out as able to provide.
- (2) When the *FSA* grants an application for *Part IV permission*, it will update the *FSA register* with a general description of the *regulated activities* the *firm* has *permission* to carry on.
- (3) The *FSA* register can be accessed at www.fsa.gov.uk.



3.11 Specific obligations: partnerships or unincorporated associations

3.11.1

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Section 32 of the *Act* (Partnerships and unincorporated associations) treats *partnerships* and unincorporated associations as if they were legal *persons* for the purposes of the grant of *Part IV permission*. So all *partnerships* or unincorporated associations should make an application for *Part IV permission* in the name of the *partnership* or unincorporated association.

3.11.2

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- (1) Once a *partnership* or an unincorporated association is *authorised* by the *FSA*, then under section 32 of the *Act*:
 - (a) it is *authorised* to carry on the *regulated activities* concerned in the name of the *partnership* or unincorporated association; and
 - (b) its *authorisation* is not affected by any change in its membership as long as the substantive continuity test described in (2) is met.
- (2) If a *partnership* or unincorporated association is dissolved, its *authorisation* continues to have effect in relation to any *partnership* or unincorporated association which succeeds to the business of the dissolved *partnership* or unincorporated association, as long as:
 - (a) the members of the resulting *partnership* or unincorporated association are substantially the same as those of the dissolved *partnership* or unincorporated association; and
 - (b) the succession is to the whole or substantially the whole of the business of the dissolved *partnership* or unincorporated association.

3.11.3

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The treatment of *partnerships* described in *AUTH 3.11.1G* and *AUTH 3.11.2G* does not apply to a partnership which is a *body corporate*, that is, a *limited liability partnership* or any other partnership which is a *body corporate* and is constituted under the law of any place outside the *United Kingdom*.



3.12 Specific obligations: applicants seeking to carry on insurance business

3.12.1 G_{/1} Under *threshold condition* 1 (Legal status) (see *COND*) and additional restrictions imposed under the *Insurance Directives*, an applicant seeking *Part IV permission* to carry on the *regulated activities* of *effecting* or *carrying out contracts of insurance* must be an incorporated *company*, a *registered friendly society* or a registered industrial and provident society.

3.12.2 G_{/1} An applicant seeking to carry on *insurance business* should note the restrictions in *IPRU(INS)* 1.3R(1) and *IPRU(FSOC)* [to be finalised] which relate to the carrying on of other commercial business.

3.12.3 G_{/1}

- (1) As a result of these restrictions, the *FSA* will grant an applicant seeking to carry on *insurance business Part IV permission* for *insurance business*, and any other *regulated activities*, only to the extent they are not restricted under *IPRU(INS)* and *IPRU(FSOC)*.
- (2) For example, it may be appropriate for an applicant to apply for the *regulated activity* of *accepting deposits*. Also, an applicant seeking to carry on *long-term insurance business* may need to apply for certain *designated investment business* activities arising directly from the *long-term insurance business* it proposes to carry on. If the *FSA* gives an applicant *Part IV permission* for *insurance business* and other *regulated activities*, these other *regulated activities* will be subject to *limitations*, as appropriate, so as to comply with *IPRU(INS)* 1.3R(1) and *IPRU(FSOC)*.

3.12.4 G_{/1} Applicants should also be aware that the *FSA* will not grant *Part IV permission* to carry on both long-term and general *insurance business*, unless:

- (1) the applicant’s business will be restricted to reinsurance; or
- (2) the applicant’s general *insurance business* will be restricted to accident or sickness contracts (or both).

Friendly societies and reinsurance

3.12.5 G_{/1} *Friendly societies* are subject to the conditions and restrictions on reinsurance business under the Friendly Societies Act 1974 (*registered friendly societies*) and the Friendly Societies Act 1992 (*incorporated friendly societies*). A *registered friendly society* or an *incorporated friendly society* may only *effect* and *carry out* contracts of reinsurance if the conditions and restrictions set out in the relevant Friendly Societies Act are met. These include that:

- (1) the approval of the *actuary* of the *friendly society* (A) is required;

- (2) the *friendly society* is carrying on (and continues to carry on) direct *insurance business* of the same *class*; and
- (3) the reinsurance is provided only to another *friendly society* (B).

The FSA will, therefore, not grant a *friendly society* a *Part IV permission* to carry on pure reinsurance business.

Contracts written on an ancillary and supplementary basis

3.12.6 G_{/1} *Part IV permission* to effect or carry out certain *classes* of *contracts of insurance* includes *permission* to effect or carry out certain *classes* of *general insurance contracts* on an ancillary or supplementary basis. In applying for *Part IV permission* to carry on *insurance business*, applicants will need to determine the *specified investments* for which *Part IV permission* will be necessary, having regard to whether certain *classes* of contract may qualify to be effected or carried out on an ancillary or supplementary basis. If they do, there is no need to apply for *Part IV permission* to *effect* or *carry out* those contracts (that is, the contracts which are eligible to be effected or carried out on an ancillary or supplementary basis) and an applicant should not do so.

3.12.7 G_{/1} *Part IV permission* to effect or carry out *life and annuity* contracts includes *permission* to effect or carry out *accident* or *sickness* contracts (or both) on a supplementary basis (see article 1(1)(c) of the *First Life Directive*).

3.12.8 G_{/1} *Part IV permission* to *effect* or *carry out* any class of *general insurance contract* includes *permission* to effect or carry out any other *class* of *general insurance contract* on an ancillary basis other than *credit*, *suretyship* or, except as provided in AUTH 3.12.9G, *legal expenses* insurance (see part C of the Annex to the *First Non-Life Directive*). However, a *friendly society* may not effect or carry out any *general insurance contracts*, whether or not on an ancillary basis, other than those permitted under the Friendly Societies Act 1992.

3.12.9 G_{/1} *Part IV permission* to effect or carry out any *class* of *general insurance contract* includes *permission* to *effect* or *carry out* *legal expenses* contracts when AUTH 3.12.10G is met and:

- (1) if the main risk relates solely to the provision of assistance provided for *persons* who fall into difficulties while travelling, while away from home or while away from their permanent residence; or
- (2) where it concerns disputes or risks arising out of, or in connection with, the use of sea-going vessels.

3.12.10 G_{/1} A *contract of insurance* will qualify to be effected or carried out on an ancillary basis if:

- (1) the business in question is to be the subject of the same contract as the principal business and concerns the same object; and
- (2) the risks covered are connected to the principal risk.

3.12.11 G_{/1} In determining the *classes* of *specified investments* for which *Part IV permission* is required, and those which may qualify to be written on an ancillary or supplementary basis, an applicant may need to take professional advice and may

also wish to discuss this with a member of the Corporate Authorisation department.

- 3.12.12 G_{/1} The application for *Part IV permission* will need to provide information about the *insurance business* to be carried on by the applicant in the *classes of specified investments* for which *Part IV permission* is requested and also that qualifying to be carried on on an ancillary or supplementary basis.

Reporting requirements

- 3.12.13 G_{/1} An applicant for *Part IV permission* which includes *insurance business* should be aware that specific reporting requirements apply during its first three years of operation (see *SUP App 2*)

Applicants seeking to carry on insurance business with a head office outside the United Kingdom (other than EEA firms or Treaty firms)

- 3.12.14 G_{/1} In addition to *AUTH 3.18*, where an applicant for *Part IV permission* which has its head office outside the *United Kingdom* seeks to carry on *insurance business* in the *United Kingdom*, the following guidance is of relevance.
- 3.12.15 G_{/1} An applicant which has its head office outside the *United Kingdom* (other than an *EEA firm*, *Treaty firm* or a *Swiss general insurance company*) should note the requirement in *IPRU(INS) 8.10R* to appoint a *chief executive* (that is, the *person* who alone or jointly with one or more others, is responsible for the conduct of its business in the *United Kingdom*) and an *authorised UK representative*.
- 3.12.16 G_{/1} A *Swiss general insurance company* seeking to establish a *branch* in the *United Kingdom* should note the requirement in *IPRU(INS) 8.11R* to appoint an *authorised UK representative* for the *United Kingdom*.
- 3.12.17 G_{/1} An applicant with its head office outside the *United Kingdom* (other than an *EEA firm* or a *Treaty firm*) seeking *permission* to carry on direct or both direct and reinsurance business in the *United Kingdom* should note that specific prudential requirements apply (see *IPRU(INS)*).



3.13 Specific obligations: applicants seeking to carry on the regulated activity of accepting deposits

3.13.1

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Under *threshold condition 1* (Legal status), an applicant who seeks to carry on the *regulated activity of accepting deposits* must be either a *body corporate* or a *partnership* (see COND).



3.14 Specific obligations: applicants seeking to hold or control client money

3.14.1

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Unlike *safeguarding and administering assets*, holding or controlling *client money* is not a *regulated activity* in the *Regulated Activities Order*. As in AUTH 3.7.3G, the FSA controls this activity by using *requirements* on a *firm's Part IV permission*.

3.14.2

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- (1) An applicant seeking to hold or control *client money* must complete the relevant sections of the application forms for *Part IV permission*. The applicant must be able to demonstrate to the FSA that it can satisfy, and continue to satisfy, the *threshold conditions* (see AUTH 3.8.1G to AUTH 3.8.3G) should the application for *Part IV permission* be granted. This will include demonstrating that it is ready, willing and organised to comply with the relevant requirements in COB 9.3 (Client money).
- (2) If an applicant is not able to demonstrate to the FSA that it can satisfy, and continue to satisfy, the *threshold conditions* to hold or control client money, but its application for *Part IV permission* is granted, the FSA will impose a *requirement* on the *permission* to the effect that the *firm* will not be able to hold, or control, *client money*.



3.15 Specific obligations: applicants seeking to manage PEPs or ISAS

- 3.15.1** **G**
/1 Management of PEPs and ISAs, in themselves, are not *regulated activities* in the *Regulated Activities Order* although the activities carried on by a *firm* in relation to PEP and ISA management constitute *regulated activities*. As a result, where the *firm* has *Part IV permission* which includes the *regulated activities* which would otherwise permit the *firm* to manage a PEP or an ISA, the FSA controls participation in these activities by using *requirements* on the *firm's permission* (see AUTH 3.7.3G).
- 3.15.2** **G**
/1 (1) An applicant seeking to manage PEPs or ISAs must complete the relevant sections of the application forms for *Part IV permission*, specifying the types of ISA and their constituent components which it intends to manage. An applicant should check that the *regulated activities* for which it is seeking *permission* will permit it to carry on the proposed activities in respect of the component concerned (for example, one of the sub categories of *safeguarding and administering assets* of the component includes equities) and:

 - (a) consider whether it needs to hold or control *client money* (see AUTH 3.14) if it has not applied for *permission* including *accepting deposits*; or
 - (b) have plans to put in place contractual provisions under which it will receive *client money* as agent for an *approved bank* so that any loss in relation to the *ISA cash component* will be compensated for by that *approved bank* or the *compensation scheme*.

(2) Cash ISAs raise particular issues. Applicants may find it helpful to seek an independent legal opinion on their proposals before they proceed and may wish to discuss their proposals with the FSA.
- 3.15.3** **G**
/1 Applicants should also be aware that a *firm* wishing to act as an ISA or PEP manager will have to obtain approval from the Inland Revenue as an account manager under the Inland Revenue regulations.
- 3.15.4** **G**
/1 To manage ISAs or PEPs, an applicant must be able to demonstrate to the FSA that it can satisfy and continue to satisfy the *threshold conditions* should the application for *Part IV permission* be granted. This will include demonstrating that it is ready, willing and organised to comply with the relevant regulatory and Inland Revenue requirements.
- 3.15.5** **G**
/1 If an applicant is not able to demonstrate to the FSA that it is able to comply with those obligation, the FSA will impose a *requirement* on the *firm's permission* to the effect that the *firm* will not be able to manage PEPs or ISAs.



3.16 Specific obligations: applicants seeking to establish, operate or wind up a stakeholder pension scheme

3.16.1

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Applicants should be aware that, in addition to requiring *permission* from the FSA to *establish, operate or wind up a stakeholder pension scheme*, a *firm* will need to obtain exempt approval of the *stakeholder pension scheme* from the Inland Revenue and to register the scheme with the Occupational Pensions Regulatory Authority.

3.16.2

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Establishment and operation of a *stakeholder pension scheme* may involve heavy investment in new systems or changes to existing systems which, in view of the limit on charges, might not be recovered for some time. So, the FSA will normally require an applicant wishing to *establish, operate or wind up a stakeholder pension scheme* to provide financial projections for the whole period up to the point at which the new business is expected to break even. The applicant must also be able to demonstrate to the FSA that it is ready, willing and organised to comply with the requirements (including those in COB 5, COB 6 and TC 2) applicable to operation of a *stakeholder pension scheme*.



3.17 Specific obligations: applicants seeking to establish a collective investment scheme or to act as manager of a regulated collective investment scheme

- 3.17.1** G_{/1} An applicant seeking to *establish a collective investment scheme* should consult *CIS* for detailed requirements and *guidance*.
- 3.17.2** G_{/1} Applicants seeking to establish a *collective investment scheme* or to act as *manager* of a *regulated collective investment scheme* should note the *rule* in *CIS* 6.5, which implements article 6 of the *UCITS Directive* and restricts the activities of a manager of an *authorised unit trust* which is a *UCITS scheme*.
- 3.17.3** G_{/1} An applicant which wishes to act as *manager* of an *authorised unit trust* which is a *UCITS scheme* should note the restriction on the activities it may engage in (see *CIS* 16.5 (Managers of UCITS Schemes)).
- 3.17.4** G_{/1} A *firm* which is subject to the rule in *CIS* 6.5 may, however, carry on 'connected activities' referred to in *CIS* 6.5, which include management of *PEPs*, *ISAs* and *stakeholder pension schemes*, as long as they are dedicated to investments in unit trusts and *OEICs* for which the *firm* acts as manager or *ACD*. The Corporate Authorisation department would be pleased to discuss any other activities which potential applicants consider may be connected.



3.18 Specific obligations: additional considerations for applicants (other than EEA firms or Treaty firms) with a head office in a country or territory outside the United Kingdom seeking to establish a branch in the United Kingdom

- 3.18.1** **G**_{/1} This section applies to applicants identified in *AUTH* 3.1.1G(1) (excluding a *Swiss general insurance company*). The exercise of *EEA rights* or *Treaty rights* by *EEA firms* or *Treaty firms* is dealt with separately in *AUTH* 5.
- 3.18.2** **G**_{/1} The *FSA* must always assess whether an applicant for *Part IV permission* as a whole will satisfy, and continue to satisfy, the *threshold conditions*. This applies even though an applicant for *Part IV permission* may have its head office outside the *United Kingdom*. In other words, the *FSA* will not just assess the circumstances of any proposed *branch* in the *United Kingdom*. In making this assessment of the applicant for *Part IV permission* as a whole, the *FSA* will take into account all relevant matters, including the extent to which the applicant is regulated in its home state. The *FSA* would seek to liaise with any home state regulator and would take into account information from it with respect to, for example, the adequacy of the applicant’s resources and the applicant’s suitability, having regard to the need to ensure that the applicant’s affairs are conducted soundly and prudently. Information with respect to the conduct of the applicant’s affairs would extend in particular to the adequacy of the internal control systems under *SYSC*.
- 3.18.3** **G**_{/1} The *FSA*’s regulatory requirements, including *IPRU*, will apply to a *firm* in full and worldwide, unless otherwise stated. Where necessary, waivers, *limitations* and *requirements* will be used to ensure that appropriate prudential requirements apply to the *branch*, taking into account the home state supervisory arrangements and the particular circumstances of an applicant.
- 3.18.4** **G**_{/1} If the *FSA* considers that the applicant may be unable to satisfy the *threshold conditions* and that this cannot be addressed by the use of *limitations* and *requirements*, the *FSA* would have to conclude that a *branch* presence in the *United Kingdom* would be inappropriate. In such circumstances, the applicant may wish to consider forming a *UK* incorporated subsidiary as an alternative method of obtaining a presence in the *United Kingdom*.



3.19 Specific obligations: applications in connection with group-restructuring

- 3.19.1** G_{/1} Where an application for *Part IV permission* is to be made as part of the restructuring of a *group* which includes, or will include, one or more *firms*, the *group's* plans should be discussed with the supervisor or lead supervisor for the *group* at the *FSA*. This is particularly important where a group intends to transfer business into a new entity from a *firm* in its group and then wishes to apply for cancellation of that *firm's Part IV permission*.
- 3.19.2** G_{/1} The application for *Part IV permission* for the new entity should be submitted to the Corporate Authorisation department with details of the *group* and any business the *group* proposes to transfer. Applicants should note that particular requirements apply to transfers of *insurance business*, or if the business includes *accepting deposits*.
- 3.19.3** G_{/1} If applications for *Part IV permission* and for cancellation of *Part IV permission* (see *SUP 6*) have been submitted, then Corporate Authorisation will liaise with the lead supervisor, who will liaise with the *group* in respect of its applications. Although the *group* will need to obtain *Part IV permission* for the new entity first, the *FSA* will endeavour to process, if possible, the other applications at the same time.
- 3.19.4** G_{/1} Statutory procedures apply to the transfer of *insurance business* or banking business (see *SUP X* [to be added later]).



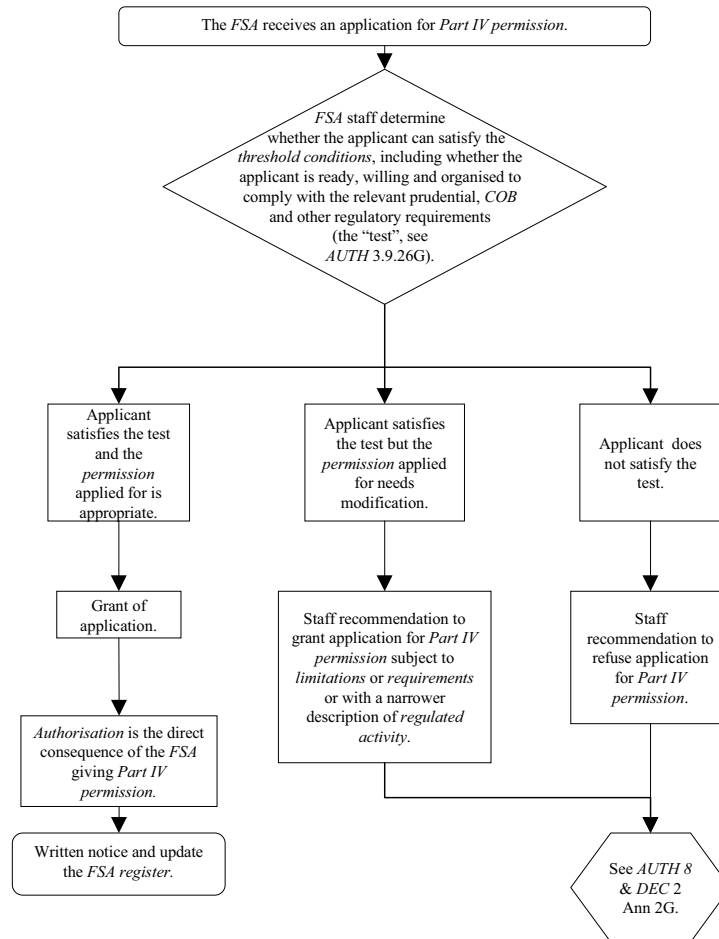
3.20 Specific obligations: applicants seeking to establish a branch in, or provide services into, another EEA State

- 3.20.1** **G**_{/1} Certain *firms* (known as *UK firms*) may establish *branches* in, or provide *cross border services* into, other *EEA States* exercising rights under one of the *Single Market Directives* (this is often referred to as *passporting*). A *firm* may also have rights under the *Treaty*.
- 3.20.2** **G**_{/1} An applicant for *Part IV permission* that wishes, if the *FSA* grants the *permission*, to passport into another *EEA State* on, or shortly after, being given *permission*, is advised to contact the Corporate Authorisation department to discuss its plans (see *AUTH 3.9.4G(2)* for contact details).
- 3.20.3** **G**_{/1}

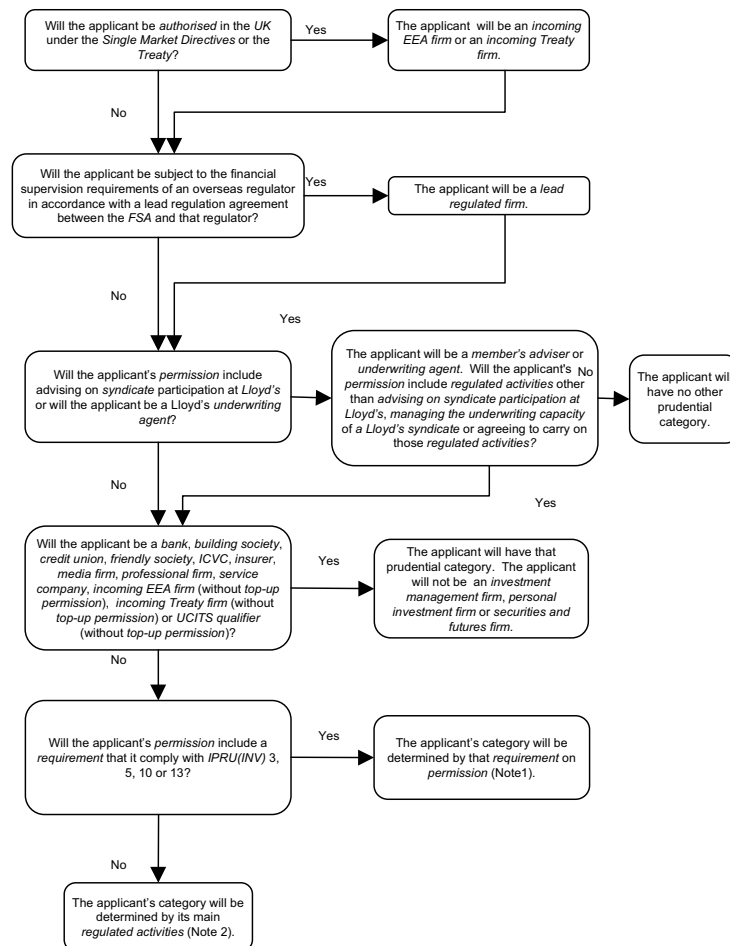
 - (1) *SUP 13* (Exercise of passport rights by *UK firms*) gives *guidance* on the procedures to be followed by a *UK firm* to establish a *branch* in, or provide *cross border services* into, another *EEA State*. *SUP 13 Ann 3G* contains *guidance* on the *Single Market Directives*, including *guidance* on which *firms* are entitled to passport.
 - (2) *CIS 2.3.4G* gives *guidance* when an *operator* of a *UCITS* wishes to market its scheme in another *EEA State*.
 - (3) *Firms* wishing to exercise rights under the *Treaty* in another *EEA State* should seek *guidance* from the *FSA* in the first instance.
- 3.20.4** **G**_{/1} An applicant may submit a separate *notice of intention* to passport (see *SUP 13.6.4R* and *SUP 13.7.3R*) with its application for *Part IV permission*. The *notice of intention* will be reviewed with the application for *Part IV permission*. The *FSA* is not, however, able to issue a *consent notice* (see *SUP 13.6.10G*), or send a *notice of intention* (see *SUP 13.7.9G*), to the relevant *Host State regulators* unless or until an applicant is *authorised*. As a result, an applicant seeking to establish a *branch* in another *EEA State* will not be able to satisfy the conditions in the *Act* for establishing a *branch* (see *SUP 13.6.2G*) until after *authorisation*.
- 3.20.5** **G**_{/1} An applicant should note, however, that the business plans and financial projections and, where relevant, *scheme of operations* submitted with its application for *Part IV permission* should reflect any *passported activity* (and any *branches* outside the *EEA*) that the *firm* plans to commence in the immediate future.

Application for Part IV Permission

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Determination of an applicant's prudential category



Applications for Part IV permission

1 Table Note 1

CHAPTER OF <i>IPRU(INV)</i> THAT REQUIREMENT ON PERMISSION REQUIRES THE FIRM TO COMPLY WITH	FIRM'S PRUDENTIAL CATEGORY
Chapter 3	<i>Securities and futures firm</i>
Chapter 5	<i>Investment management firm</i>
Chapter 10	<i>Securities and futures firm</i>
Chapter 13	<i>Personal investment firm</i>

2 Table Note 2

The table below shows how a *firm's* main *regulated activities* determine its prudential category. A *firm's* 'main *regulated activities*' in this context are the *regulated activities* included in the *firm's Part IV permission* from which the *firm* derives or is expected to derive the most substantial part of its gross income, including *commissions*. The aggregate gross income from all of the activities listed against each prudential category should be considered to determine which source is the most substantial.

The gross income is based on the business plan submitted as part of the *firm's* application for a *Part IV permission*.

3 Table

ACTIVITIES FROM WHICH THE MOST SUBSTANTIAL PART OF THE FIRM'S GROSS INCOME, INCLUDING COMMISSIONS, FROM REGULATED ACTIVITIES IS DERIVED	FIRM'S PRUDENTIAL CATEGORY
(i) <i>Managing investments</i> other than for <i>private customers</i> or where the assets managed are primarily <i>derivatives</i> ;	<i>Investment management firm</i>
(ii) <i>OPS activity</i> ;	
(iii) acting as the <i>manager</i> or <i>trustee</i> of an <i>AUT</i> ;	
(iv) acting as the <i>ACD</i> or <i>depository</i> of an <i>ICVC</i> ;	
(v) <i>establishing, operating or winding-up</i> a <i>collective investment scheme</i> other than an <i>AUT</i> or <i>ICVC</i> ; and	
(vi) <i>safeguarding and administering investments</i> .	

ACTIVITIES FROM WHICH THE MOST SUBSTANTIAL PART OF THE FIRM'S GROSS INCOME, INCLUDING COMMISSIONS, FROM REGULATED ACTIVITIES IS DERIVED	FIRM'S PRUDENTIAL CATEGORY
(i) <i>Advising on investments, or arranging (bringing about) deals in investments in relation to, packaged products; and</i> (ii) <i>managing investments for private customers.</i>	<i>Personal investment firm</i>

4 Table

ACTIVITIES FROM WHICH THE MOST SUBSTANTIAL PART OF THE FIRM'S GROSS INCOME, INCLUDING COMMISSIONS, FROM REGULATED ACTIVITIES IS DERIVED	FIRM'S PRUDENTIAL CATEGORY
(i) <i>An activity carried on as a member of an exchange;</i> (ii) <i>making a market in securities or derivatives;</i> (iii) <i>corporate finance business;</i> (iv) <i>dealing, or arranging (bringing about) deals in investments, in securities or derivatives;</i> (v) <i>the provision of clearing services as a clearing firm;</i> (vi) <i>managing investments where the assets managed are primarily derivatives; and</i> (vii) <i>activities relating to spread bets;</i>	<i>Securities and futures firm</i>

Chapter 6.

Approved persons

6.

6.1 Application and purpose

Application

6.1.1

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This chapter applies to:

- (1) a *person* who wishes to become an *authorised person* under the *Act* and who is, or is considering, applying to the *FSA* for *Part IV permission* to carry on *regulated activities* in the *United Kingdom*;
- (2) an *EEA firm*, a *Treaty firm* or a *UCITS qualifier* that wishes to establish a *branch* or provide *cross-border services* into the *United Kingdom* using *EEA rights*, *Treaty rights* or *UCITS Directive rights*, or apply for a *top-up permission*; and
- (3) a *candidate*.

6.1.2

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An *EEA firm*, a *Treaty firm* and *UCITS qualifier* should refer to *SUP 10.1 (Application)* for the special application of the *approved persons* regime to *firms* which are exercising their *passport rights*, *Treaty rights* or rights as a *UCITS qualifier*.

6.1.3

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In this chapter, references to a '*firm*' should be read as including an applicant for *Part IV permission*, or an *EEA firm* a *Treaty firm* or a *UCITS qualifier*, unless the context otherwise requires.

Purpose

6.1.4

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This chapter gives *guidance* on the provisions of the *Act* and the *Handbook* under which a *firm* must obtain the prior approval of certain *persons* to perform *controlled functions* on its behalf.

6.2 Introduction

- 6.2.1** **G**_{/1} A *controlled function* is a function specified by the FSA which cannot be performed by a *person* under an *arrangement* entered into by a *firm*, or one of its contractors, until approval for this has been given by the FSA. Approval from the FSA is required for each *controlled function* to be performed by a *person*.
- 6.2.2** **G**_{/1} An *approved person* is a *person* whose performance of one or more *controlled functions* has been approved by the FSA.
- 6.2.3** **G**_{/1} A *person* who performs a *controlled function* is likely to be an individual, but in some cases the function may be performed by others, such as a *body corporate*. References to a *person* in this chapter, and the rest of the *Handbook*, should always be read as including these other entities.
- 6.2.4** **G**_{/1} This regime covers *persons* who perform *controlled functions* in the capacity of an *appointed representative* or an employee of such an *appointed representative*. For further details on *appointed representatives*, see SUP 10.1.16R and SUP 12 (*Appointed Representatives*).
- 6.2.5** **G**_{/1} An *introducer*, that is, in outline, a *person*, other than an *appointed representative*, who is appointed by a *firm* to effect introductions between *customers* and the *firm* but not to give *advice on investments*, will not, for this reason alone, need to be an *approved person* although certain obligations will apply (for example, see COB 5 (Advising and selling)).
- 6.2.6** **G**_{/1} The *controlled functions* which have been specified by the FSA are those functions which the FSA sees as key to the operation of the provisions of Part V of the *Act* (Performance of Regulated Activities) and the provisions made under Part V. Those provisions include:
- (1) the *Statements of Principle* and *Code of Practice* for *Approved Persons* issued under section 64 of the *Act* (Conduct: statements and codes) (see *APER*); and
 - (2) the fit and proper test referred to in section 61 of the *Act* (Determination of applications) (see *FIT*).
- 6.2.7** **G**_{/1} The purpose of the direct approval of *persons* who perform controlled functions is to complement the regulation of the *firm* for which the *approved person* performs the function.
- 6.2.8** **G**_{/1} The FSA may grant an application by a *firm* for a *candidate* to perform one or more *controlled functions* only if it is satisfied that he is fit and proper to do so (see *AUTH* 6.3.13G and *AUTH* 6.3.17G).

Controlled functions





6.2.9

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The list of *controlled functions* which the *FSA* has specified in accordance with section 59 of the *Act* (Approval for particular arrangements) is set out in *SUP 10* (Approved persons) and in Form A, a copy of which is included in the application pack for *Part IV permission*, and which also may be found in *SUP 10 Ann 4G*.


6.3 Procedures relating to approved persons

- 6.3.1**  An application for the FSA's approval under section 59 of the *Act* (Approval for particular arrangements) must be made by completing Form A (included as part of the application pack for *Part IV permission*).
- 6.3.2**  In accordance with section 60 of the *Act* (Application for approval), applications for *approved persons* must be submitted by, or on behalf of, the *firm*, not by the *candidate*.
- 6.3.3**  A summary of FSA procedures is in *AUTH 6 Ann 2G*.
- 6.3.4**  Until the application has been determined by the FSA, the *firm* which submits a Form A must inform the FSA of any significant changes to the information given in the form immediately it becomes aware of the change.


Outsourcing to another firm

- 6.3.5**  Where a *firm* has outsourced the performance of a *controlled function*, the details of the outsourcing will determine who may apply for the *candidate's* approval. Further details are in *SUP 10.12.4G*.

EEA firms and Treaty firms

- 6.3.6**  The FSA encourages *EEA firms* and *Treaty firms* that wish to carry on *regulated activities* in the *United Kingdom* to submit any necessary applications for *approved person* status as early as possible. This will help to ensure that there are no delays in the *EEA firm* or *Treaty firm* complying with *applicable provisions* and commencing its *regulated activities*. For further details on the application of the *approved persons* regime to *EEA firms* and *Treaty firms* see *SUP 10.1* (Application).

Processing an application

- 6.3.7**  The *Act* allows the FSA three *months* from the time it receives a properly completed application for approval under section 59 of the *Act* (Approval for particular arrangements) to consider it and come to a decision. However, if the applicant for *Part IV permission* is not yet an *authorised person*, *approved person* status will only be effective from the date the applicant for *Part IV permission* receives *permission*.

6.3.8 G_{/1} Because *approved person* status is only effective from the date *Part IV Permission* is given, it is possible that this may take up to twelve months from the date of application if the application for *Part IV permission* is incomplete. See *AUTH* 3.9.30G (How long will an application take?) for *guidance* on how long this process may take.

6.3.9 G_{/1} Before making a decision either to approve or to give a *warning notice* (see *AUTH* 8.3 (Statutory notices and other matters), the *FSA* may request further information about the *candidate* from the applicant for *Part IV permission*. If it does this, the three *month approval* period:

- (1) will stop on the *day* the *FSA* requests the information; and
- (2) will start running again from the point at which it stopped, on the final *day* on which the *FSA* receives all the requested information.

6.3.10 G_{/1} The *FSA* may grant an application only if it is satisfied that the *candidate* is a fit and proper *person* to perform the *controlled function* stated in the application form.

6.3.11 G_{/1} For further *guidance* on criteria for assessing fitness and propriety, see *FIT* and the notes appended to the application form.

Decisions on applications

6.3.12 G_{/1} See *AUTH* 8 (Determining applications) for an overview of how applications for *Part IV permission* and for approval of a *candidate* under section 59 of the *Act* (Approval for particular arrangements) will be determined. *AUTH* 8 also includes a summary of the decision making procedures which apply.

6.3.13 G_{/1} Whenever it approves an application, the *FSA* will confirm this in writing to all *interested parties*.



6.4 Further questions

- 6.4.1** **G**_{/1} A list of frequently asked questions and answers relating to new *firms* is at *AUTH* 6 Ann 1G.
- 6.4.2** **G**_{/1} If the *firm* has questions unanswered by *AUTH* 6 Ann 1G, it should contact the *FSA*'s Individual Vetting and Approval department:
- (1) telephone 020 7676 0019; or
 - (2) write to:

Individual Vetting and Approval

The Financial Services Authority

25 The North Colonnade

Canary Wharf

LONDON E14 5HS; or
 - (3) e-mail iva@fsa.gov.uk

6.5 Notifiable persons

6.5.1

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There are four positions which require notification to the FSA but not approval by the FSA. These relate to *overseas firms* (but excluding *EEA firms*) with *branches* in the *United Kingdom*. These are:

- (1) the *firm's* worldwide chief executive where the *person* holding the position is situated outside the *United Kingdom*;
- (2) the *person*, if not the worldwide chief executive, within the *overseas firm* with a purely strategic responsibility for *UK* operations;
- (3) for a *bank*, the two or more *persons* who effectively direct its business in accordance with *IPRU(BANK)* GN 3.3.1R;
- (4) for a *UK branch* of an *insurer*, the *authorised United Kingdom representative*.

6.5.2

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For further details relating to those positions which require notification only, see *SUP* 15.4 (Notifiable persons).

Approved Persons

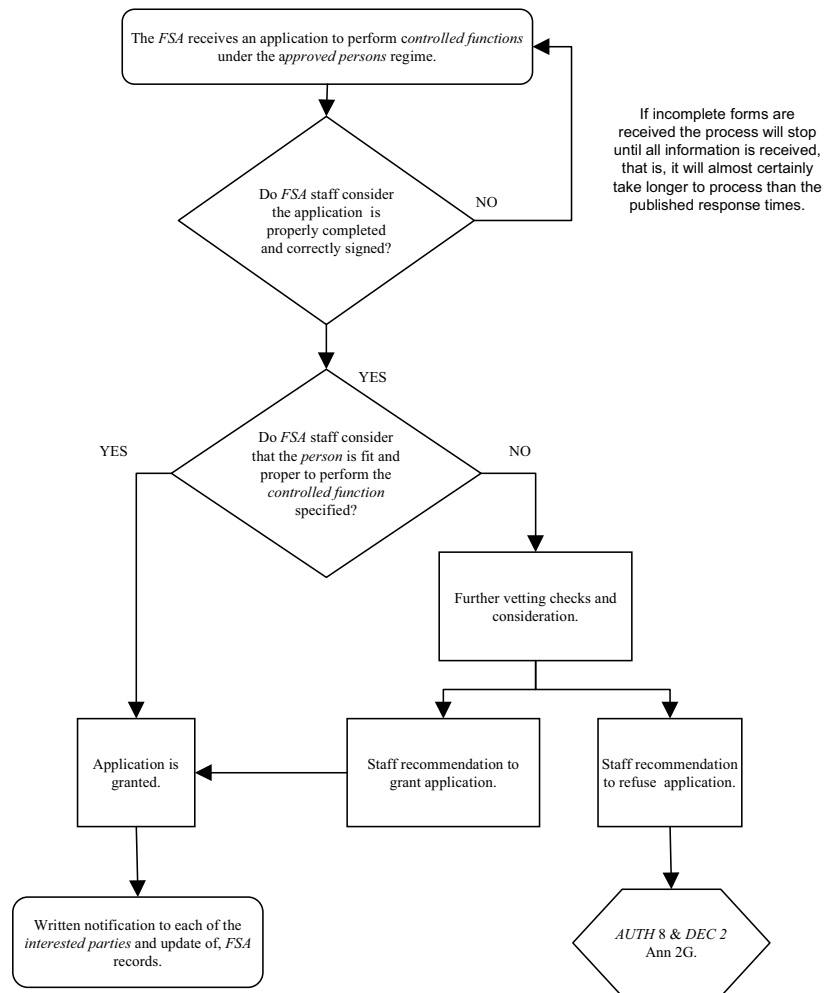
1 Table Frequently Asked Questions

	Question:	Answer:
	Requirements of the regime	
1	When is approval required?	The <i>Act</i> requires that approval be obtained before a <i>person</i> performs a <i>controlled function</i> . See section 59 of the <i>Act</i> (Approval for particular arrangements).
2	Can an individual be approved in advance of a <i>firm</i> becoming <i>authorised</i> ?	No. The application will be coordinated to ensure that the approval of the individual coincides with the giving of <i>permission</i> to the <i>firm</i> .
3	Can a <i>person</i> be approved for more than one <i>controlled function</i> ?	Yes. A <i>firm</i> will need to seek approval in respect of each <i>controlled function</i> a <i>person</i> is to perform.
4	Do the <i>controlled functions</i> apply to an <i>incoming EEA firm</i> that is providing <i>cross border services</i> into the <i>United Kingdom</i> ?	No. The <i>approved persons</i> regime does not apply to <i>cross border services</i> . See SUP 10.1.6R (Application).
5	May any activity be outsourced by a <i>firm</i> ?	Yes. But if that activity constitutes a <i>regulated activity</i> the <i>person</i> to whom it is outsourced will itself need <i>permission</i> .
6	Can a <i>significant influence function</i> be outsourced?	It is a question of fact in each case who is performing a <i>significant influence function</i> . These functions are mostly described at a high level of responsibility, that is, for example, the <i>director</i> of a <i>company</i> or a <i>partner</i> of a <i>partnership</i> . The <i>persons</i> performing these functions cannot avoid their ultimate responsibility and therefore the need for <i>approval</i> . However, some of the <i>significant influence functions</i> may be performed by a <i>person</i> who is specifically brought in to do the job, for example the <i>chief executive function</i> (where it is to be performed by a <i>body corporate</i>) and the <i>appointed actuary function</i> .
7	Do Lloyd's underwriting agents still require registration with Lloyd's?	Yes. Approval for a <i>controlled function</i> is not sufficient.

	Question:	Answer:
	Submitting an application	
8	Who applies for approval?	It is the <i>firm</i> , which applies for approval. See section 60 of the <i>Act</i> (Applications for approval).
9	What is the role of the <i>candidate</i> in the application process?	Before the <i>firm</i> submits Form A it must verify the information contained in it. As part of this verification, the form provides for the <i>candidate</i> to confirm the accuracy of the information given by the <i>firm</i> so far as it relates to him.
10	What is the “fit and proper” test for approval?	Section 61(1) of the <i>Act</i> (Determination of applications) provides that the <i>FSA</i> may grant an application only if it is satisfied that the <i>candidate</i> is a fit and proper <i>person</i> to perform the relevant function. In determining this question, the <i>Act</i> sets out the matters to which the <i>FSA</i> may have regard (section 61(2) of the <i>Act</i>) and the <i>FSA</i> has given guidance on this in <i>FIT</i> .
11	If a <i>firm</i> is unsure whether or not something may have an impact on an individual’s fitness and propriety, should it be disclosed?	Yes, always. The non-disclosure of material facts is taken very seriously by the <i>FSA</i> , as it is seen as evidence of current dishonesty. Therefore, if in doubt, disclose.
12	Must all gaps in previous employment be explained?	Yes.
	FSA procedures	
13	Does the <i>FSA</i> verify the information provided to it?	Yes, as far as possible, information is verified.
14	Will the <i>FSA</i> handle information confidentially?	Yes. The <i>FSA</i> handles all information confidentially and is subject to the provisions of the Data Protection Act 1988.

Approved Persons

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Chapter 8

Determining applications



8.1 Application and purpose

Application

8.1.1

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This chapter applies to:

- (1) an applicant for *Part IV permission* (including an applicant for *top-up permission*) which has made an application to carry on *regulated activities* in the *United Kingdom*; and
- (2) a *person* for whom an application for approval under section 59 of the *Act* (Approval for particular arrangements) has been made with an application for *Part IV permission* (including an application for *top-up permission*).

Purpose

8.1.2

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AUTH 8 gives applicants an overview of how their applications for *Part IV permission* and for approval of a candidate under section 59 of the *Act* will be determined. This overview includes a summary of the decision making procedures which apply to those decisions, within the scope of *AUTH*, that are subject to a statutory requirement to issue formal notices.

8.1.3

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Statutory notices include *warning notices* and *decision notices*. If the *FSA* proposes or decides to take certain action in respect of an application within the scope of *AUTH*, it is required by the *Act* to give a *warning notice* or a *decision notice*. These *statutory notices* have specified procedures and specific actions and protections.

8.1.4

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This chapter is only a summary and is not part of the *FSA*'s formal statement of procedure under section 395 of the *Act* (The *FSA*'s procedures). An applicant needing further details of the *FSA*'s procedure should refer to the Decision making manual (*DEC*).

8.1.5

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For guidance on the *FSA*'s procedures before it determines an application, see:

- (1) *AUTH 3* (Applications for *Part IV permission*) for applications for *Part IV permission*; and
- (2) *AUTH 6* (Approved persons) for applications for approval of a candidate under section 59 of the *Act*, made with an application for *Part IV permission*.

8.2 Determination of an application

Who makes the determination?

8.2.1

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A decision to determine an application for *Part IV permission*, or an application for approval under section 59 of the *Act*, is taken in one of two ways:

- (1) by internal staff procedures involving *FSA* staff at an appropriate level of seniority, if the decision is to grant the application on the terms applied for (this decision does not involve giving a *statutory notice*); or
- (2) by the *FSA's Regulatory Decisions Committee (RDC)*, in any other case (this decision does involve the giving of a *statutory notice*).

8.2.2

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The decision on an application will be taken by the *RDC* where *FSA* staff have recommended:

- (1) the refusal, or proposed refusal, of:
 - (a) an application for *Part IV permission* (sections 52(7) and 52(9)(c)) of the *Act* (Determination of applications); or
 - (b) an application for approval under section 59 of the *Act* made with an application for *Part IV permission* (sections 62(2) and 62(3) of the *Act* (Applications for approval: procedure and right to refer to the Tribunal)); and
- (2) the grant, or proposed grant, of an application for *Part IV permission* subject to a *limitation* or *requirement* which was not applied for by the applicant or with a narrower description of *regulated activity* than that to which the application relates (sections 52(6)(a) and 52(9)(a) of the *Act*).

What are internal staff procedures?

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The *FSA* Board has given *FSA* staff the authority to grant applications on the terms applied for. The majority of applications are determined by internal staff procedures.

8.2.4

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As part of its application for *Part IV permission*, an applicant may apply for *permission* which includes a *limitation* (for example, a *limitation* on *client* categories), or a *requirement* (for example, a *requirement* not to hold or control *client* money). *Limitations* and *requirements* may be applied for in the application pack, or in a revision to the application pack submitted by the applicant if, for example, its business plans have changed. In those situations, *FSA* staff have

authority to grant the application, on the terms applied for, using internal staff procedures.

An overview of internal staff procedures

8.2.5

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- (1) Internal staff procedures for decisions within the scope of *AUTH* are intended to ensure that decisions will, so far as possible, be taken by *FSA* staff with a good knowledge and understanding of:
 - (a) the application concerned; and
 - (b) other relevant factors in the general context of the application.
- (2) They are also designed to ensure that applicants with routine applications obtain a decision as quickly as the nature of their application allows.

8.2.6

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- (1) Internal staff procedures provide for relevant aspects of the application to be taken fully into account and require that decisions are taken by *FSA* staff with appropriate experience. For example, decisions to grant applications for *Part IV permission* on the terms applied for will usually be endorsed by a senior individual or more than one individual. Decisions to grant the majority of applications for approval of a candidate under section 59 of the *Act*, which are more routine in nature, may be made by a single individual, subject to appropriate oversight.
- (2) In particular:
 - (a) a recommendation by *FSA* staff to grant an application for *Part IV permission* on the terms applied for will be reviewed and approved by at least one *FSA* staff member at a level which is senior to the member of staff who made the recommendation; and
 - (b) a decision to grant a non-routine application for approval under section 59 of the *Act*, that is, one where difficult issues arise, will be taken by *FSA* staff at an appropriate level of seniority.

8.2.7

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The *FSA* keeps a record of each decision taken by internal staff procedures. This includes the names of the *FSA* staff taking the decision, the nature of the decision, the date it was taken and the information taken into account in arriving at the decision.

8.2.8

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FSA staff are required by their contract of employment to comply with a code of conduct which imposes strict rules to cover the handling of conflicts of interest which may arise from personal interests or associations. *FSA* staff who are subject to a conflict of interest must declare that interest to the *person* to whom they are directly responsible for the decision. This individual to whom the conflict of interest is declared will decide whether that conflict precludes the involvement of the *FSA* staff member in making a decision.

The Regulatory Decisions Committee

8.2.9

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The *RDC* is appointed by the *FSA* Board to exercise certain regulatory powers on behalf of the *FSA* Board. It is fully and directly accountable to the *FSA* Board for

the decisions it makes. The *RDC* is a body outside the *FSA*'s management structure.

8.2.10**G**
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The *RDC* has a Chairman, one or more Deputy Chairmen, and other members. Other than the Chairman, none of the members of the *RDC* is an employee of the *FSA*. Members are:

- (1) current and recently retired practitioners with financial services industry skills and knowledge; and
- (2) other suitable individuals representing the public interest.

8.2.11**G**
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For full details of the *RDC* and its procedures see *DEC 4* (The decision maker). All decisions involving giving of *statutory notices* within the scope of *AUTH* will be determined by the *RDC* (see *AUTH 8.2.2G*).

8.2.12**G**
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FSA staff are responsible for assembling and assessing the information required by the *RDC* and making recommendations to the *RDC*. Section 395 of the *Act*, however, requires the *FSA* to have procedures under which a decision which gives rise to a *statutory notice* is "taken by a person not directly involved in establishing the evidence on which that decision is based." So, the *RDC* is not directly involved in establishing the evidence on which decisions are based.

8.3 Statutory notices and other matters

- 8.3.1** G_{/1} A *statutory notice* includes a *warning notice* (see AUTH 8.3.2G to AUTH 8.3.5G) and a *decision notice* (see AUTH 8.3.8G to AUTH 8.3.10G). A *final notice* will also be given to a person which has received a *decision notice* (see AUTH 8.3.14G to AUTH 8.3.16G). See AUTH 8 Ann 1G.

Warning notices

- 8.3.2** G_{/1} A *warning notice* warns the recipient that the FSA proposes to take certain action and gives an opportunity for representations to be made to the FSA before a decision is made.
- 8.3.3** G_{/1} FSA staff will review each application that falls within the scope of AUTH. Where they consider that the application should be refused, or should be granted subject to a *limitation* or a *requirement* which was not applied for, or with a narrower description of *regulated activity* than that to which the application relates (see AUTH 8.2.2G), they will recommend to the RDC that a *warning notice* be given.
- 8.3.4** G_{/1} After considering the FSA staff recommendation, the RDC may decide to grant the application on the terms applied for. However, the RDC will decide to give a *warning notice* to the applicant, or, in the case of applications for approval under section 59 of the Act, to all *interested parties*, if it proposes that any of the following actions be taken:
- (1) grant an application for *Part IV permission* either with a *limitation* or *requirement* which was not applied for, or with a narrower description of *regulated activity* than that to which the application relates (see AUTH 3), under section 52(6)(a) of the Act; or
 - (2) refuse to grant an application for *Part IV permission* (see AUTH 3) under section 52(7) of the Act; or
 - (3) refuse to grant an application for approval under section 59 of the Act (see AUTH 6) under section 62(2) of the Act.
- 8.3.5** G_{/1} For full details of *warning notices* and the *warning notice* procedure, see DEC 2.2 (Warning notice procedure).

Representations

- 8.3.6** G_{/1} The *warning notice* will contain a statement that the *person* concerned is entitled to make representations to the RDC. It will specify a reasonable time period, of

not less than 28 *business days* from receiving the *warning notice*, within which the *person* to whom it is given may make representations to the *RDC*.

- 8.3.7 G_{/1} The procedures for making representations to the *RDC* are set out in *DEC 4.4* (Representations).

Decision notices

- 8.3.8 G_{/1} A *decision notice* states the action the *FSA* has decided to take. For the purpose of an application within the scope of *AUTH*, the *decision notice* represents the *FSA*'s determination of the application.

- 8.3.9 G_{/1} After considering any written and oral representations, the *RDC* may decide to grant the application on the terms applied for. However, the *RDC* will decide to give a *decision notice* to the *persons* to whom the *warning notice* was given if it decides that any of the following actions be taken:

- (1) grant an application for *Part IV permission* with a *limitation* or *requirement* which was not applied for, or with a narrower description of *regulated activity* than those to which the application relates (see *AUTH 3*), under section 52(9)(a) of the *Act*; or
- (2) refuse to grant an application for *Part IV permission* (see *AUTH 3*) under section 52(9)(c) of the *Act*; or
- (3) refuse to grant an application for approval under section 59 of the *Act* (see *AUTH 6*) under section 62(3) of the *Act*.

- 8.3.10 G_{/1} For full details of *final notices* and the *final notice* procedure, see *DEC 2.3.10G* to *DEC 2.3.11G*

Reference to the Financial Services and Markets Tribunal

- 8.3.11 G_{/1} (1) Any *person* who receives a *decision notice* is entitled to refer the *FSA*'s decision to the *Tribunal*.
- (2) Under section 133(1) of the *Act* (Proceedings: general provision), any reference must be made within 28 *days* of the date when the *decision notice* is given, or within any other period that may be prescribed in the *Tribunal* rules.
- (3) The *Tribunal* is appointed by the Lord Chancellor's Department.


- 8.3.12 G_{/1} A reference to the *Tribunal* will be a full rehearing and not an appeal. See *DEC 5.1* (The *Tribunal*) for the procedure on referring cases to the *Tribunal*.


- 8.3.13 G_{/1} Any party to a reference to the *Tribunal* may appeal against the *Tribunal*'s decision on a point of law to the Court of Appeal or, in Scotland, to the Court of Session.

Final notices


- 8.3.14 G_{/1} The *FSA* will give a *final notice* to the *person* that received a *decision notice* if the *FSA*:


- (1) takes the action set out in the *decision notice* (if a reference to the *Tribunal* has not been made and the time limit for making references has passed); or
- (2) takes action in accordance with any directions given by the *Tribunal* or the court under section 137 of the *Act* (Appeal on a point of law) where the matter was referred to the *Tribunal*.

8.3.15  The *final notice* will state the action being taken and the date on which it is to be taken.
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8.3.16  For full details of *final notices* and the *final notice* procedure, see *DEC 2.3.10G* to *DEC 2.3.11G*
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Publication

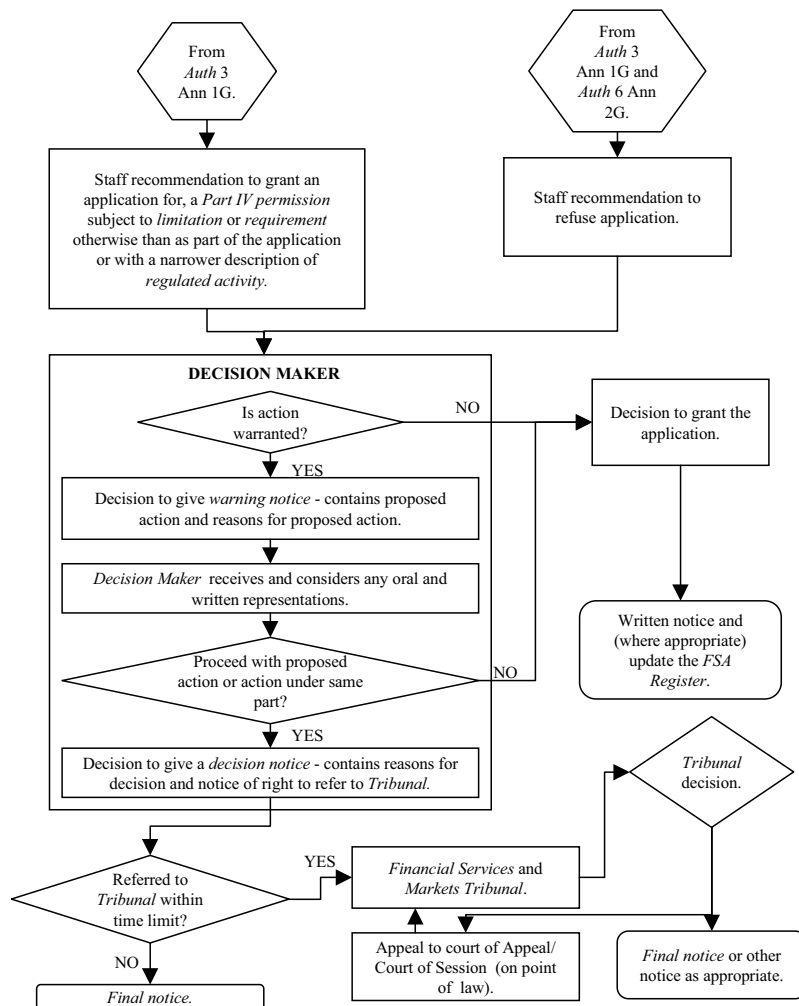
8.3.17  Details on the publication of decisions are set out in *DEC 5.2* (Publication).
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8.3.18  In the case of a decision within the scope of *AUTH*, the *FSA*'s general policy is not normally to publish *final notices* about applications in a way which would disclose confidential information about them or prejudice consumer interests.
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Determining applications

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The FSA's decision making procedures for applications involving warning notices and decision notices



Handbook Modules

Schedule1 Record Keeping Requirements

1 G
 Table

There are no record keeping requirements in *AUTH*.

Handbook Modules

Schedule2 Notification Requirements

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1 Table

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<i>AUTH 3.9.3 D</i>	Application for <i>Part IV permission</i>	Matters relevant to the application as indicated in the application pack	Application or significant changes to information given in the application	immediately applicant becomes aware
<i>AUTH 6.3.1 D</i> <i>AUTH 6.3.4 D</i>	Application for approval of <i>person</i> under section 59 of the <i>Act</i>	Matters relevant to the application as indicated in Form A and significant changes to information given in that Form		

Handbook Modules

Schedule3 Fees and other required payments

1 G Table ..

1	The aim of the <i>guidance</i> in the following table is to give the reader a quick over-all view of the relevant requirements for paying fees.
2	It is not a complete statement of those requirements and should not be relied on as if it were.

Type of fee	Trigger event	Date/Time for payment	Amount/rate	Handbook reference
Authorisation/ application fee	Application for a <i>Part IV permission</i>	On making the application	See <i>AUTH 4 Ann 1R, Part 1</i>	<i>AUTH 4.2</i>
Authorisation/ application fee	Exercise of a <i>Treaty right</i>	On exercising that right	See <i>AUTH 4 Ann 1R, Part 4</i>	<i>AUTH 4.2.6R to 4.2.7R</i>

Handbook Modules

Schedule4 Powers exercised

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 Table

The following powers and related provisions in the *Act* have been exercised by the *FSA* to make the *rules* in *AUTH*:

Section 156 (General supplementary powers)

Paragraph 17(1) of Schedule 1 (Fees).

The following power in the *Act* has been exercised by the *FSA* to give the *guidance* in *AUTH*:

Section 157(1) (Guidance).

The following powers in the *Act* have been exercised by the *FSA* in *AUTH* to direct and require:

Section 51 (Application under this Part).

Section 60 (Application for approval).

Handbook Modules

Schedule5 Rights of action for damages

1 G Table .

1	The table below sets out the <i>rules</i> in <i>AUTH</i> contravention of which by an <i>authorised person</i> may be actionable under section 150 of the Act (Actions for damages) by a <i>person</i> who suffers loss as a result of the contravention.
2	If a "Yes" appears in the column headed "For private person?", the <i>rule</i> may be actionable by a " <i>private person</i> " under section 150 (or, in certain circumstances, his fiduciary or representative; see article 6(2) and (3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001 No 2256)). A "Yes" in the column headed "Removed" indicates that the FSA has removed the right of action under section 150(2) of the <i>Act</i> . If so, a reference to the <i>rule</i> in which it is removed is also given.
3	The column headed "For other person?" indicates whether the <i>rule</i> may be actionable by a <i>person</i> other than a <i>private person</i> (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of <i>person</i> by whom the <i>rule</i> may be actionable is given.

2 Table Actions for damages: Authorisation manual

Chapter/ Appendix	Section/ Annex	Paragraph	Right of Action under section 150		
			For private person?	Removed?	For other person?
All rules in <i>AUTH</i> 4			Yes	No	No

Handbook Modules

Schedule6 Rules that can be waived

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 Table

The *rules* in *AUTH 4* cannot be *waived* by the *FSA*.

Authorisation manual

Destinations

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There is no table of destinations for *AUTH*.

Authorisation Manual

Derivations

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There is no table of derivations in *Auth*.

SUPERVISION MANUAL INSTRUMENT 2001

A. The Financial Services Authority makes the rules, gives the guidance and makes the directions and requirements in the Annex to this instrument (“SUP”) in the exercise of the powers listed in Schedule 4 to SUP (Powers exercised).

B. This instrument shall come into force as follows:

- (1) SUP 9 (Individual guidance): immediately;
- (2) the following parts of SUP: at the beginning of the first day on which section 40 (Application for permission) of the Financial Services and Markets Act 2000 (the “Act”) comes into force for any purpose:
 - (a) SUP 6 (Applications to vary and cancel Part IV permission);
 - (b) SUP 8 (Waiver and modification of rules);
 - (c) SUP 10 (Approved persons);
- (3) SUP 7 (Individual requirements): at the beginning of the first day on which section 45 of the Act (Variation etc on the Authority’s own initiative) comes into force for any purpose;
- (4) other parts of SUP: at the beginning of the day on which section 19 of the Act (The general prohibition) comes into force;
- (5) paragraphs A to E on this page: immediately.

C. The provisions of the Act relevant to making rules and listed in Schedule 4 to this instrument (Powers exercised) are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

D. This instrument may be cited as the Supervision Manual Instrument 2001.

E. The Annex to this instrument (including its Schedules) may be cited as the Supervision manual (or SUP).

By order of the Board
21 June 2001

ANNEX



Supervision



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Transitional provisions

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[* These parts of SUP will be added later]

Handbook Modules

Transitional provisions

1 Table

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1	SUP 3.3.2R(1)	R	<p><u>Auditors</u></p> <p>A firm will not contravene SUP 3.3.2R(1), if the office of auditor is filled at commencement. The auditor filling the office at that time will be deemed to be appointed under SUP 3.3.2R.</p>	From commencement	Commencement
2	SUP 3.9 and SUP 3.10	R	<p>An auditor of a firm will not contravene a rule in SUP 3.9 or SUP 3.10 to the extent that:</p> <p>(1) a report submitted under that rule relates to a period which ended before commencement and was prepared in accordance with a substantially similar pre-commencement provision (whether applicable to the auditor or the firm audited); or</p> <p>(2) a report submitted under that section relates to a period which ended on or after commencement and, as regards any part of that period prior to commencement, relates to compliance by the firm with the relevant pre-commencement provision.</p>	From commencement for 2 years	Commencement

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
3	SUP 3.9.4R and SUP 3.10.4R	R	<p>(1) Paragraph (2) applies to an auditor of a firm to whom SUP 3.9 applies if:</p> <ul style="list-style-type: none"> (a) the firm is an <i>ex-section 43 firm</i>, or was a member of <i>SFA, IMRO</i> or <i>PIA</i> immediately before commencement; (b) a report equivalent to that required under SUP 3.9 has not been submitted to the firm's previous regulator in respect of the firm's last accounting reference date; and (c) the period for submission of that report under the rules and guidance of that regulator is still running. <p>(2) An auditor in (1) must submit such a report in accordance with the rules and guidance of the <i>previous regulator</i> (as if those provisions applied directly to the auditor).</p>	From commencement for one year	Commencement
4	SUP 4.3.1R(1) and SUP 4.4.1R(1)	R	<p>Actuaries</p> <p>A firm will not contravene SUP 4.3.1R(1) or 4.4.1R(1) to the extent that the office of <i>appointed actuary</i> or <i>appropriate actuary</i>, respectively, is filled as at commencement and the appointment was made in accordance with relevant statutory requirements.</p>	From commencement	Commencement
5	SUP 4.3.3R	R	<p>If an <i>appointed actuary</i> of a firm has been appointed by a <i>previous regulator</i> under statutory or contractual powers and remains in office immediately before commencement, that appointment will be deemed to have been made under SUP 4.3.3R, but on the terms of the actual appointment.</p>	From commencement	Commencement

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
6	SUP 8.6.1R	R	<p><u>Waivers</u></p> <p>A firm which has applied to the FSA for a waiver, or been granted a waiver by the FSA before commencement under the Act, must notify the FSA immediately after commencement if it became aware, before commencement, of any matter which is material to the relevance or appropriateness of the waiver.</p>	From commencement for one month	Commencement
7	SUP 10.12.2D	D	<p><u>Approved persons</u></p> <p>If a firm submitted an application to IMRO, PIA or the SFA before applications day for individual registration of a person in accordance with the rules or guidance of that body, the firm will be treated as having submitted Form A (SUP 10 Ann 4D) in respect of that person.</p>	From commencement for three months	Commencement
8	SUP 10.13.6R	R	<p>A firm will not contravene SUP 10.13.6R, to the extent that notice of the relevant matter was given to its previous regulator before applications day in accordance with a statutory requirement or the rules or guidance of that regulator.</p>	From commencement for one month	Commencement
9	SUP 12.5.5R SUP 12.5.7R	R	<p><u>Appointed representatives</u></p> <p>A firm will not contravene SUP 12.5.5R or SUP 12.5.7R to the extent that it continues to rely on a written contract with an appointed representative entered into before commencement which complied with a substantially similar pre-commencement provision applicable to the firm.</p>	From commencement for 12 months	Commencement

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
10	SUP 16.4.5R SUP 16.5.5R	R	<p>Reporting</p> <p>(1) SUP 16.4.5R and 16.5.5R are modified so as to require a <i>firm</i> to submit the first relevant report:</p> <p>(a) prepared as at its <i>accounting reference date</i>; and</p> <p>(b) within 4 months of <i>commencement</i>;</p> <p>if the <i>firm's accounting reference date</i> falls within the 4 months before <i>commencement</i>.</p> <p>(2) SUP 16.4.5R and 16.5.5R are modified so as to require a <i>firm</i> to submit the first relevant report:</p> <p>(a) prepared as at any date falling within 4 months after <i>commencement</i>; and</p> <p>(b) within 4 months of <i>commencement</i>; and if:</p> <p>(c) the <i>firm</i> was, before <i>commencement</i>, required to submit reports equivalent to those required under SUP 16.4.5R and 16.5.5R (respectively) under a substantially similar pre-commencement provision; and</p> <p>(d) the <i>firm's first accounting reference date</i> after <i>commencement</i> falls more than eight months after the date on which it submitted its last such report under that pre-commencement provision.</p>	From <i>commencement</i> for four months	<i>Commencement</i>

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
11	SUP 16.6 SUP 16.7 SUP 16.8	R	<p>A <i>firm</i> will not contravene a requirement in SUP 16.6, SUP 16.7 and SUP 16.8 to submit a report to the extent that:</p> <p>(1) the date as at which the report must be prepared is before <i>commencement</i>; or</p> <p>(2) the period with respect to which the report must be prepared ended before <i>commencement</i>,</p> <p>and in either case:</p> <p>(3) the <i>firm</i> submits an equivalent report in accordance with a substantially similar pre-commencement provision applicable to the <i>firm</i>; or</p> <p>(4) there was no substantially similar pre-commencement provisions applicable to the <i>firm</i>.</p>	From commencement for 2 years	Commencement
12	SUP 16.7.7R; SUP 16.7.9R, SUP 16.7.11R, SUP 16.7.16R, SUP 16.7.24R, SUP 16.7.26R, SUP 16.7.35R, SUP 16.7.44R, SUP 16.7.46R, SUP 16.7.48R, SUP 16.7.57R	R	<p>A <i>firm</i> will not contravene a rule in SUP 16.7 requiring a report to be submitted using a form which is specified in an annex to SUP 16.7, to the extent that the <i>firm</i> submits the report using a substantially similar form specified by its <i>previous regulator</i>.</p>	From commencement for one year	Commencement
13	SUP 16.8	R	<p>In Forms 1R(1) to (3) in SUP 16 Ann 6R, for any <i>life policy</i> promoted before <i>commencement</i>, a reference to "direct offer financial promotion" must be read as a reference to "direct offer advertisement", as defined in the rulebook of the PIA at the time the <i>policy</i> was promoted.</p>	From commencement for 6 years	Commencement
14	SUP 16.8	R	<p>SUP 16.8 does not apply to an <i>insurer</i> (including a <i>friendly society</i>) which was not a member of the PIA immediately before <i>commencement</i>.</p>	From commencement for 6 years	Commencement

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
15	SUP 17	R	<p><u>Transaction Reporting</u></p> <p><i>A firm:</i></p> <p>(1) to whom SUP 17 applies under SUP 17.1.1R(1)(c); and</p> <p>(2) which was authorised under the Financial Services Act 1986 immediately before commencement otherwise than through membership of the SFA;</p> <p>must comply with SUP 17 as if it were:</p> <p>(3) an investment management firm, if it was a member of IMRO immediately before commencement, or</p> <p>(4) a personal investment firm, otherwise.</p>	From commencement	Commencement
16	Paragraphs 1 to 15	R	<p><u>Definitions</u></p> <p>In these transitional provisions:</p> <p>(1) "pre-commencement provision" means a provision repealed or revoked by or under the Act or a rule or guidance of the firm's previous regulator, including (where the context permits) any relevant provision which it replaced before commencement; and</p> <p>(2) "substantially similar" means substantially similar in purpose and effect.</p>	From commencement	Commencement

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Table

GEN contains some technical transitional provisions that apply throughout the *Handbook* and which are designed to ensure a smooth transition at *commencement*. These include transitional provisions relevant to record keeping and *notification rules*.

Chapter 1

The FSA's approach to supervision



1.1 Application and purpose

Application

- 1.1.1** G_{/1} This chapter applies to every *firm*, except that its relevance for an *ICVC* is limited as the *FSA* does not intend to carry out an assessment of an *ICVC* that is specific to that *ICVC*.

Purpose

- 1.1.2** G_{/1} The *Act* requires the *FSA* to “maintain arrangements designed to enable it to determine whether persons on whom requirements are imposed by or under this Act are complying with them” (paragraph 6(1) of Schedule 1 to the *Act*).
- 1.1.3** G_{/1} The design of these arrangements is shaped by the *regulatory objectives*. These are set out in section 2 of the *Act* (The Authority’s general duties) and are:
- (1) maintaining confidence in the *financial system*;
 - (2) promoting public understanding of the *financial system*;
 - (3) securing the appropriate degree of protection for *consumers*; and
 - (4) reducing the extent to which it is possible for a business carried on by a regulated person, or in contravention of the *general prohibition*, to be used for a purpose connected with financial crime.
- 1.1.4** G_{/1} In designing its approach to supervision, the *FSA* has regard to the principles of good regulation set out in section 2(3) of the *Act*. In particular, the *FSA*’s regulatory approach aims to focus and reinforce the responsibility of the management of each *firm* (section 2(3)(b) of the *Act*) to ensure that it takes reasonable care to organise and control the affairs of the *firm* responsibly and effectively and develops and maintains adequate risk management systems. It is the responsibility of management to ensure that the *firm* acts in compliance with its regulatory requirements. The *FSA* will have regard to the principle that a burden or restriction which is imposed on a *firm* should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction (section 2(3)(c) of the *Act*).

1.2 Introduction

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- (1) The Authorisation manual (*AUTH*), the Supervision manual (*SUP*), the Enforcement manual (*ENF*) and the Decision making manual (*DEC*) form the regulatory processes part of the *Handbook*.
- (2) *AUTH* sets out the relationships between the FSA and applicants for *Part IV permission* and *persons* wishing to exercise *EEA rights*, *Treaty rights* or *UCITS Directive* rights.
- (3) *SUP* sets out the relationship between the FSA and *authorised persons* (referred to in the *Handbook* as *firms*). As a general rule, material that is of continuing relevance after *authorisation* is in *SUP*.
- (4) *ENF* describes the FSA's enforcement powers under the *Act* and sets out its policies for using those powers.
- (5) *DEC* is principally concerned with, and sets out, the FSA's decision making procedures for decisions that involve the giving of *statutory notices*.

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For a *firm* which undertakes business internationally (or is part of a *group* which does), the FSA will have regard to the context in which it operates, including the nature and scope of the regulation to which it is subject in jurisdictions other than the *United Kingdom*. For a *firm* with its head office outside the *United Kingdom*, the regulation in the jurisdiction where the head office is located will be particularly relevant. As part of its supervision of such a *firm*, the FSA will usually seek to cooperate with relevant *overseas regulators*, including exchanging information on the *firm*. Different arrangements apply for an *incoming EEA firm*, an *incoming Treaty firm* and a *UCITS qualifier*. The arrangements applying for an *incoming EEA firm* and an *incoming Treaty firm* are addressed in SYSC App 1. For *UCITS qualifiers* see also *CIS 2.3*, *CIS 16*, and *CIS 17*.

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The FSA continues to develop the risk assessment approach set out in this chapter. The approach will not be introduced for all *firms* at *commencement*. For those *firms* where the approach is not introduced at *commencement*, the FSA continues to operate the risk assessment approach of the *firm's previous regulator*.



1.3 The FSA's risk based approach to supervision

Purpose

1.3.1 G_{/1} The purpose of taking a risk-based approach to supervision is to focus the FSA's resources on the mitigation of risks to the *regulatory objectives*, and to have regard to the need to use the FSA's resources in the most efficient and economic way. The approach to risk assessment of *firms* is based on the extent to which they pose risks to the FSA meeting the *regulatory objectives*. This extent encompasses both the impact of such risks were they to crystallise and the probability of their doing so. The probability of risks crystallising depends on the inherent risks run by *firms*, the environment within which they operate and the internal systems and controls designed to mitigate such risks. This approach permits a matching of the intensity of the FSA's supervisory effort with the degree of risk posed by *firms* to meeting the *regulatory objectives*.

Impact and probability assessment

1.3.2 G_{/1} The FSA uses a standard risk assessment process applied consistently across all its activities. It involves assessing the risk posed by the *firm* against a number of impact and probability factors, both initially and on a continuing basis.

1.3.3 G_{/1} The impact of a *firm* is assessed by reference to a range of factors derived from the *regulatory objectives*, including:

- (1) the degree to which risks related to the *firm*, were they to materialise, would damage market confidence;
- (2) the extent to which the *firm* may pose risks to the achievement of the objective of promoting public understanding;
- (3) the extent to which *consumers* may be adversely affected either directly or indirectly by the *firm* as a result of prudential failure, misconduct, market malfunction, market manipulation or the need to contribute to the financial reconstitution of compensation schemes;
- (4) the incidence and materiality of any *financial crime* which may be perpetrated through or by the *firm*.

1.3.4 G_{/1} The probability of a *firm* posing a risk to meeting the *regulatory objectives* is, where applicable, assessed in terms of "risk groups". These are discrete sources of risks to meeting the *regulatory objectives* which arise from:

- (1) the *firm's* strategy;
- (2) the *firm's* business risk: those risks (such as credit, market and operational risk) which are inherent in the business;
- (3) the financial soundness of the *firm*;
- (4) the nature of the *firm's customers* and the products and services it offers;
- (5) the internal systems and controls and the compliance culture of the *firm*; and
- (6) the organisation of the *firm* and the role played by its governing body, management and staff in effectively mitigating risk.

1.3.5 G_{/1} The impact and probability assessments are combined to give an overall judgment as to the *firm's* priority for the *FSA* and therefore the nature of the relationship which the *FSA* will seek to have with the *firm* (see 'A new regulator for the new millennium' and 'Building the new regulator, Progress report 1').

1.3.6 G_{/1} In addition to assessing the *firm* in terms of these impact and probability factors, the *FSA* takes into account three further factors which may affect the choice of supervisory approach and activities:

- (1) the level of confidence in the information on which the risk assessment is based;
- (2) the quality of the home regulatory regime (for *firms* with their head office overseas); and
- (3) any anticipated material change in impact and probability factors.

The scope of the risk assessment process for firms

1.3.7 G_{/1} The risk assessment process applies to all *firms*, although the detail required may vary from *firm* to *firm*. *Firms* judged as high impact are likely to require a more detailed assessment. A peer review process within the *FSA* assists consistency.

1.3.8 G_{/1} The main steps in the risk assessment process are:

- (1) preliminary assessment of a *firm's* potential impact on the *regulatory objectives*;
- (2) probability assessment – the level of detail depends on the impact rating and the complexity of the *firm* (in the case of low impact *firms*, the firm-specific probability analysis will be minimal);
- (3) for a sample of *firms*, validation panel for peer review of risk grading and resource allocation;
- (4) letter to *firm* regarding risk assessment and any remedial actions (see *SUP* 1.3.10G); and
- (5) continuing review of risk assessment as necessary.

1.3.9 G_{/1} In order to create incentives for *firms* to raise standards and to maximise the success of the *FSA's* supervisory arrangements, it is important that a *firm* understands the *FSA's* evaluation of its risk so that it can take appropriate action.

1.3.10 G_{/1} The *FSA* intends to communicate the outcomes of its risk assessment to the *firm*. In the case of *firms* in which risks have been identified which could have a material bearing on the *FSA* meeting the *regulatory objectives*, the *FSA* will also outline a programme intended to address these. The *FSA* considers that it would generally be inappropriate for the *firm* to disclose the *FSA* risk assessment to third parties, except those who have a right to be aware of it, for example external auditors. The assessment is directed towards a very specific purpose – to illustrate the risk posed by the *firm* to the *regulatory objectives* and to enable the *FSA* to allocate its resources accordingly. Using it for any other purpose might well be misleading. The *FSA* therefore discourages *firms* from disclosing their assessments.

The nature of the FSA's relationship with firms

1.3.11 G_{/1} The *FSA's* relationship with *firms* has five main elements:

- (1) Determining satisfaction of the threshold conditions: in order to carry on *regulated activities*, a *firm* must demonstrate that it can satisfy, initially and on a continuing basis, the *threshold conditions* (see *COND*) (for example, the need to maintain adequate resources).
- (2) Baseline monitoring which is designed to ensure that *firms* comply, on a continuing basis, with the regulatory requirements which apply to them (see *SUP 1.1.2G*): the *FSA* collects and analyses data supplied by *firms* (see for example *SUP 16*) and by third parties such as the *Financial Ombudsman Service Limited*, *consumers*, and by other regulators.
- (3) Sectoral reviews and thematic work which will be used, for example, to validate information provided by a *firm* and to collect up to date information on a particular sector, in order to assess whether a *firm* meets required standards: thematic work is carried out to assess the risks posed by a particular issue (rather than by a sector or group of *firms*). The issues selected for such work are likely to be broader and proportionately more significant to the *FSA's* *regulatory objectives*.
- (4) Programmes designed to mitigate specific risks in individual *firms*: these programmes depend on the *firm's* priority for the *FSA* (see *SUP 1.3.5G*).
- (5) Work undertaken after particular risks have escalated or crystallised: once the *FSA* has identified an issue, it will need to use its regulatory judgment to determine how it should respond, if at all.

1.3.12 G_{/1} The exact mixture of elements will thus vary with the *firm's* risk categorisation. Moreover, the elements being used at a particular time will depend on the *firm's* circumstances – for example, whether it is applying for *permission* to conduct other *regulated activities*, or is being investigated by the *FSA*.



1.4 Tools of supervision

- 1.4.1** G_{/1} In order to meet the *regulatory objectives* and address identified risks to those objectives, the FSA has a range of supervisory tools available to it.
- 1.4.2** G_{/1} The FSA classifies these tools under four headings:
- (1) diagnostic: designed to identify, assess and measure risks;
 - (2) monitoring: to track the development of identified risks, wherever these arise;
 - (3) preventative: to limit or reduce identified risks and so prevent them crystallising or increasing; and
 - (4) remedial: to respond to risks when they have crystallised.
- 1.4.3** G_{/1} Tools may serve more than one purpose. For example, supervisory powers can be used to address risks which have materialised or to assist in preventing risks from escalating. In the first instance they are remedial, in the second, preventative.
- 1.4.4** G_{/1} Certain of these tools, for example the use of public statements to deliver messages to *firms* or *consumers* of financial services, do not involve the FSA in direct oversight of the business of *firms*. Other tools do involve a direct relationship with *firms*. The FSA also has powers to act on its own initiative to impose individual *requirements* on a *firm* (see SUP 7).
- 1.4.5** G_{/1} The FSA uses a variety of tools to monitor whether a *firm*, once *authorised*, remains in compliance with regulatory requirements. These tools include:
- (1) desk-based reviews;
 - (2) liaison with other agencies or regulators;
 - (3) meetings with management and other representatives of a *firm*;
 - (4) on-site inspections;
 - (5) reviews and analysis of periodic returns and notifications;
 - (6) reviews of past business;
 - (7) transaction monitoring;
 - (8) use of auditors;
 - (9) use of *skilled persons*.

1.4.6

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The FSA also uses a variety of tools to address specific risks identified in *firms*. These tools include:

- (1) making recommendations for preventative or remedial action;
- (2) giving other individual *guidance* to a *firm*;
- (3) imposing individual *requirements*;
- (4) varying a *firm's permission* in another way.

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For further discussion of the FSA's regulatory approach, see publications on the FSA website (www.fsa.gov.uk): in particular, 'A new regulator for the new millennium' and 'Building the new regulator, Progress report 1'.



1.5 Lead supervision

Application

1.5.1 G_{/1} This section applies to a *firm* which is a member of a *group* with more than one supervisory contact at the *FSA*.

Purpose

1.5.2 G_{/1} The *FSA* has developed arrangements for lead supervision in order to achieve more efficient and more effective supervision of *firms* and their *groups*. Lead supervision is designed to deliver a coordinated approach to the supervision of *groups* with more than one supervisory contact at the *FSA*, assisting the *FSA* to monitor them effectively and respond to the risks that arise.

Process

1.5.3 G_{/1} The *FSA* appoints a lead supervisor for a *group* with more than one supervisory contact at the *FSA*. The choice of lead supervisor depends principally on the predominant business of the *group*.

1.5.4 G_{/1} The lead supervisor has three key responsibilities:

- (1) to produce an overall assessment of the *group*: this comprises an assessment of the strengths and weaknesses of the business of the *group* and each of the *firms* within a *group* and a risk assessment of the *group* as a whole;
- (2) to coordinate the supervision programme: based on the overall assessment, the coordinated supervision programme is a single, risk-based supervision plan for the whole *group* for a specified period; and
- (3) to act as the central point of contact for the *group* with the *FSA*, where the *group* decides to use the lead supervisor in this way; this removes the need for duplicate communication between the *FSA* and *firms* in *groups* on group-wide issues.

Chapter 2

2

Information gathering by the FSA on its own initiative



2.1 Application and purpose

Application

- 2.1.1 **R**_{/1} The application of this chapter is the same as the application of *Principle 11 (Relations with regulators)*.
- 2.1.2 **G**_{/1} *PRIN 3* (Rules about application) specifies to whom, to what and where *Principle 11* applies.

Purpose

- 2.1.3 **G**_{/1} Achieving the *regulatory objectives* involves the *FSA* informing itself of developments in *firms* and in markets. The *Act* requires the *FSA* to monitor a *firm's* compliance with requirements imposed by or under the *Act* (paragraph 6 (1) of Schedule 1). The *Act* also requires the *FSA* to take certain steps to cooperate with other regulators (section 354). For these purposes, the *FSA* needs to have access to a broad range of information about a *firm's* business.
- 2.1.4 **G**_{/1} The *FSA* receives the information in *SUP 2.1.3G* through a variety of means, including notifications by *firms* (see *SUP 15*) and regular reporting by *firms* (see *SUP 16*). This chapter is concerned with the methods of information gathering that the *FSA* may use on its own initiative in the discharge of its functions under the *Act*.
- 2.1.5 **G**_{/1} Part XI of the *Act* (Information Gathering and Investigations) gives the *FSA* statutory powers, including:
 - (1) to require the provision of information (see section 165 and *ENF 2*);
 - (2) to require reports from *skilled persons* (see section 166 and *SUP 5*);
 - (3) to appoint investigators (see sections 167, 168 and 169 of the *Act* and *ENF 2*); and
 - (4) to apply for a warrant to enter premises (see section 176 of the *Act* and *ENF 2*).
- 2.1.6 **G**_{/1} The *FSA* prefers to discharge its functions by working in an open and cooperative relationship with *firms*. The *FSA* will look to obtain information in the context of that relationship unless it appears that obtaining information in that way will not achieve the necessary results, in which case it will use its statutory powers. The *FSA* has exercised its *rule-making* powers to make *Principle 11* which requires that a *firm* must deal with its regulators in an open and cooperative way, and must

disclose to the *FSA* appropriately anything relating to the *firm* of which the *FSA* would reasonably expect notice.

2.1.7

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The *FSA* operates in the context of the *Act* and the general law. The purpose of *SUP 2.2* is to explain how certain provisions of the *Act* and the general law are relevant to the *FSA*'s methods of information gathering described in *SUP 2.3* and *SUP 2.4*.

2.1.8

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The purpose of *SUP 2.3* is to amplify *Principle 11* in the context of information gathering by the *FSA* on its own initiative in the discharge of its functions under the *Act*. *SUP 2.3* therefore sets out, in *guidance* on *Principle 11* and in *rules*, how the *FSA* expects *firms* to deal with the *FSA* in that context, including the steps that a *firm* should take with a view to ensuring that certain connected persons should also cooperate with the *FSA*.

2.1.9

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The purpose of *SUP 2.4* is to explain a particular method of information gathering used by the *FSA*, known as "mystery shopping". Information about how a *firm* sells financial products can be very difficult to obtain, and the purpose of this method is to obtain such information from individuals who approach a *firm* in the role of potential retail *consumers* on the *FSA*'s initiative. The *FSA* may seek information about particular issues or the activities of individual *firms* by means of mystery shopping.



2.2 Information gathering by the FSA on its own initiative: background

Link to the statutory information gathering and investigation powers

2.2.1 **G**_{/1} Breaching *Principle 11*, or the *rules* in this chapter, makes a *firm* liable to regulatory sanctions, including discipline under Part XIV of the *Act* (Disciplinary Measures), and may be relevant to the use of the *FSA's* other powers, including the statutory information gathering and investigation powers (see further *PRIN 1.1.7G* to *1.1.9G*). But, unlike a breach of a requirement imposed under the statutory powers listed in *SUP 2.1.5G*, a breach of *Principle 11* or a *rule*:

- (1) is not a criminal offence; and
- (2) cannot lead to a *person* being treated as if in contempt of court (see section 177 of the *Act* (Offences)).

2.2.2 **G**_{/1} Neither *Principle 11* nor *SUP 2.3.5R(1)* (Access to premises) enable the *FSA* to force access to premises.

Banking confidentiality and legal privilege

2.2.3 **G**_{/1} The *FSA* would not normally seek to gather information using the methods described in *SUP 2.3* or *SUP 2.4* in a situation where the *FSA* could not have obtained it under the powers in Part XI of the *Act* (Information Gathering and Investigations). In particular, the limitations in the following sections of the *Act* are relevant to this chapter:

- (1) section 175(5) (Information and documents: supplementary powers) under which no *person* may be required under Part XI of the *Act* (Information Gathering and Investigations) to disclose information or produce a document subject to banking confidentiality (with exceptions); the *FSA* would not normally seek such information using the methods described in *SUP 2.3* or *SUP 2.4*; and
- (2) section 413 (Protected items), under which no *person* may be required under the *Act* to produce, disclose or permit the inspection of *protected items*; a *firm* would not breach *Principle 11* or the *rules* in this chapter by not producing such items.

Confidentiality of information

2.2.4

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When the *FSA* obtains confidential information using the methods of information gathering described in *SUP* 2.3 or *SUP* 2.4, it is obliged under Part XXIII of the *Act* (Public Record, Disclosure of Information and Co-operation) to treat that information as confidential. The *FSA* will not disclose confidential information without lawful authority, for example if an exception applies under the Financial Services and Markets Act 2000 (Disclosure of Confidential Information) Regulations 2001(SI 2001/2188) or with the consent of the *person* from whom that information was received and (if different) to whom the information relates.

Admissibility of information in proceedings

2.2.5

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Information obtained by the *FSA* using the methods described in *SUP* 2.3 and *SUP* 2.4 is admissible in evidence in any proceedings, so long as it complies with any requirements governing the admissibility of evidence in the circumstances in question.



2.3 Information gathering by the FSA on its own initiative: cooperation by firms

Introduction: Methods of information gathering requiring cooperation

2.3.1 **G**_{/1} The FSA uses various methods of information gathering on its own initiative which require the cooperation of *firms*:

- (1) Visits may be made by representatives or appointees of the FSA. These visits may be made on a regular basis, on a sample basis, for special purposes such as theme visits (looking at a particular issue across a range of *firms*), or when the FSA has a particular reason for visiting a *firm*. Appointees of the FSA may include *persons* who are not FSA staff, but who have been appointed to undertake particular monitoring activities for the FSA (paragraph 6(2) of Schedule 1 to the *Act*). The FSA needs to have access to a *firm's documents*, personnel and business premises to carry out a visit.
- (2) The FSA may seek meetings at the FSA's offices or elsewhere.
- (3) The FSA may seek information or request *documents* by telephone, at meetings or in writing, including by electronic communication.

2.3.2 **G**_{/1} The FSA expects to request meetings or access to business premises during reasonable business hours. The FSA also normally expects to be able to give reasonable notice to a *firm* or connected person when it seeks information, *documents*, meetings or access to business premises. On rare occasions, however, the FSA may seek access to premises without notice. The prospect of unannounced visits is intended to encourage *firms* to comply with the requirements and standards under the *regulatory system* at all times.

Access to a firm's documents and personnel

2.3.3 **G**_{/1} In complying with *Principle 11*, the FSA considers that a *firm* should, in relation to the discharge by the FSA of its functions under the *Act*:

- (1) make itself readily available for meetings with representatives or appointees of the FSA as reasonably requested;
- (2) give representatives or appointees of the FSA reasonable access to any records, files, tapes or computer systems, which are within the *firm's* possession or control, and provide any facilities which the representatives or appointees may reasonably request;

- (3) produce to representatives or appointees of the FSA specified *documents*, files, tapes, computer data or other material in the *firm's* possession or control as reasonably requested;
- (4) print information in the *firm's* possession or control which is held on computer or on microfilm or otherwise convert it into a readily legible *document* or any other record which the FSA may reasonably request;
- (5) permit representatives or appointees of the FSA to copy *documents* or other material on the premises of the *firm* at the *firm's* reasonable expense and to remove copies and hold them elsewhere, or provide any copies, as reasonably requested; and
- (6) answer truthfully, fully and promptly all questions which are reasonably put to it by representatives or appointees of the FSA.

2.3.4

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In complying with *Principle 11*, the FSA considers that a *firm* should take reasonable steps to ensure that the following *persons* act in the manner set out in SUP 2.3.3G:

- (1) its *employees*, agents and *appointed representatives*; and
- (2) any other members of its *group*, and their *employees* and agents.

(See also, in respect of *appointed representatives*, SUP 12.5.3G(2)).

Access to premises

2.3.5

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- (1) A *firm* must permit representatives of the FSA, or *persons* appointed for the purpose by the FSA, to have access, with or without notice, during reasonable business hours to any of its business premises in relation to the discharge of the FSA's functions under the Act.
- (2) A *firm* must take reasonable steps to ensure that its agents, suppliers under *material outsourcing* arrangements and *appointed representatives* permit such access to their business premises. (See also, in respect of *appointed representatives*, SUP 12.5.3G(2)).

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The FSA normally expects to give reasonable notice of a visit (See SUP 2.3.2G).

Suppliers under material outsourcing arrangements

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A *firm* must take reasonable steps to ensure that each of its suppliers under *material outsourcing* arrangements deals in an open and cooperative way with the FSA in the discharge of its functions under the Act in relation to the *firm*.

2.3.8

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The cooperation that a *firm* is expected to procure from such suppliers is similar to that expected of the *firm*, in the light of the *guidance* in SUP 2.3.3.G to SUP 2.3.4G, but does not extend to matters outside the scope of the FSA's functions in

relation to the *firm*. SUP 2.3.5R(2) also requires a *firm* to take reasonable steps regarding access to the premises of such suppliers.

2.3.9 G_{/1} When a *firm* appoints or renews the appointment of a supplier under a *material outsourcing* arrangement, it should satisfy itself that the terms of its contract with the supplier require the supplier to give the *FSA* access to its premises as described in SUP 2.3.5R(2), and to cooperate with the *FSA* as described in SUP 2.3.7R. The *FSA* does not consider that the 'reasonable steps' in SUP 2.3.7R would require a *firm* to seek to change a contract, already in place when that *rule* was made by the *FSA*, until renewal of the contract.

2.3.10 G_{/1} The *FSA* will normally seek information from the *firm* in the first instance, but reserves the right to seek it from a supplier under a *material outsourcing* arrangement if the *FSA* considers it appropriate.

Information requested on behalf of other regulators

2.3.11 G_{/1} The *FSA* may ask a *firm* to provide it with information at the request of or on behalf of other regulators to enable them to discharge their functions properly. Those regulators may include *overseas regulators* or the *Takeover Panel*. The *FSA* may also, without notifying a *firm*, pass on to those regulators information which it already has in its possession. The *FSA's* disclosure of information to other regulators is subject to the obligation described in SUP 2.2.4G (Confidentiality of information).

2.3.12 G_{/1} In complying with *Principle 11*, the *FSA* considers that a *firm* should cooperate with it in providing information for other regulators. Section 169 of the *Act* (Investigations etc. in support of overseas regulator) gives the *FSA* certain statutory powers to obtain information and appoint investigators for *overseas regulators* if required (see *ENF 2*).



2.4 'Mystery shopping'

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Representatives or appointees of the FSA (which may include individuals engaged by a market research firm) may approach a *firm*, its agents or its *appointed representatives* in the role of potential retail *consumers* with any authorisation under the Regulation of Investigatory Powers Act 2000 that is considered appropriate. This is known as 'mystery shopping'.

2.4.2

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The FSA uses mystery shopping to help it protect *consumers*. This may be by seeking information about a particular practice across a range of *firms* (SUP 2.4.3G(1)) or the practices of a particular *firm* (SUP 2.4.3G(2)). One of the risks *consumers* face is that they may be sold financial products which are inappropriate to them. A problem in protecting *consumers* from this risk is that it is very difficult to establish after the event what a *firm* has said to a 'genuine' *consumer* in discussions. By recording what a *firm* says in discussions with a 'mystery shopper', the FSA can establish a *firm's* normal practices in a way which would not be possible by other means.

2.4.3

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The FSA may carry out mystery shopping:

- (1) together with a programme of visits to obtain information about a particular practice, looking at a particular issue across a range of *firms*, when the FSA may advise the *firms* of the issues beforehand; the practice being scrutinised may be that of *firms* or a class of *firms* in carrying on *regulated activities* or *ancillary activities* or in *communicating* or *approving financial promotions*;
- (2) together with focused visits (concentrating on particular aspects of a *firm's* business) to obtain information about the practices of a *firm*; these practices may be in carrying on *regulated activities* or *ancillary activities* or in *communicating* or *approving financial promotions* when the FSA has particular concerns about those practices;
- (3) using recording devices, telephonic or other communications; the FSA may monitor and store the contents of the materials obtained by these devices or communications.

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Telephone calls and meetings held during mystery shopping will be recorded. The FSA expects that any mystery shopping it arranges will be conducted in accordance with the Market Research Society Code of Practice.

Chapter 3

Auditors



3.1 Application

3.1.1

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This chapter applies to:

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- (1) every *firm* within a category listed in column (1) of the table in SUP 3.1.2R; and
- (2) the external auditor of such a *firm* appointed under SUP 3.3;

in accordance with column (2) or (3) of that table, except as described in the remainder of this section.

3.1.2

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Table Applicable sections (see SUP 3.1.1R)

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(1) Category of firm	(2) Sections applicable to the firm	(3) Sections applicable to its auditor
(1) <i>Bank or building society which in either case carries on designated investment business</i>	SUP 3.1 – SUP 3.7	SUP 3.1, SUP 3.2, SUP 3.8, SUP 3.10
(2) <i>Bank or building society which in either case does not carry on designated investment business</i>	SUP 3.1 – SUP 3.7	SUP 3.1, SUP 3.2, SUP 3.8
(3) <i>Investment management firm, personal investment firm (other than a small personal investment firm), or securities and futures firm (Note 1)</i>	SUP 3.1 – SUP 3.7	SUP 3.1, SUP 3.2, SUP 3.8 – SUP 3.10
(4) <i>Insurer, the Society of Lloyd's, underwriting agent or members' adviser</i>	SUP 3.1 – SUP 3.7	SUP 3.1, SUP 3.2, SUP 3.8

(1) Category of firm	(2) Sections applicable to the firm	(3) Sections applicable to its auditor
(5) <i>Small personal investment firm, service company or authorised professional firm</i> (Note 2)	SUP 3.1, SUP 3.2, SUP 3.7	SUP 3.1, SUP 3.2, SUP 3.8

Note 1 = This note applies in relation to an *oil market participant* to which *IPRU(INV)* 3 does not apply. Only *SUP* 3.1, *SUP* 3.2 and *SUP* 3.7 are applicable to such a *firm* and only *SUP* 3.1, *SUP* 3.2 and *SUP* 3.8 are applicable to its auditor.

Note 2 = This note applies in relation to an *authorised professional firm* which is required by *IPRU(INV)* 2.1.2R to comply with chapter 3, 5, 10 or 13 of *IPRU(INV)*. This chapter applies to such a *firm* (and its auditor) as if it were the relevant *firm* type in the right-hand column of *IPRU(INV)* 2.1.4R.

Incoming firms

- 3.1.3** **R**_{/1} This chapter does not apply to an *incoming EEA firm* without a *top-up permission* or an auditor of such a *firm*.
- 3.1.4** **G**_{/1} The application of *SUP* 3.10 to the auditor of an *incoming EEA firm* with a *top-up permission* is qualified in *SUP* 3.10.3R.
- 3.1.5** **R**_{/1} This chapter does not apply to an *incoming Treaty firm*, which:
- (1) does not have a *top-up permission*; and
 - (2) is not required to comply with the *client asset rules*.
- 3.1.6** **G**_{/1} The application of *SUP* 3.7 and *SUP* 3.9 to an *incoming Treaty firm* or an auditor of such a *firm* is further qualified in *SUP* 3.7.1G and *SUP* 3.9.2R.

Auditors of lead regulated firms

- 3.1.7** **G**_{/1} The application of *SUP* 3.9 and *SUP* 3.10 to the auditor of a *lead regulated firm* is qualified in *SUP* 3.9.2R and *SUP* 3.10.3R.

Auditors of firms of solicitors subject to SUP 3.10

- 3.1.8** **G**_{/1} A *firm* of solicitors is not required to comply with the *client money rules* (COB 9.3) and instead must comply with its *designated professional body's* rules (COB

9.3.25R). SUP 3.10 is therefore modified for the auditor of such a *firm*, if it applies (see Note 2 to the table in SUP 3.1.2R and SUP 3.10.2R).

Material elsewhere in the Handbook

3.1.9

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A *firm* which is a *bank, building society, friendly society* or other *insurer, investment management firm, personal investment firm, securities and futures firm* or the *Society of Lloyd’s* should see the Interim Prudential sourcebooks for further provisions on auditors as set out in SUP 3.1.10G. For the categorisations employed in SUP 3.1.2R and SUP 3.1.10G see SUP App 1.

3.1.10

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Table Other relevant sections of the Handbook (see SUP 3.1.9G)

<i>Bank</i>	<i>IPRU(BANK)</i>
<i>Building society</i>	<i>IPRU(BSOC)</i>
<i>Friendly society</i>	<i>IPRU(FSOC)</i>
<i>Insurer (other than a friendly society)</i>	<i>IPRU(INS)</i>
<i>Investment management firm, personal investment firm, securities and futures firm</i>	<i>IPRU(INV)</i>
<i>Society of Lloyd’s</i>	<i>LLD</i>

3.2 Purpose

- 3.2.1** G_{/1} This chapter sets out *rules* and *guidance* on the role auditors play in the FSA's monitoring of *firms'* compliance with the requirements and standards under the *regulatory system*. In determining whether a *firm* satisfies the *threshold conditions*, the FSA has regard to whether the *firm* has appointed auditors with sufficient experience in the areas of business to be conducted by the *firm* (COND 2.5.7G(11)). Auditors act as a source of information for the FSA in its supervision. They report, where required, on the financial resources of the *firm*, the accuracy of its reports to the FSA and its compliance with particular *rules*, such as the *client asset rules*.
- 3.2.2** G_{/1} The *Act*, together with other legislation such as the Companies Acts 1985 and 1989, the Building Societies Act 1986 and the Friendly Societies Act 1992, provides the statutory framework for *firms'* and auditors' obligations.
- 3.2.3** G_{/1} The requirements in SUP 3.9 represent an interim approach to the use of auditors, based mainly on the requirements which *previous regulators* applied to *firms*.
- 3.2.4** G_{/1} SUP 3.1.1R and SUP 3.1.2R limit the application of this chapter in relation to *authorised professional firms* and certain *oil market participants*. Such a *firm* is not required, under this chapter, to appoint an auditor. If such a *firm* appoints an auditor, for example, under the Companies Act 1985, SUP 3.7 and 3.8 nevertheless apply to help the FSA discharge its functions under the *Act*.

3.3 Appointment of auditors

Purpose

- 3.3.1** **G** ^{/1} This section requires a *firm* to appoint an auditor and supply the *FSA* with information about its auditor. The *FSA* requires such information to ensure that the *firm* has an auditor.

Appointment by firms

- 3.3.2** **R** ^{/1} A *firm* to which this section applies (see *SUP* 3.1) must:
- (1) appoint an auditor to undertake the duties and responsibilities set out in *SUP* 3.8 to *SUP* 3.10 (as applicable);
 - (2) notify the *FSA*, without delay, when it is aware that a vacancy in the office of auditor will arise or has arisen, giving the reason for the vacancy;
 - (3) appoint an auditor to fill any vacancy in the office of auditor which has arisen;
 - (4) ensure that the replacement auditor can take up office at the time the vacancy arises or as soon as reasonably practicable after that; and
 - (5) notify the *FSA* of the appointment of an auditor, advising the *FSA* of the name and business address of the auditor appointed and the date from which the appointment has effect.
- 3.3.3** **G** ^{/1}
- (1) *SUP* 3.3.2R applies to every *firm* to which this section applies. That includes a *firm* which is under an obligation to appoint an auditor under an enactment other than the *Act*, such as the Companies Act 1985. Such a *firm* is free to have a single auditor who is appointed to fulfil both obligations. *SUP* 3.3.2 R is made under section 138 of the *Act* (General rule-making power), in relation to such *firms*, and under section 340(1) (Appointment) in relation to other *firms*.
 - (2) *Building societies* and *friendly societies* are reminded that they are subject to the provisions of Schedule 11 to the Building Societies Act 1986 and Schedule 14 to the Friendly Societies Act 1992 relating to auditors, in addition to the provisions in this chapter. In relation to *SUP* 3.3.2R(2), such *firms* may give

the FSA a single notification of a vacancy in the office of auditor provided that the notification complies with the requirements of the relevant Act and SUP 3.3.2R(2).

The Society of Lloyd's

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With a view to achieving the objectives of promoting confidence in the market at Lloyd's and protecting the interests of policyholders and potential policyholders, the *Society* is directed under section 318 of the *Act* (Exercise of powers through Council), to take reasonable steps to ensure that:

- (1) every *managing agent* appoints an auditor for every *syndicate* which it manages; and
- (2) the auditor of every *syndicate* has the skill, resources and experience required to perform his duties.

Underwriting agents: notification to the Society of Lloyd's

3.3.5

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- (1) Paragraph (2) applies if the notifications required by SUP 3.3.2R(2) or (5) are within the scope of any arrangements made by the FSA with the *Society of Lloyd's* under paragraph 6(2) of Schedule 1 to the *Act*.
- (2) An *underwriting agent* must submit a notification in (1) to the *Society of Lloyd's* rather than to the FSA.

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An underwriting agent should see SUP 15.7.13G and SUP 15.7.14G for further guidance on the arrangements in SUP 3.3.5R.

Appointment by the FSA

3.3.7

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- (1) Paragraph (2) applies to a *firm* which is not under an obligation to appoint an auditor imposed by an enactment other than the *Act*.
- (2) If a *firm* fails to appoint an auditor within 28 days of a vacancy arising, the FSA may appoint an auditor for it on the following terms:
 - (a) the auditor to be remunerated by the *firm* on the basis agreed between the auditor and *firm* or, in the absence of agreement, on a reasonable basis; and
 - (b) the auditor to hold office until he resigns or the *firm* appoints another auditor.

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In addition, in the case of a *building society* or *friendly society*, Schedule 11 of the Building Societies Act 1986 and Schedule 14 of the Friendly Societies Act 1992

allow the *FSA* to appoint an auditor if this is not done at the society's annual general meeting.

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SUP 3.3.7R allows but does not require the *FSA* to appoint an auditor if the *firm* has failed to do so within the 28 day period. When it considers whether to use this power, the *FSA* will take into account the likely delay until the *firm* can make an appointment and the urgency of any pending duties of the appointed auditor.

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A *firm* must comply with and is bound by the terms on which an auditor has been appointed by the *FSA*, whether under *SUP* 3.3.7R, the Building Societies Act 1986 or the Friendly Societies Act 1992.

3.4 Auditors' qualifications

Purpose

- 3.4.1** **G**
/1 The *FSA* is concerned to ensure that the auditor of a *firm* has the necessary skill and experience to audit the business of the *firm* to which he has been appointed. This section sets out the *FSA's rules* and *guidance* aimed at achieving this.

Qualifications

- 3.4.2** **R**
/1 Before a *firm*, to which *SUP* 3.3.2R applies, appoints an auditor, it must take reasonable steps to ensure that the auditor has the required skill, resources and experience to perform his functions under the *regulatory system* and that the auditor:
- (1) is eligible for appointment as an auditor under Part II of the Companies Act 1989 or Part III of the Companies (Northern Ireland) Order 1990 (Eligibility for appointment) respectively; or
 - (2) if appointed under an obligation in another enactment, is eligible for appointment as an auditor under that enactment; or
 - (3) in the case of an *overseas firm*, is eligible for appointment as an auditor under any applicable equivalent laws of that country or territory.
- 3.4.3** **G**
/1 Enactments within *SUP* 3.4.2R(2) include the Building Societies Act 1986 and the Friendly Societies Act 1992.
- 3.4.4** **G**
/1 An auditor which a *firm* proposes to appoint should have skills, resources and experience commensurate with the nature, scale and complexity of the *firm's* business and the requirements and standards under the *regulatory system* to which it is subject. A *firm* should have regard to whether its proposed auditor has expertise in the relevant requirements and standards (which may involve access to *UK* expertise) and possesses or has access to appropriate specialist skill, for example actuarial expertise in carrying out audits of insurance companies or *friendly societies* where appropriate. The *firm* should seek confirmation of this from the auditor concerned as appropriate.

Disqualified auditors

3.4.5 **R** ^{/1} A *firm* must not appoint as auditor a *person* who is disqualified by the *FSA* under section 345 of the *Act* (Disqualification) from acting as an auditor either for that *firm* or for a relevant class of *firm*.

3.4.6 **G** ^{/1} If it appears to the *FSA* that an auditor of a *firm* has failed to comply with a duty imposed on him under the *Act*, it may disqualify him under section 345 of the *Act*. For more detail about what happens when the disqualification of an auditor is being considered or put into effect, see *ENF* 17. A list of *persons* who are disqualified by the *FSA* under section 345 of the *Act* may be found on the *FSA* website (www.fsa.gov.uk).

Requests for information on qualifications by the FSA

3.4.7 **R** ^{/1} A *firm* must take reasonable steps to ensure that an auditor, which it is planning to appoint or has appointed, provides information to the *FSA* about the auditor's qualifications, skills, experience and independence in accordance with the reasonable requests of the *FSA*.

3.4.8 **G** ^{/1} To enable it to assess the ability of an auditor to audit a *firm*, the *FSA* may seek information about the auditor's relevant experience and skill. The *FSA* will normally seek information by letter from an auditor who has not previously audited any *firm*. The *firm* should instruct the auditor to reply fully to the letter (and should not appoint an auditor who does not reply to the *FSA*). The *FSA* may also seek further information on a continuing basis from the auditor of a *firm* (see also the auditor's duty to cooperate under *SUP* 3.8.2R).

3.5 Auditors' independence

Purpose

- 3.5.1** **G**
/1 If an auditor is to carry out his duties properly, he needs to be independent of the *firm* he is auditing, so that he is not subject to conflicts of interest. Many *firms* are also subject to requirements under the Companies Act 1989, the Building Societies Act 1986 or the Friendly Societies Act 1992 on auditor's independence.

Independence

- 3.5.2** **R**
/1 A *firm* must take reasonable steps to ensure that the auditor which it appoints is independent of the *firm*.
- 3.5.3** **R**
/1 If a *firm* becomes aware at any time that its auditor is not independent of the *firm*, it must take reasonable steps to ensure that it has an auditor independent of the *firm*. The *firm* must notify the FSA if independence is not achieved within a reasonable time.
- 3.5.4** **G**
/1 The FSA will regard an auditor as independent if his appointment or retention does not breach the ethical guidance in current issue from the auditor's recognised supervisory body on the appointment of an auditor in circumstances which could give rise to conflicts of interest.
- 3.5.5** **G**
/1 *Firms* are reminded that the Building Societies Act 1986 and Friendly Societies Act 1992 provide that an auditor who is ineligible under section 27 of the Companies Act 1989 for appointment as auditor of a company (which is a subsidiary undertaking of a *building society* or a subsidiary of a *friendly society*) is ineligible for appointment as auditor to the *building society* or *friendly society* concerned.

3.6 Firms' cooperation with their auditors

- 3.6.1** **R** *A firm must cooperate with its auditor in the discharge of his duties under this chapter.*
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Auditor's access to accounting records

- 3.6.2** **G** In complying with SUP 3.6.1R, a *firm* should give a right of access at all times to the *firm's* accounting and other records, in whatever form they are held, and *documents* relating to its business. A *firm* should allow its auditor to copy *documents* or other material on the premises of the *firm* and to remove copies or hold them elsewhere, or give him such copies on request.
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- 3.6.3** **G** Section 341 of the *Act* (Access to books etc.) provides that an auditor of a *firm* appointed under SUP 3.3.2R:
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- (1) has a right of access at all times to the *firm's* books, accounts and vouchers; and
 - (2) is entitled to require from the *firm's* officers such information and explanations as he reasonably considers necessary for the performance of his duties as auditor.

- 3.6.4** **G** Section 389A of the Companies Act 1985, section 79 of the Building Societies Act 1986 and section 75 of the Friendly Societies Act 1992 give similar rights to auditors of companies, *building societies* and *friendly societies* respectively.
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- 3.6.5** **G** Section 413 (Protected items), under which no person may be required under the *Act* to produce, disclose or permit the inspection of *protected items*, is relevant to SUP 3.6.1R and SUP 3.6.3G.
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Access and cooperation: appointed representatives, material outsourcing, employees

- 3.6.6** **G** In complying with SUP 3.6.1R, a *firm* should take reasonable steps to ensure that each of its *appointed representatives* gives the *firm's* auditor the same rights of access to the books, accounts and vouchers of the *appointed representative* and entitlement to information and explanations from the *appointed representative's* officers as are given in respect of the *firm* by section 341 of the *Act* (see also SUP 12.5.5G(3)).
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- 3.6.7** **G** In complying with SUP 3.6.1R, a *firm* should take reasonable steps to ensure that each of its suppliers under a *material outsourcing* arrangement gives the *firm's* auditor the same rights of access to the books, accounts and vouchers of the *firm*
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held by the supplier, and entitlement to information and explanations from the supplier's officers as are given in respect of the *firm* by section 341 of the *Act*.

3.6.8

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In complying with *SUP* 3.6.1R, a *firm* should take reasonable steps to ensure that all its employees cooperate with its auditor in the discharge of his duties under this chapter.

Provision of false or misleading information to auditors

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Firms and their officers, *managers* and *controllers* are reminded that, under section 346 of the *Act* (Provision of false or misleading information to auditor or actuary), knowingly or recklessly giving false information to an auditor appointed under *SUP* 3.3.2R constitutes an *offence* in certain circumstances, which could render them liable to prosecution. This applies even when an auditor is also appointed under an obligation in another enactment.

3.7 Notification of matters raised by auditor

Application

- 3.7.1** **G**_{/1} SUP 3.7 does not apply to an *incoming Treaty firm* which does not have a *top-up permission*.

Notification

- 3.7.2** **G**_{/1} A *firm* should consider whether it should notify the FSA under *Principle 11* if:
- (1) the *firm* expects or knows its auditor will qualify his report on the audited annual financial statements or add an explanatory paragraph; or
 - (2) the *firm* receives a written communication from its auditor commenting on *internal controls* (see also SUP 15.3).
- 3.7.3** **G**_{/1} An *underwriting agent* should submit any notifications under this section in accordance with the arrangements made between the FSA and the *Society of Lloyd's*. For *guidance* on those arrangements see SUP 15.7.13G and SUP 15.7.14G.

3.8 Rights and duties of all auditors

Purpose

- 3.8.1** **G**
/1 The auditor of a *firm* has various rights and duties to obtain information from the *firm* and both to enable and to require him to pass information to the *FSA* in specified circumstances. This section imposes or gives *guidance* on those rights and duties.

Cooperation with the FSA

- 3.8.2** **R**
/1 An auditor of a *firm* must cooperate with the *FSA* in the discharge of its functions under the *Act*.
- 3.8.3** **G**
/1 The *FSA* may ask the auditor to attend meetings and to supply it with information about the *firm*. In complying with *SUP* 3.8.2R, the auditor should attend such meetings as the *FSA* requests and supply it with any information the *FSA* may reasonably request about the *firm* to enable the *FSA* to discharge its functions under the *Act*.
- 3.8.4** **R**
/1 An auditor of a *firm* must give any *skilled person* appointed by the *firm* all assistance that *person* reasonably requires (see *SUP* 5 and section 166(5) of the *Act* (Reports by skilled persons)).

Auditor's independence

- 3.8.5** **R**
/1 An auditor of a *firm* must be independent of the *firm* in performing his duties in respect of that *firm*.
- 3.8.6** **R**
/1 An auditor of a *firm* must take reasonable steps to satisfy himself that he is free from any conflict of interest in respect of that *firm* from which bias may reasonably be inferred. He must take appropriate action where this is not the case.
- 3.8.7** **G**
/1 *SUP* 3.5.4G explains that an auditor whose appointment does not breach the ethical guidance in current issue from the auditor's recognised supervisory body will be regarded as independent by the *FSA*.

Auditors' rights to information

- 3.8.8** G_{/1} *SUP* 3.6.1R requires a *firm* to cooperate with its auditor. *SUP* 3.6.3G refers to the rights to information which an auditor is granted by the *Act*. *SUP* 3.6.4G refers to similar rights granted by the Companies Act 1985, the Building Societies Act 1986 and the Friendly Societies Act 1992.

Communication between the FSA, the firm and the auditor

- 3.8.9** G_{/1} Within the legal constraints that apply, the *FSA* may pass on to an auditor any information which it considers relevant to his function. An auditor is bound by the confidentiality provisions set out in Part XXIII of the *Act* (Public record, disclosure of information and cooperation) in respect of confidential information he receives from the *FSA*. An auditor may not pass on such confidential information without lawful authority, for example if an exception applies under the Financial Services and Markets Act 2000 (Disclosure of Confidential Information) Regulations 2001 (SI 2001/2188) or with the consent of the *person* from whom that information was received and (if different) to whom the information relates.

Auditors' statutory duty to report

- 3.8.10** G_{/1} Auditors are subject to regulations made by the Treasury under sections 342(5) and 343(5) of the *Act* (Information given by auditor or actuary to the *FSA*). These regulations oblige auditors to report certain matters to the *FSA*. Sections 342(3) and 343(3) of the *Act* provide that an auditor does not contravene any duty by giving information or expressing an opinion to the *FSA*, if he is acting in good faith and he reasonably believes that the information or opinion is relevant to any functions of the *FSA*. These provisions continue to have effect after the end of the auditor's term of appointment.

Termination of term of office, disqualification

- 3.8.11** R_{/1} An auditor must notify the *FSA* without delay if he:
- (1) is removed from office by a *firm*; or
 - (2) resigns before his term of office expires; or
 - (3) is not re-appointed by a *firm*.
- 3.8.12** R_{/1} If an auditor ceases to be, or is formally notified that he will cease to be, the auditor of a *firm*, he must notify the *FSA* without delay:
- (1) of any matter connected with his so ceasing which he thinks ought to be drawn to the *FSA*'s attention; or
 - (2) that there is no such matter.

3.8.13

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- (1) An auditor of an *underwriting agent* must submit a notification under *SUP 3.8.11R* or *SUP 3.8.12R* to the *Society of Lloyd's* rather than to the *FSA* if (2) applies.
- (2) This paragraph applies if the notification is within the scope of any arrangements made by the *FSA* with the *Society of Lloyd's* under paragraph 6(2) of Schedule 1 to the *Act*.

3.8.14

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For *guidance* on these arrangements, see *SUP 15.7.13G* and *SUP 15.7.14G*. Notification to the *Society* acting on behalf of the *FSA* in accordance with *SUP 3.8.13R* also satisfies the obligation to notify the *FSA* in accordance with section 344 of the *Act* (Duty of auditor or actuary resigning etc. to give notice).

3.9 Duties of auditors: reports on certain investment business firms

Purpose

- 3.9.1** **G**
/1 The types of *firm* which an auditor is required to report on in this section generally have businesses and assets of a nature which lend themselves well to the use of standardised reports by auditors as a supervisory tool. To assist its supervision, the FSA therefore requires an auditor's report on these *firms'* financial statements and regulatory reporting in the format in SUP 3.9.5R as a means of obtaining information about the *firm's* financial position, and the quality of its regulatory reporting.

Application

- 3.9.2** **R**
/1 In addition to those excluded under SUP 3.1, SUP 3.9 does not apply to the auditor of:
- (1) a *lead-regulated firm*; or
 - (2) an *incoming Treaty firm*, which does not have a *top-up permission*.
- 3.9.3** **R**
/1 Where this section requires the auditor of a *firm* to report on a *firm's* compliance with *rules*, this section applies to the auditor only to the extent that the *firm* is required to comply with the relevant *rules*.

The auditor's report: content

- 3.9.4** **R**
/1 An auditor of a *firm* must:
- (1) submit a report addressed to the FSA, signed in his capacity as auditor, which states the matters set out in SUP 3.9.5R;
 - (2) in preparing a report to the FSA under (1), carry out such investigations as are reasonably necessary in order to form an opinion as to the matters required to be stated in the report; and

3.9.5

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Table Auditor's report

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- (3) submit a letter to the *firm* annually commenting on the *firm's internal controls* or stating that he has no such comments, whichever is appropriate; such a letter need only cover matters which have come to the auditor's attention while undertaking the work to produce the reports required by (1) or SUP 3.10.4R.

whether the auditor has:

- (1) audited the *firm's* annual financial statements in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board;
- (2) carried out such other procedures as he considered necessary, having regard to the relevant Auditing Practices Board's Practice Note; and
- (3) obtained all the information and explanations which to the best of his knowledge and belief are necessary for the purposes of his report to the *FSA*; and

whether in the auditor's opinion:

- (4) except in the case of an *OPS firm*, the audited annual financial statements of the *firm* give a true and fair view:
- (a) in the case of the profit and loss account, of the *firm's* profit or loss for the period to which that account relates; and
- (b) in the case of the annual balance sheet, of the state of the affairs of the *firm* at the *accounting reference date* at which that balance sheet was prepared;
- (5) in the case of an *OPS firm*, the audited annual financial statements give a true and fair view of the state of affairs:
- (a) in the case of the statements of the *firm*, of the *firm* at the *accounting reference date* of the *firm*; and
- (b) in the case of any *OPS collective investment scheme* in relation to which the *firm* carries on *OPS activities*, of the *OPS collective investment scheme* at the *accounting reference date* of the scheme;
- (6) the relevant financial reporting statement has been properly prepared in accordance with the *FSA's rules*, the relevant financial reporting statement being, in the case of:

- (a) **an investment management firm: the annual financial return (see SUP 16.7.36R) ; or**
- (b) **a personal investment firm: the annual financial statement (see SUP 16.7.45R) ; or**
- (c) **a securities and futures firm: the annual reporting statement (SUP 16.7.25R or SUP 16.7.27R);**
- (7) **the balance sheet and the profit and loss account of the relevant financial reporting statement in (6) are in agreement with the firm's accounting records and returns;**
- (8) **in the case of:**
 - (a) **a personal investment firm; or**
 - (b) **a securities and futures firm;****the balance sheet of the relevant financial reporting statement in (6) has been properly reconciled to the quarterly reporting statement or monthly reporting statement prepared as at the same accounting reference date;**
- (9) **in the case of a securities and futures firm, the balance sheet of the annual reporting statement has been properly reconciled to the balance sheet of the audited annual financial statements;**
- (10) **the firm (not being a corporate finance advisory firm or an OPS firm) has calculated its expenditure requirement in accordance with the relevant rules for the forthcoming year, the relevant rules being, in the case of:**
 - (a) **an investment management firm: IPRU(INV) 5.2.3R (4) and IPRU(INV) 5.2.4R;**
 - (b) **a category A personal investment firm (see SUP 3.9.6R): IPRU(INV) 13.2R and IPRU(INV) 13.5R;**
 - (c) **a category B personal investment firm (see SUP 3.9.6R): IPRU(INV) 13.9R and IPRU(INV) 13.12R;**
 - (d) **a securities and futures firm which is not an ISD investment firm: IPRU(INV) 3-70R, IPRU(INV) 3-71R and IPRU(INV) 3-73R;**
 - (e) **a securities and futures firm which is an ISD investment firm: IPRU(INV) 10-71R, IPRU(INV) 10-72R and IPRU(INV) 10-73R;**

- (11) the *firm's* statement of financial resources, and the *firm's* statement of financial resources requirement, have been properly prepared in accordance with the *rules*;
- (12) the *firm's* financial resources at the *accounting reference date* are sufficient to meet the *firm's* financial resources requirement;
- (13) the *firm* has kept proper accounting records in accordance with the *rules* throughout its financial year, the relevant *rules* being, in the case of:
 - (a) an *investment management firm*: IPRU(INV) 5.3.1R;
 - (b) a *personal investment firm*: IPRU(INV) 13.1.11 – 13.1.16R
 - (c) a *securities and futures firm* which is not an *ISD investment firm*: IPRU(INV) 3–10R;
 - (d) a *securities and futures firm* which is an *ISD investment firm*: IPRU(INV) 10–10R;
- (14) if the *firm* prepares a consolidated reporting statement at its *accounting reference date*, that it has been prepared in accordance with the *rules*.

3.9.6

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In SUP 3.9.5R(10)(b) and (c), a "Category A *personal investment firm*" is a *personal investment firm* which is an *ISD investment firm* and a "Category B *personal investment firm*" is a *personal investment firm* other than a category A *personal investment firm*.

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The auditor's report: timing of submission

3.9.7

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An auditor of a *firm* must submit a report under SUP 3.9.4R(1) after each *accounting reference date* of the *firm* and so as to be received by the *FSA* within:

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- (1) in the case of an auditor of a *securities and futures firm*, three months of the *firm's accounting reference date*;
- (2) in the case of an auditor of a *personal investment firm* or an *investment management firm*, four months of the *firm's accounting reference date*.

3.9.8

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If an auditor is unable to report to the *FSA* within the timetable set out in SUP 3.9.7R, the auditor must notify the *FSA* and advise the *FSA* of the reasons why it has been unable to meet the requirements of SUP 3.9.7R.

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The auditor's report: requirements not met or inability to form opinion

3.9.9

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- (1) If the report under *SUP* 3.9.4R(1) states that one or more of the applicable requirements described in *SUP* 3.9.5R(4) to (14) have not been met, the auditor must specify in the report those requirements and the respects in which they have not been met.
- (2) If an auditor is unable to form an opinion as to whether one or more of the applicable requirements described in *SUP* 3.9.5R(4) to (14) have been met, the auditor must specify in the report under *SUP* 3.9.4R(1) those requirements and the reasons why the auditor has been unable to form an opinion.

Method of submission of reports

3.9.10

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An auditor of a *firm* must submit a report under *SUP* 3.9.4(1) in accordance with the *rules* in *SUP* 16.3.6R to *SUP* 16.3.13R as if those *rules* applied directly to the auditor.

Service of Notice Regulations

3.9.11

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The Financial Services and Markets Act 2000 (Service of Notices) Regulations 2001 (SI 2001/1420) contains provisions relating to the service of documents on the *FSA*. They do not apply to reports required under *SUP* 3.9 because of the specific provisions in *SUP* 3.9.10R.

3.10 Duties of auditors: notification and report on client assets

Application

- 3.10.1** **R** ^{/1} Where this section requires an auditor of a *firm* to report on a *firm's* compliance with *rules*, this section applies to the auditor only to the extent that the *firm* is required to comply with the relevant *rules*.
- 3.10.2** **R** ^{/1} An auditor of an *authorised professional firm* need not report under this section in relation to that *firm's* compliance with the *client money rules* (COB 9.3), if that firm is regulated by:
- (1) the Law Society (England and Wales);
 - (2) the Law Society of Scotland;
 - (3) the Law Society of Northern Ireland.
- 3.10.3** **R** ^{/1} SUP 3.10.5R (3) does not apply to an auditor of a *lead regulated firm* or an *incoming EEA firm*.

Client assets report: content

- 3.10.4** **R** ^{/1} An auditor of a *firm* must submit a report addressed to the FSA, signed in his capacity as auditor, which:
- (1) states the matters set out in SUP 3.10.5; or
 - (2) if the *firm* claims not to hold *client money* or *custody assets*, states whether anything has come to the auditor's attention that causes him to believe that the *firm* held *client money* or *custody assets* during the period covered by the report.
- 3.10.5** **R** ^{/1} Table Client assets report

whether in the auditor's opinion

- (1) the *firm* has maintained systems adequate to enable it to comply with the *rules* in *COB 9 (Client assets)* throughout the period since the last date as at which a report was made;
- (2) the *firm* was in compliance with the *rules* in *COB 9 (Client assets)* at the date as at which the report has been made; and
- (3) in the case of an *investment management firm, personal investment firm or securities and futures firm*, when a *subsidiary* of the *firm* is a *nominee company* in whose name *custody assets* of the *firm* are registered, that *nominee company* has maintained throughout the year systems for the custody, identification and control of *custody assets* which:
 - (a) are adequate; and
 - (b) include reconciliations at appropriate intervals between the records maintained (whether by the *firm* or the *nominee company*) and statements or confirmations from *custodians* or from the *person* who maintains the record of legal entitlement.

Client assets report: period covered

- 3.10.6 **R** The period covered by a report under *SUP 3.10.4R* must end not more than 53 weeks after the period covered by the previous report on such matters, or, if none, after the *firm* is *authorised* or becomes a *firm* to which *SUP 3.10* applies.

Client assets report: timing of submission

- 3.10.7 **R** An auditor must deliver a report under *SUP 3.10.4R* to the *FSA* so as to be received within four months of the end of each period covered.
- 3.10.8 **R** If an auditor is unable to report to the *FSA* within the timetable set out in *SUP 3.10.7R*, the auditor must notify the *FSA* and advise the *FSA* of the reasons why it has been unable to meet the requirements of *SUP 3.10.7R*.

Client assets report: requirements not met or inability to form opinion

- 3.10.9** **R** /1 If the report under *SUP 3.10.4R* states that one or more of the applicable requirements described in *SUP 3.10.5R* have not been met, the auditor must specify in the report those requirements and the respects in which they have not been met.
- 3.10.10** **R** /1 If an auditor is unable to form an opinion as to whether one or more of the applicable requirements described in *SUP 3.10.5R* have been met, the auditor must specify in the report under *SUP 3.10.4R* those requirements and the reasons why the auditor has been unable to form an opinion.
- 3.10.11** **G** /1 An auditor may at the *firm's* request include the matters required under this section in a separate report to that required under section *SUP 3.9*.

Method of submission of reports

- 3.10.12** **R** /1 An auditor of a *firm* must submit a report under *SUP 3.10.4R* in accordance with the rules in *SUP 16.3.6R* to *SUP 16.3.13R* as if those *rules* applied directly to the auditor.

Service of Notice Regulations

- 3.10.13** **G** /1 The Financial Services and Markets Act 2000 (Service of Notices) Regulations 2001 (SI 2001/1420) contain provisions relating to the service of documents on the *FSA*. They do not apply to reports required by *SUP 3.10* because of the specific provisions in *SUP 3.10.12R*.

Chapter 4

Actuaries





4.1 Application

4.1.1

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This chapter applies to:

- (1) every *firm* within a category listed in column (1) of the table in SUP 4.1.3R; and
 - (2) the *appointed actuary* or *appropriate actuary* of such a *firm*;
- in accordance with column (2) of that table.

4.1.2

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This chapter applies to *long-term insurers* (including *friendly societies*) and other *friendly societies*. This chapter does not apply to the *Society of Lloyd's* or to Lloyd's *underwriting agents*. Requirements dealing with the appointment and duties of *actuaries* in relation to Lloyd's *insurance business* are contained in *LLD*.

4.1.3

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Table Applicable sections (see SUP 4.1.1.R)

(1) Category of firm	(2) Applicable sections
<p>(1) A long term <i>insurer</i>, other than:</p> <ul style="list-style-type: none"> (a) a <i>registered friendly society</i> which is a <i>non-directive friendly society</i>; and (b) an <i>incorporated friendly society</i> that is a <i>flat rate benefits business friendly society</i>. 	<p>SUP 4.1, SUP 4.2, SUP 4.3 and SUP 4.5</p>
<p>(2) A <i>friendly society</i>, other than a <i>friendly society</i> within (1)</p>	

4.2 Purpose

- 4.2.1** G_{/1} Section 340 of the *Act* gives the *FSA* power to make *rules* requiring an *authorised person*, or an *authorised person* falling into a specified class, to appoint an actuary. Section 340 further empowers the *FSA* to make *rules* governing the manner, timing and notification to the *FSA* of such an appointment and, where an appointment is not made, for the *FSA* to make an appointment on the *firm's* behalf. The *FSA's* rule-making powers under section 340 of the *Act* also extend to the actuary's duties and to the cessation of an actuary's term of office.
- 4.2.2** G_{/1} This chapter defines the relationship between a *firm* and its *appointed actuary* or *appropriate actuary* and clarifies the role which *appointed actuaries* and *appropriate actuaries* play in the *FSA's* monitoring of *firms'* compliance with the requirements and standards under the *regulatory system*. The chapter sets out *rules* and *guidance* on the appointment of an *actuary* to the position of *appointed actuary* or *appropriate actuary*, and the termination of the *actuary's* term of office, as well as setting out their respective rights and duties. The purpose of the chapter is to ensure that:
- (1) *long-term insurers* (other than certain *friendly societies*) have access to adequate actuarial advice; and
 - (2) other *friendly societies* carrying on *insurance business* (and which have traditionally relied upon actuarial expertise) employ or use an *actuary* of appropriate seniority and experience to evaluate the liabilities of that business.
- 4.2.3** G_{/1} The function described by *SUP* 4.2.2G(1) is performed by the *appointed actuary* who is required to hold office continuously and must be an *approved person*. The principal duty of the *appointed actuary* is to advise the *firm* (see *SUP* 4.3.13R to *SUP* 4.3.21G for the rights and duties of the *appointed actuary*).
- 4.2.4** G_{/1} The function described by *SUP* 4.2.2G(2) is performed by the *appropriate actuary* who is appointed triennially to prepare the investigation required by *IPRU(FSOC)* [number to be inserted later] (see *SUP* 4.4.7R to *SUP* 4.4.10G for the rights and duties of an *appropriate actuary*).
- 4.2.5** G_{/1} Both the *appointed actuary* and the *appropriate actuary* act as a valuable source of information to the *FSA* in carrying out its functions. For example, in determining whether a *firm* satisfies the *threshold conditions*, the *FSA* has regard to whether the *firm* has appointed an *appointed actuary* with sufficient experience in the areas of business to be conducted by the *firm* (*COND* 2.5.7G(11)).

4.3 Appointed actuaries

Appointment by firms

4.3.1

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A *firm* to which this section applies (see SUP 4.1) must:

- (1) appoint an *actuary* (the "*appointed actuary*");
- (2) notify the *FSA*, without delay, when it is aware that a vacancy in the office of *appointed actuary* will arise or has arisen, giving the reason for the vacancy;
- (3) appoint an *actuary* to fill any vacancy in the office of *appointed actuary* that has arisen; and
- (4) ensure the replacement *actuary* can take up office at the time the vacancy arises or as soon as reasonably practicable after that.

4.3.2

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The provisions relating to the duties of the *appointed actuary* are set out in SUP 4.3.13R to SUP 4.3.21G. Acting in the capacity of *appointed actuary* of a *firm* under SUP 4.3.1R is specified as a *controlled function* (CF 12, the *appointed actuary function*) in SUP 10 (*Approved persons*). As a result, an application must be made to the *FSA* under section 60 of the *Act* (Applications for approval) for approval of the *person* proposing to take up an appointment as an *appointed actuary*. Section 61(3) of the *Act* (Determination of applications) gives the *FSA* three months to grant its approval or give a *warning notice* that it proposes to refuse the application. A *firm* should not appoint an *actuary* until the *FSA* has approved the *actuary*. In order to comply with SUP 4.3.1R, a *firm* should ensure it applies to the *FSA* as soon as practicable before the date when it needs the *actuary* to take office. The *FSA* will need time to consider the application before deciding whether to grant approval. See SUP 10 (*Approved persons*).

Appointment by the FSA

4.3.3

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If a *firm*, which is required to appoint an *actuary* under SUP 4.3.1R, fails to do so within 28 days of a vacancy arising, the *FSA* may appoint an *actuary* to perform the function of *appointed actuary* on the following terms:

- (1) the *actuary* to be remunerated by the *firm* on the basis agreed between the *actuary* and the *firm* or, in the absence of agreement, on a reasonable basis; and
- (2) the *actuary* to hold office until he resigns or the *firm* appoints another *actuary*.

4.3.4 G_{/1} SUP 4.3.3R allows but does not require the FSA to appoint an *actuary* if the *firm* has failed to do so within the 28 day period. When it considers whether to use this power, the FSA will take into account the likely delay until the *firm* can make an appointment and the urgency of any pending duties of the *appointed actuary*.

4.3.5 G_{/1} The FSA will not normally seek to appoint an *actuary* under SUP 4.3.3R if a notification under SUP 10 (*Approved persons*) has been received from the *firm* in relation to a proposed appointment of an *actuary* under SUP 4.3.1R, and that application is still being considered.

4.3.6 R_{/1} A *firm* must comply with and is bound by the terms on which an *actuary* has been appointed by the FSA under SUP 4.3.3R.

4.3.7 G_{/1} If the FSA appoints an *actuary* under SUP 4.3.3R, he will not be an *appointed actuary* (not being appointed under SUP 4.3.1R) and will not therefore need to be an *approved person*. However, the *firm* is still under an obligation to appoint an *actuary* under SUP 4.3.1R and will need to seek prior approval of that person (even if the individual it proposes to appoint is the person who has been appointed by the FSA under SUP 4.3.3R).

Appointed actuary's qualifications

4.3.8 G_{/1} The FSA is concerned to ensure the *appointed actuary* of a *firm* has the necessary skill and experience to provide the *firm* with appropriate actuarial advice. SUP 4.3.9R to SUP 4.3.10G set out the FSA's *rules* and *guidance* aimed at achieving this.

4.3.9 R_{/1} Before a *firm* applies for approval of its proposed *appointed actuary*, it must take reasonable steps to ensure that the *actuary*:

- (1) has the required skill and experience to perform his functions under the *regulatory system*; and
- (2) is a Fellow of the Institute of Actuaries or of the Faculty of Actuaries.

4.3.10 G_{/1} To comply with SUP 4.3.9R and Principle 3, before an *appointed actuary* takes up his appointment the *firm* should ensure that the *actuary*:

- (1) has skills and experience appropriate to the nature, scale and complexity of the *firm's* business and the requirements and standards under the *regulatory system* to which it is subject; and
- (2) has adequate qualifications and experience, which includes holding an Appointed Actuaries Practising Certificate under the rules of the Institute of Actuaries or the Faculty of Actuaries;

and seek confirmation of these from the *actuary*, or the *actuary's* current and previous employers, as appropriate.

Disqualified actuaries

4.3.11 **R** ^{/1} A *firm* must not appoint as *appointed actuary* an *actuary* who is disqualified by the *FSA* under section 345 of the *Act* (Disqualification) from acting as an *actuary* either for that *firm* or for a relevant class of *firm*.

4.3.12 **G** ^{/1} If it appears to the *FSA* that an *appointed actuary* has failed to comply with a duty imposed on him under the *Act*, it may disqualify him under section 345 of the *Act*. For more detail about what happens when the disqualification of an *actuary* is being considered or put into effect, see *ENF 17*. A list of *actuaries* who are disqualified by the *FSA* may be found on the *FSA* website (www.fsa.gov.uk).

Rights and duties of the appointed actuary

4.3.13 **R** ^{/1} An *appointed actuary* must:

- (1) identify and monitor the risks the *firm* runs so far as they may have a material impact on the *firm's* ability to meet *liabilities to policyholders* in respect of *long-term insurance contracts* as they fall due;
- (2) inform the *firm's* management, at the level of seniority that is reasonably appropriate, if he has any material concerns or good reason to believe that the *firm*:
 - (a) is not meeting *liabilities to policyholders* under *long-term insurance contracts* as they fall due, or may not be doing so, or might not have done so, or might, in reasonably foreseeable circumstances, not do so;
 - (b) is, or may be, effecting new *long-term insurance contracts* on inadequate terms contrary to *IPRU(INS) 3.5A* or *IPRU(FSOC)* [number to be inserted later] as applicable;
 - (c) does not, or may not, have sufficient financial resources to meet *liabilities to policyholders* as they fall due (including reasonable bonus expectations) or, if the *firm* currently has sufficient resources, might, in reasonably foreseeable circumstances, not continue to have them;
- (3) perform actuarial investigations and prepare abstracts of those investigations as required by *IPRU(INS) 9.4R* or *IPRU(FSOC)* [number to be inserted later] as applicable;

- (4) request from the *firm* such information and explanations as are reasonably considered necessary to enable him to properly perform the duties described in SUP 4.3.13R(1) to (3); and
- (5) advise the *firm* as to the data and systems reasonably needing to be kept and maintained to provide such information and explanations.

4.3.14

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A *liability to a policyholder* is defined in the *Glossary* as any liability or obligation of an *insurer* to, or in respect of, a *policyholder*. It includes *policyholder's* reasonable expectations as to discretionary benefits and charges.

4.3.15

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The *appointed actuary's* duty to request information does not necessarily require him to undertake continuous monitoring. This depends on the *firm's* size, financial position, future plans and other circumstances, including the robustness of its systems and controls. If a periodic update or review is sufficient, it should be carried out as often as is reasonably necessary. An annual update may suffice for small, financially sound, well-run *insurers*. Such periodic reviews might also usefully be supplemented by desk-based monitoring to identify circumstances where the timing of the next review might need to be brought forward.

4.3.16

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If a *firm* also carries out general insurance contracts, the *appointed actuary* should consider the *general insurance business* to the extent, if any, that this might have an impact on the *long-term insurance business*.

4.3.17

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A *firm* must require and allow its *appointed actuary* to perform his duties and, in particular:

- (1) keep him informed of the *firm's business* and other plans (including, where relevant, those of any related *firm*, to the extent it is aware of these);
- (2) provide him with sufficient resources (including his own time and access to the time of others);
- (3) hold such data and establish such systems as he reasonably requires;
- (4) request his advice about the likely effect of material changes in the *firm's* business plans, practices or other circumstances on the rights and reasonable expectations of *policyholders* in respect of *long-term insurance contracts*; and
- (5) pay due regard to his advice, whether provided in response to a request under (4) or on the *appointed actuary's* own initiative; this will include, if he requests it, allowing him to present his advice directly to the *firm's governing body* (that is, the board of *directors* or, for a *friendly society*, the committee of management).

4.3.18

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A *firm's* duty to keep its *appointed actuary* informed includes providing relevant information, even where the *appointed actuary* does not ask for it. The *firm* needs to appreciate that the *appointed actuary* may be unaware of certain business developments and so unable to request relevant information.

4.3.19

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Section 341 of the *Act* (Access to books etc.) provides that an *appointed actuary*:

- (1) has a right of access at all times to the *firm's* books, accounts and vouchers; and
- (2) is entitled to require from the *firm's* officers such information and explanations as he reasonably considers necessary to perform his duties as *appointed actuary*.

4.3.20

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When carrying out his duties, an *appointed actuary* must pay due regard to generally accepted actuarial best practice.

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The standards and guidance issued from time to time by the Institute of Actuaries and the Faculty of Actuaries are important sources of actuarial best practice.

4.4 Appropriate actuaries

Appointment of an appropriate actuary

- 4.4.1 **R**_{/1} A *firm* to which this section applies (see *SUP* 4.1) and required by *IPRU(FSOC)* [number to be inserted later] to ensure that an investigation is carried out must:
- (1) appoint an *actuary* (the "*appropriate actuary*") to carry out that investigation into its business and to prepare an abstract of it; and
 - (2) appoint a replacement for that *actuary* if he ceases to hold office before he has carried out the duty described in (1).

- 4.4.2 **G**_{/1} The *appropriate actuary* need not hold office continuously. He need only be appointed in good time to prepare the investigation required by *IPRU(FSOC)* [number to be inserted later]. His appointment may cease when the abstract of that investigation has been deposited with the *FSA*.

Appropriate actuaries' qualifications

- 4.4.3 **R**_{/1} Before a *friendly society* appoints an *appropriate actuary*, it must take reasonable steps to ensure that the *actuary* is a Fellow of the Institute of Actuaries or of the Faculty of Actuaries.
- 4.4.4 **G**_{/1} An *appropriate actuary* should have skills and experience appropriate to the nature, scale and complexity of the *firm's* business and the requirements and standards under the *regulatory system* to which it is subject. In complying with *Principle 3*, a *firm* should have regard to whether its proposed *appropriate actuary* has adequate qualifications and experience, and seek confirmation of this from the *actuary*, or the *actuary's* current and previous employers, as appropriate.
- 4.4.5 **R**_{/1} A *firm* must not appoint as *appropriate actuary* an *actuary* who has been disqualified by the *FSA* under section 345 of the *Act* (Disqualification) from acting as an *actuary* either for that *firm* or for a relevant class of *firm*.
- 4.4.6 **G**_{/1} If it appears to the *FSA* that an *appropriate actuary* has failed to comply with a duty imposed on him under the *Act*, it may disqualify him under section 345 of the *Act*. For more detail about what happens when the disqualification of an *actuary* is being considered or put into effect, see *ENF* 17. A list of *actuaries* who have been disqualified by the *FSA* may be found on the *FSA* website (www.fsa.gov.uk).

Rights and duties of the appropriate actuary

- 4.4.7 **R** ^{/1} An *appropriate actuary* must carry out the triennial investigation and prepare an abstract of it as required by *IPRU(FSOC)* [number to be inserted later].
- 4.4.8 **G** ^{/1} Section 341 of the *Act* (Access to books etc.) provides that an *appropriate actuary*:
- (1) has a right of access at all times to the *firm's* books, accounts and vouchers; and
 - (2) is entitled to require from the *firm's* officers such information and explanations as he reasonably considers necessary for the performance of his duties as *appropriate actuary*.
- 4.4.9 **R** ^{/1} In carrying out his duties an *appropriate actuary* must pay due regard to generally accepted actuarial best practice.
- 4.4.10 **G** ^{/1} The standards and guidance issued by the Institute of Actuaries and the Faculty of Actuaries are important sources of actuarial best practice.

4.5 Provisions applicable to both appointed and appropriate actuaries

Objectivity

- 4.5.1** **R** ^{/1} *An appointed actuary or appropriate actuary must be objective in performing his duties.*
- 4.5.2** **G** ^{/1} Objectivity requires the *appointed actuary* or *appropriate actuary* to perform his duties in such a manner that he can have an honest belief in his work and does not compromise the quality of his work or his judgment. An *appointed actuary* or *appropriate actuary* should not allow himself to be placed in situations where he feels unable to make objective professional judgments.
- 4.5.3** **R** ^{/1} *An appointed actuary or appropriate actuary must take reasonable steps to satisfy himself that he is free from bias, or from any conflict of interest from which bias may reasonably be inferred. He must take appropriate action where this is not the case.*
- 4.5.4** **G** ^{/1} The appropriate action may include asking the *firm's governing body* to re-assign temporarily some or all of his duties to another competent *actuary*. Where this is insufficient, the *appointed actuary* or *appropriate actuary* should resign his office.
- 4.5.5** **G** ^{/1} If the *appointed actuary* or *appropriate actuary* is an *employee* of the *firm*, the ordinary incentives of employment, including profit-related pay, *share options* or other financial interests in the *firm* or any *associate*, give rise to a conflict of interest only where they are disproportionate, or exceptional, relative to those of other employees of equivalent seniority.
- 4.5.6** **G** ^{/1} The guidance and professional conduct standards in current issue from the Institute of Actuaries and the Faculty of Actuaries are relevant to compliance with *SUP* 4.5.1R and *SUP* 4.5.3R.

Appointed and appropriate actuaries' statutory duty to report

- 4.5.7** **G** ^{/1} *Appointed actuaries* and *appropriate actuaries* are subject to regulations made by the Treasury under section 342(5) and 343(5) of the *Act* (Information given by *auditor* or *actuary* to the Authority). These regulations oblige *actuaries* to report certain matters to the *FSA*. Sections 342(3) and 343(3) of the *Act* provide that an *actuary* does not contravene any duty by giving information or expressing an opinion to the *FSA*, if he is acting in good faith and he reasonably believes that the information or opinion is relevant to any functions of the *FSA*. These provisions continue to have effect after the end of the *actuary's* term of appointment.

Termination of term of office

- 4.5.8** **G**_{/1} SUP 4.5.9R to SUP 4.5.11G apply to a *person* who is or has been an *appointed actuary* or *appropriate actuary*.
- 4.5.9** **R**_{/1} An *appointed actuary* or *appropriate actuary* must notify the FSA without delay if he:
- (1) is removed from office by a *firm*; or
 - (2) resigns before his term of office expires; or
 - (3) is not reappointed by a *firm*.
- 4.5.10** **R**_{/1} An actuary who has ceased to be the *appointed actuary* or *appropriate actuary*, or who has been formally notified that he will cease to be the *appointed actuary* or *appropriate actuary*, of a *firm* must notify the FSA without delay:
- (1) of any matter connected with the cessation which he thinks ought to be drawn to the FSA's attention; or
 - (2) that there is no such matter.
- 4.5.11** **G**_{/1} When an *appointed actuary* ceases to hold office, he ceases to perform the *appointed actuary* function. A *firm* is therefore required under SUP 10.13.6R to tell the FSA within seven *business days* of its *appointed actuary* ceasing to hold office and to complete a withdrawal form (Form C, SUP 10 Ann 6R). Note also the requirement of SUP 10.13.7R in relation to qualified withdrawals.

Chapter 6

Applications to vary and cancel Part IV permission



6.1 Application and purpose

Application

- 6.1.1** G_{/1} This chapter applies to every *firm* with a *Part IV permission* which wishes to:
- (1) vary its *Part IV permission*; or
 - (2) cancel its *Part IV permission* and end its *authorisation*.
- 6.1.2** G_{/1} If appropriate, a *firm* which is the manager of a *collective investment scheme* should also refer to *CIS 14* for *guidance* on the termination of *ICVCs* and *AUTs* and on winding up schemes that are not commercially viable.
- 6.1.3** G_{/1} This chapter applies to an *incoming firm* or a *UCITS qualifier* only in respect of a *top-up permission*. An *incoming firm* or a *UCITS qualifier* should refer to *SUP 14* (Variation of passport rights by incoming EEA firms and ending authorisation) for the procedures for changes to *permission* granted under Schedules 3, 4 or 5 of the *Act*.

Purpose

- 6.1.4** G_{/1} This chapter explains:
- (1) how a *firm* with *Part IV permission* can apply to the *FSA* to vary that *permission*;
 - (2) how a *firm* which has ceased to carry on any of the *regulated activities* for which it has *Part IV permission*, or which expects to do so in the short term (normally less than six months), should apply to the *FSA* to cancel that *permission* completely;
 - (3) the additional procedures that apply to a *firm* carrying on *regulated activities* which create long term obligations to *customers* (for example, *effecting contracts of insurance*, *carrying out contracts of insurance* or *accepting deposits*) that needs to wind down (run off) its business over a long term period (normally more than six months) and the applications it should make with a view to ultimately cancelling its *permission*; and
 - (4) how the *FSA* assesses those applications.
- 6.1.5** G_{/1} This chapter also outlines the *FSA's* powers to withdraw *authorisation* from a *firm* whose *Part IV permission* has been cancelled at the *firm's* request. It does not, however, cover the *FSA's* use of its *own-initiative powers* to vary or cancel a *firm's*

Part IV permission (see *SUP 7* (Individual requirements) and *ENF 5* (Cancellation of Part IV permission on the FSA's own initiative and withdrawal of authorisation)).



6.2 Introduction

6.2.1 G_{/1} A *firm authorised* under Part IV of the *Act* (Permission to carry on regulated activity) has a single *Part IV permission* granted by the *FSA*. A *firm's Part IV permission* specifies all or some of the following elements (as detailed in *AUTH* 3.3.3G (When is Part IV permission required and what does it contain?)):

- (1) a description of the activities the *firm* may carry on, including any *limitations*;
- (2) the *specified investments* involved; and
- (3) if appropriate, *requirements*.

6.2.2 G_{/1} Under section 20(1) of the *Act* (Authorised persons acting without permission), a *firm* is prohibited from carrying on a *regulated activity* in the *United Kingdom* (or purporting to do so) otherwise than in accordance with its *permission*.

6.2.3 G_{/1} If a *firm* wishes to change its *Part IV permission*, it can apply to the *FSA* under section 44 of the *Act* (Variation etc. at request of authorised person) for a variation or cancellation of its *Part IV permission*. *SUP* 6.2.5G sets out the differences between these types of application and the circumstances in which they should be made and *SUP* 6 Ann 1G gives an overview of the considerations in these cases.

6.2.4 G_{/1} A *firm* intending to expand its business should assess, taking appropriate professional advice where necessary, whether it will need to apply to the *FSA* to vary its *Part IV permission* before making any changes to its business.

6.2.5 G_{/1} Table Variation and cancellation of Part IV permission. See *SUP* 6.2.3G

Question	Variation of Part IV permission	Cancellation of Part IV permission
What does the application apply to?	Individual elements of a <i>firm's Part IV permission</i> . Variations may involve adding or removing categories of <i>regulated activity</i> or <i>specified investments</i> or varying or removing any <i>limitations</i> or <i>requirements</i> in the <i>firm's Part IV permission</i> .	A <i>firm's</i> entire <i>Part IV permission</i> and not individual elements within it.

Question	Variation of Part IV permission	Cancellation of Part IV permission
In what circumstances is it usually appropriate to make an application?	<p>If a <i>firm</i>:</p> <ol style="list-style-type: none"> wishes to change the <i>regulated activities</i> it carries on in the <i>United Kingdom</i> under a <i>Part IV permission</i> (SUP 6.3); or has the ultimate intention of ceasing carrying on <i>regulated activities</i> but due to the nature of those <i>regulated activities</i> (for example, <i>accepting deposits</i>, or <i>insurance business</i>) it will require a long term (normally over six months) to wind down (run off) its business (see SUP 6.2.8G to SUP 6.2.11G and SUP 6 Ann 4G). 	<p>If a <i>firm</i>:</p> <ol style="list-style-type: none"> has ceased to carry on all of the <i>regulated activities</i> for which it has <i>Part IV permission</i> (SUP 6.4); or wishes or expects to cease carrying on all of the <i>regulated activities</i> for which it has <i>Part IV permission</i> in the short term (normally not more than six months). In this case, the <i>firm</i> may apply to cancel its <i>Part IV permission</i> prior to ceasing the <i>regulated activities</i> (see SUP 6.4.3G).
Where do I find a summary of the application procedures?	See SUP 6 Ann 2G.	See SUP 6 Ann 3G.

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A *firm* which is seeking to:

- vary its *Part IV permission* substantially; or
- cancel its *Part IV permission*;

should discuss its plans with its usual supervisory contact at the *FSA* as early as possible before making an application, in order to comply with *Principle 11* (see SUP 15.3.7G (Notifications to the *FSA*)). These discussions will help the *FSA* and the *firm* to agree the correct approach for the *firm*.

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If a *firm* intends to cease carrying on one or more *regulated activities* permanently, it should give prompt notice to the *FSA* to comply with *Principle 11* (see SUP 15.3.8G(1)(d)). A *firm* should consider whether it needs to notify the *FSA* before applying to vary or cancel its *Part IV permission*.

Firms with long term liabilities to customers

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Discussions with the *FSA* are particularly relevant where the *firm* has to discharge obligations to its *customers* or policyholders before it can cease carrying on a *regulated activity*. This may be the case, for example, where the *firm* is an *insurer*, a *bank* or, as is often the case, holding *client money* or *customer assets*.

6.2.9 G_{/1} If an *insurer* or a *bank* wishes to cease carrying on all *regulated activities* for which it has *Part IV permission*, it will usually be necessary to wind down the business over a long term period which is normally more than six months. This may also be the case for a *firm* holding *client money* or *customer assets*. In these circumstances, it will usually be appropriate for the *firm* to apply for variation of its *Part IV permission* before commencing the wind-down. A *firm* should only make an application for cancellation of *permission* when it expects to complete its wind-down (run-off) within six months.

6.2.10 G_{/1} A *firm* which is winding down (running off) its activities should contact its usual supervisory contact at the *FSA* to discuss its circumstances. The *FSA* will discuss the *firm's* winding down plans and the need for the *firm* to vary or cancel its *Part IV permission*. Following these discussions, an application for variation or cancellation of *Part IV permission*, as appropriate, should usually be made by the *firm*, although, in certain circumstances, the *FSA* may use its *own-initiative powers* under section 45 of the *Act* (Variation etc. on the *FSA's* own initiative) (see *SUP 7* and *ENF 3* (Variation of *Part IV permission* on the *FSA's* own initiative)).

6.2.11 G_{/1}

- (1) Specific guidance on the additional procedures for a *firm* winding down (running off) its business in the circumstances discussed in *SUP 6.2.8G* is in *SUP 6 Ann 4G*.
- (2) The guidance in *SUP 6 Ann 4G* applies to any *firm* that is applying for variation of *Part IV permission* before it applies for cancellation of *Part IV permission* to enable it to wind down (run off) its business over a long term period of six months or more. It will apply to most *insurers* and *banks* and, in some circumstances, as advised by the *FSA*, to *firms* holding *client money* or *customer assets*.
- (3) If a *firm* wishes to cease carrying on some of its *regulated activities*, or the *specified investments* in respect of which the activities are carried on, the *FSA* may consider it appropriate for the *firm* to comply with the additional procedures in *SUP 6 Ann 4G*. This would depend on the scale and nature of the *regulated activities* concerned. This might be the case, for example, if the *firm* is ceasing a significant part of its business in respect of which it has outstanding obligations to *customers* and the *FSA* believes that the additional procedures would protect *consumers*.

UK firms exercising EEA or Treaty rights

6.2.12 G_{/1} A *UK firm* should assess the effect of any change to its *Part IV permission* on its ability to continue to exercise any *EEA right* or *Treaty right* and discuss any concerns with its usual supervisory contact at the *FSA*. A variation of *Part IV permission* may also change the *applicable provisions* with which it is required to comply by a *Host State*.

6.2.13 G_{/1} A *UK firm* which, as well as applying to vary or cancel its *Part IV permission*, wishes to vary or terminate any business which it is carrying on in another *EEA State* under one of the *Single Market Directives*, should follow the procedures in *SUP 13* (Exercise of passport rights by *UK firms*) on varying or terminating its *branch* or *cross border services* business.

The Lloyd's market

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A *firm* making an application to vary or cancel its *Part IV permission* which requires any approval from the *Society of Lloyd's* should apply to the *Society* for this at the same time as applying to the *FSA* for the variation or cancellation. See *SUP 6 Ann 4G* for additional procedures.

6.3 Applications for variation of permission

What is a variation of permission?

- 6.3.1** **G**_{/1} Under section 44 of the *Act*, a *firm* may apply to the *FSA* to vary its *Part IV permission* to:
- (1) allow it to carry on further *regulated activities*; or
 - (2) reduce the number of *regulated activities* it is permitted to carry on; or
 - (3) vary the *FSA*'s description of its *regulated activities* (including by the removal or variation of any *limitations*); or
 - (4) cancel any *requirement* applied for by the *firm* or imposed by the *FSA* under section 43 of the *Act* (Imposition of requirements); or
 - (5) vary any such *requirement*.

- 6.3.2** **G**_{/1} An application for variation of *Part IV permission* may include one or more of *SUP* 6.3.1G(1)-(5). For example, a *firm* may apply to vary its *Part IV permission* to add a new *regulated activity* and at the same time remove a *regulated activity* for which it currently has *permission*.

- 6.3.3** **G**_{/1} In applying for a variation of *Part IV permission*, a branch of a *firm* from outside the *EEA* should be mindful of any continuing requirements referred to in *AUTH* 3.18 and, for *insurers*, *AUTH* 3.12.

Applications to add additional regulated activities

- 6.3.4** **G**_{/1} In determining the activities and *specified investments* for which a *Part IV permission* is required, and whether to apply for a variation of that *permission*, a *firm* may need to take professional advice and may also wish to discuss this with its usual supervisory contact at the *FSA*.

- 6.3.5** **G**_{/1} Before applying to vary its *permission*, a *firm* should determine whether there are any statutory restrictions that do not allow combinations of certain types of *regulated activity*, particularly for *insurance business* or *UCITS* managers. For example, the *FSA* will not grant a variation of *Part IV permission* to allow a *friendly society* to carry on reinsurance business (see *AUTH* 3.12.5G). A *firm* should refer to *AUTH* 3 for details of any restrictions or discuss its plans with its usual supervisory contact at the *FSA*.

6.3.6 G_{/1} If a *firm* is seeking a variation of *Part IV permission* to add categories of *regulated activities*, it should be mindful of the directive requirements referred to at *SUP* 6.3.42G relating to the need to commence new activities within 12 months.

Applications to remove certain regulated activities

6.3.7 G_{/1} If a *firm* wishes to cease carrying on an activity for which it has *Part IV permission*, it will usually apply to vary its *Part IV permission* to remove that activity. If a *firm* wishes to cease carrying on an activity in relation to any *specified investment*, it will usually apply to vary its *Part IV permission* to remove that *specified investment* from the relevant activity.

How a variation of permission may affect the firm’s approved persons

- 6.3.8** G_{/1}
- (1) Where a *firm* is submitting an application for variation of *Part IV permission* which would lead to a change in the *controlled functions* of its *approved persons*, it should, at the same time and as appropriate:
 - (a) make an application to the *FSA* for an internal transfer of an *approved person*, Form E (Internal transfer), or make an application to the *FSA* for an individual to perform additional *controlled functions*, Form A (Application); see *SUP* 10.13.3G to *SUP* 10.13.5G;
 - (b) notify the *FSA* of any *approved person* who has ceased to perform a *controlled function*, Form C (Ceasing to perform controlled functions); see *SUP* 10.13.6G to *SUP* 10.13.13G.
 - (2) If the *firm* intends to recruit new individuals to perform *controlled functions*, it should apply to the *FSA* for approval of the individuals as *approved persons* as soon as possible using Form A (Application); see *SUP* 10.12.

How a variation of permission may change a firm’s prudential category

6.3.9 G_{/1} A variation of *Part IV permission* may, in some cases, lead to a change in a *firm’s* prudential category or sub-category (see *SUP* App 1). For example, an *investment management firm* which varies its *Part IV permission* to include *accepting deposits* and as a result meets the definition of a *bank*, would move to the prudential category for a *bank* (see *SUP* App 1 1.3.1G).

6.3.10 G_{/1} Even if a variation of *permission* does not itself lead to a change in a *firm’s* prudential category or sub-category, the *FSA* may use its *own-initiative powers* to require a *firm* to comply with a different category or sub-category of prudential *rules* where it considers this to be appropriate. For details of when and how the *FSA* may use its *own-initiative powers* in this context, see *SUP* 7.

Variation of permission involving insurance business

6.3.11 G_{/1} A *firm* with *Part IV permission* to carry on *insurance business*, which is applying for a variation of its *Part IV permission* to add further *insurance activities* or *specified investments*, will be required to submit particular information on its

existing activities as part of its application. This includes the *scheme of operations* which is required to be submitted as part of the application pack (for further details on the *scheme of operations*, see SUP App 2 (Insurers: scheme of operations)).

6.3.12 G_{/1} In applying to vary its *Part IV permission* to add categories of *specified investments*, in relation to *insurance business*, a *firm* carrying on *insurance business* will need to determine the *classes* of *specified investments* relating to *effecting and carrying out contracts of insurance* for which variation of *Part IV permission* will be necessary, having regard to whether certain *classes* of contract may qualify to be effected or carried out on an ancillary or supplementary basis (see AUTH 3.12.6G to AUTH 3.12.12G).

6.3.13 G_{/1} The application for variation of *Part IV permission* will need to provide information about the *classes* of *contract of insurance* for which variation of *Part IV permission* is requested and also those *classes* qualifying to be carried on on an ancillary or supplementary basis. *Firms* should note that, as explained in AUTH 3.9.29G(3), the FSA will not use the power described in AUTH 3.9.29G(2) to grant *Part IV permission* for *insurance business* which has not been included in the application.

6.3.14 G_{/1}

- (1) A *firm* carrying on *insurance business* which is seeking to cease such business in respect of one or more *classes* of *specified investment*, but which is not intending to cease all *insurance business*, should apply to vary its *Part IV permission* to remove the activity of *effecting contracts of insurance* in respect of those *specified investments* in relation to which it no longer wishes to carry on business. A *firm* intending to cease all *insurance business* should refer to SUP 6 Ann 4G.
- (2) If the application for variation of *Part IV permission* is granted by the FSA, the *firm* will have *Part IV permission* only to *carry out contracts of insurance* in respect of the *specified investments* in relation to which it no longer wishes to carry on business (see SUP 6 Ann 4G). This will allow the *firm* to run off this aspect of its business. When the business in question has been run-off completely, the *firm* should then apply to vary its *Part IV permission* to remove the relevant *classes* of *specified investment*.

The application for variation of permission

6.3.15 D_{/1}

- (1) A *firm* which wishes to apply for a variation of *Part IV permission* must do so in writing to the FSA, explaining the variation it seeks.
- (2) A *firm's* application for variation of *Part IV permission* must be given or addressed, and delivered in the way set out in SUP 15.7.4R to SUP 15.7.6R (Form and method of notification).
- (3) Until the application has been determined, a *firm* which submits an application for variation of *Part IV permission* must inform the FSA of any significant change to the information given in the application immediately it becomes aware of the change.

6.3.16 G_{/1}

- (1) Section 51(2) of the Act (Applications under this Part) requires that the application for variation of *Part IV permission* must contain a statement:
 - (a) of the desired variation; and

(b) of the *regulated activity* or *regulated activities* which the *firm* proposes to carry on if its *permission* is varied.

(2) The full form and content of the application for variation of *Part IV permission* is a matter for direction by the *FSA*, who will determine the additional information and documentation required on a case by case basis.

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(1) Subject to *SUP* 6.3.20G, there is no application pack for a variation of *Part IV permission*. Instead, a *firm* should send an application under *SUP* 6.3.15D to its usual supervisory contact at the *FSA*. This application should set out the requirements in *SUP* 6.3.16G in as much detail as possible, together with a detailed description of the reasons and circumstances that have given rise to the request.

(2) However, a *firm* is advised to discuss its application with its usual supervisory contact at the *FSA* before submission, particularly if it is seeking a variation of *permission* within a short timescale. A *firm* is also advised to include as much detail as possible (including any additional information identified by its supervisors at this stage) with its application.

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The *FSA*, as soon as possible after receipt of an application, will advise the *firm* of any additional information which is required as part of its application (see *SUP* 6.3.23G to *SUP* 6.3.27G). The amount of information the *FSA* will require will vary depending on the scale of the variation in the context of the *firm* as a whole, and the nature, risk profile and complexity of the variation.

Applications from firms winding down (running off) business over the long term

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A *firm* which is making an application for variation of *Part IV permission* to wind down (run off) its business before applying for a cancellation of that *permission* (see *SUP* 6.2.9G) should read *SUP* 6 Ann 4G for details of the additional procedures that apply.

Applications involving significant changes

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In certain cases, *FSA* may consider that granting an application for variation of *Part IV permission* which includes adding further *regulated activities* or changing a *requirement* or *limitation* would cause a significant change in the *firm's* business or risk profile. In these circumstances, the *FSA* may require the *firm* to complete appropriate parts of the full application pack (see *AUTH* 3), as directed by the *FSA*. Applications for variation involving significant changes may be processed by the *firm's* usual supervisory contact at the *FSA*, in conjunction with the Corporate Authorisation department.

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Examples of an application for variation of *Part IV permission* which may represent a significant change include, but are not limited to, an application:

- (1) to carry on new *regulated activities* such as *accepting deposits*;
- (2) to extend the *insurance business* of a *firm* which already has *Part IV permission* which includes *carrying out* or *effecting contracts of insurance* (or both), to new *classes of specified investment*; or

- (3) to remove a *requirement* preventing a *firm* from holding or controlling *client money*; or
- (4) which causes the *firm* to change prudential category by, for example, removing a *requirement* relating to prudential category (see SUP App 1).

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A *firm* that wishes to make a significant change to its business, or is unsure whether the changes it is proposing would be considered to be significant, should contact its usual supervisory contact at the FSA. The FSA will discuss with the *firm* whether it will be required to submit parts of the application pack and whether any reports from third parties may be required.

Information to be supplied to the FSA as part of the application

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- (1) The FSA may ask for any information it reasonably requires before determining the application. The information required will be determined on a case by case basis, taking into account the FSA’s existing knowledge of the *firm* and the variation requested. The FSA will advise the *firm* of the information required at an early stage in the application process.
- (2) The nature of the information and documents requested will be related to the risks posed to the FSA’s *regulatory objectives* by the *regulated activities* and any *unregulated activities* that the *firm* is seeking to carry on. This information will be proportional to the nature of the business which the *firm* intends to carry on or the risks posed by the *firm*.

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- (1) The information the FSA may require includes, but is not limited to, the examples given in SUP 6.3.25G:

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Table Information which may be required. See SUP 6.3.24G

Type of business	Information which may be required
All	<ul style="list-style-type: none"> 1. Details of how the <i>firm</i> plans to comply with the FSA’s regulatory requirements relating to any additional <i>regulated activities</i> it is seeking to carry on. 2. Descriptions of the <i>firm</i>’s key controls, senior management arrangements and audit and proposed compliance arrangements in respect of any new <i>regulated activity</i> (see SYSC). 3. Organisation charts and details of individuals transferring or being recruited to perform new <i>controlled functions</i> (see SUP 10 for details of the application or transfer procedures under the <i>approved persons</i> regime).
<i>Insurance business</i>	<ul style="list-style-type: none"> 1. A <i>scheme of operations</i> in accordance with SUP Appendix 2.

Type of business	Information which may be required
Accepting deposits and designated investment business	1. A business plan which includes the impact of the variation on the <i>firm's</i> existing or continuing business financial projections for the <i>firm</i> , including the impact of the requested variation of <i>Part IV permission</i> on the <i>firm's</i> financial resources and capital adequacy requirements.

6.3.26 G_{/1} Specific information may also be required by the *FSA* on the activities the *firm* intends to cease, or cease carrying on in relation to any *specified investments* (see *SUP* 6 Ann 4G).

6.3.27 G_{/1} When determining whether to grant an application, the *FSA* may request further information, including reports from third parties such as the *firm's* auditors, and may require meetings with, and visits to, the *firm*. The *FSA* may also require a statement from members of the *firm's governing body* confirming, to the best of their knowledge, the completeness and accuracy of the information supplied. The *FSA* may also discuss the application with other regulators, exchanges.

When will the FSA grant an application for variation of permission?

6.3.28 G_{/1} (1) The *FSA* is required by section 41(2) of the *Act* to ensure that a *firm* applying to vary its *Part IV permission* satisfies and will continue to satisfy the *threshold conditions* in relation to all the regulated activities for which the *firm* has or will have *Part IV permission* after the variation. However, the *FSA's* duty under the *Act* does not prevent it, having regard to that duty, from taking such steps as it considers necessary in relation to a particular *firm*, to secure its *consumer* protection objective. This may include granting a *firm's* application for variation of *Part IV permission* when it wishes to wind down (run off) its business activities and cease to carry on new business as a result of no longer being able to satisfy the *threshold conditions*.

(2) In addition, the *FSA* may refuse the application if it appears that the interests of *consumers*, or a group of *consumers*, would be adversely affected if the application were to be granted and it is desirable in the interests of *consumers*, or that group of *consumers*, for the application to be refused.

6.3.29 G_{/1} In determining whether the *firm* satisfies and continues to satisfy the *threshold conditions*, the *FSA* will consider whether the *firm* is ready, willing and organised to comply with the regulatory requirements it will be subject to if the requested variation of *Part IV permission* is granted.

6.3.30 G_{/1} The *FSA* will also consider the specific requirements that apply to certain types of activity (see *AUTH* 3.11 to *AUTH* 3.20) as these may not allow certain combinations of activity.

6.3.31 G_{/1} In considering whether to grant a *firm's* application to vary its *Part IV permission*, the *FSA* will also have regard, under section 49(1) of the *Act* (Persons connected with an applicant), to any person appearing to be, or likely to be, in a relationship with the *firm* which is relevant (see *AUTH* 3.9.22G to *AUTH* 3.9.24G (*Connected persons*)).

The FSA's powers in respect of application for variation of Part IV permission

6.3.32 G_{/1} The FSA's power to vary a *Part IV permission* after it receives an application from a *firm* extends to including in the *Part IV permission* as varied any provision that could be included as though a fresh *permission* was being given in response to an application under section 40 of the *Act* (Application for permission), see *AUTH* 3. Under sections 42 (Giving permission) and 43 of the *Act* (Imposition of requirements), the FSA may:

- (1) incorporate in the description of a *regulated activity* a *limitation* (for example, as to the circumstance in which a *regulated activity* may or may not be carried on); or
- (2) specify a narrower or wider description of *regulated activity* than the *firm* applied for in the application for variation of *Part IV permission* (see *AUTH* 3.9.29G(3) for restrictions on *insurers*); or
- (3) require the *firm* not to take a specified action (for example, not to hold *client money*); or
- (4) require the *firm* to take a specified action (for example, to submit financial returns more frequently than normal).

6.3.33 G_{/1} Thus, when determining an application for variation of *Part IV permission*, the FSA can, therefore:

- (1) include new *limitations* and vary existing *limitations*, either on application from the *firm* (for example, the *customer* categories with which a *firm* may carry on a specified activity), or if considered appropriate by the FSA under section 42(7)(a) of the *Act*; or
- (2) include any new *requirements* and vary existing *requirements*, either on application from the *firm* or where considered appropriate by the FSA under section 43 of the *Act* to ensure that the *firm* satisfies and continues to satisfy the *threshold conditions*.

6.3.34 G_{/1} If *limitations* or *requirements* are varied or imposed by the FSA which were not included in the *firm's* application for variation of *Part IV permission*, the FSA will be required to issue the *firm* with a *warning notice* and *decision notice* (see *SUP* 6.3.39G).

How long will an application take?

6.3.35 G_{/1} Under section 52(1) of the *Act* (Determination of applications), the FSA has six months to consider a completed application from the date of receipt.

6.3.36 G_{/1} If the FSA receives an application which is incomplete (that is, if information or a document required as part of the application is not provided), section 52(2) of the *Act* requires the FSA to determine that incomplete application within 12 months of the initial receipt of the application.

6.3.37 G_{/1} Within these time limits, however, the length of the process will relate directly to the complexity of the variation requested. The FSA publishes standard response times on its website at www.fsa.gov.uk setting out how long the application

process is expected to take in practice. From time to time, the *FSA* also publishes its performance against these times.

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At any time after receiving an application and before determining it, the *FSA* may require the applicant to provide additional information or documents. The circumstances of each application will dictate what additional information or procedures are appropriate.

How will the FSA make the decision?

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A decision to grant an application for variation of *Part IV permission*, as applied for, will be taken by appropriately experienced *FSA* staff. However, if the *FSA* staff dealing with the application recommend that a *firm's* application for variation of *Part IV permission* be either refused or granted subject to *limitations* or *requirements* or a narrower description of *regulated activities* than applied for, the decision will be taken by either the *RDC* or *executive procedures*.

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DEC gives guidance on the *FSA's* decision making procedures including the procedures it will follow if it proposes to refuse an application for variation of *Part IV permission* either in whole or in part (for example, an application granted by the *FSA* but subject to *limitations* or *requirements* not applied for).

Commencing new regulated activities

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If the variation of *Part IV permission* is given, the *FSA* will expect a *firm* to commence a new *regulated activity* in accordance with its business plan (revised as necessary to take account of changes during the application process) or scheme of operations for an *insurer*. *Firms* should take this into consideration when determining when to make an application to the *FSA*.

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- (1) *Firms* should be aware that the *FSA* may exercise its *own-initiative power* to vary or cancel their *Part IV permission* if they do not:
 - (a) commence a *regulated activity* for which they have *Part IV permission* within a period of at least 12 months from the date of being given; or
 - (b) carry on a *regulated activity* for which they have *Part IV permission* for a period of at least 12 months (irrespective of the date of grant).
- (2) If the *FSA* considers that such a variation or cancellation of the *firm's Part IV permission* is appropriate, it will discuss the proposed action with the *firm* and its reasons for not commencing or carrying on the *regulated activities* concerned.

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When a *firm* commences new *regulated activities* following a variation of a *Part IV permission*, it should have particular regard to the requirements of *Principle 11* (Relations with regulators) (see *SUP 15.3.8G(1)(c)*).

6.4 Applications for cancellation of permission

6.4.1 **G**_{/1} Under section 44(2) of the *Act* (Variation etc. at request of authorised person), if an *authorised person* with a *Part IV permission* applies to the *FSA*, the *FSA* may cancel that *permission*. Cancellation applies to a *firm's* entire *Part IV permission*; that is to every activity and every *specified investment* and not to the individual elements such as *specified investments*. Changes to the individual elements of a *permission* would require a variation.

6.4.2 **G**_{/1} Under section 44(3) of the *Act*, the *FSA* may refuse an application from a *firm* to cancel its *Part IV permission* if it appears that:

- (1) the interests of *consumers*, or potential *consumers*, would be adversely affected if the application were to be granted; and
- (2) it is desirable in the interests of *consumers*, or potential *consumers*, for the application to be refused.

6.4.3 **G**_{/1}

- (1) A *firm* may apply to the *FSA* to cancel its *Part IV permission* before it has ceased carrying on all *regulated activities*. However, where a *firm* makes a formal application for cancellation of its *permission* when it has not yet ceased carrying on *regulated activities*, the *FSA* will expect the *firm*:
 - (a) to cease those *regulated activities* within the short term (normally no more than six months from the date of application for cancellation); and
 - (b) to have formal plans to cease its *regulated activities* in an orderly manner.
- (2) *Firms* should note, however, that the *FSA* will not grant an application for cancellation of *Part IV permission* until the *firm* can demonstrate that it has ceased carrying on all *regulated activities* (SUP 6.4.19G).
- (3) The *FSA* may apply additional procedures or require additional information, as if the *firm* had entered into a long term wind down of business (see SUP 6 Ann 4G), if it considers it appropriate to the circumstances of the *firm*.

6.4.4 **G**_{/1} Additional guidance for a *firm* carrying on *insurance business*, *accepting deposits* or which holds *client money* or *customer's* assets is given in SUP 6 Ann 4G. As noted in SUP 6.2.9G, it will usually be appropriate for a *firm* to apply for variation of its *Part IV permission* while winding down (running off) its *regulated activities* and before applying to cancel its *Part IV permission*.

The application for cancellation of permission

6.4.5 **D**_{/1} (1) If a *firm* wishes to cancel its *Part IV permission*, it must write to the *FSA* giving the reasons for its application to cancel its *Part IV*

permission and the date on which the *firm* has ceased, or expects to cease, to carry on *regulated activities*. The *firm* must explain the full circumstances of its application.

- (2) A *firm's* application for cancellation of *Part IV permission* must be:
 - (a) given to a member of, or addressed for the attention of, the Resignation Team at the *FSA*; and
 - (b) delivered to the *FSA* by one of the methods in *SUP 15.7.5R* (Form and method of notification).
- (3) A *firm's* application for cancellation of *Part IV permission* must be served in the ways set out in *SUP 15.7* (Form and method of notification).
- (4) Until the application has been determined, a *firm* which submits an application for cancellation of *Part IV permission* must inform the *FSA* of any significant change to the information given in the application immediately it becomes aware of the change.

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- (1) *SUP 6.4.5R(2)(a)* provides that the application for cancellation of *Part IV permission* must be sent to the Resignation Team in the *FSA's* Corporate Authorisation department which performs a central administrative function. The *firm's* usual supervisory contact at the *FSA* will, however, be responsible for all day-to-day contact with the *firm* and assessing the application.
- (2) To contact the Corporate Authorisation Resignation Team:
 - (a) telephone on 020 7676 1000; fax on 020 7676 1099; or
 - (b) write to: Corporate Authorisation Resignation Team, The Financial Services Authority, 25 The North Colonnade, Canary Wharf, London, E14 5HS; or
 - (c) email corporate.authorisation@fsa.gov.uk

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When it receives this application, the Corporate Authorisation Resignation Team will send the *firm* a written acknowledgement. This acknowledgement will explain the cancellation process and detail the information required as part of the application (examples of which are given in *SUP 6.4.8G* to *SUP 6.4.17G*). The *firm* will be required to provide information which, in the opinion of the *FSA*, is necessary for it to determine whether to grant or refuse the application for cancellation of *Part IV permission*. The Corporate Authorisation Resignation Team will work with the *firm's* usual supervisory contact at the *FSA* during this process.

Information to be supplied to the FSA as part of the application for cancellation of permission

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The information which the *FSA* may request on the circumstances of the application for cancellation and the confirmations which the *FSA* may require a *firm* to provide will differ according to the nature of the *firm* and the activities it has *Part IV permission* to carry on.

6.4.9 G_{/1} A *firm* will be expected to demonstrate to the *FSA* that it has ceased carrying on *regulated activities*. The *FSA* may require, as part of the application, a report from the *firm* that includes, but is not limited to, the confirmations referred to in *SUP* 6.4.12G (as appropriate to the *firm's* business). The *FSA* may also require additional information to be submitted with the report including, in some cases, confirmation or verification from a professional adviser on certain matters to supplement the report (see *SUP* 6.4.15G).

6.4.10 G_{/1}

- (1) If a *firm* is subject to the complaints rules in *DISP*, the *FSA* may request confirmation from the *firm* that there are no unresolved, unsatisfied or undischarged complaints against the *firm* from a *customer* of the *firm*.
- (2) If there are unresolved or undischarged complaints against a *firm* from a *customer* of the *firm*, the *FSA* may request confirmation, as appropriate, of the steps (if any) which have been taken under the *firm's* complaints procedures and the amount of compensation claimed. The *FSA* may also request an explanation of the arrangements made for the future consideration of such complaints.

6.4.11 G_{/1} If the *firm* is carrying on *designated investment business* with *private customers*, the *FSA* may request confirmation that the *firm* has written, or intends to write, to all *private customers* with, or for whom, the *firm* has conducted *regulated activities* within a certain period.

Confirmations and resolutions

6.4.12 G_{/1} The *FSA* will usually require the report in *SUP* 6.4.9G to be signed by a *director* or other officer with authority to bind the *firm*. It may include confirmations from the *firm* that, in relation to business carried on under its *Part IV permission*, it has:

- (1) ceased carrying on all *regulated activities*;
- (2) properly disbursed funds in its *client bank accounts* and closed those accounts;
- (3) discharged all insurance or *deposit* liabilities; and
- (4) properly transferred all *investments*, title documents and other property that it held on behalf of *clients*.

6.4.13 G_{/1} The *FSA* may also require a resolution from the *firm's governing body*, for example to support the application for cancellation of *permission*, expressed to be irrevocable, and to give the signatory the authority to sign the formal report to the *FSA*.

6.4.14 G_{/1} Under section 397 of the *Act* (Misleading statements and practices), it is an *offence*, in purported compliance with a requirement imposed by or under the *Act* (including the directions in *SUP* 6.4.5D), for a *person* to knowingly or recklessly give the *FSA* information that is false or misleading. If necessary, a *firm* should take appropriate professional advice when supplying information required by the *FSA*. An *insurer*, for example, may ask an *actuary* to check assumptions in respect of future *claims* made under *contracts of insurance*.

Reports from professionals

6.4.15 G_{/1} The *FSA* may require additional information, including professional advice, to supplement or support the report in *SUP* 6.4.9G where it considers this appropriate. Examples of reports that may be requested by the *FSA* include, but are not limited to those detailed in *SUP* 6.4.16G.

6.4.16 G_{/1} Table Types of reports. See *SUP* 6.4.15G

Category of firm	Type of report
a <i>bank</i> or <i>building society</i>	<ul style="list-style-type: none"> • an audited balance sheet which confirms that, in the auditor’s opinion, the <i>firm</i> has no remaining <i>deposit</i> liabilities to <i>customers</i>; • a report from auditors or <i>reporting accountants</i>;
a <i>securities and futures firm</i>	<ul style="list-style-type: none"> • a report from auditors or <i>reporting accountants</i>
an <i>insurer</i>	<ul style="list-style-type: none"> • an audited closing balance sheet which demonstrates that the <i>firm</i> has no insurance liabilities to <i>policyholders</i>; • a report from the auditors or <i>reporting accountants</i>: and • in some cases, an actuarial opinion as to the likelihood of any remaining liabilities to <i>policyholders</i>.

6.4.17 G_{/1} If a *firm* is transferring its business, the *FSA* may require a professional opinion in respect of certain aspects of the transfer. For example, the *FSA* may require a legal opinion on the validity of arrangements to transfer *regulated activities*, *client money*, *client deposits*, *custody assets* or any other *property* belonging to *clients*, to another *authorised person*. Alternatively, an auditor or *reporting accountant* may be requested to verify that a transfer has been properly accounted for in the *firm*’s books and records. Transfers of *insurance* and *banking business* are subject to statutory requirements (see *SUP* 18).

Approved persons

6.4.18 G_{/1} A *firm* which is applying for cancellation of *Part IV permission* and which is not otherwise *authorised* by, or under, the *Act* should, at the same time, comply with *SUP* 10.13.6R and notify the *FSA* of persons ceasing to perform *controlled functions*. These forms should give the effective date of withdrawal, if known (see *SUP* 10 (Approved persons)).

When will the FSA grant an application for cancellation of permission?

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The FSA will usually not cancel a *firm's Part IV permission* until the *firm* can demonstrate that, in relation to business carried on under that permission, it has, as appropriate:

- (1) ceased carrying on *regulated activities* or fully run off or transferred all insurance liabilities;
- (2) repaid all *client money* and *client deposits*;
- (3) discharged *custody assets* and any other *property* belonging to *clients*; and
- (4) discharged, satisfied or resolved complaints against the *firm*.

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If it is not possible for a *firm* to demonstrate a relevant matter referred to in SUP 6.4.19G, for example, depositors are uncontactable, the *firm* will be expected to have satisfied the FSA that it has made adequate provisions for discharging any liabilities to *clients* which do not involve the *firm* carrying on *regulated activities*.

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Before the FSA cancels a *firm's Part IV permission*, the *firm* will be expected to be able to demonstrate that it has ceased or transferred all *regulated activities* under that *permission*. For example, the *firm* may be asked to provide evidence that a transfer of business (including, where relevant, any *client money*, *customer* assets or *deposits* or insurance liabilities) is complete. As noted in SUP 6.4.9G, the FSA may require the *firm* to confirm this by providing a report, in a form specified by the FSA:

- (1) as part of the application for cancellation of *permission*, if the *firm* has ceased carrying on all *regulated activities* under its *Part IV permission* at the time of application (see SUP 6.4.9G); or
- (2) after the application but before its determination, if the *firm* has not ceased carrying on *regulated activities* under its *Part IV permission* at the time of application.

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In deciding whether to cancel a *firm's Part IV permission*, the FSA will take into account all relevant factors in relation to business carried on under that *permission*, including whether:

- (1) there are unresolved, unsatisfied or undischarged complaints against the *firm* from any of its *customers*;
- (2) the *firm* has complied with COB 9.3.133R (Client money: discharge of fiduciary duty) and COB 9.3.138R (Client money: allocated but unclaimed client money) if it has ceased to hold *client money*; these COB rules apply to both repayment and transfer to a third party;
- (3) the *firm* has ceased to hold or control *custody assets* in accordance with instructions received from *clients* (including instructions set out in an agreement entered into in accordance with COB 9.1.49R (Custody: client agreement));
- (4) the *firm* has repaid all *client deposits*, if it is ceasing to carry on *regulated activities* including *accepting deposits*;
- (5) the FSA or another regulator has commenced an investigation against the *firm* or continuing enforcement action against the *firm*;

- (6) there are any matters affecting the *firm* which should be investigated before a decision on whether the *firm* should have its *Part IV permission* cancelled by the *FSA* or be disciplined;
- (7) the *firm* has unsettled or unexpired liabilities to *consumers*, for example, outstanding contracts (such as *deposits* or insurance liabilities);
- (8) the *firm* has settled all its debts to the *FSA*; and
- (9) the factors set out in *SUP* 6.4.19G apply.

The FSA’s enforcement and investigation powers against a former authorised person

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If the *FSA* has granted an application for cancellation of *Part IV permission* and withdrawn a *firm’s* status as an *authorised person* (see *SUP* 6.5) it will retain certain investigative and enforcement powers in relation to the *firm* as a former *authorised person*. These include:

- (1) information gathering and investigation powers in Part XI of the *Act* (Investigation gathering and investigations) (see *ENF* 2 (Information gathering and investigation powers));
- (2) powers to apply to court for *injunctions* and restitution orders in Part XXV of the *Act* (Injunctions and restitution) (see *ENF* 6 (Injunctions) and *ENF* 9 (Restitution and redress));
- (3) powers in Part XXIV of the *Act* (Insolvency) to petition for administration orders or winding up orders against *companies* or insolvent *partnerships*, or bankruptcy orders (or in Scotland sequestration awards) against individuals (see *ENF* 10 (Insolvency proceedings and orders against debt avoidance));
- (4) powers in Part XXVII of the *Act* (Offences) to prosecute *offences* under the *Act* and other specified provisions (see *ENF* 15 (Prosecution of criminal offences)).

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However, the *FSA* will not be able to use the following powers against former *authorised persons*:

- (1) powers to take disciplinary action against *firms* by publishing statements of misconduct under section 205 of the *Act* (Public censure) or imposing financial penalties under section 206(1) of the *Act* (Financial penalties); and
- (2) the power to require *firms* to make restitution under section 384 of the *Act* (Power of the *FSA* to require restitution).

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Consequently, the *FSA* considers that it will have good reason not to grant a *firm’s* application for cancellation of *permission* where:

- (1) it proposes to exercise any of the powers described in *SUP* 6.4.24G; or
- (2) it has already begun disciplinary and restitution proceedings against the *firm* by exercising either or both of these powers against the *firm*.

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The *FSA’s* use of those powers is outlined in *ENF* 11 (Discipline of authorised firms and approved persons: The *FSA’s* general approach).

How long will an application take?

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- (1) Under section 52(1) of the *Act* (Determination of applications), the *FSA* has six months to consider a completed application.
- (2) If the *FSA* receives an application which is incomplete, that is, where information or a *document* required as part of the application is not provided, section 52(2) of the *Act* requires the *FSA* to determine the incomplete application within 12 months of the initial receipt of the application.
- (3) Within these time limits, however, the length of the process will relate directly to the complexity of variation requested and whether the *firm* has fully wound down (run off) its activities at the time it applies. The *FSA* publishes standard response times on its website setting out how long the application process is expected to take in practice. From time to time, the *FSA* also publishes its performance against these times.

How will FSA make the decision?

6.4.28

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A decision to grant an application for cancellation of *permission* will be taken by appropriately experienced *FSA* staff. Where, however, the *FSA* staff dealing with the application recommend that a *firm's* application for cancellation of *Part IV permission* be refused, the decision will be taken by the *RDC*.

6.4.29

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See *DEC* for *guidance* on the *FSA's* decision making procedures, including the procedures it will follow if it proposes to refuse an application for cancellation of *Part IV permission*.



6.5 Ending authorisation

6.5.1

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Under section 33(2) of the *Act* (Withdrawal of authorisation by the FSA), if the FSA cancels a *firm's Part IV permission*, and as a result there is no *regulated activity* for which the *firm* has *permission*, the FSA is required to give a *direction* withdrawing the *firm's* status as an *authorised person*.

6.5.2

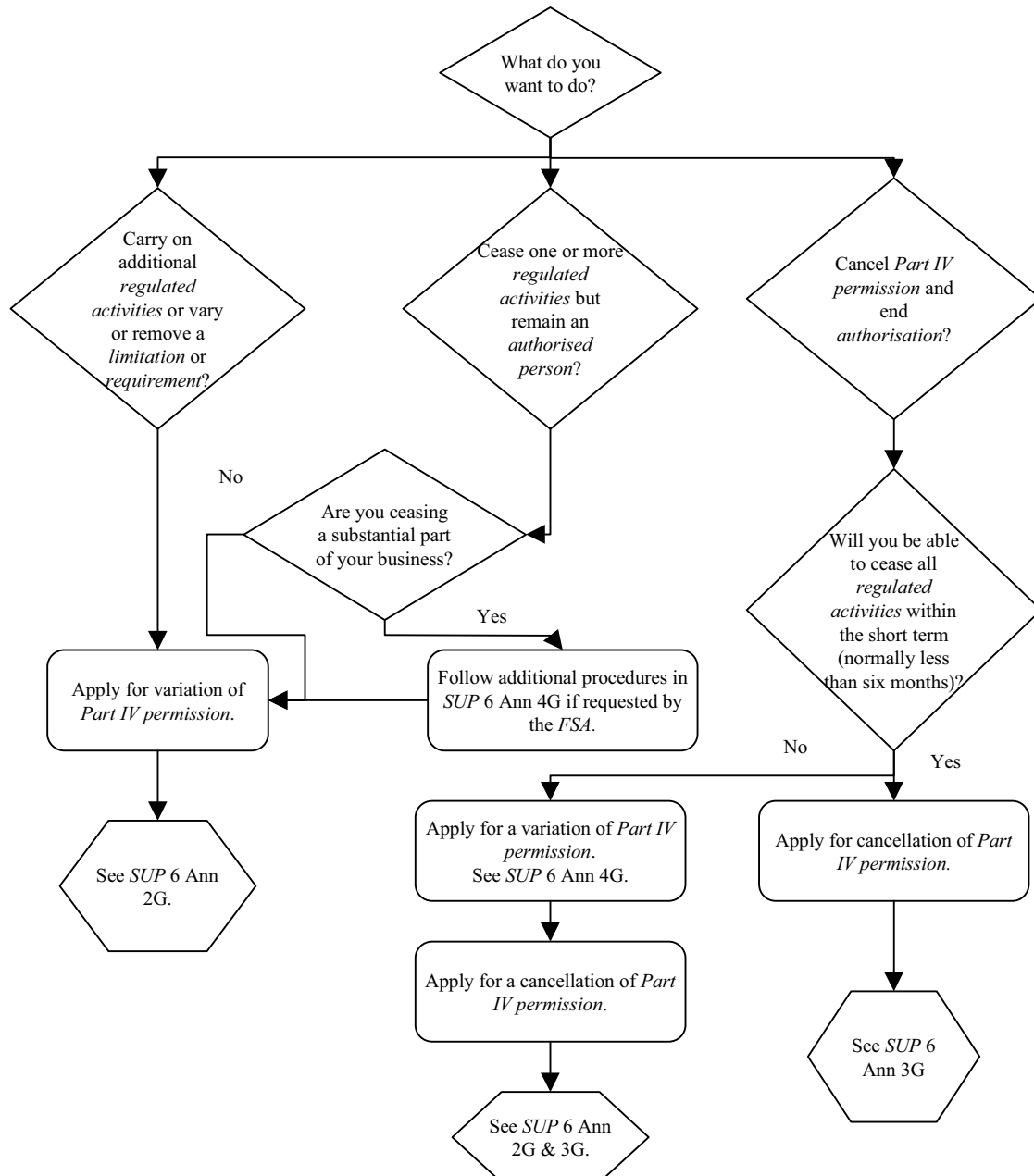
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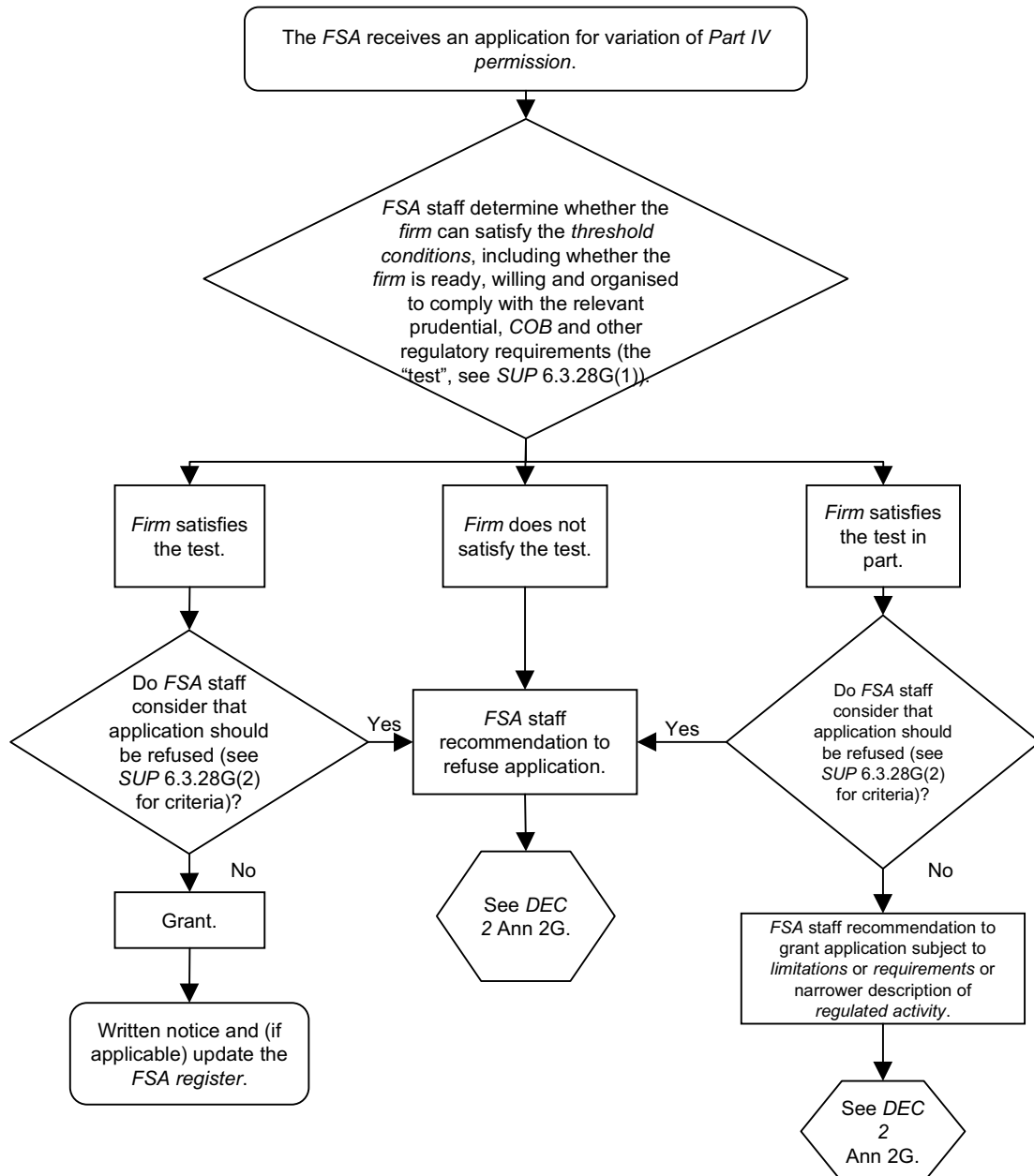
If the FSA concludes that it should grant a *firm's* application for cancellation of *permission* and end its *authorisation*, the FSA will:

- (1) cancel the *firm's Part IV permission* under section 44(2) of the *Act*;
- (2) withdraw the *firm's authorised* status under section 33(2) of the *Act* by giving the *firm* a direction in writing; and
- (3) update the *firm's* entry in the *FSA register* to show it has ceased to be *authorised*.

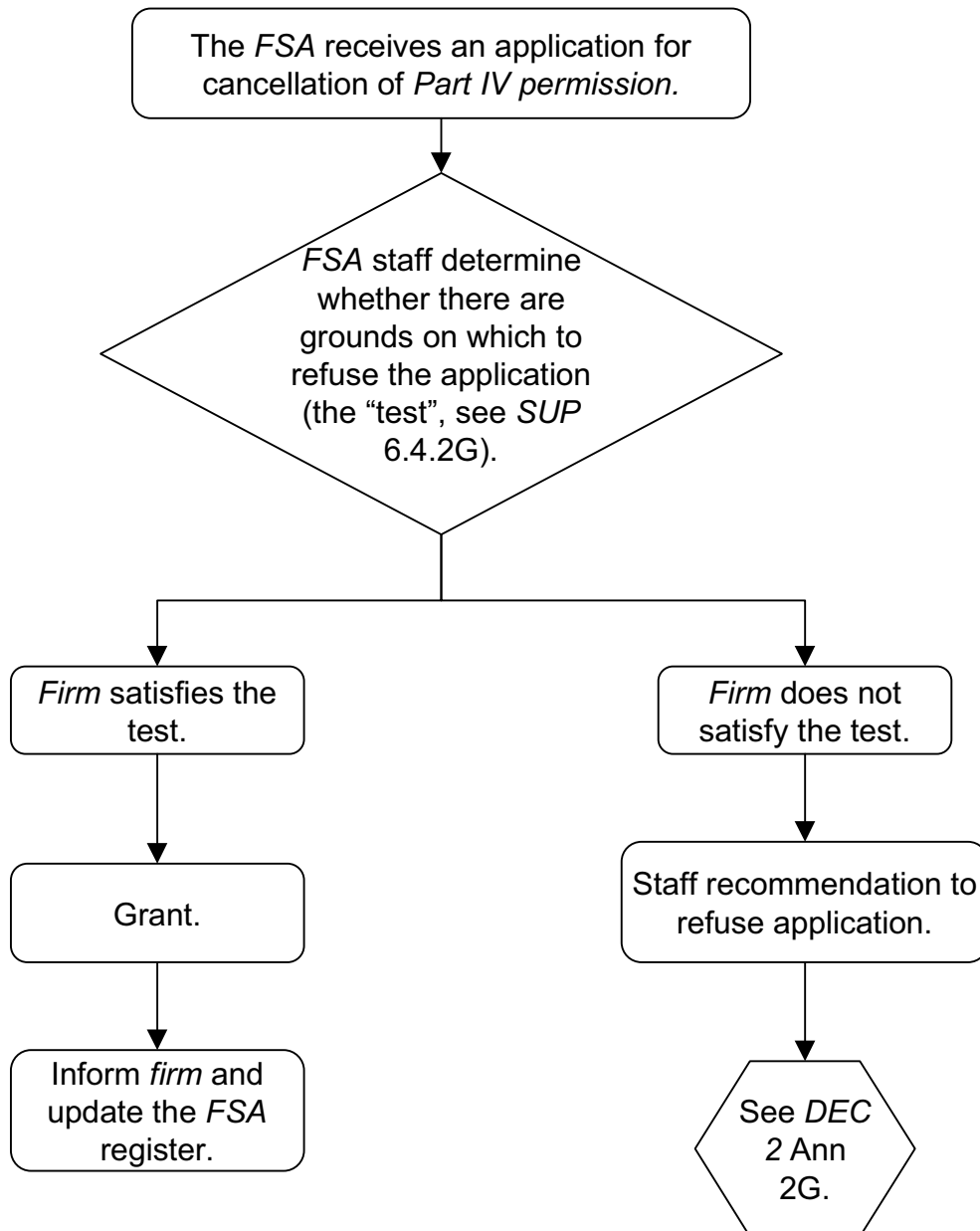
SUP 6 Ann 1G: Applications for variation and cancellation of Part IV permission



SUP 6 Ann 2G: Summary of procedures on application for variation of Part IV permission



SUP 6 Ann 3G: Summary of procedures on application for cancellation of Part IV permission



Additional guidance for a firm winding down (running off) its business

General

1. If a *firm* has *Part IV permission* which enables it to hold *client money* or to carry on *regulated activities* including:
 - (a) *carrying out contracts of insurance and effecting contracts of insurance*; or
 - (b) *accepting deposits*; or
 - (c) *safeguarding and administration of assets*;

it may require a long period (usually in excess of six months) in which to wind down (run off) its business. In these circumstances, it will usually be appropriate for the *firm* to apply for a variation of *Part IV permission* before commencing the wind down.
2. A *firm* that believes that it may need to apply for a variation of *Part IV permission* as a first step towards cancellation of its *permission* should discuss its plans with its usual supervisory contact at the *FSA*.
3. If appropriate, in the interests of *consumer* protection, the *FSA* will require details of the *firm's* plans and will discuss them with the *firm* and monitor the winding down or transfer of the *firm's* business. During the period in which it is winding down, a *firm* will also be required to notify the *FSA* of any material changes to the information provided such as, for example, receipt of new complaints and changes to plans.
4. If, after its *Part IV permission* has been varied, a *firm* has wound down its business, complied with any *requirements* imposed by the *FSA* and ceased to carry on *regulated activities* (or expects to do so within the next six months), it should then make an application for cancellation of its *Part IV permission* (see *SUP 6.4* (Applications for cancellation of permission)).

USE OF OWN-INITIATIVE POWERS

5. If, for example, the *FSA* has *consumer* protection concerns, it may, however, use its *own-initiative power* under section 45 of the *Act* (Variation etc. on the Authority's own initiative) (see *SUP 7* (Individual requirements) and *ENF 3* (Variation of Part IV permission on the *FSA's* own initiative), to vary the *Part IV permission* of a *firm* which is winding down or transferring its *regulated activities*.

REPORTING REQUIREMENTS : GENERAL

6. If a *firm* is winding down (running-off) its business, the routine reporting requirements in *SUP 16* (Reporting requirements) will apply unless the *firm* is granted a waiver. In addition, a *firm* may be asked to submit additional reports, for example, to enable the *FSA* to monitor the wind down.

Specific guidance for firms holding client money or customer assets

1. If a *firm* makes an application to vary its *Part IV permission* to effect the winding down of *regulated activities* which it is carrying on including the repayment of *client money*, or the return of *client deposits*, *custody assets* or any other property belonging to *clients*, the *FSA* will expect it to have formal plans to ensure that:

- (1) the *regulated activities* are wound down in an orderly manner;
 - (2) the *regulated activities* are properly completed and all *client deposits*, *client money*, *custody assets* or any other property belonging to *clients* are repaid, returned or transferred to another *authorised person*; and
 - (3) the interests of *customers* are not adversely affected.
2. A *firm* must comply with COB 9.3.133R (Client money : discharge of fiduciary duty) and COB 9.3.138R (Client money: allocated but unclaimed *client money*) if it is ceasing to hold *client money*. A *firm* must also cease to hold or *control custody assets* in accordance with instructions received from *clients* (including instructions set out in an agreement entered into in accordance with COB 9.1.49R (Custody: client agreement)). These *COB rules* apply to both repayment and transfer to a third party.

Specific guidance for insurers

1. A *firm* carrying on *insurance business* which, ultimately, intends to cease *insurance business* completely, will first need to apply for a variation of its *Part IV permission* while it is running off its business. The *firm* should apply for a variation of *Part IV permission* to remove the activity of *effecting contracts of insurance* from its *permission*, thus restricting its activities to *carrying out insurance contracts* to enable it to run off its remaining insurance liabilities (see SUP 6.2.9G).
2. Examples of variations of *Part IV permission* which may be appropriate in the context of winding down *insurance business* include:
 - (1) removing one or more *regulated activities* (for example, when a *firm* which has *Part IV permission* to carry on *insurance business* enters into run-off, its *Part IV permission* will need to be varied to remove the activity of *effecting contracts of insurance* in relation to new *contracts of insurance*); a new *contract of insurance* excludes contracts effected under a term of a subsisting *contract of insurance*. Thus the *firm's permission* will be restricted to *carrying out contracts of insurance* to enable it to run off its existing liabilities; or
 - (2) imposing a *limitation* on *regulated activities* in a *firm's Part IV permission* or imposing a *requirement* on the type of investments a *firm* holds to support its insurance liabilities.
3. An *insurer* ceasing to *carry out contracts of insurance* is required to submit a *scheme of operations* in accordance with SUP App 2 (Insurers: scheme of operations). The *FSA* may require other information depending on the circumstances, for example an actuarial assessment of the *firm's* run-off.
4. A *firm* that is ceasing *effecting new contracts of insurance* in all categories of *specified investment* should refer to SUP App 2 for details of the specific reporting requirements that apply.
5. An *insurer* should note that the *FSA* will not cancel a *firm's permission* until all the *firm's* insurance liabilities have been discharged, including any potential insurance liabilities. A *firm* is, therefore, advised to submit an application for cancellation of its *Part IV permission* when its run-off is completed.

Specific guidance for firms in the Lloyd's market

1. A *firm* making an application to vary or cancel its *Part IV permission* which requires any approval from the *Society of Lloyd's* should apply to the *Society* for this in addition to applying to the *FSA* for the variation or cancellation.

2. Where a *firm* has *Part IV permission to manage the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's* then, if it wishes to vary its *Part IV permission* to remove this *regulated activity* or to cancel its *Part IV permission* completely, special procedures will apply.
3.
 - (1) As a first step, the *firm* should apply to the *FSA* for a variation of its *Part IV permission* to limit the *regulated activity*, after the *Lloyd's syndicates* have been closed, to permit no new business. Once the *syndicates* have been closed, the *firm's* consent from the *Society* to manage *syndicates* will also lapse.
 - (2) After a period of one year from the date of closure of the *Lloyd's syndicates* the *firm* may apply to the *FSA* to vary its *Part IV permission*, to remove the *regulated activity* or to cancel its *Part IV permission* entirely, as appropriate. At this time, a *firm's* approval from the *Society of Lloyd's* as a *managing agent* will cease.
4. *Firms* which wish to discuss these procedures in more detail should contact their usual supervisory contact at the *FSA* and the *Society of Lloyd's*, as appropriate.

Specific guidance for firms accepting deposits

1. As stated in *SUP 6.2.9G*, where a *bank*, or other *firm* with *permission* that includes *accepting deposits*, wishes to cancel its *Part IV permission*, it will generally need to apply for a variation of that *permission* while it winds down its business.
2. When a *firm* is winding down its business activities, it may be appropriate to vary its *Part IV permission* by imposing:
 - (1) a *limitation* that no new *deposits* will be accepted; or
 - (2) a *limitation* on the purchasing of *investments* for its own account; or
 - (3) *requirements* concerning solvency.
3. After a *bank* has discussed with the *FSA* the type of variation of *Part IV permission* the *bank* requires to wind down its business, it should make an application for variation of *Part IV permission* as directed in *SUP 6.3.15D* and follow the *guidance* and procedures in *SUP 6* as well as the additional procedures set out in this annex.
4. The *FSA* may vary the *firm's Part IV permission* to impose one or more of:
 - (1) a *requirement* that the *firm* takes certain steps or refrains from adopting or pursuing a particular course of action or to restrict the scope of its business in a particular way;
 - (2) a *limitation* on *accepting deposits*, for example a *limitation* that no new deposits will be accepted;
 - (3) a *requirement* restricting the granting of *credit* or the making of investments;
 - (4) a *requirement* prohibiting the *firm* from soliciting *deposits* either generally or from *persons* who are not already depositors.
5. The information concerning the circumstances of the application for variation of *Part IV permission* and the confirmations a *firm* is required to give to the *FSA* will differ according to the nature of the *bank* and its *Part IV permission*. If appropriate, it may include, but will not necessarily be limited to:

- (1) a plan containing the arrangements made in respect of the business of any current depositors, for example how and when the *firm* intends to repay or novate arrangements with depositors; or
- (2) confirmation that the *bank* will not take any new *deposits*, will not roll over or renew any existing *deposits* at maturity and will repay all remaining *deposits* (including accrued interest) as they fall due for repayment.

DEALING WITH RESIDUAL DEPOSITS: GENERAL

6. Where a *firm* has residual *deposits* which, for whatever reason, cannot be repaid, they may be protected by a number of different methods. The precise applicability of the courses to be followed depends upon the particular circumstances of the individual *firm*. The *FSA's* supervisory approach will be determined by the course of action taken.
7. Specific issues regarding the transfer of *deposits* are discussed in *SUP 18* [to be added later].

HOLDING FUNDS ON TRUST

8. In some circumstances, it may be appropriate for the *firm* to make an irrevocable transfer of funds, at least equal to the total of its *deposits*, to an independent *trustee* to be held on *trust* for the benefit of the depositors. Any such proposal should be discussed in advance with the *FSA*. The amount of funds held on trust should at all times exceed the total of all *deposits*, in order to provide for contingencies. Trust account arrangements are appropriate only in respect of solvent institutions. The *guidance* in paragraph 10 of this section applies in most cases.
9.
 - (1) A plan containing the arrangements should be made by the *firm* in respect of the business of any current depositors, for example how and when the *firm* intends to repay or novate arrangements with depositors.
 - (2) The *trustee* should be an independent and appropriately qualified third party, nominated by the institution and acceptable to the *FSA*.
 - (a) The trustee should usually be a major *UK bank*. If appropriate, an additional trustee from within the institution may be appointed, preferably in an advisory role. An internal trustee may help to ensure continuity if the *firm* and the trust are likely to remain in existence for the foreseeable future.
 - (b) The *FSA* should be consulted about, or pre-notified of, a potential change of trustee.
 - (c) Trustees are responsible for fulfilling their obligations under the trust deed. In practice, the *FSA* may wish to point out that certain factors need to be given consideration by the trustees and the institution (for example, the procedures for paying out to depositors).
 - (3) The *FSA* would require to see an opinion by the *firm's* legal advisers, confirming the validity and enforceability of the *trust* and in particular specifying the extent (if any) to which the trust arrangements may be set aside in future. The *FSA* reserves the right to request sight of the proposed trust documentation itself.
 - (4) The trustee has the right (and probably the obligation) to invest the funds, and in doing so should normally seek to "match" the maturity profile of the *firm's deposit* base. However, the following could result in *deposit* liabilities exceeding *trust* funds at any time:

- (a) maturity mismatches, that is, whether there are insufficient liquid funds across the maturity bands to repay depositors; or
 - (b) changes in interest rates; or
 - (c) the trustee's fees and disbursements.
10. The trustee should not deposit, or otherwise invest, trust funds except in segregated accounts with third-party authorised institutions.
11. (1) An auditor's report, similar to that used to determine whether all the *deposits* have been repaid by a *firm*, should be provided to confirm that all depositors have been repaid before the discharge of a trust is allowed.
- (2) Auditors' reports, from the trust's auditors, should subsequently be obtained at intervals to demonstrate that funds in the trust continue to be at least equal to the remaining liabilities to depositors and that repayments have been properly made. The *firm* retains the ultimate responsibility to provide information to the *FSA*.
- (3) The *FSA* may, however, require the inclusion of a clause in the trust deed requiring the trustee to provide such information as may be requested.
12. Entering into a trust arrangement does not "transfer" deposits or discharge the *firm's* contractual obligations to its depositors. The *firm* will, therefore, need to continue to be an *authorised person* until these obligations are discharged.

HOLDING THE FUNDS IN SEGREGATED ACCOUNTS

13. The *firm* may place and retain an amount at all times at least equal to its *deposit* liabilities in a segregated account with its usual bankers. The advantage of this course of action is that if all *deposit* liabilities are matched by funds in such an account, then the *firm* is not carrying on the *regulated activity* of *accepting deposits* in contravention of the *Act*.
14. Placing funds in a segregated account does not discharge a *firm's* contractual obligations to its depositors; the *FSA* therefore continues to have a supervisory responsibility towards the *firm*.

Chapter 7

Individual requirements

7.1 Application and purpose

Application

- 7.1.1** G This chapter applies to every *firm* which has a *Part IV permission*.
- 7.1.2** G^{/1} The application of this chapter to an *incoming EEA firm*, *incoming Treaty firm* or *UCITS qualifier* with a *Part IV permission* (a "*top-up permission*") is limited as explained in *SUP 7.2.4G*.

Purpose

- 7.1.3** G^{/1} The *Handbook* primarily contains provisions which apply to all *firms* or to certain categories of *firm*. However, a *firm* may apply for a waiver or modification of *rules* in certain circumstances as set out in *SUP 8*; or it may receive individual *guidance* on the application of the *rules*, as set out in *SUP 9*.
- 7.1.4** G^{/1} The *FSA*, in the course of its supervision of a *firm*, may sometimes judge it necessary or desirable to impose additional *requirements* on a *firm* or in some way amend or restrict the activities which the firm has *permission* to undertake. The *guidance* in this chapter describes when and how the *FSA* will seek to do this.
- 7.1.5** G^{/1} By waiving or modifying the requirements of a *rule* or imposing an additional *requirement* or *limitation*, the *FSA* can ensure that the *rules*, and any other *requirements* or *limitations* imposed on a *firm*, take full account of the *firm's* individual circumstances, and so assist the *FSA* in meeting the *regulatory objectives* (for example, to protect *consumers* and maintain market confidence).

7.2 The FSA's powers to set individual requirements on its own initiative

- 7.2.1** ^G_{/1} The FSA has the power under section 45 of the *Act* (Variation on the Authority's own initiative) to vary a *firm's Part IV permission*. This includes imposing a statutory *requirement* or *limitation* on that *Part IV permission*. (See *AUTH* 3.6 and *AUTH* 3.7 for a further explanation of potential *limitations* and *requirements* on a *firm's permission*.)
- 7.2.2** ^G_{/1} The circumstances in which the FSA may vary a *firm's Part IV permission* on its own initiative under section 45 of the *Act* include where it appears to the FSA that:
- (1) one or more of the threshold conditions is or is likely to be no longer satisfied; or
 - (2) it is desirable to vary a *firm's permission* in order to protect the interests of consumers or potential consumers.
- 7.2.3** ^G_{/1} The FSA may also use its powers under section 45 for enforcement purposes. *ENF* 3 sets out in detail the FSA's powers under section 45 and the circumstances under which the FSA may vary a *firm's permission* in this way, whether for enforcement purposes or as part of its day to day supervision of *firms*. This chapter provides additional guidance on when the FSA will use these powers for supervision purposes.
- 7.2.4** ^G_{/1} The FSA may use its powers under section 45 of the *Act* only in respect of a *Part IV permission*; that is, a *permission* granted to a *firm* under section 42 of the *Act* (Giving permission) or having effect as if so given. In respect of an *incoming EEA firm*, an *incoming Treaty firm*, or a *UCITS qualifier*, this power applies only in relation to any *top-up permission* that it has. There are similar but more limited powers under Part XIII of the *Act* in relation to the *permission* of an *incoming EEA firm* or *incoming Treaty firm* under Schedules 3 or 4 to the *Act* (see *ENF* 4).
- 7.2.5** ^G_{/1} If the FSA exercises its powers under section 45 of the *Act*, it will do so by issuing a *supervisory notice*. The procedure that will be followed is set out in *DEC* 3 and a flowchart is provided in *DEC* 3 Ann 2G.
- 7.2.6** ^G_{/1} A *firm* has a right of referral to *the Financial Services and Markets Tribunal* (see *DEC* 5) in respect of the exercise by the FSA of its powers to vary, on its own initiative, the *firm's Part IV permission*.

7.3 Criteria for varying a firm's permission

7.3.1

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The FSA expects to maintain a close working relationship with certain types of *firm* and expects that routine supervisory matters arising can be resolved during the normal course of this relationship by, for example, issuing individual *guidance* where appropriate (see SUP 9.3). However, the FSA may seek to vary a *firm's Part IV permission*:

- (1) in circumstances where it considers it appropriate for the *firm* to be subject to a formal *requirement*, breach of which could attract enforcement action; or
- (2) if a variation is needed to enable the *firm* to comply with the *requirement*, due to agreements the *firm* may have with third parties. (For example a *firm* may be under a contractual obligation to do something, but only if it can do so lawfully. In this case, if the FSA considers the *firm* must not do it, then the FSA would need to prevent it doing so through a variation in its *Part IV permission* to enable the *firm* to avoid breaching the contractual obligation.)

7.3.2

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The FSA may seek to vary a *firm's Part IV permission* on its own initiative in certain situations, including the following:

- (1) If the FSA determines that a *firm's* management, business or *internal controls* give rise to material risks that are not fully addressed by its *rules*, the FSA may seek to vary the *firm's Part IV permission* and impose an additional *requirement* or *limitation* on the *firm*.
- (2) If a *firm* becomes or is to become involved with new products or selling practices which present risks not adequately addressed by existing requirements, the FSA may seek to vary the *firm's Part IV permission* in respect of those risks.
- (3) If there has been a change in a *firm's* structure, *controllers*, activities or strategy which generate material uncertainty or create unusual or exceptional risks, then the FSA may seek to vary the *firm's Part IV permission*. (See also SUP 11.7.14G to 11.7.18G for a description of the FSA's ability to vary a *firm's Part IV permission* on a change in *control* under section 46 of the *Act*.)

7.3.3

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The FSA may seek to impose *requirements* or *limitations* which include but are not restricted to:

- (1) requiring a *firm* to submit regular reports covering, for example, trading results, management accounts, *customer* complaints, connected party transactions;
- (2) requiring a *firm* to maintain prudential limits, for example on large *exposures*, foreign currency *exposures* or liquidity gaps;

- (3) requiring a *firm* to submit a business plan (or for an *insurer*, a *scheme of operations* (see SUP App 2));
- (4) limiting the *firm's* activities;
- (5) requiring a *firm* to maintain a particular amount or type of financial resources.

7.3.4

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The FSA will seek to give a *firm* reasonable notice of an intent to vary its *permission* and to agree with the *firm* an appropriate timescale. However, if the FSA considers that a delay may be prejudicial to the interest of *consumers*, the FSA may need to act immediately using its powers under section 45 of the *Act* to vary a *firm's Part IV permission* with immediate effect.

Chapter 8

Waiver and modification of rules





8.1 Application and purpose

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This chapter applies to every:

- (1) *firm* that wishes to apply for, consent to, or has been given a modification of or waiver of the *FSA's rules*;
- (2) *person*, as respects a particular *AUT* or *ICVC*, who wishes to apply for, or consent to, or has been given a modification of or waiver of the *rules* in *CIS*.

8.1.2

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A *recognised body* should see *REC* 3.3 for information on *waivers* of *rules* in *REC* under section 294 of the *Act*.

8.1.3

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This chapter is not relevant to the functions of the *UKLA*, that is the *FSA* acting in its capacity as the *competent authority* for the purposes of Part VI of the *Act* (Official Listing).

Purpose

8.1.4

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This chapter explains how the regime for the waiver or modification of *rules* works.



8.2 Introduction

Waivers under section 148 of the Act

- 8.2.1 **G**_{/1} Under section 148 of the *Act* (Modification or waiver of rules), the *FSA* may, on the application or with the consent of a *firm*, direct that certain *rules* (see *SUP* 8.2.6G to *SUP* 8.2.8G):
 - (1) are not to apply to the *firm*; or
 - (2) are to apply to the *firm* with such modifications as may be specified.

- 8.2.2 **G**_{/1} The directions referred to in *SUP* 8.2.1G (1) and (2) are collectively referred to in the *Handbook* as *waivers*.

Waivers of rules in CIS

- 8.2.3 **G**_{/1} Section 250 of the *Act* and regulation 7 of the *OEIC Regulations* allow the *FSA* to *wave* the application of certain *rules* in *CIS* to:
 - (1) a *person*, as respects a particular *AUT* or *ICVC*, on the application or with the consent of that *person*; and
 - (2) an *AUT* or *ICVC* on the application or with the consent of the *manager* and *trustee* (in the case of an *AUT*) or the *ICVC* and its *depository* (in the case of an *ICVC*).

- 8.2.4 **G**_{/1} Those *persons* to whom section 250 and regulation 7 of the *OEIC Regulations* are relevant, but who are not *firms*, should follow *SUP* 8 as if they were *firms*.

- 8.2.5 **G**_{/1} Section 250 of the *Act* and regulation 7 of the *OEIC Regulations* work by giving effect to section 148 of the *Act* in respect of *waivers* given under section 250(2) and (3) and regulation 7(1) and (2) of the *OEIC Regulations*.

Rules which can be waived

- 8.2.6 **G**_{/1} The *rules* which the *FSA* can *wave* are listed in section 148(1) and 250(1) of the *Act* and regulation 7 of the *OEIC Regulations*, and are set out in *SUP* 8.2.7G.

- 8.2.7 **G**_{/1} Table Rules which can be waived (see *SUP* 8.2.6G)

Rules	Section of the Act or regulation of the OEIC Regulations under which rules are made	Chapters of the Handbook where such rules appear (Note 1)
Auditors and Actuaries rules (Appointment) (Note 2)	Section 340	<i>SUP 3</i> and <i>SUP 4</i>
Control of information rules	Section 147	<i>COB 2.4</i>
Financial promotion rules	Section 145	<i>COB 3</i> , <i>PRIN</i> and <i>SYSC</i>
General rules	Section 138	Throughout the <i>Handbook</i>
Insurance business rules	Section 141	<i>IPRU(INS)</i>
Money laundering rules	Section 146	<i>ML</i>
Price stabilising rules	Section 144	<i>MAR 2</i>
<i>Authorised unit trust</i> scheme rules	Section 247	<i>CIS</i>
<i>Authorised unit trust</i> scheme particulars rules	Section 248	<i>CIS</i>
<i>Investment company with variable capital</i> rules	Regulation 6	<i>CIS</i>

Note 1=There are also relevant incidental, supplemental, consequential and transitional *rules* made under those powers in various parts of the *Handbook*, including relevant application provisions, *GEN*, the *Glossary* and relevant schedules of transitional provisions.

Note 2=The FSA does not have the power to *waive* the application of auditors and actuaries rules, if those *rules* apply directly to an auditor or actuary, as opposed to applying to a *firm*. Schedule 6 to the Supervision manual identifies those auditors and actuaries rules in *SUP 3* and *SUP 4* which can be waived.

8.2.8

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Schedule 6 identifies those *rules* that can and cannot be waived.



8.3 Applying for a waiver

Conditions for giving a waiver

8.3.1

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Under section 148(4) of the *Act*, the *FSA* may not give a *waiver* unless it is satisfied that:

- (1) compliance by the *firm* with the *rules*, or with the *rules* as unmodified, would be unduly burdensome, or would not achieve the purpose for which the *rules* were made; and
- (2) the *waiver* would not result in undue risk to *persons* whose interests the *rules* are intended to protect.

Publication of waivers

8.3.2

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The *FSA* is required by section 148(6) of the *Act* to publish a *waiver* unless it is satisfied that it is inappropriate or unnecessary to do so (see *SUP* 8.6).

Form and method of application

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If a *firm* wishes to apply for a *waiver*, it must apply in writing. The application must be given or addressed, and delivered in the way set out in *SUP* 15.7.4R to *SUP* 15.7.6R (Form and method of notification). The application must include:

- (1) the name and *FSA* firm reference number of the *firm* making the application, and a contact point for the *firm* on the application;
- (2) the reference number of the *rule* to which the application relates;
- (3) a clear explanation of the *waiver* that is being applied for and the reasons why the *firm* wants it;
- (4) details of any special requirements, for example if the *firm* needs a decision urgently, or if there is a specific period for which the *waiver* is required;
- (5) relevant facts that support the *firm's* application;
- (6) the *firm's* reasons for considering that the conditions in section 148(4) of the *Act* are satisfied (see *SUP* 8.3.1G); and

- (7) confirmation that the *firm* is content for the *waiver* to be published or, if not, the reasons, with reference to SUP 8.6.2G, why the *firm* believes that:
 - (a) it would be inappropriate or unnecessary to publish the *waiver*; or
 - (b) the *waiver* should be published without disclosing the identity of the *firm* (giving details of any possible prejudice to commercial interests).

8.3.4 G_{/1} Before sending in a *waiver* application, a *firm* may find it helpful to discuss the application with its usual supervisory contact at the *FSA*. However, the *firm* should still ensure that all relevant information is included in the application.

Procedure on receipt of an application

8.3.5 G_{/1} The *FSA* will acknowledge an application promptly and if necessary will seek further information from the *firm*. The time taken to determine an application will depend on the issues it raises. However, the *FSA* will aim to give *waiver* decisions within 20 *business days* of receiving an application which includes sufficient information. If the *FSA* expects to take longer, it will tell the *firm* and give an estimated decision date. A *firm* should make it clear in the application if it needs a decision within a specific time.

8.3.6 G_{/1} In some cases, the *FSA* may give a modification of a *rule* rather than direct that the *rule* is not to apply. The *FSA* may also impose conditions on a *waiver*, for example additional reporting requirements. A *waiver* may be given for a specified period of time only, after which time it will cease to apply. A *firm* wishing to extend the duration of a *waiver* should follow the procedure in SUP 8.3.3D. A *waiver* will not apply retrospectively.

8.3.7 G_{/1} If the *FSA* decides not to give a *waiver*, it will give reasons for the decision.

8.3.8 G_{/1} A *firm* may withdraw its application at any time up to the giving of the *waiver*. In doing so, a *firm* should give the *FSA* its reasons for withdrawing the application.

8.3.9 G_{/1} If the *FSA* believes that a particular *waiver* given to a *firm* may have relevance to other *firms*, it may publish general details about the possible availability of the *waiver*. For example, IPRU(INV)3-80(10)G explains that a *firm* that wishes to use its own internal model to calculate its position risk requirement (PRR) will need to apply for a *waiver* of the relevant *rules*.

Giving a waiver with consent rather than on an application

8.3.10 G_{/1} Under section 148(2) of the *Act* the *FSA* may give a *waiver* with the consent of a *firm*. This power may be used by the *FSA* in exceptional circumstances where the *FSA* considers that a *waiver* should apply to a number of *firms* (for example, where a *rule* unmodified may not meet the particular circumstances of a particular category of *firm*). In such cases the *FSA* will inform the *firms* concerned that the *waiver* is available, either by contacting *firms* individually or by publishing details of the availability of the *waiver* on the *FSA*'s website. The *firms* concerned will not have to make a formal application but will have to give their written consent for the *waiver* to apply.



8.4 Reliance on waivers

Application of waived rules

8.4.1

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If the FSA gives a *firm* a *waiver*, then the relevant *rule* no longer applies to the *firm*. But:

- (1) if a *waiver* directs that a *rule* is to apply to a *firm* with modifications, then contravention of the modified *rule* could lead to FSA enforcement action and (if applicable) a right of action under section 150 of the *Act* (Actions for damages); and
- (2) if a *waiver* is given subject to a condition, it will not apply to activities conducted in breach of the condition, and those activities, if in breach of the original *rule*, could lead to FSA enforcement action or such a right of action.

The effect of rule changes on waivers

8.4.2

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Substantive changes to the *rules* (this would not include simple editorial changes) in the *Handbook* may affect existing *waivers*, changing their practical effect and creating a need for a change to the original *waiver*. The FSA will consult on proposed *rule* changes. A *firm* should note proposed *rule* changes and discuss the impact on a *waiver* with its usual supervisory contact at the FSA.



8.5 Notification of altered circumstances relating to waivers

- 8.5.1 **R** /1 A *firm* which has applied for or has been granted a *waiver* must notify the *FSA* immediately if it becomes aware of any matter which could affect the continuing relevance or appropriateness of the application or the *waiver*.
- 8.5.2 **G** /1 *Firms* are also referred to *SUP* 15.6 (Inaccurate, false or misleading information). This requires, in *SUP* 15.6.4R, a *firm* to notify the *FSA* if false, misleading, incomplete or inaccurate information has been provided. This would apply in relation to information provided in an application for a *waiver*.



8.6 Publication of waivers

Requirement to publish

8.6.1 **G**_{/1} The *FSA* is required by section 148(6) of the *Act* to publish a *waiver* unless it is satisfied that it is inappropriate or unnecessary to do so. If the *FSA* publishes a *waiver*, it will not publish details of why a *waiver* was required or any of the supporting information given in a *waiver* application.

Matters for consideration

8.6.2 **G**_{/1} When considering whether it is satisfied under section 148(6), the *FSA* is required by section 148(7) of the *Act*:

- (1) to take into account whether the *waiver* relates to a *rule* contravention of which is actionable under section 150 of the *Act* (Actions for damages); Schedule 5 identifies such *rules*;
- (2) to consider whether its publication would prejudice, to an unreasonable degree, the commercial interests of the *firm* concerned, or any other member of its *immediate group*; and
- (3) to consider whether its publication would be contrary to an international obligation of the *United Kingdom* (for example, the confidentiality obligations in the *Single Market Directives*).

8.6.3 **G**_{/1} *Waivers* can affect the legal rights of third parties, including *consumers*. In the *FSA*'s view it is important that the fact and effect of such *waivers* should be transparent. So the fact that a *waiver* relates to a *rule* that is actionable under section 150 of the *Act* (see *SUP* 8.6.2G(1)) will tend to argue in favour of publication.

8.6.4 **G**_{/1} In making *waiver* applications under section 250 of the *Act* or regulation 7 of the *OEIC Regulations*, *SUP* 8.6.2G(2) should be read in application to *rules* in *CIS* as if the word "commercial" were omitted.

8.6.5 **G**_{/1} In considering whether commercial interests would be prejudiced to an unreasonable degree (see *SUP* 8.6.2G(2)), the *FSA* will weigh the prejudice to *firms*' commercial interests against the interests of *consumers*, markets and other third parties in disclosure. In doing so the *FSA* will consider factors such as the extent to which publication of the *waiver* would involve the premature release of proprietary information to commercial rivals, for example relating to a product innovation, or reveal information which could reasonably be regarded as the *firm*'s own intellectual property. In line with section 148(8) of the *Act*, the *FSA* will also

consider whether prejudice to a *firm's* commercial interests could be avoided or mitigated by publication of the *waiver* without disclosing the identity of the *firm*.

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The *FSA* may consider publication unnecessary where, for example, the *waiver* relates to a minor matter that does not affect any third party and is unlikely to be of relevance or interest to other *firms*.

Firm's objection to publication

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If, after taking into account the matters in *SUP* 8.6.2G to *SUP* 8.6.6G, a *firm* believes there are good grounds for the *FSA* either to withhold publication or to publish the *waiver* without disclosing the identity of the *firm*, it should make this clear in its application (see *SUP* 8.3.3D(7)). If the *FSA* proposes to publish a *waiver* against the wishes of the *firm*, the *FSA* will give the *firm* the opportunity to withdraw its application before the *waiver* is given.

Withholding publication for a limited period

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A decision to withhold a *waiver* or identity of a *firm* from publication may be for a limited period only, usually as long as the duration of the relevant grounds for non-publication. If the *FSA* proposes to publish information about a *waiver* that had previously been withheld, it will first give the *firm* an opportunity to make representations.

Means of publication

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The principal means of publication of *waiver* information will be the *FSA's* website (www.fsa.gov.uk).



8.7 Varying waivers

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Once the FSA has given a *waiver*, it may vary it with the *firm's* consent, or on the *firm's* application. If a *firm* wishes the FSA to vary a *waiver*, it should follow the procedures in SUP 8.3.3D, giving reasons for the application. In a case where a *waiver* has been given to a number of *firms* (see SUP 8.3.10G), if the FSA wishes to vary such *waivers* with the consent of those *firms*, it will follow the procedures in SUP 8.3.10G.

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If the *waiver* that has been varied has previously been published, the FSA will publish the variation unless it is satisfied that it is inappropriate or unnecessary to do so, having regard to any representation made by the *firm*.

8.8 Revoking waivers

- 8.8.1** **G**_{/1} The *FSA* may revoke a *waiver* at any time. In deciding whether to revoke a *waiver*, the *FSA* will consider whether the conditions in section 148(4) of the *Act* are no longer satisfied (see *SUP* 8.3.1G), and whether the *waiver* is otherwise no longer appropriate. The *FSA* may revoke a *waiver* with immediate effect, if it considers that this is necessary, for example, in order to prevent undue risk to *consumers*.
- 8.8.2** **G**_{/1} If the *FSA* proposes to revoke a *waiver*, or revokes a *waiver* with immediate effect, it will:
- (1) give the *firm* written notice either of its proposal, or of its action, giving reasons;
 - (2) state in the notice a reasonable period (usually 28 *days*) within which the *firm* can make representations about the proposal or action; if a *firm* wants to make oral representations, it should inform the *FSA* as quickly as possible, specify who will make the representations and which matters will be covered; the *FSA* will inform the *firm* of the time and place for hearing the representations and may request a written summary;
 - (3) after considering any representations, in the case of a proposed revocation, give the *firm* written confirmation of its decision to revoke the *waiver* or not; or, in the case of a revocation that has already taken effect, either confirm the revocation or seek the *firm's* consent to a new *waiver*.
- 8.8.3** **G**_{/1} If the *waiver* that has been revoked has previously been published, the *FSA* will publish the revocation unless it is satisfied that it is inappropriate or unnecessary to do so, having regard to any representations made by the *firm*.



8.9 Decision making

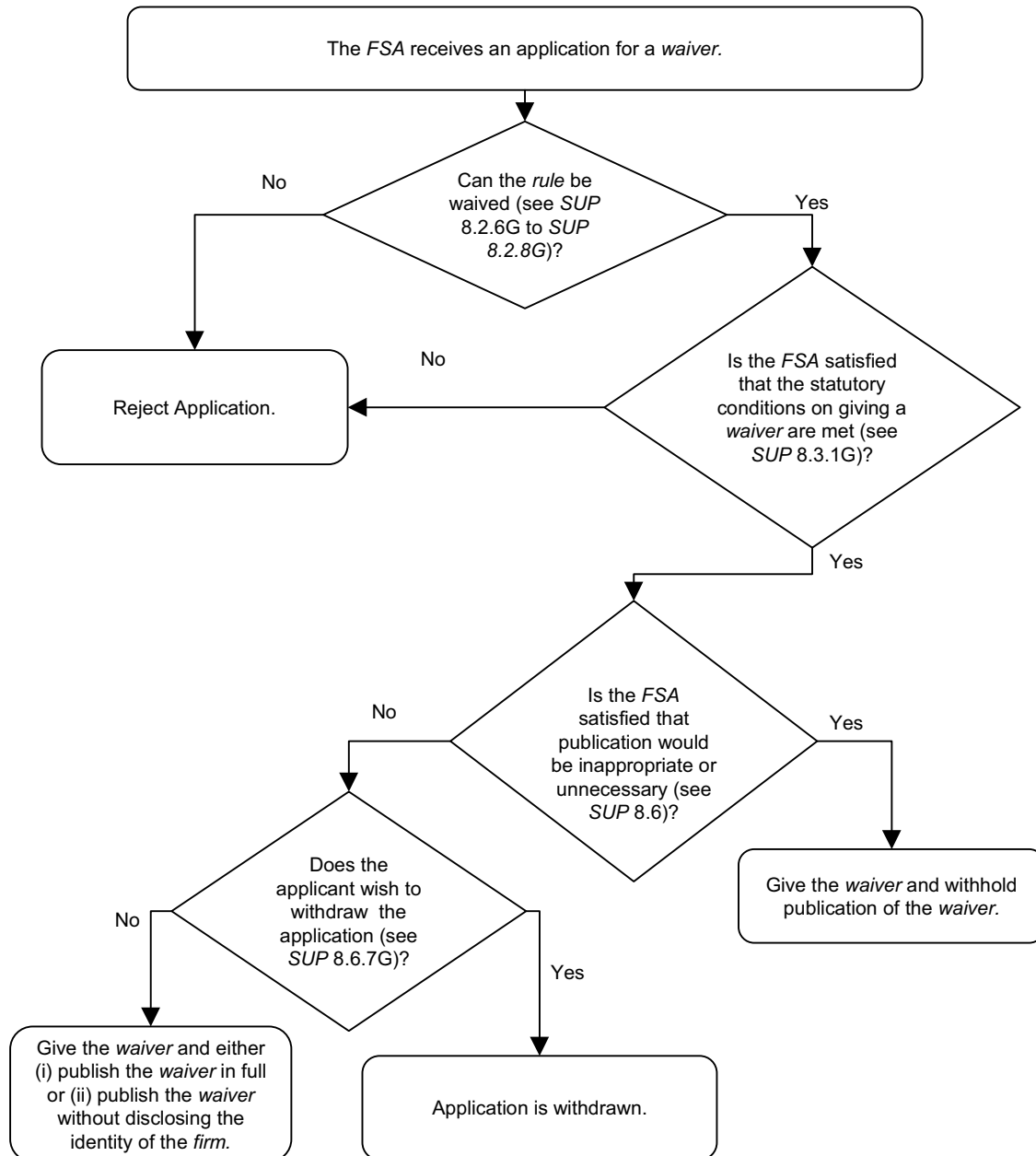
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The *waivers* regime is overseen by a staff committee. Its responsibility is to ensure that the giving of *waivers* is in accordance with the requirements of the *Act*, of the *guidance* in *SUP 8* and of other relevant *guidance*. Decisions on individual applications are made under arrangements designed to result in rapid, responsive and well-informed decision making. The arrangements include arrangements for collective decision making to set general policies, and, as necessary, determine cases for applications with substantially common characteristics (for example, *waivers* in relation to the same *rule* or related *rules* or by *firms* in a similar position). It also includes arrangements for decision making by individuals within established precedents and policies.

SUP 8: Waiver and notification of rules

Summary of procedures on application for a waiver



Chapter 9

Individual guidance



9.1 Application and purpose

Application

- 9.1.1** **G**_{/1} (1) This chapter applies to every *firm* and to *persons* generally.
- (2) *SUP 9.3* (Giving individual guidance to a firm on the FSA's own initiative) is, however, only relevant to a *firm*.
- (3) This chapter does not apply in relation to *guidance* requested from, or given by, the *UKLA*, that is the *FSA* acting in its capacity as the *competent authority* for the purposes of Part VI of the *Act* (Official Listing).

Purpose

- 9.1.2** **G**_{/1} Individual *guidance* is *guidance* given to one particular *person*, which relates to its own particular circumstances or plans. It may be oral or written. Individual *guidance* will not be published but may at the *FSA*'s discretion be converted to general *guidance* and published in the *Handbook*.
- 9.1.3** **G**_{/1} A *person* may need to ask the *FSA* for individual *guidance* on how the *rules* and general *guidance* in the *Handbook*, the *Act* or other regulatory requirements apply in their particular circumstances. This chapter describes how a *person* may do this. Section 157 of the *Act* gives the *FSA* the power to give *guidance* consisting of such information and advice as it considers appropriate.
- 9.1.4** **G**_{/1} The *FSA* may at times also consider it appropriate to give a *firm* individual *guidance* on its own initiative, for example on how it considers a *firm* should comply with a *rule*. *SUP 9.3* describes when and how the *FSA* will seek to do this.

9.2 Making a request for individual guidance

How to make a request

- 9.2.1** **G**_{/1} Requests for individual *guidance* may be made in writing or orally. If oral queries raise complex or significant issues, the *FSA* will normally expect the details of the request to be confirmed in writing. Simple requests for *guidance* may often be dealt with orally, although it is open to a *person* to seek a written confirmation from the *FSA* of oral *guidance* given by the *FSA*.

Who to address a request to

- 9.2.2** **G**_{/1} A *firm* and its professional advisers should address requests for individual *guidance* to the *firm's* usual supervisory contact at the *FSA*, with the exception of requests for *guidance* on the *Code of Market Conduct (MAR 1)* which should be addressed to the specialist team within the Markets and Exchanges Division. A *firm* may wish to discuss a request for *guidance* with the relevant contact before making a written request.
- 9.2.3** **G**_{/1} A *person* who is not a *firm* should address his request for individual *guidance* to the appropriate department within the *FSA*. A *person* who is unsure of where to address his request may address his enquiry to the *FSA*, making clear the nature of the request.

Discussions on a no-names basis

- 9.2.4** **G**_{/1} The *FSA* does not expect to enter into discussions on a 'no-name' basis about the affairs of an individual *person*.

The FSA's response to a reasonable request

- 9.2.5** **G**_{/1} The *FSA* will aim to respond quickly and fully to reasonable requests. The *FSA* will give high priority to enquiries about areas of genuine uncertainty or about difficulties in relating established requirements to innovative practices or products. What constitutes a 'reasonable request' is a matter for the *FSA*. It will depend on the nature of the request and on the resources of the *firm* or other *person* making it. The *FSA* will expect the *person* to have taken reasonable steps to research and analyse a topic before approaching the *FSA* for individual *guidance*. The *FSA* should not be viewed as a first port of call for *guidance*, except where it is only the

FSA that can give the *guidance*, for example in confirming non-standard reports that it wishes to receive from a *firm*.

Information required by the FSA

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The *FSA* will always need sufficient information and time before it can properly evaluate the situation and respond to a request. If a request is time-critical, the *person* or its professional adviser should make this clear. The more notice a *person* can give the *FSA*, the more likely it is that the *FSA* will be able to meet the *person's* timetable. However, the time taken to respond will necessarily depend upon the complexity and novelty of the issues involved. In making a request, a *person* should identify the *rule*, general *guidance*, or other matter on which individual *guidance* is sought, and provide a description of the circumstances relating to the request. The *FSA* may request further information if it considers that it does not have sufficient information.



9.3 Giving individual guidance to a firm on the FSA's own initiative

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Business and internal control risks vary from *firm* to *firm*, according to the nature and complexity of the business. The FSA's assessment of these risks is reflected in how its *rules* apply to different categories of *firm* as well as in the use of its other regulatory tools. One of the tools the FSA has available is to give a *firm* individual *guidance* on the application of the requirements or standards under the *regulatory system* in the *firm's* particular circumstances.

9.3.2

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The FSA may give individual *guidance* to a *firm* on its own initiative if it considers it appropriate to do so. For example:

- (1) the FSA may consider that general *guidance* in the *Handbook* does not appropriately fit a *firm's* particular circumstances (which may be permanent or temporary) and therefore decide to give additional individual *guidance* to the *firm*;
- (2) some of the FSA's requirements are expressed in general terms; however, there may be times when the FSA will wish to respond to a *firm's* particular circumstances by giving individual *guidance* on the application of the general requirement in these circumstances;
- (3) the FSA may consider that a *firm* should be given more detailed *guidance* than that contained in the *Handbook*; for example, where a *firm* holds positions in instruments of a non-standard form it may be appropriate to give the *firm* additional or more detailed *guidance* on how the FSA considers that it should calculate its financial resources requirement;
- (4) in some instances a *rule* allows a *firm* to select which requirement, within a range of alternative requirements, a *firm* should comply with; in many instances, the *Handbook* gives *guidance* setting out the circumstances in which compliance with a particular requirement is appropriate; the FSA may sometimes consider it necessary to give additional individual *guidance* to tell a *firm* which requirement it considers appropriate;
- (5) in relation to the maintenance of adequate financial resources, the FSA may give a *firm* individual *guidance* on the amount or type of financial resources the FSA considers appropriate, for example on individual capital ratios for *banks* and *building societies*; further *guidance* on how and when the FSA may give individual *guidance* on financial resources is contained in the Interim Prudential sourcebooks:
 - (a) for a *bank*: IPRU(BANK) CO4;
 - (b) for a *building society*: IPRU(BSOC) 1.5 and Ann 1J;

(c) for a *securities and futures firm* (or other *firm* required to comply with IPRU(INV) 3 or IPRU(INV)10): IPRU(INV)10-74R and appendix 48.

9.3.3

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If the FSA intends to give a *firm* individual *guidance* on its own initiative, it will normally seek to discuss the issue with the *firm* and agree suitable individual *guidance*.

9.3.4

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Individual *guidance* given to a *firm* on the FSA's own initiative will normally be given in writing.

9.4 Reliance on individual guidance

Reliance by recipient of individual guidance

- 9.4.1** **G**_{/1} If a *person* acts in accordance with current individual written *guidance* given to him by the *FSA* in the circumstances contemplated by that *guidance*, then the *FSA* will proceed on the footing that the *person* has complied with the aspects of the *rule* or other requirement to which the *guidance* relates.
- 9.4.2** **G**_{/1} The extent to which a *person* can rely on individual *guidance* given to him will depend on many factors. These could include, for example, the degree of formality of the original query and the *guidance* given, and whether all relevant information was submitted with the request. Individual *guidance* is usually given in relation to a set of particular circumstances which exist when the *guidance* is given. If the circumstances later change, for example, because of a change in the circumstances of the *person* or a change in the underlying *rule* or other requirement, and the premises upon which individual *guidance* was given no longer apply, the *guidance* will cease to be effective.
- 9.4.3** **G**_{/1} If the circumstances relating to individual *guidance* change it will be open to a *person* to ask for further *guidance*.

Effect on rights of third parties

- 9.4.4** **G**_{/1} Rights conferred on third parties (such as a *firm's clients*) cannot be affected by *guidance* given by the *FSA*. *Guidance* on *rules*, the *Act* or other legislation represents the *FSA's* view, and does not bind the courts, for example in relation to an action for damages brought by a *private person* for breach of a *rule* (section 150 of the *Act* (Actions for damages)) or in relation to enforceability of a contract if the *general prohibition* is breached (sections 26 and 27 of the *Act* (Enforceability of agreements)). A *person* may need to seek his own legal advice.

Chapter 10

Approved persons



10.1 Application

General

- 10.1.1** **R** This chapter applies to every *firm*.
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- 10.1.2** **G** This chapter is also relevant to every *approved person*.
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- 10.1.3** **G** The *rules* in this chapter specify descriptions of functions under section 59 of the *Act* (Approval for particular arrangements). The effect of these *rules*, and the provisions of Part V of the *Act* (Performance of *Regulated Activities*), is that every *firm* must apply to the *FSA* for the approval of one or more *persons* to perform a *controlled function* on its behalf.
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- 10.1.4** **G** The directions in this chapter relate to the manner in which a *firm* must apply for the *FSA*'s approval under section 59 of the *Act* and other procedures.
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- 10.1.5** **G** The list of *controlled functions* is at *SUP* 10.4.5R.
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Overseas firms: UK services

- 10.1.6** **R** This chapter does not apply to an *overseas firm* in relation to *regulated activities* which are carried on in the *United Kingdom* other than from an establishment maintained by it or its *appointed representative* in the *United Kingdom*.
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Overseas firms: UK establishments

- 10.1.7** **R** Only the following *controlled functions* apply to an *overseas firm* which maintains an establishment in the *United Kingdom* from which *regulated activities* are carried on:
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- (1) the *chief executive function*;
 - (2) the *required functions*;
 - (3) the *significant management (designated investment business) function*;

- (4) *the significant management (settlements) function* in so far as the activities relate to *designated investment business*; and
- (5) *the customer functions*.

10.1.8

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For an *incoming EEA firm*, *incoming Treaty firm* or *UCITS qualifier*, see SUP 10.1.9R to SUP 10.1.15G.

Incoming EEA firms, incoming Treaty firms and UCITS qualifiers

10.1.9

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This chapter does not apply to:

- (1) an *incoming EEA firm*; or
- (2) an *incoming Treaty firm*; or
- (3) a *UCITS qualifier*;

if and in so far as the question of whether a *person* is fit and proper to perform a particular *function* in relation to that *firm* is reserved, under any of the *Single Market Directives*, the *Treaty* or the *UCITS Directive* to an authority in a country or territory outside the *United Kingdom*.

10.1.10

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SUP 10.1.9R reflects the provisions of section 59(8) of the *Act* and, in relation to an *incoming Treaty firm* and a *UCITS qualifier*, the *Treaty* and the *UCITS Directive*. It preserves the principle of *Home State* prudential regulation. In relation to an *incoming EEA firm* exercising an *EEA right*, or an *incoming Treaty firm* exercising a *Treaty right*, the effect is to reserve to the *Home State regulator* the assessment of the fitness and propriety of a *person* performing a function in the exercise of that right. A member of the *governing body*, or the notified *UK branch manager*, of an *incoming EEA firm*, acting in that capacity, will not therefore have to be approved by the *FSA* under the *Act*.

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But an *incoming EEA firm*, or *incoming Treaty firm*, will have had to consider the impact of the *Host State rules* with which it is required to comply when carrying on a *passported activity* or *Treaty activity* through a *branch* in the *United Kingdom*. An *incoming EEA firm* will have been notified of those provisions under Part II of Schedule 3 to the *Act* in the course of satisfying the conditions for *authorisation* in the *United Kingdom*.

10.1.12

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An *incoming EEA firm* will have to consider, for example, the position of a *branch manager* based in the *United Kingdom* who may also be performing a function in relation to the carrying on of a *regulated activity* not covered by the *EEA right* of the *firm*. In so far as the function is within the description of a *controlled function*, the *firm* will need to seek approval for that *person* to perform that *controlled function*.

Incoming EEA firms: passported activities from a branch

10.1.13

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Only the following *controlled functions* apply to an *incoming EEA firm* with respect to its *passported activities* carried on from a *branch* in the *United Kingdom*:

- (1) the *EEA investment business oversight function*;
- (2) the *compliance oversight function*;
- (3) the *money laundering reporting function*;
- (4) the *significant management (designated investment business) function*;
- (5) the *significant management (settlements) function* in so far as the activities relate to *designated investment business*; and
- (6) the *customer functions* other than the *adviser on syndicate participation at Lloyd's function*.

Incoming EEA firms etc with top-up permission activities from a UK branch

10.1.14

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In relation to the activities of a *firm* for which it has a *top-up permission*, only the following *controlled functions* apply:

- (1) the *required functions*, other than the *apportionment and oversight function*;
- (2) the *significant management (designated investment business) function*;
- (3) the *significant management (settlements) function* in so far as the activities relate to *designated investment business*; and
- (4) the *customer functions*.

10.1.15

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An *incoming EEA firm* may require a *Part IV permission* in respect, for example, of its *commodities* business. The list of *controlled functions* which apply mirror those which apply to *overseas firms*, without the *chief executive function*. In the case of a *firm* with *top-up permission*, the *FSA* anticipates that the equivalent responsibility of the *chief executive* for the relevant business would be assumed by the *person* performing the *EEA investment business oversight function*.

Appointed representatives

10.1.16

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The descriptions of the following functions apply to an *appointed representative* of a *firm*, except an *introducer appointed representative* as they apply to a *firm*:

- (1) **the governing functions;** and
- (2) **the customer functions other than the investment management function.**

10.1.17 G_{/1} The effect of SUP 10.1.16R is that the *directors* (or their equivalent) and *senior managers* (or their equivalent) of an *appointed representative* must also be *approved* under section 59 of the *Act* for the performance of certain *controlled functions*.

Members of a profession

10.1.18 R_{/1} This chapter, except in respect of the *required functions*, does not apply to an *authorised professional firm* in respect of its *non-mainstream regulated activities*.

10.1.19 G_{/1} SUP 10.1.18R is relevant to the *person*, such as a *partner* in a *professional firm*, whose only *regulated activities* are incidental to his professional services, and where the principal purpose of the *firm* is to carry on activities which are not *regulated activities*. Any regulated activities which that *person* carries on are not within the description of a *controlled function* (except with respect to the *required functions*).

10.1.20 G_{/1} For further guidance on the supervision and regulation of activities carried on by a member of a *designated professional body*, see PROF 5.

Oil market participants and service companies

10.1.21 R_{/1} The descriptions of *significant influence functions*, other than the *required functions*, do not extend to activities carried on by a *firm* whose principal purpose is to carry on activities other than *regulated activities* and which is:

- (1) **an oil market participant;** or
- (2) **a service company.**

10.1.22 G_{/1} It will be a matter of fact in each case whether a *firm's* principal purpose is to carry on activities other than *regulated activities* having regard to all the circumstances, including in particular where the balance of the business lies. If a *firm* wishes to rely on SUP 10.1.21R, it should be in a position to demonstrate that its principal purpose is to carry on activities other than *regulated activities*.

Committees of the Society of Lloyd's

10.1.23 R_{/1} (1) For the purpose of SUP 10.6.4R (the *director function*), "director" includes an executive member of a committee to which the *Council of the Society of Lloyd's* directly delegates authority to carry out the *Society's regulatory functions*.

(2) For the purpose of SUP 10.6.8R (the *non-executive director function*), "non-executive director" includes a non-executive member of a committee to which the *Council of the Society of Lloyd's* directly delegates authority to carry out the *Society's* regulatory functions.

10.1.24

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The effect of SUP 10.6.4R is that the function of an executive member of the *Council of the Society of Lloyd's* comes within the description of the *director function*. SUP 10.1.23R(1) provides that the function of an executive member of certain committees of the *Society of Lloyd's* with regulatory functions also comes within the description of the *director function*. SUP 10.6.8R and SUP 10.1.23R(2) are the equivalent provisions for the non-executive member of certain committees of the *Society of Lloyd's* with regulatory functions.

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See SUP 10.10.15R for the *adviser on syndicate participation at Lloyd's function*.

Insolvency practitioners

10.1.26

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This chapter does not apply to a function performed by:

- (1) a *person* acting as an insolvency practitioner within the meaning of section 388 of the Insolvency Act 1986; or
- (2) a *person* acting as a nominee in relation to a voluntary arrangement under Parts I (Company Voluntary Arrangements) and VIII (Individual Voluntary Arrangements) of the Insolvency Act 1986; or
- (3) a *person* acting as an insolvency practitioner within the meaning of Article 3 of the Insolvency (Northern Ireland) Order 1989; or
- (4) a *person* acting as a nominee in relation to a voluntary arrangement under Parts II (Company Voluntary Arrangements) and VIII (Individual Voluntary Arrangements) of the Insolvency (Northern Ireland) Order 1989.

10.2 Purpose

- 10.2.1** **G**_{/1} The immediate purpose of SUP 10.3 to SUP 10.10 is to specify, under section 59 of the Act, descriptions of the 27 *controlled functions* which are listed in SUP 10.4.5R. The underlying purpose is to establish, and mark the boundaries of, the "approved persons regime". An *approved person* is a *person*, generally an individual, who is approved to perform a *controlled function*.
- 10.2.2** **G**_{/1} The *controlled functions* which have been specified in this chapter are those functions which the FSA sees as key to the operation of the provisions of Part V of the Act (Performance of *Regulated Activities*) and the provisions made under Part V. Those provisions include:
- (1) the *Statements of Principle and Code of Practice for Approved Persons* issued under section 64 of the Act (see *APER*); and
 - (2) the fit and proper test referred to in section 61 of the Act (see *FIT*).
- 10.2.3** **G**_{/1} The purpose of the direct regulation of an individual (and in some cases a *body corporate*) is to complement the regulation of the *authorised person*, that is the *firm* for which the *approved person* performs the function.
- 10.2.4** **G**_{/1} SUP 10.11 to SUP 10.14 set out the procedures for applying for approval, changing the details held by the FSA concerning an *approved person*, and withdrawing from approval.

10.3 Provisions related to the act

Arrangements and regulated activities

- 10.3.1** **R**_{/1} A function is a *controlled function* only to the extent that it is performed under an *arrangement* entered into by:
- (1) a *firm*; or
 - (2) a contractor of the *firm*;
- in relation to the carrying on by the *firm* of a *regulated activity*.
- 10.3.2** **G**_{/1} Sections 59(1) and (2) of the *Act* provide that approval is necessary in respect of a *controlled function* which is performed under an *arrangement* entered into by a *firm*, or its contractor (typically an *appointed representative*), in relation to a *regulated activity*.
- 10.3.3** **G**_{/1} *Arrangement* is defined in section 59(10) of the *Act* as any kind of *arrangement* for the performance of a function and includes the appointment of a *person* to an office, his becoming a *partner*, or his employment (whether under a contract of service or otherwise). For the provisions in this chapter relating to outsourcing, see SUP 10.12.3G and 10.12.4G.
- 10.3.4** **G**_{/1} If, however, a *firm* is a member of a *group*, and the *arrangements* for the performance of a *controlled function* of the *firm* are made by, say, the *holding company*, the *person* performing the function will only require approval if there is an *arrangement* (under section 59(1)) or a contract (under section 59(2)) between the *firm* and *holding company* permitting this. This need not be a written contract but could arise, for example, by conduct, custom and practice.
- 10.3.5** **G**_{/1} The *arrangement* must be "in relation to" the carrying on of a *regulated activity*. *Regulated activities* are defined in the *Glossary* by reference to the *Regulated Activities Order*. This order prescribes the activities which are *regulated activities* for the purposes of the *Act*.



10.4 Specification of functions

10.4.1

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(1) Each of the functions described in SUP 10.4.5R (the *table of controlled functions*) is a *controlled function*.

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(2) The descriptions of the *controlled functions* in (1) are amplified by the provisions of this chapter.

(3) A function performed by an *approved person* which is not within (1) is not within the description of the *controlled function*.

10.4.2

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SUP 10.4.1R(1), together with the *table of controlled functions* in SUP 10.4.5R, specifies, in brief terms, the descriptions of the *controlled functions*. SUP 10.4.1R(2) provides that the other *rules* in this chapter contain the detail of the description for each function. Further *rules* in this chapter contain provisions which will apply to each description as indicated in those *rules*: see in particular SUP 10.1 for the application provisions.

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10.4.3

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SUP 10.4.1R(3) also addresses the position of an *approved person* who is carrying on activities which are unrelated to *regulated activities* or are otherwise outside the description of a *controlled function*. The fact that the *person* may be approved for one purpose does not have the effect of bringing all his activities within the *controlled function*.

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10.4.4

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Certain *controlled functions* expressly include other *controlled functions*: see SUP 10.6.2R in relation to *governing functions*; SUP 10.10.7R in relation to the *investment adviser function*; and SUP 10.10.20R in relation to the *investment management function*. In view of broad descriptions of the *significant management functions* (CF16 to CF20), these are expressed so as not to include other *controlled functions*.

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10.4.5

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Table Controlled functions

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Type	CF	Description of controlled function
<i>Governing functions*</i>	1	<i>Director function</i>
	2	<i>Non-executive director function</i>
	3	<i>Chief executive function</i>
	4	<i>Partner function</i>
	5	<i>Director of unincorporated association function</i>
	6	<i>Small friendly society function</i>
	7	<i>Sole trader function</i>

Type	CF	Description of controlled function
<i>Required functions*</i>	8	<i>Apportionment and oversight function</i>
	9	<i>EEA investment business oversight function</i>
	10	<i>Compliance oversight function</i>
	11	<i>Money laundering reporting function</i>
	12	<i>Appointed actuary function</i>
<i>Systems and controls functions*</i>	13	<i>Finance function</i>
	14	<i>Risk assessment function</i>
<i>Significant management functions*</i>	15	<i>Internal audit function</i>
	16	<i>Significant management (designated investment business) function</i>
	17	<i>Significant management (other business operations) function</i>
	18	<i>Significant management (insurance underwriting) function</i>
	19	<i>Significant management (financial resources) function</i>
<i>Customer functions</i>	20	<i>Significant management (settlements) function</i>
	21	<i>Investment adviser function</i>
	22	<i>Investment adviser (trainee) function</i>
	23	<i>Corporate finance adviser function</i>
	24	<i>Pension transfer specialist function</i>
	25	<i>Adviser on syndicate participation at Lloyd's function</i>
	26	<i>Customer trading function</i>
	27	<i>Investment management function</i>
<i>*significant influence functions</i>		

10.5 Significant influence functions

What are the significant influence functions?

- 10.5.1** **G**_{/1} The *significant influence functions*, which are specified in SUP 10.4.1R, comprise the *governing functions* (see SUP 10.6), the *required functions* (see SUP 10.7), the *systems and controls functions* (see SUP 10.8) and the *significant management functions* (see SUP 10.9). SUP 10.5 applies to each of the *significant influence functions*.

The first condition

- 10.5.2** **R**_{/1} Each *significant influence function* is one which is likely to result in the *person* responsible for its performance exercising a significant influence on the conduct of a *firm's* affairs, so far as relating to a *regulated activity* of the *firm*.
- 10.5.3** **G**_{/1} SUP 10.5.2R gives effect to section 59(5) of the *Act* (where this provision is referred to as the first condition).
- 10.5.4** **G**_{/1} Whether a function is likely to result in the *person* responsible for its performance exercising significant influence on the conduct of the *firm's* affairs is a question of fact in each case. The *FSA* has identified the *significant influence functions* as satisfying this condition. What amounts to exercising significant influence in any particular case will depend on the circumstances. The *person* performing one of these functions is likely to play a part in ensuring that effective governance structures, systems and controls are developed and operated. In relation to a *firm* as a whole, this is expected to include setting the business strategy, regulatory climate and ethical standards of the *firm*. In relation to a *branch*, this will include ensuring that the *firm's* strategy (as it affects the *branch*) is appropriate in the context of the *UK regulatory system*, and setting the regulatory climate and ethical standards of the *branch* in the *United Kingdom*.

Periods of less than 12 weeks

- 10.5.5** **R**_{/1} If:
- (1) a *firm* appoints an individual to perform a function which, but for this rule, would be a *significant influence function*;

- (2) the appointment is to provide cover for an *approved person* whose absence is:
 - (a) temporary; or
 - (b) reasonably unforeseen; and
- (3) the appointment is for less than 12 weeks in a consecutive 12 month period;

the description of the relevant *significant influence function* does not relate to those activities of that individual.

10.5.6

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SUP 10.5.5R enables cover to be given for, say, holidays and emergencies and avoids the need for the precautionary approval of, for example, a deputy. However, as soon as it becomes apparent that a *person* will be performing a *controlled function* for more than 12 weeks, the *firm* should apply for approval.

10.6 Governing functions

Introduction

- 10.6.1** **G**
/1 Every *firm* will have one or more *persons* responsible for directing its affairs. These *persons* will be performing the *governing functions* and will be required to be *approved persons* unless the application provisions in *SUP* 10.1, or the particular description of a *controlled function*, provide otherwise. For example, each *director* of a *company* incorporated under the Companies Acts will perform the *governing function* in relation to that *company*.

What the governing functions include

- 10.6.2** **R**
/1 Each of the *governing functions* (other than the *non-executive director function*) includes where apportioned under *SYSC* 2.1.1R:

- (1) *systems and controls functions*; and
- (2) *significant management functions*.

- 10.6.3** **G**
/1 The effect of *SUP* 10.6.2R is that a *person* who is *approved* to perform a *governing function* (other than the *non-executive function*) will not have to be specifically approved to perform any of the *systems and controls functions* or the *significant management functions*. However, he will have to be additionally approved before he can perform any of the *required functions* or *customer functions*.

Director function (CF1)

- 10.6.4** **R**
/1 If a *firm* is a *body corporate* (other than a *limited liability partnership*), the *director function* is the function of acting in the capacity of a *director* (other than *non-executive director*) of that *firm*.

- 10.6.5** **G**
/1 The definition of *director* includes a *person* in accordance with whose directions or instructions the *directors* are accustomed to act. Such a *person* is defined in section 741 of the Companies Act 1985 as a "shadow director". The *directors* of a *holding company* would not, as such, be *shadow directors*. Neither would an individual be a *shadow director* (or *director*) because his job description included the word "director". Whether a *person* is a *director* within the definition is a question of fact in each case.

10.6.6 G_{/1} Similarly, the fact that a *person* may have "director" in his title does not of itself make him a *director* within the meaning of the definition. Whether a *person* is a *director* will depend on the facts in each case.

10.6.7 G_{/1} A *director* can be a *body corporate* and may accordingly require approval as an *approved person* in the same way as a natural *person* may require approval.

Non-executive director function (CF2)

10.6.8 R_{/1} If a *firm* is a *body corporate*, the *non-executive director function* is the function of acting in the capacity of a *non-executive director* of that *firm*.

10.6.9 G_{/1} Examples of responsibilities of a *non-executive director* may include:

- (1) playing his part, by providing an independent perspective to the overall running of the business, in setting and monitoring the *firm's* strategy;
- (2) scrutinising the approach of executive management, the *firm's* performance and its standards of conduct; and
- (3) carrying out other responsibilities as assigned by the *firm*, for example as a member of a board committee on audit or remuneration.

10.6.10 G_{/1} The extent of the responsibilities of a particular *non-executive director* will be a matter of fact in each case but they will not extend to executive responsibilities.

Chief executive function (CF3)

10.6.11 R_{/1} The *chief executive function* is the function of acting in the capacity of a *chief executive* of a *firm*.

10.6.12 G_{/1} The title given to a *person* performing the *chief executive function* is likely to be "Chief Executive Officer" or similar. However, the title, or absence of title, does not of itself determine whether the activities of a *person* amount to the *chief executive function*.

10.6.13 G_{/1} This function is having the responsibility, alone or jointly with one or more others, under the immediate authority of the *governing body*, for the conduct of the whole of the business (or relevant activities); or, in the case of a *branch* in the *United Kingdom* of an *overseas firm*, for all of the activities subject to the *UK regulatory system*.

10.6.14 G_{/1} For a *branch* in the *United Kingdom* of an *overseas firm*, the *FSA* would not normally expect the overseas *chief executive* of the *firm* as a whole to be approved for this function where there is a *senior manager* under him with specific responsibility for those activities of the *branch* which are subject to the *UK regulatory system*. In some circumstances, the person within the *firm* responsible for *UK* operations may, if the function is likely to enable him to exercise significant influence over the *branch*, also perform the *chief executive function* (see *SUP* 10.7.4G). The *senior manager* may be called a Managing Director, *UK* Regional Head, Branch Manager, *UK* Country Head; or, in the case of a non-EEA *insurer* with a *branch* in the *United Kingdom*, *UK chief executive*.

10.6.15 **G**_{/1} A *person* performing the *chief executive function* may be a *member* of the *governing body* but need not be. If the chairman of the *governing body* is also the *chief executive*, he will be discharging this function. If the responsibility is divided between more than one *person* but not shared, there is no *person* exercising the *chief executive function*. But if that responsibility is discharged jointly by more than one *person*, each of those *persons* will be performing the *chief executive function*.

10.6.16 **G**_{/1} Note that a *body corporate* may be a *chief executive*. If so, it will need to be approved to perform the *chief executive function*.

Partner function (CF4)

- 10.6.17** **R**_{/1}
- (1) If a *firm* is a *partnership*, the *partner function* is the function of acting in the capacity of a *partner* in that *firm*.
 - (2) If the principal purpose of the *firm* is to carry on one or more *regulated activities*, each *partner* performs the *partner function*.
 - (3) If the principal purpose of the *firm* is other than to carry on *regulated activities*:
 - (a) a *partner* performs the *partner function* to the extent only that he has responsibility for a *regulated activity*; and
 - (b) a *partner* in a *firm* will be taken to have responsibility for each *regulated activity* except where the *partnership* has apportioned responsibility to another *partner* or group of *partners*.

10.6.18 **G**_{/1} For the purpose of this chapter, the definition of *partner* has been extended to include a "shadow partner", that is, a *person* in accordance with whose directions or instructions the *partners* are accustomed to act. This brings the concept of a *partner* into line with the concept of a *director*.

10.6.19 **G**_{/1} Any apportionment referred to in SUP 10.6.17R(3)(b) will have taken place under SYSC 2.1.1R. The FSA may ask to see details of the apportionment but will not require, as a matter of course, a copy of the material which records this (see SYSC 2.2).

10.6.20 **G**_{/1} The effect of SUP 10.1.18R is that *regulated activity* in SUP 10.6.17R (and elsewhere) is to be taken as not including an activity that is a *non-mainstream exempt regulated activity*. Therefore, a *partner* whose only *regulated activities* are incidental to his professional services, in a *partnership* whose principal purpose is to carry on other than *regulated activities*, need not be an *approved person*. What amounts to the principal purpose of the *firm* is a matter of fact in each case having regard to all the circumstances, including the activities of the *firm* as a whole. Any *regulated activities* which such a *partner* carries on are not within the description of the *partner function*.

10.6.21 **R**_{/1} If a *firm* is a *limited liability partnership*, the *partner function* extends to the *firm* as if the *firm* were a *partnership* and a member of the *firm* were a *partner*.

10.6.22 **G** _{/1} The *Limited Liability Partnerships Act 2000* provides for a legal entity to be formed under which every member of the *limited liability partnership* is the agent of the *limited liability partnership*. The effect of SUP 10.6.21R is to treat a *limited liability partnership* as a *partnership* for the purposes of the *partner function*.

10.6.23 **R** _{/1} If a *partnership* is registered under the Limited Partnership Act 1907, the *partner function* does not extend to any function performed by a limited partner.

Director of unincorporated association function (CF5)

10.6.24 **R** _{/1} If a *firm* is an unincorporated association, the *director of unincorporated association function* is the function of acting in the capacity of a *director* of the unincorporated association.

10.6.25 **G** _{/1} There are many kinds of unincorporated association. For example, it could be a committee of management of a property unit trust; or the board of trustees of an *occupational pension scheme* where the trustees themselves carry on *regulated activities*. The FSA would expect each member of the committee of management or board to be performing the *director of unincorporated association function* and therefore to need to be approved to do so.

Small friendly society function (CF6)

10.6.26 **R** _{/1} (1) If a *firm* is a *non-directive friendly Society*, the *small friendly society function* is the function of directing its affairs, either alone or jointly with others.

(2) If the principal purpose of the *firm* is to carry on *regulated activities*, each *person* with responsibility for directing its affairs performs the *controlled function*.

(3) If the principal purpose of the *firm* is other than to carry on *regulated activities*, a *person* performs the *small friendly society function* only to the extent that he has responsibility for a *regulated activity*.

10.6.27 **G** _{/1} A *friendly society* that is not subject to the *Insurance Directives* is often referred to as a *non-directive friendly society*. For the purposes of SUP 10 it is referred to as a *small friendly society*.

10.6.28 **R** _{/1} (1) Each *person* on the *non-directive friendly society's governing body* will be taken to have responsibility for its *regulated activities*, unless the *firm* has apportioned this responsibility to one particular individual to whom it is reasonable to give this responsibility.

(2) The individual need not be a member of the *governing body*.

10.6.29 **G** _{/1} (1) Typically a *non-directive friendly Society* will appoint a "committee of management" to direct its affairs. However, the governing arrangements may

10.7 Required functions

Apportionment and oversight function (CF8)

- 10.7.1** **R**_{/1} The *apportionment and oversight function* is the function of acting in the capacity of a *director* or *senior manager* responsible for either or both of the apportionment function and the oversight function set out in SYSC 2.1.3R.
- 10.7.2** **G**_{/1} SYSC 2.1.3R provides that a *firm* must appropriately allocate to one or more individuals the functions of dealing with the apportionment of responsibilities under SYSC 2.1.1R, and of overseeing the establishment and maintenance of systems and controls under SYSC 3.1.1R. Where there is a *chief executive*, he or she must be one of the individuals to whom the functions are allocated (unless the functions are allocated to someone of greater seniority); see SYSC 2.1.6G.
- 10.7.3** **G**_{/1} The fact that there is a *person* performing the *apportionment and oversight function*, and who has responsibility for activities subject to regulation by the FSA, may have a bearing on whether a manager who is based overseas will be performing a *controlled function*. It is a factor to take into account when assessing the likely influence of the overseas manager.
- 10.7.4** **G**_{/1} Generally, in relation to a UK establishment of an *overseas firm* or a *firm* which is part of an overseas *group*, where an overseas manager's responsibilities in relation to the United Kingdom are strategic change only, he will not need to be an *approved person*. However, where, in accordance with SYSC 3, he is responsible for implementing that strategy in the *United Kingdom*, and has not delegated that responsibility to a *senior manager* in the *United Kingdom*, he is likely to be performing a *controlled function*, such as, for example, the *chief executive function*.
- 10.7.5** **G**_{/1} See also SUP 10.9.5G and SUP 10.9.6G in relation to matrix management in the context of *significant management functions*.

EEA investment business oversight function (CF9)

- 10.7.6** **R**_{/1} The *EEA investment business oversight function* is the function of acting in the capacity of an individual who is responsible, in accordance with SYSC 2.1.3R(2), for overseeing the establishment and maintenance of systems and controls in relation to *designated investment business* carried on from a *branch* in the *United Kingdom* of an *incoming EEA firm*.

- 10.7.7** **G**_{/1} Where an overseas individual has not delegated this function to a *senior manager* in the *United Kingdom*, he is likely to be performing this *controlled function*. However, the *FSA* anticipates that any individual carrying out this function will normally be located in the *United Kingdom*. He may be the local *chief executive* or one or more of the individuals *approved* to perform the *significant management (designated investment business) function*. If the local *chief executive* (or other individual) is approved for this function, this does not mean that all his responsibilities are the concern of the *FSA*. *SUP* 10.1.9R preserves the principle of *Home State* prudential regulation whenever it applies and in respect of each *controlled function*.

Compliance oversight function (CF10)

- 10.7.8** **R**_{/1} The *compliance oversight function* is the function of acting in the capacity of a *director* or *senior manager* who is allocated the function set out in SYSC 3.2.8R.
- 10.7.9** **G**_{/1} SYSC 3.2.8R provides that a *firm* which carries on *designated investment business* must allocate to a *director* or *senior manager* the function of having responsibility for oversight of the *firm's* compliance and reporting to the *governing body* in respect of that responsibility.
- 10.7.10** **G**_{/1} Compliance in SYSC 3.2.8R means compliance with the rules in *COB* and *CIS*. The *FSA* anticipates that some *firms* will include oversight of compliance with *PRIN*, *MAR*, and other requirements and standards, within its compliance function. These other responsibilities would not, however, be brought within the *compliance oversight function* (see also *SUP* 10.4.3G).
- 10.7.11** **G**_{/1} Some *firms*, particularly *firms* with complex structures or which are part of a *group*, may find it appropriate to seek approval for the group head of compliance and other *persons* to perform the *compliance oversight function*. Examples of other *persons* include the *senior manager* responsible for compliance in a *firm* which is a *subsidiary* within the *group* and a *senior manager* in a reporting line, where compliance is organised along product lines.
- 10.7.12** **G**_{/1} Although a *firm* may choose to use the services of an external compliance consultant, the responsibility for the *compliance oversight function* must, in accordance with SYSC 3.2.8R, rest with one or more *directors* or *senior managers* of the *firm*.

Money laundering reporting function (CF11)

- 10.7.13** **R**_{/1} The *money laundering reporting function* is the function of acting in the capacity of the *money laundering reporting officer* of a *firm*.
- 10.7.14** **G**_{/1} The *rules* in the *Money Laundering* sourcebook (*ML*) provide that a *firm* must have a *money laundering reporting officer* unless:
- (1) it is a *sole trader* with no *employees*; or
 - (2) its *regulated activities* are certain *insurance business* only; or
 - (3) it is an *incoming firm* providing only services into the *United Kingdom*.

10.7.15 G_{/1} The specific responsibilities of the *money laundering reporting officer* are set out in *ML 7.1*.

10.7.16 G_{/1} *ML 7.1.9R* provides that a *money laundering reporting officer* must have a "sufficient level of seniority" within the *firm*, so that he can carry out his *controlled function* effectively.

Appointed actuary function (CF12)

10.7.17 R_{/1} The *appointed actuary function* is the function of acting in the capacity of the *appointed actuary* of a *firm*.

10.7.18 G_{/1} The effect of *SUP 4.1.1R* (Application) and *SUP 4.3.1R* (Appointment of an actuary) is that a *long-term insurer* (unless it is a certain kind of *friendly society*) must appoint an *actuary*, defined in *SUP 4.3.1R* as an *appointed actuary*. The kinds of *friendly society* to which the provisions do not apply are:

- (1) a *registered friendly society* which is a *non-directive friendly society*; and
- (2) an *incorporated friendly society* that is a *flat rate benefits business friendly society*.

10.7.19 G_{/1} The *appointed actuary* is a personal appointment and typically is an *employee* of the *firm*. However, in many cases a *partner* in a firm of actuaries is appointed.

10.7.20 G_{/1} The *appointed actuary function* does not extend to the giving of actuarial advice to a *firm* by an *actuary* who is acting outside the capacity of *appointed actuary*. A *person* who gives actuarial advice, whether occasionally or regularly, other than in the course of his duties as an *appointed actuary* would not be performing the *appointed actuary function*.

10.7.21 G_{/1} The *rules* and *guidance* concerning the rights and duties of the *appointed actuary* are set out in *SUP 4.3.10R* to *SUP 4.3.17G*.

10.8 Systems and control functions

Finance function (CF13)

10.8.1 **R**_{/1} The *finance function* is the function of acting in the capacity of a *senior manager* with responsibility for reporting to the *governing body* of a *firm* in relation to its financial affairs.

10.8.2 **G**_{/1} This function is often performed by a *senior manager* who is given the title of Financial Controller, Chief Finance Officer or Finance Officer. The individual may also be given the title of Finance Director but, if he is a *director* of the *company*, he should be *approved* to perform the *director function* (and not the *finance function*). The fact that an individual may use one of these titles does not necessarily mean that he is performing a *controlled function*.

Risk assessment function (CF14)

10.8.3 **R**_{/1} The *risk assessment function* is the function of acting in the capacity of a *senior manager* with responsibility for reporting to the *governing body* of a *firm* in relation to setting and controlling its *risk exposure*.

10.8.4 **G**_{/1} Depending on the scale, nature and complexity of its business it may be appropriate for a *firm* to have a separate *risk assessment function*: see SYSC 3.2.10G.

10.8.5 **G**_{/1} This function is often performed by a *senior manager* who is given the title of Head of Risk. Other examples of titles are Head of Credit Risk and Head of Market Risk (but the fact that an individual may use one of these titles does not necessarily mean that he is performing a *controlled function*).

Internal audit function (CF15)

10.8.6 **R**_{/1} The *internal audit function* is the function of acting in the capacity of a *senior manager* with responsibility for reporting to the *governing body*, or the audit committee (or its equivalent), of a *firm* in relation to its adherence to internal systems and controls, procedures and policies.

10.8.7 **G**_{/1} Depending on the scale, nature and complexity of its business it may be appropriate for a *firm* to have a separate *internal audit function*: see SYSC

3.2.16G. If it does, this will not require the *person* performing the function to have any special obligation towards the *FSA* (such as reporting directly on matters to the *FSA*) nor will this cause the *FSA* to call for all internal audit reports as a matter of routine.

10.8.8

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This function is often performed by a *senior manager* who is given the title of Head of Internal Audit or Internal Auditor (but the fact that an individual may use one of these titles does not necessarily mean that he is performing a *controlled function*).

10.9 Significant management functions

Application

- 10.9.1** **R**_{/1} *SUP 10.9 applies only to a firm which, under SYSC 2.1.1R, apportions a significant responsibility, within the description of a significant management function, to a senior manager of a significant business unit.*
- 10.9.2** **G**_{/1} The FSA anticipates that there will be only a few firms needing to seek approval for an individual to perform a significant management function. In most firms, those approved for the governing functions, required functions and, where appropriate, the systems and controls functions, are likely to exercise all the significant influence at senior management level.
- 10.9.3** **G**_{/1} However, the scale, nature and complexity of the firm's business may be such that a firm apportions under SYSC 2.1.1R a significant responsibility to an individual who is not approved to perform the governing functions, required functions or, where appropriate, the systems and controls functions. If so, the firm should consider whether the functions of that individual fall within a significant management function. For the purposes of the description of the significant management functions, the following additional factors about the firm should be considered:
- (1) the size and significance of the firm's business in the United Kingdom; for example, a firm carrying on designated investment business may have a large number of approved persons (for example, in excess of 100 individuals); or a firm carrying on general insurance business may have gross written premiums in excess of £100mn;
 - (2) the number of regulated activities carried on, or proposed to be carried on, by the firm and (if relevant) other members of the group;
 - (3) its group structure (if it is a member of a group);
 - (4) its management structure (for example matrix management); and
 - (5) the size and significance of its international operations, if any.
- 10.9.4** **G**_{/1} When considering whether a business unit is significant, the firm should take into account all relevant factors in the light of the firm's current circumstances and its plans for the future, including:
- (1) the risk profile of the unit; or

- (2) its use or commitment of a *firm's* capital; or
- (3) its contribution to the profit and loss account; or
- (4) the number of *employees* or *approved persons* in the unit; or
- (5) the number of *customers* of the unit; or
- (6) any other factor which makes the *unit* significant to the conduct of the *firm's* affairs so far as relating to the *regulated activity*.

10.9.5 G_{/1} The question may arise whether a manager who is based overseas will be performing a *controlled function* (such as the *significant management (designated investment business) function*) and should therefore be an *approved person*. This is especially true where the *firm* operates matrix management. The fact there is a *person* performing the *apportionment and oversight function*, and who has responsibility for activities subject to regulation by the *FSA*, may have a bearing on this. It is a factor to take into account when assessing the likely influence of the overseas manager.

10.9.6 G_{/1} Generally, in relation to a *branch* of a *firm*, or a *firm* which is part of an overseas *group*, where an overseas *manager* is responsible for strategy, he will not need to be an *approved person*. However, where he is responsible for implementing that strategy in the *United Kingdom*, and has not delegated that responsibility to a *senior manager* in the *United Kingdom*, he is likely to be performing a *controlled function*.

10.9.7 G_{/1} See also *SUP* 10.7.3G to *SUP* 10.7.5G in relation to matrix management.

Reporting requirement

10.9.8 R_{/1} A *firm* must, by no later than 31 July each year, provide the *FSA* with:

- (1) the name of every individual who is *approved* to perform any of its *significant management functions*; and
- (2) brief details of the job performed by that individual, as at 30 June of that year;

unless it has, within the 12 *months* preceding 30 June, already provided the *FSA* with that information.

10.9.9 G_{/1} The broad description of each *significant management function* means that an individual may perform a different function within the *significant management function* without needing prior approval. However, the *FSA* does require a notification of the job performed by such people once a year. Typically, a *firm* will give this information to the *FSA* as a matter of routine during the year but, if not, *SUP* 10.9.8R requires it to do so by 31 July. The *rule* requires the *firm* to provide a report only in respect of individuals performing a *significant management function*: if there are none, there is no need to provide a report.

Significant management (designated investment business) function (CF16)

- 10.9.10** **R**
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- (1) The *significant management (designated investment business) function* is the function of acting as a *senior manager* with significant responsibility for a significant business unit which carries on *designated investment business*.
 - (2) This function does not include any of the activities described in any other *controlled function*.

- 10.9.11** **G**
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- Where SUP 10.9.1R and SUP 10.9.10R apply, the FSA would expect the *senior manager* of a significant trading department, such as equities in a large international *firm*, possibly with the title of *Chief Investment Officer*, to be performing this function. Other examples are *senior managers* with responsibility for investment banking, fixed income, *derivatives*, *commodities*, trading, *custody*, asset management, marketing and sales. The Regional Heads of Sales of an *insurer* are also likely to be performing this function. The *senior manager* may, for example, be responsible for about 100 individuals *approved* to perform the *investment adviser function*. The FSA would not expect an individual below this level to need to be approved to perform the *significant management (designated investment business) function*. The fact that an individual may use one of these titles does not necessarily mean that he is performing a *controlled function*. Whether he does so depends on the circumstances of the *firm* and the application of SUP 10.9.1R.

Significant management (other business operations) function (CF17)

- 10.9.12** **R**
/1
- (1) The *significant management (other business operations) function* is the function of acting as a *senior manager* with significant responsibility for a significant business unit which carries on an activity which is not in relation to *designated investments*.
 - (2) A *person* may be a *senior manager* for the purposes of this *rule* even if he is not managing any or any substantial number of staff, provided he has responsibility for managing all, or a very substantial proportion, of the assets or exposures or decision making of the unit.
 - (3) This function does not include any of the activities described in any other *controlled function*.

- 10.9.13** **G**
/1
- Where SUP 10.9.1R and SUP 10.9.12R apply, the *senior manager* could, for example, be the head of a unit carrying on the activities of: retail banking, personal lending, corporate lending; leasing assets, issuing credit cards, trade finance, loan syndicates or debt, salvage or loan recovery, or proprietary trading. The *senior manager* could also be a proprietary trader whose trading limits are such that he may put, or potentially put, his *firm* at significant risk. This function would not extend to every proprietary trader.

Significant management (insurance underwriting) function (CF18)

- 10.9.14** **R**
/1
- (1) The *insurance underwriting function* is the function of acting in the capacity of a *senior manager* with significant responsibility for the effecting by an *insurer*, or by a *managing agent* on behalf of a *member* of the *Society of Lloyd's*, of *contracts of insurance* other than *contractually based investments*.
- (2) This function does not include any of the activities described in any other controlled function.

- 10.9.15** **G**
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- Where SUP 10.9.1R and SUP 10.9.14R apply, the FSA would expect the *senior manager* with responsibility for a significant underwriting unit such as marine underwriting in a large insurer to be performing this function. Other examples are *senior managers* with underwriting responsibility for aviation, motor, property, third party liability, term insurance and health care.

Significant management (financial resources) function (CF19)

- 10.9.16** **R**
/1
- (1) The *significant management (financial resources) function* is the function of acting in the capacity of a *senior manager* with significant responsibility for the making of material decisions on the commitment of a *firm's* financial resources, its financial commitments, its asset acquisitions, its liability management and its overall cash and capital planning.
- (2) This function does not include any of the activities described in any other *controlled function*, including, in particular, the *finance function*.

- 10.9.17** **G**
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- Where SUP 10.9.1R and SUP 10.9.16R apply, the individual performing this function would typically be the Chief Treasurer, or a member of a high level committee such as an Asset and Liability Committee. In the case of the *Society of Lloyd's*, it would include being a member of the Market Board (or a successor committee performing the functions of the Market Board).

Significant management (settlements) function (CF20)

- 10.9.18** **R**
/1
- (1) The *significant management (settlements) function* is the function of acting in the capacity of a *senior manager* with significant responsibility for processing confirmations, payments, settlements, insurance claims, *client money* and similar matters.
- (2) This function does not include any of the activities described in any other *controlled function*, including, in particular, the *significant management (financial resources) function*.

- 10.9.19** **G**
/1
- The tasks within this *controlled function* are often referred to as the back office functions. Where SUP 10.9.1R and SUP 10.9.18R apply, the *person* performing this function may be known, for example, as the Head of Payments, Head of

Settlements, or Head of Claims. The fact that an individual may use one of these titles does not necessarily mean that he is performing a *controlled function*. Whether he does so depends on the circumstances of the *firm* and the application of *SUP* 10.9.1R.

10.10 Customer functions

- 10.10.1** **R** *SUP 10.10 (the customer functions) applies only in relation to a regulated activity to which COB applies under COB 1.4.*
/1
- 10.10.2** **G** (1) Without *SUP 10.10.1R* the descriptions of the *customer functions* would extend to functions wherever they are performed. The effect of *SUP 10.10.1R* is that the descriptions are limited, in relation to *regulated activities* with an overseas element, in a manner which is consistent with the scope of *COB* regulation.
/1
- (2) *COB 1.4 (General application: Where)* specifies the *rules* which apply to *regulated activities* by reference to the location from which the activity is carried on. For example, where the *regulated activity* is carried on from an establishment maintained by a *firm* (or by its *appointed representative*) in the *United Kingdom*, *COB* applies in full (but special provisions apply in relation to *financial promotion*). See *COB 1.4* for further details.
- 10.10.3** **G** The *customer functions* have to do with giving advice on, *dealing* and arranging deals in and *managing investments*; they have no application to banking business such as deposit taking and lending, nor to *general insurance business*.
/1
- The customer conditions (the second and third conditions)**
- 10.10.4** **R** Each *customer function* is one which will involve the *person* performing it in *dealing with customers*, (and for the *corporate finance adviser function, clients*), or *dealing with property of customers*, of a *firm* in a manner substantially connected with the carrying on of a *regulated activity* of the *firm*.
/1
- 10.10.5** **G** *SUP 10.10.4R* gives effect to sub-sections (6) and (7) of section 59 of the *Act* (referred to in that section as the second and third conditions). *Customer* is given the meaning in the *Glossary* (which is not the same as the definition given in section 59 (11) of the *Act*).
/1
- 10.10.6** **G** The *FSA* interprets the phrase "dealing with" as including having contact with *customers* and extending beyond "dealing" as used in the phrase "dealing in investments". "Dealing in" is used in Schedule 2 to the *Act* to describe in general terms the *regulated activities* which are specified in Part II of the *Regulated Activities Order*.
/1

Investment adviser function (CF21)

- 10.10.7 **R** /1 (1) The *investment adviser function* is the function of:
- (a) *advising on investments*; and
 - (b) performing functions within the *customer trading function* in connection with *advising on investments*.
- (2) This function does not include:
- (a) the *investment adviser (trainee) function*; and
 - (b) the *pension transfer specialist function*.
- (3) This function does not extend to an individual who is based overseas and who, in a 12 month period, spends no more than 30 days in the *United Kingdom* in so far as:
- (a) his activities relate to *designated investment business*; and
 - (b) he is supervised by an *approved person advising on investments*.

10.10.8 **G** /1 The function of *advising on investments* would include, for example, giving advice to *clients* in connection with *corporate finance business*. It does not include *managing investments* (see the *investment management function*) or advising on syndicate participation at Lloyd's (see the *adviser on syndicate participation at Lloyd's function*).

10.10.9 **G** /1 When considering an application for *approval* in relation to this *controlled function*, the *FSA* may ask for evidence of the individual's competence. *TC 2.4.1R* provides that a *firm* must ensure that an *employee* is not allowed to engage in an activity unless the *employee* has been assessed as competent in that activity, in accordance with *TC 2.4.4R*, or is appropriately supervised. *TC 2.4.2R* provides that a *firm* must, before an *employee* can be assessed as competent, ensure that the *employee* has been assessed as able to apply the knowledge and skills necessary to engage without supervision in the relevant activity and has passed the appropriate *approved examination*.

10.10.10 **G** /1 It is a matter for the *firm* to decide what level of supervision is appropriate for an individual from overseas. However, the *FSA* would expect the individual to be accompanied on a visit to a *customer*.

Investment adviser (trainee) function (CF22)

10.10.11 **R** /1 The *investment adviser (trainee) function* is the function of *advising on investments* where the individual performing the function has not yet been assessed as competent in accordance with the *rules* in the *Training and Competence sourcebook (TC)*.

10.10.12 **G** /1 If a *firm* notifies the *FSA* that an individual who is performing the *investment adviser (trainee) function* has passed the appropriate examination, and has been

assessed as competent, the FSA will treat this as an application for the individual to perform the *investment adviser function*. (Form D SUP 10 Ann 7R may be used for this purpose).

Corporate finance adviser function (CF23)

- 10.10.13 **R** /1 The *corporate finance adviser function* is the function of giving advice to *clients* only in connection with *corporate finance business*.

Pension transfer specialist function (CF24)

- 10.10.14 **R** /1 The *pension transfer specialist function* is the function of giving advice or performing related activities in connection with:

- (1) *pension transfers*; or
 - (2) *opt-outs*;
- for *private customers*.

Adviser on syndicate participation at Lloyds' function (CF25)

- 10.10.15 **R** /1 The *adviser on syndicate participation at Lloyd's function* is the function of giving advice to a person to become, or continue or cease to be, a member of a particular *Lloyds syndicate*.

Customer trading function (CF26)

- 10.10.16 **R** /1 The *customer trading function* is the function of *dealing*, as principal or as agent, and arranging *deals in investments* with or for, or in connection with, *private customers* and *intermediate customers* where:

- (1) the *dealing* or *arranging deals* is governed by COB 7 (dealing and managing); and
- (2) the *person* performing the function is not advising on or managing *investments* unless approved to perform the *investment adviser function* or the *investment management function*.

- 10.10.17 **G** /1 A *person* who advises on or manages *investments* must be approved to perform the *investment adviser function* or the *investment management function* (see SUP 10.10.7R and SUP 10.10.20R) and does not need to be separately approved for the *customer trading function* (see SUP 10.10.16R).

10.10.18 **G**_{/1} COB 7 applies to a *firm* conducting *designated investment business*. Where a firm's proprietary trader may deal with a *private* or *intermediate customer*, the *firm* should ensure that the trader is *approved* under the *customer trading function*.

10.10.19 **G**_{/1} The *customer trading function* does not extend to the individual who, on the instructions of the customer, simply inputs the customer's instructions into an automatic execution system where no discretion is or may be exercised by the individual carrying out the activity. Nor does it extend to merely introducing a *customer* to a *firm* or distributing advertisements.

Investment management function (CF27)

10.10.20 **R**_{/1} The *investment management function* is the function of *managing investments* and, when ancillary to that function, functions within:

- (1) the *customer trading function*; and
- (2) the *investment adviser function*.

10.10.21 **G**_{/1} Note that the definition of *managing investments* provides that the activity consists of managing assets comprising or including certain *specified investments* "in circumstances which involve the exercise of discretion".



10.11 Procedures relating to approved persons

Forms

10.11.1 G_{/1} The forms listed in *SUP 10.11.2G* are referred to in *SUP 10.11* (Procedures relating to approved persons) to *SUP 10.14* (Further questions).

10.11.2 G_{/1} Table Approved persons forms

Form A	SUP 10 Ann 4D	Application to perform controlled functions under the approved persons regime
Form B	SUP 10 Ann 5R	Notice to withdraw an application to perform controlled functions under the approved persons regime
Form C	SUP 10 Ann 6R	Notice of ceasing to perform controlled functions
Form D	SUP 10 Ann 7R	Notification of changes in personal information or application details
Form E	SUP 10 Ann 8G	Internal transfer of an approved person

10.11.3 G_{/1} A summary of the forms and their purposes is in *SUP 10 Ann 2G*. A summary of *FSA* procedures is in *SUP 10 Ann 3G*. For the method of notification to the *FSA*, see *SUP 15.7* (Form and method of notification).

10.11.4 G_{/1} Unless the context otherwise requires, in *SUP 10.11* (Procedures relating to *approved persons*) to *SUP 10.14* (Further questions) where reference is made to a *firm*, this also includes an applicant for *Part IV permission*, and other *persons* seeking to carry on *regulated activities* as an *authorised person*.

10.11.5 G_{/1} Forms B, C, D and E can only be submitted in respect of an *approved person* by the *firm* that submitted an *approved person's* original application (that is, Form A).

10.11.6 G_{/1} Copies of Forms A, B, C, D and E may be obtained from the *FSA* website or from the Individual Vetting and Approval department. To contact the Individual Vetting and Approval department for general enquiries:

(1) telephone 020 7676 0019; or

(2) fax 020 7676 0017; or

(3) write to:

Individual Vetting and Approval

The Financial Services Authority

25 The North Colonnade

Canary Wharf

LONDON E14 5HS; or

(4) e-mail iva@fsa.gov.uk

10.12 Application for approval and withdrawing an application for approval

When to apply for approval

- 10.12.1 **G**_{/1} In accordance with section 59 of the *Act* (Approval for particular arrangements), where a *candidate* will be performing one or more *controlled functions*, a *firm* must take reasonable care to ensure that the *candidate* does not perform these functions unless he has prior approval from the FSA.

How to apply for approval

- 10.12.2 **D**_{/1} An application by a *firm* for the FSA's approval under section 59 of the *Act* (Approval for particular arrangements) must be made by completing Form A.

Who should make the application?

- 10.12.3 **G**_{/1} In accordance with section 60 of the *Act* (Applications for approval), applications must be submitted by, or on behalf of, the *firm* itself, not by the *candidate*. Usually this will be the *firm* that is employing the *candidate* to perform the *controlled function*. Where a *firm* has outsourced the performance of a *controlled function*, the details of the outsourcing determine where responsibility lies and whom the FSA anticipates will submit *approved persons* forms. SUP 10.12.4G describes some common situations. The *firm* which is outsourcing is referred to as "A" and the *person* to whom the performance of the function has been outsourced, or which makes the *arrangement* for the function to be performed, is referred to as "B". In each situation, A must take reasonable care to ensure that, in accordance with section 59(2) of the *Act*, no *person* performs a *controlled function* under an *arrangement* entered into by its contractor in relation to the carrying on by A of a *regulated activity*, without approval from the FSA. See also SYSC 3.2.4G and if applicable IPRU (BANK) OS and IPRU (BSOC) OS.

- 10.12.4 **G**_{/1} Table Outsourcing arrangements

Outsourcing arrangement		Submitting forms
<p>Firm A to firm B</p>	<p>The FSA will consider A to have taken reasonable care if it enters into a contract with B under which B is responsible for ensuring that the relevant controlled functions are performed by approved persons, and that it is reasonable for A to rely on this</p>	<p>Firm B submits approved persons forms on behalf of firm A</p>
<p>Outsourcing by A to B (both being a member of the same United Kingdom group and each having its registered office in the United Kingdom)</p>	<p>See SUP 10.3.4G</p>	<p>See SUP 15.7.7</p>
<p>(i) A to B, where B is a non-authorised person not part of the same group as A (ii) A to B, where A is a branch of an overseas firm in the United Kingdom, and B is an overseas undertaking of the same group (iii) A to B, where A is a UK authorised subsidiary of an overseas firm, and B is an overseas undertaking of the same group</p>	<p>Responsibility for (as opposed to the performance of) any activity outsourced to B will remain with A. See SYSC 3.2.4G</p>	<p>A ensures that an individual approved under one of the significant influence functions has responsibility for the outsourced arrangement and A submits a form in relation to that individual</p>

Processing an application

- 10.12.5** G_{/1} The *Act* allows the *FSA* three *months* from the time it receives a properly completed application to consider it and come to a decision. The *FSA* must either grant the application or, if it proposes not to grant an application, issue a *warning notice* (see *DEC 2*). The *FSA* will deal with cases more quickly than this whenever circumstances allow and will try to meet the standard response times published on the website and in its Annual Report. However, if an application is incomplete when received, or the *FSA* has knowledge that, or reason to believe that, the information is incomplete, then the processing time will be longer than the published standard response times.
- 10.12.6** G_{/1} Application forms must always be completed fully and honestly. Further notes on how to complete the form are contained in each form. If forms are not completed fully and honestly, applications will be delayed and, in some cases, possibly rejected. A *person* who provides information to the *FSA* that is false or misleading may commit a criminal offence. As a general guide, disclosure is required in the application form in respect of:
- (1) previous employment history going back ten years and with reasons for leaving;
 - (2) outstanding county court judgments, bankruptcies and arrangements with creditors; and
 - (3) previous disciplinary actions by a *regulatory body*.
- 10.12.7** G_{/1} If there is a delay in processing the application within the standard response time, the *FSA* will tell the *firm* making the application as soon as this becomes apparent.
- 10.12.8** G_{/1} Before making a decision to grant the application or give a *warning notice*, the *FSA* may ask the *firm* for more information about the *candidate*. If it does this, the three *month* period in which the *FSA* must determine a completed application:
- (1) will stop on the *day* the *FSA* requests the information; and
 - (2) will start running again on the *day* on which the *FSA* finally receives all the requested information.
- 10.12.9** G_{/1} The *FSA* may grant an application only if it is satisfied that the *candidate* is a fit and proper *person* to perform the *controlled function* stated in the application form. Responsibility lies with the *firm* making the application to satisfy the *FSA* that the *candidate* is fit and proper to perform the *controlled function* applied for.
- 10.12.10** G_{/1} For further *guidance* on criteria for assessing whether a *candidate* is fit and proper, see *FIT*.

Decisions on applications

- 10.12.11** G_{/1} Whenever it grants an application, the *FSA* will confirm this in writing to all *interested parties*.
- 10.12.12** G_{/1} If the *FSA* proposes to refuse an application in relation to one or more *controlled functions*, it must follow the procedures for issuing *warning* and *decision notices* to all *interested parties*. The *requirements* relating to *warning* and *decision notices*

and the process for referrals to the *Financial Services and Markets Tribunal* are in *DEC 2* and *DEC 5* respectively.

Withdrawing an application for approval

10.12.13 **R** *A firm applying to withdraw an application must notify the FSA, using Form B.*
/1

10.12.14 **G** Under section 61(5) of the *Act* (Determination of applications), the *firm* may withdraw an application only if it also has the consent of the *candidate* and the *person* by whom the *candidate* is or would have been employed, if this is not the *firm* making the application.
/1

10.13 Changes to an approved person's details

Moving within a firm

- 10.13.1** **G**_{/1} An *approved person's* job may change from time to time as a result, for instance, of a change in personal job responsibilities or a *firm's regulated activities*. Where the changes will involve the *person* performing one or more different *controlled functions* from those for which approval has already been granted, then an application must be made to the *FSA* for approval for the *person* to perform those *controlled functions*. The *firm* must take reasonable care to ensure that an individual does not begin performing a *controlled function* until the *FSA* has granted *approved person* status to that individual in respect of that *controlled function*. This applies to *individuals* seeking approval in respect of a *controlled function* within the *firm* for which they already perform *controlled functions*. If the *approved person* is ceasing to perform *controlled functions*, as well as applying for *approval* in respect of additional *controlled functions*, then refer to *SUP* 10.13.3G.
- 10.13.2** **G**_{/1} Form A must be used to apply for an individual to perform further *controlled functions* for a *firm* for which he already performs a *controlled function* as an *approved person* (see *SUP* 10.12.2D). It is not mandatory to complete all parts of the form. See the notes attached to the form for full details.
- 10.13.3** **G**_{/1} A *firm* should use Form E where an *approved person* is both ceasing to perform one or more *controlled functions* and needs to be approved in relation to one or more new *controlled functions* within the same *firm*.

Moving between firms

- 10.13.4** **G**_{/1} If it is proposed that an *approved person* will no longer be performing a *controlled function* under an *arrangement* entered into by one *firm* or one of its contractors, but will be performing the same or a different *controlled function* under an *arrangement* entered into by a new *firm* or one of its contractors (whether or not the new *firm* is in the same *group* as the old *firm*), the new *firm* will be required to make a fresh application for the performance of the *controlled function* by that *person*.
- 10.13.5** **G**_{/1} In certain circumstances, when the *FSA* already has the information it would usually require, a shortened version of Form A may be completed. See the notes attached to the form for full details.

Ceasing to perform a controlled function

- 10.13.6** **R** ^{/1} A *firm* must submit to the *FSA* a completed Form C no later than seven *business days* after an *approved person* ceases to perform a *controlled function*.
- 10.13.7** **R** ^{/1} (1) A *firm* must notify the *FSA* as soon as practicable after it becomes aware, or has information which reasonably suggests, that it will submit a qualified Form C in respect of an *approved person*.
- (2) Form C is qualified if the information it contains:
- (a) relates to the fact that the *firm* has dismissed the *approved person* from its employment; or
 - (b) relates to the resignation by the *approved person* while under investigation by the *firm*, the *FSA* or any other regulatory body; or
 - (c) otherwise reasonably suggests that it may affect the *FSA*'s assessment of the *approved person's* fitness and propriety.
- 10.13.8** **G** ^{/1} Notification under SUP 10.13.7R may be made by telephone, fax or email and should be made, where possible, within one *business day* of the *firm* becoming aware of the information. If the *firm* does not submit Form C, it should inform the *FSA* in due course of the reason. This could be done using Form D, if appropriate.
- 10.13.9** **G** ^{/1} A *firm* is responsible for notifying the *FSA* if any *approved person* has ceased to perform a *controlled function* under an *arrangement* entered into by its *appointed representative* or former *appointed representative*.
- 10.13.10** **G** ^{/1} A *firm* can submit Form C or Form E to the *FSA* in advance of the cessation date. When a *person* ceases the *arrangement* under which he performs a *controlled function*, he will automatically cease to be an *approved person* in relation to that *controlled function*. A *person* can only be an *approved person* in relation to a specific *controlled function*. Therefore, a *person* is not an *approved person* during any period between ceasing to perform one *controlled function* (when he is performing no other *controlled function*) and being *approved* in respect of another *controlled function*.
- 10.13.11** **G** ^{/1} Sending forms promptly will help to ensure that any fresh application can be processed within the standard response times.
- 10.13.12** **R** ^{/1} (1) If a *firm* (A):
- (a) is considering appointing a *person* to perform any of the *customer functions*;
 - (b) requests another *firm* (B), as a former *employer* of that *person*, for a reference or other information in connection with that appointment; and
 - (c) indicates to B the purpose of the request;

B must, as soon as reasonably practicable, give to A all relevant information of which it is aware.

- (2) When giving the information to A under (1), B must have regard to the purpose of the request and in particular to:
- (a) any outstanding liabilities of that *person* from commission payments;
 - (b) any relevant outstanding or upheld complaint against that *person*;
 - (c) section 5 of Form A in SUP 10 Annex 4D (Application to perform controlled functions under approved persons regime);
 - (d) FIT 2 (Main assessment criteria); and
 - (e) if SUP 16.8.1R (*Persistency reports from insurers*) applies to B, the persistency of any *life policies* sold by that *person*.

10.13.13

G
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A *firm* supplying a reference in accordance with SUP 10.13.12R owes a duty to its former *employee* and the recipient *firm* to exercise due skill and care in the preparation of the reference. The reference should be accurate and based on documented fact. The *firm* may give frank and honest views, but only after taking reasonable care both as to factual content, and as to the opinions expressed, and verifying the information upon which they are based.

Changes to an approved person's personal details

10.13.14

R
/1

If an *approved person's* title, name or national insurance number changes, the *firm* for which the *person* performs a *controlled function* must notify the FSA on Form D of that change within seven *business days* of the *firm* becoming aware of the matter.

10.13.15

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The duty to notify in SUP 10.13.14R does not apply to changes to an *approved person's* private address.

10.13.16

R
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If a *firm* becomes aware of information which would reasonably be material to the assessment of an *approved person's*, or a *candidate's*, fitness and propriety (see FIT), it must inform the FSA on Form D as soon as practicable.

10.13.17

G
/1

The duty to notify in SUP 10.13.16R extends to any circumstances that would normally be declared when giving the information required for section 5 of Form A or matters considered in FIT 2.



10.14 Further questions

10.14.1

G

A list of frequently asked questions and answers is at *SUP* 10 Ann 1G.

10.14.2

G

If the *firm* or its advisers have further questions, they should contact the *FSA*'s Individual Vetting and Approval department (see *SUP* 10.11.6G).

/1

/1

SUP 10 Ann 1G: Frequently asked questions

1 Table

	Question	Answer
	Requirements of the regime	
1	Does pre-approval apply to individuals taking up a new <i>controlled function</i> within the same <i>firm</i> ?	Yes. Pre-approval applies in all circumstances (see section 59 of the <i>Act</i> (Approval for particular arrangements)) except under the temporary ('12 weeks') provision. See <i>SUP 10.5.5R</i> and question 2.
2	What are the procedures for 'emergency situations'?	Individuals may perform <i>significant influence functions</i> for up to 12 weeks in any consecutive 12 <i>month</i> period without requiring approval. When it becomes clear that a <i>person</i> will be performing the function on a permanent basis, then an application for approval should be made. However, there is no provision for individuals to perform the <i>customer functions</i> on a continuing basis without approval. See <i>SUP 10.5.5.R</i> .
3	Can a <i>person</i> be approved for more than one <i>controlled function</i> ?	Yes. A <i>firm</i> will need to seek approval in respect of each <i>controlled function</i> a <i>person</i> is to perform.
4	Do the <i>controlled functions</i> apply to an <i>incoming EEA firm</i> that is providing <i>cross border services</i> into the <i>United Kingdom</i> ?	No. The <i>approved persons</i> regime does not apply to <i>cross border services</i> . See <i>SUP 10.1.6R</i>
5	May any activity be outsourced by a <i>firm</i> ?	Yes. But if that activity constitutes a <i>regulated activity</i> , the <i>person</i> to whom it is outsourced will itself need permission.

6	Can a <i>significant influence function</i> be outsourced?	It is a question of fact in each case who is performing a <i>significant influence function</i> . These functions are mostly described at a high level of responsibility, that is, for example, the <i>director</i> of a <i>company</i> or a <i>partner</i> in a <i>partnership</i> . The <i>persons</i> performing these functions cannot avoid their ultimate responsibility and therefore the need for approval. However, some of the <i>significant influence functions</i> may be performed by a <i>person</i> who is specifically brought in to do the job, for example the <i>chief executive function</i> (where it is to be performed by a <i>body corporate</i>) and the <i>appointed actuary function</i> .
7	Do Lloyd's underwriting agents still require registration with Lloyd's?	Yes. Approval for a <i>controlled function</i> is not sufficient.
8	What should a <i>firm</i> do if it is unsure whether an individual needs approval?	The <i>firm</i> should contact the Individual Vetting and Approval Department. See SUP 10.11.6G.
Submitting an application		
9	Who applies for approval?	The <i>firm</i> . See section 60 of the <i>Act</i> (Applications for approval).
10	What is the role of the <i>candidate</i> in the application process?	Before the <i>firm</i> submits Form A it must verify the information contained in it. As part of this verification, the Form provides for the <i>candidate</i> to confirm the accuracy of the information given by the <i>firm</i> so far as it relates to him.
11	What checks must a <i>firm</i> make on a <i>candidate</i> before submitting an application for approval from the <i>FSA</i> ?	The <i>FSA</i> expects firms to perform due and diligent enquiries into their <i>candidates</i> . Note also the requirements of <i>ENF</i> 8.12.2G and <i>TC</i> 2.2.1R.

12	What is the “fit and proper” test for approval?	Section 61(1) of the <i>Act</i> (Determination of applications) provides that the <i>FSA</i> may grant an application only if it is satisfied that the <i>candidate</i> is a fit and proper <i>person</i> to perform the relevant function. In determining this question, the <i>Act</i> sets out the matters to which the <i>FSA</i> may have regard (section 61(2)) and the <i>FSA</i> has given guidance on this in <i>FIT</i> .
13	If a <i>firm</i> is unsure whether or not something may have an impact upon an individual’s fitness and propriety, should it be disclosed?	Yes, always. The deliberate non-disclosure of material facts is taken very seriously by the <i>FSA</i> as it is seen as possible evidence of current dishonesty. Therefore, if in doubt, disclose.
14	What happens if adverse information comes to light after the application form has been submitted or after the individual has been approved?	The <i>firm</i> must inform the <i>FSA</i> at the earliest opportunity. See <i>SUP</i> 10.13.16R.
15	Will the <i>FSA</i> consider an application in respect of a <i>candidate</i> who has not yet signed a contract with the <i>firm</i> ?	Yes, as the <i>FSA</i> will consider the <i>arrangement</i> under which the <i>candidate</i> will perform the function. However, the <i>FSA</i> will not consider speculative or provisional applications – such as for the candidates in an election to a mutual society Board. The <i>FSA</i> must be informed immediately of any material changes to the information provided on the application form which arises before the application has been determined. All changes must be communicated to the <i>FSA</i> by the <i>firm</i> making the application (see <i>SUP</i> 15.6.4R). Failure to notify the <i>FSA</i> may result in a delay in processing or rejection or both.
16	How can we get a supply of application forms (Form A)?	These can either be ordered through the Individual Vetting and Approval Department or obtained from the <i>FSA</i> website at www.fsa.gov.uk . There is no charge for an application form.
17	Is there a separate fee for making an application for <i>approved person</i> status?	No.
18	Must all gaps in previous employment be explained?	Yes.

FSA procedures		
19	Does the <i>FSA</i> verify the information provided to it?	Yes, as far as possible, information is verified.
20	Will the <i>FSA</i> handle information confidentially?	Yes. The <i>FSA</i> is obliged to handle all information confidentially and is subject to the provisions of the Data Protection Act 1998.
21	How long will the <i>FSA</i> take to process an application for <i>approved person</i> status?	Generally the <i>FSA</i> will handle this within seven <i>business days</i> for <i>significant influence functions</i> and four <i>business days</i> for <i>customer functions</i> . However, if information is missing, or the information provided gives the <i>FSA</i> cause for concern, processing time will almost always be longer. In each case, the <i>FSA</i> will notify the <i>firm</i> of any extension to the processing times.
22	Will the <i>firm</i> and individual be notified if there is a delay in processing the application form?	Yes. The <i>FSA</i> will contact the firm explaining the position and, where appropriate, giving the reasons for delay. It will then be the responsibility of the <i>firm</i> to keep the <i>candidate</i> and any other <i>interested party</i> informed.
23	How are non-routine cases handled?	Refer to <i>DEC 2 Ann 2G</i> .
24	Can the <i>FSA</i> apply conditions to an <i>approved person</i> ?	<p>No. The application can either be granted or refused. The <i>Act</i> provides no equivalent to the <i>limitations</i> or <i>requirements</i> which may be included in <i>permissions</i>. If the application is refused, the <i>firm</i> may re-apply in respect of the same individual but a different <i>controlled function</i>. If it is considering doing this, the <i>firm</i> is encouraged to discuss the matter with the <i>FSA</i>.</p> <p>Where there are reasonable grounds for doing so, the <i>FSA</i> may require a <i>firm</i> to provide information about an <i>approved person</i> (see section 165 of the <i>Act</i> (Power to require information)).</p>

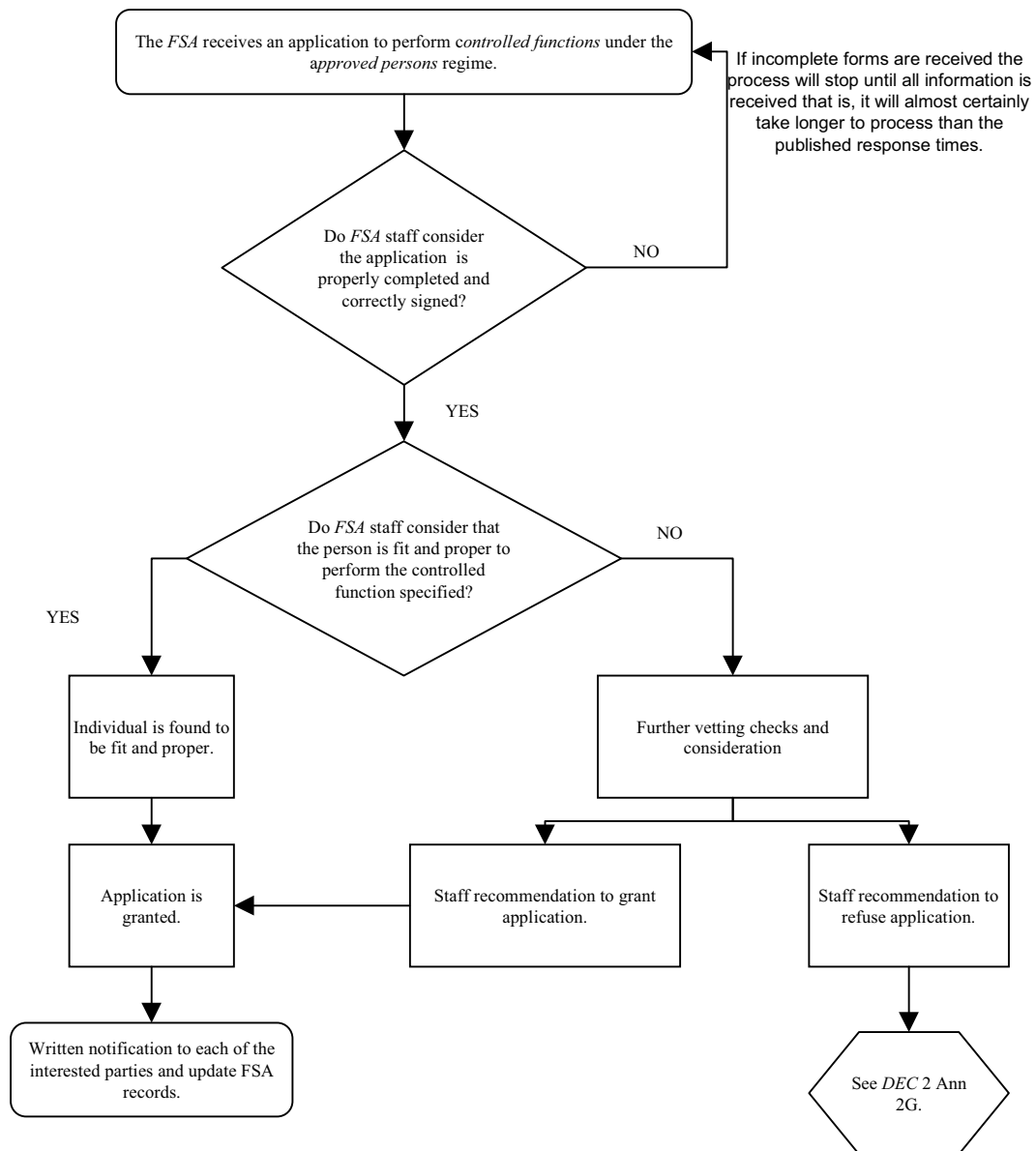
25	<p>Will the <i>firm</i> be issued with confirmation of approval?</p>	<p>Yes. The <i>firm</i> will be sent a letter setting out the effective date of approval together with the <i>controlled function</i> for which the individual has been approved. It will then be the <i>firm's</i> responsibility to inform the individual and any other <i>interested party</i>, for example any <i>appointed representative</i>.</p>
Withdrawing an application		
26	<p>Can a <i>firm</i> withdraw its application?</p>	<p>Yes, but only with the consent of the <i>candidate</i>. See section 61(5) of the <i>Act</i> (Determination of applications).</p>
27	<p>What happens if the individual refuses to consent to the withdrawal of the application?</p>	<p>The <i>FSA</i> will consider with all <i>interested parties</i> what to do. If it proposes to refuse the application, it will give a <i>warning notice</i> to all <i>interested parties</i>. See section 62 of the <i>Act</i> (Applications for approval: procedure and right to refer to the Tribunal).</p>
28	<p>Can the <i>firm</i> withdraw only part of an application – say, in relation to a specific <i>controlled function</i>?</p>	<p>The <i>FSA</i> will allow the <i>firm</i> to amend its application at any time before determination with the consent of all other <i>interested parties</i>. Whether the amendment will have the effect of amounting to a fresh application will be considered on a case by case basis.</p>
Conduct of approved persons		
29	<p>How and when must the <i>firm</i> report to the <i>FSA</i> potentially adverse information about an <i>approved person's</i> fitness and propriety?</p>	<p>Normally, the <i>firm</i> should report such matters to the <i>FSA</i> on Form D once it is reasonably satisfied as to the information's validity. See <i>SUP</i> 10.13.16R. See also, Principle for Businesses 11 (PRIN) and Statements of Principle 4 (APER).</p> <p>However, if an <i>approved person</i> is dismissed or resigns while under investigation by the <i>firm</i>, the <i>FSA</i> or another regulatory body, the <i>firm</i> should inform the <i>FSA</i> (<i>SUP</i> 10.13.7R) that it will be submitting a Form C containing adverse information. Full details must then be provided within seven <i>business days</i>, on the Form C. See <i>SUP</i> 10.13.6R.</p>

30	For how long are individuals accountable to the <i>FSA</i> after ceasing to be an <i>approved person</i> ?	A <i>person</i> is guilty of misconduct if, while an <i>approved person</i> , he fails to comply with a <i>Statement of Principle</i> or is knowingly concerned in the contravention by a <i>firm</i> of a requirement in the <i>Act</i> or the <i>Handbook</i> . But the <i>FSA</i> may not bring proceedings after two years from when it first knew of the misconduct.
----	--	---

SUP 10 Ann 2G: Approved person regime: summary of forms and their use

Circumstance:	Form	Submitted by whom and when
Person about to perform a <i>controlled function</i> for the first time.	A	Submitted by the <i>firm</i> making the application <u>before</u> activities requiring approval commence.
Person moving firms but performing the same <i>controlled function(s)</i> .	Shortened Form A if conditions met.	Submitted by the <i>firm</i> making the application <u>before</u> activities requiring approval commence.
Persons moving firms and performing different <i>controlled function(s)</i> .	A	Submitted by the <i>firm</i> making the application <u>before</u> activities requiring approval commence.
Firm applying for an outstanding application to be withdrawn.	B	Submitted by the <i>firm</i> - signed by all interested parties.
Person ceasing to perform a <i>controlled function(s)</i> .	C	Submitted by the <i>firm</i> within seven <i>business days</i> of approved person ceasing to perform <i>controlled function(s)</i> .
If an <i>approved person's</i> title, name or national insurance number change.	D	Submitted by <i>firm</i> within seven <i>business days</i> of the <i>firm</i> becoming aware of the matter.
Person remaining with the same <i>firm</i> but changing <i>controlled function(s)</i> .	E	Submitted by <i>firm</i> before changes take place.

SUP 10 Ann 3G: Summary of procedures on application for approved status





Application number
(for FSA use only)

Form A

Application to perform controlled functions under the approved persons regime

FSA Handbook Reference: SUP10 Annex 4D

30 April 2001

Name of candidate
(to be completed by applicant)

Name of firm
(as entered in 2.01)

The Financial Services Authority
Individual Vetting & Approval
25 The North Colonnade
Canary Wharf
London E14 5HS
United Kingdom
Telephone +44 (0) 20 7676 0019
Facsimile +44 (0) 20 7676 0017
E-mail iva@fsa.gov.uk
Website <http://www.fsa.gov.uk>

Registered as a Limited Company in England and Wales No 1920623. Registered Office as above

Notes for Form A

Application to perform controlled functions under the approved persons regime

PLEASE NOTE: A CANDIDATE MUST NOT BEGIN PERFORMING ANY CONTROLLED FUNCTIONS UNTIL THE FSA HAS GRANTED APPROVAL.

Full details of the approved persons regime and the application process are given in chapter 6 of the Authorisation manual and chapter 10 of the Supervision manual.

The purpose of this Form

This is Form A referred to in AUTH 3.1D and SUP 10.12.2D. This Form must be used where the candidate is an individual seeking approval to perform controlled functions. The firm is the applicant.

Applications for corporate candidates must be made using an adapted Form A that will be supplied by the FSA upon request.

Completing this Form

The Form must be completed in black ink and (if in manuscript) in BLOCK LETTERS.

All dates should be provided in numeric form (e.g. 29/02/2000 for 29 February 2000).

Indicate clearly if a question is not applicable. Tick the appropriate box where a yes/no answer is required. Further details should be given in section 6 (supplementary information) if there is insufficient space for a detailed answer.

Additional information can be attached to the Form. It must be securely attached to the rest of the Form and you must indicate at question 6.04 the number of additional sheets attached.

Do not assume that information is known to the FSA merely because it is in the public domain, or has been previously disclosed to the FSA or to another regulatory body. In all circumstances, disclosures should be full, frank and unambiguous. If there is any doubt about the relevance of information, it should be included. The information supplied by the candidate should be verified by the firm wherever possible. If the FSA's vetting checks reveal any matters that have not been disclosed, then applications will be delayed and, in some cases, possibly rejected. See SUP 10.12.6G.

Expressions in this Form in italics have the meaning given in the Glossary to the FSA's Handbook (or, if no meaning is given there, the expressions are to be interpreted in accordance with the related expression defined in the Glossary).

The firm is responsible for the accuracy of the data and completion of the Form. If the Form is not fully and correctly completed, the FSA may need to return it for proper completion. This could significantly delay the FSA's decision on whether to grant approval to perform the requested controlled functions (see SUP 10.12.6G).

The FSA may require the applicant to provide further information at any time after receiving an application and before determining whether it is to be granted or not (see AUTH 6.3.9G or SUP 10.12.8G).

If a firm has provided, or has information that reasonably suggests that it may have provided, the FSA with information which was or has become false, misleading, incomplete or inaccurate, in a material particular, it must notify the FSA immediately (see SUP 15.6.4R). Failure to notify the FSA may result in a delay in processing or rejection.

SHORTENED APPLICATION FORM

It is not necessary to complete section 4 (Employment history) and section 5 (Fitness and propriety) of Form A if:

- (1) an approved person is applying to perform an additional controlled function under an arrangement with the same firm; or
- (2) the candidate has ceased to perform a controlled function under an arrangement with firm A and now requires approval to perform a controlled function under an arrangement with firm B.

However, Form A must be completed in full if either:

- (1) the candidate ceased to be an approved person more than six months ago; or
- (2) the candidate or approved person is seeking approval in respect of a significant influence function for the first time.

SECTION 1 – PERSONAL IDENTIFICATION DETAILS

If the candidate has more than one previous name (surname or forenames), passport number or nationality, or is known by any other names, provide details in section 6.

- 1.01: If the candidate does not have an FSA Individual Reference Number or does not know it, include the name of the previous regulator and the previous Individual Reference Number, as applicable.
- 1.13: United Kingdom addresses must be given, or a statement stating that the individual resides abroad.

SECTION 2 – FIRM IDENTIFICATION DETAILS

- 2.01 & 2.02: This section identifies the firm making the application by FSA Firm Reference Number (FRN) and name.
- 2.03: The firm must indicate a point of contact for any queries in connection with the application.

SECTION 3 – ARRANGEMENTS AND CONTROLLED FUNCTIONS

The firm must tick the box in 3.01 that most accurately describes its arrangement with the candidate.

For applications from a single firm, the firm should complete 3.02, 3.03 & 3.04 indicating the controlled functions required by selecting the appropriate box in 3.02. However, if the application is being made on behalf of a candidate who will carry out controlled functions for more than one firm, 3.05 must be used to describe the controlled functions and the relationships between the candidate and those firms.

- 3.01: If this application relates to more than one appointed representative, provide details in section 6.
- 3.02: If any of controlled functions 16 to 20 are requested, the specific job title of the candidate must be included.
- 3.03: The effective date is the date on which the firm wishes the candidate to begin performing controlled functions (subject to approval). This should be left blank unless there is a reason for the effective date to be beyond the FSA's published standard response times. For instance, a firm may wish to be sure that a candidate has been approved before they take up their post.

Unless the firm indicates otherwise, the FSA assumes that the arrangement given on the application form includes all of the activities that fall within the description of the controlled function. This means that a firm may alter a candidate's responsibilities within the broad description of a controlled function without needing further approval from the FSA. However, in relation to the significant management functions, firms must comply with the reporting requirements in SUP 10.9.8R and SUP 10.9.9G.

SECTION 4 – EMPLOYMENT HISTORY FOR PAST 10 YEARS

A full ten-year employment history for the candidate must be provided – with all gaps explained. If the record of employment does not go back ten years, all periods of education and unemployment must be indicated. Full details of any periods of self-employment must be included.

The employment history should be provided in reverse chronological order, starting with the most recent period of employment, unemployment etc, but excluding the activity to which this application relates.

Always give the address of the actual place of employment, rather than a central head office.

“Regulatory body” in this context means the bodies listed in the notes to section 5 (below).

State the position held by the candidate and a brief explanation of his or her duties. If the candidate’s job title included the word “director” but his or her duties did not include those associated with the title of director, as defined in the Glossary, this should be indicated.

The reason for leaving each employer must be given. If there were any issues arising on leaving, these must be fully explained in section 6. Previous employers may be contacted and the omission of relevant details may result in applications being delayed and, in some cases, possibly rejected. See SUP 10.12.6G.

Candidates who are applying for significant influence functions (CF 1 to 20) are required to submit a copy of their curriculum vitae, in addition to completing section 4 of this Form. It should be attached securely to the Form.

SECTION 5 – FITNESS AND PROPRIETY

Answer the question by ticking the relevant ‘yes’ or ‘no’ box. If the answer to any of the questions is ‘yes’, give complete details in section 6 and attach relevant supporting documentation.

5.03 to 5.06: Court judgments (e.g. County Court Judgments) and arrangements with creditors (e.g. Individual Voluntary Arrangements) are covered by questions 5.03 to 5.06. Any outstanding County Court Judgements or arrangements with creditors must be listed in section 6, and the circumstances surrounding them explained. The FSA will conduct credit checks.

“Regulatory body” in this context refers to:

- i) the self-regulatory organisations including IMRO, SFA, PIA, LAUTRO, FIMBRA, AFBD and TSA;
- ii) the statutory bodies including the FSA, SIB, the Society of Lloyd’s, the Registry of Friendly Societies, the Friendly Societies Commission, the Building Societies Commission, the Bank of England; HM Treasury – Insurance Directorate (formerly of the DTI) and the recognised bodies;
- iii) the designated professional bodies; and
- iv) the equivalent of all such regulators overseas.

SECTION 6 – SUPPLEMENTARY INFORMATION

This section provides space for any additional information and should be used whenever a question in section 5 is answered ‘yes’.

List here all directorships currently held or held in the past 10 years by the candidate.

Relevant documents must also be provided, such as evidence of the settlements of County Court Judgements.

SECTION 7 – DECLARATIONS & SIGNATURES

This section contains declarations which must be signed by both an appropriate individual for the firm or applicant submitting the application and the candidate. The FSA considers that an appropriate individual would either be an individual approved for a controlled function described under section 59(5) of the Act (the significant influence functions – controlled functions 1 to 20) or someone to whom the firm has delegated the authority to notify the FSA. If this authority has been delegated, the firm should keep records of those individuals authorised to sign on behalf of the firm.

If you have any questions or need additional information, please contact the Individual Vetting and Approval Helpline on 020 7676 0019 or e-mail iva@FSA.gov.uk

PLEASE RETURN COMPLETED FORM TO:

THE FINANCIAL SERVICES AUTHORITY
INDIVIDUAL VETTING AND APPROVAL
25 THE NORTH COLONNADE
CANARY WHARF
LONDON E14 5HS
UNITED KINGDOM

1.01 a	FSA Individual Reference Number (IRN)	
b	OR name of previous regulatory body	
c	AND previous reference number (if applicable)	
1.02	Title (e.g. Mr, Mrs, Ms, etc)	
1.03	Surname	
1.04	ALL forenames	
1.05	Name commonly known by	
1.06	Date of birth	
1.07	National Insurance number	
1.08	Previous name SEE NOTE	
1.09	Date of change	
1.10	Reason for change	
1.11 a	Nationality SEE NOTE	
b	Passport number (if National Insurance number not available) -SEE NOTE	
1.12	Place of birth	



I have supplied further information related to this page in Section 6

YES

NO

1.13 a Private address

[Redacted address details]

b

Postcode

c Dates resident at this address (mm/yyyy)

From

[Redacted start date]

To

PRESENT

(If address has changed in the last three years, please provide addresses for the previous three years.)

1.14 a Previous address 1

[Redacted address details]

b

Postcode

c Dates resident at this address (mm/yyyy)

From

[Redacted start date]

To

[Redacted end date]

1.15 a Previous address 2

[Redacted address details]

b

Postcode

c Dates resident at this address (mm/yyyy)

From

[Redacted start date]

To

[Redacted end date]



I have supplied further information related to this page in Section 6

YES

NO

2.01 Name of firm making the application

2.02 FSA Firm Reference Number (FRN)

2.03 a Who should the FSA contact at the firm in relation to this application?

b Position

c Telephone

d Fax

e E-mail



I have supplied further information related to this page in Section 6

YES

NO

3.01 Nature of the arrangement between the candidate and the applicant.

a	Employee	<input type="checkbox"/>	
<hr/>			
b	Group employee	<input type="checkbox"/>	
	Name of group		
<hr/>			
c	Contract for services	<input type="checkbox"/>	
<hr/>			
d	Partner/Sole trader	<input type="checkbox"/>	
<hr/>			
e	Appointed rep – employee	<input type="checkbox"/>	
	Name of AR		
<hr/>			
f	Appointed rep – principal	<input type="checkbox"/>	
	Name of AR		
<hr/>			
g	Other	<input type="checkbox"/>	
	Give details		

3.02 For applications from a single firm, please tick the boxes that correspond to the controlled functions to be performed.

If the controlled functions are to be carried out for more than one firm, please go to question 3.05

a Significant influence functions

CF 1	Director function	<input type="checkbox"/>
CF 2	Non-executive director function	<input type="checkbox"/>
CF 3	Chief executive function	<input type="checkbox"/>
CF 4	Partner function	<input type="checkbox"/>
CF 5	Director of an unincorporated association function	<input type="checkbox"/>
CF 6	Small friendly society function	<input type="checkbox"/>
CF 7	Sole trader function	<input type="checkbox"/>



I have supplied further information related to this page in Section 6

YES

NO

Significant influence functions continued	CF 8	Apportionment and oversight function	<input type="checkbox"/>	
	CF 9	EEA investment business oversight function	<input type="checkbox"/>	
	CF 10	Compliance oversight function	<input type="checkbox"/>	
	CF 11	Money laundering reporting function	<input type="checkbox"/>	
	CF 12	Appointed actuary function	<input type="checkbox"/>	
	CF 13	Finance function	<input type="checkbox"/>	
	CF 14	Risk assessment function	<input type="checkbox"/>	
	CF 15	Internal audit function	<input type="checkbox"/>	
	CF 16	Significant management (designated investment business) function	<input type="checkbox"/>	
	CF 17	Significant management (other business operations) function	<input type="checkbox"/>	
	CF 18	Significant management (insurance underwriting) function	<input type="checkbox"/>	
	CF 19	Significant management (financial resources) function	<input type="checkbox"/>	
	CF 20	Significant management (settlements) function	<input type="checkbox"/>	
	b Customer functions	CF 21	Investment adviser function	<input type="checkbox"/>
		CF 22	Investment adviser (trainee) function	<input type="checkbox"/>
CF 23		Corporate adviser function	<input type="checkbox"/>	
CF 24		Pension transfer specialist function	<input type="checkbox"/>	
CF 25		Adviser on syndicate participation at Lloyd's function	<input type="checkbox"/>	
CF 26		Customer trading function	<input type="checkbox"/>	
CF 27		Investment management function	<input type="checkbox"/>	

3.03 Effective date of controlled functions indicated above

3.04 Job title (mandatory for controlled functions 16 to 20)



I have supplied further information related to this page in Section 6

YES

NO

3.05 List all firms within the group (including the firm entered in 2.01) for which the candidate requires approval and the requested controlled function for that firm.

	FSA Firm Reference Number	Name of firm	Controlled function	Job title (mandatory for controlled functions 16 to 20)	Effective date
a					
b					
c					
d					
e					

3.06 Has the individual been assessed as competent in accordance with the Training and Competence Rules (see TC 2.3.5R (Attaining Competence))?
 Tick "NOT APPLICABLE" if the candidate is not within the scope of chapter 2 of the Training and Competence Sourcebook (see TC 2.1.3R)

YES
 NO
 NOT APPLICABLE

3.07 If the answer to 3.06 is "YES", indicate which of the following formed part of the assessment (only tick one box):

Passing each module of the appropriate examination as specified in the annexes to TC2
 OR
 Complying with TC 2.4.5R (Approved examinations)
 OR
 Complying with TC Transitional Provisions



I have supplied further information related to this page in Section 6 YES NO

Note: ALL gaps must be accounted for (SEE NOTE)

4.01 Employment details (1)

a Period (mm/yyyy) From To

b Nature of employment

a	Employed	<input type="checkbox"/>
b	Self-employed	<input type="checkbox"/>
c	Unemployed	<input type="checkbox"/>
d	Full-time education	<input type="checkbox"/>

If b, c, or d is ticked, please give details

c Name of employer

d Nature of business

e Previous / other names of employer

f Last known address of employer

g Is/was employer regulated by a regulatory body? SEE NOTE YES NO Name of regulatory body

h Is/was employer an appointed representative? YES NO If yes, of which firm?

i Position held SEE NOTE

j Responsibilities

k Reason for leaving: SEE NOTE

a	Resignation	<input type="checkbox"/>
b	Redundancy	<input type="checkbox"/>
c	Retirement	<input type="checkbox"/>
d	Termination/dismissal	<input type="checkbox"/>
e	End of contract	<input type="checkbox"/>
f	Other	<input type="checkbox"/>

Specify



I have supplied further information related to this page in Section 6 YES NO

4.02 Employment details (2)

a Period (mm/yyyy) From To

b Nature of employment

a	Employed	<input type="checkbox"/>
b	Self-employed	<input type="checkbox"/>
c	Unemployed	<input type="checkbox"/>
d	Full-time education	<input type="checkbox"/>

If b, c, or d is ticked, please give details

c Name of employer

d Nature of business

e Previous / other names of employer

f Last known address of employer

g Is/was employer regulated by a regulatory body? SEE NOTE YES NO Name of regulatory body

h Is/was employer an appointed representative? YES NO If yes, of which firm?

i Position held SEE NOTE

j Responsibilities

k Reason for leaving: SEE NOTE

a	Resignation	<input type="checkbox"/>
b	Redundancy	<input type="checkbox"/>
c	Retirement	<input type="checkbox"/>
d	Termination/dismissal	<input type="checkbox"/>
e	End of contract	<input type="checkbox"/>
f	Other	<input type="checkbox"/>

Specify



I have supplied further information related to this page in Section 6

YES

NO

4.03 Employment details (3)

a Period (mm/yyyy) From To

b Nature of employment

a	Employed	<input type="checkbox"/>
b	Self-employed	<input type="checkbox"/>
c	Unemployed	<input type="checkbox"/>
d	Full-time education	<input type="checkbox"/>

If b, c, or d is ticked, please give details

c Name of employer

d Nature of business

e Previous / other names of employer

f Last known address of employer

g Is/was employer regulated by a regulatory body? SEE NOTE YES NO Name of regulatory body

h Is/was employer an appointed representative? YES NO If yes, of which firm?

i Position held SEE NOTE

j Responsibilities

k Reason for leaving: SEE NOTE

a	Resignation	<input type="checkbox"/>
b	Redundancy	<input type="checkbox"/>
c	Retirement	<input type="checkbox"/>
d	Termination/dismissal	<input type="checkbox"/>
e	End of contract	<input type="checkbox"/>
f	Other	<input type="checkbox"/>

Specify



I have supplied further information related to this page in Section 6

YES

NO

4.04 Employment details (4)

a Period (mm/yyyy) From To

b Nature of employment

a	Employed	<input type="checkbox"/>
b	Self-employed	<input type="checkbox"/>
c	Unemployed	<input type="checkbox"/>
d	Full-time education	<input type="checkbox"/>

If b, c, or d is ticked, please give details

c Name of employer

d Nature of business

e Previous / other names of employer

f Last known address of employer

g Is/was employer regulated by a regulatory body? SEE NOTE YES NO Name of regulatory body

h Is/was employer an appointed representative? YES NO If yes, of which firm?

i Position held SEE NOTE

j Responsibilities

k Reason for leaving: SEE NOTE

a	Resignation	<input type="checkbox"/>
b	Redundancy	<input type="checkbox"/>
c	Retirement	<input type="checkbox"/>
d	Termination/dismissal	<input type="checkbox"/>
e	End of contract	<input type="checkbox"/>
f	Other	<input type="checkbox"/>

Specify



I have supplied further information related to this page in Section 6

YES

NO

4.05 Employment details (5)

a Period (mm/yyyy) From To

b Nature of employment

a	Employed	<input type="checkbox"/>
b	Self-employed	<input type="checkbox"/>
c	Unemployed	<input type="checkbox"/>
d	Full-time education	<input type="checkbox"/>

If b, c, or d is ticked, please give details

c Name of employer

d Nature of business

e Previous / other names of employer

f Last known address of employer

g Is/was employer regulated by a regulatory body? SEE NOTE YES NO Name of regulatory body

h Is/was employer an appointed representative? YES NO If yes, of which firm?

i Position held SEE NOTE

j Responsibilities

k Reason for leaving: SEE NOTE

a	Resignation	<input type="checkbox"/>
b	Redundancy	<input type="checkbox"/>
c	Retirement	<input type="checkbox"/>
d	Termination/dismissal	<input type="checkbox"/>
e	End of contract	<input type="checkbox"/>
f	Other	<input type="checkbox"/>

Specify

If necessary, please continue in section 6.



I have supplied further information related to this page in Section 6 YES NO

- 5.01 a Has the candidate ever been convicted of any offence involving fraud, theft, false accounting or other dishonesty or an offence (whether or not in the United Kingdom) relating to companies, building societies, industrial and provident societies, credit unions, friendly societies, insurance, banking or other financial services, insolvency, consumer credit or consumer protection, money laundering, market manipulations or insider dealing? (Convictions spent under the Rehabilitation of Offenders Act 1974 must be included)
- YES NO
- b Is the candidate the subject of any current criminal proceedings?
- YES NO
- 5.02 Has the candidate any convictions for any offences other than those listed in 5.01 above which are not spent, whether or not in the United Kingdom (excluding traffic offences unless these resulted in a ban from driving or involved driving without insurance)?
- YES NO
- 5.03 a Is the candidate, or has the candidate ever been, the subject of any civil proceedings, arbitration or litigation, including proceedings that may lead to a County Court Judgment (“CCJ”) or other judgment debts, in the United Kingdom or elsewhere?
- YES NO
- b Is the candidate aware of any intention to begin such proceedings against the candidate in the future?
- YES NO
- 5.04 Does the candidate have any judgment debts (including CCJs) made under a court order still outstanding, whether in full or in part?
- YES NO
- 5.05 Has the candidate ever failed to satisfy any such judgment debts within one year of the making of the order?
- YES NO
- 5.06 a Is the candidate, or has the candidate ever been, the subject of any bankruptcy proceedings, or proceedings for the sequestration of the candidate’s estate?
- YES NO
- b Has the candidate ever entered into a deed of arrangement or an individual voluntary arrangement (or in Scotland a trust deed) or other agreement in favour of the candidate’s creditors, or is the candidate doing so?
- YES NO
- 5.07 Does the candidate have any outstanding financial obligations arising from regulated activities, which the candidate has conducted in the past, whether in the United Kingdom or overseas? (In the case of advisers, this will include any outstanding liabilities arising from commissions paid for the sale of packaged products that have lapsed.)
- YES NO
- 5.08 Has the candidate ever been found guilty of conducting any unauthorised regulated activities or been investigated for possible conduct of unauthorised regulated activities?
- YES NO
- 5.09 Is the candidate, or has the candidate ever been, the subject of an investigation into allegations of misconduct or malpractice in connection with any business activity?
- YES NO
- 5.10 Has the candidate ever, either in the United Kingdom, or elsewhere –
- a been refused entry to, or been dismissed or requested to resign from, any profession, vocation, office or employment, or from any fiduciary office or position of trust, whether or not remunerated?
- YES NO
- b been refused, restricted in, or had suspended, the right to carry on any trade, business or profession for which specific licence, authorisation, registration, membership or other permission is required?
- YES NO



I have supplied further information related to this page in Section 6

YES NO

c	been disqualified by a court from acting as a director of a company or from acting in a management capacity or conducting the affairs of any company, partnership or unincorporated association?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
d	been the subject of a disqualification direction under section 59 of the Financial Services Act 1986 or a prohibition order, under section 56 of the Financial Services and Markets Act 2000, or received a warning notice to make such a direction or order?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
5.11	In respect of activities regulated by the FSA or any other regulatory body (see note), has the candidate, or has any company, partnership or unincorporated association of which the candidate is or has been a controller, director, senior manager, partner or company secretary, during the candidate's association with that entity and for a period of three years after the candidate ceased to be associated with it, ever –		
a	been refused, had revoked, restricted or terminated, any licence, authorisation, registration, notification, membership or other permission granted by any such body?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
b	been criticised, censured, disciplined, suspended, expelled, fined, or been the subject of any other disciplinary or intervention action by any such body?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
c	resigned whilst under investigation by, or been required to resign from, any such body?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
d	decided, after making an application for any licence, authorisation, registration, notification, membership or other permission granted by any such body, not to proceed with it?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
e	been the subject of any civil action which has resulted in a finding against the candidate or it by a court?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
5.12	Has any company, partnership, or unincorporated association of which the candidate is or has been a controller, director, senior manager, partner, or company secretary, in the United Kingdom or elsewhere, at any time during the candidate's involvement or within one year of such an involvement –		
a	been put into liquidation, wound up, ceased trading, had a receiver or administrator appointed or entered into any voluntary arrangement with its creditors?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
b	been adjudged by a court liable for any fraud, misfeasance, wrongful trading or other misconduct?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
c	been investigated or been involved in an investigation by an inspector appointed under companies or any other legislation, or required to produce documents to the Secretary of State, or any other authority, under any such legislation?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
d	been convicted of any criminal offence, censured, disciplined or publicly criticised, by any inquiry, by the Takeover Panel or any governmental or statutory authority or any other regulatory body (other than as already indicated under 5.11(b) above)?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
5.13	Is the candidate aware of any business interests, employment obligations, or any other situations which may conflict with the performance of the controlled functions for which approval is now sought?	YES <input type="checkbox"/>	NO <input type="checkbox"/>



I have supplied further information related to this page in Section 6

YES

NO

Please complete questions 6.03 and 6.04

6.01 Include any additional information from previous sections below.

If there is insufficient space, please continue on a separate sheet of paper, and clearly identify the section and question to which the additional information relates.

Full details must be provided here if there were any issues that arose when leaving an employer listed in section 4 or if any question has been answered 'yes' in section 5.

Question	Information

6.02 Include a list of all directorships currently or previously held by the candidate (where director has the meaning given in the Glossary).

A large, empty grey rectangular box intended for listing directorships. The box is completely blank and occupies the majority of the page's vertical space below the instruction.

6.03 Is there any other information the candidate or the firm considers to be relevant to the application?

YES NO

If yes, provide details below or on a separate sheet of paper

A large, solid grey rectangular area intended for providing details if the answer to question 6.03 is 'yes'. It occupies most of the page's vertical space.

6.04 How many additional sheets are being submitted?

A horizontal grey rectangular box for entering the number of additional sheets being submitted.

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (section 398 of the Financial Services and Markets Act 2000).

It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that the information in this Form is accurate and complete to the best of my knowledge and belief and that I have read the notes to this Form.

I confirm that, where Form A is a shortened version, there have been no changes to the information previously disclosed in sections 4 and 5 of Form A.

The FSA may seek to verify the information given in this Form including answers pertaining to fitness and propriety. I authorise the FSA to make such enquiries and seek such further information as it thinks appropriate in the course of verifying the information given in this Form. I also understand that the results of these checks may be disclosed to my employer.

7.01 Candidate's full name

7.02 Signature

Date

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.4R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. APER 4.4.6E provides that, where an approved person is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of Statement of Principle 4. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

In making this application the firm believes on the basis of due and diligent enquiry that the candidate is a fit and proper person to perform the controlled function(s) listed in section 3. The firm also believes, on the basis of due and diligent enquiry, that the candidate is competent to fulfil the duties required of such function(s).

I confirm that the information in this Form is accurate and complete to the best of my knowledge and belief and that I have read the notes to this Form.

I confirm that I have authority to make this application, and sign this Form, on behalf of each firm identified in section 3.05. I also confirm that a copy of this Form, as submitted to the FSA, will be sent to each of those firms at the same time as submitting the Form to the FSA.

7.03 Name of the firm submitting the application

7.04 Name of person signing on behalf of the firm

7.05 Job title

7.06 Signature

Date

Completion checklist

- Is the Form fully completed?

- Are ALL forenames included?

- Is there a complete ten-year employment history with all gaps explained?

- Is the Form correctly signed and dated by both the firm making the application and the candidate?

- Has all supplementary information been included and clearly marked?

Note : Detach and keep the notes before returning the completed Form to the FSA.



Application number
(for FSA use only)

Form B

Notice to withdraw an application to perform controlled functions under the approved persons regime

FSA Handbook Reference: SUP10 Annex 5R

30 April 2001

Name of candidate
(to be completed by applicant)

Name of firm
(as entered in 2.01)

The Financial Services Authority
Individual Vetting & Approval
25 The North Colonnade
Canary Wharf
London E14 5HS
United Kingdom
Telephone +44 (0) 20 7676 0019
Facsimile +44 (0) 20 7676 0017
E-mail iva@fsa.gov.uk
Website <http://www.fsa.gov.uk>

Registered as a Limited Company in England and Wales No 1920623. Registered Office as above

Notes for Form B

Notice to withdraw an application to perform controlled functions under the approved persons regime

Full details of the approved persons regime and the application process are given in chapter 6 of the Authorisation manual and chapter 10 of the Supervision manual.

The purpose of this Form

This is Form B referred to in SUP 10.12.13R. This Form must be used when a firm or applicant wishes to withdraw an application to perform controlled functions under the approved persons regime (Form A) before the application has been determined and with immediate effect.

Completing this Form

The Form must be completed in black ink and (if in manuscript) in BLOCK LETTERS.

A Notice to withdraw an application may be submitted in relation to all or some of the controlled functions or firms listed on the original application (Form A). If it is submitted in relation to only some of the controlled functions or firms, you must list at section 4.01 the controlled functions and firms to which the withdrawal relates. If section 4.01 is left blank it will be assumed that the withdrawal relates to all of the controlled functions listed on the original application.

Any issues that arose in relation to this withdrawal, such as resignation or termination of contract, must be explained in section 4.01.

Additional information can be attached to the Form. It must be securely attached to the rest of the Form and you must indicate at question 4.02 the number of additional sheets attached.

Under section 61(5) of the Act (Determination of applications) the firm may withdraw the application only if it also has the consent of the candidate and the person by whom the candidate is or would have been employed, if this is not the firm making the application (see SUP 10.12.14G).

An appropriate individual must sign the declaration for the firm submitting the Form. The FSA considers that an appropriate individual would either be an individual approved for a controlled function described under section 59(5) of the Act (the significant influence functions – controlled functions 1 to 20) or someone to whom the firm has delegated the authority to notify the FSA. If this authority has been delegated, the firm should keep records of those individuals authorised to sign on behalf of the firm.

Note: Detach and keep these notes before returning the completed Form to the FSA.

If you have any questions or need additional information, please contact the Individual Vetting and Approval Helpline 020 7676 0019 or via e-mail at iva@fsa.gov.uk

PLEASE RETURN COMPLETED FORM TO:

THE FINANCIAL SERVICES AUTHORITY
INDIVIDUAL VETTING AND APPROVAL
25 THE NORTH COLONNADE
CANARY WHARF
LONDON E14 5HS
UNITED KINGDOM

1.01	FSA Individual Reference Number (IRN)	<input type="text"/>
1.02	Title (e.g. Mr, Mrs, Ms, etc)	<input type="text"/>
1.03	Surname	<input type="text"/>
1.04	ALL forenames	<input type="text"/>
1.05	Date of birth	<input type="text"/>
1.06	National Insurance number	<input type="text"/>
1.07	Candidate's private address	<input type="text"/>



I have supplied further information related to this page in Section 4

YES

NO

2.01 Name of firm

2.02 FSA Firm Reference Number (FRN)

2.03 a Who should the FSA contact at the firm in relation to this notice?

b Position

c Telephone

d Fax

e E-mail

2.04 Firms included on application Form (including applicant firm)

	FSA FRN	Name of firm	Controlled functions
a	<input type="text"/>	<input type="text"/>	<input type="text"/>
b	<input type="text"/>	<input type="text"/>	<input type="text"/>
c	<input type="text"/>	<input type="text"/>	<input type="text"/>
d	<input type="text"/>	<input type="text"/>	<input type="text"/>
e	<input type="text"/>	<input type="text"/>	<input type="text"/>



I have supplied further information related to this page in Section 4

YES

NO

3.01 Indicate the reason for withdrawal

- | | | |
|---------------------------|---------------------------------------|--------------------------|
| a | Internal movement of staff | <input type="checkbox"/> |
| b | Termination of employment or contract | <input type="checkbox"/> |
| c | Resignation | <input type="checkbox"/> |
| d | Redundancy | <input type="checkbox"/> |
| e | Withdrawal of offer of employment | <input type="checkbox"/> |
| f | End of contract | <input type="checkbox"/> |
| g | Suspension | <input type="checkbox"/> |
| h | Other | <input type="checkbox"/> |
| GIVE DETAILS IN SECTION 4 | | |

I have supplied further information
related to this page in Section 4YES NO

4.01 Include here any issues that arose in relation to this withdrawal, such as resignation or termination of contract. Indicate clearly which question supplementary information relates to.

Question	Information

4.02 How many additional sheets are being submitted?

DECLARATION OF CANDIDATE

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (section 398 of the Financial Services and Markets Act 2000).

It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that I consent to the withdrawal of the application Form with immediate effect and understand that the FSA will cease to carry out further vetting and checks on receipt of this Form.

5.01	Candidate's full name	
5.02	Signature	
	Date	

DECLARATION BY APPOINTED REPRESENTATIVE OR OTHER FIRM (if applicable)

We concur that the application to perform controlled functions under the approved persons regime made in respect of the above candidate should be withdrawn with immediate effect.

5.03	Name of appointed representative or other firm	
5.04	Name of person signing on behalf of the firm	
5.05	Job title	
5.06	Signature	
	Date	

DECLARATION BY FIRM

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.4R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. APER 4.4.6E provides that, where an approved person is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of Statement of Principle 4. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that the information in this Form is accurate and complete to the best of my knowledge and belief and that I have read the notes to this Form .

5.07	Name of firm	
5.08	Name of person signing on behalf of the firm	
5.09	Job title	
5.10	Signature	
	Date	



Application number
(for FSA use only)

Form C

Notice of ceasing to perform controlled functions

FSA Handbook Reference: SUP10 Annex 6R

30 April 2001

Name of approved person
(to be completed by applicant)

Name of firm
(as entered in 2.01)

The Financial Services Authority
Individual Vetting & Approval
25 The North Colonnade
Canary Wharf
London E14 5HS
United Kingdom
Telephone +44 (0) 20 7676 0019
Facsimile +44 (0) 20 7676 0017
E-mail iva@fsa.gov.uk
Website <http://www.fsa.gov.uk>

Registered as a Limited Company in England and Wales No 1920623. Registered Office as above

Notes for Form C

Notice of ceasing to perform controlled functions

Full details of the approved persons regime and the application process are given in chapter 6 of the Authorisation manual and chapter 10 of the Supervision manual.

The purpose of this Form

This is Form C referred to in SUP 10.13.6R. This Form must be used when an approved person ceases to perform one or more controlled functions.

If an approved person ceases to perform controlled functions in respect of a number of firms within the same group, a single Form C may be used, ensuring all firms are clearly marked on the Form.

A firm must submit to the FSA a completed Form C no later than seven business days after an approved person ceases to perform a controlled function (see SUP 10.13.6R).

If a firm has reasonable grounds for believing that it will submit a qualified Form C, it must notify the FSA of the fact as soon as practicable.

Form C is qualified if:

1. the firm submitting Form C reasonably believes that the information it contains may affect the FSA's assessment of an approved person's fitness and propriety; or
2. a firm dismisses an approved person from its employment; or
3. an approved person resigns whilst under investigation by the firm, the FSA or any other regulatory body.

Notification of a qualified Form C may be made by telephone, fax or email and should be made, where possible, within one business day of the firm becoming aware of the information. If the firm does not submit Form C, it should inform the FSA in due course of the reason. This could be done using Form D, if appropriate (see SUP 10.13.7R and SUP 10.13.8G).

A firm is responsible for notifying the FSA if any approved person has ceased to perform a controlled function under an arrangement entered into by its appointed representative or former appointed representative (see SUP 10.13.9G).

Completing this Form

This Form must be completed in black ink and (if in manuscript) in BLOCK LETTERS.

Additional information can be attached to the Form. It must be securely attached to the rest of the Form and you must indicate at question 4.02 the number of additional sheets attached.

The reasons why an approved person is no longer performing controlled functions must be indicated on the Form. However, if an approved person has been dismissed or requested to resign, or the firm has any doubts about their fitness and propriety (3.01 column B), a full explanation of the reason for the dismissal or resignation must be provided in section 4.01 (supplementary information). If the firm ticks the box marked 'Suspension', the firm will have to reapply (using Form A) for the individual to perform controlled functions again.

The firm must also include details of any other matter that the firm is aware of and which in its reasonable opinion is relevant in connection with the approved person ceasing to perform their controlled function.

An appropriate individual must sign the declaration for the firm submitting the Form. The FSA considers that an appropriate individual would either be an individual approved for a controlled function described under section 59(5) of the Act (the significant influence functions – controlled functions 1 to 20) or someone to whom the firm has delegated the authority to notify the FSA. If this authority has been delegated, the firm should keep records of those individuals authorised to sign on behalf of the firm.

Only the firm that made the original application (Form A) may sign this Form.

Note: Detach and keep these notes before returning the completed Form to the FSA.

If you have any questions or need additional information, please contact the Individual Vetting and Approval Helpline 020 7676 0019 or via e-mail at iva@fsa.gov.uk

PLEASE RETURN COMPLETED FORM TO:

THE FINANCIAL SERVICES AUTHORITY
INDIVIDUAL VETTING AND APPROVAL
25 THE NORTH COLONNADE
CANARY WHARF
LONDON E14 5HS
UNITED KINGDOM

Personal identification details

Section 1

1.01 FSA Individual Reference Number (IRN)

1.02 Title
(e.g. Mr, Mrs, Ms, etc)

1.03 Surname

1.04 ALL forenames

1.05 Date of birth

1.06 National Insurance number

1.07 Approved person's private address

Firm identification details

Section 2

2.01 Name of firm

2.02 FSA Firm Reference Number (FRN)

2.03 a Who should the FSA contact at the firm in relation to this notice?

b Position

c Telephone

d Fax

e E-mail



I have supplied further information related to this page in Section 4

YES

NO

3.01 List all controlled functions which the approved person is ceasing to perform. The effective date is the date the person will cease to perform the functions.

If the reason for ceasing to perform the controlled function is indicated in column B, the FSA should be notified in accordance with SUP 10.13.7R and SUP 10.13.8G (that is, within one business day, by telephone, fax or email) that this Form will be submitted

	FRN	Name of firm	Controlled function	Effective date	Reason	
					A	B Full explanation in 4.01
a					Resignation <input type="checkbox"/> Redundancy <input type="checkbox"/> Retirement <input type="checkbox"/> End of contract <input type="checkbox"/> Internal movement of staff <input type="checkbox"/>	Dismissal/ termination of employment or contract <input type="checkbox"/> Suspension <input type="checkbox"/> Other <input type="checkbox"/> (specify in 4.01)
b					Resignation <input type="checkbox"/> Redundancy <input type="checkbox"/> Retirement <input type="checkbox"/> End of contract <input type="checkbox"/> Internal movement of staff <input type="checkbox"/>	Dismissal/ termination of employment or contract <input type="checkbox"/> Suspension <input type="checkbox"/> Other <input type="checkbox"/> (specify in 4.01)
c					Resignation <input type="checkbox"/> Redundancy <input type="checkbox"/> Retirement <input type="checkbox"/> End of contract <input type="checkbox"/> Internal movement of staff <input type="checkbox"/>	Dismissal/ termination of employment or contract <input type="checkbox"/> Suspension <input type="checkbox"/> Other <input type="checkbox"/> (specify in 4.01)
d					Resignation <input type="checkbox"/> Redundancy <input type="checkbox"/> Retirement <input type="checkbox"/> End of contract <input type="checkbox"/> Internal movement of staff <input type="checkbox"/>	Dismissal/ termination of employment or contract <input type="checkbox"/> Suspension <input type="checkbox"/> Other <input type="checkbox"/> (specify in 4.01)
e					Resignation <input type="checkbox"/> Redundancy <input type="checkbox"/> Retirement <input type="checkbox"/> End of contract <input type="checkbox"/> Internal movement of staff <input type="checkbox"/>	Dismissal/ termination of employment or contract <input type="checkbox"/> Suspension <input type="checkbox"/> Other <input type="checkbox"/> (specify in 4.01)



I have supplied further information related to this page in Section 4

YES

NO

4.01 Please indicate clearly which question the supplementary information relates to.

Question	Information

4.02 How many additional sheets are being submitted?

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.4R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. APER 4.4.6E provides that, where an approved person is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of Statement of Principle 4. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that the information in this Form is accurate and complete to the best of my knowledge and belief and that I have read the notes to this Form.

5.01	Name of the firm	<input type="text"/>
5.02	Name of person signing on behalf of the firm	<input type="text"/>
5.03	Job title	<input type="text"/>
5.04	Signature	<input type="text"/>
	Date	<input type="text"/>



Application number
(for FSA use only)

Form D

Notification of changes in personal information or application details

FSA Handbook Reference: SUP 10 Annex 7R

30 April 2001

Name of individual
(to be completed by applicant)

Name of firm
(as entered in 2.01)

The Financial Services Authority
Individual Vetting & Approval
25 The North Colonnade
Canary Wharf
London E14 5HS
United Kingdom
Telephone +44 (0) 20 7676 0019
Facsimile +44 (0) 20 7676 0017
E-mail iva@fsa.gov.uk
Website <http://www.fsa.gov.uk>

Registered as a Limited Company in England and Wales No 1920623. Registered Office as above

Notes for Form D

Notification of changes in personal information or application details

Full details of the approved persons regime and the application process are given in chapter 6 of the Authorisation manual and chapter 10 of the Supervision manual.

The purpose of this Form

This is Form D referred to in SUP 10.13.8G, SUP 10.13.14R and SUP 10.13.16R. The firm must use this Form to inform the FSA of changes in the personal details of an approved person or a change in the details of an application to perform controlled functions (Form A). It is not necessary to notify the FSA of changes in an approved person's private address (see SUP 10.13.15G).

The firm must also keep the FSA informed of any significant circumstances directly affecting an approved person and which any reasonable person would consider relevant to the approved person's position under the FSA rules (see SUP 10.13.16R).

The firm is required to notify the FSA of any matter, in relation to an approved person, that would normally be declared when giving the information required for section 5 of Form A or matters considered in FIT 2 (see SUP 10.13.17G).

Do not use this Form if the approved person requires approval in respect of further controlled functions or has ceased to perform controlled functions.

Completing this Form

This Form must be completed in black ink and (if in manuscript) in BLOCK LETTERS.

Where a person is an approved person in respect of a number of firms within the same group, a single Form D may be used, ensuring all firms are clearly marked on the Form.

Additional information can be attached to the Form. It must be securely attached to the rest of the Form and you must indicate at question 3.02 the number of additional sheets attached.

An appropriate individual must sign the declaration for the firm submitting the Form. The FSA considers that an appropriate individual would either be an individual approved for a controlled function described under section 59(5) of the Act (the significant influence functions – controlled functions 1 to 20) or someone to whom the firm has delegated the authority to notify the FSA. If this authority has been delegated, the firm should keep records of those individuals authorised to sign on behalf of the firm.

Only the firm that made the original application (Form A) may sign this Form.

Note: Detach and keep these notes before returning the completed Form to the FSA.

If you have any questions or need additional information, please contact the Individual Vetting and Approval Helpline 020 7676 0019 or via e-mail at iva@fsa.gov.uk

PLEASE RETURN COMPLETED FORM TO:

THE FINANCIAL SERVICES AUTHORITY
INDIVIDUAL VETTING AND APPROVAL
25 THE NORTH COLONNADE
CANARY WHARF
LONDON E14 5HS
UNITED KINGDOM

1.01 FSA Individual Reference Number (IRN)

DETAILS TO BE CHANGED

1.02 Title
(e.g. Mr, Mrs, Ms, etc)

1.03 Surname

1.04 ALL forenames

1.05 Date of birth

1.06 National Insurance number

1.07 Other changes in application details, and matters relating to fitness and propriety

1.08 Effective date of change

1.09 Reason for change



I have supplied further information related to this page in Section 3

YES

NO

2.01 Name of firm

2.02 FSA Firm reference Number (FRN)

2.03 Other firms for whom the individual performs controlled functions

	FSA FRN	Name of firm	Controlled function
a	<input type="text"/>	<input type="text"/>	<input type="text"/>
b	<input type="text"/>	<input type="text"/>	<input type="text"/>
c	<input type="text"/>	<input type="text"/>	<input type="text"/>
d	<input type="text"/>	<input type="text"/>	<input type="text"/>
e	<input type="text"/>	<input type="text"/>	<input type="text"/>

2.04 a Who should the FSA contact at the firm in relation to this notification?

b Position

c Telephone

d Fax

e E-mail



I have supplied further information related to this page in Section 3

YES

NO

3.01 Please indicate clearly which question the supplementary information relates to.

Question	Information

3.02 How many additional sheets are being submitted?

DECLARATION OF APPROVED PERSON

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (section 398 of the Financial Services and Markets Act 2000).

It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that the information in this Form is accurate and complete to the best of my knowledge and belief and that I have read the notes to this Form.

The FSA may seek to verify the information given in this Form including answers pertaining to fitness and propriety. I authorise the FSA to make such enquiries and seek such further information as it thinks appropriate in the course of verifying the information given in this Form. I also understand that the results of these checks may be disclosed to my employer.

4.01	Full name of approved person i.e. Title, forenames, SURNAME	
4.02	Signature	
	Date	

DECLARATION OF FIRM

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.4R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. APER 4.4.6E provides that, where an approved person is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of Statement of Principle 4. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that the information in this Form is accurate and complete to the best of my knowledge and belief and that I have read the notes to this Form.

4.03	Name of the firm	
4.04	Name of person signing on behalf of the firm	
4.05	Position	
4.06	Signature	
	Date	



Application number
(for FSA use only)

Form E

Internal transfer of an approved person

FSA Handbook Reference: SUP 10 Annex 8G

30 April 2001

Name of approved person
(to be completed by applicant)

Name of firm
(as entered in 2.01)

The Financial Services Authority
Individual Vetting & Approval
25 The North Colonnade
Canary Wharf
London E14 5HS
United Kingdom
Telephone +44 (0) 20 7676 0019
Facsimile +44 (0) 20 7676 0017
E-mail iva@fsa.gov.uk
Website <http://www.fsa.gov.uk>

Registered as a Limited Company in England and Wales No 1920623. Registered Office as above

Notes for Form E

Internal transfer of an approved person

PLEASE NOTE: A CANDIDATE MUST NOT BEGIN PERFORMING ANY CONTROLLED FUNCTIONS UNTIL THE FSA HAS GRANTED APPROVAL.

Full details of the approved persons regime can be found in chapter 6 of the Authorisation manual and chapter 10 of the Supervision manual.

The purpose of this Form

This is Form E referred to in SUP 10.13.3G. A firm should use this form when an approved person ceases to perform one or more controlled functions and the firm wishes to apply for approval for the individual in respect of other controlled functions. This Form should not be used for a qualified withdrawal (see SUP 10.13.7R).

Form B must be used if the individual is ceasing to perform a controlled function but is not seeking approval in respect of another controlled function.

Completing this Form

The Form must be completed in black ink and (if in manuscript) in BLOCK LETTERS.

All dates should be provided in numeric form (e.g. 29/02/2000 for 29 February 2000).

Indicate clearly if a question is not applicable. Tick the appropriate box where a yes/no answer is required. Further details should be given in section 6 (supplementary information) if there is insufficient space for a detailed answer.

Additional information can be attached to the Form. It must be securely attached to the rest of the Form and you must indicate at question 5.02 the number of additional sheets attached.

Do not assume that information is known to the FSA merely because it is in the public domain, or has been previously disclosed to the FSA or to another regulatory body. In all circumstances, disclosures should be full, frank and unambiguous. If there is any doubt about the relevance of information, it should be included. The information supplied by the candidate should be verified by the firm wherever possible. If the FSA's vetting checks reveal any matters that have not been disclosed, then applications will be delayed and, in some cases, possibly rejected. See SUP 10.12.6G.

Expressions in this Form in italics have the meaning given in the Glossary to the FSA's Handbook (or, if no meaning is given there, the expressions are to be interpreted in accordance with the related expression defined in the Glossary).

The firm is responsible for the completion of the Form. If the Form is not fully and correctly completed, the FSA may need to return it for proper completion. This could significantly delay the FSA's decision on whether to grant approval to perform the requested controlled functions (see SUP 10.12.6G).

The FSA may require the applicant to provide further information at any time after receiving an application and before determining whether it is to be granted or not (see SUP 10.12.8G).

If a firm has provided, or has information that reasonably suggests that it may have provided, the FSA with information which was or has become false, misleading, incomplete or inaccurate, in a material particular, it must notify the FSA immediately (see SUP 15.6.4R). Failure to notify the FSA may result in a delay in processing or rejection.

SECTION 4 – ARRANGEMENTS AND CONTROLLED FUNCTIONS

The firm must tick the box in 4.01 that most accurately describes its arrangement with the candidate. For applications from a single firm, the firm should complete 4.02, 4.03 & 4.04 indicating the controlled functions required by selecting the appropriate box in 4.02. However, if the application is being made on behalf of a candidate who will carry out controlled functions for more than one firm, 4.05 must be used to describe the controlled functions and the relationships between the candidate and those firms.

- 4.01: If this application relates to more than one appointed representative, provide details in section 6.
- 4.02: If any of controlled functions 16 to 20 are requested, the specific job title of the candidate must be included.
- 4.03: The effective date is the date on which the firm wishes the candidate to begin performing controlled functions (subject to approval). This should be left blank unless there is a reason for the effective date to be beyond the FSA's published standard response times. For instance, a firm may wish to be sure that a candidate has been approved before they take up their post.

Unless the firm indicates otherwise, the FSA assumes that the arrangement given on the application form includes all of the activities that fall within the description of the controlled function. This means that a firm may alter a candidate's responsibilities within the broad description of a controlled function without needing further approval from the FSA.

SECTION 5 – SUPPLEMENTARY INFORMATION

This section provides extra space for any previous answer and for additional information relevant to this application.

The firm must include details of any other matter which the firm is aware of and which in its reasonable opinion is relevant in connection with the approved person ceasing to perform their controlled function. If there is insufficient space, additional sheets may be used.

SECTION 6 – DECLARATIONS AND SIGNATURES

This section contains declarations which must be signed by both an appropriate individual for the firm or applicant submitting the application and the candidate. The FSA considers that an appropriate individual would either be an individual approved for a controlled function described under section 59(5) of the Act (the significant influence functions – controlled functions 1 to 20) or someone to whom the firm has delegated the authority to notify the FSA. If this authority has been delegated, the firm should keep records of those individuals authorised to sign on behalf of the firm.

Note: Detach and keep these notes before returning the completed Form to the FSA.

If you have any questions or need additional information, please contact the Individual Vetting and Approval Helpline 020 7676 0019 or via e-mail at iva@fsa.gov.uk

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CANARY WHARF
LONDON E14 5HS
UNITED KINGDOM

Personal identification details

Section 1

1.01	FSA Individual Reference Number (IRN)	
1.02	Title (e.g. Mr, Mrs, Ms, etc)	
1.03	Surname	
1.04	ALL forenames	
1.05	Date of birth	
1.06	National Insurance number	

Firm identification details

Section 2

2.01	Name of firm	
2.02	FSA Firm Reference Number (FRN)	
2.03 a	Who should the FSA contact at the firm in relation to this application?	
b	Position	
c	Telephone	
d	Fax	
e	E-mail	



I have supplied further information related to this page in Section 5

YES

NO

3.01 List all controlled functions which the approved person is ceasing to perform. The effective date is the date the person will cease to perform the functions.

	FSA FRN	Name of firm	Controlled function	Effective date
a				
b				
c				
d				
e				



I have supplied further information related to this page in Section 5

YES

NO

4.01 Nature of the arrangement between the candidate and the applicant.

a	Employee	<input type="checkbox"/>	
<hr/>			
b	Group employee	<input type="checkbox"/>	
	Name of group		<div style="background-color: #cccccc; height: 20px; width: 100%;"></div>
<hr/>			
c	Contract for services	<input type="checkbox"/>	
<hr/>			
d	Partner/Sole trader	<input type="checkbox"/>	
<hr/>			
e	Appointed rep – employee	<input type="checkbox"/>	
	Name of AR		<div style="background-color: #cccccc; height: 20px; width: 100%;"></div>
<hr/>			
f	Appointed rep – principal	<input type="checkbox"/>	
	Name of AR		<div style="background-color: #cccccc; height: 20px; width: 100%;"></div>
<hr/>			
g	Other	<input type="checkbox"/>	
	Give details		<div style="background-color: #cccccc; height: 100px; width: 100%;"></div>

4.02 For applications from a single firm, please tick the boxes that correspond to the controlled functions to be performed.

If the controlled functions are to be carried out for more than one firm, please go to question 4.05

a Significant influence functions

CF 1	Director function	<input type="checkbox"/>
CF 2	Non-executive director function	<input type="checkbox"/>
CF 3	Chief executive function	<input type="checkbox"/>
CF 4	Partner function	<input type="checkbox"/>
CF 5	Director of an unincorporated association function	<input type="checkbox"/>
CF 6	Small friendly society function	<input type="checkbox"/>
CF 7	Sole trader function	<input type="checkbox"/>



I have supplied further information related to this page in Section 5

YES

NO

Significant influence functions continued	CF 8	Apportionment and oversight function	<input type="checkbox"/>	
	CF 9	EEA investment business oversight function	<input type="checkbox"/>	
	CF 10	Compliance oversight function	<input type="checkbox"/>	
	CF 11	Money laundering reporting function	<input type="checkbox"/>	
	CF 12	Appointed actuary function	<input type="checkbox"/>	
	CF 13	Finance function	<input type="checkbox"/>	
	CF 14	Risk assessment function	<input type="checkbox"/>	
	CF 15	Internal audit function	<input type="checkbox"/>	
	CF 16	Significant management (designated investment business) function	<input type="checkbox"/>	
	CF 17	Significant management (other business operations) function	<input type="checkbox"/>	
	CF 18	Significant management (insurance underwriting) function	<input type="checkbox"/>	
	CF 19	Significant management (financial resources) function	<input type="checkbox"/>	
	CF 20	Significant management (settlements) function	<input type="checkbox"/>	
	b Customer functions	CF 21	Investment adviser function	<input type="checkbox"/>
		CF 22	Investment adviser (trainee) function	<input type="checkbox"/>
CF 23		Corporate adviser function	<input type="checkbox"/>	
CF 24		Pension transfer specialist function	<input type="checkbox"/>	
CF 25		Adviser on syndicate participation at Lloyd's function	<input type="checkbox"/>	
CF 26		Customer trading function	<input type="checkbox"/>	
CF 27		Investment management function	<input type="checkbox"/>	

4.03 Effective date of controlled functions indicated above

4.04 Job title (mandatory for controlled functions 16 to 20)



I have supplied further information related to this page in Section 5

YES

NO

4.05 List all firms within the group (including the firm entered in 4.02) for which the applicant requires approval and the requested controlled function for that firm.

	FSA Firm Reference Number	Name of firm	Controlled function	Job title (mandatory for controlled functions 16 to 20)	Effective date
a					
b					
c					
d					
e					

4.06 Has the individual been assessed as competent in accordance with the Training and Competence Rules (see TC 2.3.5R (Attaining Competence))?
 Tick "NOT APPLICABLE" if the individual is not within the scope of chapter 2 of the Training and Competence Sourcebook (see TC 2.1.3R)

YES
 NO
 NOT APPLICABLE

4.07 If the answer to 4.06 is "YES", indicate which of the following formed part of the assessment
 Only tick one box

Passing each module of the appropriate examination as specified in the annexes to TC 2
 OR
 Complying with TC 2.4.5R (Approved examinations)
 OR
 Complying with TC Transitional Provisions



I have supplied further information related to this page in Section 5 YES NO

5.01 Is there any other information the candidate or the firm considers to be relevant to the application?

YES NO

If yes, please provide details below or on a separate sheet of paper and clearly identify the section and question to which the additional information relates.

Question	Information

5.02 How many additional sheets are being submitted?

CANDIDATE'S DECLARATION

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (section 398 of the Financial Services and Markets Act 2000). APER 4.4.6E provides that, where an approved person is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of Statement of Principle 4. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that the information in this Form is accurate and complete to the best of my knowledge and belief and that I have read the notes to this Form.

The FSA may seek to verify the information given in this Form including answers pertaining to fitness and propriety. I authorise the FSA to make such enquiries and seek such further information as it thinks appropriate in the course of verifying the information given in this Form. I also understand that the results of these checks may be disclosed to my employer.

6.01	Candidate's full name	
6.02	Signature	
	Date	

FIRM'S DECLARATION

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.4R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. APER 4.4.6E provides that, where an approved person is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of Statement of Principle 4. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

In making this application the firm believes on the basis of due and diligent enquiry that the candidate is a fit and proper person to perform the controlled function(s) listed in section 4. The firm also believes, on the basis of due and diligent enquiry, that the candidate is competent to fulfil the duties required of such function(s).

I confirm that the information in this Form is accurate and complete to the best of my knowledge and belief and that I have read the notes to this Form.

I confirm that I have authority to make this application, and sign this Form, on behalf of each firm identified in section 3.05. I also confirm that a copy of this Form, as submitted to the FSA, will be sent to each of those firms at the same time as submitting the Form to the FSA.

6.03	Name of the firm submitting the application	
6.04	Name of person signing on behalf of the firm	
6.05	Job title	
6.06	Signature	
	Date	

Chapter 11

Controllers and close links



11.1 Application

Application to firms

11.1.1 **R** This chapter applies to every *firm* except:

^{/1}

- (1) an *ICVC*;
- (2) an *incoming EEA firm*;
- (3) an *incoming Treaty firm*;
- (4) a *firm* which is a *partnership*;
- (5) a *sole trader*;
- (6) a *UCITS qualifier*;

as set out in the table in SUP 11.1.2R.

11.1.2 **R** Table Applicable sections (see SUP 11.1.1R)

^{/1}

	Category of firm	Applicable sections
(1)	A <i>UK domestic firm</i>	All except SUP 11.3 and SUP 11.4.4R
(2)	An <i>overseas firm</i>	All except SUP 11.3, SUP 11.4.2R, SUP 11.4.3G, SUP 11.4.9G, SUP 11.5.8G to SUP 11.5.10G, SUP 11.6.2R, SUP 11.6.3R, SUP 11.6.6.G, SUP 11.7

11.1.3 **G** This chapter may apply to *friendly societies* in the circumstances described in SUP 16.4.2G (1) to (3).

^{/1}

Application to controllers

11.1.4 **D** SUP 11.1, SUP 11.2, SUP 11.3 and SUP 11.7 apply to a *controller* or a proposed *controller* of a *UK domestic firm* not listed in SUP 11.1.1R(1) to (6).

^{/1}

11.1.5 **G** This chapter may apply to *controllers* and *proposed controllers* of *friendly societies* in the circumstances described in SUP 16.4.2G (1) to (3).

^{/1}

11.2 Purpose

- 11.2.1** **G**_{/1} Part XII of the *Act* (Control over authorised persons) places an obligation on the *controllers* and proposed *controllers* of those *UK domestic firms* not listed in *SUP* 11.1.1R (1) to (6) to notify the *FSA* of changes in *control*. Furthermore, those *persons* are required to obtain the *FSA's approval* before becoming a *controller* or increasing the level of *control* held (in certain circumstances). *SUP* 11.3 is intended to assist those *persons* in complying with their obligations under Part XII of the *Act* and also sets out the information which a *controller* or proposed *controller* must provide to the *FSA* before becoming a *controller* or increasing the level of *control* held.
- 11.2.2** **G**_{/1} The *rules* in *SUP* 11.4 to *SUP* 11.6 are aimed at ensuring that the *FSA* receives information it needs from *firms* to assist the *FSA* with its responsibility to monitor and, in some cases, give prior approval to *firms' controllers*. These *rules* also implement certain requirements relating to changes in *control* that are required under the *Investment Services Directive*, the *Banking Consolidation Directive*, the *Third Life Directive* and the *Third Non-Life Directive*.
- 11.2.3** **G**_{/1} As the approval of the *FSA* is not required under the *Act* for a new *controller* of an *overseas firm*, the *notification rules* on such *firms* are less prescriptive than they are for *UK domestic firms*. Nevertheless, the *FSA* still needs to monitor such an *overseas firm's* continuing satisfaction of the *threshold conditions*, which normally includes consideration of a *firm's* connection with any *person*, including its *controllers* and *parent undertakings* (see *COND*). The *FSA* therefore needs to be notified of *controllers* and *parent undertakings* of *overseas firms*.
- 11.2.4** **G**_{/1} As part of the *FSA's* function of monitoring a *firm's* continuing satisfaction of the *threshold conditions*, the *FSA* needs to consider the impact of any significant change in the circumstances of one or more of its *controllers*, for example, in their financial standing and, in respect of corporate *controllers*, in their *governing bodies*. Consequently, the *FSA* needs to know if there are any such changes. *SUP* 11.8 therefore requires a *firm* to tell the *FSA* if it becomes aware of particular matters relating to a *controller*.
- 11.2.5** **G**_{/1} Similarly, the *FSA* needs to monitor a *firm's* continuing satisfaction of *threshold condition 3* (Close links) (see *COND* 2.3), which requires that a *firm's close links* are not likely to prevent the *FSA's* effective supervision of that *firm*. Accordingly the *FSA* needs to be notified of any changes in a *firm's close links*. This requirement is contained in *SUP* 11.9 and implements a requirement of the amending Directive (the *Post BCCI directive*) in relation to *close links*.
- 11.2.6** **G**_{/1} Every *firm* other than a *firm* listed in *SUP* 11.1.1R(1) to (6) is required to submit an annual report on its *controllers* and *close links* as set out in *SUP* 16.4 and *SUP* 16.5.
- 11.2.7** **G**_{/1} A summary of the notification requirements in this chapter is given in *SUP* 11 Ann 1G.



11.3 Requirements on controllers or proposed controllers under the Act

11.3.1 G_{/1} A summary of the notification requirements described in this section is given in SUP 11 Ann 1G.

Requirement to notify a change in control

11.3.2 G_{/1} Part XII of the *Act* requires a *person* (whether or not he is an *authorised person*) to notify the *FSA* in writing if he proposes to take a step which would result in his acquiring *control* or increasing or reducing his *control* over a *firm* in a way described in SUP 11.4.2R(1) to (4). Failure to notify is an offence under section 191(1) of the *Act* (Offences under this Part). An event described in SUP 11.4.2R(1) to (4) is referred to in this chapter as a “change in *control*”.

11.3.3 G_{/1} The notifications referred to in SUP 11.3.2G may be given jointly with the *firm* as described in SUP 11.5.8G.

Prior approval of acquiring or increasing control

11.3.4 G_{/1} If a *person* proposes to acquire *control* or increase his *control* over a *firm* in a way described in SUP 11.4.2R(1) to (4), he must obtain the *FSA*’s approval before doing so. *Failure* to obtain approval is an offence under section 191(3) of the *Act* (Offences under this Part). The *FSA* has up to three *months* to consider whether to *approve* such a change in *control*. A *controller* or proposed *controller* should take this period into account when deciding when to give his notification.

11.3.5 G_{/1} The *FSA*’s *approval* is not required before a *controller* reduces his *control* over a *firm*.

Change in control without taking any step

11.3.6 G_{/1} If a change in *control* occurs without the *person* himself having taken any step (for example, because of an increase in the *firm*’s capital), he must notify the *FSA* within 14 days of becoming aware of the change (sections 178(2) and 190(2) of the *Act*). Provisions determining when such a notice is treated as being received by the *FSA* are set out in regulation 10(1) of the Financial Services and Markets Act 2000 (Service of Notices) Regulations 2001 (SI 2001/1420)).

Form of notification when acquiring or increasing control

- 11.3.7** **D**_{/1} A notification ("notice of *control*") given to the *FSA* by a *person* who is acquiring *control* or increasing his *control* over a *firm*, in a way described in *SUP* 11.4.2R(1) to (4), must :
- (1) in the case of a *controller* or a proposed *controller* who is not an *authorised person*, contain the information required in:
 - (a) Controllers Form A (*SUP* 11 Ann 4D); and
 - (b) one or more of Controllers Form B (*SUP* 11 Ann 5D) in accordance with *SUP* 11.3.8D; or
 - (2) in all other cases, contain the information required in Controllers Form A, sections 1, 5 and 6 (*SUP* 11 Ann 4D).
- 11.3.8** **D**_{/1} The information in Controllers Form B is required in relation to the following *persons*:
- (1) if the *controller* is an individual, that individual;
 - (2) if the *controller* is a *body corporate*:
 - (a) the individual who is its *chief executive*; and
 - (b) one other individual who is a *director* of the *body corporate*;
 - (3) if the *controller* is a *partnership* or is a *controller* because he is a partner in a *partnership*:
 - (a) the individual who is a managing partner or equivalent in the *partnership*; and
 - (b) one other individual who is a partner in the *partnership*.
- 11.3.9** **D**_{/1} If a Controllers Form B has already been submitted to the *FSA* in relation to a relevant individual, then the information in that form need not be submitted to the *FSA* as long as details of any changes in the information previously submitted, or confirmation that there are none, is submitted.
- 11.3.10** **D**_{/1} (1) A *person* who has submitted a notification under *SUP* 11.3.7D must notify the *FSA* immediately if he becomes aware, or has information that reasonably suggests, that he has or may have provided the *FSA* with information which was or may have been false, misleading, incomplete or inaccurate, or has or may have changed, in a material particular. The notification must include:
- (a) details of the information which is or may be false, misleading, incomplete or inaccurate, or has or may have changed;
 - (b) an explanation why such information was or may have been provided; and
 - (c) the correct information.

- (2) If the information in (1) (c) cannot be submitted with the notification (because it is not immediately available), it must instead be submitted as soon as possible afterwards.
- (3) The requirement in (1) ceases if the change in *control* occurs or will not take place.

11.3.11 G_{/1} Copies of the Controllers Form A and Controllers Form B are available on the FSA’s website at www.fsa.gov.uk.

11.3.12 G_{/1} If a *controller* or proposed *controller* considers that the requirements in SUP 11.3.7D to SUP 11.3.9D are not appropriate to his circumstances, for example,

- (1) if the *control* is to be held through a trust; or
- (2) if Form B is required (under SUP 11.3.8D) in relation to an individual who is an *approved person*;

he should consult the FSA. The FSA has power, under section 182(3) of the Act (Notification), to amend those requirements if it considers it appropriate to do so.

11.3.13 G_{/1} The Act provides that the FSA may request any additional information or documentation from the *controller* or proposed *controller* that it reasonably requires in order to determine what action it is to take in response to the notification. A *controller* or proposed *controller* which is an *authorised person* is required to submit less information under SUP 11.3.7D than other *persons* and consequently the FSA may ask for confirmation of details already held or any additional information which it considers appropriate.

11.3.14 G_{/1} If item 1.05 of Controllers Form A is answered in the affirmative, the FSA may be obliged to consult regulatory authorities in other EEA States before approving the change in *control* or giving a *warning notice*.

Form of notification when reducing control

11.3.15 G_{/1} A notification given to the FSA by a *person* who is reducing his *control* over a *firm*, in a way described in SUP 11.4.2R(1) to (4), must, in accordance with section 190(4) of the Act (Notification):

- (1) be in writing; and
- (2) provide details of the extent of *control* (if any) which the *controller* will have following the change in *control*.

Notification when change in control occurs

11.3.16 G_{/1} A *person* who is under a duty to notify the FSA of a change in *control* is also required to notify the FSA when the relevant change in *control* has occurred (sections 178(3) and 190(3) of the Act). The notification may be given jointly with the *firm* as described in SUP 11.6.6G. If a *person* has reduced his *control*, section 190(4) of the Act requires that the notification should provide details of the extent of *control* retained (if any).



11.4 Requirements on firms

11.4.1 G_{/1} A summary of the notification requirements in this section is given in *SUP* 11 Ann 1G.

Requirement to notify a change in control

11.4.2 R_{/1} A *UK domestic firm* must notify the *FSA* of any of the following events concerning the *firm*:

- (1) a *person* acquiring *control* or ceasing to have *control*;
- (2) an existing *controller* acquiring an additional *kind of control* or ceasing to have a *kind of control*;
- (3) an existing *controller* increasing or decreasing a *kind of control* which he already has so that the percentage of shares or *voting power* concerned becomes or ceases to be equal to or greater than 20, 33 or 50;
- (4) an existing *controller* becoming or ceasing to be a *parent undertaking*.

11.4.3 G_{/1} *SUP* 11 Ann 2G gives examples of the circumstances in which a notification in accordance with *SUP* 11.4.2R is required.

11.4.4 R_{/1} An *overseas firm* must notify the *FSA* of any of the following events concerning the *firm*:

- (1) a *person* acquiring *control* or ceasing to have *control*;
- (2) an existing *controller* becoming or ceasing to be a *parent undertaking*.

11.4.5 G_{/1} If there is uncertainty whether a particular relationship constitutes *control*, it may be appropriate for the *firm* or *controller* or proposed *controller* to ask the *FSA* for individual *guidance* (see *SUP* 9) and to obtain its own legal advice. For example, if the *control* is to be held through a trust, then certain trustees, beneficiaries and other parties may qualify as *controllers* for the purposes of the *Act* and this chapter. Furthermore, a *person* may qualify as a *controller* if he is able to exercise 10% or more of the *voting power* at a *firm's* general meeting as a result of the ability to exercise proxy votes.

11.4.6 G_{/1} If a *firm* is required to obtain approval from the *Society of Lloyd's* for any changes in its *controllers*, it should apply for this approval as well as notifying the *FSA*.

Content and timing of the notification

11.4.7 R_{/1} The notification by a *firm* under *SUP 11.4.2R* or *SUP 11.4.4R* must:

- (1) be in writing;
- (2) contain the information set out in:
 - (a) in the case of acquiring or increasing *control*, *SUP 11.5.1R* (subject to *SUP 11.5.2R*); or
 - (b) in the case of reducing *control*, *SUP 11.5.7R*; and
- (3) be made:
 - (a) as soon as the *firm* becomes aware that a *person* is proposing to take a step that would result in the event concerned; or
 - (b) if the event takes place without the knowledge of the *firm*, within 14 days of the *firm* becoming aware of the event concerned.

11.4.8 G_{/1} *Principle 11* requires *firms* to be open and cooperative with the *FSA*. A *firm* should discuss with the *FSA*, at the earliest opportunity, any prospective changes of which it is aware, in *controllers'* or proposed *controllers'* shareholdings or *voting power* (if the change is material). These discussions may take place before the formal notification requirement in *SUP 11.4.2R* or *SUP 11.4.4R* arises. (See also *SUP 11.3.2G*.) As a minimum, the *FSA* considers that such discussions should take place before a *person*:

- (1) enters into any formal agreement in respect of the purchase of shares or a proposed acquisition or merger which would result in a change in *control* (whether or not the agreement is conditional upon any matter, including the *FSA's* approval); or
- (2) purchases any *share options*, *warrants* or other financial instruments, the exercise of which would result in the *person* acquiring *control* or any other change in *control*.

11.4.9 G_{/1} The obligation in *SUP 11.4.2R* applies whether or not the *controller* himself has given or intends to give a notification, in accordance with his obligations under the *Act*.

Identity of controllers

11.4.10 R_{/1} A *firm* must take reasonable steps to keep itself informed about the identity of its *controllers*.

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The steps that the *FSA* expects a *firm* to take to comply with *SUP* 11.4.10R include, if applicable:

- (1) monitoring its register of shareholders (or equivalent);
- (2) monitoring notifications to the *firm* in accordance with Part VI of the Companies Act 1985;
- (3) monitoring public announcements made under the relevant disclosure provisions of the *Takeover Code* or other rules made by the *Takeover Panel* (for example the *SARs*);
- (4) monitoring the entitlement of delegates, or *persons* with voting rights in respect of group insurance contracts, to exercise or control *voting power* at general meetings.



11.5 Form of notification by firms

11.5.1 **R** Table Information to be submitted by the firm (see SUP 11.4.7R(2)(a))

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(1)	The name of the <i>firm</i>;
(2)	the name of the <i>controller</i> or proposed <i>controller</i> and, if it is a <i>body corporate</i> and is not an <i>authorised person</i>, the names of its <i>directors</i> and its <i>controllers</i>;
(3)	a description of the proposed event including the shareholding and voting power of the <i>person</i> concerned, both before and after the proposed event; and
(4)	any other information of which the <i>FSA</i> would reasonably expect notice, including information which could have a material impact on any of the approval requirements in section 186(2) of the <i>Act</i> (see SUP 11.7.5G) and any relevant supporting documentation.

11.5.2 **R** The notification from a *firm* under SUP 11.4.7R(2)(a) need only contain as much of the information set out in SUP 11.5.1R as the *firm* is able to provide, having made reasonable enquiries from *persons* and other sources as appropriate.

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11.5.3 **G** In determining what the *FSA* would reasonably expect notice of in accordance with row (4) in SUP 11.5.1R, a firm should have regard, in particular, to the matters set out in items 1.03 to 1.07 and 6.02 of Controllers Form A (SUP 11 Ann 4D) to the extent that the *firm* is aware of such matters. *Firms* are also reminded of the circumstances set out in SUP 15.3.8G (Communication with the *FSA* in accordance with Principle 11) which may arise on a change in *control* and which should also be notified.

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11.5.4 **G** *Firms* are reminded that a change in *control* may give rise to a change in the *group companies* to which the *FSA*'s consolidated financial supervision requirements apply. Also, the *firm* may for the first time become subject to the *FSA*'s requirements on consolidated financial supervision (or equivalent requirements imposed by another *EEA State*). This may apply, for example, if the *controller* is itself an *authorised undertaking*. The *FSA* may therefore request such a *firm*, *controller* or proposed *controller* to provide evidence that, following the change in *control*, the *firm* will meet the requirements of these *rules*, if appropriate.

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11.5.5 **G** If a *controller* proposes any significant changes to the *firm*, for instance to its *regulated activities*, business plan or strategy, the *firm* may be requested to provide a business plan (see SUP 2: Information gathering by the *FSA* on its own initiative). If an *insurer* comes under the *control* of a new *parent undertaking*, such a business plan would be a *scheme of operations* in accordance with SUP App 2.

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11.5.6 **G** The *FSA* may request the *firm* to provide additional information (see SUP 2 (Information gathering by the *FSA* on its own initiative)). In determining any

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additional information requirements, the *FSA* will have regard to the supervision being exercised over the *firm* by any *overseas regulators*.

Form of notification when a person reduces control

11.5.7 **R** A notification of a proposed reduction in *control* must:

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- (1) give the name of the *controller*; and
- (2) provide details of the extent of *control* (if any) which the *controller* will have following the change in *control*.

Joint and shared notifications

11.5.8 **G** A *firm* and its *controller* or proposed *controller* may discharge an obligation to notify the *FSA* by submitting a single joint notification containing the information required from the *firm* and the *controller* or proposed *controller*. In this case, the Controllers Form A may be used to submit a notification on behalf of both the *firm* and the *controller* or proposed *controller*.

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11.5.9 **G** If a *person* is proposing a change in *control* over more than one *firm* within a *group*, then the *controller* or proposed *controller* may submit a single notification in respect of all those *firms*. The notification should contain all the required information as if separate notifications had been made, but information and documentation need not be duplicated.

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11.5.10 **G** When an event occurs (for example, a *group* restructuring or a merger) as a result of which:

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- (1) more than one *firm* in a *group* would undergo a change in *control*; or
- (2) a single *firm* would experience more than one change in *control*;

then, to avoid duplication of documentation, all the *firms* and their *controllers* or proposed *controllers* may discharge their respective obligations to notify the *FSA* by submitting a single notification containing one set of information.

11.6 Subsequent notification requirements by firms

Changes in the information provided to the FSA

11.6.1 **G** ^{/1} *Firms* are reminded that *SUP 15.6.4R* requires them to notify the *FSA* if information notified under *SUP 11.4.2R* or *SUP 11.4.4R* was false, misleading, inaccurate, incomplete, or changes, in a material particular. This would include a *firm* becoming aware of information that it would have been required to provide under *SUP 11.5.1R* if it had been aware of it.

11.6.2 **R** ^{/1} After submitting a notification under *SUP 11.4.2R* and until the change in *control* occurs (or is no longer to take place), *SUP 15.6.4R* and *SUP 15.6.5R* apply to a *UK domestic firm* in relation to any information its *controller* or proposed *controller* provided to the *FSA* under *SUP 11.5.1R* or *SUP 11.3.7D*.

11.6.3 **R** ^{/1} During the period in *SUP 11.6.2R*, a *UK domestic firm* must take reasonable steps to keep itself informed about the circumstances of the *controller* or the proposed *controller* to which the notification related.

Notification that the change in control has taken place

11.6.4 **R** ^{/1} A *firm* must notify the *FSA*:

- (1) when a change in *control* which was previously notified under *SUP 11.4.2R* or *SUP 11.4.4R* has taken place; or
- (2) if the *firm* has grounds for reasonably believing that the event will not now take place.

11.6.5 **R** ^{/1} The notification under *SUP 11.6.4R* must be given within 14 *days* of the change in *control* or of having the grounds (as applicable).

11.6.6 **G** ^{/1} A notification under *SUP 11.6.4R* may be given jointly with the notification of the *controller* under *SUP 11.3.16G*.



11.7 Acquisition or increase of control: approval procedures

11.7.1 **G** /1 The approval procedures are summarised in SUP 11 Ann 3G.

Approval with or without conditions

11.7.2 **G** /1 If the FSA decides to approve a proposed acquisition or increase of *control* unconditionally, it must give an "approval notice" without delay (section 184(1) of the Act).

11.7.3 **G** /1 Alternatively, the FSA may decide to approve the proposed acquisition or increase of *control* subject to such conditions as it considers appropriate, having regard to the FSA's duty to ensure that the *firm* concerned will satisfy, and continue to satisfy, the *threshold conditions* (section 185 of the Act). If the FSA proposes to approve subject to conditions, it must give a *warning notice*. If the FSA decides to proceed to approve subject to conditions, it must give a *decision notice*.

11.7.4 **G** /1 A notice which approves a change of control (with or without conditions) is effective only for a limited period as set out in the notice (or, if no such period is specified, for one year) (section 184(3) of the Act). An approved change in *control* may not therefore take place after the end of this period.

Approval requirements and objection

11.7.5 **G** /1 The FSA may object to a proposed acquisition or increase of *control* unless it is satisfied that the approval requirements are met (section 186 of the Act). These are that:

- (1) the acquirer is a fit and proper *person* to have the *control* over the *firm* that he has or would have if he acquired the *control* in question; and
- (2) the interests of *consumers* would not be threatened by the acquirer's *control* or by his acquiring that *control*.

11.7.6 **G** /1 In deciding whether the approval requirements are met, the FSA must have regard, in relation to the *control* that the acquirer:

- (1) has over the *firm*; or
- (2) will have over the *firm* if the proposal to which the notification relates is carried out;

to the FSA's duty to ensure that the *firm* will satisfy, and continue to satisfy, the *threshold conditions* (section 186(3) of the *Act*).

11.7.7 G_{/1} If the FSA proposes to object, it must issue a *warning notice*. If the FSA decides to proceed with its proposed objection, it must issue a *decision notice*. If the FSA considers that the approval requirements would be met if a particular step were taken or not taken, the *decision notice* must identify that step (section 186(4) of the *Act*).

11.7.8 G_{/1} As well as objecting when satisfied that the approval requirements are not met, the FSA may also object if it has not received sufficient information from either the *controller* or the *firm* to satisfy itself that the approval requirements are met.

Warning notices and decision notices

11.7.9 G_{/1} The procedure followed by the FSA in relation to the giving of *warning notices* and *decision notices* and the process for referrals to the *Financial Services and Markets Tribunal* are set out in *DEC 2*.

The FSA's timeframe for responding to a notification

11.7.10 G_{/1} If the FSA receives a valid notification from a *controller* or proposed *controller* (whether a joint notification in accordance with *SUP 11.5.8G* or otherwise), the FSA must respond within three *months* regardless of when it receives a notification from the *firm* (section 183(1) of the *Act*). The response from the FSA will be either an approval notice or a *warning notice*.

11.7.11 G_{/1} Alternatively, the FSA may receive a notification from the *firm* but not from the *controller* or proposed *controller* or may otherwise become aware of a possible breach by the *controller* or proposed *controller* of his obligations under section 178(1) or (2) of the *Act* (Obligation to notify the Authority). The FSA may require the *person* concerned to provide additional information or *documents* (section 188(4) of the *Act*). If the FSA is satisfied that a breach has occurred, but is not satisfied that the approval requirements are met, the FSA may give a *warning notice* to the *controller* or proposed *controller* (section 187(1) and 188(1) of the *Act*). Alternatively, the FSA may approve the change of *control* as if a notification had been received from the *controller* or proposed *controller* (section 187(2) of the *Act*).

11.7.12 G_{/1} If the FSA does not receive a notification from the *controller* or proposed *controller* and proposes to give a *warning notice*, it must do so within three *months* of the date on which it became aware that the *controller* or proposed *controller* had failed to comply with his duty to notify (section 188(3) of the *Act*).

11.7.13 G_{/1} Before giving an approval notice or *warning notice*, the FSA may be required to consult with competent authorities outside the *United Kingdom* (sections 183(2) and 188(2) of the *Act*).

The FSA's right to object to existing controllers

11.7.14 G_{/1} If a *controller* fails to give a notification under section 178(3) of the *Act* on acquiring or increasing *control*, and the FSA is not satisfied that the approval

requirements are met, the *FSA* may propose to object to the *controller* by giving him a *warning notice* (sections 187(1) and 188(1) of the *Act*).

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The *FSA* may propose to object to a *controller* by giving him a *warning notice* at any time if it becomes aware of matters as a result of which it is satisfied that:

- (1) the approval requirements are not met with respect to the *controller*; or
- (2) a condition attached to an approval required the *controller* to do (or refrain from doing) a particular thing and that condition has been breached by the *controller* (sections 187(3) and 188(1) of the *Act*).

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If the *FSA* gives a *warning notice* as described in *SUP* 11.7.14G or *SUP* 11.7.15G, section 188 of the *Act* sets out various requirements as to timetable, consultation and provision of information.

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Following a *warning notice* as described in *SUP* 11.7.14G or *SUP* 11.7.15G, the *FSA* may decide to object to the *controller* and give him a *decision notice*. If the *FSA* does so, or if a conditional approval has been contravened, it may impose restrictions on some or all of the *controller's* shares by notice in writing or apply to the court for an order that the *controller* dispose of them (section 189 of the *Act*).

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If it appears to the *FSA* that the likely effect of an acquisition of *control* on a *firm*, or on any of its activities, is uncertain, the *FSA* may, in accordance with section 46 of the *Act* (Variation of permission on acquisition of control), vary the *firm's Part IV permission* by:

- (1) imposing a *requirement* (see *SUP* 7: Individual requirements); or
- (2) varying an existing *requirement*.

The *warning notice* and *decision notice* procedure does not apply to action taken under section 46 of the *Act*, but the *FSA* will operate a procedure that is fair in the circumstances.

11.8 Changes in the circumstances of existing controllers

- 11.8.1** **R** ^{/1} A *firm* must notify the FSA immediately it becomes aware of any of the following matters in respect of one or more of its *controllers*:
- (1) if a *controller*, or any entity subject to his *control*, is or has been the subject of any legal action or investigation which might put into question the integrity of the *controller*;
 - (2) if there is a significant deterioration in the financial position of a *controller*;
 - (3) if a corporate *controller* undergoes a substantial change or series of changes in its *governing body*;
 - (4) if a *controller*, who is authorised in another EEA State as an *ISD investment firm* or *BCD credit institution* or under the *Insurance Directives*, ceases to be so authorised.
- 11.8.2** **G** ^{/1} In assessing whether a matter should be notified to the FSA under SUP 11.8.1R(1), (2) or (3), a *firm* should have regard to the *guidance* on satisfying *threshold condition 5* (Suitability) contained in COND 2.5.
- 11.8.3** **G** ^{/1} In respect of SUP 11.8.1R(3), the FSA considers that, in particular, the removal or replacement of a majority of the members of a *governing body* (in a single event or a series of connected events) is a substantial change and should be notified.
- 11.8.4** **G** ^{/1} If a matter has already been notified to the FSA (for example, as part of the *firm's* application for a *Part IV permission*), the *firm* need only inform the FSA of any significant developments.
- 11.8.5** **G** ^{/1} The level of a *firm's* awareness of its *controller's* circumstances will depend on its relationship with that *controller*. The FSA does not expect *firms* to implement systems or procedures so as to be certain of any changes in its *controllers'* circumstances. However, the FSA does expect *firms* to notify it of such matters if the *firm* becomes aware of them, and it expects *firms* to make enquiries of its *controllers* if it becomes aware that one of the events in SUP 11.8.1R may occur or has occurred.
- 11.8.6** **G** ^{/1} The FSA may ask the *firm* for additional information following a notification under SUP 11.8.1R in order to satisfy itself that the *controller* continues to be suitable (see SUP 2: Information gathering by the FSA on its own initiative).



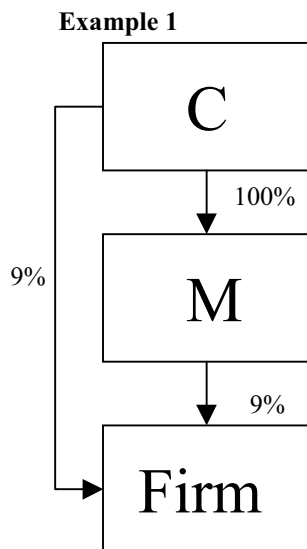
11.9 Changes in close links

- 11.9.1** **R** A *firm* must notify the *FSA* immediately it becomes aware that it has become or ceased to be *closely linked* with any *person*. The notification must include the information set out in *SUP 16.5.4R(4)*.
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- 11.9.2** **G** *Guidance* on what constitutes a *close link* is provided in *COND 2.3*.
- 11.9.3** **G** The *FSA* may ask the *firm* for additional information following a notification under *SUP 11.9.1R* in order to satisfy itself that the *firm* continues to satisfy the *threshold conditions* (see *SUP 2: Information gathering by the FSA on its own initiative*).
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Summary of notifications required in this chapter

Event triggering a notification	Requirement reference	
	When	How
Notifications from a controller or proposed controller of a UK domestic firm		
1 A <i>person</i> proposing to become a <i>controller</i> or an existing <i>controller</i> proposing to increase his level of <i>control</i>	SUP 11.3.2G SUP 11.3.6G	SUP 11.3.7D to SUP 11.3.14G
2 An existing <i>controller</i> proposing to reduce his <i>control</i>	SUP 11.3.2G SUP 11.3.6G	SUP 11.3.15G
3 When a change in <i>control</i> actually takes place	SUP 11.3.16G	SUP 11.3.16G
Notifications from a UK domestic firm relating to a change in control		
1 When a <i>firm</i> becomes aware of a <i>person</i> proposing to become a <i>controller</i> or an existing <i>controller</i> proposing to increase his level of <i>control</i>	SUP 11.4.2R SUP 11.4.7R SUP 11.4.8G	SUP 11.5.1R SUP 11.5.2R SUP 11.5.3G SUP 15.7
2 When a <i>firm</i> becomes aware that an existing <i>controller</i> is proposing to reduce his level of <i>control</i>	SUP 11.4.2R SUP 11.4.7R SUP 11.4.8G	SUP 11.5.7R SUP 15.7
3 When a <i>firm</i> becomes aware of any material inaccuracies, omissions or changes in information previously provided to the FSA either by the <i>firm</i> or by the <i>controller</i>	SUP 11.6.1G SUP 11.6.2R	SUP 15.7
4 When a change in <i>control</i> actually takes place or, although a notification has been submitted, is not, after all, going to take place	SUP 11.6.4R SUP 11.6.5R	SUP 15.7
Notifications from an overseas firm relating to a change in control		
1 When a <i>firm</i> becomes aware that a <i>person</i> is becoming or ceasing to become a <i>controller</i> or <i>parent undertaking</i>	SUP 11.4.4R SUP 11.4.7R SUP 11.4.8G	SUP 11.5.1R SUP 11.5.2R SUP 11.5.3G SUP 15.7
2 When a <i>firm</i> becomes aware of any material inaccuracies, omissions or changes in information previously provided to the FSA by the <i>firm</i>	SUP 11.6.1G	SUP 15.7
3 When a change in <i>control</i> actually takes place or, although a notification has been submitted, is not, after all, going to take place	SUP 11.6.4R SUP 11 6.5G	SUP 15.7
Other ongoing notifications from a firm (UK domestic or overseas)		
1 When a <i>firm</i> becomes aware of a change in the circumstances of an existing <i>controller</i>	SUP 11.8.1R to SUP 11.8.4G	SUP 15.7
2 When a <i>firm</i> becomes aware that it has become or ceased to be <i>closely linked</i> with any <i>person</i>	SUP 11.9.1R	SUP 15.7

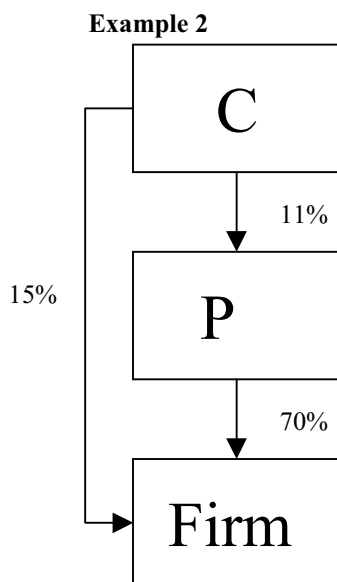
SUP 11 Ann 2G: Guidance on events requiring approval



M is associated with C (because it is a *subsidiary* of C) and therefore M's shareholding in the *firm* of 9% must be aggregated with C's direct shareholding in the *firm* of 9%. C is therefore an 18% *controller* of the *firm*, both as a holder of *shares* and as a *person with voting power*.

If M then decides to purchase a further 15% of *shares* in the *firm*, M becomes a *controller* (its shareholding becomes 24% and has therefore exceeded the 10% threshold). C becomes a 33% *controller*. These are notifiable events under SUP 11.4.2R(1) (M has become a *controller*) and under SUP 11.4.2R(3) (C's holding has become equal to 33%) and both require the *FSA's* prior approval.

If M purchases a further 5% so that M has 29% and C has 38%, the acquisition does not require notification or approval as neither holding has reached one of the limits in SUP 11.4.2R(3).

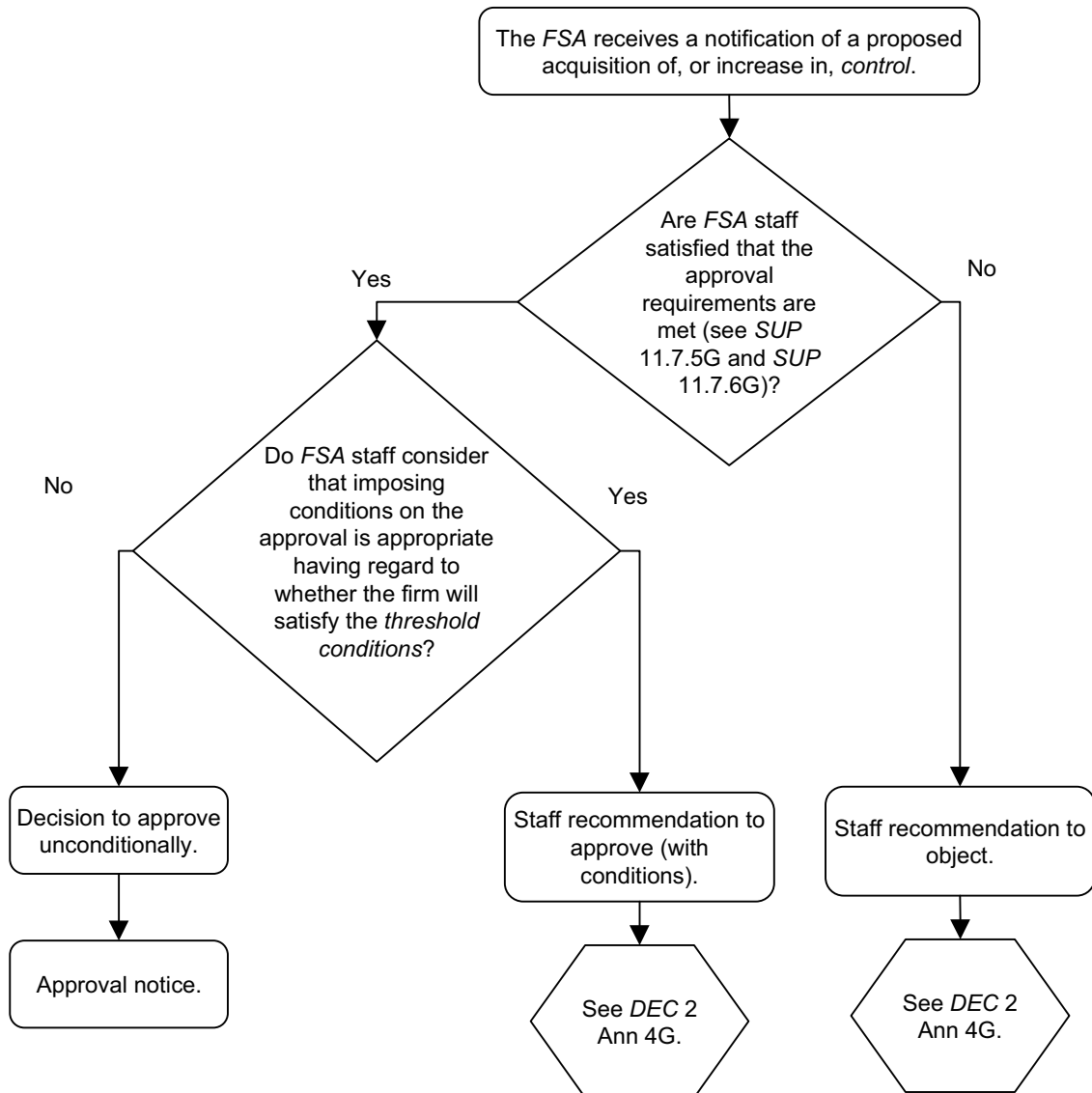


C is an 11% *controller* of the *firm* because of its shareholding in the *firm's parent undertaking* (P).

If C subsequently acquires a 15% shareholding directly in the *firm*, then this is an additional '*kind of control*' and is notifiable under SUP 11.4.2R(2). The *FSA's* prior approval of the event is required.

Note: It is assumed that M is not a *parent undertaking* of the *firm*, and C is not a *parent undertaking* of P. It is also assumed that all *shares* concerned are ordinary voting *shares* with no special rights attached.

SUP 11 Ann 3G: Summary of procedures on a notification of a change in control





Notification number
(for FSA use only)

Controllers Form A

Notification of a change in control

FSA Handbook Reference: SUP 11 Annex 4D

30 April 2001

The Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS
United Kingdom
Telephone +44 (0) 20 7676 1000
Facsimile +44 (0) 20 7676 1099
Website <http://www.fsa.gov.uk>

Registered as a Limited Company in England and Wales No 1920623. Registered Office as above

Notes for Controllers Form A

Notification of a change in control

Rules and guidance on changes in control of a firm are contained in chapter 11 of the Supervision manual.

Photocopies of this Form, or any relevant part of the Form, may be used. The Form is available on the FSA's website at www.fsa.gov.uk and downloaded copies may be completed and submitted.

The purpose of this Form

This is the Controllers Form A referred to in SUP 11.3.7D of chapter 11 of the FSA's Supervision manual.

Completing this Form

The Form should be completed in black ink and (if in manuscript) in BLOCK CAPITALS.

All dates should be written in a dd/mm/yyyy format (e.g. 29/02/2000 for 29 February 2000) unless otherwise indicated on the Form.

Indicate clearly if a question is not applicable. Tick the appropriate box where a yes/no answer is required. Further details should be given in section 6 (supplementary information) if there is insufficient space for a detailed answer.

Additional information can be attached to the Form. It should be securely attached to the rest of the Form and you should indicate at question 6.03 the number of additional sheets attached.

Do not assume that information is known to the FSA merely because it is in the public domain, or has previously been disclosed to the FSA or to another regulatory body. In all circumstances, disclosures should be full, frank and unambiguous. If there is any doubt about the relevance of information, it should be included. If the FSA's checks reveal any matters that have not been disclosed this may result in a delay in processing and/or objection to the change in control.

Expressions in the Form in italics have the meaning given in the Glossary to the FSA's Handbook (or, if no meaning is given there, are to be interpreted in accordance with the related expression defined in the Glossary).

The controller or proposed controller submitting the Form is responsible for the accuracy of the data and completion of the Form. In the case of a joint notification, the firm is responsible for the accuracy of any information contained in the Form which is required from the firm in accordance with SUP 11.5.1R. If the Form is not fully and correctly completed, the FSA may need to return it for proper completion. This could significantly delay the FSA's decision on whether to approve the change in control.

The FSA may require a controller or proposed controller to provide further information at any time after receiving a notification and before determining whether or not to approve the change in control.

The FSA must be informed immediately of any material changes to the information provided in the Form, and of any information provided which may be false, misleading, incomplete or inaccurate, which becomes known before the notification has been determined, as required by SUP 11.3.10D. All such information must be communicated to the FSA by the controller submitting the Form. Failure to inform the FSA may result in a delay in processing and/or objection to the change in control.

The Form consists of Sections 1 to 6 which are required as follows:

Section	When required
Section 1 Details of the proposed change in control	In all cases
Section 2 Information required from corporate controllers	Controller is a body corporate and is not an authorised person
Section 3 Information required from partnership controllers	Controller is partnership and is not an authorised person
Section 4 Information required from individual controllers	Controller is an individual and is not an authorised person
Section 5 Joint notifications	Joint notifications by more than one controller or controller and firm(s)
Section 6 Supplementary information	In all cases if appropriate

SECTION 1 - DETAILS OF THE PROPOSED CHANGE IN CONTROL

1.01 The events to be notified using the Form are any of the following concerning a firm:

- (1) a person acquiring control or ceasing to have control;
- (2) an existing controller acquiring an additional kind of control or ceasing to have a kind of control;
- (3) an existing controller increasing or decreasing a kind of control which he already has such that the percentage of shares or voting power concerned becomes or ceases to be equal to or greater than 20, 33 or 50; and
- (4) an existing controller becoming or ceasing to be a parent undertaking.

"Kind of control" in (2) and (3) above means:

- (a) control arising as a result of holding shares in the firm;
- (b) control arising as a result of holding shares in the parent undertaking of the firm;
- (c) control arising as a result of the entitlement to exercise or control the exercise of voting power in the firm;
- (d) control arising as a result of the entitlement to exercise or control the exercise of voting power in the parent undertaking of the firm;

in accordance with section 179 (4) of the Financial Services and Markets Act 2000 and the Glossary.

The percentages of control held and to be held after the event must be calculated having regard to the definition of "controller" in the Glossary and the guidance in SUP 11 Annex 2G.

1.03 If a controller proposes any significant changes to the firm, for instance to its regulated activities, business plan or strategy, the firm and/or controller or proposed controller may be requested to provide a business plan. For a firm that is an insurer, such a plan would comprise a scheme of operations in accordance with SUP App 2.

It may be appropriate to ask the FSA whether a business plan will be required before submitting this notification, to avoid any delay in the FSA deciding to approve the change in control.

SECTION 4 - INFORMATION REQUIRED FROM INDIVIDUAL CONTROLLERS

Individual controllers are reminded that they must submit the information required in Controllers Form B in addition to the information required in this Form.

SECTION 5 – JOINT NOTIFICATIONS

A firm and its controller or proposed controller may discharge an obligation to notify the FSA by submitting a single joint notification containing the information required from the firm and the controller or proposed controller. In this case, Controllers Form A may be used to submit a notification on behalf of both the firm and the controller or proposed controller.

If a person is proposing a change in control over more than one firm within a group, then the controller or proposed controller may submit a single notification in respect of all those firms. The notification should contain all the required information as if separate notifications had been made, but information and documentation need not be duplicated.

When an event occurs (for example, a group restructuring or a merger) as a result of which:

- (1) more than one firm in a group would undergo a change in control; or
- (2) a single firm would experience more than one change in control;

then, to avoid duplication of documentation, all the firms and their controllers or proposed controllers may discharge their respective obligations to notify the FSA by submitting a single notification containing one set of information.

In a joint notification:

- the information requirements from each firm (as set out in SUP 11.5.1R) are satisfied by completion of
 - 1.01 and 1.02 of Section 1
 - Section 6
 - (in the case of a body corporate controller which is an authorised person) 2.01, 2.06 and 2.07 of Section 2;
- Section 1 must be completed;
- depending on the type of controller or proposed controller, Section 2, 3 or 4 must be completed by each controller or proposed controller;
- Section 5 must be completed;
- Section 6 should be completed if appropriate;
- the declaration and signature should be completed by each firm, controller or proposed controller submitting the joint notification.

SECTION 6 – SUPPLEMENTARY INFORMATION

This section provides space for any additional information required.

Relevant supporting documentation must also be provided.

DECLARATION AND SIGNATURE

In the case of a joint notification, the declaration and signature should be completed by each firm, controller or proposed controller (using photocopies if necessary).

For a controller or proposed controller, the signatory to this Form should be:

Capacity in which control to be held	Signatory
As an individual	that individual
As a body corporate	an individual who is a director (if Controllers Form B is submitted in relation to directors, one of those directors should sign)
As a partnership	a partner (if Controllers Form B is submitted in relation to partners, one of those partners should sign)

If the Form is submitted by a firm, see SUP 15.7.3G in chapter 15 of the Supervision manual regarding authorisation of signatory.

PLEASE RETURN THE COMPLETED FORM TO:

THE FINANCIAL SERVICES AUTHORITY
25 THE NORTH COLONNADE
CANARY WHARF
LONDON E14 5HS
UNITED KINGDOM

The Form should be marked for the attention of the relevant firm's usual supervisory contact at the FSA; if known, please include the name of the contact.

1.01 Enter the following details of the firm to which the change in control relates.

If the change in control relates to more than one firm, enter the following details for each firm (SEE NOTE)

	FSA Firm Reference Number	Name of firm	% of control currently held	% of control to be held after the event (SEE NOTE)
a				
b				
c				
d				
e				
f				
g				
h				
i				
j				
k				

Continue in Section 6 if necessary



I have supplied further information related to this page in Section 6

YES

NO

- 1.02 Corporate structure charts must be provided (and any accompanying explanations) showing the position both before and after the event. The charts must clearly show the following matters:
- i) the name(s) of the controller(s);
 - ii) the name(s) of the firm(s);
 - iii) the percentage of shares to be held in the firm(s) or its/their parent undertakings before and after the event;
 - iv) the percentage of voting power to be exercised (or controlled) in the firm(s) or its/their parent undertakings before and after the event;
 - (v) whether the control proposed will be held directly or through associates (as defined within the definition of controller in the Glossary); and
 - (vi) (if relevant) whether the control arises from the ability to exercise a significant influence over the firm(s) or its/their parent undertakings.

1.03 Does the controller intend to make any significant changes to the firm's or firms' regulated activities, business plan or strategy as a result of the change in control (SEE NOTE)?

YES NO

(All firms listed in 1.01 must be considered.)

Firm	Proposed changes



I have supplied further information related to this page in Section 6

YES

NO

1.04 Does the controller intend any restructuring either in terms of the legal form of the firm(s) or in its/their borrowings, capital restructuring or financing arrangements?

YES NO

(All firms listed in 1.01 must be considered.)

Firm	Proposed changes



I have supplied further information related to this page in Section 6

YES NO

- 1.05 Is the controller:
- (a) authorised in another EEA State as an ISD investment firm or a BCD credit institution or pursuant to the Insurance Directives? YES NO
- (b) a parent undertaking or 50% controller of such an authorised entity? YES NO

If so, give details

- 1.06 In the case of a share acquisition or similar, how is this to be financed?

- 1.07 Does the controller have any interests which may conflict with its role as a controller of the firm? YES NO

If yes, provide details in section 6



I have supplied further information related to this page in Section 6

YES NO

For corporate controllers which are not authorised persons

2.01 Name

2.02 Registered number (or equivalent if incorporated outside the United Kingdom)

2.03 Place of incorporation

2.04 Registered office address

2.05 Location of head office (if different from registered office)

2.06 Directors

	Full name	Date of birth	Title (eg Chief Executive)	Executive/ Non-executive	
a	<input type="text"/>	<input type="text"/>	<input type="text"/>	Executive <input type="checkbox"/> Non-executive <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/>
b	<input type="text"/>	<input type="text"/>	<input type="text"/>	Executive <input type="checkbox"/> Non-executive <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/>
c	<input type="text"/>	<input type="text"/>	<input type="text"/>	Executive <input type="checkbox"/> Non-executive <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/>
d	<input type="text"/>	<input type="text"/>	<input type="text"/>	Executive <input type="checkbox"/> Non-executive <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/>
e	<input type="text"/>	<input type="text"/>	<input type="text"/>	Executive <input type="checkbox"/> Non-executive <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/>
f	<input type="text"/>	<input type="text"/>	<input type="text"/>	Executive <input type="checkbox"/> Non-executive <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/>
g	<input type="text"/>	<input type="text"/>	<input type="text"/>	Executive <input type="checkbox"/> Non-executive <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/>
h	<input type="text"/>	<input type="text"/>	<input type="text"/>	Executive <input type="checkbox"/> Non-executive <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/>

Continue in section 6 if necessary



I have supplied further information related to this page in Section 6

YES

NO

2.07 List all controllers of the corporate controller
(unless this has been provided in 1.02 in which case a cross reference to 1.02 is sufficient).

[Redacted area]

2.08 Details of any litigation (or known circumstances which might give rise to litigation) against the corporate controller currently outstanding or that has occurred in the last five years, except cases arising in the course of normal business activities.

[Redacted area]

2.09 a Is the corporate controller a regulated financial services provider? YES NO

b If yes, state name of regulator. [Redacted area]

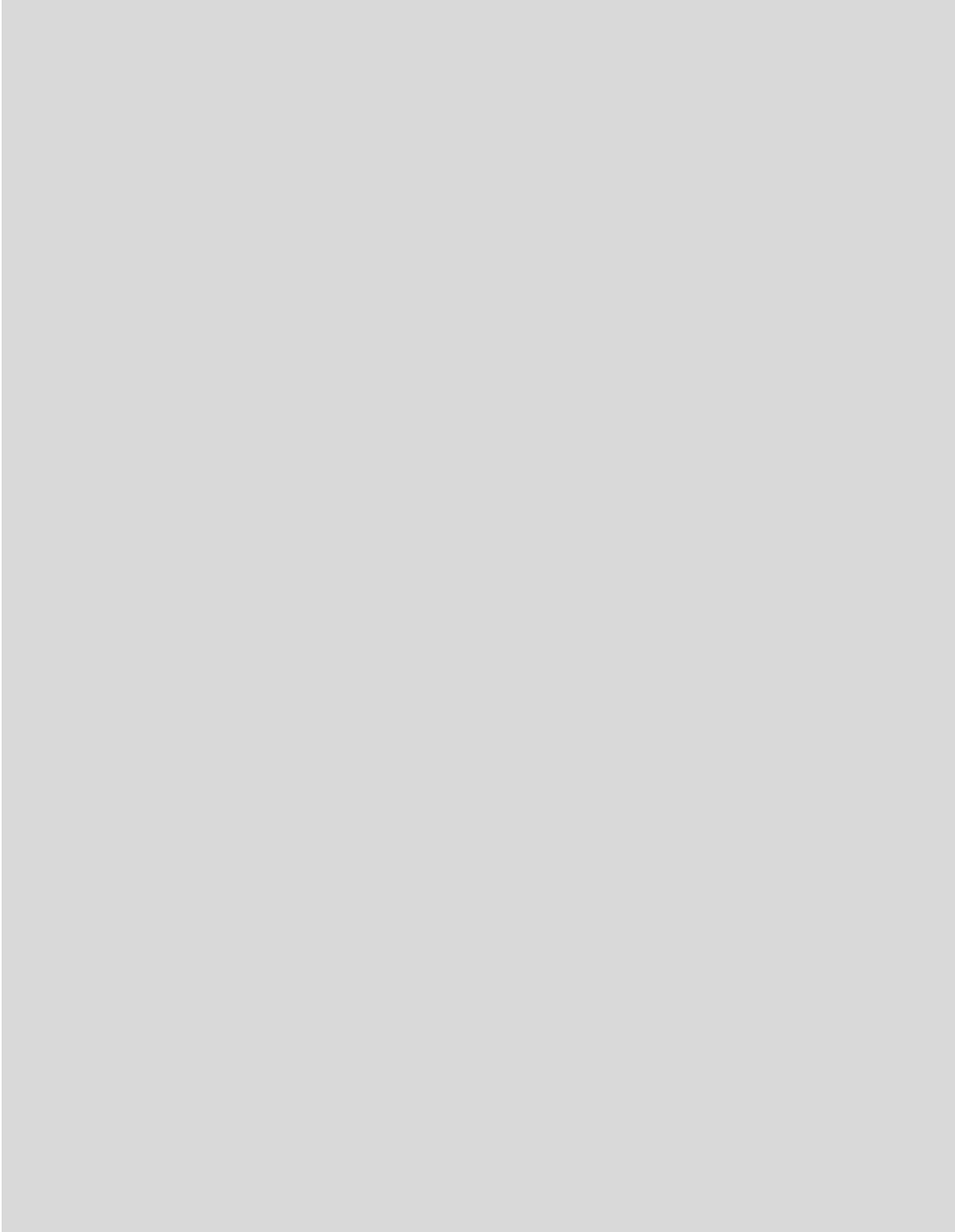


I have supplied further information related to this page in Section 6 YES NO

2.10 Provide details of the corporate controller's financial standing. This must, as a minimum, include details of the controller's solvency and, in relation to the adequacy of the firm's or firms' resources for the purposes of threshold condition 4 (Adequate resources), of:

- (i) the effect that the corporate controller's membership of the firm's or firms' group will have; and
- (ii) if appropriate, how the group will satisfy the FSA's consolidated financial supervision requirements.

Relevant supporting documentation must also be provided.



I have supplied further information related to this page in Section 6

YES

NO

2.11 List all other undertakings which the corporate controller controls (see definition of controller).
 (This information may be provided in an organisation chart)

	Name of undertaking	Business of undertaking	% control
a	Authorised persons (ie authorised under the Financial Services and Markets Act 2000)		
b	Undertakings authorised in another EEA State (other than those included above)		



I have supplied further information related to this page in Section 6

YES

NO

		Name of undertaking	Business of undertaking	% control
2.11 c	Undertakings authorised outside the EEA (other than those included above)			
d	Other bodies corporate, partnerships and unincorporated associations			



I have supplied further information related to this page in Section 6

YES

NO

For partnership controllers which are not authorised persons

3.01 Name

3.02 Registered number (if applicable)

3.03 Law under which the partnership is formed

3.04 Partnership head office address

3.05 Partners

	Full name	Date of birth	Title	Status
a	<input type="text"/>	<input type="text"/>	<input type="text"/>	Equity <input type="checkbox"/> Salaried <input type="checkbox"/> Limited partner <input type="checkbox"/> General partner <input type="checkbox"/>
b	<input type="text"/>	<input type="text"/>	<input type="text"/>	Equity <input type="checkbox"/> Salaried <input type="checkbox"/> Limited partner <input type="checkbox"/> General partner <input type="checkbox"/>
c	<input type="text"/>	<input type="text"/>	<input type="text"/>	Equity <input type="checkbox"/> Salaried <input type="checkbox"/> Limited partner <input type="checkbox"/> General partner <input type="checkbox"/>
d	<input type="text"/>	<input type="text"/>	<input type="text"/>	Equity <input type="checkbox"/> Salaried <input type="checkbox"/> Limited partner <input type="checkbox"/> General partner <input type="checkbox"/>
e	<input type="text"/>	<input type="text"/>	<input type="text"/>	Equity <input type="checkbox"/> Salaried <input type="checkbox"/> Limited partner <input type="checkbox"/> General partner <input type="checkbox"/>
f	<input type="text"/>	<input type="text"/>	<input type="text"/>	Equity <input type="checkbox"/> Salaried <input type="checkbox"/> Limited partner <input type="checkbox"/> General partner <input type="checkbox"/>

Continue in section 6 if necessary



I have supplied further information related to this page in Section 6

YES

NO

3.06 Details of any litigation (or known circumstances which might give rise to litigation) against the controller currently outstanding or that has occurred in the last five years, except cases arising in the course of normal business activities.

3.07 a Is the controller a regulated financial services provider? YES NO

b If yes, state name of regulator.

3.08 Provide details of the partnership controller's financial standing. This must, as a minimum, include details of the controller's solvency and, in relation to the adequacy of the firm's or firms' resources for the purposes of threshold condition 4 (Adequate resources), of:

- (i) the effect that the partnership controller's membership of the firm's or firms' group will have; and
- (ii) if appropriate, how the group will satisfy the FSA's consolidated financial supervision requirements.

Relevant supporting documentation must also be provided.



I have supplied further information related to this page in Section 6

YES

NO

3.09 List all other undertakings which the partnership controller controls (see definition of controller).
 (This information may be provided in an organisation chart)

	Name of undertaking	Business of undertaking	% control
a	Authorised persons (ie authorised under the Financial Services and Markets Act 2000)		
b	Undertakings authorised in another EEA State (other than those included above)		



I have supplied further information related to this page in Section 6

YES

NO

		Name of undertaking	Business of undertaking	% control
3.09 c	Undertakings authorised outside the EEA (other than those included above)			
d	Other bodies corporate, partnerships and unincorporated associations			



I have supplied further information related to this page in Section 6

YES

NO

For individual controllers who are not authorised persons (SEE NOTE)

4.01 Name

4.02 a Is the individual controller a regulated financial services provider? YES NO

b If yes, state name of regulator.

4.03 List all other undertakings which the individual controller controls (see definition of controller).
(This information may be provided in an organisation chart)

	Name of undertaking	Business of undertaking	% control
a	Authorised persons (ie authorised under the Financial Services and Markets Act 2000)	<input type="text"/>	<input type="text"/>
		<input type="text"/>	<input type="text"/>
		<input type="text"/>	<input type="text"/>
		<input type="text"/>	<input type="text"/>
		<input type="text"/>	<input type="text"/>
		<input type="text"/>	<input type="text"/>
b	Undertakings authorised in another EEA State (other than those included above)	<input type="text"/>	<input type="text"/>
		<input type="text"/>	<input type="text"/>
		<input type="text"/>	<input type="text"/>
		<input type="text"/>	<input type="text"/>
		<input type="text"/>	<input type="text"/>
		<input type="text"/>	<input type="text"/>



I have supplied further information related to this page in Section 6 YES NO

	Name of undertaking	Business of undertaking	% control
4.03 c	Undertakings authorised outside the EEA (other than those included above)		
d	Other bodies corporate, partnerships and unincorporated associations		



I have supplied further information related to this page in Section 6

YES

NO

If this notification is a joint notification (SEE NOTE) list below the controllers, proposed controllers and firms submitting this notification.

5.01 a Controllers and proposed controllers

b Firms (If this information is identical to that provided in 1.01, the information may be cross referenced and need not be duplicated)

Firms	FSA Firm Reference Number



I have supplied further information related to this page in Section 6

YES NO

Please complete questions 6.02 and 6.03

6.01 Include any additional information from previous sections below.

Three pages are provided, but if there is still insufficient space, please continue on a separate sheet of paper, and clearly identify the section and question to which the additional information relates.

Question	Additional information

Question	Additional information

Question	Additional information

6.02 Is the controller firm submitting the Form aware of any other information relevant to this notification of change in control of which the FSA would reasonably expect notice, including information which could have a material impact on any of the approval requirements described in section 186(3) of the Act (see SUP 11.7.5G)?

YES

NO

If yes, provide details below or on a separate sheet of paper

A large, solid grey rectangular area intended for providing details if the answer to question 6.02 is 'yes'. It occupies the majority of the page's vertical space below the question.

6.03 How many additional sheets are being submitted?

A small, solid grey rectangular area intended for providing the number of additional sheets being submitted.

SEE NOTE

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000).

It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that the information in the Form is accurate and complete to the best of my knowledge and belief and that I have read the notes to the Form.

I authorise the FSA to make such enquiries and seek such further information as it thinks appropriate in the course of verifying the information given in the Form.

Full name

Position

Signature

On behalf of
(name of firm, controller or proposed controller)

If on behalf of a firm or an authorised controller or proposed controller, FSA Firm Reference Number

Date of signature

Note : Please detach and keep the notes before returning the completed Form to the FSA.



Notification number
(for FSA use only)

Controllers Form B

Information in respect of directors, partners and individuals

FSA Handbook Reference: SUP 11 Annex 5D

30 April 2001

Name of individual

The Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS
United Kingdom
Telephone +44 (0) 20 7676 1000
Facsimile +44 (0) 20 7676 1099
Website <http://www.fsa.gov.uk>

Registered as a Limited Company in England and Wales No 1920623. Registered Office as above

Notes for Controllers Form B

Information in respect of directors, partners and individuals

Rules and guidance on changes in control of a firm are contained in chapter 11 of the Supervision manual.

Photocopies of the Form, or any relevant part of the Form, may be used. The Form is available on the FSA's website at www.fsa.gov.uk and downloaded copies may be completed and submitted.

The purpose of this Form

This is the Controllers Form B referred to in SUP 11.3.7D and SUP 11.3.8D of chapter 11 of the FSA's Supervision manual. The information in the Form is required from a controller or potential controller in relation to individuals as set out in SUP 11.3.8D. As indicated in SUP 11.3.9D, if the relevant individual has previously submitted the Form, then the information required in the Form need not be submitted in relation to that individual but the FSA requires details of any changes in the information previously submitted, or confirmation that there are no such changes. The information in the Form is not required from the firm in respect of which the change in control is to occur.

Completing this Form

The Form should be completed in black ink and (if in manuscript) in BLOCK CAPITALS.

All dates should be written in a dd/mm/yyyy format (e.g. 29/02/2000 for 29 February 2000) unless otherwise indicated on the Form.

Indicate clearly if a question is not applicable. Tick the appropriate box where a yes/no answer is required. Further details should be given in section 5 (supplementary information) if there is insufficient space for a detailed answer.

Additional information can be attached to the Form. It should be securely attached to the rest of the Form and you should indicate at question 5.03 the number of additional sheets attached.

Do not assume that information is known to the FSA merely because it is in the public domain, or has previously been disclosed to the FSA or to another regulatory body. In all circumstances, disclosures should be full, frank and unambiguous. If there is any doubt about the relevance of information, it should be included. If the FSA's checks reveal any matters that have not been disclosed this may result in a delay in processing and/or objection to the change in control.

Expressions in this Form in italics have the meaning given in the Glossary to the FSA's Handbook (or, if no meaning is given there, are to be interpreted in accordance with the related expression defined in the Glossary).

The controller or proposed controller submitting the Form is responsible for the accuracy of the data and completion of the Form. If the Form is not fully and correctly completed, the FSA may need to return it for proper completion. This could significantly delay the FSA's decision on whether to grant approval for the change in control.

The FSA may require a controller or proposed controller to provide further information at any time after receiving a notification and before determining whether or not to approve the change in control.

The FSA must be informed immediately of any material changes to the information provided in the Form, and of any information provided which may be false, misleading, incomplete or inaccurate, which become known before the notification has been determined, as required by SUP 11.3.10D. All changes must be communicated to the FSA by the controller submitting the Form. Failure to inform the FSA may result in a delay in processing and/or objection to the change in control.

SECTION 1 – PERSONAL IDENTIFICATION DETAILS

- 1.07 & 1.10 If the individual has more than one previous name (surname or forenames), passport number or nationality, or is known by any other names, provide details in section 5.
- 1.13 United Kingdom addresses must be given, or a statement stating that the individual resides abroad.

SECTION 2 – EMPLOYMENT HISTORY FOR PAST 10 YEARS

A full ten-year employment history must be provided – with all gaps explained. If the record of employment does not go back ten years, all periods of education and unemployment must be indicated. Full details of any periods of self-employment must be included.

The employment history must be provided in reverse chronological order, starting with the most recent period of employment, unemployment etc.

- 2.01 Always give the address of the actual place of employment, rather than a central head office.

“Regulatory body” in this context means the bodies listed in the Notes to section 3 below.

State the position held and a brief explanation of the individual’s duties. If the individual’s job title included the word “director” but his duties did not include those associated with the title of director, as defined in the Glossary, this should be indicated.

The reason for leaving each employer must be given. If there were any issues arising on leaving, these must be fully explained in section 5. Previous employers may be contacted and omission of relevant details may result in a delay in processing and/or possible objection to the change in control.

SECTION 3 – FITNESS AND PROPRIETY

Answer the question by ticking the relevant ‘yes’ or ‘no’ box. If the answer to any of the questions is ‘yes’, give complete details in section 5 and attach relevant supporting documentation.

- 3.03 to 3.06 Any outstanding county court judgements (e.g. CCJs) or arrangements (e.g. IVAs) with creditors must be listed in section 5, and the circumstances surrounding them explained.

- 3.11 & 3.12(d) “Regulatory body” in this context refers to:

- i) the SROs including IMRO, SFA, PIA, LAUTRO and FIMBRA;
- ii) the statutory bodies including the FSA, SIB, the Society of Lloyd’s, the Registry of Friendly Societies, the Friendly Societies Commission, the Building Societies Commission, the Bank of England, HM Treasury – Insurance Directorate (formerly of the DTI) and the recognised bodies;
- iii) the designated professional bodies; and
- iv) the equivalent of all such regulators overseas.

SECTION 5 – SUPPLEMENTARY INFORMATION

This section provides space for any additional information and should be used whenever a question in sections 3 or 4 is answered ‘yes’.

Relevant supporting documentation must also be provided.

SECTION 6 – DECLARATIONS AND SIGNATURES

This section contains declarations which should be signed both by the individual whose details are given in the Form and by the controller or proposed controller.

6.05(b) Indicate whether you are signing this Form in your capacity as a chief executive (or equivalent), director, managing partner (or equivalent), partner or other of a controller or proposed controller which is a legal entity. If other, specify.

6.06 This is the name of the firm which is the subject of the change in control.

6.07 to 6.12 For a controller or proposed controller, the signatory to this Form should be:

Capacity in which control to be held	Signatory
As a body corporate	an individual who is a director and is a person in relation to whom a Controllers Form B is submitted
As a partner in a partnership or as a partnership	a partner in relation to whom a Controllers Form B is submitted

If the controller or proposed controller is an individual, that individual need not complete 6.07-6.12.

If you have any queries or need additional information, please contact the relevant firm's usual supervisory contact.

PLEASE RETURN THE COMPLETED FORM TO:

THE FINANCIAL SERVICES AUTHORITY
25 THE NORTH COLONNADE
CANARY WHARF
LONDON E14 5HS
UNITED KINGDOM

The Form should be marked for the attention of the relevant firm's usual supervisory contact at the FSA; if known, please include the name of the contact.

1.01	Title (e.g. Mr, Mrs, Ms, etc)			
1.02	Surname			
1.03	ALL forenames			
1.04	Name commonly known by			
1.05	Date of birth			
1.06	National Insurance number			
1.07	Previous name SEE NOTE			
1.08	Date of change			
1.09	Reason for change			
1.10	Nationality SEE NOTE			
1.11	Passport number (if National Insurance number not available -SEE NOTE)			
1.12	Place of birth			
1.13 a	Private address			
	b		Postcode	
	c	Dates resident at this address (mm/yyyy)	From	To PRESENT

(If address has changed in the last three years, please provide addresses for the previous three years.)



I have supplied further information related to this page in Section 5

YES

NO

1.14 a Previous address 1

[Redacted address details]

b

Postcode

c Dates resident at this address (mm/yyyy)

From

[Redacted start date]

To

[Redacted end date]

1.15 a Previous address 2

[Redacted address details]

b

Postcode

c Dates resident at this address (mm/yyyy)

From

[Redacted start date]

To

[Redacted end date]

1.16 Details of professional qualifications and membership of any trade or professional body

[Redacted professional qualifications and membership details]



I have supplied further information related to this page in Section 5

YES

NO

Note: ALL gaps must be accounted for (SEE NOTE)

2.01 Employment details (1)

a Period (mm/yyyy) From To

b Nature of employment

a	Employed	<input type="checkbox"/>
b	Self-employed	<input type="checkbox"/>
c	Unemployed	<input type="checkbox"/>
d	Full-time education	<input type="checkbox"/>

If b, c, or d is ticked, please give details

c Name of employer

d Nature of business

e Previous / other names of employer

f Last known address of employer
SEE NOTE

g Is/was employer regulated by a regulatory body? SEE NOTE YES NO Name of regulatory body

h Is/was employer an appointed representative? YES NO If yes, of which firm?

i Position held
SEE NOTE

j Responsibilities

k Reason for leaving:
SEE NOTE

a	Resignation	<input type="checkbox"/>
b	Redundancy	<input type="checkbox"/>
c	Retirement	<input type="checkbox"/>
d	Termination/dismissal	<input type="checkbox"/>
e	End of contract	<input type="checkbox"/>
f	Other	<input type="checkbox"/>

If 'Other': specify



I have supplied further information related to this page in Section 5 YES NO

2.02 Employment details (2)

a Period (mm/yyyy) From To

b Nature of employment

a	Employed	<input type="checkbox"/>
b	Self-employed	<input type="checkbox"/>
c	Unemployed	<input type="checkbox"/>
d	Full-time education	<input type="checkbox"/>

If b, c, or d is ticked, please give details

c Name of employer

d Nature of business

e Previous / other names of employer

f Last known address of employer
SEE NOTE

g Is/was employer regulated by a regulatory body? SEE NOTE YES NO Name of regulatory body

h Is/was employer an appointed representative? YES NO If yes, of which firm?

i Position held
SEE NOTE

j Responsibilities

k Reason for leaving:
SEE NOTE

a	Resignation	<input type="checkbox"/>
b	Redundancy	<input type="checkbox"/>
c	Retirement	<input type="checkbox"/>
d	Termination/dismissal	<input type="checkbox"/>
e	End of contract	<input type="checkbox"/>
f	Other	<input type="checkbox"/>

If 'Other': specify



I have supplied further information related to this page in Section 5

YES

NO

2.03 Employment details (3)

a Period (mm/yyyy) From To

b Nature of employment

a	Employed	<input type="checkbox"/>
b	Self-employed	<input type="checkbox"/>
c	Unemployed	<input type="checkbox"/>
d	Full-time education	<input type="checkbox"/>

If b, c, or d is ticked, please give details

c Name of employer

d Nature of business

e Previous / other names of employer

f Last known address of employer
SEE NOTE

g Is/was employer regulated by a regulatory body? SEE NOTE YES NO Name of regulatory body

h Is/was employer an appointed representative? YES NO If yes, of which firm?

i Position held
SEE NOTE

j Responsibilities

k Reason for leaving:
SEE NOTE

a	Resignation	<input type="checkbox"/>
b	Redundancy	<input type="checkbox"/>
c	Retirement	<input type="checkbox"/>
d	Termination/dismissal	<input type="checkbox"/>
e	End of contract	<input type="checkbox"/>
f	Other	<input type="checkbox"/>

If 'Other': specify



I have supplied further information related to this page in Section 5 YES NO

2.04 Employment details (4)

a Period (mm/yyyy) From To

b Nature of employment

a	Employed	<input type="checkbox"/>
b	Self-employed	<input type="checkbox"/>
c	Unemployed	<input type="checkbox"/>
d	Full-time education	<input type="checkbox"/>

If b, c, or d is ticked, please give details

c Name of employer

d Nature of business

e Previous / other names of employer

f Last known address of employer
SEE NOTE

g Is/was employer regulated by a regulatory body? SEE NOTE YES NO Name of regulatory body

h Is/was employer an appointed representative? YES NO If yes, of which firm?

i Position held
SEE NOTE

j Responsibilities

k Reason for leaving:
SEE NOTE

a	Resignation	<input type="checkbox"/>
b	Redundancy	<input type="checkbox"/>
c	Retirement	<input type="checkbox"/>
d	Termination/dismissal	<input type="checkbox"/>
e	End of contract	<input type="checkbox"/>
f	Other	<input type="checkbox"/>

If 'Other': specify



I have supplied further information related to this page in Section 5 YES NO

2.05 Employment details (5)

a Period (mm/yyyy) From To

b Nature of employment

a	Employed	<input type="checkbox"/>
b	Self-employed	<input type="checkbox"/>
c	Unemployed	<input type="checkbox"/>
d	Full-time education	<input type="checkbox"/>

If b, c, or d is ticked, please give details

c Name of employer

d Nature of business

e Previous / other names of employer

f Last known address of employer
SEE NOTE

g Is/was employer regulated by a regulatory body? SEE NOTE YES NO Name of regulatory body

h Is/was employer an appointed representative? YES NO If yes, of which firm?

i Position held
SEE NOTE

j Responsibilities

k Reason for leaving:
SEE NOTE

a	Resignation	<input type="checkbox"/>
b	Redundancy	<input type="checkbox"/>
c	Retirement	<input type="checkbox"/>
d	Termination/dismissal	<input type="checkbox"/>
e	End of contract	<input type="checkbox"/>
f	Other	<input type="checkbox"/>

If 'Other': specify

If necessary, please continue in section 6.



I have supplied further information related to this page in Section 5 YES NO

- 3.01 a Has the individual ever been convicted of any offence involving fraud, theft, false accounting or other dishonesty or an offence (whether or not in the United Kingdom) relating to companies, building societies, industrial and provident societies, credit unions, friendly societies, insurance, banking or other financial services, insolvency, consumer credit or consumer protection, money laundering, market manipulations or insider dealing? (Convictions spent under the Rehabilitation of Offenders Act 1974 must be included) YES NO
- b Is the individual the subject of any current criminal proceedings? YES NO
- 3.02 Has the individual any convictions for any offences other than those listed in 3.01 above which are not spent, whether or not in the United Kingdom (excluding traffic offences unless these resulted in a ban from driving or involved driving without insurance)? YES NO
- 3.03 a Is the individual, or has the individual ever been, the subject of any civil proceedings, arbitration or litigation, including proceedings that may lead to a County Court Judgement (“CCJ”) or other judgement debts, in the United Kingdom or elsewhere? YES NO
- b Is the individual aware of any intention to begin such proceedings against the individual in the future? YES NO
- 3.04 Does the individual have any judgement debts (including CCJs) made under a court order still outstanding, whether in full or in part? YES NO
- 3.05 Has the individual ever failed to satisfy any such judgement debts within one year of the making of the order? YES NO
- 3.06 a Is the individual, or has the individual ever been, the subject of any bankruptcy proceedings, or proceedings for the sequestration of the individual’s estate? YES NO
- b Has the individual ever entered into a deed of arrangement or an individual voluntary arrangement (or in Scotland a trust deed) or other agreement in favour of the individual’s creditors, or is the individual doing so? YES NO
- 3.07 Does the individual or any undertaking under the management of the individual have any outstanding financial obligations arising from regulated activities conducted in the past, whether in the United Kingdom or overseas? YES NO
- 3.08 Has the individual or any undertaking under the management of the individual ever been found guilty of conducting any unauthorised regulated activities or been investigated for possible conduct of unauthorised regulated activities? YES NO
- 3.09 Is the individual, or has the individual ever been, the subject of an investigation into allegations of misconduct or malpractice in connection with any business activity? YES NO
- 3.10 Has the individual ever, either in the United Kingdom , or elsewhere –
 - a been refused entry to, or been dismissed or requested to resign from, any profession, vocation, office or employment, or from any fiduciary office or position of trust, whether or not remunerated? YES NO
 - b been refused, restricted in, or had suspended, the right to carry on any trade, business or profession for which specific licence, authorisation, registration, membership or other permission is required? YES NO



I have supplied further information related to this page in Section 5 YES NO

c	been disqualified by a court from acting as a director of a company or from acting in a management capacity or conducting the affairs of any company, partnership or unincorporated association?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
d	been the subject of a disqualification direction under section 59 of the Financial Services Act 1986 or a prohibition order, under section 56 of the Financial Services and Markets Act 2000, or received a warning notice to make such a direction or order?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
3.11	In respect of activities regulated by the FSA or any other regulatory body (see note), has the individual, or has any company, partnership or unincorporated association of which the individual is or has been a controller, director, senior manager, partner or company secretary, during the individual's association with that entity and for a period of three years after the individual ceased to be associated with it, ever –		
a	been refused, had revoked, restricted or terminated, any licence, authorisation, registration, notification, membership or other permission granted by any such body ?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
b	been criticised, censured, disciplined, suspended, expelled, fined, or been the subject of any other disciplinary or intervention action by any such body ?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
c	resigned whilst under investigation by, or been required to resign from, any such body ?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
d	decided, after making an application for any licence, authorisation, registration, notification, membership or other permission granted by any such body, not to proceed with it?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
e	been the subject of any civil action which has resulted in a finding against the individual or it by a court?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
3.12	Has any company, partnership, or unincorporated association of which the individual is or has been a controller, director, senior manager, partner, or company secretary, in the United Kingdom or elsewhere, at any time during the individual's involvement or within one year of such an involvement –		
a	been put into liquidation, wound up, ceased trading, had a receiver or administrator appointed or entered into any voluntary arrangement with its creditors?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
b	been adjudged by a court liable for any fraud, misfeasance, wrongful trading or other misconduct?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
c	been investigated or been involved in an investigation by an inspector appointed under companies or any other legislation, or required to produce documents to the Secretary of State, or any other authority, under any such legislation?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
d	been convicted of any criminal offence, censured, disciplined or publicly criticised, by any inquiry, by the Takeover Panel or any governmental or statutory authority or any other regulatory body (other than as already indicated under 3.11(b) above)?	YES <input type="checkbox"/>	NO <input type="checkbox"/>



I have supplied further information related to this page in Section 5

YES

NO

4.01 Does the individual have any personal or business interests that may conflict with his role as a controller of the firm or, with respect to his capacity indicated in 6.04b, his position within the controlling entity?

YES NO

If yes, provide details in section 5.

4.02 Please list all UK and non-UK directorships held:

	Name of undertaking	Business of undertaking
a UK directorships		
b Non-UK directorships		



I have supplied further information related to this page in Section 5

YES NO

Please complete questions 5.02 and 5.03

5.01 Include any additional information from previous sections below.

Three pages are provided, but if there is still insufficient space, please continue on a separate sheet of paper, and clearly identify the section and question to which the additional information relates.

Question	Additional information

Question	Additional information

Question	Additional information

5.02 Is the individual submitting the Form aware of any other information relevant to this notification of change in control of which the FSA would reasonably expect notice, including information which could have a material impact on any of the approval requirements described in SUP 11.7.5G?

YES

NO

If yes, provide details below or on a separate sheet of paper.

A large, solid grey rectangular area intended for providing details if the answer to question 5.02 is 'YES'. It occupies the majority of the page's vertical space.

5.03 How many additional sheets are being submitted?

A small, solid grey rectangular area intended for providing the number of additional sheets being submitted.

DECLARATION OF INDIVIDUAL WHOSE DETAILS ARE GIVEN IN THE FORM

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000).

It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that the information in this Form is accurate and complete to the best of my knowledge and belief and that I have read the notes to this Form.

I authorise the FSA to make such enquiries and seek such further information as it thinks appropriate in the course of verifying the information given in this Form.

6.01 Full name

6.02 Signature

6.03 Date of signature

6.04 Are you a controller or proposed controller as an individual in your own right? YES NO

If NO

a State the name of the entity which is the controller or proposed controller of whose notification this Form is a part (and of each of them if more than one)

b State the capacity in which you are completing this Form (SEE NOTE)

6.05 a Name of authorised firm in respect of which this Form is being submitted (SEE NOTE)

b FRN number of firm (if known)

DECLARATION OF CONTROLLER OR PROPOSED CONTROLLER (if not an individual) (SEE NOTE)

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000).

It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body.

I confirm that the information in this Form is accurate and complete to the best of my knowledge and belief and that I have read the notes to this Form.

6.06	Full name	
6.07	Signature	
6.08	Date of signature	
6.09	Position	
6.10	On behalf of: (name of controller or proposed controller)	

Completion checklist

- Is the Form fully completed?

- Are ALL forenames included?

- Is there a complete ten-year employment history with all gaps explained?

- Is the Form correctly signed and dated?

- Has all supplementary information been included and clearly marked?

Note : Please detach and keep the notes before returning the completed Form to the FSA.

Chapter 12

Appointed representatives



12.1 Application and purpose

Application

- 12.1.1** **R** /1 (1) This chapter applies to a *firm* with *permission* to carry on *designated investment business* and which is considering appointing, has decided to appoint or has appointed an *appointed representative*.
- (2) The *rules*, and *guidance on rules*, in this chapter do not apply to a *UCITS qualifier*.

Purpose

- 12.1.2** **G** /1 This chapter gives *guidance* to a *firm*, which is considering appointing an *appointed representative*, on how the provisions of section 39 of the *Act* (Exemption of appointed representatives) work. For example, it gives *guidance* on the conditions that must be satisfied for a *person* to be appointed as an *appointed representative*. It also gives *guidance* to a *firm* on the implications, for the *firm* itself, of appointing an *appointed representative*.
- 12.1.3** **G** /1 The chapter also sets out the *FSA's rules*, and *guidance on these rules*, that apply to a *firm* before it appoints, when it appoints and when it has appointed an *appointed representative*. The main purpose of these *rules* is to place responsibility on a *firm* for seeking to ensure that:
- (1) its *appointed representatives* are fit and proper to deal with *clients* in its name; and
- (2) *clients* dealing with its *appointed representatives* are afforded the same level of protection as if they had dealt with the *firm* itself.
- 12.1.4** **G** /1 A separate leaflet will be produced to give *guidance* to *appointed representatives* themselves. For a copy of this leaflet (when available) please contact the Corporate Authorisation department (see *SUP 12.7.5G*).

12.2 Introduction

What is an appointed representative?

12.2.1

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/1

- (1) Under section 19 of the *Act* (The general prohibition), no *person* may carry on a *regulated activity* in the *United Kingdom*, or purport to do so, unless he is an *authorised person*, or he is an *exempt person* in relation to that activity.
- (2) A *person* will be an *exempt person* if he satisfies the conditions in section 39(1) of the *Act*, *guidance* on which is given in SUP 12.2.2G. A *person* who is exempt as a result of satisfying these conditions is referred to in the *Act* as an *appointed representative*.

12.2.2

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- (1) A *person* must satisfy the conditions in section 39(1) of the *Act* to become an *appointed representative*. These are that:
 - (a) the *person* must not be an *authorised person*, that is, he must not have *permission* under the *Act* to carry on any *regulated activity* in his own right (section 39(1) of the *Act*);
 - (b) the *person* must have entered into a contract with an *authorised person*, referred to in the *Act* as the '*principal*', which:
 - (i) permits or requires him to carry on business of a description prescribed in the *Appointed Representatives Regulations* (section 39(1)(a)(i) of the *Act*) (see SUP 12.2.7G); and
 - (ii) complies with any requirements that may be prescribed in the *Appointed Representatives Regulations* (section 39(1)(a)(ii) of the *Act*) (see SUP 12.5.2G); and
 - (c) the *principal* must have accepted responsibility, in writing, for the activities of the *person* in carrying on the whole, or part, of the business specified in the contract.
- (2) The *appointed representative* is an *exempt person* in relation to any *regulated activity* comprised in the carrying on of the business for which his *principal* has accepted responsibility.

12.2.3

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As long as the conditions in section 39 of the *Act* are satisfied, any *person*, other than an *authorised person*, may become an *appointed representative*, including a *body corporate*, a *partnership* or an individual in business on his own account. However, an *appointed representative* cannot be an *authorised person* under the *Act*; that is, it cannot be exempt for some *regulated activities* and *authorised* for others.

- 12.2.4** G_{/1} The *Act* and the *Appointed Representative Regulations* do not prevent an *appointed representative* from acting for more than one *principal*.
- 12.2.5** G_{/1} However, an *appointed representative* of a *provider firm* may only give *advice on investments* to a *private customer* concerning the purchase of a *packaged product* if it is issued by a *firm* in the *marketing group* or is an *adopted packaged product* (see SUP 12.5.6G).
- 12.2.6** G_{/1}
- (1) An *appointed representative* may be appointed by any *firm* with *permission* to carry on *designated investment business* of the type described in SUP 12.2.7G, including a *provider firm* or an *independent intermediary*.
 - (2) An *independent intermediary* is referred to as a '*network*' if it appoints five or more *appointed representatives* or if it appoints less than five *appointed representatives* which have, between them, twenty-six or more *financial advisers*.

Business for which an appointed representative is exempt

- 12.2.7** G_{/1} The *Appointed Representatives Regulations* are made by the Treasury under section 39(1) of the *Act*. These regulations describe, among other things, the business for which an *appointed representative* may be exempt, which is business which comprises any of:
- (1) *arranging (bringing about) deals in investments* or *making arrangements with a view to transactions in investments* (article 25 of the *Regulated Activities Order*) where the arrangements are for or with a view to transactions relating to *securities or contractually based investments*;
 - (2) *arranging safeguarding and administration of assets* (part of article 40 of the *Regulated Activities Order*);
 - (3) *advising on investments* (article 53 of the *Regulated Activities Order*); and
 - (4) *agreeing to carry on a regulated activity* (article 64 of the *Regulated Activities Order*) where the *regulated activity* is one of those in (1) to (3).

What is an introducer appointed representative?

- 12.2.8** G_{/1}
- (1) An *introducer appointed representative* is an *appointed representative* appointed by a *firm* whose scope of appointment must, under SUP 12.5.7R, be limited to:
 - (a) effecting introductions between *customers* and the *firm* or other members of the *firm's marketing group*; and
 - (b) distributing *non-real-time financial promotions approved* by the *firm* or other members of the *firm's marketing group* or the producer of an *adopted packaged product*.
 - (2) The permitted scope of appointment of an *introducer appointed representative* does not include *advising on investments* or other activity that might reasonably lead a *customer* to believe that he had received *advice on*

investments or that the *introducer appointed representative* is permitted to give *advice on investments*.

12.2.9

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- (1) To become an *introducer appointed representative*, a *person* must meet the conditions in the *Act* to become an *appointed representative* (see SUP 12.2.2G).
- (2) In considering the appointment of a *person* as an *introducer appointed representative*, a *firm* should have regard to the requirements in SUP 12.5.7R. In particular, these requirements mean that the *introducer appointed representative* cannot be an *appointed representative* for a member of another *marketing group*.

12.2.10

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All *rules* in SUP 12 apply in relation to *introducer appointed representatives* except for:

- (1) SUP 12.4.2R, on the appointment of *appointed representatives*, which is replaced by SUP 12.4.6R; and
- (2) SUP 12.5.5R on required contract terms, which is replaced by SUP 12.5.7R.

12.2.11

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If an *introducer appointed representative* is an individual in business on his own, then he will also be an *introducer* (see SUP 12.2.13G). This has certain implications in COB (see COB 5 (Advising and selling)).

Introducers, representatives and financial advisers: what do these terms mean and what is the relationship with an appointed representative?

12.2.12

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A *firm* or its *appointed representative* may appoint or employ individuals to act as *introducers*, *representatives* or *financial advisers* in respect of *designated investment business*.

12.2.13

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/1

- (1) An *introducer* is an individual appointed by a *provider firm* or by an *appointed representative* of such a *firm* to carry out, in the course of *designated investment business*, either or both of the following activities:
 - (a) effecting introductions;
 - (b) distributing *non-real-time financial promotions*.
- (2) An *introducer* is not an *exempt person* under section 39 of the *Act* (unless he is also an *introducer appointed representative*) and hence cannot benefit from the exemption to carry on *regulated activities* in his own right. As a result, an *introducer* that is not an *introducer appointed representative* works in the name of his *firm* or the *firm's appointed representative* but he does not fall within the scope of the *approved persons* regime as he does not, as such, perform a *controlled function*.
- (3) An *introducer* who is also an *introducer appointed representative* in his own right may need to be approved to perform the *sole trader function* (see SUP 12.6.8G and SUP 12.6.9G). Further, in these circumstances, in addition to complying with the requirements in SUP 12, the *firm* should ensure that the rules for *introducers* in COB 5 are complied with.

12.2.14

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- (1) A *representative* is an individual appointed by a *provider firm* or by an *appointed representative* of that *firm*, to carry out, in the course of *designated investment business*, either or both of the following activities:
 - (a) advising *customers* on the merits of *packaged products* offered by that *firm* (or any other *provider firm* within the same *marketing group*);
 - (b) *arranging (bringing about) deals in investments* in relation to such products.
- (2) If a *provider firm* appoints an *appointed representative* who is an individual in (1), that *appointed representative* will also be a *representative*. The individual must be approved to perform the *investment adviser function* or the *customer trading function* or both, and possibly also the *sole trader function* (see SUP 12.6.8G and SUP 12.6.9G). In these circumstances, in addition to complying with the requirements of SUP 12 and other regulatory requirements, the *firm* should ensure that the *rules* for *representatives* in COB 5 are complied with.

12.2.15

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- (1) A *financial adviser* is an individual appointed by an *independent intermediary* or by its *appointed representative* to provide any or all of the following services:
 - (a) *advising on investments* which are *designated investments*;
 - (b) *arranging (bringing about) deals in investments* or *executing* transactions involving, in each case, *designated investments* with or for *clients*;
 - (c) *managing investments*;
 - (d) receiving or holding *client money* or other *client* assets;
 - (e) *safeguarding and administering investments*.
- (2) Many of the activities for which an *appointed representative* can be appointed (see SUP 12.2.7G) are also within (1). If an *independent intermediary* appoints an *appointed representative* which is an individual in business on his own account, to perform such activities, that *appointed representative* will also be a *financial adviser*. The individual may need to be approved to perform *the sole trader function* and other relevant *controlled functions* (see SUP 12.6.8G and SUP 12.6.9G). Further, in these circumstances, in addition to complying with the requirements of SUP 12 and other regulatory requirements, the *firm* should ensure that the *rules* for *financial advisers* in COB 5 are complied with.



12.3 What responsibility does a firm have for its appointed representatives?

- 12.3.1** G_{/1} In determining whether a *firm* has complied with any provision in or under the *Act* such as any *Principle* or other *rule*, anything that an *appointed representative* has done or omitted to do as respects the business for which the *firm* has accepted responsibility will be treated as having been done or omitted to be done by the *firm* (section 39(4) of the *Act*).
- 12.3.2** G_{/1} The *firm* is responsible, to the same extent as if it had expressly permitted it, for anything the *appointed representative* does or omits to do, in carrying on the business for which the *firm* has accepted responsibility (section 39(3) of the *Act*).
- 12.3.3** G_{/1} In determining whether the *firm* has committed any *offence*, however, the knowledge or intentions of an *appointed representative* are not attributable to the *firm*, unless in all the circumstances it is reasonable for them to be attributed to it (section 39(6) of the *Act*).

12.4 What must a firm do when it appoints an appointed representative?

The permission that the firm needs

- 12.4.1 **R** ^{/1} A *firm* may only appoint an *appointed representative* to carry on *regulated activities* on its behalf if the *firm* has *permission* to carry on those *regulated activities*.

Appointment of an appointed representative (other than an introducer appointed representative)

- 12.4.2 **R** ^{/1} Before a *firm* appoints a *person* as an *appointed representative* (other than an *introducer appointed representative*) and on a continuing basis, it must take reasonable care to ensure that:
- (1) the appointment does not prevent the *firm* from satisfying and continuing to satisfy the *threshold conditions*;
 - (2) the *person*:
 - (a) is solvent;
 - (b) is suitable to act for the *firm* in that capacity;
 - (c) has no *close links* which would be likely to prevent the effective supervision of the *person* by the *firm*; and
 - (3) the *firm* has adequate:
 - (a) controls over the *person's regulated activities* for which the *firm* has responsibility (see SYSC 3.1); and
 - (b) resources to monitor and enforce compliance by the *person* with the relevant requirements applying to the *regulated activities* for which the *firm* is responsible and with which the *person* is required to comply under its contract with the *firm* (see SUP 12.5.3R(2)).

12.4.3 **G**_{/1} In assessing, under *SUP* 12.4.2R(2)(a) and (b), whether an *appointed representative* or prospective *appointed representative* is solvent and suitable, a *firm* should determine, among other matters, whether the *person* is likely to be adversely influenced by its financial position in the conduct of the business for which the *firm* is responsible. This might arise, for example, if the *person* has cashflow problems and is not able to service its debts. Guidance for *firms* on assessing the financial position of an *appointed representative* or prospective *appointed representative* is given in *SUP* 12 Ann 1G.

12.4.4 **G**_{/1} In assessing, under *SUP* 12.4.2R(2)(b), whether an *appointed representative* or prospective *appointed representative* is suitable to act for the *firm* in that capacity, a *firm* should consider:

- (1) whether the *person* is fit and proper; *guidance* on the information that *firms* should take reasonable steps to obtain and verify is given in *SUP* 12 Ann 2G; and
- (2) the fitness and propriety (including good character and competence) and financial standing of the *controllers, directors, partners, proprietors and managers* of the *person*; *firms* seeking *guidance* on the information which they should take reasonable steps to obtain and verify should refer to *FIT* and the questions in Form A (Application to perform controlled functions under the approved person regime) in *SUP* 10 Ann 4D.

12.4.5 **G**_{/1} In determining, under *SUP* 12.4.2R(2)(c), whether an *appointed representative* or prospective *appointed representative* has any *close links* which would be likely to prevent the *firm's* effective supervision, a *firm* should consider the *guidance* to *threshold condition 3* (Close links) in *COND* 2.3.

Appointment of an introducer appointed representative

12.4.6 **R**_{/1} Before a *firm* appoints a *person* as an *introducer appointed representative*, and on a continuing basis, it must take reasonable care to ensure that the *person* is suitable to act for the *firm* in that capacity (having regard, in particular, to other *persons* connected with the *person* who will be, or who are, directly responsible for its activities).

12.4.7 **G**_{/1} In assessing, under *SUP* 12.4.6R, whether an *introducer appointed representative* or prospective *introducer appointed representative* is suitable to act for the *firm* in that capacity, the *firm* should determine whether it and those *persons* who will be, or who are, directly responsible for its activities are of sufficiently good reputation and otherwise fit and proper for that appointment. The *firm* should, as a minimum, verify the identity of a prospective *introducer appointed representative* and relevant *persons* but need not carry out the more extensive due diligence required for the appointment of an *appointed representative* under *SUP* 12.4.2R.

12.4.8 **G**_{/1} If a *firm* has doubts that a prospective *introducer appointed representative* or other *person* is of sufficiently good reputation and otherwise fit and proper, the *FSA* will expect it to resolve those doubts before appointing the prospective *introducer appointed representative*. For example, if a *firm* is aware that a *person's* previous appointment as an *introducer appointed representative* or *representative* was terminated, it should take reasonable steps to find out the reasons for the termination and the extent to which those reasons reflect on the *person* concerned.

12.5 Contracts: required terms

Required contract terms for all appointed representatives

- 12.5.1** G_{/1} The *Appointed Representative Regulations* include, among other things, the prescribed requirements applying to contracts between *firms* and *appointed representatives* for the purposes of section 39(1)(a)(ii) of the *Act*.
- 12.5.2** G_{/1}
- (1) Regulation 3 of the *Appointed Representatives Regulations* makes it a requirement that the contract between the *firm* and the *appointed representative* (unless it prohibits the *appointed representative* from representing other counterparties) contains a provision enabling the *firm* to:
 - (a) impose such a requirement; or
 - (b) impose restrictions as to the other counterparties which the *appointed representative* may represent, or as to the types of *investment* in relation to which the *appointed representative* may represent other counterparties.
 - (2) Under the *Appointed Representative Regulations*, an *appointed representative* is treated as representing other counterparties if it:
 - (a) makes arrangements (within article 25 of the *Regulated Activities Order*) for *persons* to enter into investment transactions with other counterparties; or
 - (b) *arranges the safeguarding and administration of assets* by other counterparties; or
 - (c) gives *advice* on the merits of entering into investment transactions with other counterparties;

where an "investment transaction" means a transaction to *buy, sell*, subscribe for or underwrite a *security* or a *contractually based investment*.
- 12.5.3** G_{/1} A *firm* should satisfy itself that the terms of the contract with its *appointed representative* (including an *introducer appointed representative*):
- (1) are designed to enable the *firm* to comply properly with any *limitations* or *requirements* on its own *permission*;
 - (2) require the *appointed representative* to cooperate with the *FSA* as described in *SUP 2.3.4G* (Information gathering by the *FSA* on its own initiative: cooperation by firms) and give access to its premises, as described in *SUP 2.3.5R(2)*; and

- (3) require the *appointed representative* to give the *firm's* auditors the same rights as are provided by section 341 of the *Act*, as described in SUP 3.6.6G.

12.5.4

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A *firm* should have the ability to terminate the contract with its *appointed representative* in the circumstances in SUP 12.6.1R(2). However, such a termination provision should not be automatic (see SUP 12.8.3R(1)).

Required contract terms for an appointed representative (other than an introducer appointed representative)

12.5.5

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A *firm* must ensure that its written contract with each of its *appointed representatives* (other than *introducer appointed representatives*):

- (1) complies with the requirements prescribed in regulation 3 of the *Appointed Representatives Regulations* (see SUP 12.5.2G); and
- (2) requires the *appointed representative* to comply, and to ensure that any *persons* who provide services to the *appointed representative* under a contract of services or a contract for service comply, with the relevant requirements in or under the *Act* (including the *rules*) that apply to the activities which it carries on as *appointed representative* of the *firm*.

12.5.6

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- (1) If the *appointed representative* is appointed to give *advice on investments* to *private customers* concerning *packaged products*, the *firm* should also satisfy itself that:
 - (a) the contract requires compliance with the *rules* in COB 5.1 (Polarisation and status disclosure); and
 - (b) if the *firm* is a *provider firm*, the contract prevents the *appointed representative* from giving *advice on investments* to a *private customer* concerning the purchase of a *packaged product* which is not issued by the *firm* or by another member of its *marketing group* or is not an *adopted packaged product* (see COB 5.1.8R).

- (a) the contract requires compliance with the *rules* in COB 5.1 (Polarisation and status disclosure); and
- (b) if the *firm* is a *provider firm*, the contract prevents the *appointed representative* from giving *advice on investments* to a *private customer* concerning the purchase of a *packaged product* which is not issued by the *firm* or by another member of its *marketing group* or is not an *adopted packaged product* (see COB 5.1.8R).

- (2) The contractual requirements in SUP 12.5.5R should extend to:
 - (a) the activities of the *appointed representative*, if the *appointed representative* is a *representative, introducer or financial adviser*; or
 - (b) the activities of the *employees* of, or *representatives, introducers and financial advisers* appointed by, the *appointed representative*.

Required contract terms for an introducer appointed representative

12.5.7

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A *firm* must ensure that its written contract with each of its *introducer appointed representatives* prohibits the *introducer appointed representative* from:

- (1) in relation to a *designated investment* or *designated investment business*:
 - (a) effecting an introduction between a *customer* and a *person* other than the *firm* or another member of the *firm's marketing group*; and
 - (b) distributing *non-real-time financial promotions approved* by a *person* other than the *firm* or another member of the *firm's marketing group* or the producer of an *adopted packaged product*; and
- (2) carrying on any *regulated activity* on behalf of any *person* other than the *firm* or another member of the *firm's marketing group*.

12.6 Continuing obligations of firms with appointed representatives

Suitability etc. of appointed representatives

- 12.6.1** **R**
/1 If at any time a *firm* has reasonable grounds to believe that the conditions in *SUP* 12.4.2R or *SUP* 12.4.6R (as applicable) are not satisfied, or are likely not to be satisfied, in relation to any of its *appointed representatives*, the *firm* must:
- (1) take immediate steps to rectify the matter; or
 - (2) terminate its contract with the *appointed representative*.
- 12.6.2** **G**
/1 The *FSA* would normally expect a *firm* to carry out a check on its *appointed representative's* financial position every year (more often, if necessary) and to review critically the information obtained. An appropriately experienced *person* (for example, a financial accountant) should carry out these checks.
- 12.6.3** **G**
/1 Consideration should be given, among other things, to the impact on the *appointed representative's* financial position of any debts owed to, or by, the *appointed representative*. Indicators that an *appointed representative* is experiencing financial problems may include failure to adhere to repayment schedules for any debts, failure to meet any other financial commitments or requests for advances of *commission*.
- 12.6.4** **G**
/1 A *firm* should look into any concerns that may arise at any time about an *appointed representative's* financial standing and take the necessary action. The necessary action may include, for example, increased monitoring or, if appropriate, suspension or termination of the appointment.

Appointed representatives not to hold client money

- 12.6.5** **R**
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- (1) A *firm* must not permit an *appointed representative* to hold *client money*.
 - (2) The *firm* must take reasonable steps to ensure that if *client money* is received by the *appointed representative*, it is paid into a *client bank account* of the *firm*, or forwarded to the *firm*, in accordance with *COB* 9.3.49R to *COB* 9.3.51R.

Regulated activities and investment services outside the scope of appointment

12.6.6

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A *firm* must take reasonable steps to ensure that each of its *appointed representatives*:

- (1) does not carry on *regulated activities* in breach of the *general prohibition* in section 19 of the *Act*; and
- (2) carries on the *regulated activities* for which the *firm* has accepted responsibility in a way which is, and is held out as being, clearly distinct from any of the *appointed representative's* other business:
 - (a) which is performed as an *appointed representative* of another *firm*; or
 - (b) which:
 - (i) is, or is held out as being, primarily for the purposes of investment; and
 - (ii) is not a *regulated activity*.

Senior management responsibility for appointed representatives

12.6.7

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The senior management of a *firm* should be aware that the activities of *appointed representatives* are an integral part of the business that they manage. The responsibility for the control and monitoring of the activities of *appointed representatives* rests with the senior management of the *firm*. *Guidance* is set out in SYSC 3 on delegation (for example, SYSC 3.2.3G and SYSC 3.2.4G) and in the *Statements of Principle* and *Code of Practice for Approved Persons* in APER (for example, APER 4.5 and APER 4.6).

Obligations of firms under the approved persons regime

12.6.8

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Some of the *controlled functions*, as set out in SUP 10.4.1R, apply to an *appointed representative* of a *firm* just as they apply to a *firm* (see SUP 10.1.16R). These are the *governing functions* and the *customer functions* (other than the *investment management function*), for example, CF 21, the *investment adviser function*. As explained in SUP 10.1.17G and SUP 10.3.2G respectively:

- (1) the effect of SUP 10.1.16R is that the *directors* (or their equivalent) and *senior managers* (or their equivalent) of an *appointed representative* must also be approved under section 59 of the *Act* for the performance of certain *controlled functions*; and
- (2) sections 59(1) and 59(2) of the *Act* (Approval for particular arrangements) provide that approval is necessary in respect of a *controlled function* which is performed under an *arrangement* entered into by a *firm*, or its contractors (typically an *appointed representative*), in relation to a *regulated activity*.

12.6.9

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Firms should be aware that, under the *approved persons* regime, the *firm* is responsible for submitting applications to the FSA for the approval as an *approved person* of:

- (1) any individual who performs a *controlled function* and who is an *appointed representative*; and
- (2) any *person* who performs a *controlled function* under an *arrangement* entered into by any of the *firm's appointed representatives*.

Applications for approval should be submitted as early as possible since a *person* may not perform a *controlled function* if he has not been approved by the FSA (see SUP 10.12).

Obligations of firms under the training and competence rules

12.6.10

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The *rules* and *guidance* in TC extend to any *employee* of the *firm* in respect of whom the relevant *rules* apply. For these purposes, an *employee* of a *firm* includes:

- (1) an individual who is an *appointed representative* of a *firm*; and
- (2) an individual who is employed or appointed by an *appointed representative* of a *firm* (whether under a contract of service or for services) in connection with the business of *the appointed representative* for which the *firm* has accepted responsibility.

12.6.11

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A *firm* should take reasonable care to ensure that:

- (1) it has satisfied TC 2 in respect of the relevant staff of the *appointed representative*; and
- (2) its *appointed representative* has adequate arrangements in respect of training and competence, which meet the requirements in TC.

Additional obligations for introducer appointed representatives

12.6.12

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A *firm* must take reasonable steps to ensure that each of its *introducer appointed representatives*:

- (1) does not, in relation to a *designated investment* or *designated investment business*:
 - (a) effect an introduction between a *customer* and a *person* other than the *firm* or another member of the *firm's marketing group*; or
 - (b) distribute *non-real-time financial promotions* approved by a *person* other than the *firm* or another member of the *firm's marketing group* or the producer of an *adopted packaged product*; and

- (2) does not carry on any *regulated activity* on behalf of any *person* other than the *firm* or another member of the *firm's marketing group*.

12.7 Notification requirements

- 12.7.1** **R**_{/1} (1) A *firm* which appoints an *appointed representative* must give written notice of the appointment to the *FSA* not more than ten *business days* after the date the appointment takes effect.
- (2) A *firm's* notification under (1) must be given to a member of or addressed for the attention of the Corporate Authorisation department at the address given in *SUP 12.7.5R*.
- 12.7.2** **G**_{/1} A *firm's* notice under *SUP 12.7.1R* should give details of the *appointed representative* and the *regulated activities* which the *firm* is, or intends to, carry on through the *appointed representative*, including:
- (1) the name of the *firm's* new *appointed representative* (if the *appointed representative* is a *body corporate*, this is its registered name);
- (2) any trading name under which the *firm's* new *appointed representative* carries on a *regulated activity* in that capacity;
- (3) a description of the *regulated activities* which the *appointed representative* is permitted or required to carry on and for which the *firm* has accepted responsibility; and
- (4) any restrictions imposed on the *regulated activities* for which the *firm* has accepted responsibility.
- 12.7.3** **G**_{/1} A *firm* need not notify the *FSA* of any restrictions imposed on the *regulated activities* for which the *firm* has accepted responsibility (under *SUP 12.7.2G(4)*) if the *firm* accepts responsibility for the unrestricted scope of the *regulated activities*.
- 12.7.4** **G**_{/1} (1) *Firms* can obtain a standard notification form from either the *FSA* website at www.fsa.gov.uk or by post from the Corporate Authorisation department.
- (2) A *firm's* notice under *SUP 12.7.1R* should be returned to the Corporate Authorisation department at the address below.
- 12.7.5** **R**_{/1} **To contact the Corporate Authorisation department:**
- (1) telephone on 020 7676 1000; fax on 020 7676 1099; or
- (2) write to: Corporate Authorisation department, The Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS; or
- (3) email appreps@fsa.gov.uk.

- 12.7.6** **G**_{/1} When the *FSA* receives the notification under *SUP* 12.7.1R, it will update the *firm's* entry in the *FSA Register* to include public information about the *firm's* *appointed representative*.
- 12.7.7** **R**_{/1}
- (1) A *firm* must give written notice to the *FSA* of a change in any information provided to the *FSA* under *SUP* 12.7.1R, within ten *business days* of a change being made or, if later, as soon as it becomes aware of the change. The notice must state the information that has changed.
 - (2) A *firm's* notification under (1) must be given to a member of or addressed for the attention of the Corporate Authorisation department at the address given in *SUP* 12.7.5R.
- 12.7.8** **R**_{/1}
- (1) A *firm* must give written notice to the *FSA* as soon as it has reasonable grounds to believe that any of the conditions in *SUP* 12.4.2R or *SUP* 12.4.6R (as applicable) are not satisfied, or are likely not to be satisfied, in relation to any of its *appointed representatives*.
 - (2) In its notification under *SUP* 12.7.8R(1), the *firm* must state either:
 - (a) the steps it proposes to take to rectify the matter; or
 - (b) the date of termination of its contract with the *appointed representative* (see *SUP* 12.8).
 - (3) A *firm's* notification under (1) must be given to a member of or addressed for the attention of the Corporate Authorisation department at the address given in *SUP* 12.7.5R.

12.8 Termination of a relationship with an appointed representative

Notification of termination or prohibited amendment of the contract

12.8.1

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If either the *firm* or the *appointed representative* notifies the other that it proposes to terminate a contract or to amend it so that it no longer meets the requirements prescribed in the *Appointed Representative Regulations* (see *SUP 12.5.2G*) and, in the case of an *introducer appointed representative*, *SUP 12.5.7R*, the *firm* must:

- (1) give written notice to the *FSA* no more than ten *business days* after the date of the decision to terminate or so amend the contract or, if later, as soon as it becomes aware that the contract is to be or has been terminated or amended;
- (2) include in the written notice the reason for the termination or amendment, if the termination or amendment is due to misconduct or the *appointed representative* is resigning while under investigation by the *firm*, the *FSA*, another regulator, a *clearing house*, an *exchange*, a *designated professional body*, or a government body or agency;
- (3) if relevant, include in the written notice details of action taken by the *firm* and, if applicable, its outcome; and
- (4) ensure that the written notice is given to a member of or addressed for the attention of the Corporate Authorisation department at the address given in *SUP 12.7.5R*.

12.8.2

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In assessing whether to terminate a relationship with an *appointed representative*, a *firm* should be aware that the *notification rules* in *SUP 15* require notification to be made immediately to the *FSA* if certain events occur. Examples include a matter having a serious regulatory impact or involving an *offence* or a breach of any requirement imposed by the *Act* or by regulations or orders made under the *Act* by the Treasury.

Steps to be taken on termination or prohibited amendment of the contract

12.8.3

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If a contract with an *appointed representative* is terminated, or if it is amended in a way which gives rise to a requirement to notify under SUP 12.8.1R, a *firm* must take all reasonable steps to ensure that:

- (1) if the termination is by the *firm*, the *appointed representative* is notified in writing before, or if not possible, immediately on, the termination of the contract and informed that it will no longer be an *exempt person* for the purpose of the *Act* because of the contract with the *firm*;
- (2) outstanding *regulated activities* and obligations to *customers* are properly completed and fulfilled either by itself or another of its *appointed representatives*; and
- (3) where appropriate, *clients* are informed of any relevant changes.

Notification of approved persons on termination

12.8.4

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The *firm* is responsible for notifying the *FSA* of any *approved person* who no longer performs a *controlled function* under an *arrangement* entered into by a *firm* or its *appointed representative* (see SUP 10.13).

12.9 Record keeping

12.9.1

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A *firm* must make the following records on each of its *appointed representatives*:

- (1) the *appointed representative's* name;
- (2) a copy of the original contract with the *appointed representative* and any subsequent amendments to it (including details of any restrictions placed on the activities which the *appointed representative* may carry on); and
- (3) the date and reason for terminating or amending its contract with the *appointed representative*, whenever such termination or amendment gives rise to a requirement to notify under *SUP* 12.8.1R.

12.9.2

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A *firm* must retain these records for at least three years from the date of termination or the amendment of the contract with the *appointed representative*.

12.9.3

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The *firm* should also satisfy itself that:

- (1) the *appointed representative* is making and retaining records in accordance with the relevant record keeping *rules* in the *Handbook*, if these records are not maintained by the *firm*;
- (2) the *appointed representative* (other than an *introducer appointed representative*) is making and retaining records sufficient to disclose with reasonable accuracy the financial position of the *business* it carries on in its capacity as the *firm's appointed representative*; and
- (3) the *firm* has full access to the *appointed representative's* records under (1) and (2) and any other records relevant to the *regulated activities* that the *appointed representative* carries on in that capacity.

12.9.4

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Firms are reminded that they should make and retain records in relation to any *person* who falls within the scope of the *rules* in *TC* or who performs a *controlled function* under an *arrangement* entered into by a *firm* or by an *appointed representative*. See *SUP* 10 and *TC* for the applicable record keeping *rules*.

SUP 12 Ann 1G: Guidance on steps a firm should take in assessing the financial position of an appointed representative (other than an introducer appointed representative). See SUP 12.4.3G

1 Table

1. The *guidance* in this annex applies to a *firm* which intends to appoint, or has appointed, an *appointed representative* (other than an *introducer appointed representative*).
2. All of the items in this annex should be applied, as appropriate, to an individual who is in business on his own.
3. *Partners* in *partnerships* (other than limited partners in *limited liability partnerships*) have joint and several unlimited liability. It follows that any assessment of the financial position of an *appointed representative* which is a *partnership* should take into account the financial position of the individual *partners* as well as the *partnership* itself.

2 Table Assessing the financial position of an appointed representative (other than an introducer appointed representative)

Accounts	<ol style="list-style-type: none"> 1. Consider whether the type of accounts obtained is appropriate to the type of <i>appointed representative</i> (for example, <i>companies</i> should supply audited accounts prepared in accordance with Companies Act provisions while individuals in business on their own may only prepare unaudited accounts, for example, for submission to the Inland Revenue or their bankers). 2. Consider whether the accounts have been prepared on a timely basis. Consider the content of the audit report, including all detail and explanations given, and any qualifications which it may contain. Investigate any concerns. 3. If relevant, obtain the most recent management accounts to assess whether the <i>appointed representative's</i> financial position has changed materially since the most recent audited accounts. 4. If audited accounts are not available, be more circumspect about the accounts as they have not been independently audited. If necessary, consider obtaining third party verification of material balances.
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Unusual items/ recoverability of debts/ goodwill	<ol style="list-style-type: none"> 1. Investigate fully any unusual items – in particular any amounts outstanding with <i>directors, partners, connected persons</i> or <i>associates</i> and any guarantees. 2. Consider whether any amounts due to the <i>appointed representative</i> would be recoverable; and whether the <i>appointed representative</i> would be in a position to pay any debts if it were required to do so at short notice. 3. Any balance for goodwill should be ignored since this will normally represent a stream of potential future income which may not be forthcoming if the equity interest in the <i>appointed representative</i> were sold.
Financial stability/ cash- flows	<ol style="list-style-type: none"> 1. Critically review the accounts to ensure that the <i>appointed representative</i> is financially stable. The review should take into account the overall position of the <i>appointed representative</i> and its cashflow. 2. The review should also consider the nature of the <i>appointed representative's</i> assets and whether or not they are liquid and readily available to the <i>appointed representative</i>, if required. <i>Investments</i> in (for example) unquoted <i>companies</i> or <i>property</i> may be difficult to realise if there were a sudden need for <i>cash</i>.
Income / financial pres- sures	<ol style="list-style-type: none"> 1. Assess the overall financial pressures on the <i>appointed representative</i> and <i>connected persons</i>. Account should be taken of the full range of the <i>appointed representative's</i> activities (and not merely those activities in which the <i>appointed representative</i> will be acting for the <i>firm</i>). Careful consideration should be given to any debts arising out of previous activities within the financial services industry. 2. If relevant, review the accounts of any <i>associates</i> where there is a possibility that their performance – or any commitments entered into in respect of them – may affect the financial position of the <i>appointed representative</i>. 3. Establish whether the <i>appointed representative's</i> income is sufficient both to service any debts and to provide an acceptable level of income to the proprietors.

Credit checks / dealings gov- ernment bodies	<ol style="list-style-type: none"> 1. Undertake a <i>credit</i> reference check on the <i>appointed representative</i> itself (in the case of a <i>company</i>); on the <i>partners</i> (in the case of a <i>partnership</i>); or on the individual (in the case of a <i>sole trader</i>). 2. Ask the <i>appointed representative</i> whether it is up to date in its dealings with the Inland Revenue, HM Customs and Excise (etc).
Forecasts	<ol style="list-style-type: none"> 1. If relevant, obtain a <i>forecast</i> of the next year's figures and review it to ensure that the <i>appointed representative</i> is likely to remain in a satisfactory financial position. This is particularly important where a material change is expected in the <i>appointed representative's</i> operations; or where the <i>appointed representative</i> has only recently been established so that accounts are not available for the previous three complete financial years. 2. If the <i>firm</i> decides to appoint the <i>appointed representative</i>, the <i>firm</i> should keep the <i>appointed representative's</i> actual performance under close review so as to assess whether the <i>forecasts</i> were realistic and to enable any problems to be addressed.

SUP 12 Ann 2G: Guidance on information firms should take reasonable steps to obtain to verify and to assess the fitness and propriety of an appointed representative (other than an introducer appointed representative). See SUP 12.4.4G(1).

1 Table Guidance Notes

1. The *guidance* in this annex applies to a *firm* which intends to appoint or has appointed an *appointed representative* (except an *introducer appointed representative*).
2. Items 1(c) and 1(d) in the following table will not be relevant in the case of an individual who is himself an *appointed representative*, unless, in the case of 1(d), the individual is in business on his own.
3. If the *appointed representative* is a *partnership*, the information a *firm* should obtain, having regard to SUP 12.4.4(1)G, is that contained in this annex on the basis that the information sought applies to each *partner*. When considering the fitness and propriety of each *partner*, having regard to SUP 12.4.4(1)G, information a firm should obtain will also include information in this annex. Therefore, a *firm* may wish to assess the fitness and propriety of *partners* as suggested in SUP 12.4.4(2)G and then consider if any additional information is recommended under this annex.

2 Table Verifying and assessing the fitness and propriety of an appointed representative (other than an introducer appointed representative).

(1)	Information about the <i>appointed representative</i>	(a) Name (b) Address, and, where applicable and different, address of the registered office and the principal place of <i>business</i> (c) full name of every <i>director</i> , <i>senior manager</i> and <i>controller</i> (d) accounts (see SUP 12 Ann 1G) for the last three complete financial years
	The <i>appointed representative's</i> professional reputation	(a) Disciplinary proceedings <ol style="list-style-type: none"> (i) whether the <i>appointed representative</i> has ever been publicly censured, disciplined, suspended or expelled by the <i>FSA</i>, another regulator, a <i>clearing house</i>, an <i>exchange</i>, a <i>professional body</i>, or a <i>government body</i> or agency; (ii) whether the <i>appointed representative</i> is currently the subject of any disciplinary proceedings by a body referred to in (i) above or is aware that such proceedings are pending; (iii) whether the <i>appointed representative</i> has ever been the subject of a formal investigation under the powers in the Companies Act 1985; and (iv) whether the <i>appointed representative</i> has had anything equivalent to (i) to (iii) above occur under relevant overseas provisions.

<p>The <i>appointed representative's</i> professional reputation – continued</p>	<p>(b) Criminal or civil proceedings</p> <p>Whether the <i>appointed representative</i> is a defendant in any current civil proceedings connected with professional activities in which an allegation of fraud or dishonesty is being made, the subject of any current criminal proceedings, or has been convicted of any criminal offence, either in the <i>United Kingdom</i> or overseas.</p> <p>(c) Insolvency, bankruptcy and winding up</p> <p>Whether the <i>appointed representative</i> has:</p> <ul style="list-style-type: none"> (i) been wound up or had a petition presented, or had a meeting called to consider a resolution, for winding it up; or (ii) in the case of a company, been the subject of an application to dissolve it or to strike it off the Register of Companies; or (iii) made, or proposed to make, a composition or voluntary arrangement with any one of more of its creditors; or (iv) had an administrator or trustee in bankruptcy appointed to it or had an application made for such an appointment; or (v) had a receiver appointed to it (whether an administrative receiver or a receiver appointed over particular property); or (vi) had an application for an interim order made against it under section 252 of the Insolvency Act 1986 (or, in Northern Ireland, section 227 of the Insolvency (Northern Ireland) Order 1989); or (vii) if it is a <i>sole trader</i>, been the subject of an application for a sequestration order or a petition for bankruptcy; or (viii) ceased trading in circumstances in which any of its creditors did not receive full payment; or. (ix) had anything equivalent to (i) to (viii) above occur under relevant overseas law.
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Chapter 15

Notifications to the FSA

15.1 Application

Who?

- 15.1.1 **R** This chapter applies to every *firm* except an *ICVC* or a *UCITS* *qualifier*.
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- 15.1.2 **R** The application of this chapter to an *incoming EEA firm* or an *incoming Treaty firm* is set out in *SUP 15 Ann 1R*.
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- 15.1.3 **G** In some cases, the application of provisions set out in *SUP 15 Ann 1R* depends on whether responsibility is reserved to a *Home State regulator*. *SYSC App 1* contains *guidance* on this.
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What?

- 15.1.4 **R** This chapter:
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- (1) applies with respect to the carrying on of both *regulated activities* and *unregulated activities*; and
 - (2) takes into account any activity of other members of a *group* of which the *firm* is a member.

Where?

- 15.1.5 **G** *Firms* are reminded that, unless expressly stated otherwise, where a *rule* or *guidance* includes a reference to a '*firm*' this includes all *UK* and overseas branches and representative offices of that *firm*, whether or not those branches or offices carry on any *regulated activities*.
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15.2 Purpose

15.2.1

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A *firm* is required to provide the FSA with a wide range of information to enable the FSA to meet its responsibilities for monitoring the *firm's* compliance with requirements imposed by or under the *Act*. Some of this information is provided through regular reports, including those set out in SUP 16 (Reporting requirements) and SUP 17 (Transaction reporting). In addition, other chapters in the *Handbook* set out specific notification and reporting requirements. *Principle 11* includes a requirement for a *firm* to disclose to the FSA appropriately anything relating to the *firm* of which the FSA would reasonably expect notice.

15.2.2

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This chapter sets out:

- (1) *guidance* on the type of event or change in condition which a *firm* should consider notifying in accordance with *Principle 11*; the purpose of this *guidance* is to set out examples and not to give comprehensive advice to *firms* on what they should notify in order to be in compliance with *Principle 11*;
- (2) *rules* on events and changes in condition that a *firm* must notify; these are the types of event that the FSA must be informed about, usually as soon as possible, if it is to be able to carry out its monitoring function effectively and react in good time to developments that may require a regulatory response;
- (3) *rules* on the core information that a *firm* must provide to the FSA, for example its name and address and the names of its other regulators, so that the FSA is able to maintain a relationship with the *firm* and with those regulators; and
- (4) *rules* requiring a *firm* to ensure that information provided to the FSA is accurate and complete; section 398 of the *Act* makes it an *offence* knowingly or recklessly to provide the FSA with information which is false or misleading in a material particular, in purported compliance with any requirement imposed by or under the *Act*; the purpose of the *rules* in SUP 15.6 is to ensure that *firms* take due care to ensure the accuracy of information and to require them to ensure that information is not only accurate but also complete.

15.2.3

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Rules and *guidance* have also been included to set out how *firms* should make a notification and to determine when it may be appropriate to discuss matters with their usual supervisory contact by telephone (SUP 15.7).

15.2.4

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Schedule 2 contains a consolidated summary of all the *notification rules* applicable to *firms* set out in the *Handbook*.

15.3 General notification requirements

Matters having a serious regulatory impact

- 15.3.1** **R**_{/1} A *firm* must notify the *FSA* immediately it becomes aware, or has information which reasonably suggests, that any of the following has occurred, may have occurred or may occur in the foreseeable future:
- (1) the *firm* failing to satisfy one or more of the *threshold conditions*; or
 - (2) any matter which could have a significant adverse impact on the *firm's* reputation; or
 - (3) any matter which could affect the *firm's* ability to continue to provide adequate services to its *customers* and which could result in serious detriment to a *customer* of the *firm*; or
 - (4) any matter in respect of the *firm* which could result in serious financial consequences to the *financial system* or to other *firms*.
- 15.3.2** **G**_{/1} The circumstances which may give rise to any of the events in *SUP* 15.3.1R are wide-ranging and the probability of any matter resulting in such an outcome, and the severity of the outcome, may be difficult to determine. However, the *FSA* expects *firms* to consider properly all potential consequences of events.
- 15.3.3** **G**_{/1} In determining whether an event that may occur in the foreseeable future should be notified to the *FSA*, a *firm* should consider both the probability of the event happening and the severity of the outcome should it happen.
- 15.3.4** **G**_{/1} *Guidance* on satisfaction of the *threshold conditions* is given in *COND*.
- 15.3.5** **G**_{/1} A *firm* making a notification in accordance with *SUP* 15.3.1R should consider the *guidance* in *SUP* 15.7.2G and notify the *FSA* by telephone if appropriate.
- 15.3.6** **G**_{/1} An *insurer* or *friendly society* making a notification under *SUP* 15.3.1R(1) relating to satisfaction of *threshold condition* 4 (Adequate resources) should be aware of the requirements in *SUP* App 2 (Scheme of operations).

Communication with the FSA in accordance with Principle 11

15.3.7

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Principle 11 requires a *firm* to deal with its regulators in an open and cooperative way and to disclose to the FSA appropriately anything relating to the *firm* of which the FSA would reasonably expect notice. *Principle 11* applies to *unregulated activities* as well as *regulated activities* and takes into account the activities of other members of a *group*.

15.3.8

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Compliance with *Principle 11* includes, but is not limited to, giving the FSA notice of:

- (1) any proposed restructuring, reorganisation or business expansion which could have a significant impact on the *firm's* risk profile or resources, including, but not limited to:
 - (a) setting up a new *undertaking* within a *firm's group*, or a new branch (whether in the *United Kingdom* or overseas); or
 - (b) commencing the provision of cross border services into a new territory; or
 - (c) commencing the provision of a new type of product or service (whether in the *United Kingdom* or overseas); or
 - (d) ceasing to undertake a *regulated activity* or *ancillary activity*, or significantly reducing the scope of such activities; or
 - (e) entering into, or significantly changing, a *material outsourcing* arrangement (a *bank* should also see IPRU(BANK) OS 4.2 and a *building society* should also see IPRU(BSOC) 12 OS 4.2 for further details); or
 - (f) a substantial change or a series of changes in the *governing body* of an *overseas firm* (other than an *incoming firm*); or
 - (g) any change to the *firm's* prudential category or sub-category, as used in the Interim Prudential sourcebooks and SUP and on which *guidance* is given in SUP App 1;
- (2) any significant failure in the *firm's* systems or controls, including those reported to the *firm* by the *firm's* auditor;
- (3) any action which a *firm* proposes to take which would result in a material change in its capital adequacy or solvency, including, but not limited to:
 - (a) any action which would result in a material change in the *firm's* financial resources or financial resources requirement; or
 - (b) a material change resulting from the payment of a special or unusual dividend or the repayment of *share* capital or a subordinated loan; or
 - (c) for *firms* which are subject to the *rules* on consolidated financial supervision, any proposal under which another *group company* may be considering such an action; or
 - (d) significant trading or non-trading losses (whether recognised or unrecognised).

15.3.9 G_{/1} The period of notice given to the *FSA* will depend on the event, although the *FSA* expects a *firm* to discuss relevant matters with it at an early stage, before making any internal or external commitments.

15.3.10 G_{/1} A notification under *Principle 11* may be given orally or in writing (as set out in *SUP 15.7.1R* and *SUP 15.7.2G*), although the *FSA* may request written confirmation of a matter. However, it is the responsibility of a *firm* to ensure that matters are properly and clearly communicated to the *FSA*. A *firm* should provide a written notification if a matter either is complex or may be such as to make it necessary for the *FSA* to take action. A *firm* should also have regard to *Principle 11* and the *guidance* in *SUP 15.7.2G* in respect of providing important information promptly.

Breaches of rules and other requirements in or under the Act

15.3.11 R_{/1} (1) A *firm* must notify the *FSA* of:

- (a) a significant breach of a *rule* (which includes a *Principle*) or *Statement of Principle*; or
- (b) a breach of any requirement imposed by the *Act* or by regulations or an order made under the *Act* by the Treasury (except if the breach is an *offence*, in which case (c) applies); or
- (c) the bringing of a prosecution for, or a conviction of, any *offence* under the *Act*;

by (or as regards (c) against) the *firm* or any of its *directors*, *officers*, *employees*, *approved persons*, or *appointed representatives*.

(2) A *firm* must make the notification in (1) immediately it becomes aware, or has information which reasonably suggests, that any of the matters in (1) has occurred, may have occurred or may occur in the foreseeable future.

15.3.12 G_{/1} In *SUP 15.3.11R*(1)(a), significance should be determined having regard to potential financial losses to *customers* or to the *firm*, frequency of the breach, implications for the *firm's* systems and controls and if there were delays in identifying or rectifying the breach.

15.3.13 G_{/1} In assessing whether an event that may occur in the foreseeable future should be notified to the *FSA*, a *firm* should consider the *guidance* in *SUP 15.3.3G*.

15.3.14 G_{/1} A notification under *SUP 15.3.11R* should include:

- (1) information about any circumstances relevant to the breach or *offence*;
- (2) identification of the *rule* or requirement or *offence*; and
- (3) information about any steps which a *firm* or other *person* has taken or intends to take to rectify or remedy the breach or prevent any future potential occurrence.

Civil, criminal or disciplinary proceedings against a firm

15.3.15

RA *firm* must notify the *FSA* immediately if:

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- (1) civil proceedings are brought against the *firm* and the amount of the claim is significant in relation to the *firm's* financial resources or its reputation; or
- (2) any action is brought against the *firm* under section 71 of the *Act* (Actions for damages) or section 150 (Actions for damages); or
- (3) disciplinary measures or sanctions have been imposed on the *firm* by any statutory or regulatory authority, professional organisation or trade body (other than the *FSA*) or the *firm* becomes aware that one of those bodies has started an investigation into its affairs; or
- (4) the *firm* is prosecuted for, or convicted of, any *offence* involving fraud or dishonesty, or any penalties are imposed on it for tax evasion; or
- (5) it is an *OPS firm*, which is a trustee, and is removed as trustee by a court order.

15.3.16

GA notification under *SUP* 15.3.15R should include details of the matter and an estimate of the likely financial consequences, if any.

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Fraud, errors and other irregularities

15.3.17

RA *firm* must notify the *FSA* immediately if one of the following events arises and the event is significant:

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- (1) it becomes aware that an *employee* may have committed a fraud against one of its *customers*; or
- (2) it becomes aware that a *person*, whether or not *employed* by it, may have committed a fraud against it; or
- (3) it considers that any *person*, whether or not *employed* by it, is acting with intent to commit a fraud against it; or
- (4) it identifies irregularities in its accounting or other records, whether or not there is evidence of fraud; or
- (5) it suspects that one of its *employees* may be guilty of serious misconduct concerning his honesty or integrity and which is connected with the *firm's regulated activities* or *ancillary activities*.

15.3.18

GIn determining whether a matter is significant, a *firm* should have regard to:

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- (1) the size of any monetary loss or potential monetary loss to itself or its *customers* (either in terms of a single incident or group of similar or related incidents);
- (2) the risk of reputational loss to the *firm*; and
- (3) whether the incident or a pattern of incidents reflects weaknesses in the *firm's internal controls*.

15.3.19

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The notifications under SUP 15.3.17R are required as the FSA needs to be aware of the types of fraudulent and irregular activity which are being attempted or undertaken, and to act, if necessary, to prevent effects on *consumers* or other *firms*. A notification under SUP 15.3.17R should provide all relevant and significant details of the incident or suspected incident of which the *firm* is aware.

15.3.20

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In addition, the *firm* may have suffered significant financial losses as a result of the incident, or may suffer reputational loss, and the FSA will wish to consider this and whether the incident suggests weaknesses in the *firm's internal controls*.

Insolvency, bankruptcy and winding up

15.3.21

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A *firm* must notify the FSA immediately of any of the following events:

- (1) the calling of a meeting to consider a resolution for winding up the *firm*; or
- (2) an application to dissolve the *firm* or to strike it off the Register of Companies; or
- (3) the presentation of a petition for the winding up of the *firm*; or
- (4) the making of, or any proposals for the making of, a composition or arrangement with any one or more of its creditors; or
- (5) an application for the appointment of an administrator or trustee in bankruptcy to the *firm*; or
- (6) the appointment of a receiver to the *firm* (whether an administrative receiver or a receiver appointed over particular property); or
- (7) an application for an interim order against the *firm* under section 252 of the Insolvency Act 1986 (or, in Northern Ireland, section 227 of the Insolvency (Northern Ireland) Order 1989); or
- (8) if the *firm* is a *sole trader*:
 - (a) an application for a sequestration order on the *firm*; or
 - (b) the presentation of a petition for bankruptcy; or

- (9) anything equivalent to (1) to (8) above occurring in respect of the *firm* in a jurisdiction outside the *United Kingdom*.

15.4 Notified persons

- 15.4.1** **R** /1 (1) *An overseas firm, which is not an incoming firm, must notify the FSA within 30 business days of any person taking up or ceasing to hold the following positions:*
- (a) *the firm's worldwide chief executive (that is, the person who, alone or jointly with one or more others, is responsible under the immediate authority of the directors for the whole of its business) if the person is based outside the United Kingdom;*
 - (b) *the person within the overseas firm with a purely strategic responsibility for UK operations (see SUP 10.7.4G);*
 - (c) *for a bank: the two or more persons who effectively direct its business in accordance with IPRU(BANK) GN 3.3.1R;*
 - (d) *for an insurer: the authorised UK representative.*
- (2) *The notification in (1) must be submitted using Form F (SUP 15 Ann 2R). However, if the person is an approved person, notification giving details of his name, the approved person's FSA individual reference number and the position to which the notification relates, is sufficient.*
- 15.4.2** **G** /1 *SUP 15.4.1R is not made under the powers conferred on the FSA by Part V of the Act (Performance of Regulated Activities). A person notified to the FSA under SUP 15.4.1R is not subject to the Statements of Principle or Code of Practice for Approved Persons, unless he is also an approved person.*
- 15.4.3** **G** /1 *Copies of Form F may be obtained from the FSA website at www.fsa.gov.uk or from the Individual Vetting and Approval department. See SUP 10.11.6G for contact details.*
- 15.4.4** **G** /1 *If adverse information is revealed about a person notified to the FSA under SUP 15.4.1R, the FSA may exercise its own initiative power against the firm (see SUP 7 (Individual requirements)).*

15.5 Core information requirements

Change in name

- 15.5.1 **R** A *firm* must give the FSA reasonable advance notice of a change in:
/1
- (1) the *firm's* name (which is the registered name if the *firm* is a *body corporate*);
 - (2) any business name under which the *firm* carries on a *regulated activity* or *ancillary activity* either from an establishment in the *United Kingdom* or with or for clients in the *United Kingdom*.

- 15.5.2 **G** A notification under SUP 15.5.1R should include the details of the proposed new name and the date on which the *firm* intends to implement the change of name.
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- 15.5.3 **G** *Firms* are reminded that certain name changes (for example, to include 'Limited') may also require a notification under SUP 15.5.5R.
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Change in address

- 15.5.4 **R** A *firm* must give the FSA reasonable advance notice of a change in any of the following addresses, and give details of the new address and the date of the change:
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- (1) the *firm's* principal place of business in the *United Kingdom*;
 - (2) in the case of an *overseas firm*, its registered office (or head office) address.

Change in legal status

- 15.5.5 **R** A *firm* must give the FSA reasonable advance notice of a proposed change in its legal status which limits the liability of any of its members or *partners*.
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- 15.5.6 **G** For the purpose of SUP 15.5.5R, limiting liability includes:
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- (1) re-registration as a limited liability *company* of a *company* incorporated with unlimited liability; and
- (2) a general *partner* in a *firm* becoming a limited *partner*.

Other regulators

15.5.7 **R** *A firm must notify the FSA immediately if it becomes subject to or ceases to be subject to the supervision of any overseas regulator (including a Home State regulator).*

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15.5.8 **G** The FSA's approach to the supervision of a *firm* is influenced by the regulatory regime and any legislative or foreign provisions to which that *firm*, including its branches, is subject.

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15.6 Inaccurate, false or misleading information

15.6.1

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A *firm* must take reasonable steps to ensure that all information it gives to the FSA in accordance with a *rule* in any part of the *Handbook* (including *Principle 11*) is:

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- (1) factually accurate or, in the case of estimates and judgments, fairly and properly based after appropriate enquiries have been made by the *firm*; and
- (2) complete, in that it should include anything of which the FSA would reasonably expect notice.

15.6.2

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SUP 15.6.1R applies also in relation to *rules* outside this chapter, and even if they are not *notification rules*. Examples of *rules* and chapters to which *SUP 15.6.1R* is relevant, are:

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- (1) *Principle 11*, and the guidance on *Principle 11* in *SUP 2* (Information gathering by the FSA on its own initiative);
- (2) *SUP 15* (Notifications to the FSA);
- (3) *SUP 16* (Reporting requirements);
- (4) *SUP 17* (Transaction reporting); and
- (5) any *notification rule* (see Schedule 2 which contains a consolidated summary of such *rules*).

15.6.3

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If a *firm* is unable to obtain the information required in *SUP 15.6.1R(2)*, then it should inform the FSA that the scope of the information provided is, or may be, limited.

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15.6.4

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If a *firm* becomes aware, or has information that reasonably suggests that it has or may have provided the FSA with information which was or may have been false, misleading, incomplete or inaccurate, or has or may have changed in a material particular, it must notify the FSA immediately. Subject to *SUP 15.6.5R*, the notification must include:

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- (1) details of the information which is or may be false, misleading, incomplete or inaccurate, or has or may have changed;
- (2) an explanation why such information was or may have been provided; and

(3) **the correct information.**

15.6.5 **R**
/1 If the information in *SUP 15.6.4R(3)* cannot be submitted with the notification (because it is not immediately available), it must instead be submitted as soon as possible afterwards.

15.6.6 **G**
/1 The *FSA* may request the *firm* to provide revised documentation containing the correct information, if appropriate.

15.6.7 **G**
/1 *Firms* are reminded that section 398 of the *Act* (Misleading the Authority: residual cases) makes it an *offence* for a *firm* knowingly or recklessly to provide the *FSA* with information which is false or misleading in a material particular in purported compliance with the *FSA's rules* or any other requirement imposed by or under the *Act*. An offence by a *body corporate, partnership* or unincorporated association may be attributed to an *officer* or certain other *persons* (section 400 of the *Act* (Offences by bodies corporate etc)).

15.7 Form and method of notification

Form of notification: oral or written

15.7.1 **R** A notification required from a *firm* under any *notification rule* must
/1 be given in writing, and in English, and must give the *firm's* FSA Firm Reference Number unless:

- (1) the *notification rule* states otherwise; or
- (2) the notification is provided solely in compliance with *Principle 11* (see *SUP 15.3.7G*).

15.7.2 **G** A *firm* should have regard to the urgency and significance of a matter and, if
/1 appropriate, should notify its usual supervisory contact at the *FSA* by telephone or by other prompt means of communication, before submitting a written notification. Oral notifications should be given directly to the *firm's* usual supervisory contact. An oral notification left with another person or left on a voicemail or other automatic messaging service is unlikely to have been given appropriately.

15.7.3 **G** The *FSA* is entitled to rely on any information it receives from a *firm* and to
/1 consider any notification received as being made by a *person* authorised by the *firm* to do so. A *firm* should therefore consider whether it needs to put procedures in place to ensure that only appropriate *employees* make notifications to the *FSA* on its behalf.

Method of notification

15.7.4 **R** Unless otherwise stated in the *notification rule*, a written notification
/1 required from a *firm* under any *notification rule* must be:

- (1) given to or addressed for the attention of the *firm's* usual supervisory contact at the *FSA*; and
- (2) delivered to the *FSA* by one of the methods in *SUP 15.7.5R*:

15.7.5 **R** Table Methods of notification
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Method of delivery	
1.	Post to the appropriate address in SUP 15.7.6R
2.	Leaving the notification at the appropriate address in SUP 15.7.6R and obtaining a time-stamped receipt
3.	Electronic mail to an address for the <i>firm's</i> usual supervisory contact at the FSA and obtaining an electronic confirmation of receipt
4.	Hand delivery to the <i>firm's</i> usual supervisory contact at the FSA
5.	Fax to a fax number for the <i>firm's</i> usual supervisory contact at the FSA, followed by delivery by one of methods 1– 4 in this table within five <i>business days</i> after the date of the faxed notification

15.7.6

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The address for a written notification to the FSA is:

(1) The Financial Services Authority

25 The North Colonnade

Canary Wharf

London E14 5HS

if the *firm's* usual supervisory contact at the FSA operates from London, or:

(2) The Financial Services Authority

Sutherland House

108-114 Dundas Street

Edinburgh EH3 5DQ

if the *firm's* usual supervisory contact at the FSA operates from Edinburgh.

15.7.7

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If the *firm* or its *group* is subject to lead supervision arrangements by the FSA, the *firm* or *group* may give or address a notice under SUP 15.7.4R(1) to the supervisory contact at the FSA, designated as lead supervisor, if the *firm* has chosen to make use of the lead supervisor as a central point of contact (see SUP 1.5).

15.7.8

G
/1

If a *firm* is a member of a *group* which includes more than one *firm*, any one *undertaking* in the *group* may notify the FSA on behalf of all *firms* in the *group* to which the notification applies. In this way, that *undertaking* may satisfy the obligation of all relevant *firms* in the *group* to notify the FSA. Nevertheless, the obligation to make the notification remains the responsibility of the individual *firm* itself. See also SUP 15.7.3G.

15.7.9

G
/1

Firms wishing to communicate with the FSA by electronic mail or fax should obtain the appropriate address or number from the FSA.

Timely notification

15.7.10

R
/1

If a *notification rule* requires notification within a specified period:

- (1) the *firm* must give the notification so as to be received by the *FSA* no later than the end of that period; and
- (2) if the end of that period falls on a *day* which is not a *business day*, the notification must be given so as to be received by the *FSA* no later than the first *business day* after the end of that period.

15.7.11

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/1

If a *notification rule* does not require notification within a specified period, the *firm* should act reasonably in deciding when to notify.

Underwriting agents: notification to the Society of Lloyd's

15.7.12

R
/1

- (1) Paragraph (2) applies in relation to notifications required under this chapter within the scope of any arrangements made by the *FSA* with the *Society of Lloyd's* under paragraph 6(2) of Schedule 1 to the *Act*.
- (2) An *underwriting agent* must submit the notifications in (1) to the *Society of Lloyd's* rather than to the *FSA*.

15.7.13

G
/1

Paragraph 6(2) of Schedule 1 to the *Act* enables the *FSA* to make arrangements which provide for monitoring functions to be performed by any body or *person* who, in its opinion, is competent to perform them. Arrangements made under this provision are published by the *FSA*.

15.7.14

G
/1

The *FSA* has made arrangements with the *Society of Lloyd's* with respect to the monitoring of *underwriting agents*. *Underwriting agents* should check whether these arrangements provide for any notifications required under this chapter to be sent to the *Society* instead of to the *FSA*. [For further details see the *FSA* website.]

Consequences of breach of form and method rules

15.7.15

G
/1

If a *firm* fails to comply with the *rules* in this section then the notification is invalid and there may be a breach of the *rule* that required the notification to be given.

Service of Notices Regulations

15.7.16

G
/1

The Financial Services and Markets Act 2000 (Service of Notices) Regulations 2001 (SI 2001/1420) contain provisions relating to the service of documents on the *FSA*. They do not apply to notifications required under *notification rules* because of the specific *rules* in this section.

SUP 15 Ann 1R: Application of this chapter to incoming EEA firms and incoming Treaty firms

1 Table

1. This chapter applies in full to an *incoming EEA firm*, or *incoming Treaty firm*, which has a *top up permission*.
2. SUP 15 does not apply to an *incoming EEA firm* which has *permission only for cross border services* and which does not carry on *regulated activities in the United Kingdom*.
3. For any other *incoming EEA firm* or *incoming Treaty firm*, SUP 15 applies as set out in the following table.

2 Table Application of SUP 15 to an incoming EEA firm or an incoming Treaty firm which does not have a top-up permission

Applicable sections		Application
SUP 15.1 SUP 15.2	Application, Purpose	Apply in full
SUP 15.3.1R to SUP 15.3.6G	Matters having a serious regulatory impact	15.3.1R(1) does not apply, otherwise apply in full
SUP 15.3.7G to SUP 15.3.10G	Communication with the FSA in accordance with Principle 11	Apply insofar as responsibility for the matter in question is not reserved by a European Community instrument to the <i>firm's Home State regulator</i>

Applicable sections		Application
SUP 15.3.11R to SUP 15.3.14G	Breaches of rules and other requirements in or under the Act	Apply in full
SUP 15.3.15R and SUP 15.3.16G	Civil, criminal or disciplinary proceedings against a firm	Apply insofar as responsibility for the matter in question is not reserved by a European Community instrument to the <i>firm's Home State regulator</i>
SUP 15.3.17R to SUP 15.3.20G	Fraud, errors and other irregularities	Apply insofar as responsibility for the matter in question is not reserved by a European Community instrument to the <i>firm's Home State regulator</i>
SUP 15.3.21R	Insolvency, bankruptcy and winding up	Apply insofar as responsibility for the matter in question is not reserved by a European Community instrument to the <i>firm's Home State regulator</i>
SUP 15.4	Notified persons	Does not apply

Applicable sections		Application
<i>SUP 15.5.1R to SUP 15.5.3G</i>	Change in name	Apply in full
<i>SUP 15.5.4R(1)</i>	Change in address: principal place of business in the UK	Applies in full
<i>SUP 15.5.4R(2)</i>	Change in address: registered office	Applies to an <i>incoming Treaty firm</i> . Does not apply to an <i>incoming EEA firm</i> , but such a firm is referred to <i>SUP 14</i> (Variation of passport rights by incoming EEA firms and ending automatic authorisation).
<i>SUP 15.5.5R and SUP 15.5.6G</i>	Change in legal status	Do not apply
<i>SUP 15.5.7R and SUP 15.5.8G</i>	Other regulators	Apply insofar as responsibility for the matter in question is not reserved by a European Community instrument to the <i>firm's Home State regulator</i>
<i>SUP 15.6</i>	Inaccurate, false or misleading information	Applies in full

Applicable sections		Application
<i>SUP 15.7</i>	Form and method of notification	Applies in full



Application number
(for FSA use only)

Form F

Changes in notified persons

FSA Handbook Reference: SUP 15 Annex 2R

30 April 2001

Name of notified person
(to be completed by applicant)

Name of firm
(as entered in 2.01)

The Financial Services Authority
Individual Vetting & Approval
25 The North Colonnade
Canary Wharf
London E14 5HS
United Kingdom
Telephone +44 (0) 20 7676 0019
Facsimile +44 (0) 20 7676 0017
E-mail iva@fsa.gov.uk
Website <http://www.fsa.gov.uk>

Registered as a Limited Company in England and Wales No 1920623. Registered Office as above

Notes for Form F

Changes in notified persons

The rule for notification is set out in SUP 15.4.1R.

The purpose of this Form

This is Form F referred to in SUP 15.4.1R (2).

Membership of the governing body of an overseas firm with a branch in the United Kingdom is not a controlled function requiring approval of the FSA under the approved persons regime. The rule at SUP 15.4.1R (Notified persons) is not made under the powers conferred on the FSA by Part V of the Act and the Statements of Principle do not apply to a person notified to the FSA under SUP 15.4.1R unless he is also an approved person.

An overseas firm (excluding an incoming firm) must notify the FSA within 30 business days of any person taking up or ceasing to hold the following positions (see SUP 15.4.1R):

- the firm's world-wide chief executive if the person is based outside the United Kingdom;

- the person, if not the worldwide chief executive, within the overseas firm with a purely strategic responsibility for UK operations (see SUP 10.7.4G);

- for a bank: the two or more persons who effectively direct its business in accordance with IPRU (BANK) GN 3.3.1R;

- for an insurer: the authorised UK representative.

These notifications must be submitted using this Form. However, if the person is an approved person, notification can be made by letter giving details of his name and the position to which the notification relates (see SUP 15.4.1R (2)).

If adverse information is revealed about a person notified to the FSA under SUP 15.4.1R, the FSA may exercise its own-initiative power against the firm (see SUP 15.4.4G).

Completing this Form

The Form must be completed in black ink and (if in manuscript) in BLOCK LETTERS.

All dates should be provided in numeric form (e.g. 29/02/2000 for 29 February 2000).

Indicate clearly if a question is not applicable. Tick the appropriate box where a yes/no answer is required. Further details should be given in section 6 (supplementary information) if there is insufficient space for a detailed answer.

Additional information can be attached to the form. It must be securely attached to the rest of the Form and you must indicate at question 6.03 the number of additional sheets attached.

Do not assume that information is known to the FSA merely because it is in the public domain, or has been previously disclosed to the FSA or to another regulatory body. In all circumstances, disclosures should be full, frank and unambiguous. If there is any doubt about the relevance of information, it should be included. The information supplied by the notified person should be verified by the firm wherever possible.

Expressions in this Form in italics have the meaning given in the Glossary to the FSA's Handbook (or, if no meaning is given there, the expressions are to be interpreted in accordance with the related expression defined in the Glossary).

The firm is responsible for the accuracy of the data and completion of the Form. If the Form is not fully and correctly completed, the FSA may need to return it for proper completion.

The FSA must be informed immediately of any material changes to the information provided in this Form. All changes must be communicated to the FSA by the firm (see SUP 15.6.4R).

SECTION 1 – PERSONAL IDENTIFICATION DETAILS

If the notified person has more than one previous name (surname or forenames), passport number or nationality, or is known by any other names, provide details in section 6.

- 1.01: If the notified person does not have an FSA Individual Reference Number or does not know it, include the name of the previous regulator and the previous Individual Reference Number, as applicable.
- 1.13: United Kingdom addresses must be given, or a statement stating that the individual resides abroad.

SECTION 2 – FIRM IDENTIFICATION DETAILS

- 2.01 & 2.02: This section identifies the firm making the application by FSA Firm Reference Number (FRN) and name. If the individual will be performing the notified activity in relation to more than one firm and this notification is given on behalf of those other firms, please list the names and FSA Firm Reference Numbers of the other firms at section 6.
- 2.03: The regulatory organisation and country of the firm's registered office must also be indicated.
- 2.04: The firm must also indicate a point of contact for any queries in connection with the application.

SECTION 3 – CHANGES TO NOTIFIED PERSONS

The notified position to which this Form relates should be identified, including effective date and, if applicable, the name of individual being replaced.

SECTION 4 – EMPLOYMENT HISTORY FOR PAST 10 YEARS

A full ten-year employment history for the notified person must be provided – with all gaps explained. If the record of employment does not go back ten years, all periods of education and unemployment must be indicated. Full details of any periods of self-employment should also be included.

Always give the address of the actual place of employment, rather than a central head office.

The employment history should be provided in reverse chronological order, starting with the most recent period of employment, unemployment etc, but excluding the activity to which this notification relates.

“Regulatory body” in this context means the bodies listed in the notes to section 5 (below).

State the position held by the notified person and a brief explanation of his or her duties. If the notified person's job title included the word “director” but his or her duties did not include those associated with the title of director, as defined in the Glossary, this should be indicated.

The reason for leaving each employer must be given. If there were any issues arising on leaving, these must be fully explained in section 6. Previous employers may be contacted.

SECTION 5 – FITNESS AND PROPRIETY

Answer the questions by ticking the relevant ‘yes’ or ‘no’ box. If the answer to any of the questions is ‘yes’, give complete details in section 6 and attach relevant supporting documentation.

When answering question 5.01, you must include ‘spent’ convictions, i.e. convictions for which, under the Rehabilitation of Offenders Act 1974 (and any overseas equivalent), declaration would not normally be obligatory.

5.03 – 5.06: Court judgements (e.g. County Court Judgments) (and their overseas equivalent) and arrangements with creditors (e.g. Individual Voluntary Arrangements) are covered by questions 5.03 to 5.06. Any outstanding County Court Judgments or arrangements with creditors must be listed in section 6, and the circumstances surrounding them explained.

“Regulatory body” in this context refers to:

- i) the self-regulatory organisations including IMRO, SFA, PIA, LAUTRO, FIMBRA, AFBD and TSA;
- ii) the statutory bodies including the FSA, SIB, the Society of Lloyd’s, the Registry of Friendly Societies, the Friendly Societies Commission, the Building Societies Commission, the Bank of England; HM Treasury – Insurance Directorate (formerly of the DTI) and the recognised bodies;
- iii) the designated professional bodies; and
- iv) the equivalent of all such regulators overseas.

SECTION 6 – SUPPLEMENTARY INFORMATION

This section provides space for any additional information and should be used whenever a question in section 5 is answered ‘yes’.

List here all directorships currently held or held in the past 10 years by the candidate.

Relevant documents must also be provided, such as evidence of the settlements of CCJs.

SECTION 7 – DECLARATIONS AND SIGNATURES

This section contains declarations which must be signed by both an appropriate individual for the firm or applicant submitting the application and the notified person. The FSA considers that an appropriate individual would be someone to whom the firm has delegated the authority to notify the FSA. The firm should keep records of those individuals authorised to sign on behalf of the firm.

If you have any questions or need additional information, please contact the Individual Vetting and Approval Helpline 020 7676 0019 or via e-mail at iva@fsa.gov.uk

PLEASE RETURN COMPLETED FORM TO:

THE FINANCIAL SERVICES AUTHORITY
INDIVIDUAL VETTING AND APPROVAL
25 THE NORTH COLONNADE
CANARY WHARF
LONDON E14 5HS
UNITED KINGDOM

1.01 a	FSA Individual Reference Number (IRN)	
b	OR name of previous regulatory body	
c	AND previous reference number	
1.02	Title (e.g. Mr, Mrs, Ms, etc)	
1.03	Surname	
1.04	ALL forenames	
1.05	Name commonly known by	
1.06	Date of birth	
1.07	National Insurance number	
1.08	Previous name See note	
1.09	Date of change	
1.10	Reason for change	
1.11 a	Nationality	
b	Passport number (If National Insurance number not available)	
1.12	Place of birth	



I have supplied further information related to this page in Section 6

YES

NO

1.13 a Private address

[Redacted address information]

b

Postcode

c Dates resident at this address (mm/yyyy)

From

[Redacted start date]

To

PRESENT

(If address has changed in the last three years, please provide addresses for the previous three years.)

1.14 a Previous address 1

[Redacted address information]

b

Postcode

c Dates resident at this address (mm/yyyy)

From

[Redacted start date]

To

[Redacted end date]

1.15 a Previous address 2

[Redacted address information]

b

Postcode

c Dates resident at this address (mm/yyyy)

From

[Redacted start date]

To

[Redacted end date]



I have supplied further information related to this page in Section 6

YES

NO

2.01	Name of firm making the application	
2.02	FSA Firm Reference Number (FRN)	
2.03 a	Name of Home State regulator	
b	Country	
2.04 a	Who should the FSA contact at the firm in relation to this notification?	
b	Position	
c	Telephone	
d	Fax	
e	E-mail	



I have supplied further information related to this page in Section 6

YES

NO

3.01 Notified positions individual is taking over.

- a Firm's world-wide chief executive where the person is situated outside the United Kingdom
- b The person, if not the worldwide chief executive, within the overseas firm with a purely strategic responsibility for UK operations
- c For a bank: the two or more persons who effectively direct its business in accordance with IPRU (BANK) GN 3.3.1R
- d For a UK branch of an insurer: the authorised UK representative

3.02 Effective date

3.03 FSA Individual Reference Number of individual being replaced

3.04 Name of individual being replaced



I have supplied further information related to this page in Section 6

YES

NO

Note: ALL gaps must be accounted for

4.01 Employment details (1)

a Period (mm/yyyy) From To

b Nature of employment

a	Employed	<input type="checkbox"/>
b	Self-employed	<input type="checkbox"/>
c	Unemployed	<input type="checkbox"/>
d	Full-time education	<input type="checkbox"/>

If b, c, or d is ticked, please give details

c Name of employer

d Nature of business

e Previous / other names of employer

f Last known address of employer

g Is/was employer regulated by a regulatory body? SEE NOTE

YES NO

Name of regulatory body

h Is/was employer an appointed representative?

YES NO

If yes, of which firm?

i Position held
SEE NOTE

j Responsibilities

k Reason for leaving:
SEE NOTE

a	Resignation	<input type="checkbox"/>
b	Redundancy	<input type="checkbox"/>
c	Retirement	<input type="checkbox"/>
d	Termination/dismissal	<input type="checkbox"/>
e	End of contract	<input type="checkbox"/>
f	Other	<input type="checkbox"/>

Specify



I have supplied further information related to this page in Section 6 YES NO

4.02 Employment details (2)

a Period (mm/yyyy) From To

b Nature of employment

a	Employed	<input type="checkbox"/>
b	Self-employed	<input type="checkbox"/>
c	Unemployed	<input type="checkbox"/>
d	Full-time education	<input type="checkbox"/>

If b, c, or d is ticked, please give details

c Name of employer

d Nature of business

e Previous / other names of employer

f Last known address of employer

g Is/was employer regulated by a regulatory body? SEE NOTE

YES <input type="checkbox"/>	NO <input type="checkbox"/>	Name of regulatory body
		<input type="text"/>

h Is/was employer an appointed representative?

YES <input type="checkbox"/>	NO <input type="checkbox"/>	If yes, of which firm?
		<input type="text"/>

i Position held
SEE NOTE

j Responsibilities

k Reason for leaving:
SEE NOTE

a	Resignation	<input type="checkbox"/>
b	Redundancy	<input type="checkbox"/>
c	Retirement	<input type="checkbox"/>
d	Termination/dismissal	<input type="checkbox"/>
e	End of contract	<input type="checkbox"/>
f	Other	<input type="checkbox"/>

Specify



I have supplied further information related to this page in Section 6 YES NO

4.03 Employment details (3)

a Period (mm/yyyy) From To

b Nature of employment

a	Employed	<input type="checkbox"/>
b	Self-employed	<input type="checkbox"/>
c	Unemployed	<input type="checkbox"/>
d	Full-time education	<input type="checkbox"/>

If b, c, or d is ticked, please give details

c Name of employer

d Nature of business

e Previous / other names of employer

f Last known address of employer

g Is/was employer regulated by a regulatory body? SEE NOTE YES NO Name of regulatory body

h Is/was employer an appointed representative? YES NO If yes, of which firm?

i Position held SEE NOTE

j Responsibilities

k Reason for leaving: SEE NOTE

a	Resignation	<input type="checkbox"/>
b	Redundancy	<input type="checkbox"/>
c	Retirement	<input type="checkbox"/>
d	Termination/dismissal	<input type="checkbox"/>
e	End of contract	<input type="checkbox"/>
f	Other	<input type="checkbox"/>

Specify



I have supplied further information related to this page in Section 6 YES NO

4.04 Employment details (4)

a Period (mm/yyyy)

From To

b Nature of employment

a	Employed	<input type="checkbox"/>
b	Self-employed	<input type="checkbox"/>
c	Unemployed	<input type="checkbox"/>
d	Full-time education	<input type="checkbox"/>

If b, c, or d is ticked,
please give details

c Name of employer

d Nature of business

e Previous / other names of employer

f Last known address of employer

g Is/was employer regulated by a regulatory
body? SEE NOTE

YES NO

Name of regulatory body

h Is/was employer an appointed
representative?

YES NO

If yes, of which firm?

i Position held
SEE NOTE

j Responsibilities

k Reason for leaving:
SEE NOTE

a	Resignation	<input type="checkbox"/>
b	Redundancy	<input type="checkbox"/>
c	Retirement	<input type="checkbox"/>
d	Termination/dismissal	<input type="checkbox"/>
e	End of contract	<input type="checkbox"/>
f	Other	<input type="checkbox"/>

Specify



I have supplied further information
related to this page in Section 6

YES

NO

4.05 Employment details (5)

a Period (mm/yyyy) From To

b Nature of employment

a	Employed	<input type="checkbox"/>
b	Self-employed	<input type="checkbox"/>
c	Unemployed	<input type="checkbox"/>
d	Full-time education	<input type="checkbox"/>

If b, c, or d is ticked, please give details

c Name of employer

d Nature of business

e Previous / other names of employer

f Last known address of employer

g Is/was employer regulated by a regulatory body? SEE NOTE

YES NO

Name of regulatory body

h Is/was employer an appointed representative?

YES NO

If yes, of which firm?

i Position held
SEE NOTE

j Responsibilities

k Reason for leaving:
SEE NOTE

a	Resignation	<input type="checkbox"/>
b	Redundancy	<input type="checkbox"/>
c	Retirement	<input type="checkbox"/>
d	Termination/dismissal	<input type="checkbox"/>
e	End of contract	<input type="checkbox"/>
f	Other	<input type="checkbox"/>

Specify

If necessary, please continue in section 6.



I have supplied further information related to this page in Section 6 YES NO

5.01 a	Has the notified person ever been convicted of any offence involving fraud, theft, false accounting or other dishonesty or an offence (whether or not in the United Kingdom) relating to companies, building societies, industrial and provident societies, credit unions, friendly societies, insurance, banking or other financial services, insolvency, consumer credit or consumer protection, money laundering, market manipulations or insider dealing? (Convictions spent under the Rehabilitation of Offenders Act 1974 must be included)	YES <input type="checkbox"/>	NO <input type="checkbox"/>
b	Is the notified person the subject of any current criminal proceedings?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
5.02	Has the notified person any convictions for any offences other than those listed in 5.01 above which are not spent, whether or not in the United Kingdom (excluding traffic offences unless these resulted in a ban from driving or involved driving without insurance)?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
5.03 a	Is the notified person, or has the notified person ever been, the subject of any civil proceedings, arbitration or litigation, including proceedings that may lead to a County Court Judgment (“CCJ”) or other judgment debts, in the United Kingdom or elsewhere?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
b	Is the notified person aware of any intention to begin such proceedings against the notified person in the future?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
5.04	Does the notified person have any judgment debts (including CCJs) made under a court order still outstanding, whether in full or in part?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
5.05	Has the notified person ever failed to satisfy any such judgment debts within one year of the making of the order?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
5.06 a	Is the notified person, or has the notified person ever been, the subject of any bankruptcy proceedings, or proceedings for the sequestration of the notified person’s estate?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
b	Has the notified person ever entered into a deed of arrangement or an individual voluntary arrangement (or in Scotland a trust deed) or other agreement in favour of the notified person’s creditors, or is the notified person doing so?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
5.07	Does the notified person have any outstanding financial obligations arising from regulated activities, which the notified person has conducted in the past, whether in the United Kingdom or overseas? (In the case of advisers, this will include any outstanding liabilities arising from commissions paid for the sale of packaged products that have lapsed.)	YES <input type="checkbox"/>	NO <input type="checkbox"/>
5.08	Has the notified person ever been found guilty of conducting any unauthorised regulated activities or been investigated for possible conduct of unauthorised regulated activities?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
5.09	Is the notified person, or has the notified person ever been, the subject of an investigation into allegations of misconduct or malpractice in connection with any business activity?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
5.10	Has the notified person ever, either in the United Kingdom, or elsewhere –		
a	been refused entry to, or been dismissed or requested to resign from, any profession, vocation, office or employment, or from any fiduciary office or position of trust, whether or not remunerated?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
b	been refused, restricted in, or had suspended, the right to carry on any trade, business or profession for which specific licence, authorisation, registration, membership or other permission is required?	YES <input type="checkbox"/>	NO <input type="checkbox"/>



I have supplied further information related to this page in Section 6

YES NO

c	been disqualified by a court from acting as a director of a company or from acting in a management capacity or conducting the affairs of any company, partnership or unincorporated association?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
d	been the subject of a disqualification direction under section 59 of the Financial Services Act 1986 or a prohibition order, under section 56 of the Financial Services and Markets Act 2000, or received a warning notice to make such a direction or order?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
5.11	In respect of activities regulated by the FSA or any other regulatory body (see note), has the notified person, or has any company, partnership or unincorporated association of which the notified person is or has been a controller, director, senior manager, partner or company secretary, during the notified person's association with that entity and for a period of three years after the notified person ceased to be associated with it, ever –		
a	been refused, had revoked, restricted or terminated, any licence, authorisation, registration, notification, membership or other permission granted by any such body ?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
b	been criticised, censured, disciplined, suspended, expelled, fined, or been the subject of any other disciplinary or intervention action by any such body ?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
c	resigned whilst under investigation by, or been required to resign from, any such body ?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
d	decided, after making an application for any licence, authorisation, registration, notification, membership or other permission granted by any such body, not to proceed with it?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
e	been the subject of any civil action which has resulted in a finding against the notified person or it by a court?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
5.12	Has any company, partnership, or unincorporated association of which the notified person is or has been a controller, director, senior manager, partner, or company secretary, in the United Kingdom or elsewhere, at any time during the notified person's involvement or within one year of such an involvement –		
a	been put into liquidation, wound up, ceased trading, had a receiver or administrator appointed or entered into any voluntary arrangement with its creditors?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
b	been adjudged by a court liable for any fraud, misfeasance, wrongful trading or other misconduct?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
c	been investigated or been involved in an investigation by an inspector appointed under companies or any other legislation, or required to produce documents to the Secretary of State, or any other authority, under any such legislation?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
d	been convicted of any criminal offence, censured, disciplined or publicly criticised, by any inquiry, by the Takeover Panel or any governmental or statutory authority or any other regulatory body (other than as already indicated under 5.11(b) above)?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
5.13	Is the notified person aware of any business interests, employment obligations, or any other situations which may conflict with the performance of the controlled functions for which approval is now sought?	YES <input type="checkbox"/>	NO <input type="checkbox"/>



I have supplied further information related to this page in Section 6

YES

NO

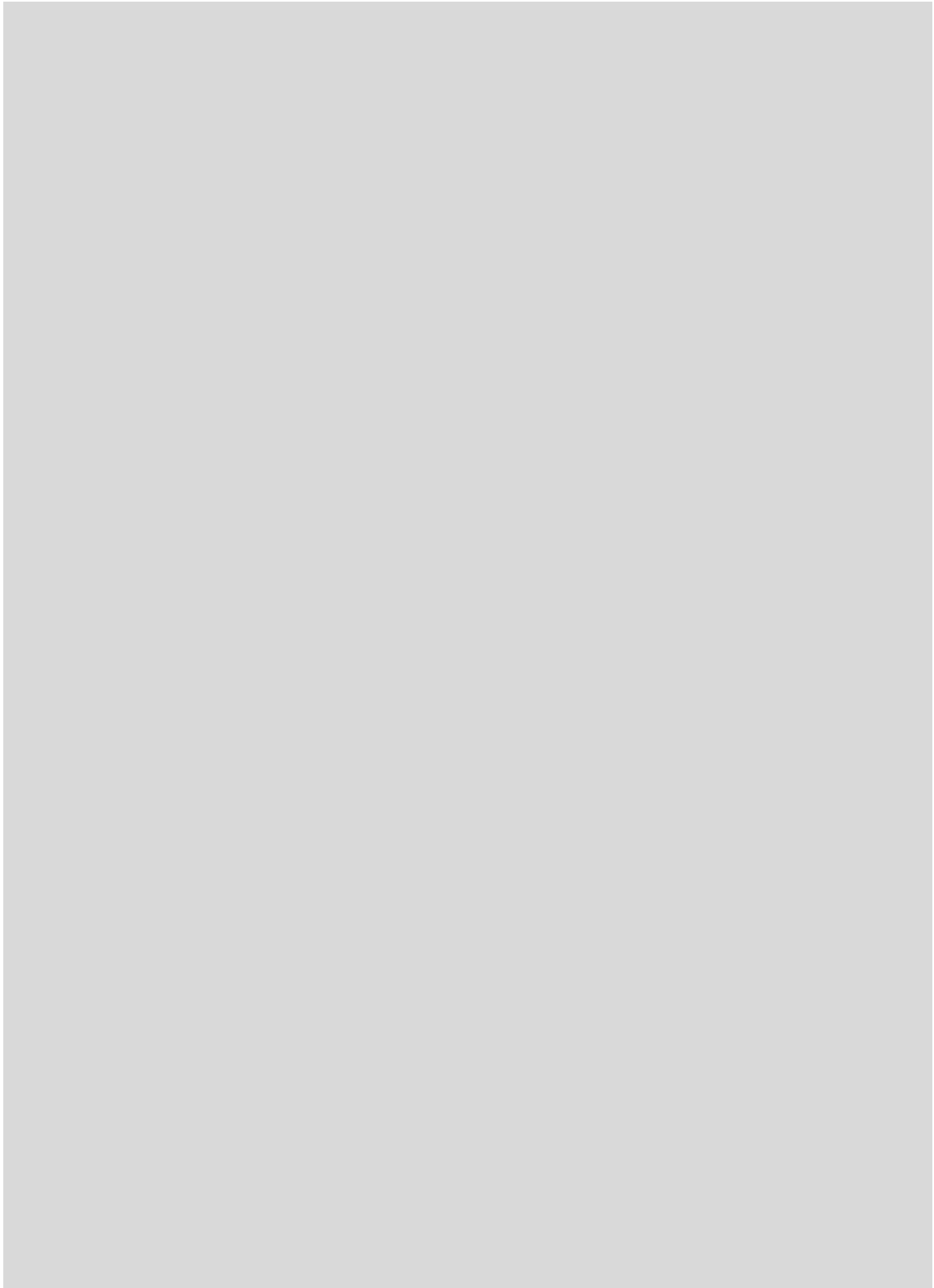
Please also complete questions 6.03 and 6.04.

6.01 Full details must be provided here if there were any issues that arose when leaving an employer listed in section 4 or if any question has been answered 'yes' in section 5.

Please indicate clearly which question additional information relates to.

Question	Information

6.02 Include a list of all directorships currently or previously held by the candidate (where director has the meaning given in the Glossary).



6.03 Is there any other information the candidate or the firm considers to be relevant to the application?

YES NO

If yes, provide details below or on a separate sheet of paper

A large, solid grey rectangular area intended for providing details if the answer to question 6.03 is 'yes'. It occupies most of the page's vertical space.

6.04 How many additional sheets are being submitted?

A small, solid grey rectangular area intended for providing the number of additional sheets being submitted.

DECLARATION OF NOTIFIED PERSON

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (section 398 of the Financial Services and Markets Act 2000).

It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that the information in this Form is accurate and complete to the best of my knowledge and belief and that I have read the Notes to this Form.

The FSA may seek to verify the information given in this Form including answers pertaining to fitness and propriety. I authorise the FSA to make such enquiries and seek such further information as it thinks appropriate in the course of verifying the information given in this Form. I also understand that the results of these checks may be disclosed to my employer.

7.01	Notified person's full name	
7.02	Signature	
	Date	

DECLARATION OF FIRM

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.4R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. APER 4.4.6E provides that, where an approved person is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of Statement of Principle 4. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

In making this application the firm believes on the basis of due and diligent enquiry that the notified person is a fit and proper person to perform the notified position(s) listed in section 3. The firm also believes, on the basis of due and diligent enquiry, that the notified person is competent to fulfil the duties required of such function(s).

I confirm that the information in this Form is accurate and complete to the best of my knowledge and belief and that I have read the Notes to this Form.

I confirm that I have authority to make this notification, and sign this Form, on behalf of each firm identified in section 6. I also confirm that a copy of this Form, as submitted to the FSA, will be sent to each of those firms at the same time as submitting the Form to the FSA.

7.03	Name of the firm submitting the application	
7.04	Name of person signing on behalf of the firm	
7.05	Job title	
7.06	Signature	
	Date	

Completion checklist

- Is the Form fully completed?

- Are ALL forenames included?

- Is there a complete ten-year employment history with all gaps explained?

- Is the Form correctly signed and dated by both the firm making the application and the notified person?

- Has all supplementary information been included and clearly marked?

Note : Detach and keep the Notes before returning the completed Form to the FSA.

Chapter 16

Reporting requirements



16.1 Application

- 16.1.1** **R** ^{/1} This chapter applies to every *firm* within a category listed in column (2) of the table in SUP 16.1.3R and in accordance with column (3) of that table.
- 16.1.2** **G** ^{/1} The only categories of *firm* to which no section of this chapter applies are:
- (1) an *ICVC*;
 - (2) an *incoming EEA firm* or *incoming Treaty firm*, unless it is:
 - (a) a *firm* of a type listed in SUP 16.1.3R as a type of *firm* to which SUP 16.6 or SUP 16.7 applies; or
 - (b) an *insurer* with *permission to effect or carry out life policies*;
 - (3) a *UCITS qualifier*.
- 16.1.3** **R** ^{/1} Table Application of different sections of SUP 16

(1) Section(s)	(2) Categories of firm to which section applies	(3) Applicable rules and guidance
SUP 16.1, 16.2 and 16.3	<p>All categories of <i>firm</i> except:</p> <p>(a) an <i>ICVC</i>;</p> <p>(b) an <i>incoming EEA firm</i> or <i>incoming Treaty firm</i>, which is not:</p> <p style="padding-left: 40px;">(i) a <i>firm</i> of a type to which <i>SUP 16.6</i> or <i>SUP 16.7</i> applies; or</p> <p style="padding-left: 40px;">(ii) an <i>insurer</i> with <i>permission to effect or carry out life policies</i>;</p> <p>(c) a <i>UCITS qualifier</i>.</p>	Entire sections
SUP 16.4 and 16.5	<p>All categories of <i>firm</i> except:</p> <p>(a) an <i>ICVC</i>;</p> <p>(b) an <i>incoming EEA firm</i>;</p> <p>(c) an <i>incoming Treaty firm</i>;</p> <p>(d) a <i>non-directive friendly society</i>;</p> <p>(e) a <i>partnership</i>;</p> <p>(f) a <i>sole trader</i>;</p> <p>(g) a <i>service company</i>;</p> <p>(h) a <i>UCITS qualifier</i>.</p>	Entire sections

(1) Section(s)	(2) Categories of firm to which section applies	(3) Applicable rules and guidance
<i>SUP 16.6</i>	<i>Bank</i>	<i>SUP 16.6.4 to SUP 16.6.5R</i>
	<i>Depository of an ICVC</i>	<i>SUP 16.6.6R to SUP 16.6.9G</i>
	<i>OPS firm</i>	<i>SUP 16.6.6R to SUP 16.6.8R</i>
	<i>Trustee of an AUT</i>	<i>SUP 16.6.6R to SUP 16.6.9G</i>
<i>SUP 16.7</i>	<i>Bank</i>	<i>SUP 16.7.7R to SUP 16.7.15R</i>
	<i>Building society</i>	<i>SUP 16.7.16R to SUP 16.7.19R</i>
	<i>Service company</i>	<i>SUP 16.7.20R to SUP 16.7.21R</i>
	<i>Securities and futures firm (other than an oil market participant to which IPRU(INV) 3 does not apply)</i>	<i>SUP 16.7.22R to SUP 16.7.34G</i>
	<i>Investment management firm</i>	<i>SUP 16.7.35R to SUP 16.7.41R</i>
	<i>Personal investment firm</i>	<i>SUP 16.7.42R to SUP 16.7.53R</i>
	<i>Authorised professional firm (note)</i>	<i>SUP 16.7.54R</i>
	<i>Society of Lloyd's</i>	<i>SUP 16.7.55R to SUP 16.7.56R and SUP 16.7.59R(1) and (2)</i>
<i>Members' adviser</i>	<i>SUP 16.7.57R to SUP 16.7.58R, SUP 16.7.59R(3), SUP 16.7.60G and SUP 16.7.61G</i>	

(1) Section(s)	(2) Categories of firm to which section applies	(3) Applicable rules and guidance
SUP 16.8	An insurer with permission to effect or carry out life policies	Entire section

Note = Section 16.7 applies to an authorised professional firm which is required by IPRU(INV) 2.1.2R(1) to comply with chapter 3, 5, 10 or 13 of IPRU(INV). Section 16.7 applies to such a firm as if it were the relevant firm category in the right hand column of IPRU(INV) 2.1R.

16.1.4

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- (1) This chapter contains requirements to report to the FSA on a regular basis. These requirements include reports relating to a firm’s financial condition, and to its compliance with other rules and requirements which apply to the firm. Where the relevant requirements are set out in another section of the Handbook, this chapter contains cross references. An example of this is financial reporting for insurers and friendly societies.
- (2) Where such requirements already apply to a firm under legislation other than the Act, they are not referred to in this chapter. An example of this is reporting to the FSA by building societies under those parts of the Building Societies Act 1986 which have not been repealed.
- (3) Requirements for individual firms reflect:
 - (a) the category of firm;
 - (b) the nature of business carried on;
 - (c) whether a firm has its registered office (or if it does not have a registered office, its head office) in the United Kingdom; and
 - (d) whether a firm is an incoming EEA firm or incoming Treaty firm.

16.1.5

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The reporting of complaints is covered in DISP 1.5.4R – DISP 1.5.8G.

16.1.6

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Reporting on pension transfers and pension opt-outs arranged by the firm against its advice is covered in COB 5.3.26R.

16.2 Purpose

16.2.1

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- (1) In order to discharge its functions under the *Act*, the *FSA* needs timely and accurate information about *firms*. The provision of this information on a regular basis enables the *FSA* to build up over time a picture of *firms*' circumstances and behaviour.
- (2) *Principle 11* requires a *firm* to deal with its regulators in an open and cooperative way, and to tell the *FSA* appropriately anything of which the *FSA* would reasonably expect notice. The reporting requirements are part of the *FSA*'s approach to amplifying *Principle 11* by setting out in more detail the information that the *FSA* requires. They supplement the provisions of *SUP 2* (Information gathering by the *FSA* on its own initiative) and *SUP 15* (Notifications to the *FSA*). The reports required under these *rules* help the *FSA* to monitor *firms*' compliance with *Principles* governing relationships between *firms* and their *customers*, with *Principle 4*, which requires *firms* to maintain adequate financial resources, and with other requirements and standards under the *regulatory system*.

16.3 General provisions on reporting

Application

16.3.1

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The effect of SUP 16.1.1R is that this section applies to every *firm* except:

- (1) an *ICVC*;
- (2) an *incoming EEA firm* or *incoming Treaty firm*, which is not:
 - (a) a *firm* of a type listed in SUP 16.1.3R as a *firm* to which section SUP 16.6 or SUP 16.7 applies;
 - (b) an *insurer* with *permission* to *effect* or *carry out life policies*;
- (3) a *UCITS qualifier*.

Structure of the chapter

16.3.2

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This chapter has been split into five sections, covering:

- (1) annual controllers reports (SUP 16.4);
- (2) annual close links reports (SUP 16.5);
- (3) compliance reports (SUP 16.6);
- (4) financial reports (SUP 16.7); and
- (5) persistency reports (SUP 16.8).

16.3.3

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The annual controllers, annual close links and persistency reports sections are the same for all categories of *firm* to which they apply.

16.3.4

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The compliance and financial reports sections are both set out by category of *firm*, with detailed requirements set out in tables giving:

- (1) a brief description of each report;
- (2) the frequency with which the report is required; and
- (3) the due date for submission of the report.

16.3.5

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Further requirements about the reports, such as form and content, are set out in the sections for each category of *firm*, where this is appropriate. In many cases, however, it is more appropriate to provide this information by means of a separate annex; in these cases the relevant section refers to the annex.

Method of submission of reports

16.3.6

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Unless a *rule* in this chapter states otherwise, a report required under this chapter must be submitted in writing in accordance with *SUP* 16.3.7R – *SUP* 16.3.10R.

16.3.7

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- (1) A report required under this chapter must give the *firm's* FSA firm reference number.
- (2) If a report required under this chapter is submitted on behalf of more than one *firm*, the report must either:
 - (a) give the FSA firm reference number of the *firm* submitting it; or
 - (b) be submitted with a covering letter or email giving:
 - (i) the FSA firm reference numbers of all *firms* on whose behalf the report has been submitted;
 - (ii) the title of the report being submitted; and
 - (iii) the date as at which the report has been prepared.

16.3.8

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A written report must be:

- (1) given to or addressed for the attention of the *firm's* usual supervisory contact at the *FSA*; and
- (2) delivered to the *FSA* by one of the methods listed in *SUP* 16.3.9R.

16.3.9

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Table Method of submission of reports (see *SUP* 16.3.8R)

Method of delivery

1. **Post to the appropriate address in *SUP* 16.3.10R**
2. **Leaving the report at the appropriate address in *SUP* 16.3.10R and obtaining a time-stamped receipt**
3. **Electronic mail to an address for the *firm's* usual supervisory contact at the *FSA* and obtaining an electronic confirmation of receipt**

4. Hand delivery to the *firm's* usual supervisory contact at the *FSA*
5. Fax to the number notified by the *firm's* usual supervisory contact at the *FSA*, followed by submission by one of methods 1– 4 in this table within five *business days* after the date of the faxed submission

16.3.10

RThe address for the submission of reports to the *FSA* is:

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- (1) The Financial Services Authority

25 The North Colonnade

Canary Wharf

London E14 5HS

if the *firm's* usual supervisory contact at the *FSA* operates from London, or:

- (2) The Financial Services Authority

Sutherland House

108-114 Dundas Street

Edinburgh EH3 5DQ

if the *firm's* usual supervisory contact at the *FSA* operates from Edinburgh.**Complete reporting**

16.3.11

RA *firm* must submit reports required under this chapter to the *FSA* containing all the information required.

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16.3.12

G*SUP* 15.6 refers to and contains requirements regarding the steps that *firms* must take to ensure that information provided to the *FSA* is accurate and complete. Those requirements apply to reports required to be submitted under this chapter.

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Timely reporting

16.3.13

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- (1) A *firm* must submit a report required by this chapter in the frequency, and so as to be received by the *FSA* no later than the due date, specified for that report.
- (2) If the due date for submission of a report required by this chapter falls on a day which is not a *business day*, the report must be

submitted so as to be received by the *FSA* no later than the first *business day* after the due date.

- (3) If the due date for submission of a report required by this chapter is a set period of time after the quarter end, the quarter ends will be the following dates, unless another *rule* or the reporting form states otherwise:
- (a) the *firm's accounting reference date*;
 - (b) 3 months after the *firm's accounting reference date*;
 - (c) 6 months after the *firm's accounting reference date*; and
 - (d) 9 months after the *firm's accounting reference date*.

Failure to submit reports

16.3.14 G_{/1} Failure to submit a report in accordance with the *rules* in this chapter may lead to the imposition of a financial penalty and other disciplinary sanctions (see *ENF* 13.5).

16.3.15 G_{/1} The *FSA* does not routinely send reminders to *firms* when reports are overdue. *Firms* should not therefore assume that the *FSA* has received a report merely because they have not received a reminder.

16.3.16 G_{/1} The *firm* is responsible for ensuring delivery of the required report at the *FSA's* offices by the due date. If a report is received by the *FSA* after the due date and the *firm* believes its delivery arrangements were adequate, it may be required to provide proof of those arrangements. Examples of such proof would be:

- (1) "proof of posting" receipts from a *UK* post office or overseas equivalent which demonstrates that the report was posted early enough to allow delivery by the due date in accordance with the delivery service standards prescribed by the relevant postal authority; or
- (2) recorded postal delivery receipts showing delivery on the required day; or
- (3) records of a courier service provider showing delivery on the required day.

Change of accounting reference date

- 16.3.17** R_{/1}
- (1) A *firm* must notify the *FSA* if it changes its *accounting reference date*.
 - (2) When a *firm* extends its accounting period, it must make the notification in (1) before the previous *accounting reference date*.
 - (3) When a *firm* shortens its accounting period, it must make the notification in (1) before the new *accounting reference date*.

16.3.18 G_{/1} *SUP* 16.2.1G emphasises the importance to the *FSA* of timely and accurate information. The extension of a *firm's* accounting period to more than 15 months may hinder the timely provision of relevant and important information to the *FSA*. This is because many due dates for reporting to the *FSA* are linked to *firms' accounting reference dates*. Indeed, for some categories of *firm*, the only reports required by the *FSA* have due dates for submission which are linked to the *firm's accounting reference date*. If the extension of a *firm's* accounting period appears likely to impair the effectiveness of the *FSA's* supervisory work, the *FSA* may take action to ensure that it continues to receive the information it requires on a timely basis. This may include the use of any of the tools of supervision set out in *SUP* 1.4.5G.

16.3.19 G_{/1} If more than one *firm* in a *group* intends to change its *accounting reference date* at the same time, a single notification may be given to the *FSA*, as described in *SUP* 15.7.8G.

Underwriting agents: submission to the Society of Lloyd's

16.3.20 R_{/1} (1) Paragraph (2) applies in relation to reports required under this chapter within the scope of any arrangements made by the *FSA* with the *Society of Lloyd's* under paragraph 6(2) of Schedule 1 to the *Act*.

(2) An *underwriting agent* must submit the reports in (1) to the *Society of Lloyd's* rather than to the *FSA*.

16.3.21 G_{/1} See *SUP* 15.7.13G and *SUP* 15.7.14G for *guidance* on arrangements in *SUP* 16.3.20R.

Service of Notices Regulations

16.3.22 G_{/1} The Financial Services and Markets Act 2000 (Service of Notices) Regulations 2001 (SI 2001/1420) contain provisions relating to the service of documents on the *FSA*. They do not apply to reports required under *SUP* 16, because of the specific *rules* in this section.

Confidentiality and sharing of information

16.3.23 G_{/1} When the *FSA* receives a report which contains confidential information and whose submission is required under this chapter, it is obliged under Part XXIII of the *Act* (Public Record, Disclosure of Information and Co-operation) to treat that information as confidential. (See *SUP* 2.2.4G)

16.3.24 G_{/1} *SUP* 2.3.12G states that the *FSA* may pass to other regulators information which it has in its possession. Such information includes information contained in reports submitted under this chapter. The *FSA's* disclosure of information to other regulators is subject to *SUP* 2.2.4G (Confidentiality of information).

Reports from groups**16.3.25****G**
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If this chapter requires the submission of a report covering a *group*, a single report may be submitted, and so satisfy the requirements of all *firms* in the *group*. Such a report should contain the information required from all of them, meet all relevant due dates and indicate all the *firms* on whose behalf it is submitted; if necessary a separate covering sheet should list the *firms* on whose behalf a report is submitted. Nevertheless, the requirement to provide a report, and the responsibility for the report, remain with each *firm* in the *group*.

16.3.26**G**
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Examples of reports covering a *group* are:

- (1) the compliance reports required from *banks* under *SUP* 16.6.4R;
- (2) annual controllers reports required under *SUP* 16.4.5R;
- (3) annual close links reports required under *SUP* 16.5.4R
- (4) consolidated financial reports required from *banks* under *SUP* 16.7.7R;
- (5) consolidated reporting statements required from *securities and futures firms* under *SUP* 16.7.24R.

16.4 Annual controllers report

Application

16.4.1

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The effect of SUP 16.1.1R is that this section applies to every *firm* except:

- (1) an *ICVC*;
- (2) an *incoming EEA firm*;
- (3) an *incoming Treaty firm*;
- (4) a *non-directive friendly society*;
- (5) a *partnership*;
- (6) a *sole trader*;
- (7) a *service company*;
- (8) a *UCITS qualifier*.

16.4.2

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This section may be of relevance to a *directive friendly society*:

- (1) if it has 10 members or less;
- (2) if it has a delegate voting system and has 10 delegates or less; or
- (3) if it has 20 members or less and effects or carries out group insurance contracts where one person may exercise one vote on behalf of the members of a group and one vote in their private capacity; or

where a member or delegate, whether alone or with any associate, is entitled to exercise, or control the exercise of, 10% or more of the total voting power.

16.4.3

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Requirements for notifications of a change in *control* can be found in SUP 11 (Controllers and close links).

Purpose

16.4.4

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A *firm* and its *controllers* are required to notify certain changes in *control* (See SUP 11 (Controllers and close links)). The purpose of the *rules* and *guidance* in this section is:

- (1) to ensure that, in addition to such notifications, the *FSA* receives regular and comprehensive information about the identities of all of the *controllers* of a *firm*, which is relevant to a *firm's* continuing to satisfy the *threshold conditions* (see *COND 2.3*) and to the protection of *consumers*;
- (2) to implement certain requirements relating to annual reporting of *controllers* which must be imposed on *firms* under the *Investment Services Directive*, the *Banking Consolidation Directive*, the *Third Life Directive* and the *Third Non-Life Directive*; and
- (3) to support the *FSA's* functions under Part XII of the *Act* (Control over authorised persons) (see *SUP 11* (Controllers and close links)).

Reporting requirement

16.4.5

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- (1) A *firm* must submit a report to the *FSA* annually, containing the information in (3) or (4) (as applicable).
- (2) A *firm* must submit the report in (1) to the *FSA* within four months of the *firm's accounting reference date*.
- (3) If a *firm* is not aware:
 - (a) that it has any *controllers*; or
 - (b) of any changes in the identity of its *controllers* since the submission of its previous report under (1); or
 - (c) of any changes in the percentage of shares or *voting power* in the *firm* held by any *controllers* (alone or with any associate) since the submission of its previous report;

then the report in (1) must confirm this.
- (4) Unless (3) applies, the report in (1) must contain a list of all the *controllers* as at the *firm's accounting reference date* of which it is aware and, for each such *controller*, state:
 - (a) its name;
 - (b) the percentage of *voting power* in the *firm*, or in the *firm's parent undertaking*, which it is entitled to exercise or control the exercise of, whether alone or with any associate;
 - (c) the percentage of shares in the *firm*, or in the *firm's parent undertaking*, which it holds, whether alone or with any associate;
 - (d) if the *controller* is a *body corporate*, its country of incorporation, address and registered number; and
 - (e) if the *controller* is an individual, his date and place of birth.

(5) **In this section, “associate” and “shares” have the meanings given in the definition of *controller*.**

- 16.4.6** **G**
/1 The information required by SUP 16.4.5R(4) may be provided in the form of a group organisation chart.
- 16.4.7** **G**
/1 If a *group* includes more than one *firm*, a single annual controllers report may be submitted, and so satisfy the requirements of all *firms* in the *group*. Such a report should contain the information required from all of them, meet all relevant due dates and indicate all the *firms* on whose behalf it is submitted. Nevertheless, the requirement to provide a report, and the responsibility for the report, remain with each *firm* in the *group*.
- 16.4.8** **G**
/1 A *firm* may submit a single report satisfying the requirements of its annual controllers report (SUP 16.4.5R) and its annual close links report (SUP 16.5.4R). Such a report should contain the information required on both *controllers* and *close links*.
- 16.4.9** **G**
/1 *Firms* are reminded of the requirement in SUP 11.4.10R to take reasonable steps to keep themselves informed about the identity of their *controllers*.
- 16.4.10** **R**
/1 If a *firm* is a *friendly society* or a *building society*, then it is required to submit a report under SUP 16.4.5R only if it is aware that it has a *controller*.

16.5 Annual close links report

Application

16.5.1

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The effect of *SUP* 16.1.1R is that this section applies to every *firm* except:

- (1) an *ICVC*;
- (2) an *incoming EEA firm*;
- (3) an *incoming Treaty firm*;
- (4) a *non-directive friendly society*;
- (5) a *partnership*;
- (6) a *sole trader*;
- (7) a *service company*;
- (8) a *UCITS qualifier*.

Purpose

16.5.2

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A *firm* is required to notify the *FSA* of changes to its *close links* (see *SUP* 11.9). *Threshold condition 3* (Close links) provides that, if a *firm* has *close links* with another *person*, the *FSA* must be satisfied that:

- (1) those *close links* are not likely to prevent the *FSA*'s effective supervision of the *firm*; and
- (2) where it appears to the *FSA* that the *person* is subject to the laws, regulations or administrative provisions of a territory which is not an *EEA State*, neither the foreign provisions, nor any deficiency in their enforcement, would prevent the *FSA*'s effective supervision of the *firm*.

16.5.3

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The purposes of the *rules* and *guidance* in this section are:

- (1) to ensure that, in addition to such notifications, the *FSA* receives regular and comprehensive information about the identities of all persons with whom a *firm* has *close links*, which is relevant to a *firm*'s continuing to satisfy the *threshold condition 3* (Close links) (see *COND* 2.3) and to the protection of *consumers*; and

- (2) to implement certain requirements relating to the provision of information on *close links* which must be imposed on *firms* under the “*Post-BCCI Directive*”.

Report

16.5.4

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- (1) A *firm* must submit a report to the *FSA* annually, containing the information in (3) or (4) (as applicable).
- (2) A *firm* must submit the report in (1) to the *FSA* within four months of the firm’s *accounting reference date*.
- (3) If a *firm* is not aware:
- (a) that it has any *close links*; or
 - (b) of any material changes to the details in (4) (a) to (c) in respect of its *close links* since the submission of its previous report under (1);
- then the report in (1) must confirm this.
- (4) Unless (3) applies, the report in (1) must contain a list of all *persons* with whom the *firm* has *close links* as at the *firm’s accounting reference date* of which it is aware, and for each such *person* state:
- (a) its name;
 - (b) the nature of the *close links*;
 - (c) if the *close link* is with a *body corporate*, its country of incorporation, address and registered number; and
 - (d) if the *close link* is with an individual, his date and place of birth.

16.5.5

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The information required by *SUP* 16.5.4R(4) may be provided in the form of a group organisation chart.

16.5.6

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If a *group* includes more than one *firm*, a single annual close links report may be submitted and so satisfy the requirements of all *firms* in the *group*. Such a report should contain the information required from all of them, meet all relevant due dates and indicate all the *firms* on whose behalf it is submitted. Nevertheless, the requirement to provide a report, and the responsibility for the report, remain with each *firm* in the *group*.

16.5.7

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A *firm* may submit a single report satisfying the requirements of its annual controllers report (*SUP* 16.4.5R) and its annual close links report (*SUP* 16.5.4R). Such a report should contain the information required on both *controllers* and *close links*.

16.5.8

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If a *firm* is an unincorporated *friendly society*, then it is only required to submit a report under SUP 16.5.4R if it is aware that it has *close links*.



16.6 Compliance reports

Application

16.6.1 G_{/1} The effect of SUP 16.1.1R is that this section applies to every *firm* within a category listed in the left hand column of the table in SUP 16.6.2G.

16.6.2 G_{/1} Table Applicable provisions of this section (see SUP 16.6.1G)

Category of firm	Applicable provisions
<i>Bank</i>	SUP 16.6.4R – SUP 16.6.5R
<i>Trustee of an AUT</i> <i>Depositary of an ICVC</i>	SUP 16.6.6R – SUP 16.6.9G
<i>OPS firm</i>	SUP 16.6.6R – SUP 16.6.8R

Purpose

16.6.3 G_{/1} The FSA performs part of its supervision work by reviewing and analysing information about *firms'* records of compliance with the requirements and standards under the *regulatory system*. The type of report the FSA requires will vary, depending on the type of business a *firm* undertakes. The requirements in SUP 16.6 represent an interim approach to compliance reporting, based mainly on the reporting requirements, which *previous regulators* applied to *firms*. This information helps the FSA to determine whether a *firm* is complying with the requirements applicable to its business, and what procedures it is operating to ensure its compliance.

Banks

16.6.4 R_{/1} **A bank must submit compliance reports to the FSA in accordance with SUP 16.6.5R.**

16.6.5 R_{/1} Table Compliance reports from a bank (see SUP 16.6.4R)

Report	Frequency	Due date
List of all <i>overseas regulators</i> for each legal entity in the <i>firm's group</i>	Annually	6 months after the <i>firm's accounting reference date</i>
Organogram showing the <i>authorised entities</i> in the <i>firm's group</i>	Annually	6 months after the <i>firm's accounting reference date</i>

Trustees of authorised unit trust schemes, depositaries of ICVCs, and OPS firms

16.6.6 **R** ^{/1} A *firm* within a category listed in the left-hand column of SUP 16.6.7R must submit compliance reports in accordance with SUP 16.6.7R.

16.6.7 **R** ^{/1} Table Compliance reports from trustees of AUTs, depositaries of ICVCs, and OPS firms (see SUP 16.6.6R)

Report	Frequency	Due date
Report from a <i>trustee</i> of an <i>AUT</i> on <i>manager's failures</i> as set out in SUP 16.6.8R(1)	Quarterly	1 month after quarter end (Note)
Report from a <i>depository</i> of an <i>ICVC</i> on failures by the <i>authorised corporate director</i> as set out in SUP 16.6.8R(2)	Quarterly	1 month after quarter end (Note)
<i>OPS firms only:</i> Annual accounts of each <i>occupational pension scheme</i> in respect of which the <i>firm</i> is acting	Annually	7 months after end of the scheme year

Report	Frequency	Due date
<i>OPS firms only:</i> Audited annual accounts of each <i>OPS collective investment scheme</i> in respect of which the <i>firm</i> is acting	Annually	7 months after end of the scheme year
Note = The quarter ends are the end of the scheme year and 3, 6 and 9 months after that date.		

16.6.8

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- (1) The report from a *trustee* of an *AUT* to the *FSA* must state, in relation to the *manager* of each *AUT* for which it is a *trustee*, the number of times during the quarter in which facts came to the *firm's* knowledge from which it appeared, or might have appeared, that the *manager* had failed (materially or otherwise) to:
- (a) give correct instructions to the *trustee* to create or cancel *units* in the *AUT* when the *manager* should have done so, and the error:
 - (i) resulted in the creation of too few *units* or in the cancellation of too many *units*; and
 - (ii) was not corrected in accordance with the *FSA's guidance* as set out in *CIS App*;
 - (b) price *units* in the *AUT* in accordance with *CIS 4* for single-priced *AUTs* and *CIS 15* for dual-priced *AUTs*, where the pricing error was:
 - (i) greater than 0.5% of the price of a *unit*; or
 - (ii) less than 0.5% of the price of a *unit*, and the *trustee* did not consider the *manager's* controls to be adequate;
- unless the failure was an isolated incident.
- (2) The report from a *depository* of an *ICVC* to the *FSA* must state, in relation to the *authorised corporate director* of each *ICVC* for which the *firm* is a *depository*, the number of times during the quarter in which facts came to the *firm's* knowledge from which it appeared or might have appeared that the *authorised corporate director* had failed (materially or otherwise) to:
- (a) arrange for the issue or cancellation of *shares* in the *ICVC* when the *authorised corporate director* should have done so, and the error:

- (i) resulted in the creation of too few *shares* or in the cancellation of too many *shares*; and
 - (ii) was not corrected in accordance with the *FSA's guidance* as set out in *CIS App*;
- (b) price *shares* in the *ICVC* in accordance with the provisions of *CIS 4* for *ICVCs*, where the pricing error was:
- (i) greater than 0.5% of the price of a *share*; or
 - (ii) less than 0.5% of the price of a *share*, and the *depository* did not consider the *authorised corporate director's* controls to be adequate;

unless the failure was an isolated incident.

- (3) An *OPS firm* must notify the *FSA* of any change in the date of commencement of the scheme year of an *OPS* or *OPS collective investment scheme*, in respect of which the *firm* is acting, not less than 15 *business days* before the date on which such a change is to become effective.

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SUP 16 Ann 12G provides *guidance* on the completion of the report from a *trustee* of an *AUT* on a *manager's* failures as set out in *SUP 16.6.8R(1)*, and the report from a *depository* of an *ICVC* on failures by the *authorised corporate director* as set out in *SUP 16.6.8R(2)*. This *guidance* includes suggested formats for the submission of the reports.



16.7 Financial reports

Application

- 16.7.1 **G**_{/1} The effect of SUP 16.1.1R is that this section applies to every *firm* within a category listed in the left hand column of SUP 16.7.5G.
- 16.7.2 **G**_{/1}
 - (1) Reporting requirements for *insurers*, excluding *friendly societies* are set out in IPRU(INS).
 - (2) Reporting requirements for *friendly societies* are set out in IPRU(FSOC).

Purpose

- 16.7.3 **G**_{/1} *Principle 4* requires *firms* to maintain adequate financial resources, and the Interim Prudential sourcebooks set out the FSA’s detailed capital adequacy requirements. By submitting regular financial reports, *firms* enable the FSA to monitor their compliance with *Principle 4* and with the detailed requirements of the Interim Prudential sourcebooks. These reports also help the FSA to analyse *firms*’ financial condition and performance and to understand their business. By means of further collation and review of the data which these reports provide, the FSA also uses the reports to identify developments across the financial services industry and its constituent sectors.
- 16.7.4 **G**_{/1} The requirements in this section differ according to *firm* categories, as different financial information is required to reflect different types of business. The requirements in SUP 16.7 represent an interim approach to financial reporting, based mainly on the reporting requirements which *previous regulators* applied to *firms*. Standard formats are used for reporting by each category of *firm*, to assist comparability between *firms* of the same category. Timely submission is important to ensure the FSA has up-to-date information.

16.7.5 **G**_{/1} Table Applicable rules and guidance on financial reports (see SUP 16.7.1G)

Firm category	Applicable rules and guidance
<i>Bank</i>	SUP 16.7.7R – SUP 16.7.15R
<i>Building society</i>	SUP 16.7.16R – SUP 16.7.19R
<i>Service company</i>	SUP 16.7.20R – SUP 16.7.21R

Firm category	Applicable rules and guidance
<i>Securities and futures firm</i> (Note 1)	SUP 16.7.22R – SUP 16.7.34G
<i>Investment management firm</i>	SUP 16.7.35R – SUP 16.7.41R
<i>Personal investment firm</i>	SUP 16.7.42G – SUP 16.7.53G
<i>Authorised professional firm</i> (Note 2)	SUP 16.7.54R
<i>Society of Lloyd’s</i>	SUP 16.7.55R – SUP 16.7.56R and SUP 16.7.59R(1) and (2)
<i>Members’ adviser</i>	SUP 16.7.57R – SUP 16.7.58R, SUP 16.7.59R(3), SUP 16.7.60G and SUP 16.7.61G

Note 1 = For an *oil market participant*, this section does not apply unless *IPRU(INV)* 3 applies to the *firm*.

Note 2 = This section applies to an *authorised professional firm* which is required by *IPRU(INV)* 2.1.2R(1) to comply with chapter 3, 5, 10 or 13 of *IPRU(INV)*. This section applies to such a *firm* as if it were the relevant *firm* category in the right hand column of *IPRU(INV)* 2.1R.

16.7.6

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For each *firm* category there is a table listing the reporting requirements. The tables state the name of each report, the frequency with which a *firm* must submit it, and the due date for submission. Detailed reporting forms and *rules* and *guidance* on their completion are contained in annexes to this chapter.

Banks

16.7.7

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A UK bank must submit reports in accordance with SUP 16.7.8R.

16.7.8

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Table Financial reports from a UK bank (see SUP 16.7.7R)

Content of Report	Form (Note 1)	Frequency	Due date
Annual report and audited accounts	N/A	Annually	3 months after the <i>firm's accounting reference date</i>
Adequate information on capital adequacy (Unconsolidated, solo consolidated)	BSD3	Quarterly	10 <i>business days</i> after quarter end (12 <i>business days</i> if submitted electronically)
Adequate information on capital adequacy (Consolidated)	BSD3	Half yearly	20 <i>business days</i> after period end (22 <i>business days</i> if submitted electronically)
Analysis of large exposures (Unconsolidated, solo consolidated)	LE2	Quarterly	10 <i>business days</i> after quarter end
Analysis of large exposures (Consolidated)	LE2	Quarterly	20 <i>business days</i> after period end

Content of Report	Form (Note 1)	Frequency	Due date
Adequate information on holdings of credit and financial institutions' and non-financial companies' capital instruments (Unconsolidated, solo consolidated)	M1 (Note 2)	Quarterly	10 <i>business days</i> after quarter end (12 <i>business days</i> if submitted electronically)
Adequate information on holdings of credit and financial institutions' and non-financial companies' capital instruments (Consolidated)	M1 (Note 2)	Half yearly	20 <i>business days</i> after period end (22 <i>business days</i> if submitted electronically)
Adequate information on sterling stock liquidity	SLR1 (Note 3)	Monthly (Note 4)	6 <i>business days</i> after second Wednesday of the month
Adequate information on mismatch liquidity	LR (Note 3)	Quarterly	10 <i>business days</i> after quarter end (12 <i>business days</i> if submitted electronically)

Content of Report	Form (Note 1)	Frequency	Due date
List of <i>companies</i> included in the <i>bank's</i> consolidated large exposure reporting	N/A	Annually	6 months after the <i>firm's accounting reference date</i>
Annual confirmation that all <i>companies</i> included in solo consolidation meet the criteria for such consolidation as set out in <i>IPRU(BANK)</i> CS 9.2	N/A	Annually	6 months after the <i>firm's accounting reference date</i>

Note 1 = When giving the report required, a *bank* must use the form indicated, if any. The content of the form has the status of *guidance* on the type of information that should be provided to meet the reporting obligation. A copy of the form is located in *SUP* 16 Ann 1R.

Note 2 = This report is only required from a *bank* which reports either on a solo or consolidated basis and:

(i) has been granted a trading book concession as explained in *IPRU(BANK)* CA 10.3; or

(ii) has qualifying holdings in non-financial *companies* as explained in *IPRU(BANK)* CA 10.4.

Content of Report	Form (Note 1)	Frequency	Due date
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Note 3 = A *bank* is not required to submit both the SLR1 and LR.

A *bank* which monitors its liquidity according to the maturity mismatch approach as set out in *IPRU(BANK) LM* must submit the LR.

A *bank* which monitors its liquidity according to the sterling stock liquidity approach as set out in *IPRU(BANK) LS* must submit the SLR1.

Note 4 = This report must be prepared as at the second Wednesday of each month. See *IPRU(BANK) LS 5.2 (2)* regarding submission of an SLR1 on breach of various limits.

16.7.9 **R** An *EEA bank* must submit reports in accordance with *SUP 16.7.10R*.

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16.7.10 **R** Table Financial reports from an *EEA bank* (see *SUP 16.7.9R*)

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Content of Report	Form (Note)	Frequency	Due date
Adequate information on mismatch liquidity (excluding deposit concentration)	LR – (excluding Part 5)	Quarterly	10 <i>business days</i> after quarter end (12 <i>business days</i> if submitted electronically)

Note = When giving the report required, a *bank* must use the form indicated. The content of the form has the status of *guidance* on the type of information that should be provided to meet the reporting obligation. A copy of the form is located in *SUP 16 Ann 1R*.

16.7.11 **R** A *bank* established outside the *EEA* must submit reports in accordance with *SUP 16.7.12R*.

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16.7.12

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Table Financial reports from a bank established outside the EEA (see SUP 16.7.11R)

Content of Report	Form (Note)	Frequency	Due date
Analysis of profits, large exposures, balance sheet, off balance sheet items and bad and doubtful debt provisions	B7	Half yearly	10 <i>business days</i> after period end (12 <i>business days</i> if submitted electronically)
Adequate information on mismatch liquidity	LR (Note 2)	Quarterly	10 <i>business days</i> after quarter end (12 <i>business days</i> if submitted electronically)

Note = When giving the report required, a *bank* must use the form indicated. The content of the form has the status of *guidance* on the type of information that should be provided to meet the reporting obligation. A copy of the form is located in SUP 16 Ann 1R.

16.7.13

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A *bank* must submit the reports described in SUP 16.7.8R, SUP 16.7.10R and SUP 16.7.12R to the following:

- (1) BSD3, LR, SLR1, B7 and M1 to: The Financial Statistics Division Domestic Banking Group (HO-4) Bank of England Threadneedle Street London EC2R 8AH;
- (2) all other reports to the *bank's* usual supervisory contact at the address in SUP 16.3.10R.

The Bank of England acts only as the agent of the *FSA* with regard to reports in (1).

16.7.14

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Guidance notes for the completion of the reports are contained in SUP 16 Ann 2G.

Electronic submission to the Bank of England

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A *bank* must submit the reports referred to in SUP 16.7.13R(1) either: in the electronic format specified in the Bank of England Reporting System specification as at *commencement*, sent either:

- (1) on paper; or
- (2) in the electronic format specified in the Bank of England Reporting System specification as at *commencement* and sent either;
 - (a) by the AT&T Global Network to one of the addresses specified in the above specification; or
 - (b) by e-mail to mfsd_beers@bofe.co.uk
 - (c) on computer diskette but to paper reporting deadlines

Building societies

16.7.16

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A *building society* must submit reports to the FSA in accordance with SUP 16.7.17R.

16.7.17

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Table Financial reports from a building society. (see SUP 16.7.16R)

Content of Report	Form (Note 1)	Frequency	Due date
Adequate information on group balance sheet, analysed between society and subsidiary undertakings	MFS1 – (Table A)	Monthly	9 <i>business days</i> after month end (largest societies) (Note 2) 12 <i>business days</i> after month end (other societies)
Adequate information on society's balance sheet and primary business transactions	MFS1 – (Tables B to G)	Monthly	7 <i>business days</i> after month end (largest societies) (Note 2) 10 <i>business days</i> after month end (other societies)
Sectoral breakdown of the society's balance sheet	MFS1 Supp (Note 3)	Monthly	7 <i>business days</i> after month end
Adequate information on balance sheets and primary business transactions of society's subsidiary undertakings accepting deposits and/ or lending	MFS2	Monthly	7 <i>business days</i> after month end (largest societies) (Note 2) 10 <i>business days</i> after month end (other societies)
Analysis of interest rate risk gap (Note 4)	N/A	Monthly	15 <i>business days</i> after month end

Content of Report	Form (Note 1)	Frequency	Due date
Adequate information on balance sheet, income and expenditure, capital, lending quality, large exposures and maturities for the society and its subsidiary undertakings, together with relevant expected and likely out-turns	QFS1	Quarterly	18 <i>business days</i> after society's financial quarter end
Sectoral and other breakdowns of assets and liabilities, gilt maturities, and derivative contracts	QFS2 (Note 3)	Quarterly	11 <i>business days</i> after calendar quarter end
Adequate information on balance sheet, income and expenditure, the range and volume of activities undertaken by the society, its subsidiary undertakings, and where relevant, its participating interests	AFS1	Annually	2 months after society's accounting reference date.

Content of Report	Form (Note 1)	Frequency	Due date
<p>Note 1 = When giving the report required, a <i>building society</i> must use the form indicated, if any. The content of the form has the status of <i>guidance</i> on the type of information that should be provided to meet the reporting obligation. A copy of the form is located in <i>SUP 16 Ann 3R</i> for all reports (except the "Analysis of interest rate gap" for which no form is provided).</p> <p>Note 2 = Largest societies are defined as those societies who were the 40 largest <i>building societies</i> (in terms of total assets) as at 31 December 1991.</p> <p>Note 3 = Only required from the largest tier (see Note 2).</p> <p>Note 4 = All societies except those on the "Administered" approach (see <i>IPRU(BSOC) 4 Ann 4A 4A.2</i>) complete the "Analysis of interest rate risk gap". <i>SUP 16.7.19R</i> does not apply to the "Analysis of interest rate risk gap".</p>			

16.7.18 G *Guidance* notes for the completion of the reports are contained in *SUP 16 Ann 4G*.
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Method of submission

16.7.19 R A *building society* must submit the reports in *SUP 16.7.17R* (other than the "Analysis of interest rate risk gap") either:
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- (1) by means of the Remote Data Entry system supplied by the *FSA* (and previously by the Building Societies Commission); or
- (2) by post or fax to the address in *SUP 16.3.10R* using:
 - (a) the pre-printed forms supplied by the *FSA* for that purpose; or
 - (b) its own version of the *FSA's* specified forms, provided that version is equivalent in terms of content and layout.

Service companies

16.7.20 R A *service company* must submit reports to the *FSA* in accordance with *SUP 16.7.21R*.
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16.7.21 R Table Financial reports required from service companies (see *SUP 16.7.20R*)
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Report	Frequency	Due date
Annual audited financial statements	Annually	6 months after the <i>firm's accounting reference date</i>

Securities and futures firms

- 16.7.22** **R** (1) *SUP 16.7.23R to SUP 16.7.30R do not apply to a lead regulated firm.*
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- (2) *A lead regulated firm must submit a copy of its audited annual financial statements to the FSA within six months of the date at which they were prepared.*
- 16.7.23** **R** For the purposes of *SUP 16.7.24R to SUP 16.7.34G*, the definitions of the following *firm* types provided in the glossaries in *IPRU(INV) 3 and 10* apply:
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- (1) adviser;
 - (2) arranger;
 - (3) broad scope firm;
 - (4) category A;
 - (5) category B;
 - (6) category C;
 - (7) category D;
 - (8) local; and
 - (9) venture capital firm.
- 16.7.24** **R** *A securities and futures firm which is a category A or B firm or a broad scope firm must submit reports to the FSA in accordance with SUP 16.7.25R.*
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- 16.7.25** **R** Table Financial reports required from a securities and futures firm which is a category A or B firm or a broad scope firm (see *SUP 16.7.24R*)
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Report	Frequency	Due date
Audited annual financial statements	Annually	3 months after the <i>firm's accounting reference date</i>
Annual reporting statement	Annually	3 months after the <i>firm's accounting reference date</i>
Annual reconciliation (Note 1)	Annually	3 months after the <i>firm's accounting reference date</i>
Audited accounts of any subsidiary, unless the <i>rules</i> in this chapter require that subsidiary to submit accounts to the <i>FSA</i>	Annually	3 months after the <i>firm's accounting reference date</i>
Consolidated reporting statement (Note 2)	Half yearly	1 month after period end
Large exposures quarterly reporting statement (Form LEM 1 or LEM 2) – solo (Notes 3 and 4)	Quarterly	15 <i>business days</i> after quarter end
Large exposures quarterly reporting statement (Form LEM 1 or LEM 2) – consolidated (Notes 2 and 4)	Quarterly	1 month after quarter end
Monthly reporting statement	Monthly	15 <i>business days</i> after month end

Report	Frequency	Due date
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Note 1 = Every year a *firm* must submit:

(a) a reconciliation and explanation of any differences between amounts shown in the balance sheet in the audited annual financial statements and the annual reporting statement; and

(b) a reconciliation and explanation of any differences between the annual reporting statement and the monthly reporting statement prepared as at the same date.

Note 2 = Only for category A and B firms which are subject to the consolidation *rules* set out in *IPRU (INV) 10–200R – 10–203R*, and are not exempt from the consolidation *rules* under *IPRU (INV) 10–200R(2)* or *IPRU (INV) 10–204R*.

Note 3 = Only for category A and B firms.

Note 4 = A *firm* which was required to submit Form LEM1 in the relevant period immediately prior to the *commencement* must continue to do so.

A *firm* which was required to submit Form LEM2 in the relevant period immediately prior to the *commencement* must continue to do so. A category A or B firm *authorised* after the *commencement* must submit Form LEM1.

16.7.26 **R** /1 A *securities and futures firm* which is a category C or D firm or an arranger or venture capital firm must submit reports to the FSA in accordance with SUP 16.7.27R.

16.7.27 **R** /1 Table Financial reports from a securities and futures firm which is a category C or D firm or an arranger or venture capital firm (see SUP 16.7.26R)

Report	Frequency	Due date
Audited annual financial statements	Annually	3 months after the <i>firm's accounting reference date</i>
Annual reporting statement	Annually	3 months after the <i>firm's accounting reference date</i>

Report	Frequency	Due date
Annual reconciliation (Note 1)	Annually	3 months after the <i>firm's accounting reference date</i>
Audited accounts of any <i>subsidiary</i> unless the <i>rules</i> in this chapter require that <i>subsidiary</i> to submit accounts to the <i>FSA</i>	Annually	3 months after the <i>firm's accounting reference date</i>
Consolidated reporting statement (Note 2)	Half yearly	1 month from period end
Large exposures quarterly reporting statement (Form LEM 1 or LEM 2) – solo (Notes 3 and 4)	Quarterly	15 <i>business days</i> after quarter end
Large exposures quarterly reporting (Form LEM 1 or LEM 2) – consolidated (Notes 2 and 4)	Quarterly	1 month after quarter end
Quarterly reporting statement	Quarterly	15 <i>business days</i> after quarter end

Note 1 = Every year a *firm* must submit:

(a) a reconciliation and explanation of any differences between amounts shown in the balance sheet in the audited annual financial statements and the annual reporting statement; and

(b) a reconciliation and explanation of any differences between the annual reporting statement and the monthly reporting statement prepared as at the same date.

Report	Frequency	Due date
<p>Note 2 = Only for category C firms (as defined in the glossaries located in <i>IPRU(INV)</i> 10), which are subject to the consolidation rules set out in <i>IPRU(INV)</i> 10–200R – 10–203R, and are not exempt from the consolidation rules under <i>IPRU(INV)</i> 10–200R(2) or <i>IPRU(INV)</i> 10–204R.</p>		
<p>Note 3 = Only for category C firms (as defined in the glossaries located in <i>IPRU(INV)</i> 10).</p>		
<p>Note 4 = A firm which was required to submit Form LEM1 in the relevant period immediately prior to commencement must continue to do so.</p>		
<p>A firm which was required to submit Form LEM2 in the relevant period immediately prior to commencement must continue to do so.</p>		
<p>A category C firm authorised after commencement must submit the Form LEM1.</p>		

16.7.28 **R** *A securities and futures firm* which is an adviser or local, or a traded options market maker (as referred to in *IPRU(INV)* 3-60R (4)) must submit reports to the FSA in accordance with SUP 16.7.29R.
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16.7.29 **R** Table Financial reports from a securities and futures firm which is an adviser, local or a traded options market maker (see SUP 16.7.28R)
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Report	Frequency	Due date
Solvency statement (<i>sole traders only</i>)	Annually	2 months after the <i>firm's accounting reference date</i>
Audited annual financial statements (<i>partnerships and bodies corporate only</i>)	Annually	3 months after the <i>firm's accounting reference date</i>
Audited accounts of any <i>subsidiary unless the rules in this chapter require that subsidiary to submit accounts to the FSA</i>	Annually	3 months after the <i>firm's accounting reference date</i>

- 16.7.30** **R**
/1 (1) *A securities and futures firm* which is an *ISD investment firm*, and which is a *sole trader*, or a *partnership* formed under the laws of England and Wales, must submit a solvency statement for the *sole trader* or each *partner* to the *FSA* every year.
- (2) The due date for the submission of the solvency statement is three months after the *firm's accounting reference date*.
- 16.7.31** **R**
/1 *A securities and futures firm* must submit the reports in accordance with, and in the same format as, the forms contained in *SUP 16 Ann 10R*, and as required by section 6 of that annex.
- 16.7.32** **G**
/1 *Guidance* notes for the completion of the reports are contained in *SUP 16 Ann 11G*.
- 16.7.33** **R**
/1 (1) Any report in *SUP 16.7.23R* to *SUP 16.7.30R* submitted to the *FSA* by a *securities and futures firm* must be signed by two authorised signatories satisfying the requirements of *SUP 16.7.33R(2)*, except for:
- (a) the audited accounts of a *subsidiary* of the *firm* and the *firm's* audited annual financial statements; and
- (b) other reports where the *firm* is a *sole trader*, when only one authorised signatory is required.
- (2) An authorised signatory must be:
- (a) for a body corporate, a *director*;

- (b) for a partnership, a *partner* who is an *approved person* of the *firm*;
 - (c) for a *sole trader*, the proprietor.
- (3) A *firm* must use the FiRSt 5.0 software package made available to *firms* by the *FSA* (and previously by the *SFA*) to submit the following reports:
- (a) annual reporting statement;
 - (b) monthly reporting statement;
 - (c) quarterly reporting statement; and
 - (d) consolidated reporting statement.
- (4) All reports in *SUP* 16.7.24R to *SUP* 16.7.30R must be sent to the address given in *SUP* 16.3.10R, using pre-printed labels provided by the *FSA* for this purpose.

16.7.34

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The *FSA* expects the audited annual financial statements to be submitted together with the auditor’s report required by *SUP* 3.9.4R.

Investment management firms

16.7.35

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An *investment management firm* which is not one of the types of *firm* specified in *SUP* 16.7.37R must submit reports to the *FSA* in accordance with *SUP* 16.7.36R.

16.7.36

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Table Financial reports from an investment management firm (see *SUP* 16.7.35R)

Report	Frequency	Due date
Annual Financial Return (Note 1)	Annually	4 months after the <i>firm’s accounting reference date</i>
Annual accounts (Note 1)	Annually	4 months after the <i>firm’s accounting reference date</i>
Annual solvency statement (only for individuals in partnership) (Note 2)	Annually	At the same time as the Annual Financial Return

Report	Frequency	Due date
Quarterly Financial Return (only for firms subject to a Liquid Capital Requirement as set out in <i>IPRU(INV) 5.2.3 (1)(a)</i>)	Quarterly	1 month after quarter end
Monthly Financial Return (only for ISD firms (Note 3) subject to the Own Funds Requirement of Euro 730,000 as set out in <i>IPRU(INV) 5.2.3(1)(b)</i>) (Note 4)	Monthly	1 month after month end

Note 1: The Annual Financial Return and the annual accounts of a *firm* must together give a true and fair view of the state of affairs of the *firm* (or in the case of a *sole trader*, of his regulated activities) and of the *firm's* profit or loss.

Note 2: The annual solvency statement is a statement from each *partner* in the following form: "I certify that I have sufficient assets to cover my personal liabilities."

Note 3: The definition of ISD firm for this purpose is provided in the glossary located in *IPRU(INV) 5*.

Note 4: A *firm* need not prepare a Monthly Financial Return as at the same date as a Quarterly Financial Return. A *firm* must therefore prepare eight Monthly and four Quarterly Financial Returns each year. One Quarterly Financial Return must be prepared to the same date as the Annual Financial Return (but submitted earlier). Monthly and Quarterly Financial Returns are not cumulative, and must relate only to the period concerned. A *firm* may need to prepare more frequent accounts, including financial resources statements, for its own internal use to ensure that it complies at all times with the *rules* in *IPRU(INV)*.

16.7.37

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SUP 16.7.36R does not apply to an *investment management firm* which is:

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(1) a *lead regulated firm* or an *OPS firm* (but if a *firm* falls into either of these categories, then it must submit a copy of its annual accounts in accordance with *SUP 16.7.36R*);

(2) a local authority.

16.7.38 **R** *An investment management firm* must submit the required reports in accordance with, and in the same format as, the forms contained in *SUP 16 Ann 5R*, and according to the requirements contained in section 4 of that annex.

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16.7.39 **G** The *FSA* expects the annual accounts to be submitted together with the auditor's report required by *SUP 3.9.4R*.

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Reporting periods

16.7.40 **R** The period covered by:

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- (1) monthly financial returns may not exceed one *month*;
- (2) quarterly financial returns may not exceed three *months*; and
- (3) annual financial returns may not exceed twelve *months*.

Timely reporting

16.7.41 **R** *An investment management firm* must notify the *FSA* in writing as soon as it has reason to believe it will be unable to submit an annual, quarterly or monthly financial return by the dates specified in *SUP 16.7.36R*. Such notice must specify why it cannot submit the report to the *FSA* on time and give the date by which it will submit the report to the *FSA*.

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Personal investment firms

16.7.42 **G** *SUP 16.7.48R* covers the reporting requirements applicable to a *small personal investment firm*.

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16.7.43 **R** For the purposes of *SUP 16.7.44R* to *SUP 16.7.51R* the definitions of the following *firm* types provided in the glossary in *IPRU(INV) 13* apply:

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- (1) Category A1 firm;
- (2) Category A2 firm;
- (3) Category A3 firm;

- (4) Category B1 firm;
- (5) Category B2 firm;
- (6) Category B3 firm;
- (7) network;

16.7.44 **R** *A personal investment firm (except a small personal investment firm) must submit reports to the FSA in accordance with SUP 16.7.45R.*
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16.7.45 **R** Table Financial reports from a personal investment firm (except a small personal investment firm) (see SUP 16.7.44R)
/1

Report	Frequency	Due date
Annual questionnaire (Note 1)	Annually	2 months after the firm's accounting reference date
Annual financial statements (Note 2)	Annually	4 months after the firm's accounting reference date
Audited consolidated statutory accounts (Note 3)	Annually	4 months after the firm's accounting reference date
Annual reconciliation (Note 4)	Annually	4 months after the firm's accounting reference date
Form 13A (Balance sheet)	Note 5	Note 5
Form 13Bi/ Bii (Profit and Loss)	Note 5	Note 5
Form 13Ci (Statement of own funds)	Note 5	Note 5
Form 13Cii (Statement of own funds) (unincorporated firms only)	Note 5	Note 5

Report	Frequency	Due date
Form 13D (Financial Resources test – current assets)	Note 5	Note 5
Form 13E (Financial Resources test – expenditure requirement) (Note 6)	Note 5	Note 5
Form 13F (Financial Resources test – assets and liabilities)	Note 5	Note 5
Form 13G (Financial Resources test – position risk deductions)	Note 5	Note 5
Form 13J (<i>Sole trader solvency statement</i>) (<i>sole traders only</i>)	Note 5	Note 5
Report on holdings of second-hand life policies (only from second hand life policy market makers) (Note 7)	Quarterly	3 weeks after quarter end

Note 1 = Not required from Category A1 and B1 firms.

Note 2 = The annual financial statements must include all reports, for which this Table specifies a monthly or quarterly frequency.

Note 3 = Only required from a *firm* if it is a *holding company*, or if one of its *controllers* is a *company*.

Note 4 = Every year a *firm* must submit a reconciliation of the amounts shown in the balance sheet in the annual financial statements with the amounts shown in the balance sheet in the last monthly or quarterly financial statements.

The *firm* must submit this reconciliation with its annual financial statements.

Report	Frequency	Due date
<p>Note 5 = For a Category A1 or B1 firm, the frequency will be monthly, and the due date will be 3 weeks after month end.</p> <p>For a Category B2 firm, which has less than 26 <i>financial advisers</i>, the frequency will be annual, and the due date will be 4 months after year end.</p> <p>For a Category B3 firm, which has less than 26 <i>financial advisers</i>, and has <i>permission to manage investments</i>, the frequency will be annual, and the due date will be 4 months after year end.</p> <p>For any other <i>firm</i> to which SUP 16.7.46R applies, frequency will be quarterly, and the due date will be 3 weeks after quarter end.</p> <p>Note 6 = A <i>firm</i> which is a Category A1 firm, a Category A2 firm with <i>permission to manage investments</i>, or a Category A network must submit the Form 13Ei as contained in SUP 16 Ann 7 (section 3). A firm which is a Category A2 firm without <i>permission to manage investments</i>, or a Category A3 firm, must submit the Form 13Eii as contained in SUP 16 Ann 7 (section 3). A <i>firm</i> which is a Category B1, B2 or B3 firm must submit the Form 13E as contained in SUP 16 Ann 7 (section 4).</p> <p>Note 7 = “Second hand life policy” in SUP 16 means a <i>life policy</i> which is to be or has been assigned for value by the <i>policyholder</i> to another <i>person</i>.</p>		

16.7.46 **R** In addition to the reports specified in SUP 16.7.45R, a Category A1, A2 or A3 *personal investment firm* must submit reports to the FSA in accordance with SUP 16.7.47R.

16.7.47 **R** Table Additional financial reports required from a Category A1, A2 or A3 firm (see SUP 16.7.46R)

Report	Frequency	Due date
Consolidated financial resources return (Note 1)	Quarterly	3 weeks after quarter end
Form CAD 13	Quarterly	3 weeks after quarter end
Form 13H (Restrictions of Financial Resources)	Note 2	Note 2
Form 13I (Statement of large exposures)	Quarterly	3 weeks after quarter end
Form 13I (Consolidated statement of large exposures) (Note 1)	Quarterly	3 weeks after quarter end

Note 1 = This report is only required from a *firm* if it is a member of a *group*, and it is subject to consolidated supervision as set out in *IPRU(INV)* 13.7.1R to 13.7.2R.

Note 2 = For a Category A1 firm frequency will be monthly and due date will be 3 weeks after month end. For a Category A2 or A3 firm frequency will be quarterly and due date will be 3 weeks after quarter end.

16.7.48 **R** *A small personal investment firm* must submit reports to the FSA in accordance with SUP 16.7.49R.
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16.7.49 **R** Table Financial reports required from a small personal investment firm. (see SUP 16.7.48R)
/1

Report	Frequency	Due date
Annual questionnaire	Annually	4 months after the <i>firm's accounting reference date</i>
Audited consolidated annual financial statements (Notes 1 and 2)	Annually	4 months after the <i>firm's accounting reference date</i>

Report	Frequency	Due date
Note 1 = Only required from a <i>firm</i> if it is a <i>holding company</i>, or if one of its <i>controllers</i> is a <i>company</i>.		
Note 2 = The <i>firm</i> must submit the statutory accounts of the <i>group</i> to which it belongs.		

- 16.7.50** **R** ^{/1} SUP 16.7.42G to SUP 16.7.49R do not apply to a *lead regulated firm*.
- 16.7.51** **R** ^{/1} (1) A Category A1, A2 or A3 firm must submit the reports in SUP 16.7.45R and SUP 16.7.47R in accordance with, and in the same format as, the forms contained in SUP 16 Ann 7R (sections 1, 3 and 6), and as required by section 5 of that annex.
- (2) A Category B1, B2 or B3 firm must submit the reports in SUP 16.7.45R and SUP 16.7.49R in the same format as the forms contained in SUP 16 Ann 7R (sections 1, 2 and 4), and as required by section 5 of that annex.
- 16.7.52** **G** ^{/1} *Guidance* notes for the completion of reports for the purposes of consolidated supervision, and of the annual questionnaire required under SUP 16.7.48R can be found in SUP 16 Ann 8G.
- 16.7.53** **G** ^{/1} If a *firm* must submit audited financial statements, the FSA expects the audited financial statements to be submitted together with the auditor's report required by SUP 3.9.4R.

Authorised professional firms

- 16.7.54** **R** ^{/1} (1) An *authorised professional firm* must submit an annual questionnaire to the FSA every year in accordance with, and in the same format as, the form contained in SUP 16 Ann 9R.
- (2) The due date for submission of the annual questionnaire is four months after the *firm's accounting reference date*.

Society of Lloyd's and members' advisers

- 16.7.55** **R** ^{/1} The *Society of Lloyd's* must submit reports to the FSA in accordance with SUP 16.7.56R.
- 16.7.56** **R** ^{/1} Table Financial reports from the Society of Lloyd's (see SUP 16.7.55R)

Report	Frequency	Due date
Annual audited accounts	Annually	6 months after the <i>Society's accounting reference date</i>
Annual Lloyd's Return	Annually	6 months after the <i>Society's accounting reference date</i>
Syndicate returns	Annually	6 months after the <i>Society's accounting reference date</i>

16.7.57 **R** ^{/1} A *members' adviser* must submit reports to the FSA in accordance with SUP 16.7.58R.

16.7.58 **R** ^{/1} Table Financial reports from a *members' adviser* (see SUP 16.7.57R)

Report	Frequency	Due date
Audited annual financial statements	Annually	3 months after the <i>firm's accounting reference date</i>
Annual reporting statement	Annually	3 months after the <i>firm's accounting reference date</i>
Annual reconciliation	Annually	3 months after the <i>firm's accounting reference date</i>
Audited accounts of any <i>subsidiary</i> , unless the <i>rules</i> in this chapter require those <i>subsidiaries</i> to submit accounts to the FSA	Annually	3 months after the <i>firm's accounting reference date</i>
Quarterly reporting statement	Quarterly	15 <i>business days</i> after quarter end

- 16.7.59** **R**_{/1} (1) The *Society of Lloyd's* must prepare its reports in the format specified in *LLD 15*, unless (2) applies.
- (2) The *Society* must ensure that the annual syndicate returns are prepared in accordance with, and in the format set out in, Lloyd's Syndicate Accounting Byelaw (No. 18 of 1994) as amended and in force at *commencement*.
- (3) A *members' adviser* must prepare its reports in accordance with, and in the format set out in, *SUP 16 Ann 10R* and as required by section 6 of that annex.
- 16.7.60** **G**_{/1} *Guidance* notes for the completion of the reports required from a *members' adviser* are contained in *SUP 16 Ann 11G*.
- 16.7.61** **G**_{/1} The nature of the advisory business of a *members' adviser* whose *permission* is restricted to *advising on syndicate participation at Lloyd's* is akin to giving corporate finance advice, and the requirements are those applicable to *firms* giving corporate finance advice.

16.8 Persistency reports from insurers

Application

- 16.8.1** **G**_{/1} The effect of *SUP* 16.1.1R is that this section applies to every *insurer* (including a *friendly society*) with *permission to effect or carry out life policies*.

Purpose

- 16.8.2** **G**_{/1} The purpose of this section is to enable information on the persistency of life policies to be prepared and provided to the *FSA* in a standard format. This information is used in the monitoring of *firms* both individually and collectively.

Requirement to submit persistency reports

- 16.8.3** **R**_{/1} A *firm* must submit a persistency report to the *FSA* by 30 April each year.

Interpretation of this section

- 16.8.4** **R**_{/1} In this section, and Forms 1R(1) to (3) in *SUP* 16 Annex 6R:
- (1) '12 month report' means the part of a persistency report reporting on *life policies effected* in Y-2, '24 month report' means the part of a persistency report reporting on *life policies effected* in Y-3, and so on;
 - (2) 'CC' means the number of *life policies* which:
 - (a) were *effected* during the year to which the calculation relates; and
 - (b) are reported on in the persistency report (see *SUP* 16.8.8R to *SUP* 16.8.15R);
 - (3) 'CF' means the number of *life policies* which:
 - (a) were *effected* during the year to which the calculation relates;

- (b) are reported on in the persistency report (see *SUP 16.8.8R* to *SUP 16.8.15R*); and
- (c) are treated as in force at the end of Y-1 (see *SUP 16.8.16R* to *SUP 16.8.18R*);
- (4) Forms 1R(1), 1R(2), 1R(3) mean the forms in *SUP 16 Ann 6R*;
- (5) 'group personal pension policy' means a *life policy* which is not a separate *pension scheme*, effected under a collecting arrangement made for the *employees* of a particular employer to participate in a personal pension arrangement on a group basis;
- (6) 'insurance ISA' means the insurance component of an *ISA* (mini or maxi);
- (7) 'ordinary assurance policy' means a *life policy* which is not an *industrial assurance policy*;
- (8) 'other life assurance' means a *life policy* other than a *pension policy*, *endowment assurance* or *whole life assurance*;
- (9) 'other pension policy' means a *pension policy* other than a *personal pension policy*;
- (10) 'persistency rate' means a rate calculated using this formula:

$$\frac{CF}{CC} \times 100$$
 (see Table *SUP 16.8.5G*);
- (11) 'persistency report' means a report complying with *SUP 16.8.19R*;
- (12) 'policy anniversary' means the anniversary, falling within Y-1, of the date on which a *life policy* was effected;
- (13) 'regular premium life policy' means a *life policy* where there is (or could be, or has been) a commitment by the policyholder to make a regular stream of contributions (for example by means of a direct debit mandate);
- (14) 'single premium life policy' means a *life policy* that is not a regular premium *life policy*, except that a recurrent single premium *life policy* must be treated as a regular premium *life policy*;
- (15) 'Y' means the year in which the report is submitted, 'Y-1' means the preceding year, 'Y-2' means the next earlier year and so on;
- (16) 'year' means calendar year, unless *SUP 16.8.7R* applies.

16.8.5 **G** The following are not within the definition of 'life policy':

^{/1}

- (1) *occupational pension schemes*; and
- (2) annuity contracts other than deferred annuity contracts.

16.8.6 **R** A *firm* may treat a 12-month period ending between 1 October and 31 March as a 'year' for the purposes of this section and Forms 1R(1) to (3):

^{/1}

- (1) if the *firm's* financial year does not end on 31 December; or
- (2) for *industrial assurance policy* business;

provided that the use of an alternative period is disclosed in the persistency report.

16.8.7 **G** Table Example of calculation of persistency rate for life policies that commenced during 1996 (see SUP 16.8.3R)

^{/1}

Y (year of reporting)	Number of life policies which commenced during 1996	Number of 1996 policies that cease to be in force during Y-1	Deaths and retirements (must not be reported on)	CF	CC
1998	1000	143	2	1000 -143 -2 = 855	1000 -2 = 998
1999	1000	25	1	1000 - 143 -25 -2 -1 = 829	1000 -2 -1 = 997

Report submitted in 1998

Persistency rate for *life policies* that commenced during Y-2 (i.e. 1996)

$$CF \times 100 = \frac{855}{1000} \times 100 = 85.5\%$$

CC 998

Report submitted in 1999

Persistency rate for *life policies* that commenced during Y-3 (i.e. 1996)

$$CF \times 100 = \frac{829}{1000} \times 100 = 82.9\%$$

CC 997

Life policies to be reported on in the persistency report

- 16.8.8** **R**_{/1} A persistency report must report on every *life policy* which was promoted subject to *rules* in *COB*, or conduct of business rules made by a *previous regulator*, is not a *life policy* of a type listed in *SUP* 16.8.13R or *SUP* 16.8.14R, and which:
- (1) was effected by the *firm* submitting the report; or
 - (2) was effected by a member of the *firm's group*, which is not an *authorised person*, and in circumstances in which the *firm* submitting the report was responsible for promoting that *life policy*; or
 - (3) was effected by another *firm*, but is being carried out by the *firm* submitting the report.
- 16.8.9** **G**_{/1} *Life policies* falling within *SUP* 16.8.8R(3) are those which have been transferred from another *firm*, for example under an insurance business transfer scheme under Part VII of the *Act* (Control of Business Transfers).
- 16.8.10** **R**_{/1} *Life policies* falling within *SUP* 16.8.8R, which were promoted subject to the conduct of business rules of a *previous regulator*, need to be reported only if they were required to be reported in the *previous regulator's* persistency reports.
- 16.8.11** **R**_{/1} A *life policy* which was issued in substitution for a similar contract may be treated as being effected on the inception date of the previous *life policy*, provided that the *firm* is satisfied that there is no loss to the *policyholder*.
- 16.8.12** **G**_{/1} Examples of loss to the *policyholder* under *SUP* 16.8.11R are higher charges and more restrictive benefits and options.
- 16.8.13** **R**_{/1} A persistency report must not report on:
- (1) a *life policy* that was cancelled from inception whether or not this was as a result of service of a notice under *COB* 6 (Cancellation rules); or
 - (2) an *appropriate personal pension scheme* to which contributions are made only by the Department of Social Security; or
 - (3) a *life policy* (excluding *income withdrawal*) which has terminated as a result of death, critical illness, retirement, maturity or other completion of the contract term; or
 - (4) *income withdrawals* that have ceased as a result of the death of the *policyholder*.
- 16.8.14** **R**_{/1} A persistency report need not report on a *life policy* if the number of *life policies* on substantially the same terms effected by the *firm* (or a member of the *firm's group*) in the relevant year did not exceed the

higher of fifty and 1% of the total reportable *life policies* effected by that *firm* in that year.

- 16.8.15 **R** /1 If the term of an *endowment assurance* is less than five years, the *life policy* must only be included in a persistency report in respect of years up to and including the anniversary prior to maturity.

Life policies to be treated as in force

- 16.8.16 **R** /1 Subject to SUP 16.8.17R and SUP 16.8.18R, a *life policy* must be treated as in force at the end of Y-1 (that is included in CF) if and only if:
- (1) in the case of a regular premium life policy:
 - (a) the *premium* has been paid in respect of the month in which the policy anniversary falls; or
 - (b) in the case of an *industrial assurance policy* on which the *premiums* are paid at intervals of four weeks, the *premium* has been paid in respect of the four-week period in which the policy anniversary falls;
 - (2) in the case of a single premium life policy, the policy has not been surrendered as at the policy anniversary.

- 16.8.17 **R** /1 A cluster *life policy* must be reported as a single *life policy* and must be treated as in force (that is included in CF) even if some of the constituent *life policies* have been terminated.

- 16.8.18 **R** /1 An *income withdrawal* that has terminated other than by death of the *policyholder* must be treated as not in force at the end of Y-1 (that is, not included in CF).

Contents of the persistency report

- 16.8.19 **R** /1 A persistency report must be a report in the format of Forms 1R(1), (2) and (3) fully completed, and must include:
- (1) a separate copy of each Form reporting on *life policies effected* during each of Y-2, Y-3, Y-4 and Y-5; and
 - (2) if indicated on the relevant Form:
 - (a) a separate copy of each Form reporting on regular premium life policies and single premium life policies; and

(b) a separate copy of each Form reporting on *life policies* classified as ordinary assurance policies and *industrial assurance policies*.

16.8.20 **R** ^{/1} If a *firm* has no *life policies* to report on in a copy of any Form, the *firm* need not submit that copy provided that it confirms in writing to the *FSA*, when submitting the persistency report, that it is not doing so and the reason for not doing so.

16.8.21 **R** ^{/1} If a persistency report reports on an *endowment assurance* with a term of five years or less, the *firm* must:

- (1) report on such a *policy* in Form 1R(2); and
- (2) not report on such a *policy* in Form 1R(1).

16.8.22 **G** ^{/1} (1) Under *SUP* 16.8.16R above, a *life policy* must be treated as not in force if *premiums* have not been paid at the relevant date. Form 1R(3) seeks additional information on the number of *policies* treated as not in force which are subject to genuine contribution holidays.

(2) A *firm* should treat a *life policy* as 'subject to a contribution holiday' if:

- (a) the terms of the *policy* allow the *policyholder* to take a contribution holiday;
- (b) the *policyholder* has opted to take a contribution holiday in accordance with those terms;
- (c) the *policyholder* has clearly stated his intention to resume payments; and
- (d) at the end of Y-1, not more than 12 months have elapsed from the date that *premiums* ceased to be paid.

Records

16.8.23 **R** ^{/1} A *firm* must make and retain such records as will enable it to:

- (1) monitor regularly the persistency of *life policies* effected through each of its *representatives*; and
- (2) make persistency reports to the *FSA* in accordance with *SUP* 16.8.3R.

16.8.24 **G** ^{/1} Separate records should be made and retained for:

- (1) *life policies* originally promoted through:
 - (a) *representatives*;
 - (b) *independent intermediaries*;
 - (c) the *firm's* own *direct offer financial promotions*;

- (2) *life policies* not within (1), including execution-only business;
- (3) single and regular premium life policies;
- (4) ordinary assurance policies and *industrial assurance policies*;
- (5) the categories of *life policies* and *pension policies* referred to in Forms 1R(1) to (3).

Persistency Report

To be submitted by 30 April each year to the Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.

Name of Firm: Firm Reference Number :

Regular Premium Policies / Single Premium Policies :

Ordinary Assurance Policies / Industrial Assurance Policies :

Year in which Policies Effected:

12 Month Report / 24 Month Report / 36 Month Report / 48 Month Report :

Policies promoted through:	Representative			Independent intermediary		
Policy Type	Number effected during the year (CC)	Number in force at end of Y-1 (CF)	Persistency rate	Number effected during the year (CC)	Number in force at end of Y-1 (CF)	Persistency rate
Endowment Assurance						
Whole Life Assurance						
Personal Pension Policy						
Other Pension Policy						
Other Life Assurance						
Income Withdrawal						
Group Personal Pension policy						
Insurance ISA						

Policies promoted through	Direct offer financial promotion			Other		
Policy Type	Number effected during the year (CC)	Number in force at end of Y-1 (CF)	Persistency rate	Number effected during the year (CC)	Number in force at end of Y-1 (CF)	Persistency rate
Endowment Assurance						
Whole Life Assurance						
Personal pension policy						
Other Pension Policy						
Other Life Assurance						
Income Withdrawal						
Group Personal Pension policy						
Insurance ISA						

Guidance notes to persistency report

Please provide (either below or on a separate sheet of paper):

- details of any alternative approaches used to calculate figures if this is permitted by the rules in SUP 16.8;
- a note of any types of policy for which no figures have been submitted (including any types to be reported on in Forms 1R(2) and 1R(3));
- a brief explanation of the effects of inaccuracies on the figures for previous years which have already been supplied; and
- confirmation that regular premium life policies have only been treated as in force if a premium has been received on or after the relevant policy anniversary.

Expressions which are defined in the Handbook Glossary, or in SUP 16.8, have the same meanings in this form.

Signature and declaration

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.4R require an *authorised person* to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. SUP 16.3.11R requires an *authorised person* to submit reports containing all the information required. APER 4.4.6E provides that, where an *approved person* is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of *Statement of Principle 4*. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief and that I have read the Guidance Notes to this form.

Form submitted by (BLOCK CAPITALS):

The following person should be able to assist the FSA with any queries that may arise:

Name: Title:

Address:

.....

.....

Telephone Number:..... e-mail:

Persistency Report - short term endowments/ assurance

To be submitted by 30 April each year to the Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.

Name of Firm:

Firm Reference Number :

Regular Premium Policies / Single Premium Policies:

Ordinary Branch Policies / Industrial Branch Policies:

Year in which Policies Effected:

12 Month / 24 Month / 36 Month / 48 Month report:

Endowment assurance term	Representative			Independent intermediary		
	Number effected during the year (CC)	Number in force at end of Y-1 (CF)	Persistency rate	Number effected during the year (CC)	Number in force at end of Y-1 (CF)	Persistency rate
2 (<3) year term						
3 (<4) year term						
4 (<5) year term						
under 5 year total						

Endowment assurance term	Direct offer financial promotion			Other		
	Number effected during the year (CC)	Number in force at end of Y-1 (CF)	Persistency rate	Number effected during the year (CC)	Number in force at end of Y-1 (CF)	Persistency rate
2 (<3) year term						
3 (<4) year term						
4 (<5) year term						
under 5 year total						

Expressions which are defined in the Handbook Glossary, or in SUP 16.8, have the same meanings in this form.

Signature and declaration

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.4R require an *authorised person* to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. SUP 16.3.11R requires an *authorised person* to submit reports containing all the information required. APER 4.4.6E provides that, where an *approved person* is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of *Statement of Principle 4*. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief and that I have read the Guidance Notes to this form.

Form submitted by (BLOCK CAPITALS):

The following person should be able to assist the FSA with any queries that may arise:

Name: Title:

Address:

.....

.....

Telephone Number:..... e-mail:

Persistency Report – Contribution Holidays

To be submitted by 30 April each year to the Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.

Name of Firm:

Firm Reference Number : Year in which Policies Effected:

12 Month Report/24 Month Report/36 Month Report/48 Month Report:

Policies promoted through:	Representative			Independent intermediary			
	Policy Type	Number effected during the year (CC)	Number subject to contribution holiday at end of Y-1 (CH)	Holiday factor (CH/CC)	Number effected during the year (CC)	Number subject to contribution holiday at end of Y-1 (CH)	Holiday factor (CH/CC)
Endowment Assurance							
Whole Life Assurance							
Personal Pension Policy							
Other Pension Policy							
Other Life Assurance							
Income Withdrawal	N/a	N/a	N/a	N/a	N/a	N/a	N/a
Group Personal Pension policy							
Insurance ISA							

Policies promoted through:	Direct offer financial promotion			Other			
	Policy Type	Number effected during the year (CC)	Number subject to contribution holiday at end of Y-1 (CH)	Holiday factor (CH/CC)	Number effected during the year (CC)	Number subject to contribution holiday at end of Y-1 (CH)	Holiday factor (CH/CC)
Endowment Assurance							
Whole Life Assurance							
Personal pension policy							
Other Pension Policy							
Other Life Assurance							
Income Withdrawal							
Group Personal Pension policy							
Insurance ISA							

Expressions which are defined in the Handbook Glossary, or in SUP 16.8, have the same meanings in this form.

Signature and declaration

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.4R require an *authorised person* to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. SUP 16.3.11R requires an *authorised person* to submit reports containing all the information required. APER 4.4.6E provides that, where an *approved person* is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of *Statement of Principle 4*. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief and that I have read the Guidance Notes to this form.

Form submitted by (BLOCK CAPITALS):

The following person should be able to assist the FSA with any queries that may arise:

Name: Title:

Address:

.....

.....

Telephone Number:..... e-mail:

SUP 16 Ann 12G: Reports from trustees of AUTs and depositaries of ICVCs (see SUP 16.6.9G)

1 Table

1. Trustees of AUTs

- (1) Form 1 at the end of this annex provides a suggested format for the submission of the reports.
- (2) The quarterly report should be completed each year as at 31 March, 30 June, 30 September, and 31 December.
- (3) The report should be signed by an *approved person* who works in the *firm's trustee* area.
- (4) A *firm* should refer to *CIS* 4, 7, 15 and Appendix *CIS* before completing this report.

2. Depositaries of ICVCs

- (1) Form 2 at the end of this annex provides a suggested format for the submission of the reports.
- (2) The quarterly report should be completed each year as at 31 March, 30 June, 30 September, and 31 December.
- (3) The report should be signed by an *approved person* who works in the *firm's depositary* area.
- (4) A *firm* should refer to *CIS* 4, 7 and Appendix *CIS* before completing this report.

Form 1

Quarterly Return of Notifiable Breaches – Authorised Unit Trusts

1. Pricing Errors

Manager	Did status of manager change in quarter? (Note)	No. of pricing errors of 0.5% and above	No. of pricing errors below 0.5%, where trustee does not consider manager's controls to be adequate	No. of authorised unit trusts in operation

Note = From “controls adequate” to “controls inadequate” (or vice versa). Where the manager’s status changed, the report should state the date of that change and the number of reportable breaches of CIS 4 and 15 before and after that change of status.

2. Negative Boxes

Manager	Did status of manager change in quarter? (Note 1)	No. of negative boxes where CIS 4.3.12R and CIS 15.3.12R have not been applied. (Note 2)	No. of authorised unit trusts in operation

Note 1 = From “controls adequate” to “controls inadequate” (or vice versa). Where the manager’s status changed, the report should state the date of that change and the number of reportable breaches of CIS 4 and 15 before and after that change of status.

Note 2 = The application of CIS 4.3.12R and CIS 15.3.12R relates to the correction of an error by the manager with the trustee’s agreement in accordance with CIS 4.3.12R and CIS 15.3.12R.

The statistical information above has been provided to the FSA in accordance with SUP 16.6.8R(1).

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.4R require an *authorised person* to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. SUP 16.3.11R requires an *authorised person* to submit reports containing all the information required. APER 4.4.6E provides that, where an *approved person* is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of *Statement of Principle 4*. Contravention of these requirements may lead to disciplinary sanctions

or other enforcement action by the *FSA*. It should not be assumed that information is known to the *FSA* merely because it is in the public domain or has previously been disclosed to the *FSA* or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief.

Signed

Name

Position

Date

Form 2

Quarterly Return of Notifiable Breaches – Investment Companies with Variable Capital

1. Pricing Errors

Authorised Corporate Director (ACD)	Did status of ACD change in quarter? (Note)	No. of pricing errors of 0.5% and above	No. of pricing errors below 0.5%, where depositary does not consider manager's controls to be adequate	No. of Investment Companies with Variable Capital in operation

Note = From “controls adequate” to “controls inadequate” (or vice versa). Where the ACD's status changed, the report should state the date of that change and the number of reportable breaches of CIS 4 before and after that change of status.

2. Negative Boxes

Authorised Corporate Director (ACD)	Did status of ACD change in quarter? (Note 1)	No. of negative boxes where CIS 4.3.12R has not been applied. (Note 2)	No. of Investment Companies with Variable Capital in operation

Note 1 = From “controls adequate” to “controls inadequate” (or vice versa). Where the ACD's status changed, the report should state the date of that change and the number of reportable breaches under CIS 4 before and after that change of status.

Note 2 = The application of CIS 4.3.12R relates to the correction of an error by the ACD with the depositary's agreement in accordance with CIS 4.3.12R.

The statistical information above has been provided to the FSA in accordance with SUP 16.6.8R(2).

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.4R require an *authorised person* to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. SUP 16.3.11R requires an *authorised person* to submit reports containing all the information required. APER 4.4.6E provides that, where an *approved person* is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of *Statement of Principle 4*. Contravention of these requirements may lead to disciplinary sanctions

or other enforcement action by the *FSA*. It should not be assumed that information is known to the *FSA* merely because it is in the public domain or has previously been disclosed to the *FSA* or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief.

Signed

Name

Position

Date

Chapter 17

Transaction reporting

17.1 Application

Who?

- 17.1.1 **R** /1
- (1) This chapter applies to every *firm* which is:
- (a) a *securities and futures firm*; or
 - (b) a *personal investment firm*; or
 - (c) an *investment firm* (including a *credit institution* which is an *investment firm*) not within (a) or (b) excluding a *firm* to whom the *ISD* does not apply under Article 2(2) of the *ISD*.
- (2) This chapter does not apply to:
- (a) an *incoming EEA firm* in relation to its *passport activities*; or
 - (b) an *oil market participant* in relation to its *oil market investment activities*.

What?

- 17.1.2 **R** /1
- This chapter applies to a *firm* in SUP 17.1.1 R that enters into *reportable transactions* (whether on its own account or on behalf of others).

Where?

- 17.1.3 **R** /1
- This chapter applies with respect to:
- (1) activities carried on from an establishment maintained by the *firm* (or its *appointed representative*) in the *United Kingdom*; or
 - (2) *passport activities* of an *ISD investment firm* (including a *credit institution* which is an *ISD investment firm*) carried on from a *branch* in another *EEA State*.

17.2 Purpose

17.2.1

G

^{/1}

This chapter sets out the requirements for *firms* to report transactions to the *FSA*. One purpose of the chapter is to implement article 20 of the *Investment Services Directive* which has the two aims of protecting investors and ensuring the smooth operation and transparency of the markets in transferable securities. *Transaction reports* also form a useful part of the *FSA*'s arrangements for monitoring (under paragraph 6(1) of Schedule 1 to the *Act*) and can assist the *FSA* in assessing the type and conduct of business carried out by a *firm*.

17.3 Introduction

17.3.1

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/1

The requirements set out in this chapter represent an interim approach to transaction reporting, based on the reporting requirements which previous regulators applied to *firms*. A number of provisions reflect the interim nature of the requirements – notably the *guidance* in SUP 17.4.4 G. Also there are still significant differences in the requirements applicable to different categories of *firm*. To help *firms* the FSA intends to publish additional *guidance* from time to time covering developments and issues in transaction reporting (including sources of relevant information).

17.3.2

G
/1

The reporting obligations vary according to the nature of a *firm's* business and the number of transactions which a *firm* ordinarily enters into. *Firms* are generally expected to report transactions through the electronic systems listed in the chapter, but *firms* which enter into relatively few transactions may report those transactions manually, by fax or e-mail (see SUP 17.7).

17.4 Obligation to make transaction reports

- 17.4.1** **R** When a *firm* (whether on its own account or on behalf of another) enters into a *reportable transaction* (as defined in SUP 17.5), it must make a *transaction report* (as set out in SUP 17.6) to the FSA.

Exceptions: general

- 17.4.2** **R** A *firm* need not make a *transaction report* to the FSA if:
- (1) the *firm* complies with a requirement on it to report the *reportable transaction* to its *Home State regulator*; or
 - (2) the *reportable transaction* is transacted on one of the exchanges listed in SUP 17 Ann 1R and the *firm* reports the *reportable transaction* to that exchange.

Exceptions: investment management firms and personal investment firms

- 17.4.3** **R** An *investment management firm* or a *personal investment firm* need not make a *transaction report* to the FSA if:
- (1) the *reportable transaction* is transacted on a *regulated market* and the *firm*:
 - (a) reports the *reportable transaction* to that *regulated market*; or
 - (b) satisfies itself that it will be so reported; or
 - (2) the *firm* is the seller, or is acting on behalf of the seller, and the counterparty for that transaction is another *firm*; or
 - (3) the *firm* has reasonable grounds to believe that:
 - (a) another *firm* is obliged to make a *transaction report* to the FSA for that transaction; and
 - (b) that other *firm* is not entitled to rely on this exception.

- 17.4.4** **G**_{/1} For the purposes of SUP 17.4.3 R (3) “reasonable grounds” would include a *firm* relying on a broker if:
- (1) the *firm* used the same broker for transactions before *commencement*;
 - (2) that *broker* was previously regulated by *SFA* and was subject to its transaction reporting requirements; and
 - (3) the *firm* is not aware of any material changes to the broker’s *permission*.

17.4.5 **G**_{/1} The *guidance* in SUP 17.4.4 G is likely to become less relevant over time.

17.4.6 **G**_{/1} “Reasonable grounds” require more than just a check as to whether the other *firm* is *authorised*. For example a *firm* should not rely on SUP 17.4.3 R (3) alone if the only other party to a *reportable transaction* is an *investment management firm* or a *personal investment firm*.

Use of reporting agents

- 17.4.7** **R**_{/1} A *firm* may appoint another *person* to make *transaction reports* on its behalf if:
- (1) the *firm* has informed the *FSA* of that appointment in writing; and
 - (2) the *transaction reports* made on its behalf comply with SUP 17 and distinguish each individual transaction, using the *firm’s* identifying code.

17.4.8 **G**_{/1} SUP 17.4.7 R sets out the conditions which must be satisfied if a *firm* wishes to appoint someone else to make *transaction reports* on its behalf. The *firm* will remain responsible for its compliance with SUP 17.

Other reporting requirements

17.4.9 **G**_{/1} A *firm’s* obligations under this chapter do not affect any obligation to report transactions under the rules of any reporting system or of any exchange, whether or not that exchange is a *regulated market*.



17.5 Reportable transactions

17.5.1

R

/1

A “*reportable transaction*” is a transaction of a type identified in SUP 17.5.4 R, except:

- (1) stock or bond lending and borrowing, repurchase or reverse repurchase agreements;
- (2) asset trading transactions, including novation, assignment and sub-participation; and
- (3) issues, market allotments and syndications which are not dealt in on a *regulated market*.

17.5.2

G

/1

For a list of *regulated markets* see SUP 17 Ann 5G.

17.5.3

G

/1

In general, transactions, other than those in *derivative* products, between the issuer of an instrument and the first taker as *principal* are not *reportable transactions*. However, if an instrument is already dealt in on a *regulated market*, all secondary issue transactions are reportable if the new issue ranks equally with those already in issue and the issue is already traded or *listed* on a *regulated market*. All secondary market transactions carried out on or off exchange, before or after the instrument is issued, are reportable. In addition, for a *firm* which is not a *personal investment firm* or an *investment management firm* (essentially *BCD credit institutions* and *securities and futures firms*), *reportable transactions* include transactions in some instruments which are not traded on a *regulated market* at all – for example the instrument concerned might only be traded over the counter or through a trading facility such as Ofex.

17.5.4

R

/1

Table Reportable transactions (see SUP 17.5.1R)

Class of firm	Reportable transactions
<i>personal investment firm</i>	<p>A transaction which is entered into within an <i>EEA State</i> and is in any of the following instruments which is dealt in on a <i>regulated market</i>:</p> <ul style="list-style-type: none"> (a) a <i>security</i> (except a <i>unit</i>); or (b) a <i>future</i>; or (c) an <i>option</i>.

Class of firm	Reportable transactions
<i>investment management firm</i>	<p>A transaction which:</p> <ul style="list-style-type: none"> (a) is executed in the <i>EEA</i>; (b) is carried out for valuable consideration; and (c) relates to an instrument which is dealt in on a <i>regulated market</i> other than: <ul style="list-style-type: none"> (i) <i>futures</i> not relating to <i>shares</i>; or (ii) <i>options</i> (including <i>covered warrants</i>) not relating to <i>shares</i>; or (iii) swaps relating to <i>designated investments</i> other than <i>shares</i> or <i>debentures</i>; or (iv) <i>currencies</i> and <i>currency derivatives</i>; or (v) <i>units</i>; or (vi) <i>futures</i> or <i>options</i> relating to a basket of <i>shares</i> or an equity index not capable of settlement by delivery.
any other <i>firm</i>	<p>A transaction in a <i>designated investment</i> except for:</p> <ul style="list-style-type: none"> (a) <i>money-market instruments</i> not dealt in on a <i>regulated market</i>; or (b) <i>units</i>; or (c) <i>contracts for differences</i> which are not related to debt or equities (see note); or (d) <i>currencies</i>; or (e) <i>commodities</i> (including <i>bullion</i>); or (f) <i>life policies</i>; or (g) <i>futures</i> or <i>options</i> on anything in (a) to (e). <p>Note: <i>Firms</i> are required to report <i>contracts for differences</i> (including <i>spread bets</i>) on the value or price of a bond, an equity or a related index or indices. <i>Firms</i> are not required to report <i>contracts for differences</i> where the contract is based on the fluctuation in the price or value of an interest rate, currency, a commodity or on the value of a dividend payment or payments on an equity or a basket of equities.</p>



17.6 Transaction reports

Timing of reports

17.6.1 **R** ^{/1} *A transaction report must be made as soon as practicable and in any event, subject to SUP 17.7.10 R (Failure of reporting systems), before the end of the next business day after the day on which the firm entered into the transaction.*

Content

17.6.2 **R** ^{/1} *A transaction report must:*

- (1) *in the case of an investment management firm, include the details set out in SUP 17.6.4 R, except that it need not provide the details in the column headed “Counterparty” if the counterparty is not an ISD investment firm; or*
- (2) *in the case of a personal investment firm, include the details set out in SUP 17.6.4 R; or*
- (3) *in the case of any other firm, include all the fields identified in SUP 17 Ann 2 for the relevant reporting system.*

17.6.3 **G** ^{/1} *SUP 15.6 applies to transaction reports and requires a firm to take reasonable steps to ensure that information provided to the FSA is accurate.*

17.6.4 **R** ^{/1} *Table Details to be reported (investment management firms and personal investment firms) (see SUP 17.6.2 R)*

Firm	Counterparty	Investment	Transaction
Name	Name	Description	Time of transaction
Address	Address	Quantity/size	Date of transaction
Whether agent or principal		Unit price	Whether purchase or sale
			Total amount of consideration payable on settlement date

- 17.6.5** **A**_{/1} (1) A *firm* subject to SUP 17.6.2 R (3) should ensure that a *transaction report* is accepted by the relevant reporting system.
- (2) Contravention of (1) may be relied on as tending to establish contravention of SUP 17.4.1 R.

- 17.6.6** **R**_{/1} The price reported in a *transaction report* must be the transaction price, excluding any *charges* or *commission* which is shown separately on the contract note or on any similar notification.

Basket trades

- 17.6.7** **R**_{/1} If a *firm* (other than an *investment management firm* or a *personal investment firm*) effects a series of transactions within a 24 hour period which is an exact replica of any of the following indices (known as a “basket trade”), it may report them as a single transaction under a single approved security code:

- (1) CAC 40; or
- (2) DAX 30; or
- (3) LSE/Nikkei 50; or
- (4) Nikkei 225; or
- (5) Standard and Poors 500; or
- (6) TOPIX.

- 17.6.8** **G**_{/1} The “single approved security code” referred to in SUP 17.6.7 R and SUP 17.6.9 R is the code issued by the relevant exchange or numbering agency.

- 17.6.9** **R**_{/1} If a *firm* (other than an *investment management firm* or a *personal investment firm*) effects a series of transactions within a 24 hour period which does not exactly replicate one of the indices listed in SUP 17.6.7 R, it may make a *transaction report* for them showing:

- (1) a single basket trade *transaction* under a single approved security code; and
- (2) the missing constituents of the relevant index, as reverse trades, with the price and quantity set according to their weighting in the index.

- 17.6.10** **G**_{/1} A *firm* which effects a series of transactions to which SUP 17.6.9 R applies may report them as individual transactions, rather than under that *rule*.



17.7 Method of making transaction reports

Use of reporting systems

- 17.7.1 **R** /1 *A transaction report must be made through one of the reporting systems listed in SUP 17.7.8 R unless SUP 17.7.4 R applies.*
- 17.7.2 **R** /1 *Before a firm uses any of the systems listed in SUP 17.7.8 R, it must notify the FSA in writing that it intends to do so.*
- 17.7.3 **R** /1 *A firm must send a notification under SUP 17.7.2 R to a member of its supervision team and to the FSA’s Transaction Monitoring Unit.*

Reporting by fax or e-mail

- 17.7.4 **R** /1 *Firms within the categories in the table in SUP 17.7.5 R may report transactions by a fax or e-mail transmission which complies with the relevant requirements in the table.*
- 17.7.5 **R** /1 *Table Reporting by fax or e-mail (see SUP 17.7.4 R)*

Category of firm	Requirements
<i>An investment management firm.</i>	<i>The firm must include the information required by SUP 17.6.2 R (1) in the fax or e-mail sent to the FSA.</i>
<i>A personal investment firm which effects reportable transactions at an average rate of fewer than 40 in a month.</i>	<i>The firm must include the information required by SUP 17.6.2 R (2) in the fax or e-mail sent to the FSA.</i>
<i>Any other firm which effects reportable transactions at an average rate of fewer than 20 in a month.</i>	<i>The firm must complete the manual reporting form set out in SUP 17 Ann 3 and send it by fax or e-mail to the FSA.</i>

- 17.7.6 **G** /1 *The manual reporting form in SUP 17 Ann 3 is not compulsory for investment management firms or personal investment firms, but those firms may use it to record the required information.*

17.7.7 **R** ^{/1} *Transaction reports* made under SUP 17.7.4 R must be sent to the FSA's Data Integrity Unit:

- (1) by fax on 020 7676 3675; or
- (2) by e-mail to tmu@fsa.gov.uk.

Permitted reporting systems

17.7.8 **R** ^{/1} The reporting systems referred to in SUP 17.7.1 R are:

- (1) CEDCOM system operated by CEDEL SA, Luxembourg;
- (2) CGO – Central Gilts Office;
- (3) CRESTCo Limited;
- (4) EUCLID operated by Euroclear SA (input directly into EUCLID or through SWIFT);
- (5) the FSA's Direct Reporting System;
- (6) SEQUAL 2000 system of Thomson Financial Services;
- (7) Tradepoint Financial Networks Plc;
- (8) Trade Registration System of The London International Financial Futures and Options Exchange (LIFFE);
- (9) TRAX system of the International Securities Market Association; and
- (10) Jiway Limited.

17.7.9 **G** ^{/1} *Guidance* on the use of particular reporting systems listed in SUP 17.7.8 R is available from the FSA's Transaction Monitoring Unit.

Failure of reporting systems

17.7.10 **R** ^{/1} If a reporting system fails (whether a relevant reporting system, the *firm's* own system or the system of a *person* reporting on its behalf), a *firm* must:

- (1) make the *transaction report* through another reporting system, if the *firm* considers it reasonably practicable to do so; or
- (2) make the *transaction report* by the end of the *business day* after the *day* when the failure is remedied, if the *firm* does not consider it reasonably practicable to comply with (1).

- 17.7.11 **R** /1 A *firm* must notify the *FSA* in writing, before the end of the *business day* after the *day* when the failure occurs, which of *SUP* 17.7.10 R (1) or *SUP* 17.7.10 R (2) it will adopt.

- 17.7.12 **R** /1 A *firm* must notify the *FSA*, in writing and without delay, of any failure of its own system, or that of a *person* reporting on its behalf, which prevents a *transaction report* being made within the period specified in *SUP* 17.6.1 R.

SUP 17 Ann 1R: Exchanges relevant for SUP 17.4.2R (2)

1 Table

American Stock Exchange (AMEX)
Australian Stock Exchange
Chicago Board of Trade
Chicago Board Options Exchange / Chicago Options Exchange
Chicago Mercantile Exchange
Chicago Stock Exchange
Coffee, Sugar and Cocoa Exchange
Hong Kong Futures Exchange
Hong Kong Stock Exchange
Johannesburg Stock Exchange
Kansas City Board of Trade
Korean Stock Exchange
MidAmerica Commodity Exchange
Minneapolis Grain Exchange
Montreal Stock Exchange
NASDAQ
New York Futures / Cotton Exchange
New York Mercantile Exchange / Commodity Exchange Inc
(NYMEX)
New York Stock Exchange
New Zealand Futures and Options Exchange
Osaka Securities Exchange
Pacific Stock Exchange
Philadelphia Board of Trade
Philadelphia Stock Exchange
Singapore Stock Exchange
South African Futures Exchange (SAFEX)
Sydney Futures Exchange
Tokyo Stock Exchange (including TIFFE)
Toronto Stock Exchange
any non UK *regulated market*

(see SUP 17 Annex 5G)

SUP 17 Ann 2R: Mandatory fields for reporting systems

1 Table

1. For the purposes of *SUP* 17.6.2(3)R, all the following are mandatory fields:
 - (1) the firm's and each counterparty's identifying code, as required under 2;
 - (2) the investment's identifying code if listed in 3 or a full description;
 - (3) the date and time of the transaction;
 - (4) the transaction size, price and currency;
 - (5) whether the transaction is a purchase or sale;
 - (6) whether the *firm* dealt as principal or agent;
 - (7) the settlement due date;
 - (8) the transaction's reference number;
 - (9) any other mandatory fields required by the reporting system;
 - (10) whether the transaction is a cancellation; and
 - (11) in the case of a *derivative* transaction, the appropriate expiry date, strike price and, if appropriate, whether a put or a call.
2. A *firm* must allocate to each counterparty an appropriate counterparty identifier code, using the following identifier codes:
 - (1) the counterparty participant code identified on the transaction report from the relevant reporting system; or
 - (2) where the counterparty is another *firm*, the *FSA* authorisation code or a *BIC* code, plus a sub-account code; or
 - (3) in the case of any other counterparty, a unique root allocated specifically to that counterparty by the reporting *firm*, plus a sub account code.

2 Table Guidance to SUP 17 Ann 2R 2

If a *firm*'s counterparty is acting for a disclosed *principal* (identified either by name or by a distinctive account indicator), the *firm* will need to allocate a counterparty identifier code which indicates the identity of the underlying *principal*. This code can use the "root code" of the immediate counterparty provided that it is coupled with a sub-account code identifying the *principal*.

3 Table The investment identification codes referred to in (1) above are:

CC	CEDEL and Euroclear Common Codes	9 Numeric
CU	CUSIP	9 Alphanumeric
IS	ISIN	2 Alphabetic and 10 Alphanumeric
SE	SEDOL	7 Numeric
SV	SICOVAM	From 5 to 7 Numeric
TR	TRAX	1 Alphabetic and 6 Numeric
TS	TOKYO STOCK EXCHANGE	From 4 to 9 Numeric

4 Table

When reporting *on-exchange derivatives* transactions (except through DRS), a market identifier code followed by the product mnemonic of that exchange will be acceptable. Codes must be left justified when they are input.

SUP 17 Ann 3R: Manual transaction reporting form

1 Table Notes for completion of manual transaction reporting form

[Field descriptions and guidelines]

NB: Fields which are denoted as “A” are fields that must be input in all circumstances. Fields which are denoted as “M” are only mandatory in the case of a firm which is not a personal investment firm or an investment management firm. Fields which are denoted as “O” are only mandatory in certain circumstances.

FIRM DETAILS

Firm Name (A)
Contact Name (M)
Telephone Number (M)
Submission date (M)
Signature (M)

TRANSACTION DETAILS

This field must contain the FSA code of the firm which is making the report (NB – The FSA code is currently six numbers).

FSA Code (A)

Internal Transaction Reference: (M)

This must be a unique reference, internal to the firm making the report, that will enable the firm to provide FSA with more information concerning the trade, if required.

Trade Date (A)

The date when the trade was executed.

Trade Time (A)

The time when the trade was executed. This should be in London time.

Bought/Sold Indicator (A)

Either “B” (i.e. Buy) or “S” (i.e. Sell) with respect to the firm making the Transaction Report.

Cancel Indicator (O)

Input a “C” for cancellation. This field can be used to cancel a trade previously submitted. For cancelled trades all of the fields apart from the Cancel Indicator, must be the same as the original trade report.

Counterparty1 Code Type (O)

The valid Counterparty Code Types, when used in conjunction with the Counterparty fields are as follows:

B – The Counterparty Root Code is a BIC code (as issued by S.W.I.F.T);

S – The Counterparty Root Code is an FSA code (as issued by the Financial Services Authority);

F – The Counterparty Root Code contains the reporting firm’s own reference code to identify the Counterparty.

If there is only a single counterparty to a principal trade, details may be supplied either in Counterparty1 fields or in Counterparty2 fields.

Counterparty1 Root Code (O)

The counterparty to the trade. Depending upon the Counterparty Code Type, it will consist of one of the following:

BIC code (11 characters)

FSA code (currently 6 digits)

Firm’s reference code (up to 11 characters).

Counterparty1 Sub Code (O)

A code identifying the lowest level of account within the reporting firm for which this transaction will be booked. This will usually be the reporting firm’s own internal account code. If the Counterparty1 Root Code is completed, the firm must also complete this field.

Trade Quantity (A)

The volume of the trade (e.g. number of units, nominal value of bonds, number of lots, number of contracts).

Security Code Type (O)

The valid Security Type Codes are as follows:

CC – CEDEL and Euroclear Common Codes;

CU – CUSIP;

IS – ISIN;

SE – SEDOL;

SV – SICOVAM;

TR – TRAX;

TS – Tokyo Stock Exchange;

ON – For trades in On-Market Derivatives.

For OTC trades where the instrument is not traded on an exchange market, please specify “OFF-market”.

Security Code (O)

The Security Code according to the value of Security Code Type (Field 11). Valid codes are:

CC – 9 Numeric;

CU – Alphanumeric
IS – 2 Alphabetic and 10 Alphanumeric
SE – 7 Numeric
SV – From 5 to 7 Numeric
TR – 1 Alphabetic and 6 Numeric
TS – From 4 to 9 Numeric
ON – The market’s own three-character Market Identifier Code followed immediately by the standard code for the contract being traded as used on that market.

Instrument type (A)

This field will be used to classify the instrument traded, or, in the case of a derivative, the underlying instrument. Valid codes are:

A – Equity;
B – Bond/Fixed Interest;
I – Index (derivatives only);
M – Commodity (derivatives only);
R – Interest Rate (derivatives only);
U – Currency (derivatives only);
W – Warrant;
O – Other (i.e. none of the above).

Issuer Name (A) (see note)

The name of the issuer of the security if the Security Type Code is specified as “OFF market”. Otherwise, completion of the field is optional. The name of the issuer of the security must be readable (i.e. meaningful).

Instrument Description (A/O)

A description of the instrument is required if the Security Type Code is specified as “OFF market”. Otherwise completion of the field is optional.

A full description of the security or derivative (e.g. “Bloggs 50p ordinary share” for equities) is required. For fixed interest securities, the following information is required:

Coupon rate;
 whether it is a bond, debenture or loan (BDS, DIB, INS);
 whether it is a convertible;
 redemption date.

Option Exercise Price (O)

This field is only required for options.

Derivative Type (O)

This field indicates the derivative type. Valid codes are:

P: Put Option;
C: Call Option;
F: Future;

D: Contract for Difference;

S: Swap.

NB: Double options must be reported as two transactions, one for call and one for put option. The premium must be halved and entered on both transactions which must have the same transaction reference number.

Delivery/Expiry/Maturity date (O)

The delivery date of a futures contract, the expiry date of an option, the maturity or redemption date of a bond. For a bond derivative, it is the delivery or expiry date.

Trade Currency (A)

The currency in which the trade was dealt; an ISO code such as USD, GBP, DEM etc. (NB: GBX, USX, and IEX are not accepted)

Trade Price (A)

The (unit) price of the trade in the currency in which the trade was dealt (as indicated by the Trade Currency Code. For bonds, it must be a percentage price. For derivatives, it must be the decimal value per contract, not the tick value.

Price Multiplier (M)

Value of unit change in price, such that for on-exchange derivatives:

Price x Quantity x Multiplier = Trade Value.

For warrants, if the trade represents units of 50 warrants then multiplier equals 50. For bonds this should equal 1 as trade price must be reported as percentage price. The default multiplier is 1.

Consideration (A/O)

The consideration to be settled. For Options, the total premium. The consideration should be in the currency indicated by either the Trade Currency Code or the Settlement Currency Code. The field must be left blank if there is no consideration (e.g. margin only trades).

Settlement Date (O)

The settlement date for the trade.

Settlement Currency Code (O)

This field is required if the Consideration field is completed and is not in the currency indicated by the Trade Currency Code. Valid codes are any ISO code, such as USD, GBP, DEM, etc.

Dealing Capacity (A)

The dealing capacity of the firm making the Transaction Report.

Valid codes are:

- A Agency;**
- C Principal Cross;**
- P Principal;**
- X Agency Cross.**

Counterparty2 Code Type (O)

The valid Counterparty Code Types, when used in conjunction with the Counterparty2 fields are as follows:

- B –The Counterparty2 Root Code is a BIC code (as issued by S.W.I.F.T);**
- S –The Counterparty2 Root Code is an FSA code (as issued by the Financial Services Authority);**
- F –The Counterparty2 Root Code contains the reporting firm’s own reference code to identify the Counterparty.**

If there is only a single counterparty to a principal trade, details may be supplied either in Counterparty1 fields or Counterparty2 fields.

Counterparty2 Root Code (O)

The second counterparty to the trade. It will consist of, depending upon the Counterparty2 Code Type, one of the following:

- BIC code (11 characters)**
- FSA code (currently 6 digits)**
- Firm’s reference code (up to 11 characters).**

Counterparty2 Sub Code (O)

A code identifying the lowest level of account within the reporting firm for which this transaction will be booked. This will usually be the reporting firm’s own internal account code. If the Counterparty2 Root code is completed, this field must also be completed.

Bargain Condition Codes (O)

Up to eight two character bargain conditions codes can be supplied. Valid conditions are:

- CB Cum Bonus**
- CC Cum Coupon**
- CD Cum Dividend**
- CP Cum Capital Repayment**
- CR Cum Rights**
- NP Delivery Free of Payment**
- RN Redemption**
- RO Result of Option**
- RP Repo**
- SB Borrowing/Lending**
- SP Special Price**

WI	When Issued
XB	Ex Bonus
XC	Ex Coupon
XD	Ex Dividend
XP	Ex Capital Payment
XR	Ex Rights
XX	Special Conditions

Market Identifier Code (M)

A three character code to indicate the market upon which the transactions was executed. The code is the first three characters of SWIFT Market Identifier Code excluding the leading “X”. OFF–market trades must be denoted by “OFF”.

(A list of “Market Identifier Codes” can be obtained from S.W.I.F.T on Tel: 020 7377 9190 – a list as at March 2000 is set out in *SUP 17 Ann 4G*.)

NB: If a valid Security Type and a valid Security Code does not exist for a transaction, the issuer Name and Instrument Description must be completed.

FSA MANUAL TRANSACTION REPORTING FORM

To: Data integrity Unit

Fax: 020 7676 3675

Email: tmu@fsa.gov.uk

FSA Handbook • SUP • Pre-release 0.1 (21 June 2001)

CONTACT NAME			
(A) FIRM NAME:			
TELEPHONE NUMBER:			
SUBMISSION DATE:			

CONTACTS	
SIGNATURE:	

(A) FSA CODE:							
INTERNAL REF NO:							
(A) TRADE DATE/TIME:							
(A) BUY/SELL:							
CANCEL INDICATOR:							
COUNTERPARTY1 CODE TYPE:							
COUNTERPARTY1 ROOT CODE:							
COUNTERPARTY1 SUB CODE:							
(A) TRADE QUANTITY:							
SECURITY CODE TYPE:							
SECURITY CODE:							
(A) INSTRUMENT TYPE:							
(A) ISSUER NAME:							
(A) INSTRUMENT DESCRIPTION:							
OPTION EX PRICE:							
DERIVATIVE TYPE:							
D/E/M:							

(A) TRADE CURRENCY:		
(A) TRADE PRICE:		
PRICE MULTIPLIER:		
(A) CONSIDERATION:		
SETTLEMENT DATE:		
SETTLEMENT CURRENCY:		
(A) DEALING CAPACITY:		
COUNTERPARTY2 CODE TYPE:		
COUNTERPARTY2 ROOT CODE:		
COUNTERPARTY2 SUB CODE:		
BARGAIN CONDITION CODES:		
MARKET ID CODE:		
COMMENTS:		

(A) – Mandatory fields for all firms.
 Other fields are mandatory for some firms, but not all.
 Please refer to guidance notes in SUP 17 Annex 3R for additional details.

SUP 17 Ann 4G: Market identifier codes [Listed alphabetically by exchange]

1 Table

MIC	EXCHANGE
ABJ	Abidjan, bourse des valeurs
ALB	Alberta Stock Ex., Calgary
ASE	American Stock Exchange
AMM	Amman Stock Exchange
ACE	Amsterdam Comm. Exchange
AMS	Amsterdam Effectenbeurs
ANT	Antwerpen Stock Exchange
FTA	ATA (Netherlands)
ATH	Athens Stock Exchange
AOM	Australian Options Mkt, Sidney
ASX	Australian Stock Exchange
OTB	Austrian Options Exchange
BAH	Bahrain Stock Exchange, Manama
BAL	Baltic Stock Exchange
BAN	Bangalore Stock Exchange
BKK	Bangkok Stock Exchange
BAR	Barcelona Stock Exchange
BSL	Basle Stock Exchange
BEY	Beirut, Bourse de
BFO	Belgian Futures and Options Ex
BER	Berlin Stock Exchange
BRN	Bern Stock Exchange
BIL	Bilbao, Borsa de
BOG	Bogata, Bolsa de
BOL	Bolivian Bolsa de Valoures, Le Paz
BDP	Bolsa de Derivados do Porto
BMF	Bolsa de Mercadorias & Futuros
BOM	Bombay Stock Exchange
BOR	Bordeaux Stock Exchange
BOS	Boston Stock Exchange
BOT	Botswana Share Market
BRA	Bratislava Stock Exchange
BRE	Bremer Wertpapierboerse
BRU	Brussels Stock Exchange
BSE	Bucharest Stock Exchange
BCE	Budapest Commodity Exchange
BUD	Budapest Stock Exchange
BUE	Buenos Aires Stock Exchange
BUL	Bulgarian, The Ist, Sofia
CAI	Cairo Stock Exchange
CAL	Calcutta Stock Exchange
CAR	Caracas Stock Exchange
CAS	Casablanca Stock Exchange
KAZ	Central Asian Stock Exchange

MIC	EXCHANGE
CBT	Chicago Board of Trade
CBO	Chicago Board Options Ex.
CME	Chicago Mercantile Exchange
CRC	Chicago Rice and Cotton Ex.
CHI	Chicago Stock Exchange
CCE	Chubu Commodity Exchange
COL	Columbo Stock Exchange
CEC	Comm. Exchange Center, NY
CSE	Copenhagen Stock Exchange
ROS	Cordoba Stock Exchange
CYS	Cyprus Stock Exchange, Nicosia
DES	Delhi Stock Exchange
DWZ	Deutsche Bourse, Frankfurt
DHA	Dhaka Stock Exchange
DTB	DTB Deutsche Terminboerse
DUB	Dublin Stock Exchange
DUS	Duesseldorf, (Rheinisch–West)
EAS	EASDAQ, Brussels
EOE	Euro. Opt. Ex. Amsterdam
FNX	Financial Instrument Exchange (FINEX)
FOM	Finnish Options Market
FIR	Florence Stock Exchange
FRA	Frankfurter Wertpapierboerse
FKA	Fukuoka Stock Exchange
DOF	FUTOP, Copenhagen
GEN	Genoa Stock Exchange
GVA	Genova Stock Exchange
GHA	Ghana Stock Exchange
GUA	Guayaquil Stock Exchange
HAM	Hamburg Stock Exchange
HAN	Hannover Stock Exchange
HEL	Helsinki Stock Exchange
HIR	Hiroshima Stock Exchange
HFE	Hong Kong Futures Exchange
HKG	Hong Kong Stock Exchange
IBR	Ibis, Frankfurt
ICE	Iceland Stock Exchange
IST	IMKB Istanbul Stock Exchange
IOM	Index and Options Mkt Chicago
IMM	Int. Monetary Mkt Chicago
DUB	Irish Stock Exchange (Dublin)
DMI	Italian Derivatives Market
JKT	Jakarta Stock Exchange
JAM	Jamaica Stock Exchange
JSE	Johannesburg Stock Exchange
KST	Kamon Commodity Exchange (Japan)
KBT	Kansas City Board of Trade
KAC	Kansai Agricultural Commodity Exchange (KANEX)
KAR	Karachi Stock Exchange
KKT	Kobe Raw Silk Exchange
KGT	Kobe Rubber Exchange
KOR	Korea Stock Exchange, Seoul
KLC	Kuala Lumpur Comm. Exchange.
LOF	Kuala Lumpur Options and Financial Futures Exchange (KLOFFE)
KLS	Kuala Lumpur Stock Exchange

MIC	EXCHANGE
KUW	Kuwait Stock Exchange
KYO	Kyoto Stock Exchange
LAU	Lausanne Stock Exchange
LIF	LIFFE
LIC	Lille Commodity Exchange
LIL	Lille Stock Exchange
LIM	Lima Bolsa de Valores
LIS	Lisbon Stock Exchange
LIT	Lithuania Stock Exchange
LJU	Ljubljana Stock Exchange
CEL	Ljubljana Commodity Exchange
LME	London Metal Exchange
ISE	London Stock Exchange
LUS	Lusaka Stock Exchange
LUX	Luxembourg Stock Exchange
LYO	Lyon Stock Exchange
MDS	Madras Stock Exchange
MAD	Madrid, Bolsa de
MKT	Maebashi Dried Cocoon Exchange
MAK	Makati Stock Exchange, Manila
MNE	Malaysian Monetary Exchange
MAL	Malta Stock Exchange
MNL	Manila Stock Exchange
MAR	Marseille Stock Exchange
MAT	Matif S.A., Paris
MAU	Mauritius Stock Exchange
MED	Medellin Bolsa
MEF	Meff Renta fija, Barcelona
MRV	Meff Renta Madrid
MIF	Mercato Italiano Futures Exchange
MEX	Mexican Stock Exchange
MAC	Mid America Comm. Exchange
MID	Midwest Stock Ex., Chicago
MIL	Milan Stock Exchange
MGE	Minneapolis Grain Exchange
MNT	Montevideo Bolse de Valores
MOO	Montreal Opt. and Der. Mkt.
MON	Montreal, (Bourse De)
MIC	Moscow Interbank Currency Exchange
MOS	Moscow Stock Exchange
MUN	Muenchen, (Bayerische Borse)
MUS	Muscat Securities Market
NGO	Nagoya Stock Exchange
NST	Nagoya Textile Exchange
NAI	Nairobi Stock Exchange
NAM	Namibian Stock Exchange
NAY	Nancy Stock Exchange
NAN	Nantes Stock Exchange
NAP	Napoli, (Borsa Valori Di)
NAS	NASDAQ
NMS	NASDAQ National Market Systems, Washington DC
NEU	Neuchatel Stock Exchange
NYC	New York Cotton Exchange
NYF	New York Futures Exchange
NYM	New York Mercantile Exchange

MIC	EXCHANGE
NYS	New York Stock Exchange
NEE	New Zealand Futures Exchange
NZE	New Zealand Stock Exchange
AUK	New Zealand Stock Exchange, Auckland
NSA	Nigerian Stock Exchange
NII	Niigata Stock Exchange
CSC	NY Cocoa, Coffee and Sugar Ex.
OFF	OFF MARKET
MCE	OM Stockholm
MLX	OMLX, London
OPO	Oporto Stock Exchange
OHS	Optionsseine Handels System
OSM	Osaka Mercantile Exchange
OSE	Osaka Securities Exchange
OST	Osaka Textile Exchange
OSL	Oslo Bors
OTC	OTC Bulletin Board, Washington
PSE	Pacific Stock Exchange, San Francisco
PAL	Palermo Stock Exchange
PTY	Panama Bolsa de Valores
PAR	Paris Stock Exchange
PHO	Philadelphia options Exchange
PHL	Philadelphia Stock Exchange
PBT	Philadelphia Board of Trade
POR	Portal, Washington
PRA	Prague Stock Exchange
QUI	Quito Stock Exchange
RAS	RASDAQ
RIS	Riga Stock Exchange
RIO	Rio de Janeiro, Bolsa de valores
ROM	Rome, Borsa valori di
RUS	Russian Exchange (The)
BNV	San Jose Stock Exchange
SGO	Santiago Stock Exchange
BMF	Sao Paulo Futures Exchange
BSP	Sao Paulo Stock Exchange
SAP	Sapporo Stock Exchange
SHG	Shanghai Stock Exchange
SME	Shenzhen Mercantile Exchange
SHE	Shenzhen Stock Exchange
SIB	Siberian Stock Exchange
SCE	Singapore Commodity Exchange
SIM	Singapore Int. Monetary Ex.
SES	Singapore Stock Exchange
SFX	SOFFEX, Zurich
SAF	South African Financial Futures Exchange (SAFFEX)
PET	St Petersburg Stock Exchange
GAL	St. Gallen Stock Exchange
SSE	Stockholm Stock Exchange
STU	Stuttgart Stock Exchange
SWX	Swiss Exchange, Zurich
SFE	Sydney Futures Exchange
TAI	Taiwan Stock Exchange
TAL	Tallinn Stock Exchange
TEH	Tehran Stock Exchange

MIC	EXCHANGE
TAE	Tel Aviv Stock Exchange
TKT	Tokyo Commodity Exchange (TOCOM)
TKO	Tokyo Grain Exchange
TFF	Tokyo Int. Financial Futures
TKS	Tokyo Stock Exchange
TOR	Torino Stock Exchange
TFE	Toronto Futures Exchange
TOE	Toronto Options Exchange
TSE	Toronto Stock Exchange
TKA	Toyohashi Dried Cocoon Exchange
TFN	Tradepoint
TRI	Trieste Stock Exchange
TRN	Trinidad & Tobago Stock Exchange
TUN	Tunis, Borsa de Valores
VAL	Valencia Bolsa de
VSE	Vancouver Stock Exchange
VEN	Venezia Stock Exchange
VIE	Vienna Stock Exchange
VLA	Vladivostok Stock Exchange
HCE	Warenterminborse Hannover
WAR	Warsaw Stock Exchange
WCE	Winnipeg Commodity Exchange
EBE	Xebec Trading, Bucharest
YKT	Yokohama Raw Silk Exchange
ZAG	Zagreb Stock Exchange
ZIM	Zimbabwe Stock Exchange
ZRH	Zurich Stock Exchange

SUP 17 Ann 5G: Regulated markets

1 Table List of the regulated markets notified to the Commission by the Member States under Article 16 of the Investment Services Directive (93/22/EEC) as at April 2001

Austria	The following two markets of the Vienna Stock Exchange (both operated by the Wiener Borse AG)
	<ul style="list-style-type: none"> Amtlicher Handel (Official Market) Geregelter Freiverkehr (Semi-Official Market)
Belgium	<p>De eerste, de tweede en de nieuwe markt van de Effectenbeurs van Brussel/Le premier, le second marché et le nouveau marché de la Bourse de valeurs mobilières de Bruxelles [Bourse de Bruxelles]</p> <p>De Belgische Future- en Optiebeurs, afgekort Belfox/La bourse belge des futures et options, en abrégé Belfox</p> <p>De secundaire buitenbeursmarkt van d lineaire obligaties, de gesplitste effecten en de scharkistcertificaten/Le marché secondaire hors bourse des obligations linéaires, des titres scindés et des certificats de trésorerie EASDAQ</p>
Denmark	<p>The Copenhagen Stock Exchange (Københavns Fondsbors)</p> <p>Dansk Autoriseret Markedplads A/S (Danish Authorised Market Place Ltd (AMP))</p>
Finland	<p>HEX Oy, Helsingin Arvopaperi- ja johdannaispörssi, selvitysyhtiö/HEX Ab, Helsingfors Värdepapper- och derivativbörs, clearingbolag (HEX Ltd, Helsinki Securities and Derivatives Exchange, Clearing House) including:</p> <ul style="list-style-type: none"> Stock Exchange Main List: Equity and Debt Instruments Parallel Lists (I List, NM List and Pre List): Equity and Debt Instruments Option Corporation: Derivatives Exchange and Clearing House
France	<p>Le Matif</p> <p>Le premier marché et le second marché de la SBF-Bourse de Paris</p> <p>Le nouveau marché</p> <p>Le Monep</p>
Germany	<p>Berliner wertpapierbörse (Amtlicher Handel, Geregelter Markt) [Berlin Stock Exchange]</p> <p>Bremer wertpapierbörse (Amtlicher Handel, Geregelter Markt) [Bremen Stock Exchange]</p> <p>Rheinisch-Westfälische Börse zu Düsseldorf (Amtlicher Handel, Geregelter Markt) [Rhine-Westphalian Stock Exchange Dusseldorf]</p> <p>Frankfurter wertpapierbörse (Amtlicher Handel, Geregelter Markt) [Frankfurt Stock Exchange]</p> <p>Eurex Deutschland</p> <p>Hanseatische Wertpapierbörse Hamburg (Amtlicher Handel, Geregelter Markt) [Hanseatic Stock Exchange Hamburg]</p>

	Niedersächsische Börse zu Hannover (Amtlicher Handel, Geregelter Markt) [(Am Stock Exchange of Lower Saxony [Hannover])] Bayrische Börse (Amtlicher Handel, Geregelter Markt) [Bavarian Stock Exchange [Munich]] Baden–Württembergische Wertpapierbörse zu Stuttgart (Amtlicher Handel, Geregelter Markt) [Baden–Wuerttemberg Stock Exchange [Stuttgart]]
Greece	Athens Stock Exchange (ASE) – Thessaloniki Stock Exchange Centre (TSEC) Athens Derivatives Exchange (ADEX)
Ireland	Irish Stock Exchange
Italy	Borsa, articolata nei comparti: Mercato telematico azionario (MTA) Mercato telematico delle obbligazioni e dei titoli di Stato (MOT) Mercato telematico dei contratti a premio (MPR) Mercato ristretto Mercato di borsa per la negoziazione degli strumenti finanziari previsti dall'articolo 1, comma 2, lettere f) e i), del decreto legislativo 24 febbraio 1998, n. 58 (Mercato degli strumenti derivati – IDEM) Mercato all'ingrosso dei titoli di Stato italiani ed esteri, articolato nei segmenti: Mercato all'ingrosso dei titoli emessi dallo Stato italiano e da Stati esteri. Mercato all'ingrosso dei titoli emessi da organismi inter–nazionali partecipati da Stati. Mercato dei contratti uniformi a termine sui titoli di Stato (MIF). Nuovo Mercato
Luxembourg	Luxembourg Stock Exchange (Société de la Bourse de Luxembourg SA)
The Netherlands	Amsterdam Exchanges (AEX) including the following markets that are held by Amsterdam Exchanges: AEX Stock Exchange AEX Options Exchange AEX Financial Futures Market NMAX New Market Amsterdam Exchanges
Portugal	Mercado de Cotações Oficiais da Bolsa de Valores de Lisboa [Market with Official Quotations of the Bolsa de Valores de Lisboa] Segundo Mercado de Bolsa de Valores de Lisboa [Second Market of the Bolsa de Valores de Lisboa] Mercado sem Cotações da Bolsa de Valores de Lisboa [Market without Quotations of the Bolsa de Valores de Lisboa] Bolsa de Derivados do Porto
Spain	La Bolsa de Valores de Barcelona La Bolsa de Valores de Bilbao La Bolsa de Valores de Madrid La Bolsa de Valores de Valencia Los mercados oficiales de futuros y opciones de Meff Sociedad Recora del Mercado de Productos Financieros Derivados de Renta Fija, SA y Meff Sociadcad Recora del Mercado de Productos Financieros Derivados de Renta Variable, SA Mercado AIAF de Renta Fija, S.A. Mercado de Deuda Pública en Anotaciones.

Sweden

Stockholm Stock Exchange (Stockholms Fondbörs AB)
Penningmarknadsinformation Pml AB
OM Stockholm AB
IM Marknadsplats AB
Aktietorget I Norden AB

United Kingdom

The following four of the markets comprising the London Stock Exchange Limited:

The Domestic Equity Market
The European Equity Market
The Gilt Edged and Sterling Bond Market
The Alternative Investment Market.

LIFFE Administration and Management
OM London Exchange Limited.
virt-x plc (formerly Tradepoint Financial Networks plc).
Jiway Limited
COREDEAL Limited

List of the regulated markets notified to the Standing Committee of the EFTA States under Article 16 of the Investment Services Directive (93/22/EEC) included in point 30b of Annex IX to the Agreement of the European Economic Area as at April 2001

Iceland

Iceland Stock Exchange (Verdbrefathing Islands)

Liechtenstein

Norway

The Oslo Stock Exchange

Chapter 19

Commodity Futures Trading Commission Part 30 exemption

19.1.1

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This chapter applies to a *firm*:

- (1) whose *permission* includes:
 - (a) the *regulated activities* of *dealing in investments as principal, dealing in investments as agent, arranging (bringing about) deals in investments or managing investments*; and
 - (b) the *specified investments* of *options or futures*;
- (2) which intends to trade on behalf of US customers on non-US futures and options exchanges; and
- (3) which wishes to seek exemption under Part 30 of the General Regulations of the US Commodity Exchange Act.



19.2 Purpose

19.2.1

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Section 30.3 of Part 30 of the General Regulations under the US Commodity Exchange Act ('CFTC Part 30') makes it unlawful for any person to trade on behalf of US customers on non-US futures and options exchanges unless the trade is transacted by or through a US-registered futures commission merchant on a fully disclosed basis. However, these regulations allow the CFTC to grant an exemption from this registration requirement on a jurisdiction by jurisdiction basis. The CFTC operates an exemption system for firms regulated by the FSA.

19.2.2

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The FSA sponsors applications for exemption from *firms* to the CFTC in line with the terms of the agreement between the *United Kingdom* and US regulators. This *guidance* is to help *firms* understand why an application may be required and to explain which *rules* apply as a result of an exemption.



19.3 Exemption under CFTC Part 30

- 19.3.1** **G**_{/1} The *CFTC* can exempt from certain *CFTC* rules and obligations a non-US firm that solicits or accepts orders for non-US futures and option transactions from customers located in the United States. The *CFTC* receives this power from *CFTC* Part 30. The exempted rules and obligations include registration and financial requirements. The firm has to comply with comparable regulatory requirements imposed by its home country regulator instead.
- 19.3.2** **G**_{/1} The scope of the exemption is limited to firms trading in non-US futures and options on behalf of US customers on non-US futures and options exchanges other than a contract market designated as such under section 5 of the US Commodity Exchange Act.
- 19.3.3** **G**_{/1} Registration is not required if a firm is trading for US customers through a futures commission merchant on an omnibus basis. Trading on an omnibus basis means the customers' identities are not revealed to the firm and all orders are given by the US futures commission merchant, so preventing the firm from having any contact with the US customers.



19.4 Applicable rules for firms under CFTC Part 30 exemption

- 19.4.1** G_{/1} A *firm* that has a *Part 30 exemption order* must continue to comply with the applicable requirements and standards under the *regulatory system* including *COB*. However, it becomes subject to a number of additional US rules. The *FSA* is responsible for the supervision of the *firm* and its adherence to the *UK* requirements and standards and additional US requirements.
- 19.4.2** G_{/1} *CFTC* rules generally require US customers to be offered segregation in accordance with the *client money rules*. This is also an *FSA* requirement for a *firm* with a *Part 30 exemption order* (see *COB 9.3.141R* to *COB 9.3.144R*).
- 19.4.3** G_{/1} *Firms* should note that, although supervision rests with the *FSA*, the *CFTC* may be allowed access to relevant documents if it requests, under the terms of the *Part 30 exemption order*.
- 19.4.4** G_{/1} As well as the *FSA*'s requirements on risk warnings, a *firm* obtaining an exemption must meet the following US documentation requirements:
- (1) general risk disclosure for foreign futures and options;
 - (2) options disclosure; and
 - (3) particular additional risk disclosure and explanatory statement to London Metal Exchange customers.

Appendix 1

Prudential categories and sub-categories

1.1 Application

- 1.1.1 **G** This appendix applies to every *firm*.
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1.2 Purpose

- 1.2.1 **G** The purpose of this appendix is to give *guidance* on the prudential categories and sub-categories of *firm* used in the Interim Prudential sourcebooks and the Supervision manual. The prudential categories are defined in the *Glossary*, and some of the sub-categories are defined there and some in the glossaries of the Interim Prudential sourcebooks.
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- 1.2.2 **G** The *FSA* is developing its approach to prudential standards and some provisions in the Supervision manual in a two-stage approach. Initially the *FSA* is including in the *Handbook* interim material as set out in the five Interim Prudential sourcebooks and the Supervision manual, for example *SUP 16* (Reporting requirements). The *FSA* is developing material which will provide an integrated approach to the setting of prudential standards. Each of the Interim Prudential sourcebooks is based on the prudential regime that existed before *commencement*, changed, mainly where the *Act*, and other statutory and international developments, have made a change desirable or essential. The Lloyd's sourcebook shows less continuity with the prudential regime previously applied to the *Society of Lloyd's*, as it introduces requirements similar to those already applied to *insurers*. Most grandfathered *firms* have a prudential category and sub-category equivalent to that which they had before *commencement*.
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- 1.2.3 **G** If there is any doubt about prudential categorisation, a *firm* should seek individual *guidance* from its usual supervisory contact at the *FSA* and an applicant for authorisation should seek *guidance* from the Corporate Authorisation department.
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1.3 Prudential categories and sub-categories

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Table Prudential categories and sub-categories used in the Interim Prudential sourcebooks and the Supervision manual

Prudential categories (Note 1)	Applicable prudential requirements (Note 2)	Prudential sub-categories
<i>Authorised professional firm*</i>	<i>IPRU(INV)</i> 1 and 2	
<i>Bank*</i>	<i>IPRU(BANK)</i>	<i>EEA bank</i> <i>Overseas bank</i> <i>UK bank</i>
<i>Building society*</i>	<i>IPRU(BSOC)</i>	
<i>Friendly society</i>	<i>IPRU(FSOC)</i>	<i>Directive friendly society</i> <i>Incorporated friendly society</i> <i>Non-directive friendly society</i> <i>Registered friendly society</i> <i>Flat rate benefits business friendly society</i>
<i>ICVC*</i>	None, but see <i>CIS</i>	
<i>Incoming EEA firm</i>	None (unless another prudential category applies)	
<i>Incoming Treaty firm</i>	None (unless another prudential category applies)	
<i>Insurer*</i>	<i>IPRU(INS)</i> or <i>IPRU(FSOC)</i>	<i>Long term insurer</i> <i>General insurer</i> <i>Friendly society</i> (see above)
<i>Investment management firm*</i>	<i>IPRU(INV)</i> 1 and 5	<i>OPS firm</i> <i>Non-OPS life office</i> <i>Non-OPS local authority</i> <i>Individuals admitted to authorisation collectively</i> <i>Individual whose sole investment business is giving investment advice to institutional or corporate investors</i> <i>Other</i>
<i>Lead regulated firm</i>	None (unless another prudential category applies)	
<i>Media firm*</i>	None	

Prudential categories (Note 1)	Applicable prudential requirements (Note 2)	Prudential sub-categories
<i>Members' adviser</i>	<i>IPRU(INV)</i> 1 and 4	
<i>Personal investment firm*</i>	<i>IPRU(INV)</i> 1 and 13	Category A firm Category A1 firm Category A2 firm Category A3 firm Category B firm Category B1 firm Category B2 firm Category B3 firm Low resource firm Network Small personal investment firm
<i>Securities and futures firm*</i>	<i>IPRU(INV)</i> 1 and either 3 or 10 There is a special transitional regime for <i>ex-section 43 lead regulated firms</i> – see transitional rules to <i>IPRU(INV)</i> .	<i>IPRU(INV)</i> 3: <i>Adviser</i> <i>Arranger</i> <i>Broad scope firm</i> <i>Corporate finance advisory firm</i> <i>Dematerialised instruction transmitter</i> <i>Derivative fund manager</i> <i>Local</i> <i>Oil market participant</i> <i>Venture capital firm</i> Other <i>IPRU(INV)</i> 10: Category A Category B Category C Category D Category D – corporate finance advisory firm
<i>Service company*</i>	<i>IPRU(INV)</i> 1 and 6	
<i>Society of Lloyd's*</i>	<i>LLD</i>	
<i>UCITS qualifier</i>	None (unless another prudential category applies)	
<i>Underwriting agent</i>	<i>IPRU(INV)</i> 1 and 4	<i>Managing agent</i> <i>Members' agent</i>

Prudential categories (Note 1)	Applicable prudential requirements (Note 2)	Prudential sub-categories
<p>Note 1 = It is possible for a <i>firm</i> to have more than one prudential category. But it cannot have more than one of the prudential categories marked with a '*'. Note 2 = Only the requirements in the Interim Prudential sourcebooks and <i>LLD</i> are listed in the column. Requirements in other parts of the <i>Handbook</i> will also apply.</p>		

1.4 Relevance of prudential categories

1.4.1 G_{/1} Many, but not all, of the categories are used only in the Interim Prudential sourcebooks and the Supervision manual. The prudential category of a *firm* will normally determine:

- (1) which Interim Prudential sourcebook is applicable to the *firm*;
- (2) if the *firm* is subject to the *IPRU(INV)*, which chapter of that sourcebook is applicable to the *firm*;
- (3) whether particular chapters of the Supervision manual are applicable to the *firm*; and
- (4) if the *firm* is subject to *SUP 3* (Auditors), *SUP 16* (Reporting) or *SUP 17* (Transaction reporting), which parts of those chapters apply to the *firm*.

1.4.2 G_{/1} In some cases, a *firm* may also fall within a prudential sub-category. This will determine which provisions within a particular sourcebook or chapter apply to the *firm*.

1.4.3 G_{/1} If a *firm* is part of a *group*, each *authorised* member of the *group* will have its own prudential category. *Firms* should refer to the provisions of the relevant Interim Prudential sourcebooks to determine whether and, if so, how consolidated supervision applies.

1.5 Determining the prudential categories of a firm

1.5.1 G_{/1} This appendix includes flow diagrams (Figures 1 and 2) to assist in determining the prudential category of a *firm*.

- 1.5.2** G_{/1} For a *firm* which became an *authorised person* after *commencement*, the *FSA* will have confirmed the applicable prudential category of the *firm* as part of the *authorisation* process.
- 1.5.3** G_{/1} For a *firm* with automatic *authorisation* by passporting under the *Single Market Directives*, exercising rights under the *Treaty* or as a *UCITS qualifier*, the *FSA* will have notified the firm of its prudential category at the same time as the *FSA* notified it of the *applicable provisions* to which it is subject (see *AUTH 5* for further details on inward passporting). If it has a *top-up permission*, then *SUP App 1 1.5.2G* may also apply.

1.6 Changing prudential category after authorisation

- 1.6.1** G_{/1} A *firm's* prudential category may change in the following circumstances:
- (1) A variation in the *firm's permission* may, in some cases, lead to an automatic change in the *firm's* prudential category or sub-category because of the way those categories are defined. For example, if an *investment management firm* is granted *permission to accept deposits*, it may become a *bank* and cease to be an *investment management firm*. Figures 1 and 2 may be used, even if a *firm's permission* is varied after *commencement*. They should enable a *firm* to determine whether any variation in its *permission* will lead to a change in prudential category.
 - (2) The *FSA* may vary the *firm's permission* and thereby require a *firm* to comply with the *rules* applicable to a different prudential category, either through using its *own-initiative power* or on the application of the *firm*.
- 1.6.2** G_{/1} A *firm* should notify the *FSA* immediately if it believes that its prudential category or sub-category has changed (see *SUP 15.3.8G(1)(g)*), or if there has been an expansion or reduction in its business that could be relevant to its prudential categorisation or sub-categorisation (see *SUP 15.3.8G*).

1.7 Prudential categories and sub-categories

Figure 1: Determination of a firm's prudential category - general

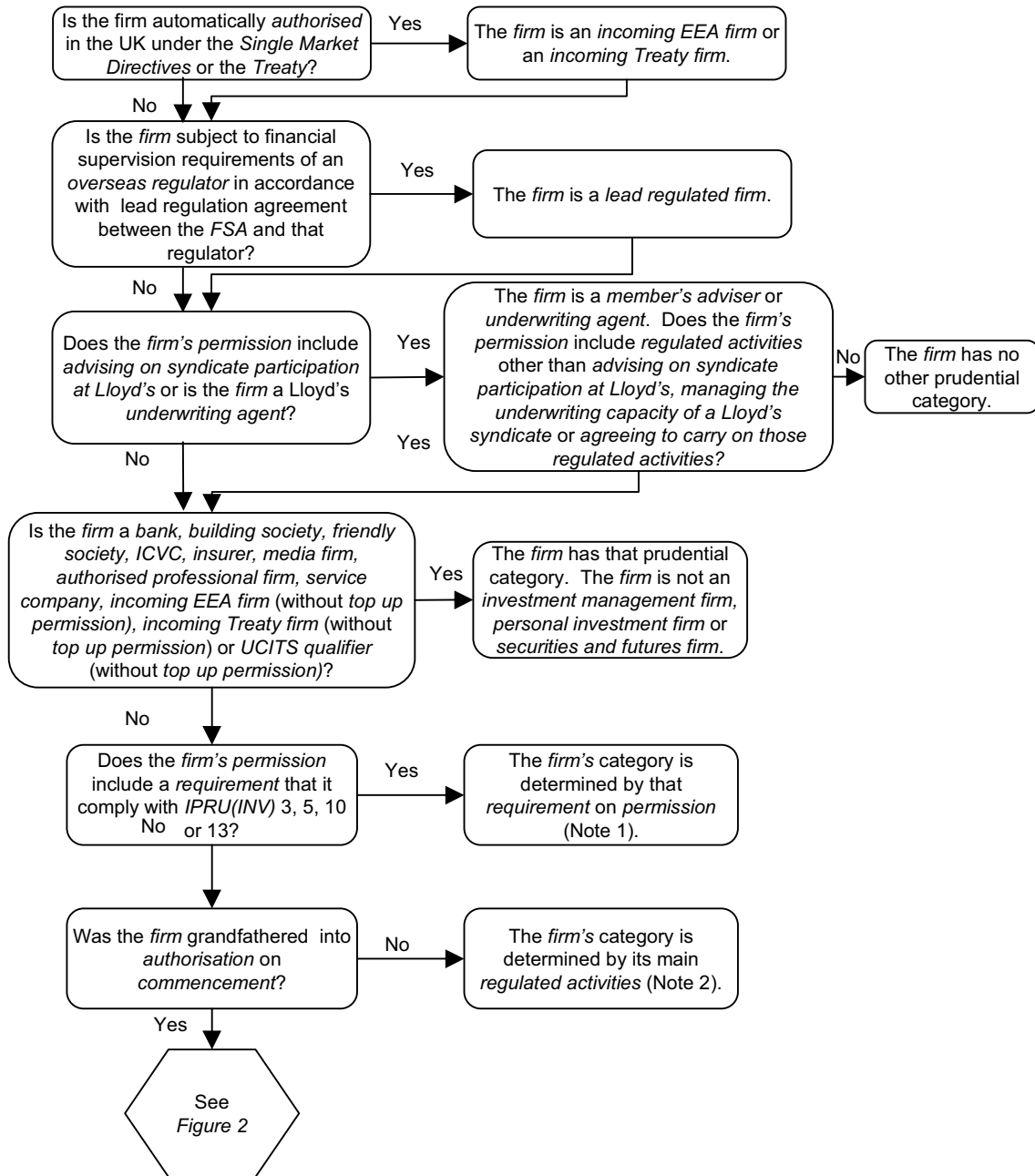
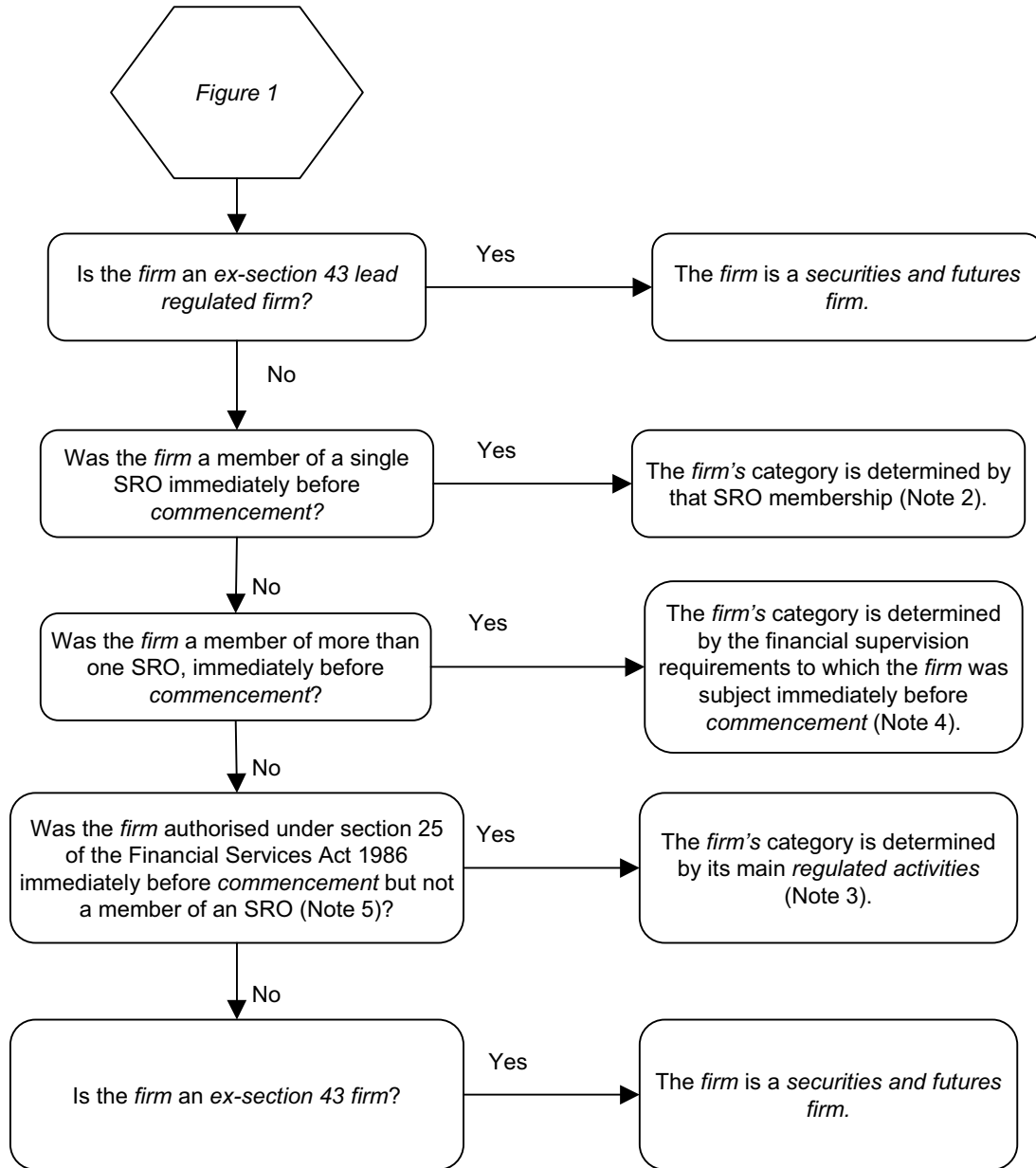


Figure 2: Determination of a firm's prudential category (cont'd)



1.8

Notes to Figures 1 and 2

1.8.1

G Table Note 1
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Chapter of IPRU(INV) that requirement on permission requires the firm to comply with	Firm's prudential category
Chapter 3	<i>Securities and futures firm</i>
Chapter 5	<i>Investment management firm</i>
Chapter 10	<i>Securities and futures firm</i>
Chapter 13	<i>Personal investment firm</i>

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Table Note 2

The table below shows how a *firm's* main *regulated activities* determine its prudential category. A *firm's* 'main *regulated activities*' in this context are the *regulated activities* included in the *firm's* *Part IV permission* from which the *firm* derives or is expected to derive the most substantial part of its gross income, including *commissions*. The aggregate gross income from all of the activities listed against each prudential category should be considered to determine which source is the most substantial.

The gross income is based on the business plan submitted as part of the *firm's* application for a *Part IV permission* (for a *firm* given a *Part IV permission* after *commencement*) or on the *firm's* financial year preceding its *authorisation* under the *Act* (for a *firm* *authorised* under section 25 of the Financial Services Act 1986 prior to *commencement*).

If the *firm's* prudential categorisation is not clear, please consult the *FSA* for *guidance*.

Activities from which the most substantial part of the firm's gross income, including commissions, from regulated activities is derived

- (i) *Managing investments* other than for *private customers* or if the assets managed are primarily *derivatives*;
- (ii) *OPS activity*;
- (iii) acting as the *manager* or *trustee* of an *AUT*;
- (iv) acting as the *ACD* or *depository* of an *ICVC*;
- (v) *establishing, operating or winding-up* a *collective investment scheme* other than an *AUT* or *ICVC*; and
- (vi) *safeguarding and administering investments*.

Firm's prudential category

Investment management firm

(i) <i>Advising on investments, or arranging (bringing about) deals in investments, in relation to packaged products; and</i>	<i>Personal investment firm</i>
(ii) <i>managing investments for private customers.</i>	
(i) <i>An activity carried on as a member of an exchange;</i>	<i>Securities and futures firm</i>
(ii) <i>making a market in securities or derivatives;</i>	
(iii) <i>corporate finance business;</i>	
(iv) <i>dealing, or arranging (bringing about) deals in investments, in securities or derivatives;</i>	
(v) <i>the provision of clearing services as a clearing firm;</i>	
(vi) <i>managing investments where the assets managed are primarily derivatives; and</i>	
(vi) <i>activities relating to spread bets;</i>	

1.8.3

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Table Note 3

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Single SRO membership	Firm's prudential category
<i>IMRO</i>	<i>Investment management firm</i>
<i>PIA</i>	<i>Personal investment firm</i>
<i>SFA</i>	<i>Securities and futures firm</i>

1.8.4

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Table Note 4

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SRO to whose Financial Supervision requirements the firm was subject	Firm's prudential category
<i>IMRO</i>	<i>Investment management firm</i>
<i>PIA</i>	<i>Personal investment firm</i>
<i>SFA</i>	<i>Securities and futures firm</i>

1.8.5

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Table Note 5

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Only a small number of *firms* are expected to be authorised under section 25 of the Financial Services Act 1986 immediately prior to *commencement* and not be a member of one of the SROs. These *firms* are directly regulated by the *FSA* under the Financial Services Act 1986.

Appendix 2

Insurers: Scheme of operations

2.1 Application

2.1.1 **R** This appendix applies to every *insurer* which is not:

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an *incoming EEA firm*; or

an *incoming Treaty firm*.

2.1.2 **G** This appendix applies to every *friendly society* as a friendly society is an *insurer*.

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2.2 Purpose

2.2.1 **G** To fulfil its obligations under the *Insurance Directives*, and as part of the FSA's risk-based approach to supervision, there are certain times when the FSA needs to monitor an *insurer* more closely than it normally would. This is so the FSA can fulfil its function of supervising *insurers* properly and meet the *regulatory objective* of securing an appropriate degree of protection for *consumers*.

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2.2.2 **G** The *rules* in this appendix require an *insurer* to submit reports and information to the FSA when:

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- (1) an *insurer* is failing to satisfy *threshold condition 4* (Adequate resources) (see COND 2.4), and its *margin of solvency* has fallen below its *required minimum margin*, or its *guarantee fund*;
- (2) an *insurer* has decided to cease to *effect new contracts of insurance*;
- (3) an *insurer* is going through periods of potential uncertainty, for example when it has come under the *control of a new parent undertaking*, or following the grant or variation of *permission*.

2.2.3 **G** In accordance with the *Insurance Directives*, an *insurer* whose *margin of solvency* has fallen below its *required minimum margin*, or its *guarantee fund*, is required, by the *rules* set out in this appendix, to submit a *scheme of operations*, together with an explanation of how the *margin of solvency* will be adequately restored. Similarly, an *insurer* which is entering into run-off is required to submit a *scheme of operations*, including also an explanation of how its *liabilities to policyholders*

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will be met in full. In other cases, such as following a change in *control*, or the grant or variation of *permission*, the reports help the *FSA* to identify when an *insurer* departs from the *scheme of operations* submitted as part of the notification of a change in *control*, or an application for the grant or variation of *permission*, and on which basis such notification or application was approved.

- 2.2.4** **G**_{/1} These *rules* are in addition to the other *rules* and *guidance* in *SUP*, in particular *SUP* 2 (Information gathering by the *FSA* on its own initiative), *SUP* 15 (Notifications to the *FSA*), *SUP* 16 (Reporting requirements) and the Principles (*PRIN*).

2.3 Margin of solvency below required margin of solvency

- 2.3.1** **R**_{/1} If an *insurer's margin of solvency* falls below its *required margin of solvency*, it must, within 28 days of the firm becoming aware of this event, submit to the *FSA* a plan for the restoration of a sound financial position including:
- (1) a *scheme of operations* (see *SUP* App 2.9); and
 - (2) an explanation of how, if at all, and by when it expects its *margin of solvency* to be adequately restored to the *required margin of solvency*.

- 2.3.2** **G**_{/1} See *SUP* App 2.8.2G for *guidance* on the period that the *scheme of operations* should cover.

2.4 Margin of solvency below guarantee fund

- 2.4.1** **R**_{/1} If an *insurer's margin of solvency* falls below its *guarantee fund*, it must, within 14 days of the firm becoming aware of this event, submit a short-term financial plan to the *FSA* including:
- (1) a *scheme of operations* (see *SUP* App 2.9); and
 - (2) an explanation of how, if at all, and by when it expects its *margin of solvency* to be adequately restored to the *guarantee fund*.

- 2.4.2** **G**_{/1} See *SUP* App 2.8.2G for *guidance* on the period that the *scheme of operations* should cover.

2.5 Ceasing to effect contracts of insurance

2.5.1 **R** /1 If an *insurer* decides to cease to *effect* new *contracts of insurance*, it must, within 28 days of that decision, submit a run-off plan to the FSA including:

- (1) a *scheme of operations*; and
- (2) an explanation of how, or to what extent, all *liabilities to policyholders* (including, where relevant, reasonable bonus expectations) will be met in full as they fall due.

2.5.2 **G** /1 *SUP* App 2.5.1R only applies if a *firm* ceases to *effect* new *contracts of insurance* in respect of the whole of its *insurance business*.

2.5.3 **G** /1 For the purposes of *SUP* App 2.5.1R a new *contract of insurance* excludes contracts effected under a term in a subsisting *contract of insurance*.

2.5.4 **G** /1 Under *Principle 11*, the FSA normally expects to be notified by an *insurer* when it decides to cease *effecting* new *contracts of insurance* in respect of one or more *classes of contract of insurance* (see *SUP* 15.3.8G). At the same time, the FSA would normally expect the *firm* to discuss with it the need for the *firm* to apply to vary its *permission* (see *SUP* 6.2.6G and *SUP* 6.2.7G) and, if appropriate, to submit a *scheme of operations* in accordance with *SUP* App 2.5.1R.

2.5.5 **G** /1 See *SUP* App 2.8.2G for *guidance* on the period that the *scheme of operations* should cover.

2.6 Under control of a new parent undertaking

2.6.1 **G** /1 An *insurer* that has notified the FSA of a new *parent undertaking* may be requested to submit a *scheme of operations* (see *SUP* 11.5.5G). A *scheme of operations* would be requested if the significance and circumstances of the change were considered to be sufficient to merit that level of scrutiny. This is normally only likely to be necessary when there has been an ultimate change in *control*, or when, as a result of the change in *control*, significant changes are proposed to the *firm's regulated activities*, business plan or strategy. An *insurer* which has submitted a *scheme of operations* under *SUP* 11.5.5G, is not required to submit a further *scheme of operations* under this Appendix unless *SUP* App 2.3 to *SUP* App 2.6 applies. *SUP* App 2.10 does, however, apply to such an *insurer*.

2.7 Grant or variation of permission

- 2.7.1** G_{/1} The *FSA* may ask an *insurer* seeking a grant or variation of permission to provide a *scheme of operations* as part of the application process (see AUTH 3.9.9G(1) and SUP 6.3.25G). Such an *insurer* is not required to submit a further *scheme of operations* under this appendix unless SUP App 2.3 to SUP App 2.6 applies. SUP App 2.10 and SUP 6 Ann 4G do, however, apply to such an *insurer*.

2.8 Submission of a scheme of operations

- 2.8.1** G_{/1} A *firm* should discuss its plan in draft with the *FSA* before submitting it. If a plan is submitted which does not satisfy the *FSA* that the *firm* can restore its *margin of solvency* (as appropriate), or meet its liabilities as they fall due, the *FSA* may use its *own-initiative power* to vary or cancel the *firm's permission*.

- 2.8.2** G_{/1} The *schemes of operations* required when an *insurer's margin of solvency* has fallen below its *required margin of solvency* or its *guarantee fund* (see SUP App 2.3.1R and SUP App 2.4.1R, respectively) should cover a period which is sufficient to demonstrate that the *insurer's margin of solvency* will be adequately restored. Typically this would be a period of at least three years. However, if a *scheme of operations* has expired, but SUP App 2.3.1R or SUP App 2.4.1R continue to apply, the *insurer* should submit a new *scheme of operations*. The *scheme of operations* required by SUP App 2.5.1R, when an *insurer* ceases to *effect new contracts of insurance*, should cover the run-off period until all *liabilities to policyholders* are met.

2.9 Content of a scheme of operations

- 2.9.1** R_{/1} A *scheme of operations* must:
- (1) describe the *firm's* business strategy;
 - (2) include financial projections (for appropriate scenarios and stress-tests) as follows:
 - (a) a forecast summary profit and loss account in accordance with SUP App 2.9.7R;
 - (b) a forecast summary balance sheet in accordance with SUP App 2.9.8R; and

- (c) a forecast statement of solvency in accordance with SUP App 2.9.9R; and
- (3) as at the end of each *financial year* which falls (in whole or part) within the period to which the *scheme of operations* relates:
- (a) describe the assumptions which underlie those forecasts and the reasons for adopting those assumptions; and
- (b) identify any material transactions (see SUP App 2.11.1R) proposed to be effected or carried out with, or in respect of, any *associate*.

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The business strategy referred to at SUP App 2.9.1R(1) should include a description of the nature of the risks which the *insurer* is underwriting, or intends to underwrite. It should also give an explanation of the *firm's* strategy for managing the risks associated with carrying on *insurance business* (including, in particular, reinsurance).

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The amount of detail to be given on the *firm's* business strategy required by SUP App 2.9.1R(1) should be appropriate to the scale and complexity of the *insurer's* operations and the degree of risk involved.

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The information required by SUP App 2.9.1R must cover the same aspects of the *firm's* business as are covered under IPRU(INS) 2.1 or IPRU(FSOC) [number to be added later] (as applicable).

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IPRU(INS) 2.1 and IPRU(FSOC) [number to be added later] set out the *margin of solvency* requirements for *insurers* (other than *friendly societies*) and *friendly societies*, respectively. The *margin of solvency* an *insurer* is required to maintain varies according to whether the *insurer* has its head office in the *United Kingdom* or overseas, and depending on the nature of the *insurance business* it carries on. A *firm* submitting a *scheme of operations* should provide the information required by SUP App 2.9.1R according to the requirements for the *margin of solvency* as set out in IPRU(INS) 2.1 and IPRU(FSOC) [number to be added later] (as applicable). For example, in order to satisfy SUP App 2.9.1R, an *insurer* with its head office outside the *United Kingdom* which is carrying on direct *insurance business* in the *United Kingdom* is required to submit separate information concerning its world-wide activities and its *UK* activities.

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In accordance with IPRU(INS) 2.1(4) and IPRU(FSOC)[number to be added later], to comply with SUP App 2.9.1R, an *insurer* which carries on both *long-term insurance business* and *general insurance business* should submit separate information for each type of *insurance business*.

2.9.7

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Table Summary profit and loss account (see SUP app 2.9.1R (2)(a))

(1)	Premiums and claims (gross and net of reinsurance) analysed by accounting class of insurance business
(2)	Investment return
(3)	Expenses

(4)	Other charges and income
(5)	Taxation
(6)	Dividends paid and accrued

2.9.8 **R** Table Summary balance sheet (see SUP App 2.9.1 R (2)(b))

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(1)	Investments analysed by type
(2)	Assets held to cover linked liabilities
(3)	Other assets and liabilities separately identifying cash at bank and in hand
(4)	Capital and reserves analysed into called up <i>share</i> capital or equivalent funds, <i>share</i> premium account, revaluation reserve, other reserves and profit and loss account
(5)	Subordinated liabilities
(6)	The fund for future appropriations
(7)	Technical provisions gross and net of reinsurance analysed by <i>class of insurance business</i> and separately identifying the provision for linked liabilities, unearned <i>premiums</i> , unexpired risks and equalisation
(8)	Other liabilities and credits

2.9.9 **R** A forecast statement of solvency (under SUP App 2.9.1R (2)(c)) must include the forecast *margin of solvency* and the forecast *required margin of solvency* at the end of each *financial year* or part *financial year*.

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2.10 Obligations on insurers which have previously submitted a scheme of operations

2.10.1 **R** An *insurer* which has submitted a *scheme of operations* to the FSA, whether required by SUP App 2.3 to SUP App 2.6, or as part of an application under SUP 6.3 (see SUP 6.3.25G), SUP 6.5 (see SUP 6

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Ann 4G), *AUTH* 3.9 (see *AUTH* 3.9.9G(1)), or *SUP* 11.5 (see *SUP* 11.5.5G), or an amended *scheme of operations*, must during the period covered by that *scheme of operations*:

- (1) notify the *FSA* at least 28 days before entering into or carrying out any material transaction (see *SUP* APP 2.11.1R) with, or in respect of an *associate*, unless that transaction is in accordance with a *scheme of operations* which has been submitted to the *FSA*;
- (2) submit a quarterly financial return to the *FSA* which must include for, or as at the end of, each quarter:
 - (a) a summary profit and loss account prepared in accordance with *SUP* App 2.9.7R;
 - (b) a summary balance sheet prepared in accordance with *SUP* App 2.9.8R; and
 - (c) a statement of solvency prepared in accordance with *SUP* App 2.9.9R;

and which must identify and explain differences between the actual results and the forecasts submitted in the *scheme of operations*; and
- (3) notify the *FSA* promptly of any matter which has either happened or is likely to happen and which represents a significant departure from the *scheme of operations*; the *insurer* must either:
 - (a) explain the nature of the departure and the reasons for it and provide revised forecast financial information in the *scheme of operations* for its remaining term; or
 - (b) include an amended *scheme of operations* and explain the amendments and the reasons for them.

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A report under *SUP* App 2.10.1R(2) must be submitted in accordance with the rules in *SUP* 16.3.6R to *SUP* 16.3.13R.

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For the purpose of *SUP* App 2.10.1R(1), the *FSA* considers that transactions with, or in respect of, *associates* include:

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- (1) contracting (as either party), advancing, repaying, writing off or agreeing to change the terms of any loan;
- (2) entering into (in any capacity), releasing, calling upon or agreeing to change the terms of any guarantee, pledge, security, charge or any off-balance-sheet transaction;
- (3) entering into agreements to acquire or dispose of *property* or which otherwise affect the nature or value of the *insurer's* assets
- (4) making an investment (directly or indirectly) in an *associate*;

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- (5) entering into (as either party), commuting or agreeing to change the terms of, any contract of reinsurance; and
- (6) entering into, or changing the terms of, any agreement to give or provide services or to share costs.

The FSA considers that a significant departure referred to in SUP App 2.10.1R(3) includes:

- (1) entry or withdrawal from a line of *insurance business*;
- (2) significant revision of the firm's strategy for managing risks, in particular the basis upon which risks are reinsured;
- (3) forecast *premiums* being exceeded, by more than 10%, for a single *financial year* (or part year if the period covered by the *scheme of operations* is or includes part of a *financial year*);
- (4) *claims* experience being significantly worse than forecast for a single *financial year* (or part year if the period covered by the *scheme of operations* is or includes part of a *financial year*);
- (5) the actual *margin of solvency* being significantly worse than forecast;
- (6) paid or proposed dividends being greater than those forecast; and
- (7) any other transaction or circumstance which is likely to have a material effect upon available assets (as defined in IPRU(INS)[number to be inserted later]).

2.11

Meaning of "material transaction"

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In this appendix, a transaction is a "material transaction" if (when aggregated with any similar transactions):

- (1) the price actually paid or received for the transfer of assets or liabilities or the performance of services; or
- (2) the price which would have been paid or received had that transaction been negotiated at arm's length between unconnected parties

exceeds:

- (3) in the case of an *insurer* which carries on either *general insurance business* or *long-term insurance business*, but not both, 5% of the general insurance business amount (as defined in IPRU(INS) 11.1), or the long-term business amount (as defined in IPRU(INS) 11.1), as applicable; or

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- (4) in the case of an *insurer* that carries on both types of business either:
- (a) 5% of the long-term insurance business amount (as defined) in *IPRU(INS) 11.1* where the transaction is in connection with the *insurer's* long-term business; or
 - (b) In other cases, 5% of the general insurance business amount (as defined in *IPRU(INS) 11.1*).

Handbook Modules

Schedule4 Powers exercised

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- 1 The following powers and related provisions in the Act have been exercised by the FSA to make the rules in SUP:
 - (1) Section 59 (Approval for particular arrangements)
 - (2) Section 138 (General rule-making power)
 - (3) Section 145 (Financial promotion rules)
 - (4) Section 146 (Money laundering rules)
 - (5) Section 149 (Evidential provisions)
 - (6) Section 156 (General supplementary powers)
 - (7) Section 340 (Appointment)
- 2 The following power in the Act has been exercised by the FSA to give the guidance in SUP:
 - (1) Section 157(1) (Guidance)
- 3 The following powers and related provisions in or under the Act have been exercised by the FSA in SUP to direct or require:
 - (1) Section 51 (Applications under this Part)
 - (2) Section 60 (Applications for approval)
 - (3) Section 148(3) (Modification or waiver of rules)
 - (4) Section 182 (Notification)
 - (5) Section 250(4) and (5) (Modification or waiver of rules)
 - (6) Section 318 (Exercise of powers through Council)
 - (7) Regulation 7(3) and (4) of the OEIC Regulations (Modification of waiver of rules)

ENFORCEMENT MANUAL INSTRUMENT 2001

- A. The Financial Services Authority makes the guidance and issues the statements of policy in the Annex to this instrument (“ENF”) in the exercise of the powers listed in Schedule 4 to ENF.
- B. This instrument shall come into force as follows:
- (1) ENF 2 (Information gathering and investigation powers) and ENF 3 (Variation of Part IV permission and withdrawal of authorisation): on the first day on which section 45 (Variation etc on the Authority's own initiative) of the Financial Services and Markets Act 2000 (the "Act") comes into force for any purpose;
 - (2) ENF 4 (Intervention against incoming firms): on the first day on which section 194 of the Act (General grounds on which power of intervention is exercisable) comes into force for any purpose;
 - (3) ENF 5 (Cancellation of Part IV permission on the FSA's own initiative and withdrawal of authorisation): on the first day on which section 45 of the Act (Variation etc on the Authority's own initiative) comes into force for any purpose;
 - (4) other parts of ENF: at the beginning of the day on which section 19 of the Act (The general prohibition) comes into force;
 - (5) paragraphs A to D on this page: immediately.
- C. This instrument may be cited as the Enforcement Manual Instrument 2001.
- D. The Annex to this instrument (including its Schedules) may be cited as the Enforcement manual (or ENF).

By order of the Board
21 June 2001

ANNEX



Enforcement



Contents

Transitional provisions

Text of ENF:

- 1 Introduction to the Enforcement manual
- 2 Information gathering and investigation powers
- 3 Variation of Part IV permission on the FSA's own initiative
- 4 Intervention against incoming firms
- 5 Cancellation of Part IV permission on the FSA's own initiative
- 6 Injunctions
- 7 Withdrawal of approval
- 8 Prohibition of individuals
- 9 Restitution and redress
- 10 Insolvency proceedings and orders against debt avoidance
- 11 Discipline: The FSA's general approach
- 12 Discipline: Public censures and public statements
- 13 Discipline: Financial penalties
- 14 Sanctions for market abuse
- 15 Prosecution of criminal offences
- 16 Collective investment schemes
- 17 Disqualification of auditors and actuaries
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Schedule 1: Record keeping requirements

Schedule 2: Notification requirements

Schedule 3: Fees and other required payments

Schedule 4: Powers exercised

Schedule 5: Rights of action for damages

Schedule 6: Rules that can be waived

Derivations

Destinations

Handbook Modules

Transitional provisions

1 G Table

There are no transitional provisions in *ENF*. *GEN* contains some technical provisions that apply throughout the *Handbook* and which are designed to ensure a smooth transition at *commencement*.

Chapter 1.

Introduction to the Enforcement manual



1.1 Application

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The Enforcement manual contains *guidance* for *firms*, *approved persons*, and other *persons*, whether or not they are regulated by the *FSA*, on the use of the *FSA*'s enforcement powers, as set out in *ENF 1 Ann 1G*.

1.2 Purpose

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The FSA's effective and proportionate use of its enforcement powers to enforce the requirements of the *Act*, the *rules*, the *Statements of Principle* and other relevant legislation (for example, the Criminal Justice Act 1993, and the *Money Laundering Regulations* 1993) play an important role in the pursuit of its *regulatory objectives*. For example:

- (1) in relation to the market confidence objective, the FSA's powers to bring criminal prosecutions for *insider dealing* and *misleading statements and practices offences*, and to impose financial penalties for *market abuse*, help to maintain confidence in the *financial system*;
- (2) in relation to the public awareness objective, the imposition of disciplinary measures such as public censures and public statements of misconduct show that regulatory standards are being upheld;
- (3) in relation to the protection of *consumers* objective, the imposition of disciplinary measures helps to deter future contraventions, ensure high standards of regulatory conduct and protect *consumers*; in addition, the FSA's powers to vary *permission* on its own initiative may be used to require a *firm* to take urgent remedial action to protect the interests of *consumers*; and
- (4) in relation to the reduction of *financial crime* objective, the FSA's use of its criminal prosecution powers under the *Act* helps to reduce *financial crime*; for example the prosecution of *insider dealing* and breaches of prescribed regulations relating to *money laundering* act as a deterrent.

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Schedule 1 to the *Act* (The Financial Services Authority) states that the FSA must 'maintain arrangements for enforcing the provisions of, or made under, this *Act*' (see paragraph 6(3) of Schedule 1). The Enforcement manual describes the FSA's policies and procedures for the exercise of the enforcement powers given to it by the *Act*, as set out in ENF 1 Ann 1G. It does not include the statement of procedures required by section 395 of the *Act* (The FSA's procedures) relating to the issue of *supervisory notices*, *warning notices* and *decision notices*, which is in the Decision making manual (*DEC*). The Enforcement manual does not (except where expressly stated) include material on the powers relating to the UKLA, which is in the *listing rules* and related *guidance*.

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In some cases, the *Act* expressly requires the FSA to prepare and publish statements of policy and procedures on the exercise of its enforcement powers. The Enforcement manual therefore contains statements of policy and procedures on the following matters:

- (1) sections 69 and 210 of the *Act* require the FSA to publish statements of policy on the imposition of financial penalties on *firms* and *approved persons* (see ENF 13);

- (2) section 124 of the *Act* requires the *FSA* to publish a statement of its policy on the imposition of financial penalties for *market abuse* (see *ENF* 14); and
- (3) section 169 of the *Act* (Investigations etc. in support of overseas regulator) requires the *FSA* to publish a statement of its policy on the conduct of certain interviews in response to requests from *overseas regulators* (see *ENF* 2).

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In addition, the Enforcement manual contains *guidance* in accordance with section 157(1) of the *Act* (Guidance) on the *FSA*'s use of its enforcement powers in other areas. These include the *FSA*'s power to vary *Part IV permissions* on its own initiative (see *ENF* 3), to apply to court for *injunctions* (see *ENF* 6), to obtain restitution (see *ENF* 9), and to prosecute for certain criminal offences (see *ENF* 15).

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For ease of reference, *ENF* 1 Ann 1G contains a table of the main enforcement powers showing where they are considered in the manual.

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The Authorisation manual (*AUTH*), the Supervision manual (*SUP*), the Enforcement manual (*ENF*), and the Decision making manual (*DEC*) form the regulatory processes part of the *Handbook*:

- (1) *AUTH* sets out the relationships between the *FSA* and applicants for *Part IV permission* and *persons* wishing to exercise *EEA rights*, *Treaty rights* or *UCITS Directive* rights;
- (2) *SUP* sets out the relationship between the *FSA* and *authorised persons* (referred to in the *Handbook* as *firms*); as a general rule, material that is of continuing relevance after *authorisation* is in *SUP*;
- (3) *ENF* describes the *FSA*'s enforcement powers under the *Act* and sets out its policies for using those powers; and
- (4) *DEC* is principally concerned with, and sets out, the *FSA*'s decision making procedures for decisions that involve the issue of statutory notices.



1.3 The FSA’s approach to enforcement

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There are a number of principles underlying the *FSA’s* approach to the exercise of its enforcement powers:

- (1) The effectiveness of the regulatory regime depends to a significant extent on the maintenance of an open and cooperative relationship between the *FSA* and those whom it regulates.
- (2) The *FSA* will seek to exercise its enforcement powers in a manner that is transparent, proportionate and consistent with its publicly stated policies.
- (3) The *FSA* will seek to ensure fair treatment when exercising its enforcement powers. For example, the *FSA’s* decision making process for regulatory enforcement cases generally gives an opportunity for both written and oral representations to be made, and also provides a facility for mediation (where settlement discussions break down) in certain disciplinary cases (see *DEC* App 1).

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The *FSA* has a range of enforcement powers and, in any particular enforcement situation, the *FSA* may need to consider which power to use and whether to use one or more powers. So in any particular case, it may often be necessary to refer to a number of chapters of the Enforcement manual. For example, in *market abuse* cases, it may be necessary to refer to *ENF* 2 (Information gathering and investigation powers), *ENF* 6 (Injunctions), *ENF* 9 (Restitution), *ENF* 14 (Sanctions for market abuse) and *ENF* 15 (Prosecution of criminal offences), as well as the *Code of Market Conduct* (see *MAR* 1). Appropriate cross-references have been included in each chapter to help the reader use this manual.

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The *FSA* has a range of regulatory tools to help it meet its *regulatory objectives*. The powers to conduct investigations which may lead to formal disciplinary action, together with powers to take intervention action and obtain restitution, are an important part of the *FSA’s* toolkit, but there are many other regulatory tools that the *FSA* can use. The requirement for *authorisation of firms* and approval of *persons* in *controlled functions* aims to allow only those who satisfy the necessary criteria (including honesty, competence and financial soundness) to engage in *regulated activity*. Supervision enables the *FSA* to monitor and influence the behaviour of *firms* and *approved persons*.

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Where a *firm* or other *person* has failed to comply with the requirements of the *Act*, the *rules*, or other relevant legislation (such as the Criminal Justice Act 1993, and the *Money Laundering Regulations* 1993), it may be appropriate to deal with this without the need for formal disciplinary or other enforcement action. The proactive supervision and monitoring of *firms*, and an open and cooperative relationship between *firms* and their supervisors, will, in some cases where a contravention has taken place, lead the *FSA* to decide against taking formal disciplinary action. However, in those cases, the *FSA* will expect the *firm* to act promptly to take the necessary remedial action agreed with its supervisors to deal

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with the *FSA's* concerns. If the *firm* does not do this, the *FSA* may take disciplinary or other enforcement action in respect of the original contravention.

The *FSA's* enforcement powers are exercised in, and reviewed by, the criminal courts, the civil courts and the *Tribunal*. For example, the *FSA* has power to prosecute particular offences in the criminal courts, it may seek to obtain *injunctions* in the civil courts, and its powers to impose disciplinary sanctions are subject to referral to the *Tribunal*.



1.4 The structure of the Enforcement manual

The Enforcement manual

- 1.4.1** G_{/1} *ENF 2* (Information gathering and investigation powers) outlines the *FSA's* information gathering and investigation powers under the *Act* (including its power to conduct investigations to assist overseas authorities), and its approach to the use of those powers.
- 1.4.2** G_{/1} *ENF 3* (Variation of Part IV permission on the *FSA's* own initiative) outlines the *FSA's* powers, policies and procedures for exercising its *own-initiative powers* to impose *limitations* or *requirements* on a *firm's* permitted business.
- 1.4.3** G_{/1} *ENF 4* (Intervention against incoming firms) is concerned with the *FSA's* power to intervene against *incoming EEA firms* and *incoming Treaty firms* and the *FSA's* policy for exercising that power.
- 1.4.4** G_{/1} *ENF 5* (Cancellation of permission) outlines the *FSA's* powers to cancel a *firm's permission*, the procedures for exercising those powers and the *FSA's* approach to their exercise.
- 1.4.5** G_{/1} *ENF 6* (Injunctions) describes the *FSA's* powers to apply to court for *injunctions*, and the *FSA's* approach to using those powers.
- 1.4.6** G_{/1} *ENF 7* (Withdrawal of approval) describes the *FSA's* power to withdraw approval from *approved persons*, the *FSA's* procedure and approach in relation to the exercise of this power, other powers that may be relevant when the *FSA* considers the exercise of the withdrawal power, and the effect of the *FSA's* decision to withdraw approval.
- 1.4.7** G_{/1} *ENF 8* (Prohibition of individuals) outlines the *FSA's* power to make a *prohibition order*, the policy and procedure for exercising that power, the effect of the decision to make a *prohibition order*, and the *FSA's* policy in relation to applications by individuals to have a *prohibition order* varied or revoked.
- 1.4.8** G_{/1} *ENF 9* (Restitution and redress) outlines the *FSA's* power to apply to the court for an order for restitution, the *FSA's* administrative power to require restitution, the *FSA's* policy concerning the use of its powers to obtain restitution, and the way in which the court or the *FSA* will determine the amount of restitution.
- 1.4.9** G_{/1} *ENF 10* (Insolvency proceedings and orders against debt avoidance) outlines the *FSA's* powers to seek *insolvency orders* from the court, the exercise of the *FSA's* rights to be involved in insolvency regimes concerning *firms* and *unauthorised persons*, and the policies in those areas.

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- 1.4.10 **G**_{/1} ENF 11 (Discipline of firms and approved persons: the FSA's general approach) explains the FSA's policy on private warnings, the criteria which the FSA will use when it decides whether to take disciplinary action against *firms* and *approved persons*; its enforcement policy relating to *approved persons*; the enforcement of the *Principles*; *guidance* on the standard of reasonable care required by some *rules*; and the FSA's approach where disciplinary action may also be taken by other UK or overseas authorities.
- 1.4.11 **G**_{/1} ENF 12 (Discipline of firms and approved persons: public censures and public statements) describes the FSA's powers to impose public censures and public statements and its approach to the exercise of those powers.
- 1.4.12 **G**_{/1} ENF 13 (Discipline of firms and approved persons: financial penalties) describes the FSA's powers to impose financial penalties (except those relating to *market abuse*), and the FSA's policy on the exercise of those powers. In particular, it contains a list of some of the factors which the FSA may take into account when it decides the level of a financial penalty.
- 1.4.13 **G**_{/1} ENF 14 (Sanctions for market abuse) describes the FSA's powers to impose financial penalties for *market abuse*, and contains a statement of policy with a non-exhaustive list of some of the factors which the FSA may take into account when it decides the level of a financial penalty. The chapter also refers to the FSA's power to publish a statement that a *person* has engaged in *market abuse*. It also considers the FSA's approach to *market abuse* cases where there may have been a breach of the *Principles*, and the FSA's approach to *market abuse* cases where other regulatory authorities may also be involved.
- 1.4.14 **G**_{/1} ENF 15 (Prosecution of criminal offences) sets out the FSA's policy on the use of its prosecution powers under sections 401 (Proceedings for offences) and 402 (Power of the FSA to institute proceedings for certain other offences) of the *Act*.
- 1.4.15 **G**_{/1} ENF 16 (Collective investment schemes) sets out the FSA's policies and procedures on the use of its enforcement powers in relation to *AUTs*, *ICVCs*, and *recognised schemes*.
- 1.4.16 **G**_{/1} ENF 17 (Disqualification of auditors and actuaries) describes the FSA's policy on its power to disqualify an auditor or *actuary* from acting as an auditor or *actuary* of a *firm*, where he has failed to comply with a duty imposed on him under the *Act*.
- 1.4.17 **G**_{/1} ENF 18 (Disapplication orders against members of the professions) describes the FSA's policy on its power to make an order disapplying *members* of the professions' exemption from the *general prohibition* on conducting *regulated activities* without *authorisation*.



1.5 Using the Enforcement manual

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- (1) Since the *FSA's* enforcement powers are derived from the *Act*, the manual contains a large number of references to the *Act*. In some instances, the manual quotes the *Act* directly (this is shown in the text by quotation marks) although, where possible, it uses *Handbook* definitions in place of the actual wordings of the *Act*. In other cases, where reproducing the entire statutory provision would need a lengthy quotation, or considerable further explanation, the relevant provision of the *Act* has been summarised. So, users of the manual should refer to the *Act* as well as to the manual where necessary.
- (2) In the event of any discrepancy between the manual and the *Act*, the provisions of the *Act* prevail.
- (3) It is a *person's* responsibility to ensure that his actions comply with the *Act* at all times, and to seek professional advice where necessary.

ENF 1 ANN 1G: Table of powers referred to in the Enforcement manual

1 Table

This table gives the main location in the Enforcement manual where *guidance* appears on those powers referred to in the *Act* listed below. In many instances the powers will be referred to in other locations.

2 Table Powers referred to in the Enforcement manual

SUBJECT	PART AND SECTION OF THE ACT	ENFORCEMENT MANUAL LOCATION
Variation and cancellation of permission and withdrawal of authorisation		
Duty to withdraw <i>authorisation</i>	Part III, s.33	<i>ENF 5</i>
Variation and cancellation on the FSA's own initiative	Part IV, s.45	<i>ENF 3</i> (Variation), <i>ENF 5</i> (Cancellation)
Variation on acquisition of <i>control</i>	Part IV, s.46	<i>ENF 3</i>
Exercise of powers in support of an <i>overseas regulator</i>	Part IV, s.47	<i>ENF 3</i> (Variation), <i>ENF 5</i> (Cancellation)
Prohibitions and restrictions	Part IV, s.48	<i>ENF 3.2.10G</i>
Prohibition of individuals		
Power to make a <i>prohibition order</i>	Part V, s.56	<i>ENF 8</i>
Withdrawal of Approval		
Power to withdraw approval	Part V, s.63	<i>ENF 7</i>
Disciplinary Powers against Approved persons		
Public statements of misconduct	Part V, s.66	<i>ENF 11</i> and <i>ENF 12</i>
Financial penalties	Part V, s.66	<i>ENF 11</i> and <i>ENF 13</i>
Penalties for Market abuse		
Power to impose penalties	Part VIII, s.123	<i>ENF 14</i>
Power to publish statement	Part VIII, s.123	<i>ENF 14</i>
Power to request court to impose penalties	Part VIII, s.129	<i>ENF 14</i>
Information Gathering and Investigation powers		
Power to require information	Part XI, s.165	<i>ENF 2.3.2G – ENF 2.3.7G</i>
Power to require reports	Part XI, s.166	<i>ENF 2.3.8G – ENF 2.3.11G</i>
Power to appoint <i>persons</i> to carry out general investigations	Part XI, s.167	<i>ENF 2.3.12G – ENF 2.3.13G</i>

SUBJECT	PART AND SECTION OF THE ACT	ENFORCEMENT MANUAL LOCATION
Power to appoint <i>persons</i> to carry out investigations in particular cases	Part XI, s.168	ENF 2.3.14G – ENF 2.3.15G
Investigations etc in support of an <i>overseas regulator</i>	Part XI, s.169	ENF 2.3.16G – ENF 2.3.17G and ENF 2.4.10G – ENF 2.4.12G
Powers of investigators appointed under s.167	Part XI, s.171	ENF 2.4.2G – ENF 2.4.5G and ENF 2.4.10G – ENF 2.4.12G
Additional powers of investigators appointed as a result of s.168(1) or (4)	Part XI, s.172	ENF 2.4.6G – ENF 2.4.7G and ENF 2.4.10G – ENF 2.4.12G
Powers of investigators appointed as a result of s.168(2)	Part XI, s.173	ENF 2.4.8G and ENF 2.4.10G – ENF 2.4.12G
Information and <i>documents</i> : supplemental provisions	Part XI, s.175	ENF 2.4.10G – ENF 2.4.12G
Entry of premises under warrant	Part XI, s.176	ENF 2.15.1G – ENF 2.15.4G
Investigation powers in relation to collective investment schemes	Part XVII, s.284	ENF 2.3.18G – ENF 2.3.21G and ENF 2.4.13G
Intervention against Incoming Firms		
General grounds on which <i>power of intervention</i> is exercisable	Part XIII, s.194	ENF 4.3
Exercise of powers in support of an <i>overseas regulator</i>	Part XIII, s.195	ENF 4.3.5G
<i>Power of intervention</i>	Part XIII, s.196	ENF 4
Power to apply to court for <i>injunctions</i> in respect of certain overseas insurance <i>companies</i>	Part XIII, s.198	ENF 6.8
Disciplinary Powers against firms		
Public censure	Part XIV, s.205	ENF 12
Financial penalties	Part XIV, s.206	ENF 13
Authorised unit trusts		
Revocation of <i>authorisation order</i> other than by consent	Part XVII, s.254	ENF 16.2.3G – ENF 16.2.4G and ENF 16.2.10G – ENF 16.2.14G

SUBJECT		PART AND SECTION OF THE ACT	ENFORCEMENT MANUAL LOCATION
	Power to give directions	Part XVII, s.257	ENF 16.2.5G – ENF 16.2.7G and
	Applications to the court	Part XVII, s.258	ENF 16.2.10G – ENF 16.2.14G ENF 16.2.8G – ENF 16.2.14G
Recognised schemes			
	Power to suspend promotion of an <i>EEA scheme</i>	Part XVII, s.267	ENF 16.4.2G – ENF 16.4.4G
	Revocation of recognition of s.270 <i>schemes</i> (designated country/territory <i>schemes</i>) and s.272 <i>schemes</i> (<i>individually recognised schemes</i>)	Part XVII, s.279	ENF 16.4.5G and ENF 16.4.7G – ENF 16.4.8G
	Directions in relation to s.270 and s.272 <i>schemes</i>	Part XVII, s.281	ENF 16.4.6G – ENF 16.4.8G
Members of designated professional bodies			
	Power to make disapplication orders	Part XX, s.329	ENF 18
Disqualification of auditors and actuaries			
	Disqualification of auditor of <i>authorised unit trust</i>	Part XVII, s.249	ENF 17
	Disqualification of auditors and actuaries of authorised persons	Part XXII, s.345	ENF 17
Insolvency proceedings and orders against debt avoidance			
	Company voluntary arrangements: power to participate in proceedings:	Part XXIV, s.356	ENF 10.7 – ENF 10.8
	Individual voluntary arrangements: power to participate in proceedings:	Part XXIV, s.357	ENF 10.7 – ENF 10.8
	Administration orders: power to present petitions	Part XXIV, s.359	ENF 10.5.1G – ENF 10.5.4G
	Administration orders: power to participate in proceedings	Part XXIV, s.362	ENF 10.11.2G – ENF 10.11.6G and ENF 10.13
	Receivership: power to participate in proceedings	Part XXIV, s.363	ENF 10.11.15G – ENF 10.11.20G
	Voluntary winding up: power to participate in proceedings	Part XXIV, s.365	ENF 10.5.9G – ENF 10.5.13G and ENF 10.11.13G – ENF 10.11.14G
	Winding-up by the court: power to present petitions	Part XXIV, s.367	ENF 10.5.5G – ENF 10.5.8G

SUBJECT	PART AND SECTION OF THE ACT	ENFORCEMENT MANUAL LOCATION
Winding up by the court: power to participate in proceedings	Part XXIV, s.371	ENF 10.11.9G – ENF 10.11.12G and ENF 10.13
Bankruptcy petitions: power to present petitions	Part XXIV, s.372	ENF 10.5.14G – ENF 10.5.17G and ENF 10.6.12G – ENF 10.6.14G
Bankruptcy: power to participate in proceedings	Part XXIV, s.374	ENF 10.11.22G – ENF 10.11.23G and ENF 10.13
Provisions against debt avoidance: right to apply for an order	Part XXIV, s.375	ENF 10.9 and ENF 10.10
Injunctions		
Power to apply to court for <i>injunctions</i> in respect of certain overseas insurance <i>companies</i>	Part XIII, s.198	ENF 6.8
<i>Injunctions</i> for breach of a relevant requirement	Part XXV, s.380	ENF 6.3 and ENF 6.5 – ENF 6.6
<i>Injunctions</i> in cases of <i>market abuse</i>	Part XXV, s.381	ENF 6.4 and ENF 6.5 – ENF 6.6
Restitution		
Power to apply to court for a restitution order	Part XXV, s.382	ENF 9
Restitution orders in cases of <i>market abuse</i>	Part XXV, s.383	ENF 9
Power to require restitution	Part XXV, s.384	ENF 9
Prosecution of Criminal Offences		
Power to prosecute offences under the <i>Act</i> and subordinate legislation	Part XXVII, s.401	ENF 15
Power to prosecute other offences	Part XXVII, s.402	ENF 15

3 Table Exclusions from the table

The Enforcement manual does not contain *guidance* inter alia, on the following:

- sections 77 and 78 Discontinuance and suspension of listing
- section 91 Penalties for breach of listing rules
- sections 297 and 298 Revoking recognition (see *REC*)
- section 348 Restrictions on disclosure of confidential information
- section 395 Procedures for the issue of supervisory notices and decision notices (See *DEC*)
- section 404 Schemes for reviewing past business
- Schedule 1, Part III, paragraph 17 Fees

Chapter 2

Information gathering and investigation powers





2.1 Application and purpose

Application

2.1.1

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This chapter applies to *firms, appointed representatives, approved persons*, and other *persons* who may be subject to the *FSA's* investigations or who may be required to provide information to the *FSA*.

Purpose

2.1.2

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This chapter explains the *FSA's* policy on how it will use its powers to gather information and investigate in support of its enforcement functions. The *FSA* may also use some of these powers to support its supervision functions and the Supervision manual explains how it will use the powers in those circumstances (see *SUP 2* (Information gathering by the *FSA* on its own initiative) and *SUP 5* (Reports by skilled persons)).

2.2 Introduction

2.2.1

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This chapter is divided into two parts. The first part of the chapter, *ENF 2.3 to ENF 2.9*, relates to the main provisions of the *Act* on information gathering and investigations. It outlines:

- (1) the *FSA*'s powers to gather information, and to appoint investigators;
- (2) the powers of investigators appointed by the *FSA*; and
- (3) the *FSA*'s policy on the use of its powers in each of the following circumstances:
 - (a) to gather information from *firms* and to conduct investigations of *firms*, *approved persons*, individuals involved in *firms*, and *appointed representatives*, including issuing preliminary findings letters;
 - (b) to investigate suspected market misconduct;
 - (c) to investigate *unauthorised* business;
 - (d) to conduct investigations to assist overseas authorities; and
 - (e) to investigate *collective investment schemes*.

2.2.2

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The second part of the chapter, *ENF 2.10 to ENF 2.15*, relates to provisions that apply to investigations generally. It outlines:

- (1) the provisions of the *Act* relating to *protected items*, banking confidentiality and the admissibility of statements made to investigators;
- (2) the *FSA*'s powers to control and direct investigations;
- (3) the *FSA*'s policy on:
 - (a) notification to the *person* under investigation;
 - (b) publicity;
 - (c) use of voluntary interviews rather than compulsory ones; and
 - (d) interview procedures; and
- (4) the *FSA*'s powers to enforce requirements on *persons* to cooperate with its information gathering and investigative powers.



2.3 The FSA's powers to gather information and investigate

2.3.1

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The *FSA's* powers to gather information and to appoint investigators are contained in sections 165 to 169 and 284 of the *Act*. They are described in this section of the chapter under the following cross-headings:

- (1) requiring information and *documents* from *firms*; (section 165: see *ENF* 2.3.2G to *ENF* 2.3.7G).
- (2) reports on *firms* by *skilled persons* (section 166: see *ENF* 2.3.8G to *ENF* 2.3.11G);
- (3) general investigations of *firms* and *appointed representatives* (section 167: *ENF* 2.3.12G and *ENF* 2.3.13G);
- (4) Investigations of specific contraventions, offences and other matters (section 168: see *ENF* 2.3.14G and *ENF* 2.3.15G);
- (5) investigations in support of *overseas regulators* (section 169: see *ENF* 2.3.16G and *ENF* 2.3.17G); and
- (6) investigations into *collective investment schemes* (section 284: see *ENF* 2.3.18G to *ENF* 2.3.21G).

Requiring information and documents from firms

2.3.2

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Section 165 of the *Act* (*FSA's* power to require information) relates to the *FSA's* powers to require information and *documents* from *firms*. There are two ways in which the *FSA* may do this.

- (1) Under section 165(1), the *FSA* may, by notice in writing, require a *firm* to:
 - (a) provide specified information or information of a specified description; or
 - (b) produce specified *documents* or *documents* of a specified description.

The *firm* must do this within a reasonable period of time, which the *FSA* will specify, at a specified place. The *firm* must provide the specified information in any form that the *FSA* may reasonably require.

- (2) Under section 165(3), an officer authorised by the *FSA* may require a *firm* without delay to:
 - (a) provide him with specified information or information of a specified description; or

(b) produce to him specified *documents* or *documents* of a specified description.

2.3.3 G_{/1} Section 165 applies to information or *documents* that the *FSA* reasonably requires in connection with the exercise of functions given to it by or under the *Act*.

2.3.4 G_{/1} The *FSA* may also require that any information given is verified, and that *documents* are authenticated, in any way that the *FSA* may reasonably require.

2.3.5 G_{/1} (1) Under section 165(7), the *FSA* may also use the power to impose *requirements* to provide information or to produce *documents* on:

- (a) a *person* who is connected with a *firm*;
- (b) an *operator, trustee* or *depository* of certain types of recognised *collective investment schemes* who is not an *authorised person*;
- (c) a *recognised investment exchange* or *recognised clearing house*.

(2) In this context a ‘*firm*’ includes a *person* who was an *authorised person* but who has now ceased to be one (section 165(8)).

2.3.6 G_{/1} Under section 165(11) a *person* is connected with a *firm* if he is or at any relevant time has been:

- (1) a member of the *firm’s group*;
- (2) a *controller* of the *firm*;
- (3) any other member of a *partnership* of which the *firm* is a member;
- (4) a *person* mentioned in Part I of Schedule 15 to the *Act* (Information and Investigations: Connected Persons), such as the officer or *manager* of the *firm* if it is a corporate body.

2.3.7 G_{/1} The *FSA* may use its section 165 power to require information and *documents* from *firms* in support of both its supervisory functions and its enforcement functions. The *FSA* will often use this power in support of its supervision functions and SUP 2 (Information gathering by the *FSA* on its own initiative) deals with the *FSA*’s use of the power in that context. For completeness, the use of the power is also referred to in ENF 2.5 in support of the *FSA*’s enforcement functions in relation to *firms*.

Reports on firms by skilled persons

2.3.8 G_{/1} Section 166 (Reports by skilled persons) relates to the *FSA*’s power to require *firms* to provide a report by a *skilled person*. Under section 166, the *FSA* may require any of the following, who are or were at the relevant time carrying on a business, to provide it with a report on any matter about which the *FSA* has required or could require the provision of information or *documents* under section 165:

- (1) a *firm* (‘A’);
- (2) any other member of A’s *group*;
- (3) a *partnership* of which A is a member;

(4) a *person* who has at any relevant time been one of the above.

The *FSA* may specify the form in which it requires the report.

2.3.9

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Under section 166(4) the *person* appointed to make the report must:

- (1) be nominated or approved by the *FSA*; and
- (2) appear to the *FSA* to have the skills necessary to report on the matter concerned.

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(1) Section 166(5) applies to any *person* ('X') who is providing or has provided a *person* whom the *FSA* has required to provide a report ('Y') with services in relation to a matter about which the *FSA* has required the report.

(2) Under section 166(5), X has a duty to give the skilled *person* appointed to provide such a report ('Z') any assistance as Z may reasonably require. The *FSA* may apply for an *injunction* or, in Scotland, for an order for specific performance, to enforce this obligation.

2.3.11

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As with its power to require information and *documents*, the *FSA* may use its section 166 power to require reports by *skilled persons* in support of both its supervision and enforcement functions. *SUP 5* (Reports by skilled persons) contains *rules* and *guidance* that will apply whenever the *FSA* uses the power. *ENF 2.5* refers briefly to the *FSA's* use of the power in support of its enforcement functions in relation to *firms*.

General investigations of firms and appointed representatives

2.3.12

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Section 167 of the *Act* (Appointment of persons to carry out general investigations) relates to the appointment of investigators to conduct general investigations into *firms* and *appointed representatives*.

- (1) Under section 167(1), if it appears to the *FSA* (or the Secretary of State) that there is good reason to do so, then the *FSA* (or the Secretary of State) may appoint one or more competent *persons* to conduct an investigation into:
 - (a) The nature, conduct or state of the business of a *firm* or of an *appointed representative*; or
 - (b) a particular aspect of that business; or
 - (c) The ownership or *control* of a *firm*.
- (2) Under Section 167(2), if the *person* appointed to investigate thinks it necessary for his investigation, he may also investigate the business of a *person* who is or has at any relevant time been:
 - (a) a member of the *group* of which the *person* under investigation ('A') is part; or
 - (b) a *partnership* of which A is a member.
- (3) Under section 167(4) the *FSA* may also use this power in relation to a former *firm* or former *appointed representative*, concerning:

- (a) Business carried on at any time when it or he was an *authorised person* or *appointed representative*; or
 - (b) The ownership or *control* of a former *authorised person* when it or he was an *authorised person*.
- (4) In section 167 'business' includes any part of a business even if it does not consist of *regulated activities*.

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The *FSA's* policy on how it will use this power (and other information-gathering and investigation powers) in support of its enforcement functions is set out in *ENF 2.5*.

Investigations of specific contraventions, offences and other matters

2.3.14

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Section 168 of the *Act* (Appointment of persons to carry out investigations in particular cases) relates to the conduct of investigations into certain specified contraventions, offences or other matters. The *FSA's* powers to appoint investigators are contained in section 168(3) and (5) and the circumstances in which it can do so are *listed* in section 168(1), (2) and (4) of the *Act*.

- (1) Under section 168(1) and (3) the *FSA* may appoint one or more competent *persons* to carry out an investigation on its behalf if it appears to the *FSA* that there are circumstances suggesting that:
 - (a) a *person* may have breached regulations made under section 142 of the *Act* (Insurance business: regulations supplementing *FSA's* rules); or
 - (b) a *person* may be guilty of an offence under section 177 (Offences), 191 (Offences under Part XII), 346 (Provision of false or misleading information to auditor or actuary) or 398(1) (Misleading the *FSA*: residual cases) of the *Act* or under Schedule 4 to the *Act* (Treaty Rights).
- (2) Under section 168(2) and (3) the *FSA* may appoint one or more competent *persons* to carry out an investigation on its behalf if it appears to the *FSA* that there are circumstances suggesting that:
 - (a) an offence under section 24(1) (False claims to be authorised or exempt) or 397 (Misleading statements and practices) of the *Act* or under Part V of the Criminal Justice Act 1993 may have been committed; or
 - (b) there may have been a breach of the *general prohibition*; or
 - (c) there may have been a contravention of section 21 (Restrictions on *financial promotion*) or 238 (Restrictions on promotion of *collective investment schemes*) of the *Act*; or
 - (d) *market abuse* may have taken place.
- (3) Under section 168(4) and (5) the *FSA* may appoint one or more competent *persons* to carry out an investigation on its behalf if it appears to the *FSA* that there are circumstances suggesting that:
 - (a) a *firm* may have breached the requirement for *permission* in section 20 of the *Act* (Authorised persons acting without permission); or

- (b) a *person* may be guilty of an offence under the *Money Laundering Regulations*; or
- (c) a *firm* may have breached a *rule* made by the *FSA*; or
- (d) an individual may not be a fit and proper *person* to perform functions in relation to a *regulated activity* carried on by an *authorised* or *exempt person*; or
- (e) an individual may have performed or agreed to perform a function in breach of a *prohibition order*; or
- (f) a *firm* or an *exempt person* may have failed to comply with section 56(6) of the *Act* (Prohibition orders); or
- (g) a *firm* may have failed to comply with section 59(1) or (2) of the *Act* (Approval for particular arrangements); or
- (h) a *person* to whom the *FSA* has given its approval under section 59 may not be a fit and proper *person* to perform the function to which that approval relates; or
- (i) a *person* may be guilty of misconduct for the purposes of section 66 of the *Act*.

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The *FSA* may use these powers to investigate *firms*, *approved persons* and individuals employed by *firms* as well as cases of market misconduct and breaches of the *general prohibition*. The *FSA*'s policies on the use of this power are therefore set out in three different sections of this chapter:

- (1) *ENF 2.5* deals with the use of this power and other powers in relation to *firms*, *approved persons*, individuals employed by *firms*, and *appointed representatives*;
- (2) *ENF 2.6* deals with the use of this power in relation to cases of *market misconduct*; and
- (3) *ENF 2.7* deals with the use of this power in relation to unauthorised business.

Investigations in support of overseas regulators

2.3.16

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Section 169 of the *Act* (Investigations etc. in support of overseas regulator) relates to investigations conducted to assist an *overseas regulator*. It states that at the request of an *overseas regulator*, the *FSA* may use its powers to require *documents* or information under section 165 or to appoint a *person* to investigate any matter. *ENF 2.8.4G* to *ENF 2.8.6G* set out the matters that the *FSA* must, or may, take into account when considering whether to use these powers in support of an *overseas regulator*.

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The *FSA*'s policy on how it will use this power is set out in section *ENF 2.8*.

Investigations into collective investment schemes

2.3.18

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Section 284(1) of the *Act* (Power to investigate) relates to the *FSA's* powers to investigate the affairs of *collective investment schemes*. Under section 284, if it appears to the *FSA* that it is in the interests of the *participants* or potential *participants*, or that the matter is of public concern, it may appoint one or more competent *persons* to investigate and report on:

- (1) the affairs of, or of the *manager* or *trustee* of, any *authorised unit trust scheme*;
- (2) the affairs of, or of the *operator*, *trustee* or *depository* of, any *recognised scheme* that relate to its activities carried on in the *UK*; or
- (3) the affairs of, or of the *operator*, *trustee* or *depository* of, any other *collective investment scheme* except a body incorporated by virtue of regulations under section 262 of the *Act* (that is, an *open-ended investment company*).

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Section 284(2) states that an investigator appointed under section 284(1) to investigate the affairs of, or of the *manager*, *trustee*, *operator* or *depository* of, any *scheme* may also, if he thinks it necessary for the purposes of that investigation, investigate:

- (1) the affairs of, or of the *manager*, *trustee*, *operator* or *depository* of, any other *scheme* that is mentioned in section 284(1) whose *manager*, *trustee*, *operator* or *depository* is the same *person* as the *manager*, *trustee*, *operator* or *depository* of the *scheme*;
- (2) the affairs of other *schemes* and *persons* (including bodies incorporated by virtue of regulations under section 262 of the *Act* (Open-ended investment companies) and the *directors* and *depositories* of those bodies) as may be prescribed.

2.3.20

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Regulations to be made by the Treasury will also give the *FSA* powers to appoint investigators to investigate and report on the affairs of *ICVCs*, or *directors* or *depositories* of *ICVCs*.

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The *FSA's* policy on how it will use its power under section 284 of the *Act* is set out in *ENF 2.9*.

2.4 Powers of FSA investigators

2.4.1

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The nature and extent of an investigator's powers depend on the provision of the *Act* under which he was appointed.

- (1) The powers of an investigator appointed under section 167 of the *Act* (Appointment of persons to carry out general investigations) are contained in section 171 (Powers of persons appointed under section 167) and 175 (Information and documents: supplemental provisions) of the *Act* and are described in *ENF 2.4.2G* to *2.4.5G* and *ENF 2.4.10G* to *2.4.12G*.
- (2) The powers of an investigator appointed under section 168 of the *Act* (Appointment of *persons* to carry out investigations in particular cases) depend on whether he is appointed to investigate the matters listed in section 168(1) and (4) (see *ENF 2.3.14G* (1) and (3)) or those listed in section 168(2) (see *ENF 2.3.14G* (2)):
 - (a) the powers of an investigator appointed as a result of section 168(1) or (4) are contained in sections 172 (Additional power of persons appointed as a result of section 168(1) or (4)) and 175 (Information and documents: supplemental provisions) and are described in *ENF 2.4.6G* to *2.4.7G* and *ENF 2.4.10G* to *2.4.12G*;
 - (b) The powers of an investigator appointed as a result of section 168(2) are contained in sections 173 (Powers of *persons* appointed as a result of section 168(2)) and 175 (Information and documents: supplemental provisions) and are described in *ENF 2.4.8G* and *ENF 2.4.10G* to *ENF 2.4.12G*.
- (3) The powers of an investigator (appointed under section 169 of the *Act* (Investigations etc. in support of overseas regulator) are the same as those of an investigator appointed as a result of section 168(1) (see *ENF 2.4.9G*, *ENF 2.4.6G* to *2.4.7G* and *ENF 2.4.10G* to *2.4.12G*).
- (4) The powers of an investigator appointed under section 284 of the *Act* (Power to investigate) are contained in section 284(3) and are described in *ENF 2.4.13G*.

Powers of section 167 investigators

2.4.2

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Section 171 states that an investigator conducting a general investigation under section 167 of the *Act* may require the *person* who is the subject of the investigation or any *person* connected with the *person* under investigation:

- (1) to attend before the investigator at a specified time and place to answer questions; or

(2) otherwise to provide such information as the investigator may require.

2.4.3 G_{/1} Under section 171(2) the investigator may also require any *person* to produce at a specified time and place any specified *documents* or *documents* of a specified description.

2.4.4 G_{/1} However, under section 171(3), the investigator may only impose requirements referred to in *ENF 2.4.2G* and *ENF 2.4.3G*) so far as he reasonably considers the question, provision of information or production of the *document* to be relevant to the purposes of the investigation.

2.4.5 G_{/1} For the purposes of section 171 (see *ENF 2.4.2G*) , a *person* is connected with the *person* under investigation ('A') if he is or has at any relevant time been:

- (1) a member of A's *group*; or
- (2) a *controller* of A; or
- (3) a *partnership* of which A is a member; or
- (4) in relation to A, a *person* mentioned in Part I or II of Schedule 15 to the *Act* (Information and Investigations: Connected Persons).

Powers of section 168(1) and (4) investigators

2.4.6 G_{/1} Section 172 states that an investigator appointed as a result of section 168(1) or (4) will have the powers given by section 171, which are described in *ENF 2.4.2G* to *ENF 2.4.5G*. Under section 172(2), he will also have the power to require a *person* who is not the subject of the investigation, nor a *person* connected with the *person* under investigation, to attend before him at a specified time and place and answer questions, or otherwise to provide such information as he may require, for the purposes of the investigation.

2.4.7 G_{/1} The investigator may only impose a requirement under section 172(2) if satisfied that this is necessary or expedient for the purposes of the investigation.

Powers of section 168(2) investigators

2.4.8 G_{/1} Section 173 sets out the powers of an investigator appointed as a result of section 168(2) (see *ENF 2.3.14G(2)*). Under section 173, if an investigator considers that any *person* is or may be able to give information which is or may be relevant to the investigation, he may require that *person*:

- (1) to attend before the investigator at a specified time and place and answer questions;
- (2) otherwise to provide such information as the investigator may require for the purposes of the investigation;
- (3) to produce at a specified time and place any specified *documents* or *documents* of a specified description which appear to the investigator to relate to any matter relevant to the investigation;

(4) to give the investigator all assistance in connection with the investigation which he is reasonably able to give.

Powers of section 169 investigators

2.4.9 G_{/1} Section 169(2) states that an investigator appointed in support of an *overseas regulator* under section 169(1)(b) has the same powers as an investigator appointed as a result of section 168(1) (see *ENF* 2.4.6G to 2.4.7G and *ENF* 2.4.10G to 2.4.12G).

Powers common to section 167, 168(1), (2) and (4), and 169 investigators

2.4.10 G_{/1} Section 175 provides that if the *FSA*, or an investigator appointed by it under Section 167 or 168 of the *Act*, has the power to require a *person* to produce a *document* but that it appears that the *document* is in the possession of a third *person*, the *FSA* or investigator may use that power in relation to the third *person*.

2.4.11 G_{/1} Section 175(2) states that the *person* to whom the *document* is produced may take copies or extracts from the *document*, or require the *person* producing the *document* (“A”) or any *relevant person* to provide an explanation of it. Under section 175(7) a *relevant person* means a *person* who:

- (1) has been or is or is proposed to be a director or *controller* of A; or
- (2) has been or is an auditor of A; or
- (3) has been or is an actuary, accountant or lawyer appointed or instructed by A; or
- (4) has been or is an employee of A.

2.4.12 G_{/1} Section 175(3) states that if a *person* who is required to produce a *document* fails to do so, the *FSA* or an investigator may require him to state, to the best of his knowledge and belief, where the *document* is. *ENF* 2.10.2G explains the provisions of section 413 of the *Act* (Protected items) relating to communications or items that a person may not be required to produce, disclose, or allow to be inspected.

Powers of section 284 investigators

2.4.13 G_{/1} Section 284(3) states that if an investigator appointed under section 284 of the *Act* (‘B’) considers that a *person* (‘C’) is or may be able to give information which is relevant to the investigation, B may require C:

- (1) to produce to B any *documents* in C’s possession or under his *control* which appear to B to be relevant to the investigation;
- (2) to attend before him; and
- (3) Otherwise to give B all assistance in connection with the investigation which C is reasonably able to give; and

that it is C’s duty to comply with that requirement.



2.5 The FSA’s policy on exercising its powers: firms, approved persons, and others

Introduction

2.5.1 G_{/1} *ENF 2.5.2G to ENF 2.5.11G refer to the FSA’s policies on using its powers to require information and reports from firms and others (which are explained in SUP 2 (Information gathering by the FSA on its own initiative) and SUP 5 (Reports by skilled persons)). They also set out the FSA’s policy on using its powers to carry out investigations into the affairs of firms, approved persons, individuals involved in firms, and appointed representatives. The powers available to the FSA are summarised in ENF 2 Annex 3G.*

Requiring information and documents under section 165 of the Act

2.5.2 G_{/1} *Section 165 of the Act (FSA’s power to require information) gives the FSA powers to require the provision of information and documents from firms.*

2.5.3 G_{/1} *The FSA may require the provision of information and documents under section 165 of the Act if it reasonably requires them, in connection with the exercise of the functions conferred on it by or under the Act (section 165(4)). This power may be used in a range of circumstances and for different purposes, such as supervision, including routine supervisory activities, and consumer education (see SUP 2).*

Reports by skilled persons under section 166 of the Act and investigations under sections 167 and 168 of the Act.

2.5.4 G_{/1} *If the information available to the FSA raises a regulatory concern about a firm or an approved person’s conduct or fitness and propriety, the FSA may need to make further enquiries by using its powers to require reports by skilled persons or to appoint investigators. The nature of the FSA’s enquiries will depend on the nature and seriousness of its concerns and on the attitude of the firm concerned.*

2.5.5 G_{/1} *The types of concern that may prompt the FSA to make further enquiries into a firm cannot be listed exhaustively. They will extend to any matter which relates to a firm’s business and to the FSA’s performance of its statutory functions, having regard to its regulatory objectives. Broadly speaking, they will include circumstances which suggest that:*

- (1) *a firm, or an approved person within a firm, may have acted in a way which prejudiced the interests of consumers;*

- (2) a *firm*, or an *approved person* within a *firm*, may have acted in breach of the requirements of the legislation or the *rules*;
- (3) a *firm* may no longer meet the *threshold conditions* or an *approved person* within a *firm* may not be a fit and proper *person* to perform a *controlled function*;
- (4) a *firm* may have been used or may be being used for the purposes of *financial crime* including *money laundering*;
- (5) the *FSA* should be concerned about the ownership or *control* of a *firm*, including whether a *person* who has acquired influence over the *firm* meets the requirements for *FSA* approval;
- (6) the conduct of certain types of *regulated activities* in which a *firm* is involved are a cause of serious public concern.

Reports by skilled persons

2.5.6

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If the *FSA* decides that it should use its statutory powers to make further enquiries, it will have regard to the objectives of those enquiries, and the relative effectiveness of its available powers to achieve those objectives. For example:

- (1) if the *FSA*'s objectives are limited to gathering historic information or evidence for determining whether enforcement action may be appropriate, the *FSA*'s information gathering and investigation powers under sections 165, 167 and 168 of the *Act* are likely to be more effective and more appropriate than the power under section 166 (Reports by skilled persons) (see *ENF* 2.3.2G to *ENF* 2.3.15G); and
- (2) if the *FSA*'s objectives include obtaining expert analysis or recommendations (or both) for remedial action, the power under section 166 may be an appropriate power to use, instead of, or in conjunction with, the *FSA*'s other available powers.

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SUP 5 contains *guidance* on the *FSA*'s use of the section 166 power, including *guidance* on the appointment and reporting process. It also contains rules and *guidance* on the duties of *firms* which are subject to section 166 requirements, and *guidance* on the contractual duties of *skilled persons* appointed as a result of section 166 requirements. The *rules* and *guidance* in *SUP* 5 apply whenever the *FSA* uses the section 166 power.

Investigations into general and specific concerns

2.5.8

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- (1) In some circumstances, the provision of a report by a *skilled person* under section 166 may not be appropriate, or may be insufficient (because of the limited nature of the power) to address the seriousness of the *FSA*'s concerns. This will include cases where an effective and thorough investigation by the *FSA* is likely to call for the exercise of powers to require the *firm* or *connected persons* to answer questions and/or produce *documents*. In those cases, the *FSA* will appoint an investigator under section 167 or 168 of the *Act*; if appropriate the *FSA* may also require the *firm* to provide a *skilled person*'s report under section 166. In other cases, the *FSA* may appoint an investigator,

under section 167 or 168, as a result of information in a report under section 166.

(2) Investigators will usually be members of the FSA’s staff.

2.5.9 G_{/1} Where the FSA has general concerns about a *firm* or an *appointed representative*, but the circumstances do not at that stage suggest any specific breach or contravention, it will rely on its power under section 167 of the *Act* and, if it appears that there are good reasons for doing so, the FSA will appoint investigators to investigate the business of a *firm* or an *appointed representative*.

2.5.10 G_{/1} Where it appears to the FSA that circumstances suggest the contraventions or offences set out in section 168 of the *Act* (listed in ENF 2.3.14G) may have happened, the FSA will appoint investigators under section 168. These powers are wider than those available to investigators under section 167 (see ENF 2.4.2G to ENF 2.4.8G). An investigator appointed under section 168 may also require *persons* who are neither the subject of the investigation, nor connected with the *person* under investigation, to attend before him, and to answer questions and provide information. In addition, where the investigator is appointed as a result of section 168(2), those *persons* may also be required to provide all assistance to the investigator that they are reasonably able to give.

2.5.11 G_{/1} In some cases where the FSA has appointed investigators into a *firm* under section 167 of the *Act*, it may decide that it is appropriate to extend the appointment to cover matters under section 168 of the *Act* as well, if circumstances suggest that one of the specific contraventions, breaches or offences listed in ENF 2.3.14G may have occurred. Where it does so, it will normally notify the *person* under investigation that it has appointed the investigators to investigate under section 168 as well (see ENF 2.12).

Preliminary Findings Letter

2.5.12 G_{/1} Unless it is not practicable to do so (such as in cases of urgency), FSA staff (or the investigator appointed by the FSA) will generally send a preliminary findings letter to a *firm*, *approved person*, individual involved in a *firm* or *appointed representative* under investigation (as the case may be) before considering whether to recommend that enforcement action be initiated.

2.5.13 G_{/1} The letter will set out the facts which the FSA staff (or the investigator appointed by the FSA) consider relevant to the matters under investigation, and will invite the person concerned to confirm that those facts are complete and accurate. FSA staff (or the investigator appointed by the FSA) will allow a reasonable period (normally 28 days) for a response to this letter.

2.5.14 G_{/1} FSA staff will take into account any response they receive within the period stated in the preliminary findings letter. They are not obliged to take into account any response received outside that period.

2.5.15 G_{/1} Where the FSA (or the investigator appointed by the FSA) has sent a preliminary findings letter and the FSA then decides not to take any further action, the FSA will communicate this decision promptly to the person concerned.

2.6 The FSA's policy on investigations into suspected market misconduct

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The FSA's power to investigate suspected market misconduct is contained in section 168(2) of the *Act* (Appointment of persons to carry out investigations in particular cases) (see *ENF 2.3.14G(2)*). The FSA may appoint an investigator if circumstances suggest that *insider dealing* or *market abuse* may have taken place, or that misleading statements have been made or misleading practices may have been engaged in. Where it appears to the FSA that there are circumstances suggesting that a *firm* may have engaged in *market abuse*, the FSA will consider appointing an investigator under section 168(2) to investigate that particular matter, rather than under section 167 (Appointment of persons to carry out general investigations). *ENF 2.6.2G* deals in more detail with the circumstances in which the FSA may appoint investigators, in relation to both *authorised persons* and *unauthorised persons*.

2.6.2

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When considering whether to use its powers to conduct formal investigations into market misconduct, the FSA will take into account a number of factors. These will include:

- (1) the seriousness of its concerns, including the effect of the misconduct on *consumers* or market confidence;
- (2) the nature of the possible contravention, including the type of market involved, and the duration and frequency of the possible contravention;
- (3) the context of the possible contravention; for example, where the *behaviour* in question happened or is happening in the context of a *takeover bid* and, in the FSA's opinion, any investigation may materially affect the timetable or outcome of that bid, the FSA will consult the *Takeover Panel* and will give due weight to its views; and
- (4) whether another regulatory authority is in a position to investigate and deal with the matters of concern.
 - (a) As far as a *recognised investment exchange* or *recognised clearing house* is concerned, the FSA will consider the extent to which the relevant exchange or *clearing house* has adequate and appropriate powers to investigate and deal with the matters of concern itself. The FSA will consult with the relevant exchange or *clearing house* and give due weight to its views. Where appropriate, the FSA may use its own powers under section 128 of the *Act* (Suspension of investigations) to prevent a *recognised investment exchange* or *recognised clearing house* from starting an investigation or to limit, stop or suspend an existing inquiry.
 - (b) As far as the *Takeover Panel* is concerned, as regards *market abuse*, the cases in which the FSA expects to take action against a *person* with *Takeover Code* responsibilities are limited, as *ENF 14.9* (Action involving

other UK regulatory authorities) makes clear. The *FSA* does not therefore expect to use relevant investigative powers unless one of the circumstances in *ENF 14.9.6G* applies. Further, unless one of the following exceptions applies, the *FSA* will not start any investigation into *behaviour* that has happened or is happening in the context of a *takeover bid* while that bid is current. The exceptions are where: (i) the case falls within *ENF 14.9.7G*, or (ii) the *person* whose *behaviour* is to be investigated is not a *person* who has responsibilities under the *Takeover Code*.



2.7 The FSA's policy on investigations into unauthorised business

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The FSA may appoint investigators into *unauthorised persons* under section 168 of the Act (Appointment of persons to carry out investigations in particular cases) (see ENF 2.3.14G(2) and (3)) where it appears to it that circumstances suggest that:

- (1) a *person* has contravened the *general prohibition* in section 19 of the Act against carrying on a *regulated activity* without *authorisation* or exemption; or
- (2) a *person* has breached a *prohibition order*; or
- (3) a *person* has committed a specified offence, including:
 - (a) Making a false claim to be *authorised* or exempt;
 - (b) Contravening the restriction on *financial promotion*; and
 - (c) Making a false or misleading statement to induce an *investment agreement*.

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The FSA's primary aim in using its investigation powers will be to protect the interests of *consumers*. The FSA's priority will be to confirm whether or not a *regulated activity* has been carried on in the *United Kingdom* by someone without *authorisation* or exemption, and, if so, the extent of that activity and whether other related contraventions have occurred. It will seek to assess the risk to *consumers'* assets and interests arising from the activity as soon as possible.

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The FSA may be alerted to possible contraventions or breaches by complaints from the public or *firms*, by referrals from other prosecuting authorities or through its own enquiries. It will assess on a case-by-case basis whether to carry out a formal investigation, after considering all the available information. Factors it will take into account are:

- (1) the elements of the suspected contravention or breach;
- (2) whether the FSA considers that the *persons* concerned are willing to cooperate with it; and
- (3) whether obligations of confidentiality inhibit individuals from providing information unless compelled to do so by the FSA's use of its formal powers.

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At an early stage in the investigation the FSA may need to consider whether to take urgent enforcement action to protect *consumers*. Its investigators will then use their powers to collect documentary and oral evidence for use in support of that action. Nevertheless, even when it has commenced enforcement proceedings, it may need to continue with its fact-finding investigations. For instance, the FSA may need further information to consider whether it should use any of its other

statutory powers, to apply for further civil remedies or to start criminal prosecutions.

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The *FSA* will not always be the only investigating, enforcement or prosecuting authority with an interest in investigating unauthorised business. From time to time the Serious Fraud Office, the Department of Trade and Industry, the police and the prosecuting authorities (both in the *United Kingdom* and overseas) may have an interest in such cases.

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The *FSA* has agreed guidelines that will establish a framework for liaison and cooperation in cases where one or more of these authorities has an interest in prosecuting any aspect of a matter that the *FSA* is considering for investigation, investigating or considering prosecuting. These Guidelines are set out in *ENF 2* Ann 1G.



2.8 The FSA's policy for exercising its power to conduct investigations to assist overseas authorities

- 2.8.1** G_{/1} The *FSA's* power to conduct investigations to assist overseas authorities is contained in section 169 of the *Act* (see *ENF 2.3.16G*).
- 2.8.2** G_{/1} Section 169(1) states that at the request of an *overseas regulator*, the *FSA* may use its power under section 165 of the *Act* (*FSA's* power to require information) power to require information and *documents*, or appoint a *person* to investigate any matter. These are referred to as the *FSA's* investigative powers.
- 2.8.3** G_{/1} If the *overseas regulator* is a *competent authority* and makes a request under any Community obligation, section 169(3) states that the *FSA* must, in deciding whether or not to exercise its investigative power, consider whether it is necessary to use it to comply with that obligation.
- 2.8.4** G_{/1} Section 169(6) states that, if the *FSA* considers that the use of its investigative power is necessary to comply with a Community obligation, the provisions of section 169(4) and (5) (set out in *ENF 2.8.5G* and *ENF 2.8.6G*) do not apply.
- 2.8.5** G_{/1} Under section 169(4), in deciding whether or not to use its investigative power, the *FSA* may take into account in particular the following factors:
- (1) whether, in the country or territory of the *overseas regulator* concerned, corresponding assistance would be given to a *UK* regulatory authority;
 - (2) whether the case concerns the breach of a law, or other requirement, which has no close parallel in the *United Kingdom* or involves the assertion of a jurisdiction not recognised by the *United Kingdom*;
 - (3) the seriousness of the case and its importance to *persons* in the *United Kingdom*; and
 - (4) whether it is otherwise appropriate in the public interest to give the assistance sought.
- 2.8.6** G_{/1} Section 169(5) states that the *FSA* may decide not to use its investigative power unless the *overseas regulator* agrees to make such contribution towards the cost as the *FSA* considers appropriate.
- 2.8.7** G_{/1} When it considers whether to use its investigative power, and whether section 169(4) applies, the *FSA* will first consider whether it is able to assist without using its formal powers, for example by getting the information voluntarily. Where that is not possible, the *FSA* will take account of all the factors in *ENF 2.8.5G*, but may give particular weight to the seriousness of the case and its importance to *persons* in the *United Kingdom*, and to the public interest.



2.9 The FSA's policy on investigations into collective investment schemes under section 284

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The FSA may appoint investigators into a *collective investment scheme* if it appears to it that it is in the interests of the *participants* or potential *participants* to do so or that the matter is of public concern (section 284(1) (Power to investigate)). In most cases it expects that those involved (such as *managers* of *schemes*) will provide information without the FSA having to use its formal powers. In other cases, circumstances may be such that the FSA relies on its general investigative powers. However, in some cases the use of the section 284 power may be more appropriate.

2.9.2

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The types of concern that may prompt the FSA to use its powers under section 284 cannot be listed exhaustively. They will include any matters that could affect the interests of *participants* or potential *participants* or matters that could be of public concern, including questions about the nature and propriety of assets held by the scheme or the accuracy and propriety of valuation of units in the scheme. When considering whether to use the powers, factors that the FSA will take into account include:

- (1) the seriousness, in the FSA's opinion, of the matter of concern;
- (2) the degree to which the interests of *consumers* may be affected;
- (3) whether the FSA considers that the *persons* concerned are willing to cooperate in giving information;
- (4) whether confidentiality obligations may inhibit individuals from giving information without the FSA having to use its formal powers.



2.10 Protected items, banking confidentiality, and admissibility

2.10.1 **G** This section sets out additional provisions that apply to investigations generally.
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Protected items

2.10.2 **G** Section 413 of the *Act* relates to *protected items*.
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- (1) Under section 413(1), a *person* may not be required under the *Act* to produce, disclose or allow inspection of *protected items*.
- (2) *Protected items* are:
 - (a) Communications between a professional legal adviser and his client or any *person* representing his client which falls within section 413(3);
 - (b) Communications between a professional legal adviser, his client or any *person* representing his client and any other *person* that falls within section 413(3) (as a result of paragraph (b) of that subsection);
 - (c) items which -
 - (i) Are enclosed with, or referred to in, such communications;
 - (ii) Fall within section 413(3); and
 - (iii) Are in the possession of a *person* entitled to have them.
- (3) A communication or item falls within section 413(3) if it is made:
 - (a) in connection with the giving of legal advice to the client; or
 - (b) in connection with, or in contemplation of, legal proceedings and for the purposes of those proceedings.
- (4) However under section 413(4) a communication or item is not a *protected item* if it is held with the intention of furthering a criminal purpose.
- (5) Also, under section 175(4) of the *Act* (Information and documents: supplemental provisions) a lawyer may be required to give the name and address of his client.

Banking confidentiality

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Under section 175(5) and section 284(8) (Power to investigate) of the *Act*, except in certain circumstances, no *person* may be required under Part XI (Information Gathering and Investigations) or section 284 of the *Act* to give information or produce a *document* in respect of which he owes an obligation of confidence by carrying on banking business. Those circumstances include, under section 175(5), circumstances where:

- (1) the *person* to whom the obligation is owed is the *person* under investigation, or a related *company*; or
- (2) the *person* to whom the duty is owed consents to its disclosure; or
- (3) the requirement to disclose has been specifically authorised by the *FSA*.

Admissibility of statements

2.10.4

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Section 174 of the *Act* (Admissibility of statements made to investigators) relates to the admissibility of statements made by a *person* in compliance with information requirements imposed under sections 171 (Powers of persons appointed under section 167), 172 (Additional power of persons appointed as a result of section 168(1) or (4)), 173 (Powers of persons appointed as a result of section 168(2)), 175 or 284 of the *Act*, to an investigator appointed under section 167 (Appointment of persons to carry out general investigations), 168 (Appointment of persons to carry out investigations in particular cases) or 284 of the *Act*.

- (1) Under section 174(1) a statement made to an investigator by a *person* complying with an information requirement can, in general, be used as evidence in any proceedings, so long as it also complies with any requirements governing the admissibility of evidence in the circumstances in question.
- (2) However, under section 174(2), such a statement cannot generally be used as evidence in criminal proceedings in which the *person* who made the statement is charged with an offence, or in proceedings in relation to action against a *person* under section 123 of the *Act* (Penalties for market abuse). Nevertheless this does not apply to the offences listed in section 174(3), such as making false statements or providing false or misleading evidence to the *FSA*'s investigators. Where section 174(2) applies:

- (a) no evidence relating to the statement may be adduced; and
- (b) no questions relating to it may be asked;

by the prosecution or the *FSA*, unless evidence relating to that statement is adduced, or a question relating to it is asked, by that *person* or on his behalf in the proceedings.

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Statements made by a *person* to an investigator other than in compliance with an information requirement (such as statements made voluntarily) are not covered by section 174 and can be used as evidence in any proceedings subject to any requirements governing the admissibility of evidence in the circumstances in question.



2.11 The FSA's policy on investigators and control of investigations

Powers of the investigators

2.11.1 **G** The *FSA* sees its investigation powers as essentially fact-finding powers. Consequently, it will ensure that its investigators use them primarily to obtain the information it needs in order to decide what further action, if any, may be necessary in a particular case.
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2.11.2 **G** In practice, investigators appointed under sections 167 (Appointment of persons to carry out general investigations), 168 (Appointment of persons to carry out investigations in particular cases) or 284 (Power to investigate) of the *Act* may not always deem it necessary to use their statutory powers. However, where they do so, they will at all times make this clear to those *persons* to whom their enquiries are addressed, and will inform those *persons* of the statutory requirements (see *ENF* 2.4) and the possible penalties for failure to comply. (See also *ENF* 2.14.3G on compulsory interviews and *ENF* 2.15 on enforcement of requirements).
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Control and direction of the investigation

2.11.3 **G** The *FSA*'s powers to control investigators are contained in section 170 of the *Act* (Investigations: general). Section 170(5) permits the *FSA* to appoint a member of its staff as an investigator, and the *FSA* will usually do this.
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2.11.4 **G** The *FSA* has power under section 170(7) to direct an investigator so that it can control:
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- (1) the scope of the investigation;
- (2) the period during which the investigation is to be conducted;
- (3) the conduct of the investigation; and
- (4) the reporting of the investigation.

2.11.5 **G** Under section 170(8) a direction may, in particular:
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- (1) Confine the investigation to particular matters;
- (2) Extend the investigation to additional matters;
- (3) Require the investigator to stop the investigation or to take only certain steps; and

(4) Require the investigator to make an interim report or reports.

2.11.6

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Section 170(5) to (9) also applies to investigations into *collective investment schemes* under section 284 of the *Act*.

2.11.7

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Where the *FSA* has appointed an investigator in response to a request from an *overseas regulator*, it may under section 169(7) (Investigations etc. in support of overseas regulator) direct the investigator to allow a *representative* of that regulator to attend, and take part in, any interview conducted for the purposes of the investigation. However, the *FSA* may only use this power if it is satisfied that any information obtained by an *overseas regulator* as a result of the interview will be subject to safeguards equivalent to those in Part XXIII of the *Act* (Public Record, Disclosure of Information and Cooperation) (section 169(8)).

2.11.8

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The factors that the *FSA* may take into account when deciding whether to make a section 169(7) interview direction include the following:

- (1) the complexity of the case;
- (2) the nature and sensitivity of the information sought;
- (3) the *FSA*'s own interest in the case;
- (4) costs, where no Community obligation is involved, and the availability of resources; and
- (5) the availability of similar assistance to *UK* authorities in similar circumstances.

2.11.9

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Under section 169(9), the *FSA* is required to prepare a statement of policy with the approval of the Treasury on the conduct of interviews attended by representatives of *overseas regulators*. The statement is set out in *ENF 2 Ann 2G*.



2.12 The FSA's policy on notification to the person under investigation

2.12.1 G_{/1} Section 170(2) of the *Act* (Investigations: general) requires the *FSA* to give to the *person* who is the subject of the investigation written notice that it has appointed an investigator, except in relation to the cases set out in section 170(3) (see *ENF* 2.12.3G). Under section 170(4), the notice must:

- (1) specify the provisions under which, and as a result of which, it appointed the investigator; and
- (2) state the reason for the investigator's appointment.

2.12.2 G_{/1} If there is a change in the scope or conduct of the investigation and, in the *FSA's* opinion, the *person* under investigation is likely to be significantly prejudiced if not made aware of this, that *person* must be given written notice of the change (see section 170(9)). It is impossible to give a definitive list of the circumstances in which a *person* is likely to be significantly prejudiced by not being made aware of the change in the scope or conduct of an investigation. However, this may include situations where there may be unnecessary costs from dealing with an aspect of an investigation which the *FSA* no longer intends to pursue or where a *person* may inadvertently incriminate himself by not knowing of the change in scope.

2.12.3 G_{/1} However, under section 170(3), sections 170(2) and (9) (see *ENF* 2.12.1G and *ENF* 2.12.2G) do not apply if:

- (1) the investigator is appointed as a result of section 168(1) or (4) (Appointment of persons to carry out investigations in particular cases) (see *ENF* 2.3.14G (1) and (3)) and the investigating authority believes the notice required would be likely to result in the investigation being frustrated; or
- (2) the investigator is appointed as a result of section 168(2) (see *ENF* 2.3.14G (2)).

2.12.4 G_{/1} Where the *Act* does not require the *FSA* to give written notice of the appointment of the investigators, for example where the investigation is into suspected breaches of the *general prohibition* or market misconduct, the *FSA* will nevertheless consider notifying the *person* under investigation when it becomes clear who that *person* is.

2.12.5 G_{/1} In investigations into possible *insider dealing*, *market abuse*, *misleading statements and practices offences*, or breaches of the *general prohibition*, the restriction on *financial promotion*, or the prohibition on promoting *collective investment schemes*, the investigator may not know the identity of the perpetrator or may be looking into market circumstances at the outset of the investigation rather than investigating a particular *person*. For example, *market abuse* investigations may often be prompted by concerns surrounding, for instance, movements in the market price of a particular *investment*. In those circumstances the *FSA* will give an

indication of the nature and subject matter of the *FSA's* investigation to those who are required to provide information to assist with the investigation.

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However, when it becomes clear who the *person* under investigation is, the *FSA* will normally notify him of that fact when it proceeds to exercise its statutory powers to require information from them. But it will not notify the *persons* under investigation if this would prejudice the *FSA's* ability to conduct the investigation effectively.

2.12.7

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Except where the *FSA* has issued a *warning notice* (See *DEC 2* Statutory notice procedure: warning notice and decision notice procedure) and the *FSA* has subsequently discontinued the proceedings, the *Act* does not require the *FSA* to provide notification of the termination of an investigation or subsequent enforcement action. However, where the *FSA* has given a *person* written notice that it has appointed an investigator and subsequently decides to discontinue the investigation without any present intention to take further action, it will confirm this to the *person* concerned as soon as it considers it is appropriate to do so, having regard to the circumstances of the case.

2.13 Publicity

- 2.13.1** G_{/1} The *FSA* will not normally make public the fact that it is or is not investigating a particular matter, or any of the findings or conclusions of an investigation.

Publicity during investigations

- 2.13.2** G_{/1} Paragraphs *ENF 2.13.3G* to *ENF 2.13.6G* deal with exceptional circumstances in which the *FSA* may make a public announcement that it is or is not investigating a particular matter.

- 2.13.3** G_{/1} Where the matter in question has occurred in the context of a *takeover bid*, and the following circumstances apply, the *FSA* may make a public announcement that it is not investigating, and does not propose to investigate, the matter. Those circumstances are where the *FSA*:

- (1) has not appointed, and does not propose to appoint, investigators; and
- (2) considers (following discussion with the *Takeover Panel*) that such an announcement is appropriate in the interests of preventing or eliminating public uncertainty, speculation or rumour.

- 2.13.4** G_{/1} Where it is investigating any matter, the *FSA* will, in exceptional circumstances, make a public announcement that it is doing so if it considers such an announcement is desirable to:

- (1) maintain public confidence in the *financial system*; or
- (2) protect *consumers*; or
- (3) prevent widespread malpractice; or
- (4) help the investigation itself, for example by bringing forward witnesses.

In deciding whether to make an announcement, the *FSA* will consider the potential prejudice that it believes may be caused to any *persons* who are, or who are likely to be, a subject of the investigation.

- 2.13.5** G_{/1} The exceptional circumstances referred to in *ENF 2.13.4G* may arise where the matters under investigation have become the subject of public concern, speculation or rumour. In this case it may be desirable for the *FSA* to make public the fact of its investigation in order to allay concern, or contain the speculation or rumour. Where the matter in question relates to a *takeover bid*, the *FSA* will discuss any announcement beforehand with the *Takeover Panel*. Any announcement will be subject to the restriction on disclosure of confidential information in section 348 of the *Act* (Restrictions on disclosure of confidential information by *FSA* etc).

2.13.6 G_{/1} There will also be cases where publicity is unavoidable. For example, investigations into suspected criminal offences may often lead the *FSA* into making enquiries amongst the general public which might attract publicity.

2.13.7 G_{/1} The *FSA* will not normally publish details of the information found or conclusions reached during its investigations. In many cases, statutory restrictions on the disclosure of information obtained by the *FSA* in the course of exercising its functions are likely to prevent publication (see section 348 of the *Act*). In exceptional circumstances, and where it is not prevented from doing so, the *FSA* may publish details. Circumstances in which it may do so include those where the fact that the *FSA* is investigating has been made public, by the *FSA* or otherwise, and the *FSA* subsequently concludes that the concerns that prompted the investigation were unwarranted. This is particularly so if the *firm* under investigation wishes the *FSA* to clarify the matter.

Publicity following an investigation

2.13.8 G_{/1} Section 391 of the *Act* (Publication) deals with publication of regulatory action resulting in *final notices* and effective *supervisory notices* (see *DEC*).

- (1) Under section 391(4) the *FSA* must publish such information about the matter to which a *final notice* relates as it considers appropriate.
- (2) Similarly under section 391(5), where a *supervisory notice* takes effect the *FSA* must publish such information about the matter to which the notice relates as it considers appropriate.
- (3) However, under section 391(6) the *FSA* may not publish information under section 391 if publication of it would, in its opinion, be unfair to the *person* with respect to whom the action was taken or prejudicial to the interest of *consumers*.

2.13.9 G_{/1} Where the *final notice* relates to *behaviour* in the context of a *takeover bid*, and the *FSA* believes that publicity may affect the timetable or outcome of that bid, the *FSA* will consult the *Takeover Panel* and will give due weight to the Panel's views.

2.13.10 G_{/1} *ENF* 9.10 (Publication) sets out the *FSA*'s policy on publishing details of applications to court for restitution or for the use of its administrative power to require restitution. The *FSA* considers that it is generally appropriate to publish details of successful applications to court or of the exercise of its administrative powers to require restitution. However, in certain circumstances it may decide not to publish, for example, if this could damage market confidence or undermine market integrity in a way that could be damaging to the interests of *consumers*. Where the relevant *behaviour* has occurred in the context of a *takeover bid*, and the *FSA* believes that publicity may affect the timetable or outcome of that bid, the *FSA* will consult the *Takeover Panel* and will give due weight to the *Takeover Panel's* views.

2.13.11 G_{/1} The *FSA* will also normally publish the outcome of other civil actions, such as the obtaining of *injunctions* prohibiting further illegal activity, and of public hearings in criminal prosecutions. Again, where the relevant *behaviour* has occurred in the context of a *takeover bid*, and the *FSA* is of the opinion that publicity may materially affect the timetable or outcome of that bid, the *FSA* will consult the *Takeover Panel* and will give due weight to the *Takeover Panel's* views.



2.14 The FSA’s policy: interviews and interview procedures

2.14.1 G_{/1} As mentioned in *ENF 2.11.2G*, the *FSA* may not always use its statutory powers to require individuals to be interviewed. If appropriate, the investigator will first seek to conduct interviews on a voluntary basis.

Voluntary Interviews

2.14.2 G_{/1} If the interviewee is the subject of the investigation, the investigator will make a record of the interview and the *FSA* will give a copy of the record to the interviewee. If the interviewee is not the subject of the investigation, the *FSA* will give the interviewee a record of the interview if one has been made by the investigator. The interviewee may be accompanied by a legal adviser, if he wishes.

Compulsory interviews

2.14.3 G_{/1} Where the *FSA* does require a *person* to answer questions in interview, using its compulsory powers, it will:

- (1) allow that *person* (whether or not he is the subject of the investigation) to be accompanied by a legal adviser, if he wishes;
- (2) give the *person* an appropriate warning and an explanation of the limited use that can be made of his answers in criminal proceedings against him, or in proceedings in which the *FSA* seeks a penalty for *market abuse* under Part VIII of the *Act* (Penalties for Market Abuse); and
- (3) give the *person* a record of the interview (in most cases this will be an audio tape recording).

Interviews under caution

2.14.4 G_{/1} Under sections 401 (Proceedings for offences) and 402 (Power of the *FSA* to institute proceedings for certain other offences) of the *Act*, the *FSA* is a prosecuting authority in England and Wales and Northern Ireland for a number of criminal offences. When conducting interviews with suspects for the purpose of obtaining evidence for use in criminal proceedings, investigators are subject (with appropriate adaptations) to the statutory requirements of the Police and Criminal Evidence Act 1984 (PACE) and its Codes, and of the Criminal Procedure and Investigations Act 1996. Individuals suspected of a criminal offence may therefore be interviewed under caution. These interviews will be subject to all the safeguards of PACE Code

C and are entirely voluntary on the part of the suspects. The *FSA* will warn the suspect at the start of the interview of his right to remain silent (and the consequences of remaining silent) and will inform the suspect that he is entitled to have a legal adviser present.

2.14.5

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If a suspect has already been interviewed by the *FSA* under compulsory powers, before he is interviewed under caution, the investigators will give him the transcript or other record of the compulsory interview and an explanation of the difference between the two types of interview. They will also tell the individual about the limited use that can be made of his previous answers in criminal proceedings or in proceedings in which the *FSA* seeks a penalty for *market abuse* under Part VIII of the *Act*.

2.14.6

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Also, where a suspect has been interviewed under caution, and the *FSA* subsequently wishes to conduct a compulsory interview with him, the *FSA* will again explain the difference between the two types of interview, and will notify the individual of the limited use that can be made of his answers in the compulsory interview.

2.14.7

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Guidance on the admissibility of statements made to investigators is set out at *ENF* 2.10.4G to 2.10.5G.

2.15 The FSA's powers to enforce requirements

Search warrants

2.15.1

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The FSA and its investigators may apply to a magistrate for a warrant to search for and seize *documents* or information. Under section 176 of the *Act* (Entry of premises under warrant) a justice of the peace or sheriff may issue a warrant if he is satisfied that there are reasonable grounds for believing that:

- (1) a *person* has failed to comply with a requirement to provide information or produce *documents*, and that the required *documents* or information are on the premises specified in the warrant (see section 176(2)); or
- (2) the premises specified in the warrant are those of a *firm* or an *appointed representative*; and that there are *documents* or information on the premises which could be the object of an information requirement; and that the requirement would not be complied with, or the *documents* or information would be removed, tampered with or destroyed if such a requirement were made (see section 176(3)); or
- (3) a serious offence has been or is being committed; and that *documents* or information relevant to that offence are on the specified premises; and that an information requirement could be imposed on those *documents* or that information; and that the requirement would not be complied with, or the *documents* or information would be removed, tampered with or destroyed (see section 176(4)).

The offences relevant to sub-paragraph (3) above are those mentioned in section 168 of the *Act* (Appointment of persons to carry out investigations in particular cases) (see *ENF* 2.3.14G), for which the maximum sentence on indictment is two years or more.

2.15.2

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The FSA will consider using these powers to apply for a search warrant when it has concerns about whether information requirements will be complied with and it believes that the grounds listed in *ENF* 2.15.1G are made out.

2.15.3

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A search warrant issued under section 176 will authorise a *constable* to:

- (1) Enter the premises specified in the warrant;
- (2) Search the premises and take possession of *documents* or information relevant to the warrant, or take any other steps which may appear to be necessary to preserve them or prevent interference with them;
- (3) take copies of, or extracts from, any such *documents* or information;

(4) require any *person* on the premises to explain any such *document* or information or to state where it may be found.

2.15.4

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As a matter of policy, the *FSA* will usually seek to ensure that the *FSA*’s investigator is named on the warrant and entitled to accompany the *constable* on the search.

Prosecutions

2.15.5

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Section 177 of the *Act* (Offences) creates three criminal offences in relation to non-cooperation with the *FSA*, information gatherers authorised by the *FSA* under section 165(3) of the *Act*, and investigators.

2.15.6

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Under section 177(3), (4) and (6) a *person* commits an offence if he:

- (1) knows or suspects that an investigation is being or is likely to be conducted, and:
 - (a) falsifies, conceals, destroys or otherwise disposes of a *document* which he knows or suspects is, or would be, relevant to the investigation; or
 - (b) causes or permits the falsification, concealment, destruction or disposal of such a *document*;

unless he shows that he had no intention of concealing facts disclosed by the *documents* from the investigator (see section 177(3)); or
- (2) in purported compliance with a requirement placed on him under Part XI of the *Act* (Information Gathering and Investigations), gives information which he knows to be false or misleading in a material particular, or recklessly gives information which is false or misleading in a material particular (see section 177(4)); or
- (3) intentionally obstructs the use of any rights conferred by a warrant (see section 177(6)).

Certification procedure

2.15.7

G /1

Section 177(1) states that if a *person* other than the investigator fails to comply with a requirement imposed on him under Part XI of the *Act*, the *person* imposing the requirement may certify that fact in writing to the court. If the court is satisfied that that *person* has no reasonable excuse for failing to comply, it may deal with him as if he were in contempt. If the *person* is a *body corporate*, the court may deal with any *director* or officer as if he were in contempt (section 177(2)).

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Guidelines on investigation of cases of interest or concern to the Financial Services Authority and other prosecuting and investigating agencies

Purpose, status and application of the guidelines

1. These guidelines have been agreed by the following bodies (“the agencies”):
 - the Financial Services Authority (“the FSA”);
 - the Serious Fraud Office (“the SFO”);
 - the Department of Trade and Industry (“the DTI”);
 - the Crown Prosecution Service (“the CPS”);
 - the Association of Chief Police Officers in England, Wales and Northern Ireland (“ACPO”);
 - the Crown Office;
 - the Department of the Director of Public Prosecutions for Northern Ireland (“the DPP(NI)”);
 - the Association of Chief Police Officers in Scotland (“ACPO(S)”).

2. The guidelines are intended to assist the agencies when considering cases concerning financial crime and/or regulatory misconduct that are, or may be, of mutual interest to the FSA and one or more of the other agencies. Their implementation and wider points arising from them will be kept under review by the agencies who will liaise regularly.

3. The purpose of the guidelines is to set out some broad principles which the agencies agree should be applied by them in order to assist them to:
 - (a) decide which of them should investigate such cases;
 - (b) co-operate with each other, particularly in cases where more than one agency is investigating;
 - (c) prevent undue duplication of effort by reason of the involvement of more than one agency;
 - (d) prevent the subjects of proceedings being treated unfairly by reason of the unwarranted involvement of more than one agency.

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4. The guidelines are intended to apply to the relationships between the FSA and the other agencies. They are not intended to apply to the relationships between those other agencies themselves where there is no FSA interest. They are not legally binding.
5. The guidelines are subject to the restrictions on disclosure of information held by the agencies. They are not intended to override them.
6. The guidelines are relevant to ACPO and ACPO(S) only in so far as they relate to investigations. Similarly, they are relevant to the CPS and the DPP(NI) only in so far as they relate to prosecutions.

Commencing Investigations

7. The agencies recognise that there are areas in which they have an overlapping remit in terms of their functions and powers (the powers and functions of the agencies are set out in the Appendix to this document). The agencies will therefore endeavour to ensure that only the agency or agencies with the most appropriate functions and powers will commence investigations.
8. The agencies further recognise that in certain cases concurrent investigations may be the most quick, effective and efficient way for some cases to be dealt with. However, if an agency is considering commencing an investigation and another agency is already carrying on a related investigation or proceedings or is otherwise likely to have an interest in that investigation, best practice is for the agencies concerned to liaise and discuss which agency or agencies should take action, ie investigate, bring proceedings or otherwise deal with the matter.

Indicators for deciding which agency should take action

9. The following are indicators of whether action by the FSA or one of the other agencies is more appropriate. They are not listed in any particular order or ranked according to priority. No single feature of the case should be considered in isolation, but rather the whole case should be considered in the round.

(a) Tending towards action by the FSA

- Where the suspected conduct in question gives rise to concerns regarding market confidence or protection of consumers of services regulated by the FSA.
- Where the suspected conduct in question would be best dealt with by:
 - criminal prosecution of offences which the FSA has powers to prosecute by virtue of the Financial Services and Markets Act 2000

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("the 2000 Act") (see Appendix paragraph 1.4) and other incidental offences;

- civil proceedings under the 2000 Act (including applications for injunctions, restitution and to wind up firms carrying on regulated activities);
 - regulatory action which can be referred to the Financial Services and Markets Tribunal (including proceedings for market abuse); and
 - proceedings for breaches of listing rules.
- Where the likely defendants are FSA authorised or approved persons.
 - Where the likely defendants are issuers or sponsors of a security admitted to the official list or in relation to which an application for listing has been made.
 - Where there is likely to be a case for the use of FSA powers which may take immediate effect (eg powers to vary the permission of an authorised firm or to suspend listing of securities).
 - Where it is likely that the investigator will be seeking assistance from overseas regulatory authorities with functions equivalent to those of the FSA.
 - Where any possible criminal offences are technical or in a grey area whereas regulatory contraventions are clearly indicated.
 - Where the balance of public interest is in achieving reparation for victims and prosecution is likely to damage the prospects of this.
 - Where there are distinct parts of the case which are best investigated with regulatory expertise.

(b) Tending towards action by one of the other agencies

- Where serious or complex fraud is the predominant issue in the conduct in question (normally appropriate for the SFO).
- Where the suspected conduct in question would be best dealt with by:
 - criminal proceedings for which the FSA is not the statutory prosecutor;
 - proceedings for disqualification of directors under the Company Directors Disqualification Act 1986 (normally appropriate for DTI action);

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- winding up proceedings which FSA does not have statutory powers to bring (normally appropriate for DTI action); or
 - criminal proceedings in Scotland.
- Where the conduct in question concerns the abuse of limited liability status under the Companies Acts (normally appropriate for DTI action).
 - Where powers of arrest are likely to be necessary.
 - Where it is likely that the investigator will rely on overseas organisations (such as law enforcement agencies) with which the other agencies have liaison.
 - Where action by the FSA is likely to prejudice the public interest in the prosecution of offences for which the FSA is not a statutory prosecutor.
 - Where the case falls only partly within the regulated area (or criminal offences for which FSA is a statutory prosecutor) and the prospects of splitting the investigation are not good.
10. It is also best practice for the agencies involved or interested in an investigation to continue to liaise as appropriate throughout in order to keep under review the decisions as to who should investigate or bring proceedings. This is particularly so where there are material developments in the investigation that might cause the agencies to reconsider its general purpose or scope and whether additional investigation by others is called for.

Conduct of concurrent investigations

11. The agencies recognise that where concurrent investigations are taking place, action taken by one agency can prejudice the investigation or subsequent proceedings brought by another agency. Consequently, it is best practice for the agencies involved in concurrent investigations to notify each other of significant developments in their investigations and of any significant steps they propose to take in the case, such as:
- interviewing a key witness;
 - requiring provision of significant volumes of documents;
 - executing a search warrant; or
 - instituting proceedings or otherwise disposing of a matter.
12. If the agencies identify that particular action by one party might prejudice an investigation or future proceedings by another, it is desirable for the parties

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concerned to discuss and decide what action should be taken and by whom. In reaching these decisions, they will bear in mind how the public interest is best served overall. The examples provided in paragraph 9 above may also be used as indicators of where the overall balance of interest lies.

Deciding to bring proceedings

13. The agencies will consider, as necessary, and keep under review whether an investigation has reached the point where it is appropriate to commence proceedings. Where agencies are deciding whether to institute criminal proceedings, they will have regard to the usual codes or guidance relevant to that decision. For example, agencies other than the DPP(NI) or the Crown Office will have regard to the Code for Crown Prosecutors (Note: Different guidance applies to the DPP(NI) and the Crown Office. All criminal proceedings in Scotland are the responsibility of the Lord Advocate. Separate arrangements have been agreed between the FSA and the Crown Office for the prosecution of offences in Scotland arising out of FSA investigations). Where they are considering whether to bring non-criminal proceedings, they will take into account whatever factors they consider relevant (for example, in the case of market abuse proceedings brought by the FSA, these are set out in paragraph 14.4 of the FSA Enforcement manual).
14. The agencies recognise that in taking a decision whether to commence proceedings, relevant factors will include:
 - whether commencement of proceedings might prejudice ongoing or potential investigations or proceedings brought by other agencies; and
 - whether, in the light of any proceedings being brought by another party, it is appropriate to commence separate proceedings against the person under investigation.
15. Best practice in these circumstances, therefore, is for the parties concerned to liaise before a decision is taken.

Closing Cases

16. It is best practice for the agencies, at the conclusion of any investigation where it is decided that no further action need be taken, or at the conclusion of proceedings, to notify any other agencies concerned of the outcome of the investigation and/or proceedings and to provide any other helpful feedback.

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APPENDIX TO THE GUIDELINES ON INVESTIGATION OF CASES OF INTEREST OR CONCERN TO THE FINANCIAL SERVICES AUTHORITY AND OTHER PROSECUTING AND INVESTIGATING AGENCIES

1. *The FSA*

1.1 The FSA is the single statutory regulator for all financial business in the UK. Its regulatory objectives (when acting other than in its capacity as the UK Listing Authority ("UKLA")) under the Financial Services and Markets Act 2000 ("the 2000 Act") are:

- market confidence;
- public awareness;
- the protection of consumers; and
- the reduction of financial crime.

(NOTE: The 2000 Act repealed and replaced various enactments which conferred powers and functions on the FSA and other regulators whose functions are now carried out by the FSA. Most notable in this context are the Financial Services Act 1986 and the Banking Act 1987. Transitional provisions under the 2000 Act permit the FSA to continue to investigate and bring proceedings for offences under the old legislation. Details of these transitional provisions are not set out in these guidelines)

1.2 The FSA is also the UKLA. The UKLA's regulatory objectives in this area are:

- the protection of investors;
- access to capital; and
- investor confidence.

1.3. Under the 2000 Act the FSA has powers to investigate concerns including:

- *regulatory concerns about authorised firms and individuals employed by them;
- *suspected market abuse under s.118 of the 2000 Act;
- *suspected misleading statements and practices under s.397 of the 2000 Act;

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- *suspected insider dealing under of Part V of the Criminal Justice Act 1993;
- suspected contraventions of the general prohibition under s.19 of the 2000 Act and related offences;
- *suspected offences under various other provisions of the 2000 Act (see below);
- suspected breaches of the Listing Rules and related offences in relation to listing.

The FSA's powers of information gathering and investigation are set out in Part XI of the 2000 Act and in s.97 in relation to its UKLA functions.

1.4. The FSA has power to take the following enforcement action:

- discipline authorised firms under Part XIV of the 2000 Act and approved persons under s.66 of the 2000 Act;
- impose civil penalties in cases of market abuse under s.123 of the 2000 Act;
- prohibit an individual from being employed in connection with a regulated activity, under s.56 of the 2000 Act;
- apply to Court for injunctions (or interdicts) and other orders against persons contravening relevant requirements (under s.380 of the 2000 Act) or engaging in market abuse (under s.381 of the 2000 Act);
- petition the court for the winding-up or administration of companies, and the bankruptcy of individuals, carrying on regulated activities;
- apply to the court under ss.382 and 383 of the 2000 Act for restitution orders against persons contravening relevant requirements or persons engaged in market abuse;
- require restitution under s.384 of the 2000 Act of profits which have accrued to authorised persons contravening relevant requirements or persons engaged in market abuse, or of losses which have been suffered by others as a result of those breaches;
- (in England and Wales) prosecute offences under the Money Laundering Regulations 1993, Part V Criminal Justice Act 1993 (insider dealing) and various offences under the 2000 Act including (Note: The FSA may also prosecute any other offences which are

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incidental to those which it has express statutory power to prosecute):

- carrying on regulated activity without authorisation or exemption, under s.23;
 - making false claims to be authorised or exempt, under s.24;
 - promoting investment activity without authorisation, under s.25;
 - breaching a prohibition order, under s.56;
 - failing to co-operate with or giving false information to FSA appointed investigators, under s.177;
 - failing to comply with provisions about influence over authorised persons, under s.191;
 - making misleading statements and engaging in misleading practices, under s.397;
 - misleading the FSA, under s.398;
 - various offences in relation to the FSA's listing authority function under Part VI;
- Fine, issue public censures, suspend or cancel listing for breaches of the Listing Rules by an issuer; and
 - Issue public censures, suspend or remove a sponsor from the UKLA list of approved sponsors for breaches of Listing Rules by a sponsor.

2. *DTI*

- 2.1 The Secretary of State for Trade & Industry exercises concurrently with the FSA those powers and functions marked with an asterisk in paragraphs 1.3 above. The investigation functions are undertaken by Companies Investigation Branch ("CIB") and the prosecution functions by the Solicitors Office.
- 2.2 The principal activities of CIB are, however, the investigations into the conduct of companies under the Companies Acts and the Fair Trading Act. These are fact-finding investigations but may lead to follow-up action by CIB such as petitioning for the winding up of a company,

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disqualification of directors of the company or referring the matter to the Solicitors Office for prosecution. CIB may also disclose information to other prosecution or regulatory authorities to enable them to take appropriate action under their own powers and functions. Such disclosure is, however, strictly controlled under a gateway disclosure regime.

- 2.3 The Solicitors Office advises on investigation work carried out by CIB and undertakes criminal investigations and prosecutions in respect of matters referred to it by CIB, the Insolvency Service or other divisions of the DTI or its agencies.

3. SFO

- 3.1 The aim of the SFO is to contribute to:

- reducing fraud and the cost of fraud;
- the delivery of justice and the rule of law;
- maintaining confidence in the UK's business and financial institutions.

- 3.2 Under the Criminal Justice Act 1987 the Director of the SFO may investigate any suspected offence which appears on reasonable grounds to involve serious or complex fraud and may also conduct, or take over the conduct of, the prosecution of any such offence. The SFO may investigate in conjunction with any other person with whom the Director thinks it is proper to do so; that includes a police force (or the FSA or any other regulator). The criteria used by the SFO for deciding whether a case is suitable for it to deal with are set out in paragraph 3.3.

- 3.3 The key criterion should be that the suspected fraud is such that the direction of the investigation should be in the hands of those who would be responsible for any prosecution.

The factors that are taken into account include:

- whether the amount involved is at least £1 million (this is simply an objective and recognisable signpost of seriousness and likely public concern rather than the main indicator of suitability);
- whether the case is likely to give rise to national publicity and widespread public concern. That includes those involving government bodies, public bodies, the governments of other countries and commercial cases of public interest;

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- whether the case requires highly specialist knowledge of, for example, stock exchange practices or regulated markets;
- whether there is a significant international dimension;
- whether legal, accountancy and investigative skills need to be brought together; and
- whether the case appears to be complex and one in which the use of Section 2 powers might be appropriate.

4. **CPS**

- 4.1. The CPS has responsibility for taking over the conduct of all criminal proceedings instituted by the police in England and Wales. The CPS may advise the police in respect of criminal offences. The CPS prosecutes all kinds of criminal offences, including fraud. Fraud cases may be prosecuted by local CPS offices but the most serious and complex fraud cases will be prosecuted centrally.

5. **ACPO and ACPO(S)**

- 5.1. ACPO represents the police forces of England, Wales, and Northern Ireland. ACPO(S) represents the police forces of Scotland.

6. **The Crown Office**

- 6.1. The investigation and prosecution of crime in Scotland is the responsibility of the Lord Advocate, who is the head of the Procurator Fiscal Service, which comprises Procurators Fiscal and their Deputies, who are answerable to the Lord Advocate. The Procurator Fiscal is the sole public prosecutor in Scotland, prosecuting cases reported not only by the police but all regulatory departments and agencies. All prosecutions before a jury, both in the High Court of Justiciary and in the Sheriff Court, run in the name of the Lord Advocate; all other prosecutions run in the name of the local Procurator Fiscal. The Head Office of the Procurator Fiscal Service is the Crown Office and the Unit within the Crown Office which deals with serious and complex fraud cases and with the investigation of cases of interest or concern to the Financial Services Authority is the Fraud and Specialist Services Unit: the remit of this Unit is directly comparable to that of the Serious Fraud Office.

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7. *The DPP(NI)*

- 7.1. The DPP(NI) is responsible for the prosecution of all offences on indictment in Northern Ireland, other than offences prosecuted by the Serious Fraud Office. The DPP(NI) is also responsible for the prosecution of certain summary offences, including offences reported to it by any government department.

ENF 2 ANN 2G: Statement of policy on section 169(7) interviews (see ENF 2.8)

1 Table Application

1	This annex applies when the <i>FSA</i> : (1) has appointed, an investigator at the request of an <i>overseas regulator</i> , under section 169(1)(b) of the <i>Act</i> ; and (2) has directed, or is considering directing, the investigator, under section 169(7) of the <i>Act</i> , to permit a representative of the <i>overseas regulator</i> to attend, and take part in, any interview conducted for the purposes of the investigation.
2	In this annex a “section 169(7) interview” means any interview conducted for the purposes of an investigation under section 169(1)(b) of the <i>Act</i> in relation to which the <i>FSA</i> has given a direction under section 169(7) of the <i>Act</i> .

2 Table Purpose and Objective

3	The purpose of this annex is to set out the statement of the <i>FSA</i> 's policy on the conduct of interviews to which a direction under section 169(7) has been given or the <i>FSA</i> is considering giving. The <i>FSA</i> is required to prepare and publish this statement of policy by section 169(9) and (11) of the <i>Act</i> . As required by section 169(10) of the <i>Act</i> , the Treasury has approved the statement of policy.
4	The <i>FSA</i> is keen to promote co-operation with <i>overseas regulators</i> . It views assistance to <i>overseas regulators</i> as an essential part of the principles set out in section 2(3)(e) of the <i>Act</i> to which it must have regard in discharging its general functions.

3 Table The *FSA*'s investigation powers in support of overseas regulators

- 5 Under section 169(1)(b) of the *Act*, the *FSA* may appoint an investigator to investigate any matter at the request of an *overseas regulator*. The powers of the investigator appointed by the *FSA* (referred to here as the '*FSA's* investigator') include the power to require *persons* to attend at a specified time and place and answer questions (the compulsory interview power).
- 6 Where the *FSA* appoints an investigator in response to a request from an *overseas regulator* it may, under section 169(7) of the *Act*, direct him to permit a representative of that regulator to attend and take part in any interviews conducted for the purposes of the investigation. The *FSA* may only give a direction under section 169(7) if it is satisfied that any information obtained by an *overseas regulator* as a result of the interview will be subject to the safeguards equivalent to those contained in Part XXIII of the *Act* (Public Record, Disclosure of Information and Cooperation).
- 7 Part XXIII of the *Act* contains restrictions on the disclosure of confidential information. The restrictions are subject to exceptions contained in regulations made by the Treasury under section 349.

4 Table The *FSA's* approach to giving an interview direction under section 169(7)

- 8 The *FSA's* policy on how it will use its investigative power, including its power to appoint investigators, in support of *overseas regulators*, is set out in *ENF* 2.8.
- 9 The *FSA* may need to consider whether to use its direction power at two stages of an investigation:
 - (1) at the same time that it considers the request from the *overseas regulator* to appoint investigators;
 - (2) after it has appointed investigators, either at the request of the *overseas regulator* or on the recommendation of the investigators.
- 10 Before making a direction under section 169(7) the *FSA* will discuss and determine with the *overseas regulator* how this statement of policy will apply to the conduct of the interview, taking into account all the circumstances of the case. Amongst other matters, the *FSA* will at this stage determine the extent to which the representative of the *overseas regulator* will be able to participate in the interview. The *overseas regulator* will be notified of this determination on the issuing of the direction.
- 11 The direction will contain the identity of the representative of the *overseas regulator* that is permitted to attend any interview and the role that he will play in the interview. If the *FSA* envisages that there will be more than one interview in the course of the investigation, the direction may also specify which interview(s) the overseas representative is allowed to attend.

5 Table Control of section 169(7) interviews

- 12 In circumstances where an interview is to be conducted as part of the investigation, the *FSA's* investigator will have conduct of the interview. In general, the *FSA's* investigators will be employees of the *FSA*, but in appropriate cases the *FSA* may appoint *persons* who are not its employees. In those cases, the *FSA* may choose to require that an *FSA* employee is present at the interview and may choose to appoint that *person* as an investigator.
- 13 The *FSA's* investigator will act on behalf of the *FSA* and under its control. He may be instructed to permit the representative of the *overseas regulator* to assist in preparation of the interview. Where the *FSA* considers it appropriate, it may permit the representative to attend and ask questions of the interviewee in the course of the interview. The interview will be conducted according to the terms of the direction and the notification referred to in *ENF 2.4.3G* Ann above.
- 14 If the direction does permit the representative of an *overseas regulator* to attend the interview and ask the interviewee questions, the *FSA's* investigator will retain control of the interview throughout. Control of the interview means the following will apply:
- (1) The *FSA's* investigator instigates and concludes the interview, introduces everyone present and explains the procedure of the interview. He warns the interviewee of the possible consequences of refusing to answer questions and the uses to which any answers that are given can and cannot be put. The *FSA's* investigator will always ask preliminary questions, such as those establishing the identity of the interviewee.
 - (2) The *FSA's* investigator determines the duration of the interview and when, if at all, there should be any breaks in the course of it.
 - (3) The *FSA's* investigator has responsibility for making a record of the interview. The record should note the times and duration of any breaks in the interview and any periods when the representative of the *overseas regulator* was either present or not present.
 - (4) Where the *FSA's* investigator considers it appropriate, he may either suspend the interview, ask the overseas representative to leave the interview, or terminate the interview and reschedule it for another occasion. In making that decision he will bear in mind the terms of the direction, any agreement made with the *overseas regulator* as to the conduct of the interview and the contents of this statement of policy.

6 Table Information for the interviewee

- 15 The *FSA* will in general provide written notice of the appointment of an investigator to the *person* under investigation pursuant to the request of an *overseas regulator*. Whether or not the interviewee is the *person* under investigation, the *FSA*'s investigator will inform the interviewee of the provisions under which he has been appointed, the identity of the requesting authority and general nature of the matter under investigation. The interviewee will also normally be informed if a representative of the *overseas regulator* is to attend and take part in the interview. Notification of any of these matters may not be provided in advance of the interview if the *FSA* believes that the circumstances are such that notification would be likely to result in the investigation being frustrated.
- 16 The interviewee will normally be given a copy of the direction issued under section 169(7) in advance of the interview unless to do so would be likely to result in the investigation being frustrated. The interviewee will also be provided with a copy of this statement of policy.
- 17 The *FSA*'s investigator will determine the venue and timing of the interview. The interviewee will be notified of the venue and timing of the interview in advance and in writing.
- 18 When the *FSA*'s investigator has exercised the compulsory interview power, at the outset of the interview the interviewee will be given an appropriate warning as stated in *ENF* 2.14.3G. The warning, amongst other things, must state that the interviewee is obliged to answer all questions put to them during the interview, including any put by the representative of the *overseas regulator*. It will also state that in criminal proceedings or proceedings for *market abuse* the *FSA* will not use as evidence against the interviewee any information obtained under compulsion during the interview.

7 Table Documents and information referred to in section 169(7) interviews

- 19 The *FSA*'s investigator may decide which documents or other information may be put to the interviewee, and whether it is appropriate to give the interviewee sight of the *documents* before the interview takes place. Where the *overseas regulator* wishes to ask questions about *documents* during the interview and the *FSA*'s investigator wishes to inspect those *documents* before the interview, he will be given the opportunity to do so. If the *FSA*'s investigator wishes to inspect them and has not been able to do so before the interview, he may suspend the interview until he has had an opportunity to inspect them.

8 Table Questions in section 169(7) interviews

- 20 When the *FSA's* investigator has exercised the compulsory interview power, the *FSA's* investigator will require the *person* attending the interview to answer questions. Where appropriate, questions may also be posed by the representative of the *overseas regulator*. The interviewee will also be required to answer these questions. The *FSA's* investigator may intervene at any stage during questioning by the representative of the *overseas regulator*.
- 21 Interviews will, in general, be conducted in English. Where the interviewee's first language is not English, at the request of the interviewee arrangements will be made for the questions to be translated into the interviewee's first language and for his answers to be translated back into English. If a translator is employed at the request of the representative of the *overseas regulator* then the translation costs will normally be met by the *overseas regulator*. Where interviews are being conducted in pursuance of a Community obligation these costs will be met by the *FSA*. In any event, the meeting of costs in relation to translators and, where applicable, the translation of *documents* will always be agreed in advance with the *overseas regulator*.
- 22 All compulsory interviews will be tape-recorded. The method of recording will be decided on and arranged by the *FSA's* investigator. Costs will be addressed similarly to that set out in the preceding paragraph. The *FSA* will not provide the *overseas regulator* with transcripts of the tapes of interviews unless specifically agreed to, but copies of the tapes will normally be provided where requested. The interviewee will be provided with a copy of tapes of the interview but will only be provided with transcripts of the tapes or translations of any transcripts if he agrees to meet the cost of producing them.
- 23 The interviewee may be accompanied at the interview by a legal adviser or a non-legally qualified observer of his choice. The costs of any representation will not be met by the *FSA*. The presence at the interview of a representative of the *overseas regulator* may mean that the interviewee wishes to be represented or accompanied by a *person* either from or familiar with that regulator's jurisdiction. As far as practical the arrangements for the interview should accommodate this wish. However, the *FSA* reserves the right to proceed with the interview if it is not possible to find such a *person* within a reasonable time or no such *person* is able to attend at a suitable venue.

9 Table Publication of the results of overseas investigations

- 24 In relation to the publication of investigations by *overseas regulators*, the *FSA* will pursue a policy similar to the policy that relates to its own investigations. The *FSA's* policy on publicity during investigations can be found at *ENF* 2.13.

ENF 2 ANN 3G: Summary of the FSA's information-gathering and investigation powers referred to in ENF 2.5

1 Table Information gathering and investigation powers

Section	165	166	167	168
Description of the power	<i>FSA's</i> power to require information.	Reports by <i>skilled persons</i> .	Appointment of <i>persons</i> to carry out general investigations.	Appointment of <i>persons</i> to carry out investigations in particular cases.
Grounds	The information and <i>documents</i> required must be reasonably required in connection with the exercise by the <i>FSA</i> of functions conferred on it by or under the <i>Act</i> .	The report must be on any matter about which the <i>FSA</i> has required or could require the provision of information or production of <i>documents</i> under section 165.	It must appear to the <i>FSA</i> that there is good reason for appointing investigators.	It must appear to the <i>FSA</i> that there are circumstances suggesting that specified breaches, contraventions, <i>market abuse</i> or offences may have occurred.

Section	165	166	167	168
Persons who may be subject of the information requirement/report/investigation	<p><i>Firm/former firm.</i></p> <p>Person connected with <i>firm/former firm.</i></p> <p><i>Operator</i> etc. of recognised <i>CIS.</i></p> <p><i>RIE</i> or <i>RCH.</i></p>	<p><i>Firm</i> ("A").</p> <p>Any other member of A's group.</p> <p>Partnership of which A is a member.</p> <p>Person who has at any relevant time been a person falling within any of the three categories mentioned above.</p>	<p><i>Firm</i> or appointed representative.</p> <p>Former <i>firm</i> or <i>appointed representative</i> (in relation to certain matters).</p> <p>Member of the <i>group</i> of which the <i>person</i> under investigation ("A") is part (if investigator thinks it necessary).</p> <p><i>Partnership</i> of which A is a member (if investigator thinks it necessary).</p>	<p>A range of <i>persons</i> depending on the circumstances or suspected breaches.</p>

Section	165	166	167	168
Type of person who may exercise or be authorised or appointed under the power	<i>FSA</i> (by notice in writing). <i>FSA</i> officer (i.e an officer of the <i>FSA</i> , including a member of <i>FSA</i> staff or agent of the <i>FSA</i>).	<i>Skilled person</i> nominated or approved by the <i>FSA</i> .	Competent <i>person</i> (including <i>FSA</i> member of staff).	Competent <i>person</i> (including <i>FSA</i> member of staff).
Powers of FSA/information-gatherers/skilled persons/investigators	To require information. To require <i>documents</i> . To require information to be verified. To require <i>documents</i> to be authenticated. To require explanations of <i>document</i> .	No specific powers – but there is a duty on <i>persons</i> providing services to the subject of the report to provide all such assistance as the <i>skilled person</i> may reasonably require.	To require <i>persons</i> to attend and answer questions. To require information. To require <i>documents</i> . To require explanations of <i>documents</i> .	To require <i>persons</i> to attend and answer questions. To require information. To require <i>documents</i> . To require explanations of <i>documents</i> . To require reasonable assistance (s168(2) investigator only).

Chapter 3

Variation of Part IV permission on the FSA's own initiative



3.1 Application and purpose

Application

3.1.1 **G** This chapter applies to all *firms*.
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Purpose

3.1.2 **G** This chapter contains a statement of the FSA's policy on how it will use its *own-initiative power* to vary a *firm's Part IV permission* under sections 45 (Variation etc on FSA's own initiative) and 47 (Exercise of power in support of overseas regulator) of the *Act*. The FSA has related powers to intervene against *incoming firms* and to cancel *Part IV permission* on its own initiative. These powers are dealt with in *ENF 4* (Intervention against incoming firms) and *ENF 5* (Cancellation of Part IV permission on the FSA's own initiative and withdrawal of authorisation).

3.1.3 **G** This chapter outlines:
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- (1) the FSA's *own-initiative power* to vary *permission* under the relevant sections of the *Act*;
- (2) the grounds for exercising that power (both generally and in support of *overseas regulators*);
- (3) the FSA's duty to ensure that *firms* satisfy the *threshold conditions* when it exercises its *own-initiative powers*; and
- (4) the FSA's policy on the exercise of the power (both generally and in support of *overseas regulators*).

3.1.4 **G** The FSA also has powers to vary a firm's *Part IV permission* at a *firm's* request under section 44 of the *Act* (Variation etc at request of authorised person). *SUP 6* (Applications to vary and cancel Part IV permission) contains a statement of the FSA's policy in relation to that section of the *Act*. In this chapter, variation of *Part IV permission* means variation of *Part IV permission* on the FSA's own initiative.



3.2 The FSA's powers to vary Part IV permission on its own initiative

3.2.1

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The FSA's powers to vary a *firm's Part IV permission* on its own initiative, and the grounds for exercising those powers, are contained in sections 45 (Variation etc on FSA's own initiative) to 47 (Exercise of power in support of overseas regulator) of the *Act*:

- (1) section 45 (Variation etc on FSA's own initiative) sets out various cases where the FSA may vary (or cancel) a *firm's Part IV permission* and identifies the types of provisions that the FSA may impose on a *firm*;
- (2) section 46 (Variation of permission on acquisition of control) gives the FSA power to vary a *firm's Part IV permission* when a *person* has acquired *control* over the *firm* (and is dealt with in SUP 11.7.18G (FSA's right to object to existing controllers)); and
- (3) section 47 (Exercise of power in support of overseas regulator) gives the FSA power to vary (or cancel) a *firm's Part IV permission* in support of an *overseas regulator*.

Limitations and requirements that the FSA may impose

3.2.2

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Sections 45(2) and (4) of the *Act* identify the types of provisions that the FSA may impose when it uses its *own-initiative power* to vary *Part IV permission* under section 45. They also apply when the FSA seeks to exercise this power in support of an *overseas regulator* under sections 47(1) and (2).

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Section 45(2) states that the FSA's *own-initiative power* includes the power to vary a *Part IV permission* in any of the ways mentioned in section 44(1) of the *Act*. Under section 44(1), the FSA may vary a *firm's Part IV permission*, amongst other ways, by:

- (1) removing a *regulated activity* from the *firm's Part IV permission*;
- (2) varying the description of a *regulated activity* included in the *firm's Part IV permission*;
- (3) varying a *requirement* imposed under section 43 of the *Act* (see ENF 3.2.8G to ENF 3.2.10G).

3.2.4

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Under section 45(4), the FSA's power extends to including in the *Part IV permission* as varied any provision that it could include if it were giving a fresh *Part IV permission* in response to an application under section 40 of the *Act* (Application for permission) (see AUTH 2 Ann 2G (Regulated activities and the permission regime) and AUTH 3 (applications for Part IV permission)).

- 3.2.5** G_{/1} The types of provisions that the *FSA* may include in a fresh *Part IV permission* are identified in section 42(7) (Giving permission) and section 43 (Imposition of requirements) of the *Act*. *ENF 3.2.6G* to *ENF 3.2.10G* describe sections 42(7) and 43 and give examples of the types of *limitations* and restrictions that the *FSA* may consider imposing when using its powers to vary *Part IV permission* in support of its enforcement activities. The *FSA* may also use its powers to vary *Part IV permission* in support of its supervision activities and *SUP 7.3* (Criteria for varying a firm's permission) includes examples of the *limitations* and restrictions that the *FSA* may consider imposing when varying *Part IV permission* in that context.
- 3.2.6** G_{/1} Under section 42(7) the *FSA* may incorporate in the description of a *regulated activity* such *limitations* as it considers appropriate (for example, about the circumstances in which the activity may, or may not, be carried on).
- 3.2.7** G_{/1} Examples of the *limitations* that the *FSA* may impose under section 42(7), when exercising its *own-initiative power* in support of its enforcement function, include *limitations* on:
- (1) The number, or category, of *customers* that a *firm* can deal with;
 - (2) The number of *specified investments* that a *firm* can deal in;
 - (3) The activities of the *firm* so that they fall within specific regulatory regimes (for example, so that *oil market participants*, *locals*, *corporate finance advisory firms* and service providers are permitted only to carry on those types of activities).
- 3.2.8** G_{/1} Section 43 relates to the imposition of *requirements*:
- (1) under section 43(1) a *Part IV permission* may include such *requirements* as the *FSA* considers appropriate;
 - (2) under section 43(2) a *requirement* may, in particular, be imposed so as to require the *firm* concerned to:
 - (a) take specified action; or
 - (b) refrain from taking specified action.
- 3.2.9** G_{/1} Examples of *requirements* that the *FSA* may consider including in a *firm's Part IV permission* when exercising its *own-initiative power* in support of its enforcement function are:
- (1) a *requirement* not to take on new business;
 - (2) a *requirement* not to hold or control *client money*; and
 - (3) a *requirement* not to trade in certain categories of *specified investment*.
- 3.2.10** G_{/1} Other *requirements* that the *FSA* may include in a *Part IV permission* are set out in section 48(3) of the *Act* (Prohibitions and restrictions) and are referred to as '*assets requirements*'. An *assets requirement* is a *requirement* (under section 43) that:
- (1) prohibits the disposal of, or other dealing with, any of the *firm's* assets (whether in the *United Kingdom* or elsewhere) or restricts those disposals or dealings; or

- (2) Requires that all or any of the *firm's* assets, or all or any assets belonging to investors but held by the *firm* or to its order, must be transferred to a *trustee* approved by the *FSA*.



3.3 Grounds for exercising the power to vary Part IV permission

3.3.1 **G**_{/1} Grounds for varying *Part IV permission* on the FSA's own-initiative are set out in section 45 and 47 of the *Act*.

General grounds for exercising the power

3.3.2 **G**_{/1} Under section 45 of the *Act* (Variation etc on FSA's own initiative), the FSA may vary a *Part IV permission* in any of the following cases:

- (1) Case A. Where it appears to the FSA that the *firm* is failing, or is likely to fail, to satisfy the *threshold conditions* in relation to one or more, or all, of the *regulated activities* for which the *firm* concerned has a *Part IV permission*;
- (2) Case B. Where it appears to the FSA that the *firm* concerned has failed, during a period of at least twelve *months*, to carry on a *regulated activity* to which the *Part IV permission* relates;
- (3) Case C. Where it appears to the FSA that it is desirable to vary the *Part IV permission* in order to protect the interests of *consumers* or potential *consumers* in relation to a *regulated activity* to which the *Part IV permission* relates.

Grounds for exercising the power in support of an overseas regulator

3.3.3 **G**_{/1} Under section 47(1) of the *Act* (Exercise of power in support of overseas regulator), the FSA may exercise its *own-initiative power* to vary a *Part IV permission* at the request of, or for the purpose of assisting, a regulator who is:

- (1) outside the *United Kingdom*; and
- (2) of a kind prescribed in regulations made by the Treasury.

3.3.4 **G**_{/1} Section 47(1) applies whether or not the FSA has powers which it can exercise in relation to the *firm* under any provision of Part XIII of the *Act*, (*Incoming firms: Intervention by FSA*) (see ENF 4).

3.3.5 **G**_{/1} If a request to the FSA for the exercise of its *own-initiative power* is made by a regulator who is:

- (1) outside the *United Kingdom*;
- (2) of a kind prescribed in regulations made by the Treasury; and

(3) acting in pursuance of provisions of a kind prescribed in regulations made by the Treasury;

the FSA must, when it decides whether to exercise that power in response to the request, consider whether it is necessary to do so to comply with a Community obligation.

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In any case in which the FSA does not consider that the exercise of its *own-initiative power* is necessary in order to comply with a Community obligation, the FSA may take into account in particular:

- (1) whether in the country or territory of the regulator concerned, corresponding assistance would be given to a UK regulatory authority;
- (2) whether the case concerns the breach of a law, or other requirement, which has no close parallel in the *United Kingdom* or which involves the assertion of a jurisdiction not recognised by the *United Kingdom*;
- (3) the seriousness of the case and its importance to *persons* in the *United Kingdom*;
- (4) whether it is otherwise appropriate in the public interest to give the assistance sought.

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The FSA may decide not to exercise its *own-initiative power*, in response to a request, unless the regulator concerned undertakes to make whatever contribution towards the cost of its exercise the FSA considers appropriate. However, this does not apply if the FSA decides that it is necessary for it to exercise its *own-initiative power* in order to comply with a Community obligation.



3.4 The FSA's duty to ensure that firms satisfy the threshold conditions

3.4.1

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When it varies a *firm's Part IV permission*, the FSA has a duty under section 41(2) of the *Act* (The threshold conditions) to ensure that the *firm* will satisfy, and continue to satisfy, the *threshold conditions* in relation to all of the *regulated activities* for which it has or will have *Part IV permission*. The duty is qualified by section 41(3) of the *Act*.



3.5 The FSA's policy on exercising its own-initiative power

3.5.1

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This section sets out the FSA's policy on how it will exercise its *own-initiative power* to vary *Part IV permission*. It is arranged as follows:

- (1) ENF 3.5.2G to ENF 3.5.13G set out the FSA's policy for exercising its power under section 45 of the Act (Variation etc on FSA's own initiative) and outline its general approach and its approach in urgent cases;
- (2) ENF 3.5.14G to ENF 3.5.26G set out the FSA's policy on exercising its power under section 47 of the Act (Exercise of power in support of overseas regulator) in support of *overseas regulators*;
- (3) ENF 3.5.27G and ENF 3.5.28G set out additional considerations that the FSA may or must have regard to when it considers using its *own-initiative power*.

SUP 7.3 (Criteria for varying a firm's permission) gives additional *guidance* on the FSA's policy for using its *own-initiative power* to vary *Part IV permission* in support of its supervision activities.

The FSA's general approach

3.5.2

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When it considers how it should deal with a concern about a *firm*, the FSA will have regard to its *regulatory objectives* and the range of regulatory tools that are available to it. It will also have regard to:

- (1) the responsibilities of a *firm's* management to deal with concerns about the *firm* or about the way its business is being or has been run; and
- (2) the principle that a restriction imposed on a *firm* should be proportionate to the objectives the FSA is seeking to achieve.

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The FSA will proceed on the basis that a *firm* (together with its *directors* and senior management) is primarily responsible for ensuring the *firm* conducts its business in compliance with the Act and the *Principles* and the *rules*. In the context of its enforcement activities, the FSA will take formal action affecting the conduct of a *firm's* commercial business only if that business is being conducted in such a way that the FSA judges it necessary to act in order to secure compliance with those requirements and/or address the consequences of non-compliance. In the context of its supervision activities, the FSA may take formal action in the circumstances described in SUP 7.3 including where:

- (1) the FSA determines that a *firm's* management, business or *internal controls* give rise to risks that are not fully captured by the FSA's *rules*; or

- (2) a *firm* becomes or is to become involved in new products or selling practices which present risks not captured by existing requirements; or
- (3) there has been a change in a *firm's* structure, *controllers*, activities or strategy which generates uncertainty or creates unusual or exceptional risks.

3.5.4 G_{/1} In the course of its supervision and monitoring of a *firm*, the *FSA* may make it clear that it expects the *firm* to take certain steps to ensure it continues to meet regulatory requirements. These steps might include the correction of financial, conduct of business or *control* weaknesses.

3.5.5 G_{/1} The *FSA* envisages that *firms* will normally take the steps referred to in *ENF* 3.5.4G without the need for it to use its *own-initiative powers*. In the vast majority of cases the *FSA* will seek to agree with a *firm* those steps the *firm* must take to address the *FSA's* concerns.

3.5.6 G_{/1} Where the *FSA* considers that it cannot rely on a *firm* taking effective action, or if the *firm* fails to comply with the *FSA's* reasonable request for it to take remedial steps, the *FSA* will consider exercising its formal powers under section 45 of the *Act*. This may include instances where the *FSA* is concerned that the consequences of a *firm* not taking the desired steps may be serious and:

- (1) the *firm* appears unwilling or unable to take adequate and timely steps to address the *FSA's* concerns; or
- (2) the imposition of a formal statutory *requirement* may assist the *firm* to take steps which would otherwise be difficult because of legal obligations owed to third parties.

3.5.7 G_{/1} Section 45 of the *Act* empowers the *FSA* to vary, or alternatively to cancel, a *firm's* *Part IV permission*. The same statutory grounds apply to the exercise of both those powers. They are set out in section 45(1) Cases A to C (see *ENF* 3.3.2G).

3.5.8 G_{/1} Circumstances in which the *FSA* will consider varying a *firm's* *Part IV permission* in support of its enforcement function include those where it has serious concerns about a *firm*, or about the way its business is being or has been conducted, but the concerns are not such as to suggest it should cancel the *firm's* *Part IV permission* (see *ENF* 5). Examples of these circumstances are where:

- (1) under Case A (see *ENF* 3.3.2G(1)), the *firm* appears to be failing, or appears likely to fail, to satisfy the *threshold conditions* relating to one or more, or all, of its *regulated activities*, because for instance:
 - (a) the *firm's* material and financial resources appear inadequate for the scale or type of *regulated activity* it is carrying on; or
 - (b) the *firm* appears not to be a fit and proper *person* to carry on a *regulated activity* because:
 - (i) it has not conducted its business in compliance with high standards which may include putting itself at risk of being used for the purposes of *financial crime* or being otherwise involved in such crime
 - (ii) it has not been managed competently and prudently and has not exercised due skill, care, and diligence in carrying on one or more, or all, of its *regulated activities*;

- (iii) it has breached requirements imposed on it by or under the *Act* (including the *Principles* and the *rules*) and the breaches are material in number or in individual seriousness;
- (2) under Case C (see *ENF 3.3.2G(3)*), it appears that the interests of *consumers* are at risk because the *firm* appears to have breached any of *Principles 6 to 10* (see *PRIN 2.1.1R*) to such an extent that it is desirable that *limitations, restrictions, or prohibitions* are placed on the *firm's regulated activity*.

The FSA's approach in urgent cases

3.5.9

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Under section 53(2) of the *Act* (Exercise of own-initiative power: procedure) the *FSA* may exercise its *own-initiative power* so that a variation of *permission* takes effect:

- (1) immediately under section 53(2)(a); or
- (2) on a specified date under section 53(2)(b); or
- (3) when the matter is no longer *open to review* under section 53(2)(c).

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If the *FSA* decides to impose the variation so that it takes effect immediately or on a specified date, it must state so in the *supervisory notice* that it is required to give to the *firm* concerned (see *DEC 3*). Under section 53(3) the *FSA* may only do this if it reasonably considers it necessary for the variation to take effect immediately (or on the date specified), having regard to the ground on which it is exercising its *own-initiative power*.

3.5.11

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The *FSA* will consider exercising its *own-initiative power* as a matter of urgency under section 53 of the *Act* where:

- (1) the information available to it indicates serious concerns about the *firm* or its business that need to be addressed immediately; and
- (2) circumstances indicate that it is appropriate to use statutory powers immediately to require and/or prohibit certain actions by the *firm* in order to ensure the *firm* addresses these concerns.

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It is not possible to provide an exhaustive list of the situations that will give rise to such serious concerns, but they are likely to include one or more of the following characteristics:

- (1) information indicating significant loss, risk of loss or other adverse effects for *consumers*, where action is necessary to protect their interests;
- (2) information indicating that a *firm's* conduct has put it at risk of being used for the purposes of *financial crime*, or of being otherwise involved in crime;
- (3) evidence that the *firm* has submitted to the *FSA* inaccurate or misleading information so that the *FSA* becomes seriously concerned about the *firm's* ability to meet its regulatory obligations;
- (4) Circumstances suggesting a serious problem within a *firm* or with a *firm's controllers* that calls into question the *firm's* ability to continue to meet the *threshold conditions*.

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Whether the urgent exercise of the FSA's *own-initiative power* is an appropriate response to serious concerns of this kind will depend on a number of factors. Set out below is a list of factors the FSA may consider. The list is not exhaustive. The FSA will consider the full circumstances of each case when it decides whether urgent variation of *Part IV permission* is needed:

- (1) the extent of any loss, or risk of loss, or other adverse effect on *consumers*.

The more serious the loss or potential loss or other adverse effect, the more likely it is that the FSA's urgent exercise of *own-initiative powers* will be appropriate, to protect the *consumers'* interests.

- (2) the extent to which *customer* assets appear to be at risk.

Urgent exercise of the FSA's *own-initiative power* may be appropriate where the information available to the FSA suggests that *customer* assets held by, or to the order of, the *firm* may be at risk.

- (3) the nature and extent of any false or inaccurate information provided by the *firm*.

Whether false or inaccurate information warrants the FSA's urgent exercise of its *own-initiative powers* will depend on matters such as:

- (a) the impact of the information on the FSA's view of the *firm's* compliance with the regulatory requirements to which it is subject, the *firm's* suitability to conduct *regulated activities*, or the likelihood that the *firm's* business may be being used in connection with *financial crime*;
- (b) whether the information appears to have been provided in an attempt knowingly to mislead the FSA, rather than through inadvertence;
- (c) whether the matters to which false or inaccurate information relates indicate there is a risk to *customer* assets or to the other interests of the *firm's* actual or potential *customers*.

- (4) the seriousness of any suspected breach of the requirements of the legislation or the *rules* and the steps that need to be taken to correct that breach.

- (5) the financial resources of the *firm*.

Serious concerns may arise where it appears the *firm* may be required to pay significant amounts of compensation to *consumers*. In those cases, the extent to which the *firm* has the financial resources to do so will affect the FSA's decision about whether exercise of the FSA's *own-initiative power* is appropriate to preserve the *firm's* assets, in the interests of the *consumers*. The FSA will take account of any insurance cover held by the *firm*. It will also consider the likelihood of the *firm's* assets being dissipated without the FSA's intervention, and whether the exercise of the FSA's power to petition for the winding up of the *firm* is more appropriate than the use of its *own-initiative power* (see ENF 10).

- (6) the risk that the *firm's* business may be used or has been used to facilitate *financial crime*, including *money laundering*.

The information available to the FSA, including information supplied by other law enforcement agencies, may suggest the *firm* is being used for, or is itself involved in, *financial crime*. Where this appears to be the case, and the *firm*

appears to be failing to meet the *threshold conditions* or has put its *customers'* interests at risk, the *FSA's* urgent use of its *own-initiative powers* may well be appropriate.

- (7) the risk that the *firm's* conduct or business presents to the *financial system* and to confidence in the *financial system*.
- (8) the *firm's* conduct.

The *FSA* will take into account:

- (a) whether the *firm* identified the issue (and if so whether this was by chance or as a result of the *firm's* normal *controls* and monitoring);
 - (b) whether the *firm* brought the issue promptly to the *FSA's* attention;
 - (c) the *firm's* past history, management ethos and compliance culture;
 - (d) steps that the *firm* has taken or is taking to address the issue.
- (9) the impact that use of the *FSA's own-initiative powers* will have on the *firm's* business and on its *customers*.

The *FSA* will take into account the (sometimes significant) impact that a variation of *permission* may have on a *firm's* business and on its *customers'* interests, including the effect of variation on the *firm's* reputation and on market confidence. The *FSA* will need to be satisfied that the impact of any use of the *own-initiative power* is likely to be proportionate to the concerns being addressed, in the context of the overall aim of achieving its *regulatory objectives*.

The FSA's approach in support of overseas regulators

- 3.5.14 G_{/1} Section 47 empowers the *FSA* to vary, or alternatively to cancel, a *firm's Part IV permission*, in support of an *overseas regulator*. The same statutory grounds apply to the exercise of both powers (see *ENF* 3.3.3G). In both cases, the *FSA* may exercise the power at the request, or for the purpose of assisting a regulator who is:
 - (1) outside the *United Kingdom*; and
 - (2) of a kind prescribed in regulations to be made by the Treasury.
- 3.5.15 G_{/1} Sections 47(3), (4) and (5) set out matters the *FSA* may, or must, take into account when it considers whether to exercise the powers (see *ENF* 3.3.5G to *ENF* 3.3.7G).
- 3.5.16 G_{/1} In certain circumstances, in support of an *overseas regulator*, the *FSA* may need to consider whether to seek to vary a *firm's Part IV permission*, or to cancel it. Circumstances in which the *FSA* may consider varying or cancelling a *firm's Part IV permission* in support of an *overseas regulator* are set out in *ENF* 3.4.6G.
- 3.5.17 G_{/1} As with *cancellation* of *Part IV permission*, the circumstances in which the *FSA* may consider varying a *firm's Part IV permission* in support of an *overseas regulator*, depend on whether the *FSA* is required to consider exercising the power in order to comply with a Community obligation.

- 3.5.18** G_{/1} Under section 47(3), if a relevant *overseas regulator* acting under prescribed provisions has made a request to the *FSA* for the exercise of its *own-initiative power*, the *FSA* must consider whether it must exercise the power in order to comply with a Community obligation.
- 3.5.19** G_{/1} Some relevant Community obligations which the *FSA* may need to consider are those under the following Directives:
- (1) The Banking Directive EC 2000/12/EC;
 - (2) The *Insurance Directives*;
 - (3) The *Investment Services Directive*.
- 3.5.20** G_{/1} Each of these Directives imposes general obligations on the relevant *EEA competent authorities* to cooperate and collaborate closely in discharging their functions under Directives relating to the *authorisation* and supervision of *credit institutions, insurance undertakings* and *investment firms*.
- 3.5.21** G_{/1} The *FSA* views this cooperation and collaboration as essential to effective regulation of the international market in financial services. It will therefore exercise its *own-initiative power* wherever:
- (1) an *EEA Competent authority* requests it to do so; and
 - (2) it is satisfied that the use of the power is appropriate (having regard to the considerations set out at *ENF 3.5.2G* to *ENF 3.5.8G*) to enforce effectively the regulatory *requirements* imposed under the *Single Market Directives* or other Community obligations.
- 3.5.22** G_{/1} The *FSA* will actively consider any other requests for assistance from relevant *overseas regulators* (that is requests in relation to which it is not obliged to *Act* under a Community obligation). Section 47(4) applies in these circumstances. It sets out matters the *FSA* may take into account when it decides whether to vary or cancel a *firm's Part IV permission* in support of the *overseas regulator* (see *ENF 3.3.6G*).
- 3.5.23** G_{/1} Where section 47(4) applies and the *FSA* is considering whether to vary a *firm's Part IV permission*, it may take account of all the factors described in *ENF 3.5.14* to *ENF 3.5.22*, but may give particular weight to:
- (1) The matters set out in paragraphs (c) and (d) of section 47(4) (seriousness, importance to *persons* in the *United Kingdom*, and the public interest); and
 - (2) any specific request made to it by the *overseas regulator* to vary, rather than cancel, the *firm's Part IV permission*.
- 3.5.24** G_{/1} The *FSA* will give careful consideration to whether the relevant authority's concerns would provide grounds for the *FSA* to exercise its *own-initiative power* if they related to a *UK firm*. It is not necessary for the *FSA* to be satisfied that the overseas provisions being enforced mirror precisely those which apply to *UK firms*. However, the *FSA* will not assist in the enforcement of regulatory *requirements* or other provisions that appear to extend significantly beyond the purposes of *UK regulatory provisions*.
- 3.5.25** G_{/1} Similarly, the *FSA* will not need to be satisfied that precisely the same assistance would be provided to the *United Kingdom* in precisely the same situation. However, it will wish to be confident that the relevant authorities in the

jurisdiction concerned would have powers available to them to provide broadly similar assistance in aid of UK authorities, and would be willing properly to consider exercising those powers.

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Under section 47(5), the FSA may decide not to exercise its *own-initiative power*, in response to a request, unless the regulator concerned undertakes to make whatever contribution towards the cost of its exercise the FSA considers appropriate.

Additional considerations

3.5.27

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Under section 49 of the Act (*Persons connected with an applicant*), when it decides whether to vary a *Part IV permission* the FSA may have regard to any *person* appearing to it to be in a relevant relationship with a *firm*. Where the FSA is considering varying the *Part IV permission* of a *firm* that is connected to an *EEA firm*, it must consult the *EEA firm's Home State regulator*. A *firm* is connected with an *EEA firm* if:

- (1) it is a *subsidiary undertaking* of the *EEA firm*; or
- (2) the *firm* and the *EEA firm* are *subsidiary undertakings* of the same *parent undertaking*.

3.5.28

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Section 50 of the Act (FSA's duty to consider other permissions etc) applies where the *firm* is an *EEA firm*, a *Treaty firm* or a *firm* authorised as a result of paragraph 1(1) of Schedule 5 (*Persons Concerned in Collective Investment Schemes*), which has an additional *Part IV permission*. Under section 50(2), if the FSA is considering whether, and if so how, to exercise its *own-initiative power* in relation to the *firm's* additional *Part IV permission* it must take into account:

- (1) the *Home State authorisation* of the *firm* concerned;
- (2) any relevant directive; and
- (3) relevant provisions of the *Treaty*.



3.6 Statutory procedure and the FSA's decision-making processes

3.6.1

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When the FSA uses, or proposes to use, its *own-initiative power* to vary a firm's *Part IV permission*, it is required to follow the supervisory procedure set out in section 53 of the Act (*Exercise of own-initiative power: procedure*). DEC 3 (Statutory notice procedure: Supervisory notice procedure) sets out this procedure in detail and describes the content of the notices that the FSA is required to give to the firm concerned. DEC 4 (The decision maker) deals with decision making by the RDC (by full or modified procedure) in cases where the variation would make a fundamental change to the nature of the firm's *Part IV permission* and with decision-making by *executive procedures* in other cases of own-initiative variations of *Part IV permission*.



3.7 Publicity

3.7.1

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The FSA has a duty under section 391(5) of the *Act* (Publication) to publish such information about *supervisory notices* (including those which relate to variations of *Part IV permission* and those which relate to intervention against *incoming firms*) as it considers appropriate. However, the FSA is prohibited from publishing information which would, in its opinion, be:

- (1) unfair to the *person* against whom the decision is made; or
- (2) prejudicial to the interests of *consumers*.

3.7.2

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The FSA also has a duty to maintain a public record containing information about *firms*. The FSA must include on the public record:

- (1) such information as it considers appropriate which may include information about a variation of *Part IV permission* (or intervention);
- (2) information about the services which the *firm* holds itself out to provide; and
- (3) any address known to the FSA at which a notice or document may be served on the firm.

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The FSA will consider the question of publicity on a case-by-case basis and will adopt a differentiated approach depending on the nature of the action taken and the circumstances of the case

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Where the FSA is using its *own-initiative power* in support of its supervisory function, and the variation does not bring about a fundamental change in the *firm's Part IV permission* (see DEC 4.1.5G), the FSA will not normally publish the *supervisory notice*, where this would disclose confidential information about the individual *firm* or would prejudice *consumers'* interests.

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However, the publication of fundamental variations of *Part IV permission* (and interventions), and the maintenance of an accurate public record, are important elements of the FSA's approach to its *consumer* protection objective. The FSA will always aim to balance both the interests of *consumers* and the possibility of unfairness to the *person* subject to the FSA's action. The FSA will publish, and include in the public record, relevant details of fundamental variations of *Part IV permission* and interventions imposed on *firms*, but will use its discretion not to do so if it considers this would best serve the interests of the *firm's* existing *customers*.

Chapter 4.

Intervention against incoming firms

4.



4.1 Application and purpose

Application

4.1.1

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This chapter applies to *incoming firms*. An *incoming firm* is:

- (1) an *EEA firm*; or
- (2) a *Treaty firm*;

which is exercising, or has exercised, its right to carry on a *regulated activity* in the *United Kingdom* under Schedule 3 (*EEA passport rights*) or Schedule 4 (*Treaty rights*) to the *Act*.

Purpose

4.1.2

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The chapter contains a statement of the *FSA*'s policy on how it will use its power to intervene against *incoming firms* under section 196 of the *Act*. It outlines:

- (1) the *FSA*'s power to intervene against *incoming firms* under section 196 of the *Act* (*The power of intervention*);
- (2) the grounds for exercising that power (both generally and in support of *overseas regulators*); and
- (3) the *FSA*'s policy on the exercise of that power.

4.1.3

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The *FSA* has related powers to impose *limitations* and *requirements* on *firms* that have *Part IV permission*, and *ENF 3* (Variation of *permission* on the *FSA*'s own initiative) contains a statement of the *FSA*'s policy on how it will use those powers. This chapter refers where appropriate to the policy in *ENF 3*.



4.2 The FSA's power to intervene against incoming firms

4.2.1

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The FSA's power to intervene against *incoming firms*, and the grounds for exercising that power, are contained in sections 194 to 196 of the *Act*. Section 196 (The power of intervention) identifies the types of *requirements* the FSA may impose when it exercises its *power of intervention* against an *incoming firm*. Section 195 (Exercise of power in support of overseas regulator) gives the FSA power to intervene against an *incoming firm* in support of an *overseas regulator* and section 194 (General grounds on which power of intervention is exercisable) relates to all other circumstances.

Requirements that the FSA may impose on incoming firms

4.2.2

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Under section 196, where the FSA is entitled to exercise its *power of intervention* in respect of an *incoming firm*, it may impose any *requirement* on the *firm* which it could impose if:

- (1) the *firm's permission* was a *Part IV permission*; and
- (2) the FSA was entitled to exercise its power under that Part to vary that *permission*.

4.2.3

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Paragraphs *ENF 3.2.8G* to *ENF 3.2.10G* explain and provide examples of the *requirements* the FSA may impose when it exercises its power to vary *permission*.

4.3 Grounds for exercising the power of intervention against incoming firms

4.3.1 **G**_{/1} Section 194 of the *Act* (General grounds on which power of intervention is exercisable) sets out the general grounds on which the *FSA* may exercise its *power of intervention*. Section 195 (Exercise of power in support of overseas regulator) relates to the exercise of the power on behalf of an *overseas regulator*.

General grounds for exercising the power against incoming firms

4.3.2 **G**_{/1} Under section 194(1) the *FSA* may exercise the *power of intervention* if it appears to it that:

- (1) an *incoming firm* has contravened, or is likely to contravene, a requirement which is imposed on it by or under the *Act* (in a case where the *FSA* is responsible for enforcing compliance in the *United Kingdom*); or
- (2) an *incoming firm* has, in purported compliance with any requirement imposed by or under the *Act*, knowingly or recklessly given the *FSA* information which is false or misleading in a material particular; or
- (3) it is desirable to exercise the power in order to protect the interests of actual or potential *customers* in relation to a *regulated activity* carried on by the *firm*.

4.3.3 **G**_{/1} Under section 194(3) the *FSA* may exercise the power if it receives certain information from the Director General of Fair Trading. Section 194(3) applies to an *incoming EEA firm* that is either:

- (1) an *investment firm* which is authorised in another Member State by its *Home State regulator*; or
- (2) a *credit institution* which is authorised in another Member State by its *Home State regulator*;

exercising an *EEA right* to carry on Consumer Credit Act business in the *United Kingdom* (see section 194(2) and paragraph 5(a) and (b) of Schedule 3 to the *Act* (*EEA Passport Rights*)).

4.3.4 **G**_{/1} Section 194(3) permits the *FSA* to exercise its *power of intervention* in respect of the *incoming firm* if the Director General of Fair Trading has informed the *FSA* that:

- (1) the *firm* concerned; or
- (2) any of the *firm's employees*, agents or *associates* (whether past or present); or

- (3) if the *firm* is a *body corporate*, a *controller* of the *authorised person* or an *associate* of such a *controller*;

has done any of the things specified in paragraphs (a) to (d) of section 25(2) of the Consumer Credit Act 1974, that is has:

- (a) committed any offence involving fraud or other dishonesty, or violence; or
- (b) Contravened any provision made by or under that *Act*, or by or under any other enactment regulating the provision of *credit* to individuals or other *transactions* with individuals; or
- (c) practised discrimination on grounds of sex, colour, race or ethnic or national origins in, or in connection with, the carrying on of any business; or
- (d) engaged in business practices appearing to the Director to be deceitful or oppressive, or otherwise unfair or improper (whether lawful or not).

Grounds for exercising the power on behalf of an overseas regulator

4.3.5

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- (1) Under section 195(1) of the *Act* (Exercise of power in support of overseas regulator), the *FSA* may exercise its *power of intervention* in respect of an *incoming firm* at the request of an *overseas regulator*.
- (2) Paragraph (1) applies whether or not the *FSA's power of intervention* is also exercisable as a result of section 194 (see *ENF 4.3.2G* to *ENF 4.3.4G*).
- (3) If:
 - (a) a *Home State regulator* in pursuance of a Community obligation has made a request to the *FSA* for the exercise of the power; or
 - (b) a *Home State regulator* has notified the *FSA* that it has withdrawn an *EEA firm's EEA authorisation*;

then, when the *FSA* decides whether to exercise its *power of intervention*, it must consider whether it is necessary to exercise the power in order to comply with a Community obligation (see *ENF 3.5.19G* for examples of relevant Community obligations).
- (4) When the *FSA* decides in any case that the exercise of its power is not necessary to comply with a Community obligation, it may take into account, in particular, the factors that are set out in *ENF 3.3.6G*.

4.4 The FSA's policy on exercising its power of intervention against incoming forms

4.4.1

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The FSA's *power of intervention* and its *own-initiative power* to vary *permission* are similar in that:

- (1) in both cases the FSA may impose *requirements* on *firms* (see ENF 3.2.8G to ENF 3.2.10G and ENF 4.2.2G);
- (2) in both cases the power may be exercised on similar grounds (see ENF 3.3.2G(3) and ENF 4.3.2G(3));
- (3) the statutory procedure and the FSA's decision making processes are similar (although there are additional procedures for the FSA to follow in certain cases where the FSA intervenes against *EEA firms*) (see ENF 3.6 and ENF 4.5);
- (4) In both cases, the FSA may exercise its power so that the action takes effect immediately, or on a specified date, or when the matter is no longer *open to review* (see section 197(1) of the Act (Procedure on exercise of power of intervention) in relation to the FSA's *power of intervention*); and
- (5) In both cases, the FSA may only state that the action will have effect immediately, or on a specified date, if the FSA reasonably considers that it is necessary for the action to take effect immediately or on that specified date, having regard to the ground on which it is exercising its power (see section 197(2) of the Act in relation to *requirements* imposed by *power of intervention*).

4.4.2

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The FSA will adopt a similar approach to the exercise of its *power of intervention* as it does to its *own-initiative powers* to vary *permission*, but with suitable modification for the differences in the statutory grounds for exercising the powers (for example, see ENF 4.3.4G). Consequently the factors and considerations set out in ENF 3.5.2G to ENF 3.5.28G are also likely to be relevant when the FSA is considering regulatory concerns about *incoming firms*.

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The FSA will seek, and take account of, the views of the *firm's Home State regulator* when it is considering action against an *incoming firm*.



4.5 Statutory procedure and FSA's decision making processes

Section 197 procedure and additional and supplemental procedures

4.5.1 G_{/1} When the FSA uses, or proposes to use, its *power of intervention* to impose a *requirement* on an *incoming firm*, it is required to follow the *supervisory notice* procedure contained in section 197 of the *Act* (*Procedure on exercise of power of intervention*). *DEC 3* (Statutory notice procedure: Supervisory notice procedure) sets out this procedure in detail and describes the content of the notices that the FSA is required to give to the *firm* concerned. *DEC 4* (The decision maker) also deals with decision making by the RDC (by full or modified procedure) in cases where the *requirement* on the *incoming firm* would have an effect equivalent to a fundamental change to the nature of a *firm's Part IV permission*; and with decision making by *executive procedures* in other intervention cases against *incoming firms*.

4.5.2 G_{/1} In addition, in certain cases relating to *EEA firms*, the FSA is required to follow the additional procedure contained in section 199 of the *Act* (*Additional procedure for EEA firms in certain cases*). Details of this procedure are set out in *ENF 4.5.4G* to *ENF 4.5.7G*.

4.5.3 G_{/1} Section 200 of the *Act* (Rescission and variation of requirements) contains supplemental procedure that the FSA must follow when it is considering rescinding or varying those *requirements* that it has imposed on an incoming firm by exercise of the *power of intervention*. Details of this procedure are set out in *ENF 4.5.8G* to *ENF 4.5.10G*.

Section 199 additional procedure for EEA firms in certain cases

4.5.4 G_{/1} The additional procedure in section 199 applies where it appears to the FSA that its *power of intervention* is exercisable:

- (1) in relation to an *incoming EEA firm*; and
- (2) in respect of the contravention of a relevant requirement.

4.5.5 G_{/1} A requirement is relevant if:

- (1) it is imposed by the FSA under the *Act*; and
- (2) With respect to its contravention, any of the *Single Market Directives* provides that a procedure of the following kind applies:

- (a) the FSA must, in writing, require the *firm* to remedy the situation;

- (b) if the *firm* fails to comply with that requirement within a reasonable time, the *FSA* must inform the *firm's Home State regulator* of this and request it to:
 - (i) take all appropriate measures to remedy the situation; and
 - (ii) inform the *FSA* of the measures it proposes to take, or has taken, or the reasons why it has not taken or will not take such measures.

4.5.6 G_{/1} Examples of relevant requirements are the requirements contained in *COB*. All of the chapters of *COB* apply to *incoming EEA firms* except *COB* 9 (Client asset rules).

4.5.7 G_{/1} The additional procedure also differs between urgent and other cases, as follows.

- (1) Except as mentioned in (2) the *FSA* may not exercise its *power of intervention* in these cases, unless it is satisfied that:
 - (a) the *firm's Home State regulator* has failed or refused to take appropriate measures to remedy the situation; or
 - (b) the measures taken by the *Home State regulator* have proved inadequate for that purpose.
- (2) If the *FSA* decides it should, as a matter of urgency, exercise its *power of intervention* to protect the interests of *consumers*, it may exercise the power:
 - (a) before complying with the procedure described in *ENF* 4.5.5G(2); or
 - (b) Where it has complied with that procedure, before it is satisfied as mentioned in (1).
- (3) If it exercises its *power of intervention* in this way, as a matter of urgency the *FSA* must, at the earliest opportunity, inform the *firm's Home State regulator* and the *European Commission*. If the *Commission* decides, under any of the *Single Market Directives*, that the *FSA* must rescind or vary any *requirement* imposed by it in this way, the *FSA* must do so.

Section 200 procedure for rescission and variation of requirements

4.5.8 G_{/1} Under section 200 of the *Act (Rescission and variation of requirements)*, the *FSA* may rescind or vary a *requirement* it imposed when exercising its *power of intervention*, either on its own initiative or on the application of the *person* subject to the *requirement*.

4.5.9 G_{/1} The following procedure applies where the *FSA* on its own initiative rescinds or varies an existing *requirement*.

- (1) The *FSA* may rescind a *requirement* on its own initiative by giving written notice to the *person* concerned. The rescission or variation takes effect on the date specified in the notice.
- (2) The *FSA* may vary a *requirement* on its own initiative by giving a *supervisory notice* to the *person* concerned and following the procedure in section 197 of the *Act* (see *ENF* 4.5.1G and *DEC* 3 (*Statutory notice procedure: Supervisory notice procedure*)).

4.5.10

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The following procedure applies where the *FSA* proposes to refuse an application to rescind or vary an existing *requirement*.

- (1) If the *FSA* proposes to refuse the application, it must give the applicant a *warning notice*.
- (2) If the *FSA* decides to refuse the application:
 - (a) it must give the applicant a *decision notice*;
 - (b) the *firm* may refer the matter to the *Tribunal*.

4.5.11

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DEC 2 (Statutory notice procedure: warning notice and decision notice procedure) contains a detailed statement of the *FSA*'s procedure for deciding whether to give *warning notices* and *decision notices*.

4.

Chapter 5

Cancellation of Part IV permission on the FSA's own initiative



5.1 Application and purpose

Application

5.1.1

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This chapter applies to all *firms* that have a *Part IV permission*.

Purpose

5.1.2

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The chapter contains a statement of the *FSA's* policy on how it will use its *own-initiative power* to cancel a *firm's Part IV permission*. The *FSA* has related powers to vary a *Part IV permission* on its own-initiative and to intervene against *incoming firms*. These powers are dealt with in *ENF 3* (Variation of Part IV permission on the *FSA's* own initiative) and *ENF 4* (Intervention against incoming firms).



5.2 Introduction

5.2.1

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The chapter outlines:

- (1) the *FSA's own-initiative power* to cancel *Part IV permission* under sections 45 (Variation etc on the FSA's own initiative) and 47 (Exercise of power in support of overseas regulator) of the *Act* and its duty to withdraw *authorisation* under section 33 (Withdrawal of authorisation by the FSA);
- (2) the procedure for exercising those powers; and
- (3) the *FSA's* policy in relation to the exercise of those powers.

5.2.2

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The statement of policy in this chapter applies to circumstances where the *FSA* is considering using its *own-initiative power* to cancel a *firm's Part IV permission* (and subsequently to withdraw *authorisation*). The *FSA* also has power under section 44 of the *Act* (Variation etc at the request of authorised person) to cancel a *Part IV permission* at the request of a *firm*. *SUP 6* (Applications to vary and cancel Part IV permission) contains a statement of the *FSA's* policy in relation to that power. In this chapter cancellation of *Part IV permission* means cancellation of *Part IV permission* on the *FSA's* own initiative.



5.3 The FSA's powers to cancel Part IV permission and withdraw authorisation

- 5.3.1** G_{/1} The FSA's *own-initiative power* to cancel *Part IV permission* is contained in section 45 of the *Act (Variation etc on the FSA's own initiative)*. Section 45 also sets out the general grounds for exercising the power. Section 47 (Exercise of power in support of overseas regulator) sets out the grounds for exercising the power on behalf of an *overseas regulator*.
- 5.3.2** G_{/1} Section 45 of the *Act* empowers the FSA to vary, or alternatively to cancel, a *firm's Part IV permission*. The general statutory grounds for exercising those powers are the same. They are set out in section 45(1) Cases A to C (see *ENF 3.3.2G*). The FSA also has a duty to cancel a *firm's Part IV permission* when it has varied a *firm's Part IV permission* to such an extent that there are no longer any *regulated activities* for which the *firm* has a *Part IV permission*.
- 5.3.3** G_{/1} Under section 47(1) of the *Act*, the FSA may exercise its *own-initiative power* to cancel a *Part IV permission* at the request of, or for the purpose of *assisting*, a regulator who is:
- (1) outside the *United Kingdom*; and
 - (2) of a kind prescribed in regulations made by the Treasury.
- 5.3.4** G_{/1} Section 47(1) applies whether or not the FSA has powers which it can exercise in relation to the *firm* under any provision of Part XIII of the *Act*, (*Incoming firms: Intervention by FSA*) (see *ENF 4*). The detailed provisions of section 47 are set out in *ENF 3.3.3G* to *ENF 3.3.7G*



5.4 Procedure

- 5.4.1** **G**_{/1} When it proposes to cancel the *Part IV permission* of a *firm* under sections 45 (Variation etc on the FSA's own initiative) or 47 (Exercise of power in support of overseas regulator) of the *Act*, the *FSA* is required to follow the statutory procedure set out in section 54 of the *Act* (*Cancellation of Part IV permission: procedure*).
- 5.4.2** **G**_{/1} Under section 54(1), if the *FSA* proposes to cancel a *firm's Part IV permission* otherwise than at the *firm's* request, it must give the *firm* a *warning notice*, and under section 54(2), if it then decides to cancel the *firm's Part IV permission*, it must give the *firm* a *decision notice*.
- 5.4.3** **G**_{/1} *DEC 2* (Statutory notice procedure: warning notice and decision notice procedure) and *DEC 4* (The decision maker) contain a detailed statement of the *FSA's* procedure for deciding whether to issue *warning notices* and *decision notices*.



5.5 The FSA's policy for exercising its power to cancel Part IV permission

- 5.5.1** **G**_{/1} The FSA will consider cancelling a *firm's Part IV permission* in two main circumstances:
- (1) where the FSA has very serious concerns about a *firm*, or the way its business is or has been conducted;
 - (2) where the *firm's regulated activities* have come to an end and it has not applied for *cancellation* of its *Part IV permission*
- 5.5.2** **G**_{/1} Examples of these circumstances are set out in ENF 3.3.2G.
- 5.5.3** **G**_{/1} The FSA's *own-initiative powers* to vary and to cancel *Part IV permission* are similar to each other. The FSA may exercise the powers on the same grounds (see ENF 5.3.2G) and where appropriate the FSA may impose a variation of *Part IV permission* which, by removing all *regulated activities* from the *Part IV permission*, has a similar effect to cancelling it. However the statutory procedure is different and this may determine how the FSA acts in any particular case. Of greater significance, however, the FSA may impose a variation of *Part IV permission* either with immediate effect, or on a date specified by it (see ENF 3.5.9G). In contrast a cancellation of *Part IV permission* only becomes effective on completion of the statutory procedure, or subsequent referral to the *Tribunal*, or completion of the appeal process.
- 5.5.4** **G**_{/1} Depending on the circumstances, the FSA may need to consider whether it should first use its *own-initiative powers* to vary a *firm's Part IV permission* before going on to cancel it. Circumstances in which the FSA will consider using its *own-initiative power* to vary a *firm's Part IV permission* are set out in ENF 3.5. Amongst other circumstances, the FSA may use this power where it considers it needs to take immediate action against a *firm* because of the urgency and seriousness of the situation (see in particular ENF 3.5.9G to ENF 3.5.11G).
- 5.5.5** **G**_{/1} Where the situation appears so urgent and serious that the *firm* should immediately cease to carry on all *regulated activities*, the FSA may first vary the *firm's Part IV permission* so that there is no longer any *regulated activity* for which the *firm* has a *Part IV permission*. If it does this, the FSA will then have a duty to cancel the *firm's Part IV permission* - once it is satisfied that it is no longer necessary to keep the *Part IV permission* in force (see ENF 5.3.3G(2)).
- 5.5.6** **G**_{/1} However, where the FSA has cancelled a *firm's Part IV permission*, it is required to go on to give a direction withdrawing the *firm's authorisation* (see ENF 5.3.2G). Accordingly, the FSA may decide to keep a *firm's Part IV permission* in force to maintain the *firm's* status as an *authorised person* and enable it (the FSA) to monitor the *firm's* activities. For example, where the FSA needs to supervise an orderly winding down of the *firm's* regulated business (see SUP 6.4.22G (When will the FSA grant an application for cancellation of permission)). Alternatively,

the FSA may decide to keep a *firm's Part IV permission* in force to maintain the firm's status as an *authorised person* to use administrative enforcement powers against the *firm*. For example, where the FSA proposes to impose a financial penalty on the *firm* under section 206 of the *Act* (Financial penalties) (see ENF 13).

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The circumstances in which the FSA may consider cancelling a *firm's Part IV permission* in support of an *overseas regulator* depend on whether or not the FSA is required to consider exercising the power in order to comply with a Community obligation. The FSA will consider the factors set out in ENF 3.5.14G to ENF 3.5.26G in relation to variation of *Part IV permission* and any specific request made to it by the *overseas regulator* to cancel, rather than vary, the *firm's Part IV permission*.

Chapter 6.

Injunctions

6.

6.1 Application and purpose

Application

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This chapter applies to *firms*, *approved persons*, and other *persons*, whether or not they are regulated by the *FSA*.

Purpose

6.1.2

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This chapter explains the *FSA*'s powers to apply to court for *injunctions* and gives *guidance* on how the *FSA* intends to use these powers. The *FSA*'s effective use of these powers will help it work towards its *regulatory objectives* of protecting *consumers*, maintaining confidence in the *financial system* and reducing *financial crime*.

6.2 Introduction

- 6.2.1** G_{/1} This chapter contains *guidance* on the use of the *FSA*'s powers under the *Act* to apply to court for orders:
- (1) in relation to the contravention of a relevant requirement (section 380 of the *Act* (Injunctions));
 - (2) in cases of *market abuse* (section 381 of the *Act* (Injunctions *in cases of market abuse*)); and
 - (3) at the request of the *Home State regulator* of an *incoming EEA firm* (section 198 of the *Act* (Power to apply to court for injunction in respect of certain overseas insurance companies)).
- 6.2.2** G_{/1} It also gives *guidance* on the circumstances in which the *FSA* may ask the court to exercise its inherent jurisdiction to grant an asset-freezing order.
- 6.2.3** G_{/1} *ENF* 6.9 to *ENF* 6.10 give *guidance* on the circumstances in which the *FSA* may use its power to apply to court for an order under Regulation 12 of the Unfair Terms in Consumer Contracts Regulations 1999.
- 6.2.4** G_{/1} The orders the court may make following an application by the *FSA* are generally known in England and Wales and Northern Ireland as *injunctions*, and in Scotland as *interdicts*. In this chapter, the word '*injunction*' and the word 'order' also mean '*interdict*'.
- 6.2.5** G_{/1} A *person* who disobeys an *injunction* may be in contempt of court and be liable to imprisonment, to a fine, and/or to have his assets seized.
- 6.2.6** G_{/1} The powers to make these orders are exercised by the High Court, or in Scotland by the Court of Session. When it seeks an order, the *FSA* will also ask the court to order that the *person* who is the subject of the application should pay the *FSA*'s costs.

6.3 Section 380: the power

- 6.3.1** G_{/1} Under section 380 of the *Act* (Injunctions), the *FSA* has power to apply to court for an *injunction* against *persons*, whether *authorised* or not, in connection with a contravention of a 'relevant requirement'. (The Secretary of State for Trade and Industry may also apply for *injunctions* under this section of the *Act*).
- 6.3.2** G_{/1} Sections 380(6)(a) and (7)(a) state that in relation to an application by the *FSA*, 'relevant requirement' means a requirement:
- (1) 'which is imposed by or under the *Act*; or
 - (2) which is imposed by or under any other Act and whose contravention constitutes an offence which the *FSA* has power to prosecute under the *Act* (or in the case of Scotland, which is imposed by or under any other Act and whose contravention constitutes an offence under Part V of the Criminal Justice Act 1993 (*insider dealing*) or under prescribed regulations relating to *money laundering*)'.
- 6.3.3** G_{/1} Sections 380(1), (2) and (3) set out the grounds on which the court may grant an *injunction*.
- 6.3.4** G_{/1}
- (1) Under section 380(1), the *FSA* may apply to court for an *injunction* restraining or prohibiting a contravention of a relevant requirement.
 - (2) Section 380(1) states, 'If, on the application of the *FSA* or the Secretary of State, the court is satisfied:
 - (a) that there is a reasonable likelihood that any *person* will contravene a relevant requirement; or
 - (b) that any *person* has contravened a relevant requirement and that there is a reasonable likelihood that the contravention will continue or be repeated,
 the court may make an order restraining (or in Scotland an *interdict* prohibiting) the contravention.'
- 6.3.5** G_{/1}
- (1) Under section 380(2), the *FSA* may apply to court for an *injunction* directing a *person* to remedy a contravention of a relevant requirement.
 - (2) Section 380(2) states, 'If on the application of the *FSA* or the Secretary of State the court is satisfied:
 - (a) that any *person* has contravened a relevant requirement; and
 - (b) that there are steps which could be taken for remedying the contravention,

the court may make an order requiring that *person*, and any other *person* who appears to have been knowingly concerned in the contravention, to take such steps as the court may direct to remedy it.’

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Under section 380(5), ‘remedying a contravention’ (see *ENF* 6.3.5G) includes mitigating the effect of that contravention.

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(1) Under section 380(3), the *FSA* may apply to court for an *injunction* to secure assets.

(2) Section 380(3) states, ‘If, on the application of the *FSA* or the Secretary of State, the court is satisfied that any *person* may have:

(a) contravened a relevant requirement; or

(b) been knowingly concerned in the contravention of such a requirement,

it may make an order restraining (or in Scotland an *interdict* prohibiting) him from disposing of, or otherwise dealing with, any assets of his which it is satisfied he is reasonably likely to dispose of or otherwise deal with.’

6.4 Section 381: the power

- 6.4.1** **G**_{/1} Under section 381 of the *Act* (Injunctions in cases of market abuse), the *FSA* has power to apply to court for an *injunction* against *persons*, whether *authorised* or not, in cases of *market abuse*. The Secretary of State for Trade and Industry has no power to apply for *injunctions* under this section of the *Act*.
- 6.4.2** **G**_{/1} Sections 381(1), (2), (3) and (4) set out the grounds upon which the court may grant an *injunction*.
- (1) Under section 381(1), the *FSA* may apply to court for an *injunction* restraining or prohibiting *market abuse*.
 - (2) Section 381(1) states, 'If, on the application of the *FSA*, the court is satisfied:
 - (a) that there is a reasonable likelihood that any *person* will engage in *market abuse*; or
 - (b) that any *person* is or has engaged in *market abuse* and that there is a reasonable likelihood that the *market abuse* will continue or be repeated,
 the court may make an order restraining (or in Scotland an *interdict* prohibiting) the *market abuse*.'
- 6.4.3** **G**_{/1} (1) Under section 381(2), the *FSA* may apply to court for an *injunction* requiring a *person* to take steps to remedy *market abuse*.
- (2) Section 381(2) states, 'If on the application of the *FSA* the court is satisfied:
- (a) that any *person* is or has engaged in *market abuse*; and
 - (b) that there are steps which could be taken for remedying the *market abuse*,
- the court may make an order requiring him to take such steps as the court may direct to remedy it.'
- 6.4.4** **G**_{/1} Under section 381(6), 'remedying the *market abuse*' (see *ENF* 6.4.3G) includes mitigating the effect of the *market abuse*.
- 6.4.5** **G**_{/1} Section 381(4) states, 'The court may make an order restraining (or in Scotland an *interdict* prohibiting) the *person* concerned from disposing of, or otherwise dealing with, any assets of his which it is satisfied that he is reasonably likely to dispose of, or otherwise deal with.'
- 6.4.6** **G**_{/1} Section 381(3) states that section 381(4) (see *ENF* 6.4.4G) applies if '.....on the application of the *FSA*, the court is satisfied that any *person* (a) may be engaged in *market abuse*; or (b) may have been engaged in *market abuse*.'



6.5 Asset-freezing injunctions

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As an alternative to applying to the court under section 380(3) (Injunctions) or sections 381(3) and (4) (Injunctions in cases of market abuse) of the *Act*, the *FSA* may ask the court to exercise its inherent jurisdiction to grant a freezing order, restraining a *person* from disposing of, or otherwise dealing with, assets. To succeed in an application for an asset-freezing *injunction* the *FSA* will have to show a good arguable case for the granting of the *injunction*.

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The *FSA* may request the court to exercise its inherent jurisdiction in cases where it has evidence showing that there is a reasonable likelihood that a *person* will contravene a requirement of the *Act* and that the contravention will result in the dissipation of assets belonging to investors. Unlike an application under section 380(3) or 381(3) and (4), the *FSA* will not have to show that a contravention has already occurred or may have already occurred.

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6.6 Section 380 and 381 injunctions: the FSA's policy

6.6.1 G Sections 380 (Injunctions) and 381 (Injunctions in cases of market abuse) of the *Act* enable the court to make three types of order: to restrain a course of conduct, to take steps to remedy a course of conduct and to secure assets (see *ENF* 6.3 and *ENF* 6.4). An application under the court's inherent jurisdiction will enable the court to make an order freezing assets. In certain cases, the *FSA* may seek only one type of order, although in others it may seek several.

6.6.2 G The *FSA* recognises that an application for an *injunction* under sections 380 and/or 381 of the *Act*, or under the court's inherent jurisdiction, will have serious consequences for those concerned. The broad test the *FSA* will apply when it decides whether to seek an *injunction* is whether the application would be the most effective way to deal with the *FSA*'s concerns. In deciding whether an application for an *injunction* is appropriate in a given case, the *FSA* will consider all relevant circumstances and may take into account a wide range of factors. The following list of factors is not exhaustive; not all the factors will be relevant in a particular case and there may be other factors that are relevant.

- (1) The nature and seriousness of a contravention or expected contravention of a relevant requirement (see *ENF* 6.3.2G). The extent of loss, risk of loss, or other adverse effect on *consumers*, including the extent to which *client* assets may be at risk, may be relevant. The seriousness of a contravention or prospective contravention will include considerations of:
 - (a) whether the losses suffered are substantial;
 - (b) whether the numbers of *consumers* who have suffered loss are significant;
 - (c) whether the assets at risk are substantial; and
 - (d) whether the number of *consumers* at risk is significant.
- (2) In cases of *market abuse*, the nature and seriousness of the misconduct or expected misconduct in question. The following may be relevant:
 - (a) the impact or potential impact on the *financial system* of the conduct in question. This would include the extent to which it has resulted in distortion or disruption of the markets, or would be likely to do so if it was allowed to take place or to continue;
 - (b) the extent and nature of any losses or other costs imposed, or likely to be imposed, on other users of the *financial system*, as a result of the misconduct.
- (3) Whether the conduct in question has stopped or is likely to stop and whether steps have been taken or will be taken by the *person* concerned to ensure that

the interests of *consumers* are adequately protected. For example, an application for an *injunction* may be appropriate where the *FSA* has grounds for believing that a contravention of a relevant requirement, *market abuse* or both may continue or be repeated. It is likely to have grounds to believe this where, for example, the *Takeover Panel* has requested that a *person* stop a particular course of conduct and that *person* has not done so.

- (4) Whether there are steps a *person* could take to remedy a contravention of a relevant requirement or *market abuse*. The steps the *FSA* may require a *person* to take will vary according to the circumstances but may include the withdrawal of a misleading *financial promotion* or publishing a correction, writing to *clients* or investors to notify them of *FSA* action, providing financial redress and repatriating funds from an overseas jurisdiction. An application by the *FSA* to the court under section 380(2) or 381(2) for an order requiring a *person* to take such steps may not be appropriate if, for example, that *person* has already taken or proposes to take appropriate remedial steps at his own initiative or under a ruling imposed by another regulatory authority (such as the *Takeover Panel* or a *recognised investment exchange*). If another authority has identified the relevant steps and the *person* concerned has failed to take them, the *FSA* will take this into account and (subject to all other relevant factors and circumstances) may consider it is appropriate to apply for an *injunction*. In those cases the *FSA* may consult with the relevant regulatory authority before applying for an *injunction*.
- (5) Whether there is a danger of assets being dissipated. The main purpose of an application under section 380(3) (see *ENF* 6.3.7G), sections 381(3) and (4) (see *ENF* 6.4.6G) or pursuant to the court's inherent jurisdiction (see *ENF* 6.5), is likely to be to safeguard funds containing *client* assets (ie *client* accounts) and/or funds and other assets from which restitution may be made (see *ENF* 9 (Restitution and redress)). The *FSA* may seek an *injunction* to secure assets while a suspected contravention is being investigated or where it has information suggesting that a contravention is about to take place.
- (6) The costs the *FSA* would incur in applying for and enforcing an *injunction* and the benefits that would result (although the *FSA* may be able to recover those costs: see *ENF* 6.2.6 G). There may be other cases which require the *FSA*'s attention and take a higher priority, due to the nature and seriousness of the breaches concerned. There may, therefore, be occasions on which the *FSA* considers that time and resources should not be diverted from other cases in order to make an application for an *injunction*. These factors reflect the *FSA*'s duty under the *Act* to have regard to the need to use its resources in the most efficient and economic way.
- (7) The disciplinary record and general compliance history of the *person* who is the subject of the possible application. This includes whether the *FSA* (or a *previous regulator*) has taken any previous disciplinary, remedial or protective action against the *person*. It may also be relevant, for example, whether the *person* has previously given any undertakings to the *FSA* (or any *previous regulator*) not to do a particular act or engage in particular *behaviour* and is in breach of those undertakings.
- (8) Whether the conduct in question can be adequately addressed by other disciplinary powers, for example public censure or financial penalties.
- (9) The extent to which another regulatory authority can adequately address the matter. Certain circumstances may give rise not only to possible enforcement action by the *FSA*, but also to action by other regulatory authorities. The *FSA* will examine the circumstances of each case, and consider whether it is

appropriate for the *FSA* to take action to address the relevant concern. In most cases the *FSA* will consult with other relevant regulatory authorities before making an application for an order. The *FSA*'s approach to potential action involving other regulatory authorities is discussed in detail, in the context of discipline of *firms* and *approved persons*, in *ENF* 11.8 (Action involving other regulatory authorities), and in the context of sanctions for *market abuse*, in *ENF* 14.9 (Action involving other UK regulatory authorities).

- (10) Whether there is information to suggest that the *person* who is the subject of the possible application is involved in *financial crime*.
- (11) In any case where the *FSA* is of the opinion that any potential exercise of its powers under section 381 may affect the timetable or the outcome of a *takeover bid*, the *FSA* will consult the *Takeover Panel* before taking any steps to exercise these powers and will give due weight to its views.

6.7 Other relevant powers

- 6.7.1** ^G_{/1} The *FSA* has a range of powers it can use to take remedial, protective and disciplinary action against a *person* who has contravened a relevant requirement or engaged in *market abuse*, as well as its powers to seek *injunctions* under sections 380 (Injunctions) and 381 (Injunctions in cases of market abuse) of the *Act* or the courts' inherent jurisdiction. Where appropriate, the *FSA* may exercise these other powers before, at the same time as, or after it applies for an *injunction* against a *person*.
- 6.7.2** ^G_{/1} When, in relation to *firms*, the *FSA* applies the broad test outlined in *ENF* 6.6.2G, it will consider the relative effectiveness of the other powers available to it, compared with injunctive relief. For example, where the *FSA* has concerns about whether a *firm* will comply with restrictions that the *FSA* could impose by exercising its own initiative powers (see *ENF* 3 (Variation of Part IV permission on the *FSA*'s own initiative)), it may decide it would be more appropriate to seek an *injunction*. This is because breaching any requirement imposed by the court could be punishable for contempt (see *ENF* 6.2.5G). Alternatively, where, for example, the *FSA* has already imposed requirements on a *firm* by exercising its *own-initiative powers* and these requirements have not been met, the *FSA* may seek an *injunction* to enforce those requirements.
- 6.7.3** ^G_{/1} The *FSA*'s *own-initiative powers* do not apply to *unauthorised persons*. This means that an application for an *injunction* is the only power by which the *FSA* may seek directly to prevent *unauthorised persons* from actual or threatened breaches or *market abuse*. The *FSA* will decide whether an application against an *unauthorised person* is appropriate, in accordance with the approach discussed in *ENF* 6.6. The *FSA* may also seek an *injunction* to secure assets where it intends to use its insolvency powers (see *ENF* 10 (Insolvency proceedings and orders against debt avoidance)) against an *unauthorised person*.
- 6.7.4** ^G_{/1} In certain cases, conduct that may be the subject of an *injunction* application will also be an offence which the *FSA* has power to prosecute under the *Act*. In those cases, the *FSA* will consider whether it is appropriate to prosecute the offence in question, as well as applying for *injunctions* under section 380, section 381, or both. *ENF* 15 (Prosecution of criminal offences) sets out the offences the *FSA* has power to prosecute, and the *FSA*'s policy and procedure for prosecution of these offences.
- 6.7.5** ^G_{/1} Where the *FSA* exercises its powers under section 380, section 381 or invokes the court's inherent jurisdiction to obtain an order restraining the disposal of assets, it may also apply to the court for a restitution order for the distribution of those assets. The *FSA*'s policy and procedure in relation to restitution orders is set out in *ENF* 9 (Restitution and redress).

6.8 Section 198

- 6.8.1** G_{/1} Under section 198 of the *Act* (Power to apply to court for injunction in respect of certain overseas insurance companies) the *FSA* has power to apply to court on behalf of the *Home State regulator* of certain *incoming EEA firms* for an *injunction* restraining the *incoming EEA firm* from disposing of, or otherwise dealing with, any of its assets.
- 6.8.2** G_{/1}
- (1) Section 198(1) sets out the circumstances in which the *FSA* may exercise the power referred to in *ENF* 6.8.1G.
 - (2) Section 198(1) states, 'This section applies if the *FSA* has received a request made in respect of an *incoming EEA firm* in accordance with:
 - (a) Article 20.5 of the *First Non-Life Directive*; or
 - (b) Article 24.5 of the *First Life Directive*.'
- 6.8.3** G_{/1} The *FSA*'s power under section 198 is intended to implement article 20.5 of the *First Non-Life Directive*, on general insurance, and article 24.5 of the *First Life Directive*, on long-term insurance. Section 198(1) limits use of the power to where it is in accordance with those articles, which means that it can be exercised only where the *Home State regulator* concerned has asked the *FSA* to prohibit the free disposal of the *incoming EEA firm*'s assets and has confirmed that:
- (1) the *incoming EEA firm* has failed to comply with the requirements of article 15 of the *First Non-Life Directive*, or article 17 of the *First Life Directive*; or
 - (2) the solvency margin of the *incoming EEA firm* has fallen below the minimum required by article 16.3 of the *First Non-Life Directive*, or article 19 of the *First Life Directive*; or
 - (3) the solvency margin of the *incoming EEA firm* has fallen below the guarantee fund as defined in article 17 of the *First Non-Life Directive*, or article 20 of the *First Life Directive*.
- 6.8.4** G_{/1} The *FSA* will therefore consider exercising this power only where a request from a *Home State regulator* satisfies the requirements of section 198(1).



6.9 Injunctions under the Unfair Terms in Consumer Contracts Regulations 1999: the power

- 6.9.1** G_{/1} Regulation 12 of the Unfair Terms in Consumer Contract Regulations 1999 states that:
- (1) The Director General of Fair Trading (the Director) or, subject to paragraph (2), any qualifying body may apply for an *injunction* (including an interim *injunction*) against any *person* appearing to them to be using, or recommending the use of, an unfair term drawn up for general use in contracts concluded with *consumers*.
 - (2) A qualifying body may apply for an *injunction* only where:
 - (a) it has notified the Director of its intentions at least fourteen *days* before applying, beginning with the date on which the notification was given; or
 - (b) the Director consents to the application being made within a shorter period.
- 6.9.2** G_{/1} The court, on an application under this regulation, may grant an *injunction* on such terms as it thinks fit.
- 6.9.3** G_{/1} An *injunction* may relate not only to the use of a particular contract term drawn up for general use but to any similar term, or term having a similar effect, used or recommended for use by any *person*.
- 6.9.4** G_{/1} The *FSA* is a qualifying body for the purposes of Regulation 12 (see *ENF* 6.9.1G).

6.10 Injunctions under the Unfair Terms in Consumer Contracts Regulations 1999: FSA policy

- 6.10.1** G_{/1} The Unfair Terms in Consumer Contracts Regulations 1999 apply, with certain exceptions, to any term which has not been individually negotiated in a contract between a seller or supplier and a consumer. The regulations specify what constitutes an unfair term and state that an unfair term is not binding on the consumer. A 'consumer' is defined for the purposes of the regulations as any natural person who, in contracts covered by the regulations, is acting for purposes which are outside his trade, business or profession.
- 6.10.2** G_{/1} Only the Director and specified qualifying bodies including the FSA have the power to apply to court under Regulation 12 of the Unfair Terms in Consumer Contracts Regulations 1999 for an *injunction* preventing the continued use of an unfair term.
- 6.10.3** G_{/1} The FSA will consider a complaint from a *consumer* that a contract term is unfair only where the seller or supplier is a *firm* and the contract containing the term relates to *regulated activities* carried out by the *firm*.
- 6.10.4** G_{/1} When it considers whether to seek an *injunction* against a *firm* under regulation 12, the FSA may take into account the following factors. The list is not exhaustive: the FSA will have regard to all the circumstances when it decides whether it is appropriate to take any action.
- (1) Whether the FSA is satisfied that the contract term which is the subject of the complaint may properly be regarded as unfair for the purposes of the Unfair Terms in Consumer Contracts Regulations 1999.
 - (2) The extent and nature of the detriment to *consumers* resulting from the term, including the number of *consumers* who appear to the FSA to be suffering detriment. The more serious the detriment and the greater the number of *consumers* affected, the more likely it is that the FSA will consider it appropriate to apply for an *injunction*.
 - (3) Whether the firm has fully cooperated with the FSA in resolving the FSA's concerns about the fairness of the particular contract term. In particular, the FSA may, in deciding whether to seek an *injunction* in respect of what it regards as an unfair term, take into account any undertakings given to it as to the continued use of the term in contracts concluded with *consumers*.
 - (4) The likelihood of success of an application for an *injunction*.
 - (5) The costs the FSA would incur in applying for and enforcing an *injunction* and the benefits that would result from that action. The FSA is more likely to be satisfied that an application is appropriate where an *injunction* would not only prevent the continued use of the particular contract term, but would also be likely to prevent the use or continued use of similar terms, or terms having the

same effect, used or recommended by other *persons* concluding contracts with *consumers*. Generally the *FSA* will have to be satisfied that the use of the power to seek an *injunction* is proportionate to the concern being addressed.

6.11 Publication

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- (1) The *FSA* considers it generally appropriate to publish details of its successful applications to the court for *injunctions*. For example, where the court has ordered an *injunction* to prohibit further illegal activity, it will normally be appropriate to publicise this to inform *consumers* of the position and help them avoid dealing with the *person* who is the subject of the *injunction*. However, there may be circumstances when the *FSA* decides not to publicise, or not to do this immediately. These circumstances might, for example, be where publication could damage confidence in the *financial system* or undermine market integrity in a way that would be prejudicial to the interests of *consumers*.
- (2) Where the *behaviour* to which the *injunction* relates has occurred in the context of a *takeover bid*, the *FSA* will consult the *Takeover Panel* over the timing of publication if the *FSA* believes that publication may affect the timetable or outcome of that bid, and will give due weight to the *Takeover Panel's* views.

Chapter 7.

Withdrawal of approval

7.



7.1 Application and purpose

Application

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This chapter applies to *approved persons* and to *firms*.

Purpose

7.1.2

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The power to withdraw approval from *approved persons* is one of various regulatory tools the *FSA* may use to help it achieve its *regulatory objectives*. The *FSA*'s effective use of this power will help ensure high standards of regulatory conduct by preventing an *approved person* from continuing to perform the *controlled function* to which the approval relates if he is not a fit and proper *person* to perform that function. It will also demonstrate generally to *approved persons* the consequences of failing to comply with appropriate standards of conduct.



7.2 Introduction

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This chapter contains guidance on:

- (1) the *FSA*'s power to withdraw approval from an *approved person*, under section 63 of the *Act* (Withdrawal of approval);
- (2) the procedure for exercising this power;
- (3) the *FSA*'s policy in relation to the exercise of this power;
- (4) other powers that may be relevant when the *FSA* considers the exercise of the power; and
- (5) the effect of the *FSA*'s decision to withdraw approval.

7.3 The FSA's power to withdraw approval

7.3.1 **G**_{/1} Under section 63(1) of the *Act* (Withdrawal of approval), the *FSA* may withdraw an approval given under section 59 of the *Act* (Approval for particular arrangements) if it considers the *person* in respect of whom it was given is not a fit and proper *person* to perform the function to which the approval relates.

7.3.2 **G**_{/1} When considering whether to withdraw its approval, the *FSA* may, under section 63(2), consider any matter which it could take into account if it were considering an application made under section 60 of the *Act* (Applications for approval) in respect of the performance of the function to which the approval relates.

7.3.3 **G**_{/1} Section 61(2) of the *Act* (Determinations of approval) sets out matters to which the *FSA* may have regard in deciding whether a *person* is a fit and proper *person*, for the purposes of an application for approval made under section 60, to perform the function to which the approval relates.

7.3.4 **G**_{/1} Section 61(2) states that the *FSA* may: 'have regard (among other things) to whether the *person*, or any *person* who may perform a function on his behalf:

- (1) has obtained a qualification;
- (2) has undergone, or is undergoing, training; or
- (3) possesses a level of competence,

required by general *rules* in relation to *persons* performing functions of the kind to which the approval relates.'

7.3.5 **G**_{/1} *Rules* and *guidance* contained in the Training and Competence sourcebook (*TC*) apply to certain specific activities that may be carried out by some *approved persons*.



7.4 Procedure

- 7.4.1** G_{/1} Under section 63(3) of the *Act* (Withdrawal of approval), if the *FSA* proposes to withdraw its approval from an *approved person* under its section 63(1) power, it must give each of the *interested parties* a *warning notice*. The *FSA*'s procedures for issuing *warning notices* in this area are those set out in *DEC 2.2* (Warning notice procedure).
- 7.4.2** G_{/1} Under section 63(4), if the *FSA* decides to withdraw its approval, it must give each of the *interested parties* a *decision notice*. The *FSA*'s procedures in relation to *decision notices* in this area are the same as those set out in *DEC 2.3* (Decision notice procedure).
- 7.4.3** G_{/1} If the *FSA* decides to withdraw its approval, each of the *interested parties* may refer the matter to the *Tribunal*. Further information about referrals to the *Tribunal* is set out in *DEC 5.1* (The Tribunal).

7.5 The FSA's policy on withdrawal of approval

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The FSA may withdraw its approval only if it considers that the *person* in respect of whom it was given is not a fit and proper *person* to perform the function to which the approval relates. Where a *person* ceases to perform *controlled functions* for a *firm* for reasons unconnected with his fitness and propriety, the *firm* must notify the FSA through the procedure set out in SUP 10 (Approved persons). ENF 7.5.2G to ENF 7.5.5G set out how the FSA will approach the question of whether a *person* is a fit and proper *person* to perform the function to which his approval relates.

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The FSA recognises that its decisions to withdraw approval will often have a substantial impact on those concerned. When it considers whether to withdraw approval from a *person* it will take account of all relevant factors, including, but not limited to, the matters set out below:

- (1) the matters set out in section 61(2) of the Act (Determination of applications) (see ENF 7.3.4G);
- (2) the criteria for assessing the fitness and propriety of *approved persons*. These are contained in FIT 2.1 (Honesty, integrity and reputation); 2.2 (Competence and capability) and 2.3 (Financial soundness). The criteria include:
 - (a) honesty, integrity and reputation; this includes an individual's openness and honesty in dealing with *consumers*, market participants and regulators, and ability and willingness to comply with the requirements placed on him by or under the Act as well as with other legal and professional obligations and ethical standards (see ENF 7.5.2G(3));
 - (b) competence and capability; this includes having the necessary skills to carry out the *controlled function* that he is performing; and
 - (c) financial soundness; this includes whether the individual has been the subject of any judgement debts or awards in the United Kingdom or elsewhere that are continuing or were not satisfied within a reasonable period;
- (3) whether, and to what extent, the *approved person* has:
 - (a) failed to comply with the *Statements of Principle*; or
 - (b) been knowingly concerned in a contravention by a relevant *firm* of a requirement imposed on the *firm* by or under the Act (including the *Principles* and other *rules*);
- (4) the relevance, materiality and length of time since the occurrence of any matters indicating unfitness;

- (5) the severity of risk which the *person* poses to *consumers* and confidence in the *financial system*; and
- (6) the previous disciplinary record and general compliance history of the *person* including whether the *FSA* (or any *previous regulator*) has previously imposed a disciplinary sanction on the *person*.

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The *FSA* may have regard to the cumulative effect of a number of factors which, when considered on their own, may not be sufficient to show that the *person* is not fit and proper to continue to carry out a *controlled function*.

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The *FSA* may also take account of the particular *controlled function* which an *approved person* is carrying out within a *firm*, the nature and activities of the *firm* concerned and the markets within which it operates.

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It is impossible to produce a definitive list of matters which the *FSA* might take into account when considering whether an *approved person* is not a fit and proper *person* to continue to carry out a particular *controlled function* in a particular *firm*. This is because of the diverse nature of the activities and *controlled functions* which the *FSA* regulates. Accordingly, certain matters that do not fall squarely, or at all, within the matters referred to above may also be considered, for example, if a *person* has been convicted of, or dismissed or suspended from employment for abuse of drugs or other substances, or has convictions for serious assault. In these circumstances, the *FSA* will consider whether the conduct or matter in question is relevant to the *person's* fitness and propriety for the particular *controlled function*.

7.6 Other powers that may be relevant

- 7.6.1** **G** This section refers to other powers that may be relevant when the *FSA* is considering whether to withdraw approval from an *approved person*.
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- 7.6.2** **G** The *FSA* may use its investigation powers in relation to *approved persons*. The *FSA*'s powers to appoint investigators are set out in *ENF 2* (Information gathering and investigation powers). In particular, the *FSA* may appoint investigators if there appear to be circumstances suggesting that:
- (1) an individual is not a fit and proper *person* to be involved in the carrying out of any function in relation to a *regulated activity* carried on by an authorised or *exempt person* (see section 168(4)(d) of the *Act* (Appointment of persons to carry out investigations in particular cases));
 - (2) a *person* in relation to whom the *FSA* has given its approval under section 59 of the *Act* (Approval for particular arrangements) may not be a fit and proper *person* to carry out the function to which the approval relates (see section 168(4)(h) of the *Act*); or
 - (3) a *person* may be guilty of misconduct for the purposes of section 66 of the *Act* (Disciplinary powers) (see *ENF 7.7.3G* and section 168(4)(i) of the *Act*).
- 7.6.3** **G** (1) Where it appears to the *FSA* that an *approved person* has been guilty of misconduct, it may consider taking disciplinary action against him under section 66 of the *Act* (Disciplinary powers), as well as withdrawing his approval. Misconduct is defined in section 66 as a failure to comply with a *Statement of Principle* issued by the *FSA* under section 64 of the *Act* (Conduct: statements and codes), or being knowingly concerned in a contravention by a *firm* of a requirement imposed on that *firm* by or under the *Act*.
- (2) When deciding whether to take disciplinary action as well as withdrawing approval, the *FSA* will be guided by the criteria set out in *ENF 11.4* and *11.5*. The *FSA*'s approach to the discipline of *approved persons* is set out in *ENF 11* (Discipline of authorised firms and approved persons: the *FSA*'s general approach), *12* (Discipline of firms and approved persons: public censures and public statements) and *13* (Discipline of firms and approved persons: financial penalties).
 - (3) If it appears to the *FSA* that the misconduct is likely to continue or that *client* assets are at risk as a result of the misconduct, it may consider applying for an *injunction* to prevent dissipation of those assets and/or to stop the misconduct from continuing. The *FSA*'s approach to the exercise of its power to apply for *injunctions* is set out in *ENF 6* (Injunctions).
- 7.6.4** **G** Where the information available to the *FSA* casts doubt on the fitness and propriety of an *approved person* to be involved in *regulated activity* conducted by *firms* generally, the *FSA* may consider making a *prohibition order* against him, as

well as withdrawing its approval from him. The scope and effect of a *prohibition order* may be wider than withdrawal of approval and can extend to a *general prohibition* on performing any function in relation to *regulated activities* of *firms* generally. The *FSA's* approach to making *prohibition orders* is set out in *ENF 8* (Prohibition of individuals).

7.7 The effect of the FSA's decision to withdraw approval

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Unless the decision has been referred to the *Tribunal*, the FSA's decision to withdraw its approval from an *approved person* will come into effect on the date specified in the *final notice* (see DEC 2.3.11G). Where the decision has been referred to the *Tribunal*, the FSA is not permitted (under section 133(9) of the *Act* (Proceedings: general provisions) to take the action specified in the *decision notice* until that reference, and any appeal against the *Tribunal's* decision, has been finally disposed of.

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When the FSA's decision to withdraw an approval has become effective, the position of the *firm* on whose application the approval was granted differs depending on whether it directly employs the *person* concerned, or whether the *person* is employed by one of its contractors.

- (1) If the *firm* directly employs the *person* concerned:
 - (a) Under section 59(1) of the *Act* (Approval for particular arrangements), a *firm* ('A') must take reasonable care to ensure that: '...no *person* performs a *controlled function* under an *arrangement* entered into by A in relation to carrying on by A of a *regulated activity*, unless the FSA approves the performance by that *person* of the *controlled function* to which the *arrangement* relates.'
 - (b) Therefore, if the *firm* continues to employ the *person* concerned to carry out a *controlled function*, it will be in breach of section 59(1) and the FSA may take enforcement action against it.
- (2) If the *person* concerned is employed by a contractor of the *firm*.
 - (a) Under section 59(2), a *firm* ('A') must: '... take reasonable care to ensure that no *person* performs a *controlled function* under an *arrangement* entered into by a contractor of A in relation to the carrying on by A of a *regulated activity*, unless the FSA approves the performance by that *person* of the *controlled function* to which the *arrangement* relates.'
 - (b) Therefore, if a contractor of the *firm* employs the *person* concerned, and the contractor continues to employ the *person* to carry out a *controlled function*, the *firm* itself will be in breach of section 59(2) unless it has taken reasonable care to ensure that this does not happen. The FSA may take enforcement action against a *firm* that breaches this requirement.

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Firms should be aware of the potential effect that these provisions may have on their contractual relationships with *approved persons* employed by them and with contractors engaged by them, and their obligations under these contracts.

7.7.4

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As stated in ENF 7.4.2G, the FSA is required to give a copy of its *decision notice* to the *firm* that applied for the approval, and also to a contractor of the *firm* if the *person* concerned is employed by the contractor.

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7.8 Publication

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DEC 5.2 (Publication) sets out certain requirements of the *Act* in relation to publication by the *FSA* of its decisions. Once a *final notice* relating to a withdrawal of approval has been issued, the *FSA* will generally publicise the decision unless this would prejudice the interests of *consumers*.

Chapter 8.

Prohibition of individuals

8.

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8.1 Application and Purpose

Application

8.1.1

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This chapter applies to all individuals, whether or not they are approved by the FSA. Some consequential *guidance* in this chapter will apply to *firms*.

Purpose

8.1.2

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The power to prohibit individuals who are not fit and proper from carrying out functions in relation to *regulated activities* helps the FSA to work towards its *regulatory objectives* of protecting *consumers*, promoting public awareness, maintaining confidence in the *financial system* and reducing *financial crime*. The FSA may exercise its power to make a *prohibition order* where it considers an individual presents such a risk to *consumers* or to confidence in the market generally that it is necessary either to prevent him from carrying out any function in relation to *regulated activities* or from being employed by any *firm*, or to restrict the functions which he may carry out or the type of *firm* by which he may be employed.



8.2 Introduction

8.2.1

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This chapter contains *guidance* on:

- (1) the *FSA*'s power to make a *prohibition order* under section 56 of the *Act* (Prohibition orders);
- (2) the *FSA*'s procedure for exercising this power;
- (3) the effect of the *FSA*'s decision to make a *prohibition order*; and
- (4) the *FSA*'s policy in relation to applications by individuals for the variation or revocation of *prohibition orders*.

8.3 The FSA's power to make a prohibition order

8.3.1 ^G_{/1} Under section 56(2) of the *Act* (Prohibition orders), the *FSA* may make a *prohibition order* if it appears that an individual is not fit and proper to carry out functions in relation to *regulated activities* carried on by *firms*. The *FSA* may make an order prohibiting the individual from carrying out a specified function in relation to *regulated activities*, any function within a specified description, or any function in relation to *regulated activities*.

8.3.2 ^G_{/1} A *prohibition order* may relate to:

- (1) a specified *regulated activity*, any *regulated activity* falling within a specified description or all *regulated activities*;
- (2) *firms* generally, or any *firm* within a specified class of *firm*.

8.3.3 ^G_{/1} Under section 56(4), an individual who carries out or agrees to carry out a function in breach of a *prohibition order* is guilty of an offence and liable, on summary conviction, to a fine not exceeding level 5 on the standard scale (section 37(1) of the Criminal Justice Act 1982 states that a level 5 fine shall not exceed £5000). In proceedings for an offence under section 56(4), it is a defence for the accused to show that he took all reasonable precautions and exercised all due diligence to avoid committing an offence.

8.3.4 ^G_{/1} Section 56(6) states that a *firm* must take reasonable care to ensure that no function which relates to the carrying on of a *regulated activity* is carried out by a *person* who is prohibited from carrying out that function by a *prohibition order* (see *ENF* 8.11.2G).

8.3.5 ^G_{/1} Section 56(8) states that the *FSA*'s power to make a *prohibition order* applies to the performance of functions in relation to *regulated activities* carried on by:

- (1) a *person* who is an *exempt person* in relation to that activity; and
- (2) a *person* to whom, as a result of Part XX of the *Act* (Provision of financial services by members of the professions), the *general prohibition* does not apply in relation to that activity (see *ENF* 8.7);

as it applies to the carrying out of functions in relation to a *regulated activity* carried on by a *firm*.

8.3.6 ^G_{/1} Under section 57(1) of the *Act* (Prohibition orders: procedure and right to refer to Tribunal), if the *FSA* proposes to make a *prohibition order* it must give the individual concerned a *warning notice* setting out the terms of the prohibition. The *FSA*'s procedures for issuing *warning notices* in this area are the same as those set out in *DEC* 2.2 (Warning notice procedure).

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Under section 57(3), if the *FSA* decides to make a *prohibition order* it must give the individual concerned a *decision notice*. The *FSA's* procedures in relation to *decision notices* in this area are the same as those set out in *DEC 2.3* (Decision notice procedure).

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An individual who receives a *decision notice* making a *prohibition order* may refer the matter to the *Tribunal*. Further information about referrals to the *Tribunal* is set out in *DEC 5.1* (The Tribunal).



8.4 The FSA’s policy on making prohibition orders

- 8.4.1** G_{/1} *ENF 8.5 to ENF 8.6 set out how the FSA will decide whether **approved persons** and other individuals are fit and proper to perform functions in relation to **regulated activities**.*
- 8.4.2** G_{/1}
- (1) The FSA will have the power to make a range of *prohibition orders* depending on the circumstances of each case and the range of *regulated activities* to which the individual’s lack of fitness and propriety is relevant.
 - (2) Depending on the circumstances of each case, the FSA may seek to prohibit individuals from carrying out any class of relevant function in relation to any class of *regulated activity*, or it may limit the *prohibition order* to specific functions in relation to specific *regulated activities*. The FSA may also make an order prohibiting an individual from being employed by a particular *firm*, type of *firm* or any *firm*.
 - (3) The scope of a *prohibition order* will depend on the range of functions which the individual concerned carries out in relation to *regulated activities*, the reasons why he is not fit and proper and the severity of risk which he poses to *consumers* or the market generally.
 - (4) The FSA may also make an order prohibiting an individual from performing functions in relation to the *regulated activities* carried out by *exempt persons* and *persons* covered by an exemption under Part XX of the *Act* (provision of financial services by members of the professions).
- 8.4.3** G_{/1} The FSA recognises that its decision to make a *prohibition order* will have a substantial impact on the individuals concerned and, where relevant, their employers. When it decides whether to make a *prohibition order* the FSA will consider all relevant circumstances including whether other enforcement action should be taken or has already been taken against the individual by the FSA. The FSA will also consider whether enforcement action has been taken against the individual by other enforcement agencies or *designated professional bodies*.
- 8.4.4** G_{/1} The FSA considers that a *prohibition order* is a more serious penalty than the withdrawal of approval because a *prohibition order* will usually be much wider in scope. In most cases the FSA will consider whether the particular unfitness can be adequately dealt with by withdrawing approval or other disciplinary sanctions, for example, public censure or financial penalties, or by issuing a private warning. The FSA will consider making a *prohibition order* only in the most serious cases of lack of fitness and propriety. In those cases the FSA may consider it necessary to prevent the individual concerned from performing any functions in relation to any *regulated activities* carried on by any *firm*. Where the individual concerned is not an *approved person* the FSA will not have the option of withdrawing approval or exercising its disciplinary powers in relation to the individual concerned and therefore a *prohibition order* may be the only appropriate action available.

8.5 Prohibition orders against approved persons

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When the FSA has concerns about the fitness and propriety of an *approved person*, it may consider whether it should seek to withdraw his approval, prohibit him from conducting *regulated activities*, or both. ENF 7 (Withdrawal of approval) sets out the FSA's approach to the use of its power to withdraw approval in relation to individuals who are *approved persons*. The grounds on which the FSA may withdraw approval are similar to the grounds on which the FSA may consider exercising its power to make a *prohibition order* against individuals who are *approved persons*. The FSA considers that the prohibition of an individual who is an *approved person* may have more serious consequences than the withdrawal of approval for a particular *controlled function*. A *prohibition order* will be wider in scope than the withdrawal of approval (see ENF 8.3.2G). Accordingly, a *prohibition order* will be used only where the *approved person* is an individual and presents a degree of risk to *consumers* or to confidence in the *financial system* that cannot be sufficiently addressed by the withdrawal of his approval or other disciplinary sanction.

8.5.2

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When it decides whether to exercise its power to make a *prohibition order* against an *approved person*, the FSA will consider the following factors:

- (1) whether the individual is fit and proper to perform functions in relation to *regulated activities*. The criteria for assessing the fitness and propriety of *approved persons* are contained in FIT 2.1 (Honesty, integrity and reputation); 2.2 (Competence and capability) and 2.3 (Financial soundness). The criteria include:
 - (a) honesty, integrity and reputation; this includes an individual's openness and honesty in dealing with *consumers*, market participants and regulators and ability and willingness to comply with requirements placed on him by or under the *Act* as well as with other legal and professional obligations and ethical standards;
 - (b) competence and capability; this includes an assessment of the individual's skills to carry out the *controlled function* that he is performing; and
 - (c) financial soundness; this includes whether the individual has been the subject of any judgment debts or awards in the United Kingdom or elsewhere that are continuing or were not satisfied within a reasonable period;
- (2) whether and to what extent, the *approved person* has:
 - (a) failed to comply with the *Statements of Principle*; or
 - (b) been knowingly concerned in a contravention by the relevant *firm* of a requirement imposed on the *firm* by or under the *Act* (including the *Principles* and other *rules*);

- (3) the relevance, materiality and length of time since the occurrence of any matters indicating unfitness;
- (4) the particular *controlled function* the *approved person* is performing, the nature and activities of the *firm* concerned and the markets in which he operates;
- (5) the severity of the risk which the individual poses to *consumers* and to confidence in the *financial system*;
- (6) the previous disciplinary record and general compliance history of the individual including whether the *FSA* (or any *previous regulator*) has previously imposed a disciplinary sanction on the individual.

8.5.3 G_{/1} The *FSA* may have regard to the cumulative effect of a number of factors which, when considered on their own, may not be sufficient to show that the individual is fit and proper to continue to carry out the *controlled function*.

8.5.4 G_{/1} It is impossible to produce a definitive list of matters which the *FSA* might take into account when considering whether an individual is not a fit and proper *person* to carry out a particular, or any, *controlled function* in relation to a particular, or any, *firm*. This is because of the diverse nature of the activities and *controlled functions* which the *FSA* regulates. Therefore, certain matters that do not fit squarely, or at all, within the matters referred to above may fall to be considered, for example, if an individual has been convicted of, or dismissed or suspended from employment for abuse of drugs or other substances, or has convictions for serious assault. In these circumstances the *FSA* will consider whether the conduct or matter in question is relevant to the individual's fitness and propriety.

8.5.5 G_{/1} Where the *FSA* has withdrawn the approval of an individual who is an *approved person* and that individual has continued to carry out *controlled functions* in relation to *regulated activities* despite the withdrawal of his approval in relation to those functions, the *FSA* will consider whether it is appropriate to make a *prohibition order* against him.



8.6 Prohibition orders against individuals employed by firms who are not approved persons

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Where the *FSA* considers making a *prohibition order* against an individual employed by a *firm* who is not an *approved person*, it may make an order only on the grounds that the individual is not fit and proper to carry out functions in relation to *regulated activities* carried on by an *authorised person*.

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When considering whether to exercise its power to make a *prohibition order* against an individual employed by a *firm*, the *FSA* will consider those factors set out in *ENF* 8.5.2G(1), (3), (5) and, if relevant, (6).

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8.7 Prohibition orders against exempt persons and members of professional firms

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The *FSA* may exercise its power to make a *prohibition order* against any individual, including individuals who carry out *regulated activities* by virtue of their status as *exempt persons* or by virtue of an exemption from the *general prohibition* under Part XX of the *Act* (Provision of financial services by members of the professions) (see *ENF* 18 (Disapplication orders against members of the professions)).

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When considering whether to exercise its power to make a *prohibition order* against an *exempt person*, the *FSA* will consider those factors set out in *ENF* 8.5.2G(1), (3), (5) and (6).



8.8 Prohibition orders against other individuals

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The FSA will consider exercising its power to make a *prohibition order* against individuals who are not *approved persons* nor employed by *firms* where they have shown themselves to be unfit to carry out functions in relation to *regulated activities*.

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The FSA will consider the individual's fitness or propriety where, for example, it appears that:

- (1) the individual has been involved in conducting *regulated activities* in breach of the *general prohibition*; or
- (2) the individual has been involved in other misconduct or offences under the *Act* which call into question his honesty, integrity or competence; or
- (3) he appears likely to pose a serious risk to *consumers* or confidence in the *financial system* in the future.

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When determining the fitness and propriety of an individual who is neither an *approved person* nor employed by a *firm*, the FSA will consider the criteria set out in *ENF 8.5.2G*(1), (3) and (5).

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8.9 Applications for variation or revocation of prohibition orders

8.9.1 G_{/1} At any time after the *FSA* has made a *prohibition order* against an individual, the individual may apply to the *FSA* to have the order varied or revoked.

8.9.2 G_{/1} When considering whether to grant or refuse an application to revoke or vary a *prohibition order* the *FSA* will consider all the relevant circumstances of a case. These may include, but are not limited to:

- (1) the seriousness of the misconduct that resulted in the order;
- (2) the amount of time since the original order was made;
- (3) any steps taken subsequently by the individual to remedy the misconduct;
- (4) any evidence which, had it been known to the *FSA* at the time, would have been relevant to the *FSA*'s decision to make the *prohibition order*;
- (5) all available information relating to the individual's honesty, integrity or competence since the order was made, including any repetition of the misconduct which resulted in the *prohibition order* being made;
- (6) where the *FSA*'s finding of unfitness arose from incompetence rather than from dishonesty or lack of integrity, evidence that this unfitness has been or will be remedied; for example, this may be achieved by the satisfactory completion of relevant training and obtaining relevant qualifications, or by supervision of the individual by his employer;
- (7) the financial soundness of the individual concerned; and
- (8) whether the individual will continue to pose the level of risk to *consumers* or confidence in the *financial system* which resulted in the original prohibition if it is lifted.

8.9.3 G_{/1} If the individual applying for a revocation or variation of a *prohibition order* proposes to take up an offer of employment to carry out *controlled functions*, the *approved persons* regime will also apply to him. In these cases, the *firm* concerned will be required to apply to the *FSA* for approval of that individual's employment in that capacity. The *FSA* will assess the individual's fitness and propriety to undertake *controlled functions* on the basis of the criteria set out in *FIT* 2.1 (Honesty, integrity and reputation); 2.2 (Competence and capability) and 2.3 (Financial soundness).

8.9.4 G_{/1} The *FSA* will not generally grant an application to vary or revoke a *prohibition order* unless it is satisfied that the proposed variation will not result in a reoccurrence of the risk to *consumers* or confidence in the *financial system* that resulted in the order being made. Equally, the *FSA* will not revoke a *prohibition*

order unless it is satisfied that the individual is fit to carry out functions in relation to *regulated activities* generally, or to those specific *regulated activities* in relation to which the individual has been prohibited.

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If the *FSA* decides to grant an application to vary or revoke a *prohibition order* it must give the applicant written notice of its decision.

8.9.6

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Where the *FSA* proposes to refuse an application for revocation or variation, the *FSA* must give the applicant a *warning notice* setting out the reasons for its proposed refusal (see *DEC 2.2* (Warning notice procedure)). If the *FSA* decides to refuse an application for revocation or variation of an order it must give the applicant a *decision notice* (see *DEC 2.3* (Decision notice procedure)). If the *FSA* refuses an application, the applicant may refer the matter to the *Tribunal* (see *DEC 5.1* (The Tribunal)).

8.10 Other powers that may be relevant

- 8.10.1** **G** This section sets out the other powers that may be relevant when the *FSA* considers whether to exercise its power to make a *prohibition order*.
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- 8.10.2** **G** The *FSA*'s powers to appoint investigators are set out in *ENF 2* (Information gathering and investigation powers). In particular, the *FSA* may appoint investigators if there appear to be circumstances suggesting that:
- (1) an individual is not fit and proper to be involved in the carrying out of any function in relation to a *regulated activity* carried on by an authorised or *exempt person* (section 168(4)(d) of the *Act* (Appointment of persons to carry out investigations in particular cases); or
 - (2) a *person* in relation to whom the *FSA* has given its *approval* under section 59 of the *Act* (Approval) may not be fit and proper to carry out the function to which that *approval* relates (section 168(4)(h) of the *Act*);
 - (3) a *person* may be guilty of misconduct for the purposes of section 66 of the *Act* (Disciplinary powers)(see section 168(4)(I) of the *Act*).
- 8.10.3** **G** Section 168(2) of the *Act* also permits the *FSA* to appoint investigators to investigate *unauthorised persons* if it appears that:
- (1) an offence has been committed under section 24(1) (False claims to be authorised or exempt) or section 397 (Misleading statements and practices) of the *Act* or under Part V of the Criminal Justice Act 1993 (section 168(2)(a) of the *Act*);
 - (2) there may have been a breach of the *general prohibition* (section 168(2)(b) of the *Act*);
 - (3) there may have been a contravention of section 21 in relation to *financial promotion* generally or section 238 in relation to promotion of *collective investment schemes* (section 168(2)(c) of the *Act*);
 - (4) *market abuse* may have taken place (section 168(2)(d) of the *Act*).
- 8.10.4** **G** (1) Where it appears to the *FSA* that an *approved person* has been guilty of misconduct, it may consider taking disciplinary action against him under section 66 of the *Act* (Disciplinary powers), as well as making a *prohibition order*. Misconduct is defined in section 66 as a failure to comply with a *Statement of Principle* or being knowingly concerned in a contravention by a *firm* of a requirement imposed on that *firm* by or under the *Act*.
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- (2) When deciding whether to take disciplinary action as well as making a *prohibition order*, the *FSA* will be guided by the criteria set out in *ENF 11.4* (Criteria for determining whether to take disciplinary action) and 11.5 (Action

against approved persons). The *FSA's* approach to the discipline of *approved persons* is set out in *ENF* 11 (Discipline of authorised firms and approved persons: the *FSA's* general approach), 12 (Discipline of firms and approved persons: public censures and public statements) and 13 (Discipline of firms And approved persons: financial penalties).

- (3) If it appears to the *FSA* that the misconduct is likely to continue or that *client* assets are at risk as a result of the misconduct, it may consider applying for an *injunction* to prevent dissipation of those assets and/or to stop the misconduct continuing. The *FSA's* approach to the exercise of its power to apply for *injunctions* is set out in *ENF* 6

8.10.5

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Where the *FSA* has information that suggests an individual has committed an offence under the *Act*, or under relevant subordinate legislation, it may consider starting criminal proceedings as well as making a *prohibition order* against him. The *FSA's* policy and procedures in relation to criminal prosecutions are set out in *ENF* 15 (Prosecution of criminal offences).

8.

8.11 The effect of the FSA's decision to make a prohibition order

- 8.11.1** **G**_{/1} When the FSA's decision to make a *prohibition order* has become effective, the individual concerned may not carry out or agree to carry out any function in breach of the *prohibition order*. Under section 168(4)(e) of the *Act* (Appointment of persons to carry out investigations in particular circumstances), the FSA may appoint investigators if it appears there are circumstances that suggest that an individual may have carried out or agreed to carry out a function in breach of a *prohibition order*. An individual who performs or agrees to perform a function in breach of a *prohibition order* is guilty of an offence under section 56(4) of the *Act* (Prohibition orders)(see ENF 15 (Prosecution of criminal offences)).
- 8.11.2** **G**_{/1} The FSA may consider taking disciplinary action against a *firm* that has breached the provision in section 56(6) (see ENF 8.3.4G). The FSA considers that a search by a *firm* of the *FSA Register* (see ENF 8.12.2G) is an essential part of the statutory duty to take reasonable care to ensure that *firms* do not employ prohibited individuals to perform functions in relation to *regulated activities*. In addition, the FSA expects *firms* to check the *FSA Register*, when making applications for approval under section 59 of the *Act* (Approval for particular arrangements).
- 8.11.3** **G**_{/1} More generally, if a *firm's* search of the *FSA Register* reveals no record of a *prohibition order*, the FSA will consider taking action for breach of section 56(6) only where the *firm* had access to other information indicating that a *prohibition order* had been made.
- 8.11.4** **G**_{/1} Section 71 of the *Act* (Actions for damages) gives a *private person* (and in prescribed cases, a *person* who is not a *private person*) a right of action against *firms* for losses resulting from a breach by the *firm* of the statutory duty in section 56(6).

8.12 Publication

- 8.12.1** G_{/1} DEC 5.2 (Publication) sets out certain requirements of the *Act* in relation to publication by the *FSA* of its decisions. Once a *final notice* relating to a *prohibition order* has been issued, the *FSA* will generally publicise the decision.
- 8.12.2** G_{/1} Under section 347(1)(g) of the *Act* (The record of authorised persons etc) the *FSA* must keep a public record of individuals against whom it has made a *prohibition order*. Section 347(2)(f) states the record must include the name of the individual and details of the effect of the *prohibition order*. The record of *prohibition orders* will be maintained on the *FSA Register*. The *FSA* will not enter details of a *prohibition order* on to the *FSA Register* until a *final notice* has been issued.
- 8.12.3** G_{/1} Once the decision to make a *prohibition order* is no longer open to review, the *FSA* will consider what additional information about the circumstances of the *prohibition order* to include on the *FSA Register*. The *FSA* will balance any possible prejudice to the individual concerned against the interests of *consumer* protection.
- 8.12.4** G_{/1} Under section 347(3) of the *Act*, if it appears to the *FSA* that an entry on the *FSA Register* ceases to apply to a *person* (in the case of a *prohibition order*, where that *prohibition order* is varied or revoked) it may remove the relevant entry from the *FSA Register*. Section 347(4) provides that, if the *FSA* decides not to remove the entry from the *FSA Register*, it must make a note of this in the *FSA Register* and state why it believes the entry on the *FSA Register* no longer applies to the *person*.
- 8.12.5** G_{/1}
- (1) The *FSA* will maintain an entry on the *FSA Register* while a *prohibition order* is in effect. If the *FSA* grants an application to vary the order a note of the variation will be made on the *FSA Register*.
 - (2) The *FSA*'s policy in relation to section 347(4) of the *Act* is that where an application to revoke a *prohibition order* is granted, a note will be made on the *FSA Register* that the order has been revoked giving reasons for the revocation. The availability to *firms* and *consumers* of a full record of *FSA* action taken in relation to an individual's fitness and propriety will assist it in furthering its *regulatory objectives*, in particular, the protection of *consumers* and the maintenance of confidence in the *financial system*.
 - (3) The *FSA* will maintain an annotated record of revoked *prohibition orders* for six years from the date of the revocation after which time the record will be removed from the *FSA Register*.

Chapter 9

Restitution and redress



9.1 Application and purpose

Application

9.1.1

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This chapter applies to all *firms* and *persons*.

Purpose

9.1.2

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This chapter sets out the *FSA*'s powers to seek redress for *consumers* in circumstances where *persons*, whether *authorised* or not, have breached a relevant requirement of the *Act* and gives *guidance* on how it intends to exercise its powers. The *FSA*'s power to apply to the court for an order for restitution, and its administrative power to require restitution, will help it to pursue its *regulatory objectives* of protecting *consumers* and maintaining confidence in the *financial system*.

9.2 Introduction

9.2.1

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This chapter outlines the FSA's powers to:

- (1) apply to the court for an order for restitution where a *person*, whether *authorised* or not, has breached a relevant requirement of the *Act* or has been knowingly concerned in such a breach (section 382 of the *Act* (Restitution orders));
- (2) apply to the court for an order for restitution where a *person*, whether *authorised* or not, has engaged in, *required or encouraged* others to engage in, *market abuse* (section 383 of the *Act* (Restitution orders in cases of market abuse));
- (3) require restitution by a *firm* which has contravened a relevant requirement of the *Act*, or been knowingly concerned in such a contravention (section 384(1) of the *Act* (Power of FSA to require restitution)); and
- (4) require restitution where a *person*, whether *authorised* or not, has engaged in, or *required or encouraged* others to engage in, *market abuse* (section 384(2) of the *Act*).



9.3 The FSA's general approach

9.3.1

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The *FSA* will consider exercising its powers to obtain restitution in the light of the facts of each case. When deciding whether to exercise these powers, the *FSA* will also consider other ways that *persons* might obtain redress, and whether it would be more efficient or cost-effective for them to use these means instead. The *FSA* will also consider any proposals by the *person* concerned to offer redress to any *consumers* or other *persons* who have suffered loss, and the adequacy of those proposals, before exercising its powers.

9.3.2

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The number of instances in which the *FSA* might consider using its powers to obtain restitution for *market counterparties* are likely to be limited. Many of the *rules* which apply to retail *consumers* will not be relevant to transactions between *market counterparties*. Transactions between *firms* classified as *market counterparties* will be subject to the *FSA*'s Inter-professional Conduct (see *MAR 3*).

9.4 The FSA's power to apply to the court for restitution

9.4.1 **G**_{/1} The FSA's power to apply to the court for an order for restitution where a *person*, whether *authorised* or not, has breached a relevant requirement of the *Act* is contained in section 382 of the *Act* (Restitution orders). The Secretary of State may also apply for an order for restitution under this section of the *Act*.

9.4.2 **G**_{/1} Section 382 states that:

(1) 'the court may, on the application of the FSA or the Secretary of State, make an order if it is satisfied that a *person* has contravened a relevant requirement (see ENF 9.4.4G), or been knowingly concerned in the contravention of such a requirement, and:

- (a) that profits have accrued to him as a result of the contravention; or
- (b) that one or more *persons* have suffered loss or been otherwise adversely affected as a result of the contravention;

(2) the court may order the *person* concerned to pay to the FSA such sum as appears to the court to be just having regard:

- (a) in a case falling within paragraph (1)(a), to the profits which appear to the court to have accrued;
- (b) in a case falling within paragraph (1)(b), to the extent of the loss or adverse effect; or
- (c) in a case falling within both these paragraphs, to the profits which appear to the court to have accrued and to the extent of the loss or other adverse effect.'

9.4.3 **G**_{/1} Where the court orders the *person* concerned to pay restitution, the sum will be paid to the FSA and distributed as the court directs. Section 382(3) provides that any amount paid to the FSA in line with an order under section 382(2) (see ENF 9.4.2G(2)) must be paid by it to such qualifying *person* (see ENF 9.4.8G) or distributed by it amongst such qualifying *persons* as the court directs.

9.4.4 **G**_{/1} Section 382(9)(a) states that 'in relation to an application by the FSA, 'relevant requirement' means a requirement:

- (1) which is imposed by or under the *Act*; or
- (2) which is imposed by or under any other *Act* and whose contravention constitutes an offence which the FSA has power to prosecute under the *Act* (or, in the case of Scotland, which is imposed by or under any other Act and whose contravention constitutes an offence under Part V of the Criminal Justice Act

1993 (*insider dealing*) or under prescribed regulations relating to *money laundering*'.

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The FSA's power to apply to the court for an order for restitution where a *person* has engaged in, *required or encouraged* others to engage in, *market abuse* is in section 383 of the *Act* (Restitution orders in cases of market abuse). Section 383(1) and (2) state that the court may, on the application of the FSA, make an order under section 383(4) if it is satisfied:

- (1) that a *person* has:
 - (a) engaged in *market abuse* (section 383(1)(a) of the *Act*); or
 - (b) by taking or not taking any action, *required or encouraged* another *person* or *persons* to engage in *behaviour* which, if engaged in by the *person* concerned, would amount to *market abuse* (section 383(1)(b) of the *Act*); and
- (2) that profits have accrued to him as a result; or that another *person* has suffered loss or been otherwise adversely affected as a result (section 383(2)(a) and (b) of the *Act*).

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However, under section 383(3) of the *Act* the court may not make an order under section 383(4) if it is satisfied that:

- (1) the *person* concerned believed, on reasonable grounds, that his *behaviour* did not fall within section 383(1)(a) or (b) of the *Act* (see *ENF 9.4.5G(1)*); or
- (2) he took all reasonable precautions and exercised all due diligence to avoid behaving in a way which fell within section 383(1)(a) or (b) of the *Act* (see *ENF 9.4.5G(1)*).

9.4.7

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The court may order the *person* concerned to pay to the FSA such sum as appears to the court to be just having regard to those factors set out in *ENF 9.4.2(2)*.

9.4.8

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Where the court orders the *person* concerned to pay restitution, the sum will be paid to the FSA and distributed as the court directs. Section 383(5) provides that any amount paid to the FSA in accordance with a restitution order under section 383(4) must be paid by the FSA to a qualifying *person* (see *ENF 9.4.8G*), or distributed between such qualifying *persons* as the court directs.

9.4.9

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A 'qualifying *person*' is a *person* appearing to the court to be someone:

- (1) to whom the profits mentioned in *ENF 9.4.2G(1)(a)* or *ENF 9.4.5G(2)* are attributable; or
- (2) who has suffered the loss or other adverse affect mentioned in *ENF 9.4.2G(1)(b)* or *ENF 9.4.5G(2)*.

9.5 The FSA's power to require restitution

9.5.1

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The FSA's administrative power to require restitution from a *firm* which has breached a relevant requirement is set out in section 384(5) of the *Act* (Power of FSA to require restitution). This power is exercisable without a court order. Section 384(1) states that the FSA may exercise this power if it is satisfied that a *firm* has contravened a relevant requirement (see ENF 9.4.4G), or has been knowingly concerned in a contravention of such a requirement, and:

- (1) that profits have accrued to him as a result of the contravention; or
- (2) that one or more *persons* have suffered loss or been adversely affected in any other way as a result of the contravention.

9.5.2

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Section 384(7) states that a relevant requirement means a requirement-

- (1) which is imposed by or under the *Act*; or
- (2) which is imposed by or under any other Act and whose contravention is an offence which the FSA has power to prosecute under the *Act*.

9.5.3

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The FSA's administrative power to require restitution in cases where a *person*, whether *authorised* or not, has engaged in *market abuse* is set out in section 384(2) and (3) of the *Act*. Together section 384(2) and (3) state that the FSA may exercise this power if it is satisfied:

- (1) that a *person* has:
 - (a) engaged in *market abuse* (section 384(2)(a)), or
 - (b) by taking or not taking any action, *required or encouraged* another *person* or *persons* to engage in *behaviour* which, if engaged in by that *person*, would amount to *market abuse* (section 384(2)(b)); and
- (2) that he has profited as a result; or that another *person* has suffered loss or been adversely affected in any other way as a result of the *market abuse*.

9.5.4

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However, under section 384(4) of the *Act* the FSA may not require restitution under section 384(2) if, having considered any representations made in response to a *warning notice*, there are reasonable grounds for it to be satisfied:

- (1) that the *person* concerned believed, on reasonable grounds, that his *behaviour* did not fall within section 384(2)(a) or (b) (see ENF 9.5.3G(1)); or
- (2) that he took all reasonable precautions and exercised all due diligence to avoid behaving in a way which fell within section 384(2)(a) or (b) (see ENF 9.5.3G(1)).

- 9.5.5** G_{/1} The FSA's administrative power to require restitution where there has been a breach of a relevant requirement or *market abuse* allows the FSA to require the *person* concerned to pay to the appropriate *person* (see ENF 9.5.6G), or share between the appropriate *persons* identified by the FSA, an amount which the FSA regards as fair. Such an amount will be determined having regard to:
- (1) in a case falling within paragraph ENF 9.5.1G(1) or the first part of ENF 9.5.3G(2), the profits that appear to the FSA to have been made; or
 - (2) in a case falling within paragraph ENF 9.5.1G(2) or the second part of ENF 9.6.3G(2), the extent of the losses or other adverse effect; or
 - (3) in a case falling within paragraph ENF 9.6.1G(1) and (2) or both parts of ENF 9.6.3G(2), the profits that appear to the FSA to have been made and the extent of the loss or other adverse effect.
- 9.5.6** G_{/1} An 'appropriate *person*' is a *person* that appears to the FSA to be someone:
- (1) to whom the profits referred to in ENF 9.5.1G(1) or the first part of ENF 9.5.3G(2) are attributable; or
 - (2) who has suffered the losses or other adverse effect referred to in ENF 9.5.1G(2) or the second part of ENF 9.5.3G(2).
- 9.5.7** G_{/1} Where the FSA proposes to exercise its administrative power under section 384(5) in relation to a *person* it must give him a *warning notice*. This must state the amount which the FSA proposes to require the *person* to pay or distribute in accordance with section 384(5) (see ENF 9.5.5G). The FSA's policy and procedure in relation to *warning notices* is set out in DEC 2.2 (Warning notice procedure).
- 9.5.8** G_{/1} Where the FSA decides to exercise its administrative power under section 384(5) in relation to a *person* it must give him a *decision notice*. Section 386(2) of the Act (Decision notices) provides that the *decision notice* must:
- (1) state the amount that he is to pay or distribute as mentioned in ENF 9.5.5G;
 - (2) identify the *person* or *persons* to whom that amount is to be paid or among whom that amount is to be distributed; and
 - (3) state the arrangements in accordance with which the payment or distribution is to be made.
- The FSA's policy and procedure in relation to *decision notices* is set out in DEC 2.3 (Decision notice procedure).
- 9.5.9** G_{/1} If the FSA decides to exercise its power under section 384(5), the *person* in relation to whom the power is exercised may refer the matter to the *Tribunal*. Further information about referrals to the *Tribunal* is set out in DEC 5.1 (The Tribunal).
- 9.5.10** G_{/1} Where the FSA takes action:
- (1) on the *decision notice* (if the matter has not been referred to *Tribunal*); or
 - (2) on the direction of the *Tribunal* or court (if the matter has been referred to the *Tribunal*, or later appealed);
- it must give a *final notice* to the *person* in relation to whom the power is exercised.

9.5.11

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The provisions relating to *final notices* in these circumstances are set out in section 390 of the *Act* (Final notices) (see *DEC 2.3.11 – DEC 2.3.12G*). Section 390(6) states that a *final notice* to make a payment must state:

- (1) the *persons* to whom;
- (2) the manner in which; and
- (3) the period in which;

the payment must be made.

9.5.12

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The obligation imposed on a *person* by a *final notice* is enforceable, on application by the *FSA*, by *injunction* or, in Scotland, by an order under section 45 of the *Court of Session Act 1988*.



9.6 Criteria for determining whether to exercise powers to obtain restitution

- 9.6.1** G_{/1} The *FSA* will consider the relevant circumstances of each case when deciding whether it is appropriate to exercise its powers to seek or obtain restitution under sections 382, 383 or 384 of the *Act*. The factors which the *FSA* will consider may include, but are not limited to, those set out in *ENF 9.6.2G – ENF 9.6.15G*.

Are the profits quantifiable?

- 9.6.2** G_{/1} The *FSA* will consider whether quantifiable profits have been made which are owed to identifiable *persons*. In certain circumstances it may be difficult to prove that the conduct in question has resulted in the *person* concerned making a profit. It may also be difficult to find out how much profit and to whom the profits are owed. In these cases it may not be appropriate for the *FSA* to use its powers to obtain restitution.

Are the losses identifiable?

- 9.6.3** G_{/1} The *FSA* will consider whether there are identifiable *persons* who can be shown to have suffered quantifiable losses or other adverse effects. In certain circumstances it may be difficult to establish the number and identity of those who have suffered loss as a result of the conduct in question. It may also prove difficult in those cases to establish the amount of that loss and whether the losses have arisen as a result of the conduct in question. In these cases it may not be appropriate for the *FSA* to use its powers to obtain restitution.

The number of persons affected.

- 9.6.4** G_{/1} The *FSA* will consider the number of *persons* who have suffered loss or other adverse effects and the extent of those losses or adverse effects. Where the breach of a relevant requirement by a *person*, whether *authorised* or not, results in significant losses, or losses to a large number of *persons* which collectively are significant, it may be appropriate for the *FSA* to use its powers to obtain restitution on their behalf. The *FSA* anticipates that many individual losses resulting from breaches by *firms* may be more efficiently and effectively redressed by *consumers* pursuing their claims directly with the *firm* concerned or through the *Financial Ombudsman Service* or the *compensation scheme* where the *firm* has ceased trading (see *ENF 9.6.6G*). However, where a large number of *persons* have been affected or the losses are substantial it may be more appropriate for the *FSA* to seek restitution from a *firm*. In those cases the *FSA* may consider combining an action

seeking restitution from a *firm* or *unauthorised person* with disciplinary action or a criminal prosecution.

FSA costs

9.6.5

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The *FSA* will consider the cost of securing redress and whether these are justified by the benefit to *persons* that would result from that action. The *FSA* will consider the costs of exercising its powers to obtain restitution and, in particular, the costs of any application to the court for an order for restitution, together with the size of any sums that might be recovered as a result. The costs of the action will, to a certain extent, depend on the nature and location of assets from which restitution may be made. In certain circumstances it may be possible for the *FSA* to recover the costs of exercising its power to apply to the court for an order for restitution, or a proportion of them, from the party against whom a restitution order is sought.

Is redress available elsewhere?

9.6.6

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The *FSA* will consider the availability of redress through the *Financial Ombudsman Service* or the *compensation scheme*. This will be relevant where the loss has resulted from the conduct of a *firm*. It will not be relevant where losses have resulted from the conduct of *unauthorised persons* operating in breach of the *general prohibition*. The *Financial Ombudsman Service* and the *compensation scheme* (where the *firm* has ceased trading) may be a more efficient and effective method of redress in many cases. The *Financial Ombudsman Service* provides a way for some *consumers* to obtain redress. The *compensation scheme* may provide redress for some *consumers* and businesses. The *FSA*'s power to obtain restitution is not intended to duplicate the functions of the *Ombudsman* or *compensation schemes* in those cases. However, in certain cases (see *ENF 9.6.4G*) it will be more appropriate for the *FSA* to pursue restitution. Further details of these schemes are set out in *COMP*.

Is redress available through another regulator?

9.6.7

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The *FSA* will consider the availability of redress through another regulatory authority. Where another regulatory authority, such as the *Takeover Panel*, is in a position to require appropriate redress, the *FSA* will not generally exercise its own powers to do so (see *ENF 14.9* (Action involving other UK regulatory authorities)). If the *FSA* does consider that action is appropriate and the matters in question have happened in the context of a *takeover bid*, the *FSA* will only take action during the bid in the circumstances set out in *ENF 14.9.6G* if the *person* concerned has responsibilities under the *Takeover Code*. If another *regulatory body* has required redress and a *person* has not met that requirement, the *FSA* will take this into account and (subject to all other relevant factors and circumstances) may consider it appropriate to take action to ensure that such redress is provided.

Can persons bring their own proceedings?

9.6.8

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The *FSA* will consider whether *persons* who have suffered losses are able to bring their own civil proceedings. In certain circumstances it may be appropriate for *persons* to bring their own civil proceedings to recover losses. This might be the

case where the *person* who has suffered loss is a *market counterparty* and so may be expected to have a high degree of financial experience and knowledge. When considering whether this might be a more appropriate method of obtaining redress, the *FSA* will consider the costs to the *person* of bringing that action and the likelihood of success in relation to the size of any sums that may be recovered.

Is the firm solvent?

9.6.9

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The *FSA* will consider the solvency of the *firm* or *unauthorised person* concerned. Where the solvency of the *firm* or *unauthorised person* would be placed at risk by the payment of restitution, the *FSA* will consider whether it is appropriate to seek restitution. In those cases the *FSA* may consider obtaining a compulsory *insolvency order* against the *firm* or *unauthorised person* rather than restitution (see *ENF* 9.6.10G). When considering these options, the *FSA* may also take account of the position of other creditors who may be prejudiced if the assets of the *firm* or *unauthorised person* are used to pay restitution payments prior to insolvency.

What other powers are available to the FSA?

9.6.10

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- (1) The *FSA* will consider the availability of its power to obtain a compulsory *insolvency order* against the *firm* or *unauthorised person* concerned or to apply to the court for the appointment of a receiver. In certain circumstances it may be appropriate for the *FSA* to obtain an administration order, winding-up order or bankruptcy order against a *firm* or *unauthorised person* carrying out *regulated activities* in breach of the *general prohibition*.
 - (a) Administration orders: the *FSA* may apply for an administration order against a *firm* or an *unauthorised person* operating in breach of the *general prohibition*. An administrative order places the assets of a *firm* or *unauthorised person* under the management of an administrator and may result in the assets of the *company* being realised to pay creditors. The *FSA*'s procedures in relation to the exercise of its powers to apply for administration orders are set out in *ENF* 10 (Insolvency proceedings and orders against debt avoidance).
 - (b) Winding-up orders: the *FSA* may apply for a winding-up order against a *firm* or an *unauthorised person* operating in breach of the *general prohibition*. A winding-up order places the assets of the *firm* or *unauthorised person* under the control of a liquidator who will apply them to repay creditors. The *FSA*'s procedures in relation to the exercise of its powers to apply for winding-up orders are set out in *ENF* 10.
 - (c) Bankruptcy orders: the *FSA* may apply for a bankruptcy order against an individual who is, or has been, an *authorised person*, or who is carrying on a *regulated activity*, in breach of the *general prohibition*. The making of a bankruptcy order places the assets of the individual under the control of a *trustee* who will use them to repay creditors. The *FSA*'s procedures in relation to the exercise of its powers to apply for bankruptcy orders are set out in *ENF* 10.
 - (d) Appointment of receivers: the *FSA* may apply to the court for the appointment of a receiver on behalf of the *debenture holders* or other creditors of a *person* where there is a risk that creditor or *debenture holder's* assets will be dissipated.

- (2) The *FSA* may decide to exercise its power to obtain a compulsory *insolvency order* or to apply for the appointment of a receiver rather than to exercise its powers to obtain restitution. This could happen if it has particular concerns about a *person's* conduct, or financial position and, in particular, whether it is solvent (though the appointment by the court of a receiver is not conditional on the insolvency of the *person* concerned). The *FSA* may also consider the cost of compulsory *insolvency orders* which will be paid out of the assets of the *firm*, or of the *unauthorised person* concerned, compared to the cost of seeking restitution. In the case of *unauthorised persons* operating in breach of the *general prohibition*, a decision to apply for a compulsory *insolvency order* rather than restitution will depend on all the circumstances of the case. In particular, the *FSA* may consider the significance of the *unauthorised* activities compared to the whole of the business; the nature and conduct of the activities carried on in breach of the *general prohibition*; and the number and nature of the claims against the *person* or *firm* concerned. The *FSA's* powers to apply for compulsory *insolvency orders* are set out in *ENF* 10.

The behaviour of the persons suffering loss

- 9.6.11** G_{/1} The *FSA* will consider the conduct of the *persons* who have suffered loss. As part of its *regulatory objectives* of increasing *consumer* awareness of the *financial system* and protecting *consumers*, the *FSA* is required to publicise information about the *authorised* status of *persons* and is empowered to give information and *guidance* about the regulation of financial services. This information should help *consumers* avoid suffering losses. When the *FSA* considers whether to obtain restitution on behalf of *persons*, it will consider the extent to which those *persons* may have contributed to their own loss or failed to take reasonable steps to protect their own interests.

Other factors which may be relevant.

- 9.6.12** G_{/1} The *FSA* will consider the context of the conduct in question. In any case where the *FSA* believes that any exercise of its powers under section 383 (Restitution orders in cases of market abuse) or 384 (Power of *FSA* to require restitution) of the *Act* may affect the timetable or outcome of a *takeover bid*, it will consult the *Takeover Panel* before taking any steps to exercise such powers, and will give due weight to its views.
- 9.6.13** G_{/1} Where the *FSA* is considering applying to court for a restitution order in relation to *market abuse* under section 383, it will also consider whether the court would be prevented from making that order by section 383(3). The court cannot make a restitution order against a *person* under section 383(3) if it is satisfied that one or both of the conditions set out in section 383(3)(a) and (b) are fulfilled (see *ENF* 9.4.6G).
- 9.6.14** G_{/1} A similar provision to section 383(3) applies where the *FSA* proposes to exercise its power to require restitution in relation to *market abuse* under section 384(2). In those cases, the *FSA* cannot exercise its power where, following representations made to it in response to a *warning notice*, there are reasonable grounds for it to be satisfied that one or both of the conditions set out in section 384(4)(a) and (b) are fulfilled (see *ENF* 9.5.4G).
- 9.6.15** G_{/1} The conditions set out in section 383(3)(a) and (b) and section 384(4)(a) and (b) are the same as those that apply to penalties for *market abuse* and the *FSA* will

take the same factors into account when considering whether the conditions have been met. *ENF* 14.4 (Factors relevant to determining whether to take action in market abuse cases) lists those factors.

9.7 The FSA's choice of powers

- 9.7.1** G_{/1} Under sections 382 (Restitution orders) and 383 (Restitution orders in cases of market abuse) of the *Act* the *FSA* can apply to the court for an order for restitution. Under section 384 (Power of *FSA* to require restitution) it can also require restitution from *firms* which have breached a relevant requirement of the *Act* and *persons*, whether *authorised* or not, who have engaged in, or have *required* or *encouraged* others to engage in, *market abuse*.
- 9.7.2** G_{/1} In cases where it is appropriate to exercise its powers to obtain restitution from *firms*, the *FSA* will first consider using its own administrative powers under section 384 before considering taking court action.
- 9.7.3** G_{/1} However, there may be circumstances in which the *FSA* will choose to use the powers under section 382 or section 383 to apply to the court for an order for restitution against a *firm*. Those circumstances may include, for example, where:
- (1) the *FSA* wishes to combine an application for an order for restitution with other court action against the *firm*, for example, where it wishes to apply to the court for an *injunction* to prevent the *firm* breaching a relevant requirement of the *Act*; the *FSA*'s powers to apply for *injunctions* restraining *firms* from breaching relevant requirements of the *Act* are set out in *ENF 6*;
 - (2) the *FSA* wishes to bring related court proceedings against an *unauthorised person* where the factual basis of those proceedings is likely to be the same as the claim for restitution against the *firm*;
 - (3) there is a danger that the assets of the *firm* may be dissipated; in those cases, the *FSA* may wish to combine an application to the court for an order for restitution with an application for an asset-freezing *injunction* to prevent assets from being dissipated; the *FSA*'s powers to apply for asset freezing *injunctions* are set out in *ENF 6*;
 - (4) the *FSA* suspects that the *firm* may not comply with an administrative requirement to give restitution; in those cases the *FSA* may consider that the sanction for breach of a court order may be needed to ensure compliance; a *person* who fails to comply with a court order may be in contempt of court and is liable to imprisonment, to a fine and/or to have his assets seized.
- 9.7.4** G_{/1} The *FSA* may not use its administrative power to obtain restitution from *unauthorised persons* except in cases of *market abuse*. Most cases where redress is obtained from *unauthorised persons* will therefore be dealt with by an application to the court.

9.8 Determining the amount of restitution

- 9.8.1** **G**_{/1} When deciding how much should be paid by a *firm* or individual following an application by the *FSA* to court for an order for restitution, the court may consider those factors set out in *ENF 9.5.2G(2)*.
- 9.8.2** **G**_{/1} Section 382(4) (Restitution orders) and section 383(6) (Restitution orders in cases of market abuse) of the *Act* state that the court may require the *person*, whether *authorised* or not, to supply it with accounts or other information to help the court:
- (1) to establish whether and, if so how much, profit may have been made as a result of the contravention; or
 - (2) to establish whether any *persons* have suffered any losses or adverse effects as a result of the contravention of a relevant requirement or *market abuse* and, if so, the extent of those losses or adverse effects; or
 - (3) to determine how any amounts are to be paid or distributed to qualifying *persons*.
- 9.8.3** **G**_{/1} An application by the *FSA* for an order for restitution under section 382 or 383 will not prevent a *person* from bringing a private action for restitution in relation to the same matter. However, the court is likely to consider whether any payments have already been made to private claimants when it decides whether to order restitution in any case.
- 9.8.4** **G**_{/1} When the *FSA* decides the amount of restitution which a *firm* or *unauthorised person* must pay following the exercise of its administrative power to require restitution, it must approach the matter in the same way as the court would in accordance with section 382(5) of the *Act*.
- 9.8.5** **G**_{/1} The *FSA* may obtain information relating to the amount of profits made and/or losses or other adverse effects resulting from the conduct of *firms* or *unauthorised persons* as a result of the exercise of its powers to appoint investigators under sections 167 (Appointment of persons to carry out general investigations) or 168 (Appointment of persons to carry out investigations in particular cases) of the *Act*. The *FSA*'s policy and procedure in respect of its powers to appoint investigators are contained in *ENF 2* (Information gathering and investigation powers).
- 9.8.6** **G**_{/1} As well as obtaining information through the appointment of investigators, the *FSA* may consider using its power under section 166 of the *Act* (Reports by skilled persons) to require a *firm* to provide a report prepared by a *skilled person* (see *ENF 2.3.8G* to *ENF 2.3.11G*). That report may be requested to help the *FSA* to:
- (1) determine the amount of profits which have been made by the *firm*; or
 - (2) establish whether the conduct of the *firm* has caused any losses or other adverse effects to qualifying *persons* and/or the extent of such losses; or

- (3) determine how any amounts to be paid by the *firm* are to be distributed between qualifying *persons*.

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The *person* appointed to make a report under *ENF 9.8.6G* must be nominated or approved by the *FSA* and appear to the *FSA* to have the necessary skills to report on the matter.

9.9 Other relevant powers

- 9.9.1** **G**_{/1} The *FSA* may apply to the court for an *injunction* if it appears that a *person*, whether *authorised* or not, is reasonably likely to breach a requirement of the *Act* or engage in *market abuse*. It can also apply for an *injunction* if a *person* has breached a requirement of the *Act* or engaged in *market abuse* and is likely to continue doing so. The *FSA*'s procedure in relation to the exercise of its powers to apply for *injunctions* is set out in *ENF* 6 (Injunctions).
- 9.9.2** **G**_{/1} The *FSA* may consider taking disciplinary action, or action to impose a penalty for *market abuse*, as well as seeking restitution, if a *person* has breached a relevant requirement of the *Act* or has engaged in, or *required* or *encouraged* others to engage in, *market abuse*. As restitution is essentially restorative it may often be appropriate for the *FSA* to take disciplinary action. Disciplinary action, or action to impose a penalty for *market abuse*, may take the form of either:
- (1) imposing a financial penalty: the *FSA*'s policy and procedures in relation to imposing financial penalties is set out in *ENF* 13 (Financial penalties against firms and approved persons) and *ENF* 14 (Sanctions for market abuse); or
 - (2) making a public statement of misconduct or public censure: the *FSA*'s policy and procedure in relation to public statements of misconduct is set out in *ENF* 12 (Public statements of misconduct about firms and approved persons) and *ENF* 14 (Sanctions for market abuse).
- 9.9.3** **G**_{/1} The *FSA* may consider exercising its power to prosecute offences under the *Act*, as well as applying to seek restitution if a *person* has breached certain requirements of the *Act*. The offences the *FSA* has power to prosecute, and the *FSA*'s policy and procedure in relation to the prosecution of these offences, are set out in *ENF* 15 (Prosecution of criminal offences).

9.10 Publication

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The *FSA* considers it generally appropriate to publish details of successful applications to court for restitution, or the exercise of its administrative power to require restitution, in order to protect and inform *consumers* and maintain *market* confidence. The *FSA*'s policy in relation to the publication of *final notices* is set out in *DEC 5.2 (Publication)*. The *FSA* will normally publish *final notices* relating to administrative restitution action. However, in certain circumstances it may decide not to publicise that it has obtained an order for restitution or exercised its power to require restitution. It may make that decision where, for example, publication could damage market confidence or undermine market integrity in a way that could be damaging to the interests of *consumers*. Where the *behaviour* to which the restitution order or exercise of the *FSA*'s restitutionary power relates has happened in the context of a *takeover bid*, the *FSA* will consult the *Takeover Panel* and, if it believes that publication may affect the timetable or outcome of that bid, will give due weight to the *Takeover Panel's* views.

Chapter 10

Insolvency proceedings and orders against debt avoidance



10.1 Application

10.1.1

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This chapter applies to:

- (1) *firms*;
- (2) *appointed representatives*; and
- (3) any other *person* who is carrying on *regulated activities* in breach of the *general prohibition*.



10.2 Purpose

10.2.1

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The purpose of this chapter is to explain the *FSA*'s policies on how it will:

- (1) use its powers under the *Act* to apply to court for orders under existing insolvency legislation;
- (2) exercise its rights in the *Act* to be involved in proceedings under that legislation.

10.2.2

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The *FSA*'s effective use of its powers and rights in insolvency proceedings will help it pursue its *regulatory objectives* of maintaining market confidence, protecting *consumers* and reducing *financial crime* by, amongst other matters, enabling it to apply to court for action to:

- (1) stop *firms* and *unauthorised persons* carrying on insolvent or unlawful business; and
- (2) ensure the orderly realisation and distribution of their assets.

10.3 Introduction

10.3.1

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This chapter outlines the *FSA*'s:

- (1) powers to seek administration, compulsory winding up and bankruptcy orders and, in Scotland, sequestration awards, from the court (*ENF* 10.5), and its policies in relation to the use of those powers (*ENF* 10.6);
- (2) powers to apply to court to challenge acts and omissions in company moratoria and to challenge an approved voluntary arrangement in respect of a corporate or individual *authorised person*, and in Scotland, a trust deed for creditors granted by an *authorised person* (*ENF* 10.7), and its policy in relation to the use of those powers (*ENF* 10.8);
- (3) power to apply to court for orders against debt avoidance (*ENF* 10.9), and its policy in relation to the use of that power (*ENF* 10.10);
- (4) rights in certain cases:
 - (a) to be informed of third party petitions for administration, compulsory winding up and bankruptcy orders and, in Scotland, sequestration awards;
 - (b) to receive information and (where relevant) to attend and be heard at meetings of creditors and creditors' committees in the following regimes:
 - (i) voluntary and compulsory winding up;
 - (ii) administrations;
 - (iii) receiverships and administrative receiverships;
 - (iv) bankruptcies and sequestrations;
 - (v) company moratoria and voluntary arrangements ;
 - (vi) individual voluntary arrangements;
 - (vii) trust deeds for creditors in Scotland;

in respect of *firms* or former *firms* or others who are or have been carrying on a *regulated activity* while unauthorised (*ENF* 10.11);
- (5) arrangements for notification of petitions and other documents to which it is entitled (*ENF* 10.12);
- (6) policy in relation to the exercise of its rights to be heard and be involved in insolvency regimes affecting *persons* whether *authorised* or not (*ENF* 10.13).

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The provisions of the *Act* relating to the *FSA*'s powers and rights in insolvency proceedings refer to the underlying insolvency legislation, namely the Insolvency Act 1986 ('the 1986 Act'), as amended by the Insolvency Act 2000, the Bankruptcy (Scotland) Act 1985 ('the 1985 Act') and the Insolvency (Northern Ireland) Order 1989 ('the 1989 Order'). *ENF* 10.5, *ENF* 10.7, *ENF* 10.9 and *ENF* 10.11 outline the statutory background to the *FSA*'s powers and rights in insolvency proceedings and summarise the relevant provisions of that underlying insolvency legislation.



10.4 The FSA's general approach

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The *FSA* takes full account of the principle consistently adopted by the courts that recourse to insolvency regimes is a step to be taken for the benefit of creditors as a whole. It also takes full account of the fact that the court will have regard to the public interest when considering whether to wind up a body on the grounds that it is just and equitable to do so. The *FSA* will use its powers to seek *insolvency orders* with these matters in mind.

10.4.2

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The *FSA* will consider the facts of each particular case when it decides whether to use its powers and exercise its rights. The *FSA* will also consider the other powers available to it under the *Act* and to *consumers* under the *Act* and other legislation, and the extent to which the use of those other powers meets the needs of *consumers* as a whole and the *FSA's regulatory objectives*.



10.5 Statutory background: The FSA's powers to seek insolvency orders

Administration orders

10.5.1

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Under section 359 of the *Act* (Petitions), the *FSA* may present a petition to the court under section 9 of the 1986 Act or article 22 of the 1989 Order, for an administration order in relation to a *company* or insolvent *partnership* which:

- (1) is, or has been, an *authorised person*; or
- (2) is, or has been, an *appointed representative*; or
- (3) is carrying on, or has carried on, a *regulated activity* in contravention of the *general prohibition*.

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The court may make an administration order only if it is satisfied that a *company* or a *partnership* is, or is likely to become, unable to pay its debts. Sections 359(3) and (4) of the Act provide that a *company* or *partnership* is to be treated as unable to pay its debts for the purpose of section 8(1)(a) of the 1986 Act or article 21(1)(a) of the 1989 Order if it is in default on an obligation to pay a sum which is due and payable under an agreement where the making or performance of this agreement constitutes or is part of a *regulated activity* carried on by the *company* or *partnership*.

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In addition, a court may only make an administration order if it considers that making the order would be likely to achieve one or more of the following purposes:

- (1) the survival of the *company* or *partnership*, and the whole or any part of its *undertaking*, as a going concern;
- (2) the approval of a *company* voluntary arrangement;
- (3) the sanctioning under section 425 of the Companies Act 1985 of a compromise arrangement between the *company* or *partnership* and any such *persons* as are mentioned in that section;
- (4) a more advantageous realisation of the assets of the *company* or *partnership* than would be effected on a winding up.

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Under section 8(4) of the 1986 Act and article 21(4) of the 1989 Order, no administration order can be made in relation to an insurance company (within the meaning of the Insurance Companies Act 1982). Section 360 of the *Act* (Insurers) empowers the Treasury to order that provisions, or specified provisions, of the 1986 Act and the 1989 Order relating to administration orders are to apply in relation to insurance companies, with such modification as may be specified. As at

the date of publication of this manual the Treasury has not yet made such an order.

Winding up by the court

10.5.5 **G**_{/1} Under section 367 of the *Act* (Winding-up petitions), the *FSA* may present a petition to the court for the winding up of a body which:

- (1) is, or has been, an *authorised person*; or
- (2) is, or has been, an *appointed representative*; or
- (3) is carrying on, or has carried on, a *regulated activity* in contravention of the *general prohibition*.

10.5.6 **G**_{/1} Under section 355 of the *Act* (Interpretation of this Part), a 'body' is any body of *persons* over which the court has jurisdiction under any provision of the 1986 Act or the 1989 Order, or made under that *Act* or Order. It does not however include a body which is a *building society*, *friendly society* or *industrial and provident society*. For the purpose of section 367 of the *Act*, 'body' includes a *partnership*.

10.5.7 **G**_{/1} Under section 367(3) of the *Act*, following a petition by the *FSA*, the court may wind up the body if:

- (1) the body is unable to pay its debts; or
- (2) the court is of the opinion that it is just and equitable that the body should be wound up.

10.5.8 **G**_{/1} Section 367(4) and (5) of the *Act* state that the body is to be treated as unable to pay its debts, within the meaning of section 123 or 221 of the 1986 Act or article 103 or 185 of the 1989 Order, if it is in default on an obligation to pay a sum due and payable under an agreement where the making or performance of this agreement constitutes or is part of a *regulated activity* carried on by the body.

Voluntary winding up

10.5.9 **G**_{/1} Under section 365 of the *Act* (*FSA's* powers to participate in proceedings), if a *company* is being wound up voluntarily and it is:

- (1) an *authorised person*; and
- (2) not an insurance *company* carrying on *long term insurance business*;

the *FSA* may apply to the court, under section 112 of the 1986 Act, or article 98 of the 1989 Order, to determine any question which arises in the winding up of a *company* or to request the court to exercise all or any of the powers which the court might exercise if it were winding up the *company*.

10.5.10 **G**_{/1} The *FSA* is entitled to be heard at any hearing of the court in relation to the voluntary winding up of the *company*.

- 10.5.11** **G**_{/1} Under section 365(6) of the *Act*, the voluntary winding up of an *authorised person* that is a *company* does not bar the right of the *FSA* to have it wound up by the court.
- 10.5.12** **G**_{/1} Under section 365(7) of the *Act*, if, while a *company* is being voluntarily wound up, a compromise or arrangement is proposed between the *company* and its creditors, or any class of creditors, the *FSA* may apply to the court, under section 425 of the Companies Act 1985 or article 418 of the Companies (Northern Ireland) Order 1986, for an order requiring the convening of a meeting of the creditors or class of creditors
- 10.5.13** **G**_{/1} Under section 366 of the *Act* (Insurers effecting or carrying out long-term contracts of insurance), an insurance *company* carrying on *long term insurance business* may not be wound up voluntarily without the *FSA*’s consent. If, in the case of such a *company*, notice of a general meeting is given specifying the intention to propose a resolution for voluntary winding up, a *director* of the *company* must notify the *FSA* as soon as practicable after he becomes aware of it. Where a moratorium is in place in relation to a *company* under Schedule A1 to the 1986 Act, the *FSA* may not petition for an administration order or winding up order in relation to the *company* while the moratorium is effective.

Bankruptcy and, in Scotland, sequestration

- 10.5.14** **G**_{/1} (1) Under section 372 of the *Act* (Petitions), the *FSA* has power to present a petition to the court, under section 264 of the 1986 Act or article 238 of the 1989 Order, for the bankruptcy of an individual or, in Scotland, under section 5 of the 1985 Act for the sequestration of the estate of an individual. A petition may be presented only on the grounds that the individual appears to be unable to pay a *regulated activity debt* or appears to have no reasonable prospect of being able to pay a *regulated activity debt*.

(2) A *regulated activity debt* is an obligation to pay a sum due and payable under an agreement where the making or performance of this agreement constitutes or is part of a *regulated activity* carried on by the individual.
- 10.5.15** **G**_{/1} Under section 372(4) of the *Act*, an individual appears to have no reasonable prospect of being able to pay a *regulated activity debt* if:

 - (1) the *FSA* has served a demand on him which requires him to establish, to the satisfaction of the *FSA*, that there is a reasonable prospect of his being able to pay a *regulated activity debt*, when it falls due; and
 - (2) at least three weeks have elapsed since the demand was served; and
 - (3) the individual has not complied with the demand and the court has not set it aside.
- 10.5.16** **G**_{/1} A demand (see *ENF* 10.5.15G (1)) is to be treated for the purposes of the 1986 Act or the 1989 Order as if it were a statutory demand under section 268 of the 1986 Act or article 242 of the 1989 Order. In relation to petitions served under section 5 of the 1985 Act, the *FSA* is to be treated as a qualified creditor and, when the petition is presented on the grounds that the individual appears unable to pay a *regulated activity debt*, that ground is to constitute apparent insolvency for the purposes of the 1985 Act.

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The FSA's power to petition only applies to individuals who are, or have been, *authorised persons* or who are carrying on, or have carried on, a *regulated activity* in contravention of the *general prohibition*.



10.6 The FSA's policy: applications for insolvency orders.

Determining whether a company or partnership is unable to pay its debts

10.6.1

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- (1) The FSA can petition for an administration order or compulsory winding up order on the grounds that the *company* or *partnership* is unable (or, in the case of administration orders, is likely to become unable) to pay its debts. The FSA does not have to be a creditor to petition on these grounds.
- (2) Under sections 359 (Petitions) and 367 (Winding-up Petitions) of the *Act*, a *company* or *partnership* is deemed to be unable to pay its debts if it is in default on an obligation to pay a sum due and payable under an agreement where the making or performance of this agreement constitutes or is part of a *regulated activity* which the *company* or *partnership* is carrying on.
- (3) The FSA would not ordinarily petition for an administration order unless it believes that the *company* or *partnership* is, or is likely to become, insolvent. Similarly, the FSA would not ordinarily petition for a compulsory winding up order solely on the ground of inability to pay debts (as provided in the *Act*), unless it believes that the *company* or *partnership* is or is likely to be insolvent.
- (4) While a default on a single agreement of the type mentioned in (2) is, under the *Act*, a presumption of an inability to pay debts, the FSA will consider the circumstances surrounding the default. In particular, the FSA will consider whether:
 - (a) the default is the subject of continuing discussion between the *company* or *partnership* and the creditor, under the relevant agreement, which is likely to lead to a resolution;
 - (b) the default is an isolated incident;
 - (c) in other respects the *company* or *partnership* is meeting its obligations under agreements of this kind; and
 - (d) the FSA has information to indicate that the *company* or *partnership* is able to pay its debts or, alternatively, that in addition to the specific default the *company* or *partnership* is in fact unable to pay its debts.

Determining whether to seek any insolvency order

10.6.2

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- (1) Where the FSA believes that a *company* or *partnership* to which sections 359(1) and 367(1) of the *Act* applies (see ENF 10.5.1G and ENF 10.5.5G) is,

or is likely to be, unable to pay its debts, the *FSA* will consider whether it is necessary to seek an administration order or compulsory winding up order from the court.

- (2) The *FSA*'s approach will be in two stages: the first is to consider whether it is appropriate to seek any *insolvency order*; the second is to consider which *insolvency order* will meet, or is likely to meet, the needs of *consumers*.

10.6.3

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In determining whether to seek an *insolvency order*, the *FSA* will consider all relevant factors, including:

- (1) Whether the *company* or *partnership* has taken or is taking steps to deal with its insolvency, including petitioning for its own administration, placing itself in voluntary winding up or proposing to enter into a *company* voluntary arrangement, and the effectiveness of those steps;
- (2) Whether any *consumer* or other creditor of the *company* or *partnership* has taken steps to seek an *insolvency order* from the court;
- (3) the effect on the *company* or *partnership* and on the creditors of the *company* or *partnership* if an *insolvency order* is made;
- (4) Whether the use of other powers available to the *FSA* will achieve the same or a more advantageous result in terms of the protection of *consumers*, and of market confidence and the restraint and remedy of unlawful activity:
 - (a) in the case of *authorised persons* and *appointed representatives*, the interests of *consumers* may, in certain circumstances, be met by the use of the *FSA*'s intervention powers and by requiring restitution to *consumers*;
 - (b) in the case of unauthorised *companies* and *partnerships*, the *FSA* will consider whether the interests of *consumers* can be achieved by seeking an *injunction* to restrain continuation of the carrying on of the *regulated activity* and an order for restitution to *consumers*;
 - (c) when it considers whether these courses of action are appropriate, the *FSA* will take full account of their effects on the creditors of the body;
- (5) the nature and extent of the body's assets and liabilities, and in particular whether the body holds *client* assets and whether its secured and preferred liabilities are likely to exceed available assets;
- (6) Whether there is a significant cross border or international element to the business which the *company* or *partnership* is carrying on and the effect on foreign assets or on the continuation of the business abroad of making an *insolvency order*; and
- (7) Whether there is a risk of creditors being preferred which may be an advantage in securing a moratorium in relation to proceedings against the body.

10.6.4

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After the *FSA* has determined that it is appropriate to seek an *insolvency order*, and there is no moratorium in place under Schedule A1 to the 1986 Act, it will consider whether this order should be an administration order or a compulsory winding up order.

Determining which insolvency order to seek

10.6.5

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- (1) As stated in *ENF 10.4* the *FSA's* general approach to the use of the power to seek an *insolvency order* from the court is to consider the needs of the *consumers* and the *FSA's regulatory objectives*.
- (2) The *FSA* will consider whether to apply for an administration order or a compulsory winding up order having regard to the purpose achieved by the insolvency procedure. In addition, however, an administration order can be made only in relation to *companies* and *partnerships* and only where the court believes that making such an order will achieve one or more of the four purposes set out in section 8 of the 1986 Act (see *ENF 10.5.3G*). The *FSA* will apply for an administration order only where it considers this will meet or is likely to meet one or more of these purposes.
- (3) In addition, the *FSA* will consider, where relevant, factors including:
 - (a) the extent to which the financial difficulties are or are likely to be attributable to the management of the *company* or *partnership* or external factors, for example, market forces;
 - (b) the extent to which it appears to the *FSA* that the *company* or *partnership* may, through an administrator, be able to trade its way out of its financial difficulties;
 - (c) the extent to which the *company* or *partnership* can lawfully and viably continue to carry on *regulated activities* through an administrator;
 - (d) the extent to which the sale of the business in whole or in part as a going concern is likely to be achievable;
 - (e) the complexity of the business of the *company* or *partnership*;
 - (f) whether recourse to one regime or another is likely to result in delays in redress to *consumers* or an additional cost;
 - (g) whether recourse to one regime or another is likely to result in better redress to *consumers*;
 - (h) the adequacy and reliability of the *company* or *partnership's* accounting or administrative records;
 - (i) the extent to which the management of the *company* or *partnership* has co-operated with the *FSA*;
 - (j) in the case of an unauthorised *company* or a *partnership* carrying on a *regulated activity* as part of a larger enterprise, the scale and importance of the unauthorised activity in relation to the whole of the *company's* or *partnership's* business;
 - (k) the extent to which the management of the *company* or *partnership* is likely to cooperate in determining whether one or more of the purposes of an administration order can be met;
 - (l) in the case of an unauthorised *company* or *partnership* carrying on a *regulated activity* as part of a larger enterprise, the extent to which the *company's* or *partnership's* survival can be anticipated without the discontinuance of the unauthorised *regulated activity*;

- (m) where an administrative receiver is in place, whether the *debenture* holder is likely to agree to an application for an administration order;
- (n) where an administrative receiver is in place, whether the *FSA* has reason to believe that the *debenture* under which the administrative receiver has been appointed is likely to be released, discharged, avoided or challenged.

Petitioning for compulsory winding up on just and equitable grounds

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- (1) The *FSA* has power under section 367(3)(b) of the *Act* to petition the court for the compulsory winding up of a *company* or *partnership*, on the grounds that it is just and equitable for the body to be wound up, regardless of whether or not the body is able to pay its debts. In some instances the *FSA* may need to consider whether to petition on both these grounds and on grounds of insolvency.
- (2) When deciding whether to petition on these grounds the *FSA* will consider all relevant facts including:
 - (a) whether the needs of *consumers* and the public interest require the body to cease to operate;
 - (b) the need to protect *consumers'* claims and *client* assets;
 - (c) whether the needs of *consumers* and the public interest can be met by using the *FSA's* other powers;
 - (d) in the case of an *authorised person*, where the *FSA* considers that the *authorisation* should be withdrawn or where it has been withdrawn, the extent to which there is other business that the *person* can carry on without *authorisation*;
 - (e) in the case of an *unauthorised* body carrying on a *regulated activity* as part of a larger enterprise, the scale and importance of the *unauthorised regulated activity* and the extent to which the enterprise is likely to survive the restraint and remedying of that activity by the use of other powers available to the *FSA*;
 - (f) whether there is reason to believe that an *injunction* to restrain the carrying on of an *unauthorised regulated activity* would be ineffective;
 - (g) whether the body appears to be or to have been involved in *financial crime* or appears to be or to have been used as a vehicle for *financial crime*.
- (3) Where appropriate the *FSA* will also take the following factors into account:
 - (a) the complexity of the body (as this may have a bearing on the effectiveness of winding up or any alternative action);
 - (b) whether there is a significant cross border or international element to the business being carried on by the body and the impact on the business in other jurisdictions;
 - (c) the adequacy and reliability of the body's accounting or administrative records;

(d) the extent to which the body’s management has cooperated with the *FSA*.

Petitioning for compulsory winding up of a company or partnership already in voluntary winding up

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Section 365(6) of the *Act* (FSA’s powers to participate in proceedings) makes clear that the *FSA* may petition for the compulsory winding up of a *company* even if that *company* is already in voluntary winding up. This power is already available to creditors and contributories of *companies* in voluntary winding up, although it is rarely exercised. In many instances where there is concern about the way in which a voluntary winding up is proceeding, any creditor or contributory of a *company* in voluntary winding up (or its liquidator) may apply to the court for it to exercise any power which it would have in a compulsory winding up. For example, the court can be asked to direct the liquidator to investigate a transaction which the *company* undertook before the winding up. Under section 365(2) of the *Act*, the *FSA* also has the power to make such an application.

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- (1) Given the powers available to creditors (or contributories), the *FSA* anticipates that there will only be a limited number of cases where it will exercise the right under section 365(6) to petition for the compulsory winding up of a *company* already in voluntary winding up. The *FSA* will only be able to exercise this right where one or both of the grounds on which it can seek compulsory winding up are met (see *ENF* 10.5.7G).
- (2) Factors which the *FSA* will consider when it decides whether to use this power (in addition to the factors identified in *ENF* 10.6.5G and *ENF* 10.6.6G in relation to the *FSA*’s decisions to seek compulsory winding up) include:
 - (a) whether the *FSA*’s concerns can properly and effectively be met by seeking a specific direction under section 365(2) of the *Act*;
 - (b) whether the affairs of the *company* require independent investigation of the kind which follows a compulsory winding up order and whether there are or are likely to be funds available for that investigation;
 - (c) the composition of the creditors of the *company* and in particular the ratio of *consumer* and non-*consumer* creditors;
 - (d) the extent to which there are creditors who are or are likely to be connected to the *company* or its *directors* and management;
 - (e) the extent to which the *directors* and management of the *company* are cooperating with the liquidator in voluntary winding up;
 - (f) the need to protect and distribute *consumers’ claims* and assets;
 - (g) whether a petition by the *FSA* for compulsory winding up is likely to have the support of the majority or a large proportion of the creditors; and
 - (h) the extent of any resulting delay and additional costs.

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Where the *FSA* is requested by a *Home State regulator* of an *EEA firm* or a *Treaty firm* to present a petition for the compulsory winding up of that *firm*, the *FSA* will first need to consider whether the presentation of the petition is necessary in order to comply with a Community obligation.

Power to apply to court for a provisional liquidator

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Where a petition has been presented for the winding up of a body, the court may appoint a provisional liquidator in the interim period pending the hearing of the petition. An appointment may be sought and made to:

- (1) enable the affairs of the *company* or *partnership* to be conducted in the proper manner; or
- (2) protect assets in the possession or under the *control* of the *company* or *partnership* (in particular where there is a risk that the assets will be dissipated); or
- (3) allow the winding up process to start before the determination of the petition where the public interest requires it.

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In cases where it decides to petition for the compulsory winding up of a body under section 367 of the *Act*, the *FSA* will also consider whether it should seek the appointment of a provisional liquidator. The *FSA* will have regard, in particular, to the extent to which there may be a need to protect *consumers'* claims and *consumers'* funds. Where the *FSA* decides to petition for the compulsory winding up of a *company* or *partnership* on the just and equitable ground, and where the *company* or *partnership* is solvent but may become insolvent, the *FSA* will also consider whether the appointment of a provisional liquidator would serve to maintain the solvency of the *company* or *partnership*.

The FSA's use of its power to petition for a bankruptcy order or a sequestration award in relation to an individual

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- (1) The *FSA* recognises that the bankruptcy of an individual or the sequestration of an individual's estate are significant measures which may have significant personal and professional implications for the individual involved. In considering whether to present a petition the *FSA's* principal consideration will be the protection of *consumers* and its regulatory obligations.
- (2) The *FSA* is also mindful that whilst the winding up of an unauthorised *company* or *partnership* should bring an end to any unlawful activity, this is not necessarily the effect of bankruptcy or sequestration. The *FSA* may, in certain cases, consider the use of powers to petition for bankruptcy or sequestration in conjunction with the use of other powers to seek *injunctions* and other relief from the court. In particular, where the individual *controls* assets belonging to *consumers* and holds, or appears to hold, those assets on trust for *consumers*, those assets will not vest in the insolvency practitioner appointed in the bankruptcy or sequestration. The *FSA* will in those circumstances consider whether separate action is necessary to protect the assets and interests of *consumers*.

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- (1) If an individual appears to be unable to pay a *regulated activity debt*, or to have no reasonable prospect of doing so, then section 372 of the *Act* permits the *FSA* to petition for the individual's bankruptcy, or in Scotland, for the sequestration of the individual's estate. The *FSA* will petition for bankruptcy or sequestration only if it believes that the individual is, in fact, insolvent.
- (2) In determining this, as a general rule, the *FSA* will serve a demand requiring the individual to establish, to the *FSA's* satisfaction that there is a reasonable prospect that he will be able to pay the *regulated activity debt*.

- (3) The *FSA* will consider the response of each individual to that demand on its own facts and in the light of information, if any, available to the *FSA*. Exceptionally, the *FSA* may not first proceed to serve a demand if:
 - (a) the individual is already in default of a *regulated activity debt* which has fallen due and payable; and
 - (b) the *FSA* is satisfied, either because the individual has confirmed it or on the information already available to the *FSA*, that the individual is insolvent and has no reasonable prospect of paying another *regulated activity debt* when it falls due.

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If the *FSA* believes that the individual is insolvent, the factors it will consider when it decides whether to seek a bankruptcy order or sequestration award include:

- (1) whether others have taken steps to deal with the individual's insolvency, including a proposal by the individual of a voluntary arrangement, a petition by the individual for his own bankruptcy or sequestration, or a petition by a third party for the individual's bankruptcy or the sequestration of the individual's estate;
- (2) whether the *FSA* can deal with the individual using other powers available to it under the *Act*, without the need to seek a bankruptcy order or sequestration award;
- (3) the extent of the individual's insolvency or apparent insolvency;
- (4) the number of *consumers* affected and the extent of their claims against the individual;
- (5) whether the individual has control over assets belonging to *consumers*;
- (6) the individual's conduct in his dealings with the *FSA*, including the extent of his cooperation with the *FSA*;
- (7) whether the individual appears to be, or to have been, involved in *financial crime*;
- (8) the adequacy of the individual's accounts and administration records;
- (9) in the case of an *unauthorised* individual who is carrying on or who has carried on a *regulated activity*, the nature, scale and importance of that activity and the individual's conduct in carrying on that activity;
- (10) whether there would be an advantage in securing a moratorium in respect of proceedings against the individual; and
- (11) whether there are any special personal or professional implications for that individual if a bankruptcy order or sequestration award is made.



10.7 Statutory background: the FSA's powers to challenge voluntary arrangements

10.7.1 **G**_{/1} Under section 357(3) of the *Act* (FSA's powers to participate in proceedings [individual voluntary arrangements]), the *FSA* is entitled to attend a creditors' meeting, called to approve proposals for an individual voluntary arrangement. The *FSA* has no power under the *Act* to attend the meeting of creditors at which proposals for a *company's* voluntary arrangement are approved, other than in the case of certain small *companies* for whom a moratorium is in place under Schedule A1 to the 1986 *Act* (see *ENF* 10.7.5G).

10.7.2 **G**_{/1} However, in relation to a *company* which is or has been an *authorised person* or *appointed representative* or is carrying on or has carried on a *regulated activity* in contravention of the *general prohibition*, where a member applies to the court to challenge a decision taken at the creditors' meeting, the *FSA* has the right to be heard by the court on that application.

10.7.3 **G**_{/1}

- (1) Under section 356 of the *Act* (FSA's powers to participate in proceedings [company voluntary arrangements]), if a voluntary arrangement has been approved in respect of a *company* which is an *authorised person*, the *FSA* may make an application to the court where it considers that:
 - (a) the voluntary arrangement approved at the relevant meetings of creditors unfairly prejudices the interests of a creditor, member or contributor of the *company*; or
 - (b) there has been some material irregularity at or in relation to the meetings; or
 - (c) both (a) and (b) apply.
- (2) In addition, the *FSA* may make an application to the court if it or any of the *company's* creditors or any other creditor is dissatisfied by any act, omission or decision of the supervisor of the voluntary arrangement.
- (3) If a *person* other than the *FSA* makes such an application to the court, the *FSA* is entitled to be heard at any hearing relating to the application.
- (4) Section 357 contains the same provision in relation to a voluntary arrangement approved in respect of an individual who is an *authorised person*.
- (5) In addition, the *FSA* is empowered to apply to the court if it or the debtor or any creditor or any other *person* is dissatisfied with any act, omission or decision made by the supervisor of the individual's voluntary arrangement.

10.7.4 **G**_{/1} Under section 358 of the *Act* (FSA's powers to participate in proceedings [trust deeds for creditors in Scotland]), if, in Scotland, a trust deed has been granted by or on behalf of a debtor who is an *authorised person*, the *FSA* has the rights of a

qualifying creditor under paragraph 7 of Schedule 5 to the 1985 Act. Consequently, the FSA may, subject to the time limits applying to that paragraph, petition for sequestration of the debtor's estate on the grounds of unduly prejudicial distribution of the estate.

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- (1) Under paragraph 44 of Schedule A1 to the 1986 Act, the FSA is empowered to apply to the court to challenge certain actions by a nominee or by *directors* of a *company* for whom a moratorium has been obtained and any voluntary arrangement subsequent to that moratorium under Schedule A1 of the 1986 Act.
- (2) Schedule A1 to the 1986 Act applies to certain small *companies*. It does not apply to insurance *companies*, authorised institutions or former authorised institutions within the meaning of the Banking Act 1987 [now repealed] parties to a market contract, a money market contract or a related contract, *companies* whose property is subject to a market charge, money market charge or a system charge, or where the *company* is a participant within the meaning of the Settlement Finality Regulations or any of its properties is subject to a collateral security charge within the meaning of these Regulations.

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The FSA's powers under Schedule A1 to the 1986 Act may be exercised by it in relation to a *company* which is or has been an *authorised person* or *appointed representative* or is carrying on or has carried on a *regulated activity* in contravention of the *general prohibition*.



10.8 The FSA's policy: applications in relation to voluntary arrangements

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In general terms, the approval of a voluntary arrangement (in relation to *companies*, *partnerships* and individuals) requires more than 75% of the creditors to whom notice of a meeting has been sent and who are present in person or by proxy. The arrangement must also not be opposed by more than 50% of creditors given notice of the meeting and who have notified their claim, but excluding secured creditors and creditors who are, in the case of *companies* or *partnerships*, connected persons and, in the case of individuals, associates. The FSA will therefore not normally challenge an arrangement approved by a majority of creditors.

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Exceptionally, the FSA will consider making such a challenge after considering, in particular, the following matters:

- (1) the ratio of *consumer* to non-consumer creditors;
- (2) Whether the FSA has concerns, or is aware of concerns of creditors, about the regularity of the meeting or the identification of connected or associated creditors and the extent to which creditors with those concerns could themselves make the application;
- (3) whether the *company*, *partnership* or individual has control of *consumer* assets which might be affected by the voluntary arrangement;
- (4) the complexity of the arrangement;
- (5) the nature and complexity of the *regulated activity*;
- (6) the *company's*, *partnership's* or individual's previous dealings with the FSA, including the extent of its cooperation with the FSA and its compliance history; and
- (7) whether the FSA is aware of any matters which would materially affect the rights and expectations of creditors under the voluntary arrangement as approved.

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Similarly, the FSA will not normally petition for sequestration of a debtor's estate following the grant of a trust deed, if the trust deed has been, or appears likely to be, acceded to by a majority of creditors.

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The FSA will consider making a challenge in relation to acts, omissions or decisions of a nominee during a moratorium having regard to the following matters in particular:

- (1) whether the FSA is aware of matters indicating that the proposed voluntary arrangement does not have a reasonable prospect of being approved and

implemented or that the *company* is likely to have insufficient funds available to it to carry on its business during the moratorium;

- (2) whether *consumer* assets held by the *company* are or may be placed at risk; and
- (3) in the case of an unauthorised *company*, whether that *company* is able to carry on its business lawfully during the moratorium without undertaking any *regulated activity* in contravention of the *general prohibition*.



10.9 Statutory background: the FSA's power to apply for orders against debt avoidance

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Under section 375 of the *Act* (Provisions against debt avoidance: FSA's right to apply for an order), the *FSA* may apply to the court, under section 423 of the 1986 Act or article 367 of the 1989 Order, for an order where a transaction is entered into at an undervalue and where:

- (1) at the time the transaction was entered into, the debtor was carrying on a *regulated activity* (whether or not in contravention of the *general prohibition*); and
- (2) a victim of the transaction is, or was, party to an agreement entered into with the debtor, the making and performance of which constituted or was part of a *regulated activity* carried on by the debtor.

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The *FSA's* application is to be treated as made on behalf of every victim of the transaction. Under section 423 of the 1986 Act or article 367 of the 1989 Order, the court may make such order as it thinks fit to restore the position to what it would have been if the transaction had not been entered into and to protect the interests of persons who are victims of the transaction.



10.10 The FSA's policy: applications for orders against debt avoidance

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When it decides whether to make an application for an order against debt avoidance, the *FSA* will consider all relevant factors, including the following:

- (1) the extent to which the relevant transactions involved dealings in *consumers'* funds;
- (2) whether it would be appropriate to petition for a winding-up order, bankruptcy order, or sequestration award, in relation to the debtor and the extent to which the transaction could properly be dealt with in that winding up, bankruptcy or sequestration;
- (3) the number of *consumers* or other creditors likely to be affected and their ability to make an application of this nature; and
- (4) the size of the transaction.



10.11 Statutory background: the FSA's rights to information in insolvency regimes

Administration

10.11.1 **G**_{/1} Under section 361 of the *Act* (Administrator's duty to report to the FSA), if an administration order is in force in relation to a *company* or *partnership* as a result of a petition presented by a *person* other than the *FSA*, and it appears to the administrator that the *company* or *partnership* is carrying on, or has carried on, a *regulated activity* in contravention of the *general prohibition*, the administrator must report the matter to the *FSA* without delay.

10.11.2 **G**_{/1} Under section 362 of the *Act* (FSA's powers to participate in proceedings), if a *person* other than the *FSA* petitions the court for an administration order in relation to a *company* or *partnership* which:

- (1) is, or has been, an *authorised person*; or
- (2) is, or has been, an *appointed representative*; or
- (3) is carrying on, or has carried on, a *regulated activity* in contravention of the *general prohibition*;

then the *FSA* is entitled to be heard at the hearing of the petition and at any other hearing of the court in relation to the *company's* or *partnership's* administration.

10.11.3 **G**_{/1} Under section 362(3), any notice or other *document* required to be sent to a creditor of such a *company* or *partnership* in administration (see *ENF* 10.11.2G) must also be sent to the *FSA*.

10.11.4 **G**_{/1} Under section 362(4), the *FSA* may apply to the court, under section 27 of the 1986 Act or article 39 of the 1989 Order, if it believes that the *company's* affairs, business and property are being or have been managed by the administrator in a manner which is unfairly prejudicial to the interest of its creditors and members generally, or to some part of its creditors and members, or that any act or proposed act or omission of the administrator is or would be prejudicial.

10.11.5 **G**_{/1} Under section 362(5), the *FSA* may appoint a *person* to:

- (1) attend any meeting of creditors of the *company* or *partnership* summoned under any enactment;
- (2) attend any meeting of a creditors' committee established in the administration, under section 26 of the 1986 Act or article 38 of the 1989 Order;
- (3) make representations as to any matter for decision at such a meeting.

10.11.6 G_{/1} Under section 362(6), if, during the course of the administration of a *company*, a compromise or arrangement is proposed between the *company* and its creditors, or any class of creditors, the *FSA* may apply to the court under section 425 of the Companies' Act 1985 or article 418 of the Companies' (Northern Ireland) Order 1986, for an order requiring a meeting of the creditors or class of creditors to be summoned.

Compulsory winding up

10.11.7 G_{/1} Under section 369 of the *Act* (Insurers: service of petition etc. on the *FSA*), if a *person* other than the *FSA* presents a petition for the winding up of an insurance *company* which is an *authorised person*, the petitioner must serve a copy of the petition on the *FSA*. In addition, if a *person* other than the *FSA* applies to have a provisional liquidator appointed in respect of an insurance *company* which is an *authorised person*, that *person* must serve a copy of the application on the *FSA*.

10.11.8 G_{/1} Under section 370 of the *Act* (Liquidator's duty to report to the *FSA*), if a *company* or *partnership* is in voluntary liquidation, or is being wound up on a petition presented by a *person* other than the *FSA*, and it appears to the liquidator that the *company* or *partnership* is carrying on, or has carried on, a *regulated activity* in contravention of the *general prohibition*, the liquidator must report the matter to the *FSA* without delay.

10.11.9 G_{/1} Under section 371 of the *Act* (*FSA's* powers to participate in proceedings), if a *person* other than the *FSA* presents a petition for the winding up of a body which is, or has been, an *authorised person* or *appointed representative*, or is carrying on, or has carried on, a *regulated activity* in contravention of the *general prohibition*, the *FSA* is entitled to be heard on the petition and any other hearing of the court in relation to the body under or by virtue of Part IV or V of the 1986 Act or Part V or VI of the 1989 Order .

10.11.10 G_{/1} Under section 371(3) of the *Act*, any notice or other *document* required to be sent to a creditor of the body must also be sent to the *FSA*.

10.11.11 G_{/1} Under section 371(4) of the *Act*, a *person* appointed for the purpose by the *FSA* is entitled:

- (1) to attend any meeting of creditors of the body;
- (2) to attend any meeting of a creditors' committee established under section 101, 141 or 142 of the 1986 Act or article 87 or 120 of the 1989 Order; and
- (3) to make representations about any matter which is to be decided at such a meeting.

10.11.12 G_{/1} Under section 371(5), if, during the winding up of a *company*, a compromise or arrangement is proposed between a *company* and its creditors or any class of creditors, the *FSA* may apply to the court under section 425 of the Companies Act 1985 or article 418 of the Companies (Northern Ireland) Order 1989 for an order requiring a meeting of the creditors or class of creditors to be summoned.

Voluntary liquidation

10.11.13 G_{/1} Under section 365(4) of the *Act*, in the case of a *company* which is being wound up voluntarily and is an *authorised person* (not an insurer) carrying on *long term insurance business*), any notice or other *document* required to be sent to a creditor of the *company* must also be sent to the *FSA*.

10.11.14 G_{/1} Also, section 365(5) of the *Act* permits a *person* appointed for the purpose by the *FSA*:

- (1) to attend any meeting of creditors of the *company* summoned under any enactment;
- (2) to attend any meeting of a creditors' committee summoned under section 101 of the 1986 Act or article 87 of the 1989 Order;
- (3) to make representations as to any matter for decision at that meeting.

Receivership

10.11.15 G_{/1} Section 363 of the *Act* (FSA's powers to participate in proceedings) entitles the *FSA* to be heard on applications and to receive reports about receiverships, where a receiver has been appointed in relation to a *company* which:

- (1) is, or has been, an *authorised person*; or
- (2) is, or has been, an *appointed representative*; or
- (3) is carrying on, or has carried on, a *regulated activity* in contravention of the *general prohibition*.

10.11.16 G_{/1} Under section 363(2) of the *Act*, the *FSA* is entitled to be heard on an application, under section 35 or 63 of the 1986 Act or article 45 of the 1989 Order, by a receiver, or a *person* by whom or on whose behalf the receiver has been appointed, for directions in relation to any particular matter arising in connection with the performance of the receiver's functions.

10.11.17 G_{/1} Under section 363(3) of the *Act*, the *FSA* is entitled to apply to the court, under sections 41(1)(a) or 69(1)(a) of the 1986 Act or article 51(1)(a) of the 1989 Order, if the Receiver:

- (1) defaults in filing, delivering or making any return, account or other *document* or in giving any notice which a receiver is, by law, required to file, deliver, make or give; or
- (2) (when the *company* is in liquidation) fails to render appropriate accounts of his receipts or payments and to vouch them and pay over to the liquidator the amount of property payable to him, when required by the liquidator to do so.

10.11.18 G_{/1} Under section 363(4) of the *Act*, where the receiver makes a report under section 48(1) or 67(1) of the 1986 Act or article 15(1) of the 1989 Order, that report must be sent to the *FSA* by the receiver.

10.11.19 G_{/1} Under section 363(5), a *person* appointed for the purpose by the *FSA* is entitled to:

- (1) attend any meeting of creditors of the *company* under any enactment;

- (2) attend any meeting of a creditors' committee established under sections 49 or 68 of the 1986 Act or article 59 of the 1989 Order;
- (3) make representations as to any matter for decision at such meetings.

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Under section 364 of the *Act* (Receiver's duty to report to the FSA), if a receiver has been appointed in relation to a *company* and it appears to the receiver that the *company* is carrying on, or has carried on, a *regulated activity* in contravention of the *general prohibition*, the receiver must report this to the *FSA* without delay.

Bankruptcy and sequestration

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Under section 373 of the *Act* (Insolvency practitioner's duty to report to the FSA), if a bankruptcy order or, in Scotland, a sequestration award is in force in relation to an individual, following a petition presented by a *person* other than the *FSA*, and it appears to the insolvency practitioner that the individual is carrying on, or has carried on, a *regulated activity* in contravention of the *general prohibition*, the insolvency practitioner must report this to the *FSA* without delay. For these purposes "individual" includes, in Scotland, an entity under section 6(1) of the 1985 Act.

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Under section 374 of the *Act* (FSA's powers to participate in proceedings), if a *person* other than the *FSA* presents a petition to the court for:

- (1) a bankruptcy order to be made against an individual; or
- (2) the sequestration of an individual's estate; or
- (3) the sequestration of the estate belonging to or held jointly by an entity mentioned in section 6(1) of the 1985 Act;

and that individual or entity is or has been an *authorised person*, or is carrying on or has carried on a *regulated activity* in contravention of the *general prohibition*, then the *FSA* is entitled to be heard at the hearing of the petition and at any other hearing relating to the bankruptcy or sequestration under Part IX of the 1986 Act, Part IX of the 1989 Order or the 1985 Act. A copy of the insolvency practitioner's report prepared under section 274 of the 1986 Act or article 248 of the 1989 Order must be sent to the *FSA*.

10.11.23

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Section 374(4) of the *Act* permits a *person* appointed for the purpose by the *FSA*:

- (1) to attend any meeting of creditors of the individual or entity;
- (2) to attend any meeting of a creditors' committee established under section 301 of the 1986 Act or article 274 of the 1989 Order;
- (3) to attend any meeting of commissioners held under paragraph 17 or 18 of Schedule 6 to the 1985 Act;
- (4) to make representations as to any matter for decision at such meetings.

Company Moratoria

10.11.24

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Under paragraph 44 of schedule A1 to the 1986 Act, where a moratorium is in place or a voluntary arrangement has been approved under that schedule in relation to a *company* to which the schedule applies (see ENF 10.7.5G) and which is or has been an *authorised person* or an *appointed representative* or is carrying on or has carried on a *regulated activity* in contravention of the *general prohibition*, the FSA has the right:

- (1) To receive any notice or other *documents* required by schedule A1 to the 1986 Act to be sent to a creditor;
- (2) To be heard in any application for leave in relation to disposal of charged property (paragraph 20 of schedule A1);
- (3) To be heard in any application made other than by the FSA to challenge the actions or omissions of a nominee (paragraphs 26 and 27 of schedule A1 to the 1986 Act);
- (4) To attend and participate in but not vote at any meeting of creditors of the *company* or of the moratorium committee ;
- (5) To be heard in any application by a member of the *company* in relation to a decision taken by the creditors' meeting under paragraph 36 of schedule A1 to the 1986 Act;
- (6) To be heard in any application made other than by the FSA to challenge a decision to approve a voluntary arrangement in relation to the *company* under paragraph 38 of schedule A1 to the 1986 Act;
- (7) To apply to the court and be heard in an application by a *person* other than the FSA to challenge any act, omission or decision of the supervisor under paragraph 39 of schedule A1 to the 1986 Act;
- (8) To apply to the court and to be heard on any application to the court by a *person* other than the FSA to challenge the actions of the *company's directors* under paragraph 40 of schedule A1 to the 1986 Act.



10.12 The FSA's arrangements for notification of petitions and other documents

10.12.1

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ENF 10.12.2G to ENF 10.12.4G contain information for insolvency practitioners and others about sending copies of petitions, notices and other documents to the FSA, and about making reports to the FSA. Insolvency practitioners and others have duties to give that information and those documents to the FSA under various sections in Part XXIV of the Act (Insolvency). ENF 10.12.2G identifies the relevant sections of the Act and paragraphs of ENF 10.11 that explain some of the duties.

10.12.2

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Table Insolvency regime and relevant sections of the Act and ENF 10.11

Insolvency regime	Relevant sections of the Act and paragraphs of ENF 10.11
Administration	Sections 361 and 362(3) – see ENF 10.11.1G and ENF 10.11.3G
Compulsory winding up	Sections 369, 370, and 371(3) – see ENF 10.11.7G, ENF 10.11.8G and ENF 10.11.10G
Voluntary liquidation	Section 365(4) – see ENF 10.11.13G
Receivership	Sections 363(4) and 364 – see ENF 10.11.18G and ENF 10.11.20G
Bankruptcy and sequestration	Sections 373 and 374(3) – see ENF 10.11.21G and ENF 10.11.22G
Company moratoria	Paragraph 44 of schedule A1 to the 1986 Act – see ENF 10.11.24G(1)
Individual voluntary arrangements	Section 357(3) – not in ENF 10.11 – relates to notices of the result of the creditors' meetings.
Trust deeds for creditors	Section 358(2)(a) and (b) – not in ENF 10.11 – relates to copies of trust deeds and copies of certain other documents of information sent to creditors. Section 358(4) – not in ENF 10.11 – relates to notices of any meeting of creditors held in relation to the trust deed.

10.12.3

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Unless ENF 10.12.4G applies, the information and documents identified in ENF 10.12.2G should be sent to the Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS marked "Insolvency Information". If the person who is subject to the insolvency regime ("the insolvent person") is an

authorised person, the information and documents should, in the first instance, be addressed to the insolvent person's supervisory contact at the *FSA* (if known).

10.12.4

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This paragraph applies if the insolvent person is an *authorised person* and the sender of the information or documents knows that the insolvent person's supervisory contact operates from Edinburgh. In this case information or documents should, in the first instance, be sent to the Financial Services Authority, Sutherland House, 108-114 Dundas Street, Edinburgh EH3 5DQ.



10.13 The FSA's policy: rights on petitions by third parties and involvement in creditors meetings

10.13.1

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Section 362 of the *Act* (FSA's powers to participate in proceedings [administration orders]) gives the *FSA* the right to be heard at the hearing of a petition by a third party for an administration order in respect of an *authorised person, appointed representative* or an unauthorised *company* or *partnership* which is carrying on or has carried on a *regulated activity* while unauthorised. The *FSA* has the same right to be heard on a petition by a third party for compulsory winding up (section 371 of the *Act* (FSA's powers to participate in proceedings [winding up by the court]) and bankruptcy or sequestration (section 374 of the *Act* (FSA's powers to participate in proceedings [Bankruptcy])). The *FSA* also has the right to be heard in any hearing in court following the making of such an order.

10.13.2

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The *FSA* will exercise the right to be heard on a third party's petition or in subsequent hearings only where it believes it has information that it considers relevant to the court's consideration of the petition or application. These circumstances may include:

- (1) where the *FSA* has relevant information which it believes may not otherwise be drawn to the court's attention; especially where the *FSA* has been asked to attend for a particular purpose (for example to explain the operations of its *rules*);
- (2) where the *FSA* believes that the *insolvency order* being sought by a third party is inappropriate to meet the needs of *consumers* and the public interest; and
- (3) where the *FSA* believes that the making of an *insolvency order* will affect the *FSA's* exercise of its other powers under the *Act*, and wishes to make the court aware of this.

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The making of an *insolvency order* operates to stay any proceedings already in place against the *company, partnership* or individual, and prevents proceedings being commenced while the *insolvency order* is in place. Proceedings can continue or be commenced against those *persons* only with the court's permission. This may affect the effectiveness of the *FSA's* use of its powers to seek *injunctions* and restitutionary orders from the court. The *FSA* will draw the court's attention to this potential effect where the *FSA* believes it is a relevant consideration, but it is a matter for the court to determine its relevance in a particular case.

10.13.4

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The *FSA* is given power to receive the same information as creditors are entitled to receive in the winding up, administration, receivership or voluntary arrangement of an *authorised person, of appointed representatives* and of *persons* who have carried out a *regulated activity* while unauthorised. The *FSA* is also entitled to attend and make representation at any creditors' meeting or (where relevant) creditors' committee meeting taking place in those regimes. When it decides whether to

exercise its power to attend and make representations at meetings the factors which the *FSA* will take into account include:

- (1) the extent of claims by *consumers* upon the body or individual;
- (2) the extent to which *consumer* assets are held by the body or individual on behalf of *consumers*;
- (3) the extent to which the *FSA* is aware of concerns of *consumers* (or other creditors or contributories) about the way in which the insolvency regime is proceeding;
- (4) whether the circumstances which gave rise to the insolvency regime might have general implications for others carrying on regulated business;
- (5) whether the creditors include *shareholders*, *directors*, or other *persons* who have a connection with the management or ownership of the body or are associated with the individual;
- (6) the complexity or specialisation of the business of the body or individual; and
- (7) where there is a significant cross border or international element to the business which the *company*, *partnership* or individual is carrying out.

Chapter 11

Discipline: The FSA's general approach





11.1 Application and purpose

Application

11.1.1

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- (1) This chapter applies to *firms* and *approved persons*.
- (2) *ENF* 11.3 also applies to any *person*, whether regulated or not.

Purpose

11.1.2

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This chapter describes the *FSA*'s general approach to the discipline of *firms* and *approved persons*. It describes the *FSA*'s policy on private warnings, explains the criteria which the *FSA* will use in determining whether to take disciplinary action, and describes some particular aspects of enforcement policy on *approved persons*, the enforcement of the *Principles*, the *FSA*'s approach where disciplinary action may also be taken by other authorities, and a particular aspect of enforcement policy relating to breaches of the *money laundering rules*.

11.2 Introduction

11.2.1

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Disciplinary measures are one of the regulatory tools available to the FSA. They are not the only tool, and it may be appropriate to address many instances of non-compliance without recourse to disciplinary action. However, the effective and proportionate use of the FSA's powers to enforce the requirements of the *Act*, the *rules* and the *Statements of Principle* will play an important role in buttressing the FSA's pursuit of its *regulatory objectives*. The imposition of disciplinary measures (that is, financial penalties, public censures and public statements) shows that regulatory standards are being upheld and helps to maintain market confidence, promote public awareness of regulatory standards and deter *financial crime*. An increased public awareness of regulatory standards also contributes to the protection of *consumers*.

11.2.2

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The disciplinary measures available to the FSA under Part V (Performance of Regulated Activities) and Part XIV (Disciplinary Measures) of the *Act* are:

- (1) public statements and public censures (described in ENF 12); and
- (2) financial penalties (described in ENF 13).

ENF 11 Ann 1G and ENF 11 Ann 2G contain diagrams describing how these disciplinary measures may apply to *firms* and *approved persons* respectively.

11.2.3

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Other measures are available to the FSA where it considers it is necessary to take protective or remedial action, (rather than disciplinary action) or where a *firm's* continuing ability to meet the *threshold conditions* or where an *approved person's* fitness and propriety to perform the *controlled functions* to which his approval relates, is called into question. These include:

- (1) the variation or *cancellation of permission* and the withdrawal of a *firm's* *authorisation* (described in ENF 3 and ENF 5);
- (2) the withdrawal of an individual's status as an *approved person* (described in ENF 7); and
- (3) the prohibition of an individual from performing a specified function in relation to a *regulated activity* (described in ENF 8).

11.2.4

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Additional considerations apply in determining whether to take enforcement action for *market abuse* cases (section 123 of the *Act* (Power to impose penalties in cases of market abuse)). These are described in ENF 14 (Sanctions for market abuse). The *Act* also gives the FSA criminal prosecution powers in relation to *insider dealing* and *misleading statements and practices offences*. These are described in ENF 15 (Prosecution of criminal offences).

11.3 Private warnings

- 11.3.1** G_{/1} In certain cases, despite having concerns regarding the *behaviour* of a *firm* or *approved person*, the *FSA* may decide that it is not appropriate, having regard to all the circumstances of the case, to bring formal disciplinary action. In these types of case, the *FSA* considers that it will be helpful for a *firm* or *approved person* to be made aware that they came close to being subject to formal disciplinary action, and may to that end, if appropriate, give a private warning. (It is, of course, open to the *FSA* not to give a private warning if it does not consider that one is necessary.)
- 11.3.2** G_{/1} Examples of circumstances where the *FSA* will tend to give a private warning rather than take formal disciplinary action include where the matter giving cause for concern is minor in nature or degree, or where the *firm* or *approved person* has taken full and immediate remedial action. However, these circumstances on their own will not determine the course of action taken by the *FSA*.
- 11.3.3** G_{/1} Generally, the *FSA* would expect to use private warnings in the context of *firms* and *approved persons*. However, the *FSA* may also issue private warnings in circumstances where the *persons* involved may not necessarily be *authorised*. For example, private warnings may be issued in potential cases of *market abuse* (see *ENF* 14), cases where the *FSA* considered making a *prohibition order* (see *ENF* 8) or a disapplication order (see *ENF* 18).
- 11.3.4** G_{/1} In relation to *firms* and *approved persons*, a private warning will state that:
- (1) the *FSA* has had cause for concern arising from the conduct of a *firm* or *approved person*, although no determination that a *firm* has contravened a *requirement*, or that an *approved person* has been guilty of misconduct, has been made by the *FSA*;
 - (2) the *FSA* does not at present intend to take formal disciplinary action, having regard to all the circumstances of the case;
 - (3) the private warning will form part of the *firm's* or *approved person's* compliance history, and may be taken into account in deciding whether the *FSA* brings disciplinary action against the *firm* or *approved person* in the future; and
 - (4) the *FSA* requires the *firm* or *approved person* to acknowledge receipt of the warning letter and invites the *firm* or *approved person* to comment on the private warning if they wish to do so.
- 11.3.5** G_{/1} Where the *FSA* gives a private warning to an *approved person*, it may if appropriate inform the *approved person's firm* (or employer, if different).
- 11.3.6** G_{/1} Private warnings, together with any comments received in response, will form part of the *firm's* or *approved person's* compliance history. As such they may influence

the FSA's decision whether to commence disciplinary action in relation to future breaches. However, where disciplinary action is commenced in those circumstances earlier, private warnings will not be relied upon in determining whether a breach has taken place, or in determining the level of sanction, if any, to be imposed.

11.3.7

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Where the FSA is assessing the relevance of private warnings in determining whether to commence disciplinary action, the age of a private warning will be taken into consideration. However, a long-standing private warning may still be relevant.

11.3.8

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Private warnings may be considered cumulatively, although they relate to separate areas of a *firm's* business, where the concerns which gave rise to those warnings are considered to be indicative of a *firm's* compliance culture. Similarly, private warnings issued to different *subsidiaries* of the same parent *company* may be considered cumulatively where the concerns which gave rise to those warnings relate to a common management team.

11.3.9

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As well as private warnings, it is also open to the FSA to indicate to a *firm* in ordinary correspondence that the FSA has concerns about a particular aspect of the way it conducts its *regulated activities*. This correspondence may, for example, have arisen from a supervision visit. This correspondence will also form part of a *firm's* compliance history.



11.4 Criteria for determining whether to take disciplinary action

11.4.1

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In determining whether to take disciplinary action in respect of conduct appearing to the *FSA* to be a breach, the *FSA* will consider the full circumstances of each case. A number of factors may be relevant for this purpose. The following list is not exhaustive: not all of these factors may be relevant in a particular case, and there may be other factors that are relevant.

- (1) The nature and seriousness of the suspected breach
 - (a) whether the breach was deliberate or reckless;
 - (b) the duration and frequency of the breach (including, in relation to a *firm*, when the breach was identified by those exercising *significant influence functions* in the *firm*);
 - (c) the amount of any benefit gained or loss avoided as a result of the breach;
 - (d) whether the breach reveals serious or systemic weaknesses of the management systems or *internal controls* relating to all or part of a *firm's* business;
 - (e) the impact of the breach on the orderliness of financial markets, including whether public confidence in those markets has been damaged;
 - (f) the loss or risk of loss caused to *consumers* or other market users;
 - (g) the nature and extent of any *financial crime* facilitated, occasioned or otherwise attributable to the breach; and
 - (h) whether there are a number of smaller issues, which individually may not justify disciplinary action, but which do so when taken collectively.
- (2) The conduct of the *firm* or the *approved person* after the breach
 - (a) how quickly, effectively and completely the *firm* or *approved person* brought the breach to the attentions of the *FSA* or another relevant regulatory authority;
 - (b) the degree of co-operation the *firm* or *approved person* showed during the investigation of the breach;
 - (c) any remedial steps the *firm* or *approved person* has taken since the breach was identified, including: identifying whether *consumers* have suffered loss and compensating them; taking disciplinary action against staff involved (where appropriate); addressing any systemic failures; and taking action designed to ensure that similar problems do not arise in future; and

- (d) the likelihood that the same type of contravention (whether on the part of the *firm* or *approved person* concerned or others) will recur if no disciplinary action is taken.
- (3) The previous regulatory record of the *firm* or *approved person*
 - (a) whether the *FSA* (or any *previous regulator*) has taken any previous disciplinary action resulting in adverse findings against the *firm* or *approved person*;
 - (b) whether the *firm* or *approved person* has previously given any undertakings to the *FSA* (or any *previous regulator*) not to do a particular act or engage in particular *behaviour*;
 - (c) whether the *FSA* (or any *previous regulator*) has previously taken protective action in respect of a *firm*, using its own initiative powers, by means of a variation of a *Part IV permission* (see *ENF 3*) or otherwise, or has previously requested the *firm* to take remedial action, and the extent to which such action has been taken; and
 - (d) the general compliance history of the *firm* or *approved person*, such as previous private warnings or the type of correspondence referred to in *ENF 11.3.9G*.
- (4) *Guidance* given by the *FSA*

The *FSA* will take into account whether any *guidance* has been issued relating to the *behaviour* in question and if so the extent to which the *firm* or *approved person* has sought to follow that *guidance*: see the Reader's Guide part of the *Handbook*.
- (5) Action taken by the *FSA* in previous similar cases

The *FSA* will take account of action which it has taken previously in cases where the breach has been the same or similar.
- (6) Action taken by other regulatory authorities

Where other regulatory authorities propose to take action in respect of the breach which is under consideration by the *FSA*, or one similar to it, the *FSA* will consider whether their action would be adequate to address the *FSA*'s concerns, or whether it would be appropriate for the *FSA* to take its own action (see *ENF 11.8*).



11.5 Action against approved persons

- 11.5.1** **G**_{/1} The primary responsibility for ensuring compliance with a *firm's* regulatory obligations rests with the *firm* itself. Normally, therefore, the *FSA's* main focus, in considering whether disciplinary action is appropriate, will be on the *firm* rather than on *approved persons*.
- 11.5.2** **G**_{/1} However, in some cases, it will not be appropriate to take disciplinary measures against a *firm* for the actions of an *approved person* (for example, if the *firm* can show that it took all reasonable steps to prevent the breach). In other cases, it may be appropriate for the *FSA* to take action against both the *firm* and the *approved person*. For example, a *firm* may have breached the *rule* requiring it to take reasonable care to establish and maintain such systems and controls as are appropriate to its business (SYSC 3.1.1R), and an *approved person* may have taken advantage of those deficiencies to front run orders or misappropriate assets.
- 11.5.3** **G**_{/1} The *FSA* will, however, only take disciplinary action against an *approved person* where there is evidence of personal culpability on the part of that *approved person*. Personal culpability arises where the *behaviour* was deliberate or where the *approved person's* standard of *behaviour* was below that which would be reasonable in all the circumstances.
- 11.5.4** **G**_{/1} Section 66 of the *Act* (Disciplinary powers) contains specific provisions stating when the *FSA* may take action against an *approved person* (see ENF 11.5.7G and ENF 11.5.8G). In accordance with section 64 of the *Act* (Conduct: statements and codes), the *FSA* has issued *Statements of Principle* (APER 2) about the conduct it expects of *approved persons* and a *Code of Practice for Approved Persons* (APER 3 and 4) to help determine whether an *approved person's* conduct complies with the *Statements of Principle*.
- 11.5.5** **G**_{/1} The *Code of Practice for Approved Persons* sets out descriptions of conduct which, in the *FSA's* opinion, do not comply with the relevant *Statements of Principle*. Account will be taken of the context in which a course of conduct was undertaken, including the precise circumstances of the individual case, the characteristics of the particular *controlled function* and the *behaviour* to be expected in that function (see APER 3.1).
- 11.5.6** **G**_{/1}
- (1) The *FSA* will consider whether disciplinary action against an *approved person*, rather than action against the *firm*, would be appropriate, taking into account the responsibility of those exercising *significant influence functions* in the *firm* for the conduct of the *firm*. The *FSA* will also consider whether to take disciplinary action against an *approved person* for an act of misconduct, if he was knowingly concerned in a breach of a *rule* by the *firm*, or if he has failed to comply with one of the *Statements of Principle*.
 - (2) However, the *FSA* will not discipline *approved persons* on the basis of vicarious liability (that is, holding them responsible for the acts of others), provided appropriate delegation has taken place (see APER 4.6.13G and

APER 4.6.14G). In particular, disciplinary action will not be taken against an *approved person* performing a *significant influence function* simply because a regulatory failure has occurred in an area of business for which he is responsible. The *FSA* will consider that an *approved person* performing a *significant influence function* may have breached *Statements of Principle 5 to 7* (see *ENF 11.5.10G*) only if his conduct was below the standard which would be reasonable in all the circumstances (see also *APER 3.1.8G*).

- (3) An *approved person* will not be in breach if he has exercised due and reasonable care when assessing information, has reached a reasonable conclusion and has acted on it.

The FSA's statutory powers to take disciplinary action against approved persons

11.5.7 G_{/1} Section 66(1) of the *Act* provides that the *FSA* may take action against an *approved person* where it appears to the *FSA* that he is guilty of misconduct and if the *FSA* is satisfied in all the circumstances that it is appropriate to take action against him.

11.5.8 G_{/1} Section 66(2) of the *Act* provides that a *person* is guilty of misconduct if, while an *approved person*:

- (1) he has failed to comply with a *Statement of Principle* issued under section 64; or
- (2) he has been knowingly concerned in a contravention by the relevant *firm* of a requirement imposed on it by or under the *Act*.

11.5.9 G_{/1} In determining whether an *approved person's* conduct complies with a *Statement of Principle*, the *FSA* will take into account in particular the extent to which the *approved person* has complied with the *Code of Practice for Approved Persons*.

11.5.10 G_{/1} The *Statements of Principle* and the *Code of Practice for Approved Persons* are set out in *APER 2, 3 and 4*. They are divided into two sections:

- (1) *Statements of Principle 1 to 4* apply to the conduct of all *approved persons*; and
- (2) *Statements of Principle 5 to 7* apply only to the conduct of those *approved persons* performing a *significant influence function*.


11.5.11 G_{/1} In assessing whether it is appropriate to take disciplinary action against an *approved person*, the *FSA* may consider the following, amongst other factors:


- (1) whether action against the *firm* rather than the *approved person* would be a more appropriate regulatory response; and
- (2) whether disciplinary action would be a proportionate response to the nature and seriousness of the breach by the *approved person*.


11.5.12 G_{/1} Where disciplinary action is taken against an *approved person* the onus will be on the *FSA* to show that the *approved person* has been guilty of misconduct.



11.6 Discipline for breaches of Principles for Businesses

11.6.1  ^{/1} The *Principles* are set out in PRIN 2.1.1R. The *Principles* are a general statement of the fundamental obligations of *firms* under the *regulatory system*. The *Principles* derive their authority from the FSA's rule-making powers set out in section 138 of the *Act* (General rule-making power). A breach of a *Principle* will make a *firm* liable to disciplinary action.

11.6.2  ^{/1} In determining whether a *Principle* has been broken, it is necessary to look to the standard of conduct required by the *Principle* in question. Under each of the *Principles*, the onus will be on the FSA to show that a *firm* has been at fault in some way. This requirement will differ depending upon the *Principle*: for example, under *Principle 1*, the FSA must show that a *firm* has failed to conduct its business with integrity; under *Principle 2*, the FSA must prove that the *firm* has failed to *Act* with due skill, care and diligence in the conduct of its business.

11.6.3  ^{/1} In certain cases it may be appropriate to discipline a *firm* on the basis of the *Principles* alone. Examples include the following:

- (1) where there is no detailed *rule* which prohibits the *behaviour* in question, but the *behaviour* clearly contravenes a *Principle*;
- (2) where a *firm* has committed a number of breaches of detailed *rules* which individually may not merit disciplinary action, but the cumulative effect of which indicates the breach of a *Principle*.

11.7 The standard of reasonable care

- 11.7.1** G_{/1} In a number of circumstances the *regulatory system* requires a *firm* to take reasonable care in relation to particular *behaviour*. For example, *Principle 3* requires a *firm* to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems, and SYSC 3.1.1R (taken with SYSC 3.1.2G) requires a *firm* to take reasonable care to establish and maintain such systems and controls as are appropriate to the nature, scale and complexity of its business.
- 11.7.2** G_{/1} In considering whether a *firm* has taken reasonable care, the *FSA* will consider all the circumstances of the case, and regards the following as particularly relevant:
- (1) what information the *firm* knew at the time of the *behaviour*, and what information they ought to have known in all the circumstances;
 - (2) what steps the *firm* took to comply with the *rule*, and what steps they ought to have taken in all the circumstances; and
 - (3) the standards of the *regulatory system* that applied at the time of the *behaviour*.
- 11.7.3** G_{/1} Similar considerations will apply to those in *ENF 11.7.2G* in considering whether an *approved person* took reasonable care or reasonable steps in relation to particular *behaviour*.



11.8 Action involving other regulatory authorities

- 11.8.1** G_{/1} Some types of breach committed by *firms* and *approved persons* may potentially result not only in disciplinary action by the *FSA*, but also action by other regulatory authorities. These authorities could include, for example, the *RIEs*, the *designated professional bodies*, and the *Society*, as well as overseas authorities (action concerning criminal offences and liaison with other prosecuting authorities is dealt with separately in *ENF* 15).
- 11.8.2** G_{/1} A *firm's* breach on a *prescribed market*, for example, could lead to the *FSA* considering whether the *firm* has engaged in *behaviour* which falls within the *market abuse* provisions of the *Act* (section 123); the same breach could also constitute a breach by the *firm* of a rule of the relevant *RIE*. The *FSA* would also consider whether to take disciplinary action against an *approved person* for an act of misconduct if he was knowingly concerned in a breach of a *rule* by the *firm*, or if he had failed to comply with one of the *Statements of Principle* (see *ENF* 11.5). *ENF* 14 contains further *guidance* on *market abuse* cases which may involve not only potential action by the *FSA*, but also potential action by other regulatory authorities.
- 11.8.3** G_{/1} The *FSA* is developing operating arrangements with each of the relevant *UK* authorities concerning cases where more than one regulatory authority may have an interest. These arrangements will ensure that the *FSA* and the other authorities approach the cases in a co-ordinated, effective and efficient manner, and that those who are the subject of investigations or potential disciplinary action are treated fairly. Similarly, the *FSA* is involved in contributing to a number of international initiatives to enhance effective enforcement action where overseas authorities also have an interest.
- 11.8.4** G_{/1}
- (1) The *FSA* will examine the circumstances of each case, and consider, in the light of the relevant investigation, disciplinary and enforcement powers, whether it is appropriate for the *FSA* or another authority to take action to address the breach.
 - (2) It may be appropriate for both the *FSA* and the other authority or authorities to be involved, and for both to take action, in a particular case arising from the same facts. For example, it may be appropriate for the *FSA* to take disciplinary action against an *approved person*, and for another authority to take separate action against the *firm*.
 - (3) In other cases, it may be appropriate for both the *FSA* and another authority to take action against a *firm* or an *approved person* in relation to the same conduct. For example, a breach of *RIE* rules may be so serious as to justify the *FSA* varying or cancelling the *firm's Part IV permission*, or withdrawing approval from *approved persons*, as well as action taken by the *RIE*.

11.8.5

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Similar considerations will apply where an overseas authority is involved. If the conduct constitutes a breach of the relevant *UK* provisions, as well as constituting a breach of the laws of the overseas jurisdiction, both the *FSA* and the overseas authority will have an interest in taking action to protect their regulatory standards.



11.9 Discipline for breaches of the money laundering rules

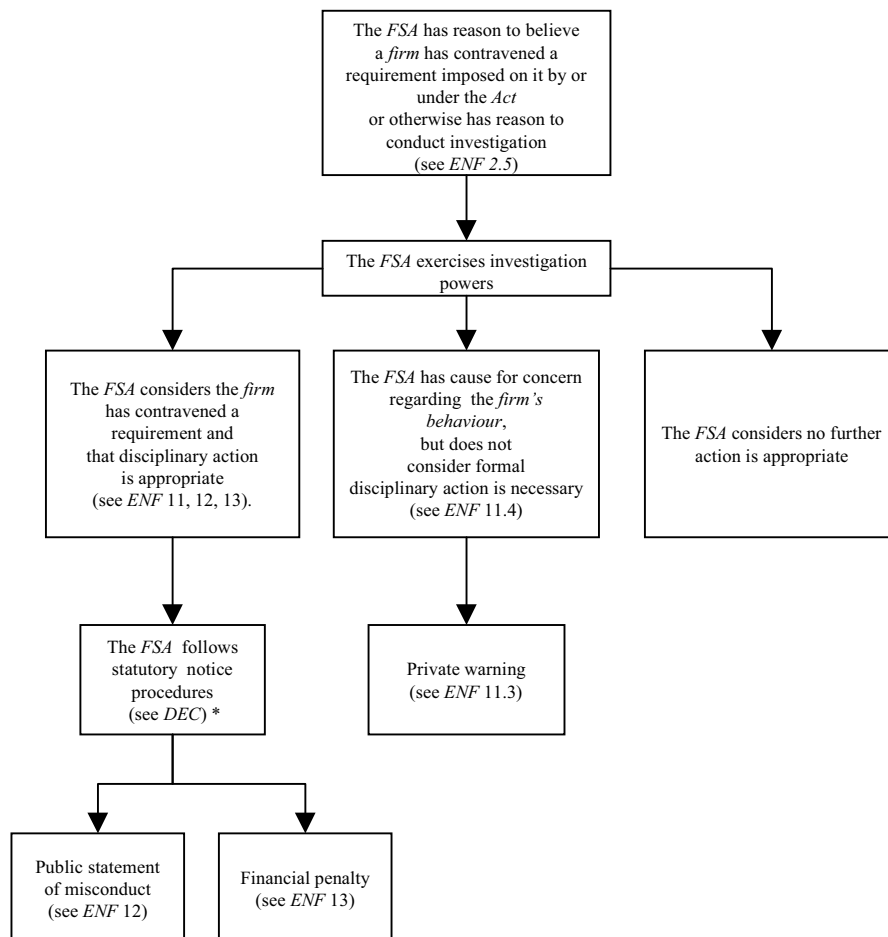
11.9.1

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The *FSA's money laundering rules* are set out in *ML 1 to 8*. The *FSA*, when considering whether to take disciplinary action in respect of a breach of those *rules*, will have regard to whether a *firm* has followed relevant provisions in the Joint Money Laundering Steering Group's Guidance Notes for the Financial Sector.

ENF 11 ANN 1G: Disciplinary action - Firms

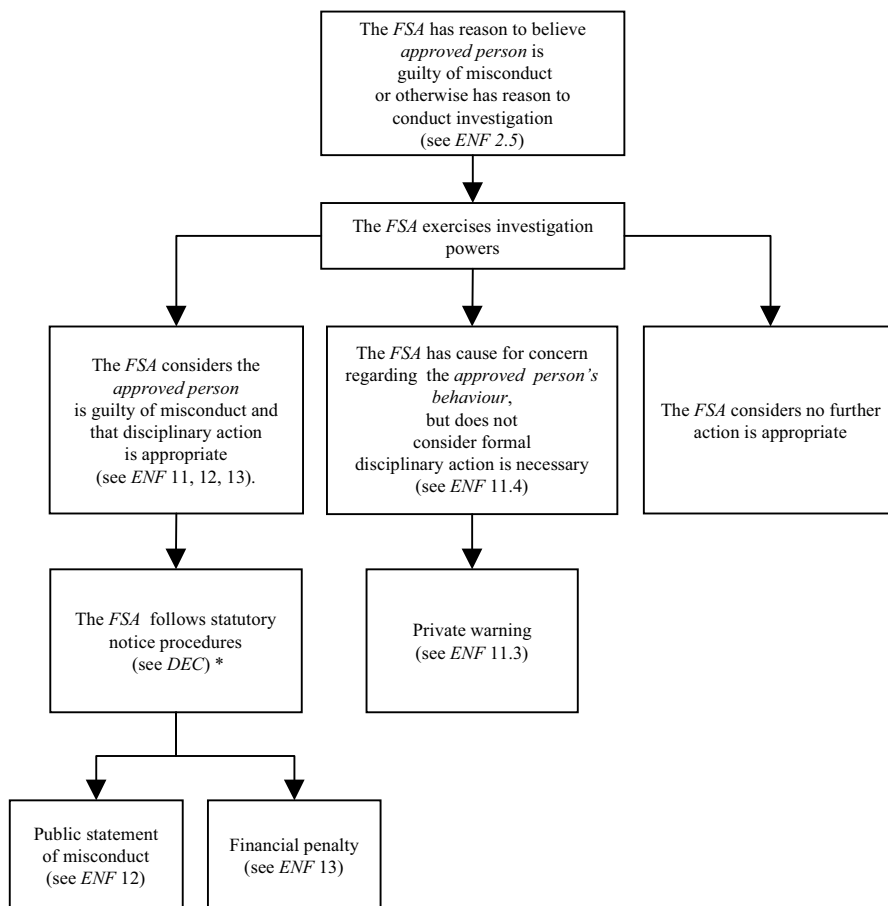
Disciplinary action - Firms



* *Firm* may refer matter to *Tribunal*

ENF 11 ANN 2G: Disciplinary action - approved persons

Disciplinary action - approved persons



* *Approved person may refer matter to Tribunal*

Chapter 12

Discipline: public censures and public statements



12.1 Application

12.1.1

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This chapter applies to any *firm* or *person* who may be the subject of public censure or a public statement. The *Act* empowers the *FSA* to issue a public censure or public statement in the following circumstances:

- (1) the *FSA* may issue a public censure on a *firm* under section 205 of the *Act* (Public censure) where it considers that the *firm* has contravened a requirement imposed on it by or under the *Act*;
- (2) the *FSA* may issue a public statement of misconduct on an *approved person* under section 66 of the *Act* (Disciplinary powers) where it considers that he is guilty of misconduct; misconduct is defined in the *Act* as failure to comply with a *Statement of Principle* issued by the *FSA* under section 64 of the *Act* (Conduct: statements and codes), or being knowingly concerned in a contravention by a *firm* of a requirement imposed on that *firm* by or under section 66 of the *Act*;
- (3) the *FSA* may issue a public statement under section 123 of the *Act* (Power to impose penalties in cases of *market abuse*) where a *person* has engaged in *market abuse*; this is considered separately in *ENF 14* (Sanctions for market abuse);
- (4) the *FSA* may issue a public statement under section 91 of the *Act* (Penalties for breach of listing rules) where there has been a contravention of the *listing rules* (the powers relating to the *UKLA* are dealt with in the *listing rules* and related *guidance*).

12.1.2

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Where the *FSA* proposes to issue a public censure or public statement under the sections of the *Act* described in *ENF 12.1.1G*, the *firm* or *approved person* in question will be given a *warning notice* setting out the terms of the statement or censure the *FSA* proposes to issue, as required by sections 207 (Proposal to take disciplinary measures), 67 (Disciplinary measures: procedure and right to refer to Tribunal), 126 (Warning notices) and 92 (Procedure). Further details of the procedure that the *FSA* will follow in these circumstances are set out in *DEC*.



12.2 Purpose

12.2.1

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The purpose of this chapter is to describe some of the factors which may be relevant to the *FSA* when it determines whether to issue a public censure or public statement. Public censures and public statements are among a variety of tools the *FSA* may use to help it achieve its *regulatory objectives*. Where the *FSA* considers that formal disciplinary action is appropriate, public censures and public statements may, in some cases, be an alternative to financial penalties.

12.2.2

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The *FSA* regards the decision to issue a public censure or public statement as a serious sanction. The *FSA* is aware of the effect such a statement may have on the reputation or business of a *firm* or *approved person*. However, where it is not appropriate to impose a financial penalty, the *FSA* considers that a public censure or public statement may have particular value in enabling the *FSA* to pursue its *regulatory objectives* by highlighting the requirements and standards of conduct expected of *firms* and *approved persons*, and demonstrating that those standards are being effectively enforced, so helping to maintain confidence in the *financial system*. In addition, public censures and public statements promote public awareness of the standards of *behaviour* expected of *firms* and *approved persons*. Increased public awareness also contributes towards greater *consumer* protection.



12.3 Factors in determining whether to issue a public censure or public statement

12.3.1 **G**_{/1} Where a breach of the *Act* or of the *rules* has occurred, the *FSA* may consider that formal disciplinary action is not warranted. For example, the proactive supervision and monitoring of *firms* is central to promoting compliance, and some instances of non-compliance may be addressed satisfactorily by a *firm's* supervisors, without the need for formal disciplinary action. Alternatively, where the *FSA* has concerns regarding the *behaviour* of a *firm* or *approved person*, but has made no determination that a breach has occurred, it may issue a private warning.

12.3.2 **G**_{/1} In more serious cases, however, the *FSA* will institute formal disciplinary action. The main criteria that the *FSA* may take into account in determining whether to take disciplinary action are listed in *ENF* 11.4 (Criteria for determining whether to take disciplinary action).

12.3.3 **G**_{/1} The criteria for determining whether it is appropriate to issue a public censure or public statement rather than impose a financial penalty are similar to those for determining the level of financial penalty listed in *ENF* 13 (Discipline of firms and approved persons: financial penalties). The starting point is that the *FSA* will consider all the relevant circumstances of the case. Some particular considerations may be relevant when the *FSA* determines whether to impose a public censure or public statement rather than a financial penalty. The following list is not exhaustive (not all of these factors may be relevant in a particular case, and there may be other factors that are relevant):

- (1) if the *firm* or *approved person* has made a profit or avoided a loss as a result of the breach or misconduct, this may be a factor in favour of a financial penalty, on the basis that a *firm* or *approved person* should not be permitted to benefit from its breach or misconduct;
- (2) if the breach or misconduct is more serious in nature or degree, this may be a factor in favour of a financial penalty, on the basis that the sanction should reflect the seriousness of the breach or misconduct; other things being equal, the more serious the breach or misconduct, the more likely the *FSA* is to impose a financial penalty;
- (3) if the *firm* or *approved person* has admitted the breach or misconduct and provides full and immediate co-operation to the *FSA*, and takes steps to ensure that *consumers* are fully compensated for any losses arising from the contravention, this may be a factor in favour of a public censure or statement of misconduct, rather than a financial penalty, depending upon the nature and seriousness of the breach or misconduct;
- (4) if the *firm* or *approved person* has a poor disciplinary record or compliance history (for example, where the *FSA* has previously brought disciplinary action resulting in adverse findings in relation to the same or similar *behaviour*), this

may be a factor in favour of a financial penalty, on the basis that it may be particularly important to deter future cases;

- (5) the *FSA's* approach in similar previous cases: the *FSA* will seek to achieve a consistent approach to its decisions on whether to impose a penalty or issue a public statement; and
- (6) if the *firm* or *approved person* has inadequate means (excluding any manipulation or attempted manipulation of their assets) to pay the level of financial penalty which their breach or misconduct would otherwise attract, this may be a factor in favour of a lower level of penalty or a public statement. However, it would only be in an exceptional case that the *FSA* would be prepared to agree to impose a public statement rather than a financial penalty, if a financial penalty would otherwise be the appropriate sanction. Examples of such exceptional cases could include:
 - (a) verifiable evidence that an *approved person* would suffer serious financial hardship if the *FSA* imposed a financial penalty; and
 - (b) verifiable evidence that the *firm* would be unable to meet other regulatory requirements, particularly financial resource requirements, if the *FSA* imposed a financial penalty at an appropriate level.

Chapter 13

Discipline: Financial penalties



13.1 Application and purpose

Application

13.1.1

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This chapter applies to any *person* on whom a financial penalty may be imposed. The *Act* empowers the *FSA* to impose a financial penalty in the following circumstances:

- (1) on a *firm*, where the *FSA* considers that the *firm* has contravened a requirement imposed on it by or under section 206 of the *Act* (Financial penalties);
- (2) on an *approved person*, where the *FSA* considers that he is guilty of misconduct; this is defined in the *Act* as failure to comply with a *Statement of Principle* issued by the *FSA* under section 64 (Conduct: statements and codes), or being knowingly concerned in a contravention by the relevant *firm* of a requirement imposed on that *firm* by or under section 66 of the *Act* (Disciplinary powers);
- (3) on any *person*, where the *FSA* is satisfied that the *person* is or has engaged in *market abuse* or, by taking or refraining from taking any action, has *required or encouraged* another *person* to engage in *market abuse*; the power to impose penalties for *market abuse* under section 123 of the *Act* is considered separately in *ENF 14*;
- (4) on an *issuer of listed securities* or an applicant for *listing*, where there has been a contravention of the *listing rules* (or on a *director* of an *issuer* or applicant who at the material time was knowingly concerned in the contravention) (section 91 of the *Act* (Penalties for breach of listing rules)). The powers relating to the *UKLA* are dealt with in the *listing rules* and related *guidance*.

Purpose

13.1.2

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Financial penalties are one of a variety of regulatory tools the *FSA* may employ to help it to achieve its *regulatory objectives*. The principal purpose of financial penalties is to promote high standards of regulatory conduct by deterring *firms* and *approved persons* who have breached regulatory requirements from committing further contraventions, helping to deter other *firms* and *approved persons* from committing contraventions, and demonstrating generally to *firms* and *approved persons* the benefits of compliant behaviour.



13.2 Introduction

13.2.1

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Sections 69 and 210 of the *Act* require the *FSA* to issue statements of policy about the imposition of financial penalties on *firms* and *approved persons*. The material in this chapter constitutes the *FSA*'s statements of policy and *guidance* under those provisions. The *FSA* may at any time alter or replace these statements of policy after consultation.

13.2.2

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The *FSA* is required to have regard to these statements of policy in exercising, or deciding whether to exercise, its powers under sections 66 (Disciplinary powers) and 206 (Financial penalties) of the *Act*.



13.3 Factors relevant to determining the appropriate level of financial penalty

13.3.1

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- (1) The *FSA* will consider all the relevant circumstances of a case when it determines the level of financial penalty (if any) that is appropriate and in proportion to the contravention in question.
- (2) With the exception of contraventions involving the submission of returns no more than 28 *business days* late (see *ENF* 13.5), the *FSA* does not propose to adopt a tariff of penalties for different kinds of contravention. This is because there will be very few other cases in which all the circumstances of the case are essentially the same, and the *FSA* considers that, in general, the use of a tariff for particular kinds of contravention would inhibit the flexible and proportionate policy which it intends to adopt in this area.

13.3.2

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- (1) Section 69 of the *Act* (Statement of policy) requires that the *FSA*'s policy in determining the amount of a penalty in relation to *approved persons* must include having regard to:
 - (a) the seriousness of the misconduct in question in relation to the nature of the principle or requirement concerned;
 - (b) the extent to which that misconduct was deliberate or reckless;
 - (c) whether the person on whom the penalty is to be imposed is an individual.
- (2) Section 210(2) of the *Act* (Statements of policy) contains similar requirements for the *FSA*'s policy in determining the amount of a penalty in relation to contraventions by *firms*.

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The factors which may be relevant when the *FSA* determines the amount of a financial penalty for a *firm* or *approved person* include the following.

- (1) The seriousness of the misconduct or contravention.

In relation to the statutory requirement to have regard to the seriousness of the misconduct or contravention, the *FSA* recognises the need for a financial penalty to be proportionate to the nature and seriousness of the misconduct or contravention in question. The following may be relevant:

- (a) in the case of an *approved person*, the *FSA* must have regard to the seriousness of the misconduct in relation to the nature of the *Statement of Principle* or requirement concerned. Similarly, in the case of a *firm*, the *FSA* must have regard to the seriousness of the contravention in relation to the nature of the requirement contravened.

- (b) the duration and frequency of the misconduct or contravention (including, in relation to a *firm*, when the contravention was identified by *persons* exercising *significant influence functions* at the *firm*);
 - (c) whether the misconduct or contravention revealed serious or systemic weaknesses of the management systems or *internal controls* relating to all or part of a *firm's* business;
 - (d) the impact of the misconduct or contravention on the orderliness of financial markets, including whether public confidence in those markets has been damaged;
 - (e) the loss or risk of loss caused to *consumers* or other market users. If a contravention has caused loss to another *firm*, that *firm* may be able to take its own action against the *firm* which has committed the contravention; however, the *FSA* generally expects *firms* to comply with regulatory requirements, regardless of the nature of the counterparty; for example, persistent departures from *MAR 3* (Inter-professional conduct) may have implications for the *FSA's* assessment of a *firm's* continued fitness and propriety.
- (2) The extent to which the contravention or misconduct was deliberate or reckless.

In determining whether a contravention or misconduct was deliberate, the *FSA* may have regard to whether the *firm's* or *approved person's behaviour* was intentional, in that they intended or foresaw the consequences of their actions. The matters to which the *FSA* may have regard in determining whether a contravention was reckless include, but are not limited to, the following:

- (a) whether the *firm* or *approved person* has failed to comply with the *firm's* procedures;
- (b) whether the *firm* or *approved person* has taken decisions beyond its or his field of competence;
- (c) whether the *firm* or *approved person* has given no apparent consideration to the consequences of the *behaviour* that constitutes the contravention.

If the *FSA* decides that *behaviour* was deliberate or reckless, it may be more likely to impose a higher penalty on a *firm* or *approved person* than would otherwise be the case.

- (3) Whether the *person* on whom the penalty is to be imposed is an individual, and the size, financial resources and other circumstances of the *firm* or individual.

This will include having regard to whether the *person* is an individual, and to the size, financial resources and other circumstances of the *firm* or *approved person*. The *FSA* may take into account whether there is verifiable evidence of serious financial hardship or financial difficulties if the *firm* or *approved person* were to pay the level of penalty associated with the particular contravention or misconduct. The *FSA* regards these factors as matters to be taken into account in determining the level of a penalty, but not to the extent that there is a direct correlation between those factors and the level of penalty. The size and financial resources of a *firm* or *approved person* may be a relevant consideration, because the purpose of a penalty is not to render a *firm* or *approved person* insolvent or to threaten its solvency. Where this would be a material consideration, the *FSA* will consider, having regard to all other

factors, whether a lower penalty would be appropriate; this is most likely to be relevant to smaller *firms* or *groups of firms* or *approved persons* with lower financial resources; but if a *firm* or individual reduces its solvency with the purpose of reducing its ability to pay a financial penalty, for example by transferring assets to third parties, the *FSA* will take account of those assets when determining the amount of a penalty. The size of the *firm* may also be a relevant consideration for the following reasons:

- (a) the degree of seriousness of a contravention may be linked to the size of the *firm*. For example, a systemic failure in a large *firm* could damage or threaten to damage a much larger number of *consumers* than would be the case with a small *firm*: contraventions in *firms* with a high volume of business over a protracted period may therefore be more serious than contraventions over similar periods in *firms* with a smaller volume of business; and
 - (b) the size of a *firm* and its resources may also be relevant in relation to mitigation, in particular what steps the *firm* took after the contravention had been identified; the *FSA* will take into account what it is reasonable to expect from the *firm* in relation to its size and resources, and factors such as what proportion of a *firm's* resources were used to resolve a problem.
- (4) The amount of profits accrued or loss avoided.

The *FSA* may have regard to the amount of profits accrued or loss avoided as a result of the contravention or misconduct, for example:

- (a) the *FSA* will propose a penalty which is consistent with the principle that a *firm* or *approved person* should not benefit from the contravention or misconduct; and
 - (b) the penalty should also act as an incentive to the *firm* or *approved person* (and others) to comply with regulatory standards.
- (5) Conduct following the contravention.

The *FSA* may take into account the conduct of the *firm* or *approved person* in bringing (or failing to bring) quickly, effectively and completely the contravention or misconduct to the *FSA's* attention and:

- (a) the degree of cooperation the *firm* or *approved person* showed during the investigation of the contravention or misconduct (where a *firm* or *approved person* has fully cooperated with the *FSA's* investigation, this will be a factor tending to reduce the level of financial penalty);
 - (b) any remedial steps taken since the contravention or misconduct was identified, including identifying whether *consumers* suffered loss, compensating them, taking disciplinary action against staff involved (if appropriate), and taking steps to ensure that similar problems cannot arise in the future.
- (6) Disciplinary record and compliance history.

The previous disciplinary record and general compliance history of the *firm* or *approved person* may be taken into account. This will include whether the *FSA* (or any *previous regulator*) has taken any previous formal disciplinary action, resulting in adverse findings, against the *firm* or *approved person*, or whether the *FSA* has previously required the *firm* to take remedial action by

means of a variation of *Part IV permission* (see *ENF 3*), or has previously requested the *firm* to take remedial action, and the extent to which that action has been taken. For example, the disciplinary record of a *firm* or *approved person* could lead to the *FSA* increasing the penalty, where the *firm* or *approved person* has committed similar contraventions or misconduct in the past. In assessing the relevance of a *firm's* or *approved person's* disciplinary record and compliance history, the age of a particular matter will be taken into account, although a long-standing matter may still be relevant. However, in undertaking this assessment, private warnings will not be taken into account.

(7) Previous action taken by the *FSA*.

The action that the *FSA* has taken previously in relation to similar *behaviour* by other *firms* or *approved persons* may be taken into account. The *FSA* will seek to ensure consistency when it determines the appropriate level of penalty. If it has taken disciplinary action previously in relation to a similar contravention or misconduct, this will clearly be a relevant factor. However, as stated at *ENF 13.3.1G*, with the exception of the specific circumstances described at *ENF 13.5*, the *FSA* does not intend to adopt a tariff system, and there may be other relevant factors which could increase or decrease the seriousness of the contravention or misconduct.

(8) Action taken by other regulatory authorities.

This could include for example:

- (a) action taken or to be taken against a *firm* or *approved person* by other regulatory authorities which may be relevant where it relates to the contravention or misconduct in question;
- (b) action taken by any *previous regulator* regarding the general level of penalties.

13.3.4

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The list of criteria in *ENF 13.3.3G* above is not exhaustive, and all the relevant circumstances of the case will be taken into consideration.

13.3.5

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Part III, Schedule 1 to the *Act* (Penalties and fees) specifically provides that the *FSA* may not, in determining its policy with respect to the amount of penalties, take account of expenses which it incurs, or expects to incur, in discharging its functions.



13.4 Decision making procedure and publication

13.4.1

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The *Act* requires the *FSA* to issue a *warning notice*, *decision notice* and *final notice* before imposing a financial penalty. More information on the procedure the *FSA* will follow in these circumstances is contained in *DEC*.

13.4.2

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The *FSA* will consider the circumstances of each case, but ordinarily will publicise the financial penalty by issuing a press release, giving details of the *behaviour* and the penalty imposed. However, the *Act* provides (section 391(6) (*Consultation*)) that the *FSA* may not publish information in these circumstances where it would be unfair to the *person* on whom the financial penalty is imposed, or prejudicial to the interests of *consumers*.



13.5 Financial penalties for late submission of reports

13.5.1

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This section sets out the *FSA*'s policy and procedures in relation to financial penalties for late submission of reports. It applies specifically to the various types of reports and other *documents* (references in *ENF* 13.5 to 'reports' include these other *documents*), including annual *controllers*' reports, annual *close links* reports, compliance reports, financial reports, accounts and balance sheets, *actuaries*' and auditors' reports, and certificates and statements that must be submitted to the *FSA* by specified dates in accordance with:

- (1) the *rules* set out in *SUP* 16 (Reporting requirements);
- (2) *IPRU(INS)* 9.37(4)R, 9.38R and 9.6(1)R (Financial reporting);
- (3) *IPRU(FSOC)* 3.1(8)R, 3.2(5)R (Management and control), 5.1(2)R and 5.2(2)R (Prudential reporting);
- (4) *DISP* 1.1.8R, 1.5.4 to 1.5.7R, (Complaint handling procedures for firms) 5.1.7R and 5.5.1R [(Draft Financial Ombudsman Service Funding rules)]; and
- (5) *LLD* 3.3.2R (The Central Fund) and 4.3.2R (Capacity transfer market) and the *rules* set out in *LLD* 15.2.1R and 15.10.2R (Reporting by the *Society*).

13.5.2

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The *FSA* attaches considerable importance to the timely submission by *firms* of the reports referred to in *ENF* 13.5.1G. This is because the information that they contain is essential to the *FSA*'s assessment of whether a *firm* is complying with the requirements and standards of the *regulatory system* and to the *FSA*'s understanding of that *firm*'s business.

13.5.3

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- (1) In general, the *FSA*'s approach to disciplinary action arising from the late submission of a report will depend upon the length of time after the due date that the report in question is submitted. Where the period of delay is no more than 28 *business days*, the *FSA* considers that in the majority of cases it will be appropriate to limit the sanction imposed on the *firm* concerned to a financial penalty fixed by reference to the indicative scale of penalties at *ENF* 13 Ann 1G.
- (2) There may, however, be exceptional circumstances in which the *FSA* considers that it is appropriate not to seek a penalty, or to impose a lower penalty than the one indicated by the scale. It should be noted that an administrative difficulty such as pressure of work does not, in itself, constitute an exceptional circumstance for this purpose.
- (3) Equally, the *FSA* may impose a higher penalty than the one indicated by the scale at *ENF* 13 Ann 1G having regard to the seriousness of the contravention and the extent to which the contravention was deliberate or reckless. This may include, for example, a case where a *firm* repeatedly fails to submit its reports

on time or where there is information that suggests that such a delay was deliberate.

- (4) The FSA will also have regard to the submission frequency of the late report when assessing the seriousness of the contravention. For example, a short delay in submitting a weekly or monthly report can have serious implications for the supervision of the *firm* in question. Such a delay may therefore be subject to a higher penalty than the one suggested by the indicative scale.

13.5.4

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Reference to an indicative scale of penalties for breaches of this nature represents an exception to the FSA's general policy described in ENF 13.3.1G. The FSA considers that it is appropriate to treat this type of breach differently from other regulatory breaches on the basis that the nature of the facts establishing the breach is likely to be similar in each case and that the scale will ensure consistency in the treatment of the *firms* in question.

13.5.5

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- (1) Where a report is submitted more than 28 *business days* after the due date, and there are no exceptional circumstances justifying the failure to submit on time, the financial penalty imposed is likely to exceed the amount indicated by the scale at ENF 13 Ann 1G for 21 to 28 *business days* delay. The FSA will determine the precise level of the financial penalty to be imposed in accordance with the approach discussed in ENF 13.3.3G.
- (2) In addition, in appropriate cases, the FSA may bring disciplinary action against the *approved person or persons* within the *firm's* management who are ultimately responsible for ensuring that the *firm's* reports are completed and returned to the FSA (see ENF 11.5 (Action against *approved persons*)).

13.5.6

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When it decides whether to impose a financial penalty for the late submission of a report (whether the period of delay is more than or less than 28 *business days*), the FSA will use the decision making procedure set out in DEC.

13.5.7

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- (1) Once a *final notice* has been issued relating to a financial penalty and any other relevant sanction for a late report, the FSA will consider whether it is unfair to the *firm* or prejudicial to the interests of *consumers* to publish information relating to the decision. The FSA anticipates that in most cases where reports have been submitted late, no such unfairness or prejudice will exist. If so, it will enter details of the decision in the *FSA Register*.
- (2) The FSA may also publicise the sanctions on a wider basis where the contravention is considered to be particularly serious. Examples of situations that may result in wider publicity include where the period of delay exceeds 28 *business days* and/or where the *firm* in question has previously failed to submit its reports on time to the FSA or to any *previous regulator*.



13.6 Breaches of prudential requirements and financial penalties

13.6.1

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Where a *firm* has breached prudential requirements (for example, *rules* relating to the adequacy of financial resources), the *FSA* will consider all the relevant circumstances of a case (including the factors listed in *ENF* 13.3.3G) in determining whether to impose a financial penalty.

13.6.2

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In considering whether to impose a financial penalty on a mutual (such as a *building society*), the *FSA* will take into account the impact that a penalty may have on a *firm's customers*, as the *FSA* would with any *firm*. However, the *FSA* may decide to impose a financial penalty on a mutual, taking into account all the circumstances of the case (including the factors listed in *ENF* 13.3.3G), even though this may have a direct impact on that mutual's *customers*. This reflects the fact that a significant proportion of a mutual's *customers* are shareholder-members; to that extent, their position involves an assumption of risk that is not assumed by *customers* of a *firm* incorporated as a *company*. Whether a *firm* is a mutual will not, by itself, increase or decrease the level of a financial penalty.

ENF 13 ANN 1G: Indicative scale of financial penalties for returns no more than 28 days late (see ENF 13.5)

1 Table Indicative scale of financial penalties for returns no more than 28 days late

Number of working days late	Annual fees payable by firm				
	<10K	<20K	<50K	<100K	>100K
22–28	400	800	2000	4000	6000
15–21	300	600	1500	3000	4500
8–14	200	400	1000	2000	3000
1–7	100	200	500	1000	1500

Chapter 14.

Sanctions for market abuse



14.1 Application and purpose

Application

- 14.1.1** G_{/1} This chapter applies to any *person*, whether regulated or not, who may be the subject of a financial penalty or public statement on the basis that the *FSA* suspects the *person*:
- (1) is or has engaged in *market abuse*; or
 - (2) by taking or refraining from taking any action has *required or encouraged* another *person* or *persons* to engage in *behaviour* which, had he engaged in it himself, would amount to *market abuse*.

- 14.1.2** G_{/1} In this chapter, the expression '*market abuse* cases' includes cases involving *market abuse* and cases involving *requiring or encouraging*.

Purpose

- 14.1.3** G_{/1} In enforcing the *market abuse regime*, the *FSA*'s priority will be to protect *prescribed markets* from any damage to their efficiency caused by manipulation of the market and misuse of information. The *FSA*'s effective and appropriate use of its powers to deal with *market abuse* cases will help ensure high standards of regulatory conduct and maintain confidence in the *UK financial system*, by demonstrating that high standards of market conduct are appropriately enforced in the *UK* financial markets. The public enforcement of these standards also furthers the *FSA*'s public awareness *regulatory objective*. In addition, the enforcement of the *market abuse regime* will help the *FSA* work towards its *regulatory objective* of protecting *consumers*, as it will help to deter future *market abuse* by market participants, and help to reduce *financial crime*.

- 14.1.4** G_{/1} However, the *FSA* is also aware that the possible or actual use of its enforcement powers may have an adverse impact on the market, for example, by causing public uncertainty or affecting the timing or outcome of a *takeover bid*, and will take this into account.

14.2 Introduction

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Section 124 of the *Act* (Statement of policy) states that the *FSA* must prepare and issue a statement of its policy on:

- (1) the imposition of penalties under section 123 (Power to impose penalties in cases of market abuse);
- (2) the amount of penalties under that section; and
- (3) the circumstances in which the *FSA* is to be expected to regard a *person* as:
 - (a) having a reasonable belief that his *behaviour* did not amount to *market abuse*; or
 - (b) having taken reasonable precautions and exercised due diligence to avoid engaging in *market abuse*.

This chapter is the *FSA*'s statement of policy under section 124 of the *Act*. However, the *FSA* may at any time change or replace this statement of policy after consultation.

14.2.2

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The *Act* gives the *FSA* criminal prosecution powers in relation to *insider dealing* and *misleading statements and practices offences*. The *FSA*'s use of these powers is considered separately in *ENF 15* (Prosecution of criminal offences). The *Act* also gives the *FSA* a power to impose a financial penalty, or, in certain circumstances, to ask the court to consider imposing a financial penalty on a *person* who has engaged in *market abuse* or *required or encouraged* (see *ENF 14.3.1G*). Where the *FSA* is entitled to impose a financial penalty, it may publish a statement that a *person* has engaged in *market abuse* instead. These powers and the *FSA*'s policy on their use are set out in this chapter. *ENF 14 Ann 1G* contains a diagram summarising the steps relating to action for financial penalties or public statements in *market abuse* cases. The *FSA*'s *Code of Market Conduct* (see *MAR 1*), issued by the *FSA* under section 119 of the *Act* (The code), contains those provisions which the *FSA* considers will give appropriate *guidance* to those deciding whether or not *behaviour* amounts to *market abuse* or *requiring or encouraging*.

14.2.3

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In addition, the *Act* gives the *FSA* power to obtain *injunctions* and restitution in relation to *market abuse* cases. These powers are described in *ENF 6* (Injunctions) and *ENF 9* (Restitution and redress) respectively.

14.3 Financial penalties and public statements in market abuse cases

Financial penalties

- 14.3.1** **G**_{/1} Under section 123(1)(a) and section 123(1)(b) of the *Act* (Power to impose penalties in cases of market abuse), the *FSA* may impose a financial penalty where a *person* (A):
- (1) is or has engaged in *market abuse*; or
 - (2) by taking or refraining from taking any action has *required or encouraged* another *person* or *persons* to engage in *behaviour* which, had it been engaged in by A, would amount to *market abuse*.
- See *ENF* 14.5.1G for the factors the *FSA* may take into account when determining whether either of these two conditions is met.
- 14.3.2** **G**_{/1} Section 123(2) of the *Act* states that the *FSA* may not impose a penalty on a *person* if, having considered any representations made to it in response to a *warning notice*, there are reasonable grounds for it to be satisfied that:
- (1) the *person* believed, on reasonable grounds, that his *behaviour* did not fall within section 123(1)(a) or section 123(1)(b) of the *Act*; or
 - (2) he took all reasonable precautions and exercised all due diligence to avoid behaving in a way which fell within section 123(1)(a) or section 123(1)(b) of the *Act*.
- 14.3.3** **G**_{/1} The *FSA* can apply to the court under section 381 of the *Act* (Injunctions in cases of market abuse) for an *injunction* restraining *market abuse* and under section 383 of the *Act* (Restitution orders in cases of market abuse) for an order for restitution in *market abuse* cases. In these cases, under section 129(1) of the *Act* (Power of court to impose a penalty in cases of market abuse), it may ask the court to consider whether the circumstances are such that a penalty should be imposed on the *person* concerned. In deciding whether to ask the court to impose a financial penalty, the *FSA* may take into account, amongst other matters, the factors set out in *ENF* 14.4.2G and *ENF* 14.6.2G(1) to (6). The *FSA*'s power to apply to court for *injunctions* and orders for restitution in *market abuse* cases are described in *ENF* 6 (Injunctions) and *ENF* 9 (Restitution and redress) respectively.

Public statements

14.3.4

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Section 123(3) of the *Act* states that if the *FSA* is entitled to impose a penalty on a *person* under section 123(1) (see *ENF* 14.3.1G and *ENF* 14.3.2G) it may, instead of imposing a penalty on him, publish a statement to the effect that he has engaged in *market abuse*.



14.4 Factors relevant to determining whether to take action in market abuse cases

14.4.1

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Not all cases involving *market abuse* or *requiring or encouraging* will warrant enforcement action. The *FSA* will consider all the relevant circumstances of the case when deciding whether to seek to impose a financial penalty or, where it is entitled to impose a financial penalty, whether a public statement would be more appropriate.

14.4.2

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When it decides whether to take action for *behaviour* appearing to the *FSA* to amount to *market abuse* or *requiring or encouraging*, the *FSA* may take into account a number of factors. The following list is not exhaustive: not all of these factors may be relevant in a particular case, and there may be other factors that are relevant.

- (1) The nature and seriousness of the suspected *behaviour*, including:
 - (a) the nature and seriousness of any breach of the *Code of Market Conduct*;
 - (b) whether the *behaviour* was deliberate or reckless;
 - (c) the duration and frequency of the *behaviour*;
 - (d) the impact of the *behaviour* on *prescribed markets*, including whether public confidence in those markets has been damaged; and
 - (e) the amount of any benefit gained or loss avoided as a result of the *behaviour*; and
 - (f) the loss or risk of loss caused to *consumers* or other market users.
- (2) The conduct of the *person* concerned after the *behaviour* was identified, including the following.
 - (a) How quickly, effectively and completely the *person* brought the *behaviour* to the attention of the *FSA* or another relevant regulatory authority.
 - (b) The degree of cooperation the *person* showed during the *FSA*'s investigation of the *behaviour* of concern or during those of any other regulatory authority (for example, the *Takeover Panel* or an *RIE*) which is allowed to share information obtained during an investigation with the *FSA*. In this context, *persons* are reminded that they may have a duty to co-operate with other regulatory authorities. For example, *MAR* 4.3.4R requires *firms* to whom that *rule* applies to assist the *Takeover Panel* in certain circumstances. However, a *person* will not necessarily avoid action for *market abuse* or *requiring or encouraging* merely by fulfilling a duty to co-operate.

- (c) Any remedial steps that the *person* has taken to address the *behaviour*, whether on his own initiative or in meeting the requirement of another regulatory authority, and how promptly that *person* has taken those steps. This might include identifying those who have suffered loss and compensating them, taking disciplinary action against staff (where appropriate), and taking action designed to ensure that similar problems do not arise in the future. It might also include (for example, in the context of a *takeover bid*) any steps taken to correct a misleading statement or misleading impression or distortion of the market. However, a *person* will not necessarily avoid a penalty merely by fulfilling a duty to take remedial action.
 - (d) Whether the *person* concerned has complied with any requirements or rulings of another regulatory authority relating to his *behaviour* (for example, where relevant, those of the *Takeover Panel* or an *RIE*).
 - (e) The nature and extent of any false or inaccurate information given by the *person* and whether the information appears to have been given in an attempt knowingly to mislead the *FSA*.
- (3) The degree of sophistication of the users of the market in question, the size and liquidity of the market, and the susceptibility of the market to *market abuse*. For example, where the users of a market are generally not market professionals, and they have suffered loss as a result of the *behaviour* and that loss has not been promptly or adequately compensated for by the *person* concerned, this may be a factor in favour of the imposition of a penalty (this does not, however, mean that the *FSA* will not take action to impose financial penalties on *persons* whose *behaviour* falls within the *market abuse* provisions where only market professionals have suffered).
- (4) Action taken by other regulatory authorities. Where other regulatory authorities propose to take action in respect of the *behaviour* which is under consideration by the *FSA*, the *FSA* will consider whether their action would be adequate to address the *FSA*'s concerns, or whether it would be appropriate for the *FSA* to take its own action. For example, the *FSA* has powers to impose unlimited financial penalties, whereas an *RIE*'s powers may be more limited in a particular case. Where the *behaviour* of the *person* concerned is also, in the opinion of the *Takeover Panel*, a breach of that *person*'s responsibilities under the *Takeover Code*, the *FSA* would not expect to use its powers under the *market abuse regime* against that *person*, except in the circumstances described in *ENF 14.9.6G*. If the *FSA* considers that using its powers may be appropriate in those circumstances, it will not take action during the bid except in the circumstances described in *ENF 14.9.7G*.
- (5) Action taken by the *FSA* in previous similar cases. The *FSA* will take account of action it has taken previously in *market abuse* cases where the *behaviour* has been the same or similar.
- (6) The impact, having regard to the nature of the *behaviour*, that any financial penalty or public statement may have on the financial markets or on the interests of *consumers*:
- (a) a penalty may show that high standards of market conduct are being enforced in the financial markets, and may bolster market confidence;
 - (b) a penalty may protect the interests of *consumers* by deterring future *market abuse* and improving standards of conduct in a market;

- (c) in the context of a *takeover bid*, the *FSA* may consider that the impact of the use of its powers is likely to have an adverse effect on the timing or outcome of that bid, and therefore it would not be in the interests of financial markets or *consumers* to take action for *market abuse* during the *takeover bid*. If the *FSA* considers that the proposed use of its powers may have that effect, it will consult the *Takeover Panel* and give due weight to its views.
- (7) The likelihood that the same type of *behaviour* (whether on the part of the *person* concerned or others) will happen again if no action is taken.
- (8) The disciplinary record and general compliance history of the *person*, including:
 - (a) whether the *FSA* has taken any previous action against the *person* for *market abuse* or *requiring or encouraging* which resulted in adverse findings;
 - (b) whether the conduct of the *person* in relation to the markets has caused concern to another regulatory authority or been the subject of a warning or other action by a regulatory authority;
 - (c) whether the *person* has previously given any undertakings to the *FSA* not to engage in particular *behaviour*; and
 - (d) the general compliance history of the *person*, such as previous private warnings (see *ENF* 11.3).



14.5 Factors determining whether the FSA may impose a financial penalty in market abuse cases

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The factors which the FSA may take into account when deciding whether either of the two conditions in ENF 14.3.2G is met, include, but are not limited to:

- (1) in relation to whether the *person* concerned reasonably believed that his *behaviour* did not amount to *market abuse* or *requiring or encouraging*
 - (a) whether, and if so to what extent, the *person* concerned took reasonable precautions to avoid engaging in *market abuse* or *requiring or encouraging* (see (2));
 - (b) whether, and if so to what extent, the *behaviour* in question was or was not analogous to *behaviour* described in the *Code of Market Conduct* (see MAR 1) as amounting or not amounting to *market abuse* or *requiring or encouraging*;
 - (c) whether the FSA has issued any *guidance* on the *behaviour* in question and if so, the extent to which the *person* sought to follow that *guidance* (see the Reader's Guide part of the *Handbook* regarding the status of *guidance*);
 - (d) whether, and if so to what extent, the *behaviour* complied with the rules of any relevant *prescribed market* or any other relevant market or other regulatory requirements (including the *Takeover Code* or the SARs) or any relevant codes of conduct or best practice;
 - (e) the level of knowledge, skill and experience to be expected of the *person* concerned; and
 - (f) whether, and if so to what extent, the *person* can demonstrate that the *behaviour* was engaged in for a legitimate purpose and in a proper way;
- (2) in relation to whether the *person* concerned took all reasonable precautions and exercised all due diligence to avoid engaging in *market abuse* or *requiring or encouraging*:
 - (a) whether, and if so to what extent, the *person* followed internal consultation and escalation procedures in relation to the *behaviour* (for example, did the *person* discuss the *behaviour* with internal line management and/or internal legal or compliance departments?);
 - (b) whether, and if so the extent to which, the *person* sought any appropriate expert legal or other expert professional advice and followed that advice;

- (c) whether, and if so to what extent, the *person* sought advice from the market authorities of any relevant *prescribed market* or, where relevant, consulted the *Takeover Panel*, and followed the advice received;
- (d) whether the *FSA* has issued any *guidance* on the *behaviour* in question and if so, the extent to which the *person* has sought to follow that *guidance* (see the Reader's Guide part of the *Handbook* regarding the status of *guidance*); and
- (e) whether, and if so to what extent, the *behaviour* complied with the rules of any relevant *prescribed market* or any other relevant market or other regulatory requirements (including the *Takeover Code* or the *SARs*) or any relevant codes of conduct or best practice.

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The list in *ENF 14.5.1G* is not exhaustive, and there may be other factors that are relevant in establishing the conditions referred to in *ENF 14.3.2G*, depending on the facts of each case.



14.6 FSA's choice of powers: financial penalties/public statements

14.6.1

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As with statements of public censure issued for other breaches of the requirements of the *Act* (see *ENF 12*), the *FSA* will consider whether to publish a statement that *market abuse* has occurred instead of imposing a financial penalty where it considers that such a statement may more appropriately address the particular *behaviour* in question.

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When considering whether a public statement is more appropriate than a financial penalty the *FSA* will take into account all the circumstances of the case. In particular, the *FSA* may have regard to factors similar to those in *ENF 12.3.3G*. Those factors include the following.

- (1) If the *person* has made a profit or avoided a loss as a result of the *behaviour*, this may be a factor in favour of a financial penalty, on the basis that a *person* should not be allowed to benefit from *market abuse* or *requiring or encouraging*.
- (2) If the *behaviour* is serious in nature or degree, this may be a factor in favour of a financial penalty, on the basis that the sanction should reflect the seriousness of the *behaviour* (other things being equal, the more serious the *behaviour*, the more likely the *FSA* is to impose a financial penalty).
- (3) If the *person* has admitted the *behaviour* and provides full and immediate cooperation to the *FSA*, and takes steps to ensure that those who have suffered loss due to the *behaviour* are fully compensated, this may be a factor in favour of a public statement, rather than a financial penalty, depending on the nature and seriousness of the *behaviour*.
- (4) The *FSA's* approach in similar previous cases. The *FSA* will seek to achieve a consistent approach to its decisions on whether to impose a financial penalty or issue a public statement.
- (5) If the *person* has a poor compliance history. For example, where the *FSA* has previously taken action against the *person* for *behaviour* amounting to *market abuse* or *requiring or encouraging* which resulted in adverse findings, this may be a factor in favour of a financial penalty.
- (6) The impact of a financial penalty on the *person* concerned. In exceptional cases, if the *person* has inadequate means (excluding any manipulation or attempted manipulation of their assets) to pay the financial penalty which the *behaviour* would otherwise attract, this may be a factor in favour of a lower level of penalty or a public statement. Circumstances in which the *FSA* may be willing to issue a public statement include where there is verifiable evidence that the *person* would suffer serious financial hardship if it imposed a financial penalty.

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The list of factors in *ENF* 14.6.2G is not exhaustive. Not all the factors may be relevant in a particular case, and there may be others that are relevant.



14.7 Determining the level of a financial penalty in a market abuse case

14.7.1 G_{/1} The *FSA*'s approach to financial penalties in *market abuse* cases will be consistent with its approach to financial penalties in other disciplinary cases concerning *firms* and *approved persons* (see *ENF* 13.3).

14.7.2 G_{/1} The *FSA* will take into account all the circumstances of a case when it determines the appropriate level of penalty, if any. The *FSA* does not propose to use a tariff of penalties for *market abuse* cases, given the wide range of different types of *behaviour* that may amount to *market abuse* or *requiring or encouraging*.

14.7.3 G_{/1} Section 124(2) of the *Act* (Statement of policy) states that the *FSA*'s policy in determining the amount of a penalty must include having regard to: '(a) whether the *behaviour* in respect of which the penalty is to be imposed had an adverse effect on the market in question and, if it did, how serious that effect was; (b) the extent to which that *behaviour* was deliberate or reckless; and (c) whether the *person* on whom the penalty is to be imposed is an individual.'

14.7.4 G_{/1} The *FSA* considers that the factors which may be relevant when it sets the amount of a penalty in *market abuse* cases include, the following.

- (1) Adverse effect on markets and the seriousness of that effect.

A financial penalty must be in proportion to the nature and seriousness of the abuse in question. The following may be relevant:

- (a) the loss or risk of loss caused to *consumers* or other market users;
- (b) the duration and frequency of the *behaviour*; and
- (c) the impact of the *behaviour* on the orderliness of *prescribed markets* including whether confidence in those markets has been damaged.

- (2) The extent to which the *behaviour* was deliberate or reckless.

In determining whether the *behaviour* was deliberate or reckless, the *FSA* will take into account all the circumstances of the *behaviour* which resulted in the *market abuse* or *requiring or encouraging*. For example, the *FSA* may have regard to whether the *person* intended or foresaw the consequences of their *behaviour*, or gave any consideration to the consequences of their *behaviour*. If the *FSA* decides that the *behaviour* was deliberate or reckless, it would be more likely to impose a higher penalty on a *person* than would otherwise be the case.

- (3) Whether the *person* on whom the penalty is to be imposed is an individual.

This will include having regard to the financial resources and other circumstances of the individual and may include whether there is verifiable

evidence of serious financial hardship or financial difficulties if the individual were to pay the financial penalty that would, in the absence of this consideration, be imposed (see also the discussion of this factor in *ENF* 13.3.3G (3)).

- (4) The amount of profits accrued or loss avoided.

The *FSA* may have regard to the amount of profits accrued or loss avoided as a result of the *behaviour*, for example:

- (a) the *FSA* will propose a penalty that is consistent with the principle that a *person* should not benefit from *behaviour* amounting to *market abuse* or *requiring or encouraging*; and
- (b) the penalty should also act as an incentive to the *person* and others to comply with required standards of market conduct.

- (5) Conduct following the *behaviour* of concern.

The *FSA* may take into account:

- (a) the conduct of the *person* in bringing (or failing to bring) the *behaviour* to the *FSA*'s attention (or the attention of other regulatory authorities, where relevant) quickly, effectively and completely;
- (b) the degree of co-operation the *person* showed during the investigation of the *behaviour* by the *FSA* or any other regulatory authority allowed to share information with the *FSA*, such as an *RIE* or the *Takeover Panel*. (In this context, *persons* are reminded that they may have a duty to co-operate with other regulatory authorities; for example, *MAR* 4.3.4R requires *firms* to whom that *rule* applies to assist the *Takeover Panel* in certain circumstances). Where a *person* has fully cooperated with an investigation, this will be a factor tending to reduce the level of financial penalty;
- (c) any remedial steps taken by the *person* since the *behaviour* was identified (whether on their own initiative or that of the *FSA* or another regulatory authority) including correcting any misleading statement or impression, identifying whether *consumers* or other market users have suffered loss and compensating them, taking disciplinary action against staff involved (if appropriate), and taking steps to ensure similar problems do not happen in the future; and
- (d) whether the *person* concerned has complied with any requirements or rulings of another regulatory authority relating to his *behaviour* (for example, where relevant, those of the *Takeover Panel*).

- (6) Disciplinary record and compliance history.

The disciplinary record and general compliance history of the *person* may be taken into account, including whether the *FSA* has previously taken any action against the *person* for *behaviour* amounting to *market abuse* or *requiring or encouraging* which resulted in adverse findings. For example, the compliance history of a *person* could lead to the *FSA* increasing the penalty where the *person* has engaged in *behaviour* falling within *ENF* 14.3.1G (1) or (2). In assessing the relevance of a *person*'s compliance history, the age of the previous *behaviour* will be taken into account, although a long-standing matter may still be relevant. However, in undertaking this assessment, private warnings will not be taken into account.

- (7) Previous action taken by the *FSA*.

The action the *FSA* has taken over previous similar *behaviour* may be taken into account. The *FSA* will seek to ensure consistency when it determines the appropriate level of penalty. For example, any disciplinary action taken in relation to similar *market abuse* cases will clearly be a relevant factor. However, as stated at *ENF* 14.7.2G, the *FSA* does not intend to set up a tariff system and there may be other relevant factors which could increase or decrease the seriousness of the matter.

- (8) Action taken by other regulatory authorities.

Action taken or to be taken by other regulatory authorities (for example, the *Takeover Panel* or an *RIE*) in relation to the *behaviour* may be relevant. The degree to which any remedial or compensatory steps required by other regulatory authorities have been taken (and whether taken promptly) may also be relevant.

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The factors listed in *ENF* 14.7.4G are not exhaustive, and all the relevant circumstances of the case will be taken into consideration.



14.8 Market abuse and breaches of the FSA Principles

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Principle 5 (Market conduct) (see *PRIN 2.1.1R*) requires a *firm* to observe proper standards of market conduct. Any *behaviour* which constitutes *market abuse* or *requiring or encouraging* will also constitute a breach of *Principle 5*. Where the principal mischief arising from the *behaviour* appears to be *market abuse* or *requiring or encouraging*, the *FSA* will take enforcement action under the *market abuse regime* rather than as a breach of *Principle 5*.

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Behaviour which breaches *Principle 5* may not necessarily be *market abuse* under section 118 of the *Act* (Market abuse). So, where the principal mischief arising from the *behaviour* appears to be a breach of *Principle 5*, and the *FSA* is satisfied that it would not be appropriate to deal with the case under the *market abuse regime*, it will take enforcement action as a breach of the *Principles* (together with other breaches of other *rules*, if relevant). However, where it is unclear or arguable where the principal mischief lies, the *FSA* may take enforcement action as a breach of the *Principles* (and, if relevant, breaches of other *rules*) and in the alternative, for *market abuse* or *requiring or encouraging*. Enforcement of the *Principles* is considered further in *ENF 11.6* (Discipline for breaches of Principles for Businesses).



14.9 Action involving other UK regulatory authorities

- 14.9.1** **G**_{/1} As stated in *ENF 11.8* (Action involving other regulatory authorities), some *market abuse* cases may involve not only potential action by the *FSA*, but also potential action by other regulatory authorities. In relation to *behaviour* which may have occurred or be occurring on a *prescribed market*, the *FSA* will refer to the relevant *RIE* and give due weight to its views. In a case where the *FSA* considers that it would be appropriate to bring action against a *person* under the *market abuse regime*, the relevant *RIE* may also wish to bring action against the *person* for breaches of its own rules. In each case, the *FSA* will coordinate action with the *RIE* concerned to ensure that cases are dealt with effectively and fairly, under operating arrangements [to be agreed] between the *FSA* and the *RIEs*. The *FSA* will have regard to all the circumstances of the case, including whether the other regulatory authorities have adequate powers to address the *behaviour* in question.
- 14.9.2** **G**_{/1} In relation to *behaviour* which may have happened or be happening in the context of a *takeover bid* or to which the *SARs* are relevant, the *FSA* will refer to the *Takeover Panel* and give due weight to its views. Where the *Takeover Code* or *SARs* have procedures for complaint about any *behaviour*, the *FSA* expects parties to exhaust those procedures. The *FSA* will not, save in exceptional circumstances, take action under any of section 123 (*FSA's* power to impose penalties), section 129 (Power of court to impose penalties), section 381 (Injunctions – see *ENF 6*), sections 383 or 384 (Restitution – see *ENF 9*) in respect of *behaviour* to which the *Takeover Code* or *SARs* are relevant before the conclusion of the procedures available under the *Takeover Code* or the *SARs*, as the case may be.
- 14.9.3** **G**_{/1} The *FSA* will not take action against a *person* over *behaviour* which (a) conforms with the *Takeover Code* or rules of an *RIE* and (b) falls within the terms of any provision of the *Code of Market Conduct* which states that *behaviour* so conforming does not amount to *market abuse*. The *FSA* will seek the *Takeover Panel's* or relevant *RIE's* views on whether *behaviour* complies with the *Takeover Code* or *RIE* rules and will attach considerable weight to its views.
- 14.9.4** **G**_{/1} If any of the circumstances in *ENF 14.9.6G* apply, and the *FSA* considers that the use of its disciplinary powers under section 123 or 129, or of its injunctive powers under section 381 or of its powers relating to restitution under section 383 or 384 is appropriate, it will not take action during an offer to which the *Takeover Code* or *SARs* apply except in the circumstances set out in *ENF 14.9.7G*.
- 14.9.5** **G**_{/1} In any case where the *FSA* considers that the use of its powers under any of sections 123, 129, 381, 383 or 384 of the *Act* may be appropriate, if that use may affect the timetable or outcome of a *takeover bid* or a tender offer governed by the *SARs*, it will consult the *Takeover Panel* before using any of those powers.
- 14.9.6** **G**_{/1} Where the *behaviour* of a *person* which amounts to *market abuse* is *behaviour* to which the *Takeover Code* or the *SARs* are relevant, the use of the *Takeover Panel's* informal powers will often be sufficient to address the relevant concerns. In cases

where this is not so, the *FSA* will need to consider, against the background of this manual, whether it is appropriate to use any of its own powers under the *market abuse regime*. The principal circumstances in which the *FSA* is likely to consider such exercise are:

- (1) where the *Takeover Panel* is unable to investigate properly due to lack of cooperation by the relevant *person*;
- (2) where the *behaviour* falls within section 118(2)(a) of the *Act* (Information not generally available);
- (3) where a *person* has deliberately or recklessly failed to comply with a *Takeover Panel* ruling;
- (4) where the *FSA's* approach in previous similar cases (which may have happened otherwise than in the context of a *takeover bid*) suggests that a financial penalty should be imposed (see *ENF* 14.6.2G(4));
- (5) where the *Takeover Panel* asks the *FSA* to consider the use of its powers to impose a financial penalty;
- (6) where the *behaviour* extends to *securities* or a class of *securities* which may be outside the *Takeover Panel's* jurisdiction;
- (7) where the *behaviour* threatens or has threatened the stability of the *financial system*; and
- (8) where for any other reason the *Takeover Panel* asks the *FSA* to consider the use of any of its powers referred to in *ENF* 14.9.2G.

14.9.7 G_{/1} The exceptional circumstances in which the *FSA* will consider the use of powers during a *takeover bid* are listed in *ENF* 14.9.6(1) to (3), (6), (7) and, depending on the circumstances, (8).

14.9.8 G_{/1} The *guidance* given in *ENF* 14.9.6G and *ENF* 14.9.7G does not apply to a *person* who has no responsibilities under the *Takeover Code*.

14.9.9 G_{/1} Where the *FSA* proposes to publish details of financial penalties it has imposed in relation to *behaviour* which has happened in the context of a *takeover bid*, it will consult the *Takeover Panel* over the timing of publication where the *FSA* is of the opinion that publication may affect the timetable or outcome of that bid, and will give due weight to the *Takeover Panel's* views.



14.10 The FSA’s endorsement of the Takeover Code and the SARs

- 14.10.1** G_{/1} *The FSA has made rules under section 143 of the Act (Endorsement of codes etc.) endorsing the Takeover Code and the SARs. The effect of the FSA’s endorsement in MAR 4.2.1R is that, under section 143 of the Act:*
- (1) at the request of the *Takeover Panel*, the FSA may take enforcement action against a *firm* which breaches the *Takeover Code* or the SARs under Part IV (Variation of *permission* – see *ENF 3*), Part XIII (Intervention against incoming firms – see *ENF 4*), Part XIV (Disciplinary measures - see *ENF 11, 12 and 13*) and Part XXV (Injunctions and restitution – see *ENF 6 and ENF 9*);
 - (2) at the request of the *Takeover Panel*, the FSA may take enforcement action against an *approved person* under section 66(2)(b) of the *Act* (Disciplinary powers - see *ENF 11*).
- 14.10.2** G_{/1} Section 143(5) of the *Act* states that ‘a failure to comply with a requirement imposed, or ruling given, under an endorsed provision is to be treated as a failure to comply with the endorsed provision under which that requirement was imposed or ruling was given’. So the FSA may take enforcement action as described in *ENF 14.10.1G* where there has been a failure of this kind.
- 14.10.3** G_{/1} A breach of the *Takeover Code* or the SARs, or being knowingly concerned in a breach by another *person*, may also be relevant to enforcement action taken by the FSA on other grounds, including:
- (1) withdrawal of approval under section 63 of the *Act* (Withdrawal of approval) on the basis that an *approved person* is not fit and proper (see *ENF 7*); and
 - (2) making a *prohibition order* against a *person* under section 56 of the *Act* (Prohibition orders - see *ENF 8*).
- 14.10.4** G_{/1} The FSA is only able to take enforcement action under section 143 of the *Act* in respect of a breach of the *Takeover Code* or the SARs at the request of the *Takeover Panel*. However, if the *behaviour* in question, leaving aside any breach of the *Takeover Code* or the SARs, could also constitute a breach of the *rules*, or in relation to an *approved person*, a *Statement of Principle*, the FSA may use its enforcement powers whether a request has been received from the *Takeover Panel* or not. In that situation, however, the FSA will consult the *Takeover Panel* and give due weight to its views.

14.11 Action involving overseas authorities

- 14.11.1** **G**_{/1} In certain circumstances, *behaviour* that takes place outside the *United Kingdom* may damage the integrity of *prescribed markets*. The *FSA's Code of Market Conduct* (see *MAR 1.2.9G*) contains *guidance* on the circumstances in which *behaviour* outside the *United Kingdom* may amount to *market abuse* or *requiring or encouraging*.
- 14.11.2** **G**_{/1} Where *behaviour* that has taken place overseas amounts to *market abuse* or *requiring or encouraging*, the *FSA* will consider whether it is appropriate to impose a financial penalty or issue a public statement about the *person* concerned. When deciding whether to impose a sanction in these circumstances the *FSA* may consider the factors in *ENF 14.4*. In addition to these factors, the *FSA* will consider the extent to which the abusive *behaviour* is capable of being dealt with by action by the relevant *overseas regulator* or other enforcement agency. The *FSA* will consider in each case whether it is appropriate for it or another enforcement agency to take action.
- 14.11.3** **G**_{/1} In some cases both the *FSA* and the relevant *overseas regulator* (or other enforcement agency) may have an interest in taking enforcement action against the *person* concerned. For example, if the *behaviour* involves a breach of relevant rules or laws of the overseas jurisdiction as well as the *market abuse* provisions of the *UK* legislation it may be appropriate for both the *FSA* and the overseas authority or agency to take action. In those circumstances, the *FSA* will work with the relevant overseas authorities to coordinate effective enforcement action.

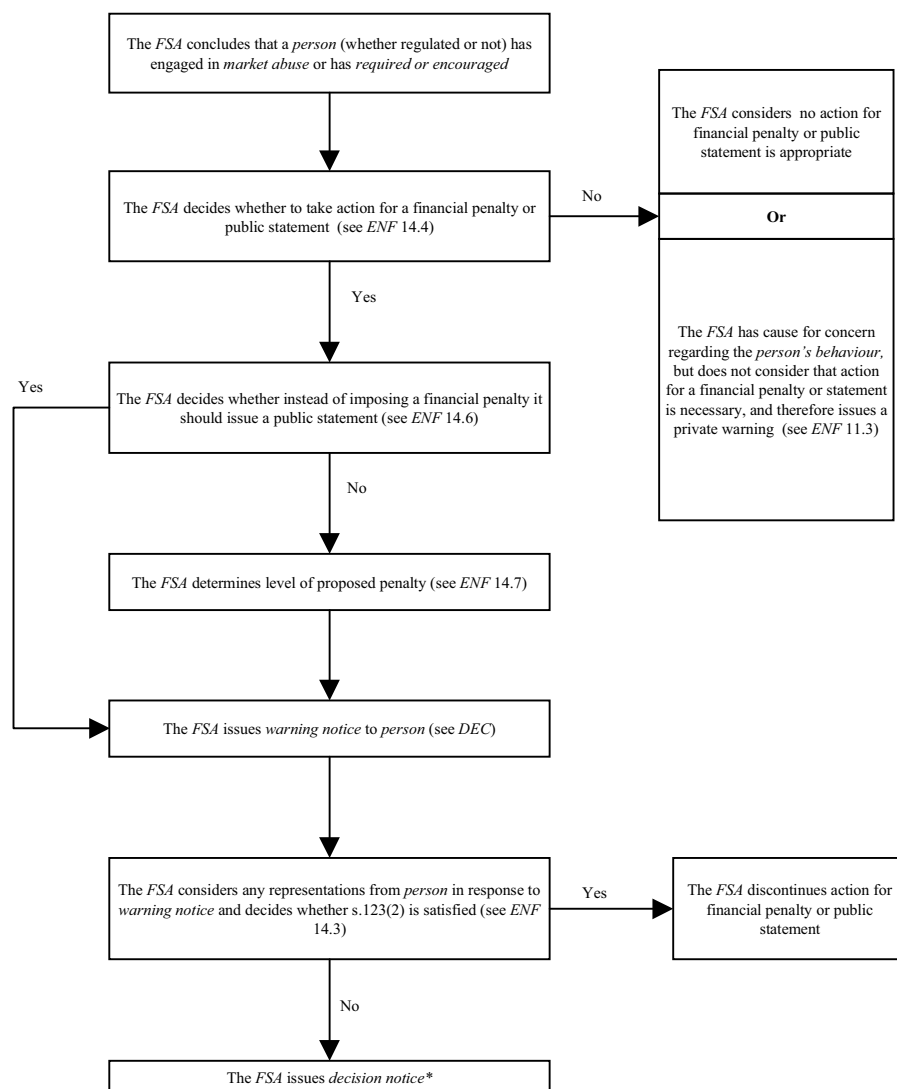


14.12 Decision making procedure and publication of sanctions

- 14.12.1** G_{/1} The *Act* requires the *FSA* to issue a *warning notice*, *decision notice* and *final notice* before imposing a financial penalty or issuing a statement. More information on the procedure the *FSA* will follow in these circumstances is contained in *DEC*.
- 14.12.2** G_{/1} The *FSA* will ordinarily publicise a financial penalty or statement by issuing a press release giving details of the *behaviour* and the sanction imposed. However, the *Act* provides that the *FSA* may not publish information in those circumstances where it would be unfair to the *person* on whom a sanction is imposed, or prejudicial to the interests of *consumers*.

ENF 14 ANN 1G: Action for financial penalties or public statements in market abuse cases

Action for financial penalties or public statements in market abuse cases



Chapter 15.

Prosecution of criminal offences



15.1 Application and purpose

Application

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This chapter applies to all *firms* and individuals employed by *firms*, *approved persons*, *appointed representatives*, and any other *persons*, who may be involved in committing criminal offences that the *FSA* has power to prosecute under the *Act*.

Purpose

15.1.2

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The purpose of this chapter is to set out the *FSA*'s powers to prosecute criminal offences under sections 401 of the *Act* (Proceedings for Offences) and 402 of the *Act* (Power of the *FSA* to institute proceedings for certain other offences), and to provide *guidance* on how the *FSA* intends to exercise these powers.

15.2 Introduction

15.2.1

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Under section 401 of the *Act* (Proceedings for Offences), the *FSA* has power to prosecute the following offences:

- (1) carrying on or purporting to carry on a *regulated activity* without *authorisation* or exemption (under section 23);
- (2) making false claims to be *authorised* or exempt (under section 24);
- (3) communicating an invitation or inducement to *engage in investment activity* in breach of the restrictions on *financial promotion* (under section 25);
- (4) misleading the *FSA* and other contraventions in relation to the exercise of *Treaty rights* (under paragraph 6 of Schedule 4);
- (5) performing or agreeing to perform functions in breach of a *prohibition order* (under section 56(4));
- (6) failing to register a copy of listing particulars on or before publication (under section 83(3));
- (7) *offering* new *securities* to the public before publishing a prospectus required by *listing rules* made under section 84 of the *Act* (section 85(2));
- (8) issuing an advertisement, or other information specified in the *listing rules*, without prior approval or authorisation from the *competent authority* (under section 98(2));
- (9) failing to cooperate with, or giving false information to, *FSA* appointed investigators (under section 177);
- (10) failing to comply with provisions about *control over authorised persons* (under section 191);
- (11) carrying on, or purporting to carry on, business in contravention of a *consumer credit prohibition* (under section 203(9));
- (12) making false claims to be a *person* to whom the *general prohibition* does not apply as a result of Part XX of the *Act* (Provision of Financial Services by Members of the Professions) (under section 333);
- (13) providing false or misleading information to an auditor or *actuary* (under section 346);
- (14) disclosing confidential information in contravention of the statutory restrictions under sections 348 and 350(5) (see section 352);

(15) failure by a *director* of an insurer carrying on long-term *insurance business* to notify the *FSA* of a general meeting to propose a resolution for voluntary winding up (under section 366(3));

(16) *Misleading statements and practices offences* (under section 397);

(17) Misleading the *FSA* (under section 398).

15.2.2



Under section 402 of the *Act* (Power of the *FSA* to institute proceedings for certain other offences), the *FSA* has power to prosecute the following offences:

(1) *insider dealing* under Part V of the Criminal Justice Act 1993 (under section 402(1)(a));

(2) Breaches of the prescribed regulations relating to *money laundering* (under section 402(1)(b)).

15.2.3



The *FSA* has power to prosecute these offences in England, Wales and Northern Ireland, but not in Scotland. In Scotland, the Crown Office will remain responsible for prosecutions.



15.3 The FSA’s power to prosecute criminal offences

- 15.3.1** G_{/1} The *FSA*’s power to prosecute criminal offences is set out in sections 401 (of the *Act* (Proceedings for Offences) and 402 (Power to prohibit the carrying on of Consumer Credit Act business) of the *Act*.
- 15.3.2** G_{/1} Under section 401 of the *Act*:

 - (1) proceedings for an offence under the *Act*, or subordinate legislation made under the *Act*, may be instituted in England and Wales only:
 - (a) by the *FSA* or the Secretary of State; or
 - (b) by or with the consent of the Director of Public Prosecutions;
 - (2) proceedings for an offence under the *Act*, or subordinate legislation made under the *Act*, may be instituted in Northern Ireland only:
 - (a) by the *FSA* or the Secretary of State; or
 - (b) by or with the consent of the Director of Public Prosecutions for Northern Ireland; and
 - (3) except in Scotland, proceedings for an offence under section 203 (Power to prohibit the carrying on of Consumer Credit Act business) may also be instituted by the Director General of Fair Trading.
- 15.3.3** G_{/1} Under section 402 of the *Act* the *FSA* may, except in Scotland, institute proceedings for an offence under:

 - (1) Part V of the Criminal Justice Act 1993 (Insider dealing); and
 - (2) Prescribed regulations relating to *money laundering*.
- 15.3.4** G_{/1} The *FSA* does not have power to prosecute the offences referred to in *ENF* 15.3.2G and *ENF* 15.3.3G in Scotland. Public prosecution of these offences in Scotland is the responsibility of the Crown Office.

15.4 The FSA's general approach

- 15.4.1** G_{/1} The FSA's general policy is to pursue through the criminal justice system all those cases where criminal prosecution is appropriate. The principles the FSA will apply when it decides whether a case is appropriate for criminal prosecution are set out in ENF 15.5. When considering whether to prosecute a breach of the prescribed regulations in relation to *money laundering* (ENF 15.2.2G(2)) the FSA will also have regard to whether the *person* concerned has complied with the "Guidance Notes for the Financial Sector" produced by the Joint Money Laundering Steering Group.
- 15.4.2** G_{/1} In relation to *misleading statements and practices offences* and *insider dealing*, where the FSA also has power to impose a sanction for *market abuse*, it will decide whether to commence criminal proceedings or impose a sanction after considering the factors set out in ENF 15.5 and ENF 15.7.2G.
- 15.4.3** G_{/1} In cases where criminal proceedings have commenced or will be commenced, the FSA may consider whether also to take civil or regulatory action. That action might include:
- (1) *injunctions* (the FSA's policy and procedure in relation to the exercise of its powers to obtain *injunctions* against *persons*, whether *authorised* or not, is set out in ENF 6);
 - (2) restitution (the FSA's policy and procedure in relation to the exercise of its power to obtain restitution against *persons*, whether *authorised* or not, is set out in ENF 9);
 - (3) own-initiative action (the FSA's policy and procedure in relation to the exercise of its *own-initiative powers* in relation to *firms* is set out in ENF 3);
 - (4) withdrawal of approval or cancellation of *permission* and withdrawal of *authorisation* (the FSA's policy and procedure in relation to its power to withdraw approval from *approved persons* is set out in ENF 7 and its policy and procedure in relation to its power to cancel a *firm's permission* and withdraw *authorisation* is set out in ENF 5);
 - (5) prohibition of individuals from carrying out functions in connection with *regulated activities* (the FSA's policy and procedure in relation to its powers to make *prohibition orders* against individuals, whether *authorised* or not, is set out in ENF 8). The commencement of criminal proceedings against an individual (particularly where that individual is an *approved person*) will raise concerns in relation to that individual's fitness and propriety to perform functions in relation to *regulated activities*. The FSA may therefore consider making a *prohibition order* against him if proceedings result in a criminal conviction.

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When it decides whether to take any of the civil or regulatory actions set out in *ENF 15.4.3G*, where criminal proceedings are in contemplation, the *FSA* will have regard to the following factors:

- (1) whether, in the *FSA*'s opinion, the taking of civil or regulatory action might unfairly prejudice the prosecution, or proposed prosecution, of criminal offences;
- (2) whether, in the *FSA*'s opinion, the taking of civil or regulatory action might unfairly prejudice the defendants in the criminal proceedings in the conduct of their defence; and
- (3) whether it is appropriate to take civil or regulatory action, having regard to the scope of the criminal proceedings and the powers available to the criminal courts.

15.5 The Code for Crown Prosecutors

15.5.1 **G**_{/1} When the *FSA* decides whether to bring criminal proceedings in England, Wales or Northern Ireland, or to refer the matter to another prosecuting authority in England, Wales or Northern Ireland (see *ENF* 15.8.1G), it will apply the basic principles set out in the Code for Crown Prosecutors. The current edition of the Code is set out in *ENF* 15 Ann 1G.

15.5.2 **G**_{/1} Under the Code for Crown Prosecutors, the *FSA* will consider in each case whether:

- (1) there is sufficient evidence to provide a realistic prospect of conviction against the defendant on each criminal charge ('the evidential test'); and
- (2) having regard to the seriousness of the offence and all the circumstances, criminal prosecution is in the public interest ('the public interest test').

The evidential test

15.5.3 **G**_{/1} The *FSA* will apply the evidential test in accordance with the guidance contained in the Code for Crown Prosecutors (see paragraph 5 of *ENF* 15 Ann 1G). In particular, the *FSA* will commence proceedings only where it is satisfied that the evidence is such that a jury or a bench of magistrates (properly directed in accordance with the law) is more likely than not to convict the defendant of the charge alleged.

15.5.4 **G**_{/1} In deciding whether there is enough evidence to prosecute, the *FSA* will consider whether the evidence can be used in criminal proceedings and is reliable. The *FSA* will not generally be able to use, or refer to, in criminal proceedings a statement made by the defendant in compliance with the *FSA*'s compulsory powers of investigation. The *FSA* will only be able to use those statements where the alleged offence is either making false statements otherwise than on oath, or providing false or misleading evidence to the *FSA*'s investigators (see section 177(4) of the *Act* (Offences)).

The public interest test

15.5.5 **G**_{/1} In each case where the evidential test is satisfied, the *FSA* will consider whether a prosecution would be in the public interest. This will depend on the circumstances of each individual case. The *FSA* will balance the factors for and against prosecution, and apply the guidelines set out in the Code for Crown Prosecutors. Only if the *FSA* determines that criminal prosecution is in the public interest (see paragraph 6 of *ENF* 15 Ann 1G) will it proceed to prosecute.

15.6 FSA cautions

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In some cases, the *FSA* may decide to issue a formal caution rather than to prosecute an offender. In these cases the *FSA* will follow the Home Office Guidance on the cautioning of offenders, currently contained in the Home Office Circular 18/1994. The *FSA* will not administer a caution unless it is satisfied that the following conditions are met:

- (1) there is sufficient evidence of the offender's guilt to give a realistic prospect of conviction;
- (2) the offender admits the offence; and
- (3) the offender understands the significance of a caution and gives informed consent to being cautioned.

15.6.2

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Where the *FSA* decides to administer a formal caution, a record of the caution will be kept by the *FSA*, but the *FSA* will not publish the caution. The issue of a caution may influence the *FSA* in its decision whether or not to prosecute the offender if he offends again. If the offender is a *firm* or an *approved person*, a caution given by the *FSA* will form part of the *firm's* or *approved person's* regulatory record for the purposes of *ENF* 11.4.1G(3). If relevant, the *FSA* will take the caution into account in deciding whether to take disciplinary action for subsequent regulatory misconduct by the *firm* or the *approved person*. The *FSA* may also take a caution into account when considering a person's honesty, integrity and reputation and his fitness or propriety to perform controlled or other functions in relation to regulated activities (see *FIT* 2.1.3G).



15.7 Criminal prosecutions in cases of market abuse

15.7.1

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The FSA’s power to impose sanctions for *market abuse* is intended to complement the existing criminal regime for *insider dealing* and *misleading statements and practices offences*. In some cases there will be instances of market misconduct that may arguably involve a breach of the criminal law as well as *market abuse* as defined in the *Act*. When the FSA decides whether to commence criminal proceedings rather than impose a sanction in relation to that misconduct, it will take into account those factors set out in the Code for Crown Prosecutors referred to in ENF 15.5. When deciding whether to prosecute market misconduct which also falls within the definition of *market abuse*, application of the tests set out in ENF 15.5 may involve consideration of some of the factors set out in ENF 15.7.2G.

15.7.2

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The factors which the FSA may consider when deciding whether to commence a criminal prosecution for market misconduct rather than impose a sanction for *market abuse* include, but are not limited to, the following:

- (1) the seriousness of the misconduct: if the misconduct is serious and prosecution is likely to result in a significant sentence, criminal prosecution may be appropriate;
- (2) whether there are victims who have suffered loss as a result of the misconduct: where there are no victims a criminal prosecution is less likely to be appropriate;
- (3) the extent and nature of the loss suffered: where the misconduct has resulted in substantial loss and/or loss has been suffered by a substantial number of victims, criminal prosecution may be appropriate;
- (4) the effect of the misconduct on the market: where the misconduct has resulted in significant distortion or disruption to the market and/or has significantly damaged market confidence, a criminal prosecution may be appropriate;
- (5) the extent of any profits accrued or loss avoided as a result of the misconduct: where substantial profits have accrued or loss avoided as a result of the misconduct, criminal prosecution may be appropriate;
- (6) whether there are grounds for believing that the misconduct is likely to be continued or repeated: if it appears that the misconduct may be continued or repeated and the imposition of a financial penalty is unlikely to deter further misconduct, a criminal prosecution may be more appropriate than a financial penalty;
- (7) whether the *person* has previously been cautioned or convicted in relation to market misconduct or has been subject to civil or regulatory action in respect

of market misconduct: where this is the case, a criminal prosecution may be appropriate;

- (8) the extent to which redress has been provided to those who have suffered loss as a result of the misconduct and/or whether steps have been taken to remedy any failures in systems or controls which gave rise to the misconduct: where such steps are taken promptly and voluntarily, criminal prosecution may not be appropriate; however, potential defendants will not avoid prosecution simply because they are able to pay compensation;
- (9) the effect that a criminal prosecution may have on the prospects of securing redress for those who have suffered loss: where a criminal prosecution will have adverse effects on the solvency of a *firm* or individual in circumstances where loss has been suffered by *consumers*, the *FSA* may decide that criminal proceedings are not appropriate;
- (10) whether the *person* is being or has been voluntarily cooperative with the *FSA* in taking corrective measures; however, potential defendants will not avoid prosecution merely by fulfilling a statutory duty to take those measures;
- (11) where an individual's misconduct involves dishonesty or an abuse of a position of authority or trust: in these circumstances, criminal prosecution may be appropriate;
- (12) where the misconduct in question was carried out by a group, and a particular individual has played a leading role in the commission of the misconduct: in these circumstances criminal proceedings may be appropriate in relation to that individual;
- (13) the personal circumstances of an individual may be relevant to a decision whether to commence a criminal prosecution.

15.7.3 G /1 The importance attached by the *FSA* to these factors will vary from case to case and the factors are not necessarily cumulative or exhaustive.

15.7.4 G /1 It is the *FSA*'s policy not to impose a sanction for *market abuse* where a *person* is being prosecuted for market misconduct or has been finally convicted or acquitted of market misconduct (following the exhaustion of all appeal processes) in a criminal prosecution arising from substantially the same allegations. Similarly, it is the *FSA*'s policy not to commence a prosecution for market misconduct where the *FSA* has brought or is seeking to bring disciplinary proceedings for *market abuse* arising from substantially the same allegations.

15.7.5 G /1 Where the *FSA* decides to commence criminal proceedings for market misconduct or imposes a sanction for *market abuse*, it may also consider taking civil or regulatory action. That action may include:

- (1) applying to court for an *injunction* to prevent *market abuse* continuing or to require the *person* to take steps to remedy the consequences of the abuse (see *ENF* 6.4);
- (2) applying to court for an order for restitution (see *ENF* 9.4) or exercising its administrative power to require restitution (see *ENF* 9.5) in relation to profits accrued by the *person* or loss suffered by others as a result of the abuse.
- (3) withdrawal of approval (see *ENF* 7) or cancellation of *permission* and withdrawal of *authorisation* (see *ENF* 5).

(4) prohibition of individuals from carrying out functions in connection with *regulated activities* (see *ENF 8*).

15.7.6

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The *FSA* does not have power to prosecute offences of market misconduct in Scotland. These proceedings will remain the responsibility of the Crown Office.



15.8 Liaison with other prosecuting authorities

15.8.1

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The *FSA* has power to prosecute offences under the *Act* in England or Wales and in Northern Ireland. In addition the following authorities also have that power:

- (1) in England and Wales: the Secretary of State for Trade and Industry, the Director General of Fair Trading (in relation to offences involving the *Consumer Credit Act*), the Crown Prosecution Service and, in cases of serious or complex fraud, the Serious Fraud Office;
- (2) in Northern Ireland: the Secretary of State for Trade and Industry, the Director of Public Prosecutions in Northern Ireland, and in cases of serious or complex fraud, the Serious Fraud Office.

15.8.2

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The *FSA* has no power to prosecute offences under the *Act* in Scotland where prosecution will remain the responsibility of the Crown Office.

15.8.3

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The *FSA* has agreed guidelines that will establish a framework for liaison and cooperation in cases where one or more of these authorities has an interest in prosecuting any aspect of a matter that the *FSA* is considering for investigation, investigating or considering prosecuting. These Guidelines are set out in *ENF 2 Ann 1G*.

Code for crown prosecutors

A new edition of the code was issued in October 2000. It is reproduced below by kind permission of the Crown Prosecution Service.

1. Introduction

1.1 The decision to prosecute an individual is a serious step. Fair and effective prosecution is essential to the maintenance of law and order. Even in a small case a prosecution has serious implications for all involved – victims, witnesses and defendants. The Crown Prosecution Service applies the Code for Crown Prosecutors so that it can make fair and consistent decisions about prosecutions.

1.2 The Code helps the Crown Prosecution Service to play its part in making sure that justice is done. It contains information that is important to police officers and others who work in the criminal justice system and to the general public. Police officers should take account of the Code when they are deciding whether to charge a person with an offence.

1.3 The Code is also designed to make sure that everyone knows the principles that the Crown Prosecution Service applies when carrying out its work. By applying the same principles, everyone involved in the system is helping to treat victims fairly and to prosecute fairly but effectively.

2. General Principles

2.1 Each case is unique and must be considered on its own facts and merits. However, there are general principles that apply to the way in which Crown Prosecutors must approach every case.

2.2 Crown Prosecutors must be fair, independent and objective. They must not let any personal views about ethnic or national origin, sex, religious beliefs, political views or the sexual orientation of the suspect, victim or witness influence their decisions. They must not be affected by improper or undue pressure from any source.

2.3 It is the duty of Crown Prosecutors to make sure that the right person is prosecuted for the right offence. In doing so, Crown Prosecutors must always act in the interests of justice and not solely for the purpose of obtaining a conviction.

2.4 It is the duty of Crown Prosecutors to review, advise on and prosecute cases, ensuring that the law is properly applied, that all relevant evidence is put before the court and that obligations of disclosure are complied with, in accordance with the principles set out in this Code.

2.5 The CPS is a public authority for the purposes of the Human Rights Act 1998. Crown Prosecutors must apply the principles of the European Convention on Human Rights in accordance with the Act.

3. Review

3.1 Proceedings are usually started by the police. Sometimes they may consult the Crown Prosecution Service before starting a prosecution. Each case that the Crown Prosecution Service receives from the police is reviewed to make sure it meets the evidential and public interest tests set out in this Code. Crown Prosecutors may decide to continue with the original charges, to change the charges, or sometimes to stop the case.

3.2 Review is a continuing process and Crown Prosecutors must take account of any change in circumstances. Wherever possible, they talk to the police first if they are thinking about changing the charges or stopping the case. This gives the police the chance to provide more information that may affect the decision. The Crown Prosecution Service and the police work closely together to reach the right decision, but the final responsibility for the decision rests with the Crown Prosecution Service.

4 Code Tests

4.1 There are two stages in the decision to prosecute. The first stage is **the evidential test**. If the case does not pass the evidential test, it must not go ahead, no matter how important or serious it may be. If the case does meet the evidential test, Crown Prosecutors must decide if a prosecution is needed in the public interest.

4.2 This second stage is **the public interest test**. The Crown Prosecution Service will only start or continue with a prosecution when the case has passed both tests. The evidential test is explained in section 5 and the public interest test is explained in section 6.

5 The Evidential Test

5.1 Crown Prosecutors must be satisfied that there is enough evidence to provide a 'realistic prospect of conviction' against each defendant on each charge. They must consider what the defence case may be, and how that is likely to affect the prosecution case.

5.2 A realistic prospect of conviction is an objective test. It means that a jury or bench of magistrates, properly directed in accordance with the law, is more likely than not to convict the defendant of the charge alleged. This is a separate test from the one that the criminal courts themselves must apply. A jury or magistrates' court should only convict if satisfied so that it is sure of a defendant's guilt.

5.3 When deciding whether there is enough evidence to prosecute, Crown Prosecutors must consider whether the evidence can be used and is reliable. There will be many cases in which the evidence does not give any cause for concern. But there will also be cases in which the evidence may not be as strong as it first appears. Crown Prosecutors must ask themselves the following questions:

Can the evidence be used in court?

a Is it likely that the evidence will be excluded by the court? There are certain legal rules which might mean that evidence which seems relevant cannot be given at a trial. For example, is it likely that the evidence will be excluded because of the way in which it was gathered or because of the rule against using hearsay as evidence? If so, is there enough other evidence for a realistic prospect of conviction?

Is the evidence reliable?

b Is there evidence which might support or detract from the reliability of a confession? Is the reliability affected by factors such as the defendant's age, intelligence or level of understanding?

c What explanation has the defendant given? Is a court likely to find it credible in the light of the evidence as a whole? Does it support an innocent explanation?

d If the identity of the defendant is likely to be questioned, is the evidence about this strong enough?

e Is the witness's background likely to weaken the prosecution case? For example, does the witness have any motive that may affect his or her attitude to the case, or a relevant previous conviction?

f Are there concerns over the accuracy or credibility of a witness? Are these concerns based on evidence or simply information with nothing to support it? Is there further evidence which the police should be asked to seek out which may support or detract from the account of the witness?

5.4 Crown Prosecutors should not ignore evidence because they are not sure that it can be used or is reliable. But they should look closely at it when deciding if there is a realistic prospect of conviction.

6 The Public Interest Test

6.1 In 1951, Lord Shawcross, who was Attorney General, made the classic statement on public interest, which has been supported by Attorneys General ever since: "It has never been the rule in this country – I hope it never will be – that suspected criminal offences must automatically be the subject of prosecution". (House of Commons Debates, volume 483, column 681, 29 January 1951.)

6.2 The public interest must be considered in each case where there is enough evidence to provide a realistic prospect of conviction. A prosecution will usually take place unless there are public interest factors tending against prosecution which clearly outweigh those tending in favour. Although there may be public interest factors against prosecution in a particular case, often the prosecution should go ahead and those factors should be put to the court for consideration when sentence is being passed.

6.3 Crown Prosecutors must balance factors for and against prosecution carefully and fairly. Public interest factors that can affect the decision to prosecute usually depend on the seriousness of the offence or the circumstances of the suspect. Some factors may increase the need to prosecute but others may suggest that another course of action would be better.

The following lists of some common public interest factors, both for and against prosecution, are not exhaustive. The factors that apply will depend on the facts in each case.

Some common public interest factors in favour of prosecution.

6.4 The more serious the offence, the more likely it is that a prosecution will be needed in the public interest. A prosecution is likely to be needed if:

- a** a conviction is likely to result in a significant sentence;
- b** a weapon was used or violence was threatened during the commission of the offence;
- c** the offence was committed against a person serving the public (for example, a police or prison officer, or a nurse);
- d** the defendant was in a position of authority or trust;
- e** the evidence shows that the defendant was a ringleader or an organiser of the offence;
- f** there is evidence that the offence was premeditated;
- g** there is evidence that the offence was carried out by a group;
- h** the victim of the offence was vulnerable, has been put in considerable fear, or suffered personal attack, damage or disturbance;
- i** the offence was motivated by any form of discrimination against the victim's ethnic or national origin, sex, religious beliefs, political views or sexual orientation, or the suspect demonstrated hostility towards the victim based on any of those characteristics;
- j** there is a marked difference between the actual or mental ages of the defendant and the victim, or if there is any element of corruption;
- k** the defendant's previous convictions or cautions are relevant to the present offence;
- l** the defendant is alleged to have committed the offence whilst under an order of the court;

m there are grounds for believing that the offence is likely to be continued or repeated, for example, by a history of recurring conduct; or

n the offence, although not serious in itself, is widespread in the area where it was committed.

Some common public interest factors against prosecution

6.5 A prosecution is less likely to be needed if:

a the court is likely to impose a nominal penalty;

b the defendant has already been made the subject of a sentence and any further conviction would be unlikely to result in the imposition of an additional sentence or order, unless the nature of the particular offence requires a prosecution;

c the offence was committed as a result of a genuine mistake or misunderstanding (these factors must be balanced against the seriousness of the offence);

d the loss or harm can be described as minor and was the result of a single incident, particularly if it was caused by a misjudgement;

e there has been a long delay between the offence taking place and the date of the trial, unless:

the offence is serious;

the delay has been caused in part by the defendant;

the offence has only recently come to light; or

the complexity of the offence has meant that there has been a long investigation;

f a prosecution is likely to have a bad effect on the victim's physical or mental health, always bearing in mind the seriousness of the offence;

g the defendant is elderly or is, or was at the time of the offence, suffering from significant mental or physical ill health, unless the offence is serious or there is a real possibility that it may be repeated. The Crown Prosecution Service, where necessary, applies Home Office guidelines about how to deal with mentally disordered offenders. Crown Prosecutors must balance the desirability of diverting a defendant who is suffering from significant mental or physical ill health with the need to safeguard the general public;

h the defendant has put right the loss or harm that was caused (but defendants must not avoid prosecution solely because they pay compensation); or

I details may be made public that could harm sources of information, international relations or national security;

6.6 Deciding on the public interest is not simply a matter of adding up the number of factors on each side. Crown Prosecutors must decide how important each factor is in the circumstances of each case and go on to make an overall assessment.

The relationship between the victim and the public interest

6.7 The Crown Prosecution Service prosecutes cases on behalf of the public at large and not just in the interests of any particular individual. However, when considering the public interest test Crown Prosecutors should always take into account the consequences for the victim of the decision whether or not to prosecute, and any views expressed by the victim or the victim's family.

6.8 It is important that a victim is told about a decision which makes a significant difference to the case in which he or she is involved. Crown Prosecutors should ensure that they follow any agreed procedures.

Youths

6.9 Crown Prosecutors must consider the interests of a youth when deciding whether it is in the public interest to prosecute. However Crown Prosecutors should not avoid prosecuting simply because of the defendant's age. The seriousness of the offence or the youth's past behaviour is very important.

6.10 Cases involving youths are usually only referred to the Crown Prosecution Service for prosecution if the youth has already received a reprimand and final warning, unless the offence is so serious that neither of these were appropriate. Reprimands and final warnings are intended to prevent re-offending and the fact that a further offence has occurred indicates that attempts to divert the youth from the court system have not been effective. So the public interest will usually require a prosecution in such cases, unless there are clear public interest factors against prosecution.

Police Cautions

6.11 These are only for adults. The police make the decision to caution an offender in accordance with Home Office guidelines.

6.12 When deciding whether a case should be prosecuted in the courts, Crown Prosecutors should consider the alternatives to prosecution. This will include a police caution. Again the Home Office guidelines should be applied. Where it is felt that a caution is appropriate, Crown Prosecutors must inform the police so that they can caution the suspect. If the caution is not administered because the suspect refuses to accept it or the police do not wish to offer it, then the Crown Prosecutor may review the case again.

7 Charges

7.1 Crown Prosecutors should select charges which:

- a** reflect the seriousness of the offending;
- b** give the court adequate sentencing powers; and
- c** enable the case to be presented in a clear and simple way.

This means that Crown Prosecutors may not always continue with the most serious charge where there is a choice. Further, Crown Prosecutors should not continue with more charges than are necessary.

7.2 Crown Prosecutors should never go ahead with more charges than are necessary just to encourage a defendant to plead guilty to a few. In the same way, they should never go ahead with a more serious charge just to encourage a defendant to plead guilty to a less serious one.

7.3 Crown Prosecutors should not change the charge simply because of the decision made by the court or the defendant about where the case will be heard.

8 Mode of Trial

8.1 The Crown Prosecution Service applies the current guidelines for magistrates who have to decide whether cases should be tried in the Crown Court when the offence gives the option and the defendant does not indicate a guilty plea. (See the 'National Mode of Trial Guidelines' issued by the Lord Chief Justice.) Crown Prosecutors should recommend Crown Court trial when they are satisfied that the guidelines require them to do so.

8.2 Speed must never be the only reason for asking for a case to stay in the magistrates' courts. But Crown Prosecutors should consider the effect of any likely delay if they send a case to the Crown Court, and any possible stress on victims and witnesses if the case is delayed.

9 Accepting Guilty Pleas

9.1 Defendants may want to plead guilty to some, but not all, of the charges. Alternatively, they may want to plead guilty to a different, possibly less serious, charge because they are admitting only part of the crime. Crown Prosecutors should only accept the defendant's plea if they think the court is able to pass a sentence that matches the seriousness of the offending, particularly where there are aggravating features. Crown Prosecutors must never accept a guilty plea just because it is convenient.

9.2 Particular care must be taken when considering pleas which would enable the defendant to avoid the imposition of a mandatory minimum sentence. When pleas are offered, Crown Prosecutors must bear in mind the fact that ancillary orders can be made with some offences but not with others.

9.3 In cases where a defendant pleads guilty to the charges but on the basis of facts that are different from the prosecution case, and where this may significantly affect sentence, the court should be invited to hear evidence to determine what happened, and then sentence on that basis.

10 Re-starting a Prosecution

10.1 People should be able to rely on decisions taken by the Crown Prosecution Service. Normally, if the Crown Prosecution Service tells a suspect or defendant that there will not be a prosecution, or that the prosecution has been stopped, that is the end of the matter and the case will not start again. But occasionally there are special reasons why the Crown Prosecution Service will re-start the prosecution, particularly if the case is serious.

10.2 These reasons include:

a rare cases where a new look at the original decision shows that it was clearly wrong and should not be allowed to stand;

b cases which are stopped so that more evidence which is likely to become available in the fairly near future can be collected and prepared. In these cases, the Crown Prosecutor will tell the defendant that the prosecution may well start again; and

c cases which are stopped because of a lack of evidence but where more significant evidence is discovered later.

The Code is a public document. It is available on the [CPS Website](#):

Further copies may be obtained from:

Crown Prosecution Service
Communications Branch
50 Ludgate Hill
London
EC4M 7EX
Telephone: 020 7796 8442
Fax: 020 7796 8351
Email: commsdept@cps.gov.uk

Translations into other languages are available and audio or braille copies are available. Please contact CPS Communications Branch (above) for details.

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Chapter 16.

Collective investment schemes



16.1 Application and purpose

Application

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This chapter provides *guidance* on the FSA's use of its enforcement powers in relation to:

- (1) *AUTs*;
- (2) *ICVCs*; and
- (3) *recognised schemes*.

Purpose

16.1.2

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The purpose of this chapter is to explain the FSA's powers in relation to the *collective investment schemes* listed at ENF 16.1.1G (1) to (3) and to provide *guidance* on how the FSA intends to exercise these powers. The effective use of these powers will help the FSA in pursuing its *regulatory objectives* of protecting *consumers*, maintaining market confidence and reducing *financial crime*.



16.2 Authorised unit trust schemes

16.2.1 G_{/1} Sections 242 to 261 of the *Act* contain provisions relating to *AUTs*. These include the following enforcement powers:

- (1) a power for the *FSA* to revoke *authorisation* of an *AUT* otherwise than by consent (section 254);
- (2) a power for the *FSA* to give directions (section 257); and
- (3) a power for the *FSA* to apply to court for the removal of a *manager* or *trustee* or the winding up of an *AUT* (section 258).

16.2.2 G_{/1} While the grounds upon which the powers under sections 254 and 257 may be used are broadly similar, there are certain material differences. These provisions are therefore set out separately in *ENF* 16.2.3G to *ENF* 16.2.4G and *ENF* 16.2.5G to *ENF* 16.2.7G respectively.

Section 254: the power

16.2.3 G_{/1}

- (1) The *FSA*'s power to revoke *authorisation* of an *AUT* otherwise than by consent is in section 254 (Revocation of authorisation order otherwise than by consent).
- (2) Section 254(1) states that 'An *authorisation order* may be revoked by an order made by the *FSA* if it appears to the *FSA* that:
 - (a) one or more of the requirements for the making of the order are no longer satisfied;
 - (b) the *manager* or *trustee* of the *scheme* concerned has contravened a requirement imposed on him by or under this *Act*;
 - (c) the *manager* or *trustee* of the *scheme* has, in purported compliance with any such requirement, knowingly or recklessly given the *FSA* information which is false or misleading in a material particular;
 - (d) no *regulated activity* is being carried on in relation to the *scheme* and the period of that inactivity began at least twelve months earlier; or
 - (e) none of paragraphs (a) to (d) applies, but it is desirable to revoke the *authorisation order* in order to protect the interests of *participants* or potential *participants* in the *scheme*'.

16.2.4 G_{/1} For the purposes of section 254(1)(e), the *FSA* may, under subsection 254(2), take into account '...any matter relating to- (a) the *scheme*; (b) the *manager* or *trustee*;

(c) any *person* employed by or associated with the *manager* or *trustee* in connection with the *scheme*; (d) any *director* of the *manager* or *trustee*; (e) any *person* exercising influence over the *manager* or *trustee*; (f) any *body corporate* in the same *group* as the *manager* or *trustee*; (g) any *director* of any such *body corporate*; (h) any *person* exercising influence over any such *body corporate*'.

Section 257: the power

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- (1) Section 257(1) (Directions) contains a power for the *FSA* to give directions to the *manager* and *trustee* of an *AUT*.
- (2) Section 257(1) states that 'The *FSA* may give a direction under this section if it appears to the *FSA* that:
 - (a) one or more of the requirements for the making of an *authorisation order* are no longer satisfied;
 - (b) the *manager* or *trustee* of an *AUT* has contravened, or is likely to contravene, a requirement imposed on him by or under this *Act*;
 - (c) the *manager* or *trustee* of such a *scheme* has, in purported compliance with any such requirement, knowingly or recklessly given the *FSA* information which is false or misleading in a material particular; or
 - (d) none of paragraphs (a) to (c) applies, but it is desirable to give a direction in order to protect the interests of *participants* or potential *participants* in such a *scheme*'.

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- (1) The types of directions the *FSA* may give under section 257 are explained in section 257(2).
- (2) Section 257(2) states that 'A direction under this section may:
 - (a) require the *manager* of the *scheme* to cease the *issue* or *redemption*, or both the *issue* and *redemption*, of *units* under the *scheme*;
 - (b) require the *manager* and *trustee* of the *scheme* to wind it up'.

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Subsection 257(6) states that 'The *FSA* may, either on its own initiative or on the application of the *manager* or *trustee* of the *scheme* concerned, revoke or vary a direction given under this section if it appears to the *FSA*: (a) in the case of revocation, that it is no longer necessary for the direction to take effect or continue in force; (b) in the case of variation, that the direction should take effect or continue in force in a different form'.

Section 258: the power

16.2.8

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- (1) Section 258(1) (Applications to the court) states that 'If the *FSA* could give a direction under section 257, it may also apply to the court for an order:
 - (a) removing the *manager* or the *trustee*, or both the *manager* and the *trustee*, of the *scheme*; and

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(b) replacing the *person* or *persons* removed with a suitable *person* or *persons* nominated by the *FSA*.

(2) The types of direction the *FSA* may give under section 257 are explained in section 257(2) (see *ENF* 16.2.6G (2)).

Section 258(2) states that the *FSA* may nominate a *person* for the purposes of section 258(1)(b) only if it is satisfied that, if the order was made, the requirements of sections 243 (4) to (7) would be complied with (these requirements include, for example, that the *manager* and *trustee* are *bodies corporate* which are independent of each other). If it appears to the *FSA* that there is no *person* it can nominate for these purposes, it may apply to the court under section 258(3) for an order:

- (1) removing the *manager* or the *trustee*, or both the *manager* and the *trustee*, of the *scheme*; and
- (2) appointing an *authorised person* to wind up the *scheme*'.

Sections 254, 257, and 258: the *FSA*'s policy

16.2.10

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The *FSA* will consider all the relevant circumstances of each case when it decides whether it is appropriate to use one or more of its powers under these sections of the *Act*. The *FSA* may take a number of factors into account when it decides whether to use the powers. The following list is not exhaustive; not all these factors may be relevant in a particular case and there may be other factors that are relevant.

- (1) The seriousness of the breach or likely breach by a *manager* or *trustee* of a requirement imposed by or under the *Act*. The following may be relevant:
 - (a) the extent to which the breach was deliberate or reckless;
 - (b) the extent of loss, or risk of loss, caused to existing, past or potential *participants* in the *AUT* as a result of the breach;
 - (c) whether the breach highlights serious or systemic weaknesses in the management or control of either the *AUT* or the property subject to the *scheme*;
 - (d) whether there are grounds for believing a breach is likely to be continued or repeated;
 - (e) the length of time over which the breach happened; and
 - (f) whether existing and/or past *participants* in the *AUT* have been misled in a material way, for example about the investment objectives or policy of the *scheme* or the level of investment risk.
- (2) The consequences of a failure to satisfy a requirement for the making of an order authorising an *AUT*. The *FSA* will expect the non-compliance to be resolved as soon as possible. Important factors are likely to be whether existing and/or past *participants* have suffered loss due to the non-compliance and whether remedial steps will be taken to satisfy all the requirements of the order.

- (3) Whether it is necessary to suspend the *issue* and *redemption* of *units* to protect the interests of existing or potential *participants* in the *AUT*. For example, this may be necessary if:
 - (a) information suggests the current price of *units* under the *AUT* may not accurately reflect the value of the property subject to the *scheme*; or
 - (b) the property subject to the *scheme* cannot be valued accurately.
- (4) The effect on the interests of *participants* within the *scheme* of the use of either or both of its powers under sections 254 and 257. However, the *FSA* will also consider the interests of past and potential *participants*.
- (5) Whether the *FSA*'s concerns can be resolved by taking enforcement action against the *manager* and/or *trustee* of the *AUT*. In some instances, the *FSA* may consider it appropriate to deal with a breach by a *manager* or *trustee* by taking direct enforcement action against the *manager* and/or *trustee* without using its powers under sections 254, 257, or 258. In other instances, the *FSA* may combine direct enforcement action against a *trustee* and/or *manager* with the use of one or more of the powers under sections 254, 257 and 258.
- (6) Whether there is information to suggest that a *trustee* or *manager* has knowingly or recklessly given the *FSA* false information. Giving false information is likely to cause very serious concerns, particularly if it shows there is a risk of loss to the property subject to the *scheme* or that *participants*' interests have been or may be affected in some other way.
- (7) The conduct of the *manager* or *trustee* in relation to, and following the identification of, the issue, for example:
 - (a) whether the *manager* or *trustee* discovered the issue or problem affecting the *AUT* and brought it to the *FSA*'s attention promptly;
 - (b) the degree to which the *manager* or *trustee* is willing to cooperate with the *FSA*'s investigation and to take protective steps, for example by suspending the *issue* and *redemption* of *units* in the *AUT*;
 - (c) whether the *manager* or *trustee* has compensated past and existing *participants* who have suffered loss.
- (8) The compliance history of the *trustee* or *manager*, including whether the *FSA* has previously taken disciplinary action against the *trustee* or *manager* in relation to the *AUT* or any other *collective investment scheme*.
- (9) Whether there is information to suggest that the *AUT* is being used for criminal purposes and/or that the *manager* or *trustee* is itself involved in *financial crime*.

Choice of powers

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The *FSA* may use its powers under sections 254, 257 and 258 individually, together, and as well as direct enforcement action against a *trustee* or *manager* in their capacity as *firms*.

16.2.12 G_{/1} Where the *FSA* has a concern about an *AUT* that must be dealt with urgently, it will generally use its power to give directions under section 257 in the first instance (see *ENF* 16.2.5G to *ENF* 16.2.7G).




16.2.13 G_{/1} The following are examples of situations where the *FSA* may consider it appropriate to seek a court order under section 258 (see *ENF* 16.2.8G) to remove the *manager* or *trustee*:

- (1) where there are grounds for concern over the *behaviour* of the *manager* or *trustee* in respect of the management of the *scheme* or of its assets;
- (2) where a *manager* or *trustee* has breached a requirement imposed on him under the *Act* or has knowingly or recklessly given the *FSA* false information.


The *FSA* appreciates the effect this action may have on the reputation of a *manager* or *trustee* and will use the power only where this is proportionate in all the circumstances of the case.

16.2.14 G_{/1} The *FSA* recognises that *participants* in an *AUT* have a direct financial interest in the property subject to the *scheme*. It follows that in cases where it considers it appropriate to use its section 254 power to revoke an *authorisation order*, the *FSA* will generally first require the *manager* or *trustee* to wind up the *AUT* (or seek a court order for the appointment of a *firm* to wind up the *AUT*).

16.3 ICVCs

- 16.3.1**  Regulations for setting up, running and regulating *ICVCs* are contained in The Open-ended Investment Companies Regulations 2001 (SI 2001/1228). The regulations include the following enforcement powers:
- (1) a power for the *FSA* to revoke authorisation of an *ICVC* (regulation 23);
 - (2) a power for the *FSA* to give directions (regulation 25); and
 - (3) a power for the *FSA* to apply to court for the removal of any *director* of an *ICVC* or its *depository* (regulation 26).
- 16.3.2**  The grounds upon which the *FSA* may use its powers under regulations 23, 25 and 26 respectively are broadly similar to those upon which it may use its equivalent enforcement powers in relation to *AUTs* (see *ENF* 16.2.1G to *ENF* 16.2.9G).
- 16.3.3**  The *FSA*'s normal disciplinary powers applicable to *firms*, including the powers to publish a public censure (see *ENF* 12) and to impose financial penalties (see *ENF* 13), are also available in relation to *ICVCs*.

Regulations 23, 25 and 26: the *FSA*'s policy

- 16.3.4**  The factors the *FSA* may take into account when it decides whether to use one or more of these powers include, but are not limited to, factors which are broadly similar to those in *ENF* 16.2.10G in the context of *AUTs*. However, the relevant conduct will, of course, be that of the *ICVC*, the *director* or *directors* of the *ICVC* and its *depository* (another difference is that the *FSA* is also able to take disciplinary action against the *ICVC* itself – see *ENF* 16.3.3G). When choosing which powers to use, the *FSA* will adopt an approach which is broadly similar to that described in *ENF* 16.2.11G to *ENF* 16.2.14G.

16.4 Recognised schemes

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Sections 264 to 283 of the *Act* relate to *recognised schemes*. These provisions contain the following enforcement powers:

- (1) the *FSA*'s power under section 267 to suspend promotion of a *scheme* constituted in another *EEA State* and recognised under section 264 (Schemes constituted in other *EEA States*);
- (2) the *FSA*'s power under section 279 to revoke recognition of:
 - (a) a *scheme* recognised under section 270 (Schemes authorised in designated countries or territories); and
 - (b) a *scheme* individually recognised under section 272 (Individually recognised overseas schemes);
- (3) the *FSA*'s power under section 281 to give directions in respect of the *schemes* identified in *ENF* 16.4.1G (2).

Section 267: the power

16.4.2

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The *FSA* has power under section 267 of the *Act* (Power of Authority to suspend promotion of scheme) to suspend promotion of a *scheme* that is constituted in another *EEA State* and recognised under section 264. The power applies if it appears to the *FSA* that the *operator* of that *scheme* has *communicated* an invitation or inducement in relation to the *scheme* in a manner contrary to the *financial promotion rules*. Under section 267(3), the suspension may last for a set period, until a certain event has happened or until certain conditions have been met. Under sections 267(4) and (5) the *FSA* may, either on its own initiative or on the application of the *operator* of the *scheme* concerned, vary or revoke a direction suspending the *scheme*.

Section 267: the *FSA*'s policy

16.4.3

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When it decides whether a suspension order under section 267 is appropriate, the *FSA* will consider all the relevant circumstances. General factors that the *FSA* may consider include, but are not limited to:

- (1) the seriousness of the breach of *financial promotion rules* by the *operator* (the matters listed at *ENF* 16.2.10G(1)(a) to (f) may be relevant in this context); and

- (2) the conduct of the *operator* after the breach was discovered including whether the *operator* has compensated past and existing *participants* who have suffered loss.

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In addition to or instead of suspending the promotion of a *scheme* recognised under section 264, the *FSA* may ask the *competent authorities* of the *EEA State* in which the *scheme* is constituted who are responsible for the authorisation of *collective investment schemes*, to take such action in respect of the *scheme* and/or its *operator* as will resolve the *FSA*'s concerns. Also, Schedule 5 to the *Act* (Persons Concerned in Collective investment Schemes) states that a *person* who for the time being is an *operator*, *trustee* or *depository* of a *scheme* recognised under section 264 of the *Act* is an *authorised person*. So, it will also be open to the *FSA* to take direct enforcement action against those *persons*.

Section 279: the power

16.4.5

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- (1) Section 279 of the *Act* (Revocation of recognition) relates to *schemes* recognised under sections 270 and 272. Section 270 sets out the requirements for the recognition of a *collective investment scheme* which is not recognised under section 264 but which is managed and authorised in a country or territory designated for the purposes of section 270. Section 272 sets out the requirements for the recognition of a *collective investment scheme* which is managed in a country or territory outside the *United Kingdom* and does not meet the requirements for recognition under section 264 or 270.
- (2) Section 279 states that 'The *FSA* may direct that a *scheme* is to cease to be recognised by virtue of section 270 or revoke an order under section 272 if it appears to the *FSA*:-
- (a) that the *operator*, *trustee* or *depository* of the *scheme* has contravened a requirement imposed on him by or under this *Act*;
 - (b) that the *operator*, *trustee* or *depository* of the *scheme* has, in purported compliance with any such requirement, knowingly or recklessly given the *FSA* information which is false or misleading in a material particular;
 - (c) in the case of an order under section 272, that one or more of the requirements for the making of the order are no longer satisfied; or
 - (d) that none of paragraphs (a) to (c) applies, but it is undesirable in the interests of the *participants* or potential *participants* that the *scheme* should continue to be recognised'.

Section 281: the power

16.4.6

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Under section 281 of the *Act* (Directions), the *FSA* can suspend the recognition of a *scheme* recognised under section 270 or section 272 for a set period, until a certain event happens or until certain conditions are met. The grounds upon which the *FSA* may give a direction under section 281 are broadly similar to those for the use of its power under section 279 (see *ENF* 16.4.5G). The section 281 power may, however, also be used if it appears to the *FSA* that the *operator*, *trustee* or *depository* of a *scheme* recognised under section 270 or 272 is likely to breach a requirement imposed on him under the *Act*.

Sections 279 and 281: the FSA's policy

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The *FSA* will consider all the relevant circumstances of each case when it decides whether it is appropriate to use its powers under sections 279 and 281. The general factors which the *FSA* may consider include, but are not limited to, those set out in *ENF* 16.2.10G (1) to (9) (the conduct of the *operator* of the *scheme* and of the *trustee* or *depository* will also, of course, be taken into account in relation to each of these factors).

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As well as or instead of using these powers, the *FSA* may ask the relevant *regulatory body* of the country or territory in which the *scheme* is authorised to take such action in respect of the *scheme* and/or its *operator*, *trustee* or *depository* as will resolve the *FSA*'s concerns.

16.5 Procedures and other relevant powers and provisions

Procedures

- 16.5.1** **G**_{/1} *ENF* 16 Ann 1G lists the procedures the *FSA* must follow when using the powers discussed in this chapter.
- 16.5.2** **G**_{/1} More information on the procedures the *FSA* will follow when issuing *statutory notices* and when deciding to use its powers to apply to court is contained in *DEC*

Relevant powers and provisions other than those discussed in this chapter

- 16.5.3** **G**_{/1} Section 238 of the *Act* (Restrictions on promotion) prohibits a *firm* from communicating an invitation or inducement to participate in a *collective investment scheme* unless an exemption applies (the exemptions include the *collective investment schemes* listed in *ENF* 16.1.1G(1) to (3)). In addition, section 240 (Restriction on approval of promotion) prohibits a *firm* from approving the content of a *communication* relating to a *collective investment scheme* if the *firm* itself would be prohibited from making the *communication* by section 238. The *FSA* has a range of powers for taking remedial, protective and disciplinary action against a *firm* over breaches of these prohibitions. These include the powers discussed in *ENF* 3 (Variation of Part IV permission on the *FSA*'s own-initiative), 5 (Cancellation of Part IV permission on the *FSA*'s own initiative), 6 (Injunctions), 9 (Restitution and redress), 10 (Insolvency proceedings and orders against debt avoidance), 11(Discipline of authorised firms and approved persons: The *FSA*'s general approach), 12 (Discipline of authorised firms and approved persons: Public censures and public statements) and 13 (Discipline of authorised firms and approved persons: Financial penalties).
- 16.5.4** **G**_{/1} *Unauthorised persons* are generally prohibited by sections 19 (The general prohibition) and 21 (Restrictions on financial promotion) of the *Act* from being involved in either the management or promotion of *collective investment schemes*. The *FSA*'s civil and regulatory powers for dealing with breaches of these prohibitions include those discussed in *ENF* 6, 9 and 10. An *unauthorised person* who breaches the prohibitions in sections 19 or 21 will also be guilty of a criminal offence under the *Act*. The *FSA*'s power to prosecute criminal offences is discussed in *ENF* 15 (Prosecution of criminal offences).
- 16.5.5** **G**_{/1} The *FSA*'s investigation powers in connection with *AUTs*, *ICVCs*, *recognised schemes* and other *collective investment schemes* are discussed in *ENF* 2 (Information gathering and investigation powers).

ENF 16 ANN 1G: Table of procedures for use of CIS powers (See ENF 16.5.1G)

1 Table

Power	Circumstance	Procedure
Section 254	If the <i>FSA</i> is proposing to revoke a section 243 <i>authorisation order</i> under section 254(1) (see ENF 16.2.3G and ENF 16.2.4G)	Section 255 – <i>Warning notice / decision notice</i> (see DEC 2 and DEC 4)
Section 257	If the <i>FSA</i> is proposing to give or vary on its own initiative a direction under section 257 (see ENF 16.2.5G to ENF 16.2.7G)	Section 259 – <i>Supervisory notices</i> (see DEC 3 and DEC 4)
Section 257	If the <i>FSA</i> is proposing to refuse an application by a <i>manager</i> or <i>trustee</i> of a scheme under section 257(6) for a direction to be revoked or varied or to vary the direction otherwise than in accordance with the application (see ENF 16.2.7G)	Section 260 – <i>Warning notice / decision notice</i> (see DEC 2 and DEC 4)
Section 257	If the <i>FSA</i> decides on its own initiative to revoke a direction, or to revoke or vary a direction in accordance with a request by a <i>manager</i> or <i>trustee</i> under section 257(6) (see ENF 16.2.7G)	Section 261 – <i>Written notice</i>
Section 258	If the <i>FSA</i> is applying to the court for orders under section 258 (see ENF 16.2.8G)	Section 258(6) <i>Application and written notice</i> (see DEC 4.6)
Section 267	If the <i>FSA</i> is proposing to suspend promotion of a section 264 <i>scheme</i> under section 267 or to vary a direction suspending a <i>scheme</i> on its own initiative (see ENF 16.4.2G)	Section 268 – <i>Supervisory notices</i> (see DEC 3 and DEC 4)

Power	Circumstance	Procedure
Section 267	If the <i>FSA</i> is proposing to refuse an application by an <i>operator</i> under section 267(4) or (5) for a direction suspending a <i>scheme</i> to be varied or revoked or to vary the direction otherwise than in accordance with the application (see <i>ENF</i> 16.4.2G)	Section 269(1)– (2) and (6) – Warning notice / decision notice (see DEC 2 and DEC 4)
Section 267	If the <i>FSA</i> decides on its own initiative to revoke a direction, or to revoke or vary a direction in accordance with a request by an <i>operator</i> (see <i>ENF</i> 16.4.2G)	Section 269(4) – (6) – Written notice
Section 279	If the <i>FSA</i> is proposing to direct that a section 270 <i>scheme</i> is no longer to be recognised or to revoke a section 272 order (see <i>ENF</i> 16.4.5G)	Section 280 <i>Warning notice / decision notice</i> (see DEC 2 and DEC 4)
Section 281	If the <i>FSA</i> is proposing to give or vary a direction under section 281 on its own initiative (see <i>ENF</i> 16.4.6G)	Section 282 – <i>Supervisory notices</i> (see DEC 3 and DEC 4)
Regulation 23 <i>OEIC</i> Regulations	If the <i>FSA</i> is proposing to revoke an <i>authorisation order</i> relating to an <i>ICVC</i> under regulation 23(1) (see <i>ENF</i> 16.3)	Regulation 24 – <i>Warning notice / decision notice</i> (see DEC 2 and DEC 4)
Regulation 25 <i>OEIC</i> Regulations	If the <i>FSA</i> is proposing to give or vary a direction under regulation 25 on its own initiative (see <i>ENF</i> 16.3)	Regulation 27– <i>Supervisory notices</i> (see DEC 3 and DEC 4)
Regulation 25 <i>OEIC</i> Regulations	If the <i>FSA</i> is proposing to refuse an application to revoke or vary a direction in accordance with a request under regulation 25(7) or to vary the direction otherwise than in accordance with the application.	Regulation 28 – <i>Warning notice / decision notice</i> (see DEC 2 and DEC 4)
Regulation 25 <i>OEIC</i> Regulations	If the <i>FSA</i> decides on its own initiative to revoke a direction, or to revoke or vary a direction in accordance with a request under regulation 25(7)	Regulation 29 – Written notice
Regulation 26 <i>OEIC</i> Regulations	If the <i>FSA</i> is applying to the court for an order under regulation 26 (see <i>ENF</i> 16.3)	Regulation 26(7) – Application and written notice (see DEC 4.6)

Chapter 17.

17.

Disqualification of auditors and actuaries



17.1 Application and purpose

Application

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This chapter applies to auditors and *actuaries* appointed by *firms* (including ICVCs) and auditors appointed by *AUTs* under section 340(1) of the *Act* (*Appointment*).

Purpose

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Auditors and *actuaries* fulfil a vital role in the management and conduct of *firms*. Regulations made by the Treasury under sections 342(5) and 343(5) [the Financial Services (Communication by Auditors) Regulations 2001 are currently the subject of consultation, draft regulations in relation to actuaries will be published in due course] and *rules* made under the *Act* impose various duties on auditors and *actuaries*. These duties and the *FSA's* power to disqualify auditors and *actuaries* if they breach them will assist the *FSA* in pursuing its *regulatory objectives* of maintaining confidence in the *financial system*, protecting *consumers* and preventing *financial crime*. The *FSA's* power to disqualify auditors in breach of duties imposed by *trust scheme rules* will also assist the *FSA* to achieve these *regulatory objectives* by ensuring that auditors fulfil the duties imposed upon them by these *rules*.



17.2 Introduction

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This chapter outlines:

- (1) the *FSA*'s power to disqualify auditors and *actuaries* under section 345 of the *Act* (Disqualification);
- (2) the *FSA*'s power to disqualify auditors under section 249 of the *Act* (Disqualification of auditor for breach of trust scheme rules);
- (3) the *FSA*'s approach to the exercise of its powers under section 345 and 249;
- (4) the *FSA*'s procedure for exercising the powers; and
- (5) the effect of the *FSA*'s decision to exercise the powers.



17.3 The FSA's power to disqualify auditors and actuaries

17.3.1 G_{/1} Under section 345 of the *Act* (Disqualification), if it appears to the FSA that an auditor or *actuary* has failed to comply with a duty imposed on him under the *Act*, it may disqualify him from acting as an auditor or *actuary* for any *firm* or any class of *firm*.

17.3.2 G_{/1} The duties imposed on the auditors and *actuaries* of *firms* under the *Act* are:

- (1) the duties imposed by *rules* made under section 340(3) of the *Act* (Appointment) contained in SUP 3 (Auditors) and SUP 4 (Actuaries) and, in the case of *firms* which are ICVCs, contained in CIS 10 (Report and accounts) and 14 (Termination of authorised funds);
- (2) the duties under sections 342(6) (Information given by auditor or actuary to the FSA) and 343(6) (Information given by auditor or actuary to the FSA: persons with close links) of the *Act* to communicate to the FSA any matter prescribed in regulations made by the Treasury;
- (3) a duty to notify the FSA (under section 344(2) of the *Act* (Duty of auditor or actuary resigning etc to give notice)), if:
 - (a) they are removed from office by a *firm*;
 - (b) they resign before the expiry of their term of office with a *firm*; or
 - (c) they are not re-appointed by a *firm*;
- (4) a duty under section 344(3), on ceasing to be an auditor or an *actuary* of a *firm*, to notify the FSA without delay:
 - (a) of any matter connected with their ceasing to be an auditor or *actuary* for that *firm* which they think ought to be drawn to the FSA's attention; or
 - (b) that there is no such matter; and
- (5) the duties imposed on auditors of ICVCs in the *OEIC Regulations 2000*.

17.3.3 G_{/1} Under section 249 of the *Act* (Disqualification of auditor for breach of trust scheme rules) if it appears to the FSA that an auditor has failed to comply with the duties imposed on him by *trust scheme rules* it may disqualify him from being the auditor for any AUT or ICVC. These duties are set out in CIS 10 (Report and accounts) and 14 (Termination of authorised funds).

17.3.4 G_{/1} The FSA's powers to disqualify auditors and *actuaries* under section 345 and auditors under section 249 of the *Act* are separate powers. However, the

procedures for exercising the powers in each case are the same and are set out in section 345:

- (1) if the *FSA* proposes to disqualify an auditor or *actuary*, it must give him a *warning notice* (section 345(2); see *DEC 2.2* (Warning notice procedure));
- (2) if the *FSA* decides to disqualify an auditor or *actuary*, it must give him a *decision notice* (section 345(3); see *DEC 2.3* (Decision notice procedure));
- (3) an auditor or *actuary* who has been disqualified by the *FSA* may refer the matter to the *Tribunal* (section 345(5); see *DEC 5.1* (The Tribunal)); and
- (4) the *FSA* may remove any disqualification if it is satisfied that the disqualified auditor or *actuary* will, in future, comply with the duty in question.



17.4 The FSA's policy on disqualification of auditors and actuaries

- 17.4.1** G_{/1} The FSA recognises that the use of its powers to disqualify auditors and *actuaries* will have serious consequences for the auditors or *actuaries* concerned and their *clients*; it will therefore exercise its power to impose a disqualification in a way that is proportionate to the particular breach of duty concerned. The FSA will consider the seriousness of the breach of duty when deciding whether to exercise its power to disqualify and the scope of any disqualification.
- 17.4.2** G_{/1} *Appointed actuaries* of firms are *approved persons* and as such will be subject to the *Statements of Principle* and *Code of Practice for Approved Persons*. When deciding whether to exercise its power to disqualify an appointed *actuary*, the FSA will consider whether the particular breach of duty can be adequately addressed by the exercise of its disciplinary powers in relation to *approved persons*. These powers and the factors that the FSA will take into account when deciding whether to exercise them are set out in ENF 11 (Discipline of authorised firms and approved persons: the FSA's general approach), 12 (Discipline of firms and approved persons: public censures and public statements) and 13 (Discipline of firms and approved persons: financial penalties).
- 17.4.3** G_{/1}
- (1) Under section 345(1) of the *Act* (Disqualification), the FSA may disqualify an auditor appointed by, or an *actuary* acting for, a *firm* (including an ICVC) from acting for a specific *firm* or a particular class of *firm*. Under section 249(1) of the *Act* (Disqualification of auditor for breach of trust scheme rules), the FSA may disqualify an auditor appointed by an *AUT* from acting for any *AUT* or ICVC.
 - (2) A disqualification order will be made against the *person* appointed as auditor or *actuary* of the *firm*. In the case of *actuaries*, the disqualification order will be made against the individual appointed by the *firm*. In the case of auditors, the disqualification order will depend on the terms of the appointment. Where the *firm* has appointed a named individual as auditor the disqualification will be made against that individual and this will be the case where the individual concerned is a member of a firm of auditors. Where the *firm* has appointed a firm as auditor the disqualification order will be against that firm. Where the *person* appointed is a *limited liability partnership* the disqualification order will be against the *limited liability partnership* rather than its members.
- 17.4.4** G_{/1} When it decides whether to exercise its power to disqualify an auditor or *actuary* under section 345(1), and what the scope of any disqualification will be, the FSA will take into account all the circumstances of the case. These may include, but are not limited to, the following factors:
- (1) the nature and seriousness of any breach of *rules* and the effect of that breach: the *rules* are set out in SUP 3 (Auditors) and 4 (Actuaries), and in the case of *firms* which are ICVCs, in CIS 10 (report and accounts) and 14 (Termination of authorised funds). The FSA will regard as particularly serious any breach of

rules which has resulted in, or is likely to result in, loss to *consumers* or has resulted in, or is likely to result in, damage to confidence in the financial markets;

- (2) the nature and seriousness of any breach of the regulations made by the Treasury under section 342(5) (Information given by auditor or actuary to the FSA) and 343(5) (Information given by auditor or actuary to the FSA: persons with close links) of the *Act*. [The *FSA* will issue further *guidance* when these regulations are finalised.] When considering the nature and seriousness of any breach of the duty to disclose information to the *FSA* the following factors may be considered:
 - (a) whether the information related to the fitness and propriety of *approved persons*;
 - (b) whether the information related to a *firm's* financial soundness;
 - (c) whether the information or other circumstances indicated that the *firm* was in breach, or is likely to breach, any requirement imposed on it by or under the *Act*;
 - (d) whether, in the case of an auditor, information or circumstances have precluded him from stating that the annual accounts of the *firm* have been properly prepared in accordance with section 235 of the Companies Act 1985;
 - (e) whether the information or circumstances show that, in complying with any duties imposed by or under the *Act*, the *firm* or the auditor or *actuary* concerned has disclosed to the *FSA* or published false, inaccurate or misleading information;
- (3) the nature and effect of any failure to disclose in accordance with the Treasury's regulations: the *FSA* will regard as particularly serious any failure to disclose to it information which has resulted in, or is likely to result in, loss to *consumers* and/or which has resulted in, or is likely to result in, damage to the integrity of the market;
- (4) action taken by the auditor or *actuary* to remedy the non-disclosure or breach: this may include whether the auditor or *actuary* brought the breach or non-disclosure to the attention of the *FSA* promptly, the degree of cooperation with the *FSA* in relation to any subsequent investigation, and whether remedial steps have been taken to rectify the breach or non-disclosure and whether reasonable steps have been taken to prevent a similar breach or non-disclosure from occurring;
- (5) action taken by *designated professional bodies*: the *FSA* will consider whether any disciplinary action has been or will be taken against the auditor or *actuary* by a relevant *designated professional body* and whether that action adequately addresses the particular breach of duty;
- (6) the previous compliance record of the auditor or *actuary* concerned: whether the *FSA* (or a *previous regulator*) or *designated professional body* has imposed any previous disciplinary sanctions on the *firm* or individual concerned.

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When deciding whether or not to disqualify an auditor under section 249(1) of the *Act* (Disqualification of auditor for breach of trust scheme rules), and in setting the disqualification, the *FSA* will take into account all the circumstances of the case. These may include, but are not limited to, the following circumstances:

17.4.5

- (1) the effect of the auditor's breach of a duty imposed by *trust scheme rules*: the FSA will regard as particularly serious a breach of a duty imposed by *trust scheme rules* (set out in CIS 10 (Report and accounts) and 14 (Termination of authorised funds)) which has resulted in, or is likely to result in, loss to *consumers* or has resulted in, or is likely to result in, damage to the integrity of the financial markets;
- (2) action taken by the auditor to remedy its breach of a duty imposed by *trust scheme rules*: this may include any steps taken by the auditor to bring the breach to the attention of the FSA promptly, the degree of co-operation with the FSA in relation to any subsequent investigation, and whether any steps have been taken to rectify the breach or prevent a similar breach;
- (3) action taken by a relevant *designated professional body*: The FSA will consider whether any disciplinary action has or will be taken against the auditor by a relevant *designated professional body* and whether such action adequately addresses the particular breach of a duty imposed by *trust scheme rules*;
- (4) the previous compliance record of the auditor concerned: whether the FSA (or a *previous regulator*) or *designated professional body* has imposed any previous disciplinary sanctions on the *firm* or individual concerned.



17.5 Removal of a disqualification

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An auditor or *actuary* may ask the *FSA* to remove the disqualification at any time after it has been imposed.

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The *FSA* will remove a disqualification if it is satisfied that the disqualified *person* will in future comply with the duty in question (and other duties under the *Act*). When it considers whether to grant or refuse a request that a disqualification be removed on these grounds, the *FSA* will take into account all the circumstances of a particular case. These circumstances may include, but are not limited to:

- (1) the seriousness of the breach of duty or non-disclosure that resulted in the disqualification;
- (2) the amount of time since the original disqualification; and
- (3) any steps taken by the auditor or *actuary* after the disqualification to remedy the factors which led to the disqualification and any steps taken to prevent a similar breach of duty or non-disclosure from happening again.



17.6 The effect of a disqualification

- 17.6.1**  A disqualification will come into effect on the date stated in the *decision notice*, unless the decision is referred to the *Tribunal*.
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- 17.6.2**  A *firm* must not appoint as an auditor a *person* who is the subject of an order disqualifying him from acting for that *firm* or that class of *firm* (see SUP 3.4.5G (Disqualified auditors)). Similarly, an *AUT* or *ICVC* must not appoint as auditor a *person* who is the subject of an order disqualifying him from acting for that *AUT* or *ICVC* or any *AUT* or *ICVC*.
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17.7 Publication of disqualification

- 17.7.1** **G**_{/1} DEC 5.2 (Publication) set out certain requirements of the *Act* in relation to the FSA’s publication by of its decisions.
- 17.7.2** **G**_{/1} Under section 347 (1)(i) of the *Act* (*The record of authorised persons etc*), the FSA must keep a record of every *person* falling within such class as the FSA may determine. To help it fulfil its *regulatory objectives* of protecting *consumers* and promoting public awareness, the FSA will keep on the *FSA Register* a record of *firms* and individuals who have been the subject of disqualification orders.
- 17.7.3** **G**_{/1} Once the decision to make a disqualification order has been set out in a *final notice*, the FSA will consider what additional information about the circumstances of the order to include on the *FSA Register* and will take into account any possible prejudice to the auditor or *actuary* concerned. In general, the FSA considers that publication of relevant information about orders to disqualify auditors or *actuaries* will be in the interests of *firms* and *consumers*.
- 17.7.4** **G**_{/1} Under section 347(3) of the *Act*, if it appears to the FSA that an entry on the public record ceases to apply to a *person*, it may remove the relevant entry from the record. Section 347(4) states that, if the FSA decides not to remove the entry in the record, it must make a note to that effect on the *FSA Register* and state why it believes the entry on the record no longer applies to the *person*.
- 17.7.5** **G**_{/1} While a disqualification order is effective, the FSA will keep a record of the order on the *FSA Register*. The FSA’s policy in relation to section 347(4) of the *Act* is that where an application to revoke a disqualification order is granted, a note will be made on the *FSA Register* giving reasons for the revocation. The availability of a record of action taken by the FSA in relation to action taken against auditors and *actuaries* will assist the FSA in furthering its *regulatory objectives*, in particular, the maintenance of confidence in the financial system. For this reason, the FSA will keep the annotated record of the revoked disapplication order for a period of six years from the date of the revocation. The record will then be removed from the *FSA Register*.

Chapter 18.

Disapplication orders against members of the professions

18.



18.1 Application and purpose

Application

- 18.1.1** G_{/1}
- (1) This chapter applies to any *person* who is, in relation to a profession, entitled to practise that profession and, in practising it, is subject to the rules of the relevant *designated professional body*, whether or not it is a member of that body ("*members*").
 - (2) A *member* is exempt from the *general prohibition*, under section 327 of the *Act* (Exemption from the general prohibition), so long as the conditions set out in sections 327(2) to (7) are satisfied and so long as there is not in force:
 - (a) a direction under section 328 of the *Act* (Directions in relation to the general prohibition) disapplying the prohibition in whole or in part; or
 - (b) an order under section 329 of the *Act* (Orders in relation to the general prohibition).







Purpose

- 18.1.2** G_{/1}
- This chapter describes the *FSA*'s general approach to the use of its power under section 329 of the *Act* (Orders in relation to the general prohibition) to make an order disapplying an exemption from the *general prohibition* in relation to a *person* who is *member*.
- 18.1.3** G_{/1}
- The chapter outlines:
- (1) the *FSA*'s power to make an order disapplying an exemption ('a disapplication order'), under section 329;
 - (2) the *FSA*'s general approach to the exercise of that power;
 - (3) the *FSA*'s procedure for exercising its power to make a disapplication order;
 - (4) the effect of the *FSA*'s decision to make a disapplication order; and
 - (5) the *FSA*'s approach to an application by a *member* of a profession to have a disapplication order varied or revoked.
- 18.1.4** G_{/1}
- The *FSA*'s powers to make a disapplication order on the grounds that a *member* is not a fit and proper *person* to conduct *exempt regulated activities*, and to maintain a public record of disapplication orders, will assist the *FSA* in pursuing its

regulatory objectives of protecting *consumers*, promoting public awareness and reducing *financial crime*.



18.2 The FSA's power to make a disapplication order

- 18.2.1**  Under section 329(1) of the *Act* (Orders in relation to the general prohibition) if it appears to the *FSA* that a *person* to whom (as a result of section 327(1) of the *Act* (Exemption from the general prohibition)) an exemption from the *general prohibition* applies, is not a fit and proper *person* to carry on *exempt regulated activities*, it may make an order under section 329(2) disapplying the exemption to the extent set out in the order.
- 18.2.2**  Sections 329(5) and 329(6) are concerned with the effect of disapplication orders on *partnerships* (including *limited liability partnerships*). Section 329(5) provides that if a *partnership* (or *limited liability partnership*) is named in a disapplication order, the order is not affected by any change in its membership.
- 18.2.3**  Under section 329(6) a *partnership* (or *limited liability partnership*) named in a disapplication order is dissolved, the order continues to have effect in relation to any *partnership* (or *limited liability partnership*) that succeeds to the business of the dissolved *partnership* (or *limited liability partnership*). Section 329(7) provides that a *partnership* will succeed to the business if:
- (1) the members of the resulting *partnership* are substantially the same as those of the former *partnership*; and
 - (2) succession is to the whole or substantially the whole of the business of the former *partnership*.
- 18.2.4**  Section 331(1) (Procedure on making or varying orders under section 329) provides that if the *FSA* proposes to make a disapplication order, it must give the *person* concerned a *warning notice* setting out the terms of the proposed order. The *FSA*'s procedures in *DEC 2.2* (Warning notice procedure) will apply.
- 18.2.5**  Section 331(3) provides that if the *FSA* then decides to make a disapplication order it must give the *person* concerned a *decision notice*. The *FSA*'s procedures in *DEC 2.3* (Decision notice procedure) will apply.
- 18.2.6**  Under section 331(9), a *person* against whom the *FSA* has decided to make a disapplication order may refer the matter to the *Tribunal* (see *DEC 5.1* (The *Tribunal*)).



18.3 The FSA’s general approach to making disapplication orders

18.3.1 G_{/1} ENF 18.4 sets out how the FSA will determine whether a *member* is not a fit and proper to carry out *exempt regulated activities* in accordance with section 327 of the Act (Exemption from the general prohibition).

18.3.2 G_{/1} The FSA may make a range of disapplication orders depending on the particular circumstances of each case, including the range of *exempt regulated activities* undertaken and the particular *exempt regulated activities* to which the *person’s* lack of fitness and propriety in that context is relevant.

18.3.3 G_{/1} The FSA recognises that a decision to make a disapplication order may have serious consequences for a *member* in relation not only to the conduct by the *member* of *exempt regulated activities*, but also in relation to the other business carried on by the *member*. When it decides whether to exercise its power to make a disapplication order, the FSA will consider all relevant circumstances including whether other action, in particular the making of a *prohibition order* (see ENF 8 (Prohibition of individuals)), would be more appropriate. In general, the FSA is likely to exercise its powers to make an order disapplying an exemption where it considers that a *member* of a profession presents such a risk to the FSA’s *regulatory objectives* that it is necessary to prevent the member from carrying out the *exempt regulated activities*. The FSA will also have regard to any disciplinary action taken, or to be taken, against the *person* by the relevant *designated professional body*.



18.4 Disapplication orders

- 18.4.1** G_{/1} The *FSA* may be alerted to concerns in relation to the carrying out of *exempt regulated activities* by a *member*, by the relevant *designated professional body* or by complaints from others such as *employees* or *clients* of the *member*.
- 18.4.2** G_{/1} When the *FSA* has concerns about the fitness and propriety of a *member* to carry out *exempt regulated activities*, it will consider all the relevant circumstances of the case, including whether those concerns arise from the fitness and propriety of specific individuals engaged to perform the *exempt regulated activities* carried out by the *member* or whether its concerns arise from wider concerns about the *member* itself.
- 18.4.3** G_{/1} In most cases, where the *FSA* is concerned about the fitness and propriety of a specific individual, it may be more appropriate for the *FSA* to consider whether to make an order prohibiting the individual from performing functions in relation to *exempt regulated activities* rather than a disapplication order in relation to the *member* concerned. The criteria which the *FSA* will apply when determining whether to make a *prohibition order* against an individual who is not regulated by the *FSA* are set out in *ENF 8.8* (Prohibition orders against other individuals). In addition to the factors referred to in *ENF 8.8*, the *FSA* may also take into consideration any disciplinary action that has been, or will be taken against the individual concerned by the relevant *designated professional body*, where that disciplinary action reflects on the fitness and propriety of the individual concerned to perform *exempt regulated activities*.
- 18.4.4** G_{/1} The *FSA* will also take into account the potentially more serious consequences that a disapplication of an exemption will have for the *member* concerned compared with the consequences of a prohibition of a particular individual engaged in *exempt regulated activities*. However, the *FSA* may consider it appropriate in some cases to disapply an exemption where it decides that the *member* concerned is not fit and proper to carry out *exempt regulated activities* in accordance with section 327 of the *Act* (Exemption from the general prohibition).
- 18.4.5** G_{/1} As an alternative to making an order to disapply an exemption, the *FSA* may consider issuing a private warning. A private warning may be appropriate where the *FSA* has concerns in relation to a *member's* fitness and propriety but feels that its concerns in relation to the conduct of *exempt regulated activities* can be more appropriately addressed by a private warning than by a disapplication of the *member's* exemption.
- 18.4.6** G_{/1} When it decides whether to exercise its power to disapply an exemption from the *general prohibition* in relation to a *member*, the *FSA* will take into account all relevant circumstances which may include, but are not limited to, the following factors:
- (1) disciplinary or other action taken by the relevant *designated professional body*, where that action relates to the fitness and propriety of the *member* concerned:

where the *FSA* considers that its concerns in relation to the fitness and propriety of the *member* concerned may be, or have been adequately addressed by disciplinary or other action taken by the relevant *designated professional body* it may consider not making a disapplication order in addition to such action; however, where the *FSA* considers that its concerns, and in particular, any risks presented to the *member's clients* in respect of its *exempt regulated activities*, are not adequately addressed by that action, the *FSA* will consider making a disapplication order;

- (2) the significance of the risk which the *member* presents to its *clients*: if the *FSA* is satisfied that there is a significant risk to *clients* and *consumers* it may consider making a disapplication order;
- (3) the extent of the *member's* compliance with *rules* made by the *FSA* under section 332(1) of the *Act* (Rules in relation to whom the general prohibition does not apply) or by the relevant *designated professional body* under section 332(3) of the *Act*;

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Where the *FSA* is considering whether to exercise its power to make a disapplication order in relation to a *member*, it will liaise closely with the relevant *designated professional body*.

18.4.8

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Where the *FSA* is considering making a disapplication order against a *member* as a result of a breach of *rules* made by the *FSA* under section 323(1) of the *Act*, it will take into account any proposed application by the *member* concerned for *authorisation* under the *Act*. The *FSA* may refrain from making a disapplication order pending its consideration of the application for *authorisation*.



18.5 Applications for variation or revocation of disapplication orders

18.5.1 **G**_{/1} Under section 329(3) of the *Act* (Orders in relation to the general prohibition), the *FSA* may, on the application of the *person* against whom an order has been made, vary or revoke a disapplication order.

18.5.2 **G**_{/1} When considering whether to grant or refuse an application to vary or revoke a disapplication order, the *FSA* will take into account all the relevant circumstances. These may include, but are not limited to:

- (1) any steps taken by the *person* to rectify the circumstances which gave rise to the original order;
- (2) whether the *person* has ceased to present the risk to *clients* and *consumers* or to the *FSA's regulatory objectives* which gave rise to the original order;
- (3) the circumstances giving rise to the original order and any additional information which, had it been known by the *FSA*, would have been relevant to the decision to make the order;
- (4) the amount of time which has elapsed since the order was made.

18.5.3 **G**_{/1} The *FSA* will not generally grant an application to vary a disapplication order unless it is satisfied that the proposed variation will not result in the *person* presenting the same degree of risk to *clients* or *consumers* that originally gave rise to the order to disapply the exemption. Similarly, the *FSA* will not revoke a disapplication order unless and until it is satisfied that the *person* concerned is fit and proper to carry out *exempt regulated activities* generally or those specific *exempt regulated activities* in relation to which the exemption has been disapplied.

18.5.4 **G**_{/1} Section 331(6) of the *Act* (procedure on making or varying orders under section 329) provides that if the *FSA* proposes to refuse an application for the variation or revocation of a disapplication order, it must give the applicant a *warning notice*. Section 331(7) provides that if the *FSA* then decides to refuse the application, it must give the applicant a *decision notice*. The *FSA's* approach to the issue of *warning notices* and of *decision notices* is described in *DEC 2.2* (Warning notice procedure) and *DEC 2.3* (Decision making procedure). A *person* whose application for variation or revocation of a disapplication order has been refused, may refer the matter to the *Tribunal* (see *DEC 5.1* (The Tribunal)).



18.6 Other powers that may be relevant

- 18.6.1** G_{/1} This section sets out the other powers that may be relevant when the *FSA* is considering whether to make a disapplication order in relation to a *member*.
- 18.6.2** G_{/1} The *FSA*'s powers to appoint investigators are set out in *ENF 2*. In particular, under section 168(4)(d) of the *Act* (Appointment of persons to carry out investigations in particular cases) the *FSA* may appoint investigators if there appear to be circumstances suggesting that an individual is not a fit and proper *person* to be involved in the discharge of any function in relation to *exempt regulated activities*.
- 18.6.3** G_{/1} Where the *FSA* considers that it may be more appropriate to take action against particular individuals engaged in the carrying out of *exempt regulated activities* within the *member* of a profession concerned (see *ENF 18.4.3G*), it may consider using its power to make *prohibition orders* against the relevant individuals (see *ENF 8* (Prohibition of individuals)).

18.7 The effect of a disapplication order

18.7.1 **G** /1 When the *FSA* has made a disapplication order, the *member* against which it has been made may not perform the *exempt regulated activities* to which the order relates. If the *member* contravenes the order, there will be a breach of the *general prohibition* that may be prosecuted under section 23 of the *Act* (see *ENF* 15).

18.7.2 **G** /1 A disapplication order in relation to *exempt regulated activities* made against a *member* will be relevant should that *member* subsequently apply for *authorisation* under the *Act*. Whether or not such an application for *authorisation* is successful will depend on many factors, including the *FSA*'s grounds for making the disapplication order. For example, if the order for disapplication of the exemption was made on the grounds of a breach of *rules* made under 332(1) the *FSA* may accept an application for *authorisation* notwithstanding the disapplication order. If, however, the order was made on grounds of a breach of the rules of a *designated professional body* resulting in a significant risk to *clients* in relation to the provision of *exempt regulated activities*, it is unlikely that an application for approval made by the *member* would be accepted by the *FSA* before the revocation of the disapplication order.



18.8 Publication

- 18.8.1** G_{/1} DEC 5.2 (Publication) set out certain requirements of the *Act* in relation to the publication by the *FSA* of its decisions.
- 18.8.2** G_{/1} Under section 347(1)(i) of the *Act* (*Record of authorised persons*), the *FSA* is required to maintain a record of every *person* falling within such class as the *FSA* may determine. To help it fulfil its *regulatory objectives* of protecting *consumers* and promoting public awareness, the *FSA* will maintain a record of *persons* who have been the subject of disapplication orders on the *FSA's Register*.
- 18.8.3** G_{/1} The *FSA* will consider what additional information about the circumstances of the order to include on the record maintained on the *FSA Register* and will take into account any possible prejudice to the *person* concerned as compared to the interests of *consumer* protection. In general, the *FSA* considers that publication of relevant information about orders to disapply an exemption will be in the interests of *clients* and *consumers*.
- 18.8.4** G_{/1} Under section 347(3) of the *Act*, if it appears to the *FSA* that an entry in the *FSA Register* ceases to apply to a *person*, it may remove the relevant entry from the record. Section 347(4) provides that, if the *FSA* decides not to remove the entry in the record, it must make a note in the record to that effect and state why it believes the entry in the record no longer applies to the *person*.
- 18.8.5** G_{/1} While a disapplication order is effective, the *FSA* will maintain a record of the order on the *FSA Register*. If the *FSA* grants an application to vary the order, a note of the variation will be made against the relevant entry on the *FSA's Register*. The *FSA's* policy in relation to section 347(4) of the *Act* is that where an application to revoke an order is granted, a note will be made on the *FSA Register* to the effect that the order has been revoked giving reasons for its revocation. The availability of a full record of action taken by the *FSA* against *persons* granted an exemption under section 327 of the *Act* will help the *FSA* to fulfil its *regulatory objectives* of protecting *consumers* and maintaining confidence in the *financial system*. For this reason, the *FSA* will maintain the annotated record of the disapplication order for a period of six years from the date of the revocation of the order after which period the record will be removed from the record on the *FSA Register*.

Handbook Modules

Schedule1 Record keeping requirements

1 G
 Table

There are no record keeping requirements in *ENF*

Handbook Modules

Schedule2 Notification requirements

1 G
 Table

There are no notification or reporting requirements in *ENF*

Handbook Modules

Schedule3 Fees and other required payments

1 G
 Table

There are no requirements for fees or other payments in *ENF*

Handbook Modules

Schedule4 Powers exercised

1 G
 Table

The following powers in the *Act* have been exercised by the *FSA* to issue the statements of policy in *ENF*:

Section 69 (Statement of policy)

Section 124 (Statement of policy)

Section 169(9) (Investigations etc in support of overseas regulator)

Section 210 (Statement of policy)

The following powers in the *Act* have been exercised by the *FSA* to give the *guidance* in *ENF*

Section 157(1) (Guidance)

Handbook Modules

Schedule5 Rights of actions for damages

1 G
 Table

There are no *rules* in *ENF*.

Handbook Modules

Schedule6 Rules that can be waived

1 G
 Table

There are no *rules* in *ENF*.

Enforcement manual

Derivations

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There is no table of derivations for *ENF*.

Enforcement manual

Destinations

G

There is no table of destinations for *ENF*.

DECISION MAKING MANUAL INSTRUMENT 2001

- A. The Financial Services Authority issues the statement of procedure and gives the guidance in the Annex to this instrument (“DEC) in the exercise of the powers listed in Schedule 4 to DEC.
- B. This instrument shall come into force at the beginning of the first day on which section 40 of the Financial Services and Markets Act 2000 (Application for permission) comes into force for any purpose.
- C. This instrument may be cited as the Decision Making Manual Instrument 2001.
- D. The Annex to this instrument (including its Schedules) may be cited as the Decision making manual (or DEC).

By order of the Board
21 June 2001

ANNEX



Contents

Transitional provisions

Text of DEC:

- 1 Application, purpose and introduction
- 2 Statutory notice procedure: warning notice and decision notice procedure
- 3 Statutory notice procedure: supervisory notice procedure
- 4 The decision maker
- 5 References to the Tribunal, publication and service of notices

Appendix 1 Settlement procedure and mediation scheme for FSA disciplinary cases

Schedule 1: Record keeping requirements

Schedule 2: Notification requirements

Schedule 3: Fees and other required payments

Schedule 4: Powers exercised

Schedule 5: Rights of action for damages

Schedule 6: Rules that can be waived

Derivations

Destinations

Handbook Modules

Transitional provisions

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- 1 There are no transitional provisions in DEC. The transitional provisions in GEN are not applicable to DEC.

Chapter 1

Application, Purpose and Introduction

1.1 Application and Purpose

Application

1.1.1

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This manual gives *guidance* on the FSA's decision making and other procedures for giving *statutory notices* listed in DEC 2 Ann 1G and DEC 3 Ann 1G. This manual also gives *guidance* on the FSA's procedure for using its powers under Part XXIV of the *Act* (Insolvency), Part XXV of the *Act* (Injunctions and restitution) and Part XXVII of the *Act* (Criminal Offences). It is relevant to *firms*, *approved persons*, applicants for *Part IV permission*, *persons* for whom an application for approval under section 59 of the *Act* has been made, and other *persons*, whether or not they are regulated by the FSA. The UKLA's procedure for giving *statutory notices* under Part VI of the *Act* (Official listing) is set out in the *listing rules* and related *guidance*.

Purpose

1.1.2

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Section 395 of the *Act* (The FSA's procedures) requires the FSA to publish a statement of its procedure for the giving of *statutory notices*. The purpose of the Decision making manual (*DEC*) is to fulfil this obligation. The following constitute the required statement of procedure:

- (1) *DEC*; and
- (2) the UKLA's procedure for giving *statutory notices* under Part VI of the *Act* (Official Listing) arising out of the FSA's exercise of its regulatory powers as the competent authority for official listing (see the *listing rules* and related *guidance*).

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DEC 4.6 sets out the FSA's policy on the procedure to be followed:

- (1) if the FSA decides to use its:
 - (a) powers to apply to the civil courts for insolvency orders, injunctions, restitution orders and *collective investment scheme* related orders; or
 - (b) powers to prosecute criminal offences; and
- (2) if the FSA decides to discontinue any proceedings begun by the use of these powers.

1.2 Introduction

DEC and the other manuals

1.2.1

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The Authorisation manual (*AUTH*), the Supervision manual (*SUP*), the Enforcement manual (*ENF*) and the Decision making manual (*DEC*) form the regulatory processes part of the *Handbook*:

- (1) *AUTH* sets out the relationships between the FSA and applicants for *Part IV permission* and *persons* wishing to exercise *EEA rights*, *Treaty rights* or *UCITS directive* rights;
- (2) *SUP* sets out the relationship between the FSA and *authorised persons* (referred to in the *Handbook* as *firms*). As a general rule, material that is of a continuing relevance after *authorisation* is in *SUP*;
- (3) *ENF* describes the FSA's enforcement powers under the *Act* and sets out its policies for using those powers; and
- (4) *DEC* is principally concerned with, and sets out, the FSA's decision making procedures for decisions that involve the giving of *statutory notices*.

Statutory notices

1.2.2

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The *Act* designates certain notices as *warning notices*, *decision notices* or *supervisory notices* ("*statutory notices*") for which there are certain specified procedures, actions and protections. *DEC* 1.2.3G summarises the *statutory notices* and related notices and provides references to where they are described in the *Act*.

1.2.3

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Table Summary of statutory and related notices

Reference to the Act	Notice	Description	Further information
Section 387	<i>Warning notice</i>	A <i>warning notice</i> gives the recipient details about action that the <i>FSA</i> proposes to take and about the right to make representations.	DEC 2.2
Section 388	<i>Decision notice</i>	A <i>decision notice</i> gives the recipient details about action that the <i>FSA</i> has decided to take.	DEC 2.3.1G to DEC 2.3.5G
Section 388	Further <i>decision notice</i>	A further <i>decision notice</i> gives the recipient details about different action from that set out in a <i>decision notice</i> and which the <i>FSA</i> has decided to take concerning the same matter covered by the <i>decision notice</i> . The <i>FSA</i> may give a further <i>decision notice</i> only if the person to whom the original <i>decision notice</i> was given consents.	DEC 2.3.6G to DEC 2.3.7G
Section 389	<i>Notice of discontinuance</i>	A <i>notice of discontinuance</i> identifies proceedings set out in a <i>warning notice</i> or <i>decision notice</i> and which are not being taken or are being discontinued.	DEC 2.3.8G to DEC 2.3.10G
Section 390	<i>Final notice</i>	A <i>final notice</i> sets out the terms of the action that the <i>FSA</i> has decided on and the date it takes effect.	DEC 2.3.11G to DEC 2.3.12G
Section 395(13)	<i>Supervisory notices</i>	A <i>supervisory notice</i> gives the recipient details about action that the <i>FSA</i> has taken or proposes to take.	DEC 3

Decision making on giving statutory notices

- 1.2.4 G_{/1} The *FSA* has different decision making procedures depending on whether or not a *statutory notice* is given.
- 1.2.5 G_{/1} Events leading to the giving of a *statutory notice* are covered in *AUTH*, *SUP*, *ENF* and *CIS*. *DEC 2* Ann 1G and *DEC 3* Ann 1G list the relevant references.
- 1.2.6 G_{/1} Decisions whether to give a *statutory notice* and decisions associated with the *statutory notice* once it has been given (a "*statutory notice associated decision*", see *DEC 4.1.2G*) will be taken by a "decision maker". References to the "decision maker" concerning *statutory notice decisions* refer to decisions taken by:
 - (1) the *Regulatory Decisions Committee (RDC)*; or
 - (2) *FSA* staff under *executive procedures*.
- 1.2.7 G_{/1} *DEC 4.1* describes the allocation of decisions between the *RDC* and *executive procedures*. *DEC 4.2* provides further information on the *RDC*. *DEC 4.3* provides further information on *executive procedures*.

Other decisions

- 1.2.8 G_{/1} The *FSA* will make regulatory decisions falling outside section 395 of the *Act*. These will include exercise of statutory powers which do not require *statutory notices* to be given, for example: when the *FSA* grants an application for a *Part IV permission* on the terms applied for (such decisions are made by internal staff procedures as described in *AUTH 8.2.5G* to *AUTH 8.2.8G*); when the *FSA* grants other applications; decisions on applications for *waivers*; decisions to give individual *guidance*; and decisions generally in the course of the *FSA*'s oversight of regulated institutions. They also include decisions on recommendations by *FSA* staff to the *RDC*.
- 1.2.9 G_{/1} The *FSA*'s general policy is that regulatory decisions should be taken at a level of seniority which is appropriate to the decision having regard to such factors as:
 - (1) the significance of the decision to those who would be affected by it;
 - (2) its novelty in the light of stated policy and established practice;
 - (3) the complexity of the relevant considerations;
 - (4) the range of alternative options; and
 - (5) the extent to which the facts relating to the decision are or may be disputed.
- 1.2.10 G_{/1} The *FSA* expects that most decisions will be made by individuals accountable through line management to the Board within the management structure of the *FSA*. Where appropriate, decisions will be made collectively by a group of staff. Decisions will be made within the stated policies of the *FSA* and in accordance with the *Act* and other legal requirements.

Chapter 2.

2.

Statutory notice procedure: Warning notice and decision notice procedure



2.1 Warning notice and decision notice procedure: Introduction

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The *Act* requires the *FSA*, when proposing to exercise its powers in certain circumstances, to use the *warning notice* and *decision notice* procedure.

2.1.2

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The circumstances to which the *warning notice* and *decision notice* procedure in *DEC* apply are set out in *DEC* 2 Ann 1G. Three flowcharts are provided in *DEC* 2 Ann 2G to *DEC* 2 Ann 4G. These illustrate:

- (1) the procedure for giving *warning notices* and *decision notices* in the case of applications for *Part IV permission*, applications for approval under section 59 of the *Act* (Approval for particular arrangements), applications for variation of *permission*, and for certain other applications (see *DEC* 2 Ann 2G);
- (2) the procedure for giving *warning notices* and *decision notices* in non-application cases (see *DEC* 2 Ann 3G); and
- (3) the procedure for giving *warning notices* and *decision notices* in the case of notifications of a change in *control* (see *DEC* 2 Ann 4G).

2.1.3

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DEC 1.2.3G includes a summary of the purpose of *warning notices* and *decision notices*.



2.2 Warning notice procedure

- 2.2.1** G_{/1} Under the circumstances listed in *DEC 2* Ann 1G, if FSA staff consider that action is appropriate, they will recommend to the relevant decision maker that a *warning notice* be given. A specimen *warning notice* for enforcement cases is at *DEC 2* Ann 5G.
- 2.2.2** G_{/1} After considering the staff recommendation, the decision maker may:
- (1) decide not to take further action (with or without a private warning (see *ENF 11.3* (Private warnings)); or
 - (2) decide to give a *warning notice* to the *person* concerned.
- 2.2.3** G_{/1} In the case of a proposed refusal of an application for approval under section 59 of the *Act*, the FSA must send a *warning notice* to all *interested parties*. Under section 62(5) of the *Act* (Applications for approval: procedure and right to refer to Tribunal), the *interested parties* in relation to an application for approval, are:
- (1) the applicant;
 - (2) the *person* in respect of whom the application is made ("A");
 - (3) the *person* by whom A's services are to be retained, if not the applicant.
- 2.2.4** G_{/1} Under regulation 22 of the *OEIC Regulations*, in the case of a *warning notice* concerning a proposed change in respect of an *ICVC*, the notice must be given to the *depository* as well as the *ICVC*. The only exception is if the proposal is to replace the *depository* or any *director*.
- 2.2.5** G_{/1} If the FSA decides to give a *warning notice* to a *person*, in accordance with section 387 of the *Act* (Warning notices), the *warning notice* must:
- (1) state the action which the FSA proposes to take;
 - (2) be in writing;
 - (3) give the FSA's reasons for the proposed action;
 - (4) state whether section 394 of the *Act* (Access to FSA material) applies (see *DEC 2.4*); and
 - (5) if that section applies, describe its effect and state whether any *secondary material* exists to which the *person* concerned must be allowed access under it.
- 2.2.6** G_{/1} If the FSA decides to take no further action and the FSA had previously informed the *person* concerned that it intended to recommend action, the FSA will communicate this decision promptly to the *person* concerned.

- 2.2.7 G_{/1} The *warning notice* will contain a statement that the *person* concerned is entitled to make representations to the *FSA*. The notice must specify a reasonable period, of at least 28 days from receiving (see *DEC 5.3*) the *warning notice*, within which the *person* to whom it is given may make representations.
- 2.2.8 G The procedures for making representations are set out in *DEC 4.4*.
- 2.2.9 G_{/1} The *warning notice* will contain (where appropriate) a statement that the mediation scheme is available. The applicability of the *FSA's* mediation scheme is described in *DEC App 1*.



2.3 Decision notice procedure

2.3.1 G_{/1} The decision maker will consider any representations made in accordance with DEC 4.4 in relation to a *warning notice* which has already been given. A decision will be stated in a *decision notice* or (where appropriate) a *notice of discontinuance* or other written notice. The *decision notice* sets out the terms of the decision. A specimen *decision notice* for enforcement cases is at DEC 2 Ann 6G.

2.3.2 G_{/1} In accordance with section 388 of the *Act* (Decision notices), the *decision notice* must:

- (1) be in writing;
- (2) give the *FSA*'s reasons for its decision to take the action to which the *decision notice* relates;
- (3) state whether section 394 of the *Act* (Access to *FSA* material) applies (see DEC 2.4);
- (4) if that section applies, describe its effect and state whether any *secondary material* exists to which the *person* concerned must be allowed access under it; and
- (5) give an indication of:
 - (a) any right given by the *Act* to have the matter referred to the *Tribunal*; and
 - (b) the procedure on referring a case to the *Tribunal*.

2.3.3 G_{/1} In the case of a proposed refusal of an application for approval under section 59 of the *Act*, the *FSA* must give a *decision notice* to all *interested parties* (see DEC 2.2.3G).

2.3.4 G_{/1} In the case of a *decision notice* concerning a notification of a proposed change in respect of an *ICVC*, the *FSA* must give a *decision notice* to the *depository* as well as to the *ICVC*, if the *depository* received the *warning notice* (see DEC 2.2.4G).

2.3.5 G_{/1} The decision maker may decide to take action different from that proposed in the *warning notice*. However, under section 388(2) of the *Act*, that action must be made under the same Part of the *Act* as the action proposed in the *warning notice*.

Further decision notice

2.3.6 G_{/1} Under section 388(3) of the *Act*, following the giving of a *decision notice* but before the *FSA* takes action to which the *decision notice* relates, the *FSA* may give the *person* concerned a further *decision notice* relating to different action

concerning the same matter. Under section 388(4) of the *Act*, the *FSA* can only do this if the *person* receiving the further *decision notice* gives his consent. In these circumstances the following procedure will apply:

- (1) *FSA* staff will recommend to the decision maker that a further *decision notice* be given, either before or after obtaining the *person's* consent;
- (2) the decision maker will consider whether the action proposed in the further *decision notice* is appropriate in the circumstances;
- (3) if the decision maker decides that the action proposed is inappropriate, he will decide not to give the further *decision notice*. In this case, the original *decision notice* will stand and the *person's* rights in relation to that notice will be unaffected. If the *person's* consent has already been obtained, the *FSA* will notify him of the decision not to give the further *decision notice*;
- (4) if the decision maker decides that the action proposed is appropriate then, subject to the *person's* consent being (or having been) obtained, a further *decision notice* will be given;
- (5) a *person* who had the right to refer the matter to the *Tribunal* under the original *decision notice* will have that right under the further *decision notice*. The time period in which the reference to the *Tribunal* may be made will begin from the date on which the further *decision notice* is given.

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For the purpose of establishing whether the *person* receiving the further *decision notice* gives his consent, the *FSA* will normally require consent in writing. If the *person* concerned is an individual, the *FSA* will normally require a letter or signed memorandum from him recording his consent. If the *person* concerned is a *body corporate* or *partnership*, the *FSA* will normally require a letter or signed memorandum on behalf of the *body corporate* or *partnership* stating its consent.

Notice of discontinuance

2.3.8

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If the *FSA* decides not to take action proposed in a *warning notice* or the action to which a *decision notice* relates, section 389 of the *Act* (Notices of discontinuance) requires the *FSA* to give a *notice of discontinuance* to the *person* to whom the *warning notice* or *decision notice* was given. (Section 389 of the *Act* does not apply if the discontinuance of the proceedings results in the granting of an application made by the *person* to whom the *warning notice* (or *decision notice*) was given.)

2.3.9

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A *notice of discontinuance*:

- (1) must identify what proceedings are being discontinued (section 389(3)); and
- (2) must state that the *FSA* may publish information about the matter if the *person* to whom the *notice of discontinuance* is given consents (section 391(2)).

2.3.10

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Where the *FSA* is required to give a *person* a copy of a *notice of discontinuance* (see DEC 2.4.10G), the copy must be accompanied by a statement that the *FSA* may publish information about the matter, so far as relevant to the *person* to whom the copy is given, if that *person* consents.

Final notice

2.3.11

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Under section 390 of the *Act* (Final notices), the *FSA* must give a *final notice* to the *person* to whom it has given a *decision notice*:

- (1) if the matter was not referred to the *Tribunal* within the period of 28 days of the date when the *decision notice* was given, or within any other period that may be prescribed in the *Tribunal* rules, in which case the *FSA* will give a *final notice* at the same time as it takes the action to which the *decision notice* relates;
- (2) if the matter was referred to the *Tribunal* within the period of 28 days of the date when the *decision notice* was given, or within any other period that may be prescribed in the *Tribunal* rules, in which case the *FSA* will give a *final notice* at the same time as it takes action in accordance with any directions given by the *Tribunal* or the Court under section 137 of the *Act* (Appeal on a point of law).

2.3.12

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A *final notice* sets out the terms of the statement, order, penalty or other action, and will give details of the date when the action takes effect.



2.4 Third party rights and access to FSA material

2.4.1

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Sections 393 (Third party rights) and 394 (Access to FSA material) of the *Act* confer additional procedural rights relating to third parties and to disclosure of *FSA* material. These rights apply in certain *warning notice* and *decision notice* cases referred to in section 392 of the *Act* (Application of sections 393 and 394). The cases in which these additional rights apply are identified in *DEC 2 Ann 1G* by asterisks; these are generally cases in which the *warning notice* or *decision notice* is given on the *FSA*'s own initiative rather than in response to an application or notification made to the *FSA*.

Access to FSA material

2.4.2

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If section 394 of the *Act* (Access to FSA material) applies and the *FSA* gives a *person* a *warning notice* or *decision notice*, it must under section 394(1) allow that *person* ("A") access to:

- (1) the material on which the *FSA* relied in taking the decision which gave rise to the obligation to give the *warning notice* (or the *decision notice*); and
- (2) any *secondary material*, which, in the opinion of the *FSA*, might undermine that decision.

2.4.3

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However, the duty under section 394(1) is qualified in the following ways:

- (1) under section 394(2), the *FSA* does not have to allow A access to material that is *excluded material*;
- (2) under section 394(2)(a) and (b), the *FSA* does not have to allow A access to material if this:
 - (a) relates to a case involving a *person* other than A; and
 - (b) was taken into account in A's case only for the purpose of comparison with other cases;
- (3) under section 394(3), the *FSA* may refuse A access to particular material to which it would otherwise have to allow him access if, in the *FSA*'s opinion, allowing him access to the material would not be in the public interest or would not be fair, having regard to:
 - (a) the likely significance of the material to the *person* concerned in relation to the matter about which he has been given a notice; and

(b) the potential prejudice to the commercial interests of a *person* (other than A) which would be caused by the material’s disclosure.

2.4.4 G_{/1} If under section 394(2) the *FSA* does not allow A access to material because it is *excluded material* consisting of a *protected item*, it must give A written notice of the existence of the *protected item* and of the *FSA*’s decision not to allow him access to it (section 394(4)).

2.4.5 G_{/1} If under section 394(3) the *FSA* refuses to allow A access to particular material, it must give him written notice of the refusal and the reasons for it (section 394(5)).

2.4.6 G_{/1} If the *FSA* receives a request for access to material, the *FSA* may within a reasonable period after the request was made:

- (1) provide facilities for the inspection and photocopying of the material that it considers it is required to disclose; or
- (2) provide a photocopy of the material.

The *FSA* will provide the first photocopy of the material free of charge, but will charge for subsequent copies it provides to the same *person*.

Third party rights

2.4.7 G_{/1} If section 393 (Third party rights) applies and any of the reasons given in the *warning notice* relate to a matter which:

- (1) identifies a *person* (“the third party”) other than the *person* to whom the *warning notice* is given; and
- (2) in the *FSA*’s opinion is prejudicial to the third party;

then the *FSA* must give the third party, in accordance with section 393 of the *Act*, a copy of the *warning notice*.

2.4.8 G_{/1} A copy of the *warning notice* will not be given if the *FSA* considers that this would be impracticable, or the *FSA* has already given the third party a separate *warning notice* about the same matter. Similarly, a copy of the *warning notice* will not be given if the *FSA* gives the third party such a notice at the same time as it gives the *warning notice* which identifies him.

2.4.9 G_{/1} DEC 2.4.7G and DEC 2.4.8G apply similarly in relation to a *decision notice*.

2.4.10 G_{/1} The *FSA* must give a copy of the *notice of discontinuance*, *decision notice* or *final notice* (as appropriate) to a third party who has been given a copy of the *warning notice* or *decision notice* (section 393(14), 393(5) and 390(1) of the *Act*).

2.4.11 G_{/1} If the *FSA* gives a copy of a *warning notice* or *decision notice* to a third party, the copy must be accompanied by an indication of the third party’s right under section 393(9) to refer the case to the *Tribunal* and the procedure on such a referral.

2.4.12 G_{/1} If the *FSA* gives a copy of a *warning notice* or *decision notice* to a third party, the provisions about access to *FSA* material also apply to the third party (DEC 2.4.2G to DEC 2.4.6G). Under section 393(12), the material that the *FSA* must disclose under section 394 is material that relates to the matter that identifies the third party.

Statutory notice procedure: Warning notice and decision notice procedure

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1 Table List of warning notices and decision notices under the Act (other than Part VI)

Note: Third party rights and access to *FSA* material apply to the powers listed in this table where indicated by an asterisk * (see *DEC* 2.4)

Section of the Act	Description	Handbook reference	Decision maker
52(6)(a)/ 52(9)(a)	when the <i>FSA</i> is proposing/deciding to grant an application for a <i>Part IV permission</i> with a <i>limitation</i> or a <i>requirement</i> which was not applied for, or with a narrower description of <i>regulated activity</i> than that applied for	<i>AUTH</i> 3	<i>RDC</i>
52(6)(b)/(9) (b)	when the <i>FSA</i> is proposing/deciding to grant an application to vary a <i>firm's Part IV permission</i> but, otherwise than as part of the application, to restrict the <i>Part IV permission</i> (either by imposing a <i>limitation</i> or <i>requirement</i> which was not applied for or by specifying a narrower description of <i>regulated activity</i> than that applied for)	<i>SUP</i> 6	<i>RDC</i> / <i>executive procedures</i> (Note 1)
52(7)/(9)(c)	when the <i>FSA</i> is proposing/deciding to refuse an application for a <i>Part IV permission</i>	<i>AUTH</i> 3	<i>RDC</i>
52(7)/(9)(c)	when the <i>FSA</i> is proposing/deciding to refuse an application to vary a <i>firm's Part IV permission</i>	<i>SUP</i> 6	<i>RDC</i> / <i>executive procedures</i> (Note 1)
52(7)/(9)(c)	when the <i>FSA</i> is proposing/deciding to refuse an application to cancel a <i>firm's Part IV permission</i>	<i>SUP</i> 6	<i>RDC</i>
54(1)/(2)	when the <i>FSA</i> is proposing/deciding to cancel a <i>firm's Part IV permission</i> otherwise than at its request*	<i>ENF</i> 5	<i>RDC</i>
57(1)/(3)	when the <i>FSA</i> is proposing/deciding to make a <i>prohibition</i> order against an individual*	<i>ENF</i> 8	<i>RDC</i>

58(3)/(4)	when the <i>FSA</i> is proposing/deciding to refuse an application for the variation or revocation of a <i>prohibition order</i>	<i>ENF</i> 8	<i>RDC</i>
62(2)/(3)	when the <i>FSA</i> is proposing/deciding to refuse an application for approval of a <i>person</i> performing a <i>controlled function</i> under section 59 of the <i>Act</i> (in conjunction with an application for <i>Part IV permission</i>)	<i>AUTH</i> 6	<i>RDC</i>
62(2)/(3)	when the <i>FSA</i> is proposing/deciding to refuse an application for approval of a <i>person</i> performing a <i>controlled function</i> (otherwise than in conjunction with an application for <i>Part IV permission</i>)	<i>SUP</i> 10	<i>RDC</i>
63(3)/(4)	when the <i>FSA</i> is proposing/deciding to withdraw approval from an <i>approved person</i> *	<i>ENF</i> 8	<i>RDC</i>
67(1)/(4)	when the <i>FSA</i> is proposing/deciding to take action against an <i>approved person</i> by exercising the disciplinary powers conferred by section 66*	<i>ENF</i> 11/12/13	<i>RDC</i>
126(1)/127(1)	when the <i>FSA</i> is proposing/deciding to impose a sanction for <i>market abuse</i> *	<i>ENF</i> 14	<i>RDC</i>
183(3)/186(1)	when the <i>FSA</i> is proposing/deciding to object to a change in <i>control</i> following receipt of a notice of control	<i>SUP</i> 11	<i>Executive procedures</i>
185(3)/(4)	when the <i>FSA</i> is proposing/deciding to approve a change in <i>control</i> following receipt of a notice of control but subject to conditions	<i>SUP</i> 11	<i>Executive procedures</i>
187(1)/(3) and 188(1)	when the <i>FSA</i> is proposing/deciding to object to a <i>person</i> who has failed to submit a notice of control or a notice on acquiring, or increasing, <i>control</i> , or to object to an existing <i>controller</i>	<i>SUP</i> 11	<i>Executive procedures</i>
200(4)/(5)	when the <i>FSA</i> is proposing/deciding to refuse an application for variation or rescission of a requirement imposed on an <i>incoming firm</i>	<i>ENF</i> 4	<i>RDC / executive procedures (Note 1)</i>
207(1)/208(1)	when the <i>FSA</i> is proposing/deciding to publish a statement in respect of an <i>authorised person</i> (under section 205) or impose a financial penalty on an <i>authorised persons</i> (under section 206)*	<i>ENF</i> 11/12	<i>RDC</i>

245(1)/(2)	when the <i>FSA</i> is proposing/deciding to refuse an application for an <i>authorisation order</i> declaring a <i>unit trust scheme</i> to be an <i>AUT</i>	<i>CIS 16</i>	<i>RDC / executive procedures (Note 2)</i>
252(1)/(4)	when the <i>FSA</i> is proposing/deciding to refuse approval of a proposal to replace the <i>trustee</i> or <i>manager</i> of an <i>AUT</i>	<i>CIS 16</i>	<i>Executive procedures</i>
255(1)/(2)	when the <i>FSA</i> is proposing/deciding to make an order under section 254 revoking the <i>authorisation order</i> of an <i>AUT</i> *	<i>ENF 16</i>	<i>RDC</i>
260(1)/(2)	when the <i>FSA</i> , on an application to revoke or vary a direction under section 257, proposes/decides to refuse to revoke or vary the direction or proposes/decides to vary the direction otherwise than in accordance with the application	<i>ENF 16</i>	<i>RDC</i>
264(2)/265(4) (Note 3)	when the <i>FSA</i> is notifying/deciding not to withdraw a notice, to the operator and relevant <i>EEA State</i> authorities, that the way in which a <i>collective investment scheme</i> constituted in another <i>EEA State</i> intends to invite <i>persons</i> in the <i>United Kingdom</i> to participate in the <i>scheme</i> does not comply with <i>UK law</i>	<i>CIS 16</i>	<i>Executive procedures</i>
269(1)/(2)	when the <i>FSA</i> , on an application under subsection (4) or (5) of section 267 by an <i>operator</i> of a section 264 <i>recognised scheme</i> to revoke or vary a direction that the promotion of the <i>scheme</i> be suspended, proposes/decides to refuse the application or to vary the direction otherwise than in accordance with the application	<i>ENF 16</i>	<i>RDC</i>
271(1)/(3)	when the <i>FSA</i> is proposing/deciding to refuse approval of a collective investment scheme as a recognised scheme under section 270	<i>CIS 16</i>	<i>Executive procedures</i>
276(1)/(2)	when the <i>FSA</i> is proposing/deciding to refuse an application for an order declaring a <i>collective investment scheme</i> to be a <i>recognised scheme</i> under section 272	<i>CIS 16</i>	<i>Executive procedures</i>

280(1)/(2)	when the <i>FSA</i> is proposing/deciding to direct that a section 270 <i>recognised scheme</i> is to cease to be recognised or to revoke a section 272 order in respect of a <i>recognised scheme</i> *	<i>ENF 16</i>	<i>RDC</i>
321(8)/(9)	when the <i>FSA</i> is proposing/deciding to refuse an application for variation or revocation of a direction or a requirement imposed on a former underwriting member of Lloyd's*	None	<i>RDC</i>
331(1)/(3)	when the <i>FSA</i> is proposing/deciding to make an order disapplying the exemption from the <i>general prohibition</i> under section 327*	<i>ENF 18</i>	<i>RDC</i>
331(7)/(8)	when the <i>FSA</i> is proposing/deciding to refuse an application for the variation or revocation of an order made under section 329*	<i>ENF 18</i>	<i>RDC</i>
345(2)/(3)	when the <i>FSA</i> is proposing/deciding to disqualify an auditor or actuary from being the auditor of, or acting as an actuary for, any <i>authorised person</i> or class of <i>authorised person</i> or from being the auditor of any <i>AUT</i> or <i>ICVC</i> *	<i>ENF 17</i>	<i>RDC</i>
385(1)/386 (1)	when the <i>FSA</i> is proposing/deciding to exercise the power under section 384(5) to require a <i>person</i> to pay restitution*	<i>ENF 9</i>	<i>RDC</i>
Paragraph 19(8)/(12) of schedule 3	when the <i>FSA</i> is proposing/deciding to refuse to give a <i>consent notice</i> to a <i>UK firm</i> wishing to establish a <i>branch</i> under an <i>EEA right</i>	<i>SUP 13</i>	<i>RDC</i>
OEIC Regulations reference	Description	Handbook reference	Decision maker
Regulation 16(1)/(2)	when the <i>FSA</i> is proposing/deciding to refuse an application for an <i>authorisation order</i> in respect of a proposed <i>ICVC</i>	<i>CIS 16</i>	<i>RDC / executive procedures (Note 2)</i>
Regulation 22(1)/(2)/(4)/(5)	when the <i>FSA</i> is proposing/deciding to refuse approval of (or, having given a <i>warning notice</i> , deciding to approve (Note 4)) a proposal to replace the <i>depository</i> or director of an <i>ICVC</i> , or any other proposal/decision falling within regulation 21	<i>CIS 16</i>	<i>Executive procedures</i>

Regulation 24(1)/(2)	when the <i>FSA</i> is proposing/deciding to revoke an <i>authorisation order</i> relating to an <i>ICVC</i> under regulation 23(1)*	<i>ENF 16</i>	<i>RDC</i>
Regulation 28(1)/(2)	when the <i>FSA</i> is proposing/deciding to refuse an application to revoke or vary a direction in accordance with a request under regulation 25(7) or to vary the direction in accordance with the application	<i>ENF 16</i>	<i>RDC</i>
Paragraph 20 of schedule 5	when the <i>FSA</i> is proposing/deciding to use the disqualification powers under section 249(1)*	<i>ENF 17</i>	<i>RDC</i>

Note 1: The decision will be made by the *RDC* if it involves a fundamental (see *DEC* 4.1.5G) change to the nature of a *permission*.

Note 2: The decision will be made by the *RDC* if it relates to an application for an *authorisation order* by an *authorised fund manager* who is not the *operator* of an existing *AUT* or *ICVC*.

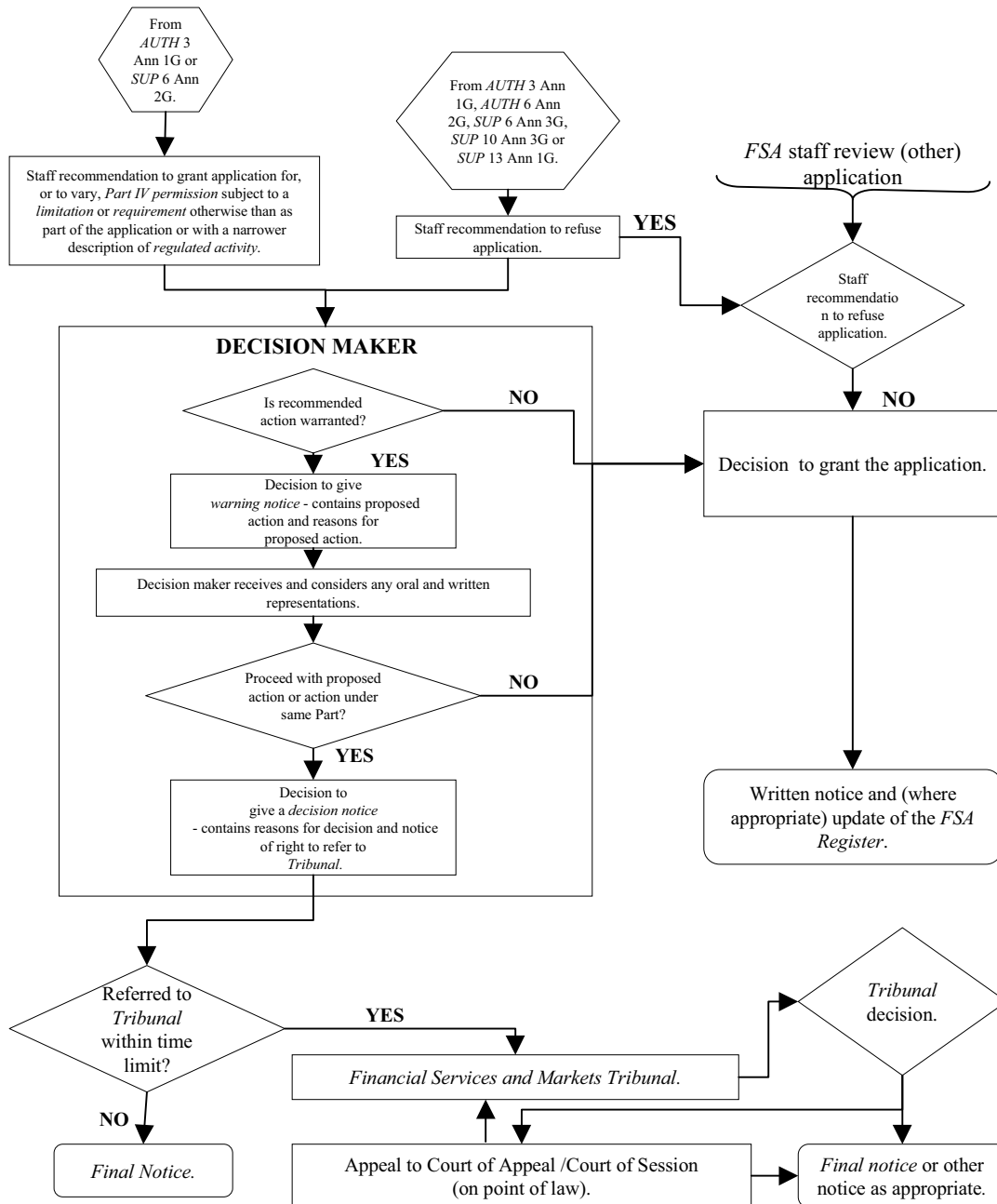
Note 3: Although the notice under section 265(4) is a *decision notice*, the notice under section 264(2) is not a *warning notice*. The *FSA* will operate a procedure compliant with section 264 for the section 264(2) notice, which will be similar to the procedure for a *warning notice*.

Note 4: The *FSA* must give a *decision notice* under regulation 22(5) of the *OEIC Regulations* when, having given a *warning notice*, it decides to approve a proposal. But this *decision notice* has the effect of a written notice giving the *FSA's* approval under regulation 21(3)(a) of the *OEIC Regulations*. Although the *FSA* will comply with the statutory requirements regarding the giving of *decision notices*, *DEC* should otherwise be read as if the *decision notice* was a written notice granting an application.

Statutory notice procedure: Warning notice and decision notice procedure

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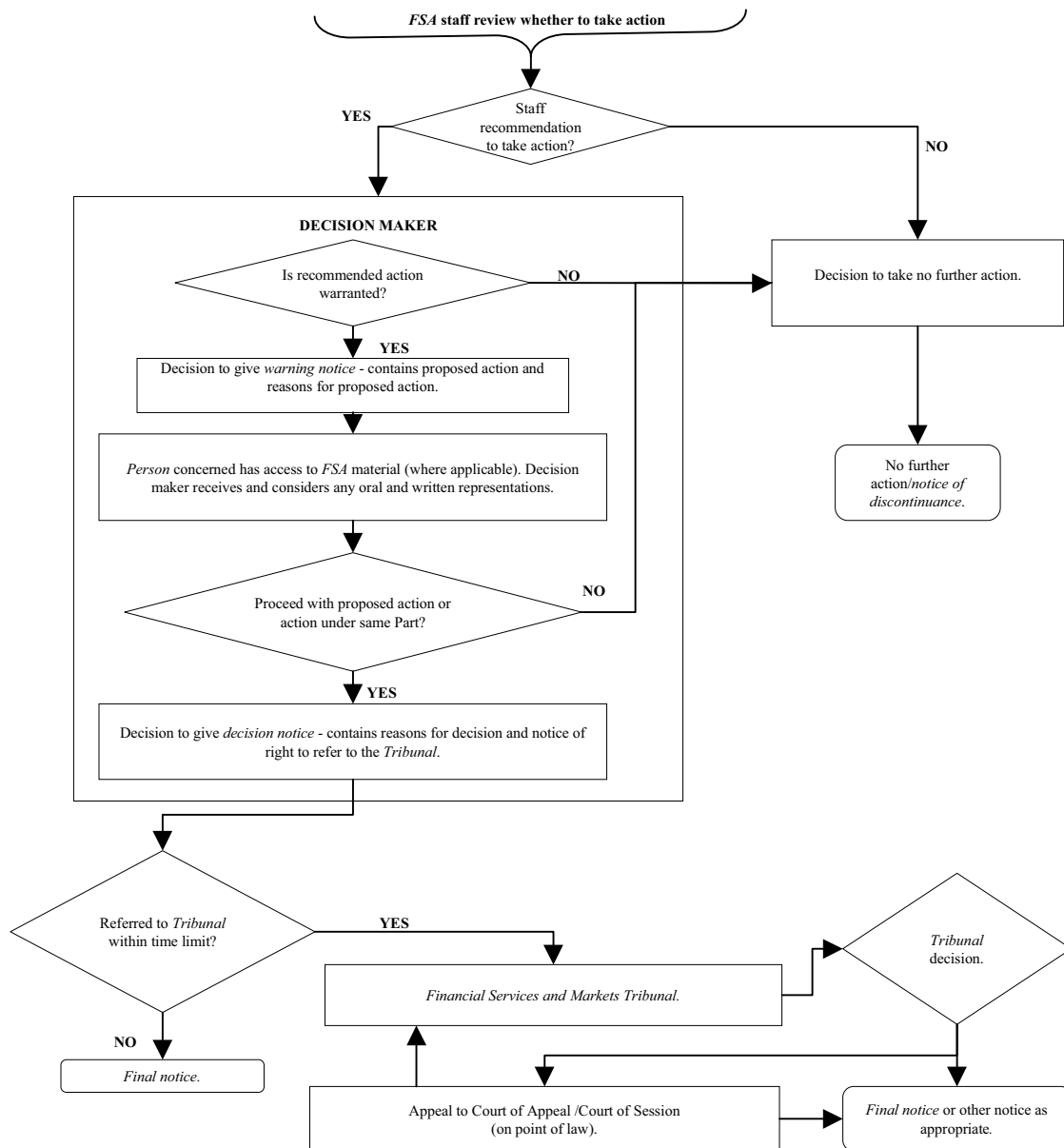
The FSA's decision making procedure for applications concerning Part IV permission, applications for approval under section 59 of the Act, and for certain other applications involving warning and decision notices



Statutory notice procedure: Warning notice and decision notice procedure

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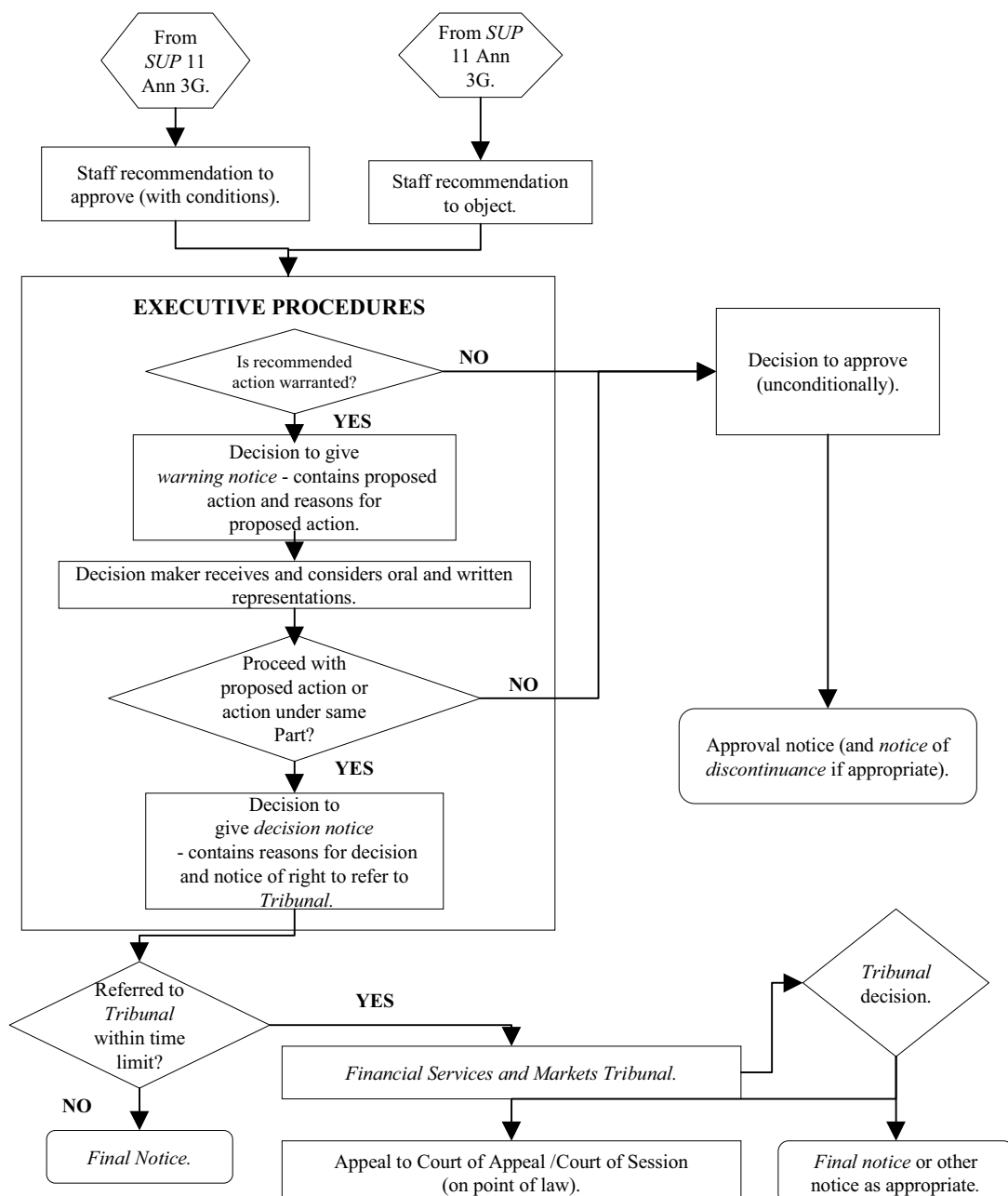
The FSA's decision making procedure in non-application cases involving warning and decision notices



Statutory notice procedure: Warning notice and decision notice procedure

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The FSA's decision making procedure on notification of a change in control involving warning and decision notices



Specimen warning notice

To: [firm or other person]

Of: [address]

[Date]

WARNING NOTICE

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS (“the FSA”) proposes to take the following action.

PROPOSED ACTION

[Details of proposed action including details of any financial penalty, the text of any public statement of misconduct, and the terms of any prohibition order]

REASONS

[Reasons for the proposed action]

DECISION MAKER

The decision to give this notice was made by [identity of relevant committee or individual] on behalf of the FSA

IMPORTANT

This warning notice is sent to you in accordance with section 387 of the Financial Services and Markets Act 2000 (“the Act”). (See DEC 2.2 of the Decision making manual.)

You may make written and oral representations to the FSA. If you wish to make representations you must do so within [28] days of receiving this warning notice or such longer period as may be permitted by the FSA. Written representations should be made to the Secretary, Regulatory Decisions Committee, at the above address. (See DEC 4.4 of the Decision making manual.)

[Section 394 of the Act applies to this warning notice. In accordance with section 394, you are entitled to have access to:

- (a) the material upon which the FSA has relied in deciding to give you this notice; and
- (b) any secondary material which, in the opinion of the FSA, might undermine that decision.

[The following secondary material exists]/[There is no such secondary material] to which you must be allowed access. (See DEC 2.4 of the Decision making manual.)]

[The FSA operates a mediation scheme for certain disciplinary and market abuse cases, where settlement discussions have taken place but broken down. You may use this scheme, but you are not obliged to do so. (See DEC App 1 of the Decision making manual.)]

Please contact [contact name and details] at the FSA for more information.

Specimen decision notice

To: [firm or other person]

Of: [address]

[Date]

DECISION NOTICE

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS (“the FSA”) has decided to take the following action.

ACTION

[Details of action (if any) including details of any financial penalty, or the text of any public statement of misconduct, or the terms of any prohibition order]

REASONS

[Reasons for the FSA’s decision to take the action]

DECISION MAKER

The decision to give this notice was made by [identity of relevant committee or individual] on behalf of the FSA

YOUR RIGHTS

This decision notice is sent to you in accordance with section 388 of the Financial Services and Markets Act 2000 (“the Act”). (See DEC 2.3 of the Decision making manual.)

[Section 394 of the Act applies to this decision notice. In accordance with section 394, you are entitled to have access to:

- (a) the material upon which the FSA has relied in deciding to give you this notice; and
- (b) any secondary material which, in the opinion of the FSA, might undermine that decision.

[The following secondary material exists]/[There is no such secondary material] to which you must be allowed access. (See DEC 2.4 of the Decision making manual.)]

Section [insert relevant section] of the Act entitles you, if you wish, to refer the FSA's decision to the Financial Services and Markets Tribunal ("the Tribunal"). Under section 133 of the Act, you have 28 days from the date of this decision notice to refer the matter to the Tribunal, although the Tribunal may permit you a longer period (see DEC 5.1 of the Decision making manual). The detailed procedures for making a reference to the Tribunal are contained in section 133 of the Act and the Tribunal rules. (See [insert where these can be found].)

Chapter 3.

Statutory notice procedure: Supervisory notice procedure

3.



3.1 Supervisory notice procedure

3.1.1 **G** _{/1} The *Act* requires the *FSA*, when proposing to exercise its powers in certain circumstances, to use the *supervisory notice* procedure. The relevant circumstances are set out in *DEC 3 Ann 1G*. *DEC 1.2.3G* includes a summary of the purpose of *supervisory notices*.

3.1.2 **G** _{/1} In *DEC 3.1.3G* to *DEC 3.1.10G*, the *supervisory notice* about a matter first given to the recipient is referred to as the "first *supervisory notice*" and the *supervisory notice* given after consideration of any representations is referred to as the "second *supervisory notice*". *DEC 3* sets out the procedure which applies when the *FSA* gives a *supervisory notice*. The flowchart in *DEC 3 Ann 2G* illustrates the procedure for the giving of *supervisory notices*. A specimen notice for enforcement cases is at *DEC 3 Ann 3G*.

First supervisory notice

3.1.3 **G** _{/1} In the circumstances listed in *DEC 3 Ann 1G*, if *FSA* staff consider that action is appropriate, they will recommend to the relevant decision maker that a *supervisory notice* be given. The recommendation will say whether the action should take effect immediately, on a specified date, or when the matter is no longer *open to review*.

3.1.4 **G** _{/1} After considering the staff recommendation, the *FSA* may:

- (1) decide to take no action; or
- (2) decide to give a first *supervisory notice* to the *person* concerned.

3.1.5 **G** _{/1} If the *FSA* decides to give a first *supervisory notice* to a *person*, in accordance with the sections of the *Act* listed in *DEC 3 Ann 1G*, the notice must:

- (1) give details of the action;
- (2) inform him when the action takes effect;
- (3) state the *FSA's* reasons for the action and for its decision as to when the action takes effect;
- (4) inform him of his right to refer the matter to the *Tribunal* and give an indication of the procedure on such a reference; and
- (5) inform him that he may make representations to the *FSA* within such a period as may be specified in the notice (whether or not the matter has been referred to the *Tribunal*).

3.1.6 G_{/1} If the *FSA* decides to take no further action and the *FSA* had previously informed the *person* concerned that it intended to recommend action, the *FSA* will communicate this decision promptly to the *person* concerned.

3.1.7 G_{/1} The procedures for making representations are set out in *DEC* 4.4.

Second supervisory notice

3.1.8 G_{/1} The *FSA* will consider any representations made in accordance with *DEC* 4.4 concerning a first *supervisory notice* which the *FSA* has already given.

3.1.9 G_{/1} If the *FSA* decides to take the proposed action, or to take action in a different way, or decides not to rescind action that is already effective, then in accordance with the sections of the *Act* listed in *DEC* 3 Ann 1G, a second *supervisory notice* must be given.

3.1.10 G_{/1} If the *FSA* decides to give a second *supervisory notice*, its content will depend on the action the *FSA* decides to take.

- (1) If the *FSA* decides to take the action proposed in the first *supervisory notice*, or if action has already been taken which the *FSA* decides not to rescind, in accordance with the sections of the *Act* listed in *DEC* 3 Ann 1G, the notice must inform the *person* concerned of his right to refer the matter to the *Tribunal*. If a notice informs a *person* of his right to refer the matter to the *Tribunal*, it must also describe the procedure on such a reference.
- (2) If the *FSA* decides to take different action from that proposed in the first *supervisory notice*, then in accordance with the sections of the *Act* listed in *DEC* 3 Ann 1G, the second *supervisory notice* must be in the same form as a first *supervisory notice* (see *DEC* 3.1.5G).

3.1.11 G_{/1} If the *FSA* decides not to take action, or decides to rescind action that is already effective, then in accordance with the sections of the *Act* listed in *DEC* 3 Ann 1G, the *person* concerned must be informed in writing.

Statutory notice procedure: Supervisory notice procedure

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1 Table List of supervisory notices under the Act (other than Part VI)

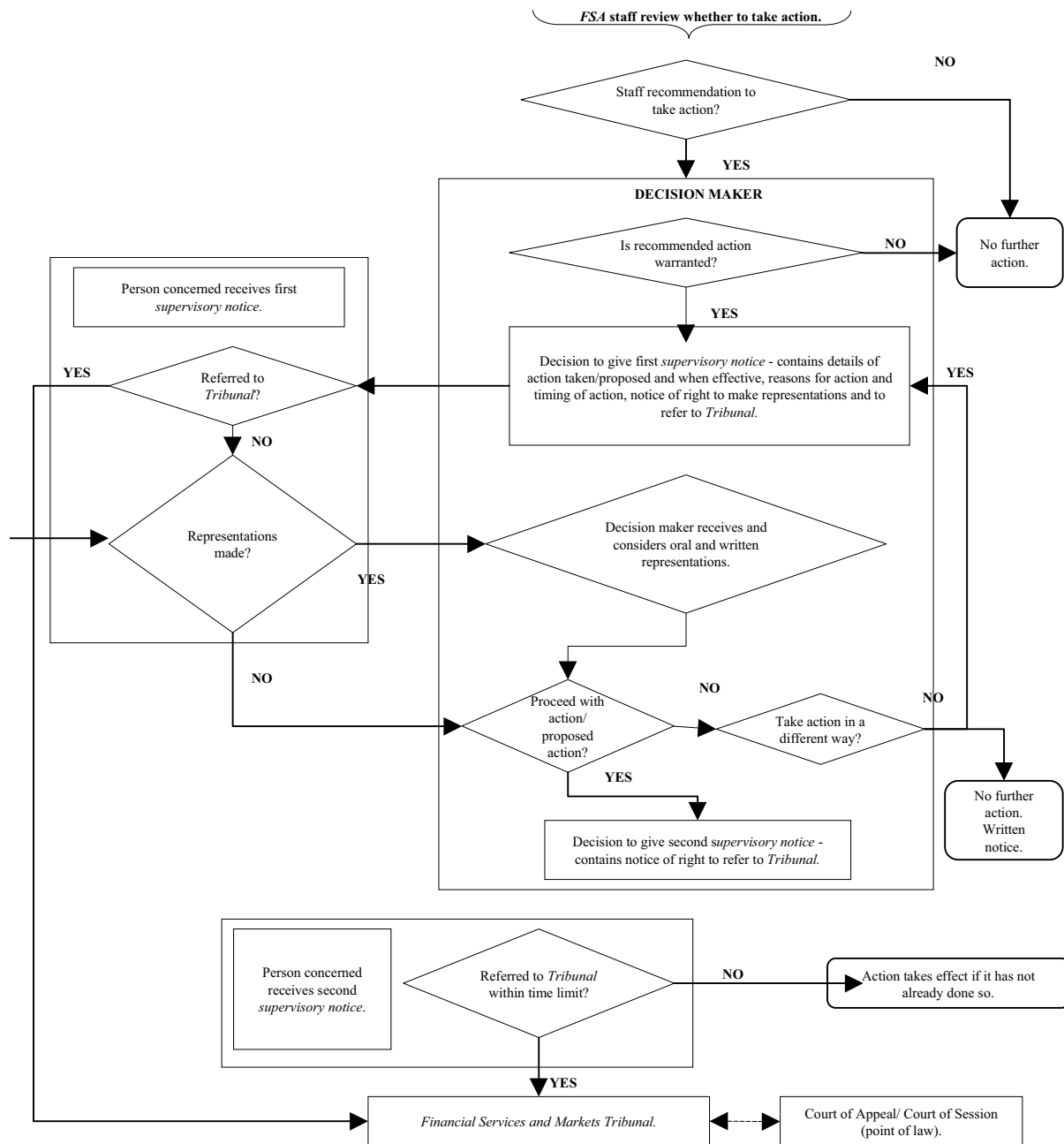
Section of the Act	Description	Handbook reference	Decision maker
53(4)/(7)/(8)(b)	when the <i>FSA</i> is exercising its <i>own-initiative power</i> to vary a <i>firm's Part IV permission</i>	<i>ENF 3</i> <i>SUP 7</i>	<i>RDC / executive procedures</i> (Note)
197(3)/(6)/(7)(b)	when the <i>FSA</i> is exercising its <i>power of intervention</i> in respect of an <i>incoming firm</i>	<i>ENF 4</i> <i>SUP 7</i>	<i>RDC / executive procedures</i> (Note)
259(3)/(8)/(9)(b)	when the <i>FSA</i> is exercising its power to give or, on its own initiative, to vary a direction to the <i>manager</i> and <i>trustee</i> of an <i>AUT</i>	<i>ENF 16</i>	<i>RDC</i>
268(3)/(7)(a) or (9)(a) (as a result of (8)(b))	when the <i>FSA</i> is exercising its power to give a direction to the <i>operator</i> of a <i>recognised scheme</i>	<i>ENF 16</i>	<i>RDC</i>
282(3)/(6)/(7)(b)	when the <i>FSA</i> is exercising its power to give a direction to an <i>operator, trustee</i> or <i>depository</i> of a <i>recognised scheme</i>	<i>ENF 16</i>	<i>RDC</i>
321(2)/(5)	when the <i>FSA</i> is exercising its power to impose a requirement on a former underwriting member of Lloyd's	None	<i>RDC</i>
OEIC Regulations reference	Description	Handbook reference	Decision maker
Regulation 27	when the <i>FSA</i> is exercising its power to give or, on its own initiative, to vary a direction to an <i>ICVC</i> and its <i>depository</i>	<i>ENF 16</i>	<i>RDC</i>

Note : The decision will be made by the *RDC* if it involves a fundamental change (see DEC 4.1.5G) to the nature of a *permission*.

Statutory notice procedure: Supervisory notice procedure

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The FSA's decision making procedure for supervisory notices



Specimen first supervisory notice

To: [firm or other person]

Of: [address]

[Date]

SUPERVISORY NOTICE

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS (“the FSA”) [has decided/ proposes] to take the following action.

[PROPOSED] ACTION

[Details of [proposed] action including details of any own-initiative variation of permission, intervention or direction]

EFFECTIVE DATE

[The date on which any own-initiative variation of permission, intervention or direction is to take effect (if a direction imposes a requirement under section 257(2)(a), state that the requirement has effect until a specified date or a further direction)]

REASONS

[Reasons for the [proposed] action, including reasons for the determination as to when the action is to take effect]

DECISION MAKER

The decision to give this notice was made by [identity of relevant committee or individual] on behalf of the FSA

IMPORTANT

This supervisory notice is sent to you in accordance with [one of the following sections:

section 53(4);

section 197(3);

section 259(3);

section 268(3);

section 282(3);

[section 321(2)] of the Financial Services and Markets Act 2000 (“the Act”).

(See DEC 3 of the Decision making manual.)

You may refer this matter to the Financial Services and Markets Tribunal (“the Tribunal”). Under section 133 of the Act you have 28 days from the date of this supervisory notice to refer the matter to the Tribunal, although the Tribunal may permit you a longer period (see DEC 5.1 of the Decision making manual). The detailed procedures for making a reference to the Tribunal are contained in section 133 of the Act and the Tribunal rules. (See [insert where these can be found].)

You may also make written and oral representations to the FSA (whether or not you refer this matter to the Tribunal). If you wish to make representations you must do so within [28] days of receiving this supervisory notice or such longer period as may be permitted by the FSA. Written representations should be made to [] of the above address. (See DEC 4.4 of the Decision making manual.)

Please contact [contact name and details] at the FSA for more information.

Chapter 4.

The decision maker

4.

4.1 Allocation of decision making

4.1.1 **G** This section sets out the allocation of decision making between the RDC and *executive procedures* for decisions which:

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- (1) give rise to an obligation to give a *statutory notice*; or
- (2) are associated with *statutory notice decisions* (“*statutory notice associated decisions*”).

4.1.2 **G** *Statutory notice associated decisions* include decisions:

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- (1) to set or extend the period for making representations (see DEC 4.4);
- (2) whether a copy of the *statutory notice* needs to be given to any third party and the period for the third party to make representations;
- (3) to refuse access to FSA material; and
- (4) as to the information it is appropriate to publish about the matter to which a *final notice*, or a *supervisory notice* which has already taken effect, relates.

4.1.3 **G** FSA staff responsible for preparing and recommending action in individual cases will allocate cases to the RDC (by full or modified procedures) or to *executive procedures* in accordance with DEC 4.1.4G and DEC 4.1.6G.

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Decisions to be taken by the RDC

4.1.4 **G** The RDC has responsibility for *statutory notice decisions* and *statutory notice associated decisions* if the FSA proposes or takes any of the following actions:

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- (1) to impose a *limitation* or a *requirement* which was not applied for, or specify a narrower description of *regulated activity* than that applied for, on the grant of a *Part IV permission*;
- (2) to restrict a *Part IV permission* on the FSA’s own initiative (by removing a *regulated activity*, by imposing a *limitation* or *requirement* or by specifying a narrower description of *regulated activity*) in a way that would make a fundamental change (see DEC 4.1.5G) to the nature of the *Part IV permission* held (whether indefinitely, or for a limited period);
- (3) to refuse an application to vary a *Part IV permission*, or to restrict a *Part IV permission* on the grant of a variation (by imposing a *limitation* or *requirement* which was not applied for or by specifying a narrower description of *regulated activity* than that applied for), in a way that would make a fundamental change (see DEC 4.1.5G) to the nature of the *Part IV permission* that would

- have been held had the application been granted in full (whether indefinitely, or for a limited period);
- (4) to refuse an application for a *Part IV permission*, to refuse an application to cancel a *Part IV permission* or to cancel a *Part IV permission* on the FSA's own initiative;
 - (5) to refuse *approved person* status, or withdraw it under section 63 of the *Act* (Withdrawal of approval);
 - (6) to make a *prohibition order* in relation to any *person*, or refuse an application to vary or revoke such an order;
 - (7) to impose a requirement on an *incoming firm* with an effect equivalent to making a fundamental change (see DEC 4.1.5G) to the nature of a *permission*, or to refuse an application to vary or rescind such a requirement;
 - (8) to exercise the FSA's powers to impose a financial penalty or public censure on any *person*, or to make a restitution order against any *person*;
 - (9) to exercise any power of the FSA relating to a *regulated collective investment scheme*, other than to:
 - (a) refuse an application for an *authorisation order* (but see (10)); or
 - (b) refuse an application for recognition of a *collective investment scheme* under section 270 (Schemes authorised in designated countries or territories) or 272 (Individually recognised overseas schemes) of the *Act*; or
 - (c) object to a notice of intention to invite *persons* to participate in a *collective investment scheme* constituted in another *EEA State*; or
 - (d) refuse approval of changes to an *AUT* or *ICVC*;
 - (10) to refuse an application for an *authorisation order*, if the applicant is not the operator of an existing *AUT* or *ICVC*;
 - (11) to impose a requirement on a *former underwriting member* of Lloyd's or refuse an application to vary or rescind such a requirement;
 - (12) to make an order disapplying the exemption in section 327(1) of the *Act* (Exemption from the general prohibition) in relation to a professional firm to the extent specified in the order, or refuse an application to vary or revoke such an order;
 - (13) to disqualify an auditor or actuary;
 - (14) to refuse to give a *consent notice* to a *UK firm* wishing to establish a *branch* under an *EEA right*.

4.1.5

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In DEC 4.1.4G(2), (3) and (7), making a fundamental change to the nature of a *permission* means:

- (1) removing a type of activity or *investment* from the *firm's permission*; or
- (2) refusing an application to include a type of activity or *investment*; or

- (3) restricting a *firm* from taking on new business, dealing with a particular category of *client* or handling *client money* by imposing a *limitation* or *requirement*, or refusing an application to vary or cancel such a *limitation* or *requirement*; or
- (4) imposing or varying an assets requirement (as defined in section 48(3) of the *Act* (Prohibitions and restrictions)), or refusing an application to vary or cancel such a requirement.

Decisions to be taken by executive procedures

4.1.6

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Statutory notice decisions and *statutory notice associated decisions* which are not taken by the RDC, will be taken under *executive procedures*.

Examples of allocation of decision making

4.1.7

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Examples of matters decided by the RDC include:

- (1) refusing an application to vary a *Part IV permission* to carry on *insurance business* or to *accept deposits* for the first time; in these cases, the *firm* will normally have been required to complete parts of the application pack (*SUP* 6.4.14G);
- (2) refusing an application to vary a *Part IV permission* to carry on *regulated activities* with *private customers* for the first time;
- (3) refusing an application to vary a *Part IV permission* to remove a *requirement* to enable the *firm* to hold or control *client money* for the first time; and
- (4) varying a *Part IV permission* on the FSA's own initiative by removing a *regulated activity* from a *firm's permission*.

4.1.8

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Examples of matters decided by *executive procedures* (where the FSA decides or is required to use the statutory powers in question rather than to achieve the action required in other ways, for example through individual *guidance* or securing the agreement of a *firm* to take action on a voluntary basis) include:

- (1) imposing a *requirement* that a *firm* submit regular reports covering, for example, trading results, management accounts, *customer* complaints, connected party transactions (*SUP* 7.4.2G(1)), or varying such a *requirement*, on the FSA's own initiative, or refusing an application by the *firm* to vary such a *requirement*;
- (2) imposing a *requirement* that a *firm* submit a business plan (*SUP* 7.3.3G(3)), or varying such a *requirement*, on the FSA's own initiative, or refusing an application by the *firm* to vary such a *requirement*;
- (3) setting prudential limits through a *requirement*, for example on large *exposures*, foreign currency *exposures* or liquidity gaps (*SUP* 7.3.3G(2)), or varying such a *requirement*, on the FSA's own initiative, or refusing an application by the *firm* to vary such a *requirement*;
- (4) imposing a *requirement* that a *firm* maintain a particular amount or type of financial resources (*SUP* 7.3.3G(5)), or varying such a *requirement*, on the

FSA's own initiative, or refusing an application by the firm to vary such a requirement;

- (5) refusing an application to vary a *Part IV permission*, or to restrict a *Part IV permission* on the grant of a variation (by imposing a *limitation* or *requirement* which was not applied for, or by specifying a narrower description of *regulated activity* than that applied for), in a way that would not make a fundamental change (see *DEC 4.1.5G*) to the nature of the *Part IV permission* that would have been held had the application been granted in full (indefinitely, or for a limited period);
- (6) objecting to the acquisition or increase of *control* under section 186 of the *Act* (Objection to acquisition of control), objecting to existing *control* under section 187 of the *Act* (Objecting to existing control), or attaching conditions to an approval to a change in *control* under section 185 of the *Act* (Conditions attached to approval); and
- (7) refusing a request for an *authorisation order* for an operator's proposed *AUT* or *ICVC* (if the operator is an operator of an existing *AUT* or *ICVC*), refusing approval of a *scheme* becoming a *recognised scheme* authorised in a designated territory under section 270 of the *Act* or refusing an application in respect of a proposed individually recognised overseas *scheme* under section 272 of the *Act*.

4.2 The Regulatory Decisions Committee

- 4.2.1** **G** _{/1} The *Regulatory Decisions Committee (RDC)* is appointed by the *FSA Board* to exercise certain regulatory powers on behalf of the *FSA Board*. The *RDC* is accountable to the *FSA Board* for its decisions.
- 4.2.2** **G** _{/1} The *RDC* comprises a Chairman, one or more Deputy Chairmen, and other members.
- 4.2.3** **G** _{/1} The *RDC* is a body outside the *FSA's* management structure. Apart from the Chairman, none of the members of the *RDC* is an *FSA* employee. The members comprise:
- (1) current and recently retired practitioners with financial services industry skills and knowledge; and
 - (2) other suitable individuals representing the public interest.
- 4.2.4** **G** _{/1} The *RDC* is supported by the *RDC Secretariat*. The *RDC Secretariat* is separate from *FSA* staff involved in making recommendations to the *RDC*.

Appointment and removal of members of the RDC

- 4.2.5** **G** _{/1} The Chairman of the *RDC* is appointed by the *FSA Board* on the recommendation of an independent group established by the Board for that purpose. A non-executive member of the *FSA Board* chairs the independent group. The *FSA Board* also appoints all other members of the *RDC*, including its Deputy Chairman or Deputy Chairmen, on the recommendation of the Chairman of the *RDC*.
- 4.2.6** **G** _{/1} All members of the *RDC* are appointed for fixed periods.
- 4.2.7** **G** _{/1} The *FSA Board* may remove a member of the *RDC* but only in the event of that member's misconduct or incapacity.

Constitution and procedure of the RDC

- 4.2.8** **G** _{/1} The *RDC* will meet as a full committee or in panels. Except in an urgent *supervisory notice* case, where the Chairman or a Deputy Chairman and, where possible, any one other member of the *RDC* will make a decision (see *DEC 4.5.7G(2)*), each meeting of the *RDC* will include:
- (1) its Chairman or a Deputy Chairman (who will chair the meeting); and
 - (2) at least two other members.

- 4.2.9** G_{/1} However, the composition and size of panels of the *RDC*, and the frequency of their meetings, may vary depending on the nature of the particular matter under consideration.
- 4.2.10** G_{/1}
- (1) If a member of the *RDC* has a potential conflict of interest in any matter before the *RDC* he will disclose the conflict to the Chairman of the *RDC* (or if he is the Chairman of the *RDC*, to the Chairman or Deputy Chairman of the *FSA*). He will also disclose the conflict to the *RDC* Secretariat.
 - (2) If the Chairman of the *RDC* (or where appropriate the Chairman or Deputy Chairman of the *FSA*) considers it reasonable and appropriate, he will require the member of the *RDC* to stand down from consideration of that particular matter. The Chairman of the *RDC* (or Chairman or Deputy Chairman of the *FSA*) may ask another member of the *RDC* to assist him in considering the potential conflict.
- 4.2.11** G_{/1} The *RDC* Secretariat will record and document all disclosures of potential conflicts of interest and the steps taken to manage them.
- 4.2.12** G_{/1} The meetings of the *RDC* will be in private, and will be conducted in the manner the *RDC* considers suitable in order to enable it to determine fairly the matters which it is required to consider.
- 4.2.13** G_{/1} Each member of the *RDC* present is entitled to vote on the matter under consideration. The Chairman of the meeting of the *RDC* will have a vote as a member of the *RDC* and will have the casting vote in a tie.
- 4.2.14** G_{/1} The *RDC* may require *FSA* staff to attend its meetings.

Consideration of previous breaches

- 4.2.15** G_{/1} *FSA* staff are entitled to put to the *RDC* the previous disciplinary record of a *person*, including any previous breach of the *Act*, the *Principles*, or other *rules* (including the record prior to the *Act*). *FSA* staff may also draw to the *RDC*'s attention the compliance history of a *person*, including that under previous legislation.
- 4.2.16** G_{/1} The *RDC* may not consider any of the matters in *DEC* 4.2.15G for the purpose of proving a later breach. The matters in *DEC* 4.2.15G may be considered when determining whether to take action or, where appropriate, as one of the factors described in *ENF* 13.3.3G, in determining the level of the financial penalty.

Administrative procedure for representations

- 4.2.17** G_{/1} Representations to the *RDC* are received in accordance with *DEC* 4.4.
- 4.2.18** G_{/1} The *FSA* will fix a date or dates for a meeting to consider the representations and to decide:
- (1) whether to take the action proposed;
 - (2) if the action has been taken, whether to rescind the action; and
 - (3) in either case, whether to take the action in a different way.

4.2.19

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The *RDC* Secretariat will ensure that a record is kept of:

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- (1) who took the decision;
- (2) the representations made to the *RDC*;
- (3) the material considered by the *RDC*;
- (4) the nature of the decision;
- (5) the reasons for the decision; and
- (6) the dates on which the decision was taken and then communicated by the *FSA* to the *person* concerned.

4.3 Executive procedure for statutory notice decisions and statutory notice associated decisions

Who makes the decision?

4.3.1

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All *statutory notice decisions* (and *statutory notice associated decisions*) under *executive procedures* are made under authority delegated by the FSA Board. The FSA Chairman's Committee may from time to time determine that particular categories of *statutory notice decision* (and *statutory notice associated decisions*) which may be made by *executive procedures* will be made by a *senior staff committee*. Alternatively, a *senior staff committee* may take such decisions if referred to it by FSA staff (see DEC 4.3.7G(2)). Otherwise, such decisions will be made by an individual FSA staff member.

Separation of functions

4.3.2

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Section 395(2) of the *Act* (The FSA's procedures) requires that the FSA's procedure for the giving of *statutory notices* must be designed to secure that "the decision which gives rise to the obligation to give any such notice is taken by a person not directly involved in establishing the evidence on which that decision is based".

4.3.3

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In accordance with section 395(2) of the *Act*, *statutory notice decisions* taken under *executive procedures* will not be taken by staff directly involved in establishing the evidence on which that decision is based, except in accordance with section 395(3) of the *Act* (see DEC 4.3.17G to DEC 4.3.19G).

Decision making by an individual FSA staff member

4.3.4

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If an individual FSA staff member makes a *statutory notice decision* (or *statutory notice associated decision*) the decision will be:

- (1) made by an executive director of the FSA Board, or his delegate (who will be of at least the level of associate);
- (2) on the recommendation of an FSA staff member of at least the level of associate; and
- (3) with the benefit of legal advice from an FSA staff member of at least the level of associate.

- 4.3.5 **G**_{/1} The individual who takes a decision under *executive procedures* is accountable to the FSA Board directly (if an executive director) or otherwise through line management responsible for the decision concerned.
- 4.3.6 **G**_{/1} An FSA staff member who considers that a *statutory notice decision* (or *statutory notice associated decision*) should be taken above his own level is free to refer that decision to a more senior level. If an FSA staff member consults another staff member about a decision, the decision remains the independent decision of the FSA staff member who consults his colleague, unless it is agreed that the decision should instead be taken by the colleague, and the colleague has the delegated authority to do so.
- 4.3.7 **G**_{/1} If an individual responsible for a decision by *executive procedures* (or a more senior FSA staff member with responsibilities in relation to the decision concerned) considers that it warrants collective consideration, the individual may:
- (1) take the decision himself, following consultation with other FSA staff members, as above; or
 - (2) refer it to a *senior staff committee*, which will take the decision itself.

Decision making by a senior staff committee

- 4.3.8 **G**_{/1} A *senior staff committee* will consist of such FSA staff members as the FSA Chairman's Committee may from time to time determine.
- 4.3.9 **G**_{/1} A *senior staff committee* is accountable for its decisions to the FSA Chairman's Committee, and through it, to the FSA Board.
- 4.3.10 **G**_{/1} A *senior staff committee* may operate through standing or specific sub-committees to consider particular decisions or classes of decision, for which accountability will lie through the committee. Each meeting of a *senior staff committee*, or sub-committee, will include:
- (1) an individual with authority to act as its chairman; and
 - (2) at least two other members.
- 4.3.11 **G**_{/1} A *senior staff committee* will operate on the basis of a recommendation from an FSA staff member of at least the level of associate, and with the benefit of legal advice from an FSA staff member of at least the level of associate.
- 4.3.12 **G**_{/1} If FSA staff recommend action be taken and they consider that the decision falls within the responsibility of a *senior staff committee* (or sub-committee):
- (1) in general, but subject to the need to act swiftly in urgent cases, the FSA staff's recommendation will go before the *senior staff committee* (or sub-committee);
 - (2) in an urgent case, if, in FSA staff's opinion, the action proposed should occur before it is practicable to convene a meeting of the *senior staff committee* (or sub-committee), the FSA staff's recommendation may be considered by the *senior staff committee's* chairman or a deputy chairman and, where possible, but subject to the need to act swiftly, one other member of the *senior staff committee*;
 - (3) in an exceptionally urgent case, if in the FSA staff's opinion:

- (a) the action should be taken before a recommendation to the chairman or a deputy chairman of the *senior staff committee* could be made; and
- (b) an urgent decision on the proposed action is necessary to protect the interests of consumers;

the *FSA* staff's recommendation will be considered and the decision made by a member of the *FSA*'s executive of at least director of division level.

General

4.3.13

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A *statutory notice* given under *executive procedures* will identify the decision maker. A decision to give a *decision notice* or second *supervisory notice* will normally be made by the same decision maker (that is, the individual or committee) who made the decision to give the *warning notice* or first *supervisory notice*.

4.3.14

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If a firm wishes to make representations in response to a *warning notice* or first *supervisory notice*, those representations will be received in accordance with *DEC* 4.4.

4.3.15

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The decision maker will ensure that a record is kept of:

- (1) who took the decision;
- (2) any representations to the decision maker;
- (3) the material considered by the decision maker;
- (4) the nature of the decision;
- (5) the reasons for the decision; and
- (6) the dates on which the decision was taken and then communicated to the *person* or *persons* concerned.

4.3.16

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FSA staff are required by their contract of employment to comply with a code of conduct which imposes strict rules to cover the handling of conflicts of interest which may arise from personal interests or associations. *FSA* staff who are subject to a conflict of interest must declare that interest to the person to whom they are immediately responsible for the decision. In the case of decisions by a *senior staff committee*, any conflict of interest must be declared to the chairman of the committee (or, if the person with the conflict is the chairman, to the *FSA* Chairman's Committee). The individual to whom the conflict of interest is declared will decide whether that conflict precludes the involvement of the *FSA* staff member in making a decision.

Section 395(3) decisions

4.3.17

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Under section 395(3) of the *Act*, the *FSA*'s procedure may permit a decision which gives rise to an obligation to give a *supervisory notice* to be taken by a person involved in establishing the evidence on which the decision is based if:

- (1) the *FSA* considers that, in a particular case, it is necessary in order to protect the interests of consumers; and
- (2) the person taking the decision is of a level of seniority laid down by the procedure.

4.3.18

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The *FSA* expects to exercise the power provided by section 395(3) only in exceptional cases. This means cases in which the *FSA* believes action is needed to protect the interests of consumers in the face of a material threat to those interests, but in which the requirements for separation cannot be met: for example where the notice needs to take immediate effect in order to protect the interests of consumers.

4.3.19

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The level of individual who may make such a decision is a member of the *FSA*'s executive of at least director of division level or a member of a committee which reports directly to the *FSA* Chairman's Committee.

4.4 Representations

- 4.4.1** G_{/1} (1) Any *warning notice* or first *supervisory notice* will contain a statement that the *person* concerned will have a certain amount of time in which to make representations to the decision maker. In the case of a first *supervisory notice* the *person* concerned may make representations whether or not the matter to which the notice relates has been referred to the *Tribunal*.
- (2) If a second *supervisory notice* is given where the decision maker has decided to take action different from that which was proposed in the first *supervisory notice*, the second *supervisory notice* will provide a similar statement about the right to make representations.
- 4.4.2** G_{/1} In the case of a *warning notice*, section 387(2) of the *Act* requires that the *warning notice* must specify a reasonable period for the making of representations. This must be at least 28 days. The *Act* does not specify a minimum period that the *FSA* must give for making representations for *supervisory notices*.
- 4.4.3** G_{/1} In deciding on the period to make representations, the decision maker will have regard to the circumstances of each case, including the nature of the proposed action and its likely effect on the *person* concerned. The decision maker will have particular regard to the risk to the *FSA's regulatory objectives* of any delay in imposing proposed action. The period for representations will normally be 28 days from the date when the *person* receives the notice, subject to his right to seek an extension of time.
- Request for an extension of time**
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- 4.4.4** G_{/1} (1) After receiving the *warning notice* or first *supervisory notice*, if the *person* concerned considers that its stated period for representations is too short, then he may, within 14 days of receiving the notice, request the *FSA* in writing for more time. In the case of a *warning notice*, this may be appropriate, for example, if a *person* has entered or wishes to enter into settlement discussions with *FSA* staff.
- (2) In accordance with section 387(3) of the *Act* and other relevant sections of the *Act*, the decision maker may extend the period of time for representations specified in the *warning notice* or *supervisory notice*.
- 4.4.5** G_{/1} Requests for an extension of time will be considered by the decision maker who will notify the recipient of the notice promptly whether the request has been accepted or not.

Written representations

- 4.4.6 **G**_{/1} Any written representations should be sent to the *FSA* at the address stated in the *warning notice* or *supervisory notice*.

Oral representations

- 4.4.7 **G**_{/1} If he so chooses, a *person* who receives a *warning notice* or first *supervisory notice* may make oral representations to the decision maker and attend a meeting for that purpose.

- 4.4.8 **G**_{/1} If the *person* wishes to make oral representations he should send a written notification of this to the *FSA* at the address stated in the *warning notice* or *supervisory notice*. The notification should be made at least five *business days* before the end of the period for representations specified in the notice. The notification should specify the matters on which the *person* wishes to make oral representations, include an estimate of how much time the *person* expects the representations to take, and provide the names of any legal representatives appointed to attend the meeting at which the representations will be made. If after notifying the *FSA* of his intention to make oral representations, the *person* chooses not to make those representations, the decision maker will nevertheless decide the matter.

- 4.4.9 **G**_{/1} A *person* may appoint a representative of his choice (who may be legally qualified) to attend the meeting at which oral representations will be made. The representative may make or assist in making the representations.

- 4.4.10 **G**_{/1} The decision maker will specify a time as soon as is reasonably possible after receiving the notification for receiving the oral representations. The decision maker may specify the place where he will receive the representations and may specify that the representations will be received in private. The decision maker may limit the type, length and content of any representations. The decision maker may ask the *person* or his representative at the meeting to clarify any issue arising out of the representations and may require the *person*, and any representatives, to leave the meeting after they have made their representations.

- 4.4.11 **G**_{/1} *DEC 4.4.13G* and *DEC 4.4.14G* explain the procedure where no representations are received or made.

Third parties

- 4.4.12 **G**_{/1} *DEC 4.4* applies also to a third party who has received a copy of a *warning notice*, in relation to those matters affecting the third party.

Default procedures

- 4.4.13 **G**_{/1} If the *FSA* receives no response or representations by the time a decision is to be made about the giving of the *decision notice* or second *supervisory notice*, the decision maker may regard as undisputed the allegations or matters in the *warning notice* or first *supervisory notice*. In such cases, a *decision notice* or second *supervisory notice* will be given accordingly. A *person* who has received a *decision notice* or second *supervisory notice* and has not previously made any response or

representations to the *FSA*, may, nevertheless, refer the *FSA*'s decision to the *Tribunal* as described in *DEC 5.1*.

4.4.14

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In exceptional cases, the decision maker may permit representations from a *person* who has received a *decision notice* (or a second *supervisory notice*) given in accordance with *DEC 2.3* (or *DEC 3.1.8G* to *DEC 3.1.10G*), and shows on reasonable grounds that he did not receive the *warning notice* (or first *supervisory notice*), or that he had reasonable grounds for not responding within the specified period. In these circumstances, the decision maker may decide to give a *notice of discontinuance* (*DEC 2.3.8G* to *DEC 2.3.9G*) or a further *decision notice* (or a written notice or a *supervisory notice*).

4.5 Delegation of RDC decisions and modified RDC procedures

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The making of the following types of *statutory notice decisions* and *statutory notice associated decisions* falling within DEC 4.1.4G (Decisions to be taken by the RDC) will be discharged, on behalf of the RDC, by the Chairman of the RDC or FSA staff, so that they will be made by modified rather than full RDC procedure:

- (1) in relation to *warning notices* and *decision notices*:
 - (a) those relating to financial penalties for late submission of reports (see DEC 4.5.2G to DEC 4.5.6G);
 - (b) those relating to the revocation of recognition of section 270 or 272 *recognised schemes*, where there is a common understanding between the scheme management and the FSA about the need for revocation (see DEC 4.5.14G to DEC 4.5.15G);
- (2) in relation to *supervisory notices*:
 - (a) those involved in taking urgent action by *supervisory notice* (see DEC 4.5.7G and DEC 4.5.8G);
 - (b) those relating to the use of the FSA's *own-initiative power* and other cases involving the imposition of *requirements*, where there is a common understanding between the FSA and the *person* concerned about the need for the action (see DEC 4.5.9G to DEC 4.5.13G).

Financial penalties for late submission of reports

4.5.2

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When the FSA decides whether to impose a financial penalty on a *firm* for the late submission of a report (regardless of the period of delay), FSA staff will report on the late submission to at least one other member of staff who is:

- (1) at a level senior to that of the member of staff who reports on the late submission and on the reasons for it; and
- (2) not directly involved in the day-to-day supervision of the *firm* concerned.

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FSA staff at the appropriate level of seniority will consider the report about the late submission. They will then decide whether a financial penalty is appropriate and, if so, its amount. If they decide a penalty is appropriate, the FSA will give a *warning notice*.

4.5.4 G_{/1} If the *firm* makes representations in relation to the penalty stated in the *warning notice*, the matter will be referred to the Chairman or Deputy Chairman of the RDC. The Chairman or Deputy Chairman of the RDC will decide whether to confirm the penalty stated in the *warning notice* or that the penalty should be of a different amount and, if so, give a *decision notice*.

4.5.5 G_{/1} If the *firm* makes no representations, FSA staff at the appropriate level of seniority will decide whether to confirm their original decision and, if so, will then give a *decision notice*.

4.5.6 G_{/1} If the *firm* objects to the *decision notice*, it may refer the matter to the *Tribunal*. The right to refer a matter to the *Tribunal* is outlined in DEC 5.1.

Supervisory notices: urgent cases

4.5.7 G_{/1} If FSA staff recommend action be taken and they consider that the decision is the RDC's responsibility:

- (1) in general, but subject to the need to act swiftly in urgent cases, the FSA staff's recommendation will go before an RDC panel;
- (2) in an urgent case, if, in FSA staff's opinion, the action proposed should occur before it is practicable to convene an RDC panel, the FSA staff's recommendation will be considered by the RDC's Chairman or a Deputy Chairman of the RDC and, where possible, but subject to the need to act swiftly, one other RDC member;
- (3) in an exceptionally urgent case, where in the FSA's opinion:
 - (a) the action should be taken before a recommendation to the Chairman of the RDC can be made; and
 - (b) an urgent decision on the proposed action is necessary to protect the interests of consumers;

the FSA staff's recommendation will be considered by a member of the FSA's executive of at least director of division level. In these circumstances, the FSA will ensure as far as possible that the executive making the decision was not involved in establishing the evidence on which the decision is based.

4.5.8 G_{/1} If the executive making the decision has been involved in establishing the evidence on which the decision is based, and a notice is given on the grounds of urgency, this will be in accordance with DEC 4.3.17G to DEC 4.3.19G.

Supervisory notices: non-urgent cases

4.5.9 G_{/1} In certain other cases, including cases relating to *collective investment schemes* (see DEC 4.5.14G to DEC 4.5.15G), FSA staff may be in a position to inform the *person* concerned of their concerns, and of the action they are considering, before they begin to exercise *supervisory notice* procedures. If the *person* concerned consents to the action at that stage, FSA staff may decide to use the modified decision making procedure in DEC 4.5.10G to DEC 4.5.13G.

- 4.5.10** G_{/1} FSA staff will make recommendations for action to at least one other member of staff who is:
- (1) at an appropriate level of seniority; and
 - (2) not directly involved in the supervision of the *person* concerned, or in establishing the evidence on which the decision is based.
- 4.5.11** G_{/1} FSA staff at the appropriate level of seniority will consider the recommendations. If they are satisfied that the *person* concerned agrees to the recommended action, they will consider whether the FSA should give a first *supervisory notice* (see DEC 3.1.3G to DEC 3.1.7G).
- 4.5.12** G_{/1} If FSA staff decide to give the first *supervisory notice* and the *person* concerned accepts its terms, the FSA will then consider whether to give a second *supervisory notice* (see DEC 3.1.8G to DEC 3.1.10G) confirming the decision.
- 4.5.13** G_{/1} The FSA will only give the second *supervisory notice* when it is satisfied that the *person* concerned accepts the terms of the first *supervisory notice*, and the circumstances of the case have not materially changed since that notice was given. If FSA staff are not satisfied, or circumstances of the case have changed, they will refer the possible giving of a second *supervisory notice* to the RDC. In such cases the RDC will follow the process in DEC 3.1.8G to DEC 3.1.10G.

Modified procedures in collective investment scheme cases

- 4.5.14** G_{/1} In DEC 4.5.15G, the term "scheme management" refers:
- (1) in relation to an AUT, to the *manager* and *trustee*;
 - (2) in relation to an ICVC, to the *directors* and the *depository*;
 - (3) in relation to a *recognised scheme*, to the operator, and (if any) the *trustee* or *depository*.
- 4.5.15** G_{/1} In certain cases where it is proposing to exercise its powers under section 257 (Directions), 279 (Revocation of recognition) or 281 (Directions) of the *Act* or under regulation 23 or 25 of the *OEIC Regulations*, the FSA may be in a position to inform the scheme management of its concerns, and of the action it is considering, before it exercises those powers. Alternatively, the scheme management may request the FSA to exercise one of the powers. For example, the *manager* and the *trustee* of an AUT may ask the FSA to give a direction under section 257(2)(a) for the suspension of the *issue* and *redemption* of *units* because of a temporary problem in valuing the property subject to the *scheme*. If there is a common understanding between the FSA and all the members of the scheme management about the need for the exercise of the power in question at that stage (that is, before the FSA begins to exercise the statutory procedures), the FSA may:
- (1) in the case of the exercise of its powers under sections 257 or 281 or under regulation 25, decide to use the modified decision making procedure for non-urgent *supervisory notices* in DEC 4.5.9G to DEC 4.5.13G; or
 - (2) in the case of the exercise of its powers under section 279 or regulation 23, decide to use a modified decision making procedure under which the matter will be delegated to FSA staff of an appropriate level of seniority. The

procedure will be as set out in *DEC 4.5.9G* to *DEC 4.5.13G* but adapted to be appropriate for a case involving a *warning notice* and *decision notice*.

4.6 Decisions to apply to the civil courts and powers to prosecute criminal offences

4.6.1 **G**_{/1} A decision to begin, or discontinue, proceedings using the powers listed in *DEC 1.1.3G* will be made by the *RDC* Chairman or, in an urgent case and if the Chairman is not available, by an *RDC* Deputy Chairman and where possible, but subject to the need to act swiftly, one other *RDC* member.

4.6.2 **G**_{/1} In an exceptionally urgent case the matter will be decided by the director of Enforcement or, in his absence, another member of the *FSA*'s executive of at least director of division level. An exceptionally urgent case in these circumstances is one where *FSA* staff believe that a decision to begin proceedings using the powers in *DEC 1.1.3G*:

- (1) should be taken before it is possible to follow the procedure described in *DEC 4.6.1G*; and
- (2) is necessary to protect the interests of consumers or potential consumers.

4.6.3 **G**_{/1} Decisions to bring proceedings using the powers in *DEC 1.1.3G* do not involve any of the procedures relating to the giving of *statutory notices* including the procedures described in *DEC 4.4* relating to representations. Further details about the *FSA*'s policy and procedures in the use of the powers to apply to the civil courts for *injunctions*, restitution orders, *insolvency orders*, *collective investment scheme* related orders and the powers to prosecute criminal offences are contained in *ENF 6* (Injunctions), *ENF 9* (Restitution and redress), *ENF 10* (Insolvency proceedings and orders against debt avoidance), *ENF 16* (Collective investment schemes) and *ENF 15* (Prosecution of criminal offences) respectively.

Chapter 5.

References to the Tribunal, publication and service of notices

5.



5.1 The Tribunal

- 5.1.1** G_{/1} (1) A *person* who receives a *decision notice* or *supervisory notice* (including a third party who has been given a copy of a *decision notice*) has the right to refer the *FSA's* decision to the *Tribunal*.
- (2) The *Tribunal* is established under Part IX of the *Act* (Hearings and Appeals) and is governed by Part IX and Schedule 13 to the *Act* (The Financial Services and Markets Tribunal). The *Tribunal* is independent of the *FSA* and appointed by the Lord Chancellor's Department in accordance with the Financial Services and Markets Tribunal Rules 2001 ("the Tribunal rules").
- 5.1.2** G_{/1} Under section 133(1) of the *Act* (Proceedings: general provisions), any reference to the *Tribunal* must be made within 28 days of the date on which the *decision notice* or *supervisory notice* is given, or within any period prescribed by the *Tribunal* rules. Under section 133(2) of the *Act*, the *Tribunal* rules may allow a reference to be made after the end of the 28 day period.
- 5.1.3** G_{/1} A reference to the *Tribunal* will be a full rehearing of the matter that gave rise to the decision referred to the *Tribunal*. On a reference the *Tribunal*:
- (1) must determine what (if any) is the appropriate action for the *FSA* to take in relation to the matter referred (section 133(4)); and
- (2) may consider any evidence relating to the subject-matter of the reference, whether or not it was available to the *FSA* at the time the *FSA* took its decision.
- 5.1.4** G_{/1} In determining a reference:
- (1) made as a result of a *decision notice*, the *Tribunal* may not (section 133(6)) direct the *FSA* to take action which the *FSA* would not, as a result of section 388(2) of the *Act* (Decision notices), have had the power to take when giving the *decision notice*;
- (2) made as a result of a *supervisory notice*, the *Tribunal* may not (section 133(7)) direct the *FSA* to take action which would otherwise have required the giving of a *decision notice*.
- 5.1.5** G_{/1} On determining a reference, the *Tribunal*:
- (1) must (section 133(5)) remit the matter to the *FSA* with such directions (if any) as the *Tribunal* considers appropriate for giving effect to its determination; and
- (2) may make recommendations as to the *FSA's* regulating provisions or its procedures.

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Under section 133(9) of the *Act*, the *FSA* must not take any action specified in a *decision notice* during the period within which a reference may be made to the *Tribunal*. Nor may it take such action, if the matter is referred, until the reference, and any appeal against the *Tribunal's* decision, has been finally disposed of.

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The *FSA* is required to act in accordance with the determination of, and any direction given by, the *Tribunal* and an order of the *Tribunal* will be enforceable as if it were an order of the county court or, in Scotland, as if it were an order of the Court of Session.

5.2 Publication

Publication of final notices and effective supervisory notices

- 5.2.1** **G**_{/1} Section 391(4) and (5) of the *Act* (Publication) provides that the *FSA* must publish such information about the matter to which a *final notice*, or *supervisory notice* that has taken effect, relates, as it considers appropriate. See also *DEC 5.2.3G*.

Publication of notices of discontinuance

- 5.2.2** **G**_{/1} If the *FSA* has given a *notice of discontinuance*, the *FSA* may, if the *person* to whom the notice is given consents, publish such information as it considers appropriate about the matter to which the discontinued proceedings related (section 391(2) of the *Act*). Similarly, section 391(3) of the *Act* indicates that where a *notice of discontinuance* has been copied to a *person*, the *FSA* may, if the *person* to whom the notice is copied consents, publish such information as it considers appropriate about the matter to which the discontinued proceedings related, so far as relevant to that *person*. See also *DEC 5.2.3G*.

No publication if unfair or prejudicial

- 5.2.3** **G**_{/1} Section 391(6) of the *Act* provides that the *FSA* may not publish information relating to a *final notice*, *supervisory notice* that has taken effect or *notice of discontinuance* if publication would, in the *FSA*'s opinion, be unfair to the *person* with respect to whom the action was taken or prejudicial to the interests of consumers.

Warning and decision notices: no publication

- 5.2.4** **G**_{/1} Section 391(1) of the *Act* provides that neither the *FSA* nor any other *person* to whom a *warning notice* or *decision notice* is given or copied may publish the notice or any details concerning it.

Manner of publication

- 5.2.5** **G**_{/1} Section 391(7) of the *Act* provides that information which is published may be published in such a manner as the *FSA* considers appropriate. The *FSA* will

consider the particular circumstances of each case in deciding what manner of publication will be appropriate.



5.3 Service of notices by the FSA

Service of Notices Regulations

5.3.1 G_{/1} The Financial Services and Markets Act 2000 (Service of Notices) Regulations 2001 (SI 2001/1420) govern service of *statutory notices* and other notices and *documents* which must be served by the FSA under the *Act*.

Methods of service by the FSA and deemed receipt

5.3.2 G_{/1} The methods by which the FSA may give a notice under the Regulations and the day on which it is deemed to be received, are set out in DEC 5.3.3G.

5.3.3 G_{/1} Table Methods of service of notices by the FSA

Method	Deemed day of receipt
(1) delivery of the notice to the recipient	not applicable: it is received when delivered
(2) leaving the notice at the recipient's proper address (as defined in the Regulations)	the business day after it is left at that address
(3) <i>posting</i> the notice to that address	if the notice is <i>posted</i> to an address in the <i>United Kingdom</i> , the second business day after <i>posting</i> if the notice is <i>posted</i> to an address in any <i>EEA State</i> (other than the <i>United Kingdom</i>), the fifth business day after <i>posting</i>
(4) transmitting the notice by fax if the recipient has indicated in writing that he is willing to receive the notice by such means and a follow-up copy is sent by another method by the end of the following business day	the business day after the day on which the document is transmitted
(5) transmitting the notice by any other electronic means of communication, if the recipient has indicated in writing that he is willing to receive the notice by such means	the business day after the day on which the document is transmitted

5.3.4 G_{/1} The Regulations also make provision for the service of notices on:

- (1) the recipient's nominee;
- (2) if the recipient is an *appointed representative*, on his *principal*; and

(3) if the recipient is not an individual, to particular *persons* on its behalf.

Meaning of "business day"

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In the Regulations and DEC 5.3.3G, "business day" means any day except Saturday, Sunday or a bank holiday, where "bank holiday" includes Christmas Day and Good Friday.

5.

Appendix 1

Settlement procedure and mediation scheme for FSA disciplinary cases

1.1 Introduction

- 1.1.1** G_{/1} A *person* who is or may be subject to enforcement action may discuss the proposed action with *FSA* staff through settlement discussions. Settlement discussions take place on an informal basis after the *FSA* has given a *warning notice*. Where *FSA* staff have recommended that disciplinary action be taken against a *person*, the mediation scheme will be available to those *persons* against whom action is proposed after settlement discussions have broken down. This appendix sets out the procedure for settlement and the framework of the mediation scheme.

1.2 Settlement

- 1.2.1** G_{/1} If a *person* who is or may be subject to enforcement action wishes to discuss the proposed action with *FSA* staff on an informal basis, he may do so after the *FSA* has given the *warning notice*. The *warning notice* will contain details of the person to contact for these purposes. (There is no bar on discussions at an earlier stage, but they are likely to be less productive until the *FSA* has given the *warning notice* to the *person* concerned.) The *FSA* and the *person* concerned should agree that discussions will take place on a "without prejudice" basis, and that neither party may subsequently rely on admissions or statements made in the context of the discussions, or *documents* recording the discussions.

- 1.2.2** G_{/1} The terms of any proposed settlement will:
- (1) be put in writing and be agreed by *FSA* staff and the *person* concerned;
 - (2) include a statement of the facts and any breaches admitted by the *person* concerned and the proposed action to be taken; and
 - (3) be considered by the *RDC*.

- 1.2.3** G_{/1} Having considered the terms of the proposed settlement, the *RDC* may ask to meet the relevant *FSA* staff or the *person* concerned in order to assist in its consideration of the proposed settlement. The *RDC* may:

- (1) accept the proposed settlement by issuing a *decision notice* or (where appropriate) *notice of discontinuance* based on the terms of the settlement; or
- (2) decline the proposed settlement;

whether or not the *RDC* has met with the relevant *FSA* staff or the *person* concerned.

1.2.4 /1 Where the *RDC* declines the proposed settlement, it may invite *FSA* staff and the person concerned to enter into further discussions to try to achieve a settlement. The *RDC* may extend the period for representations (if they have not already done so), or, if representations have already been made, the *RDC* will proceed to give a decisions notice.

1.2.5 G /1 If it is not possible to reach an agreed proposed settlement of the case by informal discussions, the *person* concerned may elect to submit the case to mediation.

1.3 Mediation

1.3.1 G /1 Mediation is a confidential without prejudice dispute resolution process in which a neutral mediator assists the parties in trying to settle their differences. The mediator is not a judge or arbitrator and has no power to bind the parties, but rather operates as a facilitator of the discussions.

1.3.2 G /1 As mediation will be on a "without prejudice" basis, admissions made by the parties in the course of the mediation and documents prepared for the purposes of the mediation may not be referred to in subsequent proceedings relating to the dispute if the mediation is unsuccessful. However, if the mediation results in a proposed settlement of the dispute which is approved by the *RDC*, the terms of the proposed settlement will form the basis of a *decision notice*, and subsequent *final notice*, or (where appropriate) *notice of discontinuance*, given by the *FSA*.

1.3.3 G /1 Following the issue of a *warning notice* the *person* will have access to certain material on which the *FSA* has relied in deciding to commence disciplinary proceedings (see *DEC* 2.4.2G). The period following the issue of the *warning notice* is therefore a natural point for informal settlement discussions to take place in an attempt to resolve the matter. Mediation is intended to supplement those discussions where the parties consider that the involvement of a neutral mediator is required to facilitate further progress.

1.4 Scope of mediation scheme

1.4.1 G /1 Mediation will be available in enforcement cases involving disciplinary matters and *market abuse*, subject to the exceptions set out in *DEC* App 1.4.2G.

- 1.4.2** **G** /1 Mediation will not be available in:
- (1) cases involving allegations of a criminal offence or offences; or
 - (2) cases involving allegations of unfitness or impropriety based on judgements about dishonesty or lack of integrity; or
 - (3) cases involving the exercise of the *FSA's own-initiative powers* on a variation of *permission*.

- 1.4.3** **G** /1 In each appropriate enforcement case (see *DEC App 1.4.1G* and *1.4.2G*), the mediation scheme will be available to the *person* against whom a *warning notice* is issued. The mediation scheme will be available after the *warning notice* has been issued and before the *RDC* issues a *final notice*. The relevant *warning notice* will state the circumstances in which mediation is available for that matter under the terms of the scheme.

- 1.4.4** **G** /1 The *person* is not obliged to submit his case for mediation.

1.5 Mediation provider

- 1.5.1** **G** /1 The scheme will be administered by a body (the mediation provider) which:
- (1) is independent of the *FSA*;
 - (2) provides a panel of experienced mediators who are independent of the *FSA*; and
 - (3) has suitable expertise of and experience in the administration of mediation schemes.

1.6 Starting the mediation

- 1.6.1** **G** /1 The *FSA* will offer the mediation facility in all appropriate enforcement cases (see *DEC App 1.4.1G*). If the *person* agrees to submit the case to mediation, the parties will send a joint mediation notice in an agreed form to:
- (1) the mediation provider; and
 - (2) the secretary to the *RDC*.

- 1.6.2** **G** /1 The mediation notice will commit each party to use their best endeavours to progress the mediation process in a timely manner.

1.6.3 G_{/1} The *person* may request in the mediation notice that the time period specified in the *warning notice* for making oral or written representations (or both) to the *RDC* be extended by a maximum of 14 days, to allow time for the mediation to be completed. On receipt of a mediation notice requesting such an extension, the *RDC* will notify the parties and the mediation provider of its agreement to the requested extension or of any other extension that it sees fit.

1.6.4 G_{/1} If required, the *person* may apply to the *RDC* for a further extension in order to complete the mediation (see *DEC App 1.7.5G*). The total of all extensions to the 28 day time period for making written or oral representations may not exceed 28 days, other than in exceptional circumstances.

1.7 **Setting up the mediation**

1.7.1 G_{/1} Once the parties have agreed to mediate, and a mediation notice has been sent to the mediation provider, the mediation provider will liaise with the parties in order to deal with the matters set out in *DEC App 1.7.2* to *1.7.11*.

Appointment of mediator

- 1.7.2** G_{/1}
- (1) The mediation provider will maintain a panel of suitable mediators, and recommend in each case a mediator to the parties. The parties are free to accept or decline the recommendation. If either party declines the recommendation, the mediation provider will seek to obtain agreement on another mediator from the panel.
 - (2) If the parties cannot agree a mediator within 7 days of the mediation notice being received by the mediation provider, the mediation provider will appoint a mediator.
 - (3) The mediators on the panel will all be:
 - (a) experienced commercial mediators; and
 - (b) accredited by or registered with a recognised mediation organisation.
 - (4) Experience of and expertise in the financial services sector will not be compulsory for panel mediators, but may be desirable.
 - (5) Mediators will, in accepting appointments, be required to confirm to the parties that they have no conflicts of interest in doing so.

Date for mediation

- 1.7.3** G_{/1}
- (1) a suitable date for the mediation; and

- (2) a timetable for the mediation process as a whole, including the date for submission of case summaries and exchange of *documents* referred to in the case summaries.

Duration of mediation

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- (1) Most mediations should last no longer than one full day, but in complex cases more time may be necessary. The mediator will assist the parties in deciding how much time to set aside. If the mediation requires more time than allotted to it, the parties may ask the mediation provider to set up a further day or days.
- (2) The parties and the mediator will use their best endeavours to complete the mediation as soon as practicable.

Mediation timetable

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- (1) In complex cases, the agreed timetable may extend beyond the initial extension agreed by the *RDC*, in which case the parties may request a further extension from the *RDC* (see *DEC* App 1.6.4G).
- (2) If the mediation has not started within the allotted timetable, the *FSA* may decline to mediate, and the matter will be referred to the *decision notice* stage.

Venue

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The mediation may take place at any venue acceptable to the parties and the mediator. This may be at the offices of the mediation provider, the mediator (if different), the *FSA* or elsewhere.

Mediation agreement

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- (1) Each mediation will take place in accordance with the terms of a mediation agreement. The agreement will set out the terms on which the mediation will take place, in particular, the agreement will provide that:
- (a) the mediation will be on a “without prejudice” basis and confidential; and
 - (b) the parties who attend the mediation will have authority to agree proposed settlement terms (subject, in relation to the *FSA* staff, to App 1.7.9G).
- (2) The mediation agreement will be signed by the parties, the mediator and the mediation provider.

Confidentiality

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- (1) Confidentiality is a key element of the mediation process. It means that:

- (a) matters disclosed in, and documents created for the purposes of, the mediation cannot be referred to in the public domain; and
 - (b) matters disclosed by one party to the mediator in confidence will not be disclosed to the other party without consent.
- (2) Under the mediation scheme, however, confidentiality will be limited in that:
- (a) if any information indicating potentially criminal conduct is disclosed to the mediator, the mediator will not be required to keep that matter confidential (and may choose to terminate the mediation);
 - (b) the terms of any settlement reached will, if approved by the *RDC*, be incorporated in a *decision notice*, and subsequent *final notice*, or (where appropriate) *notice of discontinuance* which may be made public;
 - (c) the *FSA* may publish information regarding the operation of the scheme on an anonymous basis in the *FSA's* annual report; such information may include, for example, the number of mediations conducted under the scheme and the number of those mediations which have resulted in agreed settlements.
- (3) In all other respects, documents prepared for the purposes of, and discussions taking place in the course of, the mediation will retain the confidential status they had during the mediation itself.

Authority to settle

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- (1) A key feature of mediation is the requirement that those who attend the mediation on behalf of each party have full authority to agree proposed settlement terms. In general, the *FSA's* decision making procedure for regulatory enforcement cases requires that the *RDC* approve any decision to take or refrain from taking disciplinary action. (The exception is some cases involving late submission of reports, see *DEC 4.5.2G* to *DEC 4.5.6G*) Therefore, the *RDC* must approve any proposed settlement terms agreed at the mediation.
- (2) The *FSA* will be represented during the mediation proceedings and at the mediation itself by the *FSA* staff who initially recommended that disciplinary action be taken. In order to minimise the risk that the proposed settlement terms agreed at the mediation will not be approved, the *FSA* will endeavour to ensure that the relevant members of the *RDC*, or as many of its relevant members as possible, are available for consultation by telephone during the mediation. This is to enable a clear indication to be given to the parties and the mediator whether the *RDC* will find the proposed settlement terms acceptable.
- (3) However, no involvement of the *RDC* in the mediation will in any way compromise its right subsequently to decline to approve the settlement terms.
- (4) If the *RDC* decides to decline to approve the settlement terms agreed at the mediation, the parties may, with the consent of the *RDC*, return to the mediation process if they wish to explore further settlement options. If they do, the *RDC* will ensure that its views are clearly stated as to why the terms previously agreed were not acceptable.

Paperwork for the mediation

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- (1) Mediation requires the parties to be able to discuss the dispute in an informed way. Therefore, each party attending the mediation will be required to produce:
 - (a) a short case summary setting out the issues in dispute; and
 - (b) any documents referred to in the case summary.
- (2) These documents must be submitted to the mediation provider in triplicate at least one week before the mediation. The mediation provider will be responsible for the exchange of documents.
- (3) The parties and the mediator may agree to dispense with the requirement to produce documentation before the mediation.

Costs

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- (1) The costs of the mediation provider in administering and conducting the mediation process (including the fee payable to the mediator) will be agreed between the *FSA* and the mediation provider when the mediation provider is appointed.
- (2) For each mediation, the mediation provider will invoice the parties for the anticipated costs of administering and conducting the mediation in advance. The *FSA* and the *person* will bear half of these costs each. Any additional costs incurred by the mediation provider will be invoiced after the mediation. These costs will also be shared. The costs referred to in (1) and (2) do not include legal or other costs that the *FSA* or *person* may incur in relation to the mediation, which will be the responsibility of the parties.

1.8

Preliminary meeting

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Once appointed, the mediator may (in his discretion) call a preliminary meeting with the parties and their advisers (if any). This may be used to ensure that the parties are properly prepared for the mediation, agree the issues for discussion and understand how the process will operate.

1.9

Termination of the mediation

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The mediation will take place at the agreed time and place.

- 1.9.2** G_{/1} If the *person* withdraws from the mediation process after it has agreed to mediate, it will be responsible for its share of any costs incurred by, or owing to, the mediation provider (see *DEC App 1.7.11G (1)*).
- 1.9.3** G_{/1} The mediation agreement will set out the terms on which a party or the mediator, or both, may terminate the agreement. These will include terms providing that:
- (1) either party may withdraw from and terminate the mediation at any stage before or during the mediation (subject to the provisions on costs in *DEC App 1.9.2G*, for terminations before the mediation takes place);
 - (2) either party or the mediator may withdraw if the mediation has not taken place within the agreed timetable; and
 - (3) the mediator may withdraw from and terminate the mediation if, for example, a criminal *offence* by or involving a party to the mediation is disclosed to him (see *DEC App 1.7.8G (2)(a)*).

1.10 Result of the mediation

- 1.10.1** G_{/1} Mediation can only give rise to one of two outcomes:
- (1) a proposal for settlement agreed between the parties; or
 - (2) no agreed proposal.
- 1.10.2** G_{/1} If no agreed proposal is reached, the mediation will be terminated and the case will proceed to the *decision notice* stage.
- 1.10.3** G_{/1} If a settlement proposal is agreed, it will be considered by the *RDC*, which will decide whether to approve it. If it is approved, a *decision notice*, and subsequently a *final notice*, will be issued reflecting the terms of the agreement reached. If it is not approved, the parties may return to the mediation only with the *RDC's* consent. If the *RDC* does not consent, the case will continue towards the *decision notice* stage.

1.11 Advisers

- 1.11.1** G_{/1} The parties may bring legal or other advisers of their choice with them to the mediation, although it is important to preserve the informality of the mediation process.

1.12**Review of mediation procedures****1.12.1****G**

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The use of mediation in the disciplinary context is a novel approach in the area of financial regulation, but reflects current trends in civil litigation. The *FSA* proposes to operate the mediation scheme on a pilot basis for one year and monitor it and review its operation at the end of that period. The *FSA* proposes to publish core information relating to the operation of the scheme in the *FSA's* Annual Report.

Handbook Modules

Schedule1 Record keeping requirements

G

- 1 There are no record-keeping requirements in DEC.

Handbook Modules

Schedule2 Notification requirements

G

- 1 There are no notification or reporting requirements in DEC.

Handbook Modules

Schedule3 Fees and other required payments

G

- 1 There are no requirements for fees or other payments in DEC.

Handbook Modules

Schedule4 Powers exercised

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1 The following powers in the Act have been exercised by the FSA to issue the statement of procedure and give the guidance in DEC:

(1) Section 157(1) (Guidance)

(1) Section 395(5) (The Authority's procedures)

Handbook Modules

Schedule5 Rights of action for damages

G

- 1 There are no rules in DEC.

Handbook Modules

Schedule6 Rules that can be waived

G

- 1 There are no rules in DEC.

Decision making manual

Derivations

G

There is no table of derivations for *DEC*.

Decision making manual

Destinations

G

There is no table of destinations for *DEC*.

COLLECTIVE INVESTMENT SCHEMES SOURCEBOOK INSTRUMENT 2001

- A. The Financial Services Authority makes the rules, gives the guidance and makes the directions and requirements in the Annex to this instrument (“CIS”) in the exercise of the powers listed in Schedule 4 to CIS (Powers exercised).
- B. This instrument shall come into force as follows:
- (1) CIS 16 (Application and notification) and CIS 17 (Recognised schemes): at the beginning of the first day on which section 40 (Application for permission) of the Financial Services and Markets Act 2000 (the "Act") comes into force for any purpose;
 - (2) other parts of CIS: at the beginning of the day on which section 19 of the Act (The general prohibition) comes into force;
 - (3) paragraphs A to E on this page : immediately.
- C. The provisions of the Act relevant to making rules and listed in Schedule 4 to CIS (Powers exercised) are specified for the purpose of section 153(2) of the Act (Rule-making instruments).
- D. This instrument may be cited as the Collective Investment Schemes Sourcebook Instrument 2001.
- E. The Annex to this instrument (including its Schedules) may be cited as the Collective Investment Schemes sourcebook (or CIS).

By order of the Board
21 June 2001

ANNEX

Collective Investment Schemes



Contents

Transitional provisions

Text of CIS:

1	Introduction: Collective investment schemes sourcebook
2	Constitution
3	Prospectus
4	Single-pricing and dealing
5	Investment and borrowing powers
6	Title, transfer and plan registers
7	Powers and duties
8	Charges and expenses
9	Income
10	Report and Accounts
11	Meetings of holders, amendments to the scheme and service of notices
12	Special provisions for certain categories of scheme
13	Suspension and resumption of dealings
14	Termination of Authorised funds
15	Dual-pricing and dealing
16	Application and Notification
17	Recognised schemes
18	Fees *

Schedule 1: Record keeping requirements

Schedule 2: Notification requirements

Schedule 3: Fees and other required payments *

Schedule 4: Powers exercised

Schedule 5: Rights of action for damages

Schedule 6: Rules that can be waived

Derivations

Destinations

[* These parts of CIS will be added later]

Handbook Modules

CIS Sourcebook - Transitional Provisions

1 Table Transitional Provisions

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1	<i>CIS</i>	R	In these transitional rules, “the previous regulations” means The Financial Services (Regulated Schemes) Regulations 1991 and The Financial Services (Open-Ended Investment Companies) Regulations 1997.	<i>Commencement</i>	<i>Commencement</i>
2	<i>CIS 2</i>	R	In relation to any <i>authorised fund</i> in existence on the <i>day</i> before <i>commencement</i> there is no obligation to revise the <i>instrument constituting the scheme</i> as a result of the application of the <i>rules</i> in <i>CIS</i> until the earlier of: <ul style="list-style-type: none"> (1) the first <i>day</i> on or after <i>commencement</i> on which the <i>instrument constituting the scheme</i> is first amended; (2) the <i>day</i> one year following <i>commencement</i>. 	From <i>commencement</i> for 12 months until date of revision (whichever is earlier).	<i>Commencement</i>

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
3	<i>CIS</i>	R	<p>Before the revision of an <i>instrument constituting the scheme</i>:</p> <p>(1) the <i>directors</i> (in the case of an <i>ICVC</i>) and the <i>manager</i> and <i>trustee</i> (in the case of an <i>AUT</i>) must ensure that the <i>instrument constituting the scheme</i> complies with the relevant requirements imposed by or under the previous regulations;</p> <p>(2) references in that instrument to either of the previous regulations may be treated as a reference to <i>CIS</i>;</p> <p>(3) any reference in that instrument to anything in the previous regulations may be treated as a reference to any equivalent <i>rule</i> in <i>CIS</i>; and</p> <p>(4) in the case of an <i>AUT</i>, paragraphs a and b of regulations 16.15 (Transitional : plan sub-registers) of The Financial Services (Regulated Schemes) Regulations 1991 continue to have effect.</p>	From commencement for 12 months	Commencement
4	<i>CIS 2</i>	1. R	On the earlier of the <i>day</i> referred to in 2(1) and 2(2), the <i>directors</i> (in the case of an <i>ICVC</i>), and the <i>manager</i> and <i>trustee</i> (in the case of an <i>AUT</i>), must ensure that the <i>instrument constituting the scheme</i> is amended so that its contents comply with the <i>rules</i> in <i>CIS</i> .	From commencement for 12 months until date of revision (whichever is earlier).	Commencement

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
5	<i>CIS</i> 11.4.4 R	R	No revision of an <i>instrument constituting the scheme</i> required solely as a result, or as a direct consequence, of the application of the <i>rules in CIS</i> requires any resolution of the <i>holders</i> .	<i>Commencement</i>	<i>Commencement</i>
6	<i>CIS</i> 2.2.2 R(6)	R	<p>In relation to an <i>ICVC</i> in existence on the <i>day before commencement</i>, the <i>instrument of incorporation</i> has effect until the day one year following <i>commencement</i> or, if earlier, until it is revised, as if it contained a statement:</p> <p>(1) that the <i>ICVC</i> has the power to invest in or <i>deal</i> on any <i>securities</i> or <i>derivatives</i> market which is an <i>eligible</i> market for that <i>ICVC</i> under <i>CIS</i> 5; or</p> <p>(2) that it has power to invest to the extent that power to do so is conferred by <i>CIS</i> 5 irrespective of any issue of eligibility.</p>	From <i>commencement</i> for 12 months until date of revision (whichever is earlier).	<i>Commencement</i>

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
7	CIS 5.2.10R(2)	R	<p>(1) Until the <i>day</i> one year following commencement or, if earlier, until the <i>trust deed</i> is revised, an <i>AUT</i> may invest <i>scheme property</i> in an <i>ICVC</i> which is:</p> <ul style="list-style-type: none"> (a) a <i>futures and options scheme</i>; or (b) a <i>geared futures and options scheme</i>; or (c) a <i>money market scheme</i>; or (d) a <i>fund of funds scheme</i>; or (e) a <i>property scheme</i>; or (f) a <i>sub-fund</i> falling within (a) to (e); <p>but only to the extent that a statement in its <i>trust deed</i> permits it to invest in an <i>AUT</i> of equivalent category; any such statement is to be regarded, so far as necessary, as amended accordingly.</p> <p>(2) For the purposes of (1), any restriction on the extent to which an <i>AUT</i> may invest in another <i>AUT</i>, which is by reference to the identity of the <i>manager</i> of the <i>scheme</i>, is to be treated as applying to the <i>ICVC</i> by reference to the <i>ACD</i>.</p>	From commencement for 12 months until date of revision (whichever is earlier).	Commencement

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
8	CIS 5.4.4R(5)	R	An instrument constituting the scheme of an authorised fund in existence before commencement that states that more than 35% of the scheme property is or may be invested in government and public securities issued by one issuer within a class of issuers identified by that instrument, has effect until the day one year following commencement or, if earlier, until it is revised, as if it included the names of those states, local authorities and public international bodies in whose securities the authorised fund was entitled to invest without breach of the previous regulations.	From commencement for 12 months until date of revision (whichever is earlier).	Commencement

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
9	CIS 9.2.7G	R	<p>In relation to an <i>AUT</i>:</p> <p>(1) the <i>manager</i> may on or after commencement:</p> <p>(a) continue to make <i>income equalisation</i> payments in accordance with the previous regulations; or</p> <p>(b) cease to make <i>income equalisation</i> payments;</p> <p>and for this purpose the <i>trust deed</i> has effect, until the <i>day</i> one year following <i>commencement</i> or, if earlier, until it is revised, if (a) applies, as if it made provision for <i>income equalisation</i> to be paid, calculated and accounted for in accordance with the previous regulations; or, if (b) applies, made no such provision.</p> <p>(2) the <i>manager</i> may not make <i>income equalisation</i> payments on a basis which is different from that required by the previous regulations unless and until the <i>trust deed</i> is revised so that it includes a statement how the new basis of <i>income equalisation</i> is to be calculated, paid and accounted for.</p>	From <i>commencement</i> for 12 months until date of revision (whichever is earlier).	<i>Commencement</i>

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
10	CIS 10.3 and CIS 10.4	R	<p>(1) In relation to any <i>authorised fund</i> in existence before <i>commencement</i>, the <i>directors</i> or <i>manager</i> may determine in respect of any reports or accounts for any <i>half-yearly accounting period</i> or <i>annual accounting period</i> ending before the <i>day one</i> year following <i>commencement</i> that such reports and accounts are to be governed by the previous regulations.</p> <p>(2) A <i>director</i> or <i>manager</i> who determines in accordance with (1) to prepare reports and accounts on the basis of the previous regulations must ensure that those reports and accounts comply with the requirements of those regulations.</p>	From <i>commencement</i> for 12 months.	<i>Commencement</i>
11	CIS	G	<p><i>GEN</i> contains some technical transitional provisions that apply throughout the <i>Handbook</i> and which are designed to ensure a smooth transition at <i>commencement</i>.</p>	From <i>commencement</i>	<i>Commencement</i>

Chapter 1.

Introduction - Collective investment schemes sourcebook

1.1 Application

- 1.1.1** G_{/1} This sourcebook applies to investment *companies with variable capital (ICVCs), directors and depositaries of ICVCs and managers and trustees of authorised unit trusts (AUTs)*, except for *CIS 16* which includes provisions that also apply to operators of *collective investment schemes* and *CIS 17* which applies only to operators of *collective investment schemes* which are *recognised schemes*. *CIS 10* also applies to auditors of *ICVC's* and *AUTs*.

Purpose

- 1.1.2** G_{/1} The general purpose of this sourcebook is to contribute to the *FSA* meeting its *regulatory objective* of the protection of *consumers* (see section 2 and 5 of the *Act*) by providing a regime of product regulation for *ICVCs* and *AUTs*. This regime is intended to ensure a high and uniform standard of protection for investors in those products by specifying a number of features of those products and how they are to be operated. More specific purpose statements covering how the requirements meet the *FSA's* regulatory objective of the protection of *consumers* are, where appropriate, given in subsequent chapters.

The products covered

- 1.1.3** G_{/1} Under section 238 of the *Act* only certain *collective investment schemes* may be promoted to the public. These are:
- (1) *ICVCs* and *AUTs*: these are constituted in the *United Kingdom* and are described in more detail in *CIS 1.1.4G* to *CIS 1.1.6G*; and
 - (2) *collective investment schemes* constituted outside the *United Kingdom* and recognised by the *FSA* under:
 - (a) section 264 of the *Act* (Schemes constituted in other EEA States): these are *schemes* that qualify under the *UCITS directive*;
 - (b) section 270 of the *Act* (Schemes authorised in designated countries or territories); and
 - (c) section 272 of the *Act* (Individually recognised overseas schemes).

ICVCs

1.1.4 G_{/1} Section 262 of the *Act* empowers the Government to make provisions relating to *open-ended investment companies* (as defined by section 236 of the *Act*) and they have made the *OEIC regulations* to permit establishment of *ICVCs* in Great Britain. Schedule 5.1(3) of the *Act* states that authorised open-ended investment companies are *authorised persons*, hence an *ICVC* is an *authorised person*.

1.1.5 G_{/1} The *ICVC* is constituted by an *instrument of incorporation*, drawn up by its *directors*. At least one *director* must be an *authorised corporate director* ('*ACD*'). A *depository* is also required which is responsible for the safekeeping of the *scheme* property. In order to comply with section 19 of the *Act*, the *ACD* and the *depository* must each be *authorised persons*. The *FSA* has the power under regulation 14 of the *OEIC regulations* to authorise the *ICVC* by making an *authorisation order*. *CIS 16* provides additional *guidance* on the process of applying to the *FSA* for *authorisation* of an *ICVC*.

AUTs

1.1.6 G_{/1} Under section 237 of the *Act*, an *AUT* is a *collective investment scheme* under which the property is held on trust for the *participants* by the *trustee* and which is authorised by an *authorisation order* (made by the *FSA*) in force under section 243 of the *Act*. The *AUT* will be constituted by a *trust deed*, entered into by the *manager* and *trustee*, both of whom must, under section 243(7) of the *Act*, be *authorised persons* and have *permission* to act in their respective capacities. *CIS 16* provides more detail on the process of applying to the *FSA* for the *authorisation* of an *AUT*.

Recognised schemes

1.1.7 G_{/1} For *collective investment schemes* constituted outside the *United Kingdom* and referred to in *CIS 1.1.3G(2)*, this sourcebook brings together the material relating to the admission to *marketing* in the *United Kingdom* of such *schemes*, complementing material in Chapter V of Part XVII of the *Act* (Recognised overseas schemes).

Functions of the CIS sourcebook

1.1.8 G_{/1} The sourcebook performs three main functions in respect of *ICVCs* and *AUTs*, by providing material:

- (1) relating to their constitution and management (including *rules* and *guidance* on pricing arrangements, investment powers and on certain information to be provided to investors);
- (2) relating to the process of authorising them; and
- (3) which satisfies the requirements of the *UCITS directive* (which sets minimum standards for *schemes* on a basis agreed by all *EEA States*) thereby enabling *ICVCs* and *AUTs* which meet those standards to market elsewhere in the *EEA*.

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Together, the material in Chapters 2 to 15 forms a major part of the product regulation regime for *ICVCs* and *AUTs*, complementing material in the *OEIC regulations* and Chapter III of Part XVII of the *Act* (for *Authorised unit trust schemes*).



1.2 Arrangement of this sourcebook and definitions

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Some of this sourcebook relates only to *ICVCs* and some only to *AUTs*. However, parts of this sourcebook cover both *ICVCs* and *AUTs* (in particular in *CIS* 3, 4, 5 and 9). Accordingly, some of the defined terms included relate equally to both *ICVCs* and *AUTs* (together called “*authorised funds*”). Other key examples of these terms are:

- (1) “*authorised fund manager*”: covers both the *ACD* of an *ICVC* and the *manager* of an *AUT*. (The term “*ACD*” is used only in relation to an *ICVC* and the term “*manager*” is used only in relation to an *AUT*);
- (2) “*depository*”: where used in relation to an *authorised fund*, covers both the *depository* of an *ICVC* and the *trustee* of an *AUT*;
- (3) “*holder*”: covers both a “*shareholder*” of an *ICVC* and a “*unitholder*” of an *AUT*;
- (4) “*unit*”: according to the context, can cover both a “*share*” in an *ICVC*, a “*unit*” in an *AUT* and the rights or interests of *participants* in other types of *collective investment scheme*;
- (5) “*prospectus*”: covers the *prospectus* of an *ICVC* and the “*scheme particulars*” of an *AUT*, but there is no objection to the use of the latter term as an alternative to “*prospectus*”.

Outline of the content of this sourcebook

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CIS 2 (Constitution) sets out provisions on the contents of the documents required to form *authorised funds*, and other matters relating to their constitutional features, such as *classes of shares* (in *ICVCs*) and *units* (in *AUTs*) and the categories of *authorised fund* (for example, *securities schemes*) that may be established.

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CIS 3 (Prospectus) includes requirements on the preparation, content, availability of, and changes to, an *authorised fund’s prospectus*.

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CIS 4 (Single-pricing and dealing) covers the valuation and pricing of *authorised funds* that are single-priced. In addition, it includes *rules* on the *sale* and *redemption of units* in such funds. *CIS* 7 Ann 1G and *CIS* App 1 are also relevant to this chapter.

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CIS 5 (Investment and borrowing powers) requires *authorised funds* to comply with a number of general *rules* on investment and specific *rules* depending on the category of *authorised fund*. It also includes *rules* for efficient portfolio management and borrowing.

- 1.2.6 G /1 CIS 6 (Title, transfer and plan registers) includes requirements relating to the register of *unitholders* in an AUT. (Provisions concerning the register of an ICVC are in the *OEIC regulations*.) It also deals with *plan registers* of ICVCs and AUTs.
- 1.2.7 G /1 CIS 7 (Powers and duties) apportions responsibilities between the *directors* (including the *ACD*) and *depository* of an ICVC and the *manager* and *trustee* of an AUT, to the extent that these are not covered in other chapters.
- 1.2.8 G /1 CIS 8 (Charges and expenses) lays down conditions concerning charges when investors buy or *sell units* and payments that can be made out of the *scheme property*.
- 1.2.9 G CIS 9 (Income) deals with the calculation and distribution of income.
- 1.2.10 G /1 CIS 10 (Reports and accounts) concerns the content and publication of annual and half-yearly reports and accounts of *authorised funds*.
- 1.2.11 G /1 CIS 11 (Meetings of holders, amendments to the scheme and service of notices) deals with a variety of matters relating to meetings of *holders* and includes requirements concerning the conditions under which the *instrument constituting the scheme* may be changed and how the *scheme property* of an *authorised fund* may become the property of another *scheme* (a *scheme of arrangement*). It also provides for the use of electronic media in respect of any notice, document or information that is required by CIS to be sent to any *person*.
- 1.2.12 G /1 CIS 12 (Special provisions for certain categories of scheme) provides some special *rules* for certain categories of *authorised fund*, in particular for *umbrella schemes*.
- 1.2.13 G /1 CIS 13 (Suspension and resumption of dealings) includes requirements for the suspension of dealings in the *units of authorised funds*.
- 1.2.14 G /1 CIS 14 (Termination of schemes) includes requirements relating to the winding-up of *authorised funds* and the termination of a *sub-fund* of an ICVC.
- 1.2.15 G /1 CIS 15 (Dual-pricing and dealing) sets out *rules* and *guidance* on the valuation and pricing of *units* in a *dual-priced AUT*. CIS 7 Ann G and CIS App 1 are also relevant to this chapter.
- 1.2.16 G /1 CIS 16 (Application and notification) outlines the application and notification procedures for *authorised funds* and *schemes* from other countries or territories which may be recognised by the FSA for *marketing* in the *United Kingdom*.
- 1.2.17 G /1 CIS 17 (Recognised schemes) sets out the information that the FSA requires so as to consider whether *schemes* under sections 264, 270 and 272 of the *Act* should be permitted to market in the *United Kingdom*.

Related sourcebooks

- 1.2.18 G /1 There are a number of other parts of the FSA's *Handbook* that are relevant to those having a responsibility in relation to *authorised funds*. These include:
 - (1) *PRIN* (The Principles for Businesses);
 - (2) *SYSC* (Senior management arrangements, systems and controls);

- (3) *APER* (The Statements of principle and Code of Practice for approved persons) ;
- (4) *COB* (The Conduct of Business sourcebook);
- (5) *SUP* (The Supervision manual); and
- (6) *DEC* (the Decision making manual)

1.2.19 G_{/1} *ENF 16* sets out the *FSA's* policies and procedures concerning the use of its enforcement powers in relation to *ICVCs*, *AUTs* and *recognised schemes*.

1.2.20 G_{/1} *ML* is also relevant in particular when considering *CIS 4.4.3R*, *CIS 7.10R* and *CIS 15.4.3R*.

1.2.21 G_{/1} Due regard should be given to compliance with the Joint Money Laundering Steering Group Guidance Notes for the Financial Sector in determining compliance with the *Money Laundering Regulations*.

Chapter 2.

2.

Constitution



2.1 Introduction

Application

- 2.1.1** **R** This chapter applies in relation to *ICVCs* and *AUTs*.
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- 2.1.2** **G** (1) The *persons* to whom each respective *rule* and *guidance* in this chapter applies, are stated either at the beginning of the *rule* or *guidance* or at the beginning of the section that contains the *rule* or *guidance*.
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- (2) However, to assist the understanding of this chapter, *CIS 2.1.5G* indicates which provisions in this chapter are relevant for *ICVCs* and which are relevant for *AUTs*.
- 2.1.3** **G** This chapter assists in achieving the *regulatory objective* of protecting *consumers* (as envisaged by section 2 and 5 of the *Act*). In particular, this chapter:
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- (1) lays down some requirements about provisions which must be included in the *instrument of incorporation* of each *ICVC* and in the *trust deed* of every *AUT* resulting in a similar degree of protection for all investors in an *ICVC* or in an *AUT*;
- (2) lays down the categories to only one of which each *authorised fund* must belong (see *CIS 2.1.4*);
- (3) provides *rules* which deal with the *classes of shares* (in *ICVCs*) and *units* (in *AUTs*) which may be issued and sold to investors; those *rules* will ensure that investors in each *class* are treated equally and fairly.
- ### Categories of authorised fund
- 2.1.4** **R** An *authorised fund* must belong to only one of the following categories:
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- (1) a *securities scheme*;
- (2) a *money market scheme*;
- (3) a *futures and options scheme*;
- (4) a *geared futures and options scheme*;
- (5) a *property scheme*;

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- (6) *a warrant scheme;*
- (7) *a feeder fund;*
- (8) *a fund of funds scheme;*
- (9) *an umbrella scheme*

Table Table of application
This table belongs to [CIS 2.1.2]

Handbook provision:	Relevance for:	
	ICVCs	AUTs
2.1.1R – 2.1.4R, 2.2.1R	X	X
2.2.2R – 2.2.4R	X	
2.2.5R – 2.2.8R		X
2.3.1R – 2.3.4G	X	X
2.4.1R – 2.4.6R	X	
2.5.1R – 2.5.4R	X	
2.6.1R		X

Note: "X" means "applies".

2.2 The instrument constituting the scheme

Application

- 2.2.1 **R** /1
- (1) CIS 2.2.2R – CIS 2.2.4R apply to the *directors* of an ICVC.
 - (2) CIS 2.2.5R – CIS 2.2.8R apply to *managers* and *trustees* of an AUT.

The instrument of incorporation for ICVCs: matters which must be included in the instrument of incorporation

- 2.2.2 **R** /1
- (1) The *instrument of incorporation* must not include any provision which is unfairly prejudicial to the interests of *shareholders* generally or to the *holders* of any *class* of *shares*, except to the extent that (2) and (3) applies.
 - (2) If, subject to compliance with a condition imposed by law or regulation of any part of the *United Kingdom*, any *income property* of the ICVC may be allocated or paid to a *shareholder* without deduction of *United Kingdom* tax, the *instrument of incorporation* must provide:
 - (a) that, if the condition is never, or ceases to be, fulfilled, the relevant *shares* of that *shareholder* must be:
 - (i) redeemed or cancelled; or
 - (ii) converted into or exchanged for *shares* where the income allocated or paid is subject to deduction of *UK* tax; and
 - (b) the procedure for that *redemption* or *cancellation*, conversion or exchange.
 - (3) The *instrument of incorporation* must provide that the *person* designated for the purposes of paragraph (4) of schedule 4 (*Share transfers*) to the *OEIC regulations* must be the *person* who, for the time being, is the ACD of the ICVC.

- (4) The *instrument of incorporation* must provide that the ICVC may (without prejudice to the requirements of regulation 21 of the *OEIC regulations* (Alterations)), by a resolution passed by a simple majority of the votes validly cast for and against the resolution at a general meeting of *shareholders*, remove a *director* before his period of office expires, despite anything else in the *ICVC's instrument of incorporation* or in any agreement between the ICVC and the *director*.
- (5) Nothing in (4):
- (a) deprives a *person* of any compensation or damages payable to him for terminating his appointment as *director* or of any appointment which terminates with it; or
 - (b) restricts the effect of any provision in the *instrument of incorporation* relating to a notice to be given to the ICVC or to the *shareholders* of the intention to move a resolution to remove a *director* or relating to the *director's* rights to make representations.
- (6) The *instrument of incorporation* must contain a statement that, subject to any restrictions in the *rules* in this sourcebook or in the *instrument of incorporation*, the ICVC has the power to invest in any *securities* market or *deal* on any *derivatives* market:
- (a) which is an *eligible securities* or *derivatives* market for that ICVC under CIS 5 (Investment and borrowing powers); or
 - (b) to the extent that power to do so is conferred by CIS 5 (Investment and borrowing powers), irrespective of any issue of eligibility.

The instrument of incorporation for ICVCs: matters which may be included in the instrument of incorporation

2.2.3

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The *instrument of incorporation* may provide that, if the holding of any *shares* by a *shareholder* is (or is reasonably considered by the *directors* to be) an infringement of any law or governmental regulation, the *shares* so held must be redeemed or cancelled; if the *instrument of incorporation* contains such a provision, it should also provide the procedure for that *redemption* or *cancellation*.

Relationship between instrument of incorporation and the rules in this chapter

2.2.4

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Any power conferred on any ICVC by these *rules* is subject to any express restriction contained in the ICVC's *instrument of incorporation*.

2.2.5

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The trust deed for AUTs

An *AUT* must be constituted by a *trust deed* made between the *manager* and the *trustee*.

Matters that must be included in the trust deed

2.2.6

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The *trust deed* of an *AUT* must contain at least:

(1) Name of *AUT*

a statement of the name of the *AUT* which must not be inconsistent with the *AUT*'s authorised status under (2) and any restricted economic or geographic objectives;

(2) Authorised status

(a) a statement:

- (i) in all cases, of the category to which the *AUT* belongs under *CIS* 2.1.4R (Categories of authorised fund);
- (ii) for a *feeder fund*, of the name and authorised status of the *regulated collective investment scheme* (or a *sub-fund* of such a *scheme*) or the *eligible investment trust* into which the *feeder fund* is to invest;
- (iii) for a *fund of funds scheme*, identifying the categories of *scheme* in which the *fund of funds scheme* may invest; and
- (iv) for an *AUT* that is an *umbrella scheme*, identifying the category to which each *sub-fund* would belong if the *sub-fund* were itself the subject of a separate *authorisation order*;

(3) Governing law

a statement that the *trust deed* is made under and governed by the law of England and Wales, or the law of Scotland or the law of Northern Ireland;

(4) *Trust deed* to be binding and authoritative

a statement that the *trust deed*:

- (a) is binding on each *unitholder* as if he had been a party to it and that he is bound by its provisions; and
- (b) authorises and requires the *trustee* and the *manager* to do the things required or permitted of them by its terms;

(5) *Base currency*

a statement of the *base currency* of the *AUT*;

(6) *Investment powers in eligible markets*

except in the case of a *feeder fund*, a statement that, subject to any restriction in the *rules* in this sourcebook or the *trust deed*, the *AUT* has the power to invest in any *securities* market or *deal* on any *derivatives* market:

- (a) which is an *eligible securities* or *derivatives* market for that *AUT* under *CIS 5* (Investment and borrowing powers); or
- (b) to the extent that power to do so is conferred by *CIS 5* (Investment and borrowing powers), irrespective of any issue of eligibility;

(7) *Declaration of trust*

a declaration that, subject to the provisions of the *trust deed* and all *rules* made under section 247 of the *Act* and for the time being in force:

- (a) the *scheme property* (other than sums standing to the credit of the *distribution account*) is held by the *trustee* on trust for the *unitholders* according to the number of *units* held by each *unitholder* or, in the case where *income units* and *accumulation units* are both in *issue*, according to the number of undivided *shares* in the *scheme* property represented by the *units* held by each *unitholder*; and □
- (b) the sums standing to the credit of the *distribution account* are held by the *trustee* on trust to distribute or apply them in accordance with *CIS 9* (Income);

(8) *Unitholder's liability to pay*

a provision that a *unitholder* is not liable to make any further payment after he has paid the *price* of his *units* (or, in the case of a *dual-priced AUT*, *purchase price*) and that no further liability can be imposed on him in respect of the *units* which he holds; and

(9) *Single-priced AUTs*

for a *single-priced AUT*:

- (a) a provision that there must be only a single *price* for any *unit*, determined by reference to any particular *valuation point*;

- (b) provisions additional to, but subject to the requirements of, CIS 4.8 (Valuation) stating how the value of the *scheme* property of the *AUT* is to be determined; and
- (c) if provisions in (a) and (b) do not take effect when the *trust deed* or (where appropriate) supplemental *trust deed* takes effect, a statement of the time from which those provisions are to take effect or how it will be determined.

Provisions that may be included in the trust deed

2.2.7

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- (1) There are a number of provisions in this sourcebook that only apply to the extent that they are provided for in the *trust deed*. Sub-paragraphs (a) to (n) include some provisions that may be contained in the *trust deed* for this purpose.
- (a) Duration of the *AUT*

if the *AUT* is to terminate after a particular period expires, a statement to that effect;
 - (b) *Manager's preliminary charge*

a statement

 - (i) authorising the *manager* to make a *preliminary charge*; and
 - (ii) specifying a maximum to that charge, expressed either as a fixed amount in the *base currency* or as a percentage of the *price* (or in the case of a *dual-priced AUT*, the *issue price* of a unit);
 - (c) *Manager's periodic charge*

a statement authorising the *manager* to make a periodic charge payable out of the *scheme property*; any statement under this paragraph should:

 - (i) provide for the charge to be expressed as an annual percentage (to be specified in the *prospectus* and taken in accordance with the *rules* in CIS 8 (Charges and expenses)) of the value of the *scheme property* (and the statement may provide for the addition to the charge of value added tax, if any, payable on it);
 - (ii) specify the *accrual intervals* and how the charge is to be paid; and
 - (iii) specify a maximum to that charge, expressed as an annual percentage of the *scheme property* value;
 - (d) *Manager's charge on an exchange of units*

for an *AUT* that is an *umbrella scheme*, a statement authorising the *manager* to make a percentage charge or a charge of a fixed amount on the exchange of *units* in one *sub-fund* for *units* in another (other than the first such exchange by a *unitholder* in any one *annual accounting period*) and specifying what the maximum of that percentage or amount may be;

(e) *Manager's charge on redemption*

a statement authorising the *manager* to deduct a *redemption charge* out of the proceeds of *redemption*;

(f) *Trustee's remuneration*

a statement authorising any payments to the *trustee* by way of *remuneration* for its services to be paid (in whole or in part) out of the *scheme property* and specifying the basis on which that *remuneration* is to be determined and how it should accrue and be paid;

(g) Constituents of property, permitted transactions and borrowing powers

a statement of any of:

- (i) the description of assets which the *capital property* may consist of;
- (ii) the proportion of the *capital property* which may consist of an asset of any description;
- (iii) the descriptions of transactions which may be effected on behalf of the *AUT*;
- (iv) the borrowing powers exercisable in relation to the *AUT*;

where they are narrower than those permitted for the category of *authorised fund* to which the *AUT* belongs under CIS 5 (Investment and borrowing powers);

(h) Restricted economic or geographic objectives

a statement of any restrictions on the geographic areas or economic sectors in which the *capital property* of the *AUT* may be invested;

(i) *Accumulation units*

a statement whether *units* in the *AUT* may be *accumulation units* only or *accumulation units* as well as *income units*.

(j) Limited categories of *unitholder*

a provision that *holders* of *units* in the *AUT* apart from the *manager* must be *persons* who hold *units* such that any gain accruing upon the disposal of the *units* at any time will be wholly exempt from capital gains tax and corporation tax in the *United Kingdom* other than by reason of residence;

(k) Certificates

- (i) a provision authorising the issue of *bearer certificates*, accompanied by a statement of how the *holders* of *bearer certificates* are to identify themselves;
- (ii) a provision authorising the *trustee* to charge a fee for issuing any document recording, or for amending, an entry on the *register*, other than on the *issue* or *sale* of *units*;

(l) *Income equalisation*

a provision for *income equalisation* including a statement of how *income equalisation* is to be calculated, paid and accounted for;

(m) *Relevant pension schemes*

for a *scheme* formed with the intention of it being a *relevant pension scheme*, additional provisions included with a view to the *scheme's* satisfying the requirements of the Board of Inland Revenue (Pension Schemes Office and National Insurance Contributions Office), or those of any agency which may regulate a *relevant pension scheme* from time to time;

(n) *Relevant charitable schemes*

for an *AUT* formed with the intention of it being a *relevant charitable scheme*, additional provisions included with a view to the *AUT* qualifying as a *relevant charitable scheme* and to the maintenance of its tax status after it has qualified.

(2) The *trust deed* of an *AUT* may also include any provision:

- (a) dealing with a matter not referred to in *CIS 2.2.6R* (Matters that must be included in the trust deed) or this *guidance (CIS 2.2.7G)* the inclusion of which serves to enable the *AUT*, the *manager* or the *trustee* to obtain any privilege or power conferred by the *rules* in this sourcebook; or
- (b) which is expressly contemplated in this sourcebook.

Relationship between trust deed and rules in this sourcebook

2.2.8

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- (1) **A *trust deed* must not contain any provision that conflicts with any *rule* in this sourcebook.**
- (2) **Any power conferred, by the *rules* in this sourcebook, on the *manager*, on the *trustee*, or on them together is subject to any express prohibition contained in the *trust deed*.**
- (3) ***CIS 5* (Investment and borrowing powers) has effect in relation to any *AUT* which is subject to any restriction imposed by the *trust deed*.**

2.3 UCITS obligations

2.

Application

- 2.3.1 **R** This section (CIS 2.3) applies to *ICVCs* and to *managers* of *AUTs*.
/1

UCITS schemes

- 2.3.2 **G** An *authorised fund* that is a *securities scheme*, a *warrant scheme*, or an *umbrella scheme* consisting of *sub-funds* which would, if separately authorised, be *securities schemes* or *warrant schemes*, is a *UCITS scheme*, unless, in the case of an *AUT*, the categories of *holder of units* in it are limited by a provision in the *trust deed* of a type permitted by CIS 2.2.7G(1)(j).
/1

Requirements

- 2.3.3 **R** (1) The instrument constituting a *UCITS scheme* may not be amended in such a way that it ceases to be a *UCITS scheme*.
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- (2) If an *ICVC* that is a *UCITS scheme*, or the *manager* of an *AUT* that is a *UCITS scheme*, proposes to market *units* in any *EEA State* other than the *United Kingdom*, the *ICVC* or the *manager* must notify the *FSA* of its proposal, specifying the *EEA State* concerned. The *ICVC* or the *manager* must do this at the same time as, or before, notifying the authorities in that *EEA State* of that proposal.

Outward passporting of UCITS schemes

- 2.3.4 **G** (1) Section VII of the *UCITS directive* provides the framework by which a *UCITS scheme* may undertake *marketing* in another *EEA State*. Article 44 has the effect of requiring the *UCITS scheme* to comply with the *marketing* and *advertising* rules in the relevant *Host State*. Article 45 requires the *UCITS scheme* to maintain certain facilities in the *Host State* and paragraph 25 of CIS 3.5.2 (contents of the prospectus) requires these to be set out in the *scheme's prospectus*.
/1

- (2) Article 46 sets out the documentation requirements that need to be provided to the competent authority in the relevant *EEA State*. The documents have to be provided in a compliant manner at the same time as notification of the proposal to market there. The *UCITS scheme* may begin *marketing* two months following notification.
- (3) Article 47 requires the relevant information and documents distributed in the *Host State* to be the same as those that the *UCITS scheme* provides in its *Home State*. The documents must be published in at least one of the official languages of the *Host State*. *CIS 3* (prospectus) and *CIS 10* (report and accounts) will be applicable in this case.
- (4) If the *UCITS scheme* is being marketed in another *EEA State*, Article 34 requires the publication of *prices* in the *Host State*. *CIS 4.4.8R(4)* and *CIS 15.4.14R(4)* will be applicable in this case.

2.4 Share classes

Application

- 2.4.1** **R** This section (CIS 2.4) applies to *ICVCs* and their *ACDs*.
/1

Classes of shares in an ICVC

- 2.4.2** **G** (1) The *OEIC regulations* (schedule 2, paragraph (4)(1)(e)) require the *instrument of incorporation* of an *ICVC* to state what *classes of shares* may be issued, and, in the case of an *ICVC* that is an *umbrella scheme*, require the *instrument of incorporation* to state the *classes* that may be issued in respect of each *sub-fund*.
/1
- (2) *Classes of shares* may include:
- (a) *income shares*;
 - (b) *net accumulation shares*;
 - (c) *gross accumulation shares*;
 - (d) *currency class income shares*, which are *currency class shares* in respect of which income is allocated periodically to *shareholders* under CIS 9.2.5R (Annual distribution to holders of income shares or income units);
 - (e) *currency class net accumulation shares*, which are *currency class shares* in respect of which income (net of any tax deducted or accounted for by the *ICVC*) is credited periodically to capital under CIS 9.2.4R (Annual distribution to accumulation shares or accumulation units); and
 - (f) *currency class gross accumulation shares*, which are *currency class shares* in respect of which income is credited periodically to capital under CIS 9.2.4R, but, in accordance with relevant tax law, without deduction by the *ICVC* of any income tax.

Classes of shares other than those listed in CIS 2.4.2G

- 2.4.3** **G** (1) An *instrument of incorporation* may provide for *classes of shares* different from those listed in CIS 2.4.2G(2). The *guidance* in this paragraph relates only to those *classes of shares* (and in this paragraph they are referred to as "new *share classes*").
/1

- (2) Subject to this *guidance* (CIS 2.4.3G) and the restriction in CIS 2.4.6R(2) (Rights of share classes), no special conditions are laid down in this chapter as to the nature or operational features of new *share classes*.
- (3) CIS 2.2.2R(1) does not permit a provision in an *instrument of incorporation* which is unfairly prejudicial to the interests of *shareholders* generally or to the *holders* of any *class* of *shares*. In order to be satisfied that CIS 2.2.2R(1) is complied with, the FSA will take into account the principles in (a) to (c) when considering any proposals for new *share classes*. Those principles, which are not in any particular order of importance, are:
- (a) the new *share class* should not provide advantages for that *class* if that would result in prejudice to *shareholders* of any other *class*;
 - (b) the nature, operation and effect of the new *share class* should be capable of being explained clearly to prospective investors in the *prospectus*; and
 - (c) the effect of the new *share class* should not appear to be contrary to the purpose of any part of this sourcebook.
- (4) The FSA would encourage *firms* with proposals for new *share classes* to raise them informally with it so it can determine whether the following steps are necessary:
- (a) submitting the proposal to the FSA, in draft, considerably in advance of any application for *authorisation* of an ICVC or proposal to change the *instrument of incorporation*; and
 - (b) accompanying the proposal in (a) with a detailed explanation of the purpose of the new *share class* and its intended operation and effect. In particular, the FSA would wish to receive:
 - (i) the provisions for inclusion in the *instrument of incorporation* for that new *share class*, which should describe clearly the nature of that new *share class* and deal comprehensively with the rights of *shareholders* of that new *share class*;
 - (ii) a separate and detailed explanation of how the new *share class* will operate in practice, which should describe the circumstances in which the rights and obligations of *shareholders* of that new *share class* depart from the rights and obligations of other *shareholders*;
 - (iii) an explanation of the operational features of administrative and accounting systems supporting the new *share class*.

What are currency class shares?

2.4.4

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A *currency class share* differs from other *shares* mainly in that its *price*, having been calculated initially in the *base currency*, will be quoted, and normally paid for, in the currency of the designation of the *class*. Income distributions will also be paid in the currency of designation of the *class*.

Currency class shares: requirements

2.4.5

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In the case of *currency class shares*:

- (1) the currency of the *class* concerned must not be the *base currency* (or, in the case of a *sub-fund* which, in accordance with a statement in the *prospectus*, is to be valued in some other currency, the currency of the *class* may be in the *base currency*, but must not be in that other currency);
- (2) the *price* must be expressed in the currency of the *class* concerned;
- (3) any distribution must be paid in the currency of the *class* concerned; and
- (4) statements of amounts of *money* or values included in statements and in certificates prepared under CIS 9.2.8R (Tax certificates) must be given in the currency of the *class* concerned (whether or not also given in the *base currency*).

Rights of share classes

2.4.6

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- (1) If any *class* of *shares* in the *ICVC* has different rights from any other *class* of *shares* in the *ICVC*, the *instrument of incorporation* must provide how the proportion of the value of the *scheme property* and the proportion of income available for allocation attributable to each such *class* must be calculated.
- (2) (a) For an *ICVC* which is not an *umbrella scheme*, the *instrument of incorporation* must not provide for any *class* of *shares* in respect of which:
 - (i) the extent of the rights to participate in the *capital property, income property* or *distribution account* would be determined differently from the extent of the corresponding rights for any other *class* of *shares*; or
 - (ii) payments or accumulation of income or capital would differ in source or form from those of any other *class* of *shares*;
- (b) For an *ICVC* which is an *umbrella scheme*, the provisions in (a) apply to *classes* of *shares* in respect of each *sub-fund* as if each *sub-fund* were a separate *ICVC*; and
- (c) Paragraphs (a) and (b) do not prohibit a difference between the rights attached to one *class* of *shares* and to another *class* of *shares* that relates solely to:

- (i) the accumulation of income by way of periodical credit to capital rather than distribution;
- (ii) charges and expenses that may be taken out of the scheme property or payable by the *shareholder*; and
- (iii) the currency in which *prices* or values are expressed or payments made.

2.5 Denomination of shares and their sub-division and consolidation

2.

Application

- 2.5.1 **R** /1
- (1) *CIS 2.5.2G* and *CIS 2.5.3R* apply to an ACD.
 - (2) *CIS 2.5.4R* applies only to *directors* of an ICVC.

Characteristics of larger and smaller denomination shares

- 2.5.2 **G** /1
- Although fractions of a *share* are not possible, regulation 45 of the *OEIC regulations* (Shares) provides that the rights attached to a *share* of any *class* may be expressed in two denominations, in which case the 'smaller' denomination must be such proportion of the 'larger' denomination (that is, a standard *share*) as is fixed by the ICVC's *instrument of incorporation*. This will enable holdings to consist of more or less than a complete number of *larger denomination shares*. If an ICVC wishes to take advantage of this provision, the relevant proportion must be stated in its *instrument of incorporation*. A single document of title, tax certificate or cheque may cover a single holding of both *larger denomination shares* and *smaller denomination shares* of any *class*.

Requirement

- 2.5.3 **R** /1
- (1) This *rule* (*CIS 2.5.3R*) applies whenever the *instrument of incorporation* provides, in relation to any *class*, for *smaller denomination shares* and *larger denomination shares*.
 - (2) Whenever a registered holding includes a number of *smaller denomination shares* that can be consolidated into a *larger denomination share* of the same *class*, the ACD must consolidate the relevant number of those *smaller denomination shares* into a *larger denomination share*.
 - (3) The ACD may at any time, for the purpose of effecting a transaction in *shares*, substitute for a *larger denomination share* the relevant number of *smaller denomination shares*. If it does this, (2) does not apply to the resulting smaller denomination

shareholding or holdings until immediately after the completion of the transaction.

- (4) For the purpose of (2) and (3) the relevant number must be calculated by reference to the proportion, stated in the *instrument of incorporation*, of a *larger denomination share* represented by a *smaller denomination share*.

Sub-division and consolidation of shares

2.5.4

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- (1) The *directors* of an *ICVC* may, unless expressly forbidden to do so by its *instrument of incorporation*, determine:
- (a) that each *share* of any *class* is to be subdivided into two or more *shares* (whereupon each such *share* will stand subdivided accordingly); or
 - (b) that two or more *shares* of any *class* are to be consolidated (whereupon those *shares* will stand consolidated).
- (2) The *ICVC* must (unless it has done so before the sub-division or consolidation became effective) immediately give notice to each *shareholder* (or the first named of joint *holders*) of any subdivision or consolidation under (2).

2.6 Units and classes of units in AUTs

2.6.1 **R** This section (*CIS 2.6*) applies to the types of *units*, which may exist within an *AUT*.
/1

2.6.2 **R** (1) The interests of the *unitholders* in an *AUT* consist of *units* (including fractions of a *unit*), each representing one undivided share in the *AUT's scheme property*.
/1

(2) This system of single undivided shares is modified where both *income units* and *accumulation units* are in existence, because:

(a) when income is accumulated and capitalised under *CIS 9.2.4R* (Annual allocation to accumulation shares or accumulation units), that accumulation is achieved by increasing the number of undivided shares (including fractions) which together constitute the *accumulation units* then in existence; and

(b) any *accumulation units* issued subsequently must represent when issued the same number (including fractions) of undivided shares in the *capital property* of the *AUT* as each other *accumulation unit* then in existence.

(3) Each *unit* must be either an *income unit* or an *accumulation unit*.

(4) The *AUT* will consist of *income units* only unless the *trust deed* provides, or the *manager* decides, under a power contained in the *trust deed*, that the *AUT* will consist of the other *class* or of both.

Chapter 3.

Prospectus

3.



3.1 Introduction

Application

3.1.1 **R** _{/1} The *rules* and *guidance* in this chapter apply in accordance with Table 3.1.2R (Table of application).

3.1.2 **R** _{/1} Table Table of application
This table belongs to [CIS 3.1.1]

Paragraph or section number	ICVC	ACD	Any other directors of an ICVC	Manager of an AUT
3.2	X	X	X	X
3.3	X	X		X
3.4	X	X	X	X
3.5	X	X	X	X

Note: "X" means applies.

Purpose

- 3.1.3** **G** _{/1}
- (1) The purpose of this chapter is to assist in achieving the *regulatory objective* of protecting *consumers* as envisaged by sections 2 and 5 of the *Act* by enabling *consumers* to have access to up to date detailed information about an *AUT* or *ICVC* before *units* are sold to them. The *rules* in this chapter also take account of *Principle 7* (Communication with clients) that a *firm* must pay due regard to the information needs of its *customers*.
 - (2) In addition, this chapter sets out responsibility for a *prospectus* and the requirements relating to changes to it.
 - (3) This chapter contains "*scheme particulars rules*" as provided for by section 248 of the *Act* and referred to in regulation 6(1) of the *OEIC regulations*. The *rules* in this chapter also satisfy the requirements of the *UCITS directive*, relating to the minimum information to be included in a *prospectus*.
 - (4) Although the term *prospectus* is used in regulation 6(2) of the *OEIC regulations* and in this sourcebook, the document that contains the requisite information may be entitled "*scheme particulars*".

3.2 Drawing up and availability of prospectus

Drawing up of prospectus

3.2.1

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- (1) A *prospectus* must contain the matters specified in CIS 3.5 (Information to be contained in the prospectus) and it must be drawn up by the *authorised fund manager* and, in the case of an ICVC, approved by the *directors*.
- (2) A *prospectus* must not contain any other matter unless the inclusion of it is expressly contemplated in the *rules* in this sourcebook.
- (3) A revised *prospectus* is subject to this *rule* as if it were a new *prospectus* whether or not the revisions were required under CIS 3.4 (Revision of and changes to prospectus).

Availability of prospectus

3.2.2

R

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- (1) An ICVC or the *manager* of an AUT:
 - (a) must not market *units* in an *authorised fund* in the *United Kingdom* unless:
 - (i) a *prospectus* has been drawn up in English and approved in accordance with CIS 3.2.1R;
 - (ii) arrangements have been made for that *prospectus* to be available to enable the ICVC or *manager* of the AUT to satisfy those who accept the offer referred to in CIS 3.2.2R(1)(b); and
 - (iii) a copy of that *prospectus* has been sent to the FSA and to the *depository*;
 - (b) must not effect any *sale* of those *units* to any *person* in the *United Kingdom* until it has offered that *person* free of charge a copy of that *prospectus*.

- (2) An *ICVC* which is a *UCITS scheme*, or the *manager* of an *AUT* which is a *UCITS scheme*, must not:
- (a) market *units* in the territory of another *EEA State* unless:
 - (i) a *prospectus* has been drawn up in an official language of that *EEA State* and, in the case of an *ICVC*, approved by the *directors*; and
 - (ii) arrangements have been made for the *prospectus* to be available to enable the *ICVC* or *manager* of the *AUT* to satisfy those who accept the offer referred to in (b) below;
 - (b) effect any *sale* of *units* to any *person* in the territory of that *EEA State* until it has offered that *person* free of charge a copy of that *prospectus* before the conclusion of that *sale*.

3.3 False or misleading prospectus

3.

Requirement

3.3.1

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- (1) The *authorised fund manager*, subject to (3), (4) and (5):
- (a) must ensure that the *prospectus* does not contain any untrue or misleading statement or omit any matter required by the *rules* in this sourcebook to be included in it; and
 - (b) is liable to pay compensation to any *person* who has acquired any *units* in the *authorised fund* and suffered loss in respect of them as a result of any such statement or omission. This is in addition to any liability incurred apart from this *rule* (CIS 3.3.1R).
- (2) The *authorised fund manager* is not in breach of (1)(a) and is not liable to pay compensation under (1)(b) if at the time when the *prospectus* was made available to the public it had taken reasonable care to determine that the statement was true and not misleading, or that the omission was proper, and that:
- (a) it continued to take such reasonable care until the time of the relevant acquisition of *units* in the *scheme*;
 - (b) the acquisition took place before it was reasonably practicable to bring a correction to the attention of potential purchasers;
 - (c) it had already taken all reasonable steps to secure that a correction was brought to the attention of potential purchasers;
 - (d) the *person* who acquired the *units* was not materially influenced or affected by that statement or omission in making his decision.
- (3) The *authorised fund manager* is also not in breach of (1)(a) and is not liable to pay compensation under (1)(b) if:

- (a) before the acquisition a correction had been published in a manner calculated to bring it to the attention of *persons* likely to acquire the *units* in question; or
 - (b) it took all reasonable steps to secure such publication and had reasonable grounds to conclude that it had taken place before the *units* were acquired.
- (4) The *authorised fund manager* is not liable to pay compensation under (1)(b) if the *person* who acquired the *units* knew at the time of his acquisition that the statement was untrue or misleading or knew of the omission.
- (5) For the purposes of this *rule* (CIS 3.3.1R) a revised *prospectus* will be treated as a different *prospectus* from the *prospectus* to which the revision was made.
- (6) References in this *rule* (CIS 3.3.1R) to the acquisition of *units* include references to contracting to acquire them.

3.4 Revision of and changes to prospectus

Revision of prospectus

3.4.1

R(1) *A prospectus* must be:

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- (a) revised immediately upon:
 - (i) the occurrence of any materially significant change in the matters stated in it; or
 - (ii) the occurrence of any materially significant new matter which ought to be referred to in it in advance of an annual review so far as is necessary to take account of that change or matter;
 - (b) reviewed at least once in every 12 months and revised to take account of any change or any new matter, other than one which reasonably appears to the *manager* of the *AUT* or the *directors* of the *ICVC* to be insignificant.
- (2) A revision of a *prospectus* may take the form of a complete substitution for the previous *prospectus* or of a supplement to the *prospectus* but, whichever it is, the date as at which the revision was made must be prominently displayed.

Changes to prospectus

3.4.2

R

(1) Any change to, or introduction of, any of the provisions of the *prospectus* listed in (2) (other than a reduction in (c) to (e)) requires the prior approval of a resolution of the *holders* or, (for an *ICVC*) in the case of a change that affects only the *holders* of the *units* of a particular *class* or (*classes*), a resolution (or resolutions) of a class meetings (or meetings) of those *holders*.

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- (2) The provisions referred to in (1) are those required to be included in the *prospectus* as a consequence of:
 - (a) *CIS 3.5.2R(3)* (Investment objectives and policy);

- (b) CIS 3.5.2R(12)(1) (Payments to the authorised fund manager), but only so far as it relates to an increase in the maximum rate or amount of the *authorised fund manager's remuneration*;
 - (c) CIS 3.5.2R(12)(2) (Payments to the authorised fund manager) and CIS 3.5.2R(12)(4) except if it is a change that is of minimal significance;
 - (d) CIS 3.5.2R(13) (Other payments out of the scheme property);
 - (e) CIS 3.5.2R(18) (Dilution levy); and
 - (f) CIS 3.5.2R(24)(1) (Umbrella scheme) in so far as it applies any of (a) to (e) to a *sub-fund*.
- (3) For an *AUT*, the resolution required under (1) must be an *extraordinary resolution*, and, in the case of an *ICVC*, must be an *extraordinary resolution* if it is to approve a change to, or introduction of, any of the provisions mentioned in (2)(a) or (b), (2)(c), in so far as it relates to CIS 3.5.2R(12)(4), and (2)(d), in so far as it relates to CIS 3.5.2R(13)(6).
- (4) Paragraph (1) does not apply to a change to a *prospectus* which is required:
- (a) solely to fulfil a requirement (other than a requirement of CIS 6.5 (Plan registers)) resulting from a change in the law (including the *OEIC regulations*) or a change to the *rules* in this sourcebook;
 - (b) to comply with CIS 3.5.2R(3)(4) (Investment objectives and policy-eligible markets) if the change is, in the context of the investment policy applicable to the *authorised fund* or *sub-fund* concerned, of minimal significance only, and the *authorised fund manager* and the *depository* have so agreed in writing, or the *authorised fund manager* has, not less than 90 *days* before the intended change:
 - (i) given written notice of the intended change to the *depository* and to the *holders*; and
 - (ii) revised the *prospectus* to reflect the intended change and the date of its commencement;
 - (c) solely to reflect an amendment to the *instrument constituting the scheme*:
 - (i) made either in accordance with CIS 11.4.4R (Amendments to the instrument constituting the scheme: without meeting) or by a resolution passed at a meeting or, where appropriate, *class meeting*, of *holders* and which is not a change to any of the provisions of the *prospectus* included

- to comply with *CIS* 3.5.2R(3) (Investment objectives and policy) or *CIS* 3.5.2R(12)(1) (Payments to the authorised fund managers); or
- (ii) of one of the types described in *CIS* 11.4.2R(1)(a) or (b) (Amendment to the *instrument constituting the scheme*: with meeting); or
- (d) to comply with *CIS* 3.5.2R(12)(4) (Payments to the authorised fund manager) or *CIS* 3.5.2R(13)(6) (Other payments out of the scheme property) if:
- (i) the *authorised fund* already has clear investment objectives indicating:
- (1) a greater preference for the generation of income than for capital growth; or
- (2) equal emphasis on the generation of income and capital growth; and
- 90 *days* have elapsed since the *holders* were notified in writing by the *authorised fund manager* of the change to the *prospectus* and of the date when it is to come into effect; or
- (ii) in accordance with *CIS* 8.3.5R(4) (Allocation of payments to capital or income for (for ICVCs)) or *CIS* 8.5.7R(4) (Allocation of payments to capital or income (for AUTs)) all of the *remuneration* of the *authorised fund manager* was immediately prior to the change in the *prospectus*, treated as a capital charge and the *authorised fund manager* and *depository* have agreed that the change to the *prospectus* is of minimal significance; or
- (iii) the change is only to reflect a reduction in the types or amounts of the payments which may be treated as a capital expense.
- (5) Paragraph (2) does not apply to a change to a *prospectus* of an *ICVC* which is required:
- (a) solely to reflect action taken for the purpose of compliance with *CIS* 12.5.5R (An *ICVC* with only one sub-fund); or
- (b) to comply with *CIS* 6.5 (Plan register) if the *ICVC* was incorporated on or before 31 January 1999 and for the year to 5 April 1999 (or, if shorter, the period from the initial *issue* of its *shares* to 5 April 1999) was managed with the intention that its *shares* should be qualifying *investments* for the purposes of the Personal Equity Plan Regulations 1989.

- (6) No significant departure may be made in the management of the *scheme property* of an *authorised fund* from the statements in its *prospectus* current at the relevant time in fulfilment of the requirements of CIS 3.5.2R(3)(Investment objectives and policy).

3.5 Information to be contained in the prospectus

Matters to be included in the prospectus

3.5.1 **R** The statements required by CIS 3.5.2R must be included in the prospectus of an authorised fund.
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3.5.2 **R** Table Contents of the prospectus
/1 This table belongs to [CIS 3.5.2R]

1	A prominent statement that this document is the <i>prospectus</i> or <i>scheme particulars</i> , of the <i>authorised fund</i> valid as at (and dated).
2	Description of the authorised fund Information detailing: <ol style="list-style-type: none"> (1) the name of the <i>authorised fund</i>; (2) that the <i>authorised fund</i> is either an <i>ICVC</i> or an <i>AUT</i>; (3) the relevant category of <i>authorised fund</i>; (4) that the <i>shareholders</i> of an <i>ICVC</i> are not liable for the debts of the <i>authorised fund</i>; (5) the registered number of the <i>ICVC</i>; (6) the address of the <i>ICVC</i>'s head office; (7) the effective date of the <i>authorisation order</i> made by the <i>FSA</i>; (8) if the duration of the <i>authorised fund</i> is not unlimited, when it will or may terminate; (9) the address of the place in the <i>United Kingdom</i> for service on the <i>ICVC</i> of notices or other documents required or authorised to be served on it; (10) the <i>base currency</i> for the <i>authorised fund</i>; (11) the maximum and minimum sizes of the <i>ICVC</i>'s capital; and (12) the circumstances in which the <i>authorised fund</i> may be wound up under the <i>rules</i> in this sourcebook and a summary of the procedure for, and the rights of <i>holders</i> under, such a winding up.
3	Investment objectives and policy <ol style="list-style-type: none"> (1) Sufficient information to enable a <i>holder</i> to ascertain: <ol style="list-style-type: none"> (a) the investment objectives of the <i>authorised fund</i> or of each <i>sub-fund</i> of an <i>umbrella scheme</i>; (b) the <i>authorised fund</i>'s investment policy for achieving those investment objectives, including the general nature of the <i>portfolio</i> and any intended specialisation; and

	(c)	the extent (if any) to which that policy does not envisage remaining fully invested at all times.
(2)		Where, in accordance with <i>CIS</i> 8.3.5R (Allocation of payments to capital or income – for ICVCs) or <i>CIS</i> 8.5.7R (Allocation of payments to capital or income – for AUTs), all or any part of any payments permitted by <i>CIS</i> 8.2.3R (Payments by an ICVC to an ACD) or <i>CIS</i> 8.5.1R (Managers periodic charge) and any other charges or expenses of the <i>authorised fund</i> are to be treated as a capital expense, a statement that this may constrain capital growth.
(3)		A description of any restrictions in the assets in which investment may be made, including restrictions in the extent to which the <i>authorised fund</i> may invest in any category of asset, indicating (where appropriate) where the restrictions are tighter than those imposed by <i>CIS</i> 5 (Investment and borrowing powers).
(4)		A list of any individual <i>eligible securities</i> and <i>derivatives</i> markets through which the <i>authorised fund</i> may invest or <i>deal</i> in accordance with <i>CIS</i> 5.3.3R(2) (Eligible markets) (any <i>securities</i> market in a <i>EEA State</i> which is <i>eligible</i> in accordance with <i>CIS</i> 5.3.3R(1) (Eligible markets) may be included in the list or referred to in general terms).
(5)		For an <i>authorised fund</i> that is not a <i>property scheme</i> , state whether it is intended that the <i>scheme</i> will have an interest in any immovable property or tangible movable property.
(6)		The names of the States, local authorities or public international bodies in whose <i>securities</i> the <i>authorised fund</i> may invest more than 35% of its assets.
(7)		The policy in relation to the exercise of borrowing powers by the <i>authorised fund</i> and to transactions for the purpose of efficient portfolio management.
(8)		In the case of an <i>authorised fund</i> which may invest in other <i>collective investment schemes</i> , the extent to which the <i>scheme property</i> may be invested in the <i>units</i> of <i>collective investment schemes</i> which are managed by the <i>authorised fund manager</i> or by an <i>associate</i> of the <i>authorised fund manager</i> .
(9)		In the case of a <i>property scheme</i> :
	(a)	the maximum extent to which the <i>scheme property</i> may be invested in:
	(i)	immovables;
	(ii)	<i>property related assets</i> ;
	(b)	where the <i>directors</i> of an <i>ICVC</i> or the <i>manager</i> of an <i>AUT</i> expect that the <i>scheme property</i> will be invested (during the period when that version of the <i>prospectus</i> may be in circulation) in <i>government and public securities</i> :
	(i)	the fact that the <i>scheme property</i> may be so invested; and
	(ii)	the maximum limit for such <i>investment</i> ;
	(c)	the countries or territories of situation of land or buildings in which the <i>authorised fund</i> may invest;
	(d)	the policy of the <i>authorised fund manager</i> in relation to insurance of immovables forming part of the <i>scheme property</i> ; and
	(e)	in a <i>prospectus</i> available during the period of the <i>initial offer</i> , the consequences of failure to obtain £5 million (or the equivalent in <i>base currency</i>) as set out in <i>CIS</i> 12.3.4R (Failure to obtain minimum subscriptions).
4		Distributions

Information as to:

- (1) the date on which the *authorised fund's annual accounting period* is to end in each year;
- (2) if there are *interim accounting periods*, what they are, and the policy in relation to interim distributions (for example, whether interim distributions will be made and, if so, the policy on smoothing of income distributions within an *annual accounting period*);
- (3) the date or dates in each year on or before which payment or accumulation of income is to be made or take place and, if there are *holders of bearer certificates*, how they are to identify themselves for the purposes of receiving payment of income;
- (4) if applicable, the policy on payment of *income equalisation*;
- (5) how distributable income is determined and paid; and
- (6) if applicable, that unclaimed distributions may be forfeited and a statement how such unclaimed distributions will be dealt with.

5 The characteristics of units in the authorised fund

Give information as to:

- (1) where there is more than one *class of unit* in *issue* or available for *issue*, the name of each such *class* and the rights attached to each *class* in so far as they vary from the rights attached to other *classes*;
- (2) where the *instrument constituting the scheme* provides for the *issue* of *bearer certificates*, that fact and, in the case of an *ICVC*, in what multiples *bearer certificates* may be issued;
- (3) how *holders* may exercise their voting rights and what these are;
- (4) where a mandatory *redemption, cancellation* or conversion of *units* from one *class* to another may be required (for instance, if an investor does not satisfy the residence condition for income to be paid or accumulated without tax being deducted), in what circumstances it may be required; and
- (5) in the case of an *AUT*, the fact that the nature of the right represented by *units* is that of a beneficial interest under a trust.

6 The authorised fund manager

The following particulars of the *authorised fund manager*:

- (1) its name;
- (2) the nature of its corporate form;
- (3) the country or territory of its incorporation;
- (4) the date of its incorporation;
- (5) if it is a *subsidiary*, the name of its ultimate *holding company* and the country or territory in which that *holding company* is incorporated;
- (6) the address of its registered office;
- (7) the address of its head office if that is different from the address of its registered office;
- (8) if neither its registered office nor its head office is in the *United Kingdom*, the address of its principal place of business in the *United Kingdom*;
- (9) if the duration of its corporate status is limited, when that status will or may cease;
- (10) the amount of its issued share capital and how much of it is paid up;
- (11) in what capacity, if any, it acts in relation to any other *regulated collective investment schemes* and the name of such *schemes*;

	(12)	in the case of an <i>ICVC</i> , a summary of the material provisions of the contract between the <i>ICVC</i> and the <i>authorised fund manager</i> which may be relevant to <i>shareholders</i> including provisions (if any) relating to termination, compensation on termination and indemnity; and
	(13)	in the case of an <i>AUT</i> , the names of the <i>directors</i> of the <i>manager</i> and, in each case, any significant business activities of the <i>director</i> not connected with the business of the <i>manager</i> .
7	Directors of an <i>ICVC</i> , other than the <i>ACD</i> Other than for the <i>ACD</i> :	
	(1)	the names and positions in the <i>ICVC</i> of the <i>directors</i> ;
	(2)	the main business activities of each of the <i>directors</i> (other than those connected with the business of the <i>ICVC</i>) where these are significant to the <i>ICVC</i> 's business;
	(3)	the manner, amount and calculation of the <i>remuneration</i> of <i>directors</i> ;
	(4)	the main terms of each contract of service between the <i>ICVC</i> and a <i>director</i> in summary form; and
	(5)	if the <i>director</i> is a <i>body corporate</i> in a <i>group</i> of which any other corporate <i>director</i> of the <i>ICVC</i> is a member, a statement of that fact.
8	The depositary The following particulars of the <i>depositary</i> :	
	(1)	its name;
	(2)	the nature of its corporate form;
	(3)	the country or territory of its incorporation;
	(4)	if it is a <i>subsidiary</i> , the name of its ultimate <i>holding company</i> and the country or territory in which that <i>holding company</i> is incorporated;
	(5)	the address of its registered office;
	(6)	the address of its head office if that is different from the address of its registered office;
	(7)	if neither its registered office nor its head office is in the <i>United Kingdom</i> , the address of its principal place of business in the <i>United Kingdom</i> ;
	(8)	a description of its principal business activity; and
	(9)	a summary of the material provisions of the contract between the <i>ICVC</i> or the <i>manager</i> of the <i>AUT</i> and the <i>depositary</i> which may be relevant to <i>unitholders</i> , including provisions relating to the <i>remuneration</i> of the <i>depositary</i> .
9	The investment adviser If an <i>investment adviser</i> is retained in connection with the business of the <i>authorised fund</i> :	
	(1)	its name;
	(2)	whether or not it is authorised by the <i>FSA</i> ;
	(3)	if it is a <i>body corporate</i> in a <i>group</i> of which any <i>director</i> of the <i>ICVC</i> or the <i>manager</i> of the <i>AUT</i> is a member;
	(4)	where its principal activity is not providing services to the <i>authorised fund</i> as an <i>investment adviser</i> , what the principal activity is;
	(5)	a summary of the material provisions of any contract between the <i>authorised fund manager</i> or the <i>ICVC</i> and any <i>investment adviser</i> which may be relevant to <i>holders</i> and, if the <i>investment adviser</i> has the authority of the <i>authorised fund manager</i> or the <i>ICVC</i> to make decisions on behalf of the <i>authorised fund manager</i> or the <i>ICVC</i> , that fact and a description of the matters in relation to which it has that authority.

10	The auditor Details of the name and address of the auditor of the <i>authorised fund</i> .
11	The register of holders Details of: <ol style="list-style-type: none"> (1) the address in the <i>United Kingdom</i> where the <i>register of holders</i> is kept and can be inspected by <i>holders</i> and the address where the <i>plan register</i> can be inspected; and (2) in the case of an <i>AUT</i>, (unless the <i>depository</i> is the <i>registrar</i>), the <i>registrar's</i> name and address.
12	Payments to the authorised fund manager The payments that may be made to the <i>authorised fund manager</i> (whether as such or in any other capacity) out of the <i>scheme property</i> whether by way of <i>remuneration</i> for its services, or reimbursement of expenses. For each category of <i>remuneration</i> , specify: <ol style="list-style-type: none"> (1) the maximum and current rates or amounts of such <i>remuneration</i>; (2) how it will be calculated and accrue and when it will be paid; (3) if notice has been given to <i>holders</i> of the <i>authorised fund manager's</i> intention to introduce a new category of <i>remuneration</i> for its services or to increase any rate or amount currently charged, particulars of that introduction or increase and when it will take place; (4) if, in accordance with <i>CIS</i> 8.3.5R (Allocation of payments to capital or to income (for ICVCs)) or <i>CIS</i> 8.5.7R (Allocation of payments to capital or to income (for AUTs)), all or part of the <i>remuneration</i> is to be treated as a capital charge: <ol style="list-style-type: none"> (a) that fact; and (b) the actual or maximum amount of the charge which may be so treated; and (5) if notice has been given to <i>holders</i> of an intention to propose an increase in the maximum amount of that charge at a meeting of <i>holders</i>, particulars of that proposal.
13	Other payments out of the scheme property Provide details of: <ol style="list-style-type: none"> (1) any payment to be made out of the <i>scheme property</i> to reimburse costs incurred by the <i>depository</i>, any of the <i>directors</i> of an <i>ICVC</i> or any third party; (2) any <i>remuneration</i> payable out of the <i>scheme property</i> to the <i>depository</i>; (3) any <i>remuneration</i> payable out of the <i>scheme property</i> to any third party; (4) any <i>remuneration</i>, to which (2) or (3) does not apply, payable out of the <i>scheme property</i> for services provided by an <i>affected person</i>; (5) the types of any other charges and expenses that may be taken out of the <i>scheme property</i>; and (6) if, in accordance with <i>CIS</i> 8.3.5R(4) (Allocation of payments to capital or income (for ICVCs)) or <i>CIS</i> 8.5.7R(4) (Allocation of payments to capital or income (for AUTs)), the <i>authorised fund manager</i> and the <i>depository</i> have agreed that all or part of any payments permitted (excluding any stated under <i>CIS</i> 3.5.2R(12)(4) (Payments to the authorised fund manager)) and any other charges or expenses of the <i>authorised fund</i> may be treated as a capital expense: <ol style="list-style-type: none"> (a) that fact; and

	(b)	the policy for the amount of the payments which may be so treated.
14	Movable and immovable property (ICVC only)	Give an estimate of any expenses likely to be incurred by the <i>ICVC</i> in respect of movable and immovable property in which the <i>ICVC</i> has an interest.
15	Amortisation (ICVC only)	As at the date of the <i>prospectus</i> : <ol style="list-style-type: none"> (1) the amount of any set-up costs (including any of the type described in <i>CIS</i> 8.3.4R (Set-up costs) remaining to be reimbursed out of the <i>scheme property</i> whether to the <i>ACD</i> or any other <i>person</i>, and (2) the amount of any costs remaining to be amortised under <i>CIS</i> 8.3.4R and the method of amortisation.
16	Sale and redemption of units	Details as to: <ol style="list-style-type: none"> (1) the <i>dealing days</i> and times in the <i>dealing day</i> on which the <i>authorised fund manager</i> will be available to receive requests for the <i>sale</i> and <i>redemption of units</i>; (2) the procedures for effecting the <i>sale</i> and <i>redemption of units</i> and the settlement of transactions; (3) whether certificates will be issued in respect of registered <i>units</i>; (4) the steps required to be taken by a <i>holder</i> in redeeming <i>units</i> before he can receive the proceeds; (5) the circumstances in which the <i>redemption of units</i> may be suspended; (6) the <i>days</i> and times in the <i>day</i> on which recalculation of the <i>price</i> will commence; (7) the amounts of the following minima (if they apply) for each type of <i>unit</i> in the <i>authorised fund</i>: <ol style="list-style-type: none"> (a) the minimum number or value of <i>units</i> which any one <i>person</i> may hold; and (b) the minimum number or value of <i>units</i> which may be the subject of any one transaction of <i>sale</i> or <i>redemption</i>; (8) the circumstances in which the <i>authorised fund manager</i> may arrange for, and the procedure for, a <i>cancellation of units</i> in specie; (9) when and in which <i>UK</i> national newspaper the most recent <i>price</i> will be published; (10) the <i>investment exchanges</i> (if any) on which <i>units</i> in the <i>scheme</i> are listed or dealt; and (11) for a <i>dual-priced scheme</i> or a <i>scheme</i> being valued on an <i>historic price</i> basis, the amount which constitutes a <i>large deal</i> in <i>units</i>.
17	Valuation of scheme property	Details as to: <ol style="list-style-type: none"> (1) how frequently and at what time or times of the <i>day</i> the <i>scheme property</i> will be regularly valued for the purpose of determining the <i>price</i> at which <i>units</i> in the <i>scheme</i> may be purchased from or redeemed by the <i>authorised fund manager</i> and a description of any circumstance in which the <i>scheme property</i> may be specially valued; (2) in relation to each purpose for which the <i>scheme property</i> must be valued, the basis on which it will be valued; and (3) (in the case of an <i>ICVC</i>) how the <i>price</i> of <i>units</i> of each <i>class</i> will be determined.

18	<p>Dilution levy</p> <p>In the case of an <i>ICVC</i> or a <i>single-priced AUT</i>:</p> <ol style="list-style-type: none"> (1) what is meant by <i>dilution</i>, by <i>dilution levy</i> and, for the purposes of (2), by <i>large deal</i>; and (2) the <i>authorised fund manager's</i> policy on imposing a <i>dilution levy</i>, including its policy on <i>large deals</i>.
19	<p>SDRT provision</p> <p>Details as to:</p> <ol style="list-style-type: none"> (1) what is meant by stamp duty reserve tax, <i>SDRT provision</i> and, for the purposes of (2), by <i>large deal</i>; and (2) the <i>authorised fund manager's</i> policy on imposing an <i>SDRT provision</i> including its policy on <i>large deals</i>.
20	<p>Forward and historic pricing</p> <p>The <i>authorised fund manager's</i> normal basis of <i>dealing</i> (whether at a <i>forward price</i>, or at an <i>historic price</i>, or on the basis of a switch from the latter to the former in every <i>dealing period</i>).</p>
21	<p>Preliminary charge</p> <p>If the <i>authorised fund manager</i> makes a <i>preliminary charge</i>:</p> <ol style="list-style-type: none"> (1) the maximum amount of that charge, expressed either as a fixed amount or as a percentage of the <i>issue price</i>; (2) the current rate or amount of <i>preliminary charge</i>, if different from the maximum amount or rate; and (3) if notice has been given to <i>unitholders</i> of the <i>authorised fund manager's</i> intention to introduce a <i>preliminary charge</i> or to increase the rate or amount currently charged, particulars of that introduction or increase and when it will take effect.
22	<p>Redemption charge</p> <p>If the <i>authorised fund manager</i> may make a <i>redemption charge</i>:</p> <ol style="list-style-type: none"> (1) the amount of that charge or, if it is variable, the rate or method of arriving at it; (2) if the amount or rate or method has been changed, that details of any previous amount or rate or method may be obtained from the <i>authorised fund manager</i> on request; (3) if notice has been given of an intention to introduce a <i>redemption charge</i> or to propose a change in the amount or rate or method which is adverse to <i>holders</i>, particulars of that proposal; and (4) how the order in which <i>units</i> acquired at different times by a <i>unitholder</i> is to be determined so far as necessary for the purposes of the imposition of the <i>redemption charge</i>.
23	<p>General information</p> <p>Details as to:</p> <ol style="list-style-type: none"> (1) when annual and half-yearly reports will be published and, if the <i>directors</i> of the <i>ICVC</i> or the <i>manager</i> of the <i>AUT</i> have determined that the accounts contained in the report should be short form accounts, a statement that a report containing the full accounts is available on request; (2) the address at which copies of the <i>instrument constituting the scheme</i>, any amending instrument and the most recent annual and half-yearly reports may be inspected and from which copies may be obtained; (3) (in the case of <i>dual-priced AUTs</i> only) that the <i>cancellation price</i> last notified to the <i>trustee</i> is available on request;

	<p>(4) how the <i>ICVC</i> or the <i>manager</i> of an <i>AUT</i> will publish, for the benefit of <i>holders of bearer certificates</i>, notice:</p> <p>(a) of the fact that annual and half-yearly reports are available for inspection and how copies may be obtained;</p> <p>(b) when a distribution of income will become payable and how it may be collected;</p> <p>(c) of the calling of meetings;</p> <p>(d) of the winding up of the <i>authorised fund</i> (or the termination of a <i>sub-fund</i> of an <i>umbrella scheme</i>) or the revocation of its <i>authorisation</i>;</p> <p>(e) that amendments have been made to the <i>instrument constituting the scheme</i>;</p> <p>(f) that a significant alteration has been made to the <i>prospectus</i>; and</p> <p>(g) of any sub-division or consolidation of <i>units</i> (other than a consolidation of <i>smaller denomination shares</i> into <i>larger denomination shares</i>); and</p> <p>(5) the extent to which and the circumstances in which:</p> <p>(a) the <i>scheme</i> is liable to pay or suffer tax on any appreciation in the value of the <i>scheme property</i> or on the income derived from the <i>scheme property</i>; and</p> <p>(b) deductions by way of withholding tax may be made from distributions of income to <i>holders</i> and payments made to <i>holders</i> on the <i>redemption</i> of <i>units</i>.</p>
24	<p>Umbrella scheme</p> <p>(1) In the case of an <i>umbrella scheme</i>:</p> <p>(a) that a <i>holder</i> is entitled to exchange <i>units</i> in one <i>sub-fund</i> for <i>units</i> in any other <i>sub-fund</i>;</p> <p>(b) that an exchange of <i>units</i> in one <i>sub-fund</i> for <i>units</i> in any other <i>sub-fund</i> is treated as a <i>redemption</i> and <i>sale</i> and will, for <i>persons</i> subject to <i>United Kingdom</i> taxation, be a realisation for the purposes of capital gains taxation;</p> <p>(c) that in no circumstances will a <i>holder</i> who exchanges <i>units</i> in one <i>sub-fund</i> for <i>units</i> in any other <i>sub-fund</i> be given a right by law to withdraw from or cancel the transaction;</p> <p>(d) what charges, if any, may be made on exchanging <i>units</i> in one <i>sub-fund</i> for <i>units</i> in any other <i>sub-fund</i>;</p> <p>(e) the policy for allocating between <i>sub-funds</i> any assets of, or costs, charges and expenses payable out of, the <i>scheme property</i> which are not attributable to any particular <i>sub-fund</i>;</p> <p>(f) (for <i>ICVCs</i> only) how the method of amortisation of any costs to be amortised under <i>CIS</i> 8.3.4R (Set-up costs), or any reimbursement of set-up costs may be affected by the introduction or termination of a <i>sub-fund</i>;</p> <p>(g) (for <i>ICVCs</i> only) in respect of each <i>sub-fund</i>, the currency in which the <i>scheme property</i> allocated to it will be valued and the <i>price</i> of <i>units</i> calculated and payments made, if this currency is not the <i>base currency</i> of the <i>umbrella scheme</i>; and</p> <p>(h) if there are <i>units</i> for less than two <i>sub-funds</i> in <i>issue</i>, the effect of <i>CIS</i> 12.5.5R (An <i>ICVC</i> with only one <i>sub-fund</i>).</p> <p>(2) In the application of these <i>rules</i> to an <i>umbrella scheme</i>, information required:</p>

		<ul style="list-style-type: none"> (a) must be stated in relation to each <i>sub-fund</i> where the information for any <i>sub-fund</i> differs from that for any other; (b) must be stated for the <i>umbrella scheme</i> as a whole, but only where the information is relevant to the <i>umbrella scheme</i> as a whole; and (c) must, in the case of an <i>ICVC</i>, contain a statement to the effect that the <i>sub-funds</i> of an <i>umbrella scheme</i> are not “ring fenced” and in the event of an <i>umbrella scheme</i> being unable to meet liabilities attributable to any particular <i>sub-fund</i> out of the assets attributable to that <i>sub-fund</i>, the remaining liabilities may have to be met out of the assets attributable to other <i>sub-funds</i>.
25	Marketing in another EEA State	<p>A <i>prospectus</i> of a <i>UCITS scheme</i> which is prepared for the purpose of <i>marketing units</i> in a <i>EEA State</i> other than the <i>United Kingdom</i> must give details as to:</p> <ul style="list-style-type: none"> (1) what special arrangements have been made: <ul style="list-style-type: none"> (a) for paying in that <i>EEA State</i> amounts distributable to <i>holders</i> resident in that <i>EEA State</i>; (b) for redeeming in that <i>EEA State</i> the <i>units</i> of <i>holders</i> resident in that <i>EEA State</i>; (c) for inspecting and obtaining copies in that <i>EEA State</i> of the <i>instrument constituting the scheme</i> and amendments to it, of the <i>prospectus</i> and of the annual and half-yearly reports; and (d) for making public the <i>price</i> or <i>prices</i> of <i>units</i> of each <i>class</i>; (2) how the <i>ICVC</i> or the <i>manager</i> of an <i>AUT</i> will publish in that <i>EEA State</i> notice: <ul style="list-style-type: none"> (a) that annual and half-yearly reports are available for inspection; (b) that a distribution has been declared; (c) of the calling of a meeting of <i>holders</i>; and (d) of the termination of the <i>authorised fund</i> or the revocation of its <i>authorisation</i>.
26	Additional information	<p>Any other material information which is within the knowledge of <i>the directors</i> of an <i>ICVC</i> or the <i>manager</i> of an <i>AUT</i>, or which the <i>directors</i> or <i>manager</i> would have obtained by the making of reasonable enquiries:</p> <ul style="list-style-type: none"> (1) which investors and their professional advisers would reasonably require, and reasonably expect to find in the <i>prospectus</i>, for the purpose of making an informed judgement about the merits of investing in the <i>authorised fund</i> and the extent and characteristics of the risks accepted by so participating; and (2) including a statement of any risks which investment in the <i>authorised fund</i> may reasonably be regarded as presenting for reasonably prudent investors of moderate means.

Chapter 4.

Single-pricing and dealing

4.

4.1 Introduction

Application

4.1.1

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- (1) This chapter applies in relation to *ICVCs* and *single-priced AUTs*. Accordingly, in this chapter:
- (a) references to “*authorised funds*” and to “*units*” relate only to *ICVCs* and *single-priced AUTs* and to *shares* or *units* in them;
 - (b) references to “*authorised fund manager*” or to “*depository*” relate only to the *ACD* or *depository* of an *ICVC* or to the *manager* or *trustee* of a *single-priced AUT*; and
 - (c) references to an “*AUT*”, “*manager*” or “*trustee*” relate only to a “*single-priced AUT*”, or to its *manager* or *trustee*.
- (2) (a) This section (*CIS* 4.1) applies to *ICVCs*, their *directors* (including the *ACD*) and *depositories*, and to the *managers* and *trustees* of *single-priced AUTs*.
- (b) The purposes to which (a) can apply are:
- (i) ascertaining the number of *units* to be issued or cancelled for the *authorised fund manager* to comply with *CIS* 4.3.9R(2) (Issue of units to meet authorised fund manager’s obligation to sell) and *CIS* 4.3.10R(2) (Cancellation and payment for cancelled units); or
 - (ii) compliance with requirements of this chapter relating to information to be given by the *authorised fund manager* to the *depository*.
- (c) Paragraphs (a) and (b) do not apply to the *income units* and *accumulation units* of an *ICVC* unless the rights attached to those *classes* provide for their *prices* to be calculated by reference to undivided *shares* (whatever called) in a manner similar to that resulting from *CIS* 2.6.1R (Units and classes of units in *AUTs*).

- (3) If, and to the extent that, the *authorised fund manager* and the *depository* so agree, *income units* and *accumulation units* are to be treated, for the purposes in (b) as belonging to the same *class of units*.

Persons to whom the provisions apply

4.1.2

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The *persons* to whom each *rule* and *guidance* in this chapter applies are stated either at the beginning of the *rule* or *guidance* or at the beginning of the section containing the *rule* or *guidance*.

Purpose

4.1.3

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- (1) This chapter helps in achieving the *regulatory objective* of protecting consumers (consumer's interests) as envisaged by section 2 and 5 of the *Act*. In accordance with *Principle 6*, this chapter is intended to ensure the *authorised fund manager* pays due regard to its *customers'* interests and treats them fairly.
- (2) An *authorised fund manager* is responsible for valuing the *scheme* property of the *authorised fund* it manages and for calculating the *price of units* in the *authorised fund*. As well as arranging for the *issue* and the *cancellation of units* for the account of the *authorised fund*, the *authorised fund manager* is permitted to *sell* and redeem *units* for its own account. The *rules* in this chapter are intended to ensure that the *price of units* is properly related to the net value of the *authorised fund* and, in accordance with *Principle 6*, that the *authorised fund manager* treats customers fairly with investors when they purchase or *sell units*. This chapter provides common standards for these purposes.

Explanation of this chapter

4.1.4

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- (1) The *rules* in this chapter make apparent the extent to which any of them, or any paragraph in any of them, applies only to a *single-priced AUT* or to an *ICVC*. In particular, *CIS 4.3.3R* (Issue and cancellation of shares by an *ICVC*) applies only to an *ICVC* and the following *rules* apply only to a *single-priced AUT*: *CIS 4.3.4R* (Issue and cancellation of units in an *AUT*); *CIS 4.3.5R* (Trustee's refusal to issue or cancel units); *CIS 4.3.6R* (Instructions or notifications between managers and trustees).
- (2) *Shares* in an *ICVC* are issued or cancelled when the *ACD* records the *issue* or *cancellation*. *Units* of an *AUT* are issued or cancelled by the *trustee* on the *manager's* instructions. In the case of an *issue*, payment in cash of the *price* of the *units* or a transfer of assets of an equivalent value must be made to the *depository* for the account of the *authorised fund* concerned. Payment by the *depository* for cancelled *shares* is normally to be made by the close of the fourth *business day* after the *cancellation*.
- (3) An *authorised fund manager* may hold *units* for its own account (in its 'box'): so a purchaser of *units* from the *authorised fund manager* may receive *units* which have been issued to the *authorised fund manager* or that have been redeemed (that is repurchased) by the *authorised fund manager* from a previous *holder*. In addition to selling and redeeming *units* for its own account, the

authorised fund manager may arrange for the *trustee* or the *ICVC* to *issue units* direct to an investor or to cancel a *holder's units*.

- (4) The *authorised fund manager* must be prepared to redeem *units* of a *holder* who wishes to realise the value of them. The *authorised fund manager* can then retain the *units* in its box or it can cancel them.
- (5) The special provision about initial *issues* and *sales* at the start of an *authorised fund's* life are in *CIS 4.2*, separately from the *rules* about *issues* and *sales* in an ongoing *authorised fund*.
- (6) Under this chapter, the *price* at which a *unit* is issued, sold, redeemed or cancelled will be a single *price*. Although certain additions to, or deductions from, the *price* are provided for and affect payments, they do not affect the single *price*. Except for the initial *issues* and *sales*, the single *price* will be determined in accordance with *CIS 4.3.11R* (Price of a unit) and, in broad outline, will be calculated by valuing the *scheme property* attributable to the *class* of *units* in question and dividing that value by the number of those *units* in *issue*. The valuation of the *scheme property* must be in accordance with *CIS 4.8* and with the relevant provisions of the *instrument constituting the scheme*.
- (7) *CIS 4.6* provides the *authorised fund manager* with the power to require, for the benefit of the *authorised fund*, the payment or deduction of a *dilution levy* or a provision for stamp duty reserve tax (*SDRT provision*) or both as an addition to (but not part of) the single *price*.
- (8) The requirements in this chapter are to be applied separately to each *sub-fund* of an *umbrella scheme*.

4.2 Initial offers

Application

- 4.2.1 **R**_{/1} This section (CIS 4.2) applies to *authorised fund managers* and CIS 4.2.4R(1) (Issue of units : initial offer) also applies to any *directors* of an ICVC additional to the ACD.

Purpose

- 4.2.2 **G**_{/1} This section (CIS 4.2) helps to protect investors by *rules* intended to ensure the *authorised fund* receives subscriptions for *units* and that neither the *authorised fund* nor the investor will suffer any material loss, as a result of fluctuations in the value of the *scheme* property, for so long as *units* are available at the fixed *price*.

Period of initial offer

- 4.2.3 **R**_{/1}
- (1) The period of the *initial offer* must not exceed 21 *days* and an *initial offer* must, subject to CIS 4.2.5R (Compulsory termination of initial offer), be kept open for the period of the *initial offer*.
 - (2) Where an *initial offer* is of *units* in a *sub-fund*, CIS 4.2.4R and CIS 4.2.5R apply as if references in those *rules* to a *unit* were to a *unit* in that *sub-fund*.

Issue of units: initial offer

- 4.2.4 **R**_{/1}
- (1) The *price* to be paid for a *unit* of any *class* issued during the period of the *initial offer* must be the *initial price* of a *unit* of that *class*, as determined by the *directors* of the ICVC or the *manager* of the AUT. The *price* must be notified in writing to the *depository* before the start of the period of the *initial offer*.
 - (2) For the purpose of (1), a *unit* is treated as issued during the period of the *initial offer* if the *authorised fund manager* had agreed to its *sale* or received an order for it to be sold before the close of the period, and it was issued only afterwards.

- (3) The *authorised fund manager* must, by the close of business on the fourth *business day* after receiving the *price* from the purchaser, pay the *depository* the *price* of any *unit* it agreed to sell during the period of the *initial offer*, unless payment by the *authorised fund manager* is due earlier under CIS 4.3.7R (Payments for units issued). The *authorised fund manager* may retain for its own account any *preliminary charge* it makes under CIS 8.2.2R (Preliminary charge: ICVCs and single-priced AUTs).
- (4) During the period of the *initial offer*, the *authorised fund manager* must not agree to cause *units* to be issued under CIS 4.5 (Issues and cancellations through the authorised fund manager and in specie cancellations) at a *price* other than the *initial price*.
- (5) The *initial price* of a *unit* must, subject to CIS 12.5.2R (Base currency), be expressed in the *base currency* of the *authorised fund* (or, for a *currency class share*, in the currency of designation of that *class*). However, during the period of the *initial offer*, the *authorised fund manager* may agree to sell *units*, or cause *units* to be issued under CIS 4.5.3R (Issues and cancellations through the authorised fund manager) in any other currency.
- (6) Nothing in this *rule* affects the powers of the *authorised fund manager* to require a payment of *SDRT provision* under CIS 4.6.3R (Dilution levy and SDRT provision).
- (7) Where the *initial offer* is made in a country outside the *United Kingdom*, an amount may be added to the *initial price* of *units* offered in that country which is sufficient to cover additional duty or taxation leviable in that country and the cost of remitting *money* to the *United Kingdom*.

Compulsory termination of initial offer

4.2.5

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- (1) The period of the *initial offer* comes to an end immediately if:
 - (a) the *authorised fund manager* does not carry out a valuation immediately, but after having taken reasonable care, it ascertains that, if the current *price* of a *unit* were to be calculated by reference to an immediate valuation, it would be likely to vary from the *unit's initial price* by 2% or more of the *initial price*; or
 - (b) the *authorised fund manager* carries out a valuation immediately after it has ascertained the circumstances mentioned in (a) and the valuation shows there is a variation of 2% or more.
- (2) If the period of the *initial offer* comes to an end under (1), the *authorised fund manager* must immediately refrain from:

- (a) agreeing to *sell units* at the *initial price*; and
 - (i) in the case of an *ICVC*, arranging for the *ICVC* to *issue shares* at the *initial price*, except to fulfil an existing obligation of the *ACD* to *sell shares* at the *initial price* or to fulfil an *order* for *shares* at the *initial price* which the *ACD* received before the *initial offer* came to an end; or
 - (ii) in the case of an *AUT*, instructing the *trustee* to *issue units* at the *initial price*, unless to fulfil an existing obligation of the *manager* to *sell units* at the *initial price* or to fulfil an *order* for *units* at the *initial price* which the *manager* received before the *initial offer* came to an end.
- (3) The current *price* of a *unit* for the purpose of (1) must be calculated on the basis that the number of *units* of each relevant *class* in existence immediately before the valuation is the number for which the *initial price* has been paid, or for which assets have been transferred to the *depository* in exchange (or treated for the purpose of the valuation as having been paid or exchanged), before the valuation.

4.3 Issue and cancellation

Application

- 4.3.1** **R** ^{/1} This section (*CIS* 4.3) applies in relation to the *issue, cancellation* and pricing of *units* of an *authorised fund* after the close of any *initial offer* of *units* at a fixed *price*. However, the *rules* in *CIS* 4.3.3R to *CIS* 4.3.7R and *CIS* 4.3.12R also apply to the *initial issue* of *units* under *CIS* 4.2.4R.

Purpose

- 4.3.2** **G** ^{/1} This section (*CIS* 4.3) protects investors by means of *rules* intended to ensure the *authorised fund* receives or pays out the right amounts when *units* are issued or cancelled. Accordingly, it lays down certain basic procedures for the *issue* and *cancellation* of *units* and sets out how, except for an *initial offer*, the *prices* of those *units* are to be calculated, and paid.

Issue and cancellation of shares by an ICVC

- 4.3.3** **R** ^{/1}
- (1) This *rule* (*CIS* 4.3.3R) applies to *ICVCs* and to *ACDs* and *depositories* of *ICVCs*.
 - (2) *Shares* in an *ICVC* are issued or cancelled by the *ACD* making a record for the *ICVC* of the *issue* or *cancellation* and of the number of the *shares* of each *class* concerned. *Shares* must not be issued or cancelled in any other manner.
 - (3) The time of the *issue* or *cancellation* under (2) is the time when the record is made.
 - (4) References in these *rules* to arrangements for the *ICVC* to *issue* or cancel *shares* means arrangements for making a record of the *issue* or *cancellation*.
 - (5) The *ACD* may arrange for the *ICVC* to *issue shares* in exchange for assets other than *money* if the *depository* has taken reasonable care to determine that acquiring the assets in exchange for the *issue* of *shares* is not likely to result in any material prejudice to

the interests of *shareholders* or potential *shareholders*. For this purpose the *depository* must take account of any payment that would have been required under CIS 4.6.3R (Dilution levy and SDRT provision) had the *shares* been issued for cash.

- (6) An *issue* under (5) must not be made in breach of CIS 11.5.2R (Schemes of arrangement: requirements).

Issue and cancellation of units in an AUT

4.3.4

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- (1) This *rule* (CIS 4.3.4R) applies to *managers* and *trustees*.
- (2) Where the *manager* wishes new *units* to be issued or wishes *units* to be cancelled and, in either case, complies with CIS 4.3.11R(4) and (5) (Price of a unit), it may instruct the *trustee* to *issue* or cancel *units*. Any instructions given by the *manager* must state, for each *class* of *unit* to be issued or cancelled, the number to be issued or cancelled, expressed either as a number of *units* or as an amount in value (or as a combination of the two).
- (3) The *trustee* must *issue* or cancel *units* on receipt of, and in accordance with, instructions given by the *manager* under (2) and must not *issue* or cancel *units* otherwise, but this is subject to (4) and CIS 4.3.5R(2).
- (4) The *trustee* may *issue units* in exchange for assets other than *money*, but its obligation to comply with an instruction to *issue units* in such a case arises only:
 - (a) if it has taken reasonable care to determine that (taking account of any payment that would have been required under CIS 4.6.3R (Dilution levy and SDRT provision) if the *units* had been issued for cash) the acquisition of the assets in exchange for the number of *units* to be issued is not likely to result in any material prejudice to the interests of *unitholders* or potential *unitholders*;
 - (b) in a case governed by CIS 11.5.2R(5) (Schemes of arrangement: requirements) if the resolution concerned in relation to the *AUT* of which it is the *trustee* has been duly carried or is not required.
- (5) The *manager* may, at any time during the period of an *initial offer*, instruct the *trustee* to *issue units*. Furthermore, as soon as the period of the *initial offer* has come to an end, the *manager* must instruct the *trustee* to *issue* any *units* which were sold, or treated as sold, during that period and which it has not already instructed the *trustee* to *issue*.

4.3.5

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Trustee's refusal to issue or cancel units

- (1) This *rule* (CIS 4.3.5R) applies to *managers* and *trustees* of AUTs.
- (2) If, on receiving instructions to *issue* or cancel *units*, the *trustee* is of the opinion that it is not in the interests of *unit*holders that:
 - (a) *units* should be issued; or
 - (b) *units* should be cancelled; or
 - (c) *units* should be issued or cancelled in the number requested by the *manager*;

the *trustee* must give notice to the *manager* that it refuses to *issue* or, as the case may be, cancel, all, or a specified number of, the *units*.
- (3) On giving such a notice, the *trustee* is relieved of the obligation to *issue* or cancel the number of *units* to which the notice relates.

Instructions or notifications between the manager and trustee

4.3.6

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- (1) This *rule* (CIS 4.3.6R) applies to *managers* and *trustees* of AUTs.
- (2) Any instruction or notification given (or report supplied) under this chapter by the *manager* to the *trustee*:
 - (a) must be in writing or in such other form as enables the recipient to know or record the time of receipt and to preserve a legible copy of it; and
 - (b) must be recorded by the *manager* at the time when it is given or supplied.
- (3) Instructions or notifications are given within any period under this chapter if they are received by the *trustee* within that period, and instructions or notifications received by the *trustee* after the expiry of any period are treated as given after that expiry.
- (4) This *rule* also applies, with the substitution of "*manager*" for "*trustee*" and "*trustee*" for "*manager*", to any instruction or notification given by the *trustee* to the *manager*.

Payment for units issued

4.3.7

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- (1) This *rule* (CIS 4.3.7R) applies to *authorised fund managers*.

- (2) This *rule* applies to a *unit* issued during the period of the *initial offer* (and for this purpose the time of *issue* is not governed by CIS 4.2.4R(2) (Issue of units: initial offer)).
- (3) The *authorised fund manager* must, by the close of business on the fourth *business day* following the *issue* of any *units*:
 - (a) pay to the *depository*, in cash or cleared funds, the *price* of the *units* and any payment required under CIS 4.6.3R (Dilution levy and SDRT provision) to the extent that either remains unpaid; or
 - (b) for an exchange under CIS 4.3.3R(5) or CIS 4.3.4R(4), ensure transfer to the *depository* of the assets to be taken in exchange.
- (4) For an exchange under CIS 4.3.3R(5) or CIS 4.3.4R(4), the *authorised fund manager* must ensure the beneficial interest in the assets is transferred to the *ICVC* or to the *trustee* with effect from the *issue* of the *units*, even if the legal ownership is not then transferred.

Box management errors

4.3.8

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- (1) This *guidance* (CIS4.3.8G) applies to *authorised fund managers*.
- (2) An *authorised fund manager* is not permitted to *sell* or cancel *units* that it does not own. To do so would be in breach of CIS 4.3.9R(2) (Issue of units to meet authorised fund manager's obligation to sell) or CIS 4.3.10R(2) (Cancellation and payment for cancelled units). Errors relating to the number of *units* issued or cancelled can be corrected to the extent permitted by CIS 4.3.12R (Modification to number of units issued or cancelled).
- (3) An *authorised fund manager's* holding of *units* for its own account is commonly known as its "box" of *units*. Appendix CIS G (Correction of box management errors) contains further *guidance* on:
 - (a) controls relating to the management of the *authorised fund manager's* box of *units*;
 - (b) recording and reporting errors in calculating the number of *units* in the box;
 - (c) correcting such errors; and
 - (d) the payment of compensation in relation to particular categories of error.

Issue of units to meet authorised fund manager's obligation to sell

4.3.9

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- (1) This *rule* (CIS 4.3.9R) applies to *authorised fund managers*.

(2) If, at any *valuation point*, the *authorised fund manager* has any outstanding obligation to *sell units* of any *class*, it must arrange for the *ICVC* or instruct the *trustee* before the earlier of:

- (a) the expiry of two hours since the *valuation point*; or
- (b) the next *valuation point*;

to *issue units* of that *class* in such number (expressed either as a number of *units* or as an amount in value (or as a combination of the two)) as will at least enable the *authorised fund manager* to fulfil the obligation immediately whether from the *units* so issued or from other *units* of that *class* which it owned immediately before the *valuation point* (or *notified point* if there is one).

(3) If the *authorised fund manager* wishes regularly to have a *notified point*, it may notify the *depository* of its intention, indicating the period of time not exceeding two hours after the *valuation point* at which it wishes the *notified point* to occur. Any change in the period is ineffective unless agreed by the *depository*.

Cancellation and payment for cancelled units

4.3.10

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- (1) Paragraphs (2) and (3) and (7) to (9) apply to *authorised fund managers*; (4) applies only to *ICVCs* and their *depositories* and *ACDs*; (5) and (6) apply only to *managers* and *trustees* of *AUTs*.
- (2) The *authorised fund manager* must not arrange for the *ICVC*, or instruct the *trustee*, to cancel *units* of any *class* if, or to the extent that, by so doing the *authorised fund manager* would be prevented from immediately fulfilling any outstanding obligation to *issue units* which had been assumed before the relevant *valuation point* (or *notified point* if there is one).
- (3) For the purpose of (2), the *authorised fund manager* must take account of all *units* sold or redeemed by reference to the relevant *valuation point* (or *notified point* if there is one).
- (4) On cancelling *shares* the *ACD* must, within the period specified in (7), require the *depository* to pay the *price* of the *shares* (less any deduction required under *CIS* 4.6.3R (Dilution levy and SDRT provision)) to, or to the order of, the *shareholder* or the *ACD* (as the case may be).
- (5) Where instructions are given to cancel *units* in an *AUT* at a time which is less than two hours after the last *valuation point* and the *trustee* has received but not yet executed instructions previously given, the later instructions must enable the *trustee* to *execute* both or all sets of instructions simultaneously.

- (6) On cancelling *units* in an *AUT*, the *trustee* must within the period specified in (7) pay the *price* of the *units* (less any deduction required under *CIS* 4.6.3R (Dilution levy and SDRT provision):
- (a) (except where (b) applies) to, or to the order of, the *unitholder* or the *manager* (as the case may be); or
 - (b) in the case of a *relevant pension scheme*, in accordance with the relevant provisions of the *trust deed*.
- (7) The period for payment expires at the close of business on the fourth *business day* following the *cancellation* of the *units* or, if later, as soon as practicable after delivery to the *trustee* or the *ICVC* of such evidence of title to the *units* as it may reasonably require.
- (8) If the *authorised fund manager* has not ensured that the *scheme property* includes or will include sufficient cash in the appropriate currency (or a sufficient facility to borrow without infringing any restriction in *CIS* 5.15.3R (General power to borrow) or *CIS* 5.15.4R (Borrowing limits) within the period in (7)), that period is extended, for any relevant currency, until the shortage is rectified.
- (9) Paragraphs (4) and (6) do not apply where *units* are cancelled following a *cancellation* for property transferred or sold under *CIS* 4.5.4R (In specie redemption).

Price of a unit

4.3.11

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- (1) Paragraphs (2) to (3) apply to *authorised fund managers*; (4) and (5) apply only to *ICVCs* and their *depositories* and *ACDs*; (6) and (7) apply only to *managers* and *trustees*.
- (2) The *price* of a *unit* of any *class* must, subject to (3), be calculated as follows:
- (a) take the proportion, attributable to the *units* of the *class* in question, of the value of the *scheme property* (excluding, in the case of an *ICVC*, the *distribution account* and the *unclaimed payments account*), by reference to the most recent valuation of the *scheme property*;
 - (b) compute the number of *units* of the relevant *class* in *issue* immediately before the valuation in (a);
 - (c) divide the total at (a) by the number of *units* at (b); and
 - (d) Except for *smaller denomination shares*, express the *price* in a form that is accurate to at least four significant figures.

- (3) If a method of calculation other than that at (2) is used, the *authorised fund manager* must be sure it is bound to produce the same result.
- (4) Where an *issue* or *cancellation* of *shares* is made at a time which is less than two hours after the last *valuation point* and before the next *valuation point*, it must be made by reference to the *price* of the relevant *class* of *shares* calculated (or being calculated) for the last *valuation point*.
- (5) Any *issue* or *cancellation* of *shares* to be made more than two hours after the last *valuation point* must be made by reference to the *price* of the relevant *class* of *shares* next to be calculated and made only after the next *valuation point* has been reached.
- (6) Where the *manager* gives instructions to the *trustee* to create or cancel *units* and those instructions are given less than two hours after the last *valuation point* and before the next *valuation point*, the instructions must be given by reference to the *price* of the relevant *class* of *units* calculated (or being calculated) for the last *valuation point*.
- (7) Where the *manager* gives instructions to the *trustee* to create or cancel *units* and those instructions are given more than two hours after the last *valuation point*:
 - (a) the instructions must be given by reference to the *price* of the relevant *class* of *units* next to be calculated, and
 - (b) the *trustee* must not *issue* or cancel the *units* before the next *valuation point* has been reached.

Modification to number of units issued or cancelled

4.3.12

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- (1) This rule applies to *authorised fund managers* and *depositories*.
- (2) The number of *units* issued or cancelled may be modified by the *authorised fund manager* (in the case of *shares*) making a record for the *ICVC* of the modification or (in the case of *units* in an *AUT*) changing an instruction to *issue* or cancel *units* which has been complied with, provided that:
 - (a) the *authorised fund manager* ensures that any appropriate consequential payment between the *authorised fund manager* and the *depository* is made; and
 - (b) the requirements of (3) are satisfied.

- (3) The *authorised fund manager* may only make a modification under (2) with the agreement of the *depository* and the *depository* may not agree unless it has taken reasonable care to determine:
 - (a) that the purpose of the modification is to rectify the consequences of an error relating to the number of *units* held by the *authorised fund manager*, or issued or cancelled in connection with the *sale* or *redemption* of *units* by the *authorised fund manager*; and
 - (b) that in view of the quality of the *authorised fund manager's* control systems the circumstance that resulted in the error in question is an isolated one which is unlikely to recur.
- (4) A modification under (2) is of no effect unless the corrected number of *units* is calculated by the end of the *business day* next following the *valuation point* for the *issue* or *cancellation* in question or, if the *depository* agrees, within the payment period applicable to that *issue* or *cancellation* under CIS 4.3.7R(3) (Payment for units issued) or CIS 4.3.10R(7) (Cancellation and payment for cancelled units).

4.4 Sale and redemption

Application

- 4.4.1** **R** /1 (1) This section (CIS 4.4) applies to *authorised fund managers*. CIS 4.4.5R(4) (Payment on redemption) also applies to *ICVCs* and *depositories*.
- (2) This section (CIS 4.4) applies to the *sale* and *redemption* of *units* after the close of any *initial offer*. However, the following *rules* also apply to the *sale* of a *unit* during an *initial offer*:
- (a) CIS 4.4.3R(1), (2) and (3) (other than the provision in (2)(a) relating to a *sale* at a *forward price*); and
- (b) CIS 4.4.8R (but as if CIS 4.4.8R(2) related to the *initial price*).

Purpose

- 4.4.2** **G** /1 (1) This section (CIS 4.4) protects investors by means of *rules* intended to ensure the *authorised fund manager* deals fairly with investors when they *purchase* or *redeem units*. Accordingly, this section lays down the basic procedures for the *sale* and *redemption* of *units* in an *authorised fund* and sets out how the resulting payments should be calculated and by when they should be made.
- (2) *Sales* and *redemptions* of *units* in *futures* and *options schemes* or *geared futures* and *options schemes* are, in addition, subject to the special *rules* in CIS 12.2.1R (Special rules for sales and redemptions).

Authorised fund manager's obligation to sell

- 4.4.3** **R** /1 (1) The *authorised fund manager* must, at all times during the *dealing day*, be willing to *sell units* in the *authorised fund* and, subject to (2), must, at the request in writing of any *person*, agree to *sell* to that *person units* of at least one *class* or, in the case of an *umbrella scheme*, one *class* for each of its *sub-funds*.

- (2) The *authorised fund manager's* obligation to *sell units* under (1) does not apply:
- (a) if it has not received payment for the *units* of an amount complying with (4) or (if the *sale* was at a *forward price* of a stated number of *shares*) if it has not received payment of an amount it estimated to be required; or
 - (b) if the number or value of the *units* sought to be purchased is less than any number or value stated in the *prospectus* as the minimum number or value of *units*, or *units* of the *class* concerned, that may be purchased or held; or
 - (c) for a *property scheme* if the *authorised fund manager*, having taken reasonable care, determines that the number or value of *units* sought to be purchased would lead to any one *person* (or any one *person* and any other *person* who appears to the *authorised fund* to be acting in concert with that *person*) holding more than any number or value stated in the *prospectus* as the maximum number or value to be purchased or held; or
 - (d) if it has reasonable grounds, relating to the circumstances of the *person* concerned, for refusing to *sell units* to him; and
 - (e) for an *AUT*, if the *sale* would be in breach of a provision in the *trust deed* of any of the types described in paragraphs (j) (Limited categories of unitholder), (m) (Relevant pension schemes) or (n) (Relevant charitable schemes) of CIS 2.2.7G (Provisions that may be included in the trust deed).
- (3) Paragraph (1) does not apply to *units* of any *class*:
- (a) if no *units* of that *class* are in *issue*; or
 - (b) if the *sale* of *units* of that *class* is prohibited by the *rules* in CIS 13 (Suspension and termination).
- (4) The *authorised fund manager* must not *sell* a *unit* for more than the *price* of a *unit* of the relevant *class* notified, or to be notified, to the *depository* for the last *valuation point* (or, for a *sale* at a *forward price*, to be notified for the next *valuation point*) to which may be added any *preliminary charge* permitted under CIS 8.2.2R (Preliminary charge: ICVCs and single-priced AUTs) and any payment required under CIS 4.6.3R (Dilution levy and SDRT provision).
- (5) *Units* must be sold in the *base currency*, or, for a *currency class share*, in the currency of designation of that *class*, unless the *person* concerned requests and the *authorised fund manager* agrees that the *units* should be sold in another currency.

4.4.4

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Authorised fund manager's obligation to redeem

- (1) The *authorised fund manager* must at all times during the *dealing day* be willing to redeem *units* in the *authorised fund*; and, accordingly, must at the request in writing of any *holder* agree to redeem *units* owned by that *holder* for the amount to be paid under CIS4.4.6R (Proceeds of redemption).
- (2) Paragraph (1) does not apply:
- (a) if the number or value of the *units* sought to be redeemed is:
 - (i) less than the entirety of the *holder's* holding of *units* of the *class* concerned, and
 - (ii) less than any number or value stated in the *prospectus* as the minimum number or value of *units*, or *units* of the *class* concerned, that may be redeemed;
 - (b) if the number or value of the *units* sought to be redeemed would result in the *holder* holding less than any number or value stated in the *prospectus* as the minimum number of *units*, or *units* of the *class* concerned, that may be held;
 - (c) if the *ICVC* or the *manager* ensures that the *holder* is able to sell his *units* on an *investment* exchange at a *price* not significantly different from the *price* at which they would have been redeemed;
 - (d) where *units* are redeemed in return for property transferred or sold under CIS4.5.4R (In specie redemption);
 - (e) during the period of the *initial offer*; or
 - (f) if *redemption* of the *units* of the *class* concerned is prohibited by the *rules* in CIS 13 (Suspension and termination).

Payment on redemption

4.4.5

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- (1) On agreeing to redeem *units*, the *authorised fund manager* must, within the period specified in (2):
- (a) (except where (b) applies) pay the *holder* the appropriate proceeds of *redemption* under CIS 4.4.6R (less, where applicable, the cost of remitting the sum abroad) ; or
 - (b) if a *manager* of a *relevant pension scheme*, pay or arrange for the payment of the proceeds of *redemption* in compliance with the *trust deed* (including, where applicable, any time limit in it for payment which is shorter than the period specified in (2)).

- (2) The period expires at the close of business on the fourth *business day* following the later of:
 - (a) the *valuation point* immediately after the *authorised fund manager* received the request to redeem; or
 - (b) the time when the *authorised fund manager* has all duly executed instruments and authorisations to effect (or enable the *authorised fund manager* to effect) transfer of title to the *units*.
- (3) Neither this *rule* nor CIS 4.4.6R (Proceeds of redemption) applies where the *authorised fund manager* is not redeeming *units* in accordance with this chapter but is *buying* them as *principal* on an *investment exchange* (in the case of an *AUT*, in accordance with a power in the *trust deed*) and settlement will be in accordance with the rules of that exchange.
- (4) Nothing in this *rule* or CIS 4.3.10R(5) and (6) (Cancellation and payment for cancelled units) requires an *ICVC*, a *depository* or an *authorised fund manager* to part with *money* for a *cancellation* or *redemption of units* where any *money* due on the earlier *issue* or *sale* of those *units* has not been received by the *person* entitled to it under this chapter.

Proceeds of redemption

4.4.6

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The amount to be paid by the *authorised fund manager* as the proceeds of *redemption* of a *unit* must not be less than the *price* of a *unit* of the relevant *class* notified or to be notified to the *depository* at the last *valuation point* (or, for a *redemption* at a *forward price*, to be notified in respect of the next *valuation point*) less any *redemption charge* permitted under CIS 8.2.7R (Redemption charge: ICVCs) or CIS 8.5.2R (Redemption charge: single-priced AUTs) and any deduction required under CIS 4.6.3R (Dilution levy and SDRT provision).

Notification of price to the depository

4.4.7

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- (1) Immediately after completing a valuation under CIS 4.8 (Valuation) (whether regular or otherwise) the *authorised fund manager* must notify the *depository* of the *price* of a *unit* of each *class* in *issue* as determined for the relevant *valuation point* and of the amount or rate of any *dilution levy* which applies to any *issue* or *cancellation of units*. The *prices* to be notified must be in the *base currency* or, in the case of a *currency class share*, the *currency of designation*.

- (2) Each notification under (1) must include a statement of the number of *units* of each *class* in *issue* owned by the *authorised fund manager* at the *valuation point* (or *notified point* if there is one).
- (3) As soon as practicable after each notification under (1), the *authorised fund manager* must notify the *depository* of the transactions, or types of transaction, for which an *SDRT provision* is applied and the amounts or rates of those *SDRT provisions*.

Publication of prices

4.4.8

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- (1) Where the *authorised fund manager* holds itself out as willing:
 - (a) to *sell* or redeem *units* of any *class*; or
 - (b) to *issue* or cancel *units* of any *class* under CIS 4.5.3R (Issues and cancellations through the authorised fund manager);
 it must make public the *prices* of *units* of each of those *classes*.
- (2) The *prices* made public under (1) are to be the *price* or *prices* last notified to the *depository* under CIS 4.4.7R or, in the case of publication in a newspaper, last notified before the relevant newspaper ceased to accept material for publication in the relevant edition.
- (3) The *prices* to be made public under (1) must be published in at least one national newspaper in the *United Kingdom*, except for any *class* of *units* marketed predominantly outside the *United Kingdom*.
- (4) Where the *authorised fund manager* holds itself out as willing to *sell* and redeem *units* (or, as the case may be, to *issue* or cancel *units* under CIS 4.5.3R) in any other *EEA State*, it must also comply with (1) in the manner provided for by the law of that *EEA State*.
- (5) Paragraphs (1) to (4) do not apply to *units* in relation to which the *authorised fund manager* is excused from dealing with the public.



4.5 Issues and cancellations through the authorised fund manager and in specie cancellations

Application

4.5.1 **R** This section (CIS 4.5) applies to *authorised fund managers*. CIS 4.5.3(6) R and CIS 4.5.4(4)R also apply to *ICVCs* and *depositories*.
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Purpose

- 4.5.2** **G**
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- (1) CIS 4.5.3R ensures investors are able, in certain circumstances, to require direct *issues* or *cancellations* of *units* by an *ICVC*, or by the *trustee* of an *AUT*, as an alternative to *buying units* from, or redeeming them with, the *authorised fund manager*.
 - (2) CIS 4.5.4R protects investors in the *authorised fund* by enabling an *authorised fund manager*, subject to the conditions in that *rule*, to require a *holder* who wishes to redeem or cancel his *units* to take, instead of the usual proceeds of *redemption* or *cancellation*, a transfer of assets of the *authorised fund* or, if the *holder* requires, to take the net proceeds of the *sale* of those assets.

Issues and cancellations through the authorised fund manager

- 4.5.3** **R**
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- (1) At the request of any *person*, the *authorised fund manager* is obliged to arrange for the *ICVC*, or instruct the *trustee*, to *issue units* to that *person* where the *authorised fund manager* would otherwise be obliged to *sell* them under CIS 4.4.3R (Authorised fund manager’s obligation to sell).
 - (2) At the request of any *holder*, the *authorised fund manager* is obliged to arrange for the *ICVC*, or instruct the *trustee*, to cancel *units* held by that *holder* where the *authorised fund manager* would otherwise be obliged to redeem them under CIS 4.4.4R (Authorised fund manager’s obligation to redeem).
 - (3) The *price* of a *unit* issued or cancelled under this *rule* (CIS 4.5.3R) must be the *price* of a *unit* of the relevant *class* notified to the *depository* at the next *valuation point* after the request

referred to in (1) or (2), except for an *issue* to which CIS 4.2.4R (Issue of units: initial offer) applies, when it must be the *initial price*.

- (4) (a) In the case of an *issue*, the *authorised fund manager* may require to be paid, in addition to the *price* under (3):
- (i) for the account of the *authorised fund manager*, any *preliminary charge* permitted under CIS 8.2.2R (Preliminary charge: ICVCs and single-priced AUTs);
 - (ii) for the account of the *authorised fund*, any payment required under CIS 4.6.3R (Dilution levy and SDRT provision).
- (b) In the case of a *cancellation*, the *authorised fund manager* may require to be deducted from the proceeds:
- (i) for the account of the *authorised fund manager*, any *redemption charge* permitted under CIS 8.2.7R (Redemption charge: ICVCs) or CIS 8.5.2R (Redemption charge: single-priced AUTs);
 - (ii) for the account of the *authorised fund*, any deduction required under CIS 4.6.3R (Dilution levy and SDRT provision).
- (5) The *authorised fund manager* must pay the *depository* in accordance with CIS 4.3.7R (Payments for units issued) the *price* of any *units* issued under this *rule* (CIS 4.5.3R) and any payment required under (4)(a)(ii) whether or not the *authorised fund manager* has received payment from the investor. However, the *authorised fund manager* may defer arranging for the ICVC, or instructing the *trustee*, to *issue* the *units* until full payment for them has been received.
- (6) Nothing in this *rule* (CIS 4.5.3R) requires an ICVC, a *depository* or an *authorised fund manager* to part with *money* for a *cancellation* of *units* in the circumstances described in CIS 4.4.5R(4) (Payment on redemption).

In specie redemption

4.5.4

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- (1) Whenever a *holder* requests the *redemption* or *cancellation* of *units*, the *authorised fund manager* may arrange for the *cancellation* of those *units* and that, instead of payment in cash to the *holder* of the *price* for the *units*, *scheme property* selected in accordance with (c) and (d) is transferred to the *holder*, or, if required by the *holder*, the net proceeds of the *sale* of that property is paid to him, provided that:

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- (a) the *prospectus* contains a statement describing the circumstances in which the *authorised fund manager* is permitted to arrange for, and describing the procedures for, a *cancellation of units* in the manner described above;
 - (b) the *authorised fund manager* gives the *holder* written notice before the proceeds of the *redemption* or *cancellation* would otherwise become payable in cash, that instead of such payment the *depository* will transfer *scheme property* (or the net proceeds of the *sale* of the relevant *scheme property*) to the *holder*;
 - (c) the *scheme property* to be transferred (or sold) is selected by the *authorised fund manager* in consultation with the *depository* and the selection is made with a view to achieving no more advantage or disadvantage to the *holder* requesting *cancellation* of his *units* than to the continuing *holders*; and
 - (d) the *scheme property* to be transferred, or the proceeds of the *sale* of the relevant *scheme property*, is subject to the retention by the *depository* of *scheme property* (including cash) of a value or amount equivalent to any deductions permitted by CIS 4.5.3R(4)(b) (Issues and cancellations through the authorised fund manager) and the *depository* accounts for any such deduction in the manner provided by that *rule*.
- (2) This *rule* (CIS 4.5.4R) does not enable the *authorised fund manager*, when acting as a *principal*, to cancel *units* other than for payment in cash.
 - (3) This *rule* does not enable *units* in a *relevant pension scheme* to be redeemed other than in accordance with that *scheme*.
 - (4) Nothing in this *rule* requires an *ICVC*, a *depository* or an *authorised fund manager* to transfer *scheme property*, or the proceeds of the *sale* of *scheme property*, in respect of the *cancellation* of *units* in the circumstances described in CIS 4.4.5R(4) (Payment on redemption).

4.6 Dilution levy and SDRT provision

Application

4.6.1 **R** This section (CIS 4.6) applies to *authorised fund managers*.

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Purpose

- 4.6.2 **G**
- (1) An ICVC or an AUT may suffer *dilution* (reduction) in the value of the *scheme property* as a result of the costs incurred in *dealing* in the underlying *investments* and of any spread between the *buying* and *selling prices* of these *investments*. However, an *authorised fund manager* is permitted to require the payment of a *dilution levy*, as an addition to (but not part of) the *price of units* when they are issued by the ICVC or the *trustee* or sold by the *authorised fund manager*, and as a deduction when they are cancelled by the ICVC or the *trustee* or redeemed by the *authorised fund manager*.
 - (2) Certain transactions in *units* can result in stamp duty reserve tax being paid out of the *scheme property* of an *authorised fund*. However, an *authorised fund manager* is permitted to require the payment of an *SDRT provision* as an addition to (but not as part of) the *price of units* when they are issued or sold, and as a deduction when they are cancelled (other than certain in specie *cancellations*) or redeemed.
 - (3) Any *dilution levy* or *SDRT provision* paid or received by deduction is for the account of the *authorised fund*.
 - (4) For the purposes of (1) to (3), it does not matter whether the *cancellation* is under CIS 4.3 (Issue and cancellations) or under CIS 4.5R (Issues and cancellations through the authorised fund manager and in specie redemptions). However, there are provisions to prevent the levy being imposed twice on both the *issue* and subsequent *sale* of a *unit*, or on the *redemption* and subsequent *cancellation* of a *unit*.
 - (5) CIS 4.6.3R(3)(b) makes it clear that *transactions* that are specifically excluded from a charge of stamp duty reserve tax (such as *transactions* in units within an individual pension account) can be excluded from the imposition of an *SDRT provision* without affecting the fairness required by that rule.

Dilution levy and SDRT provision

4.6.3

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- (1) The *authorised fund manager* has the power to require any one or more of:
 - (a) the payment of a *dilution levy* in respect of the *issue* or *sale* of *units* or any *class* of *units*;
 - (b) the deduction of a *dilution levy* in respect of the *redemption* or the *cancellation* of *units* or any *class* of *units*;
 - (c) the payment of an *SDRT provision* in respect of the *issue* or *sale* of *units* or any *class* of *units*;
 - (d) the deduction of an *SDRT provision* in respect of the *redemption* or *cancellation* of *units* or of any *class* of *units*, other than a *cancellation* of *units* under CIS 4.5.4R (In specie redemptions) resulting in a transfer of such part of each description of asset in the *scheme property* as is proportionate to, or as nearly as practicable proportionate to, the *holder's* share in the *scheme property* of the *AUT* or (as the case may be) share in the *ICVC*.
- (2) Any such payment or deduction becomes due at the same time as payment or transfer of property becomes due in respect of the *issue*, *sale*, *redemption* or *cancellation*.
- (3) A *dilution levy* or *SDRT provision* may be imposed only in a manner that is, so far as practicable, fair to all *holders* and potential *holders*. However: or
 - (a) the imposition of a *dilution levy* (or a higher *dilution levy*) or *SDRT provision* (or a higher *SDRT provision*) in respect of *large deals* in a manner described in the *prospectus* current at the time of the *deal*;
 - (b) the exclusion from an *SDRT provision* of any *transaction* in *units* where the *units* are so held that their redemption or cancellation is specifically excluded from a charge to stamp duty reserve tax;

or is not unfair
- (4) If the *authorised fund manager* receives a *dilution levy* or *SDRT provision* in respect of any *unit* sold or to be sold by it, it must, immediately upon receipt of that *dilution levy* or *SDRT provision*, pay it to the *depository* to become part of the *scheme property*, except to the extent that it has already been, or will be, paid by the *authorised fund* to the *depository* on the *issue* of that *unit*.

- (5) If the *authorised fund manager* deducts a *dilution levy* or *SDRT provision* from the proceeds of a *unit* it redeemed, it must immediately pay it to the *depository* to become part of the *scheme property*, except to the extent that it has already been, or will be, deducted from the *depository's* payment to the *authorised fund manager* when the *unit* is cancelled.

4.7 Forward and historic pricing

Application

- 4.1.1 **R** This section (CIS 4.7) applies to *authorised fund managers*.
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Purpose

- 4.1.2 **G** This section (CIS 4.7) protects investors by means of *rules* intended to prevent the *sale* and *redemption* of *units* at an *historic price* where this is liable to be unfair.
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Explanation

- 4.1.3 **G**
- (1) There are two ways in which an *authorised fund manager* may *sell* or redeem *units*; these are at forward and *historic prices*. A *forward price* is one which will be fixed at the next *valuation point*, while a *historic price* is one fixed on the basis of the last valuation.
 - (2) The two pricing systems have different characteristics. The investor knows that a forward *deal* will be priced at the next *valuation point*, but if he is investing a specified sum, he does not know until then how many *units* he will receive (or, if he is seeking to redeem, how much he will receive in cash). The investor knows, by contrast, that an historic *deal* may well represent a *price* which is outdated (though not by more than 2%), but is able to know, at the time of the *deal*, how much he must pay (or will receive) or the time of the valuation which will be relevant to that *price*.
 - (3) The *rules* generally express a preference for forward pricing in that there are numerous occasions when a *price* must be forward, whether or not the *authorised fund manager* chooses to *deal* in that way. *Issues* or *cancellations* by the *authorised fund manager* under CIS 4.5.3R (Issues and cancellations through the authorised fund manager) are always at a *forward price*.
 - (4) The diagram in CIS 4.7.6G indicates the *valuation point* relevant for *issues* and *cancellations* and for *sales* and *redemptions* in the period between one *valuation point* and the next. In doing so, it takes account of CIS 4.7.5R, and also of earlier provisions in this chapter, including CIS 4.3.11R(4) to (7) (Price of a unit).

Forward and historic pricing

4.1.4

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- (1) For the *sale and redemption of units*, the *authorised fund manager* must, subject to this rule (CIS 4.7.4R), operate on the basis of forward or *historic prices*, but its power to choose, or its duty to operate on one basis only, is governed by CIS 4.7.5R.
- (2) If the *prices* for the *sale and redemption of units* in any *sub-fund* of an *umbrella scheme* are on a forward basis, the *prices* for the *sale and redemption of units* related to all *sub-funds* of that *umbrella scheme* must be on a forward basis; but this paragraph (2) does not apply merely because of a requirement to *price* on a forward basis temporarily under Part 2 or Part 3 of CIS 4.7.5R.
- (3) *Prices* are to be on a forward basis only for the *issue and redemption of units* in an *authorised fund* which is a *geared futures and options scheme*, a *property scheme*, a *warrant scheme* or an *umbrella scheme* that includes a *sub-fund* which, if it were the subject of a separate *authorisation order*, would be an *authorised fund* of one of those categories.
- (4) CIS 4.7.5R does not apply during the period of *initial offer* at a fixed *price*. In CIS 4.7.5R:
 - (a) ‘F Only’ means that any *price* agreed on must be a *forward price*;
 - (b) ‘H’ means that any *price* agreed on must be an *historic price* unless the *authorised fund manager* is required by the table to *deal* at a *forward price*; and
 - (c) ‘General dealing’ means “in relation to all *sales and redemptions* agreed on during the remainder of the relevant *dealing period* (except those that are agreed upon individual deviations)”; and an ‘individual deviation’ is a decision, in relation to a particular transaction, covered by Part 3 of CIS 4.7.5R.

4.1.5

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Table Forward or historic pricing
This table belongs to [CIS4.7.4)

Table 4.7.5 R – Forward or historic pricing
Part 1: General Dealing

- | | |
|----|---|
| 1. | <i>Authorised fund manager’s</i> choice. The <i>prospectus</i> must state the <i>authorised fund manager’s</i> choice for H or else for F Only. |
| 2. | If the <i>authorised fund manager’s</i> current choice under 1. is F Only, all its <i>deals</i> must be at a <i>forward price</i> . |
| 3. | An <i>authorised fund manager</i> must not choose H if its normal arrangements for valuation envisage valuations more than one <i>business day</i> apart. |

4. The remainder of this table applies to an *authorised fund manager* with a current choice of H.
 5. It may at any time elect for F Only in respect of the rest of the then current *dealing period*.
 6. If the *authorised fund manager* binds itself to switch from H to F only at a certain point in each *dealing period* this must be stated in the *prospectus*
 7. An election for (or switch to) F Only will last until the end of the *dealing period* and will then lapse.
 8. For general dealing purposes, *redemptions* must be on the same basis as *sales*.
- Part 2: General Dealing – Duty to adopt forward pricing
9. Market movement. F Only applies once the *authorised fund manager* knows or has reason to believe that there would be a difference of 2% or more between the current value of the *scheme property*, if immediately valued, and its last calculated value (taking that as 100% for this purpose), but decides not to carry out an additional valuation under CIS 4.8.6R (Additional valuation points).
 10. Valuation taking over 2 hours. F Only applies if a new *price* for *units* of each *class* has not been notified to the *depository* after 2 hours (or such longer period as the *depository* may agree with the *authorised fund manager* generally or in any specific case) from the *valuation point*.
 11. F Only under 9 and 10 will start when the relevant moment arrives, will last until the end of the *dealing period* and will then lapse.
- Part 3: Individual Deviations
12. Paragraphs 13 to 16 apply to an individual transaction without affecting the general position arrived at under Parts 1 and 2.
 13. Request. F only applies if the applicant for *sale* or *redemption* so requests.
 14. *Large deals*: F only applies, if the *authorised fund manager* so decides, for a *large deal*.
 15. *Postal deals*: F only applies if the *order* or *offer* reaches the *authorised fund manager* through the post or by any similar form of one-way communication.
 16. *Issue* or cancellation through the *authorised fund manager* F Only applies in the case of an *issue* or cancellation under CIS 4.5.3R (Issues and cancellations through the authorised fund manager).
- Part 4: Notification to Depository
17. The *authorised fund manager* must notify the *depository* of the fact and time of any adoption of F only under 5 or Part 2.

4.8 Valuation

Application

4.8.1 **R** This section (CIS 4.8) applies to *authorised fund managers*.

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Purpose

4.8.2 **G** This section (CIS 4.8) protects investors by stating some basic requirements which apply to the valuation of the *scheme property* of an *AUT* or an *ICVC* for the purposes of determining the *price* of a *unit* in it. CIS 4.8.5R and CIS 4.8.6R provide for the frequency of valuation and when there are to be *valuation points*. A valuation which refers to a time that is not a *valuation point* will not cause that time to become a *valuation point*.

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Valuation: requirements

- 4.8.3** **R**
- (1) An *investment* included in the *scheme property* for which different prices are quoted according to whether it is being bought or sold must be valued at its mid-market price.
 - (2) Any part of the *scheme property* of an *authorised fund* that is not an *investment* must be valued at a fair value, but, for *property schemes*, this is subject to CIS 12.3.2R (Functions of the standing independent valuer) and CIS 12.3.3R (Special rules for pricing).
 - (3) For the purposes of (1) and (2), any fiscal charges or commissions or other charges that were paid, or would be payable, on acquiring or disposing of the investment or other part of the *scheme property*, must be excluded from the value of an investment or other part of the *scheme property*.
 - (4) The value of the *scheme property* of an *authorised fund* must be determined in accordance with the relevant provisions of the *instrument constituting the scheme*, except to the extent that this rule (CIS 4.8.3R) or CIS 5.2.5R (Valuation) or CIS 12.3 (Property schemes) applies.

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- (5) To determine the *price* at which *units* of any *class* in an *authorised fund* may be issued, cancelled, sold or redeemed, the *authorised fund manager* must carry out a valuation of the *scheme property* or of the *scheme property* attributable to a *sub-fund* at each *valuation point* for the *authorised fund* or the *sub-fund* (as the case may be).

Valuation: method

4.8.4

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- (1) CIS 4.8.3R(4) requires that, subject to the exceptions in it, the value of the *scheme property* of an *authorised fund* must be determined in accordance with the *instrument constituting the scheme*. Accordingly, the method of valuing *scheme property* should be set out in this instrument.
- (2) In accordance with CIS 4.8.3R(1), where different *buying* and *selling* prices are quoted for an *investment*, it should be valued at its mid-market price. The *instrument constituting the scheme* should set out the valuation method that will apply where a single price for *buying* and *selling* a *security* is quoted and where separate *buying* and *selling* prices are quoted.
- (3) In the context of *SETS*, The London Stock Exchange publishes an ‘official mid-market price’ for each *security*, calculated as the average of the best bid and best offer price, unweighted by *deal* size. Either the official mid-market price or the last trade price should provide an appropriate basis of valuation. The *authorised fund manager* should, however, document the choice of methodology and ensure the procedures are applied consistently and fairly. The basis on which the *scheme property* is to be valued must also be set out in an *authorised fund’s prospectus* as required by CIS 3.5.2R(17)(2).
- (4) Where there has been no recent trade in the *security* concerned, or where no reliable price exists, an investment should be valued at a price which, in the *authorised fund manager’s* opinion, reflects a fair and reasonable price for that investment. In such cases, the *authorised fund manager* should document the reasons for its decision and should be prepared to justify any assumptions made.

Regular valuation points

4.8.5

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- (1) There must be at least two *valuation points* in each calendar month and if there are only two *valuation points* in any calendar month they must be two weeks or more apart.
- (2) Paragraph (1) does not apply to *geared futures and options schemes* or to *warrant schemes* or to a *sub-fund* which is permitted to invest entirely in *warrants* and there must be at least one *valuation point* for them on each *business day*.
- (3) The frequency of regular *valuation points* must be specified in the *prospectus*.

- (4) Despite (1) and (2), no *valuation points* are required during the period of any *initial offer*.

Additional valuation points

4.8.6

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The *authorised fund manager* must inform the *depository* if the *authorised fund manager* determines to have an additional *valuation point* for the *authorised fund* or any *sub-fund*, but this does not prevent the *authorised fund manager* carrying out a valuation at a time that is not a *valuation point*.

Market movement

4.8.7

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- (1) This *rule* (CIS 4.8.7R) applies when an *authorised fund manager* is operating on the basis of *historic prices* and decides to carry out an additional valuation for the purpose of paragraph (9) (Market movement) of CIS 4.7.5R (Forward or historic pricing).
- (2) When the *rule* applies:
- (a) the valuation must be at an additional *valuation point* and the *authorised fund manager* must inform the *depository* of that *valuation point*;
 - (b) the valuation may be made by reference to fluctuations in an index of property whose composition is reflected by the *scheme property*, if the *authorised fund manager* having taken reasonable care determines, and the *depository* agrees, that an adequate valuation may be obtained in that way.

Chapter 5

Investment and borrowing powers



5.1 Introduction

Application

- 5.1.1 **R**_{/1} (1) This chapter applies in relation to *ICVCs* and *AUTs*.
- (2) This section (*CIS 5.1*) applies to *authorised fund managers* and *depositories*.

Application guidance

- 5.1.2 **G**_{/1} The *persons* to whom each respective *rule* and *guidance* in this chapter applies are stated either at the beginning of the *rule* or *guidance* or at the beginning of the section that contains the *rule* or *guidance*.

Purpose

- 5.1.3 **G**_{/1} This chapter helps in achieving the *regulatory objective* of protecting *consumers* by laying down minimum standards for the investments that may be held by an *authorised fund*. In particular:
- (1) the proportion of *transferable securities* and *derivatives* that may be held by an *authorised fund* is restricted if those *securities* and *derivatives* are not listed on an *eligible* market; the intention of this is to restrict investment in *transferable securities* or *derivatives* that cannot be accurately valued and readily disposed of; and
 - (2) *authorised funds* are required to comply with a number of investment *rules* that require the spreading of risk.

Explanation of this chapter

- 5.1.4 **G**_{/1} (1) Product distinctiveness
- CIS 2.1.4R* (Categories of authorised fund) lists the categories of *authorised fund*. Each *authorised fund* has distinct characteristics and can therefore only hold certain types of investments. The *rules* in this chapter outline the permitted investments for each category, and ensure that the distinct character of each *authorised fund* is maintained.

(2) *UCITS directive*

For *securities schemes*, *warrant schemes* and *umbrella schemes* (consisting of *sub-funds* which would, if separately authorised, be *securities schemes* or *warrant schemes*), this chapter sets out the investment and borrowing *rules* which these *authorised funds* have to comply with, in order to benefit from a certificate of compliance with the *UCITS directive*, with a view to enjoying the rights available under that directive.

(3) Permitted investments

The general pattern of this chapter is summarised in CIS 5.1.6G. This table sets out, for each type of *authorised fund*, or for each *sub-fund* of an *umbrella scheme*, the type of investments that each type of *authorised fund* or *sub-fund* is permitted to hold (as well as the permitted percentage), and the investment techniques that each type of *authorised fund* (or *sub-fund*) is permitted to use.

Distinct meaning of certain terms

5.1.5

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Terms used in this sourcebook should be interpreted and applied as they are defined. However, because of the distinct nature of investments in which an *authorised fund* is permitted to invest, some of these terms are not always used in a way that corresponds with their usage in certain markets, for example, the term “*warrants*”. In the CIS sourcebook “*warrants*” has a slightly wider meaning than is usually attributed to it in warrant markets. The definition of *warrants* reflects this distinction (see also CIS 5.9.2G(2))

5.1.6

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Table Indicative overview of investment and borrowing powers
This table belongs to [CIS 5.1.4(3)]

Category of <i>authorised fund</i> (note 1 and 2)	<i>Securities schemes</i> (CIS 5.4)	<i>Money market schemes</i> (CIS 5.5)	<i>Futures and options schemes</i> (CIS 5.6)	<i>Geared futures and options schemes</i> (CIS 5.7)	<i>Property schemes</i> (CIS 5.8)	<i>Warrant schemes</i> (CIS 5.9)	<i>Fund of funds schemes</i> (CIS 5.11)	<i>Feeder funds</i> (excluding <i>feeder funds</i> investing in an <i>eligible investment trust</i>) (CIS 5.10)	<i>Feeder funds</i> investing in an <i>eligible investment trust</i> (CIS 5.10)
Investments and investment techniques									
<i>Transferable securities</i>	Yes	80%	Yes	Yes	80%	Yes	NA	NA	Yes
Transferable but not <i>approved securities</i>	10%	NA	10%	10%	10%	10%	NA	NA	No
<i>Government and public securities</i>	Yes	80%	Yes	Yes	35%	Yes	No	No	No
<i>Units</i>	5%	5%	5%	5%	5%	5%	Yes	Yes	No
<i>Warrants</i>	5%	NA	5%	5%	5%	100%	No	No	No
<i>Investment trusts</i>	Yes	No	Yes	Yes	80%	Yes	No	No	Yes
Cash (<i>and near cash</i>)	RRD	Yes	Yes	Yes	RRD	RRD	RRD	RRD	RRD
<i>Derivatives</i>	EPM	EPM	Yes	Yes	EPM	EPM	EPM	No	No
Immovables	No	No	No	No	80%	No	No	No	No
Gold	No	No	10%	10%	No	No	No	No	No
Efficient portfolio management	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No
Stocklending	Yes	Yes	Yes	Yes	Yes	Yes	No	No	No
Underwriting	Yes	Yes	Yes	Yes	Yes	Yes	No	No	No
Borrowing	10%	10%	10%	No	10%	10%	10%	10%	10%

Note 1 Meaning of terms used

“Yes”	can be invested in without specific upper limit (though there may be limits of other kinds)
“No”	not available for investment.
A percentage	an upper limit (though there may be limits of other kinds).
“NA”	not generally applicable having regard to the <i>authorised fund's</i> dedication.
“RRD”	permitted if reasonably required for <i>redemption</i> or in the context of the <i>authorised fund's</i> investment objective (see <i>CIS</i> 5.15.2R (Cash and near cash)).
“EPM”	permitted in the context of efficient portfolio management (see <i>CIS</i> 5.13).
Note 2	<i>Umbrella schemes</i>

The *umbrella scheme* is not covered, but each *sub-fund* must fall within one column of the table.



5.2 General investment powers and limits for authorised funds

Application

5.2.1

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This section (*CIS 5.2*) applies to *authorised fund managers*, except :

- (1) *CIS 5.2.13R* (Significant influence for ICVCs), which applies only to ICVCs;
- (2) *CIS 5.2.14R* (Significant influence for managers of AUTs), which applies only to *managers* of AUTs; and
- (3) *CIS 5.2.15R* (Concentration), which also applies to ICVCs.

Explanation of CIS 5.2

5.2.2

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This section outlines some general investment *rules*, with which all *authorised funds* must comply, in order to ensure that they adhere to the same common standards. In line with requirements of the *UCITS directive*, this section also contains *rules* which would prevent an ICVC and a *manager* of an AUT from exercising influence over a *body corporate*.

Prudent spread of risk

5.2.3

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An *authorised fund manager* must ensure that, taking account of the investment objectives and policy of the *authorised fund* as stated in the most recently published *prospectus* of the *authorised fund*, the *scheme property* of the *authorised fund* aims to provide a prudent spread of risk.

Investment powers: general

5.2.4

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- (1) The *scheme property* of an *authorised fund* may, subject to the *rules* in this chapter, comprise any assets or investments to which it is *dedicated*. For ICVCs, the *scheme property* may also include movable or immovable property that is necessary for the direct

pursuit of the *ICVC*'s business of investing in those assets or investments.

- (2) The *scheme property* of each *authorised fund* must be invested only in accordance with the relevant provisions in this chapter that are applicable to that *authorised fund* and within any upper limit in this chapter. However, the *instrument constituting the scheme* may further restrict:
 - (a) the kind of property in which the *scheme property* may be invested;
 - (b) the proportion of the *capital property* of the *authorised fund* to be invested in assets of any description;
 - (c) the descriptions of transactions permitted; and
 - (d) the borrowing powers of the *authorised fund*.

Valuation

5.2.5

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- (1) In this chapter, the value of the *scheme property* of an *authorised fund* means the net value of the *scheme property* determined in accordance with *CIS* 4.8 (Valuation) (for *ICVCs* and *single-priced AUTs*) or *CIS* 15.8 (Valuation) (for *dual-priced AUTs*), after deducting any outstanding borrowings (including, in the case of a *property scheme*, any capital outstanding on a *mortgage* of an immovable), whether immediately due to be repaid or not.
- (2) When valuing the *scheme property* for this chapter:
 - (a) the time as at which the valuation is being carried out (“the relevant time”) is treated as if it were a *valuation point*, but the valuation and the relevant time do not count as a valuation or a *valuation point* for the purposes of *CIS* 4 (for *ICVCs* and *single-priced AUTs*) and *CIS* 15 (for *dual-priced AUTs*);
 - (b) *initial outlay* is regarded as remaining part of the *scheme property*;
 - (c) if the *authorised fund manager* having taken reasonable care determines that the *authorised fund* will become entitled to any unrealised profit which has been made on account of a transaction in *derivatives*, that prospective entitlement is regarded as part of the *scheme property*; and
 - (d) for a *dual-priced AUT*, *CIS* 15.8.4R (Valuation) applies to any valuation of the *scheme property* for the purposes of this chapter, and in applying *CIS* 15.8.4R (Valuation):

- (i) the *cancellation* basis only is required; and
- (ii) paragraphs 1 to 8, 11 and 23 are not applicable.

Valuation

5.2.6

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It should be noted that for the purpose of CIS 5.2.5R, CIS 4.8 or CIS 15.8 may be affected by specific provisions in this chapter such as, for example, CIS 5.14.6R (Stock lending: treatment of collateral) or CIS 12 (Special provisions for certain categories of scheme).

Chapter to be construed as a whole

5.2.7

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- (1) Where a *rule* in this chapter allows a transaction to be entered into or an investment to be retained only if possible obligations arising out of the investment transactions or out of the retention would not cause any breach of any limits in this chapter:
 - (a) it must be assumed that the maximum possible liability of the *authorised fund* under any other of those *rules* has also to be provided for; and
 - (b) the *scheme property* must be valued in accordance with CIS 4.8 (Valuation) (for ICVCs and *single-priced AUTs*) or CIS 15.8 (Valuation) (for *dual-priced AUTs*).
- (2) Where a *rule* in this chapter permits an investment transaction to be entered into or an investment to be retained only if that investment transaction, or the retention, or other similar transactions, are covered:
 - (a) it must be assumed that in applying any of those *rules*, the *authorised fund* must also simultaneously satisfy any other obligation relating to cover; and
 - (b) no element of cover must be used more than once.

Examples

5.2.8

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Examples of the "provisions" referred to in 5.2.7R(1) are: CIS 5.4.6R (Investment in warrants and nil and partly paid securities) and CIS 5.15.7R (General power to accept or underwrite placings).

Transferable securities

- 5.2.9 **R**
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- (1) An *investment* is not a *transferable security* if the title to it cannot be transferred, or can be transferred only with the consent of a third party.
 - (2) In applying (1) to an *investment* which is issued by a *body corporate*, and which is an *investment* falling within articles 76 (Shares, etc) or 77 (Instruments creating or acknowledging indebtedness) of the *Regulated Activities Order*, the need for any consent on the part of the *body corporate* or any members or *debenture* holders of it may be ignored.
 - (3) An *investment* is not a *transferable security* unless the liability of the *holder* of it to contribute to the debts of the issuer is limited to any amount for the time being unpaid by the holder of it in respect of the *investment*.

Investment in associated collective investment schemes

- 5.2.10 **R**
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- Units* in a *collective investment scheme* do not fall within CIS 5.4.5R (Securities Schemes : Investment in collective investment schemes), CIS 5.5.3R(2)(e) (Money market schemes: general), CIS 5.6.7R (Investment in collective investment schemes) (for *futures and options schemes*), CIS 5.7.8R (for *geared futures and options schemes*) or CIS 5.8.7R (for *property schemes*) if that *collective investment scheme* is managed or operated by (or, if it is an ICVC, has as its ACD) the *authorised fund manager* of the investing *authorised fund* or an *associate* of that *authorised fund manager*, unless:
- (1) the *instrument constituting the scheme* in which the *authorised fund* is investing states that investment by that *scheme* will be restricted or specialised in terms of a particular geographic area or economic sector;
 - (2) the *instrument constituting the scheme* of the investing *authorised fund* and its *prospectus* clearly state that the property of the investing *authorised fund* may include such *units*; and
 - (3) CIS 5.2.11R (Investment in other group schemes) is complied with.

Investment in other group schemes

- 5.2.11 **R**
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- (1) An *authorised fund* must not invest in or dispose of *units* in another *collective investment scheme* (the *second scheme*), which is managed or operated by (or in the case of an ICVC, whose ACD is):

- (a) the *authorised fund manager* of such *authorised fund*; or
 - (b) an *associate* of that *authorised fund manager*;
- unless the *authorised fund manager* of the *authorised fund* is under a duty to pay to the *authorised fund* by the close of business on the fourth *business day* next after the agreement to buy or to *sell* the amount referred to in (2) and (3).
- (2) On investment, either:
 - (a) any amount by which the consideration paid by the *authorised fund* for the *units* in the second *scheme* exceeds the *price* that would have been paid for the benefit of the second *scheme* had the *units* been newly issued or sold by it; or
 - (b) if such *price* cannot be ascertained by the *authorised fund manager* of the *authorised fund*, the maximum amount of any charge permitted to be made by the seller of *units* in the second *scheme*.
 - (3) On disposal, the amount of any charge made for the account of the *authorised fund manager* or *operator* of the second *scheme* or an *associate* of any of them in respect of the disposal.
 - (4) In (1), (2) and (3):
 - (a) any addition to or deduction from the consideration paid on the acquisition or disposal of *units* in the second *scheme*, which is applied for the benefit of the second *scheme* and is, or is like, a *dilution levy* made in accordance with CIS 4.6.3R (for *ICVCs* and *single-priced AUTs*) or *SDRT provision* made in accordance with CIS 4.6.3R (for *ICVCs* and *single-priced AUTs*) or CIS 15.6.3R (for *dual-priced AUTs*) is to be treated as part of the *price* of the *units* and not as part of any charge; and
 - (b) any charge made in respect of an exchange of *units* in one *sub-fund* or separate part of the second *scheme* for *units* in another *sub-fund* or separate part of that *scheme* is to be included as part of the consideration paid for the *units*.

Investment in other collective investment schemes: interpretation

Where a reference to an *authorised fund* of a particular category is made in CIS 5.5.3R(2)(e) (Money market schemes: general), CIS 5.6.7R (Investment in collective investment schemes) (for *futures and options schemes*), CIS 5.7.8R (for *geared futures and options schemes*) or CIS 5.8.7R (for *property schemes*), that reference is to be treated as a reference also to:

- (1) a *sub-fund* which would, if it were the subject of a separate *authorisation order* be an *authorised fund* of that particular category; and
- (2) a separate part of a *recognised scheme* that is equivalent to a *sub-fund* within (1).

Significant influence for ICVCs

5.2.13

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- (1) An ICVC must not acquire *transferable securities* issued by a *body corporate* and carrying rights to vote (whether or not on substantially all matters) at a general meeting of that *body corporate* if:
 - (a) immediately before the acquisition, the aggregate of any such *securities* held by the ICVC gives the ICVC power significantly to influence the conduct of business of that *body corporate*; or
 - (b) the acquisition gives the ICVC that power.
- (2) For the purpose of (1), an ICVC is to be taken to have power significantly to influence the conduct of business of a *body corporate* if it can, because of the *transferable securities* held by it, exercise or control the exercise of 20% or more of the voting rights in that *body corporate* (disregarding for this purpose any temporary suspension of voting rights in respect of the *transferable securities* of that *body corporate*).
- (3) This *rule* (CIS 5.2.13R) does not apply to investment by a *property scheme* in *property related assets*.

Significant influence for managers of AUTs

5.2.14

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- (1) A *manager* must not acquire, or cause to be acquired for an AUT of which it is the *manager*, *transferable securities* issued by a *body corporate* and carrying rights to vote (whether or not on substantially all matters) at a general meeting of the *body corporate* if:
 - (a) immediately before the acquisition, the aggregate of any such *securities* held for that AUT, taken together with any such *securities* already held for other AUTs of which it is also the *manager*, gives the *manager* power significantly to influence the conduct of business of that *body corporate*; or
 - (b) the acquisition gives the *manager* that power.

- (2) In (1), a *manager* is to be taken to have power significantly to influence the conduct of business of a *body corporate* if it can, because of the *transferable securities* held for all the *AUTs* of which it is the *manager*, exercise or control the exercise of 20% or more of the voting rights in that *body corporate* (disregarding for this purpose any temporary suspension of voting rights in respect of the *transferable securities* of that *body corporate*).
- (3) This *rule* (CIS 5.2.14R) does not apply to investment by a *property scheme* in *property related assets*.

Concentration

5.2.15

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An *authorised fund* must not hold:

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- (1) *transferable securities* (other than *debt securities*) which:
 - (a) do not carry a right to vote on any matter at a general meeting of the *body corporate* that issued them; and
 - (b) represent more than 10% of those *securities* issued by that *body corporate*;
- (2) more than 10% of the *debt securities* issued by any single issuing body; and
- (3) except in the case of a *fund of funds scheme* and a *feeder fund*, more than 10% of the *units* in a *collective investment scheme*.

5.2.16

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In accordance with CIS 12.5.7R (Investment and borrowing powers), CIS 5.2.13, CIS 5.2.14 and CIS 5.2.15 will apply only at the level of the *umbrella scheme*.

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5.3 Eligible markets regime

Application

- 5.3.1 **R** This section (*CIS 5.3*) applies to *authorised fund managers*, except *CIS 5.3.3R(2)(d)*, which applies to *depositories*.
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Purpose

- 5.3.2 **G** In order to protect investors, this sourcebook tries to ensure that markets on which *investments* of *authorised funds* are dealt in or traded on are of an adequate quality. To that effect, the *eligible* markets regime lays down a number of requirements relating to the nature of the markets in which the property of an *authorised fund* may be dealt in or traded. This regime is based on criteria in the *UCITS directive*.
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Eligible markets: requirements

- 5.3.3 **R** (1) A *securities* market is *eligible* for the purposes of the *rules* in this sourcebook if it is a market established in a *EEA State* on which *transferable securities* admitted to official listing in the *EEA State* are *dealt* in or traded.
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- (2) A *securities* market not falling within (1) or a *derivatives* market is, at any time, *eligible* for the purposes of the *rules* in this sourcebook if:
- (a) the *authorised fund manager*, after consultation with the *depository* (and in the case of an *ICVC*, any *directors* in addition to the *ACD*), has decided to choose that market as one which is appropriate for the purpose of investment of, or *dealing* in, the *scheme property* beyond, where appropriate, any limit which under the *rules* in this chapter would otherwise apply;
 - (b) the decision is notified in writing to the *depository* and has not been revoked;
 - (c) the market is included in a list in the *prospectus*; and

- (d) the *depository* has taken reasonable care to determine that:
 - (i) adequate *custody* arrangements can be provided for the *investments* dealt in on the market in question; and
 - (ii) all reasonable steps have been taken by the *authorised fund manager* in deciding whether the market in question is *eligible*.
- (3) In (2), a market must not be considered appropriate unless it:
 - (a) is regulated (CIS 5.3.5G);
 - (b) operates regularly (CIS 5.3.6G);
 - (c) is recognised (CIS 5.3.7G); and
 - (d) is open to the public (CIS 5.3.8G).
- (4) In exercising the choice in (2), the *authorised fund manager* must have regard to:
 - (a) whether the market is adequately liquid (CIS 5.3.9G); and
 - (b) the arrangements relevant to the market for unimpeded transmission of income and capital to or to the order of investors.

Guidance on eligible markets: introduction

5.3.4

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- (1) CIS 5.3.3R (Eligible markets: requirement) will involve *authorised fund managers* exercising integrity and competence in making a judgement as to what constitutes an *eligible* market.
- (2) The *guidance* paragraphs in this section (CIS 5.3) are indicative of the matters that *authorised fund managers* will need to take into account, using such information as is available to them, making inquiries as necessary, and taking advice as appropriate, in order to have taken reasonable care to determine that a market is *eligible*.
- (3) The items listed in the *guidance* paragraphs are not necessarily exhaustive, nor are they in any particular order of relative importance. An overall view will need to be taken on each market.

Regulated

5.3.5

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- (1) In considering whether a market is regulated, the *authorised fund manager* should assess whether the market is subject to supervision by an authority which is a statutory body, an agency of a national or State government, a department of a national government or another body designated for the purpose by one of these.

- (2) In addition, the *authorised fund manager* should take account of any of (a) to (i):
- (a) the degree to which *persons* who are bound by rules of the market are subject to formal supervision by the market or another body, and in particular whether that supervision includes level of capital;
 - (b) the powers of the market, or the supervising body, or both, to intervene in the business of *persons* who are bound by the rules of the market in the event of misconduct, financial difficulties or otherwise, including the power to reject applicants, terminate membership and de-list a *security*;
 - (c) the initial listing standards and ongoing supervision of *securities* traded on the market including the publication of prospectuses and audited annual financial statements;
 - (d) the everyday availability of current information about *securities*, *derivatives*, quotations, transactions, prices and spreads;
 - (e) requirements for the issue of contract notes (or their equivalents);
 - (f) whether there is a requirement for trade reporting to the market or other supervisory body of the *securities* or *derivatives* the *authorised fund manager* is intending to buy;
 - (g) whether the clearance and settlements arrangements normally used for transactions on the market are prompt and secure;
 - (h) the risk of loss in the event of insolvency of a *person* who is bound by the rules of the market; and
 - (i) how the market investigates and deals with complaints.

Operating regularly

5.3.6

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- (1) In considering whether a market is operating regularly, the *authorised fund manager* should assess whether the market has regular trading hours during which the *investments* listed or admitted to *dealing* may be *dealt* in.
- (2) In addition, the *authorised fund manager* should take account of:
- (a) the availability and timing of price and volume information and the way it is distributed; and
 - (b) in respect of *securities*, the degree to which, and the speed at which, companies listed on the market must release price-sensitive information, and the medium through which that information is distributed.

Recognised

5.3.7

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In considering whether a market or exchange is recognised, the *authorised fund manager* should assess whether the market is recognised or registered as a market or exchange or as a self-regulating organisation (or as both) by an authority which is a statutory body, or an agency of a national or State government or department

of a national government or another body designated for the purpose by one of these.

Open to the public

5.3.8

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- (1) In considering whether a market is open to the public, the *authorised fund manager* should assess whether *investments* listed or admitted to *dealing* on the market are freely available for trading by the public directly, or through members of the market, during normal trading hours.
- (2) In addition, the *authorised fund manager* should take account of the extent to which overseas investors are permitted to hold *securities* listed on the market.

Liquidity and repatriation of funds

5.3.9

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In considering whether a market is adequately liquid, the *authorised fund manager* should assess:

- (1) the overall liquidity of the market or exchange; whether *securities* or *derivatives* or both can be bought and sold in a reasonable time, at best execution and in adequate amounts; and
- (2) the procedures and restrictions (if they exist) on the repatriation of funds to the *United Kingdom*, bearing in mind in particular the open-ended nature of a *collective investment scheme* and the requirement that the *authorised fund manager* must at all times during the *dealing day* be willing to redeem *units*, including large redemptions, at a *price* arrived at in accordance with *CIS 4* (Single-pricing and dealing) or *CIS 15* (Dual-pricing and dealing).

Responsibility of authorised fund manager

5.3.10

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- (1) The *authorised fund manager* should, after consultation with the *depository* about safe *custody*:
 - (a) for any particular market, consider all the characteristics mentioned in *CIS 5.3.3R(3)* and *CIS 5.3.3R(4)* of that market or the lack of them, and any other characteristics which are relevant, in order to reach a view on whether that market or exchange should be an *eligible* market, for *approved securities* and *approved derivative investment* purposes; and
 - (b) continue to take reasonable care to ensure that the market continues to exhibit the characteristics which led to it being considered *eligible* and that there are no events or characteristics which undermine that eligibility.
- (2) Where a market ceases to be *eligible*, *investments* on that market will cease to be *approved securities*. The 10% restriction in *CIS 5.4.2R(2)* (Securities schemes: general) applies and, if necessary, the level of *investment* on that market must be reduced to ensure that this 10% limit is not exceeded. Exceeding the 10% limit because a market ceases to be *eligible* will generally be regarded as an inadvertent breach under *CIS 7.5.3R* (Duties of the ACD and depository: investment and borrowing powers) (in the case of an *ICVC*) and *CIS 7.10.3R* (Duties of the manager and trustee: investment and borrowing

powers). In addition, no new *derivatives exposures* on the *investments* that cease to be *approved securities* should be created.



5.4 Securities schemes

Application

5.4.1

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This section (CIS 5.4) applies to *authorised fund managers of securities schemes*.

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Securities schemes: general

5.4.2

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- (1) The *scheme property* of a *securities scheme* must, except where otherwise provided in the *rules* in this chapter, only consist of *transferable securities*.
- (2) Not more than 10% in value of the *scheme property* of a *securities scheme* is to consist of *transferable securities* which are not *approved securities*, but there is no limit on the value of the *scheme property* which is to consist of *approved securities*.
- (3) Not more than 5% in value of the *scheme property* is to consist of *transferable securities* which are *units* in *collective investment schemes*, and those *units* must fall within CIS 5.4.5R (Securities Schemes : Investment in collective investment schemes).
- (4) *Investment* under (3) counts towards the limit in (2) (except where the *units* are *approved securities*).
- (5) CIS 5.4.3R (Spread: general) and CIS 5.4.4R (Spread: government and public securities) do not apply until the earlier of:
 - (a) the expiry of a period of six months after the date of effect of the *authorisation order* in respect of the *authorised fund* (or on which the *initial offer* commenced if later); or
 - (b) the date when the value of the *scheme property* of the *securities scheme* first exceeds £2 million (or the equivalent in the *base currency* of the *securities scheme*).
- (6) The following sections also apply to *securities schemes*:

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- (a) CIS 5.2 (General investment powers and limits for authorised funds);
- (b) CIS 5.13 (Efficient portfolio management);
- (c) CIS 5.14 (Stock lending);
- (d) CIS 5.15 (Cash, borrowing, lending and other provisions); and
- (e) CIS 5.16 (Cover for sales).

Spread: general

5.4.3

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- (1) This rule (CIS 5.4.3R) does not apply to *government and public securities*.
- (2) Not more than 5% in value of the *scheme property* is to consist of *transferable securities* issued by any one issuer.
- (3) In applying (2), *certificates representing certain securities* are treated as equivalent to the underlying *security*.
- (4) The figure of 5% in (2) may be increased to 10% in respect of up to 40% of the value of the *scheme property*.

Spread: government and public securities

5.4.4

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- (1) This rule (CIS 5.4.4R) applies to *government and public securities* (“such securities”) only.
- (2) As long as no more than 35% of the value of the *scheme property* of an *authorised fund* is invested in such *securities* issued by any one issuer, there is no limit on the amount which may be invested in such *securities* or such *securities* issued by any one issuer or of any one issue.
- (3) No more than 35% in value is to be invested in such *securities* issued by any one issuer unless the *authorised fund manager*, after consultation with the *depository*, considers the issuer of such *securities* as one which is appropriate in accordance with the investment objectives of the *authorised fund*.
- (4) Where more than 35% in value of the *scheme property* is invested in such *securities* issued by any one issuer:
 - (a) up to 30% in value of the *scheme property* may consist of such *securities* of any one issue;

- (b) the *scheme property* must include such *securities* issued by that or another issuer, of at least six different issues; and
- (c) the disclosures in (5) must have been duly made.
- (5) Where it is intended that (3) and (4) may apply, the *instrument constituting the scheme*, and the most recently published *prospectus*, must clearly state:
 - (a) the fact that more than 35% in value of the *scheme property* is or may be invested in *government and public securities* issued by one issuer; and
 - (b) the names of the States, and of the local authorities or public international bodies or both in whose *government and public securities* the *authorised fund* may invest over 35% of its assets.
- (6) In (2), (3), (4) and (5), in relation to *government and public securities*:
 - (a) issue, issued and issuer include guarantee, guaranteed and guarantor; and
 - (b) an issue differs from another if there is a difference as to repayment date, rate of interest, guarantor or other material terms of the issue.

Securities schemes: investment in collective investment schemes

5.4.5

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A securities scheme may invest in units in a collective investment scheme only if the second scheme is a collective investment scheme that complies with the conditions necessary for it to enjoy the rights conferred by the UCITS directive or is a collective investment scheme that:

- (1) complies with section 243(10) of the *Act* (*Authorisation orders: entitlement to have units redeemed*) or is treated as complying with it by section 243(11) of the *Act*;
- (2) is either:
 - (a) a *recognised scheme*; or
 - (b) a *collective investment scheme* constituted outside the *United Kingdom* in which the *investments* of the *scheme* consist of *units* which are *approved securities*;
- (3) is *dedicated* to investing funds raised from the public in *transferable securities*;

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- (4) operates on the principle of risk spreading; and
- (5) has terms which prohibit more than 5% in value of the *property of the scheme* consisting of *units in collective investment schemes*.

Investment in warrants and nil and partly paid securities

5.4.6

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- (1) A *warrant* (“the proposed *warrant*”) falls within any power of investment only if, on the assumptions that:

- (a) there is no change to the *scheme property* between the acquisition of the proposed *warrant* and its exercise; and
- (b) the rights conferred by the proposed *warrant* and all other *warrants* forming part of the *scheme property* at the time of the acquisition of the proposed *warrant* will be exercised (whether or not it is intended that they will be);

it is reasonably foreseeable that the right conferred by the proposed *warrant* could be exercised by the *authorised fund* without contravening the *rules* in this chapter.

- (2) A *transferable security* on which any sum is unpaid falls within a power of investment only if it is reasonably foreseeable that the amount of any existing and potential call for any sum unpaid could be paid by the *authorised fund*, at the time when payment is required, without contravening the *rules* in this chapter.
- (3) Not more than 5% in value of the *scheme property* is to consist of *warrants*.
- (4) A *warrant* which is an *investment* falling within article 30 of the *Regulated Activities Order* (*Certificates representing certain securities*) and which is akin to an *investment* falling within article 29 (Instruments giving entitlement to *investments*) of the *Regulated Activities Order* may not be included in the *scheme property* unless it is listed on an *eligible securities* market.



5.5 Money market schemes

Application

5.5.1 **R** This section (*CIS 5.5*) applies to *authorised fund managers of money market schemes*.
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Introduction

5.5.2 **G** (1) This section (*CIS 5.5*) sets out specific *rules for money market schemes*. *Money market schemes* are *authorised funds* investing in cash and *near cash* and, subject to specified restrictions (as to which see *CIS 5.5.3R* (Money market schemes: general)) in bills of exchange and in *debentures* and other instruments creating or acknowledging indebtedness.
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(2) The *rules* in this section governing the *investment limits of money market schemes* are intended to ensure that *money market schemes* maintain a high level of liquidity.

Money market schemes: general

5.5.3 **R** (1) The *scheme property of a money market scheme* must, except where otherwise provided in the *rules* in this chapter, consist of "*money market scheme assets*".
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(2) For this purpose, "*money market scheme assets*" means any of:

- (a) *cash and near cash*;
- (b) bills of exchange accepted by an *eligible institution*, if repayable within 12 months;
- (c) instruments creating or acknowledging indebtedness which are:
 - (i) repayable within 12 months;
 - (ii) not subordinated; and

- (iii) either *approved securities* or *investments* which are issued by an *eligible institution* otherwise than in return for a *deposit* in (a);
 - (d) a *deposit* which would be within (a) (*near cash*) except that it is repayable within six months (instead of immediately) and without payment of a penalty exceeding seven days' interest calculated at ordinary commercial rates; and
 - (e) *units* in one or more *regulated collective investment schemes*, each of which is either a *money market scheme* or a *scheme* of a category that is equivalent to a *money market scheme*.
- (3) The following also apply to *money market schemes*:
- (a) CIS 5.2 (General investment powers and limits for authorised funds);
 - (b) CIS 5.4.6R(2) (Investment in warrants and nil or partly paid securities);
 - (c) CIS 5.13 (Efficient portfolio management);
 - (d) CIS 5.14 (Stock lending);
 - (e) CIS 5.15 (Cash, borrowing, lending and other provisions); and
 - (f) CIS 5.16 (Cover for sales).

Investment limits

5.5.4

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- (1) At least 50% in value of the *scheme property* of a *money market scheme* must consist of instruments or *deposits* which are permitted under CIS 5.5.3R (Money market schemes: general) and which are:
 - (a) redeemable or repayable within two weeks; or
 - (b) in the case of instruments, capable of being transferred without the consent of a third party (and for this purpose the issuer of the instrument must be regarded as a third party).
- (2) Not more than 80% in value of the *scheme property* is to consist of *transferable securities*, in accordance with CIS 5.4 (Securities schemes) (but excluding *investment in units* in *collective investment schemes* under CIS 5.4.5R).

Spread

5.5.5

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- (1) This *rule* (CIS 5.5.5R) does not apply to a *money market scheme* until the date on which the value of its *scheme property* first exceeds £1 million (or the equivalent in the *base currency* of the *money market scheme*).
- (2) Not more than 5% in value of the *scheme property* of a *money market scheme* is to consist of instruments issued by any one issuer; but this limit does not apply to instruments which are *government and public securities*.
- (3) Not more than 30% in value of the *scheme property* is to consist of *government and public securities* of the same issue.
- (4) Where more than 35% in value of the *scheme property* is invested in *government and public securities*, it must include such *securities* of at least six different issues.
- (5) Not more than 5% in value of the *scheme property* is to consist of *units* within CIS 5.5.3R(2)(e) (Money market schemes: general).
- (6) Whenever the total value of the *scheme property* of a *money market scheme* which is held on *deposit* is more than £1 million:
 - (a) not more than 10% in value is to be kept on *deposit* with any one *person*;
 - (b) for the purposes of (a):
 - (i) the *depository* and its *associates* are regarded as one *person*;
 - (ii) the *manager* and its *associates* are regarded as one *person*; and
 - (iii) each *director* of an *ICVC* including the *ACD* and his or its *associates* are regarded as one *person*; and
 - (c) the figure of 10% in (a) may be increased to 20% if:
 - (i) the *person* is an *eligible institution* and is not one of the *persons* referred to in (b); and
 - (ii) the amount of the *deposit* does not exceed 10% in value of that *eligible institution's* issued capital and reserves as shown in its most recently published annual accounts.

5.6 Futures and options schemes

Application

5.6.1

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This section (CIS 5.6) applies to *authorised fund managers of futures and options schemes* except:

- (1) CIS 5.6.6R(3), which also applies to *depositories of futures and options schemes*; and
- (2) CIS 5.6.14R, which applies to *ICVCs that are futures and options schemes* and to *trustees of AUTs that are futures and options schemes*.

Introduction

5.6.2

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- (1) This section (CIS 5.6) sets out specific *rules for futures and options schemes*. *Futures and options schemes* are *authorised funds dedicated* to investment in *approved derivatives* and other *derivatives* (whether with or without *transferable securities*), where most or all of the transactions are fully covered. The next section (CIS 5.7) deals with *geared futures and options schemes*. While the types of *scheme property* are almost the same for both of these categories, there are important differences between them in the degree to which exposure is permitted and in the manner in which exposure is measured.
- (2) The *futures and options scheme* must be "covered", in the sense that it is permitted to invest in *derivatives* and forward transactions only as long as the exposure itself is suitably covered from within its *scheme property*, including permitted borrowing. Some limited form of investment without cover is permitted, in the form of purchased *options*.
- (3) The *geared futures and options scheme*, on the other hand, is permitted to devote 20% of its *scheme property* to *initial outlay*, and this may therefore lead in volatile markets to a greater exposure to profit or loss than in the case of a *futures and options scheme*.

Futures and options schemes: general

5.6.3

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- (1) The *scheme property* of a *futures and options scheme* must, except where otherwise provided in the *rules* in this chapter, consist only of any or all of:
 - (a) *transferable securities* available to a *securities scheme*, in accordance with CIS 5.4 (Securities schemes)(but excluding *investment in units in collective investment schemes* under CIS 5.4.5R);
 - (b) *derivatives* permitted under this *rule* (CIS 5.6.3R) and CIS 5.6.4R - CIS 5.6.6R;
 - (c) forward transactions in currencies or gold permitted under this *rule* (CIS 5.6.3R), CIS 5.6.4R and CIS 5.6.5R;
 - (d) cash or *near cash*;
 - (e) *units in collective investment schemes* under CIS 5.6.7R (Investment in collective investment schemes); and
 - (f) gold.
- (2) For investment within (1)(a), CIS 5.4 (Securities schemes) applies as if the *futures and options scheme* were a *securities scheme*, but subject to any specific modification in this section (CIS 5.6).
- (3) For investment within (1)(b) or (1)(c), a transaction in *derivatives* or a forward transaction must not be effected unless:
 - (a) the transaction is of the kind specified in CIS 5.6.4R (Permitted transactions); and
 - (b) the transaction is:
 - (i) fully covered, as required by CIS 5.6.9R (Cover for transactions in derivatives and forward transactions); or
 - (ii) the subject of deposit arrangements, as required by CIS 5.6.13R (Deposit arrangements (for purchased options)).
- (4) Not more than 10% in value of the *scheme property* is to be used for transactions in *derivatives* in the form of uncovered purchased *options* (taking the current *market value* of the *option* as its value for this purpose), but there must be deducted from that figure of 10% any percentage of the value of the *scheme property* invested in *transferable securities* in the form of *warrants*.
- (5) Not more than 10% in value is to be held in the form of gold.

- (6) Whenever the total value held on *deposit* of the *scheme property* of a *futures and options scheme* is more than £1 million:
- (a) not more than 10% in value is to be kept as cash on *deposit* with any one *person*;
 - (b) in (a):
 - (i) the *depository* and its *associates* are regarded as one *person*;
 - (ii) the *manager* and its *associates* are regarded as one *person*; and
 - (iii) each *director* of an *ICVC* including the *ACD* and his or its *associates* are regarded as one *person*; and
 - (c) the figure of 10% in (a) may be increased to 20% if:
 - (i) the *person* is an *eligible institution* and is not one of the *persons* referred to in (b); and
 - (ii) the amount of the *deposit* does not exceed 10% in value of that *eligible institution's* issued capital and reserves as shown in its most recently published annual accounts.
- (7) The following also apply to *futures and options schemes*:
- (a) *CIS 5.2* (General investment powers and limits for authorised funds);
 - (b) *CIS 5.13* (Efficient portfolio management);
 - (c) *CIS 5.14* (Stock lending);
 - (d) *CIS 5.15* (Cash, borrowing, lending and other provisions); and
 - (e) *CIS 5.16* (Cover for sales).

Permitted transactions (derivatives and forwards)

5.6.4

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- (1) A transaction in *derivatives* under this section (*CIS 5.6*) must be:
- (a) in an *approved derivative*; or
 - (b) one which complies with *CIS 5.6.6R* (OTC transactions in derivatives); or
 - (c) a *synthetic future*.

- (2) Any transaction in an *approved derivative* must be effected on or under the *rules* of an *eligible derivatives* market.
- (3) Any forward transaction must be with an *approved counterparty* under CIS 5.6.6R(2) (OTC transactions in derivatives).
- (4) Not more than 5% in value of the *scheme property* is to be directed to *initial outlay* in respect of *over the counter* transactions with any one counterparty.

Transactions for the purchase of property

5.6.5

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A *derivatives* or forward transaction (which is a permitted transaction under CIS 5.6.4R (Permitted transactions (derivatives and forwards)) which will or could lead to delivery of property for the account of the *ICVC* or to the *trustee* for the account of the *AUT* may be entered into only if:

- (1) that property can be held for the account of the *ICVC* or can be held by the *AUT* (or else the transaction is a bought *future* or bought call *option*); and
- (2) the *authorised fund manager* having taken reasonable care determines that delivery of the property under the transaction will not occur or will not lead to a breach of the *rules* in this sourcebook.

OTC transactions in derivatives

5.6.6

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Any transaction in *derivatives* under CIS 5.6.4R(1)(b) must be:

- (1) a *future* or an *option* or a *contract for differences* resembling an *option*;
- (2) with an *approved counterparty*; a *counterparty* to a transaction in *derivatives* is approved only if the *counterparty* is:
 - (a) an *eligible institution*; or
 - (b) a *firm* whose *permission* (including any *requirements* or *limitations*), as published in the *FSA* record, permits it to enter into the transaction as *principal off-exchange*;
- (3) on approved terms; the terms of a transaction in *derivatives* are approved only if, before the transaction is entered into, the *depository* is satisfied that the *counterparty* has agreed with the *ICVC* or with the *manager*:

- (a) to provide a valuation in respect of that transaction (which, for *dual-priced AUTs* should be on a buying and selling basis) at least once a week and at any other time at the request of the *ICVC* or *manager*; and
 - (b) that it will, at the request of the *ICVC* or *manager*, enter into a further transaction to *close out* that transaction, at a reasonable price arrived at under the pricing model or other reliable basis agreed under (4); and
- (4) capable of valuation; a transaction in *derivatives* is capable of valuation only if the *authorised fund manager* having taken reasonable care determines that, throughout the life of the *derivative* (if the transaction is entered into), it will be able to value the *investment* concerned with reasonable accuracy:
- (a) on the basis of a pricing model which has been agreed between the *authorised fund manager* and the *depository*; or
 - (b) on some other reliable basis reflecting an up-to-date market value which has been so agreed.

Investment in collective investment schemes

5.6.7

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- (1) *Investments in units* of a *collective investment scheme* must not be made unless that *scheme*:
- (a) is a *regulated collective investment scheme* which is either a *futures and options scheme* or a *money market scheme* or a *scheme* of a category that is equivalent to the category of one of such *schemes*; or
 - (b) (after taking account of *CIS 5.2.10R*) (Investment in associated collective investment schemes):
 - (i) is within *CIS 5.4.5R* (Securities schemes : investment in collective investment schemes); or
 - (ii) would be within *CIS 5.4.5R* (Securities schemes : investment in collective investment schemes) if paragraph (3) of that *rule* read:

“is *dedicated* to investing funds raised from the public in approved and other *derivatives* (where most or all of the transactions in *derivatives* are fully covered by cash, *securities* or other *derivatives*) whether with or without *transferable securities* or covered forward transactions in currency or gold.”

- (2) Not more than 5% in value of the *scheme property* of a *futures and options scheme* is to consist of *units in collective investment schemes*.

What is cover and what is the purpose of cover?

5.6.8

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- (1) A *futures and options scheme* should be covered. This means that a *futures and options scheme* is permitted to invest in *derivatives* and forward transactions as long as the exposure itself is suitably covered from within its *scheme property* (including permitted borrowing).
- (2) A purpose of cover is to ensure that a *futures and options scheme* is not, and cannot become, exposed to the risk of loss of property, including *money*, to an extent greater than the value of the *futures and options scheme*, together with permitted borrowing of 10%. At any time, therefore, the *futures and options scheme* must hold *scheme property* which is of the right kind and sufficient in value or amount to match the exposure which exists as a result of the *derivative*. CIS 5.6.9R (Cover for transactions in derivatives and forward transactions) sets out detailed requirements for cover of a *futures and options scheme*.
- (3) In accordance with CIS 5.2.7R(2)(b), cover used in respect of one transaction in *derivatives* or forward transaction must not be used for cover in respect of another transaction in *derivatives* or a forward transaction.
- (4) However, some limited form of investment without cover is permitted, in the form of purchased *options*. Since purchased *options* result in no exposure except that of loss of the *premium* paid, they can be held on an uncovered basis, but with a cash "set aside" to ensure that holdings of such *derivatives* do not unbalance the *futures and options scheme*.
- (5) CIS 5.6.9R – CIS 5.6.13R set out detailed requirements for "cover" of a *futures and options scheme*.
- (6) CIS 5.6.16G sets out, in diagrammatic form, the various stages in defining the cover requirements in CIS 5.6.9R.

Cover for transactions in derivatives and forward transactions

5.6.9

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- (1) Except where CIS 5.6.13R(1) (Deposit arrangements (purchased options)) applies, a transaction in *derivatives* or forward transaction is to be entered into under this section (CIS 5.6) only if the maximum potential exposure created by the transaction, in terms of the *principal* or *notional principal* of the *derivative contract* or forward contract, is:
- (a) covered individually under (2) or (3); and
 - (b) covered globally under (4).
- (2) Exposure is covered individually if there is, in the *scheme property*:

- (a) (in the case of an exposure in terms of property) a *transferable security* or other property which is of the right kind, and sufficient in amount, to match the exposure; and
 - (b) (in the case of an exposure in terms of *money*), cash or *near cash* (or borrowing under CIS 5.6.14R (Borrowing)) or *transferable securities* which is or are, or, on being turned into *money* in the right currency, will be, sufficient in amount to match the exposure.
- (3) However, exposure to an index or basket of *securities* or other assets is covered individually for the purposes of (2) if the *futures and options scheme* holds *transferable securities* or other property which (taking into account the closeness of the relation between fluctuations in the price of the two) can reasonably be regarded as appropriate to provide cover for the exposure; they may be so regarded even if there is not complete congruence between the cover and the exposure.
- (4) Exposure is covered globally if, after taking account of all the cover required under (2) or (3) for other positions already in existence, adequate cover from within the *scheme property* is available to enable the fresh transaction to be entered into.
- (5) Whether or not a *derivative* or forward transaction is available under CIS 5.6.12R (Derivatives covering derivatives : requirements) to provide cover for another *derivative* or forward transaction under this section (CIS 5.6):
- (a) the two transactions involved in a *synthetic future* are to be treated as if they were a single *derivative*, and the net exposure from the combination is to be covered on the basis of the higher of the cover requirements of the *options* which make up the *synthetic future*; and
 - (b) *synthetic cash* is available to provide cover for a transaction as if it were cash.
- (6) Cash not yet received into the *scheme property* but due to be received within one month is available as cover for the purposes of (2)(b) and (3).
- (7) Property is not available for cover if it is the subject of a transaction under CIS 5.14 (Stock lending), unless the *authorised fund manager* having taken reasonable care determines that it is obtainable (by return or re-acquisition) in time to meet the obligation for which cover is required.

Examples of cover requirements

5.6.10

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Examples of the cover requirements:

- (1) A bought put *option* (or a written call *option*) on 1000 ordinary £1 *shares* (fully paid) of ABC plc is covered by an existing holding in the *futures and options scheme* of 1000 ordinary £1 *shares* (fully paid) of ABC plc (CIS 5.6.9R(2)(a)).
- (2) A bought call *option* (or written put *option*) on 1000 ordinary £1 *shares* (fully paid) of ABC plc is covered by cover (in the form of cash or an allowable substitute for cash or *transferable securities*) which is sufficient in amount to meet the *purchase* of the *shares* on exercise of the *option* (CIS 5.2.7R(2)(b)).
- (3) A sold *contract for differences* on short-dated sterling is covered by cash or *near cash* or *transferable securities*, the values of which together at least match the *notional principal* of the contract (for example a LIFFE short sterling contract, or a succession of such contracts, is covered by £500,000) (CIS 5.6.9R(2)(b) and CIS 5.2.7R(2)(b)).
- (4) A sold *future* on the FT-SE 100 Index is covered by holdings of equities (or a combination of cash (or *near cash*) and call *options* on that *future*) which satisfy the test of appropriateness for cover in CIS 5.6.9R(3) in relation to that *future*, and the values of which together at least match the current mark to market valuation of the *future* (for example, if the multiplier per full index point is £10, and if the eventual obligation under the *future* is currently at 2800, the valuation of the *futures* position is $2800 \times £10 = £28,000$) (CIS 5.6.9R(3) and CIS 5.6.12R).
- (5) Where an ICVC or the *manager* of an AUT has holdings in blue chip UK *shares*, wishes to provide more exposure to the US market, and decides to *sell* a FT-SE index *future* to the value of those *shares* (this transaction satisfying the test of appropriateness for cover in CIS 5.6.9R(3)), then the sterling *synthetic cash* position created is used as cover for a S&P 500 index *future* provided that the *authorised fund* ensures that the cover remains sufficient (for example by reference to the sterling/US dollar exchange rate) (CIS 5.6.9R(3) and CIS 5.6.9R(5)(b)).
- (6) For guidance on congruence see CIS 5.13.10G(1) (The use of index derivatives : congruence).

Derivatives covering derivatives: explanation of the use of derivatives for cover

5.6.11

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- (1) The general requirements about cover in CIS 5.6.9R (Cover for transactions in *derivatives* and forward transactions) are modified in some respects where it is sought to use two *derivatives* on the same underlying asset or *security* as cover for each other. CIS 5.6.12R (Derivatives covering derivatives: requirements) provides the basis for such mutual cover.
- (2) The main features are that:
 - (a) only a countervailing exposure can provide adequate cover;
 - (b) written *options* may be used as cover for *futures* only where the *option* is in the *money* to the purchaser: if the *option* is out of the *money* to him, the

option and the *future* each have to be covered in the ordinary way, though the *premium* acquired for writing the *option* will count as cash for that purpose; and

- (c) *contracts for differences*, such as index contracts, are included in the cover arrangements so far as they resemble *futures* or *options*.
- (3) The general effect of CIS 5.6.12R(1) and (2) is explained in CIS 5.6.12R(3).
- (4) In applying CIS 5.6.12R, it may help to regard a *future* as an obligation (in that, unless closed out, the *future* will require something to be delivered, or accepted and paid for); a bought *option* as a right (in that the purchaser can, but need not, exercise the right to require the writer to deliver and accept and pay for something); and a written *option* as a potential obligation (in that it both creates exposure and gives the right of exercise to another).
- (5) CIS 5.6.17G sets out in diagrammatic form the various cover requirement in CIS 5.6.12R

Derivatives covering derivatives: requirements

5.6.12

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- (1) Where an *authorised fund manager* proposes to use a position resulting from a transaction in *derivatives* as cover (whether in whole or in part) for the exposure of another transaction in *derivatives*, CIS 5.6.9R (Cover for derivatives and forward transactions) has effect as modified by this *rule* (CIS 5.6.12R).
- (2) On the basis that the requirements of CIS 5.6.9R (Cover for transactions in derivatives and forward transactions) about the amount and right kind of assets as cover are satisfied, (3) contains the requirements for the purposes of (1).
- (3) (a) In this *rule* (CIS 5.6.12R) "countervailing" means that one of the two *derivatives* has an exposure which, in terms of risk, is equal and opposite to the exposure of the other, and "offset" means that there is an equal and opposite coverage in terms of risk.
 - (b) A *derivative* of one type provides cover for a countervailing *derivative* of the same type.
 - (c) A *derivative* of one type provides cover for a countervailing *derivative* of a different type if, but only if:
 - (i) the right under one offsets and is offset by the obligation under the other; or
 - (ii) paragraph (g) applies.
 - (d) In applying (b) and (c), differences between the *derivatives* in terms of price, maturity and exercise price may be ignored, except where (b) is disapplied by (e).

- (e) Paragraph (b) does not apply if an opportunity to exercise the right under the one *derivative* will become available to the *futures and options scheme* only after the first date on which the potential obligation under the other may become an actual obligation.
- (f) Where, under (b), an *authorised fund manager* decides that a written *option* and a bought *option* should provide mutual cover, the *authorised fund manager* must arrange for the *depository* to deposit and set aside with an *eligible institution* the whole amount of the difference between the exercise value of the two *options* (that is the amount which would be payable by or to the *futures and options scheme* on exercise of the *options*) inclusive of any *margin* requirements of the exchange. That amount must not be used for the purposes of providing cover, other than under this paragraph (f), under the *rules* of this chapter.
- (g) A written *option* provides cover for, and is covered by, a countervailing *future* only if the *option* is in the *money* to the purchaser of the *option*. If the written *option* is out of the *money* to the purchaser, then both it and the *future* must each be separately covered under CIS 5.6.9R (Cover for transactions in derivatives and forward transactions).
- (h) A *contract for differences* may be included in this *rule* (CIS 5.6.12R) if and to the extent that it has the characteristics of a *future* or an *option*.

Deposit arrangements (for purchased options)

5.6.13

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- (1) Where the purchase of an uncovered *option* is proposed in reliance on CIS 5.6.3R(4) (Futures and options schemes: general), the *authorised fund manager* must arrange for the *depository* to deposit and set aside with an *eligible institution* any amount by which 5% of the exercise value of the *option* (that is the amount which would be payable by the *futures and options scheme* on exercise of the *option*) exceeds the amount paid by way of *premium*. That excess (if any) must not be used for the purposes of providing cover under the *rules* in this chapter.
- (2) The amount to be deposited and set aside may be in cash or in *government and public securities* (which are to be valued for this purpose at the current mark to market valuation).

Borrowing

5.6.14

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- (1) Cash obtained by borrowing, and borrowings which the *authorised fund manager* reasonably regards an *eligible institution* to be committed to provide, are available for cover under CIS 5.6.9R (Cover for transactions in derivatives and forward transactions) as long as the normal limits on borrowing (as to which see CIS 5.15.3R (General power to borrow) and CIS 5.15.4R (Borrowing limits)) are observed.
- (2) Where, for the purposes of this section (CIS 5.6), the *ICVC* or the *trustee* for the account of the *AUT* on the instructions of the *manager*:
- (a) borrows an amount of currency from an *eligible institution*; and
 - (b) keeps an amount in another currency, at least equal to the borrowing for the time being in (a), on *deposit* with the lender (or his agent or nominee);

then this section (CIS 5.6) applies as if the borrowed currency, and not the deposited currency, were part of the *scheme property*, and the normal limits on borrowing under CIS 5.15.3R and CIS 5.15.4R do not apply to that borrowing.

Continuing nature of limits and requirements

5.6.15

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- (1) An *authorised fund manager* must, at each *valuation point* (and more frequently if necessary), re-calculate the amount of cover required in respect of *derivatives* and forward positions already in existence under this section (CIS 5.6.). *Derivatives* and rights under forward transactions under this section may be retained in the *scheme property* only so long as they remain covered both individually and globally under CIS 5.6.9R (Cover for transactions in derivatives and forward transactions) (or, where relevant, the *deposit* requirements in CIS 5.6.13R (Deposit arrangements (for purchased options)) are complied with).
- (2) If at any time:
- (a) any fact or matter relating to the *futures and options scheme* or its economic environment; or
 - (b) the aggregate of all outstanding *derivatives* or forward positions under this section;

is such that at least one of the relevant transactions (assuming it did not exist) could not properly have been effected, either in that size or at all, the *authorised fund manager* must immediately on

becoming aware of that fact or matter take the necessary steps to rectify the situation, whether by closing out or providing additional cover or otherwise.

5.6.16

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Table Stages in defining cover
This table belongs to (CIS 5.6.8)

1	Take the <i>scheme property</i>		<i>Transferable Securities (TS)</i>	Cash (& <i>Near Cash</i>)	Gold	Rights obtained through <i>derivatives</i>	Stock Lent
2	ADD borrowing facilities to make a maximum of 110%	10 %			100%		
3	SUBTRACT property not eligible to provide cover to reach total of Y%		TS (used as cover) Note 1	Cash (used as cover or as deposit)	Gold (used as cover)	Rights (used as cover)	Stock Lent (unless obtainable in time)
4	Find the total available: $T = 110\% - Y\%$						
5	Take T and subdivide				$110\% - Y\%$		
	AVAILABLE SCHEME PROPERTY (T)		Property	Rights to property	Cash	Allowable substitutes for cash	TS
	EXPOSURE TO BE COVERED		cover for exposure in terms of property			cover for exposure in terms of money	

Note 1: TS, Cash, Gold or Rights are not eligible if they are being used as cover under this section (CIS 5.6) or under section CIS 5.13 (Efficient portfolio management).

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5.6.17

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Table Mutual cover as between derivatives
This table belongs to (CIS 5.6.12)

DERIVATIVE A (covers/is covered by)	DERIVATIVE B		
	(i)	(ii)	(iii)
Bought <i>Future</i>	Sold <i>Future</i>	Bought Put <i>Option</i>	Written Call <i>Option</i> (if in the money)
Sold <i>Future</i>	Bought <i>Future</i>	Bought Call <i>Option</i>	Written Put <i>Option</i> (if in the money)
Bought Call <i>Option</i>	Written Call <i>Option</i>	–	–
Bought Put <i>Option</i>	Written Put <i>Option</i>	–	–

Note
Column B(i) shows the effect of CIS 5.6.12.R(3)(b); Column B(ii) shows the effect of CIS 5.6.12.R(3)(c)(i); and Column B(iii) shows the effect of CIS 5.6.12.R(3)(c)(ii) and CIS 5.6.12.R(3)(g).

5.7 Geared futures and options schemes

Application

- 5.7.1 **R** This section (CIS 5.7) applies to *authorised fund managers of geared futures and options schemes*.
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Introduction

- 5.7.2 **G** (1) This section (CIS 5.7) sets out specific *rules* for *geared futures and options schemes*. *Geared futures and options schemes* are *authorised funds* dedicated to investment in *derivatives* (whether with or without *transferable securities*) where the extent of that investment is limited by the amount of property available to be put up as *initial outlay* or used as cover.
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- (2) A *geared futures and options scheme* is permitted to take on exposure to the extent of putting 20% of its *scheme property* into *initial outlay* on *derivatives*. The property for this purpose is not to be increased by borrowing, since a *geared futures and options scheme* cannot borrow (see CIS 5.15.3R (General power to borrow)). There is no limit on the amount of cash that can be held by the *geared futures and options scheme*.

Geared futures and options scheme: general

- 5.7.3 **R** (1) The *scheme property* of a *geared futures and options scheme* must, except where otherwise provided in the *rules* in this chapter, consist only of any or all of :
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- (a) *transferable securities* available to a *securities scheme* in accordance with CIS 5.4 (Securities schemes), (but excluding *investments in units* in *collective investment schemes* under CIS 5.4.5R);
 - (b) transactions in *derivatives* or forward transactions which are covered on the basis available to a *futures and options scheme* (see CIS 5.6.9G – CIS 5.6.12R for requirements for cover);
 - (c) *derivatives* permitted under the *rules* in this section (CIS 5.7);

- (d) forward transactions in currencies or gold permitted under the *rules* in this section (CIS 5.7);
 - (e) cash or *near cash*;
 - (f) *units* in *collective investment schemes* under CIS 5.7.8R (Investment in collective investment schemes);
 - (g) gold.
- (2) In respect of *investment* within (1)(a), CIS 5.4R (Securities schemes) applies as if the *geared futures and options scheme* were a *securities scheme*, but subject to any special modifications in this section (CIS 5.7).
- (3) In respect of transactions in *derivatives* and forward transactions under (1)(b), CIS 5.6 (Futures and options schemes), except CIS 5.6.7R (Investment in collective investment schemes), applies as if the *geared futures and options scheme* were a *futures and options scheme*, but subject to any special modifications in this section (CIS 5.7).
- (4) In respect of *derivatives* within (1)(c):
- (a) any transaction in *derivatives* must be in an *approved derivative*, or in one which complies with CIS 5.6.6R (OTC transactions in derivatives); and
 - (b) any transaction in an *approved derivative* must be effected on or under the *rules* of an *eligible derivatives* market.
- (5) In respect of transactions within (1)(d), this section (CIS 5.7), except (4) and CIS 5.7.4R(7) (Limit on investment in initial outlay), applies as if any forward transaction were a transaction in *derivatives*; and the transaction must be with a counterparty which is approved for the purposes of CIS 5.6.6R(2).
- (6) Not more than 10% in value of the *scheme property* is to be held in the form of gold.
- (7) The following also apply to *geared futures and options schemes*:
- (a) CIS 5.2R (General investment powers and limits for authorised funds);
 - (b) CIS 5.13R (Efficient portfolio management);
 - (c) CIS 5.14R (Stock lending);
 - (d) CIS 5.15R (Cash, borrowing, lending and other provisions); and

(e) CIS 5.16R (Cover for sales).

- (8) Despite the *rules* referred to in (7), an ICVC that is a *geared futures and options scheme* or the *trustee* of an AUT that is a *geared futures and options scheme* does not have power to borrow, whether under this section (CIS 5.7) or CIS 5.13R (Efficient portfolio management) or otherwise.

Limits on investment in initial outlay

5.7.4

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- (1) At any time, not more than 20% in value of the *scheme property* of a *geared futures and options scheme* is, subject to (3), to be devoted to *initial outlay* in any transactions in *derivatives* which are outstanding.
- (2) For the purposes of *initial outlay*:
- (a) regard must be had to the rules of any relevant *eligible derivatives* market;
 - (b) any increase in *margin* or *initial margin*, if required by such a market, is regarded as *initial outlay* from then on;
 - (c) any decrease in *margin* or *initial margin*, if allowed by such a market, ceases to be *initial outlay* from then on;
 - (d) *variation margin* (that is, an additional sum required to be paid to retain the rights following a movement in prices or other movements) is not *initial outlay*;
 - (e) *premium* which may become payable in the future under the transaction in respect of an *option* is regarded as *initial outlay* from the outset;
 - (f) in the case of a purchased *option*, the amount mentioned in (6) is to be regarded as *initial outlay*;
 - (g) in the case of a written *option*, the amount mentioned in (7) is to be regarded as *initial outlay*;
 - (h) in the case of an *over the counter future*, the amount mentioned in (8) is to be regarded as *initial outlay*; and
 - (i) in the case of a forward transaction, the amount mentioned in (9) is to be regarded as *initial outlay*.
- (3) Not more than 10% in value of the *scheme property* is to be used for *initial outlay* on transactions in *derivatives* in the form of purchased *options* without counting this towards the 20% in (1). The figure of 10% must be reduced by any percentage of the value

of the *scheme property* invested in *transferable securities* in the form of *warrants*.

- (4) The *authorised fund manager* must arrange for the *depository* to *deposit* and set aside with an *eligible institution* the amounts for the time being required by (6), (7), (8) and (9), and these amounts must not be used for the purpose of providing cover under the *rules* in this chapter.
- (5) The amounts to be deposited and set aside may be in cash or in *government and public securities* (which are to be valued for this purpose at the current mark to market valuation).
- (6) Where an *option* is purchased for the account of the *ICVC* or of the *AUT*, the *authorised fund manager* must ascertain the amount, if any, by which 5% of the exercise value of the *option* (that is the amount which would be payable or receivable by the *geared futures and options scheme* on exercise of the *option*) exceeds the amount paid by way of *premium*.
- (7) Where an *option* is written for the account of the *ICVC* or of the *AUT*, the *authorised fund manager* must ascertain at the outset and at each valuation the amount which is the sum of:
 - (a) 5% of the exercise value of the *option* (that is the amount which would be payable or receivable by the purchaser of the *option*, on exercise of the *option*); and
 - (b) the amount, if any, by which the *option* is in the *money* to the purchaser of the *option*.
- (8) Where a transaction in an *over the counter future* is entered into for the account of the *ICVC* or of the *AUT*, the *authorised fund manager* must ascertain at the outset and at each valuation the amount which is the sum of:
 - (a) 5% of the value of the amount of property to be bought or sold under the contract; and
 - (b) the amount, if any, by which the *future* would cause a loss to the *geared futures and options scheme* if it were to be closed out.
- (9) Where a forward transaction is entered into for the account of the *ICVC* or of the *AUT*, the *authorised fund manager* must ascertain at the outset and at each valuation the amount which is 5% of the value of the forward contract (that is the amount of currency or of gold to be purchased or sold by the transaction at the current valuation in the currency or one of the currencies relevant for the purposes of the transaction) for each period of three months (or

part of them) between the date of the latest valuation and the date of maturity.

Stages in using limit on initial outlay

5.7.5 **G** CIS 5.7.6G sets out the various stages in using *initial outlay*

5.7.6 **G** Table Stages in using limit on initial outlay
This table belongs to (CIS 5.7.5)

Calculating maximum limit on *initial outlay*

Example 1 – Start point

Take the value of the *scheme property* (£10 million)
Divide by 20% to find limit (£10m)20% = £2million)

Note:

- (1) In general, potential exposure of the *geared futures and options scheme* will increase with any increase in *initial outlay*.
- (2) If the value of the *scheme property* changes on a subsequent valuation, the maximum permitted *initial outlay* will also change as shown in Example 2 and Example 3.

Example 2 – Successful *scheme*

The *scheme* is subsequently valued at £12 million. Corresponding value of *initial outlay* becomes:–

20% of £12million = £2.4 million.

Example 3 – Unsuccessful *scheme*

The *scheme* is subsequently valued at £8 million. Corresponding value of *initial outlay* becomes:–

20% of £8 million = £1.6 million

Spread

5.7.7 **R** (1) There are no limits, other than those resulting from the requirement in CIS 5.7.4R (Limit on investment in initial outlay), on the value of the *scheme property* of a *geared futures and options scheme* which may be devoted to *initial outlay* in respect of *derivatives* on or related to any one category of underlying *security, commodity* or other factor.

(2) Not more than 5% in value of the *scheme property* of a *geared futures and options scheme* is to be devoted to *initial outlay* in respect of *over the counter* transactions with any one counterparty.

- (3) Wherever the total value held on *deposit* of the *scheme property* of a *geared futures and options scheme* is more than £1 million:
 - (a) not more than 10% in value is to be kept as cash on *deposit* with any one *person*;
 - (b) for the purposes of (a):
 - (i) the *depository* and its *associates* are regarded as the same *person*;
 - (ii) the *manager* and its *associates* are regarded as one *person*; and
 - (iii) each *director* of an *ICVC* including the *ACD* and his or its *associates* are regarded as one *person*; and
 - (c) the figure of 10% in (5) may be increased to 20% if:
 - (i) the *person* is an *eligible institution* and is not one of the *persons* referred to in (b); and
 - (ii) the amount of the *deposit* does not exceed 10% of that *eligible institution's* issued capital and reserves as shown in its most recently published annual accounts.

Investment in collective investment schemes

5.7.8

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- (1) *Investments in units of a collective investment scheme* must not be made unless that *scheme*:
 - (a) is a *regulated collective investment scheme* which is either a *futures and options scheme* or a *geared futures and options scheme* or a *money market scheme* or a *scheme* of a category that is equivalent to the category of one of such *authorised funds*; or
 - (b) (after taking account of *CIS 5.2.10R* (Investment in associated collective investment schemes)):
 - (i) is within *CIS 5.4.5R* (Securities scheme: investment in collective investment schemes); or
 - (ii) would be within *CIS 5.4.5R* if *CIS 5.4.5R(3)* read: “is *dedicated* to investing funds raised from the public:
 - (a)□in approved and other *derivatives* (where most □□or all of the transactions in *derivatives* are □□fully covered by cash, *securities* and other □□*derivatives*), whether with or without □□□*transferable securities* or covered forward □□transactions in currency or gold; or

□(b)□in approved and other *derivatives* (where the □□extent of *investment* is limited by the amount □□of *scheme property* available to be put up as □□*initial outlay*), whether with or without □□□*transferable securities* and whether with or □□without *investment* within (a).”.

- (2) Not more than 5% in value of the *scheme property* of a *geared futures and options scheme* is to consist of *units in collective investment schemes*.

Delivery of property under a transaction in derivatives

5.7.9

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- (1) When entering into any transaction in *derivatives* as a result of which any *investment* or asset may become part of the *scheme property* of the *geared futures and options scheme*, the *authorised fund manager* must take reasonable care to determine:
- (a) (where the *investment* or asset is one of which the *scheme property* could in some measure consist) that the transaction will not result in any breach of any other *rule* in this chapter:
- (i) because it can be readily closed out; or
- (ii) because the *investment* or asset concerned will at the expected time be included within the *scheme property* in a manner which conforms with the *rules* in this chapter; or
- (b) (in any other case) that the transaction can readily be closed out.
- (2) Where, in the event, the determination in (1)(a) or (1)(b) proves unjustified, and the *authorised fund manager* decides with the consent of the *depository*, in accordance with CIS 7.5.3R (Duties of the ACD and depository: investment and borrowing powers) (in the case of an *ICVC*) or CIS 7.10.3R (Duties of the manager and trustee: investment and borrowing powers) (in the case of an *AUT*) that it is in the interests of the *holders* that the property should be temporarily acquired, then the property concerned may, despite any other *rule* in this chapter, form part of the *scheme property* until the position can be rectified.

5.8 Property schemes

Application

- 5.8.1 **R** This section (CIS 5.8) applies to *authorised fund managers of property schemes*, except CIS 5.8.11R(1) (Initial periods), which also applies to the *trustee* of an AUT that is a *property scheme*.

Introduction

- 5.8.2 **G** (1) This section (CIS 5.8) sets out specific *rules* for *property schemes*, which can invest in property, whether in the *United Kingdom* or abroad.
- (2) *Property schemes* are *authorised funds* which may invest in *approved immovables* and property, related assets with or without other *transferable securities*. Under this section (CIS 5.8) a *property scheme* may not invest in immovables until £5 million has been subscribed or agreed to be subscribed. Under CIS 12.3.4R (Failure to obtain minimum subscriptions) if this amount is not subscribed for during the period of the *initial offer* (or during the first 21 days after the date on which *persons* are first invited to become *holders* in the *property scheme*, where there is no *initial offer*) the *authorised fund manager* must use its best endeavours to enable the *property scheme* to be wound up. Provided the *property scheme* obtains £5 million or more, it may then be invested within a band of 20%-80% in *approved immovables* as described in CIS 5.8.4R (Permitted immovables) and CIS 5.8.5R (Approved immovables).
- (3) For *property schemes* below £15 million in size there is, for up to two years, some transitional relief from some of the limits: in the early period a *property scheme* of small size may not be able to achieve the spread between different properties and other investments, appropriate for ongoing *property schemes* (see CIS 5.8.11R(3) (Initial period)).
- (4) The remainder of the *scheme property* (also 20% - 80%) must be either invested in so-called *property related assets* (typically *shares* in a *property investment company* which must themselves be *approved securities* or else within one of the other special limits in this section) or in *government and public securities*, but subject to a maximum of 35% for such *securities*. In addition, 5% may be invested in property related *collective investment schemes*.
- (5) To help illuminate this section, CIS 5.8.13G (Construction of property schemes) gives two examples of how a *property scheme* may be constructed, and outlines how the spread *rules* will apply to those *property schemes*.

Property schemes A and B are each invested at opposite ends of the 20%-80% band.

Property schemes: general

5.8.3

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- (1) The *scheme property* of a *property scheme* must, except where otherwise provided in the *rules* in this chapter, only consist of any or all of :
 - (a) *approved immovables*;
 - (b) *property related assets*;
 - (c) *government and public securities*; and
 - (d) *units in collective investment schemes*, under (5).
- (2) Not more than 80% in value of the *scheme property* is to consist of *approved immovables*, but this limit is subject to (6).
- (3) Not more than 80% in value is to consist of *transferable securities*, but the *transferable securities* must be property-related assets which are *approved securities* or else separately permitted under (4), (5) or (6).
- (4) Not more than 35% in value is to consist of *government and public securities*.
- (5) Not more than 5% in value is to consist of *units in collective investment schemes* under CIS 5.8.7R (Investment in collective investment schemes).
- (6) Not more than 10% in value is to consist of shares which are property-related assets but are not *approved securities*. Any shares included under this paragraph must be included in the 80% limit in (2), which may therefore on occasion produce a limit of 70% for *approved immovables*.
- (7) Not more than 5% in value is to consist of *transferable securities* within (3) which are *warrants*. These *warrants* must be property related assets which are *approved securities*.
- (8) The following also apply to *property schemes*:
 - (a) CIS 5.2 (General investment powers and limits for authorised funds);
 - (b) CIS 5.4.6R (Investment in warrants and nil and partly paid securities);
 - (c) CIS 5.13 (Efficient portfolio management);

- (d) CIS 5.14 (Stock lending);
- (e) CIS 5.15 (Cash, borrowing, lending and other provisions); and
- (f) CIS 5.16 (Cover for sales).

Permitted immovables

5.8.4

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An interest in land or a building is a *permitted immovable* if:

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- (1) the land or building is situated in a country or territory identified in the *prospectus* for the purpose of this *rule* (CIS 5.8.4R);
- (2) the land or building is situated in England and Wales or in Northern Ireland, and the interest is a freehold or leasehold interest; or if the land or building is situated in Scotland and the interest is any interest or estate in or over land or heritable right including a long lease; or if the land or building is situated elsewhere and the interest is equivalent to any of the interests mentioned in this paragraph; and
- (3) where the interest is leasehold (or its equivalent) and it has an unexpired term of 20 years or more;

and furniture, fittings or other contents of any building may for this purpose be regarded as part of it.

Approved immovables

5.8.5

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(1) In this sourcebook, an *approved immovable* is a *permitted immovable* which satisfies all of the conditions in (3) to (6) and either (2)(a) or (2)(b).

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- (2) (a) Unless (b) is satisfied, the immovable must be transferable; an immovable is not regarded as transferable unless the *manager* or the *ICVC* has received a report from an *appropriate valuer* that:
 - (i) contains a valuation of the immovable (with and without any relevant subsisting mortgage); and
 - (ii) states that, in the *appropriate valuer's* opinion, the immovable would, if acquired for the *property scheme*, be capable of being disposed of reasonably expeditiously at that valuation.
- (b) Unless (a) is satisfied, the *approved immovable* must have marriage value; an immovable is not regarded as having marriage value unless the *manager* or the *ICVC* has received a

report from an *appropriate valuer* valuing the immovable and stating that:

- (i) the immovable is adjacent to or contiguous with another immovable included in the *scheme property*; and
 - (ii) in the opinion of the *appropriate valuer*, the total value of the immovable, if acquired for the *property scheme*, and of the other immovable, would at least equal the sum of the price payable for the immovable and the existing value of the other immovable.
- (3) The immovable must be accessible; an immovable is not regarded as accessible unless the *authorised fund manager* has taken reasonable care to determine that reasonable access to it is assured.
- (4) The immovable must have a good root of title; an immovable is not regarded as having a good root of title unless the *authorised fund manager* has taken reasonable care to determine that the title to the immovable is a good marketable title.
- (5) The immovable must be unencumbered or adequately unencumbered; an immovable is not regarded:
- (a) as unencumbered, unless there is no subsisting mortgage over or on it; and
 - (b) as adequately unencumbered, unless the only mortgages over or on it are one or more *approved mortgages* within CIS 5.8.9R (Mortgaged property), which secures, or together secure, on the immovable repayment of a sum or sums not exceeding 50% of the value at (2)(a) (that is, that part of the value which is valued on the assumption that the immovable is not mortgaged).
- (6) The immovable must be or have been or is to be bought promptly and at a reasonable price; an immovable is not regarded as bought promptly and at a reasonable price unless:
- (a) it is bought or agreed by enforceable contract to be bought within six months after receipt of the report of the *appropriate valuer* referred to in (2)(a) or (2)(b);
 - (b) at the time of the purchase or agreement it would not have been apparent to the *authorised fund manager* that the report could no longer reasonably be relied upon; and
 - (c) the immovable is bought at no more than 105% of the valuation in the report.
- (7) A person is an *appropriate valuer* if:

- (a) he has knowledge of and experience in the valuation of immovables of the relevant kind in the relevant area;
- (b) he is or is qualified to be the *standing independent valuer* of a *property scheme* or is reasonably considered by the *property scheme's standing independent valuer* to hold equivalent qualifications;
- (c) he is independent of the *ICVC*, the *depository* and each of the *directors* of the *ICVC* or of the *manager* and the *trustee* of the *AUT* in the sense required for a *standing independent valuer* under *CIS 12.3.1R(2)* (Standing independent valuer); and
- (d) neither he nor any of his partners (if any) nor a fellow *director* of a corporate *appropriate valuer* (if any) have been engaged, whether as *principal* or as agent, in relation to the finding of the immovable for the *property scheme* or the finding of the *property scheme* for the immovable.

Property-related assets

5.8.6

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- (1) Property-related assets qualify for investment purposes (under *CIS 5.8.3 R (6)*) only if:
 - (a) they are *transferable securities*; and
 - (b) they are shares in a *body corporate* at least 75% of whose total assets (before deduction of liabilities and as shown in the most recently published accounts) consist of *permitted immovables*.
- (2) Not more than 5% in the value of the *scheme property* of a *property scheme* is to consist of *investments* of the type referred to in (1) issued by any one issuer. The figure of 5% may be increased to 10% if:
 - (a) the *property scheme* owns at least 90% of the rights to vote which are exercisable in all circumstances at general meetings of the *body corporate*;
 - (b) the *shares* are or were bought within six months after receipt by the *authorised fund manager* of:
 - (i) a report by an *appropriate valuer* relating to *permitted immovables* owned by the *body corporate*, indicating that they are transferable (as in *CIS 5.8.5R (2)(a)*) or have marriage value (as in *CIS 5.8.5R (2)(b)*); and
 - (ii) a report, on the value of any assets other than *permitted immovables*, from a *person* then qualified to be an auditor

of a company under the relevant legislation in any part of the *United Kingdom*;

- (c) at the time of the purchase it would not have been reasonably apparent to the *authorised fund manager* that the report at (b)(i) or (ii) could no longer reasonably be relied on; and
- (d) the *shares* were bought at no more than 105% of the total of the values in the reports at (b)(i) and (ii).

Investment in a collective investment scheme

5.8.7

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Investments in units of a collective investment scheme must not be made unless that *scheme*:

- (1) is a *regulated collective investment scheme* which:
 - (a) complies with section 243(10) of the *Act* (Authorisation orders: entitlement to have *units* redeemed) or is treated as complying with it by section 243(11) of the *Act*; and
 - (b) is *dedicated to approved immovables*, with or without *transferable securities* which are *property related assets* or *government and public securities*; or
- (2) is a *regulated collective investment scheme* which is a *money market scheme* or a *scheme* of a category that is equivalent to a *money market scheme*.

Property related limits

5.8.8

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- (1) Not more than 10% in value of the *scheme property* of a *property scheme* is to consist of *approved immovables* which are leasehold interests (or the equivalent: see *CIS 5.8.4R (2)*) having an unexpired term of less than 60 years.
- (2) Not more than 25% in value is to consist of *approved immovables* which are unoccupied and non-income producing or in course of substantial development, redevelopment or refurbishment.

Mortgaged property

5.8.9

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- (1) Not more than 15% in value of that part of the *scheme property* of a *property scheme* which for the time being consists of immovables is to consist of mortgaged immovables.

- (2) An immovable subject to one or more mortgages may be retained by the *property scheme* only so long as the mortgage or each of the mortgages is an *approved mortgage*, the total sums outstanding under which do not exceed 50% of the value of the immovable (assuming for this purpose that the immovable is not mortgaged).

Spread

5.8.10

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- (1) Not more than 15% in value of the *scheme property* of a *property scheme* is to consist of any one immovable.
- (2) In (1), immovables which would be regarded as having marriage value under *CIS 5.8.5R(2)(b)* must be regarded as one immovable.
- (3) The figure of 15% in (1) may be increased to 25% once the immovable has been included in the *scheme property* of a *property scheme* in compliance with (1).
- (4) Not more than 5% in value is to consist of *property related assets* issued (or conferring rights to *investments* issued) by any one issuer.
- (5) The figure of 5% in (4) may be increased to 10% in respect of up to 40% of the value of the *scheme property* of a *property scheme*.
- (6) Not more than 20% of the income receivable in any accounting period is to derive from members of any one *group*; but there is no restriction on the income receivable from any issuer of *government and public securities*.

Initial periods

5.8.11

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- (1) During the period of the *initial offer*, no immovable may be:
 - (a) bought or leased; or
 - (b) agreed, by enforceable contract, to be bought or leased;

unless it appears to the *ACD* or to the *manager* and *trustee* that more than £5 million (or the equivalent amount in the *base currency* of the *property scheme*) has been paid or agreed to be paid for *units* to be issued or sold.
- (2) During the first two years starting with the date on which the *property scheme* is authorised or on which the *units* are first issued (if later) and subject to (3) and (4):

- (a) CIS 5.8.8R(1) (Property related limits) and CIS 5.8.10R (Spread) do not apply; and
 - (b) the obligation, derived from CIS 5.8.3R (Property schemes: general), that at least 20% in value of the *scheme property* must consist of *approved immovables* does not apply.
- (3) Paragraph (2) ceases to apply if, at any time during the two year period, six months have elapsed from the first date on which the *scheme property* exceeds £15 million in value (or the equivalent amount in the *base currency* of the *property scheme*).
- (4) Paragraph (2) postpones the application of CIS 5.8.10R(4) (Spread – (of property related assets)) for a maximum of only six months from the date on which the *property scheme* is authorised or on which the *units* are first issued (if later), and not of two years.

Grant of options and mortgages

5.8.12

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- (1) No option may be granted to buy any immovable comprised in the *scheme property*, whether under CIS 5.13 (Efficient portfolio management) or otherwise.
- (2) No *mortgage* other than an *approved mortgage* may be created on or over any such immovable.

5.8.13

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Table Construction of property schemes
This table belongs to (CIS 5.8.2)

	Property Scheme A (fully invested in immovables)	Limits for Property scheme A	Type of Asset	Limits for Property Scheme B	Property scheme B (fully invested in transferable securities)	
80%	Immovables	up to 10% up to 25% up to 12% up to 15% up to 20%	Leases 20–60 years Vacant, repairs, ... Mortgaged immovables any one immovable rent from any one group	up to 10% up to 20% up to 3% up to 15% up to 20%	Immovables	20%
20%	Transferable securities	up to 20% 0% up to 20% up to 5% up to 5%	transferable securities which are property related assets (if approved) (if non approved) Government and public securities collective investment schemes Any one issue of securities	up to 80% up to 10% up to 35% up to 5% up to 5%	Transferable securities	80%

Note 1: This table does not include all the detail in this section (*CIS 5.8*)

Note 2: *Property scheme A* is invested in immovables to the maximum extent permitted, while *Property scheme B* is invested in immovables to the minimum extent permitted. Both *property schemes* are assumed to be fully invested in immovables and *transferable securities*, although in practice both would be likely to hold some cash as permitted by section *CIS 5.15* (Cash borrowing, lending and other provisions) and the cash held could therefore drive down to some lower figure the 20% minimum. The same effect would be produced if the *property scheme* were taking advantage of section *CIS 5.13* (Efficient portfolio management).

5.9 Warrant schemes

Application

- 5.9.1 **R** This section (CIS 5.9) applies to *authorised fund managers of warrant schemes*.

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Introduction

- 5.9.2 **G** (1) This section (CIS 5.9) sets out specific *rules for warrant schemes*. *Warrant schemes* are *authorised funds* which are akin in all respects to *securities schemes* (as to which see CIS 5.4 (Securities schemes)), except that they have an unlimited power to invest in *warrants*.

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- (2) In this sourcebook, “*warrant*” has a wider meaning than normally attributed to it in warrant markets. In this sourcebook, *warrants* are not only instruments giving entitlement to *investments* (as defined in article 79 of the *Regulated Activities Order*) but also include any other *transferable security* (not being a nil or partly paid *security*) which is listed on an *eligible securities market*, and which is akin to a *warrant* in that it involves a down payment and a right to surrender the instrument and pay more in due course in order to obtain a *transferable security*.

Warrant schemes

- 5.9.3 **R** (1) The *scheme property* of a *warrant scheme* must, except where otherwise provided in the *rules* in this chapter, only consist of *property* which could be the *scheme property* of a *securities scheme*, except that up to 100% in value of the *scheme property* may consist of *warrants*.
- (2) Accordingly, CIS 5.4 (Securities schemes) (except CIS 5.4.6R (Investment in warrants and nil and partly paid securities)) applies to a *warrant scheme* as it applies to a *securities scheme*.

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- (1) The following also apply to *warrant schemes*:
- (d) CIS 5.2 (General investment powers and limits for authorised funds);

- (b) *CIS 5.13* (Efficient portfolio management);
- (c) *CIS 5.14* (Stock lending);
- (d) *CIS 5.15* (Cash, borrowing, lending and other provisions); and
- (e) *CIS 5.16* (Cover for sales).

5.10 Feeder funds

Application

- 5.10.1 **R** This section (CIS 5.10) applies to *managers of feeder funds*, except CIS 5.10.4R(2) which applies to *trustees of feeder funds*.

Introduction

- 5.10.2 **G** (1) This section (CIS 5.10) sets out specific *rules for feeder funds*. *Feeder funds* are AUTs which are *relevant pension schemes*. Under this section (CIS 5.10), a *feeder fund* must be invested in either a single *regulated collective investment scheme* or a single *eligible investment trust*.
- (2) The *feeder fund* investing in *eligible investment trust shares* is structured under the *rules* in this section (CIS 5.10). The *rules* in this section set out the conditions that must be satisfied before a *feeder fund* can invest in an *eligible investment trust*.

Feeder funds: general

- 5.10.3 **R** (1) The *scheme property* of a *feeder fund* must, except where otherwise provided in the *rules* in this chapter, only consist of:
- (a) *units* in a single *regulated collective investment scheme*; or
 - (b) *shares* in or *debentures* of a single *eligible investment trust* (as to which see CIS 5.10.4R (Feeder funds investing in a single eligible investment trust)).
- (2) An AUT may be a *feeder fund* only if it is a *relevant pension scheme*.
- (3) A *feeder fund* under (1)(a) must not invest in:
- (a) a *geared futures and options scheme*;
 - (b) a *property scheme*;
 - (c) a *warrant scheme*;

- (d) a *feeder fund*;
 - (e) a *fund of funds scheme*, unless the *fund of funds scheme* is prevented by the *instrument constituting the scheme* from investing in any *authorised fund* within (a), (b) or (c);
 - (f) any *sub-fund* of a *regulated collective investment scheme* which is invested as if it were an *authorised fund* within (a) to (e); and
 - (g) a *recognised scheme* which would, if authorised, fall within any of (a) to (f).
- (4) A *sub-fund* of an *AUT* that is an *umbrella scheme*, which (if it were itself the subject of a separate *authorisation order*) would be a *feeder fund*, is to be treated as a *feeder fund* for the purposes of this *rule* (CIS 5.10.3R) and *rule* CIS 5.10.4R (Feeder funds investing in a single eligible investment trust); but an *AUT* that is an *umbrella scheme* must not contain such a *sub-fund* unless that *AUT* is a *relevant pension scheme*.
- (5) The following also apply to *feeder funds*:
- (a) CIS 5.2 (General investment powers and limits for authorised funds);
 - (b) CIS 5.15 (Cash, borrowing, lending and other provisions); and
 - (c) CIS 5.16 (Cover for sales).

Feeder funds investing in a single eligible investment trust

5.10.4

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An *investment trust* is an *eligible investment trust* for the purposes of CIS 5.10.3R(1)(b) only if:

- (1) at the date of the *authorisation* of the *feeder fund*, the property of the *investment trust* included net assets worth at least £25 million (or, if the *base currency* of the *feeder fund* is not sterling, the equivalent in that *base currency*); and
- (2) at any time in the last six months, the *trustee* of the *feeder fund* having taken reasonable care has determined that:
 - (a) at least 70% of the income of the *investment trust* received during either or both of:
 - (i) the last completed accounting period; and
 - (ii) the first half of the current accounting period;
 consisted of income from *approved securities*;

- (b) (apart from transactions for hedging purposes) the property of the *investment trust* either:
 - (i) cannot be invested in *derivatives*; or
 - (ii) can be invested in *derivatives* only on the footing of cover to at least the extent required of a *futures and options scheme* under CIS 5.6.9R (Cover for transactions in derivatives and forward transactions);
- (c) not more than 5% of the property of the *investment trust* consists of *warrants*;
- (d) not more than 5% of the property of the *investment trust* consists of *transferable securities* issued by any one issuer, except that the figure of 5% may be increased to 15% in respect of up to 30% in value of the *investment trust*;
- (e) the *feeder fund* owns not more than 20% of the shares (or of any *class* of shares) in or of the *debentures* (or of any *class* of *debentures*) of the *investment trust*;
- (f) the borrowing of the *investment trust* does not exceed 50% of the *market value* of the shares of the *investment trust* at the mid-value share price for the time being;
- (g) the shares in (or *debentures* of) the *investment trust* are regularly offered for *purchase* and *sale* by at least three *market makers* who are recognised or registered as *members* of an *eligible securities* market; and
- (h) the *investment trust* has no limit on its duration.



5.11 Fund of funds schemes

Application

5.11.1 **R** This section (CIS 5.11) applies to *authorised fund managers of fund of funds schemes*.
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Introduction

5.11.2 **G** (1) This section (CIS 5.11) sets out specific *rules* for *fund of funds schemes*. *Fund of funds schemes* are *authorised funds* designed to invest in a combination of at least five *regulated collective investment schemes*. A *fund of funds scheme* may combine investment in *money market schemes* or *recognised schemes* equivalent to a *money market scheme*, with investment in any one other permitted category of *scheme*. Alternatively, a *fund of funds scheme* may invest only in *money market schemes* or in *recognised schemes* equivalent to a *money market scheme* or only in *regulated collective investment schemes* from any one other permitted category of *scheme*.
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(2) The requirements in this section preserve product distinctiveness in the case of *fund of funds schemes*.

(3) For the purpose of this section, each *sub-fund* of an *umbrella scheme* and of an equivalent *recognised scheme* is to be treated as if it were a separate *authorised fund* or separate *scheme*.

Fund of funds schemes: general

5.11.3 **R** (1) The *scheme property* of a *fund of funds scheme* must, except where otherwise provided in the *rules* in this chapter, only consist of *units* in *regulated collective investment schemes*.
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(2) A *fund of funds scheme* may not invest in:

- (a) a *fund of funds scheme*;
- (b) a *feeder fund*;
- (c) any *recognised scheme* which is *dedicated* to investment in a number of *regulated collective investment schemes*;

- (d) any *recognised scheme* which is *dedicated* to investment in a single *regulated collective investment scheme* or in a single *eligible investment trust*; and
 - (e) any *sub-fund* of an *umbrella scheme* or *sub-fund* of any other *recognised scheme* which is equivalent to a *scheme* within (a) to (d).
- (3) Not more than 20% in value of the *scheme property* is to consist of *units* in any one *regulated collective investment scheme*.
- (4) The following also apply to *fund of funds schemes*:
- (a) CIS 5.2 (General investment powers and limits for authorised funds);
 - (b) CIS 5.13 (Efficient portfolio management);
 - (c) CIS 5.15 (Cash, borrowing, lending and other provisions); and
 - (d) CIS 5.16 (Cover for sales).

Eligible combinations of scheme

5.11.4

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- (1) A *fund of funds scheme* may invest in *units* in any five or more *authorised funds* within any one of CIS 5.4 (Securities schemes), CIS 5.5 (Money market schemes), CIS 5.6 (Futures and options schemes), CIS 5.7 (Geared futures and options schemes), CIS 5.8 (Property schemes) and CIS 5.9 (Warrant schemes).
- (2) A *fund of funds scheme* may invest in *units* in one or more *money market schemes* (within CIS 5.5 (Money market schemes)) and in *units* in any one or more *authorised funds* within any one of the other sections mentioned in (1).
- (3) Each *sub-fund* of an *umbrella scheme* and each *sub-fund* of any *recognised scheme* that is equivalent to an *umbrella scheme* is to be treated for the purposes of (CIS 5.11.4R) and CIS 5.11.3R(3) as if it were a separate *scheme*.
- (4) A *recognised scheme* may be treated for the purpose of this *rule* (CIS 5.11.4R) as if it were a *scheme* falling within the section which would be the relevant section if the *recognised scheme* were an *authorised fund*.



5.12 Umbrella schemes

Application

5.12.1 **R** This section (CIS 5.12) applies to *authorised fund managers* of *umbrella schemes*.
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Introduction

5.12.2 **G** This section (CIS 5.12) sets out specific *rules* for *umbrella schemes*. *Umbrella schemes* are single *authorised funds* which have at least two *sub-funds* and provide the opportunity for *holders* to switch all or part of their investment from one *sub-fund* to another. CIS 12 (Special provisions for certain categories of scheme) and other provisions of the *rules* in this sourcebook enable the *umbrella scheme* to be treated as a single *authorised fund* or as a collection of separate *sub-funds* as appropriate. CIS 12 sets out specific other provisions that apply to *umbrella schemes*.
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Umbrella schemes: general

5.12.3 **R** A *sub-fund* of an *umbrella scheme* must, subject to CIS 5.12.4R, only be invested as if it were a single *authorised fund* within one of CIS 5.4 (Securities schemes) to CIS 5.11 (Fund of fund schemes).
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Restriction on investment

5.12.4 **R** No *sub-fund* of an *umbrella scheme* may invest in *units* in another *sub-fund* of the same *umbrella scheme*.
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5.13 Efficient portfolio management

Application

5.13.1

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This section (*CIS 5.13*) applies to *authorised fund managers*, other than *managers of feeder funds*, except:

- (1) *CIS 5.13.3R* which applies to *ICVCs* and to *managers of AUTs* other than *feeder funds*;
- (2) *CIS 5.13.3R(2)(c)* which does not apply to *ICVCs* that are *fund of funds schemes* or to *managers of AUTs* that are *fund of funds schemes* or *feeder funds*;
- (3) *CIS 5.13.4R(2)(b)*, which does not apply to *authorised fund managers of fund of funds schemes* and *managers of feeder funds*; and
- (4) *CIS 5.13.12R*, which applies to *ICVCs* and to *trustees of AUTs*, other than *feeder funds*.

Explanation: requirements of efficient portfolio management

5.13.2

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- (1) This section (*CIS 5.13*) gives an *ICVC* or a *manager* of an *AUT* the ability to reduce the risks or costs associated with making investments. For that purpose, this section provides machinery to enable the property of an *authorised fund* to be used for efficient portfolio management.
- (2) There are three broadly based requirements:
 - (a) the transactions must be economically appropriate;
 - (b) the exposure must be fully covered; and
 - (c) the transactions must be entered into for one or more of three specific aims.
- (3) On (2)(a), this section (*CIS 5.13*) requires that the transaction must be economically appropriate for the purposes of efficient portfolio management.

- (4) On (2)(b), this section (CIS 5.13) requires that the exposure must be fully covered by cash or other *scheme property* sufficient to meet any obligation to pay or deliver that could arise.
- (5) On (2)(c), this section (CIS 5.13) sets out (in CIS 5.13.3R(2)) what these three aims are:
 - (a) the reduction of risk;
 - (b) the reduction of cost; and
 - (c) the generation of additional capital or income for the *authorised fund* with an acceptably low level of risk.
- (6) The first two aims, together or separately, allow for tactical asset allocation. Tactical asset allocation is a switch in exposure through the use of *derivatives* rather than through the sale and purchase of underlying property. The limits on this are set out in CIS 5.13.4R(1) and (2)(a).
- (7) There is also a specific requirement for *UCITS schemes* which is derived from the *UCITS directive*. *Authorised funds* subject to that directive must be invested in *transferable securities*, and it therefore follows that an alternative exposure obtained through *derivatives* in the *portfolio* should not remain there indefinitely; the *authorised fund* must revert to *transferable securities* of some kind, within a reasonable time. Therefore, the *rules* in this section provide that any tactical asset allocation of a *UCITS scheme* must be temporary.
- (8) The first aim of reduction of risk allows for the use of *derivatives* with a view to switching the currency exposure of all or part of the *scheme property* away from a currency which is considered to be at risk.
- (9) The third aim, of taking a low-risk gain, is further defined in CIS 5.13.5R. The gains are to be derived from arbitrage and from writing covered *options*. Gains from *stock lending* are covered in CIS 5.14.

Appropriate transactions

5.13.3

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- (1) This section enables the *ICVC*, or *manager* for the account of the *AUT*, to enter into transactions of the kind specified in CIS 5.13.6R (Permitted transactions) for the purpose of efficient portfolio management, but only when each of the following two conditions is satisfied:
 - (a) the transaction is economically appropriate to that purpose, as required by CIS 5.13.4R (Economic appropriateness); and
 - (b) the transaction is fully covered, as required by CIS 5.13.8R (Cover for transactions in derivatives and forward transactions)).
- (2) A transaction under (1) must only be entered into if it is to achieve one or more of the following in respect of the *authorised fund*:
 - (a) the reduction of risk;

- (b) the reduction of cost; and
 - (c) the generation of additional capital or income for the *authorised fund* with an acceptably low level of risk.
- (3) The purpose in (2) must relate to:
- (a) the *scheme property* of the *authorised fund*;
 - (b) property (whether precisely identified or not) which is to be or is proposed to be acquired for the *authorised fund*; and
 - (c) anticipated cash receipts of the *authorised fund*, if due to be received at some time and likely to be received within one month.

Economic appropriateness

5.13.4

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- (1) Any transaction under this section must be one which (alone or in combination with one or more others) is ascertained with reasonable care by the *authorised fund manager* to be economically appropriate to the efficient portfolio management of the *authorised fund*.
- (2) In consequence, the *authorised fund manager* must take reasonable care to determine that:
 - (a) for transactions undertaken to reduce risk or cost (or both), the transaction (alone or in combination) will diminish a risk or cost of a kind or level which it is sensible to reduce; and
 - (b) for transactions undertaken to generate additional capital or income, the *authorised fund* is certain (or certain barring events which are not reasonably foreseeable) to derive a benefit from the transaction.
- (3) A transaction may not be entered into under this section (CIS 5.13) if its purpose could reasonably be regarded as speculative.
- (4) Where the transaction is for the account of a *UCITS scheme* and relates to the actual or potential acquisition of *transferable securities*, then the *authorised fund manager* must intend that the *authorised fund* should invest in *transferable securities* within a reasonable time; and it must thereafter ensure that, unless the position has itself been closed out, that intention is realised within that reasonable time.

Generation of additional capital or income

5.13.5

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- (1) There is an acceptably low level of risk for the purposes of *CIS* 5.13.3R(2)(c), in any case where the *authorised fund manager* has taken reasonable care to determine that the *authorised fund* is certain (or certain barring events which are not reasonably foreseeable) to derive a benefit:
 - (a) on a basis set out in (2) or (3); or
 - (b) from *stock lending* under section *CIS* 5.14.
- (2) The first basis is to take advantage of pricing imperfections in relation to the acquisition and disposal (or disposal and acquisition) of rights in relation to property the same as, or equivalent to, property which the *authorised fund* holds or may properly hold.
- (3) The second basis is to receive a *premium* for the writing of a covered call *option* or a covered put *option*, even if that benefit is obtained at the expense of surrendering the chance of yet greater benefit.

Permitted transactions

5.13.6

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- (1) A transaction under this section must be:
 - (a) a transaction in *derivatives*; or
 - (b) a forward transaction in a currency (or where the *scheme* property may include gold, in gold).
- (2) A transaction in *derivatives* under (1)(a) must be:
 - (a) in an *approved derivative* ; or
 - (b) one which complies with *CIS* 5.6.6R (OTC transactions in derivatives); or
 - (c) a *synthetic future*.
- (3) Any transaction in an *approved derivative* must be effected on or under the rules of an *eligible derivatives* market.
- (4) Any forward transaction must be with an *approved counterparty* within the meaning of *CIS* 5.6.6R(2) (OTC transactions in derivatives).
- (5) Not more than 5% of the value of the *scheme property* is to be directed to *initial outlay* in respect of *over the counter* transactions with any one counterparty.

- (6) A transaction in *derivatives* or forward transaction which would or could lead to delivery of property to the *depository* (or to the *ICVC*) may be entered into only if:
- (a) the property can be held by the *authorised fund*; and
 - (b) the *authorised fund manager* has taken reasonable care to determine that delivery of the property by the transaction will not lead to a breach of the *rules* in this chapter.

Cover for transactions in derivatives and forward transactions

5.13.7

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- (1) Like *futures and options schemes*, transactions in *derivatives* and forward transactions entered into for the purpose of efficient portfolio management should be fully covered.
- (2) Cover is fully explained in *CIS 5.13.8R*. There is a general requirement for individual cover of the right kind (stock for stock, or cash sum for cash sum) and *CIS 5.13.9R* provides examples of how the cover is to be found. There is also a global cover requirement, to prevent or limit gearing.
- (3) In accordance with *CIS 5.2.7R(2)(b)* (Chapter to be construed as a whole) cover used in respect of one transaction in *derivatives* or forward transaction may not be used for cover in respect of another transaction in *derivatives* or forwards.
- (4) There must be sufficient available cover for all transactions concerned.

Cover for transactions in derivatives and forward transactions

5.13.8

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- (1) No transaction may be entered into under this section (*CIS 5.13*) unless the maximum potential exposure created by the transaction, in terms of the *principal* or *notional principal* of the *derivative* or forward contract, is:
 - (a) covered individually under (2) or (3); and
 - (b) covered globally under (4).□
- (2) Exposure is covered individually if there is, in the *scheme property*:
 - (a) (in the case of an exposure in terms of property) a *transferable security* or other property which is of the right kind, and sufficient in amount, to match the exposure; and
 - (b) (in the case of an exposure in terms of *money*), cash or *near cash* (or borrowing under *CIS 5.13.12R* (Borrowing in the context of efficient portfolio management)) or *transferable securities* which is or are, or, on being turned into *money* in

the right currency, will be, sufficient in amount to match the exposure.

- (3) However, exposure to an index or basket of *securities* or other assets is covered individually for the purposes of (2) if the *authorised fund* holds *securities* or other property which (taking into account the closeness of the relationship between fluctuations in the price of the two) can reasonably be regarded as appropriate to provide cover for the exposure; they may be so regarded even if there is not complete congruence between the cover and the exposure.
- (4) Exposure is covered globally for the purposes of this section if, after taking account of all the cover required under (2) or (3) for other positions already in existence, adequate cover from within the *scheme property* is available to enable the fresh transaction to be entered into.
- (5) A transaction in *derivatives* or forward transaction is not available to provide cover for another *derivative* or forward transaction under this section, but:
 - (a) the two transactions involved in a *synthetic future* are to be treated as if they were a single *derivative*, and the net exposure from the combination is to be covered on the basis of the higher of the cover requirements of the *options* which make up the *synthetic future*;
 - (b) *synthetic cash* is available to provide cover for a transaction as if it were cash; and
 - (c) a covered currency forward or a covered currency *derivative* may provide cover for a *derivative*.
- (6) Cash not yet received into the *scheme property* but due to be received within one month is available as cover for the purposes of (2)(b) and (3).
- (7) Property anticipated under a *derivative* transaction does not count as property under (2)(a).
- (8) Property is not available for cover if it is the subject of a transaction under CIS 5.14R (Stock lending), unless the *authorised fund manager* has taken reasonable care to determine that it is obtainable (by return or re-acquisition) in time to meet the obligation for which cover is required.

Examples of cover requirements

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Examples of the cover requirements:

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- (1) A bought put *option* (or a written call *option*) on 1000 ordinary £1 shares (fully paid) of ABC plc is covered by an existing holding in the *authorised fund* of 1000 ordinary £1 shares (fully paid) of ABC plc (CIS 5.13.8R(2)(a)).
- (2) A bought call *option* (or written put *option*) on 1000 ordinary £1 shares (fully paid) of ABC plc is covered by cover (in the form of cash or an allowable substitute for cash or *transferable securities*) which is sufficient in amount to meet the *purchase price* of the *shares* on exercise of the *option* (CIS 5.13.8R(2)(b)).
- (3) A sold *contract for differences* on short-dated sterling is covered by cash or *near cash* or *transferable securities*, the values of which together at least match the *notional principal* of the contract (for example, a LIFFE short sterling contract, or a succession of such contracts, is covered by £500,000) (CIS 5.13.8R(2)(b) and CIS 5.2.7R(2)(b)).
- (4) A sold *future* on the FT-SE 100 Index is covered by holdings of equities, which satisfy the test of appropriateness for cover in CIS 5.13.8R(3) in relation to that *future*, and the values of which together at least match the current mark to market valuation of the *future* (for example, if the multiplier per full index point is £10, and if the eventual obligation under the *future* is currently at 2800, the valuation of the *futures* position is $2800 \times £10 = £28,000$) (CIS 5.13.8R(3)).
- (5) Where an *authorised fund* has holdings in blue chip UK shares and the *authorised fund manager* wishes to provide more exposure to the US market and decides to *sell* a FT-SE index *future* to the value of those *shares* (this transaction satisfying the test of appropriateness for cover in CIS 5.13.8R(3)), then the sterling *synthetic cash* position created is used as cover for a Standard and Poors 500 index *future* provided that the *authorised fund* ensures that the cover remains sufficient (for example, by reference to the sterling/US dollar exchange rate) (CIS 5.13.8R(3) and CIS 5.13.8R(5)(b)).

The use of index derivatives: congruence

5.13.10

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- (1) CIS 5.13.6R (Permitted transactions) permits the use of index *derivatives* for efficient portfolio management (“EPM”). CIS 5.13.8R sets out the cover requirements for *derivatives* (including for index *derivatives*). Where index *derivatives* are used, cover may be provided by *securities* even if there is not complete congruence between the components of the index and the *securities*, provided that it is reasonable to use one as appropriate to cover for the other, taking into account the closeness of the relationship between fluctuations in their prices (see CIS 5.13.8R(3)). In considering the appropriateness of the instrument, *authorised fund managers* will need to take reasonable care that it is economic, suitable and reasonably congruent. This *guidance* deals with the matter of congruence.
- (2) It is not possible for the FSA to reach a view, in the abstract, on any particular level of congruence. The level of congruence necessary to satisfy the requirement that it is reasonable to regard the index *derivative* as appropriate, should be determined only in light of the individual circumstances of the case concerning a particular *authorised fund*.
- (3) Clearly, the higher the level of congruence, the less likely the *authorised fund manager* would be open to any challenge that the index *derivative* chosen is not appropriate. Whilst it does not necessary follow that a low level of

congruence means that the index *derivative* chosen will be inappropriate, the *derivative* used in those circumstances is likely to require much further justification. In certain types of *authorised fund* it may be that no index *derivative* is appropriate.

- (4) It should be noted that it is not the intention of CIS 5.13.8R to preclude the use of an appropriate index *derivative* that has a relationship with part of the *scheme property*. That is particularly so where the EPM technique is to be adopted in respect of part only of the *scheme property*, as will normally be the case.
- (5) The following steps can be taken by an *authorised fund manager* when using index *derivatives* and when determining whether or not an index *derivative* is “reasonably congruent” to an underlying portfolio of investments. Consideration of these steps needs to reflect the respective responsibilities of the *authorised fund managers* and *depositaries* under CIS 7 (Powers and duties).
 - (a) In determining the extent and manner in which index *derivatives* are used for EPM, the *authorised fund manager* should set out why it considers the transaction to be appropriate. In-house rules should be prepared which identify, on a *scheme* by *scheme* basis, the instruments the *authorised fund manager* is likely to use and the extent of this use.
 - (b) *Authorised fund managers* should show these in-house rules to, and discuss them with, the *depository*. *Depositaries* need not endorse the rules, although they may wish to give a view on whether they consider them as being reasonable in principle.
 - (c) If the matter is not covered by the in-house rules and the *authorised fund manager* is in doubt whether a particular transaction is appropriate, it should discuss this with the *depository* before taking any action.
 - (d) Any remaining doubt should be discussed with the FSA.
 - (e) Procedures should be established between the *authorised fund manager* and *depository* that enable the *depository* to monitor the investment in *derivatives* in accordance with its duty under CIS 7. These procedures will cover the details of any transactions in index *derivatives* entered into and the *authorised fund manager's* justification that the transaction complies with the *rules* in this chapter.
- (6) Other approaches to those outlined in (5) may be appropriate in the light of the *authorised fund manager's* own circumstances. Whatever approach is taken, *authorised fund managers* will need to review, as and when circumstances dictate, and in the light of developments on indices, the instruments they regard as appropriate for use in their *authorised funds*.

Borrowing in the context of efficient portfolio management

- (1) CIS 5.13.12R sets out requirements for borrowing in the context of efficient portfolio management. That *rule* deals with two aspects of such borrowing.
- (2) First, borrowed cash and cash committed for borrowing goes to swell the *scheme property* for the purpose of providing cover in the form of cash. Effectively, an additional 10% of cover can be found in this way.

- (3) Second, a back to back currency loan can be regarded as switching the borrowed currency into the *scheme property*, and switching the deposited currency out. The lending transaction does not require cover, as it is a loan rather than a forward or *future*. But it enables the *authorised fund* by borrowing to have cash in another currency to use as cover.
- (4) Although CIS 5.13.8R(2)(b) does not require cash cover to be in a currency matching the exposure, the *authorised fund manager* needs to monitor currency rates in order to ensure that cover remains sufficient. Borrowing in the right currency may thus make the cover simpler to operate.

Borrowing in the context of efficient portfolio management

5.13.12

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- (1) Cash obtained by borrowing, and borrowings which the *authorised fund manager* reasonably regards an *eligible institution* to be committed to provide, are available for cover under CIS 5.13.8R as long as the normal limits on borrowing (as to which see CIS 5.15.3R (General power to borrow) and CIS 5.15.4R (Borrowing limits)) are observed.
- (2) Where, for the purposes of this section (CIS 5.13), the *ICVC* or the *trustee* for the account of the *AUT* with the instructions of the *manager*:
 - (a) borrows an amount of currency from an *eligible institution*; and
 - (b) keeps an amount in another currency, at least equal to the borrowing for the time being in (a), on *deposit* with the lender (or his agent or nominee);

then this section (CIS 5.13) applies as if the borrowed currency, and not the deposited currency, were part of the *scheme property*, and the normal limits on borrowing under CIS 5.15.3R and CIS 5.15.4R do not apply to that borrowing.

The continuing nature of requirements and limits

5.13.13

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- (1) The *authorised fund manager* must, at each *valuation point* (and more frequently if necessary), re-calculate the amount of cover required in respect of positions already in existence under this section (CIS 5.13). *Derivatives* and rights under forward transactions under this section (CIS 5.13) may be retained in the *scheme property* only so long as they remain covered both individually and globally under CIS 5.13.8R.
- (2) If at any time:
 - (a) any fact or matter relating to the *authorised fund* or its economic environment; or

(b) the aggregate of all outstanding positions under this section (CIS 5.13);

is such that at least one of the relevant transactions (assuming it did not exist) could not properly be effected, either in that size or at all, the *authorised fund manager* must immediately on becoming aware of that fact take the necessary steps to rectify the situation, whether by closing out or by providing additional cover or otherwise.

5.14 Stock lending

Application

5.14.1

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This section (*CIS 5.14*) applies to *depositories of authorised funds* which are not *fund of funds schemes* or *feeder funds*, except:

- (1) *CIS 5.14.3R*, which applies to *ICVCs* other than *fund of funds schemes*, or to *managers of AUTs* other than *fund of funds schemes* and *feeder funds*; and
- (2) in the case of *ICVCs*, *CIS 5.14.4R* which applies to *ICVCs* other than *fund of funds schemes* if the *ICVC* enters into the *stock lending* agreement.

Stock lending permitted under this section (*CIS 5.14*)

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- (1) This section (*CIS 5.14*) should be regarded as an extension of section *CIS 5.13R* (Efficient portfolio management). It permits the generation of additional income for the benefit of the *authorised fund*, and hence for its investors, by entry into *stock lending* transactions for the account of the *authorised fund*.
- (2) The specific method of *stock lending* permitted in this section is in fact not a *transaction* which is a loan in the normal sense. Rather it is an arrangement of the kind described in section 263B of the Taxation of Chargeable Gains Act 1992, under which the lender transfers *securities* to the borrower otherwise than by way of sale and the borrower is to transfer those *securities*, or *securities* of the same type and amount, back to the lender at a later date. In accordance with good market practice, a separate transaction by way of transfer of assets is also involved for the purpose of providing *collateral* to the “lender” to cover him against the risk that the future transfer back of the *securities* may not be satisfactorily completed.
- (3) Other forms of *stock lending*, whether combined with stock borrowing or by way of loan or transfer of a beneficial interest in stock, are not envisaged in this section, and, indeed, are prohibited by *CIS 5.15.6R* (Restrictions on lending of property other than money).

Stock lending: general

- 5.14.3 **R** /1 The *stock lending* permitted by this section (CIS 5.14) may be exercised by an *authorised fund* for the purpose of efficient portfolio management, that is, when it reasonably appears to the *ICVC* or to the *manager* to be economically appropriate to do so with a view to generating additional income for the *authorised fund* with an acceptable degree of risk.

Permitted stock lending

- 5.14.4 **R** /1 (1) The *ICVC*, or the *depository* at the request of the *ICVC*, or the *trustee* at the request of the *manager*, may enter into a *stock lending* arrangement of the kind described in section 263B of the Taxation of Chargeable Gains Act 1992 (without extension by section 263C), but only if:
- (a) all the terms of the agreement under which *securities* are to be reacquired by the *depository* for the account of the *ICVC* or by the *trustee*, are in a form which is acceptable to the *depository* or to the *trustee* and are in accordance with good market practice;
 - (b) the counterparty is an *authorised person*; and
 - (c) *collateral* is obtained to secure the obligation of the counterparty under the terms referred to in (a) and the *collateral* is:
 - (i) acceptable to the *depository*;
 - (ii) adequate within CIS 5.14.6R(1); and
 - (iii) sufficiently immediate within CIS 5.14.6R(2).
- (2) The counterparty for the purpose of (1) is the *person* who is obliged under the agreement referred to in (1)(a) to transfer to the *depository* the *securities* transferred by the *depository* under the *stock lending* arrangement or *securities* of the same kind.

Stock lending: treatment of collateral

- 5.14.5 **G** /1 Where a *stock lending* arrangement is entered into, the *scheme property* remains unchanged in terms of value: the *securities* transferred cease to be part of the *scheme property*, but there is obtained in return an obligation on the part of the *counterparty* to transfer back equivalent *securities*. The *depository* will also receive *collateral* to set against the risk of default in transfer, and that *collateral* is equally irrelevant to the valuation of the *scheme property* (because it is transferred against an obligation of equivalent value by way of re-transfer). CIS 5.14.6R accordingly makes provision for the treatment of the *collateral* in that context.

Treatment of collateral

5.14.6

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- (1) *Collateral* is adequate for the purposes of this section (CIS 5.14) only if it:
- (a) is transferred to the *depository* or its agent;
 - (b) is at least equal in value, at the time of the transfer to the *depository*, to the value of the *securities* transferred by the *depository*; and
 - (c) is in the form of one or more of:
 - (i) cash;
 - (ii) *near cash*;
 - (iii) *government and public securities*;
 - (iv) a certificate of *deposit*;
 - (v) a letter of *credit*; and
 - (vi) *securities* transferred in *CREST*.
- (2) *Collateral* is sufficiently immediate for the purposes of this section (CIS 5.14) if :
- (a) it is transferred before or at the time of the transfer of the *securities* by the *depository*; or
 - (b) the *depository* takes reasonable care to determine at that time that it will be transferred at the latest by the close of business on the *day* of the transfer.
- (3) The *depository* must ensure that the value of the *collateral* at all times is at least equal to the value of the *securities* transferred by the *depository*.
- (4) The duty in (3) may be regarded as satisfied in respect of *collateral* the validity of which is about to expire or has expired where the *depository* takes reasonable care to determine that sufficient *collateral* will again be transferred at the latest by the close of business on the *day* of expiry.
- (5) Any agreement for transfer at a future date of *securities* or of *collateral* (or of the equivalent of either) under this section (CIS 5.14) may be regarded, for the purposes of valuation under CIS 4 (Single-pricing and dealing), CIS 15 (Dual-pricing and dealing) or this chapter, as an unconditional agreement for the *sale* or transfer of property, whether or not the property is part of the property of the *authorised fund*.

- (6) *Collateral* transferred to the *depository* is part of the *scheme property* for the purposes of the *rules* in this sourcebook, except in the following respects:
 - (a) it does not fall to be included in any valuation for the purposes of *CIS 4* (Single-pricing and dealing), or *CIS 15* (Dual-pricing and dealing) or this chapter, because it is offset under (5) by an obligation to transfer; and
 - (b) it does not count as *scheme property* for any purpose of this chapter other than this section (*CIS 5.14*).
- (7) Paragraph (5) and (6)(a) do not apply to any valuation of *collateral* itself for the purposes of this section (*CIS 5.14*).

Limitation by value

5.14.7

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There is no limit on the value of the *scheme property* which may be the subject of *stock lending* transactions within this section (*CIS 5.14*).

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5.15 Cash, borrowing, lending and other provisions

Application

5.15.1

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- (1) CIS 5.15.1R applies to *authorised fund managers* and *depositories*.
- (2) CIS 5.15.2R(1) (Cash and near cash) applies to *authorised fund managers*, other than *authorised fund managers* of *money market schemes*, *futures and options schemes* and *geared futures and options schemes*.
- (3) CIS 5.15.3R (General power to borrow) applies (other than for *geared futures and options schemes*) to *ICVCs* and *trustees* of *AUTs*, except CIS 5.15.3R(3) and (4), which apply to *authorised fund managers* of *authorised funds* other than *geared futures and options schemes* and *futures and options schemes*.
- (4) CIS 5.15.4R (Borrowing limits) applies to *authorised fund managers* of *authorised funds* other than *geared futures and options schemes*.
- (5) CIS 5.15.5R (Restrictions on lending of money) applies to *ICVCs* or to *managers* and *trustees*, except for CIS 5.15.5R(3) which applies to *ICVCs*.
- (6) CIS 5.15.6R (Restrictions on lending of property other than money) applies to *ICVCs* or *managers* and *trustees*, except for CIS 5.15.6R(4) which applies to *ICVCs* or to *depositories* of *ICVCs*.
- (7) CIS 5.15.7R (General power to accept or underwrite placings) applies to *ICVCs* or to *managers*.
- (8) CIS 5.15.8R (Guarantees and indemnities) applies to *ICVCs* or *depositories*.

Cash and near cash

5.15.2

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- (1) Cash and *near cash* must not be retained in the *scheme property* except to the extent that, where this may reasonably be regarded as necessary in order to enable:
 - (a) *redemption of units*; or
 - (b) efficient management of the *authorised fund* in accordance with its investment objectives; or
 - (c) other purposes which may reasonably be regarded as ancillary to the investment objectives of the *authorised fund*.
- (2) The *scheme property* of a *money market scheme*, a *futures and options scheme* and a *geared futures and options scheme* may consist of cash and *near cash* without limitation.
- (3) Paragraph (2) does not apply during the period of the *initial offer*, during which the *scheme property* may consist of cash and *near cash* without limitation.

General power to borrow

5.15.3

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- (1) The *ICVC* or *trustee* (on the instructions of the *manager*) may, in accordance with this *rule* (*CIS 5.15.3R*) and *CIS 5.15.4R*, borrow *money* for the use of the *authorised fund* on terms that the borrowing is to be repayable out of the *scheme property*. This power to borrow is subject to the obligation of the *authorised fund* to comply with any restriction in the *instrument constituting the scheme*.
- (2) The *ICVC* or *trustee* may borrow under (1) only from an *eligible institution*.
- (3) The *authorised fund manager* must ensure that any borrowing is on a temporary basis and that borrowings are not persistent, and for this purpose the *authorised fund manager* must have regard in particular to:
 - (a) the duration of any period of borrowing; and
 - (b) the number of occasions on which resort is had to borrowing in any period.
- (4) In addition to complying with (3), the *authorised fund manager* must ensure that no period of borrowing exceeds three months, whether in respect of any specific sum or at all, without the prior consent of the *depository*; the *depository's* consent may be given only on such conditions as appear to the *depository* appropriate

to ensure that the borrowing does not cease to be on a temporary basis only.

- (5) This *rule* (CIS 5.15.3R) does not apply to "back to back" borrowing under CIS 5.13.12R(2) (Borrowing in the context of efficient portfolio management).
- (6) An ICVC must not issue any *debenture* unless it acknowledges or creates a borrowing that complies with (1) to (4).

Borrowing limits

5.15.4

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- (1) The *authorised fund manager* must ensure that the *authorised fund's* borrowing does not, on any *business day*, exceed 10% of the value of the *scheme property*.
- (2) For a *property scheme*, the *authorised fund manager* must ensure that the borrowing does not, on any *business day*, exceed 10% of the value of that part of the *scheme property* which for the time being does not consist of immovables.
- (3) For a *property scheme*, an *approved mortgage* under CIS 5.8.9R (Mortgaged property) or CIS 5.8.12R (Grant of options, mortgages) does not count as borrowing for the purposes of (2).
- (4) This *rule* (CIS 5.15.4R) does not apply to "back to back" borrowing under CIS 5.13.12R(2).
- (5) In this *rule* (CIS 5.15.4R), "borrowing" includes, as well as borrowing in a conventional manner, any other arrangement (including a combination of *derivatives*) designed to achieve a temporary injection of *money* into the *scheme property* in the expectation that the sum will be repaid.
- (6) For an ICVC, borrowing does not include any arrangement for the ICVC to pay to a third party (including the ACD) any costs which the ICVC is entitled to amortise under CIS 8.3.4R (set up costs) and which were paid on behalf of the ICVC by the third party.

Restrictions on lending of money

5.15.5

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- (1) None of the *money* in the *scheme property* of an *authorised fund* may be lent and, for the purposes of this prohibition, *money* is lent by an *authorised fund* if it is paid to a *person* ("the payee") on the basis that it should be repaid, whether or not by the payee.

- (2) Acquiring a *debenture* is not lending for the purposes of (1); nor is the placing of *money on deposit* or in a current account.
- (3) Paragraph (1) does not prevent an *ICVC* from providing an *officer* of the *ICVC* with funds to meet expenditure to be incurred by him for the purposes of the *ICVC* (or for the purposes of enabling him properly to perform his duties as an *officer* of the *ICVC*) or from doing anything to enable an *officer* to avoid incurring such expenditure.

Restrictions on lending of property other than money

5.15.6

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- (1) The *scheme property* of an *authorised fund* other than *money* must not be lent by way of *deposit* or otherwise.
- (2) Transactions falling within *CIS 5.14* (Stock lending) are not lending for the purposes of (1).
- (3) The *scheme property* of an *authorised fund* must not be mortgaged except under *CIS 5.8* (Property schemes).
- (4) Nothing in this *rule* (*CIS 5.15.6R*) prevents the *ICVC* or the *depository* at the request of the *ICVC*, or the *trustee* at the request of the *manager*, from lending, depositing, pledging or charging *scheme property* for *margin* requirements where transactions in *derivatives* or forward transactions are used for the account of the *authorised fund* in accordance with any other of the *rules* in this chapter.

General power to accept or underwrite placings

5.15.7

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- (1) Any power in this chapter to invest in *transferable securities* may be used for the purpose of entering into transactions to which this *rule* (*CIS 5.15.7R*) applies, subject to compliance with any restriction in the *instrument constituting the scheme*.
- (2) This *rule* (*CIS 5.15.7R*) applies, subject to (3), to any agreement or understanding:
 - (a) which is an underwriting or sub-underwriting agreement; or
 - (b) which contemplates that *securities* will or may be issued or subscribed for or acquired for the account of the *authorised fund*.
- (3) Paragraph (2) does not apply to:
 - (a) an *option*; or

- (b) a *purchase* of a *transferable security* which confers a right :
 - (i) to subscribe for or acquire a *transferable security*; or
 - (ii) to convert one *transferable security* into another.
- (4) No agreement or understanding to which this *rule* (CIS 5.15.7R) applies may be entered into if it relates to *units in a collective investment scheme*.
- (5) The exposure of an *authorised fund* to agreements and understandings within (2) must, on any *business day*:
 - (a) be covered under CIS 5.13.8R (Cover for transactions for efficient portfolio management) as if the exposure had been incurred in the context of CIS 5.13 (Efficient portfolio management) by means of transactions in *approved derivatives*; and
 - (b) be such that, if all possible obligations arising under them had immediately to be met in full, there would be no breach of any limit in this chapter.

Guarantees and indemnities

5.15.8

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- (1) An *ICVC* or a *depository* for the account of an *authorised fund* must not provide any guarantee or indemnity in respect of the obligation of any *person*.
- (2) None of the *scheme property* of an *authorised fund* may be used to discharge any obligation arising under a guarantee or indemnity with respect to the obligation of any *person*.
- (3) Paragraphs (1) and (2) do not apply to:
 - (a) any indemnity or guarantee given for *margin* requirements where the *derivatives* or forward transactions are being used in accordance with the *rules* in this chapter;
 - (b) for an *ICVC*:
 - (i) an indemnity falling within the provisions of regulation 62(3) of the *OEIC regulations* (Exemptions from liability to be void);
 - (ii) an indemnity (other than any provision in it which is void under regulation 62 of the *OEIC regulations*) given to the *depository* against any liability incurred by it as a consequence of the safekeeping of any of the *scheme property* by it or by anyone retained by it to assist it to

perform its function of the safekeeping of the *scheme property*; and

(iii) an indemnity given to a *person* winding up a *scheme* if the indemnity is given for the purposes of arrangements by which the whole or part of the property of that *scheme* becomes the first property of the *ICVC* and the *holders* of *units* in that *scheme* become the first *shareholders* in the *ICVC*; and

(c) for an *AUT*, an indemnity given to a *person* winding up a *body corporate* or other *scheme* in circumstances to which *CIS 15.2.7R* (Creation of units) applies.

5.15.9

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CIS 8.4.1R (Payment of liabilities on transfer of assets) and *CIS 8.5.5R* (Other payments out of scheme property) contain provisions restricting payments out of *scheme property*.

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5.16 Cover for sales

Application

- 5.16.1 **R** This section (*CIS 5.16*) applies to *ICVCs* other than *futures and options schemes* and *geared futures and options schemes* and to *managers* and *trustees* of *AUTs* other than *futures and options schemes* or *geared futures and options schemes*.

Requirement to cover sales

- 5.16.2 **R** (1) No agreement by or on behalf of an *ICVC* or on behalf of an *AUT* to dispose of property or rights may be made:
- (a) unless the obligation to make the disposal and any other similar obligation could immediately be honoured by the *authorised fund* by delivery of property or the assignment (or, in Scotland, assignation) of rights; and
 - (b) the property and rights at (a) are owned by the *authorised fund* at the time of the agreement.
- (2) Paragraph (1) does not apply to a transaction in *derivatives* or a forward transaction under *CIS 5.13R* (Efficient portfolio management).

Chapter 6

Title, transfer and plan registers

6.1 Introduction

Application

- 6.1.1 **R** This chapter applies in relation to *ICVCs* and *AUTs*
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- 6.1.2 **R** This section (*CIS 6.1*) applies to *authorised fund managers* and *depositories*.
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Purpose

- 6.1.3 **G** In line with the *regulatory objective* of the protection of *consumers*, this chapter sets out requirements for a *register of unitholders* in an *AUT* and for *plan registers* of both *ICVCs* and *AUTs*. These requirements are intended to ensure that there is a proper record of the ownership of *units*, whether held directly or through a savings plan, *ISA* or *PEP*.
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Explanation of this chapter

- 6.1.4 **G** (1) *CIS 6.2* deals with a number of matters concerning the *register of unitholders*, such as its establishment, maintenance and rights of those who wish to inspect it, and the issue of certificates either of registration of ownership in that *register* or in *bearer form*.
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- (2) *CIS 6.3* deals with the transferability of *units*, whether by act of parties (for example *sales* or gifts) or by operation of law (death or bankruptcy).
- (3) *CIS 6.4* deals with changes of name and address of *unitholders* and sets out requirements for subdivision, consolidation and conversion of *classes* of *units* and default by *unitholders*.
- (4) *CIS 6.5* deals with *plan registers* of both *ICVCs* and *AUTs*.

6.2 The register of unitholders

Basic requirement

6.2.1

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- (1) This *rule* (CIS 6.2.1R) applies to *trustees*, except (5) which applies to *managers* and *trustees* and (6) which applies to the *manager* only.
- (2) The *trustee* must establish and maintain a *register* of *unitholders* (the *register*) in accordance with this *rule*.
- (3) The *register* must be maintained in a readable form or in a manner capable of being reproduced in a readable form.
- (4) The *register* must contain:
 - (a) the name and address of each *unitholder* (other than one whose *units* are represented by *bearer certificates*);
 - (b) the number of *units* (including fractions of a *unit*) of each *class* held by each *unitholder* (other than *units* that are represented by *bearer certificates*);
 - (c) the date on which the *unitholder* was registered in the *register* for the *units* standing in his name; and
 - (d) the number of *units* (including fractions of a *unit*) of each *class* currently in *issue* and represented by *bearer certificates* and the numbers of those certificates;

but the *trustee* need not *register* more than four *persons* as the joint *holders* of any *units*.

- (5) The *manager* and the *trustee* must:
 - (a) take all reasonable steps; and
 - (b) exercise all due diligence;

to ensure that the information contained in the *register* is at all times complete and up to date.

- (6) The *manager*, for the purpose of (5), must in particular:
- (a) take any necessary steps to obtain and supply information from or concerning any new *unitholder* of *units* to enable the entry in the *register* to be made; and
 - (b) immediately notify the *trustee* of any information which the *manager* receives relating to the accuracy of or any change to any entry in the *register*.

The register as evidence of title

6.2.2

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- (1) This *rule* (CIS 6.2.2R) applies to *managers* and *trustees*.
- (2) The *register* is conclusive evidence as to the *persons* respectively entitled to the *units* entered in it. This does not prevent the *trustee* making any deletion or alteration allowed by CIS 6.4.4R (Default by the unitholder).
- (3) No notice of any trust, express, implied, or constructive, which may be entered in the *register* for any *unit* is binding on the *manager* or the *trustee*. But this does not affect the obligations of the *manager* and the *trustee* under CIS 6.5.R (Plan registers).

Inspection of the register and copies of entries

6.2.3

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- (1) This *rule* (CIS 6.2.3R) applies to *trustees*.
- (2) The *trustee* must make the *register* available for inspection, by or on behalf of the *unitholders* or the *manager*, in the *United Kingdom* free of charge at all times during ordinary office hours. But the *register* may be closed at times and periods (not exceeding 30 *days* in any one year) as determined by the *trustee*.
- (3) The *trustee* must supply to the *manager* at its request a copy of the *register* or any part of it on payment, if the *trustee* so decides, of a reasonable fee.
- (4) The *trustee* must supply to a *unitholder* or his authorised representative at his request and free of charge a copy in print of the entries on the *register* relating to that *unitholder*.

The manager as unitholder

6.2.4

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- (1) This *rule* (CIS 6.2.4R) applies to *managers* and *trustees*.

- (2) The *manager* may, unless expressly forbidden to do so by the *trust deed*, be a *unitholder*.
- (3) The *manager* must be treated as the *holder* of each *unit* which is in *issue* (other than a *unit* which is represented by a *bearer certificate*) if no *person* is entered in the *register* as the *holder* of that *unit*.
- (4) Where a *unitholder* transfers *units* to the *manager*, they need not be cancelled, nor need the name of the *manager* be entered on the *register* as the new *unitholder*.

Certificates

6.2.5

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- (1) This *rule* (CIS 6.2.5R) applies to *managers* and *trustees*.
- (2) On or following the *issue* of *units* or, subject to CIS 6.3.1R (Transfer of units by act of parties), at any other time, a certificate or other document recording title to the *units* may be issued to the *unitholder* if, and in such form as, the *manager* and the *trustee* agree.
- (3) The *manager* and the *trustee* must agree on the procedures to be followed in redeeming *units*.
- (4) Where the procedures agreed under (3) require the investor to surrender any document (or provide any information) as a prior condition to obtaining the proceeds of *redemption*, they must also oblige the *trustee* to issue the document or provide any relevant information relating to an entry on the *register* in a timely manner once it is in a position to do so under those procedures.
- (5) Where the *trust deed* enables *bearer certificates* to be issued, the *manager* and *trustee* must agree on their form, and on the procedures to be followed for them.
- (6) The steps required to be taken by a *unitholder* in relation to the *issue* and *redemption* of *units* must be specified in the *prospectus*.

6.3 Transferability of units

Transfer of units by act of parties

6.3.1

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- (1) This *rule* (CIS 6.3.1R) applies to *trustees*.
- (2) Every *unitholder* is entitled, subject to (3), to transfer *units* held by him for which he is entered in the *register* by an instrument of transfer in any form the *trustee* may approve.
- (3) The *trustee* is not under any duty to accept a transfer:
 - (a) if the number or value of the *units* sought to be transferred would result in the *unitholder*, or the transferee, holding less than any number or value stated in the *prospectus* as the minimum number to be held; or
 - (b) if the *AUT* is a *relevant pension scheme* and the transfer is not one permitted by the *trust deed*; or
 - (c) if the *AUT* is a *relevant charitable scheme* and it would lose its status if the transferee became a *unitholder*; or
 - (d) if the *trust deed* contains a limitation upon the categories of *persons* who may be *unitholders* and the transferee is not within one of those categories; or
 - (e) unless the transfer is excluded by Schedule 19 of the Finance Act 1999 (or any statutory modification or re-enactment of it) from a charge to stamp duty reserve tax, or there has been paid to the *trustee*, for the account of the *AUT*, an amount agreed between the *trustee* and the *manager* not exceeding the amount that would be derived by applying the rate of stamp duty reserve tax to the market value of the *units* being transferred.
- (4) Every instrument of transfer of *units* must be signed by or on behalf of the *unitholder* transferring the *units* (or, in the case of a *body corporate*, sealed by that *body corporate* or signed by one of its *officers* (or in Scotland, two of its *officers*)) authorised to sign it and, unless the transferee is the *manager*, the transferor must be

treated as the *unitholder* until the name of the transferee has been entered in the *register*.

- (5) Every instrument of transfer, duly stamped if it is required to be stamped, must be left with the *trustee* for registration accompanied by:
 - (a) any necessary declarations or other documents that may be required in consequence of any legislation in force at the time; and
 - (b) such other evidence as the *trustee* may require to prove the right of the transferor to transfer the *units* or in the case of a *body corporate* the authority of the signatory on its behalf.
- (6) All instruments of transfer which are registered must be retained by the *trustee* in original, copy or non-documentary form for a period of six years from the date of registration.
- (7) Upon registration of an instrument of transfer, a reference must be made on the *register* enabling the name of the transferor and the transferee and the date of transfer to be identified.

Transfer of units by operation of law

6.3.2

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- (1) This *rule* (CIS 6.3.2R) applies to *managers* and *trustees*.
- (2) On the death of any one of joint *unitholders*, the surviving *unitholder* or *unitholders* must be the only *persons* recognised by the *trustee* and the *manager* as having any title to or any interest in the *units* held by those joint *unitholders*.
- (3) The executors or administrators of a deceased *unitholder* (who was not one of two or more joint *unitholders*) must be the only *persons* recognised by the *trustee* and the *manager* as having title to the *units* held by the deceased *unitholder*.
- (4) Where any *person* becomes entitled to a *unit* in consequence of the death or bankruptcy of any sole *unitholder* or of the survivor of joint *unitholders*:
 - (a) he may, subject to (b), upon producing evidence of his title required by the *trustee*, either be registered himself as *unitholder* (upon giving written notice to the *trustee*) or transfer the *unit* to some other *person*;
 - (b) CIS 6.3.1R (Transferability of units by act of parties) applies to any such notice or transfer as if the death or bankruptcy had not occurred and as if the notice or transfer were a transfer signed by the *unitholder*;

- (c) the new owner may, subject to (d), give a discharge for all *monies* payable for the *unit*, but will not, until registered as a *unitholder*, be entitled to receive notices or attend or vote at any meeting of *unitholders*; and
- (d) the *trustee* may, at its discretion, retain any *monies* payable for the *unit* until the new owner is registered as the *unitholder* or transfers the *unit*.



6.4 Permitted alterations to the register of unitholders

Change of name and address of unitholder

6.4.1

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- (1) This *rule* (CIS 6.4.1R) applies to *trustees*.
- (2) The *trustee* must:
 - (a) on receiving written notice of a change of name or change of address of any *unitholder*;
 - (b) on having taken reasonable care; and
 - (c) on compliance with any formalities the *trustee* requires;alter the *register* accordingly.
- (3) Where a certificate has been issued and remains valid and the name of the *unitholder* is altered in the *register*, the *trustee* must either issue a new certificate to the *unitholder* or make an appropriate endorsement on the *unitholder's* existing certificate.

Conversion of units

6.4.2

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- (1) This *rule* (CIS 6.4.2R) applies to *managers*, except (5), which applies to *managers* and *trustees*.
- (2) This *rule* applies to any *AUT* in which there are *units* of more than one *class* (that is, *income units* and *accumulation units*), and governs the conditions of conversion of *units* of one *class* into *units* of another.
- (3) Conversion is possible under this *rule* only if both *classes* of *unit* are in existence and are offered for *issue* or *sale* at the time of the request for conversion.
- (4) If a *unitholder* requests the *manager* to convert *units*, the *manager* must make a written request to the *trustee* for the conversion; but the *manager* need not do so, nor need the *trustee*

comply with the *manager's* request, if the conversion would result in the *unitholder* holding less than any number or value of *units* of either *class* stated in the *prospectus* as the minimum number to be held.

- (5) If the *manager* makes a request under (4), the *trustee* must, unless excused by (4), convert the *units* into the appropriate number of *units* of the other *class*. That number must be determined by the *manager*, after consulting the *trustee*, on terms that are fair to the *unitholder* requesting conversion and to other *unitholders*.
- (6) CIS 4 (Single-pricing and dealing), CIS 8 (Charges and expenses) and CIS 15 (Dual-pricing and dealing) do not apply to a conversion of *units* in accordance with this *rule*.

Subdivision and consolidation of units

6.4.3

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- (1) This *rule* (CIS 6.4.3R) applies to *managers* and *trustees*.
- (2) The *manager* may, unless expressly forbidden to do so by the *trust deed*, at any time when no *bearer certificates* are in *issue*, with the approval of the *trustee* determine:
 - (a) that each *unit* is to be subdivided into two or more *units* (after which each *unit* is to stand subdivided); or
 - (b) that two or more *units* are to be consolidated (after which those *units* are to stand consolidated).
- (3) Upon a subdivision or consolidation of *units* the *trustee* must (unless it has done so before the subdivision or consolidation became effective) immediately give to each *unitholder* (or to the first named of joint *holders*) whose name is entered in the *register*, notice of the subdivision or consolidation.

Default by the unitholder

6.4.4

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- (1) This *rule* (CIS 6.4.4) applies to *managers* and *trustees*.
- (2) Where:
 - (a) the *unitholder* of any *units* defaults in making any payment in *money* or transfer of property due to the *manager* or the *trustee* under the *rules* in this sourcebook, or the *trust deed*, for the *issue* or *sale* of *units* to that *unitholder*; and
 - (b) the *trustee* is satisfied that there has been a default;

the *trustee* may make any deletion or alteration in the *register* that is necessary to compensate for that default, after which the *manager* becomes entitled to those *units* for which the defaulting *unitholder's* name has been removed from the *register* until those *units* are either cancelled or re-sold and paid for.



6.5 Plan registers

Application

- 6.5.1** **R** (1) This rule (CIS 6.5.1R) and CIS 6.5.2G apply to ICVCs and their directors and to managers and trustees.
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- (2) The sub-paragraphs of CIS 6.5.4R apply in accordance with CIS 6.5.2R (Table of application)
- 6.5.2** **R** Table Table of application
/1 This table belongs to [CIS 6.5.1]

Sub-paragraph number	ICVC	ACD	Any other director of an ICVC	Manager	Trustee
(1)		X	X		
(2)				X	X
(3)					X
(4) – (7)		X	X	X	X
(8)		X		X	X
(9)		X		X	
(10) – (11)		X			X
(12)		X	X	X	
(13)		X		X	
(14) – (15)		X	X	X	X
(16) – (17)		X		X	
(18)		X	X	X	X
(19)	X	X	X		

Explanation

- 6.5.3** **G** This section (CIS 6.5) permits the directors of an ICVC or the trustee of an AUT to establish a plan register. This section deals with a number of matters concerning its establishment and maintenance and ensures that the holders entered in the plan register have similar rights in respect of notices and disclosure as holders in the main register of holders.
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6.5.4

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Requirement

- (1) For an *ICVC*, the *directors* must not arrange for the *ICVC* to establish a *plan register* unless the conditions in (4) have been satisfied.
- (2) For an *AUT*, the *trustee*, at the request of the *manager*, may, subject to (3), establish and maintain a *plan register* provided that the conditions in (4) have been satisfied.
- (3) The *trustee* must not establish a *plan register* without the prior sanction of an *extraordinary resolution* of the *unitholders* unless:
 - (a) paragraph (4)(b) applies; or
 - (b) for the year to 5 April 1999 (or, if shorter, for the period from the initial *issue* of *units* in the *AUT* to 5 April 1999) the *AUT* was managed with the intention that *units* in the *AUT* should be qualifying investments for the purposes of the Personal Equity Plan Regulations 1989.
- (4) The conditions referred to in (1) and (2) are that:
 - (a) not less than 90 *days* before the establishment of the *plan register*:
 - (i) notice in writing has been given by the *authorised fund manager* to *holders* of the proposal to establish it; and
 - (ii) a revised *prospectus* reflecting that proposal has become available; or
 - (b) the original *prospectus* of the *authorised fund* referred, in accordance with *CIS* 3.5.2R(12) or *CIS* 3.5.2R(13), to the payments that may be paid out of the *scheme property* for the establishment and maintenance of the *plan register*.
- (5) Paragraphs (6) to (19) apply for so long as a *plan register* is maintained.
- (6) The *plan register* must be maintained in a readable form or in a manner capable of being reproduced in a readable form.
- (7) The *plan register* must contain:
 - (a) the name and address of each *plan investor* for whom *units* in the *authorised fund* are held by a *plan manager* or a nominee under a *group plan*;
 - (b) the number of those *units* of each *class* so held for each such *person*;

- (c) the date on which the *plan investor* was registered in the *plan register* in respect of those *units* or any earlier date on which the *plan investor* was registered as a subscriber to a *group plan* in respect of those *units* on a *register* or other record from which the *plan register* was extracted; and
- (d) sufficient information to identify the *group plan* under which the *units* are held and the *plan investor* entered on the *register of holders* as their *holder*.
- (8) The *ACD* or, in the case of an *AUT*, the *manager* and the *trustee*, must:
- (a) take all reasonable steps; and
- (b) exercise all due diligence;
- to ensure that the information contained in the *plan register* is at all times complete and up to date.
- (9) In particular, for the purpose of (8) the *authorised fund manager* must ensure that:
- (a) any necessary steps are taken to obtain and supply information from or concerning any new *plan investor* to enable the entry in the *plan register* to be made; and
- (b) in the case of a *plan register* of an *AUT*, the *trustee* is immediately notified of any information which the *manager* or the *plan manager* or a nominee of the *plan manager* receives relating to the accuracy of, or any change to, any entry in the *plan register*.
- (10) The *ACD* or the *trustee* must make the *plan register* available for inspection in the *United Kingdom* by or on behalf of:
- (a) a *plan investor*, for the entries relating to him; and
- (b) a *plan manager*, for the entries relating to a *group plan* managed by it; and
- (c) for an *AUT*, the *manager*;
- free of charge at all times during ordinary office hours, except that the *plan register* may be closed when the *register* is closed.
- (11) The *ACD* or the *trustee* must supply to the *plan manager*, and (in the case of a *plan register* of an *AUT*) to the *manager*, on request, a copy of the *plan register* or any part of it on payment, if the *trustee* or the *ACD* so decides, of a reasonable fee.

- (12) In the following *rules* a reference to a *shareholder*, *unitholder* or *holder* must be treated as including a *plan investor* in respect of *group plan units* held for that *plan investor*:
- (a) CIS 3.4.2R(4)(b) and CIS 3.4.2R(4)(d) (notice of certain changes to a prospectus);
 - (b) CIS 8.2.6R (Notice of an increase: ICVCs and single-priced AUTs);
 - (c) CIS 8.5.1R(5) (Managers periodic charge);
 - (d) CIS 10.3.6R(1) (Short form accounts in reports); and
 - (e) CIS 10.5.2R(3) (Publication of reports (umbrella schemes)).
- (13) In CIS 10.5.2R(2) (Publication of reports) the reference to each *holder* (or the first named of joint *holders*) entered or entitled to be entered in the *register* must be considered to include each *plan investor* (or the first named of joint *plan investors*) entered in or entitled to be entered in the *plan register*.
- (14) In CIS 11.2.3R (Notice of meetings – for ICVCs) and CIS 11.3.6R (Notice of meetings – for AUTs) the references to *holders* must be considered to include the *persons* who were *plan investors*:
- (a) on the date seven *days* before the notices under these *rules* are sent out; or
 - (b) if the *plan investors' plan units* are *participating securities*, at the close of business on a *day* to be determined by the *authorised fund manager* in accordance with CIS 11.2.2R(2)(a) (Special meaning of shareholder) and CIS 11.3.2R(2)(a) (Special meaning of unitholder).
- (15) Where in this CIS sourcebook there is a reference to *persons* who ought reasonably to be known to an *authorised fund manager* to have made arrangements for the *purchase* of *units* at regular intervals, the reference is treated as including all *plan investors* with similar arrangements for *plan units*.
- (16) (a) The *authorised fund manager* must ensure that at no cost to the *plan investor* or the *scheme property*:
- (i) each notice of a meeting of *holders* given to a *plan investor* includes, or is accompanied by, a statement that the *plan investor* may require the *plan manager* to arrange for the *plan investor* to be able to attend that meeting or to vote on any resolution put to that meeting or both; and

- (ii) the notice is accompanied by an appropriate form of instruction to the *plan manager* for use by the *plan investor*.
 - (b) The *authorised fund manager* must procure that the *plan manager*, at no cost to the *plan investor* or the *scheme property*, acts in accordance with any duly completed form of instruction received by it at least four *business days* (excluding the *day* of receipt and the *day* of the meeting) before the *day* of the meeting or at such later time as the *plan manager* may agree.
- (17) The *authorised fund manager* must give notice to the *plan investor* of any adjourned meeting of *holders* at the same time as notice of that meeting is given to *holders*.
- (18) Any notice or document required to be served upon a *plan investor* will be treated as duly given if it is sent by post to or left at his address as appearing in the *plan register*, and the provisions of CIS 11.6 (Service of notices and other documents) apply.
- (19) For a *plan register* of an *ICVC*, information received by the *ICVC* for the purpose of the establishment or maintenance of the *plan register* under this *rule* does not amount to notice to the *ICVC* of any trust, whether express, implied or constructive.

Chapter 7.

Powers & Duties

7.

PAGE
1



7.1 Introduction

Application

- 7.1.1 **R** /1 The *rules* and *guidance* in this chapter apply in accordance with CIS 7.1.5R (Table of application).

Purpose

- 7.1.2 **G** /1 This chapter assists in achieving the regulatory objective of protecting *consumers* as envisaged by section 2 and 5 of the *Act*, and supports, in their application to ICVCs and AUTs, *Principles* 3, 8 and 10, namely that a *firm* must:

- (1) take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems;
- (2) manage conflicts of interest fairly; and
- (3) arrange adequate protection of *clients'* assets when it is responsible for them.

Content of CIS 7

- 7.1.3 **G** /1
- (1) This chapter includes *rules*:
 - (a) to apportion responsibilities between the *ACD*, any other *directors* and the *depository* of an *ICVC*;
 - (b) to apportion responsibilities between the *manager* and *trustee* of an *AUT*;
 - (c) to require the *depository* of an *ICVC* to check that the *ACD* is carrying out certain of its functions in accordance with the *rules* in this sourcebook applicable to it;
 - (d) to require the *trustee* of an *AUT* to check that the *manager* is carrying out certain of its functions in accordance with those *rules*;
 - (e) relating to the *depository's* duties in respect of the safe *custody* of the *scheme property* of an *authorised fund*;
 - (f) to avoid conflicts of interest that could prejudice investors; and

- (g) to provide safeguards when the *directors* or *depository* of an *ICVC*, or the *manager* or *trustee* of an *AUT*, have certain of their functions carried out by a third party.
- (2) *CIS 7.1.4G* to *CIS 7.6.3R* concern the powers, duties and responsibilities of the *directors*, including the *ACD*, and the *depository* of an *ICVC*. *CIS 7.7* to *CIS 7.11* and *CIS 7 Ann 1G* concern the powers and duties of the *manager* and of the *trustee* of an *AUT*.

ICVCs

7.1.4

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- (1) The *OEIC regulations* require:
 - (a) an *ICVC* to have at least one *director*; and
 - (b) that if an *ICVC* has only one *director*, that *director* must be a *body corporate* which is an *authorised person* and has *permission* under Part IV of the *Act* (Permission to carry on regulated activities) to act as a *director* of an *ICVC*;
 - (c) the business of an *ICVC* to be managed, where an *ICVC* has one *director*, by that *director*, or, where an *ICVC* has more than one *director*, by the *directors*, subject to the *rules* in this sourcebook as to the allocation between the *directors* of responsibilities for the management of the *ICVC*.
- (2) This chapter includes the main *rules* that deal with the allocation mentioned in (1)(c), although other *rules* in this sourcebook also allocate responsibilities between *directors*. This chapter includes provisions concerning the appointment and termination of the appointment of an *ACD*.
- (3) Each *ICVC* must have an *ACD*. Where an *ICVC* is formed with a sole *director*, that *director* will have to satisfy the requirements mentioned in (1)(b) and will be the *ACD*. In these circumstances the provisions that allocate responsibilities between *directors* do not apply. However, because under the *OEIC regulations* the *ACD* will then be responsible for the management of the *ICVC*, the disapplication will not result in a reduction in the *ACD*'s responsibilities.
- (4) Where there is more than one *director*, unless there is a vacancy in the position of *ACD*, no *director* other than the *ACD* is responsible for the exercise of any functions which, under this chapter, are to be exercised exclusively by the *ACD*. However, the board of *directors* is responsible for oversight of the *ACD* in the manner provided for in this chapter.
- (5) The *depository* is responsible for the safekeeping of *scheme property* entrusted to it. It has a number of other responsibilities and powers under this chapter and these responsibilities include ensuring that the *ICVC* is managed in accordance with the *rules* referred to in *CIS 7.4.1R* (General duties of the depository).
- (6) It should be noted that the *depository* and the *directors* are not only required to comply with the *OEIC regulations* and the *rules* in this sourcebook relevant to them, but, in accordance with paragraph 6(1) of schedule 2 to the *OEIC regulations*, they are also bound by the provisions of the *ICVC's instrument of incorporation*.

- (7) The *directors* (including the *ACD* in its role as such) and the *depository* may each, to the extent permitted by this chapter, retain the services of others to assist them to perform their respective functions. Where there is a vacancy in the position of an *ACD*, the *directors* must appoint one or more *authorised persons* to assist them in performing the functions that it would otherwise be the duty of the *ACD* to perform. Where there are no *directors*, the *depository's* powers are extended, temporarily, to enable it to manage the *scheme property*.
- (8) *CIS 7.6.3R* (Conflicts of interest) also contains requirements relating to transactions entered into between the *ICVC* and certain *persons* directly or indirectly connected with it. A transaction which complies with that *rule* remains subject to regulation 44 of the *OEIC regulations*, under which certain transactions between an *ICVC* and a *director* of it, or an *associate* of any such *director*, may be voidable.

7.1.5

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Table Table of application
This table belongs to (*CIS 7.1.1*)

Paragraph or section number	ICVC	ACD	Any other directors of an ICVC	Depository of an ICVC	Manager	Trustee
7.1.1G–7.1.3G	x	x	x	x	x	x
7.1.4G	x	x	x	x		
7.2.1R		x	x			
7.2.2R–7.2.3R	x	x	x	x		
7.3.1R–7.3.2G		x		x		
7.3.3R–7.3.4R		x				
7.4				x		
7.5.1R		x	x	x		
7.5.2R				x		
7.5.3R	x	x		x		
7.6		x	x	x		
7.7					x	x
7.8					x	x
7.9						x
7.10					x	x
7.11					x	x

Note: "x" means "applies".

7.

7.2 Directors

The directors

7.2.1

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- (1) If there is only one *director* of the type described in CIS 7.1.4G(1)(b), it must be the *ACD*, but if there is more than one *director* that is a *body corporate*, the *directors* must appoint one of the *directors* that is a *body corporate* to be the *ACD*.
- (2) At any time when the *ACD* is not the sole *director* and (5) does not apply, no *director* other than the *ACD*:
 - (a) is responsible for any of the functions for which the *ACD* is made responsible by CIS 7.3.1R (The *ACD*), but the other *directors* must exercise reasonable care to ensure that the *ACD* undertakes those functions in a competent manner and the *ACD* must give those *directors* the information and explanations they consider necessary for this purpose; and
 - (b) has any power to undertake the management of the *ICVC* to the extent that the management is to be undertaken by the *ACD* in accordance with CIS 7.3.1R.
- (3) In the event of:
 - (a) any *person* becoming or ceasing to be a *director*;
 - (b) the appointment of an *ACD* being terminated;
 - (c) a new *ACD* being appointed; or
 - (d) a corporate *director* (including the *ACD*) becoming aware of any change of its *controller*;

the *FSA* must, immediately after the event, be notified in writing of that event; in the case of (a), by the *ACD*; in the case of (b), by the *ACD* whose appointment is being terminated; in the case of (c), by the new *ACD*; and in the case of (d), by the corporate *director* concerned.
- (4) A *director* must not appoint an alternate *director*.

- (5) At any time when there is no *person* acting as *ACD*, the *directors* have the responsibilities and duties that an *ACD* would have had under *CIS 7.3.1R* (Functions of the *ACD*), but this does not affect the powers of the *directors* under *CIS 7.6.1R* (Committees and appointments).
- (6) At any time that (5) applies, the *directors* must retain the services of one or more *authorised persons* to assist them in performing the functions referred to in *CIS 7.3.1R(2)* and (3) (Functions of the *ACD*).
- (7) Where a document is to be executed by the *ICVC* in accordance with regulation 57 of the *OEIC regulations*, unless (5) applies, it must be executed by the *ACD* and may also be signed (or executed) by one or more of any other *directors*.
- (8) At any time when the *ACD* is the sole *director* it must, to the extent that such action is not already required by the *OEIC regulations* or by *rules* in this sourcebook, be responsible for and have the duty to take the action envisaged by *CIS 7.3.1R(3)(d)*.
- (9) At any time when the *ACD* is sole *director* this *rule* (*CIS 7.2.1R*) does not exclude the *ACD's* functions under *CIS 7.3.1R(2)* and (3) which are then necessary under the requirements of the *OEIC regulations*.

Appointment of *ACD*

7.2.2

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- (1) Before, or on, the termination of the appointment of an *ACD*, the *directors* (or *director*) of the *ICVC* must take all practicable steps to appoint as the new *ACD* another *person* who is qualified to act as *ACD* and whose appointment must, if made before that termination, take effect immediately on that termination.
- (2) If the *ICVC* ceases to have any *director*, the *depository* has power to appoint a *body corporate* as a *director* and the *ACD* of the *ICVC* (provided the *body corporate* is an *authorised person* and is not prohibited from acting as the *ACD* of an *ICVC* by or under any *rule*).
- (3) The appointment of an *ACD* (other than the first *ACD*), whether under (1) or (2), must terminate at the close of the annual general meeting next following the date of the appointment or (if later) upon the expiration of 12 months from the date the appointment takes effect, unless the appointment has been approved by a resolution of the *shareholders* before the close of that annual general meeting or expiration (as the case may be).

- (4) An *ACD* must not voluntarily terminate its appointment as *ACD* unless the termination is at the same time as the commencement of the appointment of a successor *ACD*.

Termination of appointment of *ACD*

7.2.3

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- (1) The appointment of an *ACD* as *ACD* terminates immediately upon it ceasing to be a *director*.
- (2) The appointment of an *ACD* as *ACD* terminates if a notice of termination of that appointment, the terms of which have been approved by a resolution of the board of *directors*, is given to the *ACD*.
- (3) If there is no *director* other than the *ACD*, the appointment of an *ACD* as *ACD* terminates if a notice of termination of that appointment is given by the *depository* to the *ACD* and to the *ICVC*, following any of the following events:
- (a) the *ACD* goes into liquidation (except a voluntary liquidation for the purpose of a *scheme of arrangement* upon terms previously approved in writing by the *depository*); or
 - (b) a receiver is appointed in relation to the *ACD* or any part of it; or
 - (c) an administration order is made in relation to the *ACD* under section 8 of the *Insolvency Act 1986*.
- (4) Any termination under (2) or (3) takes effect when the notice is given, or on any subsequent time for its effect stated in the notice, or, if later, the time at which the termination is permitted to take effect under regulation 21 of the *OEIC regulations* (the Authority's approval for certain changes in respect of a company).
- (5) Unless the termination of the appointment of an *ACD* takes effect at the same time as the appointment of a successor *ACD*, the *depository* must ensure that the termination is published in a manner that the *depository* considers appropriate.
- (6) The *depository* is entitled to be reimbursed out of the *scheme property* for its out of pocket expenses in complying with (5).

7.3 The ACD

Functions of the ACD

7.3.1

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- (1) This *rule* (CIS 7.3.1R) does not apply at any time when the ACD is the sole *director* of the ICVC.
- (2) The ACD must carry out such functions as are necessary in order to ensure compliance with the *rules* in this sourcebook that impose obligations upon the ICVC or the ACD. The ACD's duties under this paragraph are not restricted by (3).
- (3) The functions to be carried out by the ACD include:
 - (a) making decisions as to the constituents of the *scheme property* of the ICVC in accordance with the investment objectives and policy of the ICVC;
 - (b) instructing the *depository* from time to time in writing how rights attaching to the ownership of the *scheme property* are to be exercised, but not in any case where, under CIS 7.4.5R (Exercise of rights in respect of the scheme property), the *depository* has the right to exercise (or not exercise) voting rights after consultation with the *directors*;
 - (c) taking all reasonable steps, and exercising due diligence, to ensure that the *shares* in the ICVC are priced in accordance with CIS 4 (Single-pricing and dealing);
 - (d) taking action immediately to rectify any breach of CIS 4 and, where the breach relates to the incorrect pricing of *shares* or to the late payment in respect of the *issue* of *shares*, rectification must, unless the *depository* otherwise directs, extend to the reimbursement or payment, or arranging the reimbursement or payment, of *money*:
 - (i) by the ACD to *shareholders* and former *shareholders*;
 - (ii) by the ACD to the ICVC; or
 - (iii) by the ICVC to the ACD;

but rectification need not, unless the *depository* otherwise directs, extend to any such reimbursement or payment where it appears to the *depository* that the incorrect pricing, or late payment in respect of *issue*, is of minimal significance; and

- (e) ensuring that the *ICVC* complies with the obligations imposed by, and, when appropriate, exercises the powers provided by, the following provisions of the *OEIC regulations*:
 - (i) 21 : (The Authority's approval for certain changes in respect of *ICVC*);
 - (ii) 36 : (Inspection of directors' service contracts);
 - (iii) 46 : (Share certificates), subject to regulation 47 (exceptions from regulation 46);
 - (iv) 48 : (Bearer shares);
 - (v) 50 : (Power to close register);
 - (vi) 54(1) : (Name to appear in correspondence etc);
 - (vii) 55 : (Particulars to appear in correspondence etc);
 - (viii) Schedule 3 : (Register of shareholders) excluding paragraph 12 of Schedule 4; and
 - (ix) Schedule 4: (Share transfers).

Valuation and pricing : for ICVCs

7.3.2

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For the purposes of *CIS* 7.3.1R(3)(c) and (d), *CIS* 7 Ann 1G contains *guidance* on the valuation and pricing of *authorised funds*, including:

- (1) pricing controls and the valuation of the *scheme property*;
- (2) recording and reporting of incorrect pricing; and
- (3) procedures to be adopted following incorrect *prices*, including action that should be taken to rectify any breach.

Maintenance of records

7.3.3

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(1) The *ACD* must make and retain such accounting and other records for the *ICVC* as are necessary:

- (a) to enable the *ICVC* to comply with the *OEIC regulations* and the *rules* in this sourcebook; and

- (b) to demonstrate at any time that such compliance has been achieved.
- (2) The *ACD* must make and retain a daily record of the *shares* in the *ICVC* held, acquired or disposed of by the *ACD*, including the *classes* of such *shares*, and of the balance of any acquisitions and disposals.

Maintenance of capital

7.3.4

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If, at any time after the size of the *ICVC*'s capital (as provided for the purposes of sub-paragraph 4(1)(c) of Schedule 2 to the *OEIC regulations* in paragraph 4(2) of that Schedule) has reached the minimum size provided in its *instrument of incorporation*, the size of that capital either falls below that minimum or exceeds the maximum size provided in the *instrument of incorporation*, the *ACD* must immediately notify the *FSA* of that fact.

7.4 The depositary

General duties of the depositary

7.4.1

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- (1) The *depositary* must take reasonable care to ensure that:
- (a) the *ICVC* is managed in accordance with:
 - (i) *CIS 4* (Single-pricing and dealing);
 - (ii) *CIS 9* (Income); and
 - (iii) in relation to *umbrella schemes*, *CIS 12.5.4R* (Income) and *CIS 12.5.7R* (Investment and borrowing powers);
 - (b) the *ICVC* is managed without infringement of any provision of the *instrument of incorporation* that relates to:
 - (i) the *initial offer* or *issue* or *cancellation* or *sale* or *redemption* or pricing of *shares*;
 - (ii) the *dilution levy* or *SDRT provision*;
 - (iii) the valuation of the *scheme property*;
 - (iv) accounting periods (including *half-yearly accounting periods*);
 - (v) the calculation of income available for allocation;
 - (vi) the allocation, payment or retention of income; and
 - (vii) unclaimed distributions; and
 - (c) decisions about the constituents of the *scheme property* do not cause an infringement of *CIS 5* (Investment and borrowing powers).
- (2) The *depositary* must take reasonable care to ensure on a continuing basis that:

- (a) the *ACD* is adopting procedures and methods which are appropriate to ensure that the *price* of a *share* is calculated for each *valuation point* in accordance with *CIS 4* (Single-pricing and dealing); and
 - (b) the *ACD* has maintained sufficient records to show compliance with *CIS 4* (Single-pricing and dealing).
- (3) The *depositary*, when acting in its capacity as *depositary*, must act solely in the interests of the *shareholders*.

Valuation and pricing

7.4.2

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For the purposes of *CIS 7.4.1R(1)(a)(i)* and *CIS 7.4.1R(2)*, *CIS 7 Ann 1G* contains *guidance* on the valuation and pricing of *authorised funds*, including:

- (1) pricing controls and the valuation of the *scheme property*;
- (2) *depositary's* review of the *ACD's* controls and systems;
- (3) the recording and reporting of incorrect pricing; and
- (4) procedures to be adopted following incorrect *prices*, including action that should be taken to rectify a breach.

Duty to inform the FSA : for ICVCs

7.4.3

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(1) The *depositary* must inform the *FSA* immediately upon becoming aware of any circumstance where there is no longer certainty that:

- (a) the *ICVC* is managed in accordance with *CIS 7.4.1R(a)(i)*, (ii) and (iii) (General duties of the depositary); and
- (b) decisions about the constituents of the *scheme property* do not cause an infringement of *CIS 5* (Investment and borrowing powers);

unless the *depositary* has taken reasonable care to determine that the circumstance in question is not, and is not likely to become, materially significant.

(2) If the *depositary* becomes aware of a circumstance which it needs to investigate in order to ascertain whether its duty to inform the *FSA* under (1) arises, then:

- (a) the *depositary* must inform the *FSA* of that circumstance immediately after it determines, having taken reasonable care that the circumstance is, or is likely to become, materially significant, or if no such determination is made within 90 *days*

of so becoming aware, then the *depositary* must inform the *FSA* immediately; or

- (b) the *FSA* need not be notified where the *depositary* determines the circumstance is not, or is not likely to become, materially significant.
- (3) The *depositary* must not retire voluntarily unless, before its retirement, it has ensured that the new *depositary* has been informed of any circumstance of which the retiring *depositary* has informed the *FSA* in accordance with (1) or (2), or which is being investigated for the purpose of (2).

Control by the depositary over the scheme property

7.4.4

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- (1) The *depositary* is responsible for the safekeeping of all of the *scheme property* of the *ICVC* (other than tangible movable property) entrusted to it. The *depositary's* duties under this paragraph are not restricted by (2).
- (2) The *depositary* must:
 - (a) take all steps and execute all documents to ensure that transactions properly entered into for the account of the *ICVC* in accordance with *CIS* 7.2.1R(5) and (6) (The directors) or *CIS* 7.3.1R(3)(a) (The ACD) are completed;
 - (b) ensure that any of that *scheme property* in registered form is, as soon as practicable, registered in the name of the *depositary*, its nominee or a *person* retained by it under *CIS* 7.6.1R (Committees and appointments);
 - (c) take into its *custody* or under its control all of the deeds and other documents relating to title to the *scheme property* other than in respect of transactions in *derivatives* or forward transactions; and
 - (d) ensure that any transaction in *derivatives* or forward transaction is entered into in such a manner as to ensure that any resulting benefit is received by the *depositary*.
- (3) The *depositary* is responsible for the collection of any income due to be paid for the account of the *ICVC* and must hold and deal with any income so collected in accordance with *CIS* 9 (Income).
- (4) The *depositary* must keep such records as are necessary:
 - (a) to enable it to comply with the *rules* in this sourcebook; and
 - (b) to demonstrate that it has achieved such compliance.

Exercise of rights in respect of the scheme property

7.4.5

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- (1) The *depositary* must, subject to (2), take all steps and execute all such documents as are necessary to secure that instructions properly given to it by the *ACD* as to the exercise of rights (including voting rights) attaching to the ownership of *scheme property* are carried out.
- (2) The *depositary* may exercise (or not exercise) any right of voting conferred by any of the *scheme property* of the *ICVC* which consists of *units* in any other *collective investment scheme* managed or otherwise operated by any *director* of the *ICVC* or by an *associate* of any such *director*, but only after consultation with the *directors* of the *ICVC*.

7.5 The ICVC, its directors and the depositary

Dealings in scheme property

7.5.1

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- (1) The *ACD* may give instructions as to the acquisition or disposal of property for the account of the *ICVC*. The authority of the *depositary* to give those instructions is not required, except in the case of the acquisition or disposal of immovable property.
- (2) Where the *depositary* is of the opinion that a particular acquisition or disposal of property for the account of the *ICVC* exceeds the powers conferred on the *ICVC* by the *rules* in this sourcebook (and in particular *CIS 5* (Investment and borrowing powers)), the *depositary* may require the *ACD* to cancel the transaction or make a corresponding disposal or acquisition to secure restoration of the previous situation and to meet any resulting loss or expense.
- (3) Where the *depositary* is of the opinion that:
 - (a) an acquisition of property for the account of the *ICVC* necessarily involves documents evidencing title being kept in the *custody* of a *person* other than the *depositary*; and
 - (b) the *depositary* cannot reasonably be expected to accept the responsibility which would otherwise be placed upon it if it were to permit *custody* by that other *person*;

the *ACD* must (for the account of the *ICVC*), if the *depositary* so requests, either cancel the transaction or make a corresponding disposal.

ICVC without a Director

7.5.2

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- (1) If the *ICVC* ceases to have any *directors*, the *depositary* has the power:
 - (a) to retain the services of an *authorised person* to carry out the functions referred to in *CIS 7.3.1R(3)(a)and(b)* (The *ACD*); or

- (b) provided it is not prohibited from doing so by any law or any *rule*, to manage the *scheme property* itself on behalf of the ICVC;

until in either case; a *director* is appointed; or a winding up of the ICVC is commenced.

Duties of the ACD and depositary: investment and borrowing powers

7.5.3

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- (1) The *ACD* must take all reasonable steps and exercise due diligence to avoid the *scheme property* being used or invested contrary to any provision in *CIS 5* (Investment and borrowing powers), except to the extent permitted by (6)(c).
- (2) The *depositary* must take all reasonable steps and exercise due diligence to monitor the management of the *scheme property* sufficiently to ensure that the *ACD* complies with (1).
- (3) The *ACD* must, immediately upon becoming aware of any breach of any provision in *CIS 5*, take action, at its own expense, to rectify that breach, unless the breach occurred as the result of a circumstance of one of the types described in (5) and (6).
- (4) When this paragraph (4) applies as a result of (5) or (6), the *ACD* must take the steps necessary to ensure a restoration of compliance with *CIS 5* as soon as is reasonably practicable having regard to the interests of the *shareholders* and, in any event, within the period specified in (8) or, when applicable, (9).
- (5) Paragraph (4) applies:
 - (a) where the *scheme property* is used or invested at any time contrary to any provision of *CIS 5* (other than a provision excusing a failure to comply on a temporary basis); and
 - (b) the reason for the contravention is beyond the control of both the *ACD* and the *depositary*.
- (6) (a) Paragraph (4) applies to a transaction (“subsequent transaction”) deriving from a right (such as the right to convert stock or subscribe to a rights issue) attributable to an *investment* (‘original *investment*’) of the ICVC if:
 - (i) the subsequent transaction, but for this *rule* (*CIS 7.5.3R*) would constitute a breach of *CIS 5*; and
 - (ii) at the time of the acquisition of the original *investment*, it was reasonable for the *ACD*, on the assumption that any right attached to the original *investment* when it was

acquired would be exercised, to expect that a breach would not be caused by the subsequent transaction.

- (b) In this paragraph (6) reference to the exercise of a right includes the taking effect of a right without any action by or on behalf of the *depositary* or the *ICVC*.
 - (c) Nothing in *CIS 5* prevents the *ICVC* from entering into a transaction of the type described in (a) provided that the *ACD* obtains the prior written consent of the *depositary*.
- (7) Immediately upon the *depositary* becoming aware of any circumstance described in (5) or any breach resulting from the exercise of, or receipt of a benefit from, a right in the circumstance described in (6), it must take the steps necessary to ensure that the *ACD* complies with (4).
- (8) The maximum period for restoration of compliance under (4) starts at the date of discovery of the relevant circumstance and lasts, subject to any extension under (9):
- (a) except where (b), (c) or (d) applies, for six months;
 - (b) where the transaction in question was a transaction in *derivatives* or a forward transaction under *CIS 5.6* (Futures and options schemes) or *CIS 5.7* (Geared futures and options schemes), until the close of business five *business days* later;
 - (c) where the transaction in question was entered into under *CIS 5.13R* (Efficient portfolio management), until the close of business five *business days* later; and
 - (d) where the *ICVC* is a *property scheme* and the property in question is an immovable, for two years.
- (9) The period specified at (8)(b) and (c) (five *business days*) is extended:
- (a) if the transaction involved a delivery of a *commodity*, from five to twenty *business days*;
 - (b) if the reason for the contravention in (5) is the inability of the *ACD* to *close out* a transaction because of a limit in the number or value of transactions imposed by an *eligible derivatives* market, until five *business days* after:
 - (i) the inability resulting for any such limit is removed; or
 - (ii) it becomes, to the knowledge of the *ACD*, reasonably practicable and reasonably prudent for the transaction to be closed out in some other way.

7.6 Committee, appointments and conflicts of interest

Committees and appointments

7.6.1

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- (1) The *directors* have the power to delegate to any *director*, or any committee consisting of one or more *directors*, any of the *directors*' powers or duties, but the *directors* remain responsible for the acts or omissions of any such *director* or committee as if they were acts or omissions of the *directors*. This paragraph (1) is subject to CIS 7.2.1R(3) (The directors).
- (2) The *ACD* or the *directors* have the power to retain the services of anyone, including the *depository*, to assist the *ACD* or the *directors* (as the case may be) to perform their respective functions.
- (3) The *depository* has the power to retain the services of anyone, including a *director* of the *ICVC*, to assist the *depository* to perform its functions, but must not retain the services of:
 - (a) the *ICVC* or any *director* of the *ICVC* to assist the *depository* to perform:
 - (i) any function of oversight in respect of the *ICVC*, its *directors* or any of them; or
 - (ii) any function of *custody* or control of the *scheme property* of the *ICVC*;
 - (b) an *associate* of the *ICVC* or of any of the *directors* of the *ICVC* to assist the *depository* to perform any function in (a)(i);
 - (c) a *nominee company* or anyone else to assist it to perform the function of being a *custodian* of documents evidencing title to *scheme property* of the *ICVC* unless the arrangements with the *custodian* prohibit the *custodian* from releasing the documents into the possession of a third party without the consent of the *depository*.
- (4) If:

- (a) the *ACD* retains the services of (or causes the *ICVC* to retain the services of) anyone to assist the *ACD* to perform any function concerning the management of the *scheme property* of the *ICVC*; or
- (b) the *ACD* or the *directors* of the *ICVC* retain the services of (or cause the *ICVC* to retain the services of) the *depository*, or an *associate* of any of the *directors* of the *ICVC* or of the *depository*, to assist the *ACD* or the *directors* (as the case may be) to perform any of their respective functions; or
- (c) the *depository* retains the services of a *director* of the *ICVC* or an *associate* of such a *director* or of the *depository* to assist the *depository* to perform the functions of the *depository*

then, in the case of (a), the *ACD* and in the case of (b), the *ACD* or the *directors* and in the case of (c), the *depository*, remains responsible for the acts or omissions of the *person* retained as if they were the acts or omissions of the *ACD* or of the *directors* or of the *depository* (as the case may be).

- (5) Subject to the provisions of the *OEIC regulations* and to (1) and (4), a *person* retaining services under (2) or (3) will not be held responsible by the *FSA* by virtue of the *rules* in *CIS* for any act or omission of the *person* so retained if the *person* retaining services can show:
 - (a) that it was reasonable for the *person* retaining services to obtain assistance to perform the function in question;
 - (b) that the *person* retained was and remained competent to provide assistance in the performance of the function in question; and
 - (c) that the *person* retaining services had taken reasonable care to ensure that the assistance in question was provided by the *person* retained in a competent manner.
- (6) At any time when *CIS* 7.2.1R(5) (The directors) applies, the *directors* have, in respect of the functions conferred on the *ACD* in accordance with *CIS* 7.3.1R (The ACD), the same rights to retain the services of other *persons* to assist in the performance of those functions and have the same responsibilities for the acts or omissions of the *person* retained that an *ACD* has under this rule *CIS* 7.6.1R.

Appointments and responsibility for regulatory obligations

7.6.2

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SYSC 3.2 contains *guidance* relating to delegation, including external delegation. SYSC 3.2.4G(1) states that a *firm* cannot contract out of its regulatory obligations, but this does not affect CIS 7.6.1R(5).

Conflict of interests

7.6.3

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- (1) The *ACD*, any other *director* and the *depository*, must respectively take all reasonable steps to ensure that a transaction within any of (a) to (f) is not entered into:
- (a) the placing of cash forming part of the *scheme property* in any current, *deposit* or loan account with an *affected person* unless the *affected person* is an *eligible institution* and the arm's length requirement in (2) is satisfied;
 - (b) the lending of *money* by an *affected person* to, or for the account of, the *ICVC*, unless the *affected person* is an *eligible institution*, and the arm's length requirement in (2) is satisfied;
 - (c) the *sale* of, or dealing in, property by an *affected person*, to, or with, the *ICVC* (or the *depository* for the account of the *ICVC*), unless (4) applies; and for the purpose of this paragraph (c), a *sale* includes any lease or other transaction under which movable or immovable property is made available by the *ICVC*;
 - (d) the vesting of property (other than cash) by an *affected person* in the *ICVC* or the *depository* for the account of the *ICVC* against the *issue* of *shares* in the *ICVC*, unless:
 - (i) paragraph (3) applies; or
 - (ii) it is vested for the purpose of arrangements by which the whole or part of the property of a *body corporate* or a *collective investment scheme* becomes the first property of the *ICVC* and the *holders of shares* or *units* in the *body corporate* or *collective investment scheme* become the first *shareholders* in the *ICVC*;
 - (e) the *purchase* of *scheme property* by an *affected person* from the *ICVC* (or the *depository* acting for the account of the *ICVC*), unless CIS 4.5.4R (In specie cancellation) applies, or unless (3) applies. For the purpose of this paragraph (e), a *purchase* includes any lease or other transaction under which *scheme property* that is movable or immovable property is made available by the *ICVC*.

- (f) transactions within CIS 5.14 (Stock lending) by an *affected person* with, or in relation to, the ICVC unless the arm's length requirement in (2) is satisfied.
- (2) The arm's length requirement is that the arrangements are at least as favourable to the ICVC as would be any comparable arrangement effected on normal commercial terms negotiated at arm's length between the *affected person* and an independent party.
- (3) There is no breach of (1)(c), (d) or (e) if (4) (best execution *on-exchange*) or (5) (independent valuation) or (6) (arm's length transaction) applies.
- (4) There is best execution *on-exchange* for the purposes of (3) if:
- (a) the property is an *approved security* or an *approved derivative*;
 - (b) the transaction is effected under the rules of the relevant exchange with or through a *person* who is bound by those rules;
 - (c) there is evidence in writing of the effecting of the transaction and of its terms; and
 - (d) the ACD has taken all reasonable steps to effect the transaction or to ensure that it is effected on the terms which are the best available for the ICVC.
- (5) There is independent valuation for the purposes of (3) if:
- (a) the value of the property is certified in writing for the purpose of the transaction by a *person* selected or approved by the *depository* as:
 - (i) independent of any *affected person*; and
 - (ii) qualified to value property of the relevant kind; and
 - (b) the *depository* is of the opinion that the terms of the transaction are not likely to result in any material prejudice to *shareholders*.
- (6) There is an arm's length transaction for the purposes of (3) if:
- (a) paragraph (4)(a) is not satisfied; and
 - (b) it is not reasonably practicable to obtain an independent valuation under (5); and

- (c) the *depository* has reliable evidence that the transaction is or will be on terms which satisfy the arm's length requirement in (2).
- (7) Paragraphs (1)(a) to (f) are subject to any provision in the *instrument of incorporation* forbidding the taking of advantage of all or any of them.

7.7 AUTs: powers and duties

Introduction

7.7.1

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- (1) The *guidance* in CIS 7.8.2G (Valuation and pricing) and the rest of CIS 7 relate to the powers and duties of the *manager* and the *trustee*. In addition, both the *manager* and the *trustee* have fiduciary duties under the general law relating to trusts, and powers and duties under other chapters of this sourcebook and the *trust deed*.
- (2) Generally, the *manager* is responsible for managing the *AUT*: in particular for managing the investments, valuing the *scheme property* and pricing, selling and redeeming *units*.
- (3) The *trustee* has duties of oversight and is responsible for the title to investments.
- (4) This chapter also contains provisions relating to:
 - (a) the appointment of the *manager* or the *trustee*;
 - (b) the appointment of an auditor;
 - (c) transactions where there may be a conflict of interests between the *AUT* and the *manager* or the *trustee* or certain other *persons*;
 - (d) the delegation of functions by the *manager* or the *trustee*.

7.8 The manager

Management duties

7.8.1

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- (1) The *manager* must manage the *AUT* in accordance with:
 - (a) the *trust deed*;
 - (b) the *rules* in this sourcebook; and
 - (c) the most recently published *prospectus*.
- (2) It is the *manager's* right and duty, subject to (1), to make decisions as to the constituents of the *scheme property* in accordance with the investment objectives and policy stated in the *prospectus*.
- (3) The *manager* must instruct the *trustee* from time to time in writing how rights attaching to the ownership of the *scheme property* are to be exercised; but not in any case where, under *CIS* 7.9.5R(2) (Exercise of the rights in respect of the scheme property), the *trustee* has the right to exercise (or not exercise) voting rights after consultation with the *manager*.
- (4) The duty at (1) extends to taking all reasonable steps, and exercising due diligence, to ensure that the *units* in the *AUT* are priced in accordance with *CIS* 4 (for a *single-priced AUT*) or *CIS* 15 (for a *dual-priced AUT*).
- (5) The duty at (1) extends to taking action immediately to rectify any breach of *CIS* 4 or *CIS* 15 and, where the breach relates to the incorrect pricing of *units*, or to the late payment in respect of the *issue* of *units*, rectification must, unless the *trustee* otherwise directs, extend to the reimbursement or payment of *money*:
 - (a) by the *manager* to *unitholders* or to former *unitholders*;
 - (b) by the *manager* to the *trustee*; or
 - (c) by the *trustee* (for the account of the *AUT*) to the *manager*;

but rectification need not, unless the *trustee* otherwise directs, extend to any such reimbursement or payment where it appears to the *trustee* that the incorrect pricing, or late payment in respect of *issue*, is of minimal significance.

Valuation and pricing

7.8.2

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For the purposes of CIS 7.8.1R(4) and (5), CIS 7 Ann 1G contains *guidance* on the valuation and pricing of *authorised funds*, including:

- (1) pricing controls and the valuation of the *scheme property*;
- (2) recording and reporting of incorrect pricing; and
- (3) procedures to be adopted following incorrect prices, including action that should be taken to rectify any breach.

Maintenance of records

7.8.3

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(1) The *manager* must make and retain accounting and other records that are necessary:

- (a) to enable it to comply with the *rules* in this sourcebook; and
- (b) to demonstrate at any time that such compliance has been achieved.

(2) The *manager* must make and retain for a period of six years a daily record of the *units* held, acquired or disposed of, by it, including the *classes* of such *units*, and of the balance of any acquisitions and disposals.

(3) The *manager* must make the daily record available for inspection in the *United Kingdom* by the *trustee* free of charge at all times during ordinary office hours and must supply the *trustee* with a copy of the record or any part of it on request free of charge.

Manager to supply information to trustee

7.8.4

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The *manager* must on the request of the *trustee* immediately supply it with such information concerning the management and administration of the *AUT* as the *trustee* may reasonably require.

Auditor

7.8.5

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(1) The *manager* must, at the outset and upon any vacancy, with the approval of the *trustee* appoint as an auditor for the *AUT* any

person qualified for appointment as auditor of an *authorised person*.

- (2) The audit fees of the auditor are determined by the *manager* with the approval of the *trustee*.
- (3) The *manager* may, with the approval of the *trustee*, at any time, remove an auditor; this power exists notwithstanding anything in any agreement between the *persons* concerned.

Tax returns

7.8.6

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The *manager* must from time to time prepare and supply to the *trustee* the returns relating to the *scheme property* required to be submitted by the *trustee* to the Board of Inland Revenue.

7.9 The trustee

Oversight by the trustee of the manager

7.9.1

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- (1) The *trustee* must take reasonable care to ensure:
 - (a) except in relation to *CIS 5* (Investment and borrowing powers), and subject to (4) and (5), that the *AUT* is managed by the *manager* in accordance with *CIS 7.8.1R* (Management duties); and
 - (b) in relation to *CIS 5* (Investment and borrowing powers), that decisions about the constituents of the *scheme property* do not cause an infringement of *CIS 5*.
- (2) The *trustee* must take reasonable care to ensure on a continuing basis that:
 - (a) the *manager* is adopting procedures and methods which are appropriate to ensure that:
 - (i) the *price* of a *unit* of a *single-priced AUT* is calculated for each *valuation point* in accordance with *CIS 4*; and
 - (ii) the prices at which *units* of a *dual-priced AUT* are sold and redeemed are within the limits for the time being prescribed by *CIS 15.4.4R* (Sale price parameters) and *CIS 15.4.9R* (Redemption price parameters); and
 - (b) the *manager* makes and retains sufficient records to show compliance with *CIS 4* or *CIS 15* as the case may be.
- (3) If the *trustee* taking reasonable care is at any time not certain of any matter specified in (2), it must inform the *FSA*.
- (4) The *trustee*:
 - (a) must take reasonable care to ensure that:
 - (i) the *manager* considers whether or not to exercise the power provided by *CIS 4.6.3R(1)(c)* and (d) (Dilution levy and SDRT provision) or, for *dual-priced AUTs*, *CIS*

15.6.3R(1) (SDRT provision) and the amount or rate of any *SDRT provision* that is imposed; and

- (ii) in that consideration the *manager* has, so far as the *trustee* is aware, taken account of all factors that are material and relevant to the *manager's* decision; and
 - (b) subject to (a), has no duty in respect of the *manager's* exercise or omission to exercise the power provided referred to in (a).
- (5) The *trustee* of a *single-priced AUT*:
- (a) must also take reasonable care to ensure that:
 - (i) the *manager* considers whether or not to exercise the power provided by *CIS* 4.6.3R(1)(a) or (b) and the amount or rate of any *dilution levy* that is imposed; and
 - (ii) in that consideration the *manager* has, so far as the *trustee* is aware, taken account of all factors that are material and relevant to the *manager's* decision; and
 - (b) subject to (a), has no duty in respect of the *manager's* exercise or omission to exercise the power referred to in (a).

Valuation and pricing : for AUTs

7.9.2

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For the purposes of *CIS* 7.9.1R(1)(a) and *CIS* 7.9.1R(2), *CIS* 7 Ann 1G contains *guidance* on the valuation and pricing of *authorised funds*, including:

- (1) pricing controls and the valuation of the *scheme property*;
- (2) a *trustee's* review of the *manager's* controls and systems;
- (3) the recording and reporting of incorrect pricing; and
- (4) procedures to be adopted following incorrect prices, including action that should be taken to rectify any breach.

Duty to inform the FSA : for AUTs

7.9.3

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- (1) The *trustee* must inform the *FSA* immediately upon becoming aware of any circumstance as a result of which there is no longer certainty that:
 - (a) except in relation to *CIS* 5 (Investment and borrowing powers), the *AUT* is managed by the *manager* in accordance with *CIS* 7.8.1R(1)R (Management duties); and

- (b) decisions about the constituents of the *scheme property* do not cause an infringement of CIS 5;

unless the *trustee* has taken reasonable care to determine that the circumstance in question is not, and is not likely to become, materially significant.

- (2) If the *trustee* becomes aware of a circumstance which it needs to investigate in order to ascertain whether its duty to inform under (1) arises, then:
- (a) the *trustee* must inform the *FSA* of that circumstance immediately after it determines the circumstance is, or is likely to become, materially significant, or if no such determination is made within 90 *days* of so becoming aware, then the *depository* must inform the *FSA* immediately after the end of the 90 *days*; or
- (b) the *FSA* need not be notified where the *trustee* determines the circumstance is not, or is not likely to become, materially significant.
- (3) The *trustee* must not retire voluntarily unless, before its retirement, it has ensured that the new *trustee* has been informed of any circumstance of which the retiring *trustee* has informed the *FSA* in accordance with (1) or (2) or which is being investigated for the purpose of (2).

Control by the trustee over the scheme property

7.9.4

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- (1) The *trustee* must take all steps and complete all documents which are necessary to secure that transactions for the account of the *AUT* properly entered into by the *manager* in accordance with its powers under the *rules* in this sourcebook are completed.
- (2) The *trustee* must take into its *custody* or under its control all the *capital property* of the *AUT* and hold it in trust for the *unitholders* in accordance with the *rules* in this sourcebook and the *trust deed*.
- (3) The *trustee* is responsible for the collection of any income due to be paid for the account of the *AUT* and for claiming any repayment of tax, and must hold any income received in trust for the *unitholders* in accordance with the *rules* in this sourcebook and the *trust deed*.
- (4) The *trustee* must make and retain such records as are necessary:
- (a) to enable it to comply with the *rules* in this sourcebook; and

- (b) to demonstrate that such compliance by it has been achieved.

Exercise of the rights in respect of the scheme property

7.9.5

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- (1) The *trustee* must take all steps and execute all such documents as are necessary to secure that instructions properly given to it by the *manager* as to the exercise of rights (including voting rights) attaching to the ownership of *scheme property* are carried out.
- (2) The *trustee* may exercise (or not exercise) any right of voting conferred by any of the *scheme property* which is:
 - (a) *units* in any other *collective investment scheme* managed or otherwise operated by the *manager* or by an *associate* of the *manager*; or
 - (b) shares in an approved *investment trust* which form part of the *scheme property* of a *feeder fund* managed or otherwise operated by the *manager* or by an *associate* of the *manager*;

but in either case, only after consultation with the *manager*.
- (3) The *trustee* must, upon the written request of the *manager*, from time to time execute and deliver or cause to be executed or delivered to the *manager* or its nominees such powers of attorney or proxies as the *manager* may reasonably require, in such name or names as the *manager* may request, authorising such attorneys and proxies to vote, consent or otherwise act in respect of all or any part of the *scheme property* not included in (2).
- (4) The *trustee* must, without undue delay, forward to the *manager* all notices of meetings, reports, circulars, proxy solicitations and other documents of a like nature received by it as registered *holder* of any investment.
- (5) In this *rule* (*CIS 7.9.5R*):
 - (a) “voting” includes giving any consent to or approval of any arrangement, scheme or resolution or any alteration in or abandonment of any rights attaching to any part of the *scheme property*; and
 - (b) “right” includes a requisition or joining in a requisition to convene any meeting or a right to give notice of any resolution or to circulate any statement or to consent to any short notice of any meeting.

7.10 The manager and the trustee

Duties of the manager and trustee under the general law

7.10.1

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- (1) The duties of the *manager* and the *trustee* imposed on them by the *rules* in this sourcebook and by the *trust deed* are in addition to, and not in derogation from, the duties which are otherwise imposed on them by law.
- (2) The *manager* and the *trustee* are required to fulfil those other duties by this *rule* (CIS 7.10.1R) as well as by the general law.
- (3) The *manager* and the *trustee* have, as a result of this *rule* (CIS 7.10.1R), all the powers conferred on them by the general law.
- (4) Paragraphs (1), (2) and (3) apply only in so far as the duties imposed or powers conferred by the general law are not qualified or restricted by the *rules* in this sourcebook and by the *trust deed*.

Dealings in scheme property

7.10.2

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- (1) The *manager* may give instructions as to the acquisition or disposal of property for the account of the *AUT*. The authority of the *trustee* to give those instructions is not required except in the case of the acquisition or disposal of immovable property.
- (2) Where the *trustee* is of the opinion that a particular acquisition or disposal of property for the account of the *AUT* by the *manager* exceeds the powers conferred on the *manager* by the *rules* in this sourcebook (and in particular CIS 5), the *trustee* may require the *manager* to cancel the transaction or make a corresponding acquisition or disposal to secure restoration of the previous situation and to meet any resulting loss or expense.
- (3) Where the *trustee* is of the opinion that:
 - (a) an acquisition of property by the *manager* necessarily involves documents evidencing title being kept in the *custody* of a *person* other than the *trustee*; and

- (b) the *trustee* cannot reasonably be expected to accept the responsibility which would otherwise be placed upon it if it were to permit *custody* by such a *person*;

the *manager* must (for the account of the *AUT*) cancel the transaction or make a corresponding disposal if the *trustee* so requests.

Duties of the manager and trustee: investment and borrowing powers

7.10.3

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- (1) The *manager* must take all reasonable steps and exercise all due diligence to avoid the *scheme property* being used or invested contrary to any provision in *CIS 5* (Investment and borrowing powers), except to the extent permitted by (6)(c).
- (2) The *trustee* must take all reasonable steps and exercise due diligence to monitor the management of the *scheme property* sufficiently to ensure that the *manager* complies with (1).
- (3) The *manager* must, immediately upon becoming aware of any breach of any provision in *CIS 5*, take action, at its own expense, to rectify that breach, unless the breach occurred as a result of a circumstance of one of the types described in (5) and (6).
- (4) When this paragraph (4) applies, as a result of (5) or (6), the *manager* must take the steps necessary to ensure a restoration of compliance with *CIS 5* as soon as is reasonably practicable having regard to the interests of the *unitholders* and, in any event, within the period specified in (8) or, when applicable, (9).
- (5) Paragraph (4) applies:
 - (a) where the *scheme property* is used or invested at any time contrary to any provision of *CIS 5* (other than a provision excusing a failure to comply on a temporary basis); and
 - (b) the reason for the contravention is beyond the control of both the *manager* and *trustee*.
- (6) (a) Paragraph (4) applies to a transaction (“subsequent transaction”) deriving from a right (such as the right to convert stock or subscribe to a rights issue) attributable to an *investment* (“original *investment*”) of the *AUT* if:
 - (i) the subsequent transaction, but for this *rule CIS 7.10.3R*, would constitute a breach of *CIS 5*; and
 - (ii) at the time of the acquisition of the original *investment*, it was reasonable for the *manager*, on the assumption that any right attached to the original *investment* when it was

acquired would be exercised, to expect that a breach would not be caused by the subsequent transaction.

- (b) In this paragraph (6) reference to the exercise of a right includes the taking effect of a right without any action by or on behalf of the *trustee* or the *manager*.
 - (c) Nothing in CIS 5 prevents the *manager* from entering into a transaction of the type described in (a) provided that it has obtained the prior written consent of the *trustee*.
- (7) Immediately upon the *trustee* becoming aware of any circumstance described in (5) or any breach resulting from the exercise of, or receipt of a benefit from, a right in the circumstance described in (6), it must take the steps necessary to ensure that the *manager* complies with (4).
- (8) The maximum period for restoration of compliance under (4) starts at the date of discovery of the relevant circumstance and lasts, subject to any extension under (9):
- (a) except where (b), (c) or (d) applies, for six months;
 - (b) where the transaction in question was a transaction in *derivatives* or a forward transaction under CIS 5.6R (Futures and options schemes) or CIS 5.7R (Geared futures and options schemes), until the close of business five *business days* later;
 - (c) where the transaction in question was entered into under CIS 5.13R (Efficient portfolio management), until the close of business five *business days* later; and
 - (d) where the *AUT* is a *property scheme* and the property in question is an immovable, for two years.
- (9) The period specified at (8)(b) and (c) (five *business days*) is extended:
- (a) if the transaction involved a delivery of a *commodity*, from five to 20 *business days*;
 - (b) if the reason for the contravention in (5) is the inability of the *manager* to *close out* a transaction because of a limit in the number or value of transactions imposed by an *eligible derivatives* market, until five *business days* after:
 - (i) the inability resulting from any such limit is removed; or
 - (ii) it becomes, to the knowledge of the *manager*, reasonably practicable and reasonably prudent for the transaction to be closed out in some other way.

Delegation

7.10.4

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- (1) The *manager* may delegate any function to any *person*, including the *trustee*.
- (2) The *trustee* must not delegate:
 - (a) to the *manager*:
 - (i) any function of oversight in respect of the *manager*; or
 - (ii) any function of *custody* or control of the *scheme property*; or
 - (b) to an *associate* of the *manager*, any function in (a)(i).
- (3) The *trustee* must not delegate to anyone the function of being a *custodian* of documents evidencing title to *scheme property* unless the *arrangements* with the *custodian* prevent the *custodian* from releasing the documents into the possession of a third party without the consent of the *trustee*.
- (4) Subject to (2) and (3), the *trustee* may delegate any function to any *person* including the *manager*.
- (5) If:
 - (a) the *manager* delegates any function concerning the management of the *scheme property*; or
 - (b) the *manager* delegates any function to the *trustee* or to an *associate* of its own or of the *trustee*; or
 - (c) the *trustee* delegates any function to the *manager* or to an *associate* of its own or of the *manager*;

the *manager* or as the case may be the *trustee*, remains responsible, for the acts or omissions of the delegate as if they were the acts or omissions of the *manager*, or as the case may be of the *trustee*.
- (6) In the case of any delegation by the *manager* or the *trustee* to which (5) does not apply, the *manager*, or as the case may be the *trustee* will not be held responsible by the *FSA* by virtue of the rules in *CIS* for any act or omission of the delegate if the *manager* (or *trustee*) can show:
 - (a) that it was reasonable for a delegate to be employed for the function in question; and
 - (b) that the delegate was and remained competent to undertake the function in question; and

- (c) that the *manager* (or *trustee*) had taken reasonable care to ensure that the function in question was undertaken by the agent in a competent manner.

Delegation and responsibility for regulatory obligations

7.10.5

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SYSC 3.2 contains *guidance* relating to delegation, including external delegation, and SYSC 3.2.4(1)G states that a *firm* cannot contract out of its regulatory obligations, but this does not affect CIS 7.10.4R(6).

Conflict of interests

7.10.6

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- (1) The *manager* and the *trustee* must respectively take all reasonable steps to ensure that a transaction within any of (a) to (f) is not entered into:
- (a) the placing of cash forming part of the *scheme property* or standing to the credit of the *distribution account* in any current, *deposit* or loan account with an *affected person* unless the *affected person* is an *eligible institution* and the arms length requirement in (2) is satisfied;
 - (b) the lending of *money* by an *affected person* to, or for the account of, the *AUT* unless the *affected person* is an *eligible institution*, and the arm's length requirement in (2) is satisfied;
 - (c) the sale of, or dealing in, property to, or with, the *trustee* for the account of the *AUT* unless (3) applies and, for the purpose of this paragraph (c), a sale includes any lease or other transaction under which movable or immovable *scheme property* is made available by the *trustee*;
 - (d) the vesting of property (other than cash) by an *affected person* in the *trustee* against the *issue* of *units* in the *AUT*, unless upon a *unitisation* or unless (3) applies;
 - (e) the purchase of *scheme property* by an *affected person* from the *trustee*, acting for the account of the *AUT*, unless either CIS 4.5.4R or CIS 15.5.4R (In specie cancellation) or (3) applies. For the purpose of this paragraph (6), a purchase includes any lease or other transaction under which movable or immovable *scheme property* is made available by the *AUT*.
 - (f) transactions within CIS 5.14 (Stock lending) in relation to the *AUT* unless the arm's length requirement in (2) is satisfied.
- (2) The arm's length requirement is that the arrangements are at least as favourable to the *AUT* as would be those of any comparable arrangement effected on normal commercial terms negotiated at

arm's length between the *affected person* and an independent party.

- (3) There is no breach of (1)(c), (d) or (e) if (4) (Best execution on exchange) or (5) (Independent valuation) or (6) (Arm's length transaction) applies.
- (4) There is best execution *on-exchange* for the purposes of (3) if:
 - (a) the property is an *approved security* or an *approved derivative*;
 - (b) the transaction is effected under the rules of the relevant exchange with or through a user who is bound by those rules;
 - (c) there is evidence in writing of the effecting of the transaction and of its terms; and
 - (d) the *manager* has taken all reasonable steps to effect the transaction or to ensure that it is effected on the terms which are the best available for the *AUT*.
- (5) There is independent valuation for the purposes of (3) if:
 - (a) the value of the property is certified in writing for the purpose of the transaction by a *person* selected or approved by the *trustee* as:
 - (i) independent of any *affected person*; and
 - (ii) qualified to value property of the relevant kind; and
 - (b) the *trustee* is of the opinion that the terms of the transaction are not likely to result in any material prejudice to *unitholders*.
- (6) There is an arm's length transaction for the purposes of (3) if:
 - (a) paragraph (4)(a) is not satisfied; and
 - (b) it is not reasonably practicable to obtain an independent valuation under (5); and
 - (c) the *trustee* has reliable evidence that the transaction is or will be on terms which satisfy the arm's length requirement in (2).
- (7) Paragraphs (1)(a) to (f) are subject to any provision in the *trust deed* forbidding the taking of advantage of all or any of them.

7.11 New managers and trustees

Replacement of a manager

7.11.1

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- (1) The *manager* for the time being is subject to removal by written notice given by the *trustee* to the *manager* upon any of the following events:
 - (a) the *manager* goes into liquidation (except voluntary liquidation for the purpose of reconstruction or amalgamation upon terms previously approved in writing by the *trustee*);
 - (b) a receiver is appointed of the *undertaking* or any part of it;
 - (c) an administration order is made in relation to the *manager* under section 8 of the Insolvency Act 1986;
 - (d) for good and sufficient reason the *trustee* is of the opinion and so states in writing that a change of *manager* is desirable in the interest of the *unitholders*;
 - (e) an *extraordinary resolution* is passed removing the *manager* (or to determine that it be removed as soon as this is permitted by law);
 - (f) *unitholders* of three quarters in value of the *units in existence* (excluding *units* held or treated as held by the *manager* or by any *associate* of the *manager*) make a request in writing to the *trustee* that the *manager* should be removed.
- (2) On receipt of a notice by the *trustee* under (1), the *manager* ceases to be the *manager*; and the *trustee* must by deed appoint another *person* eligible under the *Act* to be the *manager* of the *AUT* upon and subject to that other's entering into such deed or deeds as the *trustee* may require.
- (3) If the name of the *AUT* contains a reference to the name of the former *manager*, the former *manager* is entitled to require the new *manager* and the *trustee* immediately on receipt of a notice under (2) to propose a change in the name of the *AUT*.

Retirement of a manager

7.11.2

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- (1) The *manager* has the right to retire in favour of another *person* eligible under the *Act* and approved in writing by the *trustee* upon:
 - (a) the retiring *manager* appointing that *person* by deed as *manager* of the *AUT* in its place and assigning to that *person* all its rights and duties as such a *manager*; and
 - (b) the new *manager* entering into such deed or deeds as the *trustee* reasonably considers necessary or desirable to be entered into by that *person* in order to secure the due performance of its duties as a *manager*.
- (2) Upon retirement, the retiring *manager*:
 - (a) is released from all further obligations under the *rules* in this sourcebook and under the *trust deed*. However, this does not affect the rights of the *trustee* or of any *unitholder* or any other *person* in respect of any act or omission on the part of the retiring *manager* before his retirement; and
 - (b) may retain any consideration paid to it in connection with the change without having to account for it to any or all of the *unitholders*.
- (3) Upon the retirement of the retiring *manager* the new *manager* may exercise all the powers and enjoy all the rights and becomes subject to all the duties and obligations of the *manager* under the *rules* in this sourcebook and under the *trust deed* as if the new *manager* had originally been a party to the *trust deed*.

Consequences of retirement

7.11.3

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- (1) Upon the removal or retirement of the *manager*, the removed or retiring *manager*:
 - (a) remains entitled to all *units* held or treated as held by it;
 - (b) is to be registered in the *register* in respect of those *units*; and
 - (c) may require the *trustee* to issue to it a certificate or certificates for those *units* (if not previously issued).
- (2) Paragraph (1) is subject to any restriction in the *trust deed* deriving from *CIS 2.2.4G(1)(j)* (Limited categories of holder).

Retirement of the trustee

7.11.4

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- (1) The *trustee* may not retire voluntarily except upon the appointment of a new *trustee*.
- (2) When the *trustee* wishes to retire or ceases to be an *authorised person*, the *manager* may, subject to section 251 of the *Act* (Alteration of *schemes* and changes of *manager* or *trustee*), by a supplemental *trust deed*, appoint another *person eligible* under section 243 of the *Act* (Authorisation orders) to be the *trustee* in its place.

G Valuation and Pricing of authorised funds

1 Table This table belongs to [CIS 7G]

1.	Introduction	
	Application	
(1)	(a)	This Section 1. applies to <i>authorised fund managers</i> and <i>depositories</i> ;
	(b)	Section 2. applies to <i>authorised fund managers</i> ;
	(c)	Section 3. applies to <i>depositories</i> ; and
	(d)	Sections 4. and 5. apply to <i>authorised fund managers</i> and <i>depositories</i> , as indicated.
	Explanation	
(2)	(a)	This annex provides details of the types of checks and standards of control which an <i>authorised fund manager</i> and the <i>depository</i> of <i>authorised funds</i> should have in place for the valuation of the <i>scheme property</i> and pricing of <i>units</i> .
	(b)	This annex then sets out conditions under which the <i>FSA</i> would not consider it necessary for a pricing error of below a certain amount to result in compensation being payable to an investor.
	(c)	This annex relates to <i>CIS</i> 7.3.2G, 7.4.2G, 7.8.2G and 7.9.2G.
2.	Pricing controls by authorised fund managers	
	Introduction	
(1)	This section details the type of control regime the <i>FSA</i> considers that an <i>authorised fund manager</i> should employ to satisfy its obligations under <i>CIS</i> 7.3.1R(3)(c) and <i>CIS</i> 7.8.1R(4).	
(2)	Evidence of persistent or repetitive errors, or errors consistently in an <i>authorised fund manager's</i> favour, is likely to make it more difficult for an <i>authorised fund manager</i> to demonstrate it meets the standards in this section.	
	Method for valuing scheme property	
(3)	An <i>authorised fund manager</i> should determine its method for valuing the <i>scheme property</i> and apply it on a consistent basis.	
	Source of share prices and currency rates	
(4)	(a)	Share prices and currency rates used should be up to date and from a reputable source.
	(b)	The mere use of a source for prices and rates does not amount to delegation under <i>CIS</i> 7.10.4R (Delegation) and obtaining assistance under <i>CIS</i> 7.6.1R (Committees and appointments).
	(c)	Although it should not be necessary to carry out significant substantive checking, the reliability of the source of prices and rates should be kept under regular review and doubtful prices or rates should be followed up.
	Valuation agents	
(5)	(a)	The use of a third party to carry out the valuation function amounts to delegation, in accordance with <i>CIS</i> 7.10.4R (Delegation) and obtaining assistance under <i>CIS</i> 7.6.1R (Committees and appointments).

	(b)	Where the pricing function is delegated under <i>CIS</i> 7.10.4R or when assistance is obtained under <i>CIS</i> 7.6.1R, the <i>authorised fund manager</i> should satisfy itself that the valuation agent's system is robust and will produce accurate results.
	(c)	An <i>authorised fund manager</i> should keep the valuation agent's controls and procedures under review. That review should ensure that changes to controls and procedures, including a series of minor changes, do not have a significant adverse effect on the accuracy of the system.
	(d)	An <i>authorised fund manager</i> should review the outputs from the system regularly, and on any significant system change.
	(e)	In addition, if the valuation agent is also responsible for calculating dealing <i>prices of units</i> , an <i>authorised fund manager</i> should regularly review this system.
	Reconciliation	
(6)	(a)	Unless the valuation and record keeping systems are integrated, the valuation output should be agreed with an <i>authorised fund manager's</i> records of the <i>authorised fund</i> at each <i>valuation point</i> .
	(b)	In addition, an <i>authorised fund manager's</i> records, including debtors and creditors, should be agreed with the <i>depository's</i> records of stocks and both capital and income cash on a frequency agreed between the <i>authorised fund manager</i> and <i>depository</i> . Reconciling items need to be followed up promptly, and debtors reviewed for recoverability.
	Inclusion of investment transactions in valuations	
(7)	(a)	Systems should be in place by which all <i>investment transactions</i> are confirmed as quickly as possible in writing or by electronic means to an <i>authorised fund manager</i> or to a valuation agent.
	(b)	It is desirable that all <i>deals</i> to which the <i>authorised fund</i> is committed, which have been notified not less than one hour before a valuation, are included in that valuation, at estimated prices if necessary.
	(c)	Unless, however, there is likely to be significant movement in the <i>price</i> of a <i>unit</i> , it is more important that an accurate cut-off procedure is in place to ensure that omissions or duplications do not take place, than it is to ensure that estimates are included in a valuation.
	Prices obtained otherwise than from the main pricing source	
(8)	(a)	Where prices are obtained otherwise than from the main pricing source (for example unquoted, suspended, or illiquid stocks), an <i>authorised fund manager</i> should maintain a record of the source and basis for the value placed on the <i>investment</i> .
	(b)	The methodology, procedure and controls for the valuation of those stocks should be regularly reviewed to ensure that the valuations are fair and reasonable in the circumstances.
	Investment and borrowing powers/compliance	
(9)		Procedures should be in place to monitor the applicable <i>rules</i> in <i>CIS</i> 5 and, if breaches occur, to ensure they are rectified in accordance with <i>CIS</i> 7.5.3R or <i>CIS</i> 7.10.3R.
	Unapproved securities	
(10)		To assist with the identification of the level of investment in <i>securities</i> that are not <i>approved securities</i> , the <i>authorised fund manager</i> should notify the <i>depository</i> of any trade in unapproved <i>securities</i> as soon as reasonably practicable.
	Dividends, interest and expenses	
(11)	(a)	A system should be in place to ensure that dividends are accounted for as soon as stocks are quoted ex-dividend, unless, as with some foreign stocks, it is prudent to account for them only on receipt.

	(b)	Fixed interest dividends and interest should be accrued at each <i>valuation point</i> unless the level of materiality makes a longer interval appropriate.
	(c)	Similar considerations apply to the expenses of an <i>authorised fund</i> .
	Tax positions relevant to the authorised fund	
(12)	(a)	The full tax position should be reviewed regularly, including the basis for the current tax charge, the assumptions being used, and the tax rate applicable.
	(b)	Adjustments should be made for substantive changes (for example alterations to the tax profile or likely tax charge) when they occur.
	Dual-priced AUTs	
(13)	In the case of <i>dual-priced AUTs</i> , the justification for figures included for dealing expenses and <i>commissions</i> included in the price of a <i>unit</i> should be reviewed regularly, separately for different markets of different sectors. Adjustment should be made for substantive changes (for example changes in the rate or basis of stamp duty) as and when they occur.	
	Valuation limits	
(14)	(a)	An <i>authorised fund manager</i> should fix a percentage or absolute limit for certain key elements of the valuation, so that any movement outside these limits is investigated. The investigation and its outcome should be evidenced and retained by the <i>authorised fund manager</i> .
	(b)	These key elements could, where relevant, include: <ul style="list-style-type: none"> (i) the movement of the prices and values of individual stocks; (ii) changes in currency rates; and (iii) accrual figures for income, expenses, and tax. Prices which appear not to have changed after a fixed period of time should be investigated, since this may be the result of a price movement having been missed.
	Cash	
(15)	Cash should be reconciled to the bank account regularly, with outstanding items promptly followed up, and a full reconciliation should be sent to the <i>depository</i> at a frequency agreed with the <i>depository</i> .	
	Recording of units in issue	
(16)	Controls should be in place to ensure that the correct number of <i>units</i> in <i>issue</i> is recorded at each <i>valuation point</i> . This should be reconciled with the <i>register</i> of <i>unit-holders</i> or <i>shareholders</i> at a frequency agreed with the <i>depository</i> .	
	Verification by the fund manager of the assets of the authorised fund	
(17)	A copy of the valuation used to produce the <i>price</i> of the <i>units</i> should be sent to the fund <i>manager</i> at least weekly, which he should check. When the <i>authorised fund's valuation point</i> is less frequent than weekly, a copy of the valuation used should be sent to the fund <i>manager</i> as soon as practicable after the <i>valuation point</i> .	
3.	Pricing checks by depositaries	
	Introduction	
(1)	This section provides details of the types of checks a <i>depository</i> should carry out to be satisfied that the <i>authorised fund manager</i> adopts controls and systems which are appropriate to ensure that prices of <i>units</i> are calculated in accordance with <i>CIS</i> 4 or <i>CIS</i> 15, and to ensure that the likelihood of incorrect <i>prices</i> will be minimised. These checks also apply where a <i>manager</i> has delegated all or some of its pricing functions to a third party or where an <i>ACD</i> has obtained the assistance of a third party to carry out all or some of its pricing functions.	
	Review by the depository of authorised fund manager's controls and systems	
(2)	A <i>depository</i> should thoroughly review an <i>authorised fund manager's</i> controls and systems to confirm that they are satisfactory.	

	<p>(3) This review should be carried out:</p> <ul style="list-style-type: none"> (a) at the start of a <i>depository's</i> appointment, taking into account (where relevant) any relevant report made by the retiring <i>depository</i> in accordance with <i>CIS</i> 7.4.3R(3) (Duty to inform the FSA : for ICVCs) and <i>CIS</i> 7.9.3R(3) (Duty to inform the FSA : for AUTs); and (b) thereafter, on a frequency dependent on the risk profile of the <i>authorised fund</i>; (c) when major changes are made by an <i>authorised fund manager</i> to its systems; and (d) when necessary, to ensure that a series of minor changes do not have a significant adverse effect on the integrity of the systems. <p>(4) A review should be carried out more frequently where a <i>depository</i> knows or suspects that an <i>authorised fund manager's</i> controls and systems are weak or are otherwise unsatisfactory. In particular, the prices of unapproved <i>securities</i> and (where unquoted) the basis for their calculation should be subjected to frequent verification, and an examination of the sources of the prices of those <i>securities</i> should be carried out.</p> <p>(5) Additionally, a <i>depository</i> should from time to time review other aspects of the valuation of the <i>scheme property</i> of each <i>authorised fund</i> for which it is responsible, verifying, on a sample basis, if necessary, the assets, liabilities, accruals, <i>units</i> in issue, <i>securities</i> prices and any other relevant matters, for example an accumulation factor or a currency conversion factor.</p> <p>(6) The <i>depository's</i> review should include an analysis of the controls in place to determine the extent to which reliance can be placed in them.</p> <p>(7) A <i>depository</i> should ensure that any issues, which are identified in any such review, are properly followed up and resolved.</p> <p>(8) Where an <i>authorised fund manager's</i> systems are manual, or have been installed or amended recently and are therefore unproven, the level of checking will need to be increased accordingly. This will also be necessary where a number of instances of incorrect pricing have previously been identified.</p>
4.	<p>Recording and reporting of instances of incorrect pricing</p> <p>Recording and reporting by the authorised fund manager</p> <p>(1) An <i>authorised fund manager</i> should record each instance where the fourth significant figure of a price of a <i>unit</i> is incorrect, and, as soon as the error is discovered, report the fact to the <i>depository</i> together with details of the action taken, or to be taken, to avoid repetition.</p> <p>Reporting by the depository</p> <p>(2) In accordance with <i>CIS</i> 7.4.3R and <i>CIS</i> 7.9.3R (Duty to inform the FSA), the <i>depository</i> should report any breach or potential breach of the <i>rules</i> in <i>CIS</i> 4 or <i>CIS</i> 15 immediately to the <i>FSA</i>. This would extend to instances of incorrect pricing of <i>units</i> or late payment. However, notification should relate to instances which the <i>depository</i> considers material only. Materiality should be determined by taking into account a number of factors, including:</p> <ul style="list-style-type: none"> (a) whether an <i>authorised fund manager</i> has followed the pricing controls set out in Section 2; (b) the significance of any breakdown in management controls or other checking procedures; (c) the significance of any failure of systems, including situations where inadequate back-up arrangements exist; (d) the duration of an error (the longer an error persists, the more likely that it will have a material effect on a <i>price</i>); (e) the level of compensation to be paid to <i>holders</i> in an <i>authorised fund</i>; and

		(f) an <i>authorised fund manager's</i> ability (or otherwise) to meet the need for compensation in full.
		Factor (a) would tend to decrease materiality whereas the other factors mentioned will tend to increase it.
	(3)	A <i>depository</i> should also report to the <i>FSA</i> immediately any instance of incorrect pricing where the error is greater than 0.5% of the price of a <i>unit</i> , where a <i>depository</i> believes that reimbursement or payment is inappropriate and should not be paid by an <i>authorised fund manager</i> .
	(4)	In accordance with <i>SUP</i> 16.6.13R, a <i>depository</i> should also make a return to the <i>FSA</i> on a quarterly basis which summarises, by <i>authorised fund manager</i> , the number of instances of incorrect pricing during a particular period. This should include:
	(5)	(a) the number of errors which were greater than 0.5% of the price of a <i>unit</i> ; and
		(b) the number of errors which were less than 0.5% of the price of a <i>unit</i> where a <i>depository</i> did not consider an <i>authorised fund manager's</i> controls and systems to be adequate.
5.		Incorrect pricing of units and reimbursement or payment
		Introduction
	(1)	(a) <i>CIS</i> 7.3.1R(3)(d) and <i>CIS</i> 7.8.1R(5) place a duty on the <i>authorised fund manager</i> to take action to reimburse affected <i>holders</i> , former <i>holders</i> , and the <i>scheme</i> itself, for certain instances of incorrect pricing or late payment. Paragraph (8) and <i>CIS</i> 7 Ann 1G, 2 sets out how <i>money</i> could be paid or reimbursed. This annex does not overrule any legal right to claim compensation.
		(b) However, reimbursement or payment may not be required, if it appears to the <i>depository</i> that the incorrect pricing is of minimal significance. Paragraphs (4) to (6) outline the conditions which the <i>depository</i> should take into account in considering whether an instance of incorrect pricing is of minimal significance.
	(2)	The word "normally" is used throughout this Section 5 to denote "unless the <i>depository</i> directs otherwise".
	(3)	If a <i>depository</i> deems it appropriate, it may, in spite of the circumstances outlined in (4), agree to a payment from the <i>authorised fund manager</i> or from the <i>authorised fund</i> to the <i>holders</i> , former <i>holders</i> , the <i>authorised fund</i> or the <i>authorised fund manager</i> (where appropriate), following an instance of incorrect pricing.
		Instances where incorrect pricing is normally of minimal significance
	(4)	A <i>depository</i> may consider that the instance of incorrect pricing or late payment is of minimal significance if:
		(a) the <i>authorised fund manager</i> and <i>depository</i> meet the standards of control set out in Section 2 and Section 3 of this Annex; and
		(b) in the case of incorrect pricing, the error in pricing of a <i>unit</i> is less than 0.5% of the correct price.
		Instances where incorrect pricing is not normally of minimal significance
	(5)	Any instances of incorrect pricing not covered by (4) will not normally be of minimal significance.
	(6)	Where either a single factor or more than one factor causes an incorrect price over a period of time, the incorrect price is normally not of minimal significance:
		(a) if the standards in Sections 2 and 3 are not met, for all <i>days</i> on which there is an incorrect price; or
		(b) otherwise, only on those <i>days</i> where as a result the <i>price</i> is incorrect by 0.5% or more of the price of a <i>unit</i> .

(7)	If a <i>depository</i> considers that reimbursement or payment is inappropriate, it should report the matter to the <i>FSA</i> , together with its recommendation and justification. The <i>depository</i> should take into account the need to avoid prejudice to the rights of <i>holders</i> , or the rights of <i>holders</i> in a <i>class</i> of <i>units</i> .
(8)	The summary table sets out the effect of this annex on some circumstances in which incorrect pricing can occur, and how <i>holders</i> , former <i>holders</i> , the <i>authorised fund</i> or the <i>authorised fund manager</i> can be reimbursed or paid.
(9)	It may not be practicable, or even, in some cases, legally permissible for the <i>authorised fund manager</i> to obtain reimbursement from <i>holders</i> , where the <i>holders</i> have benefited from the incorrect price.
(10)	In all cases where reimbursement or payment is normally required, amounts due to be reimbursed to <i>holders</i> for individual sums under £10 will not, normally, need to be paid, although an <i>authorised fund manager</i> may pay such a sum, or may wish to make up smaller amounts to a higher figure (such as the £10 minimum).

2 Table Summary table (This table forms part of Section 5, paragraph (8) of this Annex).

	<i>Authorised fund</i>	<i>Authorised fund manager</i>	Incoming holder	Outgoing holder
GAINS				
LOSSES				
<i>Authorised fund</i>		A		
<i>Authorised fund manager</i>	B		D	F
Incoming holder		C		
Outgoing holder		E		

DEALINGS BETWEEN AN *AUTHORISED FUND* AND *AUTHORISED FUND MANAGER* (WHETHER OR NOT *UNITS* ARE SOLD OR REDEEMED FROM *HOLDERS*)

A	The <i>authorised fund</i> gains in relation to the <i>authorised fund manager</i> (<i>issue</i> at too high or cancellation at too low a price). If: (1) incorrect price by less than 0.5%: normally no action; (2) incorrect price by 0.5% or more: the <i>depository</i> will normally compensate the <i>authorised fund manager</i> from the <i>authorised fund</i> .
B	The <i>authorised fund</i> loses vis-à-vis the <i>authorised fund manager</i> (<i>issue</i> at too low or cancellation at too high a price). If:

		(1) incorrect price by less than 0.5%: normally no action;
		(2) incorrect price by 0.5% or more: the <i>depository</i> will normally direct the <i>authorised fund manager</i> to compensate the <i>authorised fund</i> .
DEALINGS BETWEEN <i>HOLDERS</i> AND THE <i>AUTHORISED FUND MANAGER</i> (WHETHER OR NOT THERE IS AN <i>ISSUE</i> OR CANCELLATION OF <i>UNITS</i>)		
C	Incoming <i>holders</i> gain in relation to the <i>authorised fund manager</i> (New <i>holders</i> buy <i>units</i> at too low a price). If:	
	(1)	incorrect price by less than 0.5%: no action;
	(2)	incorrect price by 0.5% or more: see paragraph (9) of this Section 5.
D	Incoming <i>holders</i> lose vis-à-vis the <i>authorised fund manager</i> (New <i>holders</i> buy <i>units</i> at too high a price). If:	
	(1)	incorrect price by less than 0.5%: normally no action;
	(2)	incorrect price by 0.5% or more: the <i>authorised fund manager</i> will normally compensate incoming <i>holders</i>
E	Outgoing <i>holders</i> gain in relation to an <i>authorised fund manager</i> (Outgoing <i>holders</i> sell at too high a price). If:	
	(1)	incorrect price by less than 0.5%: no action;
	(2)	incorrect price by 0.5% or more: see paragraph (9) of this Section 5.
F	Outgoing <i>holders</i> lose in relation to the <i>authorised fund manager</i> (Outgoing <i>holders</i> sell at too low a price). If:	
	(1)	Incorrect price by less than 0.5%: normally no action;
	(2)	Incorrect price by 0.5% or more: the <i>authorised fund manager</i> will normally compensate outgoing <i>holders</i> .

Chapter 8

Charges and Expenses



8.1 Introduction

Application

- 8.1.1** **R** /1
- (1) The *rules and guidance* in this chapter apply in accordance with CIS 8.1.3R (Table of application).
 - (2) The *rules* relating to *preliminary charge*, increase of *preliminary charge*, *redemption charge*, control over maximum charges on *issue* and *redemption* and to exchange of *units* in *umbrella schemes* are, for *dual-priced AUTs*, in CIS 15.

Purpose

- 8.1.2** **G** /1
- (1) This chapter assists in meeting the *regulatory objective* of protecting *consumers* by laying down conditions governing charges imposed on investors when *buying* or *selling units* and governing payments out of *scheme property*.
 - (2) The conditions are intended to provide clarity as to the nature of permitted charges and payments and clear disclosure for existing investors of any increases in charges and payments to the *authorised fund manager*.
 - (3) The *instrument of incorporation* of an *ICVC* will, in accordance with the *OEIC regulations*, provide that the charges or expenses of the *ICVC* may be taken out of the *scheme property*. This chapter:
 - (a) prohibits, or provides conditions applying to, the payment out of the *scheme property* of certain types of charges and expenses;
 - (b) makes certain payments conditional on disclosure in the *prospectus*; and
 - (c) governs the allocation of payments between capital and income.
 - (4) For an *AUT*, this chapter provides what types of charge may be made on investors when they buy or *sell units* and what types of expenses may be met out of the *scheme property*. Provisions governing the allocation of payments between capital and income are also contained in this chapter.

- 8.1.3** **R** /1
- Table Table of application
This table belongs to CIS 8.1.1R

Paragraph or section number	ICVC	ACD	Depository of an ICVC	Manager	Trustee
8.1	X	X	X	X	X
8.2.1R		X		X(s)	
8.2.2R		X		X(s)	
8.2.3R		X			
8.2.4R		X			
8.2.5R		X		X(s)	
8.2.6R		X		X(s)	
8.2.7R		X			
8.2.8R(1) and (2)		X			
8.2.8R(3)				X(s)	
8.3.1R – 8.3.2R		X			
8.3.3R	X	X			
8.3.4R	X	X			
8.3.5R(1)–(3)	X	X			
8.3.5R(4)	X	X	X		
8.4.1R	X	X	X	X	X
8.4.2R	X	X	X	X	X
8.5.1R				X	
8.5.2R(1) to (6)				X(s)	
8.5.2R(7)				X(s)	X(s)
8.5.2R(8)				X(s)	
8.5.3R				X(s)	
8.5.4R				X	X
8.5.5R to 8.5.7R				X	X

Note: "X" means "applies". "X(s)" means "applies to the *manager* of a *single-priced AUT* only".

8.2 Charges

Application

8.2.1

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This section (CIS 8.2) relates to some of the charges that may be made by *authorised fund managers* and to increases in them. In CIS 8.5 there are additional *rules* relating to charges which apply only in relation to *AUTs* or *single-priced AUTs*.

Preliminary charge: ICVCs and single-priced AUTs

8.2.2

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- (1) In the case of an *ICVC* or a *single-priced AUT*, the *authorised fund manager* must not make any charge or levy in connection with the *issue* or *sale* of *units* except a *preliminary charge* under this rule (CIS 8.2.2R) and a *dilution levy* and *SDRT provision* under CIS 4.6.3R.
- (2) In the case of a *single-priced AUT*, a *preliminary charge* must not be made unless:
 - (a) it is permitted by the *trust deed*; and
 - (b) it is expressed either as a fixed amount or calculated as a percentage of the *price*.
- (3) The *preliminary charge* must not exceed the amount or rate stated in the current *prospectus* in respect of a *unit* of any *class*.

Payments by an ICVC to an ACD

8.2.3

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No payment may be made or benefit given to the *ACD* (in any capacity) out of the *scheme property*, whether by way of *remuneration* for its services, reimbursement of expenses or otherwise, unless the *prospectus* specifies each type of payment or benefit that may be made or given, each type of expense that may be so reimbursed and, in the case of each category of *remuneration* (or *remuneration* related to a *class* of *share*), specifies:

- (1) how it will be calculated and accrue and when it will be paid; and

- (2) the maximum and current rates or amount of such *remuneration*.

Increases in remuneration of an ACD

8.2.4

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In the case of an *ICVC*, the *ACD* must not introduce a new category of *remuneration* for its services or make any increase in the current rate or amount of its *remuneration* payable out of the *scheme property* up to or towards any maximum stated in the *prospectus*, unless it has complied with *CIS* 8.2.6R (Notice of an increase – *ICVCs* and single-priced *AUTs*).

Increase in preliminary charge of an authorised fund manager: *ICVCs* and single-priced *AUTs*

8.2.5

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In the case of an *ICVC* or a *single-priced AUT*, the *authorised fund manager* must not introduce a *preliminary charge*, or increase within any maximum stated (in the case of an *ICVC*) in the *prospectus* or (in the case of a *single-priced AUT*) in the *trust deed*, the current amount or rate of *preliminary charge*, unless it has complied with *CIS* 8.2.6 (Notice of an increase: *ICVCs* single-priced *AUTs*).

Notice of an increase: *ICVCs* and single-priced *AUTs*

8.2.6

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In the case of an *ICVC* or a *single-priced AUT*, not less than 90 *days* before the introduction or increase under *CIS* 8.2.4 or *CIS* 8.2.5, the *authorised fund manager* must:

- (1) give written notice of that introduction or increase and of the date of its commencement:
 - (a) to all the *persons* who ought reasonably to be known to it to have made an arrangement for the *purchase* of *units* at regular intervals; and
 - (b) (in the case of *remuneration* of the *ACD* payable out of the *scheme property*) to all *shareholders*; and
- (2) revise the *prospectus* to reflect the introduction or new current rate or amount of *remuneration* or *preliminary charge* (or, in the case of an *ICVC*, other *remuneration*) and the date of its commencement, and make the revised *prospectus* available.

Redemption charge: ICVCs

8.2.7

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- (1) The *ACD* must not make a *redemption charge*, except in accordance with (2), (3) and (4)
- (2) A *redemption charge* must not exceed the amount or rate of *redemption charge* stated in the *prospectus* current at the date when the relevant *shares* were sold by the *ACD* or issued through the *ACD* under CIS 4.5.3R (Issues and cancellations through the authorised fund manager) and, if there was no such statement, the *redemption* or *cancellation* of such *shares* must not be subject to any *redemption charge*.
- (3) The *ACD* must not introduce a *redemption charge* or change the rate or method of calculation of a current *redemption charge* which is adverse to *shareholders* unless, not less than 90 days before the introduction or change, the *ACD* has:
 - (a) given written notice of that introduction or change and of the date of its commencement to all the *persons* who ought reasonably to be known to the *ACD* to have made an arrangement for the *purchase* of *shares* at regular intervals; and
 - (b) revised the *prospectus* to reflect the introduction or change and the date of its commencement and made the revised *prospectus* available.
- (4) If a *prospectus* contains a statement relating to the amount, or the calculation of the amount, of a *redemption charge*, it must also contain a statement as to the determination of the order in which *shares*, which have been acquired at different times by a *shareholder*, are to be taken to be redeemed or cancelled for the purpose of the imposition of the *redemption charge*.

Charges for an exchange of units in an umbrella scheme: ICVCs and single-priced AUTs

8.2.8

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- (1) In the case of an *umbrella scheme* which is an *ICVC*, the *ACD* may make a charge on an exchange of *shares* in one *sub-fund* for *shares* in another *sub-fund*, but the charge must not exceed the aggregate of:
 - (a) any excess of the current *preliminary charge* payable on the *shares* being acquired over the *preliminary charge* actually paid on the original acquisition of the *shares* being redeemed; and
 - (b) the amount of any fee payable on switching stated in the *prospectus*.

- (2) The *ACD* must not make a charge in excess of the fee referred to in (1)(b), unless the *prospectus* contains a statement as to the determination of the order in which *shares* which have been acquired at different times by a *shareholder* are to be taken to be redeemed or cancelled in so far as necessary for calculating the maximum charge for an exchange of *shares* in one *sub-fund* for *shares* in another *sub-fund*.
- (3) For an *umbrella scheme* which is a *single-priced AUT*, the *manager* must not make any charge on an exchange of *units*:
 - (a) if the exchange is the first to be made by the *unitholder* during any *annual accounting period*;
 - (b) in the case of a second or subsequent exchange, unless:
 - (i) such a charge is authorised by the *trust deed*; and
 - (ii) the amount of the charge is within the maximum for charging on such an exchange stated in the most recently published *prospectus*.

8.3 Restrictions and other requirements relating to payments: ICVCs

Promotional payments

- 8.3.1 **R** /1 No payment or benefit, other than a payment or benefit to the *ACD* not prohibited by any other of the *rules* in this sourcebook, may be made out of or given at the expense of the *scheme property* to any *person* in consideration of that *person* acquiring (whether directly, indirectly, absolutely or conditionally) or promoting the *sale* of, or agreeing so to acquire or to promote the *sale* of, *shares* in the *ICVC*.

Performance fees

- 8.3.2 **R** /1 No payment may be made out of the *scheme property* of an *ICVC* and no *redemption charge* may be made if the amount or frequency of the payment or the amount of the *redemption charge* is intended to depend upon fluctuations in:
- (1) the value of the *scheme property*; or
 - (2) the income attributable to it; or
 - (3) the *price* of a *share* of any *class*,
- as compared with fluctuations in the value or price of property of any description or in an index or other factor designated for the purpose.

Movable and immovable property

- 8.3.3 **R** /1 An *ICVC* (other than a *property scheme*) must not incur any expense for the use by it of any movable or immovable property except to the extent that such property is necessary for the direct pursuit of its business.

Set up costs

8.3.4

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- (1) When (2) applies, costs of the *authorisation* and incorporation of an *ICVC* and of its *initial offer* or *issue of shares* (or *initial offer* or *issue of shares* in respect of a *sub-fund*) may, subject to *CIS* 8.3.1R (Promotional payments), be amortised over a period not exceeding five years.
- (2) Amortisation under (1) is only permitted if, on or before 30 November 2000, it had commenced and been disclosed in the *prospectus*.

Allocation of payments to capital or income

8.3.5

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- (1) Any *broker's commission*, fiscal charges and other disbursements, which are necessary to be incurred in effecting transactions for the *ICVC*, and normally shown in contract notes, confirmation notes or difference accounts, may be charged to the *capital account*.
- (2) Any:
 - (a) interest on borrowings and charges incurred in effecting, terminating, negotiating or varying the terms of borrowings;
 - (b) taxation and duties payable in respect of *scheme property*; and
 - (c) costs of the types described in *CIS* 8.3.4R (Set up costs);
 may be paid from *capital property* or *income property* as the *ICVC* considers appropriate.
- (3) All other payments out of the *scheme property* must be made from *income property* in the first instance, but a transfer of the debit item from the *income account* to the *capital account* may be made if the expense is considered to be capital in nature.
- (4) The *ACD* and the *depository* may agree that all or any part so agreed of:
 - (a) any payments permitted by *CIS* 8.2.3R (Payments by an *ICVC* to the *ACD*); and
 - (b) any other charges and expenses of the *ICVC*;
 may be treated as a capital expense and, if met from the *income account* in the first instance, a transfer of the relevant debit made from the *income account* to the *capital account*.

8.4 Other liabilities: ICVCs and AUTs

Payment of liabilities on transfer of assets

8.4.1

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- (1) Where the property of a *body corporate* or of another *collective investment scheme* is transferred to an *authorised fund* (or to the *depository* for the account of the *authorised fund*) in consideration of the *issue of units* in the *authorised fund* to *shareholders* in that *body corporate* or to *holders* in that other *scheme*, (2) applies.
- (2) The *ICVC* (or its *depository*) or the *trustee* of the *AUT* as the successor in title to the property transferred, may pay out of the *scheme property* any liability arising after the transfer which, had it arisen before the transfer, could properly have been paid out of the property transferred, but only if:
 - (a) there is nothing in the *instrument constituting the scheme* of the *authorised fund* expressly forbidding the payment; and
 - (b) the *directors* of the *ICVC*, or the *manager* of the *AUT*, are, or is, of the opinion that proper provision was made for meeting such liabilities as were known or could reasonably have been anticipated at the time of the transfer.

Tax

8.4.2

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The restrictions contained in this chapter do not affect any liability for any value added or similar tax related to a charge or expense, but any notice given in accordance with this chapter and any statement in a *prospectus* relating to any charge or expense payable out of the *scheme property* or by any *shareholder* or potential *shareholder* must, if the *person* liable for the charge or expense may also be liable for such tax, contain a statement to this effect.

8.5 Charges and other payments: AUTs

Managers periodic charges

8.5.1

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- (1) The only payment which may be made to the *manager* out of the *scheme* property by way of *remuneration* for the *manager's* services is a periodic charge (and value added tax on it if any) arrived at and accruing under this *rule* (CIS 8.5.1R).
- (2) A periodic charge is payable only where its payment is authorised by the *trust deed*.
- (3) The amount of periodic charge is calculated by the *manager* as follows:
 - (a) take the *scheme property* at the *valuation point* coinciding with or immediately before the start of the relevant *accrual interval*;
 - (b) take the value (or for a *dual-priced AUT* take the average of the *issue* and *cancellation* valuations) of the *scheme property* as at the point at (a);
 - (c) multiply that value (or in the case of a *dual-priced AUT* multiply the average at (b)) by a fraction (or "rate") not exceeding the maximum percentage (for example, 1/100) arrived at under (4);
 - (d) divide the resulting figure by 365 (366 in a leap year); and
 - (e) multiply the result of the division at (d) by the number of *days* (including fractions of a *day*) in the *accrual interval*.
- (4) The maximum percentage in (3)(c) is:
 - (a) if the *accrual interval* is the first since inception, the annual percentage stated in the original *prospectus* as the rate of the *manager's* periodic charge;
 - (b) if it is not the first *accrual interval* since inception, either:

- (i) the rate actually used at (3)(c) for the previous *accrual interval*; or
 - (ii) a higher rate (still however not exceeding the maximum to the rate of the *manager's* periodic charge stated in the *trust deed*) which the *manager* is permitted to use if it complies with (5).
- (5) The *manager* may not rely on any increase in the maximum percentage unless not less than 90 *days* before implementing the increase:
- (a) it has given notice in writing to the *trustee* and to the *unitholders* of its intention to increase the amount currently charged by way of periodic charge; and
 - (b) it has revised the *prospectus* to reflect the proposed increase in that amount.

Redemption charge: single-priced AUTs

8.5.2

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- (1) In the case of a *single-priced AUT* the *manager* may, if the *trust deed* permits, make a *redemption charge* for its own benefit.
- (2) (a) A *redemption charge* must not exceed the amount or rate of *redemption charge* stated in the *prospectus* current at the date when the relevant *units* were issued, other than to the *manager*, or sold; and
 - (b) the amount or rate referred to in (a) may be expressed as diminishing over the time during which the *unitholder* has held the *units*, but may not be expressed as liable to vary in any other respect.
- (3) In (2) and (7), “issued” or “sold” in the case of *units* in a *scheme* which has absorbed the whole or part of the property of another *scheme*, is (when relevant) a reference to the *issue* or *sale* of *units* in that other *scheme* so far as it is practicable for the *manager* to ascertain the timing of that *issue* or *sale* as opposed to the *issue* of other *units* held by that *holder*.
- (4) The *manager* must not introduce a *redemption charge*, or change the rate or method of calculation of a current *redemption charge*, in a manner which is adverse to *unitholders*, unless at least 90 *days* before the introduction or change, the *manager*:
 - (a) gave notice in writing of that introduction or change and of the date of its commencement, to the *trustee* and to all the *persons* who ought reasonably to be known to the *manager* to

- have made an arrangement for the *purchase* of *units* at regular intervals; and
- (b) has revised the *prospectus* to reflect the introduction or change and the date of its commencement and has made the revised *prospectus* available.
- (5) A modification of the rate or method which is adverse to redeeming *unitholders* (or *unitholders* selling under CIS 4.5.3R) must be limited so as to apply only to *units* which have been issued (whether at the request of the current *unitholder* or otherwise) after the date on which the modification takes effect.
- (6) Where the *trust deed*, whenever executed, is modified so as to authorise a *redemption charge*, the modification must be expressed so as to apply only to *units* issued after the date on which the modification takes effect.
- (7) In deciding whether and to what extent a charge is deductible for the purposes of this *rule*, *units* held by a *unitholder* are to be taken to be redeemed in the order in which they were issued (other than to the *manager*) or sold (whether or not to their current *unitholder*), unless:
- (a) the *manager* has the *unitholder's* instructions to the contrary; or
- (b) the *manager* selects as the *units* first to be redeemed *units* which are not subject to the deduction; or
- (c) the *manager* and the *trustee* have agreed on another way of deciding the order in which *units* are redeemed which appears to them unlikely materially to prejudice the *holder* concerned.
- (8) A *manager* must not make a *redemption charge* which might reasonably be regarded as restricting the right of *redemption*.

Control over maximum charges on issue, sale and redemptions: single-priced AUTs

8.5.3

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- (1) In the case of a *single-priced AUT* and in the circumstance envisaged by (2), an introduction of, or change to, either of the charges permitted by CIS 8.2.2R (Preliminary charge : ICVCs and single-priced AUTs) or CIS 8.5.2R (Redemption charge : single-priced AUTs) must not take effect unless:
- (a) the *trust deed* is modified under CIS 11.4.2R (Amendment to the trust deed: with meeting); or

- (b) the *prospectus* is amended following approval of the introduction or change by an *extraordinary resolution* at a meeting of the *holders* called for the purpose.
- (2) The circumstance mentioned in (1) is that (for any individual *unit* notionally issued and redeemed on the same *day*) the maximum amount or percentage of any *preliminary charge* and of any *redemption charge* would in aggregate exceed the maximum amount or percentage for the *preliminary charge* alone which is stated in the *trust deed*.

Remuneration of the trustee and reimbursement of trustees expenses

8.5.4

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- (1) No payment may be made to the *trustee* out of the *scheme property*, whether by way of reimbursement of expenses or otherwise, except:
 - (a) *remuneration* for the *trustee* in respect of its services and in respect of which the following have been stated in the *prospectus*:
 - (i) the actual amount or rate of the *remuneration* (or how this is determined);
 - (ii) the periods in respect of which the *remuneration* is to be paid;
 - (iii) how the *remuneration* is to accrue; and
 - (iv) when the *remuneration* is to be paid;
 - (b) value added tax on the *remuneration* specified in (a); and
 - (c) reimbursement of expenses properly incurred by the *trustee* in performing or arranging for the performance of the functions conferred on the *trustee* by the *rules* in this sourcebook.
- (2) Payment under (1)(a) must not be made unless authorised by the *trust deed*.

Payments out of the scheme property

8.5.5

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- (1) No payments may be made out of the *scheme property* of an *AUT* other than payments permitted by the *rules* in this sourcebook, and:
 - (a) *broker's commission*, fiscal charges and other disbursements which are:

- (i) necessary to be incurred in effecting transactions for the *scheme*; and
- (ii) normally shown in contract notes, confirmation notes and difference accounts as appropriate;
- (b) interest on permitted borrowings under the *AUT* and charges incurred in effecting or terminating such borrowings or in negotiating or varying the terms of such borrowings;
- (c) taxation and duties payable in respect of the *scheme property*, the *trust deed* or the *issue of units* and any stamp duty reserve tax charged in accordance with Schedule 19 of the Finance Act 1999 (or any statutory modification or re-enactment of it);
- (d) payments properly required, in the case of a *property scheme*, for the maintenance, repair, refurbishment, management, preservation, protection, development or redevelopment of an immovable owned or leased by the *property scheme*;
- (e) any costs incurred in modifying the *trust deed*, including costs incurred in respect of meetings of *unitholders* convened for purposes which include the purpose of modifying the *trust deed*, where the modification is:
 - (i) necessary to implement, or necessary as a direct consequence of, any change in the law (including changes in the *rules* in this sourcebook); or
 - (ii) expedient having regard to any change in the law made by or under any fiscal enactment and which the *manager* and the *trustee* agree is in the interest of *unitholders*; or
 - (iii) to remove from the *trust deed* obsolete provisions;
- (f) any costs incurred in respect of meetings of *unitholders* convened on a requisition by *unitholders* not including the *manager* or an *associate of the manager*;
- (g) the audit fee properly payable to the auditor and any proper expenses of the auditor;
- (h) the fees and expenses properly payable to the *standing independent valuer* of a *property scheme*;
- (i) the fees of the *FSA* under Schedule 1, Part III of the *Act* or the corresponding periodic fees of any regulatory authority in a country or territory outside the *United Kingdom* in which *units* in the *AUT* are or may be marketed;
- (j) any payment permitted by *CIS 8.4.1R* (Payment of liabilities on transfer of assets); and

(k) value added tax payable in connection with any of (a) to (j).

Exemptions from liability to account for profits

8.5.6

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- (1) The *manager* is not liable to account to the *trustee* or the *unitholders* for the amount of any charge properly taken in accordance with the *rules* in this sourcebook.
- (2) The *trustee* is not liable to account to the *manager* or the *unitholders* for the amount of any *remuneration* (or expenses) properly paid to the *trustee* in accordance with this chapter.
- (3) The *manager*, or another specified *affected person*, is not required to account to the *trustee*, or the *unitholders*, for any profit made on the *issue, sale, redemption or cancellation* of *units* where prominent disclosure of the non-accountability has been made in the *prospectus*.
- (4) A *person* who is an *affected person* is not liable to account either to another *affected person* or to the *unitholders* for any benefits or profits made or derived from or in connection with:
 - (a) his acting as agent for either or both of the *trustee* and the *manager* in the *sale or purchase* of property to or from the *trustee* for the account of the *AUT*; or
 - (b) his part in any transaction or the supply of services permitted by *CIS 7.10.6R* (Conflict of interests); or
 - (c) his dealing in property equivalent to any owned by (or dealt in for the account of) the *AUT*.

Allocation of payments to capital or income

8.5.7

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- (1) In the case of an *AUT*, any payments permitted by this chapter (except under *CIS 8.5.5R(1)(a), (b) or (c)* (Payments out of the scheme property)) must be made from the *income account* in the first instance.
- (2) Any payment under *CIS 8.5.5R(1)(a)* must be made from the *capital account*; and any payment under *CIS 8.5.5R(1)(b) or (c)* must be made from the *capital account* or the *income account* as the *trustee* having taken reasonable care determines is appropriate in accordance with the governing law of trusts.
- (3) Following a payment made from the *income account* under (1) or (2), a transfer of the debit item from the *income account* to the *capital account* may be made:

- (a) if the *manager* and the *trustee* agree that the payment is for an item of expense which is capital in nature; and
 - (b) if the governing law of trusts allows.
- (4) The *manager* and the *trustee* may agree that all or any agreed part of:
- (a) any charge permitted by CIS 8.5.1R (Manager's periodic charge); and
 - (b) any payments permitted to be made out of the *scheme property* by CIS 8.5.4R (Remuneration of the trustee and reimbursement of trustee expenses) or CIS 8.5.5R (Payments out of the scheme property);

may be treated as a capital expense and, if met from the *income account* in the first instance, a transfer of the relevant debit made from the *income account* to the *capital account*.

- (5) Where the *trustee* considers that there are insufficient funds to cover any payments made, or to be made, from the *income account* under (1) or (2), a transfer of *credit* to the *income account* from the *capital account* may be made to meet these payments. The *credit* must be re-transferred as soon as sufficient funds are available in the *income account* in respect of the same *annual accounting period*.
- (6) Where, in respect of any *annual accounting period*, taken as a whole, the amount of income received or receivable is less than the net amount of payments made from the *income account*, the shortfall must, as from the end of that period, be charged to the *capital account* and must not subsequently be transferred to the *income account*.

Chapter 9

Income





9.1 Introduction

Application

9.1.1 **R** ^{/1} The *rules and guidance* in this chapter apply in accordance with *CIS 9.1.3R* (Table of application).

Purpose

9.1.2 **G** ^{/1} This chapter assists in achieving the *regulatory objective* of protecting consumers, in particular by providing common standards relating to the periodic distribution of income (or, in the case of *accumulation shares* or *accumulation units*, the credit of the income to capital), and the calculation of the amount of that income.

9.1.3 **R** ^{/1} Table Table of application
This table belongs to [*CIS 9.1.1*]

Paragraph or section number	ICVC	ACD	Any other directors of the ICVC	Depositary of the ICVC	Manager	Trustee
9.1	X	X	X	X	X	X
9.2.1R–9.2.2R	X	X			X	
9.2.3R(1)–(2)		X	X			X
9.2.3R(3)		X	X		X	
9.2.3R(4)–(6)		X			X	
9.2.4R		X			X	
9.2.5R(1)		X		X		
9.2.5R(2)						X
9.2.5R(3)		X	X		X	X
9.2.6R		X	X	X	X	X
9.2.7G		X	X	X	X	X
9.2.8R		X			X	
9.2.9R(1)	X	X				
9.2.9R(2)				X	X	X
9.2.10R					X	X
9.2.11R					X	X

Note: "X" means "applies".

9.2 Requirements

Accounting period

9.2.1

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- (1) *An authorised fund must have an annual accounting period and a half-yearly accounting period, in accordance with (3) to (7).*
- (2) *An authorised fund must also have an accounting reference date.*
- (3) *The first annual accounting period must begin:*
 - (a) *where the authorised fund makes an initial offer, on the first day of the period of the initial offer; or*
 - (b) *in any other case, on the date on which an authorisation order for the authorised fund comes into effect;*

and each subsequent period must begin immediately after the end of the one before.
- (4) *Each annual accounting period must end either at the end of the day determined under (5) or, if the authorised fund manager so decides, at the valuation point last preceding the end of that day.*
- (5) *The day for the end of the annual accounting period referred to in (4) is:*
 - (a) *the next accounting reference date after the beginning of the period in question; or*
 - (b) *the next but one accounting reference date if:*
 - (i) *that period is the first period, or a period in the course of which a change in the accounting reference date takes place;*
 - (ii) *the next accounting reference date is less than six months after the beginning of the period; and*
 - (iii) *the authorised fund manager so determines after consulting the auditor.*

- (6) A *half-yearly accounting period* is a period beginning with the first *day* of an *annual accounting period* and ending on the *day* which is:
- (a) six months before the next *accounting reference date*; or
 - (b) if the next *accounting reference date* is less than six months after that first *day*, six months before the next *accounting reference date* but one after that first *day*.
- (7) If the *authorised fund manager* notifies the *depository* that a particular *annual accounting period* or *half-yearly accounting period* is to end on a specified *day*, which is not more than seven *days* after, and not more than seven *days* before, the *day* on which the period would otherwise end under (4), (5) and (6), that notice is to have effect provided it was given before the *day* on which the period would otherwise end.

Annual income allocation date

9.2.2

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- (1) An *authorised fund* must have an *annual income allocation date*, which is the date in any year stated in the most recently published *prospectus* as the date on or before which, in respect of each *annual accounting period*, an allocation of income is to be made.
- (2) The *annual income allocation date* must be a date within four calendar months after the relevant *accounting reference date*.

Annual allocation of income

9.2.3

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- (1) As at the end of each *annual accounting period*:
 - (a) in the case of an *ICVC*, the *directors* must arrange for the *depository* to transfer;
 - (b) in the case of an *AUT* the *trustee* must transfer;

the *income property* of the *authorised fund* to the *distribution account*.
- (2) In the case of an *ICVC*, the *directors*, and in the case of an *AUT*, the *trustee* (after consulting the *manager*), need not comply with (1) if it appears to them, or it, that the average of the allocations of income to the *holders* (disregarding *holders* of *bearer certificates* and *holders* who are the *authorised fund manager* or the *depository* or *associates* of either of them) would be less than £10 (or the equivalent amount in the *base currency*).

- (3) Any income that, under (2), is not transferred to the *distribution account* must either:
- (a) be carried forward to the next accounting period and be regarded as received at the start of that period; or
 - (b) be credited to capital, as determined by, in the case of an ICVC, its *directors*, or, in the case of an AUT, the *manager*.
- (4) On or before each *annual income allocation date* the *authorised fund manager* must calculate the amount available for income allocation for the immediately preceding *annual accounting period* and must inform the *depository* of that amount.
- (5) The amount available for income allocations is calculated by:
- (a) taking the aggregate of the *income property* received or receivable for the account of the *authorised fund* in respect of the period;
 - (b) for an ICVC:
 - (i) deducting the charges and expenses of the ICVC paid or payable out of *income property* in respect of the period; and
 - (ii) adding the ACD's best estimate of any relief from tax on those charges and expenses;
 - (c) for an AUT:
 - (i) deducting the aggregate of the *manager's* and *trustee's remuneration* and other payments properly paid or payable out of the *income account* in accordance with CIS 8.5.7R (Allocation of payments to capital or income – for AUTs) in respect of the period; and
 - (ii) adding the *manager's* best estimate of any relief from tax on that *remuneration* and those other payments;
 - (d) making such other adjustments as the *authorised fund manager* considers appropriate (in the case of (i) and (ii) below, after consulting the auditors) in relation to:
 - (i) taxation;
 - (ii) the proportion of the *prices* received or paid for *units* that is related to income (taking account of any provisions in the *instrument constituting the scheme* relating to *income equalisation*);

- (iii) potential income which is unlikely to be received until 12 months after the income allocation date;
 - (iv) income which should not be accounted for on an accrual basis because of lack of information about how it accrues;
 - (v) any transfer between income and *capital account* under CIS 8.3.5 (Allocation payments to capital or income – for ICVCs) or CIS 8.5.7 (Allocation of payments to capital or to income - for AUTs); and
 - (e) making any other adjustments (including, in the case of an ICVC, for amortisation under CIS 8.3.4R (Set-up costs) or any reimbursement of set-up costs that the *authorised fund manager* considers appropriate after consulting the auditors.
- (6) On or before the *annual income allocation date*, the *authorised fund manager* must allocate the available income to the *units* of each *class* in *issue* taking account of the provisions of CIS 9.2.4R and CIS 9.2.5R, and:
- (a) for an ICVC, the provisions of its *instrument of incorporation* relating to the proportion of available income attributable to each *class*;
 - (b) for an AUT with both income and *accumulation units* in *issue*, the number of undivided *shares* represented by *units* of each *class* in accordance with CIS 2.6.1R (Units and classes of units in AUTs).

Annual allocation to accumulation shares or accumulation units

9.2.4

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- (1) The amount of income allocated to *accumulation shares* or *accumulation units*, with effect from the end of the *annual accounting period*, becomes part of the *capital property* and, if *shares* or *units* of any other *class* were in *issue* during that period, the interests of the *holders* of *accumulation shares* or *accumulation units* in that amount must be satisfied by an adjustment, as at the end of the period:
- (a) for an ICVC, in the proportion of the value of the *scheme property* to which the *price* of an *accumulation share* of the relevant *class* is related;
 - (b) for an AUT, in the number of undivided *shares* in the *scheme property* which an *accumulation unit* represents.
- (2) The adjustment under (1) must be such as will ensure that the *price* (for a *dual-priced* AUT, the *issue price*) of an *accumulation share* or *accumulation unit* (in the case of an ICVC, of the

relevant *class*) remains unchanged despite the transfer of income to the *capital property*.

Annual distribution to holders of income shares or income units

9.2.5

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- (1) Where the *shares in issue* in an ICVC are, or include, *income shares*, on or before each *annual income allocation date*, the ACD must give the *depository* timely instructions sufficient to enable the *depository* to distribute the income allocated to *income shares* among their *holders* and the ACD in proportion to the number of such *shares* held, or treated as held, by them respectively at the end of the relevant *annual accounting period*. The *depository* must pay the distribution in accordance with the instructions.
- (2) Where the *units in issue* of an AUT are, or include, *income units*, on or before each *annual income allocation date*, the *trustee* must distribute the income allocated to *income units* amongst their *holders* and the *manager* in proportion to the numbers of such *units* held, or treated as held, by them respectively at the end of the relevant *annual accounting period*.
- (3) In calculating the amount to be distributed under (1) or (2), the ACD under (1), or the *trustee* under (2), must:
 - (a) deduct any amounts previously allocated by way of interim allocation of income for that *annual accounting period*; and
 - (b) deduct and carry forward in the *income account* such amount as is necessary to adjust that allocation of income to the nearest one-hundredth of a penny (or the equivalent amount in the *base currency*) per *income share* or *income unit*, or such lesser fraction as the *directors* of the ICVC, or the *manager* of the AUT, may determine.

Interim allocations of income

9.2.6

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- (1) This *rule* (CIS 9.2.6R) applies if at any time the most recently published *prospectus*:
 - (a) states that an allocation of income will be made before the *annual income allocation date* in any year in respect of an *interim accounting period* within the *annual accounting period*; and
 - (b) specifies a date as the *interim income allocation date* in relation to that *interim accounting period*.

- (2) When (1) applies, CIS 9.2.3R to CIS 9.2.5R apply so as to secure the making of an interim allocation of income as if:
- (a) the *interim accounting period* in question and all previous *interim accounting periods* in the same *annual accounting period*, taken together, were the *annual accounting period*;
 - (b) the *interim income allocation date* were the *annual income allocation date*; and
 - (c) in the case of an *ICVC*, the *directors*, and in the case of an *AUT*, the *manager*, were to treat as the available amount of income for the interim allocation a sum which may be less than, but does not exceed, the amount which, in the opinion of the *ACD* or the *manager*, would be available for allocation of income if the *interim accounting period* and all previous *interim accounting periods* in the same *annual accounting period*, taken together, were an *annual accounting period*.

Income equalisation

9.2.7

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The *instrument constituting the scheme* may provide that an allocation of income (whether annual or interim) be made in respect of each *unit* issued or sold during the accounting period in respect of which that income allocation is made, and may include *income equalisation*. An allocation of income should not include *income equalisation* except in accordance with any such provision.

Tax certificates

9.2.8

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The *authorised fund manager* must ensure that tax certificates for the income available for allocation are sent or given in accordance with the requirements for the time being of the Board of Inland Revenue, but in any event not less than once for every *annual accounting period*.

Unclaimed distributions

9.2.9

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Any distribution payment that remains unclaimed must:

- (1) for an *ICVC*, not be forfeited and revert to the *ICVC*, except in accordance with a provision of the *instrument of incorporation* for forfeiture and reversion to the *ICVC* of a distribution unclaimed during the period of six years (or such longer period as may be stated in the provision) after the distribution became due for payment; or

- (2) for an *AUT*, after a period of six years from the date of payment, be transferred to and become part of the *capital property* and thenceforth neither the payee nor the *holder* nor any successor in title to it will have any right except as part of the *capital property*.

Payment of distributions to joint holders (AUTs only)

9.2.10

R

Distributions made to the first named joint *holder* on the *register* will be as effective a discharge to the *trustee* and *manager* as if the first named joint *holder* had been a sole *holder*.

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Income derived from stock lending (AUTs only)

9.2.11

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(1) Where the *scheme property* of an *AUT* is used in *stock lending* transactions under *CIS 5.14*, any income derived from the transaction must form part of the *scheme property*, after deduction of:

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- (a) any income payable, immediately or otherwise, to the counterparty or for his account according to the transaction; and
- (b) any reasonable expenses of the *trustee* or *manager* (or reasonable charges of any *custodian*) associated with the transaction.

Chapter 10.

Report and Accounts

10.

10.1 Introduction

Application

- 10.1.1** **R** _{/1} This section applies to *authorised fund managers, depositaries, directors of an ICVC* and auditors.

Application : guidance

- 10.1.2** **G** _{/1} The *persons* to whom each *rule* and *guidance* in this chapter applies are stated either at the beginning of the *rule* or *guidance* or at the beginning of the section that contains the *rule* or *guidance*.

Purpose

- 10.1.3** **G** _{/1} In line with *Principle 7* (Communication with clients), this chapter requires *directors of ICVCs* and *managers of AUTs* to prepare annual and half-yearly reports to *holders* and prospective *holders*, containing up-to-date and good quality information on the progress of the *authorised fund's* investments, their costs, expenses and other related financial information.

Contents of this chapter

- 10.1.4** **G** _{/1}
- (1) This chapter covers the contents of reports on *authorised funds*, including the annual reports of the *depository* and of the auditor, and builds upon the requirements in *CIS 9* (Income), which provides how the *annual accounting periods* and *half-yearly accounting periods* are to be determined.
 - (2) This chapter requires the accounts contained in the annual and half-yearly reports to comply with the Statement of Recommended Practice, Financial Statements of Authorised *open-ended investment companies*, issued by the *FSA* in November 2000 (“SORP relating to Authorised *open-ended investment companies*”) (for a report on an *ICVC*) or with the Statement of Recommended Practice, Financial Statements of *Authorised unit trust schemes*, issued by *IMRO* in January 1997 (“SORP relating to *Authorised unit trust schemes*”) (for a report on an *AUT*).
 - (3) Finally, this chapter permits, in specified circumstances, the accounts contained in an annual or half-yearly report to be in a short form. However, this does not

discharge the *directors* of an *ICVC* or the *manager* from preparing reports with full accounts.

10.2 Preparation of annual and half-yearly reports

Preparation by the manager of an AUT of annual and half-yearly reports

10.2.1

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- (1) This *rule* (CIS 10.2.1R) applies to a *manager* of an *AUT*.
- (2) The *manager* must, in relation to each *annual accounting period* and *half-yearly accounting period*, prepare a report in respect of the period concerned.
- (3) Where an *AUT's* first *annual accounting period* is a period of less than 12 months, a half-yearly report need not be prepared for any part of that period.

Preparation by the directors of an ICVC of annual and half-yearly reports

10.2.2

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- (1) This *guidance* (CIS 10.2.2G) applies to the *directors* of an *ICVC*.
- (2) Requirements for the preparation of annual and half-yearly reports are contained in the *OEIC regulations*. Those regulations make the *directors* of an *ICVC* responsible for the preparation of annual and half-yearly reports on the *ICVC* (see regulation 66 (Reports: preparation)). A half-yearly report need not be prepared where an *ICVC's* first *annual accounting period* is less than 12 months.
- (3) The *OEIC regulations* (regulation 66 Reports: preparation), regulation 67 (Reports: accounts) and regulation 68 (Reports: voluntary revision) also contain a number of other requirements relating to reports and accounts of an *ICVC*. These include, for example, requirements that:
 - (a) the *directors* must lay copies of the annual report before the *ICVC* in general meeting; and
 - (b) every annual report is to contain accounts of the *ICVC* and a report by the auditor to the *ICVC's shareholders*.

10.3 Contents of annual and half-yearly reports

Application

- 10.3.1** **R** ^{/1} This section (*CIS 10.3*) applies to the *directors* of an *ICVC* (for a report on an *ICVC*) and to the *manager* (for a report on an *AUT*), except *CIS 10.3.7R* (Duty of the *ACD*), which applies only to the *ACD*.

Explanation

- 10.3.2** **G** ^{/1} This section sets out the contents of each annual and half-yearly report. It sets the scene for *CIS 10.4* (Information to be included in annual and half-yearly reports). That section outlines some more detailed information, which must be included in reports on *authorised funds*. In particular, it distinguishes between requirements to be included in reports on *umbrella schemes* and reports on other categories of *authorised funds*.

Annual reports

- 10.3.3** **R** ^{/1} (1) An annual report on an *authorised fund* other than an *umbrella scheme* must contain:
- (a) full accounts for the *annual accounting period* which must, subject to the *rules* in this chapter, include all the matters required to be included in them by the Statement of Recommended Practice relating to *Authorised open-ended investment companies* or by the Statement of Recommended Practice relating to *authorised unit trust schemes*. Accordingly, references to those accounts (and to short form accounts mentioned in *CIS 10.3.6R*) are not to be construed to relate only to the balance sheet and the statement of total return;
 - (b) the information required to comply with *CIS 10.4.2R* and *CIS 10.4.5R* (Comparative table);
 - (c) (for an annual report on an *ICVC*) the report of the *depository* referred to in *CIS 10.4.6R* (Report of the depository of an *ICVC*) or (for an annual report on an *AUT*) the report of the

- trustee* referred to in CIS 10.4.7R (Report of the trustee of an AUT); and
- (d) the report of the auditor referred to in CIS 10.4.8R (Report of the auditor).
- (2) An annual report on an *umbrella scheme* must contain:
- (a) reports relating to each of its *sub-funds* which must, so far as practicable, contain the accounts and the information that would be required by (1)(a) and (1)(b) if each *sub-fund* were a separate *authorised fund*;
- (b) an aggregation of the accounts required by (a); and
- (c) except as contained in a report relating to a *sub-fund* in accordance with (a):
- (i) the information referred to in (1)(b);
- (ii) (for an annual report on an *ICVC*) the report of the *depository* referred to in CIS 10.4.6R (Report of the depository of an *ICVC*) or (for an annual report on an *AUT*) the report of the *trustee* referred to in CIS 10.4.7R (Report of the trustee of an *AUT*); and
- (iii) the report of the auditor referred to in CIS 10.4.8R (Report of the auditor).
- (3) An annual report relating to a *sub-fund* which is not part of a report under (2) must contain:
- (a) so far as practicable, the accounts and the information that would be required by (1)(a) and (1)(b) if the *sub-fund* were a separate *authorised fund*;
- (b) the copy report relating to the *umbrella scheme* referred to in (2)(c)(ii); and
- (c) the report of the auditor referred to in CIS 10.4.8R (Report of the auditor).
- (4) The *directors* of an *ICVC* or the *manager* of an *AUT* must ensure that the accounts referred to in (1)(a), (2)(a) and (3)(a) give a true and fair view of the net income and the net gains or losses on the *scheme property* of the *authorised fund* or, in the case of (2)(a) and (3)(a), *sub-fund*, for the *annual accounting period* in question and the financial position of the *authorised fund* or *sub-fund* as at the end of that period.

Half-yearly reports

10.3.4

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- (1) A half yearly report on an *authorised fund*, other than an *umbrella scheme* must contain:
 - (a) full accounts for the *half-yearly accounting period* which must, subject to the *rules* in this chapter, consist of the matters required by the Statement of Recommended Practice relating to *Authorised open-ended investment companies* or by the Statement of Recommended Practice relating to *Authorised unit trust schemes* ; and
 - (b) the information required to comply with *CIS 10.4.2R*;
- (2) A half yearly report on an *umbrella scheme* must contain:
 - (a) reports relating to each of its *sub-funds* which must, so far as practicable, contain the accounts and information that would be required by (1) if each *sub-fund* were a separate *authorised fund*; and
 - (b) an aggregation of the accounts required by (a) and, except as contained in a report relating to a *sub-fund* in accordance with (a), the information required to comply with *CIS 10.4.2R*.
- (3) A half-yearly report relating to a *sub-fund* which is not part of a report under (2) must contain so far as practicable the accounts and information that would be required by (1) if the *sub-fund* were a separate *authorised fund*.

Signing of reports

10.3.5

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- (1) Each report on an *ICVC* (other than a report prepared under *CIS 10.3.3R(2)(a)* and *CIS 10.3.4R(2)(a)*) must be signed by the *ACD*, or, if there is more than one *director* of the *ICVC*, must, following approval of the report by the board of *directors*, be signed on behalf of the board of *directors* of the *ICVC* by the *ACD* and at least one other *director*.
- (2) Each report on an *AUT* (other than a report prepared in accordance with *CIS 10.3.3R(2)(a)* or *CIS 10.3.4R(2)(a)*) must be signed by two *directors* of the *manager* or, if the *manager* has only one *director*, by that *director*.

Short form accounts in reports

10.3.6

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- (1) If the *directors* of an *ICVC* or the *manager* of an *AUT* so determine, the accounts contained in a report sent or supplied to each *holder* in accordance with *CIS 10.5.2R(2)* and (3) may be

short form accounts except to the extent that, in respect of any particular accounting period, a *holder* (or for joint *holders*, the first named) has requested that a report containing the full accounts of the *authorised fund* or *umbrella scheme* be sent or supplied to him.

- (2) An annual report that contains short form accounts in accordance with (1) must contain:
 - (a) the statement and any report required under *CIS* 10.4.4R (Report of the directors or report of the manager: short form accounts); and
 - (b) the auditor's statement required under *CIS* 10.4.9R instead of the report of the auditor referred to in *CIS* 10.4.8R, unless the latter is qualified, in which case the annual report must contain both.
- (3) Short-form accounts must comply with the relevant requirements of the Statement of Recommended Practice mentioned in *CIS* 10.3.3R(1)(a).
- (4) Accounts to be included in a report to be published or offered in accordance with *CIS* 10.5.2R (Publication of reports), *CIS* 10.5.3R (Reports to be offered to purchasers of units) or *CIS* 10.5.4R (Publication of availability of reports and prospectus) may only be short form accounts to the extent permitted by (1), (2) and (3).

Duty of the ACD

10.3.7

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The ACD must ensure that each annual and half-yearly report (including any accounts to be contained in it) complies with *CIS* 10.3.3R (Annual reports), *CIS* 10.3.4R (Half yearly reports), *CIS* 10.3.5R (Signing of reports) and (where applicable) with *CIS* 10.3.6R (Short form accounts in reports).

10.4 Information to be included in annual and half-yearly reports

Application

10.4.1

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This section (CIS 10.4) applies to the *directors* of an *ICVC* (for a report on an *ICVC*) or to the *manager* (for report on an *AUT*), except:

- (1) CIS 10.4.6R (Report of the depositary of an *ICVC*) which applies only to the *depositary* of an *ICVC*;
- (2) CIS 10.4.7R (Report of the trustee of an *AUT*) which applies only to the *trustee* of an *AUT*; and
- (3) CIS 10.4.8R (Report of the auditor) and CIS 10.4.9R (Auditor's statement relating to short form accounts) which apply to the auditors of the *authorised fund*, appointed in accordance with paragraph (4) of Schedule 5 of the *OEIC regulations* (for an *ICVC*) or appointed under CIS 7.8.5R (for an *AUT*).

Report of the directors of an *ICVC* or report of the manager of an *AUT*

10.4.2

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The matters set out in (1) – (15) must be included in each report of the *directors* (for a report on an *ICVC*) and in each report of the *manager* (for a report on an *AUT*), except where otherwise indicated:

- (1) the names and addresses of :
 - (a) the *authorised fund manager*;
 - (b) the *depositary*;
 - (c) the *registrar*;
 - (d) any *investment adviser*;
 - (e) the auditor; and
 - (f) for a *property scheme*, the *standing independent valuer*;

- (2) (for a report of the *directors*), the names of any *directors* other than the *ACD*;
- (3) a statement that :
 - (a) (for a report of the *manager*) the *AUT* is an *authorised unit trust scheme* under section 243 of the *Act* (*Authorisation orders*); or
 - (b) (for a report of the *directors*) the *ICVC* is an *investment company with variable capital* under regulation 12 (*Authorisation*) of the *OEIC regulations*;
- (4) (for a report of the *directors*) a statement that the *shareholders* of the *ICVC* are not liable for the debts of the *ICVC*;
- (5) a statement as to which of the categories of *authorised fund* in *CIS 2.1.4R* (*Constitution*) the *authorised fund* belongs;
- (6) the investment objectives of the *authorised fund*;
- (7) the *ICVC's* (for a report of the *directors*) or *manager's* (for a report of the *manager*) policy for achieving those objectives;
- (8) a review of the *ICVC's* (for a report of the *directors*) or *manager's* (for a report of the *manager*) investment activities during the period to which the report relates;
- (9) where the *directors* of an *ICVC* or the *manager* of an *AUT* have determined that the accounts contained in the report should be short form accounts, a statement that a report containing the full accounts is available on request;
- (10) particulars of any significant change in the *prospectus* made since the date of the last report;
- (11) particulars of any significant change in the *instrument constituting the scheme* made since the date of the last report;
- (12) a statement of any sub-division or consolidation of *units* which has been effected during the period to which the report relates (but, for an *ICVC*, other than any as between smaller and *larger denomination shares* effected under *CIS 2.5.2G* (*Characteristics of larger and smaller denomination shares*));
- (13) any other significant information which would enable *holders* to make an informed judgement on the development of the activities of the *authorised fund* during this period and the results of those activities as at the end of that period;
- (14) for a report of the *directors* included in a report on an *umbrella scheme* (prepared in accordance with *CIS 10.3.3R(2)* or *CIS*

10.3.4R(2)), a statement to the effect that, as a *sub-fund* is not a legal entity, if the assets attributable to any *sub-fund* were insufficient to meet the liabilities attributable to it, the shortfall might have to be met out of the assets attributable to one or more other *sub-funds* of the *ICVC*; and

- (15) for a report on a *sub-fund*, prepared in accordance with *CIS* 10.3.3R(3) or *CIS* 10.3.4R(3), which is not part of a report on the *umbrella scheme* of which the *sub-fund* is part:
- (a) a statement whether the auditor's report on the annual accounts of the *umbrella scheme* for the period in question was unqualified or qualified and, if it was qualified, that report in full together with any further material needed to understand the qualification;
 - (b) a statement that a report relating to the *umbrella scheme* as a whole is available from the *authorised fund manager* on request; and
 - (c) a statement equivalent to that required by (14) making it clear that the shortfall, or part of it, might have to be met out of the *sub-fund* to which the report relates.

Report of the directors or report of the manager: umbrella schemes

10.4.3

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For a report on an *umbrella scheme* prepared in accordance with *CIS* 10.3.3R(2) or *CIS* 10.3.4R(2):

- (1) the information required by *CIS* 10.4.2R(1) – (13) must be given in respect of each *sub-fund* if it would vary from that given in respect of the *umbrella scheme* as a whole; and
- (2) *CIS* 10.4.2R(5) applies as if it required a statement in respect of each *sub-fund* that it has investment powers equivalent to those of an *authorised fund* of a stated category under *CIS* 2.1.4R (Constitution).

Report of the directors or report of the manager: short form accounts

10.4.4

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A report of the *directors* of an *ICVC* or a report of the *manager* of an *AUT* containing short form accounts for any *annual accounting period* must:

- (1) state whether the report of the auditor on the full accounts was unqualified or qualified and, if it was qualified, contain a copy of that report in full together with any further material needed to understand the qualification; and

- (2) state whether the report of the auditor contained a statement under (3), (4) or (5) of CIS 10.4.8R and, if so, set out the statement or statements in full.

Comparative table

10.4.5

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Each report of the *directors* of an *ICVC* or each report of the *manager* of an *AUT* must contain a comparative table which must set out:

- (1) a performance record over the last five calendar years, or if the *authorised fund* has not been in existence during the whole of that period, over the whole period in which it has been in existence, showing:
- (a) the highest and the lowest *price* (or, for *dual-priced AUTs*, the highest *sale price* and lowest *redemption price*) of a *unit* of each *class* in *issue* during each of those years; and
 - (b) the net income distributed (or, for *accumulation units*, allocated) for a *unit* of each *class* in *issue* during each of those years, taking account of any sub-division or consolidation of *units* that occurred during that period;
- (2) as at the end of each of the last three *annual accounting periods* (or all of the *authorised fund's* annual accounting periods, if less than three):
- (a) the total net asset value of the *scheme property* at the end of each of those years;
 - (b) the net asset value per *unit* of each *class*; and
 - (c) (i) (for a report of the *directors*) the number of *units* of each *class* in *issue*; or
 - (ii) (for a report of the *manager*) the number of *units* of each *class* in existence or treated as in existence;
- (3) if, in the period covered by the table:
- (a) the *authorised fund* has been the subject of any event (such as a *scheme of arrangement*) having a material effect on the size of the *authorised fund*, but excluding any *issue* or *cancellation* of *units* for cash; or
 - (b) there have been changes in the investment objectives of the *authorised fund*;

an indication, related in the body of the table to the relevant year in the table, of the date of the event or change in the investment objectives and a brief description of its nature; and

- (4) for an *umbrella scheme*, the information required by (1) to (3) for each *sub-fund* of the *umbrella scheme*, instead of the information for the *umbrella scheme* as a whole.

Report of the depositary of an ICVC

10.4.6

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- (1) The *depositary* must make an annual report to *shareholders* which must be delivered to the *directors* in good time to enable its inclusion in the annual report.
- (2) That report must contain:
- (a) a description, which may be in summary form, of the duties of the *depositary* under CIS 7.4.1R (General duties of the depositary) and in respect of the safekeeping of the *scheme property*;
- (b) a statement whether, in any material respect,:
- (i) the *issue, sale, redemption and cancellation*, and calculation of the *price* of the *ICVC's shares* and the application of the *ICVC's income*, have not been carried out in accordance with the *rules* in this sourcebook and, where applicable, the *OEIC regulations* and the *instrument of incorporation* of the *ICVC*;
- (ii) the investment and borrowing powers and restrictions applicable to the *ICVC* have been exceeded.

Report of the trustee of an AUT

10.4.7

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- (1) The *trustee* must enquire into the conduct of the *manager* in the management of the *AUT* in each *annual accounting period* and must report on that conduct to the *unitholders*. That report must be delivered to the *manager* in good time to enable its inclusion in the annual report.
- (2) The report of the *trustee* must state whether in the *trustee's* opinion the *manager* has managed the *AUT* in that period:
- (a) in accordance with the investment and borrowing powers and restrictions applicable to the *AUT*; and
- (b) otherwise in accordance with the provisions of the *trust deed* and the *rules* in this sourcebook.

- (3) If the *manager* has not done so, the *trustee's* report must describe any material failures and the steps which the *trustee* has taken as a result of those failures.

Report of the auditor

10.4.8

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The report of the auditor to the *holders* on the accounts of the *authorised fund*, or on the aggregated accounts of the *umbrella scheme* (or for a report prepared for the purposes of CIS 10.3.3R(3), on the accounts of the *sub-fund*) must state:

- (1) whether, in the auditor's opinion, the accounts have been properly prepared in accordance with the Statement of Recommended Practice relating to Authorised *open-ended investment companies*, or the Statement of Recommended Practice relating to *authorised unit trust schemes*, the *rules* in this sourcebook, and the *instrument constituting the scheme*;
- (2) whether, in the auditor's opinion the accounts give a true and fair view of the net income and the net gains or losses on the *scheme property* of the *authorised fund* (or, as the case may be the *scheme property* attributable to the *sub-fund*) for the *annual accounting period* in question and the financial position of the *authorised fund* or *sub-fund* as at the end of that period;
- (3) if the auditor is of the opinion that proper accounting records for the *authorised fund* (or, as the case may be, *sub-fund*) have not been kept or that the accounts are not in agreement with those records, that fact;
- (4) if the auditor has not been given all the information and explanations which, to the best of his knowledge and belief, are necessary for the purposes of his audit, that fact; and
- (5) if the auditor is of the opinion that the information given in the report of the *directors* or in the report of the *manager* for that period is inconsistent with the accounts, that fact.

Auditor's statement relating to short form accounts

10.4.9

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In relation to short form accounts for any *annual accounting period*, the auditor must state whether, in the auditor's opinion, the short-form accounts are:

- (1) consistent with the full accounts;
- (2) prepared in accordance with:

- (a) the Statement of Recommended Practice relating to Authorised *open-ended investment companies* or in accordance with the Statement of Recommended Practice relating to *authorised unit trust schemes* so far as they relate to short form accounts; and
- (b) the *rules* in this sourcebook and the *instrument constituting the scheme*.

10.5 Publication and availability of annual and half-yearly reports

Application

- 10.5.1 **R** /1
- (1) CIS 10.5.2R(1), (2), (4) - (6) and CIS 10.5.3R – 10.5.4R apply to an *authorised fund manager*; and
 - (2) CIS 10.5.2R(3) applies to the *directors* of an *ICVC* (for an *ICVC*) or to the *manager* (for an *AUT*).

Publication of reports

- 10.5.2 **R** /1
- (1) The *authorised fund manager* must, within four months after the end of each *annual accounting period* and within two months after the end of each *half-yearly accounting period* respectively, publish the *annual report* and half-yearly report in accordance with (2) and (4).
 - (2) (a) The *authorised fund manager* must, subject to (3) provide free of charge:
 - (i) a copy of each annual report and each half-yearly report to each *holder* (or to the first named of joint *holders*) entered in or entitled to be entered in the *register* at the close of business on the last *day* of the relevant accounting period or *half-yearly accounting period*; and
 - (ii) a copy of the report to each *holder* of bearer *units* at his request.
 - (b) A report relating to an *umbrella scheme* to be provided under (a)(i) or (ii) need not contain an aggregation of the accounts relating to each *sub-fund*, but such information must be sent, free of charge, to any *holder* who requests it.
 - (3) For an *umbrella scheme*, if the *directors* of the *ICVC* or *manager* so determine for any accounting period, the reports provided to *holders* in accordance with (2) may be the reports complying with CIS 10.3.3R(3) or CIS 10.3.4R(3) (as the case may be) relating to

the respective *sub-fund* to which their unitholdings relate. However, if requested to do so by any *holder* in respect of any particular accounting period, the *authorised fund manager* must provide to that *holder* (or, for joint *holders*, the first named), a report complying with CIS 10.3.3R(2) or CIS 10.3.4R(2) (as the case may be).

- (4) The *authorised fund manager* must make available the most recent *annual report* (and, if more recent, the most recent half-yearly report) on the *authorised fund* in English prepared under CIS 10.3.3R (Annual reports) and CIS 10.3.4R (Half-yearly reports) for inspection by the public free of charge during ordinary office hours at a place specified for the purpose in the most recently published *prospectus*.
- (5) The *authorised fund manager* must also make the reports referred to in (4) available for the same purpose at a place designated by it in each *EEA State* other than the *United Kingdom* in which it markets *units* in the *authorised fund*, in English and in at least one of that other *EEA State's* official languages.
- (6) The *authorised fund manager* must provide a copy of each annual report and half-yearly report, any report sent or supplied in accordance with (3) and any report containing short form accounts on publication to the *FSA*.

Reports to be offered to purchasers of units

10.5.3

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- (1) Neither the *ICVC* nor the *authorised fund manager* shall effect any *issue* or *sale* of *units* to any *person* in the *United Kingdom* until it has offered that *person* free of charge a copy in English of the most recent *annual report* of the *authorised fund* and (if more recent) the most recent half-yearly report on the *authorised fund* before the conclusion of that *sale*.
- (2) Neither the *ICVC* nor the *authorised fund manager* shall effect any *issue* or *sale* of *units* to any *person* in the territory of a *EEA State* other than the *United Kingdom* until it has offered that *person* free of charge a copy, in an official language of that *EEA State*, of the most recent *annual report* on the *authorised fund* and (if more recent) the most recent half-yearly report on the *authorised fund* before the conclusion of that *sale*.

Publication of availability of reports and prospectus

10.5.4

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- (1) The *authorised fund manager* must, with every publication of *prices* in a *UK* newspaper under CIS 4.4.8R (Publications of prices) or CIS 15.4.14R (Publications of prices), publish a

statement that a copy of the most recent annual report or half-yearly report and *prospectus* is available free of charge to anyone who requests the *ICVC* or the *authorised fund manager* for it.

- (2) It will be sufficient compliance with (1) if one of the pages in which the *authorised fund manager* publishes *prices* in the newspaper carries the statement there required in relation to all, or any relevant category of, the *collective investment schemes* referred to in those pages.

Chapter 11

Meetings of holders, amendments to the scheme and service of notices

11.1 Introduction

11.1.1 **R** /1 The *rules* and *guidance* in this chapter apply in accordance with CIS 11.1.4R (Table of application).

Purpose

11.1.2 **G** /1 This chapter helps in achieving the *regulatory objective* of protecting consumers as envisaged by section 2 and 5 of the *Act*, by:

- (1) setting out specific conditions for meetings of *holders*, in particular about convening of meetings, attendance, voting rights and quorums;
- (2) giving *holders* a right to convene a meeting in certain circumstances; and
- (3) providing conditions which must be satisfied if the *instrument constituting the scheme* is to be amended.

Explanation of this chapter

11.1.3 **G** /1 This chapter deals mainly with four subjects.

- (1) Requirements relating to meetings of *holders* (see CIS 11.2 and 11.3). These *rules* are more detailed for a meeting of *unitholders* of an *AUT* (CIS 11.3) than for a meeting of *shareholders* of an *ICVC* (CIS 11.2), where detailed procedures are left to be covered by the *instrument of incorporation* of the *ICVC*;
- (2) Requirements relating to the amendment of an *instrument of incorporation* of an *ICVC* or a *trust deed* of an *AUT* (see CIS 11.4). Changes to the *prospectus* that require approval of *holders* are covered by CIS 3.4.2R (Changes to prospectus);
- (3) Requirements relating to amalgamations, reconstructions and other *schemes of arrangement* that may affect an *authorised fund* (see CIS 11.5). The conversion of an *AUT* to an *ICVC* comes within the meaning of a *scheme of arrangement*.
- (4) Requirements for the service of notices and other documents (see CIS 11.6). The Financial Services and Markets Act 2000 (Services of Notices) Regulations 2001 (SI2001/1420) contain provisions relating to the service of documents. These do not apply to the service of documents under the *rules* in CIS owing to the specific *rules* in this chapter.

11.1.4

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Table Table of application
This table belongs to [CIS11.1.1]

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Paragraph or section number	ICVC	ACD	Any other directors of an ICVC	Depositary of an ICVC	Manager	Trustee
11.1	X	X	X	X	X	X
11.2		X	X			
11.3					X	X
11.4.1G – 11.4.2R	X	X	X			
11.4.3R					X	X
11.4.4R	X	X	X		X	X
11.4.5G					X	
11.5		X	X		X	X
11.6	X	X	X	X	X	X

Note: "X" means "applies".

11.2 Meetings of shareholders

General meetings

- 11.2.1 **R** /1
- (1) The *directors* may convene a general meeting of *shareholders* at any time.
 - (2) On receipt of a requisition that complies with (3), the *directors* must immediately proceed to convene a general meeting of the *ICVC* for a date no later than eight weeks after receipt of the requisition.
 - (3) A requisition must:
 - (a) state the objects of the meeting;
 - (b) be dated;
 - (c) be signed by *shareholders* who, at that date, are registered as the *shareholders* of *shares* representing not less than one-tenth in value of all of the *shares* in the *ICVC* then in *issue*; and
 - (d) be deposited at the head office of the *ICVC*.
 - (4) A requisition may consist of several documents deposited with the *ICVC* at the same time, which must each be in similar form and signed by one or more *shareholders*.

Special meaning of shareholder

- 11.2.2 **R** /1
- (1) Unless any *share* in the *ICVC* is a *participating security*, in *CIS* 11.2.3R to *CIS* 11.2.8R (excluding *CIS* 11.2.4R(3)(a)) "*shareholders*" means:
 - (a) in the case of a registered *share*, *shareholders* on the date seven *days* before the notices of the relevant meeting are sent out, but excluding any *persons* who are known to the *ACD* not to be *shareholders* at the time of the meeting; or

- (b) in the case of bearer *shares*, *shareholders* of bearer *shares* which were in *issue* on the date seven *days* before the notices of the relevant meeting are sent out.
- (2) If any *share* in the ICVC is a *participating security*:
 - (a) a registered *shareholder* is entitled to receive a notice of meeting under CIS 11.2.3R, or a notice of adjourned meeting, if entered on the *register* at the close of business on a *day* to be determined by the ACD, which must not be more than 21 *days* before the notices of the meeting are sent out; and
 - (b) in CIS 11.2.4R(1) and CIS 11.2.5R to CIS 11.2.8R "*shareholders*" means:
 - (i) the *persons* entered on the *register* at a time to be determined by the ACD and stated in the notice of the meeting, which must not be more than 48 hours before the time fixed for the meeting; or
 - (ii) in the case of bearer *shares*, *shareholders* of bearer *shares* which were in *issue* at the time applicable under (i).

Notice of meetings

11.2.3

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- (1) *Shareholders* must be given at least 14 *days* written notice of a general meeting, inclusive of the date on which the notice is first served and the *day* of the meeting.
- (2) Paragraph (1) does not apply to notice of an adjourned meeting.
- (3) The accidental omission to give notice to, or the non-receipt of notice by, any of the *shareholders* does not invalidate the proceedings at any meeting.

Quorum

11.2.4

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- (1) The quorum at a meeting of *shareholders* is two *shareholders*, present in *person* or by proxy or, in the case of a *body corporate*, by a duly authorised representative.
- (2) Business must not be transacted at any meeting unless the requisite quorum is present at the commencement of business.
- (3) If within half an hour from the time appointed for the meeting, a quorum is not present, the meeting:
 - (a) if convened on the requisition of *shareholders*, must be dissolved; and

- (b) in any other case, must stand adjourned to:
 - (i) a *day* and time which is seven or more *days* after the *day* and time of the meeting; and
 - (ii) a place to be appointed by the chairman (if a chairman has been appointed in accordance with the *instrument of incorporation*) or otherwise by the *directors*.
- (4) If, at an adjourned meeting under (3)(b), a quorum is not present within 15 minutes from the time appointed for the meeting, one *person* entitled to be counted in a quorum present at the meeting is a quorum.
- (5) Notice of any adjourned meeting of *shareholders* must be given to *shareholders*. That notice must state that one or more *shareholders* present at the adjourned meeting (whatever their number and whatever the number of *shares* held by that *shareholder* or *shareholders*) will form a quorum.

Resolutions

11.2.5

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- (1) Except where an *extraordinary resolution* is specifically required or permitted by the *rules* in this sourcebook, any resolution of *shareholders* required under the *rules* in this sourcebook or under the *OEIC regulations* is passed by a simple majority of the votes validly cast for and against the resolution at a general meeting of *shareholders*. This *rule* (CIS 11.2.5R) is subject to CIS 11.2.10R(2) (Variation of class rights).
- (2) In the case of an equality of votes cast (whether on a show of hands or on a poll) in respect of a resolution put to a general meeting, any chairman appointed in accordance with the *instrument of incorporation* is entitled to a casting vote in addition to any other vote the chairman may have.

Voting rights

11.2.6

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- (1) On a show of hands every *shareholder* who:
 - (a) (if an individual), is present in person; or
 - (b) (if a *body corporate*), is present by its representative duly authorised in that regard;has one vote.
- (2) On a poll:

- (a) votes may be given either personally or by proxy or in any other manner permitted by the *instrument of incorporation*;
 - (b) the voting rights attached to each *share* must be the proportion of the voting rights attached to all of the *shares in issue* that the *price* of the *share* bears to the aggregate *price* or *prices* of all of the *shares in issue*:
 - (i) if any *share* in the ICVC is a *participating security*, at the time determined under CIS 11.2.2R(2) (Special meaning of shareholder);
 - (ii) otherwise at the date specified in CIS 11.2.2R(1); and
 - (c) a *shareholder* entitled to more than one vote need not, if he votes, use all his votes or cast all his votes in the same way.
- (3) For joint *shareholders* of a *share*, the vote of the senior who votes, whether in *person* or by proxy, must be accepted to the exclusion of the votes of the other joint *shareholders*. For this purpose, seniority must be determined by the order in which the names stand in the *register of shareholders*.
- (4) (a) No *director* of the ICVC is entitled to be counted in the quorum of, and no *director* nor any *associate* of the *director* is entitled to vote at, any meeting of the ICVC.
- (b) The prohibition in (a) does not apply to any *shares* which the *director* or its *associate* holds on behalf of, or jointly with, a *person* who, if himself the registered *shareholder*, would be entitled to vote and from whom the *director* or its *associate* (as the case may be) has received voting instructions.
- (c) Therefore, for the purpose of CIS 11.2.4R (Quorum) and CIS 11.2.7R (Right to demand a poll), *shares* held, or treated as held, by any *director*, must not, except as mentioned in (b), be regarded as being in *issue*.

Right to demand a poll

11.2.7

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A resolution put to the vote of a general meeting must be determined on a show of hands unless a poll is (before or on the declaration of the result of the show of hands) demanded:

- (1) by the chairman; or
- (2) by at least two *shareholders* (present in *person* or by proxy or, in the case of a *body corporate*, by a duly authorised representative); or

- (3) by the *depository*; or
- (4) without affecting (1), (2) or (3), in accordance with any relevant provisions contained in the *instrument of incorporation*.

Proxies

11.2.8

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- (1) A *shareholder* entitled to attend and vote at a meeting of the *ICVC* is entitled to appoint another *person* to attend and vote in his place (whether a *shareholder* or not).
- (2) Except in so far as the *instrument of incorporation* otherwise provides, a *shareholder* is entitled to appoint more than one proxy to attend on the same occasion but a proxy is entitled to vote only on a poll.
- (3) Every notice calling a meeting of the *ICVC* must contain a reasonably prominent statement that a *shareholder* entitled to attend and vote is entitled to appoint a proxy to attend and vote instead of the *shareholder*.
- (4) An instrument appointing a proxy, or any other document necessary to show the validity of, or otherwise relating to, the appointment of a proxy, must not be required to be received by the *ICVC* or any other *person* more than 48 hours before the meeting or adjourned meeting for the appointment to be effective.

Class meetings

11.2.9

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This chapter applies, unless the context otherwise requires, to *class meetings* as it applies to general meetings of *shareholders*, but by reference to the *shares* of the *class* concerned and the *shareholders* and *prices* of such *shares*.

Variation of class rights

11.2.10

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- (1) The rights attached to a *class* of *shares* must not be varied except with the sanction of a resolution passed at a *class meeting* of the *shareholders* of the *class*.
- (2) The *instrument of incorporation* may require such a resolution to be passed by more than a simple majority of the votes validly cast for and against it.



11.3 Meetings of unitholders

Convening and attendance at meetings of unitholders

11.3.1

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- (1) The *trustee* or the *manager* may, at any time, convene a meeting of *unitholders*.
- (2) The *trustee* must, on request in writing of *unitholders* registered as holding not less than one-tenth (or any proportion below one-tenth specified for this purpose in the *trust deed*) in value of the *units* in *issue*, convene a meeting of *unitholders*.
- (3) Any meeting of *unitholders* must be held at such time and place as the *trustee*, after consulting the *manager*, thinks fit.
- (4) The *manager* and *trustee* are each entitled to receive notice of and to attend every meeting of *unitholders*.

Special meaning of unitholder

11.3.2

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- (1) Unless any *unit* in the *AUT* is a *participating security*, in *CIS* 11.3.3R to *CIS* 11.3.12R, “*unitholders*” means:
 - (a) in the case of registered *units*, *unitholders* on the date seven *days* before the notices of the relevant meeting are sent out, but excluding any *persons* who are known to the *manager* not to be *unitholders* at the time of the meeting; or
 - (b) in the case of bearer *units*, *unitholders* of bearer *units* which were in *issue* on the date seven *days* before the notices of the relevant meeting are sent out.
- (2) If any *unit* in the *AUT* is a *participating security*:
 - (a) a registered *unitholder* is entitled to receive a notice of meeting under *CIS* 11.3.6R, or a notice of adjourned meeting, if entered on the *register* at the close of business on a *day* to be determined by the *manager*, which must not be more than 21 *days* before the notices of the meeting are sent out; and

- (b) in CIS 11.3.3R to CIS 11.3.12R (excluding 11.3.6R), “*unitholders*” means:
- (i) the *persons* entered on the *register* at a time to be determined by the *manager* and stated in the notice of meeting, which must not be more than 48 hours before the time fixed for the meeting; or
 - (ii) in the case of bearer *units*, *unitholders* of bearer *units* which were in *issue* at the time applicable under (i).

Power of a meeting of unitholders

11.3.3 **R** /1 A meeting of *unitholders* duly convened and held in accordance with this chapter is competent by *extraordinary resolution* to require, authorise or approve any act, matter or document in respect of which any such resolution is required or expressly contemplated by the *rules* in this sourcebook, but will not have any other powers.

The chairman

- 11.3.4 **R** /1
- (1) A meeting of *unitholders* must be presided over by a chairman, (who need not be a *unitholder*), nominated in writing by the *trustee*.
 - (2) If no such *person* referred to in (1) is nominated or if at any meeting the *person* nominated is not present within 15 minutes after the time appointed for holding the meeting, the *unitholders* present must choose one of their number to be chairman.

Adjournment

- 11.3.5 **R** /1
- (1) The chairman:
 - (a) may, with the consent of any meeting of *unitholders* at which a quorum is present; and
 - (b) must, if so directed by the meeting;adjourn the meeting from time to time and from place to place.
 - (2) Business must not be transacted at any adjourned meeting, except business which might lawfully have been transacted at the meeting from which the adjournment took place.

Notice of meetings

11.3.6

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- (1) *Unitholders* must be given at least 14 *days* written notice (or any longer period of notice specified for the purpose in the *trust deed*), inclusive of the date on which the notice is first served and the *day* of the meeting.
- (2) The notice must specify the place, *day* and hour of meeting and the terms of the resolutions to be proposed.
- (3) Unless the *trustee* has convened the meeting, a copy of the notice must be sent to the *trustee*.
- (4) The accidental omission to give notice to, or the non-receipt of notice by, any of the *unitholders* does not invalidate the proceedings at any meeting.
- (5) Notice of any adjourned meeting of *unitholders* must be given to *unitholders*. That notice must state that one or more *unitholders* present at the adjourned meeting, whatever their number, and whatever the number of *units* held by them, will form a quorum.

Quorum

11.3.7

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- (1) The quorum at a meeting of *unitholders* is the *unitholders* present in person or by proxy or, in the case of a *body corporate*, by a duly authorised representative, of one-tenth in value (or any proportion more than one-tenth in value specified for this purpose in the *trust deed*) of all the *units* in issue:
 - (a) if any *unit* in the *AUT* is a *participating security*, at the time determined under *CIS* 11.3.2R(2) (Special meaning of unitholders);
 - (b) otherwise at the date specified in *CIS* 11.3.2R(1) ;excluding from the calculation any *units* known to have been redeemed before the time of the meeting.
- (2) No business is to be transacted at any meeting unless the requisite quorum is present at the commencement of business.
- (3) If within half an hour from the time appointed for the meeting a quorum is not present, the meeting must stand adjourned to:
 - (a) a *day* and time which is 14 or more *days* after the *day* and time of the meeting; and
 - (b) a place to be appointed by the chairman.

- (4) If, at an adjourned meeting under (3), a quorum is not present within 15 minutes from the time appointed for the meeting, one *person* entitled to be counted in a quorum present at the meeting is a quorum.

Restrictions on the posing of composite resolutions to meetings of unitholders

11.3.8

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- (1) The amendments to the *trust deed* set out in (2) must not be taken to have been authorised by an *extraordinary resolution* at a meeting of *unitholders*, unless each such modification has been the subject of a separate motion for its approval which has been separately approved by an *extraordinary resolution* at that meeting.
- (2) The amendments to the *trust deed* referred to in (1) are:
- (a) an increase in the maximum of any periodic charge stated in the *trust deed*;
 - (b) an increase in the maximum of any *preliminary charge* stated in the *trust deed*; and
 - (c) an amendment to any provision in the *trust deed* that restricts:
 - (i) the kind of property in which the *scheme property* may be invested; or
 - (ii) the proportion of property to be invested in assets of any description; or
 - (iii) the description of transactions permitted; or
 - (iv) the borrowing powers of the *AUT*.

Voting rights

11.3.9

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- (1) On a show of hands every *unitholder* who:
- (a) (if an individual) is present in person; or
 - (b) (if a *body corporate*) is present by its representative duly authorised in that regard;
- has one vote.
- (2) (a) On a poll, every *unitholder* who is present in person or by proxy or, in the case of a *body corporate*, by a duly authorised representative has one vote for every complete undivided *share*

in the *scheme property* and a further part of one vote proportionate to any fraction of such an undivided *share* of which he is the *unitholder*.

- (b) A *unitholder* entitled to more than one vote need not, if he votes, use all his votes or cast all the votes he uses in the same way.
- (3) A *body corporate* being a *unitholder* may authorise such *person* as it thinks fit to act as its representative at any meeting of *unitholders* and the *person* so authorised is entitled to exercise the same powers on behalf of the *body corporate* which he represents as the *body corporate* could exercise if it were an individual *unitholder*.
- (4) For joint *unitholders*, the vote of the senior who votes, whether in *person* or by proxy must be accepted to the exclusion of the votes of the other joint *unitholders*. For this purpose seniority must be determined by the order in which the names stand in the *register* of *unitholders*.
- (5) On a poll votes may be given either personally or by proxy or in any other manner permitted by the *trust deed*.
- (6) (a) No *manager* is entitled to be counted in the quorum of, and no *manager* nor any *associate* of the *manager* is entitled to vote at, any meeting of *unitholders*.
(b) The prohibition in (a) does not apply to any *units* which the *manager* or its *associate* holds on behalf of, or jointly with a *person* who, if himself the registered *unitholder*, would be entitled to vote and from whom the *manager* or its *associate* (as the case may be) has received voting instructions.
(c) Therefore, for the purpose of this *rule* (CIS 11.3.9R) and the other *rules* in this section (CIS 11.3), the *units* held treated as held by the *manager* must not, except as mentioned in (b), be regarded as being in *issue*.

Right to demand a poll

11.3.10

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- (1) An *extraordinary resolution* put to the vote of a meeting of *unitholders* must be determined on a show of hands unless a poll is (before or on the declaration of the result of the show of hands) demanded:
 - (a) by the chairman; or
 - (b) by the *trustee*; or

- (c) by one or more *unitholders* present in person or by proxy or, in the case of a *body corporate* by a duly authorised representative, and holding or representing one-twentieth (or any proportion less than one-twentieth specified for this purpose in the *trust deed*) in value of all the *units* in *issue*:
 - (i) if any *unit* in the *AUT* is a *participating security*, at the time determined under *CIS* 11.3.2R(2) (Special meaning of unitholder: participating securities);
 - (ii) otherwise at the date specified in *CIS* 11.3.2R(1) (Special meaning of unitholder);

excluding from that calculation any *units* known to have been redeemed before the time of the meeting.

- (2) Unless a poll is demanded in accordance with (1), a declaration by the chairman that a resolution has been carried or carried unanimously or by a particular majority or lost is conclusive evidence of the fact without proof of the number or proportion of the votes recorded in favour or against such resolution.
- (3) If a poll is duly demanded, it must be taken in the manner which the chairman directs. The result of a poll is deemed to be the resolution of the meeting at which the poll was demanded.
- (4) A poll demanded on the election of a chairman or on a question of adjournment must be taken immediately; a poll demanded on any other question must be taken at the time and place which the chairman directs.
- (5) The demand for a poll must not prevent the continuance of a meeting for the transaction of any business other than the question on which the poll has been demanded.

Proxies

11.3.11

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- (1) The instrument appointing a proxy must be signed by the appointor or of his attorney duly authorised in writing or, if the appointor is a *body corporate*, either under the common seal or by an *officer* or attorney so authorised.
- (2) The instrument appointing a proxy and the power of attorney or other authority (if any) under which it is signed or a notarially certified copy of that power or authority must be deposited at the place which the *trustee*, or the *manager* with the approval of the *trustee*, may in the notice convening the meeting direct (or if no such place is appointed then at the registered office of the *manager*).

- (3) The instrument must be deposited not less than 48 hours before the time appointed for holding the meeting or adjourned meeting (or in the case of a poll before the time appointed for the taking of the poll) at which the *person* named in the instrument proposes to vote, and in default the instrument of proxy is not to be treated as valid.
- (4) No instrument appointing a proxy is valid after the expiration of 12 months from the date stated in it as the date of its execution.
- (5) A *person* appointed to act as proxy need not be a *unitholder*.
- (6) An instrument of proxy may be in the usual common form or in any other form which the *trustee* approves.
- (7) (a) A vote given in accordance with the terms of an instrument of proxy is valid in spite of:
 - (i) the previous death or incapacity of the principal; or
 - (ii) revocation of the proxy or of the authority under which the proxy was executed; or
 - (iii) the transfer of the *units* in respect of which the proxy is given;provided that no intimation in writing of that death, incapacity, revocation or transfer has been received.
- (b) Any such intimation must have been received at the place appointed for the deposit of proxies or, if no such place is appointed, at the registered office of the *manager* before the commencement of the meeting or adjourned meeting at which the proxy is used.

Minutes

11.3.12

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- (1) Minutes of all resolutions and proceedings at every meeting of *unitholders* must be made and duly entered in books to be from time to time provided for the purpose by, and at the expense of, the *manager*.
- (2) Any minute referred to in (1) purporting to be signed by the chairman of the meeting of *unitholders* is conclusive evidence of the matters stated in it.
- (3) Until the contrary is proved, every such meeting in respect of the proceedings of which minutes have been made are treated as duly held and convened and all resolutions passed at it to have been duly passed.

Class meetings

11.3.13

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- (1) If the *trustee* is of the opinion that any *extraordinary resolution* to be proposed is one in relation to which there is or might be a conflict of interest between:
- (a) the *unitholders* of *accumulation units* and the *unitholders* of *income units*; or
 - (b) in the case of an *AUT* that is an *umbrella scheme*, between the *unitholders* in one *sub-fund* and the *unitholders* in another;
- that resolution is not to be treated as duly passed, unless instead of being passed at a single meeting of all *unitholders*, it is duly passed at separate meetings respectively of the *unitholders* of *accumulation units* and *income units* or of the *unitholders* in the one *sub-fund* and *unitholders* in the other (as the case may be).
- (2) This chapter applies to each separate meeting held under (1) as it applies to other meetings.



11.4 Amendments to the instrument constituting the scheme

Explanation

11.4.1

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- (1) This section (*CIS 11.4*) outlines how amendments to the *instrument constituting the scheme* may be made.
- (2) For an *ICVC*, paragraph 5 of Schedule 2 (*Instrument of incorporation*) to the *OEIC regulations*:
 - (a) prohibits any amendment to the statements in the *instrument of incorporation* which are required by Schedule 2, paragraph 2 of the *OEIC regulations*;
 - (b) prohibits any amendment to a provision contained in the instrument of incorporation in accordance with Schedule 2, paragraph 3 of the *OEIC regulations*, unless it has been approved by a resolution of the *shareholders*; and
 - (c) permits any other amendment subject to any restriction imposed by the *rules* in this chapter.
- (3) *CIS 11.4.2R* and sub-paragraphs (1), (4) and (5) of *CIS 11.4.4R* contain the *rules* referred to in (2)(c). The *rules* relating to amendments of a *trust deed* are contained in *CIS 11.4.3R* and sub-paragraphs (2) to (4) and (6) to (8) of *CIS 11.4.4R*.

Amendment to instrument of incorporation: with meeting

11.4.2

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- (1) An amendment of a provision of the *instrument of incorporation* of an *ICVC* required to comply with paragraphs (3)(1) or (4)(1)(b) or (4)(1)(d) of Schedule 2 (*Instrument of incorporation*) to the *OEIC regulations*, must not be made except by an *extraordinary resolution*, unless:
 - (a) the amendment is to the category of the *ICVC* and is made for the purpose of *CIS 12.5.5R* (An *ICVC* with only one sub-fund); or

- (b) the amendment is to a provision required to comply with paragraph (4)(1)(d) of Schedule 2 of the *OEIC regulations* and is made solely to reflect the introduction of a new *sub-fund*.
- (2) Any other amendment of the *instrument of incorporation* must not be made except by a resolution of the *shareholders*, but this is subject to (3) and to *CIS 11.4.4R* (Amendment to the instrument constituting the scheme: without meeting).
- (3) An amendment to the *instrument of incorporation* that:
 - (a) relates to a particular *class* of *shares* or particular *classes* (and does not relate to a provision required to comply with paragraph 3(1) of Schedule 2 to the *OEIC regulations*); and
 - (b) does not prejudice the *shareholders* of any other *class*;may be made by a resolution passed at a *class meeting* or *class meetings*. That resolution must be an *extraordinary resolution* if the amendment is of a type within (1) and to which (1)(a) or (1)(b) does not apply.

Amendment to the trust deed: with meeting

11.4.3

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- (1) An amendment must not be made to the *trust deed* except by a deed, expressed to be supplemental to the *trust deed*, entered into by the *manager* and the *trustee* following:
 - (a) the calling of a meeting of *unitholders* by notice (if required under (2)); and
 - (b) the approval of a meeting of *unitholders* (if required under (3)).
- (2) The calling of a meeting is necessary unless the *manager* and *trustee* have agreed that the amendment is one which may, in accordance with *CIS 11.4.4R*, be made without the approval of a resolution.
- (3) The approval of the *unitholders* (signified by the passing at the meeting of an *extraordinary resolution* authorising the amendment) is required in any case where a meeting of *unitholders* has to be called.

Amendment to the instrument constituting the scheme: without meeting

11.4.4

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- (1) An amendment to the *instrument of incorporation* of an *ICVC* may be made by a resolution of the *directors* in any of the cases to

which (4) applies, unless CIS 11.4.2(1)R (Amendment to the instrument of incorporation: with meeting) applies.

- (2) An amendment to the *trust deed* may be made without the approval of a resolution of *unitholders*, in any of the cases to which (4), (6) or (7) applies. This is subject to:
 - (a) any restriction on the powers to amend the *trust deed* which may be contained in the *trust deed*; and
 - (b) paragraph (3).
- (3) An amendment to the *trust deed* is not within (2) if it:
 - (a) would affect any express restriction imposed by the *trust deed* on the powers which the *manager* and *trustee* or either of them would otherwise be able to exercise within the *rules* in this sourcebook; or
 - (b) would increase the maximum of any *preliminary charge* or periodic charge authorised by the *trust deed* to be made by the *manager*; or
 - (c) would relate to the authority for payments to be made out of the *scheme property* to the *trustee* by way of *remuneration* for the *trustee's* services.
- (4) This sub-paragraph (4) applies in respect of an *authorised fund*, subject to sub-paragraph (5) in the case of an *ICVC*, if the amendment is required solely:
 - (a) to implement any change in the law, including a change brought about by an amendment of the *OEIC regulations* or of the *Act* or of the *rules* in this sourcebook; or
 - (b) as a direct consequence of any such change; or
 - (c) to change the name of the *authorised fund*; or
 - (d) to remove from the *instrument constituting the scheme* obsolete provisions; or
 - (e) in the case of an *umbrella scheme*, to remove references to a *sub-fund*, following the approval of the *FSA* to a proposal to alter the *umbrella scheme* by removing that *sub-fund*; or
 - (f) to make any other change to the *instrument constituting the scheme* which the *directors* (for an *ICVC*) or the *manager* and *trustee* (for an *AUT*) consider does not involve any *holder* or potential *holder* in any material prejudice.
- (5) For an *ICVC*, (4) does not apply unless:

- (a) the *instrument of incorporation* provides for the amendment to be made by a resolution of the *directors*; and
 - (b) the amendment would not introduce or affect any provision relating to the kind of property in which the *scheme property* may be invested unless the amendment is required solely to reflect the introduction of a new *sub-fund*.
- (6) This sub-paragraph (6) applies to an *AUT*, if the amendment is required solely:
- (a) for a *relevant pension scheme* or a *relevant charitable scheme*, to preserve its status as such a *scheme*; or
 - (b) for a *relevant pension scheme*, to specify as the *scheme* or the *investment trust* in which the *AUT* is to invest, a *regulated collective investment scheme* or *eligible investment trust* which has replaced the previous *scheme* or *investment trust* as a result of a *scheme of arrangement*; or
 - (c) to include a provision to enable the *manager* to deduct a *redemption charge*, where the circumstance envisaged by CIS 8.5.3R (Control over maximum charges on issue and redemption: single-priced *AUTs*) and CIS 15.4.11R (Control over maximum charges on issue and redemption: for dual-priced *AUTs*) does not apply; or
 - (d) to replace the *manager* or the *trustee* where it has been removed or wishes to retire or has retired; or
 - (e) to include or change a provision relating to the *remuneration* of the *trustee* for its services in connection with the establishment and maintenance of a *plan register*.
- (7) This sub-paragraph (7) applies to an *AUT*, if the amendment is:
- (a) (i) solely for the purpose of applying to the *AUT* the *rules* applicable to *single-priced AUTs*; or
 - (ii) an amendment which is necessary as a result of an amendment within (i); and
 - (b) made not less than six weeks after:
 - (i) the *manager* has given notice in writing to the *unitholders* and *plan investors* of the proposed amendment and the date on which it is intended to take effect or how that date will be determined; and
 - (ii) the *manager* has revised the *prospectus* to include a statement about the proposed change from dual to single-pricing.

- (8) The notice referred to in (7)(b)(i) must include or be accompanied by suitable information on the nature and implications of the proposed change.

Matters to be included in notices sent to unitholders when a manager proposes a change from dual to single pricing

11.4.5

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- (1) CIS 11.4.4 R(8) requires any notice given to *unitholders* or *plan investors* when a *manager* proposes a change from dual to single pricing to include or be accompanied by suitable information on the nature and implications of the proposed change. Paragraph (3) of this *guidance* (CIS 11.4.5G) lists some matters which could assist *managers* in their consideration of what constitutes suitable information.
- (2) (a) The matters listed in (3) are not intended to be exhaustive, nor are they in any particular order of importance.

(b) In considering whether information is suitable, *managers* are expected to take into account the amount of information, its relevance and the manner of its presentation.

(c) The *FSA* has no objection to detailed issues being covered by reference to the *prospectus*, *key features* for the *AUT* and other documents, where these documents accompany the notice sent to *unitholders* or *plan investors*.
- (3) (a) The *manager's* reason for the change

The *manager's* reason for the proposed change should be stated.

(b) Time

The notice should state when the proposed change is intended to take effect.

(c) The system

The notice should explain the main features of the single-pricing system

(d) Differences between dual and single-pricing

The notice should outline the main differences between dual and single-pricing.

(e) *Dilution levy*

The notice should also cover *dilution*: what is it, how it will affect investors and the *manager's* policy on imposing a *dilution levy*.

(f) Impact on the investor

The notice should indicate what the implications of a change from dual to single-pricing are for investors, taking into account the particular circumstances of the *AUT* concerned.

(g) Valuation of the *scheme property*

The notice should state the major differences in the valuation of the *scheme property*.

(h) Any other material facts

The notice should state any other material facts that a *unitholder* or *plan investor* should be aware of in order to understand the implications of the intended transition.



11.5 Schemes of arrangement

Schemes of arrangement: explanation

11.5.1

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- (1) Under section 251 of the *Act* (Alteration of schemes and changes of manager or trustee) or regulation 21 of the *OEIC regulations* (The Authority's approval for certain changes in respect of a company), written notice of certain types of proposed change must be given to the *FSA*. Effect cannot be given to such a change except in accordance with that section or regulation.
- (2) One of the types of proposal that is subject to section 251 or regulation 21 is a proposal that an *ICVC* or *AUT* should be involved in a *scheme of arrangement*.
- (3) The *issue* of *units* in exchange for assets is subject to:
 - (a) *CIS* 4.3.3R (Issue and cancellation of shares by an *ICVC*);
 - (b) *CIS* 4.3.4R (Issue and cancellation of units in an *AUT*);
 - (c) *CIS* 11.5.2R (Scheme of arrangement: requirements); and
 - (d) *CIS* 15.3.5R (Issue by trustee).

Schemes of arrangement: requirements

11.5.2

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- (1) *A scheme of arrangement* must not result in *holders* of *units* in an *authorised fund* becoming *holders* of *units* in any body other than a *regulated collective investment scheme*.
- (2) For a *UCITS scheme* or a *sub-fund* of a *UCITS scheme*, (1) applies as if the reference to a *regulated collective investment scheme* excluded any *recognised scheme* other than a *scheme* recognised under section 264 of the *Act* (Schemes constituted in other EEA States).
- (3) Where, for the purpose of a *scheme of arrangement*, it is proposed that *scheme property* of an *authorised fund* should become the property of another *regulated collective investment scheme* or *sub-fund* of a *regulated collective investment scheme*, the proposal must not be implemented without the sanction of an

extraordinary resolution of the *holders of units* in the *authorised fund*, unless (4) applies.

- (4) Where, for the purposes of a *scheme of arrangement*, it is proposed that *scheme property* attributable to a *sub-fund* of an *umbrella scheme* should become the property of another *regulated collective investment scheme* or of another *sub-fund* of a *regulated collective investment scheme* (whether or not of that *umbrella scheme*), the proposal must not be implemented without the sanction of:
- (a) an *extraordinary resolution* of the *holders of units* in the *sub-fund* of that *umbrella scheme*; and
 - (b) (unless implementation of the *scheme of arrangement* is not likely to result in any material prejudice to the interests of the *holders of units* in any other *sub-fund* of that *umbrella scheme*) an *extraordinary resolution* of the *holders of units* in that *umbrella scheme*.
- (5) If it is proposed that an *authorised fund* or *sub-fund* of an *umbrella scheme* should receive property (other than its first property) as a result of a *scheme of arrangement* (or an arrangement equivalent to a *scheme of arrangement*) which is entered into by some other *collective investment scheme* or *sub-fund*, or by a *body corporate*, the proposal must not be implemented without the sanction of an *extraordinary resolution* of the *holders of units* in the *authorised fund* or (as the case may be) of the *class* or *classes of units* related to the *sub-fund* unless (6) applies.
- (6) This paragraph (6) applies if the *directors* of the *ICVC* or the *manager* and *trustee* of the *AUT* agree that the receipt of the property concerned for the account of the *ICVC* or *AUT*:
- (a) is not likely to result in any material prejudice to the interests of the *holders of units* in the *authorised fund*; and
 - (b) is consistent with the objectives of the *authorised fund* or *sub-fund*; and
 - (c) could be effected without any breach of a *rule* in *CIS 5* (Investment and borrowing powers).



11.6 Service of notices and other documents

Notices to holders

11.6.1

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- (1) Where this sourcebook requires any notice or document to be served upon a *holder*, it is duly served :
 - (a) for *units* held by a registered *holder*, if it is:
 - (i) sent by post to or left at the registered *holder's* address as appearing in the *register*; or
 - (ii) delivered by using an electronic medium in accordance with CIS 11.6.2R (Other notices); or
 - (b) for *units* for the time being represented by *bearer certificates*, if it is given in the manner provided for in the most recently published *prospectus*.
- (2) Any notice or document served by post is deemed to have been served on the second *day* following the *day* on which the letter containing the notice or document is posted, and in proving such service it is sufficient to prove that that letter was properly addressed, stamped and posted. Any notice or document left at a registered address or delivered other than by post is deemed to have been served on the *day* it was so left or delivered.
- (3) Service of a notice or document on any one of joint *holders* is effective service on the other joint *holders*.

Other notices

11.6.2

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- (1) Where this sourcebook requires any notice or document to be served or information to be given to any *person*, including the *FSA*, this must be:
 - (a) in hard copy; or
 - (b) in any other legible form, provided:

- (i) this is consistent with the *ICVC's*, the *director's*, the *authorised fund manager's* or *depository's* knowledge of how the recipient of the notice or document wishes or expects to receive the notice or document;
 - (ii) the *ICVC*, the *director*, the *authorised fund manager* or *depository* is able to produce the item in hard copy;
 - (iii) the recipient is able to know or record the time of receipt; and
 - (iv) the context does not require otherwise.
- (2) In this sourcebook, any requirement that a document be signed may be satisfied by an electronic signature or electronic evidence of assent.
- (3) This *rule* (*CIS 11.6.2R*) is subject to *CIS 4.3.6R* (Instructions or notifications between manager and trustee: for single-priced AUTs) or *CIS 15.3.10R* (Instructions or notifications between manager and trustee: for dual-priced AUTs).

Form of document or notice

11.6.3

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In this sourcebook:

- (1) *CIS 11.6.2R* does not affect any other legal requirement which may apply in relation to the form or manner of executing a document or agreement; and
- (2) references to written form include hard copy and electronically displayed or recorded information.

Chapter 12

Special Provisions for Certain Categories of Scheme



12.1 Introduction

Application

12.1.1 **R** _{/1} The *rules* and *guidance* in this chapter apply in accordance with CIS 12.1.3R.

Purpose

12.1.2 **G** _{/1} This chapter provides additional *rules* for certain categories of *scheme* so as to recognise some of their special characteristics and to further the *regulatory objective* relating to the protection of *consumers* by providing detailed procedures for such specialist funds. In some cases these special *rules* adapt *rules* elsewhere in this sourcebook.

12.1.3 **R** _{/1} Table Table of application
This table belongs to [CIS 12.1]

Paragraph or section number	ICVC	ACD	Any other directors of an ICVC	Depositary of an ICVC	Manager	Trustee
12.2		X			X	
12.3.1R		X			X	
12.3.2R		X		X	X	X
12.3.3R		X			X	
12.3.4R		X			X	
12.4		X			X	
12.5.1R	X	X	X	X	X	X
12.5.2R		X		X	X	X
12.5.3R		X			X	
12.5.4R	X	X		X	X	X
12.5.5R		X	X			
12.5.6	X	X	X	X	X	X
12.5.7	X	X	X	X	X	X
12.5.8	X	X	X	X	X	X

Note: "X" means applies.



12.2 Futures and options schemes and geared futures and options schemes

Special rules for sales and redemptions

12.2.1

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- (1) In the case of a *futures and options scheme* and a *geared futures and options scheme*, CIS 4.4.3R (Authorised fund manager's obligation to sell) and CIS 4.4.4R (Authorised fund manager's obligation to redeem) do not apply:
 - (a) in the 15 minutes immediately before a regular *valuation point*, or, if the regular *valuation points* are less than one hour apart, in the last quarter of the interval between them; and
 - (b) if the *authorised fund manager* has stated in the *prospectus* that it is not obliged to *sell* or redeem in the 15 minutes (or lesser period) immediately before a regular *valuation point*.
- (2) In the case of a *futures and options scheme* and a *geared futures and options scheme* that is a *dual-priced AUT*, CIS 15.4.3R (Manager's obligation to sell) and CIS 15.4.7R (Manager's obligation to redeem) are disapplied under the same conditions as in (1)(a) and (b).

12.3 Property schemes

Standing independent valuer

12.3.1

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- (1) An *authorised fund manager* of a *property scheme* must ensure that any immovables in the *scheme property* are valued by an *appropriate valuer (standing independent valuer)* appointed by the *authorised fund manager*. The appointment must be made with the approval of the *trustee* or *depository* at the outset and upon any vacancy.
- (2) The valuer in (1) must be:
 - (a) for an *AUT*, independent of the *manager* and *trustee*; and
 - (b) for an *ICVC*, independent of the *ICVC*, the *directors* and the *depository*.

Functions of the standing independent valuer

12.3.2

R

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- (1) The *authorised fund manager* must ensure that the *standing independent valuer* appointed under CIS 12.3.1R values all the immovables held within the *scheme property*, on the basis of a full valuation with physical inspection (including, where the immovable is or includes a building, internal inspection) at least once a year.
- (2) The *authorised fund manager* must ensure that the *standing independent valuer* values the immovables, on the basis of a review of the last full valuation, at least once a month.
- (3) If either the *authorised fund manager* or the *depository* become aware of any matter appear likely to:
 - (a) affect the outcome of a valuation of an immovable; or
 - (b) cause the valuer to decide to value under (1) instead of under (2),

the one of them becoming aware must immediately inform the *standing independent valuer* of that matter.

- (4) The *authorised fund manager* must use its best endeavours to ensure that any *affected person* reports to the *standing independent valuer* immediately upon that *person* becoming aware of any matter within (3).
- (5) Any valuation by the *standing independent valuer* must be on the basis of an ‘Open Market value’ as defined in Practice Statement 4 in the Royal Institute of Chartered Surveyors’ Appraisal and Valuation Manual (first edition published September 1995) but subject to CIS 4.8.3R(3) (Valuation: requirements).

Special rules for pricing

12.3.3

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- (1) Any valuation under CIS 12.3.2R has effect, until the next valuation under that *rule*, for the purposes of the value of immovables under CIS 4 and CIS 15.
- (2) An agreement to transfer an immovable or an interest in an immovable is to be disregarded for the purpose of the valuation of the *scheme property* unless it appears to the *authorised fund manager* to be legally enforceable.
- (3) The *rules* in Table 12.3.5R do not apply to *property schemes*.

Failure to obtain minimum subscriptions

12.3.4

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- (1) Where it appears to the *authorised fund manager* that the aggregate of *monies* paid or agreed to be paid for *units* to be issued or sold is less than £5m (or the equivalent in the *base currency*), the *authorised fund manager* must use its best endeavours to enable the *scheme* to be wound up under CIS 14 or by the court.
- (2) Paragraph (1) must be complied with either:
 - (a) immediately upon the expiry of any *initial offer*; or
 - (b) where there is no *initial offer*, within 21 *days* after the date on which *persons* are first invited to become *holders* in the *scheme*.
- (3) In so far as is practicable, the *authorised fund manager* must pay back to a *holder* any preliminary or other charge by way of *remuneration* which it received in respect of *units* issued up to the end of the period in (2)(a) or (b).

12.3.5

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Table Rules which do not apply to property schemes
This table belongs to [CIS 12.3.3]

Single-priced ICVC or AUT	Dual-priced AUT
4.2.5R	15.2.4(3)R
	15.2.4(4)(a)R
	15.2.6R
	Item 10 Table 15.8R para 10 – Valuation

Note: Item 10 is disapplied in relation to immovables.



12.4 Feeder funds and Funds of Funds

Special rules for pricing

12.4.1

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- (1) So far as is practicable, the *authorised fund manager* of a *feeder fund* must *deal* on the same basis (forward or historic) as the *regulated collective investment scheme* into which the *feeder fund* invests.
- (2) The normal *valuation point* for a *feeder fund* must be within two hours after each normal *valuation point* for the *scheme*, or *sub-fund*, into which the *feeder fund* feeds.
- (3) (1) and (2) do not apply to a *feeder fund dedicated* to a single *eligible investment trust*.

Fund of funds schemes

12.4.2

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- (1) A *fund of funds scheme* must be valued no less frequently than if it were the relevant category of *scheme* by type of investment under CIS 5.11.4R (Eligible combinations of scheme) and the *authorised fund manager* of a *fund of funds scheme* must *deal* on the basis of *forward prices* if that is required for the relevant type of *scheme* under CIS 5.11.4R.
- (2) Where a *fund of funds scheme* invests in *money market schemes* (within CIS 5.5 (Money market schemes)), (1) applies only if the *scheme* does not invest in any other category of *scheme*.

12.5 Umbrella schemes

Qualification for authorisation

12.5.1

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- (1) A proposed *ICVC umbrella scheme* does not qualify for an *authorisation order* unless each constituent *sub-fund* would, if it were the subject of a separate application for an *authorisation order*, qualify for such an *authorisation order*.
- (2) A proposed *ICVC* that is intended to be an *umbrella scheme* which is to have a *sub-fund* which would, if it were a separate *ICVC*, be a *geared futures and options scheme* or a *property scheme* does not qualify for an *authorisation order* unless each of its proposed *sub-funds* would, if it were a separate *ICVC*, be an *ICVC* of the same category as each of the other *sub-funds* of the proposed *ICVC*.
- (3) A *unit trust scheme* does not qualify to be authorised as an *umbrella scheme* unless each constituent part would, if it were the subject of a separate application for an *authorisation order*, qualify for separate *authorisation* by such an order.

Base currency

12.5.2

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Any reference in these *CIS rules* to “*base currency*” that relates to:

- (1) a valuation of a *sub-fund*; or
- (2) the *price* of a *unit* in respect of a *sub-fund*; or
- (3) a payment for a *unit*;

is to be treated as if the reference were to the currency stated in the *prospectus* as being the currency to be used for the purpose in question in relation to that *sub-fund*.

Allocation of scheme property

12.5.3 **R**
/1 In so far as any of the *scheme property* of an *ICVC* or an *AUT* that is an *umbrella scheme*, or any assets to be received as part of the *scheme property*, or any costs, charges or expenses to be paid out of the *scheme property*, are not attributable to one *sub-fund* only, the *scheme property*, assets, costs, charges or expenses must be allocated between the *sub-funds* in a manner which is fair to the *holders* of the *umbrella scheme* generally.

Income

12.5.4 **R**
/1 Except in the case of *CIS 9.2.1R* (Accounting period) and *CIS 9.2.2R* (Annual income allocation date), *CIS 9* applies as if each *sub-fund* were a separate *ICVC* or *AUT* (whichever is appropriate).

An ICVC with only one sub-fund

12.5.5 **R**
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- (1) If for a period of 24 consecutive months starting at any time after the first *issue* of a *share* of an *ICVC* which is an *umbrella scheme*, *shares* of less than two *sub-funds* are in *issue*, the *directors* must take such action as is necessary to change the category of the *ICVC* or to cause *shares* of more than one *sub-fund* to be in *issue*.
- (2) If (1) becomes, or is reasonably expected by the *directors* to become, applicable, the *ACD* must, before or immediately upon the expiration of the 24 month period, notify the *shareholders* and the *FSA* of any action proposed in order to comply with (1).
- (3) Paragraph (1) does not apply if, on or before the expiration of the 24 month period, winding up of the *ICVC* has commenced.

Other sourcebook provisions relating to umbrella schemes

12.5.6 **G**
/1 *Rules* and some of the *guidance* elsewhere in this sourcebook relate specifically to *umbrella schemes*. For ease of understanding the main provisions are referred to in *CIS 12.5.8G*.

Investment and borrowing powers

12.5.7 **R**
/1 In relation to an *authorised fund* which is an *umbrella scheme* the provisions in *CIS 5* apply to each *sub-fund* as they would for an *authorised fund*, except *CIS 5.2.13R* (Significant influence for *ICVCs*), *CIS 5.2.14R* (Significant influence for managers of *AUTs*) and *CIS 5.2.15R* (Concentration) which will apply only at the level of the *umbrella scheme*.

12.5.8

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Table Main provisions relating specifically to umbrella schemes
This table belongs to [CIS 12.5.6]

Rule/Guidance (CIS)	Subject matter
2.4.6(2)R	Rights of <i>share classes</i>
3.5.2(24)R	Information to be contained in the <i>prospectus (umbrella schemes)</i>
4.4.3(1)	<i>Authorised fund manager's obligation to sell</i>
4.7.4(2)R	Forward and historic pricing (single-pricing)
5.1.4(3)G	Explanation of <i>CIS 5</i>
Table 5.1.6G Note 2	Investment powers
5.2.12R	Investment in other <i>CIS</i>
5.2.16G	Significant influence and concentration
5.12R	General investment powers and restrictions
8.2.8R	Fee payable on switching
10.3.3(2) and (3)R; 10.3.4(2) & (3)R;	Annual and half-yearly reports
10.4.2(15) and (16)R and 10.4.3R	Report of the <i>directors/manager</i>
10.4.8R	Report of the auditor
10.5.2R(3)	Publication of reports
11.5.2R	<i>Schemes of arrangement</i>
13.1.3R(9)	Suspension and resumption of <i>dealings</i>
14.3R	Termination of a <i>sub-fund</i>
15.4.3R	<i>Manager's obligation to sell</i>
15.7.4R	Forward and historic pricing (dual-pricing)

Chapter 13

Suspension and resumption of dealings



13.1 Application

- 13.1.1 **R** /1 This chapter applies to *authorised funds* and their *authorised fund managers* and *depositories*, except for CIS 13.1.3R(10) which applies only to *ICVCs* and their *ACDs* and *depositories*.

Purpose

- 13.1.2 **G** /1 This chapter helps in achieving the *regulatory objective* of protecting investors by ensuring they do not buy or redeem *units* at a *price* that cannot be calculated accurately. For instance, due to unforeseen circumstances, it may be impossible to value, or to dispose of and obtain payment for, all or some of the *scheme property* of an *authorised fund*. CIS 13.1.3R(2) sets out the circumstances in which an *authorised fund manager* must or may suspend dealings in *units* and the manner in which a suspension is to be carried into effect.

Requirement

- 13.1.3 **R** /1
- (1) Where (2) applies, the *authorised fund manager* may, with the prior agreement of the *depository*, and must without delay, if the *depository* so requires, suspend the *issue, cancellation, sale and redemption of units* (referred to in this chapter as "*dealings in units*").
 - (2) This paragraph (2) applies if the *authorised fund manager* (or the *depository* in the case of any requirement by the *depository*) is of the opinion that due to exceptional circumstances there is good and sufficient reason in the interests of *holders* or potential *holders*.
 - (3) For the purpose of (2), the *authorised fund manager* or the *depository* (as the case may be) must have regard to the interests of all of the *holders* in the *authorised fund* and not just to the interests of the *holders* of *units* of the *class* or *classes* in which *dealings* are proposed to be suspended.
 - (4) At the time of suspension under (1), the *authorised fund manager*, or the *depository* if it has required the *authorised fund manager* to suspend *dealings* in *authorised fund units*, must:

- (a) inform the *FSA* of the suspension, stating the reason for its action; and
- (b) immediately give written confirmation of the suspension and the reasons for it to:
 - (i) the *FSA*; and
 - (ii) the authorities who are responsible for the authorisation of *collective investment schemes* in each *EEA State* in which the *authorised fund manager* holds itself out as willing to *sell* or redeem *units* of the *authorised fund* concerned, stating the reason for its actions.
- (5) During the period of a suspension, none of the obligations in *CIS 4* (Single-pricing and dealing) and *CIS 15* (Dual-pricing and dealing) relating to the *issue, cancellation, sale* or *redemption* of *units* or to the valuation of *scheme property* apply.
- (6) The suspension of *dealings* in *units* must cease as soon as practicable after the *authorised fund manager*, or the *depository*, in the case of a requirement by it, is no longer of the opinion referred to in (2), and, in any event, within 28 *days* of the commencement of the suspension.
- (7) Before the suspension of *dealings* in *units* ceases, the *authorised fund manager* must inform the *FSA* of the proposed resumption and immediately after the resumption must confirm the resumption by giving notice in writing to the *FSA* and the authorities mentioned in (4)(b)(ii).
- (8) Nothing in this chapter prevents the *authorised fund manager* from agreeing, during the period of the suspension, to *sell* or to redeem *units* or to arrange for the *authorised fund* to *issue* or cancel them at a *price* calculated by reference to the first *valuation point* after resumption of *dealings* in *units*.
- (9) This *rule* (*CIS 13.1.3R*) applies to a *sub-fund* of an *umbrella scheme* as it applies to an *authorised fund*, but by reference to the *units* of the *class* or *classes* related to the *sub-fund* and to the *scheme property* attributable to the *sub-fund*.
- (10) This *rule* (*CIS 13.1.3R*) may be applied to one or more *classes* of *share* of an *ICVC* without being applied to other *classes*, but this does not affect (3).

Suspension beyond 28 days

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The *FSA* will wish to consider the case for any suspension beyond 28 *days*. It will, if it considers it appropriate, use its powers to extend that period.

Chapter 14

Termination of Authorised funds



14.1 Introduction

Application

14.1.1 **R** /1 The *rules and guidance* in this chapter apply in accordance with *CIS 14.1.4R* (Table of application)

Purpose

14.1.2 **G** /1 This chapter helps with the *regulatory objective* of protecting *consumers*, by providing a cost effective and fair means of winding-up *authorised funds* and terminating *sub-funds* of *ICVCs*. *ENF 17* deals with the *FSA's* powers to revoke the authorisation of *authorised funds* otherwise than by consent.

Explanation of this chapter

14.1.3 **G** /1 *CIS 14.2* deals with the winding-up of a solvent *ICVC*, which under regulation 21 of the *OEIC regulations* requires written notice to and consent from the *FSA*. *CIS 14.3* deals with the termination of a solvent *sub-fund* of an *ICVC*, again under regulation 21. *CIS 14.4* deals with the winding-up of an *AUT*. *CIS 14.5* provides *guidance* on the information to be supplied to the *FSA*, in certain circumstances, when an *authorised fund manager* or *depository* seek the *FSA's* consent to terminate an *authorised fund*.

14.1.4 **R** /1 Table Table of application
This table belongs to [CIS 14.1.1]

Paragraph of Section No	ICVC	ACD	Any other directors of an ICVC	Depository of an ICVC	Manager	Trustee
14.1	X	X	X	X	X	X
14.2.1–14.2.3	X	X	X			
14.2.4		X	X			
14.2.5	X	X	X			
14.2.6	X	X	X	X		
14.2.7		X	X			
14.2.8		X				
14.2.9	X	X	X	X		
14.2.10		X				
14.2.11	X	X				

14.2.12(1)		X	X			
14.2.12(2)			X	X		
14.3.1-2	X	X	X	X		
14.3.3	X	X	X			
14.3.4		X	X			
14.3.5	X	X	X			
14.3.6	X	X	X	X		
14.3.7		X	X			
14.3.8		X				
14.3.9	X	X	X	X		
14.3.10		X				
14.4.1-2					X	X
14.4.3						X
14.4.4					X	X
14.5		X	X	X	X	X

Note: "X" means "applies"



14.2 Winding up a solvent ICVC

Explanation of CIS 14.2

14.2.1

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An *ICVC* may be wound up by the court, but, provided the *ICVC* is solvent and the steps required by the *OEIC regulations* and the conditions contained in this chapter are fulfilled, the winding up may instead be carried out under this chapter. Under regulation 21 of the *OEIC regulations* the *ICVC* must give written notice to the *FSA* of a proposal to wind up the *ICVC*. This section lays down procedures to be followed and the obligations of the *ACD* and any other *directors*. A winding up may not be carried out under these *rules* if there is a vacancy in the position of *ACD*.

14.2.2

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Table This guidance (CIS 14.2.2G) provides a summary of the main steps necessary in the winding up of a solvent *ICVC* under this chapter, assuming *FSA* approval. This table belongs to [CIS 14.2.2]

Summary of the main steps in winding up a solvent *ICVC* under *FSA* regulations, assuming *FSA* approval

Step number	Explanation	When	Rule
1	Commence preparation of solvency statement	By N	14.2.4(2)
2	Send audited solvency statement to the <i>FSA</i> with copy to <i>depository</i>	By N + 21 days	14.2.4(4) and (5)
3	Receive the <i>FSA</i> approval	N + one month	Regulation 21 of <i>ICVC regulations</i>
4	Normal business ceases; publish notices	E	14.2.5
5	Realise proceeds, wind-up, instruct <i>depository</i> accordingly	ASAP after E	14.2.6
6	Inform the <i>FSA</i> of W/U completion	ASAP after W/U complete	14.2.6(8)
7	Prepare final account + have audited	On completion of W/U	14.2.7

8	Send final account and auditor's report to the FSA + shareholders	Within 2 months of FAP	14.2.7(6)
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Notes: N = Notice to be given to the FSA under regulation 21 of OEIC regulations
 E = Effective time (CIS 14.2.5(1)R)
 W/U = winding-up
 FAP = Final accounting period (CIS 14.2.7(4)R)

When an ICVC is to be wound up

14.2.3

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- (1) An ICVC must not be wound up except under this chapter or as an unregistered company under Part V of the Insolvency Act 1986.
- (2) An ICVC must not be wound up under this chapter:
 - (a) (i) unless and until effect may be given, under regulation 21 of the OEIC regulations, to a proposal to wind up the affairs of the ICVC otherwise than by the court; and
 - (ii) unless a statement has been prepared and sent or delivered to the FSA under CIS 14.2.4R (Solvency statement) and received by the FSA prior to satisfaction of the condition in (a)(i); or
 - (b) if there is a vacancy in the position of ACD at the effective time; or
 - (c) if it is being wound up under Part V of the Insolvency Act 1986.
- (3) Subject to (2) and the subsequent provisions of this section (CIS 14.2), the appropriate steps to wind up an ICVC under this section must be taken:
 - (a) if an extraordinary resolution to that effect is passed; or
 - (b) when the period (if any) fixed for the duration of the ICVC by its instrument of incorporation expires or any event occurs, for which its instrument of incorporation provides that the ICVC is to be wound up; or
 - (c) on the date stated in any agreement by the FSA in response to a request from the directors for the revocation of the authorisation order in respect of the ICVC, even if that agreement is subject to there being no material change in any relevant factor before the date of the revocation.

Solvency statement

14.2.4

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- (1) Before a notice being given to the *FSA* under regulation 21 of the *OEIC regulations* of the proposal referred to in *CIS* 14.2.3R(2)(a), the *directors* must make a full enquiry into the *ICVC's* affairs so as to ascertain whether the *ICVC* will be able to meet its liabilities (including contingent and prospective liabilities).
- (2) On or before the giving of that notice, the *ACD* must prepare a statement, reflecting the results of the enquiry in (1), and either:
 - (a) confirming that the *ICVC* will be able to meet all its liabilities within twelve months of the date of that statement; or
 - (b) stating that such confirmation cannot be given.
- (3) The statement referred to in (2) must:
 - (a) relate to the *ICVC's* affairs at a date which must not be more than 28 *days* before the date on which that notice is given to the *FSA*; and
 - (b) if there is more than one *director*, be approved by the board of *directors* and be signed on their behalf by the *ACD* and, if it contains the confirmation under (2)(a), by at least one other *director* if there is one or, if there is no *director* other than the *ACD*, the *ACD*.
- (4) A statement which contains the confirmation under (2)(a) must annex a statement signed by the auditor appointed under Schedule 5 to the *OEIC regulations* to the effect that, in his opinion, the enquiry required by (1) has been properly made and is fairly reflected by the confirmation.
- (5) The statement referred to in (2) must be sent or delivered to the *FSA* and a copy sent to the *depository* either before, or on, or within the 21 *days* following, the date on which notice is given to the *FSA* in accordance with regulation 21 of the *OEIC regulations*.

Consequences of commencement of winding up

14.2.5

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- (1) In this chapter the "effective time" means the time at which the conditions referred to in *CIS* 14.2.3R(2)(a) and (b) are both satisfied or, if later, the time, determined in accordance with *CIS* 14.2.3R(3), at which the *ICVC* must be wound up.
- (2) Immediately following the effective time:

- (a) *CIS 4* (Single-pricing and dealing) and *CIS 5* (Investment and borrowing powers) cease to apply to the *ICVC*;
 - (b) the *ICVC* must cease to *issue* and cancel *shares*;
 - (c) the *ACD* must cease to *sell* or redeem *shares* or to arrange for the *ICVC* to *issue* or cancel them;
 - (d) no transfer of a *share* may be registered and no other change to the *register* of *shareholders* may be made without the sanction of the *directors*; and
 - (e) the *ICVC* must cease to carry on its business, except so far as may be required for its beneficial winding up; however, the corporate status and corporate powers of the *ICVC* and (subject to the preceding provisions of this *rule* (14.2.5R)) the powers of the *directors* continue until the *ICVC* is dissolved.
- (3) The *ACD* must as soon as practicable after the effective time:
- (a) publish notice of the commencement of the winding up (if the head office of the *ICVC* is situated in England and Wales or Wales) in the London Gazette, or (if the head office of the *ICVC* is situated in Scotland) in the Edinburgh Gazette; and
 - (b) if the *ACD* has not previously notified *shareholders* of the proposal to wind up, give written notice of the commencement of the winding up to the *shareholders*.

Manner of winding up

14.2.6

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- (1) The *ACD* must, as soon as practicable after the effective time, cause the *scheme property* to be realised and the liabilities of the *ICVC* to be met out of the proceeds.
- (2) The *ACD* must give instructions to the *depository* how such proceeds (until utilised to meet liabilities or make distributions to *shareholders*) must be held and those instructions must be with a view to the prudent protection of creditors and *shareholders* against loss.
- (3) Provided there are sufficient liquid funds available after making adequate provision for the expenses of the winding up and the discharge of the *ICVC*'s remaining liabilities, the *ACD* may arrange for the *depository* to make one or more interim distributions out of those funds. Those distributions are to be to the *shareholders* proportionately to the right of their respective *shares* to participate in *scheme property* as at the effective time.

- (4) When the *ACD* has caused all the *scheme property* to be realised and all of the liabilities of the *ICVC* known to the *ACD* to be met, the *ACD* must arrange for the *depository* to make a final distribution. That distribution is to be on or before the date on which the final account is sent to *shareholders* in accordance with *CIS 14.2.7(6)R* (Final account), and to be of the balance remaining (net of a provision for any further expenses of the *ICVC*) to the *shareholders* in the same proportions as provided by (3).
- (5) Paragraphs (1) to (4) are subject to the terms of any *scheme of arrangement* sanctioned by an *extraordinary resolution* of the *ICVC* passed on or before the effective time.
- (6) Where the *ICVC* and one or more *shareholders* (other than the *ACD*) agree, the requirement in (1) to realise the *scheme property* does not apply to that part of the *scheme property* which is proportionate to the right to participate in *scheme property* of that or those *shareholders*.
- (7) In the case of (6), the *ACD* must cause the *ICVC* to distribute that part of the *scheme property* in specie to that or those *shareholders* in proportion to their respective rights to participate. The distribution is to be effected after making adjustments and retaining such provision as appears to the *ACD* appropriate to ensure that those *shareholders* bear the proportion of the liabilities of the *ICVC* and the expenses of the distribution attributable to their *shares*.
- (8) As soon as is reasonably practicable after the winding up of the *ICVC* (including compliance with *CIS 14.2.7R* (Final account)) is complete, the *ACD* must notify the *FSA* of that fact.
- (9) Where any sum of *money* stands to the account of the *ICVC* at the date of its dissolution, the *ACD* must arrange for the *depository* to pay or lodge that sum within one month after that date in accordance with regulation 33(4) or 33(5) of the *OEIC regulations*.

Final account

14.2.7

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- (1) As soon as the *ICVC*'s affairs are fully wound up (including distribution or provision for distribution in accordance with *CIS 14.2.6R(4)*), the *ACD* must prepare an account of the winding up showing:
 - (a) how it has been conducted; and
 - (b) how the *scheme property* has been disposed of.

- (2) The account in (1) must:
 - (a) if there is more than one *director*, be approved by the board of *directors* and be signed on their behalf by the *ACD* and at least one other *director*; or
 - (b) if there is no *director* other than the *ACD*, be signed by the *ACD*.
- (3) Once signed, this account is the “final account” for the purposes of this chapter.
- (4) The final account must state the date on which the *ICVC*’s affairs were fully wound up and the date stated must be regarded as the final *day* of the accounting period of the *ICVC* then running (‘final accounting period’).
- (5) The *ACD* must ensure that the *ICVC*’s auditor makes a report in respect of the final account, which states the auditor’s opinion whether the final account has been properly prepared for the purpose of (1).
- (6) Within two months of the end of the final accounting period, the *ACD* must send a copy of the final account and the auditor’s report on it to the *FSA* and to each *person* who was a *shareholder* (or the first named of joint *holders*) immediately before its end.

Duty to ascertain liabilities

14.2.8

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- (1) The *ACD* must use all reasonable endeavours to ensure that all the liabilities of the *ICVC* are discharged before the completion of the winding up.
- (2) The duty in (1) relates to all liabilities of the *ICVC* of which:
 - (a) the *ACD* is, or becomes, aware before the completion of the winding up; or
 - (b) the *ACD* would have become aware before the completion of the winding up had it used all reasonable endeavours to ascertain the liabilities of the *ICVC*.
- (3) If the *ACD* rejects any claim against the *ICVC* in whole or part, the *ACD* must immediately send to the claimant written notice of its reasons for doing so.

Reports and accounts

14.2.9

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- (1) While an *ICVC* is being wound up, the following continues to apply:
 - (a) the annual and *half-yearly accounting periods* (required by *CIS* 9.2.1R);
 - (b) the *rules* in *CIS* 9 about annual and interim allocation of income; and
 - (c) annual reports and half-yearly reports (the *rules* for which are in *CIS* 10).
- (2) The *ACD* need not (as would be required under *CIS* 10.5.2R(2) (Publication of reports)) send to each *shareholder* a copy of any report relating to an *annual accounting period* or *half-yearly accounting period* which began after the effective time, if the *directors* of the *ICVC*, after consulting the *FSA*, have taken reasonable care to determine that the interests of *shareholders* are not such as to require the report to be sent to *shareholders*. However, a copy of the report must be supplied free of charge to any *shareholder* requesting one.

Liabilities of the ACD

14.2.10

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- (1) The *ACD* is personally liable to meet any liability of an *ICVC* wound up under this chapter (whether or not the *ICVC* has been dissolved) that was not discharged before the completion of the winding up, except to the extent that the *ACD* can show that it has complied with *CIS* 14.2.8R (Duty to ascertain liabilities).
- (2) If the proceeds of the realisation of the assets attributable, or allocated in accordance with *CIS* 12.5.3R (Allocation of scheme property), to a particular *sub-fund* of an *umbrella ICVC* are insufficient to meet the liabilities attributable or allocated to that *sub-fund*, the *ACD* must pay to the *ICVC* for the account of that *sub-fund* the amount of the deficit. This is subject to and to the extent that the *ACD* can show that the deficit did not arise as a result of any failure by the *ACD* to comply with the *rules* in *CIS*.
- (3) The liabilities of the *ACD* under this *rule* (*CIS* 14.2.10R) create a debt (in England and Wales in the nature of a specialty) accruing due from it on the completion of the winding up and payable upon the demand of the creditor in question (including the *ICVC* in the circumstances described in (2)).
- (4) The obligations of the *ACD* under this *rule* (*CIS* 14.2.10R) do not affect any other obligation of the *ACD* under these *rules* or the general law.

Additional provisions applicable to umbrella companies

14.2.11

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- (1) Liabilities of an *umbrella ICVC* attributable, or allocated in accordance with CIS 12.5.3R (Allocation of scheme property), to a particular *sub-fund* must be met first out of the *scheme property* attributable or allocated to such a *sub-fund*.
- (2) If the liabilities to be met out of a particular *sub-fund* of an *umbrella ICVC* are greater than the proceeds of the realisation of the *scheme property* attributable or allocated to that *sub-fund*, the deficit must be met out of the *scheme property* attributable or allocated to the solvent *sub-funds* of that *umbrella ICVC* in which the proceeds of realisation exceed liabilities and divided between those *sub-funds* in a manner that is fair to the *shareholders* in those solvent *sub-funds*.
- (3) Paragraph (2) applies in respect of any deficit arising as a result of additional liabilities accruing to a *sub-fund* through the operation of (2).
- (4) In calculating the amount of liabilities for the purpose of (2), account must be taken of any payments received or to be received from the *ACD* under CIS 14.2.10R (Liabilities of the *ACD*).

Miscellaneous

14.2.12

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- (1) If:
 - (a) during the course, or as a result, of the enquiry referred to in CIS 14.2.4R(1) (Solvency statement), the *directors* become of the opinion that it will not be possible to provide the confirmation referred to in (2)(a) of that *rule*; or
 - (b) after the effective time, the *ACD* becomes of the opinion that the *ICVC* will be unable to meet all its liabilities within twelve months of the date of the statement provided under (a) of CIS 14.2.4R(2);

the *directors* must immediately present a petition or cause the *ICVC* to present a petition for the winding up of the *ICVC* as an unregistered *ICVC* under Part V of the Insolvency Act 1986.

- (2) If, after the commencement of a winding up under this chapter and before notice of completion of the winding up has been sent to the registrar of companies, there is a vacancy in the position of *ACD*, the *directors* must immediately present or cause the *ICVC* to present or, if there are no *directors*, the *depository* must immediately present, a petition for the winding up of the *ICVC* as an unregistered *ICVC* under Part V of the Insolvency Act 1986.

14.3 Termination of a sub-fund of an umbrella ICVC

Explanation of CIS 14.3

14.3.1

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- (1) A termination of a *sub-fund* in accordance with this chapter will require alterations to the *ICVC's instrument of incorporation* and *prospectus*. The proposed alterations must be notified to the *FSA* and permitted to take effect in accordance with regulation 21 of the *OEIC regulations* before the termination can commence. On termination, the assets of the *sub-fund* will normally be realised, and the *shareholders* in the *sub-fund* will receive their respective *shares* of the proceeds net of liabilities and the expenses of the termination. A *sub-fund* may also be terminated in connection with a *scheme of arrangement*. In this case, *shareholders* in the *sub-fund* will become entitled to receive *units* in another *regulated collective investment scheme* in exchange for their *shares* in the *sub-fund*.
- (2) The steps involved in the termination of a *sub-fund* are similar to those for the termination of an *ICVC*, so readers may find the *guidance* at CIS 14.2.2G helpful.

Special meanings for CIS 14.3

14.3.2

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- (1) In this section (CIS 14.3) references to:
- (2) *shares* are references to *shares* of the *class* or *classes* related to the *sub-fund* to be terminated;
- (3) *shareholders* are references to *holders* of such *shares*;
- (4) a *resolution* or *extraordinary resolution* are references to such a resolution passed at a meeting of *holders* of *shares* of the *class* or *classes* referred to in (2);
- (5) *scheme property* are references to the *scheme property* allocated or attributable to the *sub-fund* to be terminated; and
- (6) *liabilities* are references to liabilities of the *ICVC* allocated or attributable to the *sub-fund* to be terminated.

When a sub-fund is to be terminated

14.3.3

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- (1) A *sub-fund* must not be terminated:
 - (a) unless and until effect may be given under regulation 21 of the *OEIC regulations* to proposals to make the alterations to the *ICVC's instrument of incorporation* and *prospectus* that will be required if the *sub-fund* is terminated; and
 - (b) unless a statement has been prepared and sent or delivered to the *FSA* under *CIS* 14.3.4R (Solvency statement) and received by the *FSA* before satisfaction of the condition in (a).
- (2) Subject to (1) and the subsequent provisions of this section (*CIS* 14.3), a *sub-fund* must be terminated under this chapter:
 - (a) if an *extraordinary resolution* to that effect is passed; or
 - (b) when the period (if any) fixed for the duration of the *sub-fund* by the *instrument of incorporation* of the *ICVC* expires, or any event occurs on the occurrence of which the *instrument of incorporation* provides that the *sub-fund* is to be terminated; or
 - (c) on the date stated in any agreement by the *FSA* to a request from the *directors* of the *ICVC* for the termination of the *sub-fund*.

Solvency statement

14.3.4

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- (1) Before a notice is given to the *FSA* under regulation 21 of the *OEIC regulations* of the proposal referred to in *CIS* 14.3.3R(1)(a), the *directors* must make a full enquiry into the *ICVC's* affairs to the extent that they relate to the *sub-fund* so as to ascertain whether the *ICVC* will be able to meet its liabilities (including contingent and prospective liabilities).
- (2) On or before that notice is given, the *ACD* must prepare a statement, reflecting the results of the enquiry in (1), and either:
 - (a) confirming that the *ICVC* will be able to meet all liabilities within twelve months of the date of the statement; or
 - (b) stating that the confirmation cannot be given.
- (3) The statement referred to in (2) must:
 - (a) relate to the *ICVC's* affairs at a date which must not be more than 28 *days* before the date on which that notice is given to the *FSA*; and

- (b) if there is more than one *director*, be approved by the board of *directors* and be signed on their behalf by the *ACD* and, if it contains the confirmation under (2)(a), by at least one other *director* if there is one or, if there is no *director* other than the *ACD*, be signed by the *ACD*.
- (4) A statement which contains the confirmation under (2)(a) must annex a statement signed by the auditor appointed under Schedule 5 to the *OEIC regulations* to the effect that, in his opinion, the enquiry required by (1) has been properly made and is fairly reflected by the confirmation.
- (5) The statement referred to in (2) must be sent or delivered to the *FSA* and a copy sent to the *depository* either before, or on, or within the 21 *days* following, the date on which notice is given to the *FSA* in accordance with regulation 21 of the *OEIC regulations*.
- (6) Termination of a *sub-fund* commences at the time at which the conditions referred to in *CIS 14.3.3R(1)(a)* and (b) are both satisfied or, if later, the time determined under *CIS 14.3.3R(2)* at which the *sub-fund* must be terminated.

Consequences of commencement of termination of a sub-fund

14.3.5

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- (1) Immediately following the commencement of the termination of a *sub-fund*:
 - (a) *CIS 4* (Single-pricing and dealing) and *CIS 5* (Investment and borrowing powers) cease to apply to the *shares* and to the *scheme property*;
 - (b) the *ICVC* must cease to *issue* and cancel *shares*;
 - (c) the *ACD* must cease to *sell* or redeem *shares* or to arrange for the *issue* and *cancellation* of *shares*; and
 - (d) no transfer of a *share* must be registered and no other change to the *register* of *shareholders* must be made without the sanction of the *directors*.
- (2) If the *ACD* has not previously notified *shareholders* of the proposal to terminate the *sub-fund*, the *ACD* must, as soon as practicable after the commencement of the termination, give written notice of the commencement to the *shareholders*.

Manner of termination

14.3.6

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- (1) The *ACD* must, as soon as practicable after the termination of the *sub-fund* has commenced, cause the *scheme property* to be realised and the liabilities to be met out of the proceeds.
- (2) The *ACD* must give instructions to the *depository* how those proceeds (until utilised to meet liabilities or pay distributions to *shareholders*) must be held. Those instructions must be with a view to the prudent protection of creditors and *shareholders* against loss.
- (3) Provided there are sufficient liquid funds in the *scheme property* available after making adequate provision for the expenses of the termination and the discharge of the liabilities remaining to be discharged, the *ACD* may arrange for the *depository* to make one or more interim distributions out of the funds to the *shareholders* proportionately to the right to participate in *scheme property* attached to their respective *shares* as at the date of the commencement of the termination.
- (4) When the *ACD* has caused all the *scheme property* to be realised and all of the liabilities known to the *ACD* to be met, the *ACD* must arrange for the *depository* to make a final distribution, on or before the date on which the termination account is sent to *shareholders* in accordance with CIS 14.3.7R(5) (Termination account), of the balance remaining (net of a provision for any further expenses of the termination) to the *shareholders* in the same proportions as provided by (3).
- (5) Paragraphs (1) to (4) are subject to the terms of any *scheme of arrangement* sanctioned by an *extraordinary resolution* passed on or before the commencement of the termination.
- (6) Where the *ICVC* and one or more *shareholders* (other than the *ACD*) agree, the requirement in (1) to realise the *scheme property* does not apply to that part of the *scheme property* which is proportionate to the right to participate in *scheme property* of that or those *shareholders*.
- (7) In the case of (6) the *ACD* must cause the *ICVC* to distribute that part of the *scheme property* in specie to that or those *shareholders* in proportion to their respective rights to participate, after making such adjustments or retaining such provision as appears to the *ACD* appropriate for ensuring that that or those *shareholders* bear the proportion of the liabilities and the expenses of the distribution attributable to his or their *shares*.
- (8) Where any sums (including unclaimed distributions) remain standing to the account of the *scheme property* following tender of payment (whether to a creditor or a *shareholder*) the *ACD*

must instruct the *depository* to retain the sums ('tendered sums') in an account ('unclaimed payments account') separate from any other part of the *scheme property*.

- (9) The *depository* must, if and when so instructed by the *ACD*, make a payment out of the unclaimed payments account for the purpose of settling a claim for a tendered sum.
- (10) Any costs and reasonable expenses of the *ACD* for investigating a claim and any costs and expenses incurred by the *depository* in making a payment out of the unclaimed payments account may be deducted from the payment and retained for its own benefit by the *ACD* or the *depository* or both (as the case may be).
- (11) The *person* entitled to any tendered sum is not entitled to any interest in respect of the unclaimed payments account and any interest arising in respect of the unclaimed payments account must be allocated between the continuing *sub-funds* of the *ICVC* in accordance with *CIS* 12.5.3R (Allocation of scheme property).
- (12) Amounts standing to the credit of an unclaimed payments account must be excluded from the value of the *scheme property* and must not be subject to any distribution under the provisions of *CIS* 14.2.6R (Manner of winding up), but upon a dissolution of the *ICVC* under regulation 33 of the *OEIC regulations*, the *depository* must cease to hold those amounts as part of that account and they will become subject to the provisions of *CIS* 14.2.6R(9).

Termination account

14.3.7

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- (1) As soon as the termination of the *sub-fund* (including distribution or provision for distribution in accordance with *CIS* 14.3.6R(4)) has been completed, the *ACD* must prepare an account of the termination showing:
 - (a) how it has been conducted; and
 - (b) how the *scheme property* has been disposed of.
- (2) The account in (1) must:
 - (a) if there is more than one *director*, following its approval by the board of *directors*, be signed on their behalf by the *ACD* and at least one other *director*; or
 - (b) if there is no *director* other than the *ACD*, be signed by the *ACD*.

- (3) Once signed, this account is the 'termination account' for the purposes of this chapter.
- (4) The *ACD* must ensure that the *ICVC*'s auditor makes a report to the *shareholders* in respect of the termination account which states the auditor's opinion whether the termination account has been properly prepared for the purpose of (1).
- (5) Within two months of the termination of the *sub-fund* being completed, a copy of the termination account and the auditor's report on it must be sent to the *FSA* and to each *person* who was a *shareholder* (or the first named of joint *holders*) immediately before such completion.

Duty to ascertain liabilities

14.3.8

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- (1) The *ACD* must use all reasonable endeavours to ensure that all the liabilities are discharged before the completion of the termination.
- (2) The duty in (1) relates to all liabilities of which:
 - (a) the *ACD* is, or becomes, aware before the completion of the termination; or
 - (b) the *ACD* would have become aware before the completion of the termination had it used all reasonable endeavours to ascertain the liabilities.
- (3) If the *ACD* rejects any claim against the *ICVC* in respect of a liability in whole or in part, the *ACD* must immediately send to the claimant written notice of its reasons for doing so.

Reports and accounts

14.3.9

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The obligations under *CIS* 9 (Income) and *CIS* 10 (Reports and accounts) continue in respect of a *sub-fund* being terminated until the completion of the termination.

Liabilities of the ACD

14.3.10

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- (1) The *ACD* must keep the *ICVC* indemnified against any liability allocated or attributable to a *sub-fund* that has been terminated under these *rules* that was not discharged before the completion of the termination, except to the extent that the *ACD* can show that it has complied with *CIS* 14.3.8R (Duty to ascertain liabilities).

- (2) The liabilities of the *ACD* under (1) create a debt (in England and Wales in the nature of a specialty) accruing due from it on the completion of the termination and payable upon the demand of the *ICVC*.

14.4 Winding up an AUT

Explanation of CIS 14.4

14.4.1

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This section (*CIS* 14.4) deals with the circumstances in which an *AUT* falls to be wound up and the manner of winding up. Under section 256 of the *Act*, the *manager* or *trustee* of an *AUT* may request the *FSA* to revoke the *authorisation order* in respect of that *AUT*. Section 257 of the *Act* gives the *FSA* the power to make any necessary directions.

When an AUT is to be wound up

14.4.2

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- (1) Upon the happening of any of the events specified in paragraph (2) and not otherwise:
 - (a) *CIS* 4 (Single-pricing and dealing) or *CIS* 15 (Dual-pricing and dealing), whichever is applicable and *CIS* 5 (Investment and borrowing powers) cease to apply to the *AUT*;
 - (b) the *trustee* must cease to *issue* and cancel *units* in the *AUT*;
 - (c) the *manager* must cease to *sell* and redeem *units* in the *AUT*;
 - (d) the *manager* must cease to arrange the *issue* or *cancellation* of *units* under *CIS* 4.5.3R (Issues and cancellations through the authorised fund manager) or *CIS* 15.5.3R (Issues and cancellations through the manager); and
 - (e) the *trustee* must proceed to wind up the *AUT* in accordance with *CIS* 14.4.3R.
- (2) The events referred to in (1) are:
 - (a) the *authorisation order* is revoked; or
 - (b) in response to a request to the *FSA* by the *manager* or the *trustee* for the revocation of the *authorisation order*, the *FSA* has agreed, albeit subject to there being no material change in any relevant factor, that, on the conclusion of the winding up of the *AUT*, the *FSA* will accede to that request; or

- (c) the expiration of any period specified in the *trust deed* as the period at the end of which the *AUT* is to terminate; or
 - (d) the effective date of a duly approved *scheme of arrangement*, which is to result in the *AUT* that is subject to the *scheme of arrangement* being left with no property; and
 - (e) The date on which a *relevant pension scheme* is notified in writing by the Occupational Pensions Schemes Regulatory Authority that the *scheme* is no longer registered under the Welfare and Pensions Reform Act 1999 as a *stakeholder pension scheme*.
- (3) This *rule* (CIS 14.4.2R) is without prejudice to CIS 13.1.3R (Suspension and resumption of dealing: requirement) and to any order or direction made under section 257 or 258 of the *Act*.

Manner of winding up

14.4.3

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- (1) In a case falling within CIS 14.4.2R(2)(d), the *trustee* must wind up the *AUT* in accordance with the approved *scheme of arrangement*.
- (2) In any other case falling within CIS 14.4.2R:
 - (a) the *trustee* must, as soon as practicable after the *AUT* falls to be wound up, realise the *scheme property*;
 - (b) after paying therefrom or retaining adequate provision for all liabilities properly so payable and for the costs of the winding up, the *trustee* must distribute the proceeds of that realisation to the *unitholders* and the *manager* (upon production by them of such evidence as the *trustee* may reasonably require as to their entitlement thereto) proportionately to their respective interests in the *AUT* as at the date of the relevant event referred to in CIS 14.4.2R; and
 - (c) any unclaimed net proceeds or other cash (including unclaimed distribution payments) held by the *trustee* after the expiration of twelve months from the date on which they became payable must be paid by the *trustee* into court (or, in Scotland, as the court may direct), subject to the *trustee* having a right to retain any expenses incurred by him relating to that payment.
- (3) In the case of an *AUT* which is a *relevant pension scheme*, payments must not be made to *unitholders* in the *AUT*. The realisation proceeds must be paid by the *trustee* in accordance with the destinations specified in the *trust deed*.

- (4) Where the *trustee* and one or more *unitholders* agree, the requirement in (2) to realise the *scheme property* does not apply to that part of the property proportionate to the entitlement of that or those *unitholders*. The *trustee* may distribute that part in the form of property, after making adjustments or retaining provisions as appears to the *trustee* appropriate for ensuring that, that or those *unitholders* bear a proportional *share* of the liabilities and costs.
- (5) On completion of the winding up in respect of the events referred to in CIS 14.4.2R(2)(b), (c) or (d), the *trustee* must notify the *FSA* in writing of that fact and at the same time the *manager* or *trustee* must request the *FSA* to revoke the relevant *authorisation order*.

Accounting and reports during winding up

14.4.4

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- (1) Subject to any order of the court, and to paragraphs (2) and (3), while an *AUT* is being wound up, whether under CIS 14.4.3R or otherwise:
 - (a) the annual and *half-yearly accounting periods* continue to run;
 - (b) the provisions about annual and interim allocation of income (in CIS 9) continue to apply; and
 - (c) annual and half-yearly reports (in CIS 9) continue to be required.
- (2) Where, for any annual or *half-yearly accounting period*, the *trustee* (after consulting the *manager* (if appropriate) and the *FSA*) has taken reasonable care to determine that timely production of an annual or half-yearly report is not required in the interests of the *unitholders* or the *FSA*, it may direct that immediate production of the report may be dispensed with.
- (3) The period in question in (2) must be reported on together with the following period in the next report prepared for the purposes of (1) or (4).
- (4) At the conclusion of the winding up, the accounting period then running is regarded as the final *annual accounting period*.
- (5) Within two calendar months after the end of the final accounting period, the annual reports of the *manager* and *trustee* must be published and sent to each *person* who was a *unitholder* immediately before the end of the final accounting period.

14.5 Schemes that are not commercially viable

Explanation of this section

14.5.1

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- (1) The *FSA* expects that the majority of requests it will receive for the winding up of an *ICVC* (under regulation 21(1) of the *OEIC regulations*) or an *AUT* (under section 256 of the *Act*) will be from *authorised fund managers* and *depositories* who consider that the *AUT* or *ICVC* in question is no longer commercially viable.
- (2) It is in *consumers'* interests to minimise, as far as possible, the period between which the *FSA* receives such requests and responds to them. To assist the *FSA* in arriving at a quick decision, based on all the relevant factors, it would be helpful for the *FSA* to receive the information listed at *CIS 14.5.2G*. Further information, however, may be requested by the *FSA* after receipt of the information, depending on the individual circumstances of the case.

Information to be provided to the FSA

14.5.2

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The information referred to in *CIS 14.5.1G* is listed below:

- (1) name of the *authorised fund*;
- (2) size of the *authorised fund*;
- (3) number of *holders*;
- (4) whether dealing in *units* has been suspended;
- (5) why the request is being made;
- (6) what consideration has been given to the *authorised fund* entering into a *scheme of arrangement* with another *authorised fund* or *recognised scheme* and the reasons why a *scheme of arrangement* is not possible;
- (7)
 - (a) whether *holders* have been informed of the intention to seek winding up or revocation;
 - (b) if not, when they will be informed;
- (8) details of any proposed preferential switching rights offered or to be offered to *holders*;

- (9) details of any proposed rebate of charges to be made to *holders* who recently purchased *units*;
- (10) where the costs of winding-up will fall;
- (11) the *depository's*:
 - (a) statement whether having taken reasonable care it is certain that a *scheme of arrangement* is not practical and explain what steps have been considered that would result in the *authorised fund* not needing to wind up (for example appointing a replacement *authorised fund manager*);
 - (b) confirmation that:
 - (i) for an *ICVC*, it expects to report in the next report and accounts that the *issue, sale and redemption prices*, the *cancellation* of the *ICVC's shares* and the application of the *ICVC's income* has been carried out in accordance with the *rules* in *CIS*, and, where applicable, the *OEIC regulations* and the *ICVC's instrument of incorporation*, and that the investment and borrowing powers applicable to the *ICVC* have not been exceeded; or
 - (ii) for an *AUT*, it expects to report in the next report and accounts that the *manager* has managed the *AUT* in accordance with the *rules* in *CIS*, or

(for a report and accounts that is unqualified) that there are no unresolved problems concerning the *authorised fund* that ought to be brought to the *FSA's* attention in connection with the possible exercise of powers under section 256 of the *Act*;
- (12) the preferred date for the *FSA's* determination to revoke authorisation or date for the winding up; and
- (13) any additional information or material considered to be relevant to the *FSA's* decision under section 256 of the *Act* or regulation 21 of the *OEIC regulations* (as appropriate).

Chapter 15

Dual-pricing and dealing

15.1 Introduction

Application

15.1.1

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- (1) This chapter applies in relation to *dual-priced AUTs*. Accordingly, in this chapter:
- (a) references to "AUTs" and to "units" relate only to *dual-priced AUTs* and to *units* in them; and
 - (b) references to "manager" or "trustee" relate only to the *manager* or *trustee* of a *dual-priced AUT*.
- (2) This section (CIS 15.1R) applies to *managers* and *trustees*.
- (3) (a) If, and to the extent that, the *authorised fund manager* and the *depository* so agree, *income units* and *accumulation units* are to be treated, for the purposes in (b) as belonging to the same *class of units*.
- (b) The only purposes to which (a) can apply are:
- (i) ascertaining the number of *units* respectively to be issued or cancelled in order for the *authorised fund manager* to comply with CIS 15.3.4R(3) (Issue of units to meet authorised fund managers obligation to sell) and CIS 15.3.7R(3) (Cancellation and payment for cancelled units); and
 - (ii) Compliance with requirements of this chapter relating to information to be given by the *authorised fund manager* to the *depository*.
- (c) Paragraphs (a) and (b) do not apply to the *income units* and *accumulation units* of an *AUT* unless the rights attached to those *classes* provide for their prices to be calculated by reference to undivided *shares* (howsoever called) in a manner similar to that resulting from CIS 2.6.1R (Units and classes of units in AUTS).

- 15.1.2 **G**_{/1} The *persons* to whom each respective *rule* and *guidance* in this chapter applies are stated either at the beginning of the *rule* or *guidance* or at the beginning of the section containing the *rule* or *guidance*.

Purpose

- 15.1.3 **G**_{/1}
- (1) This chapter helps in achieving the *regulatory objective* of protecting consumers as envisaged by section 2 and 5 of the *Act*. In accordance with *Principle 6* (customers' interests), this chapter is intended to ensure the *manager* pays due regard to its *customers'* interests and treats them fairly.
 - (2) A *manager* is responsible for valuing the *scheme property* of the *AUT* it manages and for calculating the prices of *units* in the *AUT*. As well as arranging for the *issue* and the *cancellation* of *units* for the account of the *AUT*, the *manager* is permitted to *sell* and redeem *units* for its own account. The *rules* in this chapter are intended to ensure that the prices of *units* are properly related to the net value of the *AUT* and, in accordance with *Principle 6* that the *manager* deals fairly with investors when they *purchase* or *sell units*. This chapter provides common standards for these purposes.

Explanation

- 15.1.4 **G**_{/1}
- (1) *Units* of an *AUT* are issued or cancelled by the *trustee* on the *manager's* instructions. In the case of an *issue*, payment in cash of the *issue price* of the *units* or a transfer of assets of an equivalent value must be made to the *trustee* for the account of the *manager* concerned. Payment by the *trustee* for cancelled *units* is normally to be made in accordance with *CIS 15.3.7R* (Cancellation of units).
 - (2) A *manager* may hold *units* for its own account (in its "box"): so a purchaser of *units* from the *manager* may receive *units* which have been issued to the *manager* or that have been redeemed (that is repurchased) by the *manager* from a previous *unitholder*. In addition to *selling* and redeeming *units* for its own account, the *manager* may arrange for the *trustee* to *issue units* direct to an investor or to cancel a *unitholder's units*.
 - (3) The *manager* must be prepared to redeem *units* of a *unitholder* who wishes to realise the value of them. The *manager* can then retain the *units* in its box or it can cancel them.
 - (4) The special provision about initial *issues* and *sales*, at the start of an *AUT's* life, are in *CIS 15.2R* separately from the *rules* about *issues* and *sales* in an ongoing *AUT*.
 - (5) Under this chapter the prices at which *units* may subsequently be issued or cancelled will be determined in accordance with *CIS 15.3.6R* (Issue price) and *CIS 15.3.8R* (Cancellation price) respectively and, in broad outline, will be calculated by valuing the *scheme property* attributable to the *class of units* in question on an *issue* basis or a *cancellation* basis (as appropriate) and dividing that value by the number of those *units* in *issue*. The valuation of the *scheme property* must be in accordance with *CIS 15.8* (Valuation).

- (6) The prices at which *units* may be sold or redeemed must be in the price bracket derived from *CIS 15.4.4R* (Sale price parameters) and *CIS 15.4.9R* (Redemption price parameters).
- (7) *CIS 15.6.3R* (SDRT provision) provides the *manager* with the power to require, for the benefit of the *AUT*, the payment or deduction of a provision for stamp duty reserve tax as an addition to or deduction from (but not part of) the price of the *units*.
- (8) This *CIS 15* is to be applied separately to each *sub-fund* of an *umbrella scheme*.

15.2 Initial offers and unitisations

Application

- 15.2.1 **R** /1 This section applies to *managers*, except CIS 15.2.7R (Creation of units: unitisation) which applies to *trustees*.

Purpose

- 15.2.2 **G** /1 This section helps to protect investors by *rules* intended to ensure the *authorised fund* receives the appropriate amounts for *units* issued as a result of an *initial offer* and that neither the *authorised fund* nor the investor will suffer any material loss as a result of fluctuations in the value of the *scheme property* for so long as *units* are available at the fixed price.

Period of initial offer

- 15.2.3 **R** /1
- (1) The period of the *initial offer* must not exceed 21 *days* and an *initial offer* must, subject to CIS 15.2.6R (Compulsory termination of initial offer), be kept open for the period of the *initial offer*.
 - (2) Where an *initial offer* is of *units* of a *sub-fund*, CIS 15.2.4R, CIS 15.2.5R and CIS 15.2.6R apply as if references in those *rules* to a *unit* were to a *unit* in that *sub-fund*.

Issue of units: initial offer

- 15.2.4 **R** /1
- (1) If *units* are issued by the *trustee* during the period of the *initial offer*, the *units* must be issued by the *trustee* under (2) or (4).
 - (2) If *units* are to be issued under this paragraph, the *manager* must instruct the *trustee* to *issue units* at the beginning of the first *business day* in the period.
 - (3) If *units* are to be issued under (4), at or before the beginning of the first *business day* in the period the *manager* must irrevocably

choose, in respect of that *initial offer*, to proceed either under (4)(a) ('up and running') or under (4)(b) ('pay over and wait') and must notify its choice to the *trustee*.

- (4) Where on any *business day* during the period the *manager* assumes any obligation to *sell units*, it must, depending on its choice under (3), either:
- (a) instruct the *trustee*, at the beginning of the next *business day*, to *issue units* in such number at least as will enable the *manager* immediately to fulfil that obligation, whether from the *units* so issued or from other *units*; or
 - (b) proceed as follows:
 - (i) pay to the *trustee* (in any case where the purchaser has sent a remittance) on the *day* of receipt of the remittance or on the next *business day*, the total amount (or the total amount less the total of the *manager's preliminary charge*, if any, in respect of those *units*); and
 - (ii) as soon as the period of the *initial offer* has come to an end, instruct the *trustee* to *issue units* in the *AUT* in such number at least as will enable the *manager* to fulfil its obligations to *sell units* whether from the *units* so issued or from other *units*.
- (5) The instructions given by the *manager* must state, in relation to each *class* of *unit* to be issued, the number to be issued, expressed either as a number of *units* or as an amount in value (or as a combination of the two).
- (6) The *trustee* must, subject to CIS 15.3.9R (Trustee's refusal to issue or cancel units), *issue units* on receipt of instructions by the *manager* given under this *rule*, and must not, during an *initial offer*, *issue units* otherwise.

Initial price

15.2.5

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- (1) The *initial price* of a *unit* must be such amount as is agreed between the *manager* and the *trustee* to be the maximum amount (inclusive of any *preliminary charge*) which may be paid by a potential *unitholder* to the *manager* for *units* on an *initial offer*.
- (2) The price for each *unit* issued during the period of the *initial offer* payable by the *manager* to the *trustee* must be the *initial price* of that *unit* less the amount of any *preliminary charge* made in respect of that *unit*.

- (3) The amount which may be retained by the *manager* by way of *preliminary charge* must not exceed the amount stated in the original *prospectus* as the current charge.
- (4) For the purpose of (2), a *unit* is treated as issued during the period of the *initial offer* if the *manager* had agreed to the *sale* of it or received an order for it to be sold before the close of the offer, and it was issued only afterwards.
- (5) During the period of the *initial offer*, the *manager* must not cause *units* to be issued under CIS 15.5.3R (Issues and cancellations through the manager) at a price which is greater than the *initial price*.
- (6) The *initial price* of *units* must, subject to CIS 12.5.2R (Base currency), be expressed in the *base currency* of the *AUT*: but, during the period of the *initial offer*, the *manager* may agree to *sell units* or cause *units* to be issued under CIS 15.5.3R in any other currency.
- (7) Nothing in this *rule* affects the power of the *manager* to require a payment of *SDRT provision* under CIS 15.6.3R (SDRT provision).
- (8) Where the *initial offer* is made in a country outside the *United Kingdom*, there may be added to the *initial price* of *units* offered in that country an amount sufficient to cover additional duty or taxation leviable in that country and the cost of the remittance of *money* to the *United Kingdom*.

Compulsory termination of initial offer

15.2.6

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- (1) The period of the *initial offer* comes to an end immediately if:
 - (a) the *manager* does not carry out a valuation immediately if after having exercised reasonable care it determines that, if the current *issue price* of a *unit* were to be calculated by reference to an immediate valuation under Table CIS 15.8R (Valuation), it would be likely to vary from the *unit's initial price* (excluding any *preliminary charge* by 2% or more of the *initial price* (excluding any *preliminary charge*); or
 - (b) the *manager* carries out a valuation immediately after it determines as mentioned in (a) that the valuation shows a variation of 2% or more.
- (2) If the period of the *initial offer* comes to an end under (1), the *manager* must immediately refrain from:
 - (a) agreeing to *sell units* at the *initial price*; and

- (b) instructing the *trustee* to *issue units* at the *initial price*, unless either to fulfil an existing obligation of the *manager* to *sell units* at the *initial price* or to fulfil an order for *units* at the *initial price* which the *manager* received before the *initial offer* came to an end.
- (3) The current *issue price* of a *unit* for the purpose of (1) must be calculated on the basis that the number of *units* of each *class* in existence immediately before the valuation is the number for which the *initial price* has been paid, or for which assets have been transferred to the *trustee* in exchange (or treated for the purpose of the valuation as having been paid or exchanged), to the *trustee* before the valuation.

Creation of units: unitisation

15.2.7

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- (1) The *trustee* has the power, not dependent on an instruction by the *manager*, to *issue units*, having regard to the terms of any *unitisation* to which it is a party. For this purpose, the *trustee* may *issue* any number of *units* in exchange for assets other than *money* but only if it has taken reasonable care to determine that to do so is not likely to result in any material prejudice to the interests of *unitholders* or potential *unitholders*.
- (2) In exercise of the power, the *trustee* must only create *units* in favour of the *persons* entitled under the *unitisation*.

15.3 Issues and cancellations

Application

15.3.1

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This section applies in relation to the *issue* and *cancellation* of *units* after the close of any *initial offer* of *units* at a fixed price. However, the following *rules* in this section also apply in relation to *initial offers*:

- (1) *CIS* 15.3.5R(3), (4) and (5) (Issue by trustee), except to the extent that *CIS* 15.2.4R(4)(b) applies;
- (2) *CIS* 15.3.9R (Trustee's refusal to issue or cancel units);
- (3) *CIS* 15.3.10R (Instructions or notifications between manager and trustee); and
- (4) *CIS* 15.3.12R (Modification to number of units issued or cancelled)

Purpose

15.3.2

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This section protects investors by means of *rules* intended to ensure the *trustee* receives or pays out the right amount when *units* are issued or cancelled. Accordingly, it lays down certain procedures for the *issue* and *cancellation* of *units* and sets out how, except for an *initial offer*, the prices of those *units* are to be calculated and paid.

Box management errors

15.3.3

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- (1) This *guidance* (*CIS* 15.3.3G) applies to *managers*.
- (2) A *manager* is not permitted to *sell* or cancel *units* that it does not own. To do so would be in breach of *CIS* 15.3.4R(3) (Issue of units: manager's instructions) or *CIS* 15.3.7R(3) (Cancellation of units). Errors relating to the number of *units* issued or cancelled can be corrected to the extent permitted by *CIS* 15.3.12R (Modification to number of units issued or cancelled).

- (3) A *manager's* holding of *units* for its own account is commonly known as its "box" of *units*. Appendix CIS G (Correction of box management errors) contains further *guidance* on:
- (a) controls relating to the management of the *authorised fund manager's* box of *units*.
 - (b) recording and reporting errors in calculating the number of *units* of each *class* in the box;
 - (c) correcting such errors; and
 - (d) the payment of compensation in relation to particular categories of error.

Issue of units: manager's instructions

15.3.4

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- (1) This *rule* (CIS 15.3.4R) applies to *managers*.
- (2) Where the *manager* wishes new *units* to be issued, and complies with CIS 15.3.11R (Timing of instructions to issue or cancel units), it may instruct the *trustee* to *issue* them. Any instructions given by the *manager* must state, in relation to each *class* of *unit* to be issued, the number to be issued, expressed either as a number of *units* or as an amount in value (or as a combination of the two).
- (3) If, at any *valuation point*, the *manager* has any outstanding obligation to *sell units* of any *class*, then it must instruct the *trustee*, before the earlier of:
 - (a) the expiry of two hours since the *valuation point*; or
 - (b) the next *valuation point*;

to *issue units* of the *class* in such number as will at least enable the *manager* to fulfil that obligation immediately, (whether from the *units* so issued or from other *units* of that *class* which it owned immediately before the *valuation point* (or *notified point* if there is one).
- (4) If the *manager* wishes regularly to have a *notified point*, it may notify the *trustee* of its intention, indicating the period of time not exceeding two hours after the *valuation point* at which it wishes the *notified point* to occur; and any change in the period is ineffective unless agreed by the *manager* and the *trustee*.

Issue by trustee

15.3.5

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- (1) This *rule* (CIS 15.3.5R) applies to *managers* and *trustees*.

- (2) The *trustee* must *issue units* on receipt of and in accordance with instructions given by the *manager* under CIS 15.3.4R (Issue of units: managers instructions), and must not, after an *initial offer*, *issue units* otherwise, but this is subject to (3) and to CIS 15.3.9R (Trustee's refusal to create or cancel units).
- (3) The *trustee* may *issue units* in exchange for assets other than *money*, but its obligation to comply with an instruction to *issue units* in such a case arises only:
 - (a) if it has taken reasonable care to determine that (taking account of any payment that would have been required under CIS 15.6.3R (SDRT provision) if the *units* had been issued for cash) the acquisition of the assets in exchange for the number of *units* to be issued is not likely to result in any material prejudice to the interests of *unitholders* or potential *unitholders*;
 - (b) in a case governed by CIS 11.5.2R(5) (Schemes of arrangement: requirements) that the resolution concerned in relation to the *AUT* of which it is the *trustee* has been duly carried or is not required.
- (4) On the *issue of units*, the *manager* must, by the close of business on the fourth *business day*, following the relevant instructions that were given by the *manager*:
 - (a) pay to the *trustee* in cash or in cleared funds the *issue price* of the *units* and any payment required under CIS 15.6.3R (SDRT provision) to the extent that either remains unpaid; or
 - (b) for an exchange under (3), ensure transfer to the *trustee* of the assets to be taken in exchange.
- (5) For an exchange under (3), the *manager* must ensure that the beneficial interest in the assets is transferred to the *trustee* with effect from the *issue* of the *units*, even if the legal ownership is not then transferred.

Issue price

15.3.6

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- (1) This *rule* (CIS 15.3.6) applies to *managers*.
- (2) The *issue price* of a *unit* is, subject to (3), calculated as follows:
 - (a) take the proportion, attributable to the *units* of the *class* in question, of the value on the *issue* basis of the *scheme property* by reference to the most recent valuation of the *scheme property*;

- (b) compute the number of *units* of the relevant *class* in *issue* immediately before the valuation in (a);
 - (c) divide the total at (a) by the number of *units* at (b); and
 - (d) express the price in a form that is accurate to at least four significant figures.
- (3) If a method of calculation other than that at (2) is used the *manager* must be sure that it is bound to produce the same result.

Cancellation of units

15.3.7

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- (1) This *rule* (CIS 15.3.7R) applies to *managers* and *trustees*.
- (2) Where the *manager* wishes *units* to be cancelled, and complies with CIS 15.3.11R (Timing of instructions to issue or cancel units), it may instruct the *trustee* to cancel them. Any instructions given by the *manager* must state, for each *class* of *unit* to be cancelled, the number to be cancelled, expressed either as a number of *units* or as an amount in value (or as a combination of the two).
- (3) Where, at any moment of instruction, the *manager* has any outstanding obligation to *sell units* of a *class*, it may not instruct the *trustee* to cancel *units* of that *class* if or to the extent that its so doing would prevent it immediately from fulfilling any such obligation which had been assumed before the *valuation point* (or *notified point* if there is one).
- (4) The *trustee* must (subject to CIS 15.3.9R (Trustee's refusal to issue or cancel units)) cancel *units* on receipt of instructions given by the *manager*, and the *trustee* may not cancel *units* otherwise.
- (5) Where instructions are given at a time which is less than two hours after the last *valuation point*, and the *trustee* has received but not yet executed instructions previously given under (4), the later instructions must enable the *trustee* to execute both or all sets of instructions simultaneously.
- (6) On the *cancellation* of *units* and on delivery to the *trustee* of such evidence of the title to those *units* as it may reasonably require, the *trustee* must, within the period specified in (7), pay the *cancellation* price of the *units* less any deduction required under CIS 15.6.3R (SDRT provision):
 - (a) (except where (b) applies), to, or to the order of, the *unitholder* or the *manager* as the case may be; or

- (b) In the case of a *relevant pension scheme*, in accordance with the relevant provisions of the *trust deed*.
- (7) The period expires at the close of business on the fourth *business day* following the *cancellation* of the *units*; but, where the *manager* has not ensured that the *scheme property* includes or will include sufficient cash in the appropriate currency (or a sufficient facility to borrow without infringing any restriction in CIS 5.15.3R (General power to borrow) or CIS 5.15.4R (Borrowing limits) within that period, the period is extended, for any relevant currency, until the shortage is rectified by the *manager*.
- (8) Paragraph (6) does not apply where *units* are cancelled following a *cancellation* for property transferred or sold under CIS 15.5.4R (In specie cancellation).

Cancellation price

15.3.8

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- (1) This rule (CIS 15.3.8R) applies to *managers* and *trustees*.
- (2) The *cancellation* price payable for each *unit* by the *trustee* under CIS 15.3.7R (Cancellation of units) is calculated by:
 - (a) Following steps (a) to (d) set out in CIS 15.3.6R(2) (Issue price) or else following CIS 15.3.6R(3); but
 - (b) for the purposes of 15.3.6R(2)(a), taking the value of the *scheme property* on the *cancellation* basis, not the *issue* basis.

Trustee's refusal to issue or cancel units

15.3.9

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- (1) This *rule* (CIS 15.3.9R) applies to *trustees*.
- (2) If, on receiving instructions to *issue* or cancel *units*, the *trustee* is of the opinion that it is not in the interests of *unitholders* that:
 - (a) *units* should be issued; or
 - (b) *units* should be cancelled; or
 - (c) *units* should be issued or cancelled in the number requested by the *manager*;

the *trustee* must give notice to the *manager* that it refuses to *issue* or, as the case may be, cancel, all, or a specified number of, the *units*.

- (3) On the giving of such a notice the *trustee* is relieved of the obligation to *issue* or cancel the number of *units* to which the notice relates.

Instructions or notifications between manager and trustee

15.3.10

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- (1) This *rule* (CIS 15.3.10R) applies to *managers* and *trustees*.
- (2) Any instruction or notification given (or report supplied) under this chapter by the *manager* to the *trustee*:
- (a) must be in writing or in such other form as enables the recipient to know or record the time of receipt and to preserve a legible copy of it;
 - (b) must be recorded by the *manager*, at the time when it is given or supplied.
- (3) Instructions are given within any period under this chapter if they are received by the *trustee* within that period, and instructions received by the *trustee* after the expiry of any period are treated as given after that expiry.
- (4) This *rule* also applies, with the necessary modifications, to any instruction or notification given by the *trustee* to the *manager*.

Timing of instructions to issue or cancel units

15.3.11

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- (1) This *rule* (CIS 15.3.11R) applies to *managers* and *trustees*.
- (2) A *manager* may at any time give instructions to the *trustee* to *issue* or to cancel *units*.
- (3) Where instructions are given at a time which is less than two hours after the last *valuation point* and before the next *valuation point*, the instructions must be given by reference to the price of the relevant *class of units* calculated (or being calculated) for the last *valuation point*.
- (4) Where instructions are given at a time which is more than two hours after the last *valuation point*:
- (a) the instructions must be given by reference to the price of the relevant *class of units* next to be calculated; and
 - (b) the *trustee* must *issue* or cancel the *units* only after the next *valuation point* has been reached.

Modification to number of units issued or cancelled

15.3.12

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- (1) This *rule* (CIS 15.3.12R) applies to *managers* and *trustees*.
- (2) The number of *units* issued or cancelled may be modified by the *manager* changing an instruction to *issue* or cancel *units* which has been complied with provided that:
 - (a) the *manager* ensures that any appropriate consequential payment between the *manager* and the *trustee* is made; and
 - (b) the *trustee* agreed to the modification.
- (3) The *trustee* must not agree to a modification under (2) unless it has taken reasonable care to determine:
 - (a) that the purpose of the modification is to rectify the consequences of an error in the instruction relating to the number of *units* held by the *manager*, or issued or cancelled in connection with the *sale* or *redemption* of *units* to or by, the *manager*; and
 - (b) that in view of the quality of the *manager's* control systems the circumstance that resulted in the error in question is an isolated one which is unlikely to recur.
- (4) A modification under (2) is of no effect unless the corrected number of *units* is calculated by the end of the *business day* next following the *valuation point* for the *issue* or *cancellation* in question, or, if the *trustee* agrees, within the payment period applicable to that *issue* or *cancellation* under CIS 15.3.5R (Issue by trustee) or CIS 15.3.7R (Cancellation of units).

15.4 Sale and redemption

Application

- 15.4.1 **R** /1 (1) This section applies to *managers*. CIS 15.4.8R(6) (Payment on redemption) and CIS 15.4.10R(7)(c) (Redemption charge) also apply to *trustees*.
- (2) This section applies to the *sale and redemption* of *units* after the close of any *initial offer*. However, CIS 15.4.3R (Manager's obligation to sell) also applies to *initial offers*.

Purpose

- 15.4.2 **G** /1 This section protects investors by means of *rules* intended to ensure the *manager* deals fairly with investors when they *purchase* or redeem *units*. Accordingly, this section (CIS 15.4) lays down the basic procedures for the *sale and redemption* of *units* and sets out how the resulting payments should be calculated and paid.

Manager's obligation to sell

- 15.4.3 **R** /1 (1) The *manager* must at all times during the *dealing day* be willing to *sell units* and, subject to (2), must, at the request in writing of any *person*, agree to *sell* to that *person units* of at least one *class* or, in the case of an *umbrella scheme*, one *class* in respect of each of its *sub-funds*.
- (2) The *manager's* obligation to *sell units* under (1) does not apply:
- if it has not received payment for the *units* of an amount complying with CIS 15.4.4R (Sale price parameters) or, if the *sale* was at a *forward price* of a stated number of *units*, if it has not received payment of an amount estimated by it to be required; or
 - if the number or value of the *units* sought to be purchased is less than any number or value stated in the *prospectus* as the

minimum number or value of *units*, or *units* of the *class* concerned, that may be purchased or held; or

- (c) (for a *property scheme*) if the *manager* believes, on reasonable grounds, that the number or value of *units* sought to be purchased would lead to any one *person* (or any one *person* and any other *person* who appears to the *manager* to be acting in concert with that *person*) holding more than any number or value stated in the *prospectus* as the maximum number or value to be purchased or held; or
 - (d) if it has reasonable grounds, relating to the circumstances of the *person* concerned, for refusing to *sell units* to him; or
 - (e) if the *sale* would be in breach of a provision in the *trust deed* of any of the types described in paragraphs (j) (Limited categories of unitholders), (m) (Relevant pension schemes) or (n) (Relevant charitable schemes) of CIS 2.2.7G (Provisions that may be included in the trust deed).
- (3) Paragraph (1) does not apply to *units* of any *class*:
- (a) if no *units* of that *class* are in *issue*; or
 - (b) if the *sale* of *units* of that *class* is prohibited by CIS 13 (Suspension and termination).
- (4) *Units* must be sold in the *base currency*, unless the *person* concerned requests, and the *manager* agrees, that the *units* should be sold in another currency.

Sale price parameters

15.4.4

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- (1) Except in the case of a *large deal*, the *manager's price* for the *sale* of *units* must not exceed the maximum *sale price* of the relevant *class*; that is a price fixed by the *manager* and notified or to be notified to the *trustee* in respect of the last *valuation point* (or, for a *sale* at a *forward price*, to be notified in respect of the next *valuation point*) and that maximum *sale price* itself must not exceed the total (expressed to at least four significant figures) of:
- (a) the *issue price*; and
 - (b) the current *preliminary charge*.
- (2) In the case of an *initial offer*, the *manager's price* for *sale* of *units* must not exceed the *initial price*.

- (3) In the case of a *large deal*, the *manager's price for sale* may exceed the maximum *sale price*, but must not exceed the limit above which the maximum *sale price* could not have been fixed.
- (4) The *manager's price for sale* must not be less than the minimum *redemption price* under CIS 15.4.9R (Redemption price parameters).

Preliminary charge

15.4.5

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- (1) The *sale price* must not include a *preliminary charge* unless the *trust deed* so permits.
- (2) The *preliminary charge* must be expressed as a fixed amount or as a percentage of the *issue price* and must not exceed an amount or rate calculated in accordance with a statement in the *prospectus* as to the current charge.
- (3) The *manager* must not make any charge or levy in connection with the *sale of units* except a *preliminary charge* in accordance with (1) and (2), but this does not restrict any requirement for a payment under CIS 15.6.3R (SDRT provision).
- (4) Paragraph (1) does not apply on an exchange of *units* within an *umbrella scheme*, but nothing in this *rule* prevents the *manager* from making a charge on such an exchange in accordance with CIS 15.4.12R (Exchange of units in umbrella schemes)

Increase in preliminary charge

15.4.6

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- The *manager* must not introduce a *preliminary charge* or increase (within the maximum stated in the *trust deed*) the current amount or rate of a *preliminary charge* payable under CIS 15.4.5R unless:
- (1) the new *preliminary charge* is within the maximum stated in the *trust deed*;
 - (2) the introduction or increase would not cause an infringement of CIS 15.4.11R (Control over maximum charges on issue and redemption);
 - (3) not less than 90 *days* before the introduction or increase:
 - (a) the *manager* gave notice in writing of that introduction or increase and of the date of its commencement to the *trustee* and to all the *persons* who ought reasonably to be known to the *manager* to have made an arrangement for the purchase of *units* at regular intervals; and

- (b) the *manager* has revised the *prospectus* to reflect the introduction or new current amount or rate of *preliminary charge* and the date of its commencement and has made the revised *prospectus* available.

Manager's obligation to redeem

15.4.7

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- (1) The *manager* must at all times during the *dealing day* be willing to redeem *units*; and, accordingly, must at the request in writing of any *unitholder* agree to redeem *units* owned by that *unitholder* for the amount to be paid under CIS 15.4.8R (Payment on redemption).
- (2) Paragraph (1) does not apply:
- (a) if the number or value of the *units* sought to be redeemed is:
- (i) less than the entirety of the *unitholders* holding of *units* of the *class* concerned; and
- (ii) less than any number or value stated in the *prospectus* as the minimum number or value that may be redeemed of *units*, or *units* of the *class* concerned; or
- (b) if the number or value of the *units* sought to be redeemed would result in the *unitholder* holding less than any number or value stated in the *prospectus* as the minimum number of *units*, or *units* of the *class* concerned, that may be held; or
- (c) if the *manager* ensures that the *unitholder* is able to *sell* his *units* on an *investment* exchange at a price not significantly different from the price at which they would have been redeemed; or
- (d) where *units* are redeemed in return for property transferred or sold under CIS 15.5.4R (In specie cancellation); or
- (e) during the period of the *initial offer*; or
- (f) if *redemption* of the *units* of the *class* concerned is prohibited by CIS 13 (Suspension and termination).

Payment on redemption

15.4.8

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- (1) On agreeing to redeem *units*, the *manager* must, within the period specified in (3):

- (a) (except where (b) applies) pay the *unitholder* the proceeds of *redemption* under (3) (less any deduction under (4) and, where applicable, the cost of remitting the sum abroad); or
 - (b) if a *manager* of a *relevant pension scheme* pay or arrange for the payment of the appropriate proceeds of *redemption* in compliance with the *trust deed* including, where applicable, any time limit therein for payment which is shorter than the period specified in (2).
- (2) The proceeds of *redemption* paid under (1) must not be less than the *manager's price* for *redemption* of *units* under CIS 15.4.9R (Redemption price parameters).
 - (3) The period expires at the close of business on the fourth *business day* following the later of:
 - (a) the *valuation point* immediately after the *manager* receives the request to redeem; or
 - (b) the time when the *manager* has all duly executed instruments and authorisations to effect (or enable the *manager* to effect) transfer of title to the *units*.
 - (4) There may be deducted from the proceeds of *redemption* to be paid under (1) any *redemption charge* permitted under CIS 15.4.10R (Redemption charge) and any payment required under CIS 15.6.3R (SDRT provision).
 - (5) Neither this *rule* CIS 15.4.8R nor CIS 15.4.9R (Redemption price parameters) applies where the *manager* is not redeeming *units* in accordance with this chapter, but is *buying* them as *principal* on an *investment* exchange in accordance with a power in the *trust deed*, which envisages that settlement will be in accordance with the *rules* of that exchange.
 - (6) Nothing in this *rule* require a *manager* or *trustee* to part with *money* for a *cancellation* or *redemption* of *units* where any *money* due on the earlier *issue* or *sale* of those has not been received by the *person* entitled to it under this chapter.

Redemption price parameters

15.4.9

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- (1) Except in the case of a *large deal*, the *manager's price* for any *redemption* of *units* must not be less than the relevant minimum *redemption price* of a *unit* of the relevant *class* notified, or to be notified to the *trustee*, in respect of the last *valuation point* (or, for a *redemption* at a *forward price*, next to be notified in respect of the next *valuation point*).

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- (2) The minimum *redemption* price must not be less than the relevant *cancellation* price.
- (3) In the case of a *large deal*, the *manager's price* for *redemption* may be less than the minimum *redemption price*, but must not be less than the relevant *cancellation price*.
- (4) Subject to CIS 15.4.12R (Exchange of units in umbrella schemes), in the case of an *umbrella scheme*, the maximum price at which *units* in one *sub-fund* may be acquired in exchange for *units* in another *sub-fund* must not exceed the relevant maximum *sale* price (less any *preliminary charge*) of the new *units*; and the minimum price at which the old *units* may be taken in exchange must not be less than the equivalent minimum *redemption price*.
- (5) The *manager's price* for *redemption* of *units* must not exceed the relevant *issue price* under CIS 15.3.6R (Issue price).

Redemption charge

15.4.10

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- (1) If the *trust deed* so permits, the proceeds of *redemption* may in accordance with CIS 15.4.8R (Payment on redemption) be arrived at after deduction of a *redemption charge* for the benefit of the *manager*.
- (2) (a) A *redemption charge* must not exceed the amount or rate of *redemption charge* stated in the *prospectus* current at the date when the relevant *units* were issued, other than to the *manager*, or sold; and
 - (b) the amount or rate referred to in (a) may be expressed as diminishing over the time during which the *unitholder* has held the *units*, but may not be expressed as liable to vary in any other respect.
- (3) In (2) and (7), "issued" or "sold" in the case of *units* in an *AUT* which has absorbed the whole or part of the property of another *scheme*, is (when relevant) a reference to the *issue* or *sale* of *units* in that other *scheme* so far as it is practicable for the *manager* to ascertain the timing of that *issue* or *sale* as opposed to the *issue* of other *units* held by that *holder*.
- (4) The *manager* must not introduce a *redemption charge*, or change the rate or method of calculation of a current *redemption charge*, in a manner which is adverse to *unitholders*, unless at least 90 *days* before the introduction or change, the *manager*:
 - (a) gave notice in writing of that introduction or change and of the date of its commencement, to the *trustee* and to all the *persons* who ought reasonably to be known to the *manager* to

- have made an arrangement for the purchase of *units* at regular intervals; and
- (b) has revised the *prospectus* to reflect the introduction or change and the date of its commencement and has made the revised *prospectus* available.
- (5) A modification of the rate or method which is adverse to redeeming *unitholders* (or *unitholders* cancelling *units* under CIS 15.5.3R (Issues and cancellations through the manager)) must be limited so as to apply only to *units* which have been issued (whether at the request of the current *unitholder* or otherwise) after the date on which the modification takes effect.
- (6) Where the *trust deed*, whenever executed, is modified so as to authorise a *redemption charge*, the modification must be expressed so as to apply only to *units* issued after the date on which the modification takes effect.
- (7) In deciding whether and to what extent a charge is deductible for the purposes of this *rule*, *units* held by a *unitholder* are to be taken to be redeemed in the order in which they were issued (other than to the *manager*) or sold, unless:
- (a) the *manager* has the *unitholder's* instructions to the contrary; or
- (b) the *manager* selects as the *units* first to be redeemed *units* which are not subject to the deduction; or
- (c) the *manager* and the *trustee* have agreed on another way of deciding the order in which *units* are redeemed which appears to them unlikely materially to prejudice the *unitholder* concerned.
- (8) A *manager* must not make a *redemption charge* which might reasonably be regarded as restricting the right of *redemption*.

Control over maximum charges on issue and redemption

15.4.11

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- (1) In the circumstance envisaged by (2), an introduction of, or change to, either of the charges permitted by CIS 15.4.5R (Preliminary charge) or CIS 15.4.9R (Redemption charge) must not take effect unless:
- (a) the *trust deed* is modified under CIS 11.4.3R (Amendment to trust deed: with meeting); or
- (b) as the case may be, the *prospectus* is amended following approval of the introduction or change by an *extraordinary*

resolution at a meeting of the *unitholders* called for the purpose.

- (2) The circumstance mentioned in (1) is that (for any individual *unit* notionally issued and redeemed on the same *day*) the maximum amount or percentage of any *preliminary charge* and of any *redemption charge* would in aggregate exceed the maximum amount or percentage for the *preliminary charge* alone which is stated in the *trust deed*.

Exchange of units in umbrella schemes

15.4.12

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For an *umbrella scheme*, the *manager* must not make any charge on an exchange of *units*:

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- (1) if the exchange is the first to be made by the *unitholder* during any *annual accounting period*; or
- (2) in the case of a second or subsequent exchange, unless:
- (a) such a charge is authorised by the *trust deed*; and
 - (b) the amount of the charge is within the maximum for charging on such an exchange stated in the most recently published *prospectus*.

Notification of prices to the trustee

15.4.13

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(1) Immediately after completing a valuation under *CIS 15.8R*, (whether regular or otherwise) the *manager* must notify the *trustee* of:

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- (a) the *issue price*;
 - (b) the *cancellation price*;
 - (c) the maximum *sale price*; and
 - (d) the minimum *redemption price*; and
 - (e) (in the case of an *umbrella scheme*) the maximum *sale price* for *units* in any *sub-fund* on an exchange of *units*.
- (2) The *prices* to be notified under (1) must:
- (a) relate to *units* of each *class* in *issue*;
 - (b) be those relevant to *deals* based on prices determined at the *valuation point*; and

(c) be in the *base currency*.

- (3) Each notification under (1) must include a statement of the number of *units* of each *class* owned by the *manager* at the *valuation point* (or notified point if there is one).
- (4) As soon as practicable after each notification under (1), the *manager* must notify the *trustee* of the transactions, or types of transaction, for which an *SDRT provision* is applied and the amounts or rates of those *SDRT provisions*.

Publication of prices

15.4.14

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(1) Where the *manager* holds itself out as willing:

- (a) to *sell* or redeem *units* of any *class*; or
- (b) to *issue* or cancel *units* of any *class* under CIS 15.5.3R (Issues and cancellations through the manager);

it must make public the maximum *sale* and minimum *redemption prices* of those *units* and the current *preliminary charge* (if there is one).

- (2) The prices made public under (1) are to be the price or prices last notified to the *trustee* under CIS 15.4.13R or, in the case of publication in a newspaper, last notified before the relevant newspaper ceased to accept material for publication in the relevant edition.
- (3) The prices to be made public under (1) must be published in at least one national newspaper in the *United Kingdom*, except for any *class* of *units* that is marketed predominantly outside of the *United Kingdom*.
- (4) Where the *manager* holds itself out as willing to *sell* and redeem *units* (or, as the case may be, to *issue* or cancel *units* under CIS 15.5.3R (Issues and cancellations through the manager) in any other *EEA State*, it must also comply with (1) in the manner provided for by the law of that *EEA State*.
- (5) Paragraphs (1) to (4) do not apply to *units* in relation to which the *manager* is excused from dealing with the public.
- (6) The *manager* must disclose the *cancellation price*, orally or in writing, to any *person* who requests it, whether in *person* at, or by any communication addressed to, the *manager's* principal place of business in the *United Kingdom*, and the *manager* must have arrangements to enable it accordingly to disclose, free of

charge, at all times during the *dealing day*, the *cancellation price* last notified to the *trustee*.

15.5 Issues and cancellations through the manager and in specie cancellations

Application

- 15.5.1 **R** This section applies to *managers* and *trustees*.
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Purpose

- 15.5.2 **G** (1) CIS 15.5.3R ensures that investors are able, in certain circumstances, to require direct *issues* or *cancellations* of *units* by the *trustee* as an alternative to *buying units* from, or redeeming them with, the *manager*.
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- (2) CIS 15.5.4R protects investors in an *AUT* by enabling the *manager*, subject to the conditions in that *rule*, to require a *unitholder* who wishes to redeem his *units* to take, instead of the usual proceeds of *redemption*, a transfer of assets of the *AUT*, or if the *unitholder* requires, to take the net proceeds of the *sale* of the assets.

Issues and cancellations through the manager

- 15.5.3 **R** (1) At the request of any *person*, the *manager* is obliged to instruct the *trustee* to *issue units* to that *person* where the *manager* would otherwise be obliged to *sell* them under CIS 15.4.3R (Manager's obligation to sell).
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- (2) At the request of any *unitholder*, the *manager* is obliged to instruct the *trustee* to cancel *units* held by that *unitholder* where the *manager* would otherwise be obliged to redeem them under CIS 15.4.7R (Manager's obligation to redeem).
- (3) The price of a *unit* issued or cancelled under this *rule* must be the *issue* or *cancellation* price of a *unit* of the relevant *class* notified to the *trustee* at the next *valuation point* after the request referred to in (1) or (2), except for an *issue* to which CIS 15.2.5R (Initial price) applies, when it must be the *initial price*.
- (4) (a) In the case of an *issue*, the *manager* may require to be paid in addition to the price under (3):

- (i) For the account of the *manager*, any *preliminary charge* permitted under CIS 15.4.5R;
 - (ii) For the account of the *AUT*, any *SDRT provision* required under CIS 15.6.3R (SDRT provision).
- (b) In the case of a *cancellation*, the *manager* may require to be deducted from the proceeds:
- (i) For the account of the *manager*, any *redemption charge* permitted under CIS 15.4.10R (Redemption charge);
 - (ii) for the account of the *AUT* any deduction required under CIS 15.6.3R.
- (5) The *manager* must pay the *trustee* in accordance with CIS 15.3.5R (Issue by trustee), the *issue price* of any *units* issued under this *rule* CIS 15.5.3R and any payment required under (4)(a)(ii), whether or not the *manager* has received payment from the investor. However, the *manager* may defer instructing the *trustee* to *issue* the *units* until full payment for them has been received.
- (6) Nothing in this *rule* requires the *trustee* or the *manager* to part with *money* for a *cancellation* of *units* in the circumstances described in CIS 15.4.8R(6) (Payment on redemption).

In specie cancellation

15.5.4

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- (1) This applies where a *unitholder*:
- (a) requests *redemption*, or requests *cancellation* under CIS 15.5.3R (Issues and cancellations through the manager), of *units* representing in value not less than 5% (or any lower percentage stated in the *trust deed*) of the value of the *scheme property* of the *AUT*; and
 - (b) the transfer to him of *scheme property*, instead of a payment under CIS 15.4.8R (Payment on redemption) or CIS 15.5.3R, is either:
 - (i) chosen by the *manager* by a notice of election on the *unitholder*; or
 - (ii) requested by the *unitholder* (in a case where he is permitted to do so under the *trust deed*) at the same time as his request at (a).

- (2) A notice of election under paragraph (1)(b)(i) is invalid if served later than the close of business on the second *business day* following the *day* of receipt of the request in paragraph (1)(a);
- (3) Where a notice of election is served under paragraph 1b(i), the *unitholder* may by a notice served on the *manager* require the *manager*, instead of arranging for a transfer of property, to arrange:
 - (a) for a *sale* of the property; and
 - (b) for payment to the *unitholder* of the net proceeds of *sale*.
- (4) A *manager* must comply with the requirement of a valid notice served on it under (3). A notice under (3) is not valid if served later than the close of business on the fourth *business day* following the *day* of receipt of the notice under (1)(b)(i).
- (5) Where there is to be transfer of property, whether by election or by request:
 - (a) the *manager* must forthwith notify the *trustee* that *redemption* (or *cancellation* under CIS 15.5.3R) of the *units* is to be effected by transfer of property; and
 - (b) the *trustee* must, on receipt of such evidence of title as he may require:
 - (i) cancel the *units*; and
 - (ii) transfer to the *unitholder* his proportionate share of the due property.
- (6) In (5) in this *rule*, ‘proportionate share’ means:
 - (a) such part of each description of asset in the *scheme property* as is proportionate to or as nearly as practicable proportionate to the *unitholder’s share*; or
 - (b) such selection from the *scheme property* as the *trustee*, after consultation with the *manager*, decides is reasonable;having regard to the need to be fair both to the *unitholder* and to continuing *unitholders*.
- (7) Where there is to be a *sale* of property under (3):
 - (a) the *manager* must immediately notify the *trustee* of that fact, and must arrange for a *sale* of the assets that would otherwise have been transferred under (5) (other than any assets which are in cash in the relevant currency for the purposes of the *redemption*); and

- (b) the *trustee* must, on receipt of such evidence of title as it may require:
 - (i) cancel the *units*; and
 - (ii) pay to the *unitholder* the net proceeds of the *sale* and any relevant amount in cash.
- (8) The *scheme property* to be transferred under (6), or the proceeds of *sale* to be paid under (7), are subject to the retention of *scheme property* (including cash) of a value or amount equivalent to any deductions permitted by CIS 15.5.3R (Issues and cancellations through the manager) and which shall be accounted for in the manner provided by that *rule*. However, those deductions must not be taken into account in the value of *units* used for the purpose of (1)(a).
- (9) This *rule* does not enable *units* in a *relevant pension scheme* other than in accordance with that *scheme* to be redeemed.

15.6 SDRT provision

Application

15.6.1 **R** This section applies to *managers*.

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Purpose

- 15.6.2 **G**
- (1) Certain transactions in *units* can result in stamp duty reserve tax being paid out of the *scheme property* of the *AUT*. Accordingly, with a view to protecting investors from a resulting diminution in the value of their *units*, and in accordance with *Principle 6* (customers' interests) that a *firm* must pay due regard to the interests of its *customers* and treat them fairly, a *manager* is permitted to require the payment of an *SDRT provision* as an addition to the *price* of *units* when they are issued or sold, and as a deduction when they are cancelled (other than certain in specie *cancellations*) or redeemed.
 - (2) Any *SDRT provision* paid or received by deduction is for the account of the *AUT*.
 - (3) For the purpose of (1) and (2) it does not matter whether the cancellation is under *CIS 15.3* (Issues and cancellations) or under *CIS 15.5* (Issues and cancellations through the manager and in specie cancellations).
 - (4) *CIS 15.6.3R(3)(b)* makes it clear that transactions that are specifically excluded from a charge to stamp duty reserve tax (such as transactions in *units* within an individual pension account) can be excluded from the imposition of an *SDRT provision* without affecting the fairness required by that *rule*.

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SDRT provision

- 15.6.3 **R**
- (1) The *manager* has the power to require either or both of:
 - (a) the payment of an *SDRT provision* in respect of the *issue* or the *sale* of *units*; and
 - (b) the deduction of an *SDRT provision* in respect of the *redemption*, or *cancellation* of *units*, other than a *cancellation* of *units* under *CIS 15.5.4R* (In specie cancellation) resulting in a transfer of property that is such part of each description of

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asset in the *scheme property* as is proportionate to, or as nearly as practicable proportionate to, the *unitholder's share* in the *scheme property*.

- (2) Any such payment or deduction becomes due at the same time as payment or transfer of property becomes due in respect of the *issue, sale, redemption or cancellation*.
- (3) An *SDRT provision* may be imposed only in a manner that is, so far as practicable, fair to all *unitholders* and potential *unitholders*. However:
 - (a) the imposition of an *SDRT provision* (or a higher *SDRT provision*) in respect of *large deals*, in a manner described in the *prospectus* current at the time of the *deal*, or
 - (b) The exclusion from an *SDRT provision* of any transaction in *units* where the *units* are so held that their *redemption or cancellation* is specifically excluded from a charge to stamp duty reserve tax,

is not unfair

- (4) If the *manager* receives an *SDRT provision* in respect of any *unit* sold or to be sold by it, it must immediately upon receipt of that *SDRT provision* pay it to the *trustee* to become part of the *scheme property* of the *AUT*, except to the extent that it has already been, or will be, paid by the *manager* to the *trustee* on the *issue* of that *unit*.
- (5) If the *manager* deducts an *SDRT provision* from the proceeds of a *unit* it redeemed, it must immediately pay it to the *trustee* to become part of the *scheme property* except to the extent that it already has been, or will be, deducted from the payment by the *trustee* to the *manager* on *cancellation* of that *unit*.

15.7 Forward and historic pricing

Application

15.7.1 **R** This section applies to *managers*.

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Purpose

15.7.2 **G** This section protects investors by means of *rules* intended to prevent the *sale* and *redemption* of *units* at an *historic price* where this is liable to be unfair.

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15.7.3 **G** (1) There are two ways in which a *manager* may *sell* or redeem *units*; these are at forward and *historic prices*. A *forward price* is one to be fixed at the next *valuation point*, while a *historic price* is one fixed on the basis of the last valuation.

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(2) The two pricing systems have different characteristics. The investor knows that a forward *deal* will be priced at the next *valuation point*, but if he is investing a specified sum, he does not know until then how many *units* he will receive (or, if he is seeking to redeem, how much he will receive in cash). The investor knows, by contrast, that a historic *deal* may well represent a price which is outdated (though not by more than 2%), but is able to know, at the time of the *deal*, how much he must pay (or will receive) or the time of the valuation which will be relevant to that price.

(3) The *rules* generally express a preference for forward pricing in that there are numerous occasions when a *price* must be forward, whether or not the *manager* chooses to *deal* in that way. *Issues* or *cancellations* through the *manager* under CIS 15.5.3R (Issues and cancellations through the manager) are always at a *forward price*.

(4) The diagram in CIS 15.7.6G indicates the *valuation point* relevant for *issues* and *cancellations* and for *sales* and *redemptions* in the period between one *valuation point* and the next. In doing so, it takes account of Table 15.7.5 (2) and of earlier *rules* in this chapter, including CIS 15.3.11 (Timing of instructions to issue or cancel units).

Forward and historic pricing

15.7.4 **R** (1) For the *sale* and *redemption* of *units*, the *manager* may, subject to this *rule* CIS 15.7.4R, operate on the basis of forward or *historic*

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prices, but its power to choose, or its duty to operate on one basis only, is governed by CIS Table 15.7.5 (2).

- (2) If the prices for the *sale* and *redemption* of *units* related to any *sub-fund* of an *umbrella scheme* are on a forward basis, the prices for the *sale* and *redemption* of *units* related to each other *sub-fund* of that *umbrella fund* must also be on a forward basis; but this paragraph does not apply merely because of a requirement to price on a forward basis temporarily under Part 2 or Part 3 of CIS Table 15.7.5.
- (3) Prices are to be on a forward basis only for the *sale* and *redemption* of *units* in an *AUT* which is a *geared futures and options scheme*, a *property scheme*, a *warrant scheme* or an *umbrella scheme* that includes a *sub-fund* which, if it were the subject of a separate *authorisation order*, would be an *AUT* of one of those categories.
- (4) Table 15.7.5 does not apply during the period of *initial offer* at a fixed price. In Table 15.7.5:
 - (a) 'F Only' means that any price agreed on must be a *forward price*;
 - (b) 'H' means that any price agreed on must be an *historic price* unless the *manager* is required by the table to *deal* at a *forward price*; and
 - (c) 'General dealing' means "in relation to all *sales* and *redemptions* agreed on during the remainder of the relevant *dealing period* (except those that are agreed upon individual deviations)"; and an 'individual deviation' is a decision, in relation to a particular transaction, covered by Part 3 of the Table.

15.7.5

R

Table Explanatory table: Forward or historic pricing (This is the table referred to in CIS 15.7.4R).

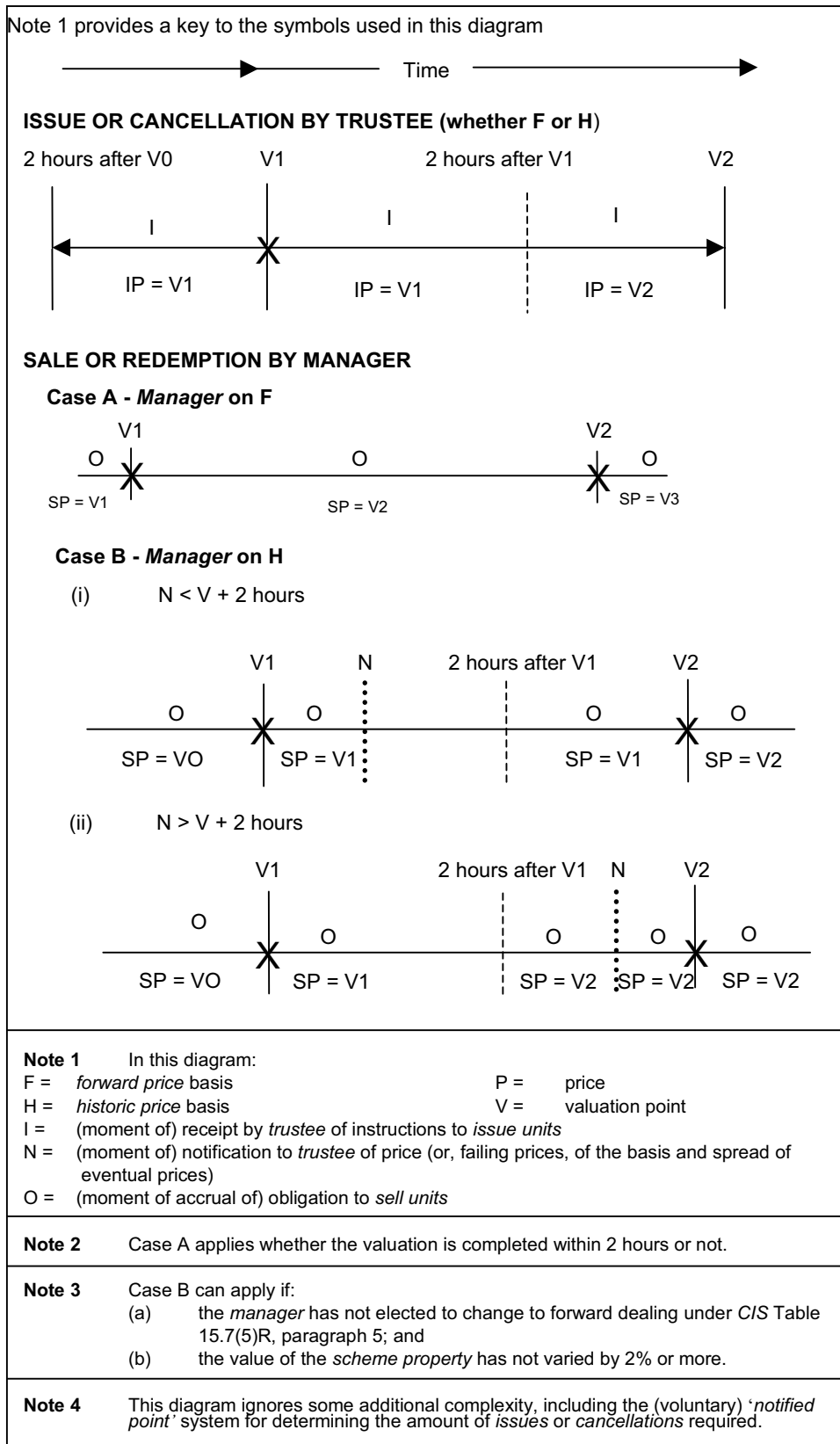
FORWARD OR HISTORIC PRICING

Part 1: General Dealing

1. *Manager's choice.* The *prospectus* must state the *manager's* choice for H or else for F Only.
2. If the *manager's* current choice under 1 is F Only, all its *deals* must be at a *forward price*.
3. A *manager* must not choose H if its normal arrangements for valuation envisage valuations more than one *business day* apart.
4. The remainder of this table applies to a *manager* with a current choice of H.
5. It may at any time elect for F Only in respect of the rest of the then current *dealing period*.

6. If the *manager* binds itself to switch from H to F Only at a certain point in each *dealing period*, this must be stated in the *prospectus*.
 7. An election for (or switch to) F Only will last until the end of the *dealing period* and will then lapse.
 8. For general *dealing* purposes, *redemptions* must be on the same basis as *sales*.
- Part 2: General Dealing – Duty To Adopt Forward Pricing
9. Market movement: F Only applies once the *manager* having taken reasonable care decides that there would be a difference of 2% or more between the current value of the *scheme property*, if immediately valued, and its last calculated value (taking that as 100% for this purpose), but decides not to carry out an additional valuation under CIS 15.8.3R (Valuation of scheme property).
 10. Valuation taking over 2 hours: F Only applies if a new price for *units* of each *class* has not been notified to the *trustee* after 2 hours.
 11. Paragraph (10) does not apply, if within two hours of the *valuation point*, the *manager* has notified the *trustee* of the basis (*issue* or *cancellation*) on which the next prices will be fixed, and of the spread (reckoned in percentage or *money* terms) between the maximum *sale price* and the minimum *redemption price*.
 12. F Only under (9) and (10) will start when the relevant moment arrives, will last until the end of the *dealing period* and will then lapse.
- Part 3: Individual Deviations
13. Paragraphs (14) to (17) apply to an individual transaction without affecting the general position arrived at under Parts 1 and 2.
 14. Request: F Only applies if the applicant for *sale* or *redemption* so requests.
 15. *Large deals*: F Only applies, if the *manager* so decides, for a *large deal*.
 16. *Postal deals*: F Only applies if the order or offer reaches the *manager* through the post or by any similar form of one-way *communication*.
 17. *Issue* or *cancellation* through the *manager*: F Only applies in the case of an *issue* or *cancellation* under CIS 15.5.3R (Issues and cancellations through the manager).
- Part 4: Notification to Trustee
18. The *manager* must notify the *trustee* of the fact and time of any adoption of F only under (5) or Part 2.

Explanatory diagram: pricing at and after valuation point (This is the diagram referred to in CIS 15.7.3G(4).)



15.8 Valuation

Application

15.8.1 **R** This section applies to *managers*.

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Purpose

- 15.8.2 **G**
- (1) This section protects investors by providing how the *issue, cancellation, sale and redemption prices* of *units* should be calculated. It also deals with the time and method of valuation of the *scheme property*, with the property that is to be included in a valuation and with the various tax and other adjustments that are either added to or deducted from such a valuation.
 - (2) CIS 15.8.4R contains the detailed *rules* for valuation of the *scheme property* by the *manager*. The Table is subject to other *rules* (see CIS 5.2.5R (Valuation) and CIS 12.3 (Property schemes)).

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Frequency of valuation

- 15.8.3 **R**
- (1) **Regular valuation:** for the purposes of determining in accordance with these *rules* the prices at which *units* of either *class* may be issued, cancelled, sold or redeemed, the *manager* must regularly carry out a valuation of the *scheme property*, which must be conducted in accordance with CIS 15.8.4R.
 - (2) **Additional valuation:** the *manager* must inform the *trustee* if the *manager* determines to have an additional *valuation point* in respect of the *AUT* or any *sub-fund*, but this does not prevent the *manager* carrying out a valuation for another purpose that is not against the interests of the *unitholders* at a time that is not to be a *valuation point*.
 - (3) **An additional valuation must be conducted in accordance with CIS 15.8.4R.**
 - (4) **An additional valuation for the purposes of paragraph (9) (market movement) of CIS 15.7.5R (forward and historic pricing) must be conducted:**

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- (a) in accordance with *CIS 15.8.4R*; but
- (b) if it is impracticable to conduct a valuation in accordance with that table, the *manager* determines having taken reasonable care, and the *trustee* agrees, that an adequate valuation may be obtained in that way, may be conducted by reference to fluctuations in an index of property reflecting in the composition the *scheme property* the additional valuations may be conducted in that way.

15.8.4

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Table 15.8R – Valuation
(This is the table referred to in *CIS 15.8.3*)

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Section 1: When?	
1.	The <i>manager</i> must carry out valuations under <i>CIS 15.8.3(1)R</i> (Regular valuations) regularly.
2.	The frequency of regular valuation must be specified in the <i>prospectus</i> .
3.	The frequency specified must be at least twice a calendar month.
4.	If the frequency specified is the minimum frequency, the regular valuations must be two weeks or more apart.
5.	Paragraphs 3. and 4. do not apply to <i>warrant schemes</i> or to a <i>sub-fund</i> which is permitted to invest entirely in <i>warrants</i> and there must be at least one <i>valuation point</i> for them on each <i>business day</i> .
6.	Additional valuations under <i>CIS 15.8.3R(2)</i> can take place at any time during a <i>dealing day</i> .
7.	There is no need to value during the period of an <i>initial offer</i> (but see <i>CIS 15.2.6R</i> (Compulsory termination of initial offer)).
Section 2: How?	
8.	The valuation takes place as at a <i>valuation point</i> fixed by the <i>manager</i> under Section 1.
9.	The valuation is in <i>base currency</i> .
10.	Prices must be the most recent prices that can reasonably be obtained after the <i>valuation point</i> with a view to giving an accurate valuation as at that point.
11.	A valuation is in two parts, one on an <i>issue</i> basis and one on a <i>cancellation</i> basis.
12.	To convert to <i>base currency</i> the value of property which would otherwise be valued in another currency the <i>manager</i> must either:
(a)	Select a rate of exchange which represents the average of the highest and lowest rates quoted at the relevant time for conversion of that currency into <i>base currency</i> on the market on which the <i>manager</i> would normally <i>deal</i> if it wished to make such a conversion; or
(b)	Invite the <i>trustee</i> to agree that it is in the interests of <i>unitholders</i> to select a different rate, and, if the <i>trustee</i> so agrees, use that other rate.
Section 3: What?	
13.	All <i>scheme property</i> is included, subject to adjustments arising from this section, and section 4, and this section is to be applied as at the <i>valuation point</i> .
14.	If the <i>trustee</i> has been instructed to <i>issue</i> or cancel <i>units</i> , assume (unless the contrary is shown) that:
(a)	it has done so;
(b)	it has paid or been paid for them; and
(c)	all consequential action required by these <i>rules</i> or by the <i>trust deed</i> has been taken.
15.	If the <i>trustee</i> has issued or cancelled <i>units</i> but consequential action as at 14(c) is outstanding, assume that it has been taken.
16.	If agreements for the unconditional <i>sale</i> or <i>purchase</i> of property are in existence but uncompleted, assume:
(a)	completion; and
(b)	that all consequential action required by their terms has been taken.
17.	Do not include in 16. any agreement which is:
(a)	A <i>future</i> or <i>contract for differences</i> which is not yet due to be performed; or
(b)	An unexpired <i>option</i> written or purchased for the <i>AUT</i> which has not yet been exercised.

18.	Include in 16 any agreement the existence of which is, or could reasonably be expected to be, known to the <i>person</i> valuing the property, assuming that all other <i>persons</i> in the <i>manager's</i> employment take all reasonable steps to inform it immediately of the making of any agreement.	
Section 4: Tax and other adjustments		
19.	Deduct an estimated amount for anticipated tax liabilities:	
	(a)	On unrealised capital gains where the liabilities have accrued and are payable out of the <i>scheme property</i> ;
	(b)	On realised capital gains in respect of previously completed and current accounting periods;
	(c)	On income where the liabilities have accrued;
	(d)	Including stamp duty reserve tax and any other fiscal charge not covered under this deduction.
20.	Deduct:	
	(a)	an estimated amount for any liabilities payable out of the <i>scheme property</i> and any tax on it (treating any periodic items as accruing from day to day);
	(b)	the principal amount of any outstanding borrowings whenever payable;
	(c)	any accrued but unpaid interest on borrowings;
	(d)	the value of any <i>option</i> written (if the <i>premium</i> for writing the <i>option</i> has become part of the <i>scheme property</i>); and
	(e)	in the case of a margined contract, any amount reasonably anticipated to be paid by way of variation <i>margin</i> (that is the difference in price between the last settlement price, whether or not variation <i>margin</i> was then payable, and the price of the contract at the <i>valuation point</i>).
21.	Add an estimated amount for accrued claims for repayment of taxation levied:	
	(a)	on capital (including capital gains); or
	(b)	on income.
22.	Add:	
	(a)	any other credit due to be paid into the <i>scheme property</i> ;
	(b)	in the case of a margined contract, any amount reasonably anticipated to be received by way of variation <i>margin</i> (that is the difference in price between the last settlement price, whether or not variation <i>margin</i> was then receivable, and the price of the contract at the <i>valuation point</i>);
	(c)	any <i>SDRT provision</i> anticipated to be received.
Section 5: Issue Basis		
23.	The valuation of property for that part of the valuation which is on a creation basis is as follows:	
	Property	To be valued at
	(a) Cash	nominal value
	(b) Amounts held in current and deposit accounts	nominal value
	(c) Property which is not within (a), (b) or (d):	
	(i) if <i>units</i> in an <i>AUT</i> to which <i>CIS 15</i> (Dual-pricing and dealing) applies	except where Note 1 applies, the most recent maximum <i>sale</i> price less any expected discount (plus <i>dealing</i> costs) [Note 2]
	(ii) if <i>shares</i> in an <i>ICVC</i> or <i>units</i> of an <i>AUT</i> to which <i>CIS 4</i> (Single-pricing and dealing) applies	the most recent price (plus <i>dealing</i> costs) [Notes 2 and 3]
	(iii) if any other <i>investment</i>	best available market <i>dealing</i> offer price on the most appropriate market in a standard size (plus <i>dealing</i> costs) [Note 2]
	(iv) if other property, or no price exists under (i) or (ii)	<i>manager's</i> reasonable estimate of a buyer's price (plus <i>dealing</i> costs) [Notes 2 and 4]
	(d) Property which is a <i>derivative</i> under the terms of which there may be liability to make, for the account of the <i>AUT</i> , further payments (other than charges, and whether or not secured by <i>margin</i>) when the transaction in the <i>derivative</i> falls to be completed or upon its closing out.	
	(i) if a written <i>option</i> under <i>rule 20(d)</i>	to be deducted (see 20.(d)) at a net valuation of <i>premium</i> . [Notes 5 and 8]
	(ii) if an <i>off-exchange</i> future	net value on closing out [Notes 6 and 8]

		(iii)	if any other such property	net value of <i>margin</i> of closing out (whether as a positive or negative figure) [Notes 7 and 8]
Notes				
	1.		The <i>issue price</i> is taken, instead of the maximum <i>sale price</i> if the <i>manager</i> of the <i>AUT</i> whose <i>scheme property</i> is being valued is also the <i>manager</i> , or an <i>associate</i> of the <i>manager</i> , of the <i>AUT</i> whose <i>units</i> form part of that property.	
	2.		In this Section and in Section 6, “dealing costs” means any fiscal charges, <i>commission</i> or other charges payable in the event of the <i>AUT</i> carrying out the transaction in question, assuming that the <i>commission</i> and charges (other than fiscal charges) which would be payable by the <i>AUT</i> are the least that could reasonably be expected to be paid in order to carry out the transaction. On the <i>issue</i> basis, dealing costs exclude any <i>preliminary charge</i> on sale of <i>units</i> in an <i>AUT</i> .	
	3.		Dealing costs under note 2. Include any <i>dilution levy</i> or <i>SDRT provision</i> which would be added in the event of a <i>purchase</i> by the <i>AUT</i> of the <i>units</i> in question but, if the <i>manager</i> of the <i>AUT</i> being valued, or an <i>associate</i> of the <i>manager</i> , is also the <i>manager</i> of the <i>AUT</i> or the <i>ACD</i> of the <i>ICVC</i> whose <i>units</i> are held by the <i>AUT</i> , must not include a <i>preliminary charge</i> which would be payable in the event of a <i>purchase</i> by the <i>AUT</i> of those <i>units</i> .	
	4.		The buyer’s price is the consideration which would be paid by a buyer for an immediate transfer or assignment (or, in Scotland, assignment) to him at arm’s length.	
	5.		Estimate the <i>premium</i> on writing an <i>option</i> of the same series on the best terms then available on the most appropriate market on which such <i>options</i> are traded; but deduct dealing costs.	
	6.		Estimate the amount of profit or loss receivable or incurable by the <i>AUT</i> on closing out the contract. Deduct minimum dealing costs in the case of profit and add them in the case of loss.	
	7.		Estimate the amount of <i>margin</i> (whether receivable or payable by the <i>AUT</i> on closing out the contract) on the best terms then available on the most appropriate market on which such contracts are traded. If that amount is receivable (e.g. the contract is “in the money”) then add minimum dealing costs to the <i>margin</i> and the value is that figure as a negative sum.	
	8.		If the property is an <i>OTC</i> transaction in <i>derivatives</i> , use the relevant valuation referred to in <i>CIS</i> 5.6.6R (<i>OTC</i> transactions in <i>derivatives</i>).	
Section 6: Cancellation basis				
24.	The valuation of property for that part of the valuation which is on a <i>cancellation</i> basis is as follows:			
	Property		To be valued at	
	(a)	Cash	nominal value	
	(b)	Amounts held in current deposit and loan accounts	nominal value	
	(c)	Property which is not within (a), (b) or (d):		
	(i)	if <i>units</i> in and <i>AUT</i> to which <i>CIS</i> 15 (Dual-pricing and dealing) applies	except where Note 1 applies, the most recent minimum <i>redemption price</i> (less dealing costs) [Note 2]	
	(ii)	if <i>shares</i> in an <i>ICVC</i> or <i>units</i> in an <i>AUT</i> to which <i>CIS</i> 4 (Single-pricing and dealing) applies	the most recent price (less <i>dealing costs</i>) [Notes 2 and 3]	
	(iii)	if any other <i>investment</i>	best available market <i>dealing bid price</i> on the most appropriate market in a standard size (less <i>dealing costs</i>) [Note 2]	
	(iv)	if other property, or no price exists under (i) or (ii)	<i>manager</i> ’s reasonable estimate of a seller’s price (less <i>dealing costs</i>) [Notes 2 and 4]	
	(d)	Property of the type described in 23.:		
	(i)	if a written <i>option</i> under 20.(d)	to be deducted (see 20.(d)) at a net valuation of <i>premium</i> [Notes 5 and 8]	
	(ii)	if an <i>off-exchange future</i>	net value of closing out [Note 8]	
	(iii)	if any other such property	net value of <i>margin</i> on closing out (whether as a positive or negative figure) [Notes 6 and 8]	
Notes				
	1.		The <i>cancellation price</i> is taken instead of the minimum <i>redemption price</i> if the property, if sold in one transaction, would amount to a <i>large deal</i> .	

2. For *dealing* costs see note 2. In 23.. Dealing costs include any charge payable on *redemption* of *units* in an *AUT* (taking account of any expected discount), except where the *manager* of the *AUT* whose property is being valued is also the *manager*, or an *associate* of the *manager*, of the *AUT* whose *units* form part of that property.
3. *Dealing* costs under note 2. include any *dilution levy* or *SDRT provision* which would be deducted in the event of a *sale* by the *AUT* of the *units* in question and, except when the *manager* of the *AUT* being valued, or an *associate* of the *manager*, is also the *manager* of the *AUT* or the *ACD* of the *ICVC* whose *units* are held by the *AUT*, include any charge payable on the *redemption* of those *units* (taking account of any expected discount).
4. The seller's price is the consideration which would be received by a seller for an immediate transfer or assignment (or, in Scotland, assignment) from him at arm's length, less dealing costs.
5. Estimate the *premium* on writing an *option* of the same series on the best terms then available on the most appropriate market on which such *options* are traded, and add dealing costs.
6. For *off-exchange futures*, see note 6. In 23..
7. For net value of *margin* see note 7. In 23..
8. For *over the counter* transactions in *derivatives*, see note 8. in 23..

Valuation under SETS

15.8.5

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- (1) CIS 15.8.4R requires certain property to be valued at the best available market dealing offer or bid price (depending on whether the property is being valued on an *issue* or *cancellation* basis) for a *deal* of standard size on the most appropriate market, after taking account of dealing costs. If no price exists, the *manager* is required to use a reasonable estimate of a *buying* or *selling* price.
- (2) Under the Stock Exchange Automated Quotation (SEAQ) System, the best market *dealing* offer or bid price in a particular *security* is generally understood to be the 'touch' price. Under *SETS*, the London Stock Exchange publishes an 'official best price' for each *security*, derived from the best prices displayed on the order book. It also publishes a 'last trade price'. The best bid price is the price of the highest buy order on the order book at any given time, and the best offer price is the price of the lowest *sell* order on the book. The last trade price for *securities* traded on *SETS* is published throughout the *day*. The 'official closing price' is based on the last automatically executed trade taken from the order book.
- (3) A *manager* may wish to use the last trade price as the basis for valuing *SETS securities* held as part of the *scheme property*. The last trade price will be a precise figure, not an estimate, and there will be complete certainty that the *security* in question has traded at that price. Alternatively, a *manager* may use the best bid and offer price displayed on the order book as the basis of valuation. Either method is acceptable, provided that the *manager* documents the choice of method and ensures that the procedures are applied consistently and fairly. The basis on which the *scheme property* is to be valued must be set out in the *AUT's prospectus*, as required by CIS 3.5.17R(2)R (Valuation of scheme property).
- (4) Circumstances may arise where the chosen method may not provide a reliable basis for valuation. This could happen, for example, where there has been no recent trade in the *security* concerned or where no reliable price exists. In such cases, the *manager* should exercise judgement to estimate a reasonable price at which the *security* could be bought or sold in the most appropriate market, and should document the reasons for its decision. Where the *manager* imputes a 'spread' in order to arrive at an estimated *buying* or *selling* price – for example,

in circumstances where there are no buy or *sell* orders on the order book, it should be able to justify any assumptions made.

Chapter 16.

Application and notification

16.1 Introduction

Application

16.1.1

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This chapter covers the processes of applying for authorisation and recognition of a *collective investment scheme*, and the notification to the FSA of the intention to market an overseas *collective investment scheme* in the *United Kingdom*. This chapter also includes *guidance* on the independence of *depositaries* of ICVCs and *managers* and *trustees* of AUTs and *rules* on notifying the FSA in its role as registrar of ICVCs. This chapter also implements Article 6 of the *UCITS Directive*.

- (1) CIS 16.1.1G, 16.1.2G and 16.1.3G apply to *directors* and proposed *directors* of an ICVC, *depositaries* and proposed *depositaries* of an ICVC, ICVCs and proposed ICVCs, *managers* and proposed *managers* of an AUT, *trustees* and proposed *trustees* of an AUT and operators of *collective investment schemes* seeking or applying for recognition under section 264, 270 or 272 of the *Act*.
- (2) CIS 16.1.4D and CIS 16.1.5G apply to the proposed *directors* and proposed *depository* of a new ICVC.
- (3) CIS 16.1.6D and CIS 16.1.7G apply to the proposed *manager* and proposed *trustee* of a new AUT.
- (4) CIS 16.1.8G applies to the operator of a *collective investment scheme* seeking recognition under section 264 of the *Act*.
- (5) CIS 16.1.9G applies to the operator of a *collective investment scheme* seeking recognition under section 270 of the *Act*.
- (6) CIS 16.1.10G applies to the operator of a *collective investment scheme* applying for recognition under section 272 of the *Act*.
- (7) CIS 16.1.11G applies to the ICVC itself, when changes to the *scheme* are proposed.
- (8) CIS 16.1.12G applies to the *manager* and *trustee* of an AUT, when changes to the *scheme* are proposed.
- (9) CIS 16.2.1G to CIS 16.2.4G apply to the *depository*, or proposed *depository*, of an ICVC, to the ICVC, or proposed ICVC, and to any corporate *director*, or proposed corporate *director*, of an ICVC.
- (10) CIS 16.3.1G to CIS 16.3.2G apply to the *trustee*, or proposed *trustee*, and to the *manager*, or proposed *manager*, of an AUT.

- (11) CIS 16.4.1R applies to the *directors* of an ICVC.
- (12) CIS 16.5 applies to the *managers* of an AUT which is a UCITS scheme

Purpose

16.1.2 G_{/1} This chapter helps in achieving the *regulatory objective* of protecting consumers by ensuring that only regulated *schemes*, vetted and approved in accordance with the relevant law and *rules*, can be promoted to the general public. *Guidance* is provided on the various application and notification procedures for *regulated collective investment schemes* as set out in the *Act* and the *OEIC regulations*.

Contacting the collective investment schemes and product regulation department

16.1.3 G_{/1} The Product Assessment Team in the Collective Investment Schemes and Product Regulation Department may be contacted:

- (1) by telephoning on 020 7676 4540; or
- (2) by writing to : The Collective Investment Schemes and Product Regulation Department, The Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS; or
- (3) by e-mailing the FSA at productassessment@fsa.gov.uk

Application for authorisation of an ICVC

16.1.4 G_{/1} (1) Regulation 12 of the *OEIC regulations* provides that any application for an *authorisation order* in respect of an ICVC must:

- (a) be made in such manner as the FSA directs;
- (b) include relevant details of all proposed *directors* of the ICVC (in accordance with regulation 13 of the *OEIC regulations*);
- (c) include details of the proposed *depository*; and
- (d) contain or be accompanied by such other information as the FSA reasonably requires.

16.1.5 G_{/1} (1) Application forms and a separate *guidance* note, containing help on how to complete the form and describing the documents the FSA requires as part of the application, are available free of charge from the Collective Investment Schemes and Product Regulation Department of the FSA. An application fee will also be required.

(2) Under regulation 14 of the *OEIC regulations*, an application for a new ICVC must be determined by the FSA within six months of receipt. But within this statutory time frame, the FSA has set a higher service level standard. Except in exceptional circumstances, applicants can expect applications under regulation

12 to be resolved within six weeks of receipt by the *FSA* of all the relevant material.

Application for authorisation of a unit trust scheme

16.1.6

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- (1) Section 242 of the *Act* provides that any application for an *authorisation order* in respect of an *AUT* must:
- (a) be made by the *manager* and *trustee* or the proposed *manager* and *trustee* of the *AUT*;
 - (b) be made in such manner as the *FSA* directs; and
 - (c) contain or be accompanied by such information as the *FSA* reasonably requires.

16.1.7

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- (1) As with *ICVCs*, application forms and a *guidance* note on how to apply are available free of charge from the *FSA*.
- (2) Under section 244 of the *Act*, an application should be determined by the *FSA* within six months of receipt. As with *ICVC* applications, the *FSA* has set itself a higher service level standard. Except in exceptional circumstances, applicants can expect applications under section 242 to be resolved within six weeks of receipt of all relevant application material.

Notification in respect of a scheme constituted in another EEA State

16.1.8

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- (1) Section 264 of the *Act* provides that a *scheme* which is constituted in another *EEA State* as a *scheme* meeting the requirements of the *UCITS directive* will become a *recognised scheme* two months after the operator notifies the *FSA* of its intention to market the *scheme* in the *United Kingdom*.
- (2) The notification is required to include certain information, details of which are set out in *CIS* 17.2. As with the applications described above, a notification form and *guidance* note are available free from the *FSA*.
- (3) Recognition is automatic, unless, within the two month period, the *FSA* notifies the operator that the manner in which it intends to market the *scheme* in the *United Kingdom* does not comply with *United Kingdom* law. However, the *Act* does not give the *FSA* any leeway to shorten the two month waiting period following notification before the *scheme* becomes recognised. Marketing activity in the *United Kingdom* can commence only once the *scheme* is recognised.

Notification in respect of a scheme constituted in a designated country or territory

16.1.9

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- (1) Section 270 of the *Act* provides that a *scheme* authorised in another country or territory which has been designated by an order made by the Treasury can become a *recognised scheme*, subject to certain specified conditions. The *scheme* is required to be of a class specified in the designation order and the notification must include certain information, details of which are set out in

CIS 17.3. As with *EEA schemes*, a notification form and *guidance* note are available free from the *FSA*.

- (2) The *scheme* becomes recognised either when the *FSA* gives its written approval, or, in the absence of a notice from the *FSA* objecting to recognition, two months after notification by the operator. In practice, the *FSA* will normally contact the operator with its decision within the two month period.

Application in respect of other overseas collective investment schemes

16.1.10

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- (1) Section 272 of the *Act* provides that the operator of any other overseas *collective investment scheme* may apply for recognition, as long as certain criteria are met. These criteria are:
- (a) that the *scheme* is managed in a country or territory outside the *United Kingdom*;
 - (b) that it does not satisfy the criteria to be recognised under section 264 of the *Act* (Schemes constituted in another EEA State);
 - (c) that it does not satisfy the criteria to be recognised under section 270 of the *Act* (Schemes authorised in a designated countries or territories);
 - (d) that adequate protection is afforded to *participants* in the *scheme*;
 - (e) that there are adequate arrangements for the constitution and management of the *scheme*; and
 - (f) that the powers and duties of the operator and, where there is one, the *trustee* or *depository*, are adequate.
- (2) The notification is required to include certain information, details of which are set out in CIS 17.3. Application forms and a *guidance* note are available free from the *FSA*.
- (3) Under section 275 of the *Act*, the *FSA* is required to determine an application under section 272 within a period of six months from receipt of the completed application. Because of the wide variety of potential applications under this section of the *Act*, the *FSA* does not set a higher service level standard for completion of the application review.
- (4) Under section 277 of the *Act*, the operator of a *scheme* which has been recognised under section 272 must give written notice to the *FSA* of any proposal to alter the *scheme*. Any proposal to replace the operator, *trustee* or *depository* should be notified to the *FSA* by either the operator, *trustee* or *depository*, or by its proposed replacement. As with proposed changes to *AUTs* and *ICVCs*, the *FSA* has one month to consider the proposal. If it does not respond within that time, the proposal automatically becomes effective. In practice, the *FSA* will always aim to respond within the one month period.

Notification of proposed changes to ICVCs

16.1.11

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- (1) Regulation 21 of the *OEIC regulations* provides that the *ICVC* must give written notice to the *FSA* of certain proposed changes to the *ICVC* (in practice

the *FSA* would expect to receive any notification from the *ACD*). Any proposal involving a change to the *instrument of incorporation* must be accompanied by a signed solicitor's certificate.

- (2) The *FSA* has one month to consider such proposals. In practice, the *FSA* will always aim to respond within the one month period.

Notification of proposed changes to AUTs

16.1.12

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- (1) Section 251 of the *Act* provides that the *manager* of an *AUT* must give written notice to the *FSA* of any proposal to alter the *scheme* or replace the *trustee*. The *FSA* takes the view that only significant alterations need to be notified, but any alteration involving a change to the *trust deed* is considered significant. Alterations involving a change to the deed must be accompanied by a certificate signed by a solicitor, stating that the change will not affect the compliance of the deed with the *rules* in this sourcebook. Under the same section, the *trustee* of an *AUT* must give written notice of any proposal to replace the *manager*.
- (2) The *FSA* has one month in which to consider the proposal. If it does not respond to the *manager* or *trustee* within that time, the proposal becomes effective. In practice, the *FSA* will always aim to respond within the one month period.

Revocation of authorisation or recognition

16.1.13

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Revocation of authorisation or recognition is dealt with in separate chapters of this sourcebook. Revocation of authorisation of *AUTs* and voluntary winding up of *ICVCs* are dealt with in *CIS 14* (Termination). Cessation of recognition is dealt with in *CIS 17* (Recognised schemes).

Warning notices

16.1.14

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- (1) If the *FSA* proposes to refuse any application or object to a notification described in any of paragraphs *CIS 16.1.4G* to *16.1.7G* and *CIS 16.1.9G* to *CIS 16.1.12G*, it must give a *warning notice*. Where the *FSA* proposes to object to a notification under Section 264 of the *Act* (Schemes constituted in other EEA States); the *FSA's* notice will be similar to a *warning notice*.
- (2) The *Act* provides that the *warning notice* must contain, amongst other matters, the *FSA's* reasons for proposing to refuse an application or object to a notification.
- (3) Following receipt of the *warning notice*, the applicant will be given a specified period of not less than 28 *days* to make representations to the *FSA*.
- (4) Further information on the procedure can be found in *DEC 2.2* (Warning notice procedure).

Decision notices

16.1.15

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- (1) In certain circumstances, after having considered any written and oral representations made by the applicant, the *FSA* may decide to refuse the application or notification. If this happens, the *FSA* is required to give a *decision notice*.
- (2) The *Act* provides that the *decision notice* must contain, amongst other matters, the *FSA*'s reasons for its decision and the procedures for making a reference to the *Financial Services and Markets Tribunal*.
- (3) Further information on the procedure can be found in *DEC 2.3* (Decision notice procedure)

16.2 Independence of depositaries of ICVCs

Introduction

16.2.1

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- (1) Regulation 15(8)(f) of the *OEIC regulations* provides that the *depositary* of an *ICVC* must be independent of the *ICVC* and of the *persons* appointed as *directors*.
- (2) References in this section (*CIS 16.2G*) to a *depositary* or to a corporate *director* include any *associate* of the *depositary* or corporate *director*.

Independence: depositary, ICVC and corporate director of an ICVC

16.2.2

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- (1) In addition to the *ACD*, there is the possibility of other *directors* of the *ICVC* being corporations.
- (2) There are at least three possible kinds of link between a *depositary* and an *ICVC*, or a corporate *director* of an *ICVC*:
 - (a) *directors* in common;
 - (b) cross-shareholdings;
 - (c) a contractual commitment.
- (3) If any of these links exists between a *depositary* and an *ICVC* or any corporate *director* of the *ICVC*, the *FSA* will expect the following tests to be satisfied before it could accept that independence is established.
- (4) Influence by *directors*: independence would be lost if by means of executive power either the *depositary* could control the action of the *ICVC* or any corporate *director* of it, or the *ICVC* and its *directors* or both could control the actions of the *depositary*.
- (5) Nor should there be any means by which one board could obtain effective, as opposed to legal, control of the other. The *FSA* would not approve any arrangement, such as quorum provisions or reservation of decision-making capacity to certain *directors*, which could result (even in exceptional circumstances) in loss of effective independence of one company's board from the other.
- (6) Influence by shareholding: independence would be lost if either the *depositary* or the *ICVC* could control the actions of the other by means of shareholders' votes, or the *depositary* or a corporate *director* of the *ICVC* could control the

actions of the other by means of shareholders' votes. Accordingly, there should not at any time be any shareholding in the *depositary* by the *ICVC* and its *directors* and their respective *associates* (taken together) which exceeds 15% of the *depositary's* share capital carrying voting rights whether or not that share capital comprises a single class or several classes of shares. Furthermore there should not be any such shareholding by a *depositary* and its *associates* in the *ICVC* or any of the *directors* of the *ICVC*.

Independence: depositary and individual directors of an ICVC

16.2.3

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The *FSA* will not consider a *depositary* to be independent of any individual who is a *director* of an *ICVC* in any of the following circumstances:

- (1) the *ICVC director* or any *associate* of the *director* is a *director* and an employee or both of the *depositary*; or
- (2) the *ICVC director* has a direct or indirect shareholding in the *depositary* which might give rise to a potential conflict of interest for the *director*, for this purpose a holding by the *director*, for investment purposes, of shares in the *depositary* that are listed and carry less than 0.5 per cent of the votes at a general meeting or a meeting of the *holders* of the class of shares concerned will not be considered to give rise to a potential conflict of interests; or
- (3) the *ICVC director* has any other relationship (contractual or otherwise) with the *depositary* which might reasonably be expected to give rise to a potential conflict of interest for the *director*.

Other matters affecting independence

16.2.4

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- (1) Independence and polarisation: the *FSA* considers that independence will need to be specifically appraised in the event of a proposal by the *depositary* to become an *appointed representative* of the *ICVC* or any corporate *director* of it, or for a *director* to become an *appointed representative* of the *depositary*.
- (2) If such a relationship should be contemplated, then arrangements may need to be put into place to satisfy the *FSA* that the necessary independence is preserved. The *FSA* would therefore expect to be consulted in advance about any such proposal.
- (3) Other commitments: the *FSA* expects to be consulted in advance about its view on the consequences for independence of any other intended commitment or relationship which could affect independence, whether directly or indirectly.

16.3 Independence of Trustees and Managers of AUTs

Introduction

16.3.1

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Section 243(4) of the *Act* states that “The *manager* and the *trustee* must be *persons* who are independent of each other.” As *managers* and *trustees* may have or develop corporate links, the *FSA* has given its view of the criteria against which independence, in the sense of this section of the *Act*, should be tested.

Independence: trustee, manager

16.3.2

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- (1) There are at least three possible kinds of link between *managers* and *trustees*:
 - (a) *directors* in common between the *manager* and the *trustee*;
 - (b) cross-shareholdings;
 - (c) a contractual commitment.
- (2) If any of these links exist between a *manager* and a *trustee*, the *FSA* expects the following tests to be satisfied in order to ensure that independence is maintained.
- (3) Influence by *directors*: independence would be lost if either company can control the action of the other by means of executive power. Accordingly, there should not be a majority of *directors* on the board of the *trustee* who simultaneously hold directorships on the board of the *manager*, or vice versa.
- (4) Nor should there be any means by which one board could obtain effective, as opposed to legal, control of the other. So, for example, the *FSA* would not approve any arrangement, whether by means of quorum or of reservation of decision-making capacity to certain *directors* which could result (even in exceptional circumstances) in loss of effective independence of one company’s board of the other.
- (5) In determining whether common directorships were curtailing independence, the *FSA* would interpret the concept of “common *director*” to include any *directors* of *associates* of the *trustee* who are simultaneously *directors* of the *manager*, and any *directors* of *associates* of the *manager* who are simultaneously *directors* of the *trustee*.
- (6) Influence by shareholding: independence would be lost if either company can control the actions of the other by means of shareholders’ votes. Accordingly,

there should not be any shareholding in the *trustee* by the *manager* (or vice versa) which exceeds 15% of the other's share capital carrying voting rights – whether or not that share capital comprises a single or several classes of shares, however described. The *FSA* would be willing, however, to look at cases where cross-shareholding exceeds 15% on a case by case basis to see whether there were exceptional grounds for concluding that independence is nevertheless safeguarded by other means.

- (7) In determining whether the 15% test was met, any shareholding held by an *associate* of the *manager* in the *trustee*, or by an *associate* of the *trustee* in the *manager*, would in each case be aggregated with shareholdings held directly by the *manager* or the *trustee* in the other.
- (8) Independence and polarisation: The *FSA* considers that independence will need to be specifically appraised in the event of a proposal by the *trustee* or *manager* (or any of either's *associates*) to become an *appointed representative* of the other. The status of a "tied agent" will mean that the *trustee* of an *AUT* is prohibited by contract from procuring or endeavouring to procure *persons* to enter into *investment agreements* (or certain kinds of *investment agreements* including those relating to *AUTs*) with *persons* other than the *manager*.
- (9) If such a tied relationship should be contemplated, then arrangements may need to be put into place to satisfy the *FSA* that the necessary independence is preserved. The *FSA* would therefore expect to be consulted in advance about any such proposal.
- (10) Other commitments: the *FSA* also expects to be consulted in advance about its view on the consequences for independence of any other intended commitment or relationship which could affect independence, whether directly or indirectly.

16.4 Notification to the FSA in its role as registrar of ICVCs

16.4.1

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An ICVC shall not later than 14 *days* after the occurrence of the change in question notify the FSA of:

- (1) any amendment to the *instrument of incorporation* of the ICVC;
- (2) any change in the address of the head office of the ICVC;
- (3) any change in the *directors* of the ICVC;
- (4) any change in the *depository* of the ICVC;
- (5) in respect of any *director* or *depository*, any change in the information mentioned in regulation 12(1)(b) or (c) of the *OEIC regulations* (Applications for authorisation);
- (6) any change in the auditor of the ICVC;
- (7) any order in respect of the ICVC made by virtue of regulation 70 of the *OEIC regulations* (Mergers and Divisions).

16.5 Managers of UCITS schemes

16.5.1

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A *firm* which is the *manger* of an *AUT* which is a *UCITS scheme* must not engage in any activities other than:

- (1) acting as *manager* of:
 - (a) a unit trust; or
 - (b) an *open-ended investment company* or any other body corporate whose business consists of investing its funds with the aim of spreading investment risk and giving its members the benefit of the results of the management of its funds by or on behalf of that body; or
 - (c) any other *collective investment scheme* under which the contribution of the *participants* and the profits or income out of which payments are to be made to them are pooled; or
- (2) acting as the *director* of an *ICVC*; or
- (3) activities for the purposes of or in connection with those in (1) or (2) above.

16.5.2

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Examples of the connected activities referred to in AUTH 3.20.3R(3) include management of *PEPs*, *ISAs* and stakeholder pensions, as long as they are dedicated to investments in unit trusts and *OEICS* for which the *firm* acts as *manager* or *ACD*.

Chapter 17

Recognised schemes

17.1 Application and purpose

Application

17.1.1

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- (1) The *rules* and *guidance* in this chapter apply in relation to *recognised schemes* and overseas *collective investment schemes* seeking recognition in the *United Kingdom*.
- (2) CIS 17.1, CIS 17.2, CIS 17.4 (excluding CIS 17.4.9G) apply to the operators of *schemes* recognised or seeking recognition under section 264 of the *Act* (Schemes constituted in other EEA States).
- (3) CIS 17.1, CIS 17.2, CIS 17.3 (excluding CIS 17.3.3R and CIS 17.3.6R) and CIS 17.4 (excluding CIS 17.4.8G) apply to the operators of *schemes* recognised or seeking recognition under section 270 of the *Act* (Schemes authorised in designated countries or territories).
- (4) CIS 17.1, CIS 17.2, CIS 17.3 (excluding CIS 17.3.5G) and CIS 17.4 (excluding CIS 17.4.8G) apply to the operators of *schemes* recognised or seeking recognition under section 272 of the *Act* (Individually recognised overseas schemes).

Purpose

17.1.2

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- (1) This chapter enables operators of *schemes* established overseas to know what information and documents the *FSA* wish to review so as to enable it to consider whether to recognise their *schemes*, under the *Act*, for *marketing* in the *United Kingdom*. This information will enable the *FSA* to make an informed decision whether or not *schemes* established overseas should be recognised under the *Act*.
- (2) This chapter sets out responsibility for the preparation and maintenance of a *prospectus* (in the case of *schemes* recognised under section 270 and section 272) and requirements relating to it.
- (3) In addition, this chapter sets out the *rules* for operators of *recognised schemes* to maintain certain facilities in the *United Kingdom* under section 283 of the *Act*. It also provides *guidance* on revocation of recognition in relation to *recognised schemes*.

17.2 Information and documents which should be supplied with a notification under section 264 of the Act

17.2.1

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- (1) If the operator of a *scheme* constituted in a *EEA State* gives notice to the *FSA* under section 264 of the *Act*, as described in that notice is required to contain or be accompanied by certain information as described in *CIS* 17.2.1G(2) to (4) (see the [Financial Services Markets Act 2000 (Recognised Schemes) Regulations 2001 (SI 2001/xx)]).
- (2) The documents must be in English, or accompanied by a translation in English.
- (3) The documents must be certified by the operator to be true copies of the original.
- (4) The following information and documentation must be provided:
 - (a) name of *scheme*;
 - (b) legal form of *scheme*;
 - (c) name and address of operator;
 - (d) the address of the place in the *United Kingdom* for the service on the operator of notices or other documents;
 - (e) the name and address of any supervisory authority or authorities to which the operator is subject in the *EEA State* in which it is established;
 - (f) whether the operator intends to market the *scheme* in the *United Kingdom* in a manner which will involve it carrying on a *regulated activity* in the *United Kingdom*;
 - (g) name and address of *depository*;
 - (h) the address in the *United Kingdom* where the *scheme* facilities (see *CIS* 17.4) will be maintained;
 - (i) details of the arrangements for the *marketing* of *units* in the *United Kingdom*, namely:
 - (i) the proposed commencement date;
 - (ii) whether the *units* or *shares* will be sold by or through: any employed *sales force*; *authorised persons*; or *unsolicited calls*;

- (j) any order or certificate from the authorities of the *EEA State* in which the *scheme* is authorised which demonstrates that the *scheme* complies with the *UCITS directive*;
- (k) a copy of the *instrument constituting the scheme*;
- (l) a copy of the *prospectus* of the *scheme*; and
- (m) a copy of the latest annual report and any subsequent half-yearly report.

Subsequent notification in respect of schemes recognised under section 264 of the Act.

17.2.2

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Whenever a change occurs in the information supplied or in a document supplied under CIS 17.2.1, the FSA wishes to be notified of these changes.

17.3 Notification to the FSA under section 270 and applications under section 272

Information and documents to be supplied with notifications under sections 270 (designated territories) and applications under section 272 (individually recognised overseas schemes) of the Act

17.3.1



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- (1) If the operator of a *scheme* gives notice to the *FSA* under section 270 or makes an application under section 272 of the *Act*, the notice or application must contain (or be accompanied by) the information in *CIS* 17.3.1D(2) to (4).
- (2) The documents must be in English or accompanied by a translation in English.
- (3) The documents must be certified by the operator to be true copies of the original.
- (4) The following list is the information and documentation which is referred to in *CIS* 17.3.1D(1) and which must be provided with a notification under section 270 or application under section 272 of the *Act*.
 - (a) name of *scheme*;
 - (b) legal form of *scheme*;
 - (c) name and address of the operator;
 - (d) the address of the place in the *United Kingdom* for service on the operator of notices or other documents;
 - (e) whether the operator intends to market the *scheme* in the *United Kingdom* in a manner which will involve it carrying on a *regulated activity* in the *United Kingdom*;
 - (f) name and address of any *person* to whom the property subject to the *scheme* is entrusted for safekeeping;
 - (g) the address of the place in the *United Kingdom* where *scheme* facilities (see *CIS* 17.4) will be maintained;
 - (h) details of the arrangements for the *marketing* of *units* in the *United Kingdom*, namely:
 - (i) the proposed commencement date;

- (ii) whether the *units* or *shares* will be sold by or through: any employed sales force (including any *appointed representative*); *persons* authorised under the *Act*; or unsolicited calls;
- (i) a copy of the *instrument constituting the scheme*;
- (j) a copy of the *prospectus* or any similar document giving details of the *scheme*;
- (k) a copy of the latest annual report and any subsequent half-yearly report;
- (l) a copy of any other document affecting the rights of *participants* in the *scheme*; and
- (m) for notifications under section 270 only, a copy of the authorisation document issued by the authority in the designated territory confirming that the *scheme* is of a class covered by the designation order.

Subsequent notification in respect of schemes recognised under sections 270 and 272 of the Act

17.3.2

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Wherever a change occurs in the information supplied or in a document supplied under CIS 17.3.1, the FSA wishes to be notified of these changes.

Additional information required in the prospectus for notifications under section 272

17.3.3

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(1) The *prospectus* must contain the following statement:

“Complaints about the operation of the *scheme* may be made to the FSA.”

(2) The *prospectus* must state whether or not investors in the *scheme* would be covered by the *Compensation Scheme*. If investors in the *scheme* are covered by the *Compensation Scheme* the *prospectus* must state how they are covered and who they would need to contact for further information.

Preparation and maintenance of prospectus

17.3.4

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(1) An operator of a *scheme* which is a *recognised scheme* by virtue of section 270 or 272 of the *Act* must comply, subject to paragraph (2) below, with the requirements set out in CIS 3 in respect of the preparation, publication and inspection of a *prospectus*.

(2) Where a *scheme* recognised under section 270 of the *Act* is managed and authorised in the Bailiwick of Guernsey or the Bailiwick of Jersey or the Isle of Man, the *prospectus* need not

comply with the requirements of *CIS* 3, providing it contains corresponding matter required under the law in their territory.

- (3) An operator of a *collective investment scheme* which is recognised under section 270 or 272 of the *Act* must comply with the requirements in *CIS* 3.3 (False or misleading prospectus) and *CIS* 3.4 (Revision of and changes to prospectus).

Refusal of approval: schemes recognised under section 270 of the Act

17.3.5

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The *FSA*'s power to refuse recognition and the procedures for this are set out in section 271 of the *Act* and described in *CIS* 16.1.

Refusal of approval: schemes recognised under section 272 of the Act

17.3.6

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The *FSA*'s power to refuse recognition and the procedures for this are set out in section 276 of the *Act* and described in *CIS* 16.1.

17.4 Facilities in the United Kingdom and revocation of recognition

General

- 17.4.1 **R** /1 The operator of a *recognised scheme* under section 264, section 270 and section 272 of the *Act* must maintain facilities in order to satisfy the requirements of *CIS* 17.4.2 to *CIS* 17.4.7. *CIS* 17.4.8G applies to revocation of a *recognised scheme* under section 264 of the *Act* and *CIS* 17.4.9G applies to cessation or revocation of recognition under section 279 of the *Act*.

Documents

- 17.4.2 **R** /1 (1) The operator of a *recognised scheme* must maintain facilities for inspection (free of charge) and for the obtaining (free of charge, in the case of the documents at (c) and (d), and otherwise at no more than a reasonable charge) of copies in English of:
- (a) the *instrument constituting the scheme*;
 - (b) any instrument amending the *instrument constituting the scheme*;
 - (c) the *prospectus* most recently prepared by the operator; and
 - (d) the annual and half-yearly reports relating to the *scheme* most recently prepared and published by the operator.
- (2) An operator to which paragraph (1) applies must, before conclusion of a *sale* of *units* in the *scheme* to any *person* in the *United Kingdom*, offer that *person* free of charge a copy of the documents mentioned at paragraphs (1)(c) and (d).

Price and redemption

- 17.4.3 **R** /1 (1) The operator must, subject to (2), maintain facilities:

- (a) where information in English can be obtained about the operator's most recently published *sale and purchase prices* of *units* in the *scheme*;
 - (b) where a *participant* in the *scheme* may redeem *units* in the *scheme* and from which payment of the *price on redemption* may be obtained.
- (2) Paragraph (1) does not apply if the operator having taken reasonable care determines that *participants* in the *scheme* are able to *sell* their *units* on an *investment* exchange at a *price* related to the net asset value of the property to which the *units* relate or at a *price* not significantly different from such a *price*: in that case it must maintain facilities for informing *participants* of the *investment* exchange concerned (and of its members or of how a list of its members can be obtained).

Bearer certificates and characteristics of units in the scheme

17.4.4

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- (1) The operator must maintain facilities at which the *holder* of a *bearer certificate* may obtain free of charge:
- (a) payment of dividends due to him;
 - (b) copies in English of the most recent annual and half-yearly reports of the *scheme*; and
 - (c) details or copies of any notices which have been given or sent to *participants* in the *scheme*.
- (2) The operator must state the nature of the right represented by the *units* in the *scheme*.
- (3) The operator must state whether *persons* other than *holders* can vote at meetings of *holders* and who those *persons* are.

Complaints

17.4.5

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The operator must maintain facilities at which any *person* who has a complaint to make about the operation of the *scheme* can submit his complaint for transmission to the operator.

Place of facilities

17.4.6

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- (1) Each of the facilities referred to in *CIS* 17.4 must be maintained at an address in the *United Kingdom*.

- (2) That address must be stated in the *prospectus*.
- (3) That address must be the address of the operator's principal place of business in the *United Kingdom*, or, if there is no such address, the alternative address in paragraph (4).
- (4) The alternative address is such convenient address as the operator determines, except that, in the case of a *scheme* recognised under section 272 of the *Act* where the operator is not an *authorised person*, the alternative address is to be the principal place of business in the *United Kingdom* of the *authorised person* who is the representative of the operator under section 272 of the *Act*.

Service of notice and other documents

17.4.7

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In relation to notices and documents sent by operators and *depositories* to and from the *United Kingdom*, CIS 11.6 (Service of notices and other documents) applies.

Revocation of recognition: schemes recognised under section 264 of the Act

17.4.8

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If the operator of a *scheme* recognised under section 264 of the *Act* gives written notice to the *FSA* under section 264(6) that it desires the *scheme* to no longer be recognised, the *scheme* ceases to be recognised.

Revocation of recognition: schemes recognised under sections 270 and 272 of the Act

17.4.9

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The *FSA* may, in accordance with section 279 of the *Act*, direct that a *scheme* is to cease to be recognised under section 270 of the *Act* or revoke a recognition order under section 272 of the *Act*. For further details, see ENF 16 (Collective Investment Schemes).

Appendix 1

Appendix CIS G

1.1

Appendix

1.1.1

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Table Correction of box management errors

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1 Introduction

APPLICATION

- (1) This appendix applies to *authorised fund managers* and to *depositories*.
- (2) This appendix is the appendix referred to in *CIS* 4.3.8G (Box management errors) and *CIS* 15.3.3G (Box management errors).

2 Controls by authorised fund managers and depositories

CONTROLS BY AUTHORISED FUND MANAGERS

- (1) An *authorised fund manager* needs to be able to demonstrate that it has effective controls over:
 - (a) its calculations of what *units* are owned by it (its "box"); and
 - (b) compliance with the *rules* preventing a negative box (*CIS* 4.3.9R(2), *CIS* 4.3.10R(2), *CIS* 15.3.4R(3), *CIS* 15.3.7R(3), *CIS* 4.3.12R and *CIS* 15.3.12R).
- (2) Evidence of persistent or repetitive errors in relation to these matters, and in particular any evidence of a pattern of errors working in an *authorised fund manager's* favour, will make demonstrating effective controls more difficult.

CONTROLS BY DEPOSITARIES

- (3) A *depository* has a duty under *CIS* 7.4.1R (General duties of the depository) and *CIS* 7.9.1R (Oversight by the trustee of the manager) to ensure (for an *AUT*) that the *manager* of an *AUT* is operating the *AUT* in accordance with the *rules* in this sourcebook, including *CIS* 4 or *CIS* 15, and to ensure (for an *ICVC*) that the *ICVC* is managed in accordance with *CIS* 4.
- (4) A *depository* should therefore make a regular assessment of the *authorised fund manager's* box management procedures (including supporting systems) and controls. This should include reviewing the *authorised fund manager's* controls and procedures when the *depository* assumes office, on any significant change and on a regular basis, to ensure that a series of minor changes do not have a significant effect on the accuracy of the controls and procedures.

3 Recording and reporting of box management errors

- (1) An *authorised fund manager* should record all errors which are made in the calculation of an *authorised fund manager's* box which result in a breach of:
- (a) *CIS* 4.3.9R(2) (Issue of units to meet authorised fund manager's obligation to sell);
 - (b) *CIS* 4.3.10R(2) (Cancellation and payment for cancelled units);
 - (c) *CIS* 15.3.4R(3) (Issue of units: manager's instructions); and
 - (d) application
- and as soon as an error is discovered, the *authorised fund manager* should report the fact to the *depository*, together with details of the action taken, or to be taken, to avoid repetition of the error.
- (2) The *authorised fund manager* should also report to the *depository* immediately any box management errors that do not result in a breach, but would be material under (3).
- (3) A *depository* should report material box management errors to the *FSA* immediately. Materiality should be determined by taking into account a number of factors including:
- (a) the existence of sufficient controls put into place by the *authorised fund manager*;
 - (b) the significance of any breakdown in management controls or other checking procedures;
 - (c) the significance of any failure of systems. This may include situations where inadequate back-up arrangements exist;
 - (d) the duration of an error; and
 - (e) the level of compensation due to *holders*, and an *authorised fund manager's* ability (or otherwise) to meet claims for compensation in full.
- (4) A *depository* should also make a return to the *FSA* (in the manner prescribed by SUP 16.6.13R) on a quarterly basis summarising, by *authorised fund manager* amongst other things, the number of box management errors during a particular period where a *depository* does not consider the breach to have been an isolated error, whether or not the error results in a negative box.

4 Correction of box management errors where no compensation is required

- (1) Correction of errors in calculating an *authorised fund manager's* box, may only be made, without an obligation to compensate *holders*, when:
- (a) the error is an isolated error, and is unlikely to recur;
 - (b) the *authorised fund manager* can demonstrate that it has effective controls in place over box management, including all the areas which affect the figures which are included in the box management calculations; and
 - (c) the requirements of *CIS* 4.3.12R (Modification to number of units issued or cancelled) for *single-priced AUTs* and *ICVCs*, or *CIS* 15.3.12R (Modification to number of units issued or cancelled) for *dual-priced AUTs*, are complied with.
- (2) In addition, no compensation is required if an error resulted in a larger positive box, because this would not have caused a breach of the *rules*.

5 Correction of box management errors where compensation to the authorised fund may be required

Paragraph 4(1) may not apply (for example, because there have been persistent errors, or an individual error has been discovered too late, or the *depository* is not satisfied about the effectiveness of the *authorised fund manager's* systems). In these circumstances, not only should all errors be corrected as soon as possible, but compensation is required to the extent that (a) to (e):

(A) ERROR RESULTS FROM AN UNDER-ISSUE

Where a negative box results from an under-*issue* of units – units sufficient to correct the negative box must immediately be issued, unless this requirement has already been satisfied by subsequent *issues* or by *redemptions* subsequent to the under-*issue*. If the *price* (or, for a *dual-priced AUT*, the *issue price*) has risen, no compensation is required. If the *price* (or, for a *dual-priced AUT*, the *issue price*) has fallen, the *authorised fund manager* must compensate the *authorised fund* for the difference in *price* (or, for a *dual-priced AUT*, the *issue price*) between the *valuation point* at which the *issue* should have been made and the *valuation point* when the under-issued position was extinguished.

(B) ERROR RESULTS FROM AN OVER-CANCELLATION AND THE PRICE OR (FOR A DUAL-PRICED AUT THE CANCELLATION PRICE) HAS RISEN

Where an error results from an over-cancellation, and the *price* (or, for a *dual-priced AUT*, the *cancellation price*) has risen, the error will be automatically corrected with no further penalty, since, when the error is discovered, an *authorised fund manager* must either undertake an *issue* of *units*, or cancel a lower number of *units*, or cover the error by redemptions, all at a higher *price* (or, for a *dual-priced AUT*, the *cancellation price*).

(C) ERROR RESULTS FROM AN OVER-CANCELLATION AND THE PRICE OR (FOR A DUAL-PRICED AUT CANCELLATION PRICE) HAS FALLEN

Where the *price* (or, for a *dual-priced AUT*, the *cancellation price*) has fallen, an *authorised fund manager* is required to rectify the breach immediately by arranging an *issue* of *units*, if it has not already been rectified by a subsequent *issue*, or *covered* by subsequent *redemptions*. An *authorised fund manager* should compensate the *authorised fund* for the difference between the *price* (or, for a *dual-priced AUT*, the *cancellation price*) when the over-cancellation was made and the *price* (or, for a *dual-priced AUT*, the *cancellation price*) when it was rectified, irrespective of whether corrected by *issue*, lower subsequent *cancellation*, or *redemptions*.

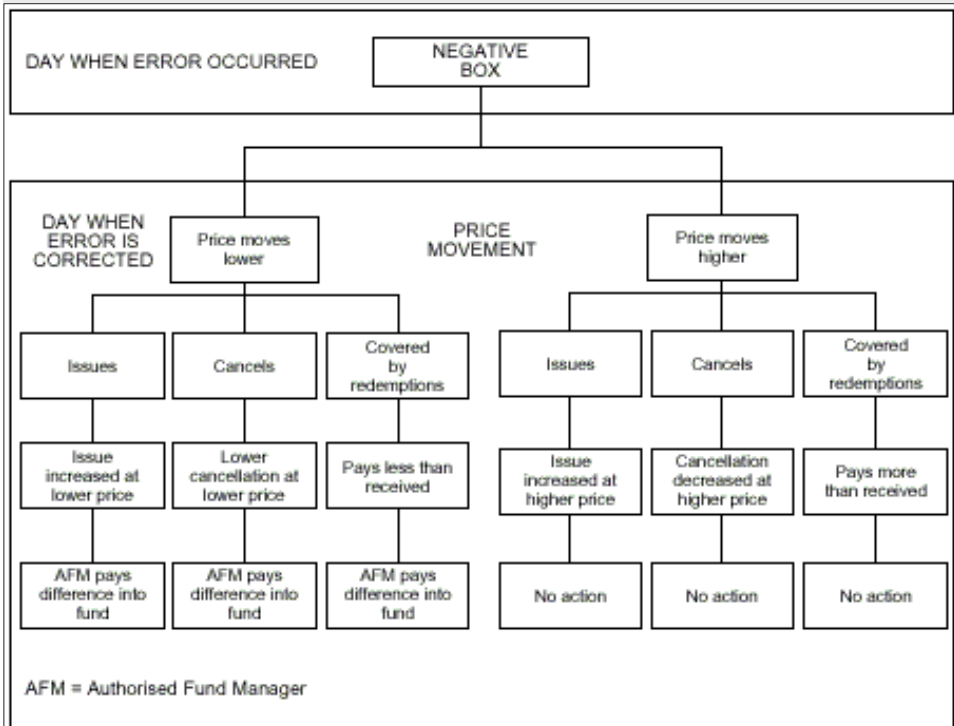
(D) DIAGRAM

Diagram1G sets out the action required under (b) when the *price* (or, in the case of a *dual-priced AUT*, *cancellation price*) has moved higher and under (c) when the *price* (or, in the case of a *dual-priced AUT*, *cancellation price*) has moved lower.

(E) DE MINIMIS PROVISION FOR LATE ISSUE SETTLEMENT OF AUTs

Where interest due on an isolated instance of a late *issue settlement* amounts to a figure which is lower than £25, this may be waived if, in the *depository's* opinion, there will be no material effect on the *authorised fund*, and the *depository* is satisfied with the *authorised fund manager's* system of controls.

Diagram 1G



Handbook Modules

Schedule1G CIS Sourcebook - Record keeping requirements

1 Table Record keeping requirements

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
<i>CIS</i> 6.3.1R	Instruments of Transfer	Full Details	From registration	6 years
<i>CIS</i> 7.3.3R	General record-keeping obligations (<i>ACD</i>)	Such as to demonstrate compliance with the <i>rules</i> in <i>CIS</i>	As implicit from the <i>rules</i> in <i>CIS</i>	As implicit from the <i>rules</i> in <i>CIS</i>
<i>CIS</i> 7.8.3R	General record-keeping obligations (<i>manager</i>)	Such as to demonstrate compliance with the <i>rules</i> in <i>CIS</i>	As implicit from the <i>rules</i> in <i>CIS</i>	As implicit from the <i>rules</i> in <i>CIS</i> . 6 years for <i>units</i> .

Handbook Modules

Schedule2G CIS Sourcebook - Notification requirements

- 1 This schedule sets out the notification requirements detailed in CIS in respect only of notifications to be provided to the FSA.
- 2 Table Notification requirements

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<i>CIS 3.2.2 R</i>	<i>Prospectus</i>	Copy provided	<i>Marketing scheme</i>	Before <i>marketing</i> begins
<i>CIS 7.2.1 R (3)</i>	Change to <i>directors</i> details or <i>controller</i> of <i>ACD</i>	Details	Immediately after the event	Immediate
<i>CIS 7.3.4 R</i>	Capital of <i>ICVC</i>	Details if capital falls below minimum or greater than maximum	Occurrence	Immediate
<i>CIS 7.4.3 R (1)</i>	Mismanagement of <i>ICVC</i>	Details	Occurrence	Immediate
<i>CIS 7.4.3.R (4)</i>	Perceived mismanagement of <i>ICVC</i>	Details	Where an investigation by the <i>depository</i> takes over 90 days	Immediate
<i>CIS 7.9.3 R (1)</i>	Mismanagement of unit trust	Details	Occurrence	Immediate
<i>CIS 7.9.3 R (2)</i>	Perceived mismanagement of unit trust	Details	Where an investigation by the <i>trustee</i> takes over 90 days	Immediate
<i>CIS 10.5.2 R (6)</i>	Annual and Half yearly reports	Copies	End of annual or <i>half-yearly accounting period</i>	Publication
<i>CIS 11.5.1 G</i>	<i>Scheme of Arrangement</i>	Details	Proposal that the <i>scheme</i> will be involved in a <i>scheme of arrangement</i>	One month before proposed change.
<i>CIS 12.5.5 R</i>	<i>ICVC</i> with only one <i>sub-fund</i>	Action to rectify situation	<i>Umbrella</i> has only one <i>sub-fund</i>	24 months
<i>CIS 13.1.3 R</i>	Suspension of <i>dealing</i>	Details including reason for suspension	Occurrence	Immediate

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
CIS 14.2.4 R (5)	Winding up a solvent <i>ICVC</i>	Solvency statement	Winding up a solvent <i>ICVC</i>	Within 21 days of notice given under regulation 20 of <i>OEIC regulations</i>
CIS 14.2.6 R (8)	Winding up a solvent <i>ICVC</i>	Completion of winding up	Winding up a solvent <i>ICVC</i>	As soon as reasonably practical after winding up completed.
CIS 14.2.7 R (6)	Winding up a solvent <i>ICVC</i>	Final accounts	End of final accounting period	Two months
CIS 14.3.4 R (5)	Winding up a solvent <i>ICVC sub-fund</i>	Solvency statement	Winding up a solvent <i>ICVC sub-fund</i>	Within 21 days of notice given under regulation 20 of <i>OEIC regulations</i>
CIS 14.3.7 R (5)	Winding up a solvent <i>ICVC sub-fund</i>	Termination account and auditor's report	Termination of sub-fund	Two months
CIS 14.4.3 R (5)	Winding up of an <i>AUT</i>	Completion of winding up	Winding up of an <i>AUT</i>	Immediate
CIS 16.1.4 G	Application for authorisation of an <i>ICVC</i>	Details	Intention to operate an <i>ICVC</i>	Six months before launch (service standard 6 weeks)
CIS 16.1.6.G	Application for authorisation of a unit trust	Details	Intention to manage a unit trust	Six months before launch (service standards 6 weeks)
CIS 16.1.8 G	Notification of <i>scheme</i> constituted in an <i>EEA State</i> to market in the UK	Details	Wish to market <i>scheme</i> in UK	May market two months after appropriate notification
CIS 16.1.9 G	Notification of a <i>scheme</i> constituted in a <i>designated territory</i>	Details	Intention to market <i>scheme</i> in UK	On approval or no later than two months following notification
CIS 16.1.10 G	Notification of a <i>scheme</i>	Details	Intention to market <i>scheme</i> in the UK	On approval which may take 6 months.
CIS 16.1.11 G	Change to <i>ICVC</i>	Details	Intention to change <i>scheme</i>	One month before change
CIS 16.1.12 G	Change to <i>AUT</i>	Details	Intention to change <i>scheme</i>	One month before change
CIS 16.4.1 R	Change to <i>ICVC</i>	Details	Change to <i>scheme</i>	14 days
App CIS G 3 (2) – (4)	Box management Errors	Details	Errors in box management	Immediate

Handbook Modules

Schedule3G CIS Sourcebook - Fees and other required payments

- 1 There are no specific requirements for fees or other payments in CIS.

Handbook Modules

Schedule4G CIS Sourcebook - Powers exercised

- 1 The following powers and related provisions in or under the Act have been exercised by the FSA to make the rules in CIS:
- 2 Section 138 (General rule-making power)
- 3 Section 140 (Restriction on managers of authorised unit trust schemes)
- 4 Section 156 (General supplementary powers)
- 5 Section 247 (Trust scheme rules)
- 6 Section 248 (Scheme particulars rules)
- 7 Section 278 (Rules as to scheme particulars)
- 8 Section 283 (Facilities and information in UK)
- 9 Section 340 (Appointment)
- 10 Regulation 6 (FSA rules) of the OEIC regulations
- 11 The following powers in the Act have been exercised by the FSA to give the guidance in CIS
- 12 Section 157(1) (Guidance)
- 13 The following powers in the Act have been exercised by the FSA in CIS to specify and direct:
- 14 Section 270(6)(b)
- 15 Section 274(2),(4) and (5)

Handbook Modules

Schedule5G CIS Sourcebook - Rights of action for damages

- 1 The table below sets out the rules in CIS contravention of which by an authorised person may be actionable under section 150 of the Act (Actions for damages) by a person who suffers loss as a result of the contravention.
- 2 If a "Yes" appears in the column headed "For private person?", the rule may be actionable by a "private person" under section 150 unless a "Yes" appears in the column headed "Removed". A "Yes" in the column headed "Removed" indicates that the FSA has removed the right of action under section 150(2) of the Act. If so, a reference to the rule in which it is removed is also given.
- 3 In accordance with The Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001/xxx), a "private person" is:
 - (1) any individual, except when acting in the course of carrying on a regulated activity; and
 - (2) any person who is not an individual, except when acting in the course of carrying on business of any kind;
- 4 but does not include a government, a local authority or an international organisation.
- 5 The column headed "For other person?" indicates whether the rule is actionable by a person other than a private person, in accordance with those Regulations. If so, an indication of the type of person by whom the rule is actionable is given.
- 6 **Table Actions for damages: the Collective Investment Schemes Sourcebook**

Chapter/ Appendix	Section/ Annex	Paragraph	Right of action under section 150				
			For private person?		For other person?		
			Yes	Removed?	No		
All rules in CIS							

Handbook Modules

Schedule6G CIS Sourcebook - Rules that can be waived

- 1 The FSA may waive any rule in CIS in relation to AUTs under section 250 of the Act (Modification or waiver of rules), except CIS 2.3.3R and CIS 16.5.1R.
- 2 The FSA may waive any rule in CIS in relation to ICVCs under section 250 of the Act (Modification or waiver of rules) , except CIS 2.3.3R.
- 3 Although the FSA has the formal power of waiver under the Act in relation to these rules, much of CIS is designed to ensure that relevant authorised funds comply with the conditions in the UCITS directive. Accordingly, it is most unlikely that in practice UCITS directive derived rules in CIS would be waived.

Collective Investment Schemes Sourcebook

Derivations

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1. The aim of the *guidance* in the following table is to give the reader a guide to the derivation of the text.
2. It is not a complete statement of the derivation and should not be relied on as if it were.

CIS sourcebook derivations Chapter 2 - Constitution

Ch/App	S/Ann	P		Subject	Source	Reference
2	1			Constitution		
2	1	1	R	Application	New	
	1	2	G		New	
	1	3	G		New	
	1	4	R	Categories of authorised fund	OEICR RSR	2.03 2.07 (1)
	1	5	G	Application	New	
2	2			Instrument constituting the scheme		
	2	1	R	Application	New	
	2	2	R	Instrument of incorporation for ICVC: matters which must be included in the instrument of incorporation	OEICR	2.01 (1), (2), (4) – (6)

Ch/App	S/Ann	P		Subject	Source	Reference
	2	3	R		Instrument of incorporation for ICVC: matters which may be included in the instrument of incorporation	OEICR 2.01 (3)
	2	4	R		Relationship between instrument of incorporation and the rules in this chapter	OEICR 2.01 (7)
	2	5	R		The trust deed for AUTs	RSR 2.02 (1) a,
	2	6	R		Matters that must be included in the trust deed	RSR Schedule 1 Part I
	2	7	R		Provisions that may be included in the trust deed	RSR Schedule 1 Part II
	2	8	R		Relationship between trust deed and rules in this sourcebook	RSR 2.02
2	3				UCITS obligations	
	3	1	R		Application	New
	3	2	G		UCITS schemes	RSR 2.07 (12)
	3	3	R		Requirements	RSR OEICR 2.03 2.02
	3	4	G		Outward passporting of UCITS schemes	New
2	4				Share classes	
	4	1	R		Application	OEICR 2.04

Ch/App	S/Ann	P		Subject	Source	Reference	
	4	2	G		Classes of shares in an ICVC	OEICR	2.04 (1)
	4	3	G		Classes of shares other than those listed in CIS 2.5.2G	SIB Guidance Release 2/97	
	4	4	G		What are currency class shares?	OEICR	2 Explanation
	4	5	R		Currency class shares – requirements	OEICR	2.04 (2)
	4	6	R		Rights of share classes	OEICR	2.04 (3) – (4)
2	5				Larger and smaller denomination shares		
	5	1	R		Application	OEICR	2.05
	5	2	G		Characteristics of larger and smaller denomination shares	OEICR	2 Explanation
	5	3	R		Requirement	OEICR	2.05
2	5	4	R		Subdivision and consolidation of shares	OEICR	2.06
2	6				Units and classes of units in AUTs		
2	6	1	R			RSR	2.05 & 6

CIS sourcebook derivations Chapter 3 - Prospectus

Ch/App	S/Ann	P		Subject	Source	Reference
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Ch/App	S/Ann	P			Subject	Source	Reference
3	1				Introduction		
3	1	1	R		Application	New	
3	1	2	R		Application	New	
3	1	3	G	(1), (3), (4)	Purpose	New	
3	1	3	G	(2)		OEICR	3 Introduction – last sentence
3	2				Drawing up and availability of prospectus		
3	2	1	R		Drawing up of prospectus	OEICR RSR	3.01.1, 3.01.2, 3.04.3
3	2	2	R		Availability of prospectus	OEICR RSR	3.02.1 (a) & (b), 3.02.2 3.03.1 (a) & (b), 3.03.2
3	3				False or misleading prospectus		
3	3	1	R		Requirement	OEICR RSR	3.03 3.06.1 to 3.06.4
3	4				Revision of and changes to prospectus		
3	4	1	R		Revision of prospectus	OEICR RSR	3.04.1 (a) & (b), 3.04.2 3.07.1 (a) & (b), 3.07.2
3	4	2	R	(1) (4)	Changes to prospectus	OEICR RSR OEICR	3.05.1 to 3.05.4 11.04 7. 12. 15
3	5				Information to be contained in the prospectus		
	5	1	R		Matters to be included	New	

Ch/App	S/Ann	P		Subject	Source	Reference
	5		R		Table: Contents of prospectus	
			R	1	Prominent statement	RSR OEICR 3.02.1 Schedule 1.1
			R	2	The authorised fund	RSR OEICR Schedule 2.7 Schedule 1.2
			R	3	Investment objectives and policy	RSR OEICR OEICR (New CP108) Schedule 2.7 a, f, g, & h Schedule 1.3 Schedule 1.3 i & j
			R	4	Distributions	RSR OEICR Schedule 2.7 j & k, 2.14 b Schedule 1.4 a to f
			R	5	Characteristics of units in the authorised fund	RSR OEICR Schedule 2.8 a, b, & f Schedule 1.4 a to c, & e, 2.8 e
			R	6	Authorised fund manager	RSR OEICR Schedule 2.1 a to e, h to km Schedule 1.6 a to j, & l to m
			R	7	Directors of an ICVC other than the ACD	OEICR Schedule 1.7 a to e
			R	8 (1) to (8)	The depositary	RSR OEICR Schedule 2.2 a to g, & j Schedule 1.8 a to h
				8 (9)		OEICR Schedule 1.8 j
			R	9	Investment advisor	RSR OEICR Schedule 2.3 a, b, d to f Schedule 1.9 a to d
			R	10	Auditor	RSR OEICR Schedule 2.5 Schedule 7.10
			R	11	Register of holders	RSR OEICR Schedule 2.4, 2.6 Schedule 1.11

Ch/App	S/Ann	P		Subject	Source	Reference	
			R	12	Payments to the authorised fund manager	RSR OEICR	Schedule 2.12 a to d Schedule 1.12 a to e, 2.12 d
			R	13	Other payments out of the scheme property	RSR OEICR	Schedule 2.13 a, b, d, e Schedule 1.13 a to e
			R	14	Moveable and immovable property	OEICR	Schedule 1.14
			R	15	Amortisation (ICVC only)	OEICR	Schedule 1.15
			R	16	Sale and redemption of units	RSR OEICR	Schedule 2.15 a to e, g, h Schedule 1.16 a to e, g to j
			R	17	Valuation of scheme property	RSR OEICR	Schedule 2.10 a to c Schedule 1.17 a to c
			R	18	Dilution levy	RSR OEICR	Schedule 2.10 a to c Schedule 1.17 a to c
			R	19	SDRT provision	RSR OEICR	Schedule 2.10A a to b Schedule 1.18A a to b
			R	20	Forward and historic pricing	RSR OEICR	Schedule 2.16 Schedule 1.19
			R	21	Preliminary charge	RSR OEICR	Schedule 2.11 a & b Schedule 1.20 a & b
			R	22	Redemption charge	RSR OEICR	Schedule 2.12A a to c Schedule 1.2 a to e
			R	23	General information	RSR OEICR	Schedule 2.17 a to d Schedule 1.22 a to d
			R	24	Umbrella scheme	RSR OEICR	Schedule 2.21 (1) a to c, 2.21 (2) a to b Schedule 1.23A i to viii, 1.23B i to iii

Ch/App	S/Ann	P		Subject	Source	Reference
			R	25	Marketing in another member state	RSR OEICR Schedule 2.18 (1) a & b Schedule 1.24 a & b
			R	26	Additional information	RSR OEICR Schedule 2.09, 2.20 Schedule 1.25

CIS sourcebook derivations Chapter 4 – Pricing and dealing

Ch/App	S/Ann	P		Subject	Source	Reference
4	1			Introduction		
4	1	1	R	Application	New	
4	1	2	G	Persons to whom the provisions apply	New	
4	1	3	G	Purpose	New	
4	1	4	G	Explanation	OEICR RSR	4 Explanation 4A Explanation
4	2			Initial offers		
4	2	1	R	Application	New	
4	2	2	G	Purpose	New	
4	2	3	R	Period of initial offer	OEICR RSR	4.01 4A.01 2 & 3
4	2	4	R	Issue of units: initial offer	OEICR RSR	4.02 4A.02
4	2	5	R	Compulsory termination of initial offer	OEICR RSR	4.03. 4A.03
4	3			Issue and cancellation		
4	3	1	R	Application	New	

Ch/App	S/Ann	P		Subject	Source	Reference	
4	3	2	G		Purpose	New	
4	3	3	R	(1) & (6) (2) to (5)	Issue and cancellation of shares by an ICVC	New OEICR	4.04.4 & 5, 4.05.1
4	3	4	R	(1) (2) to (5)	Issue and cancellation of shares by an AUT	New RSR	4A.04.4, 5, & 9, 4A.05.1
4	3	5	R	(1) (2) & (3)	Trustees refusal to issue or cancel units	New RSR	4A.04.6
4	3	6	R	(1) & (4) (2) & (3)	Instructions or modifications between the manager and trustees	New RSR	4A.04.7 & 8
4	3	7	R	(1) (2) to (4)	Payment for units issued	New RSR OEICR	4A.05.2 to 4 4.05.2 to 4
4	3	8	G		Box management errors	New	
4	3	9	R	(1) (2) & (3)	Issue of units to meet obligation to sell	New RSR OEICR	4A.04.3 & 4A.06 4.04.3 & 4.06
4	3	10	R	(1) (2)–(9)	Cancellation and payment for cancelled units	New OEICR RSR	4.07.1 & 2. 4A.07.1 & 2

Ch/App	S/Ann	P		Subject	Source	Reference
4	3	11	R	(1) (2) & (7)	Price of a unit New OEICR RSR	4.08. 1,3,4 &5 4A.08. 1,3,4 &5.
4	3	12	R	(1) (2) – (4)	Modification to number of units issued or cancelled. New OEICR RSR	4.09 4A.09
4	4			Sale and redemption		
4	4	1		Application	New	
4	4	2	G	Purpose	New	
4	4	3	R	Authorised fund manager's obligation to sell	OEICR RSR	4.11 4A.11
4	4	4	R	Authorised fund manager's obligation to redeem	OEICR RSR	4.12 4A.12
4	4	5	R	Payment on redemption	OEICR RSR	4.13 4A.13
4	4	6	R	Proceeds of redemption	OEICR RSR	4.14 4A.14
4	4	7	R	Notification of price to the depository	OEICR RSR	4.16 4A.16
4	4	8	R	Publication of prices	OEICR RSR	4.17 4A.17

Ch/App	S/Ann	P			Subject	Source	Reference
4	5				Issues and cancellations through the authorised fund manager and in specie cancellations		
4	5	1	R		Application	New	
4	5	2	G		Purpose	New	
4	5	3	R	(1) to (5) (6)	Issue and cancellation through the authorised fund manager	OEICR RSR New	4.15. 1 to 4 4A.15 2 to 5, 8
4	5	4	R	(1) to (3) (4)	In specie redemption	OEICR RSR New	4.18 4A.18
4	6				Dilution Levy and SDRT provision		
4	6	1	R		Application	New	
4	6	2	G		Purpose	OEICR RSR	Section D Explanation Section D Explanation
4	6	3	R		Dilution Levy and SDRT provision	OEICR RSR	4.19 4A.19
4	7				Forward and historic pricing		
4	7	1	R		Application	New	
4	7	2	G		Purpose	New	
4	7	3	G		Explanation	OEICR RSR	Section E Explanation Section E Explanation

Ch/App	S/Ann	P		Subject	Source	Reference
4	7	4	R	Forward and historic pricing	OEICR RSR	4.20 & Table 4.1 Notes 4A.20 & Table 4A.1 Notes
4	7	5	R	Table: Forward and historic pricing	OEICR RSR	Table 4.1 Table 4A.1
4	7	6	G	Explanatory Diagram. Pricing at and after valuation point	OEICR RSR	Explanatory diagram Explanatory diagram
4	8			Valuation		
4	8	1	R	Application	New	
4	8	2	G	Purpose	New	
4	8	3	R	Valuation: requirements	OEICR RSR	4.21. 1 to 4. 4A.21. 2 to 4, 10.
4	8	4	G	Valuation: method	IMRO rules	Chapter II, Section 7, Appendix 7.6(1)(e)
4	8	5	R	Regular valuation points	OEICR RSR	4.21. 5 to 8. 4A21. 5 –7, 12.04.3 & 12.11.3
4	8	6	R	Additional valuation points	OEICR RSR	4.21 9 & 10. 4A.21 8 & 9.
4	8	7	R	Market movement	RSR	4.29.6.b.

CIS sourcebook derivations Chapter 5 – Investment and borrowing powers

Ch/App	S/Ann	P		Subject	Source	Reference
5	1			Introduction		
5	1	1	R	Application	New	
5	1	2	G	Application guidance	New	

Ch/App	S/Ann	P		Subject	Source	Reference	
5	1	3	G	Purpose	New		
5	1	4	G	Explanation of this chapter	New		
5	1	5	G	Distinct meaning of certain terms	New		
5	1	6	G	Table	RSR	Part 5 Table	
5	2			General investment powers and limits for authorised funds			
5	2	1	R	Application	New		
5	2	2	G	Explanation of CIS 5.2	New		
5	2	3	R	Prudent spread of risk	OEICR RSR	5.12.6 5.09.6	
5	2	4	R	Investment powers: general	RSR OEICR	5.02 5.02	
5	2	5	R	(1)(2)(a-c)	Valuation	RSR OEICR	5.02 5.03
5	2	6	G		Valuation	New	
5	2	7	R	Part to be construed as a whole	RSR OEICR	5.04 5.04	
5	2	8	G	Examples	OEICR RSR	5.04 5.04 (1)	
5	2	9	R	Transferable Securities	RSR OEICR	5.05 (2)-(4) 5.05 (2)-(4)	
5	2	10	R	Investment in associated collective investment schemes	RSR OEIC	5.15, 5.22.2, 5.30.2, 5.35.2 5.18	
5	2	11	R	Investment in other group schemes	RSR OEICR	5.69 5.42	

Ch/App	S/Ann	P		Subject	Source	Reference
5	2	12	R	Investment in other collective investment schemes: interpretation	RSR	5.08A
5	2	13	R	Significant influence for ICVCs	OEICR	5.17 (1)(2)
5	2	14	R	Significant influence for managers of AUTs	IMRO	II 7.7
5	2	15	R	Concentration	RSR OEICR	5.14 5.17 (3)
5	2	16	G		New	
5	3			Eligible markets regime		
5	3	1	R	Application	New	
5	3	2	G	Purpose	New	
5	3	3	R	Eligible markets : requirements	RSR OEICR	5.07A 5.06
5	3	4	G	Guidance on eligible markets : introduction	SIB Guidance Release	3/97
5	3	5	G	Regulated	SIB Guidance Release	3/97 par. 13
5	3	6	G	Operating regularly	SIB Guidance Release	3/97 par. 14
5	3	7	G	Recognised	SIB Guidance Release	3/97 par 15
5	3	8	G	Open to the public	SIB Guidance Release	3/97 par. 16
5	3	9	G	Liquidity and repatriation of funds	SIB Guidance Release	3/97 par.12
5	3	10	G	Responsibility of authorised fund manager	SIB Guidance Release	3/97 par.10

Ch/App	S/Ann	P			Subject	Source	Reference
5	4				Securities Schemes		
5	4	1	R		Application	New	
5	4	2	R		Securities schemes: general	RSR OEICR	5.09 5.12
5	4	3	R		Spread : general	RSR OEICR	5.10 5.13
5	4	4	R		Spread : government and public securities	RSR OEICR	5.11 5.14
5	4	5	R		Securities schemes: investment in collective investment schemes	RSR OEICR	5.12 5.15
5	4	6	R		Investment in warrants and nil and partly paid securities	RSR OEICR	5.13 5.16
5	5				Money market schemes		
5	5	1	R		Application	New	
5	5	2	G		Introduction	RSR	Part5 Section C Explanation
5	5	3	R		Money market schemes : general	RSR	5.16 & 5.19
5	5	4	R		Investment limits	RSR	5.17
5	5	5	R		Spread	RSR	5.18
5	6				Futures and options schemes		
5	6	1	R		Application	New	
5	6	2	G		Introduction	RSR	Part 5 Section D Explanation
5	6	3	R		Futures and options schemes : general	RSR	5.20
5	6	4	R		Permitted transactions (derivatives and forwards)	RSR	5.21 (1) – (4)

Ch/App	S/Ann	P		Subject	Source	Reference
5	6	5	R	Transactions for the purchase of property	RSR OEICR	5.21(11) 5.25(5)
5	6	6	R	OTC transactions in derivatives	RSR OEICR	5.21 (5) – (8) 5.10
5	6	7	R	Investment in collective investment schemes	RSR	5.22
5	6	8	G	What is cover and what is the purpose of cover?	RSR	Section D Explanation
5	6	9	R	Cover for transactions in derivatives and forward transactions	RSR	5.23 (1) – (8)
5	6	10	G	Examples of cover requirements	RSR	5.23(9)
5	6	11	G	Derivatives covering derivatives : explanation for the use of derivatives for cover	RSR	5.24
5	6	12	R	Derivatives covering derivatives : requirements	RSR	Part 5 Table 5.1
5	6	13	R	Deposit arrangements (for purchased options)	RSR	5.25(1),(2)
5	6	14	R	Borrowing	RSR	5.25 (3), (4)
5	6	15	R	Continuing nature of limits and requirements	RSR	5.26
5	6	16	G	Stages in defining cover	RSR	Section D Explanatory Diagram
5	6	17	G	Mutual cover as between derivatives	RSR	5.24 diagram

Ch/App	S/Ann	P		Subject	Source	Reference
5	7			Geared futures and options schemes		
5	7	1	R	Application	New	
5	7	2	G	Introduction	RSR	Part 5 Section E Explanation
5	7	3	R	Geared futures and options scheme : general	RSR	5.27
5	7	4	R	Limits on investment in initial outlay	RSR OEICR	5.28 5.27.3 to 6
5	7	5	G	Stages in using limit on initial outlay	New	
5	7	6	G	Stages in using limit on initial outlay	RSR	Section E Explanatory Diagram.
5	7	7	R	. Spread	RSR	5.29(1),(3),(5),(6),(7)
5	7	8	R	Investment in collective investment schemes	RSR	5.30(1)
5	7	9	R	Delivery of property under a transaction in derivatives	RSR	5.31
5	8			Property schemes		
5	8	1	R	Application	New	
5	8	2	G	Introduction	RSR	Part 5 Section F Explanation
5	8	3	R	Property schemes : general	RSR	5.32, 5.41
5	8	4	R	Permitted immovables	RSR	5.33 (2)
5	8	5	R	Approved immovables	RSR	5.33 (3) (4) (5) (6) (7) (8) (10)
5	8	6	R	Property-related assets	RSR	5.34
5	8	7	R	Investment in a collective investment scheme	RSR	5.35

Ch/App	S/Ann	P		Subject	Source	Reference
5	8	8	R	Property related limits	RSR	5.36
5	8	9	R	Mortgaged property	RSR	5.37
5	8	10	R	Spread	RSR	5.38
5	8	11	R	Initial periods	RSR	5.39
5	8	12	R	Grant of options and mortgages	RSR	5.40
5	8	13	G	Construction of property schemes	RSR	Part 5 Section F Explanation
5	9			Warrant schemes		
5	9	1	R	Application	New	
5	9	2	G	Introduction	New	5.08
			(1)		OEICR	
				(2)	RSR	5.42.1
5	9	3	R	Warrant schemes	RSR	5.42
					OEICR	5.19
5	10			Feeder funds		
5	10	1	R	Application	New	
5	10	2	G	Introduction	RSR	Part 5 Section H Explanation
5	10	3	R	Feeder funds : general	RSR	5.43
5	10	4	R	Feeder funds investing in a single eligible investment trust	RSR	5.44
5	11			Funds of funds schemes		
5	11	1	R	Application	New	
5	11	2	G	Introduction	RSR	Part 5 Section I Explanation
5	11	3	R	Fund of funds schemes : general	RSR	5.45
5	11	4	R	Eligible combinations of scheme	RSR	5.46

Ch/App	S/Ann	P		Subject	Source	Reference
5	12			Umbrella schemes		
5	12	1	R	Application	New	
5	12	2	G	Introduction	RSR	Part 5 Section J Explanation
5	12	3	R	Umbrella schemes : general	RSR OEICR	5.47 (1) 5.20
5	12	4	R	Restriction on investment	RSR OEICR	5.47 (2) 5.21
5	13			Efficient portfolio management		
5	13	1	R	Application	New	
5	13	2	G	Explanation : requirements of efficient portfolio management	RSR OEICR	Part 5 Section K Explanation Part 5 Section E Explanation 5.24 (3)
5	13	3	R	Appropriate transactions	RSR OEICR	5.50 5.22
5	13	4	R	Economic appropriateness	RSR OEICR	5.51 5.23
5	13	5	R	Generation of additional capital or income	RSR OEICR	5.52 5.24
5	13	6	R	Permitted transactions	RSR OEICR	5.53 5.25 (1 - 4), 5.27 (1)
5	13	7	G	Cover for transactions in derivatives and forward transactions	RSR OEICR	Part 5 Section K Explanation Part 5 Section E Explanation
5	13	8	R	Cover for transactions in derivatives and forward transactions	RSR OEICR	5.54 (1) – (9) 5.26 (1) – (9)

Ch/App	S/Ann	P		Subject	Source	Reference
5	13	9	G	Examples of cover requirements	RSR OEICR	5.54 (10) 5.26 (10)
5	13	10	G	The use of index derivatives : congruence	IMRO Notice to Firms No 7	23/2/93
5	13	11	G	Borrowing in the context of efficient portfolio management	RSR OEICR	Part 5 Section K Explanation Part 5 Section E Explanation
5	13	12	R	Borrowing in the context of efficient portfolio management	RSR OEICR	5.55 5.28
5	13	13	R	The continuing nature of requirements and limits	RSR OEICR	5.56 5.29
5	14			Stock lending		
5	14	1	R	Application	New	
5	14	2	G	Stock lending permitted under this section (CIS 5.14)	OEICR RSR	Ch 5 Section F Explanation Ch 5 Section L Explanation
5	14	3	R	Stock lending : general	RSR OEICR	5.57 (2) 5.30 (1)
5	14	4	R	Permitted stock lending	RSR OEICR	5.58 5.31
5	14	5	G	Treatment of collateral	RSR OEICR	5.60 Explanation 5.32 Explanation
5	14	6	R	Treatment of collateral	RSR OEICR	5.60 (1) – (7) 5.32 (1) – (7)
5	14	7	R	Limitation by value	RSR OEICR	5.59 5.33

Ch/App	S/Ann	P		Subject	Source	Reference
5	15			Cash, borrowing, lending and other provisions		
5	15	1	R	Application	New	
5	15	2	R	Cash and near cash	RSR OEICR	5.61 5.34
5	15	3	R	General power to borrow	RSR OEICR	5.62 5.35
5	15	4	R	Borrowing limits	RSR OEICR	5.63 5.36
5	15	5	R	(1), (2) Restrictions on lending of money	RSR OEICR	5.64 5.37
5	15	6	R	Restrictions on lending of property other than money	RSR OEICR	5.65 5.38
5	15	7	R	General power to accept or underwrite placings	RSR OEICR	5.66 5.39
5	15	8	R	Guarantees and indemnities	RSR OEICR	5.67 5.40
5	15	9	G	Payment of liabilities on transfer of assets	New	
5	16	1	R	Application	New	
5	16	2	R	Requirement to cover sales	RSR OEICR	5.68 5.41

CIS sourcebook derivations Chapter 6 – Title transfer and plan registers

Ch/App	S/Ann	P			2. Subject	3. Source	Reference
6	1				Introduction		
6	1	1	R		Application	New	
6	1	2	G		Guidance	New	
6	1	3	G		Explanation of this chapter	New	
6	2				The register of unitholders		
6	2	1	R	(1) (2) to (6)	Basic requirements	New RSR	6.02. 1. to 5
6	2	2	R	(1) (2) & (3)	The register as evidence of title	New RSR	6.03
6	2	3	R	(1) (2) to (4)	Inspection of the register and copies of entries	New RSR	6.04
6	2	4	R	(1) (2) to (4)	The manager as unitholder	New RSR	6.05
6	2	5	R	(1) (2) to (6)	Certificates	New RSR	6.06
6	3				Transferability of units		
6	3	1	R	(1) (2) to (7)	Transfer of units by act of parties	New RSR	6.12
6	3	2	R	(1) (2) to (4)	Transfer of units by operation of law	New RSR	6.14
6	4				Permitted alterations of the register of unitholders		

Ch/App	S/Ann	P		2. Subject	3. Source	Reference
6	4	1	R	(1) (2) & (3)	Change of name and address of unitholder	New RSR 6.15
6	4	2	R	(1) (2) to (6)	Conversion of units	New RSR 6.16
6	4	3	R	(1) (2) & (3)	Subdivision and consolidation of units	New RSR 6.17
6	4	4	R	(1) (2)	Default by the unitholder	New RSR 6.19
6	5				Plan registers	
6	5	1	R		Application	New
6	5	2	R		Table of application	New
6	5	3	G		Explanation	New
6	5	4	R		Requirement	OEICR RSR 7.14.. 6.02A.

CIS sourcebook derivations Chapter 7 – Powers and duties

Ch/App	S/Ann	P		Subject	Source	Reference
7	1				Introduction	
7	1	1	R		Application	New
7	1	2	G		Purpose	New
7	1	3	G		Content of CIS 7	New
7	1	4	G		ICVCs	OEICR Part 6 Explanation
7	1	5	R		Table of application	New
7	2				Directors	
7	2	1	R		The directors	OEICR 6.01 (2) – (10)
7	2	2	R		Appointment of ACD	OEICR 6.12

Ch/App	S/Ann	P		Subject	Source	Reference
7	2	3	R	Termination of appointment of ACD	OEICR	6.13
7	3			The ACD		
7	3	1	R	Functions of the ACD	OEICR	6.02
7	3	2	G	Valuation and pricing : for ICVCs	New	
7	3	3	R	Maintenance of records	OEICR	6.04 (1), (2)
7	3	4	R	Maintenance of capital	OEICR	6.04 (3)
7	4			The depositary		
7	4	1	R	General duties of the depositary	OEICR	6.05
7	4	2	G	Valuation and pricing	New	
7	4	3	R	Duty to inform the FSA : for ICVCs	OEICR	6.05A
7	4	4	R	Control by the depositary over scheme property	OEICR	6.06
7	4	5	R	Exercise of rights in respect of the scheme property	OEICR	6.07
7	5			The ICVC, its directors and the depositary		
7	5	1	R	Dealings in scheme property	OEICR	6.03 (1) – (3)
7	5	2	R	ICVC without a director	OEICR	6.04 (4)
7	5	3	R	Duties of the ACD and depositary : investment and borrowing powers	OEICR	6.09
7	6			Committees, appointments and conflicts of interest		

Ch/App	S/Ann	P		Subject	Source	Reference
7	6	1	R		Committees and appointments	OEICR 6.10
7	6	2	G		Appointments and responsibilities for regulatory obligations	New
7	6	3	R		Conflict of interests	OEICR 6.11
7	7				AUTS: powers and duties	
7	7	1	G		Introduction	New
7	8				The manager	
7	8	1	R		Management duties	RSR 7.02
7	8	2	G		Valuation and pricing	New
7	8	3	R		Maintenance of records	RSR 7.04
7	8	4	R		Manager to supply information to trustee	RSR 7.08
7	8	5	R		Auditor	RSR 7.05
7	8	6	R		Tax returns	RSR 7.06
7	9				The trustee	
7	9	1	R	(1) – (4) (5)	Oversight by the trustee of the manager	RSR 7.09. 1 to 4 Table 4C Part 7
7	9	2	G		Valuation and pricing : for AUTs	New
7	9	3	R		Duty to inform the FSA : for AUTs	RSR 7.09A
7	9	4	R		Control by the trustee over the scheme property	RSR 7.10
7	9	5	R		Exercise of the rights in respect of the scheme property	RSR 7.11
7	10				The manager and trustee	

Ch/App	S/Ann	P		Subject	Source	Reference	
7	10	1	R		Duties of the manager and trustee under general law	RSR	7.12
7	10	2	R		Dealings in scheme property	RSR	7.03
7	10	3	R		Duties of the manager and trustee : investment and borrowing powers	RSR	7.14
7	10	4	R		Delegation	RSR	7.15
7	10	5	G		Delegation and responsibility for regulatory obligation	New	
7	10	6	R		Conflict of interests	RSR	7.16
7	11				New managers and trustees		
7	11	1			Replacement of a manager	RSR	7.17
7	11	2			Retirement of a manager	RSR	7.18
7	11	3			Consequences of retirement	RSR	7.19
7	11	4			Retirement of the trustee	RSR	7.20
7	Annex 1G				Valuation and pricing of authorised funds	IMRO	App 7.6 (1) (a) & (c)

CIS sourcebook derivations Chapter 8 – Charges and expenses

Ch/App	S/Ann	P		Subject	Source	Reference
8	1				Introduction	
8	1	1	R		Application	New
8	1	2	G		Purpose	New
8	1	3	R		Table of application	New

Ch/App	S/Ann	P		Subject	Source	Reference
8	2			Charges		
8	2	1	G	Application	New	
8	2	2	R	Preliminary charge : ICVCs and single- priced AUTs	RSR OEICR	4B.02 7.02 (2 & 3)
8	2	3	R	Payments by an ICVC to an ACD	OEICR	7.01
8	2	4	R	Increases in remuneration of an ACD	OEICR	7.03
8	2	5	R	Increase in preliminary charge of an authorised fund manager : ICVCs and single-priced AUTs	RSR OEICR	4B.03 7.03
8	2	6	R	Notice of an increase : ICVCs and single- priced AUTs	RSR OEICR	4B.03 7.03
8	2	7	R	Redemption charge : ICVCs	OEICR	7.04
8	2	8	R	Charges for an exchange of units in an umbrella scheme: ICVCs and single priced AUTs	RSR OEIC	4B.06 7.05
8	3			Restrictions and other requirements relating to payments: ICVCs		
8	3	1	R	Promotional payments	OEICR	7.06
8	3	2	R	Performance fees	OEICR	7.07
8	3	3	R	Movable and immovable property	OEICR	7.08
8	3	4	R	Set up costs	OEICR	7.10
8	3	5	R	Allocation of payments to capital or income	OEICR	7.12 (1) – (4)

Ch/App	S/Ann	P		Subject	Source	Reference
8	4			Other liabilities: ICVCs and AUTs		
8	4	1	R	Payment of liabilities on transfer of assets	OEICR RSR	7.09 8.04 (2 & 3)
8	4	2	R	Tax	OEICR	7.11
8	5			Charges and other payments: AUTs		
8	5	1	R	Managers periodic charges	RSR	8.02
8	5	2	R	Redemption charge : single-priced AUTs	RSR	4B.04
8	5	3	R	Control over maximum charges on issue, sale and redemptions: single-priced AUTs	RSR	4B.05
8	5	4	R	Remuneration of the trustee and reimbursement of trustees expenses	RSR	8.03
8	5	5	R	Payments out of the scheme property	RSR	8.04
8	5	6	R	Exemptions from liability to account for profits	RSR	8.05
8	5	7	R	Allocation of payments to capital or income	RSR	8.06

CIS sourcebook derivations Chapter 9 - Income

Ch/App	S/Ann	P		Subject	Source	Reference
9	1			Introduction		
9	1	1	R	Application	New	
9	1	2	G	Purpose	New	

Ch/App	S/Ann	P		Subject	Source	Reference
9	1	3	R		Table of application	New
9	2				Requirements	
9	2	1	R		Accounting period	OEICR RSR 8.01 9.02
9	2	2	R		Annual income allocation date	OEICR RSR 8.02 9.03
9	2	3	R		Annual allocation of income	OEICR RSR 8.03 9.04
9	2	4	R		Annual allocation of accumulation shares or accumulation units	OEICR RSR 8.04 9.05
9	2	5	R		Annual distribution to holders of income shares or income units	OEICR RSR 8.05. 9.06.
9	2	6	R		Interim allocations of income	OEICR RSR 8.06 9.07
9	2	7	G		Income Equalisation	OEICR RSR 8.07 9.08
9	2	8	R		Tax certificates	OEICR RSR 8.08 9.10.1.b.
9	2	9	R	(1) (2)	Unclaimed distributions	OEICR RSR 8.09 9.09.6
9	2	10	R		Payment of distributions to joint holders (AUTs only)	RSR 9.09.3
9	2	11	R		Income derived from stock lending (AUTs only)	RSR 9.11

CIS sourcebook derivations Chapter 10 - Report and Accounts

Ch/App	S/Ann	P			Subject	Source	Reference
10	1				Introduction		
10	1	1	R		Application	New	
10	1	2	G		Application: guidance	New	
10	1	3	G		Purpose	New	
10	1	4	G		Contents of this chapter	New	
10	2				Preparation of annual and half yearly reports		
10	2	1	R	(1) (2) & (3)	Preparation by the manager of an AUT of annual and half- yearly accounts	New RSR	10.02.1
10	2	2	G		Preparation by the directors of an ICVC of annual and half-yearly reports	OEICR	Part 9. Explanation
10	3				Contents of annual and half- yearly reports		
10	3	1	R		Application	New	
10	3	2	G		Explanation	New	

Ch/App	S/Ann	P		Subject	Source	Reference	
10	3	3	R	(1)	Annual reports	OEICR RSR	9.01.1 10.02.2, & 3
				(2) & (3)		OEICR	9.01.2 & 3
				(4)		OEICR RSR	9.01.7 10.02.3A
10	3	4	R	(1)	Half-yearly reports	OEICR RSR	9.01.4 10.02.1 & 3
				(2) & (3)		OEICR RSR	9.01.5 & 6 Table 12.1 & Note 8.
10	3	5	R	(1)	Signing of reports	OEICR	9.01.9
				(2)		RSR	10.02.4
10	3	6	R		Short form accounts in reports	OEICR RSR	9.01. 7A,7B,7C &10. 10.07
10	3	7	R		Duty of the ACD	OEICR	9.01.8
10	4				Information to be included in annual and half-yearly reports		
10	4	1	R		Application	New	
10	4	2	R		Report of the directors of an ICVC or report of the manager of an AUT	OEICR RSR	Schedule 2 Part I Schedule 3 Part I
10	4	3	R		Report of the directors or report of the manager: umbrella schemes	OEICR RSR	Schedule 2 Part I 12.a Table 12.1 Note 8.a ii & iii.

Ch/App	S/Ann	P		Subject	Source	Reference
10	4	4	R	Report of the directors or report of the manager: short form accounts	OEICR RSR	Schedule 2, Part I, 14. Schedule 3 Part IA
10	4	5	R	Comparative table	OEICR RSR	Schedule 2 Part II Schedule 3 Part III
10	4	6	R	Report of the depositary of an ICVC	OEICR	9.05 Schedule 2 Part III
10	4	7	R	Report of the trustee of an AUT	RSR	10.06 Schedule 3 Part V
10	4	8	R	Report of the auditor	OEICR RSR	Schedule 2 Part IV Schedule 3 Part IV
10	4	9	R	Auditor's statement relating to short form accounts	OEICR RSR	Schedule 2 Part IVA Schedule 3 Part IVA
10	5			Publication and availability of annual and half-yearly reports		
10	5	1	R	Application	New	
10	5	2	R	Publication of reports	OEICR RSR	9.02 10.03
10	5	3	R	Reports to be offered to purchasers of units	OEICR RSR	9.03 10.04 1&2
10	5	4	R	Publication of availability of reports and prospectus	OEICR RSR	9.04 10.05

CIS sourcebook derivations Chapter 11- Meetings of holders, amendments to the scheme and service of documents

Ch/App	S/Ann	P			Subject	Source	Reference
11	1				Introduction		
11	1	1	R		Application	New	
11	1	2	G		Purpose	New	
11	1	3			Explanation of this chapter	New	
11	1	4	R		Table of application	New	
11	2				Meetings of shareholders		
11	2	1	R		General meetings	OEICR	10.01
11	2	2	R	(1) (2)	Special meaning of shareholders	OEICR New	10.08
11	2	3	R		Notice of meetings	OEICR	10.02
11	2	4	R		Quorum	OEICR	10.03
11	2	5	R		Resolutions	OEICR	10.04
11	2	6	R		Voting rights	OEICR	10.05
11	2	7	R		Rights to demand a poll	OEICR	10.06
11	2	8	R		Proxies	OEICR	10.07
11	2	9	R		Class meetings	OEICR	10.09
11	2	10	R		Variation of class rights	OEICR	10.10
11	3				Meeting of unitholders		
11	3	1	R		Convening and attendance at meetings of unitholders	RSR	11.07.1 to4, 5.

Ch/App	S/Ann	P		Subject	Source	Reference	
11	3	2	R	(1) (2)	Special meaning of unitholders	RSR New	11.07.6
11	3	3	R		Power of a meeting of unitholders	RSR	11.08
11	3	4	R		The chairman	RSR	11.11
11	3	5	R		Adjournment	RSR	11.12
11	3	6	R		Notice of meetings	RSR	11.09
11	3	7	R		Quorum	RSR	11.10
11	3	8	R		Restriction on the posing of composite resolutions to meetings of unitholders	RSR	11.14.1 & 2 a-c.
11	3	9	R	(1) to (5) (6)	Voting rights	RSR	11.13.6 to 10 11.07.3, 3A & 4
11	3	10	R		Rights to demand a poll	RSR	11.13.1 to 5.
11	3	11	R		Proxies	RSR	11.15
11	3	12	R		Minutes	RSR	11.16
11	3	13	R		Class meetings	RSR	11.18
11	4				Amendments to the instrument constituting the scheme		
11	4	1	G		Explanation	New	
11	4	2	R	(1) (2) (3)	Amendment to instrument of incorporation: with meeting	OEICR New OEICR	10.11.1 10.11.2
11	4	3	R		Amendment to the trust deed: with meeting	RSR	11.02

Ch/App	S/Ann	P		Subject	Source	Reference	
11	4	4	R	(1) (2) & (3) (4)(a) to (d) (4) (e) (4) (f) (5) (6) (7) & (8)	Amendment to the instrument constituting the scheme: without meeting	OEICR RSR OEICR RSR RSR OEICR RSR OEICR RSR RSR	10.11.3 11.03.1 & 2. 10.11.3.b(i) to (iv) 11.03.1.a , b, d, & e 11.03.1.ff 10.11.3.b.(v) 11.03.1.h. 10.11.3.a & c. 11.03.1. c, cc, dd, f, gg. 11.03.3 & 4.
11	4	5	G		Matters to be included in notices sent to unitholders when a manager proposes a change from dual to single pricing	CP14	Letter to industry
11	5				Schemes of arrangement		
11	5	1	G		Schemes of arrangement: explanation	New	
11	5	2	R		Schemes of arrangement: requirements	OEICR RSR	12.19. 11.05.2 to 5, & 11.06.2,3.

Ch/App	S/Ann	P			Subject	Source	Reference
11	6				Service of notice and other documents		
11	6	1	R		Notice to holders	OEICR RSR	10.12.1,3 & 4. 15.02.1,3 & 4
11	6	2	R	(1) (2) & (3)	Other notices	OEICR RSR New	10.12.2 15.02.2
11	6	3	G		Form of document or notice	New	

CIS sourcebook derivations Chapter 12 – special provisions for certain categories of scheme

Ch/App	S/Ann	P			Subject	Source	Reference
12	1				Introduction		
12	1	1	R		Application	New	
12	1	2	G		Purpose	New	
12	1	3	R		Table of application	New	
12	2				Futures and options schemes and geared futures and options schemes		
12	2	1	R		Special rules for sales and redemptions	RSR	12.03A, 12.04, 12.04A
12	3				Property schemes		
12	3	1	R		Standing independent valuer	RSR	12.05 (1), (3)

Ch/App	S/Ann	P		Subject	Source	Reference
12	3	2	R		Functions of the standing independent valuer	RSR 12.06
12	3	3	R		Special rules for pricing	RSR 12.07(1),(2)
12	3	4	R		Failure to obtain minimum subscriptions	RSR 12.08
12	3	5	R		Rules which do not apply to property schemes	RSR 12.07(6)
12	4				Feeder funds and funds of funds	
12	4	1	R		Special rules for pricing	RSR 12.12
12	4	2	R		Fund of funds schemes	RSR 12.14
12	5				Umbrella schemes	
12	5	1	R		Qualification for authorisation	RSR OEICR 12.15 11.01
12	5	2	R		Base currency	OEICR 11.02
12	5	3	R		Allocation of scheme property	OEICR 11.03
12	5	4	R		Income	OEICR 11.05
12	5	5	R		An ICVC with only one sub-fund	OEICR 11.06
12	5	6	G		Other sourcebook provisions relating to umbrella schemes	New
12	5	7	R		Investment and borrowing powers	RSR OEICR Table 12.1 11.04
12	5	8	G		Main provisions relating specifically to umbrella schemes	New

CIS sourcebook derivations Chapter 13 – Suspension and resumption of dealing

Ch/App	S/Ann	P		Subject	Source	Reference
13	1			Application		
13	1	1	R		New	
13	1	2	G	Purpose	New	
13	1	3	R	Requirement	RSR OEICR	13.02 12.01
13	1	4	G	Suspension beyond 28 days	New	

CIS sourcebook derivations Chapter 14 – Termination of authorised funds

Ch/App	S/Ann	P		Subject	Source	Reference
14	1			Introduction		
14	1	1	R	Application	New	
14	1	2	G	Purpose	New	
14	1	3	G	Explanation of this chapter	New	
14	1	4	R	Table of application	New	
14	2			Winding up a solvent ICVC		
14	2	1	G	Explanation of CIS 14.2	OEICR	Part 12 Section B Explanation
14	2	2	G	Table	New	
14	2	3	R	When an ICVC is to be wound up	OEICR	12.02 (1), (2)
14	2	4	R	Solvency statement	OEICR	12.02 (3) – (5)
14	2	5	R	Consequences of commencement of winding up	OEICR	12.03

Ch/App	S/Ann	P		Subject	Source	Reference
14	2	6	R		Manner of winding up	OEICR 12.04
14	2	7	R		Final account	OEICR 12.05
14	2	8	R		Duty to ascertain liabilities	OEICR 12.06
14	2	9	R		Reports and accounts	OEICR 12.07
14	2	10	R		Liabilities of the ACD	OEICR 12.08
14	2	11	R		Additional provisions applicable to umbrella companies	OEICR 12.09
14	2	12	R		Miscellaneous	OEICR 12.10
14	3				Termination of a sub-fund of an umbrella scheme	
14	3	1	G		Explanation of CIS 14.3	OEICR Part 12 Section C Explanation
14	3	2	R		Special meaning for CIS 14.3	OEICR 12.11
14	3	3	R		When a sub-fund is to be terminated	OEICR 12.12 (1), (2)
14	3	4	R		Solvency statement	OEICR 12.12 (3) – (6)
14	3	5	R		Consequences of commencement of termination of a sub-fund	OEICR 12.13
14	3	6	R		Manner of termination	OEICR 12.14
14	3	7	R		Termination account	OEICR 12.15
14	3	8	R		Duty to ascertain liabilities	OEICR 12.16
14	3	9	R		Reports and accounts	OEICR 12.17
14	3	10	R		Liabilities of the ACD	OEICR 12.18

Ch/App	S/Ann	P		Subject	Source	Reference
14	4			Winding up an AUT		
14	4	1	G	Explanation of CIS 14.4	New	
14	4	2	R	When an AUT is to be wound up	RSR	13.03
14	4	3	R	Manner of winding up	RSR	13.04
14	4	4	R	Accounting and reports during winding up	RSR	13.05
14	5			Schemes that are not commercially viable		
14	5	1	G	Explanation of this section	New	
14	5	2	G	Information to be provided to the FSA	SIB letter to industry	1992

CIS sourcebook derivations Chapter 15 – Dual pricing and dealing

Ch/App	S/Ann	P		Subject	Source	Reference
15	1			Introduction		
15	1	1	R	Application	New	
15	1	2	R		New	
15	1	3	R	Purpose	New	
15	1	4	G	Explanation	RSR	Part 4 (Explanation)
15	2			Initial offers and unitisations		
15	2	1	R	Application	New	
15	2	2	G	Purpose	New	
15	2	3	R	Period of initial offer	RSR	4.01

Ch/App	S/Ann	P		Subject	Source	Reference
15	2	4	R		Issue of units : initial offer	RSR 4.02
15	2	5	R		Initial price	RSR 4.03
15	2	6	R		Compulsory termination of initial offer	RSR 4.04
15	2	7	R		Creation of units : unitisation	RSR 4.05
15	3				Issues and cancellations	
15	3	1	R		Application	New
15	3	2	G		Purpose	New
15	3	3	G		Box management errors	New
15	3	4	R	(1 – 3) (4)	Issue of units : manager's instructions	RSR RSR 4.07 4.06.3
15	3	5	R		Issue by trustee	RSR 4.08
15	3	6	R		Issue price	RSR 4.09
15	3	7	R		Cancellation of units	RSR 4.10
15	3	8	R		Cancellation price	RSR 4.11
15	3	9	R		Trustee's refusal to issue or cancel units	RSR 4.12
15	3	10	R		Instructions or notifications between manager and trustee	RSR 4.25
15	3	11	R		Timing of instructions to issue or cancel units	RSR 4.13
15	3	12	R		Modification to number of units issued or cancelled	RSR 4.13A
15	4				Sale and redemption	
15	4	1	R		Application	RSR 4.14
15	4	2	G		Purpose	New

Ch/App	S/Ann	P		Subject	Source	Reference
15	4	3	R	Manager's obligation to sell	RSR	4.15
15	4	4	R	Sale price parameters	RSR	4.16 (1) – (4)
15	4	5	R	Preliminary charge	RSR	4B.02
15	4	6	R	Increase in preliminary charge	RSR	4B.03
15	4	7	R	Manager's obligation to redeem	RSR	4.18
15	4	8	R	Payment on redemption	RSR	4.19
15	4	9	R	Redemption price parameters	RSR	4.20
15	4	10	R	Increase in redemption charge	RSR	4.21
15	4	11	R	Control over maximum charges on issue and redemption	RSR	4.21A
15	4	12	R	Exchange of units in umbrella schemes	RSR	4.21B
15	4	13	R	Notification of prices to the trustee	RSR	4.23
15	4	14	R	Publication of prices	RSR	4.24
15	5			Issues and cancellations through the manager and in specie cancellations		
15	5	1	R	Application	New	
15	5	2	G	Purpose	RSR	4.22
15	5	3	R	Issues and cancellations through the manager	RSR	4.22

Ch/App	S/Ann	P		Subject	Source	Reference	
15	5	4	R		In specie cancellation	RSR	4.28
15	6				SDRT provision		
15	6	1	R		Application	New	
15	6	2	G		Purpose	New	
15	6	3	R	(1), (2)	SDRT provision	RSR	4.21.c
15	7				Forward and historic pricing		
15	7	1	R		Application	New	
15	7	2	G		Purpose	New	
15	7	3	G		Purpose	New	
15	7	4	R		Forward and historic pricing	RSR	4.20A & 4.26
15	7	5	R		Forward or historic pricing	RSR	Table 4A.1
15	7	6	G		Explanatory diagram	RSR	Part 4A Section E Explanatory diagram
15	8				Valuation		
15	8	1	R		Application	New	
15	8	2	G		Purpose	New	
15	8	3	R		Valuation	RSR	4.29
15	8	4	R		Table - Valuation	RSR	Table 4.2
15	8	5	G			IMRO	II Appendix 7.6(1)(e)

CIS sourcebook derivations Chapter 16 – Application and notification

Ch/App	S/Ann	P		Subject	Source	Reference
16	1				Introduction	
16	1	1	G		Application	New
16	1	2	G		Purpose	New

Ch/App	S/Ann	P		Subject	Source	Reference
16	1	3	G	Contacting the collective investment schemes and product regulation department	New	
16	1	4	G	Application for authorisation of an ICVC	New	
16	1	5	G		New	
16	1	6	G	Application for authorisation of a unit trust scheme	New	
16	1	7	G		New	
16	1	8	G	Notification in respect of a scheme constituted in another EEA state	SIB Guidance Release	3/89. Par. 20
16	1	9	G	Notification in respect of a scheme constituted in a designated country or territory	SIB Guidance Release	3/98. Par. 4
16	1	10	G	Application in respect of other overseas collective investment schemes	New	
16	1	11	G	Notification of proposed changes to ICVCs	New	
16	1	12	G	Notification of proposed changes to AUTs	New	
16	1	13	G	Revocation of authorisation or recognition	New	
16	2			Independence of depositaries of ICVCs		

Ch/App	S/Ann	P		Subject	Source	Reference	
16	2	1	G		Introduction	SIB Guidance Release	1/97. Introduction
16	2	2	G		Independence : depository, ICVC and corporate director of an ICVC	SIB Guidance Release	1/97 par. 4 to 9.
16	2	3	G		Independence : depository and individual directors of an ICVC	SIB Guidance Release	1/97. Par. 10
16	2	4	G		Other matters affecting independence	SIB Guidance Release	1/97. Par. 11 to 13.
16	3				Independence of trustees and managers of AUTs		
16	3	1	G		Introduction	SIB Guidance Release	1/90. Par. 2
16	3	2	G		Independence : trustee, manager	SIB Guidance Release	1/90. Par 3 to 13
16	4				Notification to the FSA in its role as registrar of ICVCs		
16	4	1	R		Notification to the FSA in its role as registrar of ICVCs	New	

CIS sourcebook derivations Chapter 17 – Recognised schemes

Ch/App	S/Ann	P		Subject	Source	Reference
17	1				Application and purpose	
17	1	1	R		Application	New
17	1	2	G		Purpose	New

Ch/App	S/Ann	P		Subject	Source	Reference
17	2		G	Information and documents which should be supplied with a notification under section 264 of the Act		
17	2	1	D	Information and documents which should	RSR	14.01 & Table 14.1
17	2	2	G	Subsequent notification in respect of schemes recognised under section 264 of the Act	RSR	14.03
17	3			Notification to the FSA under sections 270 and 272		
17	3	1	D	Information and documents to be supplied with notifications under sections 270 (designated territories) and 272 (individually recognised overseas schemes) of the Act	RSR	14.02 & Table 14.2
17	3	2	G	Subsequent notification in respect of schemes recognised under sections 270 and 272 of the Act	RSR	14.03
17	3	3	R	Additional information required in the prospectus for notifications under section 272	RSR	Schedule 2, par. 17 e. & 19.

Ch/App	S/Ann	P		Subject	Source	Reference	
17	3	4	R	(1) (2) & (3)	Preparation and maintenance of prospectus	New RSR	3.05 & 3.06. 1.b.
17	3	5	G		Refusal of approval: schemes recognised under section 270 of the Act	New	
17	3	6	G		Refusal of approval : schemes recognised under section 272 of the Act	New	
17	4				Facilities in the United Kingdom and revocation of recognition		
17	4	1	R		General	RSR	14.04
17	4	2	R		Documents	RSR	14.05 (1) (2)
17	4	3	R		Price and redemption	RSR	14.06
17	4	4	R		Bearer certificates and characteristics of units in the scheme	RSR	14.07
17	4	5	R		Complaints	RSR	14.08
17	4	6	R		Place of facilities	RSR	14.09
17	4	7	R		Service of notice and other documents	RSR	15.
17	4	8	G		Revocation of recognition : schemes recognised under section 264 of the Act	New	

Ch/App	S/Ann	P		Subject	Source	Reference
17	4	9	G	Revocation of recognition : schemes recognised under sections 270 and 272 of the Act	New	

CIS sourcebook derivations - Appendix CIS G

Ch/App	S/Ann	P		4. Subject	5. Source	Reference
CIS	G			Correction of box management errors	IMRO	II Section 7, Appendix 7.6 (1)(b) & (d).

The Collective Investment Schemes Sourcebook

Destinations

Financial Services (Open-Ended Investment Companies) Regulations 1997

G

1. The aim of the *guidance* in the following table is to give the reader a guide to the destination of relevant text.
2. It is not a complete statement of the destination and should not be relied on as if it were.

Destinations

1. Source reference	Subject	Module	Ch/App	S/Ann	P		
Part 2.	Constitution	CIS	2				
Explanation		CIS	2	4	4	G	
			2	5	2	G	
2.01. 1,2,4,5, & 6	The instrument of incorporation	CIS	2	2	2	R	
2.01.3			2	2	3	G	
2.01.7			2	2	4	R	
2.02	UCITS obligations	CIS	2	3	3	R	
2.03	Categories of company	CIS	2	1	4	R	
2.04	Share Classes	CIS	2	4	1	R	
2.04 (1)			2	4	2	G	
2.04 (2)			2	4	5	R	
2.04 (3 & 4)			2	4	6	R	

1. Source reference	Subject	Module	Ch/App	S/Ann	P		
2.05 (1 – 4)	Larger and smaller denomination shares	CIS	2	5	3	R	
2.06	Sub-division and consolidation of shares	CIS	2	5	4	R	
Part 3	Prospectus	CIS	3				
Explanations		CIS	3	1	3	G	(2)
3.01	Drawing up of prospectus	CIS	3	2	1	R	
3.02	Availability of prospectus	CIS	3	2	2	R	
3.03	False or misleading prospectus	CIS	3	3	1	R	
3.04 (1 & 2)	Revision of prospectus	CIS	3	4	1	R	Deleted
3.04 (3)			3	2	1	R	
3.04 (4)							
3.05	Changes to the prospectus	CIS	3	4	2	R	
Part 4	Pricing and Dealing	CIS	4				
Explanations		CIS	4	1	4	G	
4.01	Initial Offers	CIS	4	2	3	R	
4.02	Initial price	CIS	4	2	4	R	
4.03	Compulsory termination of initial offer	CIS	4	2	5	R	
(1)	Introduction	CIS					Deleted Definitions (3)
(2)			4	3	9	R	
(3)			4	3	3	R	
4.04 (4 & 5)							

1. Source reference	Subject	Module	Ch/App	S/Ann	P		
4.05 (1)	Issue of shares by company	CIS	4	3	3	R	(5)
4.05 (2, 3 & 4)			4	3	7	R	(2 – 4)
4.06	Issue of shares to meet ACD's obligation to sell	CIS	4	3	9	R	
4.07	Cancellation of shares	CIS	4	3	10	R	(2 – 4, 7 & 9)
4.08 (1, 3 – 5)	Price of a share	CIS	4	3	11	R	(2, 3 – 5)
4.08 (2)							Deleted
4.09	Modification to number of shares issued or cancelled	CIS	4	3	12	R	(2 – 4)
4.10	Sale and redemption: Introduction						Deleted
4.11	ACD's obligation to sell	CIS	4	4	3	R	
4.12	ACD's obligation to redeem	CIS	4	4	4	R	
4.13	Payment on redemption	CIS	4	4	5	R	
4.14	Proceeds on redemption	CIS	4	4	6	R	
4.15	Issue and cancellation through the ACD when not acting as a principal	CIS	4	5	3	R	
4.16	Notification of price to the depository	CIS	4	4	7	R	
4.17	Publication of prices	CIS	4	4	8	R	
4.18	In specie cancellation	CIS	4	5	4	R	
Section D	Explanation	CIS	4	6	2	G	
4.19	Dilution levy	CIS	4	6	3	R	

1. Source reference	Subject	Module	Ch/App	S/Ann	P		
Section E	Explanation	CIS	4	7	3	G	
Section E – Explanatory diagram	Pricing at and after valuation point	CIS	4	7	6	G	
4.20	Forward and historic pricing	CIS	4	7	4	R	
Table 4.1 & notes	Rules	CIS	4	7	5	R	
4.21 (1 – 4)	Valuation of the scheme property	CIS	4	8	3	R	
4.21 (5 – 8)			4	8	5	R	
4.21 (9 & 10)			4	8	6	R	
Part 5	Investment and Borrowing powers	CIS	5				
5.01 / Explanation	General						Deleted
5.02	Investment powers: general	CIS	5	2	4	R	
5.03	Valuation	CIS	5	2	5	R	
5.04	Part to be construed as a whole	CIS	5	2	7	R	
5.05 (1)	Transferable security	CIS					Definitions
5.05 (2 – 4)			5	2	9	R	
5.06	Eligible securities and derivatives markets	CIS					Definitions
			5	3	3	R	
5.07	Approved security						Definitions
5.08	Warrants	CIS	5	9	2	G	(2)
5.09	Derivative and approved derivative						Definitions
5.10	Off-exchange derivatives	CIS	5	6	6	R	
5.11	Synthetic Future						Definitions
5.12 (1 – 5)	Securities companies: general	CIS	5	4	2	R	
5.12 (6)			5	2	3	G	

1. Source reference	Subject	Module	Ch/App	S/Ann	P		
5.13	Spread: general	CIS	5	4	3		
5.14 (1 - 4 & 7) 5.14 (5) 5.14 (6)	Spread: Government and other public securities	CIS	5	4	4		Definitions Deleted
5.15	Investment in collective investment schemes	CIS	5	4	5	R	
5.16	Investment in warrants and in nil paid or partly paid securities	CIS	5	4	6	R	
5.17 (1 & 2) 5.17 (3)	Significant influence	CIS	5 5	2 2	13 15	R R	
5.18	Investment in associated collective investment schemes	CIS	5	2	10	R	
5.19	Warrant companies	CIS	5	9	3	R	
5.20	Umbrella companies: general	CIS	5	12	3	R	
5.21	Restriction on investment	CIS	5	12	4	R	
Section E	Explanation	CIS	5	13	2	G	
5.22	Appropriate transactions	CIS	5	13	3	R	
5.23	Economic appropriateness	CIS	5	13	4	R	
5.24 (1, 2, 4 & 5) 5.24 (3)	Generation of additional capital or income	CIS	5 5	13 13	5 2	R G	(6)
5.25 (1 - 4) 5.25 (5) 5.25 (6)	Permitted transactions	CIS	5 5	13 6	6 5	R R	Deleted

1. Source reference	Subject	Module	Ch/App	S/Ann	P		
5.26	Cover for transactions under this Section	CIS	5	13	8	R	
5.27 (1)	Limits on initial outlay	CIS	5	13	6	R	(5)
5.27 (2)							Definitions
5.27 (3 – 6)		CIS	5	7	4	R	(6 – 9)
5.28	Borrowing in the context of efficient portfolio management	CIS	5	13	12	R	
5.29	Continuing nature of limits and requirements	CIS	5	13	13	R	
Section F	Explanation	CIS	5	14	2	G	
5.30	Stocklending; general	CIS	5	14	3	R	
5.31	Permitted stocklending	CIS	5	14	4	R	
5.32 (Explanation)	Treatment of collateral	CIS	5	14	5	G	
5.32 (1 – 7)				5	14	6	R
5.33	Limitation by value	CIS	5	14	7	R	
5.34	Cash and near cash	CIS	5	15	2	R	
5.35	General power to borrow	CIS	5	15	3	R	
5.36	Borrowing limits	CIS	5	15	4	R	
5.37	Restriction on lending of money	CIS	5	15	5	R	
5.38	Restriction on lending of property other than money	CIS	5	15	6	R	
5.39	General power to underwrite or accept placings	CIS	5	15	7	R	

1. Source reference	Subject	Module	Ch/App	S/Ann	P		
5.40	Guarantees and indemnities	CIS	5	15	8	R	
5.41	Requirement to cover sales	CIS	5	16	2	R	
5.42	Investment in other group schemes	CIS	5	2	11	R	
Part 6	Powers and duties of the Directors and the depository	CIS	7				
Explanation		CIS	7	1	4	G	
6.01	The Directors	CIS	7	2	1	R	
6.02	Authorised Corporate Director	CIS	7	3	1	R	
6.03 (1 – 3)	Dealings in scheme property	CIS	7	5	1	R	
6.03 (4)			7	5	2	R	
6.04 (1 & 2)	Maintenance of records etc.	CIS	7	3	3	R	
6.04 (3)			7	3	4	R	
6.05	General duties of the depository	CIS	7	4	1	R	
6.05A	Duty to inform the FSA	CIS	7	4	3	R	
6.06	Control by the depository over the scheme property	CIS	7	4	4	R	
6.07	Exercise of rights in respect of the scheme property	CIS	7	4	5	R	
6.08	Timely performance of Duties						Deleted
6.09	Duties of the ACD and depository: investment and borrowing powers	CIS	7	5	3	R	

1. Source reference	Subject	Module	Ch/App	S/Ann	P		
6.10	Committees and appointments	CIS	7	6	1	R	
6.11 (1 – 13) 6.11 (14)	Conflict of interest etc	CIS	7	6	3	R	Deleted
6.12	Appointment of ACD	CIS	7	2	2	R	
6.13	Termination of appointment of ACD	CIS	7	2	3	R	
Part 7	Charges and expenses	CIS	8				
Explanations							Deleted
7.01	Payments by the company to the ACD	CIS	8	2	3	R	
7.02 (1) 7.02 (2 &3) 7.02 (4)	Preliminary charge	CIS	8	2	2	R	Deleted (1 & 3) Deleted
7.03	Increase in remuneration or preliminary charge	CIS	8 8 8	2 2 2	5 4 6	R R R	
7.04	Redemption charge	CIS	8	2	7	R	
7.05	Umbrella companies	CIS	8	2	8	R	(1 & 2)
7.06	Restricted Payments	CIS	8	3	1	R	
7.07	Performance fees	CIS	8	3	2	R	
7.08	Movable and immovable property	CIS	8	3	3	R	
7.09	Payment of liabilities on transfer of assets	CIS	8	4	1	R	
7.10	Amortisation	CIS	8	3	4	R	
7.11	Tax	CIS	8	4	2	R	
7.12 (1 – 4) 7.12 (5)	Allocation of payments to capital or income	CIS	8 3	3 4	5 2	R R	(4) (a)

1. Source reference	Subject	Module	Ch/App	S/Ann	P		
7.13							
7.14	Plan register	CIS	6	5	4	R	
Part 8	Income	CIS	9				
8.01	Accounting periods	CIS	9	2	1	R	
8.02	Annual income allocation date	CIS	9	2	2	R	
8.03	Annual allocation of income	CIS	9	2	3	R	
8.04	Annual allocation to accumulation shares	CIS	9	2	4	R	
8.05 (1 & 2)	Annual distribution to holders of income shares	CIS	9	2	5	R	
8.06	Interim allocations of income	CIS	9	2	6	R	
8.07	Income equalisation	CIS	9	2	7	R	
8.08	Tax certificates	CIS	9	2	8	R	
8.09	Unclaimed distributions	CIS	9	2	9	R	
Part 9	Reports and Accounts	CIS	10				
Explanation		CIS	10	2	1	R	
9.01 (1a – 3 & 7)	Contents of annual and half-yearly reports	CIS	10	3	3	R	
9.01 (4 & 5)			10	3	4	R	
9.01 (9)			10	3	5	R	
9.01 (1b)			10	3	6	R	
9.01 (8)			10	3	7	R	
9.02	Publication of company reports	CIS	10	5	2	R	
9.03	Reports to be offered to purchasers of shares	CIS	10	5	3	R	

1. Source reference	Subject	Module	Ch/App	S/Ann	P		
9.04	Publication of availability of reports and prospectus	CIS	10	5	4	R	
9.05	Annual report by the depositary	CIS	10	4	6	R	
Part 10	Shareholders Meetings and Amendments to the Instrument of Incorporation	CIS	11				
Explanation							Deleted
10.01	General meetings	CIS	11	2	1	R	
10.02	Notice of meetings	CIS	11	2	3	R	
10.03	Quorum	CIS	11	2	4	R	
10.04	Resolutions	CIS	11	2	5	R	
10.05	Voting rights	CIS	11	2	6	R	
10.06	Right to demand a poll	CIS	11	2	7	R	
10.07	Proxies	CIS	11	2	8	R	
10.08	Special meaning of shareholder	CIS	11	2	2	R	(1)
10.09	Class meetings	CIS	11	2	9	R	
10.10	Variation of class rights	CIS	11	2	10	R	
10.11 (1 & 2)	Amendments to instrument of incorporations	CIS	11	4	2	R	(1 & 3)
10.11 (3)			11	4	4	R	(4 & 5)
10.12 (1, 3 & 4)	Service of notices and other documents	CIS	11	6	1	R	
10.12 (2)			11	6	2	R	(1)
Part 11	Umbrella companies						

1. Source reference	Subject	Module	Ch/App	S/Ann	P	
11.01	Qualification to be authorised as an umbrella company	CIS	12	5	1	R (1)
11.02	Base currency	CIS	12	5	2	R
11.03	Allocation of scheme property	CIS	12	5	3	R
11.04	Investment and borrowing powers	CIS	12	5	7	R
11.05	Income	CIS	12	5	4	R
11.06	Shares in respect of less than two sub-funds in issue	CIS	12	5	5	R
Part 12	Suspension and Termination	CIS	14			
Section B	Winding up a Solvent Company: Explanation	CIS	14	2	1	G
12.01	Suspension and resumption of dealings in shares	CIS	13	1	3	
12.02 (1 & 2)	When a company is to be wound up	CIS	14	2	3	R
12.02 (3 – 5)			14	2	4	R
12.03	Consequences of commencement of winding up	CIS	14	2	5	R
12.04	Manner of winding up	CIS	14	2	6	R
12.05	Final account	CIS	14	2	7	R
12.06	Duty to ascertain liabilities	CIS	14	2	8	R
12.07	Reports and accounts	CIS	14	2	9	R
12.08	Liabilities of the ACD	CIS	14	2	10	R

1. Source reference	Subject	Module	Ch/App	S/Ann	P		
12.09	Additional provisions applicable to umbrella companies	CIS	14	2	11	R	
12.10	Miscellaneous	CIS	14	2	12		
Section C	Termination of a sub-fund of an umbrella company: Explanation	CIS	14	3	1	G	
12.11	General	CIS	14	3	2	R	
12.12 (1 & 2)	When a sub-fund is to be terminated	CIS	14	3	3	R	
12.12 (3 – 6)			14	3	4	R	
12.13	Consequences of commencement of termination of a sub-fund	CIS	14	3	5	R	
12.14	Manner of termination	CIS	14	3	6	R	
12.15	Termination account	CIS	14	3	7	R	
12.16	Duty to ascertain liabilities	CIS	14	3	8	R	
12.17	Reports and accounts	CIS	14	3	9	R	
12.18	Liabilities of the ACD	CIS	14	3	10	R	
12.19	Amalgamation and reconstruction	CIS	11	5	2	R	
Schedule 1	Prominent statement	CIS	3	5	2	R	1
2	The company	CIS	3	5	2	R	2
3	Investment objectives and policy	CIS	3	5	2	R	3
4	Distributions	CIS	3	5	2	R	4

1. Source reference	Subject	Module	Ch/App	S/Ann	P	
5 (a – c & e)	The characteristics of shares in the company	CIS	3	5	2	R 5
6 (a – j & 1 – m)	The authorised corporate director (ACD)	CIS	3	5	2	R 6
7	Other director of the company	CIS	3	5	2	R 7
8	The depository	CIS	3	5	2	R 8
9	The investment adviser	CIS	3	5	2	R 9
10	The auditor	CIS	3	5	2	R 10
11	The register of shareholders	CIS	3	5	2	R 11
12	Payments to the ACD	CIS	3	5	2	R 12
13	Other payments out of the scheme property	CIS	3	5	2	R 13
14	Movable and immovable property	CIS	3	5	2	R 14
15	Amortisation	CIS	3	5	2	R 15
16	Sale and redemption of shares	CIS	3	5	2	R 16
17	Valuation of scheme property	CIS	3	5	2	R 17
18 (a)	Dilution levy	CIS	3	5	2	R 18
18 (b)			3	5	2	R 19
19	Forward and historic pricing	CIS	3	5	2	R 20
20	Preliminary charge	CIS	3	5	2	R 21
21	Redemption charge	CIS	3	5	2	22
22	General information	CIS	3	5	2	23

1. Source reference	Subject	Module	Ch/App	S/Ann	P	
23	Umbrella schemes	CIS	3	5	2	24
24	Marketing in another member State	CIS	3	5	2	25
25	Additional information	CIS	3	5	2	26
Schedule 2 : Part I	Report of the directors	CIS	10	4	2	(1 – 8) & (10 – 15)
12 (a)			10	4	3	R
Schedule 2 : Part II	Comparative tables	CIS	10	4	5	R
Schedule 2 : Part III	Report of the depositary	CIS	10	4	6	R
Schedule 2 : Part IV	Report of the auditor	CIS	10	4	8	R
Schedule 2 : Part IVA	Auditor's statement relating to short form accounts	CIS	10	4	9	R
Schedule 3	Glossary	CIS				Definitions

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Destinations

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1. The aim of the *guidance* in the following table is to give the reader a guide to the destination of relevant text.
2. It is not a complete statement of the destination and should not be relied on as if it were.

Source reference	Subject	Module	Ch/App	S/Ann	P		
Part 2	Constitution	CIS	2				
2.01	Introduction						Deleted
2.02 (1)	The trust deed	CIS	2	2	5	R	
2.02			2	2	8	R	
2.03 (1 & 2)	UCITS obligations	CIS	2	3	3	R	Deleted
2.03 (3)							
2.04	Public availability of trust deed	CIS	3	5	2	R	23 (2)
2.05 & 2.06	Units: Types of unit	CIS	2	6	1	R	
2.07 (1)	Categories of scheme	CIS	2	1	4	R	Definitions Deleted
2.07 (2 – 10)							
2.07 (11)							
2.07 (12)								2	3	2	G
Part 3	Scheme Particulars	CIS	3				

Source reference	Subject	Module	Ch/App	S/Ann	P	
3.01	Introduction					Deleted
3.02	Preparation of scheme particulars	CIS	3	5	2	R (1)
3.03 (1 & 2) 3.03 (3)	Publication of scheme particulars	CIS	3	2	2	R Deleted
3.04	Inspection of scheme particulars	CIS	17	3	4	R (1)
3.05	Schemes authorised in certain designated territories	CIS	17	3	4	R (2)
3.06 (1a, 2 – 4) 3.06. 1b 3.06 (5)	False or misleading scheme particulars	CIS	3 17	3 3	1 4	R R (3) Deleted
3.07 (1 & 2)	Revision of scheme particulars	CIS	3	4	1	R
Part 4	Pricing and dealing (dual pricing)	CIS	15			
Explanation		CIS	15	1	4	
4.01	Introduction to this part and to Section A	CIS	15	2	3	R
4.02	Creation of units: initial offer	CIS	15	2	4	R
4.03	Initial price	CIS	15	2	5	R
4.04	Compulsory termination of initial offer	CIS	15	2	6	R
4.05	Creation of units: unitisation	CIS	15	2	7	R
4.06 (1 & 2) 4.06 (3)	Introduction	CIS	15	3	4	R (3) Definitions

Source reference	Subject	Module	Ch/App	S/Ann	P		
4.07	Creation of units: manager's instructions	CIS	15	3	4	R	
4.08	Creation by trustee	CIS	15	3	5	R	
4.09	Creation price	CIS	15	3	6	R	
4.10	Cancellation of units	CIS	15	3	7	R	
4.11	Cancellation price	CIS	15	3	8	R	
4.12	Trustee's refusal to create or cancel units	CIS	15	3	9	R	
4.13	Timing of instructions to create or cancel units	CIS	15	3	11	R	
4.13A	Inadvertent error in number of units created or cancelled	CIS	15	3	12	R	
4.14 (1) 4.14 (2 & 3)	Introduction	CIS	15	4	1	R	Deleted
4.15	Manager's obligation to issue	CIS	15	4	3	R	
4.16	Issue price parameters	CIS	15	4	4	R	
4.18	Manager's obligation to redeem	CIS	15	4	7	R	
4.19	Payment on redemption	CIS	15	4	8	R	
4.20	Redemption price parameters	CIS	15	4	9	R	
4.21	Charges on redemption	CIS	15	4	10	R	
4.21A	Control over maximum charges on issue and redemption	CIS	15	4	11	R	

Source reference	Subject	Module	Ch/App	S/Ann	P		
4.21B	Exchange of units in umbrella funds	CIS	15	4	12	R	
4.21C	SDRT provision	CIS	15	6	3	R	
4.22	Sale and purchase by the trustee through the manager as agent	CIS	15	5	2, 3	R	
4.23	Notification of prices to the trustee	CIS	15	4	13	R	
4.24	Publication of prices	CIS	15	4	14	R	
4.25	Instructions etc by manager to trustee	CIS	15	3	10	R	
Explanatory Table	Pricing at or after the valuation point	CIS	15	7	6	G	
4.26	Forward and historic pricing	CIS	15	7	4	R	(1)
Table 4.1	Forward or historic pricing	CIS	15	7	5	R	
4.27	Income equalisation on reissue						Deleted
4.28	In specie redemption	CIS	15	5	4	R	
4.29	Valuation of the property of the scheme	CIS	15	8	3	R	
4.29 (6) (b)			4	8	7	R	
Table 4.2	Valuation Rules	CIS	15	8	4	R	
Part 4A	Single Pricing and Dealing	CIS	4				
Explanation		CIS	4	1	4	G	
4A.01 (2 & 3)	Introduction to this part and to Section A	CIS	4	2	3	R	
4A.02	Initial price	CIS	4	2	4	R	
4A.03	Compulsory termination of initial offer	CIS	4	2	5	R	

Source reference	Subject	Module	Ch/App	S/Ann	P		
4A.04 1 4A.04 (2 & 7.b,c.) 4A.04 (3) 4A.04 (4 & 5, 9) 4A.04 (6) 4A.04 (7a & 8)	Section B Creation and cancellation Introduction	CIS					Deleted Definitions
			4	3	9	R	
			4	3	4	R	
			4	3	5	R	
			4	3	6	R	
4A.05 (1) 4A.05 (2 – 4)	Creation of units by trustee	CIS	4	3	4	R	(4)
			4	3	7	R	(2) – (4)
4A.06	Creation of units to meet manager's obligation to issue	CIS	4	3	9	R	(2)
4A.07	Cancellation of units	CIS	4	3	10	R	
4A.08 (1, 3, 4 & 5) 4a.08 (2)	Price of a unit	CIS	4	3	11	R	Deleted
4A.09	Inadvertent error in number of units created or cancelled	CIS	4	3	12	R	
4A.10	Introduction						Deleted
4A.11	Manager's obligation to issue	CIS	4	4	3	R	
4A.12	Manager's obligation to redeem	CIS	4	4	4	R	
4A.13	Payment on redemption	CIS	4	4	5	R	
4A.14	Proceeds of redemption	CIS	4	4	6	R	
4A15 (1) 4A.15 (2 – 5 & 8)	Sale and purchase by the trustee through the manager as agent	CIS	4	5	3	R	Deleted
4A.16	Notification of price to the trustee	CIS	4	4	7	R	
4A.17	Publication of prices	CIS	4	4	8	R	

Source reference	Subject	Module	Ch/App	S/Ann	P		
4A.18	In specie cancellation	CIS	4	5	4	R	
Section D	Explanation	CIS	4	6	2	G	
4A.19	Dilution levy	CIS	4	6	3	R	
Section E	Explanation	CIS	4	7	3	G	
			15	7	6	G	
Section E	Explanatory diagram: Pricing at en after valuation point	CIS	4	7	6	G	
4A.20	Forward and historic pricing	CIS	4	7	4	G	
			15	7	4	G	
Table 4A.1	Forward or historic pricing	CIS	15	7	5	R	
			4	7	4	R	
			4	7	5	R	
4A.21 ((2 – 4 & 10)	Valuation of the property of the scheme	CIS	4	8	3	R	
4A.21 (5, 6 & 7)			4	8	5	R	
4A.21 (8 & 9)			4	8	6	R	
4A.22	Income equalisation						Deleted
Part 4B	Charges and Duties	CIS	8 & 15				
4B.01	Introduction						Deleted
4B.02	Preliminary charge	CIS	15	4	5	R	
			8	2	2	R	
4B.03	Increase in preliminary charge	CIS	15	4	6	R	
			8	2	5	R	
			8	2	6	R	
4B.04	Redemption charge	CIS	8	5	2	R	

Source reference	Subject	Module	Ch/App	S/Ann	P		
4B.05	Control over maximum charges on issue and redemption	CIS	8	5	3	R	
4B.06	Exchange of units in an umbrella	CIS	8	2	8	R	(3)
4B.07	Stamp duty and stamp duty reserve tax	CIS	15	6	3	R	
Part 5	Investment and borrowing powers	CIS	5				
Explanation							Deleted
Table	Overview of investment and borrowing powers	CIS	5	1	6	G	
5.02	Investment powers: general	CIS	5	2	4	R	(2 & 3)
5.03	Valuation	CIS	5	2	5	R	
5.04	Part to be construed as a whole	CIS	5	2	7	R	
			5	2	8	G	
5.05 (1)	Transferable security	CIS	5	2	9	R	Definitions
5.05 (2 – 4)							
5.06	Approved security						Definitions
5.07 (1 & 2)	Derivative and approved derivative						Definitions
5.07 (3 & 4)							Deleted
5.07A	Eligible securities and derivatives markets	CIS	5	3	3	R	
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Source reference	Subject	Module	Ch/App	S/Ann	P		
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Source reference	Subject	Module	Ch/App	S/Ann	P		
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Source reference	Subject	Module	Ch/App	S/Ann	P			
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Source reference	Subject	Module	Ch/App	S/Ann	P		
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2	The trustee	CIS	2	5	2	R	(8)
3 (a, b & d – f) 3 (g)	The investment adviser	CIS	3	5	2	R	(9) Deleted
4	The registrar	CIS	3	5	2	R	(11)(2)
5	The auditor	CIS	3	5	2	R	(10)
6	The register of holders	CIS	3	5	2	R	(11)(1)
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9	The characteristics of the scheme itself	CIS	2	5	2	R	(26)
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Source reference	Subject	Module	Ch/App	S/Ann	P	
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Source reference	Subject	Module	Ch/App	S/Ann	P	
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RECOGNISED INVESTMENT EXCHANGE AND RECOGNISED CLEARING HOUSE SOURCEBOOK INSTRUMENT 2001

- A. The Financial Services Authority makes the rules and gives the guidance in the Annex to this instrument (“REC”) in the exercise of the powers listed in Schedule 4 to REC.
- B. This instrument shall come into force as follows:
 - (1) in so far as it relates to applications to become a recognised body, at the beginning of the day on which sections 287 and 288 of the Financial Services and Markets Act 2000 (the "Act") come into force for the purpose of allowing applications to be made;
 - (2) in so far as it relates to applications for waiver or modification of any notification rule made under section 293 or section 295 of the Act, at the beginning of the day on which section 294 comes into force for the purpose of allowing applications to be made;
 - (3) for any other purpose, at the beginning of the day on which section 19 of the Act (The general prohibition) comes into force.
- C. The provisions of the Act relevant to making rules and listed in Schedule 4 to REC (Powers exercised) are specified for the purpose of section 153(2) of the Act (Rule-making instruments).
- D. This instrument may be cited as the Recognised Investment Exchange and Recognised Clearing House Sourcebook Instrument 2001.
- E. The Annex to this instrument (including its Schedules) may be cited as the Recognised Investment Exchange and Recognised Clearing House sourcebook (or REC).

By order of the Board
21 June 2001

ANNEX

Recognised Investment Exchanges and Recognised Clearing Houses



Contents

Transitional provisions

Text of REC:

- 1 Introduction
- 2 Recognition requirements
- 3 Notification rules for UK recognised bodies
- 4 Supervision
- 5 Applications for recognition (UK recognised bodies)
- 6 Overseas investment exchanges and overseas clearing houses
- 7 Fees*

Schedule 1: Record keeping requirements

Schedule 2: Notification requirements

Schedule 3: Fees *

Schedule 4: Powers exercised

Schedule 5: Rights of action for damages

Schedule 6: Rules that can be waived

Destinations and derivations

[* These parts of REC will be made later]

Handbook Modules

Transitional provisions

G Introduction

1 Table

1	This schedule sets out the transitional provisions in <i>REC</i> .
2	The <i>Recognition Requirements Regulations</i> also contain transitional provisions applying to <i>recognised bodies</i> .
3	<i>GEN</i> also contains some technical transitional provisions that apply throughout the <i>Handbook</i> and which are designed to ensure a smooth transition at <i>commencement</i> . These include transitional provisions relevant to record keeping and notification requirements

	Material to which the transitional provision applies		Transitional provision	Transitional provision: dates in force	Handbook provision: coming into force
1	REC 3 and REC 6	R	<p>In this schedule,</p> <p>(1) “annual report” means a report which an <i>overseas recognised body</i> has to submit to the <i>FSA</i> after <i>commencement</i> under section 295(1) of the <i>Act</i> or any similar or analogous report which an existing overseas recognised body has submitted to the Treasury before <i>commencement</i>;</p> <p>(2) “due date” means the date or time specified in the <i>Financial Services (Notification by Recognised Bodies) Regulations 1995</i> by which an existing UK recognised body was obliged under those regulations to fulfil the existing notification obligation to which the due date relates;</p>	<i>Commencement</i> until one year after <i>commencement</i>	<i>Commencement</i>

Material to which the transitional provision applies	Transitional provision	Transitional provision: dates in force	Handbook provision: coming into force
	<p>(3) “existing notification obligation” means any obligation arising under the Financial Services (Notification by Recognised Bodies) Regulations 1995 to give notice of the occurrence of any event or any information to the <i>FSA</i>;</p> <p>(4) “existing overseas recognised body” means an <i>overseas investment exchange</i> or an <i>overseas clearing house</i> which was a recognised investment exchange or a recognised clearing house under the Financial Services Act 1986 and which is a <i>recognised investment exchange</i> or a <i>recognised clearing house</i> under Regulation 9(3) or 9(5) of the <i>Recognition Requirements Regulations</i>;</p> <p>(5) “existing UK recognised body” means a recognised investment exchange or a recognised clearing house under the Financial Services Act 1986 which is a <i>recognised investment exchange</i> or a <i>recognised clearing house</i> under Regulation 9(2) or 9(4) of the <i>Recognition Requirements Regulations</i> and which is not an existing overseas recognised body.</p>		

	Material to which the transitional provision applies		Transitional provision	Transitional provision: dates in force	Handbook provision: coming into force
2	REC 3	R	Where the due date for an existing notification obligation fell before commencement and that obligation had not been discharged by the existing UK recognised body before commencement, the existing UK recognised body must immediately fulfil that existing notification obligation.	<i>Commencement until one year after commencement</i>	<i>Commencement</i>
3	REC 3	R	Where the due date for an existing notification obligation falls on or after commencement, the existing UK recognised body must fulfil that existing notification obligation on its due date.	<i>Commencement until one year after commencement</i>	<i>Commencement</i>
4	REC 6.6.3	G	In relation to an existing overseas recognised body and in relation to its first report to the <i>FSA</i> after commencement under section 295 of the <i>Act</i> : (1) the reference to the “last report” should be interpreted as a reference to the last annual report submitted to the Treasury; and (2) the reference to a “recognition order” should be interpreted as a reference to the recognition order for that body made under section 40 of the Financial Services Act 1986.	<i>Commencement until one year after commencement</i>	<i>Commencement</i>
5	REC 6.7.5	R	In relation to an existing overseas recognised body that has not previously submitted an annual report to the Treasury, the reference to “recognition order” is to be read as a reference to the recognition order for that body made under section 40 of the Financial Services Act 1986, and the reference to “<i>FSA</i>” is to be read as a reference to the Treasury.	<i>Commencement until one year after commencement</i>	<i>Commencement</i>

Chapter 1.

INTRODUCTION

1.1 Application

- 1.1.1** **G** _{/1} The *rules* and *guidance* in this sourcebook apply to *recognised bodies* and to applicants for recognition as *recognised bodies* under Part XVIII of the *Act* (Recognised Investment Exchanges and Clearing Houses).
- 1.1.2** **G** _{/1}
- (1) *Recognised bodies* are *exempt persons* under section 285 of the *Act* (Exemption for recognised investment exchanges and clearing houses).
 - (2) *UK recognised bodies* must satisfy *recognition requirements* prescribed by the Treasury (in certain cases with the approval of the Secretary of State) in the *Recognition Requirements Regulations*. *Overseas recognised bodies* must satisfy *recognition requirements* laid down in section 292 of the *Act* (Overseas investment exchanges and overseas clearing houses).
 - (3) *Recognised bodies* must also comply with notification requirements in, and with *notification rules* made under, sections 293 (Notification requirements) and 295 (Notification: overseas investment exchanges and clearing houses) of the *Act*.
- 1.1.3** **G** _{/1}
- (1) The *recognition requirements* for *UK recognised bodies* are set out, with *guidance*, in REC 2.
 - (2) The *notification rules* for *UK recognised bodies* are set out in REC 3 together with *guidance* on those *rules*.
 - (3) *Guidance* on the FSA's approach to the supervision of *recognised bodies* is given in REC 4.
 - (4) *Guidance* for applicants (and potential applicants) for *UK recognised body* status is given in REC 5.
 - (5) The *recognition requirements*, *notification rules*, and *guidance* for *overseas recognised bodies* and *guidance* for applicants (and potential applicants) for *overseas recognised body* status are set out in REC 6.
 - (6) The *fees rules* for *recognised bodies* and applicants are set out in REC 7.

1.2 Purpose, status and statutory quotations

Purpose

1.2.1

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The purpose of the *guidance* in this sourcebook is to give information on how the FSA interprets the *recognition requirements* and other obligations on *recognised bodies* in or under the *Act*. Explanations of the purposes of the *rules* in this sourcebook are given in the chapters concerned.

Status

1.2.2

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- (1) Most of the provisions in this sourcebook are marked with a G (to indicate *guidance*) or an R (to indicate a *rule*). In addition, there are quotations from statute or statutory instruments which are not marked with any letter unless they form part of a piece of *guidance*. A discussion of the status of provisions marked with a letter, and advice on all aspects of the structure, format and use of all parts of the *Handbook* (including this sourcebook), is included in the Reader's Guide.
- (2) Where the *guidance* states that the FSA may have regard to any factor in assessing or determining whether a *recognition requirement* is satisfied, or that there is compliance with another obligation under the *Act*, it means that the FSA will take that factor into account so far as it is relevant.
- (3) In determining whether a *recognised body* satisfies the *recognition requirements* or complies with other obligations in or under the *Act*, the FSA will have regard to any relevant factor, including, but not limited to, the factors specifically discussed in the *guidance*.

Statutory quotations

1.2.3

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- (1) This sourcebook contains quotations from the *Act*, the *Recognition Requirements Regulations* and the Companies Act 1989 and, where necessary, words have been added to, or substituted for, the text of these provisions to facilitate understanding.
- (2) The additions and substitutions are enclosed in square brackets ([]). The omission of words within a quotation is indicated by three dots (...).
- (3) Any words in these quotations which have the same meaning as *Handbook* defined terms are shown in italics and their definitions may be found in the *Glossary*.

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- (4) As these quotations contain provisions which impose obligations, they are printed in bold type. The use of bold type is not intended to indicate that these quotations are *rules* made by the *FSA*.
- (5) None of the editorial changes made by the *FSA* in these quotations can supersede or alter the meaning of the statutory provision concerned.

Chapter 2

RECOGNITION REQUIREMENTS

2.1 Introduction

2.1.1 **G** This chapter contains the *recognition requirements* for *UK recognised bodies* and sets out *guidance* on those requirements. (The *recognition requirements* for *overseas recognised bodies* are set out in REC 6.)
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2.1.2 **G** These *recognition requirements* must be satisfied by applicants for *recognised body* status before recognition is granted and by all *UK recognised bodies* at all times while they are recognised. The same standards apply both on initial recognition and throughout the period *recognised body* status is held. The terms *UK RIE* or *UK RCH* in the *guidance* should be taken, therefore, to refer also to an applicant when appropriate.

2.1.3 **G** (1) The paragraphs in the Schedule to the *Recognition Requirements Regulations* are grouped in this sourcebook in sections which give *guidance* on the same subject for both *UK RIEs* and *UK RCHs*.
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(2) The table in REC 2.1.4G indicates in which section each of those paragraphs (and the associated *guidance*) can be found. The *recognition requirement* is reproduced at the start of the section.

2.1.4 **G** Table Location of recognition requirements and guidance
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Recognition Re-quirements Re-gulations	Subject	Section in REC 2
Regulation 6	Method of satisfying recognition requirements	2.2
Part I of the Schedule	UK RIE recognition requirements	
Paragraph 1	Financial resources	2.3
Paragraph 2	Suitability	2.4
Paragraph 3	Systems and controls	2.5
Paragraph 4(1)	General safeguards for investors	2.6
Paragraph 4(2)(a)	Access to facilities	2.7
Paragraph 4(2)(b)	Proper markets	2.12
Paragraph 4(2)(c)	Availability of relevant information	2.12
Paragraph 4(2)(d)	Settlement	2.8
Paragraph 4(2)(e)	Transaction recording	2.9
Paragraph 4(2)(f)	Financial crime and market abuse	2.10
Paragraph 4(2)(g)	Custody	2.11
Paragraph 4(3)	Definition of relevant information	2.12
Paragraph 5	Disclosure by issuers of securities	2.12
Paragraph 6	Promotion and maintenance of standards	2.13

Recognition Requirements Regulations	Subject	Section in REC 2
Paragraph 7	Rules and consultation	2.14
Paragraph 8	Discipline	2.15
Paragraph 9	Complaints	2.16
Part II of the Schedule	UK RIE default rules in respect of market contracts	2.17
Part III of the Schedule	UK RCH recognition requirements	
Paragraph 16	Financial resources	2.3
Paragraph 17	Suitability	2.4
Paragraph 18	Systems and controls	2.5
Paragraph 19(1)	General safeguards for investors	2.6
Paragraph 19(2)(a)	Access to facilities	2.7
Paragraph 19(2)(b)	Clearing services	2.8
Paragraph 19(2)(c)	Transactions recording	2.9
Paragraph 19(2)(d)	Financial crime and market abuse	2.10
Paragraph 19(2)(e)	Custody	2.11
Paragraph 20	Promotion and maintenance of standards	2.13
Paragraph 21	Rules	2.14
Paragraph 22	Discipline	2.15
Paragraph 23	Complaints	2.16
Part IV of the Schedule	UK RCH default rules in respect of market contracts	2.17

2.2 Method of satisfying the recognition requirements

2.2.1 Table Recognition Requirements Regulations, Regulation 6

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(1) In considering whether a [UK recognised body] or applicant satisfies *recognition requirements* applying to it under these [Recognition Requirements Regulations], the [FSA] may take into account all relevant circumstances including the constitution of the *person* concerned and its *regulatory provisions* and practices within the meaning of section 302(1) of the Act.

(2) Without prejudice to the generality of paragraph (1), a [UK recognised body] or applicant may satisfy *recognition requirements* applying to it under these [Recognition Requirements Regulations] by making arrangements for functions to be performed on its behalf by any other *person*.

(3) Where a [UK recognised body] or applicant makes arrangements of the kind mentioned in paragraph (2), the arrangements do not affect the responsibility imposed by the Act on the [UK recognised body] or applicant to satisfy *recognition requirements* applying to it under these [Recognition Requirements Regulations], but it is in addition a *recognition requirement* applying to the [UK recognised body] or applicant that the *person* who performs (or is to perform) the functions is a fit and proper *person* who is able and willing to perform them.

Relevant circumstances

2.2.2

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The FSA will usually expect :

- (1) the constitution, *regulatory provisions* and practices of the *UK recognised body* or applicant;
- (2) the nature (including complexity, diversity and risk) and scale of the *UK recognised body's* or applicant's business;
- (3) the size and nature of the market which is supported by the *UK recognised body's* or applicant's *facilities*;

- (4) the nature and status of the types of investor who use the *UK recognised body's* or applicant's *facilities* or have an interest in the market supported by the *UK recognised body's* or applicant's *facilities*; and
- (5) the nature and scale of the risks to the *regulatory objectives* associated with the matters described in (1) to (4);

to be among the relevant circumstances which it will take into account in considering whether a *UK recognised body* or applicant satisfies the *recognition requirements*.

Outsourcing

- 2.2.3** G_{/1} It is the *UK recognised body's* responsibility to demonstrate to the *FSA* that a *person* who performs a function on behalf of the *UK recognised body* is fit and proper and able and willing to perform that function. The *recognition requirement* referred to in Regulation 6(3) applies to the *UK recognised body* and not to any *person* who performs any function on its behalf. In this context, for a *person* to be “fit and proper” does not necessarily imply that he is an *authorised person*, or qualified to be so, or that the required standard is the same as that required either for *authorised persons* or *recognised bodies*.
- 2.2.4** G_{/1} If a *UK recognised body* makes arrangements for functions to be performed on its behalf by *persons* who are *authorised persons* or *recognised bodies*, this does not alter its obligations under Regulation 6.
- 2.2.5** G_{/1} If a *person* who performs a function on behalf of a *UK recognised body* is himself carrying on a *regulated activity* in the *United Kingdom*, he will, unless he is a *person* to whom the *general prohibition* does not apply, need to be either an *authorised person* or an *exempt person*. The *person* to whom a function is delegated is not covered by the *UK recognised body's* exemption.
- 2.2.6** G_{/1} In determining whether the *UK recognised body* meets the *recognition requirement* in Regulation 6(3), the *FSA* may have regard to whether that body has ensured that the *person* who performs that function on its behalf:
- (1) has sufficient resources to be able to perform the function (after allowing for any other activities);
 - (2) has adequate systems and controls to manage that function and to report on its performance to the *UK recognised body*;
 - (3) is managed by *persons* of sufficient skill, competence and integrity;
 - (4) understands the nature of the function it performs on behalf of the *UK recognised body* and its significance for the *UK recognised body's* ability to satisfy the *recognition requirements* and other obligations in or under the *Act*; and
 - (5) undertakes to perform that function in such a way as to enable the *UK recognised body* to continue to satisfy the *recognition requirements* and other obligations in or under the *Act*.
- 2.2.7** G_{/1} In determining whether a *UK recognised body* continues to satisfy the *recognition requirements* where it has made arrangements for any function to be performed on its behalf by any *person*, the *FSA* may have regard, in addition to any of the

matters described in the appropriate section of this chapter, to the arrangements made to exercise control over the performance of the function, including:

- (1) the contracts (and other relevant *documents*) between the *UK recognised body* and the *person* who performs the delegated function;
- (2) the arrangements made to monitor the performance of that function; and
- (3) the arrangements made to manage conflicts of interest and protect confidential regulatory information.

2.3 Financial resources

2.3.1

Table Schedule to the Recognition Requirements Regulations, Paragraph 1

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(1) The [UK RIE] must have financial resources sufficient for the proper performance of its [relevant functions] as a [UK RIE].

(2) In considering whether this requirement is satisfied, the [FSA] may (without prejudice to the generality of regulation 6(1)) take into account all the circumstances, including the [UK RIE's] connection with any person, and any activity carried on by the [UK RIE], whether or not it is an exempt activity.

2.3.2

Table Schedule to the Recognition Requirements Regulations, Paragraph 16

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(1) The [UK RCH] must have financial resources sufficient for the proper performance of its [relevant functions] as a [UK RCH].

(2) In considering whether this requirement is satisfied, the [FSA] may (without prejudice to the generality of regulation 6(1)) take into account all the circumstances, including the [UK RCH's] connection with any person, and any activity carried on by the [UK RCH], whether or not it is an exempt activity.

2.3.3

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In determining whether a *UK recognised body* has financial resources sufficient for the proper performance of its *relevant functions*, the *FSA* may have regard to:

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- (1) the operational and other risks to which the *UK recognised body* is exposed;
- (2) if the *UK recognised body* acts as a central counterparty or otherwise guarantees the performance of transactions in *specified investments*, the counterparty and market risks to which it is exposed in that capacity;
- (3) the amount and composition of the *UK recognised body's* capital;
- (4) the amount and composition of the *UK recognised body's* liquid financial assets;
- (5) the amount and composition of the *UK recognised body's* other financial resources (such as insurance policies and guarantees, where appropriate);

- (6) the financial benefits, liabilities, risks and exposures arising from the *UK recognised body's* connection with any *person*, including but not limited to, its connection with:
- (a) any *undertaking* in the same *group* as the *UK recognised body*;
 - (b) any other *person* with a significant shareholding or stake in the *UK recognised body*;
 - (c) any other *person* with whom the *UK recognised body* has made a significant investment whether in the form of equity, debt, or by means of any guarantee or other form of commitment;
 - (d) any *person* with whom it has a significant contractual relationship.

Accounting information and standards

2.3.4

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The *FSA* will usually rely on a *UK recognised body's* published and internal *management accounts* and financial projections, provided that those accounts and projections are prepared in accordance with *UK*, *US* or international accounting standards.

Counterparty and market risks: principles

2.3.5

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In assessing whether a *UK recognised body* has sufficient financial resources in relation to counterparty and market risks, the *FSA* may have regard to:

- (1) the amount and liquidity of its financial assets and the likely availability of liquid financial resources to the *UK recognised body* during periods of major market turbulence or other periods of major stress for the *financial system*; and
- (2) the nature and scale of the *UK recognised body's* exposures to counterparty and market risks and, where relevant, the counterparties to which it is exposed.

Operational and other risks: principles

2.3.6

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In assessing whether a *UK recognised body* has sufficient financial resources in relation to operational and other risks, the *FSA* may have regard to the extent to which, after allowing for the financial resources necessary to cover counterparty and market risks, the *UK recognised body's* financial resources are sufficient and sufficiently liquid:

- (1) to enable the *UK recognised body* to continue carrying on properly the *regulated activities* that it expects to carry on; and
- (2) to ensure that it would be able to complete an orderly closure or transfer of its *exempt activities* without being prevented from doing so by insolvency or lack of available funds.

Operational and other risks: standard approach

2.3.7

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The *FSA* considers that a *UK recognised body* which (after allowing for the financial resources necessary to cover counterparty and market risks) has at any time:

- (1) liquid financial assets amounting to at least six months' operating costs; and
- (2) net capital of at least this amount;

will, at that time, have sufficient financial resources to meet the *recognition requirement* unless there are special circumstances indicating otherwise.

2.3.8

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- (1) In this standard approach, the *FSA* assumes liquid financial assets are needed to cover the costs that would be incurred during an orderly run down of the *UK recognised body's* business as such, while continuing to satisfy all the *recognition requirements* and complying with any other obligations under the *Act* (including the obligations to pay periodic fees to the *FSA* under *REC 7*).
- (2) The calculation of operating costs may exclude non-cash costs (costs that do not involve an outflow of funds) and variable costs of the *UK recognised body's exempt activities* that would not be incurred if no *exempt activities* were performed. Fixed costs should be included in the assessment of operating costs. The *FSA* would normally expect the capital equal to the amount of liquid financial assets to be in the form of equity.

Operational and other risks: alternative approaches

2.3.9

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The *FSA* recognises that *UK recognised bodies* may wish to satisfy the *recognition requirements* in different ways. The *FSA* does not prescribe any particular approach to calculating financial resources or to assessing their adequacy. It is willing to discuss with each *UK recognised body* the most appropriate way for it to meet the *recognition requirement* and each *UK recognised body* will need to be able to show the *FSA* that its financial resources are at all times sufficient to meet the *recognition requirement*.

2.4 Suitability

2.4.1 Table Schedule to the Recognition Requirements Regulations, Paragraph 2

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- (1) The [UK RIE] must be a fit and proper person to perform the [relevant functions] of a [UK RIE].**
- (2) In considering whether this requirement is satisfied, the [FSA] may (without prejudice to the generality of regulation 6(1)) take into account all the circumstances, including the [UK RIE's] connection with any person.**

2.4.2 Table Schedule to the Recognition Requirements Regulations, Paragraph 17

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- (1) The [UK RCH] must be a fit and proper person to perform the [relevant functions] of a [UK RCH].**
- (2) In considering whether this requirement is satisfied, the [FSA] may (without prejudice to the generality of regulation 6(1)) take into account all the circumstances including the [UK RCH's] connection with any person.**

2.4.3 **G** In determining whether a *UK recognised body* is a fit and proper *person*, the *FSA* may have regard to any relevant factor including, but not limited to:

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- (1) the commitment shown by the *UK recognised body's governing body* to satisfying the *recognition requirements* and to complying with other obligations in or under the *Act*;
- (2) its arrangements, policies and resources for fulfilling its obligations under the *Act* in relation to its activities as a *UK recognised body*;
- (3) the extent to which its constitution and organisation provide for effective governance;
- (4) the arrangements made to ensure that its *governing body* has effective oversight of the *UK recognised body's relevant functions*;
- (5) the access which its regulatory department has to the *governing body*;
- (6) the size and composition of its *governing body*, including:
 - (a) the number of members of the *governing body* who represent *members* of the *UK recognised body* or other *persons* and the types of *person* whom they represent;
 - (b) the number and responsibilities of any members of the *governing body* with executive roles within the *UK recognised body*; and

- (c) the number of independent members of the *governing body*;
- (7) the structure and organisation of its *governing body*, including any distribution of responsibilities among its members and committees;
- (8) the integrity and competence of its *governing body* and *key individuals*;
- (9) breaches of any relevant law, regulation or code of practice by the *UK recognised body* or its *key individuals*;
- (10) its arrangements for ensuring that it employs individuals who are honest and demonstrate high standards of integrity;
- (11) the effectiveness of its arrangements to control conflicts of interest (see also *REC 2.5*); and
- (12) the independence of its regulatory department from its commercial and marketing departments.

2.4.4

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In determining whether a *UK recognised body* is a fit and proper *person*, the *FSA* may have regard to its connections with:

- (1) any *undertaking* in the same *group*;
- (2) any owner or part-owner of the *UK recognised body*;
- (3) any *person* who has the right to appoint or remove members of the *governing body* or other *key individuals*;
- (4) any *person* who is able in practice to appoint or remove members of the *governing body* or other *key individuals*;
- (5) any *person* in accordance with whose instructions the *governing body* or any *key individual* is accustomed to act; and
- (6) any *key individual* in relation to the *UK recognised body*.

2.4.5

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In assessing whether its connection with any *person* could affect whether a *UK recognised body* is a fit and proper *person*, the *FSA* may have regard to:

- (1) the reputation and standing of that other *person*, including his standing with any relevant *UK* or *overseas regulator*;
- (2) breaches of any law or regulation by that other *person*;
- (3) the roles of any of the *UK recognised body's key individuals* who have a position within organisations under the control or influence of that other *person*, including their responsibilities in that organisation and the extent and type of their access to its senior management or governing body;
- (4) the extent to which the *UK recognised body* operates as a distinct entity notwithstanding its connection with that other *person*;
- (5) the extent to which the *UK recognised body's governing body* is responsible for its day-to-day management and operations;

but nothing in this paragraph should be taken to imply any restriction on the ability of a *UK recognised body* to outsource any function to any *person* in a manner consistent with Regulation 6 of the *Recognition Requirements Regulations*.

2.5 Systems and controls

2.5.1

Table Schedule to the Recognition Requirements Regulations, paragraph 3

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- (1) The [UK RIE] must ensure that the systems and controls used in the performance of its [relevant functions] are adequate, and appropriate for the scale and nature of its business.**
- (2) Sub-paragraph (1) applies in particular to systems and controls concerning –**
- (a) the transmission of information;**
 - (b) the assessment and management of risks to the performance of the [UK RIE's relevant functions];**
 - (c) the effecting and monitoring of transactions on the [UK RIE];**
 - (d) the operation of the arrangements mentioned in paragraph 4(2)(d) ... ; and**
 - (e) (where relevant) the safeguarding and administration of assets belonging to users of the [UK RIE's] facilities.**

2.5.2

Table Schedule to the Recognition Requirements Regulations, paragraph 18

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- (1) The [UK RCH] must ensure that the systems and controls used in the performance of its [relevant functions] are adequate, and appropriate for the scale and nature of its business.**
- (2) This requirement applies in particular to systems and controls concerning –**
- (a) the transmission of information;**
 - (b) the assessment and management of risks to the performance of the [UK RCH's relevant functions];**
 - (c) the operation of the arrangements mentioned in paragraph 19(2)(b) ... ; and**
 - (d) (where relevant) the safeguarding and administration of assets belonging to users of the [UK RCH's] facilities.**

2.5.3

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In assessing whether the systems and controls used by a *UK recognised body* in the performance of its *relevant functions* are adequate and appropriate for the scale and nature of its business, the *FSA* may have regard to the *UK recognised body's*:

- (1) arrangements for managing, controlling and carrying out its *relevant functions*, including:
 - (a) the distribution of duties and responsibilities among its *key individuals* and the departments of the *UK recognised body* responsible for performing its *relevant functions*;
 - (b) the staffing and resources of the departments of the *UK recognised body* responsible for performing its *relevant functions*;
 - (c) the arrangements made to enable *key individuals* to supervise the departments for which they are responsible;
 - (d) the arrangements for appointing and supervising the performance of *key individuals* (and their departments); and
 - (e) the arrangements by which the *governing body* is able to keep the allocation of responsibilities between, and the appointment, supervision and remuneration of, *key individuals* under review;
- (2) arrangements for the management of conflicts of interest;
- (3) arrangements for internal and external audit; and
- (4) information technology systems.

2.5.4

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The following paragraphs set out other matters to which the *FSA* may have regard in assessing the systems and controls used for the transmission of information, risk management, the effecting and monitoring of transactions, the operation of settlement arrangements (the matters covered in paragraphs 4(2)(d) and 19(2)(b) of the Schedule to the *Recognition Requirements Regulations*) and the safeguarding and administration of assets.

Information transmission

2.5.5

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In assessing a *UK recognised body's* systems and controls for the transmission of information, the *FSA* may also have regard to the extent to which these systems and controls ensure that information is transmitted promptly and accurately:

- (1) within the *UK recognised body* itself;
- (2) to *members*; and
- (3) (where appropriate) to other market participants or other relevant persons.

Risk management

2.5.6

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In assessing a *UK recognised body's* systems and controls for assessing and managing risk, the *FSA* may also have regard to the extent to which these systems and controls enable the *UK recognised body* to:

- (1) identify all the general, operational, legal and market risks wherever they arise in its activities;

2.5.7

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- (2) measure and control the different types of risk;
- (3) allocate responsibility for risk management to *persons* with appropriate knowledge and expertise; and
- (4) provide sufficient, reliable information to *key individuals* and, where relevant, the *governing body* of the *UK recognised body*.

Where the *UK recognised body* assumes significant counterparty risk (for example, by acting as a central counterparty), the *FSA* may also have regard to:

- (1) the position of the risk management department within the *UK recognised body*, including its access to the *governing body* and its relationship with the commercial or marketing departments of the *UK recognised body*;
- (2) the frequency with which all exposures and risks incurred by the *UK recognised body* are monitored against risk or exposure limits or other appropriate control parameters;
- (3) the frequency with which risk or exposure limits (or other control parameters) are reviewed;
- (4) the reliability of the arrangements for monitoring and assessing intra-day movements in exposures and risks;
- (5) the robustness of the arrangements for calculating, collecting and holding margin payments and the allocation of losses; and
- (6) the arrangements for stress testing of the adequacy of the *UK recognised body's* financial resources to cover its exposures which may arise, for example, with substantial movements in market values or counterparty defaults.

Effecting and monitoring of transactions and operation of settlement arrangements

2.5.8

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In assessing a *UK RIE's* systems and controls for the effecting and monitoring of transactions, and the systems and controls used by a *UK recognised body* for the operation of settlement arrangements, the *FSA* may have regard to the totality of the arrangements and processes through which a transaction is effected, cleared and settled, including:

- (1) a *UK RIE's* arrangements under which orders are received and matched, and its arrangements for trade and transaction reporting, and (if relevant) for transmission to a settlement system or *clearing house*;
- (2) a *UK recognised body's* arrangements under which clearing and settlement instructions arising from a transaction are entered into its systems to the point at which any rights or liabilities arising from that transaction are discharged; and
- (3) the arrangements made by the *UK recognised body* for monitoring and reviewing the operation of these systems and controls.

Safeguarding and administration of assets

- 2.5.9** G_{/1} In assessing a *UK recognised body's* systems and controls for the safeguarding and administration of assets belonging to users of its *facilities*, the *FSA* may have regard to the totality of the arrangements and processes by which the *UK recognised body*:
- (1) records the assets held and the identity of the owners of (and other *persons* with relevant rights over) those assets;
 - (2) records any instructions given in relation to those assets;
 - (3) records the carrying out of those instructions;
 - (4) records any movements in those assets (or any corporate actions or other events in relation to those assets); and
 - (5) reconciles its records of assets held with the records of any *custodian* or *sub-custodian* used to hold these assets, and with the records of beneficial or legal ownership of those assets.

Management of conflicts of interest

- 2.5.10** G_{/1} A conflict of interest arises in a situation where a *person* with responsibility to act in the interests of one *person* may be influenced in his action by an interest or association of his own, whether personal or business or employment related. Conflicts of interest can arise both for the *employees* of *UK recognised bodies* and for the *members* (or other *persons*) who may be involved in the decision-making process, for example where they belong to committees or to the *governing body*. Conflicts of interest may also arise for the *UK recognised body* itself as a result of its connection with another *person*.
- 2.5.11** G_{/1} The *FSA* recognises that a *UK recognised body* has legitimate interests of its own and that its general business policy may properly be influenced by other *persons* (such as its owners). Such a connection does not necessarily imply the existence of a conflict of interest nor is it necessary to exclude individuals closely connected with other *persons* (for example, those responsible for the stewardship of the owner's interests) from all decision-making processes in a *UK recognised body*. However, there may be decisions, primarily regulatory decisions, from which it may be appropriate to exclude an individual in certain circumstances where an interest, position or connection of his conflicts with the interest of the *recognised body*.
- 2.5.12** G_{/1} *REC 2.5.13G* to *REC 2.5.16G* set out the factors to which the *FSA* may have regard in assessing a *UK recognised body's* systems and controls for managing conflicts of interest.
- 2.5.13** G_{/1} The *FSA* may have regard to the arrangements a *UK recognised body* makes to structure itself and to allocate responsibility for decisions so that it can continue to take proper regulatory decisions notwithstanding any conflicts of interest, including:
- (1) the size and composition of the *governing body* and relevant committees;
 - (2) the roles and responsibilities of *key individuals*, especially where they also have responsibilities in other organisations;

- (3) the arrangements for transferring decisions or responsibilities to alternates in individual cases; and
- (4) the arrangements made to ensure that individuals who may have a permanent conflict of interest in certain circumstances are excluded from the process of taking decisions (or receiving information) about matters in which that conflict of interest would be relevant.

2.5.14

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The *FSA* may also have regard to the systems and controls intended to ensure that confidential information is only used for proper purposes. Where relevant, *recognised bodies* will have to comply with section 348 (Restrictions on disclosure of confidential information by the *FSA* etc.) and regulations made under section 349 (Exemptions from section 348) of the *Act*.

2.5.15

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The *FSA* may also have regard to the contracts of employment, staff rules, letters of appointment for members of the *governing body*, members of relevant committees and other *key individuals* and other guidance given to individuals on handling conflicts of interest. Guidance to individuals may need to cover:

- (1) the need for prompt disclosure of a conflict of interest to enable others, who are not affected by the conflict, to assist in deciding how it should be managed;
- (2) the circumstances in which a general disclosure of conflicts of interest in advance of any particular instance in which a conflict of interest arises may be sufficient;
- (3) the circumstances in which a general advance disclosure may not be adequate;
- (4) the circumstances in which it would be appropriate for a conflicted individual to withdraw from involvement in the matter concerned, without disclosing the interest; and
- (5) the circumstances in which safeguards in addition to disclosure would be required, such as the withdrawal of the individual from the decision-taking process, or from access to relevant information.

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The *FSA* may also have regard to the arrangements made:

- (1) for enforcing rules or other provisions applicable to staff and other *persons* involved in regulatory decisions; and
- (2) to keep records of disclosures of conflicts of interest and the steps taken to handle them.

Internal and external audit

2.5.17

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A *UK recognised body's* arrangements for internal and external audit will be an important part of its systems and controls. In assessing the adequacy of these arrangements, the *FSA* may have regard to:

- (1) the size, composition and terms of reference of any audit committee of the *UK recognised body's governing body*;
- (2) the frequency and scope of external audit;
- (3) the provision and scope of internal audit;

- (4) the staffing and resources of the *UK recognised body's* internal audit department;
- (5) the internal audit department's access to the *UK recognised body's* records and other relevant information; and
- (6) the position, responsibilities and reporting lines of the internal audit department and its relationship with other departments of the *UK recognised body*.

Information technology systems

2.5.18

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Information technology is likely to be a major component of the systems and controls used by any *UK recognised body*. In assessing the adequacy of the information technology used by a *UK recognised body* to perform or support its *relevant functions*, the *FSA* may have regard to:

- (1) the organisation, management and resources of the information technology department within the *UK recognised body*;
- (2) the arrangements for controlling and documenting the design, development, implementation and use of information technology systems; and
- (3) the performance, capacity and reliability of information technology systems.

2.5.19

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The *FSA* may also have regard to the arrangements for maintaining, recording and enforcing technical and operational standards and specifications for information technology systems, including:

- (1) the procedures for the evaluation and selection of information technology systems;
- (2) the arrangements for testing information technology systems before live operations;
- (3) the procedures for problem management and system change;
- (4) the arrangements to monitor and report system performance, availability and integrity;
- (5) the arrangements (including spare capacity and access to back-up facilities) made to ensure information technology systems are resilient and not prone to failure;
- (6) the arrangements made to ensure business continuity in the event that an information technology system does fail;
- (7) the arrangements made to protect information technology systems from damage, tampering, misuse or unauthorised access; and
- (8) the arrangements made to ensure the integrity of data forming part of, or being processed through, information technology systems.

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The *FSA* may have regard to the arrangements made to keep clear and complete audit trails of all uses of information technology systems and to reconcile (where

appropriate) the audit trails with equivalent information held by system users and other interested parties.

2.6 General safeguards for investors

2.6.1 Table Schedule to the Recognition Requirements Regulations, Paragraph 4(1)

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The [UK RIE] must ensure that business conducted by means of its *facilities* is conducted in an orderly manner and so as to afford proper protection to investors.

2.6.2 Table Schedule to the Recognition Requirements Regulations, Paragraph 19(1)

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The [UK RCH] must ensure that its *facilities* are such as to afford proper protection to investors.

2.6.3 **G** In determining whether:

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- (1) business conducted by means of a *UK RIE's facilities* is conducted so; or
- (2) a *UK RCH's facilities* are such;

as to afford proper protection to investors, the *FSA* may, in addition to the matters dealt with in *REC 2.7* to *REC 2.12*, have regard to all the arrangements made by the *UK recognised body* concerning the operation of its *facilities*.

2.6.4 **G** The *FSA* may also have regard to the extent to which the *UK recognised body's* rules, procedures and the arrangements for monitoring and overseeing the use of its *facilities*:

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- (1) include appropriate measures to prevent the use of its *facilities* for abusive or improper purposes;
- (2) provide appropriate safeguards for investors against fraud or misconduct, recklessness, negligence or incompetence by users of its *facilities*;
- (3) provide appropriate information to enable users of its *facilities* to monitor their use of the *facilities*;
- (4) include appropriate arrangements to enable users of its *facilities* to raise queries about any use of those *facilities* which they are reported to have made;
- (5) include appropriate arrangements to enable users of its *facilities* to comply with any relevant regulatory or legal requirements; and
- (6) include appropriate arrangements to reduce the risk that those *facilities* will be used in ways which are incompatible with relevant regulatory or legal requirements;

and in this paragraph "appropriate" should be taken to mean appropriate having regard to the nature and scale of the *UK recognised body's facilities*, the types of *persons* who will use the *facilities* and the use which they will make of those *facilities*.

Orderly markets

2.6.5

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In determining whether a *UK RIE* is ensuring that business conducted by means of its *facilities* is conducted in an orderly manner (and so as to afford proper protection to investors), the *FSA* may have regard to the extent to which the *UK RIE's* rules and procedures:

- (1) are consistent with the *Code of Market Conduct* (see *MAR* 1);
- (2) prohibit abusive trading practices or the deliberate reporting or publication of false information about trades; and
- (3) prohibit or prevent:
 - (a) trades in which a party is improperly indemnified against losses;
 - (b) trades intended to create a false appearance of trading activity ("wash trades");
 - (c) cross trades executed for improper purposes;
 - (d) improperly prearranged or prenegotiated trades;
 - (e) trades intended to assist or conceal any potentially identifiable trading abuse ("accommodation trades"); and
 - (f) trades which one party does not intend to close out or settle.

2.6.6

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In determining whether a *UK RIE* is ensuring that business conducted by means of its *facilities* is conducted in an orderly manner (and so as to afford proper protection to investors), the *FSA's* arrangements and practices:

- (1) enable *members* and *clients* for whom they act to obtain the best price available at the time for their size and type of trade;
- (2) ensure:
 - (a) sufficient pre-trade transparency in the *UK RIE's* markets taking account of the practices in those markets and the trading systems used; and
 - (b) sufficient post-trade transparency in the *UK RIE's* markets taking into account the nature and liquidity of the *specified investments* traded, market conditions and the scale of transactions, the need (where appropriate) to preserve anonymity for *members* and *clients* for whom they act, and the needs of different market participants for timely price information;
- (3) include procedures which enable the *UK RIE* to influence trading conditions or suspend trading promptly when necessary to maintain an orderly market; and

- (4) if they include arrangements to support or encourage liquidity:
- (a) are transparent;
 - (b) are not likely to encourage any *person* to enter into transactions other than for proper trading purposes (which may include hedging, investment, speculation, price determination, arbitrage and filling orders from any *client* for whom he acts);
 - (c) are consistent with a reliable, undistorted price-formation process; and
 - (d) alleviate dealing or other identified costs associated with trading on the *UK RIE*'s markets and do not subsidise a market position of a user of its *facilities* or subsidise any margin payments (or the provision of collateral) which such a user would have to make.

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The *FSA* accepts that block trading, upstairs trading and other types of specialist transactions (such as the "exchange of futures for physicals" in certain commodity markets) can have a legitimate commercial rationale consistent with the orderly conduct of business and proper protection for investors. They may therefore be permitted under the rules of a *UK RIE*, subject to any necessary safeguards, where appropriate.

2.7 Access to facilities

2.7.1

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Table Schedule to the Recognition Requirements Regulations, Paragraph 4(2)(a)

Without prejudice to the generality of sub-paragraph [4(1)], the [UK RIE] must ensure that – access to the [UK RIE's] facilities is subject to criteria designed to protect the orderly functioning of the market and the interests of investors;

2.7.2

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Table Schedule to the Recognition Requirements Regulations, Paragraph 19(2)(a)

Without prejudice to the generality of sub-paragraph [19(1)], the [UK RCH] must ensure that – access to the [UK RCH's] facilities is subject to criteria designed to protect the orderly functioning of those facilities and the interests of investors;

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In assessing whether access to a *UK recognised body's facilities* is subject to criteria designed to protect the orderly functioning of the market, or of those *facilities*, and the interests of investors, the *FSA* may have regard to whether:

- (1) the *UK recognised body* limits access as a *member* to *persons*:
 - (a) over whom it can with reasonable certainty enforce its rules contractually;
 - (b) who have sufficient technical competence to use its *facilities*;
 - (c) whom it is appropriate to admit to membership having regard to the size and sophistication of users of its *facilities* and the nature of the business effected by means of, or cleared through, its *facilities*; and
 - (d) (if appropriate) who have adequate financial resources in relation to their exposure to the *UK recognised body* or its central counterparty;
- (2) the *UK recognised body's* membership criteria are objective and are applied in an objective and non-discriminatory manner;
- (3) indirect access to the *UK recognised body's facilities* is subject to suitable criteria, remains the responsibility of a *member* of the *UK recognised body* and is subject to its rules; and
- (4) where access is granted to *members* outside the *United Kingdom*, there are adequate safeguards against *financial crime* (see also *REC 2.10*).

2.7.4

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/1**Electronic access**

The *FSA* may have regard to the arrangements made to permit electronic access to the *UK recognised body's facilities* and to prevent and resolve problems likely to arise from the use of electronic systems to provide indirect access to its *facilities* by *persons* other than its *members*, including:

- (1) the rules and guidance governing *members'* procedures, controls and security arrangements for inputting instructions into the system;
- (2) the rules and guidance governing the facilities *members* provide to *clients* to input instructions into the system and the restrictions placed on the use of those systems;
- (3) the rules and practices to detect, identify, and halt or remove instructions breaching any relevant restrictions;
- (4) the quality and completeness of the audit trail of any transaction processed through an electronic connection system; and
- (5) procedures to determine whether to suspend trading by those systems or access to them by or through individual *members*.

2.8 Settlement and clearing services

2.8.1

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Table Schedule to the Recognition Requirements Regulations, Paragraph 4(2)(d)

Without prejudice to the generality of sub-paragraph [4(1)], the [UK RIE] must ensure that – satisfactory arrangements are made for securing the timely discharge (whether by performance, compromise or otherwise) of the rights and liabilities of the parties to transactions effected on the [UK RIE] (being rights and liabilities in relation to those transactions);

2.8.2

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Table Schedule to the Recognition Requirements Regulations, Paragraph 19(2)(b)

Without prejudice to the generality of sub-paragraph [19(1)], the [UK RCH] must ensure that – its clearing services involve satisfactory arrangements for securing the timely discharge (whether by performance, compromise or otherwise) of the rights and liabilities of the parties to transactions in respect of which it provides such services, (being rights and liabilities in relation to those transactions);

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In determining whether there are satisfactory arrangements for securing the timely discharge of the rights and liabilities of the parties to transactions, the *FSA* may have regard to the *UK recognised body's*:

- (1) rules and practices relating to clearing and settlement;
- (2) arrangements for matching trades and ensuring that the parties are in agreement about trade details;
- (3) arrangements for making deliveries and payments and, where relevant, for collecting margin and holding collateral, in all relevant jurisdictions;
- (4) procedures to detect and deal with the failure of a *member* to settle in accordance with its rules;
- (5) arrangements for taking action to settle a trade if a *member* does not settle in accordance with its rules;
- (6) arrangements for monitoring its *members'* settlement performance; and

2.8.4

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(7) (where appropriate) *default rules* and default procedures.

A *UK recognised body* will not be regarded as failing to comply with the *recognition requirement* merely because it is unable to arrange for a specific transaction to be settled.

2.9 Transaction recording

2.9.1

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Table Schedule to the Recognition Requirements Regulations, Paragraph 4(2)(e)

Without prejudice to the generality of sub-paragraph [4(1)], the [UK RIE] must ensure that – satisfactory arrangements are made for recording transactions effected on the [UK RIE], and transactions (whether or not effected on the [UK RIE]) which are cleared or to be cleared by means of its *facilities*;

2.9.2

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Table Schedule to the Recognition Requirements Regulations, Paragraph 19(2)(c)

Without prejudice to the generality of sub-paragraph [19(1)], the [UK RCH] must ensure that – satisfactory arrangements are made for recording transactions which are cleared or to be cleared by means of its *facilities*;

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In determining whether a *UK recognised body* has satisfactory arrangements for recording the transactions effected on, or cleared or to be cleared by means of, its *facilities*, the *FSA* may have regard to:

- (1) whether the *UK recognised body* has arrangements for creating, maintaining and safeguarding an audit trail of transactions for at least three years (five years in respect of transactions carried out by *members* who are not incorporated in the *United Kingdom* if the *UK recognised body* is a *regulated market*); and
- (2) the type of information recorded and the extent to which the record includes details for each transaction of:
 - (a) the name of the *investment* (and, if relevant, the underlying asset) and the price, quantity and date of the transaction;
 - (b) the identities and, where appropriate, the roles of the counterparties to the transaction;
 - (c) if the *UK recognised body's* rules make provision for transactions to be effected, cleared or to be cleared in more than one type of *facility*, or under more than one part of its rules, the type of *facility* in which, or the part of its rules under which, the transaction was effected, cleared or to be cleared; and

(d) the date and manner of settlement of the transaction.

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Where transactions are effected on an *UK RIE* and cleared through an *UK RCH*, the *UK recognised bodies* concerned may agree which information is to be recorded by each *UK recognised body* and need not duplicate each other's records.

2.10 Financial crime and market abuse

2.10.1 /1 Table Schedule to the Recognition Requirements Regulations, Paragraph 4(2)(f)

Without prejudice to the generality of sub-paragraph [4(1)], the [UK RIE] must ensure that – appropriate measures are adopted to reduce the extent to which the [UK RIE’s] facilities can be used for a purpose connected with *market abuse* or *financial crime*, and to facilitate their detection and monitor their incidence;

2.10.2 /1 Table Schedule to the Recognition Requirements Regulations, Paragraph 19(2)(d)

Without prejudice to the generality of sub-paragraph [19(1)], the [UK RCH] must ensure that – appropriate measures are adopted to reduce the extent to which the [UK RCH’s] facilities can be used for a purpose connected with *market abuse* or *financial crime*, and to facilitate their detection and monitor their incidence;

2.10.3 /1 **G** In determining whether a *UK recognised body’s* measures are appropriate to reduce the extent to which its *facilities* can be used for a purpose connected with *market abuse* or *financial crime*, to facilitate their detection and to monitor their incidence, the *FSA* may have regard to:

- (1) whether the rules of the *UK recognised body* enable it to disclose any information to the *FSA*, or other appropriate bodies involved in the detection, prevention or pursuit of *market abuse* or *financial crime* in the *United Kingdom* or overseas; and
- (2) whether the arrangements, resources, systems, and procedures of the *UK recognised body* enable it to:
 - (a) monitor the use made of its *facilities* so as to obtain information regarding possible patterns of normal, abnormal or improper use of those *facilities*;
 - (b) detect possible instances of *market abuse* and *financial crime*, for example, by detecting suspicious patterns in the use of its *facilities*;
 - (c) communicate information about *market abuse* and *financial crime* promptly and accurately to appropriate organisations; and
 - (d) cooperate with all relevant bodies in the prevention, investigation and pursuit of *market abuse* and *financial crime*.

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The law on *market abuse* and *financial crime*, including Part VI of the Criminal Justice Act 1988 and the *Money Laundering Regulations*, applies to *UK recognised bodies*. This *recognition requirement* (and this *guidance*) does not restrict, diminish or alter the obligations contained in that legislation.

2.11 Custody

2.11.1

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Table Schedule to the Recognition Requirements Regulations, Paragraph 4(2)(g)

Without prejudice to the generality of sub-paragraph [4(1)], the [UK RIE] must ensure that – where the [UK RIE's] facilities include making provision for the safeguarding and administration of assets belonging to users of those facilities, satisfactory arrangements are made for that purpose.

2.11.2

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Table Schedule to the Recognition Requirements Regulations, Paragraph 19(2)(e)

Without prejudice to the generality of sub-paragraph [19(1)], the [UK RCH] must ensure that – where the [UK RCH's] facilities include making provision for the safeguarding and administration of assets belonging to users of those facilities, satisfactory arrangements are made for that purpose.

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In determining whether a *UK recognised body* has made satisfactory arrangements for the safeguarding and administration of assets belonging to the users of its *facilities*, the *FSA* may have regard to:

- (1) the level of protection which the arrangements provide against the risk of theft or other types or causes of loss;
- (2) whether the arrangements ensure that assets are only used or transferred in accordance with the instructions of the owner of those assets or in accordance with the terms of the agreement by which the *UK recognised body* undertook to safeguard and administer those assets;
- (3) whether the arrangements ensure that the assets are not transferred to the *UK recognised body* or to any other *person* to settle the debts of the owner (or other *person* with the appropriate rights over the assets) except in accordance with valid instructions from a *person* entitled to give those instructions, or in accordance with the terms of the agreement by which the *UK recognised body* undertook to safeguard and administer those assets;
- (4) whether the arrangements include satisfactory procedures to ensure that any rights arising in relation to the assets held as a result of any actions by the *issuers* of those assets (or other relevant persons) are held, transferred or acted upon in a timely and accurate manner in accordance with the instructions of the owner of those assets or in accordance with the terms of the agreement by

which the *UK recognised body* undertook to safeguard and administer those assets;

- (5) whether there are adequate arrangements to ensure the proper segregation of assets belonging to the *UK recognised body* (or to *undertakings* in the same *group*) from those belonging to the users of its *facilities* for the safeguarding and administration of assets;
- (6) whether the arrangements include satisfactory procedures for the selection, oversight and review of *custodians* or sub-*custodians* used to hold the assets;
- (7) whether the agreements by which the *UK recognised body* undertakes to safeguard and administer assets belonging to users of its *facilities* include appropriate information regarding the terms and conditions of that service and the obligations of the *UK recognised body* to the user of the service and of the user of the service to the *UK recognised body*;
- (8) whether the records kept of those assets and the operation of the safeguarding services provide sufficient accurate and timely information:
 - (a) to identify the legal and beneficial owners of the assets and of any *persons* who have charges over, or other interests, in the assets;
 - (b) to record separately any additions, reductions and transfers in each account of assets held for safeguarding or administration; and
 - (c) to identify separately the assets owned by (or, where appropriate, on behalf of) different *persons*, including, where appropriate, the assets owned by *members* of the *UK recognised body* and their clients;
- (9) the frequency of reconciliation of the assets held by (or on behalf of) the *UK recognised body* with the accounts held with the *UK recognised body* by the users of its safeguarding and administration services and the extent of the arrangements for resolving a shortfall identified in any reconciliation; and
- (10) the frequency with which statements of their holdings are provided to the users of the safeguarding and administration services, to the owners of the assets held and other appropriate *persons* in accordance with the terms of the agreement by which the *UK recognised body* undertook to safeguard and administer those assets.

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Where a *UK recognised body* arranges for other *persons* to provide services for the safeguarding and administration services of assets belonging to users of its *facilities*, it will also need to satisfy the *recognition requirement* in Regulation 6 of the *Recognition Requirements Regulations* (see REC 2.2).

2.12 Proper markets and disclosure of information (UK RIEs only)

2.12.1 Table Schedule to the Recognition Requirements Regulations, Paragraphs 4(2)(b) and 4(2)(c)
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Without prejudice to the generality of sub-paragraph [4(1)], the [UK RIE] must ensure that –

(b) dealings in [specified investments] on the [UK RIE] are limited to [specified investments] in which there is a proper market;

(c) appropriate arrangements are made for relevant information to be made available (whether by the [UK RIE] or, where appropriate, by issuers of the [specified investments]) to persons engaged in dealing in [specified investments] on the [UK RIE];

2.12.2 Table Schedule to the Recognition Requirements Regulations, Paragraph 4(3)
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In sub-paragraph [4(2)(c)], "relevant information" means information which is relevant in determining the current value of the [specified investments].

2.12.3 Table Schedule to the Recognition Requirements Regulations, Paragraph 5
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- (1) In this paragraph –
- “admission to trading”, “securities” and “regulated market” are to be construed in accordance with regulation 2 of the Traded Securities (Disclosure) Regulations 1994;
- “the obligation of disclosure” means the obligation imposed by regulation 3 of those Regulations;
- “issuer” means a *person* who is subject to that obligation whose securities are admitted to trading on a regulated market which the [UK RIE] regulates and supervises; and
- “the relevant securities” mean securities in relation to which the obligation of disclosure arises.
- (2) The rules of the [UK RIE] must enable the [UK RIE] in the event of a failure by an issuer to comply with the obligation of disclosure, –
- (a) to discontinue the admission of the relevant securities to trading;
- (b) to suspend trading in the relevant securities;
- (c) to publish the fact that the issuer has failed to comply with the obligation of disclosure; and
- (d) to make public itself any information which the issuer has failed to publish.
- (3) This paragraph is without prejudice to the requirement in paragraph 4(2)(c)

The general test

2.12.4

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In determining whether there is a proper market in a *specified investment*, the FSA may have regard to :

- (1) whether there is a sufficient range of *persons* already holding the *specified investment* (or, where relevant, the underlying asset) or interested in *dealing* in it to bring about adequate forces of supply and demand;
- (2) the extent to which there are any limitations on the *persons* who may hold or *deal* in the *specified investment*, or the amounts of the *specified investment* which may be held;
- (3) whether there are effective means to take and make delivery of the *specified investment* (or to settle the contract concerned) and, if appropriate, of any underlying asset; and
- (4) whether there is adequate information in the public domain to enable market participants to make a reasonably informed judgment about the value of the *specified investment* and the risks associated with it.

Comments on the general test

2.12.5

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There may be a proper market in a *specified investment* although:

- (1) different market participants have access to different information or receive information at different times;
- (2) there is more than one exchange on which the *specified investment* has been *admitted to trading*, or the *specified investment* is traded both *on-exchange* and *over the counter*;
- (3) the *specified investment* is a *derivative* of an underlying asset or other thing in which there is not a proper market;
- (4) the *specified investment* is an underlying asset of a *derivative* in which there is not a proper market for reasons not connected with the underlying asset; and
- (5) the market in the *specified investment* is illiquid, that is to say that it may not be possible to acquire, or to dispose of, a significant quantity of the *specified investment* without a substantial movement in its price.

Specific tests

2.12.6

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The *FSA* considers that there will usually be a proper market in the following types of *specified investment*:

- (1) a *security admitted to trading* by an arrangement between the *UK RIE* and the *issuer* which requires the *issuer* to comply with admission requirements and continuing obligations, if:
 - (a) in the case of a *security* which is not *listed*, the *UK RIE* requires the *issuer* to comply with initial and continuing obligations which are appropriate for *securities* which may be offered to the public in the *United Kingdom*; or
 - (b) it is a requirement under that arrangement that the *security* is *listed* in an *EEA State*;

and the *UK RIE* has adequate procedures governing the suspension or removal of the *security* from trading;
- (2) a *security admitted to trading* other than by an arrangement with the *issuer*, if:
 - (a) the *security* is admitted to, and has not been removed or suspended from, the *official list* in an *EEA State*; or
 - (b) the *security* is *admitted to trading*, and has not been removed or is not suspended from trading, by an investment exchange or similar organisation, which imposes and enforces requirements on the *issuer* comparable to those required for admission of like *securities* to an *official list* in the *EEA*;

and the *UK RIE* has adequate arrangements to suspend or remove the *security* from trading, including arrangements to obtain *relevant information*;
- (3) a *derivative*, if:

- (a) the terms of the *derivative* are sufficiently precise to provide for an understandable relationship between the price of the *derivative* and the price of the underlying asset or factor;
- (b) the *UK RIE* has adequate procedures for obtaining information relevant for determining whether or not to suspend or discontinue trading in that *derivative*;
- (c) there is sufficient information available to *persons* considering whether to enter into that *derivative* to make a reasonably informed judgment about its value and the risks associated with it; and
- (d) the additional tests in *REC 2.12.7G* or *REC 2.12.8G* are met.

2.12.7

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Where the *derivative* relates to an underlying asset, the additional tests are:

- (1) there are adequate settlement and delivery procedures for the underlying asset;
- (2) there is sufficient *relevant information* available to *persons* considering whether to enter into the *derivative* for them to make a reasonably informed judgment about the value of the underlying asset; and
- (3) the *UK RIE* has adequate arrangements to obtain *relevant information* about the underlying asset.

2.12.8

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Where the *derivative* is a *contract for differences* whose terms provide for obligations to be calculated or incurred by reference to fluctuations in an index or other factor, the additional test is that the parties to that *derivative* have access to information about that index or other factor and about fluctuations in that index or other factor.

General comment

2.12.9

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The general test set out in *REC 2.12.4G* may be satisfied in different ways. The *FSA* does not prescribe any particular requirements which *specified investments* which are to be *admitted to trading* should satisfy or any particular principles which *UK RIEs* should follow in making decisions about the *admission to trading* of *specified investments* (or about whether such *specified investments* should subsequently be removed or suspended from trading). Each *UK RIE* should be able to show the *FSA* that its policies and practices in the *admission to trading* of *specified investments* ensure that the *dealing* will be limited to *specified investments* in which there is a proper market.

Suitability

2.12.10

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The existence of a proper market in a *specified investment* does not automatically imply that it is a suitable *specified investment* for any particular investor, or class of investors.

Proper information

2.12.11

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In determining whether appropriate arrangements have been made to make *relevant information* available to *persons* engaged in *dealing in specified investments admitted to trading* on the UK RIE, the FSA may have regard to:

- (1) the extent to which *members* and *clients* for whom they act are able to obtain information about those *specified investments*, either through accepted channels for dissemination of information or through other regularly and widely accessible communication media, to make a reasonably informed judgment about the value and the risks associated with those *specified investments* in a timely fashion;
- (2) what restrictions, if any, there are on the dissemination of *relevant information* to the UK RIE's *members* and *clients* for whom they act; and
- (3) whether *relevant information* is or can be kept to restricted groups of *persons* in such a way as to facilitate or encourage *dealing* in contravention of the *Code of Market Conduct* (see MAR 1).

Own means of dissemination

2.12.12

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UK RIEs do not need to maintain their own arrangements for disseminating news or information about *specified investments* (or underlying assets) to their *members* where they have made adequate arrangements for other *persons* to do so on their behalf or there are other effective and reliable arrangements for this purpose.

Scope of paragraph 5 of the Schedule to the Recognition Requirements Regulations

2.12.13

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The *recognition requirement* set out in REC 2.12.3 applies to all UK RIEs which admit relevant securities (as defined in that *recognition requirement*) whether or not they have an arrangement with the *issuer* of those relevant securities.

2.13 Promotion and maintenance of standards

2.13.1 Table Schedule to the Recognition Requirements Regulations, Paragraph 6

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(1) The [UK RIE] must be able and willing to promote and maintain high standards of integrity and fair dealing in the carrying on of *regulated activities by persons* in the course of using the *facilities* provided by the [UK RIE].

(2) The [UK RIE] must be able and willing to cooperate by the sharing of information or otherwise, with the [FSA], with any other authority, body or *person* having responsibility in the *United Kingdom* for the supervision or regulation of any *regulated activity* or other financial service, or with an *overseas regulator* within the meaning of section 195 of the *Act*.

2.13.2 Table Schedule to the Recognition Requirements Regulations, Paragraph 20

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(1) The [UK RCH] must be able and willing to promote and maintain high standards of integrity and fair dealing in the carrying on of *regulated activities by persons* in the course of using the *facilities* provided by the [UK RCH].

(2) The [UK RCH] must be able and willing to cooperate, by the sharing of information or otherwise, with the [FSA], with any other authority, body or *person* having responsibility in the *United Kingdom* for the supervision or regulation of any *regulated activity* or other financial service, or with an *overseas regulator* within the meaning of section 195 of the *Act*.

2.13.3

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In determining whether a *UK recognised body* is able and willing to promote and maintain high standards of integrity and fair dealing in the carrying on of *regulated activities*, the *FSA* may have regard to the extent to which the *UK recognised body* seeks to promote and encourage, through its rules, practices and procedures, conduct in *regulated activities* which is consistent with the *Code of Market Conduct* (see *MAR 1*) and with any other codes of conduct, rules or principles relating to behaviour in *regulated activities* which users of the *financial system* in the *United Kingdom* would normally expect to apply to the *regulated activity* and the conduct in question.

2.13.4

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In assessing the ability of a *UK recognised body* to cooperate with the *FSA* and other appropriate bodies, the *FSA* may have regard to the extent to which the constitution and rules of the *UK recognised body* and its agreements with its

members enable it to obtain information from *members* and to disclose otherwise confidential information to the *FSA* and other appropriate bodies.

2.13.5

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In assessing the willingness of a *UK recognised body* to cooperate with the *FSA* and other appropriate bodies, the *FSA* may have regard to:

- (1) the extent to which the *UK recognised body* is willing to provide information about it and its activities to assist the *FSA* in the exercise of its functions;
- (2) the extent to which the *UK recognised body* is open with the *FSA* or other appropriate bodies in regulatory matters;
- (3) how diligently the *UK recognised body* investigates or pursues enquiries from the *FSA* or other appropriate bodies; and
- (4) whether the *UK recognised body* participates in appropriate international fora.

2.13.6

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For the purpose of this section, “information” includes information held about large positions held by *members* of a *UK recognised body*.

2.14 Rules and consultation

2.14.1 Table Schedule to the Recognition Requirements Regulations, paragraph 7

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- (1) The [UK RIE] must ensure that appropriate procedures are adopted for it to make rules, for keeping its rules under review and for amending them.**
- (2) The procedures must include procedures for consulting users of the [UK RIE's] facilities in appropriate cases.**
- (3) The [UK RIE] must consult users of its facilities on any arrangements it proposes to make for dealing with penalty income in accordance with paragraph 8(3) ... (or on any changes it proposes to make to those arrangements).**

2.14.2 Table Schedule to the Recognition Requirements Regulations, paragraph 21

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- (1) The [UK RCH] must ensure that appropriate procedures are adopted for it to make rules, for keeping its rules under review and for amending them.**
- (2) The procedures must include procedures for consulting users of the [UK RCH's] facilities in appropriate cases.**
- (3) The [UK RCH] must consult users of its facilities on any arrangements it proposes to make for dealing with penalty income in accordance with paragraph 22(3) ... (or on any changes it proposes to make to those arrangements).**

2.14.3 **G** In determining whether a *UK recognised body* has appropriate procedures for it to make rules, for keeping its rules under review and for amending them, the *FSA* may have regard to:

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- (1) the arrangements made for taking decisions about making and amending rules in the *UK recognised body*, including the level at which the decisions are taken and any provision for the delegation of decisions by the *governing body*;
- (2) the arrangements made for determining whether or not it is appropriate to consult *members* or other users of the *UK recognised body's facilities*;
- (3) the procedures for consulting *members* and other users of its *facilities* in appropriate cases; and
- (4) the arrangements for notifying *members* (and other appropriate *persons*) of rule changes.

2.14.4 **G** (1) In determining whether a *UK recognised body's* procedures include procedures for consulting users of its *facilities* in appropriate cases, the *FSA* may have

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regard to whether those procedures include provision for consulting users of those *facilities* before changes are made to any rules relating to its *regulatory functions*.

- (2) In the FSA's view, a *UK recognised body's* procedures may not need to contain provision for consulting users of its *facilities* before making minor changes to any rules of an administrative or commercial character.

2.14.5

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- (1) In determining whether a *UK recognised body's* procedures for consulting *members* and other users of its *facilities* are appropriate, the FSA may have regard to the range of persons to be consulted by the *UK recognised body* under those procedures.
- (2) In the FSA's view, consultation with a smaller range of persons may be appropriate where limited, technical changes to a *UK recognised body's* rules are proposed.
- (3) In the FSA's view, a *UK recognised body's* procedures may include provision to restrict consultation where it is essential to make a change to the rules without delay in order to ensure continued compliance with the *recognition requirements* or other obligations under the *Act*.

2.14.6

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In determining whether a *UK recognised body's* procedures for consulting *members* and other users of its *facilities* are appropriate, the FSA may have regard to the extent to which the procedures include:

- (1) informal discussions at an early stage with users of its *facilities* or appropriate representative bodies;
- (2) publication to users of its *facilities* of a formal consultation paper which includes clearly expressed reasons for the proposed changes and an appropriately detailed assessment of the likely costs and benefits;
- (3) adequate time for users of its *facilities* to respond to the consultation paper and for the *UK recognised body* to take their responses properly into account;
- (4) adequate arrangements for making responses to consultation available for inspection by users of its *facilities*, unless the respondent requests otherwise;
- (5) adequate arrangements for ensuring that the *UK recognised body* has proper regard to the representations received; and
- (6) publication, no later than the publication of the amended rules, of a reasoned account of the *UK recognised body's* decision to amend its rules.

2.15 Discipline

2.15.1 Table Schedule to the Recognition Requirements Regulations, Paragraph 8

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- (1) The [UK RIE] must have effective arrangements for monitoring and enforcing compliance with –
- (a) its rules (including rules in relation to the provision of clearing services in respect of transactions other than transactions effected on the [UK RIE]); and
 - (b) the arrangements made by it as mentioned in paragraph 4(2)(d)
- (2) Arrangements made pursuant to sub-paragraph (1) must include procedures for –
- (a) investigating complaints made to the [UK RIE] about the conduct of *persons* in the course of using the [UK RIE's] facilities; and
 - (b) the fair, independent and impartial resolution of appeals against decisions of the [UK RIE].
- (3) Where arrangements made pursuant to sub-paragraph (1) include provision for requiring the payment of financial penalties, they must include arrangements for ensuring that any amount so paid is applied only in one or more of the following ways –
- (a) towards meeting expenses incurred by the [UK RIE] in the course of the investigation of the breach in respect of which the penalty is paid, or in the course of any appeal against the decision of the [UK RIE] in relation to that breach;
 - (b) for the benefit of users of the [UK RIE's] facilities;
 - (c) for charitable purposes.

2.15.2 Table Schedule to the Recognition Requirements Regulations, Paragraph 22

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- (1) The [UK RCH] must have effective arrangements for monitoring and enforcing compliance with its rules.
- (2) The arrangements must include procedures for –
- (a) investigating complaints made to the [UK RCH] about the conduct of *persons* in the course of using the [UK RCH's] facilities; and

(b) the fair, independent and impartial resolution of appeals against decisions of the [UK RCH].

(3) Where the arrangements include provision for requiring the payment of financial penalties, they must include arrangements for ensuring that any amount so paid is applied only in one or more of the following ways –

(a) towards meeting expenses incurred by the [UK RCH] in the course of the investigation of the breach in respect of which the penalty is paid, or in the course of any appeal against the decision of the [UK RCH] in relation to that breach;

(b) for the benefit of users of the [UK RCH's] facilities;

(c) for charitable purposes.

2.15.3

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In determining whether a *UK recognised body* has effective arrangements for monitoring and enforcing compliance with its rules (and, in the case of a *UK RIE*, its settlement arrangements), the *FSA* may have regard to:

- (1) the *UK recognised body's* ability to:
 - (a) monitor and oversee the use of its *facilities*;
 - (b) assess its *members'* compliance with its rules (and settlement arrangements, where appropriate);
 - (c) assess the significance of any non-compliance;
 - (d) take appropriate disciplinary action against *members* in breach of its rules (and settlement arrangements, where appropriate);
 - (e) suspend a *member's* access to its *facilities*;
 - (f) refer *members'* or others' conduct to other appropriate authorities for possible action or further investigation;
 - (g) retain authority over a *member* for at least one year after he has ceased to be a *member*;
 - (h) where appropriate, enforce its rules (and settlement arrangements, where appropriate) against users (other than *members*) of its *facilities*; and
 - (i) take action against suppliers of services to *members* (for example, warehouses) whose performance or conduct may be critical to ensuring compliance with its rules (and settlement arrangements, where appropriate);
- (2) the position, management and resources of the departments responsible for monitoring and overseeing the use of the *UK recognised body's facilities* and for enforcing compliance with its rules (and settlement arrangements, where appropriate); and
- (3) the arrangements made for the determination of disciplinary matters including the arrangements for disciplinary hearings and the arrangements made for appeals from the *UK recognised body's* decisions in those matters.

2.15.4

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In assessing whether the procedures made by a *UK recognised body* to investigate complaints about the users of its *facilities* are satisfactory, the *FSA* may have regard to:

- (1) whether these procedures include arrangements which enable the *UK recognised body* to:
 - (a) acknowledge complaints promptly;
 - (b) consider and investigate these complaints objectively, promptly and thoroughly;
 - (c) provide a timely reply to the complainant; and
 - (d) keep adequate records of complaints and investigations;
- (2) the arrangements made to enable a *person* who is the subject of a complaint to respond in an appropriate manner to that complaint; and
- (3) the documentation of these procedures and the arrangements made to ensure that the existence of these procedures is brought to the attention of *persons* who might wish to make a complaint.

2.15.5

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In assessing whether the arrangements include procedures for the fair, independent and impartial resolution of appeals against decisions of a *UK recognised body*, the *FSA* may have regard to at least the following factors:

- (1) the appeal procedures of the *UK recognised body*, including the composition and roles of any appeal committees or tribunals, and their relationship to the *governing body*;
- (2) the arrangements made to ensure prompt hearings of appeals from decisions made by the *UK recognised body*;
- (3) the format, organisation and rules of procedure of those hearings;
- (4) the arrangements made to select the *persons* to preside over those hearings and to serve as *members* of any appeal tribunal;
- (5) the provision for determining whether or not such hearings should be in public;
- (6) the provision made to enable an appellant to be aware of the procedure at any appeal hearing and to have the opportunity to prepare and present his case at that hearing;
- (7) the provision made for an appeal tribunal to give an explanation of its decision;
- (8) the provision for publicity for any appeals or for determining whether or not publicity should be given to the outcome of any appeal.

2.15.6

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In assessing whether a *UK recognised body's* arrangements include appropriate provision for ensuring the application of any financial penalties in ways described in the *recognition requirement*, the *FSA* may have regard to:

- (1) the *UK recognised body's* policy regarding the application of financial penalties;

(2) the arrangements made for applying that policy in individual cases;
but the *FSA* does not consider that it is necessary for *UK recognised bodies* to follow any specific policy in order to meet this *recognition requirement*.

2.16 Complaints

2.16.1 Table Schedule to the Recognition Requirements Regulations, Paragraph 9

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- (1) The [UK RIE] must have effective arrangements for the investigation and resolution of complaints arising in connection with the performance of, or failure to perform, any of its *regulatory functions*.
- (2) But sub-paragraph (1) does not extend to –
- (a) complaints about the content of rules made by the [UK RIE], or
 - (b) complaints about a decision against which the complainant has the right to appeal under procedures of the kind mentioned in paragraph 8(2)(b)
- (3) The arrangements must include arrangements for a complaint to be fairly and impartially investigated by a *person* independent of the [UK RIE], and for him to report on the result of his investigation to the [UK RIE] and to the complainant.
- (4) The arrangements must confer on the *person* mentioned in sub-paragraph (3) the power to recommend, if he thinks appropriate, that the [UK RIE] –
- (a) makes a compensatory payment to the complainant,
 - (b) remedies the matter complained of,
- or takes both of those steps.
- (5) Sub-paragraph (3) is not to be taken as preventing the [UK RIE] from making arrangements for the initial investigation of a complaint to be conducted by the [UK RIE].

2.16.2 Table Schedule to the Recognition Requirements Regulations, Paragraph 23

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- (1) The [UK RCH] must have effective arrangements for the investigation and resolution of complaints arising in connection with the performance of, or failure to perform, any of its *regulatory functions*.
- (2) But sub-paragraph (1) does not extend to –
- (a) complaints about the content of rules made by the [UK RCH], or

(b) complaints about a decision against which the complainant has the right to appeal under procedures of the kind mentioned in paragraph 22(2)(b)

(3) The arrangements must include arrangements for a complaint to be fairly and impartially investigated by a *person* independent of the [UK RCH], and for him to report on the result of his investigation to the [UK RCH] and to the complainant.

(4) The arrangements must confer on the *person* mentioned in sub-paragraph (3) the power to recommend, if he thinks it appropriate, that the [UK RCH] –

(a) makes a compensatory payment to the complainant,

(b) remedies the matter complained of, or takes both of those steps.

(5) Sub-paragraph (3) is not to be taken as preventing the [UK RCH] from making arrangements for the initial investigation of a complaint to be conducted by the [UK RCH].

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In determining whether a *UK recognised body* has effective arrangements for the investigation and resolution of complaints arising in connection with the performance of, or failure to perform, any of its *regulatory functions*, the *FSA* may have regard to the extent to which the *UK recognised body's* resources and procedures enable it to:

- (1) acknowledge complaints promptly;
- (2) make an objective, prompt and thorough initial investigation of complaints;
- (3) provide a timely reply to the complainant after that initial investigation;
- (4) inform the complainant of his right to apply to the *UK recognised body's complaints investigator*; and
- (5) keep adequate records of complaints and investigations.

2.16.4

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In determining whether a *UK recognised body's* arrangements for the investigation of complaints include appropriate arrangements for the complaint to be fairly and impartially investigated by an independent *person* (a "*complaints investigator*"), the *FSA* may have regard to:

- (1) the arrangements made for appointing (and removing) a *complaints investigator*, including the terms and conditions of such an appointment and the provision for remuneration of a *complaints investigator*;
- (2) the *complaints investigator's* access to, and relationship with, the *UK recognised body's governing body* and *key individuals*;
- (3) the arrangements made for giving complainants access to the *complaints investigator*;
- (4) the facilities made available to the *complaints investigator* to enable him to pursue his investigation and prepare his report and recommendations, including access to the *UK recognised body's records, key individuals* and other

staff (including, where appropriate suppliers, contractors or other *persons* to whom any functions have been outsourced and their staff); and

- (5) the arrangements made for the *UK recognised body* to consider the *complaints investigator's* report and recommendations.

2.17 Recognition requirements relating to the default rules of UK recognised bodies

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The text of Parts II and IV of the Schedule to the *Recognition Requirements Regulations* is set out below.

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2.17.2

Table Schedule to the Recognition Requirements Regulations, Part II

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Paragraph 10 (Default rules in respect of market contracts)

(1) The [UK RIE] must have *default rules* which, in the event of a *member* of the [UK RIE] being or appearing to be unable to meet his obligations in respect of one or more *market contracts*, enable action to be taken in respect of unsettled *market contracts* to which he is party.

(2) The [*default rules*] may authorise the taking of the same or similar action in relation to a *member* who appears to be likely to become unable to meet his obligations in respect of one or more *market contracts*.

(3) The [*default rules*] must enable action to be taken in respect of all unsettled *market contracts*, other than those entered into by [an *RCH*] for the purposes of or in connection with the provision of clearing services for the [UK RIE].

Paragraph 11 (Content of rules)

(1) This paragraph applies as regards contracts falling within section 155(2)(a) of the Companies Act [1989].

(2) The [*default rules*] must provide –

(a) for all rights and liabilities between those party as principal to unsettled *market contracts* to which the defaulter is party as principal to be discharged and for there to be paid by one party to the other such sum of money (if any) as may be determined in accordance with the [*default rules*];

(b) for the sums so payable in respect of different contracts between the same parties to be aggregated or set off so as to produce a net sum; and

(c) for the certification by or on behalf of the [UK RIE] of the net sum payable or, as the case may be, of the fact that no sum is payable.

(3) The reference in sub-paragraph (2) to rights and liabilities between those party as principal to unsettled *market contracts* does not include rights and liabilities –

(a) in respect of margin; or

(b) arising out of a failure to perform a *market contract*.

(4) The [*default rules*] may make the same or similar provision, in relation to [*designated non-members*] designated in accordance with the procedures mentioned in subparagraph (5), as in relation to *members* of the [*UK RIE*].

(5) If such provision is made as is mentioned in subparagraph (4), the [*UK RIE*] must have adequate procedures –

(a) for designating the *persons*, or descriptions of person, in respect of whom action may be taken;

(b) for keeping under review the question which *persons* or descriptions of person should be or remain so designated; and

(c) for withdrawing such designation.

(6) The procedures must be designed to secure that –

(a) a *person* is not, or does not remain, designated if failure by him to meet his obligations in respect of one or more *market contracts* would be unlikely adversely to affect the operation of the market; and

(b) a description of persons is not, or does not remain, designated if failure by a *person* of that description to meet his obligations in respect of one or more *market contracts* would be unlikely adversely to affect the operation of the market.

(7) The [*UK RIE*] must have adequate arrangements –

(a) for bringing a designation or withdrawal of designation to the attention of the *person* or description of persons concerned; and

(b) where a description of *persons* is designated, or the designation of a description of persons is withdrawn, for ascertaining which *persons* fall within that description.

Paragraph 12 (Content of rules)

(1) This paragraph applies as regards contracts falling within section 155(2)(b) of the Companies Act [1989].

(2) The [*default rules*] must provide –

(a) for all rights and liabilities of the defaulter under or in respect of unsettled *market contracts* to be discharged and for there to be paid by or to the defaulter such sum of money (if any) as may be determined in accordance with the [*default rules*];

(b) for the sums so payable by or to the defaulter in respect of different contracts to be aggregated or set off so as to produce a net sum;

(c) for that sum –

(i) if payable by the defaulter to the [UK RIE], to be set off against any property provided by or on behalf of the defaulter as cover for margin (or the proceeds of realisation of such property) so as to produce a further net sum;

(ii) if payable by the [UK RIE] to the defaulter, to be aggregated with any property provided by or on behalf of the defaulter as cover for margin (or the proceeds of realisation of such property); and

(d) for the certification by or on behalf of the [UK RIE] of the sum finally payable or, as the case may be, of the fact that no sum is payable.

(3) The reference in sub-paragraph (2) to the rights and liabilities of a defaulter under or in respect of an unsettled *market contract* includes (without prejudice to the generality of that provision) rights and liabilities arising in consequence of action taken under provisions of the [default rules] authorising –

(a) the effecting by the [UK RIE] of corresponding contracts in relation to unsettled *market contracts* to which the defaulter is party;

(b) the transfer of the defaulter's position under an unsettled *market contract* to another *member* of the [UK RIE];

(c) the exercise by the UK RIE of any *option* granted by an unsettled *market contract*.

(4) A “corresponding contract” means a contract on the same terms (except as to price or premium) as the *market contract* but under which the *person* who is the buyer under the *market contract* agrees to sell and the *person* who is the seller under the *market contract* agrees to buy.

(5) Sub-paragraph (4) applies with any necessary modifications in relation to a *market contract* which is not an agreement to sell.

(6) The reference in sub-paragraph (2) to the rights and liabilities of a defaulter under or in respect of an unsettled *market contract* does not include, where he acts as agent, rights or liabilities of his arising out of the relationship of principal and agent.

Paragraph 13 (Notification to other parties affected)

The [UK RIE] must have adequate arrangements for ensuring that –

(a) in the case of unsettled *market contracts* with a defaulter acting as principal, parties to the contract are notified as soon as reasonably practicable of the default and of any decision taken under the [default rules] in relation to contracts to which they are a party; and

(b) in the case of unsettled *market contracts* with a defaulter acting as agent, parties to the contract and the defaulter's principals are notified as soon as reasonably practicable of the default and of the identity of the other parties to the contract.

Paragraph 14 (Cooperation with other authorities)

The [UK RIE] must be able and willing to cooperate, by the sharing of information and otherwise, with the Secretary of State, any *relevant office-holder* ... and any other authority or body having responsibility for any matter arising out of, or connected with, the default of a *member* of the [UK RIE] or any [*designated non-member*].

Paragraph 15 (Margin)

(1) Where the [UK RIE] provides clearing services, the [*default rules*] of the [UK RIE] must provide that in the event of a default, margin provided by the defaulter for his own account is not to be applied to meet a shortfall on a *client* account.

(2) This paragraph is without prejudice to the requirements of any *rules* relating to clients' money made by the [FSA] under sections 138 and 139 of the *Act*.

2.17.3

Table Schedule to the Recognition Requirements Regulations, Part IV

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Paragraph 24 (Default rules in respect of market contracts)

(1) The [UK RCH] must have *default rules* which, in the event of a *member* of the [UK RCH] being or appearing to be unable to meet his obligations in respect of one or more *market contracts*, enable action to be taken to close out his position in relation to all unsettled *market contracts* to which he is a party.

(2) The [*default rules*] may authorise the taking of the same or similar action where a *member* appears to be likely to become unable to meet his obligations in respect of one or more *market contracts*.

Paragraph 25 (Content of rules)

(1) The [*default rules*] must provide –

(a) for all rights and liabilities of the defaulter under or in respect of unsettled *market contracts* to be discharged and for there to be paid by or to the defaulter such sum of money (if any) as may be determined in accordance with the [*default rules*];

(b) for the sums so payable by or to the defaulter in respect of different contracts to be aggregated or set off so as to produce a net sum;

(c) for that sum –

(i) if payable by the defaulter to the [UK RCH], to be set off against any property provided by or on behalf of the defaulter as cover for margin (or the proceeds of realisation of such property) so as to produce a further net sum;

(ii) if payable by the [UK RCH] to the defaulter, to be aggregated with any property provided by or on behalf of the defaulter as cover for margin (or the proceeds of realisation of such property); and

(d) for the certification by or on behalf of the [UK RCH] of the sum finally payable or, as the case may be, of the fact that no sum is payable.

(2) The reference in sub-paragraph (1) to the rights and liabilities of a defaulter under or in respect of an unsettled *market contract* includes (without prejudice to the generality of that provision) rights and liabilities arising in consequence of action taken under provisions of the [default rules] authorising –

(a) the effecting by the [UK RCH] of corresponding contracts in relation to unsettled *market contracts* to which the defaulter is party;

(b) the transfer of the defaulter's position under an unsettled *market contract* to another *member* of the [UK RCH];

(c) the exercise by the [UK RCH] of any *option* granted by an unsettled *market contract*.

(3) A “corresponding contract” means a contract on the same terms (except as to price or premium) as the *market contract* but under which the *person* who is the buyer under the *market contract* agrees to sell and the *person* who is the seller under the *market contract* agrees to buy.

(4) Sub-paragraph (3) applies with any necessary modifications in relation to a *market contract* which is not an agreement to sell.

(5) The reference in sub-paragraph (1) to the rights and liabilities of a defaulter under or in respect of an unsettled *market contract* does not include, where he acts as agent, rights or liabilities of his arising out of the relationship of principal and agent.

Paragraph 26 (Notification to other parties affected)

The [UK RCH] must have adequate arrangements for ensuring that parties to unsettled *market contracts* with a defaulter are notified as soon as reasonably practicable of the default and of any decision taken under the [default rules] in relation to contracts to which they are a party.

Paragraph 27 (Cooperation with other authorities)

The [UK RCH] must be able and willing to cooperate, by the sharing of information and otherwise, with the Secretary of State, any *relevant office-holder* ... and any other authority or body having responsibility for any matter arising out of or connected with the default of a *member* of the [UK RCH].

Paragraph 28 (Margin)

(1) The [*default rules*] of the [UK RCH] must provide that in the event of a default, margin provided by the defaulter for his own account is not to be applied to meet a shortfall on a *client* account.

(2) This paragraph is without prejudice to the requirements of any *rules* relating to clients' money made by the [FSA] under sections 138 and 139 of the Act.

- 2.17.4 G_{/1} UK RIEs which, under their rules, have *market contracts* and UK RCHs which, under their rules, enter into *market contracts* are required to have *default rules*. The *default rules* must enable the UK recognised body to take action in relation to a *member* or, for an RIE, a *designated non-member*, who appears unable, or likely to become unable, to meet his obligations in respect of one or more unsettled *market contracts*.
- 2.17.5 G_{/1} This action is to provide for all rights and liabilities of the defaulter and any counterparty to an unsettled *market contract* to be discharged and for there to be paid between the defaulter and each counterparty one sum representing the net amount of all the contracts between them. Where property has been provided by the defaulter as cover for margin, that property may be set off against any amount owing by the defaulter. At the conclusion of this process, the UK recognised body must certify the sum finally payable in each case.
- 2.17.6 G_{/1} The Companies Act 1989 contains provisions which protect action taken by a UK recognised body under its *default rules* from the normal operation of insolvency law which might otherwise leave this action open to challenge by a *relevant office-holder*.

Chapter 3

NOTIFICATION RULES FOR UK RECOGNISED BODIES



3.1 Application and purpose

Application

- 3.1.1** **R** (1) The *notification rules* in this chapter, which are made under section 293 of the *Act* (Notification requirements), apply to all *UK recognised bodies*.
- 3.1.2** **G** (2) The *rules* relating to the form and method of notification in *REC 3.2* also apply to *overseas recognised bodies*.

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Purpose

- 3.1.4** **G** The *notification rules* in this chapter are made by the *FSA* in order to ensure that it is provided with notice of events and information which it reasonably requires for the exercise of its functions under the *Act*.

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3.2 Form and method of notification

Form of notification

3.2.1 **R** /1 Where a *recognised body* is required to give any notice or information under any *notification rule*, it may do so (unless that *rule* expressly provides otherwise) orally or in writing, whichever is the more appropriate in the circumstances, but, where it gives notice or information orally, it must confirm that notice or information in writing promptly.

Method of notification

3.2.2 **R** /1 Unless otherwise stated in the *notification rule*, a written notification required from a *recognised body* under any *notification rule* must be:

- (1) given to, or addressed for the attention of, the *recognised body's* usual supervisory contact at the *FSA*;
- (2) delivered to the *FSA* by one of the methods in *REC 3.2.3R*.

3.2.3 **R** /1 Table Methods of notification

Method of delivery	
(1)	<i>Post</i> to the address in <i>REC 3.2.4R</i>
(2)	Leaving the notification at the address in <i>REC 3.2.4R</i> and obtaining a time-stamped receipt
(3)	Electronic mail to an address for the <i>recognised body's</i> usual supervisory contact at the <i>FSA</i> and obtaining an electronic confirmation of receipt
(4)	Hand delivery to the <i>recognised body's</i> usual supervisory contact at the <i>FSA</i>
(5)	Fax to a fax number for the <i>recognised body's</i> usual supervisory contact at the <i>FSA</i> , provided that the <i>FSA</i> receives a copy of the notification by one of methods (1) – (4) in this table within five <i>business days</i> after the date of the faxed notification

3.2.4

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The address for a written notification to the *FSA* is:

The Financial Services Authority

25 The North Colonnade

Canary Wharf

London E14 5HS

Timely notification

3.2.5

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If a *notification rule* requires notification within a specified period:

- (1) the *recognised body* must give the notification so as to be received by the *FSA* no later than the end of that period; and
- (2) if the end of that period falls on a *day* which is not a *business day*, the notification must be given so as to be received by the *FSA* no later than the first *business day* after the end of that period.

Service of Notice Regulations

3.2.6

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The Financial Services and Markets Act 2000 (Service of Notices) Regulations 2001 (SI 2001/1420) contain provisions relating to the service of documents on the *FSA*. They do not apply to notifications required under the *notification rules* in this chapter and in *REC 6* because of the specific *rules* in this section.

3.3 Waivers

Statutory power

- 3.3.1** **G**_{/1} Under section 294 of the *Act* (Modification or waiver of rules), the *FSA* may, on the application or with the consent of a *recognised body* (including an *overseas recognised body*), direct that any *notification rule* is not to apply to the body or is to apply with such modifications as may be specified in the *waiver*.
- 3.3.2** **G** A *waiver* given under section 294 of the *Act* may be made subject to conditions.
- 3.3.3** **G**_{/1} Under section 294(4) of the *Act*, before the *FSA* may give a *waiver of notification rules*, it must be satisfied that:
- (1) compliance by the *recognised body* with those *notification rules*, or with those *rules* as unmodified, would be unduly burdensome or would not achieve the purpose for which those *rules* were made; and
 - (2) the *waiver* would not result in undue risk to *persons* whose interests those *rules* are designed to protect.

Applications

- 3.3.4** **G**_{/1} Where a *recognised body* wishes to make an application to the *FSA* for a *waiver of a notification rule*, it should in the first instance inform its usual supervisory contact at the *FSA*.
- 3.3.5** **G**_{/1} There is no application form, but applicants should make their application formally and in writing and in accordance with any direction the *FSA* may make under section 294(2) of the *Act*. Each application should set out at least:
- (1) full particulars of the *waiver* which is requested;
 - (2) the reason why the *recognised body* believes that the criteria set out in section 294(4) (and described in *REC 3.3.3G*) would be met, if this *waiver* were granted; and
 - (3) where the *recognised body* believes that these criteria would be met if the *FSA* gave a *waiver* under section 294 subject to any condition, particulars of the kind of condition contemplated.
- 3.3.6** **G**_{/1} The *FSA* may request further information from the applicant, before deciding whether to give a *waiver* under section 294 of the *Act*.

Waivers

3.3.7 G_{/1} Any *waiver* given by the *FSA* under section 294 of the *Act* will be made in writing, stating:

- (1) the name of the *recognised body* in respect of which the *waiver* is made;
- (2) the *notification rules* which are to be waived or modified in respect of that body;
- (3) where relevant, the manner in which any *rule* is to be modified;
- (4) any condition or time limit to which the *waiver* is subject; and
- (5) the date from which the *waiver* is to take effect.

3.3.8 G_{/1} Where the *FSA* considers that it will not give the *waiver* which has been applied for, the *FSA* will give reasons to the applicant for its decision. The *FSA* will endeavour, where practicable, to inform an applicant in advance where it seems that an application is likely to fail unless it is amended or expanded, so that the applicant will have the opportunity to make any necessary amendments or additions before the application is considered.

3.3.9 G_{/1} Where the *FSA* wishes to give a *waiver* under section 294 of the *Act* with the consent of a *recognised body* (rather than on the application of a *recognised body*), the *FSA* will correspond or discuss this with that body in order to agree an appropriate *waiver*.

Reviews of waivers

3.3.10 G_{/1} The *FSA* will periodically review any *waiver* it has given. The *FSA* has the right to revoke a *waiver* under section 294(6) of the *Act*. This right is likely to be exercised in the event of a material change in the circumstances of the *recognised body* or in any fact on the basis of which the *waiver* was given.



3.4 Key individuals and internal organisation

Purpose

3.4.1

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The purpose of *REC 3.4* is to enable the *FSA* to monitor changes in the arrangements a *UK recognised body* makes for the carrying out of its *relevant functions* or for overseeing the work of *key individuals* or departments responsible for its *relevant functions*.

Key individuals

3.4.2

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Where, in relation to a *UK recognised body*, a *person* has been appointed or elected, has resigned as, or has ceased to be, a *key individual*, that *UK recognised body* must immediately give notice of that event, and give the information specified for the purposes of this rule in *REC 3.4.4R* to the *FSA*.

3.4.3

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- (1) *Key individuals* include the *persons* who, under the operational or managerial arrangements of the *UK recognised body*, are appointed to manage the departments responsible for carrying out its *relevant functions*, whether or not they are members of its *governing body*. A *person* appointed to carry out specific tasks, such as to conduct a particular investigation into a specific set of facts, would not usually be a *key individual*.
- (2) A *key individual* need not be an *employee* of a *UK recognised body*. For example, an *employee* of an *undertaking* in the same *group* or a self-employed contractor of a *UK recognised body* might be a *key individual*, depending on the role he plays in that body.
- (3) A department of a *UK recognised body* should be regarded as responsible for carrying out a *relevant function* if it is responsible for any activity or activities which form a significant part of a *relevant function* or which make a significant contribution to the performance of a *relevant function*.
- (4) The *FSA* does not need to be notified where minor changes are made to the responsibilities of a *key individual*, but where a major change in responsibilities is made which amounts to a new appointment, the *FSA* should be notified under *REC 3.4.2R*.

3.4.4

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The following information is specified for the purposes of *REC 3.4.2R*:

- (1) where a *person* has been appointed or elected as a *key individual*:

- (a) that *person's* name;
 - (b) his date of birth;
 - (c) a description of the responsibilities which he will have in the post to which he has been appointed or elected; or
- (2) where a *person* has resigned as or otherwise ceased to be a *key individual*, that *person's* name.

Standing committees

3.4.5

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Where the *governing body* of a *UK recognised body* delegates any of its functions (which relate to that *UK recognised body's relevant functions*) to a standing committee, or appoints a standing committee to manage or oversee the carrying out of any of that *UK recognised body's relevant functions*, that *UK recognised body* must immediately notify the *FSA* of that event and give the *FSA* the following information:

- (1) the names of the members of that standing committee; and
- (2) the terms of reference of that standing committee (including a description of any powers delegated to that committee and any conditions or limitations placed on the exercise of those powers).

3.4.6

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Where:

- (1) there is any change in the composition or the terms of reference of any standing committee referred to in *REC 3.4.5R*; or
- (2) any such committee is dissolved;

the *UK recognised body* must immediately notify the *FSA* of that event and give particulars of any change referred to in (1) to the *FSA*.

3.4.7

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- (1) Standing committees include permanent committees with executive, supervisory, policy-making or rule-making responsibilities. Committees appointed for particular tasks or committees established for purely consultative or advisory purposes would not usually be considered to be standing committees.
- (2) Committees which include *persons* who are not members of the *governing body* can be standing committees.



3.5 Disciplinary action and events relating to key individuals

Disciplinary action

3.5.1

R

Where any *key individual* of a *UK recognised body*:

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- (1) is the subject of any disciplinary action because of concerns about his alleged misconduct;
- (2) resigns as a result of an investigation into his alleged misconduct; or
- (3) is dismissed for misconduct;

that body must immediately give the *FSA* notice of that event, and give the information specified for the purposes of this *rule* in *REC* 3.5.2R.

3.5.2

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The following information is specified for the purposes of *REC* 3.5.1R:

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- (1) the name of the *key individual* and his responsibilities within the *UK recognised body*;
- (2) details of the acts or alleged acts of misconduct by that *key individual*; and
- (3) details of any disciplinary action which has been or is proposed to be taken by that body in relation to that *key individual*.

Other events

3.5.3

R

Where a *UK recognised body* becomes aware that any of the following events has occurred in relation to a *key individual*, it must immediately give the *FSA* notice of that event:

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- (1) a petition for bankruptcy is presented (or similar or analogous proceedings under the law of a jurisdiction outside the *United Kingdom* are commenced) against that *key individual*; or

- (2) a bankruptcy order (or a similar or analogous order under the law of a jurisdiction outside the *United Kingdom*) is made against him; or
- (3) he enters into a voluntary arrangement (or a similar or analogous arrangement under the law of a jurisdiction outside the *United Kingdom*) with his creditors.



3.6 Constitution and governance

3.6.1 **R** ^{/1} Where a *UK recognised body* is to circulate any notice or other *document* proposing any amendment to its memorandum or articles of association (or other similar agreement or *document* relating to its constitution) to:

- (1) its shareholders (or any group or class of them); or
- (2) its *members* (or any group or class of them); or
- (3) any other group or class of *persons* which has the power to make that amendment or whose consent or approval is required before it may be made;

that *UK recognised body* must give notice of that proposed amendment, and give the information specified for the purposes of this *rule* in *REC* 3.6.2R to the *FSA*, at the same time as that notice or *document* is circulated.

3.6.2 **R** ^{/1} The following information is specified for the purposes of *REC* 3.6.1R:

- (1) the proposed amendments referred to in *REC* 3.6.1R;
- (2) the reasons for the proposal; and
- (3) a description of the group or class of *persons* to whom the proposal is to be circulated.

3.6.3 **G** ^{/1} A *UK recognised body* which is incorporated as a *company* in the *United Kingdom* will, in many circumstances, be able to comply with *REC* 3.6.1R by providing a copy of the notice of special resolution issued to its shareholders.

3.6.4 **R** ^{/1} Where a *UK recognised body* makes an amendment to its memorandum or articles of association (or other similar agreement or *document* relating to its constitution), that *UK recognised body* must immediately give the *FSA* notice of that event, and give written particulars of that amendment and of the date on which it is to become or became effective.

3.6.5 **G** ^{/1} A *UK recognised body* which is incorporated as a *company* in the *United Kingdom* will, in many circumstances, be able to comply with *REC* 3.6.4R by providing a copy of the special resolution effecting the amendment.

3.6.6

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Where any change is made to an agreement which relates to the constitution or governance of a *UK recognised body*:

- (1) between that *UK recognised body* and another *person*; or
- (2) between the owners of that *UK recognised body*; or
- (3) between the owners of that *UK recognised body* and another *person*; or
- (4) between other *persons*;

that *UK recognised body* must give the *FSA* notice of that event as soon as it is aware of it, and give written particulars of that change and of the date on which it is to become or became effective.

3.6.7

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The purpose of *REC 3.6.6R* is to ensure that the *FSA* is informed of changes to agreements which specify the arrangements by which a *UK recognised body* will be governed or by which important decisions will be taken within that body. It is not intended to cover any agreement by which someone is appointed to be a *key individual* or which covers the terms and conditions of service in such an appointment.



3.7 Auditors

3.7.1

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Where the auditors of a *UK recognised body* cease to act as such, that *UK recognised body* must immediately give the *FSA* notice of that event, and the following information:

- (1) whether the appointment of those auditors expired or was terminated;
- (2) the date on which they ceased to act; and
- (3) if it terminated, or decided not to renew, their appointment, its reasons for taking that action or decision.

3.7.2

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Where a *UK recognised body* appoints new auditors, that body must immediately give the *FSA* notice of that event, and the following information:

- (1) the name and business address of those new auditors; and
- (2) the date of their appointment as auditors.

3.8 Financial and other information

- 3.8.1** **R** A UK recognised body must give the FSA:
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- (1) a copy of its *annual report and accounts*; and
 - (2) a copy of the consolidated *annual report and accounts*:
 - (a) of any *group* in which the UK recognised body is a *subsidiary undertaking*; or
 - (b) (if the UK recognised body is not a *subsidiary undertaking* in any *group*) of any *group* of which the UK recognised body is a *parent undertaking*;
- no later than the time specified for the purpose of this *rule* in REC 3.8.2R.
- 3.8.2** **R** The time specified for the purpose of REC 3.8.1R is the latest of:
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- (1) four months after the end of the financial year to which the *document* which is to be given to the FSA relates; or
 - (2) the time when the *documents* described in REC 3.8.1R(1) or REC 3.8.1R(2)(b) are sent to the *members* or shareholders of the UK recognised body; or
 - (3) the time when the *document* described in REC 3.8.1R(2)(a) are sent to the shareholders in a *parent undertaking* of the *group* to which that *document* relates.
- 3.8.3** **R** Where an audit committee of a UK recognised body has prepared a report in relation to any period or any matter relating to any *relevant function* of that UK recognised body, the UK recognised body must immediately give the FSA a copy of that report.
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- 3.8.4** **R** A UK recognised body must give the FSA a copy of:
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- (1) its quarterly *management accounts*; or
 - (2) its monthly *management accounts*;
- within one month of the end of the period to which they relate.

3.8.5 **G**_{/1} A *UK recognised body* is not required to provide quarterly and monthly *management accounts* in respect of the same period, but *management accounts* (whether quarterly or monthly) should be submitted for all periods. A *UK recognised body* may choose whichever method is the more suitable for it, but where it intends to change from providing monthly to quarterly *management accounts* (or from quarterly to monthly *management accounts*), it should inform the FSA of that fact.

3.8.6 **R**_{/1} A *UK recognised body* must give the FSA:

- (1) a statement of its anticipated income, expenditure and cashflow for each financial year; and
- (2) an estimated balance sheet showing its position as it is anticipated at the end of each financial year;

before the beginning of that financial year.

3.8.7 **R**_{/1} Where the *accounting reference date* of a *UK recognised body* is changed, that body must immediately give notice of that event to the FSA and inform it of the new *accounting reference date*.

3.9 Fees and incentive schemes

- 3.9.1** **G** _{/1} The purpose of *REC 3.9.2R* is to enable the *FSA* to obtain information on changes to standard tariffs for matters such as *membership* and trading and of any scheme introduced by the *UK recognised body* for rebating or waiving fees or charges. A *UK recognised body* is not required to inform the *FSA* of fees or charges for which the *UK recognised body* does not charge according to a standard tariff.
- 3.9.2** **R** _{/1} A *UK recognised body* must give the *FSA* a summary of:
- (1) any proposal to change the fees or charges levied on its *members* (or any group or class of them), at the same time as the proposal is communicated to those *members*; and
 - (2) any such change, no later than the date when it is published or notified to those *members*.



3.10 Complaints

3.10.1

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Where a *UK recognised body's complaints investigator* has investigated a complaint arising in connection with the performance of, or failure to perform, any of its *regulatory functions*, and that *complaints investigator* has made a recommendation in respect of that complaint that the *UK recognised body* should:

- (1) make a compensatory payment to any *person*; or
- (2) remedy the matter which was the subject of that complaint;

the *UK recognised body* must immediately notify the *FSA* of that event, and give the *FSA* a copy of the *complaints investigator's* report and particulars of his recommendations as soon as that report or those recommendations are available to it.

3.11 Insolvency events

3.11.1

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On:

- (1) the presentation of a petition for the winding up of a *UK recognised body* (or the commencement of any similar or analogous proceedings under the law of a jurisdiction outside the *United Kingdom*); or
- (2) the appointment of a receiver, administrator, liquidator, trustee or sequestrator of assets of that body (or of any similar or analogous appointment under the laws of a jurisdiction outside the *United Kingdom*); or
- (3) the making of a voluntary arrangement by that body with its creditors (or of any similar or analogous arrangement under the law of a jurisdiction outside the *United Kingdom*);

that body must immediately give the *FSA* notice of that event.



3.12 Legal proceedings

3.12.1

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If any civil or criminal legal proceedings are instituted against a *UK recognised body*, it must, unless *REC 3.12.2R* applies, immediately give notice of that event and give the following information to the *FSA*:

- (1) in the case of civil proceedings, the name of the claimant, particulars of the claim, the amount of damages and any other remedy sought by the claimant, and particulars of any allegation that any act or omission of that body was in bad faith; and
- (2) in the case of criminal proceedings, particulars of the offence with which that body is charged.

3.12.2

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A *UK recognised body* is not required to give notice of civil legal proceedings or information about them to the *FSA* under *REC 3.12.1R*, where:

- (1) the amount of damages claimed would not significantly affect that *UK recognised body's* financial resources, if the claim were successful;
- (2) the claim would not have a significant adverse effect on the reputation and standing of that body, if that claim were successful; and
- (3) the claim does not relate to that body's *regulatory functions*.

3.13 Delegation of relevant functions

- 3.13.1** **G**^{/1} (1) The purpose of *REC 3.13* is to enable the *FSA* to monitor any significant instances where *UK recognised bodies* outsource their functions to other *persons* (as they are permitted to do under Regulation 6 of the *Recognition Requirements Regulations* – see *REC 2.2*).
- (2) The *FSA* does not need to be notified of every instance of outsourcing by a *UK recognised body*, but only where an activity or activities which form a significant part of a *relevant function* or which make a significant contribution to the performance of a *relevant function* are outsourced.
- 3.13.2** **R**^{/1} Where a *UK recognised body* makes an offer or agrees to delegate any of its *relevant functions* to another *person*, it must immediately give the *FSA* notice of that event, and:
- (1) inform the *FSA* of the reasons for that delegation or proposed delegation;
- (2) inform the *FSA* of the reasons why it is satisfied that it will continue to meet the *recognition requirements* following that delegation;
- (3) where it makes such an offer by issuing a written invitation to tender to another body or *person*, give the *FSA* a copy of that invitation to tender; and
- (4) where it makes such an agreement, give the *FSA* a copy of that agreement.
- 3.13.3** **R**^{/1} A *UK recognised body* must immediately give the *FSA* notice, where it makes an offer or agrees to undertake any *relevant function* of another *UK recognised body*.



3.14 Products, services and normal hours of operation

Purpose

3.14.1

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The purpose of *REC 3.14* is to ensure that the *FSA* is informed of planned changes to the services a *UK recognised body* intends to provide and of the normal hours of operation of those services. Unplanned suspensions of those services, unplanned changes in hours of operation and events causing a *UK recognised body* to be unable to provide those services should be notified to the *FSA* under the *rules* in *REC 3.15*.

Products and services

3.14.2

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Where a *UK RIE* proposes to *admit to trading* (or to cease to *admit to trading*) by means of its *facilities*:

- (1) a *specified investment* (other than a *security* or an *option* in relation to a *security*); or
- (2) a type of *security* or a type of *option* in relation to a *security*;

it must give the *FSA* notice of that event, and the information specified for the purposes of this *rule* in *REC 3.14.6R* to the *FSA*, at the same time as that proposal is first formally communicated to its *members* or shareholders (or any group or class of them).

3.14.3

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^{/1}

Where a *UK recognised body* proposes to provide (or to cease to provide) clearing services in respect of:

- (1) a *specified investment* (other than a *security* or an *option* in relation to a *security*); or
- (2) a type of *security* or a type of *option* in relation to a *security*;

it must, unless *REC 3.14.4R* applies, give the *FSA* notice of that event and the information specified for the purposes of this *rule* in *REC 3.14.6R*, at the same time as that proposal is first formally communicated to its *members* or shareholders (or any group or class of them).

3.14.4 **R** _{/1} A *UK RCH* is not required to give the *FSA* notice or information under *REC 3.14.3R* where it proposes to offer (or to cease to offer) clearing services under an agreement with a *UK RIE* in respect of a *specified investment* for which that *UK RIE* is required to give the *FSA* notice under *REC 3.14.2R* , provided that the *UK RIE* has given the *FSA* the information specified in *REC 3.14.6R(3)*.

3.14.5 **G** _{/1} *Securities* falling within the same article in Part III of the *Regulated Activities Order* which may be given the same generic description (for example, *shares* admitted to the *UK official list*) will normally be regarded as being of the same type. *Options* in relation to the same type of *security* will normally be regarded as being *options* of the same type.

3.14.6 **R** _{/1} The following information is specified for the purposes of *REC 3.14.2R* and *REC 3.14.3R*:

- (1) a description of the *specified investment* to which the proposal relates;
- (2) where that *specified investment* is a *derivative*, the proposed terms of that *derivative*; and
- (3) in the case of a *UK RIE* which is admitting that *specified investment* to trading, the name of any *RCH* which will provide clearing services in respect of that *specified investment* under an agreement with that *UK RIE*.

3.14.7 **R** _{/1} Where:

- (1) a *UK RIE* proposes to amend the standard terms of any *derivative admitted to trading* by means of its *facilities*; or
- (2) a *UK recognised body* proposes to amend the standard terms relating to the provision of clearing services for any *derivative* in respect of which it provides clearing services;

it must give the *FSA* notice of that event, and written particulars of those proposed amendments, at the same time as that proposal is first formally communicated to its *members* or shareholders (or any group or class of them).

3.14.8 **R** _{/1} Where a *UK recognised body* proposes to make (or to cease to make) arrangements for the safeguarding and administration of assets belonging to any other *person* (other than an *undertaking* in the same *group*), that *recognised body* must give the *FSA* notice of that event, and the information specified for the purposes of this *rule* in *REC 3.14.9R*, at the same time as that proposal is first formally communicated to its *members* or shareholders (or any group or class of them).

3.14.9 **R** _{/1} The following information is specified for the purposes of *REC 3.14.8R*:

- (1) a description of the assets (or types of assets) to which the proposal relates; and
- (2) the date or dates on which arrangements referred to in *REC 3.14.8R* will be made (or cease to be made).

3.14.10

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The *FSA* does not need to be notified of proposals to offer (or to withdraw offers of) safeguarding and administration services for individual assets of the same type. *Specified investments* (other than *securities*) falling within the same article in Part III of the *Regulated Activities Order* will normally be regarded as being of the same type. *Securities* falling within the same article in Part III of the *Regulated Activities Order* which may be given the same generic description (for example, *shares* admitted to the *UK official list*) will also normally be regarded as being of the same type.

Hours of operation

3.14.11

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Where a *UK recognised body* proposes to change its normal hours of operation, it must give the *FSA* notice of that proposal, and particulars of, and the reasons for, the actions proposed, at the same time as the proposal is first formally communicated to its *members* or shareholders, or any group or class of them.

3.15 Suspension of services and inability to operate facilities

Purpose

- 3.15.1** **G**
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- (1) The purpose of *REC 3.15.2R* to *REC 3.15.5G* is to enable the *FSA* to obtain information where a *UK recognised body* decides to suspend the provision of its services in relation to particular *investments*. Planned changes to the provision of services should be notified to the *FSA* under *REC 3.14*.
 - (2) *REC 3.15.6R* to *REC 3.15.7R* provide for notification to the *FSA* where a *UK recognised body* is unable to operate or provide its *facilities* for reasons outside its control or where it decides to extend its hours of operation in an emergency.

Suspension of services

- 3.15.2** **R**
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- Where, for any reason, an *RIE*:
- (1) suspends trading in any *derivative* (other than an *option* in relation to a *security*), in any type of *security* or in any type of *option* in relation to a *security*; or
 - (2) temporarily calls a trading halt in respect of any type of *security* or in any type of *option* in relation to a *security*;

it must immediately give the *FSA* notice of that event, particulars of that *derivative*, type of *security* or type of *option* in relation to a *security*, as the case may be, and the reasons for the action taken.

- 3.15.3** **R**
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- Where a *UK recognised body* suspends providing clearing services generally in respect of any *derivative* (other than an *option* in relation to a *security*), type of *security* or type of *option* in relation to a *security*, it must immediately give the *FSA* notice of that event, particulars of that *derivative*, type of *security* or type of *option* in relation to a *security*, as the case may be, and the reasons for the action taken.

- 3.15.4** **R**
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- Where a *UK recognised body* suspends any arrangements it makes for the safeguarding and administration of any type of asset belonging to any other *person* (other than an *undertaking* in the same *group*), that *UK recognised body* must immediately give the *FSA* notice of that

event, particulars of that type of asset and the reasons for the action taken.

3.15.5

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Specified investments (other than *securities* or *options* in relation to *securities*) falling within the same article in Part III of the *Regulated Activities Order* will normally be regarded as being assets of the same type. *Securities* falling within the same article in Part III of the *Regulated Activities Order* which may be given the same generic description (for example, *shares* admitted to the *UK official list*) will normally be regarded as being of the same type. *Options* in relation to the same type of *security* will normally be regarded as being *options* of the same type.

Inability to operate facilities

3.15.6

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Where, because of the occurrence of any event or circumstances, a *UK recognised body* is unable to operate any of its *facilities* within its normal hours of operation, it must immediately give the *FSA* notice of that inability and inform the *FSA*:

- (1) which *facility* it is unable to operate;
- (2) what event or circumstance has caused it to become unable to operate that *facility* within those hours; and
- (3) what action, if any, it is taking or proposes to take to enable it to recommence operating that *facility*.

Extension of hours of operation

3.15.7

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Where, because of the occurrence of any event or circumstances, a *UK recognised body* extends its hours of operation, it must immediately give the *FSA* notice of that event, and inform the *FSA*:

- (1) what event or circumstance has caused it to do so;
- (2) the new hours of operation; and
- (3) the date on which it expects to revert to its normal hours of operation.

3.16 Information technology systems

- 3.16.1** **G**_{/1} The purpose of *REC 3.16* is to ensure that the *FSA* receives a copy of the *UK recognised body's* plans and arrangements for ensuring business continuity if there are major problems with its computer systems. The *FSA* does not need to be notified of minor revisions to, or updating of, the *documents* containing a *UK recognised body's* business continuity plan (for example, changes to contact names or telephone numbers).
- 3.16.2** **R**_{/1} Where a *UK recognised body* changes any of its plans for action in the event of a failure of any of its information technology systems resulting in disruption to the operation of its *facilities*, it must immediately give the *FSA* notice of that event, and a copy of the new plan.
- 3.16.3** **R**_{/1} Where any reserve information technology system of a *UK recognised body* fails in such a way that, if the main information technology system of that body were also to fail, it would be unable to operate any of its *facilities* during its normal hours of operation, that body must immediately give the *FSA* notice of that event, and inform the *FSA*:
- (1) what action that *UK recognised body* is taking to restore the operation of the reserve information technology system; and
 - (2) when it is expected that the operation of that system will be restored.



3.17 Inability to discharge regulatory functions

3.17.1

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Where, because of the occurrence of any event or circumstances, a *UK recognised body* is unable to discharge any *regulatory function*, it must immediately give the *FSA* notice of its inability to discharge that function, and inform the *FSA*:

- (1) what event or circumstance has caused it to become unable to do so;
- (2) which of its *regulatory functions* it is unable to discharge; and
- (3) what action, if any, it is taking or proposes to take to deal with the situation and, in particular, to enable it to recommence discharging that *regulatory function*.

3.18 Membership

3.18.1

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- (1) The purpose of REC 3.18 is to enable the FSA to monitor changes in the types of *member* admitted by *UK recognised bodies* and to ensure that the FSA has notice of foreign jurisdictions in which the *members* of *UK recognised bodies* are based. *UK recognised bodies* may admit *persons* who are not *authorised persons* or *persons* who are not located in the *United Kingdom*, provided that the *recognition requirements* continue to be met.
- (2) REC 3.18.2R focuses on the admission of *persons* who are not *authorised persons* (whether or not they are located in the *United Kingdom*) and on whether the specific *recognition requirement* relating to access to *facilities* can still be met. REC 3.18.3R focuses on the admission of *members* from outside the UK and whether all relevant *recognition requirements* can be met.
- (3) The information required under REC 3.18 is relevant to the FSA's supervision of the *UK recognised body's* obligations in relation to the enforceability of compliance with the *UK recognised body's rules*. It is also relevant to the FSA's broader responsibilities concerning market confidence and, in particular, its functions in relation to *market abuse* and *financial crime*. It may also be necessary in the case of *members* based outside the *United Kingdom* to examine the implications for the enforceability of *default rules* or collateral and the settlement of transactions, and thus the ability of the *UK recognised body* to continue to meet the *recognition requirements*. It follows that the admission of a *member* from outside the *United Kingdom* who is not an *authorised person* could require notification under both REC 3.18.2R and REC 3.18.3R, although a single report from the *UK recognised body* covering both notifications would be acceptable to the FSA.

3.18.2

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Where a *UK recognised body* admits a *member* who is not an *authorised person* of a type of which, immediately before that time, that *UK recognised body* had not admitted to *membership*, it must immediately give the FSA notice of that event, and:

- (1) a description of the type of *person* whom it is admitting to *membership*; and
- (2) particulars of its reasons for considering that, in admitting that type of *person* to *membership*, it is able to continue to satisfy the *recognition requirement* in paragraph 4(2)(a) or paragraph 19(2)(a) of the Schedule to the *Recognition Requirements Regulations* which applies to it.

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Where a *UK recognised body* admits for the first time a *member* whose head or registered office is in a jurisdiction from which that

UK recognised body has not previously admitted *members*, it must immediately give the *FSA* notice of that event, and:

- (1) the name of that jurisdiction;
- (2) the name of any regulatory authority in that jurisdiction which regulates that *member* in respect of activities relating to *specified investments*; and
- (3) particulars of its reasons for considering that, in admitting a *member* from that jurisdiction to *membership*, it is able to continue to satisfy the *recognition requirements* which apply to it.

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A type of *member* means the description of any group of *members* to whom the same generic description could be applied. For example, the description of any group of *members* separately identified or defined in the rules might constitute a type of *member* for the purposes of this section.

3.19 Investigations

3.19.1 **R** Where a *UK recognised body* becomes aware that a *person* has been appointed by any *regulatory body* (other than the *FSA* or a *UK recognised body*) to investigate:

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- (1) any business transacted by means of its *facilities*, if it is an *RIE*; or
- (2) any aspect of the clearing services which it provides;

it must immediately give the *FSA* notice of that event.

3.19.2 **G** A *UK recognised body* need not give the *FSA* notice of:

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- (1) routine inspections or visits undertaken in the course of regular monitoring, complaints handling or as part of a series of “theme visits”; or
- (2) routine requests for information; or
- (3) investigations into the conduct of *members* of the *UK recognised body* or of other users of its *facilities* where the use of its *facilities* is a small or incidental part of the subject matter of the investigation.



3.20 Disciplinary action relating to members

3.20.1

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Where a *UK recognised body* has taken any disciplinary action against any *member* or any *employee* of a *member*, in respect of a breach of a rule relating to the carrying on by the *UK recognised body* of any of its *regulatory functions*, that body must immediately notify the *FSA* of that event, and give:

- (1) the name of the *person* concerned;
- (2) details of the disciplinary action taken by the *UK recognised body*; and
- (3) the *UK recognised body's* reasons for taking that disciplinary action.

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Where an appeal is lodged against any disciplinary action referred to in *REC 3.20.1R*, the *UK recognised body* must immediately give the *FSA* notice of that event, and:

- (1) the name of the appellant and the grounds on which the appeal is based, immediately; and
- (2) the outcome of the appeal, when known.

3.21 Criminal offences and civil prohibitions

3.21.1

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Where a *UK recognised body* has evidence tending to suggest that any *person* has:

- (1) been carrying on any *regulated activity* in the *United Kingdom* in contravention of the *general prohibition*; or
- (2) been engaged in *market abuse*; or
- (3) committed a criminal offence under the *Act* or subordinate legislation made under the *Act*; or
- (4) committed a criminal offence under Part V of the Criminal Justice Act 1993 (Insider dealing); or
- (5) committed a criminal offence under the *Money Laundering Regulations*;

it must immediately give the *FSA* notice of that event, and full details of that evidence in writing.



3.22 Restriction of, or instruction to close out, open positions

3.22.1

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Where a *UK RIE* decides to:

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- (1) restrict the open position on any of the contracts of a *member*; or
- (2) issue instructions to a *member* to close out its positions on any contracts;

that *UK RIE* must immediately give the *FSA* notice of that event, and the *member's* name, the nature and size of any position to be restricted or closed out and the reasons for the *UK RIE's* decision.

3.23 Default

3.23.1

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Where a *UK recognised body* decides to put a *member* into default, it must immediately give notice of that event, and give the following information to the *FSA*, at the same time as that decision is communicated to that *member* or to any other *member* (or group or class of them) of that body:

- (1) the name of the *member* and (where relevant) the class of membership;
- (2) the reasons for that decision; and
- (3) the names of any other exchange or *clearing house* on which, to the best of that *UK recognised body's* knowledge, that *member* clears business or transacts for, or in respect of, its *clients*;

and as soon as practicable afterwards, give the *FSA* a summary of the *member's* open positions, margin liability, cash and collateral balances in respect of that *member's* accounts (including *client* accounts).

Chapter 4

Supervision



4.1 Application and purpose

Application

- 4.1.1** **G**_{/1} REC 4.2, REC 4.3 and REC 4.5 apply to *UK recognised bodies*. REC 4.4 and REC 4.6 to REC 4.8 apply to all *recognised bodies*. REC 4.8 applies to applicants for recognition as a *recognised body*.

Purpose

- 4.1.2** **G**_{/1} This chapter sets out the FSA's approach to the supervision of *recognised bodies* and contains *guidance* on:
- (1) the arrangements for investigating complaints about *recognised bodies* made under section 299 of the *Act* (Complaints about recognised bodies) (REC 4.4);
 - (2) the FSA's approach to the exercise of its powers under:
 - (a) section 296 of the *Act* (FSA's power to give directions) to give directions to *recognised bodies* (REC 4.6);
 - (b) section 297 of the *Act* (Revoking recognition) to revoke *recognition orders* (REC 4.7);

and the procedure to be followed in those cases and where the FSA decides to refuse an application for recognition as a *recognised body* (REC 4.8); and
 - (3) the FSA's approach to, and procedures for, the exercise of its powers under sections 166 and 167 of the Companies Act 1989 to give directions to *UK recognised bodies* in relation to action under their *default rules* (REC 4.5).
- 4.1.3** **G**_{/1} The FSA's general approach to supervision is intended to ensure that:
- (1) the FSA has sufficient assurance that *recognised bodies* continue at all times to satisfy the *recognition requirements* and other obligations imposed by or under the *Act*; and
 - (2) the FSA's supervisory resources are allocated, and supervisory effort is applied, in ways which reflect the actual risks to the *regulatory objectives*.
- 4.1.4** **G**_{/1} In applying these principles of risk based supervision to the supervision of *recognised bodies*, the FSA has had particular regard to the special position of *recognised bodies* under the *Act* as well as to its general duties set out in section 2 of the *Act* (The FSA's general duties).

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More information on the supervision of *UK recognised bodies* is given in *REC 4.2* and *REC 4.3*. More information on the supervision of *overseas recognised bodies* is given in *REC 6*.



4.2 The supervisory relationship with UK recognised bodies

4.2.1

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The *FSA* expects to have an open, cooperative and constructive relationship with *UK recognised bodies* to enable it to have a broad picture of the *UK recognised body's* activities and its ability to meet the *recognition requirements*. This broad picture is intended to complement the information which the *FSA* will obtain under section 293 of the *Act* (Notification requirements) or under *notification rules* made under that section (see *REC 3*). The *FSA* will usually arrange meetings between the Markets and Exchanges Division and *key individuals* of the *UK recognised body* for this purpose. The frequency and nature of these meetings may vary in accordance with the risk profile of the *UK recognised body*.

4.2.2

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UK recognised bodies are likely to develop and adapt their businesses in response to customer demand and new market opportunities. Where such developments involve changes to the way the *UK recognised body* operates, they are likely to involve changes to the way it satisfies the *recognition requirements* and other obligations in or under the *Act*.

4.2.3

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The *FSA* expects a *UK recognised body* to take its own steps to assure itself that it will continue to satisfy the *recognition requirements* and other obligations in or under the *Act* when considering any changes to its business or operations.

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However, the *FSA* also expects that *UK recognised bodies* will keep it informed of all significant developments and of progress with its plans and operational initiatives, and will provide it with appropriate assurance that the *recognition requirements* will continue to be satisfied.

4.3 Risk assessments for UK recognised bodies

- 4.3.1** G_{/1} Information is needed to support the *FSA*'s risk based approach to the supervision of all regulated entities. Risk based supervision is intended to ensure that the allocation of supervisory resources and the supervisory process are compatible with the *regulatory objectives* and the *FSA*'s general duties under the *Act*. The central element of the process of risk based supervision is a systematic assessment by the *FSA* (a risk assessment) of the main supervisory risks and concerns for each regulated entity.
- 4.3.2** G_{/1} For each *UK recognised body*, the *FSA* will conduct a periodic risk assessment. This assessment will take into account relevant considerations including the special position of *recognised bodies* under the *Act*, the nature of the *UK recognised body's members*, the position of other users of its *facilities* and the business environment more generally.
- 4.3.3** G_{/1} The risk assessment will guide the *FSA*'s supervisory focus. It is important, therefore, that there is good dialogue between the *FSA* and the *recognised body*. The *FSA* expects to review its risk assessment with the staff of the *UK recognised body* to ensure factual accuracy and a shared understanding of the key issues, and may discuss the results of the risk assessment with *key individuals* of the *UK recognised body*. If appropriate, the *FSA* may send a detailed letter to the body's *chief executive*, chairman or both with proposals for further action or work to address particular concerns or issues and seek their comments on the risk assessment.

4.4 Complaints

Recognised body's arrangements

- 4.4.1** G_{/1} *Recognised bodies* may receive complaints from time to time from their *members* and other people, both about the conduct of *members* and about the *recognised body* itself. A *UK recognised body* will need to have satisfactory arrangements to investigate these complaints in order to satisfy the relevant *recognition requirements* (see *REC 2.15* and *REC 2.16*).

The FSA's arrangements

- 4.4.2** G_{/1} The *Act* does not provide a mechanism for appeals to the *FSA* from decisions by *recognised bodies* in relation to complaints. However, the *FSA* is required by section 299 of the *Act* (Complaints about recognised bodies) to have arrangements to investigate complaints (called *relevant complaints* in the *Act*) which it considers relevant to the question of whether a *recognised body* should remain recognised as such. This section describes aspects of the *FSA's* arrangements for investigating *relevant complaints*.
- 4.4.3** G_{/1} Where the *FSA* receives a complaint about a *recognised body*, it will, in the first instance, seek to establish whether the complainant has approached the *recognised body*. Where this is not the case, the *FSA* will ask the complainant to complain to the *recognised body*. Where the complainant is dissatisfied with the handling of the complaint, but has not exhausted the *recognised body's* own internal complaints procedures (in the case of a complaint against a *UK recognised body*, including by applying to that body's *complaints investigator*), the *FSA* will encourage the complainant to do so.
- 4.4.4** G_{/1} The *FSA* will not usually consider a complaint which has not, in the first instance, been made to the *recognised body* concerned, unless there is good reason for believing that it is a *relevant complaint* which merits early consideration by the *FSA*.
- 4.4.5** G_{/1} When it is considering a *relevant complaint*, the *FSA* will make its own enquiries as appropriate with the *recognised body*, the complainant and other *persons*. It will usually ask the *recognised body* and the complainant to comment upon any preliminary or draft conclusions of its review and to confirm any matters of fact at that stage.
- 4.4.6** G_{/1} The *FSA* will communicate the outcome of its review of a *relevant complaint* to the complainant and the *recognised body*, but will normally only discuss any action which it considers the *recognised body* should take with the *recognised body* itself.

4.5 FSA supervision of action by UK recognised bodies under their default rules

4.5.1 **G**_{/1} *UK recognised bodies* which, under their *rules*, have *market contracts* are required to have *default rules* enabling them (among other things) to take action in relation to a *member* who appears to be unable to meet his obligations in respect of one or more unsettled *market contracts*. The detailed *recognition requirements* relating to the *default rules* are set out in *REC 2.17*.

4.5.2 **G**_{/1} The *default rules* are designed to ensure that rights and liabilities between the defaulter and any counterparty to an unsettled *market contract* are discharged, and for there to be paid between the defaulter and each counterparty one net sum. The Companies Act 1989 contains provisions which protect action taken under *default rules* from the normal operation of insolvency law which might otherwise leave this action open to challenge by a *relevant office-holder*.

4.5.3 **G**_{/1} The Companies Act 1989 also gives the *FSA* powers to supervise the taking of action under *default rules*. Under section 166 of the Companies Act 1989 (Powers of the *FSA* to give directions) (see *REC 4.5.4G*), the *FSA* may direct a *UK recognised body* to take, or not to take, action under its *default rules*. Before exercising these powers the *FSA* must consult the *recognised body* concerned. The *FSA* may also exercise these powers if a *relevant office-holder* applies to it under section 167 of the Companies Act 1989 (Application to determine whether default proceedings to be taken) (see *REC 4.5.9G*).

4.5.4 **G**_{/1} Table The Companies Act 1989: section 166

The *FSA* may issue a “positive” direction (to take action) under section 166(2)(a) of the Companies Act 1989:

Where in any case a [UK RIE] or [UK RCH] has not taken action under its *default rules* – if it appears to [the *FSA*] that it could take action, [the *FSA*] may direct it to do so, ...

but under section 166(3)(a) of the Companies Act 1989:

Before giving such a direction the [FSA] shall consult the [UK RIE] or [UK RCH] in question; and [the FSA] shall not give a direction unless [the FSA] is satisfied, in the light of that consultation ... that failure to take action would involve undue risk to investors or other participants in the market, ...

The *FSA* may issue a “negative” direction (not to take action) under section 166(2)(b) of the Companies Act 1989:

Where in any case a [UK RIE] or [UK RCH] has not taken action under its *default rules* – ... if it appears to the [FSA] that it is proposing to take or may take action, [the FSA] may direct it not to do so.

but under section 166(3)(b) of the Companies Act 1989:

Before giving such a direction the [FSA] shall consult the [UK RIE] or [UK RCH] in question; and the [FSA] shall not give a direction unless [the FSA] is satisfied, in the light of that consultation ... that the taking of action would be premature or otherwise undesirable in the interests of investors or other participants in the market.

4.5.5 G_{/1} The *FSA*'s view is that the exercise of these powers will only be justified in exceptional circumstances. The most likely case in which the *FSA* would consider exercising them is if there were a need to coordinate action by different *UK recognised bodies* because, for example:

- (1) the likelihood of a default may not be apparent to all *UK recognised bodies*; or
- (2) there was a need to avoid premature default action by one *UK recognised body*; or
- (3) significantly different settlement prices had been fixed by different *UK recognised bodies*.

4.5.6 G_{/1} Under section 166(6) of the Companies Act 1989, a negative direction cannot be given if, in relation to the defaulter, either:

- (1) a bankruptcy order or an award of sequestration of the defaulter's estate has been made, or an interim receiver or interim trustee has been appointed; or
- (2) a winding-up order has been made, a resolution for voluntary winding-up has been passed or an administrator, administrative receiver or provisional liquidator has been appointed;

and any previous negative direction will cease to have effect on the making or passing of any such order, award or appointment.

4.5.7 G_{/1} Under section 166(5) of the Companies Act 1989, a negative direction may be expressed to have effect until a further direction is given, which may either be a positive direction or a revocation of the earlier negative direction.

4.5.8 G_{/1} Under section 166(7) of the Companies Act 1989, where a *UK recognised body* has taken action either of its own accord or in response to a direction, the *FSA* may direct it to do or not to do specific things subject to these being within the powers of the *UK recognised body* concerned under its *default rules*. However, the *FSA* cannot give such a direction unless it is satisfied that this will not impede or frustrate the proper and efficient conduct of the default proceedings.

Section 167 of the Companies Act 1989

4.5.9 G_{/1} Where, in relation to a *member* (or *designated non-member*) of a *UK RIE* or a *member* of a *UK RCH*:

- (1) a bankruptcy order; or
- (2) an award of sequestration of his estate; or
- (3) an order appointing an interim receiver of his property; or
- (4) an administration or winding-up order; or
- (5) a resolution for a voluntary winding-up; or
- (6) an order appointing a provisional liquidator;

has been made or passed and the *UK recognised body* has not taken action under its *default rules* as a result of this event or of the matters giving rise to it, a *relevant office-holder* appointed in connection with the order, award or resolution may make an application to the *FSA* under section 167 of the Companies Act 1989 (Application to determine whether default proceedings to be taken).

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The effect of an application under section 167 of the Companies Act 1989 is to require the *UK recognised body* concerned to take action under its *default rules* or to require the *FSA* to take action under section 166 of the Companies Act 1989 (see REC 4.5.4G).

4.5.11

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The procedure is that the *FSA* must notify the *UK recognised body* of the application and, unless within three *business days* after receipt of that notice, the *UK recognised body*:

- (1) takes action under its *default rules*; or
- (2) notifies the *FSA* that it proposes to take action forthwith; or
- (3) is directed to take action by the *FSA* under section 166(2)(a) of the Companies Act 1989;

the provisions of sections 158 to 165 of the Companies Act 1989 do not apply in relation to *market contracts* to which the *member* or *designated non-member* is a party or to anything done by the *UK recognised body* for the purpose of, or in connection with, the settlement of any *market contracts*.

4.6 The section 296 power to give directions

- 4.6.1** **G**_{/1} Under section 296 of the *Act* (FSA's power to give directions), the *FSA* has the power to give directions to a *recognised body* in order to secure its compliance with the *recognition requirements* or other obligations in or under the *Act*.
- 4.6.2** **G**_{/1} The *FSA* must also give a direction to a *recognised body* if it is directed to do so by the Treasury under section 308 of the *Act* (Directions by the Treasury).
- 4.6.3** **G**_{/1} The *FSA* is likely to exercise its power under section 296 of the *Act* if it considers that:
- (1) there has been, or was likely to be, a failure to satisfy the *recognition requirements* or there has been a failure to comply with any other obligation in or under the *Act* which has serious consequences;
 - (2) compliance with the direction would ensure that the *recognition requirements*, or other obligation in or under the *Act*, were satisfied; and
 - (3) the *recognised body* is capable of complying with the direction.
- 4.6.4** **G**_{/1} Under section 298(7) of the *Act* (Directions and revocation: procedure), the *FSA* need not follow the consultation procedure set out in the rest of section 298 (see *REC* 4.8), or may cut short that procedure, if it considers it essential to do so. The *FSA* is likely to consider it essential to cut short the procedure if, in the absence of immediate action, there would be:
- (1) a serious risk of substantial losses to investors, particularly *private customers*;
or
 - (2) a serious threat to market confidence or to the stability of the *financial system*;
or
 - (3) a serious risk of *money laundering* or other serious *financial crime*.

4.7 The section 297 power to revoke recognition

- 4.7.1** **G**_{/1} Under section 297 of the *Act* (Revoking recognition), the *FSA* has the power to revoke a *recognition order* relating to a *recognised body*.
- 4.7.2** **G**_{/1} The *FSA* will revoke a *recognition order* if:
- (1) it is directed to do so by the Treasury under section 308 of the *Act* (Directions by the Treasury); or
 - (2) the *recognised body* has asked the *FSA* to revoke the order.
- 4.7.3** **G**_{/1} The *FSA* will usually consider revoking a *recognition order* if:
- (1) the *recognised body* is failing or has failed to satisfy the *recognition requirements* or other obligations in or under the *Act* and that failure has or will have serious consequences; or
 - (2) it would not be possible for the *recognised body* to comply with a direction under section 296 of the *Act* (*FSA*'s power to give directions); or
 - (3) for some other reason, it would not be appropriate for the *FSA* to give a direction under section 296.
- 4.7.4** **G**_{/1} The *FSA* would be likely to consider the conditions in *REC* 4.7.3G(2) or *REC* 4.7.3G(3) to be satisfied in the following circumstances:
- (1) the *recognised body* appears not to have the resources or management to be able to organise its affairs so as to satisfy the *recognition requirements* or other obligations in or under the *Act*; or
 - (2) the *recognised body* does not appear to be willing to satisfy the *recognition requirements* or other obligations in or under the *Act*; or
 - (3) the *recognised body* is failing or has failed to comply with a direction made under section 296 of the *Act*; or
 - (4) the *recognised body* has ceased to carry out *regulated activities* in the *United Kingdom*, or has so changed the nature of its business that it no longer satisfies the *recognition requirements* in respect of the *regulated activities* for which *recognised body* status is relevant.
- 4.7.5** **G**_{/1} In addition to the factors set out in *REC* 4.7.4G, the *FSA* will usually consider that it would not be able to secure an *overseas recognised body's* compliance with the *recognition requirements* or other obligations in or under the *Act* by means of a direction under section 296 of the *Act*, if it appears to the *FSA* that the *overseas recognised body* is prevented by any change in the legal framework or supervisory

arrangements to which it is subject in its *home territory* from complying with the *recognition requirements* or other obligations in or under the *Act*.

4.8 The section 298 procedure

- 4.8.1** **G**_{/1} A decision to:
- (1) revoke a *recognition order* under section 297 of the *Act* (Revoking recognition); or
 - (2) make a direction under section 296 (*FSA's* powers to give directions); or
 - (3) refuse to make a *recognition order* under section 290 (Recognition orders);
- is a serious one and section 298 of the *Act* (Directions and revocation: procedure) sets out a procedure (see *REC 4.8.9G*) which the *FSA* will follow unless, in the case of a revocation of a *recognition order*, the *recognised body* concerned has given its consent (see section 297(1)) or, in a case where the *FSA* proposes to make a direction under section 296, it considers it is essential not to follow, or to cut short, the procedure (see *REC 4.6.4G* and *REC 4.8.7G*).
- 4.8.2** **G**_{/1} The *FSA's* internal arrangements provide for any of these decisions to be taken at an appropriately senior level.
- 4.8.3** **G**_{/1} In considering whether it would be appropriate to exercise the powers under section 296 or section 297 of the *Act*, the *FSA* will have regard to all relevant information and factors including:
- (1) its *guidance to recognised bodies*;
 - (2) the results of its routine supervision of the body concerned;
 - (3) the extent to which the failure or likely failure to satisfy the *recognition requirements* or other obligations in or under the *Act* may affect the *regulatory objectives*.
- 4.8.4** **G**_{/1} In considering whether or not to make a *recognition order*, the *FSA* will have regard to all relevant information and factors, including its *guidance to recognised bodies* and applicants and the information provided by applicants. Details of the application processes and other *guidance* for applicants are set out in *REC 5* and (for overseas applications) *REC 6*.
- 4.8.5** **G**_{/1} The procedures laid down in section 298 of the *Act* are summarised, with the *FSA's* *guidance* about the actions it proposes to take in following these procedures, in the table at *REC 4.8.9G*.
- 4.8.6** **G**_{/1} Before exercising its powers under section 296 or section 297 of the *Act*, the *FSA* will usually discuss its intention, and the basis for this, with the *key individuals* or other appropriate representatives of the *recognised body*. It will usually discuss its intention not to make a *recognition order* with appropriate representatives of the applicant.

4.8.7 G_{/1} Under section 298(7) of the *Act*, the *FSA* need not follow the procedure in section 298 in relation to giving a direction under section 296, when it considers it essential not to do so. *Guidance* on the circumstances in which the *FSA* will usually act in this way is given in *REC* 4.6.4G.

4.8.8 G_{/1} Under section 290(6) of the *Act*, the *FSA* need not follow the procedure in section 298 in relation to a refusal to make a *recognition order* if (under section 307) the Treasury has not given its approval for the *recognition order* to be made. Further *guidance* is given in *REC* 5 and *REC* 6 (for overseas applications).

4.8.9 G_{/1} Table Key steps in the section 298 procedure

	The <i>FSA</i> will:	<i>Guidance</i>
(1)	give written notice to the <i>recognised body</i> (or applicant);	The notice will state why the <i>FSA</i> intends to take the action it proposes to take, and include an invitation to make representations, and the date by which representations should be made.
(2)	take such steps as it considers reasonably practicable to bring the notice to the attention of the <i>members</i> of the <i>recognised body</i> or of the applicant, as the case may be;	The <i>FSA</i> will also notify <i>persons</i> individually (as far as it considers it reasonably practicable to do so) if it considers that the action it proposes to take would affect them adversely in a way which would be different from its effect on other <i>persons</i> of the same class.
(3)	publish the notice so as to bring it to the attention of other <i>persons</i> likely to be affected;	
(4)	receive representations from the <i>recognised body</i> or applicant concerned, any <i>member</i> of the <i>recognised body</i> or applicant, and any other <i>person</i> who is likely to be affected by the action the <i>FSA</i> proposes to take;	The <i>FSA</i> will not usually consider oral representations without first receiving written representations from the <i>person</i> concerned. It will normally only hear oral representations from the <i>recognised body</i> (or applicant) itself or of a <i>person</i> whom it has notified individually, on request.
(5)	write promptly to any <i>person</i> who requests the opportunity to make oral representations if it decides not to hear that <i>person's</i> representations;	The <i>FSA</i> will indicate why it will not hear oral representations and the <i>FSA</i> will allow the <i>person</i> concerned further time to respond.
(6)	have regard to representations made;	
(7)	(when it has reached its decision) notify the <i>recognised body</i> (or applicant) concerned in writing;	
(8)	(if it has decided to give a direction, or revoke or refuse to make a <i>recognition order</i>) take such steps as it considers reasonably practicable to bring its decision to the attention of <i>members</i> of the <i>recognised body</i> or applicant and to other <i>persons</i> likely to be affected.	The <i>FSA</i> will usually give notice of its decision to the same <i>persons</i> and in the same manner as it gave notice of its intention to act.

Chapter 5.

APPLICATIONS FOR RECOGNITION (UK RECOGNISED BODIES)

5.

5.1 Introduction and legal background

- 5.1.1** **G** ^{/1} A *body corporate* or an unincorporated association may apply to the *FSA* for recognition as a *UK recognised body* under sections 287 (Application by an investment exchange) or 288 (Application by a clearing house) of the *Act*.
- 5.1.2** **G** ^{/1} This chapter sets out *guidance* for *UK* applicants and for *UK* entities which are considering making an application. *Guidance* for applicants and prospective applicants for *overseas recognised body* status is given in *REC 6*.
- 5.1.3** **G** ^{/1} The Director General of Fair Trading, the Competition Commission and the Treasury also have specific roles in relation to competition issues raised by applications to become a *recognised body*.
- 5.1.4** **G** ^{/1}
- (1) Under section 303 of the *Act* (Initial report by the Director), the Director General of Fair Trading must issue a report on whether any of the applicant's *regulatory provisions* have a significantly adverse effect on competition. He must send copies of his report to the Treasury, the Competition Commission and the *FSA*.
 - (2) If the Director General of Fair Trading concludes that any of the applicant's *regulatory provisions* have a significantly adverse effect on competition, or if the Director General of Fair Trading concludes that none of the applicant's *regulatory provisions* has a significantly adverse effect on competition, but he nonetheless asks the Competition Commission to consider his report, the Competition Commission must normally make its own report under section 306 of the *Act* (Consideration by Competition Commission) on whether any of the applicant's *regulatory provisions* would have a significantly adverse effect on competition, whether any such effect is justified and, if it is not justified, what action, if any, the Treasury should direct the *FSA* to take.
 - (3) The Treasury's approval is required under section 307 of the *Act* (Recognition orders: role of the Treasury) before a *recognition order* can be made. (See also *REC 5.2.11G*.)
- 5.1.5** **G** ^{/1} The *FSA* must therefore send the Director General of Fair Trading copies of any *regulatory provisions* provided with the application. The *FSA* must also send to the Director General of Fair Trading such information in its possession as a result of the application, including supplementary information received after the application is made, but before it is determined by the *FSA*, as the *FSA* considers will assist the Director General of Fair Trading in discharging his functions in connection with the application.
- 5.1.6** **G** ^{/1} The Office of Fair Trading may also make informal requests for further information from an applicant. The Director General of Fair Trading also has powers under section 305 of the *Act* (Investigations by Director) to obtain compulsorily *documents* or information from the applicant or other *persons*.

5.1.7

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Potential applicants may wish to consult the Office of Fair Trading separately if they have any queries about the competition assessment or there are any aspects of their rules, guidance or clearing arrangements which they consider they may need to discuss with them.



5.2 Application process

- 5.2.1** G_{/1} An applicant for *recognised body* status needs to demonstrate to the FSA that it is able to meet the *recognition requirements* before a *recognition order* can be made. Once it has been recognised, a *recognised body* has to comply with the *recognition requirements* at all times. (*Guidance on the recognition requirements* applicable to *UK recognised bodies* (and applicants) is given in REC 2).
- 5.2.2** G_{/1}
- (1) There is no standard application form. A prospective applicant should contact the Markets and Exchanges Division at the FSA at an early stage for advice on the preparation, scheduling and practical aspects of its application.
 - (2) It is very important, if an application is to be processed smoothly and in a reasonable time, that it is comprehensively prepared and based on a well-developed and clear proposal.
- 5.2.3** G_{/1} An application should:
- (1) be made in accordance with any directions the FSA may make under section 287 (Application by an investment exchange) or section 288 (Application by a clearing house) of the Act;
 - (2) be accompanied by the applicant’s *regulatory provisions* (the material specifically prescribed in section 287 or section 288);
 - (3) be accompanied by the information, evidence and explanatory material (including supporting documentation) necessary to demonstrate to the FSA that the *recognition requirements* will be met; and
 - (4) be accompanied by the appropriate fee (see REC 7).
- 5.2.4** G_{/1} Other information and documentation which should normally accompany an application is listed in more detail in REC 5.2.14G.
- 5.2.5** G_{/1} A prospective applicant who is an *authorised person* may wish to consult the FSA about the extent to which information which it has already supplied in connection with its status as an *authorised person* can be used to support an application to become a *UK recognised body*.
- 5.2.6** G_{/1} Under section 289 of the Act (Applications: supplementary), the FSA may require the applicant to provide additional information, and may require the applicant to verify any information in any manner. In view of their likely importance for any application, the FSA will normally wish to arrange for its own inspection of an applicant’s information technology systems.
- 5.2.7** G_{/1} At any time after making a formal application, the applicant may make amendments to its rules, guidance or any other part of its application submitted to the FSA. Any amendments or additional information are likely to be forwarded by

the *FSA* to the Director General of Fair Trading and the Treasury under section 303 of the *Act* (Initial report by Director) (see *REC 5.1.5G*).

- 5.2.8** G /1
- (1) The *FSA* will keep the applicant informed of the progress of the application.
 - (2) It may be necessary to ask the applicant to clarify or amplify some aspects of its proposals. The *FSA* may wish to discuss various aspects of the application and may invite the applicant to attend one or more meetings for that purpose. When requested to do so, the *FSA* will explain the nature of the information which it has asked an applicant to supply in connection with its application.
- 5.2.9** G /1
- (1) While the *FSA* is considering the application, the Office of Fair Trading will be reviewing the *regulatory provisions* so that the Director General of Fair Trading is able to make the report required by section 303 of the *Act*.
 - (2) When the Director General of Fair Trading has issued his report, if the circumstances described in *REC 5.1.4G* apply, the Competition Commission must normally make its own report under section 306 of the *Act*.
- 5.2.10** G /1
- Where the *FSA* considers that an applicant satisfies the *recognition requirements*, and that the Treasury has had an opportunity to consider any reports from the Director General of Fair Trading and the Competition Commission, the *FSA* will then seek the Treasury’s approval, under section 307 of the *Act* (Recognition orders: role of the Treasury), to the making of a *recognition order*.
- 5.2.11** G /1
- Under section 307 of the *Act*, the Treasury will have to follow the advice of the Director General of Fair Trading or the Competition Commission as appropriate unless it considers that there are exceptional circumstances for not doing so. The Treasury will therefore ordinarily give its approval to the making of a *recognition order* if the applicant’s *regulatory provisions* are not considered to have a significantly adverse effect on competition or, if they are considered to have that effect, the effect is justified. It will ordinarily refuse its approval if the applicant’s *regulatory provisions* are considered to have any significantly adverse effect on competition and that effect is not considered to be justified.
- 5.2.12** G /1
- Where the *FSA* considers that it is unlikely to make a *recognition order*, or to seek the Treasury’s approval, it will discuss its concerns with the applicant as early as possible with a view to enabling the applicant to make changes to its rules or guidance, or other parts of the application (see *REC 5.2.7G*). If the *FSA* decides that it will not make a *recognition order*, it will follow the procedure set out in section 298 of the *Act* (Directions and revocation: procedure) and described in more detail in *REC 4.8*.
- 5.2.13** G /1
- The *FSA* will notify the applicant if the Treasury does not give its approval under section 307 of the *Act* (Recognition orders: role of the Treasury). Under section 290 (Recognition orders), the *FSA* does not have to follow the section 298 procedure (see *REC 4.8*) in this case and will not normally do so. The Treasury is required in those circumstances to follow a similar procedure under section 310 of the *Act* (Procedure on the exercise of certain powers by the Treasury).
- 5.2.14** G /1
- Table** Information and supporting documentation (see *REC 5.2.4G*).
- | | |
|-----|---|
| (1) | Details of the applicant’s constitution, structure and ownership, including its memorandum and articles of association (or similar or analogous <i>documents</i>) and any agreements between the applicant, its owners or other <i>persons</i> relating to its constitution or governance. |
| (2) | Details of all business to be conducted by the applicant, whether or not a <i>regulated activity</i> . |

- (3) Details of the *facilities* which the applicant plans to operate, including details of the trading platform, settlement arrangements, clearing services and *custody* services which it plans to supply.
- (4) Copies of the last three *annual reports and accounts* and, for the current financial year, quarterly *management accounts*.
- (5) Details of its business plan for the first three years of operation as a *UK recognised body*.
- (6) A full organisation chart and a list of the posts to be held by *key individuals* (with details of the duties and responsibilities) and the names of the *persons* proposed for these appointments when these names are available.
- (7) Details of its auditors, bankers, solicitors and any *persons* providing corporate finance advice or similar services (such as reporting accountants) to the applicant.
- (8) Details of any *relevant functions* to be outsourced or delegated, with copies of relevant agreements.
- (9) Details of information technology systems and of arrangements for their supply, management, maintenance and upgrading, and security.
- (10) Details of all plans to minimise disruption to operation of its *facilities* in the event of the failure of its information technology systems.
- (11) Details of internal systems for financial control, arrangements for risk management and insurance arrangements to cover operational and other risks.
- (12) Details of its arrangements for managing any counterparty risks, including details of margining systems, guarantee funds and insurance arrangements.
- (13) Details of internal arrangements to safeguard confidential or privileged information and for handling conflicts of interest.
- (14) Details of arrangements for complying with the *notification rules* and other requirements to supply information to the *FSA*.
- (15) Details of the arrangements to be made for monitoring and enforcing compliance with its rules and with its clearing, settlement and default arrangements.
- (16) A summary of the legal due diligence carried out in relation to ascertaining the enforceability of its rules (including *default rules*) and arrangements for margin against any of its *members* based outside the *United Kingdom*, and the results and conclusions reached.
- (17) Details of the procedures to be followed for declaring a *member* in default, and for taking action after that event to close out positions, protect the interests of other *members* and enforce its *default rules*.
- (18) Details of *membership* selection criteria, rules and procedures.
- (19) Details of arrangements for recording transactions effected by, or cleared through, its *facilities*.
- (20) Details of arrangements for detecting *financial crime* and *market abuse*, including arrangements for complying with *money laundering* law.
- (21) Details of criteria, rules and arrangements for selecting *specified investments* to be *admitted to trading* on (or cleared by) an *RIE*, or to be cleared by an *RCH* and, where relevant, details of how information regarding *specified investments* will be disseminated to users of its *facilities*.
- (22) Details of arrangements for cooperating with the *FSA* and other appropriate authorities, including draft memoranda of understanding or letters.
- (23) Details of the procedures and arrangements for making and amending rules, including arrangements for consulting on rule changes.
- (24) Details of disciplinary and appeal procedures, and of the arrangements for investigating complaints.

Chapter 6.

OVERSEAS INVESTMENT EXCHANGES AND OVERSEAS CLEARING HOUSES

6.

6.1 Introduction and legal background

6.1.1

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The *Act* prohibits any *person* from carrying on, or purporting to carry on, *regulated activities* in the *United Kingdom* unless that *person* is an *authorised person* or an *exempt person*. If an *overseas investment exchange* or *overseas clearing house* wishes to undertake *regulated activities* in the *United Kingdom*, it will need to:

- (1) obtain a *Part IV permission* from the *FSA*;
- (2) (in the case of an *EEA firm* or a *Treaty firm*) qualify for *authorisation* under Schedule 3 (EEA Passport Rights) or Schedule 4 (Treaty rights) to the *Act*, respectively; or
- (3) obtain *exempt person* status by being a *regulated market* under the *Investment Services Directive*; or
- (4) obtain *exempt person* status by being declared by the *FSA* to be (in the case of an *overseas investment exchange*) an *ROIE* or (in the case of an *overseas clearing house*) an *ROCH*.

6.1.2

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Having the status of an *overseas recognised body* facilitates the participation of *overseas investment exchanges* and *overseas clearing houses* in *UK markets*. In comparison with *authorisation*, it reduces the involvement which *UK* authorities need to have in the day-to-day affairs of an *overseas recognised body* because they are able to rely substantially on the supervisory and regulatory arrangements in the country where the applicant's head office is situated.



6.2 Applications

6.2.1

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- (1) *Overseas investment exchanges and overseas clearing houses* which are considering whether to seek *authorisation* or recognition should first consider whether they will be carrying on *regulated activities* in the *United Kingdom*. *Overseas investment exchanges and overseas clearing houses* which do not carry on *regulated activities* in the *United Kingdom* need take no action.
- (2) Prospective applicants should discuss *authorisation* and recognition with the *FSA* before deciding whether to seek *authorisation* or recognition.

6.2.2

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A prospective applicant may wish to contact the Markets and Exchanges Division at the *FSA* at an early stage for advice on the preparation, scheduling and practical aspects of an application to become an *overseas recognised body*.

6.2.3

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Applications for *authorised person* status should be made in accordance with the Authorisation manual (*AUTH*). Applications for recognition as an *overseas recognised body* should be addressed to:

The Financial Services Authority (Markets and Exchanges Division)

25 The North Colonnade

Canary Wharf

London E14 5HS

6.2.4

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There is no standard application form for application for recognition as an *overseas recognised body*. An application should be made in accordance with any direction the *FSA* may make under section 287 (Application by an investment exchange) or section 288 (Application by a clearing house) of the *Act* and should include:

- (1) the information, evidence and explanatory material necessary to demonstrate to the *FSA* that the *recognition requirements* (set out in *REC 6.3*) will be met;
- (2) the application fee (see *REC 7*);
- (3) the address of the applicant's head office in its *home territory*;
- (4) the address of a place in the *United Kingdom* for the service on the applicant of notices or other *documents* required or authorised to be served on it under the *Act* (see section 292(1));
- (5) the applicant's *regulatory provisions*;
- (6) one copy of each of the following *documents*:
 - (a) its most recent *annual report and accounts*; and

- (b) the applicant’s memorandum and articles of association or any similar or analogous *documents*; and
- (7) information identifying the following (if not contained in the *documents* listed in (5) or (6) or the material referred to in (1)):
 - (a) any type of *regulated activity* which the applicant envisages carrying on in the *United Kingdom*;
 - (b) any type of *specified investment dealt in* on, or cleared by, the applicant;
 - (c) the date by which the applicant wishes the *recognition order* to take effect; and
 - (d) any body or authority which supervises the applicant under the law of the *home territory*, the status of the applicant under that law, and the enactment or regulation under which the supervision is conducted.

6.2.5

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The *FSA* may require further information from the applicant and may need to have discussions with the appropriate authorities in the applicant’s *home territory*. To allow sufficient time for applications to be processed and for the necessary contacts to be made with the appropriate *home territory* authorities, applications should be made not later than six months before the applicant wishes the *recognition order* to take effect. No guarantee can be given that a decision will be reached within this time, although the *FSA* will endeavour to meet the applicant’s reasonable timing requirements.

6.2.6

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All material should be supplied in English, or accompanied, if appropriate, by an accurate English translation. An English glossary of technical or statistical terms may be sufficient to accompany tables of statistical or financial information.



6.3 Recognition requirements

6.3.1

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Before making a *recognition order*, the *FSA* will need to be satisfied that the *recognition requirements* in section 292(3) of the *Act* (Overseas investment exchanges and clearing houses) have been met. These requirements are the only *recognition requirements* applicable to *overseas recognised bodies*.

6.3.2

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Table Sections 292(3) and 292(4) state:

Section 292(3)

The requirements are that–

- (a) investors are afforded protection equivalent to that which they would be afforded if the body concerned were required to comply with *recognition requirements*;
- (b) there are adequate procedures for dealing with a *person* who is unable, or likely to become unable, to meet his obligations in respect of one or more *market contracts* connected with the [ROIE] or [ROCH];
- (c) the applicant is able and willing to co-operate with the [FSA] by the sharing of information and in other ways; and
- (d) adequate arrangements exist for co-operation between the [FSA] and those responsible for the supervision of the applicant in the country or territory in which the applicant’s head office is situated.

Section 292(4)

In considering whether it is satisfied as to the requirements mentioned in subsections (3)(a) and (b), the [FSA] is to have regard to–

- (a) the relevant law and practice of the country or territory in which the applicant’s head office is situated;
- (b) the rules and practices of the applicant.

6.3.3

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The reference to *recognition requirements* in section 292(3)(a) of the *Act* is a reference to the requirements applicable to *UK RIEs* or *UK RCHs* in the *Recognition Requirements Regulations*. These requirements are set out, together with *guidance*, in *REC 2*.



6.4 Competition scrutiny

6.4.1

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Applications from *overseas investment exchanges* and *overseas clearing houses* are subject to the same competition scrutiny as applications from prospective *UK recognised bodies* (see *REC 5*). The *FSA* will therefore follow the relevant steps set out in *REC 5.2* and may not make a *recognition order* without the approval of the Treasury.

6.4.2

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Potential applicants may wish to consult the Office of Fair Trading separately if they have any queries about the competition assessment or there are any aspects of their rules or guidance which they consider they may need to discuss with the Office of Fair Trading.

6.



6.5 FSA decision on recognition

- 6.5.1** G_{/1} If the *FSA* considers that the requirements of the *Act* are satisfied, it may make a *recognition order*, which will state the date on which it takes effect.
- 6.5.2** G_{/1} Where the *FSA* considers that it is unlikely to make a *recognition order*, it will discuss its concerns with the applicant with a view to enabling the applicant to make changes to its rules or guidance, or other parts of the application. If the *FSA* decides to refuse to make a *recognition order*, it will follow the procedure set out in section 298 of the *Act* (Directions and revocation: procedure) (which applies in consequence of section 290(5) of the *Act* (Recognition orders)) which is described in more detail in *REC* 4.8.
- 6.5.3** G_{/1} The *FSA* will notify the applicant if the Treasury fails to give its approval under section 307 of the *Act* (Recognition orders: role of the Treasury). Under section 290, the *FSA* is not required to follow the procedure under section 298 in this case and will not normally do so.

6.6 Supervision

6.6.1

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An *overseas recognised body* is required to notify the FSA of certain events and give information to it on a regular basis and when certain specified events occur. Section 295 of the *Act* (Notification: overseas investment exchanges and overseas clearing houses) requires each *overseas recognised body* to provide the FSA, the Treasury and the Director General of Fair Trading with a report (at least once a year) which contains:

- (1) a statement as to whether any events have occurred which are likely:
 - (a) to affect the FSA's assessment of whether it is satisfied that the *overseas recognised body* continues to satisfy the *recognition requirements* set out in section 292(3) of the *Act* (Overseas investment exchanges and overseas clearing houses)(see REC 6.3); and
 - (b) to have any effect on competition;
- (2) the information specified in the FSA's *notification rules* for *overseas recognised bodies* (see REC 6.7).

6.6.2

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The following events are examples of events likely to affect an assessment of whether an *overseas recognised body* is continuing to satisfy the *recognition requirements*, or to have an effect on competition:

- (1) significant changes to any relevant law or regulation in its *home territory*, including laws or regulations:
 - (a) governing exchanges or *clearing houses*;
 - (b) designed to prevent insider dealing, market manipulation or other forms of market abuse or misconduct;
 - (c) designed to protect the interests of *clients* of *members* of the *overseas recognised body*, or of a class of bodies which includes the *overseas recognised body*;
 - (d) which affect:
 - (i) the ability of the *overseas recognised body* to seek information (whether compulsorily or voluntarily) from its *members*, including information relating to the price and volume of transactions, the identity of parties to transactions, and the movement of funds associated with transactions;
 - (ii) which affect the ability of the *overseas recognised body* to pass such information, on request, to UK authorities;

- (2) significant changes to its internal organisation or structure;
- (3) significant changes to the practices of the *overseas recognised body* applying to any *regulated activities* carried on by it in the *United Kingdom*;
- (4) any other event or series of events in relation to the body which:
 - (a) affects or may significantly affect cooperation between the *overseas recognised body*, or its supervisor in its *home territory*, and the *FSA*; or
 - (b) has or may have a substantial effect on the structure of the markets in which the body operates; or
 - (c) brings about or may bring about a substantial change in the nature and composition of its *membership* in the *United Kingdom*; or
 - (d) brings about or may bring about a substantial change in the *regulated activities* undertaken by it in the *United Kingdom*.

6.6.3 G_{/1} The period covered by a report submitted under section 295(1) of the *Act* starts on the day after the period covered by its last report or, if there is no such report, after the making of the *recognition order* recognising the *overseas recognised body* as such, and ends on the date specified in the report or, if no date is specified, on the date of the report.

6.6.4 G_{/1} If an *overseas recognised body* changes the period covered by its report, it should ensure that the first day of the period covered by a report is the day immediately following the last day of the period covered by the previous report.

6.6.5 G_{/1} The period covered by a report submitted under section 295(1) of the *Act* would most conveniently be one year.

6.6.6 G_{/1} Copies of the report should be sent to the *FSA*, the Treasury and the Director General of Fair Trading within two months after the end of the period to which it relates.



6.7 Notification rules for overseas recognised bodies

Application

6.7.1 **R** _{/1} The *notification rules* in this chapter, which are made under sections 293 (Notification requirements) and 295 of the *Act* (Notification: overseas investment exchanges and overseas clearing houses), apply to all *overseas recognised bodies*.

Purpose

6.7.2 **G** _{/1} The *notification rules* in this chapter are made by the *FSA* in order to ensure that it is provided with notice of events and information which it reasonably requires for the exercise of its functions under the *Act*.

Reports under section 295

6.7.3 **R** _{/1} Where an *overseas recognised body* includes in its report made under section 295(1) of the *Act* (Notification: overseas investment exchanges and overseas clearing houses) a statement in compliance with section 295(2)(a) of the *Act* that an event has occurred in the period covered by that report which is likely to affect the *FSA*'s assessment of whether it is satisfied as to the requirements set out in section 292(3) (Overseas investment exchanges and overseas clearing houses), it must include particulars of that event.

6.7.4 **R** _{/1} An *overseas recognised body* must include in its report submitted in compliance with section 295(1) of the *Act*:

- (1) particulars of any changes to:
 - (a) its memorandum and articles of association or any similar or analogous *documents*;
 - (b) its *regulatory provisions*;
 - (c) its chairman or president, or *chief executive* (or equivalent);

(2) particulars of any disciplinary action (or any similar or analogous action) taken against it by any supervisory authority in its *home territory*, whether or not that action has been made public in that territory; and

(3) a copy of its *annual report and accounts*;

where those events occurred, or the period covered by that *annual report and accounts* ended, in the period covered by that report.

First report

6.7.5

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An *overseas recognised body* must include in the first report submitted under section 295(1) of the *Act* after the *recognition order* in relation to that *overseas recognised body* is made:

(1) particulars of any events of the kind described in section 295(2) of the *Act* which occurred;

(2) particulars of any change specified in *REC 6.7.4R(1)* or disciplinary action specified in *REC 6.7.4R(2)* which occurred; and

(3) any *annual report and accounts* which covered a period ending;

after the application for recognition was submitted to the *FSA* but which were not included in the application or in any supplementary information submitted to the *FSA* before the *recognition order* was made.

6.7.6

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Guidance on the period covered by an *overseas recognised body's* report submitted in compliance with section 295(1) of the *Act* is given in *REC 6.6.3G*.

Changes of address

6.7.7

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Where an *overseas recognised body* proposes to change:

(1) its address in the *United Kingdom* for the service of notices or other *documents* required or authorised to be served on it under the *Act*; or

(2) the address of its head office;

it must give notice to the *FSA* and inform it of the new address at least 14 days before the change is effected.

Revocation or modification of home territory licence, permission or authorisation

6.7.8 **R** ^{/1} Where an *overseas recognised body* has notice that any licence, permission or authorisation which it requires to conduct any *regulated activity* in its *home territory* has been or is about to be:

- (1) revoked; or
- (2) modified in any way which would materially restrict the *overseas recognised body* in performing any *regulated activity* in its *home territory* or in the *United Kingdom*;

it must immediately notify the *FSA* of that fact and must give the *FSA* the information specified for the purposes of this *rule* in *REC 6.7.9G*, as soon as that information is known to it.

6.7.9 **R** ^{/1} The following information is specified for the purposes of *REC 6.7.8G*:

- (1) particulars of the licence, permission or authorisation which has been or is to be revoked or modified, including particulars of the *overseas recognised body's regulated activities* to which it relates;
- (2) an explanation of how the revocation or modification restricts or will restrict the *overseas recognised body* in carrying on any *regulated activity* in its *home territory* or in the *United Kingdom*;
- (3) the date on which the revocation or modification took, or will take, effect and, if it is a temporary measure, any date on which, or any conditions that must be met before which, it will cease to have effect; and
- (4) any reasons given for the revocation or modification.

Language of notice

6.7.10 **R** ^{/1} Any notice to be given or information to be supplied under these *notification rules* must be supplied in English, and any *document* to be provided must be accompanied, if not in English, by an accurate English translation.

6.7.11 **G** ^{/1} An English glossary of technical or statistical terms may be sufficient to accompany tables of statistical or financial information.

Form and method of notification

6.7.12 **R** ^{/1} The *rules* relating to the form and method of notification in *REC 3.2* also apply to *overseas recognised bodies*.

Waivers

6.7.13

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/1

Overseas recognised bodies may apply to the *FSA* for a *waiver* of any of the *notification rules*. The procedure is the same as that for applications from *UK recognised bodies*. *Guidance* on the procedure is given in *REC 3.3*.

6.



6.8 Powers of direction and revocation of recognition orders

6.8.1

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The *FSA* has similar powers to supervise *overseas recognised bodies* to those it has to supervise *UK recognised bodies*. It may (in addition to any other powers it might exercise):

- (1) give directions to an *overseas recognised body* under section 296 of the *Act* (Authority's power to give directions) if it has failed, or is likely to fail, to satisfy the *recognition requirements* or if it has failed to comply with any other obligation imposed by or under the *Act*; or
- (2) revoke a *recognition order* under section 297 of the *Act* (Revoking recognition) if an *overseas recognised body* is failing, or has failed, to comply with the *recognition requirements* or any other obligation in or under the *Act*.

6.8.2

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The *FSA* will follow the approach in *REC 4.6*, *REC 4.7* and *REC 4.8* if it is considering exercising these powers in relation to an *overseas recognised body*.

Handbook Modules

Schedule1 Record keeping requirements

1 G
 Table

There are no record keeping requirements as such in *REC*.

UK recognised bodies have obligations under the *Recognition Requirements Regulations* to ensure that satisfactory arrangements are made for recording transactions effected by, or cleared through, their *facilities*. See *REC 2.9* for *guidance*.

Handbook Modules

Schedule2 Notification requirements

G

1 Table

The following table summarises the notification requirements applicable to all *recognised bodies*. The *notification rules* are set out in detail in *REC 3* and *REC 6.7* and, to avoid unnecessary repetition, are not set out in detail here.

For completeness, summary details of the main notification requirements in the *Act* itself and the Companies Act 1989 are also included in the table. The summary of these statutory provisions here should not be taken to imply that these are obligations imposed by the *FSA* under its powers nor that the following summary supersedes or alters the meaning of these provisions.

Guidance on the statutory notification requirements for *overseas recognised bodies* is given in *REC 6.6*.

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<i>UK recognised bodies</i>				
The Act s293(5)	Changes to rules and guidance	Details of change	Change to rule or guidance	Without delay
Companies Act 1989 s157	Proposed changes to <i>default rules</i>	Details of proposed change	Proposal to change <i>default rules</i>	14 days in advance of change
<i>UK recognised investment exchanges</i>				
The Act s293(6)(a)	Changes to arrangements for clearing <i>on-exchange</i> transactions	Details of change	Change to arrangements	Without delay
The Act s293(6)(b)	Changes to criteria determining to whom it will provide clearing services	Details of change	Change to criteria	Without delay
<i>UK recognised clearing houses</i>				
The Act s293(7)(a)	Changes to <i>RIEs</i> for whom clearing services provided	Details of change	Change to <i>RIE</i>	Without delay
The Act s293(7)(b)	Changes to criteria determining to whom (other than <i>RIEs</i>) it will provide clearing services	Details of change	Change to criteria	Without delay
<i>Notification rules for UK recognised bodies (see REC 3)</i>				
<i>REC 3.4</i>	<i>Key individuals</i> and internal organisation	Details of change	Change in <i>key individual</i> or standing committee	Immediately

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
REC 3.5	Disciplinary action and events relating to <i>key individuals</i>	Details of disciplinary action or event	Disciplinary action or awareness of event	Immediately
REC 3.6	Constitution and governance	Details of proposals to amend constitution, amendments to constitution and agreements relating to constitution	Communication of proposal to amend constitution, making amendment to constitution or awareness of agreement relating to constitution	Immediately
REC 3.7	Auditors	Details of removal or appointment of auditors	Removal or appointment of auditors	Immediately
REC 3.8	Financial and other information	See REC 3.8	See REC 3.8	See REC 3.8
REC 3.9	Fees and incentive schemes	Summary of proposals to change fees and charges and changes to fees and charges	Communication to <i>members</i>	Immediately
REC 3.10	Complaints	Copy of adverse report and details of recommendations from <i>complaints investigator</i>	Availability of report or recommendations	Immediately
REC 3.11	Insolvency events	Notice of insolvency event	Insolvency event	Immediately
REC 3.12	Legal proceedings	Details of legal proceedings commenced against <i>UK recognised body</i>	Institution of proceedings	Immediately
REC 3.13	Delegation of <i>relevant functions</i>	Details of offers or agreements to delegate <i>relevant functions</i> and offers or agreements to undertake relevant functions on behalf of another <i>recognised body</i>	Making offer or agreement to delegate	Immediately
REC 3.14	Products, services and normal hours of operation	Proposals to change products, services or normal hours of operation	Communication of proposal to <i>members</i> or shareholders	Immediately
REC 3.15	Suspension of services and inability to operate <i>facilities</i>	Details of suspension of services, inability to operate facilities and extension of hours of operation in an emergency	Event concerned	Immediately

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
REC 3.16	Information technology systems	Details of business continuity plans and details of failure of reserve information technology system	Changes to business continuity plans and failure of reserve information technology system	Immediately
REC 3.17	Inability to discharge <i>regulatory functions</i>	Details of inability to discharge a <i>regulatory function</i>	Event concerned	Immediately
REC 3.18	Membership	Information regarding new types of <i>member</i> and reasons for considering <i>recognition requirements</i> can still be met	Admission of new type of <i>non-authorised person</i> or <i>person</i> from new <i>non-UK</i> jurisdiction to membership	Immediately
REC 3.19	Investigations	Notice of appointment of person to investigate use of <i>facilities</i> or provision of services	Awareness of appointment	Immediately
REC 3.20	Disciplinary action	Details of person against whom disciplinary action taken	Taking disciplinary action	Immediately
REC 3.21	Criminal offences and civil prohibitions	Evidence tending to suggest contraventions of the <i>general prohibition</i> , certain criminal offences or <i>market abuse</i>	Having evidence concerned	Immediately
REC 3.22	Restriction or instruction to close out, open positions	Details of decision to restrict <i>member's</i> open position or instruction to close out position	Decision to take action	Immediately
REC 3.23	Default	Notice of decision to put <i>member</i> into default	Communicating decision to <i>member</i> concerned or any other member	Immediately
<i>Overseas recognised bodies</i>				
The Act s295	Report to FSA	Statement as to whether events have occurred which would affect the FSA's assessment of whether the <i>recognition requirements</i> are met or which might have an effect on competition	Not applicable	Once a year

Notification rules for overseas recognised bodies (see REC 6.7)

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<i>REC 6.7.3</i>	Events which might affect the <i>FSA's</i> assessment of whether the <i>recognition requirements</i> are met	Particulars of event	Not applicable	Include in report under s295
<i>REC 6.7.4</i>	Inclusion of certain matters in report	See <i>REC 6.7.4</i>	Not applicable	Include in report under s295
<i>REC 6.7.5</i>	First report	See <i>REC 6.7.5</i>	Not applicable	Include in report under s295
<i>REC 6.7.7</i>	Changes of address	Details of new addresses	Decision to change address	14 <i>days</i> in advance of change of address
<i>REC 6.7.8</i> and <i>REC 6.7.9</i>	Revocation or modification of home territory licence etc	Details of revocation or modification	Awareness of revocation or modification	Immediately

Handbook Modules

Schedule4 Powers exercised

1 G
 Table

The following powers and related provisions in the *Act* have been exercised by the *FSA* to make the *rules* in *REC*:

Section 156 (General supplementary powers)

Section 293 (Notification requirements)

Section 295 (Notification: overseas investment exchanges and overseas clearing houses)

The following power in the *Act* has been exercised by the *FSA* to give the *guidance* in *REC*:

Section 157 (1) (Guidance)

Handbook Modules

Schedule5 Rights of action for damages

1 G
 Table

There are no rights of action under section 150 of the *Act* in respect of any contravention by a *recognised body* of any *rule* made under the *Act*.

Handbook Modules

Schedule6 Rules that can be waived

1 G
 Table

The *notification rules* in *REC 3* and *REC 6* can be *waived* by the *FSA* under section 294 of the *Act* (Modification or waiver of rules). (The statutory notification requirements, also summarised in Schedule 2 to *REC*, cannot be *waived* by the *FSA*.)
The *fees rules* in *REC 7* cannot be *waived* by the *FSA*.

Recognised Investment Exchange and Recognised Clearing House sourcebook

Destinations and derivations

G

There was no single source of rules and guidance for recognised bodies under the Financial Services Act 1986. It is not therefore possible to produce detailed tables of destinations and derivations linking most of the provisions of *REC* to existing material.

This schedule provides:

- (i) a list of corresponding recognition requirements under the Financial Services Act 1986 and the Financial Services and Markets Act 2000 and the *Recognition Requirements Regulations*;
- (ii) a list of correspondences between notification requirements under the Financial Services Act 1986 and notification requirements under the Financial Services and Markets Act 2000;
- (iii) a summary of the main guidance issued under the Financial Services Act 1986 or other source material which was used in part in the preparation of the guidance issued in *REC*.

Entries are made in both columns where there is a nearest equivalent provision or one covering the same broad area under both the new and old legislation. "No equivalent" indicates that there is no real equivalent to the provision in the other column.

Recognition requirements

Recognition requirement under the Financial Services Act 1986	Recognition requirement under the Financial Services and Markets Act 2000
<p>UK RIEs</p> <p><u>Schedule 4 to the Financial Services Act 1986</u></p> <p>Paragraph 1 – financial resources (No equivalent) (No equivalent)</p> <p>Paragraph 2(1) – orderly markets and proper protection for investors (No equivalent)</p> <p>Paragraph 2(2) – proper markets and availability of information</p> <p>Paragraph 2(3) – repealed by the Official Listing of Securities (Change of Competent Authority) Regulations 2000</p>	<p><u>Part I of the Schedule to the Recognition Requirements Regulations</u></p> <p>Paragraph 1 – financial resources</p> <p>Paragraph 2 – suitability</p> <p>Paragraph 3 – systems and controls</p> <p>Paragraph 4(1) – orderly markets and proper protection for investors</p> <p>Paragraph 4(2)(a) – access to facilities</p> <p>Paragraphs 4(2)(b), 4(2)(c) and 4(3) – proper markets and relevant information</p> <p>(No equivalent)</p>

Recognition requirement under the Financial Services Act 1986	Recognition requirement under the Financial Services and Markets Act 2000
<p>Paragraphs 2(4) and 6(2) – settlement</p> <p>Paragraph 2(5) – transaction recording (No equivalent) (No equivalent) (No equivalent)</p> <p>Paragraph 3 – monitoring and enforcing rules</p> <p>Paragraph 4 – investigation of complaints</p> <p>Paragraph 5 – promotion and maintenance of standards</p> <p><u>Traded Securities (Disclosure) Regulations 1994</u></p> <p>Regulation 3(3)</p> <p><u>Part I of Schedule 21 to the Companies Act 1989</u></p> <p>Paragraph 1 – default rules</p> <p>Paragraph 2 – content of rules</p> <p>Paragraph 3 – notification to other parties affected</p> <p>Paragraph 4 – application of default rules to designated non-members</p> <p>Paragraph 5 – delegation of functions in connection with default procedures</p> <p>Paragraph 6 – cooperation with other authorities</p> <p>Paragraph 7 – margin</p>	<p>Paragraph 4(2)(d) – settlement</p> <p>Paragraph 4(2)(e) – transaction recording</p> <p>Paragraph 4(2)(f) – financial crime</p> <p>Paragraph 4(2)(g) – custody</p> <p>Paragraph 7 – rules and consultation</p> <p>Paragraph 8 – discipline</p> <p>Paragraph 9 – complaints</p> <p>Paragraph 6 – promotion and maintenance of standards</p> <p>Paragraph 5 – disclosure by issuers</p> <p><u>Part II of the Schedule to the Recognition Requirements Regulations</u></p> <p>Paragraph 10 – default rules in respect of market contracts</p> <p>Paragraphs 11 and 12 – content of rules</p> <p>Paragraph 13 – notification to other parties affected</p> <p>Paragraph 11 – content of rules</p> <p>Regulation 6(2) of the Recognition Requirements Regulations</p> <p>Paragraph 14 – cooperation with other authorities</p> <p>Paragraph 15 – margin</p>
<p>UK RCHs</p> <p><u>Section 39(4) of the Financial Services Act 1986</u></p> <p>Sub-section (a) – financial resources (No equivalent) (No equivalent)</p>	<p><u>Part III of the Schedule to the Recognition Requirements Regulations</u></p> <p>Paragraph 16 – financial resources</p> <p>Paragraph 17 – suitability</p> <p>Paragraph 18 – systems and controls</p>

Recognition requirement under the Financial Services Act 1986	Recognition requirement under the Financial Services and Markets Act 2000
(No equivalent) Sub-section (b) – monitoring and enforcing rules	Paragraph 21 – rules Paragraph 22 – discipline
(No equivalent)	Paragraph 19(1) – proper protection for investors
(No equivalent) Sub-section (c) – provision of settlement services for RIEs	Paragraph 19(2)(a) – access to facilities Paragraph 19(2)(b) – nature of clearing services
(No equivalent)	Paragraph 19(2)(c) – transaction recording
(No equivalent)	Paragraph 19(2)(d) – financial crime
(No equivalent)	Paragraph 19(2)(e) – custody
Sub-section (d) – promotion and maintenance of standards	Paragraphs 20 – promotion and maintenance of standards
(No equivalent)	Paragraph 23 – complaints
<u>Part II of Schedule 21 to the Companies Act 1989</u>	<u>Part IV of the Schedule to the Recognition Requirements Regulations</u>
Paragraph 8 – default rules	Paragraph 24 – default rules in respect of market contracts
Paragraphs 9 and 10 – content of rules	Paragraph 25 – content of rules
Paragraph 11 – notification to other parties affected	Paragraph 26 – notification to other parties affected
Paragraph 12 – delegation of functions in connection with default procedures	Regulation 6(2) of the Recognition Requirements Regulations
Paragraph 13 – cooperation with other authorities	Paragraph 27 – cooperation with other authorities
Paragraph 14 – margin	Paragraph 28 – margin

Recognition requirement under the Financial Services Act 1986	Recognition requirement under the Financial Services and Markets Act 2000
<p>Overseas recognised bodies</p> <p><u>Section 40(2) of the Financial Services Act 1986</u></p> <p>Sub-section (a) – equivalent protection</p> <p>Sub-section (b) – cooperation</p> <p>Sub-section (c) – supervisory or regulatory cooperation</p> <p><u>Part III of Schedule 21 to the Companies Act 1989</u></p> <p>Paragraph 15 – rules and practices</p>	<p><u>Section 292(3) of the Financial Services and Markets Act 2000</u></p> <p>Sub-section (a) – equivalent protection</p> <p>Sub-section (c) – cooperation</p> <p>Sub-section (d) – supervisory or regulatory cooperation</p> <p>Sub-section (b) – default procedures</p>

Notification requirements

Notification requirement under the Financial Services Act 1986	Notification requirement under the Financial Services and Markets Act 2000
<p>Sections 41(5) and 41(6) of the Financial Services Act 1986</p> <p>(No equivalent)</p> <p><u>Companies Act 1989</u></p> <p>Section 157</p> <p><u>The Financial Services (Notification by Recognised Bodies) Regulations 1995</u></p> <p>Rule 2.01</p> <p>Rule 2.03</p> <p>Rule 2.04</p> <p>Rule 2.05</p> <p>Rule 2.06</p> <p>Rule 2.07</p> <p>(No equivalent)</p> <p>(No equivalent)</p>	<p>Sections 293(5) to 293(8) of the Financial Services and Markets Act 2000</p> <p>Section 295(1) of the Financial Services and Markets Act 2000</p> <p><u>Companies Act 1989</u></p> <p>Section 157</p> <p><u>Chapter 3 of the RIE and RCH Sourcebook</u></p> <p>REC 3.4 and REC 3.5</p> <p>REC 3.5</p> <p>REC 3.6</p> <p>(No equivalent)</p> <p>REC 3.7</p> <p>REC 3.8 and REC 3.11</p> <p>REC 3.9</p> <p>REC 3.10</p>

Notification requirement under the Financial Services Act 1986	Notification requirement under the Financial Services and Markets Act 2000
Rule 2.08	REC 3.12
Rule 2.09	REC 3.13
Rules 2.10, 2.11 and 2.12	REC 3.14, REC 3.15 and REC 3.17
(No equivalent)	REC 3.16
Rules 3.03	REC 3.19
Rule 3.05	REC 3.20
Rule 3.06	REC 3.21
Rule 3.07	REC 3.22
Rule 3.08	REC 3.23
(No equivalent)	<u>Chapter 6 of the RIE and RCH Sourcebook</u>
(No equivalent)	REC 6.7

Main sources of guidance in the Recognised Investment Exchange and Recognised Clearing House sourcebook

FSA (formerly SIB) guidance releases etc

Endorsement of IOSCO's principles for the oversight of screen-based trading systems for derivative products (GR 2/91)

Incentive schemes in relation to on-exchange derivatives (GR 3/92)

Proper trades in relation to on-exchange derivatives (GR 1/93)

Proper markets in relation to on-exchange derivatives (GR 2/93)

Standards of regulation for recognised investment exchanges (GR 2/96)

Other material

Guidance for applicants for recognition as an overseas investment exchange or overseas clearing house – HM Treasury paper, June 1992

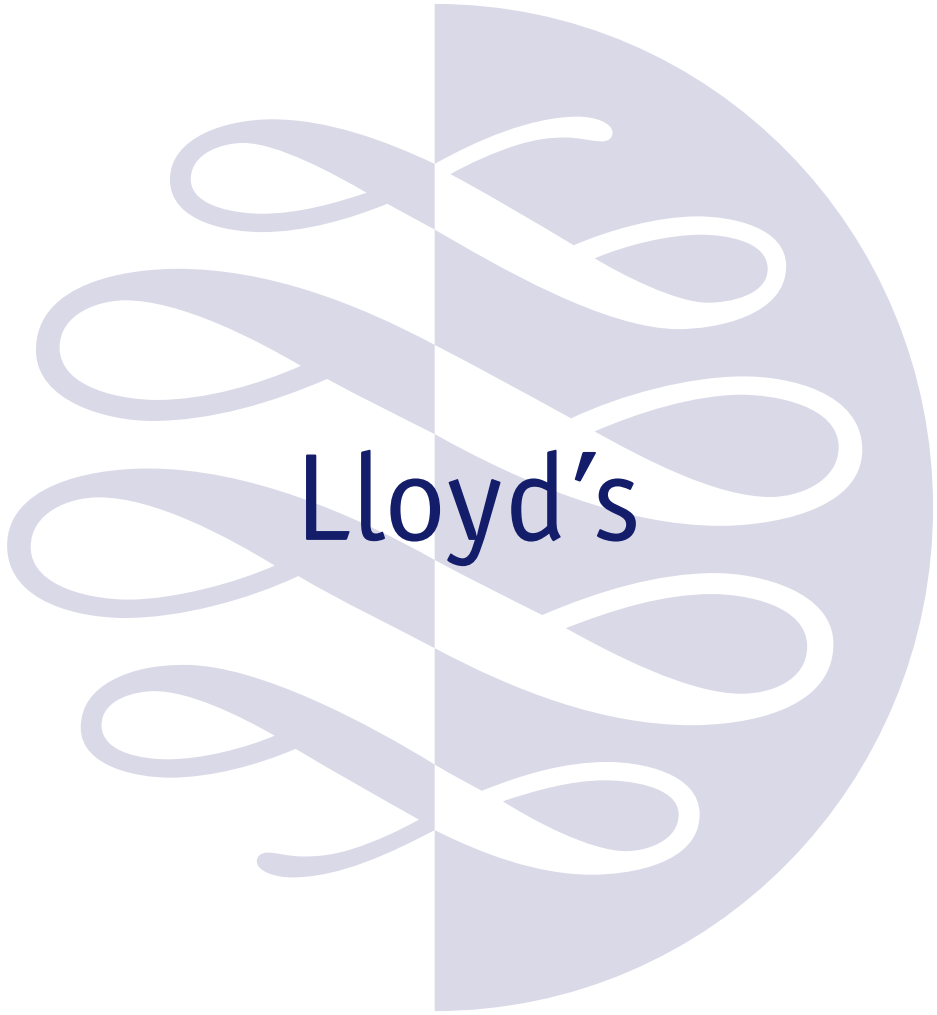
Regulation of the United Kingdom equity markets – SIB report, June 1995

LLOYD'S SOURCEBOOK INSTRUMENT 2001

- A The Financial Services Authority makes the rules and gives the directions and guidance in the Annex to this instrument ("LLD") in the exercise of the powers listed in Schedule 4 to LLD (Powers exercised)
- B This instrument shall come into force at the beginning of the day on which section 19 (The general prohibition) of the Financial Services and Markets Act 2000 (the "Act") comes into force.
- C The provisions of the Act relevant to making rules and listed in Schedule 4 to LLD (Powers exercised) are specified for the purpose of section 153(2) of the Act (Rule-making instruments).
- D This instrument may be cited as the Lloyd's Sourcebook Instrument 2001.
- E The Annex to this instrument (including its Schedules) may be cited as the Lloyd's sourcebook (or LLD).

By order of the Board
21 June 2001

ANNEX



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Lloyd's sourcebook - Transitional provisions

1 Table Transitional provisions

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1	<i>LLD 7.2.1R</i>	R	Where the <i>Society</i> receives a complaint relating to an act or a failure to act, which occurs before <i>commencement</i>, it may either handle that complaint in accordance with <i>LLD 7.2.1R</i> or with the complaints handling arrangements in effect at the time of the act or the failure to act.	Indefinite	<i>Commencement</i>
2	<i>LLD 7.4.1G</i>	G	The Society's first report to the FSA under <i>LLD 7.4.1G</i> should cover the period from <i>commencement</i> until the end of the following December or June, whichever is earlier.	From <i>commencement</i> until the end of the following December or June whichever is earlier	<i>Commencement</i>

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
3	<i>LLD</i> 13.2.2R and <i>LLD</i> 9 to <i>LLD</i> 15	R	The <i>Society</i> must comply with <i>LLD</i> 13.2.2R by identifying and valuing the assets of <i>individual members</i> that become <i>former underwriting members</i> before 1 January 2003 in accordance with the requirements for the identification and valuation of assets contained in the “Conditions and Requirements Relating to Solvency and Reporting” which were approved by the <i>FSA</i>, exercising the powers of HM Treasury under section 83 of the Insurance Companies Act 1982, and which were applicable immediately before <i>commencement</i>.	Indefinite	<i>Commencement</i>

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
4	<i>LLD 13.2.2R</i> and <i>LLD 9</i> to <i>LLD 15</i>	R	The <i>Society</i> must comply with <i>LLD 13.2.2R</i> by identifying and valuing the assets of <i>individual members</i> in accordance with the requirements for the identification and valuation of assets contained in the “Conditions and Requirements Relating to Solvency and Reporting” which were approved by the <i>FSA</i>, exercising the powers of HM Treasury under section 83 of the Insurance Companies Act 1982, and which were applicable immediately before commencement.	<i>Commencement to 31.12.2002</i>	<i>Commencement</i>
5	<i>LLD 15.9R</i> and <i>LLD 15.11R</i>	R	The <i>Society</i> need not comply with <i>LLD 15.9R</i> and <i>LLD 15.11R</i> provided the <i>Society</i> submits to the <i>FSA</i>, at the same time as the report in <i>LLD 15.2.1R</i>, a Statutory Statement of Business and Audit Certificate in the form required immediately before commencement.	<i>Commencement to 31.12.2001</i>	<i>Commencement</i>
6	<i>LLD</i>	G	<u>General transitional provisions</u> <i>GEN</i> contains some technical transitional provisions that apply throughout the <i>Handbook</i> and which are designed to ensure a smooth transition at commencement.	From commencement	<i>Commencement</i>

Chapter 1.

Society's regulatory functions



1.1 Application and purpose

Application

1.1.1

G
/1

The *guidance* in this chapter is relevant to the *Society*.

Purpose

1.1.2

G
/1

The *guidance* in this chapter is intended to:

- (1) promote confidence in the market at Lloyd's by ensuring that it is appropriately and effectively regulated by the *Society* and the *Council* and those to whom the *Council* delegates the *Society's regulatory functions*;
- (2) protect policyholders and *members*; and
- (3) enable the *FSA* to use its resources in an efficient and effective way when regulating *underwriting agents*, and *approved persons* acting for or on behalf of those agents, by making it possible for the *FSA* to rely on the *Society* and the *Council* to carry out certain functions on behalf of the *FSA* or otherwise.



1.2 Carrying out the Society's regulatory functions

Delegation

- 1.2.1** **G**_{/1} The *Society* should establish and maintain a clear, appropriate and effective delegation of responsibilities for the carrying out of the *Society's regulatory functions*, so that the *Council* can adequately monitor and control them.
- 1.2.2** **G**_{/1} The *Council* should:
- (1) approve and record the delegation referred to in *LLD 1.2.1G*; and
 - (2) review it at least once each year.
- 1.2.3** **G**_{/1} The terms and limits of any delegation of authority referred to in *LLD 1.2.1G* should be made clear to those to whom that authority is delegated.
- 1.2.4** **G**_{/1} Any committee to which the *Society* delegates authority under *LLD 1.2.1G* should:
- (1) have formal terms of reference;
 - (2) make and retain proper records, including minutes of its meetings; and
 - (3) be composed of an appropriate number of individuals who are collectively and individually fit and proper.
- 1.2.5** **G**_{/1} Any individual or other *person* to whom the *Society* delegates authority under *LLD 1.2.1G* should:
- (1) have a written statement of the scope of his delegated authority and the purpose for which it is to be exercised;
 - (2) make and retain proper records of the exercise of his delegated authority; and
 - (3) be fit and proper.

Disciplinary arrangements

- 1.2.6** **G**_{/1} The *Society's* disciplinary arrangements, including the activities of its disciplinary and appeal committees, should ensure a prompt, fair and independent hearing for any *person* accused of breaching a *byelaw*, as required by the Human Rights Act 1998.

Dealing with the FSA

- 1.2.7 **G**_{/1} In addition to complying with *Principle 11* in carrying on its *regulated activities*, the *Society* should deal with the *FSA* in an open and co-operative way in carrying out the *Society's regulatory functions* and should tell the *FSA* promptly of anything relating to the *FSA's* regulatory functions about which it would reasonably expect prompt notice.
- 1.2.8 **G**_{/1} The *Society* should ensure that the *FSA* is able to interview or otherwise obtain information directly from the committees, individuals or other *persons* to whom the *Society* delegates responsibility for carrying out the *Society's regulatory functions*.
- 1.2.9 **G**_{/1} The access described in *LLD 1.2.8G* should include appropriate access to the records of the committees, individuals or other *persons* who carry out the *Society's regulatory functions*.



1.3 Conflicts of interest

Arrangements

- 1.3.1** **G**_{/1} The *Society* should establish and maintain appropriate and effective arrangements to ensure that the carrying out of the *Society's regulatory functions* is not subject to any improper influence or appearance of improper influence.
- 1.3.2** **G**_{/1} The arrangements referred to in *LLD 1.3.1G* should extend to conflicts of interest that arise for *employees* of the *Society*, members of the *Council*, and others who may be involved in carrying out the *Society's regulatory functions*.
- 1.3.3** **G**_{/1} In *LLD 1.3* "conflicts of interest" include the appearance of a conflict of interest as well as an actual conflict of interest.
- 1.3.4** **G**_{/1} The *Society* should structure itself and delegate authority so that it can continue properly to carry out the *Society's regulatory functions* despite any conflicts of interest.
- 1.3.5** **G**_{/1} Matters that the *Society* should consider under *LLD 1.3.4G* include, but are not limited to:

 - (1) the size and composition of any committees to which authority to carry out the *Society's regulatory functions* has been or will be delegated; and
 - (2) the necessity to transfer authority to take decisions or responsibilities to alternates should a conflict of interest arise.

Guidelines

- 1.3.6** **G**_{/1} The *Society* should issue guidelines setting out how conflicts of interest are to be handled and where necessary requirements should be imposed to ensure that the guidelines are followed.
- 1.3.7** **G**_{/1} The guidelines or requirements referred to in *LLD 1.3.6G* may be contained, for example, in contracts of employment, staff rules, letters of appointment, or codes of conduct for members of the *Council* and of those committees to which authority to carry out the *Society's regulatory functions* has been delegated.
- 1.3.8** **G**_{/1} The guidelines referred to in *LLD 1.3.6G* should include:

 - (1) guidelines for determining whether a conflict of interest exists;

- (2) the need for prompt disclosure of any conflict of interest to enable others, not affected by the conflict, to decide how it should be managed;
- (3) guidelines for declaring any conflict of interest at proceedings of the *Council* and any committees to which the *Council* delegates responsibility for carrying out the *Society's regulatory functions*;
- (4) the circumstances in which a general advance disclosure of any conflicts of interest will usually be sufficient;
- (5) the circumstances in which a general advance disclosure may not be sufficient;
- (6) the circumstances in which it may be appropriate for a conflicted individual to withdraw from involvement in the matter concerned without disclosing the interest;
- (7) the circumstances in which individuals should withdraw from the decision-making process, from access to relevant information, or from proceedings of the *Council* or of any committees to which authority to carry out the *Society's regulatory functions* has been delegated by the *Council*; and
- (8) the penalty or other sanction that will apply if guidelines are not followed or requirements are not complied with.

1.3.9

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The *Society* should establish and maintain appropriate and effective arrangements to monitor compliance with the guidelines or requirements referred to in *LLD* 1.3.6G by its staff and other *persons* involved in carrying out the *Society's regulatory functions*.

Register and records

1.3.10

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The *Society* should:

- (1) make and retain a register of interests; and
- (2) make and retain records of disclosures of conflicts of interest and the steps taken to handle them.



1.4 Confidential regulatory information

1.4.1

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The *Society* should establish and maintain appropriate and effective arrangements to ensure that confidential regulatory information received or created by the *Society* is used only for carrying out the *Society's regulatory functions* and is subject to appropriate and effective restrictions limiting disclosure and use.

Chapter 2.

2.

Provision of information

2.1 Application and purpose

Application

2.1.1

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This chapter applies to the *Society* and the directions in it are given to the *Council* and to the *Society* acting through the *Council*.

Purpose

2.1.2

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The directions in this chapter are given under section 318 of the *Act* (Exercise of powers through Council), for the purpose of achieving the objective specified, as required by section 318(2) of the *Act*, in *LLD 2.2.1D*.

2.2 Specification of objective

2.2.1



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The directions and *guidance* in this chapter are given in relation to the exercise of the powers of the *Society* and of the *Council* generally, with a view to achieving the objective of enabling the *FSA* to:

- (1) comply with its general duty under section 314 of the *Act* (Authority's general duty);
- (2) determine whether *underwriting agents*, or *approved persons* acting for them or on their behalf, are complying with the requirements imposed on them by or under the *Act*;
- (3) enforce the provisions of the *Act*, or requirements made under the *Act*, by enabling the *FSA* to consider, where appropriate, whether it should use its powers, for example, to:
 - (a) vary or cancel the *permission* of an *underwriting agent*, under section 45 of the *Act* (Variation etc on the Authority's own initiative);
 - (b) withdraw approval from an *approved person* acting for or on behalf of an *underwriting agent*, under section 63 of the *Act* (Withdrawal of approval) (see *ENF* 7);
 - (c) prohibit an individual acting for or on behalf of an *underwriting agent* from involvement in *regulated activities*, under section 56 of the *Act* (Prohibition orders) (see *ENF* 8);
 - (d) require an *underwriting agent* to make restitution, under section 384 of the *Act* (Power of Authority to require restitution) (see *ENF* 9);
 - (e) discipline an *underwriting agent*, or an *approved person* acting for it or on its behalf, for a breach of a requirement made under the *Act*, including the *Principles*, *Statements of Principle* and *rules* (see *ENF* 11, 12 and 13);
 - (f) apply to court for an *injunction*, restitution order or *insolvency order* (see *ENF* 6, 9 and 10); and
 - (g) prosecute any criminal offence that the *FSA* has power to prosecute under the *Act* (see *ENF* 15).

2.2.2



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Information provided to the *FSA* by the *Society* to comply with the *Act*, requirements under the *Act* or *rules*, may also be used by the *FSA* for the purposes stated in *LLD* 2.2.1D.

2.2.3

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Other sections of *LLD* covering the provision of information to the *FSA* are:

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- (1) *LLD* 3.3 (Information about the Central Fund);
- (2) *LLD* 4.3 (Information about the capacity transfer market);
- (3) *LLD* 7.4 (Information about complaints); and
- (4) *LLD* 15 (Reporting by the Society).

2.3 Information on matters likely to be of material concern to the FSA

- 2.3.1** **D**_{/1} The *Society* must immediately inform the *FSA* in writing if it becomes aware that any matter likely to be of material concern to the *FSA* may have arisen in relation to:
- (1) the *regulated activities* for which the *Society* has permission; or
 - (2) *underwriting agents*; or
 - (3) *approved persons* or individuals acting for or on behalf of *underwriting agents*.
- 2.3.2** **G**_{/1} *LLD 2.3.1D* is designed to enable the *FSA* to fulfil its monitoring and enforcement obligations under paragraph 6 of Schedule 1 to the *Act* (The Financial Services Authority), whilst at the same time recognising the *Society's* powers and responsibilities for supervising and regulating the market.
- 2.3.3** **G**_{/1} In view of the *Society's* responsibilities for the *Society's regulatory functions*, the *FSA's* monitoring of *underwriting agents*, and *approved persons* acting for them or on their behalf, may be less intensive than its monitoring of *firms* and *approved persons* outside the Lloyd's market. The purpose of *LLD 2.3.1D* is to ensure that the *Society* informs the *FSA* when it becomes aware, as a result of carrying out the *Society's regulatory functions*, of matters likely to be of material concern to the *FSA*.
- 2.3.4** **G**_{/1} Matters likely to be of material concern to the *FSA* include but are not limited to:
- (1) facts suggesting that an *underwriting agent* may no longer satisfy the *threshold conditions* in relation to a *regulated activity* for which it has a *Part IV permission*;
 - (2) facts suggesting that an *underwriting agent* may have contravened, is contravening, or is likely to contravene, a requirement imposed on it by or under the *Act*;
 - (3) facts suggesting that the interests of *consumers* are or may be at risk;
 - (4) facts suggesting that an *approved person* acting for or on behalf of an *underwriting agent* may not be fit and proper to carry out the functions to which the approval relates;
 - (5) facts suggesting that an *approved person*, or individual acting for or on behalf of an *underwriting agent*, may not be fit and proper to perform functions in relation to a *regulated activity* carried on by a *firm* or *exempt person*;

- (6) facts suggesting that an *approved person* acting for or on behalf of an *underwriting agent* may have failed to comply with a *Statement of Principle*, or may have been concerned in the contravention by an *underwriting agent* of a requirement imposed on it by or under the *Act*; and
- (7) facts suggesting that a *person* may have committed a criminal offence that the *FSA* has power to prosecute under the *Act* and that came to the *Society's* notice in the course of its *regulated activities* or the *Society's regulatory functions*.

2.4 Information on investigations and disciplinary proceedings

2.4.1

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The *Society* must inform the *FSA* if it commences investigations or disciplinary proceedings relating to apparent breaches:

- (1) of the *Act* or requirements made under the *Act*, including the *threshold conditions* or the *Principles* or other *rules*, by an *underwriting agent*; or
- (2) of the *Statements of Principle* by an individual or other *person* who carries out *controlled functions* for or on behalf of an *underwriting agent*.

2.4.2

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The *Society* must inform the *FSA* if it commences investigations or disciplinary proceedings which do not fall within the scope of *LLD 2.4.1D* but which:

- (1) involve an *underwriting agent*, or an *approved person* who carries out *controlled functions* for it or on its behalf; or
- (2) may indicate that an individual acting for or on behalf of an *underwriting agent* may not be a fit and proper *person* to perform functions in relation to *regulated activities*.

2.4.3

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The information provided under *LLD 2.4.1D* and *LLD 2.4.2D* should include information about any:

- (1) commencement of an inquiry under Lloyd's Inquiries and Investigations Byelaw (No 3 of 1983);
- (2) issue of proceedings under Lloyd's Issue of Proceedings by Council Byelaw (No 18 of 1983);
- (3) administrative suspension under Lloyd's Administrative Suspension Byelaw (No 7 of 1987);
- (4) making of a review order under Lloyd's Review Powers Byelaw (No 5 of 1986);
- (5) imposition of penalties under Lloyd's Misconduct and Penalties Byelaw (No 30 of 1996);
- (6) directions given under Lloyd's Suspension: Supplementary and Consequential Matters Byelaw (No 19 of 1983);
- (7) institution of disciplinary proceedings, settlement of disciplinary proceedings, or decisions of a *Disciplinary Tribunal* under Lloyd's Disciplinary Committees Byelaw (No 31 of 1996); and

(8) restitution ordered under Lloyd's Restitution Orders Byelaw (No 24 of 2000).

- 2.4.4** G_{/1} The *Society* need not give the *FSA* notice of routine inspections which form part of regular monitoring or themed visits.
- 2.4.5** G_{/1} At the end of each calendar month, the *Society* should report to the *FSA* on the progress of all investigations and disciplinary proceedings previously reported under *LLD 2.4.1D* and *LLD 2.4.2D* that are still in progress or which ceased during that month.
- 2.4.6** G_{/1} The *Society* should send the *FSA* the information under *LLD 2.4.1D*, *LLD 2.4.2D* and *LLD 2.4.5G* within five business days of the end of each calendar month.

2.5 Co-operation between the FSA and the Society

2.5.1

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LLD 2.5.2G sets out the FSA's policy regarding notification to the *Society* when the FSA investigates or takes action in relation to an *underwriting agent*, an *approved person* who carries out *controlled functions* for or on behalf of an *underwriting agent*, or an individual acting for or on behalf of an *underwriting agent*.

2.5.2

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Subject to the restrictions on disclosure or use of confidential information in or under sections 348 (Restrictions on disclosure of confidential information by Authority etc) and 349 (Exceptions from section 348) of the *Act*, any restrictions on disclosure or use that apply under European or common law, and any special circumstances of an individual case, the FSA will notify the *Society* when the FSA does any of the following:

- (1) requires, or authorises an *officer* to require, an *underwriting agent* to provide specified information or documents under section 165 of the *Act* (Authority's power to require information); or
- (2) requires an *underwriting agent* to provide a report by a *skilled person* under section 166 of the *Act* (Reports by skilled persons); or
- (3) appoints an investigator to carry out an investigation under any of sections 167 to 169 of the *Act* (Appointment of persons to carry out general investigations, Appointment of persons to carry out investigations in particular cases, Investigations etc in support of overseas regulator) where the subject of the investigation is an *underwriting agent* or an *approved person* acting for or on behalf of an *underwriting agent*; or
- (4) executes a warrant to search for and to seize documents where the subject of the investigation is an *underwriting agent* or an *approved person* acting for or on behalf of an *underwriting agent*; or
- (5) issues a *supervisory notice*, a *warning notice*, a *decision notice*, a *notice of discontinuance* or a *final notice* in relation to the following administrative enforcement action against an *underwriting agent*:
 - (a) variation or cancellation of *permission* on the FSA's own initiative under sections 45 to 47 of the *Act* (Variation etc at request of authorised person, Variation of permission on acquisition of control, Exercise of power in support of overseas regulator); or
 - (b) restitution required by the FSA under section 384 of the *Act* (Power of Authority to require restitution); or
 - (c) disciplinary action under sections 205 and 206 of the *Act* (Public censure, Financial penalties); or

- (6) issues a *warning notice*, a *decision notice*, a *notice of discontinuance* or a *final notice* in relation to the following administrative enforcement action against an *approved person* acting for or on behalf of an *underwriting agent*:
 - (a) withdrawal of approval under section 63 of the *Act* (Withdrawal of approval); or
 - (b) prohibition from *regulated activities* under section 56 of the *Act* (Prohibition orders); or
 - (c) disciplinary action under section 66 of the *Act* (Disciplinary powers); or
- (7) issues a *warning notice*, a *decision notice*, a *notice of discontinuance* or a *final notice* in relation to the prohibition from *regulated activities* under section 56 of the *Act* (Prohibition orders) of an individual acting for or on behalf of an *underwriting agent*; or
- (8) applies to the court for an *injunction* under section 380 (Injunctions) or restitution order under section 382 (Restitution orders) of the *Act* in relation to an *underwriting agent* or an *approved person* acting for or on behalf of an *underwriting agent*, or for an administration order, winding up order or bankruptcy order against an *underwriting agent* under Part XXIV of the *Act* (Insolvency); or
- (9) commences a criminal prosecution against an *underwriting agent* or *approved person* acting for or on behalf of an *underwriting agent*.

2.5.3**G**

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ENF 11 gives further guidance on the policy and procedures which apply in circumstances where both the *FSA* and other regulatory authorities have an interest in investigating or disciplining a *firm*, individual or other *person*. The *FSA* and the *Society* have agreed to have enforcement co-operation arrangements to assist them when they are considering cases of regulatory concern or misconduct of mutual interest.

2.6 Information about the Society's byelaws

- 2.6.1** **G**_{/1} The defined term "*byelaw*" means any Byelaw, direction, regulation, or other instrument made using the powers of the *Council* under section 6 of Lloyd's Act 1982 (including any regulation ratified by the *Council* by special resolution) and any condition or requirement made under any such Byelaw, direction, regulation, or other instrument.
- 2.6.2** **G**_{/1} The *Society* should give the *FSA* adequate notice of all changes it proposes to make to its *byelaws* for supervising and regulating the market at Lloyd's.
- 2.6.3** **G**_{/1} The *Society* should, having regard to the materiality and urgency of a proposed change, consult interested parties on changes it proposes to make to its *byelaws* for supervising and regulating the market at Lloyd's. It should inform the *FSA* about the consultation undertaken and summarise the responses received.
- 2.6.4** **G**_{/1} The *Society* should give the *FSA* copies of all its regulatory and market bulletins and all amendments to its *byelaws* as soon as it publishes them.

Chapter 3.

The Central Fund

3.



3.1 Application and purpose

Application

3.1.1 **R** This chapter applies to the *Society*.

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3.1.2 **R** A contravention of the *rules* in this chapter does not give rise to a right of action by a *private person* under section 150 of the *Act* (Actions for damages) and each of those *rules* is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action.

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Purpose

3.1.3 **G** The *rules* and *guidance* in this chapter are intended to promote confidence in the market at Lloyd's, and to protect certain *consumers* of services provided by the *Society* in carrying on, or in connection with or for the purposes of, its *regulated activities*. They do this by:

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- (1) giving guidance to the *Society* about the protection that the *Central Fund* should provide for policyholders; and
- (2) enabling the *FSA* to keep under review the protection the *Central Fund* provides for policyholders.



3.2 The Central Fund



3.2.1

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The *Society* should seek to ensure that the *Central Fund* provides protection for policyholders at least equivalent to that available to other policyholders under the *compensation scheme*.

3.2.2

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The *Society* should seek, and take appropriate account of, the *FSA*'s views on all proposed changes in its arrangements relating to the *Central Fund*.

3.3 Information about the Central Fund

3.3.1 **R** ^{/1} The *Society* must give the *FSA* a report on the *Central Fund* as at the end of each calendar quarter.

3.3.2 **R** ^{/1} The report referred to in *LLD* 3.3.1R must reach the *FSA* within two weeks of the end of each calendar quarter and must include information on:

- (1) the net market value of the *Central Fund*;
- (2) payments made from the *Central Fund* in that quarter;
- (3) the types of investment in which the *Central Fund* is held;
- (4) the commencement or cessation of, or any changes in the terms of, any insurance policy taken out to protect the *Central Fund*; and
- (5) any claim made, or circumstances notified that are likely to lead to a claim, under any insurance policy taken out to protect the *Central Fund*.

3.3.3 **G** ^{/1} Because of the significance of the *Central Fund* in the protection of policyholders, the *Society* should notify the *FSA* under *LLD* 3.3.2R(5) of all matters relevant to any actual or potential claim. These include but are not limited to the facts on which that claim is based, the circumstances under which those facts arose and any relevant response to the claim from any insurer or reinsurer concerned.

Chapter 4.

Capacity transfer market

4.

4.1 Application and purpose

Application

4.1.1 **R** This chapter applies to the *Society*.

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4.1.2 **R** A contravention of the *rules* in this chapter does not give rise to a right of action by a *private person* under section 150 of the *Act* (Actions for damages) and each of those *rules* is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action.

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Purpose

4.1.3 **G** The *rules* and *guidance* in this chapter are intended to promote confidence in the market at Lloyd's, and to protect certain *consumers* of services provided by the *Society* in carrying on, or in connection with or for the purposes of, its *regulated activities*. They do this by ensuring that the *Society* appropriately and effectively regulates the *capacity transfer market* so that it operates in a fair and transparent manner.

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4.2 Requirement to make byelaws governing conduct in the capacity transfer market

Requirement

- 4.2.1 **R** /1 The *Society* must make appropriate *byelaws* governing conduct in the *capacity transfer market*.

Standards expected

- 4.2.2 **G** /1 The *byelaws* referred to in *LLD* 4.2.1R should:
- (1) ensure that adequate and effective arrangements are in place to enable *members* and *persons* applying to be admitted as *members* to enter into transactions to transfer *syndicate* capacity and settle these transactions in a timely manner;
 - (2) give clear and comprehensive guidance about the dissemination of information that is, or may be, relevant to the price of *syndicate* capacity and the transparency of the *capacity transfer market*; and
 - (3) prohibit unfair and abusive practices (including market manipulation), the misuse of information not generally available, and the dissemination of false or misleading information.
- 4.2.3 **G** /1 The *Society* should have adequate and effective arrangements to:
- (1) record and monitor transactions in the *capacity transfer market*, and maintain adequate audit trails; and
 - (2) suspend or annul transactions where appropriate.
- 4.2.4 **G** /1 The *Society* should have adequate and effective arrangements to monitor and enforce compliance with the *byelaws* referred to in *LLD* 4.2.1R.
- 4.2.5 **G** /1 The *Society* should regularly review the *byelaws* referred to in *LLD* 4.2.1R, taking account of the standards of conduct required in other *UK* financial markets.
- 4.2.6 **G** /1 The *Society's* arrangements for reviewing and amending the *byelaws* referred to in *LLD* 4.2.1R should be timely, effective and impartial and should take into account the *guidance* about conflicts of interest in *LLD* 1.3.

- 4.2.7** G_{/1} The *Society* should consult *members* and *underwriting agents* before it finalises material changes in the *byelaws* referred to in *LLD 4.2.1R*, and should have timely and effective arrangements for notifying them of changes in these *byelaws*.

Changes in byelaws

- 4.2.8** G_{/1} The *Society* should give the *FSA* adequate notice of all changes it proposes to make in its *byelaws* governing conduct in the *capacity transfer market*.

- 4.2.9** G_{/1} The *FSA* will take account of the standards of conduct required in other *UK* financial markets when it reviews proposed changes in the *Society's byelaws* governing the *capacity transfer market*.



4.3 Information about the capacity transfer market

- 4.3.1 **R** /1 The *Society* must give the *FSA* a report as at the end of each calendar quarter in which any capacity is transferred.
- 4.3.2 **R** /1 The report referred to in *LLD* 4.3.1R must reach the *FSA* within one month of the end of the relevant calendar quarter and must include information on:
- (1) the total capacity in *syndicates* transferred during the quarter, analysed by *syndicate* and method of transfer;
 - (2) the number, and nature, of all investigations by the *Society* into conduct in the *capacity transfer market* undertaken or continued during the quarter; and
 - (3) the number, and nature, of all complaints received during the quarter about the operation of the *capacity transfer market*.

Chapter 5.

Former underwriting members

5.



5.1 Application and purpose

Application

5.1.1 **R** This chapter applies to the *Society*.

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5.1.2 **R** A contravention of the *rules* in this chapter does not give rise to a right of action by a *private person* under section 150 of the *Act* (Actions for damages) and each of those *rules* is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action.

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Purpose

5.1.3 **G** The *rules* and *guidance* in this chapter are intended to promote confidence in the market at Lloyd's and to protect certain *consumers* of services provided by the *Society* in carrying on or in connection with or for the purposes of its *regulated activities* by:

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- (1) protecting policyholders against the risk that *former underwriting members* may not be able to meet any liabilities to carry out *contracts of insurance* that they underwrote at Lloyd's; and
- (2) enabling the *FSA* to impose requirements under section 320(3) of the *Act* (Former underwriting members) if it considers this appropriate to protect policyholders.



5.2 Requirements relating to former underwriting members

- 5.2.1 **R**_{/1} The *Society* must draw sections 320 to 322 of the *Act* (Former underwriting members, Requirements imposed under section 320, Rules applicable to former underwriting members) to the attention of any *person* ceasing to be an *underwriting member* on or after *commencement*.
- 5.2.2 **R**_{/1} The *Society* must require any *person*, other than a *body corporate*, ceasing to be an *underwriting member* on or after *commencement* to:
- (1) notify the *Society* of any change in his address within one month of the change; and
 - (2) in the case of a natural person, to make arrangements for the *Society* to be notified in the event of his death.
- 5.2.3 **G**_{/1} The *Society* should make and retain records of the notifications made to it under the requirements referred to in *LLD* 5.2.2R. It should give the *FSA* access to these records if the *FSA* requests this.

Chapter 6.

Complaints from policyholders

6.



6.1 Enabling provision, application and purpose

Enabling provision and application

6.1.1

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The *insurance market direction* in this chapter is given under section 316(1) of the *Act* (Direction by Authority) and applies to *members*.

Purpose

6.1.2





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The *insurance market direction* given in this chapter is intended to protect the interests of policyholders and potential policyholders by:

- (1) making *members* subject to the *Compulsory Jurisdiction* of the *Financial Ombudsman Service* with respect to the carrying on of insurance business; and
- (2) enabling the complaints of policyholders who are *eligible complainants* to be dealt with under the rules of the *Financial Ombudsman Service*.



6.2 Insurance market direction on policyholder complaints

- 6.2.1**  _{/1} (1) With effect from *commencement*, Part XVI of the *Act* (The Ombudsman Scheme), and in particular section 226 (Compulsory jurisdiction), applies to the carrying on of insurance business by *members*.
- (2) For the purposes of (1) “insurance business” means the *regulated activities* of effecting or carrying out contracts of insurance written at Lloyd’s.
- 6.2.2**  _{/1} Part XVI (The Ombudsman Scheme) is a *core provision* mentioned in section 317(1) of the *Act* (The core provisions).
- 6.2.3**  _{/1} Section 317(2) of the *Act* (The core provisions) provides that references in an applied *core provision* to an *authorised person* are to be read as references to a *person* in the class to which the *insurance market direction* applies. The effect of this, and of the *insurance market direction* set out at *LLD 6.2.1D*, is that Part XVI of the *Act* (The Ombudsman Scheme), and in particular section 226 (Compulsory jurisdiction), apply also to *members*.
- 6.2.4**  _{/1} *Guidance* on the jurisdiction of the *Financial Ombudsman Service* in relation to *members* is given in *DISP 2.5.3G*. The handling of a policyholder complaint against a *member* is covered in *DISP 1.7.1R* and *DISP 1.7.2G*.

Chapter 7.

Complaints from members

7.

7.1 Application and purpose

Application

- 7.1.1 **R** This chapter applies to the *Society*.
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- 7.1.2 **R** A contravention of the *rules* in this chapter does not give rise to a right of action by a *private person* under section 150 of the *Act* (Actions for damages) and each of those *rules* is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action.
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Purpose

- 7.1.3 **G** The *rules* and *guidance* in this chapter are intended to promote confidence in the market at Lloyd's, and to protect certain *consumers* of services provided by the *Society* in carrying on, or in connection with or for the purposes of, its *regulated activities*. They do this by ensuring that there are adequate and effective arrangements to handle and resolve complaints from *members* about the conduct of certain activities within the Lloyd's market by the *Society* or by *underwriting agents*.
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- 7.1.4 **G** The *Financial Ombudsman Service* will not be able to deal with these complaints and separate *rules* and *guidance* are therefore required.
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- 7.1.5 **G** Complaints from policyholders, and complaints from *members* about *members'* *advisers*, are dealt with in *LLD* 6, *DISP* 1.7 and *DISP* 2.5.3G.
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7.2 Complaints handling arrangements

7.2.1

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The *Society* must establish and maintain appropriate and effective arrangements for handling any complaint from a *member* or a *former member* about:

- (1) *regulated activities* carried on by the *Society*;
- (2) the *Society's regulatory functions* carried on by the *Society*, the *Council* or those to whom the *Council* delegates authority to carry out such functions;
- (3) advice given by an *underwriting agent* to a *person* to become, continue or cease to be, a member of a particular *syndicate*; and
- (4) the management by a *managing agent* of the underwriting capacity of a *syndicate* on which the complainant participates or has participated.

7.2.2

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In establishing the arrangements referred to in *LLD 7.2.1R* the *Society* should have regard to:

- (1) the likely number of complaints it will receive; and
- (2) the nature and complexity of the complaints it is likely to receive and investigate.

7.2.3

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The arrangements referred to in *LLD 7.2.1R* should have the following features.

- (1) They should allow for complaints to be made by any reasonable means.
- (2) The complaints handling policy and arrangements should be published and be made available to *members*, *former members* and *underwriting agents*.
- (3) Copies of the documents referred to in (2) should be sent to a complainant as soon as a complaint is received.
- (4) The *Society* should ensure that its employees and those of *underwriting agents* are aware of the complaints handling policy and arrangements, and should endeavour to ensure that they act in accordance with them.
- (5) All complaints should be investigated promptly and wherever possible provision should be made for review of that investigation by someone who was not involved in the matter complained of.

- (6) Appropriate management controls should be put in place to ensure that complaints are handled fairly, impartially and consistently and that recurring or systemic problems can be identified and remedied.
- (7) Complaints should be resolved speedily at the earliest stage possible.
- (8) If a complaint cannot be resolved speedily, a letter of acknowledgement should be sent promptly, indicating when the complainant can expect a substantive response.
- (9) All responses to complaints should adequately address the subject matter of the complaint.

7.2.4

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A response to a complaint should be sent within four weeks of its receipt. This should:

- (1) accept the complaint and where appropriate offer redress (financial or otherwise); or
- (2) reject the complaint and give reasons for doing so; or
- (3) explain that it has not yet been possible to resolve the complaint and that more time is needed to do so, giving reasons for the delay and stating when a further response will be made.

7.2.5

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If a complaint has not been resolved within eight weeks from the date on which the *Society* received it, the complainant should be told that more time is needed and reasons for the delay should be given, with a date when the complainant will get a further response.

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At the end of the eight week period referred to in *LLD 7.2.5G*, or at the time it sends a substantive response (if this is earlier), the *Society* should also send the complainant information on:

- (1) any right to refer the complaint:
 - (a) to the *Lloyd's Members' Ombudsman* if the complaint relates to the matters identified in *LLD 7.2.1R(1)* or *LLD 7.2.1R(2)*; or
 - (b) to the *Lloyd's Arbitration Scheme* if the complaint relates to the matters identified in *LLD 7.2.1R(3)* or *LLD 7.2.1R(4)*; or
 - (c) to any other independent dispute resolution scheme that may, pursuant to *LLD 7.5.1R*, replace either of the schemes referred to in (a) and (b); and
- (2) arrangements and procedures for referring the complaint.

7.2.7

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Any redress accepted by a complainant should be provided promptly.

7.2.8

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Where financial redress is appropriate, the aim should be to return the complainant to the position he would have been in had the acts or omissions giving rise to the complaint not occurred.

7.2.9

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The redress referred to in *LLD 7.2.8G* should include a reasonable rate of interest on sums to which the complainant would have been entitled but for the acts or omissions in question.

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All correspondence and literature about the *Society's* handling of complaints should be in plain language.

7.



7.3 Making and retaining records of complaints

7.3.1

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The *Society* should make records relating to complaints from *members* and *former members* involving allegations that the complainants have suffered, or may suffer, financial loss, material distress or material inconvenience.

7.3.2

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The records created under *LLD* 7.3.1G should be retained for a minimum period of three years from the date of receipt of a complaint.

7.4 Information about complaints

7.4.1

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Within one month of the periods ending June and December in each calendar year, the *Society* should give the *FSA* a report containing the following information:

- (1) the number of complaints received from *members* and *former members* during that period involving allegations that the complainants have suffered, or may suffer, financial loss, material distress or material inconvenience;
- (2) a summary of the nature of these complaints;
- (3) the number of these complaints resolved or rejected;
- (4) the amount of money paid to each complainant referred to in (1) as redress and any other form of redress made; and
- (5) the number of these complaints which have been referred to the *Lloyd's Arbitration Scheme*, the *Lloyd's Members' Ombudsman* or any other independent dispute resolution scheme that may replace either of these schemes.

7.4.2

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For the purposes of the report referred to in *LLD 7.4.1G*, "complaints resolved" include complaints where the *Society* has completed its consideration of the complaint and either knows the complaint has been resolved to the complainant's satisfaction or has no reason to suspect otherwise.

7.5 Independent dispute resolution schemes

- 7.5.1** **R** ^{/1} The *Society* must maintain by *byelaw* one or more appropriate and effective schemes for the resolution of disputes between an *individual member* or a *former member* who was an *individual member* and:
- (1) his *underwriting agent*; or
 - (2) the *Society*.
- 7.5.2** **R** ^{/1} For the purposes of *LLD 7.5.1R* "*individual member*" includes a *member* which is a *limited liability partnership* or a *body corporate* whose members consist only of, or of the nominees for, a single natural person or a group of connected natural persons.
- 7.5.3** **G** ^{/1} The schemes to which *LLD 7.5.1R* currently refers are the *Lloyd's Arbitration Scheme* and the *Lloyd's Members' Ombudsman* respectively, but the *Society* may maintain other independent dispute resolution schemes in addition to, or instead of, either of these schemes.
- 7.5.4** **G** ^{/1} The schemes referred to in *LLD 7.5.1R* should be operationally independent of the *Society*.
- 7.5.5** **G** ^{/1} An *individual member* or *former member* who was an *individual member* should not have access to the schemes referred to in *LLD 7.5.1R* unless the complaints arrangements maintained by the *Society* have failed to resolve the complaint to his satisfaction within eight weeks of receiving it.
- 7.5.6** **G** ^{/1} The *Society* should give the *FSA* adequate notice of all proposed changes to the *byelaws* relating to the schemes referred to in *LLD 7.5.1R*.
- 7.5.7** **G** ^{/1} When considering what is required to ensure the operational independence of the schemes referred to in *LLD 7.5.1R*, or proposed changes in such schemes, the *Society* should take account of similar arrangements operated by the *Financial Ombudsman Service*.

Chapter 8.

Compensation arrangements for individual members

8.



8.1 Application and purpose

Application

8.1.1 **R** This chapter applies to the *Society*.

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8.1.2 **R** A contravention of the *rules* in this chapter does not give rise to a right of action by a *private person* under section 150 of the *Act* (Actions for damages) and each of those *rules* is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action.

^{/1}

Purpose

8.1.3 **G** The *rules* and *guidance* in this chapter are intended to promote confidence in the market at Lloyd's, and to protect *consumers* of certain services provided by the *Society* in carrying on, or in connection with or for the purposes of, its *regulated activities*. They do this by ensuring that the *Society* continues to maintain adequate and effective compensation arrangements for *individual members* and *former members* who were *individual members* in respect of claims against *underwriting agents* (other than claims for losses arising only from underwriting or investment risk).

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8.1.4 **G** The *compensation scheme* will not compensate *members* or *former members* if *firms* are unable to satisfy claims made in connection with *regulated activities* relating to their participation in Lloyd's *syndicates*. Separate *rules* and *guidance* are therefore required.

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8.2 Compensation arrangements for individual members

- 8.2.1 **R**_{/1} The *Society* must maintain *byelaws* establishing appropriate and effective arrangements to compensate *individual members* and *former members* who were *individual members* if *underwriting agents* are unable, or likely to be unable, to satisfy claims by those *members* relating to *regulated activities* carried on in connection with their participation in Lloyd’s *syndicates*.
- 8.2.2 **R**_{/1} For the purposes of *LLD 8.2.1R* “*individual member*” includes a *member* which is a *limited liability partnership* or a *body corporate* whose members consist only of, or of the nominees for, a single natural person or a group of connected natural persons.
- 8.2.3 **G**_{/1} The arrangements referred to in *LLD 8.2.1R*:
- (1) will not compensate losses arising only as a result of underwriting or investment risk to which *individual members* or *former members* who were *individual members* are or were exposed by their participation in Lloyd’s *syndicates*;
 - (2) may be restricted to compensation for losses arising out of fraud, dishonesty or failure to account; and
 - (3) should cover all *regulated activities* carried on by *underwriting agents* relating to Lloyd’s *syndicate* capacity and *syndicate* membership.
- 8.2.4 **G**_{/1} The arrangements referred to in *LLD 8.2.1R* should have a governance structure that is operationally independent from the *Society*, but which is nevertheless accountable to the *Society* for the proper administration of the compensation arrangements.
- 8.2.5 **G**_{/1} If the *Society* proposes to extend the scope of the losses covered by the arrangements referred to in *LLD 8.2.1R* (beyond those resulting from fraud, dishonesty or failure to account), it should have regard to the types of losses covered by the *compensation scheme*.
- 8.2.6 **G**_{/1} In setting the limit of compensation payable for a single loss, and whatever co-insurance should apply, the *Society* should have regard to the compensation payable by the *compensation scheme* for similar claims relating to similar *regulated activities*.
- 8.2.7 **G**_{/1} The *Society* should consult interested parties on proposed changes in the *byelaws* establishing the arrangements referred to in *LLD 8.2.1R*.



8.2.8

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The *Society* should give the *FSA* adequate notice of all changes it proposes to make to the *byelaws* establishing the arrangements referred to in *LLD* 8.2.1R.

Chapter 9.

Prudential requirements for the Society

9.



9.1 Application and purpose

Application

- 9.1.1 **R** This chapter applies to the *Society*.
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- 9.1.2 **G** This chapter applies substantially the same requirements to the *Society* as *IPRU(INS)* applies to *insurers*.
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- 9.1.3 **R** A contravention of the *rules* in this chapter does not give rise to a right of action by a *private person* under section 150 of the *Act* (Actions for damages) and each of those *rules* is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action.
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Purpose

- 9.1.4 **G** The purpose of this chapter and *LLD* 10 to 15 is to:
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 - (1) protect policyholders against the risk that the *Society* and *members* may not have adequate financial resources to meet *claims* as they fall due;
 - (2) promote confidence in the market at Lloyd’s by requiring the *Society*, and through it *members*, to maintain resources which are adequate to meet their liabilities;
 - (3) promote confidence in the market at Lloyd’s and enhance public awareness by improving the transparency of financial reporting by the *Society*; and
 - (4) protect the interests of *consumers* of *insurance business* at Lloyd’s.
- 9.1.5 **G** This chapter sets out high level prudential requirements relating to *insurance business* at Lloyd’s.
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9.2 General prudential requirements

- 9.2.1 **R** ^{/1} The *Society* must manage its affairs, including the exercise of its *byelaw*-making powers, with due regard to the interests of policyholders and potential policyholders.
- 9.2.2 **R** ^{/1} The *Society* must ensure that its affairs are soundly and prudently managed and take reasonable steps to ensure that the Lloyd's market is soundly and prudently managed.
- 9.2.3 **R** ^{/1} The *Society* must adopt the standards of due care and diligence set out in the custody rules at COB 9 in relation to the custody of assets that constitute *members*' funds.
- 9.2.4 **R** ^{/1} The *Society* may not permit any *syndicate* to carry on both *long-term insurance business* and *general insurance business*.
- 9.2.5 **R** ^{/1} The *Society* must, having regard to the availability and value of the *central assets* of the *Society*, ensure that its assets and its *members*' assets are adequate to meet the liabilities which *members* assume in their *insurance business* at Lloyd's.
- 9.2.6 **R** ^{/1} The *Society* must:
- (1) ensure that its *admissible assets*:
 - (a) that are *investments* are diversified and adequately spread; and
 - (b) taking into account the risks posed to the *Society* by its activities and by the *insurance business* carried on by *members*, are of appropriate safety, yield, maturity and marketability; and
 - (2) take reasonable steps to ensure that the *admissible assets* of *members*:
 - (a) which are *investments* are diversified and adequately spread; and
 - (b) taking into account the type of *insurance business* carried on by *members*, are of appropriate safety, yield, maturity and marketability.



9.3 General guidance on financial resources

- 9.3.1** G_{/1} *LLD 9 to 15 are concerned with the adequacy of the financial resources of the Society and members, which may be threatened by the inherent uncertainties of insurance business.*
- 9.3.2** G_{/1} These uncertainties include:
- (1) uncertainty about the amount of *claims* and expenses;
 - (2) uncertainty about the timing of *claims* and expenses, which may result in assets not being realisable at full value, or at all, when they are needed to pay *claims* and expenses;
 - (3) the risk that non-insurance liabilities may deplete available assets;
 - (4) the risk of adverse movements in the value of, or income from, general or specific assets including fluctuations in interest and foreign exchange rates which may result in a fall in value of the assets held by the *Society* and by its *members*; and
 - (5) the risk of default by *counterparties*.
- 9.3.3** G_{/1} These inherent uncertainties apply both to existing *contracts of insurance* and prospectively to planned new business. In addition *members* are subject to operational risks that impact upon the adequacy of provisions established for past business, the premiums charged for new business and the funds held to support both past and new business.
- 9.3.4** G_{/1} *LLD 9 to 15 address the significant business risks faced by members. They are designed to ensure that the business of the Lloyd's market is properly managed and has in place the controls needed to safeguard policyholders' interests.*
- 9.3.5** G_{/1} The central prudential safeguard is for the *Society* to maintain sufficient net assets to cover any shortfall in *members'* resources. Detailed rules and guidance on this subject are contained in *LLD 11* (Required margins of solvency).
- 9.3.6** G_{/1} The requirement to maintain sufficient assets to cover any shortfall in *members'* resources is underpinned by a standard approach to the valuation and recognition of the assets and liabilities of the *Society* and its *members*. Requirements are made in *LLD 10 to 14* which set out:
- (1) the types of asset which can count towards meeting solvency obligations, any limits on the value which can be placed on an asset, and admissibility limits on the amount of exposure to any one *counterparty*;
 - (2) how insurance and other liabilities should be determined; and

(3) requirements that an *actuary* certify the adequacy of reserves set.

- 9.3.7 G_{/1} For the purpose of calculating solvency in accordance with *LLD 9 to 15*, the *other personal wealth* of *members* is left out of account.
- 9.3.8 G_{/1} The *Society* is required to prepare and submit an audited annual return which reports on assets and liabilities and includes a statement that any shortfall in *members'* resources has been covered. The requirements for reporting are in *LLD 15* (Reporting by the Society).
- 9.3.9 G_{/1} Requirements in relation to valuation and reporting are supplemented by requirements to hold assets that adequately match the risks posed by estimated liabilities. These requirements are contained in *LLD 14* (Assets: market and credit risk).
- 9.3.10 G_{/1} *LLD 10* (Insurance operational risk) includes *rules* requiring premiums and other assets to be held in suitable trust arrangements to provide policyholders with additional safeguards. *LLD 10* (Insurance operational risk) also includes requirements on the *Society* to assess the risks posed to the *Society* by the business underwritten by each *member* and to set capital requirements accordingly.

9.4 Accounting principles and records

Accounting principles

- 9.4.1 **R**_{/1} The *Society* must, for the purposes of *LLD 9 to 15*, apply the *insurance accounts rules* and generally accepted accounting practice, adapted where necessary to apply to the special circumstances of Lloyd's, unless the provisions of this sourcebook otherwise require.
- 9.4.2 **G**_{/1} An important source of such accounting practice is the Statement of Recommended Practice on Accounting for Insurance Business, as issued in December 1998 by the Association of British Insurers and endorsed by the Accounting Standards Board.
- 9.4.3 **G**_{/1} Assets are subject to the valuation and admissibility provisions of *LLD 13* (Assets: valuation and realisability risk) and *LLD 14* (Assets: market and credit risk) and may in the *Lloyd's Return* and for other reporting purposes have attributed to them a lesser value than would be the case under generally accepted accounting practice.
- 9.4.4 **G**_{/1} Liabilities are subject to the valuation and admissibility provisions of *LLD 12* (Determination of liabilities) and may in the *Lloyd's Return* and for other reporting purposes have attributed to them a greater value than would be the case under generally accepted accounting practice.

Records

- 9.4.5 **R**_{/1} The *Society* must make and maintain for an appropriate period adequate accounting records in the *United Kingdom*.
- 9.4.6 **G**_{/1} *LLD 9.4.5R* refers only to those accounting records appropriate to demonstrate compliance by the *Society* with the reporting requirements of *LLD 9 to 15*.
- 9.4.7 **G**_{/1} An appropriate period for the purposes of *LLD 9.4.5R* would normally be not less than 10 years.

Chapter 10.

Insurance operational risk

10.



10.1 Application and purpose

Application

10.1.1 **R** This chapter applies to the *Society*.

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10.1.2 **R** A contravention of the *rules* in this chapter does not give rise to a right of action by a *private person* under section 150 of the *Act* (Actions for damages) and each of those *rules* is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action.

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Purpose

10.1.3 **G** This chapter addresses the systems and controls appropriate to managing operational risk (see also *LLD* 9.1.4G).

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10.1.4 **G** There are significant operational risks present in the Lloyd's market arising out of the interrelationships between the entities involved in effecting and carrying out *contracts of insurance*. This chapter therefore contains specific requirements for the *Society* to continue to maintain systems for monitoring and managing operational risk in the market and ensuring that assets are adequately matched to liabilities.

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10.1.5 **G** This chapter also requires the *Society* to take reasonable steps to ensure that systems and controls are maintained by *managing agents* to address the risks that arise with respect to the effecting and carrying out of *contracts of insurance*.

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10.1.6 **G** General guidance on the adequacy of financial resources is set out at *LLD* 9.3.

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10.2 Systems and controls

10.2.1

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The *Society* must maintain systems and controls that appropriately address the operational risks to which the Lloyd's market is exposed.

10.2.2

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LLD 10.3 to 10.7 require the *Society* to maintain specific systems and controls that go towards satisfying the *Society's* obligations under *LLD* 10.2.1R.



10.3 Carrying of insurance receivables to trust funds

- 10.3.1 **R**_{/1} The *Society* must take all reasonable steps to ensure that every member carries to a trust fund, in accordance with the provisions of a trust deed, all amounts received or receivable by him, or on his behalf, in respect of any *insurance business*.
- 10.3.2 **R**_{/1} The *Society* must approve the provisions of every trust deed referred to in *LLD* 10.3.1R and any amendments to it.
- 10.3.3 **R**_{/1} The *Society* must take all reasonable steps to ensure that amounts received by *members* in respect of *long-term insurance business* are not carried to the same trust fund as amounts received in respect of *general insurance business*.
- 10.3.4 **G**_{/1} The trust deeds approved by the *Society* under *LLD* 10.3.2R may allow each *member* to pool his separate trust funds, provided that separate funds are maintained for *long-term insurance business* and for *general insurance business*.



10.4 Changes in approved trust deeds

- 10.4.1** **R** ^{/1} The *Society* must at the earliest practicable stage notify the *FSA* of its intention to approve or amend a trust deed.
- 10.4.2** **R** ^{/1} The *Society* must provide the *FSA* with full details of:
- (1) any amendments proposed to any approved trust deed; and
 - (2) any new trust deed it proposes to approve.
- 10.4.3** **R** ^{/1} The information given by the *Society* to the *FSA* under *LLD 10.4.2R* must include a statement of the purpose and the impact of the proposed amendment or new trust deed on policyholders and potential policyholders.
- 10.4.4** **G** ^{/1} The *Society* should, having regard to the materiality of a proposed change, consult interested parties before it gives information to the *FSA* under *LLD 10.4.2R*. The information given to the *FSA* should describe the consultation undertaken and summarise the responses received.
- 10.4.5** **G** ^{/1} Any information given under *LLD 10.4.2R* should be supplied in sufficient time to allow the *FSA* fully to consider the amendment or new deed before it is approved by the *Society*.



10.5 Requirement to maintain risk-based capital system

- 10.5.1** **R** ^{/1} The *Society* must maintain an appropriate and effective risk-based capital system, including:
- (1) a risk-based capital (“RBC”) model to calculate the *funds at Lloyd’s* required to support the *insurance business* of each *member*;
 - (2) arrangements for periodically comparing the premium income of each *syndicate* against the premium income forecast for that *syndicate* used in RBC calculations; and
 - (3) an appropriate dynamic financial model of the *insurance business* carried on in the Lloyd’s market.
- 10.5.2** **R** ^{/1} The *Society* must discuss with the *FSA* any material changes it proposes to make in:
- (1) the RBC model it maintains under *LLD 10.5.1R(1)*;
 - (2) the monitoring arrangements it has established to comply with *LLD 10.5.1R(2)*; and
 - (3) the dynamic financial model it maintains under *LLD 10.5.1R(3)*.
- 10.5.3** **R** ^{/1} The *Society* must give the *FSA* adequate time to review any significant changes that it proposes to make in the RBC model it maintains under *LLD 10.5.1R(1)*, and to assess the implications of those changes for policyholders and potential policyholders and for the adequacy of the *Central Fund*.
- 10.5.4** **R** ^{/1} The *Society* must establish a suitable programme of independent review of the operation of the RBC model and submit the results of each completed review to the *FSA*.
- 10.5.5** **G** ^{/1} The RBC model should take account of the best estimate of prospective losses given the current state of the market. This might be achieved by bulk percentage loads in market sectors that show evidence of soft or softening rates and should take account of the following:
- (1) the expected prospective level of underwriting losses or profits, taking account of the underwriting cycle where one can be made out;

- (2) the prospective variability of underwriting profits or losses;
 - (3) mitigation of risk because of the independence or partial independence of various tranches of *insurance business*; and
 - (4) mitigation of risk based on the prospective reinsurance programme or proxies for reinsurance.
- 10.5.6** G_{/1} The factors listed in *LLD 10.5.5G* should be adjusted for any factors that may increase underwriting risk.
- 10.5.7** G_{/1} If underwriting risk is not considered on a discounted basis within the RBC model, an explicit adjustment for future investment income is appropriate.
- 10.5.8** G_{/1} Any discount rate used in the RBC model should be set with reference to prospective returns on assets. An adjustment should be made for non-interest bearing assets.
- 10.5.9** G_{/1} The RBC model should reflect reserving risk by taking account of factors such as:
- (1) the prospective reserving run-off loss or profit;
 - (2) the prospective variance of run-off loss or profit; and
 - (3) mitigation of risk because of the independence or partial independence of various types of *insurance business* between *classes* and across time.
- 10.5.10** G_{/1} The factors listed in *LLD 10.5.9G* should be adjusted for any other factors that may increase reserving risk, including exposure to latent *claims*, significant litigation or arbitration in progress. The RBC model should also reflect substantial changes in the reinsurance purchased over time.
- 10.5.11** G_{/1} The RBC model should reflect credit risk on reinsurance recoveries by taking account of:
- (1) the spread of outcomes as regards quantum of reinsurance recoverable, for example catastrophe-exposed accounts;
 - (2) the quality of the reinsurers, for example their credit agency ratings; and
 - (3) the possibility of future reinsurer downgrade or failure if a lengthy payout pattern is envisaged.
- 10.5.12** G_{/1} The RBC model should take account of credit risk on receivables other than reinsurance recoveries if these are substantial.
- 10.5.13** G_{/1} The RBC model need not treat asset risk in a sophisticated manner where the character of the asset/liability mix is such that the residual asset risk is small compared to the risk associated with the underwriting. A simple percentage allowance in the discount rate used may well suffice. If not, the formulation of the asset risk should reflect:
- (1) prospective interest and inflation rates and their volatility;
 - (2) the nature, quality, duration and currency of assets; and
 - (3) mitigation of risk because of matching liability profiles.

- 10.5.14 G_{/1} The RBC model should reflect mitigation due to the independence or partial independence between the various risk components.
- 10.5.15 G_{/1} The RBC model should take account of concentrations of assets by *counterparty*, country and economic sector. It should also reflect the potential for asset shocks not matched by compensating changes in the value of liabilities.
- 10.5.16 G_{/1} The RBC model should also provide for loadings where this is appropriate to reflect inadequate systems and controls maintained by any *managing agent*.



10.6 Requirements relating to monitoring aggregations of risk

- 10.6.1** **R**_{/1} The *Society* must establish and maintain effective arrangements to monitor aggregations of risk within the Lloyd’s market.
- 10.6.2** **G**_{/1} The arrangements established by the *Society* under *LLD* 10.6.1R should include regular reviews of the effect on the market as a whole, and on specific parts of it, of a number of realistic disaster scenarios. The arrangements should where appropriate assess significant threats to the market posed by aggregations of risk.
- 10.6.3** **G**_{/1} These arrangements should also enable the *Society* to make and review other ad hoc or periodic analyses of aggregations, or potential aggregations, of risk within the market.
- 10.6.4** **G**_{/1} These arrangements should also enable the *Society* to obtain verification, on a sample basis, of the accuracy or reasonableness of the information on aggregations of risk given to it in respect of individual *syndicates*.
- 10.6.5** **G**_{/1} The *Society* should discuss with the *FSA* the results of its reviews of aggregations of risk and its future plans for aggregation monitoring, including the realistic disaster scenarios it proposes to specify and any other kinds of aggregation it plans to examine. The *Society* should take account of any suggestions the *FSA* makes about the types of aggregation of risk it should monitor and the techniques it should apply to do so.



10.7 Requirements relating to syndicate business plans

- 10.7.1** **R** _{/1} The *Society* must establish and maintain effective arrangements to:
- (1) satisfy itself of the adequacy of the business plans of all new *syndicates* for their first three *syndicate years*; and
 - (2) monitor the business plans of all active *syndicates* for each *syndicate year*.
- 10.7.2** **R** _{/1} The *Society* must where appropriate satisfy itself of the adequacy of the business plans of active *syndicates* for any *syndicate year* if a material change in the *syndicate's insurance business* is proposed or if there is reason to believe the interests of policyholders or potential policyholders are, or may be, threatened.
- 10.7.3** **G** _{/1} The *Society* should require that the *syndicate* business plans submitted to it under *LLD 10.7.1R* include details of:
- (1) the *syndicate's* key characteristics and strategy;
 - (2) the *syndicate's* objectives for the year, including underwriting and financial targets, investment policy, main risks to achieving the plan's targets, and contingency plans;
 - (3) the *class*, size and volume of *insurance business* to be carried on (specifying any proposed new products), including a *syndicate* income projection analysed by *class*;
 - (4) the reinsurance policy and programme, including details of proposed outward reinsurance to other *syndicates*;
 - (5) the reserving policy and methods; and
 - (6) the use of information technology.
- 10.7.4** **G** _{/1} The *Society* should consider each year, in the light of market developments and its assessment of risks to policyholders and potential policyholders, whether *syndicate* business plans should routinely cover areas other than those listed in *LLD 10.7.3G*.
- 10.7.5** **G** _{/1} The *Society* should ensure that the *syndicate* business plans required under *LLD 10.7.1R(2)* are submitted to it at least two months before the start of the relevant year.

- 10.7.6** G_{/1} The *Society* should review the *syndicate* business plans under *LLD* 10.7.1R(2), allocating the resources to be applied to each review with regard to its assessment of the relative risks to policyholders and potential policyholders posed by each *syndicate* (or type of *syndicate*).

- 10.7.7** G_{/1} The *Society* should use the *syndicate* business plans provided under *LLD* 10.7.1R when it plans and carries out its monitoring of *managing agents*, allocating the resource to be applied to monitoring each *managing agent* with regard to the *Society's* assessment of the relative risks to policyholders and potential policyholders posed by each *managing agent's* portfolio of *syndicates*.

10.8 Managing agents systems and controls

- 10.8.1** **R** ^{/1} The *Society* must take reasonable steps to ensure that *managing agents* maintain adequate internal systems and controls to manage the operational risks to which the *syndicates* they manage are exposed, including controls over the processes by which they, on behalf of *members*:
- (1) enter into *contracts of insurance*;
 - (2) settle and pay *claims*;
 - (3) determine *technical provisions* and other provisions; and
 - (4) determine the overall adequacy of the resources supporting the *insurance business*.
- 10.8.2** **G** ^{/1} *Managing agents*, as authorised persons, are required to comply with *PRIN* and *SYSC*. The *FSA* will monitor the Lloyd's market to satisfy itself that *managing agents*, by complying with the requirements of the *Society* in relation to maintaining effective systems and controls, are in compliance with the relevant requirements of *PRIN* and *SYSC*.
- 10.8.3** **G** ^{/1} In making its assessment of the adequacy of the systems and controls operated by *managing agents* the *Society* should take into account the factors listed below.
- (1) The board of *directors* of a *managing agent* is responsible for:
 - (a) approving adequate policies and procedures for managing operational risk;
 - (b) understanding and approving acceptable limits for insurance-liability risks to which *syndicate* members are or may be exposed; and
 - (c) ensuring that an adequate system is in place to enable those risks to be identified, measured and controlled.
 - (2) The policies and procedures for managing the operational risk of each *managing agent* should be:
 - (a) documented and regularly reviewed and updated;
 - (b) effectively communicated to enable all staff to understand and adhere to the policies and procedures which relate to their own responsibilities;
 - (c) comprehensive, with particular reference to business critical processes; and

- (d) regularly reviewed by operationally independent, appropriately trained and suitably skilled staff.
- (3) The senior management of each *managing agent* should have clear and well defined responsibilities for:
 - (a) implementing the policies and procedures approved by the *directors*; and
 - (b) establishing and maintaining an appropriate internal control system, including:
 - (i) an organisational structure with appropriate segregation of duties and with clearly defined responsibilities and reporting relationships;
 - (ii) an assessment procedure that ensures that all significant operational risks are recognised and continually assessed; and
 - (iii) an appropriate system to monitor and ensure compliance with procedures, limits and other controls.
- (4) Appropriate records should be made and maintained by each *managing agent*. These should include records of:
 - (a) an assessment of the validity of notified *claims* by reference to the underlying *contracts of insurance*;
 - (b) any investigations into any delays in underwriting, claims-handling, and other key processes, the remedial action taken and the effect of those delays on the reliability of the records of each *syndicate*;
 - (c) underwriting and *claims* records, so as to enable the *managing agent* to identify trends in the earnings profile and *claims* experience analysed, as appropriate for a proper control of the *insurance business*, by *class* and by source of *insurance business*;
 - (d) sufficient information from both internal and external sources to enable the *managing agent*, so far as reasonably possible, to identify new sources of loss or aggregations of risk whether from changes in the economic, business, legal or physical environment or from any other change in circumstance which might make past experience a poor predictor of the future;
 - (e) appropriate analyses (statistical or otherwise) applied to data, records and information, and appropriate assumptions made in the application of those analyses, to inform key business decisions including the setting of premium rates, the determination of the amount of *technical provisions* and the assessment of the overall adequacy of resources; and
 - (f) regular tests of the adequacy of premiums and *technical provisions* against actual results.



10.9 Requirements relating to the role of actuaries

- 10.9.1 **R** The *Society* must appoint an *actuary* (the *Lloyd's actuary*).
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- 10.9.2 **G** The position of *Lloyd's actuary* is not a *controlled function*.
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- 10.9.3 **R** The *Society* must ensure that the *Lloyd's actuary*:
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- (1) prepares the statement required under *LLD 15.9.1R(2)* to be annexed to the *Lloyd's Return*;
 - (2) is required to take reasonable steps to ensure that the *general insurance business technical provisions* for each *syndicate year* have been reviewed by the *syndicate actuary* under *LLD 10.9.4R(3)(a)* and that an appropriate opinion has been obtained under *LLD 10.9.4R(3)(b)*; and
 - (3) where a *syndicate actuary's* opinion has not been provided, sets appropriate *technical provisions* and, within 6 months of the end of the financial year, submits a report to the *FSA* on the setting of those *technical provisions*.
- 10.9.4 **R** The *Society* must have *byelaws* in place requiring:
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- (1) an *actuary* to be appointed to each *syndicate* (the *syndicate actuary*);
 - (2) the *syndicate actuary* of a *long-term insurance business syndicate* to:
 - (a) make an investigation at the end of each *financial year* into the financial condition of the business carried on through each *syndicate year* (other than a *closed year*);
 - (b) make an abstract of his report of the investigation; and
 - (c) prepare the certificate required under *LLD 15.9.1R(3)* to be annexed to the *Lloyd's Return*; and
 - (3) the *syndicate actuary* of a *general insurance business syndicate* to:

- (a) review the *technical provisions* (both gross and net of reinsurance recoveries) of each *syndicate year* (other than a *closed year*); and
- (b) provide an opinion confirming that the *technical provisions* for each *syndicate year* are no less prudent than his best estimate of the amounts required.

10.9.5

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When the *Society* becomes aware that a *syndicate actuary* of a *general insurance business syndicate* will or may be unable to provide an unqualified opinion under *LLD 10.9.4R(3)(b)*, it must promptly inform the *FSA* that this is the case.

10.9.6

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The *Society* must have *byelaws* in place requiring a *managing agent* that appoints a *syndicate actuary* to take reasonable care to ensure that the *actuary*:

- (1) has the required skill, resources and experience to perform his duties;
- (2) is a fellow of an *actuarial body* or (except for a *syndicate actuary* of a *long-term insurance business syndicate*) is a fellow of the Casualty Actuarial Society who is a member of an *actuarial body*.

10.9.7

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For a *general insurance business syndicate* each *actuarial body* requires the *syndicate actuary* to have a practising certificate.



10.10 Limitation of business

10.10.1

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The *Society* must take all reasonable steps to ensure that:

- (1) *members* which are bodies corporate or partnerships do not carry on any commercial business other than *insurance business* and activities arising directly from that business; and
- (2) *individual members* do not, in their capacity as *underwriting members*, carry on any commercial business other than *insurance business* and activities arising directly from that business.

10.10.2

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The limitation in *LLD* 10.10.1R(2) does not restrict the ability of *individual members* to conduct other business, at Lloyd's or elsewhere, for which membership of the *Society* is not a necessary pre-condition (for example, accepting employment by an *underwriting agent*).



10.11 Monitoring of transactions between members

10.11.1

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The *Society* must take reasonable steps to:

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- (1) monitor material connected-party transactions involving a *member* in the course of *members' insurance business*; and
- (2) ensure that these do not:
 - (a) distort the financial position and underwriting results of *members*; or
 - (b) result in any substantial risk that *members* may not be able to meet liabilities to policyholders.

Chapter 11.

Required margins of solvency

11.



11.1 Application and purpose

Application

- 11.1.1 **R** This chapter applies to the *Society*.
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- 11.1.2 **R** A contravention of the *rules* in this chapter does not give rise to a right of action by a *private person* under section 150 of the *Act* (Actions for damages) and each of those *rules* is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action.
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Purpose

- 11.1.3 **G** This chapter imposes on the *Society* solvency requirements that have a similar effect on Lloyd's as a whole to those imposed on *insurers*. The solvency requirements for *insurers* are set out in *IPRU(INS) 2* (Margins of solvency) (see also *LLD 9.1.4G*).
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- 11.1.4 **G** *Members* are not responsible for meeting the liabilities of other *members*, so the *Society* needs to calculate solvency requirements (the *required amount*) attributable to each *member's insurance business*. *LLD 11.2.1R* provides that, where a *member's* assets are insufficient to cover his *required amount*, any shortfall must be covered by *net central assets* of the *Society*.
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- 11.1.5 **G** However, especially for *general insurance business*, the requirements of this chapter should be regarded as the minimum. They do not relieve the *Society* of the requirement to assess the actual risks arising from its activities and the *insurance business* carried on at Lloyd's by its *members* and to ensure the adequacy of the assets and other resources available to support those risks.
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- 11.1.6 **G** In accordance with *Principle 11* (Relations with regulators), *LLD 11.2.4R* requires the *Society* to inform the *FSA* if the solvency requirement of *LLD 11.2.1R* is or is likely to have been breached. Likewise *LLD 11.2.11R* requires the *Society* to inform the *FSA* if a criterion similar to the *guarantee fund* requirement for *insurers* is or is likely to have been breached.
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11.2 Solvency requirement

11.2.1

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The *Society* must maintain *net central assets* which are adequate to cover the aggregate of:

- (1) for each *member*, the amount by which his *general insurance business assets* are less than the *required amount* calculated under *LLD 11.2.6R*;
- (2) for each *member*, the amount by which his *long-term insurance business assets* are less than the *required amount* calculated under *LLD 11.2.7R*;
- (3) the excess (if any) of the amount calculated under *LLD 11.5.1R* (the *Society margin*) over the sum for all *members* of the *members' margins* for *general insurance business*; and
- (4) the excess (if any) of the sterling equivalent of 800,000 Euros (using the conversion rate notified by the *FSA* from time to time for this purpose) over the sum for all *members* of the *members' margins* for *long-term insurance business*.

11.2.2

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Where an asset is held as part of *funds at Lloyd's* and is available to meet the liabilities of more than one *member* (interavailable funds), the *Society* may, as it considers appropriate, allocate that asset (net of any attaching liability) between those *members* for the purpose of *LLD 11.2.1R*.

11.2.3

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LLD 11.2.1R is the central financial requirement placed on the *Society*. The *Society* will need to perform an assessment of the financial position of each *member*, to the extent necessary to confirm continuing compliance with *LLD 11.2.1R*. It will need to have sufficient funds centrally to cover the total of:

- (1) any shortfall in the assets of *members* when, individually, their assets are less than the sum of their liabilities and a *member's margin*, calculated according to formulae set out in *LLD 11.3.1R* and *LLD 11.3.4R*; and
- (2) any adjustment required of the *Society* when the total of *members' margins* is less than the result would have been had the *Society* been treated as a single *insurer* and applied the relevant solvency test to itself.

11.2.4

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The *Society* must inform the *FSA* promptly if:

- (1) its *net central assets* fall below the amount required under *LLD 11.2.1R*; or

- (2) it cannot confirm that it has maintained the *net central assets* required under *LLD 11.2.1R*.
- 11.2.5** G_{/1} If the *Society* fails to maintain the *net central assets* required under *LLD 11.2.1R*, the *FSA* would expect to require the *Society* to prepare and submit a plan for the restoration of a sound financial position similar to that required from insurers by *SUP*, Appendix 2 1.3, and other remedies might also apply, including the *FSA*'s exercise of its *own-initiative power* under section 45 of the *Act* (Variation etc. on the Authority's own initiative).
- 11.2.6** R_{/1} For each *member*, the *required amount for general insurance business* is the aggregate of:
- (1) his *general insurance business liabilities*; and
 - (2) the *member's margin for general insurance business*, calculated under *LLD 11.3.1R*.
- 11.2.7** R_{/1} For each *member*, the *required amount for long-term insurance business* is the aggregate of:
- (1) his *long-term insurance business liabilities*; and
 - (2) the *member's margin for long-term insurance business*, calculated under *LLD 11.3.4R*.
- 11.2.8** G_{/1} The *member's margin* and the *Society margin* (together with the requirement for the *Society* to maintain *net central assets* to cover any shortfalls) are similar to the *required minimum margin for insurers*.
- 11.2.9** G_{/1} The *required minimum margin* for an *insurer* contains within it a further threshold, that assets must exceed liabilities by the *guarantee fund*. If this requirement is not met, further regulatory actions are triggered. The *guarantee fund* for an insurer is an amount which is calculated as one third of the *required minimum margin* (or the *minimum guarantee fund* if greater).
- 11.2.10** G_{/1} A similar test for the *Society* is whether it maintains *net central assets* to meet the criterion of *LLD 11.2.11R*.
- 11.2.11** R_{/1} The *Society* must inform the *FSA* promptly if its *net central assets* are, or are likely to be, inadequate to cover the aggregate of:
- (1) for each *member*, the amount by which his *general insurance business assets* are less than the *lower required amount* calculated under *LLD 11.2.13R*;
 - (2) for each *member*, the amount by which his *long-term insurance business assets* are less than the *lower required amount* calculated under *LLD 11.2.14R*;
 - (3) the excess (if any) of the amount determined under *LLD 11.5.2R* (the *Society guarantee fund*) over one-third of the sum for all *members* of the *members' margins for general insurance business*; and

(4) the excess (if any) of the sterling equivalent of 800,000 Euros (using the conversion rate notified by the FSA from time to time for this purpose) over one-third of the sum for all *members* of the *members' margins* for *long-term insurance business*.

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If the *Society* fails to meet this criterion, the FSA would expect to require the *Society* to prepare and submit a short-term financial scheme similar to that required from insurers by SUP, Appendix 2 1.4, and other remedies might also apply, including the FSA's exercise of its *own-initiative power* under section 45 of the *Act* (Variation etc. on the Authority's own initiative).

11.2.13

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For each *member*, the *lower required amount* for *general insurance business* is the aggregate of:

- (1) his *general insurance business liabilities*; and
- (2) one-third of the *member's margin* for *general insurance business*, calculated under LLD 11.3.1R.

11.2.14

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For each *member*, the *lower required amount* for *long-term insurance business* is the aggregate of:

- (1) his *long-term insurance business liabilities*; and
- (2) one-third of the *member's margin* for *long-term insurance business*, calculated under LLD 11.3.4R.



11.3 Member's margin

General insurance business

11.3.1 **R** ^{/1} *A member's margin for general insurance business is the higher of the amounts determined under:*

- (1) *LLD 11.4.8R* (the premiums basis); and
- (2) *LLD 11.4.13R* and *LLD 11.4.16R* (the claims basis);

multiplied by the netting-down percentage (to allow for reinsurance) determined under LLD 11.4.20R.

11.3.2 **G** ^{/1} *The member's margin applying throughout a financial year depends on premiums receivable during the previous financial year or claims incurred during the three previous financial years, multiplied in each case by a ratio derived primarily from claims incurred in the previous financial year.*

11.3.3 **G** ^{/1} *LLD 15 (Reporting by the Society) requires the annual returns to reflect the solvency requirements applicable to the following financial year in the statement of the financial position as at the end of a financial year.*

Long-term insurance business

11.3.4 **R** ^{/1} *A member's margin for long-term insurance business is the required margin of solvency which would apply to the member for his long-term insurance business if the member were an insurer and that requirement were modified as in LLD 11.3.6R.*

11.3.5 **G** ^{/1} *IPRU(INS) 2 (Margins of solvency) specifies the margins of solvency which an insurer must maintain.*

11.3.6 **R** ^{/1} *Mathematical reserves (both before and after deduction of reinsurance cessions) and capital at risk must be calculated as if every reinsurance to close were a transfer of engagements.*

11.3.7 **G** ^{/1} *The purpose of LLD 11.3.6R is to ensure that each member's margin applicable to a financial year is calculated by reference to his participation as at the start of the financial year.*

11.3.8

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As supplementary sickness and accident *insurance business* is not written as part of any *long-term insurance contract* at Lloyd's, this chapter does not include solvency requirements for that business.

11.4 General insurance

Provisions common to the premiums and claims bases

- 11.4.1 **R** /1 In *LLD 11.4.8R* and *LLD 11.4.13R*, *actuarial health insurance* means *general insurance business* which is sickness insurance and satisfies the following conditions:
- (1) the gross premiums receivable are calculated on the basis of sickness tables appropriate to *insurance business*;
 - (2) the reserves include provision for increasing age;
 - (3) an additional premium is collected in order to set up appropriate additional prudential provisions;
 - (4) it is not possible for the *member* or *syndicate* to cancel the contract after the end of the third year of insurance; and
 - (5) the contract provides for the possibility of increasing premiums or reducing benefits during its currency.
- 11.4.2 **R** /1 In *LLD 11.4.8R*, *LLD 11.4.13R* and *LLD 11.4.19R*, the *member's* share of premiums receivable and *claims* incurred:
- (1) excludes amounts in respect of *syndicate years* which have been *closed into open syndicate years* in which the member did not participate at the end of the previous *financial year*; but
 - (2) includes amounts, determined under *LLD 11.4.4R*, in respect of *syndicate years* which have been *closed into open syndicate years* in which the *member* participated at the end of the previous *financial year*.
- 11.4.3 **G** /1 The *member's* share includes amounts in respect of *open syndicate years* in which the *member* participated at the end of the previous *financial year*.
- 11.4.4 **R** /1 In *LLD 11.4.2R* the *member's* share for a *closed syndicate year* must be determined by reference to the *member's* participation in the *open syndicate year* into which it has been *closed*.

- 11.4.5** G_{/1} *LLD 11.4.4R* establishes the principle that a *member's* share of premiums and *claims* is determined according to the *member's* participation in the *open syndicate year* into which the *closed syndicate year* has been *closed*. Therefore any participation the *member* had in the *closed syndicate year* (or any other *syndicate year* into which it was previously *closed*) should not be used. This applies whenever amounts were *receivable*, paid, outstanding or recoverable, and to whatever date they relate.
- 11.4.6** R_{/1} In determining for each *member* the amount of *general insurance business premiums receivable* in a period for the purposes of *LLD 11.4.8R* and *LLD 11.4.11R*, premiums under contracts of reinsurance accepted shall be included, but amounts *receivable* under contracts of *reinsurance to close* accepted shall be excluded.
- 11.4.7** G_{/1} Subject to *LLD 11.4.2R*, *LLD 11.4.4R* and *LLD 11.4.6R*, the amounts of premiums and *claims* should be determined in accordance with the accounting principles and rules contained in the *insurance accounts rules* and generally accepted accounting practice. They should therefore exclude amounts arising from contracts, regardless of their legal form, that do not fall to be classified as insurance or reinsurance under generally accepted accounting practice.
- Premiums basis**
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- 11.4.8** R_{/1} Subject to *LLD 11.4.2R*, *LLD 11.4.6R* and *LLD 11.4.9R*, for each *member* the premiums basis referred to in *LLD 11.3.1R* is his share of the *general insurance business premiums receivable* (or one-third of his share for *actuarial health insurance*) in the previous *financial year* multiplied by 16% of the factor determined under *LLD 11.4.11R*.
- 11.4.9** G_{/1} If the *Society* cannot determine premiums gross of commission without disproportionate expense, it may calculate the premiums net of commission and then gross up by the ratio of gross to net premiums for the *members* taken together.
- 11.4.10** G_{/1} In setting the premium basis at 16% of premiums in the year (and one-third of this for *actuarial health insurance*), *LLD 11.4.8R* is similar to the corresponding calculation for *insurers*. Liabilities subjected to *reinsurance to close* are treated as having been written originally by *members* of the accepting *syndicate year*, rather than of the ceding *syndicate year*.
- 11.4.11** R_{/1} The factor referred to in *LLD 11.4.8R* is the ratio for all *members* taken together of *general insurance business premiums receivable* in the previous *financial year* net of *inter-syndicate reinsurance* premiums, to those premiums before deducting *inter-syndicate reinsurance* premiums.
- 11.4.12** G_{/1} Adjustments are made for *inter-syndicate reinsurance* on an approximate basis to enable Lloyd's as a whole to avoid double-counting part of the margin.

Claims basis

- 11.4.13 **R**_{/1} For each *member*, the claims basis referred to in *LLD* 11.3.1R is his share, determined under *LLD* 11.4.2R, of the *general insurance business claims* incurred (or one-third of his share in the case of *actuarial health insurance*) in the three previous *financial years* divided by three and multiplied by 23% of the factor determined under *LLD* 11.4.17R.
- 11.4.14 **G**_{/1} *LLD* 11.4.4R and *LLD* 11.4.6R apply to the determination of claims incurred.
- 11.4.15 **G**_{/1} In setting the claims basis at 23% of the annual average of *claims* incurred in the three year period (and one-third of this for *actuarial health insurance*), *LLD* 11.4.13R is similar to the corresponding calculation for *insurers*. Liabilities subjected to *reinsurance to close* are treated as having been written originally by *members* of the accepting *syndicate year*, rather than the ceding *syndicate year*.
- 11.4.16 **R**_{/1} For a *member*, the claims basis referred to in *LLD* 11.3.1R is nil if:
- (1) every *open syndicate year* in which the *member* participated at the end of the previous *financial year*; and
 - (2) every other *syndicate year* which has been *closed* into any such *open syndicate year*;
- commenced after the start of the third last previous *financial year*.
- 11.4.17 **R**_{/1} The factor referred to in *LLD* 11.4.13R is the ratio for all *members* taken together of *general insurance business claims* paid in the three previous *financial years* net of *inter-syndicate reinsurance* recoveries, to those *claims* before deducting *inter-syndicate reinsurance* recoveries.
- 11.4.18 **G**_{/1} Adjustments are made for *inter-syndicate reinsurance* on an approximate basis to enable Lloyd's as a whole to avoid double-counting part of the margin.

Factor to net down for reinsurance

- 11.4.19 **R**_{/1} For the purposes of *LLD* 11.4.20R and subject to *LLD* 11.4.2R, the ratio for each *member* is the ratio for the previous *financial year* of his share of net (of reinsurance) *claims* incurred to his share of gross *claims* incurred divided by the factor determined under *LLD* 11.4.21R.
- 11.4.20 **R**_{/1} For each *member* the netting-down percentage referred to in *LLD* 11.3.1R is:
- (1) where the ratio determined under *LLD* 11.4.19R is greater than 100%, 100%; or
 - (2) the ratio determined under *LLD* 11.4.19R, where it is greater than 50%, but not greater than 100%; or

(3) in any other case, 50%.

11.4.21

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The factor referred to in *LLD* 11.4.19R is the ratio for all *members* taken together of *general insurance business claims* paid in the previous *financial year* net of *inter-syndicate reinsurance recoveries*, to those *claims* before deducting *inter-syndicate reinsurance recoveries*.

11.4.22

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Adjustments are made for *inter-syndicate reinsurance* on an approximate basis to enable Lloyd's as a whole to avoid double-counting part of the margin.



11.5 Society margin

- 11.5.1** **R** _{/1} The *Society* must calculate the *required minimum margin* it would have to maintain under *IPRU(INS) 2* (Margins of solvency) if it were an *insurer* carrying on all the *general insurance business* carried on by its *members*, but eliminating *inter-syndicate reinsurance* (the *Society margin*).
- 11.5.2** **R** _{/1} The *Society* must calculate the *guarantee fund* it would have to maintain under *IPRU(INS) 2* (Margins of solvency) if it were an *insurer* carrying on all the *general insurance business* carried on by its *members*, but eliminating *inter-syndicate reinsurance* (the *Society guarantee fund*).
- 11.5.3** **G** _{/1} The *required minimum margin* and the *guarantee fund* must, under *IPRU(INS)*, at least equal the *minimum guarantee fund*. So the *Society margin* and the *Society guarantee fund* must at least equal the *minimum guarantee fund* which would apply if the *members* taken together constituted an *insurer*, other than a mutual, authorised for all *classes* of *general insurance business* carried on at Lloyd’s.
- 11.5.4** **G** _{/1} Appendices 2.1 to 2.3 of *IPRU(INS)* also set out how the “premium basis”, the “claims basis” and the *minimum guarantee fund* should be calculated for an *insurer*.
- 11.5.5** **G** _{/1} For the purpose of *LLD 11.5.1R* and *LLD 11.5.2R* the *Society* may make appropriate approximations, taking reasonable care to avoid underestimating the *Society margin* and the *Society guarantee fund*.

Chapter 12.

Determination of liabilities



12.1 Application and purpose

Application

12.1.1 **R** This chapter applies to the *Society*.

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12.1.2 **R** A contravention of the *rules* in this chapter does not give rise to a right of action by a *private person* under section 150 of the *Act* (Actions for damages) and each of those *rules* is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action.

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Purpose

12.1.3 **G** These requirements provide safeguards against the risk that insurance liabilities will be underestimated (see also *LLD 9.1.4G*).

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12.1.4 **G** Under *LLD 9.4.1R*, subject to *LLD 9 to 15*, the *insurance accounts rules* and generally accepted accounting practice apply to the valuation of assets and the determination of liabilities.

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12.2 Requirement to determine liabilities

- 12.2.1** **R** ^{/1} The *Society* must:
- (1) identify and attribute a value to its liabilities; and
 - (2) take all reasonable steps to ensure that the liabilities of its *members* arising out of the *insurance business* which they carry on at Lloyd's are identified and attributed a value, under *LLD 12.3*, *LLD 12.4* and *LLD 12.5*.
- 12.2.2** **G** ^{/1} *Members* are organised into *syndicate years*, each of which is managed by a *managing agent*. For the *Society* to comply with the requirements of this chapter, it needs to ensure that *managing agents* effectively apply the *rules* in this chapter to individual *syndicate years*.
- 12.2.3** **G** ^{/1} In general terms, the liabilities for the purposes of this chapter are:
- (1) the *member's* share of the *insurance business* liabilities which fall to be identified and valued for each *syndicate year*;
 - (2) any liabilities of a *member*, not covered by (1), arising from the *insurance business* that he carries on at Lloyd's; and
 - (3) any liabilities of the *Society*, other than liabilities that are subordinated to the interests of policyholders.
- 12.2.4** **R** ^{/1} For *credit insurance business of members*, the *Society* must determine the equalisation reserve that would apply if all the *members* taken together constituted a single *insurer* subject to *IPRU(INS)*.
- 12.2.5** **G** ^{/1} The *Society* may:
- (1) allocate the equalisation reserve under *LLD 12.2.4R* between *open syndicate years* and *members* in any way it considers appropriate; and
 - (2) choose not to allocate all or any part of it to *members* but instead treat it as a liability of the *Society*.
- Provision for related insurance undertakings**
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- 12.2.6** **R** ^{/1} Subject to *LLD 12.2.7R*, if a related undertaking is an *insurance undertaking* which has a deficit in the assets available to cover its

liabilities or to cover the notional *required minimum margin*, the *Society* must make provision for:

- (1) its proportionate share of that deficit; or
- (2) in the case of a *subsidiary undertaking*, the whole of that deficit.

12.2.7

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For the purposes of *LLD* 12.2.6R, the identification and valuation of assets must be determined, and the deficit must be valued, in accordance with *LLD* 13.15.4R, except that any liability which is a debt to the *Society* need not be valued at more than the value placed on that debt as an asset of the *Society*.



12.3 Members' liabilities

12.3.1

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For *open syndicate years*, a *member's* liabilities are the aggregate of:

- (1) his proportionate share of the liabilities of each *open syndicate year* in which he participates, including:
 - (a) liabilities associated with earlier *syndicate years* that have been *closed into* that year; and
 - (b) any equalisation reserve allocated to him for the *syndicate year* by the *Society* under *LLD 12.2.5G*; and
- (2) for *open syndicate years* through which he carries on *general insurance business* taken together, if $A+B$ exceeds C , $A+B-C$, where:
 - (a) A is the total of his proportionate shares for each *syndicate year* of the accumulated excess of income over outgoings;
 - (b) B is the amount of any unpaid additional contributions he is required to make to the funds maintained for the *syndicate years* by the *managing agents*; and
 - (c) C is the total of his proportionate shares of the liabilities net of reinsurance recoveries.

12.3.2

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For the purpose of *LLD 14.3* (Currency matching and localisation), the amounts in:

- (1) *LLD 12.3.1R(2)*, which are intended to prevent the premature release of profits; and
- (2) *LLD 12.2.4R* (the equalisation reserve);

may be left out of account.

12.3.3

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For the purposes of this chapter the following liabilities may be left out of account:

- (1) liabilities of a *member* for guarantees or letters of credit issued to support the *insurance business* he carries on at Lloyd's, where the

guarantor or issuer has no recourse to *premium trust funds* or *funds at Lloyd's*;

- (2) liabilities which have been covered by a *reinsurance to close* with reinsurers who were *members* when the *reinsurance to close* was effected;
- (3) liabilities of a *member*, which arise other than in connection with the *insurance business* he carries on at Lloyd's or his membership of the *Society*, and cannot be met from his *funds at Lloyd's* until those funds are released to him; and
- (4) liabilities for 1992 and prior *general insurance business* reinsured by Equitas Reinsurance Ltd.

12.3.4

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LLD 12.3.1R requires the aggregate net surplus (if any) in a member's participations in *open general insurance business syndicates* to be treated as part of his liabilities. This is analogous to the treatment of open years for an *insurer* using the fund basis of accounting. LLD 12.3.3R allows liabilities not relevant to the solvency of the Lloyd's market and (to prevent double-counting) amounts covered by *reinsurance to close* to be left out of account.



12.4 General insurance business technical provisions

12.4.1 G_{/1} This section relates only to liabilities arising in *general insurance business* syndicates. Each *member* is liable for his share of the liabilities of each *syndicate year* in which he participates. Provisions for these liabilities include *technical provisions* for insurance liabilities and provisions for any other liabilities. This section also provides *guidance* on the valuation of reinsurance recoveries.

12.4.2 R_{/1} The gross *technical provisions* set for *general insurance business liabilities* arising in any *syndicate year* (other than the equalisation reserve arising under *LLD 12.2.5G*) must not be less than the best estimate of the monetary amount expected ultimately to be payable to discharge all liabilities for that *syndicate year* not covered by other provisions, before taking reinsurance into account, less a prudent allowance for future premiums not yet accrued.

12.4.3 G_{/1} The *managing agent* will normally set the *technical provisions* for a *syndicate year*. The *Society* will need to take all reasonable steps to ensure that the provisions comply with these *rules*. *LLD 10.9* (Requirements relating to the role of actuaries) requires that the year end provisions be verified by an *actuary* appointed by the *managing agent* or that the *Lloyd's actuary* sets the provisions.

12.4.4 G_{/1} The gross *technical provisions* in *LLD 12.4.2R* should include:

- (1) gross notified outstanding *claims*;
- (2) incurred but not reported losses;
- (3) unexpired risks (including potential losses on *insurance business* still to be written under binding agreements and similar arrangements); and
- (4) future claims-handling costs, including the costs of managing the run-off of the *insurance business*.

12.4.5 G_{/1} The guidance in *LLD 12.4.4G* is not intended to require separate identification of these amounts beyond that required for reporting purposes, except to the extent necessary for proper estimation of the total.

12.4.6 G_{/1} The prudent allowance for future premiums in *LLD 12.4.2R* should allow for anti-selection by policyholders. Except to the extent that there is a legitimate set off against other liabilities, it should not be assumed that the liabilities arising from future premiums to be received on any group of contracts are less than those premiums.

- 12.4.7 **R**_{/1} The *technical provisions* (net of reinsurance) for any *syndicate year* being *closed by reinsurance to close* must at least equal the part of the *reinsurance to close* premium that relates to those provisions.
- 12.4.8 **R**_{/1} **Discounting** must not be applied when calculating *technical provisions*.
- 12.4.9 **G**_{/1} The provisions for incurred but not reported losses and unexpired risks should allow for a *syndicate's* exposure to losses arising from one or more known major catastrophes or from a known potential cause of loss (including post balance sheet date losses).
- 12.4.10 **G**_{/1} Where it is reasonable and prudent to do so, the provision for unallocated future claims-handling costs should be calculated on the practical assumption that each *syndicate* is a going concern. Otherwise, provision should be made on the basis that the *syndicate* has ceased or will cease trading, in whole or part, as appropriate. The gross provision for unallocated claims-handling costs should include costs of handling reinsurance recoveries as well as the costs of handling gross *claims*.
- 12.4.11 **G**_{/1} The value of reinsurance recoveries should be the net monetary amounts expected ultimately to be received for each *syndicate year*, net of future reinsurance premiums and other liabilities under the reinsurance contract, with:
- (1) an appropriate provision for potential reinsurance bad debts; and
 - (2) an allowance for any costs of borrowing necessary to cope with delays in reinsurance recoveries.
- 12.4.12 **G**_{/1} The provision for future reinsurance premiums should be made irrespective of the *syndicate year* to which the reinsurance premiums will be charged. Where the reinsurance has not yet been purchased, the appropriate provision should be no less than the reduction in liabilities assumed from that reinsurance cover.
- 12.4.13 **G**_{/1} *LLD* 12.4.12G is intended to ensure that an adequate provision is set up, where the reinsurance premium is to be charged to a *syndicate year* other than that to which the recoveries will accrue. The provision may not be avoided by charging the premium to a future *syndicate year*. This could be particularly important where reinsurance is placed on the basis of losses which occur during the year of account, or where policies are written for periods in excess of one year, or under binding arrangements. Where it is intended that the premium will be charged to a future *syndicate year*, stop loss and similar protections applicable to the current *syndicate year* would not normally cover it.
- 12.4.14 **R**_{/1} **To avoid double-counting of liabilities, reinsurance with other *syndicate years* must be treated as 100% recoverable, except that allowance must be made for reinsurance disputes.**
- 12.4.15 **G**_{/1} When making allowance for reinsurance disputes under *LLD* 12.4.14R, the scope for unidentified and potential disputes should be considered in addition to known disputes.
- 12.4.16 **G**_{/1} Contracts of reinsurance should be assessed in accordance with the Principles of Financial Reporting Standard 5 (as issued in April 1994 and amended in December 1998). That is, if the contract has the characteristics of an investment it must be treated as such and valued for solvency purposes under *LLD* 13 (Assets: valuation and realisability risk) and *LLD* 14 (Assets: market and credit risk).



12.5 Long-term liabilities

Application

- 12.5.1** **G**
/1 This section applies to the *long-term insurance business liabilities* of *members*. The requirements of this section are comparable with those that apply to *insurers* carrying on *long-term insurance business*.
- 12.5.2** **G**
/1 The requirements of this section take account of the fact that the *Society* restricts the types of *long-term insurance business* carried on at Lloyd’s to term insurance of no more than 25 years duration.
- 12.5.3** **G**
/1 *LLD* 10.9.4R(1) requires the *Society* to require each *syndicate* to have a *syndicate actuary*. *LLD* 15 (Reporting by the *Society*) requires a certificate from each *syndicate actuary* of a *long-term insurance business syndicate* in the specified format. This should attest to, among other things, compliance with the valuation and reporting requirements of *LLD* 9 to 15.

Determination of liabilities

- 12.5.4** **R**
/1 The determination of the amount of *long-term insurance business liabilities* (other than those that have fallen due for payment before the valuation date) must:

 - (1) be made on actuarial principles that have due regard to the reasonable expectations of policyholders; and
 - (2) make proper provision for all liabilities, on prudent assumptions that include appropriate allowance for adverse deviation of any relevant factors.
- 12.5.5** **R**
/1 The determination under *LLD* 12.5.4R must take account of all prospective liabilities as determined by the conditions of each existing *contract of insurance*, taking credit for premiums payable after the valuation date.
- 12.5.6** **G**
/1 In valuing liabilities, account should be taken of the following factors:

 - (1) all guaranteed benefits, including guaranteed surrender values;
 - (2) all options available to the policyholder under the terms of the contract;

- (3) expenses, including commissions; and
- (4) any rights or obligations under contracts of reinsurance in respect of *long-term insurance business*.

12.5.7 **G**_{/1} While the limitation on *long-term insurance business* described in *LLD 12.5.2G* remains in place the "gross premium" method of valuation should generally be the most appropriate. However, the *syndicate actuary* may use an alternative method where he considers this to be more appropriate to the particular circumstances of the *syndicate*.

Method of calculation

12.5.8 **R**_{/1} Subject to *LLD 12.5.9R* to *LLD 12.5.11R*, the amount of the liabilities for each *long-term insurance contract* must be determined separately by a prospective calculation.

12.5.9 **R**_{/1} A retrospective calculation may be used to determine the liabilities where a prospective method cannot be used for a particular type of *long-term insurance contract* or benefit under the contract, or where it can be demonstrated that the resulting amount of the liabilities would be no lower than would be the case with a prudent prospective calculation.

12.5.10 **R**_{/1} Appropriate approximations or generalisations may be made where they are likely to provide the same, or a higher, result than separate calculations of the liabilities for each *long-term insurance contract*.

12.5.11 **R**_{/1} Where appropriate, additional provision must be established on an aggregated basis for general risks that are not individualised.

12.5.12 **R**_{/1} The method for calculating the amount of the liabilities and the assumptions used must not be subject to discontinuities from year to year arising from arbitrary changes and must recognise the distribution of profits in an appropriate way over the duration of each contract.

Avoidance of future valuation strain

12.5.13 **R**_{/1} The total amount of the liability for a group of similar *long-term insurance contracts* must not be less than an amount which, if the assumptions adopted for the valuation remained unaltered and were fulfilled in practice, would enable similarly determined liabilities to be covered at all times in the future from resources which arise only from the contracts and assets covering the amount of the liability determined at the current valuation.

12.5.14 **R** /1 The *mathematical reserves* and other insurance and non-insurance liabilities for any *syndicate year* being *closed* by *reinsurance to close* must be at least equal to the *reinsurance to close* premium.

Rates of interest

12.5.15 **R** /1 The rates of interest used to calculate the present value of future payments by or to the fund maintained for the *syndicate year* by the *managing agent* must be no greater than the rates of interest determined:

- (1) from a prudent assessment, under *LLD 12.5.17R*, of the yields on existing assets in the *premium trust fund*; and
- (2) to the extent appropriate, from the yields assumed, under *LLD 12.5.16R* and *LLD 12.5.23R*, on sums to be invested in the future.

12.5.16 **R** /1 (1) Subject to (2), when the value of assets in the *premium trust fund* is less than the *mathematical reserves* and other insurance and non-insurance liabilities using a gross valuation interest rate under *LLD 12.5.15R*, the shortfall is assumed to be met by contributions by *members* invested at a yield not exceeding the long term reinvestment rate in *LLD 12.5.24R(1)*.

- (2) If the weighted average, using asset values and contribution amounts as weights, of:
 - (a) the yield on the assets in the *premium trust fund* backing *mathematical reserves* calculated under *LLD 12.5.15R(1)*; and
 - (b) the yield on contributions from *members* assumed under (1);
 is less than the gross valuation interest rate, the gross valuation interest rate must be reduced and additional contributions assumed from *members* until this test is satisfied.

12.5.17 **R** /1 For the purposes of *LLD 12.5.15R*, the yield (before any adjustment to take account of the effect of taxation) must not exceed the yield on that asset, calculated under *LLD 12.5.18R* to *LLD 12.5.22R*, reduced by 2.5% of that yield.

12.5.18 **R** /1 When calculating the yield on an asset under *LLD 12.5.17R*, the future income from any asset required to be taken into account (whether interest, dividends or repayment of capital) must be reduced by a proportion corresponding to such of the excess exposure to assets of that description as may reasonably be attributed to those assets.

12.5.19 **R** ^{/1} Subject to *LLD* 12.5.23R, the yield on fixed interest securities must be the annual rate of interest which, if used to calculate the present value of future interest payments before the deduction of tax and the present value of any repayments of capital, would result in the sum of those amounts being equal to the value of the asset.

12.5.20 **R** ^{/1} Subject to *LLD* 12.5.22R, the yield on equity *shares* or land (other than fixed interest securities) must be the ratio to the value of the asset of the income before deduction of tax that would be received within 12 months following the valuation date, on the assumption that the asset will be held throughout that period and that the factors that affect income will remain unchanged, taking account of any changes in those factors known to have occurred by the valuation date including:

- (1) any known changes in the rental income from land or in dividends on equity *shares*;
- (2) any forecast changes in dividends that have been publicly announced by the valuation date;
- (3) the effect of any alterations in capital structure; and
- (4) the value (at the most recent date for which it is known at the valuation date) of any determinant of the amount of any future interest payment, and this value must be treated as remaining unaltered in the future.

12.5.21 **R** ^{/1} Subject to *LLD* 12.5.22R, the yield on investments other than equity *shares*, land or fixed interest securities must be the annual rate of interest which, if it were used to calculate the present value of future interest payments (before the deduction of tax) and the present value of any repayments of capital, would result in the sum of these amounts being equal to the value of the asset, on the assumption that:

- (1) the value of any determinant of the amount of the next interest payment and capital repayment made during the following 12 months will be the value of that determinant at the most recent date for which it is known at the valuation date;
- (2) the amount of future interest payments and capital repayments will take account, where appropriate, of:
 - (a) the right of either party to have the investment repaid; and
 - (b) an assumed yield on other comparable investments made in the future not exceeding an amount determined under *LLD* 12.5.23R to *LLD* 12.5.25R; and

- (3) indices and all other factors that affect future income payments or capital repayments will remain unchanged after the valuation date.

12.5.22

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In calculating the yield on an asset:

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- (1) if the asset is not equity *shares* or land:
 - (a) a prudent adjustment must be made to exclude that part of the yield estimated to represent compensation for the risk that the income from the asset might not be maintained or that capital repayments might not be received as they fall due; and
 - (b) in making that adjustment, regard must be had wherever possible to the yields on risk-free investments of a similar term in the same currency;
- (2) if the asset is equity *shares* or land, adjustments to yields must be made, as appropriate, to exclude that part of the yield from each category of asset needed to compensate for the risk that the aggregate income from that category of asset, taking one year with another, might not be maintained;
- (3) in (2), a "category of asset" comprises assets of a similar nature, type and degree of risk.

12.5.23

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Where it is necessary to make an assumption about the yields on sums to be invested in the future, other than sums representing a shortfall referred to in *LLD* 12.5.16R, yields must be determined under *LLD* 12.5.24R and *LLD* 12.5.25R.

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12.5.24

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Where *LLD* 12.5.23R applies and liabilities are denominated in sterling, the yield (before any adjustment to take account of the effect of taxation) assumed:

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- (1) on any investment to be made more than three years after the valuation date, must not exceed the lowest of:
 - (a) the long term gilt yield current on the valuation date; or
 - (b) 3% per annum, increased by two thirds of the excess, if any, of the long term gilt yield current on the valuation date over 3% per annum; or
 - (c) 6.5% per annum;

where "the long term gilt yield" means the annualised equivalent of the 15 year yield for *United Kingdom* Government fixed-interest securities jointly compiled by the Financial Times, the Institute of Actuaries and the Faculty of Actuaries; and

(2) on any investment to be made not more than three years after the valuation date must not exceed the assumed yield determined under *LLD 12.5.17R* adjusted linearly over the three years to the yield determined in accordance with (1).

12.5.25 **R** Where *LLD 12.5.23R* applies and liabilities are denominated in currencies other than sterling, the yield must be determined on assumptions that are as prudent as those under *LLD 12.5.24R*.

12.5.26 **R** (1) A rate of interest determined for the purposes of *LLD 12.5.15R* must not exceed the adjusted overall yield on assets calculated as the weighted average of the reduced yields on the individual assets, calculated under *LLD 12.5.17R*.

(2) When the weighted average in (1) is calculated, the weight given to each investment must be its value as an asset determined under *LLD 13* (Assets: valuation and realisability risk) and *LLD 14* (Assets: market and credit risk).

12.5.27 **R** For the purpose of determining the rates of interest to be used in valuing different categories or types of *long-term insurance contract*, the assets may, where appropriate, be notionally apportioned between the different categories or types of contract.

Rates of mortality and disability

12.5.28 **R** Where relevant, the amount of the liability for any category or type of *long-term insurance contract* must be determined on the basis of prudent rates of mortality and disability.

Expenses

12.5.29 **R** (1) The provision (including any implicit provision) for expenses must be not less than the amount required, on prudent assumptions, to meet the total cost (net of the effect of taxation) likely to be incurred in fulfilling *long-term insurance contracts* if the *syndicate* were to cease to transact new business 12 months after the valuation date.

(2) Allowance must be made for the effect of inflation on future expenses, on prudent assumptions about the future rates of increase in prices and earnings.

12.5.30 **G** For an individual *syndicate year*, the provision for expenses under *LLD 12.5.29R*(1) should take into account fair apportionments of:

(1) the overall *syndicate* expenses for the year following the valuation;

- (2) any costs which would be incurred in closing the *syndicate* to new business; and
- (3) the cost of running off the *syndicate* on a care and maintenance basis, allowing for a prudent level of new business being written in the year following the valuation.

Options

12.5.31 **R** Provision must be made on prudent assumptions to cover any increase in liabilities caused by policyholders exercising options under their *contracts of insurance*.

12.5.32 **R** Where a *long-term insurance contract* includes an option for the policyholder to secure a guaranteed cash payment within 12 months following the valuation date, provision for that option must ensure that the value placed on the contract is not less than the provision needed to meet that option, if exercised.

Long-term insurance contracts not to be treated as assets

12.5.33 **R** *Long-term insurance contracts*, except reinsurance covering the *syndicate year*, must not be treated as assets.

No credit for profits from voluntary discontinuance

12.5.34 **R** Allowance must not be made for the voluntary discontinuance of any *long-term insurance contract*, if the allowance would reduce the amount of the liability.

Nature and term of assets

12.5.35 **R** The determination of the amount of *long-term insurance business liabilities* must take account of the nature and term of the assets representing those liabilities, and the value placed upon them, and must include prudent provision against the effects of possible future changes in the value of the assets on:

- (1) the ability of *syndicate* members to meet their obligations arising under *long-term insurance contracts* as they arise; and
- (2) the adequacy of the assets to meet the liabilities, as determined under *LLD 12.5.8R* to *LLD 12.5.33R*.

Chapter 13.

Assets: valuation and realisability risk



13.1 Application and purpose

Application

13.1.1 **R** This chapter applies to the *Society*.

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13.1.2 **R** A contravention of the *rules* in this chapter does not give rise to a right of action by a *private person* under section 150 of the *Act* (Actions for damages) and each of those *rules* is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action.

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Purpose

13.1.3 **G** This chapter sets out the basis on which different assets are to be identified and valued (see also *LLD 9.1.4G*).

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13.1.4 **G** The risks which this chapter in part addresses arise because of:

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- (1) uncertainty about the time at which *claims* may fall due; and
- (2) difficulties, costs and uncertainty in realising assets earlier than anticipated.

13.1.5 **G** *LLD 9.2.5R* requires the *Society* to ensure it and its *members* maintain adequate assets to meet the liabilities which it assumes and which its *members* severally assume. *LLD 11.2.1R* requires the *Society* to assess the financial position of each *member* and to maintain sufficient *net central assets* to cover at least the total of *members'* solvency deficits.

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13.2 Identification and valuation of assets

- 13.2.1 **R**_{/1} The *Society* must identify its assets and value them in accordance with this chapter and *LLD 14 (Assets: market and credit risk)*.
- 13.2.2 **R**_{/1} The *Society* must take all reasonable steps to ensure the identification and valuation (in accordance with this chapter and *LLD 14 (Assets: market and credit risk)*) of each *member's admissible assets* which are available to meet his underwriting liabilities.
- 13.2.3 **R**_{/1} For the purposes of *LLD 13.2.2R* a *member's admissible assets* which are available to meet his underwriting liabilities include his *funds at Lloyd's* and his share of *premium trust funds*, but exclude funds held outside Lloyd's (*other personal wealth*).
- 13.2.4 **R**_{/1} For the purposes of *LLD 13.2.1R* and *LLD 13.2.2R*, assets in respect of *long-term insurance business* and *general insurance business* must be separately identified.
- 13.2.5 **G**_{/1} *LLD 9.4.1R* sets out the basic rule under which assets are to be valued for the purpose of calculating solvency, including:

 - (1) whether, and when, to recognise or ignore an asset; and
 - (2) which description to place on an asset;

but the application of the basic rule in *LLD 9.4.1R* is subject both to this chapter and *LLD 14 (Assets: market and credit risk)*.
- 13.2.6 **G**_{/1} A lower value than that required by this chapter and *LLD 14 (Assets: market and credit risk)* (or a nil value) may be attributed to any asset identified under this chapter.

13.3 Maturity and marketability of assets

13.3.1 G_{/1} *LLD 9.2.6R* requires the *Society* to ensure that its *admissible assets*, and to take reasonable steps to ensure that *members' admissible assets*, are of appropriate maturity and marketability. In doing so, the *Society* should have regard to the expected timing of liabilities (especially policyholder *claims*) and the need to make a prudent allowance for the risk that liabilities may fall due earlier than expected.

13.3.2 G_{/1} In considering whether an allowance should be made for the risk that *claims* may fall due earlier than expected, the following should be taken into account:

- (1) the type of *insurance business*;
- (2) the past history of volatility;
- (3) options available to policyholders and the circumstances in which they are likely to exercise them;
- (4) options available to the *syndicate* and any incentive for the *syndicate* to exercise them;
- (5) the other cashflow needs of the *syndicate*, including the need to fund overseas regulatory requirements; and
- (6) the extent to which *technical provisions* for *long-term insurance business* are discounted (*technical provisions* for *general insurance business* cannot be discounted, under *LLD 12.4.8R*).

13.3.3 G_{/1} In determining whether assets are of appropriate maturity, marketability and realisability, the following should be taken into account:

- (1) the expected date of maturity, redemption, repayment or disposal;
- (2) foreseeable potential delays in the date of maturity, redemption, repayment or disposal;
- (3) the arrangements necessary to ensure that assets are located in, or transferred to, the appropriate trust fund;
- (4) any uncertainty about the value of the asset at its expected date of realisation;
- (5) the speed with which assets may be realised earlier if needed;
- (6) the loss in value which might occur if assets were realised quickly; and
- (7) the amount of any surplus of assets over liabilities.

13.3.4

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Reliance should not be placed upon expected cash flows from future new *insurance business* as a means of avoiding the need to hold assets that are appropriately marketable or otherwise realisable.

13.4 Admissible assets

- 13.4.1** **R** ^{/1} Assets are admissible for the purposes of *LLD* 13.2.1R only if they fall within the description of *admissible assets* in *LLD* 13.4.3R, or are a *derivative* contract or *quasi-derivative contract* falling within *LLD* 13.6.1R.
- 13.4.2** **G** ^{/1} The list of *admissible assets* has been drawn up with the aim of excluding assets:
- (1) for which there is no sufficiently objective and verifiable basis of valuation; or
 - (2) whose realisability cannot be relied upon with sufficient confidence; or
 - (3) whose nature presents an unacceptable custody risk; or
 - (4) the holding of which may give rise to significant liabilities or onerous duties; or
 - (5) which give rise to excessive market or *counterparty* risk (for which see *LLD* 14 (Assets: market and credit risk)).
- 13.4.3** **R** ^{/1} Description of *admissible assets* (see *LLD* 13.4.1R)
- (1) Investments in, and amounts due from disposal of:
 - (a) *debt securities*, bonds and other money and capital market instruments; or
 - (b) loans; or
 - (c) *shares* and other variable yield participations; or
 - (d) units in schemes falling within the *UCITS directive* and in other *collective investment schemes*; or
 - (e) land, buildings and immovable property rights.
 - (2) Debts and claims that are:
 - (a) debts owed by reinsurers, including reinsurers' shares of *technical provisions*; or
 - (b) deposits with and debts owed by ceding undertakings; or

- (c) debts owed by policyholders and intermediaries arising out of direct insurance and reinsurance operations (except where *LLD 13.8.7R* applies); or
 - (d) debts owed by a *member* to another *member* of the *Society* where the debt is a liability arising out of the *insurance business* he carries on at *Lloyd's*; or
 - (e) in respect of *general insurance business* only, claims arising out of salvage and subrogation; or
 - (f) tax recoveries; or
 - (g) claims against guarantee funds.
- (3) Other assets which are:
- (a) tangible fixed assets, other than land and buildings; or
 - (b) cash at bank and in hand, deposits with *credit institutions* and any other bodies permitted to receive *deposits*; or
 - (c) *deferred acquisition costs*; or
 - (d) accrued interest and rent, other accrued income and prepayments.
- (4) In relation to *members' funds at Lloyd's*, other assets which are:
- (a) guarantees and letters of credit issued by *credit institutions* or by *insurance undertakings*; or
 - (b) verifiable sums arising out of life insurance policies.



13.5 Restriction of value to realisable amounts

13.5.1

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The value of assets must be reduced by:

- (1) the expenses of realisation, if they were not already deducted in arriving at that value; and
- (2) any reduction in value which would occur if the asset needed to be realised at short notice to meet liabilities falling due earlier than expected.

13.5.2

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Short notice in this context should not normally be taken to be more than 12 months.

 13.6 Derivatives

- 13.6.1** **R** ^{/1} An asset which is a *derivative* contract or a *quasi-derivative contract* is not admissible unless it has a *prescribed pricing basis* and it is:
- (1) held to reduce investment risk or for the purpose of efficient portfolio management;
 - (2) held in connection with assets falling within the description of an *admissible asset* in *LLD 13.4.3R*;
 - (3) *covered*;
 - (4) capable of being readily closed out; and
 - (5) based on underlying assets falling within the description of an *admissible asset* in *LLD 13.4.3R*, an index of those assets or an official index of retail prices.
- 13.6.2** **G** ^{/1} Under *LLD 13.4.1R*, and for the purposes of *LLD 9* to *15*, a value may not be attributed to an asset that is not an *admissible asset*. The list of *admissible assets* in *LLD 13.4.3R* excludes assets that give rise to unacceptable valuation, realisability, liability, market or *counterparty* risks. *LLD 13.6.1R* applies equivalent restrictions to *derivative* contracts and *quasi-derivative contracts*. The aim is to reduce the assumption of those risks, especially market risk.
- 13.6.3** **G** ^{/1} A *derivative* contract or *quasi-derivative contract* that does not comply with *LLD 13.6.1R* is an inadmissible asset. As with other inadmissible assets the *Society* and its *members* are not prohibited from holding it provided that no value is attributed to it. In some circumstances a provision may need to be established to protect against the risk of liability from a *derivative* contract or *quasi-derivative contract* whether or not it is admissible.
- 13.6.4** **G** ^{/1} Due regard should be paid to *guidance* note 4.2 (Use of derivative contracts in insurance funds) set out in *IPRU(INS)*.

13.7 Stock lending agreements

- 13.7.1 **R** /1 Provided the conditions specified in *LLD* 13.7.2R, and either *LLD* 13.7.5R or *LLD* 13.7.6R (as appropriate), are satisfied, value may be attributed to:
- (1) *securities* sold under a stock lending agreement as if those *securities* had been retained; and
 - (2) assets provided for the purchase of *securities* under that agreement as if consideration had not been provided.
- 13.7.2 **R** /1 Subject to *LLD* 13.7.3R and *LLD* 13.7.4R, for the purposes of *LLD* 13.7.1R the conditions are that:
- (1) the *securities* have been sold to or purchased from an *approved credit institution* or an approved investment firm; and
 - (2) that sale or purchase was made subject to an agreement that the *approved credit institution* or approved investment firm would subsequently, either on demand or within six months of that sale or purchase, sell back or purchase back equivalent *securities*.
- 13.7.3 **R** /1 Value must not, however, be attributed to:
- (1) any consideration received for the sale of *securities* under a stock lending agreement (or any assets purchased with such consideration) up to the limit of the value of the *securities* sold; or
 - (2) any *securities* purchased under a stock lending agreement (or any assets purchased with the proceeds of the sale of those securities) up to the limit of the consideration provided.
- 13.7.4 **R** /1 Where, at any time after the sale or purchase of *securities* under a stock lending agreement either:
- (1) the amount of the consideration received for sale of the *securities* falls below the value of the *securities* sold by more than 2.5%; or
 - (2) the value of the *securities* purchased falls below the value of the consideration provided by more than 2.5%;

additional consideration equal to the shortfall must be obtained before the end of the working day following the day when the shortfall occurred.

13.7.5

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For the purposes of *LLD 13.7.1R*, where *securities* are purchased from an *approved credit institution* or approved investment firm and the consideration provided is other than by way of sale of the *securities*, the conditions are that the *securities* purchased:

- (1) are issued by an *approved credit institution*; and
- (2) do not include:
 - (a) *securities* (other than *approved securities*) issued by the same *counterparty* whose aggregate value amounts to more than 15% of the value of the *securities* purchased; or
 - (b) if (a) is not satisfied, *securities* whose value when aggregated with existing exposure to assets of the same description, or to the same *counterparty*, would exceed the appropriate *permitted asset exposure limit* or *permitted counterparty exposure limit*, as determined under *LLD 14* (Assets: market and credit risk).

13.7.6

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For the purposes of *LLD 13.7.1R*, where *securities* are sold to an *approved credit institution* or an approved investment firm, the conditions are that:

- (1) the consideration provided by the *approved credit institution* or approved investment firm is:
 - (a) cash; or
 - (b) *approved securities*; or
 - (c) *listed securities*; or
 - (d) *securities* issued by an *approved credit institution*; or
 - (e) a charge over the assets set out in (a) to (d); or
 - (f) a letter of credit established with an *approved credit institution*; or
 - (g) a guarantee provided by an *approved credit institution*; and
- (2) the consideration does not include:
 - (a) except to the extent that *LLD 13.7.6R(2)(b)* is satisfied, an amount which, when aggregated with existing exposure to assets of the appropriate description or to the relevant *counterparty*, would exceed the appropriate *permitted asset*

exposure limit or *permitted counterparty exposure limit*, as determined under *LLD 14* (Assets: market and credit risk); or

- (b) an amount, more than 15% of which takes the form of *securities* (other than *approved securities*) issued by, letters of credit established with, guarantees provided by, cash deposited with, a charge over cash deposited with or a charge over *securities* issued by, the same *counterparty*; and
- (3) the consideration to be provided for the subsequent purchase back of equivalent *securities* is:
 - (a) cash denominated in the same currency where the consideration for the original purchase by the *approved credit institution* or approved investment firm was (wholly or in part) cash; and
 - (b) equivalent to the *securities* provided as consideration where the consideration was (wholly or in part) *securities*.

13.7.7

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Where a number of stock lending agreements have been entered into, for the purposes of *LLD 13.7.5R* and *LLD 13.7.6R*:

- (1) any or all agreements under which the subsequent sale or purchase has not taken place at the valuation date may be treated as one agreement; and
- (2) in such case, the 15% limits in *LLD 13.7.5R(2)(a)* and *LLD 13.7.6R(2)(b)* must be calculated by reference to the aggregate of the value of the *securities* purchased under *LLD 13.7.5R* or the amount of any consideration in *LLD 13.7.6R*.

13.7.8

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Where consideration has been received for any other sale of the kind described in *LLD 13.7.1R*, in addition to any other exposure to assets or to a *counterparty*:

- (1) if the consideration takes the form of a letter of credit established with, or a guarantee provided by, an *approved credit institution*, then it must be treated as giving rise to exposure to that institution by the amount of the consideration;
- (2) if the consideration takes the form of a charge over *securities*, then it must be considered to give rise to exposure to *securities* of the same description and to the issuer of those *securities* by the amount of the consideration; and
- (3) if the consideration takes the form of cash deposited with another party for the benefit of the *Society* or a *member*, or a charge over cash deposited with another party, then it must be considered to give rise to exposure to that party by the amount of the consideration.

13.7.9

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In these *rules* the amount of any consideration must:

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- (1) in the case of a letter of credit established with an *approved credit institution*, be the lower of the amount made available under the letter of credit and the value of the assets sold; or
- (2) in the case of a guarantee provided by an *approved credit institution*, be the lower of the amount of the guarantee and the value of the assets sold; or
- (3) in the case of assets of the types in *LLD 13.7.6R(1)(a) to (d)*, or a charge over those assets, be the value of the assets as determined under this chapter and *LLD 14 (Assets: market and credit risk)*.



13.8 Debts and other rights

- 13.8.1** **R** Subject to *LLD* 13.8.12R, the value of an asset that is a *secured debt* due, or to become due, other than a debt to which *LLD* 13.8.3R or *LLD* 13.8.8R applies, must:
- /1
- (1) for a debt which is, or will become, due within 12 months of the valuation date (including any debt which would become due within that period if any right to require payment were to be exercised), be the amount which can reasonably be expected to be recovered for that debt; and
 - (2) for any other debt, be the amount which would reasonably be paid as consideration for an immediate assignment of the debt.
- 13.8.2** **G** In assessing the value of an asset under *LLD* 13.8.1R and *LLD* 13.8.5R, due account should be taken of the nature and quality of the security and the terms and conditions for payment.
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- 13.8.3** **R** For *long-term insurance business*, the value of an asset that is a debt due, or to become due, and is secured on a *policy* of insurance written at Lloyd's and which (together with any other debt secured on that *policy*) does not exceed the amount payable on a surrender of that *policy* at the valuation date, must be the amount of that debt.
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- 13.8.4** **R** Subject to *LLD* 13.8.12R, the value of an asset that is an unsecured debt due, or to become due, other than a debt to which *LLD* 13.6.1R, *LLD* 13.8.5R, *LLD* 13.8.7R or *LLD* 13.13.1R applies, must:
- /1
- (1) in the case of a debt which is, or will become, due within 12 months of the valuation date (including any debt which would become due within that period if any right to require payment were to be exercised), be the amount which can reasonably be expected to be recovered for that debt; and
 - (2) in the case of any other debt, be the amount which could reasonably be expected to be paid as consideration for an immediate assignment of the debt.
- 13.8.5** **R** Subject to *LLD* 13.8.6R, the value of any assets that are rights under a contract of reinsurance must be the amount which can reasonably be expected to be recovered by exercising those rights.
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- 13.8.6 **R** /1 *LLD* 13.8.5R does not apply to rights under a contract of reinsurance for *long-term insurance business* except to the extent that debts are due under that contract.
- 13.8.7 **R** /1 Value must not be attributed to any asset that is a debt due, or to become due:
- (1) from an *intermediary* for money advanced on account of commission to which that *intermediary* is not absolutely entitled at the valuation date; or
 - (2) in respect of *premiums* (account having been taken of rebates, refunds and commissions payable) which are recorded in the relevant accounting records as due and payable and has been outstanding for more than three months.
- 13.8.8 **R** /1 For *general insurance business*, the value of any assets that are subrogation rights must be the amount that can reasonably be expected to be recovered by exercising those rights.
- 13.8.9 **R** /1 For *general insurance business*, the value of any assets that are *salvage rights* must be the amount that can reasonably be expected to be recovered by exercising those rights.
- 13.8.10 **R** /1 The value of any asset that is a right to recover assets transferred by way of *initial margin* must be determined:
- (1) where the *initial margin* was a cash payment, as if a debt were owed for that amount; and
 - (2) where the *initial margin* took the form of a transfer of *securities*, as if a debt were owed of an amount equal to the value of such *securities* as determined under this chapter and *LLD* 14 (Assets: market and credit risk).
- 13.8.11 **R** /1 The value of any rights arising from an asset that is a *derivative contract* to which *LLD* 13.6.1R does not apply, or under a *quasi-derivative contract* to which *LLD* 13.6.1R does not apply, must be the value of any right to recover assets transferred as *initial margin* together with the value of any other unconditional right to receive a specified amount.
- 13.8.12 **R** /1 *LLD* 13.8.1R and *LLD* 13.8.4R do not apply to any rights (other than debts due) in respect of:
- (1) *securities* or beneficial interests in a *limited liability partnership*; or
 - (2) units or other beneficial interests in a *collective investment scheme*; or

- (3) a *derivative* contract, except to the extent provided under *LLD* 13.8.10R or *LLD* 13.8.11R; or
- (4) a contract or asset which is a *quasi-derivative contract* except to the extent provided under *LLD* 13.8.10R or *LLD* 13.8.11R or where a *derivative* contract asset includes an element of debt.



13.9 Land

13.9.1

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The value of an asset that is land must not be greater than the amount which would be realised (after deduction of reasonable sale expenses) if the land were sold at a price equal to the most recent valuation made by a *qualified valuer*, which valuation must have been made not more than three years before the end of the relevant *syndicate year*.



13.10 Equipment

- 13.10.1** **R** ^{/1} The value of an asset that is office machinery (other than computer equipment), furniture, motor vehicles and other equipment must, in the *syndicate year* in which it is purchased, be not greater than one-half of its cost and must be left out of account in any subsequent year.
- 13.10.2** **R** ^{/1} The value of an asset that is computer equipment, including software must:
- (1) in the *syndicate year* in which it is purchased, not be greater than three-quarters of the cost;
 - (2) in the next *syndicate year*, not be greater than one-half of the cost;
 - (3) in the *syndicate year* after that, not be greater than one-quarter of the cost; and
 - (4) in any following year, be nil.



13.11 Securities and beneficial interests in limited liability partnerships

13.11.1

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Subject to *LLD* 13.11.2R, the value of an asset that is an investment to which this *rule* applies, must:

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- (1) where the investment is transferable and *LLD* 13.11.3R does not apply, be the market value;
- (2) where the investment is transferable and *LLD* 13.11.3R applies, be the lower of:
 - (a) the market value; and
 - (b) the amount which could reasonably be expected as consideration for an assignment or transfer of the investment at a date not later than 12 months after the valuation date; or
- (3) where the investment is not transferable:
 - (a) be the amount payable on redemption on the valuation date, or on the most recent date before the valuation date when the issuer of the investment could have been required to redeem it; or
 - (b) where the investment cannot be redeemed, be the amount which would reasonably be paid as consideration for surrendering the interest in the investment.

13.11.2

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LLD 13.11.1R applies to the valuation of investments comprising *securities* (but not those which are *derivative* contracts, units or other beneficial interests in *collective investment schemes* or *quasi-derivative contracts*) and beneficial interests in *limited liability partnerships*, and, for the purposes of *LLD* 13.11.5G, investments includes loans.

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13.11.3

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Subject to *LLD* 13.11.4R, for the purposes of *LLD* 13.11.1R(1) and (2), this *rule* applies where it is not reasonable to assume that, had negotiations for assigning or transferring the investment started seven working days or less before the valuation date, the investment could have been assigned for an amount not less than 97.5% of the market value, other than to the issuer or to an associate of the issuer.

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13.11.4 **R** ^{/1} *LLD 13.11.3R does not apply if it would otherwise apply by reason only that:*

- (1) *the listing of the investment has been temporarily suspended after the stock exchange on which the investment is listed or the regulated market on which facilities for dealing have been granted received price sensitive information; or*
- (2) *the extent of the holding would prevent an orderly disposal of the investment for at least 97.5% of the market value.*

13.11.5 **G** ^{/1} Where more than one unlisted investment is made (other than investments exclusively comprising loans) and their total value is greater than the aggregate of the values of each investment valued separately, then the higher value may be attributed to the investments, if it is reasonable to assume that none of the investments would be assigned or transferred separately.

13.12 Collective investment schemes

- 13.12.1** **R** ^{/1} The value of assets that are units or other beneficial interests in a *collective investment scheme* to which *LLD 13.12.2R* applies must:
- (1) where the issuer can be required to purchase the units or other beneficial interests from the holder upon the holder giving notice of one month or less, be the price at which the issuer would have purchased the units or other beneficial interests on the valuation date or the most recent date before the valuation date on which it could have been required to make that purchase; or
 - (2) where the issuer cannot be required to purchase the units or other beneficial interests as set out in *LLD 13.12.1R(1)*, be a value determined under *LLD 13.11.1R*.
- 13.12.2** **R** ^{/1} *LLD 13.12.1R* applies to units or other beneficial interests in:
- (1) a scheme falling within the *UCITS directive*; or
 - (2) an *authorised unit trust scheme* or a *recognised scheme*; or
 - (3) any other *collective investment scheme* where:
 - (a) the scheme does not include *derivative* contracts unless they are contracts to which *LLD 13.6.1R* applies;
 - (b) the scheme does not include *quasi-derivative contracts* unless they are contracts to which *LLD 13.6.1R* applies; and
 - (c) the scheme does not include assets except those for the valuation of which provision is made in this chapter or *LLD 14* (Assets: market and credit risk).



13.13 Deferred acquisition costs

13.13.1

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In the case of *general insurance business*, the value of an asset that comprises *deferred acquisition costs* must be the value as determined under *LLD 9.4.1R*.



13.14 Reversionary interests

13.14.1

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The value of an asset that is a *long-term insurance business asset* consisting of an interest in land which is a remainder, reversionary interest, right of fee subject to a life rent or other future interest, whether vested or contingent, must be the amount that can reasonably be expected to be paid as consideration for an immediate transfer or assignment of that interest.

13.15 Related and subsidiary undertakings

- 13.15.1 **R** /1 The value of any *shares* held by the *Society* in a related undertaking of the *Society* must not exceed the value, determined in accordance with *IPRU(INS)* (other than *IPRU(INS)* 4.14(1)(a) to (c)), of its surplus assets.
- 13.15.2 **R** /1 The surplus assets of a related undertaking are its total assets excluding:
- (1) subject to *LLD* 13.15.4R, the assets that are selected to cover its liabilities and, in the case of a related undertaking which is an *insurance undertaking*, to cover the notional *required minimum margin*;
 - (2) assets that are interests directly or indirectly held in the related undertaking's own capital (including *shares* and subordinated debt) or in liabilities of the *Society* that are subordinated to the interests of policyholders;
 - (3) where the related undertaking carries on *long-term insurance business*, profit reserves and future profits;
 - (4) assets which represent either a *long-term insurance business* fund or a fund the allocation of which as between policyholders and other purposes has yet to be determined;
 - (5) amounts due, or to become due, in respect of share capital, or other contributions from members of the related undertaking, subscribed or called for but not fully paid up; and
 - (6) assets that cannot effectively be made available or realised to meet liabilities of the *Society* or *members*, including assets that represent capital not owned, directly or indirectly, by the *Society*.
- 13.15.3 **G** /1 Examples of assets that may not be effectively available include blocked currency and minority interests which cannot be readily realised.
- 13.15.4 **R** /1 The assets identified in *LLD* 13.15.2R(1) to be deducted from the total assets:
- (1) where the related undertaking is an *insurance undertaking*, must be identified and valued in accordance with relevant regulatory

requirements as to the value, admissibility, nature, location or matching that apply to the assets available to cover its liabilities and the notional required minimum margin;

- (2) where the related undertaking is not an *insurance undertaking*, must be of a value at least equal to the amount of its liabilities, determining that value and that amount in accordance with *IPRU(INS)* (other than 4.14(1)(a) to (c)); and
- (3) in both cases, must not include:
 - (a) assets falling within *LLD* 13.15.2R(2); or
 - (b) assets falling within *LLD* 13.15.2R(5) where the amount is due, or to become due, from a *member*, the *Society* or a related undertaking.

13.15.5 G_{/1} Where the relevant regulatory requirements merely identify the categories of assets that are eligible to cover liabilities or represent the notional required minimum margin, the *Society* may select which assets it actually identifies for these purposes. That selection may take the form of a selection of a pro rata proportion of all eligible assets.

13.15.6 G_{/1} Even where the relevant regulatory requirements would allow assets excluded by *LLD* 13.15.4R(3) to cover liabilities and represent the notional required minimum margin, those assets should be ignored. Without using assets excluded by *LLD* 13.15.4R(3), the assets identified should be sufficient to satisfy the relevant regulatory requirements.

13.15.7 G_{/1} Other types of asset, including those excluded from the definition of surplus assets, may be used to cover liabilities and the notional *required minimum margin* where permitted by the relevant regulatory requirements. Similarly for a non-insurance undertaking a value may be attributed, using the *IPRU(INS)* rules relating to the valuation of assets, to other types of asset, even where excluded from the definition of surplus assets.

13.15.8 R_{/1} For the purposes of *LLD* 13.15.4R the relevant regulatory requirements are:

- (1) in the case of an *insurance undertaking* established in a *designated State or territory*, the regulatory requirements of that State or territory applicable to an undertaking carrying on direct *insurance business* (even if it is a pure reinsurer); and
- (2) in the case of any other *insurance undertaking*, subject to *LLD* 13.15.9R, the rules in *IPRU(INS)* applicable to an *insurer* with its head office in the United Kingdom (whether or not it is such an *insurer*).

13.15.9 R_{/1} For the purposes of *LLD* 13.15.8R(2):

- (1) *IPRU(INS)* 2.10R to *IPRU(INS)* 2.13R are to be applied as if the *insurance undertaking* satisfied the condition in *IPRU(INS)* 2.10R(1); and

(2) *IPRU(INS) 4.14R(1)(a) to (c)* are ignored.



13.16 Debts due or to become due from a related undertaking

13.16.1

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The value of any debt due, or to become due, from a related undertaking must not exceed the amount reasonably expected to be recovered in respect of the debt, taking into account only the value of:

- (1) the assets identified under *LLD* 13.15.2R(1); and
- (2) any security held in respect of the debt.

Chapter 14.

Assets: market and credit risk



14.1 Application and purpose

Application

14.1.1 **R** This chapter applies to the *Society*.

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14.1.2 **R** A contravention of the *rules* in this chapter does not give rise to a right of action by a *private person* under section 150 of the *Act* (Actions for damages) and each of those *rules* is specified under sections 150(2) of the *Act* as a provision giving rise to no such right of action.

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Purpose

14.1.3 **G** *LLD* 9.2.5R requires the *Society* to ensure that it and its *members* maintain adequate assets to meet the liabilities that it assumes and which *members* assume. *LLD* 11.2.1R requires the *Society* to maintain sufficient *net central assets* to cover the total of solvency deficits of *members*.

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14.1.4 **G** The requirements in this chapter address both specific and general market risk. Specific market risk refers to the risk arising from fluctuations in the value of specific assets. General market risk refers to more widespread fluctuations in market values. It includes foreign exchange risk (see also *LLD* 9.1.4G).

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14.2 Limitation of general market risk □ all types

14.2.1

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A fluctuation in asset values may have an impact upon the value of the *Society's* own assets and the assets of *members* and upon the amount of their liabilities. Any of these effects may have an impact on the ability to meet valid *claims* as they fall due. In many, but not all, cases these effects may offset each other especially where assets are closely matched to the liabilities they cover.

14.2.2

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The *Society* should limit this net exposure to specific market risk by requiring a close matching of assets to the liabilities they cover.

14.2.3

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The *Society* should take all reasonable steps to ensure that prudent provision is made, or other appropriate measures taken, against the effects of likely future changes in general asset values on:

- (1) the ability of *members* to meet valid *claims* as they fall due; and
- (2) the adequacy of assets to meet those *claims*.

14.3 Currency matching and localisation

- 14.3.1** **R** ^{/1} The *Society* must take reasonable steps to ensure that *members* in aggregate comply with the matching rules set out in:
- (1) Annex 1 of the Second Non-Life Directive (88/357/EEC) in relation to *general insurance business*; and
 - (2) Annex 1 of the Third Life Directive (92/96/EEC) in relation to *long-term insurance business*;
- as if all discretionary powers of the *United Kingdom* as Member State have been fully exercised in favour of the *Society* and *members*. In complying with this *rule* the *Society* may exercise, in favour of *members*, any discretion allowed to the *United Kingdom* as a Member State under those Directive provisions.
- 14.3.2** **G** ^{/1} LLD 14.3.3R does not apply to:
- (1) *insurance business* carried on outside the *EEA States*; or
 - (2) reinsurance business (unless it is facultative reinsurance).
- 14.3.3** **R** ^{/1} The *Society* must take reasonable steps to ensure that assets (other than *claims* against reinsurers) held pursuant to LLD 14.3.1R in respect of risks situated within the *EEA* are localised within the *EEA*, or if they cover liabilities in any currency other than sterling, in any *EEA State* or the state of that currency.
- 14.3.4** **R** ^{/1} Claims against debtors must be treated as situated in the state where those debts can be liquidated.



14.4 Assets to be taken into account only to a specified extent

14.4.1

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LLD 13 (Assets: valuation and realisability risk) specifies the classes of assets which are *admissible assets* and *valuation rules*. LLD 14.5 and LLD 14.6 contain *rules* which, for certain classes of assets, place limitations on the value which may be attributed to them in the *Lloyd's Return* and for solvency purposes. So, having identified and valued assets under LLD 13 (Assets: valuation and realisability risk), the aggregate value of those assets both for each *member* (taking their *funds at Lloyd's* and share of *premium trust fund* assets together) and for the *Society* in both cases will be reduced by an amount representing the total of:

- (1) the amount of exposure to assets of any description over the *permitted asset exposure limit* for assets of that description, as determined under LLD 14.5;
- (2) the amount of exposure to a *counterparty* over the *permitted counterparty exposure limit* for that *counterparty*, as determined under LLD 14.6; and
- (3) the amount of excess concentration with a number of *counterparties*, as determined under LLD 14.6.

14.4.2

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Where a *member* carrying on *long-term insurance business* has attributed assets partly to a *long-term insurance business fund* and partly to other assets, any reduction required to be made under LLD 14.5 or LLD 14.6 must be made in the same proportion as the attribution.

14.4.3

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The following assets need not be taken into account in any of the calculations described in LLD 14.5 and LLD 14.6:

- (1) *approved securities* or any interest accrued on them; or
- (2) debts to which LLD 13.8.3R applies; or
- (3) rights to which LLD 13.8.5R, LLD 13.8.8R or LLD 13.8.9R applies; or
- (4) debts in respect of premiums; or
- (5) monies due from, or guaranteed by, the government of any *Zone A country*; or
- (6) holdings in a scheme falling within the *UCITS directive*; or
- (7) deferred acquisition costs; or

(8) any of the assets described under *LLD* 13.4.3R(4).

14.5 Permitted asset exposure limits

- 14.5.1** **R** Subject to *LLD 14.5.2R*, the *Society* must:
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- (1) ensure that the value of its *admissible assets*, calculated under *LLD 13 (Assets: valuation and realisability risk)*; and
 - (2) take reasonable steps to ensure that the value of the *admissible assets* for each *member* individually, calculated under *LLD 13 (Assets: valuation and realisability risk)*;
- do not, for each description of asset, exceed the *permitted asset exposure limits* set out in *LLD 14.5.17R*.
- 14.5.2** **R** In applying the less restrictive *permitted asset exposure limits* set out in *LLD 14.5.17R* for *individual members*, the *Society* must ensure that in aggregate compliance with Article 22 of the Third Non-Life Directive (92/49/EEC) and Article 22 of the Third Life Directive (92/96/EEC) is maintained.
- 14.5.3** **G** The percentages in the table of *permitted asset exposure limits* set out in *LLD 14.5.17R* should be applied separately to the *admissible assets* of each description for each *member* and the *Society*.
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- 14.5.4** **G** In the same way that *LLD 9 to 15* does not prohibit the holding of any type of asset, *LLD 14.5.1R* does not prohibit the holding of excess assets of each description, but simply limits the extent to which they can be counted for solvency and reporting purposes.
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- 14.5.5** **R** The asset exposure under *LLD 14.5.1R* must be calculated by determining the amount of exposure to assets of each description by:
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- (1) ascribing a value to assets of each description under *LLD 13 (Assets: valuation and realisability risk)*; or
 - (2) where the assets are of a description for which no provision for valuation is made in *LLD 13 (Assets: valuation and realisability risk)*, an amount which would reasonably be paid as consideration for an immediate assignment or transfer of those assets;
- and adjusting the value of the assets under *LLD 14.5.10R* to *LLD 14.5.15R*.

- 14.5.6 **R** /1 Where there is exposure to assets of any description in excess of the *permitted asset exposure limit* for those assets, the reduction required under *LLD 14.5.1R* must be made:
- (1) by deducting (as far as possible) the amount of the excess from the assets of that description; and
 - (2) where there are insufficient assets of that description to eliminate the excess, by making an appropriate deduction from the aggregate value of the assets which may otherwise be taken into account for any of the purposes in *LLD 13* (Assets: valuation and realisability risk) and this chapter.
- 14.5.7 **R** /1 The *permitted asset exposure limits* in *LLD 14.5.17R* are the percentages of all *admissible assets* (excluding reinsurance recoveries).
- 14.5.8 **R** /1 In the case of an *admissible asset* not covered by any of the descriptions in *LLD 14.5.17R* (other than a *derivative contract* or *quasi-derivative contract*), the *permitted asset exposure limit* in *LLD 14.5.1R* is 100%.
- 14.5.9 **R** /1 The amount arrived at under *LLD 14.5.5R* for assets of each description must be increased or decreased (as the case may be) by the value of assets of that description which are deemed to have been acquired or disposed of as a result of a futures contract.
- 14.5.10 **R** /1 For the purposes of *LLD 14.5.9R*, assets are deemed to have been acquired or disposed of as a result of a futures contract if, at the valuation date, a futures contract has been entered into (but not closed out) which:
- (1) provides for the acquisition of assets; or
 - (2) is *listed* and provides for the disposal of assets; or
 - (3) is not *listed* but provides for the disposal of assets to an *approved counterparty*, and where it is prudent to assume the disposal will take place within one year of the valuation date.
- 14.5.11 **R** /1 The amount arrived at under *LLD 14.5.5R* for assets of each description must be increased or decreased (as the case may be) by the value of assets of that description which are deemed to have been acquired or disposed of through an *option*.
- 14.5.12 **R** /1 For the purposes of *LLD 14.5.11R*, assets are deemed to have been acquired or disposed of through an *option* if, at the valuation date, it is prudent to assume the *option* will be exercised and that the *option*:
- (1) provides for the acquisition of assets; or
 - (2) is *listed* and provides for the disposal of assets; or

- (3) is not *listed* but provides for the disposal of assets to an *approved counterparty*, and it is prudent to assume the disposal will take place within one year of the valuation date.
- 14.5.13 **R** /1 The amount arrived at under *LLD 14.5.5R* for assets of each description must be increased by the value of any assets of that description which were transferred as *initial margin*.
- 14.5.14 **R** /1 The amount arrived at under *LLD 14.5.5R* for assets of each description must be increased or decreased (as the case may be) by the value of assets deemed to have been acquired or disposed of under:
- (1) an undiversified *contract for differences*; or
 - (2) a contract or asset other than a diversified *contract for differences* which is a *quasi-derivative contract*.
- 14.5.15 **R** /1 For the purposes of *LLD 14.5.14R*, assets must be treated as having been acquired when the contracts covering those assets are entered into.
- 14.5.16 **R** /1 In the case of the *Society*, the amount arrived at under *LLD 14.5.5R* and *LLD 14.5.9R* to *LLD 14.5.15R* for assets of the *Society* of any description must be increased by an amount representing the exposure, if any, of its *subsidiary undertakings* to assets of that description, calculating the exposure under paragraphs 4 to 11 of Appendix 4.2 of *IPRU(INS)* as if the *subsidiary undertakings* were *insurers* (whether they are or not).
- 14.5.17 **R** /1 Table Permitted asset exposure limits (see *LLD 14.5.1R*, *LLD 14.5.7R* and *LLD 14.5.8R*)

	Definition of asset	Percentage of all admissible assets, in each case for <i>general insurance business and long-term insurance business</i>	Percentage of all admissible assets, in each case for <i>general insurance business and long-term insurance business for individual members</i>
1	Land or an interest in land. Where there is more than one piece of land the value ascribed to the aggregate may, where applicable, be greater than the value of any pieces of land valued separately	5%	5%
1a	A reversionary interest or a remainder not falling within 1	1%	1%
2	All debts which are, or are to become, due from any one individual (except an individual connected with the <i>member</i>) being debts which are fully secured on any dwelling or any land belonging to it owned or to be purchased by the individual and used or to be used by him for his own residence	1%	1%
3	All debts due, or to become due, from an individual, other than debts specified in 2	0.25%	0.25%
4	All unsecured debts (other than those arising under the terms of debt securities or debts from a <i>regulated institution</i>) which have, or are to, become due from any one <i>counterparty</i> other than an individual, <i>body corporate</i> or group	1%	1%

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	Definition of asset	Percentage of all admissible assets, in each case for <i>general insurance business and long-term insurance business</i>	Percentage of all admissible assets, in each case for <i>general insurance business and long-term insurance business for individual members</i>
5	All unsecured debts (other than those arising under the terms of debt securities or debts from a <i>regulated institution</i>) which are, or are to become, due from any one company, taken with all such debts which are, or are to become due from a <i>connected company</i> of that company	1%	1%
6	All unsecured debts (other than those arising under the terms of debt securities or debts from an <i>approved counterparty</i>) which are, or are to become, due from any one <i>regulated institution</i> , taken together with all such debts which are, or are to become, due from a <i>connected company</i> of that institution	2.5%	2.5%
7	All debts, other than those arising under the terms of debt securities, which are, or are to become, due from any one <i>counterparty</i> which is not an <i>approved counterparty</i> taken together with all such debts which are, or are to become, due from any <i>connected company</i> (other than an <i>approved counterparty</i>) of that <i>counterparty</i>	5%	5%

	Definition of asset	Percentage of all admissible assets, in each case for <i>general insurance business and long-term insurance business</i>	Percentage of all admissible assets, in each case for <i>general insurance business and long-term insurance business for individual members</i>
8	All debts, other than short term deposits with an <i>approved credit institution</i> or debts arising under the terms of debt securities, which are, or are to become, due from any one <i>approved counterparty</i> , taken with all such debts which are, or are to become, due from any <i>connected company</i> of that <i>approved counterparty</i>	10%	10%
9	All debts which are, or are to become, due from an <i>approved credit institution</i> (or a <i>connected company</i> of that institution) taken together	20%	20%
10	The aggregate of debts of the descriptions in 3, 4 and 5	5%	5%

	Definition of asset	Percentage of all admissible assets, in each case for <i>general insurance business</i> and <i>long-term insurance business</i>	Percentage of all admissible assets, in each case for <i>general insurance business</i> and <i>long-term insurance business</i> for <i>individual members</i>
11	<p>All investments of a kind to which <i>LLD</i> 13.11.1R applies (other than secured debt securities, debt securities (excluding hybrid securities) issued by a <i>regulated institution</i> or investments which are <i>listed</i> and <i>readily realisable</i>) issued by any one issuer taken together with:</p> <p>(a) all units or other beneficial interests in a <i>collective investment scheme</i> falling within <i>LLD</i> 13.12.2R(3) issued by that issuer; and</p> <p>(b) all investments of the kinds mentioned in this section which are issued by a <i>connected company</i> of that issuer</p>	1%	2%
12	The aggregate of assets of any of the descriptions in 1a and 11	10%	20%
13	All <i>shares</i> and <i>hybrid securities</i> issued by any one issuer with all such <i>securities</i> issued by a <i>connected company</i> of that issuer	2.5%	5%
14	All <i>securities</i> issued by any one issuer which is not an <i>approved counterparty</i> , taken with all <i>securities</i> issued by a <i>connected company</i> , except an <i>approved counterparty</i> , of that issuer	5%	10%

	Definition of asset	Percentage of all admissible assets, in each case for <i>general insurance business and long-term insurance business</i>	Percentage of all admissible assets, in each case for <i>general insurance business and long-term insurance business for individual members</i>
15	All <i>securities</i> issued by any one <i>counterparty</i>	10%	20%
16	All holdings in any one <i>authorised unit trust scheme</i> or <i>recognised scheme</i>	25%	50%
17	All cash	3%	3%
18	All computer equipment	5%	5%
19	All office machinery (except computer equipment) taken together with all furniture, motor vehicles and other equipment	2.5%	2.5%

14.6 Counterparty exposure limits

- 14.6.1** **R** ^{/1} The *Society* must ensure that the value of its *admissible assets* calculated under *LLD* 14.5 are further reduced to the *permitted counterparty exposure limits* set out in *LLD* 14.6.3R, *LLD* 14.6.4R, *LLD* 14.6.10R and *LLD* 14.6.11R, subject to *LLD* 14.6.14R(2) and take reasonable steps to ensure that the value of the *admissible assets* for each *member* individually calculated under *LLD* 14.5 are further reduced to the *permitted counterparty exposure limits* set out in *LLD* 14.6.3R, *LLD* 14.6.4R, *LLD* 14.6.10R and *LLD* 14.6.11R, subject to *LLD* 14.6.14R.
- 14.6.2** **G** ^{/1} Exposure to any one *counterparty* (when taken with its *connected companies*) is also restricted. *LLD* 14.6 requires the value of all investments in debts due from a *counterparty* and rights against a *counterparty* to be aggregated in order to calculate the *counterparty* exposure. The *counterparty* exposure calculation is arrived at after taking account of the *permitted asset exposure limits*, thus avoiding double counting.
- 14.6.3** **R** ^{/1} If the *counterparty* is an individual, an unincorporated body, or a government of a state or any public body, local authority or nationalised industry of a state, the *permitted counterparty exposure limit* is 5% of all *admissible assets* (excluding reinsurance recoveries).
- 14.6.4** **R** ^{/1} If the *counterparty* is a *body corporate* or a group of companies, the *permitted counterparty exposure limit* is the lower of:
- (1) if the exposure is to a body which is not an *approved counterparty*, 5% of all *admissible assets* (excluding reinsurance recoveries); or
 - (2) if the exposure is to a body which is an *approved counterparty* and the exposure does not arise from debts which are, or will become, due as a result of short term deposits made with an *approved credit institution*, 10% (or where prudent a lower amount) of all *admissible assets* (excluding reinsurance recoveries); or
 - (3) 20% of all *admissible assets* (excluding reinsurance recoveries).
- 14.6.5** **R** ^{/1} Where a reduction is required as a result of *LLD* 14.6.3R, *LLD* 14.6.4R or *LLD* 14.6.10R, the reduction must be made by a deduction from the aggregate value of the assets which could

otherwise be taken into account for any of the purposes in *LLD 13* (Assets: valuation and realisability risk).

14.6.6

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Subject to *LLD 14.6.7R* and *LLD 14.6.8G*:

- (1) the value of all investments (determined under *LLD 13.11*) issued by any one *counterparty* and the value of all rights (determined under *LLD 13.6.1R* and *LLD 13.8*) against that *counterparty*, in each case up to the amount of the relevant *permitted asset exposure limit*, must be aggregated; and
- (2) if the *counterparty* is an issuer of a *collective investment scheme* falling within *LLD 13.12.2R(3)*, the value must include the value of units or other beneficial interests in the *collective investment scheme*.

14.6.7

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The aggregation required under *LLD 14.6.6R* need not include the value of the rights referred to in *LLD 14.6.6R(1)*, if those rights exist in respect of an obligation to be fulfilled by a *counterparty* and:

- (1) the obligation is a secured obligation which:
 - (a) is secured by cash deposited with, a letter of credit established with, or *securities* issued by, or a guarantee provided by, an *approved credit institution* or an *approved financial institution*; and
 - (b) is due to be fulfilled within 12 months of the valuation date; or
- (2) the obligation is secured by *listed securities* which are readily realisable, or by *approved securities* which:
 - (a) were deposited with an *approved credit institution*, an *approved financial institution* or an *approved investment firm*; and
 - (b) are beneficially owned by the *counterparty*, but will not be available for the benefit of creditors generally if the *counterparty* is wound up.

14.6.8

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If there are liabilities to the *counterparty* which may be offset against the assets mentioned in *LLD 14.6.7R*, in accordance with generally accepted accounting practice, then these liabilities may be offset for the purposes of the aggregation required under *LLD 14.6.6R*.

14.6.9

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[In the case of the *Society*, the amount arrived at under *LLD 14.6.6R* to *LLD 14.6.8G* must be increased by an amount representing the exposure, if any, of its *subsidiary undertakings* to the *counterparty*, calculating the exposure under paragraphs 13 to 15 of Appendix 4.2 of *IPRU(INS)* as if the *subsidiary undertakings* were insurers (whether they are or not).]

PAGE
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- 14.6.10 **R** /1 The deduction for an amount of exposure to a *counterparty* over the *permitted counterparty exposure limit* must be calculated by subtracting from the amount of the exposure to the *counterparty*, the amount of the *permitted counterparty exposure limit* and, if the figure arrived at is negative, it must be taken to be zero.
- 14.6.11 **R** /1 However, if exposure to a *counterparty* is in excess of the *permitted counterparty exposure limit* in more than one of the circumstances set out in *LLD 14.6.4R*, the deduction required must be made in the circumstances of the greatest excess exposure.
- 14.6.12 **R** /1 If there is exposure to more than one *counterparty* of the type mentioned in *LLD 14.6.4R(2)*, then the aggregate of these exposures must not exceed 40% of all *admissible assets*.
- 14.6.13 **R** /1 For the purposes of *LLD 14.6.12R*:
- (1) exposure to a *counterparty* is to be taken into account only up to the level of the *permitted counterparty exposure limit* for that *counterparty*;
 - (2) exposure to a *counterparty* is not to be taken into account if it does not exceed 5% of all *admissible assets* (excluding reinsurance recoveries); and
 - (3) exposure to a *counterparty* is not to be taken into account if the *permitted counterparty exposure limit* does not exceed 5% of all *admissible assets* (excluding reinsurance recoveries).
- 14.6.14 **R** /1 For the purposes of *LLD 14.6.1R*:
- (1) in respect of *individual members*, the *permitted counterparty exposure limits* are double those set out in *LLD 14.6.3R*, *LLD 14.6.4R* and *LLD 14.6.12R*; and
 - (2) in respect of assets falling within *LLD 14.5.17R(16)*, the *permitted counterparty exposure limits* are 50% of all *admissible assets* (excluding reinsurance recoveries).

Chapter 15.

Reporting by the Society

15.1 Application and purpose

Application

- 15.1.1 **R** This chapter applies to the *Society*.
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- 15.1.2 **R** A contravention of the *rules* in this chapter does not give rise to a right of action by a *private person* under section 150 of the *Act* (Actions for damages) and each of those *rules* is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action.
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Purpose

- 15.1.3 **G** The requirements in this chapter lay down a minimum level of disclosure of financial information and of transparency.
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- 15.1.4 **G** This chapter requires the *Society* to report on the *insurance business* carried on by *members* and on the assets and liabilities of *members* and the *Society*.
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- 15.1.5 **G** The *Lloyd's Return* is made annually and contains the statement required from the *Society* that it has maintained the margin of solvency required under *LLD 11* (Required margin of solvency). This does not absolve the *Society* from the obligation to maintain the required margin of solvency at all times.
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- 15.1.6 **G** This statement of solvency is required to be supported by sufficient detail to allow the *FSA* to form an opinion on the adequacy of the matters stated and to evaluate other key financial data. All the information submitted as part of the *Lloyd's Return* will be made available for public inspection.
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- 15.1.7 **G** The *Lloyd's Return* is based on the return required from *insurers*, but the format and content have been modified where necessary to reflect the special characteristics of Lloyd's.
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- 15.1.8 **G** Where appropriate, the *Society* is also required to modify reporting to make it more like that of an *insurer*. This is to aid comparisons between Lloyd's and *insurers*.
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15.2 Requirement to report to the FSA

- 15.2.1** **R** ^{/1} The *Society* must report to the *FSA* within 6 months of the end of each *financial year* on its financial situation and solvency and on the whole of the *insurance business* carried on by *members*.
- 15.2.2** **R** ^{/1} The report in *LLD* 15.2.1R must be prepared in accordance with *LLD* 9.4.1R and this chapter.
- 15.2.3** **R** ^{/1} The report in *LLD* 15.2.1R must include:
- (1) the *Lloyd's Return* which comprises a completed set of the forms set out in *LLD* 15 Annex 1R, together with any statements, notes, reports or certificates required by this chapter; and
 - (2) a copy of the *syndicate* accounts for each *syndicate* that is required by *byelaw* to prepare accounts for the *financial year*.
- 15.2.4** **R** ^{/1} The *Lloyd's Return* must be examined and reported on by the auditors appointed to audit the affairs of the *Society*.
- 15.2.5** **R** ^{/1} The *Society* must provide a printed copy of the *Lloyd's Return* to the *FSA*, with Form 9 signed by three signatories who are senior officers of the *Society* each duly authorised by the *Council* to sign the *Lloyd's Return* on behalf of the *Society*.
- 15.2.6** **R** ^{/1} If the *FSA* notifies the *Society* that any part of the *Lloyd's Return* is not in conformity with this chapter, the *Society* must promptly make any appropriate corrections or adjustments and if necessary re-submit the *Lloyd's Return* (or relevant part of it).
- 15.2.7** **G** ^{/1} The *Society* should make the report, including amendments and corrections, and amalgamated *syndicate* accounts available at its head office for inspection by policyholders and potential policyholders and *members*.
- 15.2.8** **G** ^{/1} The signatories that are required under *LLD* 15.2.5R should where possible include the Chairman and Chief executive of the *Society*.

15.3 Content and form of the Lloyd's Return

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In preparing the *Lloyd's Return*, the *Society* must:

- (1) complete the forms in *LLD 15 Annex 1R*, subject to *LLD 9* to *15*:
 - (a) following the requirements of and making the disclosures required under Appendices 9.1, 9.2, 9.3 and 9.4 of *IPRU(INS)*; and
 - (b) having regard to Guidance Note 9.1 of *IPRU(INS)*;

as if in the documents referred to in (a) and (b) references to an *insurer* were references to the *Society* and *members*, and adapting the requirements in (a) and the guidance in (b) where necessary;
- (2) complete the forms in *LLD 15 Annex 1R* using standard accounting classes as set out in *LLD 15 Annex 6R* where the forms require reporting by accounting class;
- (3) report treaty reinsurance general business falling in accounting classes 9 to 10 as set out in *LLD 15 Annex 6R* in Forms 28 and 29 in *LLD 15 Annex 1R* by reference to the categories in the underlying accounting classes; and
- (4) complete forms 13, 14, 40-60 in *LLD 15 Annex 1R* for each *long-term insurance business syndicate*.

15.3.2

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- (1) Where a reinsurance contract in *LLD 15.3.1R(3)* covers more than one underlying accounting class as set out in *LLD 15 Annex 6R* it must be apportioned between accounting classes in the way that best reflects its underlying composition.
- (2) However, where the apportionment in (1) cannot be made with reasonable accuracy or without disproportionate effort, then the contract must be allocated to the accounting class as set out in *LLD 15 Annex 6R* that most closely reflects its underlying composition.
- (3) Whether apportioned under (1) or allocated under (2), a consistent approach must be taken to reporting:
 - (a) the progress of a treaty in subsequent years; and

- (b) substantially similar *insurance business* in subsequent years.
- (4) Where a different policy is subsequently followed a suitable explanatory note must be provided.
- 15.3.3** **R** /1 If, during the financial year in question, the *Society* has agreed to, or carried out, a material connected party transaction, it must provide a brief description of that transaction by way of a supplementary note to the *Lloyd's Return*.
- 15.3.4** **R** /1 The description to be provided under *LLD 15.3.3R* must state:
- (1) the names of the transacting parties;
 - (2) a description of the connection between the parties;
 - (3) a description of the transaction;
 - (4) the amounts involved;
 - (5) any other elements of the transaction needed for an understanding of its effect or potential effect upon the financial position of the *Society*; and
 - (6) amounts written off in the period in respect of debts due to or from transacting parties which are connected parties.
- 15.3.5** **R** /1 Transactions with the same connected party may be disclosed on an aggregated basis unless separate disclosure is needed for a proper understanding of the effect of the transactions upon the financial position of the *Society*.

15.4 Risk groups for general insurance business

- 15.4.1** **R** ^{/1} The *Society* must for the purposes of reporting under this chapter:
- (1) classify the direct and facultative *general insurance business* of *members* according to appropriate risk groups; and
 - (2) where the risks are material, complete a separate Form 34 in *LLD 15 Annex 1R* for each group.
- 15.4.2** **R** ^{/1} The *Society* must not include:
- (1) policies falling within *classes 14, 15, 16, 17 or 18* within the same risk group as policies falling within any other *class*, except that policies falling within *class 14* may be included in the same risk group as policies falling within *class 15*; or
 - (2) policies in respect of private motor car risks, within the same risk group as policies in respect of other risks falling within accounting class 2 as set out in *LLD 15 Annex 6R*; or
 - (3) policies in respect of comprehensive private motor car risks, within the same risk group as policies in respect of non-comprehensive private motor car risks; or
 - (4) policies transferred to *members* by way of a transfer under section 111 of the *Act* (Sanction of the court for business transfer schemes), within the same risk group as other policies.
- 15.4.3** **G** ^{/1} In assessing what are appropriate risk groups for reporting purposes the *Society* should ensure where possible that:
- (1) each risk group should include only risks from within a single accounting class and in relation to a single country;
 - (2) policies are not included in the same risk group where, having regard to the patterns of risk, *claims* incurrence and settlement patterns, it is necessary to group them separately for the purposes of applying statistical methods in calculating the provision for *claims* outstanding in accordance with generally accepted accounting practice; and
 - (3) claims-made policies are not included in the same risk group as policies which are not claims-made policies, except:
 - (a) where this is not possible without disproportionate expense; and

(b) where the policies within the risk group do not exhibit materially different characteristics.

- 15.4.4** **G**_{/1} Subject to *LLD 15.4.2R(1)* and (2) and *LLD 15.4.3G(3)*, the *Society* may in respect of any accounting class include all *insurance business* carried on by *members* in any country in any *financial year* as a single risk group.
- 15.4.5** **G**_{/1} Notwithstanding the provisions of *LLD 15.4.2R(1)* and (2) and *LLD 15.4.3G(3)*, the *Society* may classify all *insurance business* carried on by *members* in any country in respect of any accounting class in any *financial year* as a single risk group, as long as gross premiums written for that year in respect of that *insurance business* are less than 5% of the world-wide gross premiums written for all accounting classes for that year.
- 15.4.6** **G**_{/1} The requirements to report a separate risk group in *LLD 15.4.2R(1)* do not apply where, in the case of any *financial year*, the gross premiums receivable for that year in respect of that risk group would be less than £1million.
- 15.4.7** **G**_{/1} Further guidance on risk groups and country classification is in *IPRU(INS)*, Guidance Note 9.1, paragraph 9.4.
- 15.4.8** **R**_{/1} **The *Society* must give the *FSA* notice of proposed changes to the definition or classification of the risk groups in *LLD 15.4.1R*, sufficient to allow the *FSA* properly to assess the implications of the proposals.**

15.5 Major treaty reinsurers

- 15.5.1** **R** ^{/1} The *Society* must, in connection with the *general insurance business* carried on by *members*, include in the *Lloyd's Return* a statement of major treaty reinsurers.
- 15.5.2** **R** ^{/1} A major treaty reinsurer is any insurance company to which in the *financial year* in question or any of the five preceding *financial years*:
- (1) in the case of proportional reinsurance, 2% or more of the gross premiums receivable in respect of *general insurance business* of the *members* in aggregate has been ceded; or
 - (2) in the case of non-proportional reinsurance, 5% or more of the gross premiums receivable in respect of *general insurance business* has been ceded.
- 15.5.3** **G** ^{/1} The *Society* should be treated as if it were a major treaty reinsurer when *inter-syndicate reinsurance* in aggregate exceeds the amounts set out in *LLD 15.5.2R*.
- 15.5.4** **G** ^{/1} The requirements of *LLD 15.5.1R*, *LLD 15.6.1R* and *LLD 15.7.1R* may be satisfied by giving a fair view and making use of an appropriate degree of approximation. The *Society* may employ any reasonable methods to establish the information required.
- 15.5.5** **G** ^{/1} *LLD 15.5.2R* and *LLD 15.7.2R* should be interpreted in relation to the period in which these reporting requirements come into effect. In the first *Lloyd's Return*, only one *financial year* will be reported on, in the second *Lloyd's Return*, two, and so on.
- 15.5.6** **R** ^{/1} The statement required under *LLD 15.5.1R* must include:
- (1) the full name of each major treaty reinsurer;
 - (2) the amount of the reinsurance premiums payable in the *financial year* to each such reinsurer;
 - (3) whether and if so how the reinsurer was connected to any *member* or any *managing agent*;
 - (4) the amount of any debt of each such reinsurer included at line 75 of Form 13 in *LLD 15 Annex 1R*;

- (5) the amount of any deposit received from each such reinsurer under reinsurance treaties included at line 31 of Form 15 in *LLD 15 Annex 1R*; and
- (6) the reinsurers' share of *technical provisions* shown on Form 13 in *LLD 15 Annex 1R*, except that in respect of claims incurred but not reported, such recoveries need only be included to the extent that they are in respect of specific occurrences for which provisions have been allocated;

or, as the case may be, a statement that having aggregated the reinsurance ceded by *members* no reinsurer is a major treaty reinsurer.



15.6 Major facultative reinsurers

- 15.6.1** **R** ^{/1} The *Society* must, in connection with the *general insurance business* carried on by *members*, include in the *Lloyd's Return* a statement of major facultative reinsurers.
- 15.6.2** **R** ^{/1} A major facultative reinsurer is an insurance company to which or with respect to which:
- (1) 0.5% or more of the gross premiums *receivable* in respect of *general insurance business* of the *members* in aggregate has been ceded; or
 - (2) the addition of the amounts in items (4) and (5) of *LLD 15.5.6R* produces an amount exceeding 1% of the aggregate gross assets of *members*.
- 15.6.3** **G** ^{/1} The *Society* should be treated as if it were a major facultative reinsurer when *inter-syndicate reinsurance* in aggregate exceeds the amounts set out in *LLD 15.6.2R*.
- 15.6.4** **R** ^{/1} The statement required under *LLD 15.6.1R* must include the matters listed in *LLD 15.5.6R*, with appropriate amendments.



15.7 Major reinsurance cedants

- 15.7.1** **R** ^{/1} The *Society* must, in connection with the *general insurance business* carried on by *members*, include in the *Lloyd's Return* a statement of major reinsurance cedants.
- 15.7.2** **R** ^{/1} A major reinsurance cedant is an insurance company which in the *financial year* in question or any of the three preceding *financial years*:
- (1) cedes an amount which exceeds 5% of the gross premiums *receivable by members* in respect of *general insurance business* accepted under reinsurance treaties; and
 - (2) cedes an amount which exceeds 2% of the gross premiums *receivable by members* in respect of *general insurance business*.
- 15.7.3** **G** ^{/1} The *Society* should be treated as if it were a major reinsurance cedant when inter-syndicate cessions in aggregate exceed the amounts set out in *LLD 15.7.2R*.
- 15.7.4** **R** ^{/1} The statement required under *LLD 15.7.1R* must include the matters listed in *LLD 15.5.6R*, with appropriate amendments.

15.8 Additional information

Derivative contracts

15.8.1

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The *Society* must annex a statement to the *Lloyd's Return* comprising a brief description of:

- (1) any *byelaws* and guidelines issued by the *Society* governing the use of *derivative* contracts;
- (2) any provision in those guidelines governing the use of contracts under which *members* have a right or obligation to acquire or dispose of assets which was not, at the time when the contract was entered into, reasonably likely to be exercised and the circumstances in which, pursuant to that provision, such contracts may be used;
- (3) the extent to which *members* were during the *financial year* a party to any contracts of the kind described in (2);
- (4) the extent to which any of the amounts recorded in Form 13 would be changed if assets which *members* had a right or obligation to acquire or dispose of under *derivative* contracts outstanding at the end of the *financial year* (being, in the case of *options*, only those *options* which it would have been prudent to assume would be exercised) had been acquired or disposed of;
- (5) the difference between (4) and the amount which would result under (4) if such *options* had been exercised and this were reflected in Form 13 to the maximum extent;
- (6) how different the information provided pursuant to (4) and (5) would have been if, instead of applying to contracts outstanding at the end of the *financial year*, (4) and (5) had applied to *derivative* contracts outstanding at such other time during the *financial year* as would have changed the amounts in Form 13 to the maximum extent;
- (7) the maximum loss which would be incurred by *members* on the failure by any one other person to fulfil its obligations under *derivative* contracts outstanding at the end of the *financial year*,

both under existing market conditions and in the event of other foreseeable market conditions, together with an assessment of whether such maximum loss would have been materially different at any other time during the *financial year*;

- (8) the circumstances surrounding the use of any *derivative* contract held at any time during the *financial year* which did not fall within *LLD* 13.6.1R; and
- (9) the total value of any fixed consideration received by *members* (whether in cash or otherwise) during the *financial year* in return for granting rights under *derivative* contracts and a summary of contracts under which such rights have been granted.

15.8.2

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In relation to required disclosures of *derivative* contracts in *LLD* 15.8.1R, references to a *derivative* contract and related expressions should be taken to include:

- (1) any *derivative* contract entered into by a *managing agent* on behalf of a *member* as part of that *member's insurance business*; and
- (2) any *derivative* contract entered into by the *Society*.

15.8.3

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Contracts that are *quasi-derivative contracts* should be treated as *derivative* contracts.

15.8.4

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For the purposes of *LLD* 15.8.1R, if *members* are a party to:

- (1) a *contract for differences*; or
- (2) any other contract which is to be, or may be, settled in cash

they must be treated as having a right or obligation to acquire or dispose of the assets underlying the contract.

General insurance business ceded

15.8.5

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The *Society* must annex to the *Lloyd's Return* a statement:

- (1) of each major treaty reinsurer and major facultative reinsurer; and
- (2) for each of the realistic disaster scenarios set by the *Society* under *LLD* 10.6, of the contribution it is assumed each such reinsurer would provide in the event of that disaster occurring.

15.8.6

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The requirements of *LLD* 15.8.5R may be satisfied by giving a fair view and may make use of an appropriate degree of approximation. The *Society* may employ any reasonable methods to establish the information required. The *Society* may also include such explanation as it considers to be necessary to allow a reasonable interpretation to be put on this statement.

The Society

15.8.7 **R** The *Society* must annex to the *Lloyd's Return* a statement naming each individual who has served:

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- (1) on the *Council*;
- (2) as Chairman of the *Council*; and
- (3) as Chief Executive Officer of the *Society*;

at any time during the *financial year*, including in each case the dates of commencement or end of service (as the case may be) of any individual who has not served for the entire year.

Capacity controlled

15.8.8 **R** The *Society* must annex to the *Lloyd's Return* a statement identifying any *members*, *members' agents* or *managing agents* that control a significant share of the underwriting capacity of the *Society*.

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15.8.9 **R** To control a significant share means:

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- (1) in relation to a *managing agent*, managing, directing through one or more Members' Agent Pooling Arrangements or owning, whether directly or in conjunction with *connected persons*, capacity which in aggregate is greater than 5% of the total underwriting capacity of the *Society*;
- (2) in relation to a *members' agent*, directing through one or more Members' Agent Pooling Arrangements or owing, whether directly or in conjunction with *connected persons*, underwriting capacity which in aggregate is greater than 2.5% of the total underwriting capacity of the *Society*; and
- (3) in relation to a *member*, owning, whether directly or in conjunction with *connected persons*, underwriting capacity which, in aggregate, is greater than 2.5% of the total underwriting capacity of the *Society*.

15.8.10 **G** The statement in *LLD* 15.8.8R should include comparative figures for the preceding two *financial years* and should state:

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- (1) the name of the *managing agent*, *members' agent* or *member*;
- (2) the amount of capacity owned, directed or managed in each case;
- (3) the names of the *connected persons* (if any); and
- (4) their respective shares.

 15.9 Certificates and audit report

Certificates

15.9.1

RThe *Society* must annex to the *Lloyd's Return*:

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- (1) a certificate from the *Council*, including the statements required by *LLD 15 Annex 2R*;
- (2) a statement from the *Lloyd's actuary*, including the statements required by *LLD 15 Annex 3R*;
- (3) a certificate from the *syndicate actuary* of each *syndicate* which carries on *long-term insurance business*, including the statements required by *LLD 15 Annex 4R*, and;
- (4) an abstract from the *syndicate actuary* of each *syndicate* which carries on *long-term insurance business* of the *actuary's* report made under *LLD 10.9.4R(2)(b)*.

Audit report

15.9.2

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The *Society* must ensure that the *Lloyd's Return* and every document annexed to or provided with it has been examined by the *Society's* auditors and must provide with the *Lloyd's Return* an audit certificate in respect of that examination.

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15.9.3

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The certificate in *LLD 15.9.2R* must be in the form set out in *LLD 15 Annex 5R*.

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 15.10 The Lloyd's global account

- 15.10.1 **R** The *Society* must prepare a global account in respect of each *financial year* that amalgamates all *syndicate* accounts for that year.
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- 15.10.2 **R** The global account must be prepared and submitted to the *FSA* within 6 months of the end of the *financial year* and state that it is prepared in compliance with *LLD* 9 to 15.
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- 15.10.3 **R** The notes to the global account must include details of:
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- (1) inter-syndicate *insurance business*, including premiums received or *receivable* and *claims* paid;
 - (2) the method by which run-off *claims* are taken into account;
 - (3) the method by which the premium income limits of *members* are calculated; and
 - (4) the bases and methods used in the calculation of *technical provisions* for *long-term insurance business*.
- 15.10.4 **R** The notes to the global account must state:
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- (1) the aggregate amount of *members'* qualifying assets and how that is divided between:
 - (a) Lloyd's deposits;
 - (b) personal reserve funds;
 - (c) special reserve funds; and
 - (d) other qualifying assets;
 - (2) the aggregate amount of the *central assets* and how that is divided between:
 - (a) the net assets of the *Central Fund*; and
 - (b) other *net central assets*;

- (3) the reason why any charges to tax are not shown in the accounts and the basic rate of tax applicable to amounts of tax deducted at source; and
- (4) the estimated average rates of commission and brokerage charged by brokers.





15.10.5

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The *Society* must provide a printed copy of the global account to the *FSA*.

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 **15.11 Public disclosure**

- 15.11.1**  The *FSA* will make all the documents received by it under this chapter available to the public.
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- 15.11.2**  The *Society* must provide within a period not exceeding 30 days:
- (1) on demand to any *member* or policyholder a copy of the *Lloyd's Return* and the *global account* most recently submitted to the *FSA*; and
 - (2) if specifically requested by a *member* or policyholder, a copy of any *syndicate* account submitted to the *FSA*.
- 15.11.3**  Copies of the *Lloyd's Return*, the *global account* and the *syndicate* accounts may be provided, if the applicant so requests, in electronic form.
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- 15.11.4**  The *Society* may make a charge for the provision of the *Lloyd's Return*, the *global account* and of each *syndicate* account to cover its reasonable costs, including those of printing and postage.
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15.12 Other requirements

15.12.1

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IPRU(INS) 9.38R requires the *Society* to make a statistical report of *members'* *insurance business* activities in *EEA States*.

Statement of solvency

The Society of Lloyd's

L9	Global	Financial year ended			Units		
		day	month	year	£000		
		31	12	20XX			
		As at the end of the financial year	As at the end of the previous financial year	Source			
		1	2	Form	Line	Column	

GENERAL INSURANCE BUSINESS**Available assets**

Other than <i>long-term insurance business assets</i> allocated towards <i>general insurance business</i> solvency requirements	11			See Instruction 1
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Solvency requirements

Solvency requirements for <i>general insurance business</i>	12			See Instruction 2
Excess (deficiency) of available assets over solvency requirements (11 - 12)	13			
Amount by which <i>members'</i> assets exceed solvency requirements	14			See Instruction 3
Amount by which <i>members'</i> assets are less than solvency requirements ¹	15			See Instruction 4
<i>Central assets</i> available to meet <i>members'</i> solvency shortfalls	16			See Instruction 5
Other assets (particulars to be specified by way of a supplementary note)	17			
Amount by which <i>central assets</i> and other assets exceed/(are less than) <i>members'</i> solvency shortfalls (16+17-15)	18			

LONG-TERM INSURANCE BUSINESS**Available assets**

<i>Long-term insurance business admissible assets</i>	21			10. 11
Other than <i>long-term insurance business assets</i> allocated towards <i>long-term insurance business</i> solvency requirements	22			See Instruction 1
Total <i>mathematical reserves</i> (after distribution of surplus)	23			See Instruction 6
Other insurance and non-insurance liabilities	24			14. 49
Available assets for <i>long-term insurance business required minimum margin</i> (21 + 22 - 23 - 24)	25			

Solvency requirements

Solvency requirements for <i>long-term insurance business</i>	41			See Instruction 7
Amount by which <i>members'</i> assets exceed solvency requirements	45			See Instruction 8
Amount by which <i>members'</i> assets are less than solvency requirements ¹	46			See Instruction 9

¹ These include any amount by which the aggregate solvency requirement exceeds the sum of the *members' margins*.

<i>Central assets</i> available to meet <i>members</i> ' solvency shortfalls	47			See Instruction 5
Other assets (particulars to be specified by way of a supplementary note)	48			
Amount by which <i>central assets</i> and other assets exceed/ (are less than) <i>members</i> ' solvency shortfalls (47+48-46)	49			

R Instructions for completion of Form 9

1 Table

1	The sum of the entries at lines 11 and 22 must equal the sum of the entries at lines 75 and 83 to Form 10 less line 89 code 2 and 4 to Form 13, i.e. $9.11+9.22 = 10.75 + 10.83 - 13.89(2+4)$.
2	The entry at line 12 must be the aggregate of the <i>members' margins</i> for <i>general insurance business</i> or, if greater, the <i>Society margin</i> .
3	The entry at line 14 must be the aggregate of the excess for each <i>member</i> of his <i>general insurance business assets</i> over his <i>required amount</i> for <i>general insurance business</i> .
4	The entry at line 15 must be the aggregate of the shortfall for each <i>member</i> of his <i>general insurance business assets</i> over his <i>required amount</i> for <i>general insurance business</i> , plus any excess of the <i>Society margin</i> over the aggregate of the <i>members' margins</i> for <i>general insurance business</i> .
5	The sum of the entries at line 16 and line 47 must equal line 83 to Form 10.
6	The entry at line 23 must equal line 15 to Form 14.
7	The entry at line 41 must be the aggregate of the <i>members' margins</i> for <i>long-term insurance business</i> or, if greater, the sterling equivalent of 800,000 Euros (using the conversion rate notified by the <i>FSA</i> from time to time for this purpose).
8	The entry at line 45 must be the aggregate of the excess for each <i>member</i> of his <i>long-term insurance business assets</i> over his <i>required amount</i> for <i>long-term insurance business</i> .
9	The entry at line 46 must be the aggregate of the shortfall for each <i>member</i> of his <i>long-term insurance business assets</i> over his <i>required amount</i> for <i>long-term insurance business</i> , plus any excess of the sterling equivalent of 800,000 Euros (using the conversion rate notified by the <i>FSA</i> from time to time for this purpose) over the aggregate of the <i>members' margins</i> for <i>long-term insurance business</i> .

Statement of net assets

Sheet 1

The Society of Lloyd's

Financial year ended

	L10	Financial year ended			Units		
		Global	day 31	month 12	year 20XX	£000	
		As at the end of this <i>financial year</i>	As at the end of the <i>previous financial year</i>	Source			
		1	2	Form	Line	Column	
<i>Long-term insurance business - admissible assets</i>	11			13.	89.	1	
				(2, 4, 6 & 200)			
<i>Long-term insurance business - liabilities</i>	12			14.	59.	1	
				(all)			
<i>Long-term insurance business - net admissible assets (11-12)</i>	13						
<i>Other than long-term insurance business -admissible assets</i>	21			13.	89.	1	
				(100)			
<i>Other than long-term insurance business - liabilities</i>	22			See Instruction 1			
<i>Other than long-term insurance business - net admissible assets (21 - 22)</i>	23						
<i>Other admissible assets</i>	31			13.	89.		
				(1, 3 & 5)			
<i>Other liabilities</i>	32			See Instruction 2			
<i>Net other admissible assets (31-32)</i>	33						
<i>Total net admissible assets (13+23+33))</i>	41			See Instruction 3			

Represented by:

Net assets held in <i>premium trust fund</i> excluding items shown at lines 50 and 52-55	49			See Instruction 7		
Declared result	50			See Instructions 4 and 7		
Undistributed profits on run-off <i>syndicate years</i>	51			See Instruction 5		
<i>Technical provisions</i> for run-off <i>syndicate years</i>	52			See Instruction 6		
<i>Technical provisions</i> for naturally <i>open</i> and <i>closing</i> <i>syndicate years</i>	53					
Credit equalisation (other than amounts allocated to the <i>Society</i>)	54			15.	15.	
				(Syndicate & members)		
Net surpluses in <i>open</i> years	55			15.	16.	
				(Members)		
Inadmissible assets	56					
<i>Other net admissible assets (line 83)</i>	57					

Other (specify)	58			
Total net <i>admissible assets</i> (49+50-56+57+58)	59			See Instruction 3

Total net admissible assets

Sheet 2

The Society of Lloyd's

Financial year ended

	L10	Global	day	month	year	Units		
			31	12	20XX	£000		
	As at the end of this financial year 1		As at the end of the previous financial year 2			Source		
	Form	Line	Column					

Members' assets and liabilities**Long-term insurance business**

Assets held in <i>premium trust funds</i>	61				13. 89. (200)
Lloyd's deposits	62				See Instruction 8
Lloyd's special reserve funds	63				
Liabilities	64				14. 59.
Net <i>admissible assets</i> (61+62+63-64)	65				

General insurance business

Assets held in <i>premium trust funds</i>	71				13. 89. (100)
Lloyd's deposits	72				See Instruction 9
Lloyd's special reserve funds	73				
Liabilities	74				15. 69. <i>Syndicate & other members</i>
Net <i>admissible assets</i> (71+72+73-74)	75				

Central assets and liabilities

Lloyd's <i>Central Fund</i>	80				13. 89. (3+4)
Corporation of Lloyd's	81				13. 89. (1+2)
Other liabilities	82				15. 69. <i>(Society)</i>
Other <i>net admissible assets</i> (80+81-82)	83				

Total			
Total net <i>admissible assets</i> (65+75+83)	89		See Instruction 3

R Instructions for completion of Form 10

1 Table

1	Line 22 is the sum of the entries at 15.69 (<i>syndicates</i>) and 15.19 (<i>members</i>).
2	Line 32 comprises <i>members'</i> liabilities other than 15.19 (<i>members</i>) and central liabilities of the <i>Society</i> .
3	Lines 41, 59 and 89 must be equal.
4	Line 50 is the amount of net results to be released from closing <i>syndicate years</i> plus <i>financial year</i> results on run-off years.
5	Line 51 is the amount of net assets held by <i>managing agents</i> for run-off <i>syndicate years</i> less the amount at line 52. The assets are to be computed before applying admissibility limits.
6	The <i>technical provisions</i> in lines 52 and 53 are the amounts shown in line 59 to Form 24 and line 15 to Form 14. They exclude amounts in lines 54 and 55.
7	The total of lines 49, 50 and 52 to 55 must equal the assets in <i>premium trust funds</i> other than the reinsurance <i>share</i> of the <i>technical provisions</i> , before applying admissibility limits, <u>less</u> liabilities other than <i>technical provisions</i> .
8	The sum of lines 62 and 63 must equal Form 13 line 89 code 6.
9	The sum of lines 72 and 73 must equal Form 13 line 89 code 5.

Analysis of admissible assets

The Society of Lloyd's

Category of assets

		<i>Financial year ended</i>			Units	Code	
		day	month	year			
L13	Global	31	12	20XX	£000		
Investments					As at the end of this financial year	As at the end of the previous financial year 2	
Land and buildings					11		
Investments in group undertakings and participating interests	UK insurance dependants	<i>Shares</i>			21		
		<i>Debt securities</i> issued by, and loans to, dependants			22		
	Other insurance dependants	<i>Shares</i>			23		
		<i>Debt securities</i> issued by, and loans to, dependants			24		
	Non-insurance dependants	<i>Shares</i>			25		
		<i>Debt securities</i> issued by, and loans to, dependants			26		
	Other group undertakings and participating interests	<i>Shares</i>			27		
		<i>Debt securities</i> issued by, and loans to, group undertakings			28		
		Participating interests			29		
		<i>Debt securities</i> issued by, and loans to, undertakings in which there is a participating interest.			30		
	Total sheet 1 (11 to 30)					39	

Analysis of *admissible assets*

The Society of Lloyd's

Category of assets

		<i>Financial year ended</i>			Units	Code		
		day	month	year				
		L13	Global	31	12	20XX	£000	
Investments							As at the end of this financial year	As at the end of the previous financial year 2
Deposits with ceding undertakings								
Other financial investments	Equity shares					41		
	Other shares and other variable yield securities					42		
	Holdings in collective investment schemes					43		
	Rights under derivative contracts					44		
	Debt securities and other fixed income securities	Fixed interest	Approved securities			45		
			Other			46		
		Variable interest	Approved securities			47		
			Other			48		
	Participation in investment pools					49		
	Loans secured by mortgages					50		
	Other loans	Loans to public or local authorities and nationalised industries or undertakings				51		
		Loans secured by policies of insurance issued by the company				52		
		Other				53		
	Deposits with approved credit institutions and approved financial institutions	Withdrawal subject to a time restriction of one month or less				54		
		Withdrawal subject to a time restriction of more than one month				55		
Other					56			
Deposits with ceding undertakings					57			
Reinsurers' share of technical provisions	Claims outstanding				61			
	Other				63			
Total sheet 2 (41 to 63)					69			

Analysis of *admissible assets*

The Society of Lloyd's

Category of assets

		<i>Financial year ended</i>			Units	Code
		day	month	year		
L13	Global	31	12	20XX	£000	
Debtors					As at the end of this <i>financial</i> year	As at the end of the previous <i>Financial</i> year
Other assets					1	2
Debtors arising out of direct insurance operations	<i>Policyholders</i>			71		
	<i>Intermediaries</i>			72		
Salvage and subrogation recoveries				73		
Debtors arising out of reinsurance operations	Due from ceding insurers and <i>intermediaries</i> under reinsurance business			74		
	Due from reinsurers and <i>intermediaries</i> under reinsurance contracts ceded			75		
Other debtors	<i>Members</i>	Due in 12 months or less after the end of the <i>financial</i> year		76		
		Due more than 12 months after the end of the <i>financial</i> year		77		
	Other	Due in 12 months or less after the end of the <i>financial</i> year		78		
		Due more than 12 months after the end of the <i>financial</i> year		79		
Tangible assets				80		
Cash at bank and in hand	Deposits not subject to time restriction on withdrawal, with <i>approved credit institutions</i> and <i>approved financial institutions</i> and local authorities			81		
	Cash in hand			82		
Other assets (particulars to be specified by way of supplementary note)				83		
Prepayments and accrued income	Accrued interest and rent			84		
	Other prepayments and accrued income			86		
Deductions under <i>LLD</i> from the aggregate value of assets				87		
Total sheet 3 (71 to 86 less 87)				88		
Grand total of <i>admissible assets</i> (39+69+88)				89		
Reconciliation to asset values in <i>global accounts</i>						
Total <i>admissible assets</i> (as per line 89 above)				91		
Total assets in excess of the admissibility limits				92		
Other differences in the valuation of assets (other than for assets not valued above)				94		
Assets of a type not valued above				95		

Total	99		
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R Instructions for completion of Form 13

1 Table

1 Form 13 must be completed separately for each code written under the following category of:

2 Table Form 13 category code

Category	Code: other than long-term insurance business assets	Code: long-term insurance business assets
Corporation	1	2
Central Fund	3	4
Members' funds at Lloyds	5	6
Total premium trust fund	100	200
Trust fund maintained in respect of an overseas regulator	102, 103, 104, etc.	–
Remaining premium trust fund	101	–
Premium trust fund maintained in respect of each syndicate	–	201, 202, 203, etc.

3 Table

2	Lines 21 to 30 do not apply to codes other than 1–4.
3	In lines 11 to 86: <ol style="list-style-type: none"> (a) for the purpose of classifying (but not valuing) assets, headings and descriptions used above, wherever they also occur in the balance sheet format in Schedule 9A to the Companies Act, (as if that schedule applied to Lloyd's and as if the Corporation was a company) must have the same meaning as in that schedule, (b) assets must be valued in accordance with <i>LLD</i> 13 (Assets: valuation and realisability risk); and (c) assets of any particular description must be shown after deduction of assets of that description which (for any reason) fall to be left out of account under <i>LLD</i> 13.4, <i>LLD</i> 14.5 and <i>LLD</i> 14.6.
4	Lines 92 to 95 provide a reconciliation of amounts valued in accordance with <i>LLD</i> 9 to 15 to the amounts that appear in published accounts.
5	The aggregate value of those investments which are: <ol style="list-style-type: none"> (a) unlisted investments falling within any of lines 41, 42, 46 or 48 which have been valued in accordance with <i>LLD</i> 13.11; or (b) listed investments falling within any of lines 41, 42, 46 or 48 which have been valued in accordance with <i>LLD</i> 13.11 and which are not readily realisable; or (c) units or other beneficial interests in <i>collective investment schemes</i> falling within <i>LLD</i> 13.12.2R; or (d) reversionary interests or remainders in property other than land or buildings, must be stated by way of a supplementary note to this form, together with a description of such investments.
6	The aggregate value of those investments falling within lines 46 or 48 which are hybrid <i>securities</i> are to be stated by way of a supplementary note.
7	Non Topic text row–text

-
- 8 In line 95 “Assets of a type not valued above” refers to assets left out of account under *LLD* 13.4.1R.
 - 9 Line 61 and 63 relate only to *general insurance business*

Long-term insurance business liabilities

The Society of Lloyd's

Category of assets	Financial year ended			Units	Category of assets		
	Day	Month	Year		Form	Line	Column
	L14	Global	31					12	20XX	£000
			As at end of this <i>financial year</i>	As at end of the previous <i>financial year</i>			
			1	2			
Technical provisions (net amount)	Reinsurance to close for closing year of account		11				
	Open years of account		12				
	Run off years of account		13				
	Other		14				
	Total (11 to 14)		15				
Claims outstanding which had fallen due for payment before the end of the <i>financial year</i> not included in line 15	Gross amount		16				
	Reinsurers' share		17				
	Net (16-17)		18				
Provision for other risks and charges	Taxation		21				
	Other		22				
Deposits received from reinsurers			23				
Creditors and other liabilities	Arising out of insurance operations	Direct business	31				
		Reinsurance accepted	32				
		Reinsurance ceded	33				
	Debenture loans	Secured	34				
		Unsecured	35				
	Amounts owed to <i>credit institutions</i>			36			
	Other creditors	Taxation	37				
		Other	38				
Accruals and deferred income			39				

Total other insurance and non-insurance liabilities (18 to 39)	49			
Total liabilities (15+49)	59			

R Instructions for completion of Form 14

1 Table

1	The form must be completed separately for the total <i>long-term insurance business</i> liabilities, the liabilities in respect of each <i>syndicate</i> and any liabilities relating to the other <i>long-term insurance business assets</i> of <i>members</i> or those of the Corporation or <i>Central Fund</i> . The same codes must be used on the corresponding Form 13.
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Liabilities (other than long-term insurance business)

The Society of Lloyd's

		Financial year ended			Units	Category of liability		
		day	month	year				
		L15	Global	31					12	20XX	£000
				As at the end of this financial year	As at the end of the previous financial year	Source		
				1	2	From	Line	Column
Technical provisions (gross amount)	Claims outstanding & unexpired risks for closing year of account		11			See Instruction 1		
	Claims outstanding & unexpired risks for open years of account		12			See Instruction 2		
	Claims outstanding & unexpired risks for run off years of account		13			See Instruction 3		
	Credit equalisation provisions		15			See Instruction 4		
	Other (particulars to be specified by way of supplementary note)		16					
	Total (11 to 16)		19					
Provisions for other risks and charges	Taxation		21					
	Other		22					
Deposits received from reinsurers			31					
Creditors	Arising out of insurance operations	Direct business	41					
		Reinsurance accepted	42					
		Reinsurance ceded	43					
	Amounts owed to credit institutions		46					
	Other creditors	Taxation	47					
		Other	49					

Accruals and deferred income	51			
Total (19 to 51)	69			

R Instructions for completion of Form 15

1 Table

1	Line 11 Column 1 corresponds to the sum of 25.11+25.13+25.15+25.30 for the closing year.
2	Line 12 Column 1 corresponds to the sum of 25.11+25.13+25.15+25.30 for naturally <i>open</i> years.
3	Line 13 Column 1 corresponds to the sum of 25.11+25.13+25.15+25.30 for run-off years.
4	The amounts in line 15 must sum to the amount at line 28 to Form 37. Any difference between the credit equalisation provisions allocated to <i>members</i> and their proportionate shares of the provisions allocated to the <i>open syndicate years</i> on which they participate must be included in the form for other <i>members'</i> liabilities.
5	Separate forms are required for <i>syndicate</i> liabilities, other <i>members'</i> liabilities, central liabilities and aggregate liabilities.
6	No entries arise in lines 11 to 13, 16 to 19 or 31 to 43 for the central liabilities of the <i>Society</i> .
7	Aggregate <i>member's</i> liabilities include aggregate net surpluses in <i>open syndicate years</i> (for those <i>members</i> with surpluses) to be shown at line 16 and credit equalisation provisions at line 15. Nothing arises in lines 11 to 13 or 31 to 46.
8	Amounts in lines 11 to 13 and 16 must be stated gross of reinsurers' share.
9	The amount at line 11 should include the amount relating to future years of account shown in a footnote as required by instruction 3 to Form 20 and exclude any amounts included in line 12.
10	The amount at line 12 should include amounts relating to <i>syndicate years</i> reinsured into the latest two years of account before the year end, but must exclude any <i>reinsurance to close</i> as at the end of the year end since these amounts are included in line 11.

Profit and loss account

The Society of Lloyd's

[Summary/run-off years/other years]

		<i>Financial year ended</i>			Units	Year of account
		day	month	year		
L16	Global	31	12	20XX	£000	
		As at the end of this <i>financial</i> <i>year</i>	As at the end of the previous <i>financial year</i>	Source		
		1	2	Form	Line	Column
Transfer (to)/from the <i>general insurance business</i> technical account from Form 20 line 59		11			20. 59	See Instruction 2
Transfer to (from) credit equalisation provision		12			See	Instruction 3
Transfer from the <i>long-term insurance business</i> revenue account		13			40. 26	
Investment income	Income	14				
	Value re-adjustments on investments	15				
	Gains on the realisation of investments	16				
Investment charges	Investment management charges, including interest	17				
	Value re-adjustments on investments	18				
	Loss on the realisation of investments	19				
Other income and charges (particulars to be specified by way of a supplementary note)		21				
Result on ordinary activities (11-12+13+14+15+16-17-18-19+21)		39				
Extraordinary profit or loss (particulars to be specified by way of a supplementary note)		41				
Personal expenses (particulars to be specified by way of a supplementary note)		42				
Sub-total (39+41-42)		49				
Other surplus and deficiencies	Corporation (particulars to be specified by way of a supplementary note)	50				

	<i>Central Fund</i> (particulars to be specified by way of a supplementary note)	51			
Result for the <i>financial year</i> (49+50+51)		59			

R Instructions for completion of Form 16

1 Table

1	Forms 16 are required for all years of account combined, run-off years, "YY", "First YY" and "Latest YY" as defined in Form 20.
2	For all years of account combined, line 11 must also include the amounts required to be stated by instruction 3 to Form 20.
3	The amounts in line 12 must sum to the amount at line 29 to form 37.

Analysis of derivative contracts

The Society of Lloyd's

Business: Long-term/other than long-term

		<i>Financial year ended</i>			Units	Category of assets
		day	month	year		
		30	12	20XX	£000	
		L17	Global			
Derivative contracts		As at the end of this <i>financial year</i>			As at the end of the previous <i>financial year</i>	
		Assets 1	Liabilities 2	Assets 3	Liabilities 4	
Futures contracts	Fixed-interest securities	11				
	Equity shares	12				
	Land	13				
	Currencies	14				
	Other	15				
Options	Fixed-interest securities	21				
	Equity shares	22				
	Land	23				
	Currencies	24				
	Other	25				
Contracts for differences	Fixed-interest securities	31				
	Equity shares	32				
	Land	33				
	Currencies	34				
	Other	35				
Adjustments for variation margin		41				
Total (11 to 41)		49				

R Instructions for completion of Form 17

1 Table

1	Form 17 must be completed in respect of each category for which a separate Form 13 is supplied.				
2	The codes specified in instruction 1 to Form 13 <i>are</i> to be used as appropriate.				
3	<i>Derivative</i> contracts must be analysed according to the description of assets shown in the second description column of Form 17, which represents the <i>principal</i> subject of the contract.				
4	<i>Derivative</i> contracts must be reported as assets in column 1 of Form 17 if their value to the <i>insurer</i> (gross of variation <i>margin</i>) is positive and as liabilities in column 2 of Form 17 if their value (gross of variation <i>margin</i>) to the <i>insurer</i> is negative.				
5	All amounts included at lines 11 to 35 of Form 17 in respect of <i>derivative</i> contracts must be as determined without making any allowance for variation margin.				
6	Amounts in respect of a <i>derivative</i> contract may only be included net of amounts in respect of any other <i>derivative</i> contract if : <table border="1" data-bbox="427 884 1444 1012"> <tr> <td>(a)</td> <td>obligations of the <i>insurer</i> under the contracts may be set off against each other under generally accepted accounting practice; and</td> </tr> <tr> <td>(b)</td> <td>such other contract has the effect (in whole or in part) of <i>closing out</i> the obligations of the <i>insurer</i> under the first mentioned contract.</td> </tr> </table>	(a)	obligations of the <i>insurer</i> under the contracts may be set off against each other under generally accepted accounting practice; and	(b)	such other contract has the effect (in whole or in part) of <i>closing out</i> the obligations of the <i>insurer</i> under the first mentioned contract.
(a)	obligations of the <i>insurer</i> under the contracts may be set off against each other under generally accepted accounting practice; and				
(b)	such other contract has the effect (in whole or in part) of <i>closing out</i> the obligations of the <i>insurer</i> under the first mentioned contract.				
7	The effect of any variation margin upon amounts included at lines 11 to 35 of Form 17 must be shown at line 41.				
8	The entry at 17.49.1 must be included at 13.44.1.				
9	The entry at 17.49.2 must be included at 15.49.1 or 14.38.1 as appropriate.				
10	Rights to recover assets transferred by way of <i>initial margin</i> must not be shown in Form 17				

Underwriting: Summary of underwriting movements

The Society of Lloyd's

Financial year ended

	L20	Global	day	month	year	Units
			30	12	20XX	£000
		Run-off year of account	YY	First YY	Latest YY	
PART 1						
Accounting class:						
movement in <i>financial year</i> (see Instruction 2)						
Accident and health	11					
Motor vehicle	12					
Aviation	13					
Marine	14					
Transport	15					
Property damage	16					
Third party liability	17					
Miscellaneous and pecuniary loss	18					
Non proportional treaty reinsurance	19					
Proportional treaty reinsurance	20					
Marine, aviation and transport reinsurance	21					
<i>General insurance business</i> (Lines 11 to 21)	59					
Life business (Form 40 line 26)	60					
Total business (lines 59+60)	61					
PART 2						
Reconciliation of movement in <i>financial year</i> with declared result for <i>financial year</i>						
This <i>financial year</i> (Form 16 line 49)	80					
Preceding <i>financial year</i>	81					
Previous <i>financial year</i>	82					
Add run-off years of account (80.1+86.1)	83					
Sub total (80 to 83)	84					
Other surpluses and deficiencies (Form 16, lines 50+51)	85					
Other adjustments (particulars to be specified by way of a supplementary note)	86					
Declared result (84 to 86)	99					

R Instructions for completion of Form 20

1 Table

1	The underwriting years commencing in the <i>financial years</i> shown between the columns headed “YY” and “Latest YY” must be in order (with the most recent year to the right) and correspond to the underwriting year commencing in this <i>financial year</i> and the previous underwriting years respectively.
2	Amounts must be analysed by year of account not by original underwriting year. A note to Form 20 must reconcile the consequential differences from amounts appearing in Form 24.
3	If any <i>syndicate year</i> has been <i>closed</i> into <i>the</i> year of account commencing after the year end and the <i>technical provision</i> is greater than the <i>reinsurance to close</i> for that <i>syndicate year</i> , (see Form 25 instruction 2) then the total of the amounts of the difference should be stated as a note to Form 20, <i>analysed</i> by accounting class.
4	The total of each row 11–21 and the amounts required to be stated by instruction 3 must equal the total in line 69 to Form 24.

Lloyd's Return

General insurance business (underwriting year accounting): Analysis of premiums, claims and expenses

The Society of Lloyd's

[Summary/run-off years/naturally open years]

Accounting class

			Financial year ended																		Accounting class					
			day	month		year		Units																		
Underwriting year ended			Prior underwriting years		MM		YY		MM		YY		MM		YY		MM		YY		MM		YY		Total all previous columns	
			29	29																						99	99
Premiums written	Gross amount	11																								
	Reinsurers' share	12																								
	Net (11-12)	19																								
Claims paid	Gross amount	21																								
	Reinsurers' share	22																								
	Net (21-22)	29																								
Reinsurance to close adjustment		30																								
Claims management costs		39																								
Net operating expenses	Commissions	41																								
	Other acquisition expenses	42																								
	Administrative expenses	43																								
	Reinsurers' commissions and profit participations	44																								
	Payable net (41+42+43-44)	49																								
Technical provisions	Brought forward	51																								

R Instructions for completion of Form 24

1 Table

1	The underwriting years commencing in the <i>financial years</i> shown between the columns headed “29 29” and “99 99” must be in order (with the most recent year to the right) and correspond to the underwriting year commencing in this <i>financial year</i> and the previous nine underwriting years respectively.
2	The amount in line 53 must equal the amount in line 31 of Form 25.
3	Amounts in lines 11–29 and 39–51 relating to <i>syndicate years</i> that commenced in the <i>financial year</i> or the previous two <i>financial years</i> (including <i>syndicate years</i> that have been <i>closed</i> into those <i>syndicate years</i>) must be included in the forms relating to naturally <i>open years</i> . Amounts relating to other <i>syndicate years</i> must be included in the forms relating to run–off years.
4	For naturally <i>open years</i> , the amount at line 30 is the total of provisions for all <i>syndicate years</i> that remain <i>open</i> (that is: go into run–off) at the end of the 3rd <i>financial year</i> less any <i>reinsurance to close premiums</i> received from run–off years <i>closed</i> at the end of, or during, the <i>financial year</i> . For run–off years, the amount at line 30 is the total of any <i>reinsurance to close premiums</i> payable to close <i>syndicate years</i> into naturally <i>open years</i> less the total of provisions for all <i>syndicate years</i> that go into run–off. In each case a <i>syndicate year</i> includes <i>syndicate years closed</i> into that <i>syndicate year</i> . Amounts relating to <i>closed syndicate years</i> must be included in the column relating to the original underwriting year. The allocation of <i>reinsurance to close premiums</i> between accounting classes <i>and</i> original underwriting year may be done in any reasonable manner.
5	Amount shown in lines 21 to 29 must exclude <i>claims</i> management costs.
6	The amounts shown in lines 51 and 53 must exclude credit equalisation provisions.
7	The amounts shown at lines 11 to 49 must be payable or receivable <i>during</i> the <i>financial year</i> .

R Instructions for completion of Form 25

1 Table

1	The underwriting years commencing in the <i>financial years</i> shown between the columns headed “29 29” and “99 99” must be in order (with the most recent year to the right) and correspond to the underwriting year commencing in this <i>financial year</i> and the previous nine underwriting years respectively.
2	Line 31 must equal line 53 to Form 24. The amount included for each <i>syndicate year</i> should sum to the solvency provision, even (in the case of a closing <i>syndicate year</i>) if this exceeds the <i>reinsurance to close</i> .
3	Amounts relating to <i>syndicate years</i> that commenced in the <i>financial year</i> or the previous <i>financial year</i> (including <i>syndicate years closed</i> , or being <i>closed</i> , into those <i>syndicate years</i> and <i>syndicate years</i> being <i>closed</i> into the following <i>open</i> underwriting years) must be included in the forms relating to naturally <i>open</i> years. Other <i>syndicate years</i> must be included in the forms relating to run-off years.
4	Lines 11 to 14 must exclude <i>claims</i> management

Lloyd's Return

General insurance business (underwriting year accounting): Analysis of premiums, claims and expenses by category for treaty reinsurance

The Society of Lloyd's

Category		Underwriting year ended	<i>Financial year ended</i>																		Units	Business category	Accounting class	Currency			
			Prior underwriting years		MM	YY	MM	YY	MM	YY	MM	YY	MM	YY	MM	YY	MM	YY	MM	YY							
			29	29																£000							
Premiums written	Gross amount	11																									
	Reinsurers' share	12																									
	Net (11-12)	19																									
Claims paid	Gross amount	21																									
	Reinsurers' share	22																									
	Net (21-22)	29																									
Reinsurance to close adjustment		30																									
Claims management costs		39																									
Net operating expenses	Commissions	41																									
	Other acquisition expenses	42																									
	Administrative expenses	43																									
	Reinsurers' commissions and profit participations	44																									
	Payable net (41+42+43-44)	49																									
Technical provisions	Brought forward	51																									
	Carried forward	53																									

Lloyd's Return

General insurance business (underwriting year accounting): Analysis of premiums, claims and expenses by category for treaty reinsurance

The Society of Lloyd's

Category

[Summary/run-off years/naturally open years]

Underwriting year ended			Financial year ended																Total all previous columns					
			Prior underwriting years		MM		YY		MM		YY		MM		YY		MM				YY		MM		YY
			29	29																			99	99
Premiums written	Gross amount	11																						
	Reinsurers' share	12																						
	Net (11-12)	19																						
Claims paid	Gross amount	21																						
	Reinsurers' share	22																						
	Net (21-22)	29																						
Reinsurance to close adjustment		30																						
Claims management costs		39																						
Net operating expenses	Commissions	41																						
	Other acquisition expenses	42																						
	Administrative expenses	43																						
	Reinsurers' commissions and profit participations	44																						
	Payable net (41+ 42 + 43 - 44)	49																						
Technical provisions	Brought forward	51																						

R Instructions for completion of Form 28

1 Table

1	The underwriting years commencing in the <i>financial years</i> shown between the columns headed "29 29" and "99 99" must be in order (with the most recent year to the right) and correspond to the underwriting year commencing in this <i>financial year</i> and the previous nine underwriting years respectively.
2	The amount in line 53 must equal the amount at line 31 to Form 29.
3	Amounts in line 11–29 and 39–51 relating to <i>syndicate years</i> that commenced in the <i>financial year</i> or the previous two <i>financial years</i> (including <i>syndicate years</i> that had been <i>closed</i> into those <i>syndicate years</i>) must be included in the forms relating to naturally <i>open years</i> . Amounts relating to other <i>syndicate years</i> must be included in the forms relating to run–off years.
4	For naturally <i>open years</i> , the amount at line 30 is the total of provisions for all <i>syndicate years</i> that remain <i>open</i> (that is: go into run–off) at the end of the 3rd <i>financial year less</i> any <i>reinsurance to close premiums</i> received from run–off years <i>closed</i> at the end of, or during, the <i>financial year</i> . For run–off years, the amount at line 30 is the total of any <i>reinsurance to close premiums</i> payable to <i>close syndicate years</i> into naturally <i>open years less</i> the total of provisions for all <i>syndicate years</i> that go into run–off. In each case a <i>syndicate year</i> includes <i>syndicate years closed</i> into that <i>syndicate year</i> . The allocation of <i>reinsurance to close premiums</i> between categories and underwriting year may be done in any reasonable manner.
5	Amounts shown in lines 21 to 29 must exclude <i>claims</i> management costs.
6	The amounts shown in the first column must be analysed on continuation sheets by underwriting year for <i>financial years</i> ending after 31 December 2003.
7	The box marked "Business category" must be completed by inserting one of the letters "a" to "h" according to which of the sub–paragraphs below describes the <i>insurance business</i> category to which the form relates: <ol style="list-style-type: none"> (a) Accident and health (corresponding <i>general insurance business</i> classes 1 (other than 1(p)) and 2); (b) Motor (corresponding <i>general insurance business</i> classes 1(p), 3 and 10); (c) Aviation (corresponding <i>general insurance business</i> classes 1(p), 5 and 11); (d) Marine (corresponding <i>general insurance business</i> classes 1(p), 6 and 12); (e) Transport (corresponding <i>general insurance business</i> class 7); (f) Property (corresponding <i>general insurance business</i> classes 4, 8 and 9); (g) Third party liability (corresponding <i>general insurance business</i> class 13); and (h) Miscellaneous and pecuniary loss (corresponding <i>general insurance business</i> classes 14, 15, 16, 17 and 18).
8	The amounts shown at lines 11 to 49 must be amounts payable or receivable during this <i>financial year</i> .

Lloyd's Return

General insurance business (underwriting year accounting): Analysis of technical provisions by category for treaty reinsurance

The Society of Lloyd's

Category

[Summary/run off years/naturally open years]

Financial year ended

day month year Units Business category Accounting class Currency

Underwriting year ended		Prior underwriting years		MM		YY		MM		YY		MM		YY		MM		YY		MM		YY		Total all previous columns	
		29	29																					99	99
Reported <i>claims</i> outstanding	Gross amount	11																							
	Reinsurer's share	12																							
Unexpired risks and <i>claims</i> incurred but not reported	Gross amount	13																							
	Reinsurer's share	14																							
<i>Claims</i> management costs		15																							
Subtotal (11-12+13-14+15)		20																							
Other <i>technical provisions</i>		30																							

Lloyd's Return

General insurance business (underwriting year accounting): Analysis of technical provisions by category for treaty reinsurance

The Society of Lloyd's

Category

[Summary/ run off years/ naturally open years]

Financial year ended

day month year Units Business Accounting Currency
category class

Underwriting year ended		Prior underwriting years		MM		YY		MM		YY		MM		YY		MM		YY		MM		YY		Total all previous columns	
		29	29																					99	99
Reported <i>claims</i> outstanding	Gross amount	11																							
	Reinsurer's share	12																							
Unexpired risks and <i>claims</i> incurred but not reported	Gross amount	13																							
	Reinsurer's share	14																							
<i>Claims</i> management costs		15																							
Subtotal (11-12+13-14+15)		20																							
Other <i>technical provisions</i>		30																							

R Instructions for completion of Form 29

1 Table

1	The underwriting years commencing in the <i>financial years</i> shown between the columns headed “29 29” and “99 99” must be in order (with the most recent year to the right) and correspond to the underwriting year commencing in this <i>financial year</i> and the previous nine underwriting years respectively.
2	The allocation of amounts in line 30 between categories and underwriting year may be done in any reasonable manner consistent with Form 25.
3	Amounts relating to <i>syndicate years</i> that commenced in the <i>financial year</i> or the previous <i>financial year</i> (including <i>syndicate years closed</i> , or being <i>closed</i> , into those <i>syndicate years</i> and <i>syndicate years</i> being <i>closed</i> into the following <i>open</i> underwriting years) must be included in the forms relating to naturally <i>open</i> years. Other <i>syndicate years</i> must be included in the forms relating to run-off years.
4	Lines 11 to 14 must exclude <i>claims</i> management costs.
5	The amounts shown in the first column must be analysed on continuation sheets by underwriting year for <i>financial years</i> ending after 31 December 2003.
6	The box marked “Business category” must be completed by inserting one of the letters “a” to “h” according to which of the sub-paragraphs of instruction 7 for completing Form 28 describes the business category to which the form relates.

Lloyd's Return

General insurance business (underwriting year accounting) : Analysis of gross claims and premiums by risk group for direct insurance and facultative reinsurance

The Society of Lloyd's

Risk group			Gross claims paid		Unexpired risks and gross claims outstanding carried forward		Unexpired risks and gross claims outstanding brought forward		Balance on each underwriting year (2+3+4-5-6)	Gross premiums	Claims ratio %
			In previous financial years	In this financial year	Reported	Unexpired risks and incurred but not reported	Reported	Unexpired risks and incurred but not reported			
Month	Year		1	2	3	4	5	6	7	8	9
		11									
		12									
		13									
		14									
		15									
		16									
		17									
		18									
		19									
		20									
Prior underwriting years		21									

Lloyd's Return

General insurance business (underwriting year accounting): Analysis of gross claims and premiums by risk group for direct insurance and facultative reinsurance

continuation sheet

The Society of Lloyd's

Accounting class: Third party liability

Currency

Risk group

				Financial year ended			Monetary units	Country	Accounting class	
				day	month	year				
				L34	Global	31	12	20XX		
Underwriting year		Gross claims paid		Unexpired risks and gross claims outstanding carried forward		Unexpired risks and gross claims outstanding brought forward		Balance on each underwriting year (2+3+4-5-6)	Gross premiums	Claims ratio %
Month	Year	In previous financial years	In this financial year	Reported	Unexpired risks and incurred but not reported	Reported	Unexpired risks and incurred but not reported			
		1	2	3	4	5	6	7	8	9

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R Instructions for completion of Form 34

1 Table

1	All figures are to be shown gross of the reinsurers' share.
2	The underwriting years commencing in the <i>financial years</i> at lines 11 to 20 must correspond to the underwriting year commencing in this <i>financial year</i> and the previous nine underwriting years respectively.
3	All amounts shown must exclude <i>claims</i> management costs.
4	The percentage shown at column 9 must be the ratio of the sum of columns 1 to 4 to column 8.
5	The percentages shown at column 9 are to be expressed as percentages to one place of decimals.
6	For risk groups falling in <i>accounting class 7</i> the amounts shown in line 21 must be analysed by underwriting year on continuation sheets for <i>financial years</i> ending after 31 December 2003

Lloyd's Return Form 35

General insurance business (underwriting year accounting): Reconciliation of gross claims and premiums for direct insurance and facultative reinsurance

The Society of Lloyd's

		Financial year ended					Units	
		day	month	year				
		L35	Global	31	12	20XX	£000	
Accounting class	Gross claims paid in this financial year	Unexpired risks and gross claims outstanding carried forward		Unexpired risks and gross claims outstanding brought forward		Balance for this financial year (1+2+3-4-5)	Gross written premiums	
		Reported	Unexpired risks and incurred but not reported	Reported	Unexpired risks and incurred but not reported			
		1	2	3	4	5	6	7
Accident and health	11							
Motor	12							
Aviation	13							
Marine	14							
Transport	15							
Property	16							

Third party liability	17							
Miscellaneous and pecuniary loss	18							

R Instructions for completion of Form 35

1 Table

1	All figures are to be shown gross of reinsurers' share.
2	All amounts shown must exclude <i>claims</i> management costs.
3	Only business not reported on Form 34 must be included in this form.
4	"Gross written <i>premiums</i> " refers to all amounts reported in column 99–99 of line 11 to Form 24, but only to the extent such <i>premiums</i> have not been reported in Form 34.

Currency rates

The Society of Lloyd's

Financial year ended

day month year

		L36	Global	31	12	20XX
Name of country	Country code	No. of units to £ sterling				

R Instructions for completion of Form 36

1 Table

1	Where any of Forms 28, 29 or 34 contains a figure in a currency other than sterling the rate of conversion of those figures to sterling shall be stated in the right hand column of this form.
2	Where the rate of conversion differs according to whether it applies to income and

Credit equalisation provisionsThe *Society* of Lloyd's

					Financial year ended			Units		
					day	month	year			
L37	Global	31	12	20XX	£000			Source		
Calculation of the transfer to/from the provision					<i>Direct credit insurance business</i>			From	Line	Column
Maximum provision					13			See Instruction 1		
Equalisation provision brought forward					21			See Instruction 2		
Transfers in					22			See Instruction 3		
Provisional transfers out					24			See Instruction 4		
Excess, if any, of 24 over (21+22)					25					
Provisional amount carried forward (21+22-24+25)					26					
Excess, if any, of 26 over 13					27					
Equalisation provision carried forward (26-27)					28					
Transfer in/(out) for <i>financial year</i> (28-21)					29					
Business in the <i>financial year</i>										
Net <i>premiums</i> written					30			See Instruction 5		
<i>Claims</i> net of reinsurance					31			See Instruction 6		
<i>Claims</i> management costs					32			See Instruction 7		
Net operating expenditure					33			See Instruction 8		
Technical surplus/ (deficit) (30-31-32-33)					39					

R Instructions for completion of Form 37

1 Table

1	Lines 13 must be 150% of the highest annual amount of net <i>premiums</i> written in the last 5 years.
2	Line 21 must equal the total of the statutory credit equalisation provisions, if any, brought forward from <i>the</i> previous year at Form 15, line 15 column 2.
3	Line 22 must be 75% of the technical surplus, if any, shown on line 39, subject to a limit of 12% of line 30.
4	Line 24 must equal the technical deficit, if any, shown on line 39.
5	The entry at line 30 must be the amounts included in line 19 of Form 24 for <i>accounting class 8</i> , relating to direct <i>insurance business</i> in <i>general insurance business class 14</i> .
6	The entry at line 31 must be the amounts included in lines 29 and 59 of Form 24 for accounting class 8 relating to direct <i>insurance business</i> in <i>general insurance business class 14</i> .
7	The entry at line 32 must be the amounts included in line 39 of Form 24 for accounting class 8, relating to direct <i>insurance business</i> in <i>general insurance business class 14</i> .
8	The entry at line 33 must be the amounts included in line 49 of Form 24 for accounting class 8, relating to direct <i>insurance business</i> in <i>general insurance business class 14</i> .
9	If the net <i>premiums</i> that would appear in line 30 are less than 2,500,000 Euros (using the conversion rate notified by the <i>FSA</i> from time to time for this purpose) and less than 4% of the total net <i>premiums</i> written by <i>members</i> in the <i>financial year</i> for <i>general insurance business</i> , no credit equalisation provision is required. In this case, a note stating the amount of net written <i>premiums</i> for direct <i>credit insurance business</i> and stating that no credit equalisation provision is required should replace this form.

Long-term insurance business: Revenue account

The Society of Lloyd's

Summary/year of account

	<i>Financial year ended</i>			Units	No. of fund/ summary	No. of part of fund
	day	month	year			
L40	Global	31	12	20XX	£000	
Items to be shown net of reinsurance ceded	This <i>financial year</i>		The previous <i>financial year</i>		Source	
	1	2	Form	Line	Column	
<i>Premiums</i>	11					See Instruction 1
Investment income before deduction of tax	12					See Instruction 2
Increase (decrease) in the value of non-linked assets brought into account	13					See Instruction 2
Other income	15					See Instruction 3
Total income (11 to 15)	19					
<i>Claims</i> incurred	21					See Instructions 1 & 4
Expenses payable	22					See Instructions 1 & 4
Interest payable before deduction of tax	23					
Taxation	24					
Other expenditure including personal expenses	25					See Instruction 3
Transfer to (from) <i>members</i>	26					See Instruction 5
Total expenditure (21 to 26)	29					
Increase (decrease) in fund in <i>financial year</i> (19-29)	39					
Fund brought forward	49					
Fund carried forward (39+49)	59					

R Instructions for completion of Form 40

1 Table

1	The entry at 40.11.1 must be equal to the sum of 41.19.3 and 41.29.3, the entry at 40.21.1 must be equal to 42.59.3 and the entry at 40.22.1 must be equal to 41.49.3.
2	The entry at line 12 is to exclude value re-adjustments on <i>investments</i> and gains on the realisation of investments, which must be shown in line 13.
3	Any item of income which cannot properly be allocated to lines 11, 12 or 13 must be entered in line 15, and similarly, any item of expenditure which cannot be properly be allocated in lines 21, 22, 23 or 24 must be entered in line 25. Particulars of such items must be specified in a supplementary note.
4	The entry at line 21 is to exclude <i>claims</i> management costs, which should be included in line 22, and any change in the provision for <i>claims</i> .
5	The entry at line shall be profits released to <i>members</i> less any calls made.

Long-term insurance business: Analysis of premiums and expenses

The Society of Lloyd's

Summary/year of account

				<i>Financial year ended</i>			Units	No of fund/ summary	No of part of fund
				day	month	year			
				L41	Global	31	12	20XX	£000
							Gross	Payable to or recoverable from reinsurers	Net of reinsurance (1-2)
							1	2	3
Earned premiums in the financial year	Life assurance and permanent health contracts	Single premium	11						
		Regular premium	12						
	Other contracts	Single premium	17						
		Regular premium	18						
	Total premiums	Single premium	19						
		Regular premium	29						
	Total premiums at lines 19 and 29 attributable to	UK contracts	31						
		Overseas contracts	32						
Expenses payable in the financial year	Commission payable in connection with acquisition of business		41						
	Other commission payable		42						
	Management expenses in connection with acquisition of business		43						
	Management expenses in connection with maintenance of business		44						
	Other management expenses		45						
	Total expenses (41 to 45)		49						
	Total expenses at line 49 attributable to	UK contracts	51						
Overseas contracts		52							

R Instructions for completion of Form 41

1 Table

1	Line 11 must include all single <i>premium</i> amounts where there is no expectation of continuing <i>premiums</i> being paid at regular intervals.
2	Lines 12 and 29 must include <i>premiums</i> payable at regular intervals during the policy year, included repeated or recurrent single <i>premiums</i> where the levels of <i>premium</i> is defined.

Long-term insurance business: Analysis of claims

The Society of Lloyd's

Summary/year of account

		<i>Financial year ended</i>			Units	No of fund/ summary	No of part of fund
		day	month	year			
L42	Global	31	12	20XX	£000		
Claims incurred in the financial year					Gross	Recoverable from reinsurers	Net of reinsurance (1-2)
					1	2	3
Life assurance and permanent health contracts	On death			11			
	By way of lump sums on maturity			12			
	By way of payments arising from other insured events			14			
	On surrender or partial surrender			15			
	Total life assurance <i>claims</i> (11 to 14)			19			
Other contracts	By way of lump sums			41			
	By way of periodical payments			42			
	Total <i>claims</i> (41 + 42)			49			
Total <i>claims</i> (19)				59			
Total <i>claims</i> at line 59 attributable to	UK contracts			61			
	Overseas contracts			62			

Lloyd's Return Form 51

Long-term insurance business: Valuation summary of non-linked contracts (other than accumulating with profit policies)

The Society of Lloyd's

				<i>Financial year ended</i>			Units		
				day	month	year			
				L51	Global	31	12	20XX	£000
Type of Insurance				Number of contracts 1	Amount of sums assured 2	Amount of annual premium 3	Value of sums assured 4	Value of future annual premiums 5	Amount of mathematical reserves 6
Direct Business and Reinsurance Accepted	Term assurance	Single premium	1						
		Regular premium	2						
	Group life assurance		3						
	Other reserves		4						
	Total (lines 1 + 2 + 3 + 4)		5						
Reinsurance ceded	Term assurance	Single premium	6						
		Regular premium	7						
	Group life assurance		8						
	Total (lines 6+7+8)		9						
Net amount of insurance (line 5 minus line 9)			10						

Adjustments (particulars to be specified by way of a supplementary note)	11						
Total (lines 10 +11)	12						

R Instructions for completion of Form 51

1 Table

1	Form 51 should be completed for each year of account. This will include the year of account which has been <i>closed</i> by a <i>reinsurance to close premium</i> after the valuation date.
2	Where outstanding <i>claims</i> are shown in line 18 to Form 14, they must not be included in line 11.

Long-term insurance business: Mathematical reserves and capital at risk

The Society of Lloyd's

Class Relevant factor		Classes I, II and IX	Classes IV and VI	Unallocated additional <i>mathematical reserves</i>	Financial year ended			Units £000	
					Year of account	day	month		year
					L60	31	12		20XX
		4% 1	4% 6	4% 11	Total for all classes				
					This <i>financial year</i> 13	The previous <i>financial year</i> 14			
<i>Mathematical reserves</i> before deduction of reinsurance		13							
<i>Mathematical reserves</i> after deduction of reinsurance		16							
Ratio of 16 to 13 or 0.85 if greater		17							
<i>Required margin of solvency</i> – first result = (line 13) * (line 17) * relevant factor		19							
Non negative <i>capital at risk</i> before reinsurance (see Instruction 1)	Temporary assurances with <i>required margin of solvency</i> of 0.1%	21							
	Temporary assurances with <i>required margin of solvency</i> of 0.15%	22							
	All other assurances with <i>required margin of solvency</i> of 0.3%	23							
	Total (21 to 23)	29							
Non negative <i>capital at risk</i> after reinsurance (all contracts)		31							
Ratio of line 31 to line 29, or 0.50 if greater		32							
<i>Required margin of solvency</i> – second result (see Instruction 2)		39							
Sum of first and second result (19 + 39)		49							

R Instructions for completion of Form 60

1 Table

1	<i>Capital at risk</i> shall be shown after distribution of surplus.
2	Line 39 equals line 32 [line 21 0.1% + line22 0.15% + line 23 0.3%] for Classes I, II and IX.

R Certificate by the Council (see LLD 15.9.1R(1))

1 Table

1	<p>Subject to 5, the certificate required by LLD 15.9.1R(1) must state:</p> <p>(1) in relation to Forms 9 to 17, 20 to 42, the supplementary notes to the forms and the statements required under LLD 15.5.1R(3), LLD 15.6.1R and LLD 15.7.1R, LLD 15.8.1R, LLD 15.5.5R and LLD 15.8.8R, that:</p> <p>(a) the <i>Lloyd's Return</i> has been prepared in accordance with LLD 9 to 15;</p> <p>(b) proper accounting records have been maintained and adequate information has been obtained by the <i>Society</i>; and</p> <p>(c) an appropriate system of control has been established and maintained by the <i>Society</i> over its transactions and records;</p> <p>(2) that reasonable enquiries have been made by the <i>Society</i> for the purpose of determining whether any <i>persons</i> are connected for the purposes of LLD 9 to 15;</p> <p>(3) that, as applicable, the assets held by <i>members</i> throughout the <i>financial year</i> in question enabled the <i>Society</i> to comply with LLD 14.3.1R (Currency matching and localisation); and</p> <p>(4) in relation to the statement required by LLD 15.9.1R(2) to be made by the <i>Lloyd's actuary</i>, that:</p> <p>(a) for the purpose of preparing the statement, proper accounts and records have been maintained; and</p> <p>(b) the information given has been ascertained in conformity with LLD 15.9.1R.</p>
2	Subject to 5, the certificate required by LLD 15.9.1R(1) must state that the required margin has been maintained throughout the <i>financial year</i> in question.
3	<p>Subject to 5, the certificate required by LLD 15.9.1R(1) must also state in relation to the <i>long-term insurance business</i> carried on by <i>members</i>:</p> <p>(1) that the requirements of IPRU(INS) 3.1R to 3.5R have been fully complied with and in particular that, subject to the provisions of IPRU(INS) 3.2R(3), assets attributable to <i>long-term insurance business</i>, the income arising, the proceeds of any realisation of such assets and any other income or proceeds allocated to the <i>long-term insurance business</i> fund or funds have not been applied otherwise than for the purpose of the <i>long-term insurance business</i>;</p> <p>(2) that any amount payable from or receivable by the <i>long-term insurance business</i> fund or funds in respect of services rendered by or to any other business carried on by a <i>member</i> or by a <i>person</i> who, for the purposes of IPRU(INS) 3.4R, is connected with it or is a subsidiary undertaking of it has been determined and where appropriate apportioned on terms which are believed to be no less than fair to that fund or those funds, and any exchange of assets representing such fund or funds for other assets of the <i>member</i> has been made at fair market value;</p> <p>(3) that all guarantees given by a <i>member</i> of the performance by a related <i>insurer</i> which would fall to be met by any <i>long-term insurance business</i> fund have been disclosed in the <i>Lloyd's Return</i>, and that the fund or funds on which each of those guarantees would fall has been identified in it;</p> <p>(4) that the return in respect of <i>long-term insurance business</i> is not distorted by agreements between the <i>members</i> concerned or by any arrangements which could affect the apportionment of expenses and income; and</p> <p>(5) that IPRU(INS) 3.5R has been fully complied with.</p>
4	<p>Subject to 5, where the <i>Council</i> is satisfied that:</p> <p>(1) the systems of control established and maintained by <i>managing agents</i> complied, at the end of the <i>financial year</i> in question, with any relevant guidance and it is reasonable to believe that those systems continued so to comply and will continue to so comply; or</p>

-
- (2) the *Lloyd's Return* has been prepared in accordance with any relevant guidance; this must be so stated, by listing that guidance, in the certificate required by *LLD* 15.9.1R(1).
- 5 Where, in the opinion of those signing the certificate, the circumstances are such that any of the statements required by 1 to 4 cannot truthfully be made, the relevant statements must be omitted.
- 6 Where, by virtue of 5, any statements have been omitted from the certificate this fact must be stated in a note.

R Statement by the Lloyd's actuary (see LLD 15.9.1R(2))

1 Table

1	<p>The statement required by <i>LLD 15.9.1R(2)</i> must be prepared and signed by the <i>Lloyd's actuary</i>, and must:</p> <p>(1) state whether, for every <i>syndicate year</i> in which <i>members</i> carry on <i>general insurance business</i> either:</p> <p>(a) the <i>syndicate actuary</i> has provided an unqualified opinion, which:</p> <p>(i) is in a form conforming to guidance from the <i>actuarial bodies</i>; and</p> <p>(ii) confirms that the <i>technical provisions</i> set by the <i>managing agent</i> are at least equal to the <i>syndicate actuary's</i> best estimate; or</p> <p>(b) the <i>Lloyd's actuary</i> has set the <i>technical provisions</i> (both gross and net of reinsurance recoveries); and</p> <p>(2) describe any source of uncertainty in the liabilities covered by the <i>technical provisions</i>, which in his opinion is material to the <i>Society</i> as a whole:</p> <p>(a) which any <i>syndicate actuary</i> mentions in his opinion; or</p> <p>(b) which affects any <i>syndicate year</i> for which the <i>Lloyd's actuary</i> has set the <i>technical provisions</i>.</p>
2	<p>If the <i>Lloyd's actuary</i> has set the <i>technical provisions</i> for any <i>syndicate year</i>, the statement must include an opinion covering those <i>technical provisions</i>, which:</p> <p>(1) confirms that they are at least equal to his best estimate; and</p> <p>(2) is in a form conforming to guidance for <i>syndicate actuaries</i> from the <i>actuarial bodies</i>, modified to show:</p> <p>(a) that he is retained by the <i>Society</i> and not the <i>managing agent</i>;</p> <p>(b) that he, and not the <i>managing agent</i>, set the <i>technical provisions</i>; and</p> <p>(c) separately, the <i>technical provisions</i> of each <i>syndicate year</i> covered.</p>
3	<p>If the <i>Lloyd's actuary</i> considers it necessary, such qualification, amplification or explanation as may be appropriate must be added to the statement.</p>

R Certificate by syndicate actuary (see LLD 15.9.1R(3))

1 Table

1	<p>The certificate required by <i>LLD 15.9.1R(3)</i> to be signed by the <i>syndicate actuary</i> appointed to a <i>syndicate</i> in which <i>members</i> carry on <i>long-term insurance business</i> must state:</p> <ol style="list-style-type: none"> (1) whether in his opinion, proper records have been kept by the <i>managing agent</i> adequate for the purpose of the valuation of the liabilities of the <i>syndicate</i>; (2) whether the sum of the <i>mathematical reserves</i> and the deposits received from reinsurers as shown in Form 14 constitute proper provision at the end of the <i>financial year</i> for the <i>long-term insurance business liabilities</i> where these liabilities: <ol style="list-style-type: none"> (a) include any increase in liabilities arising from a distribution of surplus as a result of an investigation as at the end of the <i>financial year</i> into the financial condition of the <i>long-term insurance business</i>; and (b) include all liabilities arising from deposit back arrangements; but exclude liabilities which had fallen due before the end of the <i>financial year</i>, other than those arising from deposit back arrangements; (3) whether the liabilities have been valued in accordance with <i>LLD 9 to 15</i> in the context of assets valued in accordance with <i>LLD 9 to 15</i>, as shown in Form 14; (4) by way of a list, the professional guidance that has been complied with; (5) whether in his opinion, premiums for contracts entered into during the <i>financial year</i> and the income earned on them are sufficient on reasonable actuarial assumptions, taking into account other financial resources of the <i>members</i> and the <i>Society</i> that are available for the purpose, to enable the <i>members</i> to meet their commitments and, in particular, to establish adequate <i>mathematical reserves</i>; and (6) whether the amounts in Form 60 are accurate.
2	<p>If the <i>syndicate actuary</i> considers it necessary, such qualification, amplification or explanation as may be appropriate must be added to the certificate.</p>

R Auditors' report (see LLD 15.9.3R)

1 Table

1	<p>The report required by <i>LLD 15.9.3R</i> must, in addition to any statement required by section 237(2) and (3) of the Companies Act, state:</p> <p>(1) that in the auditors' opinion, Forms 9 to 17, 20 to 42, the supplementary notes to the forms and the statements required under <i>LLD 15.5.1R(3)</i>, <i>LLD 15.6.1R</i>, <i>LLD 15.7.1R</i>, and <i>LLD 15.8.1R</i> have been properly prepared in accordance with <i>LLD 9 to 15</i>;</p> <p>(2) that according to the information and explanations that the auditors have received:</p> <p>(a) in their opinion, the certificate required to be signed in accordance with <i>LLD 15.9.1R(1)</i>, otherwise than in relation to statements to which 1(3) relates, has been properly prepared in accordance with <i>LLD 9 to 15</i>; and</p> <p>(b) subject to 1(3), it was or was not unreasonable for the persons giving the certificate to have made the statements in it (other than statements to which 1(3) relates); and</p> <p>(3) the extent to which, in giving their opinion, the auditors have relied:</p> <p>(a) in respect of financial information supplied to the <i>Society</i> by <i>managing agents</i> on behalf of <i>syndicates</i>, on work carried out by <i>syndicate</i> auditors; and</p> <p>(b) in respect of <i>long term insurance business</i> carried on by <i>members</i>, on the certificates of the <i>syndicate actuaries</i> given in accordance with the requirements of <i>LLD 9 to 15</i> with respect to the amounts in Form 60.</p>
2	<p>The audit opinion required by 1(2)(a) does not extend to cover the statements required under:</p> <p>(1) <i>LLD 15.8.5R</i> and <i>LLD 15.8.8R</i>; and</p> <p>(2) <i>LLD 15 Annex 2R 1(4)</i>, but only in so far as it relates to relevant guidance which either states that compliance with the guidance need not be audited or which relates to controls with respect to money laundering.</p>
3	<p>To the extent that the information and explanations they have received do not allow the auditors to express an opinion on whether it was or was not unreasonable for the <i>Council</i> to have made the statement required by <i>LLD 15 Annex 2R 1(c)</i> the auditors must add to their report such qualification, amplification or explanation as may be appropriate.</p>
4	<p>Where the auditors refer in their report or in any note attached to their report to any uncertainty, the report must state whether, in the auditors' opinion, that uncertainty is material to determining whether the <i>Society</i> is able to meet the solvency requirements of <i>LLD 9 to 15</i>.</p>

R Accounting classes (see LLD 15.3.1R(2))

1 Table

1 For the purposes of *LLD* 9 to 15, the accounting classes for *general insurance business* are those set out in the following table:

2 Table Accounting classes

Accounting class	Description	Corresponding classes of <i>general insurance business</i>
1	Accident and health	1 (other than 1(p) and 2
2	Motor	1(p), 3 and 10
3	Aviation	1(p), 5 and 11
4	Marine	1(p), 6 and 2
5	Transport	7
6	Property	4, 8, and 9
7	Third party liability	13
8	Miscellaneous and pecuniary loss	14, 15, 16, 17 and 18
9	Non proportional treaty	
10	Proportional treaty	
11	Marine, aviation and transport treaty	

Handbook Modules

Schedule 1G Lloyd's sourcebook - Record keeping requirements

- 1 The aim of the guidance in the following table is to give the reader a quick overall view of the relevant record keeping requirements.
- 2 It is not a complete statement of those requirements and should not be relied on as if it were.
- 3

Table	Record keeping requirements
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Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
LLD 1.2.2G(1)	Delegation of responsibility for carrying out the <i>Society's regulatory functions</i>	Not specified	Not specified	Not specified
LLD 1.2.4G(2)	Records of any committee with delegated authority to carry out the <i>Society's regulatory functions</i>	Should include minutes of its meetings	Not specified	Not specified
LLD 1.2.5G(2)	An individual's or other <i>person's</i> exercise of his delegated authority to carry out the <i>Society's regulatory functions</i>	Not specified	Not specified	Not specified
LLD 1.3.10G(1)	Interests of those involved in carrying out the <i>Society's regulatory functions</i>	Register of interests	Not specified	Not specified
LLD 1.3.10G(2)	Conflicts of interest of those involved in carrying out the <i>Society's regulatory functions</i>	Disclosures of conflicts of interest and the steps taken to handle them	Not specified	Not specified
LLD 4.2.3G(1)	Transactions in the <i>capacity transfer market</i>	Adequate audit trails	Not specified	Not specified
LLD 5.2.3G	Notifications made to the <i>Society</i> by, or on behalf of, certain <i>persons</i> who have ceased to be <i>underwriting members</i>	Changes of address and deaths of certain <i>persons</i> who have ceased to be <i>underwriting members</i>	Not specified	Not specified

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
<i>LLD 7.3.1G</i> <i>LLD 7.3.2G</i>	Complaints from <i>members</i> or <i>former members</i> involving allegations that they have suffered, or may suffer, financial loss, material distress or material inconvenience	Not specified	Not specified	Minimum period of 3 years from receipt of complaint
<i>LLD 9.4.5R</i>	Accounting records	Sufficient to demonstrate compliance with <i>LLD 9</i> to <i>15</i>	As required in accordance with <i>LLD 9</i> to <i>15</i>	Normally not less than 10 years
<i>LLD 10.8.3G(4)</i>	<i>Managing agents'</i> records	Various records and analyses of underwriting and claims	Not specified	Not specified

Handbook Modules

Schedule 2G Lloyd's sourcebook - Notification requirements

- 1 The aim of the guidance in the following table is to give the reader a quick overall view of the relevant requirements for notifications and reporting.
- 2 It is not a complete statement of those requirements and should not be relied on as if it were.
- 3

Table	Notification requirements
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Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<i>LLD 2.3.1D</i>	Any matter likely to be of material concern to the <i>FSA</i> in relation to the <i>regulated activities</i> for which the <i>Society</i> has permission; or <i>underwriting agents</i> ; or <i>approved persons</i> or individuals acting for or on behalf of <i>underwriting agents</i>	Includes but is not limited to matters listed in <i>LLD 2.3.4G</i>	The <i>Society</i> becomes aware of the matter	Immediate
<i>LLD 2.4</i>	Commencement, continuation and cessation of relevant investigations and disciplinary proceedings	Commencement, continuation and cessation of investigations and disciplinary proceedings listed in <i>LLD 2.4.1D</i> , <i>LLD 2.4.2D</i> and <i>LLD 2.4.3G</i>	End of each calendar month	5 business days
<i>LLD 2.6.2G</i> <i>LLD 2.6.3G</i>	Proposed changes in <i>byelaws</i> for supervising and regulating the market at Lloyd's	Details of proposed changes, consultation undertaken and responses to consultation	Not specified	The <i>FSA</i> should be given adequate notice
<i>LLD 2.6.4G</i>	Regulatory and market bulletins; and all amendments to <i>byelaws</i>	Copies of bulletins and amendments	Publication	Immediate

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
LLD 3.3	Information about the <i>Central Fund</i>	Information on the <i>Central Fund's</i> net market value, payments, investments, changes in any insurance policy and any claims on the latter, or circumstances likely to lead to a claim	End of each calendar quarter	2 weeks
LLD 4.3	Information about the <i>capacity transfer market</i>	Capacity transferred, investigations into conduct in the <i>capacity transfer market</i> , and all complaints received	End of each calendar quarter in which any capacity is transferred	1 month
LLD 7.4	Information about certain complaints from <i>members</i> and <i>former members</i>	Number, nature, resolution and referral of these complaints	End June and end December	1 month
LLD 10.4	Intention to approve or amend a trust deed	New trust deed and proposed amendment, plus a statement of the purpose of the deed/amendment and an analysis of its impact	The <i>Society</i> intends to approve or amend a trust deed	Sufficient time for the <i>FSA</i> to consider proposals before <i>Society</i> approval
LLD 10.5.2G	Material changes proposed to risk-based capital system	Details of proposed changes	The <i>Society</i> intends to make amendments to risk-based capital system maintained under <i>LLD 10.5.1R</i>	Adequate time for the <i>FSA</i> to review proposals and assess their implication
LLD 10.5.4G	Independent reviews commissioned by the <i>Society</i> of the operation of the RBC model	Results of each review	Completion of the review	Not specified
LLD 10.6	Reviews of aggregations of risk and plans for monitoring aggregations of risk	Discussion	Completion of regular reviews	Not specified
LLD 10.9.5R	A <i>syndicate actuary</i> of a <i>general insurance business syndicate</i> will or may be unable to provide an unqualified opinion under <i>LLD 10.9.4R(3)(b)</i>	Not specified	The <i>Society</i> becomes aware	Prompt notification

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<i>LLD 11.2.4R</i>	If the solvency requirements of <i>LLD 11.2.1R</i> are not maintained	A plan for the restoration of a sound financial position	The <i>Society</i> becomes aware	Prompt notification
<i>LLD 11.2.11R</i>	If criterion similar to the <i>guarantee fund</i> requirement for <i>insurers</i> is not maintained	A short-term financial scheme similar to that required from <i>insurers</i> under <i>SUP</i> , Appendix 2 1.4	The <i>Society</i> becomes aware	Prompt notification
<i>LLD 15</i>	<i>Lloyd's Return</i> and Lloyd's global account	Detailed reports in accordance with the requirements of <i>LLD 15</i> and its Annexes	End of each <i>financial year</i>	6 months

Handbook Modules

Schedule 3G Lloyd's sourcebook - Fees and other required payments

- 1 There are no requirements for fees or other payments in LLD.

Handbook Modules

Schedule 4G Lloyd's sourcebook - Powers exercised

- 1 The following powers have been exercised by the FSA to make LLD.
- 2 The rules in LLD 3 to LLD 5 and LLD 7 to LLD 15 are made under section 138 of the Act (General rule-making power).
- 3 The directions in LLD 2 are given under section 318 of the Act (Exercise of powers through Council).
- 4 The direction in LLD 6 is given under section 316 of the Act (Direction by Authority).
- 5 The guidance is given under section 157(1) of the Act (Guidance).

Handbook Modules

Schedule 5G Lloyd's sourcebook - Rights of action for damages

- 1 The table below sets out the rules in LLD contravention of which by an authorised person may be actionable under section 150 of the Act (Actions for damages) by a person who suffers loss as a result of the contravention.
- 2 If a "Yes" appears in the column headed "For private person?", the rule may be actionable by a "private person" under section 150 (or, in certain circumstances, his fiduciary or representative; see article 6(2) and (3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001 No 2256)). A "Yes" in the column headed "Removed" indicates that the FSA has removed the right of action under section 150(2) of the Act. If so, a reference to the rule in which it is removed is also given.
- 3 The column headed "For other person?" indicates whether the rule may be actionable by a person other than a private person (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of person by whom the rule may be actionable is given.
- 4

Table	Rights of action for damages
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Chapter/ Appendix	Section/ Annex	Paragraph	Right of action under section 150		
			For private Person?	Removed?	For other person?
3	All rules		No	Yes <i>LLD</i> 3.1.2R	No
4	All rules		No	Yes <i>LLD</i> 4.1.2R	No
5	All rules		No	Yes <i>LLD</i> 5.1.2R	No
7	All rules		No	Yes <i>LLD</i> 7.1.2R	No
8	All rules		No	Yes <i>LLD</i> 8.1.2R	No
9	Rules requiring the Society to have or maintain adequate financial resources		No	No –	No
9	All other rules		No	Yes <i>LLD</i> 9.1.3R	No

Chapter/ Appendix	Section/ Annex	Paragraph	For private Person?	Removed?		For other person?
				Yes	No	
10		<i>Rules requiring the Society to have or maintain adequate financial resources</i>	No	No	–	No
10		All other rules	No	Yes	LLD 10.1.2R	No
11		<i>Rules requiring the Society to have or maintain adequate financial resources</i>	No	No	–	No
11		All other rules	No	Yes	LLD 11.1.2R	No
12		<i>Rules requiring the Society to have or maintain adequate financial resources</i>	No	No	–	No
12		All other rules	No	Yes	LLD 12.1.2R	No
13		<i>Rules requiring the Society to have or maintain adequate financial resources</i>	No	No	–	No
13		All other rules	No	Yes	LLD 13.1.2R	No
14		<i>Rules requiring the Society to have or maintain adequate financial resources</i>	No	No	–	No
14		All other rules	No	Yes	LLD 14.1.2R	No

Chapter/ Appendix		Section/ Annex		Paragraph		For private Person?	Removed?		For other person?	
15	Rules requiring the Society to have or maintain adequate financial resources					No	No	–	No	
15	All other rules					No	Yes	LLD 15.1.2R	No	

Handbook Modules

Schedule 6G Lloyd's sourcebook - Rules that can be waived

- 1 The rules in LLD 3 to LLD 5 and LLD 7 to LLD 15 can be waived by the FSA under section 148 of the Act (Modification or waiver of rules).

Lloyd's sourcebook

Derivations

G

1. The aim of the *guidance* in the following table is to give the reader a guide to the derivation of the text.
2. It is not a complete statement of the derivation and should not be relied on as if it were.

Ch/App	S/Ann	P		Subject	Source	Reference
10	3	1	R		Carrying of <i>premiums</i> to trust fund	ICA 82 s 83(2)
10	3	3	R		Separate trust funds for long-term and general business	ICA 82 s 83(3)
10	4				Notification of amendments to trust deeds	ICA 82 s 83(2)
11					Required margins of solvency	1983 Lloyd's regs ss 3(5) - 3(7)
12					Determination of liabilities	1983 Lloyd's regs s 3(4)
13					Assets: valuation and realisability risk	1983 Lloyd's regs s 3(4)
14					Assets: market and credit risk	1983 Lloyd's regs s 3(4)
15	2	1	R		Requirement to report to the <i>FSA</i>	ICA 82 s 86(1)
15	3				Content and form of the <i>Lloyd's Return</i>	1983 Lloyd's regs ss 4 & 5
15	9	1	R	(3)	Actuarial certificate	ICA 82 s 83(6)
15	9	3	R		Audit certificate	ICA 82 s 83(4A)
15	Ann 1		R		Reporting Forms	1983 Lloyd's regs Schedule 3
15	Ann 2		R		Certificate by Council	1983 Lloyd's regs Schedule 3
15	Ann 5		R		Auditors report	ICA 82 s 83(5)
15	Ann 6		R		Accounting classes	Accounts and statements regs s 3

Lloyd's sourcebook

Destinations

G

1. The aim of the *guidance* in the following table is to give the reader a guide to the destination of relevant text.
2. It is not a complete statement of the destination and should not be relied on as if it were.
3. The following Act and regulations are referred to in the table:
 Insurance Companies Act 1982
 Insurance (Lloyd's) Regulations 1983 (SI 1983/224)
 Insurance (Lloyd's) Regulations 1996 (SI 1996/3011)

Source reference	Subject	Module	Ch/App	S/Ann	P		
ICA 82 s83(2)	Carrying of <i>premiums</i> to trust fund	<i>LLD</i>	10	3	1	R	& <i>LLD</i> 10.4 (Changes in approved trust deeds)
ICA 82 s83(3)	Separate trust funds for long-term and general business	<i>LLD</i>	10	3	3	R	
ICA 82 s83(4)	Appointment of auditors	<i>SUP</i>	3	3			
ICA 82 s83(4A)	Audit certificate to be submitted in a form prescribed	<i>LLD</i>	15	9	3	R	
ICA 82 s83(5)	Statements contained in prescribed form	<i>LLD</i>	15	Ann	5	R	
ICA 82 s83(6)	Submission of actuarial certificate	<i>LLD</i>	15	9	1	R	(3)
ICA 82 s83A	Various intervention powers may be invoked against <i>members</i> if <i>Society</i> fails to satisfy an obligation to which it is subject in another member State with regard to the insurance directives or the insurance activities of Lloyd's in that State	<i>The Act</i>					Sections 47 (Exercise of power in support of overseas regulator), 166 (Reports by skilled persons) and 169 (investigations etc. in support of overseas regulator)
ICA 82 s84(1)	Various sections of the ICA 82 relating to solvency shall apply subject to prescribed modifications	<i>LLD</i>	11				

Source reference	Subject	Module	Ch/App	S/Ann	P		
ICA 82 s84(2)	Various intervention powers may be invoked against <i>members</i> if <i>Society</i> fails to satisfy the above obligation	<i>LLD</i>	11				
ICA 82 s85	Schedule 2C shall apply to transfers of business to and from <i>members</i> if certain conditions are met	The <i>Act</i>					Section 323 in relation to modifying Part VII
ICA 82 s86(1)	The <i>Council</i> shall submit an annual statement of business	<i>LLD</i>	15	2	1	R	
ICA 82 s86(2)	The statement may need to deal separately with classes or descriptions of business as so specified	<i>LLD</i>	15				
1983 Lloyd's Regs s3	Financial resources	<i>LLD</i>	11				
1983 Lloyd's Regs s4	Audit	<i>LLD</i>	15	3			
1983 Lloyd's Regs s5	Statement of business	<i>LLD</i>	15				
1983 Lloyd's Regs schedule 1A	Calculation of prescribed surplus	<i>LLD</i>	11				
1983 Lloyd's Regs schedule 2	Prescribed audit report	<i>LLD</i>	15	Ann	5	R	
1983 Lloyd's Regs schedule 3	Prescribed statement of business	<i>LLD</i>	15	Ann	1	R	& <i>LLD</i> 15 Annex 2R
1996 Lloyd's Regs ss3 - 4	Application of ICA 82 to <i>former members</i>	The <i>Act</i>					Sections 320 – 322

THE PROFESSIONAL FIRMS SOURCEBOOK INSTRUMENT 2001

- A. The Financial Services Authority makes the rules and gives the guidance in the Annex to this instrument (“PROF”) in the exercise of powers listed in Schedule 4 to PROF (Powers exercised).
- B. This instrument shall come into force at the beginning of the day on which section 19 (The general prohibition) of the Financial Services and Markets Act 2000 (the “Act”) comes into force.
- C. The provisions of the Act relevant to making rules and listed in Schedule 4 to PROF (Powers exercised) are specified for the purpose of section 153(2) of the Act (Rule-making instruments).
- D. This instrument may be cited as the Professional Firms Sourcebook Instrument 2001.
- E. The Annex to this instrument, may be cited as the Professional firms sourcebook (or PROF).

By order of the Board
21 June 2001

ANNEX



Professional firms



Contents

Transitional provisions

Text of PROF:

- 1 Professional firms
2. Status of exempt professional firm
3. The FSA's duties and powers
4. Disclosure
5. Non-mainstream regulated activities

Schedule 1: Record keeping requirements

Schedule 2: Notification requirements

Schedule 3: Fees and other required payments

Schedule 4: Powers exercised

Schedule 5: Rights of action for damages

Schedule 6: Rules that can be waived

Derivations

Destinations

Handbook Modules

Transitional provisions

1	Table
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(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1	<i>PROF</i> 4.1.2R	G	<p>The <i>FSA</i> considers that the issue by an <i>exempt professional firm</i> of a letter to a client on a letterhead that includes a statement that it is “authorised” will be in breach of <i>PROF</i> 4.1.2R. This includes a statement such as:</p> <p>‘This firm is authorised in the conduct of investment business by [name of recognised professional body] under the Financial Services Act 1986.’</p> <p>However, an <i>exempt professional firm</i> which has been authorised for investment business by a recognised professional body under the Financial Services Act 1986 may continue to use stocks of notepaper and other material that discloses its status under that act, provided that it strikes through the disclosure statement.</p>	From commencement	<i>Commencement</i>
2	<i>PROF</i>	G	<p><u>General transitional provisions</u></p> <p><i>GEN</i> contains some technical transitional provisions that apply throughout the <i>Handbook</i> and which are designed to ensure a smooth transition at <i>commencement</i>.</p>	From commencement	<i>Commencement</i>

Chapter 1

Professional firms

1.1 Application and Purpose

Application

- 1.1.1** **R** This sourcebook applies as follows:
/1
- (1) *PROF 1 to PROF 4 apply to exempt professional firms; and*
 - (2) *PROF 5 applies to authorised professional firms.*

- 1.1.2** **G** This sourcebook is also relevant to *designated professional bodies*.
/1

Purpose

- 1.1.3** **G** Under Part XX of the *Act* (Provision of Financial Services by Members of the Professions) certain individuals, partnerships or corporate entities, known as *exempt professional firms*, can carry on particular *regulated activities* (which the *Act* terms *exempt regulated activities*) under supervision and regulation by *designated professional bodies*.
/1

- 1.1.4** **G** This sourcebook outlines:
/1
- (1) the arrangements for designation of professional bodies;
 - (2) the conditions for activities to be treated as *exempt regulated activities* (see *PROF 2.1.3G*);
 - (3) the *FSA's* duty to keep itself informed about how *designated professional bodies* supervise and regulate the *exempt regulated activities* of *exempt professional firms* and how *exempt professional firms* carry on *exempt regulated activities*;
 - (4) the *FSA's* power under section 328 of the *Act* (Directions in relation to the general prohibition) to make a direction to deny the exemption to different classes of *person* or to different descriptions of *regulated activity*;
 - (5) the implications for an *authorised professional firm* that carries on *non-mainstream regulated activities*.

- 1.1.5** **G** This sourcebook also contains disclosure *rules* made by the *FSA* under the power conferred by section 332(1) of the *Act* (Rules in relation to persons to whom the general prohibition does not apply). These *rules* apply to *exempt professional*
/1

firms for the purpose of ensuring that their *clients* are made aware that *exempt professional firms* are not *authorised persons*.

1.1.6

G

/1

The *rules* and *guidance* in this sourcebook are intended to:

- (1) assist the protection of *clients* of *exempt professional firms* by ensuring that the *FSA* has information which allows it to keep under review the exercise of the direction power under section 328 of the *Act* (see *PROF* 1.1.4G(4));
- (2) promote public understanding of the *financial system* by ensuring that the *clients* of an *exempt professional firm* are made aware that the firm is not an *authorised person*; and
- (3) enable the *FSA* to use its resources in an efficient and effective way in the collection of information relevant to its duty to keep itself informed under section 325 of the *Act* (*Authority's general duty*).

Chapter 2

2

Status of exempt professional firm

2.1 Designated professional bodies and exempt regulated activities

Designated professional bodies

- 2.1.1** G_{/1} The Treasury designates professional bodies. Section 326 of the *Act* (Designation of professional bodies) sets out the conditions a body must satisfy before it can be designated.
- 2.1.2** G_{/1} The professional bodies that have been designated by the Treasury are listed in *PROF 2 Ann 1G*.

Exempt regulated activities

- 2.1.3** G_{/1} Section 327 of the *Act* (Exemption from the general prohibition) sets out the conditions which must be met for a *person* to be treated as an *exempt professional firm*, and for the *person's regulated activities* to be treated as *exempt regulated activities*. If the exemption in section 327 does not apply to a *person* and the *person* carries on a *regulated activity*, the *person* may contravene the *general prohibition* and be committing a criminal offence. The *FSA's* approach to the use of its powers in respect of alleged contraventions of the *general prohibition* is explained in *ENF 15*.
- 2.1.4** G_{/1} If the *FSA* has made a direction under section 328 of the *Act* (Directions in relation to the general prohibition) (see *PROF 3.2*) in relation to classes of *person* (or *regulated activity*), then a *person* within the class (or carrying on the *regulated activity*) specified will not be an *exempt professional firm*. In addition, section 329 of the *Act* (Orders in relation to the general prohibition) gives the *FSA* power to make an order disapplying the Part XX exemption from a *person* named in the Order. The *FSA's* general approach to the use of this power is explained in *ENF 18*.
- 2.1.5** G_{/1} Section 327(2) provides that an *exempt professional firm* must be a *member* of a profession or be controlled or managed by one or more *members*.
- 2.1.6** G_{/1} The effect of section 327(7) of the *Act* is that an *exempt professional firm* can carry on *regulated activities* in that capacity or as an *exempt person* but not otherwise. Therefore, an *exempt professional firm* cannot be an *authorised person*.
- 2.1.7** G_{/1} The *Act* does not, however, prevent an *exempt professional firm* from carrying on, in addition to *exempt regulated activities*, any *regulated activities* in relation to which it is an *exempt person*. For example, it is possible for an *exempt professional firm* to carry on *regulated activities* as an *appointed representative*.

- 2.1.8** G
/1 Section 327 also sets out the conditions which determine the particular *regulated activities* an *exempt professional firm* may carry on.
- 2.1.9** G
/1 Section 327(6) of the *Act* gives the Treasury power to make an order specifying activities, or activities relating to specified *investments*, that a *person* cannot carry on as an *exempt professional firm*. The relevant order is listed in *PROF 2 Ann 2G*.
- 2.1.10** G
/1 Section 332(3) of the *Act* requires a *designated professional body* to make rules that define the particular *regulated activities* which its *members* are allowed to carry on. Section 332(4) of the *Act* provides that those rules must be designed to secure that, in providing a particular professional service to a particular *client*, a *member* must carry on only *regulated activities* which arise out of, or are complementary to, the provision by the *member* of that professional service to the *client*.
- 2.1.11** G
/1 The *FSA* is required to approve the rules *designated professional bodies* make under section 332(3) of the *Act*. These rules must be in place in order to allow a *person* to be an *exempt professional firm*. They add to the other conditions within section 327 but do not override them, and a firm may need to refer to section 327 if it is in doubt whether an activity is an *exempt regulated activity*.
- 2.1.12** G
/1 Section 327(3) deals with the treatment by a firm of a pecuniary reward or other advantage received from anyone other than the firm's *client*. For a *regulated activity* to be treated as an *exempt regulated activity*, the firm must account to its *client* for any such receipt. The *FSA* considers this to mean that an *exempt professional firm* must hold to the order of its *client* any such reward or other advantage that it receives.
- 2.1.13** G
/1 Section 327(4) states that the manner of the provision of any service in the course of carrying on *regulated activities* must be incidental to the provision by the *exempt professional firm* of professional services. For this purpose, professional services are services which do not constitute carrying on a *regulated activity*, and the provision of which is supervised and regulated by a *designated professional body*.
- 2.1.14** G
/1 The *FSA* considers that to satisfy the condition in section 327(4) *regulated activities* cannot be a major part of the practice of the firm. The *FSA* also considers the following further factors to be among those that are relevant:

 - (1) the scale of *regulated activity* in proportion to other professional services provided;
 - (2) whether and to what extent activities that are *regulated activities* are held out as separate services; and
 - (3) the impression given of how the firm provides *regulated activities*, for example through its advertising or other promotions of its services.
- 2.1.15** G
/1 The *FSA's* view is that, in the context of section 327 as an exemption from the *general prohibition*, the conditions in section 327 should be interpreted as not imposing any restriction on the *regulated activities* that an *exempt professional firm* may carry on outside the *United Kingdom*. For further guidance on when a *regulated activity* is carried on 'in the *United Kingdom*', *exempt professional firms* are referred to section 418 of the *Act* and the *guidance* in *AUTH 2.4*.

Status of exempt professional firm G

1 Table Designated professional bodies (see PROF 2.1.2G)

On 28 March 2001 the following professional bodies were designated by the Treasury under section 326(1) of the *Act*:

- the Law Society
- the Law Society of Scotland
- the Law Society of Northern Ireland
- the Institute of Chartered Accountants in England and Wales
- the Institute of Chartered Accountants of Scotland
- the Institute of Chartered Accountants in Ireland
- the Association of Chartered Certified Accountants
- the Institute of Actuaries

Status of exempt professional firm G

1 Table Non Exempt activities orders under section 327(6) of the Act (see PROF 2.1.9G)

As at 21 June 2001 the Treasury had made the following order under section 327(6):

The Financial Services and Markets Act 2000 (Professions)
(Non-Exempt Activities) Order 2001 (SI 2001/1227)

Chapter 3

The FSA's duties and powers





3.1 The FSA's duty to keep itself informed

3.1.1

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Section 325 of the *Act* (Authority's general duty) imposes on the *FSA* a duty to keep itself informed about:

- (1) the way in which *designated professional bodies* supervise and regulate the carrying on of *exempt regulated activities* by *exempt professional firms*; and
- (2) the way in which *exempt professional firms* carry on *exempt regulated activities*.

3.1.2

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The *FSA* keeps itself informed in a number of ways. A *designated professional body* has a duty under section 325(4) of the *Act* to cooperate with the *FSA*. The *FSA* envisages it will make arrangements with each of the *designated professional bodies* about the information they provide to it, to include information about:

- (1) complaints and redress arrangements;
- (2) complaints volumes and their analysis;
- (3) disciplinary action;
- (4) supervisory activity; and
- (5) the activities carried on by *exempt professional firms*, the risks arising from them and how they are mitigated, for example by monitoring activity or training and competence arrangements.

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Information may also be obtained from *exempt professional firms*, government departments, trade bodies, consumer organisations and *clients* of *exempt professional firms*. The *FSA* may also commission or carry out reviews of the supervisory and regulatory activities of a *designated professional body* and commission or carry out research about, or surveys of, *exempt professional firms* or their *clients*.



3.2 The FSA's power to make a direction

- 3.2.1** **G**
/1 Section 328 of the *Act* (Directions in relation to the general prohibition) gives the FSA power to make a direction that the exemption under section 327 of the *Act* (see *PROF* 2.1.3G) does not apply to the extent specified in the direction. Section 328 allows the FSA to make a direction in relation to different classes of *person* or different descriptions of *regulated activity*.
- 3.2.2** **G**
/1 If the FSA gives a direction in relation to specified classes of *person*, then any *person* within those classes may be in contravention of the *general prohibition* unless:

 - (1) it ceases to carry on *regulated activities*; or
 - (2) it is an *authorised person*; or
 - (3) it is an *exempt person*.
- 3.2.3** **G**
/1 A direction might also cover classes of *persons* who are *members* of different *designated professional bodies*.
- 3.2.4** **G**
/1 Were the FSA to give a direction in relation to a description of *regulated activity* (for example, *dealing in investments as agent*), then that activity could no longer be carried on within the terms of the exemption.
- 3.2.5** **G**
/1 The FSA may exercise its direction power only if it is satisfied that it is desirable in order to protect the interests of *clients*. In considering whether it is satisfied, the FSA is required by section 328(7) of the *Act* to have regard, among other things, to the effectiveness of any arrangements made by a *designated professional body*:

 - (1) for securing compliance with *rules* made under section 332(1) of the *Act* (see *PROF* 4.1.1G);
 - (2) for dealing with complaints against its *members* in relation to the carrying on by them of *exempt regulated activities* (see *PROF* 4.1.4G(2)(d));
 - (3) in order to offer redress to *clients* who suffer, or claim to have suffered, loss as a result of misconduct by its *members* in their carrying on of *exempt regulated activities* (see *PROF* 4.1.4G(2)(d)); and
 - (4) for cooperating with the FSA under section 325(4) of the *Act* (see *PROF* 3.1.2G).
- 3.2.6** **G**
/1 Section 330 of the *Act* (Consultation) sets out procedures which the FSA must follow if it wishes to make a direction. Except as specifically provided in section 330:

 - (1) the FSA must consult publicly on its proposed direction;

3.2.7

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- (2) the *FSA* must have regard to any representations made in response to the consultation; and
- (3) if the *FSA* then gives the proposed direction, it must publish an account of the representations made and its response to them.

The directions the *FSA* has made under section 328 are set out in *PROF 3 Ann 1G*.

The FSA's duties and powers G

1 Table Directions made by the FSA under section 328 of the Act (see PROF 3.2.7G)

As at 21 June 2001 the *FSA* had made no directions under section 328 of the *Act*.

Chapter 4

Disclosure

4.1 Disclosure rules

- 4.1.1** **G** _{/1} The effectiveness of arrangements made by a *designated professional body* for securing compliance with the *rules* in this chapter is one of the factors that the *FSA* must take into account in considering whether to exercise its power to give a direction under section 328 of the *Act* (see *PROF 3.2.5G*).
- 4.1.2** **R** _{/1} **An exempt professional firm must avoid making any representation to a client that:**
- (1) it is authorised under the *Act* or regulated by the *FSA*; or
 - (2) the regulatory protections provided by or under the *Act* to a *person* using the services of an *authorised person* are available.
- 4.1.3** **R** _{/1} **An exempt professional firm must, before it provides a service which includes the carrying on of a regulated activity in the United Kingdom with or for a client, disclose in writing to the client in a manner that is clear, fair and not misleading that it is not authorised under the Act.**
- 4.1.4** **G** _{/1}
- (1) The *FSA* considers that material provided to satisfy *PROF 4.1.3R* need not be tailored to the individual *client*. The disclosure may be provided alongside or integrated with other material provided to a *client*. *Exempt professional firms* may therefore include the information within engagement letters or client care letters, if they wish.
 - (2) The *FSA* considers that it is important that *clients* understand the implications for them of receiving services from an *exempt professional firm* that is not authorised under the *Act*. The *FSA* therefore expects *designated professional bodies* to make rules covering the information to be provided to *clients*. These rules should require *exempt professional firms* to make a disclosure to *clients* containing the following elements:
 - (a) a statement that the *exempt professional firm* is not an *authorised person*;
 - (b) the nature of the *regulated activities* carried on by the *exempt professional firm*, and the fact that they are limited in scope;
 - (c) a statement that the *exempt professional firm* is regulated for these *regulated activities* by the *exempt professional firm's designated professional body*, identifying the *designated professional body* concerned; and
 - (d) the nature of the complaints and redress mechanisms available to *clients* in respect of these *regulated activities*.

- (3) *Exempt professional firms* should also ensure that any statement that makes reference to the *FSA* does not lead a *client* to suppose that the *FSA* has direct regulatory responsibility for the *exempt professional firm*. This could be a breach of *PROF 4.1.2R*.

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For further guidance on when a *regulated activity* is carried on ‘in the *United Kingdom*’, *exempt professional firms* are referred to section 418 of the *Act* and the *guidance* in *AUTH 2.4*.

Chapter 5

Non-mainstream regulated activities



5.1 Application and Purpose

Application

- 5.1.1 **R** This chapter applies to an *authorised professional firm* that carries on *non-mainstream regulated activities*.

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Purpose

- 5.1.2 **G** This chapter:
- (1) contrasts "*exempt regulated activities*" with "*non-mainstream regulated activities*";
 - (2) sets out the conditions which must be satisfied for a *regulated activity* of an *authorised professional firm* to constitute a *non-mainstream regulated activity*; and
 - (3) refers to other parts of the *Handbook* in which provisions are disapplied or modified in relation to *authorised professional firms* when carrying on *non-mainstream regulated activities*.

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Exempt regulated activities contrasted with non-mainstream regulated activities

- 5.1.3 **G**
- (1) The FSA's policy is designed to provide so far as possible a level playing field for authorised and unauthorised members of the professions in relation to the carrying on of similar activities.
 - (2) Subject to conditions (see *PROF 2*), members of *designated professional bodies* that are not authorised can carry on particular *regulated activities*, known as *exempt regulated activities*, and obtain the benefit of the exemption under section 327 of the *Act* from the *general prohibition*.
 - (3) In contrast, *non-mainstream regulated activities* are particular *regulated activities* carried on by an *authorised professional firm*. If the *professional firm* were not authorised under the *Act*, these same activities would be *exempt regulated activities* which, if the *firm* could meet the necessary conditions in section 327, would enable it to benefit from the section 327 exemption.

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(4) Therefore, a number of provisions of the *Handbook* (see *PROF 5.3*) have been disapplied or modified in respect of these *non-mainstream regulated activities* of *authorised professional firms*.

A "non-mainstream regulated activity" is defined in the *Glossary* as "a regulated activity of an *authorised professional firm* in relation to which the conditions in *PROF 5.2.1R* are satisfied". Conditions (1) to (5) of *PROF 5.2.1R* replicate section 327(1)(b)(i), (3), (4), (5) and (6) of the *Act*, as if those conditions applied to an *authorised professional firm*.



5.2 Nature of non-mainstream regulated activities

Conditions for non-mainstream regulated activity

5.2.1

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A "*non-mainstream regulated activity*" is a *regulated activity* of an *authorised professional firm* in relation to which the following conditions are satisfied:

- (1) the *firm* must not receive from a *person* other than his client any pecuniary reward or other advantage, for which he does not account to his client, arising out of the carrying on of the *regulated activity*;
- (2) the manner of the provision by the *firm* of any service in the course of carrying on the *regulated activity* must be incidental to the provision by it of professional services (see *PROF 5.2.2R*);
- (3) the *regulated activity* must not be of a description, or relate to an investment of a description, specified in The Financial Services and Markets Act 2000 (Professions) (Non-Exempt Activities) Order 2001 (SI 2001/1227) or in any other order made by the Treasury under section 327(6) of the *Act* (see *PROF 2 Annex 2G*);
- (4) there must not be in force any direction under section 328 of the *Act* (Directions in relation to the general prohibition) in relation to:
 - (a) a class of *person* which would have included the *firm* were it not an *authorised person*; or
 - (b) a description of *regulated activity* which includes the *regulated activity* the *firm* proposes to carry on; and
- (5) the *regulated activities* must be activities which *exempt professional firms* which are *members* of the same *designated professional body* as the *authorised professional firm* are permitted to carry on under rules made by that body as required by section 332(3) of the *Act*.

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In *PROF 5.2.1R(2)*, "professional services" means services:

- (1) which do not constitute a *regulated activity*; and
- (2) the provision of which is supervised and regulated by a *designated professional body*.

5.3 Reference to sourcebooks and manuals

Introduction

- 5.3.1** **G**_{/1} Parts of the *Handbook* in which provisions are disapplied or modified in relation to *authorised professional firms* when carrying on *non-mainstream regulated activities* include those described in *PROF 5.3.2G* to *PROF 5.3.5G*.

Conduct of business sourcebook

- 5.3.2** **G**_{/1} *COB 1.2.1R(4)* provides that *COB* does not apply to an *authorised professional firm* with respect to its *non-mainstream regulated activities* except for *COB 2.1* (Clear, fair and not misleading communication), *COB 3* (Financial promotion) and *COB 4.2.1R-COB 4.2.6G*, *COB 4.2.9R-COB 4.2.11E* and *COB 4.2.15E(26)* (Terms of business and client agreements with customers).

The Training and Competence sourcebook

- 5.3.3** **G**_{/1} *TC 2.1.1R(2)* provides that chapter 2, which imposes the substantive training and competence requirements, does not apply to an *authorised professional firm* with respect to its *non-mainstream regulated activities*.

The Money Laundering sourcebook

- 5.3.4** **G**_{/1} *ML 8.1.3R* provides that the Money Laundering sourcebook does not apply to *authorised professional firms* when carrying on *non-mainstream regulated activities*.

Supervision manual

- 5.3.5** **G**_{/1} *SUP 10.1.18R* provides that *SUP 10* (Approved persons), does not apply (except in respect of the *required functions*) to an *authorised professional firm* in respect of its *non-mainstream regulated activities*. So a person such as a *partner*, whose only *regulated activities* are incidental to his professional services, in an *authorised professional firm* whose principal purpose is to carry on activities other than *regulated activities*, need not be an *approved person*.

5.3.6

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[References to other parts of the *Handbook* will be added here later when the relevant provisions have been finalised and made by the Board.]

Handbook Modules

Schedule1 Record keeping requirements

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- 1 There are no record keeping requirements in PROF.

Handbook Modules

Schedule2 Notification requirements

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- 1 There are no notification or reporting requirements in PROF.

Handbook Modules

Schedule3 Fees and other required payments

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- 1 There are no requirements for fees or other payments in PROF.

Handbook Modules

Schedule4 Powers exercised

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- 1 The following powers and related provisions in the Act have been exercised by the FSA to make the rules in PROF:
 - (1) Section 138 (General rule-making power)
 - (2) Section 156 (General supplementary powers)
 - (3) Section 332(1) (Rules in relation to persons to whom the general prohibition does not apply)

- 2 The following power in the Act has been exercised by the FSA to give the guidance in PROF:
 - (1) Section 157(1) (Guidance)

Handbook Modules

Schedule5 Rights of action for damages

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- 1 The table below sets out the rules in PROF contravention of which by an authorised person may be actionable under section 150 of the Act (Actions for damages) by a person who suffers loss as a result of the contravention.
- 2 If a "YES" appears in the column headed "For private person?", the rule may be actionable by a "private person" under section 150 (or, in certain circumstances, his fiduciary or representative; see article 6(2) and (3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001 No. 2256)). A "Yes" in the column headed "Removed" indicates that the FSA has removed the right of action under section 150(2) of the Act. If so, a reference to the rule in which it is removed is also given.
- 3 The column headed "For other person?" indicates whether the rule may be actionable by a person other than a private person (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of person by whom the rule may be actionable is given.
- 4 **Table** **Actions for damages: Professional firms sourcebook**

Chapter/ Appendix	Section/ Annex	Paragraph	Right of action under section 150		
			For private person?	Removed?	For other person?
<i>PROF</i> 5.2.1R			Yes	No	No
Conditions for non-mainstream regulated activity					

Handbook Modules

Schedule6 Rules that can be waived

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- 1 No rules in PROF can be waived by the FSA under section 148 of the Act (Modification or waiver of rules), except for PROF 5.2.1R and PROF 5.2.2R (Conditions for non-mainstream regulated activity).

Professional firms sourcebook
Derivations

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There is no table of derivations for *PROF*.

Professional firms sourcebook
Destinations

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There is no table of destinations for *PROF*.


**INTERIM PRUDENTIAL SOURCEBOOK FOR BUILDING SOCIETIES
(AMENDMENT) INSTRUMENT 2001**

- A. The Financial Services Authority gives the guidance in this instrument in the exercise of the power in section 157(1) (b) (Guidance) of the Financial Services and Markets Act 2000 (the "Act").
- B. This instrument shall come into force at the beginning of the day on which section 19 of the Act (the general prohibition) comes into force.
- C. IPRU(BSOC) shall be amended by adding, after Volume 1, the provisions contained in Volume 2 forming the Annex to this instrument .
- D. This instrument may be cited as the Interim Prudential Sourcebook for Building Societies (Amendment) Instrument 2001.

By order of the Board
19 July 2001

ANNEX

ANNEX - VOLUME 2



Interim Prudential sourcebook: Building Societies

Financial Services Authority

Final Rules – Building Societies
Volume 2 of 2

Part of:

The Interim Prudential
Sourcebook for
Building Societies

July 2001

Interim Prudential Sourcebook for Building Societies
Constitutional Guidance

**1 APPLICATIONS FOR THE RIGHT TO OBTAIN ACCESS TO
THE REGISTERS OF MEMBERS OF BUILDING SOCIETIES**

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1.1 Introduction

- 1.1.1 This chapter gives guidance to building societies, and to those members of building societies considering making an application to the FSA about the exercise of the right to obtain access to the registers of members of building societies. This right is governed by the provisions of paragraph 15 of Schedule 2 to the 1986 Act. Since the functions under paragraph 15 of Schedule 2 to the 1986 Act have not been amended by the Act, there is no material change in this guidance compared with the procedure and practice previously adopted by the Commission.
- 1.1.2 This guidance is not a definitive interpretation of the 1986 Act. That is a matter for the courts.

1.2 Registers of Members

- 1.2.1 Each society is under a statutory obligation to maintain a register of its members (although the form in which it is maintained is at the discretion of the society). The register must show each member's name and address and whether that person is a shareholding member or a borrowing member. The register must be kept at the society's principal office or such other place or places as the society's directors think fit.
- 1.2.2 Companies are under a statutory obligation to make their share registers available for inspection by the general public. There is no equivalent obligation on building societies with respect to the registers of their members. A society is not required to allow access to its register other than in the circumstances provided for in paragraph 15 of Schedule 2 to the 1986 Act. Except to the limited extent that access is permitted under that paragraph, a society's register of members is confidential (and subject to data protection legislation).
- 1.2.3 There are two principal reasons for the confidentiality of the registers of members of building societies. First, it is to protect the privacy of members, whether individually or generally, so the fact that a person is either a shareholder in or a borrower from a

particular society (or both) is not subject to indiscriminate disclosure. Second, it is to protect the commercial interests of societies given that it could be to their competitive disadvantage if the identities of their shareholding and borrowing members, who are their customers, were readily available to competitor organisations (the identity of whose customers is not so available).

1.2.4 However, building societies are mutual associations of members. As such, it is in principle reasonable for members to be able to pursue a direct interest in the business and management of “their” society and to get in touch with each other on matters of mutual concern.

1.2.5 Within the framework set out in paragraph 15 of Schedule 2 to the 1986 Act, it is the responsibility of the FSA to balance the rights of individual members generally to privacy, and of societies to commercial confidentiality, with the reasonable right of particular individual members to get in touch with each other on matters relating to the affairs of their society. The confidentiality of the information held on the register can be set aside only where the applicant can make out the case within the exceptional circumstances described in paragraph 15 of Schedule 2. In the opinion of the FSA, the exception is to be considered as much a privilege as a right.

1.3 Statutory Framework

1.3.1 Paragraph 15 of Schedule 2 to the 1986 Act governs when and how access to the register of members of a building society may be obtained. Subject to the exception provided for in paragraph 15(1) of Schedule 2, access may only be granted on a direction by the FSA. Paragraph 15(2) of Schedule 2 provides that a member may, if qualified to do so, make a written application to the FSA to exercise the right to obtain members’ names and addresses from the register of the society of which he or she is also a member, for the purposes of communicating with those other members of the society on a subject relating to its affairs. The text of the relevant legislation is at Annex A.

- 1.3.2 Paragraph 15(1) of Schedule 2 provides for an exception to the requirement to make an application to the FSA. Where the FSA has cancelled a society's permission to accept deposits and the society has not had its permission reinstated by the FSA, a member of that society has the right to obtain the names and addresses of its members from the register without application to the FSA. In this case, the applicant is not required to have been a member for any specified period but the minimum shareholding or minimum mortgage debt requirements described in paragraph 1.3.3 may still apply.
- 1.3.3 A member is qualified for the purposes of obtaining access under paragraph 15(1) or (2) of Schedule 2 if, under the rules of the society, he or she may join in a members' requisition for a special meeting or in nominating a person for election as a director. This means that the applicant must be an investing or borrowing member of the society. If the society's rules prescribe a minimum investment or mortgage debt the member must hold shares or have a mortgage debt of at least that amount. The minimum cannot exceed £100 in either case (which figure the Treasury may change by Order). In cases covered by paragraph 15(2) of Schedule 2, the society may also require the applicant to have been a member for such period as may be specified in its rules. In most cases this is two years (the maximum permitted by the 1986 Act).
- 1.3.4 An application under paragraph 15(2) of Schedule 2 is subject to the payment of a reasonable fee, currently £25, to the FSA. Where an application is made, the FSA may direct the society to give the member access to the register provided the FSA is satisfied that:
- (1) the applicant requires the right for the purposes of communicating with members of the society "*on a subject relating to its affairs*"; and
 - (2) the applicant has not, since making the application, voluntarily ceased to be a member of the society.
- 1.3.5 The FSA must also have regard to "*the interests of the members as a whole*" and "*to all the other circumstances*".

- 1.3.6 If access is granted it may only be used to obtain the names and addresses of members for the purposes of communicating with them on a subject relating to its affairs (see also paragraphs 1.5.10 to 1.5.12).
- 1.3.7 Before giving a direction, the FSA is required to give particulars of the application to the building society concerned and to give it the opportunity to make representations. If either the applicant or the society so requests, the FSA must give both the opportunity of being heard by it.
- 1.3.8 A direction given by the FSA may be subject to such limitation or conditions as the FSA may think fit.
- 1.3.9 If the FSA directs that the applicant shall have the right to obtain access to the register, the applicant may apply in writing to the society, describing the subject on which it is proposed to communicate with other members of the society. The society is required to give the applicant all necessary information as to where the register is kept and reasonable facilities (including office accommodation) for inspecting it and taking copies of any names and addresses.
- 1.3.10 The applicant only has the right to take names and addresses from the register. A society may make the information from the register available to an applicant in such a way that only those names and addresses are disclosed.
- 1.3.11 Information obtained by the applicant from the register of the society concerned and relating to a member of that society may not be disclosed to any other persons without the consent of that member whose name and address has been taken from the register. Nor may it be disclosed for purposes not connected with the purposes given at the time the FSA made its direction. Contravention of these requirements is a criminal offence.
- 1.3.12 Paragraph 6 of Schedule 14 to the 1986 Act provides that any dispute as to the rights of a member under paragraph 15 of Schedule 2 shall be referred to the FSA and

treated as a reference to arbitration; and its award shall have the same effect as that of an arbitrator in a reference under paragraph 4(1) of Schedule 14.

1.4 Making an Application

1.4.1 Applications must be made to the FSA in writing in the form of Annex B to this chapter.

1.4.2 Each application must be accompanied by the prescribed fee, which is currently £25 (cheques should be made payable to the Financial Services Authority). This fee is not refundable in any circumstances.

1.4.3 Should an applicant wish to obtain access to the registers of more than one society (the applicant must, of course, be a qualified member of each of them), there must be a separate application, for each of which a separate fee must be paid.

1.4.4 The FSA will acknowledge all applications within 5 working days of receipt.

1.4.5 To assist the FSA in its consideration of an application, and the society in making any representations on it, the application should set out clearly and concisely the issues about which the applicant wishes to communicate with other members and the purposes in doing so. In addition to this statement, the FSA requires at the time of the initial application a draft of the communication that would be sent should the FSA direct the society to give the applicant access to the register.

1.4.6 Without prejudice to its consideration of an application in any particular case, applicants should note the following general guidelines when preparing an application:

- (1) the FSA will expect the member making the application to have read carefully the relevant provisions of the 1986 Act and this chapter;

- (2) it is important to be specific about the purpose of the application, how it relates to the affairs of the society and why and how access to the register of members is necessary to achieve the applicant's objective;
- (3) an applicant should think carefully about the purpose and content of the proposed communication before making the application so as to minimise the need for substantive changes to it at a later date;
- (4) an application may be supported by such information or documents as the applicant may wish, but these will be considered to form part of the application, will be seen by the society and be open to comment by it;
- (5) where an applicant submits two or more applications (together or in quick succession) it should be made clear as to why access to the register of members of each of the societies is necessary and how the purpose of each application relates to the affairs of that society;
- (6) should an applicant be successful he or she will incur expenditure in taking names and addresses from the register and then producing and mailing the communication and the applicant should take this into account before submitting an application.

1.5 Considering an Application

- 1.5.1 The FSA will consider, first, whether the application contains all the relevant information. It may ask the applicant to provide further information or clarify what has already been given.
- 1.5.2 If, in the opinion of the FSA, the application is defamatory, frivolous or vexatious, the FSA may decide that it would be inappropriate to consider it further. The applicant will be informed of such decision as soon as practicable. In such cases the FSA may give the applicant an opportunity (normally only once) to revise the application to take the FSA's opinion into account. If a revised application is received by the FSA within

10 working days of the FSA's notice that the previous application was unacceptable (or such other period as the FSA may, in the circumstances, consider reasonable), a further fee will not be payable.

- 1.5.3 If the FSA is satisfied that the application provides all the relevant information and is, on the basis of that information, a valid application for the purposes of paragraph 15 of Schedule 2, the FSA will send the application, together with any supporting information or documents provided by the applicant, to the society. The society will be asked to confirm that the applicant was qualified to make the application at the time it was made and, if so, invited to make written representations on it to the FSA. The FSA will also ask the society whether it wishes to make oral representations at a hearing held by the FSA. The FSA will normally expect a society to submit its representations, or to confirm that none are to be made, within 15 working days of receipt of the copy of the application.
- 1.5.4 Once the FSA has received the society's written representations, together with any supporting information or documents, a copy will be sent to the applicant with an invitation to make written comments on them to the FSA. The FSA will also ask whether the applicant wishes to make oral representations, irrespective of whether the society has indicated that it would wish to do so. The FSA will normally expect an applicant to provide written comments or to confirm that none are to be made within 15 working days of receipt of the invitation.
- 1.5.5 Once the FSA has received the applicant's written comments, a copy of them will be sent to the society. This will normally be for information only. However, in any case where, in the opinion of the FSA, the applicant has introduced new matters which can properly be dealt with as part of the existing application, the society will be given the opportunity to make further representations. If the applicant has introduced new matters which, in the opinion of the FSA, cannot properly be dealt with as part of the existing application, the FSA may ask the applicant to make a new application or it may disregard the new matters for the purposes of the application under consideration. In the latter case the FSA will inform the applicant accordingly.

- 1.5.6 The FSA may seek further information or other documents from either the applicant or the society at any time.
- 1.5.7 Paragraph 15(2) of Schedule 2 sets out the criteria to which the FSA should have regard in considering an application:
- (1) the purpose of the proposed communication must be on “*a subject relating to its (the society’s) affairs*”;
 - (2) the FSA should have “*regard to the interests of the members as a whole*”;
 - (3) the FSA should have “*regard ... to all the other circumstances*”.
- 1.5.8 Paragraph 15(3) of Schedule 2 provides that the FSA may give a direction “*subject to such limitations or conditions as the Authority may think fit*”.
- 1.5.9 The FSA will consider each application on its merits. The purpose of the guidance in paragraphs 1.5.10 to 1.5.20 is to give a broad indication of the FSA’s approach and the criteria to which it will have regard.

“a subject relating to its (the society’s) affairs”

- 1.5.10 The 1986 Act does not define “*affairs*”. As a general proposition, the FSA considers that “*affairs*” will primarily relate to matters connected with the society’s finances, its business activities and the manner in which it carries on those activities, and not just to the applicant’s personal affairs. Bearing in mind the considerations discussed in paragraph 1.2.3, the matters about which the member wishes to communicate with other members, will, in the opinion of the FSA, normally need to be of a substantial nature and must relate to the particular society concerned. The FSA will expect the applicant to demonstrate not only why he or she is personally concerned about, or affected by, these matters (rather than simply being concerned or affected in some more general way) but also why it is necessary that this concern is communicated direct to other members.

1.5.11 Paragraph 15 of Schedule 2 requires each application to be considered separately by the FSA so that it cannot consider applications with the same, or similar purpose, or related to the same, or similar issue, as if they were a “class application”. So, for example, an application from a member wishing to obtain the required support of other members to stand for election to the board of directors of a society will be considered individually and on its merits, notwithstanding any previous decision the FSA may have taken on an application with the same, or similar, purpose.

1.5.12 The FSA will wish to be satisfied that the wording of the communication is consistent with the stated purpose of the application. It may invite the society to comment on the communication but the society cannot itself stipulate what its terms should be.

“the interests of the members as a whole”

1.5.13 The FSA will balance the wider interests of the membership as a whole with those of any one individual member or group of members. The FSA will require the applicant to demonstrate that the communication raises matters which are likely to be of interest to the society’s members generally or at least a substantial section of them. The FSA will take into consideration any evidence of support from other members of the society, should the applicant claim that this has already been given.

1.5.14 Whilst the right to make an application is open to all qualified members of the society, the FSA is of the opinion that, as a general proposition, access to the register is not an appropriate vehicle for the pursuit of a private grievance between a member and the society or the pursuit of a more general campaign affecting the building societies sector as a whole. The Act provides for a reference to the Financial Services Ombudsman for the investigation of a customer complaint and the 1986 Act provides for a reference to the High Court (in Scotland, the Court of Session) for the resolution of a membership dispute.

1.5.15 The 1986 Act does not require that a person who is given access to the register must write to all the members. To do so would mean that the right of access was of little

practical value. In the opinion of the FSA, it is acceptable for the applicant to write, for example, to a random selection of members or to those living in a particular geographical area. However, the FSA may require the communication to indicate whether or not it has been sent to all the members or only a proportion of them (and, if so, on what basis that proportion was selected).

“all the other circumstances”

- 1.5.16 The circumstances that may be appropriate for the FSA to take into account can only be identified in the particular case at the particular time. As a general proposition, the FSA will take into account any relevant information in respect of the applicant’s relationship with the society. This could include, for example, previous applications for access to the register. The FSA will also take into account whether the applicant has raised the issue about which he or she is concerned at the society’s annual general meeting or whether he or she would be able to do so at a future meeting. The FSA will at the same time take into account any evidence that the society has attempted to frustrate the member’s legitimate right to speak on the issue at the annual general meeting or seems likely to do so on a future occasion.
- 1.5.17 The FSA will also take into account the likely effect on building societies generally should the applicant be given access to the register of members of a particular society and write to the other members as proposed. It will consider whether, should it direct that an applicant be given access to the register of one society, this could have any adverse impact on other societies, for example, a possible risk to confidence. The FSA will also expect the applicant to explain why it is not possible to obtain support in some other way and so why it is necessary to have the privilege of accessing the register of members. The FSA will expect an applicant to show an awareness of these wider considerations and will wish to be assured that they will be appropriately reflected in both the tone and the content of the communication.
- 1.5.18 An applicant will be expected to disclose to the FSA whether he or she is acting in a purely personal capacity or on behalf of, or in concert with, any other person or institution, or whether he or she has an interest in the society beyond the fact of being

a member of it. Where the applicant has not made such a disclosure, but the FSA has reason to believe that he or she may be acting for or in concert with another party, the FSA will make enquiries to establish the facts and will invite the applicant to comment on its findings. Each application to inspect the register of members is considered on its merits. Where an application is made by a member whom the FSA considers to be in effect acting on behalf of a third party commercial institution, it will in particular have regard to: (a) the nature of the member's own interest in the application and the third party institution's objectives; (b) the interest of members as a whole in preserving privacy and the society's right to commercial confidentiality in its membership list; (c) any interaction between the application and the detailed and mandatory procedures under the 1986 Act governing mergers of building societies or as the case may be transfers of business to commercial companies; and (d) other means open to the member and the third party institution to communicate with members on the relevant subject. The interests of the members as a whole should not be confused with the personal interests of one or more individual members.

“such limitations or conditions as the Authority may think fit”

1.5.19 The 1986 Act imposes a specific restriction on any person who has taken information from the register of members. That is, the information may not be further disclosed (by that person or anyone to whom the information has been disclosed in accordance with the direction given by the FSA) except with the consent of the member to which it relates or for the purposes for which the 1986 Act provides. This is an essential safeguard against the abuse of the privilege of being given access to the register of members and contravention of the restriction is a criminal offence.

1.5.20 The FSA will consider what limitations or conditions it should properly attach to a direction in each particular case. However, and without prejudice to the exercise of its discretion, the FSA will normally consider limitations or conditions in the following areas:

- (1) whether the information taken from the register may be further disclosed and, if so, those to whom it may be disclosed and, in particular, if the FSA decides to

direct access to the register of members in the circumstances outlined in paragraph 1.5.18, it will impose such conditions as may be necessary to ensure that the third party institution does not directly or indirectly gain access to the information in the register or use the proposed communication by the applicant with other members to damage the society;

- (2) that the communication must be in writing and addressed separately to each of the members to whom it is sent;
- (3) that the material terms of the communication sent must be those seen by the FSA at the time it reached its decision on the application;
- (4) that the communication is accurate, is not offensive, is not misleading (including any inference that the communication is being made by, or on behalf of, the society), is not likely to bring about a loss of confidence in the society (or in societies generally) or otherwise harm its current or future business;
- (5) that the communication must be sent within a specified time;
- (6) that the applicant is given a specified period during which the relevant information is to be made available.

1.6 Oral hearings

1.6.1 Should either the society or the applicant ask for an opportunity of being heard by the FSA, then it will invite both parties to attend a hearing. If neither party so requests, the FSA will normally decide the application on the basis of the written evidence available to it, including the application, the society's comments (paragraph 1.5.3) and the applicant's written comments (paragraphs 1.5.4 and 1.5.5) together with the results of any enquiries the FSA itself may have made.

1.6.2 If there is an oral hearing this will normally be taken by one or more persons authorised by the FSA to act on its behalf.

- 1.6.3 The FSA will normally give the applicant and the society not less than 10 working days formal notice that there will be a hearing, including the place and time at which it will be held.
- 1.6.4 The hearing will normally be held in public. However, if either the applicant or the society requests that the hearing be held in private, the person(s) taking the hearing will listen to arguments from both parties before deciding whether to admit the public (which may include representatives of the media).
- 1.6.5 Whilst the proceedings will be comparatively informal, the applicant and the society may, if they wish, be legally represented. In any such case, the FSA must be notified at least 5 working days in advance of the hearing so that it may inform the other party. The applicant and the society may also be assisted by such other persons as the FSA considers reasonable in the circumstances.
- 1.6.6 The person(s) taking the hearing will introduce the proceedings and deal with any preliminary matters. The applicant and the society will then each be invited to present their cases, in that order. Each will have the opportunity to comment on the case presented by the other. The person(s) taking the hearing may ask such questions as they consider necessary, particularly to establish or elucidate matters of fact, but will not respond to questions from either of the parties. This procedure may be varied according to the circumstances of the particular case.

1.7 Deciding an Application

- 1.7.1 The person taking the hearing will not normally announce a decision at the hearing or give any indication as to the FSA's likely decision.
- 1.7.2 The FSA's decision with reasons will always be given in writing. The FSA will normally expect to issue its decision within 15 working days of a hearing. A copy will be sent to the applicant and to the society.

1.7.3 The FSA will make its decision public. It would also normally expect to make copies of its written decision with reasons available to those interested to see it. It may decide not to do so, however, where it considers that publication could be prejudicial to the interests of shareholders or depositors in or with the society. The FSA will, if either applicant or society objects to the publication of its written decision, give both parties the opportunity to make representations to it.

EXTRACT FROM THE 1986 ACT

Schedule 2, paragraph 15

“Right of members to obtain particulars from the register

15. (1) At any time when a building society -

(a) has had its permission under Part IV of the Financial Services and Markets Act 2000 to accept deposits cancelled;

and

(b) has not subsequently been granted such permission,

a member of the society shall, subject to sub-paragraph (1A) below, have the right to obtain, from the register kept under paragraph 13 above, the names and addressees of members of the society, for the purpose of communicating with them on a subject relating to the affairs of the society.

(1A) Sub-paragraph (1) above shall not apply unless the member in question

(a) is qualified under the rules of the society to join in a members' requisition for a special meeting, or to join in nominating a person for election as a director; or

(b) would be so qualified if any requirements as to length of time a person must have been a shareholding or borrowing member were omitted.

(2) If, at any time not falling within sub-paragraph (1) above, a member of a building society who is qualified under the rules of the society to join in a members' requisition for a special meeting, or to join in nominating a person for election as a director, makes a written application to the Authority for the right to obtain names and addresses from the register, the Authority -

(a) if satisfied that the applicant -

(i) requires that right for the purpose of communicating with members of the society on a subject relating to its affairs; and

(ii) has not, since making the application, voluntarily ceased to be a member of the society; and

(b) having regard to the interests of the members as a whole and to all the other circumstances; and

(c) on payment by the applicant of a reasonable fee;

may direct that the applicant shall have the right to obtain from the register the names and addresses of the members for the purpose of communicating with them on that subject.

(3) Any direction under sub-paragraph (2) above may be given subject to such limitations or conditions as the Authority may think fit.

(4) Before giving a direction under sub-paragraph (2) above, the Authority shall give particulars of the application to the building society and shall afford the society an opportunity of making representations with respect to the application; and the Authority shall, if the applicant or the society so requests, afford to the applicant and to the society an opportunity of being heard by it.

(5) A member entitled under this paragraph to obtain the names of members of a building society may apply in writing to the society, describing in the application the subject on which he proposes to communicate with other members of the society; and the society shall give him all necessary information as to the place or places where the register, or part of it, is kept, and reasonable facilities for inspecting the register and taking a copy of any names and addresses in the register.

(6) A building society shall not be obliged to disclose to a member making an application under this paragraph any particulars contained in the register other than the names of the members and their addresses, and may construct the register in such a way that it is possible to disclose the names and addresses to inspection without disclosing any such other particulars.

(7) No information obtained under sub-paragraph (1) or (2) above or this sub-paragraph and relating to a member of the society may be disclosed except -

(a) with the consent of that member; or

(b) in the case of information obtained under sub-paragraph (1) or (2) above, for purposes connected with the purpose mentioned in that paragraph.

(8) Any person who discloses information in contravention of subparagraph (7) above shall be liable -

(a) on conviction on indictment, to imprisonment for a term not exceeding two years or to a fine or both; and

(b) on summary conviction, to a fine not exceeding the statutory maximum.

**APPLICATION FOR THE RIGHT TO OBTAIN ACCESS
TO THE REGISTER OF MEMBERS OF A BUILDING SOCIETY**

This form is to be completed by a member of a building society who wishes to be given access to the register of members of the building society of which he or she is a member in accordance with paragraph 15 of Schedule 2 to the Building Societies Act 1986 (as amended by and under the Financial Services and Markets Act 2000) and who is qualified under that paragraph to make such an application. Before completing this form you are advised to read the guidance published by the Financial Services Authority.

On completion this form should be sent to the Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS. Copies of this form and the guidance may also be obtained from this address.

1. Name of the society of which you are a qualified member to whose register of members you wish to be given access:

2. Name and address of applicant:

Name

Address

Telephone

3. Share account details

Account name (s)

Account number (s)

4. Mortgage account details

Account name (s)

Account number (s)

NOTE

If the name and/or the address in which you hold either or both of the above accounts are different from the name and address given for the purposes of this application, please specify that in which it/they are held.

Name

Address

5. Please specify the subject on which you wish to communicate with other members of the society and the points you would wish to make in your communication. Please also enclose a draft of your proposed communication.

6. If there is any other information or documents, in addition to your draft communication, you would wish to form part of your application, please specify.

DECLARATION

7. I declare that I am qualified under the rules of the society named above to make this application.

8. I understand that this application form, and any information or documents enclosed with it, may be sent to the society, which may make representations about it to the FSA.

9. I have read and understand the statutory restrictions which will restrict me from disclosing any information I take from the register if I am given access to it.

10. I enclose payment of £25 in respect of this application. I understand that this fee is not refundable.

Signed

Date

Interim Prudential Sourcebook for Building Societies

2. MERGER PROCEDURES

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DEFINITIONS

“the 1986 Act”	the Building Societies Act 1986 ¹
“the Authority”	the Financial Services Authority
“amalgamation agreement”	a formal agreement between societies on the terms of their amalgamation
“the board”	the board of directors of a building society
“the BSA”	the Building Societies Association
“borrower” or “borrowing member”	a person who is indebted to a society in respect of a loan fully, or where the Rules so provide, substantially secured on land
“the Central Office”	the department of the Authority carrying out the registration functions transferred from the Central Office of the Registry of Friendly Societies
“this chapter”	this chapter of the IPSB on Merger Procedures
“the Commission”	the former Building Societies Commission
“DTI”	the Department of Trade and Industry, Industrial Relations Division
“Fees Rules”	the Rules made by the Authority from time to time under paragraph 17 of Schedule 1 to the Financial Services and Markets Act 2000 prescribing the fees to be paid in connection with the discharge of its functions under the 1986 Act.
“First, Second, Third Criterion”	see “the Three Criteria”
“Instrument of Transfer”	the Instrument of Transfer of Engagements required by Section 94(6) of the 1986 Act
“the IPSB”	the Interim Prudential Sourcebook for building societies
“member”	a shareholding or borrowing member of a society

¹ As amended by and under the Building Societies Act 1997 and the Financial Services and Markets Act 2000. The 1986 Act has also been amended by other legislation.

“Memorandum”	the Memorandum of a building society required by paragraph 2 of Schedule 2 to the 1986 Act
“merger”	an amalgamation or transfer of engagements
“Merger Document”	the document or booklet containing the Schedule 16 Statement
“Merger Notification Statement”	a statement sent to members in the circumstances described in section 6
“Merger Resolutions”	the shareholding members’ resolution and borrowing members’ resolution required to approve a merger where no direction under Section 42(B)(3) has been given
“OFT”	the Office of Fair Trading
“PIBS”	Permanent interest-bearing shares, a type of deferred share
“proxy voting form”	an instrument appointing a proxy to attend a meeting of a society and vote on the member’s behalf
“rationale”	the explanation of the reasons for a proposed merger provided to the members of a society by its board of directors
“the Rules”	the Rules of a building society
“Schedule 16 Statement” or “the Statement”	the statutory statement required by Schedule 16 to the 1986 Act to be sent to every member entitled to notice of a meeting of the society
“section”	a section of this chapter
“shareholder” or “shareholding member”	a person holding a share in a society (by investing in one or more share accounts or holding PIBS or other deferred shares).
“society”	a building society
“successor society”	a society accepting a transfer of engagements or the new society in the case of an amalgamation
“the Three Criteria”	the criteria prescribed by Section 95(4) of the 1986 Act which the Authority has to consider when deciding whether to confirm a merger ²

² The Three Criteria are varied in certain circumstances - see section 6.

“transferee society”	a society accepting a transfer of engagements from another society
“transferor society”	a society transferring its engagements to another society
“UKLA”	the UK Listing Authority (currently the Authority).

MERGER PROCEDURES

1. INTRODUCTION

Purpose of the chapter

- 1.1 This chapter replaces the Merger Procedures Guidance Note issued by the Commission in May 1999. It gives guidance on the requirements of the 1986 Act, as amended by and under the Financial Services and Markets Act 2000, under which certain functions of the Commission were transferred to the Authority. However, since the nature of the transferred functions remains substantially unaltered, there is no significant change in this guidance compared with the guidance previously issued by the Commission on the procedures to be followed by a building society proposing to merge with another building society. **This chapter is not intended to be exhaustive and is not a substitute for looking at the 1986 Act and the Mergers Regulations 1987 (SI 1987/2005) as amended by the Mergers (Amendment) Regulations 1995 (SI 1995/1874), the Merger Notification Statements Regulations 1999 (SI 1999/1215), where applicable, and a society's own Rules. Nor is it a substitute for the society seeking its own legal advice.** It gives a description of the relevant provisions of the 1986 Act, of the information which must be made available to the Authority and to societies' members, together with an outline of the procedures to be followed at general meetings, and the voting majorities required to pass the Merger Resolutions which the members are to be asked to approve. This chapter describes the role of the Authority in approving the statements to members under Schedule 16 to the 1986 Act, in its prudential supervision of mergers, and in confirmation hearings. It also gives a broad indication of the way in which the Authority may be expected to exercise its discretionary powers. **Except as described in section 6, to which section 7 of this chapter also applies, this chapter is concerned only with voluntary Mergers under Sections 93 and 94 of the 1986 Act.**
- 1.2 It is for the boards of societies to assess the case for a merger, and they must explain and recommend their decision to their members. However the Authority's staff are available to give advice on the procedures to be followed and the information required to ensure that the members can reach fully informed decisions. **Societies are strongly recommended to consult the Authority early on in the formative stages of merger**

discussions. Such consultation will, of course, be treated in the strictest confidence. It will also be helpful to have regard to the indicative timetable set out in paragraph 8.3.

- 1.3 Societies should consult their own legal advisers about the application of the provisions of the 1986 Act, and the general law, to the particular features of a proposed merger.
- 1.4 This chapter considers each stage of the merger procedure in chronological order. The remainder of this section gives a synopsis of the relevant requirements of the 1986 Act, which are then discussed in more detail in subsequent sections.

Section 2, Preliminary Matters, considers the rationale for a merger and its terms and the handling of public announcements, and gives guidance on certain prudential issues.

Section 3, Information Provided to Members, discusses the form and content of the statutory Schedule 16 Statement and the accompanying rationale and statements by the board of the society, and describes the form of application to be made to the Authority for approval of the Statement.

Section 4, General Meetings and Resolutions, discusses the resolutions and majorities required to pass them, the notice of meeting, the register of members and members' entitlement to vote, the arrangements for general meetings and the scrutineers' report. It also describes the Authority's discretionary powers.

Section 5, Confirmation, describes the form of application to the Authority for confirmation of a merger, and the procedures which the Authority expects to follow in considering and hearing written and oral representations and in reaching its decision.

Section 6, Transfer of Engagements under Direction, describes the modified procedure to be followed when a society has been directed by the Authority to transfer its engagements to another society and/or to proceed by board resolution.

Section 7, Registration and Dissolution, briefly discusses the process of registration of amalgamations or transfers of engagements and dissolution of the amalgamated or transferor societies.

Section 8, Timetable, reviews the expected timetable, including statutory notice periods, which may be expected to apply to a merger from start to finish.

Statutory Requirements

- 1.5 The statutory provisions concerning mergers are in Sections 93 to 96 of, and Schedule 16 to, the 1986 Act, where three types of transaction are provided for:

Amalgamation, where two or more societies unite to form a new “successor” society;

Transfer of engagements, where a society (the transferor) transfers its membership and the whole of its undertaking to another (the transferee), which then continues as before; and

Partial transfer of engagements, where a society transfers only a part of its membership and business to another society (for example, some outlying branches).

The procedures for all three are much the same, and the differences are explained in the relevant sections of this chapter. The Authority’s practice as described in this chapter is derived exclusively from previous experience of transfers of engagements because, so far, there have been no amalgamations nor partial transfers under the 1986 Act. However, it is not expected that the Authority’s handling of amalgamation procedures would be significantly different from what is described here.

- 1.6 The purposes of the provisions of the 1986 Act are to ensure that the members are given all the material information they need about the terms of the merger which they are asked to approve and a proper opportunity to cast their votes. Subsequently, they are to be given the opportunity to make representations about that process before the merger is confirmed.
- 1.7 The 1986 Act makes no provision for a merger to be initiated by any other means than a proposal by a board put to the society’s members. It requires that each member who is entitled to receive notice of the general meeting at which the Merger Resolutions are to be moved must also receive a copy of the Schedule 16 Statement. A merger must be approved by a **shareholding members’ resolution** and a **borrowing members’ resolution**. There is an additional voting requirement for the approval of a partial transfer of engagements.

- 1.8 If the terms of a merger include provision for the payment of **compensation to directors or other officers** for loss of office or of income, then the proposed payments must be approved by a separate **special resolution**. A further special resolution may also be required if there is to be a distribution to members which exceeds the limits described in paragraph 4.4.
- 1.9 Sections 93 to 96 of the 1986 Act specify certain procedures for the consideration of representations by interested parties concerning **confirmation**, and the criteria which the Authority must consider before deciding whether or not to confirm a merger. The Authority may not consider matters concerning the merits of merger proposals or the fairness of the terms which the members have approved by passing the Merger Resolutions.
- 1.10 The statutory requirements of the 1986 Act are explained and discussed in more detail in subsequent sections of this chapter. In addition, societies and their advisers must have regard to the legislation mentioned below.
- 1.11 **Fair Trading Act 1973:** societies should inform the Office of Fair Trading of a proposed amalgamation or transfer of engagements where, currently, the merged society will have a market share in the UK, or in any substantial part of the UK, of at least 25%, or where the assets of the transferor society exceed £70 million. The OFT will then advise whether or not the Director General of Fair Trading proposes to recommend to the Secretary of State that the merger be referred to the Competition Commission. In some cases the OFT may wish to discuss the proposal with the societies before deciding. It is essential that any submission to the OFT is undertaken at the earliest possible opportunity since, should the Secretary of State decide to refer a merger to the Competition Commission that would be a “material fact” to be disclosed in the Schedule 16 Statement, unless it is impracticable to put the matter to members until the Competition Commission has reported. Societies may need to consider the Competition Act 1998 when planning a merger. However, the merger control structure described above is left in place by the 1998 Act, although with some amendment.
- 1.12 **Transfer of Undertakings (Protection of Employment) Regulations 1981 (SI 1981/1794):** These Regulations have the effect that the employees of a transferor society automatically become the employees of the transferee society following the merger. They require, in particular, information to be given in certain cases to employees’ representatives, long enough before the merger takes place, to enable

consultations to be held between the society and those representatives. Failure to inform or consult in this way is a ground for reference of the matter to an industrial tribunal and there are other significant provisions. Societies are advised to consult “Employment Rights on the Transfer of an Undertaking” (Employment Legislation Pack Booklet No: PL699) which explains the Regulations and is available from the DTI Order Line (Tel: 0870 1502500).

- 1.13 **Taxes Acts:** Societies should take advice on the timing and amount of tax liabilities.

2. PRELIMINARY MATTERS

Rationale for a Merger

- 2.1 It is a matter for the board to decide whether to recommend a merger to its members. The overriding duty of the board is to reach a view having regard to what is in the best interests of the society, and its members as a whole, both present and future, borrowing members and shareholding members. The board may also reasonably consider the interests of customers who are not members, of the staff, suppliers of goods and services, and of the wider community.
- 2.2 A well planned and well matched merger can benefit both the shareholding and borrowing members and the staffs of both societies by producing a combined society with the financial strength and management expertise and experience needed to compete successfully in the market place. It must be recognised, however, that in many instances it will take time for economies of scale to be achieved and a careful assessment of projected costs is essential to a realistic view of whether such economies are likely to be achievable. On the other hand, a merger between two weak and over-extended societies may produce an even weaker one. It is better to negotiate a merger from a reasonably secure position than to be obliged to seek a merger when the society has become too weak to carry on as an independent entity.
- 2.3 This chapter cannot deal exhaustively with all the factors to be taken into account by a board when deciding whether to recommend a merger to its members. Moreover, there will be factors peculiar to particular cases. However, the following paragraphs draw attention to those matters which the Authority expects boards to consider in all cases.
- 2.4 Consideration of a merger can normally be expected to emerge from the board's regular consideration of the strategic options available to the society. That is not to say that merger as a transferor society should always figure as an option in every society's corporate plan. On the other hand, every board should be alive to business trends which point to, or which, if not altered, will point to, the need to consider options for merger. In short, a merger should be foreseen and planned. Alternatively, of course, a board which wishes its society to remain independent must have a clear strategic view of how that can be achieved in a variety of realistic planning scenarios. Whether or not a board is considering a merger, it should as a matter of prudence, know how it

would respond to a proposal or counterproposal to merge or to transfer its business to a commercial company.

- 2.5 If a board foresees the possibility of a merger, then it should plan for that eventuality. Societies which see themselves as transferees will need to consider the desired characteristics of potential partners, including, for example, geographical presence, mortgage book quality, and product market share. Societies contemplating the transfer of their engagements will need to consider whether the interests of their members would best be served by a local or regional alliance or access to a national network of branches and services. Although the interests of shareholding and borrowing members are paramount, boards also have an obligation to consider the consequences of merger options upon the terms and conditions of employment and job prospects of their staff, and the interests of their pensioners. It is also reasonable, particularly for local and regional societies, to consider the implications for the local economy, where, for example, a regional or head office may eventually be closed to achieve economies of scale.
- 2.6 The range of issues which both boards have to consider will vary from case to case and is for the board to decide. At one end of the scale there will be the case where a small society merges with a large one and, at the other end, where two or more societies of broadly comparable size join to form one significantly larger. Whatever the proposal under consideration the board will necessarily have regard to this primary duty to reach a view on what is in the best interests of the society, and its members as a whole. It will also be conscious of the need to give an account of the board's rationale in recommending the merger to members, in particular if a statutory merger statement is included in the Merger Document (see paragraph 3.23).

Terms of a Merger

- 2.7 The terms negotiated between the parties in a merger will be set out in a formal agreement. In the case of a transfer of engagements, Section 94(6) of the 1986 Act requires the "extent of the transfer", and in practice the other agreed terms, to be recorded in an Instrument of Transfer. For an amalgamation, Section 93(2) of the 1986 Act requires the parties to agree on a Memorandum and Rules for the successor society, and each to approve the terms of the amalgamation by Merger Resolutions, so that there must be agreement on the terms. The Authority will expect the Instrument of Transfer or amalgamation agreement to be signed before the Authority approves the

Schedule 16 statement, although it will be conditional on, among other things, approval by members and confirmation by the Authority. In both cases the boards of the societies will have approved the Instrument or agreement and the Schedule 16 statement and, in the case of an amalgamation, the Memorandum and Rules of the successor society. Before such approval by the boards, drafts of the proposed Memorandum and Rules should have been cleared with the Central Office. The Rules of transferee societies should provide that members of transferor societies are not disenfranchised for any period after the merger is effected (see paragraph 3.16 and rule 4(9) of the BSA Model Rules 5th edition).

2.8 Although vesting of the “property, rights and liabilities” of the transferor society in the transferee society on completion of a transfer of engagements is a statutory process by virtue of Section 94(8) of the 1986 Act, the Instrument of Transfer performs an important function. Not only is it required by the 1986 Act, but it is required to identify the extent of the transfer (Section 94(6)), since a transfer can be of all or part of the engagements of the transferor society. Thus, on a transfer of all the engagements of a society, the Instrument of Transfer should include a specific statement that all are included. If the transfer is of part only, then the instrument should specify precisely what is being transferred. As explained, an amalgamation agreement is required in practice for all amalgamations, but again the actual process of transferring the assets of the societies to, and vesting them in, the new society is by operation of the 1986 Act. Section 93(4) of the 1986 Act, which does this, does not allow for exceptions to the vesting since the nature of an amalgamation is that all the assets of all the societies are vested in the successor society.

2.9 The Instrument of Transfer, or amalgamation agreement, will also allow matters of detail to be recorded. So it will contain, for example, provision for:

- (a) any changes to the terms and conditions of PIBS and share and deposit accounts, including the integration of the product lines of the transferor society(ies) into those of the transferee or successor society;
- (b) any changes to the terms and conditions of mortgage accounts and other loans;

- (c) any bonus to be paid to members;
- (d) the terms and conditions on which staff will be employed or made redundant;
- (e) pension scheme arrangements;
- (f) integration of operations;
- (g) the terms and conditions on which directors and other officers are to continue in office or cease to hold office, including the posts they will hold and any extra-contractual compensation to be paid for loss of office or reduction in emoluments;
- (h) the specified target date for completion of the merger, bearing in mind that the actual date is a product of the 1986 Act (Sections 93(3)(b) & (4) and 94(8)), and for action if that date is not achieved;
- (i) any conditions precedent, such as members' votes and the Authority's confirmation, and for the circumstances in which the Instrument or amalgamation agreement might be terminated.

Bonus Payments to Members

2.10 Whether any bonus is to be paid to members and, if so, its amount and distribution, are matters to be agreed by the boards of the societies concerned and to be approved by their members, subject to the discretion described in paragraphs 4.41 and 4.42. However, the Authority will wish to be satisfied that the combined society will maintain a prudent solvency ratio after the bonus is paid. A bonus may, for example, be paid to the members of a transferor society with a higher capital ratio than the transferee society so as to equalise the reserves which both bring to the combined society. If it is thought desirable also to pay a bonus to the members of the transferee society, then the reserves of the combined society may be "equalised" at a level below

the capital ratio of the transferee society, but only if it is prudent to do so. The statutory requirements for approval of bonus payments are described in paragraph 4.4.

- 2.11 A bonus is a distribution of the funds of either or both societies, and may be paid by a number of methods, or some combination of them, including, for example: a flat rate lump sum; a sum calculated as a percentage of balances; or an increase or (for mortgage accounts) a decrease in the interest rates paid or charged for a limited period. Maintenance of interest rate differentials existing before the date of completion of the merger between those offered by (say) the transferor society and the transferee society would not normally be characterised as a bonus. However, each society, and the Authority, will wish to be satisfied that any differential is consistent with its established pricing policy and is not the result of a change adopted, for example, when the society decided to seek a merger. Each case where interest rate differentials are to be maintained, for whatever period, will need to be considered to determine whether or not it constitutes a bonus, and societies may wish to take professional advice on the matter.

Compensation to Directors and Other Officers

- 2.12 Any compensation proposed to be paid to directors or other officers must be disclosed in the Schedule 16 Statement and approved by a separate special resolution of the members (see paragraphs 3.11 and 4.3). “Compensation” is not defined in the 1986 Act. In the Authority’s opinion, compensation does not include statutory redundancy payments, damages for breach of contract or other payments, for example, falling due under the terms of a pre-existing contract of employment, or a pre-existing arrangement giving rise to a reasonable expectation. However, it does include any proposed ex-gratia payments in money or money’s worth. Societies should consider very carefully the extent to which any proposed payment may exceed the amount provided for by statute or contract. In view of the requirement in Section 96(3) of the 1986 Act that unauthorised payments must be repaid by the recipient, societies are advised to take legal advice on any payments which are not specifically authorised by the terms of a resolution passed by the members in accordance with Section 96(1) of the 1986 Act. All proposed payments requiring approval by such special resolution should be disclosed in the Schedule 16 Statement under the power in paragraph 1(4)(f) of that Schedule. In addition, the Schedule 16 Statement should disclose any other payments to directors or other officers arising directly from the merger. So that members are aware of the direct interest of the directors or other officers in a merger, societies should consider whether the amount, as distinct from the fact, of statutory or

contractual payments should be disclosed where these arise directly from the merger. More generally, societies need to consider whether any facts relevant to any director or other officer, or to any person(s) connected with them, should be disclosed where these are material to the interests of the members who are to be asked to vote on the proposed merger. In determining the amount of compensation which might be justified, the board must strike a balance between fairness to the individuals who will suffer a loss of income and the interests of the members, bearing in mind that the compensation will be at a cost either to any bonus to the members or to the reserves to be transferred to the combined society.

Public Announcement

- 2.13 Boards of both societies may wish to announce a merger proposal as soon as agreement in principle has been reached between them and, in particular, to inform their members and staff of the proposed terms. However, boards will often wish to delay an announcement for as long as possible, perhaps for prudential or commercial reasons, or because they first wish to settle all the details of the proposed terms. Societies with listed PIBS will need to have regard to the UKLA requirement concerning early disclosure of information affecting the price of securities. Subject to this, there is no objection to delay, in principle, and there may be good reasons for it. Unfortunately, experience shows that every day's delay after agreement in principle has been reached carries an increasing risk of premature leak. Indeed, the very reasons for delay may make the merger a subject for intense speculation and increase the risks of a leak. In these circumstances then, boards must have contingency plans to make an early announcement to deal with any potentially damaging rumours and to avoid members being misled or left in a state of uncertainty.
- 2.14 The announcement, particularly information provided directly to members and staff, should make it clear that the merger proposal is subject to approval by the members and completion of the statutory procedures. Boards should be careful to avoid giving even the impression that the outcome is a foregone conclusion, and should indicate any matters of substance on which the proposed terms of the merger remain to be settled. Briefing of staff who will be responsible for responding to enquiries from members and the press should be considered carefully and prepared in advance of the announcement to avoid any risk of members being unintentionally misled.
- 2.15 The Authority is not required to approve the content or wording of announcements or preliminary information sent to members. However, it will be happy to comment on

drafts shown to it at an early stage, and may be able to help societies to avoid unintentionally misleading statements.

Prudential Issues

- 2.16 Before a firm proposal is agreed, the participating societies should consult with the Authority's staff to discover whether there is any prudential objection to the proposal. The Authority will need to be satisfied that the combined society will be managed prudently from the date of completion of the merger and comply with the Principles for Businesses and with all the relevant rules made by the Authority. The Authority will also wish to know that post-merger arrangements and agreements provide for the proper integration or rationalisation of the operations of the combined society, and of its connected undertakings, joint ventures or arrangements with third parties (for example, for the provision of unsecured loans, insurance and investment services) and that any commercial conflicts of interest have been resolved.
- 2.17 In all cases, prudential information should be provided, but the amount of information will depend upon the circumstances of each case. For example, if a merger involves societies of much the same total asset size, or where the merger will result in a significant increase in the transferee society's assets, or involves a change of strategy, new kinds of business or carrying on business in a new geographical area, the Authority will expect substantial prudential information and societies should also expect this to form the basis of more detailed discussions with the Authority's staff. On the other hand, in a merger where a small society is transferring its engagements to a very much larger one, the prudential information to be provided is likely to be that much less. In all cases the Authority will ask for the prudential information at an early stage so that there is adequate time for discussion before it is asked formally to approve the Schedule 16 Statement.
- 2.18 Boards should note, however, that while the Authority will expect the kinds of information described here, it is for the boards themselves to exercise due diligence and to be satisfied that the merger and its terms are prudent and in the interests of their members.
- 2.19 As is noted, the Authority's need for prudential information can be expected generally to relate to prudential issues, but societies may find it helpful to note the following paragraphs which describe some of the particular issues which the Authority will

expect to be addressed. In all cases, societies should have regard to the relevant chapters of the IPSB.

Direction and management

- 2.20 Current and future board composition and succession plans for, say, the three years immediately following the merger.
- 2.21 Current and future senior management and structure, indicating spans of responsibility (which may most easily be presented in chart form) and any areas where there may be a need for additional expertise or experience to be acquired by the combined society with plans and timescale for acquiring such expertise.

Accounting and control systems

- 2.22 Generally, outline plans and timetables for the integration of accounting, control and inspection systems, including the linking or harmonisation of computer systems. This may usefully be divided between initial or short term arrangements and foreseen longer term developments. More particularly, the information should include arrangements to ensure continuity and the integration of:
 - (a) accounting records;
 - (b) systems of internal control, including management information systems and IT systems; and
 - (c) systems of inspection (internal audit)

For all significant mergers the Authority will wish to receive, prior to the effective date of the merger, a letter from the transferee society's external auditors stating whether, in their opinion, the accounting records and systems of control and of inspection established for the merged society will be effective from the effective date.

Business plan

- 2.23 The rationale for the merger will need to be explained and justified in full, including existing and potential future business and marketing opportunities, the benefits of geographical concentration or diversification of business, economies of scale

(particularly administrative), and future funding and lending strategies. Proposals for rationalisation or integration of administrative offices and branches will need to be set out in full, including the implications of the proposed merger for the terms and conditions of staff employment and their future job prospects with the combined society.

Financial prospects

2.24 Information on the financial prospects for the combined society will need to include:

- (a) estimates, broken down to an appropriate level of detail, of short term additional costs and long term savings (if any) anticipated from the merger; and
- (b) revenue account, balance sheet and solvency ratio projections for the first three to five years of operation.

This information must be supported by statements of the assumptions on which it has been based. In addition, the effect of changes on those assumptions should be illustrated, from a best case to a worst case scenario.

Connected undertakings and agencies

2.25 The integration and future operation, management and control of connected undertakings, together with arrangements with other parties for the continuing provision of services under agency agreements, should be described in full.

3. INFORMATION PROVIDED TO MEMBERS

Statutory Requirements

- 3.1 Part I of Schedule 16 to the 1986 Act requires a building society which desires to merge with another society to send to every member entitled to notice of a meeting of the society a statement concerning the matters specified in the Schedule. The statement is to be included in or with the notice of the meeting at which the Merger Resolutions are to be moved. No statement shall be sent unless its contents, so far as they concern the specified matters, have been approved by the Authority. Where the transferee society has obtained the consent of the Authority to proceed by board resolution then it is exempt from this requirement (see paragraphs 4.41 and 4.42).
- 3.2 Meeting arrangements and resolutions are discussed in section 4.

The Schedule 16 Statement

- 3.3 The Schedule 16 Statement must set out the present financial positions of each of the merging societies, the terms of the merger agreed between them and summarise the main provisions of the Instrument of Transfer. It must also include any other matter which the Authority may require. In the case of an **amalgamation**, the Statement must additionally include the proposed Memorandum and Rules of the successor society which are to be approved by the special resolution required to approve the merger (Section 93(2) of the 1986 Act), as well as the terms of the amalgamation agreement between the societies.
- 3.4 The Schedule 16 Statement does not have to be a discrete document. In fact it will usually be convenient to include it in a comprehensive Merger Document also containing the board's rationale for recommending the merger, the notice of the meeting at which the Merger Resolutions are to be moved, an explanation of the merger procedure (including details of the confirmation stage - see section 5) and a description of the requirements of the society's Rules concerning entitlement to vote. However, the Schedule 16 Statement within the Merger Document should be clearly identified as such (either by printing it on a different colour of paper or by some other means). An example of a *pro forma* Merger Document is given in Annex A.
- 3.5 The required contents of the Schedule 16 Statement are discussed in detail in the following paragraphs.

The Financial Position

- 3.6 Paragraph 1(4)(a) of Schedule 16 to the 1986 Act requires the Statement to contain information concerning the financial position of each of the societies participating in the merger. The members should be given sufficient information to enable them to gain an accurate understanding of the key financial features of their businesses. The information will include a balance sheet, recent results and certain financial ratios; for this purpose it is necessarily rather more detailed than is required for the annual Summary Financial Statement. In addition, further information will be required concerning accounting policies and other matters, as set out in paragraph 3.10.
- 3.7 The information should comprise consolidated accounts of each society and its connected undertakings prepared at a common balance sheet date which should be no more than 6 months before the date on which the Statement is approved by the Authority, or the date on which the Statement is to be sent to the members if that is expected to be significantly later. Information regarding results should relate to the relevant period ending on the chosen balance sheet date. The figures may be derived from audited or unaudited accounts. In either case, the source must be stated. If unaudited figures are used, the Authority will require a “letter of comfort” from the relevant society’s external auditors confirming that, in their opinion:
- (a) the figures have been correctly abstracted from the society’s records;
 - (b) the financial information is not misleading in the context in which it appears; and
 - (c) in reviewing the data relating to the Statement, nothing has come to their attention which would cast doubt on the directors’ statement (see paragraph 3.8) that there has been no material change affecting the information given.
- 3.8 Since the financial information will necessarily relate to a period ending somewhat before the date of approval of the Schedule 16 Statement, the board is required to state whether or not there have been any material changes to the financial position in the interim. If the effect of a change cannot be quantified, it must be described so that the members at least know that it has been identified and is relevant to their consideration of the proposed merger. Failure to disclose such changes will be relevant to the Authority’s subsequent consideration of the society’s application for confirmation of the merger (see paragraphs 5.4, 5.12 and 5.13).

- 3.9 Differences in accounting policies could result in some loss of comparability between the financial information given for each society. Some adjustments to the figures may, therefore, be necessary to give the members a proper understanding of the societies' relative financial positions. Any adjustments made should be explained by way of a note. If there are no significant differences in accounting policies, then that should be stated for the avoidance of doubt.
- 3.10 Notes to the financial position should also provide information on the following matters:
- (a) the book amounts and market values of listed securities held as liquid assets;
 - (b) the book amounts and current market values of land and buildings; with an indication of the basis on which current market value has been determined;
 - (c) any significant differences in policy or practice with regard to the depreciation and estimated asset lives of tangible fixed assets;
 - (d) pension arrangements of each society including, for funded schemes, details of latest actuarial valuations;
 - (e) summary information on the business of connected undertakings;
 - (f) an estimate of the costs and benefits of the proposed merger.

Interests of Directors and Other Officers

- 3.11 Subparagraphs 1(4)(b) and (c) of Schedule 16 to the 1986 Act require the Statement to disclose any interests of the directors in the merger and any compensation to be paid to them or other officers. This information must be comprehensive and clear. It should include the following:
- (a) the interests of the directors in the merger, including appointment of existing directors to the main board or local board of the combined society, or to any other position with that society, together with any significant resultant change in present or expected future levels of fees or other emoluments and benefits in kind;

- (b) any compensation payable to directors or other officers for loss of office or reduction in emoluments, and the basis on which it is calculated; if a global sum is proposed to be given to a group of persons, the intended manner of apportionment should be stated (see paragraph 2.12);
 - (c) any payments to be made to directors or other officers arising from the merger, whether provided for in contracts of employment or under covenant or some arrangement giving rise to a reasonable expectation;
 - (d) any proposed benefits to directors or other officers by way of fees for professional services, stating the nature of the services to be provided and the anticipated annual fee income; and
 - (e) any other benefits to directors or other officers, or to any persons connected with them, arising from, or as a consequence of, the merger.
- 3.12 If the directors or other officers have no material interest, either by way of change in remuneration, as widely defined above, or by payment of compensation for loss of office or in any other form, for example, a pension, this should be stated explicitly, for the avoidance of doubt.

Bonus Payments to Members

- 3.13 Paragraph 1(4)(d) of Schedule 16 to the 1986 Act requires the Statement to specify the bonus, if any, to be paid to members in consideration of the merger. The Authority's views on what may, or may not, be regarded as bonus are given in paragraph 2.11, and the statutory requirements for approval of bonus payments are described in paragraph 4.4.
- 3.14 The method of calculation of a bonus should be explained in the Schedule 16 Statement; for example, x% of the lower of the share account balances held at the end of the last financial year and those balances held on the effective date of merger (giving precise dates and times for calculating the balances), and the estimated maximum total amount payable to members. The effect on the reserves of the combined society should be shown by stating the estimated gross and net costs of the bonus and the resulting reduction in the reserve/asset ratio (see also Annex A, items A.3 and B.6).

Other Matters

- 3.15 As is noted in paragraph 2.9, the Instrument of Transfer (or amalgamation agreement) will normally make provision for a number of matters in addition to those concerning the interests of directors and other officers and any bonus to be paid to the members. Such matters must be explained in the Schedule 16 Statement, together with any other matters of which the Authority may require particulars to be given (see paragraph 1(4)(f) of Schedule 16 to the 1986 Act). They are discussed in the following paragraphs.
- 3.16 **Post-merger membership rights** should be secured by the adoption of BSA Model Rule 4(9) (Fifth Edition, November 1997) or a similar Rule to the same effect. The purpose of the Rule is to ensure that members of a transferor society are not disenfranchised. It provides that they are deemed to have been members of the transferee society from the date when they became members of the transferor society. Societies' Rules, in conformity with the 1986 Act, must provide, inter alia, that a member is entitled to vote on a resolution of the society if he was a member at the end of the last financial year before the voting date and on the voting date. If, for example, a transferee society has a financial year ending on 31 December, its AGM in the following April and the effective date for a merger is in March, then the deemed membership Rule will enfranchise those who were members of the transferor society on or before 31 December. The existence, or absence, of this Rule must be recorded in the Schedule 16 Statement in any case where it is likely to have any significant effect on members' rights.
- 3.17 **Proposed changes to the terms and conditions of share and deposit accounts** must be fully and clearly explained in the Schedule 16 Statement. In a transfer of engagements, shares and deposits held with the transferor society will become held with the transferee society. Such accounts will either be transferred into the nearest equivalent account of the transferee society, become new products of the transferee society, or continue on existing terms but be closed to new investors. It is most helpful to tabulate the proposed integration of accounts in a schedule listing the accounts of the transferor society opposite the accounts of the transferee society to which they are to be transferred, together with the interest rates payable, or proposed to be paid, on each account. A similar presentation will be required to show the proposed integration of accounts in an amalgamation. In preparing this the provisions of Section 8 of the 1986 Act should be borne in mind.

- 3.18 **Proposed changes to the terms and conditions of mortgage accounts** must be explained (see paragraph 1(4)(e) of Schedule 16 to the 1986 Act). Alternatively, if no changes are proposed to be made, the Schedule 16 Statement must include an assurance to that effect, for the avoidance of doubt.
- 3.19 **Terms and conditions of employment of staff**, including any special bonus or other benefits in connection with the merger, as provided by the Instrument of Transfer (or amalgamation agreement), must be set out. In addition, the Authority will require the Schedule 16 Statement to include an explanation of the Board's intentions with regard to the closure or integration of head office departments and branches, any reductions in the number of staff employed and redundancies, insofar as these matters are not provided for in the Instrument of Transfer (or amalgamation agreement).
- 3.20 **Future pension arrangements** for staff, directors and other officers, as provided by the Instrument of Transfer (or amalgamation agreement), are to be set out.
- 3.21 Finally, the **conditional and termination clauses** of the Instrument of Transfer (or amalgamation agreement) should be summarised.

Board Rationale and Statements

- 3.22 A board putting a merger proposal to its members has, in addition to its statutory duty to provide a Schedule 16 Statement, a fiduciary duty to provide its members with essential factual information and a fair assessment of the issues so that they can take informed decisions on whether to approve the board's proposals. The Authority, therefore, expects that the Merger Document (see paragraph 3.4) will include an explanation by or on behalf of the board of the reasons for the merger and the choice of merger partner. This rationale should give a fair assessment of the advantages and disadvantages of the merger and should be entirely consistent with the facts set out in the Schedule 16 Statement. In addition to explaining the rationale and its consequences for the members, it should explain the effect on the staff's terms and conditions of employment and expectations for future employment prospects. The planned timescale for integration of the businesses should also be explained.
- 3.23 The 1986 Act requires that members must be notified of written non-confidential proposals to their society either to merge with another society or to be taken over by a commercial company. Part II of Schedule 16 to the 1986 Act imposes a duty to send a **merger statement** to members, advising them of a proposal to merge, and Part IA of

Schedule 17 to the 1986 Act imposes a like duty to send a **transfer proposal notification**, advising them of a proposed takeover. If a proposal of either kind has been received, then notification of the prescribed particulars must be sent to every member entitled to notice of a meeting, either separately or together with every notice of the society's annual general meeting, and (where such notification has not already been given) must be included with every notice of the special meeting at which Merger Resolutions are to be moved.

- 3.24 Where notification of takeover or other merger proposals accompanies the notice of a meeting to consider Merger Resolutions, then
- (a) any merger statement must give notice of the fact that a written merger proposal has been received unless notice has already been given to members, or it was received 42 or less days before the meeting, with details of the identity of the proposer, with or without particulars regarding the proposal. If the proposer requests in writing that the proposal be treated as confidential, disclosure is not required. The merger which the members are being asked to vote upon need not be the subject of a merger statement.
 - (b) any transfer proposal notification must give notice of the fact that a written proposal has been received with details of the identity of the proposer, with or without particulars regarding the proposal. If the proposer requests in writing that the proposal be treated as confidential, disclosure is not required.

An invitation to discuss a possible proposal probably would not constitute a proposal within either Schedule.

Provision of merger or transfer proposal statements is a statutory requirement. Provided they accompany the notice of meeting, they may be included in a Schedule 16 Statement, or alternatively may more conveniently be included as one or more discrete paragraphs within the board's rationale explaining its choice of merger partner.

- 3.25 The rationale itself is not a statutory requirement, and is not subject to approval by the Authority. However, the Authority will take account of the information it provides when considering whether to confirm the merger (see section 5, particularly paragraphs 5.9 and 5.12). Societies will, therefore, find it helpful to consult the Authority's staff about the drafting and content of the rationale.

- 3.26 The whole Merger Document should be covered by a **responsibility statement** by the directors of each society. This may be given along the following lines:

“The directors of Building Society and the directors of Building Society accept responsibility for the information relating to their respective societies which is contained in this document. To the best of the knowledge and belief of the directors (who have taken all reasonable care to ensure that such is the case) the information contained in this document is in accordance with the facts and does not omit anything likely to affect the import of such information”.

- 3.27 The Authority will require the Schedule 16 Statement to include a statement as to whether or not the merger will conflict with any **contractual obligations**, including agency agreements, of either society or their connected undertakings.

Application and the Authority’s Approval

- 3.28 A society’s formal application to the Authority for approval of a Schedule 16 Statement is likely to be the culmination of many weeks of discussion with the Authority’s staff who will have reviewed and commented upon a draft or successive drafts of the Statement, having had regard also to drafts of the Instrument of Transfer (or amalgamation agreement) and the prudential information described in section 2. Societies should also have cleared any proposed Rule changes or, in the case of an amalgamation, the proposed Memorandum and Rules of the successor society, with the Central Office. The probable sequence of events is described more fully in section 8. The case where the Authority has consented to a transferee society proceeding by board resolution, and thereby exempting it from the requirement to put Merger Resolutions, and sending a Schedule 16 Statement, to its members, is described in paragraphs 4.41 and 4.42.

- 3.29 Schedule 16 Statements must be prepared to the same standards as apply to financial statements and directors’ reports. An application to the Authority for approval of a Schedule 16 Statement must be made in writing and should include a declaration made on behalf of the board, that the Statement is complete and includes all material information of which, in the opinion of the directors, the members should be aware. That declaration should say whether or not there have been any other merger or takeover proposals (confidential or otherwise see paragraph 3.23) and confirm that the

information about them is correct. The application should be accompanied by the following documents:

- (a) an authenticated copy of the executed amalgamation agreement or Instrument of Transfer, as the case may be;
- (b) two authenticated copies of the final draft of the Merger Document (or documents) in printer's proof form, including the Schedule 16 Statement, the board rationale, the notice of the general meeting and Merger Resolutions (including, in the case of an amalgamation, the proposed Memorandum and Rules of the successor society), any merger or transfer proposal statements as mentioned in paragraphs 3.23 and 3.24, and the directors' responsibility statements;
- (c) any other documents, such as a covering letter for the Merger Document(s) and proxy voting forms;
- (d) an assurance from the chairman of each society that the Schedule 16 Statement is complete, accompanied by a compliance schedule listing the requirements of the 1986 Act and of this chapter for a Schedule 16 Statement and indicating where in the statement of that society that requirement has been met and confirmation that all the interests of the directors and officers are included in it.
- (e) an assurance by, or on behalf, of the board that the society's systems for verification of membership records are capable of providing the information required to fulfil the relevant requirements of the 1986 Act and the Rules (see paragraph 4.15);
- (f) a letter of comfort from the society's external auditors as specified in paragraph 3.7;
- (g) the appropriate fee as specified in the current Fees Rules;
- (h) confirmation that the final draft as submitted for approval does not differ from that previously seen by the Authority or, where it does, indicating each change that has been made.

3.30 The Authority's approval of the Schedule 16 Statement will be confirmed by returning to the society one authenticated copy of the Statement with the Authority's certificate of approval signed by an authorised signatory for the Authority. There is no statutory requirement for copies of Schedule 16 Statements to be placed on the public files of societies but, because the documents are in the public domain, it is the Authority's practice to pass copies to the Central Office for filing. Were a public announcement about the merger not to be made until after the Authority had approved the Schedule 16 Statement, the Authority would not pass a copy of the Statement to the Central Office until after the announcement. The supporting documents listed above will not be passed to the Central Office.

4. GENERAL MEETINGS AND RESOLUTIONS

This section describes the requirements of the 1986 Act concerning members' entitlement to vote, the register of members and the sending of notices of meetings. It also discusses general meeting arrangements, the resolutions and majorities required and the counting of votes. Finally, it gives guidance on the discretion which the Authority may exercise in these matters. The directors of each society must satisfy themselves that they observe the general law on meetings, the relevant provisions of the 1986 Act and their own Rules.

Resolutions and Voting Majorities

4.1 The 1986 Act provides that a merger must be approved by the requisite Merger Resolutions (Sections 93(2)(c) and 94(2) and (5)(a)) as follows

- (a) **a shareholding members' resolution** (see definition in paragraph 27A of Schedule 2 to the 1986 Act) passed on a poll by a majority of at least 75% of shareholders qualified to vote and voting; and
- (b) **a borrowing members' resolution** passed on a poll by a simple majority of borrowing members qualified to vote and voting (see definition in paragraph 29(1) of Schedule 2 to the 1986 Act);

provided that, in each case, notice has been duly given that the resolution is to be moved as a shareholding members' resolution or a borrowing members' resolution, as the case may be. A member may vote either in person at the meeting or by appointing a proxy (paragraphs 27A(b) and 29(1) of Schedule 2 to the 1986 Act do not provide that the voting on these may be conducted by postal ballot).

4.2 In the case of a **partial transfer of engagements**, in addition to the approval of the members as a whole by passage of the shareholding members' resolution and borrowing members' resolution described above, the society must obtain the approval of an "affected shareholders' resolution", which must be passed by the majority of the affected shareholders eligible to vote; that is, those shareholders in respect of whose

shares it is proposed that the engagements should be transferred (Section 94(3) and (4)) of the 1986 Act. But note that the resolution must be passed by a majority of the affected members eligible to vote, not just a simple majority of those who actually do vote.

4.3 Section 96(1) of the 1986 Act provides that, where a society wishes to pay **compensation** to directors or other officers for loss of office or diminution of emoluments, such compensation must be approved by a special resolution of the society's members (see also paragraph 2.12), separate from the Merger Resolutions. The special resolution must be passed by a majority of at least 75% of those qualified to vote and voting. The Treasury has not made regulations under Section 96(2) of the 1986 Act to set limits below which compensation may be paid without the authority of a special resolution. Therefore, in every case where compensation is proposed, the members must vote on the proposal as a separate issue from whether they approve the merger itself. "Other officers" include, in addition to the Chief Executive and Secretary, any persons who exercise managerial functions under the immediate authority of a director or the Chief Executive of a society (Section 119 of the 1986 Act defines "manager" and "officer").

4.4 The **members' approval of bonus payments** is required as part of the Merger Resolutions (see Section 96(4) to (6) of the 1986 Act) and see paragraph 2.11 for the Authority's view of what may constitute a bonus). If the total gross cost of the proposed bonus(es) (i.e. without any adjustment for prospective corporation tax recovery) is within the prescribed limit, then approval for it need only be included in each of the Merger Resolutions of the society whose funds are to be distributed. If it exceeds that limit then it must be included in each of the Merger Resolutions of each participating society. The prescribed limit was changed by the Building Societies (Mergers) (Amendment) Regulations SI 1995/1874 amending SI 1987/2005 and now is:

- (a) in either a full transfer of engagements or an amalgamation, 5% of the total assets, as stated in the Schedule 16 Statement, of the society to whose members the bonus is to be paid;
- (b) in a partial transfer of engagements, 5% of the share liabilities, as given in the Schedule 16 Statement, to be transferred;

or a sum equal to the society's reserves after deducting its fixed assets (apportioned pro rata in respect of 4.4(b)), whichever is the less. The Regulations should be consulted for the full detail of the calculations.

Entitlement to Vote

- 4.5 Paragraph 5 of Schedule 2 to the 1986 Act provides that no person may be a member of a building society unless he or she is a shareholding member or a borrowing member. A shareholding member is a person who holds a share in the society (that is, an investment in a share account or PIBS). A borrowing member is a person who is indebted to the society in respect of a loan fully secured on land. However, the Rules may provide that borrowing membership is conferred by a loan substantially secured on land, or shall cease if the loan is foreclosed or the land is taken into possession by the society. A minor (that is a person under 18 years of age) may be a member, but may not vote on any resolution.
- 4.6 The mandatory provisions of Schedule 2 to the 1986 Act concerning a member's entitlement to vote on a resolution, which must be reflected in societies' Rules, are that the member must be a member on the voting date, must have been a member at the end of the last financial year before the voting date (paragraph 23(1) of Schedule 2) and must have attained the age of 18 years (paragraphs 5(3) and 34(2) of Schedule 2) on or before the date of the meeting. So far as borrowing members are concerned, the member is not entitled to vote in that capacity if his indebtedness to the society at any relevant date is less than £100 (paragraphs 29(2) and 36 of Schedule 2).
- 4.7 However, Schedule 2 specifies the following further provisions, some, none or all of which **may** be included in a society's Rules with respect to the **entitlement of shareholding members to vote** on any resolution; a person must (see Schedule 2 paragraphs 23(3) to (5) and 36):
- (a) have a qualifying shareholding (which must not be set higher than £100), in one or more share accounts or PIBS, on the "qualifying shareholding date";
 - (b) hold shares on the voting date; and
 - (c) have held shares continuously between those two dates.

4.8 The “**qualifying shareholding date**” is either the last day of the financial year preceding the voting date or, if the voting date falls during that part of a financial year which follows the conclusion of the society’s Annual General Meeting commenced in that year, the first day of the period beginning 56 days before the date of the meeting. Therefore, if a society’s Rules, following the BSA Model Rules (Fifth Edition), include the provisions concerning shareholding and continuity of membership described in paragraph 4.7, **and if the voting date is later than the AGM in that year**, a person to be entitled to vote on a shareholding members’ resolution must:

- (a) have been a shareholding member on the last day of the previous financial year;
- (b) have held shares to the value of at least £100 on the day 56 days before the date of the meeting;
- (c) have held shares continuously from the 56th day through to the voting date;
and
- (d) hold shares on the voting date

But note that there is no requirement for continuity of shareholding between 4.8(a) and (b). (In contrast, in the case of an ordinary or special resolution, membership at 4.8(a) may be satisfied by either borrowing or shareholding membership provided the shareholding member satisfies the other conditions of 4.8(b) to (d) in order to vote in his or her capacity as a shareholder.) Note also that a person cannot meet a requirement for “holding shares” on a given date, or during a given period, by relying on his holding of a share account with an overdrawn balance; and a person cannot meet a requirement for being a “member” on a given date (for example, at 4.8(a)) by relying on his holding of such a share account.

4.9 The mandatory provisions of Schedule 2 to the 1986 Act concerning **entitlement to vote on a borrowing members’ resolution** are, as noted above, that the member must have been, and be, indebted to the society for at least £100 (whether on one or

more accounts) at the end of the last financial year before the voting date, and on the voting date, in respect of an advance fully secured (or, if the Rules permit, substantially secured) on land (paragraphs 5(2), 23(1), 29(2) and 36 of Schedule 2) and have attained the age of 18 years by the date of the meeting (paragraphs 5(3) and 34(2) of Schedule 2). But note that there is no dispensation in the 1986 Act for the Rules to reduce the qualifying amount below £100, nor to provide for a continuity of membership qualification.

4.10 Schedule 2 makes provision in respect of **joint shareholders** (paragraph 7) and **joint borrowers** (paragraph 8). The only person entitled to exercise the right to vote on behalf of the joint shareholders or joint borrowers is the one who is named first in the records of the society, described respectively as the “representative joint (share)holder” or the “representative joint borrower”.

4.11 A member may vote once only on any resolution, irrespective of the number of accounts he or she may hold. The amount of the balance(s) held on an account(s) is not material, except to qualify to vote (see paragraphs 4.7 and 4.8). Thus, a member with several share accounts and/or several mortgage accounts, whether as sole and/or representative joint shareholder or representative joint borrower, may vote once only on any resolution. When the membership votes as a whole on an ordinary or a special resolution, each member may vote only once, whether he or she is a shareholding or a borrowing member or both. Where shareholding members and borrowing members vote separately, as on the Merger Resolutions, members entitled to vote may vote only once, if a shareholding member, on the shareholding members’ resolution and once, if a borrowing member, on the borrowing members’ resolution. A person entitled to vote both as a shareholding member and as a borrowing member may, of course, vote once on each resolution.

4.12 The “**voting date**” is defined by paragraph 23(6) of Schedule 2 as, for this purpose, either:

- (a) for members who appoint a proxy, the last date specified by the society for the receipt of proxy voting forms, which may not be more than 7 days before the

date of the meeting (paragraph 24(6) of Schedule 2). A proxy vote remains valid if the member ceases to be a member after the proxy voting date but before the date of the meeting (paragraph 24(2) of Schedule 2); or

(b) for all other members, the date of the meeting.

4.13 The guidance given in the foregoing paragraphs of this section is intended to give a general description of the provisions of the 1986 Act and of the Rules suggested by the BSA Model Rules. Societies should satisfy themselves that they observe the specific provisions of the 1986 Act and of their own Rules.

Register of Members

4.14 Every society is required to maintain a register of the names and addresses of its members and whether each member is a shareholding member or a borrowing member or both (paragraph 13 of Schedule 2 to the 1986 Act). The register should, so far as possible, be “de-duplicated”; that is, multiple account holders should be identified and their names recorded once only in the register. A society’s systems must also be capable of recognising those members who are eligible to vote by, for example, aggregating share account balances of multiple account holders to check that they have the requisite qualifying shareholding, by checking members’ continuity of shareholding (if and where applicable), and by identifying minors including (separately) those who will shortly attain their majority (see paragraphs 4.6 and 4.9). Other situations requiring careful consideration are, for example, in relation to powers of attorney, personal representatives, and death of the representative joint holder or borrower. This information is required to ensure that the notice of the meeting is sent to all the members entitled to receive it and so that the scrutineers have adequate systems to validate the votes cast on the Merger Resolutions (see also paragraph 4.20).

4.15 It will be necessary for the directors of a society contemplating a merger to satisfy themselves, in consultation with their external auditors, that the society’s systems are capable of delivering the information described above. The Authority will require an assurance on this point when the society applies for approval of the Schedule 16 Statement (see paragraph 3.29(e)). One of the criteria which the Authority has to consider at the confirmation stage is whether some relevant requirement of the 1986 Act or the Rules was not fulfilled (see paragraphs 5.15 to 5.19).

- 4.16 The problem of avoiding duplication in the register of members is significant for most societies of any size. It has been aggravated by the proliferation of types of account over the last decade or so. Societies generally now seek to establish, when new accounts are opened, whether or not the applicant is an existing member and, if so, which accounts are relevant to voting and other membership rights. The task of identifying multiple account holders is complicated by confidentiality requirements. For example, if two accounts are held by a Mr A Smith and a Dr A Smith, both at the same address, the society cannot know (in the absence of other information such as date of birth) whether the two accounts belong to the same person, one opened before and one after he qualified, or by the doctor and his son. A letter of enquiry to one asking about both accounts would risk breaching customer confidentiality. If it is the same person, there is a risk that he will be given the opportunity to vote twice or, if neither account holds more than £100 but they aggregate above that qualifying amount, be denied a vote to which he is entitled.
- 4.17 Where a society identifies a number of accounts which appear to be held by a single member, but it cannot be sure, then it must send separate meeting notices in respect of each account. However, its systems should identify the possible multiple holding so that, if more than one vote is received in respect of that group of accounts, the scrutineers are alerted to the possibility, and can check the proxy forms for evidence of invalid duplicate votes. The voter's declaration suggested by the BSA, in conformity with paragraph 34 of Schedule 2 to the 1986 Act, provides some protection against votes being cast by minors, and attempts the same for duplicate votes (see Enclosure 2 to BSA Circular 5177). It is, however, the duty of each society to make sure that its register of members is reliable.

General Meeting Arrangements

- 4.18 Paragraphs 4.19 to 4.34 consider the requirements for sending notices of meetings and Schedule 16 Statements to members, and the conduct of meetings at which Merger Resolutions are to be moved. It is for societies to satisfy themselves that they comply with the relevant requirements of the 1986 Act, their Rules and the general law on meetings.

Notice of Meeting

- 4.19 The statutory requirements concerning notices are in paragraph 22 of Schedule 2 to the 1986 Act. Notice of the meeting must be given to each shareholding and borrowing member of the society who would be eligible to vote at the meeting if the meeting were held on the date of the notice (a single date for all notices irrespective of when they are despatched). In addition, notice must also be given to any person who will attain the age of 18 years after the date of the notice but on or before the date of the meeting, and to every person who becomes a shareholding or borrowing member of the society after the date of the notice but before the final date for receipt of proxy voting forms, and who would, in either case, be eligible to vote at the meeting if he remained a member until then. (In practice, this may mean sending out a notice to every such person, even if they will, in fact, not be entitled to vote). The Schedule 16 Statement must be sent in or with the notices (paragraph 1(2) of Schedule 16 to the 1986 Act). Accidental omission to give notice of a meeting to any person entitled to receive it does not invalidate the proceedings at the meeting. However, “accidental omission” does not include a systemic failure to send notices (e.g. omitting to send notices to new members, or omission of a group or class of members from the mailing list arising from a fault in a computer programme), nor all cases of error by management - see also paragraph 4.39.
- 4.20 The 1986 Act also provides, in paragraph 21 of Schedule 2, for the **length of notice** to be given to members. The period of notice given must be not less than 21 days or such longer period as the society’s Rules prescribe. The precise procedures for sending notices, the way in which the days are to be counted, and presumed receipt of notices duly sent, will normally be set out in the Rules. Particular points to note are:
- (a) the 21 days’ notice expires with the closing date for the receipt of proxy voting forms, not the date of the meeting;
 - (b) if reliance is to be placed on a provision in the Rules that notices can be deemed to be served 24 hours after posting, then first class post or equivalent means of delivery should be used, but it is advisable to allow a margin of at least an extra day or two, or more if second class post is used;
 - (c) if a society contracts with a commercial mailing firm, it must ensure that the firm is comprehensively instructed about the society’s despatch and delivery requirements, and the society should carry out spot checks to satisfy itself that

its instructions are being properly carried out. A failure by the contractor may invalidate the meeting, even if the society itself has used its best endeavours to police the operation.

- 4.21 The Schedule 16 Statement is required, by paragraph 1(2) of that Schedule, to be sent “**in or with**” the notice of the meeting to every member entitled to that notice. As is suggested in paragraph 3.4, it may be expedient to include both in a comprehensive Merger Document.
- 4.22 Notices and Statements need not be sent to any member in whose case the society has reason to believe that communications sent to him at his registered address are unlikely to be received by him (paragraph 14 of Schedule 2 to the 1986 Act). However, a society is required instead to place notices of the meeting prominently in every branch office, or to place advertisements in newspapers circulating in the areas in which the society’s members live. Such notices or advertisements must be placed at least 21 days before the date of the meeting, and must state where members can obtain copies of the Schedule 16 Statement, the Merger Resolutions and proxy voting forms (Schedule 2, paragraph 35(4)).
- 4.23 It should be noted, however, that a member’s “registered address” may not be the address shown in the society’s register of members but a different address to which the member has requested that communications from the society be sent (Schedule 2, paragraph 13(4)).

Conduct of the Meeting

- 4.24 The meeting should be held at a time and place considered by the board to be most convenient for the generality of the society’s members. This may well not be the same as the traditional time and place for the annual general meeting. In deciding on this, the board should take account of the geographical location of their members. For example, for a society with a majority of its members living in a compact geographical region there must be a strong presumption in favour of an evening meeting. Consideration should be given to the possibility of a larger attendance than usual at a meeting to consider a merger.
- 4.25 Subject to the society’s Rules, its chairman will normally chair the meeting. His function as chairman of the meeting is to ensure that all views are presented and properly discussed. He is unlikely to be able to fulfil that role if he acts also as chief

advocate of a merger which is controversial among members. In such cases it might be appropriate to give to another director the initial task of explaining the merger and of responding to questions from members.

- 4.26 Merger Resolutions or the other resolutions mentioned in paragraphs 4.1 to 4.3, cannot be amended at the meeting except in a way which does not change their substance at all. This is because an amendment to such a resolution has to be subject to the same procedure and period of notice to members as the resolution itself. If a board decides, after due notice of such a resolution has been sent to the members, that the resolution should be amended, then it will be necessary to submit the amended resolution, with due notice, to a general meeting at a later date, unless of course there is still time to fulfil the notice requirements.

Conduct of the Voting

- 4.27 The conduct of the voting must not only be fair but also be seen to be fair, otherwise the result may be called into question. So it is highly desirable that the votes are counted by independent scrutineers. The board may ask the scrutineers, in advance of the meeting, for a running tally of the number of votes being cast if it thinks it might properly encourage more members to vote if the response is low. However, to ask the scrutineers **how** the votes are being cast, before the time comes at the meeting to instruct proxies, carries the risk of accusations, however unfounded they may be, and possible challenge at the confirmation stage, that the board suppressed proxy votes against the resolutions, or unduly influenced members to vote in favour. A board which asks the scrutineers for a running tally of votes, and which circulates its members with further exhortations to vote, must be prepared to argue its case in the face of such accusations at the confirmation hearing. Any circular to members sent after the Merger Document must, therefore, be very carefully considered.
- 4.28 Experience has demonstrated the need for societies to take the greatest care to ensure that they comply strictly with the statutory procedural requirements and their own Rules on meetings and resolutions. The chairman of the meeting should ensure that he or she is well briefed and aware of the Rules and the general law relating to procedural resolutions, such as resolutions to adjourn the meeting. The Authority will require a confirmatory report from the scrutineers on the validity of the voting procedures when the society applies for confirmation (see paragraph 4.38).

4.29 The procedures for the conduct of proxy voting will normally be provided for in the society's Rules, in conformity with paragraphs 24 and 34 of Schedule 2 to the 1986 Act which requires that every proxy form sent by a society to its members must enable the member to direct the proxy how to vote (Schedule 2 paragraph 24(4A)). To minimise the risk of the society's proxy voting procedures being misunderstood, the Authority recommends that the proxy form should include:

- (a) adequate space to insert the name of a proxy other than the chairman of the meeting, and a statement (which must also appear in the notice of the meeting) that the proxy appointed need not be a member of the society (a reminder that the voting member's own name should **not** be inserted might avoid a common problem);
- (b) provision to instruct the proxy to vote either in favour of the resolution, or against it;
- (c) an explicit statement that if the member does not instruct the proxy to vote for or against the resolution, then the proxy will cast the vote, or abstain, as he or she thinks fit;
- (d) the declaration in accordance with paragraph 34 of Schedule 2;
- (e) full recital of the text of the shareholding members' resolution or borrowing members' resolution or, if this is not practicable (e.g. because of space restrictions), a clear indication that the full text may be found in the notice of the meeting;
- (f) instructions as to the return of the completed proxy forms, including the last date for receipt by the society or by the scrutineers. A pre-addressed and pre-paid envelope or other sealed means of return should be provided.

4.30 The 1986 Act does not require societies to send proxy voting forms to members with notices of meetings (except where directors are to be elected). However, the Authority believes that, on a matter as important as a merger, societies would be well advised to send a proxy voting form to members with the notice of meeting. This will avoid any suggestion that members were discouraged from voting, that obstacles were put in their way, or that the society wished (for whatever reason) to be able to identify those who had requested proxy voting forms. If a society decides, nevertheless, not to

send proxy forms to members entitled to vote, then it should make clear to the members that proxy voting forms can be obtained on demand from its branches and/or by application to a central point.

- 4.31 The arrangements for the collection of the proxy forms should be such as to secure confidentiality and to avoid the risk of loss, whether accidental or deliberate. The procedures may provide for return of proxy forms to the scrutineers either directly (if permitted by the society's Rules) or to the society's offices. Where proxy forms are returned to the society's offices, the Authority recommends that the procedures should incorporate the following features:
- (a) the proxy form should be enveloped or otherwise sealed so that the members' voting instructions are concealed;
 - (b) the envelope provided should be clearly marked so that the society can readily identify and separate it from other mail without the envelope being opened;
 - (c) staff responsible for receiving and sorting mail should be given specific instructions about the handling of proxy forms and the overriding importance of security;
 - (d) secure storage of proxy forms should be provided up to the point at which they are handed over to the scrutineers;
 - (e) equivalent handling and security procedures should be applied to proxy forms handed in at branches.
- 4.32 The Authority suggests that proxy voting forms for shareholders and borrowers should be easily distinguishable, perhaps by colour coding, both as an aid to members who may be entitled to vote in each capacity, and as an aid to the scrutineers counting the votes.
- 4.33 Members may, after submitting a proxy vote, choose to attend the meeting and vote in person. There must, therefore, be satisfactory systems in place at the meeting to identify and cancel any proxy votes they may have returned.

Postal Ballots

- 4.34 Paragraph 33 of Schedule 2 to the 1986 Act specifically excludes shareholding members' resolutions and borrowing members' resolutions from its permission for the Rules to provide for voting by postal ballot. This is reinforced in the definition of these resolutions in paragraphs 27A and 29 of Schedule 2. Although other resolutions associated with the merger process might be capable of being approved by postal ballot, in practice voting on all resolutions related to the merger will be by members voting in person or by proxy at a general meeting.

Scrutineers' Report

- 4.35 The scrutineers are responsible for checking the validity of votes cast in person and by proxy. Given the need to ensure that the vote represents the views of the members, the scrutineers should be independent of the society and should not have a direct interest in the result of the voting. It will usually be appropriate to appoint the society's auditors, and it is desirable that they should be appointed not just for the arithmetical count of votes but also to supervise the voting process as a whole so that they are in a position to confirm, after the vote, that all the requirements of the 1986 Act and the society's Rules have been complied with. This would include:
- (a) determining and validating member mailing lists for notices of meetings and Schedule 16 Statements;
 - (b) despatch procedures;
 - (c) timing of notices and despatch of documents;
 - (d) form and content of proxy voting forms;
 - (e) receipt and custody of completed proxy voting forms;
 - (f) validation of completed proxy voting forms to establish that members are qualified to vote and that forms are properly completed;
 - (g) identification and validation of members attending and voting at the general meeting;

- (h) voting procedures at the meeting including casting of proxy votes, count of votes cast in person and aggregation of proxy and personal votes.

4.36 To fulfil the duties outlined above, it is suggested that the scrutineers would need to:

- (a) examine the systems and procedures to be employed by the society, before they are implemented, to ensure that they are satisfactory;
- (b) carry out such checks and tests as they consider necessary during the operation of the procedures as will enable them to be satisfied that the specified procedures are being carried out in practice;
- (c) provide that where validation functions are carried out by the society's staff this is done under the direction and supervision of the scrutineers;
- (d) direct and supervise the count of the votes cast both by proxy and personally at the meeting.

4.37 Validation checks during the counting of votes may be expected to include the following:

- (a) only proxy forms which comply with the 1986 Act and the society's Rules have been used;
- (b) the member is eligible to vote under the 1986 Act and under the society's Rules (a proxy vote may still be valid even though the member ceases to be a member after the closing date for receipt of proxies - see paragraph 4.12 (b));
- (c) only one proxy form per member eligible to vote is included in the count (separate forms may be sent to and returned by a person eligible to vote on both a shareholding members' resolution and a borrowing members' resolution);
- (d) minors are excluded or that there is an explicit confirmation by each member voting by proxy that he is aged 18 or over;
- (e) the proxy form is completed and signed and is otherwise valid (where a proxy voting form lacks a signature but is otherwise valid, it is usual, if time permits,

for the scrutineers to return the form to the member for signature and return in a pre-paid envelope).

4.38 The scrutineers' initial report will be made to the society at the meeting (which may be adjourned for this purpose). The Authority will require, in support of a society's application for confirmation under Sections 93(2)(d), 94(7)(a) and 95(3), a report from the scrutineers on the result of the vote (distinguishing between votes cast in person and by proxy), the total number of members eligible to vote (and the proportion of that number that the votes cast represent), and also confirmation that, in the opinion of the scrutineers the arrangements for the conduct of voting were such as to ensure that:

- (a) notices of the meeting and Schedule 16 Statements were sent to all those entitled to receive them, in accordance with the 1986 Act and the Rules of the society having regard, among other things, to the matters referred to in this chapter;
- (b) the periods of notice given complied with the requirements of the 1986 Act and of the society's Rules, taking into consideration established conventions for the counting of days;
- (c) there were satisfactory procedures to ensure confidentiality of proxy voting forms and to minimise the risk of loss or unauthorised access;
- (d) there were satisfactory procedures to ensure that the count of votes cast personally at the meeting included only votes cast by members eligible to vote and who had not mandated, or had withdrawn, a proxy vote.

4.39 In relation to the notice of the meeting, the scrutineers' report may properly have regard to the provision of paragraph 22(3) of Schedule 2 to the 1986 Act that "accidental omission to give notice of a meeting to, or non-receipt of notice of a meeting by, any person entitled to receive notice of the meeting shall not invalidate the proceedings at that meeting". It should be noted, however, that there is authority to the effect that "accidental" and "non-receipt" would not cover all cases of "error" on the part of the society, for example an erroneous decision of management not to send notices to particular persons or groups of persons.

4.40 The Authority would find it helpful if the scrutineers' report would also comment upon any procedural difficulties encountered and give an analysis of the reasons why

votes were found to be invalid, if the numbers of invalid votes appear to be significant (see also paragraph 5.14).

The Authority's Discretion

- 4.41 The Authority has power under Section 94(5)(b) of the 1986 Act to exempt the transferee society in a transfer of engagements from the duty to call a meeting and put a Schedule 16 Statement and Merger Resolutions to its members, but to proceed instead by board resolution (see paragraph 1(1) of Schedule 16 to the 1986 Act). Before it exercises this discretion the Authority will wish to review the prudential information described in section 2 and, in particular, will wish to be satisfied that the merger will not affect the interests of the members of the transferee society to any significant extent. The Authority will also wish to know whether the merger will mean a change of policy by the society, for example by a significant move into a new geographical area or into a new business activity. Unless it is persuaded otherwise in the circumstances of any particular case, the Authority will not normally grant this exemption unless the total assets of the transferee society are substantially larger than the total assets of the transferor society, and a total asset ratio of 5:1 will be used by the Authority as a broad first measure of relative significance. The general presumption will be that a society, being a mutual institution, should consult its members over an issue as important as a merger unless there are compelling arguments to the contrary.
- 4.42 However, if the transferor society proposes to pay bonuses in excess of the prescribed limit (see paragraph 4.4) then, notwithstanding that the Authority has granted an exemption, the transferee society must seek the approval of its members of a resolution on the terms of the merger (Section 96(4)(b) of the 1986 Act). Similarly, if the transferee society has to change its Rules to avoid disenfranchising members of the transferor society (see paragraph 3.16) it must do so by special resolution. It would be wrong to invite the members to approve a Rule change which was a consequence of a merger without inviting them to approve the merger itself.

5. CONFIRMATION

No merger can take effect until it has been confirmed by the Authority. This section describes the form of application and public notice required and explains the Authority's view of how the statutory Confirmation Criteria should be interpreted. Finally, it gives guidance on the procedure customarily followed by the Authority when considering confirmation applications and hearing representations.

Application

- 5.1 Section 93(2)(d) of the 1986 Act, on amalgamations, and Section 94(7)(a), on transfers of engagements, together with paragraph 7 of Schedule 16, provide that when the necessary Merger Resolutions have been passed the societies concerned must apply to the Authority for confirmation of the merger in such manner as the Authority may direct. The societies are also required, by paragraph 8 of Schedule 16, to publish notices of their applications in one or more of the London, Edinburgh and Belfast Gazettes as the Authority directs, and if it so directs, in one or more newspapers. The choice of official Gazettes and national or local newspapers will, of course, have regard to the area in which the societies' members live.
- 5.2 The parties in an amalgamation should make a joint application for confirmation to the Authority, while the parties to a transfer of engagements should make separate applications for confirmation of the transfer. These applications should specify the date on which the merger is intended to take effect and should be accompanied by two authenticated copies of the Instrument of Transfer, or the amalgamation agreement, and of the Merger Document or separate Schedule 16 Statement. In addition, in the case of an amalgamation, three signed copies of the Memorandum and Rules of the successor to the amalgamating societies should be sent to the Central Office. The scrutineers' report described in paragraphs 4.38 to 4.40, and a certified copy of the minutes of the general meeting at which the Merger Resolutions were moved, must be enclosed with each application.
- 5.3 A pro forma public notice of application, and pro forma letters of application are set out in Annex B.

The Confirmation Criteria

Statutory Provisions

- 5.4 Section 95(3) and (4) of the 1986 Act provides that the Authority must confirm an amalgamation or transfer of engagements **unless** it considers that any one or more of the following Three Criteria apply:
- (a) some information material to the members' decision about the merger was not made available to all the members eligible to vote; or
 - (b) the vote on any resolution approving the merger does not represent the views of the members eligible to vote; or
 - (c) some relevant requirement of the 1986 Act or of the Rules of any of the societies was not fulfilled.

Section 95(5) then provides that the Authority shall not be precluded from confirming a merger by virtue only of the non-fulfilment of some relevant requirement of the 1986 Act or the Rules (the Third Criterion in 5.4(c)) if it appears to the Authority that the failure could not have been material to the members' decision about the merger, and the Authority gives a direction under that sub-section that the failure is to be disregarded.

- 5.5 Where the Authority would be precluded from confirming a merger by reason of any of the defects specified in the Three Criteria, Section 95(6) provides that it may direct a society to remedy the defects. A direction under that sub-section may require a society to call a further meeting; for example, to vote again in the light of a revised Schedule 16 Statement containing material information previously omitted, or after correction of defects in the systems for sending notices of meeting and Statements and validation of votes. If the Authority is then satisfied, having considered evidence furnished by the society, that the defects have been substantially remedied, it must confirm the merger. If not, then confirmation must be refused.

Scope of the Authority's Powers

- 5.6 The Authority's powers in connection with applications for confirmation of a merger are confined to considerations of whether, in the light of the facts, any of the Three

Criteria apply. It is not for the Authority to consider, or make judgements about, the merits of a proposed merger or the fairness of its terms; these matters are first for the board of a society, and then for its members to decide. Once the members have approved the merger and its terms, the Authority has no powers to require a society to make any changes to those terms. The Authority's discretionary powers are similarly confined to the matters described in paragraphs 5.4 and 5.5.

- 5.7 The Authority has no general power to determine disputes between a society and its members. Disputes concerning the services provided by societies in the ordinary course of their business are generally a matter, in the first instance, for a society's internal complaints procedure. They may also fall within the jurisdiction of the Financial Services Ombudsman. Disputes between a building society and a member of the society, in his capacity as a member, in respect of any rights or obligations arising from the Rules of the society or the provisions of the 1986 Act, fall within the jurisdiction of the High Court or, in Scotland, the Court of Session (Section 85 of and Schedule 14 to the 1986 Act). However, the Authority does have power, on the written application of an eligible member, to direct that the member has the right to obtain names and addresses from the society's register of members. Before it gives such a direction, the Authority is required to be satisfied that the member requires that right for the purpose of communicating with members of the society on a subject relating to its affairs, and must have regard to the interests of the members as a whole and to all the other circumstances (Schedule 2, paragraph 15). A fee is payable by the applicant. Chapter 1 on applications for access to the register of members explains who is eligible to apply.

Purpose of Confirmation

- 5.8 The purpose of the confirmation process is to enable:
- (a) interested parties to make representations with regard to the Three Criteria;
 - (b) the society to respond to those representations;
 - (c) the Authority to make such enquiry as it considers necessary to reach informed conclusions on the Three Criteria.
- 5.9 The Authority, in reaching its view on each of the Three Criteria, has to assess not only the points made to it in representations, and the society's responses, but also to

make such further enquiries as it considers necessary. In deciding how far it should pursue such enquiries, the Authority has to have regard to the role and effect of confirmation, and to the mischief which it is intended to prevent. The Authority considers that one role of confirmation is to provide a protection to members against the provision to them by the society of information which is inadequate, obscure or misleading, and against voting irregularities: in other words to ensure that the vote represents the informed decision of the members. The Authority would hope that this safeguard would work in the majority of cases by raising relevant issues early - by causing the board of a society to take care **not** to put confirmation at risk on this account - rather than by the Authority finding that it needed to withhold confirmation at the last stage. In considering the First Criterion, the Authority will have regard to the totality of the information provided to the members by the board of a society and not exclusively to the Schedule 16 Statement.

5.10 The task of the Authority is accordingly:

- (a) to reach a considered view on each of the Three Criteria;
- (b) if that view is that none applies, to confirm;
- (c) if either of the First Two Criteria apply to direct the appropriate remedial action, or to refuse confirmation;
- (d) if the Third Criterion applies, to consider whether it is appropriate to direct that any failure be disregarded: if not, to direct the appropriate remedial action or to refuse confirmation.

In considering the Three Criteria, the Authority may well have to look again at the Schedule 16 Statement, or at issues which were considered in connection with approving that Statement. In doing so, it has a duty to consider information and arguments put to it by representers and by the society, which of their nature were not available earlier, as well as those arising from its own further consideration of the criteria. The Authority would clearly only change the view reached at the time of approval of the Schedule 16 Statement if there were good reasons to do so. But it is under a duty to examine the Statement and connected issues at the time of confirmation in the light of any new information and arguments which become available. Accordingly, the Authority cannot be bound at the confirmation stage to the

view that was taken at the earlier stage as to whether further factual information should be included in the Schedule 16 Statement or as to the accuracy of its contents.

- 5.11 The task of considering each of the Three Criteria is still necessary even if there are no representations. Without such enquiry and consideration the confirmation process would not properly be carried out. The Authority's view of how the Three Criteria should be interpreted and applied is given in the following paragraphs.

The First Criterion

- 5.12 This criterion requires the Authority to consider whether some material information was not made available to the members. The Authority's own view, in which it concurs with the view developed by the Commission in its confirmation decisions, can be summed up as follows:

- (a) the words “**made available to all the members eligible to vote**” mean that the criterion is mainly, if not exclusively, directed to the information provided by a society to the generality of its members;
- (b) the extent of “**information not made available**” can reasonably be assessed by considering how far the totality of information made available falls short of what might be expected to be put to its members by a financial institution of standing and repute seeking to put sufficient information and a fair and balanced assessment of it, and the board's conclusions, to the members to enable them to take an informed decision;
- (c) the words “**material to the members' decision**” require the Authority then to focus on whether it is within the bounds of reasonable possibility that the members' decision would have been different, had any deficiency in information been made good, i.e. whether it could have changed the decisions on voting of sufficient members to lead to a different conclusion. If it is within the bounds of reasonable possibility that the deficiency might have changed the outcome, it is not for the Authority to determine whether it would actually have done so - it should put the decision back to the members. This test requires the Authority to take account both of the size of the vote and of the size of the majority within it;

- (d) the relevance of a particular piece of information to an investor and to a borrower may well be different. Accordingly, it is necessary to consider materiality separately in relation to the shareholding members' resolution and the borrowing members' resolution.

5.13 The Authority's approach to determining whether this criterion is met will accordingly be:

- (a) to review the material put to members, in the light of the members' representations made and the society's responses, but also taking points of its own accord;
- (b) to consider, on the basis of that review, what information relevant to the decision of shareholders, or of borrowers, or both, might reasonably have been expected to be put to members by the board of a society of repute considering its fiduciary duty, and the extent to which (if at all) the information actually put falls short of that;
- (c) to consider separately in relation to the shareholding members' resolution and in relation to the borrowing members' resolution, whether any deficiency so identified was sufficient to amount to "information material to the members' decision".

The Second Criterion

5.14 This criterion requires the Authority to consider whether the votes on the Merger Resolutions do not represent the views of the members. The main mischief to which it appears to be directed is a merger approved by a small and unrepresentative vote. However, a very low turnout, of itself, does not necessarily mean that the criterion applies. It has to be considered in the context of the other criteria, and of any other factors which may have affected the turnout: for example, whether all the members entitled to vote were fully and clearly informed of the terms of the merger proposal and its consequences; whether the members were afforded adequate facilities and opportunity to cast their votes; and the scrutineers' report on the conduct and counting of votes, including the number of, and reasons for, invalid proxy votes.

The Third Criterion

5.15 This criterion requires the Authority to consider whether the relevant requirements of the 1986 Act and the Rules have been fulfilled. The phrase “**some relevant requirement of this Act or the rules of the society**” appears explicitly three times in Section 95 of the 1986 Act:

- (a) sub-section (4)(c) in the specification of this criterion;
- (b) sub-section (5) which gives the Authority power to disregard certain non-fulfilments;
- (c) sub-section (10) which provides that a failure to meet such a relevant requirement shall not invalidate a transfer of engagements, although such failure by a society without a reasonable excuse is a criminal offence.

The interpretation of the phrase is also directly relevant to sub-section (6) - the power of the Authority to give the society a direction to remedy defects specified in paragraphs (a) to (c) of sub-section (4).

5.16 Sub-section (11) defines “relevant requirement”:

“In this section “relevant requirement”, with reference to this Act or the rules of a society, means a requirement of section 93 or 94 or this section or of Schedule 16 to this Act or of any rules prescribing the procedure to be followed by the society in approving or effecting an amalgamation or transfer of engagements”.

The Authority considers that this sub-section should be read naturally. The words “prescribing the procedure to be followed by the society in approving or effecting” a merger apply only to the Rules, in order to specify which of the Rules of the society are “relevant requirements”. They do not apply as a matter of normal construction of the sentence to the “applicable provisions of this Act”: nor is it necessary that they should do so, since those provisions are specified in the sub-section.

5.17 The Authority recognises that the interpretation of “relevant requirement of the Act”, which it considers stems from the natural construction of Section 95(11) of the 1986 Act and which is necessary to give effect to Parliament’s intentions for Section 95(6)

and (10), does not quite fit Section 95(5). The test which the Authority has to apply in the case of sub-section (5) to a non-fulfilment of a relevant requirement of the 1986 Act is:

“if it appears to the Authority that it could not have been material to the members’ decision about the amalgamation or transfer”.

That test clearly is designed to relate to a failure to meet a procedural requirement or to some other failure which might have an effect on the voting.

5.18 The wording of Section 95 of the 1986 Act is such that no construction of the phrase is entirely free from difficulty. The Authority’s view is that the wording, and the intentions of Parliament, are best met by following the natural construction of sub-section (11), as a result applying a wide interpretation in sub-sections (4), (6) and (10), but only considering that it is open to the Authority to make a direction under sub-section (5) in relation to non-fulfilment of a procedural requirement or other failure to which the test in that sub-section is apposite.

5.19 The Authority considers that the relevant requirements of the Rules are those which prescribe the procedure to be followed that is, in particular, the Rules concerning membership, special meetings, notice of meetings, procedure at meetings, entitlement of members to vote on resolutions, appointment of proxies and joint shareholders and borrowers.

Procedure

5.20 The procedure to be followed in the confirmation process is prescribed by Part III, paragraphs 7 to 9, of Schedule 16 to the 1986 Act. Any interested party has the right to make written representations, and/or to give notice of intention to make oral representations to the Authority with respect to a society’s application for confirmation. Written representations are to be copied to the participating societies, which are to be afforded the opportunity to comment on them in writing or orally at the hearing of their applications.

Representations

5.21 Persons making representations should state why they claim to be interested parties, for example their category of membership of the society, and the ground or grounds

for their representations by reference to the Three Criteria discussed above. Written representations, or notice of a person's intention to make oral representations, or both, must be in writing. They must reach the Authority at the address, and by the date, given in the Merger Document issued to members and subsequently published by notice in the official Gazettes and newspapers as required by the 1986 Act. Persons who make written representations and who subsequently decide also to make oral representations must, nevertheless, give notice of that intention in writing to the Authority by the same date. Representations received out of time will not be considered unless, exceptionally and at the sole discretion of the Authority, they appear to the Authority to raise matters of substance relevant to the Three Criteria which are not already under consideration.

5.22 Representations or notices to the Authority will fall into one of the following three categories:

- (a) written representations only
- (b) written representations with notice of intention to make oral representations
- (c) notice of intention to make oral representations only.

5.23 The Authority will acknowledge the receipt of each representation or notice and will send a copy of chapter 4 of this IPSB on confirmation procedures to each representer. It will send copies of all written representations to the societies concerned and will afford them an opportunity to comment on them.

5.24 Copies of the society's comments on representations in category 5.22(b) will be sent to those who made the representations so that they may concentrate their oral representations on the points which they consider to remain at issue. Persons making written representations who wish to see the society's response must, therefore, give notice of intention to make oral representations. The Authority will consider the written representations in category 5.22(a) and the societies' responses to them in advance of the date set for hearing oral representations. The society may, exceptionally, apply to put to the Authority in confidence documents which the society considers to be commercially sensitive: the Authority will decide on the merits of each case whether, and on what terms, to accept them as being confidential. Persons in category 5.22(c) will be asked to inform the Authority, in advance of the

hearing, of the subject and general grounds of the representations they intend to make and their responses will be copied to the society.

- 5.25 Interested parties may join together in making collective representations and they may also appoint a person, either one of their number or another, to represent them at the hearing. They should notify the Authority in advance if this is what they intend to do.

Conduct of the hearing

- 5.26 The Authority may appoint one or more persons to hear and decide applications on its behalf. In the absence of notices of intention to make oral representations the Authority would expect to decide the applications having regard to the written representations, the societies' responses and other information available to it, without the need for an oral hearing.
- 5.27 The Authority will notify the societies and those making oral representations of the time and place of the hearing. If there are a significant number of persons wishing to make oral representations, then the hearing may extend beyond one day and may be adjourned from time to time and from place to place. The Authority will try to advise participants of the day when they may expect to make their representations and when the societies' representatives may be expected to respond.
- 5.28 The Authority expects that hearings will be in public. Members of the general public and the press will be asked to wait outside at the outset of the hearing. The participants will then be asked if any of them has good reason to object to the admission of the general public and the press (such as, for example, the need to refer to personal financial affairs). The Authority may decide that parts of the hearing shall be in private if that appears to it to be desirable. If there are no reasonable objections, the general public and the press will then be admitted, within the limits of the space available.
- 5.29 The procedure will be informal. While all participants will be invited to speak concisely and to avoid repetition the Authority will be considerate towards those who are not professionally represented. The individual or panel taking the hearing on behalf of the Authority may question the participants as the hearing proceeds. The sequence of events will be broadly as follows:

- (a) any preliminary matters (such as the admission of the public or other procedural questions) will be dealt with;
- (b) the person(s) appointed to hear the applications will introduce the proceedings;
- (c) the representatives of the societies will be invited to present their applications for confirmation, including a description of the events at the meetings at which the Merger Resolutions were put to the members, the statement of the voting on the resolutions, as well as any other matters which they wish to introduce at that stage;
- (d) the other participants will be invited to make their representations; where appropriate the Authority would expect to call them in a list marshalled, so far as possible, by subject matter;
- (e) the representatives of the societies (or of the relevant society) will be invited to reply to, or comment on, the points made by the other participants;
- (f) the other participants will be invited to comment on the societies' replies in so far as those replies raise new issues.

5.30 The above procedure may be varied according to the circumstances at the hearing, and is intended only as a guide to the probable order of events. The hearing may be adjourned if the Authority considers that is necessary to enable facts to be checked or additional information to be obtained.

The Authority's decision

5.31 The Authority will not normally give an oral decision at the end of the hearing and may be expected to reserve its decision to be issued later in writing, setting out its reasons. Copies of the written decision will be sent to the participants and, on request, to any other person. The decision may also be published, and the Authority usually asks the Central Office to place copies on the public files of the participating societies.

6. TRANSFER OF ENGAGEMENTS UNDER DIRECTION

This section describes the Authority’s powers to direct a society to transfer all its engagements to one or more other societies and/or to proceed by board resolution, and the modified merger procedure consequently prescribed by the 1986 Act.

- 6.1 Section 42B of the 1986 Act provides that, if the Authority considers it expedient to do so to protect the investments of shareholders or depositors, it may direct a society, among other things, to transfer all its engagements to one or more other societies within a specified period (subsection (1)(a)). In such a case, or where the Authority would have directed a transfer of engagements, but for the fact that negotiations were already under way, the Authority may also direct that the approval of the transfer of engagements by the transferor society may be by board resolution rather than by Merger Resolution. In these circumstances, because neither a Schedule 16 Statement nor Merger Resolutions are required, the 1986 Act requires the society instead to send to every member entitled to notice of a meeting a statement (referred to below as a “**Merger Notification Statement**”) before it applies for confirmation of the transfer of engagements, (paragraphs 3 and 4 of Schedule 8A to the 1986 Act). Finally, in these circumstances, the First and Second Criteria concerning information made available to, and the views of, the members (see section 5) are replaced by a single criterion:

“the members or a proportion of them would be unreasonably prejudiced by the transfer;” (paragraph 5 of Schedule 8A to the 1986 Act).

- 6.2 Where a society is proceeding under a Section 42B(3) direction by board resolution, the Schedule 16 Statement is replaced by a Merger Notification Statement and a general meeting of the society is not required. The contents of the Merger Notification Statement are prescribed by The Building Societies (Merger Notification Statement) Regulations 1999 (SI1999/1215).

- 6.3 The Merger Notification Statement must have been approved by the Authority before it is sent to the members, and must be sent within the specified time limit.

Applications for approval should, in general, follow the procedure described in paragraph 3.28, and the final draft of the Merger Notification Statement should be accompanied by the relevant documents listed in paragraph 3.29, but as appropriate to the particular case and the less extensive information the statement is required to contain.

- 6.4 Section 4 (General Meetings and Resolutions) does not apply, except that the directors will need to be satisfied that the society's register of members is correct to enable the society to send Merger Notification Statements to those entitled to receive them.
- 6.5 When the board has resolved to transfer the society's engagements and Merger Notification Statements have been sent to its members, the society may apply to the Authority for confirmation of the transfer of engagements, but using an adaptation agreed with the Authority of the *pro forma* in Annex B1. The procedure described in section 5 is to be followed, including the publication of notices in the official Gazettes and newspapers and the form of application. However, the lapse of time between each stage of the procedure may be modified according to the particular circumstances of a case, and having regard to the need to protect the investments of shareholders or depositors. While a scrutineer's report will not be required, the Authority will require a report from the society's external auditors on the adequacy of the society's systems to fulfil the requirements of the 1986 Act and the Rules with regard to the sending of Merger Notification Statements. This is, of course, relevant to the Authority's consideration of the Third Criterion.
- 6.6 As is noted in paragraph 6.1, the First and Second Criteria are replaced, in those circumstances, by a single criterion as to whether the members or a proportion of them "would be unreasonably prejudiced by the transfer". Whether this special criterion applies will be a matter of judgement for the Authority to make in the light of any representations made to it and its own enquiries in respect of the particular case. It follows also that, in considering the Third Criterion, the Authority will take account of the modified procedure.

7. REGISTRATION AND DISSOLUTION

- 7.1 When the Authority has confirmed a merger (whether voluntary or under direction) it will notify the Central Office and the societies concerned.
- 7.2 **In the case of an amalgamation**, the Central Office is required to be satisfied as regards the proposed Rules, Memorandum and name of the successor society. The amalgamating societies are, therefore, advised to clear drafts of the proposed Rules and Memorandum with the Central Office at an early stage (see paragraph 3.28). When they apply to the Authority for confirmation under Section 93(2) of the 1986 Act, the amalgamating societies must also send three signed copies of the Rules and Memorandum to the Central Office (Section 93(2)(d)). If the Central Office is satisfied on these matters it will, upon confirmation, register the successor society and issue to it a certificate of incorporation specifying the date (the specified date) from which the incorporation takes effect, and will return to it one copy each of the Rules and Memorandum together with a certificate of registration. Copies are placed on the public file of the successor society.
- 7.3 On the specified date of the amalgamation, all the property, rights and liabilities of the amalgamating societies are transferred to the successor society, the successor is given such permission under Part IV of the Act as the Authority considers appropriate, and the amalgamated societies are dissolved and their registrations cancelled (Section 93, sub-sections (4), (5) and (6) and Section 103(1) of the 1986 Act). In deciding on the appropriate terms of the permission for the successor society, the Authority will have regard to the terms of the permissions of the amalgamating societies, including any limitations or requirements. It will also have regard to the business plan for the successor society.
- 7.4 **In the case of a transfer of engagements**, the Central Office will register a copy of the Instrument of Transfer of Engagements and issue a registration certificate to the transferee society. A copy of the Instrument of Transfer and the registration certificate are placed on the public file of the transferee society. On the date specified in the registration certificate, the property, rights and liabilities of the transferor society are transferred to the transferee society, by virtue of Section 94(8) of the 1986 Act, the transferor society's authorisation is revoked by the Authority, and the society itself is dissolved (Section 94(10)). The transferor society's registration is subsequently cancelled by the Central Office under Section 103(1).

8 TIMETABLE

8.1 The time taken to complete a merger will vary from case to case. As a general rule of thumb, it is unlikely that a merger can proceed from board decision through approval of the Schedule 16 Statement, general meeting and confirmation hearing, to the effective date, in less than 6 months. It is essential to the good and orderly management of a merger that the societies concerned meet with the Authority's staff as soon as their boards have resolved to seek a merger, and agree upon a provisional timetable. This can then be fixed by the time the Schedule 16 Statement is approved. The members can then be notified, as they must be, of the date provisionally set for the confirmation hearing and of the proposed date of completion of the merger in the Merger Document.

8.2 The likely sequence of events is as follows:

Stage 1 Informal consultations with the Authority's supervisory staff on both substance and timing of the proposed merger.

Stage 2 Submission to the Authority of:

(a) prudential information: this should be available to the Authority for discussion with the society well before the Schedule 16 Statement is submitted for approval;

(b) written details of the proposed terms of the merger: it will be helpful for both the societies and the Authority to be clear about these matters as soon as possible after Stage 1 and well before Stage 3 is reached.

Submission to the Central Office, in the case of an amalgamation, of preliminary draft Rules and Memorandum, noting any unresolved issues.

Stage 3 Submission to the Authority and, in respect of (b) below, to the Central Office in draft of the following:

- (a) the Instrument of Transfer or amalgamation agreement embodying the merger terms provisionally agreed by the respective boards of directors;
- (b) in the case of an amalgamation, the proposed Rules and Memorandum of the successor society;
- (c) the Merger Document, including the Schedule 16 Statement, unless consent to proceed by way of board resolution is being sought in respect of the transferee society, together with the explanations of change, comparability and commitments referred to in paragraphs 3.8 to 3.10 and 3.27;
- (d) notice of the meeting at which the Merger Resolutions are to be moved, which may form part of (c) above;
- (e) the proxy voting forms to be used.

After examination of these drafts, the Authority or, as the case may be, Central Office staff will return them with any comments and, if necessary, will discuss them with the societies and their advisers. Any clearance by the Authority at this stage is provisional, and the Authority may seek further modification of the documents in the light of later information. Similarly, any clearance given by the Central Office is subject to review of the proofs submitted at stage 4.

If the transferee society is applying for consent to proceed by way of board resolution, formal application to do so (with supporting justification) should be made to the Authority at this stage.

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| Stage 4 | Submission of printers' proofs of the above draft documents. |
| Stage 5 | Informal clearance of near-final proofs (particularly of the Schedule 16 Statement(s)) by the Authority. |
| | Informal clearance of proof copies of Rules and Memorandum by the Central Office, in the case of an amalgamation. |

Stage 6

Formal submission of the Schedule 16 Statement(s) for approval by the Authority. The covering letter should include a declaration on behalf of the board of the society either:

- (a) that there has been no material change in the financial position of the society since the date of the information provided in the Schedule 16 Statement; or
- (b) that there has been such a change and that it is fairly reflected in the wording of the statement.

This submission should be accompanied by:

- (c) a certified copy of the Instrument of Transfer or amalgamation agreement as executed;
- (d) two copies of the final printers' proof of the Schedule 16 Statement signed by the Secretaries of each society;
- (e) a final printers' proof of the complete Merger Document to be sent to members, together with any covering letter and other documents to be sent with it, including proxy voting forms;
- (f) an assurance from the chairman of each society that the Schedule 16 Statement is complete and that all material interests of directors and officers are disclosed in it;
- (g) an assurance by or on behalf of the board on systems.
- (h) letter of comfort from the society's external auditors when required (see paragraph 3.7);
- (i) confirmation that drafts submitted for approval are identical to those seen at stage 5;
- (j) the fee payable by each society to the Authority.

NB Schedule 16 Statements should not be printed for distribution to members until after Stage 7.

Stage 7 Approval by the Authority of the Schedule 16 Statement, or the Authority's consent to proceed by board resolution. Approval or consent will be given by letter and one proof copy of the Schedule 16 Statement, with the certificate of approval signed on behalf of the Authority, will be returned to the society.

Stage 8 Printing and circulation of documents to members in time to be received by them at least 21 days before the voting date for the meeting at which the Merger Resolutions are to be moved (see paragraphs 4.12, 4.19 and 4.20).

Stage 9 The meetings at which the Merger Resolutions are moved.

Stage 10 If the Merger Resolutions have been passed, application to the Authority for confirmation and publication of notices of that application in the London and Edinburgh or Belfast Gazettes, and in other newspapers (as the Authority directs). The application must notify the Authority of the specified effective date for the merger, and be accompanied by two authenticated copies of the Instrument of Transfer or amalgamation agreement. In addition, in an amalgamation, four signed copies of the Memorandum and Rules of the successor society should be sent to the Central Office. The societies must report to the Authority on the outcome of their meetings.

Stage 11 Notification by the Authority of the time and place of the confirmation hearing, if it is necessary to hold an oral hearing. The societies should allow sufficient time before the proposed effective date for the Authority to consider and write its decision, and in case it proves necessary to adjourn the hearing.

Stage 12 Confirmation hearing and decision by the Authority whether to confirm the merger.

Stage 13 Registration by the Central Office to give effect to the amalgamation or transfer of engagements.

8.3 The following table indicates the likely minimum time to be taken by the main stages outlined above:

Pre Day 1	Board Resolution to Merge Initial discussions with Authority re timetable and prudential information Submission of terms and initial prudential information to Authority Submission of draft Rules and Memorandum to Central Office (amalgamations)
Day 1	First draft of Schedule 16 Statement and chairman's letter and notice of meetings, draft Rules and Memorandum (amalgamations) (Stage 3)
Day 28	Authority gives informal approval to Schedule 16 Statement, Instrument of Transfer signed (Stage 5)
Day 35	Formal Schedule 16 approval by the Authority (Stage 7)
Day 35-43	Printing, enveloping and mailing of Schedule 16 Statement and notice of meetings (Stage 8)
Day 65 - 70	Last date for receipt of proxy votes (depending on Act and Rules)
Day 72	SGM (Stage 9)
Day 75	Application to Authority for confirmation (Stage 10) Rules and Memorandum to Central Office (amalgamations)
Day 93	Closing date for receipt of representations
Day 114	Confirmation hearing (Stage 12)
Day 142	Authority's Decision on Confirmation (Stage 12)
Day 160	Effective Date

Notes:

- (a) Within the above timetable prudential information to be submitted.
- (b) A significant amount of financial information needs to be assessed by the Authority prior to approval of Schedule 16 Statement.
- (c) Prior to approval of Schedule 16 Statement a plan/timetable for integration of systems to be drawn up. Auditors sign off required prior to effective date.

PRO FORMA MERGER DOCUMENT

1. Title Page

Including suggestion to consult professional advisers and reference to meeting notice and voting procedures.

2. Directors' Responsibility Statement

See paragraph 3.26.

3. Board Rationale

Including statutory Merger Statement, if required (see paragraphs 3.23 and 3.24).

4. The Merger Process

Description and explanation of:

- (a) the general meeting and Merger Resolutions;
- (b) the confirmation process, including the right of interested parties to make representations to the Authority, the dates provisionally set for receipt of written representations and notice of intention to make oral representations, and for the confirmation hearing, and the confirmation criteria specified in Section 95 of the 1986 Act;
- (c) the planned effective date of the merger.

5. The Instrument of Transfer of Engagements or Amalgamation Agreement

The address of the principal office of the society where the Instrument of Transfer or amalgamation agreement will be available for inspection, and whether copies of the Instrument or agreement will also be available at branch offices, with a cross-reference to Section B of the Schedule 16 Statement.

6. The Schedule 16 Statement

Statement Required by Schedule 16 to the Building Societies Act 1986

Proposed Transfer of Engagements of [ABC] Building Society to [DEF] Building Society

or

Proposed Amalgamation of [ABC] Building Society and [DEF] Building Society to form [GHI] Building Society

Section A: Financial Position of Each Society

1. *Balance Sheets*

Summarised balance sheets derived from the audited [unaudited] [consolidated] accounts of [ABC] [society] [Group] for the financial year ended (date) [as at (date)] and from the audited [unaudited] [consolidated] accounts of [DEF] [society][Group] for the financial year ended (date) [as at (date)] are set out below:

	Notes	ABC [Group] £m	DEF [Group] £m
<i>Assets</i>			
Liquid assets	4(b)	•	•
Mortgages	4(e)	•	•
Other loans	4(e)	•	•
Fixed and other assets	4(c),(d)	•	•
		<hr/>	<hr/>
		•	•
<i>Liabilities</i>			
Shares		•	•
Borrowings		•	•
Other liabilities		•	•
Subordinated liabilities		•	•
Subscribed capital		•	•
Reserves		•	•
Other capital		•	•
- revaluation reserve		•	•
[- other]		•	•
		<hr/>	<hr/>
		•	•

2. *Results*

Particulars derived from the audited [unaudited] [consolidated] accounts of [ABC] [Group] for the period ended (date) and from the audited [unaudited] [consolidated] accounts of [DEF] [Group] for the period ended (date):

	ABC [Group] £m	DEF [Group] £m
Net interest receivable	•	•
Other income and charges	•	•
Administrative expenses	•	•
Provisions	•	•
	<hr/>	<hr/>
Profit/loss for the period before taxation	•	•
Taxation	•	•
Minority interests	•	•
	<hr/>	<hr/>
Profit/loss for the period	•	•

3. *Key Financial Ratios*

	ABC [Group] %	DEF [Group] %
As a percentage of shares and borrowings:		
Gross capital	•	•
Liquid assets	•	•
As a percentage of mean total assets:		
Profit after taxation for the period	•	•
Management expenses for the period	•	•

The above percentages have been calculated from the balance sheets summarised above.

Gross capital comprises reserves and other capital, plus subscribed capital and subordinated liabilities, and amounts to £..... million for [ABC] and £..... million for [DEF].

Shares and borrowings, adjusted to exclude interest accrued but not yet credited to accounts, amount to £..... million for [ABC] and £.... million for [DEF].

Average total assets is calculated as the mean of the total assets at the beginning and end of the period and amounts to £..... million for [ABC] and £..... million for [DEF].

The estimated gross and net costs of the bonus to be paid to members are £....

The ratio of gross capital to shares and borrowing of the combined society, after allowing for the net cost of the bonus to be paid to members, is estimated to be%. On the same basis of calculation, but not accounting for the bonus payment, this ratio is estimated to be%.

4. *Notes to the Financial Position*

(a) Accounting policies

[Identify any significant differences between the accounting policies adopted by the two societies, and quantify the impact of a change in policy to achieve consistency. If there are no such differences then this should be stated].

(b) Liquid assets include listed securities as follows:

	ABC [Group] £m	DEF [Group] £m
Amount included in the balance sheet	• _____	• _____
Market value	• _____	• _____

(c) Fixed and other assets

	ABC [Group] £m	DEF [Group] £m
Tangible fixed assets	•	•
[Intangible fixed assets]	•	•
Other assets	•	•
	<hr/>	<hr/>
	•	•
	<hr/>	<hr/>

[Describe the nature of any intangible fixed assets and the method of amortisation thereof, if any]

(d) Tangible fixed assets

	ABC [Group] £m	DEF [Group] £m
Net book amount of land and buildings		
Freehold	•	•
Long leasehold	•	•
Short leasehold	•	•
	<hr/>	<hr/>
	•	•
Other tangible fixed assets	•	•
	<hr/>	<hr/>
	•	•
	<hr/>	<hr/>

[For each society's land and buildings give the difference between the net book amount and estimated current market value, or a director's opinion that there is no material difference between the two. Indicate the basis on which current market value has been determined, the effective date of the valuation and the name(s) of the valuer(s)]

[Identify significant differences in depreciation policy or estimated asset lives, quantifying the impact of any change to a common basis]

(e) Provisions for losses on mortgages and other loans

	ABC [Group] £m	DEF [Group] £m
Specific provisions	•	•
General provisions	•	•
	<hr/>	<hr/>
Total amount offset against mortgages and other loans	•	•
	<hr/>	<hr/>

(f) Pensions

[Describe the pension schemes of each society and the extent to which funded schemes are, on the basis of the latest actuarial valuations, in surplus or deficit. Give date of most recent actuarial valuation.]

(g) Summary information on the businesses of [connected undertakings]

The financial information given above includes the assets and liabilities and results of the Society and the following subsidiary undertakings and associated undertakings.

ABC [Group]

Subsidiary undertakings [names]	Principal activity
------------------------------------	--------------------

Other associated undertakings
[names]

DEF [Group]

Subsidiary undertakings
[names]

Other associated undertakings
[names]

(h) Post balance sheet events

[see paragraph 3.8]

5. *Costs and benefits of the merger*

[Give a factual assessment of the quantifiable and unquantifiable actual and expected costs and benefits, including integration, rationalisation and future business plans]

Section B: Instrument of Transfer of Engagements or Amalgamation Agreement

The paragraphs below prefaced by “Note” do not appear in [nor are they a paraphrase of the text in] the Instrument of Transfer or amalgamation agreement and are intended for the additional information of members.

The Instrument of Transfer or amalgamation agreement provides, inter alia, for the following matters.

1. *Name of Society*

The name of the combined society will be Building Society.

2. *Transfer of Assets and Liabilities*

On the Effective Date (see item 10) the property, rights and liabilities of [ABC] Building Society will be transferred to and vest in [DEF] Building Society (the combined society). [In an amalgamation, the assets and liabilities of both societies are vested in the new successor society.]

3. *Membership Rights*

[Give the provisions of the Instrument of Transfer or amalgamation agreement concerning deemed membership. See paragraph 3.16]

4. *Share Accounts and Deposit Accounts*

On the Effective Date, share and deposit account balances of [ABC] Building Society will become share and deposit account balances with [DEF] Building Society on the following terms:

[Give the provisions of the Instrument of Transfer or amalgamation agreement and refer to the Investment Schedules in Section C]

Note: interest rates which are variable are subject to change either before or after the Effective Date of the merger.

[Provisions concerning PIBS]

5. *Mortgage Accounts*

On the Effective Date, the indebtedness of any person to [ABC] Building Society for a loan made by it [fully] secured on residential property will become indebtedness to [DEF] Building Society to the same extent and such indebtedness will be subject to the same terms and conditions as presently apply except that the Rules of [DEF] Building Society rather than the Rules of [ABC] Building Society shall apply.

[Alternatively, give the provisions of the Instrument of Transfer or amalgamation agreement concerning any change in terms and conditions]

Note: [give any further explanation necessary to a clear statement of any changes, including those effected by the transferee society's Rules]

6. *Bonus to Members*

[Give the provisions of the Instrument of Transfer or amalgamation agreement and the estimated net cost of the bonus. See paragraphs 3.13 and 3.14]

7. *Directors and Other Officers*

[Give the provisions of the Instrument of Transfer or amalgamation agreement]

Note: [Describe any changes in fees and contracts of employment or bonus schemes, or whether there will be no change]

Note: [Describe any compensation to be authorised by separate special resolution, or state that no such compensation is to be paid. State whether any person is not to take up employment with the combined society and that any payments to be made under their contracts of employment do not fall to be approved by special resolution. See paragraphs 3.11 and 3.12]

8. *Employees*

[Give the provisions of the Instrument of Transfer or amalgamation agreement]

Note: [State, unless the Instrument or agreement so provides, whether there are to be any changes to terms and conditions of employment, and what they are, and explain how any staff reductions are to be achieved and the planned timescale.]

9. *Pension Arrangements*

[Give the provisions of the Instrument of Transfer or amalgamation agreement]

10. *Conditions and Termination Provisions*

[Give details of the provisions of the Instrument of Transfer or amalgamation agreement which (a) impose conditions on the completion of the transfer of engagements, such as approval by the members and confirmation by the Authority, and (b) provide for the termination of the agreement if one or more of the conditions is not met or in any other circumstances.]

11. *Rules and Memorandum*

[Explain any proposed Rule changes and, in the case of an amalgamation, any differences in the proposed Rules and Memorandum compared with the existing societies.]

Section C: The Investment Schedules

[These are the schedules referred to in Section B.4 and in paragraph 3.17]

Section D: Information for Holders of PIBS

[If either society has issued Permanent Interest Bearing Shares]

Section E: Other Matters

1. Save for [the following and] the matters referred to in Section B.7 no director or other officer of [ABC] Building Society or [DEF] Building Society will receive any benefits in connection with the merger or will have any material interest in the merger.

[Describe any other interests of directors or other officers and persons (including companies) connected with them by way of, for example, fees for professional services, or supply of goods and services]

2. The directors of [ABC] Building Society and the directors of [DEF] Building Society confirm that the transfer of engagements [amalgamation] will not conflict with any contractual commitments of their Society or its connected undertakings.
3. The directors of [ABC] Building Society and the directors of [DEF] Building Society confirm that there has been no material change in the financial position of their Society or its connected undertakings since [date], the date to which the information in Section A relates [other than the post balance sheet event(s) described in Section A 4(h)].

[Name]
Secretary
[ABC] Building Society
[date]

[Name]
Secretary
[DEF] Building Society
[date]

7. Notice of Special General Meeting

8. Guidance on Voting

[Explanatory notes on:

The time, date and place of the meeting

Eligibility to vote:

- generally
- joint members
- minors

The Poll

Merger Resolutions:

- shareholding members
- borrowing members
- members who are shareholding and borrowing members

[Affected Members Resolution]

[Directors Compensation Resolution]

[Distribution to Members Resolution]

Voting in person

Voting by proxy

[Making enquiries, Helpline]

PRO FORMA NOTICE OF, AND APPLICATIONS FOR, CONFIRMATION

- 1. Notice of Application**
- 2. Application - amalgamation**
- 3. Application – transferor society**
- 4. Application – transferee society**

Publication of Notice of application to the Authority for confirmation of an amalgamation or transfer of engagements in the London, Edinburgh, or Belfast Gazettes and in any newspapers as may be directed by the Authority.

BUILDING SOCIETIES ACT 1986

Notice under paragraph 8 of Schedule 16 to the said Act.

Notice is hereby given that Building Society, Register No.....B, whose principal office is at, desires to amalgamate with*/transfer its engagements to*/accept a transfer of the engagements of* Building Society, Register No.....B, and that both societies have jointly*/each society has* applied to the Financial Services Authority to confirm the amalgamation*/transfer*.

Any interested party may make written representations to the Authority and/or give notice of intention to make oral representations to the Authority with respect to the application. Written representations and notices of intention to make oral representations should be received by the Authority at 25 The North Colonnade, Canary Wharf, London E14 5HS by 20 If notice is given of oral representations these will be heard by the Authority on20, at a time and place to be determined by the Authority.

***delete as applicable**

Form of application to the Authority for confirmation of an amalgamation

To the Financial Services Authority

BUILDING SOCIETIES ACT 1986

APPLICATION UNDER SECTION 93(2)(d) OF THE ACT FOR CONFIRMATION OF AN AMALGAMATION

..... **BUILDING SOCIETY, REGISTER NO.....B, AND**

.....**BUILDING SOCIETY, REGISTER NO.....B**

The above-named societies desire to amalgamate on[insert effective date] and apply to the Authority to confirm the amalgamation.

In making this application the societies declare that:

1. At a meeting of..... Building Society held on 20..., and at a meeting of Building Society held on20..., the following resolutions were passed:

A shareholding members' resolution, as required by section 93(2)(c)(i) of the Act, that the societies do amalgamate in accordance with the terms of an amalgamation agreement, two copies of which, signed by the Secretary of each society for identification, are enclosed with this application.

A borrowing members' resolution, as required by section 93(2)(c)(ii) of the Act, that the societies do amalgamate in accordance with the terms of the above-mentioned agreement.

2. A statement, in accordance with Schedule 16 to the Act, approved by the Authority, so far as it concerned matters specified in that Schedule, was sent to each member of Building Society and of Building Society who was entitled to receive it.
3. Three copies of the Memorandum and Rules of the successor society have been sent to the Central Office.

(Seals of the societies making the application)

Date:.....

*Form of application to the Authority for confirmation of transfer of engagements
(transferor society)*

To the Financial Services Authority

BUILDING SOCIETIES ACT 1986

**APPLICATION UNDER SECTION 95(3) OF THE ACT FOR CONFIRMATION OF
A TRANSFER OF ENGAGEMENTS**

..... **BUILDING SOCIETY, REGISTER NO.....B**

The above-named society desires to transfer its engagements to Building Society on20... [insert effective date] and applies to the Authority to confirm the transfer.

In making this application the society declares that:

1. At a meeting of Building Society held on20.. the following resolutions were passed:

A shareholding members' resolution, as required by section 94(2) of the Act, that Building Society do transfer its engagements to Building Society in accordance with the terms of an instrument of transfer, two copies of which, signed by the Secretary of each society for identification, are enclosed with this application.

A borrowing members' resolution, as required by section 94(2) of the Act that Building Society do transfer its engagements to Building Society in accordance with the terms of the above-named instrument.

2. A statement, in accordance with Schedule 16 to the Act, approved by the Authority, so far as it concerned matters specified in that Schedule, was sent to each member of Building Society who was entitled to receive it.

(Seal of the Society making the application)

Date.....

Form of application to the Authority for confirmation of a transfer of engagements (transferee society)

To the Financial Services Authority

BUILDING SOCIETIES ACT 1986

APPLICATION UNDER SECTION 95(3) OF THE ACT FOR CONFIRMATION OF A TRANSFER OF ENGAGEMENTS

..... **BUILDING SOCIETY, REGISTER NO.....B**

The above-named society desires to accept a transfer of engagements of Building Society on20.. [insert effective date] and applies to the Authority to confirm the transfer.

In making this application the society declares that:

- *1. At a meeting of Building Society held on 20.., the following resolutions were passed:

A shareholding members' resolution, as required by section 94(5)(a) of the Act, thatBuilding Society shall undertake to fulfil the engagements of Building Society in accordance with the terms of an instrument of transfer, two copies of which, signed by the Secretary of each society for identification, are enclosed with this application.

A borrowing members' resolution, as required by section 94(5)(a) of the Act, that Building Society shall undertake to fulfil the engagements of Building Society in accordance with the terms of the above-mentioned instrument.

- *2. The Building Society, pursuant to the consent of the Authority in accordance with section 94(5)(b) of the Act, has undertaken by a resolution of its Board of Directors to fulfil the engagements of Building Society in accordance with the terms of an instrument of transfer two copies of which, signed by the Secretary of each society for identification, are enclosed with this application.

- *3 A statement in accordance with Schedule 16 to the Building Societies Act 1986, approved by the Authority, so far as it concerned matters specified in that Schedule, was sent to each member of Building Society who was entitled to receive it.

(Seal of the Society making this application)

Date.....

***delete as applicable (either paragraph 2, or both paragraphs 1 and 3)**

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Interim Prudential Sourcebook for Building Societies

3 TRANSFER PROCEDURES

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DEFINITIONS AND NOTES

“the Act”	the Financial Services and Markets Act 2000
“the 1986 Act”	the Building Societies Act 1986 as amended ⁽¹⁾
“AGM”	Annual General Meeting
“the Authority”	the Financial Services Authority
“the Banking Regulator”	the Authority or other competent authority in another EEA state, as the case may be ⁽²⁾
“the board”	the board of directors of a society
“borrower” or “borrowing member”	a person who is indebted to a society in respect of a loan fully secured or, where the Rules so provide, substantially secured on land
“the BSA”	the Building Societies Association
“the Central Office”	the department of the Authority carrying out the registration functions transferred from the Central Office of the Registry of Friendly Societies ⁽²⁾
“the Commission”	the former Building Societies Commission ⁽²⁾
“the Confirmation Criteria”	the criteria specified in Section 98(3) of the 1986 Act which the Authority has to consider when deciding whether to confirm a transfer of the business of a society to a commercial company ⁽³⁾
“conversion”	the transfer of the business of a society to a specially formed company
“existing company”	a company which is a company within the meaning of the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 and is a public company limited by shares, or is incorporated in an EEA State other than the United Kingdom and has power to offer its shares and debentures to the public, and which is carrying on business as a going concern on the date of the Transfer Agreement

DEFINITIONS AND NOTES (Continued)

“the Fees Rules”	the Rules made by the Authority from time to time under paragraph 17 of Schedule 1 to the Act prescribing the fees to be paid in connection with the discharge of its functions under the 1986 Act
“the First, Second, Third and Fourth Criteria”	see the “Confirmation Criteria”, and relating respectively to the criteria specified in subsections (a), (b), (c) and (d) of Section 98(3) of the 1986 Act ⁽³⁾
“member”	a shareholding or borrowing member of a society
“PIBS”	Permanent interest bearing share, a type of deferred share in a society
“proxy voting form”	an instrument appointing a proxy to attend a meeting of a society and vote on the member's behalf
“Qualifying Day”	the day specified in the Transfer Agreement as the qualifying day for the purposes of Section 100 of the 1986 Act
“Rules”	the Rules of a society
“SGM”	Special General Meeting
“shareholder” or “shareholding member”	a person holding shares in a society (by virtue of investing in one or more share accounts or holding PIBS or other deferred shares)
“society”	a building society
“specially formed company”	a company formed by a society (and by no other than its nominees) for the purpose of assuming and conducting the society's business in its place, which is a company within the meaning of the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 and is a public company limited by shares, or is incorporated in an EEA State other than the United Kingdom and has power to offer its shares or debentures to the public

DEFINITIONS AND NOTES (Continued)

“Statutory Cash Bonus”	the bonus required by Section 100(2)(b) and (4) of the 1986 Act to be paid to every shareholder of the society who held shares on the Qualifying Day and was not eligible to vote on the requisite shareholding members' resolution
“successor” or “successor company”	a company, whether an existing company or a specially formed company, to which the business of a society is proposed to be transferred
“takeover”	the transfer of the business of a society to an existing company
“transfer”	a conversion or takeover, or both, as the context requires
“Transfer Agreement”	the agreement required by Section 97(4)(b) of the 1986 Act between a society and its successor company on the terms of the transfer
“Transfer Document”	the document or booklet containing, <i>inter alia</i> , either the Transfer Statement or the Transfer Summary
“Transfer Regulations”	the Building Societies (Transfer of Business) Regulations 1998 (SI 1998/212)
“Transfer Resolutions”	the shareholding members' resolution and borrowing members' resolution required to approve a transfer where no direction under Section 42B(4) of the 1986 Act has been given
“Transfer Statement”	the statement required by Schedule 17 to the 1986 Act to be sent in or with the notice of the meeting at which the Transfer Resolutions are to be considered or, if a Transfer Summary is sent, made available to every member entitled to notice of a meeting of the society
“Transfer Summary”	the summary of the Transfer Statement which may, in accordance with Schedule 17 to the 1986 Act, be sent, instead of the Transfer Statement, in or with the notice of the meeting at which the Transfer Resolutions are to be considered, to every member entitled to receive that notice

DEFINITIONS AND NOTES (Continued)

“Trustee Account Holder”	a person who is a shareholding or borrowing member of a society, by virtue of being the sole or representative joint holder of an account which he holds in trust for another person or persons any one or more of whom cannot reasonably practicably act in relation to that account themselves by reason of ill-health or old age or any physical or mental incapacity or disability, as provided by Section 102D of the 1986 Act, whether or not the account holder is a shareholding or borrowing member in respect of any other accounts
“the UKLA”	the UK Listing Authority (currently the Authority)
“vesting date”	the date on which all the property, rights and liabilities of the society making the transfer, except any shares in the successor company, are transferred to the successor company.

NOTES:

- (1) The Building Societies Act 1986 was amended by the Building Societies Act 1997 and by and under the Financial Services and Markets Act 2000. The 1986 Act has also been amended by other legislation.
- (2) The functions of the Bank of England under the Banking Act 1987, which was repealed by the Act, were transferred to the Authority by the Bank of England Act 1998. Similarly, the functions of the Commission, and of the Central Office of the Registry of Friendly Societies were transferred to the Authority by and under the Financial Services and Markets Act 2000.
- (3) The Confirmation Criteria are varied in certain circumstances - see Section 7.

1. INTRODUCTION

The Purpose of this Chapter

- 1.1 This chapter replaces the Transfer Procedures Guidance Note published by the Commission in April 1998. It gives guidance on the requirements of the 1986 Act relevant to, and on the procedures to be followed by, a building society proposing to transfer its business to a company authorised for the purposes of the Act to accept deposits. **It is not intended to be exhaustive, and is not a substitute for looking at the 1986 Act and the Transfer Regulations, on which a society should seek its own legal advice.** It describes the relevant provisions of the 1986 Act, and the information which must be made available to the Financial Services Authority and to the society's members, and outlines the procedures to be followed at general meetings, including the voting majorities required to pass the Transfer Resolutions. The chapter also describes the role of the Authority in approving the Transfer Statement which must be sent to the members and in the confirmation procedure, together with its ongoing prudential supervision during the transfer process. The Transfer Summary, which a society may send to its members instead of the Transfer Statement, is also discussed. **Except as described in section 7, to which section 8 also applies, this section is concerned only with voluntary transfers under Section 97 of the 1986 Act.**
- 1.2 It is for the directors of a society to assess the case for transfer, and they must explain and recommend their decision to the members. However, the Authority's staff are willing to discuss with a society the procedures to be followed and the information required to ensure that the members can reach fully informed decisions. **Societies are strongly recommended to consult the Authority early on in the formative stages of transfer proposals.** Such consultation will, of course, be treated in the strictest confidence. It will be helpful, also, to have regard to the indicative timetable set out in section 9.
- 1.3 Societies should consult their own legal advisers about the application of the provisions of the 1986 Act, and the general law, to the particular features of a proposed transfer.
- 1.4 This chapter considers each stage of the transfer procedure in chronological order. The remainder of this section gives a synopsis of the relevant requirements of the 1986 Act, which are then discussed in more detail in subsequent sections, as follows:

Section 2, Preliminary Matters, considers the rationale for a transfer and the handling of public announcements, and gives guidance on certain prudential issues.

Section 3, Terms of a Transfer, considers the mandatory provisions of Section 100 of the 1986 Act concerning the successor company's obligation to treat former shareholders of the society as depositors with it, and the Statutory Cash Bonus. It also considers the mandatory provisions of Sections 102B to D of the 1986 Act, concerning distributions to members who are Trustee Account Holders, the statutory restrictions on distributions to members in Section 100, and the permissive provisions of Sections 100 and 102A. The protective provisions for specially formed successor companies are also discussed.

Section 4, Information Provided to Members, discusses the form and content of the statutory Transfer Statement and the Transfer Summary, and the accompanying rationale and other statements by the board, and describes the form of application to be made to the Authority for approval of the Transfer Statement.

Section 5, General Meetings and Resolutions, discusses the register of members and members' entitlement to vote, the arrangements for general meetings, the conduct of voting on the Transfer Resolutions and the scrutineers' report.

Section 6, Confirmation, describes the form of application to the Authority for confirmation of a transfer, and the procedures which the Authority expects to follow in considering and hearing written and oral representations and in reaching its decision.

Section 7, Transfers Under Direction, describes the modified procedure to be followed when a society has been directed by the Authority to transfer its business to a company and to proceed by board resolution.

Section 8, Notification and Dissolution, briefly discusses the process of notification of the vesting date and dissolution of the society.

Section 9, Timetable, reviews the several stages of a transfer from start to finish.

Statutory Requirements

- 1.5 The provisions of the 1986 Act concerning transfers are in Sections 97 to 102D of, and paragraph 30 of Schedule 2 and Schedule 17 to the 1986 Act, where two types of transfer of business are provided for:

to a **specially formed company**, known as conversion; or

to an **existing company**, known as a takeover*.

The procedures are the same in each case, except that the specification of the turnout required to pass the shareholding members' resolution to approve a takeover is, in effect, higher than is required to approve a conversion. The 1986 Act also provides that a specially formed company shall have qualified protection from takeover for up to five years after the vesting date.

- 1.6 One of the principal purposes of these provisions of the 1986 Act is to ensure that the members are given all the material information they need about the terms of the transfer which they are asked to approve, and proper opportunity to cast their votes. Subsequently, they are given the opportunity to make representations about that process before the transfer is confirmed. The 1986 Act also prescribes certain mandatory terms, and places restrictions on certain permitted terms, of a transfer.
- 1.7 The 1986 Act makes no provision for a transfer to be initiated by any means other than a recommendation of an agreed proposal put by the board of a society to its members (see paragraph 11.10 of the Commission's *Decision to confirm the transfer of Halifax Building Society to Halifax plc*, which related to alternative distribution schemes) and the transfer Regulations require the board of a society to give particulars, in the Transfer Statement, of the options for the future conduct of the society's business which it considered before deciding to recommend the transfer to the members and of the reasons why it recommends the proposed terms. Each member who is entitled to receive notice of the general meeting at which the Transfer Resolutions are to be moved must also receive (or have made readily available to him if the Transfer Summary is provided) a copy of a statutory Transfer Statement. A transfer must be approved by a **shareholding members' resolution** and a **borrowing members' resolution**. The majorities required to pass these resolutions are described in section 5.
- 1.8 If the terms of a transfer include provision for the payment of **compensation to directors or other officers** for loss of office or of income attributable to the transfer, then the proposed payments must be authorised by a separate **special resolution**. If the

*A takeover may take the form of a transfer of the business of a society to a subsidiary of the society which is an existing company carrying on business as a going concern, as in the case of Halifax plc (formerly Halifax Syndicated Loans Limited).

terms include provision for any director or other officer to receive **increased emoluments** in consequence of the transfer, then an **ordinary resolution** approving that provision must be put before a meeting of the society.

1.9 The 1986 Act specifies certain procedures for the consideration of representations by interested parties concerning **confirmation**, and the criteria which the Authority must consider before deciding whether or not to confirm a transfer. **The matters which the Authority may consider do not include the merits of the transfer proposals, nor the fairness of the terms, which the members will have approved by passing the Transfer Resolutions.**

1.10 The statutory requirements of the 1986 Act are explained and discussed in more detail in subsequent sections of this chapter. However, as is stated in paragraph 1.1, this chapter is not exhaustive and is not a substitute for considering, and taking professional advice on, the primary documents, which include:

the Building Societies Act 1986, as amended by or under other legislation, including:

the Building Societies (Joint Account Holders) Act 1995

the Building Societies (Distributions) Act 1997

the Building Societies Act 1997 and

the Financial Services and Markets Act 2000 (in particular by the Financial Services and Markets Act 2000 (Mutual Societies) Order 2001)

the Building Societies (Transfer of Business) Regulations 1998 (SI 1998/212)

Judgments of the High Court in:

Abbey National Building Society v The Building Societies Commission [1989] 5 BCC 259

Cheltenham & Gloucester Building Society v The Building Societies Commission [1994] 4 All ER 65, [1995] Ch 185, and [1994] 3 WLR 1238

The Building Societies Commission v Halifax Building Society and Leeds Permanent Building Society [1995] 3 All ER 193

R v The Building Societies Commission, ex parte Whitmey, unreported, 16 April 1997, Lightman J (relating to the Alliance & Leicester Confirmation Decision).

Building Societies Commission Confirmation Decisions on applications by:

Abbey National Building Society (5 June 1989)

Cheltenham & Gloucester Building Society (5 July 1995)

National & Provincial Building Society (3 July 1996)

Alliance & Leicester Building Society (11 March 1997)

Woolwich Building Society (16 May 1997)

Halifax Building Society (23 May 1997)

Bristol and West Building Society (9 July 1997)

Northern Rock Building Society (18 July 1997)

Birmingham Midshires Building Society (18 March 1999)

Bradford & Bingley Building Society (28 September 2000)

2. PRELIMINARY MATTERS

Rationale for a Transfer

2.1 It is a matter for the board of a society to decide whether to recommend a transfer to its members. The overriding duty of the board is to reach a view having regard to what is in the best interests of the society in the short and long term, including the interests of the members as a whole, both present and future, as members of a building society, both borrowing members and shareholding members. The board of a society may also reasonably consider the interests of customers who are not members, of the staff, of suppliers of goods and services, and of the wider community.

2.2 The decision of the board to recommend a transfer must be based on a proper evaluation of the issues in relation to a strategic assessment of how the society can best serve its members. One element of that assessment will be the forward business plan of the successor company (including, in the case of a takeover, how the successor company plans to integrate the business of the society) which will be relevant to:

the presentation of the case to the members; and

the submission to the Banking Regulator for authorisation to accept deposits.

Copies of the plan should be provided to the Authority and to the Banking Regulator (if the latter is a different authority in another member state).

2.3 Neither conversion nor takeover are likely to figure routinely as options in societies' corporate plans. However, a board may develop the society's business in ways which point to the need to consider the transfer option: in which case, a transfer should be foreseen and emerge from the board's strategic plans. If a board is considering the options of conversion or merger with another society, it should, as a matter of prudence, consider how it would respond to a counter proposal and develop appropriate contingency plans.

2.4 When a board is seriously considering conversion or a takeover, the range of issues which it will need to assess will vary from case to case and is for the board to decide. However, the board will necessarily have regard to its primary duty to reach a view on what is in the best interest of the members, as members of a building society, and not only their short-term interests. It will also be conscious of the requirement to give, in

the Transfer Statement, a factual account of the options which it considered and of the reasons why it decided to recommend to the members the terms of any proposed transfer and of the qualifying conditions for any distribution of funds or shares in the successor company in consideration of the transfer.

Public Announcement

2.5 A board will usually wish to announce its proposals as soon as possible after it has decided to recommend a transfer to the society's members. In particular, the board will no doubt wish to inform the members and staff of the proposed terms so that they do not then operate their accounts, or otherwise act, in ignorance of proposals which would have affected their behaviour. The board will also wish to avoid misleading potential investors and borrowers; and societies with listed PIBS must have regard to the UKLA requirements concerning early disclosure of any information which might affect the price of securities. However, a board may not feel able to make an immediate announcement, perhaps for prudential or commercial reasons, or because it first wishes to settle all the details of the proposed terms. In these circumstances, the board must have contingency plans to make an early announcement to deal with any potentially damaging rumours and to avoid members being misled or left in a state of uncertainty. In considering the timing and terms of an announcement, the board will wish to minimise the risk of destabilising flows of funds.

2.6 The announcement, particularly information provided directly to members and staff, should make it clear that the proposal is subject to approval by the members and completion of the statutory procedures. It should also be made clear, in the case of a takeover, and if such is the case, that the proposal is subject to completion of due diligence investigations by the acquirer and, in either a conversion or takeover when shares in the successor company are to be issued, that the proposal is subject to the shares being listed on the London Stock Exchange or elsewhere. Boards should be careful to avoid appearing to assume that the outcome is a foregone conclusion, and should identify any matters of substance on which the proposed terms of the transfer remain to be settled. Briefing of staff who will be responsible for responding to enquiries from members and the Press should be considered carefully and prepared in advance of the announcement to avoid any risk of members being unintentionally misled. A freephone helpline may be desirable for members' enquiries about whether they qualify for any distribution under the proposed transfer scheme, but again the staff must be well briefed. It is essential that the announcement, and subsequent information given to members before they are sent the statutory Transfer Statement, or Summary,

and in any briefing of the Press, is entirely consistent with what will appear in that Statement. In particular, members should be advised to await the Transfer Summary, and especially the Transfer Statement which will contain full details of the proposals and the information relevant to their decision on how they wish to vote.

- 2.7 The Authority is not required to approve the content or wording of announcements or preliminary information sent to members. However, it will be happy to comment on drafts shown to it at an early stage, and may be able to help societies to avoid unintentionally misleading statements.
- 2.8 The board should consult the Authority and, if a different body, the Banking Regulator at an early stage in its consideration of transfer proposals, and certainly no later than its decision in principle to seek a transfer. The complexities of the statutory provisions are such that it is necessary to have the proposed transfer terms specified very closely indeed before it is possible for the Authority to take a view on whether the proposals are fully in conformity with the 1986 Act. The Banking Regulator will not be in a position, at this early stage, to give positive assurances as to the authorisation of the successor company. However, a prudent board will seek the views of the Authority, and also, if different, of the Banking Regulator, before it decides to announce its transfer proposals to the members. This preliminary discussion with the Authority will necessarily cover the proposed structure of the successor company or group and a written specification of the transfer terms, particularly the scheme for distribution of any consideration to be offered to the members for the loss of their membership rights in the society, which members and other persons are to benefit, and the criteria for qualification.
- 2.9 Should there be a difference of view between the Authority and the society as to whether a scheme, or a particular feature of it, is in conformity with the 1986 Act, it may prove desirable to apply to the High Court for a declaration. It will then be necessary for any preliminary announcement of the board's proposals to make the position clear, and for it to allow sufficient time in its proposed timetable for the application to be heard, and for any appeal.

Prudential Issues

- 2.10 In addition to information about the proposed transfer scheme, the Authority will expect the board to provide it with information about its plans for ensuring the prudent management of the society through to the proposed vesting date. That information will be consistent with what the board itself will require, bearing in mind that it is for the

board to exercise due diligence and to be satisfied that the society's business continues to be directed and managed prudently. The information required is:

- (a) the names and responsibilities of senior managers assigned to manage the transfer process;
- (b) an assessment of the systems requirements of the transfer process, together with the specification of work to be done by consultants (e.g. the external auditors/scrutineers) and their report(s);
- (c) contingency plans, with sensitivity and risk assessments, for managing funding and liquidity during the transitional period;
- (d) copies of the business plans of the successor company as submitted in connection with its authorisation to accept deposits.

2.11 The Authority will also wish to have a letter of consent, from or on behalf of the board, to the Authority discussing the society's affairs with the Banking Regulator (if a different body) and the UKLA (if a different body and an issue of shares in the successor company is intended to be made in connection with the transfer).

2.12 A transfer is exceptionally time-consuming for senior management. The Authority will wish to be satisfied that the society has sufficient management resources to cover both the transfer and its day-to-day business within its proposed transfer timetable. It will usually be necessary for the society severely to limit new business developments and initiatives during the transitional period. It should also be noted that the requirements for information to be provided to members mean that full disclosure will be required in the Transfer Statement of any negotiations in progress on acquisition or other links during the transfer process. The Banking Regulator must be kept fully informed of any such plans because any changes to the society's business, structure, controls etc. may well be important factors in its authorisation process.

2.13 The Authority will appoint a project team, responsible for operational management of the Authority's functions in relation to the transfer process. The expectation would be that the team will include the Manager responsible for the society's supervision and one of the Authority's legal advisers. Names and contact numbers will be provided to the society. The Authority would strongly advise a society similarly to appoint a project team, headed by a senior manager responsible to the board for management of the whole

process and with authority to control the drafting and verification of the Transfer Document, other briefing and information to members, and responses to representations at the confirmation stage. Strong central control under the direction of the board is, in the Authority's view, essential for effective management of a transfer.

- 2.14 The society will be expected to provide the Authority with a systems report from its auditors together with an action plan to remedy any shortcomings. The Banking Regulator, if a different body, may have similar requirements. This report is only part of the full information package which the Banking Regulator will (or is likely to) require for the purposes of authorising the successor company to accept deposits and which will be needed so that the Authority can be satisfied in relation to its requirements up to the vesting date.
- 2.15 The society will need to develop plans to deal with a number of possible contingencies; for example, receipt of a counter-offer (whether private or public) during the transfer process, changes in market conditions or financial results which materially affect the information given in the Transfer Statement, failure to obtain the members' approval, delay of the planned vesting date and of any flotation, and greater exposure to liquidity risk during the transitional period. The Transfer Agreement should include provision for its termination if, for any reason, flotation does not take place within a specified period after confirmation, and for the board to decide not to proceed if market conditions or other developments mean that it would not be reasonable to do so having regard to the basis on which it secured the approval of the members. The Authority will wish to see the society's contingency plans.
- 2.16 Before it approves the Transfer Statement, the Authority will wish to be satisfied that the successor company is expected to be authorised, or, as the case may be, to continue to be authorised, to accept deposits. It will also ask the Banking Regulator, if different, to confirm that the information given in the draft Transfer Statement appears to be consistent with, and has no material omission of, information available to the Banking Regulator.

3. TERMS OF A TRANSFER

This section discusses the provisions of the 1986 Act which prescribe the terms of a transfer which must be included in the Transfer Agreement and the restrictions on terms which may be included. It also discusses the formation of, and protective provisions for, specially formed companies and the status of existing companies.

- 3.1 Section 97(4) of the 1986 Act provides that in order to transfer its business to a company, *inter alia*, a society must agree conditionally with its successor in a Transfer Agreement on the terms of the transfer which, in so far as they are “regulated terms” (as defined in Section 97(12)), comply with Sections 99 and 100 of the 1986 Act and with the Transfer Regulations. In the case of a specially formed company, a society must also secure that the articles of association of the successor company have the requisite protective provisions prescribed by Section 101(2) of the 1986 Act.

The Qualifying Day

- 3.2 The choice of Qualifying Day is important because it is a determining factor in deciding which members must have conferred upon them a right to the Statutory Cash Bonus provided by Section 100 of the 1986 Act. It may also be relevant in deciding which members may receive certain rights under a proposed distribution of funds or of shares in the successor company. The Commission’s view was that there can be only one Qualifying Day for these purposes, which must be clearly distinguished from any other “reference dates” which may be chosen by a society for the purposes of its transfer scheme. Subsection (13) of Section 100 defines the Qualifying Day as the day specified in the Transfer Agreement as the qualifying day for the purposes of that subsection. This does not appear to restrict the society’s choice of qualifying day. A number of arguments for such a restriction have been advanced, including that the use of the past tense “which expired with the qualifying day” in subsection (9), read in the context of Section 100 as a whole, indicates that the Qualifying Day must pre-date the Transfer Agreement. The Authority has not been required to express a view on the matter (and see paragraphs 4.20 and 17.4 of the Commission’s *Decision to confirm the transfer of the business of Cheltenham & Gloucester Building Society to a subsidiary of Lloyds Bank plc*).
- 3.3 For completeness, it should be noted that the Authority takes the view that the conditional Transfer Agreement must have been signed by the society and its successor company and commenced (albeit conditionally) before the Authority can approve the

Transfer Statement. This is because the Authority must be satisfied, before it approves the Transfer Statement, that the Statement correctly describes the proposed terms of the transfer as provided by the Transfer Agreement, and the Agreement cannot properly be said to exist until it has been signed by the parties concerned. The Transfer Agreement, as is made clear by its definition in Section 97(12) of the 1986 Act, is necessarily conditional, *inter alia*, on the society's members' approval of the Transfer Resolutions under Section 97(4)(c), and confirmation of the transfer by the Authority (which includes confirmation by the Banking Regulator that it expects to authorise the successor company) under Section 98(2) of the 1986 Act.

Share Accounts

- 3.4 Section 100(2)(a) and (3) of the 1986 Act provide that the terms of a transfer **must** require the successor company to assume as from the vesting date a liability in respect of a deposit to every member of the society equal to the value of the shares held by such member immediately before the vesting date. In other words, amounts held in share accounts on the eve of the vesting date must become identical amounts held in deposit accounts from the start of the vesting date.

Statutory Cash Bonus

- 3.5 Section 100(2)(b) and (4) of the 1986 Act provide that the terms of a transfer **must** confer a right to a distribution of funds by way of bonus, whether paid by the society or its successor company, on every member of the society who held shares in the society on the Qualifying Day but was not eligible to vote on the shareholding members' resolution. Where the account is in joint names, see also paragraph 3.12, Schedule 2 to the 1986 Act and the Rules of a society prescribe who is eligible to vote (see section 5). Broadly speaking, members who are not entitled to vote on the resolution are those who are under 18 years of age on the date of the meeting or, if the Rules so provide, those who had less than the qualifying shareholding (usually £100) on the qualifying shareholding date or who ceased to hold shares in the period between the qualifying shareholding date and the voting date. However, the High Court declared in *Abbey National Building Society v The Building Societies Commission* that, in order to qualify for the Statutory Cash Bonus, in addition to having held shares in the society on the Qualifying Day, a member also must have held shares continuously between the Qualifying Day and the vesting date. In coming to this judgement, the Vice Chancellor found the sequence of tenses used in subsection (4) of Section 100 of the 1986 Act to be illuminating: "It says that a member **is** a qualifying member if he **held** shares

in the society on the qualifying day and **was not** eligible to vote The subsection is therefore looking at somebody who at a particular point of time is a member and who had certain qualifications in the past the relevant date for establishing membership is the vesting day it is implicit in subsection (4) that the person must have been a member on the qualifying day and have remained a member thereafter continuously through until the vesting day”. In settling the terms of the declaration, the Vice Chancellor confirmed that when referring to the member remaining a member between the two dates, he intended to mean as a member holding shares.

- 3.6 The bonus is to be calculated as that proportion which the society’s reserves bear to its total liability to its members in respect of shares, as shown in the latest balance sheet of the society, applied to the value of the shares held by the member on the Qualifying Day. If a Transfer Statement is approved and sent to the members just before, or shortly after, the end of the financial year of the society, it will be important to note that the Annual Report and Accounts for the year will have been published by the vesting date, when qualifying membership has to be established and the bonus is due to be paid. In those circumstances, “the latest balance sheet of the society” will be that published in the most recent Annual Accounts. The same considerations may apply when a society publishes half-yearly results.
- 3.7 The Authority may direct, however, where it confirms a transfer of a society’s business to an existing company (i.e. only in a takeover), that no Statutory Cash Bonus is paid or that a lesser amount is paid than that referred to in paragraph 3.6, having regard to what is equitable between the members.

Distributions To Members

- 3.8 Section 100(1) of the 1986 Act provides that:

“Subject to subsections (2) to (10), the terms of a transfer of business by a building society to the company which is to be its successor may include provision for part of the funds of the society or its successor to be distributed among, or other rights in relation to shares in the successor conferred on, members of the society, in consideration of the transfer”.

- 3.9 In respect of rights to shares, Section 100(8) of the 1986 Act provides that:

“Where, in connection with any transfer, rights are to be conferred on members of the society to acquire shares in priority to other subscribers, the right shall be restricted to those of its members who held shares in the society throughout the period of two years which expired with the qualifying day; and it is unlawful for any right in relation to shares to be conferred in contravention of this subsection”;

and, in respect of a distribution of funds, Section 100(9) of the 1986 Act provides that:

“Where the successor is an existing company, any distribution of funds to members of the society, except for the distribution required by subsection (2)(b), shall only be made to those members who held shares in the society throughout the period of two years which expired with the qualifying day; and it is unlawful for any distribution to be made in contravention of the provisions of this subsection”;

while, in respect of a transfer to a specially formed company, Section 100(10) of the 1986 Act provides:

“The following restrictions apply to any distribution of funds, or any conferring of rights in relation to shares, in connection with the transfer of its business from the society to its successor where the successor is a company specially formed by the society, that is to say-

(a) no distribution shall be made except that required by subsection (2)(b);
and

(b) where negotiable instruments acknowledging rights to shares are issued by the successor within the period of two years beginning with the vesting date, no such instruments shall be issued to former members of the society unless they are also issued, and on the same terms, to all other members of the company;

and it is unlawful for any distribution of funds to be made in contravention of the provisions of this subsection”.

3.10 The meanings of subsections (1), (8), (9) and (10) of Section 100 of the 1986 Act have been considered by the High Court in four cases: *Cheltenham & Gloucester Building*

Society v The Building Societies Commission, in relation to distributions of funds, and *Abbey National Building Society v The Building Societies Commission*, *The Building Societies Commission v Halifax Building Society and Leeds Permanent Building Society* and *R v The Building Societies Commission, ex parte Whitmey* in relation to share distributions. These judgments related to specific proposals and may not necessarily be directly relevant in all respects to transfer schemes proposed by other societies in the future. A society must obtain its own advice when formulating proposals for a cash or share distribution scheme.

- 3.11 As is explained in paragraph 2.8, the Authority will have to see a fully specified description of the distribution scheme before it can form its own view of whether it is in conformity with the 1986 Act. The Authority would find it helpful if the society enclosed copies of the legal advice it has received when submitting a scheme for consideration.

Joint Share Account Holders

- 3.12 Paragraph 7 of Schedule 2 to the 1986 Act deals with joint shareholders and defines the “representative joint holder” as “that one of the joint holders who is named first in the records of the society.” Paragraphs 7(5) and (5A) of that Schedule provide that, for the purposes of Sections 87 and 93 to 102 of the 1986 Act, the shares shall be treated as held by the representative joint holder alone and, accordingly, joint holders, other than the representative joint holder, shall not be regarded as members of the society by reason only of being a joint holder of those shares. The effect of this provision (but subject to the provisions of Section 102A) is that if, for example, the representative joint holder dies, or the order of names on the account is changed in the two years preceding the Qualifying Day, any rights to a distribution under a transfer scheme, which are conferred on those who have held shares for two years up to the Qualifying Day, cannot devolve upon any other joint account holder, unless that holder is in his or her own right, by virtue of another account holding, a two-year shareholding member.
- 3.13 Section 102A, however, provides that, in certain circumstances, second named joint holders, **who have themselves held shares in the society continuously during the two year qualifying period**, whether as sole or joint holders of shares, may qualify for a right which otherwise could only have gone to a first named holder. Cases which would be covered by the provisions of Section 102A include: the death of the first named holder, including where, for example, a third named joint account holder would move up the scale if both the previous first named and second named holders were killed in

the same car accident; the creation of a joint account, for example, on marriage; the division of a joint account on divorce or separation, or for any other reason, **where the previous first named holder has ceased to hold shares in the society**; and when there has been a change in the order of names within an account.

- 3.14 Points to note are that Section 102A applies only to joint share account holders (joint borrowers are not affected) and is only relevant where the application of the two year qualifying period prescribed by Section 100 is relevant to a proposed distribution of funds or conferring of rights to shares. The provisions of Section 102A are permissive, not mandatory (see paragraphs 13.2 to 13.5 of the Commission's *Confirmation Decision on the application by National & Provincial Building Society*) and are not "relevant requirements" of the 1986 Act (see paragraph 6.17). It is for the society's board when proposing a transfer scheme to decide whether to incorporate in its distribution scheme none, some, or all of the cases where Section 102A allows membership of a joint account, other than as the first named holder, to count towards the two year qualifying period. Finally, these provisions do not affect the position of the personal representatives or beneficiaries of deceased sole holders of share accounts. Societies should obtain their own advice on all these matters when considering how they wish to construct the terms of a proposed distribution scheme.

Trustee Account Holders

- 3.15 A member who holds funds in a share account, or holds a mortgage account, on trust for another person is not a Trustee Account Holder unless the following conditions are satisfied. Sections 102B to D of the 1986 Act require that, if the terms of a transfer include distributions of funds or of rights to shares to members of the society, then each Trustee Account Holder shall be treated by the society and its successor as not being disentitled from receiving, in addition to any distribution to which he or she may be entitled in any other capacity, a separate distribution in respect of each account which he or she holds in trust for certain categories of beneficiaries (provided that, as holder of that account, he or she meets the conditions for receipt of a distribution under the scheme). An account may be either a share account or a mortgage account of which the Trustee Account Holder may be the sole or representative joint holder. A member may receive only one distribution for each account he or she holds as a Trustee Account Holder (irrespective of the number of account holders or beneficiaries of that account) and a member who holds only one account may receive only one distribution in respect of that account whether as a member or, if he or she so decides, as a Trustee Account Holder. If a person is a qualifying beneficiary of more than one

account held by a Trustee Account Holder (referred to in Section 102D(5) as “duplicate accounts”), then only a single distribution is required to be paid in respect of the duplicate accounts whether or not there are other qualifying beneficiaries of those accounts. A change in the identity of the Trustee Account Holder during any qualifying period for a distribution does not affect the entitlement to a distribution in respect of the account. The categories of qualifying beneficiaries of such accounts are persons who cannot reasonably practicably act in relation to the accounts themselves by reason of ill-health or old age or any physical or mental incapacity or disability.

- 3.16 A society will need to take its own legal advice as to the interpretation of these Sections and whether and, if so, what advice it should give to its members to help them decide whether they are Trustee Account Holders. The Authority will wish to see that advice to help it reach a view on whether the society’s proposals appear to it to be lawful, while recognising that only the courts can interpret the law. With that important proviso in mind, the Authority has taken the view that a scheme may provide that a member is a Trustee Account Holder if the funds (or debt) in the relevant account are held either wholly or partly for one or more qualifying beneficiaries. PIBS do not appear to be share “accounts” as described by Sections 102B to D so that a person could not be a Trustee Account Holder in respect of a holding of PIBS.
- 3.17 A society is not required to notify its members of these provisions. However, unless it does so, it will not gain the protection of Section 102B(4) which provides that a Trustee Account Holder will not be entitled to a distribution in that capacity if the society has notified him that he must make a statutory declaration and the Trustee Account Holder has not made such a declaration before the date specified in the society’s notice to him. Moreover, the Transfer Regulations require that the Transfer Statement must contain a forecast of the amount and proportion of the total consideration which is expected to be distributed to Trustee Account Holders (see paragraph 4.2c).
- 3.18 It appears to the Authority that it will be desirable for the final date for receipt of statutory declarations from Trustee Account Holders to be shortly before the vesting date so that declarations may take account of any changes in the identity of the account holder or the status of the beneficiary or beneficiaries. Trustee Account Holders must also be able to make an informed judgement as to whether the terms of the distribution scheme are such that making a statutory declaration will be in the best interests of the beneficiary or beneficiaries of an account; they cannot do this until the

full terms of the proposed scheme have been published in the Transfer Statement and made available for inspection in the Transfer Agreement. The Authority expects, therefore, that societies will issue notices under section 102B to Trustee Account Holders not later than despatch of notices of the SGM at which the Transfer Resolutions are to be considered, and that the specified date for returning statutory declarations by Trustee Account Holders will be on, or shortly before, the vesting date or, in any event, not less than 1 month after the despatch of the notices. No regulations have been made by the Treasury under Section 102D(11). However, to meet the requirement that the Transfer Statement must contain a forecast of distributions to Trustee Account Holders, and so that it can determine the qualifying conditions for, and estimate the value of distributions to members generally, and individually, particularly if the scheme includes a variable element, the Authority expects that a society will need to write to all its members at least 2 months before the Transfer Statement is expected to be issued advising them of the procedures for dealing with distributions to Trustee Account Holders, perhaps also with the notices envisaged by Section 102B(4), and asking them, if appropriate, to register their interest in making statutory declarations as Trustee Account Holders.

The Successor Company

- 3.19 **In a conversion**, the successor company must be specially formed by the society (and by no others than its nominees) wholly or partly for the purpose of assuming and conducting the society's business in its place and must be a company within the meaning of the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 which is a public company limited by shares (Section 97(12) of the 1986 Act) or a body corporate incorporated in another EEA State with power to offer its shares or debentures to the public (Section (97(13)). Section 98(3) of the 1986 Act provides that the Authority shall not confirm the transfer if there is a substantial risk that the successor will not become a credit institution which is authorised to accept deposits for the purposes of the Act. The society must secure that the successor company is formed having articles of association with the "requisite protective provisions" (Section 97(4)(a) of the 1986 Act).
- 3.20 The terms of the transfer must include provision to secure that the society ceases to hold any shares in the specially formed successor company by the date on which the society is to dissolve (Section 100(11) of the 1986 Act). The provisions of the 1986 Act concerning the dissolution of the society and the disposal of any shares in its successor are discussed in section 8.

- 3.21 The “requisite protective provisions” are the provisions of Section 101 of the 1986 Act which require the successor company to ensure that it does not allow one person, or two or more persons acting in concert, to hold more than 15% of the shares of the company during the period from the company’s incorporation until 5 years after the vesting date. The purpose of this provision is, clearly, to protect the newly converted bank from takeover. The provisions will cease to apply if the Authority so directs, or if the successor company acquires another financial institution, as defined in Section 101(6), or if the shareholders resolve to that effect by a majority representing at least 75% of the nominal value of shares giving voting rights.
- 3.22 **For a takeover**, an existing company, which is to assume and conduct the society’s business in its place, is defined in Section 97(12) and (13) of the 1986 Act as a company within the meaning of the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 which is a public company limited by shares, or a body corporate incorporated in another EEA State with power to offer shares or debentures to the public, “carrying on business as a going concern on the date of the transfer agreement”. Section 98(3) provides that the Authority shall not confirm the transfer if there is a substantial risk that the successor will not become or, as the case may be, remain a credit institution which is authorised to accept deposits for the purposes of the Act. The effect of these provisions is that the business of a society may be transferred to a body corporate incorporated in another EEA State which, at the date of the Transfer Agreement, is a going concern and which is acceptable as a deposit taker to the appropriate regulatory authority. To be a going concern, the company must actively be carrying on a business before it can enter into an agreement to acquire the business of a society. Conversely, it would not seem possible to use a company which carries on no substantive business, other than employing its capital, simply as a vehicle for taking over a society.
- 3.23 The successor company does not need to be authorised to accept deposits at the time of the takeover offer or the Transfer Agreement; but it must be carrying on business as a going concern. However, subsequent authorisation is a key criterion. An offer will not be credible unless the company has first obtained an indication from the Authority or other EEA competent authority that it is prepared to authorise, or to continue the authorisation of, the successor company, upon transfer. As a practical matter, the authorities would find it difficult to authorise an institution whose business from the time of authorisation was not predominantly banking or deposit taking and would require to be satisfied that the parent company (if any) as controller was fit and proper.

Compensation For Loss of Office and Increased Emoluments

- 3.24 **Any compensation** for loss of office or diminution of emoluments attributable to the transfer which is proposed to be paid to directors and other officers must be approved by a separate special resolution, in addition to the Transfer Resolutions required to approve the terms of transfer as a whole (Section 99 of the 1986 Act). Loss of office includes loss of office in any other body held by virtue of the director's or other officer's position in the society. "Compensation" is not defined in the 1986 Act, except to the extent that Section 99(6) says that it includes benefits in kind. In the Authority's opinion, compensation does not include statutory redundancy payments, damages for breach of contract, or other payments, for example, falling due under the terms of a pre-existing contract of employment, or a pre-existing arrangement giving rise to a reasonable expectation. However, it does include any proposed ex-gratia payments or other provision of benefits in money or money's worth. Societies should consider very carefully the extent to which any proposed payment may exceed the amount provided for by statute or contract. In view of the requirement in Section 99(4) that unauthorised payments must be repaid by the recipient, societies are advised to take legal advice on any payments which are not specifically authorised by the terms of a special resolution passed by the members in accordance with Section 99(2)(a). The Treasury has not made any regulations under Section 99(2)(b) and (3).
- 3.25 All proposed payments requiring approval by special resolution must be disclosed in the Transfer Statement. In addition, the Authority will require disclosure in the Transfer Statement of any other payments to directors or other officers arising directly from the transfer. So that members are aware of the direct interest of the directors or other officers in a transfer, societies should consider whether the amount, as distinct from the fact, of any statutory or contractual payments should be disclosed where these arise directly from the transfer. More generally, societies need to consider whether any facts relevant to any director or other officer, or to any person(s) connected with any director, should be disclosed where these are material to the decision of the members who are to be asked to vote on the proposed transfer.
- 3.26 **Increased emoluments** are defined by Section 99A of the 1986 Act as an increase in consequence of the transfer, and included in the terms of the transfer, for any director or other officer, whether by way of increased remuneration or the grant of share options or otherwise. The Authority is of the view that this formulation would include the receipt

of distributions of funds or of rights to shares in consideration of the transfer which are made to directors or other officers in their capacity as employees or pensioners of the society or any of its subsidiaries. However, this is a matter which can only be conclusively determined by the courts.

- 3.27 Any such increase in emoluments is required by Section 99A(2) of the 1986 Act to be put before a meeting of the society in an ordinary resolution approving such provision. However, although such an ordinary resolution must be put to a meeting, it is not required to be passed in order to authorise such increases which will be authorised by the general approval of the transfer and its terms provided by the passage of the Transfer Resolutions. Neither is it required that the ordinary resolution be put before the meeting which is to consider the Transfer Resolutions. However, as is explained below, any proposed increase in emoluments will have to be explained in the Transfer Statement, and the Authority will have to be satisfied that the requisite ordinary resolution was put before a meeting of the society when it considers a society's application for confirmation of a transfer.

4. INFORMATION PROVIDED TO MEMBERS

Statutory Requirements

- 4.1 Section 98(1) of and Part I of Schedule 17 to the 1986 Act require a building society which desires to transfer its business to a company to send a statement relating to the proposed transfer to every member entitled to notice of a meeting of the society. This may be either a Transfer Statement or a Transfer Summary, and is to be included in or with the notice of the meeting at which the Transfer Resolutions are to be moved. If a Transfer Summary is sent, then the society must also make the Transfer Statement available forthwith, free of charge, to every member who asks for it. The Treasury has power to make regulations for the purpose of specifying the matters of which Transfer Statements and Transfer Summaries are to give particulars. No Transfer Statement shall be sent or made available unless its contents, so far as they concern the matters so specified, and any other matters which the Authority may require in the case of a particular transfer, have been approved by the Authority. The Transfer Summary, however, is not required to be approved by the Authority.

The Transfer Statement

- 4.2 The Transfer Statement has to contain the particulars of the “prescribed matters” which are set out in Schedule 1 to the Transfer Regulations. It must also include particulars of any other matters which the Authority may require (paragraph 3(1)(b) of Schedule 17 to the 1986 Act). Note that Regulation 3(2) of the Transfer Regulations provides that if a particular matter is not ascertainable at the time, a forecast may be given; for example, of the percentage amount of the Statutory Cash Bonus, or of the division of any distribution of shares or cash among different classes of recipient (see subparagraph c). The principal matters which a Transfer Statement must contain can be summarised as follows:
- (a) a factual statement of the strategic options considered by the board and the reasons why it decided to **recommend** the particular proposals being put to the members. In the case of a takeover, the board must also provide a valuation of the business compared with the consideration which is proposed to be paid by the successor company, and state whether it considers the offer price to be fair and reasonable;

- (b) disclosure of the names of any building societies or companies from which written proposals for merger or takeover were received within the preceding 12 months as required by Regulation 3 of the Transfer Regulations. The fact of the proposal, the name of the proposer and the terms of the proposal must be disclosed, unless the proposer has requested either that the whole matter, or just the terms of the proposal, be treated as confidential. An invitation to discuss a possible merger or takeover would probably not constitute a “proposal”. A society should consider carefully, and take advice on, whether any approach it has received does qualify as a disclosable proposal. If no proposals have been received that fact could be stated in the Transfer Statement, for the avoidance of doubt;
- (c) details of any share and/or cash distribution scheme, as provided by the Transfer Agreement, and showing separately the estimated amount of the benefits (if any) to be conferred on members, Trustee Account Holders, and on others such as employees and pensioners of the society, and giving information about the value of any shares including, if unquoted ordinary shares, an illustrative estimate of the market price of the shares if they had been issued at some specified date within the previous 6 months;
- (d) the consequences of the transfer for members of the society, including a clear explanation of the potential effects on interest rates and containing, in particular, a factual statement of changes in the factors relevant to the determination of interest rates on retail deposits and loans by the successor company compared with the society (having regard to the need for the company to pay dividends to its shareholders), and including any change in the terms on which deposits are to be held and any changes in the applicable terms of the statutory protection scheme and complaints handling arrangements;
- (e) the consequences of the transfer for employees of the society, including any changes in the branch structure or economies in head office departments;
- (f) the financial interests of the directors and other officers arising from, or as a consequence of, the transfer. If directors or other officers have no financial interests in the transfer, either by way of increased emoluments, compensation or other benefits, this should be stated explicitly, for the avoidance of doubt;

- (g) the main features of the published consolidated annual accounts of the society group for the last 3 financial years and its current financial position, including the amount of the society's reserves, at a date not more than 6 months prior to the date of the Transfer Statement;
- (h) in the case of a takeover, the main features of the published annual accounts of the successor company group for the last 3 financial years, its current financial position at a date not more than 6 months prior to the date of the Transfer Statement, and key business indicators of the society group and the successor company group for each of the past 3 financial years. If the successor company is a significant subsidiary within a group, the Authority may require corresponding information about the company alone to be given;
- (i) the future financial prospects of the successor company;
- (j) the intended range and relative importance of the activities of the successor company and any change proposed following the transfer;
- (k) in the case of a takeover, the structure and activities of any group to which the successor company belongs;
- (l) a summary of the provisions of the Transfer Agreement concerning the conditions precedent to its completion and providing for its termination;
- (m) a statement as to whether the transfer will conflict with any contractual obligations of the society (which would include agency agreements);
- (n) the total estimated costs and expenses of the transfer, together with (if applicable) the estimated amount of, and the terms on which, fees and disbursements will be paid to advisers, such as merchant bankers, relating to the valuation of the business;
- (o) responsibility statements by the directors of the society and the successor company, and opinions of the external auditors and any other experts, such as merchant bank advisers;
- (p) if a Transfer Summary is issued, a statement that the full Transfer Statement will be provided free and on request and how it can be obtained.

The Transfer Summary

- 4.3 A Transfer Summary may be sent, instead of the Transfer Statement, in or with the notice of the meeting at which the Transfer Resolutions are to be considered, to every member entitled to that notice. As its title indicates, the Transfer Summary must contain information derived from the Transfer Statement, particulars of which are prescribed by Schedule 2 to the Transfer Regulations: principally, that is, the matters described in paragraph 4.2, in summary form, excepting detailed financial information and terms of the Transfer Agreement. The basic qualifying conditions for a distribution of funds or shares might, for example, be summarised in the form of flow charts. More complex information, such as that relating to successors to deceased members, or second named joint account holders, should also be summarised with affected persons being referred to the Transfer Statement and, perhaps, special leaflets on particular terms.
- 4.4 Unlike the Transfer Statement, the Transfer Summary does not have to be approved by the Authority. It is to be compiled by, and on the responsibility of, the directors of the society and of the successor company. If a society decides to send a Transfer Summary, rather than the Transfer Statement, with the notice of the meeting, then the Transfer Summary must contain the directors' responsibility statements and state that it has not been approved by the Authority while the full Transfer Statement, which has been so approved, is on request available free of charge, to any member of the society to whom the Transfer Summary was sent, at any branch or office of the society or by post.

The Transfer Document

- 4.5 The Transfer Statement or Transfer Summary does not have to be a separate document. In practice it will usually be convenient to include it in a comprehensive Transfer Document which will also contain the notice of the meeting at which the Transfer Resolutions are to be moved, an explanation of the transfer procedure (including details of the confirmation stage - see section 6) and a description of the requirements of the society's Rules concerning entitlement to vote. It may also be convenient to include additional material required by the UKLA in connection with a flotation. However, the statutory Transfer Statement or Transfer Summary within the Transfer Document should be clearly identified as such (either by printing it on a different colour of paper or by some other means). An illustrative example of the structure of a Transfer Document containing a Transfer Statement is given in Annex A to this chapter. A Transfer Document containing a Transfer Summary should take much the same form (in that

case, the Transfer Statement made available to the members on request could be a separate document).

- 4.6 If shares in the successor company are proposed to be offered to members, either for subscription or free of charge, the society will need to consider whether and, if so, how it should combine the information relevant to the members' decision on the proposed transfer, and that relevant to the share offer, in one document. The two requirements differ, particularly in extent. Combining the Transfer Statement and share prospectus may run the risk of confusing the issues for some members.
- 4.7 The Authority and its staff may be willing, but only if time and its resources permit, to comment informally on material additional to the statutory Transfer Statement which the board proposes to put to the members. The Authority considers that, if asked, it can best help the board and the members by making informal comments at the formative stage. However, it will only comment on the clear understanding that the final decision on what information to put to the members outwith the Transfer Statement is for the board to decide. The Authority is conscious that it may have to assess such additional material in the light of representations on the society's application for confirmation of the proposed transfer, and any comments which it does offer are without prejudice to its position in those proceedings.
- 4.8 However, the Authority cannot undertake the additional work of reviewing and commenting upon the draft Transfer Summary. As is noted in paragraph 4.4, the board alone is responsible for ensuring that the Summary fairly and accurately summarises the prescribed information in the Transfer Statement, and that it fulfils the requirements of the 1986 Act and the Transfer Regulations. As with the other information provided to the members in addition to the Transfer Statement, the Authority will review the Transfer Summary at the confirmation stage of the transfer procedure.

Board Statements

- 4.9 The Transfer Regulations, deliberately confine the particulars required to be included in the statutory Transfer Statement to information which is factual and which can be verified by a society and its professional advisers, including factual statements of the reasons why the board decided to recommend the transfer and its terms (which may include statements of the board's belief and opinions, clearly identified as such) and the options it considered for the future conduct of the society's business, all of which can be verified by reference to the board's minutes and papers. A board may choose to engage

in more general advocacy of the merits or fairness of its proposals elsewhere in the documents sent to members, in which case, the Authority may have to have regard to whether such material is consistent with the information given in the statutory Transfer Statement when it comes to consider an application for confirmation.

- 4.10 The whole Transfer Document should be covered by **responsibility statements** by the directors of the society and the successor company. This may be given along the following lines (either a joint statement or separate statements by each board):

“The directors of Building Society and the directors of accept responsibility for the information relating respectively to the society and the company which is contained in this document. To the best of the knowledge and belief of the directors (who have taken all reasonable care to ensure that such is the case) the information contained in this document is in accordance with the facts and does not omit anything likely to affect the import of such information”.

Application and Authority Approval

- 4.11 It will be helpful to both the society and the Authority for the society to consult the Authority about the outline structure of, and main features to be contained in, the Transfer Document at an early, formative stage. The Authority will also be prepared to consider a full specification of the proposed cash or share distribution scheme. Thereafter, a formal written application for approval of the statutory Transfer Statement must be made to the Authority by, or on behalf of, the board and accompanied by a draft Transfer Statement which should be as complete as is reasonably practicable at that stage, together with the fee prescribed by the current Fees Rules.

- 4.12 The Authority will then consider the application and decide whether or not to approve the Transfer Statement. It must satisfy itself that:

- (a) in its opinion, the terms of the transfer scheme described in the Transfer Statement are consistent with the 1986 Act;
- (b) the Transfer Statement contains particulars of the matters required by the Transfer Regulations;
- (c) there is no further material information which it appears to the Authority, on the basis of what it knows at that time, is relevant to the decision of the members

and is appropriate to the Transfer Statement (since that Statement carries the explicit approval of the Authority);

- (d) the information in the Transfer Statement is presented clearly, in a balanced way, is consistent with the facts as known to the Authority, and is supported by responsibility statements from the directors and by opinions from the society's auditors and advisers.

For that purpose, the Authority will require supporting documentary information, including, in particular:

- (e) the draft Transfer Agreement, which will incorporate a full specification of the transfer distribution scheme (the Transfer Statement by itself being an inadequate basis for considering the legal issues);
- (f) a description, supported by opinions of the society's auditors and legal advisers, of the terms of the proposed scheme of distributions of funds or shares to members, Trustee Account Holders and others, including the systems and procedures required to make the distributions and copies of the notices and other documents to be used;
- (g) in the case of a specially formed company, the draft articles of association of the successor company (including the requisite protective provisions);
- (h) the Rules of the society (6 copies);
- (i) the full accounts and auditors' reports on which the financial information is based;
- (j) a checklist of the information required by the Transfer Regulations showing where each item may be found in the draft Transfer Statement.

4.13 The process of consideration will consist of discussions and correspondence between the Authority and the society, which are likely to lead to the production by the society of one or more redrafts of the Transfer Statement to take account of the Authority's comments, and refinements proposed by the society, to improve the clarity, completeness and drafting of the Statement. Clearly, the time necessary to complete this process will depend upon the quality and completeness of the draft Statement submitted with the first

application, the complexity of the proposed terms of the transfer and whether they include any novel features, and whether it proves necessary to apply to the High Court for the determination of any legal issues. The Authority will seek to deal with the process efficiently and expeditiously. However, its speed of response will necessarily be affected by the factors referred to above as well as the commitments and priorities of the Authority's relevant resources. The draft Transfer Statement must also be fully verified, to the satisfaction of the board, which process may be expected to take up to 6 weeks.

- 4.14 The Fees Rules provide that a further fee is payable by the society each time it submits a revised draft Transfer Statement to the Authority for approval. However, the Authority may waive or reduce the additional fee where it is satisfied that the revisions to the original, or previous, draft are not substantial.
- 4.15 When the society has settled on the final draft of a Transfer Statement which the Authority is minded to approve, the society should submit two authenticated copies of the final draft Transfer Statement to the Authority with the following documents:
- (a) a certified copy of the Transfer Agreement made between the society and the successor company;
 - (b) the Memorandum and Articles of Association of the successor company;
 - (c) a checklist of the information required to be included in the Transfer Statement pursuant to the Transfer Regulations;
 - (d) certified copy of an opinion from the society's auditors pursuant to paragraph 17 of Part I of Schedule 1 to the Transfer Regulations;
 - (e) certified copies of any other experts' reports or opinions which appear or are referred to in the Transfer Statement;
 - (f) certified copy of an opinion from the successor company's auditors pursuant to paragraph 17 of Part I of Schedule 1 to the Transfer Regulations;
 - (g) statutory accounts of the society and its connected undertakings for the previous 3 financial years, together with a reconciliation between those accounts and the figures appearing in the Transfer Statement;

- (h) in the case of an existing company, consolidated statutory accounts of the company/group for the previous 3 financial years, together with a reconciliation between those accounts and the figures appearing in the Transfer Statement;
- (i) certified copy of a letter of consent from the society's auditors relating to the issue of the Transfer Statement;
- (j) in the case of an existing company, certified copy of a letter of consent from the successor company's auditors relating to the issue of the Transfer Statement;
- (k) certified copy of a letter of consent from the Banking Regulator relating to the issue of the Transfer Statement with the inclusion of a statement as to the willingness of the Banking Regulator to authorise or, as the case may be, to continue to authorise the successor company to accept deposits;
- (l) certified copies of letters of consent from any other experts relating to the issue of the Transfer Statement with the inclusion of any reports or opinions referred to in paragraph 4.15(e);
- (m) certified copies of responsibility letters signed by the directors of the society (see paragraph 4.10);
- (n) certified copies of responsibility letters signed by the directors of the successor company (see paragraph 4.10);
- (o) certified copies of the minutes of the boards of the society and the successor company approving the Transfer Statement, the Transfer Agreement and related documents and approving the release of the responsibility letters mentioned in 4.15(m) and (n) (respectively) to the Authority;
- (p) an assurance from the directors of the society concerning the society's register of members and its systems (see paragraph 5.15);
- (q) a declaration by the directors of the society, and a similar declaration (as appropriate) by the directors of the successor company, along the following lines:

“We confirm that the statutory Transfer Statement was approved at a meeting of the Board of Directors of the Society held on (.....). The Directors of the Society agreed that copies of the responsibility letter could be made available to the Financial Services Authority in connection with this application. We also confirm that apart from the inclusion of [.....] no other changes have been made to the statutory Transfer Statement from the Pre-Approval proof dated (.....) handed to you on (.....) and that no changes have been made to the Transfer Agreement from the draft dated (.....) and handed to you on (.....).”

“We hereby request pursuant to our application dated (.....), that the Financial Services Authority approves, in accordance with paragraph 4(3) of Schedule 17 to the 1986 Act, the contents of the statutory Transfer Statement so far as they concern the prescribed matters (as defined in paragraph 1 of that Schedule) and any matter of which particulars are required to be given under paragraph 3(1)(b) of that Schedule.”

4.16 The Authority’s statement of approval of the Transfer Statement will be given as is set out in Annex A.

4.17 The Authority’s approval of the Transfer Statement will be confirmed by returning to the society one authenticated copy of the Transfer Statement with the Authority’s certificate of approval signed by an authorised signatory for the Authority. The society will be asked to give 50 copies of the printed Transfer Document and Transfer Summary, if any, to the Authority when they are available. There is no statutory requirement for copies of the Transfer Statement and Transfer Summary to be placed on the public file of a society but, because they are both public documents, the Authority will pass copies of them, and the Transfer Document, to the Central Office for filing. If a public announcement of the transfer proposal was not to be made until after the Authority had approved the Transfer Statement, the Authority would not pass copies of the Statement, Summary or Document to the Central Office until after the announcement. None of the other documents referred to in paragraph 4.15 will be passed to the Central Office.

4.18 The number of copies of the Transfer Statement to be printed will, of course, depend upon whether a society intends to distribute a Transfer Summary to its members with the notice of the general meeting. In that case, the society must make its own judgement

about the number of copies of the full Transfer Statement to be printed, bearing in mind the requirements of paragraph 4(2) of Schedule 17 that sufficient copies must be available at every office or branch of the society and for despatch by mail.

A Note on Style

4.19 A Transfer Document is bound to be lengthy and somewhat complex. It has to contain a lot of information, but its complexity will depend to a large extent on the terms of the transfer, particularly the transfer distribution scheme, proposed by the board. Bearing in mind that the purpose of the Transfer Statement is to provide information to the generality of members, it should be written in a clear and concise style and, so far as possible, in plain English. The Authority will be concerned that, because the statutory Transfer Statement is largely concerned with matters of fact, those matters are presented clearly and unambiguously. To the extent that it is necessary to include statements of the opinion or belief of the board, those statements should be clearly identified as such in the Transfer Statement. The board's views on the fairness and merits of the proposed transfer and its terms will form a separate part of the Transfer Document, as discussed in paragraph 4.9. Annex A suggests a structure for the Transfer Document which is designed to present its readers with a clear and logical sequence of topics. The Authority suggests that one of the main tasks of the society's project manager (see paragraph 2.13) should be to ensure that the Transfer Document is drafted in a clear and concise style. This will be a great help in achieving the Authority's approval of the Transfer Statement, and the board's verification of the whole Transfer Document, without undue difficulty and within a reasonable timescale.

5. GENERAL MEETINGS AND RESOLUTIONS

This section describes the requirements of the 1986 Act concerning members' entitlement to vote, the register of members and the sending of notices of meetings. It also discusses general meeting arrangements, the resolutions and majorities required and the counting of votes. *The directors of a society must satisfy themselves that they observe the general law on meetings, the relevant provisions of the 1986 Act and the society's own Rules.*

Resolutions and Voting Majorities

5.1 The 1986 Act provides that a transfer must be approved by the requisite Transfer Resolutions in accordance with paragraph 30 of Schedule 2 (Section 97(4)(c)) as follows:

- (a) **a borrowing members' resolution** passed on a poll by a simple majority of borrowing members qualified to vote and voting (see paragraph 29(1) of Schedule 2 for the definition of a borrowing members' resolution); and
- (b) **a shareholding members' resolution** (see definition in paragraph 27A of Schedule 2) passed on a poll by a majority of at least 75% of shareholders qualified to vote and voting, and on which:
 - (i) in the case of a **conversion**, not less than 50% of shareholders qualified to vote on a shareholding members' resolution **voted** (see SI 1997/2714); or
 - (ii) in the case of a **takeover**, not less than 50% of shareholders qualified to vote on a shareholding members' resolution (or shareholders so eligible who held not less than 90% of the total share balances held on the voting date by all shareholders qualified to vote) **voted in favour**;

provided that, in each case, notice has been duly given that the resolution is to be moved as a shareholding members' resolution or a borrowing members' resolution, as the case may be, and, in the case of the shareholding members' resolution, that the resolution will not be effective unless it satisfies the requirements specified in 5.1 (b) A member may vote either in person at the meeting or by appointing a proxy, and paragraph 33(1) of

Schedule 2 provides that the voting on Transfer Resolutions may **not** be conducted by postal ballot.

- 5.2 Section 99(2) of the 1986 Act provides (see paragraph 3.24) that, where a society proposes to pay **compensation to directors or other officers** for loss of office or diminution of emoluments, attributable to the transfer, such compensation must be approved by a special resolution of the society's members; that is, a resolution passed by a majority of at least 75% of members (both shareholding and borrowing members together) qualified to vote and voting (paragraph 27 of Schedule 2 to the 1986 Act). This resolution is separate from the Transfer Resolutions required to approve the other terms of transfer. The Treasury has not made regulations under Section 99(3) of the 1986 Act to set limits below which compensation may be paid without the authority of a special resolution. Therefore, in every case where compensation is proposed, the members must vote on the proposal as a separate issue from whether they approve the proposed transfer itself. "Other officers" include, in addition to the Chief Executive and Secretary, any persons who exercise managerial functions under the immediate authority of a director or the Chief Executive of a society (see "manager" and "officer" in Section 119 of the 1986 Act).
- 5.3 As is described in paragraphs 3.26 and 3.27, if the terms of a transfer include provision **for increased emoluments of directors or other officers** in consequence of the transfer, an ordinary resolution approving any such provision must be put before a meeting of the society. An ordinary resolution is passed by a simple majority of members (both shareholding and borrowing members voting together) qualified to vote and voting. However, it is not required that the resolution must be put to the same meeting as the Transfer Resolutions, neither is approval of the ordinary resolution required to authorise such increased emoluments which, as terms of the transfer, are authorised by the passage of the Transfer Resolutions. The purpose of Section 99A of the 1986 Act is to give the members an opportunity to express their views on these matters separately from their decision on whether or not to approve the transfer and its terms.

Notice of the Meeting

- 5.4 Paragraph 22 of Schedule 2 to the 1986 Act requires that notice of a meeting shall be given to every member of a society who would be eligible to vote at the meeting. The notice is also to be given to every member who will attain the age of 18 years on or before the date of the meeting, and to every person who becomes a shareholding or

borrowing member of the society after the date of the notice but before the date specified by the society as the final date for the receipt of proxy voting forms. Note also that the Transfer Statement or the Transfer Summary, as the case may be, must also be sent to every member entitled to notice of the meeting (paragraphs 2 and 4(1) of Schedule 17 to the 1986 Act).

Entitlement to Vote

- 5.5 Paragraph 5 of Schedule 2 to the 1986 Act provides that no person may be a member of a building society unless he or she is a shareholding member or a borrowing member. A shareholding member is a person who holds a share in the society (that is, an investment in a share account or PIBS). A borrowing member is a person who is indebted to the society in respect of a loan fully secured on land. However, the Rules may provide that borrowing membership is conferred by a loan substantially secured on land, or shall cease if the loan is foreclosed or the land is taken into possession by the society. A minor (that is a person under 18 years of age) may be a member, but may not vote on any resolution.
- 5.6 The mandatory provisions of Schedule 2 to the 1986 Act concerning a member's entitlement to vote on a resolution, which must be reflected in societies' Rules, are that the member must be a member on the voting date, must have been a member at the end of the last financial year before the voting date (paragraph 23(1) of Schedule 2) and must have attained the age of 18 years (paragraphs 5(3) and 34(2) of Schedule 2) on or before the date of the meeting. So far as borrowing members are concerned, the member is not entitled to vote in that capacity if his indebtedness to the society at any relevant time is less than £100 (paragraphs 29(2) and 36 of Schedule 2).
- 5.7 However, Schedule 2 specifies the following further provisions, some, none or all of which **may** be included in a society's Rules with respect to the **entitlement of shareholding members to vote** on any resolution; a person must (see Schedule 2 paragraphs 23(3) to (5) and 36):
- (a) have a qualifying shareholding (which must not be set higher than £100), in one or more share accounts or PIBS, on the "qualifying shareholding date";
 - (b) hold shares on the voting date; and
 - (c) have held shares continuously between those two dates.

5.8 The “**qualifying shareholding date**” is either: the last day of the financial year preceding the voting date; or, if the voting date falls during that part of a financial year which follows the conclusion of the society’s AGM commenced in that year, the first day of the period beginning 56 days before the date of the meeting. Therefore, if a society’s Rules, following the BSA Model Rules (Fifth Edition), include the provisions concerning shareholding and continuity of membership, described in paragraph 5.7, **and if the voting date is later than the AGM in that year**, a person to be entitled to vote on a shareholding members’ resolution must:

- (a) have been a shareholding member on the last day of the previous financial year;
- (b) have held shares to the value of at least £100 on the day 56 days before the date of the meeting;
- (c) have held shares continuously from the 56th day through to the voting date; and
- (d) hold shares on the voting date.

But note that there is no requirement for continuity of shareholding between 5.8(a) and (b) (In contrast, in the case of an ordinary or special resolution, membership at 5.8(a) may be satisfied by either borrowing or shareholding membership provided the shareholding member satisfies the other conditions of (b) to (d). in order to vote in his or her capacity as a shareholder.) Note also that a person cannot meet a requirement for “holding shares” on a given date, or during a given period, by relying on his holding of a share account with an overdrawn balance; and a person cannot meet a requirement for being a “member” on a given date (for example, at 5.8(a)) by relying on his holding of such a share account.

5.9 The mandatory provisions of Schedule 2 concerning **entitlement to vote on a borrowing members’ resolution** are, as noted above, that the member must have been, and be, indebted to the society for at least £100 (whether on one or more accounts) at the end of the last financial year before the voting date, and on the voting date, in respect of an advance fully secured (or, if the Rules permit, substantially secured) on land (paragraphs 5(2), 23(1), 29(2) and 36 of Schedule 2) and have attained the age of 18 years by the date of the meeting (paragraphs 5(3) and 34(2) of Schedule 2). But note that there is no dispensation in the 1986 Act for the Rules to reduce the qualifying amount below £100, nor to provide for a continuity of membership qualification.

- 5.10 Schedule 2 makes provision in respect of **joint shareholders** (paragraph 7) and **joint borrowers** (paragraph 8). The only person entitled to exercise the right to vote on behalf of the joint shareholders or joint borrowers is the one who is named first in the records of the society, described respectively as the “representative joint holder” or the “representative joint borrower”.
- 5.11 A member may vote once only on any resolution, irrespective of the number of accounts he or she may hold. The amount of the balance(s) held on account(s) is not material, except to qualify to vote - see paragraphs 5.6 to 5.8. Thus, a member with several share accounts and/or several mortgage accounts, whether as sole and/or representative joint holder, may vote once only on any resolution. When the membership votes as a whole on an ordinary or a special resolution, each member may vote only once, whether he or she is a shareholding or a borrowing member or both. Where shareholding members and borrowing members vote separately, as on the Transfer Resolutions, members entitled to vote may vote only once, if a shareholding member, on the shareholding members’ resolution and once, if a borrowing member, on the borrowing members’ resolution. A person entitled to vote both as a shareholding member and as a borrowing member may of course, vote once on each resolution.
- 5.12 The “**voting date**” is defined by paragraph 23(6) of Schedule 2 as, for this purpose, either:
- (a) for members who appoint a proxy, the last date specified by the society for the receipt of proxy voting forms, which may not be more than 7 days before the date of the meeting (paragraph 24(6) of Schedule 2). A proxy vote remains valid if the member ceases to be a member after the proxy voting date but before the date of the meeting (paragraph 24(2) of Schedule 2); or
 - (b) for all other members, the date of the meeting.
- 5.13 The guidance given in the foregoing paragraphs of this section is intended to give a general description of the provisions of the 1986 Act and of the Rules suggested by the BSA Model Rules. Societies are advised to satisfy themselves that they observe the specific provisions of the 1986 Act and of their own Rules.

Register of Members

- 5.14 Every society is required to maintain a register of the names and addresses of its members and whether each member is a shareholding member or a borrowing member or both. (Schedule 2, paragraph 13). The register should, so far as possible, be “de-duplicated”; that is, multiple account holders should be identified and their names recorded once only in the register. A society’s systems must also be capable of recognising those members who are eligible to vote by, for example, aggregating share account balances of multiple account holders to check that they have the requisite qualifying shareholding, by checking members’ continuity of shareholding, and by identifying minors (see paragraphs 5.5, 5.6 and 5.9). This information is required to ensure that the notice of the meeting is sent to all the members entitled to receive it, and that the scrutineers have adequate systems to validate the votes cast on the Transfer Resolutions.
- 5.15 The directors of a society contemplating a transfer must satisfy themselves, in consultation with their external auditors, or other advisers, that the society’s systems are capable of delivering the information described above. The Authority will require an assurance on this point when the society applies for approval of the Transfer Statement. One of the criteria which the Authority has to consider at the confirmation stage is whether some relevant requirement of the 1986 Act or the Rules was not fulfilled (see section 6).
- 5.16 The problem of avoiding duplication in the register of members is significant for most societies of any size. Societies generally now seek to establish, when new accounts are opened, whether or not the applicant is an existing member and, if so, which accounts are relevant to voting and other membership rights. The task of identifying multiple account holders is complicated by confidentiality requirements. For example, if two accounts are held by a Mr A Smith and a Dr A Smith, both at the same address, the society cannot know (in the absence of other information such as date of birth) whether the two accounts belong to the same person, one opened before and one after he qualified, or by the doctor and his son. A letter of enquiry to one asking about both accounts would risk breaching customer confidentiality. If it is the same person, there is a risk that he will be given the opportunity to vote twice or, if neither account holds more than £100 but they aggregate above that qualifying amount, be denied a vote to which he is entitled. It is good practice for a society, when it has announced its intention to transfer its business, to write to all its members individually setting out the information about them which it holds on its records, inviting them to confirm that the

information is correct and to say whether they have received more than one such letter as a shareholder or as a borrower.

- 5.17 Where a society identifies a number of accounts which appear to be held by a single member, but it cannot be sure, then it must send separate meeting notices in respect of each account which satisfies the qualifying conditions for entitlement to vote. Where such accounts do not separately entitle the member to vote but would do so if aggregated (by satisfying the £100 minimum shareholding condition) the society may consider it advisable to send separate notices in respect of each account with the warning that, on the information available to it, the society believes that the member is not eligible to vote. However, its systems should identify the possible multiple holding so that, if more than one vote is received in respect of that group of accounts, the scrutineers are alerted to the possibility, and can check the proxy forms for evidence of invalid duplicate votes. The voter's declaration suggested by the BSA Model Rules, in conformity with paragraph 34 of Schedule 2 to the 1986 Act, provides some protection against votes being cast by minors, but none against duplicate votes. It is, however, the duty of each society to make sure that its register of members is reliable.

General Meeting Arrangements

- 5.18 Paragraphs 5.19 to 5.25 consider the requirements for sending notices of meetings and Transfer Statements, or Transfer Summaries, to members, and the conduct of meetings at which Transfer Resolutions are to be moved. It is for societies to satisfy themselves that they comply with the relevant requirements of the 1986 Act, their Rules and the general law on meetings

Notice of Meeting

- 5.19 The statutory requirements concerning notices to members are in paragraph 22 of Schedule 2 to the 1986 Act. Notice of the meeting must be given to each shareholding and borrowing member of the society who would be eligible to vote at the meeting if the meeting were held on the date of the notice (a single date for all notices irrespective of when they are despatched). In addition, notice must also be given to any person who will attain the age of 18 years after the date of the notice but on or before the date of the meeting, and to every person who becomes a shareholding or borrowing member of the society after the date of the notice but before the final date for receipt of proxy voting forms, provided, in each case, that the member will be entitled to vote. Note also that the Transfer Statement or Transfer Summary must be sent in or with the notice to every

person entitled to receive it (paragraphs 2 and 4 of Schedule 17 to the 1986 Act). Accidental omission to give notice of a meeting to any person entitled to receive it does not invalidate the proceedings at the meeting. However, “accidental omission” does not include a systemic failure to send notices (e.g. omitting to send notices to new shareholders or borrowers, or omission of a group or class of members from the mailing list arising from a fault in a computer programme), nor all cases of error by management - see also paragraph 5.38.

5.20 The 1986 Act also provides, in paragraph 21 of Schedule 2, for the **length of notice** to be given to members. The period of notice given must be not less than 21 days or such longer period as the society’s Rules prescribe. The precise procedures for sending notices, the way in which the days are to be counted, and presumed receipt of notices duly sent, will normally be set out in the Rules. Particular points to note are:

- (a) the 21 days’ notice expires with the closing date for the receipt of proxy voting forms, not the date of the meeting;
- (b) if reliance is to be placed on a provision in the Rules that notices can be deemed to be served 24 hours after posting, then first class post or equivalent means of delivery should be used. However, it is advisable to allow a margin of at least an extra day or two, but more if second class post is used;
- (c) if a society contracts with a commercial mailing firm, it must ensure that the firm is comprehensively instructed about the society’s despatch and delivery requirements, and the society should carry out spot checks to satisfy itself that its instructions are being properly carried out. A failure by the contractor may invalidate the meeting, even if the society itself has used its best endeavours to police the operation.

5.21 The Transfer Statement or Transfer Summary, as the case may be, is required, by paragraph 4(1) of Schedule 17 to the 1986 Act, to be sent “**in or with**” the notice of the meeting to every member entitled to that notice. As is suggested in section 4, it may be expedient to include both in a comprehensive Transfer Document or booklet.

5.22 Notices and Statements or Summaries need not be sent to any member in whose case the society has reason to believe that communications sent to him at his registered address are unlikely to be received by him (Schedule 2, paragraph 14). In those circumstances, a society is required to place notices of the meeting prominently in every branch office, or

to place advertisements in newspapers circulating in the areas in which the society's members live. Such notices or advertisements must be published at least 21 days before the date of the meeting, and must state where members can obtain copies of the Transfer Summary, the Transfer Statement, the Transfer Resolutions and proxy voting forms (paragraph 35 of Schedule 2 to the 1986 Act).

- 5.23 It should be noted, however, that a member's "registered address" may not be the address shown in the society's register of members but a different address to which the member has requested that communications from the society be sent (paragraph 13(4) of Schedule 2 to the 1986 Act).

Conduct of the Meeting

- 5.24 The meeting should be held at a time and place considered by the board to be most convenient for the generality of the society's members. This may not necessarily be the same as the traditional time and place for the AGM. In deciding on this, the board should take account of the geographical location of their members, and the probability that an unusually large number of members may wish to attend a meeting to consider a proposed transfer.
- 5.25 Subject to the society's Rules, its chairman will normally chair the meeting. His function as chairman of the meeting is to ensure that all views may be presented and properly discussed. He is unlikely to be able to fulfil that role if he acts also as chief advocate of proposals which are controversial among members. In such cases it might be appropriate to give to another director the tasks of explaining the board's recommendations and of responding to questions from members.
- 5.26 A Transfer Resolution cannot be amended at the meeting except in a way which does not change its substance at all. This is because an amendment to such a resolution has to be subject to the same procedure and period of notice to members as the resolution itself. If a board decides, after due notice of such a resolution has been sent to the members, that the resolution should be amended, then it will be necessary to submit the amended resolution, with due notice, to a general meeting at a later date, unless of course there is still time to fulfil the notice requirements.

Conduct of the Voting

- 5.27 The conduct of the voting must not only be fair but also be seen to be fair, otherwise the result may be called into question by representers at the confirmation stage. The votes must be counted by independent scrutineers. The board may ask the scrutineers, in advance of the meeting, for a running tally of the number of votes being cast if it thinks it might properly encourage more members to vote if the response is low. However, to ask the scrutineers **how** the votes are being cast, before the time comes at the meeting to instruct proxies, carries the risk of accusations, however unfounded they may be, and possible challenge at the confirmation stage on the grounds that the board suppressed proxy votes against the Resolutions, or unduly influenced members to vote in favour. A board which asks the scrutineers for a running tally of votes, and which circulates its members with further exhortations to vote, must be prepared to argue its case in the face of such accusations at the confirmation hearing. Any circular to members sent after the Transfer Document was sent to them must, therefore, be very carefully considered.
- 5.28 Experience has demonstrated the need for societies to take the greatest care to ensure that they comply strictly with the statutory procedural requirements and their own Rules on meetings and resolutions. The person chairing the meeting should ensure that he or she is well briefed and aware of the Rules and the general law relating to procedural resolutions, such as resolutions to adjourn the meeting. The Authority will require a confirmatory report from the scrutineers on the validity of the voting procedures when the society applies for confirmation (see paragraph 5.34).
- 5.29 The procedures for the conduct of proxy voting will normally be provided for in the society's Rules, in conformity with paragraphs 24 and 34 of Schedule 2. The 1986 Act requires that every proxy form sent by a society to its members must enable the member to direct the proxy how to vote (paragraph 24(4A)). In addition, to minimise the risk of the society's proxy voting procedures being misunderstood, the Authority recommends that the design of the proxy form is carefully considered (preferably a self-contained form clearly to be returned intact) and that it should include:
- (a) adequate space to insert the name of a proxy other than the chairman of the meeting, and a statement (which must also appear in the notice of the meeting) that the proxy appointed need not be a member of the society (a reminder that the voting member's own name should not be inserted will also be helpful);

- (b) an explicit statement that if the member does not instruct his proxy to vote for or against the resolution, then the proxy will cast the vote, or abstain, as he thinks fit;
- (c) the declaration, as provided by the Rules, in accordance with paragraph 34 of Schedule 2;
- (d) full recital of the text of the shareholding members' or borrowing members' resolution(s) or, if this is not practicable (e.g. because of space restrictions), a clear indication that the full text may be found in the notice of the meeting;
- (e) instructions as to the return of completed proxy forms, including the last effective date for receipt by the society or by the scrutineers. A pre-addressed and pre-paid envelope or other sealed means of return should be provided.

5.30 The 1986 Act does not require societies to send proxy voting forms to members with notices of meetings. However, the Authority believes that, on a matter as important as a transfer, and bearing in mind the 50% turnout (conversion) and 50% support (takeover) requirements on the shareholding members' resolutions, societies would be well advised to send a proxy voting form to members with the meeting notice. If a society decides, nevertheless, not to send proxy forms to members entitled to vote, then it should make clear to the members that proxy voting forms can be obtained on demand from its branches and/or by application to a central point.

5.31 The arrangements for the collection of the proxy forms should be such as to secure confidentiality and to avoid the risk of loss, whether accidental or deliberate. The Rules may provide for return of proxy forms to the scrutineers either directly or to the society's principal office. Where proxy forms are returned to the society's offices, the Authority recommends that the procedures should incorporate the following features:

- (a) the proxy form should be enveloped or otherwise sealed so that the members' voting instructions are concealed;
- (b) the envelope provided should be clearly marked so that the society can readily identify and separate it from other mail without the envelope being opened;

- (c) staff responsible for receiving and sorting mail should be given specific instructions about the handling of proxy forms and the overriding importance of security;
 - (d) secure storage of proxy forms should be provided up to the point at which they are handed over to the scrutineers;
 - (e) equivalent handling and security procedures should be applied to proxy forms handed in at branches.
- 5.32 The Authority suggests that proxy voting forms for shareholders and borrowers should be easily distinguishable, perhaps by colour coding, both as an aid to members who may be entitled to vote in each capacity, and as an aid to the scrutineers counting the votes.
- 5.33 Members may attend the meeting and vote in person. There must, therefore, be satisfactory systems in place in accordance with the Rules to identify and cancel any proxy votes they may previously have returned.

Scrutineers' Report

- 5.34 The scrutineers are responsible for checking the validity of votes cast in person and by proxy. The scrutineers must be independent of the society and not have a direct interest in the result of the voting. For example, they should not be officers expecting to receive compensation or appointments under the terms of the transfer. It will usually be appropriate to appoint the society's auditors, and it is desirable that they should be appointed not just for the arithmetical count of votes but also to supervise the voting process as a whole so that they are in a position to confirm, after the vote, that all the requirements of the 1986 Act and the society's Rules have been complied with. This would include:
- (a) determining and validating member mailing lists for notices of the meeting and Transfer Statements or Transfer Summaries and for Trustee Account Holders (see paragraphs 3.15 and 5.4);
 - (b) despatch procedures;
 - (c) timing of notices and despatch of documents;

- (d) form and content of proxy voting forms;
- (e) receipt and custody of completed proxy voting forms;
- (f) validation of completed proxy voting forms to establish that members are qualified to vote and that forms are properly completed;
- (g) identification and validation of members attending and voting at the general meeting;
- (h) voting procedures at the meeting including casting of proxy votes, count of votes cast in person and aggregation of proxy and personal votes cast on the Transfer Resolutions, and on any special resolution required to authorise the payment of compensation to directors or other officers;
- (i) voting procedures at the meeting, or at another meeting, as the case may be, and the count of votes on any ordinary resolution to approved increased emoluments of directors or other officers (if required).

5.35 To fulfil the duties outlined above, it is suggested that the scrutineers would need to:

- (a) examine the systems and procedures to be employed by the society, before they are implemented, to ensure that they are satisfactory;
- (b) carry out such checks and tests as they consider necessary during the operation of the procedures as will enable them to be satisfied that the specified procedures are being carried out in practice;
- (c) provide that where validation functions are carried out by the society's staff this is done under the direction and supervision of the scrutineers;
- (d) direct and supervise the count of the votes cast both by proxy and personally at the meeting.

5.36 Validation checks during the counting of votes may be expected to include the following:

- (a) only proxy forms which comply with the 1986 Act and the society's Rules have been used;
- (b) the member is eligible to vote under the 1986 Act and under the society's Rules (**NB** a proxy vote may still be valid even though the member has ceased to be entitled to attend and vote at the meeting after the closing date for receipt of proxies - see paragraph 5.12 (a));
- (c) only one proxy form per member eligible to vote is included in the count (separate forms may be sent to and returned by a person eligible to vote on both the shareholding members' resolution and the borrowing members' resolution);
- (d) minors are excluded and that there is an explicit confirmation by each member voting by proxy that he is aged 18 or over;
- (e) the proxy form is completed and signed and is otherwise valid (where a proxy form lacks a signature but is otherwise valid, it is usual, if time permits, for the scrutineers to return the form to the member for signature and return in a pre-paid envelope).

5.37 The scrutineers' initial report will be made to the society at the meeting (which may be adjourned for this purpose). The Authority will require, in support of a society's application for confirmation under Sections 97(4)(d) and 98 of the 1986 Act, a report from the scrutineers on the result of the vote on each Resolution (distinguishing between votes cast in person and by proxy), the total number of members eligible to vote (and the proportion of that number that the votes cast represent), the numbers of invalid votes cast and also confirmation that, in the opinion of the scrutineers, the arrangements for the conduct of the voting were such as to ensure that:

- (a) notices of the meeting and Transfer Statements or Transfer Summaries were sent to all those entitled to receive them, in accordance with the 1986 Act and the Rules of the society having regard, *inter alia*, to the matters referred to in this chapter;
- (b) the periods of notice given complied with the requirements of the 1986 Act and of the society's Rules, taking into consideration established conventions for the counting of days;

- (c) there were satisfactory procedures to ensure the security of proxy voting forms and to minimise the risk of loss or unauthorised access;
- (d) there were satisfactory procedures to ensure that the count of votes cast personally at the meeting included only votes cast by members eligible to vote and who had not mandated, or had withdrawn, a proxy vote.

5.38 In relation to the notice of the meeting, the scrutineers' report may properly have regard to the provision of paragraph 22(3) of Schedule 2 to the 1986 Act that "accidental omission to give notice of a meeting to, or non-receipt of notice of a meeting by, any person entitled to receive notice of the meeting does not invalidate the proceedings at that meeting". It should be noted, however, that there is authority to the effect that "accidental" and "non-receipt" would not cover all cases of "error" on the part of the society, for example an erroneous decision of management not to send notices to particular persons or groups of persons.

5.39 The Authority would find it helpful if the scrutineers' report would also comment upon any procedural difficulties encountered and, if the numbers of invalid votes appear to be significant, give an analysis of the reasons why votes were found to be invalid (see also section 6).

6. CONFIRMATION

No transfer can take effect until it has been confirmed by the Authority. This section first describes the form of application and public notice required. It then explains the Authority's view of how the statutory Confirmation Criteria should be interpreted. Finally, it gives guidance on the procedure customarily followed by the Authority when considering confirmation applications and hearing representations.

Application

- 6.1 Sections 97(4)(d) and 98(2) of, together with Part II of Schedule 17 to the 1986 Act, provide that when the necessary Transfer Resolutions have been passed the society must apply to the Authority for confirmation of the transfer in such manner as the Authority may direct. The society is also required, by paragraph 7 of Schedule 17, to publish notices of its application in one or more of the London, Edinburgh and Belfast Gazettes as the Authority directs and, if it so directs, in one or more newspapers. The choice of official Gazettes and national or local newspapers will, of course, have regard to the area in which the society's members live.
- 6.2 The application should specify the date on which the transfer is intended to take effect and should be accompanied by two authenticated copies of the Transfer Agreement. The scrutineers' report described in section 5, and a certified copy of the minutes of the general meeting at which the Transfer Resolutions were moved, together with a transcript of the meeting, must also be enclosed with the application, together with 10 copies each of the Transfer Document and the Transfer Summary (if sent), and copies of all other documents sent to members and any advertising material in connection with the proposed transfer. If a Transfer Summary was sent, the application should also be accompanied by a checklist of the information prescribed by Schedule 2 to the Transfer Regulations showing where each item may be found in the Transfer Summary.
- 6.3 A *pro forma* public notice of application, and *pro forma* letter of application are at Annex B. The appropriate fee is payable with the application, and a further fee is payable by the society if there is an oral hearing of the application, as prescribed by the Fees Rules.

The Confirmation Criteria

Statutory Provisions

6.4 Section 98(2) and (3) of the 1986 Act provides that the Authority must confirm a proposed transfer **unless** it considers that any one or more of the following four Confirmation Criteria apply:

- (a) some information material to the members' decision about the transfer was not made available to all the members eligible to vote; or
- (b) the vote on any resolution approving the transfer does not represent the views of the members eligible to vote; or
- (c) there is a substantial risk that the successor will not become or, as the case may be, remain a credit institution which is authorised to accept deposits for the purposes of the Act; or
- (d) some relevant requirement of the 1986 Act or of the Rules of the society was not fulfilled.

Section 98(4) of the 1986 Act then provides that the Authority shall not be precluded from confirming a transfer of business by virtue only of the non-fulfilment of some relevant requirement of the 1986 Act or the Rules (the Fourth Criterion in 6.4(d)) if it appears to the Authority that the failure could not have been material to the members' decision about the transfer, and the Authority gives a direction under that subsection that the failure is to be disregarded. Section 98(7) then provides that a failure to comply with a relevant requirement of the 1986 Act or the Rules shall not invalidate a transfer, once confirmed.

6.5 Where the Authority would be precluded from confirming a transfer by reason of any of the defects specified in the Confirmation Criteria, Section 98(5) and (6) of the 1986 Act provides that it may direct a society to remedy the defects. A direction under Section 98(5) may, amongst other things, require a society to:

- (a) call a further meeting; for example, to vote again in the light of a revised Transfer Statement containing material information previously omitted or after

correction of defects in the systems for sending meeting notices and Transfer Statements or Transfer Summaries and validation of votes;

- (b) secure the variation of the Transfer Agreement; or
- (c) secure the alteration of the protective provisions in the articles of association of a specially formed successor company.

If the Authority is then satisfied, having considered evidence furnished by the society, that the defects have been substantially remedied, it must confirm the transfer. If not, then confirmation must be refused.

Scope of the Authority's Powers

- 6.6 The Authority's powers in connection with applications for confirmation of a transfer are confined to considerations of whether, in the light of the facts, any of the Confirmation Criteria apply. It is not for the Authority to consider, or make judgements about, the merits of a proposed transfer or the fairness of its terms; these matters are first for the board of a society, and then for its members, to decide. Once the members have approved the transfer and its terms, the Authority has no powers to require a society to make any changes to those terms, although it may direct a society to remedy any failure to comply with a relevant requirement of the 1986 Act as a condition of confirmation.
- 6.7 The Authority has no general power to determine disputes between a society and its members, nor to seek to enforce other legislation or the general law. Disputes concerning services provided by societies in the ordinary course of their business are generally a matter, in the first instance, for a society's internal complaints procedure. They may also fall within the jurisdiction of the Financial Services Ombudsman Scheme. Disputes between a building society and a member of the society, in his or her capacity as a member, in respect of any rights or obligations arising from the Rules of the society or the provisions of the 1986 Act, fall within the jurisdiction of the High Court or, in Scotland, the Court of Session (Section 85 of and Schedule 14 to the 1986 Act). However, the Authority does have power, on the written application of certain members, to direct that the member has the right to obtain names and addresses from the society's register of members. Before it gives such a direction, the Authority is required to be satisfied that the member requires that right for the purpose of communicating with other members of the society on a subject relating to its affairs, and must have regard to the interests of the members as a whole and to all the other circumstances (paragraph 15

of Schedule 2 to the 1986 Act). A fee is payable by the applicant. Chapter 1 of this volume 2 of the IPSB gives guidance on applications for access to the register of members

Purpose of Confirmation

- 6.8 The purpose of the confirmation process is to enable:
- (a) interested parties to make representations with regard to the Confirmation Criteria;
 - (b) the society to respond to those representations;
 - (c) the Authority to make such enquiry as it considers necessary to reach informed conclusions on each of the Confirmation Criteria.
- 6.9 The Authority, in reaching its view on each of the Confirmation Criteria, has not only to assess the points made to it in representations, and the society's responses, but also to make such further enquiries as it considers necessary. In deciding how far it should pursue such enquiries, the Authority has to have regard to the role and effect of confirmation, and to the mischiefs which it is intended to prevent. The Authority considers that one role of confirmation is to provide a protection to members against the provision to them by the society of information which is inadequate, obscure or misleading, and against voting irregularities: in other words to ensure that the vote represents the informed decision of the members. The Authority would hope that this safeguard would work in the majority of cases by causing the board of a society to take care during the preparation of the Transfer Statement **not** to put confirmation at risk on this account; otherwise the Authority might find that it had to withhold confirmation at the last stage. In considering the First Criterion, the Authority will have regard to the totality of the information provided to the members by the board of a society, and not exclusively to the Transfer Statement and Transfer Summary.
- 6.10 The task of the Authority is accordingly:
- (a) to reach a considered view on each of the Confirmation Criteria;
 - (b) if that view is that none applies, to confirm;

- (c) if one or more of the First Three Criteria apply, to direct the appropriate remedial action, or to refuse confirmation;
- (d) if the Fourth Criterion applies, to consider whether it is appropriate to direct that failure be disregarded; if not, to direct the appropriate remedial action or to refuse confirmation.

In considering the Confirmation Criteria, the Authority may well have to look again at the Transfer Statement, or at issues which were considered in connection with approving that Statement. It may also then have to consider the adequacy of the Transfer Summary. In doing so, it has a duty to consider information and arguments put to it by representers and by the society, which of their nature were not available earlier, as well as those arising from its own consideration of the Criteria. The Authority would clearly only change the view reached at the time of approval of the Transfer Statement if there were good reason to do so. But it is under a duty to examine the Statement and connected issues at the time of confirmation in the light of any new information and arguments which become available. Accordingly, the Authority cannot be bound at the confirmation stage to the view that was taken at the earlier stage as to whether further factual information should be included in the Transfer Statement or as to the accuracy of its contents or the view taken as to the legality of the scheme.

- 6.11 The task of considering each of the Confirmation Criteria would still be necessary even if there were no representations. Without such enquiry and consideration the confirmation process would not properly be carried out. The Authority's view of how the Confirmation Criteria should be interpreted and applied is given in the following paragraphs.

The First Criterion

- 6.12 This criterion requires the Authority to consider whether some material information was not made available to the members. The Authority's own view, in which it concurs with the view previously adopted by the Commission in its confirmation decisions, can be summarised as follows:
- (a) the words "**made available to all the members eligible to vote**" mean that the criterion is mainly, if not exclusively, directed to the information provided by a society to the generality of its members;

- (b) the extent of “**information not made available**” can reasonably be assessed by considering how far the totality of information made available falls short of what might be expected to be put to its members by a financial institution of standing and repute seeking to put sufficient information and a fair and balanced assessment of it, and the board’s conclusions, to the members to enable them to take an informed decision;
- (c) the words “**material to the members’ decision**” require the Authority then to focus on whether it is within the bounds of reasonable possibility that the members’ decision would have been different had any deficiency in the information been made good, i.e. whether it could have changed the decisions on voting of sufficient members to lead to a different conclusion. If it is within the bounds of reasonable possibility that the deficiency might have changed the outcome, it is not for the Authority to determine whether it would actually have done so - it should put the decision back to the members. This test requires the Authority to take account both of the size of the vote and of the size of the majority within it;
- (d) the relevance of a particular piece of information to an investor and to a borrower may well be different. Accordingly, it is necessary to consider materiality separately in relation to the shareholding members’ resolution and the borrowing members’ resolution.

6.13 The Authority’s approach to determining whether this criterion is met is accordingly:

- (a) to review the material put to members, in the light of the representations made and the society’s responses, but also taking points of its own accord;
- (b) to consider, on the basis of that review, what information relevant to the decision of shareholders, or of borrowers, or both, might reasonably have been expected to be put to members by the board of a society of repute considering its fiduciary duty, and the extent to which (if at all) the information actually put falls short of that;
- (c) to consider separately in relation to the shareholding members’ resolution and in relation to the borrowing members’ resolution, whether any deficiency so identified was sufficient to amount to “information material to the members’ decision”.

The Second Criterion

- 6.14 This criterion requires the Authority to consider whether the votes on the Transfer Resolutions do not represent the views of the members. The main mischief to which it appears to be directed is a resolution approved by a small and unrepresentative vote.

The Third Criterion

- 6.15 This criterion is concerned with a matter of fact, to be established by reference to the Banking Regulator if a different body.

The Fourth Criterion

- 6.16 This criterion requires the Authority to consider whether the relevant requirements of the 1986 Act and the Rules have been fulfilled. The phrase “**relevant requirement of this Act or the rules of the society**” appears explicitly three times in Section 98 of the 1986 Act:

- (a) sub-section (3)(d) in the specification of this criterion;
- (b) sub-section (4) which gives the Authority power to disregard certain non-fulfilments;
- (c) sub-section (7) which provides that a failure to meet such a relevant requirement shall not invalidate a transfer of business, although such failure by a society without a reasonable excuse is a criminal offence.

The interpretation of the phrase is also directly relevant to sub-section (5) - the power of the Authority to give the society a direction to remedy defects specified in paragraphs (a) to (d) of sub-section (3).

- 6.17 Sub-section (8) defines “relevant requirement”:

“(8) In this section “relevant requirement”, with reference to this Act or the rules of a society, means a requirement of the applicable provisions of this Act or of any rules prescribing the procedure to be followed by the society in approving the transfer and its terms.”

Section 97(2) in turn defines “the applicable provisions” other than Section 97 as:

“section 98, section 99, section 99A, section 100, section 101, section 102, sections 102B, 102C and 102D, paragraph 30 of Schedule 2 and Schedule 17.”

It will be noted that Section 102A (joint account holders) of the 1986 Act is not an applicable provision and, thus, not a relevant requirement.

6.18 The Authority considers that sub-section (8) of Section 98 should be read naturally. The words “prescribing the procedure to be followed by the society in approving the transfer and its terms” apply only to the Rules, in order to specify which of the Rules of the society are “relevant requirements”. They do not apply as a matter of normal construction of the sentence to the “applicable provisions of this Act”; nor is it necessary that they should do so, since those provisions are specified in Section 97(2).

6.19 In the Authority’s view, the above interpretation of “relevant requirement of the 1986 Act” stems from the natural construction of Sections 98(8) and 97(2) which, in turn, is necessary to give effect to Parliament’s intentions for Section 98(5), (6) and (7). The Authority recognises that this interpretation does not quite fit Section 98(4). The test which the Authority has to apply in the case of sub-section (4) to a non-fulfilment of a relevant requirement of the 1986 Act is:

“if it appears to the Authority that it could not have been material to the members’ decision about the transfer”.

That test clearly is designed to relate to a failure to meet a procedural requirement or to some other failure which might have an effect on the voting.

6.20 The wording of Section 98 is such that no construction of the phrase is entirely free from difficulty. The Authority’s view is that the wording, and the intentions of Parliament, are best met by following the natural construction of sub-section (8), as a result applying a wide interpretation in sub-sections (3), (5) and (7), and implicitly in (6), but only considering that it is open to the Authority to make a direction under sub-section (4) in relation to non-fulfilment of a procedural requirement or other failure to which the test in that sub-section is apposite.

6.21 The Authority accordingly considers that the relevant requirements are those in:

- (a) sections 97 to 102, and 102B to D of, together with paragraph 30 of Schedule 2 to and Schedule 17 to the 1986 Act;
- (b) the Transfer Regulations; and
- (c) the Rules which prescribe the procedure to be followed; that is, in particular, the Rules concerning: membership; special meetings; notice of meetings; procedure at meetings; entitlement of members to vote on resolutions; appointment of proxies; and joint shareholders and borrowers.

Procedure

6.22 The procedure to be followed in confirmation proceedings is prescribed by Part II of Schedule 17 to the 1986 Act. Any interested party has the right to make written and/or oral representations to the Authority with respect to a society's application for confirmation. Written representations are to be copied to the society, which is to be afforded the opportunity to comment on them orally at the hearing of its application or in writing.

Representations

6.23 Persons making representations should state why they claim to be interested parties, for example, their category of membership of the society, and the ground or grounds for their representations by reference to the Confirmation Criteria discussed above. Notice of a person's intention to make oral representations must be in writing. Such notices and written representations must reach the Authority at the address, and by the specified date customarily given in the Transfer Document issued to members and subsequently confirmed by notice published in the official Gazettes and newspapers as required by the 1986 Act. Persons who make written representations but subsequently decide also to make oral representations must, nevertheless, give notice of that intention in writing to the Authority by the same date. Representations received out of time will not be considered unless, exceptionally and at the sole discretion of the Authority, they appear to the Authority to raise matters of substance relevant to the Confirmation Criteria which are not already under consideration.

6.24 Representations or notices to the Authority will fall into one of the following three categories:

- (a) written representations only;
- (b) written representations with notice of intention to make oral representations;
- (c) notice of intention to make oral representations only.

6.25 The Authority will acknowledge the receipt of each representation or notice and will send a copy of the chapter of the IPSB on confirmation procedures to each representer. It will send copies of all written representations and notices to the society and will afford it an opportunity to comment on the written representations.

6.26 The Authority will consider the written representations in category 6.24(a) and the society's responses to them in advance of the date set for hearing oral representations. Copies of the society's comments on representations in category 6.24(b) will be sent to those who made the representations so that they may concentrate their oral representations on the points which they consider to remain at issue. A person making written representations who also wishes to see the society's response must, therefore, also give notice of intention to make oral representations. The society may, exceptionally, apply to put to the Authority in confidence documents which the society considers to be commercially sensitive: the Authority will decide on the merits of each case whether, and on what terms, to accept them as being confidential. Persons in category 6.24(c) will be asked to inform the Authority, in advance of the hearing, of the subject and general grounds of the representations they intend to make, and their responses will be copied to the Society.

6.27 Interested parties may join together in making collective representations and they may also appoint a person, either one of their number or another, to represent them at the hearing. They should notify the Authority in advance if this is what they intend to do.

Conduct of the hearing

6.28 The Authority will usually appoint one or more persons to hear and decide an application on its behalf. In the absence of notices of intention to make oral representations the Authority would expect to decide the application, having regard to the written representations, the society's responses and other information available to it, without the need for a public hearing. If there is a public hearing, an additional fee is payable by the society.

- 6.29 The Authority will notify the society and those making oral representations of the time and place of the hearing. If there are a significant number of persons wishing to make oral representations, then the hearing may extend beyond one day and may be adjourned from time to time and from place to place. The Authority will try to advise participants of the day when they may expect to make their representations and of when the society's representatives may be expected to respond.
- 6.30 The Authority expects that hearings will be in public. Members of the general public and the press will be asked to wait outside at the outset of the hearing. The participants will then be asked if any of them has good reason to object to the admission of the general public and the press (such as, for example, the need to refer to personal financial affairs). The Authority may decide that parts of the hearing shall be in private if that appears to it to be desirable. If there are no reasonable objections, the general public and the press will then be admitted, within the limits of the space available. Only the representatives of the society and those who have given due notice of intention to make oral representations may address the Authority.
- 6.31 The procedure will be informal. While all participants will be invited to speak concisely and to avoid repetition, the Authority will be considerate towards those who are not professionally represented. The panel taking the hearing on behalf of the Authority may question the participants as the hearing proceeds. The sequence of events will be broadly as follows:
- (a) any preliminary matters (such as the admission of the public or other procedural questions) will be dealt with;
 - (b) the chairman of the Authority panel will introduce the proceedings;
 - (c) the representatives of the society will be invited to present the application for confirmation, including a description of the events at the meeting at which the Transfer Resolutions were put to the members, the voting on the Resolutions, and any other matters which they wish to introduce at that stage;
 - (d) the other participants will be invited to make their representations; where appropriate the Authority would expect to call them in a list marshalled, so far as possible, by subject matter;

- (e) the representatives of the society will be invited to reply to, or comment on, the points made by the other participants;
- (f) the other participants will be invited to comment on the society's replies insofar as those replies raised new issues.

6.32 This procedure may be varied according to the circumstances at the hearing, and is intended only as a guide to the probable order of events. The hearing may be adjourned if the Authority considers that necessary to enable facts to be checked or additional information to be obtained.

The Authority's decision

6.33 The Authority will not normally give an oral decision at the end of the hearing, but may be expected to reserve its decision to be issued later in writing, setting out its reasons. Copies of the written decision will be sent to the participants, and can be purchased by any other person. The Authority will ask the Central Office to place a copy on the public file of the society.

7. TRANSFERS UNDER DIRECTION

This section describes the Authority’s powers to direct a society to transfer its business to a company, and to proceed by board resolution, and the modified transfer procedure consequently prescribed by the 1986 Act.

- 7.1 Section 42B of the 1986 Act provides that, if the Authority considers it expedient to do so to protect the investments of shareholders or depositors, it may direct a society, *inter alia*, to transfer its business to a company within a specified time (subsection (1)(b)). In such a case, or where the Authority would have directed a transfer, but for the fact that negotiations were already under way, the Authority may also direct that the approval of the transfer shall be by board resolution rather than the Transfer Resolutions. In these circumstances, because neither a Transfer Statement nor Transfer Resolutions are required, the 1986 Act requires the society instead to send to every member entitled to notice of a meeting a statement (referred to below as a “**transfer notification statement**”) before it applies for confirmation of the transfer (paragraphs 9 and 10 of Schedule 8A to the 1986 Act). Finally, in these circumstances, the first two Confirmation Criteria concerning information made available to, and the views of, the members (see section 6) are replaced by a single criterion:

“the members or a proportion of them would be unreasonably prejudiced by the transfer;”

(paragraph 11 of Schedule 8A to the 1986 Act).

- 7.2 Where a society is proceeding under a Section 42B direction by board resolution, the Transfer Statement is replaced by a transfer notification statement and a general meeting of the society is not required. The contents of the transfer notification statement are prescribed by Schedule 3 to the Transfer Regulations. In brief, the members are to be informed that the statement is issued on the responsibility of the directors of the society and the successor company, and:
- (a) that the board, acting under direction of the Authority, has resolved to transfer the business;
 - (b) of the confirmation procedure, including the last date for receipt by the Authority of written representations and notices of intention to make oral representations and the expected date of the hearing of the society’s application;

- (c) of the name, address and nature of the successor company, and the proposed vesting date;
- (d) of the consequences for the members, including the loss of membership rights in the society, any changes in the terms and conditions of share and mortgage accounts, and deposit protection schemes;
- (e) the terms of any distribution of funds or shares in the successor company and of the Statutory Cash Bonus; and
- (f) of the interests of the directors and other officers of the society in the transfer, including any compensation or increase in emoluments to which the Authority has given its consent under paragraphs 7 and 8 of Schedule 8A to the 1986 Act.

7.3 The transfer notification statement must have been approved by the Authority before it is sent to the members. Applications for approval should, in general, follow the procedure described in paragraphs 4.11 to 4.17, and the final draft of the statement should be accompanied by the relevant documents listed in paragraph 4.15, but as appropriate to the particular case and the less extensive information the statement is required to contain.

7.4 Section 5 (General Meetings and Resolutions) does not apply, except that the directors will need to be satisfied that the society's register of members is correct to enable the society to send transfer notification statements, and notices under Section 102B (Trustee Account Holders) of the 1986 Act, to those to whom they must be sent if the society is to gain the protection of Section 102B(4).

7.5 When the board has resolved to transfer the business and transfer notification statements have been sent to its members, the society may apply to the Authority for confirmation of the transfer, but using an adaptation agreed with the Authority of the *pro forma* in Annex B2. The procedure described in section 6 is to be followed, including the publication of notices in the official Gazettes and newspapers and the form of application. However, the lapse of time between each stage of the procedure may be modified according to the particular circumstances of a case, and having regard to the need to protect the investments of shareholders or depositors. While a scrutineer's report will not be required, the Authority will require a report from the society's external auditors on the adequacy of the society's systems to fulfil the requirements of the 1986

Act and the Rules with regard to the sending of transfer notification statements and notices to Trustee Account Holders. This is, of course, relevant to the Authority's consideration of the Fourth Confirmation Criterion.

7.6 As is noted in paragraph 7.1, the First and Second Confirmation Criteria are replaced, in those circumstances, by a single criterion as to whether the members or a proportion of them "would be unreasonably prejudiced by the transfer". Whether this special criterion applies will be a matter of judgement for the Authority to make in the light of any representations made to it and its own enquiries in respect of the particular case. In making its judgement, the Authority will also have regard to the view it then takes as to whether it should exercise its discretion under Section 100(7) of the 1986 Act to direct that no Statutory Cash Bonus, or a reduced bonus, is to be paid "having regard to what is equitable between the members of the society". It follows also that, in considering the Fourth Criterion, the Authority will take account of the modified procedure.

7.7 The Fees Rules provide that fees are to be paid to the Authority:

- (a) with an application for approval of a transfer notification statement under paragraph 9(4) of Schedule 8A to the 1986 Act, and a further fee with any subsequent substantial revision;
- (b) with an application for confirmation under Section 97(4)(d) of, paragraph 6 of Schedule 17 and Schedule 8A to, the 1986 Act; and a further fee if oral representations are to be heard.

8. NOTIFICATION AND DISSOLUTION

- 8.1 When the Authority has confirmed a transfer (whether voluntary or under direction) it will notify the Central Office and the society concerned.
- 8.2 Section 97(8) of the 1986 Act requires the society to notify the Authority of the vesting date, and it must do so no later than 7 days before that date, and, unless a notice is given under subsection (10), subsection (9) provides that the society shall be dissolved on that date. Subsection (10) provides that, if necessary for the purpose of facilitating the disposal of its shares in its successor, the society may include, in the notice of the vesting date, notice of a later date for the dissolution of the society, and it is on this later date that the society is dissolved. A society which gives such a notice must cease to transact any business as from the notified vesting date, except such as may be necessary to dispose of its shares in its successor.
- 8.3 Section 97(7) of the 1986 Act provides that, where a society continues to hold shares in its successor after the vesting date, the consideration for the disposal of those shares, together with any other property, rights or liabilities of the society acquired or incurred after that date, shall be transferred to and vested in the successor company on the date specified for the society's dissolution. All other property, rights and liabilities of the society are to be transferred to the successor company on the vesting date.
- 8.4 The Central Office will record the relevant date, or dates, notified to the Authority by the society.
- 8.5 The society will be dissolved on the vesting date or on the later date for dissolution referred to in paragraph 8.2, and its registration will subsequently be cancelled by the Central Office under the provisions of Section 103(1)(a) of the 1986 Act.

9. TIMETABLE

- 9.1 The society will need to draw up a project plan covering the key elements in the transfer process and the relationships between them, and specifying when it wishes to receive the necessary clearances from the Authority. The time needed for the process will depend, among other things, on the length of time it takes to settle the final terms of the distribution scheme, the complexity of those terms and whether the scheme raises new legal issues (perhaps requiring resolution by application to the High Court), and the time needed to verify the register of members and the record of Trustee Account Holders. It will also be affected by the facility with which the society and its advisers can develop satisfactory documents and respond to enquiries and representations. The plan and the timetable will, of course, need to cover all that will be required of the society, and the successor company, in relation to the requirements of the Banking Regulator, and of UKLA concerning the listing of any shares in the successor company.
- 9.2 It will be helpful for the society to discuss its plans with the Authority during their formative stages, when the Authority will be prepared to give a view on their feasibility. However, although the Authority may agree that a planned timetable appears to be manageable, it cannot undertake to meet any deadlines set by the society. In particular, the Authority cannot be constrained in the proper performance of its statutory functions by, for example, the society's wish to put the Transfer Resolutions to a SGM on or before the date of the AGM in that year, or the planned flotation date. The Authority will be mindful of the need to ensure that there is adequate time, compatible with its other business and commitments, to:
- (a) consider whether the proposed distribution scheme is in conformity with the 1986 Act;
 - (b) consider and approve the Transfer Statement, including time to deal with renewed applications if significant changes have to be made;
 - (c) give interested parties an opportunity to make considered representations at the confirmation stage, for the society to respond to those representations, and for the Authority to consider all the evidence and arguments, including making any necessary further enquiries of its own; and
 - (d) write a reasoned confirmation decision.

9.3 The likely sequence of events is as follows:

- Stage 1 Informal preliminary discussions with the Authority and, if different, the Banking Regulator on both substance and timing of the proposed transfer.
- Stage 2 Public announcement of the transfer proposals. The Authority will be ready to comment on drafts of the announcement and any supporting material, although the terms of the announcement are for the society to decide and the Authority is not required to approve them.
- Stage 3 Consultation with the Authority on the outline structure of, and main features to be contained in, the Transfer Statement, and on the full specification of the proposed cash and/or share distribution scheme.
- Stage 4 Submission to the Authority of the prudential information described in section 2.
- Stage 5 Initial application to the Authority, with the appropriate fee, for approval of a full draft of the Transfer Statement, contained within a draft Transfer Document, supported by the material described in paragraph 4.12.
- Stage 6 Consideration by the Authority, and discussion with the society and its advisers, of the draft documents, including submission by the society of revised drafts as necessary. At this stage, the Authority's staff will also be ready to comment informally on draft proxy forms and other material proposed to be sent to the members with, or in advance of, the Transfer Document. By this stage also, the society ought to have undertaken any mailing to members which it thinks necessary to verify its register of members (see paragraphs 5.14 to 5.17), and to notify them of the rights of Trustee Account Holders (See paragraph 3.18).
- Stage 7 **(if necessary)** Further application to the Authority, with a further fee, for approval of a significantly revised Transfer Statement (see paragraph 4.14).
- Stage 8 Production of printer's proofs of the draft documents. At this stage it will be advisable for the society to determine, perhaps by mailing to a

sufficient number of staff, whether the notice and Transfer Document pack (especially if it contains the Transfer Statement) is deliverable through domestic letter boxes.

- Stage 9 Informal indication by the Authority that it is satisfied with near-final proofs of the Transfer Statement, and the Transfer Agreement.
- Stage 10 Formal submission to the Authority of the final draft of the Transfer Statement, together with the supporting documents described in paragraph 4.15.
- Stage 11 Approval by the Authority of the Transfer Statement. One proof copy of the Statement, identified and signed on behalf of the Authority, will be returned to the society.
- Stage 12 Printing and distribution of meeting notice and Transfer Document to members of the society in time to be received by them **at least 21 days before the last date for receipt of proxy forms** for the meeting at which the Transfer Resolutions are to be moved. The Authority would appreciate being provided with a number (to be agreed) of copies of the final printed Transfer Document and any Transfer Summary and of the Transfer Statement if printed separately for distribution on request. Although not required by the 1986 Act, one copy of each will be passed to the Central Office to be placed on the public file of the society.
- Stage 13 The meeting at which the Transfer Resolutions are moved.
- Stage 14 If the Transfer Resolutions are passed, application to the Authority for confirmation and publication of notices of that application in the official Gazettes and newspapers. The application should be accompanied by the requisite fee and the material specified in paragraph 6.2.
- Stage 15 Last date for receipt by the Authority of representations with respect to the applications. A minimum of **four weeks should be allowed between Stages 14 and 15 and a further four weeks to Stage 16** (with extra time allowed for any public holidays which intervene). Representations will be copied to the society for its comments as and when they are received. The Authority will then require sufficient time

before the hearing to consider and assess all the representations and the society's responses, and to make any further enquiries which it may think necessary.

Stage 16 The confirmation hearing.

Stage 17 Notification to the society and representers, and publication, of the Authority's Decision. It is advisable to **allow a minimum of four weeks between Stages 16 and 17**, again allowing extra time for any public holidays.

Stage 18 Notification by the society to the Authority of the vesting date and, if later, the date of dissolution of the society.

Stage 19 Vesting date and, if later -

Stage 20 Dissolution of the society.

9.4 When considering the proposed vesting date, the society will no doubt consult its merchant bank advisers as to timing, particularly when shares are to be offered for subscription to raise new capital, having regard to other possible major share offers.

Illustrative structure for a
TRANSFER DOCUMENT
containing a Transfer Statement

Title page:

Should include a recommendation on the following lines:

“When considering what action you should take, you are recommended to obtain advice from your solicitor, accountant, or other professional financial adviser.”

and the directors’ responsibility statement (short form with cross reference to item B9)

PART A

1. Summary of the Transfer procedure and Special General Meeting

The Transfer procedure
 Notice of the SGM
 Directions to the SGM venue
 Guidance on entitlement to vote

2. Background to, and rationale for, the proposals

Merits of the proposed transfer
 Conclusions and Recommendations

PART B: THE STATUTORY TRANSFER STATEMENT

Issued in accordance with Section 98 of and Schedule 17 to the Building Societies Act 1986

(Note: If a Transfer Summary is issued it must include a statement that this Transfer Statement will be handed or sent to members forthwith free of charge and on request, and where and how it can be obtained.)

3. Review of Options and Value of Consideration

Introduction - to explain that under the proposed terms of the transfer the business of the society will be transferred to an authorised bank and that approval of the terms of the transfer will include, if such is the case, the distribution of part of the consideration for the transfer to non-members. Should also explain that the transfer is subject to approval by the members, authorisation by the Banking Regulator and confirmation by the Authority, and include a brief explanation of the termination provisions of the Transfer Agreement
 Factual statement of strategic options considered
 Disclosure of any non-confidential proposals received

Reasons for choice and recommendation of proposed transfer
Reasons for choice and recommendation of terms of the proposed distribution scheme
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Estimated value of shares in successor
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4. Consequences for shareholders, borrowers and employees

The distribution of shares and/or cash in the successor company
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Any changes in the terms and conditions of share and deposit accounts, mortgages and loans
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Directors and other officers of the company
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6. The management, activities and operations of the successor company following the transfer

Management
Activities and operations, including a comparison of their range and relative importance with those of the society and any intended change, together with, in the case of a takeover, comparative business indicators of the society and the successor company for each of the previous 3 financial years
Structure and activities of any group to which the company belongs
Ownership of the society's subsidiaries and interests in other associated bodies
Particulars of any person having an interest in 3% or more of the successor company's equity share capital.
Name, head office and principal objects of the company

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7. Financial information

The consolidated financial position of the society and its subsidiaries at the most recent practicable date, and the Society's reserves at that date and the main features of the published annual group accounts for the last 3 years

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STATEMENT OF STATUTORY APPROVAL BY THE FINANCIAL SERVICES AUTHORITY

Building Societies Act 1986

(c.53)

Approval by the Financial Services Authority of the Transfer Statement of [] Building Society.

The Financial Services Authority (“the Authority”) in exercise of the power conferred on the Authority by paragraph 4(3) of Schedule 17 to the Building Societies Act 1986 (“the 1986 Act”) and considering that the Transfer Statement of [] Building Society (“the Society”) is in conformity with the applicable provisions of the 1986 Act and the Building Societies (Transfer of Business) Regulations 1998 (SI 1998 No. 212) and appears to be factually consistent with the information provided to the Authority by the Society in connection with the Transfer Statement, which information includes the declarations of responsibility by the directors of the Society and of [] -

HEREBY APPROVES the above Transfer Statement so far as its contents concern the matters required to be approved by the said Schedule.

In this approval expressions used in the 1986 Act have the meanings which they bear in the 1986 Act and “the Transfer Statement” means the statement by the Society a draft of which is initialled for the purpose of identification “[]”.

[date]

[Name]

For and on behalf of the Authority

Notes:

This approval does not extend to any matters not forming part of the Transfer Statement as required by the 1986 Act and the Regulations, whether or not such matters are the subject of cross-reference in the statement as so required.

The giving of this approval is without prejudice to any issues which the Authority may have to consider on an application by the Society for confirmation of the transfer pursuant to Section 98 of the 1986 Act.

PART C: ADDITIONAL INFORMATION

- 12. Definitions**
- 13. List of share accounts of the society**
- 14. Documents available for inspection**
- 15. Accountants' report on the successor company**
- 16. Statutory statement for the last financial year**
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PRO FORMA:

- 1. Notice of Application**
- 2. Application to the Authority for confirmation**

Publication of Notice of application to the Authority for confirmation of a transfer in the London, Edinburgh, or Belfast Gazettes and in any newspapers as directed by the Authority.

BUILDING SOCIETIES ACT 1986

Notice under paragraph 7 of Schedule 17 to the 1986 Act

Notice is hereby given that Building Society, Register No.....B, whose principal office is at, desires to transfer its business to, and that the society has applied to the Financial Services Authority to confirm the transfer.

Any interested party may make written representations to the Authority and/or give notice of intention to make oral representations to the Authority with respect to the application. Written representations and notices of intention to make oral representations should be received by the Authority at 25 The North Colonnade, Canary Wharf, London, E14 5HS by 20.... Oral representations will be heard by the Authority on20.. at a time and place to be determined by the Authority.

Form of application to the Authority for confirmation of transfer of business to a company

To the Financial Services Authority

BUILDING SOCIETIES ACT 1986

APPLICATION UNDER SECTIONS 97(4) AND 98(2) OF, AND PART II OF SCHEDULE 17 TO, THE 1986 ACT FOR CONFIRMATION OF A TRANSFER OF BUSINESS TO A COMPANY

..... **BUILDING SOCIETY, REGISTER NO.....B**

The above-named society desires to transfer its business to on20... [insert vesting date] and applies to the Authority to confirm the transfer.

In making this application the society declares that:

1. At a meeting of Building Society held on20.. the following resolutions were passed:

A shareholding members' resolution, as required by paragraph 30 of Schedule 2 to the 1986 Act, passed in accordance with paragraph [30(2) or 30(3) as the case may be], that Building Society do transfer its business to in accordance with the terms of the transfer agreement, two copies of which, authenticated by the Secretary of the society, are enclosed with this application.

A borrowing members' resolution, as required by paragraph 30 of Schedule 2 to the 1986 Act that Building Society do transfer its business to in accordance with the terms of the above-mentioned transfer agreement.

2. A transfer statement, in accordance with Schedule 17 to the 1986 Act, approved by the Authority, so far as it concerned matters required by that Schedule to be so approved, was [sent] [made available] to each member of Building Society who was entitled to receive it [, and a transfer summary was sent to those members] in accordance with Schedule 17 to the 1986 Act.

(Seal of the Society making the application)

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4 MERGER CONFIRMATION PROCEDURES

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4.1 Introduction

4.1.1 This note is for the guidance of those making written representations to the FSA and/or those participating in oral confirmation hearings. It sets out the procedures which the FSA will normally follow.

4.1.2 The 1986 Act provides that when the necessary merger resolutions have been passed the societies must obtain confirmation by the FSA of the merger in accordance with Section 93(2) (amalgamations) or Section 94(7) (transfers of engagements) of the 1986 Act. If the FSA confirms the merger it will issue a registration certificate.

4.1.3 References to the relevant provisions of the 1986 Act are given in parenthesis in this Note. The term “merger” means either an amalgamation or a transfer of engagements as provided by sections 93 and 94 of the 1986 Act.

4.2 The Role of Confirmation

4.2.1 The role of the confirmation procedures is limited. Section 95(3) and (4) of the 1986 Act provide that the FSA must confirm a transfer unless it considers that:

- (1) some information material to the members’ decision about the merger was not made available to all the members eligible to vote; or,
- (2) the vote on any resolution approving the merger does not represent the views of the members eligible to vote; or,
- (3) some relevant requirement of the 1986 Act or the rules of any of the societies was not fulfilled.

4.2.2 These are the only grounds on which the FSA may refuse confirmation, or direct the society to remedy any defects. It is not the FSA’s function to make any judgement about the merits of the proposals which the members have approved.

- 4.2.3 If the FSA finds that there are defects, it may direct the society to take steps to remedy them. These include the calling of further meetings. If it is then satisfied that the defects have been substantially remedied, it must confirm the merger; if not, it must refuse confirmation (Section.95(6) of the 1986 Act).
- 4.2.4 The FSA may direct that non-fulfilment of some relevant requirement of the 1986 Act or of the rules of the society is to be disregarded, if it appears to the FSA that the failure could not have been material to the members' decision (Section.95(5)). "Relevant requirement" in this context means a requirement of section 93, 94 or 95 of or Schedule 16 to the 1986 Act or of any rules prescribing the procedure to be followed by the society in approving or effecting the merger (Section 95(11) of the 1986 Act).
- 4.2.5 The 1986 Act provides that any accidental failure to send the notice of meeting and merger statement to any person entitled to receive them does not invalidate the proceedings at the special general meeting (paragraph 22(3) of Schedule 2 to the 1986 Act).

4.3 Representations to the FSA

- 4.3.1 Any interested party has the right to make representations to the FSA with respect to the societies' applications for confirmation. They should state clearly why the person making the representations claims to be an interested party e.g. membership of the society and the matters to which the representations are directed.
- 4.3.2 Written representations, or notice of a person's intention to make oral representations, or both, must be in writing. They must reach the FSA at 25 The North Colonnade, Canary Wharf, London E14 5HS by the date quoted in the merger documentation issued to members and published in the official Gazettes and (usually) some newspapers. Persons who make written representations, but subsequently decide also to make oral representations must, nevertheless, give notice of that intention, in writing, to the FSA by the same date (paragraphs 8 and 9 of Schedule 16 to the 1986 Act).

4.3.3 Representations or notices to the FSA will fall into one of the following three categories:

- (1) Written representations only.
- (2) Written representations with notice of intention to make oral representations.
- (3) Notice of intention to make oral representations only.

4.3.4 The FSA will send copies of all written representations to the society, and will afford it an opportunity to comment on them (paragraph 9 of Schedule 16 to the 1986 Act).

4.3.5 Copies of the society's comments on representations in category 4.3.3(2) will be sent to those who made the representations so that they may concentrate their representations at oral hearings on the points which they consider to remain at issue. Persons making written representations who wish to see the society's comments must, therefore, also give notice of intention to make oral representations. Any documents referred to in the society's comments will be made available by the society for inspection at a specified place which will be notified to those making oral representations. (The society may, exceptionally, apply to put to the FSA in confidence documents which the society considers to be commercially sensitive: the FSA will decide on hearing argument whether, and on what terms, to accept them as confidential). Persons in category 4.3.3(3) will be asked to inform the FSA, in advance of the hearing, of the subject and general grounds of the representations they intend to make. The FSA will pass this information to the society.

4.3.6 Interested parties may join together in making collective representations and they may also appoint a person, either one of their number or another, to represent them at the hearing. They should notify the FSA in advance if this is what they intend to do.

4.4 Purpose of the hearing

4.4.1 The purpose of the hearing is to enable interested parties to make representations, and to enable the FSA to make such enquiry as it considers necessary, both of the society

and of those making representations, in order to reach an informed view on those aspects of the decision on confirmation to which the representations are directed. The FSA will examine all the representations, whether written or oral, in relation to the three statutory criteria described in paragraph 4.2.1. In the light of that examination, and consideration of all the representations and the society's response, the FSA will decide whether to confirm, or direct the society to correct any defects, or to refuse to confirm the merger. It is for the FSA to decide whether the matters discussed in representations are relevant to the statutory criteria.

4.5 Persons hearing the applications

4.5.1 The hearing will be taken by a person or persons appointed by the FSA to hear and decide the applications on its behalf, and they will be assisted by staff of the FSA.

4.6 Time and place

4.6.1 Hearings will normally start at about mid-morning on the day quoted in the merger documentation sent to members, and at a place which will be notified to the participants. If there are a significant number of persons wishing to make oral representations, then the hearing may extend beyond one day and may be adjourned from time to time and from place to place.

4.7 Procedure at the Hearing

4.7.1 The FSA expects that oral hearings will be in public. Members of the general public and the Press will be asked to wait outside at the outset of the hearing. The participants will then be asked if any of them has good reason to object to the admission of the general public (including the Press). The Press and the general public will then be admitted, within the limits of the space available, unless an objection by a participant is upheld by the FSA. However, the FSA may decide that parts of the hearing shall be in private if that appears to it to be desirable (for example, if representers feel it necessary to disclose their personal affairs).

4.7.2 The procedure will be informal. While all participants will be expected to speak concisely and to avoid repetition, the FSA will be considerate towards those who are not professionally represented. The persons appointed to hear the applications may question the participants as the hearing proceeds. The sequence of events will be broadly as follows:-

- (1) Any preliminary matters (such as the admission of the public or other procedural questions) will be dealt with.
- (2) The person chairing the hearing on behalf of the FSA will introduce the proceedings.
- (3) The representatives of the Societies will be invited to speak to their applications, including a description of the events at the meetings at which the transfer resolutions were put to the members, a statement of the voting on the resolutions, and any other matters which they wish to introduce at that stage.
- (4) The other participants will be invited to speak to their representations. Where appropriate the FSA would expect to call them in a list marshalled, so far as possible, by subject matter.
- (5) The representatives of the society will be invited to reply to, or comment on, the points made by the other participants.
- (6) The other participants will be invited to comment on the society's replies.

4.7.3 The above procedure may be varied according to the circumstances at the hearing, and is intended only as a guide to the probable order of events. The hearing may be adjourned if the FSA considers that necessary to enable facts to be checked or additional information to be obtained.

4.8 The FSA's decision

4.8.1 The FSA will not normally give an oral decision at the end of the hearing. The FSA will subsequently issue a written decision, setting out its reasons. A copy of the written decision will be sent to each of the participants in the hearing and to those who made written representations and, on request, to any other person. The decision may also be published.

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5 TRANSFER CONFIRMATION PROCEDURES

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5.1 Introduction

5.1.1 This chapter is for the guidance of those making written representations to the FSA and/or those participating in oral confirmation hearings. It sets out the procedures which the FSA intends to follow.

5.1.2 The 1986 Act provides that when a society has approved the transfer of its business to a plc by passing the transfer resolutions, it must then obtain confirmation by the FSA of the transfer and its terms (Section 97(4) of the 1986 Act). If the FSA confirms the transfer, then all the property, rights and liabilities of the society, except any shares in its successor company, transfer on the vesting date to the successor company (Section 97(6) of the 1986 Act), which date is specified in or determined by the transfer agreement between the society and the successor company.

5.2 The role of confirmation

5.2.1 The criteria to which the FSA has to have regard are limited. It is **not** within the FSA's power to make any judgement about the merits or fairness of the proposals which the members have approved.

5.2.2 Section 98(2) and (3) of the 1986 Act provide that the FSA **must** confirm a transfer **unless** it considers that:

- (1) some information material to the members' decision about the transfer was not made available to all the members eligible to vote; or
- (2) the vote on any resolution approving the transfer does not represent the views of the members eligible to vote; or,
- (3) there is a substantial risk that the successor company will not become or, as the case may be, remain a credit institution which is authorised to accept deposits for the purposes of the Financial Services and Markets Act 2000; or

- (4) some relevant requirement of the 1986 Act or the rules of the society was not fulfilled.

5.2.3 These are the **only** grounds on which the FSA may refuse confirmation, or direct the society to remedy any defects. If the FSA finds that there are defects it may direct the society to take steps to remedy them. If the FSA is then satisfied that the defects have been substantially remedied, it must confirm the transfer; if not, it must refuse confirmation (Section 98(5) and (6) of the 1986 Act).

5.2.4 In the case of the ground mentioned in paragraph 5.2.2(4), the FSA may direct that non-fulfillment of some relevant requirement of the 1986 Act or of the rules of the society is to be disregarded, if it appears to the FSA that the failure could not have been material to the members' decision (Section 98(4) of the 1986 Act). "Relevant requirement" in this context means a requirement of the provisions of the 1986 Act applicable to the transfer of a society's business (which are Sections 97 to 102 and 102B to D, paragraph 30 of Schedule 2, Schedule 17 and the Transfer Regulations made under the 1986 Act) and any Rules prescribing the procedure to be followed by the society in approving the transfer and its terms (that is, generally, the rules concerning: membership; special meetings; notice of meetings; procedure at meetings; entitlement of members to vote on resolutions; appointment of proxies; and joint shareholders and borrowers).

5.2.5 The 1986 Act provides that any accidental omission to give the notice of the meeting to, or non-receipt of the notice by, a person entitled to receive it does not invalidate the proceedings at the special general meeting (Schedule 2, paragraph 22(3)).

5.3 Purpose of the hearing

5.3.1 The purpose of the hearing is to enable interested parties to make representations, and to enable the FSA to make such enquiry as it considers necessary, both of the society and of those making representations, in order to reach an informed view. The FSA will examine all the representations, whether written or oral, in relation to the four statutory criteria described in paragraph 5.2.2. In the light of that examination, and consideration of all the representations and the society's response, the FSA will make its decision.

5.4 Making representations to the FSA

5.4.1 Any interested party has the right to make written and oral representations to the FSA with respect to the society's application for confirmation. Those making written representations and those giving notice of intention to make oral representations should state clearly why they claim to be interested parties (e.g. the category of their membership of the society). Those making written representations should also identify the ground or grounds, in paragraph 5.2.2, to which their representations are directed and it will be helpful if those giving notice of intention to make oral representations will do likewise.

5.4.2 Written representations, or written notice of a person's intention to make oral representations, or both, must be addressed to the Financial Services Authority and must reach the FSA at 25 The North Colonnade, Canary Wharf, London E14 5HS by the date quoted in the transfer documentation issued to members. Unwritten representations and notice (for example by telephone) cannot be accepted. Written representations and notices transmitted by fax or E-Mail can be accepted provided they are confirmed by the original signed copy which must be received by the FSA within 24 hours of the closing date. Persons who make written representations but subsequently decide also to make oral representations must, nevertheless, give notice of that intention, in writing, to the FSA at the above address by the same date (paragraph 7 of Schedule 17 to the 1986 Act).

5.4.3 Representations or notices to the FSA will fall into one of the following three categories:

- (1) written representations only;
- (2) written representations with notice of intention to make oral representations;
- (3) notice of intention to make oral representations only.

5.4.4 The FSA will send copies of all written representations to the society, and will afford it an opportunity to comment on them (paragraph 8 of Schedule 17 to the 1986 Act). The FSA will consider the written representations in categories 5.4.3(1) and (2), and the society's responses to them. A synopsis of the representations (probably in the form of a summary of each of the main points made and the numbers of persons making each point) and the society's responses may be made available to those participating in the oral hearing. This is intended to inform those making oral representations of the points already under consideration by the FSA with a view to avoiding unnecessary repetition.

5.4.5 Copies of the society's comments on representations in category 5.4.3(2) will be sent to those who made the representations in time for the oral hearing so that they may concentrate their oral representations on the points which they consider to remain at issue. A person making written representations who wishes to see the society's comments must, therefore, also give notice of intention to make oral representations. Any documents referred to in the society's comments will be made available by the society for inspection at a specified place which will be notified to those making oral representations. (The society may, exceptionally, apply to put to the FSA in confidence documents which the society considers to be commercially sensitive: the FSA will decide on hearing argument whether, and on what terms, to accept them as being confidential). Persons in category 5.4.3(3) will be asked to inform the FSA, in advance of the oral hearing, of the subject and general grounds of the representations they intend to make; the FSA will copy any response to the society.

5.4.6 Interested parties may join together in making collective representations and they may also appoint a person, either one of their number or another, to represent them at the oral hearing. They should notify the FSA in advance if this is what they intend to do. The FSA will notify this to the society.

5.5 Panel taking the hearing

5.5.1 A Panel will be appointed by the FSA to consider and decide the application on its behalf. The panel will conduct the oral hearing if one is required.

5.6 Time and place

5.6.1 Oral hearings will normally start at about mid-morning on the date quoted in the transfer documentation sent to members and at a place which will be notified to the participants. If there is a significant number of persons wishing to make oral representations, then the hearing may extend beyond one day and may be adjourned from time to time and from place to place. The FSA will try to advise participants of the day when they may expect to make their representations, and of when the society's representatives may be expected to respond.

5.7 Procedure at the hearing

5.7.1 The FSA expects that oral hearings will be held in public. Members of the general public and the press will be asked to wait outside at the commencement of the hearing. The participants will then be asked if any of them has good reason to object to the admission of the general public or the press (such as, for example, the need to refer to personal financial affairs). Unless an objection by a participant is upheld by the FSA, the press and the general public will then be admitted, within the limits of the space available. However, the FSA may decide that parts of the hearing shall be in private if that appears to it to be desirable.

5.7.2 The procedure will be informal. All participants will be expected to speak concisely and avoid repetition. The FSA will be considerate towards those who are not professionally represented. Members of the Panel taking the hearing may question the participants. The sequence of events will be broadly as follows:

- (1) any preliminary matters (such as the admission of the public or other procedural questions) will be dealt with;
- (2) the chairman of the Panel will introduce the proceedings;
- (3) the representatives of the society will be invited to speak to the application, including a description of the events at the meeting at which the transfer

resolutions were put to the members, a statement of the voting on the resolutions, and any other matters which they wish to introduce at that stage;

- (4) the other participants will be invited to speak to their representations. The FSA expects to call them in a list marshalled, so far as possible, by subject matter;
- (5) the representatives of the society will be invited to reply to, or comment on, the points made by the other participants;
- (6) the other participants will be invited to comment on the society's replies.

5.7.3 This procedure may be varied according to the circumstances at the hearing, and is intended only as a guide to the probable order of events. The hearing may be adjourned if the FSA considers that necessary to enable facts to be checked or additional information to be obtained.

5.8 The FSA's decision

5.8.1 At the end of the oral hearing, the FSA will reserve its decision. A copy of its written decision, including its findings on the points made in representations, will be published and copies will be sent to the society, and to those making written and/or oral representations.

**THE INTERIM PRUDENTIAL SOURCEBOOK FOR FRIENDLY SOCIETIES
INSTRUMENT 2001**

Introduction

1. The *FSA* makes the rules and other provisions in this instrument.
2. The rules and guidance in the *IPRU(FSOC)* are made under the following sections of the *Act* –
 - (a) section 138 (general rule making power);
 - (b) section 141 (insurance business rules);
 - (c) section 149 (evidential provisions);
 - (d) section 150(2) (actions for damages);
 - (e) section 156 (general supplementary powers);
 - (f) section 157(1) (guidance); and
 - (g) section 340 (appointment of auditors and actuaries).
3. This instrument will come into force at the beginning of the day on which section 19 of the *Act* (the general prohibition) comes into force.
4. This instrument is to be interpreted in accordance with, and applies subject to, the general provisions contained in the General Provisions Instrument 2001.
5. This instrument may be cited as the Interim Prudential Sourcebook for Friendly Societies Instrument 2001.
6. This instrument, excluding the provisions in this Introduction, may be cited as the Interim Prudential Sourcebook for Friendly Societies.

By order of the Board

19 July 2001

INTERIM PRUDENTIAL SOURCEBOOK FOR FRIENDLY SOCIETIES

GUIDANCE


THE PURPOSE OF THE PRUDENTIAL RULES FOR FRIENDLY SOCIETIES AND AN OVERALL DESCRIPTION

1. The prudential rules for a *friendly society* are to be seen in the context of the Principles for Businesses. These are high level obligations applying to all authorised persons and are set out in the High Level Standards part of the Handbook (PRIN).
2. So far as a *friendly society* is concerned, the Principles for Businesses are particularly relevant to its internal systems and controls. Principle 3, for example, requires a firm to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. Principle 4 requires a firm to maintain adequate financial resources.
3. In addition to the general obligations placed on a *friendly society*, certain staff of all authorised persons are subject to a number of high level obligations, referred to as Statements of Principle. The FSA has issued a Code of Practice to help determine whether an approved person's conduct has complied with a Statement of Principle. The Statements and the Code are set out in the High Level Standards part of the Handbook (APER).
4. One of the features of a *contract of insurance* is the long period of risk the contract may cover. The prudential rules for *friendly societies* seek to protect the *policyholder* against the risk that a *friendly society* will fail to meet a valid *claim* as it falls due or to fulfil the reasonable expectations of *policyholders*.

5. The Interim Prudential Sourcebook for Friendly Societies (*IPRU(FSOC)*) starts by limiting the risks to which a *friendly society may be* subject. Rule 1.3 in Chapter 1 requires that the business of a *directive friendly society* is restricted to *insurance business*.
6. Chapter 2 covers compliance and supervision of *registered branches* and *subsidiaries* and jointly controlled bodies.
7. Chapter 3 focuses on systems and controls. *Friendly societies* should also refer to the provisions on senior management arrangements, systems and controls in the High Level Standards part of the Handbook (SYSC) and to Annex 3 of *IPRU(FSOC)*.
8. The rules in Chapter 4 set out the *required margins of solvency* for a *friendly society* having regard to the type of its business.
9. The extent to which an asset may be taken into account for prudential purposes, and the method of valuing it, is determined in accordance with the rules in the Appendices. It is a fundamental part of the approach to prudential regulation for *friendly societies* that the rules limit the assets which are ‘admissible’ for solvency purposes and specify the methods of valuation. Similarly, the amount of a liability is determined in accordance with the rules in the Appendices.
10. Provisions in Chapter 4 also require a liability in any particular currency to be matched by assets in that currency. Further provisions relate to the location of assets.
11. As part of the continuing supervision of a *friendly society*, the rules in Chapter 5 require the *friendly society* to prepare certain accounts and statements in accordance with the rules and deposit them with the *FSA*. In addition, Chapter 6 requires a *friendly society* to make certain statistical returns.
12. Chapter 7 contains the definitions used throughout *IPRU(FSOC)* and some general provisions.

13. Chapter 8 contain transitional provisions.
 14. The Appendices are part of the rules.
 15. *FSA* guidance is set out in the Annexes and *friendly societies* may also wish to refer to the guidance in *IPRU(INS)*.
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ANNEX



Interim Prudential sourcebook: Friendly Societies

**INTERIM PRUDENTIAL SOURCEBOOK
FOR FRIENDLY SOCIETIES**

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Chapter 1

APPLICATION

Application

- 1.1 These rules apply to a *friendly society* which has permission under the *Act* to effect or carry out *contracts of insurance*.

Actions for damages

- 1.2 Section 150(1) of the *Act* does not apply.¹

Restriction of business to insurance

- 1.3 (1) A *directive friendly society* must not carry on any commercial business in the United Kingdom or elsewhere other than *insurance business* and activities directly arising from that business.
- (2) (1) does not prevent a *friendly society* which was on 15 March 1979 carrying on *long-term insurance business* and a savings business in the United Kingdom from continuing to carry on the savings business.

¹ A private person therefore has no right of action under this section against a *friendly society* for breach of the prudential rules.

Chapter 2

INTEGRITY, SKILL, CARE AND DILIGENCE

Legal compliance

- 2.1 A *friendly society* must take reasonable steps to ensure that –
- (a) it does not carry on activities beyond its powers;
 - (b) it and its *registered branches* comply with –
 - (i) any requirements of or under the *1992 Act* or the *Act* which relate to the conduct of its *insurance business*, and
 - (ii) any requirement (whether of the law of any part of the United Kingdom or of the law of another *EEA State*) which gives effect to the *insurance Directives* or is otherwise applicable to the insurance activities of the *friendly society*.

Supervision of subsidiaries and jointly-controlled bodies

- 2.2 (1) A *friendly society* must supervise the activities-
- (a) of any *subsidiary* or of any body of which the *friendly society* has joint control; and
 - (b) of any *registered branch* of the *friendly society*;
- with due care and diligence, having due regard to the interests of its *policyholders* and without detriment to the conduct of the *friendly society's* activities.
- 2.3 (1) A *friendly society* should ensure that its *subsidiaries, jointly controlled bodies, or registered branches* are-
- (a) directed and managed with prudence, integrity and adequate professional skill; and
 - (b) comply with any applicable requirements of or under the *Act* and the *1992 Act*.
- (2) Contravention of (1) may be relied upon as tending to establish contravention of rule 2.2

Chapter 3

MANAGEMENT AND CONTROL

Accounting records and systems of control

- 3.1 (1) Every *friendly society* must and must procure that every *registered branch*-
- (a) keep (or keeps) adequate accounting records; and
 - (b) establish and maintain (or establishes and maintains) adequate systems of control of its business and records and of inspection and report.
- (2) The accounting records must be sufficient to-
- (a) comply with the requirements of section 68 of the *1992 Act*; and
 - (b) enable the *friendly society* acting through the *committee* properly to discharge the duties imposed on it and them by or under the *1974 Act*,
as the case may be.
- (3) The systems of control which are to be established and maintained by a *friendly society* or a *registered branch* are systems for the control of the conduct of their activities in accordance with the *Act* and the *1992 Act* and the decisions of the *committee*, and for the control of the accounting and other records of its activities.
- (4) The system of inspection and report which is to be established and maintained by a *friendly society* or *registered branch* is a system of inspection on behalf of and report to the *committee* on the operation of the systems of control required by (1) (b).
- (5) The systems of control and of inspection and report must be adequate to enable the *committee* properly to discharge the duties imposed on it by or under the *Act*, the *1992 Act* or the *1974 Act* and the functions of direction of the affairs of the *friendly society* or *registered branch*. No such system of control will be treated as adequate unless there is kept available to the *committee* a detailed statement in writing of the system as in operation for the time being.
- (6) Without prejudice to the generality of (5), the systems of control and of inspection and report must be such as to secure that the activities of the *friendly society* or *registered branch* are so conducted and its records so kept that-
- (a) the information necessary to enable the *committee* to discharge its duties and functions is sufficiently accurate, and is available with sufficient regularity or at need and with sufficient promptness, for those purposes; and

- (b) the information regularly obtained by or furnished to the *FSA* under or for the purposes of this *Act* or the *1992 Act* is sufficiently accurate for the purpose for which it is obtained or furnished and is furnished at the regularity required by or under the *Act* or the *1992 Act*².
- (7) Every *friendly society* must within the period of 6 months beginning with the end of each *financial year* make and send to the *FSA* a statement of their opinion whether the requirements of this rule have been complied with in respect of that year by the *friendly society* and the statement must be signed by the chairman on behalf of the *committee* and by the chief executive.

[Audit of systems and records – proposed to be deleted in CP 91

- 3.2
- (1) A *friendly society* must procure that its auditors make a report to the *FSA* as respects each *financial year* of the *friendly society*, on the conduct of the activities of the *friendly society* in that year in relation to the matters specified in (2) below.
 - (2) The auditors' report must deal with-
 - (a) the accounting records kept by the *friendly society* under rule 3.1; and
 - (b) the systems of control of its business and records and of inspection and report maintained under that section.
 - (3) The report must state the auditors' opinion as respects the matters specified in (2) as follows, that is to say-
 - (a) as regards the accounting records of the *friendly society*, whether or not they comply with the requirements of rule 3.1 and, if not, specifying each requirement not complied with and the respects in which it was not complied with;
 - (b) as regards the system of control of its business and records, whether or not the system complies with the requirements of rule 3.1 and, if not, specifying each requirement not complied with and the respects in which it was not complied with;
 - (c) as regards the system of inspection and report, whether or not the system complies with the requirements of rule 3.1 and, if not, specifying each requirement not complied with and the respects in which it was not complied with.
 - (4) Where an *incorporated friendly society* had, at any time during the year to which the report relates, *subsidiaries* or jointly controlled other bodies, the auditors' report must deal also with and contain corresponding statements of their opinion as to compliance with the requirements of rule 3.1 in its

application to *incorporated friendly societies* having *subsidiaries* or jointly controlling other bodies.

- (5) The auditors of a *friendly society* must send their report under this rule to the *friendly society* and, subject to (6) below, must do so within the period of 6 months beginning with the end of the *financial year* to which it relates, and the *friendly society* must, within the period of 9 months so beginning, send the report to the *FSA* together with such comments as the *friendly society* acting through the *committee* thinks fit to make.
- (6) A *friendly society* may allow its auditors a longer period in which to send their report than that specified in (5), but not so as to prevent the *friendly society* from complying with the duty imposed on it by (5) as regards the *FSA*.
- (7) If the *friendly society* acting through its *committee* makes any comments to the *FSA* under (5), the *friendly society* must cause a copy of the comments to be sent to the auditors when or before they send them to the *FSA* with the report under that rule.]

Chapter 4

FINANCIAL PRUDENCE

I. MARGINS OF SOLVENCY

Basic requirement³

- 4.1 (1) Subject to (3), a *friendly society* (other than a *flat rate benefits business friendly society*) must maintain a margin of solvency in accordance with rules 4.2 to 4.10.
- (2) Where a *friendly society* carries on both *long-term insurance business* and *general insurance business*, (1) has effect as if the requirement to maintain a margin of solvency were a requirement to maintain separate margins in respect of the two kinds of business.
- (3) As long as the society maintains an excess of the value of its assets over the amount of its liabilities, (1) does not apply to a *non-directive friendly society* which does not have permission to effect *contracts of insurance* and is only carrying out contracts of *long-term* or *general insurance business* which were effected before 13 September 1993 (or effected pursuant to the terms of such a contract).
- (4) A margin of solvency is the excess of the value of the *friendly society's* assets over the amount of its liabilities, that value and amount being determined in accordance with the *asset valuation rules* and *liability valuation rules* and rule 4.7.

Calculating the required margin of solvency

- 4.2 (1) Subject to (2) to (4), the *required margin of solvency* must be determined-
- (a) with respect to a *friendly society* which carries on *long-term insurance business*, in accordance with Appendix 1; and
- (b) with respect to a *friendly society* which carries on *general insurance business*, by taking the greater of the two sums resulting from the application of the two methods of calculation set out in Parts I and II of Appendix 2.
- (2) For a *contract of insurance* to which rule 7.6(a) applies, the *required margin of solvency* must be determined by taking the aggregate of the results arrived at by applying-

³ The requirement for a plan for the restoration of a sound financial position to be submitted by a *friendly society* which breaches this rule is in *SUP*, App II, 1.3.1.

- (a) in the case of so much of the contract as is within any *class of long-term insurance business*, the appropriate method under Appendix 1; and
 - (b) in the case of so much of the contract as is within *general insurance business class 1 or 2*, the method of calculation set out in Part I of Appendix 2 (excluding 6, 7 and 8).
- (3) Where a *friendly society* carries on *long-term insurance business* and owing to the nature of that business more than one margin of solvency is produced in respect of that business by the operation of these rules, the margins in question must be aggregated.
- (4) Where a *friendly society* carries on both *long-term insurance business* and *general insurance business* and is accordingly required to maintain separate margins of solvency in respect of the two kinds of business-
- (a) the provisions in (1) to (3) apply for determining the margin of solvency for each kind of business separately; and
 - (b) assets other than those representing the funds maintained by the *friendly society* in respect of its *long-term insurance business*, if they are not included among the assets covering the liabilities and the *required margin of solvency* relating to the *friendly society's general insurance business*, may be included among the assets taken into account in covering the liabilities and the *required margin of solvency* for the *friendly society's long-term insurance business*.

The guarantee fund⁴

- 4.3 A *directive friendly society* and a *non-directive incorporated friendly society* must ensure that its *required margin of solvency* does not fall below the *guarantee fund*.

Calculating the guarantee fund

- 4.4 (1) Subject to (2) and (3), the guarantee fund is one-third of the *required margin of solvency*.
- (2) In the case of a *friendly society* which is-
- (a) an *incorporated friendly society*; or
 - (b) an (unincorporated) *friendly society*, which is not a *non-directive friendly society*,

the *guarantee fund* must not be less than an amount (the minimum guarantee fund) arrived at in accordance with rule 4.5 for *long-term insurance business*

⁴ The requirement for a short term plan to be submitted by a *friendly society* which breaches this rule is imposed by SUP, App II, 1.4.1.

and rule 4.6 for *general insurance business*, whether the *required margin of solvency* is greater or less than that amount.

- (3) In the case of *long-term insurance business*, items that are not *implicit items* must be at least large enough to cover either the *minimum guarantee fund* or 50% of the *guarantee fund*, whichever is the greater.

Minimum guarantee fund: long-term insurance business

- 4.5 (1) In the *financial year* during which a *friendly society* first obtains permission under the *Act* (or is authorised under its predecessor legislation) to carry on *long-term insurance business*, the *minimum guarantee fund* is the amount in column 2 of the table, which corresponds to the *friendly society's annual contribution income* in respect of that business in the last preceding *financial year*, as shown in column 1 of the table.

Contribution Income (in Euro)	<i>Minimum guarantee fund</i> (in Euro)
1,000,000 or less	100,000
1,000,001 - 1,500,000	200,000
1,500,001 - 2,000,000	300,000
2,000,001 - 2,500,000	400,000
2,500,001 - 3,000,000	500,000
3,000,001 or more	600,000

But where a *friendly society* had no *annual contribution income* in respect of *long-term insurance business* in the last preceding *financial year* or has not been in existence long enough to have a preceding *financial year*, the *minimum guarantee fund* is 100,000 Euro.

- (2) In any subsequent *financial year* during which a *friendly society* has permission to carry on *long-term insurance business*, the *minimum guarantee fund* is the greater of either-

- (a) the amount in column 2 of the table in (1) that corresponds to the *friendly society's annual contribution income* in respect of *long-term insurance business* in the last preceding *financial year*; or
- (b) the amount of the *minimum guarantee fund* required to be maintained by the *friendly society* in the last preceding *financial year*,

providing that if the amount referred to in (a) and (b) is the same, the *minimum guarantee fund* is that amount.

- (3) Where a *friendly society* obtains permission under the *Act* (or has obtained authorisation under its predecessor legislation) to carry on *long-term insurance business*-

- (a) of a *class* additional to that in respect of which it already has permission; or

- (b) in a part of the United Kingdom additional to that in respect of which it already has permission,

a *minimum guarantee fund* of 600,000 Euro must be maintained by that *friendly society* for the whole of its *long-term insurance business* (that is to say, not only for the additional business carried on but also for the business previously carried on).

Minimum guarantee fund: general insurance business

- 4.6 The *minimum guarantee fund* in respect of *general insurance business* carried on by a *friendly society* is 225,000 Euro.

Valuation of solvency margins

- 4.7 (1) Where a *friendly society* has assets equal to or in excess of its liabilities as valued in accordance with the *asset valuation rules* and *liability valuation rules*, then (2) and (3) have effect for determining the extent to which the value of the assets exceeds the amount of liabilities in connection with the *required margin of solvency*, the *guarantee fund* and the *minimum guarantee fund*.
- (2) In the case of *general insurance business*, any claim which a *friendly society* has against its members by way of a call for supplementary contributions for a *financial year* must be treated as having its full value for that *financial year*, but the value must not exceed-
- (a) 50% of the difference between the maximum contributions and the contributions called in; or
- (b) 50% of the *required margin of solvency* which would otherwise be required.
- (3) The items which relate to future surpluses, *zillmerising* and hidden reserves (referred to as implicit items) must be treated as having no value⁷.

4.8 – 4.10 [Moved to Annex 4]

II. ADEQUACY OF ASSETS

- 4.11 The remaining rules in this chapter do not apply to *non-directive friendly societies*.

- 4.12 (1) A *friendly society* must secure-
- (a) that its liabilities under *contracts of insurance*, other than liabilities in respect of *linked benefits*, are covered by assets of appropriate safety, yield and marketability having regard to the *classes* of business carried on; and

⁷ The *FSA* may, under section 148 of the *Act*, direct that any of the *implicit items* may be valued. See Annex 4.

- (b) without prejudice to the generality of (a), that its investments are appropriately diversified and adequately spread and that excessive reliance is not placed on investments of any particular category or description⁵.
- (2) A *friendly society* which has entered into a *linked long-term contract* must secure that, as far as practicable, its liabilities under the contract in respect of *linked benefits* are covered as follows-
- (a) if those benefits are linked to the value of units in an undertaking for collective investments in transferable *securities* or to the value of assets contained in an internal fund, by those units or assets;
 - (b) if those benefits are linked to a share index or other reference value not mentioned in (a), by units which represent that reference value, or by assets of appropriate safety, yield and marketability which correspond, as nearly as may be, to the assets on which that reference value is based⁶.
- (3) A *friendly society* which has entered into a *linked long-term contract* must also secure that its liabilities under the contract in respect of *linked benefits* which are not covered by contracts of reinsurance are covered by assets of a description contained in rule 4.21.
- (4) In (3), '*linked long-term contract*' does not include a *pension fund management contract* unless it is combined with a *contract of insurance* covering either conservation of capital or payment of a minimum interest.

III ADEQUACY OF PREMIUMS

- 4.13 (1) Before entering into a *long-term insurance contract*, a *directive friendly society* must satisfy itself that the aggregate of-
- (a) the *premiums* payable under the contract and the income which will be derived from them; and
 - (b) any other resources of the *friendly society* which are available for the purpose,
- will be sufficient, on reasonable actuarial assumptions, to meet all *commitments* arising under or in connection with the contract.
- (2) A *friendly society* must not rely on other resources for the purposes of (1) in such a way as to jeopardise the solvency of the *friendly society* in the long term.

⁵ See Guidance Note P.1 of *IPRU (INS)*.

⁶ See paragraph 2 of Guidance Note 4.4 *IPRU (INS)*.

IV CURRENCY MATCHING AND LOCALISATION

Matching: general requirement

- 4.14 (1) Where the liabilities of a *friendly society* in any particular currency exceed 5% of the *friendly society's* total liabilities, the *friendly society* must hold sufficient assets in that currency to cover at least 80% of the *friendly society's* liabilities in that currency.
- (2) Where a *friendly society* carries on both *long-term insurance* and *general insurance business*, the requirements of (1) apply to the assets and liabilities of each kind of business separately.
- (3) Where the *contract of insurance* expresses any liability in terms of a particular currency, that liability must be regarded as a liability in that currency.
- (4) For the purposes of rules 4.14 to 4.19-
- (a) “assets” means assets valued in accordance with the *asset valuation rules*;
 - (b) “liabilities” means provision by a *friendly society* to cover liabilities arising under or in connection with *contracts of insurance* (not being liabilities relating to *insurance business* excluded by rule 4.19); and
 - (c) references to ‘assets in a currency’ (or similar expressions) must be construed as references to assets expressed in or capable of being realised (without exchange risk) in that currency; and an asset is capable of being realised (without exchange risk) in a currency if it is reasonably capable of being realised in that currency without risk that changes in exchange rates would reduce the cover of liabilities in that currency.

Matching: property linked benefits

- 4.15 (1) In so far as the liabilities for *property linked benefits* and *index linked benefits* are covered by assets which determine the benefits payable under a *linked long-term contract*, rule 4.14 does not apply.
- (2) In so far as the liabilities for *property linked benefits* are determined by reference to assets in a currency other than that in which the *friendly society's* obligations to the *policyholder* are expressed, those liabilities must for the purposes of rule 4.14 be deemed to be liabilities in the first-mentioned currency.

Matching: currency of general insurance business liabilities

- 4.16 (1) The currency of a *friendly society's* *general insurance business liabilities* must, for the purposes of rule 4.14, be determined as follows.

- (2) Where the liabilities are not expressed as liabilities in terms of a particular currency, they must be regarded as liabilities in the currency of the country in which the risk is situated or, if the *friendly society* on reasonable grounds so determines, in the currency in which the *premium* payable under the contract is expressed.
- (3) However, where, in accordance with the nature of the risks, the *friendly society's* liabilities are liabilities in a currency other than that determined in accordance with (2), the *friendly society* may regard its liabilities as liabilities in the currency which it will use in accordance with past experience or, in the absence of such experience, in the currency of the country in which it is established.
- (4) Where a *claim* has been notified to a *friendly society* and the *friendly society's* liability in respect of that claim is payable in a currency other than one which would result from the application of (2) or (3), the liability must be regarded as a liability in the currency in which the *friendly society* is actually obliged to pay it.
- (5) Where a *claim* is assessed in a currency which is known to the *friendly society* in advance but which is different from a currency determined in accordance with (2), (3) or (4), the *friendly society* may regard its liabilities as liabilities in that currency.

Matching: exceptions for certain liabilities

4.17 A *friendly society* need not cover its liabilities by assets in a particular currency if those assets would amount to 7% or less of the remainder of its assets in other currencies.

Localisation

- 4.18 (1) Assets held pursuant to rule 4.14 must be held-
- (a) if they cover liabilities in sterling, in any *EEA State*;
 - (b) if they cover liabilities in any other currency, in any *EEA State* or in the country of that currency.
- (2) For the purposes of applying (1) to tangible assets and assets consisting of a claim against a debtor or a *listed* or *unlisted* investment -
- (a) a tangible asset is to be regarded as held in the place where it is situated;
 - (b) an asset consisting of a claim against a debtor is to be regarded as held in any place where it can be enforced by legal action;
 - (c) an asset consisting of a *listed* investment is to be regarded as held in any place where-

- (i) if there is a stock exchange (of the kind described in (a) of the definition of '*listed*'), it is *listed*, or
- (ii) if there is a *regulated market*, it is dealt in; and
- (d) an asset consisting of an *unlisted* investment issued by an incorporated *company* is to be regarded as held in the place where the head office of the *company* is situated.

Exclusions from rules 4.14 to 4.18

4.19 Nothing in rules 4.14 to 4.18 applies to *insurance business* carried on outside the *EEA States*.

V SEPARATION BETWEEN LONG-TERM INSURANCE BUSINESS ASSETS AND OTHER ASSETS

4.20 A *friendly society* which has permission to carry on *long-term insurance business* must –

- (a) secure that the assets representing the funds maintained by the *friendly society* in respect of its *long-term insurance business* are only applicable for the purposes of that business; and
- (b) ensure that adequate arrangements are in force for securing that transactions affecting the assets of the *friendly society* (other than transactions outside its control) do not operate unfairly between the assets representing the funds maintained by the *friendly society* in respect of its *long-term insurance business* and the other assets of the *friendly society*.

VI. LINKED LONG-TERM CONTRACTS

4.21 (1) A *friendly society* must not contract to provide benefits under any contract to which this rule applies which are determined, either wholly or partly -

- (a) by reference to the value of, or the income from, or fluctuations in the value of, property of any description other than property of any of the descriptions specified in Part I of Appendix 3 (subject to the provisions of Part II of that Appendix); or
- (b) whether directly or indirectly, by reference to fluctuations in any index of the value of property other than an *approved index*.

(2) This rule applies to *linked long-term contracts* for *ordinary long-term insurance business* other than contracts to manage the investments of pension funds that are not combined with *contracts of insurance* covering either conservation of capital or payment of a minimum interest, except that benefits payable under such contracts must not be determined, either wholly or partly,

by reference to the value of, or the income from, or fluctuations in the value of *derivative contracts* other than *permitted derivative contracts*.

- (3) Any reference to contracts of a similar description to any specified contract is a reference to contracts which correspond with that contract in both the following respects-
- (a) the provisions defining the descriptions of property or indices by reference to which the benefits are to be determined are the same; and
 - (b) the *friendly society* or other person undertaking to pay the benefits is the same.

4.22 The property described in rule 4.21 is either-

- (a) *permitted connected property*, not being a contract or asset having the effect of a *derivative contract*; or
- (b) a *permitted derivative contract* or a contract or asset having the effect of a *permitted derivative contract* either of which when taken together with a *permitted derivative contract* has the effect that the *friendly society* holds either *permitted connected property* or a *permitted derivative contract* in connection with such property.

4.23 For the purposes of rule 4.21-

- (a) a *derivative contract* is deemed to be covered if it would not require a significant provision (within the meaning of 13(4) of Appendix 4) to be made in respect of it pursuant to 3 of Appendix 5 if it were a *derivative contract* to which that provision applied; and
- (b) "*permitted connected property*" means property of any of the descriptions in 1 to 8 or 10 of Appendix 3 which is not property falling within (a) to (d) of 12 of Appendix 3.

VII. LIQUIDITY

4.24 A *friendly society* must maintain liquid assets sufficient to meet its liabilities as they become due.

Chapter 5

PRUDENTIAL REPORTING

Annual actuarial investigation

5.1 (1) A *friendly society* which-

- (a) is a *directive friendly society*; or
- (b) a *non-directive incorporated friendly society* (other than a *flat rate benefits business friendly society*),

must cause an investigation to be made by the *appointed actuary* into the financial condition of the *friendly society* in respect of its *long-term insurance business* as at the end of each *financial year*.

(2) When such an investigation has been made, the *friendly society* must-

- (a) cause an abstract of the actuary's report of the investigation to be made; and
- (b) deposit three copies of that abstract with the *FSA* within 6 months of the end of the *financial year* to which it relates,

and one of those copies must be signed as required by rule 5.12.

(3) An investigation under this rule must include-

- (a) a determination of the liabilities of the *friendly society* attributable to its *long-term insurance business*; and
- (b) a valuation of any excess over those liabilities of the assets representing the fund or funds maintained by the *friendly society* in respect of that business and, where any rights of any long-term *policyholders* to participate in profits relate to particular parts of such a fund, a determination of any excess of assets over liabilities in respect of each of those parts.

(4) Rules 5.5 to 5.12 apply in respect of the abstract required by (2)(a) (referred to as the "FSC1 return").

Triennial actuarial investigation

5.2 (1) At least once in every *period* of 3 years, a *friendly society* (other than a *flat rate benefits business friendly society*) which-

- (a) is a *non-directive unincorporated friendly society* must cause an investigation to be made by the *appropriate actuary* into the financial condition of the *friendly society* in respect of its *insurance business*; and
 - (b) is a *directive friendly society* or *non-directive incorporated friendly society* must cause an investigation to be made by the *appropriate actuary* into the financial condition of the *friendly society* in respect of its *general insurance business*.
- (2) Subject to (8) or (9), when an investigation under this rule has been made, the *friendly society* must-
- (a) cause an abstract of the actuary's report of the investigation to be made; and
 - (b) deposit three copies of that abstract with the *FSA* within 6 months of the end of the *period* to which it relates,
- and one of those copies must be signed as required by rule 5.20.
- (3) Subject to (4), a *friendly society* must deposit with the *FSA*, not later than 6 months after each anniversary of the date to which the accounts of the *friendly society* were made up for the purposes of the last investigation into its financial condition under this rule-
- (a) a certificate given by the *appropriate actuary*, in the format of Form FSC4, that there has been no material change in its financial condition in respect of its *insurance business* since it sent the last abstract under (2); or
 - (b) a statement by the *appropriate actuary* that he is unable to give such a certificate.
- (4) A *friendly society* is not under the duty imposed by (3)(b) if, before a date by which a certificate or statement must be deposited, a further investigation under this rule has been carried out and the requisite abstract has been deposited with the *FSA*.
- (5) If a *friendly society* deposits with the *FSA* a statement under (3)(b), the *friendly society* must cause an investigation to be carried out under this rule, and in such a case-
- (a) the date to which the *friendly society's* accounts are made up for the purposes of the investigation must be the latest anniversary of the date to which its accounts were made up for the purposes of the last investigation under this rule; and

- (b) the abstract required by (2) must be deposited with the *FSA* within 6 months of the date by which that statement was required to be deposited under (3).
- (6) An investigation under this rule into the financial condition of a *friendly society* which falls within (1)(a) must include-
 - (a) a valuation of the liabilities of the *friendly society* attributable to its *insurance business*; and
 - (b) a determination of any excess over the liabilities so attributable of the assets representing the fund or funds maintained by the *friendly society* in respect of its *insurance business* and, where any rights of any long-term *policyholders* to participate in profits relate to particular parts of such a fund, a determination of any excess of assets over liabilities in respect of each of those parts.
 - (7) An investigation under this rule into the financial condition of a *friendly society* falling within (1)(b) must include-
 - (a) a valuation of the liabilities of the *friendly society* attributable to its *general insurance business*; and
 - (b) a determination of any excess over the liabilities so attributable of the assets representing the fund or funds maintained by the *friendly society* in respect of that business.
 - (8) A *non-directive unincorporated friendly society* must complete an abstract in the Form required under rule 5.13 (referred to as the “FSC2 return”).
 - (9) A *directive friendly society* or *non-directive incorporated friendly society* (other than a *flat rate benefits business friendly society*) which is carrying on *general insurance business* must complete an abstract in the Form required under rules 5.14 to 5.19 (referred to as the “FSC3 return”).

Correction of abstracts

- 5.3 (1) If within 24 months of the date of deposit, the *FSA* notifies the *friendly society* that any Form (including any supplementary note to a Form) included in the FSC1, FSC2 or FSC3 return appears to it to be inaccurate or incomplete, the *friendly society* must consider the matter and within one month of the date of notification it must correct any inaccuracies and make good any omissions and deposit the relevant parts of the documents again.
- (2) One of the copies referred to in (1) must be signed –
 - (a) by the *appropriate actuary* if the Form is the actuary’s certificate;
 - (b) by the auditor if the Form is the auditor’s report;

- (c) in the case of all other Forms by the chief executive, the secretary and one *committee* member of the *friendly society* (or two members of the *committee* if the offices of chief executive and secretary are held by the same person).

The FSC1 return

5.4 [deleted]

5.5 (1) The FSC1 return must include:

- (a) Form FSC1
- (b) a balance sheet;
- (c) revenue accounts;
- (d) a valuation abstract;
- (e) a certificate by the *appointed actuary*; and
- (f) a report of the auditors.
- (g) a statement that the *friendly society* consents to the FSC1 return being placed on its *public file*.

(2) Rules 5.6 to 5.12 apply to the preparation of the FSC1 return.

Balance sheet

5.6 (1) The balance sheet must consist of Forms 9, 13, 14, 15 and 17 (as appropriate) prepared in accordance with the instructions in Appendix 6.

(2) Form 13 must be completed in respect of -

- (a) the total *long-term insurance business* assets of the *friendly society*; and
- (b) the *long-term insurance business* assets appropriated by it in respect of each separate *long-term insurance business* fund or group of funds for which separate assets have been appropriated.

(3) A separate Form 13 must be completed in respect of its total assets other than *long-term insurance business* assets and its corresponding liabilities must be shown in Form 15.

(4) Form 14 must be completed in respect of -

- (a) the total *long-term insurance business liabilities* and margins of the *friendly society*; and
- (b) the *long-term insurance business liabilities* and margins for each separate *long-term insurance business* fund or group of funds for which separate assets have been appropriated.

5.7 For each Form 13 which a *friendly society* is required to complete in accordance with rule 5.6(2) and (3), it must complete Form 17 in respect of the

same business; except that where in respect of that Form all amounts required to be shown would be zero and no supplementary note would be required, Form 13 may instead be accompanied by a supplementary note to that effect and Form 17 may be omitted.

Revenue Account

- 5.8 (1) The revenue account must consist of Forms 40, 40A, 40B and 40C (as appropriate) prepared in accordance with the instructions in Appendix 8 and so that-
- (a) a separate Form 40 is prepared in respect of each *long-term insurance business* fund, Form 40A for each other revenue account fund and Form 40B for each management fund maintained;
 - (b) where there is more than one fund for ordinary *long-term insurance business* or for *industrial assurance business*, the *friendly society* must also complete a summary Form for ordinary *long-term insurance business* or for *industrial assurance business*, as the case may require; and
 - (c) where there is more than one fund for other revenue account funds the *friendly society* must also complete a summary Form.
- (2) The revenue account must also include Forms 41 to 45 prepared separately in respect of ordinary *long-term insurance business* and *industrial assurance business* and in accordance with the instructions in Appendix 8.

Valuation abstract

- 5.9 The valuation abstract must consist of Forms 46 to 49, 51 to 58, 60 and 61A (as appropriate) prepared in accordance with the instructions in Appendix 9.

Actuary's Certificate

- 5.10 The *appointed actuary* must give a certificate in the terms, as appropriate, of Form 61B.

Auditor's Report

- 5.11 (1) The auditor's report in Form 61C must state whether in his opinion the balance sheet and revenue accounts (Forms 9 to 45 including any supplementary notes) and information relating thereto have been properly prepared and presented in accordance with the rules in chapters 4 & 5.
- (2) In giving this opinion the auditor must state whether he has relied on -
- (a) the certificate of the actuary given in accordance with rule 5.10 with respect to the *mathematical reserves* and the *required minimum margin* of the *friendly society*; and

- (b) the identity and value of any *implicit items* valued in accordance with a waiver under section 148 of the *Act*.
- (3) In giving the opinion in Form 61C, where the auditor undertaking the central audit has relied on work done at the branches by other firms of accountants, he must state that he has relied on other accountants for this work. In this case, he must ensure that a list of these firms is appended together with details of the particular branches for which they undertook the audit.
- (4) Where the auditor refers in his report or any note attached thereto to any uncertainty, the report must state whether, in the auditor's opinion, that uncertainty is material to determining whether the *friendly society* has available assets in excess of its *required minimum margin*.

Signatures

- 5.12
- (1) The *appointed actuary* must sign the certificate in Form 61B.
 - (2) The auditor must sign the report in Form 61C.
 - (3) The FSC1 Return must be signed, in Form 61D, by the *appointed actuary* and the chief executive, the secretary and one *committee* member of the *friendly society* (or two members of the *committee* if the offices of chief executive and secretary are held by the same person).

FSC2 Return

- 5.13
- (1) The FSC2 return must include –
 - (a) Forms FSC2, 9, 9A, 9B and 9C; and
 - (b) a statement that the *friendly society* consents to the FSC2 return being placed on its *public file*.
 - (2) Form 9A must provide a synopsis of the report by the *appropriate actuary* into the investigation into the financial condition of the *friendly society* in respect of its *insurance business* including the statements, information and comments set out in that Form, together with the *appropriate actuary*'s assessment of the financial viability of the *friendly society* and any changes that are necessary or desirable and the likely consequences of taking no action.
 - (3) The *appropriate actuary* must give and sign a certificate in the terms, as appropriate, of Form 9B.
 - (4) Form 9C must be signed by the chief executive, the secretary and one *committee* member of the *friendly society* (or two members of the *committee* if the offices of chief executive and secretary are held by the same person).

FSC3 return

- 5.14 (1) The FSC3 return must include:
- (a) Form FSC3
 - (b) a balance sheet;
 - (c) a revenue account;
 - (d) a certificate by the *appropriate actuary*; and
 - (e) a report of the auditors.
 - (f) a statement that the *friendly society* consents to the FSC3 return being placed on its *public file*.
- (2) Rules 5.15 to 5.19 apply to the preparation of the FSC3 return.

Balance sheet

- 5.15 (1) The balance sheet must consist of Forms 9, 11, 12, 13, 14, 15 and 17 (as appropriate) prepared in accordance with the instructions in Appendix 6.
- (2) Form 13 must be completed in respect of *general insurance business assets*. Where a *friendly society* also carries on *long-term insurance business*, a separate Form 13 must be completed by the *friendly society* in respect of its *long-term insurance business assets* and its corresponding liabilities and margins must be shown in Form 14.

Revenue Account and Additional Information

- 5.16 (1) The revenue account must comply with the instructions in Appendix 7 and must be as set out in Form 20 and a *friendly society* must complete a separate account in Form 20 in respect of each *class of general insurance business* and a summary account in that Form in respect of the whole of the *general insurance business* carried on by it.
- (2) A *friendly society* must in respect of each *class of general insurance business*, and in accordance with the instructions in Appendix 7, complete Forms 21 to 23.
- (3) Form 23A must be completed, in accordance with the instructions in Appendix 7, by a *friendly society* in respect of its *general insurance business*.

Actuary's Certificate

- 5.17 The *appropriate actuary* must give a certificate in the terms, as appropriate, of Form 23B.

Auditor's Report

- 5.18 (1) The auditor's report in Form 23C must state whether in his opinion the balance sheet, revenue accounts and *general insurance business* statements (Forms 9 to 23 including any supplementary notes) and information relating thereto have

been properly prepared and presented in accordance with the rules and guidance in this part of the *IPRU(FSOC)*.

- (2) In giving this opinion, the auditor must state whether he has relied on the identity and value of any *implicit items* valued in accordance with a waiver under section 148 of the *Act*. Where the auditor undertaking the central audit has relied on work done at the branches by other firms of accountants, he must state that he has relied on other accountants for this work. In this case, he must ensure that a list of these firms is appended together with details of the particular branches for which they undertook the audit.
- (3) Where the auditor refers in his report or any note attached thereto to any uncertainty, the report must state whether, in the auditor's opinion, that uncertainty is material to determining whether the *friendly society* has available assets in excess of its *required minimum margin*.

Signatures

- 5.19
- (1) The *appropriate actuary* must sign the certificate in Form 23B.
 - (2) The auditor must sign the report in Form 23C.
 - (3) The FSC3 Return must be signed, in Form 23D, by the chief executive, the secretary and one *committee* member of the *friendly society* (or two members of the *committee* if the offices of chief executive and secretary are held by the same person).

Completion of Forms

- 5.20
- Rules 5.21 to 5.24 apply to the completion of any Form to be included in the *FSC return*.

Headings

- 5.21
- The *friendly society's* register number is to be entered on every page in the relevant box. Boxes marked 'period ended 31 December' must be completed so as to show, in numerals, the date of the last day of the *period* to which the *FSC return* relates. Boxes marked "OB/IB" must be completed to indicate whether the Form is completed in respect of ordinary assurance business (OB) or industrial assurance (IB). No entry must be made in a box which is shaded or is not labelled.

Information to be fairly stated

- 5.22
- Every Form (including supplementary notes to Forms) required to be prepared under the rules in this chapter must fairly state the information provided in it on the basis required by the rules.

Valuation of assets and liabilities

- 5.23 Unless the context otherwise requires, the value or amount given for an asset or a liability of the *friendly society* included in any Form (or supplementary note to a Form) must be the value or amount of that asset or liability as determined in accordance with the *asset valuation rules* and *liability valuation rules* in Appendices 4 and 5.

Presentation of amounts

- 5.24 Some Forms permit amounts to be entered in £000 but advantage may be taken of this only if none of the entries in the relevant Form is less than £500. All entries in a Form must be in the same monetary units. Negative amounts must be shown between round brackets.

Intra-group transactions

- 5.25 (1) If, during the *financial year* in question, a *friendly society*, has agreed to, or carried out, a *material connected-party transaction*, it must provide a brief description of that transaction by way of supplementary note to Form 20 or Form 40.
- (2) The description to be provided in accordance with (2) must state –
- (a) the names of the transacting parties;
 - (b) a description of the relationship between the parties;
 - (c) a description of the transaction;
 - (d) the amounts involved;
 - (e) any other elements of the transaction necessary for an understanding of its effect upon the financial position or performance of the *friendly society*; and
 - (f) amounts written off in the period in respect of *debts* due to or from *connected parties*.
- (3) Transactions with the same *connected party* may be disclosed on an aggregated basis unless separate disclosure is needed for a proper understanding of the effect of the transactions upon the financial position or performance of the *friendly society*.
- 5.26 A *directive friendly society* must provide to any person (or the person who has already been provided with a copy under (a)) within 30 days of the date of request (or, in the case of (b), the date of deposit under rule 5.3):
- (a) a copy of any of the documents last deposited by the *friendly society* under rules 5.1 or 5.2; and

- (b) a copy of any document deposited under rule 5.3 which corrects or makes good any document provided under (a),

in printed form, but (in the case of (a)) the *friendly society* may make a charge to cover its reasonable costs, including those of printing and postage.

STATISTICAL INFORMATION RELATING TO EEA BRANCHES AND SERVICES OPERATIONS

Interpretation

6.1 In this chapter-

- (a) references to *insurance business*, *general insurance business* and *long-term insurance business* do not include *reinsurance business*;
- (b) "gross *claims*" means the amount paid in respect of *claims*, including reinsured amounts;
- (c) "gross premiums" means *premiums* after deduction of discounts, refunds, rebates of *premium* and any taxes or levies that are related to those *premiums* but before deduction of *premiums* for reinsurance ceded and before deduction of *commission payable* by the *friendly society*; and
- (d) references, in relation to the provision of general insurance or the carrying on of *general insurance business*, to the groups of *classes* are to the following two groups-
 - (i) accident and sickness, that is to say, *general insurance business* of *classes* 1 and 2, and
 - (ii) miscellaneous financial loss, that is to say, *general insurance business* of *class* 16.

Insurance statistics: EEA states

6.2 (1) A *directive friendly society* which in a *financial year*-

- (a) carries on *long-term insurance business* in an *EEA State* other than the United Kingdom through an overseas branch in that State; or
- (b) *provides long-term insurance* in an *EEA State* other than the United Kingdom through an establishment in another *EEA State*,

must prepare in respect of *long-term insurance business* so carried on by it, or *long-term insurance* so provided by it, a statement of gross premiums *receivable* by each of *classes* I to VII.

(2) A *directive friendly society* which in a *financial year*-

- (a) carries on *general insurance business* in an *EEA State* other than the United Kingdom through an overseas branch in that State; or

- (b) *provides general insurance* in an *EEA State* other than the United Kingdom through an establishment in another *EEA State*,

must prepare in respect of *general insurance business* so carried on by it, or general insurance so provided by it, a statement of gross premiums *receivable*, commissions attributable to those *premiums* and gross *claims* by each group of *classes*.

- (3) The statements referred to in (1) and (2) must be prepared separately in respect of each *EEA State* in which the *friendly society* carries on the *insurance business* or *provides the insurance*.

Supplementary provisions

- 6.3 (1) Where a statement or underwriting account is prepared by a *friendly society* under rule 6.2, the *friendly society* must-
 - (a) cause the statement or account to be printed; and
 - (b) deposit three copies of the statement or account with the *FSA* within nine months after the end of the *financial year* to which it relates.
- (2) One of the copies of any statement or account deposited under (1) must be signed by the chief executive or secretary of the *friendly society*.
- (3) If within 24 months of the date of deposit, the *FSA* notifies the *friendly society* that a document deposited under (1) appears to it to be inaccurate or incomplete, the *friendly society* must consider the matter and within one month of the date of notification it must correct any inaccuracies and make good any omissions and deposit the relevant parts of the documents again.

Notification of non-provision of insurance or non-carrying on of business

- 6.4 (1) Subject to (2), where a *friendly society* which has notified the *FSA* in accordance with *SUP*-
 - (a) of its intention to establish an overseas branch in an *EEA State* other than the United Kingdom; or
 - (b) of its intention to *provide insurance* in an *EEA State* other than the United Kingdom,

does not in any *financial year* carry on *insurance business* or, as the case may be, *provide insurance* in that State, it must send to the *FSA* a notification of that fact within nine months after the end of the *financial year* to which the notification relates, signed by the chief executive or secretary of the *friendly society*.

- (2) (1) does not apply if the *friendly society* has, before the beginning of the *financial year*, informed the *FSA* that it no longer intends to carry on *insurance business* or, as the case may be, *provide insurance* in the *EEA State* in question.
- (3) If within 24 months of the date of deposit, the *FSA* notifies the *friendly society* that a document deposited under (1) appears to it to be inaccurate or incomplete, the *friendly society* must consider the matter and within one month of the date of notification it must correct any inaccuracies and make good any omissions and deposit the relevant parts of the documents again.

Chapter 7

DEFINITIONS

Part I Definitions

7.1 In this Part of the *IPRU(FSOC)*, unless the contrary intention appears, the following definitions apply –

<p><i>Accounts Regulations</i> means the Friendly Societies (Accounts and Related Provisions) Regulations 1994, S.I. 1994/1983;</p>
<p><i>accumulating with-profits policy</i> means a <i>with-profits policy</i> which has a readily identifiable current benefit, whether or not this benefit is currently realisable, which is adjusted by an amount explicitly related to the amount of any <i>premium</i> payment and to which additional benefits are added in respect of participation in profits by additions directly related to the current benefit, or a policy with similar characteristics;</p>
<p><i>1974 Act</i> means the Friendly Societies Act 1974;</p>
<p><i>1992 Act</i> means the Friendly Societies Act 1992;</p>
<p><i>Accounts Directives</i> means Council Directives 78/660/EEC for companies, 91/674/EEC for insurance companies, 86/635/EEC for banks and 83/349/EEC for consolidated accounts;</p>
<p><i>Act</i> means Financial Services and Markets Act 2000;</p>
<p><i>ancillary risk</i>, in relation to a <i>friendly society</i> with permission under the <i>Act</i> to insure a principal risk belonging to one <i>class</i> of <i>general insurance business</i>, means a risk included in another such <i>class</i> which is -</p> <ul style="list-style-type: none">(a) connected with the principal risk;(b) concerned with the object which is covered against the principal risk; and(c) the subject of the same contract insuring the principal risk;
<p><i>annual contribution income</i> means, in relation to a <i>friendly society's long-term insurance business</i>, the income of the <i>friendly society</i> in a <i>financial year</i> without any deduction for reinsurance cessions;</p>
<p><i>annuities on human life</i> does not include superannuation allowances and annuities payable out of any fund applicable solely to the relief and maintenance of persons engaged or who have been engaged in any particular profession, trade or employment, or of the dependants of such persons;</p>

<i>appointed actuary</i> means an actuary appointed under <i>SUP</i> 4.13.1R;
<i>appropriate actuary</i> means an actuary appointed under <i>SUP</i> 4.4.1R;
<p><i>approved counterparty</i> means any of the following –</p> <ul style="list-style-type: none"> (a) an <i>approved credit institution</i> (b) a person who is exempt pursuant to section 43 of the Financial Services Act 1986 (c) a person who is permitted under the <i>Act</i> to conduct investment business of a kind which includes entering into <i>unlisted derivative contracts</i> as principal; or (d) in respect of a transaction involving a new issue of <i>securities</i> which are to be <i>listed</i>, the <i>issuer</i> or an <i>approved investment firm</i> acting on behalf of the <i>issuer</i>;
<i>approved credit institution</i> means an institution recognised or permitted under the law of an <i>EEA State</i> to carry on any of the activities set out in Annex 1 to the <i>Banking Co-ordination Directive</i> ;
<i>approved derivative contract</i> has the meaning given in 13(6) of Appendix 4;
<p><i>approved financial institution</i> means any of the following –</p> <ul style="list-style-type: none"> the European Central Bank; the central bank of an <i>EEA State</i>; the International Bank for Reconstruction and Development; the International Finance Corporation; the International Monetary Fund; the Inter-American Development Bank; the African Development Bank; the Asian Development Bank; the Caribbean Development Bank; the European Investment Bank; the European Community; the European Atomic Energy Community; and the European Coal and Steel Community;
<p><i>approved index</i> means either –</p> <ul style="list-style-type: none"> (a) an index which is – <ul style="list-style-type: none"> (i) calculated independently, (ii) published at least once every week, (iii) based on constituents, each of which is property falling within 1

<p>to 8 or 10 of Appendix 3, and</p> <p>(iv) calculated on a basis which is made available to the public and which includes both the rules for including and excluding constituents and the rules for valuation which must use an arithmetic average of the value of the constituents;</p> <p>(b) a national index of retail prices published by or under the authority of a government of a State belonging to Zone A as defined in Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions; or</p> <p>(c) an index which is –</p> <p>(i) based on constituents, each of which is property falling within 1 to 8 or 10 of Appendix 3, and</p> <p>(ii) in respect of which a <i>derivative contract</i> is listed;</p>
<p><i>approved investment firm</i> means an investment firm as defined in article 2 of Council Directive 93/22/EEC of 10 May 1993 on investment services in the <i>securities</i> field;</p>
<p><i>approved securities</i> means any of the following –</p> <p>(a) any <i>securities</i> issued or guaranteed by, or the repayment of the principal of which, or the interest on which is guaranteed by, and any loans to or deposits with, any of the following, namely, any government, public or local authority or nationalised industry or undertaking, which belongs to Zone A as defined in the <i>Banking Co-ordination Directive</i>; and</p> <p>(b) any loan to, or deposit with, an <i>approved financial institution</i>;</p>
<p><i>asset valuation rules</i> are the rules in Appendix 4;</p>
<p><i>associate</i> means -</p> <p>(a) the wife or husband or <i>minor son</i> or <i>daughter</i> of that person;</p> <p>(b) the trustees of any settlement under which that person has a life interest in possession, or, in Scotland, a life interest;</p> <p>(c) any <i>company</i> of which that person is a director; or</p> <p>(d) any person who is an employee or partner of that person; and</p> <p>if that person is a <i>company</i> –</p> <p>(i) any director of that <i>company</i>,</p>

<p>(ii) any <i>subsidiary undertaking</i> of that <i>company</i>, or</p> <p>(iii) any director or employee of any such <i>subsidiary undertaking</i>; and</p> <p>if that person has made an agreement or arrangement with any other person –</p> <p>(iv) with respect to the acquisition, holding or disposal of <i>shares</i> or other interests in the <i>company</i> concerned or another <i>company</i> of which it is a <i>subsidiary undertaking</i>, or</p> <p>(v) under which they undertake to act together in exercising their voting power in relation to the <i>company</i> concerned or another <i>company</i> of which it is such an undertaking,</p> <p>that other person;</p>
<p><i>Banking Co-ordination Directive</i> means Council Directive 2000/12/EC of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions;</p>
<p><i>building society</i> means a building society within the meaning of the Building Societies Act 1986;</p>
<p><i>business amount</i> means –</p> <p>(a) for a <i>friendly society</i> carrying on only <i>general insurance business</i>, the <i>general insurance business amount</i>;</p> <p>(b) for a <i>friendly society</i> carrying on only <i>long-term insurance business</i>, the <i>long-term insurance business amount</i>; and</p> <p>(c) for a <i>friendly society</i> carrying on both <i>general insurance business</i> and <i>long-term insurance business</i>, in the case of its <i>general insurance business assets</i>, the <i>general insurance business amount</i> and in the case of its <i>long-term insurance business assets</i>, the <i>long-term insurance business amount</i>;</p>
<p><i>charges for management</i> means amounts chargeable in respect of the management of an <i>internal linked fund</i> in accordance with the rules of the <i>friendly society</i> and the conditions of those <i>contracts of insurance</i> under which <i>property linked benefits</i> are linked to the value of the fund or units of the fund;</p>
<p><i>claim</i> means a claim against a <i>friendly society</i> under a <i>contract of insurance</i>;</p>

<p><i>claims-made policy</i> means a contract of liability insurance which provides that no liability is incurred by the <i>friendly society</i> in respect of an incident unless –</p> <p>(a) the incident is notified to the <i>friendly society</i> (or its agent or representative), and</p> <p>(b) such notification is received by the <i>friendly society</i> (or its agent or representative) before the end of a specified <i>period</i> which is no longer than three years following the final date for which cover is provided under the contract;</p>
<p><i>claims management costs</i> refers to those <i>claims</i> management costs required by the <i>Accounts Regulations</i> (note (4) to the income and expenditure account format) to be included in <i>claims</i> incurred other than those which, whether or not incurred through the employment of the <i>friendly society's</i> own staff, are directly attributable to particular <i>claims</i>;</p>
<p><i>class</i>, in relation to <i>insurance business</i>, means a class of <i>long-term insurance business</i> or a class of <i>general insurance business</i> listed in Part III of chapter 7;</p>
<p><i>collective investment fund</i> includes a <i>collective investment scheme</i>;</p>
<p><i>collective investment scheme</i> has the meaning given in section 235 of the <i>Act</i>;</p>
<p><i>commission payable</i> means the amounts recorded during a <i>financial year</i> of a <i>friendly society</i> as due to intermediaries and cedants in respect of the inception, amendment or renewal of <i>contracts of insurance</i>, whether or not paid during that year;</p>
<p><i>commitment</i> means a commitment represented by <i>insurance business</i> of any of the <i>classes</i> of <i>long-term insurance business</i> specified in Part III of chapter 7</p>
<p><i>committee</i> means the committee of management or other directing body of a <i>friendly society</i> or <i>registered branch</i>;</p>
<p><i>company</i> includes a body corporate;</p>
<p><i>connected</i>, in relation to two bodies corporate (A and B), means that:</p> <p>(a) B is a <i>related undertaking</i> of A;</p> <p>(b) B is a <i>participating undertaking</i> in A; or</p> <p>(c) B is a <i>related undertaking</i> of a <i>participating undertaking</i> in A;</p>

connected individual of a friendly society means a person who –

- (a) controls, or is a partner of a person who controls, the *friendly society*;
or
- (b) is a member of the *committee* of the *friendly society* or the wife or husband or a *minor son or daughter* of such a member,

and for the purposes of the above a person controls a *company* if he is –

- (c) a person in accordance with whose directions or instructions the *committee* is accustomed to act; or
- (d) a person who either alone or with any *associate* or *associates* is entitled to exercise, or control the exercise of, 15 % or more of the voting power at any general meeting of the *friendly society*;

connected-party transaction means the transfer of assets or liabilities or the performance of services by, to or for a *connected* person irrespective of whether or not a price is charged;

contract for differences means a contract which falls within article 85 of the Financial Services and Markets Act (Regulated Activities) Order 2001;

contract of insurance includes:

- (a) fidelity bonds, performance bonds, administration bonds, bail bonds, customs bonds, or similar contracts of guarantee, effected in return for the payment of one or more premiums;
- (b) tontines;
- (c) when effected or carried out by a body that carries on the business of effecting or carrying out *contracts of insurance* apart from this paragraph, capital redemption contracts and *pension fund management contracts*;
- (d) contracts to pay *annuities on human life*;
- (e) contracts of a kind referred to in article 1(2)(e) of the *first life Directive*;
and
- (f) contracts of a kind referred to in article 1(3) of the *first life Directive*;

counterparty in relation to a *friendly society* means –

- (a) any one individual;
- (b) any one unincorporated body of persons;
- (c) any one *company* not being a member of a *group*;
- (d) any *group* of *companies* excluding any *companies* within the *group* which are *subsidiary undertakings* of the *friendly society*; or
- (e) any government of a State together with all the public bodies, local authorities or nationalised industries of that State,

in which the *friendly society* has made investments or against whom it has rights whether in pursuance of a contract entered into by the *friendly society* or otherwise;

court except in relation to the winding-up of an *incorporated friendly society*, means –

- (a) in the case of a body whose registered office is situated in England and Wales or in Northern Ireland, the county *court* for the district in which the office is situated;
- (b) in the case of a body whose registered office is situated in Scotland, the sheriff in whose jurisdiction the office is situated; and, in relation to the winding-up of an *incorporated friendly society*, means the *court* which has jurisdiction under the applicable winding-up legislation to wind-up the *friendly society*;

daughter includes stepdaughter;

debt includes an obligation to pay a sum of money under a negotiable instrument;

debt security includes bonds, notes, debentures and debenture stock;

debts due or to become due includes any *debts* which would become due if the *friendly society* were to exercise any right to which it is entitled to require payment or repayment of the same;

deferred acquisition costs means those items referred to at G II under the heading "Assets" in Part I of Schedule 2 to the *Accounts Regulations*;

<p><i>dependant of a friendly society</i> means –</p> <p>(a) a <i>subsidiary undertaking</i> of that <i>friendly society</i>; or</p> <p>(b) a body jointly controlled by that <i>friendly society</i> and another person,</p> <p>within the meaning of section 13 of the <i>1992 Act</i> the value of whose shares is taken to be the value of its surplus assets under 3 of Appendix 4;</p>
<p><i>deposit back arrangement</i>, in relation to a contract of reinsurance, means an arrangement whereby an amount is deposited by the reinsurer with the cedant;</p>
<p><i>derivative contract</i> means a <i>contract for differences</i>, a <i>futures contract</i> or an <i>option</i> and includes a contract under which the amount payable by either party is calculated by reference to the amortised value of any property;</p>
<p><i>direct insurance business</i> has the meaning given in <i>IPRU(INS)</i>;</p>
<p><i>directive friendly society</i> means a <i>friendly society</i> other than a <i>non-directive friendly society</i>;</p>
<p><i>designated state or territory</i> means any <i>EEA State</i> (other than the United Kingdom), Switzerland, a state in the United States of America, Canada or a province of Canada, Australia, South Africa, Singapore and Hong Kong;</p>
<p><i>diversified contract for differences</i> means a <i>contract for differences</i> whose value does not depend to a significant extent on fluctuations in the value of, or the income from, assets of any of the descriptions in B19 to B28, B30 or B32 to B38 of Part II of this Annex and <i>undiversified contract for differences</i> must be construed accordingly;</p>
<p><i>EEA insurer</i> has the meaning given in <i>IPRU(INS)</i>;</p>
<p><i>EEA State</i> means a State which is a contracting party to the agreement on the European Economic Area signed at Oporto on 2 May 1992;</p>
<p><i>EEA State in which a risk or commitment is situated</i> in relation to a <i>contract of insurance</i> means –</p> <p>(a) where the person who entered into the contract with the <i>friendly society</i> on any date is an individual, the <i>EEA State</i> where he has his habitual place of residence on that date; and</p> <p>(b) in any other case, the <i>EEA State</i> where the establishment of that person is situated on that date;</p>
<p><i>equivalent securities</i> means <i>securities</i> issued by the same <i>issuer</i> being of an identical type and having the same nominal value, description and amount;</p>

<i>established surplus</i> has the meaning given in 6(7) of Appendix 5;
<i>excess concentration with a number of counterparties</i> has the meaning given in B17 of Annex B to Appendix 4;
<i>exposure</i> – (a) in relation to assets, means an amount determined in accordance with B4 to B12 of Annex B to Appendix 4; (b) in relation to a <i>counterparty</i> , means an amount determined in accordance with B13 to B17 of Annex B to Appendix 4;
<i>financial year</i> means the period of 12 months ending with 31 December and the initial <i>financial year</i> of a <i>friendly society</i> must be such period as expires at the end of the calendar year in which it is registered under the <i>1974 Act</i> or incorporated under the <i>1992 Act</i> and the final <i>financial year</i> of the <i>friendly society</i> must be such shorter period than 12 months as expires on the date as at which the <i>friendly society</i> makes up its final accounts;
<i>first non-life Directive</i> means Council Directive 73/239/EEC of 24 July 1973 on the co-ordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance;
<i>first life Directive</i> means Council Directive 79/267/EEC of 5 March 1979 on the co-ordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct life assurance;
<i>fixed interest securities</i> means <i>securities</i> which under their terms of issue provide for fixed amounts of interest;
<i>flat rate benefits business friendly society</i> means a <i>friendly society</i> whose <i>insurance business</i> is restricted to the provision of benefits which vary according to the resources available and in which the contributions of members are determined on a flat rate basis;
<i>friendly society</i> means an <i>incorporated friendly society</i> or a <i>registered friendly society</i> ;
<i>FSA</i> means the Financial Services Authority;
<i>FSC return</i> means any of FSC1 return, FSC2 return and FSC3 return;
<i>futures contract</i> means a contract which falls within article 84 of the Financial Services and Markets Act (Regulated Activities) Order 2001;
<i>general insurance business</i> means <i>insurance business</i> of any of the <i>classes</i> of general insurance specified in Part III of chapter 7;

<p><i>general insurance business amount</i> means the higher of –</p> <p>(a) the aggregate of the <i>friendly society's insurance liabilities</i> (net of <i>reinsurance</i>) in respect of <i>general insurance business</i> and an amount equal to whichever is the greater of 400,000 Euro or 20% of the <i>general premium income</i>; or</p> <p>(b) such other amount as the <i>friendly society</i> may select not exceeding the value of its assets (other than <i>long-term insurance business assets</i> and excluding <i>reinsurance recoveries</i>) as determined in accordance with the <i>asset valuation rules</i>;</p>
<p><i>general insurance business assets</i> means assets of a <i>friendly society</i> or <i>insurance company</i> which are, for the time being, identified as representing the <i>general insurance business</i> fund or funds maintained by that body in respect of its <i>general insurance business</i>, and</p> <p><i>general insurance business liabilities</i> means liabilities of the body which are attributable to its <i>general insurance business</i>;</p>
<p><i>general premium income</i> means, in any year, the net amount, after deduction of any <i>premiums</i> payable for <i>reinsurance</i>, of the <i>premiums receivable</i> in that year in respect of all <i>insurance business</i> other than <i>long-term insurance business</i>;</p>
<p><i>gross premiums</i>, in relation to a <i>friendly society</i> and a <i>financial year</i> –</p> <p>(a) means <i>premiums</i> after deduction of discounts, refunds and rebates of <i>premium</i> but before deduction of <i>premiums</i> for <i>reinsurance</i> ceded and before deduction of <i>commission payable</i> by the <i>friendly society</i>; and</p> <p>(b) includes <i>premiums receivable</i> by the <i>friendly society</i> under <i>reinsurance</i> contracts accepted by the <i>friendly society</i>;</p>
<p><i>group</i> has the meaning given in section 262(1) of the Companies Act 1985;</p>
<p><i>guarantee fund</i> has the meaning given in rule 4.4(1);</p>
<p><i>hybrid linked contract</i> means a <i>contract of insurance</i> the effecting of which constitutes the carrying on of <i>long-term insurance business</i> and which contains an option or options such that at some future time the contract may, according to how such option or options are exercised, constitute either a <i>linked contract</i> or a <i>non-linked contract</i>;</p>
<p><i>implicit items</i> has the meaning given in rule 4.7(3);</p>
<p><i>incepted</i> refers to the time when the liability to risk of a <i>friendly society</i> under a <i>contract of insurance</i> commenced and, for this purpose, a contract providing continuous cover is deemed to commence on each anniversary date of the contract;</p>
<p><i>incorporated friendly society</i> means a <i>friendly society</i> incorporated under the</p>

<i>1992 Act</i> ;
<i>index linked benefits</i> means benefits –
(a) provided for under a <i>linked long-term contract</i> ; and
(b) determined by reference to fluctuations in, or an index of, the value of property of any description (whether or not specified in the contract);
<i>index linked contract</i> means a <i>linked contract</i> conferring <i>index linked benefits</i> ;
<i>index linked liabilities</i> means <i>insurance liabilities</i> in respect of <i>index linked benefits</i> ;
<i>industrial and provident society</i> means any society registered (or deemed to be registered) under the Industrial and Provident Societies Act 1965 or the Industrial and Provident Societies Act (Northern Ireland) 1969;
<i>industrial assurance business</i> has the meaning given in <i>IPRU(INS)</i> ;
<i>initial margin</i> in respect of a <i>derivative contract</i> or a contract or <i>asset</i> having the effect of a <i>derivative contract</i> means assets which, before or at the time the contract is entered into, are transferred by the <i>friendly society</i> subject to a condition that such assets (or, where the assets transferred are <i>securities, equivalent securities</i>) will be returned to the <i>friendly society</i> on completion of that contract;
<i>insurance business</i> means the business of effecting or carrying out <i>contracts of insurance</i> as principal;
<i>insurance company</i> means a person or body of persons (whether incorporated or not) carrying on <i>insurance business</i> other than a <i>friendly society</i> ;
<i>insurance Directives</i> means –
(a) the <i>first non-life Directive</i> , the <i>second non-life Directive</i> and the <i>third non-life Directive</i> , and such other Directives as make provision with respect to the business of direct insurance other than long-term assurance; and
(b) the <i>first life Directive</i> , the <i>second life Directive</i> and the <i>third life Directive</i> , and such other Directives as make provision with respect to the business of direct long-term assurance;
<i>insurance holding company</i> means an undertaking whose main business is to acquire and hold <i>participations</i> in <i>subsidiary undertakings</i> , where those <i>subsidiary undertakings</i> are exclusively or mainly <i>insurance undertakings</i> ;

<i>insurance liabilities</i> means amounts calculated in accordance with <i>liability valuation rules</i> in respect of those items shown at C and D under the heading "Liabilities" in Part I of Schedule 2 to the <i>Accounts Regulations</i> ;
<i>insurance undertaking</i> has the meaning given in <i>IPRU(INS)</i> ;
<i>insurer</i> has the meaning given in <i>IPRU(INS)</i> ;
<i>intermediary</i> means a person who in the course of any business or profession invites other persons to make offers or proposals or to take other steps with a view to entering into <i>contracts of insurance</i> with a <i>friendly society</i> , other than a person who only publishes such invitations on behalf of, or to the order of, some other person;
<i>internal linked fund</i> means an account to which a <i>friendly society</i> appropriates certain <i>linked assets</i> and which may be sub-divided into units the value of which is determined by the <i>friendly society</i> by reference to the value of those <i>linked assets</i> ;
<i>IPRU(FSOC)</i> means the Interim Prudential Sourcebook for Friendly Societies;
<i>IPRU(INS)</i> means the Interim Prudential Sourcebook for Insurers;
<i>issuer</i> in respect of a <i>collective investment scheme</i> means the manager or operator of the scheme and in respect of an interest in a limited partnership means the partnership;
<i>jointly controlled body</i> is to be construed in accordance with section 13 of the <i>1992 Act</i> ;
<i>liability valuation rules</i> are the rules in Appendix 5;
<i>life Directives</i> means the <i>first life insurance Directive</i> , the <i>second life Directive</i> , and the <i>third life Directive</i> ;
<i>linked assets</i> means, in relation to a <i>friendly society</i> , <i>long-term insurance business assets</i> of the <i>friendly society</i> which are, for the time being, identified in the records of the <i>friendly society</i> as being assets by reference to the value of which <i>property linked benefits</i> are to be determined;
<i>linked benefits</i> , in relation to a <i>linked long-term contract</i> , means benefits payable to the <i>policyholder</i> which are determined by reference to the value of or the income from property of any description (whether or not specified in the contract) or by reference to fluctuations in, or in an index of, the value of property of any description (whether or not so specified);
<i>linked contract</i> means a contract falling within <i>class III</i> , and <i>non-linked contract</i> must be construed accordingly;

linked long-term contract means a *contract of insurance*, the effecting of which constitutes the carrying on of *long-term insurance business*, and under which *linked benefits* are payable;

listed means, in relation to an investment –

- (a) that there has been granted and not withdrawn a listing in respect of that investment on any stock exchange in an *EEA State* which is a stock exchange under the law of that State; or
- (b) that facilities have been granted for dealing in that investment on a *regulated market*,

and *unlisted* must be construed accordingly;

long-term insurance business means *insurance business* of any of the *classes* of long-term insurance specified in Part III of chapter 7;

long-term insurance business amount means the higher of –

- (a) the amount of the *friendly society's insurance liabilities* in respect of *long-term insurance business* (net of reinsurance ceded and excluding *property linked liabilities*), together with -
 - (i) the amount of the *required margin of solvency* (or the amount of the *minimum guarantee fund* if greater) determined in accordance with rules 4.2 and 4.5 and Appendix 1 less the amount of any *implicit item* valued in accordance with a waiver under section 148 of the *Act*, and
 - (ii) the amount of any *deposit-back* in connection with a contract of reinsurance in respect of *long-term insurance business*; or
- (b) such other amount as the *friendly society* may select not exceeding the value of its assets (other than *general insurance business assets* and excluding *reinsurance recoveries* and assets required to match *property linked liabilities*) in accordance with the *asset valuation rules*,

except that for the purposes of determining the *permitted asset exposure limit* under paragraph B3 of Annex B of Appendix 4, *index linked liabilities* must also be excluded from (a) and assets required to match such liabilities must be also excluded from (b);

long-term insurance business assets means assets of a *friendly society* or *insurance company* which are, for the time being, identified as representing the *long-term insurance business* fund or funds maintained by that body in respect of its *long-term insurance business*; and

long-term insurance business liabilities means liabilities of the body which are attributable to its *long-term insurance business*;

<p><i>long-term gilt yield</i> means the annualised equivalent of the 15 year medium coupon yield for United Kingdom Government fixed-interest <i>securities</i> jointly compiled by the Financial Times, the Institute of Actuaries and the Faculty of Actuaries;</p>
<p><i>long-term liabilities</i> means liabilities of a <i>friendly society</i> arising under or in connection with contracts for <i>long-term insurance business</i> including <i>liabilities</i> arising from <i>deposit back arrangements</i>;</p>
<p><i>management expenses</i> means all expenses, other than commission, incurred in the administration of a <i>friendly society</i> or its business;</p>
<p><i>market value</i> means the market value as determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate to societies;</p>
<p><i>material connected-party transaction</i> means a <i>connected-party transaction</i> for which (together with any similar transactions):</p> <ul style="list-style-type: none"> (a) the price actually paid or received for the transfer of assets or liabilities or the performance of services; or (b) the price which would have been paid or received had that transaction been negotiated at arm's length between unconnected parties, <p>exceeds:</p> <ul style="list-style-type: none"> (c) in the case of a <i>friendly society</i> that carries on either <i>general insurance business</i> or <i>long-term insurance business</i>, but not both, 5% of the <i>general business amount</i> or <i>long-term business amount</i>, as applicable; or (d) in the case of a <i>friendly society</i> that carries on both types of business either – <ul style="list-style-type: none"> (i) 5% of the <i>long-term business amount</i> where the transaction is in connection with the <i>friendly society's long-term business</i>; and (ii) in other cases, 5% of the <i>general business amount</i>;
<p><i>mathematical reserves</i> means the provision made by a <i>friendly society</i> to cover liabilities (excluding liabilities which have fallen due and liabilities arising from <i>deposit back arrangements</i>) arising under or in connection with contracts for <i>long-term insurance business</i>;</p>
<p><i>memorandum</i> has the meaning given by paragraph 4(3) of Schedule 3 to the 1992 Act;</p>
<p><i>minimum guarantee fund</i> has the meaning given in rule 4.4(2);</p>

minor, in relation to Scotland, means not having attained the age of sixteen;

modifications, in relation to *enactments*, includes additions, omissions and amendments;

non-directive friendly society means

- (1) a *friendly society* whose *insurance business* is restricted to the provision of benefits which vary according to the resources available and in which the contributions of the members are determined on a flat-rate basis;
- (2) a *friendly society* whose *long-term insurance business* is restricted to the provision of benefits for employed or self-employed persons belonging to an undertaking or group of undertakings, or a trade or group of trades, in the event of death or survival or of discontinuance or curtailment of activity (whether or not the *commitments* arising from such operations are fully covered at all times by *mathematical reserves*);
- (3) a *friendly society* which undertakes to provide benefits solely in the event of death where the amount of such benefits does not exceed the average funeral costs for a single death or where the benefits are provided in kind;
- (4) a *friendly society* (carrying on *long-term insurance business*) –
 - (a) whose articles of association contain provisions for calling up additional contributions from members or reducing their benefits or claiming assistance from other persons who have undertaken to provide it; and
 - (b) whose annual *gross premium* income (other than from contracts of *reinsurance*) has not exceeded 500,000 Euro for each of the three preceding *financial years*;
- (5) a *friendly society* (carrying on *general insurance business*) whose –
 - (a) registered rules contain provisions for calling up additional contributions from members or reducing their benefits;
 - (b) *gross premium* income (other than from contracts of *reinsurance*) for the preceding *financial year* did not exceed 1,000,000 Euro; and
 - (c) members provided at least half of that *gross premium* income; or
- (6) a *friendly society* whose liabilities in respect of *general insurance business* are fully reinsured with or guaranteed by other mutuals (including *friendly societies*);

and whose *insurance business* is limited to that described in paragraphs (1) to (6);

non-life Directives means the *first non-life Directive*, the *second non-life Directive*, and the *third non-life Directive*;

non-linked contract see *linked long term contract*;

non-profit policy see *with-profits policy*;

officer means –

- (a) in relation to a *registered friendly society* or a *registered branch* –
 - (i) a trustee;
 - (ii) the treasurer, secretary and chief executive (however described);
 - (iii) a member of the *committee*; and
 - (iv) a person appointed by the *friendly society* or branch to sue or be sued on its behalf; or
- (b) in relation to an *incorporated friendly society*, a member of the *committee*, the chief executive (however described) and the secretary;

option means an *option* which falls within article 83 of the Financial Services and Markets Act (Regulated Activities) Order 2001 or a *warrant*;

ordinary long term insurance business means long-term *insurance business* which is not *industrial assurance business*;

participating undertaking means an undertaking which holds a *participation* in another undertaking;

participation means:

- (a) the holding of a participating interest within the meaning of section 411(2) of the *Act*; or
- (b) the holding, directly or indirectly, of 20% or more of the voting rights or capital;

pension fund management contract means a contract to manage the investments of pension funds (other than funds solely for the benefit of the officers or employees of the person effecting or carrying out the contract and their dependants or, in the case of a *company*, partly for the benefit of officers or employees and their dependants of its *subsidiary* or holding company or a *subsidiary* of its holding company);

<p><i>period</i> means –</p> <p>(a) for the purposes of completion of the FSC2 or FSC3 return, the date since the last return or three years if there was no previous actuarial investigation; and</p> <p>(b) for the purpose of completion of the FSC1 return the <i>financial year</i> to which the return relates;</p>
<p><i>permanent health contract</i> means a contract falling within <i>class IV</i>;</p>
<p><i>permitted asset exposure limit</i> for assets of any of the descriptions in Part II of Annex B of Appendix 4 is the percentage of the <i>business amount</i> set out opposite the relevant paragraph; in the case of an asset which is not covered by any of the descriptions in Part II of Annex B of Appendix 4 (other than a <i>derivative contract</i>), the permitted asset exposure limit is nil;</p>
<p><i>permitted connected property</i> has the meaning given in rule 4.23(b);</p>
<p><i>permitted counterparty exposure limit</i> means –</p> <p>(a) where the <i>counterparty</i> is an individual or an unincorporated body of persons, 5% of the <i>business amount</i>;</p> <p>(b) where the <i>counterparty</i> is a <i>counterparty</i> of the type mentioned in (e) in the definition of <i>counterparty</i>, 5% of the <i>business amount</i>;</p> <p>(c) where the <i>counterparty</i> is a body corporate or <i>group</i>, each of</p> <p>(i) 20% of the <i>business amount</i> or £2 million, whichever is the larger,</p> <p>(ii) 10% of the <i>business amount</i> where the <i>exposure</i> arises otherwise than by reason that <i>debts</i> are due, or are to become due, as a result of <i>short term deposits</i> made with an <i>approved credit institution</i>, and</p> <p>(iii) 5% of the <i>business amount</i> where the <i>exposure</i> is other than to bodies which are <i>approved counterparties</i>;</p>

<p><i>permitted derivative contract</i> means a <i>derivative contract</i> which –</p> <p>(a) is covered and –</p> <p>(i) is held in connection with property of the type described in rule 4.22 for the purpose of reduction of investment risk or efficient portfolio management, or</p> <p>(ii) has the effect of a <i>permitted derivative contract</i> held in connection with such property for such purpose; and</p> <p>(b) satisfies the conditions in 13(6) to 13(8) of Appendix 4 except that the references in 13 of Appendix 4 to "an asset for the valuation of which provision is made in this chapter" is construed as reference to <i>permitted connected property</i>;</p>
<p><i>policyholder</i> has the meaning given in <i>IPRU(INS)</i>;</p>
<p><i>premium</i> includes a contribution in respect of an insurance benefit and the consideration for the granting of an annuity;</p>
<p><i>proper valuation</i> means, in relation to land, a valuation made by a qualified valuer not more than three years before the <i>relevant date</i> which determined the amount which would be realised at the time of the valuation on an open market sale of the land free from any mortgage or charge;</p>
<p><i>property linked benefits</i> means benefits other than <i>index linked benefits</i> –</p> <p>(a) provided for under a <i>linked long-term contract</i>; and</p> <p>(b) determined by reference to the value of, or income from, property of any description (whether specified in the contract or not);</p>
<p><i>property linked contract</i> means a <i>linked contract</i> conferring <i>property linked benefits</i>;</p>
<p><i>property linked liabilities</i> means <i>insurance liabilities</i> in respect of <i>property linked benefits</i>;</p>
<p><i>provision of insurance</i> by a <i>directive friendly society</i> in the United Kingdom or any other <i>EEA State</i> means –</p> <p>(a) the covering (otherwise than by way of reinsurance) of a risk situated there through an establishment in another <i>EEA State</i> ('the provision of general insurance'); and</p> <p>(b) the covering (otherwise than by way of reinsurance) of a <i>commitment</i> situated there through an establishment in another <i>EEA State</i> ('the provision of long-term insurance');</p>

<p><i>public file</i>, in relation to a <i>friendly society</i>, means the file relating to the <i>friendly society</i> which the <i>FSA</i> is required to maintain under section 104 of the <i>1992 Act</i>;</p>
<p><i>pure reinsurer</i> has the meaning given in <i>IPRU(INS)</i>;</p>
<p><i>qualified valuer</i>, in relation to any particular type of land in any particular area, means a person who is a fellow or professional associate of the Royal Institution of Chartered Surveyors or a fellow or associate of the Incorporated Society of Valuers and Auctioneers or a fellow or associate of the Rating and Valuation Association and either –</p> <p>(a) has knowledge of and experience in the valuation of that particular type of land in that particular area; or</p> <p>(b) has knowledge of and experience in the valuation of land and has taken advice from a valuer who he is satisfied has knowledge of and experience in the valuation of that particular type of land in that particular area;</p>
<p><i>readily realisable</i> in relation to a <i>listed</i> investment means a <i>listed</i> investment in respect of which 9(4) of Appendix 4 does not apply or, by virtue of 9(5) of Appendix 4, is to be taken not to apply;</p>
<p><i>receivable</i> in relation to a <i>friendly society</i>, a <i>period</i>, a <i>financial year</i> and a <i>premium</i> means, unless otherwise specified, such amounts as become due to the <i>friendly society</i>, whether or not received by the <i>friendly society</i> during that <i>period</i> or <i>financial year</i>, including (where appropriate) income which has accrued, except that in Appendix 2, "<i>receivable</i>" only includes amounts <i>receivable</i> in respect of <i>contracts of insurance incepted</i> in that <i>period</i> or <i>financial year</i>;</p>
<p><i>recoverable</i>, in relation to a <i>friendly society</i> and a <i>financial year</i>, means recorded in the <i>friendly society's</i> books as due in that year, whether or not the <i>friendly society</i> has received any payment;</p>
<p><i>reference period</i>, in relation to a <i>friendly society</i>, means the three last preceding <i>financial years</i>;</p>
<p><i>registered address</i>, in relation to a member of an <i>incorporated friendly society</i>, has the meaning given in paragraph 14(6) of Schedule 3 to the <i>1992 Act</i>;</p>
<p><i>registered branch</i> means a branch of a <i>registered friendly society</i> which is separately registered within the meaning of the <i>1974 Act</i>;</p>
<p><i>registered friendly society</i> means a <i>friendly society</i> registered within the meaning of the <i>1974 Act</i> by virtue of section 7(1)(a) of that Act or any <i>enactment</i> which it replaced, and includes any <i>registered branches</i> of the <i>friendly society</i>;</p>

regulated institution means any of the following –

- (a) an *EEA insurer* or *UK insurer*;
- (b) an *approved credit institution*;
- (c) a *friendly society* which is authorised to carry on *insurance business*; and
- (d) an *approved investment firm*;

regulated market means a market which is characterised by –

- (a) regular operation;
- (b) the fact that regulations issued or approved by the appropriate authority of the state where the market is situated –
 - (i) define the conditions for the operation of and access to the market,
 - (ii) define the conditions to be satisfied by a financial instrument in order for it to be effectively dealt in on the market, and
 - (iii) require compliance with reporting and transparency requirements comparable to those laid down in articles 20 and 21 of the Council Directive 93/22/EEC of 10 May 1993 on investment Services in the securities field; and
- (c) in the case of a market situated outside the *EEA States*, the fact that the financial instruments dealt in are of a quality comparable to those in a *regulated market* in the United Kingdom;

reinsurance business means the effecting and carrying out of contracts of reinsurance;

related undertaking means an undertaking in which a *participation* is held by another undertaking or which is a *subsidiary undertaking*;

relevant capital sum means –

- (a) for whole life assurances, the sum assured;
- (b) for policies where a sum is payable on maturity (including policies where a sum is also payable on earlier death), the sum payable on maturity;
- (c) for deferred annuities, the capitalised value of the annuity at the vesting date (or the cash option if it is greater);
- (d) for capital redemption contracts, the sums payable at the end of the contract period; and
- (e) for *linked long-term contracts*, notwithstanding (a) to (d), the lesser of:
 - (i) the amount for the time being payable on death, and
 - (ii) the aggregate of the value for the time being of the units allocated to the contract (or, where entitlement is not denoted by means of units, the value for the time being of any other measure of entitlement under the contract equivalent to units) and the total amount of the *premiums* remaining to be paid during such part of the term of the contract as is appropriate for *zillmerising*, or, if such *premiums* are payable beyond the age of seventy five, until that age, excluding in all cases any vested reversionary bonus and any capital sums for temporary assurances;

relevant date means, in relation to the valuation of any asset for any purpose for which the *asset valuation rules* apply, the date when the asset falls to be valued for that purpose;

required margin of solvency has the meaning given in rule 4.1;

required minimum margin means the greater of the appropriate *required margin of solvency* and the amount of the appropriate *minimum guarantee fund*;

second non-life Directive means Council Directive 88/357/EEC of 22 June 1988 on the co-ordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 73/239/EEC;

second life Directive means Council Directive 90/619/EEC of 8 November 1990 on the co-ordination of laws, regulations and administrative provisions relating to direct life assurance, laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 79/267/EEC;

<i>securities</i> includes <i>shares</i> , <i>debt securities</i> , Treasury Bills, Tax Reserve Certificates and Certificates of Tax Deposit;
<i>settlement date</i> means any date on which the fulfilment of an obligation under a <i>derivative contract</i> is or may be required;
<i>share</i> has the meaning given in Part VII of the Companies Act or Part VIII of the Companies (Northern Ireland) Order 1986;
<i>short term deposit</i> means a sum of money which may be withdrawn at the discretion of the lender without penalty or loss of accrued interest by giving notice of withdrawal of one month or less;
<i>son</i> includes stepson;
<i>subsidiary</i> is construed in accordance with section 13 of the <i>1992 Act</i> ;
<i>subsidiary undertaking</i> is construed in accordance with section 258 of the Companies Act and Article 266 of the Companies (Northern Ireland) Order 1986;
<i>SUP</i> means the Supervision Manual;
<i>surplus assets</i> has the meaning given in rule 3(3);
<i>taxes included in premiums</i> has the same meaning as the words "taxes pertaining to the <i>premiums</i> " in the third indent of the first sub-paragraph of article 16(3) of the <i>first non-life Directive</i> ;
<i>third non-life Directive</i> means Council Directive 92/49/EEC of 18 June 1992 on the co-ordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and amending Directives 73/239/EEC and 88/357/EEC;
<i>third life Directive</i> means Council Directive 92/96/EEC of 10 November 1992 on the co-ordination of laws, regulations and administrative provisions relating to direct life assurance and amending Directives 79/267/EEC and 90/619/EEC;
<i>UCITS Directive</i> means Council Directive 85/611/EEC of 20 December 1985 on the co-ordination of laws, regulations and administrative provisions relating to undertakings for collective investments in transferable securities;
<i>UK insurer</i> has the meaning given in <i>IPRU(INS)</i> ;
<i>valuation date</i> , in relation to an actuarial investigation, means the date to which the investigation relates;
<i>variation margin</i> means –
(a) in respect of a <i>derivative contract</i> , or a contract having the effect of a

<p><i>derivative contract</i>, assets (other than assets transferred by way of <i>initial margin</i>) which, at the <i>relevant date</i>, have been transferred by, to, or for the benefit of, the <i>friendly society</i> in pursuance of a condition in that contract or a related contract; and</p> <p>(b) in respect of an asset having the effect of a <i>derivative contract</i>, assets which, at the <i>relevant date</i>, have been transferred by, to, or for the benefit of, the <i>friendly society</i> in pursuance of a contractual right conferred, or obligation imposed, by the holding of the asset having the effect of a <i>derivative contract</i>;</p>
<p><i>warrant</i> means an instrument which falls within article 79 of the Financial Services and Markets Act (Regulated Activities) Order 2001 (SI 2001, No 544);</p>
<p><i>weighted average of the yield</i> has the meaning given in 19(5)(d) of Appendix 9;</p>
<p><i>with-profits fund</i> for the purposes of Chapter 5 and Appendices 6 to 10 means:</p> <p>(a) a <i>long-term insurance fund</i> (or that part of such a fund) in which <i>policyholders</i> are eligible to participate in any <i>established surplus</i>; and</p> <p>(b) where it is a <i>friendly society's</i> usual practice to restrict <i>policy-holders'</i> participation in any <i>established surplus</i> to that arising from only a part of the fund (or part fund) falling within (a), that part (or that part of the part fund);</p>
<p><i>with-profits policy</i> means a contract falling within a <i>class</i> of long-term insurance which is eligible to participate in any part of any <i>established surplus</i>, and non-profit policy must be construed accordingly;</p>
<p><i>working day</i> means any day other than Saturday, Sunday, Good Friday, Christmas Day and any day which is a bank holiday in any part of the United Kingdom under section 1 of the Banking and Financial Dealings Act 1971;</p>
<p><i>zillmerising</i> means the method known by that name for modifying the net <i>premium</i> reserve method of valuing a long-term policy by increasing the part of the future <i>premiums</i> for which credit is taken so as to allow for initial expenses.</p>

PART II – General Provisions

- 7.2 A word which is printed in italics is used in the defined sense.
- 7.3 Unless the context otherwise requires, a word or phrase which is defined in a related enactment bears the same meaning as in that enactment.
- 7.4 Unless the context requires, a word which is related to a defined word is construed by reference to the defined word.
- 7.5 In *IPRU(FSOC)*, the cross referencing within Forms follows the sequence “Form.Line.Column”.

Subsidiary and ancillary provisions

- 7.6 For the purposes of *IPRU(FSOC)*:
- (a) a *contract of insurance* is to be treated as falling within a *class* of *long-term insurance business* notwithstanding the fact that it contains supplementary provisions falling within *class* 1 (accident) or *class* 2 (sickness) if:
 - (i) its principal object is that of a contract falling within a *class* of *long-term insurance business*, and
 - (ii) it is effected or carried out by a *friendly society* which has permission to effect or carry out contracts falling within *class* I (life and annuity); and
 - (b) a *contract of insurance* whose principal risk falls within any of *classes* 1, 2 or 16 is to be treated as falling within that *class* and no other, notwithstanding the fact that it also covers *ancillary risks*.

PART III

CLASSES OF LONG-TERM INSURANCE BUSINESS

Number	Description	Nature of business
I	Life and annuity	Effecting or carrying out <i>contracts of insurance</i> on human life or contracts to pay <i>annuities on human life</i> , but excluding (in each case) contracts within <i>class III</i> .
II	Marriage and birth	Effecting or carrying out <i>contracts of insurance</i> to provide a sum on marriage or on the birth of a child, being contracts expressed to be in effect for a period of more than one year.
III	Linked long term	Effecting or carrying out <i>contracts of insurance</i> on human life or contracts to pay <i>annuities on human life</i> where the benefits are wholly or partly to be determined by reference to the value of, or the income from, property of any description (whether or not specified in the contracts) or by reference to fluctuations in, or in an index of, the value of property of any description (whether or not so specified).
IV	Permanent health	Effecting or carrying out <i>contracts of insurance</i> providing specified benefits against risks of persons becoming incapacitated in consequence of sustaining injury as a result of an accident or of an accident of a specified class or of sickness or infirmity, being contracts that - (a) are expressed to be in effect for a period of not less than five years, or until the normal retirement age for the persons concerned, or without limit of time; and (b) either are not expressed to be terminable by the <i>friendly society</i> , or are expressed to be so terminable only in special circumstances mentioned in the contract.
V	Tontines	Effecting or carrying out tontines.
VI	Capital redemption	Effecting or carrying out capital redemption contracts.

VII	Pension fund management	Effecting or carrying out- (a) <i>pension fund management contracts</i> ; or (b) contracts of the kind mentioned in (a) that are combined with <i>contracts of insurance</i> covering either conservation of capital or payment of a minimum interest.
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CLASSES OF GENERAL INSURANCE BUSINESS

Number	Description	Nature of business
1	Accident	<p>Effecting or carrying out <i>contracts of insurance</i> providing fixed pecuniary benefits or benefits in the nature of indemnity (or a combination of both) against risks of the person insured or, in the case of a contract made by virtue of section 140, 140A or 140B of the Local Government Act 1972, a person for whose benefit the contract is made -</p> <ul style="list-style-type: none"> (a) sustaining injury as the result of an accident or of an accident of a specified class, or (b) dying as the result of an accident or of an accident of a specified class, or (c) becoming incapacitated in consequence of disease or of disease of a specified class, <p>inclusive of contracts relating to industrial injury and occupational disease but exclusive of contracts falling within <i>class 2</i> or within <i>class IV</i>.</p>
2	Sickness	<p>Effecting or carrying out <i>contracts of insurance</i> providing fixed pecuniary benefits or benefits in the nature of indemnity (or a combination of the two) against risks of loss to the persons insured attributable to sickness or infirmity, but exclusive of contracts falling within <i>class IV</i>.</p>
16	Miscellaneous financial loss	<p>Effecting or carrying out <i>contracts of insurance</i> against any of the following risks, namely –</p> <ul style="list-style-type: none"> (a) risks of loss to the persons insured attributable to them being unemployed; (b) risks of loss to the persons insured attributable to them being in distressed circumstances; or (c) risks of loss to the persons insured attributable to sickness or infirmity, <p>but not including of contracts falling within <i>class 2</i> or <i>class IV</i>.</p>

Chapter 8

TRANSITIONAL PROVISIONS

Guidance:

GEN (the part of the *FSA Handbook* in High Level Standards which has the title General Provisions) contains some technical transitional provisions that apply throughout the Handbook and which are designed to ensure a smooth transition at commencement of the *Act*. These include transitional provisions relevant to record keeping and notification rules.

SUP contains transitional provisions which carry forward written concessions relating to pre-commencement provisions.

Appendix 1

LONG-TERM INSURANCE BUSINESS MARGIN OF SOLVENCY

Long-term classes I and II

1. (1) For *long-term insurance business* of class I or II the margin of solvency must be determined by taking the aggregate of the results arrived at by applying the calculation described in (2) ("the first calculation") and the calculation described in (3), (4) and (5) ("the second calculation").
 - (2) For the first calculation-
 - (a) a sum equal to 4% of the *mathematical reserves* for direct insurance business and reinsurance acceptances without any deduction for reinsurance cessions must be taken;
 - (b) the amount of the *mathematical reserves* at the end of the last preceding *financial year* after the deduction of reinsurance cessions must be expressed as a percentage of the amount of those *mathematical reserves* before any such deduction; and
 - (c) the sum mentioned in (a) must be multiplied-
 - (i) where the percentage arrived at under (b) is greater than 85% by that greater percentage, and
 - (ii) in any other case, by 85%.
 - (3) For the second calculation-
 - (a) subject to (4) and (5), a sum equal to 0.3% of the capital at risk for contracts on which the capital at risk is not a negative figure must be taken;
 - (b) the amount of the capital at risk at the end of the last preceding *financial year* for contracts on which the capital at risk is not a negative figure, after the deduction of reinsurance cessions, must be expressed as a percentage of the amount of that capital at risk before any such deduction; and
 - (c) the sum arrived at under (a) must be multiplied-
 - (i) where the percentage arrived at under (b) is greater than 50% by that greater percentage, and
 - (ii) in any other case, by 50%.

- (4) Where a contract provides for benefits payable only on death within a specified period and is valid for a period of not more than three years from the date when the contract was first made, the percentage to be taken for the purposes of (3)(a) must be 0.1%; and where the period of validity from that date is more than three years but not more than five years, the percentage to be so taken must be 0.15%.
- (5) For the purposes of (4), the period of validity of the contract evidencing a group policy is the period from the date when the *premium* rates under the contract were last reviewed for which the *premium* rates are guaranteed.
- (6) For the purposes of the second calculation, the capital at risk is-
- (a) in any case in which an amount is payable in consequence of death other than a case falling within (b), the amount payable on death; and
- (b) in any case in which the benefit under the contract in question consists of the making, in consequence of death, of the payment of an annuity, payment of a sum by instalments or any other kind of periodic payments, the present value of that benefit,
- less in either case the *mathematical reserves* in respect of the relevant contracts.
- (7) When the amount of the *mathematical reserves* referred to in (2)(a), or the amount of the capital at risk referred to in (3)(a), is to be calculated for the purposes of determining the margin of solvency, the day as on which that amount is calculated must be the same as that on which the margin of solvency is determined; and the *mathematical reserves* referred to in (6) must also be calculated as on that day when the capital at risk in question is that referred to in (3)(a), but must be calculated as at the end of the last preceding *financial year* when the capital at risk in question is that referred to in (3)(b).

Long-term classes III and VII

2. (1) For *long-term insurance business* of class III or VII the margin of solvency must be determined in accordance with (2) to (5).
- (2) In so far as a *friendly society* bears an investment risk, the first calculation must be applied.
- (3) In so far as-
- (a) a *friendly society* bears no investment risk;
- (b) the total expired and unexpired term of the relevant contract exceeds five years; and

- (c) the allocation to cover *management expenses* in the relevant contract has a fixed upper limit which is effective as a limit for a period exceeding five years,

the first calculation must be applied, but as if 1(2)(a) contained a reference to 1% instead of 4%.

- (4) If neither (2) nor (3) applies, then, subject to (5), the *required margin of solvency* is zero.
- (5) Where a *friendly society* covers a death risk, a sum arrived at by applying the second calculation (disregarding 1(4) and (5)) must be added to the margin of solvency, including a *required margin of solvency* of zero, arrived at under (2), (3) or (4).

Long-term classes IV and VI

- 3. For *long-term insurance business* of class IV or VI the margin of solvency must be determined by applying the first calculation.

Long-term class V

- 4. For *long-term insurance business* of class V the margin of solvency must be 1% of the assets of the relevant tontine.

Appendix 2

GENERAL INSURANCE BUSINESS SOLVENCY MARGIN

Part I: the Premiums Basis

1. The *gross premiums receivable* in respect of the *friendly society's* entire *general insurance business* for the last preceding *financial year* must be aggregated.
2. From the aggregate arrived at under 1 there must be deducted-
 - (a) any taxes included in the *premiums* mentioned in 1; and
 - (b) any levies that are related to *premiums* and are recorded in the *friendly society's* books as payable in the last preceding *financial year* in respect of *general insurance business*.
3. The amount arrived at under 2 must be multiplied by twelve and divided by the number of months in the *financial year*.
4. If the amount arrived at under 3 is more than 10 million Euro, it must be divided into two portions, the former consisting of 10 million Euro and the latter comprising the excess.
5. Where there has been a division into two portions pursuant to 4, there must be calculated and added together 18% and 16% of the two portions respectively; and where there has been no such division, there must be calculated 18% of the amount arrived at under 3.
6. In the case of *general insurance business* consisting of health insurance based on actuarial principles, 5 applies with the substitution of "6%" for "18%" and "5 1/3% " for "16%", but only if all the necessary conditions are satisfied.
7. For the purposes of 6, the necessary conditions are as follows-
 - (a) the *gross premiums receivable* are calculated on the basis of sickness tables appropriate to *insurance business*;
 - (b) the reserves include provision for increasing age;
 - (c) an additional *premium* is collected in order to set up a safety margin of an appropriate amount;
 - (d) it is not possible for the *friendly society* to cancel the contract after the end of the third year of insurance; and
 - (e) the contract must provide for the possibility of increasing *premiums* or reducing payments during its currency.

8. Where 6 applies to a *friendly society* whose *general insurance business* consists partly of health insurance based on actuarial principles and partly of other business, the procedure provided in 1 to 6 must operate separately for each part of the *general insurance business*, so as to produce a sum under 6 for the health insurance and a sum under 5 for the other business.
9. (1) If the provision for *claims* outstanding at the end of the last preceding *financial year* exceeds the provision for *claims* outstanding at the beginning of that year, the amount of the excess must be added to the amount of *claims* paid in the last preceding *financial year*.
- (2) If the provision for *claims* outstanding at the beginning of the last preceding *financial year* exceeds the provision for *claims* outstanding at the end of that year, the amount of the excess must be deducted from the amount of *claims* paid in the last preceding *financial year*.
10. (1) For the purposes of 9, the “amount of *claims* paid”, in relation to a *friendly society* and a *financial year*, is the amount that is recorded in the *friendly society's* books at the end of the *financial year* as paid by it (whether or not payment has been effected in that year) in full or partial settlement of-
- (a) the *claims* described in (2); and
- (b) the expenses described in (3),
- less any *recoverable* amounts within the meaning of (4).
- (2) The *claims* mentioned in (1) are *claims* including *claims* relating to business accounted for over a longer period than a *financial year*.
- (3) The expenses mentioned in (1) are expenses (such as, for example, legal or medical costs) which are incurred by the *friendly society*, whether through the employment of its own staff or otherwise, and are directly attributable to the settlement of individual *claims*, whether or not the individual *claims* in question are those mentioned in (1).
- (4) *Recoverable* amounts for the purposes of (1) are amounts *recoverable* by the *friendly society* in respect of the *claims* mentioned in (1) or other *claims*, including amounts *recoverable* from third parties and amounts *recoverable* from other *insurance undertakings* but excluding amounts *recoverable* in respect of reinsurance ceded by the *friendly society*.
11. (1) For the purposes of 9, the “provisions for *claims* outstanding”, in relation to a *friendly society* and a *financial year*, is the amount set aside by the *friendly society* as at the beginning or end of the *financial year* as being an amount likely to be sufficient to meet-
- (a) the *claims* described in (2); and
- (b) the expenses described in (3),
- less any *recoverable* amounts within the meaning of (4).

- (2) The *claims* mentioned in (1) are *claims* in respect of incidents occurring-
- (a) in the case of an amount set aside as at the beginning of the *financial year*, before the beginning of that year; and
 - (b) in the case of an amount set aside as at the end of a *financial year*, before the end of that year,

being *claims* which have not been treated as *claims* paid and including *claims* relating to business accounted for over a longer period than a *financial year*, *claims* the amounts of which have not been determined and *claims* arising out of incidents that have not been notified to the *friendly society*.

- (3) The expenses mentioned in (1) are expenses (such as, for example, legal or medical costs) which are likely to be incurred by the *friendly society*, whether through the employment of its own staff or otherwise and are directly attributable to the settlement of individual *claims*, whether or not the individual *claims* in question are those mentioned in (1).
 - (4) ‘Recoverable amounts’ for the purposes of (1) are amounts estimated by the *friendly society* to be *recoverable* by it in respect of the *claims* mentioned in (1), including amounts *recoverable* from third parties and amounts *recoverable* from other *insurance undertakings* but excluding amounts *recoverable* in respect of reinsurance ceded by the *friendly society*.
12. From the amount determined under 9(1) or (2) there must be deducted the total sum *recoverable* in respect of that amount under reinsurance contracts ceded.
13. The amount determined under 12 must be expressed as a percentage of the amount determined under 9(1) or (2).
14. The sum arrived at under 5 or 6 or the aggregate of the sums arrived at under 5 and 6, as the case may be, must be multiplied-
- (a) where the percentage arrived at under 13 is greater than 50% but not greater than 100%, by the percentage so arrived at;
 - (b) where the percentage so arrived at is greater than 100%, by 100%; and
 - (c) in any other case, by 50%.

Part II: the Claims Basis

15. If a *friendly society* has not been in existence long enough to acquire a *reference period*, this Part II does not apply to the *friendly society*, and Part I must be applied.
16.
 - (1) If the provision for *claims* outstanding at the end of the *reference period* exceeds the provision for *claims* outstanding at the beginning of the *reference period*, the amount of the excess must be added to the *amount of claims* paid in the *reference period*.
 - (2) If the provision for *claims* outstanding at the beginning of the *reference period* exceeds the provision for *claims* outstanding at the end of the *reference period*, the amount of the excess must be deducted from the amount of *claims* paid in the *reference period*.
 - (3) For the purposes of this paragraph, the expressions "amount of *claims* paid" and provision for *claims* outstanding have, in relation to a *reference period*, the same meaning as they have in 9 in relation to a *financial year*.
17. The aggregate obtained under 16(1) or (2) must be divided by the number of months in the *reference period* and multiplied by twelve.
18. If the amount arrived at under 17 is more than 7 million Euro, it must be divided into two portions, the former consisting of 7 million Euro and the latter comprising the excess.
19. Where there has been a division into two portions pursuant to 18, there must be calculated and added together 26% and 23% of the two portions respectively; and where there has been no such division, there must be calculated 26% of the amount arrived at under 17.
20. In the case of *general insurance business* consisting of health insurance based on actuarial principles, 19 applies with the substitution of "8 2/3 %" for "26%" and "7 2/3 %" for "23%", but only if all the necessary conditions are satisfied.
21. The necessary conditions for the purposes of 20 are the same as those set out in 7.
22. In a case of the kind mentioned in 8, that paragraph applies (with the necessary modifications) so as to produce separate sums under 19 and 20.
23. The sum arrived at under 19 or 20 or the aggregate of the sums arrived at under 19 and 20, as the case may be, must be multiplied by the same percentage as is applicable for the purposes of 14.

Appendix 3

PERMITTED LINKS

Part I - Descriptions of property by reference to which benefits may be determined

1. Listed securities which are *readily realisable*, not being securities which are:
 - (a) *approved securities*;
 - (b) loans or deposits of the kinds mentioned in 4 or 7;
 - (c) units or other beneficial interests in a *collective investment fund*; or
 - (d) *derivative contracts*.

2. Unlisted securities which are *readily realisable*, not being securities which are:
 - (a) *approved securities*;
 - (b) loans or deposits of the kinds mentioned in 4 or 7;
 - (c) units or other beneficial interests in a *collective investment fund*; or
 - (d) *derivative contracts*.

3. Land (including any interest in land) in an *EEA State*, Australia, Canada, the Channel Islands, Gibraltar, Hong Kong, the Isle of Man, New Zealand, the Republic of South Africa, Singapore or the United States of America.

4. Loans-
 - (a) which are fully secured by mortgage (or in Scotland, by standard security) or charge on land (or any interest in land) which-
 - (i) is situated in any of the countries specified in 3, and
 - (ii) in the case of a loan made to a person other than a body corporate, is not used wholly or mainly for domestic purposes, and
 - (b) in relation to which the rate of interest and the due dates for the payment of interest and the repayment of principal can be fully ascertained from the terms of any agreement relating to the loan.

5. Units or other beneficial interests in-
 - (a) a scheme falling within the *UCITS Directive*;
 - (b) a *collective investment fund* which satisfies the following conditions-
 - (i) the property of the fund comprises property of any of the descriptions in 1 to 10;

- (ii) the units are *readily realisable* at a price which represents the net value per unit of the assets and liabilities of the fund; and
 - (iii) the price at which the units may be bought and sold is published regularly.
6. *Approved securities.*
 7. Loans to or deposits with an *approved credit institution*, an *approved financial institution* or an *approved investment firm*.
 8. Income due, or to become due, in respect of property of any of the descriptions specified in the foregoing of this Appendix.
 9. *Permitted derivative contracts.*
 10. Cash.
 11. Units, by whatever name called, in a real or notional fund (not being a scheme or undertaking of a kind mentioned in 5) which is limited to the descriptions of property mentioned above, not being property falling within (a) to (d) of 12, and which under the contract is to be managed either-
 - (a) wholly by the *friendly society*; or
 - (b) wholly or to any extent by another person being a person for whose acts and omissions in managing the fund the *friendly society* assumes responsibility towards the policyholder as if they were the acts or omissions of the *friendly society*, and otherwise (if at all) by the *friendly society*.

Part II - Restrictions on determination of benefits by reference to property described in Part I

12. Benefits payable under any contract to which rule 4.21 applies must not be determined by reference to-
 - (a) property of any of the descriptions specified in 2, 5(b) or 7 if the value of such property is determined, either wholly or partly, by reference to the value of, the income from, fluctuations in the value of or fluctuations in the income from, property other than property of the descriptions in Part I;
 - (b) property of the description specified in 2 in excess of 10% of the aggregate *property linked benefits* under the contract;
 - (c) property of the description specified in 5(b) which in aggregate value exceeds 10% of the *property linked benefits*, unless the contract under which the benefits are payable has been marketed in accordance with

any legal restrictions which apply to the marketing of the corresponding *collective investment fund*; or

- (d) property of any of the descriptions specified in Part I which has the effect of a *derivative contract* other than a *permitted derivative contract*.

Appendix 4

ASSET VALUATION RULES

Interpretation

1. (1) [deleted]
- (2) For the purposes of this Appendix and Appendix 6, a *debt* owed to (or an obligation to be fulfilled for the benefit of) a *friendly society* must be regarded as being secured only to the extent that it is-
 - (a) secured by-
 - (i) a letter of credit established with an *approved credit institution*;
or
 - (ii) a guarantee provided by an *approved credit institution*,

and the sum of the aggregate amount available under all letters of credit established for the benefit of the *friendly society* with the same *counterparty*, the aggregate amount of all guarantees issued for the benefit of the *friendly society* by that *counterparty* and the amount of any *exposure* of the *friendly society* to that *counterparty* does not exceed the *permitted counterparty exposure limit* for that *counterparty*;
or
 - (b) secured by assets for the valuation of which provision is made in this Appendix and-
 - (i) the value of such assets (after deducting reasonable expenses of sale and the amount of any other *debt* or obligation secured thereon having priority to or ranking equally with the *debt* or obligation) is sufficient to enable the *debt* or obligation to be discharged in full;
 - (ii) the value of the assets when aggregated with the *friendly society's exposure* to assets of the same description does not exceed the *permitted asset exposure limit* for assets of that description (as set out in Part II of Annex B); and
 - (iii) where the assets give rise to *exposure* to a *counterparty*, the *exposure* of the *friendly society* to that *counterparty*, when added to the sum of the aggregate amount available under all letters of credit established for the benefit of the *friendly society* with that *counterparty*, and the aggregate amount of all guarantees issued for the benefit of the *friendly society* by that *counterparty*, does not exceed the *permitted counterparty exposure limit* for that *counterparty*.

- (3) For the purposes of (2) -
- (a) the aggregate amount available under letters of credit established with a *counterparty* must be taken not to exceed the sum of the aggregate amount of all *debts* and the aggregate value of all obligations in respect of which those letters of credit were established;
 - (b) the aggregate amount of guarantees issued by a *counterparty* must be taken not to exceed the sum of the aggregate amount of all *debts* and the aggregate value of all obligations so guaranteed; and
 - (c) assets which are securing any other *debt* owed to (or obligation to be fulfilled for the benefit of) the *friendly society* must be treated as if they were assets of the *friendly society*.

Application

2. (1) This Appendix (the ‘asset valuation rules’) applies with respect to the determination of the value of assets of a *friendly society* for the purposes of chapters 4 and 5.
- (2) Where a *friendly society* has entered into any contracts for the payment of *property linked benefits*, 3 to 15 do not apply with respect to the determination of the value of the *linked assets* to the extent that they are held in compliance with the requirements of rule 4.12(2) and (3) to match liabilities in respect of such benefits under such contracts and the value of such assets must be determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for *insurance business*.
- (3) Any asset to which 2 to 15 apply (other than cash) for the valuation of which no provision is made in those paragraphs must be left out of account for the purposes specified in (1).
- (4) Where in all the circumstances of the case it appears that any asset is of a lesser value than the amount calculated in accordance with the *asset valuation rules*, such lesser value must be the value of the asset.
- (5) For the purposes of (4), in determining whether it appears that an asset is of a lesser value than the amount calculated in accordance with the *asset valuation rules*, regard must be had to the underlying security and in, the case of bonds, *debt securities* and other money and capital market instruments, the credit rating of the *issuer*, including whether the *issuer* belongs to Zone A as defined in the Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions and, where the *issuer* is an international organisation, whether it includes at least one *EEA State* among its members.
- (6) Notwithstanding (1) (but subject to the conditions set out in (7)) and in relation to an actuarial investigation of its *long-term insurance business* only, a

friendly society may elect to assign to any of its assets the value given to the asset in question in the books or other records of the *friendly society*.

- (7) The conditions referred to in (6) are-
- (a) that the election must not enable the *friendly society* to bring into account any asset for the valuation of which no provision is made in this Appendix;
 - (b) that the value assigned to the aggregate of the assets must not be higher than the aggregate of the value of those assets as determined in accordance with the *asset valuation rules*.
- (8) Where a *friendly society* has entered into a contract for the conversion of currency which satisfies the conditions set out in (9), then for any of the purposes for which the *asset valuation rules* apply, the *friendly society* must treat the conversion as having been made on the *relevant date*.
- (9) The conditions referred to in (8) are that-
- (a) either-
 - (i) the contract provides for the conversion into another currency of an amount representing the sale of an asset which has, on the *relevant date*, been sold but not delivered, or
 - (ii) the contract provides for the purchase of currency for the purpose of settling the purchase of an asset which has, on the *relevant date*, been purchased but not delivered;
 - (b) the conversion is to take place during a period which is-
 - (i) where the contract is in connection with the delivery of a *listed security*, a period commencing on the date of the contract and extending for the usual period of settlement as laid down by the rules of the relevant stock exchange or *regulated market*; or
 - (ii) where the contract is in connection with the delivery of any other asset, a period commencing on the date of the contract and extending for twenty *working days* thereafter; and
 - (c) the contract is *listed* or has been entered into with an *approved counterparty*.

Shares in a related undertaking

3. (1) Where any *shares* are held by a *friendly society* in a *related undertaking*, which is an *insurance undertaking* or *insurance holding company*:

- (a) the value of the *shares* must not exceed the value, determined in accordance with rule 4.2 of *IPRU(INS)* of the *related undertaking's* surplus assets (as defined in *IPRU(INS)*);
 - (b) the *friendly society* must make provision in respect of the *related undertaking* in accordance with rule 5.3A of *IPRU(INS)*.
- (2) Where any *shares* are held by a *friendly society* in a *related undertaking* which is not an *insurance undertaking* or *insurance holding company*, the value of the *shares* must not exceed the greater of:
- (a) the value, determined in accordance with this Appendix (other than 15(1)(a) to (c)) of the *related undertaking's surplus assets*; and
 - (b) the value of those *shares* as determined under rule 9.
- (3) The *surplus assets* of a *related undertaking* (other than an *insurance undertaking* or an *insurance holding company*) are its total assets excluding:
- (a) the assets that are selected to cover liabilities;
 - (b) assets that are interests directly or indirectly held in the *related undertaking's* own capital;
 - (c) amounts due, or to become due, in respect of *share* capital, or other contributions from members of the *related undertaking*, subscribed or called for but not fully paid up; and
 - (d) assets that cannot effectively be made available or realised to meet losses (if any) arising in the *friendly society*, including assets that represent capital not owned, directly or indirectly, by the *friendly society*.
- (4) The assets selected in (3)(a) to be excluded from the total assets:
- (a) must be of a value at least equal to the amount of the liabilities of the *related undertaking*, determining that value and that amount in accordance with this Appendix (other than 15(1)(a) to (c)) and Appendix 5; and
 - (b) must not include:
 - (i) assets falling within (3)(b), or
 - (ii) assets falling within (3)(c) where the amount is due, or to become due, from a *related undertaking*.

Debts due or to become due from a related undertaking

4. The value of any *debt* due, or to become due, from a *related undertaking* must not exceed the amount reasonably expected to be recovered in respect of the *debt* taking into account only the value of:

- (a) the assets identified in 3(3)(a); and
- (b) any *security* held in respect of the *debt*.

Assets sold to or purchased from an approved credit institution or an approved investment firm subject to an agreement for resale or repurchase

5. (1) Where a *friendly society* has sold *securities* to or purchased *securities* from an *approved credit institution* or an *approved investment firm* and such sale or purchase was made subject to an agreement that the *approved credit institution* or *approved investment firm* would, either on demand by the *friendly society* or within six months of such sale or purchase, subsequently sell to or purchase from the *friendly society* equivalent *securities*, then if at the *relevant date* such subsequent sale or purchase has not taken place and the conditions specified in (2) and either (3) or (4) (as appropriate) are satisfied, the *friendly society*-

- (a) must value-
 - (i) *securities* sold by it under such agreement as if such *securities* had been retained by it, and
 - (ii) assets provided by it as consideration for the purchase of *securities* under such agreement as if such consideration had not been provided by it; and
- (b) must not ascribe a value to-
 - (i) any consideration received for the sale of *securities* under such agreement (or any assets purchased by it with such consideration) up to the limit of the value of the *securities* sold, or
 - (ii) any *securities* purchased by it under such agreement (or any assets purchased with the proceeds of the sale of any such *securities*) up to the limit of the consideration (valued in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate to *friendly societies*) provided by it.

(2) The condition specified in this paragraph is that, where at any time after the sale or purchase of *securities* by the *friendly society* under an agreement described in (1) either-

- (a) the amount of the consideration received by the *friendly society* for the sale of the *securities* fell below the value of the *securities* sold by it; or

- (b) the value of the *securities* purchased by the *friendly society* fell below the value of the consideration provided by it,

by more than 2.5% of the value of the *securities* sold or purchased (as the case may be), the *friendly society* demanded additional consideration whose amount was equal to the shortfall and such demand was complied with before the end of the *working day* next following the day on which such shortfall occurred.

- (3) The conditions specified in this paragraph are that, if the *friendly society* purchases *securities* from an *approved credit institution* or an *approved investment firm* and the consideration provided by the *friendly society* is other than by way of sale of *securities*-

- (a) the *securities* purchased are-

- (i) *approved securities*,
- (ii) *listed securities*, or
- (iii) *securities* issued by an *approved credit institution*; and

- (b) the *securities* purchased do not include-

- (i) *securities* (other than *approved securities*) issued by the same *counterparty* whose aggregate value amounts to more than 15% of the value of the *securities* purchased, or
- (ii) if the condition in (b)(i) is not satisfied, *securities* whose value when aggregated with the *friendly society's* existing *exposure* to assets of the same description or to the same *counterparty* would exceed the appropriate *permitted asset exposure limit* or *permitted counterparty exposure limit* as determined in accordance with 15 and Annex B.

- (4) The conditions specified in this paragraph are that, if the *friendly society* sells *securities* to an *approved credit institution* or an *approved investment firm*,-

- (a) the consideration provided by the *approved credit institution* or *approved investment firm* is-

- (i) cash,
- (ii) *approved securities*,
- (iii) *listed securities*,
- (iv) *securities* issued by an *approved credit institution*,
- (v) a charge over assets set out in (i) to (iv),
- (vi) a letter of credit established with an *approved credit institution*, or
- (vii) a guarantee provided by an *approved credit institution*; and

- (b) the consideration does not include-
 - (i) except to the extent that the condition in (b)(ii) is satisfied, consideration whose amount when aggregated with the *friendly society's* existing *exposure* to assets of the appropriate description or to the relevant *counterparty* would exceed the appropriate *permitted asset exposure limit* or *permitted counterparty exposure limit* as determined in accordance with 15 and Annex B, or
 - (ii) consideration of more than 15% of the aggregate amount of which takes the form of *securities* (other than *approved securities*) issued by, letters of credit established with, guarantees provided by, cash deposited with, a charge over cash deposited with or a charge over *securities* issued by, the same *counterparty*; and
 - (c) the consideration to be provided by the *friendly society* for the subsequent purchase of *equivalent securities* is-
 - (i) where the consideration for the original purchase by the *approved credit institution* or *approved investment firm* was (wholly or in part) cash, cash denominated in the same currency, and
 - (ii) where the consideration was (wholly or in part) *securities*, *securities* equivalent to the *securities* provided by way of consideration.
- (5) For the purposes of this paragraph, where the *friendly society* has received consideration in respect of a sale of the kind described in (1), in addition to any other *exposure* to assets or to a *counterparty*-
- (a) if such consideration takes the form of a letter of credit established with, or a guarantee provided by, an *approved credit institution*, it must be considered to give rise to *exposure* to that institution by the amount of the consideration;
 - (b) if such consideration takes the form of a charge over *securities*, it must be considered to give rise to *exposure* to *securities* of the same description and to the *issuer* of those *securities* by the amount of the consideration; and
 - (c) if such consideration takes the form of cash deposited with another party for the benefit of the *friendly society*, or a charge over cash deposited with another party, it must be considered to give rise to *exposure* to that party by the amount of the consideration.
- (6) For the purposes of this paragraph, the amount of any consideration must be-

- (a) where the consideration is a letter of credit established with an *approved credit institution*, the lower of the amount made available under the letter of credit and the value of the assets sold;
 - (b) where the consideration is a guarantee provided by an *approved credit institution*, the lower of the amount of the guarantee and the value of the assets sold;
 - (c) where the consideration takes the form of assets of any of the types mentioned in (4)(a)(i) to (iv), or a charge over such assets, the value of the assets as determined in accordance with the *asset valuation rules*; and
 - (d) where the consideration takes the form of a Talisman short term certificate, the value of the *securities* represented by that certificate.
- (7) Where a *friendly society* has entered into a number of agreements described in (1), for the purposes of (3) and (4) of this paragraph-
- (a) any or all agreements under which the subsequent sale or purchase has not taken place at the *relevant date* may be treated as one agreement; and
 - (b) in such case, the 15% limits referred to in (3)(b)(i) and (4)(b)(ii) must be calculated by reference to the aggregate of the value of the *securities* purchased under (3) and the amount of any consideration under (4).

Debts and other rights

6. (1) The value of any *debt* due, or to become due, to a *friendly society*, other than a *debt* to which 4, 11 or 13 applies or to which (2), (3), (4) or (6) of this rule applies, must be-
- (a) in the case of a *debt* which is due, or will become due, within twelve months of the *relevant date* (including any *debt* which would become due within that period if the *friendly society* were to exercise any right to which it is entitled to require payment of the same), the amount which can reasonably be expected to be recovered in respect of that *debt*; and
 - (b) in the case of any other *debt*, the amount which would reasonably be paid by way of consideration for an immediate assignment of the *debt*,
- in either case due account being taken of the terms and conditions for payment of the *debt* and, where the *debt* is secured, the nature and quality of the security.
- (2) Any *debt* due, or to become due, to a *friendly society* under a letter of credit must be left out of account for the purposes for which the *asset valuation rules* apply.

- (3) In the case of *long-term insurance business* carried on by a *friendly society*, the value of any *debt* due, or to become due, to the *friendly society* which is secured on a policy of insurance issued by the *friendly society* and which (together with any other *debt* secured on that policy) does not exceed the amount payable on a surrender of that policy at the *relevant date* must be the amount of that *debt*.
- (4) Subject to (5), the value of any rights of the *friendly society* under a contract of reinsurance to which it is a party must be the amount which can reasonably be expected to be recovered in respect of those rights.
- (5) (4) does not apply to-
- (a) rights under a contract of reinsurance in respect of *long-term insurance business* except to the extent that *debts* are due under such contracts; or
 - (b) *debts* to which 4 applies which are due or are to become due.
- (6) Any *debt* due, or to become due, to a *friendly society*-
- (a) from an *intermediary* in respect of money advanced on account of commission to which that *intermediary* is not absolutely entitled at the *relevant date*; or
 - (b) which is a *debt* owed in respect of *premiums* (due account being taken of rebates, refunds and commissions payable) which is recorded in the *friendly society's* accounting records as due and payable and has been outstanding for more than three months,
- must be left out of account for the purposes of the *asset valuation rules* .
- (7) The value of any right to recover assets transferred by way of *initial margin* in respect of a *derivative contract* or a contract or asset having the effect of a *derivative contract* must be determined-
- (a) where the *initial margin* was a payment in cash, as if there were a *debt* owed to the *friendly society* for that amount; and
 - (b) where the *initial margin* took the form of a transfer of *securities*, as if there were a *debt* owed to the *friendly society* of an amount equal to the value of such *securities* as determined in accordance with the *asset valuation rules*.
- (8) The value of any rights arising under a *derivative contract* to which 13 does not apply, or under a contract or asset having the effect of such a contract, must be the value of any right to recover assets transferred by way of *initial margin* together with the value of any other unconditional right to receive a specified amount.

- (9) This rule must not apply to any rights (other than *debts* due) in respect of-
- (a) investments in *related undertakings*;
 - (b) *securities* or beneficial interests in a limited partnership;
 - (c) units or other beneficial interests in a *collective investment scheme*;
 - (d) a *derivative contract*, except as provided under (7) or (8); or
 - (e) a contract or asset which has the effect of a *derivative contract* except as provided under (7) or (8) or under 14(4) or (5).

Land

7. (1) The value of any land of a *friendly society* (other than land held by the *friendly society* as security for a *debt* or to which (2) or 12 applies) must be not greater than the amount which (after deduction of the reasonable expenses of sale) would be realised if the land were sold at a price equal to the most recent *proper valuation* of that land which has been provided to the *friendly society* and any such land of which there is no *proper valuation* must be left out of account for the purposes for which the *asset valuation rules* apply.
- (2) The value of any interest in land which is determinable upon the death of any person or upon the happening of some other future event or at some future time must be the amount which would reasonably be paid by way of consideration for an immediate transfer thereof.

Equipment

8. (1) The value of any computer equipment of a *friendly society*-
- (a) in the *financial year* of the *friendly society* in which it is purchased, must not be greater than three-quarters of the cost thereof to the *friendly society*;
 - (b) in the first *financial year* thereafter, must not be greater than one-half of that cost;
 - (c) in the second *financial year* thereafter, must be not greater than one-quarter of that cost; and
 - (d) in any subsequent *financial year*, must be left out of account for the purposes for which the *asset valuation rules* apply.
- (2) The value of any office machinery (other than computer equipment), furniture, motor vehicles and other equipment of a *friendly society*, must be, in the *financial year* of the *friendly society* in which it is purchased, not greater than one-half of the cost thereof and must be, in any subsequent *financial year*, left out of account for the purposes for which the *asset valuation rules* apply.

Securities and beneficial interests in limited partnerships

9. (1) Subject to (2), this paragraph applies to the valuation of investments comprising *securities* and beneficial interests in limited partnerships and, for the purposes of (6), investments includes loans.
- (2) This paragraph does not apply to the valuation of *securities* which are-
- (a) *derivative contracts*;
 - (b) [deleted]
 - (c) units or other beneficial interests in *collective investment schemes*, except as provided in 10(2); or
 - (d) contracts or assets having the effect of *derivative contracts*, except as provided in 14(4).
- (3) Subject to (6), the value of an investment to which this rule applies must be-
- (a) where the investment is transferable and (4) does not apply, the *market value*;
 - (b) where the investment is transferable and (4) applies, the lower of-
 - (i) the *market value*, and
 - (ii) the amount which would reasonably be expected to be received by way of consideration for an assignment or transfer of the investment at a date not later than twelve months after the *relevant date*, it being assumed that negotiations for the assignment or transfer commenced on the *relevant date* and the assignment or transfer was made other than to the *issuer* or to an *associate* or an *associate company* of the *issuer* or of the *friendly society*; or
 - (c) where the investment is not transferable-
 - (i) the amount payable on redemption on the *relevant date* or the most recent date before the *relevant date* on which the *issuer* of the investment could have been required to redeem the investment, or
 - (ii) where the investment cannot be redeemed, the amount which would reasonably be paid by way of compensation for the surrender of the interest in the investment.
- (4) Subject to (5), this paragraph applies where it is not reasonable to assume that, had negotiations for the assignment or transfer of the investment commenced not more than seven *working days* before the *relevant date*, the investment

could have been assigned or transferred on the *relevant date* for an amount not less than 97.5% of the *market value* other than to the *issuer* or to an *associate* or an *associate company* of the *issuer* or of the *friendly society*.

- (5) (4) must be taken not to apply if it applies by reason only that-
- (a) the listing of the investment has been temporarily suspended following receipt of price sensitive information by the stock exchange on which the investment is *listed* or the *regulated market* on which facilities for dealing have been granted; or
 - (b) the extent of the holding would prevent an orderly disposal of the investment for an amount equal to or greater than 97.5% of the *market value*.
- (6) Where a *friendly society* has made more than one *unlisted* investment (other than a number of investments exclusively comprising loans) and the value of such investments when taken together is greater than the aggregate of the values of each investment valued separately, then such higher value may be ascribed to the investments if it is reasonable to assume that none of the investments would be assigned or transferred separately.

Beneficial interests in collective investments schemes

10. (1) Subject to (3), this rule applies to holdings of units, or other beneficial interests in-
- (a) a scheme falling within the *UCITS Directive*;
 - (b) an authorised unit trust scheme or a recognised scheme within the meaning of the *Act* (not falling within (a)); or
 - (c) any other *collective investment scheme* where-
 - (i) the scheme does not employ *derivative contracts* unless they are contracts to which 13 applies,
 - (ii) the scheme does not employ contracts or assets having the effect of *derivative contracts* unless they have the effect of *derivative contracts* to which 13 applies, and
 - (iii) the property of the scheme does not include assets other than those for the valuation of which provision is made in the *asset valuation rules*.
- (2) The value of units or other beneficial interests in a *collective investment scheme* to which this rule applies must be-
- (a) where the *issuer* can be required to purchase the units or other beneficial interests from the holder upon the holder giving notice of one

month or less, the price at which the *issuer* would have purchased the units or other beneficial interests on the *relevant date* or the most recent date before the *relevant date* on which it could have been required to make such a purchase; or

- (b) where the *issuer* cannot be required to purchase the units or other beneficial interests as set out in (a), a value determined in accordance with 9.
- (3) Other than as provided in 14(4), this rule must not apply to units or other beneficial interests in a *collective investment scheme* which has the effect of a *derivative contract*.

Deferred acquisition costs

- 11. In the case of *general insurance business*, the value of *deferred acquisition costs* must be the value as determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate to *friendly societies*.

Reversionary interests etc.

- 12. The value of any *long-term insurance business asset* of a *friendly society* consisting of an interest in property which is a remainder, reversionary interest, right of fee subject to a life rent or other future interest, whether vested or contingent must be the amount which would reasonably be paid by way of consideration for an immediate transfer or assignment of it.

Derivative contracts

- 13. (1) The value of rights (other than rights to recover assets transferred by way of *initial margin*) under a *derivative contract* to which this rule applies must be-
 - (a) in the case of a *listed derivative contract*, the *market value*; and
 - (b) in the case of an *unlisted derivative contract*, the amount which would reasonably be paid by way of consideration for closing out that contract,in either case taking into account the *market value* of any assets which, at the *relevant date*, have been transferred by way of *variation margin*.
- (2) This rule applies to an *approved derivative contract* which is covered and-
 - (a) which is held in connection with a contract or asset of the type described in (3) for the purposes of reduction of investment risks or efficient portfolio management; or
 - (b) which has effect as if so held for such purposes.
- (3) The contract or asset described in this paragraph must be either-

- (a) an *approved derivative contract* or a contract or asset having the effect of an *approved derivative contract* which, when taken together with the *approved derivative contract* the rights under which are being valued in accordance with this rule, would have the effect that the *friendly society* either holds an asset for the valuation of which provision is made in this chapter or holds an *approved derivative contract* in connection with such an asset; or
 - (b) an asset for the valuation of which provision is made in this chapter, being neither a *derivative contract* nor a contract or asset having the effect of a *derivative contract*.
- (4) For the purposes of this rule an *approved derivative contract* is covered if it does not require a significant provision to be made in respect of it pursuant to 3 of Appendix 5.
- (5) For the purposes of determining in accordance with (4) whether a required provision is significant, regard must be had to the obligations of the *friendly society* under the contract and the volatility of the assets identified by the *friendly society* as being suitable to cover such obligations, and the required provision in respect of any one *derivative contract* must be deemed to be significant if-
- (a) the aggregate provision required in respect of all contracts having a similar effect is significant; or
 - (b) the aggregate provision required in respect of all contracts with which it is connected is significant.
- (6) In this rule, an 'approved derivative contract' is a *derivative contract* entered into by a *directive friendly society* which-
- (a) either is *listed* or has been entered into with an *approved counterparty*;
 - (b) the *friendly society* reasonably believes may be readily closed out; and
 - (c) is either a *contract for differences* to which (7) applies or a *futures contract* or an *option* to either of which (8) applies.
- (7) This paragraph applies to-
- (a) a *contract for differences* under which the amount payable by either party is calculated solely by reference to fluctuations in any of the following-
 - (i) the value of an asset for the valuation of which provision is made in this chapter,
 - (ii) the amount of income from such an asset over a defined period,

- (iii) an index of such assets, being an index in respect of which a *derivative contract* is listed, or
- (iv) a national index of retail prices published by or under the authority of a government of a State belonging to Zone A as defined in Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions,

or an arithmetic average thereof; and

- (b) a contract under which the amount payable by either party is calculated by reference to the difference between the *market value* and the amortised value of any asset for the valuation of which provision is made in this Appendix.
- (8) This paragraph applies to a *futures contract* or an *option* which in either case provides for the acquisition or disposal of assets for the valuation of all of which provision is made in this Appendix at a price which is determined by one or more of the following methods-
- (a) for each date on which the contract may be completed or the *option* exercised, the price is a fixed amount under the terms of the contract or *option*;
 - (b) it is determined by reference to the *market value* or the amortised value of an asset for the valuation of which provision is made in this chapter or the amount of income over a defined period from such an asset;
 - (c) it is determined by reference to an index of the kind mentioned in (7)(a)(iii) or (iv).

Contracts and assets having the effect of derivatives

14. (1) Subject to (3), for the purposes of this Appendix, a contract has the effect of a *derivative contract* if it is a contract (other than a *derivative contract*) which provides whether upon the exercise of a right by the *friendly society* or otherwise-
- (a) for payment (at any time) of amounts which are determined by fluctuations in-
 - (i) the value of property of any description,
 - (ii) an index of the value of property of any description,
 - (iii) income from property of any description, or
 - (iv) an index of income from property of any description;

- (b) for delivery of an asset (other than an asset for the valuation of which provision is made in 8) to or by the *friendly society*; or
 - (c) for the conversion of an asset held by the *friendly society* or another party to-
 - (i) an asset of a different type, or
 - (ii) a different asset of the same type.
- (2) Subject to (3), for the purposes of this Appendix an asset has the effect of a *derivative contract* if the asset is an asset (other than an *approved security* or an asset falling within 10(1)(a)) and the holding of the *asset* confers contractual rights or imposes contractual obligations to make or accept payment, delivery or conversion as set out in (1)(a) to (c).
- (3) A contract or asset does not have the effect of a *derivative contract* by reason only that-
- (a) it provides for the unconditional delivery of assets, or for the payment for unconditional delivery of assets, such delivery or payment to be made within a period not exceeding the period commencing at the date of the contract and extending-
 - (i) in the case of a *listed security*, for the usual period for delivery or payment as determined by the rules of the stock exchange or *regulated market* on which the *securities* are *listed* or facilities for dealing have been granted, or
 - (ii) in any other case, for twenty *working days*;
 - (b) it is a contract of the type described in 2(8) in respect of which the conditions set out in 2(9) have been satisfied; or
 - (c) it is a transaction to which 5(1) applies.
- (4) Rights in respect of a contract or asset whose effect is that of a *derivative contract* to which 13 applies must-
- (a) where the asset is a security, be valued in accordance with 9;
 - (b) where the asset comprises units or other beneficial interests in a *collective investment scheme*, be valued in accordance with 10; and
 - (c) where the asset is a *debt* or other right, be valued in accordance with 6.
- (5) Rights in respect of a contract or *asset* whose effect is that of a *derivative contract* to which 13 does not apply must have a value determined in accordance with 6(8).

- (6) For the purposes of determining whether a contract or asset has the effect of a *derivative contract* to which 13 applies, it must be deemed to have the effect of a *derivative contract* which is *listed* or transacted with an *approved counterparty* if it is itself *listed* or so transacted.

Assets to be taken into account only to a specified extent

15. (1) Subject to (2) to (6), the aggregate value of the assets of a *directive friendly society* as determined in accordance with the *asset valuation rules* must, for any of the purposes for which the *asset valuation rules* apply, be reduced by an amount representing the aggregate of-
- (a) the amount by which the *friendly society* is exposed to assets of any description in excess of the *permitted asset exposure limit* for assets of that description;
 - (b) the amount by which the *friendly society* is exposed to a *counterparty* in excess of the *permitted counterparty exposure limit* for such *counterparty*;
 - (c) the amount by which the *friendly society* has an *excess concentration with a number of counterparties*;
 - (d) the value of any assets transferred to or for the benefit of the *friendly society* in pursuance of a condition in a *derivative contract* to which 13 does not apply or a related contract; and
 - (e) the value of any assets transferred to or for the benefit of the *friendly society* in pursuance of a contract whose effect is that of a *derivative contract* to which 13 does not apply or a related contract,

as determined in accordance with Annex B.

- (2) Where a *friendly society* is exposed to assets of any description in excess of the *permitted asset exposure limit* for such assets, the reduction required to be made by (1)(a) must be made-
- (a) by deducting (as far as possible) the amount of the excess from the assets of that description held by the *friendly society*; and
 - (b) where the *friendly society* does not hold sufficient assets of that description to eliminate the excess (or does not hold any assets of that description) by making an appropriate deduction from the aggregate value of the assets which the *friendly society* would otherwise be permitted to take into account for any of the purposes for which the *asset valuation rules* apply.
- (3) Where a *friendly society* is required to make a reduction in accordance with (1)(b), (c), (d) or (e), the reduction must be made by making a deduction from the aggregate value of the assets which the *friendly society* would otherwise be

permitted to take into account for any of the purposes for which the *asset valuation rules* apply.

- (4) Where a *friendly society* carrying on *long-term insurance business* has attributed assets partly to a *long-term insurance business* fund and partly to its other assets, any reduction required to be made by this rule must be made in the same proportion as the attribution.
- (5) Assets of a *friendly society* comprising-
 - (a) *approved securities* or any interest accrued thereon;
 - (b) *debts* to which 6(3) applies;
 - (c) rights to which 6(4) applies;
 - (d) *debts* in respect of *premiums*;
 - (e) moneys due from, or guaranteed by, the government of any State which belongs to Zone A as defined in Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions;
 - (f) *shares* in or *debts due or to become due* from a *dependant* falling within 3;
 - (g) holdings in a scheme falling within the *UCITS Directive*; or
 - (h) *deferred acquisition costs*,

must not be taken into account in any of the calculations described in (1).

- (6) Where a *friendly society* has entered into any contracts providing for the payment of *index linked benefits*, the provisions of (1)(a) must not apply to assets of that *friendly society* to the extent that they are held to match liabilities in respect of such benefits.

Annex A to Appendix 4

VALUATION OF *DEPENDANTS*

[Deleted]

Annex B of Appendix 4

ASSETS TO BE TAKEN INTO ACCOUNT ONLY TO A SPECIFIED EXTENT

PART I: the method of calculation of excess exposure

B1. [deleted]

B2. [deleted]

B3. [deleted]

Calculation of exposure to assets

B4. A value must be ascribed to assets of each description which must be an amount determined in accordance with the *asset valuation rules* or, where the assets are of a description for the valuation of which no provision is made in those rules, an amount which would reasonably be paid by way of consideration for an immediate assignment or transfer of such assets. The amount by which the *friendly society* is exposed to assets of each description must be determined by adjusting the value of the assets in accordance with B5 to B11A.

Adjustments in respect of futures contracts

B5. The value ascribed under B4 in respect of assets of each description must be increased or decreased by the value of assets of that description which the *friendly society* is deemed to have acquired or disposed of pursuant to a *futures contract*.

B6. For the purposes of B5, the *friendly society* must be deemed to have acquired or disposed of assets pursuant to a *futures contract* if, at the *relevant date*, it has entered into (and not closed out) a *futures contract* which-

- (a) provides for the acquisition of assets by the *friendly society*;
- (b) is *listed* and provides for the disposal of assets by the *friendly society*;
or
- (c) is not *listed* but provides for the disposal of assets by the *friendly society* to an *approved counterparty* and it is prudent to assume that such disposal will take place within one year of the *relevant date*.

Adjustments in respect of options

B7. The figure arrived at under B4 to B6 in respect of assets of each description must be increased or decreased by the value of assets of that description which the *friendly society* is deemed to have acquired or disposed of pursuant to an *option*.

- B8. For the purposes of B7, the *friendly society* must be deemed to have acquired or disposed of assets pursuant to an *option* if, at the *relevant date*, it is a party to an *option* and it is prudent to assume that the *option* will be exercised and the *option* is one which-
- (a) provides for the acquisition of assets by the *friendly society*;
 - (b) is *listed* and provides for the disposal of assets by the *friendly society*;
or
 - (c) is not *listed* but provides for the disposal of assets by the *friendly society* to an *approved counterparty* and it is prudent to assume that such disposal will take place within one year of the *relevant date*.

Adjustments in respect of initial margins

- B9. The figure arrived at under B4 to B8 in respect of assets of each description must be increased by an amount representing the value of any assets of that description which have been transferred by the *friendly society* by way of *initial margin*.

Adjustments in respect of an undiversified contract for differences or a contract or asset having the effect of a derivative contract

- B10. The amount arrived at in accordance with B4 to B9 must be increased or decreased by an amount representing the value of assets which the *friendly society* is deemed to have acquired or disposed of under-
- (a) an *undiversified contract for differences*; or
 - (b) a contract or asset other than a *diversified contract for differences* which has the effect of a *derivative contract*.

- B11. For the purposes of B10, the *friendly society* must be deemed to have achieved the effect of such contract by entering into appropriate *futures contracts* or *options*. The assets deemed to be acquired or disposed of must be dealt with in accordance with the provisions in B5 and B7 respectively.

Adjustment in respect of subsidiary undertakings

- B11A. The amount arrived at under B4 to B11 must be increased by an amount representing the *exposure*, if any, of the *friendly society's dependants* to assets of that description, calculating that *exposure* by applying B4 to B11 each *dependant* as if it were a *friendly society*.

Excess asset exposure

- B12. The amount by which the *friendly society* is exposed to assets of a particular description in excess of the *permitted asset exposure limit* must be calculated by subtracting the *permitted asset exposure limit* for assets of that description

from the corresponding amount of the *exposure*, calculated in accordance with B4 to B11A. For this purpose, *exposure* to assets must be excluded to the extent that such *exposure* has caused the recognition of excess *exposure* to assets of a different description. If the figure arrived at is negative, it must be taken to be zero.

Calculation of exposure to a counterparty

B13. Subject to B14 to B15A, the value of all investments (determined in accordance with 9 of Appendix 4) issued by any one *counterparty* and the value of all rights (determined in accordance with 6, 13 and 14 of Appendix 4) against that *counterparty*, in each case up to the amount of the appropriate *permitted asset exposure limit*, must be aggregated. Where the *counterparty* is an *issuer* of a *collective investment scheme* falling within 10(1)(c) of Appendix 4, the value of units or other beneficial interest in the *collective investment scheme* must be included.

B14. Where a *friendly society* has rights in respect of an obligation to be fulfilled by a *counterparty* and-

- (a) the obligation is a secured obligation which-
 - (i) is secured by cash deposited with, or a letter of credit established with, or *securities* issued by, or a guarantee provided by, an *approved credit institution* or an *approved financial institution*; and
 - (ii) is due to be fulfilled within 12 months of the *relevant date*; or
- (b) the obligation is a secured obligation which is secured by *listed securities* which are *readily realisable* or by *approved securities* which in either case-
 - (i) have been deposited with an *approved credit institution*, an *approved financial institution* or an *approved investment firm*; and
 - (ii) are beneficially owned by the *counterparty* but will not be available for the benefit of creditors generally in the event of the winding-up of the *counterparty*,

the aggregation required by B13 need not include the value of such rights.

B15. If the *friendly society* has liabilities to the *counterparty* which may be offset against the above mentioned assets in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for *friendly societies*, then such liabilities may be offset for the purposes of the aggregation required by B13.

- B15A. The amount arrived at in accordance with B13 to B15 must be increased by the amount by which any *dependant* is *exposed* to a *counterparty*.

Excess counterparty exposure

- B16. The amount by which the *friendly society* is exposed to a *counterparty* in excess of the *permitted counterparty exposure limit* must be calculated by subtracting from the amount of the *exposure* to such *counterparty* the amount of the *permitted counterparty exposure limit* for such *counterparty*. If the figure arrived at is negative, it must be taken to be zero. If the *friendly society* is exposed to a *counterparty* in excess of the *permitted counterparty exposure limit* in more than one of the circumstances set out in (c) of the definition of *permitted counterparty exposure limit*, it must make the deduction required under 15(1)(b) of Appendix 4 only in respect of the circumstances leading to the greatest excess *exposure*.

Excess concentration with a number of counterparties

- B17. Where there is *exposure* to a *counterparty* of the type mentioned in (c)(ii) of the definition of *permitted counterparty exposure limit*, 40% of the *business amount* must be deducted from the aggregate of such *exposures*. The amount so arrived at is the excess concentration with a number of counterparties. Where this amount is negative, it must be taken to be zero. For the purposes of this paragraph-

- (a) *exposure* to a *counterparty* must be taken into account only up to the level of the *permitted counterparty exposure limit* for that *counterparty*;
- (b) *exposure* to a *counterparty* must not be taken into account if it does not exceed 5% of the *business amount*; and
- (c) *exposure* to a *counterparty* must not be taken into account if the corresponding *permitted counterparty exposure limit* does not exceed 5% of the *business amount*.

Part II: description of asset and corresponding business amount

- | | | |
|------|--|----|
| B18. | A piece of land or a number of pieces of land (or one or more interests in such pieces of land) to which in the most recent <i>proper valuation</i> of such pieces of land an aggregate value is ascribed which is greater than the aggregate of the value of each of such pieces of land or interests valued separately. | 5% |
| B19. | A reversionary interest or a remainder not falling within B18. | 1% |
| B20. | All <i>debts due or to become due</i> from any one individual (other than a <i>connected individual</i> of the <i>friendly society</i>), being <i>debts</i> which are fully secured on any dwelling or any land appurtenant (or in Scotland, appertaining) thereto owned or to be purchased by the individual and used or to be used by him for his own | 1% |

residence.

B21.	All <i>debts due or to become due</i> from any one individual, other than <i>debts</i> specified in B20.	0.25%
B22.	All unsecured <i>debts</i> (other than <i>debts</i> arising under the terms of <i>debt securities</i> or <i>debts</i> from a <i>regulated institution</i>) <i>due or to become due</i> from any one <i>counterparty</i> other than an individual, body corporate or group.	1%
B23.	All unsecured <i>debts</i> (other than <i>debts</i> arising under the terms of <i>debt securities</i> or <i>debts</i> from a <i>regulated institution</i>) <i>due or to become due</i> from any one <i>company</i> , taken together with all such <i>debts due or to become due</i> from a connected company of that <i>company</i> .	1%
B24.	All unsecured <i>debts</i> (other than <i>debts</i> arising under the terms of <i>debt securities</i> or <i>debts</i> from an <i>approved counterparty</i>) <i>due or to become due</i> from any one <i>regulated institution</i> , taken together with (where that institution is a <i>company</i>) all such <i>debts due or to become due</i> from a connected company of that institution.	2.5%
B25.	All <i>debts</i> , other than <i>debts</i> arising under the terms of <i>debt securities</i> , <i>due or to become due</i> from any one <i>counterparty</i> which is not an <i>approved counterparty</i> taken together with all such <i>debts due or to become due</i> from any connected company (other than an <i>approved counterparty</i>) of that <i>counterparty</i> .	5%
B26.	All <i>debts</i> , other than short-term deposits with an <i>approved credit institution</i> or <i>debts</i> arising under the terms of <i>debt securities</i> , <i>due or to become due</i> from any one <i>approved counterparty</i> , taken together with all such <i>debts due or to become due</i> from any connected company of that <i>approved counterparty</i> .	10%
B27.	All <i>debts due or to become due</i> from an <i>approved credit institution</i> (or a <i>connected company</i> of that institution) taken together unless – (a) the <i>friendly society</i> has notified the <i>FSA</i> that it places deposits with that institution; and (b) the total amount of <i>debts due or to become due</i> does not exceed £2 million.	20%
B28.	The aggregate of <i>debts</i> of the descriptions in B21, B22 and B23.	5%

B29.	All investments of a kind which may be valued in accordance with 9 of Appendix 4 (other than secured <i>debt securities</i> , <i>debt securities</i> issued by a <i>regulated institution</i> or investments which are <i>listed</i> and <i>readily realisable</i>) issued by any one <i>issuer</i> taken together with-	1%
	(a) all units or other beneficial interests in a <i>collective investment scheme</i> failing within 10(1)(c) of Appendix 4 issued by that <i>issuer</i> ; and with	
	(b) all investments of the kinds mentioned in this paragraph issued by a <i>connected company</i> of that <i>issuer</i> .	
B30.	The aggregate of assets of any of the descriptions in B19 and B29.	10%
B31.	All <i>shares</i> issued by any one <i>issuer</i> taken together with all such <i>securities</i> issued by a <i>connected company</i> of that <i>issuer</i> .	2.5%
B32.	All <i>securities</i> issued by any one <i>issuer</i> which is not an <i>approved counterparty</i> taken together with (where that <i>issuer</i> is a <i>company</i>) all <i>securities</i> issued by a <i>connected company</i> , other than an <i>approved counterparty</i> , of that <i>issuer</i> .	5%
B33.	All <i>securities</i> issued by any one <i>counterparty</i> .	10%
B34.	All holdings in any one authorised unit trust scheme or recognised scheme.	5%
B35.	All cash.	3%
B36.	All computer equipment.	5%
B37.	All office machinery (other than computer equipment) taken together with all furniture, motor vehicles and other equipment.	2.5%

Appendix 5

LIABILITY VALUATION RULES

Application

1. This Appendix (the 'liability valuation rules') applies with respect to the determination of the amount of liabilities of a *friendly society* for the purposes of chapters 4 and 5.

Long-term and general insurance business

2. (1) Subject to the provisions below, the amount of liabilities of a *friendly society* in respect of *long-term insurance business* and *general insurance business* and other lawful activities must be determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for *insurance business*.
- (2) In determining under (1) the amount of liabilities of a *friendly society*, all contingent and prospective liabilities must be taken into account.

Provision for adverse changes

3. (1) A *friendly society* which has or may have (following the exercise of any right by the *friendly society* or any other party) an obligation to which this rule applies to deliver assets or make a payment must-
 - (a) at all times identify the assets held by it which it considers to be the most suitable to cover such obligation; and
 - (b) make prudent provision for the effect on the amount of its excess assets of adverse variations between the value of the assets identified and the value of the assets which it is or may be obliged to deliver or the amount of the payment which it is or may be obliged to make.
- (2) For the purposes of (1) the *friendly society* must take into account all reasonably foreseeable adverse variations and must have particular regard to past volatility in the value of the assets concerned (or assets of a similar nature) and the possibility of adverse changes in such volatility in the future.
- (3) For the purposes of this rule "the amount of its excess assets" means the difference between the aggregate value of its assets (other than *linked* assets to the extent that they are held to match *property linked liabilities*) determined in accordance with Appendix 4 and the amount of its liabilities (other than *property linked liabilities* or liabilities for which provision is made in accordance with this rule).
- (4) Subject to (5), this rule applies to an obligation-

- (a) under a contract relating to investments of the kinds mentioned in item B under the heading "Assets" in Part I of Schedule 2 to *Accounts Regulations* (whether such contract constitutes an asset or liability of the *friendly society*);
 - (b) undertaken for the purposes of, or in connection with the making of, investments of the kind mentioned in (a); or
 - (c) under a contract providing for the purchase, sale or exchange of currency.
- (5) This rule does not apply to a contract to the extent that it relates to, or is for the purposes of the making of an investment in, or is in connection with the making of an investment in, a building which is to be occupied by the *friendly society* and used by the *friendly society* for the conduct of its business.

General insurance business liabilities

4. The amount of *insurance liabilities* which are *general insurance business liabilities* must be determined in accordance with the regulations set out in Part VI of Schedule 6 to the *Accounts Regulations*.

Long-term insurance business liabilities

5. (1) The determination of the amount of *long-term liabilities* (other than liabilities which have fallen due for payment before the *valuation date*) must be made on actuarial principles which must have due regard to the reasonable expectations of *policyholders* and must make proper provision for all liabilities on prudent assumptions that must include appropriate margins for adverse deviation of the relevant factors.
- (2) The determination must take account of all prospective liabilities as determined by the policy conditions for each existing contract, taking credit for *premiums* payable after the *valuation date*.
- (3) Without prejudice to the generality of (1), the amount of the *long-term liabilities* must be determined in compliance with each of 6 to 16 and must take account, inter alia, the following factors:
- (a) all guaranteed benefits, including guaranteed surrender values;
 - (b) vested, declared or allotted bonuses to which *policyholders* are already either collectively or individually contractually entitled;
 - (c) all options available to the *policyholder* under the terms of the contract;
 - (cc) discretionary charges and deductions, in so far as they do not exceed the reasonable expectations of *policyholders*;
 - (d) expenses, including commissions; and

- (e) any rights under contracts of reinsurance in respect of *long-term insurance business*.

Method of calculation

- 6. (1) Subject to (2), (3) and (4), the amount of the *long-term liability* must be determined separately for each contract by a prospective calculation.
- (2) A retrospective calculation may be applied to determine the liabilities where a prospective method cannot be applied to a particular type of contract or benefit, or where it can be demonstrated that the resulting amount of liabilities would be no lower than would be required by a prudent prospective calculation.
- (3) Appropriate approximations or generalisations may be made where they are likely to provide the same, or a higher, result than individual calculations of the same amount of the liabilities in respect of each contract.
- (4) Where necessary, additional amounts must be set aside on an aggregated basis for general risks which are not individualised.
- (5) The method of calculation of the amount of the liabilities and the assumptions used must not be subject to discontinuities from year to year arising from arbitrary changes and must be such as to recognise the distribution of profits in an appropriate way over the duration of each policy.
- (6) The liabilities for contracts under which the *policyholder* is eligible to participate in any *established surplus* must have regard to the level of the *premiums* under the contracts, to the assets held in respect of those liabilities, and to the custom and practice of the *friendly society* in the manner and timing of the distribution of profits or the granting of discretionary additions, as the case may be.
- (7) In this paragraph ‘established surplus’ means an excess of assets representing the whole or a particular part of the fund or funds maintained by the *friendly society* in respect of its *long-term insurance business* over the liabilities, or a particular part of the liabilities, of the *friendly society* attributable to that business as shown by an investigation to which rule 5.1 or 5.2 applies.

Avoidance of future valuation strain

- 7. The amount of the liability determined in respect of a group of contracts must not be less than such amount as, if the assumptions adopted for the valuation were to remain unaltered and were fulfilled in practice, would enable liabilities similarly determined at all times in the future to be covered from resources arising solely from the contracts and the assets covering the amount of the liability determined at the current valuation.

Valuation of future premiums

8. (1) Where further specified *premiums* are payable by the *policyholder* under a contract (not being a *linked long-term contract*) under which the *policyholder* is eligible to participate in any *established surplus* and benefits (other than benefits arising from a distribution of surplus) are determined from the outset in relation to the total *premiums* payable thereunder, then, subject to (4) and 9 -

- (a) where the *premiums* under the contract are at a uniform rate throughout the period for which they are payable, the *premiums* to be valued must not be greater than such level *premiums* as, if payable for the same period as the actual *premiums* under the contract and calculated according to the rates of interest and rates of mortality or disability which are to be employed in calculating the liability under the contract, would have been sufficient at the outset to provide for the benefits under the contract according to the contingencies upon which they are payable, exclusive of any additions for profits, expenses or other charges;
- (b) where the *premiums* under the contract are not at a uniform rate throughout the period for which they are payable, the *premiums* to be valued must not be greater than such *premiums* as would be determined on the principles set out in (a) modified as appropriate to take account of the variations in the *premiums* payable by the *policyholder* in each year,

save that a *premium* to be valued must in no year be greater than the amount of the *premium* payable by the *policyholder*.

(2) Where the terms of the contract have changed since the contract was first made (the terms of the contract being taken to change for the purposes of this paragraph if the change is indicated in an endorsement on the policy but not if a new policy is issued), then, for the purposes of (1) one of the following assumptions must be made, namely that-

- (a) the change from the date it occurred was provided for in the contract when it was made;
- (b) the terms of the contract are those which apply from the date of the change except that a single *premium* is payable, at the date of the change, of an amount equal to the liability under the policy immediately before the change, calculated on a basis consistent with the *liability valuation rules* and with the *premiums* actually payable from the date of the change; or
- (c) the contract is in two parts, the first of which is for the benefits purchased by the actual *premiums* payable from the date of the change under the *friendly society's* scales of *premiums* at that date, and the second of which is for all other benefits under the policy for which no *premiums* are payable after that date

- (3) Where under a contract (not being a *linked long-term contract*) the *policyholder* is eligible to participate in any *established surplus*, and
- (a) each *premium* paid increases the benefits (other than benefits arising from a distribution of surplus) provided under the contract; or
 - (b) the amount of a *premium* payable in future is not determinable until it comes to be paid,

future *premiums* and the corresponding liability may be left out of account so long as adequate provision is made against any risk that the increase in the liabilities of the *friendly society* resulting from the payment of future *premiums* might exceed the amount of the *premiums*.

- (4) An alternative valuation method to that described in (1) to (3) may be used where it can be demonstrated that the alternative method results in reserves no less, in aggregate, that would result from use of the method described in (1) to (3).

Acquisition expenses

9. (1) In order to take account of acquisition expenses, the maximum annual *premium* to be valued under 8 may (subject to (2)) be increased by an amount not greater than the equivalent, taken over the whole period of *premium* payments and calculated according to the rates of interest and rates of mortality or disability employed in valuing the contract, of 3.5% (or the defined percentage, if it is lower than 3.5%) of the *relevant capital sum* under the contract.
- (2) For the purposes of (1) "the defined percentage" is the percentage arrived at by taking (for all contracts of the same type as the contract in question for which an adjustment is made) the average of the percentages of the *relevant capital sum* under each such contract that represent the acquisition costs incurred which, after allowing for the effects of taxation, might reasonably be recovered from the *premiums* payable under the contract.
- (3) The increase permitted by (1) must be subject to the limitation that the amount of a future *premium* valued must not in any event be greater than the amount of the *premium* actually payable by the *policyholder*.
- (4) For the purposes of this rule-
- (a) for contracts other than temporary assurances, the *relevant capital sum* under a contract must be arrived at in accordance with rule 4.9(4); and
 - (b) for temporary assurances, the *relevant capital sum* must be the sum assured on the *valuation date*.

Rates of interest

10. (1) The rates of interest to be used in calculating the present value of future payments by or to a *friendly society* must be no greater than the rates of interest determined from a prudent assessment of the yields on existing assets attributed to the *long-term insurance business* and, to the extent appropriate, the yields which it is expected will be obtained on sums to be invested in the future.
- (2) For the purposes of (1), the assumed yield on an asset attributed to the *long-term insurance business*, before any adjustment to take account of the effect of taxation, must not exceed the yield on that asset calculated in accordance with (3) to (7), reduced by 2.5% of that yield.
- (3) For the purpose of calculating the yield on an asset-
 - (a) the asset must be valued in accordance with the *asset valuation rules*, excluding any provision under which assets may be taken at lower book values for the purposes of an investigation to which rule 5.1 or rule 5.2 applies; and
 - (b) the future income from the asset required to be taken into account (whether interest, dividends or repayment of capital) must be reduced by a proportion corresponding to such part of any excess *exposure* to assets of that description, calculated in accordance with B11 of Annex B to Appendix 4, as may reasonably be attributed to such assets.
- (4) For *fixed interest securities* the yield on an asset, subject to (7), must be that annual rate of interest which, if used to calculate the present value of future payments of interest before the deduction of tax and the present value of repayments of capital, would result in the sum of those amounts being equal to the value of the asset.
- (5) For variable interest investments (that is to say, investments which are not *fixed interest securities*) that are equity *shares* other than those within (5A) or land, the yield on an asset, subject to (7), must be the ratio to the value of the asset of the income before deduction of tax which would be received in the period of twelve months following the *valuation date* on the assumption that the asset will be held throughout that period and that the factors which affect income will remain unchanged, so however that account must be taken of any changes in those factors known to have occurred by the *valuation date* and in particular, without prejudice to the generality of the foregoing, of-
 - (a) any known changes in the rental income from property or in dividends on equity *shares*;
 - (b) any forecast changes in dividends which have been publicly announced by the *valuation date*;
 - (c) the effect of any alterations in capital structure; and
 - (d) the value (at the most recent date for which it is known at the *valuation date*) of any determinant of the amount of any future interest payment,

the said value being deemed to remain unaltered for all subsequent dates.

- (5A) For variable interest investments that are equity *shares* in *companies* subject to, or drawing up accounts as if subject to, legislation implementing the *Accounts Directives*, or which draw up a set of accounts in accordance with International Accounting Standards Committee accounting standards or US generally accepted accounting practice, the yield on an asset, subject to (7A), must be the ratio to the value of the asset of-

- (a) A + B; or
- (b) 2 times A,

whichever is lower,

where A = the income which would be received if it were calculated in accordance with (5),

and B = half the excess (if any) of the relevant amount over A, but B must not be less than zero.

- (5B) For the purposes of (5A), the 'relevant amount' in relation to equity *shares* is the issuing *company's* profits after taxation from its ordinary activities for the preceding *financial year*, in so far as attributable to those equity *shares*, so however, without prejudice to the generality of the foregoing, that account is taken of the effect of any alterations in capital structure.
- (5C) For the purposes of (5B), the issuing *company's* profits after taxation from its ordinary activities for the preceding *financial year* must be derived from accounts drawn up in accordance with legislation implementing the *Accounts Directives* or, if accounts are not drawn up in accordance with the *Accounts Directives*, from accounts drawn up in accordance with International Accounting Standards Committee accounting standards or US generally accepted accounting practice.
- (5D) Where (5A) applies, and a *company's* accounting period is longer or shorter than a year, the amount of profits or losses for that period must be annualised, and the annualised figure must be used to calculate the yield.
- (6) Subject to (6a), for variable interest investments (that is to say, investments which are not *fixed interest securities*) other than equity *shares* or land, the yield on an asset, subject to (7), must be that annual rate of interest which, if used to calculate the present value of future payments of interest, before deduction of tax, and the present value of repayments of capital, where applicable, would result in the sum of these amounts being equal to the value of the asset, on the assumption that-
- (a) the value of any determinant of the amount of the next interest rate payment and capital repayment made during the following twelve

- months will be the value of that determinant at the most recent date for which it is known at the *valuation date*;
- (b) the amount of future interest payments and capital repayments will take account, where appropriate, of-
 - (i) the right of either party to have the investment repaid, and
 - (ii) an assumed yield on other comparable investments made in the future not exceeding an amount determined in accordance with (8) to (10); and
 - (c) indices and all other factors which affect future income payments or capital repayment will remain unchanged after the *valuation date*.
- (6A) For investments in *collective investment schemes* given a value as an asset in accordance with paragraph 10 of Appendix 4, the yield may be determined as the weighted average of the yields (as determined by this rule) on each of the investments held by the *collective investment scheme*.
- (7) In calculating the yield on an asset under this rule-
- (a) if the asset does not consist of equity *shares* or land-
 - (i) a prudent adjustment must be made to exclude that part of the yield estimated to represent compensation for the risk that the income from the asset might not be maintained or that capital repayments might not be received as they fall due; and
 - (ii) in making that adjustment, regard must be had wherever possible to the yields on risk-free investments of a similar term in the same currency;
 - (b) for assets which are equity *shares* or land, adjustments to yields must be made as appropriate to exclude that part, if any, of the yield from each category of asset that is needed to compensation for the risk that the aggregate income from that category of asset, taking one year with another, might not be maintained; for the purposes of this paragraph, a "category of asset" comprises assets of a similar nature, type and degree of risk.
- (7A) Notwithstanding (7)(b), for equity *shares* within (5A), adjustments to yields must be made as appropriate to exclude that part, if any, of the yield from each 'category of asset' that is needed to compensate for the risk that the aggregate profits earned by a *company* might not be maintained; and for the purposes of this paragraph, **category of asset** has the same meaning as in (7)(b).
- (8) To the extent that it is necessary to make an assumption about the yields which will be obtained on sums to be invested in future, the yield must be determined in accordance with (9) and (10).

- (9) Where the liabilities are denominated in sterling, the yield assumed, before any adjustments to take account of the effect of taxation-
- (a) on any investment to be made more than three years after the *valuation date*, must not exceed the lowest of-
 - (i) the long-term gilt yield current on the *valuation date*,
 - (ii) 3% per annum, increased by two-thirds of the excess, if any, of the long-term gilt yield current on the *valuation date* over 3% per annum, or
 - (iii) 6.5% per annum,where "the long-term gilt yield" means the annualised equivalent of the 15 year yield for United Kingdom Government *fixed-interest securities* jointly compiled by the Financial Times, the Institute of Actuaries and the Faculty of Actuaries; and
 - (b) on any investment to be made at any time not more than three years after the *valuation date* must not exceed the assumed yield determined under (2) adjusted linearly over the said three years to the yield determined in accordance with (a).
- (10) Where the liabilities are denominated in currencies other than sterling, the yield must be determined on assumptions that are as prudent as those made under (9).
- (11) In no case must a rate of interest determined for the purposes of (1) exceed, the adjusted overall yield on assets calculated as the weighted average of the reduced yields on the individual assets arrived at under (2); and when that weighted average is calculated-
- (a) the weight given to each investment must be its value as an asset determined in accordance the *asset valuation rules*, excluding any provision under which assets may be taken at lower book values for the purposes of any investigation to which rule 5.1 or rule 5.2 applies; and
 - (b) except in relation to the rate of interest used in valuing payments of *property linked benefits*, both the yield and the value of any *linked assets* (as so defined) must be omitted from the calculation.
- (12) For the purpose of determining the rates of interest to be used in valuing a particular category of contracts the assets may, where appropriate, be notionally apportioned between different categories of contracts.

Rates of mortality and disability

11. The amount of the liability in respect of any category of contract must, where relevant, be determined on the basis of prudent rates of mortality and disability and any other decrement that take into account-
- (a) where the *policyholder* is an individual, the state in which he has his habitual residence; and
 - (b) where the *policyholder* is not an individual, the state in which the establishment of the *policyholder* to which the *commitment* covered by the contract relates is situated.

Expenses

12. (1) Provision for expenses, whether implicit or explicit, must be not less than the amount required, on prudent assumptions, to meet the total net cost, after taking account of the effect of taxation, that would be likely to be incurred in fulfilling contracts if the *friendly society* were to cease to transact new business twelve months after the *valuation date*.
- (2) The provision mentioned in (1) must have regard to, among other things, the *friendly society's* actual expenses in the last twelve months before the *valuation date* and to the effects of inflation on future expenses on prudent assumptions as to the future rates of increase in prices and earnings.

Options

13. (1) Provision must be made on prudent assumptions to cover any increase in liabilities caused by *policyholders* exercising *options* under their contracts.
- (2) Where a contract includes an *option* whereby the *policyholder* could secure a guaranteed cash payment within twelve months following the *valuation date*, the provision for that *option* must be such as to ensure that the value placed on the contract is not less than the amount required to provide for the payments that would have to be made if the *option* were exercised.
- (3) Where a contract includes an option whereby the *policyholder* could secure a cash payment but (2) does not apply, the provision for that option must be such as to ensure that, if the assumptions adopted for the valuation of the contract are fulfilled in practice –
- (a) the resulting value (and therefore the provision) is not less than the amount required to provide for the payment which would have to be made if the option were exercised; and
 - (b) the payment when it falls due is covered from resources arising solely from the contract and from the assets covering the amount of the liability determined at the current valuation.
- (4) For the purposes of (3) the amount of a cash payment secured by the exercise of an option is assumed to be -

- (a) in the case of an *accumulating with-profits policy*, the lower of-
 - (i) the amount which would reasonably be expected to be paid if the option were exercised, having regard to the representations of the *friendly society*; and
 - (ii) that amount, disregarding all discretionary adjustments; and
- (b) in the case of any other policy to which this paragraph applies, the amount which would reasonably be expected to be paid if the option were exercised, having regard to the representations of the *friendly society*, without taking into account any expectations regarding future distributions of profits or the granting of discretionary additions in respect of an *established surplus* or in anticipation of such additions.

Contracts not to be treated as assets

- 14. No contract for *long-term insurance business* must be treated as an asset.

No credits for profits from voluntary discontinuance

- 15. Allowance must not be made in the valuation for the voluntary discontinuance of any contract if the amount of the liability so determined would thereby be reduced.

Nature and term of assets

- 16. The determination of the amount of *long-term liabilities* must take into account the nature and term of the assets representing those liabilities and the value placed upon them and must include prudent provision against the effects of possible future changes in the value of the assets on-
 - (a) the ability of the *friendly society* to meet its obligations arising under contracts for *long-term insurance business* as they arise; and
 - (b) the adequacy of the assets to meet the liabilities as determined in accordance with 6 to 15.

Appendix 6

BALANCE SHEET (Forms 9 to 17)

1. All the Forms included in the part of the *FSC return* to which this Appendix relates (Forms 9 to 17) must be completed as required by this Appendix.

Currency

2. A supplementary note to Form FSC1 or Form FSC3 (as appropriate) must be included in the *FSC return* stating the bases of conversion employed for -
 - (a) amounts of *premiums* and other income *receivable* in a currency other than sterling; and
 - (b) the amounts of *claims* and other expenditure payable in a currency other than sterling.

Presentation of Amounts

3.
 - (1) Where in any Form an amount which is shown as brought forward from a previous period differs from the corresponding amount shown as carried forward from that period and the difference is not due solely to the fact that a different rate has been used to express other currencies in sterling, an explanation of the reason for the difference must be given by way of a supplementary note to that Form.
 - (2) Except to the extent permitted by (3), amounts due to or from the *friendly society* must be shown gross.
 - (3) In calculating amounts due from or to the *friendly society* (other than for the completion of Form 17),
 - (a) amounts due from any person may, unless expressly provided otherwise, be included net of amounts which are due to that person, provided that such amounts may be set-off against each other under generally accepted accounting practice; and
 - (b) amounts due to any person may, unless expressly provided otherwise, be included net of amounts due from that person, provided that such amounts may be set-off against each other under generally accepted accounting practice.
 - (4) If the amounts shown include amounts calculated on the basis set out in (3), a supplementary note to Form 13 to that effect must be provided.
4. In Form 9 -

- (a) for a *friendly society* carrying on only *long-term insurance business*, lines 11 to 13 may be omitted;
- (b) for a *friendly society* carrying on only *general insurance business*, lines 21 to 44 may be omitted;
- (b) the *implicit items* at lines 11a, 31, 32 and 33 are those admitted under rule 4.8 to 4.10;
- (d) the entry at lines 51 and 52 must not include provision for any liability to tax on capital gains referred to in 9(2)(b); and
- (e) in the FSC1 return the entries at lines 11 to 13 may be a prudent estimate with reference to the last periodic investigation into the financial condition of the *friendly society* in respect of its *general insurance business*.

Margin of solvency for general insurance

5. (1) Amounts included in Forms 11 and 12 in respect of -

- (a) gross premiums receivable,
- (b) *claims* paid,
- (c) *claims* outstanding, and
- (d) reinsurance recoveries,

must be determined in accordance with rule 4.6 and Appendix 2.

(2) Where any amount included in Form 11 or 12 pursuant to (1) above differs from the aggregate of the corresponding amounts included in Forms 21 and 22, there must be stated by way of supplementary note to Form 11 or 12, as the case may be,

- (a) the amount of such difference, and
- (b) an explanation for such difference.

Investment

6. In Form 13 -

- (a) a Form 13 must be completed for the total *long-term insurance business* assets of the *friendly society* and for each fund or group of funds for which separate assets are appropriated. The words "Total *long-term insurance business assets*" or the name of the fund must be shown against the heading "Category of assets";
- (b) a separate Form 13 must be completed in respect of the total assets of the *friendly society* other than any *long-term insurance business assets*. The words "Total other than *long-term insurance business assets*" must be shown against the heading "Category of assets";

- (c) in lines 11 to 86: for the purpose of classifying (but not valuing) assets, headings and descriptions used in the Form, whenever they also occur in the balance sheet format prescribed by the *Accounts Regulations*, must have the same meaning as in those *Accounts Regulations*; assets must be valued in accordance with the *asset valuation rules*; and assets of any particular description must be shown after deduction of assets of that description which (for any reason) fall to be left out of account under 15(2)(a) of Appendix 4;
- (d) the aggregate value of those investments which are:
 - (i) *unlisted* investments falling within any of lines 41, 42, 46 or 48 which have been valued in accordance with 9 of Appendix 4, or
 - (ii) *listed* investments falling within any of lines 41, 42, 46 or 48 which have been valued in accordance with 9 of Appendix 4 and which are not *readily realisable*, or
 - (iii) units or other beneficial interests in *collective investment schemes* falling within 10(1)(c) of Appendix 4, or
 - (iv) reversionary interests or remainders in property other than land or buildings,

must be stated by way of a supplementary note to this Form, together with a description of such investments;

- (e) the aggregate value of those investments falling within lines 46 or 48 which are hybrid *securities* must be stated by way of a supplementary note to this Form; and
- (f) lines 60 to 63 and 85 relate only to *general insurance business*.

Counterparty exposure

- 7. (1) There must be given by way of a supplementary note to Form 13 -
 - (a) the maximum extent to which, in accordance with any investment guidelines operated by the *friendly society*, it was permitted to be exposed to any one *counterparty* during the period;
 - (b) the maximum extent to which, in accordance with such guidelines, it was permitted to be exposed to any one *counterparty*, other than by way of *exposure* to an *approved counterparty*, during the period; and
 - (c) an account of any occasions during the period on which either of those amounts was exceeded.

- (2) In each case where the *exposure* of the *friendly society* to a *counterparty* (calculated in accordance with Annex B of Appendix 4) at the end of the period exceeds 5% of its *long-term insurance business* or *general insurance business amount*, as appropriate, the amount of that *exposure* and the nature of the assets held which give rise to that *exposure*, must be stated by way of a note to Form 13.

Provision for adverse changes

8. There must be stated by way of a note to Form 14 (and in Form 15 in respect of any *general insurance business*) the methods and assumptions used to determine the amount of any provision made pursuant to 4 in Appendix 5 or, if there is no such provision, the methods and assumptions used to determine that no provision is required.

Liabilities

9. (1) Form 14 must be completed for the total *long-term insurance business liabilities* and margins of the *friendly society* and for each fund or group of funds for which separate assets are appropriated. The words "Total *long-term insurance business assets*" or the name of the fund must be shown against the heading "Category of assets".
- (2) Subject to (4) and (5), the following information must be given by way of a supplementary note to Form 14 or 15 -
- (a) in the case of any charge over the assets of the *friendly society* (including any arrangement whatsoever, whether contractual or otherwise, which operates to secure the prior claim of any person over general creditors to any assets on a winding up of a *friendly society*), the particulars specified in (3) or a statement that there are no such charges;
 - (b) the total potential liability, and the amount provided for that liability, to taxation on capital gains which might arise if the *friendly society* disposed of its assets, or a statement that there is no such potential liability;
 - (c) a brief description of any other liabilities being contingent liabilities not included in Form 14 or 15 (other than liabilities arising under an inwards *contract of insurance*) including, where practicable, the amounts or estimated amounts of those liabilities, or a statement that there are no such contingent liabilities;
 - (d) a brief description of any guarantee, indemnity or other contractual *commitment*, effected by the *friendly society* other than in the ordinary course of its *insurance business*, in respect of the existing or future liabilities of any *associate* bodies, including -

- (i) the maximum liability of the *friendly society* specified in such guarantee, indemnity or contractual *commitment*, or a statement that no such amount is specified,
 - (ii) the amount of any provision made in respect of such liability, and
 - (iii) the amount reported under (c) in respect of such liability,
- or a statement that there are no such guarantees, indemnities or contractual *commitments*; and
- (e) a description of any other uncertainty where such a description is, in the opinion of the *committee*, necessary for a proper understanding of the financial position of the *friendly society*.
- (3) The particulars referred to in (2)(a) are -
- (a) the nature of the charge, including a brief description of the terms which are relevant to securing the prior claim of any person to assets which are subject to the charge;
 - (b) for each line in Form 13, the amount included in respect of assets which are subject to the charge; and
 - (c) for each line in Form 14 or 15, the amount included in respect of liabilities which are secured by the charge.
- (4) (2)(a) and (c) may be disregarded by a *friendly society* in the case of -
- (a) one or more charges over assets which are attributable to either the *long-term insurance business assets* or the *general insurance business assets* and whose aggregate value (as shown on Form 13) does not exceed 2.5% of the long-term or *general insurance business amount*, as the case may be;
 - (b) one or more contingent liabilities whose aggregate value does not exceed 2.5% of the long-term or *general insurance business amount*, as the case may be.
- (5) (2)(d) may be disregarded by a *friendly society* in respect of one or more guarantees, indemnities or contractual *commitments* where the aggregate of the maximum liabilities specified in such guarantees, indemnities or contractual *commitments* does not exceed 2.5% of the *long-term* or *general insurance business amount*, as the case may be.

Derivative contracts

10. (1) Form 17 must be completed in respect of the total *long-term insurance business assets* and in respect of the total other than *long-term insurance*

business assets of the *friendly society*. Form 17 must also be completed for each fund or group of funds for which separate assets are appropriated. The words "Total *long-term insurance business assets*" or "Total other than *long-term insurance business assets*" or the name of the fund must be shown against the heading "Category of assets".

- (2) Any *derivative contract* entered into by the *friendly society* -
- (a) the value of which is taken into account for the purpose of calculating benefits payable to *policyholders* and members under *property linked contracts*; or
 - (b) in order to match its liabilities in respect of the payment of *index-linked benefits*,

must be excluded from Form 17. Rights to recover assets transferred by way of *initial margin* must not be shown on Form 17.

- (3) *Derivative contracts* must be analysed according to the description of assets shown in the second column to Form 17 which represents the principal subject of the contract, and must be reported as assets in column 1 of Form 17 if their value (gross of *variation margin*) to the *friendly society* is positive and as liabilities in column 2 of Form 17 if their value (gross of *variation margin*) to the *friendly society* is negative.
- (4) All amounts included in lines 11 to 35 of Form 17 in respect of *derivative contracts* must be determined without making any allowance for *variation margin* and the effect of any *variation margin* upon those amounts must be shown at line 41.
- (5) Amounts in respect of a *derivative contract* may only be included net of amounts in respect of any other *derivative contract* if -
- (a) obligations of the *friendly society* under the contracts may be set-off against each other under generally accepted accounting practice; and
 - (b) such other contract has the effect (in whole or in part) of closing out the obligations of the *friendly society* under the first mentioned contract.
- (6) Where, in respect of any *derivative contract* included in Form 17, assets have been transferred to or for the benefit of a *friendly society* by way of *variation margin* there must be stated by way of a supplementary note to Form 17 -
- (a) the aggregate amount of any liability to repay such assets or equivalent assets;
 - (b) for each line in Form 13, the amount included in respect of such assets; and

- (c) to what extent any amounts included in Form 13 have taken account of any requirement to repay such assets or equivalent assets.

(7) If -

- (a) the aggregate value of rights, under contracts or in respect of assets, either of which have the effect of *derivative contracts*, exceeds 2.5% of the aggregate value of assets shown at line 89 of Form 13; or
- (b) the aggregate amount of liabilities under contracts or in respect of assets, either of which have the effect of *derivative contracts*, exceeds 2.5% of the aggregate of the amounts shown in lines 17 to 39 of Form 14 or lines 31 to 51 of Form 15, as appropriate,

the corresponding value, if not zero, must be stated by way of a supplementary note to Form 17 for each line in Forms 13, 14 and 15 and (6) applies to the *friendly society* as if such contracts had been included in Form 17.

- (8) Every *friendly society* must, in respect of the period, annex to Form 17 a supplementary note comprising a brief description of
 - (a) any investment guidelines operated by the *friendly society* for the use of *derivative contracts* (including a contract or asset which, wholly or in part, has the effect of a *derivative contract*);
 - (b) any provision made by such guidelines for the use of contracts under which the *friendly society* had a right or obligation to acquire or dispose of assets which was not, at the time when the contract was entered into, reasonably likely to be exercised and, if so, the circumstances in which, pursuant to that provision, such contracts would be used;
 - (c) the extent to which the *friendly society* was during the period a party to any contracts of the kind described in (b);
 - (d) the extent to which any of the amounts recorded in Form 13 would be changed if assets which the *friendly society* had a right or obligation to acquire or dispose of under *derivative contracts* outstanding at the end of the period (being in the case of *options*, only those *options* which it is prudent to assume would be exercised) had been so acquired or disposed of;
 - (e) how different the information provided pursuant to (d) would have been if such *options* as were outstanding at the end of the period had been exercised in such a way as to change the amounts referred to in (d) to the maximum extent;
 - (f) how different the information provided pursuant to (d) and (e) would have been if, instead of applying to contracts outstanding at the end of the period, they had applied to *derivative contracts* outstanding at such

other time during the period as would have changed the amounts referred to in (d) and (e) to the maximum extent;

- (g) the maximum loss which would be incurred by the *friendly society* on the failure by any one other person to fulfil its obligations under *derivative contracts* outstanding at the end of the period, both under existing market conditions and in the event of other foreseeable market conditions, together with an assessment of whether such maximum loss would have been materially different at any other time during the period;
- (h) the circumstances surrounding the use of any *derivative contract* held at any time during the period which did not fall within 13(2) of Appendix 4, or (where appropriate) within the definition of *permitted derivative contract*; and
- (i) the total value of any fixed consideration received by the *friendly society* (whether in cash or otherwise) during the period in return for granting rights under *derivative contracts* and a summary of contracts under which such rights have been granted.

(9) For the purposes of 10, a *friendly society* which is a party to -

- (a) a *contract for differences*; or
- (b) any other contract which is to be, or may be, settled in cash,

must be taken to have a right or obligation to acquire or dispose of the assets underlying the contract.

Appendix 7

GENERAL INSURANCE BUSINESS: REVENUE ACCOUNT AND ADDITIONAL INFORMATION (Forms 20 to 23A)

1. All the Forms included in the part of the FSC3 Return to which this Appendix relates (Forms 20 to 23A) are to be completed as required by this Appendix.

Premiums

2. In all Forms to which this Appendix relates, amounts required to be shown in respect of *premiums* must be shown before deduction for commissions.
3. For the purposes of Form 23 -
 - (a) *gross premiums* earned in respect of a period must be such proportion of *gross premiums* written as is attributable to risks borne by the *friendly society* during that period; and
 - (b) the reinsurers' share of *premiums* earned must be attributed to the same period as the corresponding *gross premiums* earned, so as to calculate the net earned *premium* for the period.

Unearned premiums

4. In Form 21, the basis on which unearned *premiums* are calculated and the reason for adopting this basis must be stated by way of supplementary note.

Acquisition costs

5. The basis used for the determination of amounts for acquisition costs (other than commission) payable in the period in question and carried forward to the next period, as shown at line 22 of Form 22, must be stated by way of a supplementary note to that Form.

Claims

6. In all Forms to which this Appendix relates, amounts required to be shown for *claims* must not include amounts in respect of *claims management costs*.
7. (1) In Form 23, where an amount or number is required to be shown for *claims* in respect of a period, that amount or number must be determined on the basis of *claims* arising from incidents occurring during that period.
 - (2) For the purposes of (1), an incident giving rise to a claim under a *claims-made policy* must be deemed to occur on the earlier of -
 - (a) the date on which it is notified in accordance with the terms of that policy; or

- (b) the date on which the period for which cover is provided under that policy expires.

Reinsurance

- 8. Where the reinsurers' share of *claims* incurred (as stated in Form 22) includes amounts expected to be recovered from reinsurers more than twelve months after the payment of the underlying gross *claims* by the *friendly society*, the amount of such recoveries must be stated by way of note to Form 22.

Administration

- 9. Where arrangements have been made for the provision of management services to a *friendly society* by another organisation, there must be given by way of supplementary note to Form 20 a summary of the arrangements in force including details of the organisation providing the service.

Claims management costs

- 10. (1) In Form 22, the basis used for the determination of amounts for *claims management costs* payable in the period in question and carried forward to the following period must be stated by way of note.

- (2) If, in respect of any *class* of *general insurance business* -

- (a) no amount for *claims management costs* is shown as being carried forward to the following period, and
- (b) an amount for net *claims* is shown as being carried forward to that period,

the reason for anticipating that there will be no *claims management costs* incurred during the following period must be included in the note required by (1).

- (3) If, within a *class* of *general insurance business*, a *friendly society* has ceased to effect new contracts of insurance (that is any *contract of insurance* effected by the *friendly society* other than in fulfilment of its obligations under subsisting contracts) during the period in question, the basis upon which any additional costs arising as a result of such cessation have been determined or the reason for anticipating that no such additional costs will be incurred must be included in the note required by (1).

- (4) Where the amount in respect of *claims management costs* carried forward included in any Form 22 has been determined after taking into account the expected investment return, the following must be stated by way of supplementary note -

- (a) the rates of investment return assumed; and

- (b) the average interval between the end of the period in question and the date by which the *claims management costs* are expected to be expended.

Provision for unexpired risks

- 11. (1) The amount included for the provision for unexpired risks in any Form 22 prepared in respect of a *class* of *general insurance business* must include any amount determined to be a necessary provision in relation to the reasonable expectations of the *friendly society's* policyholders and must further be determined without taking into account any surplus expected to arise on the unexpired risks falling within other *classes* of *general insurance business*.
- (2) Where in determining the amount of the overall provision for unexpired risks (line 13 in Form 15 less line 62 of Form 13) credit has been taken for any aggregate surplus expected to arise on the unexpired risks falling in any *class* of *general insurance business*, the amount of that credit must be included as a negative amount at line 19 of Form 22 for that *class* of *general insurance business*.
- (3) Where the amount included at column 3 of line 19 (provision for unexpired risks) in any Form 22 has been determined after taking into account the expected investment return, the following must be stated by way of supplementary note -
 - (a) the provision for unexpired risks before taking such investment return into account;
 - (b) the rates of investment return assumed; and
 - (c) the average interval between the end of the period in question and the date at which *claims* are expected to be settled in cash.

Cessation of business

- 12. If the *friendly society* has not effected any new contracts of insurance (that is any *contract of insurance* effected by the *friendly society* other than in fulfilment of its obligations under subsisting contracts of insurance) of any one or more *classes* of *general insurance business* during the period, the date on which the last new contract of each such *class* was effected must be stated by way of supplementary note to Form 20.

General insurance business statement

- 13. The following information must be given in Form 23A -
 - (a) the date to which the investigation relates;
 - (b) the date to which the latest previous investigation under rule 5.2; and

- (c) a synopsis of the report by the *appropriate actuary* on his investigation into the financial condition of the *friendly society* in respect of its *general insurance business*, including the actuary's assessment of the financial viability of the *friendly society* and his interpretation of the reasonable expectations of its members.

Appendix 8

LONG-TERM INSURANCE BUSINESS: REVENUE ACCOUNT, OTHER REVENUE ACCOUNT AND ADDITIONAL INFORMATION (Forms 40 to 45)

1. Forms 40 to 45 are to be completed as required by this Appendix.
2.
 - (1) All amounts must be shown in sterling and, except for valuation unit prices, may only be shown to the nearer £1,000 in the circumstances described in rule 5.25.
 - (2) A note must be included in the *FSC return* stating the bases of conversion for amounts in currencies other than sterling in accordance with 2 of Appendix 6.
 - (3) Valuation unit prices must be shown to the same accuracy as used in the valuation.
3. Where a *friendly society* maintains more than one *long-term insurance business* fund, other revenue account fund or members surplus and savings accounts, a statement must be annexed to Forms 40, 40A and 40C giving the principles and methods applied to apportioning the investment income, increase or decrease in the value of assets brought into account, expenses and taxation between the different funds and accounts.
4. The box marked “Name of Fund/Summary” in each Form must be completed by the inclusion of a discrete name or number to identify each fund or, if the Form relates to a part of the fund, the fund of which it is part. Where there is only one fund for ordinary *long-term insurance business* or for *industrial assurance business* or for some other revenue account fund, as the case may be, the number “1” must be shown in the box marked “No. of Fund/Summary”. Where the Form is a summary Form the number “99” must be inserted in that box. The box marked “No. of part of fund” must show a discrete number for each part of a fund or the figure “0” if the Form is a statement of the whole fund.
5. In Form 40 –
 - (a) any item of income which cannot properly be allocated to lines 11, 12, 13, 14, or 14a must be entered in line 15, and similarly, any item of expenditure which cannot properly be allocated to lines 21, 22, 23 or 24 must be entered in line 25. Particulars of such items must be specified in a supplementary note;
 - (b) where a *friendly society* decides to allocate to the *long-term insurance business* the whole or any part of investment income and/or net capital gains arising from assets not attributable to its *long-term insurance business*, the amounts in question must be shown as a transfer in line 14a or 26 and particulars must be specified in a supplementary note;

- (c) the entry at line 12 is to exclude value re-adjustments on investments and gains on the realisation of investments, which must be shown in lines 13 or 14 as appropriate;
 - (d) the entry at line 11 is to exclude any change in the provision for unearned *premiums*; and
 - (e) the entry at line 21 is to exclude *claims management costs*, which must be included in line 21 of Form 40B, and any change in the provisions of *claims*.
6. Where arrangements have been made for the provision of management services to a *friendly society* by another organisation, there must be given by way of supplementary note to Form 40B a summary of the arrangements in force including details of the organisation providing the service.
7. Societies conducting combined sickness and savings business must, in respect of members surplus and savings accounts, complete separate Forms 40C for the transactions which have been classified as relating to *long-term insurance business* and for the transactions which have been classified as not relating to *long-term insurance business*.
8. Forms 41 to 45 are to be completed separately in respect of each fund for which a separate *long-term insurance business* revenue account fund is required to be prepared in Forms 40.
9. In Form 41, in dividing the *management expenses* between lines 43, 44 and 45;
- (a) costs of a non-recurring nature, such as those incurred in developing new systems, new premises, or the costs of corporate re-structuring, must normally be shown in line 45;
 - (b) the costs incurred in writing new business (or in obtaining incremental (but not indexed) *premiums* on existing business), such as underwriting, policy issue, setting up (or amending) records and the maintenance and development of the sales and marketing organisation must be reported in line 43; and
 - (c) the balancing item will be expenses related to the ongoing costs throughout the year of maintaining the business in force (including any investment management costs) and must be reported in line 44.
10. In Form 43 -
- (a) the basis on which assets have been valued must be stated in a supplementary note;
 - (b) the aggregate value of rights (gross of *variation margin*) and the aggregate amount of liabilities (gross of *variation margin*) under *derivative contracts* (or in respect of contracts or assets which have the

effect of a *derivative contract*) must be stated in a supplementary note. The corresponding figures net of *variation margin* must also be stated. For this purpose, rights and liabilities must not be set off against one another unless

- (i) such rights and liabilities may be set off against each other in accordance with generally accepted accounting principles, and
 - (ii) such set off results (in whole or in part) from the closing out of obligations under a contract; and
- (c) where there is a liability to repay *variation margin* and there are no arrangements for netting of amounts outstanding or the arrangements would not permit the accounting of such amounts on a net basis in accordance with generally accepted accounting principles it must be so stated in a supplementary note.

11. In Form 44 -

- (a) double counting of items arising from cross investment between *internal linked funds* is to be eliminated;
- (b) any item of income which cannot properly be allocated to lines 11, 12 or 13 must be entered in line 14, and similarly, any item of expenditure which cannot properly be allocated to lines 21, 22, 23, 24 or 25 must be entered in line 26 and particulars of such items must be specified in a supplementary note; and
- (c) the gross value of units created must be shown in line 11 and the gross value of units cancelled must be shown in line 21.

12. In Form 45 -

- (a) Column 3 must show the provision for tax on unrealised capital gains as a percentage of the taxable unrealised capital gain. Similarly, column 4 must show the provision for tax on realised capital gains as a percentage of the taxable realised capital gain;
- (b) the liquidity percentage in column 5 must be the sum of the values of *approved securities*, short-term deposits and cash held by the fund, less any liabilities included in column 6 or 7 of Form 43 shown as a percentage of the *net asset value* in column 8 of Form 43; and
- (c) where there is more than one series of units for any *internal linked fund* the valuation price of each series of unit must be given in column 6 together with the name of that series of unit.

Appendix 9

ABSTRACT OF ACTUARIAL INVESTIGATION (Forms 46 to 61A)

The following information must be given in Form 61A of the *FSC return* and

- (i) the answers must be numbered to accord with the corresponding numbers of this Appendix;
- (ii) all amounts must be shown in sterling and, except for valuation unit prices, may only be shown to the nearer £1,000 in the circumstances described in rule 5.25;
- (iii) valuation unit prices must be shown to the same accuracy as used in the valuation; and
- (iv) yields must be shown as percentages to two decimal places.

1. The *valuation date*.
2. The date to which the latest previous investigation under rule 5.1 related.
3. A statement that the valuation has been made in conformity with 5 in Appendix 5 or, where this was not the case, such qualification, amplification or explanation as necessary.
4. (1) Subject to (2), for each category of *non-linked contract* which -
 - (a) comprises *accumulating with-profit policies*, a full description of the benefits, including -
 - (i) the circumstances in which, and method by which, an adjustment to the identifiable current benefit attributable to a policy could be made on the payment of any claim, including by full or partial surrender, or upon the determination of the amount of any charges deducted under the policy together with a description of the *friendly society's* policy and past practice in this regard;
 - (ii) where the discounted value of the liability in respect of current benefits including vested bonuses shown in column 12 of Form 52 is less than the full amount of the current benefit shown in column 11 and the discounted value assumes the exercise of any discretionary adjustments of the type referred to in (a)(i), a general description of such adjustments made during the period;
 - (iii) any guaranteed investment returns or bonus rates;
 - (iv) any guaranteed surrender values; and

- (v) any material options;
 - (b) comprises policies (other than those included in (a)) which provide for benefits to be determined on the basis of interest accrued (at a rate to be determined from time to time) in respect of *premiums* paid, a full description of the benefits, including -
 - (i) the method used to calculate surrender values;
 - (ii) any guaranteed investment returns;
 - (iii) rates of interest applied during the period;
 - (iv) any guaranteed surrender values; and
 - (v) any material options; and
 - (c) does not fall within (a) or (b) and which is not sufficiently described by the entry in column 1 of Form 51, a full description of the benefits, including any *premium* rate guarantees and material options.
- (2) Information required under (1) need not be provided for any category of contract -
- (a) where no contracts were effected by the *friendly society* during the period; and
 - (b) which has been included in Forms 51 or 52 under the miscellaneous headings specified in 20(3)(e)(vi) and 20(3)(e)(x).
5. (1) Subject to (4), for each category of *linked long-term contract* -
- (a) the name given to that category;
 - (b) the type of contract, classified according to the categories set out in 20(3)(a), (b), (c), (d) and (e);
 - (c) a statement of the frequency of *premiums*;
 - (d) a brief description of the benefits under the contract, including any eligibility to participate in profits, any guarantees and any material options;
 - (e) details of any guaranteed investment returns;
 - (f) a description of the way in which the *friendly society* recovers out of policies its costs (including acquisition expenses and commission, renewal expenses and commission and the costs attributable to the provision of policy benefits). Where the policy provides for the

allocation of units, the annual rate of any management charges must be given. Where the amount of *premiums* deemed to be invested after allowing for the effect of any charges is greater than the amount of the *premiums*, an explanation must be given;

- (g) details of any restrictions on increases in charges;
 - (h) the method used to calculate surrender or transfer values;
 - (i) whether benefits are (or may be) determined (whether wholly or in part) by reference to the value of an *internal linked fund* or to the value of assets or an index. Where the link is to the value of assets or an index, those assets or that index must be specified and details of the relationship between their value and benefits payable to *policyholders* must be given;
 - (j) a brief description of any other features of the contract not disclosed which are material to the method and basis of valuation;
 - (k) whether the contract was open to new business in the period to the *valuation date*; and
 - (l) any increases in the rates of charges applied generally to contracts during the period, including charges for the provision of policy benefits met by the cancellation of units notionally allocated to contracts.
- (2) Where the terms and conditions and the method and basis for determining the amount of the *long-term liabilities* are not materially different for a number of categories of contract, only one description need be given pursuant to (1), provided that the name of each such category is given in the *friendly society's* response to (1)(a).
- (3) For each category of *linked long-term contract* which contains a with-profits option, the information required by 4(1)(a) must also be given.
- (4) Information required under (1)(a) to (k) and (3) need not be provided for any category of contract
- (a) where no contracts were effected by the *friendly society* during the period; and
 - (b) which has been included under the miscellaneous heading in Form 53 or 54.
- (5) A description of the method, or if there is more than one method of the methods and the types of unit to which each applies, used for the creation and cancellation of units in the *internal linked fund* and determining unit prices for the allocation of units to, and the cancellation of units from, policies.

- (6) A description of the method, or if there is more than one method of the methods and the types of unit to which each applies, used to determine the provision for tax on realised and unrealised capital gains and the percentage or percentages of these gains deducted or provided for during the period.
 - (7) Whenever units of the type referred to in 5 of Appendix 3 are held by an *internal linked fund*, or where *property linked benefits* are linked to such units, the rate of discount, commission or other allowance made to the *friendly society* on the purchase, sale or holding of units and the extent to which the *policyholder* or member benefits from such discount, commission or other allowance.
6. (1) The general principles and methods adopted in the valuation including specific reference to the following
- (a) the method by which account has been taken of *derivative contracts* or contracts or assets having the effect of *derivative contracts* in the determination of the amount of the *long-term liabilities*;
 - (b) the method by which due regard has been given to the reasonable expectations of *policyholders* as required by 5 in Appendix 5 by which account has been taken of the custom and practice of the *friendly society* in the manner and timing of the distribution of profits or the grant of discretionary additions over the duration of each policy, as required by 6(6) in Appendix 5;
 - (c) where the net *premium* method has been used, whether and to what extent it has been modified, for what purposes any such modification has been made and whether any modifications on account of *zillmerising* conform to 9 in Appendix 5;
 - (b) whether any negative reserves arose and the steps taken to ensure that no *contract of insurance* was treated as an asset, as required by 14 in Appendix 5;
 - (e) whether any specific reserve has been made for future bonuses and, if so, at what rate or rates;
 - (f) the basis of the provision made for any prospective liability for tax on unrealised capital gains;
 - (g) in the case of *linked long-term contracts* and contracts falling within 4(1)(a) and 4(1)(b), the basis of the reserve made for any investment performance guarantees; and
 - (h) the basis of the reserve made for any guarantees and options (other than investment performance guarantees included in (g)).
- (2) For the purpose of (1) where, in determining the provisions referred to in (1)(f) or the reserves referred to in 7(7) or 7(8), account has been taken of the fact

that the fund has been brought into Form 58 at book value in accordance with 2(6) of Appendix 4, that fact must be stated.

7. (1) Unless shown in Forms 51, 52, 53 or 54, the rates of interest and tables of mortality and morbidity assumed in the valuation of each category of contracts.
- (2) If the tables used have not been published, full details of the rates of mortality or morbidity used.
- (3) A general description of how the tables of mortality and morbidity assumed in the valuation of the various categories of contract have regard to the State of the *commitment*.
- (4) Details of any allowance made for future reductions in the rates of mortality in the tables of mortality assumed in the valuation of annuity contracts.
- (5) Details of any allowance made, and the amount of any reserve held, for any possible detrimental impact of significant changes in the incidence of disease or developments in medical science on the mortality and morbidity experience of the *friendly society* in the tables of mortality and morbidity assumed in the valuation of contracts.
- (6) A description of all the scenarios of future changes in the value of assets which have been tested in order to take account of the nature (including currency) and term of the assets held in determining the amount of the *long-term liabilities* in accordance with 16 in Appendix 5 identifying that scenario which produces the most onerous requirement (whether or not a reserve is thereby required).
- (7) The amount of any reserve made pursuant to 16(a) in Appendix 5, together with a brief description of the method used and assumptions made to calculate any such reserve.
- (8) In respect of that scenario described under (6) which produces the most onerous requirement (whether or not a reserve is thereby required), the amount of any reserve made pursuant to 16(b) in Appendix 5, together with -
 - (a) a description of the changed assumptions made (other than the changed interest rate stated in Form 57) in calculating such requirement;
 - (b) a brief description of the method used to calculate such requirement; and
 - (c) resulting from the application of such changed assumptions -
 - (i) the change in the aggregate amount of the *long-term liabilities*, and
 - (ii) the aggregate amount by which the assets allocated to match such liabilities in the scenario have changed in value from the amount of those assets shown in Form 13.

- (9) A general description of how the rates of interest assumed in the valuation of the various categories of contract with liabilities denominated in currencies other than sterling have taken into account the currency of the liabilities.
8. (1) In respect of *non-linked contracts* -
- (a) where appropriate, the proportion of the office *premiums* explicitly or implicitly reserved for expenses and profits for each type of insurance (as shown in column 8 of Form 51 or column 10 of Form 52);
 - (b) the method by which a reserve has been made for expenses after *premiums* have ceased or where no future *premiums* are payable or where the method of valuation does not take credit for future *premiums* as an asset;
 - (c) where a prospective method of valuation has not been used, details of the tests made of the adequacy of the method used; and
 - (d) where in valuing contracts falling within the circumstances described in 8 of Appendix 5, future *premiums* brought into account are not in accordance with that rule, such additional information as is necessary to demonstrate whether the *mathematical reserves* determined in the aggregate for each of the main categories of contract are greater than an amount for each such category calculated in accordance with 6 to 16 in Appendix 5.
- (2) Where the *mathematical reserves* (after deduction of reinsurance cessions) determined in the aggregate for all categories of contracts referred to in (1)(d) represent less than 5% of the total *mathematical reserves* (after deduction of reinsurance cessions) for all *non-linked contracts*, it is sufficient for the actuary to state that the *mathematical reserves* for each such category of contracts are not less than the *mathematical reserves* that would be determined on a net *premium* reserving basis which, in that case, must be specified by the actuary in the abstract.
9. For each category of *linked long-term contract*:-
- (a) all assumptions made in calculating the valuation net liability in columns 12 and 13 of Form 53 and 54; and
 - (b) where an explicit reserve has not been made for meeting the expenses likely to be incurred in future in fulfilling the existing contracts on the basis of specific assumptions in regard to the relevant factors, details of the basis used in testing the adequacy of the reserves to satisfy 12(1) of Appendix 5.
10. (1) The assumed levels of inflation of expenses and the basis used in the valuation to allow for such future inflation.

- (2) The aggregate amount, grossed up for taxation where appropriate, arising during the twelve months after the *valuation date* from implicit and explicit reserves made in the valuation to meet expenses in fulfilling contracts in force at the *valuation date* and a general description of the sources of such amounts.
 - (3) The method and basis of calculation of the requirement (whether or not a reserve is thereby required) in respect of the expenses of continuing to transact new business during the twelve months following the *valuation date* and the amount of the reserve so calculated.
 - (4) The method and basis of calculation of the requirement (whether or not a reserve is thereby required) to provide for the costs of closure to new business, if the *friendly society* were to cease to transact new business twelve months after the *valuation date* and the amount of the reserve so calculated.
- 11.
- (1) A schedule of the sum of the *mathematical reserves* (other than liabilities for *property linked benefits*) and the liabilities in respect of deposits received from reinsurers as shown in Form 14, analysed by reference to the currencies in which the liabilities are expressed to be payable together with the value of the assets, analysed by reference to currency, which match such liabilities.
 - (2) In the schedule required by (1), liabilities totalling up to 2% of the total required to be analysed may be grouped together as "other currencies", and the assets matching those liabilities need not be analysed provided that the proportion of such liabilities which are matched by assets in the same currency is stated.
- 12.
- (1) For *long-term insurance business* ceded on a facultative basis to a reinsurer who is not authorised to carry on *insurance business* in the United Kingdom at any time during the period, the aggregate of *premiums* payable by the *friendly society* to all such reinsurers (divided according to *financial years*, if appropriate) and the aggregate amount deposited at the *valuation date* under any *deposit back arrangement*; and the amount of any such *premiums* payable by the *friendly society* to a reinsurer with whom the *friendly society* is connected and the aggregate amount deposited at the *valuation date* under any *deposit back arrangement*.
 - (2) For each treaty of reinsurance where the *friendly society* is the cedant and under which business is in force at the *valuation date* -
 - (a) the name of the reinsurer;
 - (b) whether the reinsurer is authorised to carry on *insurance business* in the United Kingdom;
 - (c) whether the *friendly society* and the reinsurer are connected;
 - (d) an indication of the nature and extent of the cover given under the treaty;

- (e) the *premiums* payable by the *friendly society* under the treaty during the period;
 - (f) the amount deposited at the *valuation date* in respect of the treaty under any *deposit back arrangements*;
 - (g) the extent to which provision has been made for any liability of the *friendly society* to refund any amounts of reinsurance commission in the event of lapses or surrender of the contract; and
 - (h) whether the treaty is closed to new business.
13. (1) Subject to (2), for each *with-profits fund*⁷, except where such information is provided elsewhere in the FSC 1 return -
- (a) a revenue account in the format of Form 40 with a supplementary note stating the amount, if any, of investment income relating to *linked assets* included in line 12; and
 - (b) a statement of liabilities and margins in the format of Form 14 with a supplementary note stating the amount, if any, of the increase or decrease, as the case may be, in the value of *non-linked assets*.
- (2) Where the amount (or part of the amount) of any increase or decrease in *non-linked assets* has yet to be allocated between *with-profits funds* or between one or more *with-profits funds* and other purposes, the information required by (1)(b) in aggregate for that amount or part amount, with a supplementary note which:
- (a) identifies the *with-profits funds* to which the information relates;
 - (b) provides the information in lines 11 to 49 of Form 14 separately in respect of each *with-profits fund*; and
 - (c) without prejudice to 14(2), describes the basis upon which increases or decreases in the value of *non-linked assets* are, or will be, allocated between the *with-profits funds* or between the *with-profits funds* and other purposes.
14. (1) The principles on which the distribution of profits among *policyholders* and members is based as described in any of the following documents:
- (a) the *memorandum*, if any, and the registered rules of the *friendly society*;
 - (b) *committee* resolutions of the *friendly society*;
 - (c) any policy or contract issued by the *friendly society*;
 - (d) any advertisement issued by or on behalf of the *friendly society*;

⁷ *With-profits fund* includes subfunds (whether notional or real).

- (e) any document required to be issued under the rules in the Conduct of Business Sourcebook or which was required to be issued by any regulatory body recognised under the Financial Services Act 1986; and
 - (f) any other relevant document.
- (2) For each *with-profits fund*, a description of the *friendly society's* policy and (insofar as it may be relevant to *policyholders'* reasonable expectations) its past practice as to:
- (a) how the *with-profits fund* is defined, which assets, liabilities, income and expense are allocated to it and how the amounts of such assets, liabilities, income and expense are determined;
 - (b) whether any non-profits *insurance business*, or any profit on it, is attributed to the *with-profits fund* and, if so, the nature and volume of such business;
 - (c) how assets within the *with-profits fund* are invested;
 - (d) the level of surplus or free reserves to be maintained in the *with-profits fund*; and
 - (e) the relationship between the performance of the *with-profits fund* and discretionary benefits allocated to *policyholders* including:
 - (i) whether an asset-share methodology, or equivalent methodology, is used or is to be used and, if so, how asset shares are calculated (including whether and how investment income, increases or decreases in the value of investments or other assets, expenses, miscellaneous surpluses and deficits, taxation and other items of income and expense are attributed to asset shares) and how they relate to the benefits actually allocated to *policyholders*;
 - (ii) an indication of how, under different scenarios as to the performance of the fund, discretionary benefits are to be smoothed from period to period;
 - (iii) the pattern of allocation for discretionary benefits over the life of a *with-profits policy*, including the balance between annual and terminal bonuses;
 - (iv) how fairness is maintained between different categories of policy and different categories of *policyholder* and between *policyholders* collectively and the *friendly society* itself; and
 - (v) any other factors which are material to the allocation of discretionary benefits to *policyholders*; and

- (f) the principles followed by the *friendly society* in setting actual proportions of profits distributed to *policyholders* and shareholders.
 - (3) A description of the methods used to ensure that the aims described in (2) are achieved.
 - (4) Subject to (5), if different principles or bonus policies apply to different categories of *with-profit policies* issued by the *friendly society*, the information in (1) to (3) must be given in respect of each category.
 - (5) Categories of *with-profits policies* which, apart from this paragraph would require separate information in accordance with (4) need only be listed under this paragraph, and the information in (1) to (3) need not be supplied, provided that
 - (a) the aggregate amount of *established surplus* allocated to *policyholders* in all such categories is less than 10% of the aggregate amount of *established surplus* allocated to all *policyholders* (as reported at line 46 of Form 58);
 - (b) the amount of *established surplus* allocated to *policyholders* in any one such category is less than 5% of the aggregate amount of *established surplus* allocated to all *policyholders* (as reported at line 46 of Form 58); and
 - (c) none of the categories was introduced during the period.
15. (1) Particulars of the bonus allocated to each category of contract, including the basis of calculation and the circumstances and the form in which the bonus is payable, together with -
- (a) where the rates of bonus allocated depend on the original term of the contract or on the period of years a contract has been in force, specimen rates at 5-year intervals of original term or duration, as the case may be;
 - (b) where the rates of bonus allocated depend on the age of the life assured, specimen rates at 10-year intervals of age;
 - (c) where the rates of bonus allocated depend on the date of each previous *premium* payment, specimen rates at 5-year intervals of time since the *premium* was paid, and for *premiums* paid in each of the five years ending with the current year; and
 - (d) in all other cases, full details of the rates of bonus allocated.
- (2) Where the rates of bonus allocated depend on a formula or a series of formulae, then the formula or formulae must be listed instead of the specimen rates. Wherever appropriate, rates of bonus are to be expressed as a fraction of the

attribute of the contract to which they are related, e.g. as rates per £1000 of the sum assured and existing bonuses.

- (3) Information required under (1) need not be provided for any category of contract -
 - (a) where no contracts were effected by the *friendly society* during the report period; and
 - (b) which has been included under the miscellaneous heading in Forms 51, 52, 53 or 54.
16. (1) A statement of practice regarding any bonus payments (in addition to those for which the *friendly society* had become contractually liable) to be made on *claims* arising in the period up to the next investigation, including the basis of calculation and the form in which the bonus is payable, together with -
 - (a) where the rates of bonus depend on the original term of the contract or on the period of years a contract has been in force, specimen rates at 5-year intervals of original term or duration, as the case may be;
 - (b) where the rates of bonus depend on the age of the life assured, specimen rates at 10-year intervals of age;
 - (c) where the rates of bonus depend on the date of each previous *premium* payment, specimen rates at 5-year intervals of time since the *premium* was paid, and for *premiums* paid in each of the five years ending with the current year; and
 - (d) in all other cases, full details of the rates of bonus.
- (2) Where the rates of bonus depend on a formula or a series of formulae, then the formula or formulae must be listed instead of the specimen rates. Wherever appropriate, rates of bonus are to be expressed as a fraction of the attribute of the contract to which they are related, e.g. as rates per £1000 of the sum assured and existing bonuses.

Form 46

17. (1) A statement in Form 46 summarising changes in *long-term insurance business* for all non-group contracts. Information is to be given gross of reinsurance ceded and must be provided separately for United Kingdom and overseas business, taxable and non-taxable business, and in each case for *non-linked contracts* and *linked long-term contracts*. For group contracts only the number of contracts in force at the end of the period is to be given in a note to the appropriate statement.
- (2) In Form 46 -

- (a) the figures for annual *premiums* must include repeated or recurrent single *premiums* where the level of *premium* is defined;
- (b) for *hybrid-linked contracts*, movements between linked and non-linked business must be shown in lines 13 and 27 as appropriate; and
- (c) only claim payments which result in the termination of a contract providing cover for other insured events must be shown in line 22.

Form 47

18. (1) Separate statements in the form set out in Form 47 analysing new *long-term insurance business* for United Kingdom business and overseas business, taxable and non-taxable business, and in each case for *non-linked contracts* and *linked long-term contracts*. New business must be shown gross of reinsurance ceded and must include increases to *premiums* on existing policies, and in dealing with such increases, columns 2 and 5 must be left blank.
- (2) Single *premium* contracts must consist of those contracts under which there is no expectation of continuing *premiums* being paid at regular intervals and additional single *premiums* paid in respect of existing individual contracts must be included. Regular *premium* contracts must include those contracts under which *premiums* are paid at regular intervals during the policy year, including repeated or recurrent single *premiums* where the level of *premium* is defined.
- (3) The information must be shown separately and totalled within each section in the sequence
- (i) tax exempt business
 - (ii) taxable business.
- (4) The information must be shown separately and totalled within each section in the sequence -
- (i) United Kingdom direct written business
 - (ii) United Kingdom reinsurance accepted
 - (iii) overseas direct written business
 - (iv) overseas reinsurance accepted.
- (5) The information is to be analysed and totalled within each type of business in the following sequence -
- (i) life assurance and general annuity business
 - (ii) pension business
 - (iii) permanent health business
 - (iv) other business.
- (6) The information is to be further analysed and sub-totalled in the following sequence –

- (i) *accumulating with-profit policies*
- (ii) *non-linked with-profits policies*
- (iii) *non-linked non-profit policies*
- (iv) *index linked contracts*
- (v) *other linked long-term contracts*

and where a policy falls within more than one of the categories, it must be placed in the first appropriate category.

- (7) Within each sub-division required under (5) and (6), the appropriate types of insurance from the following list are to be shown separately -
- (i) whole life assurance
 - (ii) endowment assurance
 - (iii) pure endowment assurance
 - (iv) term assurance
 - (v) other assurance (to be specified)
 - (vi) deferred annuity
 - (vii) annuity in payment
 - (viii) other annuity (to be specified)
 - (ix) permanent health insurance
 - (x) capital redemption assurance
 - (xi) annuity certain
 - (xii) group pension
 - (xiii) group life
 - (xiv) group permanent health
 - (xv) other group (to be specified).

- (8) In the case of group contracts, the information to be given is to relate to new contracts and increments under existing contracts. The amount of the increment under an existing contract must be taken to be the increase in the annual *premium* shown in Form 51, 52, 53 or 54 as appropriate, over the previous highest level shown in those Forms. Decreases in any year for an existing contract are to be ignored.

Forms 48 and 49

19. (1) Separate statements of *long-term insurance business assets* (other than assets held to match *property linked* or *index linked liabilities*) are to be given in Forms 48 and 49 in respect of each fund or group of funds for which separate assets are appropriated. The word "Total" or the name of the fund must be shown against the heading "Category of assets".
- (2) A brief description of the extent to which any of the amounts recorded in Form 48 would be changed if assets which the *friendly society* had a right or obligation to acquire or dispose of under *derivative contracts* or contracts having the effect of *derivative contracts* outstanding at the end of the period (being in the case of *options*, only those *options* which it would have been prudent to assume would be exercised) had been so acquired or disposed of.

- (3) A brief description of how different the information provided pursuant to (2) would have been if such *options* as were outstanding at the end of the period had been exercised in such a way as to change the amounts referred to in (2) to the maximum extent.
- (4) A brief description of how different the information provided pursuant to (2) and (3) would have been if, instead of applying to contracts outstanding at the end of the period, they had applied to *derivative contracts* outstanding at such other time during the period as would have changed the amounts referred to in (2) and (3) to the maximum extent.
- (5) In Form 48 -
- (a) the expected income is to be given as the amounts before deduction of tax which would be received in the next period on the assumption that the assets will be held throughout the period and that the factors which affect income will remain unchanged but account must be taken of any changes in those factors known to have occurred by the *valuation date* (in particular, changes of the type (a), (b), (c) or (d) denoted in 10(5) of Appendix 5). The expected income shown in this Form must be that determined before any adjustments considered necessary because of 10(6) or (7) of Appendix 5;
 - (b) where a particular asset is required to be taken into account only to a specified extent by the application of the admissibility limits, the expected income from that asset must be included only to the same extent;
 - (c) the treatment of the expected income from any asset where the payment of interest is in default and the amount of interest involved must be stated in a supplementary note;
 - (d) where the yield in column 3 for a type of asset shown in line 17, 18 or 19 of the Form (assumed to be zero for assets in line 19) is significantly different from the *weighted average of the yields* for each asset of that type determined in accordance with 10(7) of Appendix 5, then the latter yield figure must be shown in a note to the Form. For this purpose, the *weighted average of the yields* means an average yield weighted by the value of each asset of that type as entered in column 1; and
 - (e) where an entry at 13.87.1 has resulted from excess *exposure* to a *counterparty* or *excess concentration with a number of counterparties*, the aggregate value of the assets of the *friendly society* giving rise to *exposure* to such *counterparties* must be stated in a supplementary note, together with the expected income from those assets.
- (6) In Form 49 -
- (a) the gross redemption yield in columns 2 and 5 for each asset must be calculated as in 10(3), (4) and (6) of Appendix 5, leaving out of account

any adjustment considered necessary because of 10(7) of Appendix 5. Where a number of assets with different gross redemption yields are held, the weighted average gross redemption yield must be calculated using as weights the value of the asset applicable for entry into columns 1 and 4 respectively;

- (b) the value of admissible higher yielding assets to be shown in columns 3 and 6 must be the value of admissible assets as shown in Form 13 where the gross redemption yield on those assets exceeds the gross redemption yield shown in columns 2 and 5 respectively by at least 1.5%; and
- (c) where *securities* may be redeemed over a period at the option of the guarantor or the *issuer*, they must be classified on the assumption that they will be redeemed at the latest possible date or, if it is assumed that they will be redeemed at any earlier date, a note must be provided explaining what assumption has been made.

Forms 51, 52, 53 and 54

- 20. (1) Separate statements in Forms 51, 52, 53 and 54 and separate valuation summaries must be completed in respect of each separate fund or part of a fund for which a surplus is determined under rule 5.1.
- (2) Separate totals for column 5 on Form 51 and columns 5, 6 and 7 on Forms 52, 53 and 54 must be shown for sums insured, for annuities per annum and for other measures of benefit.
- (3) In relation to Forms 51, 52, 53 and 54 -
 - (a) information must be shown separately and totalled for each of the following -
 - (i) United Kingdom business
 - (ii) Overseas business;
 - (b) the information must be shown on separate pages and totalled for each type of business in the following sequence -
 - (i) life assurance and general annuity business - taxable
 - (ii) life assurance and general annuity business - non-taxable
 - (iii) pension business
 - (iv) permanent health business - taxable
 - (v) permanent health business - non-taxable
 - (vi) other business;
 - (c) the information is to be further analysed and sub-totalled for -
 - (i) direct written business
 - (ii) reinsurance accepted

(iii) reinsurance ceded

and totals net of reinsurance ceded are also to be shown, provided that where any information to be provided in accordance with (c)(iii) duplicates any information required to be provided in accordance with (d), (e) and (f) in respect of (c)(i) or (ii), then for the purpose of (c)(iii), the total of the reinsurance ceded may be shown in respect of the duplicated information;

(d) the information must be further analysed and sub-totalled within each basis of participation in profits in the following sequence -

- (i) *with-profits policies*
- (ii) *non-profit policies*;

(e) within each sub-division required under (b), (c) and (d) the appropriate types of insurance from the following list must be shown separately –

- (i) whole life assurance
- (ii) endowment assurance
- (iii) pure endowment assurance
- (iv) term assurance
- (v) other assurance (to be specified)
- (vi) miscellaneous assurance
- (vii) deferred annuity
- (viii) annuity in payment
- (ix) other annuity (to be specified)
- (x) miscellaneous annuity
- (xi) permanent health insurance
- (xii) capital redemption assurance
- (xiii) annuity certain,
- (xiv) group pension
- (xv) group life
- (xvi) group permanent health
- (xvii) other group (to be specified)

and particulars must also be shown of any subsidiary provisions within *general insurance business class 1 or 2*;

(f) a further sub-division into each separate category of contract is required as follows -

- (i) Forms 51 and 52 - each category of contract which is valued on a different valuation basis;
- (ii) Form 53 - each category of contract which provides different guarantees or options, and each category of unit link. For the purpose of determining the category of the unit link, all authorised unit trusts may be considered to be one category and all *internal linked funds* may be considered to be one category;

- (iii) Form 54 - each category of contract which provides different guarantees or options, and each category of index. Where the link is to a proportion of an index each different proportion must be treated as a different category;
- (g) any contract which consists of a combination of different types of insurance, as described in (e), must be treated as a number of separate contracts each dealing with one of the different types of insurance so combined and the amount by which the total number of contracts shown in column 4 of any valuation summary exceeds the actual number of contracts to which that valuation summary relates must be stated in a supplementary note;
- (h) for *linked contracts* with both *property linked* and *index linked benefits*, each benefit must be shown on Form 53 or 54 as appropriate, and a note must be attached describing the manner in which details relating to the number of contracts and the amounts of benefits, *premiums* and other liabilities have been treated. Where the number of contracts is overstated in aggregate, the amount of the overstatement must be stated in a supplementary note;
- (i) for *linked contracts* which are also *accumulating with-profits policies*, that part of the benefits which are with-profits must be shown on Form 52 and the remainder of the benefits on Form 53 and/or 54 as appropriate, and a note must be attached describing the manner in which details relating to the number of contracts and the amounts of benefits, *premiums* and other liabilities have been treated. Where the number of contracts is overstated in aggregate, the amount of the overstatement must be stated in a supplementary note;
- (j) reserves calculated on an aggregate basis (including reserves for taxation on capital gains, for investment performance guarantees or other special reserves) or adjustments must be shown on separate lines in the *mathematical reserves* column and the particulars of such reserves or adjustments must be specified;
- (k) contracts the nature of which or the method of valuation of which makes it impossible or inappropriate to give the information in the exact form required by Forms 51, 52, 53 and 54 must be shown on a separate valuation summary with appropriately modified column headings and the reason for the modification stated in a supplementary note; and
- (l) where a net premium method of valuation is not used for contracts reported on Form 51 then, notwithstanding (k)–
 - (a) columns 7 and 8 must be left blank;
 - (b) if the method used does not separately identify suitable values to be entered in columns 9 and 10, then the total amount of

mathematical reserves must be entered in columns 9 and 12, and columns 10 and 11 must be left blank; and

- (c) if the method used does separately identify suitable values to be entered in columns 9 and 10, then the entry in column 11 must be the amount entered in column 10 less the amount reserved for future expenses, so that the amount in column 12 equals the amount in column 9 less the amount in column 11.

Forms 55 and 56

- 21. (1) Separate analyses of unit liabilities in Forms 55 and 56 in respect of each separate fund or part of a fund for which a surplus is determined under rule 5.1.
- (2) The analyses of unit liabilities must also include liability in respect of any amounts deposited with the *friendly society* under a *deposit back arrangement* which are either unit liabilities in respect of *property linked benefits* or investment liabilities in respect of *index linked benefits*.
- (3) In the event that the liability for a specific fund link is wholly reinsured so that entries in columns 8 and 9 of Form 55 are omitted in accordance with (4)(g), if such be the case, a statement to the effect that the provisions of rule 4.11 have been complied with in accordance with any published guidance in relation to the liabilities so reinsured.
- (4) In Form 55 -
 - (a) separate Forms must be prepared in respect of *internal linked funds* and directly held assets;
 - (b) separate line must be used for each asset to which benefits are linked and each different type of unit of each *internal linked fund*;
 - (c) columns 5, 6, 7, 8, 9 and 10 must be sub-totalled for each fund link and totalled for all links;
 - (d) the aggregate of the total figures shown for column 8 (excluding any amount shown in column 8 pursuant to (h)) and 9 in each Form prepared in respect of a separate fund or part of a fund must equal the appropriate figure shown as the total of column 12 of Form 53;
 - (e) for links to directly held assets, column 6 must not be used;
 - (f) for *internal linked funds*, the total of column 5 must equal the total of column 8 of the summarised Form 43, and the total of column 6 must equal the total of column 3 of the summarised Form 43;
 - (g) where the liability shown in column 11 of Form 53 for a specific fund link is wholly reinsured with a reinsurer, being an insurer (other than an EEA firm) with permission under the Act to effect or carry out contracts

of reinsurance or another *friendly society*, so that entries in columns 8 and 9 of this Form would otherwise be identical, the entries in respect of that fund link must be aggregated and shown on a separate line with the name of the fund link to be shown in column 1 as "wholly reinsured"; and

- (h) any amounts included in this analysis in accordance with (2), being unit liabilities in respect of *property linked benefits* deposited with the *friendly society* under a *deposit back arrangement*, must (for each *internal linked fund* or directly held asset), be shown on a separate line with the name of the unit type to be shown in column 2 as "amounts deposited back".

(5) In Form 56 -

- (a) assets and liabilities in column 2 must be listed individually except that where a group of assets of similar type is held which is intended to mirror the performance of an index, a description of the type of assets held may be given. Liabilities must be shown between round brackets and must be fully described;
- (b) a separate sub-total of assets and liabilities must be used for each index link and for each combination of assets and liabilities matching the *friendly society's* liability under any *deposit back arrangement*. Links to different percentages of an index must be treated as different index links;
- (c) for each index link, the sub-totalled values in column 2 (excluding those held in respect of any *deposit back arrangement*) must match the appropriate entries in column 12 of Form 54 net of reinsurance ceded;
- (d) assets and liabilities arising from *derivative contracts* (or contracts or assets which have the effect of a *derivative contract*) must be shown separately. Amounts must be shown net of *variation margin* in column 2 and gross of *variation margin* in column 3. Rights to recover assets transferred by way of *initial margin* must not be shown on Form 56;
- (e) where there is a liability to repay *variation margin* and there are no arrangements for netting of amounts outstanding or the arrangements would not permit the accounting of such amounts on a net basis in accordance with generally accepted accounting practice, it must be so stated in a supplementary note to the Form; and
- (f) any provision for adverse changes must be determined in accordance with 4 of Appendix 5 and shown in a supplementary note to the Form.

Form 57

22. (1) Separate statements in Form 57 for each fund or group of funds for which separate assets are appropriated in respect of all *long-term liabilities* except -

- (a) the unit liabilities in respect of *property linked benefits* as shown in column 12 of Form 53;
 - (b) the investment liabilities in respect of *index linked benefits* as shown in column 12 of Form 54;
 - (c) any reserve in respect of provisions made for tax on unrealised capital gains in arriving at the valuation price of *internal linked funds*; and
 - (d) the liabilities in respect of any amounts deposited with the *friendly society* under a *deposit back arrangement* which are either unit liabilities in respect of *property linked benefits* or investment liabilities in respect of *index linked benefits*.
- (2) A general description of the method by which the yield on assets other than equity *shares* and land was adjusted in accordance with 10(7) of Appendix 5.
- (3) For assets which are equity *shares* or land, a description of the categories into which such assets were divided for the purposes of 10(7) of Appendix 5, together with the method and basis by which the yield on such assets was adjusted in accordance with that rule.
- (4) In relation to Form 57 -
- (a) a separate Form must be completed in respect of each fund or group of funds for which separate assets are appropriated. The word "Total" or the name of the fund must be shown against the heading "Category of assets";
 - (b) separate Forms must be prepared for sterling and non-sterling liabilities;
 - (c) separate Forms are required for with-profit and non-profit contracts within the following types of business -
 - (i) life assurance and annuity business
 - (ii) pension business
 - (iii) permanent health business
 - (iv) other business;
 - (d) separate Forms are required for each rate of interest used in the valuation in pursuance of 10(12) of Appendix 5 and may include all contracts valued at the same rate, subject to (b) and (c). Contracts valued at a lower rate of interest but subject to the same apportionment of assets may also be included provided that the rationale for such inclusion is given in a supplementary note. Each of the valuation rates of interest used must be shown against the heading "Rate of interest". The highest valuation rate of interest used must be shown in line 31 or 32 as appropriate;

- (e) the Forms specified in (a), (b), (c) and (d) must exclude the liabilities described in (1)(a) to (d) and must cover at least 90% of the remaining *long-term liabilities*. The balance of the remaining *long-term liabilities* must be shown in a separate Form in which lines 31 and 32 must be left blank, and details of the contracts covered by the Form must be given in a supplementary note to the Form. The word "Balance" must be shown against the heading "Rate of interest";
- (f) a summary of all the separate Forms must be produced as a separate Form in which lines 31 and 32 must be left blank. The word "Total" must be shown against the heading "Rate of interest";
- (g) the risk adjusted yield in columns 2 and 6 for each asset included in column 1 and 5 respectively must be that calculated as in 10(3) to (6) of Appendix 5, taking account of any adjustment considered necessary because of 10(7) of Appendix 5. Where a number of assets with different risk adjusted yields are held, the weighted average risk adjusted yield must be calculated using as weights the value of the asset applicable for entry into columns 2 and 6;
- (h) the value of each asset included in column 1 must be the value attributed to it in Form 13 and the assets will be grouped according to Note 1 to Form 48 including adjustments in respect of accrued interest as required by that Note;
- (i) where the valuation has been carried out at a net rate or rates of interest the figure in line 31 must be the net rate grossed up at the corresponding effective rate of tax in respect of the highest valuation rate of interest used in the Form;
- (j) the mathematical reserve in line 33 must include any increase in reserve resulting from the bonus declaration for the year and must be net of reinsurance ceded;
- (k) the entries shown at columns 3, 4, 5 and 6 must be those applicable to the scenario described in the answer to 7(8). The entries in column 3 must be the value of the assets shown in column 1 according to the changed assumptions of that scenario. The entries in column 4 must be the value of assets on the changed assumptions for each type of asset notionally re-allocated to cover the mathematical reserve or other liability, net of reinsurance, in the resilience scenario. The entries in column 5 must equal the sum of the entries in columns 3 and 4; and
- (l) the entries in line 29, column 1 must equal the entries in line 33, column 1. The entries in line 29, column 5 must not be less than the entries in line 33, column 5.

Form 58

23. (1) Separate statements of the results of the valuation in Form 58 in respect of each separate fund or part of a fund for which a surplus is determined under rule 5.1.
- (2) In relation to Form 58 -
- (a) where interim, mortuary or terminal bonuses are determined in advance of a valuation and are paid in anticipation of surplus arising at the valuation, the amounts of such bonus actually paid in the period up to *valuation date* must be entered in lines 12 and 41. To the extent that it is the practice of the *friendly society* to make specific provision for the cost of such bonuses payable on future *claims* out of surplus arising at a valuation, such amounts must be treated as amounts allocated to *policyholders* and members at the valuation in question and included in line 44 and the actual amounts paid must not appear at lines 12 and 41 at future valuations. An appropriate note must be appended identifying the various items where necessary; and
- (b) where policies have been transferred from one fund to another, the associate transfer of reserves must not be included as a "transfer" in this Form. Where any other transfer has been made, only one positive figure must be inserted in either line 15 or line 34 (depending on the direction of the net transfer) leaving the other line blank.

Forms 60 and 61

24. (1) A statement of the *required minimum margin* for *long-term insurance business* in Form 60 and of the *required margin of solvency* for the subsidiary provisions in Form 61.
- (2) If the gross annual office *premiums* for the subsidiary provisions in force on the *valuation date* do not exceed 1% of the gross annual office *premiums* in force on that date for all *long-term insurance business*, Form 61 need not be completed provided it can be stated that the entry in line 51 of Form 60 exceeds the amount that would be obtained if Form 61 were to be completed. In this circumstance, the method of estimating the entry in line 51 of Form 60, together with a statement of the gross annual office *premiums* in force at the *valuation date* in respect of the subsidiary provisions, must be given.

Appendix 10

Prudential Reporting Forms

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Prudential Reporting Forms

FSC1 Return

Long Term Insurance Business: Annual Investigation

FORM FSC 1

Register Number

Year ended 31 December

Name of
Society
(as registered)

Registered
Office

Post Code:

The information provided in this FSC1 Return (Long Term Insurance Business: Annual Investigation), and the Actuary's certificate and Auditor's report included herein are the form and contents of an abstract under rule 5.1(2) for use by a directive friendly society or a non-directive incorporated friendly society (other than a flat rate benefits business friendly society) in respect of its long-term insurance business.

One copy of the Return must be signed by the appointed actuary, the chief executive, the secretary and one committee member of the society (or two members of the committee if the offices of chief executive and secretary are held by the same person).

Three copies of this Return (including the original signed copy) must be submitted as soon as possible after 31 December and not later than the following 30 June to:-

The Financial Services
Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

FSC 1 – CONTENTS (SHEET 1)

Return under the Friendly Societies Prudential Rules

Long term insurance business: Annual Investigation
Summary sheet of completed forms submitted

Name of Society

Period ended 31 December

	Reg No
<input style="width: 80%; height: 20px;" type="text"/>	<input style="width: 80%; height: 20px;" type="text"/>

Where appropriate, certain Forms need to be copied in order to furnish separate details of business in the same format (e.g. the same Form completed separately for tax-exempt or taxable business). Where a Form is completed, please enter the total number of such forms in the corresponding box in the third column below. Where no Form is completed, please enter NIL. Where an additional summary form has been completed, please indicate YES in the fourth column.

Form Number	Details on Form	Number completed	Summary form used
Form 9	Statement of solvency	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 13	Analysis of admissible assets	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 14	Long term insurance business : Liabilities and margins	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 15	Liabilities (other than long term insurance business)	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 17	Analysis of derivative contracts	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 40	Long term insurance business : Revenue account fund	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 40A	Other revenue account fund	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 40B	Management fund	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 40C	Members surplus and savings accounts	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 41	Analysis of premiums and expenses	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 42	Analysis of claims	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 43	Summarised balance sheet for internal linked funds	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 44	Aggregate revenue account for internal linked funds	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 45	Supplementary information for internal linked funds	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>

Return under the Friendly Societies Prudential Rules

Long term insurance business: Annual Investigation

Summary sheet of completed forms submitted

Form Number	Details on Form	Number completed	Summary form used
Form 46	Summary of changes in long term insurance business		
Form 47	Analysis of new long term insurance business		
Form 48	Expected income from admissible assets not held to match liabilities in respect of linked liabilities		
Form 49	Analysis of admissible fixed interest securities not held to match liabilities in respect of linked liabilities		
Form 51	Valuation summary of non-linked contracts (other than accumulating with-profits policies)		
Form 52	Valuation summary of accumulating with-profit policies		
Form 53	Valuation summary of property linked contracts		
Form 54	Valuation summary of index linked contracts		
Form 55	Analysis of unit liabilities and assets in respect of property linked benefits		
Form 56	Analysis of assets and liabilities in respect of index linked benefits		
Form 57	Matching Rectangle		
Form 58	Valuation result and distribution of surplus		
Form 60	Required minimum margin		
Form 61	Subsidiary provisions		
Form 61A	Descriptive section of actuarial investigation		
Form 61B	Actuary's certificate		
Form 61C	Auditor's report		
Form 61D	Signatures of officers and actuary		

FSC 1 – FORM 9

Returns under the Friendly Societies Prudential Rules

Statement of solvency

Name of Society

Period ended 31 December

	Reg No	Units £/£000

		1 As at the end of the year	2 As at the end of the previous year
Total available assets (Note 1)	10		
GENERAL INSURANCE BUSINESS			
Other than long term insurance business assets allocated towards general insurance business required minimum margin	11		
Implicit items valued in accordance with a waiver under section 148 of the Act	11a		
Required minimum margin for general insurance business	12		
Excess (deficiency) of available assets over the required minimum margin (11+11a – 12)	13		
LONG TERM INSURANCE BUSINESS			
Long term insurance business admissible assets	21		
Other than long term insurance business assets allocated towards long term insurance business required minimum margin	22		
Total mathematical reserves (after distribution of surplus) (Note 2)	23		
Other insurance and non-insurance liabilities (Note 3)	24		
Available assets for long term insurance business required minimum margin (21 + 22 – 23 – 24)	25		
Implicit items valued in accordance with a waiver under section 148 of the Act			
Future profits	31		
Zillmerising	32		
Hidden reserves	33		
Total of available assets and implicit items (25 + 31 + 32 + 33)	34		
Required minimum margin			
Required minimum margin for long term insurance business (Note 4)	41		
Explicit required minimum margin (1/6 x Line 41, or minimum guarantee fund if greater)	42		
Excess (deficiency) of available assets over explicit required minimum margin (25 – 42)	43		
Excess (deficiency) of available assets and implicit items over the required minimum margin (34 – 41)	44		
CONTINGENT LIABILITIES			
Quantifiable contingent liabilities in respect of other than long term insurance business (Note 5)	51		
Quantifiable contingent liabilities in respect of long term insurance business (Note 5)	52		

FSC 1 – Notes to Form 9

1

The entry at line 10 must be equal to the sum of entries at line 89 in Form 13.

2

The entry at line 23 must be equal to the sum of lines 11, 19b and 63 in Form 14.

3

The entry at line 24 must be equal to the sum of lines 12 and 49 in Form 14 less line 19b in Form 14.

4

The entry at line 41 must be equal to the entry at line 69 in Form 60.

5

Particulars to be specified by way of supplementary note.

Returns under the Friendly Societies Prudential Rules

Analysis of admissible assets

Name of Society

--

Period ended 31 December

	Reg No	Units £/£000

Category of assets / Total

--

1 As at the end of year

2 As at the end of the previous year

INVESTMENTS:

Land and Buildings			11			
Investments in associated bodies	UK insurance dependants	Shares	21			
		Debts securities issued by, and loans to, dependants	22			
	Other insurance dependants	Shares	23			
		Debts securities issued by, and loans to, dependants	24			
	Non insurance dependants	Shares	25			
		Debts securities issued by, and loans to, dependants	26			
	Other associated bodies	Shares	27			
		Debts securities issued by, and loans to, associated bodies	28			
	TOTAL (11 to 28)			39		
	Other financial investments	Equity shares		41		
Others shares and other variable yield securities		42				
Holdings in collective investment schemes		43				
Rights under derivative contracts		44				
Debt securities and other fixed income securities		Fixed interest	Approved Securities	45		
			Other	46		
		Variable interest	Approved securities	47		
			Other	48		
Participation in investment pools		49				
Loans secured by mortgages		50				
Other loans		Loans to public or local authorities and nationalised industries or undertakings		51		
		Loans secured by policies of insurance issued by the society		52		
		Other		53		
Deposits with approved credit institutions and approved financial institutions		Withdrawal subject to a time restriction of one month or less		54		
		Withdrawal subject to a time restriction of more than one month		55		
Other		56				

FSC 1 – FORM 13 (Sheet 2)

Returns under the Friendly Societies Prudential Rules

Analysis of admissible assets

Name of Society

--

Period ended 31 December

	Reg No	Units £/£000

Category of assets/Total

--

1 As at the end of the year

2 As at the end of the previous year

INVESTMENTS AND OTHER ASSETS:

Deposits with ceding undertakings		57		
Assets held to match linked liabilities	Index linked	58		
	Property linked	59		
Reinsurer's share of technical provisions	Provision for unearned premiums	60		
	Claims outstanding	61		
	Provision for unexpired risks	62		
	Other	63		
TOTAL (41 to 63)		69		
Debtors arising out of direct insurance operations	Policyholders	71		
	Intermediaries	72		
Debtors arising out of reinsurance operations	Due from ceding insurers and intermediaries under reinsurance business accepted	74		
	Due from reinsurers and intermediaries under reinsurance contracts ceded	75		
Other debtors	Due from dependants	Due in 12 months or less after the end of the financial year	76	
		Due more than 12 months after the financial year	77	
	Other	Due in 12 months or less after the end of the financial year	78	
		Due more than 12 months after the end of the financial year	79	
Tangible assets		80		
Cash at bank and in hand	Deposits not subject to time restriction on withdrawal, with approved credit institutions and approved financial institutions and local authorities	81		
	Cash in hand	82		
Other assets (particulars to be specified by way of supplementary note)		83		
Prepayments and accrued income	Accrued interest and rent	84		
	Deferred acquisition costs	85		
	Other prepayments and accrued income	86		

FSC 1 – FORM 13 (Sheet 3)

Returns under the Friendly Societies Prudential Rules

Analysis of admissible assets

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 50%; height: 20px;" type="text"/>	<input style="width: 50%; height: 20px;" type="text"/>	<input style="width: 50%; height: 20px;" type="text"/>

Category of assets / Total

1 As at the end of the year

2 As at the end of the previous year

Deductions (under rules 15(2)(b) and 15(3) of Appendix 4) from the aggregate value of assets	87	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Total (71 to 86 less 87)	88	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Grand total of admissible assets (39 + 69 + 88)	89	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>

**RECONCILIATION TO ASSET VALUES
DETERMINED IN ACCORDANCE WITH
ACCOUNTS REGULATIONS (Note 1):**

Total admissible assets (as per line 89 above)	91	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Total assets in excess of the admissibility limits of Appendix 4 (as valued in accordance with those rules before applying admissibility limits) (Note 2)	92	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
[deleted]	93	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Other differences in the valuation of assets (other than for assets not valued above)	94	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Assets of a type not valued above (as valued in accordance with the Accounts Regulations (Note 3))	95	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Total assets determined in accordance with the Accounts Regulations (91 to 95)	99	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Amounts included in line 89 attributable to debts due from associated bodies, other than those under contracts of insurance or reinsurance	100	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>

FSC 1 – Notes to Form 13

1

The Accounts Regulations refer to the Friendly Societies (Accounts and Related Provisions) Regulations 1994.

2

The admissibility limits are those applied under Annex B to Appendix 4.

3

‘Assets of a type not valued above’ refers to assets left out of account under rule 2(3) of Appendix 4.

Returns under the Friendly Societies Prudential Rules

Long term insurance business liabilities and margins

Name of Society

--

Period ended 31 December

	Reg No	Units £/£000

Category of assets/Total

--

1 As at the end of the year

2 As at the end of the previous year

<table border="1" style="width: 100%;"> <tr> <td style="width: 80%;">Mathematical reserves after distribution of surplus (Note 1)</td> <td style="width: 20%; text-align: center;">11</td> </tr> <tr> <td>Cash bonuses which had not been paid to policyholders prior to end of the financial year (Note 2)</td> <td style="text-align: center;">12</td> </tr> <tr> <td>Balance of surplus/valuation deficit ((Note 3)</td> <td style="text-align: center;">13</td> </tr> <tr> <td>Long term insurance business fund carried forward (11 to 13) (Note 4)</td> <td style="text-align: center;">14</td> </tr> <tr> <td rowspan="3">Claims outstanding which had fallen due for payment before the end of the financial year</td> <td style="text-align: center;">15</td> </tr> <tr> <td style="text-align: center;">16</td> </tr> <tr> <td style="text-align: center;">17</td> </tr> <tr> <td>Management Fund – Balance – surplus/ (deficit) (Note 5)</td> <td style="text-align: center;">19a</td> </tr> <tr> <td rowspan="2">Members' surplus and savings accounts</td> <td style="text-align: center;">19b</td> </tr> <tr> <td style="text-align: center;">19c</td> </tr> <tr> <td>Other Revenue Account funds (Note 7)</td> <td style="text-align: center;">19d</td> </tr> <tr> <td rowspan="2">Provisions for other risks and charges</td> <td style="text-align: center;">21</td> </tr> <tr> <td style="text-align: center;">22</td> </tr> <tr> <td>Deposits received from reinsurers</td> <td style="text-align: center;">23</td> </tr> <tr> <td rowspan="8">Creditors and other liabilities</td> <td style="text-align: center;">31</td> </tr> <tr> <td style="text-align: center;">32</td> </tr> <tr> <td style="text-align: center;">33</td> </tr> <tr> <td style="text-align: center;">34</td> </tr> <tr> <td style="text-align: center;">35</td> </tr> <tr> <td style="text-align: center;">36</td> </tr> <tr> <td style="text-align: center;">37</td> </tr> <tr> <td style="text-align: center;">38</td> </tr> <tr> <td>Accruals and deferred income</td> <td style="text-align: center;">39</td> </tr> <tr> <td>Provision for adverse changes</td> <td style="text-align: center;">41</td> </tr> <tr> <td>Total other insurance and non-insurance liabilities (17 to 41)</td> <td style="text-align: center;">49</td> </tr> </table>	Mathematical reserves after distribution of surplus (Note 1)	11	Cash bonuses which had not been paid to policyholders prior to end of the financial year (Note 2)	12	Balance of surplus/valuation deficit ((Note 3)	13	Long term insurance business fund carried forward (11 to 13) (Note 4)	14	Claims outstanding which had fallen due for payment before the end of the financial year	15	16	17	Management Fund – Balance – surplus/ (deficit) (Note 5)	19a	Members' surplus and savings accounts	19b	19c	Other Revenue Account funds (Note 7)	19d	Provisions for other risks and charges	21	22	Deposits received from reinsurers	23	Creditors and other liabilities	31	32	33	34	35	36	37	38	Accruals and deferred income	39	Provision for adverse changes	41	Total other insurance and non-insurance liabilities (17 to 41)	49			
Mathematical reserves after distribution of surplus (Note 1)	11																																									
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Accruals and deferred income	39																																									
Provision for adverse changes	41																																									
Total other insurance and non-insurance liabilities (17 to 41)	49																																									

FSC 1 – FORM 14 (Sheet 2)

Returns under the Friendly Societies Prudential Rules

Long term insurance business liabilities and margins

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 50px; height: 20px;" type="text"/>	<input style="width: 50px; height: 20px;" type="text"/>	<input style="width: 50px; height: 20px;" type="text"/>

Category of assets/Total

1 As at the end of the year

2 As at the end of the previous year

Excess of the value of net admissible assets (Note 8)	51	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Total liabilities and margins	59	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Amount included in line 59 attributable to liabilities to associated bodies, other than those under contracts of insurance or re-insurance	61	<input style="width: 90%; height: 40px;" type="text"/>	<input style="width: 90%; height: 40px;" type="text"/>
Amount included in line 59 attributable to liabilities in respect of property linked benefits	62	<input style="width: 90%; height: 40px;" type="text"/>	<input style="width: 90%; height: 40px;" type="text"/>
Amount of any additional mathematical reserves included in line 51 which have been taken into account in the appointed actuary's certificate (Note 9)	63	<input style="width: 90%; height: 60px;" type="text"/>	<input style="width: 90%; height: 60px;" type="text"/>

FSC 1 – Notes to Form 14

- 1** The entry at lines 11 and 19b must equal the sum of lines 21, 43, 44 and 45 of the corresponding Form or Forms 58.
- 2** The entry at line 12 must equal the total of line 42 of the corresponding Form or Forms 58.
- 3** The entry at line 13 must equal the total of line 49 of the corresponding Form or Forms 58.
- 4** The entry at line 14 must equal the total of line 59 of the corresponding Form or Forms 40.
- 5** The entry at line 19a must equal the entry at line 49 on Form 40B.
- 6** The entry at lines 19b and 19c must equal the sum of the entries at line 59 on Form 40C.
- 7** The entry at line 19d must equal the entry at line 69 on Form 40A.
- 8** The entry at line 51 must be:
 - (a) the value of the admissible assets (as included in line 89 of the appropriate Form 13) representing the long term insurance business funds, fund or group of funds to which the Form relates, less
 - (b) the amount of those funds, fund or group of funds, being the sum of the amounts shown at lines 14 and 49.
- 9** The entry at line 63 must be the amount specified in paragraphs (a)(ii) of *the appointed actuary's* certificate (Form 61B), but only insofar as it relates to the fund, funds or group of funds to which this Form 14 relates.

Returns under the Friendly Societies Prudential Rules

Liabilities (Other than long term insurance business)

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 60%; height: 20px;" type="text"/>	<input style="width: 60%; height: 20px;" type="text"/>	<input style="width: 60%; height: 20px;" type="text"/>

Class of Business (as in Part III of Chapter 7)

			1 As at the end of the year	2 As at the end of the previous year	
Technical provisions (gross amount)	Provision for unearned premiums (Note)		11	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Claims outstanding		12	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Provision for unexpired risks		13	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Other		16	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Total (11 to 16)		19	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Provisions	Taxation		21	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Other		22	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Deposits received from reinsurers			31	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Creditors	Arising out of insurance operations	Direct business	41	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
		Reinsurance accepted	42	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
		Reinsurance ceded	43	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Debenture loans	Secured	44	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
		Unsecured	45	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Amounts owed to credit institutions		46	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Other creditors	Taxation	47	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
		Other	49	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Accruals and deferred income			51	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Total (19 to 51)			59	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Provision for adverse changes			61	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Total (59 + 61)			69	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Amounts included in line 69 attributable to liabilities to associated bodies other than those under contracts of insurance or reinsurance			71	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>

NOTE The amounts shown in lines 11 to 13 and 16 must be stated gross of the reinsurer's share.

FSC 1 – FORM 17

Returns under the Friendly Societies Prudential Rules

Analysis of derivative contracts (other than those relating to property linked contracts or index linked benefits)

Name of Society

Period ended 31 December 19

	Reg No	Units £/£000
<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>

Business: Long Term/Other than long term

As at the end of the year

As at the end of the previous year

Category of assets/Total

Assets

Liabilities

Assets

Liabilities

1

2

3

4

Derivative Contracts

Futures Contracts	Fixed-interest securities	11	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Equity shares	12	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Land	13	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Currencies	14	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Other	15	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Options	Fixed-interest securities	21	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Equity shares	22	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Land	23	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Currencies	24	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Other	25	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Contracts for Differences	Fixed-interest securities	31	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Equity shares	32	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Land	33	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Currencies	34	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Other	35	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Adjustments for variation margin		41	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Total (11 to 41) (Note)		49	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>

NOTE

The entry at line 49.1 must be included at Form 13.44.1 and the entry at line 49.2 must be included at Form 14.38.1 or 15.49.1 as appropriate.

FSC 1 – FORM 40

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Revenue account fund

Name of Society

Period ended 31 December

Reg No	Units £/£000	OB/IB	No of fund/ Summary	No of part of fund
<input style="width: 60px; height: 25px;" type="text"/>	<input style="width: 60px; height: 25px;" type="text"/>	<input style="width: 60px; height: 25px;" type="text"/>	<input style="width: 60px; height: 25px;" type="text"/>	<input style="width: 60px; height: 25px;" type="text"/>

Name of Fund/Summary

1 This year

2 Previous year

**ITEMS TO BE SHOWN NET OF
REINSURANCE CEDED**

Earned premiums (Note 1)	11	<input style="width: 90%; height: 25px;" type="text"/>	<input style="width: 90%; height: 25px;" type="text"/>
Investment income receivable before deduction of tax	12	<input style="width: 90%; height: 25px;" type="text"/>	<input style="width: 90%; height: 25px;" type="text"/>
Increase (decrease) in the value of non-linked assets brought into account	13	<input style="width: 90%; height: 25px;" type="text"/>	<input style="width: 90%; height: 25px;" type="text"/>
Increase (decrease) in the value of linked assets	14	<input style="width: 90%; height: 25px;" type="text"/>	<input style="width: 90%; height: 25px;" type="text"/>
Amounts transferred from other revenue account funds (Note 2)	14a	<input style="width: 90%; height: 25px;" type="text"/>	<input style="width: 90%; height: 25px;" type="text"/>
Other income (Note 2)	15	<input style="width: 90%; height: 25px;" type="text"/>	<input style="width: 90%; height: 25px;" type="text"/>
Total income (11 to 15)	19	<input style="width: 90%; height: 25px;" type="text"/>	<input style="width: 90%; height: 25px;" type="text"/>
Claims incurred (Note 1)	21	<input style="width: 90%; height: 25px;" type="text"/>	<input style="width: 90%; height: 25px;" type="text"/>
Amounts transferred to Management Fund (Note 2)	22	<input style="width: 90%; height: 25px;" type="text"/>	<input style="width: 90%; height: 25px;" type="text"/>
Interest payable before deduction of tax	23	<input style="width: 90%; height: 25px;" type="text"/>	<input style="width: 90%; height: 25px;" type="text"/>
Taxation	24	<input style="width: 90%; height: 25px;" type="text"/>	<input style="width: 90%; height: 25px;" type="text"/>
Other expenditure (Note 2)	25	<input style="width: 90%; height: 25px;" type="text"/>	<input style="width: 90%; height: 25px;" type="text"/>
Amounts transferred to other Revenue Account Funds (Note 2)	26	<input style="width: 90%; height: 25px;" type="text"/>	<input style="width: 90%; height: 25px;" type="text"/>
Total expenditure (21 to 26)	29	<input style="width: 90%; height: 25px;" type="text"/>	<input style="width: 90%; height: 25px;" type="text"/>
Increase (decrease) in fund in year (19 – 29)	39	<input style="width: 90%; height: 25px;" type="text"/>	<input style="width: 90%; height: 25px;" type="text"/>
Fund brought forward	49	<input style="width: 90%; height: 25px;" type="text"/>	<input style="width: 90%; height: 25px;" type="text"/>
Fund carried forward (39 + 49)	59	<input style="width: 90%; height: 25px;" type="text"/>	<input style="width: 90%; height: 25px;" type="text"/>

NOTES

1. The entry at 40.11.1 must equal the sum of 41.19.3 + 41.29.3
The entry at 40.21.1 must equal 42.59.3

2. Particulars to be specified by way of note.

FSC 1 – FORM 40A

Returns under the Friendly Societies Prudential Rules

Other revenue account fund

Name of Society

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Period ended 31 December

	Reg No	Units £/£000	OB/IB	No of fund/ Summary	No of part of fund

Name of Fund/Summary

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1 This year

2 Previous year

Amounts receivable (Note)	11		
Investment income		14	
	Income		
	Value re-adjustments on investments	15	
	Gains on the realisation of investments	16	
Investment charges	Investment management charges, including interest	17	
	Value re-adjustments on investments	18	
	Loss on the realisation of investments	19	
Increase (decrease) in the value of assets brought into account	21		
Amounts transferred from other revenue account funds (Note)	22		
Total income (11 to 22)	29		
Amounts payable (Note)	31		
Amounts transferred to Management Fund	32		
Taxation	33		
Amounts transferred to other revenue account funds (Note)	34		
Other expenditure (Note)	35		
Total expenditure and transfers (31 to 35)	39		
Increase (decrease) in fund in year (29 – 39)	49		
Fund brought forward	59		
Fund carried forward (49 + 59)	69		

NOTE Particulars to be specified by way of note.

FSC 1 – FORM 40B

Returns under the Friendly Societies Prudential Rules

Management fund

Name of Society

Period ended 31 December

	Reg No	Units £/£000	OB/IB
<input style="width: 50px; height: 20px;" type="text"/>	<input style="width: 50px; height: 20px;" type="text"/>	<input style="width: 50px; height: 20px;" type="text"/>	<input style="width: 50px; height: 20px;" type="text"/>

		1 This year	2 Previous year
Amounts transferred from Revenue Account Funds (Note 1)	11	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Investment Income	12	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Other Income (Note 1)	13	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Total Income (11 to 13)	19	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Expenses payable (Note 2)	21	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Amounts transferred to Revenue Account Funds (Note 1)	22	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Increase (decrease) in fund in year (19 – 21 – 22)	29	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Fund brought forward	39	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Fund carried forward (29 + 39)	49	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>

NOTES

1. Particulars to be specified by way of note
2. The entry at 40B.21.1 must equal 41.49.3

FSC 1 – FORM 40C

Returns under the Friendly Societies Prudential Rules

Member surplus and savings accounts

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 80%; height: 20px;" type="text"/>	<input style="width: 80%; height: 20px;" type="text"/>	<input style="width: 80%; height: 20px;" type="text"/>

		1 This year	2 Previous year
Surplus/Bonus Credited to members (other than transfers shown in Line 13)	11	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Contributions/Deposits	12	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Amounts transferred from Permanent Health Long Term Insurance Benefit Funds	13	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Amounts transferred from other Long Term Insurance Benefit Funds (Note 1)	14	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Amounts transferred from other Revenue Account Funds (Note 1)	15	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Other Income (Note 1)	16	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Total Income (11 to 16)	19	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Amounts withdrawn by members	21	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Benefits charged and amounts transferred to other Long Term Insurance Benefit Funds (Note 1)	22	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Amounts transferred to other revenue account funds (Note 1)	23	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Other expenditure	24	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Total expenditure and transfers (21 to 24)	29	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Increase (decrease) in accounts in year (19 – 29)	39	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Amounts credited to members brought forward	49	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Amounts credited to members carried forward (39 + 49)	59	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>

NOTE

1. Particulars to be specified by way of note.

Returns under the Friendly Societies Prudential Rules
 Long term insurance business: Analysis of premiums and expenses

Name of Society

Period ended 31 December

	Reg No	Units £/£000	OB/IB	No of fund/ Summary	No of part of fund

Name of Fund/ Summary				1 Gross	2 Payable to or recoverable from reinsurers	3 Net of reinsurance	
Earned premiums in the financial year	Life Assurance and General Annuity contracts	Single Premium	11				
		Regular Premium	12				
	Pension Business contracts	Single Premium	13				
		Regular Premium	14				
	Permanent Health Contracts	Single Premium	15				
		Regular Premium	16				
	Other Contracts	Single Premium	17				
		Regular Premium	18				
	Total Premiums	Single Premium	19				
		Regular Premium	29				
	Total premiums at line 19 and 29 attributable to	UK Contracts	31				
		Overseas Contracts	32				
Expenses payable in the financial year	Commission payable in connection with acquisition of business		41				
	Other commission payable		42				
	Management expenses in connection with acquisition of business		43				
	Management expenses in connection with maintenance of business		44				
	Other management expenses		45				
	Total Expenses (41 to 45)		49				
	Total expenses at line 49 attributable to	UK Contracts		51			
		Overseas Contracts		52			

NOTES

The entries at lines 11,13, 15, 17 and 19 must include all single premium amounts where there is no expectation of continuing premiums being paid at regular intervals.

The entries at lines 12, 14, 16, 18 and 29 must include premiums payable at regular intervals during the policy year, including repeated or recurrent single premiums where the level of premium is defined.

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Analysis of claims

Name of Society

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Period ended 31 December

	Reg No	Units £/£000	OB/IB	No of fund/ Summary	No of part of fund

Name of Fund/Summary

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1 Gross

2 Recoverable from reinsurers

3 Net of reinsurance (1-2)

CLAIMS INCURRED IN THE YEAR

Life Assurance and Annuity Contracts	On death	11			
	By way of lump sums on maturity	12			
	By way of annuity payments	13			
	By way of payments arising from other insured events	14			
	On surrender or partial surrender	15			
	Total life assurance and annuity claims (11 to 15)	19			
Pension Business Contracts	On death	21			
	By way of lump sums on vesting	22			
	By way of vested annuity payments	23			
	On surrender or partial surrender	24			
	Total pension business claims (21 to 24)	29			
Permanent Health Contracts	By way of lump sums	31			
	By way of periodical payments	32			
	Total permanent health claims (31 + 32)	39			
Other Contracts (Note 1)	By way of lump sums	41			
	By way of periodical payments	42			
	Total other contracts claims (41 + 42)	49			
Total claims (19 + 29 + 39 + 49)		59			
Total claims at line 59 attributable to:-	UK Contracts	61			
	Overseas Contracts	62			

NOTES

1. Particulars to be specified by way of note. 2. In the case of industrial assurance, claims incurred on survival in respect of periodical endowment benefits must be shown in line 15

Returns under the Friendly Societies Prudential Rules
 Long term insurance business: Summarised balance sheet for internal linked funds

Name of Society

Period ended 31 December

Reg No	Units £/£000	OB/IB	No of fund/ Summary	No of part of fund
<input style="width: 90%;" type="text"/>	<input style="width: 90%;" type="text"/>	<input style="width: 90%;" type="text"/>	<input style="width: 90%;" type="text"/>	<input style="width: 90%;" type="text"/>

Name of fund/summary

Name of fund	Directly held assets	Investment in other internal linked funds of the society	Total assets (2 + 3)	Provision for tax on unrealised capital gains	Secured and unsecured loans	Other liabilities	Net asset value (4 – 5 – 6 – 7)
1	2	3	4	5	6	7	8
Total							

NOTE

The total of the net asset value in column 8 less the total of column 3 must equal line 59 of Form 44.

FSC 1 – FORM 44

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Aggregate revenue account for internal linked funds

Name of Society

Period ended 31 December

	Reg No	Units £/£000	OB/IB	No of fund/ Summary	No of part of fund
<input style="width: 80%; height: 20px;" type="text"/>	<input style="width: 80%; height: 20px;" type="text"/>	<input style="width: 80%; height: 20px;" type="text"/>	<input style="width: 80%; height: 20px;" type="text"/>	<input style="width: 80%; height: 20px;" type="text"/>	<input style="width: 80%; height: 20px;" type="text"/>

Name of fund/Summary

Value of total creation of units	11	<input style="width: 95%; height: 20px;" type="text"/>
Investment income attributable to the funds before deduction of tax	12	<input style="width: 95%; height: 20px;" type="text"/>
Increase (decrease) in the value of investments in financial year	13	<input style="width: 95%; height: 20px;" type="text"/>
Other income (Note 1)	14	<input style="width: 95%; height: 20px;" type="text"/>
Total income (11 to 14)	19	<input style="width: 95%; height: 20px;" type="text"/>
Value of total cancellation of units	21	<input style="width: 95%; height: 20px;" type="text"/>
Charges for management	22	<input style="width: 95%; height: 20px;" type="text"/>
Charges in respect of tax on investment income	23	<input style="width: 95%; height: 20px;" type="text"/>
Taxation on realised capital gains	24	<input style="width: 95%; height: 20px;" type="text"/>
Increase (decrease) in amount set aside for tax on capital gains not yet realised	25	<input style="width: 95%; height: 20px;" type="text"/>
Other expenditure (Note 1)	26	<input style="width: 95%; height: 20px;" type="text"/>
Total expenditure (21 to 26)	29	<input style="width: 95%; height: 20px;" type="text"/>
Increase (decrease) in funds in the year (19 – 29)	39	<input style="width: 95%; height: 20px;" type="text"/>
Internal linked funds brought forward	49	<input style="width: 95%; height: 20px;" type="text"/>
Internal linked funds carried forward	59	<input style="width: 95%; height: 20px;" type="text"/>

NOTES

1. Particulars to be specified by way of note.

FSC 1 – FORM 45

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Supplementary information for internal linked funds

Name of Society

Period ended 31 December

	Reg No	Units £/£000	OB/IB	No of fund	No of part of fund
<input style="width: 80%; height: 20px;" type="text"/>	<input style="width: 80%; height: 20px;" type="text"/>	<input style="width: 80%; height: 20px;" type="text"/>	<input style="width: 80%; height: 20px;" type="text"/>	<input style="width: 80%; height: 20px;" type="text"/>	<input style="width: 80%; height: 20px;" type="text"/>

Name of fund

Name of fund 1	Amount of taxable unrealised capital gain or loss 2	Percentage provision for tax on unrealised capital gains 3	Percentage provision for tax on realised capital gains 4	Liquidity percentage 5	Valuation price per unit 6
<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>
<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>
<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>
<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>
<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>

FSC 1 – FORM 46

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Summary of changes in long term insurance business

Name of Society

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Period ended 31 December

	Reg No	OB/IB	UK/ Overseas	Taxable/ Non Taxable	Linked Non-Linked

	Life Assurance and General Annuity		Pensions Business		Permanent Health		Other Business (Note 1)	
	1. No. of Contracts	2. Annual Premiums £	3. No. of Contracts	4. Annual Premiums £	5. No. of Contracts	6. Annual Premiums £	7. No. of Contracts	8. Annual Premiums £
In force at beginning of year	11							
New business and increases	12							
Net transfers and other alterations "on"	13							
Total "on" (12 + 13)	19							
Deaths	21							
Other insured events	22							
Maturities	23							
Surrenders	24							
Forfeitures	25							
Conversions to paid-up policies for reduced benefits	26							
Net transfers, expiries and other alterations "off"	27							
Total "off" (21 to 27)	29							
In force at end of year (11 + 19 – 29)	39							

NOTE

1. Specify particulars of other business contracts included in columns 7 and 8.

19 July 2001

FSC 1 – FORM 47

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Analysis of new long term insurance business

Name of Society

Period ended 31 December

	Reg No	Units £/£000	OB/IB	UK/Overseas	Taxable/Non Taxable
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

TYPE OF INSURANCE	Single Premium Contracts			Regular Premium Contracts		
	No of Contracts	Premiums	Sum assured, annuities per annum or other measure of benefits	No of Contracts	Annual Premiums	Sum assured, annuities per annum or other measure of benefits
1	2	3	4	5	6	7

FSC 1 – FORM 48

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Expected income from admissible assets not held to match liabilities in respect of linked benefits

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 60%; height: 20px;" type="text"/>	<input style="width: 60%; height: 20px;" type="text"/>	<input style="width: 60%; height: 20px;" type="text"/>

Category of assets/Total

1 Value of admissible assets as shown in Form 13

2 Expected income from admissible assets

3 Yield %

TYPE OF ASSETS

Land and Buildings	11			
<i>Fixed interest Securities</i>	12	Approved securities		
	13	Other		
<i>Variable interest and variable yield securities (excluding items shown in line 16)</i>	14	Approved securities		
	15	Other		
Equity shares and holdings in collective investment schemes	16			
Loans secured by mortgages	17			
All other assets	18	Producing income		
	19	Not producing income		
Total (11 to 19)	29			

FSC 1 – Notes to Forms 48 and 49

1. Where Form 13 is for the same fund or group of funds:-

- the entry at 48.11.1 must be equal to 13.11.1.
- the entry at 48.12.1 must be equal to 13.45.1 and the appropriate part of 13.84.1.
- the entry 48.13.1 must be equal to 13.46.1 and the appropriate part of 13.84.1.
- the entry 48.14.1 must be equal to 13.47.1 and the appropriate part of 13.84.1.
- the entry at 48.15.1 must be equal to 13.42.1 + 13.48.1 and the appropriate part of 13.84.1.
- the entry at 48.16.1 must be equal to 13.41.1 + 13.43.1.
- the entry at 48.17.1 must be equal to 13.50.1 and the appropriate part of 13.84.1.
- the entry at 48.29.1 must be equal to 13.87.1 + 13.89.1 – 13.58.1 – 13.59.1.

The appropriate part of the entry at 13.84.1 to be included in lines 12 to 15 is that part which represents accrued interest on assets included in the relevant line of Form 48. The amounts so included shall be stated in a supplementary note to Form 48.

- 2.
- The entries at 48.12.3, 48.13.3, 48.14.3 and 48.15.3 must be equal to 49.19.2, 49.29.2, 49.19.5 and 49.29.5 respectively. The yields to be inserted in column 3 of form 48 for other categories of asset must be the running yields determined in accordance with rules 10(3) to (6A) in Appendix 5.
 - The entry at 48.29.3 must be the weighted average of the yields in column 3 of Form 48, where the weight given to each asset is the value of that asset applicable for entry into column 1; assets not producing income must be included in the calculation.
 - The entries at 49.19.1, 49.19.2, 49.19.4, 49.19.5, 49.29.1, 49.29.2, 49.29.4 and 49.29.5 must be equal to the values at 48.12.1, 48.12.3, 48.14.1, 48.14.3, 48.13.1, 48.13.3, 48.15.1 and 48.15.3 respectively.
 - The entries at 49.19.2, 49.19.5, 49.29.2 and 49.29.5 must be the weighted average of the yields in columns 2 and 5 as appropriate for lines 11 to 18 and 21 to 28 respectively, where the weight given to each yield is the value shown in columns 1 and 4 respectively.

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Analysis of admissible fixed interest and variable yield securities not held to match liabilities in respect of linked benefits

Name of Society

Reg No Units
 £/£000

Period ended 31 December

Reg No Units
 £/£000

Category of assets/Total

Redemption Period in Years

		1 Value of admissible assets as shown in Form 13	2 Gross redemption yield %	3 Value of admissible higher yielding assets	4 Value of admissible assets as shown in Form 13	5 Gross redemption yield %	6 Value of admissible higher yielding assets
One year or less	11						
More than one year but not more than 5 years	12						
More than 5 years but not more than 10 years	13						
More than 10 years but not more than 15 years	14						
More than 15 years but not more than 20 years	15						
More than 20 years but not more than 25 years	16						
More than 25 years	17						
Irredeemable	18						
Total (11 to 18)	19						
One year or less	21						
More than 1 year but not more than 5 years	22						
More than 5 years but not more than 10 years	23						
More than 10 years but not more than 15 years	24						
More than 15 years but not more than 20 years	25						
More than 20 years but not more than 25 years	26						
More than 25 years	27						
Irredeemable	28						
Total (21 to 28)	29						

Fixed interest approved securities

Other fixed interest securities

Variable interest and variable yield approved securities excluding equities

Other variable interest and variable yield securities excluding equities

FSC 1 – FORM 51

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Valuation summary of non-linked contracts (other than accumulating with-profit policies)

Name of Society

Period ended 31 December

Reg No	Units £/£000	UK/Overseas	Taxable/Non Taxable
<input style="width: 90%;" type="text"/>	<input style="width: 90%;" type="text"/>	<input style="width: 90%;" type="text"/>	<input style="width: 90%;" type="text"/>

Name of Fund

Type of business:

Type of insurance or name of contract	VALUATION BASIS			Number of contracts	Amount of sums assured or annuities per annum, including vested reversionary bonuses	AMOUNT OF ANNUAL PREMIUMS		Proportion of office premiums reserved for expenses and profits	Value of sums assured or annuities per annum, including vested reversionary bonuses	VALUE OF ANNUAL PREMIUMS		Amount of Mathematical Reserves
	Rate of interest	Mortality or morbidity table				Office Premiums	Net premiums			Office premiums	Net premiums	
1	2	3	4	5	6	7	8	9	10	11	12	
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FSC 1 – FORM 52

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Valuation summary of accumulating with-profit policies

Name of Society

Period ended 31 December

Reg No	Units £/£000	UK/Overseas	Taxable/Non Taxable
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Name of Fund

Type of business:

Type of insurance or name of contract	VALUATION BASIS			Number of contracts	Amount of sums assured or annuities per annum including vested reversionary bonuses				AMOUNT OF ANNUAL PREMIUMS		Proportion of office premiums reserved for expenses and profits	Liability in respect of current benefits including vested bonuses		OTHER LIABILITIES		Amount of Mathematical Reserves
	Rate of interest	Mortality or morbidity table	4		Guaranteed on death	Current on death	Guaranteed on maturity	Office premiums	Net premiums	Current benefit value		Discounted value	Mortality and expenses	Options & guarantees other than investment performance guarantees		
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15		
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FSC 1 – FORM 53

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Valuation summary of property linked contracts

Name of Society

Period ended 31 December

Reg No	Units £/€000	UK/Overseas	Taxable/Non Taxable
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Name of Fund

Type of business:

Name of Contract	VALUATION BASIS			Number of contracts	Amount of sums assured or annuities per annum including vested reversionary bonuses			AMOUNT OF ANNUAL PREMIUMS		Category of unit link	UNIT LIABILITY		OTHER LIABILITIES		Amount of Mathematical Reserves
	Rate of interest	Mortality or morbidity table			Guaranteed on death	Current on death/current payable per annum	Guaranteed on maturity	Office premiums	Net premiums		Current benefit value	Discounted value	Mortality and expenses	Options & guarantees other than investment performance guarantees	
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	
<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
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FSC 1 – FORM 54

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Valuation summary of index linked contracts

Name of Society

Period ended 31 December

Reg No	Units £/£000	UK/Overseas	Taxable/Non Taxable
<input style="width: 90%;" type="text"/>	<input style="width: 90%;" type="text"/>	<input style="width: 90%;" type="text"/>	<input style="width: 90%;" type="text"/>

Name of Fund

Type of business:

Name of Contract	VALUATION BASIS			Number of contracts	Amount of sums assured or annuities per annum including vested reversionary bonuses			AMOUNT OF ANNUAL PREMIUMS		Name of index link	INVESTMENT LIABILITY		OTHER LIABILITIES		Amount of Mathematical Reserves
	Rate of interest	Mortality or morbidity table	3		5	6	7	8	9		11	12	13	14	
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	
<input style="width: 95%;" type="text"/>	<input style="width: 95%;" type="text"/>	<input style="width: 95%;" type="text"/>	<input style="width: 95%;" type="text"/>	<input style="width: 95%;" type="text"/>	<input style="width: 95%;" type="text"/>	<input style="width: 95%;" type="text"/>	<input style="width: 95%;" type="text"/>	<input style="width: 95%;" type="text"/>	<input style="width: 95%;" type="text"/>	<input style="width: 95%;" type="text"/>	<input style="width: 95%;" type="text"/>	<input style="width: 95%;" type="text"/>	<input style="width: 95%;" type="text"/>	<input style="width: 95%;" type="text"/>	
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FSC 1 – FORM 55

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Analysis of units in internal linked funds and direct holdings of assets matching liabilities in respect of property linked benefits

Name of Society

Period ended 31 December

Reg No	Units £/€000	UK/ Overseas	Internal Fund/Direct Assets
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

Name of Fund

Name of fund link or directly held asset 1	Name of unit type 2	Valuation price per unit or asset 3	Total actual number of units in force or directly held assets 4	Value of total actual units in force or directly held assets 5	Value of actual units held by other internal linked funds 6	Value of directly held assets and actual units in force excluding those held by other internal linked funds (5-6) 7	Value of units or directly held assets deemed allocated to contracts		Value of surplus units or directly held assets (7 – 8 + 9) 10
							Gross 8	Reinsurance ceded 9	
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

FSC 1 – FORM 56

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Analysis of assets and liabilities matching investment liabilities in respect of index linked benefits

Name of Society

Period ended 31 December

	Reg No	Units £/£000	UK/Overseas
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

Name of fund

TYPE OF ASSETS AND LIABILITIES	Name of index link	Value of assets or liabilities	Gross derivative value
	1	2	3
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
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<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Total assets	<input type="text"/>	<input type="text"/>	<input type="text"/>
Total liabilities	<input type="text"/>	<input type="text"/>	<input type="text"/>
Net total assets	<input type="text"/>	<input type="text"/>	<input type="text"/>

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Matching rectangle

Name of Society

Period ended 31
December

	Reg No	Units £/£000	UK/ Overseas	With-profits/ Non profit	Sterling/Non sterling	Rate of interest

Category of assets/Total

Type of business

Type of asset notionally allocated

	The valuation		The resilience scenario			
	Value of asset notionally allocated	Risk adjusted yield %	Value of assets notionally allocated			Risk adjusted yield %
			On original allocation	Increase or decrease	Total under resilience scenario	
	1	2	3	4	5	6

Land and Buildings

11						
----	--	--	--	--	--	--

Fixed interest securities	Approved securities
	Other

12						
13						

Variable interest and variable yield securities (excluding items shown at line 16)	Approved securities
	Other

14						
15						

Equity shares and holdings in collective investment schemes

16						
----	--	--	--	--	--	--

Loans secured by mortgages

17						
----	--	--	--	--	--	--

All other assets	Producing income
	Not producing income

18						
19						

Total (11 to 19)

29						
----	--	--	--	--	--	--

Gross valuation interest rate %

31						
----	--	--	--	--	--	--

Net valuation interest rate %

32						
----	--	--	--	--	--	--

Mathematical reserve or other liability, net of reinsurance

33						
----	--	--	--	--	--	--

FSC 1 – FORM 58

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Valuation result and distribution of surplus

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 80%; height: 25px;" type="text"/>	<input style="width: 80%; height: 25px;" type="text"/>	<input style="width: 80%; height: 25px;" type="text"/>

Name of Fund/Summary

Valuation result	Fund carried forward (Note 1)	11		
	Bonus payments made to policyholders in anticipation of a surplus	12		
	Net transfer to other funds (Note 2)	15		
	Total (11 + 12 + 15)	16		
	Mathematical reserves for accumulating with profit contracts	17		
	Mathematical reserves for non-linked contracts (Note 4)	18		
	Mathematical reserves for property linked contracts	19		
	Mathematical reserves for index linked contracts	20		
	Total (17 to 20)	21		
	Surplus including contingency and other reserves towards the solvency margin (Deficiency) (16 – 21)	29		
	Composition of surplus	Balance of surplus brought forward unappropriated form last valuation	31	
Net transfer from other funds (Note 2)		34		
Surplus arising since the last valuation		35		
Total (31 + 34 + 35) (= 29)		39		
Distribution of surplus	Bonus payments made to policyholders in anticipation of a surplus	41		
	Allocated to policyholders by way of	Cash bonuses	42	
		Reversionary bonuses	43	
		Other bonuses	44	
		Premium reductions	45	
	Total allocated to policyholders (41 to 45)	46		
	Transfer to other funds (Note 2 + 5)	47		
	Total distributed surplus (46 + 47)	48		
	Balance of surplus including contingency and other reserves held towards the solvency margin carried forward unappropriated (Note 3)	49		
Total (48 + 49) (= 29)	59			

NOTES

- | | | | | |
|--|---|---|---|---|
| <p>1. The entry at line 11 must be equal to the entry at line 59 in the revenue account for the relevant fund (Form 40).</p> | <p>2. Particulars to be specified by way of note.</p> | <p>3. Where the entry at line 21 exceeds the entry at line 16, the difference must be included at line 13 of Form 14.</p> | <p>4. For each fund, the entry at line 18 must be equal the total liabilities in column 12 of Form 51 and the entries at lines 17, 19 and 20 must equal the total liabilities in column 15 of Forms 52, 53 and 54 respectively.</p> | <p>5. The figure at line 47 must equal the figure at line 15.</p> |
|--|---|---|---|---|

FSC 1 – FORM 60 (Sheet 1)

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Required minimum margin

Name of Society

Reg No _____ Units £/€000 _____

Period ended 31 December

Class	Classes I & II	Class III business with relevant factor of				Classes IV & VI	Class VII business with relevant factor of				Unallocated additional mathematical reserves with relevant factor of		Total for all classes	
		4% 1	4% 2	1% 3	NIL 4		Total 5	4% 6	4% 7	1% 8	NIL 9	Total 10	4% 11	1% 12	This year 13	Previous year 14
Relevant factor (Note 1)	4% 1	4% 2	1% 3	NIL 4	Total 5	4% 6	4% 7	1% 8	NIL 9	Total 10	4% 11	1% 12	This year 13	Previous year 14
Reserves before distribution of surplus														
Reserves for bonus allocated to policyholders														
Reserves after distribution of surplus														
Reserves before distribution of surplus														
Reserves for bonus allocated to policyholders														
Reserves after distribution of surplus														
Mathematical reserves after deduction for reinsurance: (Note 5)														
Ratio of 16 to 13, or 0.85 if greater														
Required margin of solvency – first result – (Note 2)														
Temporary assurances with required margin of solvency of .001														
Temporary assurances with required margin of solvency of .0015														
All other contracts with required margin of solvency of .003														
Total for (21 to 23)														

FSC 1 – FORM 60 (Sheet 2)

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Required minimum margin

Name of Society

Reg No	Units	£/€000
<input style="width: 90%;" type="text"/>	<input style="width: 90%;" type="text"/>	<input style="width: 90%;" type="text"/>

Period ended 31 December

Class	Classes I & II		Class III business with relevant factor of				Classes IV & VI		Class VII business with relevant factor of			Unallocated additional mathematical reserves with relevant factor of		Total for all classes	
	4% 1	4% 2	1% 3	NIL 4	Total 5	4% 6	4% 7	1% 8	NIL 9	Total 10	4% 11	1% 12	This year 13	Previous year 14	
Relevant factor (Note 1)															
Non negative capital at risk after reinsurance (all contracts) (Note 3)															
Ratio of line 31 to line 29, or 0.50 if greater															
Required margin of solvency second result (Note 4)	39														
Sum of first and second results = (19 + 39)	49														
Required margin of solvency for subsidiary provisions (Note 6)	51														
Total required margin of solvency for long term business = 49 + 51	59														
Minimum guarantee fund	61														
Required minimum margin (greater of 59 and 61)	69														

NOTES

1. The appropriate factor specified in rule 1(2)(a) and 2(3) and (4) of Appendix 1.
2. Line 19 equals line 13 x Line 17 x relevant factor.
3. Capital at risk must be shown after distribution of surplus.
4. Line 39 equals line 32 x [line 21 x .001 + line 22 x .0015 + line 23 x .003] for Classes I and II or line 32 x line 29 x 0.003 for classes III and VII.
5. Any additional mathematical reserves shown at line 63 to Form 14 must be included in this Form (applied to all relevant classes)
6. For Class V business, the amount of the required margin of solvency must be stated in a note to the form and must be included in line 51.

FSC 1 – FORM 61

Returns under the Friendly Societies Prudential Rules

Long-term insurance business: Subsidiary provisions - calculation of required margin of solvency

Name of Society

Period ended 31 December

	Reg No	Units £/£000

		1 This Year	2 Previous Year
Gross premiums written	11		
Premium taxes and levies (included in line 11)	12		
Sub-total A (11 – 12)	19		
Adjusted sub-total A if financial year is not a 12 month period to produce an annual figure	21		
Division of sub-total A (or adjusted sub-total A if appropriate)	18% of amounts up to and including sterling equivalent of 10 million Euro		
	16% of excess (if any) over 10 million Euro		
Sub-total B (22 + 23)	29		
Claims paid	31		
Claims outstanding carried forward at end of financial year	32		
Claims outstanding brought forward at beginning of financial year	33		
Sub-total C (31 + 32 – 33)	39		
Amounts recoverable from reinsurers in respect of claims included in sub-total C	41		
Sub-total D (39 – 41)	49		
Required margin of solvency for Subsidiary Provisions Sub-total B x $\frac{\text{sub-total D}}{\text{sub-total C}}$ (or, if 0.5 is greater, x 0.5)	59		

NOTE

“Subsidiary provisions” means insurance falling within general insurance business class 1 (Accident) and class 2 (Sickness) which is subsidiary to long-term insurance business and for which a separate Part IV permission is not required (see AUTH).

FSC 1 – FORM 61A

Returns under the Friendly Societies Prudential Rules

Descriptive section of actuarial investigation

Name of Society:

Reg No

1. The date to which the investigation relates is

2. The date to which the latest previous investigation relates is

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Annual Investigation – Actuary’s Certificate

Name of Society

Period ended 31 December

Reg No	

I certify that:

- (a) (i) in my opinion, proper records have been kept by the society adequate for the purpose of the valuation of the liabilities of its long term insurance business;
- (ii) the sum of the mathematical reserves and the deposits received from reinsurers as shown in Form 14 together, if the case so requires, with £..... (being part of the excess of the value of the admissible assets representing the long term insurance business funds over the amount of those funds shown in Form 14) constitute proper provision at the end of the financial year for the long term insurance liabilities (including all liabilities arising from deposit back arrangements, but excluding liabilities which have fallen due before the end of the financial year) including any increase in those liabilities arising from a distribution of surplus as a result of any investigation as at that date into the financial condition of the long term insurance business; and
- (iii) for the purpose of sub-paragraph (ii) above the liabilities have been assessed in accordance with Appendix 5 in the context of assets valued in accordance with Appendix 4, as show in Form 13;
- (iv) in my opinion, premiums for contracts entered into during the financial year and income earned thereon are sufficient, on reasonable actuarial assumptions, and taking into account the other financial resources of the society that are available for the purpose, to enable the society to meet its commitments in respect of those contracts, and, in particular, to establish adequate mathematical reserves; and
- (v) I have complied with the Institute of Actuaries and Faculty of Actuaries professional guidance notes listed below.

- (b) The amount of the required minimum margin of solvency applicable to the society’s long term insurance business immediately following the end of the financial year (including any amounts resulting from any increase in liabilities arising from a distribution of surplus as a result of the investigation into the financial condition of the long term insurance business) is £.....
- (c) I have the following additional comments (use extra pages).

Signature

Date

Name:

Address:

Qualification:

FSC 1 – FORM 61C

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Annual Investigation – Auditor's Report

Name of Society

Period ended 31 December

	Reg No
<input type="text"/>	<input type="text"/>

Auditor's Report

Signature

Date

Name: _____

Address: _____

Qualification: _____

FSC 1 – FORM 61D

Returns under the Friendly Societies Prudential Rules

Long term insurance business: Annual Investigation – Signatures

Name of Society

Period ended 31 December

Reg No	
<input type="text"/>	<input type="text"/>

Signatures to the FSC1 Return

Appointed Actuary

Date

We certify that the information in this Return complies with the rules in chapter 5 of IPRU(FSOC).

We confirm also that the society consents to a copy of this Return being placed on the public file of the society.

Chief Executive

Date

Name (Block Capitals)

Secretary

Date

Name (Block Capitals)

Member of Committee

Date

Name (Block Capitals)

Additional Committee member if the offices of the Chief Executive and Secretary are held by the same person.

Date

Name (Block Capitals)

FSC 2 - RETURN

FSC2 Return Periodic Investigation: Long Term and General Insurance Business
FORM FSC 2

Register Number

Period ended 31
December

Name of Society
(as registered)

Registered Office

Post Code:

The information provided in this FSC2 Return (Periodic Investigation: Long Term and General Insurance Business) and the Actuary's certificate included herein are the form and contents of an abstract under rule 5.2(2) for use by an non-directive unincorporated friendly society (other than a flat rate benefits business friendly society) in respect of its insurance business.

One copy of the Return must be signed by the chief executive, the secretary and one committee member of the society (or two members of the committee if the offices of chief executive and secretary are held by the same person).

Three copies of this Return (including the original signed copy) must be submitted as soon as possible after 31 December and not later than 30 June:-

The Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

FSC 2 – FORM 9

Returns under the Friendly Societies Prudential Rules

Statement of solvency

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 60%; height: 20px;" type="text"/>	<input style="width: 60%; height: 20px;" type="text"/>	<input style="width: 60%; height: 20px;" type="text"/>

		1 As at the end of the period	2 As at the end of the previous period
Total available assets	10	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
GENERAL INSURANCE BUSINESS			
Other than long term insurance business assets allocated towards general insurance business required minimum margin	11	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Implicit items valued in accordance with a waiver under section 148 of the Act	11a	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Required minimum margin for general insurance business	12	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Excess (deficiency) of available assets over the required minimum margin (11+11a – 12)	13	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
LONG TERM INSURANCE BUSINESS			
Long term insurance business admissible assets	21	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Other than long term insurance business assets allocated towards long term insurance business required minimum margin	22	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Total mathematical reserves (after distribution of surplus)	23	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Other insurance and non-insurance liabilities	24	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Available assets for long term insurance business required minimum margin (21 + 22 – 23 – 24)	25	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Implicit items valued in accordance with a waiver under section 148 of the Act			
Future profits	31	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Zillmerising	32	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Hidden reserves	33	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Total of available assets and implicit items (25 + 31 + 32 + 33)	34	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Required minimum margin			
Required minimum margin for long term insurance business	41	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Explicit required minimum margin (1/6 x Line 41, or minimum guarantee fund if greater)	42	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Excess (deficiency) of available assets over explicit required minimum margin (25 – 42)	43	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Excess (deficiency) of available assets and implicit items over the required minimum margin (34 – 41)	44	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
CONTINGENT LIABILITIES			
Quantifiable contingent liabilities in respect of other than long term insurance business	51	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Quantifiable contingent liabilities in respect of long term insurance business	52	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>

FSC 2 – FORM 9A

Returns under the Friendly Societies Prudential Rules

Descriptive Section

Name of Society:

Reg No

1. The date to which the investigation relates is

2. The date to which the latest previous investigation relates is

3. A synopsis of the report by the appropriate actuary on his investigation into the financial condition of the society in respect of its insurance business, including

- a statement of the assets and liabilities of the society;
- information and comments on the
 - changes in membership of the society,
 - benefit entitlements that have been valued,
 - mortality, sickness and claims experience of the society,
 - investment returns achieved by the society,
 - suitability of the assets held by the society,
 - provisions made for future expenses,
 - reserves set aside for activities of the society not covered by the valuation,
 - scope for enhancement of benefits; and
- the actuary's assessment of the financial viability of the society and, where the assessment indicates that changes are necessary or desirable, the options open to the *committee* along with the advantages and disadvantages of each course of action and the likely consequences of taking no action.

FSC 2 – FORM 9B

Returns under the Friendly Societies Prudential Rules

Actuary's Certificate

Name of Society

Period ended 31 December

Reg No	

I certify that:

- (a) (i) in my opinion, proper records have been kept by the society adequate for the purpose of the valuation of the liabilities of its insurance business;
- (ii) the contents of the synopsis in Form 9A correctly reflect the results of my investigation into the financial condition of the society in respect of its insurance business;
- (iii) no matters, except as described in Form 9A, have come to my attention during the course of my investigation which in my opinion prejudice the financial viability of the society or the reasonable expectations of its members;
- (iv) I have had regard to the following Institute of Actuaries and Faculty of Actuaries professional guidance notes and, in so far as they are relevant to my investigation for the purposes of this certificate, I have complied with them

- (b) The amount of the required minimum margin of solvency applicable to the society's insurance business immediately following the end of the period of investigation (including any amounts resulting from any increase in liabilities arising from a distribution of surplus as a result of the investigation into the financial condition of the insurance business) is £.....
- (c) I have the following additional comments (use extra pages).

Signature
Name:
Address:

Date

Qualification:

Return under the Friendly Societies Prudential Rules

Signatures

Name of Society

Period ended 31 December

Reg No	
<input type="text"/>	<input type="text"/>

Signatures to the FSC2 Return

We certify that the information in this Return complies with the rules in chapter 5 of IPRU(FSOC).

We confirm also that the society consents to a copy of this Return being placed on the public file of the society.

Chief Executive

Date

Name (Block Capitals)

Secretary

Date

Name (Block Capitals)

Member of Committee

Date

Name (Block Capitals)

Additional Committee member if the offices of the Chief Executive and Secretary are held by the same person.

Date

Name (Block Capitals)

FSC 3 - RETURN

FSC3 Return
General Insurance Business: Periodic Investigation
FORM FSC 3

Register Number

Period ended 31
December

Name of Society (as registered)

Registered Office

Post Code:

The information provided in this FSC3 Return (General Insurance Business: Periodic Investigation), and the Actuary's certificate and Auditor's report included herein are the form and contents of an abstract under rule 5.2(2) for use by a friendly society which is a directive friendly society or non-directive incorporated friendly society (other than a flat rate benefits business friendly society) which is carrying on general insurance business.

One copy of the Return must be signed by the chief executive, the secretary and one committee member of the society (or two members of the committee if the offices of chief executive and secretary are held by the same person).

Three copies of this Return (including the original signed copy) must be submitted as soon as possible after 31 December and not later than 30 June:-

The Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

FSC 3 – CONTENTS

Returns under the Friendly Societies Prudential Rules

General insurance business: Periodic Investigation
Summary sheet of completed forms submitted

Name of Society

Period ended 31 December

Reg No
<input style="width: 40px; height: 20px; margin-right: 10px;" type="text"/> <input style="width: 40px; height: 20px;" type="text"/>

Where appropriate, certain Forms need to be copied in order to furnish separate details of business in the same format (e.g. the same Form completed separately for different classes of business). Where a Form is completed, please enter the total number of such forms in the corresponding box in the third column below. Where no Form is completed, please enter NIL. Where an additional summary form has been completed, please indicate YES in the fourth column.

Form Number	Details on Form	Number completed	Summary form used
Form 9	Statement of solvency	<input style="width: 60px; height: 25px;" type="text"/>	<input style="width: 60px; height: 25px;" type="text"/>
Form 11	Margins of solvency – first method	<input style="width: 60px; height: 25px;" type="text"/>	<input style="width: 60px; height: 25px;" type="text"/>
Form 12	Margins of solvency – second method – and Required minimum margin	<input style="width: 60px; height: 25px;" type="text"/>	<input style="width: 60px; height: 25px;" type="text"/>
Form 13	Analysis of admissible assets	<input style="width: 60px; height: 25px;" type="text"/>	<input style="width: 60px; height: 25px;" type="text"/>
Form 14	Liabilities and margins: (long term insurance business)	<input style="width: 60px; height: 25px;" type="text"/>	<input style="width: 60px; height: 25px;" type="text"/>
Form 15	Liabilities (other than long term insurance business)	<input style="width: 60px; height: 25px;" type="text"/>	<input style="width: 60px; height: 25px;" type="text"/>
Form 17	Analysis of derivative contracts	<input style="width: 60px; height: 25px;" type="text"/>	<input style="width: 60px; height: 25px;" type="text"/>
Form 20	Technical account	<input style="width: 60px; height: 25px;" type="text"/>	<input style="width: 60px; height: 25px;" type="text"/>
Form 21	Analysis of premiums	<input style="width: 60px; height: 25px;" type="text"/>	<input style="width: 60px; height: 25px;" type="text"/>
Form 22	Analysis of claims, expenses and technical provisions	<input style="width: 60px; height: 25px;" type="text"/>	<input style="width: 60px; height: 25px;" type="text"/>
Form 23	Analysis of net claims and premiums	<input style="width: 60px; height: 25px;" type="text"/>	<input style="width: 60px; height: 25px;" type="text"/>
Form 23A	Descriptive section	<input style="width: 60px; height: 25px;" type="text"/>	<input style="width: 60px; height: 25px;" type="text"/>
Form 23B	Actuary's certificate	<input style="width: 60px; height: 25px;" type="text"/>	<input style="width: 60px; height: 25px;" type="text"/>
Form 23C	Auditor's report	<input style="width: 60px; height: 25px;" type="text"/>	<input style="width: 60px; height: 25px;" type="text"/>
Form 23D	Signatures of officers	<input style="width: 60px; height: 25px;" type="text"/>	<input style="width: 60px; height: 25px;" type="text"/>

Returns under the Friendly Societies Prudential Rules

Statement of Solvency

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input type="text"/>	<input type="text"/>	<input type="text"/>

		1 As at the end of the period	2 As at the end of the previous period
Total available assets	10	<input type="text"/>	<input type="text"/>
GENERAL INSURANCE BUSINESS			
Other than long term insurance business assets allocated towards general insurance business required minimum margin	11	<input type="text"/>	<input type="text"/>
Implicit items valued in accordance with a waiver under section 148 of the Act	11a	<input type="text"/>	<input type="text"/>
Required minimum margin for general insurance business (Note 1)	12	<input type="text"/>	<input type="text"/>
Excess (deficiency) of available assets over the required minimum margin (11+11a – 12)	13	<input type="text"/>	<input type="text"/>
LONG TERM INSURANCE BUSINESS			
Long term insurance business admissible assets	21	<input type="text"/>	<input type="text"/>
Other than long term insurance business assets allocated towards long term insurance business required minimum margin	22	<input type="text"/>	<input type="text"/>
Total mathematical reserves (after distribution of surplus)	23	<input type="text"/>	<input type="text"/>
Other insurance and non-insurance liabilities (Note 2)	24	<input type="text"/>	<input type="text"/>
Available assets for long term insurance business required minimum margin (21 + 22 – 23 – 24)	25	<input type="text"/>	<input type="text"/>
Implicit items valued in accordance with a waiver under section 148 of the Act			
Future profits	31	<input type="text"/>	<input type="text"/>
Zillmerising	32	<input type="text"/>	<input type="text"/>
Hidden reserves	33	<input type="text"/>	<input type="text"/>
Total of available assets and implicit items (25 + 31 + 32 + 33)	34	<input type="text"/>	<input type="text"/>
Required minimum margin			
Required minimum margin for long term insurance business	41	<input type="text"/>	<input type="text"/>
Explicit required minimum margin (1/6 x Line 41, or minimum guarantee fund if greater)	42	<input type="text"/>	<input type="text"/>
Excess (deficiency) of available assets over explicit required minimum margin (25 – 42)	43	<input type="text"/>	<input type="text"/>
Excess (deficiency) of available assets and implicit items over the required minimum margin (34 – 41)	44	<input type="text"/>	<input type="text"/>
CONTINGENT LIABILITIES			
Quantifiable contingent liabilities in respect of other than long term insurance business (Note 3)	51	<input type="text"/>	<input type="text"/>
Quantifiable contingent liabilities in respect of long term insurance business (Note 3)	52	<input type="text"/>	<input type="text"/>

FSC 3 – Notes to Form 9

- 1** The entry at line 12 must be equal to the entry at line 49 in Form 12.
- 2** The entry at line 24 must be equal to the sum of lines 12 and 49 in Form 14, less line 19b in Form 14.
- 3** Particulars to be specified by way of supplementary note.

FSC 3 – FORM 11

Returns under the Friendly Societies Prudential Rules

General insurance business: Calculation of required margin of solvency – first method

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 60%; height: 20px;" type="text"/>	<input style="width: 60%; height: 20px;" type="text"/>	<input style="width: 60%; height: 20px;" type="text"/>

Name of Fund/Summary

1 Last 12 months of this period

2 Last 12 months of previous period

<input style="width: 100%; height: 30px;" type="text"/>			11	<input style="width: 100%; height: 30px;" type="text"/>	<input style="width: 100%; height: 30px;" type="text"/>
Gross premiums receivable					
<input style="width: 100%; height: 30px;" type="text"/>			12	<input style="width: 100%; height: 30px;" type="text"/>	<input style="width: 100%; height: 30px;" type="text"/>
Premium taxes and levies (included in line 11)					
<input style="width: 100%; height: 30px;" type="text"/>			13	<input style="width: 100%; height: 30px;" type="text"/>	<input style="width: 100%; height: 30px;" type="text"/>
Sub-total A (11 – 12)					
Division of Sub-total A	Other than health insurance	Up to and including sterling equivalent of 10M Euro x 18/100	15	<input style="width: 100%; height: 30px;" type="text"/>	<input style="width: 100%; height: 30px;" type="text"/>
		Excess (if any) over 10M Euro x 16/100	16	<input style="width: 100%; height: 30px;" type="text"/>	<input style="width: 100%; height: 30px;" type="text"/>
	Health insurance	Up to and including sterling equivalent of 10M Euro x 6/100	17	<input style="width: 100%; height: 30px;" type="text"/>	<input style="width: 100%; height: 30px;" type="text"/>
		Excess (if any) over 10M Euro x 16/300	18	<input style="width: 100%; height: 30px;" type="text"/>	<input style="width: 100%; height: 30px;" type="text"/>
<input style="width: 100%; height: 30px;" type="text"/>			19	<input style="width: 100%; height: 30px;" type="text"/>	<input style="width: 100%; height: 30px;" type="text"/>
Sub-total B (15 + 16 + 17 + 18)					
<input style="width: 100%; height: 30px;" type="text"/>			21	<input style="width: 100%; height: 30px;" type="text"/>	<input style="width: 100%; height: 30px;" type="text"/>
Claims paid					
<input style="width: 100%; height: 30px;" type="text"/>			23	<input style="width: 100%; height: 30px;" type="text"/>	<input style="width: 100%; height: 30px;" type="text"/>
Claims outstanding carried forward at the end of the period					
<input style="width: 100%; height: 30px;" type="text"/>			25	<input style="width: 100%; height: 30px;" type="text"/>	<input style="width: 100%; height: 30px;" type="text"/>
Claims outstanding brought forward at the beginning of the period					
<input style="width: 100%; height: 30px;" type="text"/>			29	<input style="width: 100%; height: 30px;" type="text"/>	<input style="width: 100%; height: 30px;" type="text"/>
Sub-total C (21 + 23 – 25)					
<input style="width: 100%; height: 30px;" type="text"/>			30	<input style="width: 100%; height: 30px;" type="text"/>	<input style="width: 100%; height: 30px;" type="text"/>
Amounts recoverable from reinsurers in respect of claims included in Sub-total C					
<input style="width: 100%; height: 30px;" type="text"/>			39	<input style="width: 100%; height: 30px;" type="text"/>	<input style="width: 100%; height: 30px;" type="text"/>
Sub-total D (29 – 30)					
<input style="width: 100%; height: 30px;" type="text"/>			41	<input style="width: 100%; height: 30px;" type="text"/>	<input style="width: 100%; height: 30px;" type="text"/>
First result Sub-total B x $\frac{\text{Sub-total D}}{\text{Sub-total C}}$ (or, if 0.5 is greater, x 0.5)					

FSC 3 – FORM 12

Returns under the Friendly Societies Prudential Rules

General insurance business: Calculation of required margin of solvency – second method, and statement of required minimum margin

Name of Society

Period ended 31 December

	Reg No	Units £/£000

Name of Fund/Summary

1 Last 12 months of this period

2 Last 12 months of the previous period

Reference period (means the three last preceding financial years) (Note 1)		11		
Claims paid in reference period		21		
Claims outstanding carried forward at the end of the period		23		
Claims outstanding brought forward at the beginning of the period		25		
Sub-total E (21 + 23 – 25)		29		
Division of Sub-total A	Other than health insurance	32		
	Up to and including sterling equivalent of 7M Euro x 26/100			
	Excess (if any) over 7M Euro x 23/100	33		
	Health insurance	34		
	Up to and including sterling equivalent of 7M Euro x 26/300			
	Excess (if any) over 7M Euro x 23/300	35		
Sub-total F (32 to 35)		39		
Second result Sub-total F x Sub-total D (or, if 0.5 is greater, x 0.5) <u>Sub-total C</u>		41		
First result (Note 2)		42		
Required margin of solvency (the higher of lines 41 and 42)		43		
Minimum guarantee fund		44		
Required minimum margin (the higher of lines 43 and 44)		49		

NOTES

1. If the society has not been in existence long enough to acquire a reference period, this must be stated and lines 11 to 41 ignored.
2. The entry at line 42 must be equal to the entry at line 41 on Form 11

Returns under the Friendly Societies Prudential Rules

Analysis of admissible assets

Name of Society

Period ended 31 December

Reg No	Units £/£000
<input style="width: 80%; height: 20px;" type="text"/>	<input style="width: 80%; height: 20px;" type="text"/>

Category of assets/Total

1 As at the end of the period

2 As at the end of the previous period

INVESTMENTS:

Land and Buildings			11	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>	
Investments in associated bodies	UK insurance dependants	Shares	21	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>	
		Debts securities issued by, and loans to, dependants	22	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>	
	Other insurance dependants	Shares	23	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>	
		Debts securities issued by, and loans to, dependants	24	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>	
	Non insurance dependants	Shares	25	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>	
		Debts securities issued by, and loans to, dependants	26	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>	
	Other associated bodies	Shares	27	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>	
		Debts securities issued by, and loans to, associated bodies	28	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>	
TOTAL (11 to 28)			39	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>	
Other financial investments	Equity shares		41	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>	
	Others shares and other variable yield securities		42	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>	
	Holdings in collective investment schemes		43	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>	
	Rights under derivative contracts		44	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>	
	Debt securities and other fixed income securities	Fixed interest	Approved Securities	45	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
			Other	46	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
		Variable interest	Approved securities	47	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
			Other	48	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
	Participation in investment pools		49	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>	
	Loans secured by mortgages		50	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>	
	Other loans	Loans to public or local authorities and nationalised industries or undertakings		51	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
		Loans secured by policies of insurance issued by the society		52	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
		Other		53	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
	Deposits with approved credit institutions and approved financial institutions	Withdrawal subject to a time restriction of one month or less		54	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>
Withdrawal subject to a time restriction of more than one month		55	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>		
Other		56	<input style="width: 90%; height: 20px;" type="text"/>	<input style="width: 90%; height: 20px;" type="text"/>		

Returns under the Friendly Societies Prudential Rules

Analysis of admissible assets

Name of Society

--

Period ended 31 December

	Reg No	Units £/£000

Category of assets / Total

--

1 As at the end of the period

2 As at the end of the previous period

INVESTMENTS AND OTHER ASSETS:

Deposits with ceding undertakings	57		
Assets held to match linked liabilities	Index linked	58	
	Property linked	59	
Reinsurer's share of technical provisions	Provision for unearned premiums	60	
	Claims outstanding	61	
	Provision for unexpired risks	62	
	Other	63	
TOTAL (41 to 63)		69	
Debtors arising out of direct insurance operations	Policyholders	71	
	Intermediaries	72	
Debtors arising out of reinsurance operations	Due from ceding insurers and intermediaries under reinsurance business accepted	74	
	Due from reinsurers and intermediaries under reinsurance contracts ceded	75	
Other debtors	Due from dependants	Due in 12 months or less after the end of the financial year	76
		Due more than 12 months after the financial year	77
	Other	Due in 12 months or less after the end of the financial year	78
		Due more than 12 months after the end of the financial year	79
Tangible assets		80	
Cash at bank and in hand	Deposits not subject to time restriction on withdrawal, with approved credit institutions and approved financial institutions and local authorities	81	
	Cash in hand	82	
Other assets (particulars to be specified by way of supplementary note)		83	
Prepayments and accrued income	Accrued interest and rent	84	
	Deferred acquisition costs	85	
	Other prepayments and accrued income	86	

Returns under the Friendly Societies Prudential Rules

Analysis of admissible assets

Name of Society

Period ended 31 December

	Reg No	Units £/£000

Category of assets/Total

	1 As at the end of the period	2 As at the end of the previous period
--	--------------------------------------	---

Deductions (under rules 15(2)(b) and 15(3) of Appendix 4) from the aggregate value of assets	87		
--	----	--	--

Total (71 to 86 less 87)	88		
--------------------------	----	--	--

Grand total of admissible assets (39 + 69 + 88)	89		
---	----	--	--

RECONCILIATION TO ASSET VALUES
DETERMINED IN ACCORDANCE WITH
ACCOUNTS REGULATIONS (Note 1):

Total admissible assets (as per line 89 above)	91		
--	----	--	--

Total assets in excess of the admissibility limits of Appendix 4 (as valued in accordance with those rules before applying admissibility limits) (Note 2)	92		
---	----	--	--

[deleted]	93		
-----------	----	--	--

Other differences in the valuation of assets (other than for assets not valued above)	94		
---	----	--	--

Assets of a type not valued above (as valued in accordance with the Accounts Regulations) (Note 3)	95		
--	----	--	--

Total assets determined in accordance with the Accounts Regulations (91 to 95)	99		
--	----	--	--

Amounts included in line 89 attributable to debts due from associated bodies, other than those under contracts of insurance or reinsurance	100		
--	-----	--	--

FSC 3 – Notes to Form 13

1

The Accounts Regulations refer to the Friendly Societies (Accounts and Related Provisions) Regulations 1994.

2

The admissibility limits are those applied under Annex B to Appendix 4.

3

‘Assets of a type not valued above’ refers to assets left out of account under 2(3) of Appendix 4.

Returns under the Friendly Societies Prudential Rules

Long term insurance business liabilities and margins

Name of Society

Period ended 31 December

Reg No	Units £/£000
<input style="width: 80%; height: 20px;" type="text"/>	<input style="width: 80%; height: 20px;" type="text"/>

Category of assets/Total		1 As at the end of the period	2 As at the end of the previous period	
Mathematical reserves after distribution of surplus	11	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
Cash bonuses which had not been paid to policyholders prior to end of the financial year	12	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
Balance of surplus/valuation deficit	13	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
Long term insurance business fund carried forward (11 to 13)	14	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
Claims outstanding which had fallen due for payment before the end of the financial year	Gross amount	15	<input style="width: 100%; height: 20px;" type="text"/>	
	Reinsurers share	16	<input style="width: 100%; height: 20px;" type="text"/>	
	Net (15 – 16)	17	<input style="width: 100%; height: 20px;" type="text"/>	
Management Fund – Balance – surplus/(deficit)	19a	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
Members' surplus and savings accounts	Long term insurance business after distribution of surplus	19b	<input style="width: 100%; height: 20px;" type="text"/>	
	Other	19c	<input style="width: 100%; height: 20px;" type="text"/>	
Other Revenue Account funds	19d	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
Provisions for other risks and charges	Taxation	21	<input style="width: 100%; height: 20px;" type="text"/>	
	Other	22	<input style="width: 100%; height: 20px;" type="text"/>	
Deposits received from reinsurers	23	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
Creditors and other liabilities	Arising out of insurance operations	Direct business	31	<input style="width: 100%; height: 20px;" type="text"/>
		Reinsurance accepted	32	<input style="width: 100%; height: 20px;" type="text"/>
		Reinsurance ceded	33	<input style="width: 100%; height: 20px;" type="text"/>
	Debenture loans	Secured	34	<input style="width: 100%; height: 20px;" type="text"/>
		Unsecured	35	<input style="width: 100%; height: 20px;" type="text"/>
	Amounts owed to credit institutions	36	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Taxation	37	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Other		<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Accruals and deferred income	39	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
Provision for adverse changes	41	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
Total other insurance and non-insurance liabilities (17 to 41)	49	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	

FSC 3 – FORM 14 (Sheet 2)

Returns under the Friendly Societies Prudential Rules Long term insurance business liabilities and margins

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 60px; height: 20px;" type="text"/>	<input style="width: 60px; height: 20px;" type="text"/>	<input style="width: 60px; height: 20px;" type="text"/>

Category of assets/Total

1 As at the end of the period

2 As at the end of the previous period

Excess of the value of net admissible assets (Note 1)	51		
Total liabilities and margins	59		
Amount included in line 59 attributable to liabilities to associated bodies, other than those under contracts of insurance or re-insurance	61		
Amount included in line 59 attributable to liabilities in respect of property linked benefits	62		
Amount of any additional mathematical reserves included in line 51 which have been taken into account in the appointed actuary's certificate	63		

NOTE

1. The entry at line 51 must be:
 - (a) the value of the admissible assets (as included in line 89 of the appropriate Form 13) representing the long-term insurance business funds, fund or group of funds to which the Form relates, less
 - (b) the amount of those funds, fund or group of funds, being the sum of the amounts shown at lines 14 and 49.

FSC 3 – FORM 15

Returns under the Friendly Societies Prudential Rules

Liabilities (Other than long term insurance business)

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 60px; height: 20px;" type="text"/>	<input style="width: 60px; height: 20px;" type="text"/>	<input style="width: 60px; height: 20px;" type="text"/>

Class of Business (as in Part III of Chapter 7)

			1 As at the end of the period	2 As at the end of the previous period
Technical provisions (gross amount)	Provision for unearned premiums (Note 1)	11	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Claims outstanding	12	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Provision for unexpired risks	13	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Other	16	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Total (11 to 16)	19	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Provisions for other risks and charges	Taxation	21	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Other	22	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Deposits received from reinsurers		31	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Creditors	Arising out of insurance operations	Direct business	41	<input style="width: 100%; height: 20px;" type="text"/>
		Reinsurance accepted	42	<input style="width: 100%; height: 20px;" type="text"/>
		Reinsurance ceded	43	<input style="width: 100%; height: 20px;" type="text"/>
	Debenture loans	Secured	44	<input style="width: 100%; height: 20px;" type="text"/>
		Unsecured	45	<input style="width: 100%; height: 20px;" type="text"/>
	Amounts owed to credit institutions		46	<input style="width: 100%; height: 20px;" type="text"/>
	Other creditors	Taxation	47	<input style="width: 100%; height: 20px;" type="text"/>
Other		49	<input style="width: 100%; height: 20px;" type="text"/>	
Accruals and deferred income		51	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Total (19 to 51)		59	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Provision for adverse changes		61	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Total (59 + 61)		69	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Amounts included in line 69 attributable to liabilities to associated bodies other than those under contracts of insurance or reinsurance		71	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>

NOTE

1. The amounts shown in lines 11 to 13 and 16 must be stated gross of the reinsurer's share.

Returns under the Friendly Societies Prudential Rules

Analysis of derivative contracts (other than those relating to property linked contracts or index linked benefits)

Name of Society

Period ended 31 December 19

	Reg No	Units £/£000

Business: Long Term/Other than long term

As at the end of the period	As at the end of the previous period
-----------------------------	--------------------------------------

Category of assets/Total

Assets 1	Liabilities 2	Assets 3	Liabilities 4
-------------	------------------	-------------	------------------

Derivative Contracts

Futures Contracts	Fixed-interest securities	11				
	Equity shares	12				
	Land	13				
	Currencies	14				
	Other	15				
Options	Fixed-interest securities	21				
	Equity shares	22				
	Land	23				
	Currencies	24				
	Other	25				
Contracts for Differences	Fixed-interest securities	31				
	Equity shares	32				
	Land	33				
	Currencies	34				
	Other	35				
Adjustments for variation margin		41				
Total (11 to 41) (Note 1)		49				

NOTE

1. The entry at line 49.1 must be included at Form 13.44.1 and the entry at line 49.2 must be included at Form 14.38.1 or 15.49.1 as appropriate.

Returns under the Friendly Societies Prudential Rules

General insurance business: Technical account

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 60%; height: 20px;" type="text"/>	<input style="width: 60%; height: 20px;" type="text"/>	<input style="width: 60%; height: 20px;" type="text"/>

Class of business (as in Part III of Chapter 7)

Items to be shown net of reinsurance

1 This period

2 Previous period

This period's underwriting	Earned premium (Note 2)	11	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Claims incurred (Note 3)	12	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Claims management costs (Note 4)	13	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Increase in provision for unexpired risks (Note 5)	15	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Other technical income or charges (Note 1)	16	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Net operating expenses (Note 6)	17	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Balance of period's underwriting (11 – 12 – 13 – 15 + 16 – 17)	19	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Previous period's underwriting	Earned premium (Note 7)	21	<input style="width: 100%; height: 20px;" type="text"/>
Claims incurred (Note 8)		22	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Claims management costs (Note 9)		23	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Other technical income or charges (Note 1)		25	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Net operating expenses		26	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Balance (21 – 22 – 23 + 25 – 26)		29	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Balance of all periods underwriting (19 + 29)		49	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>

NOTES

- | | |
|---|---|
| <p>1. Particulars to be specified by way of supplementary note.</p> <p>2. The entry at line 11 must be equal to Form 21.19.5</p> <p>3. The entry at line 12 must be equal to Form 22.17.4</p> <p>4. The entry at line 13 must be equal to Form 22.18.4</p> <p>5. The entry at line 15 must be equal to Form 22.19.4</p> | <p>6. The entry at line 17 must be equal to Form 22.29.4</p> <p>7. The entry at line 21 must be equal to Form 21.11.5</p> <p>8. The entry at line 22 must be equal to Form 22.13.4</p> <p>9. The entry at line 23 must be equal to Form 22.14.4</p> |
|---|---|

Returns under the Friendly Societies Prudential Rules

General insurance business: Analysis of premiums

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 60%; height: 20px;" type="text"/>	<input style="width: 60%; height: 20px;" type="text"/>	<input style="width: 60%; height: 20px;" type="text"/>

Class of business (as in Part III of Chapter 7)

		GROSS PREMIUMS WRITTEN		REINSURERS' SHARE		NET OF REINSURANCE	
		Earned in previous period 1		Earned in previous period 3		Earned in previous period 5	
Premiums receivable during the period							
In respect of risks incepted in previous periods		11					
		Earned in the period 1	Unearned at the end of the period 2	Earned in the period 3	Unearned at the end of the period 4	Earned in the period 5	Unearned at the end of the period 6
In respect of risks incepted in previous periods		12					
In respect of risks incepted in the period	Current financial year of period 31/12/...	For periods of less than 12 months	13				
		For periods of 12 months	14				
		For periods of more than 12 months	15				
	Previous financial year of period 31/12/...	For periods of less than 12 months	13a				
		For periods of 12 months	14a				
		For periods of more than 12 months	15a				
	Opening financial year of period 31/12/...	For periods of less than 12 months	13b				
		For periods of 12 months	14b				
		For periods of more than 12 months	15b				
Premiums receivable (less rebate and refunds) in previous periods not earned in the periods and brought forward to this period		16					
Total (12 to 16)		19					

Returns under Friendly Societies Prudential Rules

General insurance business: Analysis of claims, expenses and technical provisions

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>

Class of business (as in Part III of Chapter 7)

			1 Amount brought forward from previous period	2 Amount payable/receivable in this period	3 Amount carried forward to next period	4 Amount attributable to this period (Note 2)
Claims incurred in respect of incidents occurring prior to this period	Gross amount (Note 1)	11	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Reinsurers's share	12	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Net (11 – 12) (Note 3)	13	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Claims management costs	14	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Claims incurred in respect of incidents occurring in this period	Gross amount	15	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Reinsurers' share	16	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Net (15 – 16)	17	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Claims management costs	18	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Provision for unexpired risks		19	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Net operating expenses	Commissions	21	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Other acquisition expenses	22	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Administrative expenses	23	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Reinsurance commissions and profit participations	24	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Total (21 + 22 + 23 – 24)	29	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>

NOTES

1. Amounts included at lines 11 to 18 must be shown undiscounted.
2. The values in column 4 must be calculated as follows: for lines 11 to 18 values in columns 2 + 3 – 1; for line 19 values in columns 3 – 1; and for lines 21 to 29 values in columns 1 + 2 – 3.
3. The amounts shown at lines 11 to 13 must exclude amounts in respect of claims management costs.

FSC 3 – Notes to Form 23

1 All figures must be shown net of the reinsurers' share.

2 Columns 1 to 9 must be shown undiscounted.

3 All amounts shown must exclude claims management costs.

4 The percentage shown at column 12 must be the ratio of the columns 3 + 4 + 5 + 6 – 2 to column 2.

5 The percentage shown at column 13 must be the ratio of the columns 1 + 3 + 4 + 5 + 6 to column 11.

6 $23.29.5 + 23.29.6 = 22.13.3 + 22.17.3$;
 $23.29.7 + 23.29.8 = 22.13.1$; and
 $23.29.4 = 22.13.2 + 22.17.2$

7 The percentages shown at columns 12 and 13 must be expressed as percentages to one place of decimals.

Returns under the Friendly Societies Prudential Rules

Descriptive Section

Name of Society:

Reg No

1. The date to which the investigation relates is

2. The date to which the latest previous investigation relates is

3. A synopsis of the report by the appropriate actuary on the investigation into the financial condition of the society in respect of its general insurance business, including the actuary's assessment of the financial viability of the society and his or her interpretation of the reasonable expectations of policyholders.

Returns under the Friendly Societies Prudential Rules

General insurance business: Periodic Investigation – Actuary’s Certificate

Name of Society

Period ended 31 December

Reg No	

I certify that:

- (a) (i) in my opinion, proper records have been kept by the society adequate for the purpose of determining the technical provisions in Form 15;
- (ii) in my opinion, the technical provisions shown in Form 15 are appropriate having regard to the nature of general insurance business undertakings of the society including my interpretation of the reasonable expectations of its members as described in Form 23A; and
- (iii) for the purpose of sub-paragraph (ii) above the liabilities have been assessed in accordance with Appendix 5 in the context of assets valued by the *committee* of the society in accordance with Appendix 4, as show in Form 13;
- (iv) the contents of the synopsis in Form 23A correctly reflect the results of my investigation into the financial condition of the society in respect of its insurance business in so far as that investigation relates to general insurance business;
- (v) I have had regard to the following Institute of Actuaries and Faculty of Actuaries professional guidance notes and, in so far as they are relevant to my investigation for the purposes of this certificate, I have complied with them

(b) I have the following additional comments (use extra pages).

Signature

Date

Name:

Address:

Qualification:

Returns under the Friendly Societies Prudential Rules

General insurance business: Periodic Investigation – Auditor’s Report

Name of Society

Period ended 31 December

Reg No	
<input type="text"/>	<input type="text"/>

Auditor’s Report

Signature

Date

Name _____

Address: _____

Qualification: _____

Return under the Friendly Societies Prudential Rules

General insurance business: Periodic Investigation - Signatures

Name of Society

Period ended 31 December

Reg No	

Signatures to the FSC3 Return

We certify that the information in this Return complies with the rules in chapter 5 of IPRU(FSOC).

We confirm also that the society consents to a copy of this Return being placed on the public file of the society.

Chief Executive

Date

Name (Block Capitals)

Secretary

Date

Name (Block Capitals)

Member of Committee

Date

Name (Block Capitals)

Additional Committee member if the offices of the Chief Executive and Secretary are held by the same person.

Date

Name (Block Capitals)

CERTIFICATE OR STATEMENT

FORM FSC4

given by the appropriate actuary pursuant to rule 5.2(3)

Period ended 31 December

The appropriate actuary is requested to complete the certificate in section A, or if unable to do so, the statement in section B. The chief executive of the society is requested to sign section C.

SECTION A

CERTIFICATE

I,⁽¹⁾, CERTIFY that in my opinion there has been no material change in the financial condition of⁽²⁾ in respect of its insurance business since the society sent the last abstract of the appropriate actuary's report (on the society's financial condition as at⁽³⁾) to the Financial Services Authority under rule 5.2(2) which would be likely to result in the value of the liabilities (including any required margin of solvency) exceeding the value of the assets should a full investigation be undertaken as at⁽⁴⁾. I am unaware of any circumstances arising between the year end to which the certificate relates and the date on which it is signed which would cause the society to fail to meet its minimum solvency requirement⁽⁵⁾ / the society's liabilities to exceed its assets⁽⁵⁾.

Signed
Fellow of the of Actuaries

Date

SECTION B

STATEMENT

I,⁽¹⁾, am unable to give a certificate in the form set out in section A above in respect of⁽²⁾.

Signed
Fellow of the of Actuaries

Date

SECTION C

Signed (Chief Executive)

Date

Notes to sections A, B and C

- ⁽¹⁾ insert full name of appropriate actuary
- ⁽²⁾ insert name of friendly society
- ⁽³⁾ insert effective date of last actuarial abstract
- ⁽⁴⁾ insert date of year end to which the certificate relates
- ⁽⁵⁾ delete as appropriate – on the basis of rule 4.1

**The form should be sent to
The Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS**

GUIDANCE ON CORPORATE GOVERNANCE OF FRIENDLY SOCIETIES

This Annex sets out the *FSA's* view of best practice in the corporate governance of *friendly societies*.

The committee of management

1. (1) The *committee* should meet regularly, retain full and effective control over the *friendly society* and monitor the executive management, subject always to the authority vested in members either directly or through delegate bodies, either annually or at other properly constituted meetings.
- (2) The effectiveness of a *committee's* arrangements for monitoring the performance of executive management and for the overall control and direction of the *friendly society* are important tests of its compliance with the *FSA* principles for business in particular principles 2 (“Skill, care and diligence”) and 3 (“Management and control”).
- (3) There should be appropriate arrangements such as a clearly accepted division of responsibilities at the head of a *friendly society*, which will ensure a balance of power and authority, such that no one individual can exert undue influence.
- (4) The *1992 Act* envisages that the offices of Chairman and Chief Executive would be separately held.
- (5) In relation to the size of the *friendly society*, the *committee* should include non-executive members of sufficient number for their views to carry significant weight in the *committee's* decisions.
- (6) A *committee* should have non-executive members of sufficient quality, breadth of experience and calibre for their views to carry weight in the *committee's* decisions and who, individually, can devote the necessary time and attention to the *friendly society's* business.
- (7) There should be an agreed procedure for any member of the *committee* to seek additional information from the executives and to take independent professional advice at the *friendly society's* expense; as may be necessary in the furtherance of his/her duties.

Non-Executive members of the committee of management

2. (1) Non-executive members of the *committee* should bring an independent judgement to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct.
- (2) In assessing whether a candidate for election has an appropriate level of competence, consideration should be given to his or her previous experience of similar responsibilities, the record in performing them and, where appropriate, whether the candidate has relevant qualifications and training. Also important is the individual's ability to bring informed, independent judgement to bear on the issues considered by the *committee*.

- (3) They should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement.
- (4) If fees are paid they should reflect the time which non-executives commit to the *friendly society* and the particular responsibilities related to the size, complexity and diversity of the *friendly society's* business.
- (5) Non-executive members should be elected for specified terms subject to the ceiling imposed by paragraph 6(1)(a) of Schedule 11 to the *1992 Act*; and re-election should not be automatic. Candidates for election as non-executive members should be selected from as wide a constituency as possible.

Executive members of the committee of management

3. (1) Where appointments of senior executives are subject to a formal service contract for a fixed term, the term should not exceed 3 years.
- (2) In the case of any other service contract the period of notice which the *friendly society* has to give to terminate the contract should not exceed 1 year.
- (3) There should be full and clear disclosure of the total emoluments and terms of appointment (including notice) of all of the members of the *committee*.
- (4) Such disclosure would normally be given in the accounts issued by the *friendly society* to its members.

GUIDANCE ON RELATIONSHIPS WITH CONTROLLED BODIES

[Deleted]

GUIDANCE ON OFFICERS' LIABILITY INSURANCE

Introduction

1. This Annex draws attention to the need for a *committee* of a *friendly society* to consider whether to purchase and maintain liability insurance for *officers* and to make sure that the terms of any such policy are fully understood and meet the *friendly society's* needs. A *committee* should disclose the fact that the *friendly society* has purchased or maintained such insurance in the *committee's* annual report.

Section 106

2. Section 106 of the *1992 Act* provides that a *friendly society* cannot exempt its *officers* (including the *appropriate actuary*) or auditors from liability for negligence, default, breach of duty or breach of trust, or indemnify them against such liability. A *friendly society* may, however, indemnify its *officers* or auditors against liability for defence against proceedings where judgement is favourable or the person is acquitted. Section 106 also provides that a *friendly society* can purchase and maintain insurance against any such liability.
3. A *friendly society* which attempts either directly or indirectly (eg, via a year end bonus) to compensate its *officers* for any liabilities arising as a result of error or omission would contravene the provisions of section 106. Such contravention would also clearly risk breaching principle 2 of the *FSA Principles for Businesses* (conduct of business with due skill, care and diligence).

Duty of care

4. Annex 3 (Guidance on Systems of Accounting, Control of Business and Inspection and Report) draws attention to the increasing risks faced by *friendly societies* in the light of the increasing complexity of operations and the increasing pace of change and risks in the financial markets. These factors have led to an increase in the risk that errors and omissions will occur which may give rise to substantial liabilities for *officers*.
5. Annex 3 also draws attention to the special duty of care that the *officers* of a *friendly society* have in respect of safeguarding the interests of *policyholders*. This duty is recognised in principle 6 of the *FSA Principles for Businesses* (paying due regard to *policyholders* interests and treating them fairly). In the *FSA's* view, because of the increasing risk of error and omission, and the possibility that any liabilities which may arise as a result could be substantially greater than an *officer's* or *officers'* financial resources to cover them, that duty of care places a responsibility on a *committee* to consider whether the *friendly society* should obtain indemnity insurance cover for appropriate *officers* in the interests of members (see 6).

Liability insurance

6. The *FSA* will expect any *committee* that has not already done so to give formal consideration to whether to obtain indemnity insurance cover against error and omission for appropriate *officers* (eg. *committee* and senior executives). The *committee*

may wish to take into account a number of factors including: the implications of the risks inherent in the nature and scale of the *friendly society's* business; the cost of the indemnity insurance *premiums*; and *officers'* concerns about the risk of liability that they face because of their duties and responsibilities for the *friendly society*. The minutes of the meeting at which the issue was formally discussed by the *committee* should record the decision reached and underlying reasoning.

7. A *committee* which decides to obtain and maintain indemnity insurance cover for its *officers* will need to ensure that the implications of the policy terms and conditions, and particularly of the list of exclusions, are fully understood. The best starting point may be for the *committee* to decide the key elements it thinks are essential for such a policy before considering, in conjunction with its professional advisers, whether the terms and conditions of specific policies adequately meet those requirements.
8. The *committee* of a *friendly society* which has obtained suitable indemnity cover should not relax its approach to minimising the risks of liability arising from error and omission. It is very important that a *committee* takes every step it can to ensure its *friendly society's* systems are adequate to minimise the risks: systems of control should be sufficient to minimise the risk of errors or omissions occurring; systems of inspection and report need to be capable of identifying any such problems at an early stage, so that matters can be rectified quickly before substantial damage has occurred.

Reporting requirements

9. For companies subject to the requirements of the Companies Acts the fact of the purchase and/or maintenance of indemnity insurance against *officers'* and auditors' liabilities should be disclosed in the directors' report to the annual accounts. The *FSA* considers that the *committee* of a *friendly society* which obtains and/or maintains such an insurance policy should similarly disclose the fact to members in the *committee's* annual report.

Part I

GUIDANCE ON SYSTEMS OF ACCOUNTING, CONTROL OF BUSINESS AND INSPECTION AND REPORT

1. This Part of the Annex sets out the key issues that the *FSA* considers the *committee* and the management of a *friendly society* need to address if the *friendly society's* systems are to satisfy the principle 3 of the *FSA* Principles for Business. That principle requires a *friendly society* to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. The *FSA* expects that these issues will have been considered by a *friendly society's committee* in preparing its reports under rule 3.1.

A. INTRODUCTION

Background

2. Rule 3.1 requires the *committee* of a *friendly society* to send a statement of opinion (also referred to in this note as the rule 3.1 report) to the *FSA* each year on the compliance of the *friendly society* with that section.
3. This Annex provides practical guidance to *friendly societies* about the key issues in the *FSA's* view that:
 - (a) need to be addressed if the requirements of rule 3.1 are to be satisfied; and
 - (b) need to be considered by the *friendly society's committee* in preparing its reports to the *FSA*,

and also provides guidance on the format of reports.

Application of rule 3.1

4. Experience among financial institutions generally continues to demonstrate the importance for the protection of investors of adequate systems of control. As far as *friendly societies* are concerned the powers under the *1992 Act*, the increasing complexity of *friendly societies' operations* (including activities carried on by the controlled bodies of *incorporated friendly societies*) combined with the increased pace of change in financial markets emphasises the need for such systems. Rule 3.1 requires *friendly societies* to:
 - (a) cause adequate accounting records to be kept; and
 - (b) establish and maintain systems of control of business and records and of inspection and report.

These requirements are intended to form a sound basis for the control of *friendly societies' businesses* and the protection of *policyholders' funds*. The requirements of rule 3.1 apply to *friendly societies* and *registered branches* and should also be applied by *incorporated friendly societies* with respect to any controlled bodies (see 8).

5. Chapter 3 covers the roles of *committees*, and the *FSA* with regard to systems and reporting. As with other prudential provisions, it is the responsibility of the *committee* of a *friendly society* to ensure the requirements of rule 3.1 are met and to be able to demonstrate that to the *FSA*. The *FSA* sees the main elements of the *committee's* responsibilities to be:
- (a) establishing and maintaining arrangements for the continuous review of systems, including those for new business;
 - (b) [deleted]
 - (c) assessing whether the *friendly society* (including any *registered branches*), or the *friendly society* and any controlled bodies (“the group”), has complied with the relevant requirements of the Act, *FSA* rules made under the Act and the 1992 Act for the period under review and, as necessary, identifying any shortcomings in compliance with the requirements, together with the corrective actions taken or proposed, including timetable;
 - (d) preparing and submitting the rule 3.1 reports required by the *FSA* from the *committee* by the due date; and
 - (e) discussing with the *FSA* any issues arising from these reports and, where appropriate, corrective actions taken or planned.

Satisfying the requirements of rules 3.1

6. It would not be practical to document all the possible considerations the *committee* and management of a *friendly society* will have to take into account in considering whether their *friendly society* satisfies the requirements of rule 3.1. This note therefore focuses on the main issues which, in the opinion of the *FSA*, need to be addressed by the *committee* and by the management of a *friendly society* if the *friendly society* is to satisfy the requirements of rule 3.1. Where the chief executive of a *friendly society* is not also a member of the *committee*, it is nevertheless still important that he or she gives full consideration to these issues - not least because the chief executive is required to be a signatory to the *committee's* reports to the *FSA* under rule 3.1. This note includes a framework which the *FSA* believes can be applied to all *friendly societies* but also recognises the considerable diversity in nature, scale and scope of *friendly societies' operations*.
7. The *FSA* expects that the issues set out in this Annex will have been addressed prior to the preparation of the rule 3.1 report.

Controlled bodies

8. [deleted]

Friendly societies with registered branches

9. Rules 2.2 and 2.3 require a *friendly society* with *registered branches* to supervise the activities of the branches, notwithstanding the duties of the *committees* and managements of those branches. This includes supervision of compliance with the

requirements of rule 3.1. The management information provided to the *committee* and management of a *friendly society* which has *registered branches* will need to include information about the activities of the *friendly society* as a whole (see 18).

Business standards

10. Principle 3 of the FSA Principles for Businesses requires a *friendly society* to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. The high standards needed for the management of a *friendly society* apply not only to accounting records and controls, but more broadly to business controls over all aspects - including key management information - of the business carried on by a *friendly society*.

B. ACCOUNTING RECORDS AND SYSTEMS

11. The principal reasons why a *friendly society* (including any *registered branch*) or a group is required by rule 3.1 to maintain adequate accounting and other records are:
- (a) to provide the *committee* and management of a *friendly society* (or a branch) with adequate financial and other information to enable them to conduct its business in a prudent manner on a day to day basis;
 - (b) to enable members of the *committee* to fulfil their statutory duties in relation to the preparation of annual accounts in accordance with sections 69 and 70 and the regulations made under section 70 of the *1992 Act* (currently the *Accounts Regulations*);
 - (c) to safeguard the assets of the *friendly society* (or branch) and the interests of *policyholders*;
 - (d) to enable the *friendly society* (or branch) properly to discharge the duties imposed on it by or under the *Act*, *FSA* rules made under the *Act* and the *1974 Act* and/or the *1992 Act*; and
 - (e) to provide the *committee* and the management of the *friendly society* (or branch) with sufficiently timely and accurate information to enable them to submit the information required or requested by the *FSA*.
12. When forming their opinion on whether the accounting and other records are adequate, the *committee* and chief executive of a *friendly society* should assess the scope and nature of the records in the context of the *friendly society's* needs and particular circumstances. They should have regard to the manner in which the business is structured, organised and managed, as well as the size and nature of the *friendly society* and the volume and complexity of its transactions and commitments. In particular, they will need to satisfy themselves that the records:
- (a) are kept in legible form and/or are capable of reproduction in a legible form to be inspected or made available for inspection;
 - (b) are such that adequate precautions are taken for guarding against the possibility of falsification and for facilitating the discovery of falsification should that occur;

- (c) are such that sufficient information is available to enable the rights and expectations of the *policyholders* to be determined;
- (d) capture and record on a timely basis, and in an orderly fashion every transaction and commitment which a *friendly society* or any *registered branch* enters into with sufficient information about each to explain:
 - (i) its nature and purpose;
 - (ii) the assets and/or liabilities, actual and contingent, which arise or may arise from it;
 - (iii) the income and/or expenditure, current and deferred, which arise from it;
- (e) disclose in an orderly and integrated manner, and with reasonable accuracy and promptness, the state of the business at any time.

The *committee* and management of a *registered branch* will also need to have regard to the matters in (a) to (e).

13. The records should be maintained so as to enable the financial and business information to be extracted promptly so that the *committee* and management can monitor and control the performance of the business, the state of its affairs and the risks to which it is exposed.

C. SYSTEMS OF BUSINESS CONTROL

General

14. It is important for a *friendly society* to identify the risks associated with each area of the business it undertakes and the manner in which it carries out that business. Risks associated with the activities of any *registered branches* or controlled bodies should be similarly identified. Control objectives may then be set for each area of the business, and controls established and maintained which address appropriately the identified risks with the aim of ensuring:
- (a) the conduct of the business in a prudent manner and in accordance with the *friendly society's* statements of policy and business practice and any applicable registered rules;
 - (b) that the *committee* and management have sufficient, and sufficiently reliable, financial information to enable them to effectively direct, control and monitor the business and manage the risks identified; and
 - (c) compliance with all relevant statutory and regulatory requirements.
15. It is not practical for this section of the Annex to set out a comprehensive list of the risks that arise or the controls that might be established to address the risks. This section therefore focuses on general areas of concern to *friendly societies* and, in particular on the "high level" controls (see 16 to 24) that need to be established in these areas. "High level" controls would, in this context, be the overall supervisory controls

available to and exercised by the *committee* and other senior *officers* (eg chief executive) - see also B4 in Attachment B of this Annex and C2(e) and C5(b) in Attachment C of this Annex.

Organisational control systems

16. A *friendly society* needs:
- (a) clearly defined organisational arrangements together with a defined structure of authorities and responsibilities - including reporting lines - distinguishing between decisions to be reserved for the *committee* and those to be delegated to managers and other employees; and
 - (b) arrangements for reviewing compliance with, and effectiveness of, organisational controls.
17. In forming their opinion on systems of business control the *committee* and chief executive of a *friendly society* need to establish whether:
- (a) the *friendly society's* overall organisational arrangements are adequately defined and documented, for example in an organisational manual;
 - (b) the *friendly society's* decision-making processes together with authority limits and responsibilities are adequately defined and documented, for example in operating manuals; and
 - (c) compliance with approved authority limits and stipulated segregation of duties is effectively monitored and controlled.

Management information systems

18. Rule 3.1(5) requires the *committee* of a *friendly society* (including a *friendly society* with *registered branches*, see 9) or the *committee* of a *registered branch* to maintain information systems which, amongst other matters:
- (a) enable the respective *committee* to direct and control the *friendly society's* business or the *registered branch's* business; and
 - (b) provide information required by the *FSA* in its role of prudential supervisor.
19. In evaluating whether a *friendly society* has complied with the requirements, the *committee* and management of the *friendly society* need to satisfy themselves that:
- (a) the information is sufficient to enable the *committee* to determine whether the *friendly society* is meeting the requirement to maintain adequate financial resources (see the rules in chapter 4 and also the guidance in 21);
 - (b) the information available for the different areas of a *friendly society's* activities, including those of controlled bodies, is sufficient for the proper assessment of the risks (including those arising from current relevant market conditions and trends) and the proper determination of the need for capital and liquidity;

- (c) the information about the relative assets and liabilities attributable to different classes of members is sufficient to enable the *friendly society* to determine whether the reasonable expectations of each class of *policyholders* are likely to be met;
- (d) the information available is sufficiently comprehensive to provide the *committee* with a clear statement of the performance and financial position of the *friendly society* (including any *registered branches*) and, if appropriate, the group;
- (e) management information reports are prepared as regularly as necessary to ensure that the *committee* is given timely information about all aspects of the business;
- (f) actual performance is compared with planned or budgeted performance on a regular basis and significant variations are highlighted and explained (see also A6 of Attachment A of this Annex);
- (g) sufficient attention is focused on key factors affecting income and expenditure, including capital expenditure, and that appropriate performance indicators are employed; and
- (h) management information is accurately prepared from the underlying accounting and other records and is presented in a form which is clear, consistent and understandable to those persons for whom it is provided.

The *committee* and management of a *registered branch* will also need to have regard to the matters in (a) to (h) in so far as they are relevant to a branch.

- 20. It is important that the form and content of management information is regularly reviewed to ensure that it remains appropriate and relevant to the current pattern of a *friendly society's* business and to market conditions.
- 21. In forming a view on whether the management information system is sufficiently comprehensive, the *committee* and management of a *friendly society* need to consider whether the information made available to them provides, where relevant, a clear statement of:
 - (a) the solvency position;
 - (b) the liquidity position;
 - (c) surpluses and shortfalls, assets and liabilities, profits and losses in respect of controlled bodies;
 - (d) the performance of investments;
 - (e) for a *friendly society* which makes use of *derivative contracts* the *exposures* and uncovered transactions arising from off-balance sheet transactions; and
 - (f) the financial viability of products and controlled bodies.

The *committee* and management of a *registered branch* will also need to have regard to the matters in (a) to (f) in so far as they are relevant to a branch.

22. Where the *friendly society* has controlled bodies it is particularly important that information covers all the component activities and also the overall group position.

Information for the FSA

23. Rule 3.1(5)(b) requires the systems of control and of inspection and report to be maintained to ensure that the information reported to the *FSA* is sufficiently accurate for the purpose for which it is obtained and is regularly provided. In the case of items requiring estimates or judgement by management there will inevitably be a degree of approximation involved. In these cases, the approximations should be capable of being clearly explained, and should be based on stated assumptions. Financial information should be reviewed prior to submission to the *FSA* at sufficiently senior levels in the *friendly society* to ensure, amongst other matters, consistency with any applicable guidance notes and consistency of information provided in different returns but drawn from the same data source.

Planning systems

24. The *committee* and management of a *friendly society* have to satisfy the *FSA* Principles for Businesses in respect of the *friendly society's* current and its future business. For this reason the *committee* and management need to satisfy the *FSA* that the *friendly society* currently meets the requirements of the *FSA* Principles for Businesses and in addition that there is the capacity and intention to continue to do so. A satisfactory planning system is essential for this latter purpose. Further details are set out in Attachment A of this Annex.

Compliance with statutory and other requirements

25. [Deleted]

26. [Deleted]

Documentation of systems

27. Rule 3.1(4)(b) provides that systems of control should not be treated as if they have been established or maintained unless a detailed statement in writing of the systems as in operation for the time being is kept available for the *committee*. Further details are set out in Attachment B of this Annex.

D. SYSTEM OF INSPECTION AND REPORT

28. The requirement for a *friendly society* or a *registered branch* to establish and maintain a system of inspection and report is distinct from the requirement to establish and maintain systems of control. The *FSA* expects that the system of inspection will be undertaken by one or more independent inspectors ("the inspection function"). In this context independent means independent of the functions inspected, see C3(a) at Attachment C of this Annex. The precise arrangements will depend upon the size and nature of the *friendly society* and could therefore vary considerably. Suitable arrangements would include a department (eg an internal audit department) of one or

more members of staff appointed on a full or part-time basis or inspection services provided from outside the *friendly society*, for example from an auditing firm other than the *friendly society's* auditors (who would not normally be expected to provide inspection services - see C6(a) of Attachment C of this Annex). The inspection function should report direct to the *committee* or the audit sub-committee (see 29). The needs of the smallest *friendly societies* with respect to a system of inspection and report may be very simple and it is for the *committee* of such a *friendly society* to consider how best to fulfil the requirements. Further details are set out in Attachment C of this Annex.

E. COMMITTEE REVIEW AND OVERSIGHT

29. The ultimate responsibility for ensuring a *friendly society* complies with the requirements of rule 3.1 rests with the *committee* (see 5). The *committee* will therefore need effective oversight and review procedures to be able to discharge its responsibilities, including those under rule 3.1. An audit sub-committee can assist a *committee* in this respect - although such a sub-committee cannot have delegated to it the responsibilities of the full *committee* for the systems of control and of inspection and report. The *committee* of a *friendly society* may wish to consider whether to establish an audit sub-committee, which would normally be expected to consist of non-executive *committee* members, to advise it on at least some of the issues it will need to consider. As with any sub-committee of the *committee*, the audit sub-committee will need to have documented terms of reference which make clear its role, responsibilities and reporting lines. It would not be appropriate for an audit sub-committee, or any of its members, to carry out inspections themselves, since this would put the members of the sub-committee in the position of being responsible for reviewing the effectiveness of their own work. The matters on which an audit sub-committee might advise include:
- (a) the review of the adequacy of the *friendly society's* system of business control;
 - (b) the preparation and supervision of the *friendly society's* inspection programme;
 - (c) the receiving of reports from the inspection function and reporting to the *committee* on the inspection programme together with recommendations for improvements;
 - (d) the review of the effectiveness of the *friendly society's* system of inspection and report, including an assessment of the scope of work performed by the inspection function, the nature and timing of inspection reports and the adequacy of resources available to the inspection function;
 - (e) the review of the adequacy of management information and other reports made available to the *committee*;
 - (f) the review of the annual accounts prior to their approval by the *committee*;
 - (g) any major problems arising which might have a detrimental impact upon the *friendly society's* solvency position or reputation; and
 - (h) liaison with the *friendly society's* auditors, including discussion on the scope of and matters arising from the audit.

If a *friendly society* has not established an audit sub-committee the matters in (a) to (h) will need to be dealt with directly by the full *committee*.

F. ANNUAL REPORTS BY THE COMMITTEE

Statement of opinion of committee of management and chief executive

30. As explained in 2 the *committee* of a *friendly society* is required to send a statement of opinion to the *FSA* every year stating whether the *friendly society* has complied with the requirements of rule 3.1 and, in the case of a *friendly society* with branches or a *friendly society* with controlled bodies, stating whether its branches or controlled bodies have complied with the requirements.
31. The purposes of requiring an annual statement of opinion by the *committee* and chief executive are:
- (a) to focus the attention of the *committee* on the need to review and develop systems in line with the changing business environment and risks associated with it, in order to provide adequate protection to members' funds; and
 - (b) to take the first step in satisfying the *FSA* that the *committee* has done so.

In forming their opinion, the *committee* and chief executive will need to consider the matters which are set out in rule 3.1 and in this Annex.

Criteria for determining compliance and non-compliance

32. The *FSA* considers that rule 3.1(6) requires matters to be reported which individually or collectively are significant and which result in there not being reasonable assurance that the requirements of rule 3.1 have been complied with in some significant respect at any time during the year. The matters reported should be confined to significant shortcomings and exceptions only (see 34). It is not necessary for the reports to detail how the *friendly society* has achieved compliance with the provisions of rule 3.1. Where significant deficiencies have been identified and reported, the *FSA* expects the report to include: explanations of the shortcomings or exceptions which are sufficiently detailed to enable the *FSA* to understand the matters being reported and their seriousness without the necessity to refer to other sources of information; a statement of the corrective measures taken and/or to be taken; and date of full rectification or target timetable for completion of the corrective action. A shortcoming that has been rectified before the year end will still need to be reported, with details provided of the corrective action that was taken and the date rectification was achieved.
33. [deleted].
34. The *FSA* does not consider that minor deficiencies identified in the accounting records, or systems of control and of inspection and report, need to be reported provided that the *committee* and the chief executive have satisfied themselves that those deficiencies were not symptomatic of more serious problems. If a *committee* is undecided as to whether a particular marginal matter is of sufficient significance to require inclusion in its rule 3.1 report, it should seek the advice of the *friendly society's* auditors.

Matters to be reported to the FSA

35. Circumstances in which the *FSA* would normally expect exceptions to be included in the rule 3.1 report include:
- (a) the absence of accounting records, or of systems of control, or of the system of inspection and report, or of the documentation of the systems of control necessary to enable *committee* members and other *officers* to discharge their duties;
 - (b) a significant weakness or failure in any of the records or systems or documentation of those systems which occurred during the year; and
 - (c) other matters which resulted, individually or collectively, in there not being reasonable assurance that the requirements of rule 3.1 have been complied with.

36. A format for rule 3.1 reports is provided in Attachment D of this Annex.

37. The *FSA* intends the rule 3.1 reporting process to be beneficial for the *committee* of a *friendly society*, as well as fulfilling the purposes of prudential supervision. In the normal course of events the *FSA* would not expect a qualified report to trigger the exercise of any of its powers provided there was evidence that the *committee* was carrying out its duties conscientiously and taking appropriate corrective action. Conversely, in the context of maintaining a frank and open supervisory relationship between the *FSA* and a *friendly society*, the *FSA* would view seriously any failure to disclose known significant shortcomings.

38. [deleted].

The FSA's response to reports received

39. The reports received from *friendly societies* will, together with other information available to it, be used by the *FSA* as part of its evaluation of the position of each *friendly society* in relation to:

- (a) the requirements of rule 3.1; and
- (b) the *FSA* Principles for Businesses.

40. When a qualified report is received the *FSA* will consider whether the corrective action appears sufficient, and whether it calls in question the adequacy of the protection of the interests of *policyholders* of the *friendly society*. A qualification of the rule 3.1 report may not call such protection into question, provided that the report also indicates timely and effective corrective action. Before reaching any conclusions, however, a meeting with a *friendly society's committee* and/or management may be arranged, which the *friendly society's* auditors may also be asked to attend. The purposes of such a meeting would be to:

- (a) establish whether or not the matters reported are prudentially significant;
- (b) understand fully any proposals in the report for corrective action; and

- (c) where appropriate, agree a basis for monitoring the implementation and effectiveness of the proposals.

Whether or not a report is qualified, the *FSA* may wish to explore the basis of the assessment by the *committee* in its report. In so doing, the *committee* may be asked to satisfy the *FSA* on how it has dealt with the various issues in this Annex.

Part II

GUIDANCE ON SYSTEMS OF CONTROL OVER INVESTMENTS

1. This Part of the Annex provides guidance on the main elements of systems of control over investments in conjunction with Part I of this Annex which provides guidance on Systems of Accounting, Control of Business and Inspection and Report. A and B of this Part of the Annex include guidance of general application to *friendly societies*. C provides guidance to *directive friendly societies* which make use of *derivative contracts*.

A - Background

2. Chapter 3 includes a number of provisions with implications for the establishment and maintenance of systems of control over a society's investments - the main provisions are listed below. For ease of reference the provisions listed are split into two elements, those with general implications for the accounting records of, systems of control over, and inspection and report on a society's investments (see 3 to 5) and those which have specific implications for a society's investment policy (see 6 to 13). These lists are not intended to be exhaustive.
3. Principle 3 of the *FSA Principles for Businesses* requires a *friendly society* to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems.
4. Rule 3.1(1) requires every society and branch to "establish and maintain adequate systems of control of its business and records and of inspection and report".
5. Rule 3.1(4) requires the systems of control and inspection and report to be such as to enable the *committee* properly to discharge the duties imposed on them under the *Act*, the *1992 Act* or the *1974 Act*, and for the *committee*, the functions of direction of the affairs of the society or branch.

Requirements with implications for investment policy

General

6. Section 46 of the *1974 Act* (as amended by the *1992 Act*): this section provides information about the investments into which societies registered under the *1974 Act* may place funds, and includes any investment in which trustees are authorised by law to invest funds.
7. Section 14 of the *1992 Act*: this section provides information about the investments into which incorporated societies may place funds.
8. [deleted].

Applicable to directive friendly societies

9. Rule 4.12(1) requires the assets backing insurance liabilities (other than in respect of *linked benefits*) for a *directive friendly society* to satisfy the following conditions:

- (a) “.....of appropriate safety, yield and marketability having regard to the *classes* of business carried on”; and
 - (b) “..... investments are appropriately diversified and adequately spread and that excessive reliance is not placed on investments of any particular category or description”.
10. Rule 4.12(2) applies to the *linked long-term contracts* of a directive society for which liabilities are covered by the value of assets in an internal fund, or units in a collective investment in transferable *securities*, or by reference to a share index, or by assets of appropriate safety, yield and marketability which correspond, as nearly as may be, to the assets on which the reference value is based.
 11. Rule 4.12(3) also applies in respect of the *linked long-term contracts* of a directive society and requires the society to secure that its liabilities under the contract in respect of *linked benefits* are covered by assets of a description specified in Appendix 3.
 12. 15 of, and Annex B to, Appendix 4 **specify** the reductions that should be applied to the aggregate value of a directive society’s assets for the purposes of the determination of the society’s *required margin of solvency* taking account, amongst other matters, of *permitted asset* and *counterparty exposure limits* and *excess concentration with a number of counterparties* (see 20 to 22).
 13. Rules 4.14 to 4.19, which apply to directive societies, set out the requirements for matching and localisation of assets.

B - Systems of control

Importance of adequate controls

14. The investments a *friendly society* makes on behalf of its *policyholders* are an important area of its operations: the transactions may be large in relation to other areas of the society's business; and the effects on the society arising from negligence, error or irregularity could be significant. It is therefore important for a society to have preventative controls in place. The nature of those controls will vary with the size and nature of the society and whether or not it makes use of complex investment instruments such as *derivative contracts*. The following guidance on the systems of control over investments should be considered within the overall context of the guidance in Annex 3.
15. The systems of control over investments of societies will generally include the following features:
 - (a) documentation: this is usually in the form of the investment policy (see 17 to 23);
 - (b) a comprehensive management information system (see 24); and
 - (c) adequate operational controls over investments (see 25 to 27).
16. Additional considerations for *directive friendly societies* which make use of *derivative contracts* are included in C (see 31 and 32).

Investment policy - general

17. It is important that the *committee* gives consideration to documenting the investment policy and takes the necessary steps to ensure that the current investment policy is being applied, and that there are systems of control which would result in the *committee* being consulted before any decision is made which may not be in accordance with the current policy. In establishing the policy a *committee* will need to take account of these rules, any requirements in the society's registered rules and advice from the *appointed* or *appropriate actuary*.
18. The *committee* should ensure that the society's investment policy is one which is appropriate for the society's type of business and its business plans. The policy needs to be appropriate to the size and nature of the society, and recognise changing market circumstances and be reviewed and revised as necessary from time to time. Where a *friendly society* instructs an investment adviser to make investments for it, the society's investment policy should be reflected in any contracts or agreements made with the organisation engaged to invest the funds of the society.

Investment policy of a society doing linked long-term business

19. The *committee* of a society which has been authorised to write *class III* business (linked long-term), will need to ensure that the investment policy with respect to the assets of its linked long-term funds takes into account fully the requirements of the rules in chapter 4.

Investment policy of a directive society - exposure limits

20. The *committee* of a *directive friendly society* should consider whether to include limits in its investment policy on the following matters:
 - (a) the society's *exposure* to particular assets, taking the provisions and limits in Annex B to Appendix 4 (see 12) into account; and
 - (b) the society's *exposure* to particular *counterparties* taking the limits in B2 of Annex B to Appendix 4 into account (see also 22).
21. The *committee* of a society which has, or is likely to have, significant aggregate exposures to one or more *counterparties* will need to ensure the society has appropriate procedures in place for assessing the creditworthiness of those *counterparties*. The *committee* may, as a result of the assessments, consider it prudent to set lower internal limits than those in Annex B to Appendix 4. The *committee* of a society which uses a third party to manage some of its investments should ensure that for monitoring purposes (see 24) the exposure to a particular *counterparty* in the funds under third party management is aggregated with the *exposure* to that *counterparty* in the funds managed by society staff.
22. In considering counterparty exposure limits, and for the purposes of monitoring aggregate *exposures* to particular *counterparties* (see 24), the *committee* will need to take into account the requirements in B13 to B15A of Annex B to Appendix 4. These provide for the aggregation of *exposures* arising from all types of investment in or with a *counterparty*, together with the value of all rights against that *counterparty* (subject to the exceptions in B14 and B15 of Annex B to Appendix 4) in each case up to the permitted asset exposure limits. The *committee* should also take into account the provisions of B16 of Annex B to Appendix 4 with respect to *excess concentration with a number of counterparties*. The *committee* will need to remember that the permitted *exposure* limits set out in Annex B to Appendix 4 represent the maximum amounts which can be valued for solvency purposes.

Exposure limits - additional considerations

23. The *committee* of a *directive friendly society*, particularly if it makes use of the powers under section 14 of the *1992 Act*, should consider whether, in addition to any policy limits arising from the *exposure* and concentration provisions in Annex B to Appendix 4 (see 20 to 22), internal policy limits for aggregate exposures to certain categories of assets should be included in the investment policy. The limits for certain categories of assets will need to take account, where applicable, of rule 4.12(1) (see 9). In addition the level of the society's free assets should be taken into account, bearing in mind the possibility that such assets might in future be needed to cover *insurance liabilities* or minimum margin of solvency.

Management information

24. It is important for a society to have adequate monitoring and reporting arrangements commensurate with the size and nature of the investment activities. The management information needs to be designed to: enable monitoring against policy limits (and statutory limits where applicable); help assess, in conjunction with the inspection function, the effectiveness of existing operations and controls over the management of investments; and provide a basis on which to determine future investment policy. In this context a *committee* will need to ensure a record of investment decisions, and who made them, is kept for reference purposes. Reports should be provided at regular intervals to the society's *committee* and senior management; frequent reporting being essential where material investment transactions are regularly made and/or where complex investment instruments such as *derivative contracts* are being used.

Operational controls

25. The operational controls necessary for a satisfactory control system will vary with the size and nature of the society, the investment strategy and whether third parties are used to manage the investments (see 26). The control system will need to be sufficient to match the complexity of the investment instruments being used. Controls need to be designed to ensure:
- (a) the safeguarding of the assets of the society;
 - (b) compliance with the documented investment policy;
 - (c) investment deals are performed in an orderly and efficient manner; and
 - (d) the risk of loss from negligence, error or irregularity is minimised.

Third party investment managers

26. Where a third party has been appointed to manage part or all of a society's investments, the *committee* should be satisfied that the third party is able to comply with, and adhere to, the society's investment policy criteria and policy limits. In addition the *committee* will need to be satisfied that there are appropriate and effective controls in place. This is particularly important for an *incorporated friendly society* if the investment manager holds funds on its behalf. Before appointing such a third party, or in reviewing the appointment of the existing investment manager, the *committee* will need to be satisfied as to the following:
- (a) the standing of the third party, including whether it is subject to a regulatory regime;

- (b) compliance by the third party with the parameters the *committee* considers essential for the society's investment manager. Such parameters might include: performance requirements, minimum staff size (e.g. so that there are sufficient staff to allow for adequate segregation of duties, particularly if complex investment instruments such as derivatives are to be used) and capitalisation requirements;
- (c) the terms of the agreement with the third party:
 - (i) that the agreement sets out clearly the parameters within which the third party may operate, in particular:
 - does it take account of the relevant legislative constraints?
 - does it take account of the society's investment policy criteria and policy limits?
 - (ii) that the agreement provides adequate safeguard for the society in the event of negligence, error or irregularity by the third party;
- (d) the management information (see 24) to be provided by the third party, in particular is the information sufficient for the *committee* to be able to assess performance and monitor compliance with legislative constraints, investment policy criteria and policy limits.

27. The service provided by the investment manager should not only be monitored throughout the year but should also be subject to more fundamental review on a regular basis.

Audit

28. Internal audit will have a role in the operation of the systems of control over investments. Internal audit may:
- (a) advise on design of systems of control or improvements to existing systems
 - (b) assess the effectiveness of systems from time to time
 - (c) test compliance with existing procedures.

29. [deleted].

Committee responsibilities

30. The *committee* of a *friendly society* will need to assess the effectiveness of the arrangements for the systems of control over the society's investments (including where transactions are carried out by a third party on a society's behalf) drawing on the auditors' advice as appropriate, in order to satisfy the requirements of rule 3.1 on this aspect of their responsibilities.

C - Additional considerations for controls over derivative contracts

31. 13 to 15 of, and Annex B to, Appendix 4 includes specific provisions with respect to *derivative contracts* and contracts or assets having the effect of *derivative contracts*. This includes provisions restricting those contracts which may be counted as assets for the purposes of determining a *directive friendly society's* regained *margin of solvency*. Annex 6 refers to

Guidance Note 4.2 in *IPRU(INS)* which discusses valuation issues surrounding the use of *derivative contracts*. That Annex also draws attention to the need for the *committee* and management of a society which uses *derivative contracts* to have sufficient understanding of the nature and risks of the contracts it uses to ensure there are effective systems in place to monitor the use of derivatives.

32. The *committee* of a society which uses *derivative contracts* will need to take all steps which are reasonable, taking into account the nature and scale of the use of derivatives, to ensure that:
- (a) the nature of the derivatives being used and the related risks (including interest rate risk, foreign exchange risk and operational risk) are fully understood by management even where a third party manages derivative transactions as part of the investment management service supplied to the society;
 - (b) the investment policy document sets out the objectives and policies for the use of derivatives; there are documented exposure limits for: total exposure to, and/or volume of, derivative transactions; maximum exposures to, and/or volumes of, permitted types of derivative transactions; exposure to counterparties; and exposure to uncovered transactions; where a society's staff manage derivative transactions dealer limits for individual dealers will need to be documented;
 - (c) the society has control and/or monitoring procedures which:
 - (i) ensure that transactions are in line with the *committee's* policies and new types of instrument are not dealt with without prior consideration at *committee* level;
 - (ii) ensure the *committee* and senior management are provided regularly with statistics and information (appropriately summarised) on the trading volumes of derivatives by type of product including regular reports of all off-balance sheet transactions, mark-to-market position, contingencies and commitments; and
 - (iii) focus particular attention on uncovered transactions (which may only be undertaken in relation to assets which do not match technical provisions) so that in no circumstances is the minimum margin of solvency endangered nor are members' reasonable expectations adversely affected. Systems are needed which are adequate to prevent exposure to unacceptable volatile risks, and to monitor transactions with a frequency commensurate with volatility and risk. The systems in place need to be designed to trigger the society's strategy to hedge or close out a transaction whenever adverse movements or events threaten a significant worsening of the solvency position;
 - (d) where derivative transactions are managed by society staff:
 - (i) staff authorised to carry out derivative transactions are suitably qualified and competent to transact the range and type of transactions being undertaken and understand the nature of the exposures (including both *counterparty* and market risk) which the use of *derivative contracts* will create;
 - (ii) the resources (including staff resources) and systems are sufficient to cope with the volume and volatility of transactions undertaken. This applies to back office (e.g. accounting staff, record keepers), as well as front office (e.g. fund managers, dealers) systems;

- (iii) control procedures include independent agreement and reconciliation of positions, independent checking of prices, agreement of profits to accounting profit, appropriate authorisation where dealing limits have been exceeded;
 - (iv) to ensure effective control, those with responsibility for the control systems in respect of derivative transactions are independent of the dealers; and
 - (v) senior managers have the capacity and resources to be able to analyse and monitor the risk of all derivative transactions undertaken both by individual transaction and in aggregate (including interest rate risk, foreign exchange risk, fraud, error, unauthorised access to confidential information and other operational risks). Basic monitoring information may be needed in a daily report to managers. Monitoring information (including that supplied by third party managers) will need to include mark-to-market information in respect of all outstanding derivative transactions, valuing derivatives and underlying assets hedged at their current market price to check whether instruments are fulfilling expectations; and
- (e) there are adequately tested and approved valuation models which are used to value open positions and derivative instruments and that amendment to their programmes are controlled. Such models should include an appropriate test of the robustness of the portfolio to stress in changing investment conditions.

BUSINESS PLANNING

Introduction

- A1. The *committee* of a *friendly society* should be aware of the importance of having an integrated system for planning, budgeting, financial accounting, monitoring of actual against budget and feedback of results into management decisions and back into the planning process. However, just how sophisticated a *friendly society's* planning systems need to be will depend upon the size and nature of the *friendly society's* operations. The information in this Annex is neither intended to be prescriptive of what elements of a *friendly society* should be included in its system of business planning, nor can it be comprehensive of all matters that might be appropriate to the business planning of a *friendly society* - there are other publications available on such matters. The information in this Annex is intended to be helpful to *committees* and management, in particular, in providing information on key elements of a full planning system which the *committee* and management of a *friendly society* need to consider before determining on or revising the *friendly society's* system of business planning and documented plans. The *committee* and management will need to decide on the appropriate planning horizon for their *friendly society*, consistent with the *friendly society's* circumstances and appropriate to the effective management of the risks the *friendly society* faces, including any risks that may arise from its own initiatives as well as those arising from the changing business environment.
- A2. The key features of an integrated planning system include:
- (a) clearly defined and documented short, medium and long-term planning, with clear allocation of responsibilities within the *friendly society* for the development, review and approval of plans, and the subsequent monitoring of performance against them;
 - (b) the conclusions, recommendations, financial projections and assumptions set out in any plan need to be based on adequate data obtained from internal and external sources, and by appropriate critical analysis;
 - (c) a range of possible outcomes need to be considered, relating to varying levels of risk and/or uncertainty, and the financial impact on a *friendly society's* solvency margin should be considered by the *friendly society's* actuary; and
 - (d) key indicators should be identified against which actual performance can be tracked. Actual data should be prepared on a basis consistent with the plan, to enable proper comparison to be made.

Strategic planning

- A3. A corporate plan focusing on longer term strategic issues may be developed. Such a plan should be reviewed regularly in the light of experience and changing circumstances and could include elements of the *friendly society's* medium term planning, see A5. The key elements for a strategic plan include:

- (a) views on the markets in which the *friendly society* competes or proposes to compete in;
- (b) identification of the *friendly society's* strengths and weaknesses, market and other opportunities open to it, and threats to the *friendly society's* market and financial strength;
- (c) the *friendly society's* strategic aims and the action which needs to be taken to achieve those aims;
- (d) any major resource implications of the strategic aims - including for information technology, senior management and staff as well as financial implications; and
- (e) financial projections - including cash flow forecasting and projections based on different assumptions (eg. on optimistic, pessimistic and expected bases).

A4. A corporate plan including a *friendly society's* strategic aims should not simply consist of a number of desirable aims, but should set out the processes whereby these will be achieved. It will then be important to monitor the extent of achievement of the specified action steps, so that, if necessary, appropriate corrective action may be taken.

Medium term planning

A5. The medium term planning of a *friendly society*:

- (a) may provide for the setting, review and revision of medium term financial and other objectives, as appropriate, consistent with the *friendly society's* longer term strategic aims and targets; and
- (b) as appropriate, may include new business activities, which need to be adequately researched, analysed and appraised in terms of feasibility, financial returns and requirements for capital.

Short term planning

A6. Adequate short term financial and operating plans are necessary as a basis for measuring performance and taking tactical decisions. In general terms this means that a *friendly society's* short term planning will need to include the setting of an annual budget (which may include cash flow forecasting), against which actual performance can be monitored (see also 19(f) of Part I of this Annex).

Business continuity planning

A7. A *friendly society* will need to consider its arrangements to ensure continuity of business in the event of some unforeseen disaster such as a fire or bomb damage. A business continuity plan should, as appropriate, deal with the possibility of major computer hardware or software failure as well as other wider aspects such as premises, personnel and external communications. These arrangements should be regularly reviewed and tested to ensure that they work in practice.

Information technology

- A8. Information technology (IT) will be a major feature of the business of a number of *friendly societies*. IT brings significant benefits to such *friendly societies*, but also brings considerable risks. The issues which the *committee* and management of a *friendly society* will need to address, as appropriate, include:
- (a) the extent to which a *friendly society's* IT strategy is consistent with its longer term strategic aims;
 - (b) whether the procedures for evaluating significant IT investments are sufficiently comprehensive to ensure that the technical and business cases for the investments are clearly demonstrated;
 - (c) within the *friendly society*, at *committee* as well as operational level, there should be an appropriate allocation of responsibility for IT issues;
 - (d) the security of data and systems is of paramount importance, controls will therefore need to be in place to minimise the risk of unauthorised access or the loss of data. Such controls should cover not only centralised mainframe processing but also remote terminals and stand-alone or linked PCs;
 - (e) the exercise of strong control by the *committee* over the development of new or significantly modified IT systems. Appropriate technical and project management skills are likely to be required and a *committee* will need to determine whether it is appropriate to seek expert assistance from outside the *friendly society* in order to facilitate the process; and
 - (f) appropriate skills and experience are needed to enable the inspection function to assess the effectiveness of IT controls. The involvement of the inspection function in an advisory capacity during the development of significant new IT systems, will be needed to help ensure that appropriate controls are in place.

Human resources planning

- A9. The *committee* and management of a *friendly society*, in particular one which has taken, or proposes to take, advantage of the opportunities afforded by the *1992 Act*, may need to consider the overall current and future human resources requirements. Such considerations include the planning for, and development of, human resources where a *friendly society* is proposing to enter a field of business activity with which it is not familiar. The matters on which the *committee* and management may need to be satisfied include that:
- (a) the *friendly society* has identified its present and future staffing and skill requirements relative to its business activities and has defined recruitment, training and development plans to achieve them; and
 - (b) there are arrangements for securing the supply of appropriately skilled members of the *committee*, directors of controlled bodies, managers and staff.

ATTACHMENT B TO ANNEX 3

DOCUMENTATION OF SYSTEMS

Introduction

- B1. The need for the documentation of systems is primarily twofold:
- (a) whilst control systems might be operated satisfactorily for a time without documentation, the absence of documentation makes it impossible to ensure that the systems of control are maintained over time; and
 - (b) the *committee* and others (e.g. external auditors and those carrying out the inspection function) have specific responsibilities in respect of the control systems. The absence of documentation makes it impossible for those reviewing the systems to satisfy themselves that the controls being operated are those that have been authorised, that they are complete and that they are adequate for their purpose.
- B2. Whilst the overall content of such documentation should be comprehensive (see B3(a)), it will of course vary from *friendly society* to *friendly society*, according to the nature and scale of business and may only need to be relatively simple for a small *friendly society* with few staff. The specific content of documents may also need to vary within a *friendly society* appropriate to the levels of staff for whose use it has been prepared. Documentation prepared for the *committee* and/or management (see also B4) may need to be wider in scope and to include a greater emphasis on controls, but less detail about operational procedures, than documentation for more junior staff. Documentation prepared for more junior staff will need to include detailed information about the procedures to be followed but may only need to cover the control procedures applicable to the work of the staff concerned.

Form of documentation

- B3. The *committee* and management of a *friendly society* will determine the form of control system documentation to be adopted. They should, however, take into account a number of considerations about the documentation, including that:
- (a) **it should be comprehensive:** and should cover all material aspects of the operations and business of the *friendly society*;
 - (b) **it should be integrated:** separate elements of the system should be interrelated and cross-referred in such a way that the system can be viewed as an integrated whole;
 - (c) **it should identify risks, and the controls established to guard against those risks:** the controls need to be identified and their purpose defined so that their effectiveness can be evaluated and so that the relationship and interdependency with other controls can be established;

- (d) **it should attribute responsibility for operating the controls:** there need to be named persons or posts for each control operation, alternatives in case of absence and continuity of standards of control during absence;
- (e) **it should state how the operation of the control is to be evidenced:** methods of evidencing include - signatures or initials; records and registers; retention of control documents; staff attendance records;
- (f) **it should establish a comprehensive and unambiguous control discipline:** the instructions should be clear and precise, avoiding expressions in relation to control functions such as “normally” and “if possible”;
- (g) **it should be suitable for practical day to day use:** the separate specifications of controls should have a practical role in the review and improvement of systems, for example, through the inspection function;
- (h) **it should be up to date:** there should be an accurate description of the system that has been established and is operating. When changes or modifications are made, the appropriate systems of control will need to be established and documented by the time the changes become operative; and
- (i) **it should require confirmation of compliance:** managers of different areas of a *friendly society*'s business are key control points within the overall control system. They should periodically be required to confirm to the *committee*, to the best of their knowledge and belief, compliance of controls within the system which has been established.

B4. Documentation should not be restricted to “lower level” clerical and authorisation controls applied in transaction processing, but should also cover “high level” controls (see 15 of Part I of this Annex), including:

- (a) powers to be exercised only by the *committee*, and powers delegated to others;
- (b) the purpose, composition and reporting lines of *committee* member sub-committees and senior management to whom powers and responsibilities have been delegated;
- (c) the role, responsibilities and reporting lines of *committee* members; and
- (d) the timing, form and purpose of *committee* meetings and the mechanism whereby agreed *committee* strategies, policies and decisions are recorded and their implementation monitored.

Computer controls

B5. The documentation of computer controls need to be integrated within the overall documentation of a *friendly society*'s system of business control. Where operating manuals are provided by a computer supplier these can often form a useful part of a *friendly society*'s procedures documentation but it is unlikely that such manuals will be in a form which enables them to form part of the control documentation. The matters set out in B3 apply equally to the controls surrounding computer systems.

- B6. There will be a number of key controls performed within the computer programs and a *friendly society* will need to ensure that it documents all such controls if reliance is being placed on them.

ATTACHMENT C TO ANNEX 3

SYSTEM OF INSPECTION AND REPORT

Purpose of the system

- C1. The purpose of a system of inspection is:
- (a) to provide a continuous appraisal for management and the *committee* as to the overall effectiveness of the control systems, including all proposed changes, and to recommend improvements where considered desirable or necessary;
 - (b) to determine whether the systems and controls established by the management and the *committee* have operated as laid down in the control documentation of the *friendly society* or *registered branch* and comply with policies, procedures, laws, regulations and any other requirements; and
 - (c) to assess whether financial and operating information supplied to management and the *committee* is accurate, appropriate, timely and complete.
- C2. A *friendly society* should ensure that, in addition to coverage of operational activities, its system of inspection adequately covers the following areas - as appropriate to the scale and nature of the business:
- (a) controls to verify the accuracy and completeness of returns and other information provided to the *FSA*;
 - (b) controls to ensure compliance with relevant statutory and regulatory requirements;
 - (c) broader management controls, such as controls over business planning, systems for monitoring and reporting on financial performance and other key business indicators;
 - (d) controls over new areas of business and other initiatives, whether carried out within the *friendly society* or through controlled bodies; and
 - (e) the “high level” controls referred to Part I of this Annex.
- C3. The *committee* and management of a *friendly society* will need to satisfy themselves that the following considerations have been properly addressed within the context of the scale, range, complexity and pace of development of the *friendly society*'s business:
- (a) the inspection function is independent of the functions it inspects in order to maintain its objectivity;
 - (b) sufficient resources are available to achieve the agreed objectives of the inspection function;

- (c) qualifications, experience and training of individuals performing the inspection function are adequate in relation to the objectives; and
- (d) the status and reporting relationship of the head of the inspection function is sufficient to maintain the independence and objectivity of the function. It is important to ensure that, in addition to regular reporting to management and the *committee* (see C5(f)), the head of the inspection function has the right of direct access to the highest level of management and the *committee*.

C4. An audit sub-committee can have a key role to play in controlling the work of the inspection function and receiving its reports. The role of the audit sub-committee is covered in more detail in 29 of the main text of this Appendix.

Key elements of a system

C5. The key elements of a satisfactory system of inspection include:

- (a) **Terms of reference:** these should be specified with precision and should include, amongst other matters, scope and objectives of the inspection function, access to records, powers to obtain information/explanations from staff, and reporting requirements. The terms of reference should be approved by management and the *committee*. The *friendly society's* inspectors (or internal auditors) will require a wide-ranging access to records and documents, including material prepared for and by the *committee*. They will also need to be empowered to obtain information and explanations from staff at all levels, and *committee* members.
- (b) **Risk analysis:** risks identified and the controls put in place by management to address those risks should be considered in each area or cycle of the *friendly society's* business. The adequacy of the controls should be assessed. Weaknesses in control should be drawn to the attention of the *committee* or audit sub-committee and other senior *officers* of the *friendly society* as specified in the terms of reference. In this context risk factors may include more than just the risk of pecuniary loss, or error or mis-statement in the accounting records. As appropriate, reputational risk, and wider business and operational risk, may also need to be considered. Full consideration should be given to the high level controls in place within the *friendly society*. These include the controls referred to in 15 of Part I of this Annex and C2(e) - see also B4 in Attachment B of this Annex.
- (c) **Inspection plan:** an inspection plan should be developed covering all aspects of the *friendly society's* business and which, in the opinion of the *committee*, satisfies the requirements of rule 3.1. The inspection function should focus in particular on those areas identified in the risk analysis as higher risk, taking into account the related inherent risk factors and controls in place. However, all areas of the *friendly society's* business should be covered over a set time frame and the inspection plan should identify the scope and frequency of the work to be carried out in each area. The plan should be reviewed and approved at *committee* level, or by the audit sub-committee on behalf of the *committee*, before work commences.

- (d) **Detailed programmes:** these will set out the specific tests to be performed in each area of the inspection plan.
- (e) **Working papers:** adequate working papers should be maintained to record audit planning and execution, principal findings and follow-up action. Amongst other matters, the papers should provide: evidence of the individual who performed the programmed work; how it was controlled and supervised; and record the conclusions reached - with cross-referencing to the reports made and action taken.
- (f) **System of reporting:** the results of the work performed should be reported to senior management and any audit sub-committee and the *committee* in accordance with the terms of reference. Such reporting should be carried out on a regular and timely basis. Obviously serious matters should be raised immediately. The reports should briefly describe the area(s) covered, significant matters arising, recommendations and overall conclusions. Procedures should be established to make sure the recommendations have been implemented or non-implementation validly justified.

Reporting and review

C6. The *committee* and management of a *friendly society* need to satisfy themselves that the system of inspection is being properly carried out. In order to review the overall effectiveness of the inspection function, the *committee* needs to consider the following aspects:

- (a) adequacy of resources, including number, experience and skills of those providing inspection services. There may be areas (eg computer audit) for which specific skills may need to be obtained from an external source. A *friendly society's* auditors would not normally be expected to provide such inspection services, as there is potential for a conflict of interest to arise. This position is so, regardless of whether the work would be carried out by persons not directly involved in the audit or rule 3.2 review of the *friendly society*;
- (b) adequacy and scope of planning and work performed, including the allocation of inspection effort to each area of the *friendly society's* business;
- (c) frequency, quality and timeliness of reporting on matters arising from the inspections;
- (d) consideration and resolution of points and recommendations raised, and reasons for any rejection of major points; and
- (e) review of overall effectiveness of the inspection function.

ATTACHMENT D TO ANNEX 3

**Report by the Committee of Management of [NAME OF *FRIENDLY SOCIETY*]
under rule 3.1 of *IPRU(FSOC)***

In our opinion during the year ended _____, the requirements of rule 3.1 were* (complied with)/ (complied with except in the respects set out in the attached Schedule [A]).

Signed by:

_____ Chairman

_____ Chief Executive

Date _____

* Delete as appropriate

Schedule [A] to the Committee's report for the year ended
_____ under rule 3.1 of IPRU(FSOC)

1. Exceptions arising in previous years:

(a) Remedied during 200_ [current report year]

Under each appropriate heading provide a clear description of the exception, remedial action(s) taken and date of full rectification.

(b) Exceptions not fully rectified during 200_ [current report year]

Under each appropriate heading provide a clear description of the exception, the action(s) taken and/or remaining to be taken and timetable for completion.

2. Exceptions arising in 200_ [current report year]

(a) Remedied during 200_ [current report year]

Under each appropriate heading provide a clear description of the exception, remedial action(s) taken and date of full rectification.

(b) Exceptions not rectified during 200_ [current report year]

Under each appropriate heading provide a clear description of the exception, action(s) taken and/or to be taken and timetable for completion.

GUIDANCE ON MARGINS OF SOLVENCY AND THE GUARANTEE FUND

Introduction

1. This Annex gives guidance to *friendly societies* on the application of rules 4.1 to 4.7 which set out the requirements for maintenance of a *required margin of solvency* and a *guarantee fund*. It explains how different categories of *friendly societies* are affected. This Annex does not apply to *flat rate benefits business friendly societies*.

The required margin of solvency

2. Rule 4.1 provides that a *friendly society* which has permission to carry on *general insurance business* and/or *long-term insurance business* is required to maintain a margin of solvency of an amount prescribed in rules 4.2 to 4.10.
3. Rules 4.2 to 4.10 do not apply to any *friendly society* which does not have permission to effect new contracts of insurance and is only carrying out contracts of *long-term or general insurance business* which were effected before 13 September 1993. Such societies must maintain an excess of the value of the *friendly society's* assets over the amount of its liabilities.
4. A *friendly society's* failure to maintain a *required margin of solvency* would be an early warning sign of difficulty. The *FSA* would under *SUP* require the *friendly society* to submit a suitable restoration plan within a specified reasonable time and give effect to the plan. The *required margin of solvency* might be restored by, for example, tighter budgetary control, restriction of new business, reinsurance arrangements or changes in investment mix.

Implicit items: future surpluses

- 4A. (1) A *friendly society* may apply for a waiver from rule 4.7(3) under section 148 of the *Act* (see *SUP*) so that the *implicit item* relating to future surpluses may be valued at not more than 50% of the full amount of future surpluses.
 - (2) For the purposes of (1), the full amount of future surpluses is the estimated annual surplus multiplied by a factor which as nearly as may be represents the average number of years remaining to run on policies, but does not exceed 10.
 - (3) For the purposes of (2) -
 - (a) the estimated annual surplus is one-fifth of the surplus ("the periodic surplus") made in *long-term insurance business* over a period of five years ("the relevant period") ending on the last day of the most recent *financial year* for which a valuation for the purposes of rule 5.1 has been carried out, substantial items of an exceptional nature being excluded; and
 - (b) the average number of years remaining to run on policies is calculated-

- (i) by multiplying the number of years to run on each policy by the actuarial value of the benefits payable under the policy, adding together the products so obtained and dividing the total by the aggregate of the actuarial values of the benefits payable under all the policies, or
- (ii) by an approximation to this method of calculation suitable to the circumstances of the case, including, where appropriate, an approximation involving the grouping of contracts,

appropriate allowance being made in either case for premature termination of contracts.

(4) For the purposes of (3)(a) -

- (a) where a valuation under rule 5.1 has been carried out annually in relation to the relevant period, the annual surplus made in *long-term insurance business* for any particular year of the relevant period is the surplus (if any) arising in the *long-term insurance business* fund since the last such valuation, and the periodic surplus must be taken to be the aggregate of those annual surpluses less any deficiencies in the *long-term insurance business* fund during that period;
- (b) where a *friendly society* has carried on *long-term insurance business* throughout the relevant period, but valuations under rule 5.1 have not been made annually in that period, the periodic surplus is the aggregate of surpluses arising in the *long-term insurance business* fund since the last valuation preceding the relevant period less any deficiencies in the *long-term insurance business* fund since the last valuation, except that the surplus or deficiency arising in the period ending with the first valuation within the relevant period is proportionately reduced to allow for any period of time falling outside the relevant period; and
- (c) where a *friendly society* has not carried on *long-term insurance business* throughout the relevant period, the periodic is the aggregate of any surpluses arising in the *long-term insurance business* fund during that part of the relevant period for which *long-term insurance business* was carried on less any deficiencies in the *long-term insurance business* fund during that part of that period.

Implicit items: Zillmerising

- 4B. (1) A *friendly society* may apply for a waiver from rule 4.7(3) so that where *zillmerising* is appropriate, but either is not practised or is at a rate less than the loading for acquisition costs included in the *premium* then, subject to (6), the item relating to *zillmerising* is valued at an amount not exceeding the difference between-
- (a) the *non-zillmerised* or partially *zillmerised* figure for *mathematical reserves* maintained by the *friendly society* concerned; and
 - (b) a figure for *mathematical reserves* (not less than those required in accordance with Appendix 5) *zillmerised* at a rate equal to the loading for acquisition costs included or allowed for in the *premium*.

- (2) Where *zillmerising* is not practised, then subject to (6), the value given by (1) (less any amount relating to temporary assurances) may not exceed 3.5% of the aggregate of the difference between-
- (a) the *relevant capital sums* for *long-term insurance business* activities; and
 - (b) the *mathematical reserves* (excluding *mathematical reserves* for temporary assurances).
- (3) Where *zillmerising* is practised but is at a rate less than the loading for acquisition costs, then, subject to (6), the value given by (1) (less any amount relating to temporary assurances) together with the difference between the partially *zillmerised mathematical reserves* and the *non-zillmerised mathematical reserves* may not exceed 3.5% of the aggregate of the difference between-
- (a) the *relevant capital sums* of *long-term insurance business* activities; and
 - (b) the *mathematical reserves* (excluding *mathematical reserves* for temporary assurances).
- (4) In (2) and (3) "*relevant capital sums*" means-
- (a) for whole life assurances, the sum assured;
 - (b) for policies where a sum is payable on maturity (including policies where a sum is also payable on earlier death), the sum payable on maturity;
 - (c) for deferred annuities, the capitalised value of the annuity at the vesting date (or the cash option if it is greater);
 - (d) for capital redemption contracts, the sums payable at the end of the contract period; and
 - (e) for *linked long-term contracts*, notwithstanding (a) to (d), the lesser of-
 - (i) the amount for the time being payable on death, and
 - (ii) the aggregate of the value for the time being of the units allocated to the contract (or, where entitlement is not denoted by means of units, the value for the time being of any other measure of entitlement under the contract equivalent to units) and the total amount of the *premiums* remaining to be paid during such part of the term of the contract as is appropriate for *zillmerising*, or, if such *premiums* are payable beyond the age of seventy five, until that age, excluding in all cases any vested reversionary bonus and any capital sums for temporary assurances.
- (5) Where, under the contract relating to any such business as is mentioned in (4), the payment of *premiums* is to stop before the sum assured becomes due, then, notwithstanding (4), "*relevant capital sums* " in (1) to (3) means the *mathematical reserves* appropriate for that contract at the end of the *premium-paying* term.
- (6) For the purposes of this guidance-

- (a) reserves for vested reversionary bonuses will not be regarded as *mathematical reserves*; and
- (b) the result given by (1), (2) or (3) will be reduced by the amount of any undepreciated acquisition costs brought into account as an asset.

Implicit items: hidden reserves

- 4C. A *friendly society* may apply for a waiver from rule 4.7(3) so that the *implicit item* relating to hidden reserves, if it consists of hidden reserves resulting from the underestimation of assets and overestimation of liabilities (other than *mathematical reserves*), may, in so far as the hidden reserves in question are not of an exceptional nature, be given its full value.

Guarantee fund

5. Rules 4.3 to 4.7 provide for the maintenance of the *guarantee fund*. The *guarantee fund* is generally one-third of the calculated *required margin of solvency*. For *directive* and *incorporated friendly societies*, the *guarantee fund* should be not less than the amount set out in rules 4.5 and 4.6 and this is known as the *minimum guarantee fund*.
6. Failure to meet the *guarantee fund* requirement would be regarded as very serious. The *FSA* would require the *friendly society* to submit and effect a short-term financial scheme if a *friendly society's guarantee fund* or *minimum guarantee fund* falls below requirement. Reasonable time would be granted to have discussions and to convene a meeting, and this would be expected normally to be followed by immediate action, for example, increased contributions or reduced benefits.

Minimum Requirements

7. Chapters 4 and 5 which are based on the *insurance Directives*, set out the current solvency and valuation requirements for *friendly societies* carrying on *insurance business*. Rules of this type cannot take into account the individual needs of a particular *friendly society*, but should be regarded as an absolute minimum requirement which will be supplemented by explicit or implicit margins on the advice of the actuary.
8. There are some important modifications contained in Chapter 4 by way of relaxation of the requirements for *friendly societies* which are neither *directive friendly societies* nor *incorporated friendly societies* in recognition of their different status or much smaller size. These modifications are:
- (a) a *non-directive friendly society* which does not have permission to effect new contracts of insurance and is only carrying out contracts of *long-term* or *general insurance business*, which were effected before 13 September 1993, will not be subject to the specific margin of solvency requirements, as rules 4.2 to 4.10 are not applied to such *friendly societies* (rule 4.1);
 - (b) the requirement to have a *minimum guarantee fund* does not apply to *directive* and *incorporated friendly societies* (rule 4.4);

- (c) the matching and localisation provisions in rules 4.14 to 4.19 apply only to *directive friendly societies* (rule 4.11); and
- (d) the limits placed on the extent to which certain assets may be taken into account in determining their value in the insurance fund apply only to *directive friendly societies* (15(1) of Appendix 4).

9. In addition to these modifications, the *FSA* has power under section 148 of the *Act* to direct that certain requirements do not apply to any particular *friendly society*, and there may be circumstances where the *minimum guarantee fund* may be varied in the case of certain *non-directive incorporated friendly societies*.

10. These waivers or modifications do not lessen the requirement for prudent management, and may be accompanied by conditions.

11.1 The requirements for the various categories are summarised below:

Life Directive Friendly Societies

11.2 (1) These would include any *friendly society* which carries on *long-term insurance business* where:

- (a) its rules do not contain provision for calling up additional contributions, for reducing benefits or for claiming assistance from other persons who have undertaken to provide it; or
- (b) its *annual contribution income* from *long-term insurance business* exceeded 500,000 Euro for 3 consecutive years.

(2) Valuation is made annually and the rules in chapter 4 and rule 5.1 apply.

Non-life Directive Friendly Societies

11.3 (1) Similarly, these would include any *friendly society* which carries on *general insurance business* where:

- (a) its rules do not contain provision for calling up additional contributions or for reducing benefits; or
- (b) its *annual contribution income* from *general insurance business* in any previous year exceeded 1,000,000 Euro.

(2) Valuation is made triennially and rules in chapter 4 (other than rules 4.5 – *minimum guarantee fund* and rule 4.12 – adequacy of *premiums*) and rule 5.2 apply.

Incorporated Friendly Societies other than those included above

11.4 (1) Long-term Business

These may fall outside the EC requirements but fall within the scope of rule 5.1 and are required to be valued annually. The *required margin of solvency* is set out in rules 4.1 to 4.10. New *friendly societies* should have margins of solvency at least equal to the

appropriate *minimum guarantee fund*. Rule 4.5 specifies a *minimum guarantee fund* with a threshold of 100,000 Euro increasing in steps. This may be varied by the exercise of the *FSA*'s power under section 148 of the *Act*.

- (2) Accordingly, a *non-directive friendly society* carrying on *long-term insurance business* will be expected to meet the solvency margin requirement immediately following incorporation. However, a valuation at that date is not necessarily required unless that date would otherwise be a normal *valuation date*.

Non-directive incorporated Friendly Societies carrying on general insurance business

- 11.5 Similar considerations will apply in the case of *friendly societies* carrying on *general insurance business*. The *minimum guarantee fund* is 225,000 Euro. These societies are required to be valued triennially.

Other non-directive Friendly Societies

- 11.6 (1) *Non-directive friendly societies* which have permission to carry on *long-term* or *general insurance business* are within the scope of rule 4.1 and are required to be valued triennially.
- (2) The margin of solvency requirements for these societies are set out in Chapter 4. However the specific requirements in respect of the maintenance of a *minimum guarantee fund* (rules 4.5 and 4.6) and 4.11 to 4.19 (including those in respect of matching and localisation) do not apply to them. These societies are also not subject to the admissibility limit rules in paragraph 15(1) of Appendix 4.
- (3) Societies which do not have permission to effect new *contracts of insurance* and are only carrying out contracts of *long-term* or *general insurance business*, which were effected before 13 September 1993 are not required to maintain a specified margin of solvency. Such societies should maintain an excess of the value of the *friendly society's* assets over the amount of its liabilities. They will be required to carry out triennial valuations unless exempted under the *Act*. If any valuation nevertheless discloses a level of concern then the *FSA* may take appropriate remedial action.

GUIDANCE ON EXEMPTION FROM TRIENNIAL VALUATION

- 1 This Annex gives guidance to *friendly societies* who may wish to seek exemption from the requirement in rule 5.2 to cause an actuarial investigation to be carried out.
- 2 Rule 5.1 requires any *friendly society* with permission to carry on *long-term insurance business* which is-
- (a) a *directive friendly society*; or
 - (b) an *incorporated friendly society*,
- to cause the *appointed actuary* to carry out an annual investigation into the *friendly society's* financial condition in respect of its *long-term insurance business*.
- 3 Rule 5.2 provides that any *friendly society* which carries on any *insurance business* which is not subject to the annual valuation requirement under rule 5.1 should cause the *appropriate actuary* to carry out an investigation into the financial condition of that *insurance business* at least once every 3 years. Generally this would be as at the 3rd anniversary of the 31 December when the previous valuation was due. The requirements in relation to this triennial valuation are set out in rule 5.2(1) to (6).
- 4 The *FSA* has power under section 148 of the *Act* to waive or modify the application of rule 5.2 to a particular *friendly society* (see *SUP*). This may include dispensing with the valuation requirement entirely or modifying it, e.g. to substitute a quinquennial valuation or to restrict the scope of the valuation to only part of the *insurance business*.
- 5 Notwithstanding the fact that a *friendly society* may have been exempted from the requirement to carry out an actuarial investigation under rule 5.2, there may be circumstances when the *committee* may, in order to comply with the FSA Principles for Businesses, nonetheless need to cause an actuarial valuation to be carried out.
- 6 Applications for exemption should be made as soon as possible after the *financial year* end for which valuation is due. Initial enquiries may be made before the end of the *financial year*.
- 7 An application form for a waiver or modification of rule 5.2 is set out below.

PROFORMA APPLICATION

Insurance Firms Division
The Financial Services Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

Dear Sir or Madam,

Request for dispensation from actuarial investigation

The _____ (insert name of friendly society) _____ hereby requests dispensation from the requirement to cause an actuarial investigation to be carried out as at under rule 5.2 of the FSA Interim Prudential Sourcebook for Friendly Societies for one or more of the following reasons -

(a) the purposes of the friendly society are such that (1)

(b) the nature of the friendly society's business is such that (1)

(c) the manner in which the friendly society's business is carried on is such that (1)

(d) the scale of the business is such that the contribution income for each year since the previous valuation date has been as follows, _____ the assets as at the valuation date are £ _____ and no changes in rates of benefits or contributions have been made since the previous valuation date.

[I am also attaching a certificate signed by the friendly society's appropriate actuary supporting the friendly society's request for a dispensation (2)].

(Signed) Chief Executive

Notes

(1) Please provide details of why the friendly society is seeking dispensation;

(2) The actuary's certificate is optional - please delete this sentence if the certificate is not provided. If an actuary's certificate is to be attached it should be in the form set out overleaf.

[where supporting actuary's certificate is to be attached it should read as follows]

I have performed an initial investigation as follows:-

I am of the opinion that the friendly society's margin of solvency as at [] was/is likely to be in excess of the required margin of solvency and is expected to remain so for the foreseeable future and for so long as there is no significant change in the nature or volume of business transacted or in the nature or distribution of the assets held by the friendly society and I support the application on the ground(s) that

(Signed) Fellow of the

of Actuaries

Annex 6

GUIDANCE ON NEW BUSINESS DEVELOPMENTS AND NEW INITIATIVES

[Deleted]

GUIDANCE ON THE USE OF DERIVATIVE CONTRACTS BY DIRECTIVE FRIENDLY SOCIETIES

Introduction

1. The main purpose of this Annex is to draw attention to the rules which cover whether a *derivative contract* has an admissible value which can count towards a *friendly society's* solvency margin. Guidance Note 4.2 in *IPRU(INS)* applicable to *insurers* other than *friendly societies* discusses the valuation issues surrounding the use of *derivative contract*. The guidance it gives is also generally applicable to *friendly societies*.

Approved derivatives contracts

2. An *approved derivative contract*, if held by a *directive friendly society* which maintains the *required margin of solvency*, in accordance with Part I of Chapter 4, may have an admissible value which can count towards a *friendly society's required solvency margin*. However, any *derivative contract* which is a liability to a *friendly society* (whether or not it falls within the definition of an *approved derivative contract* and is held for the purposes specified in 13 of Appendix 4) will count as a liability for solvency purposes.
3. [deleted].

Information for the FSA

4. A *friendly society* which proposes to make use of *derivative contracts* for the first time is asked to inform *FSA* staff of its proposals.

Note of caution

5. You will no doubt be aware, from the publicity given to a number of cases, that the use of *derivative contracts* can, if not properly controlled, adversely affect the financial viability of an institution. It is important that any institution which decides to use such contracts has sufficient understanding at board/*committee* and senior executive level of the nature and risks of the *derivative contracts* it is proposed to use, to ensure there are effective systems in place to monitor and control the use of derivatives - including where derivative transactions are carried out by investment managers on behalf of the institution. The *committee* of a *friendly society* which is considering using *derivative contracts* will need to be satisfied that there is sufficient understanding at appropriate levels, and that effective control systems are in place, before the *friendly society* commences to use *derivative contracts*.

MARKET CONDUCT SOURCEBOOK (AMENDMENT) INSTRUMENT 2001

- A. The Financial Services Authority alters MAR 1 (Code of Market Conduct) in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000:

Section 119 (The Code);

Section 157(1) (Guidance).

- B. This instrument comes into force immediately.
- C. MAR 1 is amended as set out in the Annex to this instrument.
- D. This instrument may be cited as the Market Conduct Sourcebook (Amendment) Instrument 2001.

By order of the Board
19 July 2001

ANNEX
Amendments to MAR 1

1. In both MAR 1.4.3E and MAR 1.4.4E, change "MAR 1.4.20C - MAR 1.4.28C" to "MAR 1.4.20C - MAR 1.4.31C".
2. In MAR 1.4.19E, change "MAR 1.4.26C and MAR 1.4.28C" to "MAR 1.4.26C, MAR 1.4.28C and MAR 1.4.31C".
3. In MAR 1.4.28C(1)(a), delete "or non-equity".
4. In MAR 1.4.29E, after "MAR 1.4.28C" insert ":".
5. In MAR 1.4.30E, delete "or non-equity" in the first sentence.
6. After MAR 1.4.30E, insert:

"(E) UNDERWRITING AGREEMENTS

1.4.31 C Agreeing to underwrite an issue of *securities* will not of itself amount to a misuse of information."

7. In MAR 1.6.17G, delete the final sentence; that is, delete the sentence which reads "For example, where a long position holder has accumulated his position in an open and transparent manner, the *regular user* is likely to expect the short position holders to be aware of the situation and to protect themselves accordingly".
8. In both MAR 1.8.7G(1) and (2), delete "or non-equity"
9. In MAR 1.11.2G:
 - (1) substitute "19 July 2001" for "31 May 2001"; and
 - (2) insert "virt-x Exchange Limited" before "virt-x plc".

SUPERVISION MANUAL (AMENDMENT) INSTRUMENT 2001

- A. The Financial Services Authority makes the rules and gives the guidance in this instrument in the exercise of the powers and related provisions in or under the Financial Services and Markets Act 2000 (the "Act") listed in Annex D to this instrument.
- B. The provisions of the Act relevant to making rules and listed in Annex D to this instrument are specified for the purpose of section 153(2) of the Act (Rule-making instruments).
- C. This instrument comes into force as follows:
- (1) Annex A: immediately;
 - (2) Annex B: at the beginning of the day on which section 19 of the Act (The general prohibition) comes into force;
 - (3) Annexes C and D and paragraphs A to E on this page: immediately.
- D. SUP is amended as follows:
- (1) in the Transitional provisions, after paragraph 6 in the table under the heading "G (1) Transitional provisions relating to the Supervision manual only" insert the paragraph in Annex A to this instrument;
 - (2) in the Transitional provisions, under the heading "G (2) Transitional provisions relating to written concessions" insert the provisions in Annex B to this instrument;
 - (3) Schedule 4 to SUP is amended in accordance with Annex C to this instrument.
- E. This instrument may be cited as the Supervision Manual (Amendment) Instrument 2001.

By order of the Board
19 July 2001

ANNEX A
Additional paragraph for the Transitional provisions
relating to the Supervision manual only

6A	SUP 9.4	G	<p><u>Individual guidance</u></p> <p>(1) If a <i>person</i> acts in accordance with individual written guidance:</p> <p style="padding-left: 40px;">(a) given to him by any <i>previous regulator</i> (or body whose functions were assumed by a <i>previous regulator</i>);</p> <p style="padding-left: 40px;">(b) relating to any pre-commencement provision; and</p> <p style="padding-left: 40px;">(c) in the circumstances contemplated by that guidance;</p> <p>then the <i>FSA</i> will proceed on the footing that the <i>person</i> has complied with the aspects of any provision in or under the <i>Act</i> (including a <i>rule</i> or <i>guidance</i> in the <i>Handbook</i>) to which the guidance relates if:</p> <p style="padding-left: 40px;">(d) that provision is substantially similar to the pre-commencement provision in relation to the matter with which the guidance is concerned;</p> <p style="padding-left: 40px;">(e) the guidance was current immediately before <i>commencement</i>; and</p> <p style="padding-left: 40px;">(f) the guidance has not been superseded.</p> <p>(2) SUP 9.4.2G to SUP 9.4.4G are relevant for individual written guidance in (1) in the same way as for individual written <i>guidance</i> given by the <i>FSA</i>.</p> <p>(3) References to "individual written guidance" in (1) and (2) include a written concession from a pre-commencement provision which is substantially similar to <i>guidance</i> in the <i>Handbook</i>.</p>	From 19 July 2001	21 June 2001
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ANNEX B
Transitional provisions relating to written concessions

1. The purpose of the transitional provisions in the following table is to carry forward existing written concessions relating to pre-commencement provisions – for example, formal waivers or modifications given by IMRO, PIA or SFA (“an SRO”) and the recognised professional bodies, written concessions from the standards in the FSA’s Guide to Banking Supervisory Policy, and formal written consents and determinations made by an SRO under an SRO rule.
2. An existing written concession is only carried forward if the pre-commencement provision to which it relates is substantially similar to a *rule* in the *Handbook*. The substantially similar test should be applied to the specific element of the *rule* to which the written concession relates. An existing written concession from a pre-commencement provision which is substantially similar to *guidance* in the *Handbook* is carried forward in the same way as pre-commencement individual written guidance; see transitional provision 6A (Individual guidance) in the schedule of Transitional provisions applying to the Supervision manual only.
3. An existing written concession is carried forward on a temporary basis only – for 12 months from *commencement* or, in the case of modifications relating to the Interim Prudential sourcebooks or *SUP* 16.6 (Compliance reports) or *SUP* 16.7 (Financial reports), until the relevant provisions cease to apply. A *firm* wishing to retain the benefit of a concession after that time will need to apply in good time for a *waiver* (see *SUP* 8 (Waiver and modification of rules)).
4. An existing written concession is carried forward as an amendment to the *rule* to which it relates. Any such amendment has effect for all purposes (including *FSA* enforcement action and actions for damages under section 150 of the *Act*).
5. An existing written concession is not carried forward if, and to the extent that, doing so would be inconsistent with a community obligation of the *United Kingdom*, in particular with the proper implementation of a directive.
6. These transitional provisions do not apply to *rules* which are continued by designation of pre-commencement provisions rather than made as new *rules*. Written concessions of such *rules* are carried forward, to similar effect, as *waivers* (given under section 148 of the *Act*) by article 8 of The Financial Services and Markets Act 2000 (Transitional Provision and Savings) (Rules) Order 2001 (SI 2001/1534). The relevant *rules* are:
 - (1) in *IPRU(BANK)*, 3.3.15R in chapter GN; and
 - (2) in *IPRU(INV)*, those identified as designated *rules* in the schedule to *IPRU(INV)* entitled "Powers exercised".
7. Definitions for these transitional provisions, additional to those in the *Glossary*, are provided at paragraph 4 of the table.

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1	<p>Rules in:</p> <p>COB</p> <p>IPRU</p> <p>MAR 2</p> <p>SUP</p> <p>TC</p>	R	<p>(1) A <i>rule</i> listed in column (2) (including <i>evidential provisions</i>, <i>transitional rules</i> and relevant defined expressions) is disapplied, or is modified in its application, to a <i>firm</i>:</p> <p>(a) in order to produce the same effect, including any conditions, as a written concession had on a pre-commencement provision listed in paragraph 2; and</p> <p>(b) for the same period as the written concession would have lasted, if shorter than the period in column (5);</p> <p>if:</p> <p>(c) the <i>rule</i> is substantially similar to the pre-commencement provision in relation to the matter with which the written concession is concerned;</p> <p>(d) the written concession was current as respects the <i>firm</i> immediately before <i>commencement</i>;</p> <p>(e) there is no specific transitional <i>rule</i> relating to the written concession; and</p> <p>(f) the written concession has not been superseded by a <i>waiver</i> from the <i>FSA</i>.</p> <p>(2) Paragraph (1) does not have effect if, and to the extent that, it would be inconsistent with any community obligation of the <i>United Kingdom</i>.</p>	<p>If the <i>rule</i> in column (2) appears in <i>IPRU</i> or in <i>SUP</i> 16.6 or 16.7, from <i>commencement</i> until that <i>rule</i> is revoked.</p> <p>Otherwise, from <i>commencement</i> for 12 months.</p>	<p><i>Commencement</i></p>

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
2	As paragraph 1	R	<p>The pre-commencement provisions referred to in paragraph 1(1) are those contained in any of the following (including relevant defined expressions):</p> <ul style="list-style-type: none"> (1) the legislative provisions of the <i>FSA</i> as designated agency under the Financial Services Act 1986; (2) the rules of <i>IMRO</i>, <i>PIA</i>, <i>SFA</i> and the <i>recognised professional bodies</i>; (3) the Insurance Companies Act 1982 and relevant secondary legislation; (4) the Friendly Societies Act 1992 and relevant secondary legislation; (5) the Banking Act 1987, relevant secondary legislation and the <i>FSA</i>'s Guide to Banking Supervisory Policy; (6) the Building Societies Act 1986, relevant secondary legislation and the Building Societies Commission's Prudential Notes, Guidance Notes and DCE (Dear Chief Executive) letters. 	As paragraph 1	<i>Commencement</i>
3	As paragraph 1	R	<p><u>Notification of relevance etc of concession</u></p> <p>A <i>firm</i> which has the benefit of a written concession to which paragraph 1 applies must notify the <i>FSA</i> immediately if it becomes aware of any matter which is material to the relevance or appropriateness of the written concession.</p>	As paragraph 1	<i>Commencement</i>

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
4	Paragraphs 1 to 3	R	<p><u>Definitions</u></p> <p>In these transitional provisions:</p> <p>(1) "substantially similar" means substantially similar in purpose and effect; and</p> <p>(2) "written concession" means a waiver, exemption, concession, modification, consent, approval, determination or similar exercise of discretion which:</p> <p>(a) disappplied, or tended to reduce the burden of complying with, a pre-commencement provision (with or without conditions); and</p> <p>(b) was evidenced in writing.</p>	As paragraph 1	<i>Commencement</i>

ANNEX C
Amendment to Schedule 4 to SUP

In Schedule 4 to SUP, insert the following in the list of powers and related provisions exercised by the FSA to make the rules in SUP:

- Section 118(8) (Market abuse)
- Section 139(1) and (4) (Miscellaneous ancillary matters)
- Section 141 (Insurance business rules)
- Section 144 (Price stabilising rules)
- Section 147 (Control of information rules)
- Section 150(2) (Actions for damages)
- Section 238(5) (Restrictions on promotion)
- Section 247 (Trust scheme rules)
- Section 340 (Appointment)
- Regulation 6(1) of the *OEIC Regulations* (FSA rules)

ANNEX D

Powers exercised

The following powers and related provisions in or under the Act have been exercised to make the rules in this instrument:

- Section 59 (Approval for particular arrangements)
- Section 118(8) (Market abuse)
- Section 138 (General rule-making power)
- Section 139(1) and (4) (Miscellaneous ancillary matters)
- Section 141 (Insurance business rules)
- Section 144 (Price stabilising rules)
- Section 145 (Financial promotion rules)
- Section 146 (Money laundering rules)
- Section 147 (Control of information rules)
- Section 149 (Evidential provisions)
- Section 150(2) (Actions for damages)
- Section 156 (General supplementary powers)
- Section 238(5) (Restrictions on promotion)
- Section 247 (Trust scheme rules)
- Section 340 (Appointment)
- Regulation 6(1) of the Financial Services and Markets Act 2000 (Open-ended investment company) Regulations 2001 (FSA rules)

The following power in the Act has been exercised to give the guidance in this instrument:

- Section 157(1) (Guidance)

COMPLAINTS AGAINST THE FSA SCHEME

INSTRUMENT 2001

- A. The Financial Services Authority makes the arrangements and the provisions in the Annex to this instrument ("COAF") in the exercise of the powers listed in Schedule 4 to COAF (Powers exercised).
- B. This instrument comes into force at the beginning of the day on 3rd September 2001.
- C. This instrument may be cited as the Complaints against the FSA Scheme Instrument 2001.
- D. The Annex to this instrument (including its schedules) may be cited as the Complaints against the FSA Scheme, or COAF.

By order of the Board

19 July 2001

ANNEX



Complaints against the FSA

Contents

Transitional provisions

Text of COAF:

Chapter 1: Complaints against the FSA Scheme

- 1.1 Introduction
- 1.2 Application
- 1.3 The Complaints Commissioner
- 1.4 Coverage and scope of the Scheme
- 1.5 Procedure
- 1.6 General

Chapter 2: Transitional Complaints Scheme

- 2.1 Introduction
- 2.2 Application
- 2.3 Coverage and scope of the Scheme
- 2.4 Procedure
- 2.5 General

Schedule 1: Record keeping requirements

Schedule 2: Notification requirements

Schedule 3: Fees and other required payments

Schedule 4: Powers exercised

Schedule 5: Rights of action for damages

Schedule 6: Rules that can be waived

Derivations

Destinations

Handbook Modules

Transitional Provisions

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- 1 There are no transitional provisions in COAF. However, COAF 2 (Transitional Complaints Scheme) is itself a separate Transitional Complaints Scheme covering complaints against the FSA or PIA, IMRO or SFA in respect of matters arising before the date that section 19 (the general prohibition) of the Act comes into force.

Chapter 1

Complaints against the FSA

1.1 Introduction

- 1.1.1** G_{/1} (1) Paragraph 7 of Schedule 1 to the *Act* requires the *FSA* to maintain a *complaints scheme* for the investigation of complaints arising in connection with the exercise of, or failure to exercise, any of its functions under the *Act* (other than its legislative functions).
- (2) The *FSA* is required to appoint an independent person as *Complaints Commissioner* to be responsible for the conduct of investigations in accordance with the *complaints scheme*.
- 1.1.2** G_{/1} The *complaints scheme* provides that there may be two distinct stages for each complaint. In the first stage, the *FSA* itself will investigate any complaint that meets the requirements of the *complaints scheme* (see *COAF* 1.4) and take whatever action to resolve the matter it thinks appropriate. A complaint will normally only proceed to the second stage if the complainant is dissatisfied with the *FSA*'s determination of his complaint or how it has been handled. This second stage consists of investigation of the complaint by the *Complaints Commissioner*, followed, wherever he finds for the complainant, by his recommendation to the *FSA* on the form of redress that is appropriate in the circumstances.
- 1.1.3** G_{/1} (1) The *complaints scheme* is made by the *FSA* in accordance with its obligations under paragraphs 7 and 8 of Schedule 1 to the *Act*.
- (2) Where the *Act* requires the *FSA* to make a particular arrangement as part of the *complaints scheme*, this is recognised in the following text by the use of the word 'must'. In contrast, where a provision in the *complaints scheme* states that someone "will" do something, this denotes that the *FSA* is committing itself or the *Complaints Commissioner* to some action which, though not specifically required by the *Act*, is nevertheless viewed as necessary to give effect to the intentions of the *Act*.
- (3) Each provision in the *complaints scheme* is, consistent with the style and format of the Handbook, identified by the letter "G". It nevertheless constitutes a definitive statement of the *complaints scheme* which the *FSA* is required to maintain.
- 1.1.4** G_{/1} The *complaints scheme* has effect from 3 September 2001.
- 1.1.5** G_{/1} In this *complaints scheme*, "complaint" means any expression of dissatisfaction about the manner in which the *FSA* has carried out its functions under the *Act* other than its legislative functions.
- 1.1.6** G_{/1} The transitional provisions in *GEN* do not apply to the *complaints scheme*.
- 1.1.7** G_{/1} Further details of the practical operation of the *complaints scheme* are available from the office of the *FSA*'s company secretary, who may be contacted at 25 The

North Colonnade, Canary Wharf, London E14 5SH, Tel No. 020 7676 9870 or by e-mail at complaints@fsa.gov.uk.

1.2 Application

- 1.2.1** **G**_{/1} Anyone directly affected by the way in which the *FSA* has carried out its functions may bring a complaint under the *complaints scheme*, provided the complaint meets the requirements of the *complaints scheme* (see *COAF* 1.4). This includes *firms* and issuers of listed securities and any *customer* or prospective *customer*, whether an individual or a *body corporate*, or *market counterparty*.
- 1.2.2** **G**_{/1} The *complaints scheme* applies in relation to complaints made about the way in which the *FSA* has carried out its functions under the *Act*. The *FSA* is also applying the main elements of the *complaints scheme* in respect of complaints against the *FSA* arising in connection with the exercise of its functions under previous legislation and in respect of complaints made against *PIA*, *IMRO* and *SFA*. Those arrangements are set out in the *transitional complaints scheme*.

1.3 The Complaints Commissioner

1.3.1

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- (1) The *FSA* must appoint an individual, subject to the approval of the Treasury, as *Complaints Commissioner* to carry out the functions conferred on him by the *complaints scheme*.
- (2) In appointing the *Complaints Commissioner*, the *FSA* is advised by an appointment panel comprising the Deputy Chairman of the *FSA*, the Chairmen of the Practitioner and Consumer Panels established under sections 9 and 10 of the *Act* and another person who is independent of the *FSA*.

1.3.2

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- (1) The *Complaints Commissioner* is appointed for a period of three years and may be dismissed from office only for reason of becoming:
 - (a) incapacitated by physical or mental illness; or
 - (b) otherwise unfit to discharge the functions of his office;and subject in either event to the approval of the Treasury.
- (2) No person who has attained the age of 70 years is eligible to be or to remain a *Complaints Commissioner*.
- (3) The *Complaints Commissioner* must not be an employee of the *FSA* and is required to act independently of, and without favouring, the *FSA*.

1.3.3

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The *FSA* will remunerate the *Complaints Commissioner* and will provide him with sufficient resources to equip him with suitable accommodation and staff. No member of the *Complaints Commissioner's* staff may be an employee of, or perform any duties for, the *FSA*.

1.4 Coverage and scope of the scheme

1.4.1

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- (1) The *complaints scheme* provides a procedure for enquiring into and, if necessary, addressing allegations of misconduct by the *FSA* arising from the way in which it has carried out or failed to carry out its functions. The *complaints scheme* covers complaints about the way in which the *FSA* has acted or omitted to act, including complaints alleging:
 - (a) mistakes and lack of care;
 - (b) unreasonable delay;
 - (c) unprofessional behaviour;
 - (d) bias; and
 - (e) lack of integrity.
- (2) Because the *complaints scheme* is concerned with complaints about the way in which the *FSA* has discharged its functions, it does not cover complaints about the actions of the *Financial Ombudsman Service* or the *Financial Services Compensation Scheme*.
- (3) To be eligible to make a complaint under the *complaints scheme*, a person (see *COAF* 1.2.1G) must be seeking a remedy (which for this purpose may include an apology) in respect of some inconvenience, distress or loss which the person has suffered as a result of being directly affected by the *FSA*'s actions or inaction.

Exclusions from the scheme

1.4.2

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Each of the following is excluded from the *complaints scheme*:

- (1) complaints about the *FSA*'s relationship with its employees;
- (2) complaints connected with contractual or commercial disputes involving the *FSA* and not connected to its functions under the *Act*; and
- (3) complaints in relation to the performance of the *FSA*'s legislative functions under the *Act* (including making *rules* and issuing codes and general *guidance*).

Alternative remedies

1.4.3

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The *FSA* will not investigate a complaint under the *complaints scheme* which it reasonably considers:

- (1) could have been, or would be, more appropriately dealt with in another way (for example by referring the matter to the *Tribunal* or by the institution of other legal proceedings); or
- (2) amounts to no more than dissatisfaction with the *FSA*'s general policies or with the exercise of discretion where no unreasonable, unprofessional or other misconduct is alleged.

1.4.4

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A complaint which is connected with, or which arises from, any form of continuing action by the *FSA* will not normally be investigated by either the *FSA* or the *Complaints Commissioner* until the complainant has exhausted the procedures and remedies under the *Act* which are relevant to that action. An investigation may be commenced before the completion of those procedures if, in the exceptional circumstances of the case, it would not be reasonable to expect the complainant to await the conclusion of the *FSA*'s action.

Certain complaints to be in writing

1.4.5

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- (1) A complaint made orally by a consumer will be investigated by the *FSA*. If the complaint cannot be resolved quickly, the *FSA* will write to the complainant inviting him to confirm its understanding of the complaint.
- (2) Other persons complaining orally will be asked to confirm their complaint in writing (this includes in electronic form), and the *FSA* will not normally investigate a complaint until the complainant has done so.

Time limits

1.4.6

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Complaints should be made within 12 months of the date on which the complainant first became aware of the circumstances giving rise to the complaint. Complaints made later than this will be investigated under the *complaints scheme* only if the complainant can show reasonable grounds for the delay.

Cost

1.4.7

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The *FSA* will not make any charge to complainants in relation to the *complaints scheme*.

1.5 Procedure

The FSA's initial response to complaints

- 1.5.1** **G**_{/1} The FSA will acknowledge a complaint within five working days of receipt. It will send each complainant a leaflet explaining how the *complaints scheme* works, including details of his right to refer the complaint to the *Complaints Commissioner* if he is dissatisfied with the way in which the FSA has dealt with it (see COAF 1.5.5G).

Stage 1: Investigation of complaints by the FSA

- 1.5.2** **G**_{/1} The FSA will arrange for an initial investigation by its own staff of any complaint which satisfies the provisions of COAF 1.4.1G to COAF 1.4.6G. That investigation will be carried out by a suitably senior member of staff who has not previously been involved in the matter complained of, with a view to resolving the matter to the complainant's satisfaction. The FSA will seek to resolve the complaint as quickly as possible.
- 1.5.3** **G**_{/1} The FSA will aim to ensure that all investigations are completed within eight weeks. If it has not completed the investigation of a complaint within four weeks, the FSA will write to the complainant reporting that fact.
- 1.5.4** **G**_{/1} If the FSA concludes that a complaint is well founded, it will tell the complainant what it proposes to do to remedy the matters of complaint.
- 1.5.5** **G**_{/1} Remedying a well founded complaint may include offering the complainant an apology, taking steps to rectify an error or, if appropriate, the offer of a compensatory payment on an ex-gratia basis. If the FSA decides to reject a complaint, it will give its reasons for doing so to the complainant.
- 1.5.6** **G**_{/1} Complainants who are dissatisfied with the outcome of an investigation, or who are dissatisfied with the FSA's progress in investigating a complaint, may refer the matter to the *Complaints Commissioner*, who may decide to carry out his own investigation.

If the FSA does not investigate a complaint, will the Complaints Commissioner do so?

- 1.5.7** **G**_{/1} Within ten working days of receiving a complaint, the FSA will notify the *Complaints Commissioner* of each complaint which it decides not to investigate and will inform the complainant that it has done so. The *Complaints*

Commissioner will, after considering any representations from the complainant and the FSA, then decide whether the complaint falls within the scope of the *complaints scheme* and, if so, whether to conduct an investigation.

1.5.8 G_{/1} If a complaint is referred or notified to the *Complaints Commissioner* before the FSA has had the opportunity to conduct or complete an investigation, the *Complaints Commissioner* will consider whether it would be desirable to allow the FSA that opportunity before conducting his own investigation.

1.5.9 G_{/1} The *Complaints Commissioner* will not investigate any complaint which is outside the scope of the *complaints scheme*, but the final decision on whether a particular case is so excluded rests with the *Complaints Commissioner*.

Stage 2: Conduct of investigations by the Complaints Commissioner

1.5.10 G_{/1} The *Complaints Commissioner* may conduct an investigation in whatever manner he thinks appropriate including obtaining, at the FSA's expense, such external resources as may be reasonable. In performing his functions in accordance with the *complaints scheme*, the *Complaints Commissioner* must at all times act independently of the FSA.

1.5.11 G_{/1} The *Complaints Commissioner* may appoint a person to conduct the whole or any part of an investigation on his behalf but subject to his direction. That person must not be an officer or employee of the FSA.

1.5.12 G_{/1} The FSA will afford the *Complaints Commissioner* all reasonable co-operation, including giving access to its staff and information. The FSA may, in affording the *Complaints Commissioner* access to information, have regard to the need to maintain the confidentiality of certain kinds of information. This would include, for example, taking appropriate steps to ensure that the identity of an informant is not disclosed, or maintaining the confidentiality of information given to the FSA under international arrangements. In any case where the FSA decides that it should withhold information, it will inform the Commissioner of the nature of that information and its reasons for withholding it.

1.5.13 G_{/1} The FSA is not, because of any investigation being conducted by the *Complaints Commissioner*, prevented from continuing to take such action, or such further action, as it considers appropriate in relation to any matter which is related to a complaint or a complainant.

1.5.14 G_{/1} The *Complaints Commissioner* will ensure that, before he concludes an investigation and makes a report, any *person* who may be the subject of criticism in it is given notice of, and the opportunity to respond to, that criticism.

1.5.15 G_{/1} In the investigation of a complaint by either the FSA or the *Complaints Commissioner*, any finding of fact of:

- (1) a court of competent jurisdiction (whether in the *United Kingdom* or elsewhere); or
- (2) the *Tribunal*; or
- (3) any other tribunal established by legislative authority (whether in the *United Kingdom* or elsewhere); or

(4) any independent tribunal charged with responsibility for hearing a final appeal from the regulatory decisions of *PIA*, *IMRO* or *SFA*;

which has not been set aside on appeal or otherwise, shall be conclusive evidence of the facts so found, and any decision of that court or tribunal shall be conclusive.

1.5.16 G_{/1} Any findings of fact or decisions of courts or tribunals not covered by *COAF* 1.5.15G will carry such weight as the *FSA* or the *Complaints Commissioner* considers appropriate in the circumstances.

1.5.17 G_{/1} In deciding whether a complaint is well founded and, if so, in deciding what steps he should recommend the *FSA* to take, the *Complaints Commissioner* will have regard to the *FSA*'s statutory objectives and the considerations set out in sections 2(3) or 73(1) of the *Act*.

1.5.18 G_{/1} The *Complaints Commissioner* may, if he thinks it appropriate, recommend that the *FSA* take either or both of the following steps:

- (1) remedy the matters of complaint; or
- (2) make a compensatory payment to the complainant.

Reports on investigations

1.5.19 G_{/1} The *Complaints Commissioner* must report to the *FSA* and to the complainant on the results of his investigation, giving reasons for any recommendations he makes.

1.5.20 G_{/1} The *Complaints Commissioner* will ensure that his report, apart from identifying the *FSA*, does not mention the name of any other person or contain particulars which are likely to identify any other person unless:

- (1) in the opinion of the *Complaints Commissioner* the omission of such particulars would be likely to impair the effectiveness of the report; or
- (2) after taking into account the public interest, as well as the interests of the complainant and the interests of other persons, the *Complaints Commissioner* considers it necessary to mention the name of that person or to include in the report those particulars (see also *COAF* 1.5.14G).

1.5.21 G_{/1} The *Complaints Commissioner* may publish his report (or any part of it) if he considers that the report (or any part of it) ought to be brought to the attention of the public.

1.5.22 G_{/1} The *FSA* must, in any case where the *Complaints Commissioner* has reported that a complaint is well founded, or where he has criticised the *FSA* in his report, inform the *Complaints Commissioner* and the complainant of the steps which it proposes to take by way of response.

1.5.23 G_{/1} The *FSA* must, if required by the *Complaints Commissioner* to do so, publish the whole or a specified part of its response.

1.5.24 G_{/1} In deciding how it should respond to a report from the *Complaints Commissioner*, the *FSA* will, as well as having regard to its statutory objectives and the considerations set out in section 2(3) or 73(1) of the *Act*, normally take into account the following:

- (1) the gravity of the misconduct which the *Complaints Commissioner* has identified and its consequences for the complainant;
- (2) the nature of the *FSA*'s relationship with the complainant and the extent to which the complainant has been adversely affected in the course of his direct dealings with the *FSA*;
- (3) whether what has gone wrong is at the operational or administrative level (rather than in relation to matters of policy or where the *FSA*'s actions have necessarily had to reflect a balancing of conflicting interests and complex issues);
- (4) the impact of the cost of compensatory payments on *firms*, issuers of listed securities and, indirectly, consumers.



1.6 General

Confidentiality

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The *Complaints Commissioner* must observe any statutory restrictions applicable to him relating to the disclosure of confidential information.

Annual Report

1.6.2

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The *Complaints Commissioner* will each year submit a report to the *FSA Board*, for publication, on investigations concluded by him during the 12-month period ending 31 March. The report may include information concerning trends in the subject matter of complaints and on the general lessons which he considers the *FSA* should learn.

Chapter 2

2

Transitional complaints scheme

2.1 Introduction

- 2.1.1** G_{/1} In accordance with the power conferred by The Financial Services and Markets Act 2000 (Transitional Provisions) (Ombudsman Scheme) Order 2001 (“the Order”), the *FSA* has made arrangements for the investigation of complaints:
- (1) arising in connection with the exercise before the *commencement day* of any functions conferred on the *FSA* by or under any enactment (other than the *Act*), or the failure to exercise any such function before *commencement*; or
 - (2) against *PIA*, *IMRO* or *SFA* in respect of matters arising before the *commencement day*.
- 2.1.2** G_{/1} The arrangements made by the *FSA* are set out in the following provisions of this *transitional complaints scheme*.
- 2.1.3** G_{/1} The Order requires the *FSA* to ensure that the *transitional complaints scheme* complies with paragraph 7 of Schedule 1 to the *Act* and provides that the *FSA* may apply such provisions of paragraph 8 of Schedule 1 as it considers to be appropriate. The *FSA* has decided to apply most of the provisions of paragraph 8 so that, with suitable modification to take account of the different persons involved, the *transitional complaints scheme* will operate in substantially the same way as the *complaints scheme* which, going forward, provides a scheme for investigating complaints against the *FSA* in respect of its functions under the *Act*. One difference is that the *transitional complaints scheme* does not make provision for compensatory payments to be made to complainants.
- 2.1.4** G_{/1} The *FSA* is required to appoint an independent person as *Complaints Commissioner* to be responsible for the conduct of investigations in accordance with the *complaints scheme*, and that person is also responsible for the conduct of investigations under this *transitional complaints scheme*.
- 2.1.5** G_{/1}
- (1) Where the *FSA* is required to make a particular arrangement as part of the *transitional complaints scheme*, this is recognised in the following text by use of the word ‘must’. In contrast, where a provision in the *transitional complaints scheme* states that someone “will” do something, this denotes that the *FSA* is committing itself or the *Complaints Commissioner* to some action which, though not specifically required, is nevertheless viewed as necessary to give effect to the intentions of the *Act*.
 - (2) Each provision in the *transitional complaints scheme* is, consistent with the style and format of the Handbook, identified by the letter “G”. It nevertheless constitutes a definitive statement of the *transitional complaints scheme* which the *FSA* is maintaining.
- 2.1.6** G_{/1} References in this *transitional complaints scheme* to the *FSA*’s functions are references to its statutory functions (other than its legislative functions) arising in connection with the Financial Services Act 1986 and the Banking Act 1987 and

functions conferred on the *FSA* by or under other enactments (other than the *Act*). References to the functions of *PIA*, *IMRO* or *SFA* are references to their functions arising in connection with the Financial Services Act 1986 (other than their functions of making rules and issuing guidance).

2.1.7 G_{/1} For the purposes of the *transitional complaints scheme*, the *FSA* is responsible for receiving, investigating and responding to complaints made against *PIA*, *IMRO* or *SFA*.

2.1.8 G_{/1} The *transitional complaints scheme* has effect from 3 September 2001 and is concerned with complaints against the *FSA*, *PIA*, *IMRO* and *SFA* made on or after that date and with complaints made before that date but only if they had not, by 3 September, been referred to an independent person for review.

2.1.9 G_{/1} In this *transitional complaints scheme*:

- (1) “complaint” means any expression of dissatisfaction about the manner in which the *FSA* has carried out its statutory functions (other than its legislative functions) and about the manner in which *PIA*, *IMRO* or *SFA* have carried out their functions arising in connection with the Financial Services Act 1986 (other than their functions of making rules and issuing guidance);
- (2) *firm* includes any person who is or was a person authorised under Chapter III of Part I of the Financial Services Act 1986; and
- (3) “Financial Services Tribunal” means the Tribunal established under section 96 of the Financial Services Act 1986.

2.1.10 G_{/1} The transitional provisions in *GEN* do not apply to the *transitional complaints scheme*.

2.1.11 G_{/1} Further details of the practical operation of the *transitional complaints scheme* are available from the office of the *FSA*’s company secretary who may be contacted at 25 The North Colonnade, Canary Wharf, London E14 5SH, Tel No. 020 7676 9870 or by e-mail at complaints@fsa.gov.uk.



2.2 Application

2.2.1

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Anyone directly affected by the way in which the *FSA*, *PIA*, *IMRO* or *SFA* has carried out their functions may bring a complaint under the *transitional complaints scheme*, provided the complaint meets the requirements of the *transitional complaints scheme* (see *COAF* 2.3). This includes *firms* and issuers of listed securities and any customer or prospective customer, whether an individual or a body corporate, or market counterparty.



2.3 Coverage and scope of the scheme

2.3.1

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- (1) The *transitional complaints scheme* provides a procedure for enquiring into and, if necessary, addressing allegations of misconduct by the *FSA*, *PIA*, *IMRO* and *SFA* arising from the way in which they have carried out or failed to carry out their functions. The *transitional complaints scheme* covers complaints about the way in which the *FSA*, *PIA*, *IMRO* or *SFA* have acted or omitted to act, including complaints alleging:
 - (a) mistakes and lack of care;
 - (b) unreasonable delay;
 - (c) unprofessional behaviour;
 - (d) bias; and
 - (e) lack of integrity.
- (2) The *transitional complaints scheme* does not cover complaints about the actions of the Financial Ombudsman Service, the Financial Services Compensation Scheme, the Investors' Compensation Scheme or of any independent complaints investigation body established by *PIA*, *IMRO* or *SFA*.
- (3) The *transitional complaints scheme* does not cover complaints arising in connection with the functions which the *FSA* was authorised to carry out by the Contracting Out (Functions in Relation to Insurance) Order 1998.
- (4) To be eligible to make a complaint under the *transitional complaints scheme*, a person (see *COAF 2.2.1G*) must be seeking a remedy (which for this purpose may include an apology) in respect of some inconvenience, distress or loss which the person has suffered as a result of being directly affected by the actions or inaction of the *FSA*, *PIA*, *IMRO* or *SFA*.

Exclusions from the scheme

2.3.2

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Each of the following is excluded from the *transitional complaints scheme*:

- (1) complaints about the relationship of the *FSA*, *PIA*, *IMRO* or *SFA* with its employees;
- (2) complaints connected with contractual or commercial disputes involving the *FSA*, *PIA*, *IMRO* or *SFA* and not connected to their regulatory functions; and
- (3) complaints in relation to the performance of the *FSA*'s legislative functions under the Financial Services Act 1986 or the Banking Act 1987, or the

functions of *PIA*, *IMRO* or *SFA* in relation to their functions of making rules or issuing guidance;

- (4) complaints which, before 3 September 2001, have, following an investigation by the executive of the *FSA*, *PIA*, *IMRO* or *SFA*, been referred for further investigation by a person who is independent of the *FSA* or of any such organisation.

Alternative remedies

2.3.3

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The *FSA* will not investigate a complaint under the *transitional complaints scheme* which it reasonably considers:

- (1) could have been, or would be, more appropriately dealt with in another way (for example by referring the matter to the Financial Services Tribunal or to the committees, tribunals and appeal bodies or to any successor tribunal of *PIA*, *IMRO* or *SFA* or by the institution of other legal proceedings); or
- (2) amounts to no more than dissatisfaction with the general policies of the *FSA* or of *PIA*, *IMRO* or *SFA* or with the exercise of discretion by any such body where no unreasonable, unprofessional or other misconduct is alleged.

2.3.4

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A complaint which is connected with, or which arises from, any form of continuing action by the *FSA*, *PIA*, *IMRO* or *SFA* will not normally be investigated by either the *FSA* or the *Complaints Commissioner* until the complainant has exhausted the procedures and remedies under the Financial Services Act 1986 or, as appropriate, under the rules of *PIA*, *IMRO* or *SFA* which are relevant to that action. An investigation may be commenced before the completion of those procedures if, in the exceptional circumstances of the case, it would not be reasonable to expect the complainant to await the conclusion of such action.

Certain complaints to be in writing

2.3.5

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- (1) A complaint made orally by a consumer will be investigated by the *FSA*. If the complaint cannot be resolved quickly, the *FSA* will write to the complainant inviting him to confirm its understanding of the complaint.
- (2) Other persons complaining orally will be asked to confirm their complaint in writing (this includes in electronic form) and the *FSA* will not normally investigate a complaint until the complainant has done so.

Time limits

2.3.6

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Complaints should be made within 12 months of the date on which the complainant first became aware of the circumstances giving rise to the complaint. Complaints made later than this will be investigated under the *transitional complaints scheme* only if the complainant can show reasonable grounds for the delay.

Cost

2.3.7

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The FSA will not make any charge to complainants in relation to the *transitional complaints scheme*.

2.4 Procedure

The FSA's initial response to complaints

- 2.4.1** G_{/1} The *FSA* will acknowledge a complaint within five working days of receipt. It will send each complainant a leaflet explaining how the *transitional complaints scheme* works, including details of his right to refer the complaint to the *Complaints Commissioner* if he is dissatisfied with the way in which the *FSA* has dealt with it (see *COAF* 2.4.6G).

Stage 1: Investigation of complaints by the FSA

- 2.4.2** G_{/1} The *FSA* will arrange for an initial investigation by its own staff of any complaint which satisfies the provisions of *COAF* 2.3.1G to *COAF* 2.3.6G. That investigation will be carried out by a suitably senior member of staff who has not previously been involved in the matter complained of, with a view to resolving the matter to the complainant's satisfaction. The *FSA* will seek to resolve the complaint as quickly as possible.
- 2.4.3** G_{/1} The *FSA* will aim to ensure that all investigations are completed within eight weeks. If it has not completed the investigation of a complaint within four weeks, the *FSA* will write to the complainant reporting that fact.
- 2.4.4** G_{/1} If the *FSA* concludes that a complaint is well founded it will tell the complainant what it proposes to do to remedy the matters of complaint.
- 2.4.5** G_{/1} Remediating a well-founded complaint may include offering the complainant an apology and taking steps to rectify an error. If the *FSA* decides to reject a complaint, it will give its reasons for doing so to the complainant.
- 2.4.6** G_{/1} Complainants who are dissatisfied with the outcome of an investigation, or who are dissatisfied with the *FSA*'s progress in investigating a complaint, may refer the matter to the *Complaints Commissioner*, who may decide to carry out his own investigation.

If the FSA does not investigate a complaint, will the Complaints Commissioner do so?

- 2.4.7** G_{/1} Within ten working days of receiving a complaint, the *FSA* will notify the *Complaints Commissioner* of each complaint which it decides not to investigate and will inform the complainant that it has done so. The *Complaints Commissioner* will, after considering any representations from the complainant and

the *FSA*, then decide whether the complaint falls within the scope of the *transitional complaints scheme* and, if so, whether to conduct an investigation.

2.4.8 G_{/1} If a complaint is referred or notified to the *Complaints Commissioner* before the *FSA* has had the opportunity to conduct or complete an investigation, the *Complaints Commissioner* will consider whether it would be desirable to allow the *FSA* that opportunity before conducting his own investigation.

2.4.9 G_{/1} The *Complaints Commissioner* will not investigate any complaint which is outside the scope of the *transitional complaints scheme*, but the final decision on whether a particular case is so excluded rests with the *Complaints Commissioner*.

Stage 2: Conduct of investigations by the Complaints Commissioner

2.4.10 G_{/1} The *Complaints Commissioner* may conduct an investigation in whatever manner he thinks appropriate including obtaining, at the *FSA*'s expense, such external resources as may be reasonable. In performing his functions in accordance with the *transitional complaints scheme*, the *Complaints Commissioner* must at all times act independently of the *FSA*, *PIA*, *IMRO* and *SFA*.

2.4.11 G_{/1} The *Complaints Commissioner* may appoint a person to conduct the whole or any part of an investigation on his behalf but subject to his direction. That person must not be an officer or employee of the *FSA*, *PIA*, *IMRO* or *SFA*.

2.4.12 G_{/1} The *FSA* will afford the *Complaints Commissioner* all reasonable co-operation including giving access to its staff and information. The *FSA* may, in affording the *Complaints Commissioner* access to information, have regard to the need to maintain the confidentiality of certain kinds of information. This would include, for example, taking appropriate steps to ensure that the identity of an informant is not disclosed or maintaining the confidentiality of information given to the *FSA* under international arrangements. In any case where the *FSA* decides that it should withhold information it will inform the *Complaints Commissioner* of the nature of that information and its reasons for withholding it.

2.4.13 G_{/1} The *FSA*, *PIA*, *IMRO* and *SFA* are not, by reason of any investigation being conducted by the *Complaints Commissioner*, prevented from continuing to take such action, or such further action, as they consider appropriate in relation to any matter which is related to a complaint or a complainant.

2.4.14 G_{/1} The *Complaints Commissioner* will ensure that, before he concludes an investigation and makes a report, any person who may be the subject of criticism in it is given notice of, and the opportunity to respond to, that criticism.

2.4.15 G_{/1} Upon *PIA*, *IMRO* or *SFA* ceasing to have any further regulatory functions, the *Complaints Commissioner* may discharge his obligation to give notice of any potential criticism of them by giving such notice to, and inviting representations from, the *FSA*.

2.4.16 G_{/1} In the investigation of a complaint by either the *FSA* or the *Complaints Commissioner*, any finding of fact of:

- (1) a court of competent jurisdiction (whether in the *United Kingdom* or elsewhere); or
- (2) the Financial Services Tribunal; or

(3) any other tribunal established by legislative authority (whether in the *United Kingdom* or elsewhere); or

(4) any independent tribunal charged with responsibility for hearing a final appeal from the regulatory decisions of *PIA*, *IMRO* or *SFA*;

which has not been set aside on appeal or otherwise, shall be conclusive evidence of the facts so found and any decision of that court or tribunal shall be conclusive.

2.4.17 G_{/1} Any findings of fact or decisions of courts or tribunals not covered by *COAF* 2.4.16G will carry such weight as the *FSA* or the *Complaints Commissioner* considers appropriate in the circumstances.

Reports on investigations

2.4.18 G_{/1} The *Complaints Commissioner* must report to the *FSA* and to the complainant on the results of his investigation, giving reasons for any recommendations he makes.

2.4.19 G_{/1} The *Complaints Commissioner* will ensure that his report, apart from identifying the *FSA*, *PIA*, *IMRO* or *SFA*, does not mention the name of any other person or contain particulars which are likely to identify any other person unless:

- (1) in the opinion of the *Complaints Commissioner* the omission of such particulars would be likely to impair the effectiveness of the report; or
- (2) after taking into account the public interest, as well as the interests of the complainant, and the interests of other persons, the *Complaints Commissioner* considers it necessary to mention the name of that person or to include in the report those particulars (see also *COAF* 2.4.14G).

2.4.20 G_{/1} The *Complaints Commissioner* may publish his report (or any part of it) if he considers that the report (or any part of it) ought to be brought to the attention of the public.

2.4.21 G_{/1} The *Complaints Commissioner* may, if he thinks it appropriate, recommend that the *FSA* remedy the matters of complaint, but any such remedy shall not include a recommendation that a compensatory payment be made.

2.4.22 G_{/1} The *FSA* must, in any case where the *Complaints Commissioner* has reported that a complaint is well founded or where he has criticised the *FSA*, *PIA*, *IMRO* or *SFA* in his report, inform the *Complaints Commissioner* and the complainant of the steps which it proposes to take by way of response.

2.4.23 G_{/1} The *FSA* must, if required by the *Complaints Commissioner* to do so, publish the whole or a specified part of its response.



2.5 General

Confidentiality

2.5.1

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The *Complaints Commissioner* must observe any statutory restrictions applicable to him relating to the disclosure of confidential information.

Annual Report

2.5.2

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The *Complaints Commissioner* will each year submit a report to the *FSA Board*, for publication, on investigations concluded by him during the 12-month period ending 31 March. The report may include information concerning trends in the subject matter of complaints and on the general lessons which he considers the *FSA* should learn.

Handbook Modules

Schedule1 Record keeping requirements

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- 1 There are no record keeping requirements in COAF.

Handbook Modules

Schedule2 Notification requirements

G

- 1 There are no notification requirements in COAF.

Handbook Modules

Schedule3 Fees and other required payments

G

- 1 There are no requirements for fees or other payments in COAF.

Handbook Modules

Schedule4 Powers exercised

G

- 1 The following powers and related provisions in the Act, the Financial Services and Markets Act 2000 (Commencement No.4 and Transitional Provisions) Order 2001 (SI 2001/2364) (the "Commencement No.4 Order") and the Financial Services and Markets Act 2000 (Transitional Provisions) (Ombudsman Scheme and Complaints Scheme) Order 2001 (SI2001/2326) (the "Transitional Provisions Order") have been exercised by the FSA to make the Complaints against the FSA Scheme:
 - (1) Paragraphs 7 and 8 (Arrangements for the investigations of complaints) of Schedule 1 to the Act;
 - (2) Article 2(2) of the Commencement No.4 Order; and
 - (3) Article 18 (Transitional complaints against the Authority) of the Transitional Provisions Order.

Handbook Modules

Schedule5 Rights of action for damages

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- 1 There are no rules in COAF.

Handbook Modules

Schedule6 Rules that can be waived

G

- 1 There are no rules in COAF.

Complaints against the FSA Scheme

Derivations

G

There is no table of derivations for *COAF*.

Complaints against the FSA Scheme

Destinations

G

There is no table of destinations for *COAF*.

FEES INSTRUMENT 2001

- A. The Financial Services Authority makes the rules and gives the guidance in this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (the "Act"):
- Section 156 of the Act (General supplementary powers);
 - Section 157(1) of the Act (Guidance);
 - Paragraph 17(1) of Schedule 1 to the Act (Fees).
- B. The provisions of the Act relevant to making rules and listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).
- C. This instrument shall come into force at the beginning of the day on which section 40 of the Act (Application for permission) comes into force.
- D. AUTH is amended by:
- (i) inserting, after AUTH 3, the provisions in Annex A to this instrument;
 - (ii) inserting, after Schedule 2, the provisions in Annex B;
 - (iii) inserting, at the beginning of Schedule 4, "The following powers and related provisions in the *Act* have been exercised by the *FSA* to make the *rules* in *AUTH*:
 - Section 156 (General supplementary powers)
 - Paragraph 17(1) of Schedule 1 (Fees)";
 - (iv) deleting Schedule 5, and replacing it with the provisions in Annex C;
 - (v) deleting Schedule 6, and replacing it with the provisions in Annex D.
- E. CIS is amended by:
- (i) inserting, after CIS 17, the provisions in Annex E to this instrument;
 - (ii) inserting, after Schedule 2, the provisions in Annex F;
 - (iii) inserting, in Schedule 4, before " Regulation 6 of the *OEIC regulations* (FSA rules)", "Paragraph 17(1) of Schedule 1 (Fees)";
 - (iv) inserting at the end of Schedule 6, "4. No *rules* in *CIS* 18 can be *waived* by the *FSA*".
- F. REC is amended by:
- (i) inserting, after REC 6, the provisions in Annex G to this instrument;
 - (ii) inserting, after Schedule 2, the provisions in Annex H;

- (iii) inserting, in Schedule 4, after " Section 295 (Notification: overseas investment exchanges and overseas clearing houses)", "Paragraph 17(1) of Schedule 1 (Fees)".

G. This instrument may be cited as the Fees Instrument 2001.

By order of the Board
19 July 2001

ANNEX A

Chapter 4.

Authorisation Fees

4.

4.1 Introduction

Application

- 4.1.1** **R** This chapter applies to:
/1
- (1) every applicant for *Part IV permission* (including an *incoming firm* applying for *top-up permission*); and
 - (2) every *Treaty firm* that wishes to exercise a *Treaty right* to qualify for *authorisation* under Schedule 4 to the *Act* (Treaty rights) in respect of *regulated activities* for which it does not have an *EEA right*.

- 4.1.2** **G** This chapter does not apply to:
/1
- (1) an *EEA firm* that wishes to exercise an *EEA right*; or
 - (2) an *ICVC*; or
 - (3) a *UCITS qualifier*.

Purpose

- 4.1.3** **G** The purpose of this chapter is to set out the requirements on applicants for *Part IV permission*, and *Treaty firms* qualifying for *authorisation* under Schedule 4 to the *Act* (Treaty rights), to pay fees.
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Background

- 4.1.4** **G** *GEN 3* (FSA Fees – General Provisions) applies to fees required by this chapter.
/1
- 4.1.5** **G** Most of the detail of what fees are payable by applicants and *Treaty firms* is set out in *AUTH 4 Ann 1R*, the provisions of which will vary from one financial year to another. Accordingly a fresh *AUTH 4 Ann 1R* will come into force, following consultation, for each financial year.
/1
- 4.1.6** **G** The rates set for authorisation fees represent an appropriate proportion of the costs of the *FSA* in processing the application or exercise of *Treaty rights*.
/1

- 4.1.7** G_{/1} Applications (and exercises of *Treaty rights*) are categorised by the *FSA* for the purpose of fee raising as complex, moderately complex and straightforward as identified in *AUTH 4 Ann 1R*. This differentiation is based on the permitted activities sought and does not reflect the *FSA*'s risk assessment of the applicant (or *Treaty firm*).
- 4.1.8** G_{/1} A potential applicant (or *Treaty firm*) has the opportunity to discuss its proposed application (or exercise of *Treaty rights*) with the *FSA* before submitting it formally (see *AUTH 3.9.1G*). If an applicant (or *Treaty firm*) does so, the *FSA* will be able to use that dialogue to make an initial assessment of the fee categorisation and therefore indicate the authorisation fee that should be paid.
- 4.1.9** G_{/1} See *AUTH 3.9* in relation to the procedures for making applications for *Part IV permission* and *AUTH 5* for procedures for the exercise of *Treaty rights* by *Treaty firms*.
- 4.1.10** G_{/1} Authorisation fees are not refundable.

4.2 Obligation to Pay Authorisation Fees

General

- 4.2.1 **R** ^{/1} A person to whom this chapter applies must pay to the FSA an authorisation fee for each application made (or exercise of a *Treaty right*), as set out in *AUTH 4 Ann 1R*.

Amount

- 4.2.2 **R** ^{/1} In respect of a particular application (or exercise) the authorisation fee referred to in *AUTH 4.2.1R* is the highest of the tariffs set out in part 1 of *AUTH 4 Ann 1R* which apply to that application (or exercise).
- 4.2.3 **G** ^{/1} If an application (or exercise of a *Treaty right*) falls within more than one category, only one fee is payable. That fee is the one for the category to which the highest fee tariff applies.

Due date and method of payment

- 4.2.4 **R** ^{/1} The sum payable under *AUTH 4.2.2R* must be paid:
- (1) by bankers draft, cheque or other payable order;
 - (2) in full without deduction; and
 - (3) on or before the date on which the application is made (or notice of exercise is given).
- 4.2.5 **G** ^{/1} An application for a *Part IV permission* will not be complete until the appropriate fee is paid, and the six month period for consideration will not start until that time (see further *AUTH 3.9.30G*).

Modification for certain Treaty firms

4.2.6

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If a certificate has been issued under paragraph 3(4) of schedule 4 to the *Act* in respect of an exercise of a *Treaty right*, no sum payable under *AUTH* 4.2.2R.

4.2.7

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If no certificate has been issued under paragraph 3(4) of schedule 4 to the *Act* in respect of an exercise of a *Treaty right*, the sum payable is as specified in Part 4 of *AUTH* Ann 1R.

Authorisation fees payable in relation to the period from applications day to 31 March 2002

Part 1 – Authorisation fees payable

Application type (see Part 2)	Amount payable
(a) Version 1 credit unions	£500
(b) Straightforward	£2,000
(c) Moderately complex	£5,000
(d) Complex	£25,000

Part 2 – Complexity Groupings

Straightforward cases

Activity grouping	Description
A.1	Version 2 credit unions only
A.3	Friendly societies only
A.4	Friendly societies only
A.12	Advisory arrangers, dealers or brokers (holding or controlling client money and/or assets)
A.13	Advisory arrangers, dealers or brokers (not holding or controlling client money and/or assets)
A.14	Corporate finance advisers
A.15	Advisory only firms

Moderately complex cases

Activity grouping	Description
A.5	Managing agents at Lloyd's
A.7	Fund managers (holding or controlling client money and/or assets)
A.8	Fund managers (not holding or controlling client money and/or assets)
A.9	Operators, trustees and depositaries of collective investment schemes
A.10	Firms dealing as principal
A.11	Execution only arrangers, dealers or brokers

Complex cases

Activity grouping	Description
A.1	Deposit acceptors (excluding credit unions)
A.3	Firms conducting insurance activities subject only to prudential regulation (excluding friendly societies)
A.4	Firms conducting insurance activities subject to both prudential and conduct of business regulation (excluding friendly societies)

Part 4 – Authorisation fees for Treaty firms

- 1 If the Treaty firm wishes to undertake the permitted activities in question through its branch in the United Kingdom, the fee is 50% of the fee that would be payable under AUTH 4.2.2R.
- 2 If the Treaty firm wishes to undertake the permitted activities in question by providing services in the United Kingdom, the fee is 25% of the fee which would be payable under AUTH 4.2.2R.

Part 5 – Activity groupings

Activity grouping	Fee-payer falls in the activity group if:
A.1 Deposit acceptors	<p>Its permission includes accepting deposits</p> <p>BUT DOES NOT include one or more of the following:</p> <ul style="list-style-type: none"> • effecting contracts of insurance; • carrying out contracts of insurance.
A.3 Firms conducting insurance activities subject only to prudential regulation	<p>Its permission includes either or both of the following:</p> <ul style="list-style-type: none"> • effecting contracts of insurance; • carrying out contracts of insurance; <p>BUT ONLY in respect of specified investments that are:</p> <ul style="list-style-type: none"> – general insurance contracts; or – long-term insurance contracts other than life-policies.
A.4 Firms conducting insurance activities subject to both prudential and conduct of business regulation	<p>Its permission includes one or more of :</p> <ul style="list-style-type: none"> • effecting contracts of insurance; • carrying out contracts of insurance; <p>both in respect of specified investments including life policies.</p> <ul style="list-style-type: none"> • entering as provider into a funeral plan contract.
A.5 Managing agents at Lloyd's	<p>Its permission includes:</p> <p>managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's.</p>
A.6 The Society of Lloyd's	<p>It is an authorised person under section 315(2) of the Act.</p>
A.8 Fund Managers (not holding or controlling client money and/or assets)	<p>Its permission includes the following:</p> <ul style="list-style-type: none"> • managing investments; and • a requirement that prohibits the firm from holding and/or controlling client money. <p>BUT MUST NOT include:</p> <ul style="list-style-type: none"> • safeguarding and administration of assets (without arranging); • arranging safeguarding and administration of assets.

<p>A.9 Operators, Trustees and Depositaries of collective investment schemes</p>	<p>Its permission includes one or more of the following:</p> <ul style="list-style-type: none"> • establishing, operating or winding up a regulated collective investment scheme; • establishing, operating or winding up an unregulated collective investment scheme; • acting as trustee of an authorised unit trust scheme; • acting as the depositary or sole director of an open-ended investment company. <p>AND PROVIDED the firm is NOT a corporate finance advisory firm OR the activities it has (as listed above) are otherwise limited to carrying out corporate finance business.</p>
<p>A.10 Firms dealing as principal</p>	<p>Its permission includes:</p> <p>dealing in investments as principal</p> <p>BUT NOT if one or more of the following apply:</p> <ul style="list-style-type: none"> • activity is carried on exclusively in respect of life policies; • firm is acting exclusively as a matched principal broker <p>AND PROVIDED the firm is NOT a corporate finance advisory firm OR the activities it has (as listed above) are otherwise limited to carrying out corporate finance business.</p>
<p>A.11 Execution-only arrangers, dealers or brokers</p>	<p>Its permission includes one or more of the following:</p> <ul style="list-style-type: none"> • dealing in investments as agent; • arranging (bringing about) deals in investments; • making arrangements with a view to transactions in investments; • dealing as principal in investments where the activity is carried on exclusively in respect of life policies or where the firm acts as a matched principal broker. <p>BUT MUST NOT include one or more of the following:</p> <ul style="list-style-type: none"> • advising on investments (except pensions transfers and pension opt-outs); or • advising on pension transfers and pension opt-outs. <p>AND PROVIDED the firm is NOT a corporate finance advisory firm OR the activities it has (as listed above) are otherwise limited to carrying out corporate finance business.</p>

<p>A.12 Advisory arrangers, dealers, or brokers (holding or controlling client money and/or assets)</p>	<p>Its permission includes one or more of the following:</p> <ul style="list-style-type: none"> • dealing in investments as agent; • arranging (bringing about) deals in investments; • making arrangements with a view to transactions in investments ; • dealing as principal in investments where the activity is carried on as a matched principal broker. <p>AND MUST INCLUDE one or more of:</p> <ul style="list-style-type: none"> • advising on investments (except pension transfers and pension opt-outs); • advising on pension transfers and pension opt-outs; • advising on syndicate participation at Lloyd's. <p>AND PROVIDED the firm is NOT a corporate finance advisory firm OR the activities it has (as listed above) are otherwise limited to carrying out corporate finance business.</p> <p>AND CAN HAVE one or more of:</p> <ul style="list-style-type: none"> • safeguarding and administering of assets; • arranging safeguarding and administration of assets • the ability to hold and/or control client money (that is there is no requirement which prohibits a firm from doing this) <p>AND MUST NOT otherwise meet the requirements to fall in the A.4 activity group.</p>
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<p>A.13 Advisory arrangers, dealers, or brokers (not holding or controlling client money and/or assets)</p>	<p>Its permission includes one or more of the following:</p> <ul style="list-style-type: none"> • dealing in investments as agent; • arranging (bringing about) deals in investments; • making arrangements with a view to transactions in investments; • dealing as principal in investments where the activity is carried on as a matched principal broker. <p>AND MUST include one or more of:</p> <ul style="list-style-type: none"> • advising on investments (except pension transfers and pension opt-outs); • advising on pension transfers and pension opt-outs; • advising on syndicate participation at Lloyd's <p>BUT NOT include:</p> <ul style="list-style-type: none"> • safeguarding and administration of assets. • arranging safeguarding and administration of assets <p>AND PROVIDED the firm is NOT a corporate finance advisory firm OR the activities it has (as listed above) are otherwise limited to carrying out corporate finance business.</p> <p>AND MUST HAVE a requirement in its permission that the firm cannot hold and/or control client money.</p> <p>AND MUST NOT otherwise meet the requirements to fall in the A.4 activity group.</p>
<p>A.14 Corporate finance advisers</p>	<p>The firm is carrying on corporate finance business.</p>
<p>A.15 Advisory only firms</p>	<p>Its permission includes one or more of the following:</p> <ul style="list-style-type: none"> • advising on investments (except pension transfers and pension opt-outs); • advising on syndicate participation at Lloyd's <p>BUT MUST NOT include any of the dealing/arranging activities used in defining the A.11 to A.13 activity groups above.</p> <p>AND PROVIDED the firm is NOT a corporate finance advisory firm OR the activities it has (as listed above) are otherwise limited to carrying out corporate finance business.</p>
<p>A.16 Pensions review levy firms</p>	<p>It was liable to pay the Pensions Levy to the PIA in 2001/2002.</p>

ANNEX B

Authorisation manual Schedule 3 Fees and other required payments

G

1. The aim of the *guidance* in the following table is to give the reader a quick over-all view of the relevant requirements for paying fees.
2. It is not a complete statement of those requirements and should not be relied on as if it were.

Type of fee	Trigger event	Date/Time for payment	Amount/rate	Handbook reference
Authorisation/ application fee	Application for a <i>Part IV permission</i>	On making the application	See <i>AUTH 4 Ann</i> 1R, Part 1	<i>AUTH 4.2</i>
Authorisation/ application fee	Exercise of a <i>Treaty</i> <i>right</i>	On exercising that right	See <i>AUTH 4 Ann</i> 1R, Part 4	<i>AUTH 4.2.6R to</i> <i>4.2.7R</i>

ANNEX C

Authorisation manual
Schedule 5
Rights of action for damages

G

1. The table below sets out the *rules* in *AUTH* contravention of which by an *authorised person* may be actionable under section 150 of the *Act* (Actions for damages) by a *person* who suffers loss as a result of the contravention.

2. If a “Yes” appears in the column headed “For private person?”, the *rule* may be actionable by a “*private person*” under section 150 (or, in certain circumstances, his fiduciary or representative; see article 6(2) and (3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001 No 2256)). A “Yes” in the column headed “Removed” indicates that the *FSA* has removed the right of action under section 150(2) of the *Act*. If so, a reference to the *rule* in which it is removed is also given.

3. The column headed “For other person?” indicates whether the *rule* may be actionable by a *person* other than a *private person* (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of *person* by whom the *rule* may be actionable is given.

Actions for damages: Authorisation manual

Chapter/ Appendix	Section/ Annex	Paragraph	Right of action under section 150			
			For private person?	Removed?	For other person?	
All rules in <i>AUTH 4</i>			Yes	No	No	

ANNEX D

Authorisation manual **Schedule 6** **Rules that can be waived**

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The *rules* in *AUTH 4* cannot be *waived* by the *FSA*.

ANNEX E

18.1 Introduction

Application

18.1.1

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This chapter applies to:

- (1) every *person* seeking an *authorisation order* for, or recognition of, a *collective investment scheme*;
- (2) every *manager* of an *authorised unit trust*;
- (3) every *ACD* of an *ICVC*; and
- (4) every *person* who, under the constitution or founding arrangements of a *recognised scheme*, is responsible for the management of the property held for or within the *scheme*;

Purpose

18.1.2

G

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The purpose of this chapter is to set out the requirements for the payment of fees relating to *collective investment schemes*.

Background

18.1.3

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GEN 3 (FSA Fees – General Provisions) applies to fees required by this chapter and explains how the *FSA* sets fees.

18.1.4

G

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Most of the detail of the fees payable in relation to a *collective investment scheme* is set out in *CIS 18 Annex 1R*. The provisions of the Annex may vary from one financial year to another. Accordingly a fresh *CIS 18 Annex 1R* will come into force, following consultation, for each financial year.

18.1.5

G

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The fees for *collective investment schemes* reflect the estimated costs to the *FSA* of assessing applications and notifications, considering proposals to change *regulated collective investment schemes*, maintaining up to date records about them, and related policy work.

18.1.6

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The level of fees payable in respect of an application or a notification will vary depending upon the provision of the *Act* under which it is made. This fee is adjusted when the *scheme* concerned is an *umbrella scheme*.

18.3 Obligation to pay notification and application fees

General

- 18.3.1 **R**_{/1} The *person* identified in Part A of CIS 18 Annex 1R as the "relevant fee payer" must pay each fee applicable to any application or notification as specified in part A of CIS 18 Annex 1R.

Due date

- 18.3.2 **R**_{/1} The relevant fee payer must pay a fee identified in Part A of CIS 18 Annex 1R on or before the date on which the relevant application or notification is made.
- 18.3.3 **G**_{/1} Any application or notification, for which a fee is payable under this section, will be treated as incomplete until that *fee* is paid.

Method of payment

- 18.3.4 **R**_{/1} A fee identified in Part A of CIS 18 Annex 1R must be paid by bankers draft, cheque or other payable order.

R Fees payable in relation to the period from applications day to 31 March 2002

1 Table Part A – Application and notification

Section of the Act etc	Nature and purpose of fee	Payable by	Amount of fee	Umbrella fund factor (Note 3)
Regulation 85 of the OEIC Regulations	On application for an order declaring a scheme to be an ICVC	An applicant (Note 1)	£1,200	2
Section 242	On application for an order declaring a scheme to be an authorised unit trust scheme	An applicant (Note 1)	£1,200	2
Section 264	On giving notice under section 264	The operator (Note 2)	£600	2
Section 270	On giving a notice under section 270	The operator (Note 2)	£600	2
Section 272	On application for an order declaring a scheme to be an individually recognised overseas scheme	An applicant (Note 1)	£14,000	2

2 Table Part B – Periodic fees

Nature and purpose of fee	Payable by	Amount of fee	Umbrella fund factor (Note 3)
Periodic fee for an ICVC	The authorised corporate director		
Periodic fee for an authorised unit trust scheme	The manager		
Periodic fee for a scheme recognised under section 264 of the Act	The operator		
Periodic fee for a scheme recognised under section 270 of the Act	The operator		
Periodic fee for a scheme recognised under section 272 of the Act	The operator		

Notes:

- 3 The fee must accompany the application
- 4 The fee must accompany the notice

-
- 5 For an umbrella fund the fee is multiplied by the factor shown in the final column of the above tables

ANNEX F

Collective Investment Schemes sourcebook Schedule 3 Fees and other required payments

G

1. The aim of the *guidance* in the following table is to give the reader a quick over-all view of the relevant requirements for paying fees.
2. It is not a complete statement of those requirements and should not be relied on as if it were.

Type of fee	Trigger event	Date/Time for payment	Amount/rate	Handbook reference
Periodic fee	-	On or before 30 April in each year, or 30 days after the <i>scheme</i> is <i>recognised</i> or the <i>scheme's</i> <i>authorisation order</i> is made	See <i>CIS</i> 18 Ann 1R, Part B	<i>CIS</i> 18.2
Application/ notification fee	See <i>CIS</i> 18 Ann 1R, Part A	On or before making the relevant application or notification	See <i>CIS</i> 18 Ann 1R, Part A	<i>CIS</i> 18.3

ANNEX G

7.1 Introduction

Application

- 7.1.1** **R** This chapter applies to every *recognised body* and to every applicant for recognition as a *recognised body* under Part XVIII of the *Act* (Recognised investment exchanges and clearing houses).
/1

Purpose

- 7.1.2** **G** The purpose of this chapter is to set out the requirements on *recognised bodies* and applicants for recognition as *recognised bodies* to pay fees which (with other fee requirements in the *Handbook*) provide the funding for the *FSA's* functions.
/1

Background

- 7.1.3** **G** *GEN 3* (FSA Fees – General Provisions) applies to fees required by this chapter, and explains how the *FSA* sets its fees.
/1
- 7.1.4** **G** Most of the detail of the fees payable by *recognised bodies* and applicants is set out in *REC 7 Annex 1R*. The provisions of the annex will vary from one financial year to another. Accordingly a new annex will come into force, following consultation, for each financial year.
/1
- 7.1.5** **G** The fee applicable to a *recognised body* reflects the estimated cost to the *FSA* of discharging its functions in relation to that *recognised body*. Fees are set for *UK recognised bodies* on an individual basis.
/1
- 7.1.6** **G** Application fees are calculated from a tariff structure intended to reflect the estimated cost of processing an application of that type and complexity.
/1
- 7.1.7** **G** A *recognised body* may also have obligations to pay fees to the *FSA* under other *rules* or arising from legislation other than the *Act*. For example, a *recognised body* may have an obligation to pay a fee as an approved operator of a relevant system under the Uncertificated Securities Regulations 1995.
/1
- 7.1.8** **G** The *FSA* does not specify a method of payment for *recognised bodies* or applicants. However the *FSA* expects that a *recognised body* or an applicant will generally pay its fee by electronic credit transfer.
/1



7.3 Application fees

Amount

7.3.1 **R** ^{/1} An applicant for recognition as a *UK recognised body* under section 287 or section 288 of the *Act* must pay to the *FSA* in full and without any deduction the application fee specified for that type of application in part 3 of *REC 7 Annex 1R* for the year in which the application is made.

7.3.2 **R** ^{/1} An applicant for recognition as an *overseas recognised body* under section 287 or section 288 and section 292 of the *Act* must pay to the *FSA* in full and without any deduction the application fee specified in part 4 of *REC 7 Annex 1R* for the year in which the application is made.

Due dates

7.3.3 **R** ^{/1} An applicant must pay the application fee on or before the date on which the application is made.

7.3.4 **G** ^{/1} The *FSA* will not consider an application for recognition until the application fee has been paid.

Fees (2001/2002)

R

1 Table Fees payable in relation to the period from applications day to 31 March 2002

In this table:

the term "recognised body" includes a recognised investment exchange or a recognised clearing house recognised under the Financial Services Act 1986 and which is a *recognised body* under Regulation 9 of the *Recognition Requirements Regulations*; and

the term "recognition order" includes a recognition order made by the FSA under section 37 or section 39 of the Financial Services Act 1986 or a recognition order made by the Treasury under section 40 of the Financial Services Act 1986.

Part 1 – Periodic fees for UK recognised bodies

Name of UK recognised body	Amount payable	Due date
COREDEAL Limited		
CRESTCo Limited		
The International Petroleum Exchange of London Limited		
Jiway Limited		
LIFFE Administration and Management		
The London Clearing House Limited		
The London Metal Exchange Limited		
The London Stock Exchange Limited		
OM London Exchange Limited		
virt-x Exchange Limited		
Any other UK recognised body recognised as such by a recognition order made:		
– before 30 June 2001		
– between 1 July 2001 and 30 September 2001		
– between 1 October 2001 and 31 December 2001		
– between 1 January 2002 and 31 March 2002		

Part 2 – Periodic fees for overseas recognised bodies

Name of overseas recognised body	Amount payable	Due date
Cantor Financial Futures Exchange		
Chicago Mercantile Exchange		
Chicago Board of Trade		

Eurex Zurich		
NASDAQ		
New York Mercantile Exchange		
New Zealand Futures and Options Exchange		
Swiss Exchange		
Sydney Futures Exchange		
Warenterminbörse Hannover		
Any overseas recognised body recognised as such by a recognition order made:		
– before 30 June 2001		
– between 1 July 2001 and 30 September 2001		
– between 1 October 2001 and 31 December 2001		
– between 1 January 2002 and 31 March 2002		
Part 3 – Application fees for applicants for recognition as a UK recognised body		
Description of applicant	Amount payable	Due date
Applicant for recognition as a UK RIE	£ 75,000	Date application is made
Applicant for recognition as a UK RCH	£ 75,000	
Additional fees for applicant who proposes to:		
– act as a central counterparty	£ 25,000	
– offer safeguarding and administration services	£ 25,000	
– use substantially new and untested information technology systems in the performance of its relevant functions	£ 25,000	
Part 4 – Application fees for applicants for recognition as an overseas recognised body		
Description of applicant	Amount payable	Due date
Applicant for recognition as an overseas recognised body	£ 35,000	Date application is made

ANNEX H

Recognised Investment Exchange and Recognised Clearing House sourcebook Schedule 3 Fees and other required payments

G

1. The aim of the *guidance* in the following table is to give the reader a quick over-all view of the relevant requirements for paying fees.
2. It is not a complete statement of those requirements and should not be relied on as if it were.

Type of fee	Trigger event	Date/Time for payment	Amount/rate	Handbook reference
Periodic fee	See <i>REC 7</i> Ann 1R, Part 1	See <i>REC 7</i> Ann 1R, Part 1	See <i>REC 7</i> Ann 1R, Parts 1 and 2	<i>REC 7.2</i>
Application fee	See <i>REC 7</i> Ann 1R, Part 2	On or before making the relevant application	See <i>REC 7</i> Ann 1R, Parts 3 and 4	<i>REC 7.3</i>

GENERAL PROVISIONS AND GLOSSARY (AMENDMENT) INSTRUMENT 2001

Powers exercised

- A. The Financial Services Authority makes the provisions in this instrument in the exercise of:
- (1) the powers and related provisions listed in Schedule 4 to the General provisions (Powers exercised);
 - (2) article 15 of The Financial Services and Markets Act 2000 (Transitional Provisions) (Ombudsman Scheme and Complaints Scheme) Order 2001 (SI 2001/2326);
 - (3) the following articles of the Financial Services and Markets Act 2000 (Transitional Provisions, Repeals and Savings)(Financial Services Compensation Scheme) Order 2001 (SI 2001/2967):
 - (a) articles 4(3) and 4(4) (Pending applications);
 - (b) article 6(2) (Post-commencement applications);
 - (c) articles 9(3) and 9(4) (Article 9 defaults occurring before commencement);
 - (d) article 10(2) (Applications in respect of compulsory liability insurance);
 - (e) article 12(3) (Applications under the new scheme);
 - (f) article 23 (Record keeping and reporting requirements relating to pre-commencement acts).
- B. The provisions of the Financial Services and Markets Act 2000 (the "Act") relevant to making rules and referred to above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force immediately.

Amendment of the General provisions and the Glossary

- D. The Glossary is amended in accordance with Annexes A, B, C and D to this instrument.
- E. The General provisions are amended in accordance with Annex E to this instrument.
- F. Both the General provisions (other than GEN 2.1.8R) and the Glossary are made, additionally, under the powers and related provisions listed at A(2) and (3).

Citation

- G. This instrument may be cited as the General Provisions and Glossary (Amendment) Instrument 2001.

By order of the Board
20 September 2001

ANNEX A

Amendments to the Glossary arising from completion of statutory instruments

1. Insert the following definitions at the place already indicated in the Glossary:

policy (as defined in article 2 of the Financial Services and Markets Act 2000 (Meaning of "Policy" and "Policyholder") Order 2001 (SI 2001/2361)) as the context requires:

(a) a *contract of insurance*, including one under which an existing liability has already accrued; or

(b) any instrument evidencing such a contract.

policyholder (as defined in article 3 of the Financial Services and Markets Act 2000 (Meaning of "Policy" and "Policyholder") Order 2001 (SI 2001/2361)) the *person* who for the time being is the legal holder of the *policy*, including any *person* to whom, under the *policy*, a sum is due, a periodic payment is payable or any other benefit is to be provided or to whom such a sum, payment or benefit is contingently due, payable or to be provided.

2. Amend the definition of "previous regulator" as shown below (underlining indicates new text, striking through indicates deleted text):

previous regulator ...

(5) (in relation to an *underwriting agent* which obtained the *permission* relevant to that category under the Financial Services and Markets Act 2000 (Repeals, Transitional Provisions and Savings) Order 2001 (SI 2001/2636 [~~number to be added later~~])) the *Society of Lloyd's*;

ANNEX B
Technical corrections of the Glossary

1. Delete the definition of "takeover promotion".
2. Amend the following definitions as shown below (underlining indicates new text, striking through indicates deleted text):

approved depositary any depositary:

(a) ~~that~~ which is subject to regulation by a national regulatory body in connection with its custody services;

(b) ~~that~~ which is required to prepare audited accounts;

(c) whose latest annual audit report is not materially qualified;
and

(d) which:

~~(e) that~~ (i) has minimum net assets of £5 million (or its equivalent in any other currency at the relevant time) and has surplus revenue over expenditure for the last two financial years; or

(ii) if not, nevertheless has adequate financial resources for its business.

~~(d) whose latest annual audit report is not materially qualified.~~

direct offer financial promotion

a *non-real time financial promotion* which:

(a) contains:

(i) an offer by the *firm* or another person to enter into a *controlled agreement* with anyone who responds to the *financial promotion*; or

(ii) an invitation to anyone who responds to the *financial promotion* to make an offer to the *firm* or another person to enter into a *controlled agreement*; and

(b) specifies the manner of response or includes a form in which any response is to be made (for example by providing a tear-off slip).

life policy

(1) (except in COB) (in accordance with the definition of "qualifying contract of insurance" in article 3(1) of the *Regulated Activities Order*) a *long-term insurance contract* ~~(which includes a *pension policy*)~~ other than a reinsurance contract and a *pure protection contract*.

(2) (in COB) a long-term insurance contract in (1) or a pension policy.

overseas financial services institution

an institution authorised to carry on any regulated activity or other financial service by an overseas regulator in an EEA State other than the United Kingdom by a competent authority, or in any other country or territory by a regulatory body which is a member of IOSCO.

parent undertaking

...

(iii) it has the right to exercise a dominant influence over S through:

(A) provisions contained in S's memorandum or articles; or

(B) a control contract; or

...

professional firm

~~(in accordance with sections 325(2) (Definition of "members") and 327(2) (Exemption from the general prohibition of the Act)-~~
a *person* which is:

(a) an individual who is entitled to practise a profession regulated by a *designated professional body* and, in practising it, is subject to its rules, whether or not he is a member of that body; or

(b) a *person* (not being an individual) which is controlled and managed by one or more such individuals
~~managed and controlled by one or more individuals each of whom:~~

~~(i) is entitled to practise a profession regulated by a *designated professional body*, and~~

~~(ii) in practising it is subject to the rules of the *designated professional body*.~~

regulated market

(a) (as defined in article 1 of the *ISD*) a market for the instruments listed in Section B of the Annex to the *ISD* which:

(~~ia~~) appears on the list of such markets drawn up by the market's *Home State* as required by article 16 of the *ISD*;

(~~iib~~) functions regularly;

(~~iiie~~) is characterised by the fact that regulations issued or approved by the competent authorities define the conditions for the operation of the market, the conditions for access to the market and, where Directive 79/279/EEC is applicable, the conditions governing admission to listing imposed in that Directive and, where that Directive is not applicable, the

conditions that must be satisfied by a financial instrument before it can effectively be dealt in on the market; and

(iv~~d~~) requires compliance with all the reporting and transparency requirements laid down by articles 20 and 21 of the *ISD*;

(see Part 1 of SUP 17 Ann 5G for an indicative list of these markets-); and

(b) (in SUP 17 and, unless the context otherwise requires, elsewhere in the Handbook) a market notified under article 16 of the ISD, as included in point 30b of Annex IX to the Agreement of the European Economic Area, to the Standing Committee of the EFTA States as defined in that agreement;

(see Part 2 of SUP 17 Ann 5G for an indicative list of these markets).

requisite details

the details required ~~under in~~ the ~~Financial Services and Markets Act 2000 (EEA Passport Rights) Regulations 2001 (SI 2001/1376)~~ *EEA Passport Rights Regulations* and set out in *SUP 13 Ann 1R (Requisite details: branches)* and *SUP 13 Ann 1R (Requisite details: cross border services)*.

safeguarding and administering investments

the *regulated activity*, specified in article 40 of the *Regulated Activities Order* (Safeguarding and administering investments), which is in summary: the safeguarding ~~and the administration of~~ assets belonging to another and the administration of those assets, or arranging for one or more other *persons* to carry on that activity, where: ...

Annex C

Amendments to the Glossary arising from the making of DISP

1. Insert the following definitions in the appropriate alphabetical position:

<i>annual budget</i>	the annual budgeted costs of operating the <i>Financial Ombudsman Service</i> .
<i>Banking Ombudsman scheme</i>	the <i>former scheme</i> set up, on a voluntary basis, to handle complaints against those banks which subscribed to it.
<i>Building Societies Ombudsman scheme</i>	the <i>former scheme</i> set up and recognised under the Building Societies Act 1986 to handle complaints about <i>building societies</i> .
<i>former Ombudsman</i>	an ombudsman, arbitrator or independent investigator appointed under a <i>former scheme</i> .
<i>former scheme</i>	any of the following: (a) the <i>Banking Ombudsman scheme</i> ; (b) the <i>Building Societies Ombudsman scheme</i> ; (c) the <i>FSA scheme</i> ; (d) the <i>IMRO scheme</i> ; (e) the <i>Insurance Ombudsman scheme</i> ; (f) the <i>Personal Insurance Arbitration Service</i> ; (g) the <i>PIA Ombudsman scheme</i> ; (h) the <i>SFA scheme</i> .
<i>FSA scheme</i>	the <i>former scheme</i> operated by the <i>FSA</i> under paragraph 4 of Schedule 7 to the Financial Services Act 1986 for the investigation of complaints arising out of the conduct of investment business.
<i>IMRO scheme</i>	the <i>former scheme</i> set up by <i>IMRO</i> under the Financial Services Act 1986 and the <i>Investment Ombudsman Memorandum</i> to handle complaints against members of <i>IMRO</i> .

<i>Independent Investigator</i>	the <i>former Ombudsman</i> under the <i>FSA scheme</i> .
<i>Insurance Ombudsman scheme</i>	the <i>former scheme</i> set up, on a voluntary basis, to handle complaints against those insurance companies which subscribed to it.
<i>Investment Ombudsman</i>	the <i>former Ombudsman</i> under the <i>IMRO scheme</i>
<i>Ombudsman Transitional Order</i>	the Financial Services and Markets Act 2000 (Transitional Provisions) (Ombudsman Scheme and Complaints Scheme) Order 2001 (SI 2001/2326).
<i>Personal Insurance Arbitration Service</i>	the <i>former scheme</i> set up on a voluntary basis and run by the Chartered Institute of Arbitrators to handle complaints against those insurance companies which subscribed to it.
<i>PIA Ombudsman scheme</i>	the <i>former scheme</i> set up by <i>PIA</i> under the Financial Services Act 1986 and operated by the PIA Ombudsman Bureau Ltd to handle complaints against members of <i>PIA</i> .
<i>relevant existing complaint</i>	<p>(in accordance with <i>the Ombudsman Transitional Order</i>) a complaint which:</p> <p>(a) was referred to a <i>former scheme</i> at any time before <i>commencement</i>, by a person who was at that time entitled, under the terms of the <i>former scheme</i>, to refer such a complaint (whether described in that scheme as the making of a complaint, the referral of a dispute, the submission of a claim, or otherwise); and</p> <p>(b) has not, before <i>commencement</i>, been rejected, withdrawn, settled or determined by <i>the former Ombudsman</i> (whether by a substantive decision, or by closure of the case without a substantive decision).</p>
<i>relevant new complaint</i>	<p>(in accordance with the <i>Ombudsman Transitional Order</i>) a complaint referred to the <i>Financial Ombudsman Service</i> after <i>commencement</i> which relates to an act or omission occurring before <i>commencement</i> if:</p> <p>(a) the act or omission is that of a person who was, immediately before <i>commencement</i>, subject to a <i>former scheme</i>;</p> <p>(b) the act or omission occurred in the carrying on by that</p>

person of an activity to which that *former scheme* applied;
and

(c) the complainant is eligible and wishes to have the
complaint dealt with under the new scheme;

for the purposes of (c), where the complainant is not eligible
in accordance with *DISP 2* (Jurisdiction of the Financial
Ombudsman Service), an *Ombudsman* may, nonetheless, if
he considers it appropriate, treat the complainant as eligible
if he would have been entitled to refer an equivalent
complaint to the *former scheme* in question immediately
before *commencement*.

*relevant new
complaint*

(in accordance with the *Ombudsman Transitional Order*) a
complaint referred to the *Financial Ombudsman Service*
after *commencement* which relates to an act or omission
occurring before *commencement* if:

(a) the act or omission is that of a person who was,
immediately before *commencement*, subject to a *former
scheme*;

(b) the act or omission occurred in the carrying on by that
person of an activity to which that *former scheme* applied;
and

(c) the complainant is eligible and wishes to have the
complaint dealt with under the new scheme;

for the purposes of (c), where the complainant is not eligible
in accordance with *DISP 2* (Jurisdiction of the Financial
Ombudsman Service), an *Ombudsman* may, nonetheless, if
he considers it appropriate, treat the complainant as eligible
if he would have been entitled to refer an equivalent
complaint to the *former scheme* in question immediately
before *commencement*.

*SFA Complaints
Bureau*

the first stage of the *SFA scheme* which aimed to resolve
complaints by conciliation.

*SFA Consumer
Arbitration Scheme*

the second stage of the *SFA scheme*, which determined
complaints by means of arbitration.

SFA scheme

the *former scheme* (including the *SFA Complaints Bureau*
and the *SFA Consumer Arbitration Scheme*) set up by the
SFA to handle complaints against members of the *SFA* under
the Financial Services Act 1986.

2. Amend the following definitions as shown below (underlining indicates new text, striking through indicates deleted text):

<i>Compulsory Jurisdiction</i>	the jurisdiction of the <i>Financial Ombudsman Service</i> to which <i>firms</i> <u>(and certain <i>unauthorised persons</i> as a result of the <i>Ombudsman Transitional Order</i>)</u> are compulsorily subject.
<i>chargeable case</i>	any complaint referred to the <i>Financial Ombudsman Service</i> , apart from those where the <i>Ombudsman</i> considers it apparent from the complaint received, and from any <i>final response</i> which has been issued by the <i>firm</i> , that the complaint should not proceed because: (a) the complainant is not an <i>eligible complainant</i> in accordance with <i>DISP 2</i> ; or (b) the complaint does not fall within the jurisdiction of the <i>Financial Ombudsman Service</i> (as described in <i>DISP 2</i>) or falls outside the time limits set out in <i>DISP 2.3</i> (Time limits for referral of complaints to the <i>Financial Ombudsman Service</i>); or (c) the <i>Ombudsman</i> considers that the complaint should be dismissed without consideration of its merits under <i>DISP 3.3</i> (Dismissal of complaints without consideration of the merits); or (d) the <i>Ombudsman</i> considers, at any stage, that the complaint should be dismissed under <i>DISP 3.3.1R(2)</i> on the grounds that it is frivolous or vexatious.
<i>final response</i>	a written response from the <i>firm</i> which: (a) accepts the complaint, and, where appropriate, offers redress; or (b) offers redress without accepting the complaint; or (c) rejects the complaint <u>and gives</u> reasons for doing so; and contains information about the right to refer the complaint to the <i>Financial Ombudsman Service</i>. <u>and which informs the complainant that, if he remains dissatisfied with the <i>firm's</i> response, he may now refer his complaint to the <i>Financial Ombudsman Service</i> and must do so within six months.</u>

- general levy* (in *DISP*) the annual fee raised from a *firm* under the *rules* to fund a part agreed between the *Financial Ombudsman Service* and the *FSA* of the *Financial Ombudsman Service's annual budget*.
- industry_block* (in *DISP*) a grouping of *firms* by common business activity for the purposes of calculating the *general levy*.
- relevant business* (in *DISP*) that part of a *firm's* business which it conducts with private individuals and which is subject to the jurisdiction of the *Financial Ombudsman Service* as provided for ~~under~~ in *DISP* 2.6 (To which activities do the rules apply?) , measured by reference to the appropriate tariff_base for each *industry_block*.
- relevant complaint* (1) (in *DISP*) a relevant existing complaint or a relevant new complaint.
- (2) (in *REC*) (as defined in section 299(2) of the *Act* (Complaints about recognised bodies)) a complaint which the *FSA* considers is relevant to the question of whether a *recognised body* should remain a *recognised body*.

Annex D

Amendments to the Glossary arising from the making of AUTH 5, SUP 13, SUP 14 and SERV

1. Insert the following definitions at the appropriate alphabetical position:

EEA Passport Rights Regulations the Financial Services and Markets Act 2000 (EEA Passport Rights) Regulations 2001 (SI 2001/2511).

financial institution (in accordance with paragraph 5(c) of Schedule 3 to the *Act* (EEA Passport Rights: EEA firm) and article 1(5) of the *Banking Consolidation Directive* (Definitions)) an undertaking, other than a *credit institution*, the principal activity of which is to acquire holdings or to carry on one or more of the *listed activities* listed in points 2 to 12 of Annex I to the *BCD*, which is a subsidiary of the kind mentioned in article 19 of the *BCD* and which fulfils the conditions in articles 18 and 19 of the *BCD*.

SERV the Special guide for service companies, forming part of the *Handbook*.

2. Amend the following definition as shown below (underlining indicates new text):

permitted activity (1) (except in AUTH 5 and SUP 14) a regulated activity which a firm has permission to carry on.

(2) (in AUTH 5 and SUP 14) an activity identified in a consent notice, a regulator's notice or, where none is required, a notice of intention.

Annex E
Amendments to the General provisions

1. In paragraph 6 of the table of transitional provisions for GEN, delete the sentence which starts "Transitional provisions in *COB* ...".

2. In Schedule 4 to GEN:

(a) in paragraph 1(43), delete the full stop at the end;

(b) after paragraph 1(43), add:

"(44) article 15 of The Financial Services and Markets Act 2000 (Transitional Provisions) (Ombudsman Scheme and Complaints Scheme) Order 2001 (SI 2001/2326)

(45) the following articles of the Financial Services and Markets Act 2000 (Transitional Provisions, Repeals and Savings)(Financial Services Compensation Scheme) Order 2001 (SI 2001/2967):

(a) articles 4(3) and 4(4) (Pending applications);

(b) article 6(2) (Post-commencement applications);

(c) articles 9(3) and 9(4) (Article 9 defaults occurring before commencement);

(d) article 10(2) (Applications in respect of compulsory liability insurance);

(e) article 12(3) (Applications under the new scheme);

(f) article 23 (Record keeping and reporting requirements relating to pre-commencement acts)."

(c) renumber paragraph 7 as paragraph 8 and insert above it:

"7 *GEN* 2.1.8R is made by *FOS Ltd* in the exercise of its powers referred to in Schedule 4 to *DISP*."

**CONDUCT OF BUSINESS SOURCEBOOK (AMENDMENT) INSTRUMENT
2001**

Powers exercised

- A. The Financial Services Authority alters the Conduct of Business sourcebook in the exercise of the powers listed in Schedule 4 to the Conduct of Business sourcebook (Powers exercised).
- B. The provisions of the Financial Services and Markets Act 2000 (the "Act") relevant to making rules and identified in paragraph A are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force immediately.

Amendment of the Conduct of Business sourcebook

- D. The Conduct of Business sourcebook is amended as set out in Annex 1 to this instrument.
- E. The transitional rules in the Conduct of Business sourcebook are amended as set out in Annex 2 to this instrument.

Citation

- F. This instrument may be cited as the Conduct of Business Sourcebook (Amendment) Instrument 2001.

By order of the Board
20 September 2001

ANNEX 1

Amendments to the Conduct of Business Sourcebook

In this Annex, where amendments are shown rather than described, underlining indicates new text and striking through indicates deleted text.

COB 1.4 General application: where?

1. COB 1.4.3R (b) Amend as shown below:

COB 6.5, COB 6.7 and COB 6.8 (Content of key features, Cancellation and withdrawal, Insurance contracts; life and general) but only in relation to long term insurance business carried on with a customer habitually resident in the United Kingdom; and

- if relevant, the provisions in (c)

Otherwise, *COB* applies in full

2. COB 1.4.3R (d) Amend as shown below:

Only the following apply:—

- *COB 5.5.7R and COB 5.5.8R (Overseas business); and*
- *COB 6.5, COB 6.7 and COB 6.8 (Content of key features, Cancellation and withdrawal, Insurance contracts - life and general) but only in relation to long term insurance business carried on with a customer habitually resident in the United Kingdom*

COB 1.6 Application to stock lending activity, corporate finance business and oil market participants

1. COB 1.6.4R Amend as shown below:

Corporate finance business

Chapter 3 Financial promotion, except COB 3.8.6G – COB 3.8.20G and COB 3.9

COB 2.2 Inducements and soft commission

1. COB 2.2.7G In the heading to the table, delete "- joint marketing exercises".

2. COB 2.2.16R Delete from "If a *firm*" to "in writing of:" and replace with the following:

Before a *firm* enters into a *client agreement* authorising it to *deal* for a *customer*, either directly or indirectly, with or through the agency of another *person*, under a *soft commission agreement* which the *firm* has, or knows, or ought reasonably to know, that another member of its *group* has, with that other *person*, the *firm* must inform the *customer* in writing of:

3. COB 2.2.18R Delete from "If a *firm*" to "the *firm* must:" and replace with the following:

If a *firm* has, or knows, or ought reasonably to know, that another member of its *group* has a *soft commission agreement* with another *person* under which either the *firm* or that other member of its *group* *deals* for a *customer*, the *firm* must:

COB 2.4 Chinese Walls

1. COB 2.4.4R Amend as shown below:

(1)...but only to the extent that the business of one of those parts involves the carrying of *designated investment business* or related ancillary activities.

COB 3 Financial Promotion

1. COB 3.2.4R (2)(c) Amend as shown below:

(except where COB 3.2.3R applies) if the *firm*.....
2. COB 3.2.4R (3) Amend as shown below:

(except where COB 3.2.3R applies) if the *firm*.....
3. COB3 Ann 4G Table B Amend the following provision as shown below:

A *direct offer financial promotion* for a *PEP* or *ISA transfer* should include details of the likely advantages and disadvantages of transferring an existing *PEP* or *ISA* holding, including:
4. COB 3.1.5R Insert a new heading for COB 3.1.5R as follows:

Authorised professional firms
5. COB 3.3.4G Amend as shown below:

There is no need for a *financial promotion* which is indicated in ~~COB 3.3.3~~ COB 3.3.1R to be outside the territorial scope of the application of the chapter to be *approved* before being *communicated* by an

unauthorised person (because the restriction in section 21 of the *Act* does not apply).

6. COB 3.5.6R (3)

Amend as shown below:

a "recipient" of a communication is the *person* to whom the communication is made or, in the case of a *non-real time communication* financial promotion which is directed at *persons* generally, any *person* who reads or hears the communication.

7. COB 3.8.7G

Amend the heading for this provision as shown below:

Non-real time financial promotions: guidance on ~~fair, clear~~ clear, fair and not misleading

8. COB 3.10.3R (2)(b)

Delete the full stop at the end and replace with "; or".

9. COB 3.10.3R

Insert the following new provision after COB 3.10.3R(2):

(3) the *financial promotion*:

- (a) relates to a *controlled activity* to be carried on by an *authorised person* or *exempt person*; and
- (b) the only *controlled investments* involved or which reasonably could be involved are:
 - (i) *readily realisable securities* (other than *warrants*); and
 - (ii) generally marketable non-g geared *packaged products*.

COB 4.1 Client classification

1. COB 4.1.11E (1)(a)(i)

Amend as shown below:

COB 3.9 (Direct offer financial promotions), COB 3.12-4 (Communication and approval of financial promotions of overseas or an unauthorised person) and COB 3.13 (Additional requirements for financial promotions for an overseas long-term insurer);

COB 5.7 Disclosure of charges, remuneration and commission

1. COB 5.7.5R Amend as shown below:
 - (1) Before effecting a transaction in a *life policy* with or for a *private customer*, and subsequently on request of the *private customer*, a *firm* must disclose to that *private customer*, in cash terms:
 - (a) except where the firm is an independent intermediary, any remuneration payable by it or its *associates* to its *employees* or agents; and
 - (b) any remuneration or commission receivable by it, in connection with the transaction;unless COB 5.7.9R or COB 5.7.10R ~~apply~~ applies.
 - (2) Before effecting a transaction in any other *packaged product* with or for a *private customer*, ~~or~~ and subsequently on request of the *private customer*, an *independent intermediary* or *product provider* must disclose to that *private customer*, in cash terms:
 - (a) except where the firm is an independent intermediary, any remuneration payable by it or its *associates* to its *employees* or agents; and
 - (b) any remuneration or commission receivable by it, in connection with the transaction;unless COB 5.7.9R or COB 5.7.10R ~~apply~~ applies.
2. COB 5.7.17G (2)(d)(i) Add "or" at the end of this provision.
3. COB 5.7.17G (2)(d)(ii) Renumber this provision as (iii) and insert above it the following:
 - (ii) for arranging this policy xyz Ltd expect to incur sales costs of £ ..."; or

COB 6.3 Post-sale confirmation: life policies

1. COB 6.3.1R Amend as shown below:

COB 6.3 applies to a *firm* in accordance with COB 6.1.1R, in respect of life policies.

COB 6.5 Content of key features and important information

1. COB 6.5.21G Amend as shown below:

~~A firm should set out the following information:~~ The information required by COB 6.5.20R should include:

COB 6.6 Projections

1. COB 6.6.34R (2) Amend as shown below:

The relevant *premium* must be accumulated to the *projection date* at the rate of return for its class of business as detailed in COB 6.6.50R - COB 6.6.52R, subject to charges and expenses (as described in COB 6.6.23R) and the cost of risk benefits. The intermediate projection rate need not be used for an existing contract.

2. COB 6.6.36R (2) Amend as shown below:

The relevant contribution must be accumulated to the *projection date* at the rates of return for the relevant class of business as detailed in COB 6.6.50R, subject to charges and expenses (as described in COB 6.6.23R). The intermediate rate of return need not be used for an existing contract.

3. COB 6.6.81R Amend as shown below

Factor	Formula
(1)	$(1+E)*[\ddot{a}_n^{(12)} + D_{x+n}/D_x * \ddot{a}_{x+n}^{(12)}]$
(2)	$(1+E)*[\ddot{a}_n^{(12)} + D_{x+n}/D_x * \ddot{a}_{x+n}^{(12)}]$
(3)	$(1+E)*[a_y - a_{x:y}]$
(4)	$(1+E)*[\ddot{a}_f^{(12)} + .045 * 0.45*(a_m - a_{m:t})]$
(5)	$(1+E)*[\ddot{a}_f^{(12)} + 0.50*(a_m - a_{m:t})]$
(6) namely $a_x^{(12)}$	$= a_x + 13/24$
(7) namely $\ddot{a}_{x:t}^{(12)}$	$= 13/24 * \ddot{a}_{x:t} + 11/24 * a_{x:t}$

COB 6.9 With-Profits Guides

1. COB 6.9.4R (1) Amend as shown below:

not later than six months after its financial year end or, if later, two months after the end of the lodgement period for annual regulatory returns, produce a separate and self-contained guide for each with-profits fund that it maintains, unless the fund is closed to new policyholders;

COB 7.1 Conflict of interest and material interest

1. COB 7.1.7G Amend as shown below:

When it is not practical for a *firm* to act in accordance with COB 7.1.6E, it may demonstrate that it has taken reasonable steps to ensure fair treatment for its ~~private~~ *customers* by relying on a policy of independence....

COB 7.9 Lending to private customers

1. COB 7.9.5R (2) Delete the full stop and replace it with "; or".
2. COB 7.9.5R Insert after COB 7.9.5R (2):
 - (3) a *long-term insurer* lends *money* or grants *credit* to a *private customer*, or arranges for any other *person* to do so, in connection with a *life policy*.

COB 8.1 Confirmation of transactions

1. COB 8.1.17E Amend as shown below:

Content of a confirmation of transaction - additional content relating to transactions in units in a regulated collective investment scheme	
1.	If the <i>firm</i> is not the <i>operator</i> and the transaction was <i>executed</i> with the <i>customer</i> by the <i>firm</i> as <i>principal</i> , that fact.
2.	The name of the <i>scheme</i> and the type and number of <i>units</i> involved.
3.	The amount of:
	(a) the <i>operator's</i> initial <i>charges</i> if any (in cash or percentage terms), if any; and
	(b) any <i>charges</i> (other than the initial <i>charges</i>) made by the <i>firm</i> to the <i>customer</i> in respect of the transaction and, unless such <i>charges</i> to the <i>customer</i> are made on the same basis, the basis on which the amount of the <i>charges</i> was determined.
4.	A statement that the price at which the transaction has been <i>executed</i> is on an

COB 9.3 General transactions

1. COB 9.3.105R (2) Amend as shown below:

the total ~~contingent liability investment~~ margined transaction requirement, which is calculated in accordance with COB 9.3.115R.

2. COB 9.3.118G Amend the following provision as shown below:
- The terms '*client* equity balance' in COB 9.3.113R and '*firm's* equity balance' in COB 9.3.114R refer to cash values and do not include non-cash *collateral* or other *designated investments* held in respect of a ~~*contingent liability investment*~~ *margined transaction*.

COB 9.5 Client money distribution

1. COB 9.5.5R Amend as shown below:
- A *primary pooling event* occurs:
- (1) on the *failure* of the *firm*; or
- (2) on the vesting of assets in a *trustee* in accordance with an '*assets requirement*' imposed under section ~~46-48~~ (1)(b) of the *Act*; or

COB 10.2 Application of general COB rules

1. COB 10.2.1R Amend as shown below:
- An *operator* when it is undertaking *scheme management activity*:
- (1) must comply with the *rules* specified in COB 10.2.5R as modified by COB 10.2.3R and in COB 10.2.5R; and
- (2) need not comply with any other rule in COB; ~~and~~ .

2. COB 10.2.2G Define "operator" as shown below:
- Firms* which are ~~operators~~ *operators* are reminded that under the *Glossary*:

COB 10.3 Modification of the allocation rule

1. COB 10.3.2G Amend the following provision as shown below:
- COB 10.3.3E replaces COB 7.7.6E. COB 10.3.3E modifies the general *rule* on the timing of allocation (~~ie that is~~, COB 7.7.5R) to take into account the kind of *scheme* in which no *participant* is a *private customer*.

COB 10.7 Periodic Statements for an unregulated collective investment scheme

1. COB 10.7.5R Before "if the *participant* has so requested", delete "(1)".

ANNEX 2

Amendments to the Transitional Rules

In this Annex, where amendments are shown rather than described, underlining indicates new text and striking through indicates deleted text.

COB Table TR1: COB Transitional Provisions

1. 1.4 ETP2 R Delete the wording in columns (2) to (6) and insert "[deleted]" in column (4).
2. 1.5 ETP2 G In column (2), amend "ETP2" to "ETP1".
3. 1.13 ETP8 R (2) Delete the current wording and replace with the following:
 - (2) A *pre-N2 firm* which, before *commencement*, was an appointed representative under the Financial Services Act 1986, but has now become an *authorised person*, must, if it wishes to take advantage of the transitional relief in (1), take reasonable steps to ensure that it does not mislead *customers* as to its status as an *authorised person* in any of the written material in (1).
4. 1.14 ETP8 G Number the existing text as (1) and insert below it the following:
 - (2) A statement that the *firm* is a 'representative' of another *firm* is unlikely, on its own to mislead. But if written materials refer to the *firm* as an appointed representative, reasonable steps under COB TR1 1.13 R (2) could include notifying the *firm's private customers* of the change in its status to an *authorised person*; or modifying the *firm's* existing stationery.
5. 2.3 TTP3 R Amend as shown below:

A *pre-N2 firm* will not contravene any of the provisions labelled *TTP3* in Table *COB TR 2* to the extent that it is able to demonstrate that, on or after *commencement*, it has provided its *customers* with a *periodic statement* required by *COB 8.2.4R* (Requirement for a periodic statement) or a *client statement* required by *COB 9.1.59R* (Production and despatch of client

statements) for the period in which *commencement* falls, in accordance with the *corresponding rules* of its *previous regulator*.

6. 3.2 TSP2 R (1) Amend as shown below:

(1) Subject to (2) and (3), a *pre-N2 firm* will not contravene any of the provisions in Table *COB TR 2* labelled *TSP2* to the extent that, on or after *commencement*, it is able to demonstrate that it has continued to use, or rely upon, *terms of business* (including a *client agreement*), or a *soft commission agreement*, given to, or made with, a *person* before the end of the *transitional period* in accordance with the *corresponding rule* of its *previous regulator*.

7. 3.8 TSP6 R Number existing text as (1) and insert below it the following:

(2) A *pre-N2 firm* will not contravene any of the provisions labelled TSP in Table COB TR2 to the extent that it is able to demonstrate that, on or after *commencement*, its auditors have provided its *previous regulator* with written confirmation of the type required by COB 9.3.42R (2)(a) in accordance with the *corresponding rule* of its *previous regulator*.

COB Table TR2: COB provisions to which transitional relief attaches

Amend those parts of the table that follow as shown:

COB Rule	Rule Heading	Label		
		ETP	TTP	TSP
Chapter 2 Rules which apply to all firms conducting designated investment business				
2.2 Inducements and soft commission				
2.2.8R	Requirements when using a soft commission agreement	ETP1		<u>TSP2</u>
Chapter 3 Financial promotion (whole chapter)		<u>ETP1</u>		TSP7
3.6 Confirmation of compliance				
3.6.2R 3.6.3R	Withdrawing confirmation	ETP1		TSP1
3.7 Records		ETP1		

COB Rule	Rule Heading	Label		
		ETP	TTP	TSP
3.8	Form and content of financial promotions	ETP1		
3.9	Direct offer financial promotions	ETP1		
3.10	Unsolicited real time financial promotions			
3.10.1R	Meaning of "solicited" and "unsolicited" real time	ETP1		
3.11	Unregulated collective investment schemes			
3.11.4R	Limited disapplication of this chapter	ETP1		
3.12	Communication and approval of financial promotions for an			
3.12.2R	No approval of real time financial promotions	ETP1		
3.12.3R	Approval of financial promotions when not all the	ETP1		
3.13	Additional requirements for financial promotions for an			
3.13.2R		ETP1		
3.13.3R		ETP1		
Annex 2R	Contents of Enterprise Investment Scheme	ETP1		
Annex 3R	Additional contents of Enterprise Investment Scheme	ETP1		
Annex 5R	Permitted promotion of unregulated investment	ETP1		
Chapter 4 Accepting customers				
4.1 Client classification (whole section)		ETP3		
4.2 Terms of business and client agreements with customers (whole section)		ETP1		TSP2
Chapter 6 Product disclosure and the customers' right to cancel		ETP1		TSP7
6.7 Cancellation and withdrawal (whole section)		ETP1		TSP6
6.9 With-profits guides (whole section)			TTP2	
Chapter 7 Dealing and managing				
Chapter 9 Client assets (whole chapter)		ETP5		
9.1.59R	Production and despatch of client statements	ETP1	TTP1	
9.1.60R			TTP1	
9.1.61R			TTP1	
9.1.78R		ETP1		<u>TSP6</u>
9.3 Client money		ETP7		
<u>9.3.42R</u>				<u>TSP6</u>
9.3.64(2)R		ETP6		<u>TSP6</u>
<u>9.3.138R</u>				<u>TSP6</u>
9.5 Client money distribution (whole section)		ETP7		

COB Rule	Rule Heading	Label		
		ETP	TTP	TSP
Chapter 10 Operators of collective investment schemes				
10.3 Modification of the allocation rule				
10.3.1R		ETP1		
<u>10.4 Suitability of the portfolio of an unregulated collective investment scheme</u>				
<u>10.4.3R</u>		<u>ETP1</u>		
10.7 Periodic statements for an unregulated collective investment scheme (whole section)		ETP1	TTP3	
10.7.2R	The requirement to prepare and issue periodic	ETP1		
10.7.6R	Record keeping requirements	ETP1		

COB Table TR3: Client classification provisions

1. 1.1R (2), (4), (6) and (8) Amend as shown below:

- (2) If a *firm* before *commencement* classified an existing *client*, other than another *firm* or *overseas financial services institution*, as a *market counterparty* in accordance with the rules of its *previous regulator*, it will not contravene a *rule* in the *Handbook* by treating the *client* as a *market counterparty*, unless (3) applies.
- (4) If a *firm* before *commencement* classified an existing *client*, other than another *firm* or *overseas financial services institution* or a *client* within COB TR1 1.6, as a non-private customer in accordance with the rules of its *previous regulator*, it will not contravene a *rule* in the *Handbook* by treating that *client* as an *intermediate customer*.
- (6) If a *firm* before *commencement* classified an existing *client*, other than another *firm* or *overseas financial services institution*, as a *private customer* in accordance with the rules of its *previous regulator*, it will not contravene a *rule* in the *Handbook* by treating that *client* as a *private customer*.
- (8) If a *firm* before *commencement* classified an existing *client*, other than another *firm* or *overseas financial services institution*, as an ordinary business investor in accordance with the rules of its *previous regulator*, it will not

contravene a *rule* in the *Handbook* by treating that *client* as an *intermediate customer*.

TRAINING AND COMPETENCE SOURCEBOOK

(AMENDMENT) INSTRUMENT 2001

Powers exercised

A. The Financial Services Authority amends the Training and Competence Sourcebook in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (the "Act"):

(1) section 138 (General rule-making power)

(2) section 150(2) (Actions for damages)

(3) section 156 (General supplementary powers).

B. The provisions of the Act relevant to rules and listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

C. This instrument shall come into force at the beginning of the day on which section 19 of the Act (The general prohibition) comes into force.

Amendments to the Training and Competence Sourcebook

D. The Training and Competence Sourcebook is amended in accordance with the Annex to this instrument.

Citation

E. This instrument may be cited as the Training and Competence Sourcebook (Amendment) Instrument 2001.

By order of the Board
20 September 2001

ANNEX

1. For TC Transitional Provision 5 substitute the following:

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
5	TC 2	R	(1) TC 2 does not apply to an <i>ex-section 43 firm</i> in respect of activities for which it would have been an exempted person under section 43 of The Financial Services Act 1986 before <i>commencement</i>.	From <i>commencement</i> for 24 months	<i>commencement</i>

MARKET CONDUCT SOURCEBOOK (AMENDMENT NO 2) INSTRUMENT 2001

Powers exercised

- A. The Financial Services Authority alters MAR 2 (Price stabilising rules) and MAR 3 (Inter-professional conduct) in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000:
- (1) section 138 (General rule-making power);
 - (2) section 144 (Price stabilising rules);
 - (3) section 145 (Financial promotion rules);
 - (4) section 150(2) (actions for damages); and
 - (5) section 156 (General supplementary powers).

Commencement

- B. This instrument comes into force immediately.

Amendment of Price stabilising rules

- C. MAR 2 is amended by the insertion of the following heading above MAR 2.1.9R:
"Rights of action for damages".
- D. MAR 2 is amended by the deletion of the following wording in MAR 2.1.9R:
"price stabilising"

Amendment of Inter-professional conduct

- E. MAR 3 is amended by the insertion of the following after MAR 3.1.4R:
"Rights of action for damages
3.1.5 R "A contravention of the rules in MAR 3 does not give rise to a right of action by a private person under section 150 of the Act (and each of the rules in this instrument is specified under section 150(2) of the Act as a provision giving rise to no such right of action.)"

Destinations

- F. MAR is amended by the deletion of the following text:
"The rules in MAR can be waived by the FSA under section 148 of the Act (modification or waiver of rules), except for:
MAR 2.1.1(2)R (Application)
MAR 2.X.XR (Actions for damages)
MAR 3.1.5R (Actions for damages)"

Citation

G. This instrument may be cited as the Market Conduct Sourcebook (Amendment) Instrument 2001.

By order of the Board
20 September 2001

MARKET CONDUCT SOURCEBOOK (AMENDMENT NO 3) INSTRUMENT 2001

Powers exercised

A. The Financial Services Authority makes the rules and gives the guidance in the Annex to this instrument (MAR 4 (Endorsement of the Takeover Code)) in the exercise of the following powers and related provisions in the Act:

- (1) section 138 (General rule-making power)
- (2) section 143 (Endorsement of codes etc.)
- (3) section 157(1) (Guidance).

Commencement

B. This instrument comes into force immediately.

Amendment of schedules

C. In schedule 4 (Powers exercised), insert the following after “Section 138 (General rule-making power)”

“Section 143 (Endorsement of codes etc.)”.

D. In schedule 5 (Rights of action for damages), insert the following at the end of the table:

Chapter/ Appendix	Section/ Annex	Paragraph	For Private Person?	Removed	For other person?
<i>MAR 4</i>			Yes	No	No
(all rules)					

Amendment of Derivations

E. The table of derivations is amended by the insertion of the following at the end of the table:

Ch/App	S/Ann	P		Subject	Source	Reference
MAR 4	3	1	R	Further support of the Takeover Panel's functions	FSA rules and SFA rules	Financial Services (Conduct of Business) Rules 1990, rule 2.12(1) SFA rule 5-48(1)
MAR 4	3	5	R	Further support of the Takeover Panel's functions	SFA rules	SFA rule 5-48(2)

Amendment of destinations

F. The table of destinations is amended by the insertion of the following at the end of the table:

Source reference	Subject	Module	Ch/App	S/Ann	P		
Financial Services (Conduct of Business) Rules 1990, rule 2.12(1) and SFA rule 5.48(1)	Further support of the Takeover Panel's functions	MAR	4	3	1	R	
Financial Services (Conduct of Business) Rules 1990, rule 2.12(2) and SFA rule 5.48(2)	Further support of the Takeover Panel's functions	MAR	4	3	5	R	

Citation

G. This instrument may be cited as the Market Conduct Sourcebook (Amendment No 3) Instrument 2001.

By order of the Board
20 September 2001

ANNEX

Chapter 4

Endorsement of the Takeover Code



4.1 APPLICATION AND PURPOSE

Application

4.1.1 **R** This chapter applies to every *firm* whose *permission* includes, or ought to include, any *designated investment business*, except as set out in MAR 4.4.1R.
/1

4.1.2 **G** MAR 4.1.1R applies regardless of whether the *firm's* activity:
/1

- (1) is a *regulated activity*;
- (2) is carried on from an office of the *firm* in the *United Kingdom*; or
- (3) is in respect of a *client* in the *United Kingdom*.

Purpose

4.1.3 **G** The *Takeover Code* and the *SARs* provide valuable regulation in the areas of takeovers, mergers and substantial acquisition of *shares* of companies. The purpose of endorsing the *Takeover Code* and the *SARs* is to provide them with statutory support. The other requirements in this chapter provide further support for the functions of the *Takeover Panel*.
/1

4.1.4 **G** Endorsing the *Takeover Code* and the *SARs* and imposing the other requirements in this chapter furthers the FSA's *regulatory objectives*, and in particular the objectives of market confidence and protection of consumers.
/1



4.2 ENDORSEMENT

4.2.1

R

The *FSA* endorses:

^{/1}

- (1) the *Takeover Code*; and
- (2) the *SARs*;

as respects the *firms* described in *MAR 4.1.1R*.

4.2.2

G

The *FSA*'s endorsement in *MAR 4.2.1R* has effect in relation to the *Takeover Code* and the *SARs* as amended from time to time. This is because the *FSA* has notified the *Takeover Panel* that it is satisfied with the *Takeover Panel's* consultation procedures, and not withdrawn that notification, in accordance with section 143(6) of the *Act* (Endorsement of codes etc.).

^{/1}

4.2.3

G

The effect of the *FSA*'s endorsement in *MAR 4.2.1R* is that, under section 143 of the *Act* (Endorsement of codes etc.):

^{/1}

- (1) at the request of the *Takeover Panel*, the *FSA* may take enforcement action against a *firm* which contravenes the *Takeover Code* or the *SARs*, under Part IV (Permission to Carry on Regulated Activities), Part XIII (Incoming firms: Intervention by Authority), Part XIV (Disciplinary Measures) and Part XXV (Injunctions and Restitution) of the *Act* (see *ENF 14.10*); and
- (2) at the request of the *Takeover Panel*, the *FSA* may take enforcement action against an *approved person* under section 66(2)(b) of the *Act* (Disciplinary powers).

4.2.4

G

A failure to comply with a requirement imposed, or ruling given, by the *Takeover Panel* under the *Takeover Code* or the *SARs* has the same effect as a contravention of the *Takeover Code* or the *SARs*, under section 143(5) of the *Act* (Endorsement of codes etc.).

^{/1}

4.2.5

G

ENF 14.10 contains *guidance* on the *FSA*'s exercise of its enforcement powers in this area.

^{/1}

4.3 FURTHER SUPPORT OF THE TAKEOVER PANEL'S FUNCTIONS

- 4.3.1** **R** ^{/1} A *firm* must not act, or continue to act, for any *person* in connection with a transaction to which the *Takeover Code* or the *SARs* apply (including a *rule 8 transaction*) if the *firm* has reasonable grounds for believing that the *person* in question, or his principal, is not complying or is not likely to comply with the *Takeover Code* or the *SARs*.
- 4.3.2** **G** ^{/1}
- (1) The *Takeover Panel* publishes notices regarding compliance with the *Takeover Code* and *SARs*. It may also, from time to time, name in those notices *persons* as *persons* that, in the *Takeover Panel's* opinion, are not likely to comply with the *Takeover Code* or the *SARs*. Any notices of this type will be available on the *Takeover Panel's* website (www.thetakeoverpanel.org.uk).
 - (2) A *firm* should keep itself informed of *Takeover Panel* notices and take them into account in seeking to comply with *MAR 4.3.1R*. If the *Takeover Panel* were to name such a *person* in such a notice, the *FSA* would expect a *firm* to comply with *MAR 4.3.1R* by not acting or continuing to act for that *person*.
 - (3) The *FSA* would not regard a *firm* as in breach of *MAR 4.3.1R* where the *Takeover Panel* has indicated that it is content for the *firm* to act in relation to that transaction.
- 4.3.3** **G** ^{/1}
- (1) Where a restriction under *MAR 4.3.1R* applies, among other things the *firm* is prevented from carrying on any *designated investment business* activity, or *communicating* or *approving* any *financial promotion*, in connection with a transaction to which the *Takeover Code* or the *SARs* apply.
 - (2) Where a restriction under *MAR 4.3.1R* applies, the *firm* is not prevented from carrying on other activities (including *regulated activities*) in relation to that *person*. This includes *designated investment business* activity which is not in connection with a transaction to which the *Takeover Code* or the *SARs* apply.
- 4.3.4** **G** ^{/1}
- (1) Where a restriction under *MAR 4.3.1R* applies, an *authorised professional firm* is not prevented from providing professional advice or representation in any proceedings to the *person* where that falls within section 327(8) of the *Act*. This means that the *person* can obtain legal advice or representation in any proceedings from a law firm and accounting advice from an accounting firm: see *MAR 4.4.1R(2)*.
 - (2) While the *FSA* recognises the duty of *authorised professional firms* to act in the best interests of their clients, the duty cannot override the provisions of the *Takeover Code* or *SARs* so as to require the *authorised professional firm* to provide services in breach of, or enable breach of, the *Takeover Code* or *SARs*.

- 4.3.5 **R**^{/1} A *firm* must provide to the *Takeover Panel*:
- (1) any information and documents in its possession or under its control which the *Takeover Panel* requests to enable the *Takeover Panel* to perform its functions; and
 - (2) such assistance as the *Takeover Panel* requests and as the *firm* is reasonably able to provide to enable the *Takeover Panel* to perform its functions.
- 4.3.6 **G**^{/1} In MAR 4.3.5R, “documents” includes information recorded in any form and, in relation to information recorded otherwise than in legible form, references to providing documents include references to producing a copy of the information in legible form.
- 4.3.7 **G**^{/1} As a result of section 413 of the *Act* (Limitation on powers to require documents), MAR 4.3.5R does not require a *firm* or an *authorised professional firm* to produce, disclose or permit the inspection of *protected items*.

4.4.1

R

/1

This chapter is subject to the following exceptions:

- (1) this chapter does not require an *authorised professional firm* to contravene any rule or principle of, or requirement of a published guidance note relating to, professional conduct applying generally to members of the profession regulated by its *designated professional body*;
- (2) this chapter does not prevent an *authorised professional firm* from providing professional advice, that is, in accordance with section 327(8) of the *Act*, advice:
 - (a) which does not constitute carrying on a *regulated activity*; and
 - (b) the provision of which is supervised and regulated by a *designated professional body*;
- (3) this chapter does not have effect in relation to an *authorised professional firm* in respect of *non-mainstream regulated activity*; and
- (4) this chapter does not apply to:
 - (a) a *UCITS qualifier*; or
 - (b) an *incoming EEA firm* which has *permission* only for *cross border services* and which does not carry on *regulated activities* in the *United Kingdom*.

**INTERIM PRUDENTIAL SOURCEBOOK FOR FRIENDLY SOCIETIES
(AMENDMENT) INSTRUMENT 2001**

- A. The Financial Services Authority amends the Interim Prudential Sourcebook for Friendly Societies in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (the "Act"):
- (a) section 138 (general rule making power);
 - (b) section 141 (insurance business rules);
 - (c) section 150(2) (actions for damages);
 - (d) section 156 (general supplementary powers);
 - (e) section 157 (guidance); and
 - (f) section 340 (appointment of auditors and actuaries).
- B. The provisions of the Act relevant to making rules and listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).
- C. This instrument comes into force immediately.
- D. IPRU(FSOC) is amended in accordance with the Annex to this instrument.
- E. This instrument may be cited as the Interim Prudential Sourcebook for Friendly Societies (Amendment) Instrument 2001.

By order of the Board
20 September 2001

ANNEX

1. Delete rule 3.2 (Audit of systems and records).
2. For paragraph C6(a) of Attachment C to Annex 3 substitute:

“adequacy of resources, including number, experience and skills of those providing inspection services. There may be areas (eg computer audit) for which specific skills may need to be obtained from an external source. *A friendly society’s* auditors would not normally be expected to provide such inspection services, as there is potential for a conflict of interest to arise;”

3. For rule 4.11 substitute:

“Except for rule 4.24, which applies to all *friendly societies*, the remaining rules in this chapter do not apply to *non-directive friendly societies*.”

4. For the rider to paragraph 4 of Annex 3, Part I substitute:

“These requirements are intended to form a sound basis for the control of *friendly societies’* businesses and the protection of *policyholders’* funds. The requirements of rule 3.1 apply to *friendly societies* and *registered branches*.”

5. For paragraph 30 of Annex 3, Part I substitute:

“As explained in 2 the *committee* of a *friendly society* is required to send a statement of opinion to the *FSA* every year stating whether the *friendly society* has complied with the requirements of rule 3.1 and in the case of a *friendly society* with *registered branches*, stating whether its branches have complied with the requirements.”

6. For paragraph 31 of Annex 3, Part II substitute:

“13 to 15 of, and Annex B to, Appendix 4 includes specific provisions with respect to *derivative contracts* and contracts or assets having the effect of *derivative contracts*. This includes provisions restricting those contracts which may be counted as assets for the

purposes of determining a *directive friendly society's required margin of solvency*. Annex 7 refers to Guidance Note 4.2 in *IPRU(INS)* which discusses valuation issues surrounding the use of *derivative contracts*. That Annex also draws attention to the need for the *committee* and management of a society which uses *derivative contracts* to have sufficient understanding of the nature and risks of the contracts it uses to ensure there are effective systems in place to monitor the use of derivatives.”

**INTERIM PRUDENTIAL SOURCEBOOK FOR INSURERS (AMENDMENT)
INSTRUMENT 2001**

- A. The Financial Services Authority amends the Interim Prudential Sourcebook for Insurers in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (the "Act"):
- (a) section 138 (general rule making power);
 - (b) section 141 (insurance business rules);
 - (c) section 150(2) (actions for damages);
 - (d) section 156 (general supplementary powers);
 - (e) section 157 (guidance); and
 - (f) section 340 (appointment of auditors and actuaries).
- B. The provisions of the Act relevant to making rules and listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).
- C. This instrument comes into force immediately.
- D. IPRU(INS) is amended:
- (1) in accordance with Annex A to this instrument;
 - (2) by suspending DAA14 in volume 3 until 1 June 2002; and
 - (3) by adding DAA15 (as set out in Annex B to this instrument) at the end of volume 3 for temporary period until 31 May 2002.
- E. This instrument may be cited as the Interim Prudential Sourcebook for Insurers (Amendment) Instrument 2001.

By order of the Board
20 September 2001

Annex A

1. For part (a) of the definition of *participation* in rule 11.1 substitute the following:

“(a) the holding of a participating interest within the meaning of section 421(2) of the *Act*;
or”

2. For rule 10.(2)(4) substitute the following:

“(4) The declaration required by (1):

- (a) must be made in writing and deposited with the FSA at the same time as the documents required by rules 9.3 and 9.4;
- (b) must be signed by the persons described in rule 9.33(1)(a); and
- (c) must include a statement from the auditors that, in their opinion, it has been properly compiled in accordance with rule 10.2 from information provided to the *insurer* by other members of the *insurance group* and from the *insurer's* own records.”

3. For part (b) of the definition of *long-term insurance business amount* in rule 11.1 substitute the following:

“(b) such other amount as the *insurer* may select not exceeding the value of its assets (other than *general insurance business assets* if the *insurer* is a *general insurer* and excluding *reinsurance recoveries* and assets required to match *property linked liabilities*) in accordance with the *Valuation of Assets Rules*,”

4. For the first paragraph of the definition of *contract for differences* in rule 11.1 substitute the following:

“a contract for differences or any other contract the purpose or pretended purpose of which is to secure a profit or avoid a loss by reference to fluctuations in-”

5. For the last paragraph of the definition of *non-directive insurer* in rule 11.1 substitute the following:

“whose *insurance business* is limited to that described in paragraphs (1) to (7)”

6. For rule 10.1 substitute the following:

“10.1 This chapter applies to an *insurer* (other than a *pure reinsurer*) that is a *subsidiary undertaking* of an *ultimate insurance parent undertaking* and whose head office is in the United Kingdom.”

Direct line:
Local fax:
Email:

10 September 2001

Our Ref: DAA15

Your Ref:

Dear Appointed Actuary

Resilience Test

As you will be aware, Regulation 75 of the determination of liability regulations in the Insurance Companies Regulations 1994 requires prudent provision to be made against the effects of possible future changes in the value of assets on the adequacy of these assets to meet the liabilities. This regulation is being carried forward, from 1 December 2001, in Rule 5.17 of the Interim Prudential Sourcebook for Insurers.

Guidance on how Appointed Actuaries should interpret this regulation has, in the past, been given in letters from the Government Actuary, which give advice on how this so-called 'resilience test' should be applied. These letters explain that actuaries should consider a range of possible financial conditions in the future, and the extent to which the solvency margin should be viewed as sufficient to enable the office to meet its liabilities in such circumstances. The present guidance is in the Government Actuary's letter (DAA14) dated 14 May 2000.

This concept of resilience testing is of course fully consistent with the proposed new regime for all financial institutions, as set out in our recent consultation document on the Integrated Prudential Sourcebook, CP97. This document envisages that there should be appropriate judgement by each firm of the financial scenarios to be considered for this purpose, taking account of the nature of the assets and liabilities of the firm as well as perceptions of potential market movements. Accordingly, we consider that this element of the guidance is the key aspect on which attention should now be focused.

The present guidance sets out three specific possible future scenarios, each of which should be tested by the actuary in his or her resilience test. These scenarios have been developed and modified over the last ten years to reflect changing perceptions of the range of investment scenarios that could arise, and changes to the regulations. Since we are now operating in a low inflationary environment in which a significant rise in interest rates on fixed interest securities is considerably less likely, the FSA considers that the test set out in the present scenario three appears unrealistic. (In the possible converse scenario, the present rules for valuing liabilities do of course already make proper allowance for possible falls in the yield on fixed-interest securities.)

Accordingly, in the light of all the above considerations, the FSA has decided that the guidance should be modified and simplified so that, in place of the present recommended set of scenarios for the resilience test, the actuary should, as a minimum, consider the scenario of a fall in the value of equities of the greater of

- (a) 25%, subject to the fall being restricted to such as would not produce a P/E ratio on the FTSE Actuaries All Share Index lower than 75% of the inverse of the long term gilt yield (as defined in regulation 69 of the Insurance companies Regulations 1994 and rule 5.11 of the Interim Prudential Sourcebook for Insurers), and
- (b) 10%.

At the same time, the actuary should make the prudent assumption that company earnings might fall by 10% (shortly after the above fall in equity values), but that dividends would remain unaltered when assessing the corresponding rate of interest at which the liabilities should be valued.

The actuary would then be expected to apply his or her own professional judgement in considering the level of changes in the value of other types of investment held by the insurer for the purpose of this resilience test. Naturally the prudence concept must be paramount. Reductions in fixed interest yields, and/or the reversion of the current yield curve to a more normal shape, are among the obvious possibilities.

The actuary should also take account of the nature of the assets and liabilities. For example the actuary to an insurer which has only unit linked business, some of which carries a guaranteed annuity rate, should not necessarily assume equity values fall in applying tests for lower fixed interest rates. Indeed actuaries to such insurers should consider their resilience to a rise in equity values combined with falling interest rates.

The above text replaces with immediate effect the guidance in the Government Actuary's letter DAA14. This guidance is also given under section 157 of the Financial Services and Markets Act 2000 and, on a temporary basis until 31 May 2002, replaces that contained in the Interim Prudential Sourcebook for Insurers as DAA14 in Volume 3. After 31 May 2002, this guidance will lapse or (following consultation) become permanent guidance. This temporary

guidance has been given without consultation because the FSA considers that the delay involved in consulting would be prejudicial to the interests of consumers. The FSA will make a further announcement about this guidance when it is appropriate to do so. In the meantime, the FSA expects actuaries to apply the above principles when monitoring and assessing the ongoing financial condition of their firms.

We would also of course expect that actuaries will continue to investigate a wide range of possible future investment scenarios for the purpose of reporting to their boards on their stress testing of the firm. As I am sure you will be aware, we are likely to ask to see a copy of these reports from time to time as part of our ongoing supervision of firms.

Yours sincerely

T W Hewitson
Head of Actuarial Department
Financial Services Authority

AUTHORISATION MANUAL (AMENDMENT) INSTRUMENT 2001

Powers exercised

- A. The Financial Services Authority alters the Authorisation manual in the exercise of the following powers in the Financial Services and Markets Act 2000 (the "Act"):
- (1) paragraph 5(4) of Schedule 4 (Treaty Rights: Notice to Authority) (and sections 51(3) and (6) (Applications under this Part));
 - (2) section 157(1) (Guidance).

Commencement

- B. This instrument comes into force at the beginning of the day on which section 19 of the Act (The general prohibition) comes into force.

Amendment of the Authorisation manual

- C. The Authorisation manual is amended by inserting, after AUTH 4, the provisions in the Annex to this instrument.
- D. Schedule 2 to the Authorisation manual (Notification requirements) is amended by inserting the following new row as the penultimate row of the table:

<i>AUTH</i> 5.3.9D	Intention of <i>incoming Treaty firm</i> to carry on a <i>regulated activity</i> in the <i>United Kingdom</i>	Matters relevant to the notice as indicated in the application pack	Intention to carry on a <i>regulated activity</i>	At least seven days in advance
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- E. Schedule 4 to the Authorisation manual (Powers exercised) is amended by inserting at the end "Paragraph 5(4) of Schedule 4 (Treaty Rights: Notice to Authority).".

Citation

- F. This instrument may be cited as the Authorisation Manual (Amendment) Instrument 2001.

By order of the Board
20 September 2001

Annex
AUTH 5 (Qualifying for authorisation under the Act)

SUPERVISION MANUAL (AMENDMENT NO 2) INSTRUMENT 2001

Powers exercised

- A. The Financial Services Authority alters the Supervision manual in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (the "Act"):
- (1) section 59 (Approved persons)
 - (2) section 138 (General rule-making powers);
 - (3) Section 156 (General supplementary powers);
 - (4) section 157(1) (Guidance);
 - (5) section 340 (Appointment);
 - (6) paragraph 19 of Schedule 3 (EEA Passport Rights: Establishment);
 - (7) paragraph 20 of Schedule 3 (EEA Passport Rights: Services).
- B. The provisions of the Act listed above (other than section 157(1)) are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force as follows:
- (1) the provisions in Annexes A, B, C and D to this instrument: at the beginning of the day on which section 19 of the Act (The general prohibition) comes into force;
 - (2) the remainder of this instrument: immediately.

Amendment of the Supervision manual

- D. SUP is amended as follows:
- (1) after SUP 4, insert the provisions in Annex A to this instrument;
 - (2) after SUP 12, insert the provisions in Annex B to this instrument;
 - (3) after SUP 15.7, insert the provisions in Annex C to this instrument;
 - (4) in SUP 16, insert the provisions in Annex D to this instrument;
 - (5) SUP is amended in accordance with Annex E to this instrument.

Citation

E. This instrument may be cited as the Supervision Manual (Amendment No 2)
Instrument 2001.

By order of the Board
20 September 2001

ANNEX A

Chapter 5

Reports by skilled persons



5.1 Application and purpose

Application

- 5.1.1** **R**_{/1} (1) This chapter applies to every *firm*.
(2) The *rules*, and the *guidance on rules* in SUP 5.5 (Duties of firms), do not apply to a *UCITS qualifier*.

- 5.1.2** **G**_{/1} This chapter (other than the *rules*, and *guidance on rules*, in SUP 5.5 (Duties of firms)) is also relevant to certain unauthorised *persons* within the scope of section 166 of the *Act* (Reports by skilled persons) (see SUP 5.2.1G).

Purpose

- 5.1.3** **G**_{/1} The purpose of this chapter is to give *guidance* on the *FSA*'s use of the power in section 166 of the *Act* (Reports by skilled persons). The purpose is also to make *rules* requiring a *firm* to include certain provisions in its contract with a *skilled person* and to give assistance to a *skilled person*. These *rules* are designed to ensure that the *FSA* receives certain information from a *skilled person* and that a *skilled person* receives assistance from a *firm*.



5.2 The FSA's power

Who may be required to provide a report?

5.2.1

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Under section 166 of the *Act* (Reports by skilled persons), the *FSA* may, by giving a written notice, require any of the following *persons* to provide it with a report by a *skilled person*:

- (1) a *firm*;
- (2) any other *member* of the *firm's group*;
- (3) a *partnership* of which the *firm* is a *member*;
- (4) a *person* who has at any relevant time been a *person* falling within (1), (2) or (3);

but only if the *person* is, or was at the relevant time, carrying on a business.

5.3 Policy on the use of skilled persons

5.3.1

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The appointment of a *skilled person* to produce a report under section 166 of the *Act* (Reports by skilled persons) is one of the *FSA's* regulatory tools. The tool may be used:

- (1) for diagnostic purposes, to identify, assess and measure risks;
- (2) for monitoring purposes, to track the development of identified risks, wherever these arise;
- (3) in the context of preventative action, to limit or reduce identified risks and so prevent them from crystallising or increasing; and
- (4) for remedial action, to respond to risks when they have crystallised.

SUP 5 Ann 1G gives examples of circumstances in which the *FSA* may use the *skilled persons* tool.

5.3.2

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The decision to require a report by a *skilled person* will normally be prompted by a specific requirement for information, analysis of information, assessment of a situation or expert advice or recommendations. It will usually be part of the risk mitigation programme applicable to a *firm*, or the result of an event or development relating or relevant to a *firm*, or prompted by a need for verification of information provided to the *FSA*.

5.3.3

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When making the decision to require a report by a *skilled person*, the *FSA* will have regard, on a case-by-case basis, to all relevant factors. Those are likely to include:

- (1) circumstances relating to the *firm*;
- (2) alternative tools available, including other statutory powers;
- (3) legal and procedural considerations;
- (4) the objectives of the *FSA's* enquiries;
- (5) cost considerations; and
- (6) considerations relating to *FSA* resources.

SUP 5.3.4G to *SUP 5.3.10G* give further guidance on these listed factors.

5.3.4

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Circumstances relating to the firm

The *FSA* will have regard to circumstances relating to the *firm*, for example:

- (1) attitude of the *firm*: whether the *firm* is being cooperative;

- (2) history of similar issues: whether similar issues have arisen in the past and, if so, whether timely corrective action was taken;
- (3) quality of a *firm's* systems and records: whether the *FSA* has confidence that the *firm* has the ability to provide the required information;
- (4) objectivity: whether the *FSA* has confidence in the *firm's* willingness and ability to deliver an objective report;
- (5) conflicts of interest: whether the subject matter of the enquiries or the report involves actual or potential misconduct and it would be inappropriate for the *FSA* to rely on the *firm* itself to enquire into the matter; and
- (6) knowledge or expertise available to the *firm*: whether it would be appropriate to involve a third party with the required technical expertise.

Alternative tools available, including other statutory powers

5.3.5

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The *FSA* will have regard to alternative tools that may be available, including for example:

- (1) obtaining what is required without using specific statutory powers (for example, by a visit by *FSA* staff or a request for information on an informal basis);
- (2) requiring information from *firms* and others, including authorising an agent to require information, under section 165 of the *Act* (Authority's power to require information);
- (3) appointing investigators to carry out general investigations under section 167 of the *Act* (Appointment of persons to carry out general investigations) (see *ENF* 2.5 for the *FSA's* policy on the use of this power); and
- (4) appointing investigators to carry out investigations in particular cases under section 168 of the *Act* (Appointment of persons to carry out investigations in particular cases) (see *ENF* 2.5 for the *FSA's* policy on the use of this power).

Legal and procedural considerations

5.3.6

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The *FSA* will have regard to legal and procedural considerations including:

- (1) statutory powers: whether one of the other available statutory powers is more appropriate for the purpose than the power in section 166 of the *Act* (Reports by skilled persons);
- (2) subsequent proceedings: whether it is desirable to obtain an authoritative and independent report for use in any subsequent proceedings; and
- (3) application of the *Handbook rules*: whether it is important that the relevant *rules* in the *Handbook* should apply, for example *SUP* 5.5.1R which obliges the *firm* to require and permit the skilled person to report specified matters to the *FSA*.

The objectives of the FSA's enquiries

5.3.7

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The FSA will have regard to the objectives of its enquiries, and the relative effectiveness of its available powers to achieve those objectives. For example:

- (1) historic information or evidence: if the objectives are limited to gathering historic information, or evidence for determining whether enforcement action may be appropriate, the FSA's information gathering and investigation powers under sections 165 (Authority's power to require information), 167 (Appointment of persons to carry out general investigations) and 168 (Appointment of persons to carry out investigations in particular cases) of the Act are likely to be more appropriate than the section 166 power (Reports by skilled persons); and
- (2) expert analysis or recommendations: if the objectives include obtaining expert analysis or recommendations (or both) for diagnostic, monitoring, preventative or remedial purposes, the section 166 power (Reports by skilled persons) may be an appropriate power to use, instead of, or in conjunction with, the FSA's other available powers.

Cost considerations

5.3.8

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In accordance with its general policy the FSA will have regard to the question of cost, which is particularly pertinent in relation to *skilled persons* because:

- (1) if the FSA uses the section 166 power (Reports by skilled persons) the *firm* will appoint, and will have to pay for the services of, the *skilled person*;
- (2) if the FSA uses its other information gathering and investigation powers, it will either authorise or appoint its own staff to undertake the information gathering or investigation (or both), or it will pay for the services of external competent persons to do so; in either case the costs will be recovered under the FSA's general fee scheme.

5.3.9

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In having regard to the cost implications of using the section 166 power (Reports by skilled persons) alternative options (such as visits) or other powers, the FSA will take into account relevant factors, including:

- (1) whether the *firm* may derive some benefit from the work carried out and recommendations made by the *skilled person*, for instance a better understanding of its business and its risk profile, or the operation of its information systems, or improvements to its systems and controls;
- (2) whether the work to be carried out by the *skilled person* is work that should reasonably have been carried out by the *firm*, or by persons instructed by the *firm* on its own initiative; for instance a compliance review or the development of new systems;
- (3) whether the *firm's* record-keeping and management information systems are poor and:
 - (a) the required information and *documents* are not readily available; or
 - (b) an analysis of the required information cannot readily be performed without expert assistance;

- (4) whether the *firm* appears to have breached requirements or standards under the *regulatory system* or otherwise put the interests of consumers at risk, and it is unable or unwilling to review and remedy the matters of concern, or the *FSA* considers that it cannot rely on the *firm* to do so; and
- (5) the perceived probability and seriousness of possible breaches of regulatory requirements and the possible need for further action.

Considerations relating to FSA resources

5.3.10

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The *FSA* will have regard to *FSA*-related considerations including:

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- (1) *FSA* expertise: whether the *FSA* has the necessary expertise; and
- (2) *FSA* resources: whether the resources required to produce a report or to make enquiries are available within the *FSA*, or whether the exercise will be the best use of the *FSA*'s resources at the time.

5.4 Appointment and reporting process

Scope of report

- 5.4.1** **G**_{/1} The *FSA* will send a notice in writing requiring the *person* in *SUP* 5.2.1G to provide a report by a *skilled person* on any matter if it is reasonably required in connection with the exercise of its functions conferred by or under the *Act*. The *FSA* may require the report to be in whatever form it specifies in the notice (*SUP* 5 Ann 2G summarises the appointment and reporting processes).
- 5.4.2** **G**_{/1} As part of the decision making process the *FSA* will normally contact the *person* in *SUP* 5.2.1G to discuss its needs before finalising its decision to require a report by a *skilled person*. This will provide an opportunity for discussion about the appointment, whether an alternative means of obtaining the information would be better, what the scope of a report should be, who should be appointed, and the likely cost.
- 5.4.3** **G**_{/1} The *FSA* will give written notification to the *person* in *SUP* 5.2.1G of the purpose of the report, its scope, the timetable for completion and any other relevant matters. The *FSA* will state the matters which the report is to contain as well as any requirements as to the report's format. For example, a report on controls may be required to address key risks, key controls and the control environment. The *FSA* attaches importance to there being a timetable for each report and to the *skilled person*, with the cooperation of the *person* in *SUP* 5.2.1G, keeping to that timetable.
- 5.4.4** **G**_{/1} The written notification in *SUP* 5.4.3G may be preceded or followed by a discussion of the *FSA*'s requirements and the reasons for them. This may involve the *FSA*, the *person* in *SUP* 5.2.1G and the person who has been, or is expected to be, appointed as the *skilled person*. The *FSA* recognises that there will normally be value in holding discussions involving the *skilled person* at this stage. These discussions may include others if appropriate.
- 5.4.5** **G**_{/1} The *FSA* will wish to conduct the discussion with the *firm*, its *skilled person* and any others within a timescale appropriate to the circumstances of the case.

Appointment process

- 5.4.6** **G**_{/1} The *skilled person* is appointed by the *person* in *SUP* 5.2.1G. The *FSA* will normally seek to agree in advance with the person in *SUP* 5.2.1G the *skilled person* who will make the report. The *Act* requires that the *skilled person* be nominated or approved by the *FSA*:

- (1) if the *FSA* decides to nominate the *skilled person* who is to make the report, it will notify the *person* in *SUP 5.2.1G* accordingly; and
- (2) alternatively, if the *FSA* is content to approve a *skilled person* selected by the *person* in *SUP 5.2.1G*, it will notify the latter *person* of that fact.

The *FSA* may give the *person* in *SUP 5.2.1G* a shortlist from which to choose.

5.4.7

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A *skilled person* must appear to the *FSA* to have the skills necessary to make a report on the matter concerned. A *skilled person* may be an accountant, lawyer, *actuary* or *person* with relevant business, technical or technological skills.

5.4.8

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When considering whether to nominate or approve a *skilled person* to make a report, the *FSA* will have regard to the circumstances of the case, including whether the proposed *skilled person* appears to have:

- (1) the skills necessary to make a report on the matter concerned;
- (2) the ability to complete the report within the time expected by the *FSA*;
- (3) any relevant specialised knowledge, for instance of the *person* in *SUP 5.2.1G*, the type of business carried on by the *person* in *SUP 5.2.1G*, or the matter to be reported on;
- (4) any professional difficulty or potential conflict of interest in reviewing the matters to be reported on, for instance because the matters to be reported on may involve questions reflecting on the quality or reliability of work previously carried out by the proposed *skilled person*; and
- (5) enough detachment, bearing in mind the closeness of an existing professional or commercial relationship, to give an objective opinion on matters such as:
 - (a) matters already reported on by the *skilled person* (for example, on the financial statements of the *person* in *SUP 5.2.1G* or in relation to their systems and controls);
 - (b) matters that are likely to be contentious and may result in disciplinary or other enforcement action against the *person* in *SUP 5.2.1G*, its management, *shareholders* or *controllers*; or
 - (c) matters that the *skilled person* has been involved in, in another capacity (for example, when a *skilled person* has been involved in developing an information system it may not be appropriate for him to provide a subsequent opinion on the adequacy of the system).

5.4.9

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In appropriate circumstances, it may be cost effective for the *FSA* to nominate or approve the appointment of a *skilled person* who has previously acted for, or advised, the *person* in *SUP 5.2.1G*. For example, the *FSA* may nominate, or approve the appointment of, the auditor of a *person* in *SUP 5.2.1G* to prepare a report taking into account, where relevant, the considerations set out in *SUP 5.4.7G*.

Reporting process

5.4.10

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The *FSA* will normally require the *person* in *SUP 5.2.1G* to appoint a *skilled person* to report to the *FSA* through that *person*. In the normal course of events the *FSA*

expects that the *person* in SUP 5.2.1G will be given the opportunity to provide written comments on the report prior to its submission to the FSA (SUP 5 Ann 2G summarises the reporting process).

5.4.11

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The FSA may enter into a dialogue with the *skilled person*, and is ready to discuss matters relevant to the report with him, during the preparation of the report. Such discussions will normally involve or be through the *person* in SUP 5.2.1G.

5.4.12

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The FSA will normally specify a time limit within which it expects the *skilled person* to deliver the report. The *skilled person* should, in complying with its contractual duty under SUP 5.5.1R, take reasonable steps to achieve delivery by that time. If the *skilled person* becomes aware that the report may not be delivered on time, he should inform the FSA and the *person* in SUP 5.2.1G as soon as possible. If the *skilled person* becomes aware that there may be difficulties delivering the report within cost estimates, he will no doubt wish to advise the *firm*.

5.4.13

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The FSA may meet with the *person* in SUP 5.2.1G and the *skilled person* together to discuss the final report. The FSA may also wish to discuss the final report with the *skilled person* present but without the *person* in SUP 5.2.1G.

5.5 Duties of firms

Contract with the skilled person

5.5.1

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When a *firm* appoints a skilled person to provide a report under section 166 of the *Act* (Reports by skilled persons), the *firm* must, in a contract with the *skilled person*:

- (1) require and permit the *skilled person* during and after the course of his appointment:
 - (a) to cooperate with the *FSA* in the discharge of its functions under the *Act* in relation to the *firm*; and
 - (b) to communicate to the *FSA* information on, or his opinion on, matters of which he has, or had, become aware in his capacity as *skilled person* reporting on the *firm* in the following circumstances:
 - (i) the *skilled person* reasonably believes that, as regards the *firm* concerned
 - (A) there is or has been, or may be or may have been, a contravention of any relevant *requirement* that applies to the *firm* concerned; and
 - (B) that the contravention may be of material significance to the *FSA* in determining whether to exercise, in relation to the *firm* concerned, any functions conferred on the *FSA* by or under any provision of the *Act* other than Part VI. (Official Listing); or
 - (ii) the *skilled person* reasonably believes that the information on, or his opinion on, those matters may be of material significance to the *FSA* in determining whether the *firm* concerned satisfies and will continue to satisfy the *threshold conditions*; or
 - (iii) the *skilled person* reasonably believes that *firm* is not, may not be or may cease to be a going concern;

- (2) require the *skilled person* to prepare a report, as notified to the *firm* by the *FSA*, *within the time specified by the FSA*; and
- (3) waive any duty of confidentiality owed by the *skilled person* to the *firm* which might limit the provision of information or opinion by that *skilled person* to the *FSA* in accordance with (1) or (2). (See also *SUP 5.5.13G*. and *SUP 5.6*)

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In complying with the contractual duty in *SUP 5.5.1R(1)* the *FSA* expects that a *skilled person* appointed under section 166 of the *Act* (Reports by skilled persons) will cooperate with the *FSA* by, amongst other things, providing information or documentation about the planning and progress of the report and its findings and conclusions, if requested to do so. A *firm* should therefore ensure that the contract it makes with the *skilled person* requires and permits the *skilled person* to provide the following to the *FSA* if requested to do so:

- (1) interim reports;
- (2) source data, *documents* and working papers;
- (3) copies of any draft reports given to the *firm*; and
- (4) specific information about the planning and progress of the work to be undertaken (which may include project plans, progress reports including percentage of work completed, details of time spent, costs to date, and details of any significant findings and conclusions).

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If the *FSA* is considering asking for the information specified in *SUP 5.5.2G* it will take into consideration the cost of the *skilled person* complying with the request, and the benefit that the *FSA* may derive from the information. For example, in most cases, the *FSA* will not need to request a *skilled person* to give it source data, *documents* and working papers. However, the *FSA* may do so when it reasonably believes that this information will be relevant to any investigation it may be conducting, or any action it may need to consider taking against the *firm*.

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In complying with the contractual duty in *SUP 5.5.1R*, the *FSA* expects that, in the case of substantial or complex reports, the *skilled person* will give a periodic update on progress and issues to allow for a re-focusing of the report if necessary. The channel of communication would normally be directly between the *skilled person* and the *FSA*. However, the *FSA* would also expect *firms* normally to be informed about the passage of information, and the *skilled person* would usually be expected to keep the *firm* informed of any communication between the *skilled person* and the *FSA*.

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A *firm* must ensure that the contract required by *SUP 5.5.1R*:

- (1) is governed by the laws of a part of the *United Kingdom*;
- (2) expressly
 - (a) provides that the *FSA* has a right to enforce the provisions included in the contract under *SUP 5.5.1R* and *SUP 5.5.5R(2)*;
 - (b) provides that, in proceedings brought by the *FSA* for the enforcement of those provisions, the *skilled person* is not to

have available by way of defence, set-off or counterclaim any matter that is not relevant to those provisions;

- (c) (if the contract includes an arbitration agreement) provides that the *FSA* is not, in exercising the right in (a), to be treated as a party to, or bound by, the arbitration agreement; and
 - (d) provides that the provisions included in the contract under *SUP 5.5.1R* and *SUP 5.5.5R(2)* are irrevocable and may not be varied or rescinded without the *FSA*'s consent; and
- (3) is not varied or rescinded in such a way as to extinguish or alter the provisions referred to in (2)(d).

5.5.6 G /1 The Contracts (Rights of Third Parties) Act 1999, or Scots common law, enables the *FSA* to enforce the rights conferred on it under the contract against the *skilled person*.

5.5.7 G /1 If the *FSA* considers it appropriate, it may request the *firm* to give it a copy of the draft contract before it is made with the *skilled person*. The *FSA* will inform the *firm* of any matters that it considers require further clarification or discussion before the contract is finalised.

5.5.8 G /1 The *FSA* expects the *firm*, in complying with *Principle 11*, to give the *FSA* information about the cost of the *skilled persons* report. This may include both an initial estimate of the cost as well as the cost of the completed report. This information is required to help inform the *FSA*'s decision making in the choice of regulatory tools. Information about the number and cost of reports by *skilled persons* will be published by the *FSA*.

Assisting the skilled person

5.5.9 R /1 A *firm* must provide all reasonable assistance to any *skilled person* appointed to provide a report under section 166 of the *Act* (Reports by skilled persons).

5.5.10 G /1 In providing reasonable assistance under *SUP 5.5.9R*, a *firm* should take reasonable steps to ensure that, when reasonably required by the *skilled person*, each of its *appointed representatives* waives any duty of confidentiality and provides reasonable assistance as though *SUP 5.5.1R(3)* and *SUP 5.5.9R* applied directly to the *appointed representative*.

5.5.11 G /1 Reasonable *assistance* in *SUP 5.5.9R* should include:

- (1) access at all reasonable business hours for the *skilled person* to the *firm*'s accounting and other records in whatever form;
- (2) providing such information and explanations as the *skilled person* reasonably considers necessary or desirable for the performance of his duties; and
- (3) permitting a *skilled person* to obtain such information directly from the *firm*'s auditor as he reasonably considers necessary or desirable for the proper performance of his duties.

Responsibility for delivery

5.5.12

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In complying with *Principle 11*, a *firm* is expected to take reasonable steps to ensure that a *skilled person* delivers a report in accordance with the terms of his appointment.

Assistance to skilled persons from others

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Section 166(5) of the *Act* (Authority's power to require information) imposes a duty on certain *persons* to give assistance to a *skilled person*. The *persons* on whom this duty is imposed are those who are providing, or have at any time provided, services to any *person* falling within *SUP 5.2.1G*. They include suppliers under *material outsourcing arrangements*.

5.6 Confidential information and privilege

Confidential information

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Within the legal constraints that apply, the *FSA* may pass on to a *skilled person* any information which it considers relevant to the *skilled person's* function. A *skilled person*, being a primary recipient under section 348 of the *Act* (Restrictions on disclosure of confidential information by Authority etc.), is bound by the confidentiality provisions in Part XXIII of the *Act* (Public record, disclosure of information and cooperation) as regards confidential information he receives from the *FSA* or directly from a *firm* or other *person*. A *skilled person* may not pass on confidential information without lawful authority, for example, where an exception applies under the Financial Services and Markets Act 2000 (Disclosure of Confidential Information) Regulations 2001 (SI 2001/2188) or with the consent of the *person* from whom that information was received and (if different) to whom the information relates. The *FSA* will indicate to a *skilled person* if there is any matter which cannot be discussed with the *person* in SUP 5.2.1G

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Banking confidentiality and legal privilege

The *limitations* in the following sections of the *Act* are relevant to this chapter:

- (1) section 175(5) (Information and documents: supplemental provisions) under which a person may be required under Part XI of the *Act* (Information Gathering and Investigations) to disclose information or produce a document subject to banking confidentiality (with exceptions); and
- (2) section 413 (Protected items), under which no *person* may be required to produce, disclose or allow the inspection of *protected items*.

ANNEX B

Chapter 13

Exercise of passport rights by UK firms

13.1 Application and purpose

Application

- 13.1.1** G_{/1} This chapter applies to a *UK firm*, that is, a *person* whose head office is in the *United Kingdom* and which is entitled to carry on an activity in another *EEA State* subject to the conditions of a *Single Market Directive*. Such an entitlement is referred to in the *Act* as an *EEA right* and its exercise is referred to in the *Handbook* as passporting.
- 13.1.2** G_{/1} This chapter also applies to a *UK firm* which wishes to establish a *branch* in, or provide *cross border services* into, Gibraltar. The Financial Services and markets Act 2000 (Gibraltar) Order 2001 provides that a *UK firm* is to be treated as having an entitlement corresponding to its *EEA right*, to establish a *branch* in, or provide *cross border services* into, Gibraltar under any of the *Single Market Directives*. So, references in this chapter to an *EEA State* or an *EEA right* include references to Gibraltar and the entitlement under the Gibraltar Order respectively.
- 13.1.3** G_{/1} This chapter does not apply to:
- (1) a *firm* established in an *EEA State* other than the *United Kingdom*; passporting by such a *firm* in or into the *United Kingdom* is a matter for its *Home State regulator* although *guidance* is given in ■ **AUTH 5** (Qualifying for authorisation under the Act);
 - (2) other *overseas firms* (that is, *overseas firms* established outside the *EEA*); such *firms* are not entitled to passport into another *EEA State* and, where relevant, may need to obtain authorisation in each *EEA State* in which they carry on business;
 - (3) any insurance activity by way of provision of services which is provided by an *EEA firm* participating in a *community co-insurance operation* otherwise than as *leading insurer*; article 26.2 of the *Second Non-Life Directive* provides that only the *leading insurer* in such an operation is required to complete any passporting formalities (see also article 11 of the *Regulated Activities Order*); or
 - (4) the marketing of a *UCITS* scheme by its operator in another *EEA State* under the *UCITS Directive* (see ■ **CIS 2.3.4G**).
- 13.1.4** G_{/1} ■ **SUP 13 Ann X** [to be issued later] contains *guidance* on the *Single Market Directives*.

Purpose

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This chapter gives *guidance* on Schedule 3 to the *Act* for a *UK firm* which wishes to exercise its *EEA right* and establish a *branch* in, or provide *cross border services* into, another *EEA State*. That is, when a *UK firm* wishes to establish its first *branch* in, or provide *cross border services* for the first time into, a particular *EEA State*.

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The chapter also explains how a *UK firm* which has already established a *branch* in, or is providing *cross border services* into, another *EEA State*, may change the details of its *branch* or of the *cross border services* it is providing: for example, where a *UK firm* wishes to establish additional *branches* in an *EEA State* in which it has already established a *branch* where this would result in a change to the details provided previously. Such changes are governed by the *EEA Passport Rights Regulations*.

 13.2 Introduction

- 13.2.1**  This *chapter* gives *guidance* to *UK firms*. In most cases *UK firms* will be *authorised persons* under the *Act*. However, under the *Banking Consolidation Directive*, a subsidiary of a *firm* which is a *credit institution* which meets the criteria set out in that Directive also has an *EEA right*. Such an unauthorised subsidiary is known as a *financial institution*. References in this chapter to a *UK firm* include a *financial institution*.
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- 13.2.2**  A *UK firm* should be aware that the *guidance* is the *FSA's* interpretation of the *Single Market Directives*, the *Act* and the legislation made under the *Act*. The *guidance* is not exhaustive and is not a substitute for *firms* consulting the legislation or taking their own legal advice in the *United Kingdom* and in the relevant *EEA States*.
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- 13.2.3**  In some circumstances, a *UK firm* that is carrying on business which is outside the scope of the *Single Market Directives* has a right under the *Treaty* to carry on that business. For example, an *insurer* carrying on both direct insurance and reinsurance business is not covered by the *Insurance Directives* in respect of the reinsurance element. It may, however, have rights under the *Treaty* in respect of its reinsurance business. Such *UK firms* may wish to consult with the *FSA* on their particular circumstances (see ■ SUP 13.12.2G).
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13.3 Establishing a branch in another EEA State

What constitutes a branch

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Guidance on what constitutes a *branch* is given in ■ SUP 13 Ann X [to be issued later].

The conditions for establishing a branch

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A *UK firm* cannot establish a *branch* in another *EEA State* for the first time under an *EEA right* unless the conditions in paragraphs 19(2), (4) and (5) of Part III of Schedule 3 to the *Act* are satisfied. It is an offence for a *UK firm* which is not an *authorised person* to contravene this prohibition (paragraph 21 of Part III of Schedule 3 to the *Act*). These conditions are that:

- (1) the *UK firm* has given the *FSA*, in accordance with the *FSA rules* (see ■ SUP 13.5.1R), notice of its intention to establish a *branch* (known as a notice of intention) which;
 - (a) (i) identifies the activities which it seeks to carry on through the *branch*; and
 - (b) (i) includes such other information as may be specified by the *FSA* (see ■ SUP 13.5.1R);
- (2) the *FSA* has given notice (known as a *consent notice*) to the *Host State regulator*; and
- (3) (a) the *Host State regulator* has notified the *UK firm* (or, where the *UK firm* is passporting under the *Insurance Directives*, the *FSA*) of the *applicable provisions*; or
 - (b) two months have elapsed beginning with the date on which the *FSA* gave the *consent notice*.

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Where the *UK firm* is passporting under the *Insurance Directives* and the *Host State regulator* has notified the *FSA* of the *applicable provisions*, then under paragraph 19(9) of Part III of Schedule 3 to the *Act*, the *FSA* is required to inform the *firm* of these provisions.

How long will the process take?

13.3.4 G_{/1} The FSA has three months from receiving a UK firm's notice of intention to consider it and, if satisfied with the proposal, notify the relevant *Host State regulator*. The *Host State regulator* then has a further two months to notify the *applicable provisions* (if any) and prepare for the supervision, as appropriate, of the UK firm.

Issue of a consent notice to the Host State regulator

13.3.5 G_{/1} (1) If a UK firm has given the FSA a notice of intention in the required form, then:

- (a) if the UK firm's EEA right derives from the *Banking Consolidation Directive* or the *Investment Services Directive*, the FSA will give the *Host State regulator* a *consent notice* within three months unless it has reason to doubt the adequacy of a UK firm's resources or its administrative structure;
- (b) if the UK firm's EEA right derives from the *Insurance Directives*, the FSA will give the *Host State regulator* a *consent notice* within three months unless it has reason to:
 - (i) doubt the adequacy of the UK firm's resources or its administrative structure; or
 - (ii) question the reputation, qualifications or experience of the *directors* or managers of the UK firm or its proposed authorised agent,
 in relation to the business the UK firm intends to conduct through the proposed *branch*;

(2) in assessing the matters in ■ SUP 13.3.5G(1)(b) the FSA may, in particular, seek further information from the *firm* or require a report from a *skilled person* (see ■ SUP 5 (Skilled Persons)).

13.3.6 G_{/1} (1) If the FSA gives a *consent notice*, it will inform the UK firm in writing that it has done so.

(2) The *consent notice* will contain, among other matters, the *requisite details* (see ■ SUP 13 Ann 1R) or (if the firm is passporting under the *Insurance Directives*) the EEA relevant details (see ■ SUP 13 Ann 2R) provided by the UK firm in its notice of intention (see ■ SUP 13.5(Notices of intention)).

13.3.7 G_{/1} (1) If the FSA proposes to refuse to give a *consent notice*, then paragraph 19(8) of Part III of Schedule 3 to the *Act* requires the FSA to give the UK firm a *warning notice*.

(2) If the FSA decides to refuse to give a *consent notice*, then paragraph 19(12) of Part III of Schedule 3 to the *Act* requires the FSA to give the UK firm a *decision notice* within three months of the date on which it received the UK firm's notice of intention. The UK firm may refer the matter to the *Tribunal*.

(3) For details of the FSA's procedures for the giving of *warning notices* or *decision notices* and references to the *Tribunal* see ■ DEC 2 (Statutory notice procedure: Warning notice and decision notice procedure) and ■ DEC 5 (References to the Tribunal, publication and service of notices).



13.4 Providing cross border services into another EEA State

Where is the service provided?

- 13.4.1 **G**_{/1} Guidance on where a *cross border service* is provided is given in ■ SUP 13 Ann 3G [to be issued later].

The conditions for providing cross border services into another EEA State

- 13.4.2 **G**_{/1} A *UK firm* cannot start providing *cross border services* into another *EEA State* under an *EEA right* unless it satisfies the conditions in paragraphs 20(1) of Part III of Schedule 3 to the *Act* and, if it derives its *EEA right* from the *Insurance Directives*, paragraph 20(4B) of Part III of Schedule 3 to the *Act*. It is an offence for a *UK firm* which is not an *authorised person* to breach this prohibition (paragraph 21 of Part III of Schedule 3 to the *Act*). The conditions are that:

- (1) the *UK firm* has given the *FSA*, in the way specified by *FSA rules* (see ■ SUP 13.5.2R), notice of its intention to provide *cross border services* (known as a notice of intention) which:
 - (a) identifies the activities which it seeks to carry on by way of provision of *cross border services*; and
 - (b) includes such other information as may be specified by the *FSA* (see ■ SUP 13.5.2R); and
- (2) if the *UK firm* is passporting under the *Insurance Directives*, the *firm* has received written notice from the *FSA* as described in ■ SUP 13.4.6G.

How long will the process take?

- 13.4.3 **G**_{/1} On receipt of a *UK firm's* notice of intention (prepared in accordance with ■ SUP 13.4.2(1) and ■ SUP 13.5.2R) then:
- (1) if the *EEA right* is derived from the *Investment Services Directive* or the *Banking Consolidation Directive*, the *FSA* has one month to notify the relevant *Host State regulator*;
 - (2) however, a *UK firm* passporting under the *Banking Consolidation Directive* and the *Investment Services Directive* may start providing *cross border services* as soon as it satisfies the relevant conditions (see ■ SUP 13.4.2G);

- (3) if the *EEA right* is derived from the *Insurance Directives*, the *FSA* has one month to consider it and, if satisfied with the proposal, notify the relevant *Host State regulator*.

Issuing a consent notice or notifying the Host State regulator

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If a *UK firm* has given the *FSA* a notice of intention in the required form, then:

- (1) if the *UK firm's EEA right* derives from the *Investment Services Directive* or the *Banking Consolidation Directive*, paragraph 20(3) of Part III of Schedule 3 to the *Act* requires the *FSA* to send a copy of the notice of intention to the *Host State regulator* within one month of receipt; or
- (2) (a) if the *UK firm's EEA right* derives from the *Insurance Directives*, paragraph 20(3A) of Part III of Schedule 3 to the *Act* requires the *FSA*, within one month of receiving the notice of intention, to:
 - (i) give notice in a specified form (known as a *consent notice*) to the *Host State regulator*; or
 - (ii) give written notice to the *UK firm* of its refusal to give a *consent notice* and the reasons for that refusal.
- (b) The issue or refusal of a *consent notice* is the consequence of a regulatory decision, and the *consent notice* is not a *statutory notice* as set out in section 395 of the *Act*. As such, the *FSA* will follow the decision making procedures set out in ■ **DEC 1** (Application, Purpose and Introduction). A *UK firm* that receives notice that the *FSA* refuses to give a consent notice may refer the matter to the *Tribunal* under paragraph 20(4A) of Part III of Schedule 3 to the *Act*. For procedures relating to references to the *Tribunal* see ■ **DEC 5** (References to the Tribunal, publication and service of notices).

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When the *FSA* sends a copy of a notice of intention, or if it gives a *consent notice* to the *Host State regulator*, it must inform the *UK firm* in writing that it has done so (para 20 (4) of Schedule 3 to the *Act*).

Applicable provisions for cross border services

13.4.6

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- (1) If the *UK firm* is passporting under the *Investment Services Directive*, then when the *Host State regulator* receives the notice of intention, it should inform the *UK firm* of any *applicable provisions*.
- (2) If the *UK firm* is passporting under the *Insurance Directives*, then the *Host State regulator* may notify the *FSA* if there are any applicable provisions. If so, the *FSA* will inform the *UK firm* of the *applicable provisions*.
- (3) If a *UK firm* is not notified of the *applicable provisions*, it should, for its own protection, take all reasonable steps to determine the *applicable provisions* for itself.



13.5 Notices of intention

Specified contents: notice of intention to establish a branch

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A UK firm wishing to establish a *branch* in a particular EEA State for the first time under an EEA right must include in its notice of intention given to the FSA:

- (1) The information specified in ■ SUP 13 Ann 1R; and
- (2) if the UK firm is passporting under the *Insurance Directives*, the information specified in ■ SUP 13 Ann 2R.

Specified contents: notice of intention to provide cross border services

13.5.2

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A UK firm wishing to provide *cross border services* into a particular EEA State for the first time under an EEA right must include, in its notice of intention given to the FSA:

- (1) if the UK firm is passporting under the *Investment Services Directive* or the *Insurance Directives*, the information specified in ■ SUP 13 Ann 3R;
- (2) if the UK firm is passporting under the *Banking Consolidation Directive*, the activities which it intends to carry on.

Specified manner: form and delivery

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(1) The notice of intention under ■ SUP 13.5.1R and ■ SUP 13.5.2R must be:

- (a) given to a member of, or addressed for the attention of, the Corporate Authorisation department, if submitted with an application for *Part IV permission*, or the Passport Notifications Unit in any other circumstances; and
- (b) delivered to the FSA by one of the methods in (2).

- (2) The notice of intention may be delivered by:
- (a) *post* to the address in (3); or
 - (b) leaving the application at the address in (3) and obtaining a time-stamped receipt; or
 - (c) hand delivery to a member of the Corporate Authorisation department (if submitted with an application for *Part IV permission*) or to the Passport Notification Unit;
 - (d) electronic mail to the address in (4) if not submitted with an application for *Part IV Permission* and obtaining an electronic confirmation of receipt;
 - (e) fax to the Passport Notifications Unit on 0207 676 xxxx (if not submitted with an application for *Part IV Permission*) provided that the FSA receives a copy by one of the methods (a) to (d) above within five *business days* after the date of the faxed notification.
- (3) The address for notices of intention is: The Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.
- (4) Email: passport.notifications@fsa.gov.uk

13.5.4



A standard form of notice of intention that a *UK firm* may wish to use is available from the Passport Notifications Unit (see ■ SUP 13.12 (Sources of further information)).

Unregulated activities

13.5.5



A notice of intention may include activities within the scope of the relevant *Single Market Directive* which are not *regulated activities* (paragraphs 19(3) and 20(2) of Part III of Schedule 3 to the *Act*). Regulation 19 of the *EEA Passport Rights Regulations* states that where a *UK firm* is able to carry on such an *unregulated activity* in the *EEA State* in question without contravening any law of the *United Kingdom* (or any part of the *United Kingdom*) the *UK firm* is treated, for the purposes of the exercise of its *EEA right*, as being authorised to carry on that activity.

Translations

13.5.6



- (1) A *UK firm* passporting under the *Banking Consolidation Directive* or the *Insurance Directives* may have to submit the *requisite details* or relevant details in the language of the *Host State* as well as in English. For a *UK firm* passporting under the *Insurance Directives* this translated document will not include the relevant UK details. Further information is available from the Passport Notification Unit.

- (2) A *UK firm* may wish to discuss with the Passport Notifications Unit the appropriate time for providing the translations in (1), given that further information or clarification of the details provided may be required by the *FSA*.
- (3) A *UK firm* passporting under the *Insurance Directives* should keep the *EEA* and *UK* relevant details separate as, if the application is approved, only the former will be sent to the *Host State regulator*.

Notifications to more than one EEA State

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If a *UK firm* wishes to establish *branches* in, or *provide cross border services* into, more than one *EEA State*, a single notification may be provided but the *requisite details* or relevant details for each *EEA State* should be clearly identifiable.

13.6 Changes to branches

13.6.1 G_{/1} Where a *UK firm* is exercising an *EEA right* and has established a *branch* in another *EEA State*, any changes to the details of the *branch* are governed by the *EEA Passport Rights Regulations*. References to regulations in this section are to the *EEA Passport Rights Regulations*. A *UK firm* which is not an *authorised person* should note that, under regulation 18, contravention of the prohibition imposed by regulation 11(1), 13(1) or 15(1) is an offence. It is a defence, however, for the *UK firm* to show that it took all reasonable precautions and exercised due diligence to avoid committing the offence.

13.6.2 G_{/1} *UK firms* should note that if a *branch* in another *EEA State* ceases to provide services, this may represent a change in *requisite details* or relevant details.

13.6.3 G_{/1} *UK firms* should also note that changes to the details of *branches* may lead to changes to the *applicable provisions* to which the *UK firm* is subject. These changes should be communicated to the *UK firm* either by the *Host State regulator*, or, if the *firm* is passporting under *Insurance Directives*, via the *FSA*.

Firms passporting under the Investment Services Directive and Banking Consolidation Directive

13.6.4 G_{/1} If a *UK firm* has exercised an *EEA right*, under the *Investment Services Directive* or the *Banking Consolidation Directive*, and established a *branch* in another *EEA State*, regulation 11(1) states that the *UK firm* must not make a change in the *requisite details* of the *branch* (see ■ SUP 13 Ann 1R), unless it has satisfied the requirements of regulation 11(2), or, where the change arises from circumstances beyond the *UK firm's* control, regulation 11(3) (see ■ SUP 13.6.10G).

13.6.5 G_{/1} Where the change arises from circumstances within the control of the *UK firm*, the requirements in regulation 11(2) are that:

- (1) the *UK firm* has given notice to the *FSA* and to the *Host State regulator* stating the details of the proposed change;
- (2) the *FSA* has given the *Host State regulator* a notice informing it of the details of the change; and
- (3) either the *Host State regulator* has informed the *UK firm* that it may make the change, or the period of one month beginning with the day on which the *UK firm* gave the *Host State regulator* the notice in (1) has elapsed.

Firms pasporting under the Insurance Directives

13.6.6 G_{/1} If a *UK firm* has exercised an *EEA right* under the *Insurance Directives* and established a *branch* in another *EEA State*, regulation 13(1) states that the *UK firm* must not make a change in the relevant *EEA details* (see ■ SUP 13 Ann 3R), unless it has satisfied the requirements of regulation 13(2), or, where the change arises from circumstances beyond the *UK firm's* control, regulation 13(3) (see ■ SUP 13.6.10G).

13.6.7 G_{/1} Where the change arises from circumstances within the control of the *UK firm*, the requirements in regulation 13(2) are that:

- (1) the *UK firm* has given notice to the *FSA* and to the *Host State regulator* stating the details of the proposed change;
- (2) the *FSA* has given the *Host State regulator* a notice informing it of the details of the proposed change;
- (3) the period of at least one month beginning on the day on which the *UK firm* gave the *FSA* the notice in (1) has elapsed; and
- (4) either:
 - (a) a further period of one month has elapsed; or
 - (b) the *FSA* has informed the *UK firm* of any consequential changes in the applicable provisions of which the *FSA* has been notified by the *Host State regulator*.

13.6.8 G_{/1} If a *UK firm* has exercised an *EEA right* under the *Insurance Directives* and established a *branch* in another *EEA State*, regulation 15(1) states that the *UK firm* cannot make a change in any of the *UK relevant details* (see ■ SUP 13 Ann 2R) unless the *UK firm* has given a notice to the *FSA* stating the details of the proposed change at least one month before the change is effected.

13.6.9 G_{/1} Where a *UK firm* with *Part IV permission* to carry on both *long-term* and *general insurance business*, is passporting under the *Insurance Directives* and wishes to extend its *general insurance business* to include *long term insurance business* (or vice versa), it should complete a new notice of intention (see ■ SUP 13.5(Notices of intention) and not a change in *requisite details* notification.

Changes arising from circumstances beyond the control of a UK firm

13.6.10 G_{/1} (1) If the change arises from circumstances beyond the *UK firm's* control, the *UK firm*:

- (a) is required by regulation 11(3) or regulation 13(3) to give a notice to the *FSA* and to the *Host State regulator* stating the details of the change as soon as reasonably practicable;
- (b) may, if it is passporting under the *Insurance Directives*, make a change to its *UK relevant details* under regulation 15(1) if it has, as soon as practicable (whether before or after the change), given notice to the *FSA* stating the details of the change.

- (2) The *FSA* believes that for a change to arise from circumstances beyond the control of a *UK firm*, the circumstances should be outside the control of the firm as a whole and not just the branch in the *EEA State*.

The process

- 13.6.11** G_{/1} When the *FSA* receives a notice from a *UK firm* (see ■ SUP 13.6.5G(1) and ■ SUP 13.6.7G(1)) it is required by regulations 11(4) and 13(4) to either refuse, or consent to the change within a period of one month from the day on which it received the notice.
- 13.6.12** G_{/1} If the *FSA* consents to the change, then under regulations 11(5) and 13(5) it will:
- (1) give a notice to the *Host State regulator* informing it of the details of the change; and
 - (2) inform the *UK firm* that it has given the notice, stating the date on which it did so.
- 13.6.13** G_{/1} If a *UK firm* is passporting under the *Investment Services Directive* or *Banking Consolidation Directive*, then regulation 11(7) states that the *FSA* may not refuse to consent to a change unless, having regard to the change and to the EEA activities the *UK firm* is seeking to carry on, it doubts the adequacy of the administrative structure or the financial situation of the *UK firm*. In reaching its determination, the *FSA* may have regard to the adequacy of management, systems and the presence of relevant skills needed for the EEA activities to be carried on.
- 13.6.14** G_{/1} If a *UK firm* is passporting under the *Insurance Directives*, then regulation 13(7) states that the *FSA* may not refuse to consent to a change unless, having regard to the change, the *FSA* has reason:
- (1) to doubt the adequacy of the *UK firm's* administrative structure or financial situation; or
 - (2) to question the reputation, qualifications or experience of the directors or managers of the firm or the authorised agent;
- in relation to the business conducted, or to be conducted, through the branch.
- 13.6.15** G_{/1} If the *FSA* refuses to consent to a change, then under regulations 11(6) and 13(6):
- (1) the *FSA* will give notice of the refusal to the *UK firm*, stating its reasons and giving an indication of the *UK firm's* right to refer the matter to the *Tribunal* and the procedures on such a reference; to satisfy this requirement, the *FSA* will give the *UK firm* a *decision notice* following the procedures in *DEC* (but they will not get a *warning notice* first); and
 - (2) the *UK firm* may refer the matter to the *Tribunal*; for details of procedures for a reference to the *Tribunal* see *DEC* 5 (References to the *Tribunal*, publication and service of notices).



13.7 Changes to cross border services

13.7.1 G_{/1} Where a *UK firm* is exercising an *EEA right*, other than under the *Banking Consolidation Directive*, and is providing *cross border services* into another *EEA State*, any changes to the details of the services are governed by the *EEA Passport Rights Regulations*. References to regulations in this section are to the *EEA Passport Rights Regulations*. A *UK firm* which is not an *authorised person* should note that contravention of the prohibition imposed by regulation 12(1) or 16(1) is an offence. It is a defence, however, for the *UK firm* to show that it took all reasonable precautions and exercised due diligence to avoid committing the offence.

13.7.2 G_{/1} *UK firms* should also note that changes to the details of *cross border services* may lead to changes to the *applicable provisions* to which the *UK firm* is subject.

Firms passporting under the Investment Services Directive

13.7.3 G_{/1} If a *UK firm* is passporting under the *Investment Services Directive*, regulation 12(1) states that the *UK firm* must not make a change in its programme of operations, or the activities to be carried on under its *EEA right*, unless the relevant requirements in regulation 12(2) have been complied with. These requirements are:

- (1) the *UK firm* has given a notice to the *FSA* and to the *Host State regulator* stating the details of the proposed change; or
- (2) if the change arises as a result of circumstances beyond the *UK firm's* control, the *UK firm* has as soon as practicable (whether before or after the change) given a notice to the *FSA* and to the *Host State regulator*, stating the details of the change.

Firms passporting under the Insurance Directives

13.7.4 G_{/1} If a *UK firm* has exercised an *EEA right* under the *Insurance Directives* and is providing *cross border services* into another *EEA State*, regulation 16(1) states that the *UK firm* must not make a change in the relevant details (see ■ SUP 13 Ann 3R) unless the relevant requirements in regulation 16(3) or, where the change arises from circumstances beyond the *UK firm's* control, regulation 16(4), have been complied with.

13.7.5 G_{/1} Regulation 16(3) provides that:

- (1) the *UK firm* has given a notice to the *FSA* stating the details of the proposed change; and

(2) the *FSA* has given the *Host State regulator* a notice informing it of the details of the proposed change.

13.7.6

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If the change arises from circumstances beyond the *UK firm's* control, the *UK firm* is required by regulation 16(4) to give a notice to the *FSA* stating the details of the change as soon as reasonably practicable (whether before or after the change). See also ■ SUP 13.6.10G(2), as relevant to *cross border services*.

13.7.7

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When the *FSA* receives a notice from a *UK firm* (see ■ SUP 13.7.3G(1) and ■ SUP 13.7.5G), it is required by regulations 16(5) to either refuse or consent to the change within one month of receipt.

13.7.8

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If the *FSA* consents to the change it will:

- (1) give a notice to the *Host State regulator* informing it of the details of the proposed change; and
- (2) inform the *UK firm* that it has given the notice, stating the date on which it did so.

13.7.9

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If the *FSA* refuses to consent to a change it will follow the decision making procedures set out in ■ DEC 1 (Application, Purpose and Introduction). The *FSA* is required by regulation 16(7) to give notice of the refusal to the *UK firm*, stating its reasons and giving an indication of the *UK firm's* right to refer the matter to the *Tribunal* and the procedures that apply to such a reference; to satisfy this requirement, the *FSA* will give the *UK firm* a *decision notice* following the procedures in *DEC* (but it will not get a *warning notice* first). For details of procedures relating to references to the *Tribunal* see ■ DEC 5 (References to the *Tribunal*, publication and service of notices).

13.7.10

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Where a *UK firm* with *Part IV permission* to carry on both *long-term* and *general insurance business* is passporting under the *Insurance Directives* and wishes to extend its *general insurance business* to include *long term insurance business* (or vice versa), it should complete a new notice of intention (see ■ SUP 13.5 (Notices of intention)) and not a change in *requisite details* notification.

Firms passporting under the Banking Consolidation Directive

13.7.11

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A *UK firm* providing *cross border services* under the *Banking Consolidation Directive* is not required to supply *requisite details*. Therefore there are no *requisite details* for changes to *cross-border services* provided under the *Banking Consolidation Directive*.



13.8 Changes of details: provision of notices to the FSA

13.8.1

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- (1) A notice of a change to a *branch* under ■ SUP 13.6.5 G(1), ■ SUP 13.6.7G(1) and ■ SUP 13.6.8G(1) and a notice of a change to *cross border services* under ■ SUP 13.7.3G(1) or ■ SUP 13.7.5G(1) must be:
 - (a) given to a member of, or addressed for the attention of, the Passport Notifications Unit; and
 - (b) delivered to the FSA by one of the methods in (2).
- (2) The notice of intention may be delivered by:
 - (a) *post* to the address in (3); or
 - (b) leaving the application at the address in (3) and obtaining a time-stamped receipt; or
 - (c) hand delivery to a member of the Corporate Authorisation department (if submitted with an application for *Part IV permission*) or the Passport Notification Unit;
 - (d) electronic mail to the address in (4) if not submitted with an application for *Part IV Permission* and obtaining an electronic confirmation of receipt;
 - (e) fax to the Passport Notifications Unit on 0207 676 xxxx (if not submitted with an application for *Part IV Permission* provided that the FSA receives a copy by one of the methods (a) to (d) above within five *business days* after the date of the faxed notification.
- (3) The address for notices of intention is: The Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.
- (4) Email: passport.notifications@fsa.gov.uk

13.8.2

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UK firms passporting under the *Banking Consolidation Directive* or the *Insurance Directives* may be required to submit the changes to the *requisite details* or relevant details in the language of the *Host State* as well as in English. See ■ SUP 13.5.6G.



13.9 How does the Handbook apply to branches and cross border services?

13.9.1

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Annex [X] [to be issued later] summarises how the *FSA Handbook* applies to *branches* of a *UK firm* established in other *EEA States* or to *cross border services* provided by a *UK firm* into another *EEA State*.



13.10 Applicable provisions

- 13.10.1** G_{/1} *UK firms* are reminded that conduct of business rules, and other rules made for the general good, may apply to business carried on in the *Host State* by a *UK firm*. These are known in the *Act* as the *applicable provisions* (paragraph 19(13) of Part III of Schedule 3 to the *Act*).
- 13.10.2** G_{/1} *UK firms* passporting under the *Banking Consolidation Directive* should note that, under the Directive, the *Host State* is responsible, together with the *FSA*, for monitoring the liquidity of a *branch* established by a *UK firm* in another *EEA State*.
- 13.10.3** G_{/1} These *Host State* provisions often have requirements about the soliciting of business, for example, advertising and cold-calling rules. A *UK firm* should ensure it is familiar with, and acts in compliance with, the relevant requirements of its *Host State regulator*.

13.11 Record keeping

13.11.1

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(1) A *UK firm* which is exercising an *EEA right* must make and retain a record of:

- (a) the services or activities it carries on from a *branch in*, or provides cross-border into, another *EEA State* under that *EEA right*; and
- (b) the *requisite details* or relevant details relating to those services or activities (if applicable).

(2) The record in (1) must be kept for three years from the earlier of the date on which:

- (a) it was superseded by a more up-to-date record; or
- (b) the *UK firm* ceased to have a *branch in*, or carry on *cross border services* into, any *EEA State* under an *EEA right*.

13.11.2

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The record in ■ SUP 13.11.1R need not relate to the level of business carried on. A *UK firm* may comply with ■ SUP 13.11.1R by, for example, keeping copies of all notices of intention and notices of changes of *requisite details* or relevant details.

13.11.3

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A *UK firm* should monitor the business carried on under an *EEA right* to ensure that any changes to *requisite details* or relevant details are notified as required by ■ SUP 13.7 (Changes to cross border services).



13.12 Sources of further information

13.12.1

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- (1) Given the complexity of issues raised by passporting, *UK firms* are advised to consult legislation and also to obtain legal advice at earliest opportunity. Firms are encouraged to contact their usual supervisory contact at the *FSA* to discuss their proposals. However, a *UK firm* which is seeking *guidance* on procedural or notification issues relating to passporting should contact the Passport Notifications Unit.
- (2) An applicant for *Part IV permission* which is submitting a *notice of intention* with its application for such *permission* (see ■ [AUTH 3.20](#) (Specific obligations: applicants seeking to establish a branch in, or provide services, into another EEA State)) should contact the Corporate Authorisation department in the first instance (see ■ [AUTH 1.9](#) (Next Steps)).

13.12.2

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To contact the Passport Notifications Unit, from which a standard form of notice of intention can be obtained:

- (1) telephone on 020 7676 1000; fax on 020 7676 xxxx; or
- (2) write to: The Passport Notifications Unit, The Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS; or
- (3) Email: passport.notifications@fsa.gov.uk

Requisite details: branches

1 Table

Type of firm	Requisite details (see notes 1 & 2)
Credit institution or	(a) particulars of the programme of operations carried on, or to be carried on, from the <i>branch</i> , including a description of the particular <i>EEA</i> activities to be carried on, and of the structural organisation of the <i>branch</i> ;
Investment firm	(b) the address in the <i>EEA State</i> in which the <i>branch</i> is, or is to be, established from which information about the business may be obtained; and (c) the names of the managers of the branch.
Insurance undertaking	(1)(a) the address of the <i>branch</i> ; (b) the name of the <i>UK firm's</i> authorised agent (see note 3) and, in the case of a <i>member of Lloyd's</i> , confirmation that the authorised agent has power to accept service of proceedings on behalf of <i>Lloyd's</i> ; (c) the <i>classes</i> or parts of <i>classes</i> of business carried on, or to be carried on, and the nature of the risks or commitments covered, or to be covered, in the <i>EEA State</i> concerned; (d) details of the structural organisation of the <i>branch</i> ; (e) the guiding principles as to reinsurance of business carried on, or to be carried on, in the <i>EEA State</i> concerned, including the <i>firm's</i> maximum retention per risk or event after all reinsurance ceded; (f) estimates of: (i) the costs of installing administrative services and the organisation for securing business in the <i>EEA State</i> concerned; (ii) the resources available to cover those costs; and (iii) if contracts of a kind falling within paragraph 18 of Schedule 1 to the <i>Regulated Activities Order</i> (assistance) are, or are to be, effected or carried out, the resources available for providing assistance; (g) for each of the first three years following the establishment of the <i>branch</i> : (i) estimates of the <i>firm's</i> margin of solvency and the margin of solvency required and the method of calculation; (ii) if the <i>firm</i> carries on, or intends to carry on, business comprising the effecting or carrying out of contracts of <i>long-term insurance</i> , the details mentioned in paragraph (2) as respects the business carried on, or to be carried on, in the <i>EEA State</i> concerned; and

- (iii) if the *firm* carries on, or intends to carry on, business comprising the effecting or carrying out of contracts of *general insurance*, the details mentioned in paragraph (3) as respects the business carried on, or to be carried on, in the *EEA State* concerned;
- (h) if the *firm* covers, or intends to cover, relevant motor vehicle risks, details of the *firm's* membership of the national bureau and the national guarantee fund in the *EEA State* concerned; and
- (i) if the *firm* covers, or intends to cover, health insurance risks, the technical bases used, or to be used, for calculating premiums in respect of such risks.
- (2) The details referred to in (1)(g)(ii) are:
 - (a) the following information, on both optimistic and pessimistic bases, for each type of contract or treaty:
 - (i) the number of contracts or treaties expected to be issued;
 - (i) the total premium income, both gross and net of reinsurance ceded;
 - (i) the total sums assured or the total amounts payable each year by way of annuity;
 - (b) detailed estimates, on both optimistic and pessimistic bases, of income and expenditure in respect of direct **business**, reinsurance acceptances and reinsurance cessations; and
 - (c) estimates relating to the financial resources intended to cover underwriting liabilities.
 - (3) The details referred to in (1)(g)(iii) are:
 - (a) estimates relating to the expenses of management (other than the costs of installation), and in particular those relating to current general expenses and **commissions**;
 - (b) estimates relating to premiums or contributions (both gross and net of all reinsurance ceded) and to claims (after all reinsurance recoveries); and
 - (c) estimates relating to the financial resources intended to cover underwriting liabilities.

Notes

Note 1: The *requisite details* or relevant details specified in this annex are those in the *EEA Passport Rights Regulations*; that is, those in regulation 1 for *credit institutions* and *investment firms* and those in regulation 14 for *insurance undertakings*.

Note 2: In this table, the references to classes of insurance have the meaning given to them in Schedule 1 to the **Regulated Activities Order**.

Note 3: For the purposes of this table, 'authorised **agent**' means an agent or **employee** of the **insurance undertaking** who has authority (a) to bind the **insurance undertaking** in its relations with third parties, and (b) to represent the **insurance undertaking** in its relations with **overseas regulators** and courts in the **EEA State** of the **branch**.

Relevant UK details: branches of insurance undertakings

1 Table

Relevant UK details	
(1)	the names of the <i>UK firm's</i> managers and main agents in the <i>EEA State</i> concerned;
(2)	particulars of any association which exists or is proposed to exist between: <ol style="list-style-type: none"> (a) the directors and controllers of the <i>UK firm</i>; (b) any <i>person</i> who will act as insurance broker, agent, loss adjuster or reinsurer for the <i>UK firm</i> in the <i>EEA State</i> concerned;
(3)	the names of the principal reinsurers of business to be carried on in the <i>EEA State</i> concerned;
(4)	the sources of business in the <i>EEA State</i> concerned (for, example, insurance brokers, agents, own employees or direct selling) with the approximate percentage expected from each of these sources;
(5)	copies or drafts of: <ol style="list-style-type: none"> (a) any separate reinsurance treaties covering business to be written in the <i>EEA State</i> concerned; (b) any standard agreements which the <i>UK firm</i> will enter into with brokers or agents in the <i>EEA State</i> concerned; (c) any agreements which the insurance undertaking will enter into with persons (other than employees of the <i>UK firm</i>) who will manage the business to be carried on in the <i>EEA State</i> concerned;
(6)	in the case of a <i>UK firm</i> which intends to carry on long-term business: <ol style="list-style-type: none"> (a) the technical bases which the actuary appointed in accordance with <i>SUP 4.3.1R</i> proposes to use for each class of business to be carried on in the <i>EEA State</i>, including the bases needed for calculating premium rates and mathematical reserves; (b) a statement by the actuary so appointed whether he considers that the premium rates which will be used in the <i>EEA State</i> concerned are suitable; (c) a statement by that actuary whether he agrees with the information provided under relevant EEA details (1)(e) and (2)(b) and (c); (d) the technical bases used to calculate the statements and estimates referred to in relevant EEA details (2); and
(7)	in the case of a <i>UK firm</i> which intends to carry on general business, copies or drafts of any agreements which the <i>UK firm</i> will have with main agents in the <i>EEA State</i> concerned.

Requisite and relevant details: Cross Border Services

1 Table

Type of firm	Requisite / relevant details
<i>Investment firm</i>	<p>Requisite Details</p> <p>(a) details of the programme of operations, stating in particular the service or services the <i>UK firm</i> intends to provide.</p>
<i>Insurance Undertaking</i>	<p>Relevant details (regulation 17)</p> <p>(a) the <i>EEA State</i> in which the EEA activities are carried on, or are to be carried on;</p> <p>(b) the nature of the risks or commitments covered, or to be covered, in the <i>EEA State</i> concerned;</p> <p>(c) if the <i>firm</i> covers, or intends to cover, relevant motor vehicle risks (note 1):</p> <p>(i) the name and address of the claims representative (note 2); and</p> <p>(ii) details of the firm's membership of the national bureau and the national guarantee fund in the <i>EEA State</i> concerned; and</p> <p>(d) if the insurer covers, or intends to cover, health insurance, the technical bases used, or to be used, for calculating premiums in respect of such risks;</p>

Chapter 14

Incoming EEA firms:
changing details and
cancelling qualification
for authorisation.

14.1 Application and purpose

Application

- 14.1.1** G_{/1} This chapter applies to an *incoming EEA firm* which has established a *branch* in, or is providing *cross border services* into, the *United Kingdom* under one of the *Single Market Directives* and, therefore, qualifies for *authorisation* under Schedule 3 to the *Act*.
- 14.1.2** G_{/1} ■ SUP 14.6(Cancelling qualification for authorisation), which sets out how to cancel qualification for *authorisation* under the *Act*, also applies to:
- (1) an *incoming Treaty firm* that qualifies for *authorisation* under Schedule 4 to the *Act*; and
 - (2) a *UCITS qualifier* that is an *authorised person* under Schedule 5 to the *Act*; a *UCITS qualifier* should, however, refer to *CIS* for full details of applicable *rules* and *guidance*.
- 14.1.3** G_{/1}
- (1) Under the Gibraltar Order made under section 409 of the *Act*, a Gibraltar firm is treated as an *EEA firm* under Schedule 3 to the *Act* if it is:
 - (a) authorised in Gibraltar under the *Insurance Directives*; or
 - (b) authorised in Gibraltar under the *Banking Consolidation Directive*.
 - (2) A Gibraltar insurance company is allowed to passport its services into the *United Kingdom* if it complies with the relevant notification procedures. Similarly, a Gibraltar *credit institution* is allowed to passport into the *United Kingdom* to provide banking services provided those services fall within items 1 to 6 in Annex 1 to the *Banking Consolidation Directive*. So, any references in ■ SUP 14 to *EEA State* or *EEA right* include references to Gibraltar and the entitlement under the Gibraltar Order.

Purpose

- 14.1.4** G_{/1} This chapter gives *guidance* on the *Act* and the *EEA Passport Rights Regulations* made under the *Act*, for an *incoming EEA firm* which has established a *branch* in, or is providing *cross border services* into, the *United Kingdom* and wishes to change the details of the *branch* or *cross border services*. These are known as *requisite details*, or for firms passporting under the *Insurance Directives* relevant details.
- 14.1.5** G_{/1} This chapter also explains how an *incoming EEA firm*, an *incoming Treaty firm* or a *UCITS qualifier* may cancel its qualification for *authorisation* under the *Act*.

14.1.6

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This chapter does not, however, give *guidance* on the procedures for the establishment of a *branch* in, or the providing of *cross border services* into, the *United Kingdom* for the first time. So, an *incoming EEA firm* that wishes to change or supplement the nature of its operations in the *United Kingdom* from the providing of *cross border services* to the establishment of a *branch* (or vice versa) should refer to ■ **AUTH 5** (Qualifying for authorisation under the Act).

14.1.7

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In addition, the chapter does not give *guidance* on the procedures for making an application for *top-up permission*, to carry on *regulated activities* in the *United Kingdom* which are outside the scope of the *Single Market Directives* and for which the firm cannot exercise *Treaty rights*. *Incoming EEA firms* seeking a *top-up permission* should refer to ■ **AUTH 5**.



14.2 Changes to branch details

14.2.1

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Where an *incoming EEA firm* is exercising an *EEA right* and has established a *branch* in the United Kingdom, the *EEA Passport Rights Regulations* govern any changes to the details of that *branch*. Where an *incoming EEA firm* has complied with the relevant provisions in the *EEA Passport Rights Regulations*, then the *firm's permission* given under Schedule 3 to the *Act* is to be treated as varied accordingly. All references to regulations in ■ SUP 14 are to the *EEA Passport Rights Regulations*.

Firms passporting under the Investment Services Directive and Banking Consolidation Directive

14.2.2

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- (1) Where an *incoming EEA firm*, passporting under the *Investment Services Directive* or *Banking Consolidation Directive*, has established a *branch* in the *United Kingdom*, regulation 4 states that it must not make a change in the *requisite details* of the *branch* (see ■ AUTH 5 Ann 1G) unless it has complied with the relevant requirements.
- (2) The relevant requirements are set out in regulation 4(4) or, where the change arises from circumstances beyond the *incoming EEA firm's* control, in regulation 4(5).

14.2.3

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Where the change arises from circumstances within the control of the *incoming EEA firm*, the requirements in regulation 4(4) are that:

- (1) the *incoming EEA firm* has given notice to the *FSA* (see ■ SUP 14.4.1G) and to its *Home State regulator* stating the details of the proposed change;
- (2) the *FSA* has received a notice stating those details; and
- (3) either:
 - (a) the *FSA* has informed the firm that it may make the change; or
 - (b) the period of one month beginning with the date on which the *incoming EEA firm* gave the *FSA* the notice mentioned in (1) has elapsed.

14.2.4

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Changes to the *requisite details* may lead to changes to the *applicable provisions* to which the *incoming EEA firm* is subject. The *FSA* will, as soon as practicable after receiving a notice in ■ SUP 14.2.2G or ■ SUP 14.2.3G, inform the *incoming EEA firm* of any consequential changes in the *applicable provisions* (regulation 4(6)).

Firms passporting under the Insurance Directives

- 14.2.5** G_{/1} (1) Where an *incoming EEA firm*, passporting under the *Insurance Directives* has established a *branch* in the *United Kingdom*, regulation 6 states that it must not make a change to the information referred to in regulation 2(5)(a) to (c) (see ■ AUTH 5 Annex 1G) unless it has complied with the relevant requirements.
- (2) The relevant requirements are set out in regulation 6(4) or, where the change arises from circumstances beyond the *incoming EEA firm's* control, regulation 6(5).

- 14.2.6** G_{/1} Where the change arises from circumstances within the control of the *incoming EEA firm*, the relevant requirements in regulation 6(4) are that:
- (1) the *incoming EEA firm* has given a notice to the *FSA* (see ■ SUP 14.4.1G) and to its *Home State regulator* stating the details of the proposed change;
- (2) the *FSA* has received from the *Home State regulator* a notice stating that it has approved the proposed change;
- (3) the period of at least one month beginning with the day on which the *incoming EEA firm* gave the *FSA* the notice in (1) has elapsed; and
- (4) either:
- (a) a further period of one month has elapsed; or
 - (b) the *FSA* has informed the *Home State regulator* of any consequential changes in the *applicable provisions*.

- 14.2.7** G_{/1} Under regulation 6(6) the *FSA* is required, as soon as practicable, to:
- (1) acknowledge receipt of the documents sent under regulation 6(4) or 6(5); and
- (2) in the case of a notice under regulation 6(5), inform the *incoming EEA firm's Home State regulator* of any consequential changes in the *applicable provisions*.

Changes arising from circumstances beyond the control of an incoming EEA firm

- 14.2.8** G_{/1} If the change arises from circumstances beyond the *incoming EEA firm's* control, the *firm* is required by regulation 4(5) (see ■ SUP 14.2.2G) or regulation 6(5) (see ■ SUP 14.2.5G(2)) to give a notice to the *FSA* (see ■ SUP 14.4.1G) and to its *Home State regulator* stating the details of the change as soon as reasonably practicable.

- 14.2.9** G_{/1} The *FSA* believes that for a change to arise from circumstances beyond the control of an *incoming EEA firm*, the circumstances should be outside the control of the firm as a whole and not just its *UK branch*. For example, the *FSA* considers that this provision would be unlikely to apply to circumstances in which lack of planning at the *incoming EEA firm's* head office resulted in a problem arising in a *UK branch* which was outside its control. In practice, therefore, use of this provision is likely to be rare.

14.3 Changes to cross border services

- 14.3.1** G_{/1} Where an *incoming EEA firm* passporting under the *Investment Services Directive* or *Insurance Directives* is exercising an *EEA right* and is providing *cross border services* into the *United Kingdom*, the *EEA Passport Rights Regulations* govern any changes to the details of those services. Where an *incoming EEA firm* has complied with the relevant provisions in the *EEA Passport Rights Regulations*, then the *firm's permission* given under Schedule 3 to the *Act* is to be treated as varied accordingly.

Firms passporting under the Investment Services Directive

- 14.3.2** G_{/1} Where an *incoming EEA firm*, passporting under the *Investment Service Directives*, is providing *cross border services* into the *United Kingdom*, it must not make a change in the details referred to in regulation 5(1) (see ■ AUTH 5 Ann 2G) unless it has complied with the relevant provisions in regulation 5(3).

- 14.3.3** G_{/1} The relevant provisions in regulation 5(3) are that:
- (1) the *incoming EEA firm* has given a notice to the *FSA* (see ■ SUP 14.4.1G) and to its *Home State regulator* stating the details of the proposed change;
 - (2) if the change arises from circumstances beyond *the incoming EEA firm's* control, that firm has, as soon as practicable, given to the *FSA* and to its *Home State regulator* the notice in (1).

- 14.3.4** G_{/1} Under regulation 5(4), the *FSA* is required, as soon as practicable after receiving the notice in ■ SUP 14.3.3G, to inform the *incoming EEA firm* of any consequential changes in the *applicable provisions*.

Firms passporting under the Insurance Directives

- 14.3.5** G_{/1} If an *incoming EEA firm* passporting under the *Insurance Directives* is providing *cross border services* unto the *United Kingdom*, it must not make a change to the details referred to in regulation 7(1) (see ■ AUTH 5 Ann 2G) unless it has complied with the relevant provisions.

- 14.3.6** G_{/1} The relevant provisions are those set out in regulation 7(4), namely that:
- (1) the *incoming EEA firm* has given a notice to its *Home State regulator* stating the details of the proposed change; and
 - (2) the *Home State regulator* has passed on to the *FSA* the information contained in that notice.

14.3.7

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If the change arises from circumstances beyond the *incoming EEA firm's* control, the *incoming EEA firm* is required to comply with the relevant provisions referred to in ■ SUP 14.3.6G as soon as reasonably practicable (whether before or after the change). See also ■ SUP 14.2.9, as relevant to *cross border services*.



14.4 Notices of proposed changes: form and delivery

14.4.1

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- (1) Regulation 7 to 9 of the Financial Services and Markets Act 2000 (Services of Notices) Regulations 2001 (SI2001/1420) govern the manner in which notices may be submitted to the FSA under the *EEA Passport Rights Regulations*. In summary, they should be delivered or posted to the FSA's address (See (2) below) and will be treated as given when received by the FSA. They should not be sent by fax or electronic mail.
- (2) The address for notices is: The Financial Services Authority, 25 The North Colonnade, Canary Wharf, London, E14 5HS



14.5 Variation of a top-up permission to carry on regulated activities outside the scope of the Single Market Directives

- 14.5.1** G_{/1} Where an *incoming EEA firm* has been granted *top-up permission* by the FSA and wishes to vary that *permission*, the *Act* requires it to apply to the FSA for a variation of that *top-up permission*.
- 14.5.2** G_{/1} Guidance on the procedures for applying for a variation of a *permission* granted under Part IV of the *Act*, including a *top-up permission*, is given in ■ SUP 6 (Applications to vary and cancel Part IV Permission).

14.6 Cancelling qualification for authorisation

Incoming EEA firms

- 14.6.1** G_{/1} Section 34 of the *Act* states that an *incoming EEA firm* no longer qualifies for *authorisation* under Schedule 3 to the *Act* if it ceases to be an *incoming EEA firm* as a result of:
- (1) having its *EEA authorisation* withdrawn by its *Home State regulator*; or
 - (2) ceasing to have an *EEA right* in circumstances in which *EEA authorisation* is not required; this is relevant to a *financial institution* that is a subsidiary of a *credit institution* (of the kind mentioned in Article 19 of the *Banking Consolidation Directive*) which fulfils the conditions in articles 18 and 19 of that *Directive*.
- 14.6.2** G_{/1} In addition, under section 34(2) an *incoming EEA firm* may ask the *FSA* to give a direction cancelling its *authorisation* under Schedule 3 to the *Act*.
- 14.6.3** G_{/1} Regulation 8 states that where an *incoming EEA firm* which qualifies for *authorisation* under Schedule 3:
- (1) has ceased, or is to cease, to carry on *regulated activities* in the *United Kingdom*; and
 - (2) gives notice of that fact to the *FSA*;
- the notice is treated under regulation 8 as a request for cancellation of the *incoming EEA firm's* qualification for *authorisation* under Schedule 3 to the *Act* and so as a request under section 34(2) of the *Act*.
- 14.6.4** G_{/1} Where a *financial institution* (that is, a subsidiary of a *credit institution*) is passporting under the *Banking Consolidation Directive* (see ■ SUP 14.6.1G(2)), regulation 9(1) states that the *incoming EEA firm* may request the *FSA* to direct that its qualification for *authorisation* under Schedule 3 to the *Act* is cancelled from such date as may be specified in the direction.
- 14.6.5** G_{/1} The *FSA* may not, however, give a direction referred to in ■ SUP 14.6.4G unless:
- (1) the *incoming EEA firm* has given notice to its *Home State regulator*; and
 - (2) the *FSA* has agreed with the *Home State regulator* that the direction should be given.
- 14.6.6** G_{/1} Regulation 9(3) requires that the date specified by the *FSA* in a direction referred to in ■ SUP 14.6.4G:

- (1) must not be earlier than the date requested in the application; but
- (2) subject to (1), is as agreed between the FSA and the *incoming EEA firm's Home State regulator*.

14.6.7 G_{/1} The FSA is required to send, as soon as practicable, a copy of the direction to the *incoming EEA firm* and to its *Home State regulator* (regulation 9(4)).

14.6.8 G_{/1} Where the FSA gives a direction referred to in ■ SUP 14.6.4G, the *incoming EEA firm* may apply for *Part IV permission* (see ■ AUTH 3 (Applications for Part IV Permission)) to take effect not earlier than the date that its qualification for *authorisation* is cancelled (as specified in the direction).

Incoming Treaty firms

14.6.9 G_{/1} Section 35 of the *Act* states that an *incoming Treaty firm* no longer qualifies for *authorisation* under Schedule 4 to the *Act* if its *Home State* authorisation is withdrawn.

14.6.10 G_{/1} In addition, under section 35(2) an *incoming Treaty firm* may ask the FSA to give a direction cancelling its *authorisation* under Schedule 4 to the *Act*.

UCITS qualifiers

14.6.11 G_{/1} Section 36 of the *Act* states that a *UCITS qualifier* may ask the FSA to give a direction cancelling its *authorisation* under paragraph 1(1) of Schedule 5 to the *Act*. *UCITS qualifiers* should also refer to ■ CIS 17.4.8G (Revocation of recognition: Schemes recognised under section 264 of the *Act*).



14.7 Cancellation of a top-up permission to carry on regulated activities outside the scope of the Single Market Directives

14.7.1

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Where an *incoming EEA firm*, an *incoming Treaty firm* or a *UCITS qualifier* wishes to cancel its *top-up permission*, either with or without cancellation of its qualification for *authorisation* under Schedule 3, 4, or 5 to the *Act*, it should make an application following the procedures set out in ■ SUP 6 (Applications to vary and cancel Part IV Permission).



14.8 Further guidance

14.8.1

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For further *guidance* on passporting procedures, an *incoming EEA firm* should contact the *FSA's* Passport Notifications Unit or their usual supervisory contact at the *FSA*. *Incoming Treaty firms* and *UCITS qualifiers* should speak to their usual supervisory contact at the *FSA* in the first instance

ANNEX C



15.8 Notification in respect of particular products and services

Management of occupational pension scheme assets

15.8.1

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A *firm* which manages the assets of an *occupational pension scheme* must notify the *FSA* as soon as reasonably practicable if it receives any request or instruction from a trustee which it:

- (1) knows; or
- (2) on substantial grounds:
 - (a) suspects; or
 - (b) has cause reasonably to suspect;

is at material variance with the trustee's duties.

ANNEX D

SUP 16 Ann 1R: Banks' reporting forms

1. FORM B7
2. FORM BSD3
3. FORM LE2
4. FORM LR
5. FORM M1
6. FORM SLR1

To be used for all reports completed as at 1 December 2001 or after

FORM B7 - Analysis of profits, large exposures and certain other miscellaneous information



Reporting institution _____

Reporting date

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 eg 31 12 2001

FSA Number *

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Please tick if this return is completed in Euros (Item A).....

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.3R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. SUP 16.3.10R requires an authorised person to submit reports containing all the information required. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. Any additional information of relevance should be provided by letter direct to the FSA.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief and that I have read the Guidance Notes to this form.

Signature of authorised signatory: _____ Date _____

Name: _____ Position held: _____

In the event of a query, the FSA or the Bank of England may, in the first instance, contact (block letters please)

_____ Tel No _____ Ext _____

Notes on Completion

- 1 If you have any difficulty in completing this return, please telephone your normal supervisory contact at the FSA.
- 2 Complete the return half yearly as at end of June and December. Institutions wishing to report at dates which coincide with the financial year end should apply to the FSA for a waiver (see SUP 8).
- 3 Enter amounts to the nearest thousand omitting £000s/€000s.
Calculated amounts should be rounded to the nearest thousand, or two decimal places as appropriate.
- 4 For definitions of items, refer to the Guidance Notes for the form.
- 5 To assist with the scanning process, please enter all data neatly within the relevant boxes and do not enter the % symbol in any boxes on this return
- 6 Submit the form within **10 business days**, or **12 business days** for those institutions reporting electronically, clearly addressed to:
The Financial Services Authority
c/o Monetary and Financial Statistics Division
Domestic Banking Statistics (HO-4)
Bank of England
Threadneedle Street
London EC2R 8AH
- 7 Returns may also be delivered to the Works Gate at the Lothbury entrance of the Bank of England between 9.00am and 5.00pm, Monday to Friday. Envelopes should be clearly addressed as above.

FSA use only	Logged in	Data entered

September 2001

* This should be the FSA firm reference number. This box must be filled in by all reporters (SUP 16.3.7R).

B7.1.FS

CURRENT YEAR'S PROFIT AND LOSS

Item No	000s	000s
1	TOTAL INCOME	
1.1	Interest received and receivable.....	
1.2	Dividend income.....	
1.3	Fees and commissions received and receivable.....	
1.4	Dealing profit/(loss).....	
1.5	Intra-group income.....	
1.6	Other operating income including:.....	
	<i>of which:</i>	
1.6A		
1.6B		
1.6C		
2	TOTAL EXPENDITURE	
2.1	Interest paid and payable.....	
2.2	Fees and commissions paid and payable.....	
2.3	Staff expenses.....	
2.4	Other administrative expenses.....	
2.5	Depreciation.....	
2.6	Intra-group expenditure.....	
2.7	Other operating charges including:.....	
	<i>of which:</i>	
2.7A		
2.7B		
2.7C		
3	OPERATING PROFIT	
4	TOTAL PROVISIONS	
4.1	Provisions for bad and doubtful debts.....	
4.2	Provisions for contingent liabilities and commitments.....	
4.3	Taxation.....	
4.4	Provisions / amounts written off fixed asset investments.....	
5	CURRENT YEAR'S PROFIT AND LOSS	
	B7.1.1	

BALANCE SHEET ANALYSIS

Item No			000s	000s
			Market valuation	Book value
6	TOTAL INVESTMENTS			
6.1	Quoted:	British Government stock.....		
6.2		Other public sector (UK only).....		
6.3		Equities.....		
6.4		Overseas Government stock.....		
6.5		Other investments.....		
6.6	Unquoted:	Public sector (UK only).....		
6.7		Equities.....		
6.8		Overseas Public sector.....		
6.9		Other investments.....		
			B7.1.2	

OFF-BALANCE-SHEET ITEMS

Item No

000s

000s

- 7 TOTAL CONTINGENT LIABILITIES**.....
- 7.1 Acceptances and endorsements.....
- 7.2 Guarantees and irrevocable letters of credit.....
- 7.3 Assets pledged by the bank as collateral security.....
- 7.4 Other contingent liabilities.....

- 8 TOTAL COMMITMENTS**.....
- 8.1 Sale and option to resell transactions.....
- 8.2 Documentary credits and short-term trade-related transactions.....
- 8.3 Forward asset purchases and forward deposits placed.....
- 8.4 Undrawn facilities.....
- 8.5 Other commitments.....

9 EXCHANGE RATE AND INTEREST RATE RELATED CONTRACTS

- 9.1 Exchange rate contracts principal amount.....
- 9.2 credit equivalent.....
- 9.3 Interest rate contracts principal amount.....
- 9.4 credit equivalent.....

	Less than 1 year	1 year and over

Original exposure method / replacement cost method

- 9M Please tick if using replacement cost method

B7.1.3

MEMORANDUM ITEMS

Item No 000s 000s 000s

10 PROVISIONS AGAINST BAD AND DOUBTFUL DEBTS

	mm	yyyy	Specific	General	Total
10.1 Previous balance as at (mm/yyyy).....					
10.2 Adjustments for exchange rate movements.....					
10.3 Charge (credit) to profit and loss*.....					
10.4 Amounts written off.....					
10.5 Recoveries of amounts previously written off.....					
10.6 Other.....					
10.7 Current balance.....					

* This should equal item 4.1

B7.1.4

11 TWENTY LARGEST EXPOSURES TO BANKS AND BUILDING SOCIETIES

000s

(irrespective of currency)

Counterparty	Total Exposure*	of which the total exposure is:			Specific bad debt provisions made against exposures reported in column 1
		On balance sheet	Denominated in sterling	1 year or less to maturity	
	1	2	3	4	5
TOTAL					
A					
B					
C					
D					
E					
F					
G					
H					
J					
K					
L					
M					
N					
P					
Q					
R					
S					
T					
U					
V					

* Gross of bad debt provisions in column 5

B7.1.5

12 TWENTY LARGEST EXPOSURES TO OTHER COUNTERPARTIES
(irrespective of currency)

000s

Counterparty	Total Exposure*	of which the total exposure is:			Specific bad debt provisions made against exposures reported in column 1
		On balance sheet	Denominated in sterling	1 year or less to maturity	
	1	2	3	4	5
TOTAL					
A					
B					
C					
D					
E					
F					
G					
H					
J					
K					
L					
M					
N					
P					
Q					
R					
S					
T					
U					
V					

* Gross of bad debt provisions in column 5



FORM BSD3 - Capital Adequacy Return

Reporting institution _____

as at.

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 FSA number *

--	--	--	--	--	--

(eg 31 12 2001)

Unconsolidated/solo consolidated/consolidated - tick as appropriate
 Unconsolidated Solo consolidated Consolidated

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.3R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. SUP 16.3.10R requires an authorised person to submit reports containing all the information required. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. Any additional information of relevance should be provided by letter direct to the FSA.

I confirm the information in this form is accurate and complete to the best of my knowledge and belief and that I have read the Guidance Notes to this form.

Signature of authorised signatory: _____ Date: _____

Name: _____ Position held: _____

In the event of a query, the FSA or the Bank of England may, in the first instance, contact (block letters please)

Tel No _____ Ext _____

Notes on Completion

- 1 If you have any difficulty in completing this return, please telephone your normal supervisory contact at the FSA for guidance.
- 2 Complete the return quarterly on an unconsolidated/solo consolidated basis as at end of March, June, September and December. Institutions wishing to report at dates which coincide with the financial year end should apply to the FSA for a waiver (see SUP 8).
- 3 Complete the return half-yearly on a consolidated basis as at end of June and December. Institutions wishing to report at dates which coincide with the financial year end should apply to the FSA for a waiver (see SUP 8).
- 4 Enter amounts to the nearest thousands omitting £000s/€000s.
Calculated amounts should be rounded to the nearest thousands, or two decimal places as appropriate.
- 5 For definitions of items, refer to the Guidance Notes
- 6 To assist with the scanning process, please enter all data neatly within the relevant boxes and do not enter the % symbol in any boxes on this return.
- 7 Submit within 10 business days for unconsolidated/solo consolidated returns and 20 business days for consolidated returns or 12 and 22 business days respectively for those institutions reporting electronically to:

The Financial Services Authority
c/o Monetary and Financial Statistics Division
Domestic Banking Statistics (HO-4)
Bank of England
Threadneedle Street
London EC2R 8AH

- 8 Returns may also be delivered to the Works Gate at the Lothbury entrance of the Bank of England between 9.00am and 5.00pm, Monday to Friday. Envelopes should be clearly addressed as above.

FSA use only	Logged in	Data entered
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September 2001

* For unconsolidated/solo-consolidated entities, this should be the FSA firm reference number. For consolidated reports, this will be the FSA firm reference number of the institution on whom the requirement to report has been placed. This box must be filled in by all reporters (SUP 16.3.7R).

A1 Please tick if completion in Euros

SECTION A: BANKING BOOK

Item No	Item	Trading Book Amount (000s)	Banking Book Amount (000s)	Weight	Weighted Banking Book Amount (000s)
ASSETS					
A10	Cash.....	<input type="text"/>	<input type="text"/>	0%	<input type="text"/>
A20	Gold Bullion and coin.....	<input type="text"/>	<input type="text"/>	0%	<input type="text"/>
A30	Cash items in course of collection.....	<input type="text"/>	<input type="text"/>	20%	<input type="text"/>
A40	Items in suspense.....	<input type="text"/>	<input type="text"/>		
A40.1		<input type="text"/>	0%	<input type="text"/>
A40.2		<input type="text"/>	10%	<input type="text"/>
A40.3		<input type="text"/>	20%	<input type="text"/>
A40.4		<input type="text"/>	50%	<input type="text"/>
A40.5		<input type="text"/>	100%	<input type="text"/>

Item No	Item	Trading Book Amount (000s)	Banking Book Amount (000s)	Weight	Weighted Banking Book Amount (000s)
LOANS, ADVANCES AND BILLS HELD					
A50	Central governments and central banks	<input type="text"/>	<input type="text"/>		
A50.1		<input type="text"/>	0%	<input type="text"/>
A50.2		<input type="text"/>	10%	<input type="text"/>
A50.3		<input type="text"/>	20%	<input type="text"/>
A50.4		<input type="text"/>	100%	<input type="text"/>
A60	Lending to group companies	<input type="text"/>	<input type="text"/>		
A60.1		<input type="text"/>	0%	<input type="text"/>
A60.2		<input type="text"/>	10%	<input type="text"/>
A60.3		<input type="text"/>	20%	<input type="text"/>
A60.4		<input type="text"/>	100%	<input type="text"/>
A70	Banks and investment firms (inc building societies & MDBs)	<input type="text"/>	<input type="text"/>		
A70.1		<input type="text"/>	0%	<input type="text"/>
A70.2		<input type="text"/>	10%	<input type="text"/>
A70.3		<input type="text"/>	20%	<input type="text"/>
A70.4		<input type="text"/>	100%	<input type="text"/>
A80	Public sector entities	<input type="text"/>	<input type="text"/>		
A80.1		<input type="text"/>	0%	<input type="text"/>
A80.2		<input type="text"/>	10%	<input type="text"/>
A80.3		<input type="text"/>	20%	<input type="text"/>
A80.4		<input type="text"/>	100%	<input type="text"/>
A90	Loans secured on residential property..	<input type="text"/>	<input type="text"/>	50%	<input type="text"/>
A100	Other loans, advances and bills held....	<input type="text"/>	<input type="text"/>		
A100.1		<input type="text"/>	0%	<input type="text"/>
A100.2		<input type="text"/>	10%	<input type="text"/>
A100.3		<input type="text"/>	20%	<input type="text"/>
A100.4		<input type="text"/>	100%	<input type="text"/>
A110	Unanalysed.....	<input type="text"/>	<input type="text"/>	100%	<input type="text"/>

Item No	Item	Trading Book Amount (000s)	Banking Book Amount (000s)	Weight	Weighted Banking Book Amount (000s)
INVESTMENTS					
A120	Central governments and central banks..	<input type="text"/>	<input type="text"/>		
		Banking Book Net Long			
A120.1	<input type="text"/>	<input type="text"/>	0%	<input type="text"/>
A120.2	<input type="text"/>	<input type="text"/>	10%	<input type="text"/>
A120.3	<input type="text"/>	<input type="text"/>	20%	<input type="text"/>
A120.4	<input type="text"/>	<input type="text"/>	100%	<input type="text"/>
A130	Public sector entities.....	<input type="text"/>	<input type="text"/>		
A130.1		<input type="text"/>	10%	<input type="text"/>
A130.2		<input type="text"/>	20%	<input type="text"/>
A130.3		<input type="text"/>	100%	<input type="text"/>
A140	Banks (Unsubordinated FRNs etc)..	<input type="text"/>	<input type="text"/>		
A140.1		<input type="text"/>	10%	<input type="text"/>
A140.2		<input type="text"/>	20%	<input type="text"/>
A140.3		<input type="text"/>	100%	<input type="text"/>
A150	Mortgage backed securities.....	<input type="text"/>	<input type="text"/>		
A150.1		<input type="text"/>	10%	<input type="text"/>
A150.2		<input type="text"/>	20%	<input type="text"/>
A150.3		<input type="text"/>	50%	<input type="text"/>
A150.4		<input type="text"/>	100%	<input type="text"/>
A160	Investments in subsidiaries and associated companies	<input type="text"/>	<input type="text"/>		Deducted from Tier 1 & 2
A170	Investments in bank and financial firm capital	<input type="text"/>	<input type="text"/>		
A171	<input type="text"/>	<input type="text"/>		Deducted from Tier 1 & 2
A172	Trading Book or other concession (from Form M1).....	<input type="text"/>	<input type="text"/>	100%	<input type="text"/>
A180	Qualifying holdings / other investment.	<input type="text"/>	<input type="text"/>		
A180.1		<input type="text"/>	10%	<input type="text"/>
A180.2		<input type="text"/>	20%	<input type="text"/>
A180.3		<input type="text"/>	100%	<input type="text"/>
A180.4	Deductions from Form M1		<input type="text"/>		Deducted from Tier 1 & 2
A190	Unanalysed.....	<input type="text"/>	<input type="text"/>	100%	<input type="text"/>

Item No	Item	Trading Book Amount (000s)	Banking Book Amount (000s)	Weight	Weighted Banking Book Amount (000s)
OTHER ASSETS					
A200	Goodwill.....				Deducted from Tier 1
A210	Other intangible assets.....				
A210.1	.....			100%	
A210.2	.....				Deducted from Tier 1
A220	Own premises			100%	
A230	Other property/real estate.....			100%	
A240	Operating leases.....				
A240.1	.....			0%	
A240.2	.....			20%	
A240.3	.....			100%	
A250	Plant, equipment and other fixed assets			100%	
A260	Other.....				
A260.1	.....			0%	
A260.2	.....			10%	
A260.3	.....			20%	
A260.4	.....			100%	
A265	Assets consolidated via aggregation plus.				
A270	Total assets (items A10 to A265).....				

Item No	Item	Trading Book Amount (000s)	Banking Book Amount (000s)	Weight	Weighted Banking Book Amount (000s)
MEMORANDUM ITEMS					
A280	Connected lending of a capital nature..				Deducted from Tier 1 & Tier 2
A280.1			0%	
A280.2			10%	
A280.3			20%	
A280.4			50%	
A280.5			100%	
A290	Loans to directors, controllers and their associates.....				
A290.1			0%	
A290.2			10%	
A290.3			20%	
A290.4			50%	
A290.5			100%	
A300	Loans to non-group companies with which directors and controllers are associated.....				
A300.1			0%	
A300.2			10%	
A300.3			20%	
A300.4			50%	
A300.5			100%	
A310	Direct credit substitutes given on behalf of connected counterparties.....				
A310.1			0%	
A310.2			10%	
A310.3			20%	
A310.4			50%	
A310.5			100%	

Item No **Item**
MEMORANDUM ITEMS
(Continued)

Banking Book Amount (000s) Weight Weighted Banking Book Amount (000s)

A320	Investments in central governments and central banks..... (net short positions)			
A320.1	.....		0%	
A320.2	.....		10%	
A320.3	.....		20%	
A320.4	.....		100%	

	Col 1 Liabilities being secured at the reporting date	Col 2 Assets at the reporting date securing liabilities reported in column 1
A330	Encumbered assets.....	
A330.1	Payment/settlement systems.....	
	
	
	
	
A330.2	Other.....	
	
	
	
	
A335	Total assets of "deduction plus" subsidiaries	

Item No	Item	Trading Book Amount (000s)	Banking Book Amount (000s)	Credit Conversion Factor	Weight	Weighted Banking Book Amount (000s)
OFF BALANCE SHEET ITEMS						
A340	Direct credit substitutes.....	<input type="text"/>	<input type="text"/>			
A340.1		<input type="text"/>	100%	0%	<input type="text"/>
A340.2		<input type="text"/>	100%	10%	<input type="text"/>
A340.3		<input type="text"/>	100%	20%	<input type="text"/>
A340.4		<input type="text"/>	100%	50%	<input type="text"/>
A340.5		<input type="text"/>	100%	100%	<input type="text"/>
A340.6	<input type="text"/>	<input type="text"/>	Deducted from Tier 1 & 2		<input type="text"/>
A340.7	Unanalysed.....		<input type="text"/>	100%	100%	<input type="text"/>
A350	Transaction-related contingents.....	<input type="text"/>	<input type="text"/>			
A350.1		<input type="text"/>	50%	0%	<input type="text"/>
A350.2		<input type="text"/>	50%	10%	<input type="text"/>
A350.3		<input type="text"/>	50%	20%	<input type="text"/>
A350.4		<input type="text"/>	50%	50%	<input type="text"/>
A350.5		<input type="text"/>	50%	100%	<input type="text"/>
A350.6	Unanalysed.....		<input type="text"/>	50%	100%	<input type="text"/>
A360	Trade-related contingents.....	<input type="text"/>	<input type="text"/>			
A360.1		<input type="text"/>	20%	0%	<input type="text"/>
A360.2		<input type="text"/>	20%	10%	<input type="text"/>
A360.3		<input type="text"/>	20%	20%	<input type="text"/>
A360.4		<input type="text"/>	20%	50%	<input type="text"/>
A360.5		<input type="text"/>	20%	100%	<input type="text"/>
A360.6	Unanalysed.....		<input type="text"/>	20%	100%	<input type="text"/>
A370	Sale and repurchase agreements...	<input type="text"/>	<input type="text"/>			
A370.1		<input type="text"/>	100%	0%	<input type="text"/>
A370.2		<input type="text"/>	100%	10%	<input type="text"/>
A370.3		<input type="text"/>	100%	20%	<input type="text"/>
A370.4		<input type="text"/>	100%	50%	<input type="text"/>
A370.5		<input type="text"/>	100%	100%	<input type="text"/>
A370.6	<input type="text"/>	<input type="text"/>	Deducted from Tier 1 & 2		<input type="text"/>
A370.7	Unanalysed.....		<input type="text"/>	100%	100%	<input type="text"/>

Item No	Item	Trading Book Amount (000s)	Banking Book Amount (000s)	Credit Conversion Factor	Weight	Weighted Banking Book Amount (000s)
OFF BALANCE SHEET ITEMS (CONTINUED)						
A380	Asset sales with recourse					
A380.1	.....			100%	0%	
A380.2	.....			100%	10%	
A380.3	.....			100%	20%	
A380.4	.....			100%	50%	
A380.5	.....			100%	100%	
A380.6	.....			Deducted from Tier 1 & 2		
A380.7	Unanalysed.....			100%	100%	
A390	Forward asset purchases					
A390.1	.....			100%	0%	
A390.2	.....			100%	10%	
A390.3	.....			100%	20%	
A390.4	.....			100%	50%	
A390.5	.....			100%	100%	
A390.6	.....			Deducted from Tier 1 & 2		
A390.7	Unanalysed.....			100%	100%	
A400	Forward deposits placed					
A400.1	.....			100%	0%	
A400.2	.....			100%	10%	
A400.3	.....			100%	20%	
A400.4	.....			100%	100%	
A400.5	Unanalysed			100%	100%	
A410	Uncalled partly-paid shares and..... securities					
A410.1	.....			100%	0%	
A410.2	.....			100%	10%	
A410.3	.....			100%	20%	
A410.4	.....			100%	100%	
A410.5	.....			Deducted from Tier 1 & 2		
A410.6	Unanalysed.....			100%	100%	

Item No	Item	Trading Book Amount (000s)	Banking Book Amount (000s)	Credit Conversion Factor	Weight	Weighted Banking Book Amount (000s)
OFF BALANCE SHEET ITEMS (CONTINUED)						
A420	NIFs and RUFs					
A420.1	.....			50%	0%	
A420.2	.....			50%	10%	
A420.3	.....			50%	20%	
A420.4	.....			50%	100%	
A420.5	Unanalysed.....			50%	100%	
A430	Endorsements of bills					
A430.1	Accepted by banks.....			0%	0%	
A430.2	Not accepted by banks			100%	20%	
A430.3	.....			100%	100%	
A430.4	Unanalysed.....			100%	100%	
A440	Other commitments.....					
A440.1	1 year or less or unconditionally cancellable.....			0%	0%	
A440.2	Over 1 year.....			50%	0%	
A440.3	.....			50%	10%	
A440.4	.....			50%	20%	
A440.5	.....			50%	50%	
A440.6	.....			50%	100%	
A440.7	(report 50% of nominal values).....			Deducted from Tier 1 & 2		
A440.8	Unanalysed.....			50%	100%	
A452	OTC Derivative Contracts (Replacement Cost Methods) (from Appendix A-I).....					
A462	Foreign Exchange Position (NSOP) [CAD Exempt banks only].				100%	
A472	Interest Rate Related Contracts (Original Exposure Method).....					
A474	Exchange Rate Related Contracts (Original Exposure Method).....					

LIABILITIES

Item No	Item	Amount (000s)
CORE CAPITAL - TIER 1		
A480	Ordinary shares/common stock (issued and paid up).....	<input type="text"/>
A490	Perpetual non-cumulative preferred share/stock (issued and paid up).....	<input type="text"/>
A500	Reserves.....	<input type="text"/>
A500.1	Share Premium Account.....	<input type="text"/>
A500.2	Disclosed prior years reserves (excluding item 580) etc.....	<input type="text"/>
A500.3	Current year's retained profit verified by external audit.....	<input type="text"/>
A510	Current year's losses.....	<input type="text"/>
A520	Minority Interests (in Tier One Capital).....	<input type="text"/>
A530	Total of Items A480 to A520.....	<input type="text"/>
A540	Goodwill and other intangible assets (items A200 and A210.2).....	<input type="text"/>
A550	TOTAL TIER ONE CAPITAL (Item A530 less A540).....	<input type="text"/>
SUPPLEMENTARY CAPITAL - TIER 2		
A580	Fixed asset revaluation reserve.....	<input type="text"/>
A590	General provisions.....	<input type="text"/>
A600	Hybrid (debt/equity) instruments.....	<input type="text"/>
A610	Subordinated term debt.....	<input type="text"/>
A620	Minority Interests (in Tier 2 capital).....	<input type="text"/>
LESS ADJUSTMENTS TO CAPITAL		
A621	Excess general provisions.....	<input type="text"/>
A622	Excess Tier 2 subordinated debt.....	<input type="text"/>
A623	Amortisation on Tier 2 subordinated debt.....	<input type="text"/>
A624	Total of (items A580 to A620) less total of (items A621 to 623)	<input type="text"/>
A625	Tier 2 capital in excess of the overall limit/Excess Tier 2 capital	<input type="text"/>
A630	TOTAL ELIGIBLE TIER TWO CAPITAL (Items A624 less A625)	<input type="text"/>

Item
No **Item**

Amount
(000s)

TRADING BOOK CAPITAL - TIER 3

A631 Short term subordinated debt.....

A633 Minority Interests (in short term subordinated debt).....

LESS ADJUSTMENTS TO CAPITAL

A635 Excess Tier 3 Subordinated debt.....

A638 **TOTAL ELIGIBLE TIER THREE CAPITAL** (Items A631 plus A633 less A635).

OTHER CAPITAL

A660 Total ineligible Tier 2 and Tier 3 capital.....

A670 Other capital

**Item
No Item**

Amount
(000s)

OTHER NON-CAPITAL LIABILITIES

A680	Own bank notes issued.....	
A690	Deposits.....	
A690.1	<i>Banks</i>	
A690.2	<i>Other</i>	
A700	Marketable securities issued.....	
A700.1	<i>Certificates of deposit</i>	
A700.2	<i>Promissory notes and bills</i>	
A700.3	<i>Unsubordinated FRNs and other long term paper</i>	
A710	Investments (gross short positions).....	
A710.1	<i>Central governments and central banks</i>	
A710.2	<i>Other</i>	
A720	Liabilities in respect of sale and repurchase agreements.....	
A730	Tax provisions.....	
A730.1	<i>Current tax</i>	
A730.2	<i>Deferred tax liabilities</i>	
A740	Provisions for dividends payable.....	
A750	Other provisions.....	
A760	Other.....	
A760.1	<i>Credit items in course of settlement</i>	
A760.2	<i>Other</i>	
A765	Liabilities consolidated via consolidated plus.....	
A770	Total Liabilities (Item A530, A630 and A638 to A765).....	

Item No **Item**

Amount
(000)s

MEMORANDUM ITEMS

A780	Deposits from connected customers.....	
A790	Subordinated term debt.....	
A790.1	Mandatorily convertible subordinated bonds.....	
A790.2	Dated preference shares and subordinated term loan capital.....	

A790.21 *Repayable in full on maturity*

	Amount	Currency		Repayment Date		Sterling equivalent	Amortisation factor
				mm	yyyy		
a				/			
b				/			
c				/			
d				/			
e				/			
f				/			
g				/			
h				/			
i				/			
j				/			

A790.22 *Repayable in instalments*

	Amount	Currency		Repayment Date		Sterling equivalent	Amortisation factor
				mm	yyyy		
a				/			
b				/			
c				/			
d				/			
e				/			
f				/			
g				/			
h				/			
i				/			
j				/			

APPENDIX A-I: COUNTERPARTY EXPOSURE ON OTC DERIVATIVE CONTRACTS (BANKING BOOK)

REPLACEMENT COST METHOD (000s)

	OTC CONTRACTS Counterparty Risk Weight All maturities	Replacement cost	Potential Future Exposure	Credit Equivalent Amount	Weight	Weighted Amount
10	0%.....				0%	
20	10%.....				10%	
30	20%.....				20%	
40	50%.....				50%	
50	Unanalysed.....				50%	
60	TOTAL (to be carried forward to item A452)					

APPENDIX A-II: SUPPLEMENTARY INFORMATION ON DERIVATIVE CONTRACTS (BANKING BOOK)

REPLACEMENT COST METHOD (000s)

		Notional Principal Amounts By Residual Maturity			
INTEREST RATE CONTRACTS		<=1 Year	1-5 Years	over 5 Years	Total
10	0%.....				
20	10%.....				
30	20%.....				
40	50%.....				
50	Exchange-traded.....				

of which					
60	OTC Options.....				
70	Exchange Traded Options				

		Notional Principal Amounts By Residual Maturity			
FOREIGN EXCHANGE CONTRACTS		<=1 Year	1-5 Years	over 5 Years	Total
80	0%.....				
90	10%.....				
100	20%.....				
110	50%.....				
120	Exchange-traded.....				

of which					
130	OTC Options.....				
140	Exchange Traded Options				

		Notional Principal Amounts By Residual Maturity			
EQUITY CONTRACTS		<=1 Year	1-5 Years	over 5 Years	Total
150	0%.....				
160	10%.....				
170	20%.....				
180	50%.....				
190	Exchange-traded.....				

of which					
200	OTC Options.....				
210	Exchange Traded Options.....				

APPENDIX A-II: SUPPLEMENTARY INFORMATION ON DERIVATIVE CONTRACTS (BANKING BOOK)

Continued

REPLACEMENT COST METHOD (000S)

INTEREST RATE CONTRACTS		Replacement Cost By Residual Maturity			
		<=1 Year	1-5 Years	over 5 Years	Total
10	0%.....				
20	10%.....				
30	20%.....				
40	50%.....				

FOREIGN EXCHANGE CONTRACTS		Replacement Cost By Residual Maturity			
		<=1 Year	1-5 Years	over 5 Years	Total
80	0%.....				
90	10%.....				
100	20%.....				
110	50%.....				

EQUITY CONTRACTS		Replacement Cost By Residual Maturity			
		<=1 Year	1-5 Years	over 5 Years	Total
150	0%.....				
160	10%.....				
170	20%.....				
180	50%.....				

APPENDIX A-II: SUPPLEMENTARY INFORMATION ON DERIVATIVE CONTRACTS (BANKING BOOK)

Continued

REPLACEMENT COST METHOD (000s)

COMMODITY CONTRACTS		Notional Principal Amounts By Residual Maturity			
		<=1 Year	1-5 Years	over 5 Years	Total
220	0%.....				
230	10%.....				
240	20%.....				
250	50%.....				
260	Exchange Traded Options....				

of which		<=1 Year	1-5 Years	over 5 Years	Total
270	OTC Options				
280	Exchange Traded Options....				

PRECIOUS METALS		Notional Principal Amounts By Residual Maturity			
		<=1 Year	1-5 Years	over 5 Years	Total
290	0%.....				
300	10%.....				
310	20%.....				
320	50%.....				
330	Exchange Traded Options....				

of which		<=1 Year	1-5 Years	over 5 Years	Total
340	OTC Options.....				
350	Exchange Traded Options....				

TOTAL CONTRACTS		Notional Principal Amounts By Residual Maturity			
		<=1 Year	1-5 Years	over 5 Years	Total
360	0%.....				
370	10%.....				
380	20%.....				
390	50%.....				
400	Exchange Traded Options....				

of which		<=1 Year	1-5 Years	over 5 Years	Total
410	OTC Options.....				
420	Exchange Traded Options....				

APPENDIX A-II: SUPPLEMENTARY INFORMATION ON DERIVATIVE CONTRACTS (BANKING BOOK)

Continued

REPLACEMENT COST METHOD (000s)

COMMODITY CONTRACTS		Replacement Cost By Residual Maturity			
		<=1 Year	1-5 Years	over 5 Years	Total
220	0%.....				
230	10%.....				
240	20%.....				
250	50%.....				

PRECIOUS METALS		Replacement Cost By Residual Maturity			
		<=1 Year	1-5 Years	over 5 Years	Total
290	0%.....				
300	10%.....				
310	20%.....				
320	50%.....				

TOTAL CONTRACTS		Replacement Cost By Residual Maturity			
		<=1 Year	1-5 Years	over 5 Years	Total
360	0%.....				
370	10%.....				
380	20%.....				
390	50%.....				

APPENDIX A-III: EXPOSURES COLLATERALISED/GUARANTEED/NETTED

This return records the adjustments made by the reporting institution in respect of exposures collateralised or guaranteed or netting, where the collateral/guarantee has been used to reduce the risk weight coefficient of the underlying asset, eg show the amounts in column 3 transferred from item A100.4 (100% weight) to item A100.1 (0% weight).

		1	2	3	4	5
		From Item Number	To Item Number	Amount Collateralised <u>000s</u>	Amount Guaranteed <u>000s</u>	Amount Netted <u>000s</u>
1	A					
2	A					
3	A					
4	A					
5	A					
6	A					
7	A					
8	A					
9	A					
10	A					
11	A					
12	A					
13	A					
14	A					
15	A					
16	A					
17	A					
18	A					
19	A					
20	A					
21	A					
22	A					
23	A					
24	A					
25	A					
26	A					
27	A					
28	A					
29	A					
30	A					
31	A					
32	A					
33	A					
34	A					
35	A					

APPENDIX A-IV: CURRENT YEAR'S PROFIT & LOSS

based on management accounts to(dd/mm/yyyy)

	/		/	
--	---	--	---	--

Quarterly reporters (input reporting period as appropriate: Qtr1=1, Qtr2=2, etc)

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Half-yearly reporters (input reporting period as appropriate: H1=1, H2=2)

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Item	000s	000s	000s
INCOME			
10 Interest received and receivable.....			
20 Interest paid and payable.....			
30 Net interest income			
40 Profit/(Loss) on foreign exchange dealing			
50 Profit/(Loss) on investments held for dealing			
60 Sub-total			
70 Income from fees and commissions.....			
80 Dividends/share of profits from subsidiary and associated companies.....			
90 Profit/(Loss) on fixed assets (inc. revaluation of fixed assets).....			
100 Other Income.....			
EXPENSES			
110 Operation expenses for: staff.....			
120 occupancy.....			
130 other.....			
140 Net Charge/(credit) provisions: capital.....			
150 suspended interest.....			
160 Provisions for: taxation.....			
170 dividends.....			
180 Sub-total.....			
190 Current year's Profit/(Loss).....			
200 Extraordinary items.....			
210 TOTAL			

APPENDIX A-V: PROVISIONS AGAINST BAD AND DOUBTFUL DEBTS AND INVESTMENTS

Item No	Item	Col 1 000s SPECIFIC	Col 2 000s GENERAL	Col 3 000s TOTAL
10	Previous balance as at.. (mm / yyyy) <input type="text"/> / <input type="text"/>			
20	Adjustments for acquisitions/disposals.....			
30	Adjustments for exchange rate movements.....			
40	Charge/credit to profit & loss *.....			
50	Amounts written off (gross).....			
60	Recoveries of amounts previously written off.....			
70	Other.....			
80	Current balance **.....			

Specific provisions against bad and doubtful debts

90	for assets of 0% weight.....			
100	for assets of 10% weight.....			
110	for assets of 20% weight.....			
120	for assets of 50% weight.....			
130	for assets of 100% weight.....			
140	for assets deducted from capital base.....			
150	Total specific provisions.....			
160	Gross value of loans against which specific provisions have been made.....			

SPECIFIC PROVISIONS AGAINST THE VALUE OF INVESTMENTS OTHER THAN TRADING INVESTMENTS

170	for assets of 0% weight.....			
180	for assets of 10% weight.....			
190	for assets of 20% weight.....			
200	for assets of 50% weight.....			
210	for assets of 100% weight.....			
220	for assets deducted from capital base.....			
230	Total specific provisions against investments.....			

* Column 3 to equal items 140 & 150 on Form BSD3 (Appendix A-IV)

** Column 2 to equal items A590 in Section A, column 1 to equal items 150 and 230 in this section (from November 2001)

SECTION B: TRADING BOOK

NON-MARKET RISK IN THE TRADING BOOK

	Amount 000s		Weighted amount 000s		Capital Requirement 000s
COUNTERPARTY RISK ARISING FROM:					
B10	Free Deliveries.....				
B10.1	.....		0%		8%
B10.2	.....		10%		8%
B10.3	.....		20%		8%
B10.4	.....		100%		8%
B20	Margins.....				
B20.1	.....		0%		8%
B20.2	.....		10%		8%
B20.3	.....		20%		8%
B20.4	.....		100%		8%
B30	Fees.....				
B30.1	.....		0%		8%
B30.2	.....		10%		8%
B30.3	.....		20%		8%
B30.4	.....		100%		8%
B40	Other counterparty risk in the trading book.....				
B40.1	.....		0%		8%
B40.2	.....		10%		8%
B40.3	.....		20%		8%
B40.4	.....		100%		8%
B50	Unsettled transactions (from Appendix B-I).....				
B60	OTC Derivatives (from Appendix B-II).....				8%
B70	Undocumented repos/reverse repos (from Appendix B-IV).....				8%
B80	Documented repos (from Appendix B-IV).....				8%
B90	Documented reverse repos (from Appendix B-IV).....				8%
B100	TOTAL COUNTERPARTY RISK IN THE TRADING BOOK				

LARGE EXPOSURES IN THE TRADING BOOK

		Amount 000s	
B110	Adjusted Large Exposures Capital Base (from Form LE2 Part 5).....		<input type="text"/>
		Specific Risk Charge (000s)	Capital Requirement (000s)
B120	Excesses that have existed for 10 days or less.....	<input type="text"/>	200% <input type="text"/>
B130	Excesses that have existed for more than 10 days.....	<input type="text"/>	<input type="text"/>
B130.1	>25% and <=40% of adjusted capital base.....	<input type="text"/>	200% <input type="text"/>
B130.2	>40% and <=60% of adjusted capital base.....	<input type="text"/>	300% <input type="text"/>
B130.3	>60% and <=80% of adjusted capital base.....	<input type="text"/>	400% <input type="text"/>
B130.4	>80% and <=100% of adjusted capital base.....	<input type="text"/>	500% <input type="text"/>
B130.5	>100% and <=250% of adjusted capital base.....	<input type="text"/>	600% <input type="text"/>
B130.6	>250%.....	<input type="text"/>	900% <input type="text"/>
B140	CAPITAL REQUIREMENT FOR LARGE EXPOSURES.....	<input type="text"/>	<input type="text"/>

MARKET RISKS IN THE TRADING BOOK

I STANDARD APPROACH		Capital Requirement (000)s	
FOREIGN EXCHANGE RISK			
B150	For basic approach (from Appendix B-V).....		
B160	For backtesting approach (from Appendix B-V).....		
B170	Additional Capital Charge for Options.....		
B170.1	Using Curve Out.....		
B170.2	Using CAD1 Models Approach.....		
B180	Total foreign exchange risk		
INTEREST RATE POSITION RISK		Specific Risk Weights	Capital Requirement (000)s
B190	Specific Risk.....		
B190.1	.....	0.00%	
B190.2	.....	0.25%	
B190.3	.....	1.00%	
B190.4	.....	1.60%	
B190.5	.....	8.00%	
B200	General Market Risk (from Appendix B-VI).....		
B210	Additional Capital Charge for Options:.....		
B210.1	Using Curve Out.....		
B210.2	Using CAD1 Models Approach.....		
B215	Embedded Interest Rate Risk in Equity Derivatives.....		
B220	Total interest rate position risk		
EQUITY POSITION RISK		Capital Requirement (000)s	
B230	Specific Risk (from Appendix B-VII).....		
B240	General Market Risk (from Appendix B-VII).....		
B250	Additional Capital Charge for Options:.....		
B250.1	Using Curve Out.....		
B250.2	Using CAD1 Models Approach.....		
B270	Total equity position risk		

COMMODITY POSITION RISK

Capital Requirement (000s)

B280	Commodity position risk (from Appendix B-VIII).....	
B282	Additional Capital Charge for Options:.....	
B282.1	Using Curve Out.....	
B282.2	Using CAD1 Models Approach.....	
B284	Total commodity position risk	

II INTERNAL MODELS APPROACH

Capital Requirement (000s)

B290	Previous day's value at risk.....	
B300	Average of previous 60 days' value at risk	
B310	Multiplication factor (rounded to 2 decimal places and multiplied by 100) .	
B320	Capital requirement for general market risk	
B330	Capital surcharge for specific risk	
B340	Total capital requirement for risks subject to internal models (items B320 + B330)	

APPENDIX B-I: COUNTERPARTY RISK ON UNSETTLED TRANSACTIONS (000s)

Standard Method (Capital Charge based on potential loss)

	Unsettled Transactions	Potential Loss		Capital Charge
10	0 - 4 days.....		0%	
20	5 - 15 days.....		8%	
30	16 - 30 days.....		50%	
40	31 - 45 days.....		75%	
50	46 or more days.....		100%	
60	Total.....			

Alternative Method (Capital Charge based on agreed settlement price)

	Unsettled Transactions	Agreed Settlement price		Capital Charge
70	0 - 4 days.....		0%	
80	5 - 15 days.....		0.5%	
90	16 - 30 days.....		4%	
100	31 - 45 days.....		9%	
	46 or more days	Use Standard Method		
110	Total.....			
120	Total unsettled transactions.....			

**APPENDIX B-II: COUNTERPARTY EXPOSURE ON OTC DERIVATIVE CONTRACTS
(TRADING BOOK)
REPLACEMENT COST METHOD (000s)**

	OTC CONTRACTS Counterparty Risk Weight All maturities	Replacement cost	Potential Future Exposure	Credit Equivalent Amount	Weight	Weighted Amount
10	0%.....				0%	
20	10%.....				10%	
30	20%.....				20%	
40	50%.....				50%	
50	Unanalysed.....				50%	
60	TOTAL.....					

**APPENDIX B-III: SUPPLEMENTARY INFORMATION ON DERIVATIVE CONTRACTS
(TRADING BOOK)
REPLACEMENT COST METHOD (000s)**

		Notional Principal Amounts By Residual Maturity			
INTEREST RATE CONTRACTS		<=1 Year	1-5 Years	over 5 Years	Total
10	0%.....				
20	10%.....				
30	20%.....				
40	50%.....				
50	Exchange-traded.....				
of which					
60	OTC Options.....				
70	Exchange Traded Options				

		Notional Principal Amounts By Residual Maturity			
FOREIGN EXCHANGE CONTRACTS		<=1 Year	1-5 Years	over 5 Years	Total
80	0%.....				
90	10%.....				
100	20%.....				
110	50%.....				
120	Exchange-traded.....				
of which					
130	OTC Options.....				
140	Exchange Traded Options				

		Notional Principal Amounts By Residual Maturity			
EQUITY CONTRACTS		<=1 Year	1-5 Years	over 5 Years	Total
150	0%.....				
160	10%.....				
170	20%.....				
180	50%.....				
190	Exchange-traded.....				
of which					
200	OTC Options.....				
210	Exchange Traded Options				

**APPENDIX B-III: SUPPLEMENTARY INFORMATION ON DERIVATIVE CONTRACTS
(TRADING BOOK) - continued
REPLACEMENT COST METHOD (000s)**

		Replacement Cost By Residual Maturity			
INTEREST RATE CONTRACTS		<=1 Year	1-5 Years	over 5 Years	Total
10	0%.....				
20	10%.....				
30	20%.....				
40	50%.....				

		Replacement Cost By Residual Maturity			
FOREIGN EXCHANGE CONTRACTS		<=1 Year	1-5 Years	over 5 Years	Total
80	0%.....				
90	10%.....				
100	20%.....				
110	50%.....				

		Replacement Cost By Residual Maturity			
EQUITY CONTRACTS		<=1 Year	1-5 Years	over 5 Years	Total
150	0%.....				
160	10%.....				
170	20%.....				
180	50%.....				

**APPENDIX B-III: SUPPLEMENTARY INFORMATION ON DERIVATIVE CONTRACTS
(TRADING BOOK) - continued
REPLACEMENT COST METHOD (000s)**

Notional Principal Amounts By Residual Maturity

COMMODITY CONTRACTS		<=1 Year	1-5 Years	over 5 Years	Total
220	0%.....				
230	10%.....				
240	20%.....				
250	50%.....				
260	Exchange-traded.....				
of which					
270	OTC Options.....				
280	Exchange Traded Options				

Notional Principal Amounts By Residual Maturity

PRECIOUS METALS		<=1 Year	1-5 Years	over 5 Years	Total
290	0%.....				
300	10%.....				
310	20%.....				
320	50%.....				
330	Exchange-traded.....				
of which					
340	OTC Options.....				
350	Exchange Traded Options				

Notional Principal Amounts By Residual Maturity

TOTAL CONTRACTS		<=1 Year	1-5 Years	over 5 Years	Total
360	0%.....				
370	10%.....				
380	20%.....				
390	50%.....				
400	Exchange-traded.....				
of which					
410	OTC Options.....				
420	Exchange Traded Options				

**APPENDIX B-III: SUPPLEMENTARY INFORMATION ON DERIVATIVE CONTRACTS
(TRADING BOOK) - continued
REPLACEMENT COST METHOD (000s)**

		Replacement Cost By Residual Maturity			
PRECIOUS METALS		<=1 Year	1-5 Years	over 5 Years	Total
220	0%.....				
230	10%.....				
240	20%.....				
250	50%.....				

		Replacement Cost By Residual Maturity			
PRECIOUS METALS		<=1 Year	1-5 Years	over 5 Years	Total
290	0%.....				
300	10%.....				
310	20%.....				
320	50%.....				

		Replacement Cost By Residual Maturity			
TOTAL CONTRACTS		<=1 Year	1-5 Years	over 5 Years	Total
360	0%.....				
370	10%.....				
380	20%.....				
390	50%.....				

APPENDIX B-IV: COUNTERPARTY EXPOSURE FOR REPOS, REVERSE REPOS AND SIMILAR TRANSACTIONS (000s)

	1	2	3	4	5
UNDOCUMENTED REPOS/ REVERSE REPOS	Replacement Cost	Potential Future Credit Exposure	Amount at Risk (1 + 2)	Weight	Weighted Amount (3 * 4)
10				0%	
20				10%	
30				20%	
40				100%	
50 TOTAL.....					
	1	2	3	4	5
DOCUMENTED REPOS	Market value of securities sold or lent	Market value of collateral taken	Amount at Risk (1 - 2)	Weight	Weighted Amount (3 * 4)
60				0%	
70				10%	
80				20%	
90				100%	
100 TOTAL.....					
	1	2	3	4	5
DOCUMENTED REVERSE REPOS	Market value of collateral given	Market value of securities bought or borrowed	Amount at Risk (1 - 2)	Weight	Weighted Amount (3 * 4)
110				0%	
120				10%	
130				20%	
140				100%	
150 TOTAL.....					

APPENDIX B-V: CAPITAL REQUIREMENT FOR FOREIGN EXCHANGE RISK (000s)

			Column 1 Net Overall Long (short) Position	Column 2 Positions to be treated under basic method	Column 3 Positions being treated under backtesting approach
BASE CURRENCY	<input type="text"/>	<input type="text"/>	(1 = 2 + 3)		
Other Currencies					
Belgium/Luxembourg Francs	BE	BELG			
Canadian Dollars	CA	CANA			
Danish Kronor	DK	DENM			
EUROS	ER	EURO			
French Francs	FR	FRAN			
Deutschmarks	DE	RGER			
Irish Pounds	IE	EIRE			
Italian Lire	IT	ITAL			
Japanese Yen	JP	JAPA			
Netherlands Guilders	NL	NETH			
Spanish Pesetas	ES	SPAI			
Swedish Kroner	SE	SWED			
Swiss Francs	CH	SWIT			
Sterling	UK	UKIN			
US Dollars	US	USA			
.....					
.....					
.....					
.....					
.....					
.....					
.....					
.....					
.....					
.....					
.....					
.....					
.....					
.....					
.....					
.....					
.....					
.....					
.....					
.....					
.....					
Other Material currencies	U9	UNAL			
Other Aggregate Net Long Positions		OTHL			
Other Aggregate Net Short Positions		OTHS			
TOTAL			ZERO		
Higher of aggregate net short/long open positions					
GOLD	GO	GOLD			
.....					
SUM OF GROSS POSITION.....					
CAPITAL REQUIREMENT.....					

APPENDIX B-VI: CAPITAL REQUIREMENT INTEREST RATE GENERAL MARKET RISK (000s)

			1	2	3	4	5
			Zone One	Zone One	Zone Two	Zone Two	Zone Three
			Net Long position	Net Short Position	Net Long position	Net Short Position	Net Long position
Australia	AU	AUSL					
Austria	AT	AUSR					
Belgium	BE	BELG					
Brazil	BR	BRAZ					
Canada	CA	CANA					
Denmark	DK	DENM					
EUROS	ER	EURO					
Finland	FI	FINL					
France	FR	FRAN					
Germany	DE	RGER					
Greece	GR	GREE					
Ireland	IE	EIRE					
Italy	IT	ITAL					
Japan	JP	JAPA					
Malaysia	MY	MALA					
Mexico	MX	MEXI					
Netherlands	NL	NETH					
Norway	NO	NORW					
Portugal	PT	PORT					
Singapore	SG	SING					
South Africa	RA	SAFR					
Spain	ES	SPAI					
Sweden	SE	SWED					
Switzerland	CH	SWIT					
Turkey	TR	TURK					
UK	UK	UKIN					
Sterling Index Linked Gilts							
USA	US	USA					

Other Material Countries

.....							
.....							
.....							
.....							
.....							
.....							
.....							
.....							
.....							
.....							
.....							
.....							
.....							
.....							
.....							
.....							
Other.....	U9	UNAL					

Non Material Countries	XF	NONM					
------------------------	----	------	--	--	--	--	--

TOTAL

APPENDIX B-VI: CAPITAL REQUIREMENT INTEREST RATE GENERAL MARKET RISK - continued (000s)

			6 Zone Three Net Short Position	7 Maturity based approach (Method one)	8 Duration based Approach (Method two)	9 Simplified Method	10 Total General Market Interest Rate Risk (7 + 8 + 9)	
Australia	AU	AUSL						
Austria	AT	AUSR						
Belgium	BE	BELG						
Brazil	BR	BRAZ						
Canada	CA	CANA						
Denmark	DK	DENM						
EUROS	ER	EURO						
Finland	FI	FINL						
France	FR	FRAN						
Germany	DE	RGER						
Greece	GR	GREE						
Ireland	IE	EIRE						
Italy	IT	ITAL						
Japan	JP	JAPA						
Malaysia	MY	MALA						
Mexico	MX	MEXI						
Netherlands	NL	NETH						
Norway	NO	NORW						
Portugal	PT	PORT						
Singapore	SG	SING						
South Africa	RA	SAFR						
Spain	ES	SPAI						
Sweden	SE	SWED						
Switzerland	CH	SWIT						
Turkey	TR	TURK						
UK	UK	UKIN						
Sterling Index Linked Gilts								
USA	US	USA						
Other Material Countries								
.....								
.....								
.....								
.....								
.....								
.....								
.....								
.....								
.....								
.....								
.....								
Other.....	U9	UNAL						
Non Material Countries	XF	NONM						
TOTAL							

APPENDIX B-VII: EQUITY POSITION RISK (000s)

Gross Positions for Specific Risk

			1	2	3	4
			Positions attracting 8% specific / Execution risk	Positions attracting 4% specific/ Execution risk	Positions attracting 0% execution risk	Total Gross Equity Positions for specific / Execution risk (1 + 2 + 3)
Positions, including positions in indices, allocated by country						
Australia	AU	AUSL.....				
Belgium	BE	BELG.....				
Canada	CA	CANA.....				
France	FR	FRAN.....				
Germany	DE	RGER....				
Japan	JP	JAPA.....				
Netherlands	NL	NETH.....				
Spain	ES	SPAI.....				
Sweden	SE	SWED....				
Switzerland	CH	SWIT.....				
United Kingdom	UK	UKIN.....				
United States	US	USA.....				
Denmark	DK	DENM....				
Finland	FI	FINL.....				
Greece	GR	GREE.....				
Ireland	IE	EIRE.....				
Italy	IT	ITAL.....				
Luxembourg	LU	LUXE.....				
Portugal	PT	PORT.....				
.....						
.....						
.....						
.....						
.....						
.....						
Other material ctry.	U9	UNAL				
Non material ctry...	XF	NONM				
TOTAL.....						

APPENDIX B-VII: EQUITY POSITION RISK - continued (000s)

Positions for General Market Risk

			5	6	7
			Excess amount of concentrated positions (Gross)	Other Positions	Total Equity Positions for General Market Risk (5 + 6)
Positions, including positions in indices, allocated by country					
Australia	AU	AUSL.....			
Belgium	BE	BELG.....			
Canada	CA	CANA.....			
France	FR	FRAN.....			
Germany	DE	RGER....			
Japan	JP	JAPA.....			
Netherlands	NL	NETH.....			
Spain	ES	SPAI.....			
Sweden	SE	SWED....			
Switzerland	CH	SWIT.....			
United Kingdom	UK	UKIN.....			
United States	US	USA.....			
Denmark	DK	DENM....			
Finland	FI	FINL.....			
Greece	GR	GREE.....			
Ireland	IE	EIRE.....			
Italy	IT	ITAL.....			
Luxembourg	LU	LUXE.....			
Portugal	PT	PORT.....			
.....					
.....					
.....					
.....					
.....					
.....					
Other material ctry.	U9	UNAL			
Non material ctry...	XF	NONM			
TOTAL	.....			

APPENDIX B-VIII: COMMODITY POSITION RISK (000s)

Commodity types	Positions			Capital Charges		
	Column A Gross Long	Column B Gross Short	Column C Net Open position	Column D Simplified approach	Column E Maturity approach	Column F Total charges
10 Precious metals (excluding gold) ..						
20 Base metals						
30 Energy contracts (including oil)						
40 Other contracts ..						
50 Total capital requirement						

Top ten commodities by capital charge

60 1						
70 2						
80 3						
90 4						
100 5						
110 6						
120 7						
130 8						
140 9						
150 10						

APPENDIX B-IX: BACKTESTING RESULTS

Multiplication factor

10	Minimum multiplication factor (rounded to 2 decimal places x 100, ie input as integers)	<input style="width: 100%;" type="text"/>
20	Number of regulatory backtesting exceptions recorded over last 250 business days.	<input style="width: 100%;" type="text"/>
30	Plus factor (rounded to 2 decimal places x 100, ie input as integers)	<input style="width: 100%;" type="text"/>
40	Multiplication factor (items 10 and 30)	<input style="width: 100%;" type="text"/>

Backtesting on total portfolio

50	Number of recorded backtesting exceptions in last reporting period	<input style="width: 100%;" type="text"/>
----	--	---

51.0 Exceptions recorded during last reporting period:

	Date (dd / mm / yyyy)	VaR measure (note 1) (000s)	Actual loss (note 2) (000s)
51.01	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
51.02	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
51.03	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
51.04	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
51.05	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
51.06	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
51.07	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
51.08	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
51.09	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
51.10	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
51.11	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
51.12	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>

52.0 Five largest daily losses over last reporting period:

	Date (dd / mm / yyyy)	VaR measure (note 1) (000s)	Actual loss (note 2) (000s)
52.1	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
52.2	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
52.3	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
52.4	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
52.5	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>

53.0 Five largest backtesting VaRs¹ over last reporting period:

	Date (dd / mm / yyyy)	VaR measure (note 1) (000s)	Actual loss (note 2) (000s)
53.1	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
53.2	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
53.3	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
53.4	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
53.5	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>

Note 1. The VaR measure for backtesting purposes should be calibrated to a one-day holding period and a 99% one-tailed confidence limit.
 Note 2 Actual profit/loss is the day's actual P&L arising from trading activities within the scope of the model.

Backtesting on portfolios for specific risk

60 Number of backtesting exceptions on interest rate portfolio in last reporting period

60.1 Exceptions reported during last reporting period:

	Date (dd / mm / yyyy)		VaR measure (note 3) (000s)		Actual loss (note 4) (000s)
60.11		/			
60.12		/			
60.13		/			
60.14		/			
60.15		/			
60.16		/			
60.17		/			
60.18		/			
60.19		/			
60.20		/			
60.21		/			
60.22		/			

If the reporting institution conducts backtesting on a sub-portfolio level, this should be repeated for each sub-portfolio that is subject to interest rate specific risk

70 Number of backtesting exceptions on equities portfolio in last reporting period

70.1 Exceptions reported during last reporting period:

	Date (dd / mm / yyyy)		VaR measure (note 3) (000s)		Actual loss (note 4) (000s)
70.11		/			
70.12		/			
70.13		/			
70.14		/			
70.15		/			
70.16		/			
70.17		/			
70.18		/			
70.19		/			
70.20		/			
70.21		/			
70.22		/			

If the reporting institution conducts backtesting on a sub-portfolio level, this should be repeated for each sub-portfolio that is subject to interest rate specific risk

Note 3 This is the VaR measure (99% confidence limit, one-day holding period) related to specific risk on the sub-portfolio.

Note 4 This is the actual loss related to specific risk on the sub-portfolio.

APPENDIX B-X: EXPOSURES COLLATERALISED/GUARANTEED/NETTED

This return records the adjustments made by the reporting institution in respect of exposures collateralised or guaranteed or netting, where the collateral/guarantee has been used to reduce the risk weight coefficient of the underlying asset, eg show the amounts in column 3 transferred from item B40.4 (100% weight) to item B40.1 (0% weight).

		1 From Item Number		2 To Item Number		3 Amount Collateralised 000s	4 Amount Guaranteed 000s	5 Amount Netted 000s
1	B							
2	B							
3	B							
4	B							
5	B							
6	B							
7	B							
8	B							
9	B							
10	B							
11	B							
12	B							
13	B							
14	B							
15	B							
16	B							
17	B							
18	B							
19	B							
20	B							
21	B							
22	B							
23	B							
24	B							
25	B							
26	B							
27	B							
28	B							
29	B							
30	B							
31	B							
32	B							
33	B							
34	B							
35	B							

SECTION C - CONSOLIDATION VIA AGGREGATION PLUS (INTO THE TRADING BOOK)

INVESTMENT FIRM SUBSIDIARIES

	A	B	C	D	E
	FSA=1 or local regulator's rules= 0 applied	Trigger ratio applied = (% to 2d.px100)	(000)s Trigger capital requirement	(000)s Notional risk weighted assets	(000)s Incremental capital for large exposures
C10.1					
C10.2					
C10.3					
C10.4					
C10.5					
C10.6					
C10.7					
C10.8					
C10.9					
C10.10					
C10.11					
C10.12					
C10.13					
C10.14					
C10	TOTAL FOR INVESTMENT FIRMS.....				

BANKING SUBSIDIARIES

C20.1					
C20.2					
C20.3					
C20.4					
C20.5					
C20.6					
C20.7					
C20.8					
C20.9					
C20.10					
C20.11					
C20.12					
C20.13					
C20.14					
C20	TOTAL FOR BANKING SUBSIDIARIES.....				
C30	GRAND TOTAL				

**SECTION C - CONSOLIDATION VIA AGGREGATION PLUS
(INTO THE TRADING BOOK) - continued**

INVESTMENT FIRM SUBSIDIARIES	CAPITAL REQUIREMENT					L (000)s Target capital requirement
	F (000)s MR against which Tier 3 may be held	G (000)s MR against which Tier 3 may not be held	H (000)s Non-MR against which Tier 3 may be held	J (000)s Non-MR against which Tier 3 may may not be held	K (no) Plus factor (nox100)	
C10.1						
C10.2						
C10.3						
C10.4						
C10.5						
C10.6						
C10.7						
C10.8						
C10.9						
C10.10						
C10.11						
C10.12						
C10.13						
C10.14						
C10 TOTAL.....						
BANKING SUBSIDIARIES						
C20.1						
C20.2						
C20.3						
C20.4						
C20.5						
C20.6						
C20.7						
C20.8						
C20.9						
C20.10						
C20.11						
C20.12						
C20.13						
C20.14						
C20 TOTAL.....						
C30 GRAND TOTAL						

SECTION D - CAPITAL ADEQUACY SUMMARY

CAPITAL BASE

000s

D10	Tier 1 (A550)	
D20	Eligible Tier 2 (A630)	
D30	Eligible Tier 3 (A638)	
D40	TOTAL ELIGIBLE CAPITAL (D10 to D30)	

BANKING BOOK CAPITAL REQUIREMENTS/RISK WEIGHTED ASSETS

D50	Banking Book Trigger Ratio (% multiplied by 100, ie input as integers)	
D60	Banking Book Target Ratio (% multiplied by 100, ie input as integers)	
D70	Total Banking Book Risk Weighted Assets by risk weighting bands:..... by weighting bands:	
D70.1	Risk weighted at 0%.....	
D70.2	Risk weighted at 10%.....	
D70.3	Risk weighted at 20%.....	
D70.4	Risk weighted at 50%.....	
D70.5	Risk weighted at 100%.....	
D70.6	Items A452, A472 and A474 of Section A.....	
D80	Banking Book Capital Requirements	

CAPITAL ALLOCATED TO THE BANKING BOOK

D90	Tier 1 capital.....	
D100	Eligible Tier 2 capital.....	
D110	Total capital allocated to the Banking Book (items D90 + D100)	

TRADING BOOK CAPITAL REQUIREMENT/NOTIONAL RISK WEIGHTED ASSETS

D120	Exempt from CAD capital requirements at reporting date ? (please tick if yes)	Yes	<input type="checkbox"/>
D130	If yes, number of days over threshold in reporting period		
D140	Trading Book Trigger Ratio (% multiplied by 100, ie input as integers)		
D150	Trading Book Target Ratio (% multiplied by 100, ie input as integers)		

Standard approach

000S

D160	Counterparty/Settlement Risk	
D170	Incremental capital for large exposures	
D180	Foreign exchange risk	
D190	Interest Rate Position Risk.....	
D200	Equity Position Risk.....	
D210	Commodity Position Risk.....	
D220	Total capital requirement for trading book risks not subject to models (items D160 to D210)	

Internal models approach

D230	Capital requirement for market risk.....	
D240	Capital surcharge for specific risk.....	
D250	Total capital requirement for risks subject to internal models (items D230+D240).....	

Capital requirements for entities consolidated via aggregation plus

D260	Market Risks against which Tier 3 capital may be held.....	
D270	Market Risks against which Tier 3 capital may not be held.....	
D280	Non-Market Risk against which Tier 3 capital may be held.....	
D290	Non-Market Risk against which Tier 3 capital may not be held.....	
D300	Total capital requirement for entities consolidated via aggregation plus	
D310	Total Trading Book Capital Requirements (items D220+D250+D300).....	
D320	Total Trading Book Notional Risk Weighted Assets.....	

CAPITAL ALLOCATED TO THE TRADING BOOK

D330	Tier 1 capital.....	
D340	Eligible Tier 2 capital.....	
D350	Eligible Tier 3 capital.....	
D360	Total capital allocated to the trading book (items D330 to D350).....	

ELIGIBLE CAPITAL NOT USED TO SUPPORT EITHER BOOK

D370	Tier 1.....	
D380	Eligible Tier 2.....	
D390	Total excess Tier 1 and eligible Tier 2 capital before deduction.....	

DEDUCTIONS

000s

D400	Investments in subsidiaries and associated companies (item A160).....	
D410	Connected lending of a capital nature (A280)	
D420	Off-balance sheet items of a capital nature.....	
D430	Investments in bank and financial firm capital (item A171).....	
D440	Qualifying holdings (item A180.4).....	
D450	Deduction plus consolidation.....	
D460	Other deductions.....	
D470	Total Deductions (items D400 to D460)	
D480	OWN FUNDS	
D490	ADJUSTED CAPITAL BASE	
D500	TOTAL CAPITAL REQUIREMENTS	
D510	TOTAL RISK-WEIGHTED ASSETS	
D520	'PUBLISHED' RISK ASSET RATIO (% multiplied by 100, ie input as integers)	
D530	TRIGGER CAPITAL ADEQUACY RATIO (% multiplied by 100, ie input as integers)	
D540	TARGET CAPITAL ADEQUACY RATIO (% multiplied by 100, ie input as integers)	



FORM LE2 – Analysis of Large Exposures

Reporting institution _____
(Unconsolidated/Solo consolidated/Consolidated - delete as appropriate)

as at _____ FSA Number*

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Capital base for the period of this report: _____ Date agreed: _____

Currency of completion: _____

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.3R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. SUP 16.3.10R requires an authorised person to submit reports containing all the information required. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. Any additional information of relevance should be provided by letter direct to the FSA.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief and that I have read the Guidance Notes to this form.

Signature of authorised signatory: _____ Date: _____

Name: _____ Position held: _____

In the event of a query, the Financial Services Authority may, in the first instance, contact (block letters please):

_____ Tel No: _____ Ext: _____

Notes on completion

- 1 Complete the return quarterly on an unconsolidated/solo-consolidated basis and consolidated basis as at end of March, June, September and December. Institutions wishing to report as at dates which coincide with the financial year end should apply to the FSA for a waiver (see SUP 8).
- 2 The form should be returned within 10 business days of the reporting date when completed on an unconsolidated/ solo-consolidated basis and within 20 business days of the reporting date when completed on a consolidated basis. Please address the form to your normal supervisory contact in:

**Financial Services Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS**
- 3 If you have any difficulty in completing this form, please telephone your FSA supervisor for guidance.

FSA use only	Logged in	Data entered
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September 2001

* For unconsolidated/solo-consolidated entities, this will be the FSA firm reference number. For consolidated reports, this will be the FSA firm reference number of the institution on whom the requirement to report has been placed. This box must be filled in by all reporters (SUP 16.3.7R).

PART 1

LARGEST EXPOSURES TO INDIVIDUAL NON-BANK COUNTERPARTIES AND GROUPS OF CLOSELY RELATED

Counterparty (i) (1)	Gross exposure (ii) (2)		Net exposure (ii) (3)	
	(a) At reporting date	(b) Maximum during period	(a) At reporting date	(b) Maximum during period

(i) Principal counterparty(ies) in the case of groups of closely related non-bank counterparties.

(ii) Any exposure denominated other than in £ (either partially or wholly) should be marked with a *.

NON-BANK COUNTERPARTIES

Specific bad debt provisions made at reporting date against the exposure in column 2(a) or 3(a) (4)	Eligible collateral held (5)		Covered by guarantees (6)		Amount included in clustering ratio calculation (7)
	(a) Cash	(b) Zone A Government securities	(a) Parent bank	(b) Third party	

PART 2 (i)

LARGEST EXPOSURES TO INDIVIDUAL NON-BANK COUNTERPARTIES AND GROUPS OF CLOSELY RELATED

Counterparty (i) (1)	Gross exposure (ii)(iii) (2)		Net exposure (ii)(iii) (3)		Specific bad debt provisions made at reporting date against the exposure in column 2(a) or 3(a) (4)
	(a) At reporting date	(b) Maximum during period	(a) At reporting date	(b) Maximum during period	

(i) Principal counterparty(ies) in the case of groups of closely related non-bank counterparties.

(ii) Any exposure denominated other than in £ (either partially or wholly) should be marked with a *.

NON-BANK COUNTERPARTIES CONNECTED TO THE REPORTING BANK

Eligible collateral held (5)		Covered by guarantees (6)		Amount exempt under a connected exposure concession (7)	Amount included in clustering ratio calculation (8)
(a) Cash	(b) Zone A Government securities	(a) Parent bank	(b) Third party		

(iii) The total exposure to the counterparty(ies) listed in column 1 should be reported but exposures up to and including 1 year (original) maturity to group financial companies should also be separately identified in brackets.

PART 2 (ii)

LARGEST EXPOSURES TO BANKS, BUILDING SOCIETIES, RECOGNISED INVESTMENT FIRMS,
RECOGNISED CLEARING HOUSES AND RECOGNISED EXCHANGES CONNECTED TO THE REPORTING BANK

Counterparty (1)	Gross exposure (i) (2)		Net exposure (i) (3)		Specific bad debt provisions made at reporting date against the exposure in column 2(a) or 3(a) (4)
	(a) At reporting date	(b) Maximum during period	(a) At reporting date	(b) Maximum during period	

(i) Any exposure denominated other than in £ (either partially or wholly) should be marked with a *.

Eligible collateral held		Covered by guarantees		Amount exempt under a connected exposure concession	Amount included in clustering ratio calculation
(a) Cash	(b) Zone A Government securities	(a) Parent bank	(b) Third party		
(5)		(6)		(7)	(8)

PART 3 (i)

LARGEST EXPOSURES TO BANKS, BUILDING SOCIETIES, RECOGNISED INVESTMENT FIRMS, GILT-EDGED RECOGNISED CLEARING HOUSES AND RECOGNISED EXCHANGES WITH A MATURITY OF 1 YEAR OR LESS

Counterparty (1)	Gross exposure (i) (2)		Net exposure (i) (3)		Specific bad debt provisions made at reporting date against the exposure in column 2(a) or 3(a) (4)
	(a) At reporting date	(b) Maximum during period	(a) At reporting date	(b) Maximum during period	

(i) Any exposure denominated other than in £ (either partially or wholly) should be marked with a *.

MARKET MAKERS, STOCK EXCHANGE MONEY BROKERS,

Exposure to counterparties closely related to counterparty in column 1 (ii) (5)	Eligible collateral held (6)		Covered by guarantees (7)	
	(a) Cash	(b) Zone A Government securities	(a) Parent bank	(b) Third party

(ii) Other than banks, building societies, recognised investment firms, gilt-edged market makers, stock exchange money brokers, recognised clearing houses and recognised exchanges.

PART 3 (ii)

LARGEST EXPOSURES TO BANKS, BUILDING SOCIETIES, RECOGNISED INVESTMENT FIRMS, GILT-EDGED RECOGNISED CLEARING HOUSES AND RECOGNISED EXCHANGES WITH A MATURITY OF OVER 1 YEAR

Counterparty (1)	Gross exposure (i) (2)		Net exposure (i) (3)		Specific bad debt provisions made at reporting date against the exposure in column 2(a) or 3(a) (4)
	(a) At reporting date	(b) Maximum during period	(a) At reporting date	(b) Maximum during period	

(i) Any exposure denominated other than in £ (either partially or wholly) should be marked with a *.

MARKET MAKERS, STOCK EXCHANGE MONEY BROKERS,

Exposure to counterparties closely related to counterparty in column 1 (ii) (5)	Eligible collateral held (6)		Covered by guarantees (7)		Amount exempt under a 1-3 year derivative concession (8)	Amount included in clustering ratio calculation (9)
	(a) Cash	(b) Zone A Government securities	(a) Parent bank	(b) Third party		

(ii) Other than banks, building societies, recognised investment firms, gilt-edged market makers, stock exchange money brokers, recognised clearing houses and recognised exchanges.

PART 4

LARGEST EXPOSURES TO CENTRAL GOVERNMENTS AND CENTRAL BANKS

Counterparty (1)	Gross exposure (1) (2)		Net exposure (1) (3)	
	(a) At reporting date	(b) Maximum during period	(a) At reporting date	(b) Maximum during period
ZONE A				
ZONE B				

(i) Any exposure denominated other than in £ (either partially or wholly) should be marked with a *.

PART 5

EXPOSURES SUBJECT TO SOFT LIMITS

Adjusted capital base: _____

ISSUER	EXCESS OVER ADJUSTED CAPITAL BASE	CAPITAL CHARGE (i)

(i) To be carried to items 120 and 130 of the Form CAD1

To be used for all reports completed as at 1 December 2001 or after

FORM LR - Liquidity Return



Reporting institution _____

Reporting date

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 eg 31 12 2001

FSA number *

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Unconsolidated / Solo consolidated (tick as appropriate).....

Unconsolidated	Solo consolidated

Please tick if this return is completed in Euros (Item A).....

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.3R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. SUP 16.3.10R requires an authorised person to submit reports containing all the information required. Contravention of these requirements may lead to disciplinary action or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. Any additional information of relevance should be provided by letter direct to the FSA.

I confirm the information in this form is accurate and complete to the best of my knowledge and belief and that I have read the Guidance Notes to this form.

Signature of authorised signatory: _____ Date: _____

Name: _____ Position held: _____

In the event of a query, the FSA or the Bank of England may, in the first instance, contact (block letters please)

Tel No _____ Ext _____

Notes on Completion

1. If you have any difficulty in completing this return, please telephone your normal supervisory contact at the FSA.
2. Complete the return quarterly on an unconsolidated / solo consolidated basis.
3. Monthly BT reporters should complete Form LR as at the end of February, May, August and November. Quarterly BT reporters should complete Form LR as at the end March, June, September and December.
4. Enter amounts to the nearest thousand omitting £000s/€000s.
5. For definitions of items, refer to the Guidance Notes
6. To assist with the scanning process, please enter all data neatly within the relevant boxes and do not enter the % symbol in any boxes on this return
7. Submit the form within **10 business days** or **12 business days** for those institutions reporting electronically, clearly addressed to:

The Financial Services Authority
c/o Monetary and Financial Statistics Division
Domestic Banking Statistics (HO-4)
Bank of England
Threadneedle Street
London EC2R 8AH
- 8 Returns may also be delivered to the Works Gate at the Lothbury entrance of the Bank of England between 9.00am and 5.00pm, Monday to Friday. Envelopes should be clearly addressed as above.

FSA use only	Logged in	Data entered
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September 2001

* This should be the FSA firm reference number. This box must be filled in by all reporters (SUP 16.3.7R).

PART 1

Marketable Assets

Zone A currencies

Mark to market
value

Item No

1

A1A Cash held.....

Debt instruments issued in Zone A countries

A2A Central government/central government guaranteed, including Treasury bills, eligible Local Authority paper and eligible bank bills with a residual maturity of up to 1 year.....

A2B Central government/central government guaranteed and Local Authority marketable debt of 1 to 5 years...

A2C Central government/central government guaranteed and Local Authority marketable debt of over 5 years..

A2D Non-government of 6 months or less.....

A2E Non-government of 6 months to 5 years.....

A2F Non-government of over 5 years.....

Debt instruments issued in Zone B countries

A3A Central government/central government guaranteed with a residual maturity of up to 1 year.....

A3B Central government/central government guaranteed of 1 to 5 years.....

A3C Central government/central government guaranteed of over 5 years.....

A3D Eligible non-government of 6 months or less.....

A3E Eligible non-government of 6 months to 5 years.....

A3F Eligible non-government of over 5 years.....

A4A **Brady bonds**.....

--

A5A **Highly liquid equities/equity indices**.....

--

A6A **Total discounted amount**.....

LR.2.1

Zone B currencies

Discount where
denominated in zone A
currency (%)

Discount where
denominated in zone B
currency (%)

Discounted to

**Mark to market
value**

**8 days
and under**

**Over 8 days
to 1 month**

2

3

4

Item No



.....

--



A1A

0
5
10
5
10
15

20
25
30
25
30
35

A2A
A2B
A2C
A2D
A2E
A2F

20
30
40
30
40
50

20
30
40
30
40
50

A3A
A3B
A3C
A3D
A3E
A3F

--

20

40

--	--

A4A

--

20

40

--	--

A5A

.....

--	--

A6A



LR.2.2

PART 2

Contractual basis: residual maturity

Item No	<u>Cashflow basis</u>			
	1	2	3	4
	Overdue	Demand (incl. next day)	8 days and under (excl. next day)	Over 8 days to 1 month

Inflows

B Please tick if reported on a Cashflow basis (blank represents Maturity basis).....

Retail

B1A	Mortgages.....				
B1B	Personal loans.....				
B1C	Overdrafts.....				
B1D	Credit card inflows.....				
B1E	Repayment of advances.....				
B1F	Other retail inflows.....				

Wholesale

B2A	Non-marketable securities and debt instruments and marketable assets maturing within 1 month...				
B2B	Intragroup / connected.....				
B2C	Interbank (excluding any intragroup).....				
B2D	Corporate (non interbank, non intragroup).....				
B2E	Government / Public sector.....				
B2F	Repos / reverse repos.....				
B2G	Trade related letters of credit.....				
B2H	Overdrafts.....				
B3A	Swaps and FRAs.....				
B3B	Forward foreign exchange.....				
B3C	Forward sales and purchases.....				
B3D	Other off balance sheet.....				
B4A	Fees and other income.....				
B4B	Other funding sources.....				
B5A	Total inflows				

LR.2.3

5 Over 1 months to 3 months 6 Over 3 months to 6 months 7 Total (Cashflow basis)

--	--

--	--	--

Assets: Maturity analysis

8 Over 6 months to 1 year 9 Over 1 year to 3 years 10 Over 3 years to 5 years 11 Total (Maturity basis)

Item No

B1A
B1B
B1C
B1D
B1E
B1F

B2A
B2B
B2C
B2D
B2E
B2F
B2G
B2H

B3A
B3B
B3C
B3D

B4A
B4B

--	--	--	--

B5A

LR.2.4

PART 2 (continued)

Contractual basis: residual maturity

Item No	<u>Cashflow basis</u>			
	1	2	3	4
	Overdue	Demand (incl. next day)	8 days and under (excl. next day)	Over 8 days to 1 month

Outflows

C Please tick if reported on a Cashflow basis (blank represents Maturity basis).....

Retail

C1A	Time deposits.....			
C1B	No notice / current accounts.....			
C1C	Additional advances committed.....			

Wholesale

Non-marketable securities and debt instruments and marketable assets				
C2A	maturing within 1 month.....			
C2B	Additional advances committed.....			
C2C	Intragroup / Connected.....			
C2D	Interbank (excluding any intragroup).....			
C2E	Corporate (non-interbank and non-intragroup).....			
C2F	Government / Public sector.....			
C2G	Repos / Reverse Repos.....			
C2H	Trade related letters of credit.....			
C3A	Swaps and FRAs.....			
C3B	Forward foreign exchange.....			
C3C	Forward sales and purchases.....			
C3D	Other off balance sheet.....			
C4A	Dividends, tax, other costs and outflows.....			
C5A	Total outflows			

Memo Items

D1A	Option inflows.....			
D1B	Option outflows.....			
D1C	Undrawn committed facilities granted to the bank.....			
D1D	Undrawn committed facilities granted by the bank.....			
D1E	Commitments to lend under credit card and other revolving credit type facilities.....			
D1F	Total deposits			
D2A	Undrawn treasury concessions granted by the bank.....			
D2B	Amount of total cash inflows in arrears.....			

5 6 7
Over 1 months to **Over 3 months to** **Total (Cashflow**
3 months **6 months** **basis)**

┌

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└

Liabilities: Maturity analysis

8 9 10 11 Item No
Over 6 months to **Over 1 year to 3** **Over 3 years to 5** **Total (Maturity**
1 year **years** **years** **basis)**

┌

C1A
C1B
C1C

C2A
C2B
C2C
C2D
C2E
C2F
C2G
C2H

C3A
C3B
C3C
C3D

--	--	--	--

C4A

--	--	--	--

C5A

└

LR.2.6

PART 3

Behavioural basis

Item No

1	2	3
Overdue	Demand (incl. next day)	8 days and under (excl. next day)

Inflows

Retail

E1A	Mortgages.....			
E1B	Personal loans.....			
E1C	Overdrafts.....			
E1D	Credit card inflows.....			
E1E	Repayment of advances.....			
E1F	Other retail inflows.....			

Wholesale

E4A	Non-marketable securities and debt instruments and marketable assets maturing within 1 month...			
E4B	Intragroup / connected.....			
E4C	Interbank (excluding any intragroup).....			
E4D	Corporate (non interbank, non intragroup).....			
E4E	Government / Public sector.....			
E4F	Repos / reverse repos.....			
E4G	Trade related letters of credit.....			
E4H	Overdrafts.....			
E5A	Swaps and FRAs.....			
E5B	Forward foreign exchange.....			
E5C	Forward sales and purchases.....			
E5D	Other off balance sheet.....			
E2A	Fees and other income.....			
E2B	Other funding sources.....			
E3A	Total inflows.....			

LR.2.7

4	5	6	7	8	9	Item No
Over 8 days to 1 month	Over 1 months to 3 months	Over 3 months to 6 months	Over 6 months to 1 year	Over 1 year	Total (Columns 1 to 8)	

						E1A
						E1B
						E1C
						E1D
						E1E
						E1F

						E4A
						E4B
						E4C
						E4D
						E4E
						E4F
						E4G
						E4H

						E5A
						E5B
						E5C
						E5D

						E2A
						E2B

						E3A
--	--	--	--	--	--	-----

LR.2.8

PART 3 (continued)

Behavioural basis

Item No	1	2	3
	Overdue	Demand (incl. next day)	8 days and under (excl. next day)

Outflows

Retail

F1A Time deposits.....		
F1B No notice / current accounts.....		
F1C Additional advances committed.....		

Wholesale

Non-marketable securities and debt instruments and marketable assets		
F5A maturing within 1 month.....		
F2A Additional advances committed.....		
F5C Intragroup / Connected.....		
F5D Interbank (excluding any intragroup).....		
F5E Corporate (non-interbank and non-intragroup).....		
F5F Government / Public sector.....		
F5G Repos / Reverse Repos.....		
F5H Trade related letters of credit.....		
F6A Swaps and FRAs.....		
F6B Forward foreign exchange.....		
F6C Forward sales and purchases.....		
F6D Other off balance sheet.....		
F3A Dividends, tax, other costs and outflows.....		
F4A Total outflows		

LR.2.9

4	5	6	7	8	9	Item No
Over 8 days to 1 month	Over 1 months to 3 months	Over 3 months to 6 months	Over 6 months to 1 year	Over 1 year	Total (Columns 2 to 8)	

						F1A
						F1B
						F1C

						F5A
						F2A
						F5C
						F5D
						F5E
						F5F
						F5G
						F5H

						F6A
						F6B
						F6C
						F6D

						F3A
--	--	--	--	--	--	-----

						F4A
--	--	--	--	--	--	-----

LR.2.10

PART 4

Calculation of liquidity mismatches

Item No	1 Overdue (excluded)	2 Demand (incl. next day)	3 8 days and under	4 1 month and under	Item No
Contractual Basis					
<i>Inflows</i>					
G1A					G1A
G1B					G1B
G1C					G1C
G1D					G1D
G1E					G1E
<i>Outflows</i>					
G2A					G2A
G2B					G2B
G2C					G2C
G2D					G2D
G2E					G2E
G2F					G2F
<i>Mismatch</i>					
G3A					G3A
G4A					G4A
G5A					G5A
Behaviourally Adjusted Basis					
<i>Inflows</i>					
G6A					G6A
G6B					G6B
G6C					G6C
G6D					G6D
G6E					G6E
<i>Outflows</i>					
G7A					G7A
G7B					G7B
G7C					G7C
G7D					G7D
G7E					G7E
G7F					G7F
<i>Mismatch</i>					
G8A					G8A
G8B					G8B
G8C					G8C

In order to assist with the scanning process please enter decimal points clearly and do not enter the % symbol in any of the boxes of this form

PART 4 (continued)

Exceptions to Guidelines

**Net cumulative mismatch
as a percentage of total deposits**

		1				2		3				
Item No		Date (ddmm format)				Sight to eight days (to 2 decimal places)	Sight to one month (to 2 decimal places)			Sight to eight days (to 2 decimal places)	Sight to one month (to 2 decimal places)	Item No
H1A											H1A	
H1B											H1B	
H1C											H1C	
H1D											H1D	
H1E											H1E	
H1F											H1F	
H1G											H1G	
H1H											H1H	
H1J											H1J	
H1K											H1K	
H1L											H1L	
H1M											H1M	
H1N											H1N	
H1P											H1P	
H1Q											H1Q	
H1R											H1R	
H1S											H1S	
H1T											H1T	
H1U											H1U	
H1V											H1V	
						LR.2.12						

In order to assist with the scanning process please enter decimal points clearly and do not enter the % symbol in any of the boxes of this form

PART 5

Deposit Concentration

Part A: Large Deposits

	1	2					3				
Item No	Customer (a)	Maturity date (b) (ddmmyy format blank=undated, V=various)					Currency (c) (using international country codes blank=sterling, V=various)				
J1A											
J1B											
J1C											
J1D											
J1E											
J1F											
J1G											
J1H											
J1J											
J1K											
J1L											
J1M											
J1N											
J1P											
J1Q											
J1R											
J1S											
J1T											
J1U											
J1V											
K1A											
K1B											
K1C											
K1D											
K1E											
K1F											
K1G											
K1H											
K1J											
K1K											
K1L											
K1M											
K1N											
K1P											
K1Q											
K1R											
K1S											
K1T											
K1U											
K1V											

4

5

6

7

8

Amount (d)	Maximum amount in reporting period (e)	Client money (C) (f) (please tick)	Mandated accounts (M) (g) (please tick)	Customers connected to reporting bank (CC) (please tick)	Item No
					J1A
					J1B
					J1C
					J1D
					J1E
					J1F
					J1G
					J1H
					J1J
					J1K
					J1L
					J1M
					J1N
					J1P
					J1Q
					J1R
					J1S
					J1T
					J1U
					J1V
					K1A
					K1B
					K1C
					K1D
					K1E
					K1F
					K1G
					K1H
					K1J
					K1K
					K1L
					K1M
					K1N
					K1P
					K1Q
					K1R
					K1S
					K1T
					K1U
					K1V

PART 5 (continued)

Deposit Concentration

Part B: Client money and mandated accounts held

Item No	1	2	3	Item No
		Amount	Maximum amount in reporting period	
L1A	Client Money (f).....			L1A
L1B	Mandated accounts (g).....			L1B

Notes for completing Part 5

- a) Principal customer in the case of closely related depositors/lenders.
- b) Where an individual deposit comprises 25% or more of the total for a particular depositor / group of depositors and has a different maturity from the remainder, it should be reported separately and bracketed. Otherwise where deposits have been received with a variety of maturity dates, reporting institutions need not supply a full list of dates but may write the letter V in the first section of column 2. Where the deposit is undated, this column should be left blank.
- c) Enter the currency and not the amount. The codes used for each currency should be consistent with the international codes used for the Bank of England returns. Where an individual deposit comprises 25% or more of the total for a particular depositor/group of depositors and has a different currency from the remainder, it should be reported separately and bracketed. Otherwise, where deposits are received in a variety of currencies, reporting institutions need not supply details of each currency amount but may write the letter V in the first section of column 3. Where the deposit is in sterling, this column should be left blank.
- d) Enter the sterling (or euro amount, if appropriate) or the sterling equivalent (or euro equivalent) if the deposit/loan is in currency other than sterling (or euro).
- e) Only complete this column for deposits still outstanding at the reporting date.
- f) Funds subject to the FSA's (previously SIB's) client money regulations.
- g) Funds held in accounts operated by a Financial Services Act authorised firm under a mandate signed by the account holder.

LR.2.15

To be used for all reports completed as at 1 December 2001 or after

FORM M1 - Holdings of credit and financial institutions' and non-financial companies' capital instruments



Reporting institution _____

as at.

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(eg 31 12 2001)

FSA number *

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Unconsolidated/solo consolidated/consolidated - tick as appropriate

Unconsolidated Solo consolidated Consolidated

(sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.3R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. SUP 16.3.10R requires an authorised person to submit reports containing all the information required. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. Any additional information of relevance should be provided by letter direct to the FSA.

I confirm the information in this form is accurate and complete to the best of my knowledge and belief and that I have read the Guidance Notes to this form.

Signature of authorised signatory: _____ Date _____

Name: _____ Position held: _____

In the event of a query, the FSA or the Bank of England may, in the first instance, contact (block letters please)

_____ Tel No _____ Ext _____

Notes on Completion

- 1 If you have any difficulty in completing this return, please telephone your normal supervisory contact at the FSA.
- 2 Complete the return quarterly on an unconsolidated/solo consolidated basis in conjunction with Form BSD3.
- 3 Complete the return half-yearly on a consolidated basis in conjunction with Form BSD3.
- 4 Enter amounts to the nearest thousands omitting £000s/€000s
- 5 For definitions of items, refer to the Guidance Notes
- 6 To assist with the scanning process, please enter all data neatly within the relevant boxes and do not enter the % symbol in any boxes on this return.
- 7 Submit within 10 business days for unconsolidated/solo consolidated returns and 20 business days for consolidated returns or 12 and 22 business days respectively for those institutions reporting electronically to:

**The Financial Services Authority
c/o Monetary and Financial Statistics Division
Domestic Banking Statistics (HO-4)
Bank of England
Threadneedle Street
London EC2R 8AH**

- 8 Returns may also be delivered to the Works Gate at the Lothbury entrance of the Bank of England between 9.00am and 5.00pm, Monday to Friday. Envelopes should be clearly addressed as above.

FSA use only	Logged in	Data entered
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September 2001

* For unconsolidated/solo-consolidated entities, this should be the FSA firm reference number. For consolidated reports, this will be the FSA firm reference number of the institution on whom the requirement to report has been placed. This box must be filled in by all reporters (SUP 16.3.7R).

1 Please tick if completion in Euros

SECTION 1: Holdings in credit and financial institutions' capital instruments

10	Trading Book concession granted (tick if yes).....	<input type="checkbox"/>	
			000s
20	If Trading Book concession granted, what amount.....		<input type="text"/>
30	Concession to hold own group paper in Trading Book (tick if yes)	<input type="checkbox"/>	
40	If concession granted, what amount.....		<input type="text"/>
	Total amount of credit and financial institutions' capital instruments held		
50	Total amount held (items 60 + 70)		<input type="text"/>
60	Banking Book		<input type="text"/>
70	Trading Book (items 70.1 to 70.4).....		<input type="text"/>
70.1	other institutions' paper eligible for a Trading Book concession.....		<input type="text"/>
70.2	holdings eligible for own group concession.....		<input type="text"/>
70.3	paper not eligible for Trading Book concession (deductible from Tiers 1 & 2).		<input type="text"/>
70.4	holdings of own Tier 1 instruments (deductible from Tier 1).....		<input type="text"/>
80	Holdings in excess of 10% of other credit and financial institutions' capital		<input type="text"/>
	Credit or financial institution	Amount	Excess
80.01	<input type="text"/>	<input type="text"/>
80.02	<input type="text"/>	<input type="text"/>
80.03	<input type="text"/>	<input type="text"/>
80.04	<input type="text"/>	<input type="text"/>
80.05	<input type="text"/>	<input type="text"/>
80.06	<input type="text"/>	<input type="text"/>
80.07	<input type="text"/>	<input type="text"/>
80.08	<input type="text"/>	<input type="text"/>
80.09	<input type="text"/>	<input type="text"/>
80.10	<input type="text"/>	<input type="text"/>
Total	<input type="text"/>	<input type="text"/>

Total amount deducted from Tier 1 and Tier 2 capital or risk weighted as at reporting date:

000s

- 90 Banking Book on-Balance sheet (deductions).....
- 100 Banking Book off-Balance sheet (deductions).....
- 110 Trading Book (deductions).....
- 120 Banking Book (risk weighted)
- 130 Trading Book (non deductible)

140 Five largest holdings in credit and financial institutions, at reporting date

Credit or financial institution

- 140.1
- 140.2
- 140.3
- 140.4
- 140.5

Amount

SECTION 2: Qualifying holdings in non-financial companies

- 150 Total amount of qualifying holdings
- 160 Total amount of qualifying holdings in excess of 15% of capital
- 170 Total amount of qualifying holdings in excess of 60% of capital
- 180 Total deductions from capital (also report this figure in item A180.4 on BSD3)

To be used for all reports completed as at 1 December 2001 or after



FORM SLR1 - Stock Liquidity Return

Reporting Institution

as at.....

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 (eg 12 12 2001) **FSA Number***

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Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.3R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. SUP 16.3.10R requires an authorised person to submit reports containing all the information required. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. Any additional information of relevance should be provided by letter direct to the FSA. I confirm the information in this form is accurate and complete to the best of my knowledge and belief and that I have read the Guidance Notes to this form.

Signature of authorised signatory: _____ Date: _____

Name: _____ Position held: _____

In the event of a query, the FSA or the Bank of England may, in the first instance, contact (block letters please)

_____ Tel No _____ Ext _____

Notes on completion

- 1 If you have any difficulty in completing this return, please telephone your usual supervisory contact at the FSA.
- 2 For definitions, refer to the Guidance Notes
- 3 Enter amounts to nearest thousands omitting £000s.
- 4 This form should be completed as at the **SECOND WEDNESDAY OF THE MONTH**. It should also be completed for any exception within the month.
- 5 To assist with the scanning process, please enter all data neatly within the relevant boxes and do not enter the % symbol in any boxes on this return.
- 6 Submit the **monthly** return within **six business days** of the reporting date, clearly addressed to:

FINANCIAL SERVICES AUTHORITY
c/o Monetary and Financial Statistics Division
Domestic Banking Statistics (HO-4)
Bank of England
Threadneedle Street
London EC2R 8AH

- 7 Returns may also be delivered to the Works Gate at the Lothbury entrance of the Bank of England between 9.00am and 5.00pm, Monday to Friday. Envelopes should be clearly addressed as above.
- 8 Submit any **exception** reports direct to your supervisor at the Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.

FSA use only	Logged in	Date entered
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September 2001

* For unconsolidated/solo-consolidated entities, this should be the FSA firm reference number. For consolidated reports, this will be the FSA firm reference number of the institution on whom the requirement to report has been placed. This box must be filled in by all reporters (SUP 16.3.7R).

1 STERLING STOCK:

1.1	Cash.....		
1.2	Operational balances with Bank of England.....		
1.3	Treasury Bills.....		
1.4	Gilts.....		
1.5	Eligible bank bills.....		
1.6	Eligible local authority bills.....		
1.7	Certificates of tax deposits.....		
1.8	Other.....		
1.0	TOTAL		<input type="text"/> (A)
	<i>(Item 1 should be equal or greater than item 2.2)</i>		
2.1	WHOLESALE STERLING NET OUTFLOW LIMIT		<input type="text"/>
	5 WORKING DAYS as agreed with Bank of England		
2.2	STERLING STOCK FLOOR		<input type="text"/>
	5 WORKING DAYS as agreed with Bank of England		
3.0	WHOLESALE STERLING NET OUTFLOW		<input type="text"/> (B)
	5 WORKING DAYS		
4.0	STERLING CERTIFICATES OF DEPOSITS HELD		<input type="text"/>
4.1	TOTAL.....	<input type="text"/>	
4.2	Liquidity conversion factor..... X	<input type="text" value="0.85"/>	
4.3	Total discounted certificates of deposit..... =	<input type="text"/>	
	<i>(Equal to item 4.1 times item 4.2)</i>		
4.4	Allowable certificates of deposit.....		<input type="text"/> (C)
	<i>(Item 4.4 should not be greater than 50% of item 3.0)</i>		
4.5	Remaining certificates of deposit.....	<input type="text"/>	
	<i>(Item 4.4 plus item plus 4.5 should equal 4.3)</i>		
5.0	STERLING RETAIL DEPOSITS:		
5.1	Sterling retail deposits falling due in next 5 working days.....	<input type="text"/>	
5.2	Liquidity conversion factor..... X	<input type="text" value="0.05"/>	
5.3	Sterling retail deposits to be covered..... =		<input type="text"/> (D)
	<i>(Equal to item 5.1 times item 5.2)</i>		
6.0	STERLING LIQUIDITY RATIO (LQR) (rounded to two decimal places and multiplied by 100, ie places input as integers).....		<input type="text"/>

$$LQR = \left(\frac{A}{(B - C) + D} \right) \times 100\%$$

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

1. FORM B7
2. FORM BSD3
3. FORM LE2
4. FORM LR
5. FORM M1
6. FORM SLR1
7. Supervisory guidance notes

Analysis of Profits, Large Exposures and Certain Other Miscellaneous Information (Form B7)

Form B7 should be completed by UK branches of banks established outside the EEA (as defined in the Handbook Glossary of Definitions) as at end-June and end-December, or at dates which coincide with the branch's accounting period and have been agreed with the Financial Services Authority (FSA). This form should be completed using the accruals based accounting method, although market value based accounting may be used if the branch prepares its financial statements on this basis. It will, however, be assumed that branches are completing the form using the accruals based accounting method unless they have otherwise notified the FSA in writing.

Please read the Supervisory Guidance Notes (SGN), the FSA Banking Supervisory Policy Guide and the Interim Prudential Sourcebook for Banks in conjunction with these reporting instructions.

CURRENT YEAR'S PROFIT AND LOSS

1.1 Interest received and receivable

Include under this heading:

- (a) interest income which had accrued during the current accounting period whether or not it has been received;
- (b) all income having the character of interest and, in particular, amounts arising from the amortisation of discounts on the purchase of investment securities and fees and commissions which are similar in nature to interest, including swap interest where the instrument is used for hedging purposes. Interest which is identified as doubtful should not be credited to the profit and loss account but should instead be credited to an interest suspense account on the balance sheet. The crediting of interest to the suspense account should cease when there is no longer any realistic prospect of receiving it, and the balance should be written off once it is beyond realistic prospect of recovery.

1.2 Dividend income

Reporting institutions should include here all dividend income received and receivable (ie where the stock has gone "ex-div") from equity shares. Dividends from equity shares should be included from the announcement date or in the case of quoted shares from the "ex-div" date.

1.3 Fees and commissions received and receivable

Income from charges made for services provided by the reporting institution, eg for the provision of current account facilities, trade finance activities, corporate advice, investment management and trustee services, guarantees and indemnities, commission on foreign currency transactions, underwriting the issue of securities etc.

Do not include here fees and commissions which are similar in nature to interest such as front end fees in lieu of interest, as these should be reported under item 1.1.

1.4 Dealing profit/(loss)

This is the buying or selling of any financial instrument. Interest should be reported gross except where the interest flows arising from a contract are settled net, eg the interest flows on an interest rate swap would normally be reported net.

Include:

- (a) all profits and losses, including amounts resulting from marking-to-market from dealing in securities, foreign exchange, and other financial instruments;
- (b) fees received for dealing in securities such as brokerage costs; and
- (c) amounts resulting from the marking-to-market of the financial instruments held for dealing.

Profits and losses from the sale of investment securities should not be reported here but under item 1.6. The funding cost of the dealing operation may be included within this item where such a treatment is adopted in the financial statements of the branch.

1.5 Intra-group income

Include all income here which would otherwise have been included under items 1.1 to 1.4 and 1.6, but which has been earned from group companies. (This income should not also be reported under items 1.1 to 1.4.) The definition of group companies should include Head Office, fellow branches and other group companies as defined in SGN12.

Where the systems of the branch are such that it would be unduly expensive, impractical or of little benefit to the FSA to provide an analysis of intra-group income then such income need not be separately reported. The written agreement of the FSA should be obtained for reporting on this basis.

1.6 Other operating income

Include here the profit or loss on the sale of investment securities and tangible fixed assets, rentals receivable and sundry sources of income which do not fall into one of the other income categories. Investment securities are defined as securities intended for use on a continuing basis in the activities of the bank, but securities should not be treated as investment securities unless they are held for identified purpose and the securities held are clearly identifiable. Amounts within other operating income that represent more than 5% of the total income figure (item 1) should be entered in items 1.6A, 1.6B and 1.6C in descending order of size. Ignore further items if there are more than three breaking the 5% limit.

2.1 Interest paid and payable

Include under this heading:

- (a) interest expense which has accrued during the current accounting period whether or not it has been paid; and
- (b) all expenditure having the character of interest, and, in particular, amounts arising from the amortisation of premiums on the purchase of investment securities and fees and commissions which are similar in nature to interest and swap interest where the instrument is used for hedging purposes.

2.2 Fees and commissions paid and payable

Include charges for all services rendered to the company by third parties, excluding those which have the character of interest and are included under item 2.1.

2.3 Staff expenses

Include here:

- (a) salary costs;
- (b) employer's national insurance contributions;
- (c) employer's contribution to any pension scheme; and
- (d) costs of staff benefits paid on a per capita basis, such as private medical insurance and luncheon vouchers.

2.4 Administration expenses

Include here any general staff benefits, together with rent, rates, electricity, stationery costs, etc.

2.5 Depreciation

This item should include depreciation, amortisation and other amounts written off in respect of tangible and intangible fixed assets.

2.6 Intra-group expenditure

Include all expenditure which would otherwise have been included within items 2.1 to 2.4 and 2.7, but which has been paid to, or is due to, group companies as defined in SGN12. Where the systems of the branch are such that it would be unduly expensive, impractical or of little benefit to the FSA to provide an analysis of intra-group expenditure then such expenditure need not be separately reported. The written agreement of the FSA should be obtained before reporting on this basis.

2.7 Other operating charges

Include here those items of expenditure which do not fall within items 2.1 to 2.5. Amounts within other operating charges which represent more than 5% of the total expenditure figure (item 2) should be entered in items 2.7A, 2.7B and 2.7C in descending order of size. Ignore further items if there are more than three breaking the 5% limit.

4.1 Provisions for bad and doubtful debts

Suspended interest should not be included here, nor should suspended interest be included within item 1.1. This item should equal item 10.3. Specific and General should be as per the branch balance sheet.

4.2 Provisions for contingent liabilities and commitments

Include here charges for provisions against contingent liabilities and commitments which would, if not provided for here, be shown under off-balance sheet items 7 and 8.

4.3 Taxation

Include here the tax charge for the period. Where this has not yet been arrived at, an estimation of the tax charge should be included, based on the pre-tax profit figure and the average historic tax rate of the institution in previous years. The historic rate of tax should be adjusted for any changes in circumstances as appropriate, including changes in the rate of corporation tax, changes in the nature of businesses, etc.

4.4 Provisions / Amounts written off fixed asset investments

Provisions / amounts written off, and adjustments to amounts previously written off, in respect of fixed asset investments, including debt and equity securities held either to maturity or as long term investments.

BALANCE SHEET ANALYSIS

6.1-6.5 Quoted investments

This should comprise the net long or short position of investments listed on recognised exchanges (the UK and overseas official stock exchanges and the Unlisted Securities Market) and "over the counter" stock markets for which a publicly ascertainable price is regularly available. In arriving at the market valuation, long positions should be valued at bid price and short positions should be valued at the offer price. In the event that the bank is only able to access the mid-market or single values, it should have regard to the fact these prices will have to be adjusted to some degree in order to arrive at a prudent valuation.

6.6-6.9 Unquoted investments

Include here, at the original cost valued at the reporting rate of exchange, those investments which are not traded on a recognised exchange as defined for items 6.1 to 6.5, and those "over the counter" investments which do not meet the criteria to be included under items 6.1 and 6.5.

OFF-BALANCE SHEET ITEMS

7.1 Acceptances and endorsements

Endorsements of bills for customers (including per aval endorsements) should be reported at the full nominal amount, less any amount for bills which the branch now holds but had previously endorsed. Where the reporting institution is the first endorser of a bill which has been accepted by a bank other than the reporting bank, such endorsements should be reported in item 7.2. (Where a reporting institution has endorsed its own acceptances no further amount should be reported than the acceptance reported in item 7.2.) If the reporting institution is not the first endorser of a bill already accepted by a bank, such endorsements need not be reported.

Endorsements of bills which have not been accepted by a bank should be reported here, but endorsements of bills which have been previously endorsed by two or more banks need not be reported.

Acceptances, other than own acceptances which represent a genuine liability as opposed to a contingent liability and should be reported on balance sheet, should also be reported here.

7.2 Guarantees and irrevocable letters of credit (Direct credit substitutes)

Guarantees and irrevocable letters of credit (ie direct credit substitutes) relate to the financial requirements of a counterparty, where the risk of loss to the reporting institution on the transaction is equivalent to a direct claim on the counterparty, ie the risk of loss depends on the creditworthiness of the counterparty (refer to Form BSD3 item A340 for detail of instruments which should be reported).

Letter of credit not eligible for inclusion in item 8.2 should be reported here. However, standby letters of credit which are related to non-financial transaction should be reported in item 7.4.

7.3 Assets pledged by the bank as collateral security

Include all guarantee obligations incurred and assets pledged as collateral security on behalf of third parties. Where the assets have been given as security in connection with the reporting institution's participation in a payments/settlements system such as CREST or Euroclear, the particular payments/settlements system should be reported with the liabilities being secured at the reporting date. Where assets have been given as security to secure the reporting institution's other liabilities (for example, property which has been mortgaged and hire purchase agreements pledged as collateral), the assets reported should exclude any element of unearned finance charges.

7.4 Other contingent liabilities

Report all contingent liabilities which do not fall within one of the definitions for items 7.1 and 7.3.

8.1 Sale and option to resell transactions

Include all instruments where the purchaser of assets has the option to resell them to the vendor. They should be reported under this item at the price agreed in the event of a repurchase. If there is no repurchase price agreed then use the price at the reporting date.

8.2 Documentary credits and short-term trade-related transactions

Report short-term (defined as less than or equal to six months), self liquidating trade-related items such as documentary letters of credit issued by the reporting institution which are, or are to be, collateralised by the underlying shipment, ie where the credit provides for the reporting institution to retain title to the underlying shipment. Such letters should be weighted according to the counterparty on whose behalf the credit is issued and reporting whether or not the terms and conditions of the credit have yet to be complied with.

Letters of credit issued by the reporting institution without provision for the reporting institution to retain title to the underlying shipment or where the title has passed from the reporting institution should be reported under Guarantees and irrevocable letters of credit (direct credit substitutes), ie item 7.2. A memorandum of pledge and a trust receipt are not regarded as giving the reporting institution title, and transactions secured by these should be shown under item 7.2.

Letters of credit issued on behalf of a counterparty back-to back with letters of credit of which the counterparty is a beneficiary ("back-to-back" letters) should be reported in full.

Letters of credit advised by the reporting institution or for which the reporting institution is acting as reimbursement agent should not be reported.

8.3 Forward asset purchases and forward deposits placed

Include commitments for loans and other on-balance-sheet items with certain drawdown. Exclude foreign currency spot deposits with value dates one or two working days after the reporting date.

8.4 Undrawn facilities

Include all undrawn committed credit facilities with uncertain drawdown, including those with bank counterparties.

9 Exchange rate and interest rate related contracts

Counterparty risk on exchange rate and interest rate related contracts should be reported in this section. Exposures should be reported on a gross basis, unless they are netted by novation or in accordance with the guidance set out in Chapter NE (Collateral and netting) of the FSA Banking Supervisory Policy Guide and/or the Interim Prudential Sourcebook for Banks.

Only contracts with a positive mark to market value should be included. However, institutions should record a potential future credit exposure in respect of all OTC derivative contracts.

9.1 Exchange rate contracts

Only exchange rate contracts of over 14 days original maturity (excluding a settlement period of up to 2 days) should be reported in this section. Foreign currencies should be interpreted to include gold, silver, platinum and palladium. Report the amount arising from cross currency swaps, cross currency interest rate swaps, outright forward foreign exchange contracts, currency futures, currency options purchased, equity futures, equity swaps, equity options purchased, commodity futures, commodity swaps, commodity options purchased and similar instruments.

9.3 Interest rate contracts

Report the amount arising from single currency interest rate swaps, basis swaps, forward rate agreements and products with similar characteristics, interest rate futures (including bond futures and options purchased), interest rate options purchased, synthetic agreements for forward exchange (SAFE), exchange rate agreements (ERA), forward exchange agreements (FXA) and similar instruments.

For forward foreign exchange agreements, if the notional principal amounts, between the front and back legs, differs by more than 10%, then the lower amount should be reported as the notional principal for the interest rate treatment and the difference will attract exchange rate add-ons.

9.1 & 9.3 Notional principal

For exchange rate contracts, the notional principal should be taken as the contract amount or the underlying principal amount of the contract. As regards the notional currency being received by the reporting institution, this should be translated into sterling at the spot exchange rate on the reporting date (see SGN34 for more detail generally).

Refer to SGN34 for guidance on remaining maturity.

9.2 & 9.4 Credit Equivalent

Reporting institutions should complete these lines using either the replacement cost or original exposure method. In general, where a reporting institution actively trades these instruments or where such instruments form a significant part of its treasury operation, the replacement cost method should be used. The original exposure method should only be used where the institution does not actively trade and with written agreement from the FSA. Reporting institutions should indicate the method used in the boxes provided.

Further guidance is included in Appendix 1 (replacement cost method) and SGN36 (original exposure method).

MEMORANDUM ITEMS

Provisions against bad and doubtful debts

10.1 Previous balance

Show the balance outstanding on the specific and general provisions account at the end of the previous accounting year relating to debts considered bad or doubtful. Do not include provisions made against the value of investments. **The date to which the balance refers should be shown in the space provided.**

10.2 Adjustments for exchange rate movements

Enter any adjustments made for exchange rate movements in respect of provisions denominated in currencies other than sterling. Where the adjustment is negative, report the amount in brackets.

10.3 Charge/credit to profit and loss account

Enter the net charge or credit to the profit and loss account in respect of provisions; this should equal item 4.1. A net credit should be shown in brackets. The gross charge for new provisions should be offset by other items, including any provisions made in earlier years but now released in the current year's profit and loss account. The charge or credit for specific provisions should not include the charge or credit for provisions in respect of suspended interest (unless it is the practice of the reporting institution to show suspended interest as interest receivable in the P&L account).

10.4 Amounts written off

Enter the gross amount written off (before recoveries, which should be reported in item 10.5).

10.5 Recoveries of amounts previously written off

Enter the total amount of loans recovered which have previously been written-off.

10.6 Other

Enter any other items, including exceptional provisions and transfers between general and specific provisions.

10.7 Current balance

The current balance should be the sum of items 10.1 to 10.6.

LARGE EXPOSURES

11 Twenty largest exposures to banks and building societies

List in descending order of magnitude (ie the largest exposure first) the twenty largest credit exposures to banks and building societies. The listing should commence on line 11A. Each large exposure should only be reported once, at the top level. The total of each column of the large exposures should be entered on the first line.

For the definitions of exposures and counterparties which should be used (see SGN9 to SGN13), for banks, see SGN20 (excluding investment firms).

Exposures of up to and including **1 year remaining maturity at the reporting date should be reported in column 4.**

For interest rate and foreign exchange rate contracts, the amounts at risk should be reported as the "credit equivalent amount" using the same basis of valuation as in item 9.

12 Twenty largest exposures to other counterparties

List in descending order of magnitude (ie the largest exposure first) the twenty largest credit exposures to counterparties other than those covered in item 11 (both UK and overseas). Include the non-bank private sector, central banks, international organisations (including regional development banks and the Bank for International Settlements (BIS)), and the UK and overseas public sectors. The listing should commence on line 12A. Each large exposure should only be reported once, at the top level. The total of each column of the large exposures should be entered on the first line.

See SGN9 to SGN13, SGN18, SGN20 to SGN23.

Exposures of up to and including **1 year remaining maturity at the reporting date should be reported in column 4.**

For interest rate and foreign exchange rate contracts, the amounts at risk should be reported as the "credit equivalent amount" using the same basis of valuation as in item 9.

Exposures should be valued in accordance with the Supervisory Guidance Notes, except that, in the circumstances below, the exposure should be measured as less than the nominal exposure. In reporting large exposures, credit balances should not be offset against debit balances unless consistent with Chapter NE (Collateral and netting) of the FSA Banking Supervisory Policy Guide or the Interim Prudential Sourcebook for Banks, whichever is current at the reporting date.

Underwriting commitments

The exposure arising from underwriting commitments should be taken as the full amount of the sum underwritten, less amounts of the issue which the reporting bank has sub-underwritten with, or sold to, another counterparty.

APPENDIX 1 - REPLACEMENT COST METHOD

Reporting institutions should mark-to-market in a prudent and consistent manner. Institutions should develop their own methodology for calculating market values, details of which should be made available to the FSA on request; the following guidelines should however be observed.

For swaps, forward rate agreements and products with similar characteristics, outright forward foreign exchange contracts and futures, the mark-to-market approach should be based on an estimation of the net present value of the future cash flows of the contract, using interest rates based on current market rates and relevant to periods in which the cash-flows will arise (commonly for example, the rates from a derived yield curve for zero-coupon government bonds).

For options purchased, the mark-to-market approach should be based on a value of the option reflecting, inter alia, the amount by which the option is "in the money" (ie the amount, if any, by which the rate at which the option can be exercised is more favourable than the current market rate when applied to the notional principal underlying the option), the time to expiry of the option, the volatility of the underlying exchange or interest rate, and (for currency options) the interest rate differential between the two currencies. Typically such valuations will be based on mathematically complex formulae, and will value the option at an amount above its "in the money" value. Reporting institutions whose involvement in options is limited and who have not developed suitable methodology may value options at their "in the money" value. The written consent of the FSA should be obtained to valuing options in this way.

Credit equivalent amount

In order to calculate the credit equivalent amount of these instruments, a bank should add together:

- (a) the total replacement cost (obtained by marking to market) of all its contracts with a positive value; and
- (b) an amount for potential future credit exposure which reflects the residual maturity of the contract, calculated as a percentage of notional principal amount according to the following matrix.

Residual maturity	Interest rate contracts	Exchange rate contracts
One year or less	Nil	1.0%
Over one year	0.5%	5.0%

Institutions should record a potential future credit exposure in respect of all OTC derivative contracts that might in the future have a positive mark-to-market value. Thus for a given contract, an amount may arise under (b) even if no amount arises under (a).

No potential exposure should be calculated for single currency interest rate basis swaps; the credit equivalent amount on these contracts should be evaluated solely on the basis of mark-to-market value.

**FORM B7
ANALYSIS OF PROFITS, LARGE EXPOSURES AND CERTAIN OTHER MISCELLANEOUS
INFORMATION**

INTERNAL VALIDATIONS

Ref no	B7 item numbers	
1	1	= 1.1 + 1.2 + 1.3 + 1.4 + 1.5 + 1.6
2	2	= 2.1 + 2.2 + 2.3 + 2.4 + 2.5 + 2.6 + 2.7
3	3	= 1 – 2
4	4	= 4.1 + 4.2 + 4.3 + 4.4
5	5	= 3 – 4 or 1 – 2 – 4
6	6	= B6.1 + B6.2 + B6.3 + B6.4 + B6.5 + B6.6 + B6.7 + B6.8 + B6.9
7	7	= 7.1 + 7.2 + 7.3 + 7.4
8		Superseded by validation 38, SRN/2001/1
9	S10.7	= S10.1 + S10.2 + S10.3 + S10.4 + S10.5 + S10.6
10	G10.7	= B10.1 + B10.2 + B10.3 + B10.4 + B10.5 + B10.6
11	T10.7	= T10.1 + T10.2 + T10.3 + T10.4 + T10.5 + T10.6
12	T10.1	= S10.1 + G10.1
13	T10.2	= S10.2 + G10.2
14	T10.3	= S10.3 + G10.3
15	T10.4	= S10.4 + G10.4
16	T10.5	= S10.5 + G10.5
17	T10.6	= S10.6 + G10.6
18	T10.7	= S10.7 + G10.7
19	T10.3	= 4.1
20		Superseded by validation 39, SRN/2001/1
21		Superseded by validation 40, SRN/2001/1
22		Superseded by validation 41, SRN/2001/1
23		Superseded by validation 42, SRN/2001/1
24		Superseded by validation 43, SRN/2001/1
25		Superseded by validation 44, SRN/2001/1
26		Superseded by validation 45, SRN/2001/1
27		Superseded by validation 46, SRN/2001/1
28	11LE1	= 11LE1A + 11LE1B + 11LE1C + 11LE1D + 11LE1E + 11LE1F + 11LE1G + 11LE1H + 11LE1J + 11LE1K + 11LE1L + 11LE1M + 11LE1N + 11LE1P + 11LE1Q + 11LE1R + 11LE1S + 11LE1T + 11LE1U + 11LE1V
29	11LE2	= 11LE2A + 11LE2B + 11LE2C + 11LE2D + 11LE2E + 11LE2F + 11LE2G + 11LE2H + 11LE2J + 11LE2K + 11LE2L + 11LE2M + 11LE2N + 11LE2P + 11LE2Q + 11LE2R + 11LE2S + 11LE2T + 11LE2U + 11LE2V

30	11LE3	=	11LE3A + 11LE3B + 11LE3C + 11LE3D + 11LE3E + 11LE3F + 11LE3G + 11LE3H + 11LE3J + 11LE3K + 11LE3L + 11LE3M + 11LE3N + 11LE3P + 11LE3Q + 11LE3R + 11LE3S + 11LE3T + 11LE3U + 11LE3V
31	11LE4	=	11LE4A + 11LE4B + 11LE4C + 11LE4D + 11LE4E + 11LE4F + 11LE4G + 11LE4H + 11LE4J + 11LE4K + 11LE4L + 11LE4M + 11LE4N + 11LE4P + 11LE4Q + 11LE4R + 11LE4S + 11LE4T + 11LE4U + 11LE4V
32	11LE5	=	11LE5A + 11LE5B + 11LE5C + 11LE5D + 11LE5E + 11LE5F + 11LE5G + 11LE5H + 11LE5J + 11LE5K + 11LE5L + 11LE5M + 11LE5N + 11LE5P + 11LE5Q + 11LE5R + 11LE5S + 11LE5T + 11LE5U + 11LE5V
33	12LE1	=	12LE1A + 12LE1B + 12LE1C + 12LE1D + 12LE1E + 12LE1F + 12LE1G + 12LE1H + 12LE1J + 12LE1K + 12LE1L + 12LE1M + 12LE1N + 12LE1P + 12LE1Q + 12LE1R + 12LE1S + 12LE1T + 12LE1U + 12LE1V
34	12LE2	=	12LE2A + 12LE2B + 12LE2C + 12LE2D + 12LE2E + 12LE2F + 12LE2G + 12LE2H + 12LE2J + 12LE2K + 12LE2L + 12LE2M + 12LE2N + 12LE2P + 12LE2Q + 12LE2R + 12LE2S + 12LE2T + 12LE2U + 12LE2V
35	12LE3	=	12LE3A + 12LE3B + 12LE3C + 12LE3D + 12LE3E + 12LE3F + 12LE3G + 12LE3H + 12LE3J + 12LE3K + 12LE3L + 12LE3M + 12LE3N + 12LE3P + 12LE3Q + 12LE3R + 12LE3S + 12LE3T + 12LE3U + 12LE3V
36	12LE4	=	12LE4A + 12LE4B + 12LE4C + 12LE4D + 12LE4E + 12LE4F + 12LE4G + 12LE4H + 12LE4J + 12LE4K + 12LE4L + 12LE4M + 12LE4N + 12LE4P + 12LE4Q + 12LE4R + 12LE4S + 12LE4T + 12LE4U + 12LE4V
37	12LE5	=	12LE5A + 12LE5B + 12LE5C + 12LE5D + 12LE5E + 12LE5F + 12LE5G + 12LE5H + 12LE5J + 12LE5K + 12LE5L + 12LE5M + 12LE5N + 12LE5P + 12LE5Q + 12LE5R + 12LE5S + 12LE5T + 12LE5U + 12LE5V
38	8	=	8.1 + 8.2 + 8.3 + 8.4 + 8.5 (Replaces validation 8, SRN/2001/1)
39	1.6A	≤	1.6 (Replaces validation 20, SRN/2001/1)
40	1.6B	≤	1.6 (Replaces validation 21, SRN/2001/1)
41	1.6C	≤	1.6 (Replaces validation 22, SRN/2001/1)
42	1.6	≥	1.6A + 1.6B + 1.6C (Replaces validation 23, SRN/2001/1)
43	2.7A	≤	2.7 (Replaces validation 24, SRN/2001/1)
44	2.7B	≤	2.7 (Replaces validation 25, SRN/2001/1)
45	2.7C	≤	2.7 (Replaces validation 26, SRN/2001/1)
46	2.7	≥	2.7A + 2.7B + 2.7C (Replaces validation 27, SRN/2001/1)
47	FSA	>	0 (Introduced SRN/2001/2, effective December 2001)

BSD3 REPORTING INSTRUCTIONS

These instructions should be read in conjunction with the Supervisory Guidance Notes as necessary. For convenience, these reporting instructions will refer to the Supervisory Guidance Notes as 'SGN', the FSA Banking Supervisory Policy Guide as 'FSA Policy Guide', and the Interim Prudential Sourcebook for Banks as 'IPRU (BANK)'.

A1 Currency of completion

The form should be completed in Sterling until further notice. This box has been included in preparation of possible future entry to EMU by the UK.

SECTION A: BANKING BOOK

ASSETS

A10 Cash

Notes and coin, including holdings of notes issued by the appropriate authority which are required to be held as backing for the reporting institution's own issue of bank notes. (Gold coin should be reported in item A20 unless there is difficulty in separately identifying such holdings.)

A20 Gold bullion and coin

Physical holdings of gold bullion and gold coin beneficially owned by the reporting institution, including that held on an allocated basis by other institutions. Gold held as custodian for others should not be reported. Short positions in gold should not be reported here but reported with liabilities in this return.

The treatment of other precious metals (silver, platinum and palladium) should be discussed with the Financial Services Authority (FSA). (See also item A260.)

A30 Cash items in the course of collection

The total amount of cheques, etc drawn on and in the course of collection on other banks, and debit items in transit between domestic offices of the reporting institution in each country. Report cheques that have been credited to customer's accounts but are held overnight before being presented or paid into the reporting institution's account with another institution.

A40 Items in suspense

All debit balances not in customers' names but relating to customers' funds, eg debit balances awaiting transfer to customers' account rather than the reporting institution's own internal funds. Also report funds of the reporting institution lodged with applications for new issues, even if the funds may be returnable, and items in the course of settlement (amounts receivable in respect of transactions not due until a future settlement date, where the asset is to be reported on a contract date basis).

Items in the course of settlement resulting from securities transactions should be treated as follows:

- (a) Sales of securities from the banking book where delivery will only take place against receipt of cash (“cash against documents”):
- (i) amounts receivable where the transactions have not reached settlement date should be reported in the 0% band;
 - (ii) amounts receivable where the transactions are up to and including 4 days past due settlement date should be reported in the 0% band;
 - (iii) when an unsettled transaction is more than 4 days past the due settlement date, a capital requirement should be calculated based on either the potential loss on the deal, defined as the difference between the amount due and the current market value of the security being settled (column one below) or the agreed settlement price (column two below). That capital requirement should be entered in item A40.5 and be weighted at 100%. The difference between the capital requirement and the total amount receivable should continue to be weighted at 0%.

Number of Working Days past due settlement date	Column One Percentage of Potential Loss	Column Two Percentage of Agreed Settlement Price
0 - 4	Nil	Nil
5 -15	8%	0.5%
16-30	50%	4.0%
31-45	75%	9.0%
46 or more	100%	100% of Potential Loss (as Column 1)

- (b) Transactions in tradeable securities involving the delivery of the securities (cash), when the cash (securities) are not received at the same time (“free delivery”):-
- (i) if settlement of the transaction is effected across a national border, amounts receivable up to and including one business day after the securities (cash) have been delivered without the cash (securities) being received in return should be reported in the 0% band;
 - (ii) all unsettled transactions more than one day past the due settlement date should be weighted according to the counterparty of the transaction.
- (c) Settlement risk arising from trading securities in the Trading Book should be reported in the Trading Book column of item A40. The capital requirement should also be reported in item B10 (Free Deliveries) or item B50 (Unsettled Transactions).

In the case of rolling settlement dates the due settlement date should be interpreted as the first settlement date, ie the settlement date before the settlement date is rolled over.

A50-A110 LOANS, ADVANCES AND BILLS HELD

Funds lent to or placed with customers/counterparties including :

- (a) the book value of assets leased out under finance lease agreements net of deferred tax provided, but legally owned by the reporting institution;
- (b) holdings of certificates of deposit (other than those issued by the reporting institution) and negotiable deposits made on terms identical to those on which a certificate of deposit would have been issued, but for which it has been mutually convenient not to have issued a certificate (these items should be reported on a contract date basis);
- (c) loans made under conditional sale agreements and hire purchase contracts;
- (d) acceptances discounted;
- (e) advances purchased by or assigned to the reporting institution under a transferable loan facility, purchase and resale agreements, factoring, or similar arrangement;
- (f) initial margin payments with futures markets. These are effectively exposures to a recognised exchange and will therefore attract a weight of 20% (unless the exchange is not recognised for this purpose, see Chapter BC (Credit Risk In The Banking Book), Section 5, of the FSA Policy Guide/IPRU (BANK), as relevant, in which case a weight of 100% will apply).

Exclude unearned finance charges.

Bills, etc

Enter at book value bills, promissory notes and other negotiable paper owned (including à forfait paper). These items (including those bills eligible for rediscount at the Bank of England and other central banks) should be reported in the categories below according to the drawee; the weighting for accepting bills, however, should be determined according to the acceptor.

Accruals

Wherever possible, accruals should be reported against the relevant category of counterparty (see SGN7).

Export credit

Report in the 0% band of the relevant counterparty category all medium and long-term lending (ie with an original maturity of two years and over) covered by an unconditional ECGD bank guarantee (Supplier Credit Finance Facility, Buyer Credit, ECGD guaranteed Lines of Credit and any outstanding lending under the, now discontinued, Specific Bank Guarantee, Comprehensive Extended Terms Bank Guarantee and all lending supported by a FINCOBE endorsement of by an irrevocable letter of credit, confirmed by a bank, which, in turn, has obtained an ECGD guarantee on its confirmation).

Only the part of the loan fully and unconditionally guaranteed by ECGD should be reported in the 0% band (that part of the loan not guaranteed by ECGD should be reported in other weighting bands as appropriate).

The reporting institution should report in the 0% band its own participation in syndicated loans made under ECGD bank guarantee, even if it does not itself hold the guarantee.

The following should not be reported in the 0% band:

- (a) lending under ECGD bank guarantees where the cover is conditional in that it is restricted to certain political risks (eg confiscation cover or, cover under option 1 or 2 of the Project Financing Scheme);
- (b) outstanding lending supported by an ABE endorsement under the (now discontinued) ECGD Comprehensive Extended Terms Guarantee;
- (c) loans made against assignments of rights by exporters to the reporting institution under ordinary ECGD policies; and
- (d) loans made against the security of ECGD insurance cover.

Lending under equivalent schemes operated by other Zone A countries, and Zone B countries where denominated in local currency and funded in that currency, should be reported in the 0% band to the extent of the cover. Reporting institutions should agree with the FSA which schemes may be regarded as "equivalent" and merit a 0% weighting.

Where lower risk weights have been applied as a result of export credit guarantees, an entry should be made in Appendix A-III.

Factoring

Report the total amount of debts assigned to the reporting institution under factoring or other similar arrangements as an exposure to the debtor.

Where the debt is assigned to the reporting institution with no recourse the debt should be weighted as a claim on the debtor.

Where the debt is assigned to the reporting institution for no consideration and on a recourse basis the debt should be weighted at 0%.

Where the debt is assigned to the reporting institution for a consideration and on a recourse basis the amount of the consideration should be weighted as a claim on the debtor and the remaining portion should be weighted at 0%.

Where a guarantee has been given eg from the assignor's parent, the risk weighting of the guarantor may be applied.

A50 Central governments and central banks

Deposits placed with, and loans made to central governments and central banks, including funds which the reporting institution is required to place on deposit with central banks and monetary authorities. Include in the 10% weighting band Treasury bills and any other bills (by definition with one year or less original maturity) issued by central governments and central banks.

Include similar claims on the European Commission, the European Economic Community (EEC), the European Coal and Steel Community (ECSC) and Euratom.

Do not report balances with international organisations such as the Council of Europe, the United Nations or European Space Agency in this item; they should be reported in item A100 in the 100% band.

A60 Lending to group companies

Claims on those group companies which are not required to be consolidated for the purposes of this return should be recorded. Only claims on group companies which meet the conditions set out in Chapter CS (Consolidated supervision), Section 3, Paragraph 2(b), of the FSA Policy Guide/IPRU (BANK) should be reported in the 0% band. Those claims which are eligible for inclusion in the 0% band should first be agreed with the FSA.

For the unconsolidated return, include lending to subsidiaries and associates included in the consolidated RAR and those that would be included were it not for the fact they are supervised by another UK regulator until the Financial Services and Markets Act 2000 is in force.

A70 Banks and investment firms (including building societies & MDBs).

For the definition of banks, investment firms and multilateral development banks (MDBs), see SGN20 and SGN Appendix E.

A80 Public sector entities

For the definition of public sector entities, see SGN23.

A90 Loans secured by mortgage(s) on residential property

Report loans to individuals secured by mortgage on residential properties (both freehold and leasehold) which are or will be occupied by the borrower, or which are rented, where such loans are fully secured by a first priority charge. If any part of the property is used for non-residential purposes, the mortgage loan should not be reported here but should be reported in item A100. However, mortgage loans secured on property where the occupier works at home but no structural alterations are required to return the property to full residential use may be reported here.

Report mortgage loans to housing associations* registered with the Housing Corporation, Scottish Homes and Tai Cymru (Housing for Wales), and to housing companies that are registered with Scottish Homes, which are fully secured by a first priority charge on housing association/company residential property which is rented.

Report loans to the Housing Finance Corporation which are secured by a first priority charge over its assets.

Report mortgage sub-participations which are fully and specifically secured against residential mortgage loans which are eligible for a 50% weight.

For the purposes of this item the following definitions apply:

* Also called 'residential social landlords'.

“Fully secured” means that the value of the property is greater than or equal to the value of the loan (ie a maximum loan to value ratio of 100%). Whilst there is no requirement for reporting institutions to revalue properties on a regular basis, where such valuation has been made and it is found that the loan to value ratio exceeds 100%, such loans should be weighted at 100% (and reported in item A100). (However, if the shortfall in the security value is fully covered by a specific provision, the net amount of the exposure may continue to be weighted at 50%). Conversely, where revaluation indicates that the loan to value ratio has fallen to 100% or less, the loan may be weighted at 50% and reported in item A90.

“First priority charge” means a first fixed (legal or equitable) charge or a first floating charge. In the case of the latter, reporting institutions should ensure (by, for example, including a negative pledge to this effect in the documentation) that no prior ranking charges can be taken over the assets concerned.

The above treatment may also be applied to loans to special purpose mortgage finance vehicles which include covenants restricting the vehicles’ activities to mortgage business and which provide for the loan to be repaid on demand should the covenants be breached and which also meet the criteria to be met by mortgage backed securities qualifying for a 50% risk weighting set out in item A150.

A100 Other loans, advances and bills held

Report here exposures to counterparties not already included above, including exposures to recognised clearing houses and exchanges.

The Council of Europe, United Nations and its agencies (other than the World Bank and International Finance Corporation - see SGN Appendix E), European Space Agency and Eurofima should be included here rather than under item A50. Report balances with Euroclear and Cedel in the 20% band.

A120-A190 INVESTMENTS

Report securities, together with any associated accrued interest, with an original maturity of over one year such as equities, eurobonds and FRNs (instruments with an original maturity of one year or less should be reported in items A50-A110). All securities (including British Government stocks) should be reported on a contract day basis, with the payments due or receivable in respect of such transactions to be shown gross in items A760 and A40. Only long positions in securities should be reported in this section of the return (see SGN27). Where it is not possible to identify separately interest accruals they should be reported in item A260 in the appropriate risk weighting band.

Enter in items A130, A140, A150, A170 and A180 securities guaranteed by central governments or central banks meeting the conditions for guarantees (see SGN28) at either 10% or 20% depending on whether the residual maturity of the security is one year or less or over one year respectively. If the guarantor is a Zone B central government or central bank, the security must be in the local currency of the issuer and guarantor.

A120 Central governments and central banks

Holdings of securities and debt instruments (other than bills - see item A50) issued by central governments and central banks. Include such instruments issued by the European Commission, the European Coal and Steel Community and Euratom.

Only holdings of certificates of tax deposit should be reported in the 0% band together with interest accruals on holdings of securities and debt instruments where the issuer is a Zone A central government or central bank or where the issuer is a Zone B central bank or government and the security is in the local currency of the issuer. For the determination of the appropriate weight band for other securities held, see SGN15. Where it is not possible to identify separately interest accruals they should be reported in item A260 in the appropriate risk weighting bands.

Report both the gross long position and net long position (ie the gross long position minus the gross short position - item A120 less item A710) in such securities (see SGN27). The total (item A120) should be the sum of the gross long positions. If there are no short positions relevant to a particular band, the net long position box should nevertheless be completed showing an amount equal to the gross long position.

See SGN27 for the treatment of short positions in these securities taken on behalf of the reporting institution by related Gilt Edged Market Makers.

A130 Public sector entities

For the definition of public sector entities, see SGN23.

A140 Banks (unsubordinated FRNs etc)

Unsubordinated FRNs and similar types of non-capital debt instruments issued by banks and investment firms (for definition, see SGN20) with an original maturity of over one year. In the case of securities issued by Zone B banks, the weighting applied should be 20% if the residual maturity is one year or less and 100% if over one year.

Holdings of subordinated debt issued by Multilateral Development Banks (as listed in SGN Appendix E) attract a risk weighting of 100%.

A150 Mortgage backed securities

Only holdings of US GNMA securities with a floating rate, or with a fixed rate if the residual maturity is one year or less, should be reported in item A150.1. Fixed rate GNMA securities with a residual maturity of over one year together with FHLMC and FNMA mortgage backed securities should be reported in item A150.2.

Stripped bonds should be reported in the 100% risk weight category regardless of counterparty.

Report in item A150.3 holdings of securities issued by special mortgage finance vehicles which meet the following conditions (also set out in Chapter BC (Credit risk in the banking book), Section 3, Paragraph 7d, of the FSA Policy Guide/IPRU (BANK)). Holdings of securities which do not meet these conditions should be reported in item A150.4.

- (i) they are fully secured against residential mortgages which meet the conditions set out in item A90, with a first priority charge;
- (ii) the vehicle's activities are restricted by its articles of association to mortgage business. The vehicle may also hold assets qualifying for a risk weighting of 50% or less;
- (iii) the mortgage loans must not be in default at the time at which they are transferred to the vehicle;

- (iv) the notes embody an express promise to repay the bearer;
- (v) the issue documentation contains provisions which would ultimately enable noteholders to initiate legal proceedings directly against the issuer of the mortgage backed security. As an example such provisions would allow noteholders to proceed against the issuer where the trustee, having become bound to take steps and/or to proceed against the issuer, fails to do so within a reasonable time and such failing is continuing;
- (vi) the documentation contains provisions which would ultimately enable noteholders to acquire the legal title to the security (ie the mortgagee's interest in it) and to realise the security in the event of a default by the mortgagor.

Report in item A150.4 notes:

- (i) issued by those companies whose business is not limited as specified above by their articles of association; and/or
- (ii) which absorb more than their pro rata share of losses in the event of arrears or default, eg junior notes, and/or
- (iii) where the security agreement does not provide that noteholders remain fully secured at all times; and/or
- (iv) where mortgage loans backing the securities were in default at the time when they were transferred to the vehicle.

A160 Investments in subsidiaries and associated companies

In determining which entities count as subsidiaries and associated companies, the same accounting treatment should be adopted as that used in the preparation of statutory accounts.

Investments that have a negative value should not be offset against those with a positive value. Investments that have a negative value should instead be reported in item A260.1 until they again have a positive value.

Where the 'embedded value' method is used to value investments in life assurance subsidiaries and associates, the value using this method should be reported here.

When completing this return on a consolidated basis, investments in subsidiary and associated companies should not be included when those companies are included in the consolidation.

A170 Investments in bank and financial firm capital

All items reported here should be shown at full book value, with no reduction for any amortisation which the issuer may be applying in calculating its own capital base. Any amounts shown in respect of net underwriting commitments should be shown at book value and not reduced to take account of any scaling factors which may have been agreed by the FSA; this may result in a difference between the figures shown here and those on the Form M1. Banks which have agreed a trading book or other concession with the FSA **should complete the Form M1.**

Report here

- (i) all long, physical positions in instruments which are included in the capital of the issuing credit or financial institution (including such instruments sold under sale and repurchase or similar agreements, instruments carrying third party guarantees (including central government guarantees), American depository receipts, and net commitments to underwrite new issues of such instruments (from working day zero);
- (ii) all indirect holdings of credit or financial institution's capital taken via instruments issued by their holding companies or vehicles whose business is exclusively or mainly to hold or repackage credit and/or financial institutions' capital instruments. (The FSA may however agree that it is appropriate not to include these where the instruments are fully protected from any risk on the underlying capital instruments);
- (iii) equity holdings in investment trusts, and holdings of units in unit trusts, mutual funds or other investment vehicle established exclusively or mainly to hold credit or financial institutions' capital instruments;
- (iv) any other holdings of instruments of a capital nature relating to credit or financial institutions.

A credit institution is an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account. The term financial institution for the purposes of this item should be taken to include all directly regulated or supervised institutions or financial holding companies whose exclusive or main business is to carry out one or more of activities listed in points 2-12 in Annex I to the Banking Consolidation Directive (2000/12/EC). These activities are outlined in Chapter CA (Definition of capital), Section 10, of the FSA Policy Guide/IPRU (BANK). Long and short positions in any of the above may be netted only where they are in identical instruments.

Banks need not report here

- (i) short positions in capital instruments; or
- (ii) exposures to capital instruments taken through forward purchases, futures, options and other derivative instruments.

Where banks are unsure what instruments it is appropriate to deduct they should refer to their line supervisor.

Unless the conditions set out in Section 10.3 of Chapter CA (Definition of capital) of the FSA Policy Guide/IPRU (BANK) apply, all holdings of bank and financial institution capital instruments held in the Banking Book should be reported in item A171 as deductible. Banks which do not have a Trading Book concession should also report all holdings of bank and financial institution capital instruments in the Trading Book as deductible in item A171. Banks should ordinarily record the book value of their holdings. However, where banks are underwriting the capital instruments of banks and financial institutions they may apply the relevant scaling factors listed in Chapter TU (Underwriting in the capital adequacy framework), Section 3, Paragraphs 8-10, of the FSA Policy Guide/IPRU (BANK).

The value of items falling within the Trading Book concession as reported on Form M1 should be entered in item A172. It may be appropriate to risk weight other holdings. The reporting institution should obtain the FSA's agreement before including such other holdings.

Where scaling factors have been applied to capital instruments reported in A171, the sum of A171 and A172 will not necessarily equal to the amount reported in item A170.

A180 Qualifying holdings / other investments

Report here any qualifying holdings in commercial companies which are not reported as subsidiaries or associates. A reporting institution's holding constitutes a 'qualifying holding' if it is a direct or indirect holding in an undertaking which represents 10% or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the undertaking in which the holding subsists.

Banks may not include positions where

- the shares held are not financial fixed assets;
- the FSA has agreed that non-deduction is appropriate in cases where the shares are held temporarily during a financial reconstruction or rescue operation;
- the shares are held during the normal course of underwriting;
- the shares are held in the bank's name on behalf of others; or
- the shares are held in exceptional circumstances. Banks should obtain the FSA's agreement to non-deduction in such cases. The FSA is only likely to agree non deduction is appropriate where the bank has increased its capital or taken other equivalent measures, or has agreed to do so.

All banks which have qualifying holdings **should complete the Form M1**. Any qualifying holding which is in excess of the thresholds indicated on form M1 should be reported as deductible. The deductible amount reported in item A180.4 should equal the deductible holdings reported on Form M1. Non-deductible holdings should be reported in items A180.1 to A180.3.

Other Investments in counterparties not already included in items above (ie items 120 to 170) and are not qualifying holdings as defined in above should be reported in A180 and in items A180.1 to A180.3 as appropriate.

A200-A260 OTHER ASSETS

A210 Other intangible assets

Only report in item A210.1 mortgage servicing rights where there is an active and liquid market in which they can be traded. At present, this condition is only met in respect of mortgage servicing rights traded in the US market. (Valuation of these items should be discussed with the FSA.)

A220 & A230 Own premises and other property/real estate

Own premises should include the value in its books of property occupied or being developed for occupation by the reporting institution. Also report in item A220 property which is occupied or is for the purpose of occupation by employees of the reporting institution. Other property and real estate beneficially owned by the reporting institution but not occupied or used in the operation of its business should be reported in item A230.

A240 Operating leases

Report equipment owned by the reporting institution which has been leased out under an operating lease. Report any contracted future rental payments (net of future finance charges) weighted according to the lease; the residual value of the asset should be reported in the 100% weighting band.

A250 Plant, equipment and other fixed assets

This should include plant and equipment owned or recorded as such by the reporting institution and used in connection with its own business. Equipment leased out under operating leases should not be reported here but in item A240. Equipment leased out under finance leases should be reported in items A50 to A110.

Where the reporting institution is the lessee under a finance lease, or a hirer under a hire purchase contract, the asset should be recorded in the 100% band. If the reporting institution is acting as a broker or agent for a sub-lease or back-to-back lease, the asset should not be reported on the balance sheet provided that there is no recourse to the reporting institution in the event of a default (see Chapter SE (Securitisation and asset transfers) of the FSA Policy Guide/IPRU (BANK)).

A260 Other assets

Report any other assets not reported elsewhere, eg sundry debtors, prepayments and accruals not identified elsewhere (see SGN7). Also include investments in subsidiaries and associated companies where the value of these investments is currently negative (investments with a positive value should be reported in A160).

Overall net positive mark-to-market valuations of interest rate, foreign exchange, equity, commodity and precious metals related contracts in the Banking Book should be weighted at 0% here - see items A472, A474, A452. Overall net negative mark-to-market values should be included under item A760.2. Assets relating to premia paid out on interest rate and foreign exchange options contracts bought on exchanges and subject to daily margining requirements should be reported under item A260.1. Also include in A260.1 negative investments in subsidiaries and associated companies.

In appropriate cases, physical positions in respect of commodities may be reported here. Reporting institutions should agree such cases with the FSA before reporting on this basis. Physical positions should be weighted at 100%. Positions in different commodities should not be netted.

Deferred tax assets should be included in item A260.4.

A265 Assets consolidated via Aggregation Plus

When completing this return on a consolidated basis, which includes subsidiaries consolidated via aggregation plus (rather than on a line by line basis), the total assets of the subsidiaries consolidated in this manner should be reported in this box. Intra-group assets should be excluded.

A280-A330 MEMORANDUM ITEMS

A280 Connected lending of a capital nature

Report all connected lending of a capital nature and indicate, in the lines provided, in which weight band on the assets section of this return the lending has been reported. Also report both long term subordinated loans and one-off payments by the reporting institution to vehicles established for loan packaging schemes, where the reporting institution is the servicing agent (see Chapter SE (Securitisation and asset transfers) of the FSA Policy Guide/IPRU (BANK)). For the definition of a connected counterparty see SGN13.

Do not report loans to subsidiaries and associated companies where the loan has already been reported in item A160.

Any items included here should be excluded from total risk assets in the appropriate risk weight band in Section B (see note to item B330). If doubt exists as to the inclusion of an asset in this item refer to the FSA for guidance.

A290 Loans to directors, controllers and their associates

Directors, controllers, and their associates are as defined in sections 417, 178/180, and 422 of the Financial Services and Markets Act 2000 respectively (and in Section 105 of the Banking Act 1987 as amended by The Banking Co-ordination (Second Council Directive) Regulations 1992). Loans to employees of a reporting institution's parent undertaking should also be included here. Indicate, in the lines provided, in which weight band on the assets of this return the lending has been reported.

If a loan reported here is of a capital nature, it should be included additionally in item A280.

A300 Loans to non-group companies with which directors and controllers are associated

For the purposes of this item (refer to SGN12 and 13), include as a director/controller any employee of the reporting institution who is appointed by the reporting institution to be a director of another company.

Any employee of the reporting institution is deemed to be associated with another company, whether the company is registered or domiciled in the UK or overseas, if any of the conditions set out in SGN14 are met:

The definition should be consistent with that adopted for reporting on Form LE2.

Indicate, in the lines provided, in which weight band on the assets section of this return the lending has been reported.

If a loan reported here is of a capital nature, it should be included additionally in item A280.

A310 Direct credit substitutes give on behalf of connected counterparties.

For the definition of connected counterparties, see SGN13. Indicate, in the lines provided, in which weight band within item A340 the direct credit substitute has been reported.

A320 Investments in central governments and central banks (net short positions)

Report net short positions in central government and central bank securities. This should equal item A710.1 after allowing for any long positions in the same securities (see SGN27).

See SGN27 for the treatment of short positions in these securities taken on behalf of the reporting institution by related Gilt Edged Market Makers.

All positions after weighting shown here should be reported with a positive sign.

A330 Encumbered assets

List in these lines any assets not freely available to meet the claims of the generality of creditors in a liquidation of the reporting institution because they are subject to charge, pledge or other restriction.

Under item A330.1, list the assets and the item number (indicating whether in the Banking Book or Trading Book) within the return to which they refer, which have been given as security in connection with the reporting institution's participation in a payments/settlements system such as CREST or Euroclear. The particular payments/settlements system should be listed with the liabilities being secured at the reporting date recorded under column 1. For the purposes of detailing the total amount of assets securing liabilities, assets pledged in excess of the actual liability to individual systems at the reporting date should not be reported.

Under item A330.2, list the assets and the item number on the return to which they refer, which have been given as security to secure the reporting institution's other liabilities (for example, property which has been mortgaged and hire purchase agreements pledged as collateral). Assets reported should exclude any element of unearned finance charges.

Total liabilities being secured at the reporting date (item A330, column 1) should equal the sum of items A330.1 and A330.2 below. Total assets at the reporting date securing liabilities reported in column 1 (item A330, column 2) will not necessarily equal the sum of items A330.1 and A330.2 below as any asset which is securing more than one creditor should not be double counted in the total.

A335 Deduction plus subsidiaries

When completing this return on a consolidated basis, which includes subsidiaries consolidated via deduction plus, the total assets of the subsidiaries consolidated in this manner should be reported in this box.

OFF BALANCE SHEET

For off-balance items A340 to A440, the principal amount should be shown.

The credit equivalent amount for off-balance sheet items is derived by first multiplying the nominal/principal amount by the given credit conversion factor. The weighted amount column is then derived by multiplying the resultant credit equivalent amount by the appropriate risk weight or by deducting it from the reporting institution's capital base (see SGN15).

Intra group off-balance sheet items should be reported under the relevant item and weighted according to the terms in the Chapter CS (Consolidated supervision), Section 3, Paragraph 2a, of the FSA Policy Guide/IPRU (BANK).

Multi-option facilities and other composite products should be disaggregated into their component parts, eg into a credit commitment, NIF, etc, and each component weighted according to the usual classification. However, components carrying the lowest conversion factors should be disregarded to the extent that the total value of all components exceeds the value of the facility.

A340 Direct credit substitutes

Direct credit substitutes relate to the financial requirements of a counterparty, where the risk of loss to the reporting institution on the transaction is equivalent to a direct claim on the counterparty, ie the risk of loss depends on the creditworthiness of the counterparty. Report instruments such as:

- (a) acceptances granted and risk participations in bankers' acceptances. Where a reporting institution's own acceptances have been discounted by that institution the nominal value of the bills held should be deducted from the nominal amount of the bills issued under the facility and a corresponding on-balance sheet entry made:
- (b) guarantees given on behalf of customers to stand behind the current obligations of the customer and to carry out these obligations should the customers fail to do so, eg a loan guarantee;
- (c) guarantees of leasing operations;
- (d) guarantees of a capital nature such as undertakings given to non-bank company authorised under the Financial Services Act (being replaced by the Financial Services and Markets Act 2000) which are considered as capital by the appropriate regulatory body until the Financial Services and Markets Act 2000 applies. Such guarantees given to a company which is not connected to the reporting institution should be weighted at 100% and those to a connected company should be deducted from the reporting institution's capital base (item A340.6);
- (e) letters of credit not eligible for inclusion in item A360;
- (f) standby letters of credit, or other irrevocable obligations, serving as financial guarantees where the bank has an irrevocable obligation to pay a third party beneficiary if the customer fails to repay an outstanding commitment, eg letters of credit supporting the issue of commercial paper, delivery of merchandise, or for stock lending (standby letters of credit which are related to non-financial transactions should be reported in item A350 below);

- (g) re-insurance or window letters of credit;
- (h) acceptances drawn under letters of credit, or similar facilities where the acceptor does not have specific title to an identifiable underlying shipment of goods (eg sales of electricity);
- (i) confirmations of letters of credit.

Direct credit substitutes of a capital nature

Any direct credit substitutes which are of a capital nature and connected to the reporting institution or given to another bank should be reported in item A340.6 and will be deducted from capital in the calculation of the risk asset ratio.

Include:

- a) guarantees of other credit and financial institutions' capital instruments given by the reporting institution;
- b) guarantees given by the reporting institution which are included in the supervisory capital of another credit or financial institution eg the subordinated guarantee of loan stocks raised by vehicle company subsidiaries of the reporting institution, where the loan stock is treated as subordinated term debt of the reporting institution should not be included here. (The FSA may however agree that a different treatment is appropriate. Reporting institutions should discuss such cases with the FSA.)

A350 Transaction-related contingents

Transaction-related contingents relate to the on-going trading activities of a counterparty where the risk of loss to the reporting institution depends on the likelihood of a future event which is independent of the creditworthiness of the counterparty. They are essentially guarantees which support particular non-financial obligations rather than supporting customers' general financial obligations. Report such items as:

- (a) performance bonds, warranties and indemnities (indemnities given for lost share certificates or bills of lading and guarantees of the validity of papers rather than of payment under certain conditions should not be reported in this return);
- (b) bid or tender bonds;
- (c) advance payment guarantees;
- (d) VAT, customs and excise bonds. The amount recorded for such bonds should be the reporting institution's maximum liability (normally twice the monthly amount being guaranteed);
- (e) standby letters of credit relating to a particular contract or to non-financial transactions (including arrangements backing, inter alia, subcontractors' and suppliers' performance. labour and materials, contracts, and construction bids).

A360 Trade-related contingents

Report short-term, self liquidating trade-related items such as documentary letters of credit issued by the reporting institution which are, or are to be, collateralised by the underlying shipment, ie where the credit provides for the reporting institution to retain title to the underlying shipment. Such letters should be weighted according to the counterparty on whose behalf the credit is issued and reporting whether or not the terms and conditions of the credit have yet to be complied with.

Letters of credit issued by the reporting institution without provision for the reporting institution to retain title to the underlying shipment or where the title has passed from the reporting institution should be reported under direct credit substitutes (item A340). A memorandum of pledge and a trust receipt are not regarded as giving the reporting institution title, and transactions secured by these should be shown under item A340.

Letters of credit issued on behalf of a counterparty back-to back with letters of credit of which the counterparty is a beneficiary ("back-to-back" letters) should be reported in full.

Letters of credit advised by the reporting institution or for which the reporting institution is acting as reimbursement agent should not be reported.

A370 Sale and repurchase agreements

See SGN29.

Repos

Report sale and repurchase agreements ("repos"), ie when the reporting institution is the seller of the asset where the asset sold is not reported on the balance sheet. If the asset sold is kept on balance sheet it should not be reported here but in the relevant line in the on-balance sheet section of this return. When the asset does not appear on the balance sheet the weighting category is to be determined by the issuer of the security (or borrower in the case of a loan) and not according to the counterparty with whom the transaction has been entered into.

Purchase and resale agreements ("reverse repos") should not be reported in item A370; the liability under such reverse repos should be reported under item A720.

The reporting institution should refer to the FSA where it has a repo in item A370 and offsettable short stock positions on balance sheet in item A320 or A710.2 which would comply with the guidance for the netting of stock positions (see SGN27).

A380 Asset sales with recourse

Asset sales with recourse where the credit risk remains with the bank fall into the weighting category determined by the asset and not according to the counterparty with whom the transaction has been entered into. Report put options written where the holder of the asset is entitled to put the asset back to the reporting institution, eg if the credit quality deteriorates. Also report put options written by the reporting institution attached to marketable instruments or other physical assets.

A390 Forward asset purchases

The weight should be determined by the asset to be purchased, not the counterparty with whom the contract has been entered into. Include commitments for loans and other on-balance sheet items with certain drawdown. Exclude foreign currency spot deposits with value dates one or two working days after trade date.

A400 Forward forward deposits placed

Agreements between two parties whereby one will pay, and the other receive, an agreed rate of interest on a deposit to be placed by one with the other at some predetermined date in the future. Exclude foreign currency spot deposits with value dates one or two working days after trade date.

The weight should be determined according to the counterparty with whom the deposit will be placed.

A410 Uncalled partly-paid shares and securities

Only report if there is a specific date for the call on the unpaid part of the shares and securities held. If there is no specific date, the unpaid part should be treated as a long-term commitment (see item A440).

A420 NIFs and RUFs

Note issuance facilities and revolving underwriting facilities should include the total amounts of the reporting institution's underwriting obligations of any maturity. Where the facility has been drawn down by the borrower and the notes are held by anyone other than the reporting institution, the underwriting obligation should continue to be reported at the full nominal amount.

The reporting institution's own holding of the notes should be reported in items A50 to A110 and therefore the nominal amount of the notes held should be deducted from the nominal amount of the facility to be shown here.

A430 Endorsements of bills

Endorsements of bills (including per aval endorsements) should be reported at the full nominal amount, less any amount for bills which the reporting institution now holds but had previously endorsed.

Where the reporting institution is the first endorser of a bill which has been accepted by a bank other than the reporting bank, such endorsements should be reported in item A430.1. (Where a reporting institution has endorsed its own acceptances no further amount should be reported than the acceptance reported in item A340.) If the reporting institution is not the first endorser of a bill already accepted by a bank, such endorsements may not be reported.

Endorsements of bills which have not been accepted by a bank should be reported in items A430.2 to A430.4 according to the risk weight category of the issuer; where such a bill has been previously endorsed by a bank, the reporting institution's endorsement will justify a 20% weight. Endorsements of bills which have been previously endorsed by two or more banks may not be reported.

A440 Other commitments

Report here other undrawn commitments, classified as to whether:

- (i) they have an original maturity of one year or less or are unconditionally cancellable at any time (item A440.1); or
- (ii) they have an original maturity of over one year (items A440.2 to A440.7) and are not unconditionally cancellable at any time.

The reporting institution is regarded by the FSA as having a commitment regardless of whether it is revocable or irrevocable, conditional or unconditional and, in particular whether or not it contains a "material adverse change" clause.

Rolling or undated/open-ended commitments ("evergreens" and including overdrafts) should be included under (i) providing that they are unconditionally cancellable at any time without notice and subject to credit review at least annually. Other rolling or undated commitments should normally be reported under (ii) (but see (b) below).

Unused credit card lines should be reported under (i).

Securities underwriting

Securities underwriting commitments should not be reported on this return, with the exception of NIFs and RUFs (item A420).

Commitments to provide capital to connected counterparties (and other banks)

Amounts reported under item A440.7 should be multiplied by the 50% credit conversion factor before entering, so that an appropriately reduced amount is carried through to Section D (item D420). If, however, the item would normally attract a credit conversion factor of 0% for the reasons above, it should continue to be reported under item A440.1.

Commitments with certain drawdown

Commitments for loans and other on-balance sheet items with certain drawdown should not be reported here but under item A390.

The maturity of a commitment

See SGN8 for general guidance on maturity. The maturity of a commitment should be determined in accordance with the following:

(a) *Original maturity*

The maturity of a commitment should be measured from the earlier of (i) thirty days (sixty days in the case of syndicated facilities) following the date of 'firm offer' or (ii) the date at which the facility becomes available to be drawn down, until its expiry date, after which the facility is no longer available to be drawn down.

The date of 'firm offer' will often be earlier than the date of signature of the agreement to provide a facility. For example, a 'firm offer' may still be subject to documentation and material adverse change. However, if an offer is made prior to the credit assessment of the customer and/or the institution reserves the right to withdraw the offer at its discretion, this should not be regarded as firm. In the case of a non-underwritten (or best efforts) syndicated facility, the date of 'firm offer' is deemed to be that on which the arranger(s) confirms to the potential borrower that the facility is fully subscribed. Where an institution(s) underwrites a facility which is subsequently to be syndicated (notwithstanding the fact that the offer to underwrite may be subject to documentation and 'force majeure' clauses), it should measure its commitment from the date of its 'firm offer'. However, if the subsequent syndication is 'successful', the underwriter(s) may then measure its commitment afresh from the same date as the syndicate banks ie the earlier of 60 days after the date on which the underwriter(s) confirms to the borrower the results of general syndication or the date at which the facility becomes available for draw down. Syndication of an underwritten commitment is deemed to be 'successful' if, after the close of syndication, the underwriter(s) is not left with more than:

- (i) any specified target amount (in circumstances where such a precise target has been set and advised to the bank); or
- (ii) 50% of the total underwritten amount.

The thirty day (sixty day in the case of syndicated facilities) 'window' is intended to be a reasonable period after the date of firm offer during which the practicalities of arranging a facility (eg finalising documentation) can be completed.

Even if the formal agreement to provide the facility indicates an original maturity of one year or under, a commitment should be reported as having an original maturity of over one year if the reporting institution assumes additional legal or moral obligations which imply a maturity of over one year. Reporting institutions should satisfy themselves that no such additional obligations exist.

Examples of facilities with such obligations include, but are not limited to:-

- (i) facilities with provisions for extension in the documentation, other than in accordance with (b)(i) or (ii) below;
- (ii) facilities which the customer reasonably expects to be extended automatically; and
- (iii) facilities on terms which may be used to penalise an institution if it declines to extend a commitment in accordance with (b)(i) below; eg for the remaining period of the commitment the customer has the right to make drawings of a longer maturity or on otherwise better terms than if the institution had not declined to extend; or, in a syndicated facility where the borrower is able to draw on the institution individually before the other syndicate banks (up to the limit of its commitment) for the remaining period of the facility.

(b) *Extensions/renegotiations of commitments prior to their expiry date*

In cases where the terms of a commitment have been renegotiated and/or the maturity of a commitment extended, the original maturity should be measured from the start of the initial commitment (see (a) above) until the expiry date of the renegotiated/extended facility. The only exceptions should be where either:

- (i) the 'firm offer' to extend the commitment is given in the final thirty days (sixty days in the case of syndicated facilities) of the initial commitment period, following a full credit assessment of the customer; or
- (ii) the renegotiation/extension involves a full credit assessment of the customer and the reporting institution has the right, without notice, to withdraw the existing commitment at the time when the renegotiation/extension is requested and to refuse the request for the renegotiated/extended commitment.

In these two cases the extended/renegotiated facility may be reported as a new commitment. This applies equally to extensions/renegotiations of facilities of one year and under and facilities of over one year. Again the thirty day (sixty day for syndicated facilities) 'window' is considered a reasonable period after the date of firm offer in which the practicalities of extending a facility (eg finding replacement banks in a syndicate) can be completed. Reporting institutions should note that completion of new documentation may not be sufficient to cause a facility to be considered as a new commitment.

(c) *A commitment to provide a loan (or purchase an asset) which has a maturity of over one year but which must be drawn down within a period of one year or under.*

Such commitments should be treated as having a maturity of one year or under provided any undrawn portion of the facility is automatically cancelled at the end of the draw-down period.

(d) *A commitment to provide a loan (or purchase an asset) to be drawn down in a number of tranches, some where the availability of the commitment is one year or under, some where it is over one year.*

The whole commitment should be considered as having a maturity of over one year.

(e) *Commitments for fluctuating amounts*

Where a commitment provides for a customer to have a facility limit which varies during the period of the commitment, eg for seasonal reasons, the amount of the commitment should at all times be taken as the maximum amount that can be drawn under the commitment for the remaining period of the commitment.

(f) *Forward commitments*

A forward commitment is where the reporting institution is committed to making a facility available at a future date. The original maturity of the commitment should be measured from the earlier of

- (i) thirty days following the date of 'firm offer' or
- (ii) the date at which the facility is available to be drawn down, until the facility expires.

(g) *Commitments for off-balance sheet transactions*

A distinction is drawn between a commitment to provide an off-balance sheet facility which may or may not be drawn by the customer, and a commitment to provide an off-balance sheet instrument with certain draw-down. For example:

- (i) a commitment of over one year to provide a trade related contingent facility at a future date which may or may not be drawn down should be given a credit conversion factor (ccf) of 50% (the ccf for long-term commitments) multiplied by 20% (the ccf for trade-related contingents), ie an effective ccf of 10%; report 20% of the principal amount in the relevant section in item A440, depending on the counterparty weight. Similarly, a long-term commitment to provide a guarantee facility would receive a ccf of 50% multiplied by 100%, ie an effective ccf of 50%; report 100% of the principal amount in the relevant section of item A440; but
- (ii) a commitment (short-term or long-term) to provide a trade-related contingent item where it is certain that the draw-down will occur at some date, or range of dates, in the future should be given a ccf of 20% (ie without multiplying by the relevant ccf for a commitment) and reported in the relevant section of item A360. Similarly, a commitment to issue a guarantee with certain draw-down at a particular date, or range of dates, in the future should receive a ccf of 100% and be reported under item A340.

(h) *'Linked' commitments*

Two or more commitments may be regarded as 'linked' if they are arranged simultaneously for the same or connected customer(s). Where a reporting institution enters into one or more commitment(s) of over one year and one or more commitment(s) of one year and under, these should be reported as 'linked' (ie aggregated and reported according to the maturity of the longer/longest of the commitments) where either:

- (i) the facilities cannot be drawn down, renegotiated or cancelled separately; or
- (ii) the customer is seeking two or more commitments for the same purpose and has no legitimate commercial reason for doing so.

Where a reporting institution enters into 'linked' commitments which begin and/or mature at different dates, the maturity of the combined commitment should be measured from the commencement of the first commitment (as set out in section (a) above) to the expiry date of the last commitment. For example, where one 'linked' commitment runs from January to January and another runs from June to June, the institution would report a single commitment of over one year (ie ccf of 50%) running from January to June.

A452 OTC Derivative Contracts (replacement cost method)

This item gives the capital requirement for counterparty risk on OTC derivatives contracts under the replacement cost method. It equals the Weighted Amount in item 60 of Appendix A-I.

Note the general comments for Appendices A-I and A-II on what appendices should be completed.

A462 Aggregate net short open foreign currency position

Reporting institutions which also complete Section B should not report a number in this item, as the capital requirement for foreign exchange risk should be calculated via item B180. All other reporting institutions should complete this item. The figure reported here should have a positive sign.

The aggregate net short position (net foreign exchange position) should be calculated in accordance with Chapter FX (Foreign exchange risk), Section 3, of the FSA Policy Guide/IPRU (BANK) as relevant. The amount reported in item A462 should be equal to $Y+g$ in the notation of Chapter FX (Foreign exchange risk), Section 4.4, of the FSA Policy Guide/IPRU (BANK). However, where fx options business is undertaken, the following adjustments should be made:

- (1) where the simple carve-out method is used, the options capital charges should be multiplied by 12.5 and added to the net short position, so that the amount reported in item A462 is equal to $Y+g+12.5*(C+D)$ in the notation of Chapter FX (Foreign exchange risk), Section 4.4, of the FSA Policy Guide/IPRU (BANK).
- (2) where one of the write-off methods is used, the options should not be included in the calculation of the net short position.
- (3) where one of the other options methods are used, banks should consult their supervisor.

Institutions whose net open position calculated according to Chapter FX (Foreign exchange risk), Section 3, of the FSA Policy Guide/IPRU (BANK) is less than or equal to 2% of previous period's Large Exposures Capital Base may alternatively calculate their net open position as the difference between the value of foreign currency assets and the value of foreign currency liabilities (regardless of whether the result is long or short), on a consistent basis.

The basic method should be used to calculate foreign exchange risk unless the reporting institution is using a VaR model.

A472 & A474 Original exposure method

The original exposure method is not considered to be appropriate after end March 1999. The replacement cost method should be used to calculate the counterparty risk on OTC derivative contracts. Consequently, these boxes should contain zeros in future.

LIABILITIES

CORE CAPITAL - TIER 1

A480 Ordinary shares/common stock

This should be reported at nominal paid-up value; where shares have been issued at a premium, the premium should be reported under reserves (item A500.1). Partly-paid shares should be reported at the amount paid. Do not report the unpaid element of partly-paid shares, or authorised but unissued share capital; also exclude holdings by the reporting institution of its own shares and shares issued after 1 January 1992 by the capitalisation of property revaluation reserves.

A490 Perpetual non-cumulative preferred shares/stock

Report perpetual non-cumulative preferred shares/stock and perpetual non-cumulative preferred shares convertible into ordinary shares, including any such shares redeemable at the option of the issuer and with the prior consent of the FSA. Only shares which have been issued and paid up should be reported.

Preferred shares issued via limited purpose vehicles may be included here. Reporting institutions should obtain the agreement of the FSA before doing this.

A500 Reserves

A500.1 Share premium account

Report any amount received by the reporting institution in excess of the nominal value of shares reported in items A480 or A490. Any share premium in respect of Tier 2 instruments should be reported indistinguishably with those instruments.

A500.2 Disclosed prior years reserves (excluding item A580), disclosed current year's positive movement on reserves and negative movements on reserves

Report the disclosed, undistributed balance on profit and loss account attributable to previous years (ie revenue reserves), reserves arising from exchange rate translation differences and other reserves (eg capital redemption reserves and capital gifts). Do not report reserves arising from the revaluation of fixed assets; such reserves should be shown under item A580. Report here any adjustment in respect of dividends which are not covered by current year's profit verified by external audit.

Before publication of full year prior year reserves, include here any prior year's earnings which have been verified by external auditors in accordance with Chapter CA (Definition of capital), Section 5.3, of the FSA Policy Guide/IPRU (BANK).

Report here disclosed (ie published) current year's positive movement on reserves (other than those shown under item A580). If current year's movements on reserves are negative report these here (whether or not disclosed).

A500.3 Current year's retained profit verified by external audit

Report only current year's earnings (net of foreseeable charges) where they have been verified by external auditors (in accordance with Chapter CA (Definition of capital), Section 5.3, of the FSA Policy Guide/IPRU (BANK)) at the date the return is submitted to the FSA. However, if this verification took place **after** the date to which the return relates, the FSA should be alerted to this fact when the return is submitted. No deduction need be made for dividends that have not been announced by the reporting date. Interim retained earnings of subsidiaries within banking groups which have been verified by external auditors may also be reported even if they are not separately disclosed. Current year's profit that has not been verified by external audit should be reported in item A670. Current's year's losses should be reported in item A510.

If dividends paid or proposed before the reporting date exceed verified earnings, then that excess should be deducted from item A500.2 and '0' should be reported here.

Pension fund assets arising from either a pension fund surplus or deficiency should be deducted from this item. Pension fund liabilities arising from pension fund surpluses should be added; whereas pension fund liabilities arising from pension fund deficiencies should not be added back but should be added to item A760.2.

A510 Current year's losses

Report all current year's losses. Unpublished losses from the previous accounting period should also be shown here.

Where the reporting institution has verified its position, in accordance with Chapter CA (Definition of capital), Section 5.3, of the FSA Policy Guide/IPRU (BANK), up to an earlier reporting date, subsequent unverified profits do not reduce the loss reported here, but should instead be reported in item A670.

A520 Minority interests (in Tier 1 capital)

Where the reporting institution reports on a solo consolidated or consolidated basis, enter the claim by outside interests in Tier 1 capital items (see items A480 and A490) of any partly-owned subsidiary company or minority owned company which is included in this particular return.

A530 Total of items 480 to 520

This should equal the sum of items A480 to A520, taking account of any negative figures, ie those with a **minus sign**.

A540 Goodwill, other intangible assets and other adjustment

This should equal the sum of items A200 and A210.2. Include here the deduction for holdings of own shares not held for trading but which have not been excluded in item A480.

A550 Total Tier 1 capital

Tier 1 capital equals item A530 less any amounts reported in item A540.

SUPPLEMENTARY - TIER 2

A580 Fixed asset revaluation reserves

Report reserves relating to the revaluation of fixed assets. Report also shares issued by the capitalisation of property revaluation reserves after 1 January 1992.

A590 General provisions

Report general provisions that are held against possible or latent losses but where the losses have not as yet been identified. Provisions earmarked or held specifically against lower valuations of particular claims or classes of claims should not be reported here, but netted against the value of the asset against which they have been made (see SGN6). This item should include any general provisions against the value of investments.

A600 Hybrid (debt/equity) capital instruments

Report:

- (i) Perpetual cumulative preferred shares, including such shares redeemable at the option of the issuer with the prior consent of the FSA, and including also share premia on these instruments;
- (ii) Perpetual subordinated debt which meets the conditions for primary perpetual subordinated debt set out in Chapter CA (Definition of capital), Sections 6 and 8, of the FSA Policy Guide/IPRU (BANK), including such debt which is convertible into equity, either mandatorily or at the option of either the issuer or lender.

A610 Subordinated term debt

Report here the amount of subordinated term debt (ie the amount of principal outstanding before amortisation) which has been approved by the FSA as qualifying for inclusion in Tier 2 capital under the terms of Chapter CA (Definition of capital), Sections 7 and 8, of the FSA Policy Guide/IPRU (BANK) (see item A790). This item should equal the sum of items A790.21 column "Sterling equivalent", A790.22 column "Sterling equivalent" and A790.1.

A620 Minority interests in Tier 2 capital

Where the reporting institution reports on a solo consolidated or consolidated basis, enter the claim by outside interests in any partly-owned subsidiary or minority owned company in the form of any Tier 2 capital term.

ADJUSTMENT TO CAPITAL (see ANNEX 1 for details of calculation)

A621 Excess general provisions

The maximum amount allowable for inclusion in Tier 2 capital is 1.25% of total risk weighted assets. This item equals the greater of item (A590 less total risk weighted assets multiplied by 1.25%) and zero.

A622 Excess Tier 2 subordinated term debt

The maximum amount of Tier 2 subordinated term debt that qualifies for inclusion as capital is 50% of Tier 1 capital. Report here the subordinated term debt which exceeds the limit on Tier 2 subordinated term debt. This item equals the greater of (item A790 **less** 50% of A550) and zero.

Subordinated term debt that does not qualify for inclusion as capital (under the terms of Chapter CA (Definition of capital), Sections 7 and 8, of the FSA Policy Guide/IPRU (BANK)) should be reported in item A670.

A623 Amortisation on Tier 2 subordinated term debt

Report here the difference between the nominal amount of the stock and the amortised amount (ie item A610 **less** A790).

A624 Total of items A580 to A623

This equals the sum of items A580 to A620 **less** the sum of items A621 to A623.

A625 Tier 2 capital in excess of the overall limit / Excess Tier 2 capital

The maximum amount (ie the overall limit at the consolidated level, or the solo level when a bank is not part of a consolidated group) of Tier 2 (or Tier 2 plus Tier 3 for institutions that are subject to CAD capital requirements) which is eligible for inclusion as capital is 100% of Tier 1 capital. Where the reporting institution is exempt from the Capital Adequacy Directive capital requirements at the reporting date (see Chapter CB (Trading book/banking book division), Section 4, of the FSA Policy Guide/IPRU (BANK) for details of exemption), the amount by which Tier 2 capital exceeds Tier 1 capital overall should be reported here (ie it equals the greater of zero and (item A624 **less** item A550)).

Where the reporting institution is subject to CAD capital requirement, the excess (Tier 2 plus Tier 3) capital which is not eligible for inclusion as capital equals the greater of (the sum of items A624, A631 and A633 **less** item A550) and zero. Tier 2 capital plus Tier 3 subordinated debt used to meet the Trading Book capital requirement is limited to 200% of Tier 1 capital used to meet those requirements. Tier 3 subordinated debt should first be designated as excess capital, if any excess capital remains when Tier 3 subordinated debt has been used up, then Tier 2 capital should be designated as being excess capital.

A630 Total eligible Tier 2 capital

This is item A624 **less** A625.

TRADING BOOK CAPITAL - TIER 3

A631 Short term subordinated debt

Report short term subordinated debt which has been approved by the FSA as qualifying for inclusion in Tier 3 capital detailed in Chapter CA (Definition of capital), Section 9.2, of the FSA Policy Guide/IPRU (BANK).

A633 Minority Interests (in short term subordinated debt)

Where the reporting institution reports on a solo consolidated or consolidated basis, enter the claim by outside interests in any partly owned subsidiary or minority owned company in the form of Tier 3 capital.

ADJUSTMENT TO CAPITAL (see ANNEX 1 for details of calculation)

A635 Excess Tier 3 debt

The overall limit on (Tier 2 plus Tier 3) capital which is eligible for inclusion as capital is 100% of Tier 1 capital. Excess (Tier 2 plus Tier 3) capital equals the greater of (the sum of items A624, A631 and A633 less item A550) and zero. Tier 3 subordinated debt should first be designated as excess capital, if any excess capital remains when Tier 3 subordinated debt has been used up, then Tier 2 capital should be designated as being excess capital. Report here the amount of Tier 3 capital which exceeds the overall limit.

A638 Total eligible Tier 3 Capital

Eligible Tier 3 capital is limited to 200% of Tier 1 capital left over after supporting the Banking Book capital requirements. Report Tier 3 capital not eligible for inclusion in item A635. This item equals the sum of items A631 and A633 less item A635.

OTHER CAPITAL

A660 Ineligible Tier 2 and Tier 3 capital

This is the capital which has been deducted from Tier 2 and Tier 3 capital as being not eligible for inclusion as capital. This item equals the sum of items A621 to A623, A625 and A635.

A670 Other capital

Report preference shares, perpetual loan stocks and subordinated term debt not accepted by FSA as qualifying for inclusion as capital within the terms of Chapter CA (Definition of capital), Sections 6-8, of the FSA Policy Guide/IPRU (BANK).

Also report working capital provided by a non-resident office of the reporting institution.

Report current year's profits which have not been verified by external audit in accordance with Chapter CA (Definition of capital), Section 5.3, of the FSA Policy Guide/IPRU (BANK) and also any undisclosed profits relating to the previous year which have not been so verified.

OTHER NON-CAPITAL LIABILITIES

A680 Own bank notes issued

Bank notes in circulation, ie the reporting institution's issue of notes less any own notes held.

A700 Marketable securities issued:

A700.1 Certificates of deposit

Report all certificates of deposit issued by the reporting institution, whether at fixed or floating rates, and still outstanding. Also report negotiable deposits taken on terms in all respects identical to those on which a certificate of deposit would have been issued, but for which it has been mutually convenient not to have issued certificates. If a reporting institution holds certificates of deposits which it has itself issued, these should not be reported in this return.

A700.2 Promissory notes and bills

Report promissory notes, bills and other negotiable paper issued (including commercial paper) by the reporting institution including bills drawn under an acceptance credit facility provided by another institution.

A700.3 Unsubordinated FRNs and other long term paper

Report unsubordinated FRNs and other unsubordinated market instruments issued. Subordinated capital market instruments should be reported under item A610 or A631 as appropriate.

A710 Investments (short positions)

See SGN27. Do not use brackets in the weighted amount column.

Report gross short positions in securities issued by central governments and central banks under item A710.1 and gross short positions in other investments under item A710.2.

A720 Liabilities in respect of sale and repurchase agreements

See SGN29.

This entry applies to sale and repurchase agreements associated with reverse repos. Where the reporting institution reports assets reversed in on the balance sheet, the liability under such agreements should be reported here.

A730 Tax provisions

Deferred tax assets should be reported as an asset in item A260.4.

A750 Other provisions

Report provisions made other than those reported above (items A590, A730 and A740). Specific provisions (see SGN6) should also be excluded from this item, except where they have been created in respect of off-balance sheet items.

A760 Other

Report credit items in the course of transmission and items in suspense (including credit items in the course of settlement, to be shown separately in item A760.1).

Also report all internal accounts and other liabilities not reported elsewhere, eg sundry creditors and liabilities under finance leases.

Include net short positions in physical commodities where the FSA has agreed that commodity transactions may be included in the Banking Book.

Include also liabilities arising in respect of pension scheme deficiencies; those arising in respect of a pension fund surplus should be included under item A500.3.

A765 Non capital liabilities consolidated via aggregation plus

When completing this return on a consolidated basis which includes subsidiaries consolidated via aggregation plus, rather than on a line by line basis, the total liabilities of those subsidiaries should be reported here. Intra group capital and liabilities should be excluded.

A770 Total liabilities

This is the sum of items A530, A630 and A638 to A765. It should equal item A270.

A780-A790 MEMORANDUM ITEMS

A780 Deposits from connected customers

Connected customers are defined as other group companies (excluding those companies which are included in the consolidation of this particular return), directors, controllers and their associates, and non-group companies with which directors and controllers are associated as set down in items A290 and A300, and SGN12 and SGN13.

A790 Subordinated term debt

Only the issues of subordinated term debt which the FSA has agreed qualify for inclusion in Tier 2 capital under the terms of Chapter CA (Definition of capital), Sections 7 and 8, of the FSA Policy Guide/IPRU (BANK) should be reported here.

Report under item A790.1 only convertible subordinated term bonds which are mandatorily convertible into equity (but see item A600 for treatment of convertible subordinated perpetual debt). Subordinated bonds which are convertible into equity at either the issuer's or investors' option (where these bonds are not eligible for inclusion in item A600) should be reported under item A790.2.

Dated preference shares and subordinated, unsecured loan stocks of over 5 years' original maturity issued by the reporting institution should be shown after amortisation in item A790.2. The amount shown in item A790.2 should be further divided between items A790.21 and A790.22 as necessary in the relevant sub-total boxes. The amount of principal outstanding before amortisation should also be entered in the sub-total boxes in the "amount" column in the currency of repayment, which should be entered in the "currency" column. The "sterling equivalent" is then this amount converted to sterling at the current exchange rate for the currency concerned on the day of the report unless, via a subordinated swap or some other hedging mechanism that is an integral part of the original preference share or subordinated loan stock agreement, the exchange rate has effectively been fixed - in which case that fixed rate may with be used. The reporting institution should obtain the FSA's agreement before doing this.

Individual stocks which are repayable in full on maturity should be listed in item A790.21 in lines a to e. Where there are more than five stocks issued (ie a to e) annotate the form "see attached list" in this section and attach a full list of such stocks. The amounts to be reported after amortisation are shown below and relate to the period between the date of the return and maturity date:

<u>Years to maturity</u>	<u>Amortised amount</u>
more than 4	100% of nominal
less than and including 4 but more than 3	80% of nominal
less than and including 3 but more than 2	60% of nominal
less than and including 2 but more than 1	40% of nominal
less than and including 1	20% of nominal

The amount of subordinated, unsecured loan stock should be multiplied by the amortisation values shown above. In the case of optional repayment dates the longest date should be used to determine the final maturity if the exercise of the option lies with the issuer, and the shortest date if with investors.

Report in item A790.22 in lines a to h the original outstanding value of individual stocks which are repayable in instalments. Where banks have more than 10 such holdings, they may aggregate the smallest holdings (by value) and record the total under A190.21j and A790.22j. The amortised amount shown should be agreed with the FSA.

APPENDICES A-I & A-II

For those reporting institutions that also complete Section B, Appendices A-I and A-II should include only those contracts that fall within the Banking Book. Contracts within the Trading Book should be reported in Section B. Reporting institutions which do not complete Section B should give details of all their interest rate, exchange rate, equity, commodity and precious metal related contracts in these appendices.

Swaps attached to loans and bonds.

Under certain conditions the risk attached to a floating (or fixed) rate loan/bond and a linked interest rate or currency swaps may be equivalent to a fixed (or floating) rate loan. In this case the swap need not be reported providing the following conditions are met;

- (i) the swap and loan should have matching obligations (ie identical interest periods);
- (ii) the swap and loan should be explicitly linked such that if the counterparty defaults under the loan or swap, or goes into liquidation, all payments under the swap agreement cease and the loan becomes immediately repayable;
- (iii) netting or floating (or fixed) rate payments on the loan and the swap should meet all the existing (or future) on-balance sheet netting criteria (see SGN26).

Appx A-I Counterparty exposure on OTC derivative contracts-Replacement Cost Method

The credit equivalent amount is the sum of the replacement cost and the potential future credit exposure. The weighted amount is the product of the credit equivalent amount and the risk weight. Claims in respect of foreign exchange contracts with original maturity of 14 days or less should not be reported on this Appendix. Futures and options should not be reported on this Appendix if the contracts concerned are traded on exchanges subject to daily margining requirements.

All exposures in this section should be reported gross, unless they are netted by novation or the terms set out in Chapter NE (Collateral and netting), Sections 5-8, of the FSA Policy Guide/IPRU (BANK) have been met.

Note that Appendix A-I will not agree with Appendix A-II, since Appendix A-II is completed on a gross basis and also includes exchange traded items.

Replacement Cost

See SGN34 for guidance more generally. Only contracts with a positive mark-to-market value should be reported under this heading (however, institutions should record a potential future credit exposure in respect of all OTC derivative contracts that might in the future have a positive mark-to-market value). All contracts with a positive mark-to-market value should be reported in Appendix I (unless netting is consistent with Chapter NE (Collateral and netting), Sections 5-8, of the FSA Policy Guide/IPRU (BANK)). The overall net positive mark-to-market value should be allocated to the 0% band in the on-balance sheet section of the form (see item A260).

Potential Future Credit Exposure

Potential FCE should be calculated in accordance with the guidance set out in SGN34.

Net reporting of Replacement Cost

Where the terms of Chapter NE (Collateral and netting) of the FSA Policy Guide/IPRU (BANK) have been met then, on a bilateral basis (ie for each counterparty), the net replacement cost of nettable contracts may be reported (see SGN26 and SGN35).

Net Reporting of Potential Future Credit Exposure

The netting of add-ons is possible provided the terms of Chapter NE (Collateral and netting) of the FSA Policy Guide/IPRU (BANK) have been met. (See SGN26 and SGN35.)

Forward FX Contracts undertaken through Multilateral Netting Schemes

The credit equivalent amount for a reporting institution using a multilateral netting scheme should also be reported in Appendix I as outlined in SGN35.

Appendix A-II: Supplementary Information On Derivative Contracts

Replacement Cost Method

This section should be completed on a gross basis, even where legally enforceable netting agreements are in place, and is used for general supervisory information. As a result, this section will not necessarily reconcile with the previous section. All contracts (ie those with positive, negative and zero mark to market values) should be reported under the heading 'Notional Principal Amounts by Residual Maturity'.

Reporting institutions' exposure to OTC contracts should be reported by the relevant product and counterparty type. Their exposure to exchange traded contracts should be reported by product type only.

Reporting institutions should include their exposures arising from options with their other contracts, but should also identify them separately as a memo item. Within the memo item on options, those which are exchange traded should be separately identified from those originating from the OTC market.

Interest Rate Contracts

Report single currency interest rate swaps, basis swaps, forward rate agreements and products with similar characteristics, interest rate futures, interest rate options purchased and written (including caps, collars and floors purchased as stand-alone contracts), forward purchases and sales of bonds, and similar instruments. Bond futures and bond options purchased and written should also be reported here.

Foreign Exchange Contracts

Only exchange rate contracts of over 14 days original maturity (excluding a settlement period of up to 2 days) should be reported. Foreign exchange contracts with a shorter original maturity do not require regulatory capital for counterparty risk (but do require capital for market risk).

Report cross currency swaps, cross currency interest rate swaps (the exchange of principal on such swaps should be excluded from the on-balance sheet section of this return), outright forward foreign exchange contracts, currency futures, currency options purchased and written and similar instruments. Contracts based on gold should be included here.

For the reporting of SAFEs (synthetic agreements for forward exchange), ERAs should be treated as interest rate instruments; FXAs may also qualify for interest rate add-ons unless the notional principal amounts for the first (front-end) and second (back-end) contracts differ by more than 10%, in which event the lower amount should be treated as the notional principal for the interest rate contract and the difference in the contract amounts should attract the exchange rate add-ons.

Equity Contracts

Equity options purchased and written, forward purchases and sales of equities, and equity futures should also be reported here.

Commodity Contracts

All positions in respect physical commodities and derivative positions relating to commodities should be reported in the Trading Book for CAD banks. The reporting institution may agree with the FSA a different reporting treatment.

Precious Metals Contracts

All positions in respect of physical amounts of precious metals (not gold) and derivative positions relating to precious metals (other than gold) should be reported in the Trading Book for CAD banks. The reporting institution may agree with the FSA a different reporting treatment.

Notional principal amounts by maturity

The notional principal amount for each contract should be reported in these items, regardless of whether it is matched by another contract or whether it has a positive mark to market value. This section should include all derivative contracts to which the reporting institution is party, including options written and purchased (see SGN35 for more detail generally).

For exchange traded contracts, margins paid to exchanges should be separately identified and reported on the counterparty risk section of Sections A and B. The value of the underlying contracts should be reported here.

Remaining maturity

The remaining maturity of a swap should be taken as the time until final expiry of the swap. For FRAs and similar products, the remaining maturity should be taken as the time from the reporting date until the end of the period to which the interest rate underlying the contract relates (see SGN35 for more detail generally).

APPENDIX A-III: EXPOSURES COLLATERALISED/GUARANTEED/NETTED

When exposures being netted for the calculation of counterparty risk all fall in the Banking Book, the net exposure should be reported as a risk in Section A (in the Banking Book column). Similarly if all exposures fall in the Trading Book, the net exposure should be reported as a risk in the Trading book (in Section B, with a corresponding entry in the Trading Book column in Section A). If the exposures are divided between both Banking and Trading Book, the net amount should be reported as a risk in the Trading Book in Section B. As soon as a counterparty ceases to be a counterparty to an exposure in the Trading Book, the net amount should be considered to be in the Banking Book.

The residual netted amount should be reported in the relevant risk weighting band for counterparty risk. But see SGN5. If the statutory accounting treatment is gross but the terms of Chapter NE (Collateral and netting) of the FSA's Policy Guide/IPRU (BANK) have been met, and the FSA has agreed netting is appropriate for the Trading Book (Section B) reporting purposes, those exposures netted out should be reported in the zero percent band in the relevant asset category. The adjustments made by the reporting institution to the Trading Book (Section B) in respect of netted exposures should be shown additionally in Appendix B-X.

The above treatment should be applied to netting of on balance sheet exposures, the netting of the replacement cost of off balance sheet exposures and any netting of the potential future credit exposure (add-on).

APPENDIX A-IV - CURRENT YEAR'S PROFIT & LOSS ACCOUNT

This appendix covers the reporting institution's profit & loss account for the current financial year up to the reporting date. For those reporting institutions which have elected to report at dates which do not coincide with their financial year end, this appendix should be completed as at their last management accounts. In such instances, the specific period and relevant quarter covered should be inserted in the space and box provided.

INCOME

10 & 20 Interest received and receivable/interest paid and payable

Include under these headings both interest actually received and paid, and interest receivable and payable which has accrued but has not yet been received or paid. Amounts accrued should be based on the latest date to which these calculations were made; thus for an institution which accrues profits on a daily basis, accruals should include amounts up to and including the reporting date. Also include under this heading income accrued in respect of the amortisation of discounts (and premiums) on the purchase of fixed maturity investments which are not held for dealing (eg Treasury Bills).

30 Net interest income

Show under this heading the net interest received and receivable (ie item 10 less item 20). Where interest paid any payable exceeds interest received and receivable the net figures should be shown with a minus sign (not brackets) to indicate a negative figure.

40 Profit/(loss) on foreign exchange dealing

Revelations of foreign exchange positions and, if identifiable, fees and commissions of foreign exchange business should be included under this heading. If it is not possible to identify fees and commissions derived from this activity separately, they should be included with other fees and commissions in item 70.

A net loss should be shown with a minus sign (not brackets) to indicate a negative figure.

Where the reporting institution is engaged in deposit swap dealing (also sometimes known as interest arbitrage dealing) and does not distinguish between profits and losses on the foreign exchange element of the transaction and the interest differential, the whole transaction should be shown under items 10 to 30; a deposit swap profit should be treated as income (item 10) and a loss as an expense (item 20).

50 Profit/(loss) on investments held for dealing

Include all profits or losses (including revaluation profits or losses) other than those arising from the sale of investments in subsidiary or associated companies, trade investments or the amortisation of premiums or discounts on the purchase of fixed maturity investments which are not held for dealing.

70 Income from fees and commissions

Include charges made for services provided by the reporting institution, eg for the provision current account facilities, corporate advice, investment management and trustee services, guarantees and indemnities, commission on the sale of insurance of travellers cheques etc. Only include fees and commissions from customers for the provision of foreign exchange services if they cannot be separately identified and included under item 40.

80 Dividends/share of profits from subsidiary and associated companies

Reporting institutions reporting on an unconsolidated basis should include the dividends from other group companies only, together with the revaluation of any investment in subsidiaries or associates if equity accounting; those reporting on a consolidated basis should include only the share of profits from associated companies according to the normal convention of accounting as currently set out in Financial Reporting Standard 9, "Accounting for the Results of Associated Entities".

90 Profit/(loss) on fixed assets (including revaluation)

Include the profit or loss on the sale of non-trading assets of the reporting institution, eg premises, equipment, subsidiary and associated companies and trade investments. In respect of revaluation surpluses/deficits, reporting institutions should follow normal accounting practice: amounts in respect of surpluses/deficits normally taken to the profit and loss account, eg movements in provisions against trade investments, should be included in this item; amounts normally taken direct to reserves should not be included here.

100 Other income

Include under this heading income from any other source (other than extraordinary items which should be included under item 200).

EXPENSES

Operation expenses

110 Staff

Include salary costs, employer's national insurance contributions, the employer's contribution to any pension scheme, and the costs of staff benefits paid on a per capita basis such as private medical insurance and luncheon vouchers; general staff benefits, such as subsidised restaurants, should be included under "occupancy" (item 120) or "other" (item 130) as appropriate.

120 Occupancy

Include rates, rent, insurance of building, lighting, heating, depreciation and maintenance costs.

130 Other

This comprises all other expenditure.

140 Net charge/(credit) for provisions

150

This should equal item 40 on Appendix A-V (see relevant definition).

160 Provisions for taxation

For returns covering less than a year, the taxation charge should be estimated by applying a reasonable estimate of the reporting institution's effective tax rate applicable for the year in question.

170 Provisions for dividends

For returns covering less than a year, provision should be made for an appropriate portion of the estimated total dividend to be paid for the year.

200 Extraordinary items

Extraordinary items, as defined by Financial Reporting Standard 3, should be reported net of attributable taxation. Where extraordinary charges exceed extraordinary income, the net negative figure should be shown with a minus sign (not brackets).

APPENDIX A-V - PROVISIONS AGAINST BAD AND DOUBTFUL DEBTS AND INVESTMENTS

10 Previous balance

Show the balance outstanding on the specific and general provisions account at the end of the previous accounting year relating to debts considered bad or doubtful. From end December 2001, this should include provisions made against the value of investments. The date to which the balance refers should be shown in the space provided.

20 Adjustments for acquisitions/disposals

Enter any adjustments made as a result of an acquisition or disposal of a subsidiary company the balance sheet of which includes specific or general provisions and is included in the consolidation for the particular return. Where the net adjustment is negative, report the amount with a minus sign (not brackets).

30 Adjustments for exchange rate movements

Enter any adjustments made for exchange rate movements in respect of provisions denominated in currencies other than sterling. Where the adjustment is negative, report the amount a minus sign (not brackets).

40 Charge/credit to profit and loss account

Enter the net charge or credit to the profit and loss account in respect of provisions; this should equal items 140 & 150 on Appendix A-IV. A net credit should be shown with a minus sign (not brackets). The gross charge for new provisions should be offset by other items including any provisions made in earlier years but now released in the current year's profit and loss account. The charge or credit for specific provisions should include the charge or credit for provisions in respect of suspended interest where it is the practice of the reporting institution to show suspended interest as interest receivable in the profit and loss account.

50 Amounts written off

Enter the gross amount written off (before recoveries which should be reported in item 60).

60 Recoveries of amounts previously written off

Enter the total amount of loans recovered which have previously been written-off.

70 Other

Enter any other items, including exceptional provisions and transfers between general and specific provisions.

80 Current balance

The current balance should be the sum of items 10-70. The figure in column 1 should, from December 2001, equal the total of items 150 and 230.

**90 - Specific provisions against bad and doubtful debts
150**

In the relevant boxes, show the assets (by risk weights) against which specific provisions have been made. Total specific provisions (item 150) should equal the total of items 90 to 140. Include in column 1 earmarked general provisions which are in the nature of specific provisions. Such cases should be agreed with the FSA. All figures should be positive. Specific provisions against the value of investments should be reported in items 170-230.

160 Gross value of loans against which specific provision have been made

Enter the total gross value, before deduction of provisions, of loans against which specific provisions have been made.

Where specific provisions have been made against credit card lending, the aggregate value of these provisions should be reported here, and the FSA informed as to the amount of this item relating to such provisions.

**170 - Specific provisions against the value of investments other than trading investments
230**

Where the reporting institution carries provisions in its books for the diminution in value of investments other than trading investments they should be shown here, analysed according to the risk weighting of the investment to which they relate. Total provisions (item 230) should equal the total of items 170 to 220. All figures should be positive.

ANNEX 1: CALCULATION FOR ELIGIBLE TIER 2 AND TIER 3 CAPITAL

CAPITAL BASE BEFORE ADJUSTMENT		£'000s
1	Total Tier 1 :(Section A item A550)	<input type="text"/>
2	Total Tier 2 : Supplementary capital before adjustments (sum of items A580 to A620 of Section A)	<input type="text"/>
3	Total Tier 3 : Trading book capital before adjustments (Section A items A631 + A633)	<input type="text"/>
 ADJUSTMENTS TO CAPITAL		
General Provisions Adjustment		
4	Total Risk Weighted Assets from Section D item D510	<input type="text"/>
5	Limit on general provisions (1.25% of item 4)	<input type="text"/>
6	Eligible general provisions (lower of item A590 and item 5)	<input type="text"/>
7	Excess general provisions (higher of [item A590 - item 5] and zero)	<input type="text"/>
Subordinated Term Debt Adjustment		
8	Amortisation on Tier 2 subordinated term debt (item A610 - item A790)	<input type="text"/>
9	Tier 2 subordinated term debt after amortisation (item A610 - item 8)	<input type="text"/>
10	Limit on Tier 2 subordinated term debt (50% of item 1)	<input type="text"/>
11	Eligible Tier 2 subordinated term debt (lower of item 9 and item 10)	<input type="text"/>
12	Excess Tier 2 subordinated term debt (higher of [item 9 - item 11] and zero)	<input type="text"/>
Eligible Capital Adjustment		
13	Tier 2 less excess general provisions and excess Tier 2 subordinated term debt (item 2 - [items 7+8+12])	<input type="text"/>
 <u>Non-CAD Banks only (exempt from CAD capital requirements at reporting date)</u>		
14	Overall limit on Tier 2 (100% of item 1)	<input type="text"/>
15	Tier 2 capital in excess of the overall limit (higher of [item 13 - item 14] and zero)	<input type="text"/>
 <u>CAD Banks only:</u>		
16	Overall limit on Tier 2 plus Tier 3 (100% of item 1)	<input type="text"/>
17	Excess Tier 2 and Tier 3 capital (higher of [items 3+13-16] and zero)	<input type="text"/>
	<i>of which:</i>	
	Excess Tier 3 capital (subordinated term debt not eligible for inclusion)	<input type="text"/>
	Excess Tier 2 capital (item 17 - item 17.1)	<input type="text"/>
18	Eligible Tier 2 capital (items 13 - [item 15 or item 17.2])	<input type="text"/>
 Capital Allocated To The Banking Book		
19	Banking Book Capital Requirements (RWA for the current reporting period x B Book trigger ratio)	<input type="text"/>
20	Tier 1 capital (item 19 - item 21)	<input type="text"/>
21	Eligible Tier 2 capital (lower of item 18 and 50% of item 22)	<input type="text"/>
22	Total capital allocated to the Banking Book (items 20+ 21)	<input type="text"/>

ELIGIBLE CAPITAL AVAILABLE TO SUPPORT THE TRADING BOOK

23	Tier 1 capital remaining after supporting the Banking Book (item 1 - item 20)	<input type="text"/>
24	Eligible Tier 2 capital remaining after supporting the Banking Book (item 18 - item 21)	<input type="text"/>
25	Limit on Eligible Tier 3 capital (item 23 x 2)	<input type="text"/>
26	Eligible Tier 3 capital (lower of [item 3 - item 17.1] and item 25)	<input type="text"/>
27	TOTAL ELIGIBLE CAPITAL (TIERS 1, 2 AND 3) (items 1+ 18+26)	<input type="text"/>

Note.

Items 14 and 16 are the overall limit at the consolidated level, or the solo level when a bank is not part of a consolidated group.

Where the reporting institution is subject to CAD capital requirement, at a solo-consolidated and consolidated level, tier 2 capital plus Tier 3 subordinated debt used to meet the Trading Book capital requirement is limited to 200% of Tier 1 capital used to meet those requirements. For item 17, Tier 3 subordinated debt should first be designated as excess capital, if any excess capital remains when Tier 3 subordinated debt has been used up, then Tier 2 capital should be designated as being excess capital.

Total capital allocated to the Banking Book (Item 22) should equal the capital required to support the Banking Book as reported in item 19 unless there is insufficient capital available to meet the regulatory capital requirements while satisfying the constraints on capital. Item 22 should equal the sum of Tier 1 and Eligible Tier 2 capital (ie items 20 and 21). Use as much Tier 2 capital as possible subject to the constraint that *at least half the capital used to support the banking book should be Tier 1 capital*: eligible Tier 2 capital allocated to the Banking Book (ie item 21) should be less than or equal to Tier 1 capital allocated to the Banking Book (item 20). Item 21 should equal item 22 divided by 2 unless (item 22/2) is greater than eligible Tier 2 capital (ie item 18); in this case item 21 should equal 18, and item 20 should equal item 19 **less** item 21. Tier 3 capital should not be held against Banking Book risks. If item 22 is less than item 19 then the institution may have insufficient capital to meet its regulatory capital requirements and should contact its line supervisor immediately.

Item 7 equals Section A item A621.

Item 8 equals Section A item A623.

Item 12 equals Section A item A622.

Item 15 or item 17.2 equals Section A item A625.

Item 17.1 equals Section A item A635.

BSD3-SECTION B: TRADING BOOK FOR SOLO BANK AND LINE BY LINE CONSOLIDATED ENTITIES

General Notes

- 1 For consolidated returns, the companies to be included in the consolidation should be those agreed between the reporting institution and the FSA in accordance with the FSA's Policy on Consolidated Supervision (Chapter CS (Consolidated supervision) of the FSA Policy Guide/IPRU (BANK)).

The Trading Book

- 2 The coverage of this section is limited to the Trading Book of a bank. Banks which have agreed with the FSA that they do not have a Trading Book should not fill in this section, and should proceed to Section D.
- 3 Article 2.6 of the Capital Adequacy Directive (CAD - 93/6/EEC) and its subsequent amendment (98/31/EC) provide the Trading Book definition.

In accordance with this, a bank's trading book consists of:

- a) an institution's proprietary positions in financial instruments, commodities and commodity derivatives which are held for resale and/or which are taken on by the institution with the intention of benefiting from actual and/or expected short-term price or interest rate movements, matched principal broking positions in financial instruments commodities and commodity derivatives, and positions in financial instruments, commodities, commodity derivatives and other non-financial instruments taken in order to hedge other elements of the Trading Book.
- b) the exposures arising from unsettled transactions, free deliveries and over-the-counter (OTC) derivative instruments referred to in paragraphs 1, 2, 3 and 5 of Annex II of the CAD (as amended),
- c) the exposures due to repurchase agreements (repos) and securities and commodity lending which are based on securities or commodities included in the Trading Book as defined in (a) referred to in paragraph 4 of Annex II of the CAD (as amended),
- d) those exposures due to reverse repurchase agreements and securities and commodities borrowing transactions described in the paragraph 4 of Annex II of the CAD (as amended), which meet all the following conditions:
 - i) the exposures are marked to market daily following the procedures laid down in Annex II of the CAD unless they are cash items;
 - ii) the collateral is adjusted daily to take account of changes in the value of the securities or commodities involved and the bank's rule for collateralisation should be acceptable to the FSA;

- iii) the agreement or transaction provides for the bank's claims to be automatically and immediately offset against its counterparty's claims if the latter defaults;
- iv) such agreements or transactions are confined to their accepted and appropriate use and artificial transactions, especially those not of a short-term nature, should be excluded;

Where the contractual relationship fails to meet conditions (ii) and (iii) above, the contract may still be included in the Trading Book but should be treated as an undocumented reverse repo.

- e) exposures in the form of fees, commission, interest, dividends, and margin on exchange-related derivatives directly related to the items included in the Trading Book referred to in paragraph 6 of Annex II of the CAD (as amended).

Whether particular items fall to be included or excluded from an institution's Trading Book should be decided in accordance with objective procedures including, where appropriate, accounting standards in the institution concerned. A reporting institution should set out its procedures in its Trading Book policy statement.

4 The financial instruments referred to in the preceding paragraph are defined in Section B of the Annex to the Investment Services Directive (ISD - 93/22/EEC). These are:

- 1)
 - a) Transferable securities;
 - b) Units in collective investment undertakings.
- 2) Money-market instruments¹.
- 3) Financial-futures contracts, including equivalent cash settled instruments.
- 4) Forward interest rate agreements (FRAs).
- 5) Interest-rate, currency and equity swaps.
- 6) Options to acquire or dispose of any instruments falling within this section of the annex including equivalent cash-settled instruments. This category includes in particular options on currency and on interest rates."

Valuation

5 See SGN5. Each bank should have agreed a Trading Book policy with the FSA which, amongst other items, covers the valuation of positions. Positions should be valued for reporting on this form in line with the valuation procedure set out in the Trading Book policy. However, positions in the Trading Book should be marked to market on a daily basis and valued on this basis for inclusion on this form.

¹ This does not include deposits and loans.

- 6 The valuation of individual complex instruments might not be covered explicitly in the Trading Book policy, but the policy should outline a procedure for dealing with such instruments. Advice should be sought from the FSA on the treatment of such instruments.

Specific Provisions

- 7 All items reported for the purpose of calculating the capital requirement for counterparty risk (items B10 to B100) should be reported net of any specific or earmarked general provisions made.

Transfers of general market risk

- 8 See SGN33.

B10-B100 COUNTERPARTY RISK ARISING FROM:

Analysis of Categories

For each category of counterparty risk there is a breakdown of the total into different weighting bands (0%, 10%, 20% 100%) depending on the risk weight attributed to the counterparties. For a list of items and more detail on risk weights, see SGN15.

B10 Free deliveries

Reporting institutions should include here any transactions in tradable securities which involve the delivery of the securities (cash) when the cash (securities) is not received at the same time [this is termed a "free delivery"]. When the securities (cash) have been delivered this will be considered to be a claim on the counterparty equivalent to the current market value of the tradable security for the provider of the cash or the cash for the provider of the securities, whichever is outstanding. This includes exchange-traded contracts involving physical delivery.

If settlement of the transaction is effected across a national border, the capital requirement may only be triggered one business day after the securities (cash) have been delivered without the cash (securities) being received in return.

B20 Margins

Reporting institutions should include both initial margin payments and any surplus margin payments placed with exchanges and clearing houses. These are taken to be exposures to the exchanges and clearing houses and will attract the relevant weight for the exchange.

B30 Fees and commissions

Reporting institutions should include any fees due to them which arise from transactions falling in the Trading Book, which have not yet been received.

B40 Other counterparty risk in the Trading Book

Reporting institutions should report here all other counterparty risk that arises in the Trading Book. For example, if a loan is transferred to the Trading Book because it is hedging a position in a financial instrument (see Chapter CB (Trading book/banking book division), Section 3, Paragraph 9, of the FSA Policy Guide (in IPRU (BANK), Section 3, Paragraph 11)), the counterparty risk on the loan should be reported here. When the reporting institution has transferred general market risk from the Banking Book to the Trading Book (see Chapter CB of the FSA Policy Guide, Section 3, Paragraph 11 (Paragraph 13 in IPRU (BANK))), there is no associated transfer of specific or counterparty risk and the transfer will not result in an entry in item B40. Off balance sheet items reported here should attract the standard Credit Conversion Factors prior to be risk weighted (see Reporting Instructions to Section A for details of these factors).

B50 Unsettled transactions

Reporting institutions should report here the total capital requirement for counterparty risk on unsettled transactions. Item B50 should equal item 120 of Appendix B-I.

B60 OTC Derivatives

Reporting institutions should report here the total capital requirement for counterparty risk on OTC derivatives. The weighted amount in item B60 should equal line 60 of Appendix B-II.

B70 Undocumented repos/reverse repos

Reporting institutions should report here the total capital requirement for undocumented repos/reverse repos, and, if line supervisors have so requested, documented repos/reverse repos. The weighted amount in item B70 should equal line 50 of Appendix B-IV. Additionally, repos will give rise to a general market risk position that should be reported in either item B200 or B240 and their underlying Appendices.

B80 Documented repos

Reporting institutions should report here the total capital requirement for documented sale and repurchase agreements (repos). The weighted amount item in item B80 should equal item 100 of Appendix B-IV. Additionally, repos will give rise to a general market risk position that should be reported in either item B200 or B240 and their underlying Appendices.

B90 Documented reverse repos

Reporting institutions should report here the total capital requirement for documented reverse sale and repurchase agreements (reverse repos). The weighted amount item in B90 should equal item 150 of Appendix B-IV. Additionally, reverse repos will give rise to a general market risk position that should be reported in either item B200 or B240 and their underlying Appendices.

B100 Total counterparty risk in the Trading Book

This equals the sum of items B10 to B90.

B110-B140 LARGE EXPOSURES IN THE TRADING BOOK

When an exposure arising from tradable securities in the Trading Book exceeds 25% of adjusted capital base, it should be broken down on the Form LE2 into the individual exposures undertaken with the group of connected counterparties. The nature of each exposure should be identified along with the appropriate capital charge for counterparty or specific risk. The reporting institution should show how these capital charges have been used to generate the additional capital charge for large exposures reported in items B120 and B130.

The calculation for determining the incremental capital requirement involves the following sequential steps:

- a) Net any short securities positions against long securities positions, netting the short items against the highest long specific risk weighted items (Note: the specific risk weights of netted items need not be identical).
- b) Rank the remaining net long securities positions in order according to specific risk weighting factors (ie lowest weighted items first, highest weighted items last).
- c) Taking the lowest weighted items first, apply these exposures to the difference between the non securities exposure to the counterparty and 25% of the amended capital base (ie the "headroom" up to 25% of the amended capital base is employed to cover the lowest weighted exposures)
- d) Incremental capital is considered necessary for remaining net long securities exposures as follows:
 - i) if the excess exposure has been extant for 10 days or less, the specific risk weighting for exposures ranked in excess of 25% of the amended capital are multiplied by 200%.
 - ii) if the excess exposure has been extant for more than 10 days, the specific risk weightings for exposures ranked in excess of 25% of the amended capital base are multiplied by the following factors.

Excess exposure over 25% of amended capital base (acb)	Factor applied to specific risk weighting
Up to 40% of acb	200%
From 40% to 60% of acb	300%
From 60% to 80% of acb	400%
From 80% to 100% of acb	500%
From 100% to 250% of acb	600%
Over 250% of acb	900%

B110 Adjusted large exposures capital base

Report here the adjusted large exposures capital base (ie the adjusted capital base shown on Form LE2 (part 5) as at BSD3 reporting date) which the bank has agreed with the FSA.

B120 Excesses that have existed for 10 days or less

Report here the aggregate specific risk capital requirement of any large exposures excesses that have arisen on tradable securities in the Trading Book which have been in existence for 10 days or less. Only the amount of the exposure over 25% of the adjusted capital base should be reported here.

B130 Excesses that have existed for more than 10 days

Report here the aggregate specific risk capital requirement of any large exposures excesses that have arisen on tradable securities in the Trading Book which have been in existence for more than 10 days. The excess should be broken down into those parts within each band above 25%. Only the amount of the exposure over 25% and up to 40% of capital should be reported in item B130.1, that part of the exposure over 40% and up to 60% should be reported in item B130.2, etc. Item B130 should be the sum of items B130.1 to B130.6.

B140 Capital Requirement for Large Exposures

Report here the sum of the capital requirements generated from items B120 and B130.

B150-B180 FOREIGN EXCHANGE POSITION RISK

For more detailed information on the specification of capital for foreign exchange risk, see Chapter FX (Foreign exchange risk) of the FSA Policy Guide/IPRU (BANK).

B150 For basic approach

The total capital required for foreign exchange risk treated under the basic approach should be reported here. Item B150 should equal the item for the capital requirement for the basic method from Appendix B-V (column 2).

B160 For Backtesting Approach

The total capital required for foreign exchange risk treated under the backtesting approach should be reported here. Item B160 should equal the item for the capital requirement for the backtesting method from Appendix B-V (column 3).

B170 Additional Capital Charge for Options

The way in which these items should be completed should depend upon the method under which the reporting bank has agreed with its supervisor that it will calculate the capital requirement on its options portfolio.

B170.1 Using the Carve Out Approach

Banks should report here the capital requirement arising from options on foreign exchange instruments treated under the carve out approach to options.

B170.2 Using CAD1 Models (Scenario Matrix/Buffer) Approach

Banks should report here the capital requirement arising from options on foreign exchange instruments treated under the scenario matrix or buffer approach to options.

B180 Total foreign exchange risk

This item should be the sum of the capital requirement for foreign exchange risk treated under each of the different methods plus any additional capital requirements reported for options. Item B180 should equal the sum of items B150, B160 and B170.

B190-B220 INTEREST RATE POSITION RISK

For more detailed information on the specification of capital for interest rate risk, see Chapter TI (Interest rate position risk) of the FSA Policy Guide/IPRU (BANK).

B190 Specific Risk

Report here the sum of individual net position (as defined in Chapter TI (Interest rate position risk) of the FSA Policy Guide/IPRU (BANK) within each risk weighted amount. Specific risk on positions arising from underwriting should be included here. The risk weights refer to those applicable for interest rate specific risk. Item B190 should equal the sum of items B190.1 to B190.5.

The specific risk weights are:

0.00% Certain Central Government debt instruments;

Debt instruments should be given a 0% specific risk weighting if:

- a) they are issued by, fully guaranteed by, or fully collateralised by securities issued by Zone A² central governments and central banks, including the European Communities; or
- b) they are issued by, or fully guaranteed by, Zone B central governments and central banks with a residual maturity of 1 year or less and are denominated in local currency and funded by liabilities in the same currency.

0.25% Qualifying Items up to 6 months residual maturity

1.00% Qualifying Items over 6 and up to 24 months residual maturity

1.60% Qualifying Items over 24 months residual maturity

² See SGN Appendix C.

Debt instruments should be treated as qualifying if any of the following conditions apply:

- a) they are issued by, or fully guaranteed by, Zone B central governments and central banks with a residual maturity of over 1 year and are denominated in local currency and funded by liabilities in the same currency.
- b) They are securities issued by, or fully collateralised by claims on, a multilateral development bank as listed in the Solvency Ratio Directive. The European Commission may amend this list periodically (see SGN Appendix E for more detail).
- c) They are issued, guaranteed, endorsed, or accepted, by a credit institution incorporated in a Zone A country (see SGN Appendix C for details of Zone A and B countries);
- d) They are issued, or guaranteed, endorsed, or accepted, by a credit institution incorporated in a Zone B country and have a residual maturity of 1 year or less;
- e) They are issued, or guaranteed, by an investment firm that is incorporated in a Zone A country and subject to the Capital Adequacy Directive, or to a regime that FSA deems to be CAD equivalent;
- f) They are issued, or guaranteed, by an investment firm that is incorporated in a Zone B country and subject to the Capital Adequacy Directive, or to a regime that the FSA deems to be CAD equivalent; and they have a residual maturity of 1 year or less;
- g) They are issued by, or guaranteed by, Zone A public sector entities (see SGN23);
- h) They are issued by, or guaranteed by, a company whose equity is eligible for 2% equity specific risk weighting.
- i) The issue, or an issue of equivalent ranking in a liquidation, or an issue of equivalent ranking in a liquidation of the guarantor, is rated investment grade (or its equivalent for money market obligations), or above and the reporting bank is unaware of any sub-investment grade³ rating issued by any of the relevant credit rating agencies (see SGN Appendix H for the list of agencies which are considered relevant).

Convertible securities, such as bonds and preference shares, that are treated as debt instruments should be given a specific risk weighting identical to other debt items for the same issuer as described in the preceding paragraphs. Convertible securities (as defined in Chapter TE (Equity position risk), Section 2, Paragraph 4, of the FSA Policy Guide/IPRU (BANK)) should be treated as equities when:

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

³ Chapter BC (Credit risk in the banking book), Section 5, of the FSA Policy Guide/IPRU (BANK) includes a list of the relevant cut off points for investment grade for each relevant ratings agency.

Otherwise, a bank may treat equity convertibles as either:-

- a) an equity position based upon conversion of the bond and deducting from capital (by including in item B215) any losses, including accrued interest, that may arise from this "conversion" for the purposes of calculating the capital requirements, but limiting the size of any profits from the "conversion" to the sum of the specific and general risk requirements; or
- b) a debt item.

8.00% Non-Qualifying Items

Debt instruments where the issuer does not meet the requirements established above are deemed to be non-qualifying items.

B200 General Market Risk

This item should contain the total capital requirement for general market risk arising from positions in interest rate instruments and their derivatives. The detail behind this calculation should be reported in Appendix B-VI. Item B200 should equal the total Item in the Total General Market Interest Rate Risk column of Appendix B-VI.

B210 Additional Capital Charge for Options

The way in which these items are completed should depend upon the method under which the reporting bank has agreed with its supervisor it will calculate the capital requirement on its options portfolio.

B210.1 Using the Carve Out Approach

Banks should report here the capital requirement arising from options on interest rate instruments treated under the carve out approach to options (see in Chapter TI (Interest rate position risk), Section 7, of the FSA Policy Guide/IPRU (BANK)).

B210.2 Using CAD1 Models Approach

Banks should report here the capital requirement arising from options on interest rate instruments treated under the scenario matrix or buffer approach to options.

B215 Interest Rate Risk on Equity Derivatives

Reporting institutions should include in this box any interest rate risk arising from equity derivatives (including options) which is not processed via either an approved model or the usual methods for interest rate general market risk (see in Chapter TE (Equity position risk), Section 5, Paragraph 5, of the FSA Policy Guide/IPRU (BANK)).

Reporting institutions should also report here the absolute value of any loss on "conversion" for those convertibles and depository receipts that are being treated as equities for regulatory reporting purposes. Where there is a profit on "conversion", this profit may be reported here as a negative number up to a maximum of the sum of the specific and general risk requirements reported on the underlying equities.

B220 Total Interest Rate Position Risk

This item should be the sum of items B190, B200, B210 and B215.

B230-B270 EQUITY POSITION RISK**B230 Specific Risk**

This item should contain the total capital requirement for specific risk arising from positions in equities and their derivatives. The details behind this calculation should be reported in Appendix B-VII. Item B230 should equal 8% of the total of Columns 1 plus 4% of the total of Column 2 on Appendix B-VII.

B240 General Market Risk

This item should contain the total capital requirement for general market risk arising from positions in equities and their derivatives. The details behind this calculation should be reported in Appendix B-VII. Item B240 is 8% of the sum of the total of Columns 5 and 6 on Appendix B-VII.

B250 Additional Capital Charge for Options

The way in which these items are completed should depend upon the method under which the reporting bank has agreed with its supervisor it will calculate the capital requirement on its options portfolio.

B250.1 Using the Carve Out Approach

Banks should report here the capital requirement arising from options on equities treated under the carve out approach to options.

B250.2 Using CAD1 Models Approach

Banks should report here the capital requirement arising from options on equities treated under the scenario matrix or buffer approach to options.

B270 Total Equity Position Risk

This item should be the sum of the capital requirements for specific and general market risk on equities plus any additional capital requirements reported for options.

B280 Commodity position risk

Report here the total capital requirement for commodity position risk under the standard approach. This item should equal item 50 (column F) from Appendix B-VIII.

B282 Additional Capital Charge for Options

The way in which these items are completed should depend upon the method under which the reporting bank has agreed with its supervisor it will calculate the capital requirement on its options portfolio. This item should equal the sum of items B282.1 and B282.2

B282.1 Using the Carve Out Approach

Banks should report here the capital requirement arising from options on commodity instruments treated under the carve out approach to options.

B282.2 Using CAD1 Models (Scenario Matrix/Buffer) Approach

Banks should report here the capital requirement arising from options on commodity instruments treated under the scenario matrix or buffer approach to options.

B284 Total commodity position risk

Report here the total capital requirement for commodity position risk. This item should equal the sum of items B280 and B282.

B290-B340 INTERNAL MODELS APPROACH

B290 Previous day's value at risk

This equals the bank's regulatory (10 day, 99%) VaR calculated for the previous day.

B300 Average of previous 60 days' value at risk

This equals the average of the bank's regulatory VaR figures over the last 60 business days.

B310 Multiplication factor

This equals item 40 of Appendix B-IX. This item should be rounded to 2 decimal places and multiplied by 100 and entered in the relevant box as integers, eg a multiplication factor of 3.0 should be entered as 300.

B320 Capital charge for general market risk

This equals the greater of (item B300 multiplied by B310/100) and item B290.

B330 Capital surcharge for specific risk

A bank that models specific risk should increase its market risk capital requirement by a surcharge for specific risk. A bank may choose to calculate its surcharge as either:

- (a) an amount equal to the specific risk portion of the VaR measure calculated according to the Guidelines on internal models.
- (b) an amount equal to the VaR measures of sub-portfolios that are subject to specific risk.

In both cases, the surcharge for specific risk should be calculated as an average over the previous 60 business days.

B340 Total capital requirement for risk subject to internal models

This equals the sum of items B320 and B330.

APPENDIX B-I: UNSETTLED TRANSACTIONS

Reporting institutions should report any transactions (excluding repurchase and reverse repurchase agreements and stock borrowing and lending) where delivery of the instrument takes place against receipt of cash, but which remain unsettled 5 business days after their due date. Banks should report the difference between the contracted amount due and the current market value of the instrument as the "potential loss" (Lines 10 to 60) but may agree a different treatment with the FSA. This should be multiplied by the relevant factor in column 1 of the table below to obtain the capital requirement. A bank may instead report the agreed settlement price (Lines 70 to 110), which should be multiplied by the relevant factor in column 2 of the table below. This treatment should be agreed with the FSA before being adopted. Transactions 46 or more days past due should be reported on the basis of "potential" loss.

Note that the capital requirement for such transactions should not be multiplied by the counterparty risk weight.

Number of Working Days after due Settlement Date	Column 1	Column 2
0 - 4	Nil	Nil
5 - 15	8%	0.5%
16 - 30	50%	4.0%
31 - 45	75%	9.0%
46 or more	100%	100% of Potential Loss (as per Column 1)

Within Appendix B-I, item 60 should equal the capital charge figure for Rows 10 to 50 and item 110 should equal the capital charge figure for Rows 70 to 100. Item 120 is the sum of items 60 and 110.

APPENDIX B-II - COUNTERPARTY EXPOSURE ON OTC DERIVATIVE CONTRACTS (REPLACEMENT COST METHOD)

OTC Contracts

The credit equivalent amount is the sum of the replacement cost and the potential future credit exposure. The weighted amount is the product of the credit equivalent amount and the risk weight. This section should be filled in only for OTC derivative contracts within the Trading Book. Capital charges for counterparty risk on forward sales and purchases of equities and bonds should not be reported in this Appendix, but in Appendix B-IV. All forward transactions in the Trading Book should, however, also be reported in Appendix B-III. Similar contracts in the Banking Book should be reported in Section A. The reporting instructions for Appendix A-I should also be applied to this Appendix. Foreign exchange contracts with original maturity of 14 days or less should not be reported on this Appendix. Futures and options should not be reported where the contracts concerned are traded on exchanges subject to daily margining requirements.

Appendix B-II will not agree with Appendix B-III, since Appendix B-III is completed on a gross basis and includes exchange traded items.

Replacement Cost

For the purposes of measuring counterparty risk inherent in derivative contracts, a risk weight of 50% should be applied in respect of counterparties which would usually attract a counterparty risk weight of 100% (see SGN34 for more detail generally).

These instruments should be valued in line with the valuation policy included in the Reporting Institution's Trading Book policy statement.

Potential Future Credit Exposure

All OTC derivative contracts that may in the future have a positive mark-to-market value should be subject to a capital charge for potential future credit exposure (see SGN34 for guidance on calculation).

Net reporting of Replacement Cost

Where the terms of Chapter NE (Collateral and netting) of the FSA Policy Guide/IPRU (BANK) have been met then, on a bilateral basis (ie for each counterparty) the net replacement cost of nettable contracts may be reported (See SGN26, SGN35).

Net Reporting of Potential Future Credit Exposure

See SGN35.

Forward FX Contracts undertaken through Multilateral Netting Schemes

The credit equivalent amount for a reporting institution using a multilateral netting scheme should also be reported in Appendix B-II as set out in SGN35.

APPENDIX B-III: SUPPLEMENTARY INFORMATION ON OTC DERIVATIVE CONTRACTS

(REPLACEMENT COST METHOD)

This appendix should be completed on a gross basis, even where legally enforceable netting agreements are in place. It is used for general supervisory information. All derivative contracts should be reported on this section, including options written and other contracts with negative mark to market value. As a result, this section will not usually reconcile with the previous section. Contracts which do not have positive mark to market values should be reported in the Notional Principal Amounts section (the first four columns) only.

Reporting institutions' exposure to OTC contracts should be reported by the relevant product and counterparty type. Their exposure to exchange traded contracts should be reported by product type only.

Reporting institutions should include their exposures arising from options with their other contracts, but should also identify them separately as a memo item. Within the memo item on options, those which are exchange traded should be separately identified from those originating from the OTC market.

Interest Rate Contracts

The reporting instructions for Appendix A-II should also be applied to this item.

Foreign Exchange Contracts

Only exchange rate contracts of over 14 days original maturity (excluding a settlement period of up to 2 days) should be reported. The reporting instructions for Appendix A-II should also be applied to this item.

Equity Contracts

The reporting instructions for Appendix A-II should also be applied to this item.

Commodity Contracts

All positions in respect of physical commodities and derivative positions relating to physical commodities should be reported here. Reporting institutions may however seek the agreement of the FSA that a different reporting treatment is appropriate. Commodity futures and options should not be reported where the contracts concerned are traded on exchanges subject to daily margining requirements.

Precious Metals Contracts

Include here futures, forwards, swaps, options and similar instruments involving precious metals other than gold. Futures and options should not be reported where the contracts concerned are traded on exchanges subject to daily margining requirements.

Notional principal amounts by maturity

The notional principal amount for each contract should be reported in these items, regardless of whether it is matched by another contract or whether it has a positive mark to market value. This section should include all derivative contracts to which the reporting institution is party, including options written and purchased (see SGN 34 for more detail generally).

For exchange traded contracts, margins paid to exchanges should be separately identified and reported on the counterparty risk section of Sections A and B. The value of the underlying contracts should be reported here.

Replacement Cost

Reporting institutions should include here the replacement cost (mark-to-market) on off balance sheet contracts. Items with a negative mark to market value should be excluded.

APPENDIX B-IV: COUNTERPARTY RISK ON REPOS AND REVERSE REPOS

This appendix covers all repos, reverse repos and other transactions with a similar economic effect (eg stock borrowing/stock lending or sell-buy/buy-sell).

In the Trading Book, repo transactions are deemed to give rise to counterparty exposure.

Counterparty Risk On Documented Repos/Reverse Repos

In these sections, banks should report **all** Trading Book transactions, regardless of the terminology used, that meet the following criteria (arrangements where the bank has lent a third party's securities at its own risk are included):

- i) a bank has sold (or lent) Trading Book securities to a counterparty subject to buy back (or a return clause), and
- ii) the documentation forming the written agreement (whether a master agreement, or documentation used on specific occasions) provides for the claims of the bank to be automatically and immediately set off against the claims of the counterparty in the event of the latter's default, and the bank has the right to call for variation margin daily when there is a material adverse market move against it.

Transactions which fail to meet these criteria should be reported as undocumented repos/reverse repos.

Transactions that are fully collateralised should still be reported in columns 1 and 2. As the amount reported in each of these two columns will be the same for fully collateralised deals, the counterparty risk requirement will be zero. However, it is important that these deals are included otherwise these items would understate the volume of repo/reverse repo business being transacted.

When completing Lines 60 to 90 and Lines 110 to 140, it should be assumed that each individual repo or reverse repo cannot be overcollateralised in the absence of netting. Regarding repos (lines 60 to 90): if collateral held is worth more than 100% of the market value of the securities sold or lent, then the reported value of collateral on that deal should be the same as the market value of the securities. Excess collateral held for a repo with one counterparty should not offset a shortfall in collateral held for another repo with the same counterparty or another counterparty. Regarding reverse repos (lines 110 to 140): if the market value of securities bought or borrowed on a reverse repo is more than 100% of the market value of the collateral given, the reported value of the securities on that deal should be the same as the market value of the collateral. Excess securities received under a reverse repo with one counterparty should not offset a shortfall in securities received under another reverse repo with the same counterparty or another counterparty.

This Appendix only captures counterparty risk on repos and reverse repos. Consequently, the market risk arising from transactions that are reported in this section should still be reported in those sections of the form which capture market risk exposures arising from interest rate and equity position risk, depending on the nature of the security underlying the repo or reverse repo.

In both cases, Column 3 should be Column 1 minus Column 2. The weighted amount in Column 5 should be the multiple of the amount at risk (Column 3) and the Weight (Column 4). Item 100 is the sum of the Weighted Amount (Column 5) in rows 60 to 90. Item 150 is the sum of the Weighted Amount (Column 5) in rows 110 to 140.

Documented Repos

For documented repos, the weighted amount should be the higher of zero and:

{Market value of securities sold or lent - Market value of collateral taken}

x counterparty risk weight x 8%

If it seems to the FSA that the nature of a bank's repo/reverse repo business is such that the risks are significant (eg in terms of the volume or nature of activity), the FSA may require that all such transactions are treated as forwards (ie with risk cushions applying). Where the terms of Chapter NE (Collateral and netting) of the FSA Policy Guide/IPRU (BANK) are met, the replacement cost of a bank's repos and reverse repos with a single counterparty may still be netted, but the risk cushion factors should not be netted.

Securities, and if appropriate collateral, should be marked to market at least once a day. The amounts to be received or given should include all cashflows related to the securities and the transactions - manufactured dividends, interest, fees. Thus the amount to be received would include payments which the counterparty should have made to the bank but which have not yet been received, and the amount to be given would include payments which should have been made to the counterparty but which have not yet been paid. Receivables may not be included on the day when they are due, but they should be included if not received the following business day.

Collateral received may take the form of a guarantee, letter of credit, or similar instrument provided by a Zone A bank if that bank would not be considered to be a connected lender if it was making a loan to the recipient of the securities. In the event that the guarantor is not a Zone A bank or is a connected bank, the capital requirement for the securities lender should be:-

Market Value of Securities lent x Counterparty Risk Weight x 8%

Documented Reverse Repos

For documented reverse repos, the weighted amount will be the higher of zero and:

{Market value of collateral given - Market value of securities bought or borrowed}

x counterparty risk weight x 8%

If it seems to the FSA that the nature of a bank's reverse repo business is such that the risks are significant (eg in terms of the volume or nature of activity), the FSA may require that all such transactions are treated as forwards (with the application of risk cushion factors). Where the terms of Chapter NE (Collateral and netting) of the FSA Policy Guide/IPRU (BANK) are met, the replacement cost of a bank's repos and reverse repos with a single counterparty may still be netted, but the risk cushion factors should not be netted.

Undocumented Repos / Reverse Repos

Repos/reverse repos that do not meet the documentation and margining requirements set out above are referred to as undocumented repos and should be treated as follows: the measure used takes account of both the current replacement cost of the contract, and its potential value. The latter is incorporated through use of risk cushion factors (RCF) which reflect the likely volatility of security prices. These risk cushion factors are derived from the matrix of add-ons used to calculate the capital requirements for potential future exposures on off-balance sheet contracts. In determining the size of the risk cushion factor, reference is made to the maturity of the securities and of the collateral, rather than to the maturity of the transaction. The risk cushion factors are:

Interest rate products

<u>Residual maturity:</u>	<u>risk factor</u>
less than one year	0.25%
to five years	0.50%
five years or over	1.50%
Equities	6.00%

Where one side of a transaction is denominated in a currency other than that of the other side, and circumstances are such that a risk cushion factor applies, the risk cushion factors should be each increased by 1%.

In assigning risk cushions, banks should be aware of the following:

Where the collateral is provided in the form of cash, a guarantee, a letter of credit, or an instrument performing a similar function issued by a Zone A bank, a risk cushion factor of 0% should be applied.

Where the bank is receiving securities in exchange for cash (or collateral), the weighted amount is:

{replacement cost of forward + potential future credit exposure}

x counterparty risk weight x 8%

where

replacement cost

= higher of zero and the difference between market value of securities to be received and contracted value for forward delivery (in the case of forward purchases) or market value of collateral (in the case of repos);

potential future credit exposure

= the risk cushion factor applicable to the securities (or collateral if it is higher) multiplied by the contracted value for forward delivery;

Column 3 should be the sum of Columns 1 and 2. The weighted amount in Column 5 should be the multiple of the amount at risk (Column 3) and the Weight (Column 4). Item 50 is the sum of the Weighted Amount (Column 5) in rows 10 to 40.

Netting Of Counterparty Risk On Repos/Reverse Repos

Counterparty risk on repos and reverse repos with the same counterparty may be netted when the terms of Chapter NE (Collateral and netting) of the FSA Policy Guide/IPRU (BANK) have been met. Counterparty risk on repos arises when the value of the collateral reversed in is less than the value of the securities repoed out, while counterparty risk on reverse repos arises when the value of the securities reversed in is less than the value of the collateral given. This counterparty risk can be offset either by excess collateral on other repos or excess securities received on other reverse repos with the same counterparty.

Lines 60 to 90: If the total amount of collateral held on repos with the same counterparty is worth more than 100% of the market value of the securities sold or lent, the reported value of collateral on these deals should be the same as the market value of the securities. Excess collateral held on repos with one counterparty (lines 60 - 90 column 2) may be used to offset a shortfall in securities received on reverse repos with that counterparty (by transferring the excess to column 2 of lines 110 - 140). In other words if reverse repos with one counterparty are undercollateralised, any excess collateral received on repos with that counterparty may be included to increase the market value of securities received on reverse repos.

Lines 110 to 140: If the market value of securities bought or borrowed on reverse repos with the same counterparty is worth more than 100% of the market value of the collateral given, the reported value of the securities on these deals should be the same as the market value of the collateral. Again, excess securities received on reverse repos with one counterparty (column 2 lines 110 - 140) may be used to offset a shortfall in collateral held on repos with that counterparty (by transferring the excess to column 2 of lines 60 - 90). In other words if repos with one counterparty are undercollateralised, any excess securities received on reverse repos with that counterparty can be included to increase the market value of collateral taken on repos.

Example

Repos: market value of securities sold = 100mn

market value of cash received = 95mn

Reverse repos: market value of cash forwarded = 200mn

market value of securities bought = 202mn

All transactions are conducted with a Zone A bank (weighted at 20%).

Reporting: Line 80 column 1 = 100mn; column 2 = 97mn; column 3 = 3mn;

Line 130 column 1 = 200mn; column 2 = 200mn; column 3 = 0mn.

In this particular example, the 2mn of excess securities on the reverse repos has been transferred to collateral taken on the repos (column 2).

Repos

When netting is allowed, the weighted amount will be the higher of zero and:

{Market value of securities sold or lent - Market value of collateral taken - Reductions from netting} x counterparty risk weight x 8%

Reverse Repos

When netting applies, the weighted amount will be the higher of zero and:

{Market value of collateral given - Market value of securities bought or borrowed - Reductions from netting} x counterparty risk weight x 8%

APPENDIX B-V: CAPITAL REQUIREMENT FOR FOREIGN EXCHANGE RISK

Appendix B-V should be completed on the basis of underlying positions and not capital requirements. The capital requirement derived from the positions reported in this Appendix should be reported in items B150 and B160.

Banks should identify their "base currency" in the "Base currency" box. A UK-incorporated bank's base currency will generally be sterling, in which case the bank should write the 2 and 4 character country codes (UK / UKIN) in the base currency box. Where a bank wishes to use another currency as base, it should first discuss the matter with its supervisor.

The net open position in each currency (including gold but excluding the base currency) should be calculated according to Chapter FX (Foreign exchange risk), Section 3, of the FSA Policy Guide/IPRU (BANK). Positions in composite currencies may either be broken down into positions in the component currencies according to the quotas in force, or treated as positions in a separate currency. However, one or other method should be used consistently. Positions in American depository receipts should be treated as positions in the currency of the underlying instrument.

For consolidated returns, net open positions should include the non-base currency exposures of any subsidiaries where the Trading Book is consolidated line-by-line. When subsidiaries' Trading Books are consolidated by aggregation-plus, the subsidiaries' foreign exchange exposure should be calculated separately. Where a reporting institution has a non-base currency investment in an aggregation-plus subsidiary and the foreign exchange risk in that subsidiary is calculated using that currency as the base currency, then the investment, including retained earnings, should be included in the reporting institution's foreign currency position for the purposes of this appendix. Where the foreign exchange risk in the subsidiary is calculated using the same base currency as in the reporting institution then the investment in the subsidiary, plus retained earnings, should not be included in the calculation of the reporting institution's foreign currency position for the purposes of this appendix.

The net position in all currencies in which either the gross long or the gross short position exceeds £1million equivalent should be separately identified in column 1. Institutions should enter the 2 and 4 character country codes in the relevant boxes for any additional currencies not listed on the appendix. Where the number of currencies exceeds the number of lines provided, these (the smallest in value) should be aggregated and reported on lines U8 / UNAS (for net long positions) and U9 / UNAL (for net short positions).

The net position in other currencies (ie individual positions below £1million) should be aggregated according to whether they are long or short and included in the lines OTHL and/or OTHS. Net positions in gold should be separately identified in the "gold" section of column 1.

The base currency item in Column 1 (usually sterling) is a balancing item. It should be calculated as the amount required to make the sum of the positions in currencies (excluding gold) reported in Column 1 equal to zero.

Positions in Column 1, other than the balancing item in the base currency, should be allocated to either Column 2 or 3 in line with the agreed policy set out in the Trading Book Policy Statement. (In certain circumstances, it may be appropriate to split the position in one pre-determined currency, with only a proportion included in the backtesting method. Such a treatment should also be agreed in advance with the supervisor).

The capital requirement for the basic method, which should be reported at the bottom of Column 2, is 8% of the higher of the aggregate net short/long open currency positions reported in Column 2 plus 8% of the absolute value of gold position reported in column 2. This will appear in item B150.

The capital requirement for currency and gold positions included in the backtesting method should be reported at the bottom of column 3 and in item B160. The minimum requirement is 2% of the sum of the higher of net short/long open currency positions and the absolute value of the position in gold in Column 3: the entry at the bottom of Column 3 and in item B160 must be at least as large as this in order for the return to be processed.

From 1 September 1999, only the basic method should be used to calculate foreign exchange risk unless the reporting institution is using a VaR model. Accordingly, Columns 2 and 3 are no longer applicable, as column 1 is the same as column 2.

APPENDIX B-VI - CAPITAL REQUIREMENT FOR INTEREST RATE GENERAL MARKET RISK

Chapter TI (Interest rate position risk) of the FSA Policy Guide/IPRU (BANK) contains three alternative methods that may be used for the calculation of interest rate general market risk. Reporting institutions should specify which method they use for each category of instrument, but this will form part of their Trading Book policy statement and will not be reported on this form. Reporting institutions are not required to report the full details of the calculation performed under those methods to arrive at the capital requirement for each currency. However, banks should maintain systems to perform this calculation, and their supervisors might sometimes ask to see the detailed calculations for particular currencies. These need not be produced in a standard format, as the supervisor will accept a printout from the reporting bank's internal system.

Reporting institutions should report the weighted net long and net short position in interest rate products in each zone, broken down by currency of denomination (rather than country of issue,) as listed (for unlisted currencies, use the 2 and 4 character country codes where appropriate) on the appendix: ie for banks reporting under the duration-based approach, $\text{nominal} \times \text{price} \times \text{duration} \times \text{assumed move in rates}$ (or if using models, $\text{PV01} \times \text{assumed move in rates}$), and under the maturity-based approach, $\text{nominal} \times \text{price} \times \text{weighting factors}$. These figures should be derived from the individual net positions used in either the maturity or duration based approaches or from models recognised by the FSA, and will not necessarily (depending on whether the duration or maturity approach, or a combination of the two, is used) cross reference with the capital requirement arising from the maturity based, duration based and simple approaches (Columns 1 to 6 do not equal Columns 7 to 10). The total general market interest rate risk position will be the sum of the columns for maturity based approach, duration based approach and simplified method.

Simplified Method: Interest Rate

Reporting institutions which have chosen to apply the simplified method (Chapter TI (Interest rate position risk), Section 4, of the FSA Policy Guide/IPRU (BANK)) for interest rate risk should report the resultant capital requirement for each currency in the simplified method column. The figures input to this column should be derived using the simplified approach.

Maturity Based Approach

The capital requirement for positions treated under the maturity based approach should be reported in column 7. The maturity bands covered by each zone are:

	Maturity Based Approach	Maturity Based Approach
	Coupon of 3% or more	Coupon under 3%
Zone One	12 Months & Under	12 Months & Under
Zone Two	Over 12 Months & Up to 4 Years	Over 12 months & Up to 3.6 Years
Zone Three	Over 4 Years	Over 3.6 Years

Duration Based Approach

The capital requirement for positions treated under the duration based approach should be reported in column 8. The duration bands covered by each zone are:

	Duration Approach
Zone One	12 months & Under
Zone Two	Over 12 months and up to 3.6 Years
Zone Three	Over 3.6 Years

General

Positions in sterling index linked gilts should be reported in a separate line.

From 1 January 1999, the euro and the participating national currency units should be treated as the same currency and be reported in the line for the euro. The euro should not be capitalised.

Details should be provided for each individual currency listed on this form. Details for individual currencies in which the reporting institution has aggregate long and short positions equivalent to £1million or more should be entered in the blank rows provided.

Business in currencies with aggregate long and short positions below £1million should be aggregated and reported in the row for non material countries. This row should be completed on a gross basis. Positions in one currency should not be used to offset positions in another currency.

Reporting institutions which prefer to submit data on interest rate positions in each currency (using the 2 and 4 character country codes) regardless of materiality may do so. Where the number of currencies exceeds the number of lines provided, these (the smallest in value) should be aggregated and reported on the line U9 / UNAL.

Embedded Interest Rate Risk On Equity Derivatives (Including Options)

For general interest rate position risk on equity derivatives, an amount equal to the notional underlying equities may be included in Appendix B-VI as government securities with a coupon below 3% in the currency concerned. Banks should only report in this way if the FSA is satisfied, and has given express written agreement, that sufficient controls are in place to monitor this interest rate exposure and to take account of dividend exposures and liquidity risk. If a bank has an approved interest rate sensitivity model, the interest exposure may be incorporated into that model.

Unless otherwise agreed with the FSA, embedded interest rate exposures in equity derivatives should be calculated as in Chapter TE (Equity position risk), Section 5, Paragraphs 5-7, of the FSA Policy Guide/IPRU (BANK) and reported in item B215.

APPENDIX B-VII: EQUITY POSITION RISK

Banks should report their equity portfolio subdivided by country of issuer (rather than by currency). Banks should report separately their equity position in each country listed in Appendix B-VII. For all other countries, banks may choose to report these using the additional lines (using the 2 and 4 character country codes, largest in value first) or aggregate the material countries and report on line U9 / UNAL where the number of currencies exceeds the number of lines provided, or aggregate into a single row (XF / NONM) the reported figures for those countries in which the total gross equity position is less than £1 million, but offsetting of positions should not be applied between countries so aggregated (ie net equity positions for each country should be aggregated disregarding sign).

Standard Method

Gross equity positions (including positions in indices) should be reported in Columns 1, 2 or 3 according to the tests and definitions set out in Chapter TE (Equity position risk), Section 4, of the FSA Policy Guide/IPRU (BANK). Under the standard method positions in "highly liquid" stocks which form a "diversified portfolio" for the country concerned should be reported in Column 2. Positions in highly liquid indices which attract a charge for execution risk should be reported in column 3. All other positions should be reported in Column 1. Banks should include any notional equity instruments underlying positions in derivatives, but should exclude positions in "highly liquid" equity indices, unless they have been broken down into their components for the purpose of offsetting other positions. The capital requirement for specific/execution risk calculated from these positions is the total of Column 1 multiplied by 8% plus the total of Column 2 multiplied by 4% plus the total of Column 3 multiplied by 0%. This capital requirement should not be reported in Appendix B-VII, but in item B230. Column 4 is the sum of Columns 1, 2 and 3.

The absolute value (ie disregarding sign) of net equity positions should be reported in Columns 5 and 6. Banks should include any notional equity instruments, underlying positions in derivatives and also any positions in indices. For “concentrated” positions, ie those which form more than 20% of the total gross equity position for the country concerned, the value of the position in excess of 20% should be reported in Column 5 (disregarding sign), the remainder of the position being included in Column 6. If more than one concentrated position exists within a country portfolio, the reported excess positions should be aggregated without offsetting (ie disregarding sign) or use zone A/B distinction.

Column 7 is the sum of Columns 5 and 6. The capital requirement for general risk calculated from these positions is the total of Columns 5 and 6 multiplied by 8%. This capital requirement should not be reported in Appendix B-VII, but in item B240.

Equity positions arising from underwriting should be included within the gross and net equity positions reported for the relevant country. When discount factors are applied to underwriting positions prior to Working Day Zero and for the subsequent five days, the discounted position should be aggregated with other net equity positions for that country without offsetting (ie disregarding sign). [See Chapter TU (Underwriting in the capital adequacy framework) of the FSA Policy Guide/IPRU (BANK) for more details on the treatment of underwriting.]

Equity Simplified Method

Banks which have chosen to apply the simplified method for equity position risk should report gross equity positions either entirely in Column 1 (attracting an 8% charge). Equity index positions should be included in the gross position for the relevant country. The capital requirement for specific risk, which should be reported in item B230, is the total of Column 1 multiplied by 8%.

Under the simplified method the general risk requirement is calculated in the same way as under the standard method: the capital requirement for general market risk, which should be reported in item B240, is the total of Columns 5 and 6 multiplied by 8%.

APPENDIX B-VIII - COMMODITY POSITION RISK

This section outlines the calculation of capital charges for commodity position risk. For the purposes of this section, a commodity includes any physical product which is or can be traded on a secondary market and positions in respect of contracts whether tangibles or intangibles not covered elsewhere in these reporting instructions. Commodities therefore include agricultural products, base metals, other minerals and various precious metals; however, gold is excluded and is treated as a foreign currency according to the methodology set out under Appendix B-V. Any bank which is unsure whether a particular type of contract should be treated as a commodity for the purposes of this note should contact its line supervisor.

The capital requirements outlined here are intended to cover market-related risks. Banks may in addition face counterparty credit risk; the methodology for calculating the capital requirements in respect of such credit risk remains unchanged as is explained in Appendix A-1. The funding of commodities positions may, moreover, result in a bank incurring interest or foreign exchange exposure. If this is so, then such positions should be recorded as described in Appendices B-V and B-VI.

There are three alternatives for measuring commodity position risk: the internal models approach, the maturity ladder approach and the simplified approach. This section is concerned with the maturity ladder and simplified approaches only. Banks may choose themselves whether they wish to use the simplified or maturity ladder methodologies or some combination of the two.

Definition of a single commodity

Capital charges should be calculated for each commodity separately; long and short positions in the same commodity only should be matched (see below) prior to determining the net open position. For the purpose of these calculations, specific items may be considered as being elements of the same commodity if:

- (a) positions in different sub-categories are deliverable against each other; or
- (b) positions in commodities which are close substitutes for each other such that price movements over a minimum period of one year can be shown to have a stable and reliable correlation of at least 0.9.

Banks may undertake the matching of positions under option (b) above. However they should obtain the prior approval of their line supervisor before doing so. A bank wishing to treat positions in respect of non-identical items as the same commodity should be able to demonstrate that the correlation is valid and to monitor its continuing validity.

Derivative positions

All commodity derivatives and off-balance sheet positions which are affected by changes in commodities prices should be included in the calculation of commodity risk capital charges. These include commodity futures, commodity swaps and options. In applying the maturity ladder and simplified approaches, commodity derivative positions should be converted into notional commodity positions and assigned a maturity as follows:

- futures and forward positions relating to individual commodities should be included as notional amounts of barrels, kilos etc. and should be assigned a maturity based on their expiry date;
- commodity swaps where one leg is fixed price and the other is the current market price should be incorporated as a series of positions equal to the notional amount of the contract, with one position corresponding with each payment on the swap and slotted into the maturity ladder accordingly. The positions will be long positions if the bank is paying fixed and receiving floating and short positions if the bank is receiving fixed and paying floating; and
- for commodity swaps where the legs are in different commodities, each leg should be included in the relevant maturity ladder. No matching or off-setting should be carried out unless the commodities belong to the same sub-category as defined above.
- options and warrants on commodities may be treated under one of two methods. A simple method, called the carve-out, may be used for portfolios which contain (at most) only a small number of written options or warrants, and providing also they contain only plain vanilla and shorter-dated instruments. Banks with larger and/or more complex options portfolios should seek recognition for one of the option risk management models described in Chapter TS (CAD1 models) in the FSA Policy Guide/IPRU (BANK).

Maturity ladder approach

In utilising this methodology, each commodity position (spot plus forward) should be expressed in terms of a standard unit of measurement (barrels, tonnes, kilos). The adjustment of derivative items into notional commodity amounts is dealt with below. For each commodity, contracts or holdings expressed in a standard unit of measurement should be assigned to one of seven maturity or time bands (see below). Physical stocks should be entered into the first time band. A separate maturity ladder will apply to each commodity as defined above.

Table 1 - Time bands and spread rates

Time bands and spread rates

Time band	Spread rate
0-1 month	1.5%
1-3 months	1.5%
3-6 months	1.5%
6-12 months	1.5%
1-2 years	1.5%
2-3 years	1.5%
over 3 years	1.5%

Matched long and short positions in each time band should incur a capital charge. When calculating this charge, the sum of matched positions (i.e. both long and short positions) should be multiplied first by the spot price for that commodity and second by the spread rate for that band (1.5%). Any remaining unmatched position in a time band may be carried forward to the next time band. This amount may then be used to off-set positions in time bands that are further out. As the hedging of positions in different time bands is imprecise, a surcharge equal to 0.6% of the net position carried forward should be added in respect of each time band that the net position is carried forward.

In addition to matching within time bands set by the maturity ladder, banks may also engage in pre-processing (also known as off-setting or optimisation) in respect of commodities which have daily delivery dates. Under this procedure, banks may off-set long and short positions in a given commodity which mature on the same day or which mature within ten days of each other and are not required to carry these positions into the maturity ladder calculation. Banks may treat these ten-day periods as referring to business days. In addition, such ten-day periods need not be fixed and sequential and may overlap; a bank may therefore off-set a long position on day 45 with a short position on day 54 and another long position on day 48 with a short position on day 57 (all expressed in terms of working days). Ten-day off-set periods may cross maturity time bands.

A capital charge of 15% is applied to the residual net open amount after any pre-processing/optimisation, matching and carrying forward is complete.

Simplified approach

In calculating the capital charge for directional risk under the simplified approach, a similar procedure is adopted to that under the maturity ladder approach but with the important exception that all positions are treated as if they are in the same time band. A capital charge equal to 15% of the net position, long or short, is incurred in respect of each commodity. To guard against basis risk, interest rate risk and forward gap risk, the total capital charge for each commodity is subject to an additional capital charge equal to 3% of a bank's gross positions, long plus short, in the relevant commodity.

Reporting instructions - definitions

The total gross value of short and long positions for each commodity group should be recorded in columns A and B. Net open positions for each commodity group should be represented in column C. The total capital charge incurred in respect of the simplified approach should be recorded in column D and the total capital charge incurred through the maturity ladder approach in column E. The total of columns D and E should be recorded in column F.

Banks should use their judgement as to which commodities fall within a particular group. The same data as defined in the preceding paragraph should also be given for the top ten commodity positions, ranked by capital, which are held by the reporting bank. The definition of a commodity is given above. Banks may however agree materiality levels with their line supervisor. In such cases, banks may report separately commodity positions or capital charges that fall below the materiality threshold.

APPENDIX B-IX - BACKTESTING RESULTS

10 Minimum multiplication factor

This is the minimum multiplication factor which the FSA considers to be appropriate. This item should be rounded to 2 decimal places, multiplied by 100 and entered in the relevant box as integers (eg, a multiplication factor of 3.15 should be reported as 315).

20 Number of recorded backtesting exceptions

Reporting institutions should determine daily whether an exception has occurred. In order to determine whether an exception has occurred, the institution should compare the 'actual profit and loss' for the previous trading day with the corresponding VaR forecast for that trading day (calibrated to a one-day holding period and a 99% one-tail confidence limit). An exception occurs each time the actual daily loss exceeds the corresponding VaR estimate. This exception should be recorded. However the FSA may agree in particular cases that it is appropriate for such exceptions not to be recorded.

For this purpose, 'actual P&L' means the day's P&L arising from trading activities within the scope of the model. This measure should be 'cleaned' by excluding material non-market elements which might mask a loss. As part of the model recognition process, a reporting institution will agree its backtesting procedures with the FSA. Inter alia, the reporting institution and the FSA will agree on a definition of profit and loss to be used in backtesting, and on the scope of activities which should be included in the calculation of profit and loss. The profit and loss figures reported here should be based on this agreed definition and scope.

30 Plus factor

The plus factor is based on the number of recorded backtesting exceptions in item 20 :

<u>Exceptions</u>	<u>Pus Factor</u>
Up to 4	0.00
5	0.40
6	0.50
7	0.65
8	0.75
9	0.85
10 or more	1.00

The plus factor should be multiplied by 100 and entered in the relevant box as integers (eg, a factor of 0.40 should be reported as 40).

40 Multiplication factor

This equals the sum of items 10 and 30.

50 Number of backtesting exceptions on total portfolio

A reporting institution should report the number of exceptions recorded over the last reporting period (ie quarter for solo-consolidated/unconsolidated return, half year for consolidated return). These exceptions should be specified under item 51.0. In addition, the five largest daily losses and the five largest VaR measures (based on the one-day holding period and 99% confidence interval) should be reported separately under item 52.0 and item 53.0 respectively.

The VaR measure for backtesting purposes should be calibrated to a one-day holding period and a 99% one-tail confidence limit, and the actual profit and loss is the day's actual profit and loss arising from trading activities within the scope of the model. The VaR for a particular date should be the VaR forecast that was produced as at close of business on the previous trading day.

60 Number of backtesting exceptions on interest rate specific risk

A reporting institution should report the number of exceptions on portfolio for specific risk over the last reporting period. At a minimum, a reporting institution should conduct backtesting on the portfolios containing interest rate specific risk and the portfolios containing equity specific risk separately. The exceptions for interest rate specific risk should be specified under item 60.1. If the reporting institution conducts backtesting on a sub-portfolio level, this should be repeated for each sub-portfolio that is subject to interest rate specific risk.

The VaR measure for backtesting purposes should be calibrated to a one-day holding period and a 99% one-tail confidence limit, and the actual profit and loss is the day's actual profit and loss arising from trading activities within the scope of the model. The VaR for a particular date should be the VaR forecast that was produced as at close of business on the previous trading day.

70 Number of backtesting exceptions on equity specific risk

Report here the exceptions reported on backtesting on the portfolios containing equity specific risk. If the reporting institution conducts backtesting on a sub-portfolio level, this should be repeated for each sub-portfolio that is subject to equity specific risk.

The VaR measure for backtesting purposes should be calibrated to a one-day holding period and a 99% one-tail confidence limit, and the actual profit and loss is the day's actual profit and loss arising from trading activities within the scope of the model. The VaR for a particular date should be the VaR forecast that was produced as at close of business on the previous trading day.

APPENDIX B-X: EXPOSURES COLLATERALISED/GUARANTEED/NETTED

When exposures being netted for the calculation of counterparty risk all fall in the Banking Book, the net exposure should be reported as a risk in Section A (in the Banking Book column). Similarly if all exposures fall in the Trading Book, the net exposure should be reported as a risk in the Trading book (in Section B, with a corresponding entry in the Trading Book column in Section A). If the exposures are divided between both Banking and Trading Book, the net amount should be reported as a risk in the Trading Book in Section B. As soon as a counterparty ceases to be a counterparty to an exposure in the Trading Book, the net amount should be reported as part of the Banking Book.

The residual netted amount should be reported in the relevant risk weighting band for counterparty risk. But see SGN5 for guidance. If the statutory accounting treatment is gross but the terms of Chapter NE (Collateral and netting) of the FSA Policy Guide/IPRU (BANK) on netting have been met, and netting has been agreed for Trading Book (Section B) reporting purposes, those exposures netted out should be reported in the zero percent band in the relevant asset category. The adjustments made by the reporting institution to the Trading Book (Section B) in respect of netted exposures should be shown additionally in Appendix B-X.

The above treatment may be applied to netting of on balance sheet exposures, the netting of the replacement cost of off balance sheet exposures, and any netting of the potential future credit exposure (add-on).

BSD3 SECTION C - CONSOLIDATION VIA AGGREGATION PLUS INTO THE TRADING BOOK

Reporting institutions using the aggregation plus methodology to consolidate entities into the consolidated Trading Book should complete this section on consolidated returns. Each entity consolidated via aggregation plus should be entered on a separate line. Entities consolidated using the line-by-line method should not be reported here, but should be included in the consolidated Section B.

Note that incremental capital for large exposures is calculated on a line-by-line basis.

The Trading Book capital requirement for each entity is based on either the FSA's capital requirements or those of the subsidiary's local regulator; each reporting institution should have agreed with its line supervisor which the appropriate treatment for each subsidiary, and should annotate this on each line of the form.

Part of the Trading Book may be consolidated using line by line consolidation and part using aggregation plus; in this case, only the capital requirement for risks consolidated using aggregation plus should be reported here, with the remaining Trading Book positions reported in the consolidated Section B.

The FSA may agree with reporting institutions which are part of large groups that it is appropriate for them to report at the level of an intermediate holding company. The way in which this should be reported on the form will be agreed directly with the institution concerned.

Column A FSA / local regulator's rules applied

Where the FSA's requirements are applied, enter '1'. Where the local regulator's rules are applied, enter '0'. The local regulator's rules should only be used where they are considered to be equivalent to the CAD. The bank should seek the FSA's opinion on whether this is the position in particular cases. For further details see Chapter CS (Consolidated supervision) of the FSA Policy Guide/IPRU (BANK).

Column B Trigger ratio applied

Where the FSA's requirements are applied, the trigger ratio applied should be the consolidated Trading Book trigger ratio. The ratio (ie percentage rounded to 2 decimal places) should be multiplied by 100 and entered in the relevant boxes as integers (eg, a ratio of 8.50% should be reported as 850).

Where local regulator's rules are applied, some local regulators set more than one supervisory ratio, the first ratio being the figure below which the subsidiary risks withdrawal of authorisation or some formal sanction, and another ratio being a figure below which the subsidiary must report its position immediately to the local supervisor but no remedial action or sanction will be imposed. In such cases, the capital requirement reported here should be that according to the former ratio.

Where no supervisory ratio is used, and instead a capital requirement is directly computed, then the subsidiary should report 8% here.

Column C Trigger capital requirement

Institutions should report here for each subsidiary the total capital requirement set by the supervisor whose rules or requirements are applied. If the FSA requirements are applied, the capital charges should be calculated for the subsidiary in accordance with Chapters CS (Consolidated supervision) and CO (Capital adequacy overview) of the FSA Policy Guide/IPRU (BANK) and should be scaled up (ie the capital charge divided by 8% and multiplied by the trigger ratio) by institution's consolidated Trading Book trigger ratio.

If another (CAD-equivalent) supervisor's rules are applied, the capital requirement is the amount set by that supervisor. FSA's consolidated Trading Book trigger ratio should not be applied.

Where the subsidiary's capital requirement for market risks is partly or wholly determined by use of a recognised internal model, then any plus factor applied on a solo basis to that subsidiary should also be applied during the process of aggregation plus consolidation: that is, the capital requirement reported should include the plus factor. It should also use the same multiplication factor as that imposed by the local regulator.

Where the capital requirement of the subsidiary includes an incremental capital charge for large exposures on a solo basis, this charge should **not** be included in column C; the exposures of each entity should be consolidated line-by-line instead and any incremental capital for large exposures will be reported in a consolidated Section B.

Column D Notional risk weighted assets

Report here the notional risk weighted assets applicable to the capital requirement reported in each subsidiary. The notional risk weighted assets equal (column C divided by column B) multiplied by 10000.

Column E Incremental capital for large exposures

Column E is a memorandum item. The incremental capital charge applied to each subsidiary should be reported here.

Columns F-J Capital requirement against which Tier 3 capital may / may not be held

Report in column F the capital requirement for market risks, where local regulator's rules are applied and the local regulator allows the use of Tier 3 capital, or where the FSA requirements are applied.

Report in column G the capital requirements for market risks, where the local regulator does not allow the use of Tier 3 capital.

Tier 3 capital should not be used to support counterparty/settlement risks. However, where the local regulator permits a subsidiary to use Tier 3 capital to support counterparty/settlement risks, the institution may apply to the FSA for permission to use Tier 3 capital to support counterparty/settlement risks in that subsidiary on consolidation. Where the FSA has given express written agreement, these counterparty/settlement risks should be reported in column H.

Report in column J the capital requirement for counterparty/settlement risks against which Tier 3 may **not** be held.

Column K Plus factor

Report here the plus factor applied to the internal model in each entity (where applicable). Where no internal model is used for regulatory purposes, report 'N/A'. Where an internal model is used for regulatory purposes, but the plus factor applied is zero, report '0' (where the factor is greater than zero, this should be multiplied by 100 and reported as integers).

Column L Target capital requirement

Report here the capital requirement when the target ratio is applied. Where the FSA requirements are applied to a subsidiary, the capital requirements reported in column C should be multiplied by the consolidated Trading Book target ratio and divided by the consolidated Trading Book trigger ratio. Capital requirements for subsidiaries consolidated using local regulators' rules need not be scaled up.

Thus, column L equals the greater of column A * column C * (item D150/Column B) and column C

BSD3 SECTION D: CAPITAL ADEQUACY SUMMARY

D10-D30 CAPITAL BASE

D10 Tier 1: Core capital

This equals item A550.

D20 Eligible Tier 2

This equals item A630.

D30 Eligible Tier 3

This equals item A638.

D40 Total Eligible capital

This equals the sum of item D10 to item D30.

D50-D90 BANKING BOOK CAPITAL REQUIREMENTS / RISK WEIGHTED ASSETS

D50 Banking Book trigger ratio

This item equals the Banking Book trigger ratio set by the FSA. The ratio (ie percentage rounded to 2 decimal places) should be multiplied by 100 and reported as integers (eg, a ratio of 10.5% should be reported as 1050).

D60 Banking Book target ratio

This item equals the Banking Book target ratio set by the FSA. The ratio (ie percentage rounded to 2 decimal places) should be multiplied by 100 and reported as integers (eg a ratio of 12% should be reported as 1200).

D70 Total Banking Book risk weighted assets

This item collects totals for risk weighted assets and off-balance sheet items, by weighting band, reported in Section A.

Item D70.1 equals zero.

Item D70.2 equals the sum of the amounts reported in the column of weighted Banking Book amounts for the 10% band for all assets and off-balance sheet items in Section A (ie all the 10% band assets from item A40.2 to item A260.2, all the 10% band off-balance sheet items from item A340.2 to item A 440.3) plus the weighted Banking Book amount column for memorandum item A320.2 (which should be a positive number), **less** the weighted Banking Book amount for memorandum item A280.2. (Memorandum item A280. 2 is deducted in the above sum because it will be deducted elsewhere from capital, and yet has also been included within one of the amounts recorded in the risk weighted items above.)

Item D70.3 equals the sum of the amounts reported in the column of weighted Banking Book amounts for the 20% band for all assets and off-balance sheet items in Section A (ie all the 20% band assets from item A30 to item A260.3, and all the 20% band off-balance sheet items from item A340.3 to item A 440.4) plus the weighted Banking Book amount column for memorandum item A320.3 (which should be a positive number), **less** the weighted Banking Book amount for memorandum item A280.3. (Memorandum item A280.3 is deducted in the above sum because it will be deducted elsewhere from capital, and yet has also been included within one of the amounts recorded in the risk weighted items above.)

Item D70.4 equals the sum of the amounts reported in the column of weighted Banking Book amounts for the 50% band for all assets and off-balance sheet items in Section A (ie all the 50% band assets from item A40.4 to item A150.3, and all the 50% band off-balance sheet items from item A340.4 to item A440.5), **less** the weighted Banking Book amount for memorandum item A280.4. (Memorandum item A280.4 is deducted in the above sum because it will be deducted elsewhere from capital, and yet has also been included within one of the amounts recorded in the risk weighted items above.)

Item D70.5 equals the sum of the amounts reported in the column of weighted Banking Book amounts for the 100% band for all assets and off-balance sheet items in Section A (ie all the 100% band assets from item A40.5 to item A260.4, and all the 100% band off-balance sheet items from item A340.5 to item A440.8) plus the weighted Banking Book amount column for memorandum item A320.4 (which should be a positive number), plus item A462, **less** the weighted Banking Book amount for memorandum item A280.5. (Memorandum item A280.5 is deducted in the above sum because it will be deducted elsewhere from capital, and yet has also been included within one of the amounts recorded in the risk weighted items above.)

Item D70.6 is the sum of the original exposure and replacement cost methods for OTC derivatives in the Banking Book (ie the sum of items A452, A472 and A474).

D80 Banking book capital requirements

This equals total Banking Book risk weighted assets (item D70) multiplied by the Banking Book trigger ratio (item D50/10000).

D90-D110 CAPITAL ALLOCATED TO THE BANKING BOOK

Item D110 should equal the capital required to support the Banking Book as reported in item D80 unless there is insufficient capital available to meet the regulatory capital requirements while satisfying the constraints on capital.

Total capital allocated to the Banking Book (ie item D110) should equal the sum of Tier 1 and Eligible Tier 2 capital (ie items D90 and D100). Use as much Tier 2 capital as possible subject to the constraint that *at least half the capital used to support the banking book should be Tier 1 capital* : eligible Tier 2 capital allocated to the Banking Book (ie item D100) should be less than or equal to Tier 1 capital allocated to the Banking Book (item D90). Item D100 should equal item D110 divided by 2 unless (item D110/2) is greater than eligible Tier 2 capital (ie item D20); in this case item D100 should equal D20, and item D90 should equal item D80 **less** item D100.

Tier 3 capital should not be held against Banking Book risks. If item D110 is less than item D80, then the institution may have insufficient capital to meet its regulatory capital requirements and should contact its line supervisor immediately.

D120-D320 TRADING BOOK CAPITAL REQUIREMENTS/NOTIONAL RISK WEIGHTED ASSETS

D120 Exempt from CAD reporting date

This is a simple YES/NO field. If reporting institutions were exempt from the Capital Adequacy Directive capital requirement at the reporting date (see Chapter CB (Trading book/banking book division), Section 4, of the FSA Policy Guide/IPRU (BANK) for details of exemption), they should tick "YES" and progress to item D130. Non-exempt institutions should progress to D140.

D130 If Yes, number of days over threshold in reporting period

If a reporting institution is exempt from the CAD capital requirement at the reporting date, it should report here the number of days on which it has exceeded the lower threshold (euro 15mn or 5% of its combined on- and off-balance sheet positions, see Chapter CB (Trading book/banking book division), Section 4, Paragraph 2, of the FSA Policy Guide (Section 4, Paragraph 3 of IPRU (BANK)) for details) since the last reporting date. If on any day it has exceeded the higher threshold (euro 20mn or 6%), it should complete Section B.

D140 Trading Book trigger ratio

This is the Trading Book trigger ratio set by the FSA for CAD banks. The ratio (ie percentage rounded to 2 decimal places) should be multiplied by 100 and reported as integers (eg, a ratio of 11% should be reported as 1100).

D150 Trading Book target ratio

This is the Trading Book target ratio set by the FSA for CAD banks. The ratio (ie percentage rounded to 2 decimal places) should be multiplied by 100 and reported as integers (eg, a ratio of 11.50% should be reported as 1150).

D160-D220 CAPITAL REQUIREMENTS FOR SOLO AND LINE BY LINE CONSOLIDATED ENTITIES

The Standard Approach takes the Trading Book capital "haircuts" from Section B (ie the capital which would be required for these exposures if the Basle minimum 8% capital ratio were applied) and calculates the capital requirements by applying the reporting institution's Trading Book trigger ratio. Where this form is completed on a consolidated basis, the institution's consolidated Trading Book trigger ratio will apply. If the FSA has agreed that it is appropriate for an institution to use a Value at Risk model (Internal Model Approach) in calculating capital requirements, it will also have discussed with the institution extra reporting appropriate to its particular circumstances. The numbers for the Internal Model Approach are reported in item B290 to item B340, and may replace all or part of the Trading Book capital requirements reported in items D180 to D210 above, or for aggregation plus consolidated subsidiaries reported in item D300 below.

D160 Counterparty/Settlement risk

This equals item B100 divided by 8% and multiplied by the institution's Trading Book trigger ratio.

D170 Incremental capital for large exposures

This equals item B140 of section B divided by 8% and multiplied by the institution's Trading Book trigger ratio. Note that when this form is completed on a consolidated basis, item B140 will include incremental capital for large exposures for the consolidated group as set out on Form LE2 (part 5) (ie including subsidiaries consolidated using the aggregation plus method as well as those consolidated line-by-line), since large exposures are consolidated line-by-line only.

D180 Foreign exchange risk

This equals item B180 divided by 8% and multiplied by the institution's Trading Book trigger ratio.

D190 Interest rate position risk

This equals item B220 divided by 8% and multiplied by the institution's Trading Book trigger ratio.

D200 Equity position risk

This equals item B270 divided by 8% and multiplied by the institution's Trading Book trigger ratio.

D210 Commodity position risk

This equals item B284 divided by 8% and multiplied by the institution's Trading Book trigger ratio.

D220 Total capital requirement for trading book risk not subject to models

This equals the sum of item D160 to item D210 above.

D230-D250 INTERNAL MODELS APPROACH**D230 Capital charge for market risk**

This equals item B320 divided by 8% and multiplied by the institution's Trading Book trigger ratio.

D240 Capital charge for specific risk

This equals item B330 divided by 8% and multiplied by the institution's Trading Book trigger ratio.

D250 Total capital requirement for risk subject to internal models

This item should equal the sum of items D230 and D240.

D260-D300 CAPITAL REQUIREMENTS FOR ENTITIES CONSOLIDATED VIA AGGREGATION PLUS

Reporting institutions should complete these items only when the return is submitted on a consolidated basis. The capital requirements for individual subsidiaries consolidated using the aggregation plus methodology (see Chapter CS (Consolidated supervision) of the FSA Policy Guide/IPRU (BANK)) are reported in Section C.

D260 Market risk against which Tier 3 capital may be held

This equals item C30 column F.

D270 Market risk against which Tier 3 capital may not be held

This equals item C30 column G.

D280 Non-market risk against which Tier 3 capital may be held

This equals item C30 column H.

D290 Non-market risk against which Tier 3 capital may not be held

This equals item C30 column J.

D300 Total capital requirements for entities consolidated via aggregation plus

This equals item C30 column C.

D310 Total Trading Book capital requirements

This item is the sum of items D220, D250 and D300.

D320 Total Trading Book notional risk weighted assets

This equals items $([D220 \text{ plus } D250] \text{ divided by item } D140) * 10000 \text{ plus item } C30 \text{ column } D$.

D330-D360 CAPITAL ALLOCATED TO THE TRADING BOOK

These items depend on the total Trading Book capital requirements and on the capital remaining after allocating capital to support the Banking Book. Tier 1 capital remaining after supporting the Banking Book equals item D10 less item D90; eligible Tier 2 capital remaining after supporting the Banking Book equals item D20 **less** item D100.

D330 Tier 1 capital

This item must not exceed the amount of Tier 1 remaining after supporting the Banking Book.

D340 Eligible Tier 2 capital

This item should not exceed the amount of eligible Tier 2 capital remaining after supporting the Banking Book. It should not exceed 200% of Tier 1 capital used to support the Trading Book (ie item D330 multiplied by 2).

D350 Eligible tier 3 capital

This item must not be greater than item D30 for the form to be processed. Institutions should allocate as much Tier 3 capital as possible to the Trading Book, since it should not be allocated to the Banking Book and should not contribute to the adjusted capital base if it is not used. Therefore, maximise the use of Tier 3 subject to the following two constraints: first, capital requirements for counterparty/settlement risk should not be satisfied using Tier 3 capital; second, the amount of Tier 2 capital and Tier 3 subordinated term debt used to satisfy the Trading Book capital requirements should not exceed twice the amount of Tier 1 capital used to meet those requirements (ie item D330 should be at least 50% of the sum of items D340 and D350).

The following method may be used to fill in item D330 to item D350:

- (i) Item D330 should be at least one third of item D310.
- (ii) Item D350 should be maximised subject to it not exceeding either the available Tier 3 capital (item D30) or the capital requirement against which Tier 3 capital may be used (the sum of items D220, D250, D260 and D280 less item D160).
- (iii) Item D340 is the remaining capital which has not yet been met by either Tier 1 or Tier 3 capital. This should equal item D310 less the sum of items D330 and D350.

Tier 3 capital should not be used to meet counterparty / settlement risk capital requirements.

D360 Total capital allocated to the Trading Book

This equals the sum of items D330 to D350. If the institution has sufficient capital after supporting its Banking Book requirements to support its Trading Book requirements, then item D360 should also equal item D310. If item D360 is less than item D310, then the institution may have insufficient capital to meet its regulatory capital requirements and should contact its line supervisor immediately.

D370-D390 ELIGIBLE CAPITAL NOT USED TO SUPPORT EITHER BOOK

D370 Tier 1

This is the amount of Tier 1 capital remaining after supporting the Banking Book and the Trading Book but before deductions (ie item D10 **less** the sum of items D90 and D330).

D380 Eligible Tier 2

This is the amount of Eligible Tier 2 capital remaining after supporting the Banking Book and the Trading Book but before deductions (ie item D20 **less** the sum of items D100 and D340).

D390 Total excess Tier 1 and eligible Tier 2 capital before deductions

This is the amount of total Tier 1 and eligible Tier 2 capital remaining after supporting the Banking Book and the Trading Book but before deduction (ie item D390 equals the sum of items D370 and D380). If item D390 is less than item D470, then the reporting institution may have insufficient Tier 1 and 2 capital left over after supporting the Banking Book and the Trading Book capital requirements to support the deductions from capital; it should contact its supervisor immediately in this case.

D400-D470 DEDUCTIONS FROM CAPITAL

D400 Investment in subsidiaries and associated companies

This equals item A160.

D410 Connected lending of a capital nature

This equals item A280.

D420 Off-balance sheet items of a capital nature

This equals item A340.6, A370.6, A380.6, A390.6, A410.5 and A440.7.

D430 Investments in bank and financial firm capital

This equals item A171.

D440 Qualifying holdings

This equals item A180.4

D450 Deduction plus consolidation

Where a reporting institution is exempt from capital requirements under CAD at both the solo level and consolidated level, and where it has been determined that some or all of its subsidiaries should be consolidated using deduction plus, these deductions should be reported here. The amounts deducted should be the higher of the investment in the affiliate and the affiliate's capital requirement as determined by its deduction from capital base. The assets of the affiliate should not be included in the calculation of weighted risk assets.

D460 Other deductions

All deductions from capital under The Banking Consolidation Directive (2000/12/EC) arising from subsidiaries which are consolidated using aggregation plus are reported here. For subsidiaries consolidated according to the FSA's requirements, the deductions should be for items which would correspond to item D400 to item D460 for that subsidiary. For subsidiaries consolidated using a local regulator's rules, the deduction should be all the deductions from capital made by the local regulator; for example, for subsidiaries of a securities and futures firm, this would include any deductions made from capital when assessing the "financial resources". However, in that case, if a deduction related to a firm which is part of the group consolidation (and which would then result in a double deduction), the institution should agree with the FSA the method of reporting. The FSA may require further deductions relating to any part of the consolidated reporting institution on a case by case basis; these would probably relate to amounts reported in items A290, A300 and A310.

D470 Total deductions

This equals the sum of item D400 to item D460.

D480 Own Funds

This is 'own funds' as defined in Article 34 of the Banking consolidation Directive (2000/12/EC), as amended by CAD Annex V. This directive replaces The Directive on Own Funds, "OFD" (89/229/EEC). This should equal total eligible capital (ie item D40) **less** total deductions from Tier 1 and eligible Tier 2 capital (ie item D470).

D490 Adjusted capital base

The adjusted capital base is the sum of Tier 1 capital, eligible Tier 2 capital and **used** Tier 3 capital **less** deductions from capital (ie the sum of items D10, D20 and D350 less item D470).

D500 Total capital requirements

This represents the Banking Book and Trading Book capital requirements when the trigger ratios are applied. This equals the sum of items D80 and D310.

D510 Total risk weighted assets

This represents the Banking Book risk weighted assets and Trading Book notional risk weighted assets. This item equals the sum of items D70 and D320.

D520 Published risk asset ratio

This is an expression of the institution's capital adequacy relative to the Basle minimum 8% capital ratio. It is the ratio of the institution's adjusted capital base to the sum of its Banking Book risk weighted assets and its Trading Book notional risk weighted assets, expressed as a percentage. It equals item D490 multiplied by 100 and divided by item D510.

The ratio (ie percentage rounded to 2 decimal places) should be multiplied by 100 and reported as integers in the relevant box (eg, a ratio of 10.50% should be reported as 1050).

D530 Trigger capital adequacy ratio

This is the institution's capital adequacy relative to its trigger capital requirements. It is the ratio of the institution's adjusted capital base to its supervisory capital requirement according to the trigger ratios set by the FSA (or by the local regulator for entities consolidated using the aggregation plus methodology). The ratio is expressed as a percentage: an institution with a trigger capital adequacy ratio less than 100 has insufficient capital to meet its regulatory requirements and it should contact its line supervisor immediately. This item should equal (item D490 multiplied by 100) and divided by item D500.

The ratio (ie percentage rounded to 2 decimal places) should be multiplied by 100 and reported as integers in the relevant box (eg a ratio of 110.40% should be reported as 11040).

D540 Target capital adequacy ratio

This is the institution's capital adequacy relative to its supervisory target capital requirements. It is the ratio of the institution's adjusted capital base to its supervisory capital requirement according to the target ratios set by the FSA. The ratio is expressed as a percentage: an institution with a target capital adequacy ratio less than 100 has insufficient capital to meet its regulatory requirements and it should contact its line supervisor immediately. This item should equal item D490 multiplied by 100 and divided by the sum of (item D70 multiplied by item D60/10000, item D150 divided by item D140 and multiplied by items [D220 plus D250], and item C30 column L).

The ratio (ie percentage rounded to 2 decimal places) should be multiplied by 100 and reported as integers (eg a ratio of 105.35% should be reported as 10535).

FORM BSD3 - CAPITAL ADEQUACY RETURN

GENERAL

Ref No	Item Number	
G1	FSA	> 0 (Introduced in SRN/2001/2, effective December 2001)

SECTION A : BANKING BOOK

INTERNAL VALIDATIONS

Ref No	Item Number	
1	AB40	= AB40.1 + AB40.2 + AB40.3 + AB40.4 + AB40.5
2	AB50	= AB50.1 + AB50.2 + AB50.3 + AB50.4
3	AB60	= AB60.1 + AB60.2 + AB60.3 + AB60.4
4	AB70	= AB70.1 + AB70.2 + AB70.3 + AB70.4
5	AB80	= AB80.1 + AB80.2 + AB80.3 + AB80.4
6	AB100	= AB100.1 + AB100.2 + AB100.3 + AB100.4
7	AB120	= AB120.1 + AB120.2 + AB120.3 + AB120.4
8	ANL120.1	≤ AB120.1
9	ANL120.2	≤ AB120.2
10	ANL120.3	≤ AB120.3
11	ANL120.4	≤ AB120.4
12	AB130	= AB130.1 + AB130.2 + AB130.3
13	AB140	= AB140.1 + AB140.2 + AB140.3
14	AB150	= AB150.1 + AB150.2 + AB150.3 + AB150.4
15	AB170	≥ AB171 + AB172
16	AT170	≥ AT171 + AT172
17	AB180	= AB180.1 + AB180.2 + AB180.3 + AB180.4
18	AB210	= AB210.1 + AB210.2
19	AT210	= AT210.1 + AT210.2
20	AB240	= AB240.1 + AB240.2 + AB240.3
21	AB260	= AB260.1 + AB260.2 + AB260.3 + AB260.4
22	AT270	= AT10 + AT20 + AT30 + AT40 + AT50 + AT60 + AT70 + AT80 + AT100 + AT110 + AT120 + AT130 + AT140 + AT150 + AT160 + AT170 + AT180 + AT190 + AT200 + AT210 + AT220 + AT230 + AT240 + AT250 + AT260 + AT265
23	AB270	= AB10 + AB20 + AB30 + AB40 + AB50 + AB60 + AB70 + AB80 + AB90 + AB100 + AB110 + AB120 + AB130 + AB140 + AB150 + AB160 + AB170 + AB180 + AB190 + AB200 + AB210 + AB220 + AB230 + AB240 + AB250 + AB260
24	AB280	= AB280.1 + AB280.2 + AB280.3 + AB280.4 + AB280.5
25	AT280	= AT280.1 + AT280.2 + AT280.3 + AT280.4 + AT280.5
26	AB290	= AB290.1 + AB290.2 + AB290.3 + AB290.4 + AB290.5

27	AB300	= AB300.1 + AB300.2 + AB300.3 + AB300.4 + AB300.5
28	AB310	= AB310.1 + AB310.2 + AB310.3 + AB310.4 + AB310.5
29	AB320	= AB320.1 + AB320.2 + AB320.3 + AB320.4
30	A330.01	= A330.11 + A330.21
31	A330.02	≤ A330.12 + A330.22
32	A330.01	≤ A770
33	A330.02	≤ AB270 + AT270
34	AB340	= AB340.1 + AB340.2 + AB340.3 + AB340.4 + AB340.5 + AB340.6 + AB340.7
35	AB350	= AB350.1 + AB350.2 + AB350.3 + AB350.4 + AB350.5 + AB350.6
36	AB360	= AB360.1 + AB360.2 + AB360.3 + AB360.4 + AB360.5 + AB360.6
37	AB370	= AB370.1 + AB370.2 + AB370.3 + AB370.4 + AB370.5 + AB370.6 + AB370.7
38	AB380	= AB380.1 + AB380.2 + AB380.3 + AB380.4 + AB380.5 + AB380.6 + AB380.7
39	AB390	= AB390.1 + AB390.2 + AB390.3 + AB390.4 + AB390.5 + AB390.6 + AB390.7
40	AB400	= AB400.1 + AB400.2 + AB400.3 + AB400.4 + AB400.5.
41	AB410	= AB410.1 + AB410.2 + AB410.3 + AB410.4 + AB410.5 + AB410.6
42	AB420	= AB420.1 + AB420.2 + AB420.3 + AB420.4 + AB420.5
43	AB430	= AB430.1 + AB430.2 + AB430.3 + AB430.4
44	AB440	= AB440.1 + AB440.2 + AB440.3 + AB440.4 + AB440.5 + AB440.6 + AB440.7 + AB440.8
45	AW452	= Appendix A-I W60
46		Superseded by validation 68 (val 3), SRN/1998/4
46	A530	= A480 + A490 + A500 + A510 + A520
47	A540	≥ AT200 + AB200 + AT210.2 + AB210.2
48	A550	= A530 - A540
49	A590	= Appendix A-V 80G
50		Superseded by validation 69 (val 3), SRN/1998/4
51	A610 - A623	= A790
52	A622	= max (0, (A790 - (50% A550)))
53		Superseded by validation 70 (val 3), SRN/1998/4
54	A624	= A580 + A590 + A600 + A610 + A620 - A621 - A622 - A623
55		Duplication of validation 56 (val 2), SRN/1998/4
56	A630	= A624 - A625
57	A638	= A631 + A633 - A635
58	A660	= A621 + A622 + A623 + A625 + A635
59	A690	= A690.1 + A690.2
60	A700	= A700.1 + A700.2 + A700.3
61	A710	= A710.1 + A710.2
62	A730	= A730.1 + A730.2
63	A760	= A760.1 + A760.2

64	A770	= A530 + A630 + A638 + A660 + A670 + A680 + A690 + A700 + A710 + A720 + A730 + A740 + A750 + A760 + A765
65	A770	= AT270 + AB270
66	A790	= A790.1 + A790.2
67	A790.2	= AA790.21+ AA790.22
68	A500	= A500.1 + A500.2 + A500.3
69	A610 - A622 - A623	≤ 50% A550
70	A623	= (AS790.21+AS790.22)-(AA790.21+AA790.22)

APPENDIX A-I VALIDATIONS

Ref No	Appx A-I Item No	
1	R60	= R10 + R20 + R30 + R40 + R50
2	P60	= P10 + P20 + P30 + P40 + P50
3	C60	= C10 + C20 + C30 + C40 + C50
4	W60	= W10 + W20 + W30 + W40 + W50
5	W60	= Section A W452

APPENDIX A-II VALIDATIONS

Ref No	Appx A-II Item No	
1	ND10	= NA10 + NB10 + NC10
2	ND20	= NA20 + NB20 + NC20
3	ND30	= NA30 + NB30 + NC30
4	ND40	= NA40 + NB40 + NC40
5	ND50	= NA50 + NB50 + NC50
6	ND60	= NA60 + NB60 + NC60
7	ND70	= NA70 + NB70 + NC70
8	ND80	= NA80 + NB80 + NC80
9	ND90	= NA90 + NB90 + NC90
10	ND100	= NA100 + NB100 + NC100
11	ND110	= NA110 + NB110 + NC110
12	ND120	= NA120 + NB120 + NC120
13	ND130	= NA130 + NB130 + NC130
14	ND140	= NA140 + NB140 + NC140
15	ND150	= NA150 + NB150 + NC150
16	ND160	= NA160 + NB160 + NC160
17	ND170	= NA170 + NB170 + NC170
18	ND180	= NA180 + NB180 + NC180
19	ND190	= NA190 + NB190 + NC190
20	ND200	= NA200 + NB200 + NC200
21	ND210	= NA210 + NB210 + NC210
22	ND220	= NA220 + NB220 + NC220
23	ND230	= NA230 + NB230 + NC230
24	ND240	= NA240 + NB240 + NC240
25	ND250	= NA250 + NB250 + NC250
26	ND260	= NA260 + NB260 + NC260
27	ND270	= NA270 + NB270 + NC270
28	ND280	= NA280 + NB280 + NC280

29	ND290	= NA290 + NB290 + NC290
30	ND300	= NA300 + NB300 + NC300
31	ND310	= NA310 + NB310 + NC310
32	ND320	= NA320 + NB320 + NC320
33	ND330	= NA330 + NB330 + NC330
34	ND340	= NA340 + NB340 + NC340
35	ND350	= NA350 + NB350 + NC350
36	ND360	= NA360 + NB360 + NC360
37	ND370	= NA370 + NB370 + NC370
38	ND380	= NA380 + NB380 + NC380
39	ND390	= NA390 + NB390 + NC390
40	ND400	= NA400 + NB400 + NC400
41	ND410	= NA410 + NB410 + NC410
42	ND420	= NA420 + NB420 + NC420
43	NA60	≤ NA10 + NA20 + NA30 + NA40
44	NB60	≤ NB10 + NB20 + NB30 + NB40
45	NC60	≤ NC10 + NC20 + NC30 + NC40
46	ND60	≤ ND10 + ND20 + ND30 + ND40
47	NA70	≤ NA50
48	NB70	≤ NB50
49	NC70	≤ NC50
50	ND70	≤ ND50
51	NA130	≤ NA80 + NA90 + NA100 + NA110
52	NB130	≤ NB80 + NB90 + NB100 + NB110
53	NC130	≤ NC80 + NC90 + NC100 + NC110
54	ND130	≤ ND80 + ND90 + ND100 + ND110
55	NA140	≤ NA120
56	NB140	≤ NB120
57	NC140	≤ NC120
58	ND140	≤ ND120
59	NA200	≤ NA150 + NA160 + NA170 + NA180
60	NB200	≤ NB150 + NB160 + NB170 + NB180
61	NC200	≤ NC150 + NC160 + NC170 + NC180
62	ND200	≤ ND150 + ND160 + ND170 + ND180
63	NA210	≤ NA190
64	NB210	≤ NB190
65	NC210	≤ NC190
66	ND210	≤ ND190
67	NA270	≤ NA220 + NA230 + NA240 + NA250
68	NB270	≤ NB220 + NB230 + NB240 + NB250
69	NC270	≤ NC220 + NC230 + NC240 + NC250

70	ND270	\leq ND220 + ND230 + ND240 + ND250
71	NA280	\leq NA260
72	NB280	\leq NB260
73	NC280	\leq NC260
74	ND280	\leq ND260
75	NA340	\leq NA290 + NA300 + NA310 + NA320
76	NB340	\leq NB290 + NB300 + NB310 + NB320
77	NC340	\leq NC290 + NC300 + NC310 + NC320
78	ND340	\leq ND290 + ND300 + ND310 + ND320
79	NA350	\leq NA330
80	NB350	\leq NB330
81	NC350	\leq NC330
82	ND350	\leq ND330
83	NA410	\leq NA360 + NA370 + NA380 + NA390
84	NB410	\leq NB360 + NB370 + NB380 + NB390
85	NC410	\leq NC360 + NC370 + NC380 + NC390
86	ND410	\leq ND360 + ND370 + ND380 + ND390
87	NA420	\leq NA400
88	NB420	\leq NB400
89	NC420	\leq NC400
90	ND420	\leq ND400
91	RD10	= RA10 + RB10 + RC10
92	RD20	= RA20 + RB20 + RC20
93	RD30	= RA30 + RB30 + RC30
94	RD40	= RA40 + RB40 + RC40
95	RD80	= RA80 + RB80 + RC80
96	RD90	= RA90 + RB90 + RC90
97	RD100	= RA100 + RB100 + RC100
98	RD110	= RA110 + RB110 + RC110
99	RD150	= RA150 + RB150 + RC150
100	RD160	= RA160 + RB160 + RC160
101	RD170	= RA170 + RB170 + RC170
102	RD180	= RA180 + RB180 + RC180
103	RD220	= RA220 + RB220 + RC220
104	RD230	= RA230 + RB230 + RC230
105	RD240	= RA240 + RB240 + RC240
106	RD250	= RA250 + RB250 + RC250
107	RD290	= RA290 + RB290 + RC290
108	RD300	= RA300 + RB300 + RC300
109	RD310	= RA310 + RB310 + RC310
110	RD320	= RA320 + RB320 + RC320

111	RD360	= RA360 + RB360 + RC360
112	RD370	= RA370 + RB370 + RC370
113	RD380	= RA380 + RB380 + RC380
114	RD390	= RA390 + RB390 + RC390
115	NA360	= NA10 + NA80 + NA150 +NA220 + NA290
116	NB360	= NB10 + NB80 + NB150 +NB220 + NB290
117	NC360	= NC10 + NC80 + NC150 +NC220 + NC290
118	ND360	= ND10 + ND80 + ND150 +ND220 + ND290
119	RA360	= RA10 + RA80 + RA150 +RA220 + RA290
120	RB360	= RB10 + RB80 + RB150 +RB220 + RB290
121	RC360	= RC10 + RC80 + RC150 +RC220 + RC290
122	RD360	= RD10 + RD80 + RD150 +RD220 + RD290
123	NA370	= NA20 + NA90 + NA160 +NA230 + NA300
124	NB370	= NB20 + NB90 + NB160 +NB230 + NB300
125	NC370	= NC20 + NC90 + NC160 +NC230 + NC300
126	ND370	= ND20 + ND90 + ND160 +ND230 + ND300
127	RA370	= RA20 + RA90 + RA160 +RA230 + RA300
128	RB370	= RB20 + RB90 + RB160 +RB230 + RB300
129	RC370	= RC20 + RC90 + RC160 +RC230 + RC300
130	RD370	= RD20 + RD90 + RD160 +RD230 + RD300
131	NA380	= NA30 + NA100 + NA170 +NA240 + NA310
132	NB380	= NB30 + NB100 + NB170 +NB240 + NB310
133	NC380	= NC30 + NC100 + NC170 +NC240 + NC310
134	ND380	= ND30 + ND100 + ND170 +ND240 + ND310
135	RA380	= RA30 + RA100 + RA170 +RA240 + RA310
136	RB380	= RB30 + RB100 + RB170 +RB240 + RB310
137	RC380	= RC30 + RC100 + RC170 +RC240 + RC310
138	RD380	= RD30 + RD100 + RD170 +RD240 + RD310
139	NA390	= NA40 + NA110 + NA180 +NA250 + NA320
140	NB390	= NB40 + NB110 + NB180 +NB250 + NB320
141	NC390	= NC40 + NC110 + NC180 +NC250 + NC320
142	ND390	= ND40 + ND110 + ND180 +ND250 + ND320
143	RA390	= RA40 + RA110 + RA180 +RA250 + RA320
144	RB390	= RB40 + RB110 + RB180 +RB250 + RB320
145	RC390	= RC40 + RC110 + RC180 +RC250 + RC320
146	RD390	= RD40 + RD110 + RD180 +RD250 + RD320
147	NA400	= NA50 + NA120 + NA190 +NA260 + NA330
148	NB400	= NB50 + NB120 + NB190 +NB260 + NB330
149	NC400	= NC50 + NC120 + NC190 +NC260 + NC330
150	ND400	= ND50 + ND120 + ND190 +ND260 + ND330
151	NA410	= NA60 + NA130 + NA200 +NA270 + NA340
152	NB410	= NB60 + NB130 + NB200 +NB270 + NB340

153	NC410	= NC60 + NC130 + NC200 +NC270 + NC340
154	ND410	= ND60 + ND130 + ND200 +ND270 + ND340
155	NA420	= NA70 + NA140 + NA210 +NA280 + NA350
156	NB420	= NB70 + NB140 + NB210 +NB280 + NB350
157	NC420	= NC70 + NC140 + NC210 +NC280 + NC350
158	ND420	= ND70 + ND140 + ND210 +ND280 + ND350

APPENDIX A-IV VALIDATIONS

Ref No	Appx A-IV Item No	
1	30	= 10 - 20
2	60	= 30 + 40 + 50
3	180	= 110 + 120 + 130 + 140 + 150 + 160 + 170
4	180 + 190	= 60 + 70 + 80 + 90 + 100
5	210	= 190 + 200
6	140 + 150	= Appendix A-V 40T (Introduced SRN/2001/2, effective December 2001)

APPENDIX A-V VALIDATIONS

Ref No	Appx A-V Item No	
1	80S	= 10S + 20S + 30S + 40S + 50S + 60S + 70S
2	80G	= 10G + 20G + 30G + 40G + 50G + 60G + 70G
3	80T	= 10T + 20T + 30T + 40T + 50T + 60T + 70T
4	150	= 80S
5	150	= 90 + 100 + 110 + 120 + 130 + 140
6	230	= 170 + 180 + 190 + 200 + 210 + 220
7	80S	= 150 + 230 (Introduced SRN/2001/2, effective December 2001)
8	160	≥ 150 (Introduced SRN/2001/2, effective December 2001)
9	90	≥ 0 (Introduced SRN/2001/2, effective December 2001)
10	100	≥ 0 (Introduced SRN/2001/2, effective December 2001)
11	110	≥ 0 (Introduced SRN/2001/2, effective December 2001)
12	120	≥ 0 (Introduced SRN/2001/2, effective December 2001)
13	130	≥ 0 (Introduced SRN/2001/2, effective December 2001)
14	140	≥ 0 (Introduced SRN/2001/2, effective December 2001)
15	150	≥ 0 (Introduced SRN/2001/2, effective December 2001)
16	160	≥ 0 (Introduced SRN/2001/2, effective December 2001)
17	170	≥ 0 (Introduced SRN/2001/2, effective December 2001)

18	180	≥ 0 (Introduced SRN/2001/2, effective December 2001)
19	190	≥ 0 (Introduced SRN/2001/2, effective December 2001)
20	200	≥ 0 (Introduced SRN/2001/2, effective December 2001)
21	210	≥ 0 (Introduced SRN/2001/2, effective December 2001)
22	220	≥ 0 (Introduced SRN/2001/2, effective December 2001)
23	230	≥ 0 (Introduced SRN/2001/2, effective December 2001)

SECTION A AND SECTION D - CROSS SECTION VALIDATIONS

Ref	Item Number	
1		Superseded by validation 3 (val 9), SRN/1999/1
2	A625	= if D120 = "yes" then $\max [(A624 - A550), 0]$ else $\max \{[\max(A624 + A631 + A633 - A550), 0] - A635, 0\}$
3	A621	$\geq \max [(A590 - (D320 + D70) * 1.25\%), 0]$

FORM BSD3 - SECTION B : TRADING BOOK FOR SOLO BANK AND LINE BY LINE CONSOLIDATED ENTITIES

INTERNAL VALIDATIONS

Ref No	Item No	
1	B10	= B10.1 + B10.2 + B10.3 + B10.4
2	B20	= B20.1 + B20.2 + B20.3 + B20.4
3	B30	= B30.1 + B30.2 + B30.3 + B30.4
4	B40	= B40.1 + B40.2 + B40.3 + B40.4
5		Superseded by validation 33 (val 10), SRN/1998/4
6	BW60	= Appendix B-II W60
7	BW70	= Appendix B-IV W50
8	BW80	= Appendix B-IV W100
9	BW90	= Appendix B-IV W150
10	B100	= B10 + B20 + B30 + B40 + B50 + B60 + B70 + B80 + B90
11	BS130	= BS130.1 + BS130.2 + BS130.3 + BS130.4 + BS130.5 + BS130.6
12	B130	= B130.1 + B130.2 + B130.3 + B130.4 + B130.5 + B130.6
13	BS140	= BS120 + BS130
14	B140	= B120 + B130
15	B150	= Appendix B-V Column 2 Capital Requirement
16	B160	= Appendix B-V Column 3 Capital Requirement
17	B170	= B170.1 + B170.2
18	B180	= B150 + B160 + B170
19	B190	= B190.1 + B190.2 + B190.3 + B190.4 + B190.5
20	B200	= Appendix B-VI Column 10 Total
21	B210	= B210.1 + B210.2
22	B220	= B190 + B200 + B210 + B215
23		Superseded by validation 34 (val 10), SRN/1998/4
24		Superseded by validation 35 (val 10), SRN/1998/4
25	B250	= B250.1 + B250.2
26	B270	= B230 + B240 + B250
27	B280	= Appendix B-VIII Column F, Total capital requirement
28	B310	= Appendix B-IX 40
29	B320	= max (B300 * B310/100, B290)
30	B340	= B320 + B330
31	B282	=B282.1 + B282.2
32	B284	=B280 + B282
33	B50	= Appendix B-I C120
34		Superseded by validation 36 (VAL 11), SRN/2001/2
35	B240	= 8% Appendix B-VII (Column 5 Total + Column 6 Total)
36	B230	= (8% Appendix B-VII Column 1 Total) + (4% Appendix B-VII Column 2 Total) (from SRN/2001/2)

APPENDIX B-I VALIDATIONS

Ref No	Appx B-I Item No	
1	C10	= Zero
2	C20	= 8% x P20
3	C30	= 50% x P30
4	C40	= 75% x P40
5	C50	= P50
6	C60	= C10 + C20 + C30 + C40 + C50
7	C70	= Zero
8		Superseded by validation 13 (val11), SRN/1998/4
9		Superseded by validation 14 (val11), SRN/1998/4
10		Superseded by validation 15 (val11), SRN/1998/4
11	C110	= C70 + C80 + C90 + C100
12	C120	= C60 + C110
13	C80	= 0.5% x P80
14	C90	= 4% x P90
15	C100	= 9% x P100

APPENDIX B-II VALIDATIONS

Ref No	Appx B-II Item No	
1	R60	= R10 + R20 + R30 + R40 + R50
2	P60	= P10 + P20 + P30 + P40 + P50
3	C60	= C10 + C20 + C30 + C40 + C50
4	W60	= W10 + W20 + W30 + W40 + W50
5	W60	= Section B (item B60) W60

APPENDIX B-III VALIDATIONS

Ref No	Appx B-III Item No	
1	ND10	= NA10 + NB10 + NC10
2	ND20	= NA20 + NB20 + NC20
3	ND30	= NA30 + NB30 + NC30
4	ND40	= NA40 + NB40 + NC40
5	ND50	= NA50 + NB50 + NC50
6	ND60	= NA60 + NB60 + NC60
7	ND70	= NA70 + NB70 + NC70

8	ND80	= NA80 + NB80 + NC80
9	ND90	= NA90 + NB90 + NC90
10	ND100	= NA100 + NB100 + NC100
11	ND110	= NA110 + NB110 + NC110
12	ND120	= NA120 + NB120 + NC120
13	ND130	= NA130 + NB130 + NC130
14	ND140	= NA140 + NB140 + NC140
15	ND150	= NA150 + NB150 + NC150
16	ND160	= NA160 + NB160 + NC160
17	ND170	= NA170 + NB170 + NC170
18	ND180	= NA180 + NB180 + NC180
19	ND190	= NA190 + NB190 + NC190
20	ND200	= NA200 + NB200 + NC200
21	ND210	= NA210 + NB210 + NC210
22	ND220	= NA220 + NB220 + NC220
23	ND230	= NA230 + NB230 + NC230
24	ND240	= NA240 + NB240 + NC240
25	ND250	= NA250 + NB250 + NC250
26	ND260	= NA260 + NB260 + NC260
27	ND270	= NA270 + NB270 + NC270
28	ND280	= NA280 + NB280 + NC280
29	ND290	= NA290 + NB290 + NC290
30	ND300	= NA300 + NB300 + NC300
31	ND310	= NA310 + NB310 + NC310
32	ND320	= NA320 + NB320 + NC320
33	ND330	= NA330 + NB330 + NC330
34	ND340	= NA340 + NB340 + NC340
35	ND350	= NA350 + NB350 + NC350
36	ND360	= NA360 + NB360 + NC360
37	ND370	= NA370 + NB370 + NC370
38	ND380	= NA380 + NB380 + NC380
39	ND390	= NA390 + NB390 + NC390
40	ND400	= NA400 + NB400 + NC400
41	ND410	= NA410 + NB410 + NC410
42	ND420	= NA420 + NB420 + NC420
43	NA60	≤ NA10 + NA20 + NA30 + NA40
44	NB60	≤ NB10 + NB20 + NB30 + NB40
45	NC60	≤ NC10 + NC20 + NC30 + NC40
46	ND60	≤ ND10 + ND20 + ND30 + ND40
47	NA70	≤ NA50
48	NB70	≤ NB50
49	NC70	≤ NC50

50	ND70	\leq ND50
51	NA130	\leq NA80 + NA90 + NA100 + NA110
52	NB130	\leq NB80 + NB90 + NB100 + NB110
53	NC130	\leq NC80 + NC90 + NC100 + NC110
54	ND130	\leq ND80 + ND90 + ND100 + ND110
55	NA140	\leq NA120
56	NB140	\leq NB120
57	NC140	\leq NC120
58	ND140	\leq ND120
59	NA200	\leq NA150 + NA160 + NA170 + NA180
60	NB200	\leq NB150 + NB160 + NB170 + NB180
61	NC200	\leq NC150 + NC160 + NC170 + NC180
62	ND200	\leq ND150 + ND160 + ND170 + ND180
63	NA210	\leq NA190
64	NB210	\leq NB190
65	NC210	\leq NC190
66	ND210	\leq ND190
67	NA270	\leq NA220 + NA230 + NA240 + NA250
68	NB270	\leq NB220 + NB230 + NB240 + NB250
69	NC270	\leq NC220 + NC230 + NC240 + NC250
70	ND270	\leq ND220 + ND230 + ND240 + ND250
71	NA280	\leq NA260
72	NB280	\leq NB260
73	NC280	\leq NC260
74	ND280	\leq ND260
75	NA340	\leq NA290 + NA300 + NA310 + NA320
76	NB340	\leq NB290 + NB300 + NB310 + NB320
77	NC340	\leq NC290 + NC300 + NC310 + NC320
78	ND340	\leq ND290 + ND300 + ND310 + ND320
79	NA350	\leq NA330
80	NB350	\leq NB330
81	NC350	\leq NC330
82	ND350	\leq ND330
83	NA410	\leq NA360 + NA370 + NA380 + NA390
84	NB410	\leq NB360 + NB370 + NB380 + NB390
85	NC410	\leq NC360 + NC370 + NC380 + NC390
86	ND410	\leq ND360 + ND370 + ND380 + ND390
87	NA420	\leq NA400
88	NB420	\leq NB400
89	NC420	\leq NC400

90	ND420	\leq ND400
91	RD10	= RA10 + RB10 + RC10
92	RD20	= RA20 + RB20 + RC20
93	RD30	= RA30 + RB30 + RC30
94	RD40	= RA40 + RB40 + RC40
95	RD80	= RA80 + RB80 + RC80
96	RD90	= RA90 + RB90 + RC90
97	RD100	= RA100 + RB100 + RC100
98	RD110	= RA110 + RB110 + RC110
99	RD150	= RA150 + RB150 + RC150
100	RD160	= RA160 + RB160 + RC160
101	RD170	= RA170 + RB170 + RC170
102	RD180	= RA180 + RB180 + RC180
103	RD220	= RA220 + RB220 + RC220
104	RD230	= RA230 + RB230 + RC230
105	RD240	= RA240 + RB240 + RC240
106	RD250	= RA250 + RB250 + RC250
107	RD290	= RA290 + RB290 + RC290
108	RD300	= RA300 + RB300 + RC300
109	RD310	= RA310 + RB310 + RC310
110	RD320	= RA320 + RB320 + RC320
111	RD360	= RA360 + RB360 + RC360
112	RD370	= RA370 + RB370 + RC370
113	RD380	= RA380 + RB380 + RC380
114	RD390	= RA390 + RB390 + RC390
115	NA360	= NA10 + NA80 + NA150 +NA220 + NA290
116	NB360	= NB10 + NB80 + NB150 +NB220 + NB290
117	NC360	= NC10 + NC80 + NC150 +NC220 + NC290
118	ND360	= ND10 + ND80 + ND150 +ND220 + ND290
119	RA360	= RA10 + RA80 + RA150 +RA220 + RA290
120	RB360	= RB10 + RB80 + RB150 +RB220 + RB290
121	RC360	= RC10 + RC80 + RC150 +RC220 + RC290
122	RD360	= RD10 + RD80 + RD150 +RD220 + RD290
123	NA370	= NA20 + NA90 + NA160 +NA230 + NA300
124	NB370	= NB20 + NB90 + NB160 +NB230 + NB300
125	NC370	= NC20 + NC90 + NC160 +NC230 + NC300
126	ND370	= ND20 + ND90 + ND160 +ND230 + ND300
127	RA370	= RA20 + RA90 + RA160 +RA230 + RA300
128	RB370	= RB20 + RB90 + RB160 +RB230 + RB300
129	RC370	= RC20 + RC90 + RC160 +RC230 + RC300
130	RD370	= RD20 + RD90 + RD160 +RD230 + RD300
131	NA380	= NA30 + NA100 + NA170 +NA240 + NA310

132	NB380	= NB30 + NB100 + NB170 +NB240 + NB310
133	NC380	= NC30 + NC100 + NC170 +NC240 + NC310
134	ND380	= ND30 + ND100 + ND170 +ND240 + ND310
135	RA380	= RA30 + RA100 + RA170 +RA240 + RA310
136	RB380	= RB30 + RB100 + RB170 +RB240 + RB310
137	RC380	= RC30 + RC100 + RC170 +RC240 + RC310
138	RD380	= RD30 + RD100 + RD170 +RD240 + RD310
139	NA390	= NA40 + NA110 + NA180 +NA250 + NA320
140	NB390	= NB40 + NB110 + NB180 +NB250 + NB320
141	NC390	= NC40 + NC110 + NC180 +NC250 + NC320
142	ND390	= ND40 + ND110 + ND180 +ND250 + ND320
143	RA390	= RA40 + RA110 + RA180 +RA250 + RA320
144	RB390	= RB40 + RB110 + RB180 +RB250 + RB320
145	RC390	= RC40 + RC110 + RC180 +RC250 + RC320
146	RD390	= RD40 + RD110 + RD180 +RD250 + RD320
147	NA400	= NA50 + NA120 + NA190 +NA260 + NA330
148	NB400	= NB50 + NB120 + NB190 +NB260 + NB330
149	NC400	= NC50 + NC120 + NC190 +NC260 + NC330
150	ND400	= ND50 + ND120 + ND190 +ND260 + ND330
151	NA410	= NA60 + NA130 + NA200 +NA270 + NA340
152	NB410	= NB60 + NB130 + NB200 +NB270 + NB340
153	NC410	= NC60 + NC130 + NC200 +NC270 + NC340
154	ND410	= ND60 + ND130 + ND200 +ND270 + ND340
155	NA420	= NA70 + NA140 + NA210 +NA280 + NA350
156	NB420	= NB70 + NB140 + NB210 +NB280 + NB350
157	NC420	= NC70 + NC140 + NC210 +NC280 + NC350
158	ND420	= ND70 + ND140 + ND210 +ND280 + ND350

APPENDIX B-IV VALIDATIONS

Ref No	Appx B-IV Item No	
1	A10	= R10 + P10
2	W10	= Zero
4	A20	= R20 + P20
5	W20	= 10% x (R20 + P20)
6	A30	= R30 + P30
7	W30	= 20% x (R30 + P30)
8	A40	= R40 + P40
9	W40	= R40 + P40
10	W50	= W10 + W20 + W30 + W40
12	A60	= S60 - C60
13	W60	= Zero
14	A70	= S70 - C70
15	W70	= 10% x (S70 - C70)
16	A80	= S80 - C80
17	W80	= 20% x (S80 - C80)
18	A90	= S90 - C90
19	W90	= S90 - C90
20	W100	= W60 + W70 + W80 + W90
21	A110	= C110 - S110
22	W110	= Zero
23	A120	= C120 - S120
24	W120	= 10% x (C120 - S120)
25	A130	= C130 - S130
26	W130	= 20% x (C130 - S130)
27	A140	= C140 - S140
28	W140	= C140 - S140
29	W150	= W110 + W120 + W130 + W140

APPENDIX B-V VALIDATIONS

Ref No	Appx B-V Item No	
1	Column 1	= Column 2 + Column 3
2	NSOP Column 1	0
3	NSOP Column 2	= <u>higher</u> of the sum of the negatives or the sum of the positives (if equal defaults to positive)
4	NSOP Column 3	= <u>higher</u> of the sum of the negatives or sum of the positives (if equal defaults to positive)
5	SUMG Column 1	0
6	SUMG Column 2	sum of the absolute values of gold
7	SUMG Column 3	sum of the absolute values of gold
8	CAPR Column 1	Zero
9	CAPR Column 2	8% of absolute value of NSOP in Column 2 plus SUMG in Column 2
10	CAPR Column 3	\geq 2% of absolute value of NSOP in Column 3 plus SUMG in Column 3

APPENDIX B-VI VALIDATIONS

Ref No	Appx B-VI Item No	
1	Column 10	= Column 7 + Column 8 + Column 9

APPENDIX B-VII VALIDATIONS

Ref No	Appx B-VII Item No	
1	Column 4	= Column 1 + Column 2 + Column 3
2	Column 7	= Column 5 + Column 6

APPENDIX B-VIII VALIDATIONS

Ref No	Appx B-VIII Item No	
1	10 Column C	= 10 Column A + 10 Column B
2	20 Column C	= 20 Column A + 20 Column B
3	30 Column C	= 30 Column A + 30 Column B
4	40 Column C	= 40 Column A + 40 Column B
5	10 Column F	= 10 Column D + 10 Column E
6	20 Column F	= 20 Column D + 20 Column E
7	30 Column F	= 30 Column D + 30 Column E
8	40 Column F	= 40 Column D + 40 Column E
9	50 Column F	= 10 Column F + 20 Column F + 30 Column F + 40 Column F

APPENDIX B-IX VALIDATIONS

Ref No	Appx B-IX Item No	
1	30	= {0 if $20 \leq 4$; $0.4*100$ if $20 = 5$; $0.5*100$ if $20 = 6$; $0.65*100$ if $20 = 7$; $0.75*100$ if $20 = 8$; $0.85*100$ if $20 = 9$; $1*100$ if $20 \geq 10$ }
2	40	= 10 + 30

FORM BSD3 - SECTION C : CONSOLIDATION VIA AGGREGATION PLUS INTERNAL VALIDATIONS

Ref No	Item Number	
1	C10.1 column D	= (C10.1 column C / C10.1 column B)*10000
2	C10.2 column D	= (C10.2 column C / C10.2 column B)*10000
3	C10.3 column D	= (C10.3 column C / C10.3 column B)*10000
4	C10.4 column D	= (C10.4 column C / C10.4 column B)*10000
5	C10.5 column D	= (C10.5 column C / C10.5 column B)*10000
6	C10.6 column D	= (C10.6 column C / C10.6 column B)*10000
7	C10.7 column D	= (C10.7 column C / C10.7 column B)*10000
8	C10.8 column D	= (C10.8 column C / C10.8 column B)*10000
9	C10.9 column D	= (C10.9 column C / C10.9 column B)*10000
10	C10.10 column D	= (C10.10 column C / C10.10 column B)*10000
11	C10.11 column D	= (C10.11 column C / C10.11 column B)*10000
12	C10.12 column D	= (C10.12 column C / C10.12 column B)*10000
13	C10.13 column D	= (C10.13 column C / C10.13 column B)*10000
14	C10.14 column D	= (C10.14 column C / C10.14 column B)*10000
15	C20.1 column D	= (C20.1 column C / D20.1 column B)*10000
16	C20.2 column D	= (C20.2 column C / D20.2 column B)*10000
17	C20.3 column D	= (C20.3 column C / C20.3 column B)*10000
18	C20.4 column D	= (C20.4 column C / C20.4 column B)*10000
19	C20.5 column D	= (C20.5 column C / C20.5 column B)*10000
20	C20.6 column D	= (C20.6 column C / C20.6 column B)*10000
21	C20.7 column D	= (C20.7 column C / C20.7 column B)*10000
22	C20.8 column D	= (C20.8 column C / C20.8 column B)*10000
23	C20.9 column D	= (C20.9 column C / C20.9 column B)*10000
24	C20.10 column D	= (C20.10 column C / C20.10 column B)*10000
25	C20.11 column D	= (C20.11 column C / C20.11 column B)*10000
26	C20.12 column D	= (C20.12 column C / C20.12 column B)*10000
27	C20.13 column D	= (C20.13 column C / C20.13 column B)*10000
28	C20.14 column D	= (C20.14 column C / C20.14 column B)*10000
29	C30 column C	= C10 column C + C20 column C
30	C30 column C	= C30 column F + C30 column G + C30 column H + C30 column J
31	C30 column D	= C10 column D + C20 column D
32	C30 column E	= C10 column E + C20 column E
33	C30 column F	= C10 column F + C20 column F

34	C30 column G	= C10 column G + C20 column G
35	C30 column H	= C10 column H + C20 column H
36	C30 column J	= C10 column J + C20 column J
37	C30 column L	= C10 column L + C20 column L

SECTION C AND SECTION D - CROSS SECTION VALIDATIONS

Ref No	Item Number	
1	Column L	= max [column A * column C * (D150/column B), Column C]

FORM BSD3 - SECTION D : CAPITAL ADEQUACY SUMMARY

INTERNAL VALIDATIONS

Ref No	Item Number	
1	D40	= D10 + D20 + D30
2	D70	= D70.1 + D70.2 + D70.3 + D70.4 + D70.5 + D70.6
3	D80	= (D70 * D50)/10000
4	D90	≥ D110 * 50%
5	D90	= D80 - D100
6	D100	= IF(D110/2 ≥ D20, D20, D110/2)
7	D110	= D90 + D100
8	D110	= D80
9	D220	= D160 + D170 + D180 + D190 + D200 + D210
10	D250	= D230 + D240
11	D300	= D260 + D270 + D280 + D290
12	D310	= D220 + D250 + D300
13	D330	≥ 0.5 * (D340 + D350)
14	D330	≥ D310 / 3
15		Superseded by validation 34 (val 21), SRN/1998/4
16		Superseded by validation 35 (val 21), SRN/1998/4
17	D340	≤ D330 * 2
18		Superseded by validation 36 (val 21), SRN/1998/4
19	D350	≤ D30
20	D350	≤ D170 + D180 + D190 + D200 + D210 + D250 + D260 + D280
21	D360	= + D330 + D340 + D350
22	D360	= D310
23	D370	= D10 - D90 - D330
24	D380	= D20- D100 - D340
25	D390	= D370 + D380
26	D390	≥ D470
27	D470	= D400 + D410 + D420 + D430 + D440 + D450 + D460
28	D480	= D40- D470
29	D490	= D10 + D20 + D350 - D470
30	D500	= D80 + D310
31	D510	= D70 + D320
32	D520	= round [(D490 * 100) / D510, 2] * 100
33	D530	= round[(D490 * 100) / D500, 2] * 100

34	D330	$\leq D10 - D90$
35	D340	$\leq D20 - D100$
36	D340	$\leq D310 - (D330 + D350)$

SECTION D AND SECTION A - CROSS SECTION VALIDATIONS

Ref	Item Number	
1	D10	= A550
2	D20	= A630
3	D30	= A638
4	D70.2	= 10% [AB40.2 + AB50.2 + AB60.2 + AB70.2 + AB80.2 + AB100.2 + ANL120.2 + AB130.1 + AB140.1 + AB150.1 + AB180.1 + AB260.2 - AB280.2 + absolute value of AB320.2 + AB340.2 + (AB350.2/2) + (AB360.2/5) + AB370.2 + AB380.2 + AB390.2 + AB400.2 + AB410.2 + (AB420.2/2) + (AB440.3/2)]
5	D70.3	= 20% [AB30 + AB40.3 + AB50.3 + AB60.3 + AB70.3 + AB80.3 + AB100.3 + ANL120.3 + AB130.2 + AB140.2 + AB150.2 + AB180.2 + AB240.2 + AB260.3 - AB280.3 + absolute value of AB320.3 + AB340.3 + (AB350.3/2) + (AB360.3/5) + AB370.3 + AB380.3 + AB390.3 + AB400.3 + AB410.3 + (AB420.3/2) + AB430.2 + (AB440.4/2)]
6	D70.4	= 50% [AB40.4 + AB90 + AB150.3 - AB280.4 + AB340.4 + (AB350.4/2) + (AB360.4/5) + AB370.4 + AB380.4 + AB390.4 + (AB440.5/2)]
7	D70.5	= 100% [AB40.5 + AB50.4 + AB60.4 + AB70.4 + AB80.4 + AB100.4 + AB110 + ANL120.4 + AB130.3 + AB140.3 + AB150.4 + AB172 + AB180.3 + AB190 + +AB210.1 + AB220 + AB230 + AB240.3 + AB250 + AB260.4 - AB280.5 + absolute value of AB320.4 + AB340.5 + AB340.7 + (AB350.5/2) + (AB350.6/2) + (AB360.5/5) + (AB360.6/5) + AB370.5 + AB370.7 + AB380.5 + AB380.7 + AB390.5 + AB390.7 + AB400.4 + AB400.5 + AB410.4 + AB410.6 + (AB420.4/2) + (AB420.5/2) + AB430.3 + AB430.4 + (AB440.6/2) + (AB440.8/2) + AW462]
8	D70.6	= AW452 + AW472 + AW474
9	D400	= AT160 + AB160
10	D410	= AT280 + AB280
11	D420	$\geq (AT340.6 + AT370.6 + +AT380.6 + AT390.6 + AT410.5 + AT440.7 + AB340.6 + AB370.6 + +AB380.6 + AB390.6 + AB410.5 + AB440.7)$
12	D430	= AT171 + AB171
13		Superseded by validation 14 (val 22), SRN/1998/4
14	D440	= AB180.4

SECTION D AND SECTION B - CROSS SECTION VALIDATIONS

Ref No	Item Number	
1	D160	= $B100 * 12.5 * D140/10000$
2	D170	= $B140 * 12.5 * D140/10000$
3	D180	= $B180 * 12.5 * D140/10000$
4	D190	= $B220 * 12.5 * D140/10000$
5	D200	= $B270 * 12.5 * D140/10000$
6	D210	= $B284 * 12.5 * D140/10000$
7	D230	= $B320 * 12.5 * D140/10000$
8	D240	= $B330 * 12.5 * D140/10000$

SECTION D AND SECTION C - CROSS SECTION VALIDATIONS

Ref No	Item Number	
1	D260	= C30 column F
2	D270	= C30 column G
3	D280	= C30 column H
4	D290	= C30 column J
5	D300	= C30 column C
6	D320	= $[(D220 + D250)/D140] * 10000 + C30 \text{ column D}$
7		Superseded by validation 8 (val 23), SRN/1998/5
8	D540	= $\text{round}\{(D490 * 100) / [(D70 * D60/10000) + (D150 / D140) * (D220 + D250) + C30 \text{ column L}], 2\} * 100$

CROSS FORM VALIDATIONS : FORM M1 AND FORM BSD3

Ref no	BSD items	M1 items
1		Removed, SRN/1998/5
2	AB180.4	= 180
3		Removed, SRN/1998/5
4		Removed, SRN/1998/5
5		Superseded by validation 8 (val 24), SRN/1998/4
6		Removed, SRN/1998/5
7	AT172	= 130
8		Removed, SRN/1998/5

CROSS FORM VALIDATIONS : FORM LE2 AND FORM BSD3

Ref no	BSD items	LE2 items
1	Appendix A-V 80S	$\geq \sum A4 + \sum B4 + \sum C4 + \sum D4 + \sum E4 + \sum FB4$ (SRN/1998/5)

Large Exposures (Form LE2)

Introduction

Form LE2 should be completed quarterly by UK banks only, as defined in the Handbook Glossary of Definitions. These notes should be read in conjunction with all relevant chapters set out in the Financial Services Authority Banking Supervisory Policy Guide or the Interim Prudential Sourcebook for Banks (and the Supervisory Guidance Notes (SGN) in this folder) in force at the date to which the form relates. There are a number of ways in which the Financial Services Authority (FSA) may seek additional information to be reported by the reporting bank either regularly or in respect of certain reporting dates only.

For convenience, these reporting instructions will refer to the FSA Banking Supervisory Policy Guide as 'FSA Policy Guide' and the Interim Prudential Sourcebook for Banks as 'IPRU (BANK)'.

Denomination of Reported Exposures

Exposures should be reported in £000s but a different currency denomination may be agreed in writing with the FSA. Claims, loans and advances, whether denominated in currencies other than sterling, gold and other precious metals or other commodity units should be translated into sterling at the closing middle market spot rate for the day of the report. Where the maximum exposure during a reporting period is required to be reported, the closing middle market spot rate for the day on which the maximum exposure occurs should be used.

Exposure Limits and Concessions

Prior agreement should be obtained from the FSA before an exposure is entered into which exceeds 25% of LECB. Such agreement may be obtained for: (1) exempt exposures eg interbank exposures with a maturity of one year or less; (2) exposures covered by collateral¹; (3) exposures covered by guarantees²; (4) exposures within the scope of a connected exposure concession; (5) exposures covered by a 1-3 year derivative concession; or (6) exposures subject to soft limits. The written prior agreement of the FSA should be obtained before any exposures falling into any of the aforementioned categories are entered in the appropriate columns.

An exposure

See SGN9. For the purpose of reporting large exposures on both an unconsolidated/solo-consolidated and consolidated basis, an exposure should be measured as the amount at risk arising from the aggregate of the reporting bank's business, whether conducted on or off-balance sheet³.

¹ Only cash and Zone A central government and central bank securities should be regarded as eligible collateral.

² Either parental or third party guarantees.

³ **NOTE :** Exposures entered into by a bank as a trustee are excluded from the scope of the large exposures return.

A counterparty

See SGN11 to SGN13 and SGN19 to SGN23.

References to banks hereafter in these reporting instructions are intended to include banks, building societies and recognised investment firms (as defined in SGN20), as well as recognised clearing houses and recognised exchanges (these being listed in Chapter BC (Credit risk in the banking book), Section 5, of the FSA Policy Guide/IPRU (BANK)).

The identity of a counterparty will generally be one of the following:

- (i) the borrower (customer);
- (ii) the person guaranteed (where the reporting bank is providing such guarantee);
- (iii) in the case of a security held, the issuer of a security;
- (iv) or in the case of a derivatives contract the party with whom the contract was made.

In some circumstances, it may be uncertain which of two counterparties is the primary obligor (eg on a bill where there is a claim on both the drawer and the acceptor). When in doubt, the reporting bank should either report the exposure twice, as an exposure to each counterparty, or ask the FSA for its view. However, in the case of:-

- (a) bills held which have been accepted by a bank (other than the reporting bank), the claim should be reported as a claim on a bank;
- (b) per aval endorsements on the bills held by the reporting bank, the claim should be reported as a claim of over one year maturity on the avalising bank;
- (c) transactions where a third party has provided an explicit unconditional irrevocable guarantee, may be reported as an exposure to the guarantor. Banks should seek the FSA's agreement to their reporting in this way. In agreeing this, the FSA would expect banks to include a section on guaranteed exposures in their large exposures policy statement. In particular, the FSA would expect a consistent approach to be adopted in the reporting of such exposures. The FSA does not expect banks to report exposures to guarantors without having first approved the credit risk on the guarantor and the type of the exposure under the bank's normal credit approval procedures. In the case of bills issued by Westminster Council on behalf of London boroughs (within the terms of S.35 of the Greater London (General Powers) Act 1969) the exposures should be reported as an exposure to Westminster Council; and
- (d) banks should exercise care in identifying the entity with whom they have entered into a contract. For example, where the reporting institution funds the activities of a company that trades on an exchange, whether for that company's own account or on behalf of clients, the full amount of such funding should be reported as an exposure to that company. An alternative reporting method may however be agreed with the FSA in writing.

Coverage

Form LE2 should be completed both on an unconsolidated/solo-consolidated basis and, where relevant, a consolidated basis:-

- (a) Exposures arising in all of the bank's branches (including overseas branches) and any subsidiaries which are included for the purpose of the bank's 'solo' (unconsolidated) capital ratio should be reported in Form LE2 completed on an unconsolidated/solo-consolidated basis. Where subsidiaries are included, this should be agreed in writing with the FSA.
- (b) Exposures in companies reported under (a) above, together with exposures arising in group companies which are included for the purpose of the bank's consolidated reporting, should be reported on Form LE2 on a consolidated basis. Where such group companies are included, this should be agreed in writing with the FSA.

Important: All companies subject to consolidation should be included in a reporting bank's consolidated large exposures return regardless of the technique used for consolidation on the Form BSD3. The scope of a bank's solo and consolidated supervisory returns should be determined by the principles set out in Chapter CS (Consolidated supervision) of the FSA Policy Guide/IPRU (BANK). Whether there are such companies to be included should be agreed in writing with the FSA.

Large Exposures Capital Base (LECB)

The capital base used as the basis for monitoring and controlling large exposures should be calculated in the same way as that used for capital adequacy monitoring ie the sum of allowable Tier 1 and Tier 2 capital less any deductions. The LECB should be agreed in writing with the FSA on an annual basis and reported on the front of Form LE2. Where holdings of tradeable securities subject to soft limits have been agreed with the FSA, an adjusted capital base incorporating Tier 3 capital may be used to measure exposures against. This adjusted capital base should be reported in Part 5.

Netting

The circumstances in which net exposures are considered appropriate for LE2 purposes are set out below.

1 On balance sheet

- (a) credit balances should not be offset against debit balances unless the provisions set out in Chapter NE (Collateral and netting) of the FSA Policy Guide/IPRU (BANK) are met.

Note: Back-to-backs allowed to be netted out on returns made to the Bank of England for statistical purposes should not be netted out in calculating the size of an exposure for LE2 purposes.

- (b) where a repo/reverse repo or similar transaction is involved, this should be consistent with Chapter NE (Collateral and netting) of the FSA Policy Guide/IPRU (BANK). Netting of claims and obligations arising from all repos/reverse repos held in the trading book will then be considered acceptable.

However, note that in the banking book netting of counterparty risk will not generally be considered acceptable because:

- (i) repos should attract issuer risk on the securities repoed out;
- (ii) reverse repos where eligible collateral⁴ is reversed in should attract issuer risk on that eligible collateral.

As there is no counterparty risk reportable in the above circumstances it follows that there are no claims capable of being netted.

The only circumstances in which counterparty risk will arise is when a reverse repo is undertaken where the collateral reversed in is ineligible. Such reverse repos should be reported as if an unsecured cash loan had been made to the counterparty to the reverse repo. It is acceptable for such counterparty risk to be reported net of obligations to the same counterparty arising from:

- (i) other reverse repo business where eligible collateral has been taken, with the same counterparty and only to the extent that the value of the collateral taken is in excess of the cash paid away;
- (ii) on repos with the same counterparty and similarly only to the extent that the cash reversed in exceeds the value of the securities repoed.

Reporting banks wishing to net counterparty risk arising from repo business in the banking book should first contact their line supervisors. The FSA would consider that it was appropriate to report on this basis where the bank's systems were adequate for this purpose.

Risk cushion factors, when applicable, should be reported gross. The residual maturity of the securities should be used to calculate the risk cushion factor (not the maturity of the repo transaction). Where both legs of the transaction involve securities, the risk cushion factor should be calculated using the maturity of the longer dated securities.

2 Off balance sheet netting

Amounts due in respect of foreign exchange, interest rate, equity and commodity related transactions may be reported net if the net amount derived is pursuant to the application of a bilateral agreement (between two counterparties) based upon netting by novation (see SGN26).

⁴ For these purposes eligible collateral is restricted to Zone A central government and central bank securities.

To benefit from close-out netting, the terms of Chapter NE (Collateral and netting) of the FSA Policy Guide/IPRU (BANK) should be met; if they are, then the credit equivalent amount of a bank's portfolio of contracts with each counterparty should be obtained by adding together:

- (a) the net replacement cost of all nettable contracts with a positive mark to market value offset by all contracts with a negative mark to market value;
- (b) for each contract in the portfolio the amount for the potential future credit exposure (add-on) as described elsewhere.

NOTE: For these purposes, the maturity of the net replacement cost should be taken as ≤ 1 year if there is at least one ≤ 1 year obligation included under the netting agreement. In such circumstances reporting of net current exposure to banks may only be reported in Part 3(i) of the Form.

If there are no ≤ 1 year obligations but there exist obligations of >1 year but ≤ 3 years then the maturity of the net replacement cost figure should be taken to fall between 1 and 3 years also.

The netting of add-ons is considered acceptable where the terms of Chapter NE (Collateral and netting) of the FSA Policy Guide/IPRU (BANK) have been met (see SGN35). However, where the potential future exposures (add-ons) cannot be netted, these should be calculated and reported according to the residual maturity of the contract (ie add-ons relating to >1 year contracts should be reported gross in either Part 3(i) or 3(ii)).

When dealing with a counterparty incorporated in a netting friendly jurisdiction but which has subsidiaries or branches located in netting unfriendly jurisdictions, transactions with those subsidiaries and branches should continue to be reported gross. Thus the aggregate exposure to such a counterparty will be a mixture of net and gross exposures.

The Amount at Risk

For exposures arising in the banking book the amount at risk should, with certain exceptions detailed below (or otherwise advised to the reporting bank), be reported as the book value of the reporting bank's actual or potential claims, contingent liabilities or assets.

Exposures should be calculated in accordance with UK generally accepted accounting practice. In certain cases the reporting bank may wish to adopt an alternative accounting practice. Such cases should be discussed with the FSA in order to determine whether reports are acceptable on that basis. The accounting practice adopted for the reporting of exposures should, unless otherwise stated below, be consistent with that used for the calculation of the reporting bank's capital base.

For exposures arising in the trading book, all positions should be marked-to-market daily. (However, if for cash items with a residual maturity of one month or less the bank wishes not to do this, it should seek the prior approval of the FSA in writing.) Where a market determined price is not readily available, the reporting bank may generate its own mark-to-market valuation. Positions should be valued in accordance with the procedures outlined in the trading book policy statement agreed with the FSA.

Interest and Dividends

The value of outstanding claims should include interest and dividends due but not yet received if such amounts are reflected in the reporting bank's capital base. However, in recognising the systems difficulties of reporting inclusive of such amounts, the FSA may agree, in writing, for the following treatment to be applied to exposures in the Banking Book. Provided the exposure is well below 25% of LECB, or a pre-agreed limit, there is no need for the bank to include the accrued interest element in the reported figure. If an exposure is close to the 25% level, or a pre-agreed limit, then the bank should be able to demonstrate that the exposure, inclusive of the accrued interest element, is below the limit and to guarantee that the limit is not breached. This treatment should not be adopted for Trading Book exposures. Since these exposures are marked to market daily, the accrued interest element is included in the mark to market valuation. (Unearned finance charges in relation to instalment lending should be excluded.)

Securities Positions and Positions Arising from Derivative Contracts

(i) Issuer risk

Where a bank deals in securities the exposure (to the issuer of the security) should be calculated as follows:

- (a) Banking Book - the sum of the excess, where positive, of the book value of all long positions over all short positions, (ie the net long position), for each instrument issued by the issuer. A long position in one security issue should not be offset by a short position in another security issue made by the same issuer except for securities issued by central governments and central banks.

Netting of long and short positions may be adopted for securities issued by central governments and central banks, where the criteria set out in SGN27 are all met.

- (b) Trading Book - the excess of the current market value of all long positions over all short positions for each instrument issued by the counterparty should first be calculated. The exposure is then calculated as the excess, where positive, of the current market value of all long positions over all short positions in **all** the financial instruments issued by the counterparty. (Positions should not be netted within groups of closely related counterparties.)

Positions should not be netted between banking and trading books.

Forward Transactions

For both Banking and Trading Book calculations, commitments to buy securities at a future date (including futures contracts) should be included as long positions and forward sales as short positions. Where a bank has made a commitment to an issuer under a note issuance facility to purchase, at the request of the issuer, securities which are unsold on the issue date, these should be added to the long positions. (Note issuance facilities include revolving underwriting facilities, Euronote facilities and any similar arrangements.) A net short position does not give rise to an exposure covered by this return.

Options Positions

The following treatment should be given to options:

- (a) on securities
 - (i) Written Put - long position in the underlying security.
 - (ii) Purchased Put - short position in the underlying security
 - (iii) Purchased Call (where the contract has been given a book value in the accounts of the reporting institution) - long position in the underlying security.
 - (iv) Written Calls - do not give rise to an exposure covered by this return.
- (b) on an index
 - (i) Broadly based and cash settled indices - there is no requirement for these indices to be broken down into their constituent elements. The highly liquid equity indices listed in Chapter LE (Large exposures), Section 12, of the FSA Policy Guide/IPRU (BANK) may be regarded as broadly based.
 - (ii) Narrowly based/non-cash settled indices - these indices should be decomposed into their component stocks in order to calculate the issuer risk on the underlying.

In order to calculate the amount to be included in the issuer risk calculation, the notional principal valued at the strike price should be used.

Repos/Reverse Repos

- (a) Banking Book - For repos in the banking book the security sold should be included as a long position. Reverse repos should be treated as loans unless eligible collateral is held (ie Zone A government securities and cash) in which case they should be regarded as collateralised loans and the collateral held included as a long position. (The forward leg should not be included as a short position.) Where collateral is ineligible the counterparty risk on the cash loan should be reported in full.
- (b) Trading Book - For both repos and reverse repos in the trading book include outgoing security if the reporting bank is the ultimate owner. In addition the counterparty risk on both repos and reverse repos should be reported (see below Counterparty Risk - Repos/Reverse Repos).

For stock lending transactions the same reporting treatment as in respect of repos apply and those in respect of reverse repos should be adopted for stock borrowing.

Underwriting commitments

This covers discrete issues of securities (equities and bonds) only. The treatment for underwriting set out here does not extend to any commitment of a continuing or revolving nature. The exposure arising from other underwriting commitments should be taken to be the full amount of the sum underwritten.

There are two distinct phases in the reporting of underwriting commitments in respect of securities issues: (i) date of initial commitment until Working Day Zero and (ii) Working Day Zero onwards. (Date of initial commitment and working day zero are defined in Chapter TU (Underwriting in capital adequacy framework) of the FSA Policy Guide/IPRU (BANK).)

- (i) Date of initial commitment until working day zero - for both non-expert and expert underwriters notification should be on the basis of a credit equivalent amount (CEA). Amounts sub-underwritten or sold forward should only be offset against the underwriting commitment when calculating the CEA when such commitments are received prior to the reporting institution committing to the client. The CEA should be calculated (on the basis of the net amount where applicable) using the credit conversion factors set out in the following table:

	Implied Conversion Factor	Post-notify (10%) (1)	Pre-notify (25%) (2)	Maximum "expert" guideline (3)
All debt instruments	18.75%	53%	133%	400%
Preference share, constituents of the FT-SE 100 index, and related convertibles, US S&P 500, Japan Nikkei 225	23%	44%	108%	325%
Constituents of FT All-share index & related convertibles; other major non-UK equities	30%	34%	83%	250%
Other equities with a normal market size and other second tier non-equities	43%	24%	58%	175%
Other UK and non-UK equities and related convertibles	75%	14%	33%	100%

(1) The nominal amount (expressed as a percentage of capital) which corresponds to the post-notification threshold when converted into credit equivalent terms.

(2) The nominal amount (expressed as a percentage of capital) which corresponds to the post-notification threshold when converted into credit equivalent terms.

(3) The lower of 400% nominal or three times the pre-notification trigger. (The latter applies in all cases other than debt underwriting.)

- (ii) Working Day Zero Onwards - post working day zero exposures for both experts and non-experts are calculated on the same basis. The measure of exposure is based upon the net underwriting position (= gross underwriting commitment + purchases - sales - sub-underwritings) multiplied by a discount factor. Discount factors should be applied as follows:

Working Day 0	100%
Working Day 1	90%
Working Day 2	75%
Working Day 3	75%
Working Day 4	50%
Working Day 5	25%
after Working Day 5	0%

The amount to be reported = the net underwriting position x (100% - discount factor). This net exposure should be aggregated with other exposures to the issuer. Holdings of securities as a result of an underwriting commitment are also eligible for soft limits as set out below.

(ii) Counterparty risk

Forward Transactions

Forward sales and purchases of securities in both the banking and trading books give rise to a counterparty exposure. When receiving securities in exchange for cash or securities the reporting bank should report the higher of:

- (i) zero plus an add-on for potential future exposure; or
- (ii) the difference between the market value of the securities to be received and the contracted value for forward delivery plus an add-on for potential future exposure.

When receiving cash or securities in exchange for securities, the reporting bank should report the higher of:

- (i) zero plus an add-on for potential future exposure; or
- (ii) the difference between the contracted value for forward delivery and the market value of the securities to be delivered plus an add-on.

The amounts to be received or given should include all cash flows related to the securities and the transactions.

The add-on should be calculated in accordance with the risk cushion factors set out in Chapter TC (Counterparty risk in the trading book), Section 3.3.3, of the FSA Policy Guide/IPRU (BANK).

In addition to these types of exposure, where compensation is due to be paid in the future in exchange for a contract, the current market value of the payment due should be reported.

Settlement of transactions

(a) Free Deliveries

An immediate exposure arises where the reporting bank has settled its side of the transaction but not yet received the countervalue ie final funds or an undertaking to effect transfer of funds by close of business on the same business day. Where the reporting institution has provided the cash the current market value of the asset being purchased should be reported for trading book exposures, and the book value for banking book exposures. Where the reporting institution has the asset the cash due should be reported for both banking and trading book exposures. (Where the transaction is effected across a national border there is a window of one working day.)

(b) Unsettled Securities Transactions

In both the banking and trading books, claims on a counterparty arising in the course of settlement of a securities transaction where neither the reporting institution nor the counterparty have settled their side of the transaction should be reported where settlement is 5 days overdue. The exposure should be calculated as the difference between the amount due and the current market value of the instrument.

Repos/Reverse Repos

For repos/reverse repos in the trading book the exposure to the counterparty should be calculated as the mark-to-market differential between the collateral provided by the reporting bank and that received from the counterparty. In the case of undocumented repos, an add-on for potential future exposure should be included in accordance with the risk cushion factors set out in Chapter TC (Counterparty risk in the trading book), Section 3.3.3, of the FSA Policy Guide/IPRU (BANK).

Interest Rate, Foreign Exchange Rate, Equity and Commodity Related Contracts

For exposures relating to over-the-counter interest rate (OTC), foreign exchange rate, equity and commodities contracts the amount at risk for the reporting of large exposures may be less than the nominal exposure. These exposures should be reported and aggregated with other exposures to the same counterparty.

Interest rate related contracts: single currency interest rate swaps, basis swaps, forward rate agreements and products with similar characteristics, interest rate options purchased (including caps, collars and floors purchased as stand-alone contracts) and similar instruments should be reported as interest rate related contracts. Contracts of a similar nature concerning bonds should also be included in this category.

Foreign exchange rate related contracts: cross currency swaps, cross currency interest rate swaps, forward foreign exchange contracts, currency options purchased and similar instruments should be reported as foreign exchange related contracts. Contracts of a similar nature concerning gold should also be included in this category.

Equity and Commodities Contracts: Equity options purchased, swaps and similar contracts, commodity options purchased, swaps and similar instruments involving physical commodities.

The amount at risk should be calculated as the credit equivalent amount (CEA) of these items which should be arrived at by the replacement cost method. For Banking Book transactions, this should be consistent with reporting on Form BSD3. For Trading Book exposures, valuations should be made in line with the valuation procedures outlined in the Trading Book Policy Statement which should be agreed with the FSA.

Note: *No CEA should be reported for either contracts traded on exchanges where they are subject to daily margining requirements or for OTC foreign exchange contracts (except contracts concerning gold) with an original maturity of 14 calendar days or less. When trading on an exchange with daily margining requirements, credit exposure only arises in respect of initial margin and excess variation margin payments. These exposures should be reported as on-balance sheet exposures to the exchange (or its associated clearing house).*

Mark-to-market amount

Reporting banks should mark-to-market in a prudent and consistent manner. See SGN34 for further guidance.

Notional principal amount

For exchange rate contracts and bond options, the notional principal amount should be taken as the amount of principal underlying the contract, as regards the asset (currency, equity, bond or commodity) being received by the reporting bank, translated into sterling at the spot exchange rate on the reporting date.

For an amortising swap, ie one based on a steadily declining notional principal, the notional principal should be taken as the amount outstanding at the reporting date.

For a swap based on a fluctuating level of principal, the notional principal should be taken as the maximum notional principal outstanding over the remaining life of the swap.

For amortising interest rate swaps with cash-flow mismatches in payments, the notional principal may differ between the two sides of the swap. The notional principal amount should be taken as the amount of principal underlying the contract as regards the asset being received by the reporting bank.

For swaps involving reference assets, the notional principal should relate to the total volume over the whole contract (not simply the volume per settlement period).

For options purchased, the notional principal should be taken as the underlying principal on the option, using for currency options, the received currency at the spot rate on the reporting date.

For contracts with multiple exchanges of principal the potential future exposure should be multiplied by the number of payments still to be made under the contract.

Banks should not generally enter into contracts at off market prices. If any contracts are undertaken at off market prices banks should contact their line supervisor to discuss the background and to agree a reporting treatment. Where swaps are arranged at off-market rates or where options begin deep in the money, contracts may include an element of “disguised” credit exposure. In general, the FSA would consider a disguised credit exposure to be present where the contract either starts with a significantly positive mark to market, or because of an assumption of unchanged interest and exchange rates. In the case of interest rate or cross currency swaps arranged at off-market prices, the FSA will require special treatment for contracts which have been created in order to disguise a credit exposure to the counterparty. Such cases should be discussed with the FSA.

Remaining maturity

The remaining maturity of a swap should be taken as the time until the final expiry of the swap. For FRAs and similar products, the remaining maturity should be taken as the time from the reporting date until the end of the period to which the interest rate underlying the contract relates (see SGN34 for more detail generally).

For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the mark to market value of the contract is zero on these specified dates, the residual maturity should be set equal to the time until the next reset date. However, in the case of interest rate contracts with a residual maturity of more than one year, the potential future exposure matrix multiplier may be subject to a floor of 0.5% even if there are reset dates of a shorter duration.

Replacement cost methodology

The credit equivalent amount should be calculated in accordance with the reporting instructions set out in SGN34.

Reportable Exposures

Exposures to the following categories of counterparties should be reported separately:-

- (i) An individual non-banks counterparty
- (ii) Closely related counterparties
- (iii) A connected counterparty
- (iv) A bank, building society, recognised investment firm, recognised clearing house or recognised exchange
- (v) A central government
- (vi) Zone A/Zone B countries

Exposure to individual, or groups of closely related, counterparties should be reported in columns 2 and 3 in each category of counterparty in descending order by size. Exposures to individual counterparties which constitute a group of closely related counterparties (see SGN12) should be reported as one exposure.

Where reporting is on a gross basis, the exposure at the reporting date should be included in column 2(a) and the maximum during the period in 2(b). Where the terms outlined in Chapter NE (Collateral and netting) of the FSA Policy Guide/IPRU (BANK) are met, such that reporting is on a net basis, the exposure at the reporting date should be included in column 3(a) and the maximum during the period in 3(b).

Exposure Categories

PART 1

Exposures to individual non-bank counterparties and groups of closely related non-bank counterparties should be reported in this section. Exposures to international organisations (including multilateral development banks and the Bank for International Settlements (BIS)) should be included here.

The 20 largest exposures should be listed (unless a lower number has been agreed by the reporting bank with the FSA) and any other exposure which exceeds 10% (unless a lower % has been agreed with the FSA) of the reporting bank's capital base.

PART 2

This includes exposures to individual non-bank counterparties and groups of closely related non-bank counterparties which are connected to the reporting bank should be reported in Part 2(i). Exposures to banks connected to the reporting bank should be included in Part 2(ii). Any amounts exempt under a connected exposure "concession", agreed in writing with the FSA, should be reported in column (7).

PART 3

This covers exposures to banks, building societies, recognised investment firms, recognised clearing houses and recognised exchanges. Additionally, where the reporting bank is exposed to a bank which is closely related to a non-bank counterparty to which the reporting bank is also exposed and the exposure to the bank and *the non-bank counterparties* taken together exceeds 10% of the reporting bank's capital base, the exposure to the bank should be reported here in Part 3(i) if the exposure is ≤ 1 year in maturity and that part of the exposure $>$ one year maturity, if any, reported in Part 3(ii). Exposures to counterparties closely related to the counterparties reported in column 1 should be reported in column 5.

The 20 largest exposures (unless a lower number has been agreed by the reporting bank with the FSA) and any other exposures which exceed 10% of the reporting bank's large exposures capital base (LECB) should be reported. Where a loan is repayable in instalments the amounts should be reported in parts (i) and (ii) in accordance with the maturity of the instalments, such that the amount repayable within one year will be included in Part 3(i) and that part due to be paid in over 1 year will be included in Part 3(ii). A security with optional redemption dates which are exercisable by the holder should be classified according to the first optional redemption date. Exposures arising from repos/reverse repos should be reported in 3(i) or 3(ii) according to the maturity of the repo contract not the security repoed.

PART 4

Exposures to central governments and central banks which exceed 10% of the reporting bank's capital base should be included in this section. Exposures to local authorities, states, other public sector bodies and state owned banks which it is appropriate to treat as an exposure to a central government should also be reported here (such cases should be agreed with the FSA). The reported exposures should be split between Zone A and Zone B.

PART 5

Holdings of tradeable securities in the Trading Book which are subject to soft limits should be included in this section.

Where an exposure to an issuer arising as a result of inclusion of holdings of tradeable securities in the Trading Book exceeds 25% of LECB the FSA may agree in writing that the use of soft limits is appropriate. Where the FSA has been pre-notified of and agreed a reporting institution's limits for soft limited exposures, exposures which do not exceed these limits need not be further pre-notified to the FSA although they should be post-notified on the Form LE2 and subject to incremental capital requirements. Such exposures should be marked with an (S) and listed in Part 5 of the Form. The capital charges listed here should be carried across to items B120 and B130 of the Form BSD3 and any incremental capital charge calculated on that form.

Reducing an Exposure

Syndicated loans/Sub-participations

Where the reporting bank acts as manager or co-manager of a loan financed by more than one institution, the other participating institution's share of the loan should not be reported as an exposure by the reporting bank. The participating institution, however, should have made a deposit with the manager covering its full share of the loan, and there should be no recourse to the manager by the participating institution should the borrower fail to repay. A participating institution should report its exposure as an exposure to the ultimate borrower.

Bad debt provisions

The book value should be reported gross of provisions for bad and doubtful debts. Similarly, where an exposure is marked to market the valuation should be gross of any provisions. Such provisions should however be reported in column 4 and the calculation of exposures against large exposures limits in Chapter LE (Large exposures) of the FSA Policy Guide/IPRU (BANK) should be made using exposures net of specific provisions (ie figures in column 2 or 3 of the return net of column 4). Exposures should also be reported net of write-offs which have occurred since the last reporting date. These write-offs should be reported in a schedule to the form.

Exposures secured by Eligible Collateral

Where an exposure is fully secured by cash collateral in accordance with the terms of Chapter NE (Collateral and netting) of the FSA Policy Guide/IPRU (BANK), the value of collateral held should be reported in column 5(a) of Parts 1, 2 and 4, and column 6(a) of Parts 3(i) and 3(ii). Where Zone A government securities are held as collateral, the value of the securities held should be reported in column 5(b) of parts 1, 2 and 4, and 6(b) in parts 3(i) and 3(ii).

Exposures covered by guarantees

Where an exposure is guaranteed, either by the parent bank of the reporting bank or a third party, the amount so guaranteed should be reported in column 6(a) and 6(b) respectively in Parts 1, 2 and 4 and column 7(a) and 7(b) in parts 3(i) and 3(ii). If an exposure to the original counterparty is reduced by virtue of a guarantee the exposure to the guarantor should be recorded.

1-3 year derivative concession

Derivative exposures with a maturity of over one year but under three years may be weighted at 20% for the calculation of exposures against limits in appropriate cases. Such cases should be agreed in advance in writing with the FSA. For reporting, these exposures should be included un-weighted in amounts reported in column 2 or 3 of Part 3(ii). The amount exempt under this treatment should be reported in column 8.

Connected exposure concessions

Where a connected exposure concession eg a treasury concession has been agreed, amounts covered by the concession should be included in column 7 of Part 2(i) and Part 2(ii).

Amount included in clustering ratio

This should be the gross/net exposure less any amounts allowed to be set off under columns (4)-(9) where relevant. **Care:** amounts reported as being covered by a third party guarantee may not be excluded from the clustering ratio calculation depending upon the status of the guarantor. All entries in the clustering ratio columns in Parts 1-4 should be summed and the total reported in the box provided in Part 4. This total should be measured as a % of capital base so as to monitor compliance with the limit agreed with the FSA for the reporting bank.

**FORM LE2
ANALYSIS OF LARGE EXPOSURES**

INTERNAL VALIDATIONS

Ref no	LE2 column number	
1	A2A	≤ A2B
2	A3A	≤ A3B
3	A4	≤ A2A+A3A
4	A7	if $((A2A+A3A-A4-A5A-A5B-A6A-A6B) < CB1*0.1, 0,$ $\geq(A2A+A3A-A4-A5A-A5B-A6A-A6B))$
5	B2A	≤ B2B
6	B3A	≤ B3B
7	B4	≤ B2A+B3A
8	B8	if $((B2A+B3A-B4-B5A-B5B-B6A-B6B-B7) < CB1*0.1, 0,$ $\geq(B2A+B3A-B4-B5A-B5B-B6A-B6B-B7))$
9	C2A	≤ C2B
10	C3A	≤ C3B
11	C4	≤ C2A+C3A
12	C8	if $((C2A+C3A-C4-C5A-C5B-C6A-C6B-C7) < CB1*0.1,$ $0, \geq(C2A+C3A-C4-C5A-C5B-C6A-C6B-C7))$
13	D2A	≤ D2B
14	D3A	≤ D3B
15	D4	≤ D2A+D3A
16	E2A	≤ E2B
17	E3A	≤ E3B
18	E4	≤ E2A+E2B
19	E9	if $((E2A+E3A-E4-E6A-E6B-E7A-E7B-E8) < CB1*0.1, 0,$ $\geq(E2A+E3A-E4-E6A-E6B-E7A-E7B-E8))$
20	FA2A	≤ FA2B
21	FA3A	≤ FA3B
22	FA4	≤ FA2A+FA2B
23	FB2A	≤ FB2B
24	FB3A	≤ FB3B
25	FB4	≤ FB2A+FB3A
26	FB7	if $((FB2A+FB3A-FB4-FB5A-FB5B-FB6A-$ $FB6B) < CB1*0.1, 0, \geq(FB2A+FB3A-FB4-FB5A-FB5B-$ $FB6A-FB6B-FB7))$
27	FTOT	= $\Sigma A7 + \Sigma B8 + \Sigma C8 + \Sigma E9 + \Sigma FB7$
28	FSA	> 0 (Introduced SRN/2001/2, effective December 2001)

**FORM LE2
ANALYSIS OF LARGE EXPOSURES**

CROSS FORM VALIDATIONS

LE2 AND BSD3

Ref no LE2 items

1 $\Sigma A4 + \Sigma B4 + \Sigma C4 + \Sigma D4 + \Sigma E4 + \Sigma FB4 \leq$

BSD3 items

Appendix A-V 80S (SRN/1998/5)

LIQUIDITY RETURN (FORM LR)

These instructions should be read in conjunction with the Supervisory Guidance Notes as necessary. For convenience, these reporting instructions will refer to the Supervisory Guidance Notes as 'SGN', the FSA Banking Supervisory Policy Guide as 'FSA Policy Guide' and the Interim Prudential Sourcebook for Banks as 'IPRU (BANK)'.

General Notes¹

Completion and submission to the FSA

- 1 Institutions should submit completed and signed returns to the Financial Services Authority (FSA) c/o Monetary and Financial Statistics Division of the Bank of England. All returns should be sent to the address printed on the cover page of the form within ten business days after the reporting date, or twelve business days for those institutions reporting electronically. For reporting dates and the basis of reporting, see SGN3 and SGN Appendix I respectively. Institutions should note that the reporting cycle is dependent upon the basis on which they report to the Bank of England on Form BT (see Note 3 on the front of the Form LR)².
- 2 Institutions may choose whether they report on a trade date or settlement date basis. However, the institution should report consistently on one basis both across the return and between reporting periods.
- 3 Branches of European Union and non-European Union institutions (EEA banks and UK branches of banks established outside the EEA) who have agreed a global concession with regard to liquidity reporting will not normally be required to complete this return. This is because their liquidity is supervised by the home supervisor. However, the supervisor may request such information in a similar format should the need arise. .

Cross validation

- 4 This return does not cross reconcile with any other prudential or statistical returns.
- 5 Validations are carried out internally within the form. In addition, the FSA will wish to compare for reasonableness the figures provided on this return with those provided on other returns.

Liquidity reporting in individual currencies

- 6 This return should be completed on the basis of all currencies combined. Currencies should be translated into sterling (or euros if appropriate, see SGN2a) at the closing spot mid price on the reporting date and entered in the relevant time band. However, the FSA may require institutions to provide management information on positions in individual currencies in the event of difficulties either in the individual institution or with the currency in question.

¹ The FSA has produced a text-based Distance Learning pack titled "Measuring banks' liquidity: Form LR". It is designed to help users understand the FSA's liquidity reporting guidance using Form LR. It is principally targeted at those responsible for overseeing liquidity reporting to the FSA and managers in treasury functions; but it could also be of benefit to a wider audience. It is suitable for a range of banks carrying out a wide range of activities.

The material comes in two packs - the Resource Pack and a Learning Pack, one providing a source of information and the other exercises to test understanding. A set of both packs costs £95. Special offers are available if you want more copies of the Learning Pack to go with one Resource Pack.

For more information or to order a copy, please contact the Industry Training Helpline on 020 7676 0752

Cashflow vs maturity analysis approach

- 7 The policy aim is to ensure that institutions hold sufficient liquid assets to meet their obligations as they fall due and the FSA agrees mismatch guidelines to help secure the policy objective.
- 8 The form is there to monitor institutions' compliance with their guidelines.
- 9 It does this in two ways: firstly, by including a maturity analysis of known and/or potential cashflows out to six months and secondly, by a maturity analysis of assets and liabilities from 6 months to 5 years. Non-marketable assets, and liabilities with a maturity of more than five years or which have no maturity, are not covered. During the transitional period, institutions should only provide an analysis of cashflows out to 1 month; the period beyond 1 month may be reported as a maturity analysis of assets and liabilities. Institutions may decide how and when they effect the transition to reporting cashflows out to six months but the transition should be completed by the fourth quarter 2001. Marketable assets with a maturity greater than 1 month should generally be shown separately and not included in the cashflow ladder (but see paragraph 44 below).
- 10 Institutions should report both inflows and outflows on the same basis. Therefore, if an institution reports inflows on the cashflow basis out to three months it should also report outflows on the cashflow basis out to three months. **The split between the cashflow basis of reporting and the maturity analysis should occur at the same timeband throughout the return.**
- 11 Items reported on a cashflow basis should include both interest and principal amounts, together with any other income relating to them.
- 12 Items reported on a maturity basis should be reported at their value on the institution's books. However, any cashflows arising from these items (eg interest payments) within the cashflow reporting period should be included in the relevant cashflow periods.
- 13 Thus cashflows (eg interest payments on a loan) arising from items (however reported) should be entered in the relevant cashflow timebands (ie those which the institution reports) when they fall due.
- 14 Part 2 of this return is divided into sections asking for details of 'Retail' and 'Wholesale' inflows and outflows. The exact division between the two sections is a matter for individual institutions to decide and include within their liquidity policy statement.
- 15 Where the amounts of cashflows are not material in relation to the total cashflows, the institution may agree with their supervisor that they need not be reported.. The institution should agree in advance with their supervisor which flows are not considered 'material' for the purposes of liquidity reporting. Any such arrangements should be included within the institution's liquidity policy statement, particularly for the purposes of reports commissioned under Section 39 of the Banking Act 1987 or Section 166 of the Financial Services and Markets Act 2000.

² In general, any change in Form LR reporting dates as a result of the Bank of England changing the institution's reporting frequency of the Form BT will take effect within the subsequent quarter.

“Contractual” vs “Behavioural” approach to liquidity position measurement: Parts 2 and 3 of the return

- 16 For supervisory monitoring, the FSA will normally wish to assess an institution’s liquidity position on a “worst-case” basis. Therefore, in Part 2 of this return (Contractual basis), cash inflows should be assumed to occur at their latest contractual maturity, while cash outflows should be assumed to occur at their earliest contractual maturity.
- 17 The contractual maturities pertaining to some assets and liabilities do not bear close relation to their actual behavioural characteristics. Examples might be overdrafts and credit card receivables. For this reason, for some limited categories of inflow and outflow, it is considered appropriate for institutions to report data on one of two bases. The basis of reporting should be agreed in advance with the FSA. First, the “contractual” basis, under which it will generally be assumed that items behave in accordance with their contractual terms; second, with certain “behavioural” assumptions factored into the calculations. In certain circumstances, the FSA may require an institution to report behavioural adjustments, particularly in respect of overdrafts (see items B1C and items B2A-B5A).
- 18 In instances where institutions apply for behavioural treatments, the FSA will expect such applications to be properly supported by empirical data running over an appropriate period of time.

Arrears and overdue

- 19 Where assets or other items giving rise to cashflows are non-performing, poorly performing or there is reasonable doubt about the certainty of receipt of inflows of funds pertaining to them, cashflows arising from them should not be included as receivable in the timeband columns. Rather the items should be reported in the ‘overdue’ column.
- 20 Non-performing or poorly performing assets are described as assets where on any reporting date, the asset or part of it, has passed the due date for repayment by fourteen days or more (or, in the case of lending under unconditional ECGD bank guarantee, ie Buyer Credit and the Supplier Credit Financing Facility, by thirty days or more). Assets, where the institution does not consider there is reasonable doubt over the certainty of receipt of inflows, but which have passed the due date by fourteen days or less (or less than thirty days for lending under unconditional ECGD bank guarantee, ie Buyer Credit and the Supplier Credit Financing Facility), should be entered as ‘next day’.
- 21 Unless the whole of the loan or asset has been formally declared to be in default within the terms of the contract, only that part of a loan/interest or other asset actually overdue should be reported in the ‘overdue’ column on a contractual basis. If the whole of the loan or asset has been formally declared to be in default within the terms of the contract, the institution should exclude any unmatured instalments of a loan which is partially in arrears. The institution should also report the amount of their debt portfolio which is in arrears in item D2B of the memo items to Part 2.
- 22 Where an asset or cashflow previously reported according to the treatment in paragraphs 20 and 21 is contractually rescheduled according to a written agreement, institutions should cease to report these items as ‘overdue’ and report them according to the new agreed dates for repayment.

- 23 However, certain institutions work on a recency basis, ie the customer is not deemed to be in arrears if repayments are still being met, even if one or more payments have been missed. In this case, they may report the debt accordingly on the maturity ladder, ie reporting the number of payments at their prescribed intervals with an extension on the maturity of the loan to account for the missed payments. Such treatment should however be regarded as an exception and institutions should contact their supervisor before adopting this method of reporting, which should be shown in the behavioural adjustments section of the Form (Part 3).

Provisions

- 24 Items should be reported net of specific provisions. General provisions should not be recorded on this return.

Residual Maturity

- 25 Unless otherwise stated in the reporting instructions, all references to maturity for the purpose of this return refer to residual maturity.
- 26 Cash inflow and outflow items and assets and liabilities should be classified according to their remaining maturity. Cashflows such as receipts of interest on performing loans or payments of interest on deposits should be recorded in the timeband in which they will occur.
- 27 Deposits placed with the reporting institution should - as appropriate - be reported either as outflows occurring on the earliest possible repayment date, or as liabilities maturing at the earliest possible repayment date. In this context, the earliest repayment date means the first rollover date or the shortest period of notice required to withdraw the funds or to exercise a break clause, where applicable.
- 28 Loans made by the reporting institution should - as appropriate - be entered as inflows occurring on the latest possible repayment date or as liabilities maturing at the latest possible repayment date. Purely technical break facilities should be disregarded for fixed term loans. Where the institution has loans outstanding at the reporting date under revolving credit lines and has not received notification that they will be redrawn on maturity, the intermediate date should be taken as the maturity date.
- 29 Where an institution holds a security where the issuer has the option to repay over a range of dates, the last repayment date should be taken as the date of repayment, unless notice has been given of redemption at an earlier date. Where the institution has issued such a security the first repayment date should be taken as the date of repayment, unless notice has been given of redemption at a later date.
- 30 The treatment of spot foreign exchange deals will depend upon whether the institution reports on a trade or settlement date basis. Those reporting on a trade date basis should only include the effect of any transactions which take place on the reporting date, whereas those reporting according to the settlement date may need to report deals from previous days which have yet to settle. This should not affect an institution's decision about the basis on which it should report the Form LR. As long as the Form LR is reported consistently on one basis across the form and between quarters, it will not have any impact on an institution's compliance with its mismatch guidelines.

- 31 Where an institution has entered into a forward deal where it is fully committed (eg a loan/deposit with a start date of two days forward and spot foreign exchange trade) and the cashflows will take place within the sight to 8-day time band, it should be reported on the return as such. However, where the institution intends to enter into an agreement in two days time but has not yet committed itself, this should not be reported as this return is intended to be a snapshot at the end of the quarter.
- 32 The timeband 'next day' comprises cashflows or asset items due, available or maturing on the next business day after the reporting date.
- 33 Cashflows arising or assets/liabilities maturing on a non-business day should be reported as taking place on the following business day.
- 34 Funds callable at one day's notice should be entered as two-day maturity unless notice has been received or given on the reporting date.
- 35 Funds callable at seven days' notice should be entered in the '8 days and under (excluding next day)' maturity band, even if not called.
- 36 Where the period to remaining maturity is to be entered in months, it should be calculated on a calendar month basis starting from the reporting date.
- 37 The following example sets out in which timeband cashflows and assets/liabilities due, available and maturing on the reported dates stated will be reported. All dates are inclusive.

Reporting date	28/29 February	31 May	31 August	30 November
'Demand (inc. next day)' covers:	1 March/next business day	1 June/next business day	1 September/next business day	1 December/next business day
'8 days and under' covers:	Up to 8 March*	Up to 8 June*	Up to 8 September*	Up to 8 December*
'over 8 days – 1 month' covers:	9 - 31 March	9 – 30 June	9 - 30 September	9 - 31 December
'over 1 month – 3 months' covers:	1 April - 31 May	1 July – 31 August	1 October - 30 November	1 January - 28/29 February
'over 3 months - 6 months' covers:	1 June - 31 August	1 September - 30 November	1 December - 28/29 February	1 March - 31 May
'over 6 months - 1 year' covers:	1 September - 28/29 February	1 December - 31 May	1 March - 31 August	1 June - 30 November

* but excluding next day

Netting of debts and claims

- 38 All claims and liabilities should be reported gross. Reporting institutions should not net (or offset) claims on counterparties or groups of counterparties against debts owed to those counterparties or groups of counterparties, even where a legal right of set off exists. Where the maturity of the claims and debts falls within the same timeband, the claims and debts will automatically offset each other on the return in the calculation of the mismatch.
- 39 Institutions should report long positions in marketable assets on Part 1 of this return. Long positions in 'non-marketable' items should be entered in Part 2 of the form as inflows. Short positions should be reported on Part 2 of the return. Short positions arising from either forward sales/purchases or repos have their own designated lines on Part 2, items C2G and C3C. An outflow relating to these types of short position should be reported in the timeband corresponding to the maturity of the contract. In the case of short positions arising from anything other than forward sales/purchases or repos, eg short-selling a bond, the outflow should be reported in Part 2 in the line corresponding to the expected counterparty eg C2D (interbank), C2E (corporate) or C2F (government). If the counterparty is not known, the outflow should be reported by default in C2D (interbank). These types of short positions should be reported as outflows in the demand timeband. In the case of marketable assets, institutions should enter the marked-to-market value of the asset as an outflow in the demand timeband. Non-marketable assets should be reported in the demand timebands at their redemption value or, where this is unavailable or inappropriate (eg in the case of equities), the book value should be reported.
- 40 For example, assume two months before the reporting date, an institution made a loan to a customer of £1mn for 6 months and that customer placed funds with the institution of £500,000 for three months. Assuming that the institution reports on a cashflow basis out to 6 months, it should record an inflow of £1mn in the 'Over 3 months - 6 months' column under the appropriate category and an outflow of £500,000 in the 'Over 8 days - 1 month' column under the appropriate category. In addition, any interim cashflows such as interest payments and receipts should be recorded in the appropriate timebands. During the transition period however, the institution may only report on a cashflow basis out to one month. In this case, the Form will show an asset of £1mn maturing in the 'Over 3 months - 6 months' column and an outflow of £500,000 in the 'Over 8 days - 1 month' column. Only the outflow would include any interim cashflows in the appropriate timebands.

Marketable securities

- 41 In reporting liquidity positions, institutions should normally apply "worst case" assumptions about the timing of inflows and outflows of funds. However, some categories of asset are clearly marketable and could be readily converted into cash where necessary. These assets are reported in Part 1 of the Form, Marketable Assets. Institutions should enter the full value of the marketable asset concerned in columns 1 and 2 according to the currency of denomination. The following two columns then set out the discount which will need to be applied to the full value of the asset. Discounts are applied to reflect that an institution may realise less than the market price quoted for an asset where the institution is seeking to realise assets quickly because of liquidity problems pertaining either to itself, or to general market conditions, or both. The institution should then allocate the discounted value of the assets to either of columns 3 or 4.

- 42 The timeband into which a marketable asset may be brought is determined by the length of the settlement period for the instrument in question. This reflects the length of time it would take for an institution to receive the proceeds of any sale. For example, equities quoted in the FTSE 100 index may be reported as funds receivable in the sight - eight days category because settlement for equities sold today occurs in less than eight days. Where the settlement period for items is more than eight days, or where there are other factors which mean that funds would not be received within the sight to eight days category were the asset sold or repo'd today, then the funds should be recorded as receivable in the over eight days to one month column of Part 1. Where settlement or other delays mean that funds would not be received within one month, then the items should be recorded in Part 2 of this return.
- 43 Marketable assets maturing at exactly one month should be reported in Part 1 of the return. Institutions however, may include the full value of the asset in the one month timeband and not to discount at all during the life of the asset
- 44 Where assets have a residual maturity of less than one month, the FSA recognises that it is not relevant to automatically apply a discount to such assets. In general, these assets should be entered as cashflows in the relevant timeband in Part 2 of the form (not Part 1) and no discount will be applied. The FSA acknowledges, however, that certain assets may be marketable right up to the day before they mature, and the agreement of the FSA should be sought before such assets are included in Part 1.
- 45 Assets which do not meet the criteria in paragraph 46 below, or which cannot be fitted into the tables below, are non-marketable assets for the purposes of this return and should be reported in Part 2 of the form according to their residual maturity. This covers:
- (a) Non-investment grade debt instruments (as rated by a recognised credit agency) issued by a Zone B issuer;
 - (b) Non-investment grade debt instruments (as rated by a recognised credit agency) issued by a non-government Zone A issuer;
 - (c) Commercial paper and certificates of deposit that do not meet the definition of marketable assets as set out in paragraph 46 below and Chapter LM (Mismatch liquidity), Section 5.1.3, of the FSA Policy Guide/IPRU (BANK).
- 46 Marketable assets need to fulfil all the following criteria:
- (a) prices are regularly quoted for the item by a range of counterparties;
 - (b) the item is regularly traded;
 - (c) the item may be sold (or repo'd) either on an exchange or in a deep and liquid market, for payment in cash; and
 - (d) settlement is according to a prescribed timetable rather than a negotiated timetable.
- 47 To avoid double counting, cashflows (of principal or interest) arising from holdings of marketable assets should not be included in Part 2 of this return.

- 48 Where Brady bonds have been issued by Zone A governments, these securities should be reported as zone A government debt under items A2A/A2B/A2C rather than as Brady bonds in item A4A.
- 49 The value included at demand-eight days or demand-one month will normally be a discount to the marked-to-market value of the asset (taken from the bid price) at the reporting date. The range of discounts is set out below.

(i) Zone A items issued in zone A currencies

Asset	Discount factor
Central government and central government guaranteed marketable securities, including Treasury bills, eligible local authority paper and eligible bank bills with 0 - 12 months residual maturity. Also Brady Bonds issued by Zone A governments of similar maturity.	0% (20% if denominated in a zone B currency)
Other central government, central government guaranteed and local authority marketable debt with over 12 months - 5 years residual maturity or issued at variable rates with over 12 months residual maturity. Also Brady Bonds issued by Zone A governments of similar maturity.	5% (25% if denominated in a zone B currency)
Other central government, central government guaranteed and local authority marketable debt with over five years residual maturity. Also Brady Bonds issued by Zone A governments of similar maturity.	10% (30% if denominated in a zone B currency)
Non-government debt securities which are either issued by a zone A credit institution or an investment firm subject to a CAD equivalent regime or which are classified investment grade by a relevant credit ratings agency (see paragraph 50) and which have 0 - 6 months residual maturity.	5% (25% if denominated in a zone B currency)
Non-government debt securities which are issued by a zone A credit institution or an investment firm subject to a CAD equivalent regime or which are classified investment grade by a relevant credit ratings agency (see paragraph 50) and which have over 6 months - 5 years residual maturity.	10% (30% if denominated in a zone B currency)
Non-government debt securities which are issued by a zone A credit institution or an investment firm subject to a CAD equivalent regime or which are classified investment grade by a relevant credit ratings agency (see paragraph 50) and which have over 5 years residual maturity.	15% (35% if denominated in a zone B currency)

(ii) Zone B items (irrespective of currency)

Asset	Discount factor
Central government and central government guaranteed marketable securities, including Treasury bills, with 0 - 12 months residual maturity which are classified investment grade by a relevant credit ratings agency (see paragraph 50).	20%
Other central government and central government guaranteed marketable debt with over 12 months - 5 years residual maturity, or at variable rates, which is classified investment grade by a relevant credit ratings agency (see paragraph 50).	30%
Other central government and central government guaranteed marketable debt with over five years residual maturity which is classified investment grade by a relevant credit ratings agency (see paragraph 50).	40%
Non-government debt securities which are classified investment grade by a relevant credit ratings agency (see paragraph 50) and which have 0 - 6 months residual maturity.	30%
Non-government debt securities which are classified investment grade by a relevant credit ratings agency (see paragraph 50) and which have over 6 months - 5 years residual maturity.	40%
Non-government debt securities which are classified investment grade by a relevant credit ratings agency (see paragraph 50) and which have over 5 years residual maturity.	50%

(iii) Brady Bonds

Brady Bonds (other than those issued by Zone A governments)	20% (40% if denominated in a zone B currency)
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(iv) Equities

Equities which are listed on a recognised stock index (see paragraph 51).	20% (40% if recognised stock index in a zone B country)
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- 50 The list of relevant credit ratings agencies is given in SGN Appendix H and in Section 9 (Appendix 2) of Chapter TI (Interest rate position risk) of the FSA Policy Guide/IPRU (BANK).
- 51 The list of recognised stock indices is listed in Section 6 of Chapter TE (Equity position risk) of the FSA Policy Guide/IPRU (BANK).

Collateral/assets pledged

- 52 Where an institution has pledged assets as collateral (ie where those assets remain on the institution's balance sheet but have been charged as collateral), it should no longer count them either as being available for sale as discounted marketable assets (in Part 1 of the form), or at their residual maturity in the timebands (in Part 2 of the form) for the period until they are again available for immediate sale. However, where an institution receives coupon or interest payments arising from pledged assets, it may record those cashflows as receivables in the timeband according to their receipt.
- 53 Where an institution has collateral pledged to it, or does not have full legal title to collateral, it should not count the assets that make up the collateral as available for sale as marketable assets. Only where full legal title to the assets received as collateral has passed to the reporting institution, and the assets are available for immediate resale, may that institution treat them as marketable assets.
- 54 Where an institution has received assets as collateral but they are not beneficially owned nor available for sale by the institution immediately (for example, unless there is an event of default by the counterparty), they should not be reported as forming part of the institution's stock of marketable assets.

Public Sector Entities (PSEs)

- 55 See SGN23 for the definition of PSEs.

Off balance sheet cashflows

- 56 For forward sales and purchases, when the institution sells forward an asset on Part 1 of the return, that particular asset may continue to be reported in Part 1 of the form until the date of the forward sale, when the asset leaves the institution's ownership. The inflow of the cash and the outflow of the asset should still be reported in Part 2 of the return at the 'residual maturity' of the deal. This treatment is the same as for repos where the asset ceases to appear on Part 1 from the start of the repo (paragraphs 63-67 below).
- 57 Swaps, FRAs and futures should be reported according to the cashflows they entail. Fixed legs of swaps should be recorded as the amount of the known cashflow; floating legs of swaps, FRAs and futures will be recorded according to the cashflow implied by their market value at the reporting date.
- 58 Option inflows and outflows are reported as memo items in items D1A and D1B in Part 2 of the return. Institutions may use one of two methods (see the instructions for items D1A and D1B). Whichever method is adopted, it should be specified in the institution's liquidity policy statement. Margin payments on exchange traded options should be reported according to the treatment outlined in paragraph 61; amounts relating to the principal on exchange traded options should be reported in the same way as other option inflows and outflows.

- 59 Warrants should be reported according to the treatment for options outlined in the previous paragraph.
- 60 Convertible debt securities should be treated as equities where the convertible debt security is trading at a premium of less than 10%, where the premium is defined as the current mark-to-market value of the convertible debt security less the mark-to-market value of the underlying equity, expressed as a percentage of the mark-to-market value of the underlying equity. Convertible debt securities other than those defined above may be treated as equity or debt securities.

Margin

- 61 Since variation margin payments on exchange traded futures take place every day, no amount should be recorded on the form for these payments. Held options should be reported in the memo items for options (items D1A and D1B). For other futures, institutions should enter the mark-to-market value of the future in the appropriate band. Where there is no exchange of principal, the institution should only report the flows in the timebands which it reports on a cashflow basis. However, should the institution hold an additional amount at the clearing house to cover variation margin, this should be entered as a demand asset on Part 2 of the form under 'Other inflows'. The amount of initial margin held by the institution at a clearing house should be entered in the 'Corporate' item B2D in the relevant timeband according to the residual maturity of the longest delivery date on the account.
- 62 For deposits with brokers, where the broker is acting as an intermediary, the same treatment should be applied to the deposits as that applied to variation and initial margin posted with clearing houses. Where institutions cannot distinguish between variation and initial margin, the amount should be entered at the furthest maturity of all contracts on the exchange.

Repos and reverse repos

- 63 The treatment of repos, reverse repos, stock lending and stock borrowing is essentially analogous to that of forward sales and purchases and is described in Appendix 1 to these instructions. Stock lending and borrowing is treated as being analogous to repo and reverse repo where ownership of the items borrowed and loaned is transferred under the transaction; the item borrowed is then available for sale immediately by the borrowing institution. The following treatment should therefore be applied:
- (a) The borrowed item should be reported in Part 1 of the form; the loaned item should cease to be reported in Part 1 of the form.
 - (b) Report the discounted value of the loaned item as an inflow; report the discounted value of the borrowed item as an outflow in the 'Repo/Reverse Repo' line at the maturity of the transaction where both are marketable assets.
 - (c) Should either asset be classed as 'non-marketable', the relevant adjustments should be made to the non-marketable assets line in Part 2 of the form.
- 64 It has been assumed throughout this definition that the cash leg of the transaction is effected through Nostro accounts.

- 65 Throughout this section of the General Notes, the term 'discounted value of the security' will refer to the value of the security once the supervisory discount has been applied to the market value of the asset.
- 66 During the lifetime of a repo, the discounted value of the asset should be reported in item B2F according to the timeband corresponding to the maturity of the repo. Assets repo'd out will re-appear in Part 1 of the form once the asset has been received back by the reporting institution. Reappearance in Part 1 therefore occurs at the settlement date of the asset, which may not necessarily be the next working day.
- 67 For reverse repos, the discounted value of the asset received should only be reported in Part 1 from the first working day after the start of the reversed repo. The asset should be removed from the Form LR on the day of the maturity of the reverse repo not the first working day after the maturity of the reverse repo.

Repo against DBV

- 68 Where an institution has undertaken an (overnight) repo/stock lending in return for unknown collateral, it should report as though non-government debt of over 5 years residual maturity has been received. Only where the quality of the collateral received is constrained and the institution can evidence the constraint should a more favourable treatment be adopted.

Swaps and FRAs

- 69 Institutions should report all projected flows associated with a swap (including any bullet payments) during the periods where they report on a cashflow basis. Interest amounts on swaps should only be reported in the cashflow section.
- 70 With currency swaps, where an exchange of principal is effected at the start or maturity of the swap, the two amounts should be treated as a forward foreign exchange contract and reported in both the cashflow and maturity analysis sections of the form, in either item B3B or item C3B.
- 71 For interest rate swaps, eg a 5-year fixed rate against a 3 month LIBOR swap, institutions should report the known amount of the fixed leg of the cashflow out to the last cashflow timeband (initially this will be the 'Over 8 days to 1 month' period, but by the fourth quarter of 2001, this will be the 'Over 3 months to 6 months' timeband). The floating leg should be reported out to the same timeband according to the cashflow implied by yields prevailing at the reporting date (or alternatively a forward LIBOR rate). Both legs should be reported in items B3A or C3A.
- 72 For fixed legs, the known amount of the fixed leg should be entered. For floating legs, the amount of the cashflow to be received should be derived from the swap's present value at yields prevailing at the reporting date and entered as an inflow in the relevant timeband. Where the floating leg has been agreed in advance for a specified period, institutions should report the cashflow according to this rate.
- 73 Cashflows arising from FRAs should only be reported in the cashflow section, NOT in the maturity analysis section. The present marked-to-market value of the FRA, or the settlement amount post fixing, should be recorded in the time period based on the actual settlement date of the FRA, ie when the institution makes a payment or receives funds.

REPORTING INSTRUCTIONS

A Reporting in euros

Only institutions which the FSA has agreed should report in euros (see SGN2a) should tick this box.

Part 1: Marketable Assets

General Notes

This section is used for reporting holdings of marketable assets which are in the institution's ownership and available for sale immediately at the reporting date.

Assets should be reported at their mark-to-market value (bid price) at the reporting date. Where the institution's system does not operate on this basis, they may follow their own valuation practice, eg mid market or bid/offer prices. Institutions should always report the dirty price ie including accrued interest.

Assets pledged as collateral, or assets not otherwise available for immediate resale, should not be reported in Part 1 as marketable assets. Where an institution has pledged assets as collateral in a transaction and they are no longer available for sale by the institution, they should cease to be reported in the marketable assets section (Part 1) of this form for the period until they are again available immediately for sale. Interest received on these pledged assets, however, may be reported in Parts 2 and 3 of the Form LR as receivable by the reporting institution in the appropriate line as cash inflows in the period in which they occur.

For the treatment of repo/reverse repo and stock borrowing/lending, see the General Notes (paragraphs 63 to 68) to this form.

Where assets, which would otherwise be eligible to be included in Part 1 of this form, mature within one month, they should generally be reported in Part 2 of this form under 'Non marketable capital items and debt instruments maturing within 1 month' (item B2A) as an inflow/asset in the timeband corresponding to the residual maturity of the asset. Items should then be reported at full marked-to-market value, with no discount applied. The FSA recognises, however, that certain assets might be marketable up to the day they mature. It may agree with institutions that it is appropriate for them to include identifiable assets maturing within one month on Part 1 until maturity.

Discount factors

To reflect the risk of price variations, a range of discount factors is applied to the marked-to-market values of assets brought forward in maturity into Part 1 of this form. The range of discount factors is listed in the General Notes (paragraph 49).

Definitions

A1A Cash held

This comprises holdings of notes and coin.

A2A-A2F DEBT INSTRUMENTS ISSUED IN ZONE A COUNTRIES³

A2A Central government/central government guaranteed, including Treasury bills, eligible Local Authority paper and eligible bank bills with a residual maturity of up to 1 year

Include:

- Short term central government (including central government guaranteed) paper and paper eligible for discount at the Central Bank issued by either HM Government/another UK issuer or by another Zone A Central Government/ another Zone A issuer;
- Treasury bills;
- Bank of England euro bills;
- Eligible local authority paper, defined as UK local authority bills which are eligible for rediscount at the Bank of England, if they have an original term to maturity of not more than (6 months) 187 days and meet certain requirements concerning publication and notice set out in the Bank of England's notice of 8 June 1983.
- UK bank bills which are eligible for rediscount at the Bank of England if they are sterling bills, irrespective of issuer, which are both payable in the United Kingdom and have been accepted by eligible banks (see SGN Appendix G). Also include any holdings of non-UK bills which are eligible for discount at the central bank in the country of issue, as part of its open market operations.
- Brady bonds issued by Zone A governments.

Both fixed and variable rate securities should be reported. Only record those securities currently in the reporting institution's ownership (including where these are held in a clearing system such as Euroclear).

A2B/A2C Central government/central government guaranteed and Local Authority marketable debt between 1 year and under 5 years / of 5 years and over

Include central government (including central government guaranteed) paper and paper eligible for discount at the Central Bank issued by HM Government / another UK issuer or by another Zone A Central Government / another Zone A issuer, as well as Brady bonds issued by a Zone A government. Only record those securities currently in the reporting institution's ownership (including where these are held in a clearing system such as Euroclear).

A2D/A2E/A2F Non-government of up to 6 months / between 6 months and 5 years / over 5 years

Non-government debt securities which are classified as 'qualifying' by the FSA in its implementation of the Capital Adequacy Directive (see Chapter TI (Interest rate position risk), Section 5.2, of the FSA Policy Guide/IPRU (BANK)). Hence, debt instruments should be treated as qualifying if any of the following conditions apply:

- (a) They are securities issued by, or fully collateralised by claims on, a multilateral development bank listed in the Solvency Ratio Directive (see Chapter BC (Credit risk in the banking book), Section 3.2, of the FSA Policy Guide/IPRU (BANK)). The European Commission may amend this list periodically;

³ Zone A and Zone B countries are listed in SGN Appendix C.

- (b) They are issued, guaranteed, endorsed, or accepted, by a credit institution incorporated in a Zone A country;
- (c) They are issued, or guaranteed, by an investment firm that is subject to the Capital Adequacy Directive, or a regime that is as stringent (for a list of such regimes see Chapter CS (Consolidated supervision), Section 10.3, of the FSA Policy Guide/IPRU (BANK));
- (d) They are issued by, or guaranteed by, Zone A PSEs;
- (e) They are issued by, or guaranteed by, a company whose equity is eligible for 4% equity specific risk weighting (see Chapter TE (Equity position risk), Section 6.1, of the FSA Policy Guide/IPRU (BANK)).

Only those securities in the reporting institution's ownership, which the institution may freely dispose of at any time with no restrictions (including where these are held in a clearing system such as Euroclear), should be recorded. Those assets pledged to another institution or otherwise encumbered should not be included.

A3A-A5A DEBT INSTRUMENTS ISSUED BY ENTITIES IN ZONE B COUNTRIES

A3A Central government/central government guaranteed of up to 1 year

Short term central government (including central government guaranteed) paper and paper eligible for discount at the Central Bank issued by a Zone B Central Government/ another Zone B issuer. Also include Treasury bills, eligible local authority paper and eligible bank bills. Only those securities currently in the reporting institution's ownership (including those which are held in a clearing system such as Euroclear) should be recorded. Securities should only be included in this section if they are classified investment grade by a recognised credit ratings agency (see SGN Appendix H), or if they are eligible for discount at the central bank in the country of issue.

A3B/A3C Central government/Central government guaranteed of between 1 year and under 5 years / over 5 years

Central government (including central government guaranteed) paper and paper eligible for discount at the Central Bank issued by a Zone B Central Government/ another Zone B issuer. Include only those securities issued by, or fully guaranteed by, Zone B central governments and central banks with a residual maturity of over 1 year. Only those securities currently in the reporting institution's ownership (including those held in a clearing system such as Euroclear) should be recorded. Securities should only be included in this section if they are classified investment grade by a recognised credit ratings agency (see General Notes, paragraph 50).

A3D/A3E/A3F Eligible non-government of up to 6 months / between 6 months and 5 years / over 5 years

Non-government debt securities issued, guaranteed, endorsed or accepted by an entity in a Zone B country and are investment grade. Also include those securities issued, or guaranteed by, an investment firm that is subject to the Capital Adequacy Directive or a regime that is as stringent (for a list of such regimes, see Chapter CS (Consolidated supervision), Section 10.3, of the FSA Policy Guide/IPRU (BANK)). Only those securities in the reporting institution's ownership should be recorded (including where these are held in a clearing system such as Euroclear).

A4A Brady bonds

Brady bonds currently in the reporting institution's ownership (including those held in a clearing system such as Euroclear). Do not include Brady bonds issued by Zone A governments here. These should be discounted and reported as Zone A government debt in lines A2A, A2B and A2C.

A5A Highly liquid equities and equity indices

Equities that are eligible for a specific risk weight of 4% or less under the FSA's Implementation of the Amending Capital Adequacy Directive (CAD2) and the amendment to the Basle Accord for Market Risks and which are currently in the reporting institution's possession.

Part 2: Contractual Basis: Residual Maturity

Definitions

B-B5A INFLOWS

Where items fall within a timeband which is reported on a cashflow basis, institutions should include any interest payments or other cashflows associated with the inflow or outflow. Where the item falls within the maturity analysis of assets and liabilities, the institution should only include any of the associated interest or other payments/receipts that fall due within the cashflow reporting period.

Thus, where cashflows eg interest payments take place during the cashflow timebands, they should be reported on the return regardless of the residual maturity of the instrument. Hence, if an institution has a personal loan with a residual maturity of 1 year and is reporting on a cashflow basis out to six months, it should report, in item B1B, those cashflows arising during the first six months. After that only repayments of principle should be reported.

Where an institution has been provided with a committed facility and has notified the provider of a specific draw down date, the amount of the facility which will be drawn down on that date should be included in section B2. Any part of the committed facilities for which notification of draw down has not been given should be reported in item D1C.

B Cashflow or maturity basis

Institutions should enter a tick where a particular timeband has been reported according to the cashflow basis. Where a timeband has been reported as a maturity analysis of assets, institutions should leave the box for that time period blank.

B1A-B1F RETAIL

B1A Mortgages

Any repayments of loans to individuals secured by mortgage on residential properties (both freehold and leasehold) which are or will be occupied by the borrower, or which are rented. Report mortgage loans to housing associations registered with the Housing Corporation, Scottish Homes and Tai Cymru (Housing for Wales) on housing association residential property which is rented.

B1B Personal loans

Repayments of any personal loans granted by the reporting institution to retail customers.

B1C Overdrafts

Repayments of any overdrafts granted, including any interest, where appropriate.

Note that the FSA may require institutions to complete Part 3 of the Form LR (ie apply a behavioural adjustment) for retail overdrafts.

Wholesale overdrafts should not be included here but should be reported in line B2H.

B1D Credit card inflows

Report the minimum repayment required by the institution of debt arising from credit cards issued by the reporting institution. Subsequent repayments should be reported according to the minimum percentage repayment required.

B1E Repayment of advances

Any other repayments of loans associated with retail banking business that have not already been included in the above.

B1F Other retail inflows

Any other retail associated inflows that have not already been included in the above, such as fees and commissions.

B2A-B5A WHOLESALE

Behavioural adjustments to these items should be reported in Part 3 of the Form.

B2A Non-marketable securities and debt instruments, and marketable assets maturing within 1 month

Include here any securities which the reporting institution holds or will receive, but which it cannot classify as marketable. An institution should report non-marketable assets according to the redemption value of the asset or alternatively, where the redemption value is unavailable or not appropriate (eg in the case of equities), the book value. This reflects the potential inflow of cash when the asset matures. Marketable assets maturing within one month reported at their full marked-to-market value, ie undiscounted, should also be reported here. The reporting institution may however agree with the FSA that they should be included in Part 1.

Refer to the 'Marketable securities' section of the General Notes (paragraph 45) for further guidance on what should be reported in this line.

B2B Intragroup/Connected

Report any inflows from counterparties connected to the reporting institution. Where the institution is reporting on a solo consolidated basis, inflows from entities within the solo-consolidated group should not be reported. Entries should be made in this item rather than any other item in the Wholesale section if any intragroup/connected counterparties are involved.

B2C Interbank (excluding any intragroup)

Report inflows arising from placements with other institutions, including any funds held in NOSTRO balances. Also include the entire inflows from those entities that would attract a 20% counterparty weighting as outlined in SGN15. Exclude from this line inflows from other bank entities within the group, which should go in item B2B (ie intragroup/connected). Include that element of committed facilities provided to the institution where notification of draw down date has been given.

B2D Corporate (non-interbank and intragroup)

Report inflows from non-bank, non-connected corporate counterparties. Initial margins held at clearing houses should be entered here according to their residual maturity. Repayments from leases should also be recorded in this line.

B2E Government/Public Sector

Report inflows from central governments, PSEs, local authorities and central banks. Also include funds received from the European Commission, the European Economic Community (EEC), the European Coal and Steel Community (ECSC) and Euratom. For guidance on what constitutes public sector, see SGN23.

B2F Repos/Reverse Repos

This item should include any transactions relating to repos and reverse repos. Institutions should also enter any transactions relating to stock borrowing and lending. Refer to the 'Repo/Reverse repo' section of the General Notes (paragraphs 63-68) for further guidance on what should be reported in this item.

B2G Trade related letters of credit

Report here any inflows arising from trade related letters of credit.

B2H Overdrafts

Report here any wholesale overdrafts, irrespective of the counterparty. Any behavioural adjustments to this item should be effected through Part 3 of the Form, item E4H.

B3A Swaps and FRAs

For interest rate and currency swaps, enter the receipts of fixed and floating legs in the cashflow section.

For FRAs, enter the marked-to-market receipt in the relevant time period. The amount of receipts should be derived from the contract's present value at yields prevailing at the reporting date.

Refer to the 'Swaps and FRAs' section of the General Notes (paragraphs 69-73) for further guidance on what should be reported in this item.

B3B Forward foreign exchange

Enter any cashflows relating to forward purchases of foreign currency, where an exchange of principal is effected at the start or maturity of the swap. The amount received should be entered in the appropriate maturity band.

B3C Forward sales and purchases

The cash leg of any forward sales should be treated as an inflow in the timeband corresponding to the date of the forward sale. For forward purchases, where the asset purchased is a marketable asset, the institution should report the sterling (or euro) equivalent discounted value of the security purchased at the maturity of the contract. Where the asset purchased is non-marketable, the institution should enter the sterling (or euro) equivalent discounted value of the security at the maturity of the asset.

B3D Other off balance sheet

Include here any other off balance sheet items not included elsewhere, according to their cashflows. For example, the inflow (£100,000) of a three month OTC interest rate future with one month to maturity and a marked-to-market value of £100,000 should be reported in the “over 8 days to 1 month” timeband.

Institutions should exclude any cash inflows associated with options and enter these in item D1A.

B4A Fees and other income

Report here fees, commissions or other income receivable by the institution relating to their wholesale business, according to their known date of receipt. Where the date of receipt is unknown, do not report these flows.

B4B Other inflows

Report here any other inflows, which have not been included elsewhere, according to the timing of their cashflows. Also report any inflows from settlement accounts, using the trade date plus the settlement period to determine the appropriate timeband. Where the inflow is later than this date, the amount should be entered as ‘overdue’.

B5A Total inflows

Report here the sum of items B1A to B4B for each column as appropriate.

C-C5A OUTFLOWS

Where an institution has made a firm commitment to participate in a syndicated loan arrangement, then it should record an outflow of the amount paid in the relevant box in the outflows section of Part 2. Where for example an institution pays by debiting the NOSTRO balance, it would enter an outflow in item C2D. Should the institution have already bought their share of the syndicated loan on the reporting date, the effect will be a reduction in the NOSTRO balance and an increase reflected in the line corresponding to the particular asset purchased.

Where the institution is the lead manager, it can be in one of three positions. First, it can act as the agent – however, this role will not lead to any inflows or outflows since it merely involves setting up a group of institutions to buy parts of the issue. Second, it can be an agent and take a share of the issue. In this case, the institution should report the cashflows arising from the latter role. Third, it can also underwrite the issue in conjunction with the previous two options. In this case, it should record the full amount of the issue in item D1D as an undrawn committed facility.

C Cashflow or maturity basis

Institutions should enter a tick where a particular timeband has been reported according to the cashflow basis. Where a timeband has been reported as a maturity analysis of liabilities, institutions should leave the box for that time period blank.

C1A-C1C RETAIL

C1A Time deposits

Include any deposits taken which have a residual maturity of more than overnight or which require prior notice to be given by the customer before withdrawal of funds. Also include deposits which include an agreement within the contract not to withdraw before a certain date. Where an institution has a material number of deposits where the depositor incurs an interest penalty in lieu of notice, it should agree with its supervisor whether it should report these deposits on a behavioural basis. Deposits should be entered in the timeband corresponding to the minimum amount of notice of withdrawal required. Saving deposits, deposit accounts and deposit receipts should also be entered here.

C1B No notice/ current accounts

Include here any amounts in accounts which are not subject to a minimum notice period ie funds which are available on demand. Also include deposits received with a residual maturity of no longer than overnight. Report any balances, whether interest bearing or not, where the entire balance is accessible without penalty either on demand or by close of business on the day following that on which the deposit was made.

C1C Additional advances committed

Report here any undrawn commitments to lend made by the reporting institution where the draw down date is known. The full amount of the commitment for the draw down date should be entered in the appropriate maturity band. Where the institution has made a commitment to lend, where the date of draw down is uncertain or not known, these should be reported in item D1D.

Where notification of draw down (of facilities that can be drawn down on demand) has been received, enter the flows in the 'Demand' timeband.

Also enter on this line any facilities that may be drawn down on demand where no notification of draw down has been received. These facilities should be entered in the '8 days and under' timeband.

Do not include undrawn facilities where no draw down date(s) have been notified or agreed (these should be included in item D1D of the memo items pertaining to commitments below).

C2A-C5A WHOLESALE

C2A Non-marketable securities & debt instruments and marketable assets maturing within 1 month

Include here at residual maturity outflows pertaining to maturing securities or debt instruments, which the institution cannot classify as marketable. Marketable assets maturing within one month at their full marked-to-market value, ie undiscounted should also be reported here.

Refer to the 'Marketable securities' section of the General Notes (paragraphs 45) for further guidance on what should be reported in this item.

C2B Additional advances committed

Enter here commitments to lend, or to take up, bills, certificates of deposit, investments etc, where there has been an agreed date(s) for the draw down of the facility. The full amount of the commitment should be entered. Also include any other contingent liabilities which it is known will actually be called on a specific date (eg performance bonds and guarantees due to be invoked), as well as money market placements and forward deposits.

Where notification of draw down (of facilities that can be drawn down on demand) has been received, enter the flows in the 'Demand' timeband.

Also enter on this line any facilities that may be drawn down on demand where no notification of draw down has been received. These facilities should be entered in the '8 days and under' timeband.

Do not include undrawn facilities where no draw down date(s) have been notified or agreed (these should be included in item D1D of the memo items pertaining to commitments below).

C2C Intragroup/Connected

Report any outflows of funds to counterparties connected⁴ to the reporting institution. Where the institution is reporting on a solo consolidated basis, outflows to entities within the solo-consolidated group should not be reported. Entries should be made in this item rather than any other item in the Wholesale section if any intragroup/connected counterparties are involved.

C2D Interbank (excluding any intragroup)

Report outflows arising from placements with or from, or repayments of loans to or from, other banks. Also include the entire outflows to those entities that would attract a 20% counterparty weighting as outlined in SGN15. Exclude from this item loans to, or placements with, or deposits/placements from, other bank entities within the group (these should be reported under "intragroup/connected", item C2C).

⁴ 'Connected' is as defined in the Supervisory Guidance Notes (SGN13).

C2E Corporate (non-interbank and intragroup)

Report outflows to non-bank, non-connected, corporate counterparties.

C2F Government / Public Sector

Report funds lent to central governments, PSEs, local authorities and central banks. Also include funds lent to the European Commission, the European Union (EU), the European Coal and Steel Community (ECSC) and Euratom. Where an institution is required to place funds on deposit with central banks and monetary authorities, these should be entered as an outflow in the relevant time band.

For guidance on what constitutes public sector, see SGN23.

C2G Repo/reverse repos

Record in this item any outflows related to repos or reverse repos. Also include any outflows relating to stock borrowing and lending. Refer to the 'Repos and Reverse Repos' section of the General Notes (paragraphs 63-68) for further guidance on what should be reported here.

C2H Trade related Letters of Credit

Report here any outflows arising from trade related letters of credit.

C3A Swaps and FRAs

For interest rate and currency swaps, enter payments of fixed and floating legs in the cashflow section.

For FRAs, enter the marked-to-market payment in the relevant time period. The amount paid should be derived from the contract's present value at yields prevailing at the reporting date.

Refer to the 'Swaps and FRAs' section of the General Notes (paragraphs 69-73) for further guidance on what should be reported in this item.

C3B Forward foreign exchange

Enter any cashflows relating to forward sales of foreign currency, where an exchange of principal is effected at the start or maturity of the swap. The amount paid should be entered in the appropriate maturity band.

C3C Forward sales and purchases

For forward sales, the sterling (or euro) equivalent discounted value of the security sold should be recorded as an outflow. The cash leg of any forward purchases should be treated as an outflow in the timeband corresponding to the date of the forward purchase.

C3D Other off balance sheet

Report here any outflows relating to off balance sheet items that have not been reported elsewhere on the Form LR. Institutions should exclude any cash outflows associated with options and enter these in item D1B.

C4A Dividends, tax, other costs and outflows

Report any outflows relating to payments of dividends and tax, or any other outflows that have not previously been reported elsewhere. Also report any outflows relating to settlement accounts, using the trade date plus the settlement period to determine the appropriate timeband.

C5A Total outflows

Report here the sum of items C1A to C4A for each column as appropriate.

D1A-D2B MEMO ITEMS

Options

There are two ways in which options can be reported in items D1A and D1B. Institutions should be consistent and use the same method for both inflows and outflows. Institutions should also inform the FSA of the method adopted, and record this in their liquidity policy statement.

Method 1

Report the inflows and outflows of cash arising from the exercise of the options. It is assumed for reporting purposes that all options are exercised. Any movement of the underlying financial instrument to which the option relates should be ignored.

The 'options inflows' item D1A should contain

- Purchased puts for equity or commodity transactions (if the option is exercised, the institution sells the asset and receives cash);
- Written calls for equity or commodity transactions (if the counterparty exercises its right to buy, the institution sells the asset in question and receives cash);
- All inflows relating to the exercise of interest rate options held/purchased by the institution, whether call options or put options (written interest rate options are not included here but in item D1B).

The 'options outflows' box (D1B) should contain

- Written puts for equity and commodity transactions (if the counterparty exercises this option, the institution purchases the asset and pays out cash);
- Purchased calls for equity or commodity transactions (if this type of option is exercised by the reporting institution, it purchases an asset and pays out cash).
- All outflows relating to the exercise of interest rate options written by your bank, whether call options or put options.

Method 2

Rather than reporting potential inflows of cash if all the options are exercised (ie method 1), this method of reporting is on the basis of marked-to-market value. Purchased options giving rise to either nothing or inflows are therefore treated as assets. Written options giving rise to either nothing or outflows are seen as liabilities.

The 'options inflows' item D1A should contain

- The marked-to-market value of all purchased options (puts or calls) multiplied by the number of options, irrespective of whether these are in or out of the money (the marked-to-market value should be reported on the reporting date).

The 'options outflows' item D1B should contain

- The marked-to-market value of all sold/written options (puts and calls) multiplied by the number of options, irrespective of whether these are in or out of the money (the marked-to-market value should be used on the reporting date).

D1C Undrawn committed facilities granted to the bank

Report any facilities which have been committed to the institution and which, at the reporting date, remain undrawn. Also include any flows arising from standby letters of credit and guarantees. Where a date for draw down has been agreed, the amount should be entered in the appropriate line in the inflows section of Part 2 according to the source of the facility and entered in the corresponding timeband.

D1D Undrawn committed facilities granted by the bank

Report any facilities which the institution has committed to provide (including by way of repos) and which, at the reporting date, remain undrawn. Include only those facilities where a date for draw down has not been agreed. Where a date for draw down has been agreed or where a facility may be drawn down on demand, the amount should be entered in item C1C or C2B of Part 2 (depending on whether they are retail or wholesale facilities). Do not include repo liabilities here, refer to the General Notes (paragraphs 63-68) for guidance as to how these should be reported.

D1E Commitments under credit card and other revolving credit type facilities

Report any commitments which the institution has entered into under credit cards which have not been drawn down at the reporting date (ie available credit to cardholders).

D1F Total deposits

Report the total deposits outstanding as at the reporting date, excluding any liabilities under repo/reverse repo agreements. This figure should be used as the denominator for the mismatch and in the Deposit Concentration section (Part 4) of this form. Include:

- (a) All bank notes issued by the reporting institution;
- (b) No notice/current accounts;
- (c) All time deposits;
- (d) All certificates of deposit issued by the reporting institution, whether at fixed or floating interest rates which are still outstanding;
- (e) Negotiable deposits taken on terms in all respects identical to those on which a certificate of deposit would have been issued, but for which it has been mutually convenient not to have issued a certificate;
- (f) All other issues of commercial paper and medium term notes, bonds, FRNs and other instruments, with the exception of subordinated loan capital of over two years' original maturity;
- (g) Working capital provided by non-resident offices of the reporting institution.

Exclude any certificates of deposit which the reporting institution holds which it itself has issued.

D2A Undrawn treasury concessions granted by the bank

Where an institution has taken on a treasury role on behalf of its group, it may have agreed with the FSA a "group treasury concession" for large exposures purposes (see Chapter LE (Large exposures) of the FSA Policy Guide/IPRU (BANK). The institution should report here the amount of that treasury concession.

D2B Amount of total cash inflows in arrears

Where payments on debt are contractually in arrears, the amount of the debt in arrears should be reported in this item. Only that part of the debt, along with any related interest which is in arrears, should be entered here. That part of the loan which is still due and therefore not yet in arrears should be entered in the inflows section of Part 2 in the maturity ladder in the relevant time band, provided that there is not reasonable doubt over the receipt of those inflows. Where reasonable doubt exists, the institution should report these flows in the 'overdue' timeband in the main body of the form; they should not be entered here until the due date for payment has passed.

Part 3: Behavioural basis

Institutions should complete specific items in this section in appropriate cases only. Such cases should be agreed in advance with the FSA.

E1A-E5D/F1A-F6D INFLOWS / OUTFLOWS

Institutions should report in this section cashflows after adjustment for the behavioural patterns they expect to occur. Where a reporting institution considers an adjustment is appropriate, it should approach its supervisor who will consider proposed adjustments on an individual institution basis. Institutions should be able to provide empirical evidence to support the adjustments they propose. No institution should make behavioural adjustments without the prior written agreement of the FSA.

Where behavioural adjustments are agreed, the reporting institution should report, in the relevant line of Part 3, all the data reported in the equivalent line in Part 2 but adjusted as agreed between the reporting institution and the FSA.

For example, if an institution has one class of no notice accounts which sum to £50mn, and another class of no notice accounts which sum to £30mn, a figure of £80mn will be shown in the appropriate line in Part 2 as a 'demand' outflow. However, the deposits in the first class of account are relatively 'sticky' and a behavioural adjustment is agreed to reflect this. For the purposes of this example, the reporting institution may treat 50% of these outflows as occurring in the 'eight days and under (excl. next day)' timeband. In Part 3, this reporting institution will therefore report a demand outflow of £55mn and an 'eight days and under (excl. next day)' outflow of £25mn. Part 2 will, of course, continue to show a demand outflow of £80mn.

Part 4: Calculation of mismatches and exceptions reporting

Calculation of mismatches

Institutions should monitor compliance with their liquidity mismatch guidelines each business day and should report in this section the mismatch on the reporting date, using the data from the previous parts of the return. Where component boxes of this section relate back to an item in the previous three parts of the return, this is clearly shown in the list of validations. The components then sum to form the mismatches for each period.

All mismatch percentages (lines G5A and G8C and also columns 2 and 3 of the Exceptions) should be reported to two decimal places. For example, where an institution had a mismatch of -5%, it should be reported as -5.00 on the form. There is no limit to the size of the field.

The figures that are entered in items G6D, G7C and G7E should be shown to two decimal places. Thus, if it had been agreed that 15% of undrawn commitments to lend should be included in the 'demand' column, 15.00 should be entered in item G7C.

In order for the forms to be processed, mismatch calculations should be completed on both the contractual basis and the behaviourally adjusted basis, even if the final figures (in G5A and G8C) will be the same. Institutions should only enter figures in line G6D if figures have previously been agreed with the supervisors: if no figures have been agreed, line G6C should be blank. If no behavioural adjustments have been agreed for lines G7C or G7E, institutions should enter the figure 15.00 in these boxes (assuming they have figures in items D1D or D1E respectively, otherwise the items should remain blank). This will enable them to include the default adjustment of 15% to lines D1D or D1E, mirroring that part of the mismatch calculation on the contractual basis.

Exceptions reporting

Institutions are expected to stay within their liquidity mismatch guidelines. Where an institution exceeds its guideline during the reporting period, it should contact the supervisor to inform them of any exception as soon as it occurs. Such breaches should also be reported on this return in the 'Exceptions to guidelines' section.

Dates should be reported in 'ddmm' format, so for example, 18 June would be shown as 1806. Percentages should be reported to two decimal places, so that -5% would be reported as -5.00. Where an institution has an exception to their guideline which lasts longer than one day, it should report each consecutive day's exception separately on the form, ie an exception running from 18 until 20 June would be reported as 18, 19 and 20 June, not 18 and 20 June.

Part 5: Deposit concentration

EEA banks, as defined in the Handbook Glossary of Definitions, are not required to complete any part of Part 5 of this form.

Part A Large Deposits

List all deposits which, at the reporting date, exceed 2% of total deposit liabilities (reported in item D1F). For this part of the form, 'deposits' includes any interbank loans received by the reporting institution. Exclude liabilities under sale and repurchase agreements.

Where a particular deposit, which exceeded the 2% limit during the reporting period, has been withdrawn by the reporting date, the institution need not report this deposit. If, however, the deposit remains (although for a lower amount), the institution should report the deposit on this part of the form.

Where the same depositor/lender has made more than one deposit/loan, or where depositors/lenders are closely related, the deposits/loans should be aggregated for the purpose of this return. (Where an individual deposit comprises 25% or more of the aggregate for a counterparty and has a different maturity or currency from the remainder, it should be reported separately and bracketed.)

When the reporting institution acts as agent in its receipt of funds and these funds are never reported on the institution's balance sheet, they should be excluded from this return.

Where fiduciary/agency funds are received from another institution, reporting institutions should consider deposit size in relation both to the depositing institution and (where possible) to the originator of the deposits. Where this leads to double counting - ie a deposit is included both under the originator's name and under the name of an institution handling fiduciary/agency funds - reporting institutions should indicate this by showing which part of the originator's deposit is already recorded and under what name.

Part B Client Money and Mandated Accounts Held

List the total amounts of client money and mandated accounts held.

REPOS

MARKETABLE ASSETS

	<u>Marketable asset leg (lent out)</u>	<u>Cash Leg (Received)</u>
IF MARKETABLE ASSET > 1 MONTH RESIDUAL MATURITY		
Start	<p>Cease to be reported as owned by institution.</p> <p>Cease to be reported in Part 1 as marketable asset.</p>	<p>Report according to use of funds subsequent to repo.</p> <p><i>Timeband – according to date of contract re the subsequent use, not the date of the repo.</i></p>
During life of repo	<p>Report discounted marked-to-market value of asset in Part 2, item B2F (Repos/reverse repos) to reflect future inflow.</p> <p><i>Timeband – corresponding to maturity of repo.</i></p>	<p>Report full value of repo liability (future outflow of funds include interest) in Part 2, item C2G (Repos/reverse repos).</p> <p><i>Timeband – maturity of repo.</i></p>
Maturity of repo	<p>Day after maturity or at settlement date of the asset</p> <p>Report marked-to-market value of asset (& subsequent discounted value Col 3 & 4) in Part 1.</p>	<p>Day of maturity of repo</p> <p>Reduce Nostro balance</p> <p>Report in Part 2, item B2C (cash returned including interest).</p>
IF A MARKETABLE ASSET < 1 MONTH RESIDUAL MATURITY		
Start	<p>Cease to be reported as owned by institution.</p> <p>Cease to be reported in Part 2, item B2A (full marked-to-market value), or in Part 1 if agreed by the FSA.</p>	<p>Report according to use of funds subsequent to repo.</p> <p><i>Timeband – according to date of contract re the subsequent use, not the date of the repo.</i></p>
During life of repo	<p>Report full marked-to-market value of asset in Part 2, item B2F (Repos/reverse repos) to reflect future inflow.</p> <p><i>Timeband – corresponding to residual maturity of asset.</i></p>	<p>Report full value of the repo liability or the cash leg (future outflow of funds include interest) in Part 2, item C2G (Repos/reverse repos).</p> <p><i>Timeband – maturity of repo.</i></p>
Maturity of repo	<p>Day after maturity or more precisely at settlement date of the asset</p> <p>Report marked-to-market value of asset at residual maturity in Part 2, item C2A (Non-marketable securities and debt instruments and marketable assets maturing within one month) to reflect future outflow</p> <p><i>Timeband - corresponding to residual maturity of asset (if in Part 2).</i></p>	<p>Day of maturity of the repo</p> <p>Reduce Nostro balance</p> <p>Report in Part 2, item B2C (cash returned including interest).</p>

REPOS

NON-MARKETABLE ASSETS

	<u>Non-Marketable asset leg (lent out)</u>	<u>Cash Leg (Received)</u>
Start	<p>Cease to be reported as owned by institution.</p> <p>Cease to be reported in Part 2, item B2A (redemption* value).</p>	<p>Report according to use of funds subsequent to repo.</p> <p><i>Timeband – according to date of contract re the subsequent use, not the date of the repo.</i></p>
During the life of repo	<p>Report redemption* value of asset in Part 2, item B2F (Repos/reverse repos).</p> <p><i>Timeband – corresponding to residual maturity of asset.</i></p>	<p>Report full value of repo liability or cash leg (future outflow of funds include interest) in Part 2, item C2G (Repos/reverse repos).</p> <p><i>Timeband – maturity of repo.</i></p>
Maturity of repo	<p>Day after maturity or more precisely at settlement date of the asset</p> <p>Report redemption* value of asset at residual maturity in Part 2, item B2A (Non-marketable securities & debt instruments and marketable assets maturing within one month).</p> <p><i>Timeband - corresponding to residual maturity of asset.</i></p>	<p>Day of maturity of repo</p> <p>Reduce Nostro balance</p> <p>Report in Part 2, item B2C (cash returned including interest).</p>

Undated Repo: Maturity of repo is minimum notice period required under terms of contract.

*** Where redemption value of the asset is unavailable or not appropriate (eg in the case of equities), report the book value.**

REVERSE REPOS

MARKETABLE ASSETS

	Marketable asset leg (Borrowed)	Cash leg (paid)
<div style="border: 1px solid black; padding: 5px; display: inline-block;">IF MARKETABLE ASSET > 1 MONTH RESIDUAL MATURITY</div>		
Start	<p>Report discounted marked-to-market value of asset received for period of reverse repo in Part 1.</p>	<p>Reflected by decrease in Nostro in Part 2, item B2C</p>
During the life of reverse repo	<p>Report discounted marked-to-market value of asset (to reflect future outflow of marketable asset) in Part 2, item C2G (Repos/reverse repos).</p> <p><i>Timeband - day of maturity of</i></p>	<p>Report full value of funds to be received include interest in Part 2, item B2F (Repo/Reverse repo) to reflect future inflow.</p>

	<i>reverse repo.</i>	<i>Timeband – maturity of reverse repo</i>
Maturity of reverse repo	Day of maturity of reverse repo Cease to report discounted marked-to-market value of asset received under reverse repo in Part 1.	Day of maturity of reverse repo Increase in Nostro balance Report in Part 2, item B2C (cash received including interest).
IF MARKETABLE ASSET < 1 MONTH RESIDUAL MATURITY		
Start	Report marked-to-market value of marketable asset received for period of reverse repo in Part 2, item B2A(Non-marketable securities and debt instruments & marketable assets maturing within one month). <i>Timeband - residual maturity of assets received (if in Part 2).</i>	Reflected by decrease in Nostro Report in Part 2, item B2C.
During the life of reverse repo	Report full marked-to-market value of asset (to reflect future outflow of marketable asset) in Part 2, item C2G (Repos/reverse repos). <i>Timeband - maturity of reverse repo.</i>	Report full value of funds to be received including interest in Part 2, item B2F (Repos/reverse repos). <i>Timeband – maturity of reverse repo.</i>
Maturity of reverse repo	Day of maturity of reverse repo Cease to report mart-to-market value of asset received under reverse repo in Part 1 or Part 2.	Day of maturity of reverse repo Increase in Nostro balance Report in Part 2, item B2C (cash received including interest).

REVERSE REPO

NON-MARKETABLE ASSETS

	Non-Marketable asset leg (Borrowed)	Cash Leg (Paid)
Start	Report redemption* value of non-marketable asset received for period of reverse repo in Part 2: 'Non-marketable securities and debt instruments & marketable assets maturing within one month'. <i>Timeband - at residual maturity of assets received.</i>	Reflected by decrease in Nostro Report in Part 2, item B2C.
During life of reverse repo	Report full redemption* value of asset (to reflect outflow of non-marketable asset) in Part 2, item C2G (Repo/Reverse repo). <i>Timeband – maturity of reverse repo.</i>	Report full value of funds to be received including interest in Part 2, item B2F (Repos/reverse repos). <i>Timeband - maturity of repo.</i>
Maturity of reverse repo	Day of maturity of reverse repo Cease to report redemption* value of asset received under reverse repo in Part 2.	Day of maturity of reverse repo Increase in Nostro balance Report in Part 2, item B2C (cash received including interest).

Undated reverse repo: Assume institution has security indefinitely and repo does not as such have a maturity. Return to show decrease in Nostro balance in item B2B and an increase in stock of marketable (non-marketable) assets. Nothing further need be reported until the maturity of the reverse repo is known.

* Where redemption value of the asset is unavailable or not appropriate (eg in the case of equities), report the book value.

FORM LR - LIQUIDITY RETURN

GENERAL

Ref No **Item Number**

G1 FSA > 0 (Introduced in SRN/2001/2, Effective December 2001)

PART 1: MARKETABLE ASSETS

Ref No **Item Number**

1	$A2A01 + (A2A02 * 0.80)$	= A2A03 + A2A04
2	$(A2B01 * 0.95) + (A2B02 * 0.75)$	= A2B03 + A2B04
3	$(A2C01 * 0.90) + (A2C02 * 0.70)$	= A2C03 + A2C04
4	$(A2D01 * 0.95) + (A2D02 * 0.75)$	= A2D03 + A2D04
5	$(A2E01 * 0.90) + (A2E02 * 0.70)$	= A2E03 + A2E04
6	$(A2F01 * 0.85) + (A2F02 * 0.65)$	= A2F03 + A2F04
7	$(A3A01 + A3A02) * 0.80$	= A3A03 + A3A04
8	$(A3B01 + A3B02) * 0.70$	= A3B03 + A3B04
9	$(A3C01 + A3C02) * 0.60$	= A3C03 + A3C04
10	$(A3D01 + A3D02) * 0.70$	= A3D03 + A3D04
11	$(A3E01 + A3E02) * 0.60$	= A3E03 + A3E04
12	$(A3F01 + A3F02) * 0.50$	= A3F03 + A3F04
13		Replaced by Part 1 Marketable Assets Validation 17, SRN 1999/5
14	$(A5A01 * 0.80) + (A5A02 * 0.60)$	= A5A03 + A5A04
15	A6A03	= A1A03 + A2A03 + A2B03 + A2C03 + A2D03 + A2E03 + A2F03 + A3A03 + A3B03 + A3C03 + A3D03 + A3E03 + A3F03 + A4A03 + A5A03
16	A6A04	= A2A04 + A2B04 + A2C04 + A2D04 + A2E04 + A2F04 + A3A04 + A3B04 + A3C04 + A3D04 + A3E04 + A3F04 + A4A04 + A5A04
17	$(A4A01 * 0.80) + (A4A02 * 0.60)$	= A4A03 + A4A04 (introduced SRN 1999/5)

PART 2: CONTRACTUAL BASIS

INFLOWS

Ref No	Item Number	
1		Replaced by validation 53 from August 2000
2		Replaced by validation 54 from August 2000
3	B5A03	= B1A03 + B1B03 + B1D03 + B1E03 + B1F03 + B2A03 + B2B03 + B2C03 + B2D03 + B2E03 + B2F03 + B2G03 + B3A03 + B3B03 + B3C03 + B3D03 + B4A03 + B4B03
4	B5A04	= B1A04 + B1B04 + B1D04 + B1E04 + B1F04 + B2A04 + B2B04 + B2C04 + B2D04 + B2E04 + B2F04 + B2G04 + B3A04 + B3B04 + B3C04 + B3D04 + B4A04 + B4B04
5	B5A05	= B1A05 + B1B05 + B1D05 + B1E05 + B1F05 + B2A05 + B2B05 + B2C05 + B2D05 + B2E05 + B2F05 + B2G05 + B3A05 + B3B05 + B3C05 + B3D05 + B4A05 + B4B05
6	B5A06	= B1A06 + B1B06 + B1D06 + B1E06 + B1F06 + B2A06 + B2B06 + B2C06 + B2D Col 6 + B2E06 + B2F06 + B2G06 + B3A06 + B3B06 + B3C06 + B3D06 + B4A06 + B4B06
7		Replaced by Part 2 Inflows validation 51, SRN 1999/3
8	B5A08	= B1A08 + B1B08 + B1D08 + B1E08 + B1F08 + B2A08 + B2B08 + B2C08 + B2D08 + B2E08 + B2F08 + B2G08 + B3A08 + B3B08 + B3C08 + B3D08 + B4A08 + B4B08

9	B5A09	= B1A09 + B1B09 + B1D09 + B1E09 + B1F09 + B2A09 + B2B09 + B2C09 + B2D09 + B2E09 + B2F09 + B2G09 + B3A09 + B3B09 + B3C09 + B3D09 + B4A09 + B4B09
10	B5A10	= B1A10 + B1B10 + B1D10 + B1E10 + B1F10 + B2A10 + B2B10 + B2C10 + B2D10 + B2E10 + B2F10 + B2G10 + B3A10 + B3B10 + B3C10 + B3D10 + B4A10 + B4B10
11	B5A11	= B1A11 + B1B11 + B1D11 + B1E11 + B1F11 + B2A11 + B2B11 + B2C11 + B2D11 + B2E11 + B2F11 + B2G11 + B3A11 + B3B11 + B3C11 + B3D11 + B4A11 + B4B11
12	B1A07	= B1A01 + B1A02 + B1A03 + B1A04 + (IF BCF05 = 1 ADD B1A05) + (IF BCF06 = 1 ADD B1A06)
13	B1A11	= (IF BCF05 = 0 ADD B1A05) + (IF BCF06 = 0 ADD B1A06) + B1A08 + B1A09 + B1A10
14	B1B07	= B1B01 + B1B02 + B1B03 + B1B04 + (IF BCF05 = 1 ADD B1B05) + (IF BCF06 = 1 ADD B1B06)
15	B1B11	= (IF BCF05 = 0 ADD B1B05) + (IF BCF06 = 0 ADD B1B06) + B1B08 + B1B09 + B1B10
16	B1C07	= B1C01 + B1C02
17	B1D07	= B1D01 + B1D02 + B1D03 + B1D04 + (IF BCF05 = 1 ADD B1D05) + (IF BCF06 = 1 ADD B1D06)
18	B1D11	= (IF BCF05 = 0 ADD B1D05) + (IF BCF06 = 0 ADD B1D06) + B1D08 + B1D09 + B1D10
19	B1E07	= B1E01 + B1E02 + B1E03 + B1E04 + (IF BCF05 = 1 ADD B1E05) + (IF BCF06 = 1 ADD B1E06)
20	B1E11	= (IF BCF05 = 0 ADD B1E05) + (IF BCF06 = 0 ADD B1E06) + B1E08 + B1E09 + B1E10
21	B1F07	= B1F01 + B1F02 + B1F03 + B1F04 + (IF BCF05 = 1 ADD B1F05) + (IF BCF06 = 1 ADD B1F06)

22	B1F11	= (IF BCF05 = 0 ADD B1F05) + (IF BCF06 = 0 ADD B1F06) + B1F08 + B1F09 + B1F10
23	B2A07	= B2A01 + B2A02 + B2A03 + B2A04 + (IF BCF05 = 1 ADD B2A05) + (IF BCF06 = 1 ADD B2A06)
24	B2A11	= (IF BCF05 = 0 ADD B2A05) + (IF BCF06 = 0 ADD B2A06) + B2A08 + B2A09 + B2A10
25	B2B07	= B2B01 + B2B02 + B2B03 + B2B04 + (IF BCF05 = 1 ADD B2B05) + (IF BCF06 = 1 ADD B2B06)
26	B2B11	= (IF BCF05 = 0 ADD B2B05) + (IF BCF06 = 0 ADD B2B06) + B2B08 + B2B09 + B2B10
27	B2C07	= B2C01 + B2C02 + B2C03 + B2C04 + (IF BCF05 = 1 ADD B2C05) + (IF BCF06 = 1 ADD B2C06)
28	B2C11	= (IF BCF05 = 0 ADD B2C05) + (IF BCF06 = 0 ADD B2C06) + B2C08 + B2C09 + B2C10
29	B2D07	= B2D01 + B2D02 + B2D03 + B2D04 + (IF BCF05 = 1 ADD B2D05) + (IF BCF06 = 1 ADD B2D06)
30	B2D11	= (IF BCF05 = 0 ADD B2D05) + (IF BCF06 = 0 ADD B2D06) + B2D08 + B2D09 + B2D10
31	B2E07	= B2E01 + B2E02 + B2E03 + B2E04 + (IF BCF05 = 1 ADD B2E05) + (IF BCF06 = 1 ADD B2E06)
32	B2E11	= (IF BCF05 = 0 ADD B2E05) + (IF BCF06 = 0 ADD B2E06) + B2E08 + B2E09 + B2E10
33	B2F07	= B2F01 + B2F02 + B2F03 + B2F04 + (IF BCF05 = 1 ADD B2F05) + (IF BCF06 = 1 ADD B2F06)
34	B2F11	= (IF BCF05 = 0 ADD B2F05) + (IF BCF06 = 0 ADD B2F06) + B2F08 + B2F09 + B2F10
35	B2G07	= B2G01 + B2G02 + B2G03 + B2G04 + (IF BCF05 = 1 ADD B2G05) + (IF BCF06 = 1 ADD B2G06)
36	B2G11	= (IF BCF05 = 0 ADD B2G05) + (IF BCF06 = 0 ADD B2G06) + B2G08 + B2G09 + B2G10

37	B3A07	= B3A01 + B3A02 + B3A03 + B3A04 + (IF BCF05 = 1 ADD B3A05) + (IF BCF06 = 1 ADD B3A06)
38	B3A11	= (IF BCF05 = 0 ADD B3A05) + (IF BCF06 = 0 ADD B3A06) + B3A08 + B3A09 + B3A10
39	B3B07	= B3B01 + B3B02 + B3B03 + B3B04 + (IF BCF05 = 1 ADD B3B05) + (IF BCF06 = 1 ADD B3B06)
40	B3B11	= (IF BCF05 = 0 ADD B3B05) + (IF BCF06 = 0 ADD B3B06) + B3B08 + B3B09 + B3B10
41	B3C07	= B3C01 + B3C02 + B3C03 + B3C04 + (IF BCF05 = 1 ADD B3C05) + (IF BCF06 = 1 ADD B3C06)
42	B3C11	= (IF BCF05 = 0 ADD B3C05) + (IF BCF06 = 0 ADD B3C06) + B3C08 + B3C09 + B3C10
43	B3D07	= B3D01 + B3D02 + B3D03 + B3D04 + (IF BCF05 = 1 ADD B3D05) + (IF BCF06 = 1 ADD B3D06)
44	B3D11	= (IF BCF05 = 0 ADD B3D05) + (IF BCF06 = 0 ADD B3D06) + B3D08 + B3D09 + B3D10
45	B4A07	= B4A01 + B4A02 + B4A03 + B4A04 + (IF BCF05 = 1 ADD B4A05) + (IF BCF06 = 1 ADD B4A06)
46	B4A11	= (IF BCF05 = 0 ADD B4A05) + (IF BCF06 = 0 ADD B4A06) + B4A08 + B4A09 + B4A10
47	B4B07	= B4B01 + B4B02 + B4B03 + B4B04 + (IF BCF05 = 1 ADD B4B05) + (IF BCF06 = 1 ADD B4B06)
48	B4B11	= (IF BCF05 = 0 ADD B4B05) + (IF BCF06 = 0 ADD B4B06) + B4B08 + B4B09 + B4B10
49	B5A07	= B5A01 + B5A02 + B5A03 + B5A04 + (IF BCF05 = 1 ADD B5A05) + (IF BCF06 = 1 ADD B5A06)
50	B5A11	= (IF BCF05 = 0 ADD B5A05) + (IF BCF06 = 0 ADD B5A06) + B5A08 + B5A09 + B5A10
51		Replaced by validation 55 from August 2000
52	B2H07	= B2H01 + B2H02 (from August 2000)
53	B5A01	= B1A01 + B1B01 + B1C01 + B1D01 + B1E01 + B1F01 + B2A01 + B2B01 + B2C01 + B2D01 + B2E01 + B2F01 + B2G01 + B2H01 + B3A01 + B3B01 + B3C01 + B3D01 + B4A01 + B4B01 (from August 2000)

54 B5A02

= B1A02 + B1B02 + B1C02 + B1D02 + B1E02 +
B1F02 + B2A02 + B2B02 + B2C02 + B2D02 + B2E02
+ B2F02 + B2G02 + B2H02 + B3A02 + B3B02 +
B3C02 + B3D02 + B4A02 + B4B02 (from August
2000)

55 B5A07

= B1A07 + B1B07 + B1C07 + B1D07 + B1E07 + B1F07
+ B2A07 + B2B07 + B2C07 + B2D07 + B2E07 +
B2F07 + B2G07 + B2H07 + B3A07 + B3B07 + B3C07
+ B3D07 + B4A07 + B4B07 (from August 2000)

OUTFLOWS

Ref No	Item Number	
1	C5A02	= C1A02 + C1B02 + C1C02 + C2A02 + C2B02 + C2C02 + C2D02 + C2E02 + C2F02 + C2G02 + C2H Col 2 + C3A02 + C3B02 + C3C02 + C3D02 + C4A02
2	C5A03	= C1A03 + C1C03 + C2A03 + C2B03 + C2C03 + C2D03 + C2E03 + C2F03 + C2G03 + C2H Col 3 + C3A03 + C3B03 + C3C03 + C3D03 + C4A03
3	C5A04	= C1A04 + C1C04 + C2A04 + C2B04 + C2C04 + C2D04 + C2E04 + C2F04 + C2G04 + C2H Col 4 + C3A04 + C3B04 + C3C04 + C3D04 + C4A04
4	C5A05	= C1A05 + C1C05 + C2A05 + C2B05 + C2C05 + C2D05 + C2E05 + C2F05 + C2G05 + C2H Col 5 + C3A05 + C3B05 + C3C05 + C3D05 + C4A05
5	C5A06	= C1A06 + C1C06 + C2A06 + C2B06 + C2C06 + C2D06 + C2E06 + C2F06 + C2G06 + C2H Col 6 + C3A06 + C3B06 + C3C06 + C3D06 + C4A06
6		Replaced by Part 2 Outflows validation 46, SRN 1999/3
7	C5A08	= C1A08 + C1C08 + C2A08 + C2B08 + C2C08 + C2D08 + C2E08 + C2F08 + C2G08 + C2H Col 8 + C3A08 + C3B08 + C3C08 + C3D08 + C4A08
8	C5A09	= C1A09 + C1C09 + C2A09 + C2B09 + C2C09 + C2D09 + C2E09 + C2F09 + C2G09 + C2H Col 9 + C3A09 + C3B09 + C3C09 + C3D09 + C4A09
9	C5A10	= C1A10 + C1C10 + C2A10 + C2B10 + C2C10 + C2D10 + C2E10 + C2F10 + C2G10 + C2H Col 10 + C3A10 + C3B10 + C3C10 + C3D10 + C4A10
10	C5A11	= C1A11 + C1C11 + C2A11 + C2B11 + C2C11 + C2D11 + C2E11 + C2F11 + C2G11 + C2H Col 11 + C3A11 + C3B11 + C3C11 + C3D11 + C4A11
11	C1A07	= C1A02 + C1A03 + C1A04 + (IF CCF05 = 1 ADD C1A05) + (IF CCF06 = 1 ADD C1A06)

12	C1A11	= (IF CCF05 = 0 ADD C1A05) + (IF CCF06 = 0 ADD C1A06) + C1A08 + C1A09 + C1A Co 10
13	C1B07	= C1B02
14	C1C07	= C1C02 + C1C03 + C1C04 + (IF CCF05 = 1 ADD C1C05) + (IF CCF06 = 1 ADD C1C06)
15	C1C11	= (IF CCF05 = 0 ADD C1C05) + (IF CCF06 = 0 ADD C1C06) + C1C08 + C1C09 + C1C10
16	C2A07	= C2A02 + C2A03 + C2A04 + (IF CCF05 = 1 ADD C2A05) + (IF CCF06 = 1 ADD C2A06)
17	C2A11	= (IF CCF05 = 0 ADD C2A05) + (IF CCF06 = 0 ADD C2A06) + C2A08 + C2A09 + C2A10
18	C2B07	= C2B02 + C2B03 + C2B04 + (IF CCF05 = 1 ADD C2B05) + (IF CCF06 = 1 ADD C2B06)
19	C2B11	= (IF CCF05 = 0 ADD C2B05) + (IF CCF06 = 0 ADD C2B06) + C2B08 + C2B09 + C2B10
20	C2C07	= C2C02 + C2C03 + C2C04 + (IF CCF05 = 1 ADD C2C05) + (IF CCF06 = 1 ADD C2C06)
21	C2C11	= (IF CCF05 = 0 ADD C2C05) + (IF CCF06 = 0 ADD C2C06) + C2C08 + C2C09 + C2C10
22	C2D07	= C2D02 + C2D03 + C2D04 + (IF CCF05 = 1 ADD C2D05) + (IF CCF06 = 1 ADD C2D06)
23	C2D11	= (IF CCF05 = 0 ADD C2D05) + (IF CCF06 = 0 ADD C2D06) + C2D08 + C2D09 + C2D10
24	C2E07	= C2E02 + C2E03 + C2E04 + (IF CCF05 = 1 ADD C2E05) + (IF CCF06 = 1 ADD C2E06)
25	C2E11	= (IF CCF05 = 0 ADD C2E05) + (IF CCF06 = 0 ADD C2E06) + C2E08 + C2E09 + C2E10
26	C2F07	= C2F02 + C2F03 + C2F04 + (IF CCF05 = 1 ADD C2F05) + (IF CCF06 = 1 ADD C2F06)
27	C2F11	= (IF CCF05 = 0 ADD C2F05) + (IF CCF06 = 0 ADD C2F06) + C2F08 + C2F09 + C2F10
28	C2G07	= C2G02 + C2G03 + C2G04 + (IF CCF05 = 1 ADD C2G05) + (IF CCF06 = 1 ADD C2G06)

29	C2G11	= (IF CCF05 = 0 ADD C2G05) + (IF CCF06 = 0 ADD C2G06) + C2G08 + C2G09 + C2G10
30	C2H Col 7	= C2H Col 2 + C2H Col 3 + C2H Col 4 + (IF CCF05 = 1 ADD C2H Col 5) + (IF CCF06 = 1 ADD C2H Col 6)
31	C2H Col 11	= (IF CCF05 = 0 ADD C2H Col 5) + (IF CCF06 = 0 ADD C2H Col 6) + C2H Col 8 + C2H Col 9 + C2H Col 10
32	C3A07	= C3A02 + C3A03 + C3A04 + (IF CCF05 = 1 ADD C3A05) + (IF CCF06 = 1 ADD C3A06)
33	C3A11	= (IF CCF05 = 0 ADD C3A05) + (IF CCF06 = 0 ADD C3A06) + C3A08 + C3A09 + C3A10
34	C3B07	= C3B02 + C3B03 + C3B04 + (IF CCF05 = 1 ADD C3B05) + (IF CCF06 = 1 ADD C3B06)
35	C3B11	= (IF CCF05 = 0 ADD C3B05) + (IF CCF06 = 0 ADD C3B06) + C3B08 + C3B09 + C3B10
36	C3C07	= C3C02 + C3C03 + C3C04 + (IF CCF05 = 1 ADD C3C05) + (IF CCF06 = 1 ADD C3C06)
37	C3C11	= (IF CCF05 = 0 ADD C3C05) + (IF CCF06 = 0 ADD C3C06) + C3C08 + C3C09 + C3C10
38	C3D07	= C3D02 + C3D03 + C3D04 + (IF CCF05 = 1 ADD C3D05) + (IF CCF06 = 1 ADD C3D06)
39	C3D11	= (IF CCF05 = 0 ADD C3D05) + (IF CCF06 = 0 ADD C3D06) + C3D08 + C3D09 + C3D10
40	C4A07	= C4A02 + C4A03 + C4A04 + (IF CCF05 = 1 ADD C4A05) + (IF CCF06 = 1 ADD C4A06)
41	C4A11	= (IF CCF05 = 0 ADD C4A05) + (IF CCF06 = 0 ADD C4A06) + C4A08 + C4A09 + C4A10
42	C5A07	= C5A02 + C5A03 + C5A04 + (IF CCF05 = 1 ADD C5A05) + (IF CCF06 = 1 ADD C5A06)
43	C5A11	= (IF CCF05 = 0 ADD C5A05) + (IF CCF06 = 0 ADD C5A06) + C5A08 + C5A09 + C5A10
44	CCF05	= BCF05
45	CCF06	= BCF06
46	C5A07	= C1A07 + C1B07 + C1C07 + C2A07 + C2B07 + C2C07 + C2D07 + C2E07 + C2F07 + C2G07 + C2H Col 7 + C3A07 + C3B07 + C3C07 + C3D07 + C4A07 (introduced SRN 1999/3, replacing validation 6)

PART 3: BEHAVIOURAL ADJUSTMENTS

Ref No	Item Number	
1	E1A09	= E1A01+ E1A02 + E1A03 + E1A04 + E1A05 + E1A06 + E1A07 + E1A08
2	E1B09	= E1B01+ E1B02 + E1B03 + E1B04 + E1B05 + E1B06 + E1B07 + E1B08
3	E1C09	= E1C01+ E1C02 + E1C03 + E1C04 + E1C05 + E1C06 +E1C07 + E1C08
4	E1D09	= E1D01+ E1D02 + E1D03 + E1D04 + E1D05 + E1D06 + E1D07 + E1D08
5	E1E09	= E1E01+ E1E02 + E1E03 + E1E04 + E1E05 + E1E06 + E1E07 + E1E08
6	E1F09	= E1F01+ E1F02 + E1F03 + E1F04 + E1F05 + E1F06 + E1F07 + E1F08
7	E2A09	= E2A01+ E2A02 + E2A03 + E2A04 + E2A05 + E2A06 + E2A07 + E2A08
8	E2B09	= E2B01+ E2B02 + E2B03 + E2B04 + E2B05 + E2B06 + E2B07 + E2B08
9	E3A09	= E3A01+ E3A02 + E3A03 + E3A04 + E3A05 + E3A06 + E3A07 + E3A08
10	F1A09	= F1A02 + F1A03 + F1A04 + F1A05 + F1A06 + F1A07 + F1A08
11	F1B09	= F1B02 + F1B03 + F1B04 + F1B05 + F1B06 + F1B07 + F1B08
12	F1C09	= F1C02 + F1C03 + F1C04 + F1C05 + F1C06 + F1C07 + F1C08
13	F2A09	= F2A02 + F2A03 + F2A04 + F2A05 + F2A06 +F2A07 + F2A08
14	F3A09	= F3A02 + F3A03 + F3A04 + F3A05 + F3A06 + F3A07 + F3A08
15	F4A09	= F4A02 + F4A03 + F4A04 + F4A05 + F4A06 + F4A07 + F4A08
16		Replaced by validation 45 from August 2000
17		Replaced by validation 46 from August 2000
18		Replaced by validation 47 from August 2000

19		Replaced by validation 48 from August 2000
20		Replaced by validation 49 from August 2000
21		Replaced by validation 50 from August 2000
22		Replaced by validation 51 from August 2000
23		Replaced by validation 52 from August 2000
24		Replaced by validation 53 from August 2000
25		Replaced by validation 65 from August 2000
26		Replaced by validation 66 from August 2000
27		Replaced by validation 67 from August 2000
28		Replaced by validation 68 from August 2000
29		Replaced by validation 69 from August 2000
30		Replaced by validation 70 from August 2000
31		Replaced by validation 71 from August 2000
32		Replaced by validation 72 from August 2000
33	E4A09	= E4A01+ E4A02 + E4A03 + E4A04 + E4A05 + E4A06 + E4A07 + E4A08 (from August 2000)
34	E4B09	= E4B01+ E4B02 + E4B03 + E4B04 + E4B05 + E4B06 + E4B07 + E4B08 (from August 2000)
35	E4C09	= E4C01+ E4C02 + E4C03 + E4C04 + E4C05 + E4C06 + E4C07 + E4C08 (from August 2000)
36	E4D09	= E4D01+ E4D02 + E4D03 + E4D04 + E4D05 + E4D06 + E4D07 + E4D08 (from August 2000)

37	E4E09	= E4E01+ E4E02 + E4E03 + E4E04 + E4E05 + E4E06 + E4E07 + E4E08 (from August 2000)
38	E4F09	= E4F01+ E4F02 + E4F03 + E4F04 + E4F05 + E4F06 + E4F07 + E4F08 (from August 2000)
39	E4G09	= E4G01+ E4G02 + E4G03 + E4G04 + E4G05 + E4G06 + E4G07 + E4G08 (from August 2000)
40	E4H09	= E4H01+ E4H02 + E4H03 + E4H04 + E4H05 + E4H06 + E4H07 + E4H08 (from August 2000)
41	E5A09	= E5A01+ E5A02 + E5A03 + E5A04 + E5A05 + E5A06 + E5A07 + E5A08 (from August 2000)
42	E5B09	= E5B01+ E5B02 + E5B03 + E5B04 + E5B05 + E5B06 + E5B07 + E5B08 (from August 2000)
43	E5C09	= E5C01+ E5C02 + E5C03 + E5C04 + E5C05 + E5C06 + E5C07 + E5C08 (from August 2000)
44	E5D09	= E5D01+ E5D02 + E5D03 + E5D04 + E5D05 + E5D06 + E5D07 + E5D08 (from August 2000)
45	E3A01	= E1A01 + E1B01 + E1C01 + E1D01 + E1E01 + E1F01 + E4A01 + E4B01 + E4C01 + E4D01 + E4E01 + E4F01 + E4G01 + E4H01 + E5A01 + E5B01 + E5C01 + E5D01 + E2A01 + E2B01 (from August 2000)
46	E3A02	= E1A02 + E1B02 + E1C02 + E1D02 + E1E02 + E1F02 + E4A02 + E4B02 + E4C02 + E4D02 + E4E02 + E4F02 + E4G02 + E4H02 + E5A02 + E5B02 + E5C02 + E5D02 + E2A02 + E2B02 (from August 2000)
47	E3A03	= E1A03 + E1B03 + E1C03 + E1D03 + E1E03 + E1F03 + E4A03 + E4B03 + E4C03 + E4D03 + E4E03 + E4F03 + E4G03 + E4H03 + E5A03 + E5B03 + E5C03 + E5D03 + E2A03 + E2B03 (from August 2000)
48	E3A04	= E1A04 + E1B04 + E1C04 + E1D04 + E1E04 + E1F04 + E4A04 + E4B04 + E4C04 + E4D04 + E4E04 + E4F04 + E4G04 + E4H04 + E5A04 + E5B04 + E5C04 + E5D04 + E2A04 + E2B04 (from August 2000)
49	E3A05	= E1A05 + E1B05 + E1C05 + E1D05 + E1E05 + E1F05 + E4A05 + E4B05 + E4C05 + E4D05 + E4E05 + E4F05 + E4G05 + E4H05 + E5A05 + E5B05 + E5C05 + E5D05 + E2A05 + E2B05 (from August 2000)
50	E3A06	= E1A06 + E1B06 + E1C06 + E1D06 + E1E06 + E1F06 + E4A06 + E4B06 + E4C06 + E4D06 + E4E06 + E4F06 + E4G06 + E4H06 + E5A06 + E5B06 + E5C06 + E5D06 + E2A06 + E2B06 (from August 2000)

51	E3A07	= E1A07 + E1B07 + E1C07 + E1D07 + E1E07 + E1F07 + E4A07 + E4B07 + E4C07 + E4D07 + E4E07 + E4F07 + E4G07 + E4H07 + E5A07 + E5B07 + E5C07 + E5D07 + E2A07 + E2B07 (from August 2000)
52	E3A08	= E1A08 + E1B08 + E1C08 + E1D08 + E1E08 + E1F08 + E4A08 + E4B08 + E4C08 + E4D08 + E4E08 + E4F08 + E4G08 + E4H08 + E5A08 + E5B08 + E5C08 + E5D08 + E2A08 + E2B08 (from August 2000)
53	E3A09	= E1A09 + E1B09 + E1C09 + E1D09 + E1E09 + E1F09 + E4A09 + E4B09 + E4C09 + E4D09 + E4E09 + E4F09 + E4G09 + E4H09 + E5A09 + E5B09 + E5C09 + E5D09 + E2A09 + E2B09 (from August 2000)
54	F5A09	=F5A02 + F5A03 + F5A04 + F5A05 + F5A06 + F5A07 + F5A08 (from August 2000)
55	F5C09	=F5C02 + F5C03 + F5C04 + F5C05 + F5C06 + F5C07 + F5C08 (from August 2000)
56	F5D09	=F5D02 + F5D03 + F5D04 + F5D05 + F5D06 + F5D07 + F5D08 (from August 2000)
57	F5E09	=F5E02 + F5E03 + F5E04 + F5E05 + F5E06 + F5E07 + F5E08 (from August 2000)
58	F5F09	=F5F02 + F5F03 + F5F04 + F5F05 + F5F06 + F5F07 + F5F08 (from August 2000)
59	F5G09	=F5G02 + F5G03 + F5G04 + F5G05 + F5G06 + F5G07 + F5G08 (from August 2000)
60	F5H09	=F5H02 + F5H03 + F5H04 + F5H05 + F5H06 + F5H07 + F5H08 (from August 2000)
61	F6A09	=F6A02 + F6A03 + F6A04 + F6A05 + F6A06 + F6A07 + F6A08 (from August 2000)
62	F6B09	=F6B02 + F6B03 + F6B04 + F6B05 + F6B06 + F6B07 + F6B08 (from August 2000)
63	F6C09	=F6C02 + F6C03 + F6C04 + F6C05 + F6C06 + F6C07 + F6C08 (from August 2000)
64	F6D09	=F6D02 + F6D03 + F6D04 + F6D05 + F6D06 + F6D07 + F6D08 (from August 2000)
65	F4A02	= F1A02 + F1B02 + F1C02 + F5A02 + F2A02 + F5C02 + F5D02 + F5E02 + F5F02 + F5G02 + F5H02 + F6A02 + F6B02 + F6C02 + F6D02 + F3A02 (from August 2000)
66	F4A03	= F1A03 + F1B03 + F1C03 + F5A03 + F2A03 + F5C03 + F5D03 + F5E03 + F5F03 + F5G03 + F5H03 + F6A03 + F6B03 + F6C03 + F6D03 + F3A03 (from August 2000)

- 67 F4A04 = F1A04 + F1B04 + F1C04 + F5A04 + F2A04 + F5C04 + F5D04 + F5E04 + F5F04 + F5G04 + F5H04 + F6A04 + F6B04 + F6C04 + F6D04 + F3A04 (from August 2000)
- 68 F4A05 = F1A05 + F1B05 + F1C05 + F5A05 + F2A05 + F5C05 + F5D05 + F5E05 + F5F05 + F5G05 + F5H05 + F6A05 + F6B05 + F6C05 + F6D05 + F3A05 (from August 2000)
- 69 F4A06 = F1A06 + F1B06 + F1C06 + F5A06 + F2A06 + F5C06 + F5D06 + F5E06 + F5F06 + F5G06 + F5H06 + F6A06 + F6B06 + F6C06 + F6D06 + F3A06 (from August 2000)
- 70 F4A07 = F1A07 + F1B07 + F1C07 + F5A07 + F2A07 + F5C07 + F5D07 + F5E07 + F5F07 + F5G07 + F5H07 + F6A07 + F6B07 + F6C07 + F6D07 + F3A07 (from August 2000)
- 71 F4A08 = F1A08 + F1B08 + F1C08 + F5A08 + F2A08 + F5C08 + F5D08 + F5E08 + F5F08 + F5G08 + F5H08 + F6A08 + F6B08 + F6C08 + F6D08 + F3A08 (from August 2000)
- 72 F4A09 = F1A09 + F1B09 + F1C09 + F5A09 + F2A09 + F5C09 + F5D09 + F5E09 + F5F09 + F5G09 + F5H09 + F6A09 + F6B09 + F6C09 + F6D09 + F3A09 (from August 2000)

PART 4: CALCULATION OF LIQUIDITY MISMATCHES

Ref No	Item No	
1	G1B02	= B5A02
2	G1E02	= G1B02
3	G1A03	= A6A03
4	G1B03	= B5A02 + B5A03
5	G1E03	= G1A03 + G1B03
6	G1A04	= A6A03 + A6A04
7	G1B04	= B5A02 + B5A03 + B5A04
8	G1E04	= G1A04 + G1B04
9	G2A02	= C5A02
10	G2B02	= 15% x D1D
11	G2D02	= 15% x D1E
12	G2F02	= G2A02 + G2B02 + G2D02
13	G2A03	= C5A02 + C5A03
14	G2F03	= G2A03 + G2B02 + G2D02
15	G2A04	= C5A02 + C5A03 + C5A04
16	G2F04	= G2A04 + G2B02 + G2D02
17	G3A02	= G1E02 - G2F02
18	G4A02	= D1F
19		Replaced by validation 55, SRN/1999/4
20	G3A03	= G1E03 - G2F03
21		Replaced by validation 56, SRN/1999/4
22	G3A04	= G1E04 - G2F04
23		Replaced by validation 57, SRN/1999/4

24		Replaced by validation 70 from August 2000
25		Replaced by validation 61, SRN/1999/5
26	G6E02	= G6B02 + G6C02
27	G6A03	= A6A03
28		Replaced by validation 71 from August 2000
29		Replaced by validation 62, SRN/1999/5
30	G6E03	= G6A03 + G6B03 + G6C03
31	G6A04	= A6A03 + A6A04

32		Replaced by validation 72 from August 2000
33		Replaced by validation 63, SRN/1999/5
34	G6E04	= G6A04 + G6B04 + G6C04
35		Replaced by validation 73 from August 2000
36		Replaced by validation 64, SRN/1999/5
37		Replaced by validation 65, SRN/1999/5
38	G7F02	= G7A02 + G7B02 + G7D02
39		Replaced by validation 74 from August 2000

40		Replaced by validation 66, SRN/1999/5
41		Replaced by validation 67, SRN/1999/5
42	G7F03	= G7A03 + G7B03 + G7D03
43		Replaced by validation 75 from August 2000
44		Replaced by validation 68, SRN/1999/5
45		Replaced by validation 69, SRN/1999/5
46	G7F04	= G7A04 + G7B04 + G7D04
47	G8A02	= G6E02 - G7F02
48	G8B02	= D1F
49		Replaced by validation 58, SRN/1999/4
50	G8A03	= G6E03 - G7F03
51	G8B02	= G4A02
52		Replaced by validation 59, SRN/1999/4
53	G8A04	= G6E04 - G7F04
54		Replaced by validation 60, SRN/1999/4

55		Replaced by validation 85 from August 2000
56		Replaced by validation 86 from August 2000
57		Replaced by validation 87 from August 2000
58		Replaced by validation 88 from August 2000
59		Replaced by validation 89 from August 2000
60		Replaced by validation 90 from August 2000
61	G6C02	= if(G6D02 <> 0, then (G6D02 * D1C / 100) , else no validation) Introduced SRN/1999/5
62	G6C03	= if(G6D03 <> 0, then (G6D03 * D1C / 100), else no validation) Introduced SRN/1999/5
63	G6C04	= if(G6D04 <> 0, then (G6D04 * D1C / 100), else no validation) Introduced SRN/1999/5
64	G7B02	= if(G7C02 <> 0, then (G7C02 * D1D /100), else no validation) Introduced SRN/1999/5
65	G7D02	= if(G7E02 <> 0, then (G7E02 * D1E / 100), else no validation) Introduced SRN/1999/5
66	G7B03	= if(G7C03 <> 0, then (G7C03 * D1D / 100), else no validation) Introduced SRN/1999/5
67	G7D03	= if(G7E03 <> 0, then (G7E03 * D1E / 100), else no validation) Introduced SRN/1999/5
68	G7B04	= if(G7C04 <> 0, then (G7C04 * D1D / 100), else no validation) Introduced SRN/1999/5
69	G7D04	= if(G7E04<> 0, then (G7E04* D1E / 100), else no validation) Introduced SRN/1999/5

70	G6B02	= the components of G1B02 substituting, as agreed with supervisors, the individual items within E1A02—E1F02, E2A02—E2B02, E4A02—E4H02 and E5A02—E5D02 for the corresponding items in B1A02—B1F02, B4A02—B4B02, B2A02—B2G02, and B3A02—B3D02 respectively, for those lines where the figures in Part 3 Column 9 are greater than zero ¹ (from August 2000)
71	G6B03	= G6B02 + (the components of B5A03 substituting, as agreed with supervisors, the individual items within E1A03—E1F03, E2A03—E2B03, E4A03—E4H03 and E5A03—E5D03 for the corresponding items in B1A03—B1F03, B4A03—B4B03, B2A03—B2G03, and B3A03—B3D03 respectively, for those lines where the figures in Part 3 Column 9 are greater than zero) (from August 2000)
72	G6B04	= G6B03 + (the components of B5A04 substituting, as agreed with supervisors, the individual items within E1A04—E1F04, E2A04—E2B04, E4A04—E4H04 and E5A04—E5D04 for the corresponding items in B1A04—B1F04, B4A04—B4B04, B2A04—B2G04, and B3A04—B3D04 respectively, for those lines where the figures in Part 3 Column 9 are greater than zero) (from August 2000)

¹ Expanding this to explain the logic (which also applies to validations 71-75 in Part 4), the figures are an adjustment of the contractual basis figures, hence G1B02 as the starting point in this validation. (The individual item making up G1B02 (validation 1 on LR/VAL 11) is in turn the sum of various items (validation 2 on LR/VAL 2).) Setting out the validation in detail gives:

G6B02 = G1B02 - B1A02 + if(E1A09 > 0, then E1A02, else B1A02)

- B1B02 + if(E1B09 > 0, then E1B02, else B1B02)
- B1C02 + if(E1C09 > 0, then E1C02, else B1C02)
- B1D02 + if(E1D09 > 0, then E1D02, else B1D02)
- B1E02 + if(E1E09 > 0, then E1E02, else B1E02)
- B1F02 + if(E1F09 > 0, then E1F02, else B1F02)
- B2A02 + if(E4A09 > 0, then E4A02, else B2A02)
- B2B02 + if(E4B09 > 0, then E4B02, else B2B02)
- B2C02 + if(E4C09 > 0, then E4C02, else B2C02)
- B2D02 + if(E4D09 > 0, then E4D02, else B2D02)
- B2E02 + if(E4E09 > 0, then E4E02, else B2E02)
- B2F02 + if(E4F09 > 0, then E4F02, else B2F02)
- B2G02 + if(E4G09 > 0, then E4G02, else B2G02)
- B2H02 + if(E4H09 > 0, then E4H02, else B2H02)
- B3A02 + if(E5A09 > 0, then E5A02, else B3A02)
- B3B02 + if(E5B09 > 0, then E5B02, else B3B02)
- B3C02 + if(E5C09 > 0, then E5C02, else B3C02)
- B3D02 + if(E5D09 > 0, then E5D02, else B3D02)
- B4A02 + if(E2A09 > 0, then E2A02, else B4A02)
- B4B02 + if(E2B09 > 0, then E2B02, else B4B02)

73	G7A02	= the components of G2A02 substituting, as agreed with supervisors, the individual items within F1A02—F1C02, F5A02, F2A02, F5C02—F5H02, F6A02—F6D02 and F3A02 for the corresponding items in C1A02—C1C02, C2A02, C2B02, C2C02—C2H02, C3A02—C3D02 and C4A02 respectively, for those lines where the figures in Part 3 Column 9 are greater than zero (from August 2000)
74	G7A03	= G7A02 + (the components of C5A03 substituting, as agreed with supervisors, the individual items within F1A03—F1C03, F5A03, F2A03, F5C03—F5H03, F6A03—F6D03 and F3A03 for the corresponding items in C1A03—C1C03, C2A03, C2B03, C2C03—C2H03, C3A03—C3D03 and C4A03 respectively, for those lines where the figures in Part 3 Column 9 are greater than zero) (from August 2000)
75	G7A04	= G7A03 + (the components of C5A04 substituting, as agreed with supervisors, the individual items within F1A04—F1C04, F5A04, F2A04, F5C04—F5H04, F6A04—F6D04 and F3A04 for the corresponding items in C1A04—C1C04, C2A04, C2B04, C2C04—C2H04, C3A04—C3D04 and C4A04 respectively, for those lines where the figures in Part 3 Column 9 are greater than zero) (from August 2000)
76		Replaced by validation 91, SRN/2001/2
77		Replaced by validation 92, SRN/2001/2
78		Replaced by validation 93, SRN/2001/2
79		Replaced by validation 94, SRN/2001/2
80		Replaced by validation 95, SRN/2001/2
81		Replaced by validation 96, SRN/2001/2
82		Replaced by validation 97, SRN/2001/2
83		Replaced by validation 98, SRN/2001/2
84	G7E04	Replaced by validation 99, SRN/2001/2

85	G5A02	= ((G3A02/G4A02) x 100) ± 0.01, to 2 decimal places (from August 2000)
86	G5A03	= ((G3A03/G4A02) x 100) ± 0.01, to 2 decimal places (from August 2000)
87	G5A04	= ((G3A04/G4A02) x 100) ± 0.01, to 2 decimal places (from August 2000)
88	G8C02	= ((G8A02/G8B02) x 100) ± 0.01, to 2 decimal places (from August 2000)
89	G8C03	= ((G8A03/G8B02) x 100) ± 0.01, to 2 decimal places (from August 2000)
90	G8C04	= ((G8A04/G8B02) x 100) ± 0.01, to 2 decimal places (from August 2000)
91	G6D02	≤ 100 (Introduced SRN/2001/2)
92	G6D03	≤ 100 (Introduced SRN/2001/2)
93	G6D04	≤ 100 (Introduced SRN/2001/2)
94	G7C02	≤ 100 (Introduced SRN/2001/2)
95	G7C03	≤ 100 (Introduced SRN/2001/2)
96	G7C04	≤ 100 (Introduced SRN/2001/2)
97	G7E02	≤ 100 (Introduced SRN/2001/2)
98	G7E03	≤ 100 (Introduced SRN/2001/2)
99	G7E04	≤ 100 (Introduced SRN/2001/2)

M1 REPORTING INSTRUCTIONS

This form should be completed by institutions which report either on a solo or a consolidated basis and:

- i) have agreed a "Trading Book concession" with the FSA, in which case Section 1 should be completed; or
- ii) have "qualifying holdings"¹ in non-financial companies, in which case Section 2 should be completed.

For convenience, these instructions refer to the FSA Banking Supervisory Policy Guide as 'FSA Policy Guide', and the Interim Prudential Sourcebook for Banks as 'IPRU (BANK)'.

Trading Book concessions

Banks which hold the capital instruments of other banks and financial institutions² should deduct these unless they are covered by a Trading book concession. They should also deduct holdings of their own group capital instruments. The following items may give rise to a deduction but (i) to (iii) and (vi) are capable of being covered by a Trading Book concession:

- (i) all long, physical positions in instruments which are included in the capital of the issuing credit or financial institution (including such instruments sold under sale and repurchase or similar agreements, instruments carrying third party guarantees (including central government guarantees), depository receipts, and net commitments³ to underwrite new issues of such instruments (from working day zero));
- (ii) all indirect holdings of credit or financial institution's capital taken via instruments issued by their holding companies on behalf of such institutions. Also indirect holdings taken via instruments issued by vehicles whose business is exclusively or mainly to hold or repackage credit and/or financial institutions' capital instruments, unless the instruments are fully protected from any risk on the underlying capital instruments (the reporting institution should agree such cases with the FSA);
- (iii) equity holdings in investment trusts, and holdings of units in unit trusts, mutual funds or other investment vehicle established exclusively or mainly to hold credit or financial institutions' capital instruments;

¹ As defined in The Banking Consolidation Directive (2000/12/EC).

² This should be taken to mean instruments which are included in the supervisory capital of the issuing credit or financial institution by its supervisory body. The term financial institution for the purposes of this notice should be defined as a directly-supervised financial institution or a financial holding company above a supervised financial institution whose exclusive or main business is to carry out (or is connected with) one or more of the activities listed in points 2-12 in Annex I to The Banking Consolidation Directive (2000/12/EC); see Section 10, Chapter CA (Definition of capital) of the FSA Policy Guide /IPRU (BANK). Parent companies which are primarily engaged in commercial activities but which have a supervised financial subsidiary do not fall within the definition of a financial institution.

³ The scaling factors set out in Chapter TU (Underwriting in the Capital Adequacy Framework) of the FSA Policy Guide/IPRU (BANK) may be applied before deduction but only with the FSA's prior written agreement.

- (iv) guarantees of other credit and financial institutions' capital instruments given by the reporting institution;
- (v) guarantees given by the reporting institution which are included in the supervisory capital of another credit or financial institution; and
- (vi) any other holdings of instruments of a capital nature relating to credit or financial institutions.

The policy on deductions is set out in Section 10, Chapter CA (Definition of capital) in the FSA Policy Guide/IPRU (BANK). Where reporting institutions are unsure whether a deduction should be made from capital they should refer to their supervisory analyst.

Qualifying holdings

The Banking Consolidation Directive (2000/12/EC) requires deductions from capital in respect of material holdings in certain companies which exceed a given threshold. A reporting institution's holding constitutes a 'qualifying holding' if it is:

a direct or indirect holding in an undertaking which represents 10% or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the undertaking in which the holding subsists.

Deductions are not necessary when shares are not financial fixed assets, the shares are held in the normal course of underwriting or if the shares are held in the bank's name on behalf of others. In addition, the FSA may agree that non-deduction is appropriate where shares are held temporarily during a financial reconstruction or rescue operation.

The policy on qualifying holdings is outlined in Chapter CA (Definition of capital), Section 10, of the FSA Policy Guide/IPRU (BANK).

SECTION 1: Holdings in credit and financial institutions' capital instruments

10 Record whether the reporting institution has agreed with the FSA that a Trading Book concession should apply.

20 Record the amount of the Trading Book concession. This will normally be set as a percentage of the previous period's capital base.

30 Record whether a concession to hold own group paper has been agreed with the FSA.

40 Record the amount of the own group paper concession. This concession will normally be a sub component of 20.

50-70 Total amount of credit and financial institutions' capital instruments held

50 Total amount held

Include the total value of the reporting institution's holdings of capital instruments (whether or not they fall within the reporting institution's Trading Book concession and whether or not issued by own institution or another). Institutions whether reporting on a solo or consolidated basis should exclude investments in respect of unconsolidated subsidiaries and associates which are subject to deduction elsewhere. Holdings will generally be recorded at book value but scaling factors may be applied to underwriting positions (see below). This treatment should be agreed with the FSA before being adopted. No allowance should be made for any amortisation applied by issuers of bank or financial institution capital in meeting their own supervisory requirements.

The sum of items 60 and 70 should equal item 50.

60 Banking Book

Include all holdings of credit and financial institutions' capital instruments and capital related guarantees in the Banking Book (whether relating to own institution or others).

70 Trading Book

Include all capital items held in the Trading Book relating to banks and financial institutions. The figures cited here may differ from those recorded under item A170 of the BSD3 since amounts recorded under the latter item will be at book value and will not include holdings of own institution Tier 1.

The sum of items 70.1, 70.2, 70.3 and 70.4 should equal item 70.

70.1 Other institutions' paper eligible for a Trading Book concession

Include all holdings of capital instruments relating to other credit and financial institutions which are not part of own group. Include net underwriting commitments; where the FSA has agreed to the scaling factors set out in Chapter TU (Underwriting in the capital adequacy framework) of the FSA Policy Guide/IPRU (BANK), the discounted value of any commitment should be applied. At a consolidated level, where own group equity is held solely as a result of a designated equity index arbitrage trading, it may be classified as equivalent to paper belonging to other institutions; other holdings of own group paper should not be reported here but in 70.2, 70.3 or 70.4 as appropriate. This treatment should be agreed with the FSA before being adopted.

70.2 Holdings eligible for own group concession

For solo reporting institutions with an own group concession, include any paper issued by sister or parent undertakings within own group. This treatment should be agreed with the FSA before being adopted. Do not report here holdings of own institution paper and holdings of capital instruments issued by subsidiaries or associate companies in which a participating interest is held.

All own group paper held at a consolidated level should be deducted and should be reported under 70.3 or 70.4 as appropriate.

70.3 Paper not eligible for Trading Book concession (and deductible from Tiers 1 + 2)

At a solo level, include all holdings of own institution Tier 2 paper, capital instruments issued by subsidiaries and associate companies in own consolidated group in which a participating interest is held. Include any other instruments which are not eligible for a Trading Book concession.

At a consolidated level, include all holdings of consolidated group paper contributing to Tier 2 capital. Include any other instruments which are ineligible for a concession. Own group equity held solely as a result of designated equity index arbitrage trading at a consolidated level may be classified as paper belonging to other institutions (item 70.1). This treatment should be agreed with the FSA before being adopted. Holdings of own group paper taken via subsidiaries consolidated via the aggregation plus methodology should be included here.

70.4 Holdings of own Tier 1 instruments (and deductible from Tier 1)

At a solo level, include all holdings of own institution Tier 1 instruments.

At a consolidated level, include all holdings of instruments which contribute to consolidated Tier 1 capital. Where a bank or consolidated group holds capital instruments which are included in its Tier 1 capital, the value of these should be deducted from Tier 1 directly. Holdings taken through equity index arbitrage may be treated as equivalent to other banks' paper (and included under item 70.1). This treatment should be agreed with the FSA before being adopted.

80 Holdings in excess of 10% of other credit and financial institutions' capital

List all credit and financial institutions in which the reporting institution has direct or indirect holdings which amount to more than 10% of the acquired institutions' capital; this calculation may be based on information contained in public financial statements. Identify both the total value of the holdings and the amount by which they exceed 10% of the other credit or financial institutions' capital. Where banks have more than 10 such holdings, they may aggregate the smallest holdings (by value) and record the total under 80.10.

90-130 Total amounts to be deducted from Tier 1 and Tier 2 capital or non-deductible

90 Banking Book (on-balance sheet deductions)

Report the total amount of Banking Book holdings of capital instruments to be deducted from Tier 1 and Tier 2 capital at the reporting date. Banking Book deductions from Tiers 1 and 2 will normally equal item 60 less any guarantees of other banks' or financial institutions' capital instruments or the provision of any guarantees which are included as part of the supervisory capital of another bank or financial institution, which are reported at item 100 below. [It is assumed that any purchases of own Tier 1 instruments not held for trading purposes would be cancelled; such instruments should not in any case be included here but should be deducted from Tier 1 capital on the form BSD3.] This figure should be reported on line A171 of BSD3.

100 Banking book (off-balance sheet - deductions)

Report guarantees of other banks' or financial institutions' capital instruments or the provision of any guarantees which are included as part of the supervisory capital of another bank or financial institution. Guarantees should not be held in the Trading Book. The amount reported here should be included in line A340.6 of the form BSD3.

The total of items 90, 100 and 120 will equal item 60.

110 Trading Book (deductions)

Report the total amount of Trading Book holdings deducted from Tier 1 and Tier 2 capital at the reporting date. Banks should follow methodology (a) or (b) below depending on whether they have any holdings listed under item 80 above in the Trading Book. This figure should be recorded on line A171 of the form BSD3.

a) For institutions with no holdings listed under item 80 (holdings in excess of 10%):

First, determine the positive excesses, if any, of (i) items 70.1 and 70.2 combined over the Trading Book concession and (ii) item 70.2 over any Trading Book concession for own group paper. Take the larger of these excesses and add to item 70.3 (items not eligible for Trading Book concession) to give the overall amount to be deducted from Tiers 1 and 2. Holdings of own Tier 1 instruments should be deducted directly from Tier 1 and not from Tiers 1 and 2 combined.

b) For institutions with holdings listed under item 80 (holdings in excess of 10%):

All amounts in excess of 10% of the other credit and financial institutions' capital should be deducted. Where banks have such holdings in the Trading Book, adjustments may be made to the calculation of excesses over total and own paper Trading Book concessions under (a) above to avoid double deductions.

120 Banking Book (non deductible)

Capital items held in the Banking Book should be deducted other than in exceptional circumstances, such as when they are held temporarily for the purposes of a financial assistance operation. Such cases should be agreed with the FSA in advance. In such cases, the figure may be reported on line A172 of the form BSD3.

130 Trading Book (non deductible)

Include amounts under items 70.1 and 70.2 which fall within a Trading Book concession and which are not deductible by reason of being an excess included under item 80 above. Amounts recorded under both items 70.1 and 70.2 count towards the overall Trading Book concession. This amount should be reported on line A172 of the form BSD3.

140 Five largest holdings in credit and financial institutions, at reporting date

Include the five largest holdings (taking direct and indirect together) in credit and financial institutions, ranked by the value of holdings. Include holdings taken in the Banking and Trading Books. Include the name of the credit and financial institution and the book value of the reporting institution's holding. Banks may agree a de minimis reporting level with their line supervisor.

SECTION 2: Qualifying holdings in non-financial companies

150 Total amount of qualifying holdings

Include here the book value of all qualifying holdings in non-financial companies. Holdings in unconsolidated subsidiaries and associates in which there is a participating interest (under the Companies Act 1985), for which deductions are made elsewhere, need not be reported here. Institutions reporting on a consolidated basis should include holdings taken anywhere in the consolidated group, including holdings taken in subsidiaries consolidated using the aggregation-plus method. This sum should be reported on item A180 of the form BSD3 under Banking Book deductions.

160 Total amount of qualifying holdings in excess of 15% of capital

Sum the amounts by which any of the qualifying holdings reported in item 150 individually exceeds 15% of the reporting institution's Tier 1 and Tier 2 capital for the previous reporting period (adjusted for deductions for holdings of other credit and financial institutions' capital instruments).

170 Total amount of qualifying holdings in excess of 60% of capital

Include here the amount by which the aggregate of qualifying holdings reported in item 150 exceed 60% of the reporting institution's Tier 1 and Tier 2 capital for the previous reporting period (adjusted for deductions for holdings of other credit and financial institutions' capital instruments).

180 Total deduction to be made from capital

Include here the larger of items 160 and 170 above. This amount should be reported as deductible under item A180.4 of the form BSD3. Any qualifying holding which is not deducted should be recorded as a risk weighted amount under item A180 of the form BSD3.

**FORM M1
HOLDINGS OF CREDIT AND FINANCIAL INSTITUTIONS' AND NON-FINANCIAL COMPANIES' CAPITAL
INSTRUMENTS**

INTERNAL VALIDATIONS

Ref no	item numbers	
1	50	= 60 + 70
2	70	= 70.1 + 70.2 + 70.3 + 70.4
3	80	= 80.01E + 80.02 E+ 80.03E + 80.04 E + 80.05E + 80.06E + 80.07E + 80.08E + 80.09E + 80.10E
4	110	$\geq \max \{ \max [(70.1+70.2)-20, (70.2 - 40)], 0 \} + 70.3$
5	120	= 60 - 90 - 100
6	130	= 70 - 70.4 - 100
7	150	> 160
8	150	> 170
9	180	= max (160, 170)
10	20	> 0 if item 10 = 1(yes), else 0 Introduced SRN/1999/4, effective March 2000
11	40	> 0 if item 30 = 1(yes), else 0 Introduced SRN/1999/4, effective March 2000
12	FSA	> 0 (Introduced SRN/2001/2, effective December 2001)

CROSS FORM VALIDATIONS : FORM M1 AND FORM BSD3

Ref no	M1 items	BSD3 items
1		Removed SRN/1998/5
2	180	= AB180.4
3		Removed SRN/1998/5
4		Removed SRN/1998/5
5		Superceded by validation 8, SRN/1998/4
6		Removed SRN/1998/5
7	130	= AT172
8		Removed SRN/1998/5

Sterling stock liquidity return (Form SLR1)

Only those banks which have been specifically requested by the Financial Services Authority (FSA) to complete this form, in place of the Form LR, should do so.

This return is used to calculate the level of sterling stock liquidity which the reporting institution should hold against its estimated outflow of funds arising from liabilities to wholesale and retail customers. This level should be maintained at all times. Unless otherwise agreed, the return should be completed on a consolidated basis. Where a bank wishes to report on a different basis this should be agreed in advance with the FSA.

These reporting instructions should be read in conjunction with the Supervisory Guidance Notes (SGN).

SLR1 item

1.0 **Sterling stock**

1.1 **Cash**

Include all sterling notes including Bank of England notes and also notes issued by the Scottish and Northern Irish banks. Include cash which the reporting institution has paid into another UK bank, EEA bank or UK branch of a bank established outside the EEA (as defined in the Handbook Glossary of Definitions), or the Banking Department of the Bank of England, which has not yet been credited to the reporting institution's account in the books of the other bank.

Holdings of gold sovereigns should be excluded.

1.2 **Operational balances with the Bank of England**

Enter balances with the Head Office of the Bank of England, except special deposits and cash ratio deposits, which should be excluded.

Amounts receivable under finance leases from the Bank of England should be excluded (in contrast to statistical reporting to the Bank of England).

1.3 **UK Treasury Bills**

Enter holdings of UK Treasury bills issued by H M Government. UK Treasury bills denominated in euros and Bills for which the Bank of England is obligor may also be included.

1.4 **Gilts**

Enter all holdings of sterling and foreign currency denominated stock issued by H M Government and the Irish land purchase stocks. Other British Government-guaranteed stocks should be excluded from this return.

1.5 **UK Bank bills eligible for rediscount at the Bank of England**

These comprise holdings of sterling bills irrespective of issuer which are both payable in the United Kingdom and have been accepted by eligible banks. A list of eligible banks is contained in SGN Appendix G.

1.6 **UK local authority bills eligible for rediscount at the Bank of England**

Local authorities are defined in SGN Appendix F.

1.8 **Other**

Institutions may, with the prior agreement of the FSA, include any of the following

- sterling international bonds issued by EEA governments and certain international financial institutions, where they have been issued directly into the Euroclear and Cedel settlement systems;
- sterling bonds ('bulldogs') of the same issuers, where they have been issued into (and are now held by) the CREST settlement system; and
- Euro denominated bonds of the same issuers where they are eligible for use in ESCB monetary policy operations.

You will find more detailed lists of all three categories of assets on the Bank of England's website under OMO on the "Eligible Securities" page (www.bankofengland.co.uk/markets/money/eligiblesecurities.htm).

The FSA will automatically extend the list of assets that it considers appropriate for banks to count as 'sterling liquid assets' in line with the Bank of England's programme of extending its list of 'eligible securities', as described in its notice of 15 October 1998. The Bank will maintain updated lists of the relevant assets on its website.

The international financial institutions whose issues may be included are:

- African Development Bank
- Asian Development Bank
- Council of Europe Social Development Fund
- European Atomic Energy Community
- European Bank for Reconstruction and Development
- European Community
- European Coal and Steel Community
- European Investment Bank
- Inter-American Development Bank
- International Bank for Reconstruction and Development/World Bank
- International Finance Corporation
- Nordic Investment Bank

2.1 **Wholesale sterling net outflow limit over five working days**

Enter the institution's internal limit for the wholesale sterling net outflow over five working days. The limit should be agreed with the FSA. This should be the limit shown in the institution's most recent liquidity policy statement submitted to the FSA unless it has been agreed with the FSA that a different limit is appropriate. This limit should not be changed without the prior agreement of the FSA.

2.2 **Sterling Stock Floor over five working days**

Enter the floor for the sterling stock over five working days, as agreed with the FSA. Unless otherwise agreed, the floor should normally be the figure entered in item 2.1 multiplied by 0.5, rounded down to an integer where appropriate. The floor should not be changed without the prior agreement of the FSA.

3.0 **Wholesale sterling net outflow over five working days**

Include all deposits from banks and building societies taken via the institution's Treasury Division.

Include all other deposits of £1mn or more taken on wholesale market terms. For this purpose, wholesale deposits shall be defined as deposits closely related to money market operations which are made as a result of customers being offered a specific rate for a particular deposit for a particular period. This shall be taken to include interest-bearing funds deposited either at branches or direct with, for example, the bank's Treasury Division, on the strength of an interest rate quoted on enquiry on each occasion that a deposit is made.

Include sterling certificates of deposit maturing within five working days.

In normal circumstances, item 3 should not exceed item 2.1. Exceptions should be notified to the normal supervisory contact at the FSA unless the institution has enough surplus stock liquidity, over and above that needed to meet the LQR (item 6.0 below), to cover the excess. Where this is the case, the exception should not be reported to the FSA.

Any cases of doubt should be referred to the normal supervisory contact at the FSA.

4.1 Sterling certificates of deposit held - total

Exclude sterling certificates of deposit maturing within five working days which have been included in item 3.0 above.

If a reporting institution holds certificates of deposit which it has itself issued, these should be excluded from item 4.1.

Include negotiable deposits made on terms identical to those on which a certificate of deposit would have been issued, but for which it is mutually convenient not to issue a certificate.

4.3 Total discounted certificates of deposit

The figure should be rounded down, where appropriate, to an integer.

4.4 Allowable certificates of deposit

This figure should be calculated using the figure reported in 4.3 (after any rounding down). The limit, expressed as 50% of item 3.0, should also be rounded down if appropriate.

5.1 Sterling retail deposits falling due in next five working days

Include all retail deposits with a residual contractual maturity of five working days or less as at the reporting date. Deposits subject to a penalty on withdrawal should only be included if the residual contractual maturity is five working days or less.

For this purpose, retail deposits shall be defined as deposits which arise from customer acceptance of an advertised rate (including nil) for a particular product. This shall be taken to include deposits taken in a bank's branch network on the grounds of an existing or new customer relationship where the rates of interest are not directly linked to interbank rates, and are advertised or displayed at the branch counter or are part of standard tariff terms so that depositors can establish, without further enquiry, the rate applicable to each type of deposit.

Any cases of doubt should be referred to the normal supervisory contact at the FSA.

5.3 Sterling retail deposits to be covered

The figure should be rounded up, where appropriate, to an integer (being prudent).

6.0

Sterling liquidity ratio (LQR)

The sterling liquidity ratio should be 100% or more unless it is appropriate for the institution to maintain a lower ratio (such cases should be agreed with the FSA). The figure should be calculated to two decimal places (rounding .005 and above up, and below .005 down). The calculated figure should then be multiplied by 100 and reported on line 6.0 as integers.

Repo activity

Where gilts or other assets qualifying for inclusion in the sterling liquidity stock have been acquired as a result of entering into a repo or reverse repo transaction, they can be included in a bank's liquidity stock for the duration that they are held; conversely, the asset sold should be excluded until it is repurchased.

Breaches

Any breaches of the stock liquidity ratio should be reported immediately to the normal supervisory contact at the FSA.

**FORM SLR1
STOCK LIQUIDITY RETURN**

INTERNAL VALIDATIONS

Ref no	SLR1 Item No	
1	1.0	= 1.1 + 1.2 + 1.3 + 1.4 + 1.5 + 1.6 + 1.7 + 1.8
2	2.2	≤ 1.0
3	4.3	= 4.1 multiplied by 4.2, rounded down to an integer
4	4.4	≤ 3.0 / 2, rounded down to an integer
5	4.4	≤ 4.3
6	4.5	= 4.3 – 4.4
7	5.4	= 5.1 multiplied by 5.2, rounded up to an integer
8		Superseded by validation 9, SRN/1998/4
9	6.0	= If item 3.0 > 0, then (1.0 / (3.0 – 4.4 + 5.3)) multiplied by 100, to 2 decimal places (rounding 5 and over up, and under 5 down), then multiplied by 100, otherwise (1.0 / (zero – 4.4 + 5.3)) multiplied by 100, to 2 decimal places (rounding .005 and over up, and under .005 down), then multiplied by 100
10	FSA	> 0 (Introduced SRN/2001/2, effective from 1 December 2001)

Supervisory Guidance Notes (SGN)

1 The following guidance notes and the reporting instructions apply specifically to the supervisory returns contained in this folder (Annex 2 of *SUP*). They do not relate to the completion of the forms contained in the Bank of England's Banking Statistics Definitions folder. There are some common areas, nevertheless, where the definitions in the Bank's statistical folder apply equally to items reported in the supervisory returns. Thus, where no specific guidance is contained within these notes and definitions, reporting institutions should be guided by the Bank of England's Banking Statistics Definitions.

In these Guidance Notes, the term 'bank' is generally used to cover those institutions defined as a UK bank, an EEA bank or a bank established outside the EEA in the Handbook Glossary of Definitions, unless specified otherwise. In the case of the capital adequacy (BSD3), liquidity (LR) and large exposures (LE2) returns, it also covers building societies as defined in the Handbook Glossary of Definitions.

2 In general, supervisory returns should include all of the assets, liabilities and off-balance sheet items of the reporting institution (for Coverage see notes 3 & 4 below) and not only those related to its UK offices.

For convenience, these guidance notes refer to the FSA Banking Supervisory Policy Guide as 'FSA Policy Guide', and the Interim Prudential Sourcebook for Banks as 'IPRU (BANK)'.

2 a Whilst there are substantial advantages in preserving sterling as the sole reporting unit (particularly because of the complexity of the supervisory data), the FSA will observe similar standards to and practices of the Bank of England after the introduction of the single currency in January 1999. Institutions should note that the FSA and the Bank of England would expect the currency of reporting to be consistent between supervisory and statistical returns. Any institution with a strong business case for switching to reporting in euros should write to the Financial Risk Analysis and Monitoring Unit at the FSA.

Coverage

3 The reporting dates for the various supervisory returns are set out on the front of the individual forms and are summarised below. The reporting schedule for January 2001 to December 2001 is contained in Appendix I.

Frequency	Report	Reporting dates	Basis of reporting
Monthly	SLR1	Second Wednesday	Consolidated (unless agreed otherwise), UK banks
Quarterly	BSD3, M1	End calendar quarters, or at dates coinciding with the financial year end	Unconsolidated or solo consolidated, UK banks

	LE2	End calendar quarters, or at dates coinciding with the financial year end	Unconsolidated or solo consolidated and consolidated, UK banks
	LR	End February, May, August and November for Form BT monthly reporter, or end calendar quarters for Form BT quarterly reporter	Unconsolidated including any overseas branches or solo-consolidated if capital and large exposures are reported on a solo-consolidated basis (UK banks), or business conducted by EEA banks and banks established outside the EEA
Half yearly	BSD3, M1	End June and December, or at dates coinciding with the financial year end	Consolidated, UK banks
	B7	End June and December, or at dates coinciding with accounting periods	UK branches of banks incorporated outside the EEA ¹ (banks established outside the EEA)

- 4 For certain returns, different reporting dates may be agreed with the FSA for those institutions with a financial year which does not coincide with an end calendar quarter date. The companies to be included in any solo consolidation or consolidation should be those agreed between the reporting institution and the FSA in accordance with Chapter CS (Consolidated supervision) of the FSA Policy Guide/IPRU (BANK).

Valuation

- 5 Outstanding liabilities and holdings of assets should normally be reported at the value outstanding in the reporting institution's books (ie book value), in accordance with the reporting institution's usual accounting practices. Where the terms of Chapter NE (Collateral and netting) of the FSA Policy Guide/IPRU (BANK) are met, certain assets and liabilities may be netted for the purpose of calculating risk-weighted assets. However, reporting institutions should report in accordance with their statutory accounting practices - see example below. For positions held in the Trading Book, the reporting institution should report on a mark-to-market basis. Reporting institutions wishing to report on a different basis should agree this with the FSA. For valuation of interest and exchange rate contracts, see the Form BSD3 definitions for items A472 and A474.

¹ The EEA comprises the European Union and Norway, Iceland and Liechtenstein.

Netting Example

Consider assets of 100 and liabilities capable of being netted against those assets of 30. The terms of the relevant FSA Policy Guide/IPRU (BANK) have been met:

- (i) If the reporting institution's statutory accounts record this situation as 70 of assets and no liabilities, then Section A of the Form BSD3 should show the same;
- (ii) If the reporting institution's statutory accounts record this situation as 100 of assets and 30 of liabilities, then the Form BSD3 reporting should be: 70 of assets at the counterparty risk weight, 30 of assets at 0% risk weight and 30 of liabilities. This is in order to preserve the correspondence between statutory balance sheet footings and the unweighted BSD3 footings. The adjustment should be recorded in columns 1, 2 and 5 of Appendix A-III of the Form BSD3.

Specific provisions

- 6 All loans, advances, bills and securities (and also off-balance sheet items) reported on the capital adequacy returns should be included net of any specific or earmarked general provisions made. Off-balance sheet items should also be reported net of specific provisions, although the amount of such provisions should be included in item A750 on Form BSD3. For large exposures purposes, the exposures should be reported gross of provisions for bad and doubtful debts.

Accruals

- 7 In general, returns should be completed on an accruals rather than a cash basis. On the Form BSD3, such accruals should be shown, where possible, against the relevant category of counterparty for assets or under item A260 for accruals not specifically identified; accruals on liabilities should be included under item A760.2.

Maturity of assets and off-balance sheet items

- 8 Certain on- and off-balance sheet items should be reported according to their maturity. Liabilities and assets should be classified according to their remaining maturity ie on the basis of a residual maturity of one year or less or more than one year, and not according to their original maturity. Reporting institutions with non-resident offices may discuss the implications of this with the FSA if the reporting of exactly one year maturities are treated differently in the countries in which they are operating. Off-balance sheet commitments, on the other hand, should be reported according to their original maturity.

Exposures

9

An exposure is the Amount at Risk arising from the aggregate of the reporting bank's business, whether conducted on or off-balance sheet², as follows:

(1) Claims on a counterparty including actual claims, and potential claims which would arise from the drawing down in full of undrawn advised facilities (whether revocable or irrevocable, conditional or unconditional) which the bank has committed itself to provide, and claims which the bank has committed itself to purchase or underwrite. Typically these will be in the form of:

- (a) all loans and advances (including overdrafts) however denominated;
- (b) nostro accounts
- (c) the net book value of finance leases, less deferred tax provided;
- (d) discounted bills held;
- (e) bonds, acceptances, promissory notes, loan stocks and other paper held;
- (f) margin held with investment exchanges, their clearing houses or other counterparties;
- (g) OTC futures (including forwards), options, swaps and similar contracts on interest rates, foreign currencies, equities, securities, commodities etc. (Note: foreign exchange related contracts should only be included if their original maturity was over 14 days.)
- (h) claims arising in the course of settlement of a securities or other transactions;
- (i) claims arising in the case of forward sales and purchases of instruments in both the Trading and Banking Books that either settle on a date beyond the market norm for that instrument or where the payment due is deferred until some future date;

² NOTE : Exposures entered into by a bank as a trustee are excluded from the scope of the large exposures return.

- (j) any commitment with a certain or uncertain drawdown entered into by the reporting bank. This should include amounts outstanding under:
- sale and repurchase agreements;
 - forward asset purchase agreements;
 - buy back agreements;
 - forward forward deposits placed;
 - the unpaid part of partly-paid shares.
- (k) any other claims arising from similar transactions entered into by the reporting bank.

The following should be excluded:

- (i) claims and other assets which have been deducted from the reporting bank's capital base in order to determine the capital base for the purpose of calculating capital ratios and reporting large exposures. Such deductions are listed in Section 10 of Chapter CA (Definition of capital) of the FSA Policy Guide/IPRU (BANK);
- (ii) claims on group companies which are consolidated for the purpose of the reporting bank's solo reporting within the terms of the FSA Policy Guide/IPRU (BANK) on consolidated supervision (Chapter CS (Consolidated supervision), Section 9.2). The reporting institution should agree such cases with the FSA;
- (iii) claims arising in the course of settlement of a foreign exchange transaction on a counterparty where the reporting institution has settled its side of the transaction but has not received the countervalue, for a period of up to 2 working days after payment was made. After this period such claims should be reported as an exposure;
- (iv) in the case where an asset is traded, claims on the counterparty to the transaction which occur whilst the transaction is in the course of settlement where neither the reporting bank nor the counterparty have settled their side of the transaction, for a period of five working days after settlement was due. (*Amounts which have not been settled within 5 working days after the due date should, however, be reported as an exposure.*)
- (v) counterparty risk on futures and options should not be reported where the contracts concerned are traded on exchanges subject to daily margining requirements. However, issuer risk on any underlying bonds/equities should be reported since the value of these contracts is dependent on the issuer's financial soundness. Where contracts relate to a broadly based cash settled index, no issuer risk need be reported.

(2) Contingent liabilities arising in the normal course of business and those contingent liabilities which would arise from the drawing down in full of undrawn advised facilities³ (whether revocable or irrevocable, conditional or unconditional) which the bank has committed itself to provide. This would include:

- (a) direct credit substitutes (including guarantees, standby letters of credit serving as financial guarantees, bills accepted by the reporting institution but not held by it, 'per aval' endorsements and other endorsements with equivalent effect);
- (b) claims sold with recourse, where the credit risk remains with the reporting bank;
- (c) transaction related contingents not having the character of direct credit substitutes (including tender and performance bonds, bid bonds, warranties, standby letters of credit related to particular transactions, retention money guarantees, import and export excise duty bonds, VAT bonds);
- (d) undrawn documentary letters of credit issued or confirmed; and
- (e) those arising from similar transactions entered into by the reporting bank.

The following should be excluded:

- (i) indemnities in respect of lost share certificates and import/export carnets;
- (ii) bill endorsements on bills already endorsed by another bank; and
- (iii) where the reporting bank acts as a lessor, mortgagee, or owner of goods under a hire-purchase agreement, those contingent liabilities which may result from injuries, damage or loss suffered by third parties and caused by the goods.

³ NOTE: For these purposes, facilities include overdraft, standby, revolving underwriting, and multiple option facilities and similar facilities provided by the reporting bank. It may be the practice for a bank or banking group to advise sub-limits within an overall facility limit for different types of business or to be advised by different branches or subsidiaries of the bank. These sub-limits may total more than the overall facility limit. In such cases, the exposure should be taken as the overall facility limit rather than the aggregate of the sub-limits.

(3) **Assets, and assets which the bank has committed itself to purchase or underwrite, whose value depends wholly or mainly on a counterparty performing his obligations, or whose value otherwise depends on that counterparty's financial soundness but which do not represent a claim on the counterparty. This would include:**

- (a) equities, equity warrants and options which do not represent a claim on the issuer but whose value depends, inter alia, on the issuer's financial soundness.

10 For the purposes of determining **large exposures**, separate exposures granted to the same counterparty should be aggregated. Exposures to a number of individual counterparties should be aggregated and considered as a single exposure where those counterparties are financially connected with one another so that the financial soundness of one of them may affect the other or others. Exposures to a number of public sector bodies or local authorities should be reported as separate exposures. Exposures to individual counterparties within a group should be separately identified within their respective aggregates on the Form LE2. In the case of the B7, institutions should send these details directly to their supervisor and not include the breakdown on the Form itself.

Counterparties

11 A counterparty is a borrower from or customer of the reporting bank, or some other party to which the reporting bank is directly or indirectly exposed. In general, the identification of counterparties follows similar practice to that used in the Bank of England's statistical returns, and a copy of their guidance is reproduced in Appendix A. Exposures to the following categories of counterparties should be reported separately in both capital adequacy and large exposures returns:

An individual non-bank counterparty

An individual non-bank counterparty comprises natural and legal persons and includes individual trusts, corporations, unincorporated businesses (whether as sole traders or partnerships) and non-profit making bodies. This category *excludes* governments, and *includes* local authorities and public sector bodies.

Closely related counterparties

12 A group of closely related counterparties exists where:-

- (a) unless it can be shown otherwise, two or more individual counterparties constitute a single risk because one of them has, directly, or indirectly, control over the other or others; or
- (b) individual counterparties are connected in such a way that the financial soundness of any of them may affect the financial soundness of the other or others or the same factors may affect the financial soundness of both or all of them.

In such cases the exposure to these individual counterparties should be aggregated and considered as a single exposure to a group of closely related counterparties.

It is not possible to give a comprehensive list of the different types of relationship between individual counterparties which it might be reasonable to consider as giving rise to common risk and therefore which constitutes for these purposes a group of closely related counterparties. The following list is therefore indicative and not comprehensive:-

- Group undertakings as defined in the Companies Act;
- Companies whose ultimate owner (whether in whole or in significant part) is the same individual or individuals and which do not have a formal group structure;
- Companies having common directors or management; and
- Counterparties linked by cross guarantees.

Where there is doubt in a particular case as to whether a number of individual persons constitute a group of closely related counterparties or, notwithstanding that a relationship as identified above exists, it is considered that the counterparties do not share a 'common risk', the circumstances should be discussed with the FSA to determine how the exposure(s) should be reported. Exposures to a number of public sector bodies, or local authorities are considered not to constitute a single exposure to "a group of closely related non-bank counterparties".

An undertaking (as defined in Financial Reporting Standard 2, Paragraph 14) is the parent undertaking of another undertaking (a subsidiary undertaking) if any of the following (from section 259, Companies Act 1985) apply.

- (a) It holds a majority of the voting rights in the undertaking.
- (b) It is a member of the undertaking and has the right to appoint or remove directors holding a majority of the voting rights at meetings of the board on all, or substantially all, matters.
- (c) It has the right to exercise a dominant influence over the undertaking:
 - (i) by virtue of provisions contained in the undertaking's memorandum or articles; or
 - (ii) by virtue of a control contract. The control contract must be in writing and be of a kind authorised by the memorandum or articles of the controlled undertaking. It must also be permitted by the law under which that undertaking is established.

- (d) It is a member of the undertaking and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in the undertaking.
- (e) It has a participating interest in the undertaking and:
 - (i) it actually exercises a dominant influence over the undertaking; or
 - (ii) it and the undertaking are managed on a unified basis.
- (f) A parent undertaking is also treated as the parent undertaking of the subsidiary undertakings of its subsidiary undertakings.

Connected counterparties

13 Parties connected to the reporting institution comprise:-

- (i) other group companies⁴, excluding those companies which are included in the consolidation on a particular return;
- (ii) associated companies as defined in the Statement of Standard Accounting Practice 1 (SSAP1);
- (iii) directors, controllers and their associates as defined in Sections 417, 178/180, and 422 of the Financial Services and Markets Act 2000 respectively (or Section 105 of the Banking Act 1987 as amended by The Banking Co-ordination (Second Council Directive) Regulations 1992): loans to employees of a reporting institution's parent undertaking should also be included;
- (iv) non-group companies with which directors and controllers are associated.

A pension fund or other trust fund of the group should not necessarily be classified as connected. However, it should be treated as a connected counterparty if a director/controller of the reporting institution is both a director of the fund and is involved in decision-making on whether or not an exposure to that fund should be undertaken. Funds managed within the banking group need not be treated as connected, and similarly for funds managed third party groups. However, the onus remains on banks which undertake such exposures to examine closely each case on its own merits. Notwithstanding the FSA's acceptance that such funds may, provided banks can satisfy themselves that they meet the criteria, be treated as unconnected/unrelated, there remains some aggregated risk.

Include as a director/controller any employee of the reporting institution who is appointed by the reporting institution to be a director of another company.

⁴ The definition of group companies used for supervisory reporting is that set out for "group undertakings" in section 262 of the Companies Act 1985 as amended by the Companies Act 1989, together with any associated companies that are consolidated with the institution for reporting purposes, or that would be consolidated but for the fact that they are supervised by another UK supervisory authority. (For definitions of parent and subsidiary undertakings refer to section 258 of the Companies Act 1985 as amended by the Companies Act 1989.)

14 Any employee of the reporting institution should be treated as being associated with another company, whether the company is registered or domiciled in the UK or not, if he/she holds the office of director (or alternate director) with that company in his/her own right, or as a result of:

- (i) a loan granted by the reporting institution to the company;
- (ii) a financial interest taken by the reporting institution in the company;
- (iii) by virtue of a professional interest unconnected with the reporting institution;
- (iv) if he/she and/or his/her associates, as defined above, together hold 10% or more of the equity share capital of that company.

In the case of consortium banks with no definable parent, the reporting of connected exposures should be discussed with the FSA.

Reporting institutions should ensure that reporting is consistent between the capital adequacy and large exposures reports.

Analysis of Categories

15 For each category of on- and off-balance sheet item there is a breakdown of the total into different weighting bands, ie 0%, 10%, 20%, 50% or 100%, depending on the risk weight attributed to the counterparties. The following summary list identifies the counterparty weights. It is not a full list of all on- and off-balance sheet items, eg cash is not shown here (see Definitions for Form BSD3 Section A for a full list of items and for more detail generally);

- 0%** (i)* Claims on, other than holdings of bills or securities issued by, Zone A central governments and central banks;
- (ii)* Claims on, other than holdings of bills or securities issued by, Zone B central governments and central banks denominated in local currency and funded by liabilities in the same currency.

- 10%** (i)* Holdings of Treasury bills and fixed interest securities (including index-linked securities) issued by Zone A central governments and central banks with a residual maturity of 1 year or less, and floating rate Zone A central government and central bank securities of any maturity;
- (ii)* Holdings of Zone B central government and central bank securities with a residual maturity of 1 year or less denominated in local currency and funded by liabilities in the same currency.

- 20%**
- (i)* Holdings of Zone A central government and central bank fixed interest securities (including index-linked securities) of a residual maturity of over 1 year;
 - (ii)* Holdings of Zone B central government and central bank securities of a residual maturity over 1 year denominated in local currency and funded by liabilities in the same currency;
 - (iii) Claims on multilateral development banks;
 - (iv) Claims on banks incorporated in Zone A countries;
 - (v) Claims on banks incorporated in Zone B countries with a residual maturity of 1 year or less;
 - (vi) Claims on Zone A public sector entities (PSEs);
 - (vii) Claims on investment firms subject to the CAD or incorporated in a non EU/EEA State but subject to an equivalent regime. See Chapter CS (Consolidated supervision), Section 10, of the FSA Policy Guide/IPRU (BANK) for more detail on which entities are subject to an equivalent regime;
 - (viii) Claims on recognised clearing houses and exchanges, to include initial cash margins and surplus variation margins. See Chapter BC (Credit risk in the banking book), Section 5, of the FSA Policy Guide/IPRU (BANK) for more detail on which clearing houses and exchanges are recognised.
- 50%**
- (i)** Certain loans to Housing Associations meeting the criteria set out in the reporting instructions for item A90 on the Form BSD3;
 - (ii)** Mortgage loans to individuals meeting the criteria set out for item A90 on the Form BSD3;
 - (iii)** Loans to special purpose mortgage finance vehicles meeting the criteria set out for item A150 on the Form BSD3;
 - (iv)** Mortgage sub-participations, where the risk to the sub-participating bank is fully and specifically secured against residential mortgage loans which would themselves qualify for the 50% weight;
 - (v)** Mortgage backed securities meeting the criteria set out for item A150 on the Form BSD3.
- 100%**
- (i) Claims on the non-bank private sector;
 - (ii) Claims on banks incorporated in Zone B countries with a residual maturity over 1 year;
 - (iii) Claims on Zone B central governments and central banks (unless denominated in the national currency and funded by liabilities in the same currency);
 - (iv) Claims on commercial entities owned by the public sector;
 - (v) Claims on Zone B public sector entities.

Note.

Items marked with * - All claims on Zone A central governments and central banks, and all claims on Zone B central governments and central banks denominated in local currency and funded by liabilities in the same currency are weighted at 0% for counterparty risk in the Trading Book; accordingly, these items are not applicable to Section B of the Form BSD3.

Items marked with ** - these are not Trading Book items for counterparty risks, and are therefore not applicable to Section B of the Form BSD3.

Some on and off-balance sheet assets should be deducted from total capital (total of tier 1 and tier 2) rather than receive a risk weight:

- (i) Investments in unconsolidated subsidiaries and associates;
- (ii) Connected lending of a capital nature;
- (iii) Holdings of all capital instruments issued by any financial institution, investment firm or other bank in which the reporting institution owns more than 10% of the equity capital of the financial institution or bank (other than investments already deducted in (i) above);
- (iv) All other holdings of other banks' capital instruments including those held in the trading portfolio, except those held under primary and secondary market makers' concessions;
- (v) Any holdings of bank or investment firm capital instruments held under a market making concession which exceed 10% of the Total (gross) capital of the reporting institution;
- (vi) Guarantees of a capital nature given on behalf of connected companies;
- (vii) Other off-balance sheet items of a capital nature, eg a forward asset purchase of a bank capital instrument.

16 For each category of assets and off-balance sheet position, reporting institutions should separately identify their Banking Book and Trading Book positions. Banks which are exempt from the Capital Adequacy Directive and which do not fill in Section B of Form BSD3 should ignore the Trading Book column and report all their assets and positions within the Banking Book. Banks which fill in Section B of Form BSD3 will have agreed a Trading Book policy statement with the FSA. Assets and positions should be split between the Banking and Trading Books in accordance with that statement. The risk weighted amount in Section A of Form BSD3 is calculated by multiplying the Banking Book figure by the risk weight. The Trading Book figure is provided for information only and is not used in any calculation.

17 Where the reporting institution would face substantial difficulty in providing a breakdown by counterparty type which outweighs the benefit received from a weighting lower than 100%, the relevant assets may be entered in the 'unanalysed' boxes at the foot of each of the main categories on the Form BSD3 eg where a major institution has a category of assets or non-resident branch(es) which represents an insignificant part of the institution's overall assets. Such treatment should be discussed with the FSA before being adopted.

Investment trusts/Unit trusts/Mutual funds

- 18 Equity holdings in investment trusts and holdings of “units” in unit trusts or mutual funds should normally attract the highest risk weighting of 100%. However, when the assets held by the investment institution are legally restricted to assets of a lower weight (eg by articles of association or loan documentation) then a holding should be weighted at that lower weight. If a range of lower weighted assets are included in a fund or trust a holding should be weighted at the highest of these weights. Holdings in entities established to hold capital instruments issued by banks should normally be deducted from capital.

Zone A/Zone B countries

- 19 A list is provided in Appendix C.

Central governments

Comprises all departments, establishments and bodies of a central government located in its domestic territory performing government functions and the embassies, consulate and military establishments of the government located elsewhere.

Banks and recognised investment firms

- 20 The term “bank” as used in the capital adequacy and large exposures returns refers to those institutions that are regarded as banks in the countries in which they are incorporated, and supervised by the appropriate banking supervisory or monetary authority as banks. In general, banks will engage in the business of banking and accept deposits in the regular course of business. For large exposures purposes, central banks, multilateral development banks and the Bank for International Settlements (BIS) should be excluded. **Note** that the definition of UK banks in the Form SLR1 is restricted to banks in the United Kingdom, together with the Banking Department of the Bank of England.

For banks incorporated in countries that are members of the European Economic Area (EEA), classify as banks those credit institutions authorised in accordance with the Banking Consolidation Directive (2000/12/EC) . A list of such institutions is published in the EC Official Journal from time to time.

All banks incorporated in the Channel Islands, Gibraltar, Bermuda and Isle of Man are regarded as Zone A banks.

In the USA, banks are referred to as depository institutions which include branches of federally-insured banks and depository institutions chartered and headquartered in the 50 states of the United States, the District of Columbia, Puerto Rico, and US territories and possessions. The definition encompasses banks, mutual or stock savings banks, savings (or building) and loans associations (S&Ls), co-operative banks and credit unions; it excludes bank holding companies (other than those which are themselves banks).

Recognised investment firms include all investment firms incorporated within the European Union/European Economic Area, as defined by the Investment Services Directive (ISD). Note that not all securities firms incorporated in these countries are investment firms within the terms of the ISD. For instance, in the United Kingdom there are some companies (such as commodity trading companies) which, although required to be authorised under the Financial Services Act 1986 / Financial Services and Markets Act 2000, are not investment firms within the terms of the ISD.

Investment firms incorporated outside the EEA may be classified as a recognised investment firm, if they are subject to a regulatory regime deemed to be broadly equivalent to the Capital Adequacy Directive. Chapter CS (Consolidated supervision), Section 10, Appendix D of the FSA Policy Guide/IPRU (BANK) lists which countries currently fall into this category. Banks should be aware that many investment firms are part of complex groups containing both regulated and unregulated entities. Only the relevant regulated entity should be reported as an investment firm.

Central banks

- 21 With the exception of several Eastern European foreign trade banks (FTBs), the list of central banks (central monetary institutions) are the same as used by the Bank of England for statistical purposes. The list is set out in Appendix D to these notes.

Multilateral Development Banks (MDBs)

A list is set out in Appendix E.

Financial Institutions

- 22 The definition of financial institution used the capital adequacy returns is the same as that which applies in the Banking Consolidation Directive (formerly the Second Banking Co-ordination Directive). A financial institution is an undertaking, other than a bank or recognised investment firm (as defined in SGN20), the principal activity of which is to acquire holdings or to carry on one of the activities listed below.

- (i) Lending including inter alia
 - consumer credit
 - mortgage credit
 - factoring, with or without recourse
 - financing of commercial transactions (including forfeiting)
- (ii) Financial leasing
- (iii) Money transmission services

- (iv) Issuing and administering means of payment (eg credit cards, travellers' cheques and bankers' drafts)
- (v) Guarantees and commitments
- (vi) Trading for own account or for the account of customers in:
 - (a) money market instruments (cheques, bills, CDs etc.)
 - (b) foreign exchange
 - (c) financial futures and options
 - (d) exchange and interest rate instruments
 - (e) transferable securities
- (vii) Participation in securities issues and provision of services related to such issues
- (viii) Advice to undertakings on capital structure, industrial strategy and related questions and advice and services relating to mergers and the purchase of undertakings
- (ix) Money broking
- (x) Portfolio management and advice
- (xi) Safekeeping and administration of securities

Public Sector Entities (PSEs)

23

General

Principally regional governments and local authorities, but bodies which carry out non-commercial functions on behalf of and are responsible to regional governments or local authorities similar to those shown in the UK lists below may also be classified as PSEs. Also includes bodies owned by the central or regional government or local authorities which perform regulatory or other non-commercial functions. Commercial entities or companies (other than banks) owned by the public sector, including public utilities, should be classified as "other" and carry a weighting of 100%.

UK

An illustrative list of UK PSEs is included in Appendix F.

G10 and EU countries - Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, Netherlands, Portugal, Spain, Sweden, Switzerland, United States.

Principally regional governments and local authorities. The reporting institution may include those bodies regarded locally as PSEs where the relevant banking supervisor has published either a list or general guidance.

Other countries

The general definition above should be applied. The state governments in the Channel Islands, the Isle of Man Government, the government of Gibraltar, and the government of Bermuda are PSEs. Where doubt exists as to the appropriate classification of an organisation reference should be made to the FSA.

Collateral

24

Where claims on a counterparty are collateralised by cash (see SGN25) or by securities or bills issued by Zone A central governments, Zone A central banks or multilateral development banks (see Appendix E), a lower risk weight may apply. The risk weight category under which the claim should be reported is determined by the nature of the collateral, as follows:

- 0% Cash (see SGN25).
- 10% Zone A central government and central bank treasury bills and fixed interest securities (including index-linked securities) of a residual maturity of 1 year or less, or similar floating rate securities of any maturity.
- 20% (i) Zone A central government and central bank fixed interest securities (including index-linked securities) of a residual maturity of over 1 year;
(ii) Multilateral development banks' securities.

If the value of the collateral covers less than the book value of the asset, that part of the asset which is fully covered may receive the appropriate lower weight. Securities used as collateral should be marked to market. If the reporting institution proposes to adopt a different treatment, this should first be agreed with the FSA. No other forms of collateral should be taken as justifying a reduced risk weighting.

For collateralised off-balance sheet exposures (other than contracts reported in Appendices A-I, A-II, B-I, B-II, or B-III of the Form BSD3) the value of the collateral should be set against the nominal value of the exposure before calculating the credit equivalent amount. An exposure should only be regarded as fully covered if the collateral is at least equal to 100% of the nominal value of the exposure (not of any smaller credit equivalent amount). For example where cash collateral covers 75% of a nominal exposure, the collateral should first be applied to the nominal principal, which would leave an uncovered exposure of 25%. The appropriate credit conversion factor should then be applied to this uncovered portion in order to realise the amount that should be weighted. Thus, to continue the example, if the exposure had been in respect of a direct credit substitute (CCF of 100%) the weighted amount would equate to 25% of the nominal principal; but if the exposure had been in respect of a transaction related contingent (CCF of 50%) the weighted amount would equate to 12.5% of the nominal principal. Recall that the full nominal value of collateralised off-balance sheet exposures should be reported in the appropriate risk weighting bands, ie the 100% is split in order to reflect either the collateral or the counterparty as appropriate.

For interest and exchange rate contracts however the value of collateral should be compared to the credit equivalent amount. Where collateral fully covers this amount the risk weighting may be reduced accordingly. Where collateral covers only part of the credit equivalent amount the part that is fully covered may receive the appropriate reduced weight. The part that is not fully covered should receive the unreduced weight.

Where lower risk weights have been applied to reflect collateral, enter the relevant amounts in Form BSD3 Appendix A-III and/or B-IX as appropriate (Exposures Collateralised/Guaranteed/Netted). Collateral on large exposures should also be reported on Form LE2.

Cash Collateral

25

Where exposures which do not meet the criteria for set-off (see SGN24) are collateralised by cash, ie balances held with the reporting institution denominated in sterling, foreign currency or gold, or CDs issued by the reporting institution and lodged with it, such exposures should be reported under the relevant item in the 0% band. For these purposes an exposure should be treated as being collateralised by cash only if the cash is held by the reporting institution for the account of the depositor/customer on express terms such that:

- i) the cash may not be withdrawn for the duration of the exposure; and
- ii) the reporting institution may apply the cash to discharge the exposure if and to the extent that it is not discharged by the borrower/customer in accordance with the terms of the loan etc agreement with the borrower/customer.

In the case of an exposure partially collateralised by cash only that part of the exposure which is fully collateralised should be reported in the 0% weight band.

The adjustments made by the reporting institution to the Capital Adequacy Returns in respect of exposures collateralised by cash should be shown in Appendices A-III and B-IX of Form BSD3.

An exposure should be reported as being collateralised by cash where:

- i) The reporting institution has an opinion from its legal advisers to the effect that the set-off arrangements, charges, or other equivalent security interests referred to below are legally well founded in **all** relevant jurisdictions, and would be enforceable in the default, liquidation or bankruptcy of the customer or depositor, or in the liquidation or bankruptcy of the institution itself.
- ii) In the case of the reporting institution's *unconsolidated* return, the cash is held with the reporting institution. In the case of a reporting institution's *consolidated* return, the cash is held with the company which has the exposure.
- iii) Where the cash is held at a UK office of a UK incorporated lending institution, the lending institution has a legally enforceable right of set-off over the cash. Where the cash is held at a non-resident branch of the lending institution, or where the lending institution is incorporated outside the UK, it has a first charge over cash held with itself where this is enforceable in the local legal jurisdiction or other equivalent security interest or a legally enforceable right of set-off over the cash.

- iv) Where the reporting institution meets the criteria set out in Chapter CS (Consolidated supervision), Section 3.1.1, Paragraph 2(b), of the FSA Policy Guide/IPRU (BANK), (i) to (iii) above apply. However cash may be held with another bank which is consolidated with the reporting institution for the purpose of calculating the institution's consolidated capital ratio. In this case the lending institution should have a first charge over the cash held with the other bank or other equivalent security interest. Where an exposure is reported by the lending bank as collateralised by cash under this provision, the cash is not available to the other bank as collateral for reporting purposes, and should not be subject to set-off in the other bank's books.

Where the reporting institution is a member of a syndicate and cash has been deposited with, and is held by, the agent itself for the benefit of the syndicate, the claims (or portion of the claims) of members of the syndicate which are cash collateralised may attract the weight appropriate for claims on the agent. If the agent is a bank its own claims which are cash collateralised may receive a 0% weight.

Netting

26

On-balance sheet

Debit balances on accounts with the reporting bank may be offset against credit balances on other accounts with that bank where all the following criteria have been met:

- a) a legal right of set-off exists, and the reporting institution has obtained an opinion from its legal advisers to the effect that its right to apply set-off is legally well-founded in all relevant jurisdictions and would be enforceable in the default, liquidation or bankruptcy of the customer(s) or in the liquidation or bankruptcy of the institution itself. For a group facility, the arrangement is supported by a full cross guarantee structure;
- b) the debit and credit balances relate to the same customer, or to customers in the same company group, eg a parent company and its subsidiary. For all customers, the netted accounts should be managed and controlled on a net basis and, in the case of a group facility, the facility should be advised in the form of a net amount.

The reporting institution's application of these principles should remain consistent.

Where this SGN or SGN25 require a legal opinion to be sought, the FSA expects such opinions to be provided by an independent, external source of advice of appropriate professional standing. In seeking these opinions, the reporting institution should bear in mind that in certain jurisdictions assets may be seized to satisfy local creditors. In those cases involving cross-jurisdictional transactions, the FSA will usually ask for a side-letter from the institution's advisers confirming that the set-off arrangements have a well-founded legal basis in all relevant jurisdictions. In certain cases, the FSA may ask for a copy of the legal opinion.

Reporting of net balances should follow the reporting institution's statutory accounting practice (see SGN5).

Credit balances which cannot be off-set against debit balances may be eligible for inclusion as cash collateral (see SGN24 and SGN25).

Note: Back-to-backs allowed to be netted out on returns made to the Bank of England for statistical purposes should not be netted out in calculating the size of an exposure for LE2 purposes (see Definitions for Form LE2 for more guidance generally).

Off-balance sheet

Pending further consideration, net amounts due in respect of eg foreign exchange transactions may be reported only if the net amount derived is pursuant to the application of a bilateral agreement (between two counterparties) based upon netting by novation. Netting by novation is where obligations between counterparties to deliver given amounts on a given date are automatically amalgamated with all other obligations to deliver the same currency on the same value date and netted. Such netting should have the effect of legally discharging performance of the original obligation and substituting the single net amount as the sole remaining obligation between the parties for the relevant value date.

In addition, certain contracts reported in Appendices A-I and B-II of Form BSD3 may be reported on a net basis when the legal and systems criteria of Section 5, Chapter NE (Collateral and netting) of the FSA Policy Guide/IPRU (BANK) have been met. For each counterparty, the net replacement cost to be reported is obtained by taking the sum of the replacement costs of all nettable contracts with a positive mark-to-market value offset by all nettable contracts with a negative mark-to-market value. The replacement costs of contracts which are not nettable should continue to be reported gross.

Where the terms of the Collateral and netting chapter have been met, report net the potential future credit exposure through the formula outlined in section 8 thereof.

The net replacement cost of a portfolio of nettable contracts with a Zone B bank should be distributed across 20% and 50% counterparty risk weightings pro rata to the distribution of the notional principal amounts between ≤ 1 year and >1 year.

Example

Net replacement cost of portfolio = 100mn

Notional Principal Amount of ≤ 1 year contracts = 12bn

Notional Principal Amount of >1 year contracts = 3bn

Net replacement cost reported at 20% counterparty riskweight
= 80mn ($12/15 \times 100$ mn)

Net replacement cost reported at 50% counterparty riskweight
= 20mn ($3/15 \times 100$ mn)

Long and short positions in Investments

27

In certain circumstances, long positions in securities may be offset against short positions for the purposes of calculating the weighted amount in the Banking Book (Section A) on Form BSD3¹. The gross amounts should be recorded under items A120-A190 (long positions) and under item A710 (short positions) on that form. Additionally, short positions in central government and central bank securities should be reported under item A320 and will attract a risk weight.

The conditions to be satisfied for netting of long and short positions are:

(a) *Central governments and central banks*

Netting of long and short positions should only be carried out where the following criteria are all met:

- (i) the long and short positions are in securities issued by the same central government or bank;
- (ii) the long and short positions are in securities denominated in the same currency;
- (iii) the long and short positions are in fixed rate securities within the same maturity time band, ie one year or less (10% risk weight) or over one year (20% risk weight). Similarly, index-linked securities should only be offset against each other if they are within the same maturity time band. Floating rate securities of any maturity may offset against each other but no netting of floating rate securities against fixed rate or index-linked securities should be carried out.

Both the gross and net long positions in central government and central bank securities should be reported under item A120 on Form BSD3, with the net long positions attracting the relevant risk weights. Gross short positions should be reported under item A710.1 with the net short positions being reported under item A320 on that form.

¹ The requirements of SGN25 refer to the Banking Book only: positions in instruments in the Trading Book are reported on a net basis in Section B of Form BSD3.

A simplified reporting example is set out below (the netting criteria are met for securities A and B but not C):

	Long position	Short position	Net
UK government security A	100	-	100
UK government security B	-	(50)	(50)
US government security C	5	(25)	(20)
	<hr/> 105	<hr/> (75)	

Gross long position (item 120) = 105 ie sum of individual long positions
Gross short position (item 710) = (75) ie sum of individual short positions
Net long position (item 120) = [100+(50)] = 50 ie sum of net positions after netting gross positions permitted by (i) to (iii) above (in this case the netting of positions in A and B)
Net short position (item 320) = (20) ie sum of net short positions after netting of gross positions as permitted by (i) to (iii) above (in this case none)

(b) *Other securities*

Report gross positions, net only of short positions in the same security issue. Warrants and convertibles should not be offset against the underlying equity into which they may convert.

Guarantees

28

(a) Guarantees received

Claims that have been explicitly, irrevocably and unconditionally guaranteed by those counterparties listed below may be weighted according to the risk weight of the guarantor where the effect is to reduce the weighting; such guarantees should be legally enforceable. Where a claim is partially guaranteed, only that part of the claim which is fully guaranteed should be weighted according to the risk weight of the guarantor. Only direct guarantees of a bank's claims should be treated in this way. Guarantees of a counterparty's assets, or general guarantees of its financial position, are considered insufficient in themselves to merit a reduced risk weighting.

The notes in this section apply to the instruments serving as guarantees and insurance/indemnities discussed below as well as to guarantees.

Instruments serving as guarantees

Apart from traditional bank guarantees, certain other financial instruments (eg a letter of credit (or standby letter of credit), a purchased put option that may be exercised at any time, and a risk participation) may be regarded as guarantees as long as they provide the same comfort as a guarantee, ie they provide an explicit, irrevocable and unconditional obligation to pay a third party beneficiary when a customer fails to repay an outstanding loan or to meet a financial obligation (including contingent obligations).

Insurance/indemnities

Where a claim is covered for all risks by an insurance policy, or where an indemnity is explicit, irrevocable and unconditional, reduced weighting may also be appropriate; such claims should be discussed on a case by case basis with the FSA.

Guarantees received from subsidiaries

In reporting capital adequacy on a solo or unconsolidated basis, reporting institutions may accept a guarantee from a subsidiary as reducing the risk weight of an asset, but only when the following conditions are met:

- (i) the guarantee is direct, unconditional and irrevocable;
- (ii) the reporting institution is adequately capitalised on a consolidated basis;
- (iii) the guarantee is not being given to circumvent regulatory rules;
- (iv) the guarantee should have sound commercial rationale and should be made on proper commercial terms.

Risk weighting

On and off-balance sheet items subject to guarantees should still be reported in the same counterparty category, rather than that of the guarantor, but shown in the weighting band relative to the guarantor. For example, a loan to a non-bank customer which is guaranteed by a Zone A incorporated bank should be reported in item A100.3 instead of A100.4, and not in item A70 on the Form BSD3. The relevant risk weights are as follows:

- 0% (i) Zone A central governments and central banks (other than securities guaranteed);
- (ii) Zone B central governments and central banks (other than securities guaranteed), where the claim being guaranteed is denominated in the local currency of the guarantor and borrower and funded in that currency.

- 10% (i) Fixed rate securities, guaranteed by Zone A central governments and central banks, which have a residual maturity of 1 year or less;
- (ii) Floating rate securities of any maturity guaranteed by Zone A central governments and central banks;
- (iii) Any securities, guaranteed by Zone B central governments and central banks, which have a residual maturity of 1 year or less and are denominated in the local currency of the guarantor and issuer and funded in that currency.
- 20% (i) Fixed rate securities, guaranteed by Zone A central governments and central banks, which have a residual maturity of over 1 year;
- (ii) Any securities, guaranteed by Zone B central governments and central banks, which have a residual maturity of over 1 year and are denominated in the local currency of the guarantor and issuer and funded in that currency;
- (iii) Multilateral development banks;
- (iv) Banks incorporated in Zone A countries;
- (v) Banks incorporated in Zone B countries, where the claim being guaranteed has a residual maturity of 1 year or less;
- (vi) Zone A public sector entities.

Holdings of bank capital instruments which carry a central government or central bank guarantee should be deducted from capital in accordance with the definition of item A170 on the Form BSD3 except where a Trading Book concession applies when they should be weighted at 100%.

Guarantees of swaps etc.

Guarantees of swaps etc will be acceptable for reducing the risk weighting of an item where they meet the above criteria, where the reporting institution receiving the guarantee calculates daily the mark-to-market valuation of the asset being guaranteed (using the institution's own mark-to-market methodology) and where the guarantee is valued at the current mark-to-market value of the contract plus "add-ons". (See also the reporting instructions for items A472/A474 on Form BSD3.)

Guarantees of a capital nature

See the reporting instructions for item A340 on the Form BSD3 for details.

Where lower risk weights have been applied, enter the relevant amounts in Form BSD3 Section A or Section B as appropriate (Exposures Collateralised/Guaranteed/Netted).

(b) Guarantees given

Joint and several guarantees given by the reporting institution

Where the reporting institution has guaranteed an exposure jointly and severally with other institutions, its share of the guarantee (as explicitly defined or otherwise equal to the total value of the guarantee divided by the number of guarantors) should be reported as an exposure on the counterparty and the balance of the guarantee as an exposure on the other guarantors.

Sale and Repurchase Agreements ("Repos")

29

This note refers to the treatment for capital adequacy purposes of repos and reverse repos in the Banking Book only. It is expected that most banks with a Trading Book will treat repos and reverse repos as being part of the Trading Book, in which case the capital requirement arising from these deals should be reported in Section B of Form BSD3. The instructions to that form outline how such deals should be reported when they fall in the Trading Book.

Repos

Reporting institutions that have sold loans or other assets to other institutions for a finite period with a commitment to repurchase should continue to report the loan or asset on the balance sheet. Where this is not the reporting institution's normal accounting practice, the loan or asset should be reported under item A370 in the off-balance sheet section of the Form BSD3.

Reverse repos

Reporting institutions which have purchased such loans or assets (ie purchase and resale agreements or reverse repos) should for the duration of the agreement report the transaction as an unsecured loan adopting the normal weight for the counterparty unless the assets are eligible for a reduced weight (eg Zone A government securities) in which case they should be reported as collateralised loans (see SGN24).

Netting of counterparty risk arising from reverse repos

Where a repo contract in the Banking Book involves the sale of a security, the transaction should be recorded as ongoing issuer risk in respect of the security sold. No counterparty risk should be recorded, which means netting of counterparty risk on a portfolio of repos is not a relevant consideration.

Note that counterparty risk can only arise when a reverse repo is undertaken and the collateral reversed in is ineligible collateral (see SGN24 for a definition of eligible collateral). Such reverse repos should be reported as if an unsecured cash loan had been made to the counterparty to the reverse repo. As long as the terms of Chapter NE (Collateral and netting), Section 8, of the FSA Policy Guide/IPRU (BANK) have been met, such counterparty risk should be reported under items A50-A100 on the Form BSD3, net of obligations to the same counterparty arising only from:

- (i) other reverse repo business with the same counterparty, where eligible collateral has been taken, and only to the extent that the value of the eligible collateral taken is in excess of the cash paid away. If the asset reversed in is reported on the balance sheet, the adjustment should be recorded under item A720. If the asset reversed in is not reported on the balance sheet, the adjustment should be made under items A50-A100 to reflect the reduced risk weight, eg transfer the netted amount from item A100.4 (100% weight) to item A100.1 (0% weight).
- (ii) on repos with the same counterparty and similarly only to the extent that the cash reversed in exceeds the value of the securities repoed. The adjustment should be recorded under item A690.

Note that reporting institutions wishing to net counterparty risk arising from repo business in the Banking Book should first contact their line supervisors who will wish to determine whether their systems are adequate for them to report on this basis.

Stock lending/borrowing as principal

30

When a reporting institution has entered into a stock lending agreement as principal, the stock lent should continue to be reported as an asset on its balance sheet. No exposure in respect of the counterparty in the transaction should be reported.

When an institution has entered into a stock borrowing transaction as principal, the reporting treatment will depend upon the type of collateral given.

If the collateral given is cash, the exposure should be treated as a collateralised loan to the counterparty. If the securities borrowed by the reporting institution qualify as eligible collateral, then a lower risk weighting may be applied accordingly. If the securities borrowed by the reporting institution do not qualify as eligible collateral, then the exposure should be reported as an unsecured loan to the counterparty.

If the collateral given is not cash, then the reporting institution should continue to report the collateral given on its own balance sheet. No exposure to the counterparty should be reported.

Netting of counterparty risk

Where a stocklending/borrowing agreement meets the terms of Chapter NE (Collateral and netting) of the FSA Policy Guide/IPRU (BANK), there will be scope for netting of counterparty risk arising from borrowing of stock which does not qualify as eligible collateral in the same way as for reverse repos (see SGN29). Exposures to be reported on such a net basis should be reported as if they were reverse repos.

“Disguised” credit exposure in interest and exchange rate contracts

31 The arrangement of certain contracts may include an element of "disguised" credit exposure. In general, the FSA would consider a disguised credit exposure to be present where the contract either starts with a significantly positive mark-to-market value or, on an assumption of unchanged interest and exchange rates, is designed at some time in its life to have a significantly positive mark-to-market value. (Institutions should discuss with the FSA what constitutes such a mark-to-market value.)

The reporting institution should contact the FSA to agree on suitable reporting where it has such contracts. In general, the disguised credit exposure should be reported separately from the swap in a manner fixed at the outset of the contract. For example on the Form BSD3:

- (a) the up-front payment on a swap at off-market rates should be reported as a loan in items A50-A110, and amortised over the life of the swap;
- (b) a staggered exchange of principal, where the reporting institution has paid away its side and has not received the counterparty's side, should be reported as a loan in items A50-A110.

Where the disguised credit exposure is reported separately as in the above examples, the mark-to-market value of the swap as reported in Appendix A-I of the Form BSD3 should exclude the disguised credit exposure reported as above.

Where a reporting institution has a contract that gives rise to a "disguised" credit exposure on itself for its counterparty (eg receiving interest quarterly and paying interest annually), the reporting institution should report the contract as normal.

Participations/Syndicates

32 Where the reporting institution transfers a loan by *novation*, *assignment* or through a *sub-participation*, the part of the loan transferred should not be reported on the supervisory returns, subject to the satisfaction of the conditions specified in Chapter SE (Securitisation and asset transfers), Section 5, of the FSA Policy Guide/IPRU (BANK). In a *sub-participation*, where the reporting institution acts as a manager or co-manager, deposits received from the other participating institutions (representing their shares of the amounts to be lent) should not be included under deposits, nor should their shares of the loan be included in assets.

Where the reporting institution buys all or part of a loan from another institution, it should report its holding as an advance to the borrower and not as lending to the institution from which it has purchased the loan.

If the reporting institution has transferred undrawn commitments to lend (or part of them), the commitment (or part) should not be reported when the transfer is either by *novation* or by an *assignment* accompanied by a formal acknowledgement from the borrower. A transfer by means of *silent assignment* or *sub-participation* should be reported as a commitment in the off-balance section of the return, with the counterparty risk assigned to the buyer of the commitment. The buyer of a commitment (or part) should report in the off-balance section under the relevant counterparty weight of the borrower, irrespective of the method of transfer used.

Transfers of General Market Risk

- 33 When general market risk is transferred between the Banking and Trading Books without reference to individual instruments, this will not be reflected in Section A of the Form BSD3. As no underlying instruments are transferred, such transfers should only be reported in items B200 and B240 of Section B of the Form BSD3 (and their underlying Appendices).

Counterparty Exposure On OTC Derivative Contracts - Replacement Cost Method

- 34 The credit equivalent amount is the sum of the replacement cost (obtained by marking to market) of all its contracts with a positive value and the potential future credit exposure which reflects the residual maturity of the contract, calculated as a percentage of the notional principal amount of each contract (according to the residual maturity of each contract as set out in the matrix below). The weighted amount is the product of the credit equivalent amount and the risk weight.

Mark-to-market amount

Reporting institutions should mark-to-market in a prudent and consistent manner; only contracts with a positive mark-to-market value should be reported under this heading (however, institutions should record a potential future credit exposure in respect of all OTC derivative contracts that might in the future have a positive mark-to-market value).

In general, no readily observable market prices will be available for these instruments. Reporting institutions should develop their own methodology for calculating market values, details of which should be made available to the FSA. The FSA will monitor the approaches adopted by institutions and will be concerned that such approaches should be broadly comparable across all institutions in line with best market and supervisory practice. The following general guidelines should be observed:

For swaps, forward rate agreements and products with similar characteristics, outright forward foreign exchange contracts and futures (if appropriate), the mark-to-market approach should be based on an estimation of the net present value of the future cash flows of the contract, using interest rates based on current market rates and relevant to periods in which the cash-flows will arise (commonly for example, the rates from a derived yield curve for zero-coupon government bonds).

For options purchased, the mark-to-market approach should be based on a valuation of the option reflecting, inter alia, the amount by which the option is "in the money" (ie the amount, if any, by which the rate at which the option can be exercised is more favourable than the current market rate when applied to the notional principal underlying the option), the time to expiry of the option, the volatility of the underlying exchange or interest rate, and (for currency options) the interest rate differential between the currencies. Typically such valuations will be based on a mathematically complex formula, and will value the option at an amount above its "in the money" value

Reporting institutions whose involvement in options is limited and who have not developed suitable methodology may value options at their "in the money" value. Reporting institutions should obtain the FSA's agreement before reporting on this basis.

Potential Future Credit Exposure

To calculate the potential future credit exposure (add on) for each contract, the notional principal amount should be multiplied by the following factors. No potential future exposure should be calculated for single currency interest rate basis swaps: the credit exposure on these contracts should be evaluated solely on the basis of the replacement cost.

Type of contract	Residual Maturity		
	≤ 1 Year	>1 Year and ≤ 5 Years	> 5 Years
Interest Rate (except basis swaps)	0.0%	0.5%	1.5%
Foreign Exchange (including Gold)	1.0%	5.0%	7.5%
Equities	6.0%	8.0%	10.0%
Precious Metals (except Gold)	7.0%	7.0%	8.0%
Commodities	10.0%	12.0%	15.0%

Notional principal amounts by maturity

For exchange rate contracts, the notional principal should be taken as the amount of principal underlying the contract, as regards the currency being received by the reporting institution, translated into sterling at the spot exchange rate on the reporting date.

For an amortising swap, ie one based on a steadily declining notional principal, the notional principal should be taken as that which is outstanding at the reporting date.

For a swap based on a fluctuating level of principal, the notional principal should be taken as the maximum notional principal outstanding over the remaining life of the swap.

For amortising interest rate swaps with cash-flow mismatches in payments, the notional principal may differ between the two sides of the swap - the higher of the two should be used.

For swaps involving physical commodities, and other contracts with multiple exchanges of principal, the notional principal should relate to the total volume over the whole contract (not simply the volume per settlement period), eg for a two-year oil swap involving one million barrels with quarterly settlement, the exposure should be reported as covering the full period of the contract (not just one quarter at a time) and the notional principal would be eight million barrels (not just one million), converted to sterling at the spot rate on the day of the report. (The reported principal in this example would decline as each quarterly settlement is made.)

For options, the notional principal should be taken as the underlying principal of the option, using, for currency options, the received currency at the spot rate on the reporting date.

Remaining maturity

The remaining maturity of a swap should be taken as the time until final expiry of the swap, except for swaps with interim mark-to-market settlements, where the remaining maturity should be set equal to the time until the next reset date. An interim mark-to-market settlement occurs where the contract is structured to settle an outstanding exposure following specified payment dates and where the terms are reset such that the mark-to-market value of the contract is zero on these specified dates.

For FRAs and similar products, the remaining maturity should be taken as the time from the reporting date until the end of the period to which the interest rate underlying the contract relates, eg for an FRA with three months until settlement based on a one year rate, the remaining maturity would be 15 months. Where settlement of an FRA takes place at the start of the period to which the interest rate underlying the contract relates, no account should be taken of the FRA following such settlement, ie the FRA should no longer be reported; where settlement takes place at the end of this period, the FRA should continue to be reported until settlement takes place given that, even after the settlement amount is fixed, the contract will continue to have a mark-to-market value which will be subject to fluctuation.

For interest rate options, the remaining maturity should be taken as the time from the reporting date until the end of the period to which the interest rate underlying the option relates, ie in a similar way to FRAs.

Net reporting of Replacement Cost (see also SGN26)

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Where the terms of Chapter NE (Collateral and netting) of the FSA Policy Guide/IPRU (BANK) have been met then, on a bilateral basis (ie for each counterparty), the net replacement cost of nettable contracts may be reported ie nettable contracts with a positive mark-to-market value may be offset by the sum of nettable contracts with a negative mark-to-market value.

For interest rate, foreign exchange, commodities, precious metals and equities contracts only, the replacement cost (positive mark-to-markets) arising from options purchased may be offset by the liabilities (negative mark-to-markets only) arising from options written with the same counterparty.

Net Reporting of Potential Future Credit Exposure

Where the terms of the Chapter NE (Collateral and netting) of the FSA Policy Guide/IPRU (BANK) have been met, report net the potential future credit exposure through the formula outlined in section 8 thereof.

Forward FX Contracts undertaken through Multilateral Netting Schemes

The credit equivalent amount for a reporting institution using a multilateral netting scheme should also be reported as follows:

Current exposure: the replacement cost is the sum of the primary loss allocations to each of the other participants in the scheme;

Potential future credit exposure: the add-ons should be calculated by taking a percentage of the notional principal amount of each underlying contract in exactly the same way as if the contracts had been undertaken directly with the other participants.

NOTE: the counterparty risk weight applicable to the current exposure is 20%. As to potential future credit exposure, 20% should apply in the case of participants which are Zone A banks or investment firms subject to CAD equivalent regimes and ≤ 1 year contracts with Zone B banks, and 50% should apply otherwise.

Interest and Foreign Exchange Rate Related Contracts - Original Exposure Method

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Credit equivalent

With effect from SRN/1999/2, this method should only be adopted by EEA banks and banks established outside the EEA. To obtain the credit equivalent amount using the original exposure method, the notional principal amount should be multiplied by the following conversion factors to obtain the future credit exposure:

Original Maturity	Interest Rate Contracts	Exchange Rate Contracts
One year or less	0.5%	2.0%
Over one year and up to and including two years	1.0%	5.0%
For each additional year	1.0%	3.0%

Contact with the FSA

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In the event of any difficulties in completing any of the returns, please telephone your FSA supervisor for guidance.

Appendix A

Extract from the Bank of England's Banking Statistics Definitions folder, Classification of Accounts Guide Part II (February 2001)

"II RESIDENCE

II.1 Introduction

For the purpose of all returns, ***the United Kingdom (UK) comprises the mainland of Great Britain and Northern Ireland.*** The Channel Islands and the Isle of Man (referred to elsewhere in the definitions as the UK offshore islands) will *not* form part of the UK for statistical purposes; this is in line with international standards¹ which are reflected in the new and revised returns for implementation from end-September 1997.

In many returns it is necessary to classify assets and liabilities as relating to UK residents, and to non-residents (previously termed "overseas residents"). A small number of returns additionally break down those relating to non-residents by country of residence. This classification depends on the residence of the person or body who is the immediate debtor or creditor [as normal, in determining the immediate debtor or creditor, transactions made through agencies and agents should be treated as though made directly with the principal (but payment of agency fees should be treated as a transaction with the agent)].

For the purpose of all returns Sections 2 to 5 below determine whether a person or body is a "UK resident" or a "non-resident". They also determine the country of residence of a non-resident. See Part I section 3 (in this *guide*) for some useful practical hints [especially sub-item I.3(d)]. Additional guidance is given in section 6 (below) for securities, bills, notes, ECGD lending and acceptances.

II.2 Individuals

(a) **UK residents** comprise :

- (i) Individuals permanently resident in the UK;
- (ii) All temporary residents from a country outside the UK who have stayed, or who intend to stay, in the UK for a year or more - except members of the armed forces and career and established government officials of a country outside the UK who are serving in military bases, embassies, etc in the UK, together with their dependants;
- (iii) Individuals normally resident in the UK who are temporarily overseas for less than a year; or
- (iv) Members of the UK armed forces and career and established officials of HM Government serving in military bases, embassies, etc. overseas, together with their dependants.

¹ European System of Accounts 1995 (EC Regulation); System of National Accounts (United Nations Statistical Commission. Feb. 1993)

Appendix A (continued)

- (b) **Non-residents** comprise all those individuals who are not UK residents, namely :
- (i) Individuals permanently resident in a country outside the UK (**including** the Channel Islands and the Isle of Man);
 - (ii) All temporary residents from the UK who have stayed, or who intend to stay, in a country outside the UK for a year or more - except members of the UK armed forces and career and established officials of HM Government serving in military bases, embassies, etc overseas, together with their dependants;
 - (iii) Individuals normally resident in a country outside the UK who are temporarily resident in the UK for less than a year; or
 - (iv) Members of the armed forces and career and established government officials of a country outside the UK who are serving in military bases, embassies, etc. in the UK, together with their dependants.

The country of residence of a non-resident is determined for each of the previously mentioned four categories according to the relevant country outside the UK. Thus for example :

- (i) An individual permanently resident in Switzerland is a Swiss resident.
- (ii) An individual normally resident in the UK visiting Brazil for two years is a Brazilian resident (but a UK diplomat in Brazil is a UK resident).
- (iii) An individual normally resident in the United States but visiting London for six months is a US resident.
- (iv) A US air-force officer serving in the UK is a US resident, and a Spanish diplomat serving in London is a Spanish resident.

Note that residence status is not necessarily the same as nationality [e.g. a Frenchman staying in London for two years is a UK resident].

Also note that, while career and established government officials (and their dependants) serving abroad are residents of the country whose government they serve, the same does not apply to locally recruited staff of embassies etc. Thus, for example, a typist or interpreter permanently resident in the UK or staying in the UK for a year or more and recruited by the Spanish embassy in London remains a UK resident.

II.3 Businesses

- (a) **UK residents** comprise all enterprises which produce goods or provide services in the United Kingdom, namely :
- (i) UK-owned businesses' branches and subsidiaries located and operating in the UK;
 - (ii) Overseas-owned businesses' branches and subsidiaries located and operating in the UK.;
 - (iii) A head office located in the UK from which an enterprise operating internationally (e.g. an air or shipping line) is administered.

Appendix A (continued)

- (b) **Non-residents** comprise all enterprises which produce goods or provide services outside the United Kingdom, namely :
- (i) UK-owned businesses' branches and subsidiaries located and operating in a country outside the UK;
 - (ii) Foreign-owned businesses' branches and subsidiaries located and operating in a country outside the UK;
 - (iii) A head office located in a country outside the UK from which an enterprise operating internationally is administered.

The country of residence of a non-resident business is determined for each category above according to the relevant country outside the UK. Thus for example :

- (i) the French branch of a UK company is a French resident;
- (ii) the French branch of a German company is a French resident;
- (iii) the New York head office of an international airline is a US resident.

Note that :

- UK branches of non-resident banks which are listed under the Banking Act are UK residents.
- Non-resident offices of reporting institutions, as defined in III.12(a) of the Classification of Accounts guide accompanying the new Banking Statistics Definitions ("yellow") folder, are non-residents.
- UK representative offices of non-resident banks, being only agencies of their parent banks, are non-residents.
- It is the country of location and operation which determines the country of residence, not the country of ultimate ownership. Thus foreign branches of a company will have a different country of residence from the company itself.
- An enterprise which merely has a "brass-plate" presence in a country is not a resident of that country, and the residence of each branch or subsidiary of that company will depend on its country of location and operation.

II.4 Governments, CMI's and International Organisations

HM Government and other UK public authorities, including HM Government diplomatic, military and other offices in other countries, are UK residents. Foreign central, state and local governments, including their diplomatic, military and other offices in the UK and elsewhere, are residents of the country which they serve.

Central monetary institutions are residents of the country they serve. Complete lists by country are given in Part III Section 12(b), grouped by area. Note that the Kuwait Investment Office in London is regarded as a resident of Kuwait and the Bank for International Settlements as a resident of Switzerland, and both are regarded as non-resident central monetary institutions.

Appendix A (continued)

International organisations, including their branches or representatives in the United Kingdom, are non-residents. They should be classified as "International Organisations" in returns where country breakdowns are required (such returns always have this category shown clearly as a separate item). Employees of international organisations who intend to be based in the UK for over one year are residents of the UK, although the organisations themselves are non-residents. The main international organisations are listed in Part III section 12. Note that certain international organisations, such as the European Investment Bank (EIB) and the International Bank for Reconstruction and Development (IBRD) are banking organisations - see Part III section 12(c) in particular.

II.5 Other

UK-based charities and other private non-profit-making bodies

Such bodies based in the United Kingdom are UK residents. Accounts for public subscription in the name of UK charities should be classified as accounts for UK residents, but a UK charity's account specifically for the running of an operation overseas (for example a hospital or school abroad) should be classified as an account for a resident of the country in which the operation is located.

Great Peter Nominees Ltd

Funds placed with reporting institutions by Great Peter Nominees Ltd should be regarded as liabilities to non-residents, and classified as "unallocated by country" in returns where country breakdowns are required (such returns always have this category shown clearly as a separate item).

Estates and Settlements

Executors or administrators of the estate of a deceased person who at the time of death was a resident of another country, and agents acting on inter-vivos settlements where the settlor is a resident of another country, should be regarded as residents of that other country.

II.6 Securities, bills, notes, ECGD lending, and acceptances

When it is necessary to define a company security as issued either by a UK resident or a non-resident, this should be done on the basis of the location of the registered office of the issuing enterprise. Note, however, that the location of the registered office is synonymous with residence provided that the enterprise is operating in the country concerned on a permanent basis (ie for a period of over one year) and engages in economic activity (in this context the issuing of securities) which is subject to the fiscal and regulatory framework applicable in that country. For a security issued by a government or public corporation, the allocation is based on the residence of the issuing body. The question of whether the security is denominated in sterling or any other currency is not relevant to this allocation.

A security which is in "secondary" form, eg in the form of an allotment letter or of American, European, Global or Bearer Depository Receipts, should be attributed to the country of residence of the issuer of the underlying security. The same principle of "looking through" should apply to "repackaged" securities (ie securities issued by a body, for example a bank, a securities house, or a purpose-formed body, in respect of other, underlying securities held by that body), provided that a purchaser of the "repackaged" securities has a right to transfer to the underlying securities. If the purchaser does not have such a right, reporting institutions should not look through to the underlying securities.

Appendix A (continued)

A stripped security (strip) which remains the direct obligation of the original issuer should be attributed to the residency of the issuer of the original security. A strip which has been created and issued by an entity in its own name should be attributed to the residency of the issuer of the strip.

Bills should be classified according to the country of residence of the drawer, and notes according to that of the issuer; lending under ECGD guarantee should be allocated to the overseas country in which the debtor is resident; and bills accepted by the reporting institution itself reported as acceptances to the country of residence of the enterprise or body on whose behalf the acceptance credit facility has been opened.”

Appendix B

Discount houses

With effect from 23 December 1998, Discount houses are no longer applicable.

Appendix C

Zone A/Zone B countries

The term "Zone A" covers full members of the OECD and those countries which have concluded special lending arrangements with the IMF associated with the IMF's General Arrangements to Borrow, provided they have not rescheduled their external sovereign debt to official or commercial bank creditors in the previous five years. At present, these countries comprise:

Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Saudi Arabia, Spain, South Korea, Sweden, Switzerland, Turkey, United Kingdom and United States.

The Channel Islands, Gibraltar, Bermuda and Isle of Man should also be regarded as being within Zone A. The reporting institution should discuss with the FSA the appropriate treatment of particular dependencies of Zone A countries.

Zone B comprises all countries not in Zone A.

For the purpose of determining whether a bank is in Zone A or B, the place of incorporation is the relevant factor to be considered rather than the location of the branch. For example, a loan made to a branch located in a Zone A country of a Zone B incorporated bank should be classified as a loan to Zone B bank.

Appendix D

Central banks (central monetary institutions)

The list of central banks set out below is similar to the list used to complete the Bank of England's statistical returns, except for the exclusion of the following Eastern European foreign trade banks (FTBs):

Bulgaria	Bulgarian Foreign Trade Bank
Poland	Bank Handlowy w Warszawie (non-UK offices only)

Reporting institutions may however classify FTBs as Zone B banks if they so wish, and should notify the FSA if they do so.

European Union

Austria	Oesterreichische Nationalbank
Belgium	Banque Nationale de Belgique, SA
Denmark and Greenland	Danmarks Nationalbank
Finland	Suomen Pankki - Finlands Bank
France	Banque de France
Germany	Deutsche Bundesbank European Central Bank
Greece	Bank of Greece
Ireland	Central Bank of Ireland
Italy	Banca d'Italia Ufficio Italiano dei Cambi
Luxembourg	Institut Monétaire Luxembourgeois
Netherlands	De Nederlandsche Bank NV
Portugal	Banco de Portugal
Spain	Banco de España
Sweden	Sveriges Riksbank

Other Western Europe

Bosnia and Herzegovina	National Bank of Bosnia and Herzegovina
Croatia	National Bank of Croatia
Cyprus	Central Bank of Cyprus
Gibraltar	The Commissioner of Currency
Guernsey	The Treasurer, States of Guernsey / Guernsey Financial Services Commission
Jersey	The Treasurer, States of Jersey / States of Jersey Financial Services Department
Isle of Man	The Treasurer, Isle of Man Government / Isle of Man Financial Supervision Commission
Macedonia	National Bank of Macedonia
Malta	Central Bank of Malta
Norway	Norges Bank
Slovenia	Banka Slovenije

Central Banks - Other Western Europe (continued)

Switzerland and Liechtenstein	Schweizerische Nationalbank Bank for International Settlements
Turkey	Banque Centrale de la République de Turquie SA
Yugoslavia, (former Kosovo, Montenegro, Serbia, Vojvodina)	National Bank of Yugoslavia (Narodna Bank Jugoslavije)

Other OECD countries

Australia	Reserve Bank of Australia
Canada	Bank of Canada
Czech Republic	Czech National Bank (Ceská Národní Banka)
Hungary	National Bank of Hungary (Magyar Nemzeti Bank)
Iceland	Central Bank of Iceland (Sedlabanki Islands)
Japan	The Bank of Japan
Korea (South)	The Bank of Korea
Mexico	Banco de México SA
Poland	National Bank of Poland (Narodowy Bank Polski)
New Zealand	Reserve Bank of New Zealand
United States	Federal Reserve System (comprising the Federal Reserve Board and 12 Federal Reserve banks)

Eastern Europe

Albania	Bank of Albania
Armenia	Central Bank of the Republic of Armenia
Azerbaijan	National Bank of Azerbaijan
Belarus	National Bank of Belarus
Bulgaria	National Bank of Bulgaria (Bulgarska Narodna Banka) Bulgarian Foreign Trade Bank
Estonia	Bank of Estonia (Eesti Pank)
Georgia	National Bank of Georgia
Kazakhstan	National State Bank of Kazakhstan
Kirgizstan (Kyrgyzstan)	National Bank of Kyrgyzstan
Latvia	Bank of Latvia (Latvijas Banka)
Lithuania	The Bank of Lithuania (Lietuvos Bankas)
Moldova	National Bank of Moldova
Romania	National Bank of Romania
Russia	Central Bank of the Russian Federation
Slovakia, the Republic of	National Bank of Slovakia (Národná Banka Slovenska)
Tajikistan	National Bank of Tajikistan
Turkmenistan	State Central Bank of Turkmenistan
Ukraine	National Bank of Ukraine
Uzbekistan	State Bank of Uzbekistan

Central Banks (continued)

Latin America and Caribbean

Argentina	Banco Central de la Republica Argentina
Aruba	Centrale Bank van Aruba
Bahamas	Central Bank of the Bahamas
Barbados	Central Bank of Barbados
Belize	Central Bank of Belize
Bermuda	Bermuda Monetary Authority
Bolivia	Banco Central de Bolivia
Brazil	Banco Central do Brazil
British Virgin Islands	Commissioner of Currency
Cayman Islands	Cayman Islands Currency Board
Chile	Banco Central de Chile
Colombia	Banco de la República (Colombia)
Costa Rica	Banco Central de Costa Rica
Cuba	Banco Nacional de Cuba
Dominican Republic	Banco Central de la Republica Dominicana
El Salvador	Banco Central de Reserva de El Salvador
Falkland Islands	The Commissioner of Currency
Guatemala	Banco de Guatemala
Guyana	Bank of Guyana
Haiti	Banque de la République d’Haiti
Honduras	Banco Central de Honduras
Jamaica	Bank of Jamaica
Netherlands Antilles	Bank van de Nederlandse Antillen
Nicaragua	Banco Central de Nicaragua
Panama	Banco Nacional de Panama
Paraguay	Banco Central de Paraguay
Peru	Banco Central de Reserva del Peru
Suriname	Centrale Bank van Suriname
Uruguay	Banco Central del Uruguay
Anguilla	}
Antigua and Barbuda	}
Dominica	}
Grenada	}
Montserrat	} Eastern Caribbean Central Bank
St Kitts - Nevis	}
Saint Lucia	}
Saint Vincent and the Grenadines	}
Turks and Caicos Islands	}

Central Banks (continued)

Middle East oil exporting countries

Bahrain	Bahrain Government Bahrain Monetary Agency
Dubai	Government of Dubai
Iran	Bank Markazi Jomhuri Islami Iran
Iraq	Central Bank of Iraq
Kuwait	Central Bank of Kuwait Kuwait Investment Authority Kuwait Investment Office (London) - regard as non-resident Government of Kuwait: Ministry of Finance
Libyan Arab Jamahiriya	Central Bank of Libya
Oman	Central Bank of Oman
Qatar	Qatar Central Bank Government of Qatar
Saudi Arabia	Saudi Arabian Monetary Agency
United Arab Emirates ¹	Abu Dhabi Investment Authority Central Bank of the United Arab Emirates Government of Dubai

Other oil exporting countries

Algeria	Banque Centrale d'Algérie
Brunei	Brunei Currency Board Brunei General Reserve Fund Brunei Investment Agency
Ecuador	Banco Central del Ecuador
Indonesia	Bank Indonesia
Nigeria	Central Bank of Nigeria
Trinidad and Tobago	Central Bank of Trinidad and Tobago
Venezuela	Banco Central de Venezuela

Other Africa

Angola	Banco Nacional de Angola
Botswana	Bank of Botswana
Burundi	Banque de la République du Burundi
Cape Verde	Banco de Cabo Verde
Comoros	Banque Centrale des Comoros
Congo, Democratic Republic	Banque du Congo
Djibouti	Banque Nationale de Djibouti
Egypt	Central Bank of Egypt
Eritrea	National Bank of Eritrea
Ethiopia	National Bank of Ethiopia

¹ United Arab Emirates includes Abu Dhabi, Dubai, Sharjah, Ajman, Umm Al Qaiwain, Ras al-Khaimah and Fujairah

Central Banks - Other Africa (continued)

Gambia	Central Bank of the Gambia
Ghana	Bank of Ghana
Guinea	Banque Centrale de la République de Guinée
Guinea-Bissau	Banco Central da Guiné-Bissau
Kenya	Central Bank of Kenya
Lesotho	Central Bank of Lesotho
Liberia	National Bank of Liberia
Madagascar	Banque Centrale de la République Malgache
Malawi	Reserve Bank of Malawi
Mauritania	Banque Centrale de Mauritanie
Mauritius	Bank of Mauritius
Morocco	Banque Al-Maghrib
Mozambique	Banco de Moçambique
Namibia	Bank of Namibia
Rwanda	Banque Nationale du Rwanda
St Helena	Commissioners of Currency
Sao Tome and Principe	Banco Nacional de São Tomé e Príncipe
Seychelles	Central Bank of the Seychelles
Sierra Leone	Bank of Sierra Leone
Somalia	Central Bank of Somalia
South Africa	South African Reserve Bank
Sudan	Bank of Sudan
Swaziland	Central Bank of Swaziland
Tanzania	Bank of Tanzania
Tunisia	Banque Centrale de Tunisie
Uganda	Bank of Uganda
Zambia	Bank of Zambia
Zimbabwe	Reserve Bank of Zimbabwe
Cameroon	}
Central African Republic	}
Chad	} Banque des États de l'Afrique Centrale
Congo	}
Equatorial Guinea	}
Gabon	}
Benin	}
Burkina Faso	}
Côte d'Ivoire (Ivory Coast)	}
Mali	} Banque Centrale des États de l'Afrique de l'Ouest
Niger	}
Senegal	}
Togo	}

Central Banks (continued)

Far East

Afghanistan	Da Afghanistan Bank (The Central Bank of Afghanistan)
Bangladesh	Bangladesh Bank
Bhutan	Bank of Bhutan Royal Monetary Authority of Bhutan
Cambodia	Banque Nationale du Cambodge
China	People's Bank of China
Hong Kong	Hong Kong Monetary Authority
India	Reserve Bank of India
Korea (North)	Central Bank of the Democratic People's Republic of Korea
Lao People's Democratic Republic	Banque d'Etat de la République Democratique Populaire Laos
Macao	Instituto Emissar de Macao
Malaysia	Bank Negara Malaysia
Maldives	Maldives Monetary Authority
Mongolia	State Bank of Mongolia
Myanmar, Union of (formerly Burma)	Central Bank of Myanmar
Nepal	Nepal Rastra Bank
Pakistan	State Bank of Pakistan
Philippines	Central Bank of the Philippines (Bangko Sentral ng Pilipinas)
Singapore	Government of Singapore Investment Corporation Monetary Authority of Singapore The Board of Commissioners of Currency
Sri Lanka	Central Bank of Sri Lanka
Taiwan	Central Bank of China (Taiwan)
Thailand	Bank of Thailand
Vietnam	National Bank of Vietnam

Other

Fiji	Reserve Bank of Fiji
Israel	Bank of Israel
Jordan	Central Bank of Jordan
Kiribati	Government of Kiribati
Lebanon	Banque du Liban
Palestinian Autonomy	Pelestine Monetary Authority
Papua New Guinea	Bank of Papua New Guinea
Solomon Islands	Central Bank of the Solomon Islands
Syrian Arab Republic	Central Bank of Syria
Tonga	National Reserve Bank of Tonga
Vanuatu	Central Bank of Vanuatu
Western Samoa	Central Bank of Western Samoa
Yemen, The Republic of	Central Bank of Yemen

Central Banks (continued)

Countries : Notes regarding geographical coverage

For the purposes of the supervisory returns, the following apply :-

Country	Also includes
Australia	Ashmore and Cartier Islands, Australian Antarctic Territory, Christmas Island, Cocos (Keeling) Islands, Coral Sea Islands, Heard and McDonald Islands, Norfolk Island
British Indian Ocean Territory	Chagos Archipelago
Comoros	Mayotte
Falkland Islands	South Georgia, South Sandwich Group
French Polynesia	Society Archipelago, Marquesas Islands, Austral Islands, Tuamotu Archipelago
Indonesia	East (formerly Portuguese) Timor
Italy	San Marino (but not Vatican City State)
Kiribati	Gilbert Islands, Line Islands (except Jarvis, Palmyra and Kingman Reef), Ocean Island, Phoenix Islands
New Zealand	Cook Islands, Niue, Ross Dependency, Tokelau
Norway	Bouvet Island, Dronning Maud Land, Jan Mayen, Peter I Island, Svalbard
Panama	Panama Canal Zone
Portugal	The Azores, Madeira
St Helena	Ascension, Tristan da Cunha
Spain	Balearic Islands, Canary Islands, Spanish North Africa
United Arab Emirates	Abu Dhabi, Dubai, Sharjah, Ajman, Umm Al Qaiwain, Ras al-Khaimah, Fujairah
United States	American Samoa, Guam, Midway Islands, Puerto Rico, Wake Islands
US Trust Territories in the Pacific	Howland & Baker, Johnston Atoll, Jarvis Island, Kingman Reef, Marianas, Marshall Islands, Micronesia (Carolines), Palau, Palmyra

Appendix E

Multilateral Development banks

Only the following institutions are classified as MDBs for supervisory purposes:

International Bank for Reconstruction and Development (IBRD): "World Bank"

International Finance Corporation (IFC)

Inter-American Development Bank (IABD)

Asian Development Bank (AsDB)

African Development Bank (ADB)

European Investment Bank (EIB)

European Investment Fund (EIF)

Caribbean Development Bank (CDB)

Nordic Investment Bank (NIB)

European Bank for Reconstruction and Development (EBRD)

Council of Europe Social Development Fund

Inter-American Investment Corporation (IAIC)

Appendix F

The following lists show examples of UK public bodies which are classified as PSEs for the purposes of this return and also public bodies which are not classified as PSEs. These lists are illustrative and are not intended to be comprehensive. If doubt exists as to the appropriate classification of an organisation reference should be made to the FSA.

(i) *UK public bodies eligible for classification as PSEs*

(a) *Local Authorities*

Include London borough councils, county and district councils in Northern Ireland, parish, town and new Unitary authorities in England, and Wales, and district, island and regional councils in Scotland, together with those attached statutory departments (eg gas departments in Northern Ireland, water service departments). Also those bodies formed on 1 April 1986 to take over the assets and functions of the former metropolitan councils and the GLC, eg residuary bodies, joint police authorities, joint police and fire boards.

The following local bodies are also included in this category:

- Central Scotland Water Development Board
- Fire services
- Forth Road Bridge Joint Board
- Humber Bridge Board
- Magistrates' Courts
- Police Forces (including Metropolitan Police)
- Passenger Transport Authorities/Executives
- Probation Service in England and Wales
- Scottish River Purification Boards
- Tay Road Bridge Joint Board

(b) *Non-commercial public corporations*

The Audit Commission	Northern Ireland Housing Executive
Black Country Development Corporation	Oil and Pipelines Agency
Bristol Development Corporation	Royal Mint
Cardiff Bay Development Corporation	Scottish Enterprise
Central Manchester Development Corporation	Scottish Homes
Central Office of Information	Sheffield Development Corporation
Covent Garden Market Authority	Teeside Development Corporation
Development Board for Rural Wales	Telford Development Corporation
Driving Standards Agency	Trafford Park Development Corporation
English Industrial Estates Corporation	Tyne and Wear Development Corporation
Highlands and Islands Enterprise	United Kingdom Atomic Energy Authority
Land Authority for Wales	Urban Development Corporations
Leeds Development Corporation	Welsh Development Agency
Letchworth Garden City Corporation	Welsh Fourth Channel Authority
New Towns Commission (and new town development corporations)	

The following UK public bodies are NOT classified as PSEs

Air Travel Trust	Housing Action Trusts
British Broadcasting Corporation	Local Authority Airports
British Nuclear Fuels plc	Local Authority Bus Companies
British Railways Board	London Regional Transport
Buying Agency	Meteorological Office
Civil Aviation Authority	NHS Trusts
Commonwealth Development Corporation	North of Scotland Water Authority
Crown Estate Commissioners	Patent office
Defence Research Agency	Pilotage Commission
East of Scotland Water Authority	Post Office Corporation, include Post Office Counters Ltd
Fire Services Colleges	Remploy Ltd
Forest Enterprise	Trust Ports in Northern Ireland
HM Land Registry	United Kingdom Nirex Ltd
Horseshoe Totalisator Board	West of Scotland Water Authority

Appendix G

Eligible banks (banks whose acceptances are eligible for discount at the Bank of England)

This list (21 May 2001) is issued by the Bank of England.

“An institution’s appearance on the list should not be misconstrued as evidence that it is qualitatively different in terms of financial soundness, standards of conduct or otherwise, from institutions which are not included on the list. The inclusion of an institution on this list does not mean that the Bank of England in any way guarantees its obligations.

ABN AMRO Bank NV	Robert Fleming & Co Ltd
Allied Irish Banks plc	Fortis Bank S.A./N.V.
The Asahi Bank, Ltd	The Fuji Bank, Ltd
Australia & New Zealand Banking Group Ltd	Halifax plc
Banca di Roma SpA	HSBC Bank plc
Banca Nazionale del Lavoro SpA	The Industrial Bank of Japan, Ltd
Banco Bilbao Vizcaya Argentaria SA	ING Bank NV
Banco Santander Central Hispano SA	IntesaBci SpA (Banca Intesa Banca Commerciale Italiana SpA)
Bank Austria AG	KBC Bank NV
Bank Brussels Lambert	Lloyds TSB Bank plc
Bank of America, NA	Lloyds TSB Scotland plc
The Bank of Ireland	Mellon Bank, NA
Bank of Montreal	Merita Bank plc
The Bank of Nova Scotia	The Mitsubishi Trust and Banking Corporation
Bank One, NA	Natexis Banques Populaires
Bank of Scotland	National Australia Bank Ltd
The Bank of Tokyo - Mitsubishi, Ltd	National Westminster Bank plc
Barclays Bank plc	Northern Bank Ltd
Bayerische Hypo-und Vereinsbank AG	Rabobank International (Coöperatieve Centrale Raiffeisen-Boerenleenbank BA)
Bayerische Landesbank Girozentrale	N M Rothschild & Sons Ltd
BNP Paribas	Royal Bank of Canada
Brown, Shipley & Co Ltd	The Royal Bank of Scotland plc
The Chase Manhattan Bank	Sanpaolo IMI SpA
CIBC World Markets plc	The Sanwa Bank, Ltd
Citibank NA	Singer & Friedlander Ltd
Clydesdale Bank plc	Skandinaviska Enskilda Banken AB (publ)
Commerzbank AG	Société Générale
Commonwealth Bank of Australia	Standard Chartered Bank
The Co-operative Bank plc	Sumitomo Mitsui Banking Corporation
Crédit Agricole Indosuez	The Sumitomo Trust & Banking Co Ltd
Crédit Industriel et Commercial	Svenska Handelsbanken AB (publ)
Crédit Lyonnais	The Tokai Bank, Ltd
Credit Suisse First Boston	The Toronto-Dominion Bank
The Dai-Ichi Kangyo Bank, Ltd	UBS AG
Danske Bank A/S	UniCredito Italiano SpA
Den norske Bank ASA	Westdeutsche Landesbank Girozentrale
Deutsche Bank AG	Westpac Banking Corporation
Dexia Banque Internationale à Luxembourg SA	Yorkshire Bank plc”
Dresdner Bank AG	
Fleet National Bank	

Appendix H

Credit rating agencies

Please refer to Chapter TI (Interest rate position risk), Section 9, of the FSA Policy Guide/IPRU (BANK) for more detail.

For all issuers

Moody's Investors Service
Standard & Poor's Corporation
FITCH IBCA

For all banks, Building Societies and parent companies and subsidiaries of banks

Thomson Bankwatch

For Canadian issuers

Canadian Bond Rating Service
Dominion Bond Rating Service

For Japanese issuers

Japan Credit Rating Agency, Ltd
Japan Rating and Investment Information Inc
Mikuno & Co

For United States issuers

Duff & Phelps, Inc

Appendix I

REPORTING SCHEDULE FOR SUPERVISORY RETURNS 2001

1. This schedule covers the period from **January 2001 to December 2001**. Not all the forms listed may be required from every reporting institution. The most common exceptions are covered in the footnotes. Individual reporting institutions which have been requested specifically by the FSA not to complete certain forms, or complete them less frequently or at different days from those shown below, should continue to follow their special arrangements.
2. The submission of these forms is covered by the rules and guidance set out in *SUP 16.7.7R – SUP 16.7.15R*. Failure to submit a report in accordance with the rules in *SUP Chapter 16* may lead to the imposition of a financial penalty and other disciplinary actions (see ENF 13.5) once the Financial Services and Markets Act 2001 comes into force.
3. **Institutions should note that the due dates set out below are based on the Bank Holidays applicable in England. The due dates should be adjusted to take account of local Bank Holidays (but not Public Holidays) and any waivers or concessions agreed with the FSA.** Reporting institutions should telephone their regular supervisor in the FSA in advance of any difficulty they may have in meeting a deadline.
4. Banks with any questions on this reporting schedule may also ring Financial Risk Analysis and Monitoring Unit, FSA on 020 7676 0660.

Reporting date	Forms	Due dates							
		<u>Paper reporters</u>		<u>Electronic reporters</u>		<u>Submitted to FSA</u>		Via MFSD, Bank of England	Direct to supervisor at FSA
2001									
JANUARY	10 SLR1 ¹	Thursday	18/01/01	Thursday	18/01/01		X		
FEBRUARY	14 SLR1 ¹	Thursday	22/02/01	Thursday	22/02/01		X		
	28 LR ⁷	Wednesday	14/03/01	Friday	16/03/01		X		
MARCH	14 SLR1 ¹	Thursday	22/03/01	Thursday	22/03/01		X		
	30 BSD3 ³ , M1 ^{3,4} , LR ⁷ , B7 ⁵	Tuesday	17/04/01	Thursday	19/04/01		X		
	30 LE2 ⁶	Tuesday	17/04/01	Thursday	19/04/01				X ²
APRIL	11 SLR1 ¹	Monday	23/04/01	Monday	23/04/01		X		
MAY	9 SLR1 ¹	Thursday	17/05/01	Thursday	17/05/01		X		
	31 LR ⁸	Thursday	14/06/01	Monday	18/06/01		X		
JUNE	13 SLR1 ¹	Thursday	21/06/01	Thursday	21/06/01		X		
	29 BSD3 ³ , M1 ^{3,4} , LR ⁷ , B7 ⁵	Friday	13/07/01	Tuesday	17/07/01		X		
	29 LE2 ⁶ ,	Friday	13/07/01	Friday	13/07/01				X ²
JULY	11 SLR1 ¹	Thursday	19/07/01	Thursday	19/07/01		X		
AUGUST	8 SLR1 ¹	Thursday	16/08/01	Thursday	16/08/01		X		
	31 LR ⁸	Friday	14/09/01	Tuesday	18/09/01		X		
SEPTEMBER	12 SLR1 ¹	Thursday	20/09/01	Thursday	20/09/01		X		
	28 BSD3 ³ , M1 ^{3,4} , LR ⁸ , B7 ⁵	Friday	12/10/01	Tuesday	16/10/01		X		
	28 LE2 ⁶ ,	Friday	12/10/01	Friday	12/10/01				X ²
OCTOBER	10 SLR1 ¹	Thursday	18/10/01	Thursday	1//10/01		X		
NOVEMBER	14 SLR1 ¹	Thursday	22/11/01	Thursday	22/11/01		X		
	30 LR ⁸	Friday	14/12/01	Tuesday	18/12/01		X		
DECEMBER	12 SLR1 ¹	Thursday	20/12/01	Thursday	20/12/01		X		
	31 BSD3 ³ , M1 ^{3,4} , LR ⁷ , B7 ⁵	Tuesday	15/01/02	Thursday	17/01/02		X		
	31 LE2 ⁶ ,	Tuesday	15/01/02	Tuesday	15/01/02				X ²

For footnotes, see over.

1. Form SLR1 should also be completed for any exception during the month. These exception reports should be submitted directly to your supervisor (and not the Bank of England).
2. Until notified by the FSA, these returns should be sent direct to your supervisor.
3. Forms BSD3 and M1 apply only to UK banks. They may be submitted alternatively on a different quarterly cycle to coincide with a reporting institution's accounting year end. Institutions wishing to report at dates which coincide with the financial year end should agree this with the FSA. For institutions reporting on an unconsolidated / solo consolidated basis, these forms must be completed within 10 business days of the reporting date (12 business days if reported electronically). Institutions reporting on a consolidated basis are required to submit Forms BSD3 and M1 at the reporting group's accounting year-end and half year -end. The consolidated forms must be returned within 20 business days of the reporting date (22 business days for electronic reporters).
4. Form M1 applies only to market makers holding loan capital issued by banks and non-resident banks. These reporting institutions are required to submit Form M1 in conjunction with Form BSD3.
5. Form B7 applies only to UK branches of banks established outside the EEA. Banks may complete Form B7 at dates coinciding with their accounting year-end: this should be agreed with the FSA.
6. Form LE2 applies only to UK banks. Those banks which complete Form LE2 on an unconsolidated basis should report at dates which coincide with Form BSD3. The form must be completed within 10 business days of the reporting date on an unconsolidated / solo consolidated basis, or 20 business days when completed on a consolidated basis.
7. Banks (other than those which report to the Bank of England on Form BT quarterly), should complete the Form LR as at end February, May, August and November. For those banks reporting to the Bank of England on Form BT quarterly, Form LR should be completed at end March, June, September and December.
8. These returns should be sent direct to your supervisor unless the FSA has requested otherwise..
9. Forms BSD3 and M1 apply only to UK banks. They may be submitted alternatively on a different quarterly cycle to coincide with a reporting institution's accounting year end. Institutions wishing to report at dates which coincide with the financial year end should agree this with the FSA. For institutions reporting on an unconsolidated / solo consolidated basis, these forms must be completed within 10 business days of the reporting date (12 business days if reported electronically). Institutions reporting on a consolidated basis are required to submit Forms BSD3 and M1 at the reporting group's accounting year-end and half year -end. The consolidated forms must be returned within 20 business days of the reporting date (22 business days for electronic reporters).
10. Form M1 applies only to UK banks which have been granted a trading book concession, or have qualifying holdings in non-financial companies. These reporting institutions are required to submit Form M1 in conjunction with Form BSD3.

Appendix J

GUIDELINES FOR COMPLETING FORMS FOR SCANNING

For hand-written returns only:-

- 1 Write **neatly**.
- 2 Do **not join** numbers together.

For hand-written, typed or computer produced paper returns:-

- 3 Figures should be **fully** inside the databoxes and not touching the surrounding edges of the databox.
- 4 Commas and dots should **not** be used to indicate thousands and millions but you may leave spaces if you find it helpful e.g. 1293 or 1 293 are acceptable; 1,293 or 1.293 are not.
- 5 Boxes that are nil returns should be left **blank**. Do **not** write "NIL", "ZERO", "N/A" or other text in databoxes. Similarly do **not** put dashes, 0, strike through or shade sections of the return that are not relevant for your institution.
- 6 Where appropriate, tick boxes should contain a tick. If it is not technically possible to reproduce a tick, any mark in these boxes will be read as a tick.
- 7 Negative entries should be indicated by a **minus sign** preceding the figure. Brackets should **not** be used.
- 8 Computer produced paper returns should be printed using a HP III printer driver. Most laser printers are able to emulate a HP III driver.
- 9 Ensure the print quality is good, ie no smudging, fading, etc.
- 10 You should send all the sheets not just the ones that have data on.
- 11 Returns should be printed in the correct order with **single-sided** pages (not back-to-back) and should have no **missing** or **additional** pages. It is **not** necessary to use coloured paper for returns printed on coloured paper by the Bank of England. Pre-printed forms issued by the Bank of England should **not** be copied onto single sheets of paper before submission.
- 12 Returns consisting of pre-printed Bank of England pages combined with pages from the Excel 97 spreadsheet or with Software House output cannot be accepted for processing. Returns should consist entirely of one (accepted) version of the form.
- 13 Banks choosing to use Excel 97 versions of the returns should **not** amend the forms of the returns in any way. Do not attempt to convert the spreadsheet to Microsoft Excel 5 or any other spreadsheet type.
- 14 Do not staple covering letters to the returns.
- 15 Do not hole-punch the returns.
- 16 **Faxes** of most returns will be accepted but these should be **correctly aligned** on the paper. However, the Bank of England request that, owing to their size, reporting institutions do not submit the Forms B1, C1, DQ or any of the "C" Forms by fax. Banks are strongly encouraged to send paper returns of these forms to reach the Bank in advance of the deadlines, but the Bank understands that on occasion the use of fax is the only means of avoiding returns arriving late. In this case, the Bank asks reporting institutions to telephone and inform it of the problems. The original version of the return should **not** be sent to the Bank of England (unless specifically requested) providing an authorised official signed the faxed version.

- 17 Any forms submitted with text (ie B7, BSD3) should have all text items completed in CAPITAL LETTERS and should be computer generated or typed.

If you wish to check that the output produced from spreadsheets is suitable for scanning, the Bank of England will be happy to test the output for you. Please send your test output to Julie Bigwood at the address shown on the front of the form.

SUP 16 Ann 3R: Building societies' reporting forms

1. MFS1
2. MFS1 Supp
3. MFS2
4. QFS1
5. QFS2
6. AFS1

DECLARATION AND RDE NOTIFICATION SHEET

Please complete this sheet for each return and fax to the FSA: 020 7676 3905

Name of Society / Subsidiary:

Section A: Data Transmission

The following return has been successfully transmitted:

1. First transmission
2. Re-transmission #
3. Return Type (i.e. MFS1, TABA, QFS1 etc)
4. Period ending (e.g. Aug-2001)

If a re-transmission, please give brief details below of the changes made, including the specific tables amended:

Section B: Declaration Statement **

I confirm that the information in this form is accurate, has been prepared in accordance with the underlying Guidance Notes, and is complete to the best of my knowledge and belief.

Return completed by:

Name:
Position Held:
Tel No:
Signed: Date:.....

Note: ** Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). [SUP 15.6.1R and SUP 15.6.3R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided.] [SUP 16.3.11R requires an authorised person to submit reports containing all the information required]. [APER 4.4.6E provides that, where an approved person is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of Statement of Principle 4.] [Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA.] It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. [If there is any doubt about the relevance of information, it should be included.]



Building Society

Monthly Statement MFS1

FMS number

FSA register number

Month ended / /

Tables enclosed (tick) Table A

Name of society

Statement Completed by:

Name (BLOCK LETTERS):

Position held:

Signature:

Telephone

Address

Blank lines for Name, Position, and Signature.

STD Code: No. Extn:

Blank lines for Telephone and Address, followed by Post Code:

Summary of Contents Table

Summary Balance Sheet: Society and Group	A
Balance Sheet : Liabilities	B (1)
Balance Sheet : Liabilities (continued)	B(2)
Balance Sheet : Assets	B(3)
Balance Sheet : Assets (continued)	B(4)
Balance Sheet : Assets (continued)	B(5)
Balance Sheet : Assets (continued)	B(6)
Balance Sheet : Eligible Liabilities	B(7)
Shares	C
Deposits and Debt Securities	D
Liquid assets	E
Loans and Investments	F(1)
Loans and Investments (continued)	F(2)
Interest rates	G

- Notes on completion:**
- For details of items please refer to Guidance Notes
 - If you have any queries please telephone 020-7676-0630 or 0690
 - See Introduction, paragraph 7 (iv) of Guidance Notes for treatment of negative values
 - Enter amounts throughout in £ thousands
 - Show interest rates and percentages to 2 decimal places
 - A separate return MFS2 must be completed for each subsidiary undertaking doing "core" business (as defined in paragraph 5 (ii) of Introduction to Guidance Notes)
 - The statement must be completed monthly and submitted in 2 parts (each with a copy of this front sheet) to:

Table: A is for the Group
B to G are for society only

Financial, Risk Analysis and Monitoring Unit

as follows

Largest societies

Other societies

Financial Services Authority
14th Floor (ROSD)
25 The North Colonnade
Canary Wharf
LONDON E14 5HS

Tables B to G : within 7 business days
Table A : within 9 business days

10 business days
12 business days

A SUMMARY BALANCE SHEET : Society and Group

(£000s)

Society: Month ended :/...../.....

A

	Society		Subsidiary undertakings			Consolidation		GROUP	
			Deposit takers	Secured lenders	Unsecured lenders	Other "core" subsidiary undertakings	Other subsidiary undertakings	adjustments	(Consolidated)
Liabilities									
A1	Shares								
A2	Deposits and debt securities								
A3	Capital								
A4	Long term insurance liabilities								
A5	Other liabilities								
A6	Minority interests								
A7	TOTAL LIABILITIES								
Assets									
A8	Liquid assets								
A9	Loans and investments								
A9.1	Loans FSRP to individuals								
A9.2	Loans FSRP to others								
A9.3	Other loans fully secured on land								
A9.4	Other loans to customers								
A9.5	Investments								
A9.6	Provisions								
A10	Fixed assets								
A11	Long term insurance funds								
A12	Other assets								
A13	TOTAL ASSETS								

	<i>Sterling</i>	<i>Euro</i>	<i>Other currencies</i>	<i>Total</i>
B1.1				
B1.2				
B1.3				
B1.4				
B2.0				
B2.1				
B2.2 a				
B2.2 b				
B2.3				
B2.4				
B2.5 a				
B2.5 b				
B2.6				
B2.7				
B2.8				
B2.9				
B2.10				
B2.11				
B2.12				
B2.13				

* B2.5 Sterling Or which repo liabilities to the B of E.
.....

	<i>Sterling</i>	<i>Euro</i>	<i>Other currencies</i>	<i>Total</i>
Debt securities				
B2.14	Certificates of deposit			
B2.15	Commercial paper			
Bonds, notes, other instruments:				
B2.16	Up to 5 years original maturity			
B2.17	Over 5 years original maturity			
B2.18	TOTAL debt securities			
B2.19	Interest accrued			
B2.20	TOTAL deposits and debt securities			
Capital				
B3.1	Reserves			
B3.2	Subscribed capital			
B3.3	Revaluation reserves			
B3.4	Subordinated debt (qualifying)			
B3.5	Other capital			
B3.6	TOTAL capital			
Other liabilities				
B4.1	Income tax			
B4.2	Corporation tax			
B4.3	Interest accrued on capital			
B4.4	Long term insurance liabilities			
B4.5	Other			
B4.6	TOTAL other liabilities			
B4.7	Minority interests			
B5	TOTAL LIABILITIES			
Memorandum items:				
B/ML1	Transit and suspense (liabilities)			
B/ML1a	Of which : items in suspense			
B/ML1b	: credit items in transmission			

Liquid assets	<i>Sterling</i>	<i>Euro</i>	<i>Other currencies</i>	<i>Total</i>
B6.1 Cash (notes & coins)	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
B6.2 Deposits with central banks				
a Bank of England (*)	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
b Non-resident sector	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
c TOTAL Deposits with central banks	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
B6.3 Bank deposits				
a UK banking sector (*)	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
b Non-resident sector	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
c TOTAL Bank deposit	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
B6.4 Certificates of deposit				
a Building Societies	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
b UK banking sector	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
c Non-resident sector	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
d TOTAL Certificates of deposit	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
B6.5 Other money market instruments				
a Building societies	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
b UK banking sector	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
c Other UK sector	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
d Non-resident sector	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
e TOTAL Other money market instruments	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
B6.6 Bonds, notes and other capital instruments				
a) up to 5 years original maturity				
a1 Building societies	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
a2 UK banking sector	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
a3 Non-resident sector	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
b) over 5 years original maturity				
b1 Building societies	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
b2 UK banking sector	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
b3 Non-resident sector	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
c) TOTAL Bonds, notes etc	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

* B6.3a: See note a) on page B(5)

* B6.2a: See note a) on page B(5)

	Sterling	Euro	Other currencies	Total
Liquid assets (continued)				
B6.7	Bills			
a				
b				
c				
B6.8	Local Authority			
a				
b				
c				
d				
B6.9	Certificates of tax deposit			
B6.10	Mortgage backed securities			
a)	up to 5 years original maturity			
a1				
a2				
a3				
a4				
b)	over 5 years original maturity			
b1				
b2				
b3				
b4				
c)	TOTAL Mortgage backed securities			

	<i>Sterling</i>	<i>Euro</i>	<i>Other currencies</i>	<i>Total</i>
Liquid assets (continued)				
B6.11 Sovereign securities				
a) Sovereign debt				
a1 UK government securities				
a2 Overseas government				
b) Sovereign backed or supported by				
b1 UK government				
b2 Overseas government				
c) TOTAL Sovereign securities				
B6.12 Other liquid assets with:				
a Building society sector				
b Other UK sector				
c Non-resident sector				
d TOTAL Other Liquid assets				
B6.13 Interest accrued				
B6.14 TOTAL Liquid assets				
Note a) Of which : non-interest bearing with :				
Bank of England (part of B6.2a)				
OW1.1 Cash ratio deposits				
OW1.2 Other non-interest bearing				
OW1.3 Other UK Banking Sector (part of B6.3a)				
OW1.4 TOTAL non-interest bearing				

	<i>Sterling</i>	<i>Euro</i>	<i>Other currencies</i>	<i>Total</i>
Loans and Investments				
B7.1	Loans fully secured on residential property to:			
a	Individuals			
b	Housing associations			
c	Other			
B7.2	Other loans fully secured on land to:			
a	Individuals			
b	Housing associations			
c	Other			
B7.3	Other loans to customers:			
a	Individuals			
b	Other			
B7.4	Investments			
B7.5	TOTAL Loans and Investments (Gross)			
B7.6	Provisions			
B7.7	TOTAL Loans and Investments (Net)			
B7.8	Analysis of B7.5 by sector:			
a	UK public sector			
b	UK banking sector			
c	Building society sector			
d	Other UK (private) sector			
e	Non-resident sector			
B8	Fixed assets			
B9	Long term insurance funds			
B10	Other assets			
B11	TOTAL ASSETS			
Memorandum item:				
B/MA 1	Transit and suspense (assets)			
B/MA1a	Of which : items in suspense			
B/MA1b	: debit items in transmission			

= B7.5 - B7.6

Note: B7.8 should only be completed by those societies who also complete form QFS2.

B(7) BALANCE SHEET : ELIGIBLE LIABILITIES : Society

£000's

Society

Month ended/...../.....

B(7)

Sterling (except where indicated)

B20.1	Sterling share and deposit liabilities	_____	<i>(B1.1 + B1.2 + B2.0a + B2.0b + B2.10 + B2.13 + B2.14 + B2.15 + B2.16)</i>
B20.2	Sterling items in suspense	_____	<i>(B/M/L/a)</i>
B20.3	60% of sterling credit items in the course of transmission	_____	<i>(60% of item shown at B/M/L/b)</i>
B20.4	Net currency liabilities (if positive)	_____	<i>(B5[Column 2+3] minus B11[Column 2+3])</i>
B20.5	Total of items 1 to 4 above	<input style="border: 1px dashed black;" type="text"/>	
B20.6	Sterling repo liabilities with the Bank of England	_____	<i>(Column 5 of item B2.5a)</i>
B20.7	Sterling funds lent to UK banks	_____	<i>(B6.3a + B.M.L/b minus B.M.A1b + (B6.4b + B6.5b + B6.6a2 + B6.10a2)</i>
B20.8	Sterling funds lent to other building societies	_____	<i>(B6.4a + B6.5a + B6.6a1 + B6.10a1 + B6.12a)</i>
B20.9	60% of sterling debit items in the course of collection	_____	<i>(60% of item shown at B.M.A1b)</i>
B20.10	Sterling balances with the Bank of England (excluding CRD's)	_____	<i>(B6.2a minus OW1.1)</i>
B20.11	Total of items 6 to 10 above.	<input style="border: 1px dashed black;" type="text"/>	
B20.12	Over 2 year sterling share and deposit liabilities (optional)	_____	
B20.13	Non-resident offices adjustment (optional)	_____	
B20.14	Total ELIGIBLE LIABILITIES (item 5 minus items 11, 12 and 13)	<input style="border: 2px solid black;" type="text"/>	

MFS1

(V/200598)N2R

C SHARES (excluding accrued interest): Society

(£000s)

Society:

Month ended: / /

C

	<i>Balance at end of previous month</i>	<i>Receipts</i>	<i>Withdrawals</i>	<i>Interest paid Gross</i>	<i>Tax deducted</i>	<i>Interest credited Gross</i>	<i>Tax deducted</i>	<i>Other (debits)/credits and transfers(net)</i>	<i>Balance at end of month</i>
C1	TOTAL Shares (a)	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/> = B1.4 - B1.3
C2	Analysis by account type (original maturity):								
C2.1	Instant access (0-7 days)	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
C2.2	Notice : 1 month (8-45 days)	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
C2.3	2 months (46-75 days)	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
C2.4	3 months (76 or more)	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
C2.5	Term : Less than 6 months	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
C2.6	6 months < 12 months	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
C2.7	1 year < 2 years	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
C2.8	2 years < 5 years	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
C2.9	5 years and over	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
C2.10	Contractual : Tessa	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
C2.11	Other	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
C2.12	Other	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
C2.13	TOTAL shares (b)	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/> = C1[8]
C2.14	Of which : ISAs	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
		<i>Balance at end of month</i>		<i>Balance at end of month</i>		<i>Balance at end of month</i>		<i>Balance at end of month</i>	
C3	Shares analysis (sums to C1[9])	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
C3.1	Shares held by individuals	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
C3.2	Shares held by others	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

	<i>Balance at end of month</i>
C4 Large share and deposit holdings (see section C4 of guidance notes)	<input type="text"/>
C4.1 Single holdings in excess of 0.25% SDL (c)	<input type="text"/>

Note a) Column 9 = Col 1 + Col 2 - Col 3 + Col 6 - Col 7 + Col 8

b) Column 6 = Col 1 + Col 2 + Col 3 + Col 4 - Col 5

c) SDL here should also exclude accrued interest

D DEPOSITS AND DEBT SECURITIES (excluding accrued interest): Society (£000s)

Society: Month ended:/...../.....

D

	<i>Balance at end of previous month</i>	<i>Receipts</i>	<i>Withdrawals / Repayments</i>	<i>Interest paid Gross</i>	<i>Tax deducted</i>	<i>Interest credited Gross</i>	<i>Tax deducted</i>	<i>Other (debits)/credits and transfers(ies) month</i>	<i>Balance at end of month</i>
<i>D1 Deposits and debt securities</i>									
<i>D1.1 Deposits from individuals</i>									
<i>D1.2 Other deposits and debt securities</i>									
<i>D1.3 TOTAL Deposits and debt securities (a)</i>									
	<small>= B2.20 - B2.19 - B2.0c</small>								
	<small>= B2.0a + b</small>								
D2 Committed facilities									
<i>D2.1 Banks</i>									
<i>D2.2 Other sources</i>									
<i>D2.3 All sources</i>									
	<small>**</small>								

Note: * This will not necessarily be the sum of the 2 boxes above
 ** This box will be the sum of the 2 boxes above

Maximum drawn down at any time during month

Position at end of month

Drawn down Undrawn

NB: Large deposit holdings: See Table C(4) for reporting requirements.

		<i>Balance outstanding at end of month</i>					<i>Amount of prudential liquidity (a)</i>
		<i>As per balance sheet</i>	<i>Intermediate Workings</i>	<i>Market value (MT)</i>	<i>Discounted value</i>		
			<i>Inteligible amounts</i>				
E1	Realisable within :						
E1.1	Up to 8 days						
		Gilts with residual maturities					
	a.	less than 1 year		.....	.....	=MV	
	b.	1 to 5 years		.....	.....	=(MVx0.95)	
	c.	Over 5 years		.....	.....	=(MVx0.90)	
	d.	TOTAL gilts					
	e.	Other					
				= sum of all above		= sum of all above	
E1.2	9 days up to 3 months						
E1.3	Over 3 months						
E1.4	TOTAL liquid assets						
		= B6.14					= Sum of all above
E2	Amounts of prudential liquidity at any time during the month (end day balance)	<i>Amount</i>	<i>As % total SDL(b)</i>	<i>Date</i>			
E2.1	Minimum total prudential liquidity						
E2.2	Maximum total building society holdings						
E3	Building society holdings	Balance at end month 					

Note a) Show amounts after making relevant deductions, adjustments as in Chapter 5 of Vol. 1 of the IPSB for Building Societies.

b) SDL, as defined in guidance notes, includes accrued interest

F(1) LOANS & INVESTMENTS : Society

(€000 s)

Society:

Month ended :/...../.....

F(1)

	<i>Balance at end of previous month</i>	<i>Advances/payments made in month</i>	<i>Interest earned in month</i>	<i>Repayment/realisation of principal</i>	<i>Repayment of interest</i>	<i>Write offs/ depreciation in month</i>	<i>Other debits/credits and transfers (net)</i>	<i>Balance at end of month (a)</i>
F1	Loans fully secured on residential property (FSRP):							
F1.1								= B7.1a
								= B7.1b
F1.2								= B7.1c
F1.3								
F1.4								
F2	Other loans fully secured on land (FSOL) :							
F2.1								= B7.2a
F2.2								= B7.2b
F2.3								= B7.2c
F2.4								
F3	Other loans to customers : individuals:							
F3.1								
F3.2								
F3.3								
F3.4								
F3.5								
F3.6								= B7.3a
F4	Other loans to customers : other:							
F4.1								
F4.2								
F4.3								= B7.3b
F5	Investments							
F5.1								
F5.2								
F5.3								
F5.4								= B7.4
F6	Loans : Analysis of repayments of principal							
F6.1								= F1.1 [4]
F6.2								= (F1.2 [4] + F1.3 [4] + F2.4 [4])
F6.3								

Note

a) Column 8 = Col 1 + Col 2 + Col 3 - Col 4 - Col 5 - Col 6 + Col 7

	<i>Commitments outstanding at end of previous month</i>	<i>Commitments made since end of previous month</i>	<i>Cancellations in month</i>	<i>Advances made in month (b)</i>	<i>Commitments outstanding at end of month</i>
F7	Loan commitments				
F7.1	Loans FSRP to individuals				
F7.2	Loans FSRP to others				
F7.3	Other loans fully secured on land				
F7.4	TOTAL loan commitments (a)				
F8	Numbers of mortgages outstanding	<i>Number at end of month (c)</i>			
F8.1	Mortgages FSRP to individuals				
F8.2	Mortgages FSRP to others				
F8.3	Other mortgages fully secured on land				
F9	Loan book acquisitions (and sales) and loans securitised and/or subject to non-recourse funding	<i>Transactions in month Books acquired (d)</i>	<i>Books sold (e)</i>	<i>Loans securitised (f)</i>	<i>Balance at end month on loan assets subject to non-recourse funding (g)</i>
F9.1	Loans fully secured on residential properties				
	a. Individuals				
	b. Housing associations				
	c. Other				
	d. TOTAL				
F9.2	Other loans fully secured on land				
F9.3	Other loans to customers				
	a. Individuals				
	b. Others				
	c. TOTAL				

Notes a) Column 5 = Col 1 + Col 2 - Col 3 - Col 4
 b) Entries here should agree with relevant items in Column 2 of F1 to F2
 c) Numbers here relate to corresponding balances shown at B7.1 and B7.2
 d) Included within "other debits/(credits)" in main analysis
 e) Included within "other debits/(credits)" in main analysis
 f) Included within "other debits/(credits)" in main analysis
 g) Such assets will be subject to "linked presentation" accounting treatment in the balance sheet. The amount shown here should be "gross assets".
 MFS1 (V200659)/2R

G INTEREST RATES (Gross rates) : Society

(£000s)

Society:

Month ended/...../.....

G

	Balances at end of month (a)			Interest rates at end of month (to 2 decimal places)					
	TOTAL £000s	Gross references	Of which at: Fixed rates £000s	Basic rate %	Weighted average nominal rate on all balances %	on balances at fixed rates %	on balances at variable rates %		
G1 Shares		= B1/4							
G2 Deposits and debt securities		= B2/20							
G3 Capital instruments		= B3.2 + B3.4 + B3.5 + B4.3							
G4 Liquidity		= B6/14							
G5 Loans and advances									
		Loans FSRP to individuals:							
G5.1 total		= B7/1a							
G5.2 advances in month		= F1.1/2]							
		Other loans FSRP and other loans FSOL:							
G5.3 total		= B7.1b+B7.1c+ B7.2a to c +F1.2/2] +F1.3/2]+ F2.4/2]							
G5.4 advances in month									
		All loans fully secured on land:							
G5.5 total		= [G5.1 + G5.3]							
G5.6 advances in month		= [G5.2 + G5.4]							
G5.7 Other loans to customers : individuals		= B7/3a							
G5.8 Other loans to customers : other		= B7/3b							
G5.9 OVERALL total balance/average weighted rate on loans above									

Interest rates decided but not implemented at end of month (b)

Basic rate %	Date effective (dd/mm)	New borrowers	Existing borrowers

Notes a) Balances include accrued interest
 b) Give the latest known interest rate decisions as of the date of submission of the return. Where a new interest rate has already been implemented for new borrowers before the reporting month ended, please give the effective date.

BUILDING SOCIETY: MONTHLY STATEMENT

MFS1: CROSS CHECKS (other than those shown on return):

A1	col 1	=	B1.4	col 4	Total shares
A2	col 1	=	B2.20	col 4	Total Deposits and debt securities
A3	col 1	=	B3.6	col 4	Total capital
A4	col 1	=	B4.4	col 4	Long term insurance liabilities
A5	col 1	=	B4.6 - B4.4	col 4	Total other liabilities
A6	col 1	=	B4.7	col 1	Minority interests
A7	col 1	=	B5	col 4	Total liabilities
A8	col 1	=	B6.14	col 4	Total liquid assets
A9.1	col 1	=	B7.1a	col 4	Loans FSRP to individuals
A9.5	col 1	=	B7.4	col 4	Investments
A9.6	col 1	=	B7.6	col 4	Provisions
A10	col 1	=	B8	col 4	Fixed assets
A11	col 1	=	B9	col 4	Long term insurance funds
A12	col 1	=	B10	col 4	Other assets
A13	col 1	=	B11	col 4	Total assets

DECLARATION AND RDE NOTIFICATION SHEET

Please complete this sheet for each return and fax to the FSA: 020 7676 3905

Name of Society / Subsidiary:

Section A: Data Transmission

The following return has been successfully transmitted:

1. First transmission
2. Re-transmission #
3. Return Type (i.e. MFS1, TABA, QFS1 etc)
4. Period ending (e.g. Aug-2001)

If a re-transmission, please give brief details below of the changes made, including the specific tables amended:

Section B: Declaration Statement **

I confirm that the information in this form is accurate, has been prepared in accordance with the underlying Guidance Notes, and is complete to the best of my knowledge and belief.

Return completed by:

Name:
Position Held:
Tel No:
Signed: Date:.....

Note: ** Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). [SUP 15.6.1R and SUP 15.6.3R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided.] [SUP 16.3.11R requires an authorised person to submit reports containing all the information required]. [APER 4.4.6E provides that, where an approved person is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of Statement of Principle 4.] [Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA.] It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. [If there is any doubt about the relevance of information, it should be included.]



Building Society Monthly Supplementary Statement MFS1

COMMERCIAL IN CONFIDENCE

FMS number	
FSA register number	
Month ended	/ /

Summary of Contents	Table
Balance Sheet Liabilities : Sectoral Analysis	B (8)
Balance Sheet Assets : Sectoral Analysis	B(9)
Balance Sheet Assets : Sectoral Analysis	B(10)
Balance Sheet : Repo & Stocklending	B(11)

Name of society

Statement Completed by:

Name (BLOCK LETTERS):

Position held:

Signature:

Telephone

Date:

STD Code:	No:	Extn:
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Notes on completion:

- For details of items please refer to Guidance Notes
- If you have any queries please telephone 020-7676-0630 or 0690
- This statement should only be completed by those societies required to complete the MFS1 return to the faster timetable. It must be submitted by close on the 7th business day after the month end.

Financial, Risk Analysis and Monitoring Unit
 Financial Services Authority
 14th Floor (ROSD)
 25 The North Colonnade
 Canary Wharf
 LONDON E14 5HS

MFS1 Supp
 (V/200598)N2R

MFS1 SUPPLEMENT 1(a) : BALANCE SHEET : LIABILITIES : Society (£000s)

Society:

Month Ended:

B(8)

Sectoral Analysis of "Other UK sector" (UK non-bank non-b/soc private sector)

	Shares			Deposits		
	Sterling	Euro	Other currencies	Sterling	Euro	Other currencies
B25.1 MFI's other than banks and building societies						
B25.2 Financial corporations other than MFIs						
B25.3 Non-financial corporations other than public corporations						
B25.4 Households and individual trusts						
B25.5 Non-profit institutions serving households						
B25.6 TOTAL *	0	0	0	0	0	0
* Cross reference :	MFS1 line item	B1.1 col. 1	B1.1 col. 2	B1.1 col. 3	B2.0(a)+B2.1+B2.3 col. 2	B2.0(a)+B2.1+B2.3 col. 3

MFS1 SUPPLEMENT 1(b) : BALANCE SHEET : ASSETS : Society (£000s)

Sectoral Analysis of "Other UK Sector"

Society:

Month ended:

/

B(9)

Other Money Market Instruments

Sterling Euro Other currencies

B26.1	MFI's other than banks and building societies			
B26.2	Financial corporations other than MFI's			
B26.3	Non-financial corporations other than public corporations			
B26.4	Households and individual trusts			
B26.5	Non-profit institutions serving households			
B26.6	TOTAL *	0	0	0

* Cross reference : MFS1 line item

B6.5c col. 1

B6.5c col. 2

B6.5c col. 3

Mortgage backed securities - up to 5 yrs

Sterling Euro Other currencies

		0	0	0

B6.10 a3 col. 1

B6.10 a3 col. 2

B6.10 a3 col. 3

Mortgage backed securities - over 5 yrs

Sterling Euro Other currencies

		0	0

B6.10 b3 col. 1

B6.10 b3 col. 2

B6.10 b3 col. 3

MFS1 SUPPLEMENT 1(c) : BALANCE SHEET : ASSETS : Society (£000s)

Society: / **Month ended:** / **B(10)**

Sectoral Analysis of "Other UK Sector"

	Other Liquid Assets			Loans and Investments		
	Sterling	Euro	Other currencies	Sterling	Euro	Other currencies
B27.1 MFIs other than banks and building societies						
B27.2 Financial corporations other than MFIs						
B27.3 Non-financial corporations other than public corporations						
B27.4 Households and individual trusts						
B27.5 Non-profit institutions serving households						
B27.6 TOTAL *						

* Cross reference : MFS1 line item **B6.12b col. 1** **B6.12b col. 2** **B6.12b col. 3** **B7.8d col. 1** **B7.8d col. 2** **B7.8d col. 3**

B(11) BALANCE SHEET : REPO & STOCKLENDING ANALYSIS : Society

(£000s)

Society:

Month ended /

B(11)

		Balance outstanding at end of month		Amount with Bank of England facility included in TOTAL column	
		Of which:			
		Sterling	Other currencies		
		TOTAL			
Reference to balance sheet					
B28	Deposit funding resulting from REPO transactions:				
B28.1	Gilt Repo:				
B28.2	with Other UK sector (non-bank non-b/soc private sector)				
B28.3	with building societies				
B28.4	with UK banking sector				
B28.5	with other counterparty				
B28.6	Non-Gilt Repo:				
B28.7	with Other UK sector (non-bank non-b/soc private sector)				
B28.8	with building societies				
B28.9	with UK banking sector				
B28.10	with other counterparty				
B28.11	TOTAL REPO FUNDING				
B29	Liquid asset deposits placed under REVERSE REPO transactions:				
B29.1	Gilt Reverse Repo:				
B29.2	with Other UK sector (non-bank non-b/soc private sector)				
B29.3	with building societies				
B29.4	with UK banking sector				
B29.5	with other counterparty				
B29.6	Non-Gilt Reverse Repo:				
B29.7	with Other UK sector (non-bank non-b/soc private sector)				
B29.8	with building societies				
B29.9	with UK banking sector				
B29.10	with other counterparty				
B29.11	TOTAL DEPOSITS PLACED UNDER REVERSE REPO				
B30	Liquid assets subject to STOCKLENDING transactions:				
B30.1	Gilt Stocklending				
B30.2	Non-Gilt Stocklending				
B30.3	TOTAL STOCKLENDING				

DECLARATION AND RDE NOTIFICATION SHEET

Please complete this sheet for each return and fax to the FSA: 020 7676 3905

Name of Society / Subsidiary:

Section A: Data Transmission

The following return has been successfully transmitted:

1. First transmission
2. Re-transmission #
3. Return Type (i.e. MFS1, TABA, QFS1 etc)
4. Period ending (e.g. Aug-2001)

If a re-transmission, please give brief details below of the changes made, including the specific tables amended:

Section B: Declaration Statement **

I confirm that the information in this form is accurate, has been prepared in accordance with the underlying Guidance Notes, and is complete to the best of my knowledge and belief.

Return completed by:

Name:
Position Held:
Tel No:
Signed: Date:.....

Note: ** Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). [SUP 15.6.1R and SUP 15.6.3R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided.] [SUP 16.3.11R requires an authorised person to submit reports containing all the information required]. [APER 4.4.6E provides that, where an approved person is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of Statement of Principle 4.] [Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA.] It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. [If there is any doubt about the relevance of information, it should be included.]



Name of company

Name of parent society

Statement Completed by:

Name (BLOCK LETTERS):

Position held:

Signature:

Telephone

Address

[Empty box for Name of company]

[Empty box for Name of parent society]

[Empty box for Statement Completed by]

[Empty box for Name (BLOCK LETTERS)]

[Empty box for Position held]

[Empty box for Signature]

Building Society (Company)

Monthly Statement MFS2

FMS number

FSA register number

Month ended

[Empty box for FMS number]

[Empty box for FSA register number]

[Empty box for Month ended]

COMMERCIAL IN CONFIDENCE

Summary of Contents Table

Balance Sheet : Liabilities	B (1)
Balance Sheet : Liabilities (continued)	B(2)
Balance Sheet : Assets	B(3)
Balance Sheet : Assets (continued)	B(4)
Balance Sheet : Assets (continued)	B(5)
Balance Sheet : Assets (continued)	B(6)
Shares	C
Deposits and Debt Securities	D
Liquid assets	E
Loans and Investments	F(1)
Loans and Investments (continued)	F(2)
Interest rates	G

Notes on completion:

- For details of items please refer to the MFS1 Guidance Notes
- If you have any queries please telephone 020-7676-0690 or 0630
- See Introduction, paragraph 7 (iv) of Guidance Notes for treatment of negative values
- Enter amounts throughout in £ thousands
- Show interest rates and percentages to 2 decimal places
- A separate return MFS2 must be completed for each subsidiary undertaking doing "core" business (as defined in paragraph 5 (ii) of Introduction to MFS1 Guidance Notes)
- The statement must be completed monthly and submitted by the advised dates to:

Financial, Risk Analysis and Monitoring Group
 Financial Services Authority
 14th Floor (ROSD)
 25 The North Colonnade
 Canary Wharf
 LONDON E14 5HS

as follows:
 within 7 business days for undertakings of "largest" societies
 within 10 business days for undertakings of "other" societies

MFS2
(V/200598)N2R

B(1) BALANCE SHEET : LIABILITIES

(£000s)

Company:

Month ended:/...../.....

B(1)

	<i>Sterling</i>	<i>Euro</i>	<i>Other currencies</i>	<i>Total</i>
Shares				
B1.1 UK non-bank non b/soc private sector				
B1.2 Non-resident sector				
B1.3 Interest accrued				
B1.4 TOTAL shares				
Deposits and debt securities				
B2.0 Deposits from individuals				
a UK non-bank non b/soc private sector				
b Non-resident sector				
c Interest accrued				
d TOTAL deposits from individuals				
Other deposits				
B2.1 UK non-bank non b/soc private sector (other than B2.3)				
B2.2 a Building society deposit subsidiaries : Soc's own				
b : Other socs'				
B2.3 Building society other subsidiaries : Soc's own				
B2.4 Building societies				
B2.5 a UK banking sector : Bank of England				
b : Other				
UK public sector:				
B2.6 Central government				
B2.7 Local authorities				
B2.8 Public corporations				
B2.9 Non-resident sector				
B2.10 TOTAL other deposits				
Borrowing from banks				
B2.11 UK banking sector				
B2.12 Non-resident sector				
B2.13 TOTAL borrowing from banks				

B2.4 For returns completed for subsidiary undertakings
All loans from parent society should go in B2.4

MFS2
(V/200598)N2R

B(2) BALANCE SHEET : LIABILITIES (continued)

(£000s)

Company:

Month ended:

B(2)

	<i>Sterling</i>	<i>Euro</i>	<i>Other currencies</i>	<i>Total</i>
Debt securities				
B2.14 Certificates of deposit				
B2.15 Commercial paper				
Bonds, notes, other instruments:				
B2.16 Up to 5 years original maturity				
B2.17 Over 5 years original maturity				
B2.18 TOTAL debt securities				
B2.19 Interest accrued				
B2.20 TOTAL deposits and debt securities				
Capital				
B3.1 Reserves				
B3.2 Subscribed capital				
B3.3 Revaluation reserves				
B3.4 Subordinated debt (qualifying)				
B3.5 Other capital				
B3.6 TOTAL capital				
Other liabilities				
B4.1 Income tax				
B4.2 Corporation tax				
B4.3 Interest accrued on capital				
B4.4 Long term insurance liabilities				
B4.5 Other				
B4.6 TOTAL other liabilities				
B4.7 Minority interests				
B5 TOTAL LIABILITIES				
Memorandum items:				
B/ML1 Transit and suspense (liabilities)				
B/ML1a Of which : items in suspense				
B/ML1b : credit items in transmission				

B3.5 For returns completed for subsidiary undertakings only:

*

All capital provided by parent building society should go in

	<i>Sterling</i>	<i>Euro</i>	<i>Other currencies</i>	<i>Total</i>
Liquid assets				
B6.1 Cash (notes & coins)				
B6.2 Deposits with central banks				
a Bank of England (*)				
b Non-resident sector				
c TOTAL Deposits with central banks				
B6.3 Bank deposits				
a UK banking sector (*)				
b Non-resident sector				
c TOTAL Bank deposit				
B6.4 Certificates of deposit				
a Building Societies				
b UK banking sector				
c Non-resident sector				
d TOTAL Certificates of deposit				
B6.5 Other money market instruments				
a Building societies				
b UK banking sector				
c Other UK sector				
d Non-resident sector				
e TOTAL Other money market instruments				
B6.6 Bonds, notes and other capital instruments				
a) up to 5 years original maturity				
a1 Building societies				
a2 UK banking sector				
a3 Non-resident sector				
b) over 5 years original maturity				
b1 Building societies				
b2 UK banking sector				
b3 Non-resident sector				
c) TOTAL Bonds, notes etc				

* B6.2a: See note a) on page B(5)

* B6.3a: See note a) on page B(5)

B(4) BALANCE SHEET : ASSETS (continued)**(£000s)**

Company:

Month ended:/...../..... **B(4)**

	<i>Sterling</i>	<i>Euro</i>	<i>Other currencies</i>	<i>Total</i>
Liquid assets (continued)				
B6.7 Bills				
a UK Treasury				
b UK banking sector				
c TOTAL Bills				
B6.8 Local Authority				
a Temporary debt				
b Long term debt - listed securities				
c Long term debt - other				
d TOTAL Local Authority				
B6.9 Certificates of tax deposit				
B6.10 Mortgage backed securities				
a) up to 5 years original maturity				
a1 Building societies				
a2 UK banking sector				
a3 Other UK sector				
a4 Non-resident sector				
b) over 5 years original maturity				
b1 Building societies				
b2 UK banking sector				
b3 Other UK sector				
b4 Non-resident sector				
c) TOTAL Mortgage backed securities				

MFS2

	<i>Sterling</i>	<i>Euro</i>	<i>Other currencies</i>	<i>Total</i>
Liquid assets (continued)				
B6.11 Sovereign securities				
a) Sovereign debt				
a1 UK government securities				
a2 Overseas government				
b) Sovereign backed or supported by				
b1 UK government				
b2 Overseas government				
c) TOTAL Sovereign securities				
B6.12 Other liquid assets with:				
a Building society sector				
b Other UK sector				
c Non-resident sector				
d TOTAL Other Liquid assets				
B6.13 Interest accrued				
B6.14 TOTAL Liquid assets				
Note a) Of which : non-interest bearing with :				
Bank of England (part of B6.2a)				
OW1.1 Cash ratio deposits				
OW1.2 Other non-interest bearing				
OW1.3 Other UK Banking Sector (part of B6.3a)				
OW1.4 TOTAL non-interest bearing				

	<i>Sterling</i>	<i>Euro</i>	<i>Other currencies</i>	<i>Total</i>
Loans and Investments				
B7.1 Loans fully secured on residential property to:				
a Individuals				
b Housing associations				
c Other				
B7.2 Other loans fully secured on land to:				
a Individuals				
b Housing associations				
c Other				
B7.3 Other loans to customers:				
a Individuals				
b Other				
B7.4 Investments				
B7.5 TOTAL Loans and Investments (Gross)				
B7.6 Provisions				
B7.7 TOTAL Loans and Investments (Net)				= B7.5 - B7.6
B7.8 Analysis of B7.5 by sector:				
a UK public sector				
b UK banking sector				
c Building society sector				
d Other UK private sector				
e Non-resident sector				
B8 Fixed assets				
B9 Long term insurance funds				
B10 Other assets				
B11 TOTAL ASSETS				
Memorandum item:				
B/MA 1 Transit and suspense (assets)				
B/MA 1a Of which : items in suspense				
B/MA 1b : debit items in transmission				

Note: B7.8 should not be completed by companies

C SHARES (excluding accrued interest)

(£000s)

Company: Month ended:/...../..... **C**

	Balance at end of previous month	Receipts	Withdrawals	Interest paid		Interest credited		Other (debits)/credits and transfers (net)	Balance at end of month
				Gross	Other (debits)/credits and transfers (net)	Gross	Other (debits)/credits and transfers (net)		
C1	TOTAL Shares (a)								
C2	Analysis by account type (original maturity):								
C2.1	Instant access (0-7 days)								
C2.2	Notice : 1 month (8-45 days)								
C2.3	2 months (46-75 days)								
C2.4	3 months (76 or more)								
C2.5	Term : Less than 6 months								
C2.6	6 months < 12 months								
C2.7	1 year < 2 years								
C2.8	2 years < 5 years								
C2.9	5 years and over								
C2.10	Contractual : Tessa								
C2.11	Other								
C2.12	Other								
C2.13	TOTAL shares (b)								
C2.14	Of which : ISAs								
.....									
	Balance at end of month								
C3	Shares analysis (sums to C1[9])								
C3.1	Shares held by individuals								
C3.2	Shares held by others								

C4 Large share and deposit holdings (see section C4 of MFSI guidance notes)	Balance at end of month
C4.1 Single holdings in excess of 0.25% SDL (c)	

Note a) Column 9 = Col 1 + Col 2 - Col 3 + Col 6 - Col 7 + Col 8
 b) Column 6 = Col 1 + Col 2 + Col 3 + Col 4 - Col 5

c) SDL here should also exclude accrued interest

D DEPOSITS AND DEBT SECURITIES (excluding accrued interest): Society (£000s)

Company: _____ Month ended:/...../..... **D**

	Balance at end of previous month	Receipts	Withdrawals / Repayments	Interest paid Gross	Tax deducted	Interest credited Gross	Tax deducted	Other (debits)/credits and transfers(net)	Balance at end of month
D1 Deposits and debt securities									
D1.1 Deposits from individuals									
D1.2 Other deposits and debt securities									
D1.3 TOTAL Deposits and debt securities (a)									

= B2.0a + b

a) Column 9 = Col 1 + Col 2 - Col 3 + Col 6 - Col 7 + Col 8

= B2.20 - B2.19 - B2.0c

	Maximum drawn down at any time during month	Position at end of month Drawn down	Undrawn
D2 Committed facilities			
D2.1 Banks			
D2.2 Other sources			
D2.3 All sources	*	**	**

Note: * This will not necessarily be the sum of the 2 boxes above

** This box will be the sum of the 2 boxes above

NB: Large deposit holdings: See Table C(4) for reporting requirements.

F(1) LOANS & INVESTMENTS

(£000's)

Company:

Month ended :/...../.....

F(1)

	Balance at end of previous month	Advances/payments made in month	Interest earned in month	Repayment/realisation of principal	Repayment of interest	Write offs/ depreciation in month	Other debits/(credits) and transfers (net)	Balance at end of month (a)
F1								
	Loans fully secured on residential property (FSRP):							
F1.1								= B7.1a
	Individuals							
F1.2								= B7.1b
	Housing associations							
F1.3								= B7.1c
	Other							
F1.4								
	TOTAL loans FSRP							
F2								
	Other loans fully secured on land (FSOL) :							
F2.1								= B7.2a
	Individuals							
F2.2								= B7.2b
	Housing associations							
F2.3								= B7.2c
	Other							
F2.4								
	TOTAL other loans FSOL							
F3								
	Other loans to customers : individuals.							
F3.1								
	Bridging loans							
F3.2								
	Personal loans							
F3.3								
	Credit cards							
F3.4								
	Overdrafts							
F3.5								
	Other							
F3.6								= B7.3a
	TOTAL other loans to individuals							
F4								
	Other loans to customers : other.							
F4.1								
	Connected undertakings							
F4.2								
	Other							
F4.3								= B7.3b
	TOTAL other loans to customers							
F5								
	Investments							
F5.1								
	Shares in connected undertakings							
F5.2								
	Loans to connected undertakings							
F5.3								
	Other equity shares							
F5.4								= B7.4
	TOTAL Investments							
F6								
	Loans : Analysis of repayments of principal							
F6.1								= F1.1 [4]
	Loans FSRP to individuals							
F6.2								= (F1.2 [4] + F1.3 [4] + F2.4 [4])
	Other loans FSRP and other loans FSOL							
F6.3								
	TOTAL Repayment of principal							
		Regular repayment	On redemption	Other repayment	Total			

Note

a) Column 8 = Col 1 + Col 2 + Col 3 - Col 4 - Col 5 - Col 6 + Col 7

F(2) LOANS AND INVESTMENTS (continued)

(£000s)

Company:

Month ended :/...../.....

F(2)

	<i>Commitments outstanding at end of previous month</i>	<i>Commitments made since end of previous month</i>	<i>Cancellations in month</i>	<i>Advances made in month</i> (b)	<i>Commitments outstanding at end of month</i>
F7 Loan commitments					
F7.1 Loans FSRP to individuals					
F7.2 Loans FSRP to others					
F7.3 Other loans fully secured on land					
F7.4 TOTAL loan commitments (a)					
F8 Numbers of mortgages outstanding	<i>Number at end of month (c)</i>				
F8.1 Mortgages FSRP to individuals					
F8.2 Mortgages FSRP to others					
F8.3 Other mortgages fully secured on land					
F9 Loan book acquisitions (and sales) and loans securitised and/or subject to non-recourse funding	<i>Transactions in month</i>				
	<i>Books acquired</i> (d)	<i>Books sold</i> (e)	<i>Loans securitised</i> (f)	<i>Balance at end month on loan assets subject to non-recourse funding</i> (g)	
F9.1 Loans fully secured on residential properties					
a. Individuals					
b. Housing associations					
c. Other					
d. TOTAL					
F9.2 Other loans fully secured on land					
F9.3 Other loans to customers					
a. Individuals					
b. Others					
c. TOTAL					

Notes a) Column 5 = Col 1 + Col 2 - Col 3 - Col 4

b) Entries here should agree with relevant items in Column 2 of F1 to F2

c) Numbers here relate to corresponding balances shown at B7.1 and B7.2

d) Included within "other debits/(credits)" in main analysis

e) Included within "other debits/(credits)" in main analysis

f) Included within "other debits/(credits)" in main analysis

g) Such assets will be subject to "linked presentation" accounting treatment in the balance sheet. The amount shown here should be "gross assets".

G INTEREST RATES (Gross rates)

(£000s)

Company:

Month ended

	Balances at end of month (a)		Of which at :		Interest rates at end of month (to 2 decimal places)				Date effective (dd/mm)
	TOTAL £000s	Cross references	Fixed rates £000s	Variable rate £000s	Basic rate %	Weighted average nominal rate on all balances %	on balances at fixed rates %	on balances at variable rates %	
G1 Shares		= B1.4							
G2 Deposits and debt securities		= B2.20							
G3 Capital instruments		= B3.2 + B3.4 + B3.5 + B4.3							
G4 Liquidity		= B6.14							
G5 Loans and advances									
Loans FSRP to individuals:									
G5.1 total		= B7.1a							
G5.2 advances in month		= F1.1 [2]							
Other loans FSRP and other loans FSOL:									
G5.3 total		= B7.1b + B7.1c + B7.2a to c							
G5.4 advances in month		= F1.2 [2] + F1.3 [2] + F2.4 [2]							
All loans fully secured on land:									
G5.5 total		= [G5.1 + G5.3]							
G5.6 advances in month		= [G5.2 + G5.4]							
G5.7 Other loans to customers : individuals		= B7.3a							
G5.8 Other loans to customers : other		= B7.3b							
G5.9 OVERALL total balance/average weighted rate on loans above									

Interest rates decided but not implemented at end of month (b)

Basic rate %

New borrowers

Existing borrowers

Notes a) Balances include accrued interest
b) Give the latest known interest rate decisions as of the date of submission of the return. Where a new interest rate has already been implemented for new borrowers before the reporting month ended, please give the effective date.

DECLARATION AND RDE NOTIFICATION SHEET

Please complete this sheet for each return and fax to the FSA: 020 7676 3905

Name of Society / Subsidiary:

Section A: Data Transmission

The following return has been successfully transmitted:

1. First transmission
2. Re-transmission #
3. Return Type (i.e. MFS1, TABA, QFS1 etc)
4. Period ending (e.g. Aug-2001)

If a re-transmission, please give brief details below of the changes made, including the specific tables amended:

Section B: Declaration Statement **

I confirm that the information in this form is accurate, has been prepared in accordance with the underlying Guidance Notes, and is complete to the best of my knowledge and belief.

Return completed by:

Name:
Position Held:
Tel No:
Signed: Date:.....

Note: ** Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). [SUP 15.6.1R and SUP 15.6.3R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided.] [SUP 16.3.11R requires an authorised person to submit reports containing all the information required]. [APER 4.4.6E provides that, where an approved person is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of Statement of Principle 4.] [Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA.] It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. [If there is any doubt about the relevance of information, it should be included.]



**Building Society
Quarterly Statement QFS1**

COMMERCIAL IN CONFIDENCE

FMS number

FSA register number

Quarter ended / /

Society's financial year end / /

Name of society

Statement completed by:
Name (BLOCK CAPITALS)

Position held:

Signature:

Telephone

Address

	Date:

STD Code:	No:	Extn:
-----------	-----	-------

	Post Code :

Summary of Contents covering Society / Subsidiary undertakings / Group

	Table
Balance Sheet	A
Income & Expenditure	B
Income & Expenditure - Further Analysis	C
Capital Available : Own Funds	D
Capital: Solvency Ratio	F
Loans FSRP to Individuals	G(1)
Loans FSRP to Individuals (continued)	G(2)
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Loans secured on land - Further analysis	I
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Lending: Arrears analysis - Subsidiary undertakings	K(2)
Exposure Analysis: Large Exposures	L
Maturity analysis	M
Organisation	N
Investments : By type of activity	P

Notes on completion:

- Updated assessments of "Expected Outturn for CFY/E" and "Likely Outturn" for NFY/E should be prepared each quarter.
- For details of items please refer to Guidance Notes
- If you have any queries please telephone 020-7676-0630 or 0690
- See Introduction, paragraph 8(iv) of Guidance Notes for treatment of negative values
- Enter amounts throughout in £ thousands
- All references to Q4 in this statement are to final quarter of the society's financial year
- Dates entered in column headings of tables should be month number and calendar year eg 12/98
- Internal cross checks are indicated in brackets (=B5), or in footnotes but see also section X of Guidance Notes
- The statement must be completed quarterly and submitted by close on the 18th business day after the society's financial quarter end, to :

Financial, Risk Analysis and Monitoring Unit
Financial Services Authority
14th Floor (ROSD)
25 The North Colonnade
Canary Wharf
LONDON E14 5HS

A BALANCE SHEET : Society and Group

(£000s)

Society: Quarter ended: /

A

	Society			Subsidiary undertakings			Group (consolidated) (b)		
	Actual Outturn LQE = ... /	Expected Outturn (a) CFYE = ... /	Likely Outturn (a) NFYE = ... /	Actual Outturn LQE = ... /	Expected Outturn (a) CFYE = ... /	Likely Outturn (a) NFYE = ... /	Actual Outturn LQE = ... /	Expected Outturn (a) CFYE = ... /	Likely Outturn (a) NFYE = ... /
A1	Liabilities								
A1	Shares								
A2	Deposits and debt securities								
A3	Capital								
A4	Long term insurance liabilities								
A5	Other Liabilities								
A6	Minority interests								
A7	TOTAL LIABILITIES								
	Assets								
A8	Liquid assets								
A9	Loans and Investments								
A9.1	Loans FSRP to individuals								
A9.2	Loans FSRP to others								
A9.3	Other loans fully secured on land								
A9.4	Other loans to customers								
A9.5	Investments								
A9.6	Provisions								
A10	Fixed Assets								
A11	Long term insurance funds								
A12	Other assets								
A13	TOTAL ASSETS								

Operational values of statutory percentages (to 2 decimal places)

Funding : other than shares held by individuals (X-Y as % of X, in Section 7 of the 1986 Act)

Lending : other than fully secured on residential property (X-Y as % of X, in Section 6 of the 1986 Act)

_____ %

_____ %

Notes (a) When return is for Q4 then CFYE is Q4 + 1 year and NFYE is Q4 + 2 years

(b) This will not necessarily be the sum of Society and Subsidiary undertakings columns

QFSI

(V/200598)N2R

B INCOME AND EXPENDITURE : Society and Group (£000s)

Society: _____ Quarter ended:/...../.....

	Society			Subsidiary undertakings			Group (consolidated) (b)		
	Actual Outturn (c) YTD to .../.....	Expected Outturn (a) CFY to.../.....	Likely Outturn (a) NFY to.../.....	Actual Outturn (c) YTD to .../.....	Expected Outturn (a) CFY to.../.....	Likely Outturn (a) NFY to.../.....	Actual Outturn (c) YTD to .../.....	Expected Outturn (a) CFY to.../.....	Likely Outturn (a) NFY to.../.....
B1 Interest receivable									
B2 Interest payable									
B3 Net interest receivable									
B4 Income from investments									
B5 Other income and charges									
B6 Administrative expenses									
B6.1 Staff costs									
B6.2 Other (inc. appointed agents)									
B7 Depreciation and amortisation									
B8 Provisions									
B9 Fixed asset write offs									
B10 Other (please specify in a note) (e)									
B11 Profit/(loss) before tax on ordinary activities									
B12 Tax on profit on ordinary activities									
B13 Profit/(loss) after tax on ordinary activities									
B14 Minority interests									
B15 Extraordinary profit/(loss) after tax									
B16 NET PROFIT/(LOSS)									
B17 Reserves at start of period									
B18 Adjustments to reserves in period									
B19 Reserves at end of period									

Notes
 (a) When return is for Q4 then CFY is Q4 + 1 year, and NFY is Q4 + 2 years
 (c) YTD is cumulative financial year to date (ie end of quarter)
 (e) Show in brackets only if this is an "expense" item

C INCOME AND EXPENDITURE : Further analysis: Society and Group

Society: _____ Quarter ended:/ ...

(£000s)

	Society			Subsidiary undertakings			Group (consolidated) (b)		
	Actual Outturn (c) YTD to .. /.....	Expected Outturn (a) CFY to .. /.....	Likely Outturn (a) NFY to .. /.....	Actual Outturn (c) YTD to .. /.....	Expected Outturn (a) CFY to .. /.....	Likely Outturn (a) NFY to .. /.....	Actual Outturn (c) YTD to .. /.....	Expected Outturn (a) CFY to .. /.....	Likely Outturn (a) NFY to .. /.....
C1 Other income and charges (analysis of B5)									
C1.1 Fees & Commission receivable on:									
a Life insurance & pensions									
b General insurance									
c Other									
d TOTAL Fees & commission receivable									
C1.2 Fees & Commission payable									
C1.3 Net profit/(loss) on financial operations									
C1.4 Other operating income									
C1.5 Other operating charges									
C1.6 TOTAL Other income & charges									
C2 Impact of loan book acquisition and loan incentives/discounts:									
C2.1 Where expenditure is deferred									
a) Balance at start of year *									
b) Amounts added in period									
c) Amounts taken to Income & Expenditure in period									
d) Balance at end of period *									
* as shown in the balance sheet									
C2.2 Where expenditure is NOT deferred									
a) Amounts taken to Income & Expenditure in period									
Notes									

(b) This will not necessarily be the sum of Society and Subsidiary undertakings column

(a) When return is for Q4 then CFYE is Q4 + 1 year and NFYE is Q4 + 2 year:
(c) YTD is cumulative financial year to date (ie end latest quarter).

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CAPITAL AVAILABLE: Own Funds: Society and Group

	Society		Group (consolidated)	
	Actual Outturn at/to LQE = ... /.....	Expected Outturn (a) CFYE =.../.....	Actual Outturn at/to LQE = ... /.....	Expected Outturn (a) CFYE =.../.....
		Likely Outturn (a) NFYE =... /.....		Likely Outturn (a) NFYE =... /.....
D1 TIER I CAPITAL				
D1.1 Reserves at start of year				
D1.2 Interim profits (since start of year) (b)				
D1.3 or Less : overall losses in period				
D1.4 Less : intangible fixed assets				
D1.5 Subscribed capital - deferred shares				
D1.6 PIBS				
D1.6 Others				
D1.7 Minority interests (allowable)				
D1.8 TOTAL TIER I				
D2 TIER II CAPITAL				
D2.1 Revaluation reserves (net) (c)				
D2.2 General provisions for bad debt				
D2.3 Undated subordinated debt				
D2.4 Term subordinated debt				
D2.5 Other tier II				
D2.6 Less : Amounts in excess of Tier II limits				
D2.7 TOTAL TIER II				
D3 DEDUCTIONS from Tier I + Tier II				
D3.1 Deductions not shown elsewhere (d)				
D3.2 Capital deficits in subsidiary undertakings				
D4 CAPITAL AVAILABLE (Own Funds)				

Notes

- (a) When return is for Q4 then CFYE is Q4 + 1 year, and NFYE is Q4 + 2 years
- (b) At Q4 interim profits for LQE means full year profits. At Q1,2 & 3 the figure for LQE is the cumulative year to date amount and may only be included if externally audited.
For CFYE/NFYE interim profits means full year profits and should be shown here.
- (c) Net of any foreseeable tax charge due on realisations
- (d) Capital instruments in other CFIs, deductions in respect of life companies, mortgage indemnity insurance captives, securitisations etc. - [Chapter 1 (Solvency) of Volume 1 of the IPSB for building societies refers].

	Weight	Society		Weighted amounts		Group (consolidated)		Weighted amounts					
		Asset Amount	Actual Outturn LQE = ... /.....	Actual Outturn LQE = ... /.....	Expected Outturn (a) CFYE =.../.....	Likely Outturn (a) NFYE =... /.....	Asset Amount	Actual Outturn LQE = ... /.....	Expected Outturn (a) CFYE =.../.....	Likely Outturn (a) NFYE =... /.....			
On balance sheet items													
F1.1 Liquid assets	at 0%												
F1.2	at 10%												
F1.3	at 20%												
F1.4	at 50%												
F1.5	at 100%												
F2.1 Loans FSRP:	at 50%												
F2.2	at 60%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
F2.3 Loans in arrears	at 75%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
F2.4 Other FSRP	at 100%												
F2.5 Other loans FSOL:	at 50%												
F2.6	at 100%												
F2.7 Investments and Other loans to customers	at 100%												
F3 Fixed assets	at 100%												
F4.1 Other assets	at 0%												
F4.2	at 20 %												
F4.3	at 100%												
F5 TOTAL on balance sheet													
F6 Off balance sheet items													
F6.1 Interest rate contracts													
F6.2 Foreign exchange contracts													
F6.3 Other : Full risk													
F6.4 Medium risk													
F6.5 Medium/Low Risk													
F6.6 Low risk & other items													
F6.7 TOTAL off balance sheet													
F7 Solvency ratio = (D4*100)/(F5+F6.7)													

Notes a) When return is for Q4, then CFYE is Q4 + 1 year, and NFYE is Q4 + 2 years

G(1) LOANS FSRP TO INDIVIDUALS: Society and Subsidiary undertakings

£000's

Society: _____ Quarter ended ://

<i>Society</i>		<i>Gross advances in quarter</i>			<i>Balance outstanding at LQE</i>		
		<i>Number</i>	<i>Amount</i>	<i>at LQE</i>			
G1	By type						
G1.1	Seasoned	N/A	N/A	N/A	N/A	N/A	N/A
G1.2	Traditional	N/A	N/A	N/A	N/A	N/A	N/A
G1.3	Second mortgage	N/A	N/A	N/A	N/A	N/A	N/A
G1.4	Other	N/A	N/A	N/A	N/A	N/A	N/A
G1.5	TOTAL	N/A	N/A	N/A	N/A	N/A	N/A
G2	By purpose						
G2.1	House Purchase: Owner occupation						
G2.2	Buy to let						
G2.3	Further Advance						
G2.4	Remortgage: Own borrowers						
G2.5	From other lenders						
G2.6	Other						
G2.7	TOTAL						

Society
Gross advances in quarter : (amount) by LTV

Society
Gross advances in quarter : (amount) by LTV

	< = 75 %	Over 75 < = 90 %	Over 90 < = 95 %	Over 95 < = 100 %
G3 By income multiple & LTV				
Single income basis				
G3.1 Less than 2.50				
G3.2 2.50 < 3.00				
G3.3 3.00 < 3.50				
G3.4 3.50 or over (a)				
G3.5 SUB TOTAL A				
Joint income basis				
G3.6 Less than 2.00				
G3.7 2.00 < 2.50				
G3.8 2.50 < 2.75				
G3.9 2.75 or over				
G3.10 SUB TOTAL B				
G3.11 TOTAL (A+B) (b)				

Of which:

G4 Insured exposure above 75% LTV	
G4.1 Amount of advances representing the excess above 75% valuation	
G4.2 Amount of this excess covered by Insurance	

Notes (a) Also include here any advances where income was not ascertained (eg non status loans)
 (b) Sum of G3.11 cols 1 to 4 = G2.7 col 2 ; similarly the sum of G3.11 cols 5 to 8 = G2.7 col 5

H LOANS: OTHER FSRP AND OTHER FSOL : Society and Subsidiary undertakings (£000s)

H

Society: _____ Quarter ended:/...../.....

		Society		Subsidiary undertakings	
		Gross advances in quarter Number	Amount	Gross advances in quarter Number	Amount
H1	Type of Property (a)				
H1.1	Housing association				
H1.2	Residential - Development				
H1.3	Residential - Investment				
H1.4	Residential - other				
H1.5	Commercial - Development				
H1.6	Commercial - Investment				
H1.7	Commercial - other				
H1.8	TOTAL				
	Note (a) Commercial includes industrial				(=A9.2 col 1 + A9.3 col 1)

		Society		Subsidiary undertakings	
		Gross advances in quarter Number	Amount	Gross advances in quarter Number	Amount
H2	By size & LTV				
	Size in £ :				
H2.1	Less than 50k				
H2.2	50k < 100k				
H2.3	100k < 250k				
H2.4	250k < 500k				
H2.5	500k < 1 million				
H2.6	1m < 5 million				
H2.7	5m < 10 million				
H2.8	10 million or more				
H2.9	TOTAL (b)				
	Gross advances in quarter : (Amount) by LTV				
	<= 75 %				
	Over 75 <= 90 %				
	Over 90 <= 95 %				
	Over 95 <= 100 %				
	> 100 %				

Note b) Sum of H2.9 Cols 1 to 4 = H1.8 col 2 ; similarly the sum of H2.9 cols 5 to 8 = H1.8 col 5

I ALL LOANS SECURED ON LAND : Further analysis : Society and Subsidiary undertakings (£000's)

Society: _____ Quarter ended :/...../.....

	Society			Subsidiary undertakings		
	Lending in quarter		Balance outstanding	Lending in quarter		Balance outstanding
	Gross advances	Other "advances"	Total "advances"	Gross advances	Other "advances"	Total "advances"
						at LQE
I1	Loans FSRP to individuals only					
	Fixed and capped lending					
I1.1	Fixed rate loans					
I1.2	Capped rate loans					
I1.3	TOTAL Fixed & Capped loans					
	of which :					
I1.4	Weighted average residual maturity to end of fixed/capped period in years (to 2 decimal places)					
I1.5	Discounted variable rate loans					
	of which : weighted average (to 2 decimal places)					
I1.6	Residual maturity (in years)					
I1.7	Cumulative discount (in %)					
I1.8	Nominal discount per annum (in %)					
I2	Loans: other FSRP + other FSOL					
	Fixed and capped lending					
I2.1	Fixed rate loans					
I2.2	Capped rate loans					
I2.3	TOTAL Fixed & Capped loans					
	of which :					
I2.4	Weighted average residual maturity to end of fixed/capped period in years (to 2 decimal places)					
I2.5	Discounted variable rate loans					
	of which : weighted average (to 2 decimal places)					
I2.6	Residual maturity (in years)					
I2.7	Cumulative discount (in %)					
I2.8	Nominal discount per annum (in %)					

	Society		Subsidiary undertakings	
	<i>Loans FSRP to individuals</i>	<i>Loans: other FSRP + other FSOL</i>	<i>Loans FSRP to individuals</i>	<i>Loans: other FSRP + other FSOL</i>
(Period = Latest quarter)	<i>Other loans to customers</i>	<i>Businesses etc</i>	<i>Other loans to customers</i>	<i>Businesses etc</i>
J1 All loans at end period:				
J1.1 Number				
J1.2 Balance outstanding	(=A9.1 col 1)	(=A9.2 col 1 + A9.3 col 1)	(=A9.1 col 4)	(=A9.2 col 4 + A9.3 col 4)
		{ These two columns add to A9.4 col 1 }		{ These two columns add to A9.4 col 4 }
J2 Capitalisation of arrears cases in period (a)				
J2.1 Number of cases				
J2.2 Amount of arrears capitalised				
J2.3 Balance outstanding on these cases				
J3 Properties sold in period (b)				
J3.1 Number of cases sold in period				
J3.2 Balance outstanding on these cases				

Notes: a) Those excluded from table K during period, but included in previous period
 b) Include ALL properties sold in period. For Other loans, J3 refers to those cases where the loan has been written off in the quarter.

Arrears categorisation by type of loan	Cases entering higher (ie more serious) arrears band in quarter (d)			Position on all arrears cases at end of quarter			Performance of current arrears cases during the quarter (e)
	Number	Amount of arrears	Balance outstanding	Number	Amount of arrears	Balance outstanding	
K1 Loans FSRP to individuals (a)							
K1.1 2.5 < 5 %							
K1.2 5.0 < 7.5 %							
K1.3 7.5 < 10 %							
K1.4 10% or more							
K1.5 In possession (b)							
K1.6 TOTAL							
K2 Loans: other FSRP + other FSOL (a)							
K2.1 2.5 < 5 %							
K2.2 5.0 < 7.5 %							
K2.3 7.5 < 10 %							
K2.4 10% or more							
K2.5 In possession (b)							
K2.6 TOTAL							
K3 Other loans to customers (c)							
K3.1 Loans to individuals							
K3.2 Loans to others							

Notes a) Arrears cases are classified according to percentage bandings (eg 2.5 or less than 5%) determined by the amount of arrears on a loan as a percentage of the balance outstanding on the loan.
 b) See Guidance Notes for types of loans included.
 c) On other loans to customers, arrears cases are those as defined in the Guidance Notes.
 d) Refers to those cases entering the higher numeric band during the quarter and still there at the quarter end.
 e) Actual payments received as a percentage of expected payments in last 3 months.

K(2) LENDING: Arrears analysis - Subsidiary undertakings

(£000s)

Society: Quarter ended :// **K(2)**

Arrears categorisation by type of loan	Cases entering higher (ie more serious) arrears band in quarter (d)			Position on all arrears cases at end of quarter			Performance of current arrears cases during the quarter (e) %
	Number	Amount of arrears	Balance outstanding	Number	Amount of arrears	Balance outstanding	
K4 Loans FSRP to individuals (a)							
K4.1 2.5 < 5 %							
K4.2 5.0 < 7.5 %							
K4.3 7.5 < 10 %							
K4.4 10% or more							
K4.5 In possession (b)							
K4.6 TOTAL							
K5 Loans: other FSRP + other FSOL (a)							
K5.1 2.5 < 5 %							
K5.2 5.0 < 7.5 %							
K5.3 7.5 < 10 %							
K5.4 10% or more							
K5.5 In possession (b)							
K5.6 TOTAL							
K6 Other loans to customers (c)							
K6.1 Loans to individuals							
K6.2 Loans to others							

Notes a) Arrears cases are classified according to percentage bandings (eg 2.5 or less than 5%) determined by the amount of arrears on a loan as a percentage of the balance outstanding on the loan.

b) See Guidance Notes for types of loans included.

c) On other loans to customers, arrears cases are those as defined in the Guidance Notes.

d) Refers to those cases entering the higher numeric band during the quarter and still there at the quarter end.

e) Actual payments received as a percentage of expected payments in last 3 months.

QFSI

(V/200598)N2R

L EXPOSURE ANALYSIS: Large exposures - Group (£000s)

Society: L(1)

Quarter ended:/ ...

- List below - first, the 10 largest loan asset exposures (a); and if applicable any others 10% or more of capital (b);
- then, all liquid asset, all connected undertakings and other investments, and all off balance sheet exposures amounting to 10% or more of capital (b)
- and for each of the 4 sets of exposures please rank by descending order of total exposure within each set

Item	Lender Code	Name of counterparty or connected group	Exposure type		TOTAL Exposure	Security Value	Year of Valuation	Specific Provisions	Amount of Arrears
			Class	Code					
1									
2									
3									
4									
5									
6									
7									
8									
9									
10									
11									
12									
13									
14									
15									
16									
17									
18									
19									
20									

Notes a) Loans and advances to customers
 b) Refers to exposures where "Actual Exposure" column is 10% or more of Capital on Group (consolidated) basis.

L EXPOSURE ANALYSIS: Large exposures - Group

(£000s)

Society: Quarter ended:/ ... **L(2)**

(If necessary continue on a copy/copies of this table)

<i>Item</i>	<i>Lender Code</i>	<i>Name of counterparty or connected group</i>	<i>Exposure type Class</i>	<i>Code</i>	<i>Actual Exposure</i>	<i>TOTAL Exposure</i>	<i>Security Value</i>	<i>Year of Valuation</i>	<i>Specific Provisions</i>	<i>Amount of Arrears</i>
21										
22										
23										
24										
25										
26										
27										
28										
29										
30										

L2 SUB TOTAL of all exposures listed (here or on continuation sheets)

L2.1 Loan assets (a): TOTAL of 10 largest (lines 1 to 10)

L2.2 TOTAL of all others listed

L2.3 TOTAL of all listed (L2.1 + L2.2)

L2.4 Of which: TOTAL of exposures marked - Q

L2.5 Liquid assets: TOTAL of exposures marked - Q

L2.6 TOTAL of exposures marked - E

L2.7 Connected undertakings and other investments: TOTAL of exposures marked - Q

L2.8 TOTAL of exposures marked - E

L2.9 Off balance sheet: TOTAL of exposures marked - Q

L2.10 TOTAL of exposures marked - E

Note a) Loans and advances to customers

M MATURITY ANALYSIS (Residual maturity): Society and Group (£000s)

Society: _____ Quarter ended : / ... **M**

Society : Amount repayable (without penalty) at LQE

Up to 8 days 9 days < 1 mth 1 mth < 3 mth 3 mth < 1 yr 1 yr or more

Group : Amount repayable (without penalty) at LQE

Up to 8 days 9 days < 1 mth 1 mth < 3 mth 3 mth < 1 yr 1 yr or more

	<i>Up to 8 days</i>	<i>9 days < 1 mth</i>	<i>1 mth < 3 mth</i>	<i>3 mth < 1 yr</i>	<i>1 yr or more</i>	<i>Up to 8 days</i>	<i>9 days < 1 mth</i>	<i>1 mth < 3 mth</i>	<i>3 mth < 1 yr</i>	<i>1 yr or more</i>
M1 Shares (a)										
M1.1 Instant access a/cs										
M1.2 Notice a/cs										
M1.3 Term a/cs										
M1.4 Contractual a/cs										
M1.5 Other a/cs										
M1.6 TOTAL shares										
M2 Deposits and debt securities (a)										
M2.1 Deposits										
M2.2 Borrowing from banks										
M2.3 CDs										
M2.4 Commercial paper										
M2.5 Other debt securities										
M2.6 TOTAL deposits & debt securities										
M3 Liquid assets (a)										
M3.1 Cash										
M3.2 Bank deposits										
M3.3 CDs										
M3.4 Other money market instruments										
M3.5 Marketable securities										
M3.6 Other										
M3.7 TOTAL liquid assets										
M4 Committed facilities available										

Note a) Excluding accrued interest

QFS1
(V/200598)N2R

	Society		Subsidiary undertakings		Group	
	Actual position LQE =.../.....	Expected position (a) CFYE =.../.....	Actual position LQE =.../.....	Expected position (a) CFYE =.../.....	Actual position LQE =.../.....	Expected position (a) CFYE =.../.....
Number of staff at end of period						
N1 TOTAL Staff (full time equivalent) (b)						
Of which :						
N1.1 Staff at branch offices						
N1.2 Staff at estate agency offices						
Number of offices						
N2 Branch offices staffed by employees (c)						
N3 Estate agency offices						
N3.1 As part of a society branch office						
N3.2 Independent offices						
N3.3 TOTAL Estate agency offices						
N4 Appointed agents						
N5 Number of members and creditors						
N5.1 Shareholding members						
N5.2 Borrowing members						
N5.3 Creditors for deposits						

Notes a) When return is for Q4 then CFYE is Q4 + 1 year
 b) Staff should be stated as actual number at end period (counting part time staff as half a unit)
 c) Include any "branch" at Head Office site. For some societies this may be the only branch. A zero entry is therefore not applicable.

P INVESTMENTS (f): By type of activity

(£000s)

Society:

Quarter ended :/...../.....

Activity type	All investments		Subsidiary undertakings (SUs)				Staff employed (FTE)			All investments		
	Amount of society's		Profit/(loss) before tax attributable to society				Actual			Income attributable to:		
	Investments in at LQE	Other loans to at LQE	C/ NC (a)	Actual Outturn YTD =.../9..	Expected Outturn (b) CFY=.../9..	Likely Outturn (b) NFY =.../9..	Actual at LQE	Expected at (b) CFYE=.../9..	Society Outturn YTD	Group Outturn YTD		
P1-9 Subsidiary undertakings & participating interests												
P1.1 Deposit taking : UK operation												
P1.2 Non UK operation												
P2.1 Lending: UK operation												
P2.2 Non UK operation												
P2.3 Unsecured lending												
P2.4 Loan admin for 3rd parties												
P3.1 Housing: Development/Rental												
P3.2 Association/Trust												
P4.1 Insurance: Life												
P4.2 General												
P5 Financial Services												
P6 Estate Agency												
P7 Money transmission												
P8 Society support operations												
P9 Other :												
P10 Other investments (c)												
P11 TOTALS												
P12.1 TOTALS: Undertakings included in table B (d)												
P12.2 Amounts attributable to Minority interest (e)												
P13 TOTALS: Other bodies (sum of all entries marked NC in Col 3)												

Notes a) CNC : enter C or NC to indicate whether profit figures included in table B, where C = included (consolidated), and NC = excluded (not consolidated)

b) When return is for Q4, then CFY/CFYE is Q4 + 1 year, and NFY is Q4 + 2 years.

c) Investments which are neither subsidiary undertakings nor participating interests eg LINK, BACS etc (trade investments) and equity shares.

(d) That is undertakings for which a 'C' entry is made in column 3

(e) Total of P12.1 and P12.2 should agree with corresponding columns of B11 in table B.

(f) Also covers "other loans" in column 2.

QUARTERLY STATEMENT

QFS1: SUMMARY OF CROSS CHECKS

A) Cross checks within QFS1

C1.6	all cols	=	B5	corres cols	Total other income & charges	[Soc/Subs/Group]
D1.1 + D1.2 + D1.5 + D1.6 + D2.1 + D2.3 + D2.4 + D2.5	all cols	<=	A3	cols 1-3, 7-9	Capital	[Soc/Group]
F1.1 + F1.2 + F1.3 + F1.4 + F1.5	cols 1 and 5	=	A8	cols 1 and 7	Liquid Assets	[Soc/Group]
F2.5 + F2.6	cols 1 and 5	>=	A9.3	cols 1 and 7	Other loans FSOL	[Soc/Group]
F2.7	cols 1 and 5	>=	A9.4 + A9.5	cols 1 and 7	Investments and Other loans to customers	[Soc/Group]
F3	cols 1 and 5	=	A10	cols 1 and 7	Fixed Assets	[Soc/Group]
F4.1 + F4.2 + F4.3	cols 1 and 5	=	A11	cols 1 and 7	Other Assets	[Soc/Group]
F4.1 + F4.2 + F4.3	cols 1 and 5	=	A11 + A12	cols 1 and 7	Other Assets	[Soc/Group]
G1.5	col 3	=	A9.1	col 1	Loans FSRP	[Society]
G1.5	col 6	=	A9.1	col 4	Loans FSRP	[Subs]
G2.7	cols 1, 2, 4 and 5	=	G1.5	corres cols	Total FSRP (no/amount)	[Society/Subs]
G3.11	agg cols 1 to 4	=	G1.5	col 2	FSRP lending (amount)	[Society]
G3.11	agg cols 5 to 8	=	G1.5	col 5	FSRP lending (amount)	[Subs]
H1.8	col 3	=	A9.2 + A9.3	col 1	Other FSRP and other FSOL assets	[Society]
H1.8	col 6	=	A9.2 + A9.3	col 4	Other FSRP and other FSOL assets	[Subs]
H2.9	agg cols 1 to 4	=	H1.8	col 2	Other FSRP and other FSOL lending	[Society]
H2.9	agg cols 5 to 8	=	H1.8	col 5	Other FSRP and other FSOL lending	[Subs]
J1.2	col 1	=	A9.1	col 1	FSRP to individuals	[Society]
J1.2	col 2	=	A9.2 and A9.3	col 1	Other FSRP and other FSOL	[Society]
J1.2	col 3 and 4	=	A9.4	col 1	Other loans to customers	[Society]
J1.2	col 5	=	A9.1	col 4	FSRP to individuals	[Subs]
J1.2	col 6	=	A9.2 and A9.3	col 4	Other FSRP and other FSOL	[Subs]
J1.2	col 7 and 8	=	A9.4	col 4	Other loans to customers	[Subs]
L	Total Capital	=	D4	col 4	Capital	[Group]
M	[see note (a)]					
P11	col 1	=	A9.5	col 1	Investments	[Society]
P12.1 + P12.2	cols 4, 5 and 6	=	B11	corres cols	Profit/(loss) before tax	[Subs]
P12.1	cols 7 and 8	=	N1	cols 3 and 4	Subsidiary undertakings : staff numbers	[Subs]
P11	col 9	=	B4	col 1	Income from subsidiary undertakings	[Society]
P11	col 10	=	B4	col 7	Income from subsidiary undertakings	[Group]

A) Cross checks with MFS1

J1.1	col 1	=	F8.1	col 1	Number of FSRP loans
J1.1	col 3	=	F8.3	col 1	Number of FSOL loans

a) The aggregate of amounts repayable at line M1.6, M2.6 and M3.7 are not directly comparable with the corresponding items in the balance sheet, by virtue of accrued interest, which has been excluded from the figures in table M.

N.B. The cross checks on Tables D to A and F to A will not apply to those society's for whom "solo consolidation" and "exclusion from consolidation" apply.

DECLARATION AND RDE NOTIFICATION SHEET

Please complete this sheet for each return and fax to the FSA: 020 7676 3905

Name of Society / Subsidiary:

Section A: Data Transmission

The following return has been successfully transmitted:

1. First transmission
2. Re-transmission #
3. Return Type (i.e. MFS1, TABA, QFS1 etc)
4. Period ending (e.g. Aug-2001)

If a re-transmission, please give brief details below of the changes made, including the specific tables amended:

Section B: Declaration Statement **

I confirm that the information in this form is accurate, has been prepared in accordance with the underlying Guidance Notes, and is complete to the best of my knowledge and belief.

Return completed by:

Name:
Position Held:
Tel No:
Signed: Date:.....

Note: ** Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). [SUP 15.6.1R and SUP 15.6.3R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided.] [SUP 16.3.11R requires an authorised person to submit reports containing all the information required]. [APER 4.4.6E provides that, where an approved person is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of Statement of Principle 4.] [Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA.] It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. [If there is any doubt about the relevance of information, it should be included.]



Building Society Quarterly Statement QFS2

COMMERCIAL IN CONFIDENCE

FMS number

FSA register number

Calendar quarter ending /

Society's financial year end /

Name of society

Statement Completed by:

Name (BLOCK LETTERS):

Position held:

Signature:

Telephone

STD Code: No: Extn:

Address

Post Code:

Notes on completion:

- The statement covers "society only" figures
- This statement should only be completed by those societies required to complete the MFS1 return to the faster timetable.
- For details of items please refer to Guidance Notes
- If you have any queries please telephone 020-7676-0630 or 0690
- Enter amounts to the nearest £million (omitting £000,000s)
- Enter negative values in brackets ()
- Amounts cross referenced to line items in the MFS1 return should, after rounding, agree with those entered on the society's corresponding monthly return coinciding with the calendar quarter end.
- This statement must be completed as at the end of March, June, September and December, and submitted by close on the 11th business day after the calendar quarter end to :

Statement summary :

Page	Summary of Contents	Table
1	Sectorisation of Selected Liabilities	A
2	Sectorisation of Loans and Investments	B
3	Residual Maturity Analysis of Gilts	C
4	Derivative Contracts	D

Financial, Risk Analysis and Monitoring Unit
 Financial Services Authority
 14th Floor (ROSD)
 25 The North Colonnade
 Canary Wharf
 LONDON E14 5HS

A BALANCE SHEET: Sectorisation of Selected Liabilities: Society (£ million)

Society

Quarter ended :/...../.....

	Shares			Deposits				
	MFSI line item	Sterling	Euro	Other currencies	MFSI line item	Sterling	Euro	Other currencies
A1 OTHER UK SECTOR (UK non-bank non-b/soc private sector)								
A1.0 Money market mutual funds								
A1.1 Financial corporations								
a) Insurance companies								
b) Pension funds								
c) Financial auxiliaries								
d) Financial U.L. partnerships*								
e) Other institutions								
A1.2 Non-financial corporations								
a) Non-financial U.L. partnerships*								
b) Other non-financial corporations								
A1.3 Individuals and individual trusts								
A1.4 Unincorporated businesses								
A1.5 Non-profit institutions serving households								
A1.6 TOTAL OTHER UK SECTOR	B1.1				B2.0a + B2.1 + B2.3			

* U.L. means unlimited liability.

B BALANCE SHEET: Sectorisation of Loans and Investments (Gross) : Society (£ million)

Society:

Quarter ended :...../..... 2

	Loans fully secured on Residential Property		Other loans fully secured on land		Investments and Other Loans to Customers			TOTAL			
	Sterling		Sterling		Investments (Equities)			Loans and Investments (Gross)			
	Euro and Other currencies	Euro and Other currencies	Euro and Other currencies	Euro and Other currencies	Sterling	Euro and Other currencies	Sterling	Euro and Other currencies	Sterling	Euro and Other currencies	
B1 OTHER UK SECTOR (UK non-bank B/soc private sector)											
B1.0 Money market mutual funds											
B1.1 Financial corporations											
a) Insurance companies											
b) Pension funds											
c) Financial auxiliaries											
d) Financial U.L. partnerships*											
e) Other institutions											
B1.2 Non-financial corporations											
a) Non-financial U.L. partnerships*											
b) Other non-financial corporations											
B1.3 Individuals and individual trusts											
B1.4 Unincorporated businesses											
B1.5 Non-profit institutions serving households											
B1.6 TOTAL OTHER UK SECTOR											
B2 NON-RESIDENT SECTOR											
B2.1 Direct investment											
B2.2 Other											
B2.3 TOTAL NON-RESIDENT SECTOR											

MFSI Cross reference : The amounts shown in the final 2 columns here should agree with corresponding items in MFS1 as follows

B1.6 should agree with MFSI item B7.8d

B2.3 should agree with MFSI item B7.8e

* U.L. means unlimited liability.

	<i>Balance at end previous quarter (book value)</i> <i>(a)</i>	<i>Purchases in quarter</i> <i>(b)</i>	<i>Realisations in quarter</i> <i>(c)</i>	<i>Other debit/(credit) (net) in quarter</i> <i>(d)</i>	<i>Balances at end quarter Book value basis</i> <i>(a)+(b)-(c)+(d)</i>	<i>Market value basis</i>
C1 Index linked						
C1.1 Up to 1 year						
C1.2 Over 1 and up to 3 years						
C1.3 Over 3 years and up to 7 years						
C1.4 Over 7 years or undated						
C2 Other						
C2.1 Up to 1 year						
C2.2 Over 1 and up to 3 years						
C2.3 Over 3 years and up to 7 years						
C2.4 Over 7 years or undated						
C3 TOTAL UK Government securities						

MFS1 line item cross reference B6.11 al (sterling)

B6.11 al (sterling)

Notes

* Includes the effect of holdings passing from one maturity band to the next during the quarter

	<i>Sterling</i>	<i>Euro</i>	<i>Other currencies</i>	<i>TOTAL</i>
D.1 TOTAL NOTIONAL DERIVATIVE CONTRACTS				
D1.1 Interest rate products				
D1.2 Foreign exchange products				
D1.3 Other products				
D1.4 Total notional derivatives contracts				
D.2 TOTAL MARKET VALUE OF DERIVATIVE CONTRACTS				
D2.1 Gross assets				
D2.2 Gross liabilities				
D2.3 Total net derivatives position				
D.3 NET TRANSACTIONS IN DERIVATIVE CONTRACTS				
Transactions with ALL counterparties				
D3.1 a) Interest rate swaps				
D3.2 b) FRAs				
D3.3 c) Other				
D3.4 Total transactions with all counterparties				
Of which :				
transactions with NON-RESIDENT counterparties				
D4.1 a) Interest rate swaps				
D4.2 b) FRAs				
D4.3 c) Other				
D4.4 Total transactions with non-resident counterparties				

DECLARATION AND RDE NOTIFICATION SHEET

Please complete this sheet for each return and fax to the FSA: 020 7676 3905

Name of Society / Subsidiary:

Section A: Data Transmission

The following return has been successfully transmitted:

1. First transmission
2. Re-transmission #
3. Return Type (i.e. MFS1, TABA, QFS1 etc)
4. Period ending (e.g. Aug-2001)

If a re-transmission, please give brief details below of the changes made, including the specific tables amended:

Section B: Declaration Statement **

I confirm that the information in this form is accurate, has been prepared in accordance with the underlying Guidance Notes, and is complete to the best of my knowledge and belief.

Return completed by:

Name:
Position Held:
Tel No:
Signed: Date:.....

Note: ** Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). [SUP 15.6.1R and SUP 15.6.3R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided.] [SUP 16.3.11R requires an authorised person to submit reports containing all the information required]. [APER 4.4.6E provides that, where an approved person is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of Statement of Principle 4.] [Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA.] It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. [If there is any doubt about the relevance of information, it should be included.]



COMMERCIAL IN CONFIDENCE

Building Society

FMS number:

FSA register number:

Annual Statement AFS1

Financial year ended:

Name of Society

Statement completed by:

Name (BLOCK CAPITALS)

Position held

Signature

Date:

Telephone:

STD Code:

No:

Extn:

Address:

Post Code:

Summary of Contents:

	Table
Balance Sheet	A
Income & Expenditure	B
Miscellaneous	C
Diversification	F
Selected business volumes	G

Notes on completion:

- For details of items please refer to Guidance Notes
- If you have any queries please telephone 020-7676-0630 or 0690
- See Introduction, paragraph 8 (iii) of Guidance Notes for treatment of negative values
- Enter amounts throughout in £ thousands
- The statement must be completed annually and submitted within 2 months of financial year end to:

Financial, Risk Analysis and Monitoring Unit
Financial Services Authority
14th Floor (ROSD)
25 The North Colonnade
Canary Wharf
LONDON E14 5HS

A(1) BALANCE SHEET: LIABILITIES (£000s)

Society :

FYE: /

A(1)

Outturn for financial year

	Society	Subsidiary Undertakings	Group (consolidated)
A1 Shares			
A1.1 Shares held by individuals	_____	_____	_____
A1.2 Other shares	_____	_____	_____
A1.3 TOTAL Shares	<input type="text"/>	<input type="text"/>	<input type="text"/>
A2 Deposits and debt securities			
A2.1 Amounts owed to credit institutions	_____	_____	_____
A2.2 Amounts owed to other customers	_____	_____	_____
A2.3 Debt securities in issue			
a Certificates of deposit	_____	_____	_____
b Fixed and floating rate notes	_____	_____	_____
c Other	_____	_____	_____
A2.4 TOTAL Deposits and debt securities	<input type="text"/>	<input type="text"/>	<input type="text"/>
A3 Other liabilities			
A3.1 Income tax	_____	_____	_____
A3.2 Corporation tax	_____	_____	_____
A3.3 Long term insurance	_____	_____	_____
A3.4 Other creditors	_____	_____	_____
A4 Accruals and deferred income	_____	_____	_____
A5 Provisions for liabilities and charges			
A5.1 For pensions and similar obligations	_____	_____	_____
A5.2 For tax	_____	_____	_____
A5.3 Other	_____	_____	_____
A6 Subordinated liabilities	_____	_____	_____
A7 Subscribed capital	_____	_____	_____
A8 Revaluation reserve	_____	_____	_____
A9 Reserves			
A9.1 General reserves	_____	_____	_____
A9.2 Other reserves	_____	_____	_____
A10 Minority interests	_____	_____	_____
A11 TOTAL LIABILITIES	<input type="text"/>	<input type="text"/>	<input type="text"/>
MEMORANDUM ITEMS			
A12 Contingent liabilities			
A12.1 Acceptances and endorsements	_____	_____	_____
A12.2 Guarantees and assets pledged as collateral security	_____	_____	_____
A12.3 Other contingent liabilities	_____	_____	_____
A12.4 TOTAL contingent liabilities	<input type="text"/>	<input type="text"/>	<input type="text"/>
A13 Commitments			
A13.1 Arising out of sale and repurchase transactions	_____	_____	_____
A13.2 Other commitments	_____	_____	_____
A13.3 TOTAL committments	<input type="text"/>	<input type="text"/>	<input type="text"/>

(V/200598)N2R

afsp2.xls

AFS1 : A(1)

A(2) BALANCE SHEET: ASSETS (£000s)

Society :

FYE: /

A(2)

Outturn for financial year

		Society	Subsidiary Undertakings	Group (consolidated)
A21	Liquid assets			
A21.1	Cash in hand and balances with Bank of England	_____	_____	_____
A21.2	Treasury and other eligible bills	_____	_____	_____
A21.3	Loans and advances to credit institutions	_____	_____	_____
A21.4	Debt securities			
A21.4a	Issued by public bodies	_____	_____	_____
A21.4b	Issued by other borrowers	_____	_____	_____
A21.5	Other liquid assets	_____	_____	_____
A21.6	TOTAL Liquid assets	<input type="text"/>	<input type="text"/>	<input type="text"/>
Loans				
A22	Loans fully secured on residential property to:			
A22.1	Individuals	_____	_____	_____
A22.2	Housing associations	_____	_____	_____
A22.3	Others	_____	_____	_____
A22.4	TOTAL Loans FSRP	<input type="text"/>	<input type="text"/>	<input type="text"/>
A23	Other loans fully secured on land to:			
A23.1	Individuals	_____	_____	_____
A23.2	Housing associations	_____	_____	_____
A23.3	Others	_____	_____	_____
A23.4	TOTAL Other Loans FSOL	<input type="text"/>	<input type="text"/>	<input type="text"/>
A24	Other loans to customers			
A24.1	Individuals	_____	_____	_____
A24.2	Others	_____	_____	_____
A24.3	TOTAL Other loans to customers	<input type="text"/>	<input type="text"/>	<input type="text"/>
A25	Investments			
A25.1	In equity shares	_____	_____	_____
A25.2	In unconsolidated subsidiary undertakings	_____	_____	_____
A25.3	In consolidated subsidiary undertakings	_____	_____	_____
A25.4	In associated undertakings	_____	_____	_____
A25.5	In other participating interests	_____	_____	_____
A25.6	Other investments	_____	_____	_____
A25.7	TOTAL Investments	<input type="text"/>	<input type="text"/>	<input type="text"/>

(continued)

A(3) BALANCE SHEET: ASSETS (continued) (£000s)

Society :

FYE: /

Outturn for financial year

	Society	Subsidiary Undertakings	Group (consolidated)
A26 Intangible fixed assets	_____	_____	_____
A27 Tangible fixed assets			
A27.1 Land and buildings	_____	_____	_____
A27.2 Plant and machinery	_____	_____	_____
A27.3 Equipment, fixtures, fittings & vehicles	_____	_____	_____
A27.4 Payments on account & assets in course of construction	_____	_____	_____
A28.1 Long term insurance funds			
A28.2 Other assets	_____	_____	_____
A29 Prepayments and accrued income	_____	_____	_____
A30 TOTAL ASSETS	<input type="text"/>	<input type="text"/>	<input type="text"/>

MEMORANDUM ITEMS :

**PRIOR YEAR END BALANCES (i.e balances one year prior
to financial year end reported in A1 to A30 above)**

A31 TOTAL Assets	_____	_____	_____
A32 Shares	_____	_____	_____
A33 Deposits and debt securities	_____	_____	_____
A34 Capital			
a) Subordinated liabilities	_____	_____	_____
b) Subscribed capital	_____	_____	_____
c) Revaluation reserves	_____	_____	_____
Reserves:			
d) General reserves	_____	_____	_____
e) Other reserves	_____	_____	_____
f) TOTAL Capital (= a + b + c + d + e)	<input type="text"/>	<input type="text"/>	<input type="text"/>
A35 Loans fully secured on residential property	_____	_____	_____
A36 Other loans fully secured on land	_____	_____	_____
A37 Other loans to customers	_____	_____	_____

A(4) BALANCE SHEET: PROVISIONS (£000s)

Society :

FYE: /

A(4)

Outturn for financial year

			Provisions balance at start of year	Write offs in year	Provisions charge for year (a)	Provisions balance at end of year (b)
Asset categories: Society						
A41.1	Loans FSRP:	Individuals				
A41.2		Housing associations				
A41.3		Other				
A42.1	Other loans FSOL:	Individuals				
A42.2		Housing associations				
A42.3		Other				
A43.1	Other loans to customers:	Individuals				
A43.2		Others				
A44	Investments					
A45	TOTAL:	Society				
A46	of which: charges in column 3 not included in B8					
Asset categories: Subsidiary undertakings						
A51.1	Loans FSRP:	Individuals				
A51.2		Housing associations				
A51.3		Other				
A52.1	Other loans FSOL:	Individuals				
A52.2		Housing associations				
A52.3		Other				
A53.1	Other loans to customers:	Individuals				
A53.2		Others				
A54	Investments					
A55	TOTAL:	Subsidiary undertakings				
A56	of which: charges in column 3 not included in B8					
Asset categories: Group (consolidated)						
A61.1	Loans FSRP:	Individuals				
A61.2		Housing associations				
A61.3		Other				
A62.1	Other loans FSOL:	Individuals				
A62.2		Housing associations				
A62.3		Other				
A63.1	Other loans to customers:	Individuals				
A63.2		Others				
A64	Investments					
A65	TOTAL:	Group				
A66	of which: charges in column 3 not included in B8					

Notes a) Charged within the income and expenditure account
 b) Column 4= Column1 - Column 2 + Column 3

B(1) INCOME AND EXPENDITURE (£000s)

Society :

FYE: /.....

B(1)

Outturn for financial year

	Society	Subsidiary Undertakings	Group (consolidated)
B1 Interest receivable and similar income:			
a) On loans fully secured on residential property	_____	_____	_____
b) On other loans	_____	_____	_____
c) On debt securities	_____	_____	_____
d) On other liquid assets	_____	_____	_____
e) Other interest receivable and similar income	_____	_____	_____
f) TOTAL interest receivable and similar income	<input type="text"/>	<input type="text"/>	<input type="text"/>
B2 Interest payable and similar charges:			
a) On shares held by individuals	_____	_____	_____
b) On other shares	_____	_____	_____
c) On subscribed capital	_____	_____	_____
d) On deposits and other borrowings	_____	_____	_____
e) Other interest payable and similar charges	_____	_____	_____
f) TOTAL interest payable and similar charges	<input type="text"/>	<input type="text"/>	<input type="text"/>
B3 Net interest receivable	<input type="text"/>	<input type="text"/>	<input type="text"/>
B4 Income from investments:			
a) From equity shares	_____	_____	_____
b) From shares in unconsolidated subsidiary undertakings	_____	_____	_____
c) From shares in consolidated subsidiary undertakings	_____	_____	_____
d) From interests in associated undertakings	_____	_____	_____
e) From other participating interests	_____	_____	_____
f) From other investments	_____	_____	_____
g) TOTAL income from investments	<input type="text"/>	<input type="text"/>	<input type="text"/>
B5 Other income and charges:			
a) Fees and commissions receivable	_____	_____	_____
b) Fees and commissions payable	_____	_____	_____
c) Net profit/(loss) on financial operations	_____	_____	_____
d) Other operating income	_____	_____	_____
e) Other operating charges	_____	_____	_____
f) TOTAL other income & charges (= a - b + c + d - e)	<input type="text"/>	<input type="text"/>	<input type="text"/>
B6 Administrative expenses			
a) Staff costs	_____	_____	_____
b) Auditors remuneration : on audit work	_____	_____	_____
c) Auditors remuneration : on other work	_____	_____	_____
d) Other administrative expenses	_____	_____	_____
e) TOTAL administrative expenses	<input type="text"/>	<input type="text"/>	<input type="text"/>

B(2) INCOME AND EXPENDITURE (continued) (£000s)

Society :

FYE: /

Outturn for financial year

	Society	Subsidiary Undertakings	Group (consolidated)
B7 Depreciation and amortisation	_____	_____	_____
B8 Provisions for bad and doubtful debts	_____	_____	_____
B9 Provisions for contingent liabilities and commitments	_____	_____	_____
B10 Amounts written off fixed asset investments	_____	_____	_____
B11 Profit/(loss) on ordinary activities before tax (a)	<input type="text"/>	<input type="text"/>	<input type="text"/>
B12 Tax on profit/(loss) on ordinary activities	_____	_____	_____
B13 Profit/(loss) on ordinary activities after tax (= B11 - B12)	<input type="text"/>	<input type="text"/>	<input type="text"/>
B14 Minority interests	_____	_____	_____
B15 Profit/(loss) before extraordinary items (= B13 - B14)	<input type="text"/>	<input type="text"/>	<input type="text"/>
B16 Extraordinary income	_____	_____	_____
B17 Extraordinary charges	_____	_____	_____
B18 Extraordinary Profit/(loss) before tax (= B16 - B17)	<input type="text"/>	<input type="text"/>	<input type="text"/>
B19 Tax on extraordinary profit/(loss)	_____	_____	_____
B20 Extraordinary profit/(loss) after tax (= B18 - B19)	<input type="text"/>	<input type="text"/>	<input type="text"/>
B21 Minority interests in extraordinary profit/(loss) after tax	_____	_____	_____
B22 Other taxes not shown under preceding items	_____	_____	_____
B23 PROFIT/(LOSS) for the financial year (b)	<input type="text"/>	<input type="text"/>	<input type="text"/>

MEMORANDUM ITEM :

B24 Amount of interest suspended on loan assets
(ie. interest not charged to B1 on arrears cases and on
possession cases) during the year

Notes a) B11 = B3 + B4(g) + B5(f) - B6(d) - B7 - B8 - B9 - B10

b) B23 = B15 + B20 - B21 - B22

Outturn for financial year

*Group
(consolidated)*

C1 Operational value of statutory percentages (to 2 decimal places)

C1.1 Funding : other than shares held by individuals (X-Y as % of X, in Section 7 of the 1986 Act) _____

C1.2 Lending : other than fully secured on residential property (X-Y as % of X, in Section 6 of the 1986 Act) _____

<u>Society</u>			<u>Group (consolidated)</u>		
<i>Book Premia</i>	<i>Loan incentives</i>	<i>Loan discounts</i>	<i>Book Premia</i>	<i>Loan incentives</i>	<i>Loan discounts</i>

C2 Impact of loan book acquisition and loan incentives/discounts

C2.1 Where expenditure is deferred

a) Balance at start of year *	_____	_____	_____	_____	_____
b) Amounts added in period	_____	_____	_____	_____	_____
c) Amounts taken to Income & Expenditure in period:					
1) to net interest receivable	_____	_____	_____	_____	_____
2) to other income & expenditure items	_____	_____	_____	_____	_____
d) Balance at end of period *	_____	_____	_____	_____	_____

* as shown in the balance sheet

C2.2 Where expenditure is NOT deferred

a) Amounts taken to Income & Expenditure in period:				
1) to net interest receivable	_____	_____	_____	_____
2) to other income & expenditure items	_____	_____	_____	_____

F(1): DIVERSIFICATION

(Enter Y for "Yes" in box if the activity is undertaken, otherwise leave blank)

Society:

FYE:...../

F(1)

Undertaken by

Society

Connected undertaking

Subsidiary
undertaking

Other

F1 Banking Services

F1.1 Arranging :

- a) Taking of deposits
- b) Lending of money
- c) Hire purchase & leasing
- d) Guarantees
- e) Foreign exchange services

F1.2 Directly provided:

- a) Current accounts
- b) Cheque guarantee cards
- c) Debit cards
- d) ATMs
- e) Foreign exchange services
- f) Credit cards
- g) Personal loans
- h) Overdrafts
- i) Bridging loans
- j) Hire purchase & leasing
- k) Administrative / Registration of shares issues / transfers
- l) Advice on taxation or financial planning

F2 Investment services

F2.1 Arranging:

- a) Stockbroking
- b) Management of investments

F2.2 Directly provided:

- a) Stockbroking
- b) Portfolio management
- c) Nominee services
- d) Fund management of:
 - d1 Pension schemes
 - d2 PEPS
 - d3 Unit trusts
 - d4 Investment trust companies
 - d5 Other (including BES)
- e) Investment advice

(Enter Y for "Yes" in box if the activity is undertaken, otherwise leave blank)

Undertaken by

Society

Connected undertaking

Subsidiary
undertaking

Other

F3 Insurance Services

F3.1 Arranging :

a) General insurance

b) Life insurance

F3.2 Directly provided:

a) General insurance underwriting

b) Life insurance underwriting

F4 Trusteeship

F4.1 Directly provided:

a) Charitable trusts

b) Trusts for individuals

F5 Executorship

F5.1 Directly provided:

a) Arranging wills

b) Executors for wills

c) Administrators for estates

F6 Land Services

F6.1 Directly provided:

a) Estate Agency

b) Removal and storage of furniture

c) Surveys and valuation

d) Management of land

e) Development of land

f) Conveyancing

G(1): SELECTED BUSINESS VOLUMES

Society:	FYE:/
----------	-------------------

G(1)

(Amount in £000s)		Outturn for financial year					
		Society		Subsidiary undertakings		Participating interests	
		Number	Amount	Number	Amount	Number	Amount
G1	Money transmission: (*)						
	(a) Current Accounts	_____	_____	_____	_____	_____	_____
	(b) Guarantee cards	_____	_____	_____	_____	_____	_____
	(c) Debit cards	_____	_____	_____	_____	_____	_____
	(d) ATMs	_____	_____	_____	_____	_____	_____
G2	Lending:						
	Advances in period						
G2.1	Fully secured on residential property to:						
	(a) Individuals	_____	_____	_____	_____	_____	_____
	(b) Housing associations	_____	_____	_____	_____	_____	_____
	(c) Others	_____	_____	_____	_____	_____	_____
	(d) TOTAL	_____	_____	_____	_____	_____	_____
G2.2	Other loans fully secured on land to:						
	(a) Individuals	_____	_____	_____	_____	_____	_____
	(b) Housing associations	_____	_____	_____	_____	_____	_____
	(c) Others	_____	_____	_____	_____	_____	_____
	(d) TOTAL	_____	_____	_____	_____	_____	_____
	Balances at end period(*)						
G2.3	Others loans to customers: individuals of which:						
	(a) Credit cards	_____	_____	_____	_____	_____	_____
	(b) Personal loans	_____	_____	_____	_____	_____	_____
	(c) Overdrafts	_____	_____	_____	_____	_____	_____
	(d) Bridging loans	_____	_____	_____	_____	_____	_____
	(e) Hire purchase & leasing	_____	_____	_____	_____	_____	_____
	(f) Other	_____	_____	_____	_____	_____	_____
G2.4	Other loans to customers: others	_____	_____	_____	_____	_____	_____
G3	Housing Activity						
G3.1	Development properties						
	(a) Starts (in period)	_____	_____	_____	_____	_____	_____
	(b) Completed (in period)	_____	_____	_____	_____	_____	_____
	(c) Disposals (in period)	_____	_____	_____	_____	_____	_____
	(d) Under construction (at end period)	_____	_____	_____	_____	_____	_____
	(e) Unsold stock (at end period)	_____	_____	_____	_____	_____	_____
G3.2	Rented housing						
	(a) Net acquisitions (in period)	_____	_____	_____	_____	_____	_____
	(b) Dwellings held (at end period)	_____	_____	_____	_____	_____	_____
G3.3	Shared ownership schemes						
	(a) Net acquisitions (in period)	_____	_____	_____	_____	_____	_____
	(b) Dwellings held (at end period)	_____	_____	_____	_____	_____	_____
G4	Estate agency (Number of properties)						
	(a) Coming onto books in period	_____	_____	_____	_____	_____	_____
	(b) Sales in period	_____	_____	_____	_____	_____	_____
	(c) On books at end period	_____	_____	_____	_____	_____	_____

Notes : * : Information relates to the end year position
(V/200598)N2R
G1.XLS

(Amount in £000s)		Outturn for financial year					
		Society		Subsidiary undertakings		Participating interests	
		Number	Amount	Number	Amount	Number	Amount
G5	Administration / Registration of share issues / transfers						
(a)	Transfers registered / new issues transactions						
G6	Investment services:						
(a)	Stockbroking : Clients & value of transactions in year						
(b)	Portfolio management : Clients & funds under management (*)						
(c)	Nominee services : Clients & value of securities (*)						
	Funds under management (number of investors and balances) (*)						
(d)	Pension Schemes						
(e)	Other (e.g PEPs, unit & investment trusts etc)						
G7	Insurance:						
(a)	Funds of life companies (Nos. Policies / amounts of policy holders' funds)						
G8	Trusteeship (Assets)						
(a)	Charitable Trusts						
(b)	Trusts for individuals						
G9	Executorship (at end year unless indicated)						
(a)	Wills arranged in year						
(b)	Wills / estates for which appointments held as executor / administrator at year end						
G10	Organisation (numbers) (a) (*)						
(a)	Staff at end year : full time						
(b)	Staff at end year : part time						
(c)	Branches						
(d)	Agencies						
(e)	Shareholding members						
(f)	Borrowing members						
(g)	Creditors for deposits						

Note a) Staff included should be as per definitions for table N of QFS1

* : Information relates to the end year position

NB: Part time staff at G10(b) refers to actual numbers of part time staff, not full time equivalents

BUILDING SOCIETY: ANNUAL STATEMENT

AFS1: SUMMARY OF CROSS CHECKS *Cross checks within AFS1*

A11	col 1, 2 and 3	=	A30	cols 1, 2 and 3	Total liabilities / assets	[Soc/Subs/Group]
A24.1	cols 1 and 2	=	G2.3	cols 2 and 4	Other loans to customers: individuals	[Soc/Subs]
A45-A46	col 3	=	B8	col 1	Total loan and investments provisions	[Soc]
A55-A56	col 3	=	B8	col 2	Total loan and investments provisions	[Subs]
A65-A66	col 3	=	B8	col 3	Total loan and investments provisions	[Group]

Section F Where there is a tick in any box in section F, there should be a corresponding entry in Section G, in the appropriate column.

NB. Column 3 in Section G ('Participating Interests') does not necessarily represent the totality of Column 3 in Section F ('Other')

SUP 16 Ann 4G: Guidance notes on completion of building societies' reporting forms

1. MFS1 and MFS2
2. MFS1 Supp
3. QFS1
4. QFS2
5. AFS1
6. Analysis of interest rate risk gap

FINANCIAL SERVICES AUTHORITY

BUILDING SOCIETY: MONTHLY STATEMENT

MFS1

GUIDANCE NOTES

Sections

Introduction:	General notes on the return
Section A:	Summary balance sheet
Section B:	Balance sheet
Section C:	Shares
Section D:	Deposits and Debt Securities
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Section F:	Loans and Investments
Section G:	Interest rates
Section X:	Summary of cross checks within the return

Appendices (classification of Institutional Sectors)

Appendix I:	Residence (ie 'UK' or 'overseas')
Appendix II:	Sector classification lists

Submission of returns (by close on number of business days after month end as indicated)

	Tables B to G	Table A
Largest societies	7	9
Other societies	10	12

- Notes:
- please submit sets B to G and A separately, with each accompanied by a copy of the front sheet of the return;
 - dates also apply in respect of MFS2 returns to be completed for subsidiary undertakings.

BUILDING SOCIETY: MONTHLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

1. Introduction

This section covers a number of points that have relevance across the return generally:

- 2) Building Societies Act 1986
- 3) Accounting conventions
- 4) Accuracy
- 5) Society, connected undertakings and group figures
- 6) Sector analysis
- 7) Specific items:
 - (i) position to be reported gross
 - (ii) accrued interest
 - (iii) foreign currencies
 - (iv) use of brackets (..) around figures
 - (v) cross checks within the return
- 8) Building society mergers

2. Building Societies Act 1986

Any reference to "the 1986 Act" is a reference to this legislation (as subsequently amended).

3. Accounting conventions

Unless advice is given to the contrary in these Guidance Notes, the return should be compiled using standard accounting practice and in accordance with accounts regulations made under the 1986 Act.

The return has been designed with the aim of harmonising line items wherever possible with those required under accounts regulations, and as used in societies' published and internal accounts. In many instances line items reflect the basis adopted in the 1998 accounts regulations.

BUILDING SOCIETY: MONTHLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

4. Accuracy

It is expected that entries on the return will be actual values or in some cases close approximations established or drawn from the society's systems and prepared on the basis of being the best information in the time available for their compilation.

5. Society, Connected Undertakings and Group figures

Societies may hold investments in different types of undertakings.

The 1986 Act defines certain undertakings in which a society may have an interest as "connected undertakings", that is "subsidiary undertakings" and "associated undertakings". In addition to these however a society may also have "other participating interests" or hold "other equity shares" (that is non participating interests). These terms are amplified below:

Subsidiary undertakings: As defined in Companies Act 1985, section 258, which essentially means undertakings over which the society exercises control or dominant influence.

Participating interests: An interest held by a society in the shares of another undertaking which it holds on a long term basis for the purpose of securing a contribution to its activities by the exercise of control or influence arising from or related to that interest. A holding of 20 per cent or more of the shares of an undertaking is presumed to be a participating interest unless the contrary has been agreed with the Financial Services Authority. (Full definition is that given in Companies Act 1985, section 260).

BUILDING SOCIETY: MONTHLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

For the purposes of group figures the category "**participating interests**" subdivides into:

Associated undertakings: A participating interest in which the society exercises a significant influence over the operating and financial policy. (Full definition given in Companies Act 1985, schedule 4A paragraph 20).

Other participating interests: A participating interest that does not fall to be included within the definition of an associated undertaking.

Other equity shares: These essentially refer to non-participating interests in other undertakings. They include any other investments which do not fall to be included within any definition above, such as trade investments (eg BACS, APACS etc) or other forms of equity holdings (eg XYZ plc).

BUILDING SOCIETY: MONTHLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

5. Society, Connected Undertakings and Group figures (continued)

The accounting treatment of these investments is best summarised. Reference to the table below should help societies to determine an acceptable and reasonable approach:

BALANCE SHEET		Society	Group
(a)	Subsidiary undertakings	Investment at cost less any permanent diminution in value	Full consolidation line by line.
(b)	Participating interests in:		
(b).1	Associated undertakings	Investment at cost less any permanent diminution in value.	Cost of investment and share of post acquisition retained reserves.
(b).2	Other participating interests	Investment at cost less any permanent diminution in value.	Investment at cost less any permanent diminution in value.
(c)	Other equity investments	Investment at cost less any permanent diminution in value.	Investment at cost less any permanent diminution in value.

Note: only one of (b)1 or (b)2 applies for each column.

INCOME AND EXPENDITURE ACCOUNT		Society	Group
(a)	Subsidiary undertakings	Dividend receivable	Full consolidation line by line.
(b)	Participating interests in:		
(b)1	Associated undertakings	Dividend receivable	Share of profits or losses.
(b)2	Other participating interests	Dividend receivable	Dividend receivable.
(c)	Other equity investments	Dividend receivable	Dividend receivable.

Note: only one of (b)1 or (b)2 applies for each column.

BUILDING SOCIETY: MONTHLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

The return is designed to collect balance sheet and transaction data for the society and where applicable "core" connected undertakings, together with a limited amount of information on the building society group. Coverage is as described below:

5(i) Society and Group

One return must be completed by each society with

Section A covering society/subsidiary undertakings/group.

Section B-G covering society only.

5(ii) "Core" subsidiary undertakings

A separate return (MFS2), comprising sections B to G inclusive, must also be completed for each "**subsidiary undertaking**" doing "core" business. For the purpose of this return **an undertaking** is doing "core" business if it is one doing any of the following mainstream or **core** activities:

- Deposit taking
- Lending secured on residential property or other land
- Unsecured lending

NB See notes on table A for fuller details.

BUILDING SOCIETY: MONTHLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

In the summary balance sheet (Section A) the column entries in respect of core and non-core "**subsidiary undertakings**" refer only to those required to be consolidated in Group Accounts under the Accounts Regulations. The summary balance sheet figures will exclude figures in respect of **associated undertakings** (even though separate monthly returns may also be submitted in respect of such bodies) except that entries will be needed in the consolidation adjustments to ensure the final column includes the associated undertaking, or other participating interests adjustments (see Introduction/4) included in the Group figures.

5(iii) **Companies not covered by the monthly financial statement**

The Financial Services Authority may from time to time also request information on either a **subsidiary or an associated undertaking** not covered by the monthly return (i.e. those not referred to above). These will be requested on an individual society basis.

6. **Sector analysis**

NB: Transactions with Offshore deposit takers (i.e. in Channel Islands and Isle of Man) are now classified as transactions with the non-resident sector.

The classification of balance sheet items by institutional sector essentially follows the current international guidelines embodied in the European System of Accounts 1995. On this return it identifies:

- (a) UK public sector
- (b) UK banking sector
- (c) UK building society sector
- (d) Other UK sector (UK non-bank, non-building society private sector).

NB: For national accounts purposes building society connected undertakings or other interests may fall into the Other UK Sector (eg doing secured/unsecured lending in the UK); the Banking Sector (eg doing deposit taking in the UK) or the non-resident sector (eg doing deposit taking outside the UK).

BUILDING SOCIETY: MONTHLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

- (e) Non-resident sector.

Further details are given in (i) to (vi) below:

6(i) United Kingdom ("UK")

For the purposes of this return it comprises Great Britain and Northern Ireland; **but not (as previously)** the Channel Islands and the Isle of Man.

6(ii) UK public sector

Comprises central government, public corporations and local authorities. See detailed definition in Appendix II, sections 5-7.

6(iii) UK banking sector

It includes the following:

- (a) UK offices of banks (Appendix II, section 2);
- (b) the Bank of England (unless where separately identified on return).

Do not include building society subsidiary undertakings, or subsidiaries of UK banks unless they are UK banks in their own right.

Also exclude the following, which should be classified as "Other UK sector" (other financial corporations):

- (a) bank holding companies (see Appendix II, Section 3(9)(c));
- (b) gold dealers which are not banks;
- (c) certain institutions which are not banks whose main function is to extend credit abroad (see Appendix II, section 3(9)(a)).

BUILDING SOCIETY: MONTHLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

Care must be taken to distinguish between UK offices of banks which should be classified as UK banking sector, and their branches, subsidiaries and associates overseas, which should be classified within the non-resident sector.

6(iv) UK building society sector

Comprises building societies only. Branches of building societies located in the Channel Islands, the Isle of Man or elsewhere outside of the UK etc should be excluded.

6(v) Other UK Sector (UK non-bank non-building society private sector)

Comprises all other UK residents. UK residents comprise both individuals and businesses. Individuals are UK residents if permanently resident in the UK (even if temporarily resident overseas for less than a year), or if temporarily resident in the UK for more than a year, or if members of the UK armed forces or officials of HM Government serving overseas.

Businesses resident in the UK comprise enterprises which produce goods and services in the UK, including overseas enterprises' branches and subsidiaries located and operating in the UK. See Appendix I for a detailed definition of residence.

6(vi) Non-resident sector

Comprises all individuals and businesses not treated as resident in the UK. See Appendix I for a detailed definition of residence.

7 Specific items

7(i) Positions to be reported gross

In general, liabilities and assets should be shown gross, and not netted off. Thus an account which moves from credit to debit will move from one side of the balance sheet to the other.

BUILDING SOCIETY: MONTHLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

A notable exception to this however concerns the reporting of loan assets (eg in tables A, B and F) which are subject to "linked presentation" under FRS5. Such assets should be shown in the balance sheet net of linked funding and also on this basis in table F(1). But in the special analysis in section F9 (table F(2)) they should be shown on a gross basis.

7(ii) Accrued interest

Accrued interest is identified explicitly in the balance sheet under specific sub-heads. Analysis elsewhere on the return may require either the inclusion or exclusion of accrued interest, but this is indicated on the face of the return as appropriate.

7(iii) Foreign currencies

Any liabilities (including borrowing whose proceeds are swapped into sterling) or assets that are denominated in currencies other than sterling should be shown separately in the columns provided in the balance sheet sections of the return. Amounts in foreign currencies should be translated into their equivalent sterling value at the closing middle market spot rate on the reporting date, or where appropriate, at the rates of exchange fixed under the terms of any relevant currency hedging transaction, and that value entered in the column headed 'euro' or 'other currencies' as appropriate. Thus all entries in the form represent sterling amounts. Societies should apply the same accounting treatment as for the published accounts having regard to SSAP 20.

7(iv) Use of brackets (..) around figures

All amounts should be shown without brackets unless:

- (a) the amount is of the opposite sign to that expected
- (b) the entry could either be positive or negative: in which case the sub heading should indicate which of "other debit/credit" is to be shown in brackets.

BUILDING SOCIETY: MONTHLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

In either balance sheet or transactions analyses where an item is routinely to be deducted (eg provisions in balance sheet, or "withdrawals" in table C) the amount should **not** be shown in brackets. The **exception** would be if the value was itself of the opposite sign (ie negative) and required to be added not deducted in which case brackets would be necessary.

7(v) **Cross checks within the return**

The return features a number of cross references or cross checks where an item should agree with another item elsewhere in the return, or should agree mathematically with some stated relationship between two or more other items. These are conveniently summarised in Section X of the guidance notes.

8 **Building society mergers**

Where a merger of societies takes place, then **in the month during which the merger occurs:-**

- i. the transferring society should complete a return detailing its transactions in the period to the date of the merger and its closing balances;
- ii. the accepting society should complete a normal monthly return which reflects both its transactions before the merger and the transactions and balances of the combined society post merger. The share, deposit and debt securities and loan asset balances acquired from the transferring society should be included in the "Other debits/(credits) and transfers (net)" column in tables C, D and F respectively. Loan commitments taken over from the merged society should be included in the column headed "Commitments made since end of previous month".

NB **Specific** guidance covering both the contents and submission of returns is routinely provided to the societies involved at the time of a merger.

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION A: SUMMARY BALANCE SHEET

1 Balance sheet items

Balance sheet items are as defined in Section B which provides notes on specific line items.

2 Society/Subsidiary undertakings/Group

The columnar analysis should be prepared as follows:

Column 1: Society

Figures should agree with those prepared for the society in the more detailed balance sheet in Section B of the return.

Columns 2-5: "Core" subsidiary undertakings

Refers to those undertakings which are a) doing business closely related to the mainstream business of the society, and which are b) required to be consolidated within Group Accounts under the Accounts Regs. Mainstream or "core" business is taken as deposit taking, secured lending and unsecured lending. Figures supplied should be in respect of the reporting month and not for any earlier time period. If 'actuals' are not readily available then estimates should be used. Details of individual columns follow:

Column 2: Deposit takers

Undertakings doing deposit taking, the main examples of which are currently UK registered companies operating offshore in the Channel Islands or Isle of Man; companies established in the Channel Islands or Isle of Man; or other undertakings established in other countries primarily to take deposits. It would also include a UK deposit taker (in which case such an undertaking would be a bank).

Column 3: Secured lenders

Mortgage companies, primarily set up to do secured lending, whether registered in UK or in other countries, and whether lending in UK or elsewhere.

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION A: SUMMARY BALANCE SHEET (continued)

- Column 4: Unsecured lenders
- Undertakings primarily doing any form of unsecured lending, eg personal loans, credit card etc. Applies to any country.
- Column 5: Other "core" subsidiary undertakings
- Other subsidiary undertakings doing "core" business:
- (a) at present there are no such examples, but it would include any undertaking that was doing both deposit taking **and** secured lending, as opposed to primarily doing one or the other;
 - (b) if there are cases in the future, then societies will be advised as to their treatment in the return.
- Column 6: Other subsidiary undertakings
- Covers all non-core subsidiary undertakings but only those requiring to be consolidated within Group Accounts under the Accounts Regs.
- Because of the need to compile timely figures it will be acceptable for societies where such information for the reporting month is not readily available, to either use estimates or, to use figures on a lagged basis providing they do not refer to a period more than 3 months earlier than the reporting month.
- Column 7: Consolidation adjustments
- Adjustments to eliminate intra group balances in order that the group be presented as a single entity.

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION A: SUMMARY BALANCE SHEET (continued)

Column 8: Group

The total for the Group prepared on a consolidated basis in line with standard accounting practice.

NB: In relation to columns 2-6 it should be noted that where an overseas undertaking is involved the classification of its particular assets and liabilities may not exactly match the society's balance sheet headings. In these circumstances the society should follow the same classification conventions as used in the preparation of published group accounts.

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION B: BALANCE SHEET: Liabilities

B1-B2.10 Shares/Deposits

Should the balance on a **current account** become overdrawn the debit balance should be treated as an "Other Loan to Customers".

B1 - B4. Interest accrued

This should be shown gross.

B1. SHARES

This covers shares as referred to in Section 8 of the 1986 Act.

It should include:

- (a) shares from individuals
- (b) shares from any others entitled to hold such accounts under the 1986 Act, ie shares held by corporate bodies on the day before a society's "effective date"
- (c) shares placed with any branch of the society (in the UK or overseas)
- (d) interest credited to accounts
- (e) investment receipts temporarily posted to mortgage accounts in a combined investment/mortgage transaction

but should exclude:

- (f) mortgage payments temporarily posted to investment accounts in a combined investment/mortgage transaction (eg one banker's order)

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION B: BALANCE SHEET: Liabilities (continued)

B2. DEPOSIT AND DEBT SECURITIES

This is a breakdown of liabilities in respect of deposits accepted by the society (including the issue of debt securities), subject to the limitations in Section 8 of the 1986 Act.

B2.0 Deposit from individuals

Individuals means a natural person.

B2.4 Building Societies

In the case of a return completed for a subsidiary undertaking, all loans from the parent should go here.

B2.5 UK Banking Sector

i. Bank of England

Deposits includes funds received arising from repo-transactions with the Bank itself.

ii. Other Banks

Includes deposits from banks in the UK [including any building society subsidiary undertaking **taking deposits in the UK** which is a UK bank] but excludes bank borrowing which should be included under B2.11. In addition to ordinary deposits, it also includes any funds arising from repo-transactions with banks in the UK.

B2.11-13 Borrowing from banks

Includes syndicated and other borrowing from banks. If the exact split of syndicated borrowing between the UK banking sector and non-resident sector is not known, then an estimate should be made. If that is not possible then the loan should be shown according to the sector of the lead manager. (Syndicated borrowing other than from banks should be shown under 'Other deposits' in B2.1-2.10.) Overdrafts and any other form of borrowing from UK banks not shown elsewhere, should be included here.

BUILDING SOCIETY: MONTHLY STATEMENT**SECTION B: BALANCE SHEET: Liabilities (continued)****B2.14-18 Debt Securities**

Deep discounted bonds should be included at issue/purchase price with the "discount" accruing in interest accrued at item B2.19.

B3 CAPITAL

B3.1 Reserves should include general and any 'special' reserves but not revaluation reserves (which should be included at B3.3).

B3.2 Subscribed capital includes permanent interest bearing shares (PIBS), and any other subscribed capital which may be approved in the future.

B3.4 Subordinated debt (qualifying). Subordinated debt **not** qualifying as capital should be included under an appropriate heading in section B2. Includes both term and undated subordinated debt.

B3.5 Other capital - covers capital not described above, and in particular new forms of capital that may be approved in the future but which do not qualify for inclusion in any of items B3.2 or B3.4. In the case of a **return completed for a subsidiary undertaking** all capital provided by the parent society should go here.

B4. OTHER LIABILITIES includes:

B4.4 Long term insurance liabilities is the total amount due to policyholders. This entry will only be relevant on MFS2, and then only in rare circumstances where an undertaking is carrying on life insurance business and is also doing "core" business. It will however be relevant for the corresponding item in table A where a society has a life insurance subsidiary.

B4.5 Other includes trade creditors and deferred income; provisions for liabilities and charges.

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION B: BALANCE SHEET: Liabilities (continued)

B5. TOTAL LIABILITIES

For each of the columns "sterling", "euro", "other currencies" and "total", the amount at 'Total liabilities' should agree with each of the total of all solid boxed entries;

Memo items LIABILITIES

B/ML1 TRANSIT AND SUSPENSE ITEMS (Liabilities)

These items represent amounts not included in Total Liabilities. They:

Include all such items which are essentially en route between customers of banks and building societies; but

Exclude items which are essentially the society's **own** funds, such as trade creditors: these should be included under "Other Liabilities".

and are analysed separately between items in suspense, and credit items in transmission as described below:

B/ML1a Items in suspense

This comprises all credit balances not in customers' names, but relating to customers' funds (as opposed to the society's internal funds)

Include, for example,

- a. Valuation fees where the society passes on the fee to the property valuer
- b. Special accounts where the society is acting as a collecting agent (eg for charities)
- c. Accounts holding funds awaiting transfer to customers (but not accounts relating to interest accruing, or interest suspense accounts)
- d. Customers' funds awaiting investment which have been transferred to an account not in the name of the customer

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION B: BALANCE SHEET: Liabilities (continued)

- e. Funds placed on account to meet travellers' cheques issued by the society but not yet presented
- f. Returnable application monies for capital issues
- g. Funds transferred from customers' accounts to an account not in the name of the customer to meet acceptances, confirmed credits, etc

But exclude any amounts payable in respect of transactions not due until a future settlement date which arise if the society reports investments on a contract date basis.

If any credit balances relating to customers' funds of a suspense nature have already been included in total liabilities, do **NOT** include these in this item as no liabilities should be counted again here.

B/ML1b Credit items in the course of transmission

This comprises transit liabilities which are essentially en route between customers of banks and building societies eg standing orders and credit transfers debited to customers' accounts, and other items for which the corresponding payment has not yet been made by the society to a UK bank or another building society. Exclude items where the corresponding payment is to a non-resident bank.

Include all credits in course of transmission, including those to the society's own UK branches, whether passing through the credit clearing system or not. Also include unpresented cheques, bankers' payments etc. drawn on the society's sight or correspondent accounts with UK banks but not yet debited by the bank and which do not yet appear on the bank statement.

In the memorandum item, report 100% of the sterling credit items in course of transmission. In the calculation of eligible liabilities in table B(7) however, only 60% of this figure is used.

NB: Transit and Suspense items are not a component of total liabilities. They are essentially a negative item within "bank deposits" on the asset side (see B6.3 below).

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION B: BALANCE SHEET: Assets

B6. LIQUID ASSETS

General Liquid assets in this section of the return are those assets shown as liquid assets under the Accounts Regulations and in a society's published and other accounts. Liquid assets in the balance sheet (and in table A) are not the same as prudential liquidity, which is analysed in table E.

Stock Lending No adjustment should be made to the amount or categorisation of liquid assets shown in the balance sheet to take account of any stock lending carried out as provided for in the Financial Services Authority's Prudential Guidance on Liquidity. [Chapter 5 of Volume 1 of the Interim Prudential Source Book ("IPSB") for Building Societies]. In subsequent pages of these guidance notes, prudential guidance in the IPSB for Building Societies will be referred to as P/G.

Gilt Repo The Prudential Guidance on Liquidity refers to gilt-repo activity, and provides details of reporting implications in an Annex. That part referring to the balance sheet is reproduced below, but includes amplification of the line items relevant to the coding of liquid asset deposits in a reverse repo.

Repo	Reverse Repo												
<p>Balance Sheet</p> <p>a. The security which is the subject of the repo remains on balance sheet</p> <p>b. Proceeds received as a result of the repo are treated as deposit funding, and classified according to the type of counterparty providing the funding</p> <p>c. The corresponding asset for this new funding will depend on its disposition at the reporting date. Whilst at the time of receipt it will no doubt constitute part of the society's liquid assets, at the time of reporting it may either still form part of liquid assets (classified according to its use) or may by then have been advanced as a loan asset etc</p> <p>d. The net effect of the repo is that liabilities and assets are increased by the amount of funding received as a result of the repo.</p> <p>NB: In the case of complex, multi-step transactions:</p> <div style="border: 1px solid black; padding: 5px; margin-top: 10px;"> <p><i>Whether conducting a repo or a reverse repo, societies should take particular care not to "double count" either the stock or the cash as liquidity. This is especially relevant to more complex situations where, for example, gilts reversed in are subsequently repoed out or sold, taking into account any timing mismatches that occur.</i></p> </div>	<p>a. Funds paid to the counterparty as part of a reverse repo (in return for securities) remain on balance sheet, and should be recorded as a liquid asset deposit (classified according to the type of counterparty). This is, in MFS1:</p> <table style="margin-left: 40px;"> <tr><td>B6:2</td><td>Central Bank counterparty</td></tr> <tr><td>B6:3</td><td>Bank counterparty</td></tr> <tr><td>B6:8</td><td>Local authority counterparty</td></tr> <tr><td>B6.12a</td><td>Building societies</td></tr> <tr><td>B6.12b</td><td>Other UK counterparty</td></tr> <tr><td>B6.12c</td><td>Other non-resident counterparty</td></tr> </table> <p>b. but securities received (collateral) should not be shown in the balance sheet.</p> <p>c. The net effect of the reverse repo is that assets and liabilities do not materially change.</p> <p>d. Subsequently, if these securities received under the reverse repo are used in a new repo transaction, then the new funds are treated as in steps (b) and (c) under the Repo column.</p>	B6:2	Central Bank counterparty	B6:3	Bank counterparty	B6:8	Local authority counterparty	B6.12a	Building societies	B6.12b	Other UK counterparty	B6.12c	Other non-resident counterparty
B6:2	Central Bank counterparty												
B6:3	Bank counterparty												
B6:8	Local authority counterparty												
B6.12a	Building societies												
B6.12b	Other UK counterparty												
B6.12c	Other non-resident counterparty												

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION B: BALANCE SHEET: Assets (continued)

The type of assets available to societies for the management of liquidity is outlined in the above mentioned P/G. Connected undertakings may hold other types of asset as "liquidity" depending on the powers available to them, in which case such assets should either be classified to the relevant generic category or "other liquid assets" as appropriate.

B6.1 **Cash (notes and coins)** should include UK coin, and bank notes issued by the Bank of England, the Scottish and Northern Irish note issuing banks and Channel Island authorities under "sterling" column. Notes and coin of other countries outside of the UK should be disclosed in the appropriate column. Unbanked cheques should not be included. If it is not possible to distinguish between cash and unbanked cheques then the split should be estimated.

B6.2 **Deposits with central banks** refers to the Bank of England in the UK and equivalent institutions in other countries.

B6.3 **Bank Deposits**

should include:

(a) current and deposit accounts with UK banking sector institutions (excluding Bank of England) and banks resident overseas (and which are not part of UK banking sector). Balances should be balances with banks as shown by the society's records (eg "cashbook"), and should be equivalent to taking the bank statement balance as the starting point, **less:**

(i) cheques drawn by the Society on a bank but not yet presented to the bank by the payee and any other similar liability transit and suspense items (see memo item after B5 above); **plus**

(ii) cheques drawn in favour of the Society but not yet presented to the bank. This amount should be shown in the memorandum item: 'Transit & Suspense items' (Assets).

but should exclude:

(b) bank overdrafts which should be shown as a liability under item 'Borrowing from banks', not included as a negative figure in this section except where there is a legal right of set off by the bank against debit balances held on other bank accounts.

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION B: BALANCE SHEET: Assets (continued)

- B6.5** **Other money market instruments** covers those other than CDs. Commercial paper is the only example at present but there may be others at some future date.
- B6.6** **Bonds, notes and other capital instruments** includes fixed rate bonds, floating and variable rate bonds, medium term notes and euro-notes.
- B6.7** **Bills** include bills accepted by any eligible bank, and Treasury bills.
- B6.8a)** **Local Authority temporary debt** should include all loans to local authorities, holdings of local authority securities, bills and other paper, and deposits with local authorities, with an original maturity [NB not current maturity] of less than 12 months including longer term loans and mortgages repayable at the lender's option within one year.
- B6.8b)** **Local Authority long-term debt - listed securities** covers those issued by local authorities with an original maturity over 12 months.
- B6.8c)** **Local Authority long-term debt - other** includes all other lending to local authorities, including deposits, not included above.
- B6.11** **Sovereign securities:** covers securities which are issued by or guaranteed/backed by UK or overseas governments. They are analysed as follows:
- (a) **Sovereign debt** which is debt securities issued by UK or overseas governments:
- a1) **UK government:** covers gilts. UK government ECU issues would go under Euro column.
- a2) **Overseas governments** cover those debt securities issued by overseas governments.

BUILDING SOCIETY: MONTHLY STATEMENT**SECTION B: BALANCE SHEET: Assets (continued)**

- (b) **Sovereign backed or supported by** covers those securities not issued by a government but which are either guaranteed by a government or where the issuer is either backed by a government or whose capital has been subscribed by a government:
- b1) **UK government** backed or supported, includes securities guaranteed by UK government (eg those issued by nationalised industries), or securities issued by any body whose capital is subscribed by UK government only (eg GEFCO [Government Export Finance Company])
- b2) **Overseas government** backed or supported, includes securities guaranteed by other governments, and securities issued by intergovernmental investment and development institutions whose capital is subscribed by one or more overseas governments. These latter institutions are often referred to as supra national bodies and agencies. Examples would include:

Backed or supported by a single overseas government:

- France: EDF (Electricite de France), SNCF
- Italy: Feroovie dello Stato (State Railway)

Backed or supported by more than one overseas government

- African or Asian or Caribbean Development Banks;
- Council of Europe Resettlement Fund
- European Atomic Energy Community
- European Bank for Reconstruction and Development
- European Coal and Steel Community
- European Company for the Financing of Railway Rolling Stock
- European Economic Community
- European Investment Bank
- European Telecommunications Satellite Organisation
- Inter-American Development Bank
- International Bank for Reconstruction and Development (the World Bank)
- International Finance Corporation
- International Monetary Fund
- Nordic Investment Bank

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION B: BALANCE SHEET: Assets (continued)

B6.12 Other liquid assets: includes those with

- (a) **Building society sector:** deposits placed with other societies, and any other liquid asset with the building society sector not shown in B6.1-11; or where the return is completed for a subsidiary undertaking it is the amount placed with the parent or other building society.
- (b) **Other UK sector** including any liquid asset not included above, eg National Savings Bank deposits and instruments; deposits with gilt-edged market makers; deposits with Stock Exchange money brokers.
- (c) **Non-resident sector**, that is any overseas institutions not included in any other category of liquid assets.

B7 LOANS AND INVESTMENTS

Loans fully secured on residential property (FSRP) and other loans fully secured on land (FSOL) are as defined in the 1986 Act.

Reclassification of old Class 2 loans

NB: The following two paragraphs cover the situation when loans were reclassified onto the new basis under the amended 1986 Act when a society reached its "effective date" for adoption of new powers under the 1986 Act.

However, it should be noted that due to a drafting error in the 1997 Act not all old Class 2 loans secured on residential property will, after a society's "effective date", count as FSRP (ie they will not be within the new 75% lending nature limit). This applies in particular to **existing loans secured on residential property: to housing associations**, to individuals on **second mortgages** (other than where the first mortgage is also to the society) and to any such **loans to companies**.

This anomaly only applies to existing loans as at the date on which a society adopts the new memorandum and rules under the 1997 Act. Such loans made on or after that date will count as FSRP (and be within the 75% lending nature limit).

BUILDING SOCIETY: MONTHLY STATEMENT**SECTION B: BALANCE SHEET: Assets (continued)**

All balances entered should only bring into account interest which is due at the reporting date: interest in respect of the remainder of the society's financial year should be excluded since it is not due at the reporting date. Provisions for bad and doubtful debts should not be deducted from individual line items B7.1-7.4 and each of these asset line items should be shown 'gross'. The amount of provisions should be shown separately (B7.6). Balances will however take account of any amounts written off loan assets as shown in the transaction table in Section F.

B7.1&2 Loans FSRP and Other Loans FSOL are the aggregate amounts of mortgage debts outstanding in respect of advances on these categories of loans. Include mortgage receipts temporarily posted to investment accounts, but exclude investment receipts temporarily posted to mortgage accounts.

B7.3(a) **Other Loans to Customers: Individuals** includes bridging loans, personal loans, credit cards, overdrafts, and also some secured loans.

B7.3(b) **Other Loans to Customers: Other** includes all other loan assets not included above, including loans to connected undertakings (except where they fall to be treated as "investments" in B7.4).

B7.4 **Investments** are the aggregate amount outstanding in respect of:

- i. Shares (ie share capital) in connected undertakings
- ii. Certain loans of a longer term nature (and typically where a repayment schedule is not expected) to connected undertakings; and
- iii. Other equity Shares.

See Introduction, section 5, first paragraph for details of connected undertakings

B7.5 **TOTAL Loans and Investments (Gross)** is a subtotal of all items in B7.1 to B7.4.

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION B: BALANCE SHEET: Assets (continued)

B7.6 **Provisions:** cover general and specific and refers to amounts prepared on a basis consistent with the same items presented in the published accounts. The amount shown should be updated throughout the year whenever updates are made to provisions charged in the Income and Expenditure Account.

B7.7 **TOTAL Loans and Investments (Net)** is B7.5 net of provisions in B7.6.

B7.8 Is an **analysis by sector** of all loan assets before deducting provisions, that is of the total in B7.5 (to which the sum of component sector lines should agree). Sector definitions are referred to at section 6 of the Introduction to these notes.

B8 **FIXED ASSETS**

Comprises all fixed assets including residential properties held for rental purposes.

B9. **LONG TERM INSURANCE FUNDS**

Means assets of long term insurers which represent funds arising from the carrying on of long term insurance business. See also note against B4.4 for application to MFS2 and table A.

B10. **OTHER ASSETS** includes

- (a) trade debtors
- (b) any other item for which payment is due to the society but has not yet been received
- (c) all other assets not shown elsewhere.

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION B: BALANCE SHEET: Assets (continued)

B 11. TOTAL ASSETS

For each of the columns "sterling", "euro", "other currencies", and "total", the amount at 'Total Assets' should agree with each of:

- (a) the total of all solid boxed entries; and similarly
- (b) the dotted box against B6.14 together with solid boxed entries against subsequent items.

Memo item ASSETS

B/MA1 TRANSIT AND SUSPENSE (Assets)

This is subdivided into items in suspense, and debit items in the course of transmission.

B/MA1a Items in suspense

This includes any items which are debit balances not in customers' names but relating to customers' funds, eg debit balances awaiting transfer to customers' accounts rather than the society's own internal funds, and funds of the society lodged with applications for new issues, even if the funds are returnable and any amounts receivable in respect of transactions not due until a future settlement date which arise if the society reports investments on a contract date basis.

B/MA1b Debit items in course of transmission

This comprises cheques, etc, drawn in favour of the society and drawn on, and in course of collection on, UK banks (including the Bank of England) and other building societies, and debit items in transit between UK offices of the society.

Include cheques that have been credited to customers' accounts but are held overnight before being presented or paid into the society's account with a UK bank.

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION B: BALANCE SHEET: Assets (continued)

Items sent by post for collection from a UK bank or other building society should be regarded as in course of collection until it is reckoned that they have been received by the addressee.

Excludes cheques, etc, which have been passed to UK banks or other building societies for collection and credited to the society's account irrespective of whether this account is the society's sight account, or a settlement or clearing (ie correspondent) account in the books of the UK banks or other building societies. These should be included in item B6.3a.

In this item, report 100% of debit items in course of transmission. The calculation of eligible liabilities in table B(7) will however use only 60% of this.

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION B: BALANCE SHEET: Eligible Liabilities

(There are no items B12-B19 in the return)

B20 ELIGIBLE LIABILITIES

This information forms the basis on which the Bank of England will monitor a society's eligible liabilities and issue call notices concerning the amount of **cash ratio deposits** to be placed with the Bank.

This section of the return is designed to capture all of the component items that go to make up eligible liabilities, including relevant offsets and other deductions.

Apart two items (B20.12 and B20.13 which are covered below), all other items in table B(7) are directly extractable from specific line items in tables B(1) to B(6), and relevant cross references are given which define the amounts to be included in the various B20 items.

B20.12 Over 2 year sterling share and deposit liabilities (optional)

This is an optional item that you may choose not to complete. It should comprise sterling shares and deposit liabilities that were included in B20.1 where the shares and deposits cannot be withdrawn under any circumstances within two years of being placed, except when specified exceptional events occur, such as the death of a personal depositor. For example, a deposit placed for three years but which can be withdrawn at anytime either with a notification period or loss of interest (or both) should **not** be included in this item. Also exclude from this category any deposits from UK banks or non-resident offices of the society (see B20.13 below for definition).

BUILDING SOCIETY: MONTHLY STATEMENT**SECTION B: BALANCE SHEET: Eligible Liabilities** (continued)**B20.13 Non-resident offices adjustment (optional)**

This is an optional item that you may choose not to complete. Its aim is to allow any **gross** sterling deposit liabilities from non-resident offices of the society (which were included in B20.1) to be scored **net**. However a net asset position cannot be treated as an offset in the calculation. Enter any funds lent to non-resident offices of the society up to a value equal to, or less than, the deposit liabilities received from the non-resident offices of the society. Non-resident **includes** the Channel Islands and Isle of Man. Non-resident offices of the society are:

- a. a non-resident branch of the society
- b. a wholly-owned non-resident banking subsidiary undertaking of the society

B20.14 Total eligible liabilities

Total eligible liabilities comprise B20.5 less B20.11, B20.12 (if completed) and B20.13 (if completed).

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION C: FUNDING: SHARES

C1. SHARES

This provides a breakdown of the change in the balance sheet item between this return and the previous return in respect of **shares from individuals and others**. Accrued interest is excluded. The columns are as follows:

Receipts

should include

- (a) interest paid to investors by warrant and re-invested by them at a later stage.
- (b) investment receipts temporarily posted to mortgage accounts which are combined investment/mortgage transactions.

but should exclude

- (c) transfers between accounts.
- (d) mortgage payments temporarily posted to investment accounts which are combined investment/ mortgage transactions (eg one banker's order).
- (e) interest credited either to an account or transferred to an alternative account (warrant transfers).

Withdrawals

should include:

- (a) transfers to mortgage accounts.
- (b) withdrawals which incorporate in part or in whole previously credited interest and bonuses.
- (c) withdrawals of credit balances on current accounts. (Should the current account become overdrawn the debit balance should be treated as an "other loan to customers: individuals".)

but should exclude

- (d) transfers between accounts.

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION C: FUNDING: SHARES (continued)

- (e) interest and bonuses paid out.

Interest Paid

should include:

- (a) interest or bonuses paid out on account closure.
- (b) interest paid out monthly, quarterly, half yearly or annually.

but should exclude:

- (c) any interest already counted as 'interest credited' in this or previous returns.

Interest paid has two components:

- (d) the total amount of interest paid shown on a gross basis
- (e) the amount of tax deducted, so that (d) minus (e) is the actual amount paid out

Interest Credited

should include:

- (a) interest capitalised at normal due dates.
- (b) interest credited to alternative accounts (warrant transfers)

but should exclude:

- (c) all interest provisions eg SAYE and regular savings bonuses until added to accounts.

Interest credited has two components:

- (d) the total amount of interest credited shown on a gross basis

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION C: FUNDING: SHARES (continued)

- (e) the amount of tax deducted, so that (d) minus (e) is the actual amount credited to account balances.

Other (debits)/credits and transfers (net)

should include share balances acquired on acceptance of a transfer of engagements.

C2. ANALYSIS BY ACCOUNT TYPE (original maturity)

Investments are classified according to the original notice period and all the investments in a particular account are classified together ie all the investments in a 90 day account are classified in the 3 months notice/penalty category, even if investments above a certain level in an individual account are withdrawable on demand and without penalty.

The basis of the "CAR" interest rate is described in Section G (at 3(b)).

Where the society credits interest to an account other than that on which such interest is earned, the amount should be shown under "interest credited" on the account type on which it is earned, and the transfer to another account should be recorded under "other (debits)/credits and transfers (net)".

C2.1 Instant Access (0-7 days) includes

Ordinary Share accounts: those share accounts with no special terms relating to receipts or withdrawals.

Cheque/Transactions accounts: those share accounts which include, as an integral part of the account, the means to make payments to third parties. Any accounts specifically established for use with ATMs should also be included here.

NB: excludes those cheque/transaction accounts which are designated as deposits (and not shares).

BUILDING SOCIETY: MONTHLY STATEMENT**SECTION C: FUNDING: SHARES (continued)**

Seven day and instant access/no penalty accounts: those accounts offering a higher rate of interest than ordinary shares and include accounts from which investments can be withdrawn at seven days' notice or less or from which immediate withdrawals can be made with seven days interest penalty or less. See below for treatment of investments above a certain level in certain longer notice accounts which are withdrawable on demand without penalty.

C2.2-4 Notice accounts includes

One month's notice/penalty accounts include all accounts from which investments can be withdrawn at one month's (or 28 days') notice or from which immediate withdrawals can be made with one month's (or 28 days') penalty. Include also any accounts requiring a notice period of 8 to 45 days inclusive.

Two/Three months' notice/penalty accounts refers to accounts which require more than one month's notice of withdrawal or impose penalties of more than one month's interest on an immediate withdrawal but which are not term accounts. Two and three months' (60 and 90 day) notice/ penalty accounts fall into this category. Because of varying notice periods required the '2 month' and '3 month' categories are defined in days as well.

C2.5-9 Term accounts includes

Term accounts with withdrawal facility: those accounts which require investment for a fixed term (offering variable or fixed rate of interest), and which also permit withdrawals at, for example, three months' notice, on terms set out in the investment prospectus.

Terms accounts without withdrawal facility: those accounts which also require an initial investment period, during which no withdrawals can be made (except in the case of death).

C2.10-11 Contractual includes:

Tessa: Tax-exempt Special Savings Accounts

Other: includes regular savings such as SAYE

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION C: FUNDING: SHARES (continued)

NB: Individual Savings Accounts (ISAs) are not necessarily contractual and should be allocated to the lines most appropriate to the nature of the share account making up that part of the ISA.

C2.12 **Other:** any account not shown above

C3 **SHARES ANALYSIS**

Breaks down the balances shown in the final column of item C1 into shares held by individuals and shares held by others.

C3.1 **Shares held by individuals**

Individuals means a natural person.

C4 **LARGE SHARE AND DEPOSIT HOLDINGS**

C4.1 **Single holdings in excess of 0.25% of SDL (excluding accrued interest)**

This item, exceptionally, relates to both shares and deposits. It refers to the aggregate balances on both share and deposit holdings (where a single holding in respect of an individual is the totality of accounts held by that individual), excluding accrued interest, which are each in excess of 0.25% of total shares, deposits and debt securities (SDL), where total SDL is the sum of balance sheet items as below:

- (i) share liabilities excluding interest accrued (B1.1 + B1.2)
- (ii) deposits and debt securities less interest accrued (B2.20 - B2.19 - B2.0(c))

This item relates to "large share and deposit holdings" as referred to in the Prudential Guidance on Financial Risk Management. [Chapter 4 of Volume 1 of the Interim Prudential Source Book ("IPSB") for Building Societies.

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION D: DEPOSITS AND DEBT SECURITIES

D1. TOTAL DEPOSITS AND DEBT SECURITIES

Analyses the transactions between opening month and closing month balances but excluding accrued interest for 'Deposits from individuals' and 'Other deposits and debt securities'.

D2. COMMITTED FACILITIES

The sources of such facilities, divided between "banks" and "other sources", are individually considered in terms of:

(i) maximum drawn down at any time during month

Requires each end of day total drawn down balance position (ie the sum of positions on each line of committed facilities, eg from banks in the case of D2.1) to be established and the maximum of these daily amounts to be entered.

The maximum drawn down from "all sources" will not necessarily be the sum of the two component boxes in this column unless the maximum drawn down position in the month occurred on the same day for both D2.1 and D2.2.

(ii) Position at end of month

Analyses balances drawn and undrawn at the end of the month. The horizontal sum of balances drawn plus balances undrawn will be the total amount of committed facilities by source.

BUILDING SOCIETY: MONTHLY STATEMENT**SECTION E: LIQUID ASSETS****E1. REALISABLE WITHIN**

This analyses the realisability of liquid assets (**NB now including accrued interest**) held at the end of the month into three time bands; those realisable up to and including 8 days, those up to and including three months, and those over three months. "Realisable" means the ability to translate the liquid asset into money (ie cash or in current account).

The columnar analysis categorises "realisable" in terms of balances outstanding at the end of the month according to the following breakdown:

(i) Balances at the end of the month: as per balance sheet

Show amounts in this column on the same basis as included in the balance sheet, but in table E include accrued interest along with each line item (in the balance sheet it appears as a separate amount).

(ii) Intermediate workings

The next 3 columns are designed to show the necessary intermediate steps before the amount of prudential liquidity can be derived in column 5. They implement the deductions and adjustments referred to in Chapter 5 of Volume 1 of the Interim Prudential Source Book ("IPSB") for Building Societies.

Ineligible amounts (which only applies to the final rows) means the amount, if applicable, that represents liquid assets in the balance sheet which does not qualify as prudential liquidity (taking into account transitional provisions referred to in the P/G). When this is subtracted from column 1, giving the amount qualifying for prudential liquidity purposes, the result is shown in column 5.

Market value only applies to gilts, and means the market value at the month end, but before any discounting is applied.

Discounted value means the result of applying the following discount factors to the market values in the previous column according to **residual** maturity.

BUILDING SOCIETY: MONTHLY STATEMENT**SECTION E: LIQUID ASSETS (continued)**

residual maturity	discount factor	multiplier
less than 1 year:	zero	1
1 to 5 years:	5%	0.95
over 5 years:	10%	0.90

The discounted value is the market value times the "multiplier" shown above.

(iii) Amount of prudential liquidity

For gilts, this is the total of discounted market values shown in the previous column.

For other line items, it is the value in column 1 less ineligible amounts shown in column 2.

E1.1 Realisable within "Up to 8 days"

Only include within this line item the following:

- (i) cash; current account balances; Treasury, Local Authority and eligible bank bills;
- (ii) deposits with local authorities, banks and building societies with not more than 8 days notice or within 8 days of maturity;
- (iii) all gilt-edged securities; CDs (banks and building societies) with 3 months or less to maturity; and commercial paper with a residual maturity up to 1 month.

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION E: LIQUID ASSETS (continued)

E2. AMOUNTS OF PRUDENTIAL LIQUIDITY AT ANY TIME DURING THE MONTH

This shows the minimum balance of total prudential liquidity (including accrued interest) held at any time during the month, and also the maximum total of building society holdings counting as prudential liquidity. "Any time" means based on end day positions. The percentage of total SDL should be based on estimated SDL on the relevant day, and where SDL is defined as:

- a. share liabilities including accrued interest (B1.4)
- b. deposits and debt securities including accrued interest (B2.20)

E3. BUILDING SOCIETY HOLDINGS

This shows a society's liquid asset holdings with all other societies in total. **The amount reported here should also include any undrawn committed facilities provided to societies. [NB: This disclosure is different to the basis used for reporting in line item E2.2 above which should reflect the maximum amount drawn].**

This covers securities and other money market instruments issued by, and deposits placed with any other building society.

"Securities and other money market instruments" refers to all holdings of building society paper and follows the terminology used in the P/G on Liquidity.

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION F: LOAN AND INVESTMENTS

F1-4 LENDING: Categories

For each category of loan assets, details are requested under various transaction columns that explain the transition from last month's balances to this month's balances.

F1-2 LOANS FSRP AND LOANS FSOL

Both categories of lending are split between individuals, housing associations, and other. "Individuals" comprise individuals, households and private trusts. "Other" includes loans to companies, unincorporated businesses, and non-profit-making bodies (except housing associations, which are included under "housing associations"), provided they are fully secured on residential property or on other land respectively.

F3 OTHER LOANS TO CUSTOMERS: INDIVIDUALS are split between bridging loans, personal loans, credit cards, overdrafts and other.

F4 OTHER LOANS TO CUSTOMERS: OTHER comprises loans not shown above and includes loan to businesses not FSRP or FSOL.

F5 INVESTMENTS is split between shares in, and certain loans to connected undertakings, (See G/N on item B7.4(ii)) and any other holdings of equities.

F1-5 LENDING: Transactions (columns)

Advances in month

should include:

- (a) instalments released in the month for instalment advances.
- (b) re-advances, ie where previous charge cancelled.
- (c) further advances.
- (d) mortgages transferred from one borrower to another [there should be a corresponding entry under "Repayment of principal" and "Repayment of interest" as appropriate]

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION F: LOANS AND INVESTMENTS (continued)

- (e) the deduction from advances made of advance cheques cancelled.

but should exclude:

- (f) amount of any loan books acquired in the month [now reported in "other debits/credits etc"]
- (g) retentions imposed, which should be included as they are released.
- (h) sundry debits, ie any items not approved and not included in commitments eg insurance debits, fines, insurance guarantees (unless part of loan), valuation fees etc.

Interest earned in month

Is that amount of interest due to the society for the current month as determined by

- (a) applying the rate(s) of interest prevailing (i.e. charged) during the month to mortgage balances at the end of the previous month (subject to any adjustments in respect of redemptions and new loans in the month) and multiplying by the appropriate fraction to convert the per annum rate(s) of interest to daily rate(s) and then multiplying by the number of days for which the rate(s) applied in the month, or
- (b) such other methods as are normally used by the society, for example the "Rule of 78" or "sum of the digits" method sometimes used for unsecured personal loans.

Repayment of Principal

should include:

- (a) repayment of principal including capital repayments, redemptions and the principal element of the normal monthly payment.
- (b) mortgage receipts temporarily posted to investment accounts.
- (c) transfers from investment accounts to mortgage accounts.

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION F: LOANS AND INVESTMENTS (continued)

but should exclude

- d) amount of any loan book sold during the month [now reported in "other debits/credits etc"]
- (e) sundry credits to accounts, such as insurance premiums, fines, fees, etc.
- (f) advance cheques cancelled.
- (g) investment receipts temporarily posted to mortgage accounts.

Repayment of Interest

It is recognised that societies may need to estimate the amount of interest repaid where amounts repaid include both interest and principal, and/or where the amount of interest repayable is not the same as the amount charged (eg annual review or deferred interest schemes, or where a loan is not being fully serviced).

Amounts written off

Is the amount written off mortgage balances in the month (and off provisions charged to the income and expenditure account) and is to be on a basis consistent with amounts shown in the society's published accounts as "written off" within the analysis of changes in loss provision usually appearing as Notes to the Accounts.

The amount written off may arise for example from:

- sale of a property in possession; or
- a decision to write down the mortgage debt on a loan still on the books. This may arise where the society has taken the view that it is certain that a loss will arise and that it is prudent to write down the mortgage debt rather than carry the full debt and an offsetting provision. Examples might include certain fraud cases, or where arrangements have been reached with the borrower to reduce the mortgage debt repayable.

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION F: LOANS AND INVESTMENTS (continued)

Other debits/(credits) and transfers (net) includes:

- a. Such items as insurance premium receipts, valuation fees, and fines etc.;
- b. Mortgage balances acquired following a transfer of engagements;
- c. Loan books acquired from other lenders in the month;
- d. Loan books sold to other lenders in the month;
- e. Loan books securitised during the month;
- f. Transfers (net) should include loans which are reclassified under section 6B(7) of the 1986 Act (for example, where there has been a change in the use of the land on which the loan is secured to/from residential).

Societies are asked to take care in reporting transactions given the potential for distortion arising from the netting effect of compensating transactions (eg a loan book acquisition and a securitisation of similar values taking place in the same month).

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION F: LOANS AND INVESTMENTS (continued)

F6 LOANS: ANALYSIS OF REPAYMENT OF PRINCIPAL

It is recognised that where amounts repaid cover both principal and interest, that societies' analysis of repayment of principal may involve some degree of estimation.

"On redemption" includes amounts repaid on either premature or final redemptions. It should include payments made where the mortgage is essentially redeemed but where a nominal residual balance is retained on the account in order for the society to maintain safe keeping of the deeds (eg Deedcare schemes).

"Other repayment" includes all other irregular or lump sum payments, that is amounts in excess of regular repayment such as those on conventional mortgages (where regular or occasional overpayment may be made) and also those on flexible mortgages (when the repayment is in excess of the monthly amount due under normal commercial terms).

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION F: LOANS AND INVESTMENTS (continued)

F7 LOAN COMMITMENTS (columns)

Commitments made since end of previous month

should include:

- (a) the aggregate of agreed advances (whether or not the mortgage offer has been accepted by the prospective borrower), including amounts recommended for retention, all instalment elements, and further advances.

but should exclude:

- (b) commitments from previous months that have been cancelled in the current month.
- (c) retentions imposed and subsequently not released.
- (d) instalment commitments that have not been taken up.
- (e) advance cancellations that are not re-issued.
- (f) sundry debits, eg insurance guarantee premiums (unless additional to the loan), insurance of contents etc.

Cancellations in month

Includes (b), (c), (d) and (e) above.

F8 NUMBERS OF MORTGAGES OUTSTANDING

Gives the number of mortgages included in the balance sheet amounts for FSRP and FSOL loan assets. (Where multiple accounts exists on a single security these should be amalgamated).

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION F: LOANS AND INVESTMENTS (continued)

F9 LOAN BOOK ACQUISITIONS/SALES AND LOANS SECURITISED

The "**transactions in the month**" columns are analyses of amounts already included within the "other debits/(credits) and transfers (net)" column of table F(1).

(NB for books acquired and books sold, this represents a change in treatment from the previous MFS1 reporting which required them to be shown in gross advances and repayments of principal respectively):

- (i) "**books acquired**" represents balances on any relevant loan books acquired during the month from other lenders.
- (ii) "**Books sold**" represents balances on any relevant loan book (ie parcel of loans) sold during the month to another lender.
- (iii) "**loans securitised**" represents balances on any loans that the society (or subsidiary undertaking in the case of MFS2 reporting) has "securitised" in the month, where "securitised" has the same meaning as described in the Prudential Guidance on Securitisation [Chapter 10 of Volume 1 of the Interim Prudential Source Book ("IPSB") for Building Societies]. It includes balances on loans subject to securitisation transactions qualifying either for "linked presentation" or "derecognition" methods of accounting.

The final column "**balance at end month on loan assets subject to non-recourse funding**" represents all such loan assets (and not just the amount treated as transactions in the month), and requires the "gross amount" of such loan assets to be reported against relevant line item categories. The "gross amount" is the amount of any such loan that, under the "linked presentation" method of accounting, would be shown in a society's published or other balance sheet (but not Financial Services Authority returns) as X in the example below:

gross loan asset	=	X
less non-recourse funding	=	Y
net loan asset	=	X-Y

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION F: LOANS AND INVESTMENTS (continued)

In the Financial Services Authority's returns, it is only the net loan asset that is normally reported (eg in tables A, B, and in F(1)), but in the analysis here at F9, it is instead the gross loan asset at the end of the reporting month. Once securitised, it is recognised that end month gross balances will not necessarily remain constant (due either to borrower repayments, the possibility of any further advances, or other arrangement for "topping up" a pool of securitised loans etc).

- F9.1** **Loans fully secured on residential property** is split between loans to individuals; housing associations and other and is a sub-analysis corresponding to line items F1.1 to F1.3 respectively in table F(1).
- F9.2** **Other loans fully secured on land** is a sub-analysis the total of loans to individuals, housing associations and other loan and corresponds to line item F2.4 in table F(1).
- F9.3** **Other loans to customers** is split between individuals and others and is a sub-analysis corresponding to line items F3.6 and F4.3 respectively in table F(1).

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION G: INTEREST RATES (Gross rates)

Basis

Interest rates in this table are **nominal rates**, and should ignore the effect of any interest rate swaps or other hedging contracts that might exist.

This provides an analysis of basic and weighted average interest rates for shares, deposits and debt securities, capital instruments, liquidity and loan assets. "Interest rates at end of month" (columns 4, 5, 6 and 7 of table G) means rates applying at least throughout the last day of the month, so societies should not use rates which only come into operation at the beginning of the next month. Points to note on specific columns are:

(1) **Balances at end month**

Include accrued interest (even though it is excluded when computing the weighted average rate)

The "of which" analysis is designed to obtain information on balances subject to fixed rates of interest and balances subject to variable rates of interest. (The two amounts should add to the balance in column 1). For these purposes:

"fixed" means the rate of interest is fixed for a stated period. For shares or deposits and debt securities also include any products with a "floored rate" (ie subject to a guaranteed minimum rate). For loans also include any products with a "capped rate" (ie subject to a guaranteed maximum rate) and any products that are "collared loans" (ie subject to a minimum and a maximum rate)

"variable" includes all other interest rate bases (ie other than those defined above as "fixed") applying to particular products, including those at one of the society's administered funding or lending rates; those linked to Libor, (or other market rate); those linked to an index (eg FTSE) etc. However if any such funding products are subject to a "floored rate" or any such loan products are subject to a "capped rate", then treat as "fixed".

(2) **Basic rate**

For loans fully secured on residential property to individuals, it is the society's basic rate applying to the majority (by value) of existing accounts in this category.

BUILDING SOCIETY: MONTHLY STATEMENT

SECTION G: INTEREST RATES (Gross rates)

(3) **Weighted average rates**

(a) Interest rates reported in Table G provide a broad indication of **market rates** as well as being a simple and necessarily crude measure of nominal interest rate margins. **They should ignore the effect of any interest rate swap or hedging.** For each line item the weighted average rate should be derived as follows:

- (i) identify the various nominal/quoted interest rates (including any bonus element that the society is liable to pay) that apply to elements of this line item; then
- (ii) for each separate nominal/quoted rate, multiply that rate by the amount of end month balances (excluding accrued interest) for which that rate applies; and
- (iii) add up the results of (ii) for all the different rates for this line item; and
- (iv) divide the total calculated in (iii) by the end month balance in column 1 less accrued interest (against the line item concerned).

NB: In the "of which" analysis that requires separate reporting of weighted "fixed" and "variable" rates, a cross check for each row is that the weighted average nominal rate on all balances is equal to the weighted average of the reported fixed and variable rates in the subsequent two columns. Details of "fixed" and "variable" are given in 1) above.

BUILDING SOCIETY: MONTHLY STATEMENT**SECTION G: INTEREST RATES (gross rates) (continued)****(b) Table C: For section C2 only**

CAR or compounded annual rate basis for shares only, as set out in Section C2 of the return.

The formula for the CAR is:

$$\text{CAR} = 100 \times \left\{ \frac{[(1 + \text{nominal rate}]^N - 1}{100 \times N} \right\}$$

where N is the number of compounding periods per annum (ie 2 if half yearly, 12 if monthly).

G1 SHARES

The rates shown in table G are all based on gross nominal rates including any bonus element which the society may be liable to pay and not the CAR (compounded annual rate) which is only required for section C2 of table C.

G2 DEPOSITS AND DEBT SECURITIES

Covers all deposits accepted by the society and debt securities issued (except qualifying subordinated debt which is covered under capital instruments).

G3 CAPITAL INSTRUMENTS

Refers to forms of capital that incur a liability to pay interest (eg PIBS and subordinated debt), and therefore excludes general reserves and revaluation reserves.

G4 LIQUIDITY

The nominal or flat yield should be used for interest rates on liquid assets.

G5 LOAN ASSETS

The interest rate to be used is the rate charged to the loan account, and in certain circumstances will differ from the interest rate "payable" by a borrower. These circumstances include deferred interest loans, interest roll up loans, and annual review schemes.

Advances in month refers to the same amount as covered under "advances in month" in the Loans and Investments table in Section F

APPENDICES TO NOTES ON FORM MFS1.

Classification of residence and institutional sectors

These appendices supplement the guidance notes to the MFS1 return [as well as the MFS1 Supplement and the QFS2 returns] by providing the detailed information needed to sectorise items on these returns.

All queries on **building societies, building society subsidiary undertakings and other connected undertakings of building societies** should be addressed to the Financial Risk Analysis and Monitoring Group, Financial Services Authority (telephone 020-7676-0630/0690).

Queries on these appendices, or suggestions for their clarification or improvement, should be addressed to the Monetary Statistics Division of the Bank of England (telephone 020-7601-3742); Threadneedle Street, London EC2R 8AH.

FSA MONITORING RETURNS: A SECTOR COMPONENTS MAPPING DOCUMENT

MFS1	MFS1 SUPPLEMENT	QFS2
A.U.K. banking sector	-	-
B. Building societies sector	-	-
C. UK public sector	-	-
D. Non-resident sector	-	-
E. Other UK sector (U.K. non-bank non-b/soc private sector)	<p>1. MFI's other than banks and building societies.</p> <p>2. Financial corporations other than MFI's.</p> <p>3. Non-financial corporations</p> <p>4. Households and individual trusts</p> <p>5. Non-profit institutions serving households</p>	<p>Money market mutual funds [A1.0]</p> <p><i>[A1.1 Financial Corporations]</i></p> <p>i. Insurance companies [A1.1a]</p> <p>ii. Pension funds [A1.1.b]</p> <p>iii. Financial auxiliaries [A1.1c]</p> <p>iv. Financial U L partnerships [A1.1d]</p> <p>v. Other institutions [A1.1e]</p> <p><i>[A1.2 Non-financial Corporations]</i></p> <p>i. Non-financial unlimited liability partnerships [A1.2a]</p> <p>ii. Other non-financial corporations [A1.2b]</p> <p>i) Individuals and individual trusts [A1.3]</p> <p>ii) Unincorporated businesses.[A1.4]</p> <p>Non-profit institutions serving households [A1.5]</p>

FINANCIAL SERVICES AUTHORITY

BUILDING SOCIETY : MONTHLY SUPPLEMENTARY STATEMENT

MFS1 SUPPLEMENT

GUIDANCE NOTES

Sections

Introduction:	General notes on return
Sections B8-10:	Sectoral Analysis: Balance Sheet - Liabilities/Assets
Section B11:	Balance Sheet: Repo & Stocklending Analysis
Appendix A:	Sector mapping document

Submission of returns

This statement must be submitted by close on the 7th business day after the month end. It should only be completed by those societies required to complete the MFS1 return to the faster timetable.

BUILDING SOCIETY : MONTHLY SUPPLEMENTARY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

1. Introduction

Following enactment of EU legislation, the UK, in concert with all other EU member states, have adopted the new scheme of sector classification as defined in the European System of National and Regional Accounts (abbreviated to "ESA 95"). The analyses set out in Forms B8-10 arise from these requirements.

2. Sector classification

The MFS1 guidance notes [Introduction 5 and 7] provide general information about the main institutional sectors. The supplementary return Forms B8-10 seeks a more detailed analysis of one of these sectors, namely, the "Other UK sector" (UK non-bank non-building society private sector). To enhance understanding of these analyses and to ensure consistency with corresponding data items in the QFS2 statement a 'sector mapping document' is attached as Appendix A.

Societies should refer to Appendix II to the main MFS1 Guidance Notes which gives fuller details of the sectoral classifications.

3. Accuracy

As the main purpose of the figures is to provide broadly accurate aggregates for the total of all societies, estimates of less precision than the data entered on the MFS1 return will be acceptable in compiling the component sectoral details required on the MFS1 Supplementary return.

However, societies are asked to advise the Financial Services Authority (the Financial Risk Analysis and Monitoring Unit) of any subsequently discovered errors resulting in changes of over £25 million.

BUILDING SOCIETY : MONTHLY SUPPLEMENTARY STATEMENT

SECTIONS B8-B10 : SECTORAL ANALYSIS: BALANCE SHEET - LIABILITIES/ASSETS

B25.1-B27.5 SECTOR INSTITUTIONS

The UK Sector is analysed here under five components as follows:

a. MFI's other than banks and building societies

this category comprises money market mutual funds only.

b. Financial corporations other than MFI's

this category comprises insurance companies, pension funds, financial auxiliaries and other institutions. Societies' subsidiary undertakings which fall within the 'other UK sector (eg a subsidiary undertaking doing lending within the UK) should be included here being part of the "other institutions" category.

c. Non-financial corporations

this effectively refers to industrial and commercial companies, that is, mainly ordinary plc's.

d. Households and Individual trusts

this category includes individuals and individual trusts as well as unincorporated businesses other than **unlimited liability partnerships**. It should be noted that unlimited liability partnerships are now part of the corporate sector (financial or non-financial).

e. Non-profit institutions serving households includes organisations such as the AA; non-profit making schools etc.

BUILDING SOCIETY : MONTHLY SUPPLEMENTARY STATEMENT

B28-30 REPO & STOCKLENDING ANALYSIS

Guidance on the completion of the Repo & Stocklending analysis (Form B.11) is provided in section B/6 of the MFS1 guidance notes.

FINANCIAL SERVICES AUTHORITY
BUILDING SOCIETY: QUARTERLY STATEMENT
QFS1
GUIDANCE NOTES

Sections

Introduction:	General notes on the return
Section A:	Balance Sheet
Section B:	Income and Expenditure
Section C:	Income and Expenditure: Further analysis
Section D:	Capital Available: Own Funds
Section F:	Capital: Solvency Ratio
Section G:	Loans FSRP to individuals
Section H:	Loans: other FSRP and other FSOL
Section I:	All loans secured on land - further analysis
Section J:	Lending: Capitalisations and Sales
Section K:	Lending: Arrears analysis
Section L:	Exposure Analysis: Large exposures
Section M:	Maturity analysis
Section N:	Organisation
Section P:	Investments: By type of activity
Section X:	Summary of cross checks on the return
Section Y:	Checklist of line items routinely to be deducted

Submission of return This return must be sent by close on 18th business day after society's financial quarter end.

QFS1: INTRODUCTION/1

BUILDING SOCIETY: QUARTERLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

1. Introduction

This section covers a number of points that have relevance across the return generally:

- 2) Building Societies Act 1986
- 3) Accounting conventions
- 4) Accuracy
- 5) Society, connected undertakings and group figures
- 6) Time horizons
- 7) Outturn information
- 8) Specific items:
 - (i) positions to be reported gross
 - (ii) accrued interest
 - (iii) foreign currencies
 - (iv) use of brackets (..) around figures
- 9) Building society mergers
- 10) Overseas subsidiary undertakings
- 11) Subsidiary undertakings: year ends

2. Building Societies Act 1986

Any reference to "the 1986 Act" is a reference to this legislation (as subsequently amended).

3. Accounting conventions

Unless advice is given to the contrary in these Guidance Notes, the return should be compiled using standard accounting practice and in accordance with accounts regulations made under the 1986 Act.

BUILDING SOCIETY: QUARTERLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

3. Accounting conventions (continued)

The return has been designed with the aim of harmonising line items wherever possible with those required under accounting regulations, and as used in societies' published and internal accounts. In many instances line items reflect the basis adopted in the 1998 accounting regulations.

4. Accuracy

It is expected that entries on the return will be actual values or in some cases close approximations established or drawn from the society's systems and prepared on the basis of being the best information in the time available for their compilation.

5. Society, Connected Undertakings and Group figures

Societies may hold investments in different types of undertakings.

The 1986 Act defines certain undertakings in which a society may have an interest as "connected undertakings", that is "subsidiary undertakings" and "associated undertakings". In addition to these however a society may also have "other participating interests" or hold "other equity shares" (that is non participating interests). These terms are amplified below:

Subsidiary undertakings: As defined in Companies Act 1985, section 258, which essentially means undertakings over which the society exercises control or dominant influence.

Participating interests: An interest held by a society in the shares of another undertaking which it holds on a long term basis for the purpose of securing a contribution to its activities by the exercise of control or influence arising from or related to that interest. A holding of 20 per cent or more of the shares of an undertaking is presumed to be a participating interest unless the contrary has been agreed with the Financial Services Authority. (Full definition is that given in Companies Act 1985, section 260).

QFS1: INTRODUCTION/3

BUILDING SOCIETY: QUARTERLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

5. Society, Connected Undertakings and Group figures (continued)

For the purposes of group figures the category "**participating interests**" subdivides into:

Associated undertakings: A participating interest in which the society exercises a significant influence over the operating and financial policy. (Full definition given in Companies Act 1985, schedule 4A paragraph 20).

Other participating interests: A participating interest that does not fall to be included within the definition of an associated undertaking.

Other equity shares: These essentially refer to non-participating interests in other undertakings. They include any other investments which do not fall to be included within any definition above, such as trade investments (e.g. BACS, APACS etc) or other forms of equity holdings (e.g. XYZ plc).

BUILDING SOCIETY: QUARTERLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

5. Society, Connected Undertakings and Group figures (continued)

The accounting treatment of these investments is best summarised. Reference to the table below should help societies to determine an acceptable and reasonable approach:

BALANCE SHEET		Society	Group
(a)	Subsidiary undertakings	Investment at cost less any permanent diminution in value	Full consolidation line by line.
(b)	Participating interests in:		
(b).1	Associated undertakings	Investment at cost less any permanent diminution in value.	Cost of investment and share of post acquisition retained reserves.
(b).2	Other participating interests	Investment at cost less any permanent diminution in value.	Investment at cost less any permanent diminution in value.
(c)	Other equity investments	Investment at cost less any permanent diminution in value.	Investment at cost less any permanent diminution in value.

Note: only one of (b)1 or (b)2 applies for each column.

INCOME AND EXPENDITURE ACCOUNT		Society	Group
(a)	Subsidiary undertakings	Dividend receivable	Full consolidation line by line.
(b)	Participating interests in:		
(b)1	Associated undertakings	Dividend receivable	Share of profits or losses.
(b)2	Other participating interests	Dividend receivable	Dividend receivable.
(c)	Other equity investments	Dividend receivable	Dividend receivable.

Note: only one of (b)1 or (b)2 applies for each column.

BUILDING SOCIETY: QUARTERLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

5(i) Society, subsidiary undertakings and Group (consolidated)

The quarterly return is designed to collect information in respect of the society itself, of the society's subsidiary undertakings and for the group (on a consolidated basis).

5(ii) Subsidiary undertakings

Columns headed "subsidiary undertakings" means the total in respect of all such bodies which are required to be fully consolidated in group accounts (e.g. published accounts)

5(iii) Group (consolidated)

Columns headed "Group (consolidated)" should be compiled on a basis equivalent to that used in preparing published Group figures. The figures under "Group" will not necessarily be the total of those under "society" and "subsidiary undertaking" because of consolidation adjustments.

6. Time horizons

The return seeks information in respect of 3 different time horizons as follows:

6(i) Latest quarter (LQE/YTD)

Where stock figures are required (e.g. balance sheet, capital position etc) the information is as at the "latest quarter end", abbreviated to **LQE**.

Where flow figures are required these are either for **3 months only** (i.e. the latest quarter) as in for example lending figures in table G and H, or **cumulative in the "year to date"**, abbreviated to **YTD** (e.g. income and expenditure table B etc), covering the period from the start of the society's financial year to the end of the reporting quarter.

For the society's financial year the four quarters are numbered Q1, Q2, Q3 and Q4. These will only coincide with calendar year quarters if the society's financial year end is 31 December, which means that Q4 is always for the end of the society's financial year.

BUILDING SOCIETY: QUARTERLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

6(ii) Current financial year (CFYE/CFY)

When the return is being completed at end Q1, Q2 or Q3, then current financial year is that same year. However at Q4, the "current financial year" refers to the year covering the 12 months immediately following Q4.

Where stock information is required at the current financial year end this is abbreviated to **CFYE**.

Where flow figures are required, covering the whole current financial year, this is abbreviated to **CFY**.

6(iii) Next Financial Year (NFYE/NFY)

This is always the 12 month period immediately following "current financial year" (defined above).

Abbreviations used in column headings for "next financial year" are NYFE (stocks), and NFY (flows).

7 Outturn information (Actual/Expected/Likely)

Information required in respect of the three different time horizons (described in 6) above) has the following meanings associated with "outturn":

7(i) Actual means as derived from the society's information system(s) within the time period allowed for its compilation and timely submission to the Financial Services Authority. It does not mean audited (Interim profits in table D is the one exception). In many cases the information will be substantially the same but there may be certain items that are not so readily available in which case close approximations should be provided, being prepared on the basis of being the best information in the time available for their compilation.

BUILDING SOCIETY: QUARTERLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

7(ii) **Expected** means the outturn figures that the society considers are the best estimate (at the time of their compilation) of how the full year will turn out. **It is anticipated that a society will be updating its view each quarter of how it sees the full year position**, and that whereas the basis of that estimate the first time it is compiled for CFY/CFYE (i.e. Q4) may well be a current "budget" figure, subsequent quarterly updates of the full year position will be revised estimates based on business experience in the year to date and an updated assessment of business expected to be undertaken in the remainder of the current year.

7(iii) **Likely** means the aim here is to get a reasonable assessment of the outturn for the next financial year (NFY). This assessment will first of all be given in the return at Q4, at which time the end of the NFY is 8 quarters away. At this stage a "reasonable assessment" of outturn may well be planning figures in the society's corporate plan or more recently decided budget figures. The source of figures for later **quarterly assessments of NFY** will depend on the society's arrangements for revising budgets, preparing projections/forecasts etc for future time periods, but the aim is to make use of the most recently compiled set of figures which provides a reasonable assessment of the likely outturn for NFY. The term "likely" is used since it will be a less firm basis than "expected" (for CFY) because of the longer time horizon involved.

8 **Specific items**

8(i) **Positions to be reported gross**

In general, liabilities and assets should be shown gross, and not netted off. Thus an account which moves from credit to debit will move from one side of the balance sheet to the other.

A notable exception to this however concerns the reporting of loan assets which are subject to "linked presentation" under FRS5. Such assets should be shown in the balance sheet net of linked funding and also on this basis in other tables where balances are reported on the same basis (e.g. F, G, H, I as relevant).

QFS1: INTRODUCTION/8

BUILDING SOCIETY: QUARTERLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

8(ii) **Accrued interest**

Accrued interest is identified explicitly in the monthly return MFS1, in the balance sheet under specific sub-heads. Analysis elsewhere on that return may require either the inclusion or exclusion of accrued interest, but this is indicated on the face of that return as appropriate. Where an item in the MFS1 (excluding accrued interest) is also analysed in QFS1 the same approach is used, for example in table M.

8(iii) **Foreign currencies**

Amounts in foreign currencies should be translated into their equivalent sterling value at the closing middle market spot rate on the reporting date, or where appropriate, at the rates of exchange fixed under the terms of any relevant currency hedging transaction, and that value used in the return. Thus all entries in the form represent sterling amounts. Societies should apply the same accounting treatment as for the published accounts having regard to SSAP 20.

8(iv) **Use of brackets (..) around figures**

All amounts should be shown without brackets, that is shown as a positive amount, unless:

- a) the amount is of the opposite sign to that expected
- b) the entry could either be positive or negative: in which case the sub-heading should indicate which of the alternatives e.g. "profit/(loss)" is to be shown in brackets.

In any table where an item is routinely to be deducted (e.g. provisions in balance sheet and income and expenditure) the amount should **not** be shown in brackets.

The **exception** would be if the value was of the opposite sign (i.e. negative) and required to be added not deducted, in which case brackets would be necessary. "Deducting" items are summarised in Section Y of these Notes.

QFS1: INTRODUCTION/9

BUILDING SOCIETY: QUARTERLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

9 **Building society mergers**

When a merger of societies takes place, the quarterly return should be completed as follows:

transferring society: should always complete a "closing" return up to the date of the merger, with flow/transaction figures for the "latest quarter" covering the relevant period to the date of transfer, and balances as at the date of transfer;

accepting society: in completing its first quarterly return after the merger should include flow/transaction figures of the transferring society only from the date of merger. This return will of course show the balance sheet amounts in respect of the combined society.

10 **Overseas subsidiary undertakings**

Should be treated as they would for the purposes of the society's published accounts (e.g. attributing such overseas assets and liabilities to the relevant balance sheet items used in the Accounts Regs.)

11 **Subsidiary undertakings: non-coterminous financial year ends**

The basis of figures included in the return for subsidiary undertakings with the same financial year end as that for the society should be for the same 3 month periods as for those of the society.

However where a subsidiary undertaking's financial year end is non-coterminous with that of the society, the basis of the subsidiary's figures should be as follows:

- a) data should relate to the same 3 months period as that applicable for the society; or
- b) where a) would not match a quarter financial year of the subsidiary (e.g. where society's financial year end is say 31 January but subsidiary's is 31 December) and to extract data to match the society's 3 month period would be difficult, then data for the subsidiary may be based on its own quarterly period ending within - but not prior to - the society's 3 month period. This would result in the subsidiaries figures "lagging" by no more than 2 months in relation to those of the society.

QFS1: INTRODUCTION/10

BUILDING SOCIETY: QUARTERLY STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

Whereas the Accounts Regulations permit a lag of up to 3 months in annual data, the more frequently collected quarterly data needs to be more time-relevant and, where possible, societies should provide information on subsidiaries for the society's actual quarter rather than lagged by up to 2 months.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION A: BALANCE SHEET

1. This is a summarised analysis of those balance sheet items given in the Monthly Statement (MFS1) with information being separately required for society, subsidiary undertakings and group (consolidated).
2. For definitions/notes on balance sheet items please refer to Notes for Guidance on MFS1.
3. Figures for "Society" and "Group (consolidated)" at LQE should be prepared on a basis consistent with that used for corresponding entries in the society's MFS1 return (Table A) for the month coincident with the quarter end. Because of the later preparation of the QFS1 it is possible that some societies will have firmer, more up to date figures, than those used in the MFS1. Accordingly the QFS1 should be compiled using these more accurate figures where these are available.

Statutory Percentages (Nature Limits)

The purpose of lines items A14 and A15 is to report the actual value at the quarter end (and the expected value for the current financial year end) of the statutorily defined percentages related to the funding and lending nature limits.

A14 **Value of funding percentage:** as defined in section 7(1), (2) and (3) of the 1986 Act this will give the percentage of total funding (i.e. all shares plus deposits & debt securities) accounted for by those elements of funding which are restricted (i.e. all funding apart from shares held by individuals). In the terminology of the 1986 Act the amount to be calculated is

$$\frac{X - Y}{X} * 100$$

where: Y is Shares held by individuals, and X is all shares plus all deposits & debts securities. As in the 1986 Act, Y should be the value on that day or on the immediately preceding quarter day, whichever is the greater. Both X and Y should be inclusive of accrued interest.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION A: BALANCE SHEET

A15 **Value of lending percentage:** as defined in section 6(1), (2) and (3) of the 1986 Act, this will give the percentage of "business assets" (see X below) accounted for by those "business assets" other than loans fully secured on residential property. In the terminology of the 1986 Act the amount to be calculated is

$$\frac{X - Y}{X} * 100$$

where: Y is loans fully secured on residential property, and X is defined as (total assets **less** fixed assets, liquid assets and long term insurance funds, **adding** back provisions for bad and doubtful debts). Both X and Y are inclusive of accrued interest.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION B: INCOME AND EXPENDITURE ACCOUNT

Items should be compiled on the same basis as specified in the Accounts Regulations [1998]. See also Guidance Notes on AFS1 (Table B).

B6.2 Administrative Expenses: Other (inc. appointed agents)

"**Appointed agents**" refers to those properly appointed by the society to act as its agent mainly for the purpose of obtaining retail funding or making loans.

The amount is the cost to the society of commissions (e.g. on shares or deposits from individuals) and any other payments made by the society to its appointed agents.

This amount is included within the **other expenses** sub-head of **Administrative Expenses** in published accounts under the Account Regulations and is shown similarly on the return.

B9 Fixed asset write offs

Includes amounts written off fixed asset investments (i.e. transferable securities held as financial fixed assets, participating interests and shares in subsidiary undertakings).

B10 Other (please specify in a note)

Includes exceptional items (unless already included within any other earlier item).

B15 Extraordinary profit/(loss) after tax

This is to be shown after deducting any relevant amount of extraordinary profit/(loss) attributable to minority interests.

B17-19 Reconciliation of net Profit/(Loss) with changes in reserves

The purpose of these items is to show the analysis of changes in reserves during the relevant period, and the reconciliation is

B19 must equal (B16 + B17 + B18)

"Reserves" has the same meaning as in the Accounts Regs and hence excludes revaluation reserves.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION B: INCOME AND EXPENDITURE ACCOUNT

B18 Adjustments to reserves in period

Refers to non income and expenditure account effects on reserves, that is for example on mergers etc.

In the case of columns for subsidiary undertakings, also use B18 to include dividends payable.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION C: INCOME AND EXPENDITURE ACCOUNT - Further Analysis

C1 Other income and charges

Line items C1.1 d) and C1.2 to C1.6 correspond with the same headings in the Accounts Regulations.

C1.1 Fees and Commission receivable

Is further analysed into "Life insurance & pensions", "general insurance" and "other".

C1.3 Net profit/(loss) on financial operations

The Accounts Regulations define this category as including:

- (i) net profit or loss on transactions in securities which are not held as financial fixed assets (see Note below), that is on such liquid assets held as a trading book, together with amounts written off or written back arising from valuation differences between book value and market value;
- (ii) net profit or loss on financial instruments (hedging instruments) except in so far as that income or charge is treatable as interest and included in interest receivable/payable (e.g. as may be the case for interest rate swaps).

Note: "**Financial fixed assets**" means securities held as fixed assets; participating interests and shareholdings in subsidiary undertakings should always be regarded as financial fixed assets.

"**Fixed assets**" means assets of a society which are intended for use on a continuing basis in the society's activities, and "**current assets**" means assets not intended for such use.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION C: INCOME AND EXPENDITURE ACCOUNT - Further Analysis

C2 Impact of loan book acquisition and loan incentives/discounts

This table analyses the impact on the Income & Expenditure account, and on the Balance Sheet, of the **gross** amounts (shown under "deductions from Own Funds") as follows:

- (i) **premia** (i.e. the difference between the total cost of the acquisition and the book amount, in the books of the vendor, of the assets acquired) and/or other acquisition and set up costs paid on the acquisition of mortgage or other loan assets;
- ii. amounts paid, by way of an up-front **incentive** to take out or retain a loan, which are being amortised over a number of accounting periods; and
- iii. amounts relating to the amortisation of **discounts** offered on loans (i.e. balances created as a result of spreading interest receivable on a loan across a number of accounting periods).

C2.1/2 A distinction is drawn between two situations: where expenditure on any of the above is deferred (analysed in C2.1) and where expenditure is not deferred (shown in C2.2).

C2.2 In the case of **loan incentives where expenditure is not deferred**, the amounts shown here should include the cost of cash backs and of meeting any costs which in normal circumstances would be paid by the borrower e.g. legal costs, valuation or other costs.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION D: CAPITAL AVAILABLE : Own Funds

Introduction

This section and section F are based predominantly on the Prudential Guidance on Solvency (referred to below as P/G) and to a limited extent on the Prudential Guidance on Issued Capital (referred to below as such) contained in Volume 1 of the Interim Prudential Source Book ("IPSB") for Building Societies which together implement those parts of the Banking Consolidation Directive (2000/12/EC) which replaced the former EC Directives on a Solvency Ratio for Credit Institutions and on the Own Funds of Credit Institutions. These guidance notes should be read in conjunction with the Prudential Guidance.

However there are two specific concepts in the P/G that call for further advice. These are "**Solo consolidation**" (where a society's figures should in certain circumstances be aggregated with those for specific subsidiaries before reporting in "society" columns) and "**Exclusion from consolidation**" (where figures for certain undertakings such as a life insurance subsidiary should be excluded in the reporting of "Group" columns). A technical note on how they impact on tables D and F is included at section F/3.

D1-4 Capital available (own funds)

Sets out the individual components of capital permitted under the Banking Consolidation Directive (each of which should correspond by amount with the same headings in the balance sheet, except D2.1 - see below) and the separate deductions that should be made to arrive at qualifying capital. (See also relevant Annex of P/G).

TIER I CAPITAL

D1.1 Reserves at start of year

Reserves exclude revaluation reserves which are to be shown at D2.1

NB: In the case of a merger, reserves acquired on merger should be added in to opening reserves, and B17 should be similarly adjusted.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION D: CAPITAL AVAILABLE : Own Funds

D1.2 Interim profits (since start of year)

Interim profits refers to the cumulative amount covering either the financial year to end of latest quarter, or covering the whole of the current or next financial year.

In the case of interim profits covering the period from the start of the CFY to the end of the latest quarter (columns 1 and 4) such profits may only be shown if they have been verified by the society's external auditors. See also relevant Annex of P/G.

D1.3 Overall losses in period

This refers to any overall current year loss, which must be deducted. Only one of D1.2 or D1.3 will apply, but while there is an option to include interim profits (assumed positive) it is mandatory under the Banking Consolidation Directive to deduct interim losses (i.e. where the society or group is showing an overall loss).

D1.4 Intangible fixed assets

Should be deducted. It includes, for example, goodwill to the extent that it is already included in the balance sheet (and hence already included in reserves). See also fuller details for this item in the Accounts Regs.

D1.5/6 Subscribed capital - deferred shares

Covers deferred shares permitted as additional capital resources (at present, **Permanent Interest Bearing Shares - PIBS**, and existing **deferred shares** issued prior to 1 June 1991).

D1.7 Minority interests (allowable)

The Banking Consolidation Directive provides for the inclusion, subject to certain conditions, of **minority** interests in the calculation of the **consolidated** own funds of a society and its subsidiaries. (See section on Minority Interests in P/G for those which can be treated as Tier I)

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION D: CAPITAL AVAILABLE : Own Funds

TIER II CAPITAL

D2.1 Revaluation reserves (net)

Means revaluation reserves net of any foreseeable tax charge. Revaluation reserves should be included on the basis set out in the P/G.

D2.2 General provisions for bad debt

General provisions should be included on the basis set out in the relevant Annex of the P/G.

D2.3 Undated subordinated debt

As referred to in Issued Capital P/G.

D2.4 Term subordinated debt

As referred to in Issued Capital P/G.

D2.5 Other tier II

Any tier II capital resource that may be permitted in the future and which does not fall to be included under any of the above sub heads.

Also include here under "**group**" columns only, the amount of any allowable minority interests that count as Tier II.

D2.7 Amounts in excess of Tier II limits

These amounts not qualifying as capital are calculated in respect of two limitations on the extent to which certain items can be taken into account:

- (i) The total of all Tier II capital resources taken into account must not exceed the total of Tier I constituents (i.e. reserves, interim profits, PIBS and other deferred shares), less intangible fixed assets; and

QFS1: SECTION D/4

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION D: CAPITAL AVAILABLE : Own Funds

- (ii) Term subordinated debt may not count to an amount in excess of 50% of the (total of Tier I constituents [i.e. reserves, interim profits, PIBS and other deferred shares], less intangible fixed assets).

D3 Deductions from Tier I and Tier II

D3.1 Deductions not shown elsewhere

Deduct all holdings of capital instruments of other credit or financial institutions, CFIs. (See Annex of P/G for fuller definitions). This means holdings of share capital in a society's connected undertakings. For society columns it is any such holdings in CFIs; for Group columns only include holdings in such bodies that are not consolidated in Group figures.

Also include deductions (described in P/G) in respect of the following: life and general insurance companies, mortgage indemnity insurance captives, securitisations, etc.

D3.2 Capital deficits in subsidiary undertakings

By **Capital deficit** is meant the excess (if any) of a subsidiary undertaking's liabilities over its assets, that is the net amount of capital (made up of retained profits and issues of capital) is negative. However, if the society has already excluded (that is made a provision for) the amount of any such capital deficit in a subsidiary undertaking (or undertakings) from the society's own reserves then it is not necessary to also include such an amount at line D3.2.

For these purposes capital deficits in subsidiary undertakings should represent the aggregate of all such capital deficits, but should not be offset by any capital surpluses in other subsidiary undertakings.

The amount of the capital deficit of any subsidiary undertaking with such a deficit should be deducted (for society only calculations); and

The proportion attributable to outside minority interests in the capital deficit of any subsidiary undertaking with such a deficit should be deducted (for consolidated calculations).

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION F: CAPITAL: Solvency Ratio

This sets out the components required for calculation of the solvency ratio in accordance with the EC Banking Consolidation Directive. Details of individual components are given in the Prudential Guidance on Solvency (referred to below as the P/G).

However there are two specific concepts in the P/G that call for further guidance. These are "**Solo consolidation**" (where a society's figures should in certain circumstances be aggregated with those for specific subsidiaries before reporting in "society" columns) and "**Exclusion from consolidation**" (where figures for certain undertakings such as a life insurance subsidiary should be excluded in the reporting of "Group" columns). A technical note on how they impact on tables D and F is included at section F/3.

On balance sheet items

Details of risk asset weights are given in an Annex of the P/G.

All loan asset balances in table F should be shown net of specific provisions (see below).

F2

Loan assets are sub-divided into three distinct categories:

- i. Loans fully secured on residential property (FSRP), with amounts shown separately for weights of 50% (e.g. to individuals on owner-occupied property, loans to individuals on buy to let mortgages, to housing associations), and 100% (e.g. loans to corporates)
- ii. Other loans fully secured on land (FSOL) with amounts again shown separately for weights of 50% (e.g. pre-existing loans to housing associations), 100% (e.g. to corporates and others where not on residential property)
- iii. Other loans to customers covering consumer credit to individuals and other loans (not secured on land) to businesses etc.

NB : Line items F2.2 and F2.3 of the QFS1 return (i.e. loans weighted at 60% and 75% respectively) should be left blank as they no longer apply.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION F: CAPITAL: Solvency Ratio

Off balance sheet items

The treatment of off balance sheet items is described in the P/G.

The treatment of **mortgage commitments** as falling within either F6.4 (medium risk) or F6.6 (low risk) depends on the conditions of mortgage offer letters. Offers (deemed to be commitments) are classified under the 50% medium risk category providing that the letters make no statement to the effect that the offer can be unconditionally withdrawn by the society without notice. Otherwise offers attract a low risk weighting of zero percent.

Columns Asset amount and Weighted amounts

Columns headed "**asset amount**" should show the nominal asset figures (including accrued interest). For "on balance sheet" items totals of relevant categories (e.g. liquid assets) should agree with amounts shown in the balance sheet table A (except in the case of loan assets, where balances should be shown after the deduction of specific provisions), unless of course "solo consolidation" or "exclusion from consolidation" applies to table F. For "off balance sheet" items the nominal asset amount is the amount of principal involved (which in the case of F6.3 to F6.6 is the amount prior to the application of any credit conversion factor).

Columns headed "**weighted amounts**" should show figures arrived at after completing the relevant stages described in, and shown in the examples in, the P/G.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION F: SOLO CONSOLIDATION & EXCLUSION FROM CONSOLIDATION

Solo Consolidation

Only tables D and F of QFS1 are affected by solo consolidation.

Table D The **society** columns (1 to 3) should be compiled as follows:

- (i) for each line item in turn, the amount entered in D1.1 to D4 on the return should be the sum of:
 - a. the "society only" figure for that line item, plus
 - b. a percentage of the individual subsidiary undertaking figure for that line item,
 - c. minus, the amount of any of the subsidiary undertaking's own funds included in (b) which represents an investment by the society (being the consolidation adjustment)
- (ii) the percentage in (i)(b) will either be 100%, or such lower amount that results after applying the deduction specified by the society's Supervisor when agreement is given for the subsidiary to be solo-consolidated.

Table F The **society** columns (1 to 4) should be compiled as follows:

- (i) for each line item in turn, the amount entered in F1.1 to F6.7 should be the net result of a), b) and c):
 - a. the "society only" figure for that line item, plus,
 - b. the full amount (i.e. without deduction) in respect of that subsidiary undertaking,
 - c. minus the amount of any of the society's or subsidiary undertaking's assets that represent investment in or loans to the other party.
- (ii) the solvency ratio then follows, using the solo-consolidated figures in tables D and F.

BUILDING SOCIETY: QUARTERLY STATEMENT**SECTION F: CAPITAL: Solvency Ratio****Exclusion from Consolidation**

Only tables D and F of QFS1 are affected by the exclusion from consolidation of a life or general insurance company (or other undertaking agreed with the Financial Services Authority).

Details of the adjustments for "**society**", and "**group**" columns are:

Society Columns

Table F (i) in **table F**, deduct from the "asset amount" column the carrying value of the society's investment (see note (a)) in the undertaking being excluded from the consolidation. This deduction will apply to other assets (F4.3). The "weighted amount" columns will need to be calculated after the deduction has been made from column 1 (and from equivalent "asset amount" figures used in the derivation of "weighted amounts" for CFYE and NFYE columns); and

Table D (ii) in **table D**, deduct from the society's own funds the same amount deducted from table F (as described above). This amount should be included in line D3.1 Deductions not shown elsewhere.

Note (a) In the case of an intermediate holding company, it is the holding company's investment in

Group (Consolidated) Columns

Table F (i) in **table F**, the starting point is notional group (consolidated) figures which include the undertaking to be excluded from the consolidation. The effects of "exclusion from consolidation" in respect of the particular undertaking concerned are then achieved by:

a. for each line item in turn (F1.1 to F6.7), deducting from the "asset amount" and "weighted amount" columns the relevant amounts attributable to the undertaking being excluded.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION F: CAPITAL: Solvency Ratio

Group (Consolidated) Columns (continued)

Table D (ii) in **table D**, the starting point is notional group (consolidated) figures which include the undertaking to be excluded from the consolidation. From these figures:

- a. for each line item in turn (D1.1 to D4) deduct the relevant amounts attributable to the undertaking being excluded, except where any such amount relates to an investment by the parent society (that is capital other than reserves, since this will already have been eliminated in compiling notional group consolidated figures),
- b. deduct from group reserves (at D1.1) the amount of any embedded value included in respect of a life company.

NB: the above treatment for **group columns** in tables D and F is **not** the same as compiling group (consolidated) figures for the society and all consolidatable undertakings other than the undertaking being excluded from the consolidation (which would give a different treatment in respect of the society's investment in, and loans to, the undertaking being excluded from the consolidation).

BUILDING SOCIETY: QUARTERLY STATEMENT**SECTION G: LOANS FSRP TO INDIVIDUALS****Introduction**

Loans and advances to customers are analysed as follows in tables G to K:

Lending category	Table in QFS1
Loans fully secured on residential property (FSRP):	
To individuals	G(1), G(2), I, J, K(1), K(2)
To housing associations	
To others	
Other loans fully secured on land (FSOL):	
To individuals	Loans in these 5 lines have been combined together as "Loans: other FSRP + other FSOL" in tables H, I, J, K(1), K(2)
To housing associations	
To others	
Other loans to customers:	
To individuals	J, K(1), K(2)
To others	

The focus on "Loans FSRP to individuals", as opposed to the wider category of "All loans FSRP" (which includes to housing associations and corporates etc) is deliberate. The nature of the market, the lending products and volumes involved, and the risk profile of "loans FSRP to individuals" are considered to be sufficiently distinct as to merit separate analysis. This category is the dominant element of total lending, in the same way that class 1 loans were dominant among commercial assets under classifications used prior to late 1998, and also happens to cover broadly the same range of loans as old class 1 (the category is marginally wider).

Gross advances in quarter

Covers actual advances made in the quarter. For these purposes separate advances (e.g. stage payments) on the same mortgage should count as a single advance for the "number" column.

NB: "gross advances" should be compiled on the same basis as for the MFS1/2, and accordingly exclude any mortgage book acquisitions in the quarter.

G1 **Type** [NB: "By Type" analysis no longer required –Paragraphs G.1.1 to G1.4 deleted]

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION G: LOANS FSRP TO INDIVIDUALS

G2 Purpose

This analysis is to identify the principal purpose of the loan, which should be available from the application form. A loan should therefore only be classified to one category of G2.1 - 2.6. A stage advance should be classified for the same purpose as the main advance.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION G: LOANS FSRP TO INDIVIDUALS

G2.1/2 House purchase

Loans where the borrower is purchasing a house (or flat etc). Include stage payments on such transactions here and not in "further advances". A distinction is drawn between loans for house purchase where the purpose is for owner occupation, or for buying with a view to letting ("buy to let").

G2.3 Further advance

A further loan (either as a normal further advance, or as a second charge loan where the society has the first charge) to an existing borrower of the society, secured on the same property.

(The underlying purpose of the further advance is not relevant and could include e.g. purchasing freehold interest in a currently owned leasehold property, buying a second property on the security of the first, or as a consumer loan fully secured on residential property.)

G2.4/5 Remortgage

Loans where the borrower is not moving house but is refinancing an existing loan, either one already with the society or one from another lender. The whole amount of the new advance should be classified as 'remortgage' even if it is larger than the existing loan.

G2.6 Other

Would include for example where a borrower is not moving house but takes a loan on the security of his previously unmortgaged property.

G3 By Income Multiple and LTV

The amount to be included in the table is the **gross advance**, but its allocation to a specific cell is determined according to income multiple and LTV which are both defined using the size of **the loan (as defined below)**.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION G: LOANS FSRP TO INDIVIDUALS

G3 By Income Multiple and LTV (continued)

Income multiple based on single or joint incomes

The loan should first of all be categorised to "single" or "joint" income basis, and the income multiple calculated as described below:

- (i) **single income basis.** This means only one person's income was taken into account when making the lending assessment/decision.

The income multiple here is the total loan amount divided by the borrower's total income (total of the borrower's main income and any other reckonable income e.g. overtime etc, to the extent that the society takes such additional income into account in whole or in part).

- (ii) **joint income basis.** This means that two persons' incomes were used in the lending assessment/decision.

The income multiple here is the total loan amount divided by the aggregate income of the two borrowers.

G3.4 In the following cases, irrespective of whether it is a single or joint application, the advance should be allocated to the highest single income multiple (i.e. line G3.4: income multiples of 3.5 or more):

- (i) where income is not known, or
- (ii) where the loan application fails the "status confirmed" test (see P/G on Solvency) **and** there is no documentary evidence of income.

For the purpose of income multiples, the multiple is of loan to income where loan is as defined below.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION G: LOANS FSRP TO INDIVIDUALS

G3 By Income Multiple and LTV (continued)

Loan to valuation ratio LTV

Should be based on the following:

- (i) **Loan** is defined for:
 - (a) **new borrowers** - as the amount of actual advance or, in the case of instalments/stage payments/retentions, is the amount of committed advance (including any committed drawing facilities)
 - (b) **existing borrowers** - as the total amount of debt outstanding including the further advance plus any committed drawing facilities at the time of the further advance;

and will include MIG, building and other insurance premiums and other sundry items if these are included in the amount advanced.

- (ii) **Valuation** is to be taken as the most recent valuation of the property which is subject to the mortgage. (The existence of additional collateral on any other property should be ignored when calculating LTV.) In the case of staged construction or self-build schemes, valuation means "expected final value of the property" at the time the society is committed to making the loan (i.e. takes the lending decision).

G4 Insured exposure above 75% LTV

Is an analysis of amount shown in G3.11 columns 2-4 and 6-8.

G4.1 Amount of advances representing the excess above 75% valuation

Advances refers to those included in the same column of line item G3.11.

The amount of the advance required is the total for each such loan of:

amount of advance - 75% valuation

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION G: LOANS FSRP TO INDIVIDUALS

G4.2 Amount of this excess covered by insurance

Is that part of the amount in G4.1 which is covered by insurance taken out by the society (i.e. mortgage indemnity cover) either with its own insurance captive or a third party insurer.

In respect of an individual loan, the amount shown under G4.2 will be less than or equal to (but not greater than) the amount of the excess above 75% valuation included under G4.1.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION H: LOANS: OTHER FSRP + OTHER FSOL

Introduction

This table covers all loans fully secured on land apart from those loans included in table G (i.e. loans FSRP to individuals). See also the introduction to table G.

H1 Type of Property

This analysis is to identify the type of property on which the advance is secured.

When classifying a loan, other than to a housing association, to one of the other **types of property** a practical and commonsense approach should be adopted where the characteristics of the property appear to give rise to a choice of property type. This will usually involve a situation where the property is being used for more than one purpose, for example multiple storeys given over to say a mix of business/living accommodation/or business/living accommodation/residential letting.

The loan should be classified according to the majority or main use and if it is not obvious then consider floor area or if this does not help (for example equal amounts given over to different uses) then allocate on main source of income from the property.

"Development" means the loan is for building new or refurbishing existing property whether for ultimate sale or rental.

"Investment" means the loan is on property which is to be let.

H1.1 "Housing association" covers those registered and unregistered.

H1.2-4 "Residential" excludes all loans to housing associations, and means where the property is, or will be used for, wholly or mainly residential purposes. It includes houses, flats and sheltered accommodation.

H1.5-7 "Commercial" includes industrial and covers all property not allocated to one of the above categories, including retail shop, office, professional business use (e.g. accountants/lawyers), or manufacturing or other industrial premises.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION H: LOANS: OTHER FSRP + OTHER FSOL

Balance outstanding at LQE (columns 3 and 6)

It is recognised that societies may need to use some degree of estimation in compiling the analysis of balance outstanding.

H2 By size and LTV

Each advance in the quarter should be classified by size and loan to valuation ratio (LTV) as follows:

(i) **Size** is to be taken as the total balance outstanding on the loan at the end of the quarter together with any unused drawing facilities and the total of any instalments/stage payments/retentions which the society is committed to making based on the most recent valuation. In this way successive stage payments/instalments arising out of the same lending commitment decision will be classified to the same cell in the table.

(ii) **Valuation** is the most recent valuation of the property/security used when assessing the amount of the society's commitment.

If a later stage payment is conditional on a revised valuation then the amount of the stage payment on that later return will probably be allocated to a cell with a higher size category and possibly, but not necessarily, to a higher LTV category since the total commitment will have increased, and possibly the valuation also.

(iii) the amount of advance included in a cell will be the actual amount advanced in the quarter, and when more than one advance on a loan takes place in the quarter they should be amalgamated.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION I: ALL LOANS FULLY SECURED ON LAND - Further Analysis

This table covers all loans FSRP and other loans FSOL, but with the analysis divided into two sub sections: I1 Loans FSRP to individuals only, and I2 Other FSRP loans and other FSOL.

Lending in quarter [columns 1-3, and 5-7]

The three types of information are as follows:

- (i) **gross advances** refers to advances on the same basis as reported in the relevant parts of table G(1) or H as applicable (although clearly totals will not agree).
- (ii) **"other advances"** refers to advances which have not been reported in gross advances but where, during the quarter, an existing loan has:
 - a. switched from being on a variable rate interest rate basis to either a fixed or capped rate basis [I1.1, 1.2 and I2.1, 2.2]
 - b. changed from being on one fixed or capped rate basis to a new fixed or capped rate [I1.1, 1.2 and I2.1, 2.2]
 - c. switched from being at the standard variable rate of interest to a discounted rate basis [I1.5 and I2.5]
 - d. changed from being on one discounted rate to a new discounted rate, irrespective of whether the new rate is lower or higher than the previous discounted rate [I1.5 and I2.5].
- (iii) **total "advances"** is the sum of (i) and (ii) above.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION I: ALL LOANS FULLY SECURED ON LAND - Further Analysis

Fixed and capped lending

11.1/2.1 **Fixed rate loans** refers to loans where the interest rate is fixed for a stated period. It also includes "collared" loans (where the loan is subject to a minimum **and** maximum rate). Exclude however annual review or stabilised payment loans (since the purpose is merely to smooth cash flow on variable rate loans).

11.2/2.2 **Capped rate loans** refers to loans, other than fixed rate, where there is an upper limit on the interest rate payable but where the rate may vary below that limit.

11.4/2.4 **Weighted average residual maturity to end of fixed/capped period** is described in steps (a) to (c) below, and

where: **residual maturity** on a loan is the period from the quarter end to the end of the fixed/capped period, expressed in years to a minimum of 2 decimal places (e.g. a residual fixed rate period of 2 years 7 months is 2.58 years etc).

(a) *for each fixed/capped loan (included in the box above this line on the return), multiply size of loan (£) by residual maturity (years).*

(b) *add up the result in (a) for all fixed/capped loans in the box concerned.*

(c) *divide the sum in (b) by the total of fixed/capped loans (£) in the box concerned.*

11.5/2.5 **Discounted variable rate loans**

Refers to variable rate loans where the rate is at a discount to the society's standard variable rate (the "basic rate" on loans FSRP to individuals defined in MFS1 table G). This also includes:

(i) loans to long-standing borrowers as part of a loyalty scheme which gives discounts off the society's standard variable rate.

(ii) loans as in (i) but where the discount is applied retrospectively. E.g. once a year eligible borrowers may receive a discount, of say ½%, in the form of an interest credit depending on a satisfactory payment record in the previous 12 months. Since not all eligible borrowers

BUILDING SOCIETY: QUARTERLY STATEMENT**SECTION I: ALL LOANS FULLY SECURED ON LAND - Further Analysis**

will necessarily qualify for this type of discount, the £ amounts reported should be calculated after applying the estimated percentage who are likely to qualify to the total £ amounts of eligible loans. If this percentage is not known, or cannot readily be estimated then assume 100%.

- (iii) any staff loans that are at a discount to the society's standard variable rate.

I1.6-8 & I2.6-8 The **three weighted average quantities**, which all make use of the residual maturity of the discounted loan, are described at (i) to (iii) below, and

where: **residual maturity** on a loan is the period from the quarter end to the end of the discount period, expressed in years to a minimum of 2 decimal places (e.g. a residual discount period of 3 years 5 months is 3.42 years).

The **discount period** on loans to long-standing borrowers as part of a loyalty scheme should be taken as the shorter of:

- a. 5 years from the quarter end (this is intended as a proxy for the expected residual maturity of such a loan, recognising that since few loans survive the full term (e.g. 10, 15, 20 or 25 years) it would be inappropriate to take the remaining period of the notional term as the length of the discount period); or
- b. the period from the quarter end to any such later date as to which the borrower has formally been advised (either at the time of becoming eligible for the discount or subsequently) that the loyalty discount will cease.

NB: In cases where it is the society's practice to review periodically (annually or otherwise) the continued existence of a loyalty scheme, this should not be taken to imply that the discount period is at most the period between periodic reviews. Many societies regard the

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION I: ALL LOANS FULLY SECURED ON LAND - Further Analysis

loyalty scheme as being a long term commitment even if it is reviewed periodically. It is felt therefore that it is more realistic to use 5 years (as in a)), rather than say 1 year (period between annual reviews) as the discount period. However, if the review triggers cessation of the scheme then clearly b) above would apply.

The **discount period on staff loans** should be calculated in the same way as above.

and: **percentage discount** is the difference between the society's standard variable rate of interest (see above) and the rate of interest payable on the discounted loan at the reporting date e.g. if standard variable rate is 8.7% and the discounted rate is 6.2%, the percentage discount is 2.5%.

II.6/2.6 (i) **weighted average: residual maturity**

- (a) *for each discounted loan (included in the box above this line on the return), **multiply** size of loan (£) **by** residual maturity (years)*
- (b) *add up the result in (a) for all discounted loans in the box concerned*
- (c) *divide the sum in (b) by the total of discounted loans (£) in the box concerned*

II.7/2.7 (ii) **weighted average: cumulative discount**

- (a) *for each discounted loan (shown in the box above this line on the return) **multiply** size of loan (£) **by** percentage discount (%) **by** residual maturity (years)*
- (b) *add up the result in (a) for all discounted loans in the box concerned*
- (c) *divide the sum in (b) by the total of all discounted loans (£) in the box concerned.*

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SECTION I: ALL LOANS FULLY SECURED ON LAND - Further Analysis

11.8/2.8 (iii) **weighted average: nominal discount per annum**

- (a) for each discounted loan (shown in the box above this line on the return) **multiply** size of loan (£) **by** percentage discount (%) **by** residual maturity (years) [**NB:** this is the same as (ii)(a)].
- (b) add up the result in (a) for all discounted loans in the box concerned
- (c) for each discounted loan (included in the box above this line on the return), **multiply** size of loan (£) **by** residual maturity (years) [**NB:** this is the same as in (i)(a)]
- (d) add up the result in (c) for all discounted loans in the box concerned
- (e) divide the sum in (b) by the sum in (d).

Example To illustrate the calculations involved in the three weighted averages a **worked example** follows:

Discounted loans: worked example of weighted rates (for 3 loans)					
Loan Size £000	Discount period	Percentage discount	Products as used in the calculation for:		
			Residual maturity (£ x yrs)	Cumulative/Nominal discount (£ x % x yrs)	
5	4 yrs	2%	20	40	
10	2 yrs	3%	20	60	
15	1 yr	5%	15	75	
30 (= 'A')			55 (= 'B')	175 (= 'C')	
Weighted averages (using totals A, B and C are):					
Residual maturity		=	B/A	=	55/30 = 1.83 years
Cumulative discount		=	C/A	=	175/30 = 5.83%
Nominal discount p.a.		=	C/B	=	175/55 = 3.18%

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SECTION J: LENDING- Capitalisations and Sales

Number of loans/Number of (arrears) cases

In cases where there is more than one loan secured on a single property, these should be amalgamated where possible in reporting details of loans at the end of the period in J1, and details of arrears cases in J2 and J3.

Balance outstanding

In J1.2 this means the same basis as presented in the balance sheet.

However, in J2.3 and J3.2 it is as defined in section K/1 paragraph 1.1 (including in the case of J3 the costs of sale where these have been debited to the borrower's account).

J2 Capitalisation of arrears cases in period

Details should be given in respect of those cases which, having previously been in arrears, have now been capitalised (or treated as if capitalised), have satisfied certain performance criteria for six months, and have been **removed** during the latest quarter from the arrears figures which now appear in table K. See paragraph 3 of section K of the guidance notes.

J3 Properties sold in period

Include in J3.1 and J3.2 **all** properties sold in the quarter irrespective of whether losses have occurred.

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SECTION K: LENDING - ARREARS ANALYSIS

NB: Guidance notes for table K(1) also apply to similar items on table K(2).

K1 & K2 Arrears categorisation by type of loan

For these sections, the analysis of lending is divided into two main types:

- (i) loans fully secured on residential property to individuals;
- (ii) all other loans fully secured on land (that is, other loans fully secured on residential property, and other loans fully secured on land).

The analysis is based on expressing the amount of arrears on each loan as a percentage of the balance outstanding on the loan, allocating cases to relevant arrears bands, providing details of cases moving up into more serious arrears bands in the quarter, and giving information on loan performance during the quarter. (In cases where there is more than one loan secured on a single property, these should be amalgamated, where possible, in reporting details of arrears cases). Definitions of terms used are given below:

K1.5 & K2.5 **In possession:** include here cases where the property is taken in possession (through any method e.g. voluntary surrender, court order etc); and particularly for development loans also include cases where the appointment of a receiver and/or a manager has been made, or where the security is being enforced in other ways (which may or may not also involve the existence of arrears e.g. building finance case with interest roll up, no arrears, but a current valuation is less than the outstanding debt).

1. Balance outstanding (columns 3 and 6)

1.1 This is the amount of total debt at the reporting date and comprises the total amount outstanding (after deducting any write offs but without deduction for any provisions) in respect of:

- (i) the principal of the advance (including any further advances made)
- (ii) interest accrued on the advance (but only up to the reporting date), including any interest suspended

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SECTION K: LENDING - ARREARS ANALYSIS

- (iii) any other sum which the borrower is obliged to pay the society and which is due from the borrower e.g. fees, fines, administration charges, penalty interest and insurance premiums

and is intended to be consistent with the basis used for presentation of balances outstanding shown in the balance sheet section of the return, with the addition for table K of any interest suspended not included in the balance sheet.

2. Amount of arrears (columns 2 and 4)

2.1 Arrears will arise through the borrower failing to service any element of his debt obligation to the society, including capital, interest, or fees, fines, administrative charges, penalty interest and insurance premiums.

2.2 At the reporting date, the **amount of arrears** is the difference between

- (i) the accumulated total amounts of (monthly or other periodic) payments due to be received from the borrower; and
- (ii) the accumulated total amount of payments actually made by the borrower.

2.3 Only amounts which are contractually due at the reporting date should be included in 2.2(i) above, that is include accrued interest only up to the reporting date but not beyond, and for example only include a proportion of any annual insurance premium if the society permits such amounts to be paid in periodic instalments.

2.4 In the case of **annual review schemes** the 'payment due to be received' under 2.2(i) is that calculated under the scheme. This may well differ from the amount charged to the account but should not of itself give rise to any arrears providing the borrower is making the level of payments advised by the society. The same principles apply to deferred interest products - if the borrower is making the payments that are required under the loan arrangements then he is not in arrears, even though the debt outstanding is increasing.

BUILDING SOCIETY: QUARTERLY STATEMENT**SECTION K: LENDING - ARREARS ANALYSIS**

- 2.5** Where a society makes a **temporary "concession"** to a borrower (i.e., an agreement with the borrower whereby monthly payments are either suspended or less than they would be on a fully commercial basis) for a period, the amounts included in 2.2(i) are those contractually due (and at commercial rates of interest) and hence the borrower will continue to be in arrears and the level of arrears will in fact continue to increase until such time as he is able fully to service the debt outstanding.
- 2.6** Where the terms of the loan do not require payment of interest (or capital) until a stated date or until redemption or until certain conditions are triggered, as for example in the case of certain building finance loans, then the loan is not in arrears until such time as contractual repayments are overdue. There may be circumstances however where, even though the loan is not in arrears, it falls to be reported under K1.5 or K2.5. (See notes on K1.5/K2.5 at beginning of Section K).
- 2.7** The reporting treatment of cases where arrears have been capitalised is dealt with in section 3 below.
- 2.8** Where a "capitalisation" case that has at one time been correctly removed as fully performing (see section 3) but at some later time defaults, then this should be treated as a new default and the amount of arrears taken as that arising from this new default. That is, the previously capitalised arrears should not be reinstated as current arrears.

3. Capitalisation of arrears and reporting criteria

- 3.1** By "**capitalisation**" is meant a formal arrangement agreed with the borrower to add all or part of a borrower's arrears to the amount of outstanding principal (i.e. advance of principal including further advances less capital repayments received during the period of the loan) and then treating that amount of overall debt as the enlarged principal. This enlarged principal is then used as the basis for calculating future monthly payments over the remaining term of the loan. Where less than the full amount of arrears is capitalised (or indeed where none of the arrears is capitalised) then, providing there are arrangements made for the borrower to repay the non-capitalised arrears over a shorter period ranging for example from 3 to 18 months, this type of arrangement should also be regarded as an equivalent of "capitalisation".

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SECTION K: LENDING - ARREARS ANALYSIS

- 3.2 The decision to "capitalise" (or treat as if capitalised) is a business decision between the society and the borrower. However for the purposes of consistency in reporting arrears cases in table K (and reporting capitalisations in table J) the following **reporting criteria** should be used where a society has capitalised the loan (or treated as if capitalised) and reset the monthly payment:
- (i) such an arrears case should continue to be included in table K until the loan has been "**fully performing**" (see (ii) below) for a period of six consecutive months (any temporary increase in arrears during this qualifying period has the effect of requiring six consecutive months of fully performing **after** such an event). Until that time it should be included in table K, and be allocated to the arrears band applicable at each reporting date as if "capitalisation" had not taken place;
 - (ii) for these purposes a loan is considered to be "fully performing" only where the borrower has been meeting all obligations on the loan with regard to repayments of principal, interest (at a normal mortgage rate on the full balance outstanding, including as appropriate any relevant past arrears), any payment towards clearing past arrears as agreed with the society and any penalty payments due levied in respect of previous missed repayments. That is, amounts may be either added to the principal of the loan or otherwise repaid over a shorter period than the residual term of the mortgage, as agreed between society and borrower. But then this revised payment schedule must be fully maintained for a six month period before the arrears can qualify to be treated as capitalised for reporting purposes and hence removed from the arrears cases in table K
 - (iii) arrears cases qualifying as "fully performing" in (ii) **should then be omitted from table K**, and should then be reported in table J (at section J2) for the same reporting period during which the removal occurs.
 - (iv) as regards capitalisation in relation to unsecured lending to individuals (consumer lending recorded in K3.1), with the possible exception of personal loans, it is not expected that the concept of capitalisation will generally be applicable.

BUILDING SOCIETY: QUARTERLY STATEMENT**SECTION K: LENDING - ARREARS ANALYSIS****4. Cases entering higher (i.e. more serious) arrears band in quarter (columns 1 to 3)**

Refers to those cases now included in a particular arrears banding which were classified in a **less severe (i.e. lower numerical) band** at the end of the previous quarter but which have deteriorated sufficiently during the quarter to move to a more severe arrears band. For example against K1.1 entries under this heading will show cases now "2.5 < 5%" (i.e. 2.5 or less than 5%) in arrears that were previously excluded from the arrears table being less than 2.5% in arrears, and K1.5 (and K2.5) will show details of those cases taken into possession during the quarter. Cases which have improved during the quarter by now being classified to a less severe arrears band should not be included in these 3 columns.

5. Performance of current arrears cases (column 7)**5.1** This analyses all those arrears cases included in columns 4 to 6 and gives a measure of performance covering all of the loans in a particular arrears band at the end of the quarter. The measure which compares "actual" with "expected" payments is required to be calculated for a single time period: the last 3 months. For this time period, the performance measure should be calculated as a percentage as follows:

$$\frac{\text{total of "payments received" from borrowers}}{\text{total of "payments due" from borrowers}} \times 100$$

where "payments due" means amounts due under normal commercial terms (and not the lesser amounts which may have been agreed as part of any temporary arrangement) fully to service the loans: that is the balances outstanding including those elements referred to in 1.1 above such as insurance, fees and fines etc. (If for some reason this is not readily available then a suitable approximation can be derived for each relevant month by applying one twelfth of the annual interest rate to the appropriate balance outstanding), and

where "payments received" should be limited to regular repayment of interest, capital and other sundry charges to the loan account, and should exclude abnormal repayments (e.g. sale proceeds of property in possession, and large lump sum repayment of part or all of the outstanding balance). The reasoning behind this is that excess payments on one or more arrears cases would

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SECTION K: LENDING - ARREARS ANALYSIS

otherwise have the effect of compensating for underpayment on other arrears cases and, as a result, give an overstated performance measure.

5.2 The amount to be entered on the return is a percentage to 2 decimal places and omitting the % sign.

5.3 In calculating the performance measure on possession cases (K1.5 and K2.5), the following points are relevant:

- (i) "payments received": in many cases these may well be nil, but not always since the property in possession may be let out and a rental income received. In each case the payment received should be included for the purposes of calculating the performance measure;
- (ii) "payments due": in recognition of the fact that amounts of interest will still be charged to the borrowers account, then the "payments due" should be calculated as three months interest at normal commercial rates of interest;
- (iii) however, in K1.5 and K2.5, it is likely that the performance measure will in most instances be zero;
- (iv) the relevance of the above however, is that "payments due" on possession cases need to be computed in order to feed into the overall performance measure at K1.6 and K2.6.

5.4 The overall measures of performance at K1.6 includes possessions, and is the ratio of:

- (i) "payments received" on all cases in K1.1 to K1.5
- (ii) "payments due" on all cases in K1.1 to K1.5

NB The same approach applies to K2.6

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SECTION K: LENDING - ARREARS ANALYSIS

K3.1 Other loans to customers: loans to individuals

Covers a subset of those loans included within QFS1 line item A9.4 (but analysed fully within MFS1 line items F3.1 -3.6) i.e. bridging loans, personal loans, credit cards, overdrafts and any other such lending to individuals.

These loans to individuals differ significantly in nature from mortgage loans, particularly as regards interest rates, repayment periods and the extent to which the advance is fixed (e.g. bridging and personal loans) or elastic (e.g. credit cards and overdrafts). As a consequence, the trigger points for reporting arrears cases are not defined in the same way as for mortgage loans.

For the purposes of this arrears analysis, the criteria for inclusion as an arrears case at the end of the quarter are as follows:

(i) Personal loans

These should be included where the amount of unpaid repayments (that are actually due by the reporting date) is greater than or equal to 3 times the current monthly contractual repayment expected;

In the case of "negative equity" loans (i.e. that part of a loan on land that is not fully secured, and which is therefore treated as a personal unsecured loan), arrears reporting here should be based on the same 2.5% criterion as used for loans fully secured on residential property.

(ii) Bridging loans

Those subject to scheduled repayments during the period of the loan should be treated as for personal loans.

Those not subject to scheduled repayments, that is those where interest is added to the account and repaid only when the loan is redeemed, will in general not give rise to an "arrears situation". However there may be circumstances when, even though scheduled repayments are not required, the loan is in default of the terms of the loan agreement. For example, it may have been a condition of the loan that the accumulated debt would

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SECTION K: LENDING - ARREARS ANALYSIS

(ii) **Bridging loans (continued)**

not exceed a specified limit or that the loan would be redeemed within a stated period. In these circumstances the amount of debt in excess of such a pre-set limit should be treated as **arrears** (or the whole amount if no limit has been pre-set).

If for any reason, the property on which the loan is secured is taken into possession then the loan should be included in columns 4 and 6 (even if there are deemed to be no "arrears").

(iii) **Overdrafts**

Authorised overdrafts will normally have an overdraft limit pre-set by the society and communicated to the customer. Those accounts where the borrower has exceeded an overdraft limit should be treated as being in arrears, with the amount of arrears being the excess over the pre-set overdraft limit.

Unauthorised overdrafts are those which arise on accounts that, at the time, had no agreed pre-set overdraft limit (e.g. on certain cheque or current accounts), of which the customer had been made aware. In such cases the amount of arrears will be the total amount of the overdraft. Where societies operate a policy of allowing an account (on which there is no authorised overdraft) to become overdrawn up to an administrative limit before refusing to accept cheques, standing orders, direct debits etc, but without advising this limit to the customer, this administrative limit should be disregarded for arrears reporting purposes, and the total amount of the overdraft reported as arrears. If, subsequently, arrangements are made with the borrower for an authorised overdraft then the account should be treated as for authorised overdrafts above;

(iv) **Credit cards/budget plans/revolving credit agreements**

The lender will normally establish a pre-set credit limit for each borrower.

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SECTION K: LENDING - ARREARS ANALYSIS

(iv) **Credit cards/budget plans/revolving credit agreements**
(continued)

Loans where the debt (i.e. balance outstanding) exceeds the pre-set credit limit should be treated as an arrears case, with the amount of arrears being the excess of the balance outstanding over the credit limit.

Where a loan is operating within a credit limit, the criterion for being treated as an arrears case is whether the minimum monthly contractual repayments are being made. If the borrower fails for three months to meet in full the minimum monthly contractual repayment then the loan should be shown as being in arrears, with the amount of arrears taken as the latest calculated minimum contractual repayment (which should include previous under payments).

(v) **"Contractual repayments"/"pre-set limits"**

For the purposes of (i) to (iv) above, these terms are subject to the following points:

Contractual repayments: is a reference to an amount determined on a normal commercial basis fully to service the balance outstanding, and not to any lesser amount which may be the subject of agreed arrangements with the borrower.

Pre-set limit: is the credit limit in operation on the account at the end of the quarter, and is to be used in establishing the amount, if any, of arrears at the reporting date.

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SECTION K: LENDING - ARREARS ANALYSIS

K3.2 Other loans to customers: loans to others

This type of lending is likely to be predominantly to business customers. In a number of instances, such lending may have similar characteristics to loans to individuals in K3.1 and accordingly the same criteria can be used in assessing whether a particular loan is in arrears and if so by an amount that qualifies for being included in K3.2.

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SECTION L: EXPOSURE ANALYSIS: Large exposures - Group

The notes below should be read in conjunction with the Prudential Guidance on Large Exposures contained in Chapter 7 of Volume 1 of the Interim Prudential Sourcebook for building societies.

Because of the need for numerous references to "subsidiary undertaking" in this section, for convenience the term has been abbreviated to "subsidiary" throughout.

1. **Basis for reporting Large Exposures on Table L**

- | | |
|------------------------------|---|
| Supervised Group | (i) The reference in the table heading to Group refers to the Supervised Group . This term is defined in the P/G as meaning the society and those subsidiaries subject to consolidated supervision (i.e. those subsidiaries included in the Group (consolidated) solvency ratio calculation - see also Solvency P/G). In cases where a society has no subsidiaries, the Supervised Group is then the society. |
| Own Funds | (ii) The measure of own funds to be used in large exposure calculations is the Group (consolidated) amount of Capital Available at the quarter end as reported in table D, line item D4, column 4 (taking account of any exclusions from consolidation that may be required, as referred to in the Solvency P/G). |
| Types of counterparty | (iii) The Supervised Group may have exposures to two types of counterparty : those external to the Group, and those intra-Group, that is: <ul style="list-style-type: none"> a. exposure to an external counterparty (or group of connected counterparties) which is not connected with the society or any member of the supervised group. <p style="margin-left: 40px;">In this case the exposure of the supervised group means the aggregate of all individual exposures of the society and any of its subsidiaries in the supervised group to that counterparty (or group of connected counterparties).</p> b. intra-group exposure to connected undertakings, which should be monitored as two separate categories as set out below. |

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SECTION L: EXPOSURE ANALYSIS: Large exposures - Group

Type of Counterparty (continued)	(iii) b. intra-group exposures (continued)
	<p>b.(1) exposures of the society itself to an individual subsidiary or sub group of subsidiaries (that is where a subsidiary has subsidiaries of its own) in the Supervised Group.</p> <p>For reporting purposes the exposure to each single subsidiary (or sub group of subsidiaries) should be assessed in isolation and tested against the reporting criteria for large exposures (below). A large exposure (before exemptions) to a subsidiary which is subject to agreed solo-consolidation should also be reported (with the effect of the exemption resulting in a zero entry in the total exposure column).</p> <p>Additionally, societies are asked to provide one extra line of information, being the sub-total of all "small" exposures to individual subsidiaries in the supervised group. Where the society has no large exposures to any subsidiary in the supervised group then this extra information will be the total of exposures to every subsidiary in the supervised group, otherwise it will be the total of non-large exposures. The counterparty column should be completed with the name "Small Exposures to Subsidiaries".</p>
	<p>b.(2) exposures of the supervised group to counterparties connected with the society but outside of the supervised group.</p> <p>Counterparties here includes any subsidiary not included in the supervised group (e.g. a Life Company) and any other relevant undertakings that are connected with the society.</p> <p>Exposures of the society itself and those of individual subsidiaries in the supervised group to all such counterparties should be aggregated and the aggregate exposure tested for being a reportable large exposure.</p>
Multi-Exposure	(iv) An exposure to a counterparty (or group of connected counterparties) is the aggregate of all individual exposures to that counterparty (and adding together different categories of exposure to the same counterparty e.g. loan asset, liquid asset, connected undertakings and other investments, and off-balance sheet).

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SECTION L: EXPOSURE ANALYSIS: Large exposures - Group

Reportable Large Exposures (v) The P/G requires **all exposures** (described above) **which are "large"** (see (vi)) **exposures to be reported on table L irrespective of whether the exposure is eligible for full or partial exemption**, and to give **two measures of the exposure**. These two measures are:

- a. **Actual exposure** which is the amount of the exposure before the application of any full or partial exemptions (details of the full or partial exemptions are to be found in the P/G.
- b. **Total exposure** which is the amount of exposure net of any full or partial exemptions.

Details of "**actual exposure**" and "**total exposure**" for different categories of exposure are given further on in these guidance notes at section 3(e) and (f).

Defining Reportable (vi) In considering whether an exposure is a **reportable large exposure** the test is whether the **actual exposure** amount is 10% or more of **own funds** (as defined in (ii) above).

Taking account of exemptions (vii) For each **reportable large exposure** (i.e. based on actual exposure as above) the return also asks for certain other information in order to establish the net effect of any full or partial exemption. This is established by means of information on:

- a. the amount of **total exposure**, which is the amount after taking account of any full or partial exemption; and
- b. whether the **total exposure** is a **qualifying** large exposure, that is the amount of **total exposure** is 10% or more of own funds. **Qualifying** is used in the sense that, after taking account of exemptions, the **total exposure** amount counts towards the 300% or 800% limit. Where this is the case this should be indicated by "Q" as part of the "Class" column (under Exposure Type), otherwise where it is not a qualifying large exposure then this should be indicated by "E". (See section 3(c) for further detail).

BUILDING SOCIETY: QUARTERLY STATEMENT**SECTION L: EXPOSURE ANALYSIS: Large exposures - Group****2. Categories of Large Exposure**

This "large exposures" analysis covers loan asset and liquid asset exposures together with exposures to connected undertakings and other investments and off balance sheet exposures, as follows:

- (i) **loan assets:** list the 10 largest exposures (irrespective of size in relation to own funds) **and** if applicable any others where the "**actual exposure**" amounts to 10% or more of own funds. For these purposes, exposures to connected undertakings are treated as a separate category (see (iii) below) including any which may be secured on land.
- (ii) **liquid assets:** list (after (i)) all exposures where the "**actual exposure**" amounts to 10% or more of own funds.
- (iii) **connected undertakings and other investments:** list (after (ii)) all exposures of the society to its **individual** subsidiaries in the supervised group, and the **aggregate** exposure of the supervised group to subsidiaries or other connected undertakings outside of the supervised group (but which are connected with the society), being investments in or loans to such bodies including any which are fully secured on land. Then list, if applicable, any such aggregate exposure of the supervised group to investments in other undertakings. In each case only list where the "**actual exposure**" amounts to 10% or more of own funds. Finally, include the **additional** line on "small exposures" described in (1)b.(1) above.
- (iv) **off balance sheet:** list (after (iii)) all exposures where the "**actual exposure**" amounts to 10% or more of own funds.

NB: Where a reportable large exposure to a counterparty is made up of **different categories of exposure** (i.e. combinations of two or more of loan assets, liquid assets, connected undertakings and other investments, and off-balance sheet) **the separate amounts falling into each of the four categories should be listed separately on the return** as individual line items within the appropriate set (i.e. loan asset set, liquid asset set etc). This same approach should be followed for both **actual exposure** and **total exposure**. As regards the use of "Q" or "E" in the "Class" column (see section 3(c)), then the same letter should appear on each of the individual line items making up the exposure to this counterparty, and should be determined on the basis of the aggregate total exposure amount. The most likely combination of different categories of exposure is liquid asset and off-balance sheet (e.g. hedging contracts) for example to banks.

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SECTION L: EXPOSURE ANALYSIS: Large exposures - Group

3. (a) Lender code

This is to identify the "lender" (i.e. the party with the exposure) by distinguishing loans made (or other exposures incurred) by the society itself from those made by subsidiaries of the society.

Code

Society only	SOC
Subsidiary only	Abbreviated name or initials, sufficient to identify company
Subsidiaries	SUBX
Society plus subsidiary(ies)	GRP

3. (b) Name of counterparty or connected group

This is to identify the name of an individual counterparty to the exposure (i.e. the borrower), or, where the counterparty is a group of connected counterparties (see P/G), the name of the principal counterparty or other name used to identify the whole group of connected counterparties. In the case of a housing association its registration status should be included in brackets as (R)/(UR) to indicate whether registered with the Housing Corporation (or Tai Cymru/Scottish Homes) or unregistered.

3. (c) Exposure type - class

This consists of two single characters separated by a hyphen to indicate:

- firstly the "class" of exposure as detailed below -

For **loan assets** (excluding exposures to connected undertakings) the "class" is F (fully secured on land), or U (unsecured on land)

For **liquid assets** the class is "L";

For **connected undertakings and other investments** the class is "C";

For **off balance sheet** items the class is "X".

- and second, whether the exposure (as measured by the value recorded under the "**Total Exposure**" column) is 10% or more of own funds and therefore **qualifies** (designated by the character "Q") for aggregation against the 300% or 800% limit, or is less than 10% of own funds and therefore should be **excluded** (designated by the character "E") from that aggregation.
- example entries are:

F - Q for a loan fully secured on land with "**total exposure**" 10% or more of own funds.

C - E For an exposure to a connected undertaking with "**total exposure**" less than 10% of own funds.

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SECTION L: EXPOSURE ANALYSIS: Large exposures - Group

3. (d) Exposure type - code

A two character code, identifying security or counterparty type which should be allocated on the basis of the type of the main or majority of balances when exposure is to a connected group. The code is as follows:

(i) for **loan asset** exposures they are as follows:

Exposure Type "Class"	Code	Type of security/loan or other exposure
F	RL	Loans FSRP to individuals only Other FSRP and other FSOL loans:
F	HA	Housing Association
F	RD	Residential - Development
F	RI	Residential - Investment
F	RO	Residential - Other
F	CD	Commercial - Development
F	CI	Commercial - Investment
F	CO	Commercial - Other
U	LI	Other loans to individuals
U	LB	Other loans to businesses etc.

(ii) for **liquid asset** exposures they are as follows:

Exposure Type "Class"	Code	Type of counterparty
L	BA	Bank
L	BS	Building society
L	GV	Government (UK or overseas)
L	LA	Local authority
L	OC	Other counterparty

(iii) for exposures to **connected undertakings and other investments** they are as follows:

Exposure Type "Class"	Code	Type of counterparty
C	SU	Subsidiary within Supervised Group
C	OC	Other connected undertaking
C	OI	Other investment

(iv) for **off balance sheet** exposures they are as follows:

Exposure Type "Class "	Code	Type of exposure
X	IR	Interest rate contract
X	FX	Foreign exchange contract
X	FR	other: Full risk*
X	MR	Medium risk*
X	ML	Medium/Low risk*
X	LR	Low risk and other*

* terms as used in Solvency P/G

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION L: EXPOSURE ANALYSIS: Large Exposures - Group

3. (e) **Actual Exposure**

See tabular information below for details. **NB** the "actual exposure" includes future commitments.

Total exposure

This is the "**actual exposure**" after the application of any percentage weights to give effect to relevant exemptions. Percentage weights are as in the P/G (with fully exempt exposures having a 0% weighting), and all references to asset **maturities** are to **residual** maturities. See tabular information below.

3. (f) **Actual & Total Exposure by Category of Exposure:**

Category of Exposure	Actual Exposure	Total Exposure
Loan Assets:	Balance outstanding (as included in the balance sheet) on the account(s) of the counterparty or group of connected counterparties at the end of the reporting period, plus future commitments	Amount as in previous column.
Liquid Assets	Balance outstanding (as above) but excluding accrued interest.	The amount that results from the application of relevant percentage weights to the previous column.
Connected undertakings and other investments	Balance outstanding (as above) plus future commitments	The amount that results from the application of relevant percentage weights to the previous column.
Off Balance Sheet:		
(i) Interest rate and	Current replacement cost of all contracts with positive values(* ₁), plus potential future credit exposure. (The sum of amounts calculated in steps (a) and (b) of section 1C5.1 of Annex 1C of Solvency P/G)	Same as previous column.
(ii) Foreign exchange contracts		
(iii) Full risk	Nominal Value (* ₂)	Same as previous column.
(iv) Medium risk	Nominal Value (* ₂ and g)	Same as previous column.
(v) Medium/Low risk	Nominal Value (* ₂ and g)	Same as previous column.
(vi) Low risk	Nominal Value (* ₂ and g)	Same as previous column.

*₁ That is where the replacement "cost" would represent a payment by the society, as opposed to a payment by the counterparty (because interest rates had moved in the society's favour).

*₂ In terms of Annex 1C of the P/G, this value is the amount without application of the credit conversion factor.

3. (g) **Future commitments**

This represents the amount of a commitment to a counterparty or a group of connected counterparties, to advance further sums, as at the end of the reporting period.

Include contingent liabilities if they are loan asset related.

If a development property is taken in possession, it includes the future cost of build-out of the development.

In respect of the medium, medium/low and low risk off-balance sheet categories in (f), the value of any commitments to a counterparty that have already been reported with balances outstanding (under loan assets or connected undertaking or other investment exposures) should be omitted from medium, medium/low or low risk categories to avoid double counting.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION L: EXPOSURE ANALYSIS: Large Exposures - Group

3. (h) **Security value**

For loan assets this is to be the 'most recent valuation' of tangible security held in respect of the relevant current exposure. Estimates of future value should not be used. The 'most recent valuation' is a reference to the most recent written report on the value of the property.

For liquid assets it is market value (or book value if not marketable).

For **connected undertakings and other investments**, and **off balance sheet exposures** this column will not normally be applicable.

3. (i) **Year of valuation**

This represents the year in which the security was last valued.

For **connected undertakings and other investments**, and **off balance sheet exposures** this column will not normally be applicable.

3. (j) **Specific provisions**

This is to be the amount of any specific provision which has been included in the income and expenditure account in respect of the relevant lending or investment.

For **liquid assets, connected undertakings and other investments**, and **off balance sheet exposures** this column will not normally be applicable.

3. (k) **Amount of arrears**

This is the total amount of any accumulated arrears on the particular exposure.

For **liquid assets, connected undertakings and other investments**, and **off balance sheet exposures** this column will not normally be applicable.

4. **OTHERS POINTS ON P/G**

(i) References to **compliance** with various large exposure limits (e.g. 20% of own funds) should be interpreted as references to the **total exposure** measure (i.e. after taking account of any full or partial exemptions).

(ii) References in paragraphs 7.6 and 7.8 of the P/G to

(a) "**exempt**" exposures means exposures which, after taking into account full or partial exemptions, are below the relevant reporting percentage (e.g. if less than or equal to 20% it is not required to be **pre-reported**);

(b) the need for **pre-reporting** should therefore be based on the **total exposure** measure as a percentage of own funds.

(iii) All references to **maturities** in the text and paragraph 7.8 of the P/G are to **residual** maturities.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION M: MATURITY ANALYSIS (Residual maturity)

This table analyses the maturity profile of a society's shares and deposits & debt securities, liquid assets and committed facilities. The analyses are of balance sheet amounts excluding accrued interest.

The amounts repayable within the particular bandings should represent the residual maturity rather than that based on the original or contractual maturity date. [The time bandings are exactly as set out at the head of the table, where a "month" means the normal 30 days, and not as used in MFS1 Table C, Section C2 which only applies for items in C2]

M1/2 Shares and Deposits & debt securities: residual maturity

The amount repayable by time band for an item should be the earlier of

- (i) the residual period up to original maturity date; or
- (ii) where repayment is available before that time without penalty, as for example:
 - a) by giving a period of notice, in which case residual maturity is the remaining time before any such notice comes into effect (all investors accounts of a given type/product which has a 'notice' option will not necessarily have the same residual maturity - different accounts will have different periods of residual notice to penalty free access); or
 - b) in certain accounts where an investor can have instant access without penalty to amounts in excess of a certain amount (e.g. amounts in excess of £10,000), then the total amounts "accessible" above the various minima should be treated as repayable in the "up to 8 days" band.

Residual maturity for FRNs and similar instruments, should generally be treated in the same way.

However if there is an option for early repayment the treatment depends on whether the society has the choice in exercising that option or whether it could be obliged to repay at a third party's option:

- (a) if it is at the society's option then classify by full residual maturity (i.e. period to original maturity)
- (b) if the obligation is on the society then the earliest repayment date, that would apply in normal circumstances, determines the residual maturity period.

BUILDING SOCIETY: QUARTERLY STATEMENT**SECTION M: MATURITY ANALYSIS (Residual maturity)****M3 Liquid assets: residual maturity**

The same approach should be adopted as in M1 & 2, except for the treatment of the society's option/obligation where the rules are reversed.

In classifying the various liquid assets shown in the (corresponding) monthly MFS1 return, the following scheme should be used:

QFS1 item		MFS1 items to be included	
M3.1	Cash	B6.1	Cash
M3.2	Bank deposits	B6.2 (a+b) B6.3 (a+b)	Central banks Banks
M3.3	CDs	B6.4 (a to c)	CDs
M3.4	Other money market instruments (OMMIs)	B6.5 (a to d) B6.7 (a to b)	OMMIs Bills
M3.5	Marketable securities	B6.6 (a1 to b3) B6.10 (a1 to b4) B6.11 (a1 to b2)	Bonds, notes & OCIs Mortgage backed securities Sovereign securities
M3.6	Other	B6.8 (a to c) B6.9 B6.12 (a to c)	Local authority Certs of tax deposit Other liquid assets

M4 Committed facilities available

These represent formal and confirmed standby facilities including overdraft facilities. Only **undrawn** amounts of such facilities should be included.

BUILDING SOCIETY: QUARTERLY STATEMENT**SECTION N: ORGANISATION**

Requests details of number of staff and offices.

Staff numbers refers to actual (or expected) numbers in post or otherwise engaged by the society (including temporary and contract staff, staff on paid maternity or sick leave; and unfilled vacancies which the society actually plans to fill) at the relevant period end. Numbers should be stated in terms of full-time equivalents, counting part time staff as half. Where staff are employed by the society but in fact work for a subsidiary undertakings then numbers should be allocated to "subsidiary undertakings" columns but only where the costs of such staff are charged to the subsidiary.

- N1** **Total staff (full time equivalent)** covers all staff employed at the period end, counting part time staff as half a staff unit.
- N1.1** **Staff at branch offices** covers all staff (on a full time equivalent basis) at branches which provide deposit taking and/or lending services to members. Include any such office located within a head office: for very small societies this may be the only branch. Staff that are not located at branch offices should be excluded from the branch count (i.e. do not include staff at local or regional administration centres in the branch count).
- N1.2** **Staff at estate agency offices** covers all staff (on a full time equivalent basis) employed at estate agency offices included under N3.
- N2** **Branch offices staffed by employees** covers those described in N1.1 (and therefore includes any such branch at head office offering deposit taking/and or lending services to members). A zero entry is therefore not applicable.
- N3** **Estate agency offices** distinguishes between those existing within a society branch office and those independently sited.
- N5** **Members and creditors: numbers**
- N5.1** **Shareholding members:** the number of share investors (not the number of accounts). Societies are expected to use best endeavours to eliminate duplication from the count of investing shareholders. Joint holdings should be counted as one "shareholder".

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION N: ORGANISATION

N5.2 **Borrowing members:** the number of borrowers (not the same as the total number of mortgages) with joint borrowers being counted as one. A borrower with more than one mortgage should only be counted as one borrower. Societies should use best endeavours to eliminate duplication (where a borrower has both a solo loan and another loan jointly with a second person then societies may compile figures on the basis that there are two borrowers: the individual and the joint borrower).

In the case of subsidiary undertakings, "borrowers" is as above, although the concept of membership does not apply.

N5.3 **Creditors for deposits:** the same principles as for N5.1 should be applied to the range of deposit accounts.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION P: INVESTMENTS: By type of activity

- a) This table is an analysis of the society's **investments** (as shown in the balance sheet under this same title) by different types of business activity, plus in column 2 the amount of other loans (not treated as investments in the balance sheet, but as other loans to customers) made to the various types of undertakings.
- b) The analysis by line item is divided between activities undertaken by subsidiary undertakings and participating interests (lines P1 to P9) and those related to other investments (i.e. trade investments such as LINK, BACS etc, and other equity shares) shown at line P10.
- c) When a society has more than one body undertaking a particular business activity (e.g. 3 estate agency companies) then figures should be aggregated for all such companies and shown on a single line in the table.

In the case of a connected body undertaking more than one type of activity then it should be classified on the basis of the main type of activity.

- d) Profit figures for subsidiary undertakings should be included on the basis of the amount attributable to the society: this is less than the amount shown in table B which includes amounts attributable to minority interests. The reconciliation is covered in P12.
- e) **Staff employed (FTE)** refers to staff employed at the respective period ends. "FTE" is full time equivalent, counting part time staff as half a staff unit.

P8 **Society support operations** is intended to cover companies set up to deal with particular aspects of running the society's core business. Examples are computer services company, property company (holding HQ and/or branches), mortgage administration of loans on society's balance sheet, etc.

Reconciliation of sub-totals

P11 The total of "**investments in**" in column 1 should agree with the amount shown in the balance sheet against "Investments" at A9.5 (col 1). The total of "**loans to**" in column 1 will be part of the amount shown in the balance sheet against "Other loans to customers" at A9.4.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION P: INVESTMENTS: By type of activity

P11 The total income in the final two columns for "All investments" made up of (i) Income from participating interests (which includes associated undertakings) and (ii) income from trade and other investments and totalled in P11, should agree with income from investments in table B as follows:

- Income attributable to the society, totalled at P11, should agree with B4 (Column 1).
- Income attributable to the Group, totalled at P11, should agree with B4 (Column 7) and will be the share of profits after tax in associated undertakings together with dividend receivable from other participating interests and other investments.

Please also see Introduction/3 which provides a useful summary of the accounting treatment in the Income & Expenditure Account of the various types of connected undertakings and other investments.

P12 The total profits of all subsidiary undertakings included in the sub-total at P12.1 (which only represents the amounts attributable to the society) together with P12.2 (the amounts attributable to minority interests) should agree with the equivalent total under "Subsidiary undertakings" in table B at B11.

P13 Is the total of figures for subsidiary undertakings (shown in P1 to P9) which have not been included in consolidated figures in table B, i.e. those entries marked "NC" in column 3 of table P.

BUILDING SOCIETY: QUARTERLY STATEMENT

SECTION Y: CHECKLIST OF LINE ITEMS ROUTINELY TO BE DEDUCTED

The purpose of this section is to indicate those line items in the various tables which will be "deducting" items when arriving at sub-totals or totals. These should be shown without sign and should **not** be shown in brackets unless the conditions in paragraph 8(iv) of the Introduction to these Notes require.

Table	Line items
A	A9.6
B	B2 B6.1 & 6.2 B7 B8 B9 B12 B14
C	C1.2 C1.5 C2.1c C2.2a
D	D1.3 D1.4 D2.6 D3.1 D3.2

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FINANCIAL SERVICES AUTHORITY

BUILDING SOCIETY: QUARTERLY STATEMENT

QFS 2

GUIDANCE NOTES

Sections

Introduction: **General Notes on the return**

Section A: **Sectorisation of selected liabilities**

Section B: **Sectorisation of loans and investments**

Section C: **Residual maturity analysis of gilts**

Section D: **Derivative contracts**

Submission of return: **By close on the 11th business day after each of the calendar quarters (i.e. ending March, June, September, December).**

BUILDING SOCIETY: QUARTERLY STATEMENT QFS2 ("Society only" return)

INTRODUCTION: GENERAL NOTES ON THE RETURN

1. Introduction

The QFS2 return is only required to be completed by the larger societies (i.e. those societies completing the monthly MFS1 return to the faster timetable). The reporting quarters are **calendar** quarters, that is end March/June/September/December.

The main purpose of QFS2 is to collect the detailed sectoral analysis needed for the monetary and financial accounts statistics. The starting point for this is the increased sectoral analysis on the monthly statement MFS1 (including the MFS1 supplementary statement [Forms B8-10]), which is supplemented quarterly by the more detailed sectoral analysis of particular balance sheet items collected on QFS2 (whose structure is harmonised with that used in the MFS1 return).

2. Unit of measurement

Amounts should be entered to the nearest £ million (i.e. not thousands as on the MFS1 return), omitting £000,000s. In all cases on the return, totals should equal the sum of component items (with any adjustment due to rounding being made on the largest component item).

3. Cross validation to return MFS1

A number of sub totals on QFS2 are direct equivalents of line items on return MFS1, and the amounts entered on QFS2 should agree with the corresponding item on MFS1 (subject to rounding to the nearest £ million). For this reason the return has MFS1 cross references to facilitate comparison with corresponding items in the monthly return.

BUILDING SOCIETY: QUARTERLY STATEMENT QFS2

INTRODUCTION: GENERAL NOTES ON THE RETURN (continued)

4. Accuracy

As the main purpose of the figures is to provide broadly accurate aggregates for the total of all societies, estimates of less precision than the data entered on the monthly MFS1 return will be acceptable in compiling the component sectoral details required on QFS2.

However, societies are asked to advise the Financial Services Authority (the Financial, Risk Analysis and Monitoring Group) of any subsequently discovered errors resulting in changes of over £25 million.

5. Society/Connected Undertakings

The return should be compiled on a society only basis. Separate returns are not required to be completed in respect of subsidiary or other undertakings.

6. Sectoral classification

Societies should refer to the Guidance Notes on the monthly MFS1 (for the main sector definitions), Appendix II of those notes, together with the sector mapping document appended to the MFS1 Supplementary Statement guidance notes.

BUILDING SOCIETY: QUARTERLY STATEMENT QFS2

SECTION A: SECTORISATION OF SELECTED LIABILITIES

A1 OTHER UK SECTOR (UK NON-BANK NON-BUILDING SOCIETY PRIVATE SECTOR)

This analyses two funding items as follows:

- (i) **Share liabilities** reflects the entry reported at B1.1 on the MFS1 and this is analysed by the relevant component sector.

- (ii) **Deposits** is the sum of three line items on MFS1 (namely B2.0(a), B2.1 and B2.3).

BUILDING SOCIETY: QUARTERLY STATEMENT QFS2**SECTION B: SECTORISATION OF LOANS AND INVESTMENTS (Gross)**

This table analyses loan assets on a gross basis (i.e. without deduction of provisions) for two specific sectors: the "other UK Sector" (UK non-bank non-building society private sector) and the "non-resident sector". This is a further analysis of two of the loan asset sector figures in B7.8 of the MFS1 return (with which relevant totals should agree).

B1-6 COLUMNAR ANALYSIS

Loans fully secured on residential property and loans fully secured on land (balances) are as defined in the 1986 Act and the MFS1 Guidance Notes.

Investments and Other Loans to Customers are analysed as follows:

- i. **Investments (Equities).** These refer to investments in connected undertakings (share or other capital in the society's undertakings, being part of MFS1 line item B7.4) together with any other 'securities'. For the purposes of this return, securities are taken as investments in related companies, and other marketable or potentially marketable instruments (with an original maturity of one year or more) e.g. mortgage backed or other securities.
- ii. **All other loan and investments.** These include certain loans of a longer term nature (and typically where a repayment schedule is not expected) to connected undertakings (being part of MFS1 line item B7.4) and other loans provided to subsidiary undertakings (being part of MFS1 line item B7.3(b)).

NB: Subsidiary undertakings primarily set up to do secured lending in the UK fall to be disclosed at line B1.1(e).

B2 NON-RESIDENT SECTOR

B2.1 Direct investment comprises investment (including retained earnings) by the society in the fixed assets (such as premises and equipment) of its overseas branches and in the share capital, loan capital and other capital funds of its subsidiary undertakings. Also include any working capital in the form of equipment provided free of charge to branches and subsidiary undertakings overseas. [This analysis is used in balance of payments statistics].

BUILDING SOCIETY: QUARTERLY STATEMENT QFS2**SECTION C: UK GOVERNMENT STERLING SECURITIES****C1-3 BY RESIDUAL MATURITY**

Analyses residual maturity of gilts by index linked and other, showing opening and closing balances along with transactions and valuation changes in the quarter. The analysis is 'sterling' only, being an analysis of the amount shown in the sterling column against item B6.11 a1) of the MFS1 return.

A note on securities subject to a stock lending agreement

The treatment in table C should be as follows:

- (i) **balances:** include securities lent (or pledged), but exclude securities or other instruments held as collateral under a stock lending agreement.
- (ii) **transactions:** exclude transactions in which securities are lent (or pledged) under a stock lending agreement. The receipt of securities or other instruments as collateral under a stock lending agreement should also be excluded.

C1-3 TRANSACTIONS (Columns)

Points on individual columns are:

- (i) **Balance at end previous quarter** should agree with the figure provided on MFS1 for the corresponding month. Here book value means the basis on which the society records gilts in its accounts.
- (ii) **Purchases in quarter** is the value of all such acquisitions in the period
- (iii) **Realisations in quarter** is the amount received from sale or redemption of gilts in the period.
- (iv) **Other debit/credit net** will include for example:
 - depreciation (or amortisation of premium)/appreciation (or amortisation of discount)
 - net surplus/deficit on realisation

BUILDING SOCIETY: QUARTERLY STATEMENT QFS2

SECTION C: UK GOVERNMENT STERLING SECURITIES

- amounts in respect of holdings which have passed from one maturity band to another in the quarter
- any other adjustment to the previous quarter's book value.

(v) **Balances at end quarter** is given on two bases:

- (a) **Book value** - which should reconcile with the previous columns
- (b) **Market value** - which provides a bench-mark for compilation of sector balance sheets.

BUILDING SOCIETY: QUARTERLY STATEMENT QFS2**SECTION D: DERIVATIVE CONTRACTS**

This return records building societies' asset and liability positions in derivatives as at the end of the period and transactions in derivatives over the period. These data will contribute to the UK National Accounts and Balance of Payments.

D.1 TOTAL NOTIONAL DERIVATIVE CONTRACTS

Derivative contracts are to be categorised here under 3 market risk categories: **interest rate, foreign exchange and other (e.g. equity)**. In practice, derivatives may involve more than one category. In such cases the contract should be reported in only one category to avoid double counting, with the allocation being based on the underlying risk component which primarily determines the price of the contract.

The entry to be shown in each line item is the gross amount of the principal involved.

D.2 TOTAL MARKET VALUE OF DERIVATIVE CONTRACTS

Societies should include all contracts at their market or fair value, where the fair value is the amount at which the contract could be exchanged in an arms length transaction between informed and willing parties. Contracts with a positive marked-to-market value should be recorded as an asset: contracts with a negative marked-to-market value should be recorded as a liability.

D.3 NET TRANSACTIONS IN DERIVATIVE CONTRACTS

This includes all transactions in derivatives by the society. All derivative contracts should be recorded on a cash basis with the values reflecting market settlement values rather than daily unrealised revaluation amounts (of accruals). **Where cash is received a negative transaction should be recorded and where a payment is made a positive transaction should be recorded.** If delivery of the underlying asset occurs (e.g. with some option contracts) then only the difference between the market price and the contract paid should be reported as a transaction. Similarly, the exchange of principal (e.g. in cross currency SWAPS) should also be excluded.

D.4 TRANSACTIONS WITH NON-RESIDENT COUNTERPARTIES

This is an "of which" of the data included in D.3 above. Societies should separately identify net receipts associated with interest rate swaps, FRA's and other products where the counterparty is a non-resident.

FINANCIAL SERVICES AUTHORITY

BUILDING SOCIETY: ANNUAL STATEMENT

AFS1

GUIDANCE NOTES

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Introduction:	General notes on the return
Section A:	Balance Sheet
Section B:	Income and Expenditure
Section C:	Miscellaneous
Section F:	Diversification
Section G:	Selected Business Volumes
Section X:	Summary of cross checks
Section Y:	Summary of deducting items

Submission of AFS1: **must** be within 2 months of financial year end.

BUILDING SOCIETY: ANNUAL STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

1. Introduction

This section covers a number of points that have relevance across the return generally:

- 2) Building Societies Act 1986
- 3) Accounting conventions
- 4) Accuracy
- 5) Society, connected undertakings and group figures
- 6) Time horizons
- 7) Outturn information
- 8) Specific items:
 - (i) positions to be reported gross
 - (ii) foreign currencies
 - (iii) use of brackets (..) around figures
- 9) Building society mergers

2. Building Societies Act 1986

Any reference to "the 1986 Act" is a reference to this legislation (as subsequently amended).

BUILDING SOCIETY: ANNUAL STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

3. Accounting conventions

Unless advice is given to the contrary in these Guidance Notes, the return should be compiled using standard accounting practice and in accordance with accounts regulations made under the 1986 Act.

The return has been designed with the aim of harmonising line items wherever possible with those required under accounts regulations, and as used in societies' published and internal accounts. In most instances line items reflect the basis adopted in the 1998 accounting regulations. Given the existence of detailed "definitions" in the Accounts Regs (in the form of particular treatments to be adopted in compiling balance sheet and income and expenditure accounts) and also guidance in the BSA's Annual Accounts Manual, sections A and B of these Guidance Notes deal only with a limited number of line items where additional notes are thought likely to be needed.

4. Accuracy

It is expected that entries on the return will be actual values. Although the return is not required to be formally audited, figures which are common to (i.e. the line item is the same and the definition is the same as) those in the Published Accounts (mainly in Sections A and B) should agree with those figures.

5. Society, Connected Undertakings and Group figures

Societies may hold investments in different types of undertakings.

The 1986 Act defines certain undertakings in which a society may have an interest as "connected undertakings", that is "subsidiary undertakings" and "associated undertakings". In addition to these however a society may also have "other participating interests" or hold "other equity shares" (that is non participating interests). These terms are amplified below:

Subsidiary undertakings: As defined in Companies Act 1985, section 258, which essentially means undertakings over which the society exercises control or dominant influence.

BUILDING SOCIETY: ANNUAL STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

5. Society, Connected Undertakings and Group figures (continued)

Participating interests: An interest held by a society in the shares of another undertaking which it holds on a long term basis for the purpose of securing a contribution to its activities by the exercise of control or influence arising from or related to that interest. A holding of 20 per cent or more of the shares of an undertaking is presumed to be a participating interest unless the contrary has been agreed with the Financial Services Authority. (Full definition is that given in Companies Act 1985, section 260).

For the purposes of group figures the category "**participating interests**" subdivides into:

Associated undertakings: A participating interest in which the society exercises a significant influence over the operating and financial policy. (Full definition given in Companies Act 1985, schedule 4A paragraph 20).

Other participating interests: A participating interest that does not fall to be included within the definition of an associated undertaking.

In tables A and B of the return there is however no separate line for "participating interests", and any entry appropriate to this category should be included in the line for "other participating interests".

Other equity shares: These essentially refer to non-participating interests in other undertakings. They include any other investments which do not fall to be included within any definition above, such as trade investments (e.g. BACS, APACS etc) or other forms of equity holdings (e.g. XYZ plc).

BUILDING SOCIETY: ANNUAL STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

5. Society, Connected Undertakings and Group figures (continued)

The accounting treatment of these investments is best summarised. Reference to the table below should help societies to determine an acceptable and reasonable approach:

BALANCE SHEET		Society	Group
(a)	Subsidiary undertakings	Investment at cost less any permanent diminution in value	Full consolidation line by line.
(b)	Participating interests in:		
(b).1	Associated undertakings	Investment at cost less any permanent diminution in value.	Cost of investment and share of post acquisition retained reserves.
(b).2	Other participating interests	Investment at cost less any permanent diminution in value.	Investment at cost less any permanent diminution in value.
(c)	Other equity investments	Investment at cost less any permanent diminution in value.	Investment at cost less any permanent diminution in value.

Note: only one of (b)1 or (b)2 applies for each column.

INCOME AND EXPENDITURE ACCOUNT		Society	Group
(a)	Subsidiary undertakings	Dividend receivable	Full consolidation line by line.
(b)	Participating interests in:		
(b)1	Associated undertakings	Dividend receivable	Share of profits or losses.
(b)2	Other participating interests	Dividend receivable	Dividend receivable
(c)	Other equity investments	Dividend receivable	Dividend receivable.

Note: only one of (b)1 or (b)2 applies for each column.

BUILDING SOCIETY: ANNUAL STATEMENT

INTRODUCTION: GENERAL NOTES ON THE RETURN

5(i) Society, subsidiary undertakings and Group (consolidated)

The annual return is designed to collect information in respect of the society itself, of the society's subsidiary undertakings and for the group (on a consolidated basis).

5(ii) Subsidiary undertakings

Columns headed "subsidiary undertakings" means the total in respect of all such bodies which are required to be fully consolidated in group accounts (e.g. published accounts)

5(iii) Group (consolidated)

Columns headed "Group (consolidated)" should be compiled on a basis equivalent to that used in preparing published Group figures.

6. Time horizons

The return seeks information in respect of 2 different time horizons as follows:

6(i) Society

For the society and subsidiary undertakings with the same year end as the society this will be the latest financial year.

6(ii) Subsidiary undertaking

If the financial year of a subsidiary undertaking included in the consolidation differs from that of the society, the "group" column shall be made up -

- (a) from the accounts of the subsidiary undertaking for its financial year last ending before the end of the society's financial year, provided that year ended no more than three months before that of the society, or
- (b) from interim accounts prepared by the subsidiary undertaking as at the end of the parent society's financial year.

BUILDING SOCIETY: ANNUAL STATEMENT**INTRODUCTION: GENERAL NOTES ON THE RETURN****7. Information contained in the AFS1: Basis**

Information should, where relevant, agree with the audited information contained in the society's Published Accounts. Where figures have no audited equivalent they should wherever possible be on an 'actual' basis and taken from the society's information system(s).

Although the AFS1 covers the same accounting period as the society's Q4 QFS1 return, it is not expected that the information in these two returns will necessarily be exactly the same for those items which are common (e.g. balance sheet and income and expenditure). However if, on examination, the Financial Services Authority considers that sufficiently material differences are apparent in key items (particularly in table B) then it may ask for revisions to relevant parts of the Q4 QFS1 return. Previous experience suggests that only a small number of societies are likely to be affected.

8. Specific items**8(i) Positions to be reported Gross**

In general, Accounts Regulations indicate that amounts in respect of items representing assets or income may not be set off against amounts in respect of items representing liabilities or expenditure, subject to certain exceptions relating to financial operations and to provisions and amounts written off which are dealt with in paragraphs B5, B9 and B10 of these Guidance Notes.

A notable exception to this however concerns the reporting of loan assets which are subject to "linked presentation" under FRS5. Such assets should be shown in the balance sheet net of linked funding and also on this basis in other tables where balances are reported on the same basis (e.g. G).

8(ii) Foreign currencies

Amounts in foreign currencies should be translated into their equivalent sterling value at the closing middle market spot rate on the reporting date, or where appropriate, at the rates of exchange fixed under the terms of any relevant currency hedging transaction, and that value entered in the return. Thus all entries in the form represent sterling amounts. Societies should apply the same accounting treatment as for the published accounts having regard to SSAP 20.

BUILDING SOCIETY: ANNUAL STATEMENT**INTRODUCTION: GENERAL NOTES ON THE RETURN****8(iii) Use of brackets (..) around figures**

All amounts should be shown without brackets, that is shown as a positive amount, unless:

- a) the amount is of the opposite sign to that expected
- b) the entry could either be positive or negative: in which case the sub-heading should indicate which of the alternatives e.g. "profit/(loss)" is to be shown in brackets.

In any table where an item is routinely to be deducted (e.g. provisions in balance sheet and income and expenditure) the amount should **not** be shown in brackets.

The **exception** would be if the value was of the opposite sign (i.e. negative) and required to be added not deducted, in which case brackets would be necessary. "Deducting" items are summarised in Section Y of these Notes.

9. Building society mergers

When a merger of societies takes place, the AFS1 should be completed as follows:

transferring society: should always complete a "closing" return up to the date of the merger, with flow/transaction figures for the period since the previous year end date and balances as at the date of transfer.

accepting society: in completing its first AFS1 after the merger should include flow/transaction figures of the transferring society only from the date of merger. This return will of course show the balance sheet amounts in respect of the combined society.

BUILDING SOCIETY: ANNUAL STATEMENT

SECTION A: BALANCE SHEET: LIABILITIES

A2 Deposits and debt securities

Although this is not a specific sub-head in the Accounts Regs, it is used for convenience to bring together three sources of funding other than "shares".

A2.1 Amounts owed to credit institutions

Credit institution means an undertaking whose principal business is carrying on regulated activity of accepting deposits within the meaning of the Financial Services and Markets 2000 (Regulated Activities) Order 2001 or any successor regulations made under section 22 of the Act.. It includes banks **and** building societies.

A3 Other liabilities: Long term insurance

Societies are asked to show the amount of long term life insurance liabilities (if applicable) as part of other liabilities at A3.3.

A7 Subscribed capital

This will include deferred shares issued on formation, permanent interest bearing shares ("PIBS") and any other forms of subscribed capital that may be permitted in future.

A13 Commitments

This will include every irrevocable commitment which would give rise to a credit risk to the society or the society and its subsidiary undertakings.

A13.2 It excludes ordinary mortgage commitments. However include any retentions on a secured loan and any stage payments (e.g. on a housing development or similar loan) which the society is contractually obliged to advance at the balance sheet date.

BUILDING SOCIETY: ANNUAL STATEMENT

SECTION A: BALANCE SHEET: ASSETS

A21.3 Liquid assets: loans and advances to credit institutions

Credit institutions - see A2.1 above - include banks **and** building societies.

A25 Investments

Analyses holdings of shares in and certain types of loans (notably those of a longer term nature, typically where a repayment schedule is not expected. NB Loans with a repayment schedule are expected to be included within A24.2) to various connected undertakings. Such undertakings are defined in section 5 of the Introduction to these Notes.

Equity shares in A25.1 excludes investments in any subsidiary undertaking or other participating interests (shown in A25.2 to A25.5) and relates to holdings in bodies unconnected with the society or group (e.g. holding of shares in XYZ plc).

A25.4/5 Associated undertakings and other participating interests are also defined in Section 5 of the Introduction. As indicated in the table in that section, entries in respect of a society's or subsidiary undertakings' holdings in "participating interests" should be entered against "other participating interests".

A28 Other assets: Long term insurance funds

This refers to assets of long term insurers which represent funds arising from the carrying on of long term insurance business.

BUILDING SOCIETY: ANNUAL STATEMENT

SECTION A: BALANCE SHEET: PROVISIONS ANALYSIS

A41-A66 The analysis of provisions balances refers to those amounts deducted in arriving at the amounts shown in the balance sheet (in contrast to monthly and quarterly returns where all loan asset balances are shown "gross" i.e. without deduction of provisions which are shown separately).

BUILDING SOCIETY: ANNUAL STATEMENT**SECTION B: INCOME AND EXPENDITURE****B4 Income from investments**

Please refer to the definition of connected undertakings and other investments in section 5 to the Introduction to these Notes.

B5 Other income and charges

Although no longer a sub-head in the Accounts Regs, it has been retained since all the component items remain.

B5(c) Net profit/(loss) on financial operations includes:

- (i) net profit or loss on transactions in securities which are not held as financial fixed assets (see Note below), that is on such liquid assets held as a trading book, together with amounts written off or written back arising from valuation differences between book value and market value;
- (ii) net profit or loss on financial instruments (hedging instruments) except in so far as that income or charge is treatable as interest and included in interest receivable/payable (e.g. as may be the case for interest rate swaps)

Note: "financial fixed assets" means securities held as fixed assets; participating interests and shareholdings in subsidiary undertakings should always be regarded as financial fixed assets.

"fixed assets" means assets of a society which are intended for use on a continuing basis in the society's activities, and **current assets**" means assets not intended for such use.

B8 Provision for bad and doubtful debts will comprise charges for amounts written off (i.e. where not previously provided for in prior year accounts) and for additional provisions made in respect of loan asset items A22, A23 and A24 in the balance sheet. Also include **adjustments to provisions for bad and doubtful debts** e.g. arising from recoveries against previous write-offs.

BUILDING SOCIETY: ANNUAL STATEMENT

SECTION B: INCOME AND EXPENDITURE

B9 **Provisions for contingent liabilities and commitments** will comprise charges for provisions (net of any credits from the reduction of provisions previously made) for contingent liabilities and commitments of a type which would, if not provided for, be shown under items A12 or A13 in the balance sheet.

B10 **Amounts written off fixed asset investments**

This will comprise amounts written off (net of amounts written back following earlier write-offs) in respect of transferable securities held as financial fixed assets, participating interests, and shares in subsidiary undertakings which are included in Asset items A21.2 to A21.4, and A25.

BUILDING SOCIETY: ANNUAL STATEMENT

SECTION C: MISCELLANEOUS

Introduction

For details of items required on this part of the AFS1, please refer to relevant guidance notes on QFS1:

Section A: for values of statutory percentages

Section C: for information on loan book acquisitions and mortgage discounts/incentives

BUILDING SOCIETY: ANNUAL STATEMENT**SECTION F: DIVERSIFICATION**

- (i) The purpose of this section is to seek information on the extent to which societies have made use of the wider powers available to them under the 1986 Act, both following the 1988 review and now the 1997 Act. Although the structure and format of this section remains as it was when first introduced by the Building Societies Commission in 1992, there are good reasons for so doing. First, it still represents a comprehensive checklist of possible areas of diversification. Second, although in theory the 1997 Act opened up a wider range of possibilities, it is far from clear at this stage what other "services" would need to be added to this section. In due course it may be necessary to supplement the range of services listed, but for the immediate future the current listing is felt to be adequate.
- (ii) The various activities are divided between those which are "**directly provided**" and those which the society or group is "**arranging**". These terms can be defined as follows:
- (a) **Arranging** means that the society or a connected undertaking is acting as an agent for a third party;
- (b) **Directly provided** means provided by the society itself or by a connected undertaking. See also (iii) below.
- (iii) For the purposes of this table the term "**undertaken**" in the column sub-heading means undertaken as at year end. A service undertaken during the year but which is formally no longer arranged or provided at the year end (that is, has formally ceased) is not required to be reported as "undertaken". However, for the purposes of table G please include details of transactions (i.e. flows) during the relevant period for any service no longer **provided** at the year end (at which point of course, if the service is no longer provided, then an entry in table G will not be relevant for any stock or year end position / balance related to that service).

BUILDING SOCIETY: ANNUAL STATEMENT**SECTION G: SELECTED BUSINESS VOLUMES****Introduction**

This section covers selected areas of activity and generally asks for two volumes, numbers and amounts. It is intended to supplement information provided elsewhere in the return. In a number of instances it is asking for volumes of activities indicated in Section F. In all cases it refers to services **directly provided** rather than **arranged** [see Section F/1 of these Notes for definitions].

G1 Money Transmission**G1(a) Current Accounts**

The term is not defined in the 1986 Act as amended, and there is no direct definition in case law or in statute. However, it would appear that because the function of a current account is to facilitate day to day payments, the two essential characteristics are -

- (i) that balances must be repayable on demand, and
- (ii) that the customer has the right to draw personal cheques on the account.

Although certain other features may be common in current accounts (such as overdraft and other money transmission facilities), these would not seem to be essential characteristics.

G1(b) Guarantee Cards

This covers cards which guarantee cheques up to a stated value e.g. of £50 or £100 etc.

Where a card is 'multi purpose' that is it can be used, e.g., as a cheque guarantee card [G1(b)], and a debit card [G1(c)], it should be included separately under each applicable category in the numbers column.

BUILDING SOCIETY: ANNUAL STATEMENT

SECTION G: SELECTED BUSINESS VOLUMES

G1(d) ATMs

These are the **numbers of machines** operated from premises of the society, e.g. Head Office, branch offices, or companies within the group or at the society's agencies, or remote locations where no branch exists (e.g. petrol station, shopping centre etc) but which are owned (or rented) by the society and at which cash withdrawal cards issued by the society can be used.

G2 Lending**G2.1 and G2.2 Advances**

- (i) For definitions please refer to section F/1 and F/2 of the MFS1 Guidance Notes.
- (ii) Advances which include provisions for stage payments should count as **one** in the numbers column, that is the stage payments do not count as separate advances. Further advances however should be counted in addition to the original advance.

G3 Housing Activity

This section provides a breakdown of residential housing activity, between property development, properties for rental and properties involving shared ownership.

G3.1 Development properties

This analyses development activity in the construction of residential properties.

G3.2 and G3.3 Rented housing and shared ownership schemes

This is an analysis of residential properties distinguishing between those let solely as rented housing and those held as part of shared ownership schemes. Neither should include any development activities which should be dealt with in Section G3.1.

BUILDING SOCIETY: ANNUAL STATEMENT

SECTION G: SELECTED BUSINESS VOLUMES

G4 Estate Agency (Number of properties)

G4(b) Sales in period

This should include only those sales which have reached the stage of completion.

Properties which have been removed by the vendor unsold should not be included in 'sales'.

G5 Administration/Registration of share issues/transfers

G5(a) Transfers registered

- (i) Count as **one** transfer registering the transfer of a parcel of shares (arising through sales or purchases) or handling the issue of new share certificates or other new issue documentation.
- (ii) The **amount** to be entered is the nominal value of the shares subject to transfer/new issues.

G6 Investment Services

G6(a) Stockbroking: Clients and value of transactions in year

- (i) numbers of clients should not be adjusted to relate to shares transacted, i.e. where two separate parcels of shares are bought or sold for the same client this should count as **one**.
- (ii) Transactions. The amount is as defined in sub-paragraph G5(a)(ii) above.

G6(b) & (c) Numbers of clients as in sub paragraph G6(a)(i) above.

BUILDING SOCIETY: ANNUAL STATEMENT

SECTION G: SELECTED BUSINESS VOLUMES

G8 Trusteeship (Assets)

The value should be the amount of assets held at the year end on behalf of Charitable Trusts (a), or Trusts for Individuals (b).

G9 Executorship

G9(b) Wills/estates for which appointments held as executor/administrator at year end

This should be the totality of all appointments held regardless of whether any action has been, or is currently being, taken by the executor or administrator.

G10 Organisation

Please refer to section N of Guidance Notes for QFS1 return for definitions of line items used here.

BUILDING SOCIETY: ANNUAL STATEMENT**SECTION Y: SUMMARY OF DEDUCTING ITEMS**

Paragraph 8(iii) of the Introduction to these Guidance Notes makes reference to the treatment of items which are to be routinely 'deducted' in arriving at sub-totals or totals.

The items listed are those which are deducting items and which should **not** be shown in brackets unless the conditions in paragraph 8(iii) are met:

Table A(4) Column 2 (write offs) for every item A41.1 to A65.

Table B(1)	B2 (f)	all columns.
	B5 (b), (e)	all columns.
	B6(e)	all columns.

Table B(2) B7, B8, B9, B10 all columns.

B12, B14, B17, B19, B21, B22	all columns.
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AFS1.Doc

FINANCIAL SERVICES AUTHORITY

BUILDING SOCIETY: MONTHLY GAP RETURN

Guidance on Completion of Interest Rate Risk Gap Analysis

BUILDING SOCIETY: MONTHLY GAP RETURN

Introduction to gap analysis

1. Gap analysis is undertaken by examining details of interest sensitive assets and liabilities to establish when they will next reprice (i.e. be subject to a change in interest rate), and then tabulating those which reprice within set time periods (known as 'time buckets', within which all items repricing are grouped together). Interest rate sensitive items are those assets and liabilities that are subject to contractual change in interest rates, or which mature (fall due for repayment) during the period of the return. (Note that the contractual date for repricing purposes is not necessarily the maturity date of the asset/liability. For example, a 3 year loan could be repriced every six months at a spread above 6 month LIBOR. If it was rolled over a month ago then it will reprice in 5 months', not in 3 years', time.)
2. When fixed rate liabilities in an individual time bucket exceed fixed rate assets in the same bucket, a 'negative gap' exists for that period - implying that a rise in interest rates for that period should produce an increase in net interest income, and a fall in rates should give rise to a fall in net interest income. Conversely, when fixed rate assets exceed fixed rate liabilities in the same time bucket, a 'positive gap' exists and net interest income should fall if interest rates increase and rise if rates reduce.
3. The interest rate risk gap analysis incorporates three inter-linked limit structures:
 - (1) individual limits for each time bucket;
 - (2) cumulative limits for each successive time bucket; and
 - (3) sensitivity limits for the maximum change in economic value and interest income arising from a 3% parallel shift in interest rates.
4. All limits are sign insensitive - i.e., a £10m gap limit applies to both positive and negative gaps. Individual and cumulative gap limits need not be reported for periods up to one year ahead.

BUILDING SOCIETY: MONTHLY GAP RETURN

Setting Gap Limits

5. There are (at least) three possible approaches to the setting of cumulative limits, any of which will be acceptable:

- (1) totals of gaps from overnight forward, but with no limit on positions for less than one year out (i.e. count all positions into the total, but only monitor the total for buckets 1 year +);
- (2) ignore all gaps for periods up to one year out, then start accumulating gap positions, and setting limits, from one year forward; and
- (3) accumulate gap positions in reverse from the most distant period (but not including “no fixed repricing date” items) back towards today, setting limits accordingly.

6. In the first two cases, cumulative limits will become progressively larger as the period becomes more distant, until an overall limit is reached (the cumulative limit, to have any effect, needs to be set at less than the sum of individual gap limits). In the third case, limits will become progressively smaller as the period becomes more distant (i.e. because gaps accumulate in reverse, the limits increase towards the present). The advantage of the reverse cumulative limit structure is that it restricts the total extent of positions taken within and beyond each successive time bucket - where risks to economic value increase - whereas standard cumulative limits govern positions taken up to, and including, each time bucket. The reverse cumulative position can also be used to calculate net interest sensitivity by period.

7. All societies except those on the administered approach to financial risk management (see chapter 4 of the IPSB for building societies) must complete the Interest Rate Risk Gap Analysis.

BUILDING SOCIETY: MONTHLY GAP RETURN

8. A sample return was sent to societies in June 1996 as Annex 1 to the Building Societies Commission DCE letter (number DCE1996/9). For the reasons outlined in this guidance, this format is not mandatory and societies may use an alternative form of report. Accordingly, the sample format is not replicated here.

9. Societies should complete a gap report for each currency (including sterling) converted into its base currency (sterling) in which it has an exposure (hedged or not) on a group basis. The balance sheet categories in the sample return reflect those used in the MFS1 return. It is not expected that the MFS1 return and gap return figures will necessarily agree because of timing differences and the different bases of their preparation.

10. Suggested time buckets are:

Overnight (for variable items), O/N+ to 3 months, 3 to 6 months, 6 to 12 months, 1 to 2 years, etc to 9 to 10 years, 10 years + and “no specific repricing date”.

11. Variable rate items, for which there is no lead time between a change in market rates and a corresponding change in the contracted interest rate (i.e. effectively overnight) should be placed in the “overnight” time bucket. Conventionally, first year time buckets are of shorter duration than later time buckets. However, the precise choice of time buckets is a matter for each society.

12. On and off balance sheet items should be allocated to the various time buckets in accordance with their repricing date.

13. Care should be taken in allocating off balance sheet items. Societies need to consider the essential interest-bearing characteristics of these instruments. For example:

- 1 **Swaps:** if a fixed rate mortgage of 3 years maturity is swapped to a 6 month LIBOR rate then the impact on the gap analysis should be shown by placing the notional swapped amount into the 3 year liability time bucket and the same amount in the 6 month asset time bucket.

BUILDING SOCIETY: MONTHLY GAP RETURN

2. **FRAs:** if a deposit is due to reprice in 3 months' time for 3 months and the society wishes to hedge its exposure, then it might do so by buying an FRA where in 3 months' time it receives an amount of interest covering the further 3 month period (i.e. it will buy a 3v6 FRA). This should be shown as a 6 month liability and a 3 month asset in the gap analysis, reflecting the fact that effectively (a) the society has locked in now (at time zero) to paying a fixed rate in 3 months' time covering a 3 month period (hence in total 6 months), and (b) the society has an exposure now for 3 months to the rate at which the receiving leg of the FRA will settle. In 3 months' time, on settlement, the FRA will disappear from the analysis as proceeds, or preferably payments, will have been settled and the derivative interest rate exposure extinguished.

14. Any individual time bucket mismatches exceeding board-approved limits should be highlighted and the society should send, with the return, an explanation of the limit breach and its plan to rectify the situation.

15. Societies should apply cumulative limits to ensure that blocks of time buckets are monitored.

16. Societies should include (where material) a proportion of contracted balance sheet **commitments** (e.g. commitments for mortgage advance or future payments on SAYE/Sharesave accounts) and the corresponding funding requirement. It is considered that the interest rate risks of commitments are too significant to justify their exclusion from the return, even though this results in a return which shows a hybrid, as opposed to a purely static or dynamic, position. The proportion of commitments included in the gap analysis could be justified (for example) by reference to the society's average rate of conversion of commitments into advances. These items should be treated as "forward start" items, with the exposure starting on the estimated completion dates. The overriding criterion for the return is that it looks at a traded basis rather than a settled basis, recognising that the risk occurs at the point of commitment rather than when settlement occurs. If societies wish to isolate commitments for separate analysis, they can show them on a separate row(s) on the return.

BUILDING SOCIETY: MONTHLY GAP RETURN

17. The return also show the impact of three different “parallel across the yield curve” interest rate changes on net interest income. A “parallel across the yield curve” change assumes that a 0.5% rate change causes 6 month and 5 year rates to change by 0.5%. This assumes that short and long positions across different time buckets can be regarded as offsetting positions, i.e. hedging each other. In reality, of course, changes are not parallel and 6 month rates will change by a different amount to 5 year rates. However, the simplification is a fair starting point. If they wish, societies may provide an additional analysis justifying a different yield curve change to their usual supervisory contact at the FSA.

18. An indication of the sensitivity of the society to interest rate changes can be obtained by determining the effect on aggregate net interest income of a range of interest rate changes (+1%, +2%, +3%, -1%, -2%, -3%). The aggregate net interest income for this purpose will comprise the implicit cashflow (discounted to reflect the “time value of money”, i.e. more distant flows have less “value” than near flows) arising from an interest rate change for each time bucket and summed for all time buckets. The choice of discount factor will be at the discretion of the society and represents its estimated cost of money, which can be taken to be its weighted average cost of funds. Societies need to take into account the merits of achieving increased accuracy in calculating the discount rate for each time bucket given the other approximations already built in to the return. For example, time buckets over 1 year in the future are of 1 year duration and could conceal significant intra time bucket mismatches, yet these are netted and given a simple average time weighting (e.g. a 1 to 2 year time bucket mismatch is assumed to exist for 1½ years).

19. Only where there are no options in the balance sheet will the aggregate net interest income for an increase in interest rates equate (though be opposite in direction) to that for a fall in interest rates. Where options are in place, not only will be direction of interest rate changes become relevant but also will the size of the change. For example, take the case of minimum guaranteed savings accounts which become fixed rate accounts if interest rates fall: far more accounts will become fixed rate if rates fall by 1.5% rather than by 0.5%. The society’s systems will need to cater for these effects.

BUILDING SOCIETY: MONTHLY GAP RETURN

20. Non interest rate sensitive items (e.g. fixed assets, reserves or interest accruals) should be placed in the most distant time bucket. This should not be included in the sensitivity calculations but remains on the gap report for the sake of balance sheet completeness. The FSA recognises that there are several schools of thought over where to allocate reserves in a gap analysis and will consider other board-approved scenarios which are consistently applied and rationalised.

21. Where societies fully hedge or match customer products, in theory, there is no gap created. However, in practice, permanent one-for-one matching is not always possible. There may be lead times during which the asset/liability and the related hedge/match are out of step. For example, this may occur when swapping fixed rate mortgages: the mortgages can complete over a period of time, whilst the swap is typically effected in full at a particular point in time. A perfect match or hedge may be disrupted by the early repayment of a fixed rate mortgage or early withdrawal of a fixed rate savings product on the death of an investor. A gap analysis serves as a useful tool to monitor the extent of this mismatch and can act as a trigger for remedial action.

SUP 16 Ann 5R: Investment management firms' reporting forms and requirements applying to their completion

1. Annual Financial Return
2. Quarterly Financial Return
3. Monthly Financial Return
4. Requirements applying to the completion of annual, quarterly and monthly financial returns



Investment Management Firms

Annual Financial Return

For the year ended _____

Name of Firm _____

FSA firm reference number _____

Date of Audit Opinion _____

For FSA use

Date received _____

Entered _____

Completed _____

For the period from _____ (date) to _____ (date)

(Accounting Reference Date)

£000

Dealing Profit/(Loss)

Dealing profit or (loss) - trading	_____	(1)
Dealing profit or (loss) - long term investments	_____	(2)
Charges on unit trust sales/redemptions	_____	(3)
Total dealing profit or (loss) [(1) to (3)]	=====	(4)

Revenue

Commission	_____	(5)
Investment management fees	_____	(6)
Investment advisory fees	_____	(7)
Unit trust management fees	_____	(8)
Other revenue	_____	(9)
Total revenue [(5) to (9)]	=====	(10)

Expenditure

Commissions and fees	_____	(11)
Exceptional items (specify below)	_____	(12)
Other expenditure	_____	(13)
Total expenditure (to AFS5) [(11) to (13)]	=====	(14)
Profit or (loss) on ordinary activities before taxation [(4)+(10)-(14)]	_____	(15)
Taxation	_____	(16)
Extraordinary items net of attributable taxation	_____	(17)
Profit or (loss) after taxation and extraordinary items [(15)-(16)+(17)]	=====	(18)
Appropriations	_____	(19)
Retained profit or (loss) for the period [(18)-(19)]	=====	(20)

Details of exceptional items of expenditure

As at _____ (Accounting Reference Date)

£000

Fixed Assets

Intangible assets	_____	(21)
Tangible assets	_____	(22)
Investments	_____	(23)
Total fixed assets [(21) to (23)]	=====	(24)

Current Assets

Investments	_____	(25)
Debtors	_____	(26)
Bank and cash balances	_____	(27)
Total current assets [(25) to (27)]	=====	(28)

Creditors: Amounts falling due within One Year

Net current assets (liabilities) [(28)-(29)]	_____	(29)
	=====	(30)
Total assets less current liabilities [(24)+(30)]	=====	(31)

Creditors: Amounts falling due after more than One Year

_____ (32)

Provisions for Liabilities and Charges

_____ (33)

Total assets less total liabilities [(31)-(32)-(33)]	=====	(34)
--	-------	------

Capital and Reserves

(Indicate constituent items from AFS3)

=====

Off Balance Sheet Items (detailed below with values)

(35)

	£000	£000
Financial Resources		
<i>Note: The references in brackets are to the items of capital in Part I of IPRU(INV) Table 5.2.2(1)</i>		
TIER 1		
Paid up share capital (excluding preference shares) (Item 1)	_____	(36)
Share premium account (Item 2)	_____	(37)
Audited reserves (Item 3)	_____	(38)
Non-cumulative preference shares (Item 4)	_____	(39)
Less: Investment in own shares (Item 5)	_____	
Intangible assets (Item 6)	_____	
Material current year losses (Item 7)	_____	
Material holdings in credit and financial institutions (Item 8)	_____	(40)
Tier 1 Capital [(36) to (39)-(40)]	=====	(41)
TIER 2		
Revaluation reserves (Item 9)	_____	(42)
Fixed term cumulative preference share capital (Item 10)	_____	(43)
Long term subordinated loans (Item 11)	_____	(44)
Other cumulative preference share capital and debt capital (Item 12)	_____	(45)
Qualifying arrangements (Item 13)	_____	(46)
Own Funds [(41) + (42) to (46)]	=====	(47)
TIER 3		
Net Trading Book profits (Item 14)	_____	(48)
Short term Qualifying Subordinated Loans and excess Tier 2 capital (Item 15)	_____	(49)
Less: Illiquid assets (Item 16)	_____	(50)
Add: Qualifying Property (Item 17)	_____	(51)
Liquid Capital [(47)+(48)+(49)-(50)+(51)]	=====	(52)

	£000	£000
Own Funds Test (<i>ISD Firms subject to IPRU(INV) 5.2.3(1)(b)R</i>)		
Own Funds (<i>from AFS3 line (47)</i>)		_____ (53)
Own Funds Requirement		
(Euro 50,000 or Euro 125,000 or Euro 730,000) x spot rate	_____	(54)
Surplus/Deficit of Own Funds over Own Funds Requirement [(53)-(54)]		===== (55)
Own-Funds Test (<i>Non-ISD Firms subject to IPRU(INV) 5.2.3(2)R</i>)		
Own Funds (<i>from AFS3 line (47)</i>)		_____ (56)
Own Funds Requirement: either:		
(i) £5 or	_____	
(ii) £4,000	_____	(57)
Surplus/Deficit of Own Funds [(56)-(57)]		===== (58)
Liquid Capital Test (<i>Firms subject to IPRU(INV) 5.2.3(1)R</i>)		
Liquid Capital (<i>from AFS3 line (52)</i>)		_____ (59)(A)
Capital Requirement:		
Expenditure Based Requirement (<i>IPRU(INV) Table 5.2.3(5)(a)</i>)	_____	(60)
Position Risk Requirement (<i>IPRU(INV) Table 5.2.3(5)(b)</i>)	_____	(61)
Counterparty Risk Requirement (<i>IPRU(INV) Table 5.2.3(5)(c)</i>)	_____	(62)
Foreign Exchange Requirement (<i>IPRU(INV) Table 5.2.3(5)(d)</i>)	_____	(63)
Other Assets Requirement (<i>IPRU(INV) Table 5.2.3(5)(e)</i>)	_____	(64)
Total Capital Requirement		(65)(B)
13 weeks Expenditure Based Requirement		_____ (66)(C)
Surplus/Deficit of Liquid Capital		
For an ISD Firm on a 6 week EBR = (A) – the greater of (B) or (C)		===== (67)
Other Firms = (A) – (B))		===== (68)

	£000	£000
Expenditure Based Requirement (IPRU(INV) Table 5.2.3(5)(a))		
Total Expenditure (per profit and loss account AFS1 line (14))		_____
Less: Staff bonus, except to the extent that they are guaranteed	(_____)	
Employees' and Directors' shares in profits, except to the extent that they are guaranteed	(_____)	
Other appropriations of profits	(_____)	
Allowable commission and fees	(_____)	
Interest charges in respect of borrowings made to finance the acquisition of the Firm's Readily Realisable Investments	(_____)	
Interest paid to Customers on Client Money	(_____)	
Interest paid to counterparties	(_____)	
Fees, brokerage and other charges paid to clearing houses, exchanges and intermediate brokers for the purposes of executing, registering or clearing transactions	(_____)	
Foreign exchange losses	(_____)	
Audited Expenditure		=====
Annual Audited Expenditure (pro-rated where relevant to annual amount) (IPRU(INV) 5.2.4(1)(b)R)		=====
Expenditure Based Requirement (6/52* or 13/52* of Annual Audited Expenditure)		===== (69)
Fraction indicator (6* or 13*)		===== (70)

Note: The Expenditure Based Requirement calculated above becomes effective from the date on which this Annual Financial Return is approved by the auditor. At all times throughout the period from this date until the next Annual Financial Return is approved, the Firm's Financial Resources must satisfy its Financial Resources Requirement incorporating the above Requirement.

*Delete whichever is not applicable

(Not subject to audit)

£000

1. FUNDS UNDER MANAGEMENT

Value of total funds under management
at Accounting Reference Date

_____ (71)

2. CLIENT MONEY AND ASSETS

During the period, has the Firm
held Client Money? **

*YES/NO (72)

During the period, has the Firm
held customers' assets? **

*YES/NO (73)

3. OWN ACCOUNT TRADING

Has the Firm traded on its own
account and taken active positions during the period
(other than the box position taken by
an Authorised Unit Trust Manager)?

*YES/NO (74)

If yes, give brief details of nature and scale of transactions:

4. LARGE EXPOSURES (ISD Firms only)

Provide details of all Large Exposures outstanding at the end of the period

(75)

Counterparty

Value of Exposure

**Percentage
of Own Funds**

Nature of Item
*(eg Accrued fees, billed
fees, settlement balance
etc)*

* Delete whichever is not applicable

** Consider by reference to Part IV Permission Statement

This Annual Financial Return has been properly prepared in accordance with the rules,
and was approved by the Firm on (date).

It is accompanied by the Annual Accounts and the report of the auditor to the FSA as required by the rules.

SIGNATURE AND DECLARATION

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief.

Signed on behalf of the Firm by:

..... (authorised signatory) (date)

..... (authorised signatory) (date)



Investment Management Firms

Quarterly Financial Return

For the quarter ended _____

Name of firm _____

FSA firm reference number _____

For FSA use

Date received _____

Entered _____

Completed _____

For the period from _____ (date) to _____ (date)

£000

Dealing Profit/(Loss)

Dealing profit or (loss) - trading	_____	(1)
Dealing profit or (loss) - long term investments	_____	(2)
Charges on unit trust sales/redemptions	_____	(3)
Total dealing profit or (loss) [(1)+(2)+(3)]	=====	(4)

Revenue

Commission	_____	(5)
Investment management fees	_____	(6)
Investment advisory fees	_____	(7)
Unit trust management fees	_____	(8)
Other revenue	_____	(9)
Total revenue [(5) to (9)]	=====	(10)

Expenditure

Commissions and fees	_____	(11)
Exceptional items (specify below)	_____	(12)
Other expenditure	_____	(13)
Total expenditure [(11) to (13)]	=====	(14)
Profit or (loss) on ordinary activities before taxation [(4)+(10)-(14)]	_____	(15)
Taxation	_____	(16)
Extraordinary items net of attributable taxation	_____	(17)
Profit or (loss) after taxation and extraordinary items [(15)-(16)+(17)]	=====	(18)
Appropriations	_____	(19)
Retained profit or (loss) for the period [(18)-(19)]	=====	(20)

Details of exceptional items of expenditure

As at _____ (Quarter End Date)

£000

Fixed Assets

Intangible assets	_____	(21)
Tangible assets	_____	(22)
Investments	_____	(23)
Total fixed assets [(21) to (23)]	=====	(24)

Current Assets

Investments	_____	(25)
Debtors	_____	(26)
Bank and cash balances	_____	(27)
Total current assets [(25) to (27)]	=====	(28)

Creditors: Amounts falling due within One Year

Net current assets (liabilities) [(28)-(29)]	_____	(29)
	=====	(30)
Total assets less current liabilities [(24)+(30)]	=====	(31)

Creditors: Amounts falling due after more than One Year

	_____	(32)
--	-------	------

Provisions for Liabilities and Charges

	_____	(33)
Total assets less total liabilities [(31)-(32)-(33)]	=====	(34)

Capital and Reserves (Indicate constituent items from QFS3)

=====

Off Balance Sheet Items (detailed below with values)

(35)

	£000	£000
Financial Resources		
<i>Note: The references in brackets are to the items of capital in Part I of IPRU(INV) Table 5.2.2(1)</i>		
TIER 1		
Paid up share capital (excluding preference shares) (Item 1)	_____	(36)
Share premium account (Item 2)	_____	(37)
Audited reserves (Item 3)	_____	(38)
Non-cumulative preference shares (Item 4)	_____	(39)
Less: Investment in own shares (Item 5)	_____	
Intangible assets (Item 6)	_____	
Material current year losses (Item 7)	_____	
Material holdings in credit and financial institutions (Item 8)	_____	(40)
Tier 1 Capital [(36) to (39)-(40)]	=====	(41)
TIER 2		
Revaluation reserves (Item 9)	_____	(42)
Fixed term cumulative preference share capital (Item 10)	_____	(43)
Long term subordinated loans (Item 11)	_____	(44)
Other cumulative preference share capital and debt capital (Item 12)	_____	(45)
Qualifying arrangements (Item 13)	_____	(46)
Own Funds [(41) + (42) to (46)]	=====	(47)
TIER 3		
Net Trading Book profits (Item 14)	_____	(48)
Short term Qualifying Subordinated Loans and excess Tier 2 capital (Item 15)	_____	(49)
Less: Illiquid assets (Item 16)	_____	(50)
Add: Qualifying Property (Item 17)	_____	(51)
Liquid Capital [(47)+(48)+(49)-(50)+(51)]	=====	(52)

	£000	£000
Own Funds Test (<i>ISD Firms subject to IPRU(INV) 5.2.3(1)(b)R</i>)		
Own Funds (<i>from QFS3 line (47)</i>)		_____ (53)
Own Funds Requirement (Euro 50,000 or Euro 125,000 or Euro 730,000) x spot rate	_____	(54)
Surplus/Deficit of Own Funds over Own Funds Requirement [(53)-(54)]		===== (55)
 Own-Funds Test (<i>Non-ISD Firms subject to IPRU(INV) 5.2.3(2)R</i>)		
Own Funds (<i>from QFS3 line (47)</i>)		_____ (56)
Own Funds Requirement: either:	(i) £5 or _____	
	(ii) £4,000 _____	(57)
Surplus/Deficit of Own Funds[(56)-(57)]		===== (58)
 Liquid Capital Test (<i>Firms subject to IPRU(INV) 5.2.3(1)R</i>)		
Liquid Capital (<i>from QFS3 line (52)</i>)		_____ (59)(A)
Capital Requirement:		
Expenditure Based Requirement (<i>IPRU(INV) Table 5.2.3(5)(a)</i>)	_____	(60)
Position Risk Requirement (<i>IPRU(INV) Table 5.2.3(5)(b)</i>)	_____	(61)
Counterparty Risk Requirement (<i>IPRU(INV) Table 5.2.3(5)(c)</i>)	_____	(62)
Foreign Exchange Requirement (<i>IPRU(INV) Table 5.2.3(5)(d)</i>)	_____	(63)
Other Assets Requirement (<i>IPRU(INV) Table 5.2.3(5)(e)</i>)	_____	(64)
Total Capital Requirement		_____ (65)(B)
13 weeks Expenditure Based Requirement		_____ (66)(C)
 Surplus/Deficit of Liquid Capital		
For an ISD Firm on a 6 week EBR = (A) – the greater of (B) or (C)		===== (67)
Other Firms = (A) – (B)		===== (68)

£000

1. FUNDS UNDER MANAGEMENT

Value of total funds under management
at Quarter End Date

_____ (69)

2. CLIENT MONEY AND ASSETS

During the period, has the Firm
held Client Money? **

*YES/NO (70)

During the period, has the Firm
held customers' assets? **

*YES/NO (71)

3. OWN ACCOUNT TRADING

Has the Firm traded on its own
account and taken active positions during the period
(other than the box position taken by an Authorised Unit Trust Manager)?

*YES/NO (72)

If yes, give brief details of nature and scale of transactions:

4. LARGE EXPOSURES (ISD Firms only)

Provide details of all Large Exposures outstanding at the end of the period

(73)

Counterparty	Value of Exposure	Percentage of Own Funds	Nature of Item <i>(eg Accrued fees, billed fees, settlement balance etc)</i>
--------------	-------------------	----------------------------	---

* Delete whichever is not applicable

** Consider by reference to Part IV Permission Statement

- 1. Is the Firm able, and will it be able for the foreseeable future, to meet all of its liabilities as they fall due for payment? *YES/NO

- 2. Have the Firm's Financial Resources been greater than its Financial Resources Requirement throughout the Quarter? *YES/NO

We confirm that:

- (i) The Firm's Financial Resources have been properly calculated in accordance with the Financial resources rules.

- (ii) All matters (including contingent liabilities, claims and litigation) which might reasonably be expected to have a material effect on the Firm's financial position at the date of submission of these statements have been declared herewith or notified in writing to the FSA.

SIGNATURE AND DECLARATION

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief.

Signed Date
 (Finance Officer or appointed deputy)

Signed Date
 (Second authorised signatory)

** Delete whichever is not applicable*



Investment Management Firms

Monthly Financial Return

For the month ended _____

Name of firm _____

FSA firm reference number _____

For FSA use

Date received _____

Entered _____

Completed _____

For the period from _____ (date) to _____ (date)

£000

Dealing Profit/(Loss)

Dealing profit or (loss) - trading	_____	(1)
Dealing profit or (loss) - long term investments	_____	(2)
Charges on unit trust sales/redemptions	_____	(3)
Total dealing profit or (loss) [(1)+(2)+(3)]	_____	(4)

Revenue

Commission	_____	(5)
Investment management fees	_____	(6)
Investment advisory fees	_____	(7)
Unit trust management fees	_____	(8)
Other revenue	_____	(9)
Total revenue [(5) to (9)]	=====	(10)

Expenditure

Commissions and fees	_____	(11)
Exceptional items (specify below)	_____	(12)
Other expenditure	_____	(13)
Total expenditure [(11) to (13)]	=====	(14)
Profit or (loss) on ordinary activities before taxation [(4)+(10)-(14)]	_____	(15)
Taxation	_____	(16)
Extraordinary items net of attributable taxation	_____	(17)
Profit or (loss) after taxation and extraordinary items [(15)-(16)+(17)]	=====	(18)
Appropriations	_____	(19)
Retained profit or (loss) for the period [(18)-(19)]	=====	(20)

Details of exceptional items of expenditure

As at _____ (Month End Date)

£000

Fixed Assets

Intangible assets	_____	(21)
Tangible assets	_____	(22)
Investments	_____	(23)
Total fixed assets [(21)to(23)]	=====	(24)

Current Assets

Investments	_____	(25)
Debtors	_____	(26)
Bank and cash balances	_____	(27)
Total current assets [(25) to (27)]	=====	(28)

Creditors: Amounts falling due within One Year

Net current assets (liabilities) [(28)-(29)]	_____	(29)
	=====	(30)
Total assets less current liabilities [(24)+(30)]	=====	(31)

Creditors: Amounts falling due after more than One Year

_____ (32)

Provisions for Liabilities and Charges

_____ (33)

Total assets less total liabilities [(31)-(32)-(33)]	=====	(34)
--	-------	------

Capital and Reserves

(Indicate constituent items from MFS3)

=====

Off Balance Sheet Items (detailed below with values)**(35)**

	£000	£000
Financial Resources		
<i>Note: The references in brackets are to the items of capital in Part I of IPRU(INV) Table 5.2.2(1)</i>		
TIER 1		
Paid up share capital (excluding preference shares) (Item 1)	_____	(36)
Share premium account (Item 2)	_____	(37)
Audited reserves (Item 3)	_____	(38)
Non-cumulative preference shares (Item 4)	_____	(39)
Less: Investment in own shares (Item 5)	_____	
Intangible assets (Item 6)	_____	
Material current year losses (Item 7)	_____	
Material holdings in credit and financial institutions (Item 8)	_____	(40)
Tier 1 Capital [(36) to (39)-(40)]	=====	(41)
TIER 2		
Revaluation reserves (Item 9)	_____	(42)
Fixed term cumulative preference share capital (Item 10)	_____	(43)
Long term subordinated loans (Item 11)	_____	(44)
Other cumulative preference share capital and debt capital (Item 12)	_____	(45)
Qualifying arrangements (Item 13)	_____	(46)
Own Funds [(41) + (42) to (46)]	=====	(47)
TIER 3		
Net Trading Book profits (Item 14)	_____	(48)
Short term Qualifying Subordinated Loans and excess Tier 2 capital (Item 15)	_____	(49)
Less: Illiquid assets (Item 16)	_____	(50)
Add: Qualifying Property (Item 17)	_____	(51)
Liquid Capital [(47)+(48)+(49)-(50)+(51)]	=====	(52)

	£000	£000
Own Funds Test (<i>ISD Firms subject to IPRU(INV) 5.2.3(1)(b)R</i>)		
Own Funds (<i>from MFS3 line (47)</i>)		_____ (53)
Own Funds Requirement		
(Euro 730,000) x spot rate	_____	(54)
Surplus/Deficit of Own Funds over Own Funds Requirement [(53)-(54)]		===== (55)
Own-Funds Test (<i>Non-ISD Firms subject to IPRU(INV) 5.2.3(2)R</i>)		
Own Funds (<i>from MFS3 line (47)</i>)		_____ (56)
Own Funds Requirement: either:		
(i) £5 or	_____	
(ii) £4,000	_____	(57)
Surplus/Deficit of Own Funds [(56)-(57)]		===== (58)
Liquid Capital Test (<i>Firms subject to IPRU(INV) 5.2.3(1)R</i>)		
Liquid Capital (<i>from MFS3 line (52)</i>)		_____ (59)(A)
Capital Requirement:		
Expenditure Based Requirement (<i>IPRU(INV) Table 5.2.3(5)(a)</i>)	_____	(60)
Position Risk Requirement (<i>IPRU(INV) Table 5.2.3(5)(b)</i>)	_____	(61)
Counterparty Risk Requirement (<i>IPRU(INV) Table 5.2.3(5)(c)</i>)	_____	(62)
Foreign Exchange Requirement (<i>IPRU(INV) Table 5.2.3(5)(d)</i>)	_____	(63)
Other Assets Requirement (<i>IPRU(INV) Table 5.2.3(5)(e)</i>)	_____	(64)
Total Capital Requirement		_____ (65)(B)
13 weeks Expenditure Based Requirement		_____ (66)(C)
Surplus/Deficit of Liquid Capital		
For an ISD Firm on a 6 week EBR = (A) – the greater of (B) or (C)		===== (67)
Other Firms = (A) – (B))		===== (68)

£000

1. FUNDS UNDER MANAGEMENT

Value of total funds under management
at Month End Date

_____ (69)

2. CLIENT MONEY AND ASSETS

During the period, has the Firm
held Client Money? **

*YES/NO (70)

During the period, has the Firm
held customers' assets? **

*YES/NO (71)

3. OWN ACCOUNT TRADING

Has the Firm traded on its own
account and taken active positions during the period
(other than the box position taken by an Authorised Unit Trust Manager)?

*YES/NO (72)

If yes, give brief details of nature and scale of transactions:

* Delete whichever is not applicable

** Consider by reference to Part IV Permission Statement.

- 1. Is the Firm able, and will it be able for the foreseeable future, to meet all of its liabilities as they fall due for payment? *YES/NO
- 2. Have the Firm's Financial Resources been greater than its Financial Resources Requirement throughout the Month? *YES/NO

We confirm that:

- (i) The Firm's Financial Resources have been properly calculated in accordance with the Financial resources rules.
- (ii) All matters (including contingent liabilities, claims and litigation) which might reasonably be expected to have a material effect on the Firm's financial position at the date of submission of these statements have been declared herewith or notified in writing to the FSA.

SIGNATURE AND DECLARATION

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief.

Signed
(Finance Officer or appointed deputy)

Date

Signed
(Second authorised signatory)

Date

* Delete whichever is not applicable

Section 4: Investment management firms: requirements applying to the completion of annual, quarterly and monthly financial returns

1 Table

(see SUP 16.7.38R)

1.1.1	<ol style="list-style-type: none"> (1) Financial Returns must be in agreement with the underlying accounting records. (2) Accounting policies must be consistent with those adopted in the Annual Accounts and must be consistently applied. (3) Information required in the Annual, Quarterly and Monthly Financial Returns must be prepared in accordance with generally accepted accounting practice. (4) Investments (other than investments in <i>subsidiary</i> and related <i>companies</i>) must be included in the balance sheet at cost or market value (or the <i>directors'</i> estimate of them). (5) The Financial Returns of an individual (or individuals in partnership or association) must deal only with his <i>regulated activities</i> (or, in the case of individuals in <i>partnership</i> or association, the business of the <i>partnership</i> or association). (6) The Financial Return of a <i>firm</i> must not give a misleading impression of the <i>firm</i>.
1.1.2	A Financial Return is likely to give a misleading impression if a <i>firm</i> wrongly omits or includes a material item, or presents a material item in the wrong way.

Persistency Report

To be submitted by 30 April each year to the Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.

Name of Firm: Firm Reference Number :

Regular Premium Policies / Single Premium Policies :

Ordinary Assurance Policies / Industrial Assurance Policies :

Year in which Policies Effected:

12 Month Report / 24 Month Report / 36 Month Report / 48 Month Report :

Policies promoted through:	Representative			Independent intermediary		
Policy Type	Number effected during the year (CC)	Number in force at end of Y-1 (CF)	Persistency rate	Number effected during the year (CC)	Number in force at end of Y-1 (CF)	Persistency rate
Endowment Assurance						
Whole Life Assurance						
Personal Pension Policy						
Other Pension Policy						
Other Life Assurance						
Income Withdrawal						
Group Personal Pension policy						
Insurance ISA						

Policies promoted through	Direct offer financial promotion			Other		
Policy Type	Number effected during the year (CC)	Number in force at end of Y-1 (CF)	Persistency rate	Number effected during the year (CC)	Number in force at end of Y-1 (CF)	Persistency rate
Endowment Assurance						
Whole Life Assurance						
Personal pension policy						
Other Pension Policy						
Other Life Assurance						
Income Withdrawal						
Group Personal Pension policy						
Insurance ISA						

Guidance notes to persistency report

Please provide (either below or on a separate sheet of paper):

- details of any alternative approaches used to calculate figures if this is permitted by the rules in SUP 16.8;
- a note of any types of policy for which no figures have been submitted (including any types to be reported on in Forms 1R(2) and 1R(3));
- a brief explanation of the effects of inaccuracies on the figures for previous years which have already been supplied; and
- confirmation that regular premium life policies have only been treated as in force if a premium has been received on or after the relevant policy anniversary.

Expressions which are defined in the Handbook Glossary, or in SUP 16.8, have the same meanings in this form.

Signature and declaration

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.4R require an *authorised person* to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. SUP 16.3.11R requires an *authorised person* to submit reports containing all the information required. APER 4.4.6E provides that, where an *approved person* is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of *Statement of Principle 4*. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief and that I have read the Guidance Notes to this form.

Form submitted by (BLOCK CAPITALS):

The following person should be able to assist the FSA with any queries that may arise:

Name: Title:

Address:

.....

.....

Telephone Number:..... e-mail:

Persistency Report - short term endowments/ assurance

To be submitted by 30 April each year to the Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.

Name of Firm:

Firm Reference Number :

Regular Premium Policies / Single Premium Policies:

Ordinary Branch Policies / Industrial Branch Policies:

Year in which Policies Effected:

12 Month / 24 Month / 36 Month / 48 Month report:

Endowment assurance term	Representative			Independent intermediary		
	Number effected during the year (CC)	Number in force at end of Y-1 (CF)	Persistency rate	Number effected during the year (CC)	Number in force at end of Y-1 (CF)	Persistency rate
2 (<3) year term						
3 (<4) year term						
4 (<5) year term						
under 5 year total						

Endowment assurance term	Direct offer financial promotion			Other		
	Number effected during the year (CC)	Number in force at end of Y-1 (CF)	Persistency rate	Number effected during the year (CC)	Number in force at end of Y-1 (CF)	Persistency rate
2 (<3) year term						
3 (<4) year term						
4 (<5) year term						
under 5 year total						

Expressions which are defined in the Handbook Glossary, or in SUP 16.8, have the same meanings in this form.

Signature and declaration

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.4R require an *authorised person* to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. SUP 16.3.11R requires an *authorised person* to submit reports containing all the information required. APER 4.4.6E provides that, where an *approved person* is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of *Statement of Principle 4*. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief and that I have read the Guidance Notes to this form.

Form submitted by (BLOCK CAPITALS):

The following person should be able to assist the FSA with any queries that may arise:

Name: Title:

Address:

.....

.....

Telephone Number:..... e-mail:

Persistency Report – Contribution Holidays

To be submitted by 30 April each year to the Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.

Name of Firm:

Firm Reference Number : Year in which Policies Effected:

12 Month Report/24 Month Report/36 Month Report/48 Month Report:

Policies promoted through:	Representative			Independent intermediary		
	Number effected during the year (CC)	Number subject to contribution holiday at end of Y-1 (CH)	Holiday factor (CH/CC)	Number effected during the year (CC)	Number subject to contribution holiday at end of Y-1 (CH)	Holiday factor (CH/CC)
Endowment Assurance						
Whole Life Assurance						
Personal Pension Policy						
Other Pension Policy						
Other Life Assurance						
Income Withdrawal	N/a	N/a	N/a	N/a	N/a	N/a
Group Personal Pension policy						
Insurance ISA						

Policies promoted through:	Direct offer financial promotion			Other		
	Number effected during the year (CC)	Number subject to contribution holiday at end of Y-1 (CH)	Holiday factor (CH/CC)	Number effected during the year (CC)	Number subject to contribution holiday at end of Y-1 (CH)	Holiday factor (CH/CC)
Endowment Assurance						
Whole Life Assurance						
Personal pension policy						
Other Pension Policy						
Other Life Assurance						
Income Withdrawal						
Group Personal Pension policy						
Insurance ISA						

Expressions which are defined in the Handbook Glossary, or in SUP 16.8, have the same meanings in this form.

Signature and declaration

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.4R require an *authorised person* to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. SUP 16.3.11R requires an *authorised person* to submit reports containing all the information required. APER 4.4.6E provides that, where an *approved person* is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of *Statement of Principle 4*. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief and that I have read the Guidance Notes to this form.

Form submitted by (BLOCK CAPITALS):

The following person should be able to assist the FSA with any queries that may arise:

Name: Title:

Address:

.....

.....

Telephone Number:..... e-mail:

SUP 16 Ann 7R: Personal investment firms' reporting forms and requirements applying to their completion

1. Annual questionnaire for Category A2, A3, B2 and B3 personal investment firms
2. Annual questionnaire for small personal investment firms
3. Schedule 13A: Financial reporting forms for Category A personal investment firms
4. Schedule 13B: Financial reporting forms for Category B personal investment firms
5. Personal investment firms: requirements applying to the completion of reports
6. Consolidated financial resources return for personal investment firms



(for FSA use only)

Annual questionnaire

for Category A2, A3, B2 and B3 personal investment firms

(except for low resource firms as defined in IPRU(INV) 13)

FSA Handbook Reference: SUP 16 Annex 7(1)R

September 2001

Name of firm

FSA firm reference number

Category

Accounting reference date

The Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS
United Kingdom
Telephone +44 (0) 20 7676 1000
Website <http://www.fsa.gov.uk>

Registered as a Limited Company in England and Wales No 1920623. Registered Office as above

Notes

Please read the following notes before completing the questionnaire.

Completing this form

The Form must be completed in black ink and (if in manuscript) in BLOCK LETTERS.

All dates should be provided in numeric form (e.g. 29/02/2000 for 29 February 2000).

The form must be submitted to your usual supervisory contact within **TWO MONTHS** of the accounting reference date to which it relates.

The questionnaire is split into two parts.

Category A3 and **B3** firms must complete the whole form.

Category A2 and **B2** firms must complete Section 1 and the Declaration.

Declaration

The declaration must be signed as follows:

- (i) if the firm is a **sole trader**, by that person.
- (ii) if the firm is a **partnership**, by two partners.
- (iii) if the firm is a **company**, by two directors. If the firm has only one director, by the director and the Company Secretary.

PLEASE RETURN COMPLETED FORM TO:

THE FINANCIAL SERVICES AUTHORITY
25 THE NORTH COLONNADE
CANARY WHARF
LONDON E14 5HS
UNITED KINGDOM

This section must be completed by all Category A2, B2, A3 and B3 firms

1.01 Have you received any written complaints in respect of your regulated activities?

YES NO

If YES, please summarise

1.02 During the period has more than 20% of new business commission been generated from one company?

YES NO

If YES, please identify the company or companies concerned and give an explanation

1.03 During the period did you receive 20% or more of your commission income from one company in respect of single premium bonds or-unit trusts or investment trusts (including those within ISA[®])?

YES NO

If YES, please identify the company or companies concerned and give an explanation

1.04 During the period have you been asked to pay or have you repaid indemnity commissions?

YES NO

Does this repayment represent more than 5% of your commission income received on indemnity terms?

YES NO

1.05 During the period have you advised any of your clients to discontinue regular premiums on any life policy or pension contract and substituted any similar contract?

YES NO

If YES, please give details

1.06 Are there any outstanding legal proceedings against you or any approved persons of yours or of your appointed representatives?

YES NO

If YES, please provide details, including all parties involved; amount(s) involved; reason for the proceedings; (if you expect to settle the dispute) the likely date of settlement; and the date the proceedings (if not settled) are expected to be heard

1.07 Have all terminated contracts of registered individuals or appointed representatives been notified to FSA?

YES NO

If NO, please explain

1.08 Have all notifiable matters relating to changes of control, partners, directors, auditors and accounting reference date been notified to FSA?

YES NO

If NO, please explain

1.09 Have you complied with the rules relating to complaints procedures as set out in DISP Chapter 1?

YES NO

If NO, please explain

1.10 a Does any life office or collective investment operator own more than 5% of your share capital?

YES NO

If YES, please give details

b Has any life office or collective investment operator provided unsecured loans or any other benefit to you?

YES NO

If YES, please give details

These questions must be answered by Category A3 and B3 firms ONLY

- 2.01** Have you received, during the period, any cash or cheques made out to you, in error, which should have been made out to a third party?

YES

NO

If YES, please give details of the action you have taken in each case

- 2.02** Have you held any certificates relating to the clients' investments for more than four weeks?

YES

NO

If YES, please explain

- 2.03 a** What was your turnover (commission, fees, interest etc) from business activities?

£

- b** Did this exceed expenditure (excluding expenditure on purchase of fixed assets) — i.e. has a profit resulted for the period under review?

YES

NO

If NO, please forward an explanation supported by your most recent Profit and Loss Account and Balance Sheet

- 2.04** What proportion of that income is generated by non-regulated activities?

%

Please provide details

2.05 a Have you maintained accounting and other records in accordance with IPRU(INV) 13.1.11R? YES NO

If NO, please provide explanations

b Have you maintained records which are sufficient to enable the FSA to verify the calculations you have prepared to support your Financial Declaration? YES NO

If NO, please explain

2.06 **In the case of incorporated businesses only**, have the most recent statutory accounts which are due been prepared and submitted in accordance with the Companies Acts timetable? YES NO

If NO, please explain

2.07 **In the case of incorporated businesses only**, did the audit opinion given in respect of the most recent set of statutory accounts contain any qualification? YES NO

If YES, please explain

2.08 Has the firm undertaken any transaction in respect of the following investments?:

a equities/gilts YES NO

b BES/PETs YES NO

c other notifiable transactions YES NO

Declaration

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief.

Name of firm

FSA firm reference number

Name of first signatory

Signature

Position

Date

Name of second signatory

Signature

Position

Date

Annual financial declaration

A IN THE CASE OF A SOLE TRADER:

I certify that to the best of my knowledge and belief I can meet my liabilities, both personal and those relating to my business activities, as they fall due.

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief.

B IN THE CASE OF A PARTNERSHIP OR INCORPORATED BUSINESS:

We certify that to the best of our knowledge and belief the partnership/company can meet its liabilities as they fall due.

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief.

Name of firm

FSA firm reference number

Name of first signatory

Signature

Position

Date

Name of second signatory

Signature

Position

Date



(for FSA use only)

Annual questionnaire

for small personal investment firms

FSA Handbook Reference: SUP 16 Annex 7(2)R

September 2001

Name of firm

FSA firm reference number

Accounting reference date

The Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS
United Kingdom
Telephone +44 (0) 20 7676 1000
Website <http://www.fsa.gov.uk>

Registered as a Limited Company in England and Wales No 1920623. Registered Office as above

Notes

Please read the **GUIDANCE NOTES** before completing the questionnaire.

Small personal investment firms is defined in the Glossary of the FSA Handbook.

Completing this form

The form must be completed in black ink and (if in manuscript) in BLOCK LETTERS.

All dates should be provided in numeric form (e.g. 29/02/2000 for 29 February 2000).

The form must be submitted to your usual supervisory contact within **FOUR MONTHS** of the accounting reference date to which it relates.

Part 1 must be answered by all firms which have not enclosed accounts made up at the accounting reference date in accordance with the format specified by the FSA in the guidance notes.

Part 2 must be answered by all firms

Part 3 must be answered by incorporated businesses only

Part 4 must be answered by unincorporated businesses only

Declaration

In accordance with SUP 16 Ann7R (Section 5, Table 2R) the declaration must be signed as follows:

- (i) if the firm is a **sole trader**, by that person.
- (ii) if the firm is a **partnership**, by two partners.
- (iii) if the firm is a **company**, by two directors. If the firm has only one director, by the director and the Company Secretary.

PLEASE RETURN COMPLETED FORM TO:

THE FINANCIAL SERVICES AUTHORITY
25 THE NORTH COLONNADE
CANARY WHARF
LONDON E14 5HS
UNITED KINGDOM

You need not answer these questions if you have enclosed accounts in the format specified by the FSA in the Guidance Notes

1 a What was the total turnover from the business activities of the firm during the period? £

b Have there been any significant changes in the composition of turnover compared with the previous period? YES NO

If YES, please explain

c What proportion of the turnover was generated by business which the FSA does not regulate? %

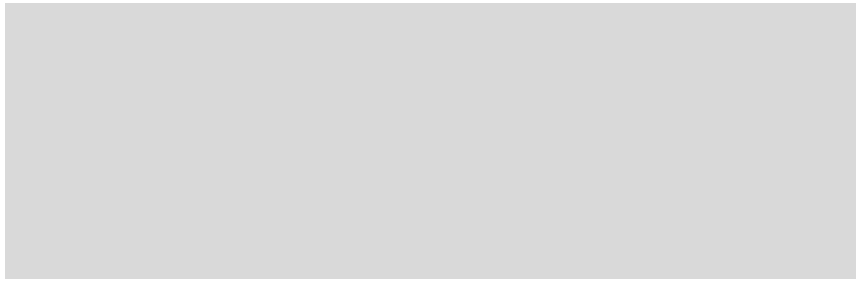
Please provide details

2 Has there been any material change in the firm's financial position during the period? YES NO

If YES, please give details

3 Please provide the following details:

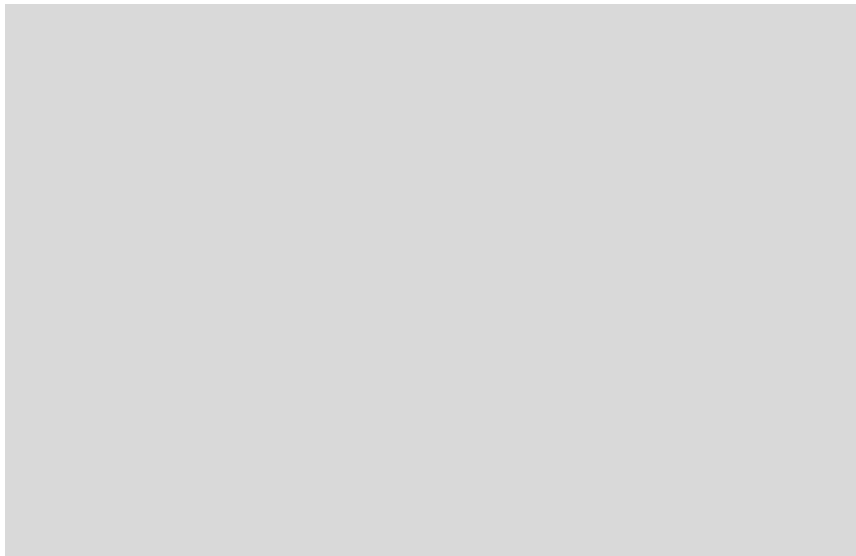
a The firm's bank position at the accounting reference date



b Any major fixed asset additions or disposals during the period



c The major creditors at the accounting reference date, together with payment terms



These questions must be answered by all firms

- 4 Does the firm have, and has it had **at all times** during the period, own funds of at least £10,000 as required by IPRU(INV) 13.10.1R?

YES NO

If NO, please explain

- 5 Is the firm able, and has it been able **at all times** during the period, to meet its liabilities as they fall due, as required by IPRU(INV)13.1.2(2)?

YES NO

If NO, please explain

- 6 a Has the firm maintained accounting and other records in accordance with IPRU(INV)13.1.11R and SYSC 3.2.20R?

YES NO

If NO, please explain

- b Has the firm maintained records to enable the FSA to verify the calculations prepared to support the financial declarations made in response to questions 4 and 5 above?

YES NO

If NO, please explain

- 7 Has more than 20 per cent of new business commission been generated from any one product provider during the period?

YES NO

If YES, please identify the company or companies concerned together with the percentage and give an explanation

8 Has the firm been asked to repay or has it repaid indemnity commission during the period?

YES NO

If YES, do these requests for repayment represent more than 5 per cent of the firm's commission income received on indemnity terms during the period?

YES NO

If YES, please provide an explanation and details of the proportion of commission income received on indemnity terms which the repayments represent and whether these amounts have been repaid.

9 a How many complaints has the firm received during the period?

b Has the firm complied with the requirements relating to complaints procedures as set out in DISP Chapter 1?

YES NO

If NO, please explain

10 Are there outstanding, or have there been at any time during the period, any legal proceedings against the firm, its principals or any of its appointed representatives? YES NO

If YES, please give details

11 Has the firm received, during the period, any cash or cheques made out to it, which should have been made out to a third party? YES NO

If YES, please give details of the action taken in each case

12 Has the firm held any client title documents or other assets belonging to clients (other than client money) for more than four weeks? YES NO

If YES, please explain

13 a Have the firm's investment business activities during the period been such that it has engaged in business outside its permission? YES NO

If YES, please explain

13 b Does the firm have any close links with other persons which have not previously been notified to the FSA?

YES

NO

If YES, please provide details

14 Has the firm complied with the requirements relating to training and competence as set out in the Training and Competence Sourcebook?

YES

NO

If NO, please provide details

This question must be answered by incorporated businesses only

- 15 a Have the most recent statutory accounts been prepared and submitted to the Registrar of Companies in accordance with the Companies Act timetable?

YES NO

If NO, please explain

- b Did the audit opinion given in respect of the most recent set of statutory accounts contain any qualification or include any reference to a fundamental uncertainty?

YES NO

If YES, please provide a copy of these accounts and the audit report.

- c Is the firm a holding company or is any of its qualifying holders a company?

YES NO

If YES, please submit with this questionnaire, in accordance with SUP 16.7.49R, a copy of the latest available audited, consolidated annual financial statements for the group and an organisation chart, tracing the route to the ultimate qualifying holder or holders.

If the required documents are not being submitted, please explain

- d Has the firm received an auditor's report to management during the period?

YES NO

If YES, has the firm promptly informed the FSA of anything in that report, which relates to the firm, and of which the FSA would reasonably expect prompt notice (see SUP 15.3.8G(2))?

YES NO

If NO, please explain

These questions must be answered by unincorporated businesses only

16 a If the firm is a **sole trader**

(i) Does the total of your personal and business assets exceed the total of your personal and business liabilities?

YES NO

(ii) Will you be able to meet those liabilities as they fall due?

YES NO

If the answer to either question is NO, please explain

b If the firm is a **partnership**

(i) Do the personal assets of each individual partner exceed his or her personal liabilities?

YES NO

(ii) Will they be able to meet those liabilities as they fall due?

YES NO

If the answer to either question is NO, please explain

c In confirming the statement of solvency in question 16(a) or 16(b), has the firm applied the accounting principles set out in SUP 16 Ann7R (Section 5, Table 1R) (excluding paragraph 2) and included as a liability a provision for taxation on the whole of its profits up to the date when the last balance sheet was prepared?

YES NO

If NO, please explain

17

If the firm is a **sole trader**, has it reviewed its arrangements, and the arrangements of its appointed representatives, as required by SYSC 3.2.19G, to ensure that they remain effective to safeguard the interests of customers in the event of the absence, illness, disability or death of any essential member of its staff?

YES

NO

If YES, please provide details of any change in the arrangements or confirm that no changes are required

If NO, please explain

Declaration

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief, and that I have read the Guidance Notes to this form.

Name of firm

FSA firm reference number

Name of first signatory

Signature

Position

Date

Name of second signatory

Signature

Position

Date



Schedule 13A

Financial reporting forms for Category A personal investment firms

FSA Handbook reference SUP 16 Annex 7(3) R

September 2001

The Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS
United Kingdom
Telephone +44 (0) 20 7676 1000
Facsimile +44 (0) 20 7676 1099
Website <http://www.fsa.gov.uk>

Registered as a Limited Company in England and Wales No 1920623. Registered Office as above

As at _____ (accounting reference date)

£

A FIXED ASSETS

1 Intangible assets

2 Tangible assets

3 Investments

4 TOTAL FIXED ASSETS

B CURRENT ASSETS

1 Physical stocks

2 Amounts due from group companies

3 Amounts due from other connected persons
(including Appointed Representatives)

4 Other debtors

5 Investments - long positions

6 Cash at bank and in hand

7 Prepayments and accrued income

8 TOTAL CURRENT ASSETS

C CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

1 Trade creditors

2 Investments - short positions

3 Loans and overdrafts

4 Taxation

5 Amounts due to group companies

6 Amounts due to other connected persons
(including Appointed Representatives)

7 Obligations under finance leases

8 Other creditors

9 Accruals and deferred income

10 TOTAL CREDITORS FALLING DUE WITHIN ONE YEAR

D NET CURRENT ASSETS (B8 - C10)

E TOTAL ASSETS LESS CURRENT LIABILITIES (A4 + D)

As at _____ (accounting reference date)

£

F CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

1	Loans	_____
2	Taxation	_____
3	Amounts due to group companies	_____
4	Amounts due to other connected persons	_____
5	Obligations under finance leases	_____
6	Other creditors	_____
7	Accruals and deferred income	_____
8	TOTAL CREDITORS FALLING DUE AFTER MORE THAN ONE YEAR	_____

G PROVISIONS FOR LIABILITIES AND CHARGES

1	Commission on indemnity terms	_____
2	Provisions for pension opt-outs and transfers	_____
3	Taxation including deferred taxation	_____
4	Other provisions	_____
5	TOTAL PROVISIONS FOR LIABILITIES AND CHARGES	_____

H TOTAL ASSETS LESS TOTAL LIABILITIES (E - F8 - G5)

I CAPITAL AND RESERVES

1	Called up share capital	_____
2	Share premium account	_____
3	Proprietor's or partners' capital accounts	_____
4	Proprietor's or partners' current accounts	_____
5	Revaluation reserve	_____
6	Other reserves	_____
7	Profit and loss account	_____
	- prior year	_____
	- current year	_____
8	TOTAL CAPITAL AND RESERVES	_____

SIGNATURE AND DECLARATION

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief.

The financial statements set out on pages ____ to ____

were approved on _____ (date)

(proprietor/partner/director) (signature)

(partner/director) (signature)

For the period from _____ (date) to _____ (date)

£

A	REVENUE	
I	Commissions on transactions in:	
1	Collective investment schemes	_____
2	Life assurance policies	
	(a) on indemnity terms	_____
	(b) other initial commission	_____
	(c) renewal commission	_____
3	Direct investments	_____
4	Other - please specify	_____
II	Investment management fees	_____
III	Fees for investment advice	_____
IV	Interest and dividends	
1	Investments	_____
2	Loan accounts	_____
3	In respect of client bank accounts	_____
4	Other - please specify	_____
V	Exceptional items - please specify	_____
VI	Other revenue - please specify	_____
VII	TOTAL REVENUE	_____
B	TOTAL EXPENDITURE (see XII on Form 13Bii)	_____
C	PROFIT BEFORE TAXATION (A VII – B)	_____
D	TAXATION	_____
E	EXTRAORDINARY ITEMS - please give details	_____
F	PROFIT FOR THE PERIOD (C - D - E)	_____
G	DISTRIBUTIONS	
I	Dividends	_____
II	Proprietor's/partners' drawings - please specify	_____
III	Other - please specify	_____
H	RETAINED PROFIT OR LOSS FOR THE PERIOD (F - G)	_____

For the period from _____ (date) to _____ (date)

£

B	TOTAL EXPENDITURE	
I	Shared commissions paid	
	1 attributable directly to commissions received	_____
	2 not attributable directly to commissions received	_____
II	Salaries and other employment costs	_____
III	Directors' or partners' emoluments	_____
IV	Staff bonuses	_____
V	1 Employees' and directors' shares in profits	_____
	2 Other appropriations of profits	_____
VI	Interest charges	
	1 Payable to clients in respect of client money balances	_____
	2 Payable to counterparties	_____
	3 Subordinated loans	_____
	4 Other loans	_____
	5 Bank overdrafts	_____
	6 Other - please specify	_____
VII	Audit fees	_____
VIII	Other professional charges	_____
IX	Regulatory fees and expenses	_____
X	Other expenditure	
	1 Establishment costs	_____
	2 Communications and marketing	_____
	3 Office equipment and services	_____
	4 Depreciation	_____
	5 Other office expenses	_____
	6 Provision for losses	_____
	7 Bad and doubtful debts	_____
	8 Provision for pension transfer compensation	_____
	9 Professional indemnity insurance	_____
	10 Customers' claims and compensation - please give details	_____
	11 Other claims - please give details	_____
	12 Management fees payable to connected companies	_____
	13 Fees, brokerage to clearing houses etc	_____
	14 Foreign exchanges losses	_____
	15 Other expenses - please give details	_____
XI	Exceptional items - please give details	_____
XII	TOTAL EXPENDITURE	_____

FINANCIAL RESOURCES TEST 1		Admissible amount
As at _____ (accounting reference date)		£
1	Paid-up ordinary share capital	_____
2	Share premium account	_____
3	Audited reserves (excluding revaluation reserves) and verified interim net profits	_____
4	Non-cumulative preference shares (if not redeemable by shareholders within 5 years)	_____
INITIAL CAPITAL		(1+2+3+4) _____ A
7	Investments in own shares	_____
8	Intangible assets	_____
9	Material current year losses	_____
10	Material holdings in credit and financial institutions	_____
		(7+8+9+10) _____ B
ORIGINAL OWN FUNDS		(A-B) _____ C
12	Revaluation reserves*	_____
13	Cumulative preference share capital (if not redeemable by shareholders within 5 years)*	_____
14	Long-term subordinated loans*	_____
15	Preference share capital (if not redeemable by shareholders within 2 years) and debt capital*	_____
OWN FUNDS		(C+12+13+14+15) _____
OWN FUNDS REQUIREMENT		
50,000 ECU / 125,000 ECU / 730,000 ECU		
converted to sterling at _____ (rate)		
(if IPRU(INV) 13.3.3R applies then replace with highest reference level)		
OWN FUNDS SURPLUS/(DEFICIT)		_____

* these items may be restricted in accordance with IPRU(INV) Table 13.3.2(2)

FINANCIAL RESOURCES – TEST 1

Admissible amount

As at _____ (accounting reference date)

£

Balances on proprietor's or partners'

5 Capital accounts

6 Current accounts (to the extent that the profits are audited and interim net profits are verified)

INITIAL CAPITAL

(5+6)

A

8 Intangible assets

9 Material current year losses

10 Material holdings in credit and financial institutions

11 Excess of current year drawings over current year profits

(8+9+10+11)

B

ORIGINAL OWN FUNDS

(A-B)

C

12 Revaluation reserves*

14 Long-term subordinated loans*

OWN FUNDS

(C+ 12+14)

OWN FUNDS REQUIREMENT

50,000 ECU / 125,000 ECU / 730,000 ECU

converted to sterling at _____ (rate)

(If IPRU(INV) 13.3.3R applies then replace with highest reference level)

OWN FUNDS SURPLUS/(DEFICIT)

* these items may be restricted in accordance with IPRU(INV) Table 13.3.2(2)

NET CURRENT ASSETS TEST

As at _____ (accounting reference date)

£

ADJUSTED NET CURRENT ASSETS	(IPRU(INV) 13.4)	
NET CURRENT ASSETS	(D in Form 13A)	_____
ADJUSTMENTS		
1 Long term assets	(IPRU(INV) 13.4.1R(1))	_____
2 Connected persons	(IPRU(INV) 13.4.1R(2))	_____
3 Investments	(IPRU(INV) 13.4.1R(3))	_____
ADJUSTED NET CURRENT ASSETS		_____
LESS: REQUIREMENT		_____ 1 _____
SURPLUS (DEFICIT)		_____

EXPENDITURE BASED REQUIREMENT

(This applies to Firms in Cat A1, Cat A2 with permission to manage investments and Cat A networks)

£

£

FINANCIAL RESOURCES (from Form 13F)

Less: **FINANCIAL RESOURCES REQUIREMENT**

Total expenditure

(XII on Form 13Bii from your last annual financial statements)

Less: staff bonuses

employees' and directors' shares in profits

shared commissions

interest charges in respect of borrowing made to finance the acquisition of your readily realisable investments

interest paid to clients on client money

interest paid to counterparties

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

foreign exchange losses

(A)

Relevant Annual Expenditure Requirement is the higher of the following

(A) multiplied by 13/52 or

An amount equal to £400 multiplied by the number of investment staff (see note)

FINANCIAL RESOURCES SURPLUS/(DEFICIT)

NOTE: The number of the Firm's investment staff includes the investment staff of its appointed representatives

**EXPENDITURE BASED REQUIREMENT
(Modified Test)**

(This applies to Cat A2 Firms without permission to manage investments and Cat A3 Firms)

£

£

FINANCIAL RESOURCES (from Form 13F)

Less: **FINANCIAL RESOURCES REQUIREMENT**

Total expenditure

(XII on Form 13Bii from your last annual financial statements)

Less: staff bonuses

employees' and directors' shares in profits

shared commissions

interest charges in respect of borrowing made to finance
the acquisition of your readily realisable investments

interest paid to clients on client money

interest paid to counterparties

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

foreign exchange losses

(A)

Relevant Annual Expenditure Requirement is the higher of the following

(A) multiplied by 4/52 or 8/52
(whichever applies in IPRU(INV) 13.5.1(R) or

(A) multiplied by 13/52 then the total of special adjustments
from Form 13F deducted or

An amount equal to £400 multiplied by
the number of investment staff (see note)

FINANCIAL RESOURCES SURPLUS/(DEFICIT)

NOTE: The number of the Firm's investment staff includes the investment staff of its appointed representatives

EXPENDITURE BASED REQUIREMENT

ASSETS	Balance Sheet £	Adjustment IPRU(INV) Table 13.5.4 * Item no.	Position Risk	Other Special Adjustment	Illiquid Assets	Admissible amount £
FIXED ASSETS						
Intangible assets		(13)				NIL
Tangible assets- land and buildings		(1)				NIL
- other tangible assets		(13)				NIL
Investments		(2), (3)				
CURRENT ASSETS						
Physical stocks		(13)				NIL
Debtors - unsettled securities transactions		(4), (5)				
- regulated collective investment schemes		(6)				
- group debtors		(7)				
- trade debtors		(8)				
- prepayments		(9)				
- accrued income		(10)				
- deposits		(11)				
- government bodies		(12)				
- other debts		(13)				NIL
Investments		(2), (3)				
Cash at bank and in hand		(11a)				
TOTAL ASSETS						

C/f

* A Category A1 firm must use IPRU(INV) Table 13.5.4(1)
 A Category A2 or A3 firm must use IPRU(INV) Table 13.5.4(2).

LIABILITIES	Balance Sheet £	Adjust- ment IPRU(INV) Table 13.5.4 * Item no.	Position Risk	Other Special Adjust- ment	Illiquid Assets	Admissible amount £
					b/f	
CURRENT LIABILITIES						
Creditors: amounts falling due within one year						
Liabilities secured on property		(14)				
Investments (short positions)		(17)				
Taxation		(19)				
Unsettled securities transactions		(20), (21)				
Other current liabilities		(26)				
TOTAL CURRENT LIABILITIES						
Creditors: amounts falling due after more than one year						
Liabilities secured on property		(14)				
Short-term subordinated loans		(15)				
Long-term subordinated loans		(15)				
Taxation		(19)				
Other liabilities		(26)				
PROVISIONS FOR LIABILITIES AND CHARGES						
Commission on indemnity terms		(16)				
Other provisions		(26)				
TOTAL LIABILITIES						
					<i>c/f</i>	
TOTAL ASSETS LESS TOTAL LIABILITIES						

* A Category A1 firm must use IPRU(INV) Table 13.5.4(1)
 A Category A2 or A3 firm must use IPRU(INV) Table 13.5.4(2).

	Balance Sheet £	Adjustment IPRU(INV) Table 13.5.4 * Item no.	Position Risk	Other Special Adjustment	Illiquid Assets	Admis- sible amount £
					b/f	
Capital and reserves						
Called up share capital						
Proprietor's or partners' capital and current accounts						
Other reserves						
Total capital and reserves						
Other adjustments						
Deficiencies in subsidiaries		(18)				
Contingent liabilities		(23)				
Foreign exchange risk		(25)				
Preference shares		(24)				
OTC derivatives		(22)				
Deduction required per Form 13H		(18)				
Large exposure adjustment						

FINANCIAL RESOURCES

(Form 13E)

TOTALS

A	B

TOTAL SPECIAL ADJUSTMENT (A+B)

* A Category A1 firm must use IPRU(INV) Table 13.5.4(1)
A Category A2 or A3 firm must use IPRU(INV) Table 13.5.4(2).

POSITION RISK DEDUCTIONS FOR INVESTMENTS

Where some of your investments are to be classified as fixed assets and others as current assets, you must submit a copy of this form for EACH of those classes of assets.

INVESTMENTS	Balance sheet	Market value	Discount rate	Amount of discount
UK or other Central Government securities with less than 2 years to final redemption			2%	
UK or other Central Government securities with between 2 and 5 years to final redemption			5%	
Other qualifying fixed rate debt securities with less than 5 years to final redemption			8%	
Other qualifying floating rate debt securities with less than five years to final redemption			10%	
UK and other Central Government securities with 5 years or more to final redemption			13%	
Other qualifying debt securities with 5 years or More to final redemption			15%	
Non-qualifying fixed rate debt securities with less than 2 years to final redemption			10%	
Non-qualifying fixed rate debt securities with between 2 and 5 years to final redemption			20%	
Non-qualifying fixed rate debt securities with 5 years or more to final redemption			30%	
Non-qualifying floating rate debt securities of any duration			30%	
With-profit life policies (at surrender value)			20%	
Units in regulated collective investment schemes			25%	
Shares traded on a recognised or designated investment exchange			25%	
Units in higher volatility funds or property funds			50%	
Derivatives (see IPRU(INV) Table 13.5.4A)				
Other investments			100%	
TOTALS				

RESTRICTIONS ON FINANCIAL RESOURCES

Guidance: Where you have been required to make deductions to your own funds level as a result of the restrictions detailed in IPRU(INV) Table 13.3.2(2), the amounts that were deducted can be used in Financial Resources Test 2, but subject to separate restrictions which also take into account the level of short-term subordinated loans and preference shares. This form is required to establish whether any deductions are required to the amounts entered in Form 13F

£

1 Short term subordinated loans

2 Preference shares

3 Amount deducted as a result of the restrictions of IPRU(INV) Table 13.3.2(2)

(1+2+3)

A

Original own funds (Item C on Form 13Ci or Cii)

Less: Position risk (from Form 13F)

B

Multiplied by 250%

C

If A is greater than C, you must deduct the difference in your calculation of Financial Resources Test 2 on Form 13F

Statement of large exposures

Form 13I

As at _____ (date)

£

Own funds level (from Form 13Ci or Cii)

Reportable level (10% of own funds)

Name of counterparty or group of counterparties	Level of exposure	Proportion exempt (%)	Amount included
TOTAL			

Statement of solvency

I certify that, to the best of my knowledge and belief, the total of my personal and business assets exceeds the total of my personal and business liabilities and that I am able to meet those liabilities as they fall due.

Confirmation

I confirm that, in making this statement of solvency, I have applied the Accounting Principles set out in SUP16 Ann 7R (Section 5, Table 1R) of the Rules (excluding paragraph 2(a)) and included as a liability a provision for taxation on the whole of my profits up to the date of the accompanying balance sheet.

Signature and declaration

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body.

I confirm that the information in this statement is accurate and complete to the best of my knowledge and belief.

_____ (signature)
(sole trader)

_____ (date)

Quarterly financial resources statement

Form CAD13

This form applies to all Category A1, A2 and A3 Firms and must be submitted at all quarterly reporting dates other than the annual accounting reference date.

	£000	£000
Financial resources from latest audited Form 13F	<hr/>	
Less: Material changes	<hr/>	
Current year losses to date	<hr/>	
Share capital or proprietor's/partners' capital introduced/ withdrawn since date of last audited figures; subordinated loans introduced/repaid	<hr/>	
Relevant Annual Expenditure Requirement from Form	13Ei	
or	13Eii	
	as applicable	
Financial Resources Surplus/(Deficit)		<hr/> <hr/>



Schedule 13B

Financial reporting forms for Category B personal investment firms

FSA Handbook reference SUP 16 Annex 7(4) R

September 2001

The Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS
United Kingdom

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Facsimile +44 (0) 20 7676 1099

Website <http://www.fsa.gov.uk>

Registered as a Limited Company in England and Wales No 1920623. Registered Office as above

Category B firms except B3 with 1 –25 investment staff

As at _____ (accounting reference date)

£

A FIXED ASSETS

1 Intangible assets

2 Tangible assets

3 Investments

4 TOTAL FIXED ASSETS

B CURRENT ASSETS

1 Physical stocks

2 Amounts due from group companies

3 Amounts due from other connected persons
(including Appointed Representatives)

4 Other debtors

5 Investments - long positions

6 Cash at bank and in hand

7 Prepayments and accrued income

8 TOTAL CURRENT ASSETS

C CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

1 Trade creditors

2 Investments - short positions

3 Loans and overdrafts

4 Taxation

5 Amounts due to group companies

6 Amounts due to other connected persons
(including Appointed Representatives)

7 Obligations under finance leases

8 Other creditors

9 Accruals and deferred income

10 TOTAL CREDITORS FALLING DUE WITHIN ONE YEAR

D NET CURRENT ASSETS (B8 - C10)

E TOTAL ASSETS LESS CURRENT LIABILITIES (A4 + D)

As at _____ (accounting reference date)

£

F CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

1	Loans	_____
2	Taxation	_____
3	Amounts due to group companies	_____
4	Amounts due to other connected persons	_____
5	Obligations under finance leases	_____
6	Other creditors	_____
7	Accruals and deferred income	_____
8	TOTAL CREDITORS FALLING DUE AFTER MORE THAN ONE YEAR	_____

G PROVISIONS FOR LIABILITIES AND CHARGES

1	Commission on indemnity terms	_____
2	Provisions for pension opt-outs and transfers	_____
3	Taxation including deferred taxation	_____
4	Other provisions	_____
5	TOTAL PROVISIONS FOR LIABILITIES AND CHARGES	_____

H TOTAL ASSETS LESS TOTAL LIABILITIES (E - F8 - G5)

I CAPITAL AND RESERVES

1	Called up share capital	_____
2	Share premium account	_____
3	Proprietor's or partners' capital accounts	_____
4	Proprietor's or partners' current accounts	_____
5	Revaluation reserve	_____
6	Other reserves	_____
7	Profit and loss account	_____
	- prior year	_____
	- current year	_____
8	TOTAL CAPITAL AND RESERVES	_____

SIGNATURE AND DECLARATION

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief.

The financial statements set out on pages ____ to ____

were approved on _____ (date)

(proprietor/partner/director) (signature)

(partner/director) (signature)

For the period from _____ (date) to _____ (date)

£

A REVENUE

I Commissions on transactions in:

1 Collective investment schemes _____

2 Life assurance policies _____

(a) on indemnity terms _____

(b) other initial commission _____

(c) renewal commission _____

3 Direct investments _____

4 Other - please specify _____

II Investment management fees

III Fees for investment advice

IV Interest and dividends

1 Investments _____

2 Loan accounts _____

3 In respect of client bank accounts _____

4 Other - please specify _____

V Exceptional items - please specify

VI Other revenue - please specify

VII TOTAL REVENUE

B TOTAL EXPENDITURE (see XII on Form 13Bii)

C PROFIT BEFORE TAXATION (A VII – B)

D TAXATION

E EXTRAORDINARY ITEMS - please give details

F PROFIT FOR THE PERIOD (C - D - E)

G DISTRIBUTIONS

I Dividends _____

II Proprietor's/partners' drawings - please specify _____

III Other - please specify _____

H RETAINED PROFIT OR LOSS FOR THE PERIOD (F - G)

For the period from _____ (date) to _____ (date)

£

B TOTAL EXPENDITURE

I Shared commissions paid

1 attributable directly to commissions received _____

2 not attributable directly to commissions received _____

II Salaries and other employment costs

III Directors' or partners' emoluments

IV Staff bonuses

V Employees' and directors' shares in profits

VI Interest charges

1 Payable to clients in respect of client money balances _____

2 Payable to counterparties _____

3 Subordinated loans _____

4 Other loans _____

5 Bank overdrafts _____

6 Other - please specify _____

VII Audit fees

VIII Other professional charges

IX Regulatory fees and expenses

X Other expenditure

1 Establishment costs _____

2 Communications and marketing _____

3 Office equipment and services _____

4 Depreciation _____

5 Other office expenses _____

6 Provision for losses _____

7 Bad and doubtful debts _____

8 Provision for pension transfer compensation _____

9 Professional indemnity insurance _____

10 Customers' claims and compensation - please give details _____

11 Other claims and compensation - please give details _____

12 Management fees payable to connected companies _____

13 Fees, brokerage to clearing houses etc _____

XI Exceptional items - please give details

XII TOTAL EXPENDITURE

--

FINANCIAL RESOURCES TEST 1

As at _____ (date)

£

Paid up share capital (excluding preference shares redeemable by shareholders within 2 years)	_____
Share premium account	_____
Audited retained profits and verified interim net profits	_____
Revaluation reserves	_____
Short-term subordinated loans	_____
Debt capital	_____
LESS Intangible assets	_____
Material current year losses	_____
Own funds requirement	10,000
OWN FUNDS SURPLUS/(DEFICIT)	£ _____

FINANCIAL RESOURCES – TEST 1

Admissible amount

As at _____ (date)

£

Balances on proprietor's or partners'

Capital accounts

Current accounts

Revaluation reserves

Short-term subordinated loans

LESS:

Intangible assets

Material current year losses

Excess of current year drawings over current year profits

OWN FUNDS

Own funds requirement

10,000

OWN FUNDS SURPLUS/(DEFICIT)

NET CURRENT ASSETS TEST

As at _____ (date)

£

ADJUSTED NET CURRENT ASSETS	(IPRU(INV) 13.11)	
NET CURRENT ASSETS	(D in Form 13A)	_____
ADJUSTMENTS		
1 Long term assets	(IPRU(INV) 13.11.1R(1))	_____
2 Connected persons	(IPRU(INV) 13.11.1R(2))	_____
3 Investments	(IPRU(INV) 13.11.1R(3))	_____
ADJUSTED NET CURRENT ASSETS		_____
LESS: REQUIREMENT		_____ 1
SURPLUS (DEFICIT)		_____

EXPENDITURE BASED REQUIREMENT

(This applies to Firms in Cat B, except low resource Firms)

£

£

ADJUSTED CAPITAL/LIQUID CAPITAL (from Form 13F)

Less: **ADJUSTED CAPITAL REQUIREMENT**

Total expenditure

(B in the profit and loss account on Form 13Bi from your last annual financial statements)

Less: staff bonuses

employees' and directors' shares in profits

shared commissions

interest charges in respect of borrowing made to finance the acquisition of your readily realisable investments

emoluments of directors, partners or a sole proprietor (see Note 1)

(A)

Relevant Annual Expenditure Requirement is the higher of the following

(A) multiplied by 4/52 or 8/52 or 13/52 (see IPRU(INV) 13.12.1R), or

An amount equal to £400 multiplied by the number of investment staff (see Note 2)

ADJUSTED CAPITAL/LIQUID CAPITAL SURPLUS/(DEFICIT)

NOTE 1: Category B1 Firms must not deduct this item.

NOTE 2: The number of the Firm's investment staff includes the investment staff of its appointed representatives.

EXPENDITURE BASED REQUIREMENT

	Balance Sheet £	Cat B1 Firms		Cat B2 and B3 Firms		Admissible amount £
		Adjustment IPRU(INV) Table 13.12.3(1) Item no.	Amount of discount	Adjustment IPRU(INV) Table 13.12.3(2) Item no.	Amount of discount	
ASSETS						
FIXED ASSETS						
Intangible assets						NIL
Tangible assets - land and buildings		(1)		(1)		
- motor vehicles				(2)		
- other tangible assets		(13)		(13)		NIL
Investments		(2)(3)		(3)		
CURRENT ASSETS						
Physical stocks		(13)		(13)		NIL
Debtors - unsettled securities transactions		(4)(5)		(4)(5)		
- regulated collective investment schemes		(6)		(6)		
- group debtors		(13)		(7)		
- trade debtors (authorised persons)		(8)		(8)		
- prepayments		(9)		(9)		
- accrued income		(10)		(10)		
- deposits		(11)		(11)		
- government bodies		(12)		(12)		
- other debts		(12)		(13)		
Investments		(2)		(3)		
Cash at bank		(11)		(11)		
TOTAL ASSETS						

C/f

LIABILITIES	Balance Sheet £	Cat B1 Firms		Cat B2 and B3 Firms		Admissible amount £
		Adjustment IPRU(INV) Table 13.12.3(1) Item no.	Amount of discount	Adjustment IPRU(INV) Table 13.12.3(2) Item no.	Amount of discount	
					b/f	
CURRENT LIABILITIES						
Creditors: amounts falling due within one year						
Liabilities secured on property		(14)		(14)		
Investments (short positions)		(17)		(17)		
Taxation		(19)		(19)		
Unsettled securities transactions		(20), (21)		(20), (21)		
Other current liabilities		(26)		(27)		
TOTAL CURRENT LIABILITIES						
Creditors: amounts falling due after more than one year						
Liabilities secured on property		(14)		(14)		
Subordinated loans		(15)		(15)		
Long-term subordinated loans		(15)		(15)		
Taxation		(19)		(19)		
Other liabilities		(26)		(27)		
PROVISIONS FOR LIABILITIES AND CHARGES						
Commission on indemnity terms		(16)		(16)		
Other provisions		(26)		(27)		
TOTAL LIABILITIES						
					c/f	
TOTAL ASSETS LESS TOTAL LIABILITIES						

	Balance Sheet £	Cat B1 Firms		Cat B2 and B3 Firms		Admissible amount £
		Adjustment IPRU(INV) Table 13.12.3(1) Item no.	Amount of discount	Adjustment IPRU(INV) Table 13.12.3(2) Item no.	Amount of discount	
					b/f	
Capital and reserves						
Called up share capital						
Proprietor's or partners' capital and current accounts						
Other reserves						
Total capital and reserves						
Other adjustments						
Deficiencies in subsidiaries		(18)		(18)		
Contingent liabilities		(23)		(23)		
Foreign exchange risk		(25)		(26)		
Redeemable preference shares		(24)		(25)		
Derivatives		(22)		(22)		

ADJUSTED CAPITAL/LIQUID CAPITAL



DISCOUNTS FOR INVESTMENTS

Where some of your investments are to be classified as fixed assets and others as current assets, you must submit a copy of this form for EACH of those classes of assets.

INVESTMENTS	Balance sheet	Market value	Discount rate	Amount of discount
UK Government or local authority stocks with less than one year to final redemption and debt instruments issued or accepted by an approved bank with less than 90 days to final redemption			2%	
UK Government or local authority stocks with more than one year but less than five years to final redemption			5%	
Other debt instruments which are marketable investments with less than one year to final redemption			5%	
Floating rate notes which are marketable investments with no more than 20 years to final redemption			5%	
UK Government or local authority stocks with 5 years or more to final redemption and other debt instruments which are marketable investments with less than 5 years to final redemption			10%	
Floating rate notes which are marketable investments with more than 20 years to final redemption			10%	
Other debt instruments which are marketable investments			15%	
With-profit life policies (at surrender value)			20%	
Other investments listed on a recognised or designated investment exchange			25%	
Unit-linked bonds and units in authorised unit trusts (other than higher volatility funds and property funds) or regulated collective investment schemes			25%	
Shares traded on a recognised or designated investment exchange			35%	
Other shares for which there is a market maker in the UK			35%	
Units in higher volatility funds or property funds			50%	
Shares in subsidiary companies and shares which are not readily realisable in connected companies			100%	
Derivatives (see IPRU(INV) Table 13.12.3A)				
Other investments			100%	
TOTALS				

Statement of solvency

I certify that, to the best of my knowledge and belief, the total of my personal and business assets exceeds the total of my personal and business liabilities and that I am able to meet those liabilities as they fall due.

Confirmation

I confirm that, in making this statement of solvency, I have applied the Accounting Principles set out in SUP16 Ann 7R (Section 5, Table 1R) of the Rules (excluding paragraph 2(a)) and included as a liability a provision for taxation on the whole of my profits up to the date of the accompanying balance sheet.

Signature and declaration

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body.

I confirm that the information in this statement is accurate and complete to the best of my knowledge and belief.

_____ (signature)
(sole trader)

_____ (date)

Section 5: Personal investment firms: requirements applying to the completion of reports

1 Table

		(See SUP 16.7.51R)
1.	(1)	Each report must provide the required information:
	(a)	fully and accurately;
	(b)	where applicable, in accordance with the accounting principles set out in Table 1 of this annex.
	(2)	A <i>firm</i> must prepare its reports as at its annual <i>accounting reference date</i> and at the applicable intervals between those dates which are specified in SUP 16.7.45R, SUP 16.7.47R and SUP 16.7.49R.
	(3)	A <i>firm</i> must submit reports to the FSA by the dates for submission to the FSA stipulated in SUP 16.7.45R, SUP 16.7.47R and SUP 16.7.49R.
	(4)	Financial statements and any questionnaire, which a <i>firm</i> is required to complete, must be approved and signed as set out in Table 2R.
	(5)	For Form CAD 13 (a copy of which is to be found at the end of Schedule 13A in section 3 of SUP16 Ann 7R), the <i>firm</i> must use figures which are taken from its most recently audited accounts, unless they relate to a material change of a kind specified in that form.
	(6)	A report on holdings of second-hand <i>life policies</i> must contain the following information:
	(a)	the value at the reporting date of each <i>policy</i> held for resale or <i>investment</i> , calculated in accordance with IPRU(INV) 13.12.3R and discounted where appropriate in accordance with IPRU(INV) 13.12.3R;
	(b)	the length of time for which it has been held; and
	(c)	the date to which the <i>surrender value</i> calculated in IPRU(INV) 13.12.3R is or was valid.

2 Table

Table 1R – Accounting Principles

(1) Except as in (2) and (12) below, amounts to be included for all items shown in the *firm's* balance sheet and profit and loss account must be determined in accordance with:

(a) the accounting principles and rules contained in the Companies Acts;

(b) generally accepted accounting standards; and

(c) the provisions of (3) to (11) below

(2) (a) If the *firm* is a *sole trader*, the items to be included in a financial statement must only be those which relate to the *sole trader's* business as a *firm*.

(b) If the *firm* is a *body corporate* with one or more *subsidiaries*, its financial statements must be unconsolidated.

(3) (a) All amounts must be shown in pounds sterling.

(b) A *firm* must translate assets and liabilities denominated in other currencies into pounds sterling using the closing mid-market rate of exchange (or, where appropriate, the rates of exchange fixed under the terms of related or matching forward contracts).

(4) All balances with *counterparties* which are due to be settled against delivery of documents of title must be reflected at their gross amounts unless the parties to the transactions have expressly agreed in writing that they are to be settled on a net basis.

(5) The items in the balance sheet and profit and loss account must be shown in the order and under the headings and sub-headings given in Forms 13A and 13B respectively (but may be shown in more detail than those forms require).

(6) The balance sheet or profit and loss account may include as a separately identified sum any asset or liability, or income or expenditure, not otherwise covered by one of the items listed in Forms 13A and 13B.

(7) A heading or sub-heading corresponding to an item listed in Form 13A or 13B need not be included if there is no amount to be shown for that item in respect of the period to which the balance sheet or profit and loss account relates or in respect of the preceding period.

(8) In the annual statements, in respect of every item in the balance sheet or profit and loss account the corresponding amount for the financial year immediately preceding must also be shown.

(9) No netting is allowed (that is amounts in respect of items representing assets or income may not be offset against amounts in respect of items representing liabilities or expenditure, as the case may be, or vice versa).

Table 1R – Accounting Principles

(10) Balances on *client bank accounts* and related client accounts must not form part of the *firm's* own balance sheet, but must be shown in the notes to the financial statements. If the *firm* has *permission* to perform discretionary portfolio management it must disclose in the notes to the financial statements the value of clients' assets of which the *firm* is discretionary portfolio manager and which are in the *firm's* possession or held to its order

(11) The Notes to the balance sheet and profit and loss account must include the following information where applicable:

(a) A statement of accounting policies

This must include details of the accounting policies which have been adopted in respect of the items which are material to the balance sheet and profit and loss account. However, where the *firm* has revenue from *commissions* on transactions in *life policies* or *pension contracts* there must be an accounting policy note on the recognition of this income, and in particular in respect of any indemnity *commission* income (see (c) below).

There should also be a statement that the balance sheet and profit and loss account have been prepared in accordance with the Companies Acts and with the standards specified in (1)(b) above

(b) Detailed analyses of items in the balance sheet or profit and loss account

The notes are expected to include, where appropriate, analysed information on items in the balance sheet or profit and loss account.

(c) Indemnity *commission* income. A *firm* must disclose fully:

- (i) its accounting policy in respect of indemnity *commission*;**
- (ii) the actual provision made in the financial statements;**
- (iii) the value of *commission* which has been repaid to *suppliers* during the period covered by the financial statements;**
- (iv) the number of *policies* subject to clawback of *commission* which have lapsed during the accounting period.**

(d) Contingent liabilities

A *firm* must disclose fully every contingent liability which exists at the balance sheet date, in particular:

Table 1R – Accounting Principles

- (i) an indication of the amount of the potential liability involved;
- (ii) an indication of the likelihood that the potential liability will crystallise;
- (iii) full details of the background to the contingency.

If no contingent liabilities exist at the balance sheet date there should be a note to this effect.

(12) If it appears to the *firm* that there are special reasons for departing from any of the principles and rules in this table in preparing its financial statements in respect of any financial year, it may do so, but the *firm* must include in a note to the financial statements particulars of the departure, reasons for it and its effect.

3 Table**TABLE 2R****APPROVAL AND SIGNATURE OF REPORTS**

	<i>Sole trader</i>	<i>Partnership</i>	<i>Company</i>
The <i>firm's</i> financial statements must contain a statement setting out:	whether his total assets exceed his total liabilities (whether or not the assets and liabilities arose in the course of <i>regulated activities</i>)	that the financial statements were approved at a meeting of the <i>partners</i>	that the financial statements were approved at a meeting of the <i>directors</i>
The <i>firm's</i> financial statements and any questionnaire must be signed by:	the proprietor	at least two <i>partners</i>	at least two <i>directors</i> *

*Note: If there is only one *director*, then that *director* and the company secretary must sign.

Consolidated financial resources return for personal investment firms

Consolidated financial resources return

GROUP	A	B	C	D	E	F	G	H	I
		% Shareholding in subsidiary or associate	Local regulator or state	Group investment in subsidiary or associate	Financial resources of subsidiary or associate	FRR of subsidiary or associate	Surplus or deficit of subsidiary or associate	Subs./ Assoc. externally generated F resources	FRR for consolidated capital test
Subsidiary or associate							E - F	E - D	F
			FSA						
Total									

Total Financial Resources Requirement of Subsidiaries (Total Column I)

Holding Company Financial Resources Requirement

Total Consolidated Financial Resources Requirement

Total Subsidiary Externally Generated Financial Resources (Total Column H)

Holding Company Financial Resources

Total Consolidated Financial Resources

Total Consolidated Surplus/(Deficiency)

Consolidated financial resources return for personal investment firms

Calculation of financial resources requirement

Calculation of financial resources requirement (FRR) for personal investment firms other than low resource firms
(for subsidiaries or associates the FRR is transferred to column F of main schedule)

GROUP

A	B	C	D	E	F	G	H	I
Name of Company	% Shareholding in Subsidiary or Associate	Own Funds	Financial Resources	C-D	Expenditure based requirement	Total Exp Based reqt E+F	Own Funds requirement	FRR: Greater of G&H



Consolidated financial resources return for personal investment firms

Signature and declaration

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief, and that I have read the Guidance Notes to this form.

Name of signatory

Signature

Position

Date

SUP 16 Ann 8G: Guidance notes on completion of personal investment firms' reporting forms

1. Consolidated financial resources return for personal investment firms
2. Annual questionnaire for small personal investment firms

GUIDANCE NOTES on completion of the pro forma Consolidated financial resources return for personal investment firms

INTRODUCTION

Excessive risks or financial deficiencies in other parts of a group may damage the financial viability of a Category A firm. IPRU(INV)13.7 in the FSA Handbook enables the FSA to gather information so that it can watch for such weaknesses in a group and, if necessary, call for protective or remedial action.

IPRU(INV)13.7.1R states that you must comply with IPRU(INV)13.7 if you are a member of a group.

IPRU(INV)13.7.2R states that where IPRU(INV)13.7 applies, you must provide to the FSA information about yourself and other members of your group relevant to the formation of a complete picture of the group, its structure and organisation and risks to which the firm may be subject as a member of that group.

IPRU(INV) 13.7.2AR states that a Category A firm must ensure that it and other members of its group apply the provisions of chapter 13 of IPRU(INV) on a consolidated basis unless:

- (1) the group is subject to the consolidated supervision requirements imposed by the FSA rules in another chapter or sourcebook; or
- (2) the FSA is not the consolidating supervisor for the firm's group.

IPRU(INV)13.7.2BR states that where a Category A firm is exposed to undue risk in consequence its membership of a group, it must provide against, reduce or eliminate that risk.

To enable the FSA to obtain a complete picture of financial position of the group of which the firm is a member, in accordance with IPRU(INV)13.7.2R, you are required to complete the consolidated financial resources return.

In accordance with IPRU(INV)13.7.2BR, the FSA will require the firm to take steps to eliminate a consolidated deficiency shown by the return.

The guidance for completion of each page of the consolidated financial resources return are given below.

PAGE 1 OF THE RETURN

COLUMN	GUIDANCE
Column A	List each subsidiary and associated company in the group. Complete columns B to I on a line by line basis.
Column B	<p>If the shares in the subsidiary or associate are held by the holding company, enter the percentage share holding in the subsidiary or associate.</p> <p>If the shares in the subsidiary or associate are not held directly by the holding company, but are held by another group company, enter the effective percentage interest of the holding company in the subsidiary or associate. In this case, where the guidance below refers to percentage interest or interest, these should be read as effective percentage interest or effective interest, respectively.</p>
Column C	Specify whether the subsidiary or associate is regulated by the FSA or by another regulator. If the firm is not regulated, state "unregulated"
Column D	<p>The figure entered under Column D should be the sum of the following:</p> <ul style="list-style-type: none"> (a) the interest in the ordinary share capital of the subsidiary or associate. (b) the interest in the preference share capital of the subsidiary or associate.
Column E	<p>Subsidiaries</p> <p>The figure entered under Column E will generally be the sum of the following:</p> <ul style="list-style-type: none"> (a) the ordinary share capital and reserves of the subsidiary. (b) the preference share capital of the subsidiary. <p>However, if the subsidiary has an investment in another group company which is a subsidiary or associate, and the value of that investment as shown on the balance sheet of the subsidiary company holding the shares, is greater than the nominal value of the investment, then the excess should be deducted from the sum of a) and b).</p> <p>Associates</p> <p>The figure entered under Column E should be the sum of the following:</p> <ul style="list-style-type: none"> (a) the holding company's interest in the ordinary share capital and reserves of the associate. This will be the percentage interest from Column B multiplied by the ordinary share capital and reserves of the associate; <p>An adjustment may be required if an associate holds shares in another associate. If the value at which the investment in those shares is held is greater than the par value of those shares, then the excess should be deducted from the total of the capital and reserves of the associate which holds the investment, before calculating the holding company's interest in those capital and reserves.</p> <ul style="list-style-type: none"> (b) the holding company's interest in the preference share capital of the associate. This should be the same figure as used in the calculation under point b) for Column D.

COLUMN	GUIDANCE
Column F	
Subsidiaries	<p>If the subsidiary is an FSA regulated firm, other than a low resource firm as defined in the glossary to IPRU(INV) 13, then the figure in Column F will be taken from page 2 of the return (see later).</p> <p>If the subsidiary is an FSA regulated Category B3 low resource firm then enter £10,000 in Column F. This is the own funds requirement for a low resource firm (see IPRU(INV)13.10.1R). If the subsidiary or associate has intangible assets these will be added to the financial resource requirement.</p> <p>If another regulator regulates the subsidiary enter the financial resource requirement of that other regulator in Column F. If the subsidiary has intangible assets these will be added to the financial resource requirement. If the subsidiary has made a subordinated loan to another group company this should also be added to the financial resource requirement.</p> <p>If the subsidiary is unregulated then provisionally enter £1 in Column F. If the subsidiary has intangible assets these will be added to the financial resource requirement. If the subsidiary has made a subordinated loan to another group company this will also be added to the financial resource requirement.</p>
Associates	<p>If the associate is an FSA regulated firm, other than a low resource firm as defined in the glossary to IPRU(INV) 13, then the figure in Column F will be taken from page 2 of the return (see later).</p> <p>If the associate is an FSA regulated B3 low resource firm then enter £10,000 x holding company's percentage interest in the ordinary shares, in Column F. £10,000 is the own funds requirement (see IPRU(INV)13.10.1R).</p> <p>If another regulator regulates the associate, enter the financial resource requirement of that other regulator x the holding company's percentage interest in the ordinary share capital.</p> <p>If the associate is unregulated then provisionally enter £1 in Column F.</p>
Column G	The figure in Column G is that in Column E less that in column F.
Column H	The figure in Column H is that in Column E less that in Column D. If, for a subsidiary, the minority interest in ordinary share capital and preference share capital is greater than the financial resource requirement in column F then a deduction should be made for the excess. This is because the excess is not freely transferable to other group companies.
Column I	The figure in Column I is that in Column F.

Total Financial Resources Requirement of Subsidiaries	This is the total of the figures in Column I.
Holding Company Financial Resource Requirement	<p>If the holding company is an FSA regulated firm, other than a low resource firm as defined in the glossary to IPRU(INV) 13, then the figure will be taken from page 2 of the return (see later).</p> <p>If the holding company is an FSA low resource firm, then enter £10,000. This is the own funds requirement for a low resource firm (see IPRU(INV)13.10.1R). If the holding company has intangible assets these will be added to the financial resource requirement.</p> <p>If the holding company is regulated by another regulator, provisionally enter the financial resource requirement of that regulator.. If the holding company has intangible assets these will be added to the financial resource requirement. If the holding company has made a subordinated loan to another group company this should be added to the financial resource requirement.</p> <p>If the holding company is unregulated provisionally enter £1. If the holding company has intangible assets these will be added to the financial resource requirement. If the holding company has made a subordinated loan to another group company this should be added to the financial resource requirement.</p>
Total Consolidated Financial Resources Requirement	This is the sum of total financial resource requirement of subsidiaries and the holding company financial resource requirement.
Total Subsidiary Externally Generated Financial Resources	This is the total of Column H.
Holding Company Financial Resources	<p>This is generally the capital and reserves of the holding company.</p> <p>However, if the value at which the investment in directly held subsidiary and associates is shown on the balance sheet of the holding company, is greater than the value at which the investment in subsidiaries and associates, held directly by the holding company, is shown in Column D, then the excess should be deducted from the capital and reserves of the holding company.</p>
Total Consolidated Financial Resources	This is the total of total subsidiary externally generated financial resources and holding company financial resources.
Total Consolidated Excess/(Deficiency)	<p>This is the total consolidated financial resources less total consolidated financial resources requirement.</p> <p>The FSA will require the firm to take steps to eliminate a total consolidated deficiency.</p> <p>In calculating the total consolidated excess/(deficiency) of the group of which the regulated firm is a part, the FSA may review the audited accounts of each subsidiary and associate in the group and audited accounts of the holding company, and may make additional adjustments to those specified above. These adjustments will arise if as a result of the review, the FSA identifies any assets against which a provision is required or liabilities for which a provision should be made.</p>

PAGE 2 OF THE RETURN

This page should be completed for all subsidiaries and associates who are FSA regulated firms, other than low resource firms as defined in the glossary to IPRU(INV) 1.

This page should also be completed in respect of the holding company if it is an FSA regulated firm, other than a low resource firm.

The guidance refers to forms in the schedule of forms(SUP 16 Ann 7(3) R for category A firms and SUP 16 Ann 7(4) R for category B firms). These forms should be those which have been prepared at the same date as the return.

COLUMN	GUIDANCE
Column A	Enter the name of the subsidiary or the associate or the holding company as applicable. Complete columns B to I on a line by line basis.
Column B	If the shares in the subsidiary or associate are held by the holding company, enter the percentage share holding in the subsidiary or associate.
Column C	
Subsidiary	Enter the own funds of the regulated firm from Form 13Ci.
Associate	Enter the own funds of the regulated firm from Form 13Ci multiplied by the percentage interest of the holding company.
Holding Company	Enter the own funds of the regulated firm from Form 13Ci.
Column D	
Subsidiary	Take the total financial resources from Form 13F and add back any investment in subsidiaries or associates and any inter company debtors. Enter the total figure in the column.
Associates	Take the total financial resources from Form 13F and add back any investment in associates and any inter company debtors. Multiply the total figure by the percentage interest of the holding company in the associate and enter the result in the column.
Holding Company	Take the total financial resources from Form 13F and add back any investment in subsidiaries or associates and any inter company debtors. Enter the total figure in the column.
Column E	The figure in column E is that in column C less that in Column D.
Column F	
Subsidiary	Enter the expenditure based requirement from Form 13Ei or 13Eii (Category A firms) or from Form 13E (Category B firms).
Associates	Enter the expenditure based requirement from Form 13Ei or 13Eii (Category A firms) or from Form 13E (Category B firms) multiplied by the percentage interest of the holding company.
Holding Company	Enter the expenditure based requirement from Form 13Ei or 13Eii (Category A firms) or from Form 13E (category B firms).
Column G	The figure in column G is the figure in column E plus the figure in column F.

COLUMN	GUIDANCE
<p>Column H</p> <p>Subsidiary</p> <p>Associate</p> <p>Holding Company</p>	<p>Enter the own funds requirement from Form 13Ci.</p> <p>If a Category A firm is required to comply with IPRU(INV)13.3.3, enter the highest reference level of own funds.</p> <p>Enter the own funds requirement from Form 13Ci multiplied by the percentage interest of the holding company.</p> <p>If a Category A firm is required to comply with IPRU(INV)13.3.3, enter the highest reference level of own funds multiplied by the percentage interest of the holding company.</p> <p>Enter the own funds requirement from Form 13Ci.</p> <p>If a Category A firm is required to comply with IPRU(INV)13.3.3, enter the highest reference level of own funds.</p>
<p>Column I</p>	<p>The figure in Column I is the greater of the figure in Column G and the figure in Column H.</p> <p>If the firm is a subsidiary or an associate, then the figure in Column I should be entered on page 1 in Column F.</p> <p>If the firm is a holding company then the figure in Column I should be entered on page 1, on the line entitled "Holding company financial resources requirement"</p>

Guidance for the completion of Form 13I (Consolidated statement of large exposures)

Introduction

IPRU(INV)13.7, consolidated supervision of group companies, applies to you as you are a member of a group.

IPRU(INV) 13.7.2AR states that a category A firm must ensure that it and other members of its group apply the provisions of chapter 13 of IPRU(INV) on a consolidated basis unless:

- (1) the group is subject to the consolidated supervision requirements imposed by the FSA rules in another chapter or sourcebook; or
- (2) the FSA is not the consolidating supervisor for the firm's group.

As the regulated firm is a member of a group, you are required by SUP16.7.47R to report your large exposures to the FSA on a consolidated basis.

A large exposure exists where:

- (1) the group is owed a debt by, or is otherwise exposed to, another person, or two or more affiliated persons, and
- (2) that exposure equals or exceeds 10% of total consolidated financial resources.

If one group firm is owed a debt by another person, or two or more affiliated persons, then this debt may not be offset by a credit balance with that same person or two or more affiliated persons, in another group company, unless there is a legal right of setoff.

No Large Exposure should exceed 25% of your total consolidated financial resources.

The aggregate of your large exposures should not exceed 800% of your total consolidated financial resources.

You should identify the following in your calculations of large exposures:

- (1) an exempt exposure specified in IPRU(INV) Table 13.6.2(1).
- (2) any exposure covered by any excess of your total consolidated financial resources over your total consolidated financial resources requirement.

The large exposures should be reported on Form 13I (consolidated statement of large exposures) within the period for submission specified in SUP 16.7.47R.

Form 13I (consolidated statement of large exposures) should be completed at the same date as the consolidated financial resources return.

Guidance

Enter the **total consolidated financial resources** from Page 1 of the consolidated financial resources return.

Calculate 10% of the total consolidated financial resources. This is the **reportable level** of large exposures.

Column A	List the names of the counterparties or group of counterparties with whom the group has a large exposure.
Column B	List the level of exposure to each counterparty or group of counterparties.
Column C	Specify the proportion of any exposure which is exempt in accordance with IPRU(INV) Table 13.6.2(1).
Column D	<p>Calculate the net amount of the large exposure after deducting the proportion that is exempt from Column C.</p> <p>The excess of any net large exposure in Column D over 25% of your total consolidated financial resources should be offset against any excess of your total consolidated financial resources over your total consolidated financial resources requirement.</p> <p>If the group does not have a sufficient excess of total consolidated financial resources over its total consolidated financial resources requirement, the FSA will require you to do one of the following:</p> <ol style="list-style-type: none">(1) take steps to reduce the level of your large exposure below 25% of your total consolidated financial resources; or(2) introduce additional capital into the group to provide sufficient financial resources to cover the excess of the large exposure over 25% of your total consolidated financial resources.

GUIDANCE NOTES

These guidance notes are intended to provide assistance to a firm in the completion of the annual questionnaire for small personal investment firms. They are not, however, a substitute for the detailed rules and guidance contained in the FSA Handbook and it remains the responsibility of each firm to ensure that it complies with all the requirements of the rules and guidance.

General

The questionnaire must be completed by each firm which was in category B3 and had 25 or fewer financial advisers at the accounting reference date to which the questionnaire relates (but not by a firm which has permission to manage investments).

A questionnaire must be completed as at each accounting reference date of the firm and the answers must be in respect of the period since the firm's previous accounting reference date.

The questionnaire must be returned to the FSA so that it is received by the firm's usual supervisory contact within **FOUR MONTHS** after the accounting reference date.

If there is insufficient space in the questionnaire to answer a question then the information should be provided on a separate sheet or sheets, which must be marked with the firm's name and the FSA firm reference number and the accounting reference date.

The questionnaire sent to the firm by the FSA should be retained as a master copy for each accounting period.

Submission of Accounts

Part 1 of the questionnaire need not be answered by a firm which submits accounts that comply with the following requirements.

- a) The accounts must be made up for the same period as that covered by the questionnaire.
- b) The accounts must include a profit and loss account, a balance sheet and notes to the accounts which include a statement of the accounting policies adopted. Forms 13A, 13Bi, and 13Bii in SUP16 Ann 7(4)R provide an example of a format which is acceptable. Accounts which have been prepared in the format required by the Companies Acts will be acceptable.
- c) If the firm is in a group, then the accounts must be unconsolidated.
- d) If the firm is a sole trader, the items included in the accounts must be only those which relate to its business as a member of the FSA. (Separate confirmation in respect of the overall financial position of a sole trader is required by Question 16(a)).
- e) Amounts included for all items in the balance sheet and the profit and loss account must be determined in accordance with the accounting principles and rules contained in the Companies Acts and generally accepted accounting standards effective at the relevant time.
- f) All amounts must be shown in pounds sterling.
- g) The corresponding amount for the financial period immediately preceding must also be shown in respect of every item in the balance sheet and the profit and loss account.
- h) No netting is allowed. This means that amounts in respect of items representing assets or income may not be offset against amounts in respect of items representing liabilities or expenditure as the case may be or vice versa.
- i) The profit and loss account must disclose the proportion of turnover which was generated by any business which FSA does not regulate.

If the proportion of turnover generated by business not regulated by the FSA (paragraph (i) above) is not disclosed in the accounts then it must be provided in a separate note.

PART 1

The question in this part should only be answered by a firm which has chosen not to submit accounts with the questionnaire.

The questions should be answered as accurately as possible, based upon the firm's accounting records which, in accordance with IPRU(INV) 13.1.13R, must have been kept up to date.

Question 1(a)

This question requires details of the total turnover from the firm's business activities during the period.

This is the total income which the firm has earned from all its operations. It can include commissions received, fees for investment advice and any income from business which the FSA does not regulate.

Question 1(b)

This question requires details of any significant changes in the composition of turnover compared with the previous period.

The firm must analyse the composition of its turnover for the two periods in accordance with the table below and then compare the relative percentages. For the purposes of this question, a significant change is one where the percentage of turnover number from a particular activity differs from one period to the next by more than ten percentage points.

Analysis of turnover

1. Commission income from collective investment scheme business.
2. Commission income from life assurance business on indemnity terms.
3. Commission income from life assurance business not on indemnity terms.
4. Commission income from direct investment business.
5. Income from fees for investment advice.
6. Interest and dividend income.
7. Other income.

If the answer to the question is YES then an explanation must be provided.

Question 1(c)

This question requires the proportion of turnover generated by business which the FSA does not regulate.

An explanation of the nature of the business which the FSA does not regulate must be provided.

Question 2

This question requires details of any material change in the firm's financial position during the period.

For the purpose of this question, a material change is one which represents at least ten per cent of the own funds of the firm as at the accounting reference date (see the guidance to question 4 for details of the own funds calculation). Particular items which should be reported include profits or losses made during the period and the injection or withdrawal of capital from the firm.

If the answer to the question is YES then full details must be provided.

Question 3

This question requires details of the firm's bank position, any fixed asset additions or disposals during the period and any major creditors at the accounting reference date.

The firm should provide the following information-

- a) **The firm's bank position.** This should include the bank balance (whether in credit or overdrawn), any overdraft facility and the security given to the bank in respect of the overdraft. Details of when the overdraft facility is due for review are also required.
- b) **Any major fixed asset additions or disposals during the period.** For the purpose of this question, a major fixed assets is one which exceeds the higher of £1,000 or ten per cent of the firm's own funds (see the guidance to question 4 for details of the own funds calculation). An addition should be reported at its cost to the business. A disposal should be reported as the gross sale proceeds (before any selling expenses have been deducted). A revaluation, whether upwards or downwards, of a fixed asset should be regarded as an addition or disposal.
- c) **The major creditors.** These should be analysed by the type of creditor, such as trade creditors or tax payable. For the purpose of this question, a major creditor is one which exceeds the higher of £1,000 or ten per cent of the firm's own funds. Where possible the amounts reported should be based upon the invoiced value.

PART 2

The questions in this part must be answered by each firm.

Question 4

This question requires the firm to confirm that it has, and has had at all times during the period, own funds of at least £10,000.

IPRU(INV) 13.10 provides details of how the firm should calculate the amounts of its own funds at any time and IPRU(INV) Table 13.10(2) schedules the items which should be included in the computation.

Interim net profits can only be included if they have been verified by an external auditor. Subordinated loans can only be included if they are subject to agreements in the prescribed format to which the FSA is a party.

If the answer to the question is NO, then the firm must provide an explanation which should include details of when the deficiency occurred, when it was reported to the FSA and the steps which have been taken to resolve the problem.

Question 5

This question requires the firm to confirm whether it is able, and has been able **at all times** during the period, to meet its liabilities as they fall due.

To answer YES to the question the firm must be able to demonstrate that it has sufficient assets available to it to meet any of its liabilities as and when they may need to be paid.

If the answer to the question is NO, then the firm must provide an explanation of the circumstances which must include details of when the failure occurred, when it was reported to the FSA and the steps which were taken to resolve the problem.

Question 6(a)

This question requires the firm to confirm whether it has maintained accounting and other records in accordance with IPRU(INV) 13.1.11R and SYSC 3.2.20R.

A firm must keep records which are sufficient to show at any time that it has complied with the requirements of the FSA Handbook. It must establish procedures and controls to ensure that those records are made promptly and accurately and, where appropriate, brought up-to-date at regular and frequent intervals.

In particular, a firm must keep records of the matters specified in SYSC 3.2.22G. These include details of investment advertisements, customers, transactions, investment staff and appointed representatives, and compliance and complaints.

If the answer to the question is NO, then the firm must provide an explanation of the circumstances and steps taken to resolve the problem.

Question 6(b)

This question requires the firm to confirm whether it has maintained records to enable the FSA to verify the calculations prepared to support the financial declarations made in response to questions 4 (own funds) and 5 (meet its liabilities as they fall due) of the questionnaire.

The rules require that the accounting records of a firm must be kept up-to-date and must disclose with reasonable accuracy **at any time** the firm's financial position at that time and enable the firm to show its continuing compliance with the applicable financial resource requirements. The records must be able to provide the information needed to enable the firm to prepare any calculations needed to support the financial declarations which are required by the rules.

In order to answer YES, the firm should have prepared, as a minimum, calculations as at the accounting reference date which demonstrate it had sufficient own funds and could meet its liabilities as they fall due. These calculations must agree with the underlying accounting records. It should be noted, however, that the firm should be capable of demonstrating that it could also comply with the requirements at all times during the period.

If the answer to the question is NO, then the firm must provide an explanation of the circumstances and the steps taken to resolve the problem.

Question 7

This question requires the firm to confirm whether more than 20 per cent of its new business commission has been generated from any one product provider during the period.

To answer this question the firm must analyse its commission income for the period between the product providers with which it has arranged transactions.

If the answer is YES, then the firm must provide the name of the company or companies from which the commission has been generated, the percentage of income which this represents, and provide an explanation. The reasons given should include comments on the possibility that a high percentage of business with one particular product provider might indicate bias.

Question 8

This question requires the firm to confirm whether it has been asked to repay or has repaid indemnity commission during the period.

If the answer is YES, then the firm must calculate the value of the repayment requests which it has either received or has repaid during the period. This amount will include both repayments which were requested in earlier accounting periods and repaid in this and repayment requests received in this period but not yet repaid.

This amount must then be compared with the commission income which the firm has received on indemnity terms during the period.

If the proportion of repayment requests is more than five per cent then the firm must disclose the proportion and provide an explanation as to why the repayments of commission were required. The firm should also provide details of any of the repayments requests which have not been paid as at the date of completion of this questionnaire.

Question 9

This question requires the firm to state the number of complaints which it has received during the period.

A complaint is defined as any oral or written accusation or expression of grievance made by or on behalf of a complainant against the firm or its appointed representative which alleges

- (a) a breach of the rules or guidance;
 - (b) a failure to comply with any obligation arising under or by virtue of the Financial Services and Markets Act 2000;
 - (c) negligence, a breach of a term of any client agreement or of any enactment or other rule of law which may be applicable to the relevant business of the firm;
 - (d) misrepresentation, bad faith or other malpractice,
- and indicates that the complainant is, or may be, seeking a remedy from the firm in respect of loss, damage or inconvenience.

The firm is also required by this question to state whether it has complied with the requirements relating to complaints procedures as set out in DISP Chapter 1. These require a firm to establish and maintain written procedures for the proper handling of complaints and to take reasonable steps to ensure that its staff, including its appointed representatives and their staff, are aware of the procedures and their duty to act in conformity with them.

If the answer to the question is NO, then the firm must provide details of the particular requirement with which it has not complied and the steps which it has taken to resolve the problem.

Question 10

This question requires the firm to provide details of any legal proceedings against the firm, its principals or any of its appointed representatives which were outstanding either at the date the questionnaire was completed or at any time during the period.

If the answer to the question is YES, then the firm must provide the following information:-

- a) details of all parties involved
- b) the amounts involved
- c) the reasons for the proceedings
- d) the likely date of settlement, if the dispute is expected to be settled
- e) the date the proceedings (if not already settled) are expected to be heard

- f) any other information which is necessary for a full understanding of the legal proceedings.

Question 11

This question requires the firm to confirm whether it has received, during the period, any cash or cheques made out to it, which should have been made out to a third party.

A firm in category B3 is prohibited from holding or handling client money in connection with its business which is regulated by the FSA. It must establish procedures to ensure that if anyone connected with the firm receives cash or cheques which it is prohibited from receiving, then the amount is counted, recorded and returned immediately to the sender.

The rules allow the following instances where a firm is allowed to receive cash or a cheque from or for a client if it is entirely in the course of a business activity which is not investment business:

- » the firm is able to demonstrate that it is regulated for that activity by another regulatory authority or
- » the firm is able to demonstrate that the cash or cheque is properly applied for the purposes for which the firm has received it.

Such instances do not need to be reported.

A firm is also allowed to receive cash or cheque from a client in payment of its fees and these payments do not need to be considered for this question.

If the answer is YES, then the firm must provide details of each occurrence together with the action which was taken. All relevant situations should be reported including those where a product provider has issued a cheque which was made out incorrectly to the firm and also where a client has made a cheque out in favour of the firm.

Question 12

This question requires the firm to confirm whether it has temporarily held any designated investments belonging to clients for more than four weeks.

A firm which does not have the permission of arranging safeguarding and administration of assets, or the permission of safeguarding and administration of assets, may receive documents relating to an investment solely for the purpose of onward transmission to, from or at the discretion of the person to whom the investment belongs. For the purposes of this questionnaire we require the firm to report all instances when documents or assets have been held for a client for more than four weeks.

If the answer to this question is YES then the firm must provide a full explanation for each occurrence including the reason why the documents or assets have been kept for more than four weeks.

Question 13(a)

This question requires the firm to confirm whether its investment business activities during the period have been such that it has engaged in business outside its category or permitted activities.

In order to answer NO to this question the member must have restricted its investment business activities to those which are allowed by the category and permitted activities for which the FSA has granted its permission.

If there is any doubt about whether or not the firm's activities have fallen within the scope of its category or permitted activities then reference should be made to AUTH 3.5.3.G and part II of the Regulated Activities Order.

If the answer to the question is YES then the firm must provide an explanation, including the type of business transacted, the date when the rule breach was reported to the FSA and the steps which have been taken to resolve the problem.

Question 13(b)

This question requires the firm to confirm whether it has any close links with other persons, which have not been previously notified to the FSA.

A close link exists in a situation where two or more persons, by which is meant corporate or unincorporated bodies or individuals, are linked either by common ownership or by control, such as the relationship between a parent company and its subsidiary.

If the answer to the question is YES then the firm must provide full details of close links not already notified including the nature of the close link and when the change which gave rise to it took place. The FSA is required to consider all close links to ensure that there is nothing which could prevent effective supervision, such as a group structure where it is impossible to identify the ultimate controllers.

Question 14

This question requires the firm to confirm whether it has complied with the requirements relating to training & competence. Full details of the requirements are set out in the Training & Competence Sourcebook. If the answer to the question is NO, then the firm must provide details of the particular requirement with which it has not complied and the steps which it has taken to resolve the problem.

PART 3

The questions in this part must be answered by incorporated businesses only.

Question 15(a)

This question requires the firm to confirm whether its most recent statutory accounts have been prepared and submitted to the Registrar of Companies in accordance with the Companies Act timetable.

The Companies Acts require that a private limited company must file its statutory accounts with the Registrar of Companies within ten months of its accounting reference date. A public limited company must file its accounts within seven months. A firm which is authorised as a result of its membership of the FSA is not allowed to take advantage of the exemption which allows some small and medium-sized companies to file abbreviated accounts with the Registrar.

If the answer to the question is NO, then the firm must provide an explanation, including the reason why the statutory accounts were not submitted to the Registrar within the time allowed.

Question 15(b)

This question requires the firm to confirm whether the audit opinion given in respect of its most recent set of statutory accounts contained any qualification or included any reference to a fundamental uncertainty.

A limited company is required to appoint an auditor whose duty is to report to the members of the company of the firm's annual accounts. The auditor's report must state whether in his opinion the accounts have been prepared in accordance with the Companies Acts and whether they give a true and fair view.

It should be noted that a company which is regulated by the FSA cannot take advantage of the small company exemption from the Companies Act requirement to have an annual audit.

The auditor must undertake his audit in accordance with approved Auditing Standards.

In certain circumstances, he will have to qualify his audit opinion for example because of a limit placed on the scope of his work or because of a disagreement over an accounting treatment or disclosure. In some circumstances the auditor may decide that there is fundamental uncertainty about the validity of the going concern assumption in the preparation of the accounts and he will have to refer to this in the audit report.

If the answer to the question is YES, then the firm must provide a full explanation of the circumstances together with a copy of the relevant accounts and the audit report.

Question 15(c)

This question requires the firm, if it is a holding company or if any of its qualifying holders is a company, to submit, with the questionnaire, a copy of the latest available audited, consolidated annual financial statements for the group and an organisation chart, which traces the route to the ultimate qualifying holder or holders.

This is required by SUP 16.7.55R. In practice it is likely that the most recently available consolidated accounts will be for the accounting reference date at the beginning of the period for which the questionnaire is submitted.

The organisation chart should be up-to-date and show clearly the structure of the group and the manner in which the control is exercised by the ultimate qualifying holder or holders.

If the required documents are not being submitted with the questionnaire then the reasons must be fully explained.

Question 15(d)

This question requires the firm to confirm whether it has received an auditor's report to management during the period.

If the answer to the question is YES, then the firm should send to the FSA a copy of the report. If the report contains recommendations to remedy any weakness in the firm's procedures or internal controls, then the firm should, at the same time, also provide the FSA with a statement setting out either how the recommendations are being implemented or, if the firm is not implementing the recommendations, the reasons for that decision.

If the firm has received an auditor's report but not already sent it to the FSA, then it must provide a full explanation of the reasons for not having done so and also submit, with the questionnaire, a copy of the report and statement of remedial action.

PART FOUR

The questions in this part must be answered by unincorporated businesses (sole traders and partnerships) only.

Question 16(a)

This question should only be answered by a firm which is a sole trader.

It requires the individual who is the sole trader to confirm that the total of his or her personal and business assets exceeds the total of his or her personal and business liabilities and also that the sole trader will be able to meet those liabilities as they fall due.

Because the business assets of a sole trader are available to settle personal liabilities, the FSA requires comfort that the sole trader is solvent on an overall basis, by comparing his or her total assets with the total liabilities. This is in addition to the confirmation asked for in questions 4 and 5 in respect of the firm's financial position.

To answer the question the individual will need to list the values of the relevant assets and liabilities and compare them to ensure the requirements are met.

If the answer is NO then the sole trader must provide a full explanation together with details of the steps which are being taken to resolve the problem.

Question 16(b)

This question should only be answered by a firm which is a partnership.

It requires the firm to confirm that the personal assets of each individual partner exceed his or her personal liabilities and that the partner can meet those liabilities as they fall due.

The FSA requires confirmation that each partner is solvent. This is in addition to the confirmation asked for in questions 4 and 5 in respect of the firm's financial position.

To answer the question the firm will have to consider the personal position of each partner and ensure that the requirement is met in each case.

If the answer to the question is NO then the firm must provide a full explanation together with details of the steps which are being taken to resolve the problem.

Question 16(c)

This question requires the firm to confirm that when answering question 16(a) or 16(b) it has applied the accounting principles set out in SUP 16 Ann 7R (Section 5, Table 1R) and included as a liability a provision for taxation on the whole of its profits up to the date when the last balance sheet was prepared.

SUP 16 Ann 7R (Section 5, Table 1R) requires that any amounts included in the schedules used to support the answers given to the previous two questions must be determined in accordance with the accounting principles and rules contained in the Companies Act and generally accepted accounting standards.

It is important to ensure that any taxation which may be payable by the sole trader or partners on the profits of the firm up to the accounting reference date is recognised as a liability in the schedules.

If the answer to the question is NO, then a full explanation must be provided.

Question 17

This question should only be answered by a firm which is a sole trader.

The firm is required to confirm that it has reviewed its arrangements in accordance with SYSC 3.2.19G to ensure they remain effective to safeguard the interests of customers in the event of the absence, illness, disability or death of any essential member of staff.

Each firm is required to review annually its arrangements in accordance with SYSC 3.2.19G to ensure that they remain effective and a firm which is a sole trader must notify the FSA that it has carried out the review.

If the answer is YES, then the firm should also provide any details of the change in the arrangements or confirm that no changes are required.

If the answer is NO, then the firm must provide a full explanation of the reasons why the review has not been completed.

DECLARATION

The Declaration must be completed by each firm.

It is most important that the declaration is signed by the relevant principals of the firm. They are required to confirm that the answers to the questionnaire have been given only after appropriate enquiries have been made and these will be subject to verification checks during routine monitoring visits.



(for FSA use only)

Annual questionnaire for Authorised professional firms

FSA Handbook Reference: SUP16 Annex 9R

20 September 2001

Name of firm

FSA firm reference number

The Financial Services Authority
Notification, Reporting and Data Maintenance Department
11th Floor
25 The North Colonnade
Canary Wharf
London E14 5HS
United Kingdom
Telephone +44 (0) 20 7676 1000
Website <http://www.fsa.gov.uk>

Registered as a Limited Company in England and Wales No 1920623. Registered Office as above

Guidance notes

This form should be completed only by authorised professional firms as defined in the FSA's Handbook of rules and guidance.

Completing this Form

This form must be submitted to the FSA within four months of the accounting reference date to which it relates.

The Form must be completed in black ink and (if in manuscript) in BLOCK LETTERS.

All dates must be provided in numeric form (e.g. 29/02/2000 for 29 February 2000).

Tick the appropriate box where a yes/no answer is required.

Further details must be given in section 4 (supplementary information) if there is insufficient space for a detailed answer.

Additional information can be attached to the Form. It must be securely attached to the rest of the form and you must indicate at question 4.02 the number of additional sheets attached.

Expressions in the form in italics have the meaning given in the Glossary to the FSA's Handbook of rules and guidance (or, if no meaning is given there, are to be interpreted in accordance with the related expressions defined in the Glossary).

Section 1 – Professional regulation

This section must be completed to show which of the designated professional bodies the firm is regulated by.

Section 2 – Supervision and monitoring data

The questions must be completed for the period ending on the firm's latest accounting reference date.

Section 3 – Financial resources and reporting

The questions must be completed for the period ending on the firm's latest accounting reference date.

Section 4 – Supplementary information

This section provides space for additional information which could not be included elsewhere in the form. If there is still insufficient space, please use a separate sheet or sheets, marked with the firm's name and FSA firm reference number.

Declaration

The declaration must be signed as follows:

- (i) If the firm is a sole practitioner, by that person;
- (ii) If the firm is a partnership (or limited liability partnership), by two partners (or designated members);
- (iii) If the firm is a company, by two directors. If the company has only one director, by the director and the Company Secretary.

PLEASE RETURN COMPLETED FORM TO:

THE FINANCIAL SERVICES AUTHORITY
SUPERVISION OF PROFESSIONAL FIRMS
25 THE NORTH COLONNADE
CANARY WHARF
LONDON E14 5HS
UNITED KINGDOM

1.01 Indicate whether the firm is:

- a** an individual who is entitled to practice a profession regulated by a designated professional body and in doing so is subject to its rules; or
- b** a person (not being an individual) which is managed and controlled by one or more individuals each of whom is entitled to practice a profession regulated by a designated professional body and in doing so is subject to the rules of the designated professional body.

YES NO

YES NO

1.02 To which of the following designated professional bodies is the firm subject?

PLEASE TICK ALL APPROPRIATE BOXES

The Association of Chartered Certified Accountants	<input type="checkbox"/>
The Institute of Actuaries	<input type="checkbox"/>
The Institute of Chartered Accountants in England & Wales	<input type="checkbox"/>
The Institute of Chartered Accountants in Ireland	<input type="checkbox"/>
The Institute of Chartered Accountants of Scotland	<input type="checkbox"/>
The Law Society (England & Wales)	<input type="checkbox"/>
The Law Society of Scotland	<input type="checkbox"/>
The Law Society of Northern Ireland	<input type="checkbox"/>

I have supplied further information related to this page in Section 4 YES NO

2.01 a What was the total income (excluding VAT) from all the business activities (including regulated activities) of the firm during the latest and previous periods?

**Latest period
£000**

**Previous period
£000**

--	--

Please state length of period if not 12 months

--	--

b Please indicate the firm's **four main business activities**.

<ul style="list-style-type: none"> 1. Accounts preparation/bookkeeping <input type="checkbox"/> 2. Audit <input type="checkbox"/> 3. Business start-ups <input type="checkbox"/> 4. Consultancy <input type="checkbox"/> 5. Corporate Finance <input type="checkbox"/> 6. Information Technology <input type="checkbox"/> 7. Insolvency <input type="checkbox"/> 8. Investment business <input type="checkbox"/> 9. Payroll preparation <input type="checkbox"/> 10. Taxation <input type="checkbox"/> 11. Pensions advice to individuals <input type="checkbox"/> 12. Advice to pension scheme trustees <input type="checkbox"/> 13. Technical advice to product providers <input type="checkbox"/> 14. Banking & Finance <input type="checkbox"/> 15. Competition <input type="checkbox"/> 16. Corporate/Commercial <input type="checkbox"/> 17. Crime <input type="checkbox"/> 	<ul style="list-style-type: none"> 18. Defamation <input type="checkbox"/> 19. Employment <input type="checkbox"/> 20. Human Rights <input type="checkbox"/> 21. Immigration <input type="checkbox"/> 22. Intellectual Property <input type="checkbox"/> 23. Landlord & Tenant <input type="checkbox"/> 24. Matrimonial/Family <input type="checkbox"/> 25. Personal Injury <input type="checkbox"/> 26. Planning <input type="checkbox"/> 27. Probate/Executory <input type="checkbox"/> 28. Professional Negligence <input type="checkbox"/> 29. Property/Conveyancing <input type="checkbox"/> 30. Road Traffic <input type="checkbox"/> 31. Trusts <input type="checkbox"/> 32. Other <input type="checkbox"/> <p>Specify: _____</p>
--	---

c Does the firm have any branches or other places of business?

YES NO

d Does the firm have any appointed representatives?

YES NO

If YES, how many?

(Give figure as at the date of this questionnaire)

--

I have supplied further information related to this page in Section 4 YES NO

	Latest period £000	Previous period £000
2.02 a What was the total income from the firm's regulated activities during the latest and previous periods? (Income excludes commission rebated to clients (as defined for PROF) or used to enhance policies)		

		Percentage	
b During the period, what proportion of this income was generated from the following regulated activities? (An estimate to the nearest 10% is sufficient)	i) Fund management		(see 3.09)
	ii) Corporate finance		(see 2.04)
	iii) Packaged products		
	iv) Other		
	TOTAL	100	

	£000
2.02 c How much income from regulated activities arose from retained commission received from third parties? (An estimate to the nearest 10% is sufficient.)	

d Did the firm during the period carry on any regulated activities in relation to			
(i) Trusts	YES <input type="checkbox"/>	NO <input type="checkbox"/>	
(ii) Powers of attorney	YES <input type="checkbox"/>	NO <input type="checkbox"/>	
(iii) Pension transfers/pension opt-outs	YES <input type="checkbox"/>	NO <input type="checkbox"/>	
(iv) FSAVCs	YES <input type="checkbox"/>	NO <input type="checkbox"/>	
(v) Endowments	YES <input type="checkbox"/>	NO <input type="checkbox"/>	
(vi) Handling client money (i.e. money held in the course of designated investment business)	YES <input type="checkbox"/>	NO <input type="checkbox"/>	
(vii) Handling custody assets (i.e. assets held in the course of designated investment business e.g. custodial investments)	YES <input type="checkbox"/>	NO <input type="checkbox"/>	

e Did the firm during the period introduce clients to other authorised persons?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
--	------------------------------	-----------------------------

2.03 How many transactions during the period in the course of regulated activities were execution-only transactions? PLEASE TICK APPROPRIATE BOX	None <input type="checkbox"/>
	1 –10 <input type="checkbox"/>
	> 10 <input type="checkbox"/>

I have supplied further information related to this page in Section 4 YES NO

2.04 Did the firm carry out any corporate finance business in the period?

YES NO

If YES

Describe the nature of services provided during the period (summarise if necessary), and indicate whether the firm or any individual, company or trust within or associated with the firm, has taken an equity share as a result of a deal or been remunerated on a contingency basis.

Nature of services provided

**Equity share taken or
contingency basis
for fee?**

YES NO

YES NO

YES NO

YES NO

YES NO

I have supplied further information
related to this page in Section 4

YES NO

2.05 Were any life policies, including pension policies arranged by the firm **surrendered** or **cancelled** in the period? YES NO

If YES

(i) How many?

(ii) Are any of them associated with a complaint against the firm about poor advice on investments? YES NO

If YES, how many?

2.06 Was the firm been asked to repay or did it repay **indemnity** commission during the period? YES NO

If YES

(i) On how many cases?

(ii) Do these requests for repayment represent more than 5 per cent of the firm's commission income received on indemnity terms during the period? YES NO

2.07 Since the accounting reference date, have there been, or will there be, changes in the way the firm carries on its regulated activities or other business, which may have a material effect on the type and volume of such work? YES NO

If YES, please explain the main changes and their expected effects.

(e.g. New branch or department dealing with regulated activities, new computer systems, employment of staff with relevant expertise, merger of businesses, hiving off of business area dealing with regulated activities)

2.08 a Has the firm maintained **accounting and other records** in accordance with the FSA's Handbook of rules and guidance? YES NO

If NO, please explain

b Has the firm maintained records to enable the FSA to verify the calculations prepared to support the financial declarations made in this questionnaire? YES NO

If NO, please explain

I have supplied further information related to this page in Section 4 YES NO

2.09 a Expiry date of the firm's current professional indemnity policy.

(For firms who are members of the Law Society of Scotland: please give details of the firm's professional indemnity insurance under the Law Society of Scotland's Master Policy.)

b Limit of indemnity

c Excess per claim

d Annual premium

I have supplied further information related to this page in Section 4 YES NO

3.01 a Was there any material change in the firm's income (from all activities) during the period as compared with the previous period?

YES NO

If YES, please give details
 For the purposes of this question "material" is regarded as 25% of total income at the end of the accounting period, but will depend also on the size and nature of the firm's business.
 Details should include the actual change in the figures to show the impact and the reasons for the change, which might include opening a new branch/office, gain/loss of sources of business, downsizing/merger.

b Has the firm made a profit after tax for the period?

YES NO

If NO, please explain how the loss has occurred.

3.02 a If the firm has produced accounts with a balance sheet as at the end of the period ending on the firm's latest accounting reference date, please state the firm's total:

Latest Accounting Reference Date

Previous Accounting Reference Date

(i) net assets, or

--	--

(ii) net liabilities

--	--

b If the firm has net liabilities, please explain how the firm has met its liabilities and will continue to meet them as they fall due in future

I have supplied further information related to this page in Section 4 YES NO

3.03 a Please state the firm's net bank position at the firm's latest accounting reference date

(i) net credit balance (£000), or

(ii) net overdrawn balance (£000)

b Overdraft facility (£000)

c Overdraft review date

d Details of security for the overdraft

3.04 Please state whether the firm has any other loans.

YES NO

If YES, please give details

3.05 If the above bank balance is overdrawn by more than the overdraft limit, please provide details of the current position and explain how the firm has met and will continue to meet its liabilities as they fall due.

3.06 **Contingent liabilities**

Are there outstanding any legal proceedings or County Court Judgements or Decrees (Scotland) against the firm or its principals or any other contingent liabilities that may affect the firm's ability to meet its liabilities as they fall due in the future?

YES NO

If YES, please give details

I have supplied further information related to this page in Section 4 YES NO

3.07 Solvency

Have the partners/directors of the firm carried out appropriate procedures to enable them to satisfy themselves that the firm is able to meet its liabilities as they fall due until the end of the current accounting period (or twelve months from the last accounting reference date, if later)?

(Supporting papers should be retained. The FSA may at any time require a firm to produce evidence to demonstrate that it can meet this requirement.)

YES NO

3.08 Pensions/FSAVCs

Has the firm had to review any pension transfer/pension opt out or FSAVC cases? (This information is additional to that information provided in the return to the Pensions Review Monitoring Department)

YES NO

If YES, please provide the following information in respect of the amounts that have been included in the firm's accounts to its latest accounting reference date, or would be included if the accounts had been prepared by the date of signature of this Questionnaire

	Accounting Reference Date	£000
a The provision in respect of redress		
b The provision for the cost of conducting the review to completion		
c Details and amounts of any contingent liabilities not recorded on the balance sheet in respect of pension transfers and pension opt outs or FSAVCs		

3.09 Fund management

Did the firm provide any investment management services during the period?

YES NO

If YES, please provide the following information

a If this includes **discretionary** management, what type of services has the firm provided during the period?
(e.g. Managing investments for private customers/intermediate customers/non-UK customers, trustee activities, ISA manager)

b Funds under **discretionary** management

	Date	£000
(i) At the start of the accounting period		
(ii) At the end of the accounting period		
(iii) At latest practicable date within 1 month of date of signature of the Declaration on page 12.		

I have supplied further information related to this page in Section 4 YES NO

3.09 c Funds under **non-discretionary** management

At latest practicable date within 1 month of date of signature of the Declaration on page 10.

Date	£000

d **Total funds** under management (exclude Custody only Funds)

At latest practicable date within 1 month of date of signature of the Declaration on page 12.

--	--

I have supplied further information related to this page in Section 4 YES NO

4.01 Please use this space to provide any additional information relating to the previous sections.

If there is insufficient space, please continue on a separate sheet of paper, and clearly identify the section and question to which the additional information relates. Please include the name of the firm and the FSA firm reference number.

Question	Information

4.02 How many additional sheets are being submitted?

Declaration

THIS DECLARATION MUST BE COMPLETED BY ALL FIRMS

I/ we confirm that the firm is, and continues to be, an 'authorised professional firm' as defined in the Financial Services Authority's Handbook of Rules and Guidance.

I/ we declare that the firm is able to meet its liabilities as they fall due until the end of the current accounting period (or twelve months from the last accounting reference date, if later).

Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief.

Name of firm

FSA firm reference number

Name of first signatory

Position of first signatory

Signature of first signatory

Date

Name of second signatory

Position of second signatory

Signature of second signatory

Date

The declaration must be signed as follows:

- (i) If the firm is a sole practitioner, by that person;
- (ii) If the firm is a partnership (or limited liability partnership), by two partners (or designated members);
- (iii) If the firm is a company, by two directors. If the company has only one director, by the director and the Company Secretary.

SUP 16 Ann 10R: Securities and futures firms' reporting forms and requirements applying to their completion

1. Standard reporting statement for securities and futures firms which are ISD firms
2. Consolidated reporting statement for securities and futures firms
3. Standard reporting statement for securities and futures firms which are not ISD firms
4. Large exposures monitoring (LEM 1) quarterly return
5. Large exposures monitoring (LEM 2) quarterly return
6. Securities and futures firms; Form and content of reports

**STANDARD REPORTING STATEMENT
FOR SECURITIES AND FUTURES FIRMS WHICH ARE
ISD FIRMS**

Standard Reporting Statement (Securities and futures firms which are ISD firms)

Firm Code	Statement Date	Currency	Date Submitted
<input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/>	<input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/>	<input type="text"/>	<input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/>
Final Version <input type="text"/>			
Modem Confirmation Number <input type="text"/>			

DECLARATION

- (a) This statement has been drawn up in accordance with the rules in IPRU(INV) 10 which are relevant to the firm in calculating the firm's financial resources. It has been prepared from, and is in agreement with, the books and records of the firm.
 - (b) The firm's accounting records, systems and controls are maintained in accordance with IPRU(INV) 10 and SYSC 3.2.20R.
 - (c) We are not aware of any matters which could have a material effect upon the financial position of the firm before the due date of the next statement, which are not declared herein, or have not been notified to, and acknowledged by, the FSA.
 - (d) Since the date of the last reporting statement, the firm has/has not* been in compliance with IPRU(INV) 10 except as already notified to the FSA. { * Delete as appropriate }
 - (e) Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.4R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. SUP 16.3.1IR requires an authorised person to submit reports containing all the information required. APER 4.4.6E provides that, where an approved person is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of Statement of Principle 4. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.
- We confirm that the information in this form is accurate and complete to the best of my knowledge and belief and that we have read the Guidance Notes to this form.

Signature _____ Position _____ Date _____

Signature _____ Position _____ Date _____

BALANCE SHEET

Fixed assets	Intangible 1	Land & buildings 8	Other tangible 15	Investments 16	17 1+8+15+16
Current assets Stock & investments	Non trading book 2	Trading book 9	Commodities 9A		18 2+9
Trading book debtors (subject to CRR)	Non affiliate due within 90 days 3	Non-affiliates due after-90 days 10	Affiliates due within 90 days 10A	Affiliates due after 90 days 10B	19 3+10
Non trading book debtors	4	11	11A	11B	20 4+11
Loans	5	12	12A	12B	21 5+12
Other assets	6	13	13A	13B	22 6+13
Prepayments					23
Cash at bank & in hand Segregated	Non-Affiliates 24A	Affiliates 24B			24 24A+24B
Non segregated	Qualifying 7	Non qualifying 14	Qualifying 14A	Non qualifying 14B	25 7+14
Total assets					26 sum(17-25)

Liabilities Bank loans and overdrafts Segregated	27			
Non segregated	Affiliates Due within 1 year	Non Affiliates Due within 1 year	Affiliates Due after 1 year	Non Affiliates Due after 1 year
	28	33	33A	33B
Trading book creditors				
	29	34	34A	34B
Non trading book creditors (including accruals, deferred income & provisions)				
	30	35	35A	35B
Subordinated loans	41 31+36			
Short term	Due within 1 year	Due after 1 year		
	31	36		
Long term	Fixed term	Non-fixed term		
	32	37		
Total liabilities	43 sum(38-42) + 27			
Net assets	44 26-43			

Capital		Fixed term		Non fixed term		65
		45		46		
Corporate	Ordinary shares					66 sum(45-48)
		47		48		
Non cumulative preference shares						67
Cumulative preference shares						68
Share premium account						69
Other Reserves						
Revaluation reserve						
Profit/(loss)						
Previous years		Externally audited	Unaudited trading book	Unaudited non trading book		70 sum(49-56)
Current year		49	51	52		
		53	55	56		
Partnership/Sole trader						71
Capital account						
Current account						72 sum(57-64)
Previous years		Externally audited	Unaudited trading book	Unaudited non trading book		
Current year		57	59	60		
		61	63	64		
Total capital						73 sum(65-72)

PROFIT & LOSS

Revenue	Note 1	74
Dealing profit/(loss)		75
Gross commission and brokerage		76
Investment management fees		76A
Corporate Finance		77
Interest and dividends receivable		78
Other revenue		78
Total revenue for the period		79 <small>sum(74, 78)</small>
Items not in relevant annual expenditure		
Commission and brokerage	80	85
Establishment costs		86
Staff costs	81	87
Bad and doubtful debts		88
Intercompany charges		89
Interest payable	82	90
Foreign exchange losses	83	91
Exceptional and other expenses	84	92
Items in relevant annual expenditure		

Profit/(loss) before tax	93	79- sum(80.97)
Tax reclaimed/(provided)	94	
Add/(less) reserves	95	
less Dividend payable	96	
Retained profit/(loss) for the period	97	sum(93.95)-96

Note 1: Box 74 will drill down to 6 boxes for member firms to input their 5 main income centres

FINANCIAL RESOURCES

Initial capital	SUM(65+45+46+67+68+57+61+49+53+71)	98
Investments in own shares		99
Intangible assets	1	100
Material unaudited losses IF $-(59+60+63+64 > 10\% * 98)$ THEN $(59+60+63+64)$ OTHERWISE NIL +51+52+55+56		101
Original own funds	(98 - 99 - 100 - 101)	102
Non-fixed term cumulative preference shares		103
Fixed term cumulative preference shares		105
Non-fixed term long term subordinated loan		106
Fixed term long term subordinated loan		104
Revaluation reserve		107
Liquidity adjustment on illiquid assets		108
Liquidity adjustment on other non trading book assets		109
Charged assets		110
Contingent liabilities		111
Deficiencies in subsidiaries		112
Short term subordinated loans		113
Net interim trading book profit/(loss) $(51+52+55+56) - 101$		114
Net interim trading book partners' current account $(59+60+63+64) - 101$		115
	Group	Non group
Material holdings in credit institutions and investment firms	116A	116
Financial resources	sum(102.107) - sum(108.112) + 113+114+115-116-116A	117

POSITION RISK REQUIREMENT

Positions treated under the equity method		Valuation of Longs	Valuation of Shorts	PRR
Positions				
in method 1	301	305	309	
in method 2	302	306	310	
in method 3	303	307	311	
in method 4	303A	307A	311A	
additional requirements			312	
Totals	304 sum301.303	308 sum305.307	313 sum309.312	
Details of positions treated in the equity method				
equity	314	323	332	
preference securities	315	324	333	
convertibles	316	325	334	
company issued warrants	317	326	335	
equity options	318	327	336	
index futures	319	328	337	
index options	320	329	338	
others	321	330	339	
Positions netted under IPRU(INV) 10-83R	322	331	339A	
			Net valuation of instrument	

Equity derivatives treated outside the equity method

	Aggregate MTM value of underlying	Net valuation of derivatives	PRR
Hedging method	340	341	346
Margin requirement method		342	347
Basic method			
purchased options and warrants		343	348
written options and warrants		343A	349
Total		344 sum 341...343	350 sum 346,349
MTM of cash positions included in hedging method		345A	
		345 344 + 345A	

Equity and equity derivative positions treated under approved risk assessment models not included above

Net valuation of options	351		
Net valuation of futures	352		
Net valuation of cash instruments	353		
Total PRR			354

Positions treated under the interest rate method		Valuation of Longs	Valuation of Shorts	General Market Risk
Positions in Maturity Based approach	Method 1	360	364	368
	Method 2	361	365	369
Positions in Duration based approach		362	366	370
Interest rate risk on equity derivatives				371
Additional requirements				372
Totals		363 sum 360..362	367 sum 364..366	374 sum 368..372
Specific risk	0.125%	375	377	Total
	0.25%			380 sum 375..379
	1.00%			
	1.60%	378	379	381 374 + 380
Total PRR			8.00%	

Details of positions included in interest rate method		Net valuation of instrument	
debt securities	400	411	422
non-convertible preference securities	401	412	423
convertibles	402	413	424
options on debt securities	403	414	425
options on interest rates	404	415	426
futures on interest rates	405	416	427
forwards and futures on debt securities	406	417	428
interest rate and currency swaps	407	418	429
options on swaps	408	419	430
others	409	420	431
Positions netted under IPRU(INV) 10-102R	410	421	431A

Interest rate derivatives treated outside the interest rate method		Aggregate MTM value of underlying	Net valuation of derivatives	PRR
Hedging method		432	433	439
Margin requirement method			434	440
Basic method	purchased options and warrants		435	441
	written options and warrants		436	442
Total			437 sum 433,437	443 sum 439,442
MTM of cash positions included in hedging method			438	
Total valuation			439 437+438	
Interest rate and interest rate derivatives positions treated under risk assessment models not included above				
Net valuation of options			450	
Net valuation of swaps			451	
Net valuation of futures			452	
Net valuation of cash instruments			453	
Total PRR				462

	Net valuation	PRR
Issuing market method	455	459
Commodities	456	460
Other positions not included in above methods	457	461
Total sum (332.339) +345 + sum(351.353) + 439 + sum (422.431) + sum(450.457)	458	463
		313 + 350 + 354 + 381 + 443 + sum(459.462)

FOREIGN EXCHANGE RISK REQUIREMENT

Note 2

242 501+502

COUNTERPARTY RISK REQUIREMENT

Cash against documents

Free deliveries

Repurchase, reverse repurchase, securities borrowing and lending and sale and buy back agreements

Derivatives Transactions - exchange listed

- OTC

Deposits and other amounts due arising from trading book activities

Total balance sheet debtors and creditors and CRR

	Assets	Liabilities	CRR
Cash against documents	243	249	254
Free deliveries	244		255
Repurchase, reverse repurchase, securities borrowing and lending and sale and buy back agreements	245	250	256
Derivatives Transactions - exchange listed	246	251	257
- OTC	246A	251A	257A
Deposits and other amounts due arising from trading book activities	247	252	258
Total balance sheet debtors and creditors and CRR	248 sum(243, 247)	253 sum(249, 252)	259 sum(254, 258)

Note 2: Box 242 will drill down in to a screen detailing foreign exchange exposures and FER (see next page)

FOREIGN EXCHANGE RISK REQUIREMENT

FER Method 1 Currency Code	Balance Sheet Debits/Credits	Forward Contracts	Futures Contracts	Options Contracts	Other	Net for Currency
<input type="text"/> Long	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/> Less: short	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/> Long	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/> Less: short	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/> Long	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/> Less: short	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/> Long	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/> Less: short	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/> Long	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/> Less: short	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/> Long	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/> Less: short	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Total net long positions						<input type="text"/>
Less: Total net short positions						<input type="text"/>
8% of total long positions = Requirement						<input type="text"/>
FER Method 2						<input type="text"/>
Total long positions						<input type="text"/>
Total short positions						<input type="text"/>
Requirement						<input type="text"/>

CREDIT EXPOSURE

**Intra Group Exposures
10 largest intra group exposures**

Name of Company	Gross Exposure	Net Exposure (if netting agreement in place)
200A	200B	200C
201A	201B	201C
202A	202B	202C
203A	203B	203C
204A	204B	204C
205A	205B	205C
206A	206B	206C
207A	207B	207C
208A	208B	208C
209A	209B	209C

**Non group Exposures
10 largest gross exposures**

Net Exposure
(if netting agreement
in place)

Gross Exposure

Name of Company

210A		210B	210C
211A		211B	211C
212A		212B	212C
213A		213B	213C
214A		214B	214C
215A		215B	215C
216A		216B	216C
217A		217B	217C
218A		218B	218C
219A		219B	219C

10 largest net exposures (only where there is a netting agreement in place) if not included above

Name of Company	Net Exposure
220A	220B
221A	221B
222A	222B
223A	223B
224A	224B
225A	225B
226A	226B
227A	227B
228A	228B
229A	229B

LARGE EXPOSURES REQUIREMENT

Name of counterparty	Trading book exposure	Non-trading book exposure	LER
270 A Narrative	270	282	294
	260	272	284
	261	273	285
	262	274	286
	263	275	287
	264	276	288
	265	277	289
	266	278	290
	267	279	291
	268	280	292
Others	269	281	293
Total	271 sum(260,270)	283 sum(272,282)	295 sum(284,294)

Base requirement		296
Primary requirement	higher of initial capital requirement and (242 + 259 + 295 + 296 + 463)	297
Secondary requirement		301
FINANCIAL RESOURCES REQUIREMENT		302 297 + 301

Reconciliations	Date of last reconciliation					
Crest	<table border="1"> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td> </td> </tr> </table>					
LCH	<table border="1"> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td> </td> </tr> </table>					
Euroclear	<table border="1"> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td> </td> </tr> </table>					
Cedel	<table border="1"> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td> </td> </tr> </table>					
Safe custody nominees	<table border="1"> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td> </td> </tr> </table>					
Other depots	<table border="1"> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td> </td> </tr> </table>					
Intermediate brokers - UK	<table border="1"> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td> </td> </tr> </table>					
Intermediate brokers - Overseas	<table border="1"> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td> </td> </tr> </table>					
Clients' money bank accounts - UK	<table border="1"> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td> </td> </tr> </table>					
Clients' money bank accounts - Overseas	<table border="1"> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td> </td> </tr> </table>					
Collateral	<table border="1"> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td> </td> </tr> </table>					

Part 30 report

This schedule applies only to a firm subject to CFTC part 30 exemption order in respect of open positions for LME transactions of US customers.

Client Money And Other Assets (COB 9.3.141 – COB 9.3.144)

Omnibus letter of credit	Number	Value	
(a) Balance per previous reporting date	<input type="text"/>	<input type="text" value="664"/>	
(b) Addition	<input type="text"/>	<input type="text" value="665"/>	
(c) Termination/cancellation	<input type="text"/>	<input type="text" value="666"/>	<input type="text" value="667"/> <input type="text" value="664+665-666"/> a + b - c
Secured amount			
(a) Deficit open trade equity on LME		<input type="text" value="668"/>	
(b) House losses at LCH		<input type="text" value="669"/>	
(c) Deficit open trade equity of non LME customers at LCH		<input type="text" value="670"/>	
(d) LME forward profit		<input type="text" value="671"/>	<input type="text" value="672"/> Lower of d or Total (a to c)
Excess/(deficiency)			<input type="text" value="673"/> <input type="text" value="667-672"/>

Number of occasions when the omnibus letter of credit was deficient					<input type="text"/>
Total excess/(deficiency) for individual letter of credit					
(a)	secured amount	value of letter of credit	excess/(deficiency)	date rectified	
(b)					
(c)					
(d)					
(e)					
			679	SUM(674..678)	
Number of occasions when any one individual letter of credit was deficient					
					<input type="text"/>

“FLOATING WINDOW”

Financial Resources	415	117
Base requirement	416	296
Position Risk Requirement	417	463
Foreign Exchange Risk Requirement	418	242
Counterparty Risk Requirement	419	259
Large Exposures Requirement	419A	295
Secondary Requirement	420	301
Excess (Deficit) 415-302	421	
Percentage 415/302	422	

SUP 16 Ann 10R section 2

**CONSOLIDATED REPORTING STATEMENT
FOR SECURITIES AND FUTURES FIRMS**

Consolidated Reporting Statement for securities and futures firms

Firm Code	Statement Date	Currency	Date Submitted												
<table border="1"> <tr> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> </tr> </table>					<div style="border: 1px solid black; width: 100%; height: 100%;"></div>	<table border="1"> <tr> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> </tr> </table>					<table border="1"> <tr> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> </tr> </table>				
Final Version	<div style="border: 1px solid black; width: 100%; height: 100%;"></div>														
Modem Confirmation Number		<div style="border: 1px solid black; width: 100%; height: 100%;"></div>													

DECLARATION

- (a) This statement has been drawn up in accordance with the rules in IPRU(INV) 10 which are relevant to the firm in calculating the firm's financial resources. It has been prepared from, and is in agreement with, the books and records of the firm.
- (b) The firm's accounting records, systems and controls are maintained in accordance with IPRU(INV) 10 and SYSC 3.2.20R.
- (c) We are not aware of any matters which could have a material effect upon the financial position of the firm before the due date of the next statement, which are not declared herein, or have not been notified to, and acknowledged by, the FSA.
- (d) Since the date of the last reporting statement, the firm has/has not* been in compliance with IPRU(INV) 10 except as already notified to the FSA.
{* Delete as appropriate}
- (e) Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.4R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. SUP 16.3.1R requires an authorised person to submit reports containing all the information required. APER 4.4.6E provides that, where an approved person is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of Statement of Principle 4. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

We confirm that the information in this form is accurate and complete to the best of my knowledge and belief and that we have read the Guidance Notes to this form.

Signature _____ Position _____ Date _____

Signature _____ Position _____ Date _____

CONSOLIDATED FINANCIAL RESOURCES TEST

A	B	C	D	E	F	G	H
Subsidiary (name)	Local Regulator [or state if unregulated]	Parent's Investment in Subsidiary / Participation	Subsidiary's / Participation's Local Financial Resources [where different from C]	Subsidiary's / Participation's Local Financial Resources Requirement [or 'notional requirement' if unregulated]	Surplus/(Deficit) in Subsidiary at Local Level [D-E]	Subsidiary's "Externally Generated" etc. Financial Resources [usually D-C]	Financial Resource Requirement for Consolidated Capital Test [> C or E]
		(£000s)	(£000s)	(£000s)	(£000s)	(£000s)	(£000s)
		Total Financial Resource Requirements of Subsidiaries etc.				[I = Sum H]	
		Parent/Holding Company's Financial Resource Requirement				[J]	
		Total Consolidated Financial Resource Requirement				[K = I + J]	
		Total Subsidiary Externally Generated Financial Resources				[L = Sum G]	
		Parent/Holding Company's Financial Resources				[M]	
		Total Consolidated Financial Resources				[N = L + M]	

Total Consolidated Excess/Deficiency	[O = N - K]
--------------------------------------	-------------

SUP 16 Ann 10R section 3

**STANDARD REPORTING STATEMENT
FOR SECURITIES AND FUTURES FIRMS WHICH
ARE NOT ISD FIRMS**

Standard Reporting Statement

(Securities and futures firms which are not ISD firms)

Firm Code	Statement Date	Currency	Date Submitted												
<table border="1"> <tr> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> </tr> </table>					<div style="border: 1px solid black; width: 100%; height: 100%;"></div>	<table border="1"> <tr> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> </tr> </table>					<table border="1"> <tr> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> </tr> </table>				
Final Version	Modem Confirmation Number														
<div style="border: 1px solid black; width: 100%; height: 100%;"></div>															

DECLARATION

- (a) This statement has been drawn up in accordance with the rules in IPRU(INV) 3 which are relevant to the firm in calculating the firm's financial resources. It has been prepared from, and is in agreement with, the books and records of the firm.
- (b) The firm's accounting records, systems and controls are maintained in accordance with IPRU(INV) 3 and SYSC 3.2.20R.
- (c) We are not aware of any matters which could have a material effect upon the financial position of the firm before the due date of the next statement, which are not declared herein, or have not been notified to, and acknowledged by, the FSA.
- (d) Since the date of the last reporting statement, the firm has/has not* been in compliance with IPRU(INV) 3 except as already notified to the FSA. { * Delete as appropriate }
- (e) Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.4R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. SUP 16.3.11R requires an authorised person to submit reports containing all the information required. APER 4.4.6E provides that, where an approved person is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of Statement of Principle 4. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.

We confirm that the information in this form is accurate and complete to the best of my knowledge and belief and that we have read the Guidance Notes to this form.

Signature _____

Position _____

Date _____

Signature _____

Position _____

Date _____

BALANCE SHEET

Fixed assets	Intangible 1	Land & buildings 8	Other tangible 15	Investments 16	17	1+8+15+16	
Current assets Stock & investments						18	2+9
Trade debtors (subject to CRR)	Non affiliates due within 90 days 3	Non-affiliates due after 90 days 10	Affiliates due within 90 days 10A	Affiliates due after 90 days 10B			
Non trade debtors	4	11	11A	11B			
Loans	5	12	12A	12B			
Other assets	6	13	13A	13B			
Prepayments						23	
Cash at bank & in hand Segregated	Non-Affiliates 24A	Affiliates 24B					
Non segregated	Qualifying 7	Non qualifying 14	Qualifying 14A	Non-qualifying 14B			
Total assets						26	sum(17- 25)

Liabilities Bank loans and overdrafts Segregated	<div style="display: flex; justify-content: space-around;"> <div style="text-align: center;"> Affiliates Due within 1 year 28 <input type="text"/> 29 <input type="text"/> 30 <input type="text"/> </div> <div style="text-align: center;"> Non Affiliates Due within 1 year 33 <input type="text"/> 34 <input type="text"/> 35 <input type="text"/> </div> <div style="text-align: center;"> Affiliates Due after 1 year 33A <input type="text"/> 34A <input type="text"/> 35A <input type="text"/> </div> <div style="text-align: center;"> Non Affiliates Due after 1 year 33B <input type="text"/> 34B <input type="text"/> 35B <input type="text"/> </div> </div>	<div style="display: flex; justify-content: space-around;"> <div style="text-align: center;">27 <input type="text"/></div> <div style="text-align: center;">38 <input type="text"/> 28+33 <input type="text"/></div> <div style="text-align: center;">39 <input type="text"/> 29+34 <input type="text"/></div> <div style="text-align: center;">40 <input type="text"/> 30+35 <input type="text"/></div> <div style="text-align: center;">41 <input type="text"/></div> </div>
Total liabilities		<div style="display: flex; justify-content: space-around;"> <div style="text-align: center;">42 <input type="text"/> sum(38,41) + 27 <input type="text"/></div> </div>
Net assets		<div style="display: flex; justify-content: space-around;"> <div style="text-align: center;">43 <input type="text"/> 26-42 <input type="text"/></div> </div>

Capital Corporate						65
Approved share capital						66
Non-approved share capital						67
Share premium account						68
Approved reserves						69
Non-approved reserves						70
Profit/(loss)						(40+60+53+54)
Previous years						
Current year	Audited		Unaudited			
	49		50			
	53		54			
Partnership/Sole trader						71
Capital account						
Current account						
Previous years	Audited		Unaudited			
Current year	57		58			
	61		62			
Total capital						72
						(57+68+61+62)
						73
						sum(65-
						72)

PROFIT & LOSS

Revenue					
Dealing profit/(loss)					74
Gross commission and brokerage					75
Investment management fees					76A
Corporate Finance					76B
Interest and dividends receivable					77
Other revenue					78
Total revenue for the period					79 sum(74.78)
	Items not in relevant annual expenditure	Items in relevant annual expenditure			
Commission and brokerage	80	85			
Establishment costs		86			
Staff costs	81	87			
Bad and doubtful debts		88			
Intercompany charges		89			
Interest payable	82	90			
Foreign exchange losses		91			
Exceptional and other expenses	84	92			
Profit/(loss) before tax					93 79- sum(80.92)

Tax reclaimed/(provided)	94	
Add/(less) reserves	95	
less Dividend payable	96	
Retained profit/(loss) for the period	97	sum(93.95)-96

TANGIBLE NET WORTH		
Capital	101	73-66-69
Less: intangible assets	102	
State percentatge if tangible net worth falls by > 10% since the last reporting date (IPRU(INV) 3-32R(2))	103	
ELIGLIBLE CAPITAL SUBSTITUTES		
Approved subordinated loans	104	Allowable
Approved bank bonds	105	
Approved undertakings	106	
FINANCIAL RESOURCES		
PRIMARY REQUIREMENT		
Base requirement	109	
Liquidity adjustment	110	Balance sheet value
Charged assets	111	Non-trade debtors
Contingent liabilities	112	Prepayment
Deficiencies in subsidiaries	113	
	116	sum(104.106)
	117	115+116
	115	101-102
	118	sum(109.113)

POSITION RISK REQUIREMENT		Long	Short	Requirement
Foreign currency				149 501
Physical commodities		128	138	151
Other		128A	138A	151A
				152 149 + 151 + 128C
COUNTERPARTY RISK REQUIREMENT				
Securities and physical	Assets	Liabilities		Requirement
Balance sheet	160	164		
Off balance sheet	170	174	Cash against documents and free deliveries	186
Margined transactions and options				
Balance sheet	161	165	Exchange traded margined transactions	187
Off balance sheet	171	175	Concentrated risk	188
OTC				
Balance sheet	162	166	Options purchased	189
Off balance sheet	172	176	Swaps, forward contracts and OTC derivatives	190
Other				
Balance sheet	163	167	Qualifying and other deposits	191
Off balance sheet	173	177	Other receivables	192
Sub-totals				
Balance sheet	180 sum(160,163)	182 sum(164,167)		
Off balance sheet	181 sum(170,173)	183 sum(174,177)		
FINANCIAL RESOURCES REQUIREMENT				
EXCESS/DEFICIENCY IN FINANCIAL RESOURCES				196 118+152+195
				197 117/196%
				%

Currency Code	Balance Sheet Debits/Credits	Forward Contracts	Futures Contracts	Options Contracts	Other	Net for Currency
<input type="text"/> Long	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Less: short	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/> Long	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Less: short	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/> Long	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Less: short	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/> Long	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Less: short	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/> Long	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Less: short	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/> Long	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Less: short	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Total net long positions						
Less: Total net short positions						
8% of total long positions = Requirement						<input type="text"/>
						<input type="text"/>

CREDIT EXPOSURE

**Intra Group Exposures
10 largest intra group exposures**

Net Exposure
(if netting
agreement in place)

Gross Exposure

Name of Company			
200A		200B	200C
201A		201B	201C
202A		202B	202C
203A		203B	203C
204A		204B	204C
205A		205B	205C
206A		206B	206C
207A		207B	207C
208A		208B	208C
209A		209B	209C

**Non group Exposures
10 largest gross exposures**

Name of Company	Gross Exposure	Net Exposure (if netting agreement in place)
210A	210B	210C
211A	211B	211C
212A	212B	212C
213A	213B	213C
214A	214B	214C
215A	215B	215C
216A	216B	216C
217A	217B	217C
218A	218B	218C
219A	219B	219C

10 largest net exposures (only where there is a netting agreement in place) if not included above

Name of Company	Net Exposure
220A	220B
221A	221B
222A	222B
223A	223B
224A	224B
225A	225B
226A	226B
227A	227B
228A	228B
229A	229B

Reconciliations	Date of last reconciliation		
Crest	|	|	|
LCH	|	|	|
Euroclear	|	|	|
Cedel	|	|	|
Safe custody nominees	|	|	|
Other depots	|	|	|
Intermediate brokers - UK	|	|	|
Intermediate brokers - Overseas	|	|	|
Clients' money bank accounts - UK	|	|	|
Clients' money bank accounts - Overseas	|	|	|
Collateral	|	|	|

Part 30 report

This schedule applies only to a firm subject to CFTC part 30 exemption order in respect of open positions for LME transactions of US customers.

Client Money And Other Assets (COB 9.3.141 – COB 9.3.144)

Omnibus letter of credit	Number	Value					
(a) Balance per previous reporting date	<input type="text"/>	<input type="text" value="664"/>	<table border="1" style="margin-left: auto; margin-right: auto;"> <tr> <td style="padding: 2px;">667</td> <td style="padding: 2px;">664+665- 666</td> </tr> <tr> <td colspan="2" style="text-align: center; padding: 2px;">a + b - c</td> </tr> </table>	667	664+665- 666	a + b - c	
667	664+665- 666						
a + b - c							
(b) Addition	<input type="text"/>	<input type="text" value="665"/>					
(c) Termination/cancellation	<input type="text"/>	<input type="text" value="666"/>					
Secured amount							
(a) Deficit open trade equity on LME		<input type="text" value="668"/>	<table border="1" style="margin-left: auto; margin-right: auto;"> <tr> <td style="padding: 2px;">672</td> <td style="padding: 2px;">Lower of d or Total (a to c)</td> </tr> </table>	672	Lower of d or Total (a to c)		
672	Lower of d or Total (a to c)						
(b) House losses at LCH		<input type="text" value="669"/>					
(c) Deficit open trade equity of non LME customers at LCH		<input type="text" value="670"/>					
(d) LME forward profit		<input type="text" value="671"/>					
Excess/(deficiency)			<table border="1" style="margin-left: auto; margin-right: auto;"> <tr> <td style="padding: 2px;">673</td> <td style="padding: 2px;">667-672</td> </tr> </table>	673	667-672		
673	667-672						

Number of occasions when the omnibus letter of credit was deficient					<input type="text"/>
Total excess/(deficiency) for individual letter of credit					
(a)	secured amount	value of letter of credit	excess/(deficiency)	date rectified	
(b)					
(c)					
(d)					
(e)					
					679
					SUM(674..678)
Number of occasions when any one individual letter of credit was deficient					
					<input type="text"/>

“FLOATING WINDOW”

Financial Resources	415	
	117	
Primary Requirement	416	
	118	
Position Risk Requirement	417	
	152	
Counterparty Risk Requirement	418	195
Excess (Deficit)	419	
Percentage	420	

LARGE EXPOSURES MONITORING (LEM 1) QUARTERLY RETURN Standard Reporting Statement for securities and futures firms (ISD firms)

Firm Code	Statement Date	Solo or Consolidated	Date Submitted
Legal Entity 	Own Funds @ the Reporting Date 	Reporting Currency 	
Date ACMP Granted (if applicable) 	Financial Resources @ the Reporting Date 		

DECLARATION

- (a) This return has been drawn up in accordance with the rules in IPRU(INV) 10 and guidance in SUP 16 Ann 11G relating to Large Exposures Monitoring.
- (b) The firm's accounting records systems and controls are maintained in accordance with IPRU(INV) 10 and SYSC 3.2.20R.
- (c) We are not aware of any matters which could have a material effect upon the financial position of the firm before the due date of the next statement, which are not declared herein, or have not been notified to, and acknowledged by, the FSA.
- (d) Since the date of the last reporting statement, the firm has been in compliance with IPRU(INV) 10 except as already notified to the FSA.
- (e) Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.4R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. SUP 16.3.11R requires an authorised person to submit reports containing all the information required. APER 4.4.6E provides that, where an approved person is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of Statement of Principle 4. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included.
We confirm that the information in this form is accurate and complete to the best of my knowledge and belief and that we have read the Guidance Notes to this form.

All figures should be in £000, unless the firm prepares its UK statutory accounts in another currency(see SUP 16 Ann 10R). All conversions of foreign currency should be at the mid market rate, or the bid/offer spread for exposure included in trading book.

nature _____ Print Name _____ Position _____ Date _____

nature _____ Print Name _____ Position _____ Date _____

Form LEM 1

Largest Exposures to all Counterparties

Counterparty/ Group	Netting of Exposure	Specific Bad Debt Provision	Acceptable/ Adequate Collateral Against Actual Exposure	Actual Exposure at the Reporting Date			Highest Exposure During the Reporting Period	% of Financial Resources	Amount of Exposure Guaranteed by Parent/Third Party
				R	S	T			
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	

LARGE EXPOSURES MONITORING (LEM 2) QUARTERLY RETURN Standard Reporting Statement for securities and futures firms (ISD firms)

Firm Code			Statement Date			Solo or Consolidated			Date Submitted		
Legal Entity			Own Funds @ the Reporting Date			Reporting Currency					
Date ACMP Granted (if applicable)			Financial Resources @ the Reporting Date								

DECLARATION

- (a) This return has been drawn up in accordance with the rules in IPRU(INV) 10 and guidance in SUP 16 Ann 11G relating to Large Exposures Monitoring.
- (b) The firm's accounting records, systems and controls are maintained in accordance with IPRU(INV) 10 and SYSC 3.2.20R.
- (c) We are not aware of any matters which could have a material effect upon the financial position of the firm before the due date of the next statement, which are not declared herein, or have not been notified to, and acknowledged by, the FSA.
- (d) Since the date of the last reporting statement, the firm has been in compliance with IPRU(INV) 10 except as already notified to the FSA.
- (e) Knowingly or recklessly giving the FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). SUP 15.6.1R and SUP 15.6.4R require an authorised person to take reasonable steps to ensure the accuracy and completeness of information given to the FSA and to notify the FSA immediately if materially inaccurate information has been provided. SUP 16.3.11R requires an authorised person to submit reports containing all the information required. APER 4.4.6E provides that, where an approved person is responsible for reporting matters to the FSA, failure to inform the FSA of materially significant information of which he is aware is a breach of Statement of Principle 4. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the FSA. It should not be assumed that information is known to the FSA merely because it is in the public domain or has previously been disclosed to the FSA or another regulatory body. If there is any doubt about the relevance of information, it should be included. We confirm that the information in this form is accurate and complete to the best of my knowledge and belief and that we have read the Guidance Notes to this form.

(f) All figures should be in £000, unless the firm prepares its UK statutory accounts in another currency (see SUP 16 Ann 10R). All conversions of foreign currency should be at the mid market rate, or the bid/offer spread for exposure included in trading book.

Signature _____ Print Name _____ Position _____ Date _____

Signature _____ Print Name _____ Position _____ Date _____

Please list all material holdings in Credit and Financial Institutions, per IPRU(INV) 10-61R(7) on the form provided.

Name of Counterparty	Exposure																				
	<table border="1"> <tr> <td></td> <td></td> </tr> <tr> <td></td> <td></td> </tr> <tr> <td></td> <td></td> </tr> <tr> <td></td> <td></td> </tr> <tr> <td></td> <td></td> </tr> <tr> <td></td> <td></td> </tr> <tr> <td></td> <td></td> </tr> <tr> <td></td> <td></td> </tr> <tr> <td></td> <td></td> </tr> <tr> <td></td> <td></td> </tr> </table>																				

These exposures listed above should not be included within Parts 3(i) and 3(ii) of Form LEM 2, having been fully deducted from capital when calculating own funds.

Form LEM 2, Part 1

Largest Exposures to Individual Corporates and Corporate Groups

Counterparty/ Group	Netting of Exposure	Specific Bad Debt Provision	Acceptable/ Adequate Collateral Against Actual Exposure	Actual Exposure at the Reporting Date			Highest Exposure During the Reporting Period	% of Financial Resources	Amount of Exposure Guaranteed by Parent/Third Party
				R	S	T			
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	

Form LEM 2, Part 2

Largest Exposures to Individual Group Members of Counterparties Connected to the Firm

Counterparty/ Group	Netting of Exposure	Specific Bad Debt Provision	Acceptable/ Adequate Collateral Against Actual Exposure	Actual Exposure at the Reporting Date			Highest Exposure During the Reporting Period	% of Financial Resources	Amount of Exposure Guaranteed by Parent/Third Party
				R	S	T			
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	

Form LEM 2, Part 3 (i)

Largest Exposures to Unconnected Credit Institutions/Investment Firm/Third Country Investment Firms/Recognised Clearing Houses and Recognised Exchanges

Counterparty/ Group	Netting of Exposure	Specific Bad Debt Provision	Acceptable/ Adequate Collateral Against Actual Exposure	Actual Exposure at the Reporting Date			Highest Exposure During the Reporting Period	% of Financial Resources	Amount of Exposure Guaranteed by Parent/Third Party
				R	S	T			
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

Form LEM 2, Part 3 (ii)

Largest Exposures to Unconnected Credit Institutions/Investment Firm/Third Country Investment Firms/ Clearing Houses and Exchanges with a remaining maturity of over 1 year – derivatives exposure to be inserted as a memorandum below the large exposures

Counterparty/ Group	Netting of Exposure	Specific Bad Debt Provision	Acceptable/ Adequate Collateral Against Actual Exposure	Actual Exposure at the Reporting Date			Highest Exposure During the Reporting Period	% of Financial Resources	Amount of Exposure Guaranteed by Parent/Third Party
				R	S	T			
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

Form LEM 2, Part 4

Largest Exposures to Zone B governments

Counterparty/ Group	Netting of Exposure	Specific Bad Debt Provision	Acceptable/ Adequate Collateral Against Actual Exposure	Actual Exposure at the Reporting Date			Highest Exposure During the Reporting Period	% of Financial Resources	Amount of Exposure Guaranteed by Parent/Third Party
				R	S	T			
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	

Section 6: Securities and futures firms: Form and content of reports

1 Table Financial reporting statements (see Table 1 for list of reports defined as such)

		(See SUP 16.7.31R)
1.1.1	(1)	A <i>firm</i> must prepare the financial reporting statements from, and ensure that they are in agreement with, the books and records of the <i>firm</i> .
	(2)	A <i>firm</i> must prepare the financial reporting statements so as to give a true and fair view in accordance with UK Companies Acts of the results for the period, the financial position and state of affairs of the <i>firm</i> .
	(3)	A <i>firm</i> may not offset amounts on the balance sheet and profit and loss account in its financial reporting statements in respect of items representing assets or income against amounts in respect of items representing liabilities or expenditure except in the case of balances with <i>counterparties</i> where the parties to the transaction have expressly agreed that they shall be settled on a net basis for the same value date.
	(4)	A <i>firm</i> must not consolidate the accounts of a separately incorporated <i>body corporate</i> within the <i>group</i> into figures of a <i>firm's</i> financial reporting statements other than for the purposes of completing the consolidated reporting statement, but must include the assets, liabilities, income and expenditure of all <i>branches</i> of the <i>firm</i> .
	(5)	A <i>firm</i> must show as a separately identified item appended to a financial reporting statement any item representing or covering the amount of any asset or liability, income or expenditure not otherwise covered by any of the items on the required format of the statement.
	(6)	A <i>firm</i> : <ol style="list-style-type: none"> (a) must use either sterling or the currency used for its UK statutory accounts as its reporting currency in its financial reporting statements; (b) may not change its reporting currency more than once in any 12 month period; and (c) must notify the FSA immediately of any change to its reporting currency.
	(7)	A <i>firm</i> which is a <i>sole trader</i> must include in any financial reporting statement only those items which arise in the course of the business of the <i>firm</i> as such.

2 Table

Table 1

Reports defined as financial reporting statements for the purposes of this Annex

Annual reporting statement

Quarterly reporting statement

Monthly reporting statement

Consolidated reporting statement

Large exposures quarterly reporting statement – solo

Large exposures quarterly reporting – consolidated

3 Table Audited Annual Financial Statements

1.1.2	A <i>firm's</i> audited annual financial statements must be drawn up in accordance with Schedule 4 of the Companies Act 1985 as at the <i>firm's accounting reference date</i> .
-------	--

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

1. Standard reporting statement for securities and futures firms which are ISD firms
2. Consolidated reporting statement for securities and futures firms
3. Standard reporting statement for securities and futures firms which are not ISD firms
4. Large exposures monitoring quarterly returns

SUP 16 Ann 11G section 1

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

INTRODUCTION

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

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

Self-generated computer statement

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

Declaration

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

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

Categories of firms

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

Some pertinent rules and guidance

IPRU(INV) 10-10R Keeping of records

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

IPRU(INV) 10-11R Reconciliation of balances

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

Notification

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

SUP 15.6.4R Misleading information supplied to the FSA.

SUP 16.3.17R Changes in reporting dates.

SUP 3.7.2G Qualification of an audit report.

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

SUP 16 Ann 10R Agreement with records

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

SUP 16 Ann 10R Offsetting and netting

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

SUP 16 Ann 10R Consolidation

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

SUP 16 Ann 10R Greater detail

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

SUP 16 Ann 10R Reporting currency

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

SUP 16 Ann10R Accounting policies

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

Reporting unit

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

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

Sign convention and totals

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

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

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

Segregation

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

BALANCE SHEET

A. FIXED ASSETS

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

2. Intangible Assets

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

B. CURRENT ASSETS

3. Stock and Investments

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

4. Trading Book Debtors

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

5. Non Trading Book Debtors

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

6. Loans and other assets

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

7. Cash at Bank and in Hand

Segregated client moneys on the balance sheet must be disclosed separately from other non segregated funds. Non segregated funds must be divided into qualifying and non qualifying deposits in accordance with the definition in IPRU(INV)_10 App 1.

C. CURRENT LIABILITIES

8. Bank Loans and Overdrafts

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

9. Trading Book Creditors

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

10. Non Trading Book Creditors

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

11. Subordinated Loans

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

D. CAPITAL

12. Share Capital

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

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

13. Profit and Loss

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

14. Partnership/Sole trader current account

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

15. Total Capital

Total Capital should agree with Net Assets in Box 44.

PROFIT AND LOSS ACCOUNT

E. REVENUE

16. Dealing profit/(loss)

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

17. Gross commission and brokerage

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

18. Investment management fees

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

19. Corporate Finance Fees

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

20. Other Revenue

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

F. EXPENDITURE

21. This section should show the expenditure for the period reported on under each of the headings specified below. Expenditure should be split between those items included in relevant annual expenditure and those excluded under IPRU(INV) 10-73R (see G below).

22. Commission and brokerage

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

23. Establishment costs

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

24. Staff Costs

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

25. Bad and Doubtful Debts

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

26. Intercompany charges

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

27. Interest payable

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

28. Foreign exchange losses

This shall be the total of foreign exchange losses.

29. Exceptional and other expenses

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

G. ITEMS NOT INCLUDED IN RELEVANT ANNUAL EXPENDITURE

30. Commission and brokerage

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

31. Staff costs

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

32. Interest payable

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

33. Foreign Exchange Losses

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

34. Exceptional items

A firm may exclude exceptional items as defined in IPRU(INV) 10 App 1.

FINANCIAL RESOURCES

H. INITIAL CAPITAL

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

I. ORIGINAL OWN FUNDS

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

J. SUBORDINATED LOANS

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

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

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

38. In addition, the total of fixed term long term subordinated loan and fixed term cumulative preference shares which may be taken into financial resources

can not exceed 50% of original own funds; and the total of all long term subordinated loan, cumulative preference shares and revaluation reserves must not exceed 100% of original own funds.

K. LIQUIDITY ADJUSTMENT

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

L. MATERIAL HOLDINGS IN CREDIT AND FINANCIAL INSTITUTIONS

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

M. POSITION RISK REQUIREMENT

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

42. Equity method

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

43. Equity derivative method

Equity derivative positions not included in the equity method must be included in the next section of the form, split between the hedging, margin and basic methods. The balance sheet value of the derivative positions should be included in boxes 341 to 343A. The net balance sheet value of cash positions included in

the hedging method should be inserted in box 345A. Balance sheet values of positions in approved risk assessment models, including cash positions should be included in boxes 351 to 353.

44. Interest rate method

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

45. Interest rate derivative method

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

46. Other methods

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

N. FOREIGN EXCHANGE REQUIREMENT

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

O. COUNTERPARTY RISK REQUIREMENT

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

49. Cash Against Documents

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

50. Free Deliveries

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

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

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

52. Derivatives Transactions

In the column headed "assets", a firm should report the value of all amounts due from counterparties, clearing banks and exchanges arising on derivatives, where these are shown on the firm's balance sheet. In the column headed "liabilities", a

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

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

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

P. CREDIT EXPOSURES

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

Q. LARGE EXPOSURE REQUIREMENT

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

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

56. Firms' reporting requirements consist of two strands:

1. model derived capital requirements; and
2. back-testing exceptions.

These guidance notes address each of these in turn.

57. Model derived regulatory capital requirements

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

58. Backtesting exceptions

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

- t=-1: firm makes t=0 VaR prediction based upon its positions at close of business t=-1.
- t=0: firm incurs profit or loss.
- t=+1: firm calculates daily P&L for t=0 and compares to VaR prediction in accordance with the CAD backtesting requirements.
- t=+2: firm should notify the FSA of an exception by close of business. All exceptions should be reported.
- t=+3: firm should reflect increased capital requirement (if appropriate) in accordance the CAD backtesting requirements.

Firms should additionally be mindful of the following:

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

should submit to the FSA a written explanation of why the exception occurred, and why it would be appropriate to 'disregard' it.

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

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

Firm Code:

Currency:

Statement date:

Date Submitted:

Previous
Day's VaR

60 Day
Average
VaR

Modelled Market Risk and FX Risk

Specific Risk Surcharge

Overall VaR

Multiplication factor

Reg. Cap. requirement

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

Explanation of significant changes from previous report date

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

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

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

INTRODUCTION

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

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

Self-generated computer statement

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

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Declaration

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

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

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

Some pertinent rules

IPRU(INV) 10-10R Keeping of records

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

Notifications

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

SUP3.7.2G Qualification of an audit report.

SUP 15.6.4R Misleading information supplied to the FSA.

SUP 16.3.17R Changes in reporting dates.

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

Form and content of financial reporting statements and accounting policies

SUP16 Ann10R Agreement with records

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

SUP16 Ann10R Greater detail

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

SUP16 Ann10R Reporting currency

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

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

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

Reporting unit

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

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

Sign convention and totals

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

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

CONSOLIDATED FINANCIAL RESOURCES TEST

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

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

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

SUP 16 Ann 11G section 3

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

INTRODUCTION

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

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

Self-generated computer statement

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

Declaration

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

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

Categories of firms

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

statement and submit it on an annual and monthly basis in accordance with SUP 16.7.25R.

Some pertinent rules and guidance

IPRU(INV) 3-10R Keeping of records

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

IPRU(INV) 3-11R Reconciliation of balances

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

Notifications

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

SUP 15.6.4R Misleading information supplied to the FSA.

SUP 16.3.17R Changes in accounting reference dates.

SUP 3.7.2G Qualification of an audit report.

Form and content of financial reporting statements and accounting policies

SUP 16 Ann 10R Agreement with records

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

SUP 16 Ann 10R Offsetting and netting

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

SUP 16 Ann 10R Consolidation

A firm must not consolidate the accounts of separately incorporated group companies other than for the purposes of completing the consolidated reporting

statement, but must include the assets, liabilities, income and expenditure of all branches of the firm.

SUP 16 Ann 10R Greater detail

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

SUP 16 Ann 10R Reporting currency

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

SUP 16 Ann 10R Accounting policies

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

Reporting unit

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

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

Sign convention and totals

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

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

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

Segregation

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

BALANCE SHEET

A. FIXED ASSETS

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

2. Intangible Assets

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

B. CURRENT ASSETS

3. Stock and Investments

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

4. Trade Debtors

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

5. Non Trade Debtors

These include debtors not arising from trading activities. Examples of these are corporate finance fees, commissions, interest and dividends not directly related to the firm's investment or associated business. Firms must ensure that non trade

debtors under and over 90 days and debts with affiliates and non-affiliates are disclosed separately.

6. Loans and other assets

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

7. Cash at Bank and in Hand

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

C. CURRENT LIABILITIES

8. Bank Loans and Overdrafts

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

9. Trade Creditors

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

10. Non Trade Creditors

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

D. CAPITAL

11. Approved Share Capital

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

12. Non-approved Share Capital

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

13. Profit and Loss

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

14. Partnership/Sole trader current account

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

15. Total Capital

Total Capital should agree with Net Assets in Box 43.

PROFIT AND LOSS ACCOUNT

E. REVENUE

16. Dealing profit/(loss)

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

17. Gross commission and brokerage

This shall be the total commission and brokerage earned by the firm, before the deduction of commissions shared or paid to third parties.

18. Investment management fees

This shall be the total of underwriting fees and commissions, fees from investment advice, valuations, management of investments and unit trusts, pension funds and collective investment schemes.

19. Corporate Finance Fees

This shall be the total of all income earned by the firm from corporate finance business.

20. Other Revenue

This shall be the total of all other revenue of the firm, including all interest and dividends receivable (except for that arising out of dealing as principal, which is included in 16 above).

F. EXPENDITURE

21. This section should show the expenditure for the period reported on under each of the headings specified below. Expenditure should be split between those items included in relevant annual expenditure and those excluded under IPRU(INV) 3-73R (see G below).

22. Commission and brokerage

This shall be the total of commissions paid away and shared, plus fees, brokerage and other charges paid in relation to the execution, registration or clearing of transactions.

23. Establishment costs

This shall include marketing, communications, office services costs, rent, rates, heating, electricity, maintenance, depreciation, professional fees and other general overheads of the business.

24. Staff Costs

This shall be the aggregate of gross salary costs, including National Insurance contributions, pensions contributions, benefits in kind and bonuses or profit shares.

25. Bad and Doubtful Debts

This shall be the charge to the profit and loss account which the firm considers to be an adequate provision for all doubtful debts, even where there is no addition to CRR or deduction from financial resources.

26. Intercompany charges

This shall be charges made by affiliated companies whether for the recharge of costs incurred by the affiliate on behalf of the firm, or for management fees.

27. Interest payable

This shall be the total of any interest payable on borrowings of the firm and interest payable on client bank accounts.

28. Foreign exchange losses

This shall be the total of foreign exchange losses.

29. Exceptional and other expenses

Exceptional expenses shall be those arising from events within the ordinary course of business which are not expected to recur frequently or regularly.

G. ITEMS NOT INCLUDED IN RELEVANT ANNUAL EXPENDITURE

30. Commission and brokerage

A firm may exclude commission shared with third parties other than employees, directors, half commission men or appointed representatives. Fees, brokerage and other charges paid for the purposes of executing, registering or clearing transactions may also be excluded.

31. Staff costs

A firm may exclude bonuses or profit sharing where they are discretionary and paid out of current year profits.

32. Interest payable

A firm may exclude interest which is payable to counterparties or which relates to borrowings which finance the firms regulated activities.

33. Exceptional and extraordinary items

A firm may exclude exceptional items and extraordinary items as defined in IPRU(INV) 3 App 1.

FINANCIAL RESOURCES

H. TANGIBLE NET WORTH

34. For an incorporated firm, tangible net worth includes ordinary share capital plus redeemable preference shares, meeting the criteria set out in IPRU(INV) 3-62R, approved reserves as explained in IPRU(INV) 3-62R, share premium account and retained earnings, less any intangible assets.

35. For a partnership or sole trader, tangible net worth includes the capital account plus current account, less any intangible assets.

I. ELIGIBLE CAPITAL SUBSTITUTES

36. There are certain limits on subordinated loans, approved bank bonds and approved undertakings which may be taken into financial resources. The total of boxes 104 to 106 must not exceed four times tangible net worth. The other limits are detailed in IPRU(INV) 3-63R.

J. PRIMARY REQUIREMENT

37. This requirement is set out in IPRU(INV) 3-70R and is the sum of boxes 107 to 113.

38. Base requirement

The base requirement is the greater of–

- the absolute minimum requirement which is determined in accordance with IPRU(INV) 3-72R;
- the expenditure requirement which is determined in accordance with IPRU(INV) 3-73R; and
- the volume of business requirement which is 3.5% of the aggregate of the firm's counterparties' total initial margin requirement.

39. Liquidity adjustment

The liquidity adjustment must be calculated in accordance with IPRU(INV) 3-75R and must be deducted in order to arrive at the financial resources.

40. Charged assets

This is the balance sheet value of each asset charged to a third party (IPRU(INV) 3-76R) unless the related exposure has already been recorded as a liability or is subject to CRR.

41. Contingent liabilities

An amount must be added to primary requirement in accordance with IPRU(INV) 3-77R.

42. Deficiency in subsidiaries

Unless a provision has already been made (ie a reduction of the firm's financial resources), the amount is equal to the deficiency in shareholders' funds in the subsidiary of the firm (IPRU(INV) 3-78R).

POSITION RISK REQUIREMENT

43. A firm which carries a house position must calculate a position risk requirement. The methods and position risk weightings (known as PRAs) to be used can be found in IPRU(INV) 3-80R to 3-169R and IPRU(INV)_3 App 26.

44. Foreign exchange requirement

This section of the standard reporting statement captures the firm's position risk requirement arising from foreign exchange exposures, calculated in accordance with IPRU(INV) 3-150R to IPRU(INV) 3-154R. Box 149 will drill down into a screen detailing foreign exchange exposures and the resulting PRR. The long and short positions in all the currencies must net to zero.

45. Physical commodities

Boxes 128 and 138 include the balance sheet value of positions subject to the physical commodities method IPRU(INV) 3-166R to 3-169R. Box 151 should include the PRR calculated under these rules.

46. Other

The balance sheet value of positions in interest rate instruments taken on to hedge interest rate risks in the commodities portfolio should be included in boxes 128A and 138A. Box 151A should include the PRR calculated on these positions.

COUNTERPARTY RISK REQUIREMENT

48. This section is split into debtors and creditors arising on the trading book. The headings for assets and liabilities are designed to reflect the balance sheet values of transactions analysed by type.

49. Cash Against Documents and Free Deliveries

Where a firm expects to receive cash against unsettled securities transactions, such as gilts, bonds, it should enter the total value of all such amounts at their

balance sheet value in the column headed "assets". Where a firm has a liability to pay cash in respect of unsettled securities transactions, it should enter the total value of all such liabilities at their balance sheet value in the column headed "liabilities".

50. Where a firm has made a free delivery of either commodities or securities, it should enter the balance sheet value of the related amounts receivable in the column headed "assets". Where a firm has made a free delivery of cash in respect of the anticipated receipt of securities or commodities, it should not enter the balance sheet value of such payments in the section headed "liabilities", since this is no longer a creditor.

51. In the column headed "requirement", a firm should enter its total CRR in respect of unsettled securities transactions and free deliveries.

52. Margined Transactions and Options

In the column headed "assets", a firm should report the value of all amounts due from counterparties, clearing houses and exchanges arising on exchange-traded-margined transactions, where these are shown on the firm's balance sheet. In the column headed "liabilities", a firm should report the value of all amounts due to counterparties, clearing houses and exchanges arising on exchange-traded-margined transactions, where these are shown on the firm's balance sheet. In the column headed "requirement", a firm should report its CRR calculated in accordance with IPRU(INV) 3-173A.

53. OTC

In the column headed "assets", a firm should report the value of amounts due from counterparties on OTC transactions, where these are shown on the balance sheet. In the column headed "liabilities", a firm should report the value of all amounts due to counterparties on OTC transactions, where these are shown on the firm's balance sheet. In the column headed "requirement", a firm should report its CRR calculated in accordance with IPRU(INV) 3-173A.

54. Other

A firm should report its remaining balance sheet trade debtors and creditors not covered in 49 to 53 above as assets or liabilities, as appropriate, and enter the CRR arising from these activities in the column headed "requirement".

CREDIT EXPOSURES

55. The credit exposure section is designed to pick up all third party credit exposures. The form is designed to pick up the total exposure to a counterparty,

ie trade debtors and non-trade debtors, including all transaction exposures between trading date and settlement date. Boxes 200 to 209C should be completed for intra group exposures, listing for each of the 10 group counterparties with the largest credit exposures, the gross exposure to the counterparty, and, if there is a netting agreement in place the net exposure to the counterparty. Boxes 210 to 219C should be completed giving the same information for the 10 non group counterparties with the largest credit exposures. Boxes 220 to 229B should include the 10 largest net credit exposures, where there is a netting agreement in place, which have not been reported in the two previous sections.

56. REPORTING REQUIREMENTS FOR FIRMS PERMITTED TO USE INTERNAL MODELS FOR CALCULATING REGULATORY CAPITAL

Firms' reporting requirements consist of two strands:

1. model derived capital requirements; and
2. back-testing exceptions.

These guidance notes address each of these in turn.

57. Model derived regulatory capital requirements

There are specific requirements for those firms which are permitted by the FSA to calculate some or all of their regulatory capital requirements using their internal risk assessment models in accordance with IPRU(INV) 3. This permission will be granted in the form of a waiver or modification of the relevant rules. As stated in SUP 8.3.6G, the FSA may impose conditions on a waiver, such as additional reporting requirements. The reporting requirements set out below are a condition for the granting of the relevant waiver(s) in this case. The proforma overleaf sets out the information which the FSA requires from firms in this regard. Firms should submit this information with the same frequency as they currently submit their regular financial reporting statements - the paper report will be regarded as forming a part of a firm's standard reporting statement. Frequency and timing of reporting should be in accordance with SUP 16.7.25R to SUP 16.7.27R.

58. Backtesting exceptions

Further guidance on the review process for internal models can be obtained from the FSA. Notifications of exceptions to the FSA and adjustments to capital requirements should be made in accordance with the timing of the following schedule:

- t=-1: firm makes t=0 VaR prediction based upon its positions at close of business t=-1.
- t=0: firm incurs profit or loss.

t=+1: firm calculates daily P&L for t=0 and compares to VaR prediction in accordance with the CAD backtesting requirements.

t=+2: firm should notify the FSA of an exception by close of business. All exceptions should be reported.

t=+3: firm should reflect increased capital requirement (if appropriate) in accordance the CAD backtesting requirements.

Firms should additionally be mindful of the following:

(a) An exception is considered to have occurred where the daily loss experienced by a firm exceeds its VaR prediction. For these purposes, the VaR prediction should be compared to daily 'cleaned actual P&L' at the whole-book level (or other level as appropriate to the scope of the model). 2. Firms should report all exceptions in accordance with the schedule above. This may be done by telephone to the firm's usual supervisory contact. An exception will automatically lead to the adjustment of a firm's capital on t=3 (if required in accordance with the CAD criteria) unless a firm has agreed with the FSA that the exception may be 'disregarded'. The FSA's agreement to 'disregard' an exception may additionally be granted retrospectively. A firm seeking to have an exception 'disregarded' should submit to the FSA a written explanation of why the exception occurred, and why it would be appropriate to 'disregard' it.

(b) All firms should submit to the FSA a written report of exceptions, with details of the amount of each exception, explanations for why each exception occurred and consequent action taken-on a monthly basis.(Category A and B firms and Broadscope firms should submit this in conjunction with their standard reporting statement. Category C and D firms and Arrangers should submit exception reports in accordance with the timing of the standard monthly reporting cycle.) There is no prescribed format for the reporting of exceptions.

59. Calculation of Regulatory Capital based on Firm's Internal Assessment of Value-at Risk

Firm Code:

Currency:

Statement date:

Date Submitted:

Previous	60 Day
Day's VaR	Average
	VaR

Modelled Market Risk and FX Risk

Specific Risk Surcharge

Overall VaR

Multiplication factor

Reg. Cap. requirement

*Number of instances in reporting period when previous day's VaR exceeded 60 day average VaR x multiplication factor.

Explanation of significant changes from previous report date

Notes: Value of positions should be shown in box 128 of the standard reporting statement for non-ISD firms.

* Where firms have reported instances, a supplementary written explanation of the causes should be submitted.

Guidance on the completion of LEM Forms for securities and futures firms which are ISD firms

I SUMMARY OF REPORTING REQUIREMENTS

(1) An exposure

The measurement of an exposure should reflect the maximum loss, which would occur should a counterparty fail, or the loss that may be experienced due to the realisation of assets or off-balance sheet positions. IPRU(INV) 10 provides details of the rules, which have been expanded upon below.

A large exposure forms the basis for the completion of Form LEM, as required under CAD. With regard to the compliance of quarterly reporting of large exposures, FSA, with prior authorisation, will allow firms to measure whether a large exposure has occurred, based upon the firm's own funds rather than financial resources and own funds, on condition that financial resources are higher than own funds.

Exposures should be measured prior to any exemptions detailed in IPRU(INV) 10-192R(1),(2), and (3), unless otherwise detailed in IPRU(INV) 10-32R(3) to 10-32R(7).

Whether an exposure falls as a trading book or non trading book item will vary from firm to firm. For the purpose of this return, an exposure should be classified as trading book or non trading book in the same manner as it is for the capital calculation, as detailed in IPRU(INV) 10 and any further updates thereto.

Exposures entered into by a firm as trustee are excluded from the scope of the large exposures return. This covers all client assets, but excludes any buffer held by the firm within the segregated client account, which is reflected within the firm's balance sheet, and should be included in the large exposures return.

Non trading book issuer risk is the full market value of the underlying exposure.

If the firm has any doubt on whether a constituent of a large exposure should be reported, it should continue to report the exposure until it has received guidance to the contrary from FSA.

Examples of exposures include, but are not limited to:—

- (a) fees receivable/prepayments;
- (b) stockborrowing/stocklending, repos/reverse repos; and their foreign equivalents; buy/sells, sell/buys - these should be recorded as for CRR but without any counterparty weighting factors;

- (c) deposits, loans, current account credit balances, including those denominated in precious metals;
- (d) discounted bills held;
- (e) the net investment in finance leases;
- (f) bonds, bond futures, and bond options;
- (g) equity positions held as principal, equity options, equity warrants, equity futures, swaps, contracts for difference, and similar instruments;
- (h) interest rate contracts, including single currency interest rate swaps, basis swaps, forward rate agreements, interest rate futures, and products with similar characteristics;
- (i) foreign exchange rate contracts, cross currency swaps, cross currency interest rate swaps, outright forward foreign exchange contracts, currency futures, currency options purchased, outstanding currency option premia, and similar instruments;
- (j) acceptances, promissory notes, loan stock, commercial paper, MTN's, and other paper held;
- (k) margin deposits with futures, options, commodities exchanges, and other clearing houses, brokers, investment exchanges;
- (l) forwards, including buy/sells, sell/buys and similar transactions;
- (m) free deliveries, failed trades, and any trade with extended settlement day;
- (n) those claims arising from similar transactions entered into by the firm;
- (o) all intra-group exposures which do not fall within any consolidation.

Exposures which are exempt from the quarterly report:–

(a) exposures and other assets which have already been deducted when calculating the firm's own funds for the purpose of monitoring large exposures. Such deductions can be found in IPRU(INV) 10-61R(1)B - these include the reporting firm's own shares and investments in subsidiaries and associated companies;

Material holdings in credit and financial institutions which have been deducted in full when calculating own funds. See IPRU(INV) 10-192R(1)(k);

(b) claims arising in the course of settlement of a foreign exchange transaction on a counterparty where the firm has settled its side of the transaction, but has not received the corresponding payment, for a period of up to two working days after payment was made. After this period such claims will constitute an exposure. See IPRU(INV) 10-190R(2)(a);

(c) exposures to Zone A governments, related government entities (e.g. Inland Revenue, Bank of England, government debt), and the EU/European Communities see - IPRU(INV) 10-32R(7). This does not extend to local

government, unless a full legal guarantee exists, and complies where appropriate with EU legislation in respect of government support;

(d) in the case of securities, which are settled on a delivery versus payment basis, claims on the counterparty to the transaction which occur in the normal course of business up to and including the five business days (see IPRU(INV) 10-190R(2)(b)) following the due payment or delivery date;

(e) counterparty risk exposure on commodities, commodity derivatives, and other physical assets.

(2) The amount at risk

The amount at risk should, with certain exceptions detailed below (or otherwise advised to the firm) be reported as the exposure of the firm's actual or potential claim, contingent liability, or assets. IPRU(INV) 10 methodology takes precedence and should be followed in calculating all exposures, unless an alternative format is indicated within these reporting instructions.

Completion of the return should be in accordance with UK accepted accounting standards and practice subject to the paragraph above.

Bank accounts

Credit balances should not be offset with debit balances with any credit institution, unless legal opinion has been obtained. This opinion should address the issue of set off for term versus demand deposits/loans, and cross border set off. Firms internally should monitor their exposure to the counterparty in this manner to utilise this form of set off.

Balances recorded within forms LEM 1 or LEM 2 should be the cashbook value rather than the bank statement value. It should be noted that this is different to the methodology applied for completing Form LE under the provisions set out in IPRU(BANK).

Free Deliveries/Failed Trades

Free deliveries are reportable from the business day when delivery took place, at full value. The exposure recorded should be the higher of the market value of the underlying or the cash side to the transaction, where the firm has made a payment. Where the firm has made a delivery of securities, then the cash value of the transaction should be reported.

For transactions which are deemed to be cross border, then a window of one working day is available before the transaction becomes reportable, in line with IPRU(INV) 10-172R(4).

Failed trades have occurred if a trade for the purchase/sale of a security, incurred in the ordinary course of settlement, fails to settle during the five

business days following and including due payment or due delivery date, where neither cash nor securities have been delivered.

Other failed transactions are reportable under the large exposures regime, such as foreign exchange. An exposure should become a reportable item when a foreign exchange transaction remains outstanding for two business days following due payment date in the ordinary course of settlement.

Interest and dividends

The value of outstanding claims should include interest and dividends due. Once the underlying equity issue has gone ex-dividend, and the dividend will not be reflected in the underlying price of the equity, then there will be a receivable due to the firm until payment is received.

Interest Rate Contracts/Equity Derivatives/Foreign Exchange

The reportable exposure for derivatives should be calculated in line with IPRU(INV) 10-174R.

Where a netting agreement is held which complies with current FSA requirements, it may then be utilised if the firm calculates its exposure to the counterparty or counterparty group on a net basis.

Loans, advances etc denominated in gold, silver, and other precious metals

Exposures in this form should be translated into the reporting currency at the closing spot price. Where the maximum exposure during a reporting period is required to be reported, the closing spot rate for the day on which the exposure occurred should be used. Precious metals should not be considered as a "cash equivalent", but as a commodity.

Netting

In reporting large exposures, counterparty credit balances should not be offset against counterparty debit balances, unless a netting agreement is in place. At no time may issuer exposure to company "A" be netted with counterparty exposure to "A".

Debt securities should not be netted against equity exposure for the same issuer. **The netting of debt securities issued by the same legal entity together with underlying derivatives are allowable.**

Firms should indicate, by way of a "*" against the relevant counterparty groups (next to column "a") on forms LEM 1 & 2, where they have reported net amounts.

Firms should be aware that currently there is a difference between CRR and large exposures with regard to the measurement of exposure and the maturity of the net exposure. Large exposure calculates the exposure using the underlying positive exposure with the longest maturity.

Any netting agreements should comply with FSA requirements at all times.

Receivables

Receivables, which include prepayments, dividends receivable (see **Interest and dividends**), and other receivables not exempted under the large exposures guidance notes, are reportable within the quarterly return.

Replacement cost/mark to market for derivative transactions

In order to include exposures which fall within the trading book, a firm should aggregate:—

(a) the total replacement cost (obtained by marking to market) of all of its contracts with a positive value. The exception to this is if the firm has a netting agreement with the counterparty, which complies with FSA requirements.

(b) an amount for potential future credit exposure which reflects the residual maturity of the contract, calculated as a percentage of the underlying notional amount in accordance with IPRU(INV) 10-174R(3).

Where a firm has not received option premia or acceptable collateral, this shortfall should be recorded as 100% of the exposure to the counterparty.

Any acceptable or adequate collateral held by a firm, should be recorded in column “c” of LEM 2.

Residual Maturity

The residual maturity of an option/swap, or any other derivative product falling within IPRU(INV) 10-174R, should be taken as the time from the reporting date until the final expiry date. Rollovers which are reset with a new contract, which details when the exposure will be cleared by either party to the contract, have maturity lengths equal to the total rollover period.

Underwriting Commitments - IPRU(INV) 130R to IPRU(INV) 133R

The firm's exposure (debt or equity), if using the Issuing Market Method, shall be its net exposure in line with IPRU(INV) 10-132R(1) and 10-132R(2). The net position can be reduced for new issues/tranches, using the discount percentages for the issuing market method (IPRU(INV) 10-133R(5)).

After “working day five”, the full market value of the remaining underwriting “stick” should be reported when taken in aggregation with other exposures to the counterparty/group.

(3) A counterparty

A counterparty is an individual, a legal entity, partnership/sole trader, or some other party to which the member firm is directly or indirectly exposed. Large exposures to the following types of counterparties should be reported as follows:—

A counterparty dealing as agent

Firms should treat the exposure as an exposure to the counterparty with whom it has contracted. This will mean the disclosed underlying clients where possible. If there are no disclosed underlying clients, then the deal should be deemed as being with the agent.

Group of connected third parties

A group of connected third parties is defined in IPRU(INV) 10 App 1.

A pension fund or other trust fund of the group should not be classified as connected for the purposes of this return.

Those counterparties which merge during the reporting period, should be included as connected counterparties from the date the offer goes unconditional. In such cases the exposure to these individual counterparties should be aggregated and considered as a single exposure to a group of closely related counterparties.

Exposures to a number of public sector bodies, or local authorities are deemed not to constitute a single exposure to a group of connected counterparties.

Where consolidated quarterly reporting on a sub-group basis has been requested, then all group exposures outside the sub-group should be included in Part 2.

Multilateral Development Banks

Multilateral development banks, as defined in IPRU(INV) 10 App 1, should be reported in Part 3(i) and 3(ii) of the return for those firms using Form LEM 2.

Parental or third party guarantees

The exposure should be recorded against the end counterparty, without any deduction for the amount provided for by the guarantor. The amount of guarantee utilised/drawn at the reporting date should be noted and recorded in column (i) of the return. The highest exposure to the “guarantor” during the reporting period should be included within column “g” of the return, and disclosed by way of memorandum below the details of the other exposure to the guarantor.

Guarantees granted by firms should be disclosed separately. The disclosure should be in the standard format required under **Part 2** of Form LEM 2. Utilisation at the reporting date should show the exposure to the firm if the guarantee were to be drawn, in order to cover the value of guaranteed reportable exposure at the close of business.

Credit institutions/Investment firms/ Third Country Investment Firm/ Clearing Houses and Exchanges

Definitions are provided in IPRU(INV) 10 App 1, and lists of recognised clearing houses and exchanges recognised for these purposes are shown in IPRU(INV) 10 Appendix 57.

(4) Identity of counterparty

The identity of a counterparty will generally be the customer named in a contract note. Where an agent identifies the underlying client, then the underlying client is the counterparty. In the case of a security held, the exposure should be against the issuer. In an equity derivative transaction, the underlying security should be included as exposure to the issuer, and the firm should record counterparty exposure against the relevant counterparty to the transaction.

Exposures guaranteed by a parent or third party should be recorded as exposure to the original counterparty, with the amount of exposure guaranteed by the guarantor recorded in column "i". The overall utilisation of the guarantee should be recorded against the guarantor, with a memorandum indicating the amount of the guarantee included within the overall exposure.

II THE REPORTING FORM (LEM)- GENERAL, COVERAGE AND LAYOUT.

GENERAL

Forms LEM 1 or LEM 2 should be completed both on a solo and, where relevant a consolidated basis:

- (a) Those firms who have been granted a waiver from consolidation (IPRU(INV) 10-204R) and hold a group wide ACMP (IPRU(INV) 10-196R), are exempt from reporting large exposures on a consolidated basis.
- (b) Nil returns are required to be submitted.
- (c) LEM 2 Forms are required to be submitted in line with SUP 16.7.25R and SUP 16.7.27R.
- (d) Details of counterparty risk netting with counterparty groups during any part of the quarter, should be indicated by way of (*) against the counterparty group recorded in column "a" of Forms LEM 1 or 2.

Coverage and Layout of Forms LEM 1 and 2

All counterparties which have had a large exposure during the quarter should report that exposure. Firms should make further copies of the enclosed forms where required.

Large exposures should be reported in the same currency and format that the FSA requires for all other regulatory reporting.

Large exposures to individual counterparties and counterparty groups should be reported, in each category of counterparty, ranked in descending order using the "highest exposure during the reporting period".

Details of own funds/financial resources as at the reporting date should be reported on the front cover of Forms LEM 1 and LEM 2.

Large exposures as at the reporting date (see Form LEM 2, columns "d", "e", and "f"), should be reported, and split between trading book and non trading book exposure.

An exposure which is not a large exposure as at the reporting date, but where there has been a large exposure since the previous reporting date should also be reported.

Any specific bad debt provisions raised but not yet passed through the accounting records should be indicated in column "b". Any non performing assets held where no specific provision has been raised should also be recorded here.

A memorandum showing the breakdown of material holdings in credit institutions/investment firms at the reporting date should be reported in the space provided on Form LEM 2. Any exposures which have been deducted from own funds and detailed in the Material Holdings in Credit and Financial Institutions_will not appear in any further part of the quarterly return.

There may be circumstances where it is possible to record the exposure more than once. When in doubt, the firm should either report the exposure twice as an exposure to each counterparty, or seek guidance from the FSA.

PART 1

Large exposures to Corporates (individual non-credit institutions/non investment firms and groups of closely related non-credit institutions/investment firms)

Part 1 of Form LEM 2 - exposures to Corporates, which include all counterparties which do not fall within **Parts 2, 3, or 4** of Form LEM 2;

Exposures to individual counterparties which constitute a group of connected third parties should be reported as one exposure.

Exposures to individual non-credit institution/investment firm counterparties and groups of closely related counterparties which are connected to the firm should be reported in **Part 2**.

Exposures to a local authority, state or public sector body about which the FSA has given guidance stating that it may be considered as an exposure to a central government, should be reported in **Part 4**.

PART 2

Exposures to individual group members of closely related counterparties connected to the reporting firm

Part 2 of Form LEM 2 - exposures to each individual legal entity within the firm's group which constitute a large exposure. Any legal entity which comes within the firm's world-wide group, should be reported here, rather than Part 3(i) or 3(ii) of the return.

When completing a consolidated version of Form LEM 2, only exposures to group members outside the scope of the group for FSA consolidation need to be reported.

For those firms required to complete a full group consolidated quarterly return, this part of the return will be nil. Those firms subject to sub-consolidation, as advised by the FSA, will be required to include connected exposure falling outside the "advised" consolidated group.(This is likely to be connected companies falling outside the EEA).

PART 3(i)

Large exposures to credit institutions/investment firms/ third country investment firms/ clearing houses and exchanges

References to "investment firms" hereafter are intended to include credit institutions, third country investment firms, clearing houses and exchanges recognised for the purposes of IPRU(INV) 10.

Exposures to groups of closely related investment firms should be recorded by legal entity basis within **Part 2** of LEM 2. An aggregation of the exposure to the group falling within this sector should be provided,(though it should not include capital instruments) deducted in calculating own funds. A breakdown of those material holdings deducted from own funds must be provided within the Material Holdings in Credit and Financial Institutions section of your return.

Exposures to exchanges should be reported as a separate entity, rather than splitting the exposure to the "owners" of the exchange, unless one owner either has a majority holding or management control.

Where a counterparty group contains a legal entity to which the firm has exposure, and this legal entity would be classified as an "Investment Firm", then all exposure to that counterparty group should be reported within **Part 3(i)/3(ii)**.

All exposure to entities which fall within the title for inclusion in **Part 3**, should fall within **Part 3(i)**, and any part of that total large exposure over 1 year, which taken in aggregate, and is equal to being classified as a large exposure, should be reported in **Part 3(ii)**.

A list of clearing houses/ exchanges recognised for these purposes can be found in, IPRU(INV) 10 App 57.

PART 3(ii)

Large exposures appearing in **Part 3(ii)**, should also be included in **Part 3(i)**. This will provide a breakdown of all medium to long term exposure - this is defined as exposure of one year and over (including a further breakdown of derivatives over 1 year).

Most issuer risk to counterparties falling within **Part 3** of LEM 2, unless there is less than 1 year to redemption, will fall within this section. An exposure with optional redemption dates for exercise should be classified in accordance with the latest redemption/maturity date.

Derivative exposure which falls within this category, should be shown separately from the total exposure over 1 year, by way of memorandum,[ie a second entry below the individual total large exposure for the counterparty group].

PART 4

Large Exposures to Zone B central governments and central banks

List the highest large exposures which have occurred during the quarter to each Zone B counterparty group. Exposures to European Communities, and institutions which would fall under a formal guarantee issued by the above, should not be included.

For the purposes of this form of this report, exposure to the European Union (EU)/EEC should be considered to be equivalent to Zone A governments and not reportable for LEM.

General

The reporting forms only differ in the amount of data that needs to be completed. The standard form (LEM 1) only requires columns "a", "f" and "g" to be completed.

Form LEM 1

There is no segregation between the type of counterparty within the standard form LEM 1. Exposures should simply be listed using the highest exposure during the quarter, in descending order.

See **Appendix 1** and **2** for copies of the quarterly reports (LEM 1 & 2). The column references referred to below are cross referenced accordingly.

Form LEM 2

Column reference

(a) This will be the counterparty, or where relevant the counterparty group - the exception to this is **Part 3i** and **3ii**, where a breakdown by legal entity to which the reporting firm has exposure is required.

##(b) This is any specific bad debt raised, which has already been deducted from own funds. This should also include any non-performing assets, where it is reasonable to determine that the counterparty to the transaction is outside the parameters set for the specific transaction, or the market norm. This is not aimed at failed trades, but at aged debt repayments which are unlikely to be repaid and for which no specific provision has been raised.

##(c) This should include any acceptable or adequate collateral at the reporting date which has not already been used to reduce an exposure [trading or non trading] at the reporting date. With regard repos/reverse repos and other similar instruments dealt with under IPRU(INV) 10-173R, adequate collateral may be included where appropriate.

Items that should be recorded here would be any *exposures* not exempted or discussed above, where acceptable/adequate collateral has been lodged, which could cover a number of transactions. Partial coverage by acceptable/adequate collateral is permissible.

##(d) "R"- non-trading book exposure as at the reporting date.

##(e) "S"- trading book exposure at the reporting date.

(f) "T"- is the aggregate of "R" and "S" for each respective counterparty or group of counterparties.

(g) This should be the highest large exposure that occurred during the reporting period.

If a limits based approach is used, then the aggregate of the limits marked, plus any excesses, will be the highest large exposure during the reporting period.

##(h) The figure in "g" as a percentage of financial resources, at the date the highest large exposure occurred.

##(i) This should record the amount of exposure guaranteed by a parent/third party.

The aggregate amount of guaranteed exposure by each guarantor should be recorded by the firm within the total exposure to the guarantor. A memorandum line beneath each guarantor, should break out the size of the guaranteed exposure from the total [guarantee + other reportable exposure] to the guarantor.

SUP 16 Ann 12G: Reports from trustees of AUTs and depositaries of ICVCs (see SUP 16.6.9G)

1 Table

1. Trustees of AUTs

- (1) Form 1 at the end of this annex provides a suggested format for the submission of the reports.
- (2) The quarterly report should be completed each year as at 31 March, 30 June, 30 September, and 31 December.
- (3) The report should be signed by an *approved person* who has responsibility for the *firm's trustee* area.
- (4) A *firm* should refer to *CIS* 4, 7, 15 and Appendix *CIS* before completing this report.

2. Depositaries of ICVCs

- (1) Form 2 at the end of this annex provides a suggested format for the submission of the reports.
- (2) The quarterly report should be completed each year as at 31 March, 30 June, 30 September, and 31 December.
- (3) The report should be signed by an *approved person* who has responsibility for the *firm's depositary* area.
- (4) A *firm* should refer to *CIS* 4, 7 and Appendix *CIS* before completing this report.

Form 1

Quarterly Return of Notifiable Breaches – Authorised Unit Trusts

1. Pricing Errors

Manager	Did status of manager change in quarter? (Note)	No. of pricing errors of 0.5% and above	No. of pricing errors below 0.5%, where trustee does not consider manager's controls to be adequate	No. of authorised unit trusts in operation
Note = From "controls adequate" to "controls inadequate" (or vice versa). Where the manager's status changed, the report should state the date of that change and the number of reportable breaches of CIS 4 and 15 before and after that change of status.				

2. Negative Boxes

Manager	Did status of manager change in quarter? (Note 1)	No. of negative boxes where CIS 4.3.12R and CIS 15.3.12R have not been applied. (Note 2)	No. of authorised unit trusts in operation
Note 1 = From "controls adequate" to "controls inadequate" (or vice versa). Where the manager's status changed, the report should state the date of that change and the number of reportable breaches of CIS 4 and 15 before and after that change of status.			
Note 2 = The application of CIS 4.3.12R and CIS 15.3.12R relates to the correction of an error by the manager with the trustee's agreement in accordance with CIS 4.3.12R and CIS 15.3.12R.			

The statistical information above has been provided to the *FSA* in accordance with *SUP* 16.6.8R(1).

Knowingly or recklessly giving the *FSA* information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). *SUP* 15.6.1R and *SUP* 15.6.4R require an *authorised person* to take reasonable steps to ensure the accuracy and completeness of information given to the *FSA* and to notify the *FSA* immediately if materially inaccurate information has been provided. *SUP* 16.3.11R requires an *authorised person* to submit reports containing all the information required. *APER* 4.4.6E provides that, where an *approved person* is responsible for reporting matters to the *FSA*, failure to inform the *FSA* of materially significant information of which he is aware is a breach of *Statement of Principle 4*. Contravention of these requirements may lead to disciplinary sanctions

or other enforcement action by the *FSA*. It should not be assumed that information is known to the *FSA* merely because it is in the public domain or has previously been disclosed to the *FSA* or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief.

Signed

Name

Position

Date

Form 2

Quarterly Return of Notifiable Breaches – Investment Companies with Variable Capital

1. Pricing Errors

Authorised Corporate Director (ACD)	Did status of ACD change in quarter? (Note)	No. of pricing errors of 0.5% and above	No. of pricing errors below 0.5%, where depositary does not consider manager's controls to be adequate	No. of Investment Companies with Variable Capital in operation

Note = From “controls adequate” to “controls inadequate” (or vice versa). Where the ACD’s status changed, the report should state the date of that change and the number of reportable breaches of CIS 4 before and after that change of status.

2. Negative Boxes

Authorised Corporate Director (ACD)	Did status of ACD change in quarter? (Note 1)	No. of negative boxes where CIS 4.3.12R has not been applied. (Note 2)	No. of Investment Companies with Variable Capital in operation

Note 1 = From “controls adequate” to “controls inadequate” (or vice versa). Where the ACD’s status changed, the report should state the date of that change and the number of reportable breaches under CIS 4 before and after that change of status.

Note 2 = The application of CIS 4.3.12R relates to the correction of an error by the ACD with the depositary’s agreement in accordance with CIS 4.3.12R.

The statistical information above has been provided to the *FSA* in accordance with *SUP* 16.6.8R(2).

Knowingly or recklessly giving the *FSA* information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). *SUP* 15.6.1R and *SUP* 15.6.4R require an *authorised person* to take reasonable steps to ensure the accuracy and completeness of information given to the *FSA* and to notify the *FSA* immediately if materially inaccurate information has been provided. *SUP* 16.3.11R requires an *authorised person* to submit reports containing all the information required. *APER* 4.4.6E provides that, where an *approved person* is responsible for reporting matters to the *FSA*, failure to inform the *FSA* of materially significant information of which he is aware is a breach of *Statement of Principle 4*. Contravention of these requirements may lead to disciplinary sanctions

or other enforcement action by the *FSA*. It should not be assumed that information is known to the *FSA* merely because it is in the public domain or has previously been disclosed to the *FSA* or another regulatory body. If there is any doubt about the relevance of information, it should be included.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief.

Signed

Name

Position

Date



NAME OF RETURN (To be put on each return by FSA)

Return Reference Number (To be put on each return by FSA)

This return is date critical.

To be Completed by Firm	
Firm's Name	
Firm's Reference Number	
To be completed by FSA	
Date and Time of Receipt	
Entry Receipt Number	
Name & Initials of Person Receiving it	
Division Passed To	

Annex E
Amendments to text already made

Transitional provisions

Transitional provision 3 In column (2), delete "and SUP 3.10.4R".

Chapter 4 Actuaries

SUP 4.2.4G Amend as shown below:

The function described by SUP 4.2.2G(2) is performed by the *appropriate actuary* who is appointed ~~triennially~~ to prepare the triennial investigation and interim certificate or statement required by *IPRU(FSOC) 5.2.(1)* (see SUP 4.4.7R to SUP 4.4.10G for the rights and duties of an *appropriate actuary*).

SUP 4.4.1R Amend as shown below:

A *firm* to which this section applies (see SUP 4.1) and required by *IPRU(FSOC) 5.2.(1)* to ensure that an investigation is carried out must:

(1) appoint an *actuary* (the "*appropriate actuary*") to carry out the triennial investigation and prepare an abstract of the report as required by *IPRU(FSOC) 5.2(2)* and provide the interim certificate or statement as required by *IPRU(FSOC) 5.2(3)*; and

(2) appoint a replacement for that *actuary* if he ceases to hold office before he has carried out the duty described in (1).

SUP 4.4.2G Delete this provision.

SUP 4.4.7R Amend as shown below:

An *appropriate actuary* must carry out the triennial investigation and prepare an abstract of ~~the report~~ as required by *IPRU(FSOC) 5.2(2)* ~~{number to be inserted later}~~ and provide the interim certificate or statement as required by *IPRU(FSOC) 5.2(3)*.

Chapter 10 Approved persons

SUP 10.1.16R Insert a comma before "as they apply".

Chapter 11 Controllers and close links

SUP 11.1.2R Amend as shown below:

	Category of firm	Applicable sections
(1)	A UK domestic firm <u>other than a non-directive friendly society</u>	All except SUP 11.3 and SUP 11.4R
(2)	A <u>non-directive friendly society</u>	SUP11.1, SUP 11.2, and SUP 11.9
(3)	An overseas firm	.....

SUP 11.1.3G Before "*friendly societies*", add "*directive*".

SUP 11.1.5G Before "*friendly societies*", add "*directive*".

SUP 11.3.11G Add the following at the end:

"Regulations 7 to 9 of the Financial Services and Markets Act 2000 (Service of Notices) Regulations 2001 (SI 2001/1420) govern the manner in which a notice of *control* may be submitted. In summary, it should be delivered or *posted* to the *FSA*'s address as shown on the Forms, and will be treated as given when it is received by the *FSA*. It should not be sent by fax or electronic mail."

Chapter 12

SUP 12.2.13G(3) Delete this provision.

SUP 12.6.8G In the first sentence, after "of a *firm*", add ", other than an *introducer appointed representative*,".

SUP 12.6.8(1) After "*appointed representative*", add ", other than an *introducer appointed representative*,".

Chapter 15 Notifications to the FSA

Annex 1R Amend as follows:

(a) in the heading and in paragraph 1, replace "this chapter" with "*SUP 15*";

(b) in paragraph 2, move "only" to come after "*services*" rather than after "*permission*";

- (c) in the table, third column, second row, insert "*SUP*" before "15.3.1R(1)";
- (d) in the table, third column, rows 3, 5, 6, 7 and 10, set out " in so far" as three words;
- (e) in the table, third column, row 11, replace from "but such a firm" to "automatic authorisation)." with "but see *SUP* 14 (Incoming EEA firms: changing authorisation and cancelling qualification for authorisation).";
- (f) add a new row at the end of the table as follows:

<i>SUP</i> 15.8	Notifications in respect of particular products and services	Applies in full
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Chapter 16 Reporting requirements

SUP 16.1.3R In the row entitled *SUP* 16.7, replace "*Bank*" with "*Bank, other than an EEA bank with permission for cross border services only*".

SUP 16.3.7R Replace this provision with the following:

"A report required under this chapter must:

- (1) give the *firm's* FSA firm reference number; and
- (2) if submitted in paper form, be submitted with the cover sheet contained in *SUP* 16 Ann 13R."

SUP 16.3.15G Replace this provision with the following:

"The *FSA* may from time to time send reminders to *firms* when reports are overdue. *Firms* should not, however, assume that the *FSA* has received a report merely because they have not received a reminder."

SUP 16.4.7G For "and indicate all the *firms* on whose behalf it is submitted" substitute ", indicate all the *firms* on whose behalf it is submitted and give their FSA firm reference numbers".

SUP 16.5.6G For "and indicate all the *firms* on whose behalf it is submitted" substitute ", indicate all the *firms* on whose behalf it is submitted and give their FSA firm reference numbers".

SUP 16.6.7R For the Note, substitute the following:

"Note = The quarter ends are 31 March, 30 June, 30 September, 31 December."

SUP 16.7.5R In first row, replace "*Bank*" with "*Bank, other than an EEA bank with permission for cross border services only*".

SUP 16.7.8R Amend as follows:

(a) Note 2, and the cross-references to it in the table, become Note 3;

(b) Note 3, and the cross-references to it in the table, become Note 4;

(c) Note 4, and the cross-references to it in the table, become Note 5;

(d) insert a new Note 2 as follows:

"Note 2 = The requirement to submit consolidated reports applies only to a *bank* which calculates its capital requirements on a consolidated basis. See *IPRU(BANK)* GN 3.3.13R(2) and *IPRU(BANK)* CS 4. All consolidated reports required on a half yearly basis must be prepared as at the end of June and December of each year. ";

(e) insert the cross-reference "(Note 2)" in the column of the table headed "Form" in the rows entitled:

- "Adequate information on capital adequacy (Consolidated)";
- "Analysis of large exposures (Consolidated)"; and
- "Adequate information on holdings of credit and financial institutions' and non-financial companies' capital instruments (Consolidated)";

(f) insert a new Note 6 as follows:

"Note 6 = Reports required on a quarterly basis must be prepared as at the end of March, June, September and December of each year, except that a *bank*, which submits the BT report to the Bank of England monthly, must prepare the Form LR (Adequate information on mismatch liquidity) as at the end of February, May, August and November each year.";

(g) in the column headed "Due date", after each reference to "after quarter end" insert "(Note 6)".

SUP 16.7.9R Replace "*EEA Bank*" with "*EEA Bank, other than one with permission for cross border services only*".

SUP 16.7.10R In the column headed "Due date", after "submitted electronically)", insert ". The report must be prepared as at the dates set out in Note 6 to SUP 16.7.8R."

SUP 16.7.12R Amend the column headed "Due date" as follows:

- (a) in the row containing a reference to "B7", after "submitted electronically)", insert ". Period ends are the end of June and December each year.";
- (b) in the row containing a reference to "LR", after "submitted electronically)", insert ". The report must be prepared as at the dates set out in Note 6 to SUP 16.7.8R."

SUP 16.7.12R In the column headed "Form", delete "(Note 2)".

SUP 16 Ann 12G Amend as follows:

- (a) in paragraph 1.(3), for "an *approved person* who works in the *firm's trustee area*" substitute "an *approved person* who has responsibility for the *firm's trustee area*";
- (b) in paragraph 2.(3), for "an *approved person* who works in the *firm's depositary area*" substitute "an *approved person* who has responsibility for the *firm's depositary area*";
- (c) in Form 2, Table 1, fourth column, for "manager's" substitute "ACD's".

SUP 17 Annex 5G: Regulated markets

Replace the existing text with the following:

- 1 Table List of the regulated markets notified to the Commission by the Member States under Article 16 of the *ISD* as at 22 March 2001

Austria

- 1. Amtlicher Handel (official market)
- 2. Geregelter Freiverkehr (semi-official market)
- 3. Amtlicher Handel NEWEX (official market)
- 4. Geregelter Freiverkehr NEWEX (semi-official market)

Belgium

- 1. Bourse de valeurs mobilières d'Euronext Brussels:
 - Le premier marché (official market)
 - Le second marché
 - Le nouveau marché
- 2. Belfox (Bourse belge des futures et options)
- 3. Le marché secondaire hors bourse des obligations linéaires, des titres scindés et des certificats de trésorerie
- 4. EASDAQ

Denmark

1. Københavns Fondsbørs
 - Equity market;
 - Bond market;
 - Derivatives market
2. Dansk Autoriseret Markedsplads A/S (Danish Authorised Market Place Ltd. (DAMP))
[authorised market place = regular trade in securities admitted for trading but not listed on stock exchange]

Finland

1. Arvopaperipörssi (Stock Exchange);
 - Päälista (Main List for equity and Debt Instruments);
 - I-, NM- ja Prelista (parallel Lists I-, NM-and pre-list for equity and debt instruments);
2. Optioyhteisö (Option Corporation).
(Derivatives exchange and clearing house).

France

1. Bourse de Paris:
 - Premier marché (official list);
 - Second marché;
 - Marché des EDR (European Depositary Receipts).
2. Nouveau marché
3. MATIFgi
4. MONEP

Germany

1. Berliner Wertpapierbörse: (Amtlicher Handel, Geregelter Markt)
2. Bremer Wertpapierbörse (Amtlicher Handel, Geregelter Markt)
3. Rheinisch-Westfälische Börse zu Düsseldorf (Amtlicher Handel, Geregelter Markt)
4. Frankfurter Wertpapierbörse (Amtlicher Handel, Geregelter Markt, Neuer Markt);
5. Eurex Deutschland
6. Hanseatische Wertpapierbörse Hamburg (Amtlicher Handel, Geregelter Markt, Start-up market)
7. Niedersächsische Börse zu Hannover (Amtlicher Handel, Geregelter Markt)
8. Bayerische Börse (Amtlicher Handel, Geregelter Markt)
9. Baden-Württembergische Wertpapierbörse (Amtlicher Handel, Geregelter Markt)

Greece

1. Athens Stock Exchange (A. S. E.)/Thessaloniki Stock Exchange Centre (T. S. E. C. = remote platform)
 - Main Market
 - Parallel Market
 - Parallel Market for Emerging Markets
 - New Market
2. Athens Derivatives Exchange (A. D. EX.)

Ireland

- Irish Stock Exchange comprising:
- Official List
 - Exploration Securities Market
 - Developing Companies Market
 - ITEQ

Italy

1. Stock Exchange, divided into the following segments:
 - Electronic share market (MTA);
 - Electronic covered warrants market (MCW);
 - After-Hours Market (TAH);
 - Electronic bond and government securities market (MOT);
 - Electronic market for Eurobonds, foreign bonds and asset-backed securities (EuroMOT);

- Electronic traditional options market (MPR);
- 2. Mercato Ristretto (second market);
- 3. Derivatives market (IDEM);
- 4. Nuovo Mercato (New Market -NM);
- 5. Italian Government Securities Derivatives Market (MIF);
- 6. Wholesale Market for Government Securities (MTS);
- 7. Wholesale Market for Corporate and International Organisations Bonds.

Luxembourg

Bourse de Luxembourg:

- Main market;
- International Bond market

Netherlands

Amsterdam Stock exchange (AEX):

- Main market
- Domestic market for unlisted securities:
- Nieuwe Markt Amsterdam

Portugal

1. Mercado de Cotações Oficiais (Official Quotation Market)
2. Segundo Mercado (Second Market)
3. Novo Mercado (New Market)
4. Mercado de Futuros e Opções (Futures and Options Market)
5. MEOG – Mercado Especial de Operações por Grosso (Special Market for Block Trading)
6. MEDIP – Mercado Especial de Dívida Pública (Special Market for Public Debt)

Spain

- A. Bolsas de Valores (all comprise first, second and new market segments)
 1. Bolsa de Valores de Barcelona;
 2. Bolsa de Valores de Bilbao;
 3. Bolsa de Valores de Madrid;
 4. Bolsa de valores de Valencia.
- B. Mercados oficiales de Productos Financieros Derivados
 1. MEFF Renta Fija;
 2. MEFF Renta Variable.
- C. Mercados FC&M de Futuros y Opciones sobre Cítricos [commodity derivatives not covered by section B annex ISD: related markets do not fall within ISD definition of “regulated market”]
- D. AIAF Mercado de Renta Fija
- E. Mercado de Deuda Pública en Anotaciones

Sweden

1. OM Stockholmsbörsen:
 - “A-list” market;
 - “OTC-list” (small companies);
 - “O-list” (unlisted companies)
2. OM Räntebörsen (fixed income);
3. SBI Marknadsplats
4. Aktietorget

United Kingdom

1. Domestic Equity Market
2. European Equity Market
3. Gilt Edged and Sterling Bond Market
4. Alternative Investment Market (AIM).
5. The London International Financial Futures and Options Exchange (LIFFE)
6. OM London
7. Tradepoint [this market has since changed its name to virt-x]
8. Coredeal (primarily a eurobond market)
9. Jiway

- 2 Table List of the regulated markets notified under Article 16 of the *ISD*, as included in point 30b of Annex IX to the Agreement of the European Economic Area, to the Standing Committee of the EFTA as defined in that agreement as at April 2001

Iceland
Iceland Stock Exchange (Verdbrefathing Islands)
Liechtenstein
Norway
The Oslo Stock Exchange

Chapter 19 Commodity Futures Trading Commission Part 30 exemption

SUP 19.1.1G Amend as follows:

- (a) renumber existing provision (2) as (3);
- (b) insert after a new provision (2) as follows:

"which carries on those activities from an establishment maintained by the *firm* in the *United Kingdom*;"

Appendix 2 Insurers: Scheme of operations

SUP App 2.6.1G For "*SUP* App 2.3 to App 2.6" substitute "*SUP* App 2.3 to App 2.5".

SUP App 2.7.1G For "*SUP* App 2.3 to App 2.6" substitute "*SUP* App 2.3 to App 2.5".

SUP App 2.9.1R(2) In the brackets, for "for" substitute "including".

SUP App 2.9.4R Insert the *IPRU(FSOC)* reference as "4.1".

SUP App 2.9.5G Insert the *IPRU(FSOC)* reference as "4.1".

SUP App 2.9.6G Insert *IPRU(FSOC)* reference as "4.1(2)".

SUP App 2.9.8R In row (7), before "class of insurance", add "accounting".

SUP App 2.10.1R For "*SUP* App 2.3 to App 2.6" substitute "*SUP* App 2.3 to App 2.5" and for "*SUP* 6.5" substitute "*SUP* 6.4".

SUP App 2.10.4G(7) Insert the *IPRU(INS)* reference as "11.1".

SUP App 2.11.1R(3) After "5%" add "in any one year".

SUP App 2.11.1R(4)(a) and (b) After "5%" add "in any one year".

COMPLAINTS SOURCEBOOK INSTRUMENT 2001

- A. The Financial Services Authority makes the rules and gives the guidance in this instrument (“DISP”), except those provisions which are made solely by the Financial Ombudsman Service Limited, in the exercise of the powers listed in Schedule 4 to DISP (Powers exercised).
- B. The instrument shall come into force as follows: (1) DISP 1.5.4R – DISP 1.5.7R come into force on 1 April 2002; (2) the remainder of this instrument comes into force at the beginning of the day on which section 19 of the Act (the general prohibition) of the Financial Services and Markets Act 2000 (“the Act”) comes into force.
- C. The provisions of the Act relevant to making rules and listed in Schedule 4 to DISP (Powers exercised) are specified for the purpose of section 153(2) of the Act (Rule-making instruments).
- D. This instrument may be cited as the Complaints Sourcebook Instrument 2001.
- E. This Annex to this instrument (including its Schedules) may be cited as Dispute resolution: the Complaints sourcebook (or DISP).

By order of the Board

20 September 2001

ANNEX



Dispute resolution: Complaints



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1 Table Transitional Provisions table

(1)	(2) Material provision to which transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1	<i>DISP</i> 1.2.15G	R	A firm must cease to use letter-headed paper or marketing literature which refers to its membership of a former scheme no later than 30 June 2002.	<i>Commencement</i> to 30.6.02	<i>Commencement</i>
2	<i>DISP</i> 1.5.4R – <i>DISP</i> 1.5.7R	R	A firm must include, in the first report which it submits to the FSA under <i>DISP</i> 1.5.4R in respect of the 1 April 2002 – 30 September 2002 reporting period, the total number of reportable complaints (that is, complaints subject to <i>DISP</i> 1.4 – <i>DISP</i> 1.6) which it has received but not closed by the beginning of that reporting period (including any such complaint which could be referred to the <i>Financial Ombudsman Service</i> as a relevant new complaint under the <i>Ombudsman Transitional Order</i>.	01.4.02 – 31.10.02	01.4.02

(1)	(2) Material provision to which transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
3	<i>DISP</i> 1.5.4R – <i>DISP</i> 1.5.7R	G	Transitional provision 2R requires a <i>firm</i> , in addition to complying with the reporting requirements in <i>DISP</i> 1.5.4R, to include in its first report under <i>DISP</i> 1.5.4R the total number of complaints subject to <i>DISP</i> 1.4 – <i>DISP</i> 1.6 which remain open at the beginning of that reporting period (that is, on 1 April 2002). This will enable the <i>FSA</i> to know how many complaints were carried forward into the first reporting period. (A <i>firm</i> is not required to provide a breakdown by category code or generic product type of the complaints carried forward at 1 April 2002, but must do so in respect of complaints received during the 1 April 2002 to 30 September 2002 reporting period and in respect of subsequent reporting periods.)	01.4.02 – 31.10.02	01.4.02
4	<i>DISP</i> App 1	R	<i>Firms are subject to DISP App 1 in relation to relevant existing complaints.</i>	From commencement	Commencement
5	<i>DISP</i> App 1	G	The <i>Ombudsman Transitional Order</i> makes special provision for the handling by <i>FOS Ltd</i> of "relevant existing complaints" (that is, complaints which the former schemes have partly completed at commencement). The arrangements for handling these complaints are set out in <i>DISP</i> App 1. (The handling of complaints which <i>firms</i> have partly completed at commencement is described at <i>DISP</i> 1.4.6R.)	From commencement	Commencement
6	<i>DISP</i> 2, <i>DISP</i> 3, <i>DISP</i> 5 and <i>DISP</i> App 1	R	<i>In DISP 2, DISP 3, DISP 5 and DISP App 1, references to a "firm" or "firms" include unauthorised persons subject to the Compulsory Jurisdiction in relation to relevant complaints in accordance with the Ombudsman Transitional Order.</i>	From commencement	Commencement

(1)	(2) Material provision to which transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
7	<i>DISP 2, DISP 3, DISP 5 and DISP App 1</i>	G	Under the <i>Ombudsman Transitional Order</i> , a <i>relevant complaint</i> is subject to the <i>Compulsory Jurisdiction</i> whether or not it is about a <i>firm</i> or an <i>unauthorised person</i> . <i>Unauthorised persons</i> are not subject to <i>DISP 1</i> , but references to "firm" in <i>DISP 2, DISP 3, DISP 5 and DISP App 1</i> include <i>unauthorised persons</i> subject to the <i>Compulsory Jurisdiction</i> in relation to <i>relevant complaints</i> , where applicable.	From commencement	Commencement
8	<i>DISP 1, DISP 2, DISP 3, DISP 4, DISP 5 and DISP App 1</i>	R	In relation to <i>relevant complaints</i>, references in <i>DISP 1, DISP 2, DISP 3, DISP 4, DISP 5 and DISP App 1</i> to an "eligible complainant" include a person who is to be treated as an <i>eligible complainant</i> in accordance with the <i>Ombudsman Transitional Order</i> and references to a complaint shall be construed accordingly.	From commencement	Commencement

COMPLAINTS SOURCEBOOK

DISPUTE RESOLUTION: COMPLAINTS

Introduction

Access for retail consumers to mechanisms for dealing with complaints about financial services *firms* is a key part of the regulatory regime. The *Act* gives the *FSA* the power to make rules relating to the handling of complaints by *firms* and provides for the establishment of an independent dispute resolution scheme (the *Financial Ombudsman Service*) to resolve complaints about financial services *firms* quickly and with minimum formality. The body established to administer and operate this scheme (the “scheme operator”) is the Financial Ombudsman Service Limited (“*FOS Ltd*”).

This module of the *FSA Handbook* contains the rules and guidance relating to the handling of complaints by *firms* and to the operation of the *Financial Ombudsman Service*. Responsibility for the rules relating to the *Financial Ombudsman Service* is shared under the *Act* between the *FSA* and the *FOS Ltd*, with those rules and other requirements written by the *FOS Ltd* being subject to approval by, or the consent of, the *FSA*.

Under the *Act*, the *Financial Ombudsman Service* comprises two jurisdictions:

- (a) The *Compulsory Jurisdiction* covers *firms* which are required to participate in the *Financial Ombudsman Service* in respect of complaints about activities specified by the *FSA* [and *unauthorised persons* subject to the *Compulsory Jurisdiction* in relation to *relevant complaints*];
- (b) The *Voluntary Jurisdiction* can cover financial services activities not included in the *Compulsory Jurisdiction*. Both *firms* and *unauthorised firms* can participate in the *Voluntary Jurisdiction* by contractual agreement with the *FOS Ltd* (in accordance with the *Standard Terms* – see below) and are known as *VJ participants*.

Although the authority to make the rules relating to the *Compulsory Jurisdiction* and the *Voluntary Jurisdiction* derives from different sections of the *Act*, the provisions have been co-ordinated to ensure that, wherever possible, they are identical.

Chapter 1: Complaint handling procedures for firms

These rules set out the complaint handling procedures which *firms* capable of giving rise to an eligible complaint under the *Compulsory Jurisdiction* (see Chapter 2) must establish. They are made by the *FSA* under section 138 of the *Act* and paragraph 13 of Schedule 17 to the *Act*. These rules, with some exceptions, are applied to *VJ participants* by contract via the *Standard Terms* set by the *FOS Ltd* (Chapter 4).

Chapter 2: Jurisdiction rules

These rules set out the scope of the *Compulsory Jurisdiction* and the *Voluntary Jurisdiction* of the *Financial Ombudsman Service*. They specify who can refer a complaint to the *Financial Ombudsman Service* and the time limits for doing so, as well as which activities are covered by the *Compulsory Jurisdiction* and the *Voluntary Jurisdiction*. The rules also set out the territorial scope of the *Financial Ombudsman Service*. They are relevant to consumers who may wish to refer complaints to the *Financial Ombudsman Service*; to firms which are subject to the *Compulsory Jurisdiction*; to *unauthorised persons* who are subject to the *Compulsory Jurisdiction* in relation to *relevant complaints*; to *VJ participants* and to the *Ombudsman* himself. The rules relating to the scope of the *Compulsory Jurisdiction* are made by the *FSA* (under section 226 of the *Act*); the rules relating to the scope of the *Voluntary Jurisdiction* are made by the *FOS Ltd*, with *FSA* approval (under section 227). The rules relating to the time limits for referring a complaint to the *Financial Ombudsman Service* are made by the *FSA* under paragraph 13 of Schedule 17 to the *Act* and are applied to *VJ participants* by contract via the *Standard Terms* set by the *FOS Ltd*.

Chapter 3: Complaint handling procedures of the Financial Ombudsman Service

These rules apply to the *Ombudsman*, to *firms*, and to *unauthorised persons* who are subject to the *Compulsory Jurisdiction* in relation to *relevant complaints*. They are also relevant to complainants. They set out how the *FOS Ltd* and, in particular, the *Ombudsman* will handle complaints under the *Financial Ombudsman Service*. For the purposes of the *Compulsory Jurisdiction*, they comprise the scheme rules and the costs rules (made by the *FOS Ltd*, with *FSA* consent or approval, under paragraph 14 of Schedule 17 and section 230 respectively) and rules made by the *FSA* on the kinds of loss or damage that can be compensated, including the maximum amount which can be awarded (s229). These procedural rules are applied to *VJ participants* via the *Standard Terms*.

Chapter 4: The Standard Terms

The *Standard Terms* are made, with *FSA* approval, by the *FOS Ltd* under paragraph 18 of Schedule 17 to the *Act* and are the contractual terms by which *VJ participants* participate in the *Voluntary Jurisdiction*.

Appendix 1: Relevant Existing Complaints

The *Ombudsman Transitional Order*, made by HM Treasury under sections 426-428 of the *Act*, extends the scope of the *Financial Ombudsman Service* to enable it to deal with complaints about pre-commencement business where these could have been handled by a former scheme ("*relevant complaints*") and makes special provision for the handling of these complaints.

It distinguishes between:

- (a) *relevant existing complaints* (ie complaints referred to, but not determined by, a former scheme (other than the *Personal Insurance Arbitration Service*) before commencement (see article 2 of the *Ombudsman Transitional Order*); and

- (b) *relevant new complaints* (ie complaints referred to the *Financial Ombudsman Service* after *commencement* which relate to a pre-*commencement* act or omission, in respect of which the *firm* was, immediately before *commencement*, subject to a *former scheme*) (see article 3 of the *Ombudsman Transitional Order*).

The Order enables the *FOS Ltd*, with only a few exceptions, to handle *relevant new complaints* in accordance with its new procedures, as set out in *DISP* 1 to 5 and these are covered in the main body of the *DISP* rules. Except as otherwise indicated, the term "complaint" in *DISP* 1 to 5 therefore includes a *relevant new complaint*.

However, the *Ombudsman Transitional Order* makes different provision for the handling of *relevant existing complaints* (ie complaints which the *former schemes* have partly completed at *commencement*). These complaints will be passed over to the *Financial Ombudsman Service* by the *former schemes* (except the | *Personal Insurance Arbitration Service*) at *commencement* and the *Ombudsman Transitional Order* requires the *FOS Ltd* to complete the handling of these cases. However, it provides that the *Financial Ombudsman Service* must do this, in a significant number of respects, in accordance with the procedures of the relevant *former scheme*. The arrangements for dealing with these complaints are set out in *DISP* App 1. This describes the ways in which *relevant existing complaints* must be treated differently from other complaints dealt with under the *Financial Ombudsman Service*, but cross refers to the provisions in *DISP* 1 to 5, where appropriate. (*DISP* 1 explains how complaints which are partly completed by *firms* (as distinct from *former schemes*) at *commencement* are to be handled.)

Appendix 2: FSA's guidance on handling mortgage endowment complaints

DISP App 2 contains FSA's guidance to *firms* on handling mortgage endowment complaints..

Chapter 1

Complaint handling procedures for firms

1.1 Application and Purpose

Application

- 1.1.1** **R** _{/1} This chapter applies to every *firm* in respect of activities carried on from an establishment maintained by the *firm* (or its *appointed representative*) in the *United Kingdom*, except:
- (1) (a) a *firm* that is exempt under *DISP* 1.1.7R;
 - (b) a *UCITS* *qualifier*;
 - (c) an *authorised professional firm* in so far as its *non-mainstream regulated activities* are concerned; and
- (2) in relation to the *Society of Lloyd's*, *members of the Society* and *managing agents*, *DISP* 1 applies subject to *DISP* 1.7 (the *Society of Lloyd's*).
- 1.1.2** **G** _{/1} This chapter is also relevant to those who might wish to refer a complaint to the *Financial Ombudsman Service*.
- 1.1.3** **G** _{/1} *Firms* are responsible for ensuring their *appointed representatives'* compliance with *DISP* 1.
- 1.1.4** **G** _{/1} *VJ participants* are subject to *DISP* 1, except *DISP* 1.1.5R and *DISP* 1.5 (Record keeping and reporting), by contract under the *standard terms* (see *DISP* 4). *DISP* 1.2 applies to *VJ participants* only in relation to complaints about activities of the *VJ participant* specified in *DISP* 2.6.9R.
- 1.1.5** **R** _{/1} Except as otherwise specified, references to a "complaint" in this chapter include a complaint which is capable of becoming a *relevant new complaint*.
- 1.1.6** **G** _{/1} A complaint about pre-commencement investment business carried on by a *firm* which was regulated in respect of that business by a *recognised professional body* will be handled under the arrangements of that *professional body*, and is outside the scope of *DISP*.

Exemption

1.1.7 **R** ^{/1} A *firm* which does not conduct business with *eligible complainants* and has no reasonable likelihood of doing so is exempt from *DISP* 1.2 – *DISP* 1.7, if it notifies the *FSA* in writing of this fact and that notice remains current, with effect from the date that notice is received by the *FSA*.

1.1.8 **R** ^{/1} A notice under *DISP* 1.1.7R must be given:

- (1) by 28 February 2002, in which case it will remain current until 31 March 2003; or
- (2) before, or as soon as practicable after, the time of the *firm's* *authorisation* by the *FSA*, in which case it will remain current until the end of the *financial year* in which it is given; or
- (3) as soon as practicable after the *firm* ceases to conduct business with *eligible complainants*, in which case it will remain current until the end of the *financial year* in which it is given; or
- (4) in February of each *financial year* (beginning with February 2003), in which case it will remain current until the end of the next *financial year*.

1.1.9 **G** ^{/1} A notice under *DISP* 1.1.7R will be renewable every 12 *months*.

End of exemption

1.1.10 **R** ^{/1} A *firm* which is exempt under *DISP* 1.1.7R must notify the *FSA* if the conditions in *DISP* 1.1.7R no longer apply.

1.1.11 **G** ^{/1} A *firm* to which the conditions in *DISP* 1.1.7R no longer apply is subject to *DISP* 1.2 – *DISP* 1.7.

Purpose

1.1.12 **G** ^{/1} The purpose of this chapter is to set out the rules relating to the internal handling of complaints by *firms*, including the procedures which a *firm* must put in place; the time limits within which a *firm* must deal with a complaint; the records of a complaint which a *firm* must make and retain; and the requirements on a *firm* to report information about complaints to the *FSA*. This is to ensure that complaints are handled fairly, effectively and promptly, and resolved at the earliest possible opportunity, minimising the number of unresolved complaints which need to be referred to the *Financial Ombudsman Service*. This purpose is consistent with the *FSA's* consumer protection regulatory objective.

1.2 Internal complaint handling procedures: general requirements

Requirement to have internal complaint handling procedures

- 1.2.1** **R** _{/1} A *firm* must have in place and operate appropriate and effective internal complaint handling procedures (which must be written down) for handling any expression of dissatisfaction, whether oral or written, and whether justified or not, from or on behalf of an *eligible complainant* about that *firm's* provision of, or failure to provide, a financial service.
- 1.2.2** **G** _{/1} An *eligible complainant* is a *person* who would be eligible to refer a complaint to the *Financial Ombudsman Service*, as defined in *DISP* 2.4.
- 1.2.3** **G** _{/1} *Firms* are not obliged to restrict their internal complaint handling procedures to expressions of dissatisfaction from *eligible complainants*. They may, if they wish, also establish procedures for handling complaints from other customers.
- 1.2.4** **G** _{/1} The internal complaint handling procedures should provide for:
- (1) receiving complaints;
 - (2) responding to complaints;
 - (3) the appropriate investigation of complaints; and
 - (4) notifying complainants of their right to go the *Financial Ombudsman Service* where relevant.
- 1.2.5** **G** _{/1} When deciding what constitutes an appropriate complaint handling procedure (see *DISP* 1.2.1R), a *firm* should have regard to:
- (1) the type of business it undertakes;
 - (2) its size and organisational structure;
 - (3) the nature and complexity of the complaints it is likely to receive; and
 - (4) the likely number of complaints it will receive and have to investigate.
- 1.2.6** **G** _{/1} *DISP* 1.2.1R does not prevent the use of a third party administrator for the purposes of handling complaints.

1.2.7 G /1 In establishing their internal complaint handling procedures, *firms* may wish to take account of British Standard 8600:1999 “Complaints Management Systems - Guide to Design and Implementation”. This is available on request from the *FSA*.

1.2.8 G /1 The internal complaint handling procedures should enable complainants to make a complaint by any reasonable means (for example, letter, telephone, e-mail or in person).

Publicising the procedures

1.2.9 R /1 **A *firm* must:**

- (1) **refer in writing to the availability of its internal complaint handling procedures at, or immediately after, the point of sale;**
- (2) **publish details of its internal complaint handling procedures, supply a copy on request, and supply a copy automatically to the complainant when it receives a complaint (unless the complaint is resolved by close of business on the next *business day*); and**
- (3) **display in each of its branches or sales offices to which *eligible complainants* have access a notice indicating that it is covered by the *Financial Ombudsman Service*.**

1.2.10 G /1 The requirements in *DISP* 1.2.9R(1)-(3) relate to the internal complaints procedures required by *DISP* 1.2.1R.

1.2.11 G /1 In order to comply with *DISP* 1.2.9R(1), a *firm* may include reference to its complaint handling procedures in contractual documentation, for example, (where the *firm* is subject to the requirements in *COB*) in a *terms of business* letter, *key features document* or *client agreement*.

1.2.12 G /1 Where a complaint is also subject to the more detailed requirements in *DISP* 1.4 - *DISP* 1.6, the *firm* may send out a copy of its complaint handling procedures (as required by *DISP* 1.2.9R (2)) at the same time as the acknowledgement required by *DISP* 1.4.1R.

1.2.13 G /1 For the purposes of satisfying *DISP* 1.2.9R(2) a *firm* may wish to produce a leaflet which summarises its internal complaint handling procedures.

1.2.14 G /1 *Firms’* literature and correspondence relating to complaints should be in clear and plain language.

1.2.15 G /1 A *firm* may also, if it wishes to do so, disclose the fact that it is covered by the *Financial Ombudsman Service* by including the *Financial Ombudsman Service* logo in any marketing literature or correspondence directed at *eligible complainants*, provided that it does so in a way which is not misleading.

Particular matters for which procedures must make provision

1.2.16 R /1 **A *firm’s* internal complaint handling procedures under *DISP* 1.2.1R must make provision for:**

- (1) complaints to be investigated by an employee of sufficient competence who, where appropriate, was not directly involved in the matter which is the subject of the complaint;
- (2) the *person* charged with responding to complaints to have the authority to settle complaints (including the offering of redress where appropriate) or to have ready access to someone who has the necessary authority; and
- (3) responses to complaints to address adequately the subject matter of the complaint and, where a complaint is upheld, to offer appropriate redress.

Providing compensation

- 1.2.17 **R** /1 Where a *firm* decides that redress is appropriate, a *firm* must provide a complainant with fair compensation for any acts or omissions for which it was responsible and comply with any offer of redress which the complainant accepts.
- 1.2.18 **G** /1 In deciding whether or not to accept a complaint and what would be appropriate redress, *firms* may wish to consider any relevant guidance published by the FSA, the *Financial Ombudsman Service* or by any of the *former schemes*.
- 1.2.19 **G** /1 Appropriate redress will not always involve financial redress. It may, for example, simply involve an apology. Where financial redress is deemed appropriate, it may include a reasonable rate of interest.
- 1.2.20 **G** /1 *DISP* App 2 contains *guidance* to *firms* on the approach to assessing financial loss and appropriate compensation in circumstances where a *firm* regards a complaint in relation to the sale of an endowment policy (which is sold for the purposes of repaying a mortgage) as justified.

Using the procedures

- 1.2.21 **R** /1 A *firm* must take reasonable steps to ensure that all relevant employees (including employees of *appointed representatives*) are aware of the *firm's* internal complaint handling procedures and must endeavour to ensure that they act in accordance with them.
- 1.2.22 **R** /1 A *firm* must put in place appropriate management controls and take reasonable steps to ensure that in complying with *DISP* 1.2.1R it handles complaints fairly, consistently and promptly and that it identifies and remedies any recurring or systemic problems, as well as any specific problem identified by a complaint.



1.3 Internal complaint handling procedures: additional requirements

- 1.3.1** **G**_{/1} *DISP 1.4-DISP 1.6* contain additional requirements, concerning time limits, record keeping and reporting and cooperation with the *Ombudsman*, for handling complaints, unless *DISP 1.3.3R* applies.
- 1.3.2** **R**_{/1} *DISP 1.4-DISP 1.6* also apply to any complaints that are capable of becoming *relevant new complaints*, unless *DISP 1.3.3R* applies.
- 1.3.3** **R**_{/1} *DISP 1.4 – DISP 1.6* do not apply:
- (1) where the *firm* has taken reasonable steps to determine, and has determined, that the complaint:
 - (a) is not made by, or on behalf of, an *eligible complainant*; or
 - (b) does not relate to an activity of that *firm* which comes under the jurisdiction of the *Financial Ombudsman Service*; or
 - (c) does not involve an allegation that the complainant has suffered, or may suffer, financial loss, material distress or material inconvenience; or
 - (2) where the complaint has been resolved by close of business on the *business day* following its receipt.
- 1.3.4** **G**_{/1} Under the *Ombudsman Transitional Order*, a complaint received by a *firm* either before or after *commencement* is capable of becoming a *relevant new complaint*. A *firm* is expected to handle such complaints in accordance with *DISP 1*. However, where a *firm* has already received, but only partly completed the handling of, such a complaint by *commencement*, *DISP 1.4.6R* recognises that this may not always be practicable.
- 1.3.5** **G**_{/1} Financial loss includes consequential or prospective loss, in addition to actual loss. For example, a complaint may involve an allegation that the complainant may suffer financial loss which has not yet crystallised because of the type of product involved (for example, pensions, endowments etc).

1.4 Time limits for dealing with a complaint

Written acknowledgement within five business days

1.4.1 **R** ^{/1} A *firm* must send a written acknowledgement of a complaint within five *business days* of its receipt, giving the name or job title of the individual handling the complaint for the *firm* (together with details of the *firm*'s internal complaint handling procedures).

1.4.2 **G** ^{/1} A *firm* which is able to provide a *final response* within five *business days* of receipt of a complaint may combine its acknowledgement of the complaint with the *final response*. (For complaints which are subject to the FSAVC review, see *DISP* 1.4.15R to *DISP* 1.4.17G.)

1.4.3 **G** ^{/1} A *firm* should aim to resolve complaints at the earliest possible stage.

Final or holding response within four weeks

1.4.4 **R** ^{/1} A *firm* must, within four weeks of receiving a complaint, (unless *DISP* 1.4.7R or *DISP* 1.4.9R applies) send the complainant either:

- (1) a *final response*; or
- (2) a holding response, which explains why it is not yet in a position to resolve the complaint and indicates when the *firm* will make further contact (which must be within eight weeks of receipt of the complaint).

Final or other response within eight weeks

1.4.5 **R** ^{/1} A *firm* must, by the end of eight weeks after its receipt of a complaint, (unless *DISP* 1.4.7R or *DISP* 1.4.9R applies) send the complainant either:

- (1) a *final response*; or
- (2) a response which:

- (a) explains that the *firm* is still not in a position to make a *final response*, gives reasons for the further delay and indicates when it expects to be able to provide a *final response*; and
- (b) informs the complainant that he may refer the complaint to the *Financial Ombudsman Service* if he is dissatisfied with the delay and encloses a copy of the *Financial Ombudsman Service's* explanatory leaflet.

Complaints being dealt with at commencement

1.4.6

R

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Where, at *commencement*, a *firm* is still dealing with a complaint that is capable of being referred to the *Financial Ombudsman Service* as a *relevant new complaint*:

- (1) it may continue to try to resolve the complaint in accordance with its *pre-commencement* complaints procedures; but
- (2) it must, within eight weeks of *commencement*, send the complainant a response which satisfies *DISP 1.4.5R*, unless *DISP 1.4.7R* or *DISP 1.4.9R* applies)

Early resolution of complaints

1.4.7

R

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DISP 1.4.4R to *DISP 1.4.6R* do not apply if the complainant has already indicated in writing acceptance of a response by the *firm*, provided that the response informed the complainant how to pursue his complaint if he remained dissatisfied.

1.4.8

G

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DISP 1.4.7R recognises that a response by the *firm* will not necessarily be its *final response* but that it may, nonetheless, resolve the complaint.

Firms with two-stage complaints procedures

1.4.9

R

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Where, within eight weeks of receiving a complaint, the *firm* sends the complainant a written response which:

- (1) offers redress (whether or not it accepts the complaint) or rejects the complaint and gives reasons for doing so;
- (2) informs the complainant how to pursue his complaint with the *firm* if he remains dissatisfied;
- (3) refers to the ultimate availability of the *Financial Ombudsman Service* if he remains dissatisfied with the *firm's* response; and

- (4) indicates that it will regard the complaint as closed if it does not receive a reply within eight weeks;

the *firm* is not obliged to continue to comply with *DISP* 1.4.4R or *DISP* 1.4.5R unless the complainant indicates that he remains dissatisfied, in which case, the obligation to comply with *DISP* 1.4.5R resumes.

1.4.10

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If the complainant takes more than a week to reply to a written response of the kind described in *DISP* 1.4.9R, the additional time in excess of a week will not count for the purposes of the time limits in *DISP* 1.4.4R-*DISP* 1.4.6R.

1.4.11

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- (1) *DISP* 1.4.9R caters for the situation where a *firm's* complaints procedures provide for a complainant who is dissatisfied with the *firm's* response to refer the complaint back to the *firm* again or to the *firm's* head office before a *final response* is issued.
- (2) Such *firms* are subject to the time limits in *DISP* 1.4.4R to *DISP* 1.4.6R in the same way as any other *firm*. However, *DISP* 1.4.9R recognises that some complainants may never respond to a *firm* or may take a long time to do so.
- (3) Provided that the *firm* has sent a letter which complies with the conditions in *DISP* 1.4.9R within eight weeks of receiving the complaint:
- (a) if the complainant does not reply at all, the *firm* is not required to send a *final response*;
 - (b) if the complainant does not reply within eight weeks of the *firm's* letter, *DISP* 1.5.7R(3) enables the *firm* to treat the complaint as a closed complaint for the purposes of the reporting requirement in *DISP* 1.5.4R;
 - (c) if the complainant does reply (within or after eight weeks), the *firm* is required to continue to comply with *DISP* 1.4.5R, and the time limits in *DISP* 1.4.5R therefore resume. But *DISP* 1.4.10R allows the *firm* to discount, for the purposes of the time limits in *DISP* 1.4.4R to *DISP* 1.4.6R, any time in excess of a week taken by the complainant to reply.
- (4) The *FSA* expects that *firms* operating a two-stage complaints procedure will wish to provide complainants with easy access to the second stage of the process (for example, by referring complaints on to the next stage for them if they remain dissatisfied).

The final response

1.4.12

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When a *firm* sends a complainant its *final response*, the *final response* must:

- (1) inform the complainant that he may refer the complaint to the *Financial Ombudsman Service* if he is dissatisfied with the *final response* and that he must do so within six *months*; and

(2) enclose a copy of the *Financial Ombudsman Service's* explanatory leaflet (unless it has already done so under *DISP 1.4.5R(2)(b)*).

1.4.13

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Copies of the *Financial Ombudsman Service's* explanatory leaflet may be reproduced under licence or can be obtained from the *Financial Ombudsman Service*.

1.4.14

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Under *DISP 1.4.5R* and *DISP 1.4.6R*:

- (1) a complainant can refer his complaint to the *Financial Ombudsman Service* if he receives a *final response* with which he is dissatisfied or the *firm* has had at least eight weeks to resolve the complaint and has failed to do so in that time; the complainant may decide whether to give the *firm* more time before exercising any right he may have to refer a complaint to the *Financial Ombudsman Service*;
- (2) the six *month* time limit within which a complainant must refer a complaint to the *Financial Ombudsman Service* begins at the date when the *final response* is sent by the *firm*.

Complaints subject to the FSAVC review

1.4.15

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DISP 1.4.1R to *DISP 1.4.14G* and *DISP 1.5.1R* and *DISP 1.5.4R* do not apply where the complaint is subject to a review directly or indirectly under the terms of the policy statement for the review of specific categories of FSAVC business issued by the *FSA* on 28 February 2000.

1.4.16

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Where *DISP 1.4.15R* applies, the *firm* must, if the complainant remains dissatisfied on completion of that review, treat that expression of dissatisfaction as a complaint and comply with *DISP 1.4.1R-DISP 1.4.14G*, *DISP 1.5.1R* and *DISP 1.5.4R*.

1.4.17

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The effect of *DISP 1.4.15R* is to relieve the *firm* of the obligation to comply with the requirements and time limits for replying to complainants, and the record-keeping and reporting requirements in *DISP 1.5.1R* and *DISP 1.5.4R*, where a complaint is subject to the FSAVC review. However, if a complainant remains dissatisfied with the outcome of the review, *DISP 1.4.16R* requires the *firm* to treat this as a complaint and comply with these requirements just as it would in respect of any other complaint. *Firms* are therefore required to record and report such complaints only where they receive a complaint about the outcome of the review.

1.5 Record keeping and reporting

Making and retaining records of complaints

1.5.1 **R** ^{/1} A *firm* must make and retain records of complaints subject to *DISP* 1.4 – *DISP* 1.6 for a minimum period of three years from the date of its receipt of the complaint.

1.5.2 **G** ^{/1} The records required by *DISP* 1.5.1R are for the purposes of monitoring by the *FSA* and also to ensure that the *firm* is able to cooperate, as necessary, with the *Financial Ombudsman Service*. They should include:

- (1) the name of the complainant;
- (2) the substance of the complaint; and
- (3) any correspondence between the *firm* and the complainant, including details of any redress offered by the *firm*.

1.5.3 **G** ^{/1} *DISP* 4.2.3G covers record keeping by *VJ participants*.

Reporting complaints to the *FSA*

1.5.4 **R** ^{/1} A *firm* must provide the *FSA*, twice a year, with a report containing (for the relevant reporting period) information about:

- (1) the total number of complaints subject to *DISP* 1.4 – *DISP* 1.6 received by the *firm*, broken down according to the categories and in respect of each of the generic product types listed at *DISP* 1 Ann 1R which are relevant to the *firm*; and
- (2) the total number of complaints subject to *DISP* 1.4 - *DISP* 1.6 closed by the *firm*:
 - (a) within four weeks or less of receipt;
 - (b) within four to eight weeks of receipt; and
 - (c) more than eight weeks after receipt; and

(3) the total number of complaints subject to *DISP 1.4 - DISP 1.6* outstanding at the end of the reporting period.

1.5.5

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Where a complaint could fall into more than one category, the complaint should be recorded in the category which the *firm* considers to form the main part of the complaint.

1.5.6

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For the purposes of *DISP 1.5.4R*:

- (1) the relevant reporting periods are from 1 April to 30 September and from 1 October to 31 March each year; and
- (2) reports are to be submitted to the *FSA* within one *month* of the end of the relevant reporting period.

Reporting: when is a complaint closed?

1.5.7

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For the purpose of *DISP 1.5.4R(2)*, a closed complaint is a complaint:

- (1) where the *firm* has sent a *final response*; or
- (2) where the complainant has indicated in writing acceptance of the *firm's* earlier response; or
- (3) where *DISP 1.4.9R* applies, provided that the complainant has not responded to the *firm* within eight weeks of the written response referred to in that *rule*.

1.5.8

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Where a complaint is reported as closed under *DISP 1.5.7(3)* because the complainant has not replied to the *firm* within eight weeks of a written response which meets the requirements in *DISP 1.4.9R*, the *firm* may treat the date of that response as the date when the complaint was closed for the purposes of the reporting requirements in *DISP 1.5.4(2)*.

Reporting: complaints subject to the FSAVC review

1.5.9

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Where a complaint is subject to the FSAVC review, the record keeping and reporting requirements in *DISP 1.5.1R* and *DISP 1.5.4R* apply only where the complainant is dissatisfied with the outcome of that review (under *DISP 1.4.15R* and *DISP 1.4.16R*).

Method of submission of reports

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A report under this section must be given or addressed, and delivered, in the way set out in *SUP 16.3.6R - SUP 16.3.16G* (General provisions on reporting), except that, instead of the *firm's* usual supervisory contact, the report should be given or addressed to [to be added later].

Notification of contact point for complainants

1.5.11

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For the purpose of inclusion in the public record maintained by the *FSA*, a *firm* must provide the *FSA*, at the time of its *authorisation*, with details of a single contact point within the *firm* for complainants and must notify the *FSA* of any subsequent change.

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The contact point can be by name, job title or department and may include, for example, a helpline telephone number.



1.6 Cooperation by firms with the Ombudsman

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A *firm* must cooperate fully with the *Ombudsman* in the handling of complaints against it.

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Cooperation with the *Ombudsman* includes, but is not limited to, producing requested *documents*, adhering to any specified time limits, attending hearings when requested to do so and complying promptly with any settlements or awards.

1.7 The Society of Lloyd's

- 1.7.1 **R** /1 The *Society* of Lloyd's must establish and maintain appropriate and effective procedures for handling complaints by policyholders against *members* of the *Society*, which comply with *DISP* 1.
- 1.7.2 **R** /1 *Members* of the *Society* of Lloyd's must, in complying with *DISP* 1, ensure that the arrangements which the *member* maintains are compatible with the procedures maintained by the *Society* in accordance with *DISP* 1.7.1R, so that, taken as a whole, the requirements of *DISP* are met.
- 1.7.3 **R** /1 The *Society* of Lloyd's must take reasonable steps to ensure that complaints by policyholders against *members* of the *Society* are dealt with under the procedures in *DISP* 1.7.1R and that *members* comply with the requirements of those procedures.
- 1.7.4 **R** /1 A complaint by a policyholder against a *member* of the *Society* of Lloyd's may not be referred to the *Financial Ombudsman Service* until after the internal procedures in *DISP* 1.7.1R have been completed or until after the end of eight weeks from receipt of the complaint, whichever is the earlier.
- 1.7.5 **R** /1 Notices under *DISP* 1.1.7R must be given to the *FSA* by the *Society* of Lloyd's on behalf of any *member* eligible for an exemption under that *rule*.
- 1.7.6 **R** /1 The *Society* of Lloyd's must notify the *FSA* if the conditions in *DISP* 1.1.7R no longer apply to a *member* who is exempt.
- 1.7.7 **R** /1 The report in *DISP* 1.5.4R must be provided by the *Society* of Lloyd's and must cover all complaints by policyholders against *members* falling with the scope of *DISP* 1.5.4R.
- 1.7.8 **G** /1 Each *member* of the *Society* of Lloyd's is individually subject to the *rules* in *DISP* 1 as a result of the *insurance market direction* given in *LLD* 6.2.1D under section 316 of the *Act* (Direction by Authority).
- 1.7.9 **G** /1 However, the *Society* of Lloyd's operates a two-tier internal complaints handling procedure, currently set out in the "Code for Underwriting agents: UK Personal Lines Claims and Complaints Handling". Under this procedure, complaints by policyholders against *members* of the *Society* are considered by the *managing agent* and then, if necessary, by the *Society* of Lloyd's in-house Complaints Department.

This procedure (and any procedure that may replace it) will be subject to the requirements in *DISP* 1.

1.7.10

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Members will individually comply with *DISP* 1 if and only if all complaints by policyholders against *members* are dealt with under the internal procedure established by the *Society* of Lloyd's for handling those complaints, provided that this procedure complies with *DISP*. Accordingly, certain of the obligations under *DISP* 1, for example the obligation to report on complaints received and the obligation to pay fees under *DISP* 5, must be complied with by the *Society* on behalf of *members*. *Managing agents* will not have to make a separate report to the *FSA* on complaints reported under *DISP* 1.7.7R.

1.7.11

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A members' adviser must establish and maintain effective arrangements for handling any complaint from a member of the Society of Lloyd's regarding advice given to the member in connection with the acquiring or disposing of syndicate participation.

1.7.12

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Complaints from *members* of the *Society* of Lloyd's regarding the activities of *members' advisers*, which cannot be resolved by the *members' adviser*, cannot be referred to the *Financial Ombudsman Service*. (See *LLD* (the Lloyd's sourcebook), for further information concerning complaints by *members* of the *Society* of Lloyd's.)

DISP 1 Ann 1R

Table

DISP 1 Ann 1R (see DISP 1.5.4R)
Complaint Categories

Firms are required to report the total number of complaints subject to DISP 1.4-1.6 received in respect of each of the generic product types listed, according to the categories below.

Generic Product Type*	
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Category	Total Number of Complaints	
	Private Individual	Small Businesses
Overcharging/incorrect charges		
Delay		
Other administrative errors		
Unsuitable or misleading advice		
Failure to carry out instructions		
Poor customer service		
Misleading advertising/product information		
Disputes over sums/amounts payable		
Switching/Churning (wrong advice to surrender one investment and take out another)		
Breach of customer agreement or contract		
Other		
Other		

*Generic Product Types
Free Standing AVC
Personal Pension
Stakeholder Pension
Mortgage Endowment
Other Endowment
Whole of Life
Permanent Health
Term Assurance
PEP/ISA
Unit Trust/OEIC
Investment Bond
Share/Derivative
Current Account
Deposit and savings accounts
Loan secured on land
Other loans
General insurance - motor
General insurance - property
General insurance - other
Other

Chapter 2

2

Jurisdiction of the Financial Ombudsman Service

2.1 Application and Purpose

Application

- 2.1.1** **R** _{/1} This chapter applies to the *Ombudsman*, to *firms* (except *UCITS qualifiers*) and to *VJ participants*.
- 2.1.2** **G** _{/1} It is also relevant to those who might wish to refer a complaint to the *Financial Ombudsman Service*.
- 2.1.3** **R** _{/1} A reference in this chapter to a "complaint" under the *Compulsory Jurisdiction* includes a *relevant new complaint*.
- 2.1.4** **G** _{/1} References in this chapter to "*firms*" are to be construed, where relevant, as including:
- (1) in accordance with the *Ombudsman Transitional Order*, *unauthorised persons* subject to the *Compulsory Jurisdiction* in relation to *relevant complaints*; and
 - (2) as a result of section 226 of the *Act*, *unauthorised persons* who were formerly *firms* in respect of complaints about acts or omissions which occurred at the time when they were *authorised*, provided that the *Compulsory Jurisdiction* rules were in force in relation to the activity in question.

Purpose

- 2.1.5** **G** _{/1} The purpose of this chapter is to set out the rules which govern the scope of both the *Compulsory Jurisdiction* and the *Voluntary Jurisdiction* of the *Financial Ombudsman Service*. They specify who may refer a complaint to the *Financial Ombudsman Service* and the time limits for doing so. They also set out which activities are covered by the *Compulsory Jurisdiction* and the *Voluntary Jurisdiction* and the territorial scope of the *Financial Ombudsman Service*.



2.2 Which complaints can be dealt with under the Financial Ombudsman Service?

Complaints (other than relevant new complaints)

2.2.1

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The following conditions will need to be satisfied before a complaint (other than a *relevant new complaint*) can be dealt with under the *Financial Ombudsman Service*:

- (1) the complainant must be an *eligible complainant* (see *DISP* 2.4);
- (2) the *firm* or *VJ participant* about which the complaint is made must be one which is subject to either the *Compulsory Jurisdiction* or the *Voluntary Jurisdiction*, as appropriate;
- (3) the activity to which the complaint relates must be subject to either the *Compulsory Jurisdiction* or the *Voluntary Jurisdiction*, as appropriate;
- (4) in relation to the *Compulsory Jurisdiction*, the act or omission complained of must have occurred at a time when the *rules* in *DISP* 2 were in force, in relation to the activity being complained about;
- (5) the *firm* or *VJ participant* must have failed to resolve the complaint to the satisfaction of the complainant within eight weeks of receiving it; and
- (6) the *firm* or *VJ participant* about which the complaint is made must:
 - (a) in the case of the *Compulsory Jurisdiction*, have been *authorised* under the *Act* at the time of the act or omission to which the complaint relates; or
 - (b) in the case of the *Voluntary Jurisdiction*, have been a *VJ participant* at the time of the act or omission to which the complaint relates or have agreed to let the *Financial Ombudsman Service* consider such complaints, and must not have withdrawn from being a *VJ participant* at the time when the complaint is referred to the *Financial Ombudsman Service*.

Relevant new complaints

2.2.2

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- (1) Article 3 of the *Ombudsman Transitional Order* provides that (subject to certain modifications) the *Compulsory Jurisdiction* applies to a *relevant new complaint*, provided that:
 - (a) the act or omission is that of a *person* who was, immediately before *commencement*, subject to a *former scheme*;

- (b) the act or omission occurred in the carrying on by that *person* of an activity to which that *former scheme* applied; and
 - (c) the complainant is eligible and wishes to have the complaint dealt with under the new scheme.
- (2) For the purposes of (1)(c), the *Ombudsman Transitional Order* enables the *Ombudsman*, if he considers it appropriate, to treat the complainant as eligible if he would have been entitled to refer an equivalent complaint to the *former scheme* in question immediately before *commencement*.
- (3) The *Ombudsman Transitional Order* enables *relevant new complaints* to be handled, as far as possible, under the *Financial Ombudsman Service* procedures, but provides for the rules of the *former schemes* to apply or be taken into account in certain circumstances.
- (4) The *Ombudsman Transitional Order* makes separate provision for the treatment of *relevant existing complaints*, as described in *DISP* App 1.

Dismissal of complaints without consideration of the merits

2.2.3

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Under *DISP* 3.3.1R(1), the *Ombudsman* may dismiss a complaint without considering its merits if he is satisfied that the complainant has not suffered, or is unlikely to suffer, financial loss, material distress or material inconvenience.



2.3 Time Limits for referral of complaints to the Financial Ombudsman Service

2.3.1

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- (1) The *Ombudsman* cannot consider a complaint (except as described in (2)) if the complainant refers it to the *Financial Ombudsman Service*:
 - (a) less than eight weeks after receipt of the complaint by the *firm* or *VJ participant*, unless the *firm* or *VJ participant* has already sent the complainant its *final response*; or
 - (b) more than six *months* after the date on which the complainant is advised by the *firm* or *VJ participant* in its *final response* that he may refer his complaint to the *Financial Ombudsman Service*; or
 - (c) more than six years after the event complained of or (if later) more than three years from the date on which he became aware (or ought reasonably to have become aware) that he had cause for complaint (but see *DISP 2.3.5R*).
- (2) The *Ombudsman* can consider complaints outside the time limits in (1)(b) or (c) when, in his view, the failure to comply with the time limits was as a result of exceptional circumstances or where he is required to do so by the *Ombudsman Transitional Order* (see *DISP 2.3.2G*).

2.3.2

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In relation to *DISP 2.3.1R* (1)(b) and (c), article 4(2) of the *Ombudsman Transitional Order* requires an *Ombudsman* to extend the time limit in respect of a *relevant new complaint* referred to the *Financial Ombudsman Service* not later than twelve *months* after *commencement*, so the time limit applying to the complaint is the same as that which would have applied under the *former scheme* in question as it had effect immediately before *commencement*.

2.3.3

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For the purposes of *DISP 2.3.1R*(2), an example of an exceptional circumstance might be where the complainant has been or is incapacitated or where the *firm* or *VJ participant* has failed, in its *final response*, to inform the complainant that he may refer his complaint to the *Financial Ombudsman Service* or that he must do so within six *months*.

2.3.4

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Under *DISP 5.6.1R* a *firm* or *VJ participant* is liable to pay a case fee in respect of *chargeable cases*. However, in some circumstances, the *Ombudsman* may conclude that a *firm* or *VJ participant* should have more time to resolve a complaint before a case fee is incurred (for example, where there has been delay in obtaining information from third parties or where the *Ombudsman* considers that the

complainant has not fully cooperated with the *firm* or *VJ participant* in the investigation of the complaint).

Exceptions for reviews of past business

2.3.5

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DISP 2.3.1R(1)(c) does not apply where:

- (1) the time limit has been extended under a scheme for review of past business approved by the Treasury under section 404 of the *Act* (Schemes for reviewing past business); or
- (2) the complaint concerns a contract or policy which is the subject of a review directly or indirectly under:
 - (a) the terms of the Statement of Policy on 'Pension transfers and Opt-outs' issued by the *FSA* on 25 October 1994; or
 - (b) the terms of the policy statement for the review of specific categories of *FSAVC* business issued by the *FSA* on 28 February 2000.



2.4 Who can refer a complaint to the Financial Ombudsman Service?

2.4.1 **R** /1 A complaint may be dealt with under the *Financial Ombudsman Service* only if it is brought by or on behalf of an *eligible complainant*.

2.4.2 **G** /1 *Eligible complainants* are those falling within one of the classes of *person* specified in *DISP* 2.4.3R; and

- (1) having a customer or potential customer relationship with a *firm* or *VJ participant* (as specified in *DISP* 2.4.7R and *DISP* 2.4.8R); or
- (2) having an indirect relationship with a *firm* or *VJ participant* (as specified in *DISP* 2.4.10R);

or, in relation to *relevant complaints*, those specified in the *Ombudsman Transitional Order* (see *DISP* 2.4.14G and *DISP* 2.4.15G and *DISP* App 1.3.1G).

Classes of person

2.4.3 **R** /1 (1) Subject to (2), a *person* is an *eligible complainant* if he is:

- (a) a private individual; or
- (b) a business, which has a group annual turnover of less than £1million at the time the complainant refers the complaint to the *firm* or *VJ participant*; or
- (c) a charity which has an annual income of less than £1million at the time the complainant refers the complaint to the *firm* or *VJ participant*; or
- (d) a trustee of a trust which has a net asset value of less than £1million at the time the complainant refers the complaint to the *firm* or *VJ participant*;

who satisfies the relevant criteria in *DISP* 2.4.7R – *DISP* 2.4.12R, and is not within (2).

(2) The following are not *eligible complainants*:

- (a) an individual, business, charity or trustee, who was an *intermediate customer* or *market counterparty* in relation to the *firm* in question at the time of the act or omission, and in respect of the activity, which is the subject of the complaint;
- (b) a *firm* or *VJ participant* whose complaint relates in any way to an activity which the *firm* itself has *permission* to carry on or which the *VJ participant* itself conducts, and which is subject to the *Compulsory Jurisdiction* or the *Voluntary Jurisdiction* of the *Financial Ombudsman Service*.

2.4.4 **G**_{/1} For the purposes of *DISP* 2, a business includes a *sole trader*, a *company*, an unincorporated body and a *partnership* carrying on any trade or profession.

2.4.5 **G**_{/1} If a *firm* or *VJ participant* is in any doubt about the eligibility of a business, charity or trust, it should treat the complainant as if it were eligible. If the complaint is referred to the *Financial Ombudsman Service*, the *Ombudsman* will determine eligibility by reference to appropriate evidence, such as audited accounts or VAT returns.

2.4.6 **G**_{/1} For the purposes of *DISP* 2.4.3R(1)(b), a subsidiary of a corporate group (as defined in section 262(1) of the Companies Act 1985) will be eligible only where the corporate group as a whole meets the turnover test.

Eligible complainants: customers

2.4.7 **R**_{/1} A *person* is an *eligible complainant* if:

- (1) he is or has been a customer of a *firm* or *VJ participant*;
- (2) the complaint arises out of matters relevant to his being or having been a customer of the *firm* or *VJ participant*; and
- (3) he falls into one of the classes of *person* in *DISP* 2.4.3R(1).

Eligible complainants: potential customers

2.4.8 **R**_{/1} A *person* is an *eligible complainant* if:

- (1) the complaint arises out of a *firm's* or *VJ participant's* actions or failure to act for the complainant in his capacity as a potential customer of the *firm* or *VJ participant*; and
- (2) he falls into one of the classes of *person* in *DISP* 2.4.3R(1).

2.4.9 **G**_{/1} *DISP* 2.4.8R is intended to enable a potential customer to use the *Financial Ombudsman Service* where the complaint involves an allegation that he has suffered or may suffer financial loss, material distress or material inconvenience as a result of a *firm's* or *VJ participant's* wrongful act or omission (for example, where, as a result of maladministration or illegal discrimination, a service has not been provided). A complaint about the legitimate exercise of a *firm's* or *VJ participant's* commercial

judgment may be dismissed by an *Ombudsman* without consideration of its merits under *DISP* 3.3.1R(11).

Eligible complainants: indirect complaints

2.4.10

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A *person* is an *eligible complainant* if:

- (1) he is not, and has not been, a customer or potential customer of the *firm* or *VJ participant* in relation to the subject matter of the complaint; and
- (2) he has a complaint against the *firm* or *VJ participant* which either:
 - (a) arises out of a relationship which he has with the *firm* or *VJ participant* as described in *DISP* 2.4.11R; or
 - (b) is derived from another *person* and which arises from any of the circumstances described in *DISP* 2.4.12R; and
- (3) he falls into one of the classes of *persons* in *DISP* 2.4.3R(1).

2.4.11

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The relationships with the *firm* or *VJ participant* relevant for *DISP* 2.4.10R(2)(a) are:

- (1) the complainant has given the *firm* or *VJ participant* a guarantee or security for a mortgage or loan; or
- (2) the complainant has relied in the course of his business on a cheque guarantee card issued by the *firm* or *VJ participant*; or
- (3) the complainant is the true owner or the *person* entitled to immediate possession of a cheque, or of the funds it represents, collected by the *firm* or *VJ participant* for someone else's account; or
- (4) the complainant is the recipient of a banker's reference given by the *firm* or *VJ participant*; or
- (5) the complainant is the holder of *units* in a *collective investment scheme* and the *firm* or *VJ participant* is the *operator* or *depository* of the *scheme*.

2.4.12

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The circumstances relevant for *DISP* 2.4.10R(2)(b) are:

- (1) that the complainant is a beneficiary under a trust or estate of which the *firm* or *VJ participant* is trustee or personal representative; or
- (2) that the complainant is a *person* for whose benefit a *contract of insurance* was taken out or was intended to be taken out; or

(3) that the complainant is a *person* on whom the legal right to benefit from a claim under a *contract of insurance* has been devolved by contract, statute or subrogation.

2.4.13

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DISP 2.4.12R(2) and(3) include, for example, employees covered by a group permanent health policy taken out by an employer, which provides in the insurance contract that the policy was taken out for the benefit of the employee.

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In respect of a *relevant new complaint*, where the complainant is not eligible in accordance with DISP 2.4, article 3(3) of the *Ombudsman Transitional Order* provides that the *Ombudsman* may, nonetheless, if he considers it appropriate, treat the complainant as an *eligible complainant* if he or she would have been entitled to refer an equivalent complaint to the *former scheme* in question immediately before *commencement*, provided that the complainant wishes to have the complaint dealt with under the new scheme.

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Article 3(4) of the *Ombudsman Transitional Order* provides that, in the case of a *relevant new complaint*, where the *former scheme* in question is the *Insurance Ombudsman Scheme*, a complainant is not to be treated as an *eligible complainant* unless:

- (1) he is an individual; and
- (2) the complaint does not concern aspects of a policy relating to a business or trade carried on by him.

Representatives of eligible complainants

2.4.16

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A complaint may be brought on behalf of an *eligible complainant*, or a deceased *person* who would have been an *eligible complainant*, by a *person* authorised by the *eligible complainant* or authorised by law.

2.4.17

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It is immaterial whether the *person* authorised to act on behalf of an *eligible complainant* under DISP 2.4.16R:

- (1) can satisfy any of the criteria applicable to the *person* under DISP 2.4.3R(1); or
- (2) has a claim of his own, or is acting for another *person* against the *firm* or *VJ participant*; or
- (3) is or was a customer or potential customer of the *firm* or *VJ participant*.



2.5 Which firms are subject to the jurisdiction of the Financial Ombudsman Service?

- 2.5.1** G_{/1} All *firms* are subject to the *Compulsory Jurisdiction* of the *Financial Ombudsman Service*. *VJ participants* are subject to the *Voluntary Jurisdiction* and to *DISP 2* to the extent specified in the *standard terms (DISP 4)*.
- 2.5.2** G_{/1} *Firms* may, however, be exempt from the requirements of *DISP 1* (Complaint handling procedures for firms) and *DISP 5 (Financial Ombudsman Service funding rules)*, if they qualify under *DISP 1.1.7R (Exemption)*.
- 2.5.3** G_{/1} *Members* of the *Society of Lloyd’s* are treated as *firms* for the purposes of the *Compulsory Jurisdiction* (including the *rules* in *DISP 1* relating to *firms’* complaints procedures) and are subject to *DISP 1* as a result of the *insurance market direction* given in *LLD 6.2.1D*, under section 316 of the *Act* (Direction by Authority). However, as set out in *DISP 1.7*, *members* will individually comply with *DISP 1* if and only if all complaints by policyholders against *members* are dealt with under the internal procedures established by the *Society of Lloyd’s* for handling those complaints, provided that these procedures themselves comply with *DISP 1*. Accordingly, certain of the obligations under *DISP 1*, for example, the obligation to report on complaints received, must be complied with by the *Society* on behalf of *members*.



2.6 To which activities do the rules apply?

The Compulsory Jurisdiction

2.6.1

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The *Ombudsman* can consider a complaint under the *Compulsory Jurisdiction* only if it relates to an act or omission by a *firm* in the carrying on of one or more of the following activities (unless the provision described in DISP 2.6.3G applies):

- (1) *regulated activities*;
 - (2) lending money secured by a charge on land;
 - (3) lending money (other than *restricted credit*);
 - (4) paying money by a *plastic card* (other than a *store card*);
 - (5) the provision of ancillary banking services (see DISP 2.6.6G);
- or activities ancillary to them (see DISP 2.6.2R).

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The activities in DISP 2.6.1R include any ancillary activities, including advice, provided by the *firm* in connection with those activities.

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Under article 3 of the *Ombudsman Transitional Order*, the *Ombudsman* can also consider a *relevant new complaint* under the *Compulsory Jurisdiction* where it relates to an act or omission of a *firm* which was, immediately before *commencement*, subject to a *former scheme*, provided that:

- (1) the act or omission occurred in the carrying on by that *firm* of an activity to which that *former scheme* applied; and
- (2) the complainant is eligible and wishes to have the complaint dealt with under the new scheme.

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The carrying on of an activity in DISP 2.6.1R includes offering, providing or failing to provide and administering or failing to administer a service in relation to the activities covered by that rule. This includes the manner in which a *firm* has administered its business, provided that the business is an activity subject to the jurisdiction of the *Financial Ombudsman Service*.

- 2.6.5 G_{/1} Complaints about acts or omissions by a *firm* include complaints about acts or omissions in respect of activities for which the *firm* is responsible (that is the activities of their *appointed representatives*).
- 2.6.6 G_{/1} For the purposes of *DISP* 2.6.1R(5), ancillary banking services include, for example, the provision and operation of cash machines and safe deposit boxes.
- 2.6.7 R_{/1} A complaint about an *authorised professional firm* cannot be handled under the *Compulsory Jurisdiction* of the *Financial Ombudsman Service* if it relates solely to a *non-mainstream regulated activity* and can be handled by a *designated professional body*.
- 2.6.8 G_{/1} A complaint about a *non-mainstream regulated activity* conducted by an *authorised professional firm* will be handled by the relevant *professional body*.

The Voluntary Jurisdiction

- 2.6.9 R_{/1} The *Ombudsman* can consider a complaint under the *Voluntary Jurisdiction* only if it is not covered by the *Compulsory Jurisdiction* and it relates to an act or omission in the carrying on of one or more of the following activities by a *VJ participant*:
 - (1) lending money secured by a charge over land;
 - (2) a financial services activity carried on after *commencement* and which had been covered by a *former scheme* in so far as the *VJ participant* was a member of that *former scheme*, in respect of that activity, immediately before the *commencement day*;

or an activity ancillary to it (see *DISP* 2.6.11R).
- 2.6.10 G_{/1} *DISP* 2.6.9R(2) enables complaints about *VJ participants* which, immediately before the *commencement day*, were members of one of the *former schemes* replaced by the *Financial Ombudsman Service* to be dealt with under the *Voluntary Jurisdiction*. This is in respect of the financial services activities for which the *VJ participant* was previously covered but excludes complaints which fall into the *Compulsory Jurisdiction* as *relevant complaints*. So the complaints which are covered by *DISP* 2.6.9R(2) are only those which arise out of acts or omissions occurring after the *commencement day*.
- 2.6.11 R_{/1} The activities in *DISP* 2.6.9R include any ancillary activities, including advice, provided by the *VJ participant* in connection with those activities.
- 2.6.12 R_{/1} A complaint subject to these rules which is not covered by the *Compulsory Jurisdiction* can be considered by the *Ombudsman* even though it relates to an act or omission that occurred before the *VJ participant* was participating in the *Financial Ombudsman Service*, and whether the act or omission occurred before or after the *commencement day*, either:

2.6.13

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- (1) if the complaint could have been dealt with under a *former scheme*; or
- (2) as a consequence of the agreement of the *VJ participant* in *DISP 4.2.5R*.

The provisions of *DISP 2.6.12R* are made under the power in section 227(13) of the *Act*. The section allows for a complaint relating to an act or omission occurring either before *commencement* or before the *VJ participant* joined the *Voluntary Jurisdiction* (or both) to be dealt with under the *Financial Ombudsman Service* provided the *VJ participant* agrees. The act or omission must, however, be one which could have been dealt with under a *former scheme*. Where complaints in this category are not already covered by the *Compulsory Jurisdiction* as *relevant complaints*, they can, therefore, be included in the *Voluntary Jurisdiction* under *DISP 2.6.12R*.



2.7 The territorial scope of the jurisdiction of the Financial Ombudsman Service

- 2.7.1 **R**_{/1} The territorial scope of the jurisdiction of the *Financial Ombudsman Service* covers complaints about the activities of a *firm*, an *appointed representative* or a *VJ participant* carried on from an establishment in the *United Kingdom*.
- 2.7.2 **G**_{/1} The territorial scope therefore covers *firms* (including *appointed representatives*) or *VJ participants* operating from a permanent place of business in the *United Kingdom*, including *incoming EEA firms* and *incoming Treaty firms* which qualify for *authorisation* under Schedule 3 (*EEA Passport Rights*) or Schedule 4 (*Treaty rights*) to the *Act*.
- 2.7.3 **G**_{/1} Complaints which concern business conducted by branches of *firms* or *VJ participants* outside the *United Kingdom* or by *EEA firms* operating in the *United Kingdom* on a services basis from outside the *United Kingdom* are not subject to the *Compulsory Jurisdiction* or the *Voluntary Jurisdiction* of the *Financial Ombudsman Service*.
- 2.7.4 **G**_{/1} A complaint can be dealt with under the *Financial Ombudsman Service* irrespective of whether the complainant lives or is based in the *United Kingdom*.

Chapter 3

Complaint handling procedures of the Financial Ombudsman Service

3.1 Application and Purpose

Application

- 3.1.1** **R** This chapter applies to the *Ombudsman* and to *firms*.
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- 3.1.2** **G** It is also relevant to those who might wish to refer a complaint to the *Financial Ombudsman Service*.
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- 3.1.3** **G** *VJ participants* are subject to the rules in this chapter by contract under the *standard terms* (see *DISP* 4).
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- 3.1.4** **R** Except as otherwise specified, references in this chapter to a "complaint" include a *relevant new complaint*.
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- 3.1.5** **G** References in this chapter to "*firms*" are to be construed, where relevant, as including:
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- (1) in accordance with the *Ombudsman Transitional Order*, *unauthorised persons* subject to the *Compulsory Jurisdiction* in relation to *relevant complaints*; and
 - (2) as a result of section 226 of the *Act*, *unauthorised persons* who were formerly *firms* in respect of complaints about acts or omissions which occurred at the time when they were *firms*, provided that the *Compulsory Jurisdiction* rules were in force in relation to the activity in question.
- 3.1.6** **G** The *Ombudsman Transitional Order* provides, with some exceptions (see *DISP* 2.2.2G (scope of *Compulsory Jurisdiction*), *DISP* 2.3.2G (time limits), *DISP* 2.4.14G and *DISP* 2.4.15G (*eligible complainant*) and *DISP* 3.8.2G (determinations), for *relevant new complaints* to be determined in accordance with the requirements of the *Financial Ombudsman Service*.
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Purpose

- 3.1.7** **G** The purpose of this chapter is to set out the way in which the *Financial Ombudsman Service* and, in particular, the *Ombudsman*, will operate to ensure that complaints may be resolved quickly and with minimum formality. It sets out the procedures for the investigation and consideration of complaints, including the circumstances in which a complaint may be terminated without consideration of its merits; the evidence which may be required or admitted; the provisions for fixing and extending time limits for different aspects of the proceedings; the factors which the *Ombudsman* will take into account in determining what is fair and reasonable;
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the types of loss or damage for which the *Ombudsman* can award compensation; the limits on awards and the costs that can be awarded.

3.2 The investigation and consideration of complaints by the Ombudsman

- 3.2.1** **R** /1 On receipt of a complaint (and subsequently if necessary) the *Ombudsman* must have regard to the following matters:
- (1) whether or not the complaint meets the criteria in *DISP 2.2* (Which complaints can be dealt with under the *Financial Ombudsman Service*?);
 - (2) whether or not the complaint is within the time limits in *DISP 2.3* (Time limits for referral of complaints to the *Financial Ombudsman Service*);
 - (3) whether or not the complainant is an *eligible complainant*; and
 - (4) whether or not the complaint is one which should be dismissed without consideration of its merits under *DISP 3.3* (Dismissal of complaints without consideration of the merits).
- 3.2.2** **G** /1 In the case of *relevant new complaints*, the *Ombudsman* will take account of the relevant criteria under the *Ombudsman Transitional Order*, referred to in *DISP 2.2.2G*, and will extend the time limits in *DISP 2.3*, as required under article 4(2) of the *Ombudsman Transitional Order* and described in *DISP 2.3.2G*.
- 3.2.3** **R** /1 Where the *firm* has not had the eight weeks provided for under *DISP 1.4.5R* to consider the complaint, the *Ombudsman* will refer the complaint to the *firm*, unless the *firm* has already issued a *final response*.
- 3.2.4** **R** /1 Where a *firm* fails to send a complainant a *final response* by the end of eight weeks, the *Ombudsman* may consider the complaint.
- 3.2.5** **R** /1 Where the *Ombudsman* considers that the complaint or the complainant may be ineligible under the jurisdiction rules (see *DISP 2* (Jurisdiction of the *Financial Ombudsman Service*)) he must give the complainant an opportunity to make representations before he reaches his decision and he must give reasons to the complainant for that decision and inform the *firm* of his decision.
- 3.2.6** **G** /1 *DISP 3.2.5R* applies without prejudice to a *firm*'s right to raise the issue of eligibility subsequently.

- 3.2.7 **R**_{/1} Where the *firm* disputes the eligibility of the complaint or the complainant, the *Ombudsman* must give the parties an opportunity to make representations before he reaches his decision and he must give reasons to the parties for that decision.
- 3.2.8 **R**_{/1} Where the *Ombudsman* considers that the complaint may be one which should be dismissed without consideration of its merits, under *DISP* 3.3 (Dismissal of complaints without consideration of the merits), he must give the complainant an opportunity to make representations before he makes his decision. If he then decides that the complaint should be dismissed, he must give reasons to the complainant for that decision and inform the *firm* of that decision.
- 3.2.9 **R**_{/1} Where the *Ombudsman* considers that both the complaint and the complainant are eligible and that there is a reasonable prospect of resolving the complaint by mediation, he may attempt to negotiate a settlement between the parties.
- 3.2.10 **G**_{/1} The *Ombudsman* will attempt to resolve complaints at the earliest possible stage and by whatever means appear to him to be most appropriate, including mediation or investigation.
- 3.2.11 **R**_{/1} If the *Ombudsman* decides that an investigation is necessary, he will:

 - (1) during the investigation, give both parties an opportunity of making representations;
 - (2) send to the parties a provisional assessment, setting out his reasons and a time limit within which either party must respond; and
 - (3) if either party indicates disagreement with the provisional assessment within the time limit prescribed in *DISP* 3.2.11R(2), proceed to determination (see *DISP* 3.8 (Determination by the *Ombudsman*)).
- 3.2.12 **R**_{/1} The parties will be informed of their right to make representations before the *Ombudsman* makes a determination. If he considers that the complaint can be fairly determined without convening a hearing, he will determine the complaint. If not, he will invite the parties to attend a hearing. No hearing will be held after the *Ombudsman* has determined the complaint.
- 3.2.13 **R**_{/1} A party who wishes to request a hearing must do so in writing, setting out the issues he wishes to raise and (if appropriate) any reasons why he considers the hearing should be in private, so that the *Ombudsman* may consider whether the issues are material, whether a hearing should take place and, if so, whether it should be held in public or private.

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In deciding if there should be a hearing and, if so, whether it should be in public or private, the *Ombudsman* will have regard to the provisions of the European Convention on Human Rights.



3.3 Dismissal of complaints without consideration of the merits

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The *Ombudsman* may dismiss a complaint without considering its merits if he:

- (1) is satisfied that the complainant has not suffered, or is unlikely to suffer, financial loss, material distress or material inconvenience; or
- (2) considers the complaint to be frivolous or vexatious; or
- (3) considers that the complaint clearly does not have any reasonable prospect of success; or
- (4) is satisfied that the *firm* has already made an offer of compensation which is fair and reasonable in relation to the circumstances alleged by the complainant and which is still open for acceptance; or
- (5) is satisfied that the complaint relates to a transaction which the *firm* in question has reviewed in accordance with the regulatory standards for the review of such transactions prevailing at the time of the review, or in accordance with the terms of a scheme order under section 404 of the *Act* (Schemes for reviewing past business), including, if appropriate, making an offer of redress to the complainant, unless he is of the opinion that the standards or terms of the scheme order did not address the particular circumstances of the case; or
- (6) is satisfied that the matter has previously been considered or excluded under the *Financial Ombudsman Service*, or a *former scheme* (unless material new evidence likely to affect the outcome has subsequently become available); or
- (7) is satisfied that the matter has been dealt with, or is being dealt with, by a comparable independent complaints scheme or dispute resolution process; or
- (8) is satisfied that the subject matter of the complaint has been the subject of court proceedings where there has been a decision on the merits; or

- (9) is satisfied that the subject matter of the complaint is the subject of current court proceedings unless proceedings are stayed or sisted (by agreement of all parties or order of the court) in order that the matter may be considered under the *Financial Ombudsman Service*; or
- (10) considers that it would be more suitable for the matter to be dealt with by a court, arbitration or another complaints scheme; or
- (11) is satisfied that it is a complaint about the legitimate exercise of a *firm's* commercial judgment; or
- (12) is satisfied that it is a complaint about employment matters from an employee or employees of a *firm*; or
- (13) is satisfied that it is a complaint about investment performance; or
- (14) is satisfied that it is a complaint about a *firm's* decision when exercising a discretion under a will or private trust; or
- (15) is satisfied that it is a complaint about a *firm's* failure to consult beneficiaries before exercising a discretion under a will or private trust, where there is no legal obligation to consult; or
- (16) is satisfied that a complaint which involves or might involve more than one *eligible complainant* has been referred without the consent of the other complainant or complainants and the *Ombudsman* considers that it would be inappropriate to deal with the complaint without that consent; or
- (17) is satisfied that there are other compelling reasons why it is inappropriate for the complaint to be dealt with under the *Financial Ombudsman Service*.

3.3.2 G_{/1} Under article 5(2)(c) of the *Ombudsman Transitional Order*, the *Ombudsman*, in deciding whether a *relevant complaint* is to be dismissed without consideration of its merits, is to take into account whether an equivalent complaint would have been so dismissed under the *former scheme* in question, as it had effect immediately before *commencement*.

3.3.3 G_{/1} For the purposes of *DISP* 3.3.1R(4), offers of compensation include ex gratia payments.

3.3.4 G_{/1} In *DISP* 3.3.1R(5) the transaction could, for example, be a pension transaction which has been reviewed by the *firm* in accordance with the relevant regulatory standards. The *Ombudsman* may decide not to proceed with a complaint about the result of that review unless he considers that the standards or guidance published by the regulator did not address the particular circumstances of the case.

3.3.5 G_{/1} When deciding if it would be suitable for a complaint to be dealt with outside the *Financial Ombudsman Service* (*DISP* 3.3.1R(10)), the *Ombudsman* may consider whether, in view of a conflict of evidence, a fair resolution of the complaint could be achieved only through examination of the evidence by the courts.

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The *Ombudsman* may decide to proceed with a complaint which would otherwise be dismissed under *DISP* 3.3.1R(13), (14) or (15) if he considers that the complaint involves an allegation of negligence or maladministration.



3.4 Referral of a complaint to another complaints scheme for determination

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The *Ombudsman* may refer a complaint to another complaints scheme where he considers that it would be more suitable for the matter to be determined by that scheme and the complainant consents to the referral.



3.5 Evidence

3.5.1

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The *Ombudsman* may, in relation to the evidence which may be required or admitted when he considers and determines a complaint, give directions as to:

- (1) the issues on which evidence is required;
- (2) the extent to which the evidence required to decide those issues should be oral or written; and
- (3) the way in which the evidence should be presented to the *Ombudsman*.

3.5.2

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The *Ombudsman* may:

- (1) exclude evidence that would otherwise be admissible in a court of law or include evidence that would not be admissible in such a court;
- (2) where he considers it necessary or appropriate, accept information in confidence, so that only an edited version or (where this is not practicable) a summary or description is disclosed to the other party;
- (3) reach a decision on the basis of what has been supplied and take account of the failure by a complainant or a *firm* to provide information that an *Ombudsman* has requested; and
- (4) dismiss a complaint if a complainant fails to supply required information.

3.5.3

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The provisions in *DISP* 3.5.2R(1) follow the provisions of the Civil Justice Rules.

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For the purposes of *DISP* 3.5.2R(2), evidence which the *Ombudsman* may accept in confidence includes confidential evidence about third parties and security information.

3.5.5

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The *Ombudsman* may request a party to a complaint to provide evidence necessary for the determination of the complaint under section 231 of the *Act*. A failure to comply with the request can be dealt with by the court under section 232.



3.6 Time limits

- 3.6.1 **R** ^{/1} The *Ombudsman* may fix time limits and extend fixed time limits for any aspect of the consideration of a complaint by the *Financial Ombudsman Service*.
- 3.6.2 **R** ^{/1} If a *firm* fails to comply with a time limit, the *Ombudsman* may proceed to the next stage of consideration of the complaint and may, if appropriate, make provision for any material distress or material inconvenience caused by that failure in any award which he decides to make.
- 3.6.3 **R** ^{/1} If a complainant fails to comply with a time limit, the *Ombudsman* may either proceed to the next stage or dismiss the complaint.



3.7 Delegation of the Ombudsman's powers

3.7.1

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- (1) Only an *Ombudsman* may determine a complaint or decide the circumstances in which information may be disclosed under *DISP* 3.10.1R (3).
- (2) The *Ombudsman* may designate members of the staff of *FOS Ltd* to exercise any of the other powers of the *Ombudsman* relating to the reference, investigation or consideration of a complaint.
- (3) Where any *person* is so designated, *DISP* 2 - *DISP* 4 apply as if any reference to "the *Ombudsman*" included a reference to that *person*.

3.7.2

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The Chief *Ombudsman* will designate those members of staff of *FOS Ltd* who are to have these powers.

3.8 Determination by the Ombudsman

Opinion as to fairness and reasonableness

- 3.8.1** **R** /1 (1) The *Ombudsman* will determine a complaint by reference to what is, in his opinion, fair and reasonable in all the circumstances of the case.
- (2) In considering what is fair and reasonable in all the circumstances of the case, the *Ombudsman* will take into account the relevant law, regulations, regulators' rules and guidance and standards, relevant codes of practice and, where appropriate, what he considers to have been good industry practice at the relevant time.

- 3.8.2** **G** /1 In determining, in relation to a *relevant new complaint*, what is fair and reasonable in all the circumstances of the case and what amount (if any) constitutes fair compensation, for the purposes of section 229(2)(a) of the *Act* (money awards), the *Ombudsman* is required, under article 7(2) of the *Ombudsman Transitional Order*, to take into account:
- (1) what determination the *former Ombudsman* might have been expected to reach, and
- (2) what amount (if any) might have been expected to be awarded by way of compensation;

in relation to an equivalent complaint dealt with under the *former scheme* in question immediately before *commencement*.

The Ombudsman's determination

- 3.8.3** **R** /1 The *Ombudsman's* determination will include the following stages:
- (1) When a complaint has been determined, the *Ombudsman* will give both the complainant and the *firm* a signed written statement of the determination, stating the reasons for it.
- (2) The statement will invite the complainant to notify the *Ombudsman* in writing before the date specified in the statement whether he accepts or rejects the determination.

- (3) If the complainant notifies the *Ombudsman* that he accepts the determination within the time limit set, it is final and binding on both the complainant and the *firm*.
- (4) If the complainant either rejects the determination or does not notify the *Ombudsman* by the specified date that he accepts the determination, the complainant will be treated as having rejected the determination, and the *firm* will not be bound by it.
- (5) The *Ombudsman* must notify the *firm* of the complainant's response (or lack of response).



3.9 Awards by the Ombudsman

Money awards

3.9.1

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As provided for under section 229 of the *Act* (Awards), if a complaint is determined in favour of the complainant, the determination may include:

- (1) a money award against the *firm* of such amount as the *Ombudsman* considers fair compensation for financial loss or for loss or damage of a kind specified in *DISP* 3.9.2R and subject to the maximum limit in *DISP* 3.9.5R; or
- (2) a direction that the *firm* take such steps in relation to the complainant as the *Ombudsman* considers just and appropriate (whether or not a court could order those steps to be taken); or
- (3) both of these.

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Where the *Ombudsman* decides to make a money award, in addition to (or instead of) awarding compensation for financial loss, he may award compensation for the following kinds of loss or damage, whether or not a court would award compensation:

- (1) **pain and suffering; or**
- (2) **damage to reputation; or**
- (3) **distress or inconvenience.**

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For the purposes of awards by the *Ombudsman*, financial loss includes consequential or prospective loss.

3.9.4

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In determining, in relation to a *relevant new complaint*, what amount (if any) constitutes fair compensation for the purposes of a money award, the *Ombudsman* is required under article 7(2) of the *Ombudsman Transitional Order* to take into account what amount (if any) might have been expected to be awarded by way of compensation, in relation to an equivalent complaint dealt with under the *former scheme* in question immediately before *commencement*.

Limits on money awards

3.9.5

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The maximum money award which the *Ombudsman* may make is £100,000.

- 3.9.6 G
/1 If the *Ombudsman* considers that an amount more than the maximum is required as fair compensation, then he may in addition recommend to the *firm* that it pays the balance.
- 3.9.7 G
/1 The *Ombudsman* may specify in his award that reasonable interest must be paid on the award (at the rate and from the date he states).
- 3.9.8 G
/1 For the purposes of calculating the monetary limit referred to in *DISP* 3.9.5R the amount of interest awarded does not form part of the award itself.
- 3.9.9 G
/1 The limit on the maximum money award has no bearing on any direction which an *Ombudsman* may make as part of a determination.

Costs

- 3.9.10 R
/1 **When the *Ombudsman* finds in a complainant’s favour, he may also award an amount which covers some or all of the costs which were reasonably incurred by the complainant in respect of the complaint.**
- 3.9.11 G
/1 It is not anticipated that awards of costs will be common, since in most cases complainants should not need to have professional advisers to bring complaints to the *Financial Ombudsman Service*.
- 3.9.12 R
/1 **The amount payable under the award of costs may, if the *Ombudsman* orders, bear interest at a reasonable rate specified in the order and from a date specified in the order.**
- 3.9.13 G
/1 For the purposes of calculating the monetary limit specified in *DISP* 3.9.5R, an award of costs does not form part of the award itself.

Complying with awards and settlements

- 3.9.14 R
/1 **A *firm* must comply promptly with:**
 - (1) any money award or direction made by the *Ombudsman*; and
 - (2) any settlement which it agrees at an earlier stage of the procedures.
- 3.9.15 R
/1 **The *Ombudsman* must maintain a register of each money award and direction made.**
- 3.9.16 G
/1 A money award registered in accordance with *DISP* 3.9.15R can be recovered or enforced through the courts under paragraph 16 of Schedule 17 to the *Act*.
- 3.9.17 G
/1 A complainant may enforce a direction by injunction or order in accordance with section 229(9) of the *Act* (Awards).

3.10 Dealing with information

3.10.1

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- (1) In dealing with any information received in relation to the consideration or investigation of a complaint, the *Financial Ombudsman Service* must have regard to the parties' rights of privacy.
- (2) Paragraph (1) does not prevent the *Ombudsman* disclosing information (either in full, or where he considers it necessary or appropriate under *DISP* 3.5.2R(2), in the form of an edited version or (where this is not practicable) a summary or description):
 - (a) to the extent that he is required or authorised to do so by law; or
 - (b) to the parties to the complaint; or
 - (c) in his determination; or
 - (d) at a hearing in connection with the complaint.
- (3) So long as he has regard to the parties' rights of privacy, the *Ombudsman* may disclose information to the *FSA* or any other body exercising regulatory or statutory functions for the purpose of assisting that body or the *Financial Ombudsman Service* to discharge its functions.

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Under article 11 of the *Ombudsman Transitional Order*, any information held by any *person* responsible for the operation of a *former scheme* in connection with the operation of a *former scheme* may be disclosed by that *person* (after *commencement*) to *FOS Ltd* or to an *Ombudsman* without contravening any restriction on disclosure of that information (imposed by statute or otherwise) to which that *person* was subject. But *FOS Ltd* or the *Ombudsman* is subject to any restrictions on disclosure (and exceptions) which would have applied to the former holder of that information.

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Article 11 of the *Ombudsman Transitional Order* does not, however, prevent the application of section 31(4A) of the Data Protection Act 1998. This provides for an exemption in respect of subject information provisions to the extent to which the application of those provisions to data would be likely to prejudice the proper discharge of the functions conferred under Part XVI of the *Act* (The *Ombudsman Scheme*).

Chapter 4

Standard terms



4.1 Application and Purpose

Application

4.1.1

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The *standard terms* apply to any *company, partnership*, individual practitioner or other business which has decided to be a participant in the *Voluntary Jurisdiction* (a *VJ participant*). They are fixed by *FOS Ltd* with the approval of the *FSA* in accordance with paragraph 18 of Schedule 17 to the *Act*.

Purpose

4.1.2

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The *standard terms* are the basis on which complaints will be dealt with and determined under the *Voluntary Jurisdiction*. They cover:

- (1) the rules and guidance for handling complaints (see *DISP* 4.2.2R to *DISP* 4.2.6R);
- (2) an indemnity for *FOS Ltd*, any member of its governing body, any member of its staff and any *person* acting as an *Ombudsman*, as permitted by paragraph 18(5) of Schedule 17 to the *Act* (see *DISP* 4.2.7R);
- (3) the *Ombudsman's* powers relating to determinations and awards (see *DISP* 4.2.8R);
- (4) the enforcement of a determination (see *DISP* 4.2.10R); and
- (5) the process for withdrawal by a *VJ participant* from the *Voluntary Jurisdiction* (see *DISP* 4.2.11R).

4.2 The standard terms

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- (1) For the purposes of the *standard terms*, a *company, partnership, individual practitioner or other business*, whether authorised or unauthorised, agreeing to participate in the *Voluntary Jurisdiction* of the *Financial Ombudsman Service* is known as a *VJ participant*.
- (2) In consequence of the agreement by the *VJ participant* to participate in the *Voluntary Jurisdiction*, the *standard terms* fix the basis on which complaints relating to relevant acts or omissions of the *VJ participant* are to be dealt with and determined.
- (3) Where the *standard terms* apply rules relating to the *Compulsory Jurisdiction* for the purposes of the *Voluntary Jurisdiction*, those are to be treated as part of the *standard terms*.
- (4) A *VJ participant* is subject to the *standard terms*, which may be amended or supplemented with the approval of the *FSA*.

Complaint handling procedures

4.2.2

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The rules and guidance contained in *DISP 1* (Complaint handling procedures for firms) will apply to *VJ participants* for the purposes of the *Voluntary Jurisdiction* as if they were *firms*, with the exception of *DISP 1.5* (Record keeping and reporting). *DISP 1.2* (Internal complaint handling procedures: general requirements) applies in relation to complaints about activities of the *VJ participant* specified in *DISP 2.6.9R*.

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DISP 1.5.1R contains a requirement for a *firm* in the *Compulsory Jurisdiction* to make and retain records of complaints subject to *DISP 1.4-DISP 1.6* for a minimum period of three years from the date of its receipt of a complaint. Although this requirement is not applied to *VJ participants*, they may need to keep records of complaints for sufficient time to enable them to provide the *Ombudsman* with necessary information in the event of a complaint being referred to the *Financial Ombudsman Service*. The requirement for reporting complaints to the *FSA* under *DISP 1.5.4R* is also not applied to *VJ participants*.

Jurisdiction of the Financial Ombudsman Service

4.2.4 **R** /1 The rules and guidance contained in *DISP 2* will apply for the purposes of the *Voluntary Jurisdiction*, with the exception of *DISP 2.6.1R - DISP 2.6.8G*.

4.2.5 **R** /1 By agreeing to participate in the *Voluntary Jurisdiction*, a *VJ participant* also agrees to complaints relating to activities covered by *DISP 2.6.9R* being dealt with under *DISP 2.6.12R*.

Complaint handling procedures of the Financial Ombudsman Service

4.2.6 **R** /1 The rules and guidance contained in *DISP 3* will apply to *VJ participants* for the purposes of the *Voluntary Jurisdiction* as if they were *firms* (except where their application to *VJ participants* is specifically excluded or necessarily inapplicable).

Liability

- 4.2.7 **R** /1
- (1) None of the following is to be liable in damages for anything done or omitted in the discharge, or purported discharge, of any functions in connection with the *Voluntary Jurisdiction*:
- (a) *FOS Ltd*;
 - (b) any member of its governing body;
 - (c) any member of its staff;
 - (d) any *person* acting as an *Ombudsman* for the purposes of the *Financial Ombudsman Service*.
- (2) Paragraph (1) does not apply:
- (a) where the act or omission is shown to have been in bad faith; or
 - (b) so as to prevent an award of damages made in respect of an act or omission on the ground that the act or omission was unlawful as a result of section 6(1) of the Human Rights Act 1998.

Determination and awards

4.2.8 **R** /1 If the *Ombudsman* determines a complaint under the *Voluntary Jurisdiction* in favour of the complainant, the determination may include:

- (1) a “money award”, that is, an award against the *VJ participant* of such amount as the *Ombudsman* considers fair compensation for financial loss or for loss or damage of a kind specified in *DISP* 3.9.2R that has been suffered, or may be suffered, by the complainant;
- (2) a direction that the *VJ participant* take such steps in relation to the complainant as the *Ombudsman* considers just and appropriate (whether or not a court could order those steps to be taken).

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DISP 4.2.8R gives the *Ombudsman* the same powers to make money awards and directions as he has, under section 229 of the *Act* (Awards), in relation to *firms* in the *Compulsory Jurisdiction*.

Enforcement of a determination

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The *Ombudsman's* determination, if accepted by the complainant within the time limit specified by the *Ombudsman*, will be binding on the *VJ participant* and final, and may be enforced in court by the complainant.

Withdrawal from the Voluntary Jurisdiction of the Financial Ombudsman Service

4.2.11

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A *VJ participant* may not withdraw from the *Voluntary Jurisdiction* of the *Financial Ombudsman Service* unless the *VJ participant*:

- (1) has submitted a written plan to *FOS Ltd* setting out its proposals for:
 - (a) notifying its existing customers of its intention to withdraw from the *Voluntary Jurisdiction*; and
 - (b) the handling of complaints against it prior to its withdrawal from the *Voluntary Jurisdiction*; and
- (2) the plan has been approved in writing by *FOS Ltd*; and
- (3) the *VJ participant* has paid the *general levy* for the year in which it withdraws and any other fees payable; and
- (4) *FOS Ltd* has agreed in writing the date on which the *VJ participant* may withdraw from the *Voluntary Jurisdiction* (which date is not to be earlier than six *months* from the date of approval of the plan).

Appendices



Appendix 1

Relevant Existing Complaints

1.1 Application and Purpose

Application

1.1.1 **R** This appendix applies to *firms*, to *FOS Ltd*, to the *Ombudsman* and to those who might wish to refer a complaint to the *Financial Ombudsman Service* in respect of *relevant existing complaints*.
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1.1.2 **G** References in this chapter to “*firms*” are to be construed, where relevant, as including:
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- (1) in accordance with the *Ombudsman Transitional Order*, *unauthorised persons* subject to the *Compulsory Jurisdiction* in relation to *relevant complaints*; and
- (2) as a result of section 226 of the *Act*, *unauthorised persons* who were formerly *firms* in respect of complaints about acts or omissions which occurred at the time when they were *firms*, provided that the *Compulsory Jurisdiction* rules were in force in relation to the activity in question.

Purpose

1.1.3 **R** *DISP 2* to *DISP 5* apply to *firms*, to the *Ombudsman* and to *FOS Ltd* in respect of *relevant existing complaints*, except as stated in this appendix.
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1.1.4 **G** The purpose of this appendix is to describe how *FOS Ltd* must handle *relevant existing complaints* (that is, the partly completed complaints which it inherits from the *former schemes* at *commencement* under the *Ombudsman Transitional Order*). Complaints which *firms* (as opposed to the *former schemes*) have partly completed at *commencement* will be handled as described in *DISP 1* (Complaint handling procedures for firms) (see, in particular, *DISP 1.4.6R*).
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1.1.5 **G** *Relevant existing complaints* will be referred by the *former schemes* to *FOS Ltd* for completion at *commencement*. Article 2 of the *Ombudsman Transitional Order* provides that *FOS Ltd* will complete the handling of these cases, but requires that, in a significant number of respects, it must do this in accordance with the requirements of the relevant *former scheme*.
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- 1.1.6** G_{/1} This appendix describes the ways in which *FOS Ltd* is required to treat these complaints differently from the other complaints which are subject to *DISP* 1 to 5. Apart from these exceptions, the rules in *DISP* 2 to *DISP* 5 and the statutory provisions in sections 225-234 of the *Act* apply as they do to other complaints.

1.2 Eligible complaint

- 1.2.1** G_{/1} (1) Article 2 of the *Ombudsman Transitional Order* requires that, irrespective of whether the conditions set out in section 226(2) of the *Act* are met (see *DISP* 2.2.1G), a complaint which:
- (a) was referred to a *former scheme* (other than the *Personal Insurance Arbitration Service*) at any time before *commencement*, by a *person* who was at that time entitled, under the terms of the *former scheme*, to refer such a complaint (whether described in that scheme as the making of a complaint, the referral of a dispute, the submission of a claim, or otherwise), and
 - (b) has not, before *commencement*, been rejected, withdrawn, settled or determined, by the *former Ombudsman* (whether by a substantive decision, or by closure of the case without a substantive decision);

- 1.2.1** G_{/1} is to be dealt with under the *Financial Ombudsman Service* (and not the *former scheme*).

(2) These complaints are described as *relevant existing complaints*.

- 1.2.2** G_{/1} Article 2 of the *Ombudsman Transitional Order* provides that a complaint is not to be treated as determined before *commencement* if the determination was, at *commencement*, subject to (or capable of being subject to) an appeal, a reference to arbitration or similar procedure.

- 1.2.3** G_{/1} The definition of a *relevant existing complaint* excludes complaints referred to the *Personal Insurance Arbitration Service* before *commencement*, which will be completed by the *Personal Insurance Arbitration Service*, not *FOS Ltd*. It also excludes complaints about pre-*commencement* investment business conducted by *firms* which were formerly authorised by a *recognised professional body*. These will be handled by the relevant *professional body*.

1.3 Eligible complainant

- 1.3.1** G_{/1} Under article 2(1)(a) of the *Ombudsman Transitional Order*, a *person* will be treated under the *Financial Ombudsman Service* as an *eligible complainant* in respect of a *relevant existing complaint*, if he was entitled, under the terms of the

former scheme, to refer such a complaint at the time when the complaint was referred to that scheme.

1.4 Time limits

- 1.4.1** G_{/1} Article 4(2) of the *Ombudsman Transitional Order* requires an *Ombudsman* to extend the time limits set under *DISP* 2.3.1R(1)(b) and (c) in respect of a *relevant existing complaint* where the effect of that extension is that the time limit applying to the complaint is the same as that which would have applied under the *former scheme* in question as it had effect immediately before *commencement*.

1.5 Determination of complaints

- 1.5.1** G_{/1} Article 5(2)(a) provides that *FOS Ltd's* power to specify in its scheme rules the matters to be taken into account in making determinations does not apply to *relevant existing complaints* (see *DISP* 3.8.1R).
- 1.5.2** G_{/1} Article 5(2)(c) requires the *Ombudsman*, in deciding whether a *relevant complaint* (including a *relevant existing complaint*) is to be dismissed without consideration of its merits under the scheme rules, to take into account whether an equivalent complaint would have been so dismissed under the *former scheme* in question, as it had effect immediately before *commencement*.
- 1.5.3** G_{/1} Article 6(1) disapplies, in respect of *relevant existing complaints*, the provisions in the *Act* relating to the criteria for determining complaints in section 228(2) and those relating to awards in section 229 (with the exception of those in section 229(8)(b) and paragraph 16 of Schedule 17 relating to the enforceability of money awards and those in section 229(9) and (10) relating to the enforceability of directions made by the *Ombudsman*). It also disapplies the provisions relating to costs awards in section 230, except to the extent referred to in *DISP* App 1.11.1G.
- 1.5.4** G_{/1} Apart from this, section 228 of the *Act* applies in relation to *relevant existing complaints* as it applies to other complaints which are subject to the *Compulsory Jurisdiction*.

1.6 Criteria for determining complaints

- 1.6.1** G_{/1} Article 6(2) provides that a *relevant existing complaint* is to be determined (so far as practicable) by reference to such criteria as would have applied to the determination

of the complaint by the *former ombudsman* under the *former scheme* in question immediately before *commencement* (provided that where the *former scheme* in question is the *FSA scheme*, the criteria are those which would have applied to the determination of the complaint by an *independent investigator* under that scheme at that time).

- 1.6.2** G_{/1} An exception is, however, made in respect of *relevant existing complaints* about former *IMRO* members inherited from the *Investment Ombudsman* under the *IMRO scheme* in order to reflect the way in which those complaints have been determined in practice under that scheme. The effect of article 6(2) and 6(11) taken together is that, as with all new complaints received after *commencement*, these will be determined according to what is, in the opinion of the *Ombudsman*, fair and reasonable in all the circumstances of the case and will be binding on both parties subject to the complainant's agreement.

1.7 Awards and remedies

- 1.7.1** G_{/1} The remedy that the *Ombudsman* can impose in determining a *relevant existing complaint* is limited by article 6(3) to such remedy as could have been included in a determination (whether described as a determination, award, recommendation or otherwise) made by the *former Ombudsman* under the *former scheme* in question immediately before *commencement*.

1.8 Extent to which awards are binding

- 1.8.1** G_{/1} Under article 6, except in the circumstances set out in *DISP* App 1.8.2G to *DISP* App 1.8.6G, the *Ombudsman* will, in respect of *relevant existing complaints*, provide the *firm* and the complainant with a written statement of his determination (including reasons) in accordance with section 228(3)-(9) of the *Act* (see *DISP* 3.8.3R) and if the complainant notifies the *Ombudsman*, within the time period specified, that he accepts the determination, it is binding on both parties and final.
- 1.8.2** G_{/1} Under article 6(7), where the *former scheme* in question was the *FSA scheme* and the *relevant existing complaint* was, at *commencement*, subject to arbitration in accordance with that scheme, the extent to which the determination of the complaint under the new scheme is binding and final depends on the terms of the arbitration. Where a complaint under the *FSA scheme* was not subject to arbitration at *commencement*, the determination of the case under the new scheme is not binding on the *firm* or the complainant. The requirements in section 228(4)(c) and (5) to (7) of the *Act* do not apply in relation to the complaint.
- 1.8.3** G_{/1} Under article 6(8), where the *former scheme* in question was the *SFA scheme*:
- (1) if the *relevant existing complaint* has not been submitted to arbitration under that scheme, and would not have been *eligible* to be so submitted under that

scheme as it had effect immediately before *commencement* (disregarding any requirement for certification by the *SFA Complaints Bureau* that the complaint had not been resolved by conciliation), the determination of the complaint under the *Financial Ombudsman Service* is not binding on the *firm* or the complainant;

- (2) if the *relevant existing complaint* has been submitted to arbitration under the *SFA scheme*, or would have been eligible to be so submitted under that scheme as it had effect immediately before *commencement* (disregarding any such requirement), the determination of the complaint under the *Financial Ombudsman Service* is binding on the *firm* and the complainant and final, but if the complaint has been submitted to arbitration, the terms of arbitration are otherwise unaffected;

and the requirements in section 228(4)(c) and (5) to (7) of the *Act* do not apply in relation to the complaint.

1.8.4 G_{/1} Under article 6(9), where the *former scheme* in question was the *Building Societies Ombudsman Scheme* and the *relevant existing complaint* was, at *commencement*, subject to arbitration in accordance with that scheme, the extent to which the determination of the complaint under the *Financial Ombudsman Service* is binding and final depends on the terms of the arbitration (which remain unaffected), and the requirements in section 228(4)(c) and (5) to (7) of the *Act* do not apply in relation to the complaint.

1.8.5 G_{/1} Under article 6(10), where the *former scheme* in question was the *Building Societies Ombudsman Scheme* and the *firm* would have been relieved of its obligation to comply with a determination under that scheme if it had complied with conditions as to the giving of notice of its non-fulfilment of the obligations imposed by the determination, the determination of the complaint under the *Financial Ombudsman Service* is (notwithstanding section 228(5) of the *Act*) not binding on the *firm* if it complies with equivalent conditions. (This preserves the "publicity option" under the *Building Societies Ombudsman Act 1986* in respect of *relevant existing complaints*.)

1.8.6 G_{/1} The effect of article 6(2) and 6(11) taken together is that, where the *former scheme* in question was the *IMRO scheme*, the determination will be binding on both parties subject to the complainant's agreement, unless, before *commencement*, the complaint has been determined by a *former ombudsman* under that scheme and the *former ombudsman* has offered the complainant adjudication (see *DISP App 1.9.1G-1.9.2G*).

1.9 Complaints determined before commencement

1.9.1 G_{/1} Under article 8, where, before *commencement*, a *relevant existing complaint* has been determined by a *former ombudsman* under the *IMRO scheme* and that *former ombudsman* has offered adjudication:

- (1) if the matter is already subject to adjudication at *commencement*, the relevant provisions of the *former scheme* will continue to apply so far as practicable, with references to the *Investment Ombudsman* or "the Ombudsman" being read as references to *FOS Ltd* or an *Ombudsman*, as appropriate; or

- (2) if the matter has not been referred to adjudication before *commencement*, but the complainant accepts adjudication, *FOS Ltd* must appoint an adjudicator to determine the matter, and if the complainant agrees to the appointment of the adjudicator, the *firm* must concur in the reference to adjudication.

1.9.2 G_{/1} The relevant provisions of the *IMRO scheme* will apply, so far as practicable, as they would have applied to adjudication under that scheme, with references to the *Investment Ombudsman* or "the Ombudsman" being read as references to *FOS Ltd* or an *Ombudsman*, as appropriate.

1.9.3 G_{/1} Under article 9, where a *relevant existing complaint* has been determined before *commencement* by a *person* appointed as an arbitrator under the *SFA scheme*:

- (1) if, at *commencement*, that determination is the subject of an appeal, or an application for leave to appeal, under that scheme which has not been determined or withdrawn, the relevant provisions of that scheme will continue to apply to that appeal or application (and any ensuing appeal) so far as practicable;
- (2) if, at *commencement*, an application for leave to appeal against the determination was capable of being entertained under that scheme, the relevant provisions of that scheme will apply, so far as practicable, to the making of any such application for leave and any ensuing appeal, as they would have applied to an application for leave or an appeal before *commencement*.

1.9.4 G_{/1} *FOS Ltd* may appoint such *persons*, on such terms and for such duration, as it thinks fit to hear any appeal or application for leave to appeal made after *commencement* and references in the relevant provisions of the *SFA scheme* to the *SFA* or its Arbitration Secretariat will be read as references to *FOS Ltd*.

1.9.5 G_{/1} Under article 10, where a complaint has been determined before *commencement* under the *Building Societies Ombudsman Scheme*, and, at *commencement*, a case either has been stated with respect to that determination for the opinion of the High Court or Court of Session under section 84(5) to (7) of the Building Societies Act 1986 and no decision has been reached on the case or could be stated under those provisions, those subsections continue to apply as if they provided for the Court to direct that the complaint be dealt with under the *Financial Ombudsman Service* as a *relevant existing complaint*.

1.10 Enforceability of awards

1.10.1 G_{/1} Where the *Ombudsman* makes a determination which includes an award against a *firm* of compensation payable to the complainant, it is enforceable (under article 6(4)) in the same way as a money award made under the *Compulsory Jurisdiction*.

1.10.2 G_{/1} Where the *Ombudsman* makes a determination which includes a requirement for the *firm* to take any steps in relation to the complainant, it is enforceable (under article 6(5)) in the same way as a direction made under the *Compulsory Jurisdiction*.

1.11 Costs

- 1.11.1** G^{/1} Where the *former scheme* in question, as it had effect immediately before *commencement*, included provision for the award of costs, the *Ombudsman* may, under article 6(6), on determining the *relevant existing complaint*, award costs in accordance with that provision (irrespective of whether those costs were incurred, or relate to anything done, before or after *commencement*) and section 230(6) and (7) and paragraph 16 of Schedule 17 to the *Act* apply in relation to the enforcement of such an award of costs in the same way as they apply to awards of costs made under the *Financial Ombudsman Service* procedures.

1.12 Funding and fees

- 1.12.1** G^{/1} Under *DISP 5*, *firms* will be subject to case fees in respect of *relevant complaints*. If *FOS Ltd* deals with a *relevant existing complaint* against a *person* who is not *authorised* by the *FSA*, a special case fee will be charged (see *DISP 5 (Financial Ombudsman Service Funding Rules)*) and this will be recoverable as a debt to *FOS Ltd* in the same way as case fees relating to complaints about *firms*.

1.13 Time limits, record keeping and reporting requirements

- 1.13.1** G^{/1} The time limits, record keeping and reporting requirements in *DISP 1.4* (Time limits for dealing with a complaint) and *DISP 1.5* (Record keeping and reporting) do not apply to *firms* in respect of *relevant existing complaints* since these, by definition, will already have been referred to a *former scheme*.

1.14 Cooperation with the Ombudsman

- 1.14.1** R^{/1} *Firms* must comply with *DISP 1.6 (Cooperation by firms with the Ombudsman)* in respect of *relevant existing complaints*.

Appendix 2

Handling Mortgage Endowment Complaints

2.1 Introduction

2.1.1 G_{/1} This appendix sets out the approach and standards which *firms* should use when investigating complaints relating to the sale of endowment *policies* for the purposes of achieving capital repayment of a mortgage. It is not intended to be comprehensive. It is primarily concerned with the assessment of whether the complainant may have suffered financial loss, and if so, how much that loss is, and therefore what amount a *firm* should consider offering by way of fair and appropriate compensation in circumstances where the *firm's* investigation of a complaint reveals:

- (1) the complainant has received negligent *advice on investments*; and
- (2) if this advice had not been negligent, either:
 - (a) the complainant would be unlikely to have acquired the endowment policy but instead would have taken out the same amount of loan on a repayment basis; or
 - (b) the complainant would have acquired an endowment mortgage for a shorter term.

2.1.2 G_{/1} There will also be cases where a *firm* will conclude after investigation that, notwithstanding its own failure to give compliant and proper advice, the complainant would nevertheless have proceeded with the endowment policy as sold, in which case no compensation will be due.

2.1.3 G_{/1} This appendix only addresses how *firms* should approach the assessment of loss and compensation where negligence on the part of the *firm* is established.

2.1.4 G_{/1} This appendix is relevant both to the obligations arising under the complaints handling *rules* contained in *DISP* 1.2 and to the *FSA's* approach to the supervision of *firms*.

2.1.5 G_{/1} This appendix is also relevant to complaints which the *Ombudsman* may investigate under the *Compulsory Jurisdiction* or *Voluntary Jurisdiction* of the *Financial Ombudsman Service* established under Part XVI of the *Act* (The *Ombudsman Scheme*).

2.1.6 G_{/1} Before proceeding to assess the extent of a complainant's financial loss, a *firm* will usually have completed the following stages:

- (1) gathering all relevant facts and information;

- (2) making a fair and objective assessment whether it has failed to comply with a relevant duty owed to the complainant; and
- (3) assessing whether any failure of duty by it was in the circumstances a material failure in the sense that if it had not occurred the complainant would have been likely to have acted differently.

2.1.7 G_{/1} If it is concluded that the complainant would have acted differently, the *firm* should proceed to assess any direct or consequential loss.

2.1.8 G_{/1} Nothing in this appendix relieves *firms* of the obligation to consider the particular facts and circumstances of each complaint and to consider whether the assessment of loss and compensation should, in the light of those facts and circumstances, be carried out on a different basis. If, however, the facts and circumstances make it appropriate to do so, the *FSA's* expectation is that *firms* will apply the approach and standards set out in this appendix, and where they do not, the *FSA* is likely to require them to demonstrate the adequacy and completeness of their alternative approach.

2.2 The standard approach to redress

2.2.1 G_{/1} If there has been a failure to give compliant and proper advice, or some other breach of the duty of care, the basic objective of redress is to put the complainant, so far as is possible, in the position he would have been in if the inappropriate advice had not been given, or the other breach had not occurred. In many cases, although it must be a matter for inquiry and assessment in each individual case, this position is likely to have resulted in the complainant taking a repayment mortgage with accompanying life cover, and this is the assumption which underpins the standard approach to redress.

2.2.2 G_{/1} Unless the contrary is demonstrated, it should be assumed that the complainant could have afforded the mortgage on a repayment basis.

2.2.3 G_{/1} The measure of any financial loss suffered by the complainant will be arrived at by:

- (1) comparing the complainant's current capital position with the position he would have been in had the loan been a standard repayment mortgage as at the date the *firm* decides to regard the complaint as justified; and
- (2) comparing the cost of the complainant's actual monthly outgoings and those he would have made had his loan been on a standard repayment basis as at the date the *firm* decides to regard the complaint as justified.

2.2.4 G_{/1} In some cases other factors may be included in the overall calculation, for example, if mortgage arrangement fees were waived by agreement on the occasion of the endowment *policy* being taken out.

2.2.5 G_{/1} If, on comparing the complainant's current endowment position with the repayment alternative, the *surrender value* of the endowment *policy* exceeds the amount of the capital which the complainant would have repaid through the repayment method, then, at the point of the assessment, the complainant has suffered no capital loss (but the complainant may suffer some compensatable consequential loss associated

with changing the mortgage arrangements to the repayment basis, see *DISP* App 2.3). Conversely, if the capital which would have been repaid on the repayment basis exceeds the *surrender value*, there is a capital loss represented by the difference between the two amounts.

- 2.2.6** G_{/1} If the complainant's endowment mortgage outgoings exceed the equivalent cost for the repayment method, the complainant should be compensated for the higher payments in addition to any loss on the *surrender value* and capital repaid comparison. This means, for example, that if the endowment arrangement has been more expensive, this may result in compensatable loss even though the capital repayment against surrender comparison may be favourable to the endowment.
- 2.2.7** G_{/1} If the total cost of the outgoings for the endowment calculation is less than that for the repayment calculation, the "savings" should be brought into account in assessing any overall loss unless it is unreasonable to do so.
- 2.2.8** G_{/1} It is unlikely to be reasonable to bring "savings" into account in circumstances where, at the time of the sale of the *policy*:
- (1) the complainant was advised or informed orally or in writing that he would have lower outgoings than would be the case under a repayment mortgage, whether or not the difference was quantified; and
 - (2) the complainant has dissipated those "savings" on the strength of this advice or information.
- 2.2.9** G_{/1} The circumstances in which it may be appropriate to take some or all of the "savings" into account are those where, subject to *DISP* App 2.2.7G, the complainant is of "sufficient means" so that it is reasonable for a *firm* to assume that the "savings" have contributed to those means.
- 2.2.10** G_{/1} Where it is otherwise reasonable for "savings" to be brought into account, determining whether or not a complainant is of sufficient means and, if so, to what extent the "savings" are to be brought into account, will have to be based on the facts of each individual case. It will be appropriate to require the complainant to provide adequate information to assist the *firm* in this task. Matters to be taken into account in this assessment may include:
- (1) the length of the remaining mortgage term;
 - (2) the complainant's current and prospective resources;
 - (3) the amount of the capital shortfall in proportion to the endowment outgoings balance.
- 2.2.11** G_{/1} Firms may adopt streamlined processes to assist them in individual assessments of "sufficient means", but will have to satisfy themselves that the complainant's position is nevertheless protected. Firms will need to ensure that the complainant is given an opportunity to make an informed choice whether to accept the streamlined process, that the process itself is transparent, and that the firm is satisfied that the outcome would be fair to complainants.
- 2.2.12** G_{/1} If a *firm* intends to make a deduction for all or any part of the lower endowment outgoings, the *firm* should explain clearly to the complainant in writing both how the "sufficient means" test has been satisfied, including details of the information taken into account in reaching the decision, and how the deduction has been arrived at. The letter should further inform the complainant that if he is unhappy with the

proposal to make a deduction, either in principle or as to the amount, he should give his reasons to the *firm*.

- 2.2.13** G_{/1} If a complainant puts forward a case that it would be unreasonable for a deduction to be made, the *firm* should reach a fair and objective determination on the facts of all relevant matters including those set out at *DISP* App 2.2.8G and *DISP* App 2.2.9G.
- 2.2.14** G_{/1} In recognition that *firms* may not wish, for practical reasons, to make individual assessments of “sufficient means”, *firms* may decide not to seek to bring into account any benefit to the complainant in assessing overall compensation.
- 2.2.15** G_{/1} It would not be unreasonable if a *firm* providing redress in these circumstances were to frame its offer of redress on the assumption that the complainant will agree to surrender the *policy*. However, *firms* should bear in mind that there may be circumstances where it is appropriate for the complainant to retain the *policy*, for example, where it is being retained as a savings vehicle.
- 2.2.16** G_{/1} If a complainant becomes aware that he has taken out the endowment *policy* on the basis of unsuitable advice and inadequate information, he should if necessary, after taking appropriate advice, take reasonable steps to limit his loss, and may in any subsequent *claim* be unable to recover for losses which are avoidable. The complainant may have to show that he has not delayed unreasonably since becoming aware of his loss. The reasonable costs and expenses the complainant may have incurred in limiting his loss are to be taken into account in assessing his compensation. These costs and expenses are likely to include the complainant taking advice on whether he should convert from an endowment to a repayment mortgage and incurring expenses in doing so, see *DISP* App 2.3.
- 2.2.17** G_{/1} The standard approach to redress can be illustrated by the following examples, which show how redress would be calculated in certain hypothetical but typical scenarios. (Because the examples are illustrative, round numbers have been used for “established facts” in each example. The payments should be taken as being made monthly: *firms* should not approximate by assuming that payments are made annually. If the complainant has benefited from MIRAS, the calculations should allow for the effect of MIRAS both on the endowment mortgage and the repayment comparison.)
- 2.2.18** G_{/1} Table Table of examples of typical redress calculations

Example 1	Capital shortfall and higher endowment outgoings
Example 2	Capital shortfall partially offset by lower endowment mortgage outgoings
Example 3	Capital shortfall more than offset by lower endowment mortgage outgoings
Example 4	Capital surplus more than offset by higher endowment mortgage outgoings
Example 5	Capital surplus partially offset by higher endowment mortgage outgoings
Example 6	Capital surplus and lower endowment mortgage outgoings
Example 7	Low start endowment mortgage

- 2.2.19** G_{/1} Table Example 1

EXAMPLE 1	
Capital shortfall and higher endowment mortgage outgoings	
<u>Background</u>	
Capital sum of £50,000	
25 year endowment <i>policy</i>	
Duration to date: 5 years	
Endowment <i>premium</i> per month: £75	
<u>Established facts</u>	
Endowment <i>surrender value</i>:	£3,200
Capital repaid under equivalent repayment mortgage:	£4,200
<i>Surrender value</i> less capital repaid:	(£1,000)
Cost of converting from endowment mortgage to repayment mortgage:	(£200)
<u>Total outgoings to date</u>	
Equivalent repayment mortgage (capital + interest + DTA life cover):	£21,950
Endowment mortgage (endowment <i>premium</i> + interest):	£22,250
Difference in outgoings (repayment – endowment):	(£300)
<u>Basis of compensation</u>	
In this example, the complainant has suffered loss because the <i>surrender value</i> of the endowment is less than the capital repaid and also because of the higher total outgoings to date of the endowment mortgage relative to the repayment mortgage. The two losses and the conversion cost are therefore added together in order to calculate the redress.	
<u>Redress</u>	
Loss from <i>surrender value</i> less capital repaid:	(£1,000)
Loss from total extra outgoings under endowment mortgage:	(£300)
Cost of converting to repayment mortgage:	(£200)
Total loss:	(£1,500)
Therefore total redress is:	£1,500

2.2.20

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Table Example 2

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EXAMPLE 2	
Capital shortfall partially offset by lower endowment mortgage outgoings	
<u>Background</u>	

EXAMPLE 2	
Capital sum of £50,000	
25 year endowment <i>policy</i>	
Duration to date: 5 years	
Endowment <i>premium</i> per month: £60	
<u>Established facts</u>	
Endowment <i>surrender value</i> :	£2,500
Capital repaid under equivalent repayment mortgage	£4,200
<i>Surrender value</i> less capital repaid under equivalent repayment mortgage:	(£1,700)
Cost of converting from endowment mortgage to repayment mortgage	(£300)
<u>Total outgoings to date:</u>	
Repayment mortgage (capital + interest + DTA life cover):	£21,950
Endowment mortgage (endowment <i>premium</i> + interest):	£21,350
Difference in outgoings (repayment – endowment):	£600
<u>Basis of Compensation</u>	
In this example, the complainant has suffered loss because the <i>surrender value</i> of the endowment is less than the capital repaid but has gained from the lower outgoings of the endowment mortgage to date. In calculating the redress the gain may be offset against the loss unless the complainant's particular circumstances are such that it would be unreasonable to take account of the gain.	
Redress if it is not unreasonable to take account of the whole of the gain from lower outgoings	
Loss from <i>surrender value</i> less capital repaid:	(£1,700)
Gain from total lower outgoings under endowment mortgage:	£600
Cost of converting to repayment mortgage:	(£300)
Net loss:	(£1,400)
Therefore total redress is:	£1,400
Redress if it is unreasonable to take account of gain from lower outgoings	
Loss from <i>surrender value</i> less capital repaid:	(£1,700)
Gain from total lower outgoings under endowment mortgage:	Ignored*
Cost of converting to repayment mortgage:	(£300)
Net loss taken into account:	(£2,000)

EXAMPLE 2	
Therefore total redress is:	£2,000
* In this example, and also in Examples 3, 7, 8 and 9, the complainant's circumstances are assumed to be such as to make it unreasonable to take account of <i>any</i> of the gain from lower outgoings.	

2.2.21

G Table Example 3

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EXAMPLE 3	
Capital shortfall more than offset by lower endowment mortgage outgoings	
<u>Background</u>	
Capital sum of £50,000	
25 year endowment <i>policy</i>	
Duration to date: 8 years	
Endowment <i>premium</i> per month: £65	
<u>Established facts</u>	
Endowment <i>surrender value</i> :	£7,300
Capital repaid under equivalent repayment mortgage:	£7,600
<i>Surrender value</i> less capital repaid:	(£300)
Cost of converting from endowment mortgage to repayment mortgage:	(£200)
<u>Total outgoings to date</u>	
Repayment mortgage (capital + interest + DTA life cover):	£34,510
Endowment mortgage (endowment <i>premium</i> + interest):	£33,990
Difference in outgoings (repayment – endowment):	£520
<u>Basis of Compensation</u>	
In this example, the complainant has suffered loss because the surrender value of the endowment is less than the capital repaid but has gained from the lower total outgoings of the endowment mortgage. In calculating redress the gain may be offset against the loss unless the complainant's particular circumstances are such that it would be unreasonable to take account of the gain.	
Redress if it is not unreasonable to take account of the whole of the gain from lower outgoings	
Loss from <i>surrender value</i> less capital repaid:	(£300)
Gain from total lower outgoings under endowment mortgage:	£520
Cost of converting to repayment mortgage:	(£200)
Net gain:	£20
Therefore, there has been no loss and no redress is payable.	
Redress if it is unreasonable to take account of gain from lower outgoings	

EXAMPLE 3	
Loss from <i>surrender value</i> less capital repaid:	(£300)
Gain from total lower outgoings under endowment mortgage:	Ignored
Cost of converting to repayment mortgage:	(£200)
Net loss taken into account:	(£500)
Therefore total redress is:	£500

2.2.22

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Table Example 4

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EXAMPLE 4	
Capital surplus more than offset by higher endowment mortgage outgoings	
<u>Background</u>	
Capital sum of £50,000	
25 year endowment <i>policy</i>	
Duration to date: 8 years	
Endowment <i>premium</i> per month: £75	
<u>Established facts</u>	
Endowment <i>surrender value</i> :	£7,800
Capital repaid under equivalent repayment mortgage:	£7,600
<i>Surrender value</i> less capital repaid:	£200
Cost of converting from endowment mortgage to repayment mortgage:	(£250)
<u>Total outgoings to date</u>	
Repayment mortgage (capital + interest + DTA life cover):	£34,510
Endowment mortgage (endowment <i>premium</i> + interest):	£34,950
Difference in outgoings (repayment – endowment):	(£440)
<u>Basis of compensation</u>	
In this example, the complainant has suffered loss because of the higher total outgoings to date of the endowment mortgage but has gained because the <i>surrender value</i> of the endowment is greater than the capital repaid. Since the sum of the loss and the conversion cost is greater than the gain, the redress is calculated as the difference between the two.	
<u>Redress</u>	
Gain from <i>surrender value</i> less capital repaid:	£200
Loss from total extra outgoings under endowment mortgage:	(£440)
Cost of converting to repayment mortgage:	(£250)

EXAMPLE 4	
Net loss:	(£490)
Therefore total redress is:	£490

2.2.23

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Table Example 5

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EXAMPLE 5	
Capital surplus partially offset by higher endowment mortgage outgoings	
<u>Background</u>	
Capital sum of £50,000	
25 year endowment <i>policy</i>	
Duration to date: 10 years	
Endowment <i>premium</i> per month: £75	
<u>Established facts</u>	
Endowment <i>surrender value</i> :	£11,800
Capital repaid under equivalent repayment mortgage:	£9,700
<i>Surrender value</i> less capital repaid:	£2,100
Cost of converting from endowment mortgage to repayment mortgage:	(£300)
<u>Total outgoings to date</u>	
Repayment mortgage (capital + interest + DTA life cover):	£46,800
Endowment mortgage (endowment <i>premium</i> + interest):	£47,500
Difference in outgoings (repayment – endowment):	(£700)
<u>Basis of compensation</u>	
In this example, the complainant has suffered loss because of the higher total outgoings to date of the endowment mortgage relative to the repayment mortgage. However the sum of this and the conversion cost is less than the complainant's gain from the difference between the <i>surrender value</i> of the endowment and the capital repaid. Thus no redress is payable.	
<u>Redress</u>	
Gain from <i>surrender value</i> less capital repaid:	£2,100
Loss from total extra outgoings under endowment mortgage:	(£700)
Cost of converting to repayment mortgage:	(£300)
Net gain:	£1,100
Therefore there has been no loss and no redress is payable.	

2.2.24

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Table Example 6

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Example 6	
Capital surplus and lower endowment mortgage outgoings	
<u>Background</u>	
Capital sum of £50,000	
25 year endowment <i>policy</i>	
Duration to date: 10 years	
Endowment <i>premium per month</i> : £65	
<u>Established facts</u>	
Endowment <i>surrender value</i> :	£10,100
Capital repaid under equivalent repayment mortgage:	£9,700
<i>Surrender value</i> less capital repaid:	£400
Cost of converting from endowment mortgage to repayment mortgage:	(£200)
<u>Total outgoings to date</u>	
Repayment mortgage (capital + interest + DTA life cover):	£46,800
Endowment mortgage (endowment <i>premium</i> + interest):	£46,300
Difference in outgoings (repayment – endowment):	£500
<u>Basis of compensation</u>	
In this example, the complainant has gained both because the <i>surrender value</i> of the endowment is greater than the capital repaid and because of the lower total outgoings of the endowment mortgage. These gains are larger than the cost of converting to a repayment mortgage. Thus no further action is necessary.	
<u>Redress</u>	
As there has been no loss, no redress is payable.	

2.2.25

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Table Example 7

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Example 7	
Low start endowment mortgage	
<u>Background</u>	
Capital sum of £50,000	
25 year endowment <i>policy</i>	
Duration to date: 10 years	
Endowment <i>premium per month</i> : starting at £35 in first year, increasing by 20% simple on each <i>policy</i> anniversary, reaching £70 after five years and then remaining at that level.	
<u>Established facts:</u>	
Endowment <i>surrender value</i> :	£8,200
Capital repaid under equivalent repayment mortgage::	£9,700

Example 7	
<i>Surrender value</i> less capital repaid:	(£1,500)
Cost of converting from endowment mortgage to repayment mortgage:	(£250)
<u>Total outgoings to date</u>	
Repayment mortgage (capital + interest + DTA life cover):	£46,800
Endowment mortgage (endowment <i>premium</i> + interest):	£45,640
Difference in outgoings (repayment minus endowment):	£1,160
Of this difference in outgoings, £800 arose in the five year period when the complainant was paying a low endowment <i>premium</i> .	
<u>Basis of compensation</u>	
In this example, the complainant has suffered loss because the <i>surrender value</i> of the endowment is less than the capital repaid but has gained from the lower total outgoings of the endowment mortgage. As in Example 3, in calculating redress the whole of the gain should be offset against the loss unless the complainant's particular circumstances are such that it would be unreasonable to do so. However, unlike Example 3, in a low start endowment mortgage the complainant may have chosen to pay a lower than usual <i>premium</i> in the early years (this would need to be established on the facts of the case). Where it has been established that the complainant chose to make lower payments, even if it is unreasonable to take account of the whole of the gain from total outgoings, the gain from paying a lower <i>premium</i> during the low start period is normally taken into account. In such cases the redress is calculated as the capital loss plus the conversion cost minus the total amount by which repayment mortgage outgoings would have exceeded the actual low start endowment mortgage outgoings during the five year low start period.	
Redress if it is not unreasonable to take account of the whole of the gain from lower outgoings	
Loss from <i>surrender value</i> less capital repaid:	(£1,500)
Gain from total lower outgoings under endowment mortgage:	£1,160
Cost of converting to repayment mortgage:	(£250)
Net loss:	(£590)
Therefore total redress is:	£590
Redress if it is unreasonable to take account of gain from lower outgoings	
Loss from <i>surrender value</i> less capital repaid:	(£1,500)
Gain from total lower outgoings during low start period of endowment mortgage:	£800
Cost of converting to repayment mortgage:	(£250)
Net loss taken into account:	(£950)
Therefore total redress is:	£950

Interest rates

- 2.2.26** G_{/1} In fixing a repayment comparator, it would be appropriate to have regard to the repayment quotation actually provided at the time of sale. If more than one repayment quotation was obtained, the comparison should be with the quotation which approximates most closely to the terms of the endowment mortgage actually taken. If a repayment quotation was not provided, or is not now available, it should be assumed that the interest rate for the repayment comparison is the same as that of the mortgage endowment arrangements. *Firms* will then need to replicate interest rate changes throughout the lifetime of the comparator mortgage.

Life cover

- 2.2.27** G_{/1} Unless after due inquiry there is clear evidence that the complainant with a mortgage endowment had no foreseeable need for life cover at the time the endowment arrangements were concluded, in the overall comparison between a repayment mortgage and an endowment mortgage the monthly outgoings under the repayment will include the premium for the decreasing term assurance that would have been required. This adjustment for the cost of life cover is only to be made if the *firm* is undertaking a comparison of monthly outgoings. It is not appropriate to deduct the cost of life cover from the capital loss calculation, as this would constitute double counting.
- 2.2.28** G_{/1} If a deduction is to be attributed to the provision of life cover, the appropriate approach is to assume that the complainant took out the insurance quoted in the alternative repayment quotation provided at the time of the sale. If the quotation is not available, the deduction should be at the rates that would have been quoted at the time.

2.3 Remortgaging

- 2.3.1** G_{/1} As already noted, the basic objective of redress is to put the complainant, so far as is possible, in the position he would have been in if the inappropriate advice or other breach had not occurred: for their part, the complainants should take such reasonable steps as they can to limit loss once they are informed of the position they are in because of the failure of advice at the time of sale.
- 2.3.2** G_{/1} In practice, it is likely to be appropriate for a complainant whose complaint has been upheld to convert to a repayment mortgage, whether or not there is financial loss to date. It will normally be possible for complainants to do so without incurring unreasonable cost. Conversion will of course mean that the complainant no longer has a *policy*.
- 2.3.3** G_{/1} *Firms* should therefore in the case of upheld complaints inform complainants that it is likely to be appropriate and necessary for them to convert to a repayment arrangement.
- 2.3.4** G_{/1} *Firms* should make it clear that they will bear the costs of conversion if the rearrangement is made with the existing lender and to the equivalent repayment mortgage. If a complainant is not willing to rearrange with the existing lender, then

the costs to be paid by the *firm* should normally be limited to those which would have been payable had the rearrangement been made with the existing lender and to the equivalent repayment mortgage. If it is not possible to rearrange with the existing lender, for example, if the lender has a closed book, the *firm* should pay all costs which are not unreasonable in completing the rearrangement with an alternative provider. Such costs might include an administration fee for changing the existing arrangement, redemption penalty, arrangement fee for the new mortgage and the reasonable cost of further advice if necessary.

- 2.3.5** G_{/1} If the “new” mortgage is, in fact, arranged at a lower interest rate than the existing loan, the benefit to the complainant should usually be disregarded, as it is always open to complainants to change their underlying mortgage arrangements at any time.
- 2.3.6** G_{/1} If the “new” mortgage is arranged at a higher interest rate than the existing loan, the increased payment should not normally be taken into account in calculating any payment to be made to the complainant.
- 2.3.7** G_{/1} If the complainant takes the opportunity to increase his loan on the occasion of the remortgage, the expenses which a *firm* pays by way of compensation should be paid by reference to the capital sum due under the “old” loan.
- 2.3.8** G_{/1} As stated, one aspect of the conversion process is the disposal of the endowment *policy*. The standard approach to assessing loss requires *firms* to calculate loss using the *surrender value*. However, once loss is established on this basis and *firms* move to deal with redress, they may wish to consider whether there is a role for the *policy*’s “market value” within the traded endowment *policy* (TEP) market.
- 2.3.9** G_{/1} A *firm* may arrange the sale of the endowment *policy* on the traded endowment market, provided the full implications of such a course of action are explained to the complainant and his express consent is obtained for the firm to arrange the sale. This includes informing the investor that he will continue to be the life assured under the *policy*. The complainant should be informed that such an arrangement may reduce or eliminate the amount of redress actually borne by the *firm*, but not so as to affect the amount of redress he receives.
- 2.3.10** G_{/1} In the event that a complainant is willing to pursue this option, a *firm* should first have assessed the complainant’s loss using the approach set out in this appendix, and the minimum amount the complainant should receive under such a sale arrangement is the sum representing the position the complainant should have been in under this appendix together with the reimbursement of remortgaging costs. In order to ensure the process does not delay the provision of redress, the *firm* must pay this minimum sum immediately the complainant agrees to the sale arrangement. To the extent that the net amount realised by the sale of the *policy* on the traded endowment market exceeds the total redress due to the complainant, this greater sum is to be paid to the complainant on completion of the sale. If the amount realised by the sale of the *policy* on the traded endowment market is less than the total redress due to the complainant, the *firm* will be responsible for the amount of the shortfall.

- 2.3.11** G_{/1} Table Example of assessment set out at 2.3.10

The following example illustrates the position:

Surrender value	£10,000	TEP value	£16,000
Loss calculated by standard approach	£5,000		

Remortgaging costs	£300		
Total	<u>£15,300</u>		
Complainant receives £16,000 all ultimately funded from the TEP sale.			
Surrender value	£10,000	TEP value	£13,000
Redress calculated by standard approach	£5,000		
Remortgaging costs	£300		
Total	<u>£15,300</u>		
Complainant receives £15,300, £13,000 ultimately funded from the TEP sale and £2,300 ultimately funded from the <i>firm</i> .			

2.4 Policy reconstruction

2.4.1 G_{/1} This section of this appendix is primarily concerned with circumstances where the term of the mortgage and associated endowment *policy* extend beyond the individual complainant's normal retirement age in circumstances where the *firm* regards a complaint as justified because the arrangement is not affordable in retirement; and this could have, and should have, been foreseen at the time of the advice.

2.4.2 G_{/1} Two sets of circumstances are examined at *DISP* App 2.4.3G to *DISP* App 2.4.13G. Although these are considered in isolation, *firms* should, as part of their investigation of all of the factors involved in the complaint, consider whether either set of circumstances should be considered in conjunction with those factors examined at *DISP* App 2.2G.

Case 1

2.4.3 G_{/1} If on enquiry it is found that no proper assessment of the complainant's post-retirement means had been undertaken at the time of *sale*, but if the likelihood had been that the complainant would have borrowed the same amount over a shorter term (up to retirement) using an endowment *policy* as a repayment vehicle, then an appropriate form of redress would be for the *policy* to be reconstructed with a shorter term.

2.4.4 G_{/1} Redress should in most cases be provided by meeting the cost of rearranging the *policy*, by way of a lump sum payment into the *policy* in respect of the higher rate of *premium* due from its inception. It may be appropriate in individual cases to take account of the lower *premiums* that the complainant will have paid to date. The *guidance* in *DISP* App 2.2, as to the circumstances in which this will be appropriate, will be relevant here.

- 2.4.5** G_{/1} If the *policy* extends beyond retirement age and the complainant is already retired, the *policy* should be reconstructed to a maturity date as at the accepted retirement date, with the *policy* proceeds becoming immediately payable. The costs are to be borne by the *firm*, subject to any lower outgoings adjustment.
- 2.4.6** G_{/1} *Firms* should consider whether the reconstruction would have tax implications for complainants (see *DISP* App 2.5.8G and *DISP* App 2.5.9G).
- 2.4.7** G_{/1} The reconstruction process deals with the situation to the date the *policy* is reconstructed. The complainant will generally be responsible for paying the increased *premiums* for the remaining term.
- 2.4.8** G_{/1} At the time the complainant is advised of the revised *premium*, he should as a matter of good practice be provided with a reprojection based on the prevailing *projection* rates, which will allow him to address any projected shortfall.
- 2.4.9** G_{/1} If it is not possible for a *firm* to reconstruct a *policy*, then it should offer the investor equivalent redress, for example, by paying a cash lump sum equivalent to the amount that would have been credited to a reconstructed *policy*.

Case 2

- 2.4.10** G_{/1} If a loan extending into retirement was on any basis not affordable, whether or not it is reconstructed to the retirement date, *firms* will need to consider whether, if proper advice had been given, the loan would have been taken out at all and, if not, consider what arrangements might now need to be made in order to reduce the amount of the complainant's borrowings.

Mismatched loans and policy terms

- 2.4.11** G_{/1} If a complaint is regarded as justified by the *firm* on the basis that the endowment *policy* maturity date extends beyond the mortgage term expiry date and the *firm* is responsible for this situation, the *policy* should be reconstructed so that it matures at the expiry of the mortgage term.
- 2.4.12** G_{/1} In these circumstances the *guidance* given elsewhere in *DISP* App 2.4 will apply as appropriate.

Examples

- 2.4.13** G_{/1} The following examples illustrate the approach to redress as described in this section.
- 2.4.14** G_{/1} Table Example 8

EXAMPLE 8

Term extends beyond retirement age and *policy* reconstruction

Background

45 year old male non-smoker, having taken out a £50,000 loan in 1998 for a term of 25 years. Unsuitable sale identified on the grounds of affordability and complaint raised on 12th *policy* anniversary.

It has always been the intention of the complainant to retire at State retirement age 65.

Term from date of sale to retirement is 20 years and the maturity date of the mortgage is 5 years after retirement.

Established facts

Established <i>premium</i> paid by investor on <i>policy</i> of original term (25 years):	£81.20
<i>Premium</i> that would have been payable on <i>policy</i> with term from <i>sale</i> to retirement (20 years):	£111.20
Actual <i>policy</i> value at time complaint assessed:	£12,500
Value of an equivalent 20-year <i>policy</i> at time complaint assessed:	£21,300
Difference in <i>policy</i> values at time complaint assessed:	£8,800
Difference in outgoings (20 year <i>policy</i> – 25 year <i>policy</i>):	£4,320

Basis of compensation

The *policy* is reconstructed as if it had been set up originally on a term to mature at retirement age, in this example, a term of 20 years. The difference in the current value of the *policy* actually sold to the complainant and the current value of the reconstructed *policy*, as if the *premium* on the reconstructed *policy* had been paid from outset, is calculated. The complainant has gained from lower outgoings (lower *premiums*) of the actual endowment *policy* to date. In calculating the redress, the gain may be offset against the loss unless the complainant's particular circumstances are such that it would be unreasonable to take account of the gain.

Redress generally if it is not unreasonable to take account of the whole of the gain from lower outgoings

Loss from current value of reconstructed <i>policy</i> less current value of actual <i>policy</i> :	(£8,800)
Gain from total lower outgoings under actual <i>policy</i> :	£4,320
Net loss:	(£4,480)
Therefore total redress is:	£4,480

Redress if it is unreasonable to take account of gain from lower outgoings	
Loss from current value of reconstructed <i>policy</i> less current value of actual <i>policy</i> :	(£8,800)
Gain from total lower outgoings under actual <i>policy</i> :	<i>Ignored</i>
Therefore total redress is:	<u>£8,800</u>
<u>Additional Information</u>	
<p>If the <i>policy</i> is capable of reconstruction, the complainant must now fund the higher <i>premiums</i> himself for the remainder of the term of the shortened <i>policy</i> until maturity. In this example the higher <i>premium</i> could be £111.20. However the <i>firm</i> should provide the complainant with a reprojection letter based on the reconstructed <i>policy</i> such that the actual monthly payment required to achieve the target sum could be even higher, say £130. The reprojection letter should set out the range of options facing the complainant to deal with the projected shortfall, if any.</p>	

2.4.15

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Table Example 9

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EXAMPLE 9	
Term extends beyond retirement age: example of failure to explain investment risks	
<u>Background</u>	

EXAMPLE 9

45 year old male non-smoker, having taken out a £50,000 loan in 1998 for a term of 25 years. Unsuitable sale identified on the grounds of affordability and complaint raised on 12th anniversary.

It has always been the intention of the complainant to retire at state retirement age 65.

Term from date of sale to retirement is 20 years and the maturity date of the mortgage is five years after retirement.

In addition, an endowment does not meet the complainant's attitude to investment risk and a repayment mortgage would have been taken out if properly advised.

Established facts

<i>Surrender value</i> (on the 25 year <i>policy</i>) at time complaint assessed:	£12,500
Capital repaid under repayment mortgage of term to retirement date (20 years):	£21,000
<i>Surrender value</i> less capital repaid:	(£8,500)
Difference in outgoings (repayment – endowment):	£5,400
Cost of converting from endowment mortgage to repayment mortgage:	£200

Basis of compensation:

The *surrender value* of the (25 year term) endowment *policy* is compared to the capital that would have been repaid to date under a repayment mortgage arranged to repay the loan at retirement age, in this example, a repayment mortgage for a term of 20 years. The complainant has gained from lower outgoings of the endowment mortgage to date. In calculating the redress, the gain may be offset against the loss unless the complainant's particular circumstances are such that it would be unreasonable to take account of the gain. The conversion costs are also taken into account in calculating the redress.

Redress generally

Loss from <i>surrender value</i> less capital repaid:	(£8,500)
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EXAMPLE 9	
Gain from total lower outgoings under endowment mortgage:	£5,400
Cost of converting to a repayment mortgage:	(£200)
Net loss:	(£3,300)
Therefore total redress is:	<u>£3,300</u>
Redress if it is unreasonable to take account of gain from lower outgoings	
Loss from <i>surrender value</i> less capital repaid:	(£8,500)
Gain from total lower outgoings under endowment mortgage:	<i>Ignored</i>
Cost of converting to a repayment mortgage:	(£8,700)
Therefore total redress is:	<u>£8,700</u>

2.5 Additional considerations

Introduction

- 2.5.1 G_{/1} This section addresses two issues which may be relevant to the standard redress for unsuitability cases, as well as some post-retirement cases upheld on the grounds of affordability.

Continuing life cover and other policy benefits

- 2.5.2 G_{/1} *Firms* will need to consider the importance for many complainants of having life assurance in place to ensure a mortgage is paid off in the event of death.
- 2.5.3 G_{/1} If a complaint is upheld and the *policy* is to be surrendered as part of the settlement, the *firm* should remind the complainant in writing that the life cover within the endowment will be terminated and that it may therefore be appropriate to take advice about the merits or otherwise of taking out a stand-alone *life policy* in substitution.
- 2.5.4 G_{/1} If a need for life assurance at inception has been established so that a deduction representing its cost has been made from the redress payable under *DISP* App 2.2.4G, the *firm* should advise the complainant that the *firm* would be responsible for paying any *premium* for an appropriate replacement *policy* which exceeds that used for calculating the deduction or alternatively will, where possible, provide the

cover itself at that cost. If it is not possible for the *firm* to provide the cover itself at the original cost, it may choose to discharge that obligation by the payment of an appropriate lump sum. Any such amount should enable the complainant to effect the cover at the original cost, with no additional cost in respect of increased age or deterioration in health. This option may be particularly relevant if the *firm* against which the complaint has been made is an independent intermediary which cannot itself provide the cover, although it may be possible for such a *firm* to arrange for the product provider to offer cover to the complainant at the original *premium* on payment by the independent intermediary of an appropriate lump sum to meet any increased cost.

- 2.5.5** G_{/1} *Firms* will not be responsible for any increased costs resulting from the complainant choosing another *product provider* or for increased *premiums* charged by another provider chosen by the complainant in respect of the risk now presented, for example, higher *premiums* charged by the other provider due to deterioration in health, unless the original *product provider* no longer writes new business and is unable to offer revised life cover on a decreasing term assurance basis.
- 2.5.6** G_{/1} There can be exceptional circumstances where, in order to retain suitable life cover, the endowment *policy* has to be retained and any additional costs will be the responsibility of the *firm* that sold the endowment *policy*.
- 2.5.7** G_{/1} The same considerations will apply to the establishment of the need for other *policy* benefits including critical illness cover, disability cover and waiver of *premium*.

Taxation

- 2.5.8** G_{/1} *Firms* will need to consider the likely taxation implications for complainants if *policies* are surrendered or reconstructed, or any form of underpinning or guarantee is given.
- 2.5.9** G_{/1} If there is potential tax liability for the complainant, it will be appropriate for *firms* to undertake in writing to the complainant to reimburse any tax payable, or which becomes payable, and make payment on production of appropriate evidence of the liability and payment having been made.

”Underpinning”

- 2.5.10** G_{/1} *Firms* proposing to offer arrangements involving some form of minimum underpinning or “guarantee” should discuss their proposals with the *FSA* and the Inland Revenue at the earliest possible opportunity (see *DISP* App 2.5.8G). The *FSA* will need to be satisfied that these proposals provide complainants with redress which is at least commensurate with the standard approaches contained in this appendix.

Reference to the guidance in firms’ complaints settlement letters

- 2.5.11** G_{/1} One of the reasons for introducing the *guidance* in this appendix is to seek a reduction in the number of complaints which are referred to the *Financial Ombudsman Service*. If a *firm* writes to the complainant proposing terms for settlement which are in accordance with this appendix, the letter may include a statement that the calculation of loss and redress accords with the *FSA guidance*,

but should not imply that this extends to the assessment of whether or not the complaint should be upheld. *Firms* should point out that if the complainant remains dissatisfied, he may refer the complaint to the *Financial Ombudsman Service*.

2.5.12**G**

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A statement under *DISP* App 2.5.11G should not give the impression that the proposed terms of settlement have been expressly endorsed by either the *FSA* or the *Financial Ombudsman Service*.

Schedules



Handbook Modules

Schedule1 Record keeping requirements

1 Table

G

The aim of the *guidance* in the following table is to give the reader a quick overall view of the relevant record keeping requirements.

It is not a complete statement of those requirements and should not be relied on as if it were.

2 Table

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
<i>DISP</i> 1.5.1R	Complaints subject to <i>DISP</i> 1.4– <i>DISP</i> 1.6.	Not specified, but see <i>DISP</i> 1.5.2G	On receipt	3 years

Handbook Modules

Schedule2 Notification requirements

1 Table

G

The aim of the *guidance* in the following table is to give the reader a quick overall view of the relevant requirements for notification and reporting.

It is not a complete statement of those requirements and should not be relied on as if it were.

2 Table

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<i>DISP</i> 1.1.7R	<i>Firm</i> qualifies for exemption	Confirmation that a <i>firm</i> does not do business with <i>eligible complainants</i> and has no reasonable likelihood of doing so	If the <i>firm</i> wishes to take advantage of the exemption in <i>DISP</i> 1.1.7R an annual renewal is required. See <i>DISP</i> 1.1.8R for timing of notice	N/A
<i>DISP</i> 1.1.10R	End of exemption	Confirmation that the conditions in <i>DISP</i> 1.1.7R no longer apply	Conditions in <i>DISP</i> 1.1.7R no longer apply	Not specified
<i>DISP</i> 1.5.4R	Complaints report	Details	– 30 September – 31 March each year	One <i>month</i>
<i>DISP</i> 1.5.11R	Single contact point	Details	At the time of authorisation or on subsequent change	Not specified
<i>DISP</i> 1.7.5R	<i>Member</i> of Lloyd's qualifies for exemption	Confirmation by the <i>Society</i> of Lloyd's that a specified <i>member</i> of Lloyd's does not do business with <i>eligible complainants</i> and has no reasonable likelihood of doing so	[As above]	N/A

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<i>DISP</i> 1.7.6R	End of exemption for <i>member</i> of Lloyd's	Confirmation by the <i>Society</i> of Lloyd's that the condition in <i>DISP</i> 1.1.7R no longer apply to a specified <i>member</i> of Lloyd's	Conditions in <i>DISP</i> 1.1.7R no longer apply	Not specified
<i>DISP</i> 1.7.7R	Complaints report by <i>Society</i> of Lloyd's	Details	– 30 September – 31 March each year	One <i>month</i>

Handbook Modules

Schedule3 Fees and other required payment

- 1 The table of fees and other required payments will be inserted in DISP at a later date.

Handbook Modules

Schedule4 Powers Exercised

1 Table

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- 1 The following powers and related provisions in the *Act* and in the *Ombudsman Transitional Order* have been exercised by the *FSA* to make the *rules* in *DISP*:
 - (1) Section 138 (General *rule*-making power)
 - (2) Section 156 (General supplementary powers)
 - (3) Section 226 (*Compulsory Jurisdiction*)
 - (4) Section 229 (Awards)
 - (5) Schedule 17 paragraph 13 (*FSA's* procedural *rules*)
 - (6) Article 15 (Record-keeping and reporting requirements relating to *relevant complaints*) of the *Ombudsman Transitional Order*.

- 2 The following power in the *Act* has been exercised by the *FSA* to give the *guidance* in *DISP*:
 - (1) Section 157(1) (*Guidance*)

- 3 The following powers and related provisions in the *Act* have been exercised by the *FOS Ltd* to make the *rules* in *DISP*:
 - (1) Section 227 (*Voluntary Jurisdiction*)
 - (2) Section 230 (Costs)
 - (3) Schedule 17 paragraph 8 (*Guidance*)
 - (4) Schedule 17 paragraph 14 (The scheme's *rules*)
 - (5) Schedule 17 paragraph 15 (*Fees*)
 - (6) Schedule 17 paragraph 18 (Terms of reference to the scheme)

- 4 For convenience, the table below shows the various powers exercised by the *FSA* and *FOS Ltd* in making the various *rules* in *DISP*.

- 5 The aim of the *guidance* in the following table is to give the reader a quick overall view of the *rule*-making powers exercised by the *FSA* and *FOS Ltd*.

2 Table

- 6 It is not a complete statement of those requirements and should not be relied on as if it were.
- 7 The powers to make *rules* relating to the new *ombudsman* scheme are shared between the *FSA* and the *Financial Ombudsman Service (FOS Ltd)*. *FOS Ltd's* rules are subject to *FSA* consent or approval. (Powers exercised by *FOS Ltd* are marked by * in the table below).

3 Table

The Handbook					The Financial Services and Markets Act 2000	
					Reference	
Chapter/ Appendix	Section/ Annex	Paragraph or paragraphs				
1	Complaint handling procedures for firms	1	Application and purpose	1R	Application	Schedule 17 paragraph 13 (4) s.138
				7R	Exemption	Schedule 17 paragraph 13(4) s.138
				8R		Schedule 17 paragraph 13(4) s.138
				10R	End of exemption	Schedule 17 paragraph 13(4) s.138
				1R		Schedule 17 paragraph 13(4) s.138
				–		Schedule 17 paragraph 13(4) s.138
				9R		Schedule 17 paragraph 13(4) s.138
				16R		Schedule 17 paragraph 13(4) s.138
				–		Schedule 17 paragraph 13(4) s.138
				17R		Schedule 17 paragraph 13(4) s.138
		21R		Schedule 17 paragraph 13(4) s.138		
		–		Schedule 17 paragraph 13(4) s.138		
		22R		Schedule 17 paragraph 13(4) s.138		
		3	Internal complaint handling procedure: additional requirements	2R		Schedule 17 paragraph 13(4)
		–		3R		
		4	Time limits for dealing with a complaint	1R		Schedule 17 paragraph 13(4)
–		4R				
–		5R		Schedule 17 paragraph 13(4)		
–		6R				
–		7R		Schedule 17 paragraph 13(4)		
–		9R				
–		10R		Schedule 17 paragraph 13(4)		
–		12R				

				15R – 16R		Schedule 17 paragraph 13(4)
		5	Record keeping and reporting	1R – 4R 6R – 7R 10R – 11R	Making and retaining records of complaints Reporting complaints to the <i>FSA</i> Method of submission of reports Notification of contact point for complainants	s.138 Schedule 17 paragraph 13(4) Schedule 17 paragraph 13(4)
		6	Cooperation by <i>firms</i> with the <i>Om- budsman</i>	1R		Schedule 17 paragraph 13(4)
		7	The <i>Society</i> of Lloyds	1R – 2R 3R – 4R 5R – 6R 7R – 11R		Schedule 17 paragraph 13(4) Schedule 17 paragraph 13(4) Schedule 17 paragraph 13(4) Schedule 17 paragraph 13(4)
		Ann	Complaint categories	1R		Schedule 17 paragraph 13(4)
2	Jurisdiction of the <i>Financial Om- budsman Service</i>	1	Application and Pur- pose	1R	Application	s.226(3) s.227(3)*
		3	Time limits for refer- ring complaints to the <i>Fi- nancial Ombudsman Service</i>	1R – 5R		Schedule 17 paragraph 13(1) and (2) Art 4(2) of <i>Om- budsman Transi- tional Order</i> s.227(3)*
		4	Who can refer a com- plaint to the <i>Finan- cial Ombudsman Service</i> ?	1R – 3R 7R – 8R 10R – 11R 12R – 16R	Classes of person <i>Eligible complainants</i> : customers <i>Eligible complainants</i> : potential customers <i>Eligible complainants</i> : indirect complaints Representatives of <i>eligible com- plainants</i>	s.226(3), (6) and (7) s.227(3), (7) and (8) s.226(3), (6) and (7) s.227(3), (7) and (8)* s.226(3), (6) and (7) s.227(3), (7) and (8) s.226(3), (6) and (7) s.227(3), (7) and (8)

3	Complaint handling procedures of the <i>Financial Ombudsman Service</i>	6	To which activities do the rules apply?	17R	The <i>Compulsory Jurisdiction</i>	s.226(3), (6) and (7) s.227(3), (7) and (8) s.226(3) Art 3 of <i>Ombudsman Transitional Order</i> s.226(3) s.227(3)*
				1R		
				–		
				2R		
				7R		
				9R		The <i>Voluntary Jurisdiction</i>	s.227(3)*
		–				
		11R				
		12R		s.227(3) and (14)*		
		7	The territorial scope of the jurisdiction of the <i>Financial Ombudsman Service</i>	1R		s.226(3) s.227(3)*
		1	Application and purpose	1R	Application	Schedule 17 paragraph 14(1)*
		–				
		2	The investigation and consideration of complaints by the <i>Ombudsman</i>	1R		Schedule 17 paragraph 13(3)*
		–				
		3R				
		4R				Schedule 17 paragraph 14(1)*
		–				
		5R				
		7R				Schedule 17 paragraph 14(1) and (2)(b)*
		–				
		8R				
9R				Schedule 17 paragraph 14(1)*		
–						
11R						
12R				Schedule 17 paragraph 14(1)*		
–						
13R						
3	Dismissal of complaints without consideration of the merits	1R		Schedule 17 paragraph 14(1), (2)(b) and (3)*		
4	Referral of a complaint to another complaints scheme for determination	1R		Schedule 17 paragraph 14(1) and (2)(c)*		
5	Evidence	1R		Schedule 17 paragraph 14(1) and (2)(d)*		
–						
2R						
6	Time limits	1R		Schedule 17 paragraph 14(1), (2)(d) and (e)*		
–						
2R				Schedule 17 paragraph 14(1), (2)(c) and (d)*		
3R						

4	<i>Standard terms</i>	7	Delegation of the <i>Ombudsman's</i> Powers	1R		Schedule 17 paragraph 14(1) and (2)*	
		8	Determination by the <i>Ombudsman</i>	1R	Opinion as to fairness and reasonableness	s.228(2), (3) and (7)	
				–			
				3R	The <i>Ombudsman's</i> determination	Schedule 17 paragraph 14(1) and (2)(c)*	
		9	Awards by the <i>Ombudsman</i>	2R	Money Awards	s.229(3)(b) and (11)	
				–			
				5R	Limits on money awards	s.229(6)	
				10R	Costs	s.230(1) and (5)*	
				–			
				12R			
				14R	Complying with awards and settlements	Schedule 17 paragraph 14(1) and (16)*	
				–			
				15R			
				10	Dealing with information	1R	Schedule 17 paragraph 14(1)*
		App 1	<i>Relevant existing complaints</i>	2	The <i>standard terms</i>	1R		Schedule 17 paragraph 18(1)*
				–			
				2R	Complaint handling procedures		
				4R	Jurisdiction of the <i>Financial Ombudsman Service</i>	Schedule 17 paragraph 18(1)	
				–			
				5R			
				6R		Schedule 17 paragraph 18(1) and (5)*	
				–			
				7R	Liability		
				8R	Determination and awards	Schedule 17 paragraph 18(1)*	
				–			
		10R	Enforcement of a determination				
		11R	Withdrawal from the Voluntary Jurisdiction of the <i>Financial Ombudsman Service</i>				
		1	Application and purpose	1R	Application	Article 2 <i>Ombudsman Transitional Order</i>	
				–			
				2R	Purpose		
		14	Cooperation with the <i>Ombudsman</i>	1R		Article 4(4), <i>Ombudsman Transitional Order</i>	

Handbook Modules

Schedule 5

Actions for damages for contravention under section 150 of the Act

1 Table

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1	The table below sets out the rules in <i>DISP</i> contravention of which by an <i>authorised person</i> may be actionable under section 150 of the <i>Act</i> (Actions for damages) by a <i>person</i> who suffers loss as a result of the contravention.
2	If a "Yes" appears in the column headed "For <i>private person</i> ?", the rule may be actionable by a " <i>private person</i> " under section 150 (or, in certain circumstances, his fiduciary or representative; see article 6(2) and (3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001 No 2256)). A "Yes" in the column headed "Removed" indicates that the <i>FSA</i> has removed the right of action under section 150(2) of the <i>Act</i> . If so, a reference to the rule in which it is removed is also give.
3	The column headed "For other person?" indicates whether the rule may be actionable by a <i>person</i> other than a <i>private person</i> (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of <i>person</i> by whom the rule may be actionable is given.

2 Table

Chapter/ Appendix	Section/ Annex	Paragraph	Right of action under s150			
			For Private Person?	Removed?	For Other Person?	
1 Complaints handling arrangements for <i>firms</i>	--	--	Yes	---	---	---
2 Jurisdiction rules	--	--	Yes	-	-	---

3	Complaints handling procedures of the <i>Financial Ombudsman Service</i>	--	--	Yes	—		—	
4	The <i>standard terms</i>	--	--	N/A	—			
5	Funding	--	--	Yes	—			

Handbook Modules

Schedule6 Rules that can be waived

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- 1 No rules in DISP may be waived, other than DISP 1.5.4R.

Handbook Modules

Dispute resolutions: Complaints sourcebook

Derivations

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1. There is no table of derivations for this sourcebook.

Handbook Modules

Dispute resolutions: Complaints sourcebook

Destinations

G

1. There is no table of destinations for this sourcebook.

**THE PROFESSIONAL FIRMS SOURCEBOOK (AMENDMENT) INSTRUMENT
2001**

- A. The Financial Services Authority amends the Professional firms sourcebook ('PROF') in the exercise of the powers in Section 138 (General rule-making power) and in Section 157(1) (Guidance) of the Financial Services and Markets Act 2000.
- B. This instrument shall come into force immediately.
- C. PROF is amended as set out in the Annex to this instrument.
- D. This instrument may be cited as the Professional Firms Sourcebook (Amendment) Instrument 2001.

By order of the Board

20 September 2001

ANNEX

Amendments to PROF

1. In *PROF* 5.2.1R(5) substitute "the regulated activity must be an activity" for "the regulated activities must be activities".
2. In *PROF* 5.3 insert "other" before "sourcebooks".
3. In *PROF* 5.3.1G substitute "The parts" for "Parts" and substitute "*PROF* 5.3.7G" for "*PROF* 5.3.5G".
4. In *PROF* 5.3.3G delete "The" at the beginning of the heading and substitute "TC 2" for "chapter 2".
5. In the heading of *PROF* 5.3.4G delete "The".
6. In place of *PROF* 5.3.6G insert the following:

Dispute resolution: Complaints sourcebook

5.3.6 G *DISP* 1.1.1R(1)(c) provides that *DISP* 1 (Complaint handling procedures for firms) does not apply to an *authorised professional firm* in so far as its *non-mainstream regulated activities* are concerned. *DISP* 2.6.7R further provides that a complaint about an *authorised professional firm* cannot be handled under the *Compulsory Jurisdiction* of the *Financial Ombudsman Service* if it relates solely to *non-mainstream regulated activity* and can be handled by a *designated professional body*. This is because such a complaint will be handled by the relevant professional body.

7. Insert the following after *PROF* 5.3.6G:

Market Conduct sourcebook

5.3.7 G *MAR* 4.4.1R(3) provides that *MAR* 4, which deals with the endorsement of the City Code on Takeovers and Mergers and the Rules Governing Substantial Acquisitions of Shares, does not have effect in relation to an *authorised professional firm* in respect of *non-mainstream regulated activity*.

COLLECTIVE INVESTMENT SCHEMES (AMENDMENT) INSTRUMENT 2001

Powers Exercised

- A. The Financial Services Authority amends the Collective Investment Schemes Sourcebook in the exercise of the powers and related provisions listed in Schedule 4 to the Collective Investment Schemes Sourcebook (Powers Exercised)
- B. The provisions of and under the Act relevant to making rules and listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement:

- C. This instrument shall come into force at the beginning of the day on which section 19 of the Act (The general prohibition) comes into force.

Amendments to the Collective Investment Schemes Sourcebook

- D. The Collective Investment Schemes Sourcebook is amended in accordance with the Annex to this instrument.

Citation

- E. The instrument may be cited at the Collective Investment Schemes (Amendment) instrument 2001

By order of the Board
20 September 2001

ANNEX

Transitional 7	(1) Delete '(d) a fund of funds scheme; or'
	(2) Replace '(e)' with '(d)'
	(3) Replace '(f)' with '(e)' and at the end of '(f)' replace '(e)' with '(d)'
CIS 4.7.5G	Replace 'G' with an 'R'
CIS 5.4.6R(4)	Replace '(30)' and '(29)' with '(80)' and '(79)' respectively
CIS 15.8.4R Section 5 Note 7	Replace the second sentence with 'If that amount is receivable (for example, the contract is "in the money") deduct minimum dealing costs. If, however, the amount is payable (for example, the contract is "out of the money") then add minimum dealing costs to the <i>margin</i> and the value is that figure as a negative sum.'
CIS 16.5.2G	Replace the cross reference ' <i>AUTH</i> 3.20.3R(3)' with ' <i>CIS</i> 16.5.1R(3)'

Special Guide for Energy Market Participants Instrument 2001

- A. The Financial Services Authority gives the guidance in the Annex to this instrument in the exercise of the power in section 157(1) of the Financial Services and Markets Act 2000.
- B. This instrument comes into force immediately.
- C. This instrument may be cited as the Special Guide for Energy Market Participants Instrument 2001.
- D. The Annex to this instrument may be cited as the Special guide for energy market participants, or EMPS.

By order of the Board
20 September 2001

Annex

EMPS: Special guide for energy market participants

EMPS: Special guide for energy market participants

1. Special guide for energy market participants

1.1 Application and purpose

- 1.1.1 G This special guide is for *energy market participants*.
- 1.1.2 G The purpose of this special guide is to help prospective and actual *energy market participants* find their way around the *Handbook* by setting out which parts of it apply to them and by setting out a form of *waiver* that the *FSA* will be minded to grant to *energy market participants*.

1.2 Parts of Handbook applicable to energy market participants

- 1.2.1 G The parts of the Handbook and their applicability to *energy market participants* are listed in *EMPS 1.2.3G*. *Energy market participants* should read applicable parts of the *Handbook* to find out what the detailed regulatory requirements for *energy market participants* are.
- 1.2.2 G *EMPS 1.2.3G* takes account of the availability of the *waiver* mentioned in *EMPS 2*.
- 1.2.3 G Table Applicability of parts of Handbook to energy market participants

This table belongs to *EMPS 1.2.1G*

	Part of Handbook	Applicability to energy market participants
High Level Standards	Principles for Businesses (<i>PRIN</i>)	This applies.
	Senior management arrangements, Systems and Controls (<i>SYSC</i>)	This applies.
	Threshold Conditions (<i>COND</i>)	This applies.
	Statements of Principle and Code of Practice for Approved Persons (<i>APER</i>)	This applies to an <i>approved person</i> who performs a <i>controlled function</i> for an <i>energy market participant</i> .
	The Fit and Proper test for Approved Persons (<i>FIT</i>)	This applies.
	General provisions (<i>GEN</i>)	This applies.

	Part of Handbook	Applicability to energy market participants
Business standards	Interim Prudential sourcebooks (<i>IPRU</i>)	<p>Chapter 1 (Application and General) of <i>IPRU(INV)</i> (Interim Prudential sourcebook: Investment Businesses) applies.</p> <p>Chapter 3 (Financial resources for Securities and Futures Firms which are not Investment Firms) of <i>IPRU(INV)</i> applies, but <i>energy market participants</i> whose main business consists of the generation, production, storage, distribution and/or transmission of <i>energy</i> may be granted a waiver of Chapter 3 in the FSA's discretion: see <i>EMPS 2</i>.</p> <p>The other parts of <i>IPRU(INV)</i> do not apply.</p> <p>The other <i>IPRU</i> sourcebooks do not apply.</p>
	Conduct of Business sourcebook (<i>COB</i>)	Only some parts of <i>COB</i> apply to <i>energy market activity</i> : see <i>COB 1.6.6R – COB 1.6.11G</i> .
	Market Conduct sourcebook (<i>MAR</i>)	This applies; however <i>MAR 2</i> (Price stabilising rules) is likely to be of only marginal relevance to the business of an <i>energy market participant</i> .
	Training and Competence sourcebook (<i>TC</i>)	<p><i>TC 1</i> (Commitments) applies.</p> <p><i>TC 2</i> (Rules and guidance) is likely to apply where an <i>energy market participant</i> conducts activities set out in <i>TC 2.1.4R</i>. However, <i>energy market participants</i> may be granted a waiver of <i>TC 2.4.5R(2)</i> in the FSA's discretion: see <i>EMPS 2</i>. Where such a waiver is granted the <i>energy market participant</i> will be entitled to assess an <i>employee</i> as competent to engage in or oversee an activity even though the <i>employee</i> has not passed each module of the appropriate <i>approved examination</i>.</p>
	Money Laundering sourcebook (<i>ML</i>)	This applies.

	Part of Handbook	Applicability to energy market participants
Regulatory processes	Authorisation manual (<i>AUTH</i>)	This applies in relation to an application by a prospective <i>energy market participant</i> for a <i>Part IV permission</i> .
	Supervision manual (<i>SUP</i>)	This applies, with the following qualifications: <ul style="list-style-type: none"> (a) in <i>SUP</i> 3 (Auditors), only some provisions apply if <i>IPRU(INV)</i> 3 (Financial resources for Securities and Futures Firms which are not Investment Firms) does not apply to an <i>energy market participant</i> (because it has been granted a <i>waiver</i> of that chapter as described in <i>EMPS</i> 2): see <i>SUP</i> 3.1.2R and <i>SUP</i> 3.2.4G; (b) in <i>SUP</i> 10 (Approved persons), if an <i>energy market participant's</i> principal purpose is to carry on activities other than <i>regulated activities</i>, then the scope of the <i>significant influence functions</i> is restricted to the <i>required functions</i>: see <i>SUP</i> 10.1.21R – <i>SUP</i> 10.1.22G; (c) <i>SUP</i> 16.7 (Financial reports): <i>energy market participants</i> whose main business consists of the generation, production, storage, distribution and/or transmission of <i>energy</i> may be granted a <i>waiver</i> of this section in the <i>FSA's</i> discretion: see <i>EMPS</i> 2; (d) <i>SUP</i> 17 (Transaction reporting): <i>energy market participants</i> may be granted a <i>waiver</i> of this section in the <i>FSA's</i> discretion: see <i>EMPS</i> 2; and (e) <i>SUP</i> App 2 (Insurers: Scheme of operations) does not apply.
	Enforcement manual (<i>ENF</i>)	This applies.
	Decision making manual (<i>DEC</i>)	This applies.
Redress	Dispute resolution: Complaints sourcebook (<i>DISP</i>)	<p><i>Energy market participants</i> are subject to the <i>compulsory jurisdiction</i> of the <i>Financial Ombudsman Service</i>.</p> <p>However, a <i>firm</i> which does not, and notifies the <i>FSA</i> under <i>DISP</i> 1.1.7R that it does not, conduct business with <i>eligible complainants</i> (persons eligible to have a complaint considered under the <i>Financial Ombudsman Service</i>, as defined in <i>DISP</i> 2.4) will be exempt from the <i>rules</i> on complaint handling procedures for <i>firms</i> (<i>DISP</i> 1.2 to <i>DISP</i> 1.7) and from the <i>Financial Ombudsman Funding rules</i> (<i>DISP</i> 5.2 to <i>DISP</i> 5.8).</p>

	Part of Handbook	Applicability to energy market participants
	Compensation sourcebook (<i>COMP</i>)	<i>COMP</i> applies to all <i>firms</i> . However, <i>energy market participants</i> that do not conduct business that could give rise to a <i>protected claim</i> by an <i>eligible claimant</i> as defined and have no reasonable likelihood of doing so can gain exemption under <i>COMP</i> 13.3 from some compensation scheme levies.
	Complaints against the FSA (<i>COAF</i>)	This applies.
Specialist sourcebooks	Collective Investment Schemes sourcebook (<i>CIS</i>)	<i>CIS</i> will ordinarily apply to an <i>energy market participant firm</i> that carries on <i>regulated activities</i> in relation to an <i>energy collective investment scheme</i> .
	Professional firms sourcebook (<i>PROF</i>)	None of the other specialist sourcebooks applies.
	Lloyd's sourcebook (<i>LLD</i>)	
	Recognised Investment Exchange and Recognised Clearing House sourcebook (<i>REC</i>)	
Special guides	Special guide for service companies (<i>SERV</i>)	This does not apply because an <i>energy market participant</i> is defined to exclude a <i>service company</i> .
	Special guide for energy market participants (<i>EMPS</i>)	This applies.
	Special guide for oil market participants (<i>OMPS</i>)	This does not apply because an <i>energy market participant</i> is defined to exclude an <i>oil market participant</i> .
Schedules	Summary schedules	These apply, but only to the extent that the sourcebook or manual to which they relate applies.
	1. Record keeping requirements	
	2. Notification requirements	
	3. Fees and other required payments	
	4. Powers exercised in making the Handbook	
	5. Rights of action for damages	
	6. Rules that can be waived	
	7. Releases	
	Glossary of definitions	This applies.
	Index	This applies.

2 Waiver

2.1 Form of waiver

- 2.1.1 G *EMPS 2 Ann 1G* sets out a form of *waiver* that the *FSA* will be minded to give to *energy market participants* in the exercise of its statutory discretion under section 148 of the *Act* to grant a *waiver* of certain *rules*.
- 2.1.2 G *Energy market participants* should bear in mind that section 148 of the *Act* requires that in order to give a *waiver* of particular *rules*, the *FSA* must be satisfied that:
- (1) compliance with the *rules*, or with the *rules* as unmodified, would be unduly burdensome or would not achieve the purpose for which the *rules* were made; and
 - (2) the *waiver* would not result in undue risk to persons whose interests the *rules* are intended to protect.
- 2.1.3 G Accordingly, the *FSA* must be satisfied that the statutory criteria will be met in each case where an *energy market participant* applies for a *waiver* in the form in *EMPS 2 Ann 1G*.
- 2.1.4 G In particular, clause 4 of the form of *waiver* in *EMPS 2 Ann 1G* will not ordinarily be inserted in *waivers* for *energy market participants* that will not, at the time the *waiver* will take effect, clearly satisfy the conditions set out in that clause. For these purposes the *FSA* will take into account the relative proportions of the *energy market participant's* assets and revenues that are referable to the various parts of its business, as well as to any other factor that the *FSA* considers is relevant to an assessment of the prudential risk presented by the *energy market participant*.

Form of Waiver: Energy Market Participant

Power

1. This *waiver* is given by the *FSA* under section 148 of the *Act* (Modification and waiver of rules).

Authorised person to whom this waiver applies

2. This *waiver* applies to (the “firm”).

Guidance Note

In addition to the provisions of this *waiver*, the following special application provisions in the *Handbook* will apply to the firm because it is an *energy market participant*: *COB* 1.6.6R – *COB* 1.6.11G and *SUP* 3.1.2R, *SUP* 3.2.4G, *SUP* 10.1.21R and *SUP* 10.1.22G.

Term

3. (1) This *waiver* takes effect from the date of this notice.

(2) However, if the firm is not then an *energy market participant*, this *waiver* takes effect only when the firm becomes one.

(3) This *waiver* ends, except as specified in (4):

(a) when the firm first stops being an *energy market participant*; or

(b) if (a) does not happen earlier, 30 November 2003.

(4) The modification of *TC* 2.4.1R in this *waiver* ends 12 months after the date in (3).

Waiver: Capital and financial reporting requirements¹

4. The *FSA* directs that the parts of the *Handbook* mentioned in the table do not apply to the firm, if the firm satisfies both the following conditions:

(1) the firm’s main business consists of the generation, production, storage, distribution, or transmission of *energy*; and

(2) the firm does not engage in *oil market activity* as a member of a *recognised investment exchange* or *designated investment exchange* which is under the rules of that exchange entitled to trade with other members.

Table:

Part of Handbook	Waiver
<i>IPRU(INV)</i> 3	<i>IPRU(INV)</i> 3 (Financial resources for Securities and Futures Firms which are not Investment Firms) does not apply to the firm if the firm satisfies both the conditions in this clause.

¹ For whether this clause would be inserted in a particular case, see *EMPS* 2.1.4G.

Part of Handbook	Waiver
SUP 16.7	SUP 16.7 (Financial reports) does not apply to the firm if the firm satisfies both the conditions in this clause.

Guidance Notes

An *energy market participant* to which IPRU(INV) 3 does not apply is still subject to the requirement of *Principle 4* to have adequate financial resources.

The conditions in this clause are imposed under s. 148(5) of the *Act*. For *guidance* on the effect of conditions attached to a *waiver*, see SUP 8.4.1G(2).

Waiver: Training and competence

5. The *FSA* directs that the parts of the *Handbook* mentioned in the table apply to the firm with the modifications specified in the table.

Table:

Part of Handbook	Modifications
TC 2.4.1R and TC 2.4.5R	<p>TC 2.4.1R and TC 2.4.5R are modified:</p> <p>(1) so that TC 2.4.5R(2) does not apply to the firm during the term of this <i>waiver</i> in relation to any <i>person</i> who is an <i>employee</i> of the firm during the term of this <i>waiver</i>; and</p> <p>(2) so that any assessment of an <i>employee</i> in reliance on (1) ceases to have effect for the purposes of TC 2.4.1R 12 months after the end of this <i>waiver</i>.</p>

Guidance Note

TC 2.4.1R provides (with certain exceptions) that a *firm* must not permit an *employee* to engage in or oversee an activity unless the *employee* has been assessed as competent in that activity in accordance with TC 2.4.5R

TC 2.4.5R(2) provides that a *firm* must not assess an *employee* as competent to engage in or oversee an activity unless the *employee* has passed each module of the appropriate *approved examination* specified in the annexes to TC 2.

Twelve months after the end of this *waiver*, an assessment of competence carried out in reliance on this *waiver* will cease to have effect. The effect of this is to require a re-assessment of the competence of an *employee* who was assessed as competent without having passed each module of the appropriate *approved examination* specified in the annexes to TC 2 in accordance with TC 2.4.1R and TC 2.4.5R (to the extent that TC 2.4.1R would otherwise apply to the firm in relation to that *employee*).

Modification: Transaction reports

6. The *FSA* directs that the part of the *Handbook* mentioned in the table apply to the firm with the modifications specified in the table.

Table:

Part of Handbook	Modification
SUP 17	SUP 17 (Transaction reports) does not apply to the firm in relation to its <i>energy market activity</i> .

Interpretation

7. (1) Unless the contrary intention appears, interpretative provisions in *GEN 2* (Interpreting the Handbook) apply to this *waiver* in the same way they apply to the *Handbook*.

Guidance Note

Defined terms in this *waiver* (other than the term "the firm") are italicised.

(2) For the purposes of this *waiver*, the term "employee" has the same meaning as in *TC*.

Special Guide for Oil Market Participants Instrument 2001

- A. The Financial Services Authority gives the guidance in the Annex to this instrument in the exercise of the power in section 157(1) of the Financial Services and Markets Act 2000.
- B. This instrument comes into force immediately.
- C. This instrument may be cited as the Special Guide for Oil Market Participants Instrument 2001.
- D. The Annex to this instrument may be cited as the Special guide for oil market participants, or OMPS.

By order of the Board
20 September 2001

Annex

OMPS: Special guide for oil market participants

OMPS: Special guide for oil market participants

1. Special guide for oil market participants

1.1 Application and purpose

- 1.1.1 G This special guide is for *oil market participants*.
- 1.1.2 G The purpose of this special guide is to help prospective and actual *oil market participants* find their way around the *Handbook* by setting out which parts of it apply to them.

1.2 Parts of the Handbook applicable to oil market participants

- 1.2.1 G The parts of the *Handbook* and their applicability to *oil market participants* are listed in OMPS 1.2.2G. *Oil market participants* should read applicable parts of the *Handbook* to find out what the detailed regulatory requirements for *oil market participants* are.
- 1.2.2 G Table: Parts of *the Handbook* applicable to *oil market participants*

This table belongs to OMPS 1.2.1G

	Part of Handbook	Applicability to oil market participants
High Level Standards	Principles for Businesses (<i>PRIN</i>)	This applies.
	Senior management arrangements, Systems and Controls (<i>SYSC</i>)	This applies.
	Threshold Conditions (<i>COND</i>)	This applies.
	Statements of Principle and Code of Practice for Approved Persons (<i>APER</i>)	This applies to an <i>approved person</i> who performs a <i>controlled function</i> for an <i>oil market participant</i> .
	The Fit and Proper test for Approved Persons (<i>FIT</i>)	This applies.
	General provisions (<i>GEN</i>)	This applies.

	Part of Handbook	Applicability to oil market participants
Business standards	Interim Prudential sourcebooks (<i>IPRU</i>)	<p>Chapter 1 (Application and General) of <i>IPRU(INV)</i> (Interim Prudential sourcebook: Investment Businesses) applies.</p> <p>Chapter 3 (Financial resources for Securities and Futures Firms which are not Investment Firms) of <i>IPRU(INV)</i> only applies to an <i>oil market participant</i> if it is a member of a <i>recognised investment exchange</i> or a <i>designated investment exchange</i> which is, under the rules of that exchange, entitled to trade with other members: see <i>IPRU(INV)</i> 3-1A.</p> <p>The other parts of <i>IPRU(INV)</i> do not apply.</p> <p>The other <i>IPRU</i> sourcebooks do not apply.</p>
	Conduct of Business sourcebook (<i>COB</i>)	Only some parts of <i>COB</i> apply to <i>oil market activity</i> : see <i>COB</i> 1.6.6R - <i>COB</i> 1.6.11G.
	Market Conduct sourcebook (<i>MAR</i>)	This applies; however <i>MAR</i> 2 (Price stabilising rules) is likely to be of only marginal relevance to the business of an <i>oil market participant</i> .
	Training and Competence sourcebook (<i>TC</i>)	<i>TC</i> 1 (Commitments) applies. <i>TC</i> 2 (Rules and guidance) is likely to apply where an <i>oil market participant</i> conducts activities set out in <i>TC</i> 2.1.4R.
	Money Laundering sourcebook (<i>ML</i>)	This applies.

	Part of Handbook	Applicability to oil market participants
Regulatory processes	Authorisation manual (<i>AUTH</i>)	This applies in relation to an application by a prospective <i>oil market participant</i> for a <i>Part IV permission</i> .
	Supervision manual (<i>SUP</i>)	This applies, with the following qualifications: <ul style="list-style-type: none"> (a) in <i>SUP</i> 3 (Auditors), only some provisions apply if <i>IPRU(INV)</i> 3 (Financial Resources for Securities and Futures Firms which are not Investment Firms) does not apply to an <i>oil market participant</i>: see <i>SUP</i> 3.1.2R and <i>SUP</i> 3.2.4G; (b) in <i>SUP</i> 10 (Approved persons), if an <i>oil market participant's</i> principal purpose is to carry on activities other than <i>regulated activities</i>, then the scope of the <i>significant influence functions</i> is restricted to the <i>required functions</i>: see <i>SUP</i> 10.1.21R – <i>SUP</i> 10.1.22G; (c) <i>SUP</i> 16.7 (Financial reports) does not apply to the <i>firm</i> if <i>IPRU(INV)</i> 3 does not apply: see <i>SUP</i> 16.1.3R and <i>SUP</i> 16.7.5G; (d) <i>SUP</i> 17 (Transaction reporting) does not apply to an <i>oil market participant</i> in relation to its <i>oil market activity</i>: see <i>SUP</i> 17.1.1R; and (e) <i>SUP</i> App 2 (Insurers: Scheme of operations) does not apply.
	Enforcement manual (<i>ENF</i>)	This applies.
	Decision making manual (<i>DEC</i>)	This applies.
	Dispute resolution: Complaints sourcebook (<i>DISP</i>)	<i>Oil market participants</i> are subject to the <i>Compulsory Jurisdiction</i> of the <i>Financial Ombudsman Service</i> . However, a <i>firm</i> which does not, and notifies the <i>FSA</i> under <i>DISP</i> 1.1 that it does not, conduct business with <i>eligible complainants</i> (persons eligible to have a complaint considered under the <i>Financial Ombudsman Service</i> , as defined in <i>DISP</i> 2.4) will be exempt from the <i>rules</i> on complaint handling procedures for <i>firms</i> (<i>DISP</i> 1.2 to <i>DISP</i> 1.7) and from the <i>Financial Ombudsman Funding rules</i> (<i>DISP</i> 5.2 to <i>DISP</i> 5.8).
Redress	Compensation sourcebook (<i>COMP</i>)	<i>COMP</i> applies to all <i>firms</i> . However, <i>oil market participants</i> that do not conduct business that could give rise to a <i>protected claim</i> by an <i>eligible claimant</i> as defined and have no reasonable likelihood of doing so can gain exemption under <i>COMP</i> 13.3 from some compensation scheme levies.

	Part of Handbook	Applicability to oil market participants
	Complaints against the FSA (<i>COAF</i>)	This applies.
Specialist sourcebooks	Collective Investment Schemes sourcebook (<i>CIS</i>)	<i>CIS</i> will ordinarily apply to an <i>oil market participant</i> that carries on <i>regulated activities</i> in relation to an <i>oil collective investment scheme</i> . None of the other specialist sourcebooks applies.
	Professional firms sourcebook (<i>PROF</i>)	
	Lloyd's sourcebook (<i>LLD</i>)	
	Recognised Investment Exchange and Recognised Clearing House sourcebook (<i>REC</i>)	
Special guides	Special guide for service companies (<i>SERV</i>)	This does not apply because <i>oil market participant</i> is defined to exclude a <i>service company</i> .
	Special guide for energy market participants (<i>EMPS</i>)	This does not apply because <i>energy market participant</i> is defined to exclude an <i>oil market participant</i> .
	Special guide for oil market participants (<i>OMPS</i>)	This applies.
Schedules	Summary schedules	These apply, but only to the extent that the sourcebook or manual to which they relate applies.
	1. Record keeping requirements	
	2. Notification requirements	
	3. Fees and other required payments	
	4. Powers exercised in making the Handbook	
	5. Rights of action for damages	
	6. Rules that can be waived	
	7. Releases	
Glossary of definitions		This applies.
Index		This applies.

Energy Market Participants and Oil Market Participants (Consequential Amendments) Instrument 2001

- A. The Financial Services Authority (the “FSA”) amends the Conduct of Business sourcebook, the Supervision manual, and the Glossary, in the ways indicated in Annexes A, B and C to this instrument.
- B. The FSA makes this instrument in the exercise of the powers and related provisions in or under the Financial Services and Markets Act 2000 (the “Act”) listed in Annex D.
- C. The provisions of the Act relevant to altering rules and listed in Annex D are specified for the purpose of section 153(2) of the Act (Rule-making instruments).
- D. This instrument comes into force immediately.
- E. This instrument may be cited as the Energy Market Participants and Oil Market Participants (Consequential Amendments) Instrument 2001.

By order of the Board
20 September 2001

Annex A

Changes to the Conduct of Business sourcebook

A.1 Amend the title of COB 1.6 in the following way:

1.6 Application to stock lending activity, corporate finance business, and oil market participants activity and energy market activity

A.2 Replace COB 1.6.6R – COB 1.6.7R with the following:

OIL MARKET ACTIVITY AND ENERGY MARKET ACTIVITY

1.6.6 R Only the provisions of COB listed in COB 1.6.7R apply in respect of:

(1) *oil market activity*; and

(2) *other energy market activity*;

undertaken by any *firm* (but see COB 1.6.8R).

1.6.7 R Table Provisions applied to oil market activity and energy market activity

This table belongs to COB 1.6.6R.

COB	Subject
Chapter 1	Application and general provisions
2.1	Clear, fair and not misleading
2.3	Reliance on and responsibility for others
2.4	Chinese walls
2.5	Exclusion of liability
Chapter 3	Financial promotion
4.1	Client classification
7.1	Conflict of interest and material interest
7.13	Dealing ahead
7.15	Non-market-price transactions
8.1	Confirmation of transactions
Chapter 9	Client assets

1.6.8 R Despite COB 1.6.6R, only the provisions of COB listed in COB 1.6.9R apply to:

(1) *oil market activity*; or

(2) *other energy market activity*;

undertaken by any *firm* where, if the *firm* were not *authorised*, the activity would not be a *regulated activity* because of:

(3) article 16 of the *Regulated Activities Order* (Dealing in contractually based investments); or

(3) article 22 of the *Regulated Activities Order* (Deals with or through authorised persons etc.).

- 1.6.9 R Table Oil market activity and energy market activity: provisions applied to certain dealings with or through authorised persons etc.

This table belongs to 1.6.8R.

COB	Subject
Chapter 1	Application and general provisions
2.3	Reliance on and responsibility for others
2.4	Chinese walls
2.5	Exclusion of liability
3.11	Unregulated collective investment schemes
7.15	Non-market-price transactions
Chapter 9	Client assets

- 1.6.10 G Article 16 of the *Regulated Activities Order* (Dealing in contractually based investments) sets out an exclusion for *unauthorised persons* who *deal in investments as principal* in *contractually based investments*. The exclusion relates to dealings:
- (1) with or through an *authorised person* or, in certain cases, an *exempt person*; or
- (2) in certain cases, through an office outside the *United Kingdom* maintained by a party to the transaction.
- 1.6.11 G Article 22 of the *Regulated Activities Order* (Deals with or through authorised persons) sets out an exclusion for *unauthorised persons* who *deal in investments as agent*. The exclusion relates to dealings with or through an *authorised person* if:
- (1) the transaction is entered into on advice given to the client by an *authorised person*; or
- (2) it is clear, in all the circumstances, that the client, in his capacity as an investor, is not seeking and has not sought advice from the agent as to the merits of the client's entering into the transaction (or the agent has declined to give such advice but has recommended the client seek such advice from an *authorised person*); and
- in either case, the agent does not receive from any person other than the client any pecuniary reward or advantage for which he does not account to the client.

Annex B

Changes to the Supervision manual

B.1 Amend note 1 to SUP 3.1.2R in the following way:

3.1.2 R Table

...

Note 1 = This note applies in relation to an *oil market participant* to which *IPRU(INV) 3* does not apply and in relation to an *energy market participant* to which *IPRU(INV) 3* does not apply. In SUP 3:

(a) Only SUP 3.1, SUP 3.2 and SUP 3.7 are applicable to such a *firm*; and

(b) only SUP 3.1, SUP 3.2 and SUP 3.8 are applicable to its auditor;

and, in each case, only if it has an auditor.

B.2 Amend SUP 3.2.4 G in the following way:

3.2.4 G SUP 3.1.1R and SUP 3.1.2R limit the application of this chapter in relation to *authorised professional firms* and certain *oil market participants* and certain *energy market participants*. Such a *firm* is not required, under this chapter, to appoint an auditor. If such a *firm* appoints an auditor, for example, under the Companies Act 1985, SUP 3.7 and SUP 3.8 nevertheless apply to help the FSA discharge its functions under the Act.

B.3 Amend SUP 10.1.21R and SUP 10.1.22G in the following way:

OIL MARKET PARTICIPANTS, AND SERVICE COMPANIES AND ENERGY MARKET PARTICIPANTS

10.1.21 R The descriptions of *significant influence functions*, other than the *required functions*, do not extend to activities carried on by a *firm* whose principal purpose is to carry on activities other than *regulated activities* and which is:

(1) an *oil market participant*; or

(2) a *service company*; or

(3) an *energy market participant*.

- 10.1.22 G It will be a matter of fact in each case whether, having regard to all the circumstances, including in particular where the balance of the business lies, a *firm's* principal purpose is to carry on activities other than *regulated activities* ~~having regard to all the circumstances, including in particular where the balance of the business lies~~. If a *firm* wishes to rely on SUP 10.1.21R, it should be in a position to demonstrate that its principal purpose is to carry on activities other than *regulated activities*.
- B.4 In SUP 17.1.1R, replace “***oil market investment activities***” with “***oil market activities***”.
- B.5 In the table in SUP App 1, 1.3.1G, in the column headed “Prudential sub-categories”, insert the expression “Energy market participant” after “Derivative fund manager” in the row headed “Securities and futures firm”.

Annex C

Changes to the Glossary

C.1 In the *Glossary*, insert the following definitions in the appropriate alphabetical order:

Definition title	Definition text
<i>Balancing and Settlement Code</i>	the document designated by the Secretary of State and adopted by the National Grid Company plc as the Balancing and Settlement Code as modified from time to time in accordance with the terms of the transmission licence granted under section 6(1)(b) of the Electricity Act 1989 in respect of England and Wales, or any subsequent similar instrument or arrangements.
<i>electricity</i>	(a) electricity in any form, including electricity as deliverable through the <i>Balancing and Settlement Code</i> ; (b) any right that relates to electricity, for example the right under a contract or otherwise to require a person to take any action in relation to electricity, including: <ul style="list-style-type: none"> (i) supplying electricity to any person or accepting supply of electricity; or (ii) providing any information or notice in relation to electricity; or (iii) making any payment in relation to the supply or non-supply, or acceptance or non-acceptance of supply, of electricity.
<i>EMPS</i>	the Special guide for energy market participants, forming part of the <i>Handbook</i> .
<i>energy</i>	coal, <i>electricity</i> , <i>natural gas</i> (or any by-product or form of any of them) or <i>oil</i> .
<i>energy collective investment scheme</i>	a <i>collective investment scheme</i> , the property of which consists only of <i>energy</i> , <i>energy investments</i> , <i>greenhouse gas emissions allowances</i> , <i>tradable renewable energy credits</i> or cash awaiting investment.
<i>energy investment</i>	any of the following: <ul style="list-style-type: none"> (a) a <i>unit</i> in an <i>energy collective investment scheme</i>; (b) an <i>option</i> to acquire or dispose of an <i>energy investment</i>; (c) a <i>future</i> or a <i>contract for differences</i> where the commodity or property of any other description in question is: <ul style="list-style-type: none"> (i) <i>energy</i>; or (ii) an <i>energy investment</i>; or (iii) a <i>greenhouse gas emissions allowance</i>; or (iv) a <i>tradable renewable energy credit</i>; (d) a <i>contract for differences</i> where the index or other factor in question is linked to or otherwise dependent upon fluctuations in the value or price of any of (c)(i) to (iv) (including any prices or charges in respect of imbalances under the <i>Network Code</i> or the <i>Balancing and Settlement Code</i>); (e) a <i>weather derivative</i>; (f) a <i>greenhouse gas emissions allowance</i>, if it is a <i>specified</i>

Definition title	Definition text
	<p><i>investment</i>;</p> <p>(g) a <i>tradable renewable energy credit</i>, if it is a <i>specified investment</i>;</p> <p>(h) <i>rights to or interests in investments</i> in (a) – (g).</p>
<i>energy market activity</i>	<p>(a) any <i>regulated activity</i> in relation to an <i>energy investment</i> or to <i>energy</i> which:</p> <p>(i) is the <i>executing of own account transactions</i> on any <i>recognised investment exchange</i> or <i>designated investment exchange</i>; or</p> <p>(ii) if it is not the <i>executing of transactions</i> on such exchanges, is performed in connection with or for persons who are not <i>private customers</i>;</p> <p>(b) <i>establishing, operating or winding up a collective investment scheme</i> which is an <i>energy collective investment scheme</i> in which <i>private customers</i> do not participate.</p>
<i>energy market participant</i>	<p>a <i>firm</i>:</p> <p>(a) whose permission:</p> <p>(i) includes a <i>requirement</i> that the firm must not carry on any <i>designated investment business</i> other than <i>energy market activity</i>;</p> <p>(ii) does not include a <i>requirement</i> that it comply with <i>IPRU(INV) 5</i> (Investment management firms) or <i>13</i> (Personal investment firms); and</p> <p>(b) which is not an <i>authorised professional firm, bank, building society, credit union, friendly society, ICVC, insurer, ISD investment firm, media firm, oil market participant, service company, incoming EEA firm</i> (without a <i>top-up permission</i>), or <i>incoming Treaty firm</i> (without a <i>top-up permission</i>).</p>
<i>greenhouse gas emissions allowance</i>	<p>an allowance, licence, permit, right, note, unit, credit, asset, certificate or instrument (the "allowance") where:</p> <p>(a) the allowance confers or may result in a benefit or advantage to its holder or another <i>person</i>; and</p> <p>(b) the allowance, or the benefit or advantage in (a), is linked to the emission or non-emission of quantities of carbon dioxide or other greenhouse gases into the environment by the holder of the allowance or someone else.</p>
<i>natural gas</i>	<p>(a) natural gas in any form, including natural gas as deliverable through the <i>Network Code</i>; and</p> <p>(b) any right that relates to natural gas, for example the right under a contract or otherwise to require a person to take any action in relation to natural gas, including:</p> <p>(i) delivering natural gas to any person or taking delivery of natural gas; or</p> <p>(ii) providing any information or notice in relation to natural gas; or</p> <p>(iii) making any payment in relation to the delivery or non-delivery, or the taking or non-taking of delivery, of natural gas.</p>

Definition title	Definition text
<i>Network Code</i>	the network code prepared by Transco plc in accordance with condition 7 of the public gas transporter licence granted or treated as granted to Transco plc under section 7(2) of the Gas Act 1986, as in force from time to time, or any subsequent similar instrument or arrangement.
<i>OMPS</i>	the Special guide for oil market participants, forming part of the <i>Handbook</i> .
<i>tradable renewable energy credit</i>	an allowance, licence, permit, right, note, unit, credit, asset, certificate or instrument (the "credit") where: (a) the credit confers or may result in a benefit or advantage to its holder or someone else; and (b) the credit, or the benefit or advantage in (a), is linked to the supply, distribution or consumption of energy derived from renewable sources by the holder of the credit or someone else.
<i>weather derivative</i>	a <i>contract for differences</i> where the index or other factor in question is a climatic variable.

C.2 In the *Glossary*, replace the following definitions with the text indicated:

Definition title	Definition text
<i>oil market activity</i>	(a) any <i>regulated activity</i> in relation to an <i>oil investment</i> or to <i>oil</i> which: (i) is the <i>executing of own account transactions</i> on any <i>recognised investment exchange</i> or <i>designated investment exchange</i> ; or (ii) if it is not the <i>executing</i> of transactions on such exchanges, is performed in connection with or for persons who are not individuals; and (b) <i>establishing, operating or winding up a collective investment scheme</i> which is an <i>oil collective investment scheme</i> in which individuals do not participate.
<i>oil market participant</i>	a <i>firm</i> : (a) whose permission: (i) includes a <i>requirement</i> that the firm must not carry on any <i>designated investment business</i> other than <i>oil market activity</i> ; and (ii) does not include a <i>requirement</i> that it comply with <i>IPRU(INV) 5</i> (Investment management firms) or <i>13</i> (Personal investment firms); and (b) which is not an <i>authorised professional firm, bank, building society, credit union, friendly society, ICVC, insurer, ISD investment firm, media firm, service company, incoming EEA firm</i> (without a <i>top-up permission</i>), or <i>incoming Treaty firm</i> (without a <i>top-up permission</i>).

C.3 In the *Glossary*, amend the following definition in the following way:

Definition title	Definition text
<i>oil investment</i>	any of the following: (a) a <i>unit</i> in an <i>oil collective investment scheme</i> ; (b) an <i>option</i> to acquire or dispose of an <i>oil investment</i> ; (c) a <i>future</i> where the <i>commodity</i> in question is <i>oil</i> ; (d) a <i>contract for differences</i> where the property in question is <i>oil</i> or an <i>oil investment</i> or the index or other factor in question is linked to or otherwise dependent upon fluctuations in the value or price of <i>oil</i> or any <i>oil investments</i> ; (e) rights to and interests in an <i>oil investment</i> <u><i>rights to or interests in investments in (a) – (d).</i></u>

C.4 In the *Glossary*, in the definition of “*investment management firm*”:

- (a) immediately after the expression “*credit union*, ”, insert the expression “*energy market participant*, ”; and
- (b) immediately after the expression “*media firm*, ”, insert the expression “*oil market participant*, ”.

C.5 In the *Glossary*, in the definition of “*investment management firm*”:

- (a) immediately after the expression “*credit union*, ”, insert the expression “*energy market participant*, ”; and
- (b) immediately after the expression “*media firm*, ”, insert the expression “*oil market participant*, ”.

C.6 In the *Glossary*, in the definition of “*securities and futures firm*”:

- (a) amend the following expression in the following way:
 “which is within (a), (b), (c), ~~(d)~~, (e) or (f)”; and
- (b) delete the full stop at the end of paragraph (d) and replace with a semi-colon; and
- (c) immediately after paragraph (d), insert new paragraphs as follows:
 “(e) an *energy market participant*;
 (f) an *oil market participant*.”

Annex D

Powers exercised

The following powers and related provisions in or under the Act have been exercised to alter rules under this instrument:

- Section 59 (Approval for particular arrangements)
- Section 118(8) (Market abuse)
- Section 138 (General rule-making power)
- Section 139(1) and (4) (Miscellaneous ancillary matters)
- Section 141 (Insurance business rules)
- Section 144 (Price stabilising rules)
- Section 145 (Financial promotion rules)
- Section 146 (Money laundering rules)
- Section 147 (Control of information rules)
- Section 149 (Evidential provisions)
- Section 150(2) (Actions for damages)
- Section 156 (General supplementary powers)
- Section 238(5) (Restrictions on promotion)
- Section 247 (Trust scheme rules)
- Section 340 (Appointment)
- Regulation 6(1) (FSA rules) of the Financial Services and Markets Act 2000 (Open-ended Investment Company) Regulations 2001

The following power in the Act has been exercised to alter guidance under this instrument:

- Section 157(1) (Guidance)

Special Guide for Service Companies Instrument 2001

- A. The Financial Services Authority gives the guidance in the Annex to this instrument in the exercise of the power in section 157(1) of the Financial Services and Markets Act 2000.
- B. This instrument comes into force immediately.
- C. This instrument may be cited as the Special Guide for Service Companies Instrument 2001.
- D. The Annex to this instrument may be cited as the Special guide for service companies, or SERV.

By order of the Board
20 September 2001

Annex

Special guide for service companies

SERV: Special guide for service companies

1. Handbook requirements for service companies

1.1 Application and purpose

- 1.1.1 G This special guide is for *service companies*. Its purpose is to help *service companies* find their way around the *Handbook* by setting out which parts of it apply to them.
- 1.1.2 G *Service companies* are firms whose *regulated activities* are restricted to making arrangements with a view to transactions in investments and agreeing to carry on that regulated activity. They are, in the main, technology companies who provide order routing, post-trade processing, or other services to market participants which assist them to deal in investments or arrange (bring about) deals in investments among themselves. A light-touch regulatory regime applies to *service companies* as set out in this Special guide.

1.2 Parts of the Handbook applicable to service companies

- 1.2.1 G The parts of the Handbook applicable to *Service companies* are listed in *SERV 1.2.2G*. *Service companies* should read applicable parts of *the Handbook* to find out what the detailed regulatory requirements for *service companies* are.
- 1.2.2 G Table: Parts of *the Handbook* applicable to *service companies*

This table belongs to *SERV 1.2.1G*

	Part of Handbook	Applicability to service companies
High Level Standards	Principles for Businesses (<i>PRIN</i>)	This applies.
	Senior management arrangements, Systems and Controls (<i>SYSC</i>)	This applies.
	Threshold Conditions (<i>COND</i>)	This applies.
	Statements of Principle and Code of Practice for Approved Persons (<i>APER</i>)	This applies to an <i>approved person</i> who performs a <i>controlled function</i> for a <i>service company</i> .
	The Fit and Proper test for Approved Persons (<i>FIT</i>)	This applies.
	General provisions (<i>GEN</i>)	This applies.

	Part of Handbook	Applicability to service companies
Business Standards	Interim Prudential sourcebooks (<i>IPRU</i>)	In the Interim Prudential sourcebook for investment business (<i>IPRU(INV)</i>), only Chapters 1 (Application and General) and 6 (Service Companies) apply: see <i>IPRU (INV)</i> 1.2.4R. The other Interim Prudential sourcebooks do not apply.
	Conduct of Business sourcebook (<i>COB</i>)	<i>COB</i> 3 (Financial promotion rules), and any provision of <i>COB</i> incorporated by reference in <i>COB</i> 3, applies. The rest of <i>COB</i> does not apply: see <i>COB</i> 1.2.1R(2). The <i>permission</i> given to <i>service companies</i> means that they must not <i>approve financial promotions</i> on behalf of another <i>person</i> or specified class of <i>person</i> , or deal with <i>private customers</i> . If the <i>firm communicates financial promotions to market counterparties and intermediate customers</i> only, <i>COB</i> 3 will have only very limited application (see <i>COB</i> 3.2.4R and <i>COB</i> 3.2.5R(1)).
	Market Conduct sourcebook (<i>MAR</i>)	<i>MAR</i> 1 (Code of market conduct), <i>MAR</i> 2 (Price stabilising rules) and <i>MAR</i> 4 (Endorsement of the Takeover Code) apply to <i>service companies</i> . <i>MAR</i> 3 (Inter-professional conduct) does not apply to <i>service companies</i> : see <i>MAR</i> 3.1.1R.
	Training and Competence sourcebook (<i>TC</i>)	<i>TC</i> 1 (Commitments) applies. <i>TC</i> 2 (Rules and guidance) does not apply to <i>service companies</i> because the only <i>regulated activities</i> for which they have <i>permission</i> are not within the activities mentioned in <i>TC</i> 2.1.4R.
	Money Laundering sourcebook (<i>ML</i>)	This applies.

	Part of Handbook	Applicability to service companies
Regulatory processes	Authorisation manual (<i>AUTH</i>)	This applies in relation to an application by a prospective <i>service company</i> for a <i>Part IV permission</i> .
	Supervision manual (<i>SUP</i>)	This applies, with the following qualifications: <ul style="list-style-type: none"> (a) in <i>SUP</i> 3 (Auditors), only sections 3.1, 3.2, and 3.7 apply to a service company (and only if it has an auditor) and only sections 3.1, 3.2 and 3.8 apply to its auditor (if it has one): see <i>SUP</i> 3.1.2R; (b) <i>SUP</i> 4 (Actuaries) does not apply: see <i>SUP</i> 4.1.1R; (c) in <i>SUP</i> 10 (Approved persons), if a <i>service company's</i> principal purpose is to carry on activities other than <i>regulated activities</i>, then the scope of the <i>significant influence functions</i> is restricted to the <i>required functions</i>: see <i>SUP</i> 10.1.21R – <i>SUP</i> 10.1.22G; (d) <i>SUP</i> 13 (Exercise of passport rights by UK firms) does not apply because <i>making arrangements with a view to transactions in investments</i> is not a <i>core investment service</i>; (e) <i>SUP</i> 14 (Incoming EEA firms changing details and cancelling qualification for authorisation) does not apply because a <i>service company</i> cannot be an <i>incoming EEA firm</i> (see explanation in (d)); (f) in <i>SUP</i> 16 (Reporting requirements), sections 16.4-16.6 do not apply and in section 16.7, only <i>SUP</i> 16.7.20R – <i>SUP</i> 16.7.2R apply: see <i>SUP</i> 16.1.1R; (g) <i>SUP</i> 17 (Transaction reporting) does not apply: see <i>SUP</i> 17.1.1R; and (h) <i>SUP</i> App 2 (Insurers: Scheme of operations) does not apply.
	Enforcement manual (<i>ENF</i>)	This applies.
	Decision making manual (<i>DEC</i>)	This applies.

	Part of Handbook	Applicability to service companies
Redress	Dispute resolution: the Complaints sourcebook (<i>DISP</i>)	<p>All firms are subject to the <i>Compulsory Jurisdiction</i> of the <i>Financial Ombudsman Service</i>.</p> <p>However, a <i>firm</i> which does not, and notifies the <i>FSA</i> under <i>DISP</i> 1.1 that it does not, conduct business with <i>eligible complainants</i> (persons eligible to have a complaint considered under the <i>Financial Ombudsman Service</i>, as defined in <i>DISP</i> 2.4) will be exempt from the <i>rules</i> on complaint handling procedures for <i>firms</i> (<i>DISP</i> 1.2 to <i>DISP</i> 1.7) and from the <i>Financial Ombudsman Funding rules</i> (<i>DISP</i> 5.2 to <i>DISP</i> 5.8).</p> <p>The definition of a <i>service company</i> means that a <i>service company</i> will qualify for these exemptions if it applies for them: see <i>DISP</i> 2.4.3R(2)(a).</p>
	Compensation sourcebook (<i>COMP</i>)	<i>COMP</i> does not apply to <i>service companies</i> , which are not <i>participant firms</i> under the <i>compensation scheme</i> , and are exempt from funding it.
	Complaints against the FSA (<i>COAF</i>)	This applies to <i>service companies</i> , although it contains no requirements for <i>service companies</i> .
Specialist sourcebooks	Collective Investment Schemes sourcebook (<i>CIS</i>)	None of the specialist sourcebooks applies.
	Professional firms sourcebook (<i>PROF</i>)	
	Lloyd's sourcebook (<i>LLD</i>)	
	Recognised Investment Exchange and Recognised Clearing House sourcebook (<i>REC</i>)	
Special guides	Special guide for service companies (<i>SERV</i>)	This applies.
	Special guide for energy market participants (<i>EMPS</i>)	This does not apply because an <i>energy market participant</i> is defined to exclude a <i>service company</i> .
	Special guide for oil market participants (<i>OMPS</i>)	This does not apply because an <i>oil market participant</i> is defined to exclude a <i>service company</i> .

	Part of Handbook	Applicability to service companies
Schedules	Summary schedules 1. Record keeping requirements 2. Notification requirements 3. Fees and other required payments 4. Powers exercised in making the Handbook 5. Rights of action for damages 6. Rules that can be waived 7. Releases	These apply, but only to the extent that the sourcebook or manual to which they relate applies.
	Glossary of definitions	This applies.
	Index	This applies.

**CONDUCT OF BUSINESS SOURCEBOOK (AMENDMENT No 2)
INSTRUMENT 2001**

Powers exercised

- A. The Financial Services Authority alters the Conduct of Business sourcebook in the exercise of the powers listed in Schedule 4 to the Conduct of Business sourcebook (Powers exercised).
- B. The provisions of the Financial Services and Markets Act 2000 (the "Act") relevant to making rules and identified in paragraph A are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force immediately.

Amendment of the Conduct of Business sourcebook

- D. The Conduct of Business sourcebook is amended as set out in Annex 1 to this instrument.
- E. The transitional rules in the Conduct of Business sourcebook are amended as set out in Annex 2 to this instrument.

Citation

- F. This instrument may be cited as the Conduct of Business Sourcebook (Amendment No 2) Instrument 2001.

By order of the Board
18 October 2001

ANNEX 1

Amendments to the Conduct of Business sourcebook

In this Annex, underlining indicates new text and striking through indicates deleted text.

COB 6.8 Insurance contracts: life and general

COB 6.8.1

Amend as shown below:

COB 6.8 applies to a *firm* which *effects* or *carries out pure protection contracts, life policies or general insurance contracts.*

COB 6.8.2G

Amend as shown below:

- (1) *Principle 7* (Communications with clients) requires a *firm* to pay due regard to the information needs of its *customers*. This section reinforces *Principle 7* by requiring certain information to be provided to a *customer* before a *pure protection contract* or *general insurance contract* is entered into. Certain information must also be provided on ~~an ongoing~~ a continuing basis to a *customer* with a *pure protection contract* or life policy. (COB 6.1 to COB 6.5 deal with pre-sale information for life policies).
- (2) This section implements certain requirements of the *Third Life and Non-Life Directives*.
- (3) For *general insurance contracts*, *firms* may find it helpful to take account of the requirements issued by the General Insurance Standards Council ("GISC") ~~code for private customers~~. The provisions in this section relating to *general insurance contracts* are broadly in line with ~~not intended to exceed the~~ those requirements ~~of that code~~.

COB 6.8.5R

Amend the heading of the table as shown below:

~~Provision of information for pure protection in contracts.~~

COB 6.8.6R

Amend the heading as shown below:

Pure protection contracts and life policies: Information to be provided during the term of the contract.

COB 6.8.6R

Amend as shown below:

COB 6.8.7R and COB 6.8.8R apply to a *long-term insurer* if the policyholder is in the *United Kingdom* at the time of signing the application for the *pure protection contract or life policy*.

COB 6.8.7R

Amend as shown below:

If during the term of a *pure protection contract or life policy* entered into on or after 1 July 1994 there is any proposed change in the information ~~provided under~~ referred to in COB 6.8.5R items (1) to (10), the *long-term insurer* must inform the policyholder of the effect of the change before the change is made.

COB 6.8.8R

Amend as shown below:

If a *pure protection contract or life policy* entered into on or after 1 July 1994 provides for the payment of bonuses and the amounts of bonus are unspecified, the *long-term insurer* must, at least once a year coincident with or immediately following the first contract anniversary, either:

- (1) notify the policyholder of the amount of any bonus which has become payable under the contract, and which has not previously been notified under this rule; or
- (2) give the policyholder sufficient information to enable him to determine the amount of any such bonus.

COB 6.8.12R

Amend as shown below:

Before entering into a *general insurance contract* with a *customer*, covering a risk situated in the *United Kingdom*, a *firm* must, subject to COB 6.8.13R, provide the *customer* with:

- (1) details of its complaints procedure; and
- (2) a statement whether the firm or customer is entitled to choose the law applicable to the contract and, if so, the law which the firm proposes to choose.

COB 6.8.15R

Amend the heading as shown below:

Provision of information: general

COB 6.8.15R(2)

Amend as shown below:

If the contract is being made by telephone, the *firm* may give the information orally to the *customer*. If the *customer* ~~has entered into~~ enters into ~~committed to~~ the contract, a written version of the required information must be sent to the

customer within five *business days* of the ~~oral explanation~~ contract being entered into.

COB 6.8.17R

Amend as shown below:

Where a *pure protection contract*, *life policy* or *general insurance contract* is *effected* jointly, the information required by COB 6.8.3R, COB 6.8.7R, COB 6.8.8R or COB 6.8.12R may be sent to the first named *customer*.

COB 6.8.18R

Amend as shown below:

A *firm* must make an adequate record of information provided to a *customer* under COB 6.8 and retain that record for a minimum period after the information is provided of:

- (1) six years in the case of a *pure protection contract* or *life policy*; or
- (2) three years in the case of a *general insurance contract*.

ANNEX 2

Amendments to the Conduct of Business Transitional Rules

COB Table TR1: COB Transitional Provisions:

1. In column (2) of paragraphs 1.2 and 1.3 delete "ETPs 1 to 8" and substitute with "ETPs 1 to 9".
2. Insert the following additional paragraphs into the table as shown:

1.15	<i>ETP9</i>	R	<p><u>Group business disapplication for ex-IMRO firms</u></p> <p>(1) This paragraph applies to a <i>pre-N2 firm</i> which immediately before <i>commencement</i> was a member of <i>IMRO</i>.</p> <p>(2) <i>COB 1.3.1R</i> applies to a <i>pre-N2 firm</i> in (1) as if it provided as follows:</p> <p>"<i>COB</i> applies to <i>firms</i> with respect to the carrying on of:</p> <p>(1) all <i>regulated activities</i> except:</p> <p style="padding-left: 40px;">(a) to the extent that a provision of <i>COB</i> provides for a narrower application; and</p> <p style="padding-left: 40px;">(b) activities which fall within article 69 of the <i>Regulated Activities Order (Groups and joint enterprises)</i>, notwithstanding, in respect of article 69, article 4 (4) of that Order (Specified activities: general: investment firms); and</p> <p>(2) <i>unregulated activities</i> to the extent specified in any provision of <i>COB</i>."</p>	<i>commencement</i> to 30 June 2002	<i>commencement</i>
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1.16	<i>ETP9</i>	G	<p>The purpose of <i>ETP 9</i> is to carry forward for ex-<i>IMRO firms</i> the former regulatory treatment of intra-group investment business, which is carried on in conjunction with investment business for third parties. The effect of that treatment was that under the <i>IMRO</i> rulebook the rules did not apply to the business done for group companies which fell within the group business exemption in paragraph 18 of Schedule 1 to the Financial Services Act 1986. Effectively it was only the non-group third party element of the ex-<i>IMRO firm's</i> investment business that was subject to <i>IMRO's</i> rules. <i>COB</i> would not have carried forward this group business disapplication for such <i>firms</i>, were it not for the introduction of <i>ETP 9</i>.</p> <p>Note that during the <i>transitional period</i> the <i>FSA</i> will be consulting on its proposals how this issue should be treated in <i>COB</i> after 30 June 2002.</p>	<i>commencement</i> to 30 June 2002	<i>commencement</i>
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COB Table TR2: COB provisions to which transitional relief attaches

1. Insert the following additional section into the table as shown:

COB Rule	Rule Heading	Label		
		ETP	TTP	TSP
Chapter 1 Application and general provisions				
1.3 General application: what?				
1.3.1R		ETP9		

AUTHORISATION MANUAL (AMENDMENT NO 2) INSTRUMENT 2001

Powers exercised

- A. The Financial Services Authority amends the Authorisation manual in the exercise of the power in section 157(1) of the Financial Services and Markets Act 2000 (Guidance).

Commencement

- B. This instrument comes into force immediately.

Amendments to the Authorisation manual

- C. The Authorisation manual is amended in accordance with the Annex to this instrument.

Citation

- D. This instrument may be cited as the Authorisation Manual (Amendment No 2) Instrument 2001.

By order of the Board

18 October 2001

ANNEX

- AUTH 1.1.3G(2) replace "Fees [to be added later]" with "Authorisation Fees"
- AUTH 1.3.2G replace "[to be added later]" with "(Authorisation Fees)"
- AUTH 1.7.2G(2) replace "in" with "is"
- AUTH 2.7.7G(1) replace "*making arrangements with a view to transactions in investments*" with "*arranging (bringing about) deals in investments*"
- AUTH 2.7.7G(2) replace "*arranging (bringing about) deals in investments*" with "*making arrangements with a view to transactions in investments*"
- AUTH 2.9.1G in the third sentence, after "syndicate as" insert "a"
- AUTH 2 Ann 2G 1.1 in the second sentence, after "of" insert "the"
- AUTH 3.6.3G(4) replace "[]" with "()"
- AUTH 3.9.4G(1) replace "[to be added]" with "(Authorisation Fees)"
- AUTH 3.9.28G in the final sentence, after "conditions" insert "being met"
- AUTH 3.12.2G delete "[to be finalised]"
- AUTH 6.1.1G(3) after "*candidate*" insert ", but only as a matter of general relevance"
- AUTH 6.2.7G italicise "controlled functions"
- AUTH 6.2.9G replace "4G" with "4D"
- AUTH 6.3.9G de-italicise "*approval*"
- AUTH 6.5 heading, replace "Notifiable" with "Notified"
- AUTH 6.5.1G(3) replace "," with ":"
- AUTH 6.5.1G(4) delete "a *UK branch* of"
replace "," with ":"
replace "*United Kingdom*" with "*UK*"
- AUTH 6.5.2G replace "Notifiable" with "Notified"

SUPERVISION MANUAL (AMENDMENT NO 3) INSTRUMENT 2001

Powers exercised

- A. The Financial Services Authority amends the Supervision manual in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (the "Act"):
- (1) section 59 (Approval for particular arrangements);
 - (2) section 60 (Applications for approval);
 - (3) section 138 (General rule-making power);
 - (4) section 156 (General supplementary powers);
 - (5) section 157(1) (Guidance);
 - (6) section 182 (Notification);
 - (7) section 340 (Appointment).
- B. The provisions of the Act relevant to rules and listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force immediately.

Amendments to the Supervision manual

- D. The Supervision manual is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Supervision Manual (Amendment No 3) Instrument 2001.

By order of the Board
18 October 2001

Annex
Amendments to text already made

SUP Transitional provisions

Transitional provision 7 Delete this provision

Transitional provision 8 At the top of column (4), add the heading "Approved persons"

SUP 3 Auditors

In the amendments to this chapter, underlining indicates new text and striking through indicates deleted text.

SUP 3.1.1R Amend as shown below:

This chapter applies to:

- (1) every *firm* within a category listed in column (1) of the table in *SUP 3.1.2R*; and
- (2) the external auditor of such a *firm* (if appointed under *SUP 3.3* or appointed under or as a result of a statutory provision other than in the *Act*);

in accordance with column (2) or (3) of that table, except as described in the remainder of this section.

SUP 3.1.2R Amend the following parts of the table as shown below

(1) Category of firm	(2) Sections applicable to the firm	(3) Sections applicable to its auditor
(5) <i>Small personal investment firm, service company or authorised professional firm</i> <u>which, in each case, has an auditor appointed under or as a result of a statutory provision other than in the <i>Act</i></u> (Note 2)	<i>SUP 3.1, SUP 3.2, SUP 3.7</i>	<i>SUP 3.1, SUP 3.2, SUP 3.8</i>

(1) Category of firm	(2) Sections applicable to the firm	(3) Sections applicable to its auditor
<p>Note 1 = This note applies in relation to an <i>oil market participant</i> to which <i>IPRU(INV) 3</i> does not apply and in relation to an <i>energy market participant</i> to which <i>IPRU(INV) 3</i> does not apply. In <i>SUP 3</i>:</p> <p>(a) only <i>SUP 3.1</i>, <i>SUP 3.2</i> and <i>SUP 3.7</i> are applicable to such a <i>firm</i>; and</p> <p>(b) only <i>SUP 3.1</i>, <i>SUP 3.2</i> and <i>SUP 3.8</i> are applicable to its auditor;</p> <p>and, in each case, only if it has an auditor <u>appointed under or as a result of a statutory provision other than in the <i>Act</i></u>.</p>		

SUP 3.2.4G Amend as shown below:

SUP 3.1.1R and *SUP 3.1.2R* limit the application of this chapter in relation to:

- (1) *authorised professional firms*;
- (2) ~~and certain~~ *oil market participants*, and ~~certain~~ *energy market participants*, to whom *IPRU(INV) 3* does not apply;
- (3) *small personal investment firms*; and
- (4) *service companies*.

Such a *firm* is not required, under this chapter, to appoint an auditor because *SUP 3.3 (Appointment of auditors)* does not apply. If such a *firm* appoints an auditor under or as a result of a statutory provision other than in the *Act*, for example, under the Companies Act 1985, *SUP 3.7 (Notification of matters raised by auditor)* and *SUP 3.8 (Rights and duties of all auditors)* nevertheless apply to help the *FSA* discharge its functions under the *Act*.

SUP 3.3.2R Amend the following parts of this rule as shown below:

A *firm* to which this section applies (see *SUP 3.1*) must:

- (1) appoint an auditor ~~to undertake the duties and responsibilities set out in *SUP 3.8* to *SUP 3.10* (as applicable)~~;

SUP 3.3.3G Amend the following sentence in this guidance as shown below:

Such a *firm* is expected to wish to ~~free to~~ have a single auditor who is appointed to fulfil both obligations.

SUP 6 Applications to vary and cancel Part IV permission

SUP 6 Ann 4G In the section entitled ‘Dealing with Residual Deposits: General’, delete provision 7.

SUP 10 Approved persons

- SUP 10.1.16R Add a comma between ‘*appointed representative*’ and ‘as they apply to a *firm*’
- SUP 10.1.23R(1) Remove italics from ‘*regulatory functions*’
- SUP 10.6.14G Before ‘*regulatory system*’, italicise ‘UK’
Italicise ‘person’
- SUP 10.6.22G Remove italics from ‘*Limited Liability Partnerships Act*’
- SUP 10.6.26R(1) Replace the upper case ‘S’ in ‘*Society*’ with a lower case ‘s’
- SUP 10.7.4G After ‘in relation to the’, italicise ‘United Kingdom’
Delete ‘change’
Italicise ‘SYSC’
- SUP 10.7.7G Remove italics from ‘*approved*’
After ‘the concern of the’, italicise ‘FSA’
- SUP 10.7.11G Before ‘head of compliance’, italicise ‘group’
- SUP 10.9.14R(2) Italicise ‘controlled function’
- SUP 10.10.4R Remove italics from ‘*dealing*’ in both places
- SUP 10.10.9G Change ‘TC 2.4.4.R’ and ‘TC 2.4.2R’ to ‘TC 2.4.5R’
- SUP 10.10.12G Delete the last sentence in brackets and replace with ‘A Form E (SUP 10 Ann 8G) may be used for this purpose.’
- SUP 10.10.15R Change ‘*Lloyds*’ to ‘*Lloyd’s*’
- SUP 10.10.18G Italicise ‘firm’s’;
Remove italics from ‘*approved*’
- SUP 10.10.19G Italicise ‘customer’ and ‘customer’s’
- SUP 10.11.2G Italicise the five instances of ‘SUP’ in the middle column
- SUP 10.12.1G Italicise ‘FSA’
- SUP 10.12.4G Italicise the following terms when they appear: firm, FSA, controlled functions, United Kingdom, UK, branch, group, authorised person, undertaking, subsidiary, overseas firm, outsourcing, outsourced, SUP, SYSC, approved persons, significant

influence functions, arrangement

In the third column, change 'SUP 15.7.7' to 'SUP 15.7.8G'

Insert two horizontal lines across all three columns, one above 'Outsourcing by A to B...' and the other above '(i) A to B, where B is a...'

SUP 10.13.3G After 'within the same *firm*', add 'or *group*'

SUP
10.13.7R(2)(b) Italicise 'regulatory body'

SUP 10 Ann 2G Under 'Circumstance', replace the text in the second box with the following:

Candidate is either an *approved person* or was the subject of a Form C submitted within the previous six *months* and is not seeking approval for a *significant influence function* for the first time.

Under 'Circumstance', replace the text in the third box with the following:

Candidate ceased to be an *approved person* more than six *months* ago is seeking to perform a *significant influence function* for the first time.

SUP 10 Ann 4D (Form A) On page ii, under 'Purpose of this Form', change 'AUTH 3.1D' to 'AUTH 6.3.1D'

In the Notes on page iii, under 'SHORTENED APPLICATION FORM', at the end of the second '(1)', delete 'or', at the end of the second '(2)', replace '.' with '; or' and after the second (2), add the following:

(3) there have been any significant changes to the answers provided in section 5 of the application form.

In the Notes on page iii, after paragraph 3.03 add the following:

3.06 & 3.07: The *firm* must complete question 3.06 and, if applicable, question 3.07. The *firm* must note that although *TC 2* may not apply, the commitments contained in *TC 1* apply to all *employees*.

In question 3.01e, replace 'Appointed rep – employee' with 'Appointed representative – customer function'

In question 3.01f, replace 'Appointed rep – principal' with 'Appointed representative – governing function'

In question 3.06, change 'TC 2.3.5R' to 'TC 2.4.5R' and change 'TC 2.1.3R' to 'TC 2.1.4R'

In question 3.07, delete 'each module' and replace with 'the

relevant module(s)' and change 'TC 2.4.5R' to 'TC 2.5.5R'

SUP 10 Ann 6R
(Form C)

In question 3.01, column A, move 'Internal movement of staff' to the top of the list

SUP 10 Ann 8G
(Form E)

On page ii, under 'The purpose of this Form', at the end of the first paragraph, add 'This form may also be used for transfers between *firms* that are part of the same *group*.'

On page ii, under 'The purpose of this Form', in the second paragraph, replace 'Form B' with 'Form C'.

On page ii, under 'The purpose of this Form', add a new paragraph at the end as follows:

A Form A must be completed in full if the *approved person* is seeking approval in respect of a *significant influence function* for the first time.

In the Notes on page iii, after paragraph 4.03 add the following:

4.06 & 4.07: The *firm* must complete question 4.06 and, if applicable, question 4.07. The *firm* must note that although TC2 may not apply, the commitments contained in TC1 apply to all *employees*.

In question 4.06, change 'TC 2.3.5R' to 'TC 2.4.5R' and change 'TC 2.1.3R' to 'TC 2.1.4R'

In question 4.07, delete 'each module' and replace with 'the relevant module(s)' and change 'TC 2.4.5R' to 'TC 2.5.5R'

SUP 11 Controllers and close links

SUP 11 Ann 4D
(Controllers
Form A)

In question 1.05, replace the question with the following:

Are all three conditions in either or both (a) or (b) satisfied?

Yes [] No []

(a) The conditions are:

(i) the *firm* is an *ISD investment firm*;

(ii) the *controller* is either an *ISD investment firm* or the *parent undertaking* of an *ISD investment firm*;
and

(iii) as a result of the proposed change in *control*, the *controller* would become a *parent undertaking* of the *firm*.

(b) The conditions are:

- (i) the *firm* is a *BCD credit institution*;
- (ii) the *controller* is either a *BCD credit institution* or the *parent undertaking* of a *BCD credit institution*; and
- (iii) as a result of the proposed change in *control*, the *controller* would become a *parent undertaking* of the *firm*.

If so, give details

SUP 13 Exercise of passport rights by UK firms

- SUP 13.1.2G In the second sentence, replace 'markets' with 'Markets'
- SUP 13.3.2G(1) Delete both references to '(i)'
- SUP 13.4.1G For 'SUP 13 Ann 3G' substitute 'SUP 13 Ann XG'
- SUP 13.4.4G(2)(b) In the first sentence, after ' refusal of a *consent notice*' insert 'under paragraph 20(3A) of Part III of Schedule 3 to the *Act*'

In the first sentence, in 'and the *consent notice*', change 'the' to 'this'

In the first sentence, after 'in this *consent notice*', insert '(unlike the *consent notice* for establishment of a *branch*)'

In the third sentence, italicise 'consent notice'
- SUP 13.5.3R(2)(e) Italicise 'FSA'
- SUP 13.5.5G In the last sentence, italicise 'authorised'
- SUP 13.5.6G(1) Replace 'Notification' with 'Notifications'
- SUP 13.6.10G(1)(b) Italicise 'UK'
- SUP 13.8.1R(1) Replace 'SUP 13.6.8G(1)' with 'SUP 13.6.10G(1)'
- SUP 13.8.1R(2)(c) Replace 'Notification' with 'Notifications'
- SUP 13.8.1R(2)(d) Replace '*Permission*' with '*permission*'
- SUP 13.8.1R(2)(e) Replace '*Permission*' with '*permission*'
- SUP 13.12.1G(2) Remove italics from '*notice of intention*'
- SUP 13 Ann 3G Change the status description of this Annex to Annex 3R

SUP 14 Incoming EEA firms: changing authorisation and cancelling qualification for authorisation

Title	Change the title of this chapter to 'Incoming EEA firms changing details, and cancelling qualification for authorisation'.
SUP 14.2.4G	Replace 'SUP 14.2.2G or SUP 14.2.3G' with 'SUP 14.2.3G or SUP 14.2.8G'
SUP 14.2.5G(2)	At end of the sentence, insert '(see SUP 14.2.8G)'
SUP 14.2.9G	In the first sentence, italicise 'firm'
SUP 14.4.1G(1)	Replace 'markets' with 'Markets'
SUP 14.4.1G(2)	Before 'The Financial Services Authority', insert 'The Passport Notifications Unit,'
SUP 14.5.1G	Replace the second instance of 'that' with 'the'

SUPERVISION MANUAL (AMENDMENT NO 4) INSTRUMENT 2001

Powers exercised

- A. The Financial Services Authority amends the Supervision manual in the exercise of the power in section 157(1) of the Financial Services and Markets Act 2000.

Commencement

- B. This instrument comes into force immediately.

Amendment of the Supervision manual

- C. The Supervision manual is amended by adding Schedule 1 (Record keeping requirements) as set out in the Annex to this instrument.

Citation

- D. This instrument may be cited as the Supervision Manual (Amendment No 4) Instrument 2001.

By order of the Board
18 October 2001

Annex
SUP Schedule 1 (Record keeping requirements)

Schedule 1
Record keeping requirements

G

- 1 The aim of the guidance in the following table is to give the reader a quick overall view of the relevant record keeping requirements.
- 2 It is not a complete statement of those requirements and should not be relied on as if it were.
- 3 Table

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
<i>SUP 4.3.17R(3)</i>	Data for <i>appointed actuary</i>	Such data as the <i>appointed actuary</i> reasonably requires	Not specified	Not specified
<i>SUP 12.9.1R,</i> <i>SUP 12.9.2R</i>	<i>Appointed representatives</i>	(1) <i>Appointed representative's</i> name (2) Copy of the original contract with the <i>appointed representative</i> and any subsequent amendments to it (including details of any restrictions placed on the activities which the <i>appointed representative</i> may carry on) (3) Date and reason for terminating or amending the contract	On appointment, amendment of contract or termination of contract	3 years from termination or amendment of the contract

<p><i>SUP 13.11.1R</i></p>	<p>Exercise of passport rights by <i>UK firms</i></p>	<p>(1) Services or activities carried on from a <i>branch</i> in, or cross-border into, another <i>EEA State</i> under an <i>EEA right</i></p> <p>(2) The <i>requisite details</i> or relevant details (if applicable)</p>	<p>Not specified</p>	<p>Three years from earlier of:</p> <p>(1) record being superseded;</p> <p>(2) <i>firm</i> ceasing to have any <i>EEA branches</i> or <i>cross-border services</i>.</p>
<p><i>SUP 16.8.23R</i></p>	<p>Persistency reports</p>	<p>Records to enable the <i>firm</i> to monitor regularly the persistency of <i>life policies effected</i> through each of its <i>representatives</i> and make the required reports to the <i>FSA</i>.</p>	<p>Not specified</p>	<p>Not specified</p>

DECISION MAKING MANUAL (AMENDMENT) INSTRUMENT 2001

Powers exercised

A. The Financial Services Authority amends the Decision making manual in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000:

(1) section 157(1) (Guidance); and

(2) section 395(5) (The Authority's procedures).

Commencement

B. This instrument comes into force immediately.

Amendments to the Decision making manual

D. The Decision making manual is amended in accordance with the Annex to this instrument.

Citation

C. This instrument may be cited as the Decision Making Manual (Amendment) Instrument 2001.

By order of the Board
18 October 2001

ANNEX

- DEC 4.3.8G After “*senior staff committee*”, insert “, other than the *FSA* Chairman’s Committee,”
- At the end of the provision, insert "The *FSA* Chairman's Committee may authorise the chairman of a *senior staff committee* to select its other members."
- DEC 4.3.9G After “*senior staff committee*”, insert “, other than the *FSA* Chairman’s Committee,”
- At the end of the provision, insert “The *FSA* Chairman’s Committee is accountable for its decisions to the *FSA* Board.”
- DEC 4.4.8G In the first sentence, insert a comma after “representations”
- In the third sentence, delete "legal" before "representatives"
- DEC 4.5.7G(3)(a) After "Chairman", add "or a Deputy Chairman"
- DEC 4.6 In the heading, delete "powers"

**LISTING RULES (FINANCIAL SERVICES AND MARKETS ACT 2000
AMENDMENT) INSTRUMENT 2001**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the powers and related provisions listed in Annex 1 (Powers exercised).

Commencement

- B. This instrument comes into force at the beginning of the day on which section 72 of the Act (The competent authority) comes into force.

Amendments to the Listing Rules

- C. The Listing Rules are amended in accordance with Annex 2 to this instrument.

Guidance

- D. The Financial Services Authority gives the guidance in Annex 3 to this instrument.

Citation

- E. This instrument may be cited as the Listing Rules (Financial Services and Markets Act 2000 Amendment) Instrument 2001.

By order of the Board
18 October 2001

ANNEX 1

The Listing Rules – powers exercised

1. The following powers and related provisions in the Financial Services and Markets Act 2000 are exercised by the FSA to amend the Listing Rules:

- (a) sections 74 and 75
- (b) section 77
- (c) section 79 to 89 (inc)
- (d) section 91
- (e) section 96
- (f) section 98 to 101 (inc)

The fining policy is published in accordance with section 93

2. The following power in the Act is exercised by the FSA to give guidance:

- section 157(1).

ANNEX 2

The Listing Rules are amended as shown in the document attached (underlining indicates new text, striking through indicates deleted text).

[attach the Listing Rules with changes shown]

ANNEX 3

Guidance is given as shown in the document attached.

[attach the Guidance Manual]

READER'S GUIDE AMENDMENT INSTRUMENT 2001

Power exercised

- A. The Financial Services Authority amends the Reader's Guide in the exercise of the power in section 157(1) of the Financial Services and Markets Act 2000 (Guidance).

Commencement

- B. This instrument comes into force immediately.

Amendments to the Reader's Guide

- C. The Reader's Guide is amended in accordance with the Annex to this instrument.

Citation

- D. This instrument may be cited as the Reader's Guide Amendment Instrument 2001.

By order of the Board
15 November 2001

ANNEX

In this Annex, where amendments are shown rather than described, underlining indicates new or substituted text and ^ indicates deleted text.

Paragraph 2: Amend as shown:

2. The guide covers:
 - (1) structure (paragraphs 3 to 17);
 - (2) status of provisions (paragraphs 18 to 32);
 - (3) contents pages (paragraph 33);
 - (4) numbering :
 - pages (paragraphs 34 to 37);
 - contents (paragraphs 38 to 42);
 - (5) cross-references (paragraphs 43 to 45);
 - (6) defined terms (paragraph 46);
 - (7) schedules (paragraphs 47 to 59);
 - (8) glossary of definitions (paragraphs 60 to 63); and
 - (9) index (paragraphs 64 to 67).

Paragraphs 4 and 5:

4. Section 153 of the Act requires the FSA to exercise its rule-making powers in writing. The Act describes the document by which the rules are made as a 'rule-making instrument' and imposes a number of requirements, including a requirement to publish it. The FSA will publish all instruments by which provisions in the Handbook are made or amended in full on its website. These fulfil the statutory and other legal requirements for publication, and will be the definitive source for determining what the text was at any particular time for legal purposes (see section 154 of the Act (Verification of rules)). There is a list of the dates on which the various parts of the Handbook came into force in the latest Handbook Notice.
5. The Handbook as published on CD-ROM and on paper will provide a continuously updated consolidation of the contents of the instruments by which the provisions in the Handbook are made. This consolidation may contain typographical improvements, with no legal effect, which do not appear in the legal instruments.

Paragraph 8: After "Interim Prudential sourcebooks" add "(see the table at the end of this guide)." and delete from ": (1) for banks" to "(IPRU(INV))".

Paragraph 10:

- (1) For "contains" substitute "has with or in it".
- (2) Delete "with each module or group of modules as appropriate".

Paragraph 12(2):

- (1) For "typeface" substitute "font and size of type".
- (2) Delete "Sabon" and "Officina Sans".

Paragraph 19: Delete "Schedule 5,".

Paragraph 28 to 31: Amend as shown:

28. The letter G is normally used to indicate guidance given under section 157. The guidance in the Handbook relates to the operation of the Act, the rules in the Handbook and other matters. Most general guidance (meaning, in this Guide, guidance given to persons or regulated persons generally or to a class of regulated person) will be given through the Handbook, but in certain cases, where the guidance is urgent or temporary, it will be published in a separate Guidance Note. Material published in vehicles other than the Handbook or Guidance Notes, for example in newsletters or on the FSA's website, is not guidance unless it says that it is.
29. Guidance may be used ... breach of the relevant rule.
30. Guidance is generally designed to throw light on a particular aspect of regulatory requirements, not to be an exhaustive description of firms' obligations. If a person acts in accordance with general guidance in the circumstances contemplated by that guidance, then the FSA will proceed on the footing that the person has complied with the aspects of the rule or other requirement to which the guidance relates. (For the reliance that can be placed on other guidance, see SUP 9.4 (Reliance on individual guidance).
31. Rights conferred on third ... seek his own legal advice.
32. G is also used for the FSA's statement of the procedure for giving statutory notices under section 395 of the Act (see DEC), for the various statements of policy regarding use of the FSA's enforcement powers (see ENF), \wedge to indicate the arrangements made by the FSA under paragraph 7 of Schedule 1 to the Act for the investigation of complaints arising in connection with its exercise or non-exercise of its non-legislative functions (see COAF) and to indicate background information which is not guidance under the Act.

Paragraphs 32 to 35:

- (1) Renumber paragraph 32 as 33.
- (2) Renumber paragraph 33 as 34 and for "Section 1" substitute "Section 3.1".
- (3) Renumber paragraph 34 as 35.
- (4) Delete the paragraph number of paragraph 35 and add the text at the end of renumbered paragraph 35.

Paragraph 40: For "COB 1.2.3AR" substitute "COB 1.2.3A R".

Paragraph 44: For "the annex to COB 1 appears" substitute "an annex to COB 1 would appear".

Paragraph 46: Amend as shown:

46. Defined terms used in the text are shown in italic type. Where a word or phrase is in italics, its definition can be found in the Handbook Glossary. \wedge Where a word or phrase which is shown in italics in one part of the text appears without italics in another part, it is meant to be given, where unitalicised, its ordinary natural meaning. Paragraphs 60 to 63 give more information about the Glossary.

Paragraphs 49 to 51: Amend as shown:

49. Schedules 4, 5 and 6 specify the powers the FSA has exercised in making the provisions in the sourcebook or manual (see paragraph 4), summarise the rights of action for damages which attach to many rules, and state which rules can be waived, and under which section of the Act.
50. Where comprehensive schedules may be useful, consolidated versions, drawing together the contents of the schedules from each sourcebook and manual, will be provided.
51. A single consolidated schedule (Schedule 7) will provide a check-list of releases for the Handbook as a whole.

Paragraph 54: After "detailed notification" insert "and reporting".

Paragraph 57(2): Amend as shown:

57. ...
 - (2) lists the rules in the sourcebook or manual:
 - (a) to which rights of action apply under section 150(1) of the Act;
 - ∧
 - (b) to which rights of action apply at the suit, not only of a private person, but of a person who is not a private person, in accordance with section 150(3), with a statement to whom the rights have been extended;
 - (c) to which rights of action do not apply because the rights have been removed under section 150(2) of the Act, because they are not binding on authorised persons, or because they are listing rules or financial resources rules, in accordance with section 150(4).

Paragraphs 58 to 60: Amend as shown:

58. Schedule 6 specifies the rules in the sourcebook or manual (if any) which the FSA has power to waive or modify, and the section of the Act which gives the FSA that power in respect of the rules in question. For more information about this power and its limits, see SUP 8 (Waiver and modification of rules) or REC 3.3 (Waivers).

Consolidated schedule of releases

59. The purpose of Schedule 7 is to help firms keep track of amendments made to the Handbook since it was first published. It lists by serial number each release issued, its date of publication and its contents and refers to the relevant Handbook Notice. The full text of each release and of each Handbook Notice is on the FSA's website at www.fsa.gov.uk.

GLOSSARY OF DEFINITIONS

60. ∧ The Handbook also contains a glossary of definitions. This lists the defined terms used in the sourcebook or manual and gives their meaning. It also contains guidance reminding the reader of the main General provisions for interpreting the Handbook (GEN 2).

Paragraph 62: After "in italics (and not" insert ", for example,".

Paragraphs 63 and 64: Delete paragraph 63 and renumber paragraph 64 as 63.

Paragraph 65: Amend as shown:

64. In addition to the links in the electronic versions of the Handbook, it is planned that the Handbook will contain an index.

65. The index will warn ...

Paragraph 66: For "33" substitute "34".

Paragraph 68: Delete.

Table: Contents of the Handbook: Amend the table as shown:

Contents of the Handbook

	Sourcebook or manual	Reference Code	
High Level Standards	Principles for Businesses	PRIN	
	Senior Management Arrangements, Systems and Controls	SYSC	
	Threshold Conditions	COND	
	Statements of Principle and Code of Practice for Approved Persons	APER	
	The Fit and Proper test for Approved Persons	FIT	
	General provisions	GEN	
Business Standards	^ Interim Prudential sourcebooks ^: <u>for banks</u> IPRU(BANK) <u>for building societies</u> IPRU(BSOC) <u>for friendly societies</u> IPRU(FSOC) <u>for insurers</u> IPRU(INS) <u>for investment</u> <u>businesses</u> IPRU(INV)	IPRU	
	Conduct of Business	COB	
	Market conduct ^: Code of Market Conduct Price stabilising rules Inter-professional conduct <u>Endorsement of the Takeover Code</u>	MAR	
	Training and Competence	TC	
	Money Laundering	ML	
	Regulatory Processes	Authorisation	AUTH
		Supervision	SUP
Enforcement		ENF	
Decision making		DEC	
Redress	Dispute resolution: Complaints	DISP	
	Compensation	COMP	
	Complaints against the FSA	COAF	

Specialist sourcebooks	Collective Investment Schemes	CIS
	^ Credit unions ^	^CRED^
	Professional firms	PROF
	Lloyd's	LLD
	^ Mortgages^	^MORT^
	Recognised Investment Exchanges and Recognised Clearing Houses	REC
	(Later: United Kingdom Listing Authority)	(UKLA)
<u>Special guides</u>	<u>Energy Market Participants</u>	<u>EMPS</u>
	<u>Small Friendly societies</u>	<u>FREN</u>
	<u>Oil Market Participants</u>	<u>OMPS</u>
	<u>Service companies</u>	<u>SERV</u>
Schedules: Transitional provisions Summary schedules: 1. Record keeping requirements 2. Notification requirements 3. Fees and other required payments 4. Powers exercised in making the Handbook 5. Rights of action for damages 6. Rules that can be waived 7. Releases		
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THRESHOLD CONDITIONS (AMENDMENT) INSTRUMENT 2001

Powers exercised

- A. The Financial Services Authority amends Threshold Conditions (COND) in the exercise of the power in section 157(1) the Financial Services and Markets Act 2000 (Guidance).

Commencement

- B. This instrument comes into force immediately.

Amendments to Threshold Conditions

- C. COND is amended:
- (1) in accordance with Annex A to this instrument (Amendments to made text);
 - (2) by deleting the existing COND 1 Annex 1G and replacing it with the material in Annex B to this instrument (COND 1 Annex 1G);
 - (3) by inserting the material in Annex C to this instrument (COND 1 Annex 2G);
and
 - (4) by deleting the existing COND 2 Annex 1G and replacing it with the material in Annex D to this instrument (COND 2 Annex 1G).

Citation

- D. This instrument may be cited as the Threshold Conditions (Amendment) Instrument 2001.

By order of the Board
15 November 2001

Annex A

Amendments to made text

- 1.1.1G (1) For “. ” at the end of (1) and (2), insert “ ; ”.
- (2) After (2), insert:
- “(3) *threshold conditions* 3, 4 and 5 do not apply to a *Swiss General Insurance Company*; and
- (4) *COND 2.6* (Additional conditions) is only relevant to *non-EEA insurers*.”
- 1.2.1G After “set out in”, insert "or under"
- 1.3.4G After “set out in”, insert "or under"
- 2.1.1 In paragraph 1(1), after “body corporate” insert:
- “(other than a limited liability partnership)”
- 2.4.6G(3) In the second sentence, for “General *guidance* on the contents of a business plan is”, insert:
- “Notes on the contents of a business plan are”
- 2.5.4G(3) In the second sentence, after "(The FSA's general duties)", insert “;”
- 2.6.1 After “(b) ... **insurance business**”, insert a new heading and text:
- “Article 3 of The Financial Services and Markets Act 2000 (Variation of Threshold Conditions) Order 2001 (SI 2001/2507)**
- Non-EEA insurers**
- 3. - (1) If paragraph 8 of Schedule 6 (additional conditions applying to non-EEA insurers) applies to the person concerned, it must, for the purposes of section 41 and Schedule 6, satisfy the following additional conditions -**
- (a) it must have a representative who is resident in the United Kingdom and who has authority to bind it in its relations with third parties and to represent it in its relations with the [FSA] and the courts in the United Kingdom;**
- (b) subject to paragraph (2), if the person concerned is not a Swiss general insurance company -**

(i) it must be a body corporate entitled under the law of the place where its head office is situated to effect and carry out contracts of insurance;

(ii) it must have in the United Kingdom assets of such value as may be specified;

(iii) unless the regulated activity in question relates solely to reinsurance, it must have made a deposit (of money or securities, as may be specified) of such an amount and with such a person as may be specified, and on such terms and subject to such other provisions as may be specified.

(2) Where the person concerned is seeking to carry on an activity relating to insurance business in one or more other EEA States (as well as in the United Kingdom), and the [FSA] and the supervisory authority in the other EEA State or States concerned so agree -

(a) the reference in paragraph (1)(b)(ii) to the United Kingdom is to be read as a reference to the United Kingdom and the other EEA State or States concerned; and

(b) the reference in paragraph (1)(b)(iii) to such a person as may be specified is to be read as a reference to such a person as may be agreed between the [FSA] and the other supervisory authority or authorities concerned.”

2.6.2G

For 2.6.2G, and following 2.6.2G, insert:

“2.6.2 G The Financial Services and Markets Act 2000 (Variation of Threshold Conditions) Order 2001 (SI 2001/2507) imposes certain additional conditions on non-*EEA insurers*, as set out above.

2.6.3 G The order referred to in *COND 2.6.2G* implements requirements under *the Insurance Directives*, and the *Act* extends these requirements to *firms* outside of the *EEA*.

2.6.4 G The effect of article 3(a) of the Order is that a non-*EEA insurer* (including a *Swiss General insurance company*) must appoint an *authorised UK representative*.

2.6.5 G (1) A non-*EEA insurer* must be a *body corporate* formed under the law of the country where its head office is situated.

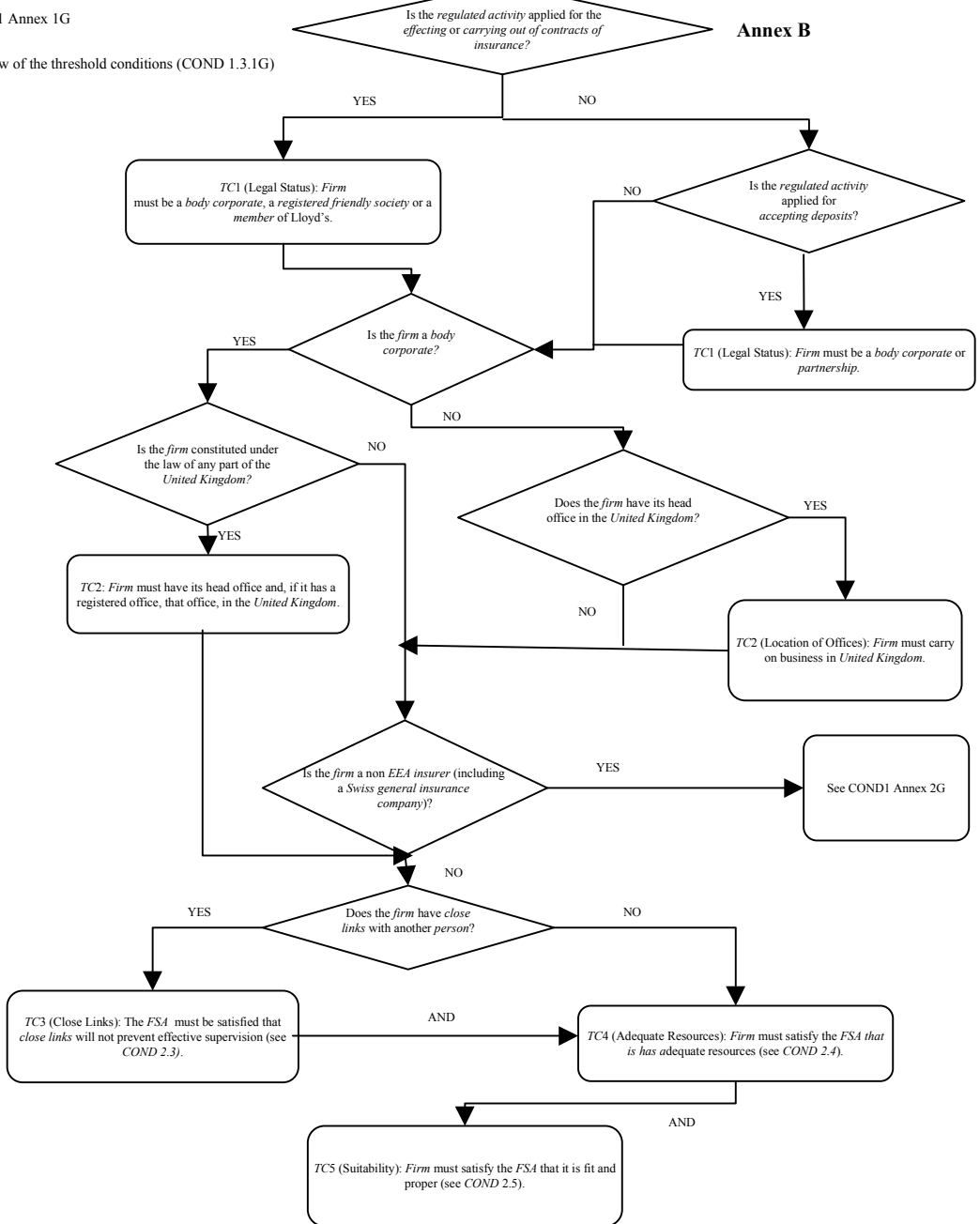
(2) A *person* seeking to carry on *insurance business* in the *United Kingdom* must have assets in the *United Kingdom* to a value specified in *IPRU(INS)*. Where the applicant wants to carry on *insurance business*

in other *EEA States*, the applicant must have assets in those other *EEA States* as are agreed between the *FSA* and the supervisory authorities in the other states.

- (3) Unless the *regulated activity* to be carried on by the applicant relates solely to reinsurance business, the applicant must make a deposit of an amount and type and on terms with a *person* and agreed between the *FSA* and the supervisory authorities in other *EEA States* where the applicant wishes to carry on *insurance business*. This deposit will be subject to the provisions as set out in *IPRU(INS)*.

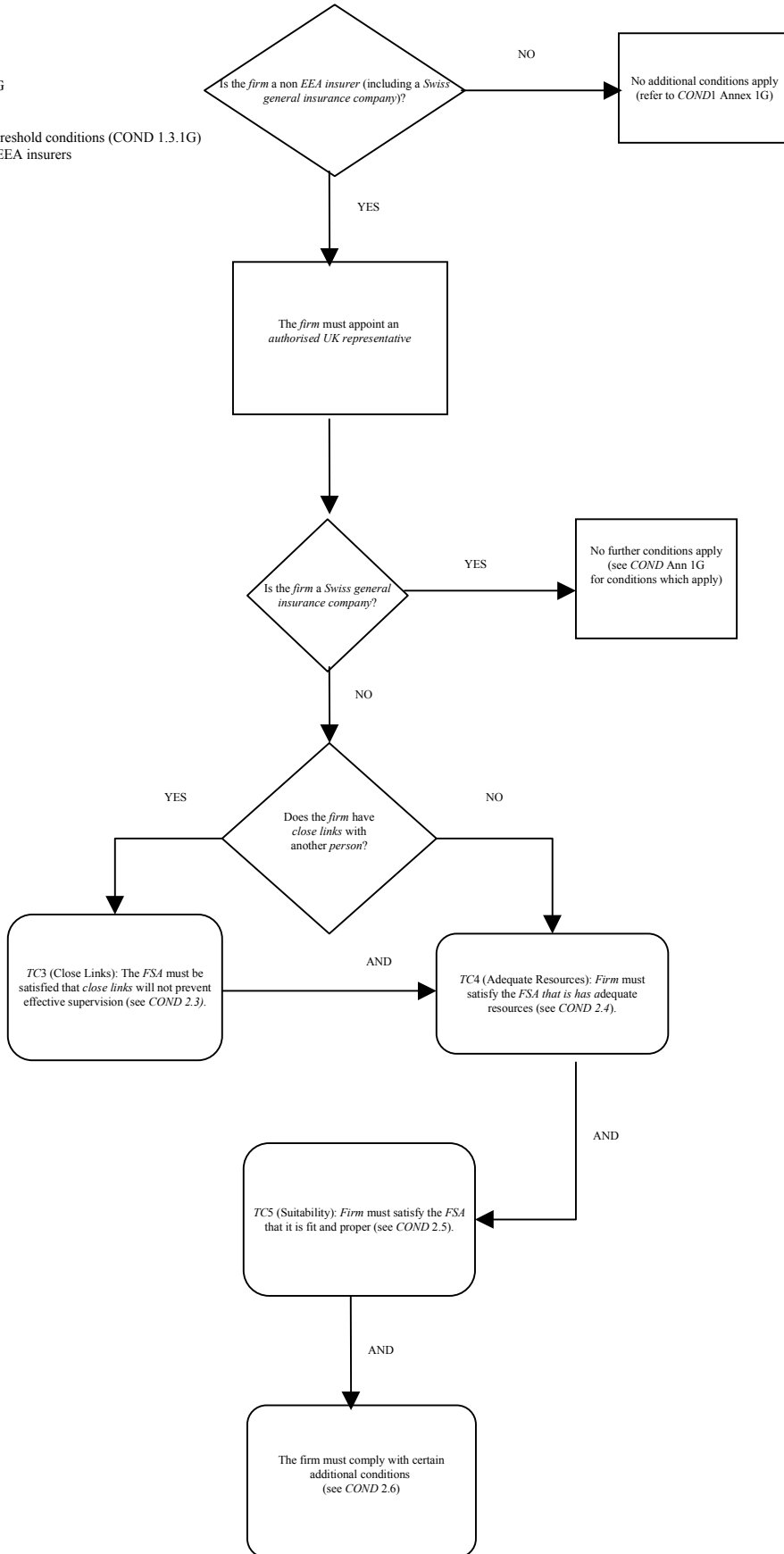
2.6.6 G The additional conditions in *AUTH 2.6.5G(1), (2) and (3)* do not apply to *Swiss general insurance companies*.”

Overview of the threshold conditions (COND 1.3.1G)

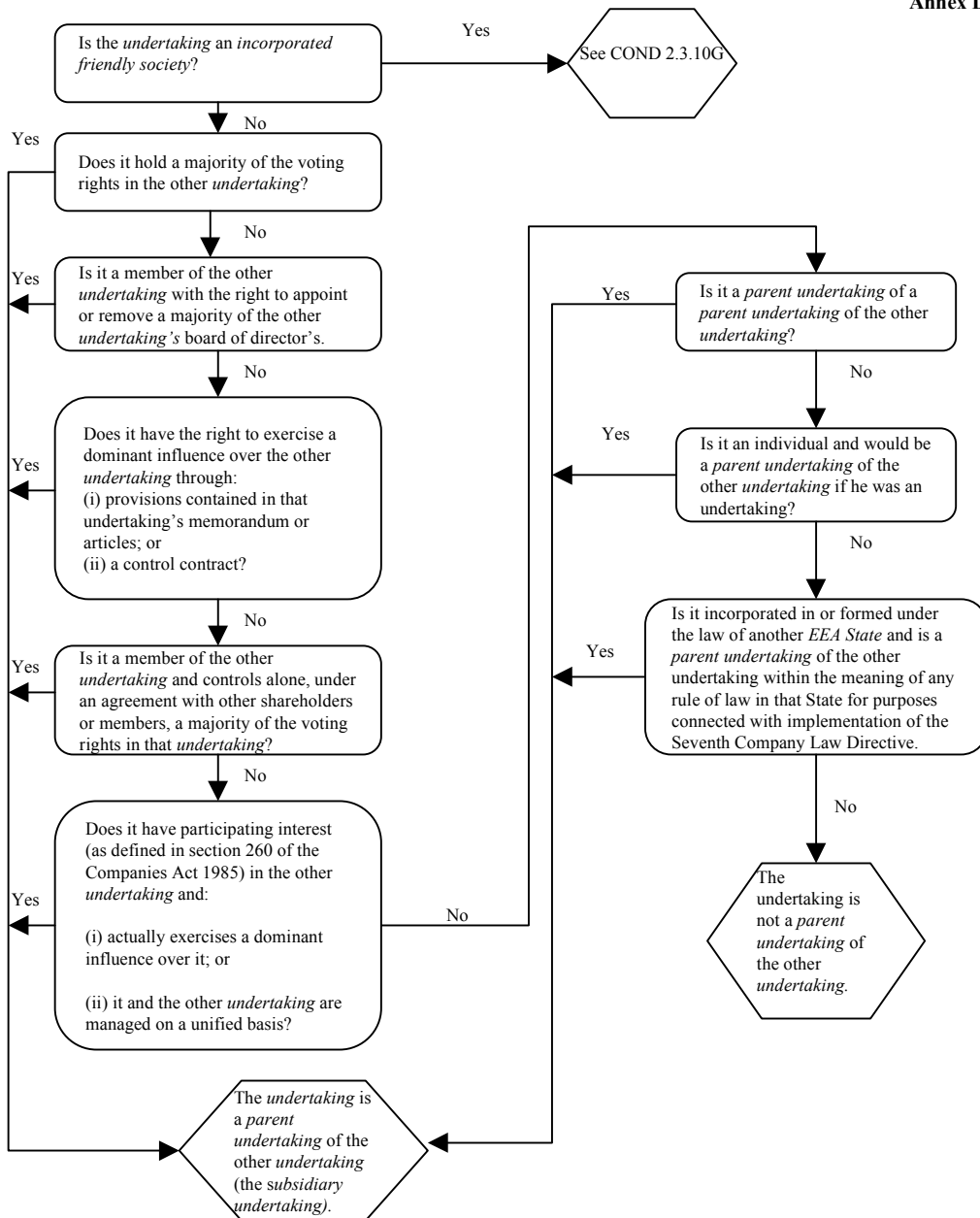


COND 1 Annex 2G

Overview of the threshold conditions (COND 1.3.1G) applicable to non-EEA insurers



Close links: is an undertaking the parent undertaking of another undertaking (COND 2.3.7G(2))



FSA 2001/54

**STATEMENTS OF PRINCIPLE AND CODE OF PRACTICE
FOR APPROVED PERSONS (REVOKING) INSTRUMENT 2001**

The Financial Services Authority revokes the Statements of Principle and Code of Practice for Approved Persons Instrument 2001 made on 21 June 2001.

By order of the Board

15 November 2001

**STATEMENTS OF PRINCIPLE AND CODE OF PRACTICE
FOR APPROVED PERSONS INSTRUMENT 2001**

Powers exercised

- A. The Financial Services Authority issues the statements and related code of practice and gives the guidance in the Annex to this instrument (“APER”) in the exercise of the powers listed in Schedule 4 to APER (Powers exercised).

Commencement


- B. This instrument shall come into force at the beginning of the day on which section 19 of the Financial Services and Markets Act 2000 (The general prohibition) comes into force.

Citation

- C. This instrument may be cited as the Statements of Principle and Code of Practice for Approved Persons Instrument 2001.
- D. The Annex to this instrument (including its Schedules) may be cited as the Statements of Principle and Code of Practice for Approved Persons (or APER).

By order of the Board
15 November 2001

ANNEX



Statements of Principle and Code of Practice for Approved Persons

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Statements of Principle and Code of Practice for Approved Persons

Transitional Provisions

G

- 1 There are no transitional provisions in APER. However, GEN contains some technical transitional provisions that apply throughout the Handbook and which are designed to ensure a smooth transition at commencement.

Chapter 1

Application and purpose

1



1.1 Application

1.1.1









G

APER applies to approved persons.

01.12.01/001



1.2 Purpose

- 1.2.1**  The *Statements of Principle* contained in ■ APER 2 are issued under section 64(1) of the *Act* (Conduct: statements and codes).
01.12.01/001
- 1.2.2**  Section 64(2) of the *Act* states that if the FSA issues *Statements of Principle* it must also issue a code of practice for the purpose of helping to determine whether or not a *person's* conduct complies with the *Statements of Principle*. The *Code of Practice for Approved Persons* in ■ APER 3 and ■ APER 4 fulfils this requirement.
01.12.01/001
- 1.2.3**  The *Code of Practice for Approved Persons* sets out descriptions of conduct which, in the opinion of the FSA, do not comply with a *Statement of Principle* and, in the case of *Statement of Principle* 3, conduct which tends to show compliance within that statement. The *Code of Practice for Approved Persons* also sets out, in certain cases, factors which, in the opinion of the FSA, are to be taken into account in determining whether or not an *approved person's* conduct complies with a *Statement of Principle*. The *guidance* set out in ■ APER 3 and ■ APER 4 does not form part of the *Code of Practice for Approved Persons*.
01.12.01/001
- 1.2.4**  Section 64(11) of the *Act* states that the power to *issue Statements of Principle* and codes of practice includes power to make different provisions in relation to *persons*, cases or circumstances of different descriptions. *Statements of Principle* 1, 2, 3 and 4 apply to all *approved persons*, and *Statements of Principle* 5, 6 and 7 apply to those approved to perform *significant influence functions*.
01.12.01/001
- 1.2.5**  As set out in ■ SUP 10.3.1 R (Arrangements and regulated activities), a function is a *controlled function* only to the extent that it is performed under an *arrangement* entered into by:
- (1) a *firm*; or
 - (2) a contractor of the *firm*;
- in relation to the carrying on by the *firm* of a *regulated activity*.
- 1.2.6**  The *Statements of Principle* apply only to the performance of a *controlled function* (that is, to the activities carried on under the *arrangement* described in the *firm's* application for approval).
01.12.01/001
- 1.2.7**  The FSA recognises that an *approved person* may be performing functions which are unrelated to *regulated activities* or are otherwise outside the description of a *controlled function*. The fact that a *person* may be approved for one purpose does not have the effect of bringing all his functions within the *controlled function*, nor of making those functions subject to the *Statements of Principle*.
01.12.01/001
- 1.2.8**  The territorial scope of the *approved persons* regime is set out in ■ SUP 10.1 (Application).
01.12.01/001

1.2.9

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01.12.01/001

The *Statements of Principle* apply only to the extent that a *person* is performing a *controlled function* for which approval has been sought and granted.

Chapter 2

2

The Statements of Principle for Approved Persons

2.1 The Statement of Principle

2.1.1

G
01.12.01/001

■ APER 2.1.2 P sets out the *Statements of Principle* issued by the FSA to which ■ APER 1.2.1 G refers and to which the provisions of the *Code of Practice for Approved Persons* and *guidance* in ■ APER 3 and ■ APER 4 apply.

2.1.2

P
01.12.01/001

Table Statements of Principle issued under section 64 of the Act

Statement of Principle 1

An approved person must act with integrity in carrying out his controlled function.

Statement of Principle 2

An approved person must act with due skill, care and diligence in carrying out his controlled function.

Statement of Principle 3

An approved person must observe proper standards of market conduct in carrying out his controlled function.

Statement of Principle 4

An approved person must deal with the FSA and with other regulators in an open and cooperative way and must disclose appropriately any information of which the FSA would reasonably expect notice.

Statement of Principle 5

An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function is organised so that it can be controlled effectively.

Statement of Principle 6

An *approved person* performing a *significant influence function* must exercise due skill, care and diligence in managing the business of the *firm* for which he is responsible in his *controlled function*.

Statement of Principle 7

An *approved person* performing a *significant influence function* must take reasonable steps to ensure that the business of the *firm* for which he is responsible in his *controlled function* complies with the relevant requirements and standards of the *regulatory system*.

Chapter 3

Code of Practice for Approved Persons: general

3

3.1 Introduction

3.1.1

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01.12.01/001

This *Code of Practice for Approved Persons* is issued under section 64 of the *Act* (Conduct: statements and codes) for the purpose of helping to determine whether or not an *approved person's* conduct complies with a *Statement of Principle*. The code sets out descriptions of conduct which, in the *FSA's* opinion, do not comply with the relevant *Statements of Principle*. The code also sets out certain factors which, in the opinion of the *FSA*, are to be taken into account in determining whether an *approved person's* conduct complies with a particular *Statement of Principle*. The description of conduct, the factors and related provisions are identified in the text by the letter 'E' as explained in paragraph 25 of the Readers Guide.

3.1.2

G
01.12.01/001

The *Code of Practice for Approved Persons* in issue at the time when any particular conduct takes place may be relied on so far as it tends to establish whether or not that conduct complies with a *Statement of Principle*.

3.1.3

G
01.12.01/001

The significance of conduct identified in the *Code of Practice for Approved Persons* as tending to establish compliance with or a breach of a *Statement of Principle* will be assessed only after all the circumstances of a particular case have been considered. Account will be taken of the context in which a course of conduct was undertaken, including the precise circumstances of the individual case, the characteristics of the particular *controlled function* and the behaviour to be expected in that function.

3.1.4

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01.12.01/001

- (1) An *approved person* will only be in breach of a *Statement of Principle* where he is personally culpable. Personal culpability arises where an *approved person's* conduct was deliberate or where the *approved person's* standard of conduct was below that which would be reasonable in all the circumstances (see ■ ENF 11.5.3 G (Action against approved persons)).
- (2) For the avoidance of doubt, the *Statements of Principle* do not extend the duties of *approved persons* beyond those which the *firm* owes in its dealings with *customers* or others.

3.1.5

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01.12.01/001

In particular, in determining whether or not an *approved person's* conduct complies with a *Statement of Principle*, the *FSA* will take into account the extent to which an *approved person* has acted in a way that is stated to be in breach of a *Statement of Principle*.

3.1.6

G
01.12.01/001

The *Code of Practice for Approved Persons* (and in particular the specific examples of behaviour which may be in breach of a generic description of conduct in the code) is not exhaustive of the kind of conduct that may contravene the *Statements of Principle*. The purpose of the code is to help determine whether or not a *person's* conduct complies with a *Statement of Principle*. The code may be supplemented from time to time. The *FSA* will amend the code if there is a risk that unacceptable practice may become prevalent, so as to make clear what conduct falls below the standards expected of *approved persons* by the *Statements of Principle*.

3.1.7

G
01.12.01/001

Statements of Principle 1 to 4 apply to all approved persons. In the Statements of Principle and in the Code of Practice for Approved Persons, a reference to "his controlled function" is a reference to the controlled function to which the approval relates. A person performing a significant influence function is also subject to the additional requirements set out in Statements of Principle 5 to 7 in performing that controlled function. Those responsible under ■ SYSC 2.1.3 R (Apportionment of responsibilities) for the firm's apportionment obligation will be specifically subject to Statement of Principle 5 (and see in particular ■ APER 4.5.6 E). In addition, it will be the responsibility of any such approved person to oversee that the firm has appropriate systems and controls under Statement of Principle 7 (and see in particular ■ APER 4.7.3 E).

3.1.8

G
01.12.01/001

In applying Statements of Principle 5 to 7, the nature, scale and complexity of the business under management and the role and responsibility of the individual performing a significant influence function within the firm will be relevant in assessing whether an approved person's conduct was reasonable. For example, the smaller and less complex the business, the less detailed and extensive the systems of control need to be. The FSA will be of the opinion that an individual performing a significant influence function may have breached Statements of Principle 5 to 7 only if his conduct was below the standard which would be reasonable in all the circumstances. (See also ■ APER 3.3.1 E (3)to (5))

3.1.9

G
01.12.01/001

UK domestic firms listed on the London Stock Exchange are subject to the Combined Code developed by the Committee on Corporate Governance, whose internal control provisions are amplified in the Guidance for Directors issued by the Institute of Chartered Accountants in England and Wales. FSA-regulated firms in this category will thus be subject to that code as well as to the requirements and standards of the regulatory system. In forming an opinion whether approved persons have complied with its requirements, the FSA will give due credit for their following corresponding provisions in the Combined Code and related guidance.



3.2 Factors relating to all Statements of Principle

3.2.1



01.12.01/001

In determining whether or not the particular conduct of an *approved person* within his *controlled function* complies with the *Statements of Principle*, the following are factors which, in the opinion of the *FSA*, are to be taken into account:

- (1) whether that conduct relates to activities that are subject to other provisions of the *Handbook*;
- (2) whether that conduct is consistent with the requirements and standards of the *regulatory system* relevant to his *firm*.



3.3 Factors relating to Statements of Principle 5 to 7

3.3.1



01.12.01/001

In determining whether or not the conduct of an *approved person* performing a *significant influence function* complies with *Statements of Principle 5 to 7*, the following are factors which, in the opinion of the *FSA*, are to be taken into account:

- (1) whether he exercised reasonable care when considering the information available to him;
- (2) whether he reached a reasonable conclusion which he acted on;
- (3) the nature, scale and complexity of the *firm's* business;
- (4) his role and responsibility as an *approved person* performing a *significant influence function*;
- (5) the knowledge he had, or should have had, of regulatory concerns, if any, arising in the business under his control.

Chapter 4

Code of Practice for Approved Persons: specific

4

4.1 Statement of Principle 1

4

4.1.1



01.12.01/001

The *Statement of Principle 1* (see ■ APER 2.1.2 P) is in the following terms: "An *approved person* must act with integrity in carrying out his *controlled function*."

4.1.2



01.12.01/001

In the opinion of the FSA, conduct of the type described in ■ APER 4.1.3 E, ■ APER 4.1.5 E, ■ APER 4.1.6 E, ■ APER APER 4.1.8 E, ■ APER 4.1.10 E, ■ APER 4.1.12 E or ■ APER 4.1.13 E does not comply with *Statement of Principle 1* ■ APER 2.1.2 P).

4.1.3



01.12.01/001

Deliberately misleading (or attempting to mislead) by act or omission:

- (1) a *client*; or
- (2) his *firm* (or its auditors or *appointed actuary*); or
- (3) the FSA;

falls within ■ APER 4.1.2 E.

4.1.4






01.12.01/001

Behaviour of the type referred to in ■ APER 4.1.3 E includes, but is not limited to, deliberately:


- (1) falsifying *documents*;
- (2) misleading a *client* about the risks of an *investment*;
- (3) misleading a *client* about the charges or surrender penalties of *investment* products;
- (4) misleading a *client* about the likely performance of *investment* products by providing inappropriate *projections* of future *investment* returns;
- (5) misleading a *client* by informing him that products require only a single payment when that is not the case;
- (6) mismarking the value of *investments* or trading positions;
- (7) procuring the unjustified alteration of prices on illiquid or *off-exchange* contracts, or both;
- (8) misleading others within the *firm* about the credit-worthiness of a borrower;



- (9) providing false or inaccurate documentation or information, including details of training, qualifications, past employment record or experience;
- (10) providing false or inaccurate information to the *firm* (or to the *firm's* auditors or *appointed actuary*);
- (11) providing false or inaccurate information to the *FSA*;
- (12) destroying, or causing the destruction of, *documents* (including false documentation), or tapes or their contents, relevant to misleading (or attempting to mislead) a *client*, his *firm*, or the *FSA*;
- (13) failing to disclose dealings where disclosure is required by the *firm's* personal account *dealing rules*;
- (14) misleading others in the *firm* about the nature of risks being accepted.

4.1.5  01.12.01/001 Deliberately recommending an *investment* to a *customer*, or carrying out a discretionary *transaction* for a *customer* where the *approved person* knows that he is unable to justify its suitability for that *customer*, falls within  APER 4.1.2 E.



4.1.6  01.12.01/001 Deliberately failing to inform, without reasonable cause:



- (1) a *customer*; or
- (2) his *firm* (or its auditors or *appointed actuary*); or
- (3) the *FSA*;

of the fact that their understanding of a material issue is incorrect, despite being aware of their misunderstanding, falls within  APER 4.1.2 E.

4.1.7  01.12.01/001 Behaviour of the type referred to in  APER 4.1.6 E includes, but is not limited to, deliberately:

- (1) failing to disclose the existence of falsified *documents*;
- (2) failing to rectify mismarked positions immediately.

4.1.8  01.12.01/001 Deliberately preparing inaccurate or inappropriate records or returns in connection with a *controlled function*, falls within  APER 4.1.2 E.

4.1.9  01.12.01/001 Behaviour of the type referred to in  APER 4.1.8 E includes, but is not limited to, deliberately:

4.1.10



01.12.01/001

- (1) preparing performance reports for transmission to *customers* which are inaccurate or inappropriate (for example, by relying on past performance without appropriate warnings);
- (2) preparing inaccurate training records or inaccurate details of qualifications, past employment record or experience;
- (3) preparing inaccurate trading confirmations, contract notes or other records of *transactions* or holdings of *securities* for a *customer*, whether or not the *customer* is aware of these inaccuracies or has requested such records.

Deliberately misusing the assets or confidential information of a *client* or of his *firm* falls within ■ APER 4.1.2 E.

4.1.11



01.12.01/001

Behaviour of the type referred to in ■ APER 4.1.10 E includes, but is not limited to, deliberately:

- (1) front running *client* orders;
- (2) carrying out unjustified trading on *client* accounts to generate a benefit (whether direct or indirect) to the *approved person* (that is, churning);
- (3) misappropriating a *client's* assets, including wrongly transferring to personal accounts cash or *securities* belonging to *clients*;
- (4) wrongly using one *client's* funds to settle margin calls or to cover trading losses on another *client's* account or on *firm* accounts;
- (5) using a *client's* funds for purposes other than those for which they were provided;
- (6) retaining a *client's* funds wrongly;
- (7) pledging the assets of a *client* as security or margin in circumstances where the *firm* is not permitted to do so.

4.1.12



01.12.01/001

Deliberately designing *transactions* so as to disguise breaches of requirements and standards of the *regulatory system* falls within ■ APER 4.1.2 E.

4.1.13



01.12.01/001

Deliberately failing to disclose the existence of a conflict of interest in connection with dealings with a *client* falls within ■ APER 4.1.2 E.



4.2 Statement of Principle 2

4.2.1



01.12.01/001

The *Statement of Principle 2* (see ■ APER 2.1.2 P) is in the following terms: "An *approved person* must act with due skill, care and diligence in carrying out his *controlled function*."

4.2.2



01.12.01/001

In the opinion of the FSA, conduct of the type described in ■ APER 4.2.3 E, ■ APER 4.2.5 E, ■ APER 4.2.6 E, ■ APER 4.2.8 E, ■ APER 4.2.10 E, ■ APER 4.2.11 E or ■ APER 4.2.13 E does not comply with *Statement of Principle 2* ■ APER 2.1.2 P).

4.2.3



01.12.01/001

Failing to inform:

- (1) a *customer*; or
- (2) his *firm* (or its auditors or *appointed actuary*);

of material information in circumstances where he was aware, or ought to have been aware, of such information, and of the fact that he should provide it, falls within ■ APER 4.2.2 E.

4.2.4



01.12.01/001

Behaviour of the type referred to in ■ APER 4.2.3 E includes, but is not limited to:









- (1) failing to explain the risks of an *investment* to a *customer*;
- (2) failing to disclose to a *customer* details of the charges or surrender penalties of *investment* products;
- (3) mismarking trading positions;
- (4) providing inaccurate or inadequate information to a *firm*, its auditors or *appointed actuary*;
- (5) failing to disclose dealings where disclosure is required by the *firm's* personal account *dealing rules*.

4.2.5







01.12.01/001

Recommending an *investment* to a *customer*, or carrying out a discretionary *transaction* for a *customer*, where he does not have reasonable grounds to believe that it is suitable for that *customer*, falls within ■ APER 4.2.2 E.

- 4.2.6  01.12.01/001 Undertaking, recommending or providing advice on *transactions* without a reasonable understanding of the risk exposure of the *transaction* to a *customer* falls within ■ APER 4.2.2 E.
- 4.2.7  01.12.01/001 *Behaviour* of the type referred to in ■ APER 4.2.6 E includes, but is not limited to, recommending *transactions* in *investments* to a *customer* without a reasonable understanding of the liability (either potential or actual) of that *transaction*.
- 4.2.8  01.12.01/001 Undertaking *transactions* without a reasonable understanding of the risk exposure of the *transaction* to the *firm* falls within ■ APER 4.2.2 E.
- 4.2.9  01.12.01/001 *Behaviour* of the type referred to in ■ APER 4.2.8 E includes, but is not limited to, trading on the *firm's* own account without a reasonable understanding of the liability (either potential or actual) of the *transaction*.
- 4.2.10  01.12.01/001 Failing without good reason to disclose the existence of a conflict of interest in connection with dealings with a *client* falls within ■ APER 4.2.2 E.
- 4.2.11  01.12.01/001 Failing to provide adequate control over a *client's* assets falls within ■ APER 4.2.2 E.
- 4.2.12  01.12.01/001 *Behaviour* of the type referred to in ■ APER 4.2.11 E includes, but is not limited to:
- (1) failing to segregate a *client's* assets;
 - (2) failing to process a *client's* payments in a timely manner.
- 4.2.13  01.12.01/001 Continuing to perform a *controlled function* despite having failed to meet the standards of knowledge and skill set out in the Training and Competence sourcebook (TC) for that *controlled function* falls within ■ APER 4.2.2 E.










4.3 Statement of Principle 3


- 4.3.1**  The *Statement of Principle 3* (see ■ APER 2.1.2 P) is in the following terms: "An *approved person* must observe proper standards of market conduct in carrying out his *controlled function*."
- 01.12.01/001
- 4.3.2**  In many cases the required standard will be set out in ■ MAR 3 (Inter-Professional Conduct) and the *Code of Market Conduct* ■ MAR 1). Market codes and exchange rules will also be relevant.
- 01.12.01/001
- 4.3.3**  A factor to be taken into account in determining whether or not an *approved person's* conduct complies with this *Statement of Principle* ■ APER 2.1.2 P) is whether he, or his *firm*, has complied with ■ MAR 3 (Inter-Professional Conduct) or the *Code of Market Conduct* ■ MAR 1) or relevant market codes and exchange rules.
- 01.12.01/001
- 4.3.4**  Compliance with the code or *rules* described in ■ APER 4.3.3 E will tend to show compliance with this *Statement of Principle* ■ APER 2.1.2 P).
- 01.12.01/001

4.4 Statement of Principle 4


4

- 4.4.1**  The *Statement of Principle 4* (see ■ APER 2.1.2 P) is in the following terms: "An *approved person* must deal with the *FSA* and with other regulators in an open and cooperative way and must disclose appropriately any information of which the *FSA* would reasonably expect notice."
- 01.12.01/001
- 4.4.2**  For the purpose of this *Statement of Principle* ■ APER 2.1.2 P), regulators in addition to the *FSA* are those which have recognised jurisdiction in relation to *regulated activities* and a power to call for information from the *approved person* in connection with his *controlled function* or (in the case of an individual performing a *significant influence function*) in connection with the business for which he is responsible. This may include an exchange or an *overseas regulator*.
- 01.12.01/001
- 4.4.3**  In the opinion of the *FSA*, conduct of the type described in ■ APER 4.4.4 E, ■ APER 4.4.7 E, or ■ APER 4.4.9 E does not comply with *Statement of Principle 4* ■ APER 2.1.2 P).
- 01.12.01/001
- 4.4.4**  Failing to report promptly in accordance with his *firm's* internal procedures (or if none exist direct to the *FSA*), information which it would be reasonable to assume would be of material significance to the *FSA*, whether in response to questions or otherwise, falls within ■ APER 4.4.3 E.
- 01.12.01/001
- 4.4.5**  There is no duty on an *approved person* to report such information directly to the *FSA* unless he is one of the *approved persons* responsible within the *firm* for reporting matters to the *FSA*. However, if an *approved person* takes steps to influence the decision so as not to report to the *FSA* or acts in a way that is intended to obstruct the reporting of the information to the *FSA*, then the *FSA* will, in respect of that information, view him as being one of those within the *firm* who has taken on responsibility for deciding whether to report that matter to the *FSA*.
- 01.12.01/001
- 4.4.6**  In determining whether or not an *approved person's* conduct under ■ APER 4.4.4 E complies with *Statement of Principle 4*, the following are factors which, in the opinion of the *FSA*, are to be taken into account:
- 01.12.01/001
- (1) the likely significance to the *FSA* of the information which it was reasonable for the individual to assume;
 - (2) whether the information related to the individual himself or to his *firm*;
 - (3) whether any decision not to report the matter internally was taken after reasonable enquiry and analysis of the situation.

4.4.7  01.12.01/001 Where the *approved person* is, or is one of the *approved persons* who is, responsible within the *firm* for reporting matters to the *FSA*, failing promptly to inform the *FSA* of information of which he is aware and which it would be reasonable to assume would be of material significance to the *FSA*, whether in response to questions or otherwise, falls within ■ APER 4.4.3 E.

4.4.8  01.12.01/001 In determining whether or not an *approved person's* conduct under ■ APER 4.4.7 E complies with *Statement of Principle 4* ■ APER 2.1.2 P), the following are factors which, in the opinion of the *FSA*, are to be taken into account:








- (1) the likely significance of the information to the *FSA* which it was reasonable for the *approved person* to assume;
- (2) whether any decision not to inform the *FSA* was taken after reasonable enquiry and analysis of the situation.

4.4.9  01.12.01/001 Failing without good reason to:

- (1) inform a regulator of information of which the *approved person* was aware in response to questions from that regulator;
- (2) attend an interview or answer questions put by a regulator, despite a request or demand having been made;
- (3) supply a regulator with appropriate *documents* or information when requested or required to do so and within the time limits attaching to that request or requirement;

falls within ■ APER 4.4.3 E.

4.5 Statement of Principle 5

- 4.5.1**  The *Statement of Principle 5* (see ■ APER 2.1.2 P) is in the following terms: "An *approved person* performing a *significant influence function* must take reasonable steps to ensure that the business of the *firm* for which he is responsible in his *controlled function* is organised so that it can be controlled effectively."
- 01.12.01/001
- 4.5.2**  In the opinion of the *FSA*, conduct of the type described in ■ APER 4.5.3 E, ■ APER 4.5.4 E, ■ APER 4.5.6 E or ■ APER 4.5.8 E does not comply with *Statement of Principle 5* ■ APER 2.1.2 P).
- 01.12.01/001
- 4.5.3**  Failing to take reasonable steps to apportion responsibilities for all areas of the business under the *approved person's* control falls within ■ APER 4.5.2 E (see ■ APER 4.5.11 G).
- 01.12.01/001
- 4.5.4**  Failing to take reasonable steps to apportion responsibilities clearly amongst those to whom responsibilities have been delegated falls within ■ APER 4.5.2 E (see ■ APER 4.5.11 G).
- 01.12.01/001
- 4.5.5**  Behaviour of the type referred to in ■ APER 4.5.4 E includes, but is not limited to:
- 01.12.01/001
- (1) implementing confusing or uncertain reporting lines (see ■ APER 4.5.12 G);
 - (2) implementing confusing or uncertain authorisation levels (see ■ APER 4.5.13 G);
 - (3) implementing confusing or uncertain job descriptions and responsibilities (see ■ APER 4.5.13 G).
- 4.5.6**  In the case of an *approved person* who is responsible under ■ SYSC 2.1.3 R (1) for dealing with the apportionment of responsibilities under ■ SYSC 2.1.1 R, failing to take reasonable care to maintain a clear and appropriate apportionment of significant responsibilities among the *firm's directors* and *senior managers* falls within ■ APER 4.5.2 E.
- 01.12.01/001
- 4.5.7**  Behaviour of the type referred to in ■ APER 4.5.6 E includes, but is not limited to:
- 01.12.01/001
- (1) failing to review regularly the significant responsibilities which the *firm* is required to apportion under ■ APER 2.1.1 R;

4.5.8  01.12.01/001

(2) failing to act where that review shows that those significant responsibilities have not been clearly apportioned.

Failing to take reasonable steps to ensure that suitable individuals are responsible for those aspects of the business under the control of the individual performing a *significant influence function* falls within ■ APER 4.5.2 E (see ■ APER 4.5.14 G).

4.5.9  01.12.01/001


Behaviour of the type referred to in ■ APER 4.5.8 E includes, but is not limited to:

- (1) failing to review the competence, knowledge, skills and performance of staff to assess their suitability to fulfil their duties, despite evidence that their performance is unacceptable (see ■ APER 4.5.14 G);
- (2) giving undue weight to financial performance when considering the suitability or continuing suitability of an individual for a particular role (see ■ APER 4.5.14 G);
- (3) allowing managerial vacancies which put at risk compliance with the requirements and standards of the *regulatory system* to remain, without arranging suitable cover for the responsibilities (see ■ APER 4.5.15 G).

4.5.10  01.12.01/001

Strategy and plans will often dictate the risk which the business is prepared to take on and high level controls will dictate how the business is to be run. If the strategy of the business is to enter high-risk areas, then the degree of control and strength of monitoring reasonably required within the business will be high. In organising the business for which he is responsible, the *approved person* performing a *significant influence function* should bear this in mind.

Apportionment of responsibilities

4.5.11  01.12.01/001

In order to comply with the obligations of *Statement of Principle 5* (having regard to ■ APER 4.5.3 E and ■ APER 4.5.4 E), the *approved person* performing a *significant influence function* may find it helpful to review whether each area of the business for which he is responsible has been clearly assigned to a particular individual or individuals.

Reporting lines

4.5.12  01.12.01/001

The organisation of the business and the responsibilities of those within it should be clearly defined (see ■ APER 4.5.5 E (1)). Reporting lines should be clear to staff. Where staff have dual reporting lines there is a greater need to ensure that the responsibility and accountability of each individual line manager is clearly set out and understood.

Authorisation levels and job descriptions

4.5.13

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01.12.01/001

Where members of staff have particular levels of authorisation (see ■ APER 4.5.5 E (2) and ■ APER 4.5.5 E (3)), these should be clearly set out and communicated to staff. It may be appropriate for each member of staff to have a job description of which he is aware.

Suitability of individuals

4.5.14

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01.12.01/001

If an individual's performance is unsatisfactory, then the appropriate *approved person* (if any) performing a *significant influence function* should review carefully whether to allow that individual to continue in position. In particular, if he is aware of concerns relating to the compliance with requirements and standards of the *regulatory system* (or internal controls) of the individual concerned, or of staff reporting to that individual, the *approved person* performing a *significant influence function* should take care not to give undue weight to the financial performance of the individual or group concerned when considering whether any action should be taken. An adequate investigation of the concerns should be undertaken (including, where appropriate, adherence to internal controls). The *approved person* performing a *significant influence function* should satisfy himself, on reasonable grounds, that the investigation is appropriate, the results are accurate and that the concerns do not pose an unacceptable risk to compliance with the requirements and standards of the *regulatory system* (see in particular *Statement of Principle 6* and ■ APER 4.5.8 E and ■ APER 4.5.9 E (1) and ■ APER 4.5.9E (2)).

Temporary vacancies

4.5.15

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01.12.01/001

In organising the business, the *approved person* performing a *significant influence function* should pay attention to any temporary vacancies which exist (see ■ APER 4.5.9 E (3)). He should take reasonable steps to ensure that suitable cover for responsibilities is arranged. This could include taking on temporary staff or external consultants. The *approved person* performing a *significant influence function* should assess the risk that is posed to compliance with the requirements and standards of the *regulatory system* as a result of the vacancy, and the higher the risk the greater the steps he should take to fill the vacancy. It may be appropriate to limit or suspend the activity if appropriate cover for responsibilities cannot be arranged. To the extent that those vacancies are in respect of one of the *customer functions*, they may only be filled by *persons* approved for that function.



4.6 Statement of Principle 6

4.6.1

 01.12.01/001

The *Statement of Principle 6* (see ■ APER 2.1.2 P) is in the following terms: "An *approved person* performing a *significant influence function* must exercise due skill, care and diligence in managing the business of the *firm* for which he is responsible in his *controlled function*."

4.6.2

 01.12.01/001

In the opinion of the FSA, conduct of the type described in ■ APER 4.6.3 E, ■ APER 4.6.5 E, ■ APER 4.6.6 E or ■ APER 4.6.8 E does not comply with *Statement of Principle 6* ■ APER 2.1.2 P).

4.6.3

 01.12.01/001

Failing to take reasonable steps adequately to inform himself about the affairs of the business for which he is responsible falls within ■ APER 4.6.2 E.

4.6.4

 01.12.01/001

Behaviour of the type referred to in ■ APER 4.6.3 E includes, but is not limited to:

- (1) permitting *transactions* without a sufficient understanding of the risks involved;
- (2) permitting expansion of the business without reasonably assessing the potential risks of that expansion;
- (3) inadequately monitoring highly profitable *transactions* or business practices or unusual *transactions* or business practices;
- (4) accepting implausible or unsatisfactory explanations from subordinates without testing the veracity of those explanations;
- (5) failing to obtain independent, expert opinion where appropriate; (see ■ APER 4.6.12 G).

4.6.5

 01.12.01/001

Delegating the authority for dealing with an issue or a part of the business to an individual or individuals (whether in-house or outside contractors) without reasonable grounds for believing that the delegate had the necessary capacity, competence, knowledge, seniority or skill to deal with the issue or to take authority for dealing with part of the business, falls within ■ APER 4.6.2 E (see ■ APER 4.6.13 G).

4.6.6

 01.12.01/001

Failing to take reasonable steps to maintain an appropriate level of understanding about an issue or part of the business that he has

4.6.7



01.12.01/001

delegated to an individual or individuals (whether in-house or outside contractors) falls within ■ APER 4.6.2 E (see ■ APER 4.6.14 G).

Behaviour of the type referred to in ■ APER 4.6.6 E includes but is not limited to:

- (1) disregarding an issue or part of the business once it has been delegated;
- (2) failing to require adequate reports once the resolution of an issue or management of part of the business has been delegated;
- (3) accepting implausible or unsatisfactory explanations from delegates without testing their veracity.

4.6.8



01.12.01/001

Failing to supervise and monitor adequately the individual or individuals (whether in-house or outside contractors) to whom responsibility for dealing with an issue or authority for dealing with a part of the business has been delegated falls within ■ APER 4.6.2 E.

4.6.9



01.12.01/001

Behaviour of the type referred to in ■ APER 4.6.8 E includes, but is not limited to:

- (1) failing to take personal action where progress is unreasonably slow, or where implausible or unsatisfactory explanations are provided;
- (2) failing to review the performance of an outside contractor in connection with the delegated issue or business.

4.6.10



01.12.01/001

In determining whether or not the conduct of an *approved person* performing a *significant influence function* under ■ APER 4.6.5 E, ■ APER 4.6.6 E and ■ APER 4.6.8 E complies with *Statement of Principle 6* (see ■ APER 2.1.2 P), the following are factors which, in the opinion of the FSA, are to be taken into account:

- (1) the competence, knowledge or seniority of the delegate; and
- (2) the past performance and record of the delegate.

4.6.11



01.12.01/001

An *approved person* performing a *significant influence function* will not always manage the business on a day-to-day basis himself. The extent to which he does so will depend on a number of factors, including the nature, scale and complexity of the business and his position within it. The larger and more complex the business, the greater the need for clear and effective delegation and reporting lines. The FSA will look to the *approved person* performing a *significant influence function* to take reasonable steps to ensure that systems are in place which result in issues being addressed at the appropriate level. When issues come to his attention, he should deal with them in an appropriate way.

4.6.12



01.12.01/001

Knowledge about the business

- (1) It is important for the *approved person* performing a *significant influence function* to understand the business for which he is responsible ■ APER 4.6.4 E). An *approved person* performing a *significant influence function* is unlikely to be an expert in all aspects of a complex financial services business. However, he should understand and inform himself about the business sufficiently to understand the risks of its trading, credit or other business activities.
- (2) It is important for an *approved person* performing a *significant influence function* to understand the risks of expanding the business into new areas and, before approving the expansion, he should investigate and satisfy himself, on reasonable grounds, about the risks, if any, to the business.
- (3) Where unusually profitable business is undertaken, or where the profits are particularly volatile or the business involves funding requirements on the *firm* beyond those reasonably anticipated, he should require explanations from those who report to him. Where those explanations are implausible or unsatisfactory, he should take steps to test the veracity of those explanations.
- (4) Where the *approved person* performing a *significant influence function* is not an expert in a business area, he should consider whether he or those with whom he works have the necessary expertise to provide him with an adequate explanation of issues within that business area. If not he should seek an independent opinion from elsewhere within or outside the *firm*.

Delegation

4.6.13



01.12.01/001

- (1) An *approved person* performing a *significant influence function* may delegate the investigation, resolution or management of an issue or authority for dealing with a part of the business to individuals who report to him or to others.
- (2) The *approved person* performing a *significant influence function* should have reasonable grounds for believing that the delegate has the competence, knowledge, skill and time to deal with the issue. For instance, if the compliance department only has sufficient resources to deal with day-to-day issues, it would be unreasonable to delegate to it the resolution of a complex or unusual issue without ensuring it had sufficient capacity to deal with the matter adequately.
- (3) If an issue raises questions of law or interpretation, the *approved person* performing a *significant influence function* may need to take legal advice. If appropriate legal expertise is not available in-house, he may need to consider appointing an appropriate external adviser.
- (4) The FSA recognises that the *approved person* performing a *significant influence function* will have to exercise his own judgment in deciding how issues are dealt with, and that in some cases that judgment will, with the benefit of hindsight, be shown to have been wrong. He will not be in breach of *Statement of Principle 6* unless he fails to exercise due and reasonable consideration before he delegates the resolution of an issue or authority for dealing with a part of the business and fails to reach a reasonable conclusion. If he is in doubt about how to deal with an issue or the seriousness of a particular compliance problem, then, although he cannot delegate to the FSA the responsibility for dealing with the problem or issue, he can speak to the FSA to discuss his approach (see ■ APER 4.6.5 E).

Continuing responsibilities where an issue has been delegated

4.6.14








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01.12.01/001

Although an *approved person* performing a *significant influence function* may delegate the resolution of an issue, or authority for dealing with a part of the business, he cannot delegate responsibility for it. It is his responsibility to ensure that he receives reports on progress and questions those reports where appropriate. For instance, if progress appears to be slow or if the issue is not being resolved satisfactorily, then the *approved person* performing a *significant influence function* may need to challenge the explanations he receives and take action himself to resolve the problem. This may include increasing the resource applied to it, reassigning the resolution internally or obtaining external advice or assistance. Where an issue raises significant concerns, an *approved person* performing a *significant influence function* should act clearly and decisively. If appropriate, this may be by suspending members of staff or relieving them of all or part of their responsibilities (see ■ APER 4.6.6 E).



4.7 Statement of Principle 7

- 4.7.1**  The *Statement of Principle 7* (see ■ APER 2.1.2 P) is in the following terms: "An *approved person* performing a *significant influence function* must take reasonable steps to ensure that the business of the *firm* for which he is responsible in his *controlled function* complies with the relevant requirements and standards of the *regulatory system*."
- 01.12.01/001
- 4.7.2**  In the opinion of the *FSA*, conduct of the type described in ■ APER 4.7.3 E, ■ APER 4.7.4 E, ■ APER 4.7.5 E, ■ APER 4.7.7 E, ■ APER 4.7.9 E or ■ APER 4.7.10 E does not comply with *Statement of Principle 7* ■ APER 2.1.2 P).
- 01.12.01/001
- 4.7.3**  Failing to take reasonable steps to implement (either personally or through a compliance department or other departments) adequate and appropriate systems of control to comply with the relevant requirements and standards of the *regulatory system* in respect of its *regulated activities* falls within ■ APER 4.7.2 E. In the case of an *approved person* who is responsible, under ■ SYSC 2.1.3 R (2), with overseeing the *firm's* obligation under SYSC 3.1.1R, failing to take reasonable care to oversee the establishment and maintenance of appropriate systems and controls falls within ■ APER 4.7.2 E.
- 01.12.01/001
- 4.7.4**  Failing to take reasonable steps to monitor (either personally or through a compliance department or other departments) compliance with the relevant requirements and standards of the *regulatory system* in respect of its *regulated activities* falls within ■ APER 4.7.2 E (see ■ APER 4.7.12 G).
- 01.12.01/001
- 4.7.5**  Failing to take reasonable steps adequately to inform himself about the reason why significant breaches (whether suspected or actual) of the relevant requirements and standards of the *regulatory system* in respect of its *regulated activities* may have arisen (taking account of the systems and procedures in place) falls within ■ APER 4.7.2 E.
- 01.12.01/001
- 4.7.6**  Behaviour of the type referred to in ■ APER 4.7.5 E includes, but is not limited to, failing to investigate what systems or procedures may have failed including, where appropriate, failing to obtain expert opinion on the adequacy of the systems and procedures.
- 01.12.01/001
- 4.7.7**  Failing to take reasonable steps to ensure that procedures and systems of control are reviewed and, if appropriate, improved, following the identification of significant breaches (whether suspected or actual) of the relevant requirements and standards of the *regulatory system*
- 01.12.01/001

4.7.8



01.12.01/001

relating to its *regulated activities*, falls within ■ APER 4.7.2 E (see ■ APER 4.7.13 G).

Behaviour of the type referred to in ■ APER 4.7.7 E includes, but is not limited to:

- (1) unreasonably failing to implement recommendations for improvements in systems and procedures;
- (2) unreasonably failing to implement recommendations for improvements to systems and procedures in a timely manner.

4.7.9



01.12.01/001

In the case of the *Money Laundering Reporting Officer*, failing to discharge the responsibilities imposed on him in accordance with chapter 8 of the *Money Laundering* sourcebook (*ML*) falls within ■ APER 4.7.2 E.

4.7.10



01.12.01/001

In the case of an *approved person* performing a *significant influence function* responsible for compliance under ■ APER 3.2.8 R, failing to take reasonable steps to ensure that appropriate compliance systems and procedures are in place falls within ■ APER 4.7.2 E (see ■ APER 4.7.14 G).

4.7.11



01.12.01/001

The *FSA* expects an *approved person* performing a *significant influence function* to take reasonable steps both to ensure his *firm's* compliance with the relevant requirements and standards of the *regulatory system* and to ensure that all staff are aware of the need for compliance.

Systems of control

4.7.12



01.12.01/001

An *approved person* performing a *significant influence function* need not himself put in place the systems of control in his business ■ APER 4.7.4 E). Whether he does this depends on his role and responsibilities. He should, however, take reasonable steps to ensure that the business for which he is responsible has operating procedures and systems which include well-defined steps for complying with the detail of relevant requirements and standards of the *regulatory system* and for ensuring that the business is run prudently. The nature and extent of the systems of control that are required will depend upon the relevant requirements and standards of the *regulatory system*, and the nature, scale and complexity of the business (see ■ APER 3.3.2 E).

Possible breaches of regulatory requirements

4.7.13



01.12.01/001

Where the *approved person* performing a *significant influence function* becomes aware of actual or suspected problems that involve possible breaches of relevant requirements and standards of the *regulatory system* falling within his area of responsibility, then he should take reasonable steps to ensure that they are dealt with in a timely and appropriate manner ■ APER 4.7.7 E). This may involve an adequate investigation to find out what systems or procedures may have failed and why. He may need to obtain expert opinion on the adequacy and efficacy of the systems and procedures.

Review and improvement of systems and procedures

4.7.14

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01.12.01/001

Where independent reviews of systems and procedures have been undertaken and result in recommendations for improvement, the *approved person* performing a *significant influence function* should ensure that, unless there are good reasons not to, any reasonable recommendations are implemented in a timely manner ■ APER 4.7.10 E). What is reasonable will depend on the nature of the inadequacy and the cost of the improvement. It will be reasonable for the *approved person* performing a *significant influence function* to carry out a cost benefit analysis when assessing whether the recommendations are reasonable.

Schedules

Statements of Principle and Code of Practice for Approved Persons

Schedule1 Record keeping requirements

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- 1 There are no record keeping requirements in APER.

Statements of Principle and Code of Practice for Approved Persons

Schedule2 Notification requirements

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- 1 The aim of the guidance in the following table is to give the reader a quick over-all view of the relevant requirements for notification and reporting.
- 2 It is not a complete statement of those requirements and should not be relied on as if it were.
- 3

Table	Notification requirements
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Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<i>Statement of Principle 4 (APER 2.1.2P)</i>	Any information of which the <i>FSA</i> would reasonably expect notice	Appropriate disclosure	Any information of which the <i>FSA</i> would reasonably expect notice	Appropriate

Statements of Principle and Code of Practice for Approved Persons

Schedule3 Fees and other required payments

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- 1 There are no requirements for fees or other payments in APER.

Statements of Principle and Code of Practice for Approved Persons

Schedule4 Powers exercised

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- 1 The following powers in the Act have been exercised by the FSA to issue the Statements of Principle and Code of Practice for Approved Persons:

Section 64(1) and (2) (Conduct: statements and codes).
- 2 The following power in the Act has been exercised by the FSA to give the guidance in APER:

Section 157(1) (Guidance).

Statements of Principle and Code of Practice for Approved Persons

Schedule5 Rights of action for damages

G

- 1 There are no rules in APER.

Statements of Principle and Code of Practice for Approved Persons

Schedule6 Rules that can be waived

G

- 1 There are no rules in APER.

**GENERAL PROVISIONS AND GLOSSARY (AMENDMENT NO 2)
INSTRUMENT 2001**

Powers exercised

- A. The Financial Services Authority makes the provisions in this instrument in the exercise of the powers and related provisions:
- (1) listed in Schedule 4 to the General provisions (Powers exercised); and
 - (2) in article 3 of the Financial Services and Markets Act 2000 (Variation of Threshold Conditions) Order 2001 (SI 2001/2507).
- B. The provisions of or under the Financial Services and Markets Act 2000 (the "Act") relevant to making rules and referred to above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force as follows:
- (1) Annex A comes into force on 1 January 2002;
 - (2) the remainder of this instrument comes into force immediately.

Amendment of the General provisions and Glossary

- D. The Glossary is amended in accordance with Annexes A, B, C, D, E, F and G to this instrument.
- E. The General provisions are amended in accordance with Annex H to this instrument.
- F. Both the General provisions (other than GEN 2.1.8R) and the Glossary are made, additionally, under the power listed at A(2).

Citation

- G. This instrument may be cited as the General Provisions and Glossary (Amendment No 2) Instrument 2001.

By order of the Board
15 November 2001

Annex A

Amendments to the Glossary to take into account funeral plan contracts

Amend the following definitions as shown below (underlining indicates new text, striking through indicates deleted text):

<i>advising on investments</i>	<p>the <i>regulated activity</i>, specified in article 53 of the <i>Regulated Activities Order</i> (Advising on investments), which is in summary: advising a <i>person</i> if the advice is:</p> <p>(a) given to the <i>person</i> in his capacity as an investor or potential investor, or in his capacity as agent for an investor or a potential investor; and</p> <p>(b) advice on the merits of his doing any of the following (whether as principal or agent):</p> <p>(i) <i>buying, selling</i>, subscribing for or underwriting a particular <i>investment</i> which is a <u><i>security or contractually based investment</i></u> (that is, <u><i>any designated investment, funeral plan contract or right to or interest in a funeral plan contract</i></u>) <i>designated investment</i>; or</p> <p>(ii) exercising any right conferred by such an <i>investment</i> to <i>buy, sell</i>, subscribe for or underwrite such an <i>investment</i>.</p>
<i>arranging (bringing about) deals in investments</i>	<p>the <i>regulated activity</i>, specified in article 25(1) of the <i>Regulated Activities Order</i>, which is in summary: making arrangements for another <i>person</i> (whether as <i>principal</i> or agent) to <i>buy, sell</i>, subscribe for or underwrite a particular <i>investment</i> which is:</p> <p>(a) a <i>designated investment</i>; or</p> <p><u>(b) a funeral plan contract; or</u></p> <p>(c) the <i>underwriting capacity of a Lloyd's syndicate</i>; or</p> <p>(d) <i>membership of a Lloyd's syndicate</i>; or</p> <p>(e) <i>rights to or interests in investments</i> in <u>(b), (c) or (d)</u> (b) or (e).</p>
<i>contract of insurance</i>	<p>....</p> <p>(2) (in relation to a contract) (in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation)) any contract of insurance which is a <i>long-term insurance contract</i> or a <i>general insurance contract</i>, including:</p> <p>(a)</p> <p>.....</p> <p>(f) contracts of a kind referred to in article 1(3) of the <i>First Life Directive</i> (Social insurance);</p>

but not including a funeral plan contract (or a contract which would be a funeral plan contract but for the exclusion in article 60 of the Regulated Activities Order (Plans covered by insurance or trust arrangements));

....

contractually based investment (in accordance with article 3(1) of the *Regulated Activities Order* (Interpretation)):

- (a) a *life policy*;
- (b) an *option, future, or contract for differences or funeral plan contract*;
- (c) *rights to or interests in an investment* falling within (a) or (b).

designated investment a *security* or a *contractually based investment* (other than a *funeral plan contract* and a *right to or interest in a funeral plan contract*), that is, any of the following *investments*, specified in Part III of the *Regulated Activities Order* (Specified Investments):

...

designated investment business any of the following activities, specified in Part II of the *Regulated Activities Order* (Specified Activities), which is carried on by way of business:

- (a) *dealing in investments as principal* (article 14), but disregarding the exclusion in article 15 (Absence of holding out etc);
- (b) *dealing in investments as agent* (article 21);
- (c) *arranging (bringing about) deals in investments* (article 25(1)), but only in relation to *designated investments*;
- (d) *making arrangements with a view to transactions in investments* (article 25(2)), but only in relation to *designated investments*;
- (e) *managing investments* (article 37), but only if the assets consist of or include (or may consist of or include) designated investments;
- (f) *safeguarding and administering investments* (article 40), but only if the assets consist of or include (or may consist of or include) designated investments; for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *safeguarding and administration of assets (without arranging)*;
 - (ii) *arranging safeguarding and administration of assets*;

...

	<p>(m) <i>advising on investments</i> (article 53), <u>but only in relation to <i>designated investments</i></u>; for the purposes of the <i>permission</i> regime, this is sub-divided into:</p> <p>(i) <i>advising on investments (except pension transfers and pension opt-outs)</i>;</p> <p>(ii) <i>advising on pension transfers and pension opt-outs</i>;</p> <p>(n) <i>agreeing to carry on a regulated activity</i> in (a) to (h) and (m) (article 64).</p>
<i>making arrangements with a view to transactions in investments</i>	<p>the <i>regulated activity</i>, specified in article 25(2) of the <i>Regulated Activities Order</i> (Arranging deals in investments), which is in summary: making arrangements with a view to a <i>person</i> who participates in the arrangements <i>buying, selling</i>, subscribing for or underwriting any of the following <i>investments</i> (whether as <i>principal</i> or agent):</p> <p>(a) a <i>designated investment</i>;</p> <p><u>(b) a <i>funeral plan contract</i></u>;</p> <p>(bc) the <i>underwriting capacity of a Lloyd's syndicate</i>;</p> <p>(ed) <i>membership of a Lloyd's syndicate</i>;</p> <p>(de) <i>rights to or interests in investments</i> in <u>(b), (c) or (d)</u>(b) or (e).</p>
<i>managing investments</i>	<p>the <i>regulated activity</i>, specified in article 37 of the <i>Regulated Activities Order</i> (Managing investments), which is in summary: managing assets belonging to another <i>person</i> in circumstances which involve the exercise of discretion, if:</p> <p>(a) the assets consist of or include any <u><i>security or contractually based investment (that is, any designated investment, funeral plan contract or right to or interest in a funeral plan contract)</i></u>; or</p> <p>....</p>
<i>regulated activity</i>	<p>...</p> <p>(s) <i>arranging deals in contracts of insurance written at Lloyd's</i> (article 58);</p> <p><u>(t) <i>entering as provider into a funeral plan contract</i></u> (article 59);</p> <p>(tu) <i>agreeing to carry on a regulated activity</i> (article 64);</p> <p>...</p>
<i>safeguarding and administering investments</i>	<p>the <i>regulated activity</i>, specified in article 40 of the <i>Regulated Activities Order</i> (Safeguarding and administering investments), which is in summary: the safeguarding of assets belonging to another and the administration of those assets, or arranging for one or more other <i>persons</i> to carry on that activity, where:</p>

(a) the assets consist of or include any security or contractually based investment (that is, any designated investment, funeral plan contract or right to or interest in a funeral plan contract); or

specified investment ...

(n) *membership of a Lloyd's syndicate* (article 86(2));

(o) *funeral plan contract* (article 87);

(~~op~~) *rights to or interests in investments* (article 89).

ANNEX B
Technical amendments to the Glossary

Delete the definition of "50% controller"

Amend the following definitions as shown below (underlining indicates new text, striking through indicates deleted text):

- business day* (1) (in relation to anything done or to be done in (including to be submitted to a place in) any part of the *United Kingdom*):
- (a) (except in *REC*) any *day* which is not a Saturday or Sunday, Christmas Day, Good Friday or a bank holiday in that part of the *United Kingdom*;
- (b) (in *REC*) (as defined in section 167 of the Companies Act 1989) any *day* which is not a Saturday or Sunday, Christmas Day, Good Friday or a bank holiday in any part of the *United Kingdom*.
- (2) (in relation to anything done or to be done by reference to a market outside the *United Kingdom*) any *day* on which that market is normally open for business.
- controller*
- ~~(see also 50%controller.)~~
- EEA firm* ...
- (d) an ~~undertaking~~ undertaking pursuing the activity of direct insurance (within the meaning of article 1 of the *First Life Directive* or of the *First Non-Life Directive*) which has received authorisation under article 6 from its *Home State regulator*.
- group* (1) (except in relation to an ICVC) (as defined in section 421 of the *Act* (Group)) (in relation to a *person* ("A")) A and any *person* who is:
-
- (2) (in relation to an ICVC) a group as in (1) but (in ML and SYSC) including also the ICVC's authorised corporate director (if any).
- operator* (1) (except in *ENF*):
- (a) (in relation to an *AUT*) the *manager*;
- (b) (in relation to an *ICVC*) that *company* or, if applicable, the *authorised corporate director*;
- (c) (in relation to any other *collective investment scheme* that is a *unit trust scheme* with a separate *trustee*) any *person* who, under the *trust deed* establishing the *scheme*, is responsible for the management of the property held for

or within the *scheme*;

(d) (in relation to any other *collective investment scheme* that is an *open-ended investment company*) that *company* or, if applicable, any *person* who, under the constitution or founding arrangements of the *scheme*, is responsible for the management of the property held for or within the *scheme*;

(e) (in relation to any other *collective investment scheme*) any *person* who, under the constitution or founding arrangements of the *scheme*, is responsible for the management of the property held for or within the *scheme*;

~~(f)~~ (in relation to an *investment trust savings scheme*) any *person* appointed, by those responsible for managing the property of the *investment trust*, to manage the *investment trust savings scheme*.

(2) (in *ENF*) (in accordance with section 237(2) of the *Act* (Other definitions)):

(a) (in relation to a *unit trust scheme* with a separate *trustee*) the manager; and

(b) (in relation to an *open-ended investment company*) that company.

permission

...

(b) the permission that an *incoming EEA firm* has, under paragraph 15(1) 4(4) of Schedule 3 to the *Act* (EEA Passport Rights), on qualifying for *authorisation* under paragraph 12 of that Schedule;

(c) the permission that an *incoming Treaty firm* has, under paragraph 4(1) 15(4) of Schedule 4 to the *Act* (Treaty Rights), on qualifying for *authorisation* under paragraph 2 of that Schedule;

.....

personal investment firm

a *firm* whose *permitted activities* include *designated investment business*, which is not an *authorised professional firm*, *bank*, *building society*, *credit union*, *energy market participant*, *friendly society*, *ICVC*, *insurer*, *media firm*, *oil market participant*, *service company*, *incoming EEA firm* (without a *top-up permission*), *incoming Treaty firm* (without a *top-up permission*) or *UCITS qualifier* (without a *top-up permission*), whose *permission* does not include a *requirement* that it comply with *IPRU(INV)* 3 (Securities and futures firms), 5 (Investment management firms) or 10 (Securities and futures firms), and which is within (a), (b) or (c):

<i>regulated activity</i>	... <p>(p) <i>advising on investments</i> (article 5357); for the purposes of the <i>permission</i> regime, this is sub-divided into:</p> <p>(i) <i>advising on investments (except pension transfers and pension opt-outs)</i>;</p> <p>(ii) <i>advising on pension transfers and pension opt-outs</i>;</p> <p>(q) <i>advising on syndicate participation at Lloyd's</i> (article 56);</p> <p>(r) <i>managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's</i> (article 5753);</p> <p>...</p>
<i>soft commission agreement</i>	an agreement in any form, the terms of which permit under which a firm to receives <u>certain</u> goods or services from another person in return for transacting <u>designated investment business with or put through that or in the way of another person.</u>
<i>takeover or related operation</i>	(a) any transaction falling within paragraph 4(b) (Companies and Transactions to which the Code applies) of the introduction to the <i>Takeover Code</i> <u>and, for this purpose, an offer for non-voting, non-equity share capital is to be regarded as falling within the <i>Takeover Code</i> even if not required by rule 15 of that Code;</u>
	(b) any transaction subject to the <i>SARs</i> ;
	(c) any transaction which would have fallen within (a) were it not for the fact that the company which is the subject of the transaction does not satisfy the tests set out in paragraph 4(a) (Companies and Transactions to which the Code applies) of the introduction to the <i>Takeover Code</i> and, for this purpose, an offer for non-voting, non-equity share capital is to be regarded as falling within the <i>Takeover Code</i> even if not required by rule 15 of that Code;

Annex C

Amendment to the Glossary to refer to a new Special guide

Insert the following new definition in the appropriate alphabetical position:

FREN the Special guide for small Friendly societies, forming part of the *Handbook*.

Annex D

Amendments to the Glossary resulting from the making of COMP

Amendments resulting from the making of COMP transitional rules

Insert the following new definitions in the appropriate alphabetical position:

- article 9 default* (as defined in article 2(2) of the *compensation transitionals order*) any of the following:
- (a) the passing of a resolution for the voluntary winding up of an authorised insurance company within the meaning of section 3 of the Policyholders Protection Act 1975 in circumstances falling within section 5(1)(a) of that Act;
 - (b) the making by the court of an order for the winding up of such a company in accordance with section 5(1)(b) of that Act;
 - (c) the appointment of a provisional liquidator in the circumstances falling within section 15 of that Act in respect of such a company;
 - (d) such a company becoming a company in financial difficulties within the meaning of section 16 of that Act;
 - (e) a *participating deposit-taker* becoming insolvent for the purposes of Part II of the Banking Act 1987;
 - (f) a *participating institution* becoming insolvent within the meaning of section 25A of the Building Societies Act 1986;
 - (f) the beginning of a dissolution or transfer of engagements of a *member society* in accordance with rule 9(2) of the Rules of the Friendly Societies Protection Scheme.
- compensation transitionals order* the Financial Services and Markets Act 2000 (Transitional Provisions, Repeals and Savings) (Financial Services Compensation Scheme) Order 2001 (SI 2001/2967).

<i>investment business compensation scheme</i>	<p>(as defined in article 2(2) of the <i>compensation transitionals order</i>) any of the following:</p> <ul style="list-style-type: none"> (a) the scheme established under section 54 of the Financial Services Act 1986 and known as the Investors Compensation Scheme; (b) the scheme established under section 22j of the Grey Paper published by the <i>FSA</i> on 26 September 1998 and known as the Section 43 Compensation Scheme; (c) the scheme established by chapter II of part L:VIII of the <i>PIA</i> rule book and known as the PIA Indemnity Scheme; (d) the scheme resulting from an agreement dated 1 February 1999 between the Association of British Insurers and the Investors Compensation Scheme Limited for the making of payments by way of compensation to widows, widowers and dependants of persons (since deceased), in connection with advice given to such persons in relation to pensions, or the arranging of pensions for such persons, and known as the ABI/ICS scheme.
<i>member society</i>	<p>(as defined in article 2(2) of the <i>compensation transitionals order</i>) a person who at any time before <i>commencement</i> was a member society within the rules of the Friendly Societies Protection Scheme established in accordance with section 141 of the Financial Services Act 1986.</p>
<i>participating deposit-taker</i>	<p>(as defined in article 2(2) of the <i>compensation transitionals order</i>) a <i>person</i> who was at any time before <i>commencement</i>:</p> <ul style="list-style-type: none"> (a) a UK institution, participating institution, former UK institution or former participating institution as defined in section 52(6) of the Banking Act 1987; or (b) a former authorised institution (as defined in section 106(1) of the Banking Act 1987 (other than a former UK institution or former participating institution as defined in section 52(6) of that Act), which was not a recognised bank or licensed institution excluded by an order under section 23(2) of the Banking Act 1979.
<i>participating institution</i>	<p>(as defined in article 2(2) of the <i>compensation transitionals order</i>) a <i>person</i> who was at any time before <i>commencement</i> a participating institution within the meaning of section 24(4) of the Building Societies Act 1986.</p>

<i>pending application</i>	(as defined in article 3(1) of the <i>compensation transitionals order</i>): <ul style="list-style-type: none"> (a) an application for compensation made under an <i>investment business compensation scheme</i> before <i>commencement</i> in relation to which a <i>terminating event</i> did not occur before <i>commencement</i>; and (b) an application made to the <i>FSCS</i> after <i>commencement</i> under an <i>investment business compensation scheme</i>, even if at the time of application that scheme had otherwise ceased to exist.
<i>relevant former scheme</i>	(as defined in article 2(2) of the <i>compensation transitionals order</i>): <ul style="list-style-type: none"> (a) in relation to a <i>pending application</i>, the <i>investment business compensation scheme</i> under which the application was made; (b) in relation to an <i>article 9 default</i>, one of the following that applied to the default before <i>commencement</i>: <ul style="list-style-type: none"> (i) the Policyholders Protection Scheme established by the Policyholders Protection Act 1975; (ii) the Deposit Protection Scheme established by Part II of the Banking Act 1987; (ii) the Building Societies Investor Protection Scheme established by Part IV of the Building Societies Act 1986; (iv) the Friendly Societies Protection Scheme established in accordance with section 141 of the Financial Services Act 1986.
<i>terminating event</i>	(as defined in article 2(1) of the <i>compensation transitionals order</i>) in relation to applications made under an <i>investment business compensation scheme</i> , the withdrawal, discontinuance or rejection of the application, or its determination by a final payment of compensation to the applicant.

Amendments resulting from the making of COMP 13 (Funding)

Insert the following new definitions in the appropriate alphabetical position:

<i>base costs</i>	<i>management expenses</i> , other than <i>establishment costs</i> , which are not dependent on the level of <i>claims</i> made on the <i>FSCS</i> .
<i>base costs levy</i>	a levy, forming part of the <i>management expenses levy</i> , to meet the <i>base costs</i> in the financial year of the <i>compensation scheme</i> to which the levy relates, each <i>participant firm's</i> share being calculated in accordance with <i>COMP 13.5.5R</i> .

<i>compensation costs</i>	the costs incurred in paying compensation or as a result of making the arrangements set out in <i>COMP</i> 3.3.2R or taking the measures set out in <i>COMP</i> 3.3.3R.
<i>compensation costs levy</i>	a levy imposed by the <i>FSCS</i> on <i>participant firms</i> to meet <i>compensation costs</i> , each <i>participant firm's</i> share being calculated in accordance with <i>COMP</i> 13.6.
<i>employers' liability insurance</i>	a <i>contract of insurance</i> against risks of the <i>persons</i> insured incurring liabilities to their employees.
<i>establishment costs levy</i>	a levy, forming part of the <i>management expenses levy</i> , to meet the <i>establishment costs</i> , each <i>participant firm's</i> share being calculated in accordance with <i>COMP</i> 13.5.10G.
<i>management expenses</i>	(in accordance with section 223 of the <i>Act</i> (Management expenses)) expenses incurred or expected to be incurred by the <i>FSCS</i> in connection with its function under <i>COMP</i> , other than <i>compensation costs</i> ; for the purposes of <i>COMP</i> these are subdivided into <i>base costs</i> , <i>specific costs</i> and <i>establishment costs</i> .
<i>management expenses levy</i>	a levy imposed by the <i>FSCS</i> on <i>participant firms</i> to meet the <i>management expenses</i> and which is made up of one or more of a <i>base cost levy</i> , a <i>specific costs levy</i> and an <i>establishment costs levy</i> , each <i>participant firm's</i> share being calculated in accordance with <i>COMP</i> 13.5.
<i>relevant net premium income</i>	the premium income in respect of <i>protected contracts of insurance</i> of the <i>firm</i> in the year preceding that in which the date for submission of the information under <i>COMP</i> 13.6.9R falls, net of any relevant rebates or refunds.
<i>specific costs</i>	<i>management expenses</i> other than <i>base costs</i> and <i>establishment costs</i> .
<i>specific costs levy</i>	a levy, forming part of the <i>management expenses levy</i> , to meet the <i>specific costs</i> in the financial year of the <i>compensation scheme</i> to which the levy relates, each <i>participant firm's</i> share being calculated in accordance with <i>COMP</i> 13.5.7R.
<i>sub-scheme</i>	one of the three sub-schemes to which the <i>FSCS</i> allocates liabilities for <i>compensation costs</i> , as described in <i>COMP</i> 13.6.7R.

Amend the following definitions as shown below (underlining indicates new text, striking through indicates deleted text):

- contribution group one of the groups of participant firms within a sub-scheme set out listed in COMP 13.6.7R, which are being groups of participant firms which share the costs of funding compensation from claims arising from firms in default which carry on similar business that carry on business of a similar nature, to which compensation costs and specific costs are allocated in accordance with COMP 13.5 and COMP 13.6.
- establishment costs (1) (in COMP) the costs of establishing the compensation scheme.
(2) (in DISP) the costs of establishing the Financial Ombudsman Service.

Amendments resulting from the making of COMP 14 (Participation by EEA firms)

Insert the following new definition in the appropriate alphabetical position:

- Electing Participants Regulations* the Financial Services and Markets Act 2000 (Compensation Scheme: Electing Participants) Regulations 2001 (SI 2001/1783).

Amend the following definitions as shown below (underlining indicates new text, striking through indicates deleted text):

- participant firm* a firm other than:
- (a) (in accordance with section 213(10) of the Act (The compensation scheme) and regulation 2 of the *Electing Participants Regulations* (Persons not to be regarded as relevant persons)) an incoming EEA firm which is:
 - (i) a credit institution; or
 - (ii) an ISD investment firm; or
 - (iii) both (i) and (ii);in relation to its passported activities, unless it has top-up cover;
 - ~~(a) an incoming EEA firm which is a BCD credit institution or ISD investment firm and whose permission is confined to cross border services;~~
 - ~~(b) an incoming EEA firm without top up cover which is:~~
 - ~~(i) a BCD credit institution whose permission to carry on regulated activities from a UK branch is confined to accepting deposits; or~~
 - ~~(ii) an ISD investment firm (including a credit institution~~

~~which is an ISD investment firm) whose permission to carry on regulated activities from a UK branch is confined to passported activities;~~

~~(be)~~ a service company ;

~~(cd)~~ the Society, in respect of activities included in its permission under section 315(2) of the Act (The Society: authorisation and permission);

~~(de)~~ a member, in respect of effecting or carrying out Lloyd's policies;

~~(ef)~~ an underwriting agent, or members' adviser, in respect of advising on syndicate participation at Lloyd's or managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's;

~~(fg)~~ an authorised professional firm that is subject to the rules of the Law Society (England and Wales) or the Law Society of Scotland;

~~(gh)~~ an ICVC;

~~(hi)~~ a UCITS qualifier.

top-up cover

cover provided by the compensation scheme for claims against an incoming EEA firm (which is a credit institution or an ISD investment firm):-

~~(a) in relation to protected deposits ;or~~

~~(b) in relation to protected investment business ;or~~

~~(c) in relation to both protected deposits and protected investment~~

~~business ;~~ in relation to the firm's passported activities and in addition to the cover provided by the firm's Home State compensation scheme (see COMP 14 (Participation by EEA firms)).

Annex E

Amendments to the Glossary resulting from amendments to COND and AUTH

Insert the following new definition in the appropriate alphabetical position:

Gibraltar Order the Financial Services and Markets Act 2000 (Gibraltar) Order 2001 (SI 2001/3084).

Amend the following definitions as shown below (underlining indicates new text, striking through indicates deleted text):

Swiss general insurance company (in accordance with article 1(2) of the Financial Services and Markets Act 2000 (Variation of Threshold Conditions) Order 2001 (SI 2001/2507)) a person:

- (a) whose head office is in Switzerland;
- (b) who is authorised by the supervisory authority in Switzerland as mentioned in article 7.1 of the *Swiss Treaty Agreement*; and
- (c) who is seeking to carry on, or is carrying on, from a branch in the *United Kingdom*, a regulated activity consisting of the *effecting or carrying out of contracts of insurance* of a kind which is subject to that agreement.

~~a company:~~

- ~~(a) whose head office is in Switzerland;~~
- ~~(b) which has permission in Switzerland (not restricted to reinsurance business) to carry on general insurance business; and~~
- ~~(c) which proposes to establish a branch or agency in the *United Kingdom* to carry out *insurance business* which is confined to the classes referred to in article 2 of the *Swiss Treaty Agreement* and not subject to any of the exceptions referred to in article 3 of the *Swiss Treaty Agreement*.~~

threshold condition (in relation to a *regulated activity*) any of the conditions set out in or under Schedule 6 to the *Act* (Threshold conditions)₂ including the additional conditions in the Financial Services and Markets Act 2000 (Variation of Threshold Conditions) Order 2001 (SI 2001/2507) (see *COND*).

Annex F

Amendments to the Glossary resulting from making SUP 18

Insert the following new definitions in the appropriate alphabetical position:

<i>independent expert</i>	(in SUP 18) the person approved or nominated by the FSA to make the <i>scheme report</i> for an <i>insurance business transfer scheme</i> .
<i>insurance business transfer</i>	a transfer in accordance with an <i>insurance business transfer scheme</i> .
<i>insurance business transfer scheme</i>	(a) a scheme, defined in section 105 of the <i>Act</i> , which is in summary: a scheme to transfer the whole or part of the business of an <i>insurer</i> (other than a <i>friendly society</i>) to another body; (b) a similar scheme to transfer the whole or part of the business carried on by one or more <i>members</i> of the <i>Society</i> or former underwriting <i>members</i> that meets the conditions of article 4 of the Financial Services and Markets Act 2000 (Control of Transfers of Business Done at Lloyd's) Order 2001 (SI 2001/[number to be inserted later]).
<i>scheme report</i>	(in SUP 18) the report on the terms of an <i>insurance business transfer scheme</i> required by section 109 of the <i>Act</i> (Scheme reports).
<i>state of the commitment</i>	(in SUP 18) (in accordance with paragraph 6(1) of Schedule 12 to the <i>Act</i> (Transfer schemes: certificates)) (in relation to a commitment entered into at any date): (a) if the <i>policyholder</i> is an individual, the State in which he had his habitual residence at that date; (b) if the <i>policyholder</i> is not an individual, the State in which the establishment of the <i>policyholder</i> to which the commitment relates was established at that date; in this definition, "commitment" means (in accordance with article 2 of the Financial Services and Markets Act 2000 (Control of Business Transfers) (Requirements on Applicants) Regulations 2001 (SI 2001/[number to be inserted later]) any contract of insurance of a kind referred to in article 1 of the <i>First Life Directive</i> .
<i>state of the risk</i>	(in SUP 18) (in accordance with paragraph 6(3) of Schedule 12 to the <i>Act</i> (Transfer schemes: certificates)) (in relation to the <i>EEA State</i> in which a risk is situated): (a) if the insurance relates to a building or to a building and its contents (so far as the contents are covered by the same

- policy), the *EEA State* in which the building is situated;
- (b) if the insurance relates to a vehicle of any type, the *EEA State* of registration;
- (c) in the case of *policies* of a duration of four months or less covering travel or holiday risks (whatever the class concerned), the *EEA State* in which the *policyholder* took out the *policy*;
- (d) in a case not covered by (a) to (c):
- (i) if the *policyholder* is an individual, the *EEA State* in which he has his habitual residence at the date when the contract is entered into; and
- (ii) otherwise, the *EEA State* in which the establishment of the *policyholder* to which the *policy* relates is situated at that date.

UK-deposit insurer a UK-deposit insurer, as defined in *IPRU(INS)*, which is in summary: a non-EEA insurer which has made a deposit in the United Kingdom in accordance with *IPRU(INS)* 8.1.

UK insurer a UK insurer, as defined in *IPRU(INS)*, which is in summary: an insurer, other than a pure reinsurer or a non-directive insurer, whose head office is in the United Kingdom.

Annex G

Amendment to the Glossary resulting from CP 88 (Wholesale only deposit-takers)

Insert the following new definition in the appropriate alphabetical position:

- wholesale depositor* a person who is:
- (a) a *credit institution*; or
 - (b) a *large company*; or
 - (c) a *large mutual association* which is:
 - (i) a *firm*; or
 - (ii) an *overseas financial services institution*; or
 - (iii) a *collective investment scheme* or an operator or trustee of a *collective investment scheme*; or
 - (iv) a pension or retirement fund, or a trustee of such a fund (except a trustee of a small self-administered scheme or an occupational scheme of an employer which is not a *large company* or a *large partnership*); or
 - (d) a supranational institution, government or central administrative authority; or
 - (e) a provincial, regional, local or municipal authority; or
 - (f) a *body corporate* in the same *group* as the *person* with whom the *deposit* is made.

Annex H
Amendments to the General provisions

In paragraph 1 of Schedule 4 to GEN, add the following additional power at the end of the list of rule-making powers:

"Article 3 of the Financial Services and Markets Act 2000 (Variation of Threshold
Conditions) Order 2001 (SI 2001/2507)"

**INTERIM PRUDENTIAL SOURCEBOOK FOR
INVESTMENT BUSINESSES (AMENDMENT) INSTRUMENT 2001**

Powers exercised

1. The Financial Services Authority amends the interim Prudential sourcebook for investment businesses and the Supervision manual in the exercise of the powers and related provisions in or under the Financial Services and Markets Act 2000 (the “Act”) listed in the schedule to this instrument.
2. The provisions of or under the Act relevant to the making of rules and listed in the schedule are specified for the purpose of section 153(2) of the Act.

Commencement

3. This instrument comes into force at the beginning of the day on which section 19 of the Act (the general prohibition) comes into force.

Amendments

4. Chapter 3 of the Interim prudential sourcebook for investment businesses is amended as specified in Annex C.
5. Chapter 5 of the Interim prudential sourcebook for investment businesses is amended as specified in Annex D.
6. Chapter 10 of the Interim prudential sourcebook for investment businesses is amended as specified in Annex E.
7. Chapter 13 of the Interim prudential sourcebook for investment businesses is amended as specified in Annex F.
8. Annex 10R to Chapter 16 of the Supervision manual is amended as specified in Annex H.

Citation

9. This instrument may be cited as the Interim Prudential Sourcebook for Investment Businesses (Amendment) Instrument 2001.

By order of the Board, 15 November 2001

Schedule - Powers exercised

1. The powers in articles 4(1) of the Financial Services and Markets Act 2000 (Transitional Provisions and Savings) (Rules) Order 2001 have been exercised by the Financial Services Authority ("FSA") to designate the rules identified in the tables in Annex A as they are in force at the date of this instrument (the "continued provisions").
2. The powers in section 138 of the Act have been exercised by the FSA to make the provisions set out in paragraph E of Annex C and paragraphs F and G of Annex D.
3. The powers in article 11(1) of the The Financial Services and Markets Act 2000 (Transitional Provisions and Savings) (Rules) Order 2001 and section 157(1) of the Act have been exercised by the FSA to give the guidance on the continued provisions.
4. The continued provisions and the guidance on them are applicable to:
 - (a) securities and futures firms (as defined by the Glossary annexed to the General Provisions and Glossary Instrument 2001) to the extent that they were provisions made by the Securities and Futures Authority Limited and appearing as part of its rulebook;
 - (b) investment management firms (as defined by the Glossary annexed to the General Provisions and Glossary Instrument 2001) to the extent that they were provisions made by the Investment Management Regulatory Organisation Limited and appearing as part of its rulebook;
 - (c) personal investment firms (as defined by the Glossary annexed to the General Provisions and Glossary Instrument 2001) to the extent that they were provisions made by the Personal Investment Authority Limited and appearing as part of its rulebook;

and are modified:

- (1) so as to be interpreted in accordance with and to apply subject to the General provisions contained in the General Provisions and Glossary Instrument 2001;
- (2) in the manner identified in the tables in Annex A.

The continued provisions are to be treated as having effect under section 138 of the Act (General rule making power). The statements of compatibility and purpose required under article 4(1) of the Financial Services and Markets Act 2000 (Transitional Provisions and Savings) (Rules) Order 2001 are set out in Annex B.

5. All of the rules in IPRU(INV) as amended can be waived using the powers exercisable under section 148 of the Act.

ANNEX A

[The Continued Provisions]

Provisions made by the Securities and Futures Authority Limited And appearing as part of its rulebook		
Designated Provision	Modifications	
	Changes in text	Where the designated provision (as modified) appears in IPRU(INV)
3-79	<p>In each of (1) and (2) delete "SFA may at its desretion require a <i>firm</i> to" and replace with "A <i>firm</i> must", and delete "an amount" and replace with "any amount specified in any <i>requirement</i>".</p> <p>In the guidance delete the first sentence; delete "SFA" and replace with "the FSA" throughout; delete "whether a <i>firm</i> must include a secondary requirement" and replace with "whether to impose a requirement on a <i>firm</i>"; in the final sentence delete "have typically been applied" and replace with "may be applied, for example,".</p>	3-79
3-170(11)	No changes	3-170(11)
3-190	<p>In (1) delete "SFA otherwise permits" and replace with "otherwise permitted";</p> <p>In (2) delete "SFA informs the <i>firm</i> that it" and replace with "the <i>FSA</i>";</p> <p>After (2) add guidance paragraph - "The <i>FSA</i> will notify the <i>firm</i> if it is not the consolidating supervisor for the group.";</p> <p>In (3) delete "in a manner agreed with SFA" and replace with "and notify the <i>FSA</i> of the manner in which the shortfall will be made good";</p> <p>In (4) delete ", and as further specified by SFA, SFA will also specify the form of reporting for the test" and replace with "and the <i>firm</i> must make appropriate reports to the <i>FSA</i>";</p> <p>After (4) add guidance paragraph - "The <i>firm</i> may use the consolidated reporting statement forms required under <i>SUP</i> 16.7.25R.".</p>	3-190

3-191	<p>In (2) (which becomes guidance) delete the words before (a) and replace with "The <i>FSA</i> may exercise its powers (whether through imposing a <i>requirement</i> or by using its general information gathering powers) to obtain information about the structure of a <i>firm's</i> group for the purposes of consolidated supervision including the position of any of the following:";</p> <p>In the guidance following (2) delete the first sentence and replace "SFA" with "the <i>FSA</i>" throughout;</p> <p>In (3) delete "with SFA's prior written approval" and replace with "having first notified the <i>FSA</i> in writing";</p> <p>Delete (4) and the guidance to it.</p>	3-191
3-192	No changes	3-192
3-193	<p>In (2) delete "the higher of: (a)"; delete "; and" and replace with "if any."; delete paragraph (b);</p> <p>In (3) delete "the higher of"; delete "and any requirement imposed in accordance with rule 3-193(4)" and replace with "if any";</p> <p>In (4) delete "a requirement calculated" and replace with "any alternative requirement calculated"; delete "if SFA so requires" and replace with "which is imposed on it by a <i>requirement</i>";</p> <p>In the guidance after (4) delete the first word and replace with "Any";</p> <p>In (5) (which becomes guidance) delete "be required" and replace with "seek a modification or waiver permitting it"; delete ", if SFA so requires".</p>	3-193
3-194	<p>Delete "SFA may permit the <i>firm</i> to" and replace with "A <i>firm</i> may";</p> <p>Delete the guidance after (c) and insert the provisions from "provided that" to the end of paragraph (g) as set out in the modified form of the rule at paragraph B of annex C to this instrument.</p>	3-194

3-195	In the heading delete "Waiver" and replace with "Exemption"; Delete the words before (a) and replace with "A <i>firm</i> need not apply rules 3-190 to 3-194 to its group if:" Before (d) delete "and"; At the end of (d) delete "." and insert "; (e) the <i>firm</i> first notifies the <i>FSA</i> in writing that it intends to rely upon this rule."	3-195
10-68(2)	No changes	10-68(2)
Guidance to 10-74(2)	No changes	Guidance after 10-74(2)(b)
10-80(6)	Delete "the <i>firm</i> must immediately seek guidance from SFA on the <i>PRR</i> treatment to apply and until an appropriate treatment is determined must calculate a <i>PRR</i> of 100% of the current <i>mark to market</i> value of the position" and replace with "it must calculate a <i>PRR</i> of an appropriate percentage of the current <i>mark to market</i> value of the position and the <i>firm</i> must immediately notify the <i>FSA</i> of the details of the instrument, the <i>PRR</i> calculated and the reasons for the calculation".	10-80(6)
10-120	No changes	10-120
10-170(10)	No changes	10-170(10)
Definition of "EEA parent"	No changes	In appendix 1 to each of IPRU(INV) 3 and 10
Board Notices 292 and 353	As shown in annex G	Appendix 62 to each of IPRU(INV) 3 and 10
Board Notices 414, 482 and 520	As shown in annex G	Appendix 63 to IPRU(INV) 10

**Provisions made by the Securities and Futures Authority Limited
and appearing as part of its rulebook**

Designated Provision	Modifications	
	Changes in text	Where the designated provision (as modified) appears in SUP
3-41 (1) to (6) and (8)	<p>In the main heading add “and audited annual financial statements” at the end.</p> <p>In (1) delete “<i>of SFA</i>” and replace with “, and subject to (2) below”; delete “<i>financial reporting statements</i>” and replace with “financial reporting statements and audited annual financial statements”; insert “accounting principles and rules” after “Companies Act 1985 including those”; delete “, subject to (2) below” at the end.</p> <p>In (2) delete “items” and replace with “each item”; delete “<i>financial reporting statements</i>” and replace with “financial reporting statements and audited annual financial statements”; insert “and balances” at the end.</p> <p>In (3) delete “<i>trade date accounting</i>” and replace with “trade date accounting”.</p> <p>In (4) delete “, and SFA may require it to,”.</p> <p>In (5) delete “<i>sole trader</i>” and replace with “sole trader”; add “For this purpose, the definition of a sole trader in the glossary in IPRU(INV) 10 applies.” at the end.</p> <p>In (6) add “or physical commodities” after “<i>securities</i>” throughout; add “For this purpose, the definition of a physical commodity in the glossary in IPRU(INV) 10 applies.” at the end.</p> <p>Re-number (8) as (7).</p>	SUP 16 Annex 10R, as new 4 at end of section 6
10-41 (1) to (6) and (8)	<p>In the main heading add “and audited annual financial statements” at the end.</p> <p>In (1) delete “<i>of SFA</i>”; delete “<i>financial reporting statements</i>” and replace with “financial reporting statements and audited annual financial statements”; delete “as” after “which the <i>firm</i> would apply”.</p> <p>In (2) delete “<i>financial reporting statements</i>”</p>	SUP 16 Annex 10R, as new 4 at end of section 6

	<p>and replace with “financial reporting statements and audited annual financial statements”.</p> <p>In (4) delete “, and SFA may require it to,”.</p> <p>In (5) delete “<i>sole trader</i>” and replace with “sole trader”; add “For this purpose, the definition of a sole trader in the glossary in IPRU(INV) 10 applies.” at the end.</p> <p>In (6) delete “<i>physical commodities</i>” and replace with “physical commodities” throughout; add “For this purpose, the definition of a physical commodity in the glossary in IPRU(INV) 10 applies.” at the end.</p> <p>Re-number (8) as (7).</p>	
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Provisions made by the Investment Management Regulatory Organisation Limited		
And appearing as part of its rulebook		
Designated Provision	Modifications	
	Changes in text	Where the designated provision (as modified) appears in IPRU(INV)
Definition of "Group of Connected Counterparties"	<p>In (a) delete ", unless it is shown otherwise to the satisfaction of IMRO,";</p> <p>Change to lower case and italics for defined terms.</p>	In appendix 1 to IPRU(INV) 5
Definition of "Large Exposure"	<p>Change to lower case and italics for defined terms.</p>	In appendix 1 to IPRU(INV) 5

Provisions made by the Personal Investment Authority Limited		
And appearing as part of its rulebook		
Designated Provision	Modifications	
	Changes in text	Where the designated provision (as modified) appears in IPRU(INV)
Table 13.6.2(2), second paragraph under "Special Limits"	Delete "per cent." and replace with "%"; delete "your" and replace with "the <i>firm's</i> ".	Table 13.6.2(2), second paragraph under "Special Limits"
Rule 13.12.5(2)	Delete "You" and replace with "A <i>Category B firm</i> "; delete "your" and replace with "its"; delete "(1)(a) above" and replace with "13.12.5(1)"; delete "(1)(b) above" and replace with "13.12.5(2)"	13.12.5A

ANNEX B

[Statement of Purpose and Compatibility for the Continued Provisions]

The purpose of the continued provisions is to supplement the requirements of the provisions contained in IPRU(INV) that a firm must maintain adequate financial resources, taking into account the nature and scale of its business, and also to supplement in SUP 16 Annex 10R the reporting requirements applying to securities and futures firms. The continued provisions provide for continuation of provisions which were only incorporated into SFA's rulebook in the most recent release, and to correct some technical errors in relation to the SFA, IMRO and PIA rules carried forward into the IPRU(INV) and SUP 16 Annex 10R.

Statement of compatibility with the FSA's regulatory objectives

The FSA considers that including the continued provisions together with the other provisions in IPRU(INV) and SUP will contribute to meeting two of the FSA's regulatory objectives – maintaining market confidence and consumer protection. In particular they will contribute to the reduction of the risk of investment business firms being unable to meet their liabilities and their commitments to investors and counterparties as they fall due. Although the continued provisions are not intended to contribute to the regulatory objectives of increasing public awareness and reducing financial crime, the FSA believes them to be compatible with those objectives.

Market confidence

IPRU(INV) (including the continued provisions) sets out standards relating to minimum financial resources, risk management and notifications. The continued provisions set out requirements about consolidated supervision for some firms, the treatment of units in collective investment schemes and note issuance facilities and use of secondary requirements. SUP 16 Annex 10R (including the continued provisions) sets out requirements for reporting financial positions and financial resources and the continued provisions specify the accounting policies to be followed in preparing those reports. Requiring firms to meet the standards in IPRU(INV) and SUP 16 Annex 10R, including these, will reduce the risk that firms are unable to meet their commitments as they fall due.

Consumer Protection

As with the market confidence objective, requiring firms to meet prudential standards and to keep appropriate accounting records will reduce the risk that firms are unable to meet their commitments, including their commitments to consumers, as they fall due. Inadequate financial resources relative to the scale and nature of a firm's commitments or inadequate systems and controls expose an investment firm to the risk of failure, for example in stressed market conditions, leading to potential loss to customers as well as disruption to the market. Prudential standards, where complied with fully, do not eliminate the risk of such failure but can reduce the likelihood of failure or minimise the adverse consequences for customers where a failure does occur. The FSA has had regard to the matters set out in section 5(2) of the Act, but they are not directly relevant to the continued provisions.

How the continued provisions are most appropriate for meeting the regulatory objectives

IPRU(INV) and SUP 16 are based on the prudential standards set out in the legislation, rulebooks and other material of the previous regulators. For the reasons described above its provisions (including those of the continued provisions) will contribute to meeting at least two of the regulatory objectives. The continued provisions add to the carry forward of existing regulatory standards. The FSA considers that this particular approach is the most appropriate way of meeting the objectives at this stage (i.e. when the new legislation takes effect) because:

- ◇ it builds on existing regulators' approaches to setting standards for the same risks; and
- ◇ it is consistent with enabling us to introduce a new set of standards covering all market sectors over the medium term, leaving adequate time for the preparation and implementation of such standards and taking account as far as possible of recent international developments in the area of prudential standards.

Principles of good regulation

Section 2(3) of the Act sets out various principles to which the FSA must have regard in exercising its general functions. The FSA's reasons for believing that making the provisions of IPRU(INV) and SUP 16 Annex 10R are compatible with these principles are set out below.

The need to use its resources in the most efficient and economic way

IPRU(INV) as amended by this instrument essentially carries forward the prudential standards contained in various legislation and rulebooks for firms previously regulated by IMRO, PIA, SFA and FSA (formerly SIB), professional firms, wholesale market brokers and non-bank principals. SUP 16 Annex 10R essentially carries forward the prudential reporting requirements for firms previously regulated by SFA.

The proposals for the Integrated prudential sourcebook are still out for consultation and the FSA has decided that firms and the FSA would be best served by preserving continuity for firms through the carry forward of existing standards. The inclusion of the continued provisions in the IPRU(INV) and SUP 16 Annex 10R are necessary to the achievement of that approach.

For this reason, we believe that the most efficient and economic way to set standards regarding the matters contained in the continued provisions is to continue those provisions.

The responsibilities of those who manage the affairs of authorised persons

Nothing in IPRU(INV) or SUP 16 Annex 10R as amended or the provisions continued by this instrument removes from the senior management of firms the obligation to run their businesses in a sound and prudent way.

The principle that a burden or restriction...should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction

Given that the continued provisions maintain an existing standard, we do not believe that any cost benefit issues will arise for a firm in maintaining that standard. As explained above, we believe that carrying forward the continued provisions is a proportionate approach at this stage.

The desirability of facilitating innovation in connection with regulated activities

The continued provisions will not restrict the scope of management to develop their regulated activities in an innovative manner, provided they meet the business standards set out in other parts of the Handbook.

The international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom

Given that the continued provisions maintain an existing standard, we do not believe that they will have any impact on the competitive position of the United Kingdom.

The need to minimise the adverse affects on competition that may arise from any exercise of its general functions

Although the continued rules carry forward existing differences in the regulatory regimes of the previous regulators, we believe that any adverse effects on competition are small and are outweighed by the advantages of maintaining the existing standards as explained above.

The desirability of facilitating competition between those who are subject to any form of regulation by the Authority

The FSA is currently consulting on an integrated approach to setting prudential standards in the near future, which should lead to a harmonisation of standards. We believe that until those integrated standards are ready, the most appropriate approach is to maintain the existing standards.

ANNEX C
Amendments to IPRU(INV) 3

A. After IPRU(INV) 3-78 insert:

SECONDARY REQUIREMENT

Risk Profile

3-79 R (1) A firm must include in its secondary requirement any amount specified in any requirement to cover an unusual risk profile.

Operational risks

(2) A firm must include in its secondary requirement any amount specified in any requirement to cover the inadequate management of operational risk to which a firm is exposed.

G In assessing whether to impose a *requirement* on a *firm* to cover an unusual risk profile or operational risks, the *FSA* will consider various criteria. Relevant *guidance* can be found in sections 4 and 5 of Appendix 48 to IPRU(INV) 10. In addition, the *FSA* will take into account material group risks to a *firm*, where these have not been captured in a group financial resources test. Secondary requirements may be applied, for example, where there has been a major failure on the part of a *firm* to maintain adequate controls, as a means of providing an additional capital buffer whilst these problems are addressed.

B. Delete IPRU(INV) 3-170(11) and replace with:

Netting

3-170 R (11) A firm which has offsetting exposures in similar types of transactions with a counterparty may offset these in accordance with rules 3-171(2A), 3-173(2A), 3-173A(3), 3-176(3), 3-180(2A), 3-181(1) and 3-182(4A) when calculating CRR if it has a contractual netting agreement with that counterparty, which:

- (a) covers the transactions which the firm is seeking to net;**
- (b) creates a single obligation in each currency or a single overall obligation to pay (or receive) a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances;**
- (c) does not include a walkaway clause;**

- (d) is supported by written and reasoned independent legal opinions to the effect that, in the event of a legal challenge, the relevant courts would find the *firm's* exposure to be the single net amount mentioned in (b) above.

C. After IPRU(INV) 3-82(5) insert:

CONSOLIDATED SUPERVISION

Scope of test

- 3-190** **R** **(1)** **A *firm* must at all times ensure that its group maintains externally generated group *financial resources* in excess of its group *financial resources requirement*, unless otherwise permitted under rule 3-195.**
- R** **(2)** **A *firm* is exempt from (1) above when the *FSA* is not the consolidating supervisor for the *firm's* group.**
- G** The *FSA* will notify the *firm* if it is not the consolidating supervisor for the group.
- R** **(3)** **Should such a test reveal a shortfall in group *financial resources* with respect to the group's *financial resources requirement*, the *firm* must ensure that its group makes good the shortfall, and notify the *FSA* of the manner in which the shortfall will be made good.**
- R** **(4)** **The test is to be applied in accordance with rules 3-191 to 3-194 below and the *firm* must make appropriate reports to the *FSA*.**
- G** The *firm* may use the consolidated reporting statement forms required under *SUP* 16.7.25R.

Constituents of a group

- 3-191** **R** **(1)** **For the purposes of the test in 3-190 above, a *firm's* group must include the following:**
- (a)** **any *EEA subsidiary* of the *firm* which is a *credit institution, investment firm* or *financial institution*;**
- (b)** **any *EEA participation* of the *firm* which is a *credit institution, investment firm* or *financial institution*;**

- (c) **any EEA parent which is a financial holding company, and**
 - (d) **any EEA credit institution, investment firm or financial institution which is a subsidiary or participation of the firm's EEA parent which is a financial holding company.**
- G (2) The FSA may exercise its powers (whether through imposing a *requirement* or by using its general information gathering powers) to obtain information about the structure of a *firm's* group for the purposes of consolidated supervision including the position of any of the following:
- (a) any of the *firm's subsidiaries* or *participations* which are incorporated or have their head offices outside the EEA;
 - (b) any of the *firm's subsidiaries* or *participations* which are not *credit institutions, investment firms* or *financial institutions*;
 - (c) the *firm's parent* if it is incorporated or has its head office outside of the EEA;
 - (d) the *firm's parent* if it is not a *financial holding company*;
 - (e) any of the *parent's other subsidiaries* or *participations* which are incorporated or have their head offices outside the EEA; and
 - (f) any of the *parent's other subsidiaries* or *participations* which are not *credit institutions, investment firms, or financial institutions*.
- G The FSA's intention in defining the scope of a group for the purposes of a group financial resources test is to capture financial activities. 'Financial activities' is defined for these purposes as any *investment business* or *credit institution*, or other entity whose principal activity is to undertake their activities. It is not the FSA's intention to capture commercial activities. The FSA does not exclude the possibility that it may judge it necessary to capture a commercial entity; but were such circumstances to arise – for instance because financial risks had been moved from a *firm* to a commercial enterprise, and the FSA judged the consequences to the *firm* to be sufficiently material as to justify a response – the FSA would usually expect to address these risks through applying a secondary requirement, rather than extending the scope of the consolidated group to the commercial entity. Similarly, the FSA will not – other than in the most exceptional circumstances – consolidate any non-EEA parent entities of the *firm*.

Exemptions

- R (3) **A firm may, having first notified the FSA in writing, exclude from the group defined in (1), the following:**
- (a) **any subsidiary or participation, the total assets of which are less than the lower of euro 10 million or 1% of the total assets of the firm; and**

- (b) any *subsidiary, participation or firm's parent*, the inclusion of which within the group would lead to a misleading or inappropriate consolidation,

provided that in aggregate the total assets of such *subsidiaries and participations* would still satisfy (a) above.

Group financial resources

- 3-192 R A *firm* must calculate the externally generated *financial resources* of its group as the sum of:
- (a) the *financial resources* of the most senior undertaking in the group; and
 - (b) for each *subsidiary or participation*, the group's share of the *financial resources* of the *subsidiary or participation*, which was not provided by undertakings within the group subject to consolidated supervision, provided that:
 - (i) these *financial resources* are freely transferable and suitable for the purposes of covering the group's *financial resources requirement*; or
 - (ii) if not, they are limited to the value of the *subsidiary's or participation's financial resources requirement* from which they originate.

- G Where there is no senior undertaking in the defined group because, for example, the *firm's parent* is not included and only affiliates of the *firm* rather than any of its direct *subsidiaries or participations* are included, then the *financial resources* of the group is calculated as the sum of the externally generated *financial resources* of its constituents (i.e. excluding amounts provided by undertakings within the group subject to consolidated supervision), subject to the conditions in (i) and (ii) above.

Group financial resources requirement

- 3-193 R (1) A *firm* must calculate the group *financial resources requirement* as the aggregate of the *financial resources requirements* of the *firm* and any constituents of the defined group, as determined in accordance with rule 3-191.
- (2) The *financial resources requirement* of any *subsidiary or participation* of the *firm* or its *parent* is the *subsidiary or participation's* local regulatory capital requirement if any.

- (3) The *financial resources requirement* of the most senior undertaking within the group likewise is its local regulatory capital requirement if any.
- (4) Where a *firm* has a *parent, subsidiary or participation* which is not subject to local regulatory capital requirements, it must include in the group *financial resources requirement* any alternative requirement calculated on the business of that *parent, subsidiary or participation*, or the group's investment in that *subsidiary or participation*, which is imposed on it by a *requirement*.

G Any *requirement* will be calculated by applying the *Financial Rules* to the entity's business.

G (5) Where a *firm* has a *parent, subsidiary or participation* which is subject to local regulatory capital requirements, it may seek a modification or waiver permitting it to adopt an alternative methodology of determining the group's *financial resources requirement*.

Intra-group offsets and netting

3-194 R A *firm* may take into account:

- (a) the benefits of netting intra-group counterparty exposures;
- (b) offsetting positions, for the purposes of calculating its position risk requirements, held by different group companies; and
- (c) the group's share of capital surpluses in *subsidiaries* not subject to local regulatory capital requirements,

provided that:

- (d) the *firm* can ensure that the group has sufficient *financial resources* to cover its *financial resources requirements* at all times between *consolidated reporting statements*;
- (e) there is satisfactory allocation of capital within the group;
- (f) the regulatory, legal and contractual framework is sufficient to guarantee mutual financial support within the group; and

- (g) such intra-group benefits are only recognised where no regulations exist in the country of incorporation of the entity which might significantly affect the transfer of funds within the group.

Exemption from consolidated supervision

- 3-195 R A *firm* need not apply rules 3-190 to 3-194 to its group if:
- (a) There are no *credit institutions* in the group;
 - (b) all *firms* within the group:
 - (i) deduct from their *financial resources*, calculated in accordance with Table 3-61, any *material holdings* in *credit institutions* and *financial institutions*; and
 - (ii) meet their applicable primary, secondary and position/counterparty risk requirements (rules 3-70 to 3-78, 3-79 and 3-80 to 3-182 respectively);
 - (c) all other entities comply with applicable local regulatory capital requirements;
 - (d) the *firm's* group has in place systems to monitor and control the sources of capital and funding of all its constituents; and
 - (e) the *firm* first notifies the *FSA* in writing that it intends to rely upon this rule.

D. In the glossary at appendix 1, after the definition of "EEA" insert:

EEA parent means a *firm's* direct or indirect *parent* which is incorporated or has its head office in the *EEA*, or a *firm's parent* which is incorporated or has its head office outside the *EEA* but which in turn has a *parent* incorporated or which has its head office in the *EEA*;

E. Delete the existing Appendix 33 and replace with:

Appendix 33 (exchanges)

LIST OF RECOGNISED INVESTMENT, DESIGNATED INVESTMENT AND APPROVED EXCHANGES

1 Recognised investment exchanges

UK

COREDEAL

International Petroleum Exchange (IPE)

Jiway

London International Financial Futures and Options Exchange (LIFFE)

London Metal Exchange (LME)

London Stock Exchange (LSE)

OM London Exchange (formerly OMLX)

virt-x (formerly Tradepoint)

Overseas

Cantor Financial Futures Exchange (CFFE)

Chicago Board of Trade (CBOT)

Chicago Mercantile Exchange (CME)

Eurex Zurich

NASDAQ

New York Mercantile Exchange (NYMEX)

New Zealand Futures and Options Exchange (NZFOE)

Swiss Exchange (SWX)

Sydney Futures Exchange (SFE)

Wareterminbourse Hannover

2 Designated investment exchanges

American Stock Exchange

Australian Stock Exchange

Bolsa Mexicana de Valores

Bourse de Montreal Inc

Chicago Board of Trade

Chicago Board Options Exchange

Chicago Stock Exchange

Coffee, Sugar and Cocoa Exchange, Inc

Euronext Amsterdam Commodities Market

Hong Kong Exchanges and Clearing Limited

International Securities Market Association

Johannesburg Stock Exchange

Kansas City Board of Trade

Korea Stock Exchange

MidAmerica Commodity Exchange
Minneapolis Grain Exchange
New York Cotton Exchange
New York Futures Exchange
New York Stock Exchange
New Zealand Stock Exchange
Osaka Securities Exchange
Pacific Exchange
Philadelphia Stock Exchange
Singapore Exchange
South African Futures Exchange (SAFEX)
Tokyo International Financial Futures Exchange (TIFFE)
Tokyo Stock Exchange
Toronto Stock Exchange

3 Approved exchanges

The following exchanges are approved for the purposes of the definition of “approved exchange” -

Athens Stock Exchange (ASE)
Barcelona Stock Exchange (Bolsa de Valores de Barcelona)
Belgian Futures & Options Exchange (BELFOX)
Berlin Stock Exchange (Berliner Börse)
Bilbao Stock Exchange (Bolsa de Valores de Bilbao)
BVL (Bolsa de Valores de Lisboa e Porto)
Bolsa de Mercaderias & Futures (BM&F)
Boston Stock Exchange
Bovespa (The São Paulo Stock Exchange)
Bremen Stock Exchange (Bremer Wertpapierbörse)
BVRJ (The Rio de Janeiro Stock Exchange)
Cincinnati Stock Exchange
Copenhagen Stock Exchange (Københavns Fondsbørs)
Düsseldorf Stock Exchange (Rheinisch-Westfälische Börse zu Düsseldorf)
Frankfurt Stock Exchange (Frankfurter Wertpapierbörse)
Hannover (Niedersächsische Börse zu Hannover)
Italian Exchange
Kuala Lumpur Stock Exchange
Luxembourg Stock Exchange (Société de la Bourse de Luxembourg SA)
Madrid Stock Exchange (Bolsa de Valores de Madrid)
Mercato Italiano Futures (MIF)
Munich Stock Exchange (Bayerische Börse in München)
Nagoya Stock Exchange
New Zealand Stock Exchange
Oslo Stock Exchange (Oslo Børs)
Stuttgart Stock Exchange (Baden-Württembergische Wertpapierbörse zu Stuttgart))

Swiss Exchange (SWX)
Taiwan Stock Exchange
Tel Aviv Stock Exchange
The Stock Exchange of Thailand
Valencia Stock Exchange (Bolsa de Valores de Valencia)

F. After the end of appendix 59 insert:

Appendix 62

NETTING

Similar Types of Transactions

The rules set out the requirements to be met by firms before offsetting exposures in 'similar types of transactions' with a counterparty (i.e. being those transactions falling under a particular counterparty risk rule). The netting of exposures within a particular rule is to be applied on a first in first out basis.

Derivative Transactions

Firms may offset the negative replacement cost on written OTC options against the positive replacement cost of OTC purchased options with the same counterparty.

Guidance On The Netting Of Counterparty Exposures

Introduction

1. This appendix contains guidance on the requirements to be attained in order for firms to net counterparty exposures assessed under the following areas.

Subject
Cash against documents transactions
Free deliveries of securities
Repurchase and reverse repurchase, securities lending and borrowing and sale and buy back agreements
Derivative transactions
Other amounts owed to a firm arising out of trading book business

Scope

2. The guidance applies to any firm subject to the CRR rules and which takes advantage of the netting provisions contained therein.

Background

3. Agreements which can effect set-off of counterparty exposures exist in two forms:
 - (a) novation agreements (referred as netting by novation) which replace existing contracts with one new contract and therefore can only be used to cover similar transactions with payments in the same currency for the same value dates; and
 - (b) netting agreements which can be used to cover transactions of very different types.

The guidance below applies to both novation agreements and netting agreements.

Principles of Offset

4. Before offsetting exposures in similar types of transactions with a counterparty a firm must have a contractual netting agreement with that counterparty which:
 - (a) covers the transactions which the firm is seeking to net;
 - (b) creates a single obligation in each currency or a single obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances;
 - (c) does not include a walkaway clause; and

- (d) is supported by written and reasoned independent legal opinions to the effect that, in the event of a legal challenge, the relevant courts would find the firm's exposure to be the single net amount mentioned in (b) above.

Statement of Law on Netting

5. The prerequisite of holding a netting agreement supported by an independent legal opinion in order to offset exposures is not required where the Financial Law Panel's (November 1993) Statement of Law on netting applies. This Statement of Law indicates that under English law rule 4-90 of the Insolvency Rules 1986 imposes a requirement for complete set-off of transactions between parties incorporated in England and Wales, provided the transactions are mutual (i.e. credits, debts or claims arise from dealings between the same parties and that the parties are acting in the same capacity). Furthermore, it indicates that set-off is mandatory, applies whether or not there is any contractual entitlement to set-off and cannot be excluded by agreement between the parties.
6. As mentioned above mutuality is required in order for there to be complete set-off of transactions. Accordingly, firms are expected to have procedures in place to identify the counterparty and the capacity in which the counterparty is acting. Firms proposing to rely on the Statement of Law on netting must satisfy themselves of the appropriateness of such reliance and, where in doubt, obtain legal advice. It is important to note that Insolvency Rule 4.90 does not apply to building societies, statutory organisations generally, mutual societies, partnerships and individuals.

Legal Requirements

7. Legal opinions will be needed for the:
- law of the jurisdiction in which the counterparty is organised;
 - law of the jurisdiction in which any branch involved is located;
 - law that governs the agreement and, if different, the law that governs individual transactions pursuant to it; and
 - law that governs the legal status of the counterparty who is entering into transactions of the type which the firm is seeking to net.
8. Where a firm uses an industry standard agreement which contains netting/set-off clauses the firm may rely only on a legal opinion relating to the netting/set-off clauses in that standard agreement where no amendment has been made to the agreement which would materially affect these clauses and where the legal opinion addresses the capacity of counterparties of the type with which the firm wishes to contract, the contract type and the relevant jurisdictions.

9. Where a netting agreement provides that one or both parties may enter into transactions with each other under the agreement through any of its (or certain designated) branches, then all such branches included in the agreement will be considered to be located in relevant jurisdictions for the purpose of this guidance.
10. Where a netting agreement involves more than one jurisdiction, a legal opinion is required for each to the effect that the agreement creates a single obligation in each currency or a single obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances.
11. As mentioned above legal opinions should relate to the law of the jurisdiction in which the counterparty is organised (i.e. incorporated or resident). However, certain circumstances may arise where this requirement could be considered not to be applicable; for example where:
 - a firm has no assets or exposure in that jurisdiction;
 - any judgement obtained in that jurisdiction against a firm would not be enforceable under any of the rules in the UK relating to the enforcement of foreign judgements; or
 - there are no other factors relating to that jurisdiction which would affect the ability of a firm to make net payments as contemplated by the netting agreement.
12. Where a firm believes that the law of the jurisdiction in which a counterparty is organised is not relevant, that point must be addressed in the legal opinion supporting the netting agreement. The ability to exclude the law of the jurisdiction in which a counterparty is organised does not extend to the netting of those off balance sheet exposures listed in the Solvency Ratio Directive: the amendment to this directive (to permit netting) specifically requires this matter to be addressed in the legal opinion.
13. It is recognised that, with certain aspects of the agreement, it may not be possible to obtain a definite opinion or that a positive opinion regarding enforceability of the netting agreement can only be obtained subject to certain assumptions and/or qualifications. Where qualifications are made, they should be specific and their effect adequately explained. In the same way, assumptions should be specific, of a factual nature (except in relation to matters subject to the law of a jurisdiction other than that covered by the opinion) and should be explained in the opinion.
14. Legal opinions on netting agreements must be obtained from independent legal advisers with sufficient expertise and experience in this area of law. Opinions from in-house counsel will not be acceptable. Where the regulator in the jurisdiction of the counterparty is satisfied that the netting agreement is not enforceable under the laws of that jurisdiction, the netting agreement cannot be relied upon regardless of the opinions obtained by a firm.

Compliance with the Legal Requirements

15. It is the responsibility of firms to ensure that the legal requirements set out above are met (firms are to calculate CRR on the gross value of exposures to counterparties where this is not the case). Firms do not need to apply to the FSA in order to net exposures. Similarly, legal opinions on netting agreements and the agreements themselves are not required to be submitted to the FSA for approval. The FSA will establish the existence of legal opinions and netting agreements when compliance with the above requirements is being monitored by its staff.
16. Firms are expected to put procedures in place to ensure that the legal characteristics of netting arrangements are kept under review in light of possible changes in the relevant law.
17. Firms are expected to maintain records demonstrating that, in relation to the legal requirements, the following considerations have been addressed:
 - the applicability of the netting agreement to the counterparties, jurisdictions and transactions involved;
 - the applicability of the opinions to the counterparties, jurisdictions and transactions involved;
 - where more than one jurisdiction is involved, the potential for conflicts in law;
 - all documentation is complete and still valid and that the agreement has been properly executed (i.e. that the acceptance of terms have been evidenced);
 - the nature and effect of any qualifications in the legal opinions and assessment that these do not impair the obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances; and
 - where an industry standard agreement is used upon which a generic legal opinion has been obtained, identification of those clauses which if altered during the course of negotiating the agreement would affect the right to offset. Internal legal counsel is to evidence review of these agreements to ensure that the effectiveness of the set off clauses has not been altered directly or indirectly by virtue of other clauses being added or deleted.
18. Firms are expected to hold a copy of the legal opinion and the agreement to which it relates.
19. Firms are to net exposures within a particular rule on a FIFO basis. Firms may net only current exposures and cannot net potential future exposures.

Cross-Product Netting

Introduction

The FSA will consider granting rule waivers in order to permit firms to take account of cross-product netting in the calculation of their Counterparty Risk Requirement (CRR) in instances where the FSA regards it appropriate.

The current drafting of the FSA's Financial Rules for securities and futures firms allows 'similar' types of transactions to be netted (where those transactions are covered by a valid netting agreement, with a supporting legal opinion). In practice, 'similar' has been defined as all transactions which fall within a particular CRR Rule treatment. Thus, currently, for the calculation of CRR in relation to exposures to a counterparty which are covered by valid netting arrangements, a firm would be required to assess, for example, a net exposure for all derivative transactions with that counterparty and a separate net exposure for all repo type transactions with that counterparty.

The FSA will consider granting waivers in accordance with SUP 8, though in general it will expect the following conditions to be met:

1. For the types of transaction which the firm is seeking to net, the firm must have the capability to monitor, and must in practice manage, the resultant exposures on a net basis.
2. All transactions which the firm is seeking to net must be covered by valid netting agreements and supported by legal opinions, in accordance with the requirements of the FSA's Financial Rules; and
3. Where underlying netting agreements are linked by a master netting agreement, the legal opinion must address the enforceability of the netting arrangements in their entirety;

One factor that the FSA will consider in assessing whether a particular applicant meets these requirements is whether the firm has had the use of its ACMP sanctioned for the purposes of calculating CRR.

ANNEX D
Amendments to IPRU(INV) 5

A. In the glossary at appendix 1, after the definition of "*group*" insert:

group of connected counterparties

means:

- (a) two or more natural or legal persons who constitute a single risk because one of them, directly or indirectly, has *control* over the other or others; or
- (b) two or more natural or legal persons between whom there is no relationship of *control* as in (a) but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter difficulties in performing its or their obligations.

B. In the glossary at appendix 1, after the definition of "*ISD investment services*" insert:

large exposure

means any *exposure* to a *counterparty* or *group of connected counterparties* which exceeds 10 per cent of a *firm's own funds*.

ANNEX E
Amendments to IPRU(INV) 10

A. After 10-68 (1)(b) insert:

Note issuance and revolving underwriting facilities

R (2) A firm must calculate a requirement for each note issuance and revolving underwriting facility as 4% of the facility multiplied by the appropriate counterparty weight, where:

the date of commencement of the commitment is the date when the facility agreement becomes legally binding; and

the date of the maturity of the commitment is the date of termination of the facility agreement.

B. After 10-74(2)(b) insert:

G Firms may apply a reduced secondary requirement in the following cases:

- The following non-trading book investments attract a reduced secondary requirement of 17%:
- Gilts, US treasuries, EIB and World Bank securities;
- Listed Equities i.e. stocks that are constituents of the table of constituent indices in Appendix 49;
- London Stock Exchange shares;
- LCH: contributions to the Member Default Fund - Board Notice 352. Secondary Requirement need only be calculated as 92% of the excess of the value of the contribution over the 10% threshold (rule 10-74(2)(b), as opposed to 92% of the full value of the contribution. (This concession is not a precedent which can be extended to other types of deposit);
- LIFFE seats/shares: reduction only where the seat is unused by the firm or another lessee and is purely held for investment purposes;
- Loans to the extent that the loan is secured by unencumbered acceptable collateral.

Firms may apply for the Secondary Requirement to be reduced, giving reasons why the Secondary Requirement on illiquid assets should be reduced.

C. Delete the existing rule 10-80(6) and replace with:

Instruments for which no PRR treatment has been specified

- 10-80(6)** **R** **Where the *firm* has a position in an instrument for which no *PRR* treatment has been specified, it must calculate a *PRR* of an appropriate percentage of the current *mark to market* value of the position and the *firm* must immediately notify the *FSA* of the details of the instrument, the *PRR* calculated and the reasons for the calculation.**

D. Delete the existing rule 10-120 and replace with:

COLLECTIVE INVESTMENT SCHEMES

Eligible collective investment schemes

- 10-120** **R** **(1) A *firm* must calculate the *PRR* for a position in an *eligible collective investment scheme* as the *mark to market* value of the *firm's* aggregate position multiplied by:**
- (a) 8%, provided that:**
 - (i) the scheme only invests in *qualifying debt securities* and *qualifying deposits*;**
 - (ii) the maturities of *qualifying debt securities* does not exceed 2 years; and**
 - (iii) any right to restrict the withdrawal of funds has not been exercised.**
 - (b) 16 % in the case of other *eligible collective investment schemes*.**

Other collective investment schemes

- (2) (a) A *firm* must calculate the *PRR* for a position in any other *collective investment scheme* as the *mark to market* value of the *firm's* aggregate position multiplied by 16%, provided that:**
- (i) 100% of the scheme funds are invested in liquid and readily realisable *securities* which are *marketable investments* or held in cash;**

- (ii) the *firm* knows the underlying constituents of the scheme on a daily basis;
 - (iii) shares or units can be created or redeemed in exchange for underlying constituents;
 - (iv) investment in the scheme results in an equivalent or higher *PRR* than the underlying constituents would attract if directly held; and
 - (v) any right to restrict the withdrawal of funds has not been exercised.
- (b) A *firm* must calculate the *PRR* for a position in any other *collective investment scheme* as the *mark to market* value of the *firm's* aggregate position multiplied by 100%.

G For the purposes of 10-120(1)(a), the scheme may invest in other financial instruments but for hedging purposes only.

E. In the glossary at appendix 1, after the definition of "EEA" insert:

EEA parent means a *firm's* direct or indirect *parent* which is incorporated or has its head office in the *EEA*, or a *firm's parent* which is incorporated or has its head office outside the *EEA* but which in turn has a *parent* incorporated or which has its head office in the *EEA*;

F. Delete the existing Appendix 33 and replace with:

Appendix 33 (exchanges)

LIST OF RECOGNISED INVESTMENT, DESIGNATED INVESTMENT AND APPROVED EXCHANGES

1 Recognised investment exchanges

UK

COREDEAL

International Petroleum Exchange (IPE)

Jiway

London International Financial Futures and Options Exchange (LIFFE)

London Metal Exchange (LME)
London Stock Exchange (LSE)
OM London Exchange (formerly OMLX)
virt-x (formerly Tradepoint)

Overseas

Cantor Financial Futures Exchange (CFFE)
Chicago Board of Trade (CBOT)
Chicago Mercantile Exchange (CME)
Eurex Zurich
NASDAQ
New York Mercantile Exchange (NYMEX)
New Zealand Futures and Options Exchange (NZFOE)
Swiss Exchange (SWX)
Sydney Futures Exchange (SFE)
Wareterminbourse Hannover

2 Designated investment exchanges

American Stock Exchange
Australian Stock Exchange
Bolsa Mexicana de Valores
Bourse de Montreal Inc
Chicago Board of Trade
Chicago Board Options Exchange
Chicago Stock Exchange
Coffee, Sugar and Cocoa Exchange, Inc
Euronext Amsterdam Commodities Market
Hong Kong Exchanges and Clearing Limited
International Securities Market Association
Johannesburg Stock Exchange
Kansas City Board of Trade
Korea Stock Exchange
MidAmerica Commodity Exchange
Minneapolis Grain Exchange
New York Cotton Exchange
New York Futures Exchange
New York Stock Exchange
New Zealand Stock Exchange
Osaka Securities Exchange
Pacific Exchange
Philadelphia Stock Exchange
Singapore Exchange
South African Futures Exchange (SAFEX)
Tokyo International Financial Futures Exchange (TIFFE)

Tokyo Stock Exchange
Toronto Stock Exchange

3 Approved exchanges

The following exchanges are approved for the purposes of the definition of “approved exchange” -

Athens Stock Exchange (ASE)
Barcelona Stock Exchange (Bolsa de Valores de Barcelona)
Belgian Futures & Options Exchange (BELFOX)
Berlin Stock Exchange (Berliner Börse)
Bilbao Stock Exchange (Bolsa de Valores de Bilbao)
BVL (Bolsa de Valores de Lisboa e Porto)
Bolsa de Mercaderios & Futures (BM&F)
Boston Stock Exchange
Bovespa (The São Paulo Stock Exchange)
Bremen Stock Exchange (Bremer Wertpapierbörse)
BVRJ (The Rio de Janeiro Stock Exchange)
Cincinnati Stock Exchange
Copenhagen Stock Exchange (Københavns Fondsbørs)
Düsseldorf Stock Exchange (Rheinisch-Westfälische Börse zu Düsseldorf)
Frankfurt Stock Exchange (Frankfurter Wertpapierbörse)
Hannover (Niedersächsische Börse zu Hannover)
Italian Exchange
Kuala Lumpur Stock Exchange
Luxembourg Stock Exchange (Société de la Bourse de Luxembourg SA)
Madrid Stock Exchange (Bolsa de Valores de Madrid)
Mercato Italiano Futures (MIF)
Munich Stock Exchange (Bayerische Börse in München)
Nagoya Stock Exchange
New Zealand Stock Exchange
Oslo Stock Exchange (Oslo Børs)
Stuttgart Stock Exchange (Baden-Württembergische Wertpapierbörse zu Stuttgart))
Swiss Exchange (SWX)
Taiwan Stock Exchange
Tel Aviv Stock Exchange
The Stock Exchange of Thailand
Valencia Stock Exchange (Bolsa de Valores de Valencia)

G. Delete the existing appendix 57 and replace with:

Appendix 57

List of recognised exchanges and recognised clearing houses

1 Recognised Exchanges

American Stock Exchange LLC
Athens Stock Exchange (ASE) - Thessaloniki Stock Exchange Centre (TSEC)
Australian Stock Exchange Ltd.
Baden-Württemberg Stock Exchange Stuttgart (Bayrische Börse)
Barcelona Stock Exchange (La Bolsa de Valores de Barcelona)
Bavarian Stock Exchange Munich (Bayrische Börse)
Belgian Futures and Options Exchange (BELFOX)
Berlin Stock Exchange (Berliner Wertpapierbörse)
Bilbao Stock Exchange (Bolsa de Bilbao)
Bolsa de Valores de Lisboa e Porto (BVLVP)
Bourse de Montréal
Bremen Stock Exchange (Bremer Wertpapierbörse)
Canadian Venture Exchange
Chicago Board of Trade
Chicago Board Options Exchange Inc.
Chicago Mercantile Exchange
Coffee, Sugar and Cocoa Exchange
Copenhagen Stock Exchange (Københavns Fondsbørs)
Eurex Deutschland
Eurex Zurich
Euronext Amsterdam Commodity Market
Euronext Amsterdam NV
Euronext Brussels Ltd.
Euronext Paris SA
Frankfurt Stock Exchange (Frankfurter Wertpapierbörse)
Hanseatic Stock Exchange Hamburg (Hanseatische Wertpapierbörse Hamburg)
Helsinki Exchanges
Hong Kong Exchanges and Clearing
International Petroleum Exchange of London Ltd.
Irish Stock Exchange

Italian Exchange
Kansas City Board of Trade
London International Financial Futures and Options Exchange (LIFFE)
London Metal Exchange Ltd.
London Stock Exchange Ltd.
Luxembourg Stock Exchange (Société de la Bourse de Luxembourg SA)
Madrid Stock Exchange (La Bolsa de Valores de Madrid)
MEFF Renta Fija
MEFF Renta Variable
Mercato Italiano Derivati (IDEM)
Mercato Italiano Futures (MIF)
Munich Stock Exchange (Bayerische Borse in Munchen)
Nagoya Stock Exchange
Nasdaq Stock Exchange
New York Mercantile Exchange
New York Stock Exchange
OM London
OM Stockholm Exchange
Osaka Securities Exchanges
Oslo Stock Exchange (Oslo Bors)
Pacific Exchange
Rhine-Westphalian Stock Exchange Dusseldorf (Rheinisch-Westfälische Börse zu Düsseldorf)
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Sydney Futures Exchange
Tokyo International Financial Futures Exchange
Tokyo Stock Exchange
Toronto Stock Exchange
Valencia Stock Exchange (La Bolsa de Valores de Valencia)
Wiener Borse AG

2 Clearing Houses

ASX Settlement and Transfer Corporation Pty Ltd (ASTC)
Austrian Kontroll Bank (OKB)
Board of Trade Clearing Corporation
Cassa di Compensazione e Garanzia S.p.A (CCG)
Commodity Clearing Corporation
Emerging Markets Clearing Corporation
FUTOP Clearing Centre (FUTOP Clearingcentralen A/S)

Hong Kong Futures Exchange Clearing Corporation Ltd
Hong Kong Securities Clearing Company Ltd
Kansas City Board of Trade Clearing Corporation
London Clearing House (LCH)
Norwegian Futures & Options Clearing House (Norsk Oppsjonssentral A.S. (NOS))
N.V. Nederlandse Liquidatiekas (NLKKAS)
OM Stockholm Exchange
Options Clearing Corporation
Options Clearing House Pty Ltd (OCH)
Sydney Futures Exchange Clearing House (SFECH Ltd)
TNS Clearing Pty Ltd (TNSC)

H. After the end of appendix 59 insert:

Appendix 62

NETTING

Similar Types of Transactions

The rules set out the requirements to be met by firms before offsetting exposures in 'similar types of transactions' with a counterparty (i.e. being those transactions falling under a particular counterparty risk rule). The netting of exposures within a particular rule is to be applied on a first in first out basis.

Derivative Transactions

Firms may offset the negative replacement cost on written OTC options against the positive replacement cost of OTC purchased options with the same counterparty.

Guidance On The Netting Of Counterparty Exposures

Introduction

1. This appendix contains guidance on the requirements to be attained in order for firms to net counterparty exposures assessed under the following areas.

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Cash against documents transactions
Free deliveries of securities
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2. The guidance applies to any firm subject to the CRR rules and which takes advantage of the netting provisions contained therein.

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 - (b) netting agreements which can be used to cover transactions of very different types.

The guidance below applies to both novation agreements and netting agreements.

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 - (a) covers the transactions which the firm is seeking to net;
 - (b) creates a single obligation in each currency or a single obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances;
 - (c) does not include a walkaway clause; and

- (d) is supported by written and reasoned independent legal opinions to the effect that, in the event of a legal challenge, the relevant courts would find the firm's exposure to be the single net amount mentioned in (b) above.

Statement of Law on Netting

5. The prerequisite of holding a netting agreement supported by an independent legal opinion in order to offset exposures is not required where the Financial Law Panel's (November 1993) Statement of Law on netting applies. This Statement of Law indicates that under English law rule 4-90 of the Insolvency Rules 1986 imposes a requirement for complete set-off of transactions between parties incorporated in England and Wales, provided the transactions are mutual (i.e. credits, debts or claims arise from dealings between the same parties and that the parties are acting in the same capacity). Furthermore, it indicates that set-off is mandatory, applies whether or not there is any contractual entitlement to set-off and cannot be excluded by agreement between the parties.
6. As mentioned above mutuality is required in order for there to be complete set-off of transactions. Accordingly, firms are expected to have procedures in place to identify the counterparty and the capacity in which the counterparty is acting. Firms proposing to rely on the Statement of Law on netting must satisfy themselves of the appropriateness of such reliance and, where in doubt, obtain legal advice. It is important to note that Insolvency Rule 4.90 does not apply to building societies, statutory organisations generally, mutual societies, partnerships and individuals.

Legal Requirements

7. Legal opinions will be needed for the:
- law of the jurisdiction in which the counterparty is organised;
 - law of the jurisdiction in which any branch involved is located;
 - law that governs the agreement and, if different, the law that governs individual transactions pursuant to it; and
 - law that governs the legal status of the counterparty who is entering into transactions of the type which the firm is seeking to net.
8. Where a firm uses an industry standard agreement which contains netting/set-off clauses the firm may rely only on a legal opinion relating to the netting/set-off clauses in that standard agreement where no amendment has been made to the agreement which would materially affect these clauses and where the legal opinion addresses the capacity of counterparties of the type with which the firm wishes to contract, the contract type and the relevant jurisdictions.

9. Where a netting agreement provides that one or both parties may enter into transactions with each other under the agreement through any of its (or certain designated) branches, then all such branches included in the agreement will be considered to be located in relevant jurisdictions for the purpose of this guidance.
10. Where a netting agreement involves more than one jurisdiction, a legal opinion is required for each to the effect that the agreement creates a single obligation in each currency or a single obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances.
11. As mentioned above legal opinions should relate to the law of the jurisdiction in which the counterparty is organised (i.e. incorporated or resident). However, certain circumstances may arise where this requirement could be considered not to be applicable; for example where:
 - a firm has no assets or exposure in that jurisdiction;
 - any judgement obtained in that jurisdiction against a firm would not be enforceable under any of the rules in the UK relating to the enforcement of foreign judgements; or
 - there are no other factors relating to that jurisdiction which would affect the ability of a firm to make net payments as contemplated by the netting agreement.
12. Where a firm believes that the law of the jurisdiction in which a counterparty is organised is not relevant, that point must be addressed in the legal opinion supporting the netting agreement. The ability to exclude the law of the jurisdiction in which a counterparty is organised does not extend to the netting of those off balance sheet exposures listed in the Solvency Ratio Directive: the amendment to this directive (to permit netting) specifically requires this matter to be addressed in the legal opinion.
13. It is recognised that, with certain aspects of the agreement, it may not be possible to obtain a definite opinion or that a positive opinion regarding enforceability of the netting agreement can only be obtained subject to certain assumptions and/or qualifications. Where qualifications are made, they should be specific and their effect adequately explained. In the same way, assumptions should be specific, of a factual nature (except in relation to matters subject to the law of a jurisdiction other than that covered by the opinion) and should be explained in the opinion.
14. Legal opinions on netting agreements must be obtained from independent legal advisers with sufficient expertise and experience in this area of law. Opinions from in-house counsel will not be acceptable. Where the regulator in the jurisdiction of the counterparty is satisfied that the netting agreement is not enforceable under the laws of that jurisdiction, the netting agreement cannot be relied upon regardless of the opinions obtained by a firm.

Compliance with the Legal Requirements

15. It is the responsibility of firms to ensure that the legal requirements set out above are met (firms are to calculate CRR on the gross value of exposures to counterparties where this is not the case). Firms do not need to apply to the FSA in order to net exposures. Similarly, legal opinions on netting agreements and the agreements themselves are not required to be submitted to the FSA for approval. The FSA will establish the existence of legal opinions and netting agreements when compliance with the above requirements is being monitored by its staff.
16. Firms are expected to put procedures in place to ensure that the legal characteristics of netting arrangements are kept under review in light of possible changes in the relevant law.
17. Firms are expected to maintain records demonstrating that, in relation to the legal requirements, the following considerations have been addressed:
 - the applicability of the netting agreement to the counterparties, jurisdictions and transactions involved;
 - the applicability of the opinions to the counterparties, jurisdictions and transactions involved;
 - where more than one jurisdiction is involved, the potential for conflicts in law;
 - all documentation is complete and still valid and that the agreement has been properly executed (i.e. that the acceptance of terms have been evidenced);
 - the nature and effect of any qualifications in the legal opinions and assessment that these do not impair the obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances; and
 - where an industry standard agreement is used upon which a generic legal opinion has been obtained, identification of those clauses which if altered during the course of negotiating the agreement would affect the right to offset. Internal legal counsel is to evidence review of these agreements to ensure that the effectiveness of the set off clauses has not been altered directly or indirectly by virtue of other clauses being added or deleted.
18. Firms are expected to hold a copy of the legal opinion and the agreement to which it relates.
19. Firms are to net exposures within a particular rule on a FIFO basis. Firms may net only current exposures and cannot net potential future exposures.

Cross-Product Netting

Introduction

The FSA will consider granting rule waivers in order to permit firms to take account of cross-product netting in the calculation of their Counterparty Risk Requirement (CRR) in instances where the FSA regards it appropriate.

The current drafting of the FSA's Financial Rules for securities and futures firms allows 'similar' types of transactions to be netted (where those transactions are covered by a valid netting agreement, with a supporting legal opinion). In practice, 'similar' has been defined as all transactions which fall within a particular CRR Rule treatment. Thus, currently, for the calculation of CRR in relation to exposures to a counterparty which are covered by valid netting arrangements, a firm would be required to assess, for example, a net exposure for all derivative transactions with that counterparty and a separate net exposure for all repo type transactions with that counterparty.

The FSA will consider granting waivers in accordance with SUP 8, though in general it will expect the following conditions to be met:

1. For the types of transaction which the firm is seeking to net, the firm must have the capability to monitor, and must in practice manage, the resultant exposures on a net basis.
2. All transactions which the firm is seeking to net must be covered by valid netting agreements and supported by legal opinions, in accordance with the requirements of the FSA's Financial Rules; and
3. Where underlying netting agreements are linked by a master netting agreement, the legal opinion must address the enforceability of the netting arrangements in their entirety;

One factor that the FSA will consider in assessing whether a particular applicant meets these requirements is whether the firm has had the use of its ACMP sanctioned for the purposes of calculating CRR.

Appendix 63

GUIDANCE ON CREDIT DERIVATIVES

THIS APPENDIX APPLIES TO FIRMS WHICH TAKE, OR INTEND TO TAKE, POSITIONS IN CREDIT DERIVATIVE PRODUCTS

INTRODUCTION

Over the past few years, there has been an increasing amount of interest and activity in credit derivatives, a class of products that includes credit-linked notes, total return swaps and default options and swaps. For at least some of these products, the commodity being traded is 'pure' credit risk. Through these instruments firms are no longer seeking to contain a risk which is incurred as a by-product of their mainstream trading activity, but are increasingly moving towards trading that very risk. The FSA requires firms to operate robust internal control systems; the advent of credit derivatives highlights the need for increased vigilance in the assessment, monitoring and control of market risk, credit risk and operational risk. **The primary purpose of this Appendix is to underscore the importance of internal control procedures, particularly in circumstances where firms are trading new risks, or new combinations of risk.**

In addition, this Appendix gives some general guidance on capital issues. The non-homogeneity of products under the umbrella term 'credit derivatives' makes it difficult for the FSA to write explicit rules which cover all circumstances. Furthermore, an apparently small change in contract specification might require a significant change in capital treatment. Matters are further complicated by constraints on regulatory capital treatment imposed by European Directives.

To date, the FSA has provided guidance to firms on an ad-hoc basis, and it intends to continue with this practice for the time being. That said, the FSA is able to give a flavour of the capital treatments by way of the brief explanations and examples below. This should not, however, be taken as a definitive guide. **Any firm which has positions in credit derivatives, or intends to acquire such positions, should seek advice from the FSA on the capital to be set aside for regulatory purposes.**

INTERNAL CONTROL ISSUES

Most of the risks to which credit derivatives give rise are familiar, as the same types of risk are present in longer-established instruments. However, they may be present in different combinations in new credit products, and this can add challenges to the manner in which risk is measured, monitored and controlled. For this reason it is of particular importance that any firm engaging in credit derivatives, or one which is intending to undertake such activity, considers whether additions or amendments to established procedures and control routines are required in order to capture and monitor the particular combinations of risks inherent in the products they intend to trade.

The following remarks are not intended as an exhaustive review of the matters which firms may need to address in considering the control of their credit derivatives business, but are merely illustrative of some of the issues which are pertinent. While they relate primarily to credit default type products, many of the considerations will be equally applicable to other credit derivative structures. Firms should also note that procedures for the control of credit derivatives cannot be viewed in isolation: they must mesh seamlessly with the procedures in place for the control of other forms of risk.

New product approval

Before a firm enters into any new type of business, it must ensure that it has in place systems and controls that are adequate to record and monitor the risks of that business. Control issues should be addressed by the firm's senior management, although the level and nature of the controls to be considered during the new product approval process will depend on a variety of factors, including the type and volume of business that will be entered into.

Among the factors which should be considered during the new product process are the following -

- whether the new business falls within the risk appetite of the firm, as established by the Board or equivalent management body;
- an exact description of the type of products to be introduced;
- accounting policies (which firms may wish to discuss with their external auditors);
- valuation methodology, and systems for ensuring that this policy is adhered to;
- authority and level of knowledge of risk managers and/or independent price-checkers;
- format and content of risk reports;
- limits, and systems for measuring and monitoring usage of those limits;
- type of documentation to be used, and other legal risks;
- clearing and settlement procedures;
- adequacy of the firm's computer systems for representing the new transaction type(s);
- reliance on key staff;
- risks arising from the remuneration strategy.

Senior management should approve the procedures and controls and management at all levels must understand and enforce them.

Risk appetite

It is crucial that a firm understands the risks to which credit derivatives give rise, and that resulting exposures are consistent with the overall risk appetite of the firm, as approved by the Board or equivalent management body. At the highest level, firms

will need to consider their objectives in using such instruments. Are they buying and selling credit protection in order to diversify or hedge their portfolio of credit risk? Are they offering credit protection to others, thereby incurring risks which may need to be hedged? Are they seeking to make a turn from buying and selling credit protection? Or, as is most likely, a mixture of all three? The level of control required will, as ever, be a function of the trading strategy.

Understanding the products

Although many of risks to which credit derivatives give rise are familiar, it is important to understand the significant differences between these instruments and more traditional products of a similar nature.

For example, many commentators have drawn parallels between credit derivatives and products such as guarantees or insurance. While some credit derivatives exhibit many of the characteristics of both of these instruments, it is important to recognise a credit derivative as a product in its own right with its own set of associated risks. An over-reliance on similarities between products can lead to the obscuring of genuine differences between their risk characteristics.

Many default options have an economic structure similar to that of guarantees: if issuer A defaults in the repayment on maturity of a bond held by Firm X, Firm X can immediately put the defaulted bond to Firm Y at par in exchange for full payment. It is tempting to see this as analogous to a first on demand guarantee, where on a default by the guaranteed party the guarantor pays the guaranteed party's debt as if it were its own.

However, there is a strong argument that the legal risk in the derivative transaction is greater than that in the guarantee, since guarantee documentation has been tested in the courts over centuries, whereas the default option documentation is as yet untried. It can therefore be argued that while the economic intent may be similar in the two products, there is greater risk engendered by following the credit derivative path rather than the well-trodden guarantee route.

Given that the market is still in a fairly early stage of development, and that structures and terminologies are not yet standardised, participants should be aware of the transactional risks involved and ensure that they have fully understood (and exchanged confirmation of) the exact commercial terms of the transactions entered into.

Credit approval

Firms will need to consider the mechanisms in place for approval of the acquisition of credit risk. Will the sale of credit protection be subject to appropriate levels of credit approval, and will the process be the same as that for other credit exposures the firm incurs? Is the approval process separate from the dealing function? Are those making the decisions fully aware of the particular risks of credit derivatives? It would plainly be dangerous for product originators, whose prime motivation will often be the provision of innovative financial engineering solutions for clients, to be committing the firm to acquiring risk, without the nature of that risk being fully understood, and

consequently approved, by those responsible for the protection of the firm's assets. There may be a need for education of those making credit decisions in the peculiar risks inherent in credit derivatives, particularly if the decision to incur risk is truly to be kept separate (in management terms) from those who are trading it.

Mismatches and imperfect hedges

In documenting credit derivatives, firms should review the degree to which default criteria match in the reference asset and the derivative. In the simplest asset structures, mere failure to pay constitutes default; if this is matched in the derivative the credit hedge is clearly highly effective. If, alternatively, further conditionality is imposed in the default criteria of the derivative - for example, the payoff is triggered only when a payment has failed and this fact has become public and the price of the underlying has been affected by more than a certain amount - then the hedge is less effective.

Consideration should also be given to maturity mismatches. Where the underlying credit exposure continues beyond the maturity of the hedge, firms may wish to consider the appropriate exposure reporting treatment. For example, where the underlying credit risk is deteriorating, and default is considered probable, but not before the expiry of any protection held, is it prudent to consider the risk to be transferred at all? Arguably not only is the risk not transferred, but firms should be giving consideration to provisioning.

Where firms sell credit protection, the question of the firm's rights in a receivership or bankruptcy will be crucial. For example, if a firm receives an underlying bond when it is called under any protection sold, then it will clearly have rights in any eventual receivership. However, a structure where a firm merely undertakes to pay an amount to a protection buyer in the event of the default of the reference asset, and the protection seller acquires no rights in bankruptcy against the defaulting party, will have a wholly different risk profile.

The degree of correlation between the default of the reference asset and that of the protection seller must be considered. Where the two are highly correlated, it will plainly be inappropriate to regard the risk as effectively transferred. Would it be prudent to consider exposure to a sovereign issuer to be reduced by the purchase of protection from an entity located in the same country? Is protection sold by a subsidiary a valid hedge against a parent company exposure? (In the latter case firms may also wish to consider any legal restrictions which there may be on the support of parent companies by subsidiaries).

None of the foregoing is to say that firms should not enter in to imperfect credit hedges, merely that they should be aware of the risks involved in doing so, and ensure that these are reflected in the monitoring and review procedures applied.

Monitoring of credit exposures

A firm's systems must be capable of aggregating credit exposures arising from credit derivatives with other exposures to a given entity. Furthermore, systems must be capable of reflecting the "dual" credit risk exhibited by many credit derivatives: where

protection is bought for an asset held in the firm's portfolio, the firm has credit exposure both to the issuer of the reference asset and to the protection seller. Similarly, where cash flows are swapped, a firm may acquire a dual risk, depending on the exact nature of the structure. Firms should ensure that they have monitoring systems which are capable of reflecting this dual risk, so that exposure to both the issuer of the reference asset and to the protection seller can be monitored.

Credit review and provisioning procedures

In considering the ongoing credit review of exposures, firms will again need to address the dual nature of the exposure to which most credit derivatives give rise. They will need to review both the financial strength of the underlying credit risk and the creditworthiness of the protection seller from whom protection has been bought. In this regard firms may wish to investigate fully the rights they have to financial information on the underlying credit risk and whether any restrictions in access to information would put a seller of protection at a disadvantage compared to a holder of the underlying credit risk, and whether any such disadvantage significantly alters the risk profile. Plainly where there is a lack of transparency, and firms may not be party to information which holders of the reference asset may receive, there will be a need for greater vigilance in monitoring.

Traditionally, securities houses have rarely become involved in "work outs". However, where firms become the ultimate bearer of the credit risk of a certain counterparty, they will need to consider whether they have the necessary expertise in insolvency to make the best recovery possible. While it can be argued that even defaulted instruments can be sold "at a price", such a sale may result in greater financial loss than if the firm managed the recovery itself.

Scenario testing

It is important that any firm which incurs significant trading risk undertakes a rigorous and comprehensive programme of scenario testing covering all major types of risk, including market risk, credit risk and operational risk. Routine scenario testing should be undertaken in order to aid the measurement and control of risks in 'normal' circumstances. In addition 'stress' scenarios should be designed to test the potential for losses under extreme conditions, or to highlight possible risk control problems that may arise. These should include -

- abnormal market movements;
- periods of inactivity or illiquidity; and
- the break-down of key assumptions.

Individual firms will need to devise tests which are meaningful to their particular situations; in each case the criteria should explicitly identify plausible events or influences to which the firm could be exposed. Of crucial importance in the case of credit derivatives is that the results should be capable of clear interpretation even where, by the very nature of the instruments, the distinction between market risk and credit risk becomes somewhat blurred. In addition, credit pricing is evolving as the derivatives market develops, and subjective judgements may need to be made in

order to price or mark to market these instruments, which may in turn affect the performance of the hedge. Such judgements should be routinely reviewed and their potential effect included within the scenario testing.

The results of scenario testing should be regularly communicated to senior management, and to the Board or equivalent body, and should be reflected in the policies and limits set by management.

Reality testing

The essence of reality testing is the comparison of actual trading results with expected outcomes. Firms are familiar with the idea of checking whether their assumptions about the direction of markets have held, but have been slower to apply similar techniques to credit spreads, ratings migration and default.

Any firm which incurs credit risk in its trading activities should ensure that it has a mechanism to test whether, and to what extent, its assumptions have been robust. There should also be a recognised route for the results of reality testing to feed back into the process governing the way in which the firm limits its risk-taking activity.

REGULATORY CAPITAL TREATMENT

Some of the products which are by common consent termed credit derivatives are covered by the FSA's rules (for example, options on an individual bond or equity). Other instruments, however, show characteristics of a type not explicitly covered by the rules, and for these products the FSA has in the past provided guidance on an ad-hoc, though consistent basis. Both the credit derivatives market, and indeed the international regulatory capital regime, are evolving, and the FSA does not believe it is appropriate at this stage to propose rule changes to accommodate the full range of new products.

The following paragraphs outline the general approach which the FSA will follow, and show the way in which capital charges might be calculated for some given examples of transactions. However, **any firm with a position in a credit derivative product should seek guidance on its treatment from the FSA.** There is as yet little standardisation of products, and an apparently small difference in specification might require a significant change in capital treatment. Furthermore, the FSA is constrained by the requirements of the Capital Adequacy Directive, and associated pieces of legislation; it is possible that what seems a common-sense approach could be illegal.

Mark to market

Valuation is fundamental to the question of capital adequacy, as it has a direct effect on firms' financial resources. The FSA requires marking on a 'close-out' basis - a long position should be valued at the bid side of the market, and a short position at the offered side. Where a product is illiquid, the bid-offer spread available in the market will tend to be wide, and this must be reflected in the mark to market value. Firms are also required to take account of factors such as the size of the position.

For example, if the size is larger than that for which a market bid-offer spread would hold, the spread must be widened to take account of this.

Credit derivatives offer certain additional challenges to the valuation process, but the FSA believes that the principles remain the same. There are many products commonly traded by authorised firms which, because of their peculiar characteristics, are complex to value, but which the FSA nonetheless requires to be marked to market. In all cases, the valuation must reflect the level at which a firm realistically expects to be able to liquidate the position. Where there is any uncertainty, the overriding principle is that of prudence.

Notwithstanding this, the reliability of the pricing process for some credit default products may leave regulators with a residual concern. For this reason, **a firm's proposed methodology for marking to market must be agreed with the FSA.** In extreme cases, the FSA may require extra buffers to be included in the valuation, and may even restrict any unrealised profit from inclusion in a firm's financial resources.

For the sake of clarity it should be noted that all credit derivatives must be marked to market, whether or not they are trading book positions, and that they must be marked on a close-out basis.

Trading book/non-trading book

The FSA believes that it is likely that most credit derivative transactions entered into by firms will be trading book items, and will therefore be subject to PRR and CRR. Some firms are aiming to develop a two-way market, and others have bought protection for specific assets or asset classes in their trading book. Where a credit derivative position is clearly not a trading book item, it will be subject to a liquidity adjustment of either 100% or 8% (depending on which method a firm uses to calculate its financial resources).

Position Risk Requirement

Most credit derivative products can be slotted into the standard calculation methodologies (i.e. equity methods 1-4, and interest rate methods 1-3). The PRR calculation is divided into two distinct parts, being 'general market risk' and 'specific risk'. Some credit default products may not give rise to general market risk; where this is the case, instruments are likely to incur only the specific risk component of the relevant PRR charge.

Example 1: Credit default option

Firm A purchases option from Firm B.

A Credit Event is defined in terms of the default of XYZ Co. 8% notes 1999. Should a Credit Event occur, Firm B will pay Firm A £1m against delivery of £1m nominal of XYZ Co. 8% notes 1999.

For firm A -

General market risk: Nil

Specific risk: PRA of reference asset * nominal amount

Where the default protection is embedded in a credit-linked note issued by a third party, it is likely that both general market risk and specific risk charges will apply. Since there is a dual issuer risk, two specific risk charges should be calculated.

Example 2: Credit-linked note

Firm A holds a note issued by ABC Co, maturity 5 years, coupon 8%.

Should a Credit Event occur, the note is terminated. The Credit Event is defined in terms of the default of a bond issued by a third party - XYZ Co.

General market risk: 5 year PRA for relevant currency * mark to market value of note.

Specific risk: (PRA ABC Co + PRA XYZ Co) * mark to market value of note.

A total return swap should be treated as two notional positions, representing respectively the interest rate leg, and a position in the reference asset.

Example 3: Total return swap

Firm A pays 3 months LIBOR and any price depreciation on 100 XYZ Co shares;

Firm B pays dividend and any price appreciation on 100 XYZ Co shares.

Firm A: short debt equivalent position at three months; long equity equivalent position in 100 XYZ Co.

Firm B: long debt equivalent position at three months; short equity equivalent position in 100 XYZ Co.

Firms are reminded that if they are in any doubt as to the appropriate PRR treatment for any position or exposure, they should seek guidance from the FSA.

Offset for capital adequacy purposes

The Capital Adequacy Directive allows the competent authorities to recognise certain offsets for general market risk, but requires that the specific risk charge is applied to gross positions.

Where a position in a credit derivative has been represented as a notional debt or equity position, it automatically becomes eligible for the netting provisions set out in 10-83 and 10-102.

Example 4: Total return swap + hedge

Firm A pays 3 months LIBOR and any price depreciation on 100 XYZ Co shares;

Firm B pays any price appreciation and dividends on 100 XYZ Co shares.

Firm A is short 100 shares in XYZ Co.

Firm A's long equity equivalent position arising from the swap may be netted with its short position, giving rise to a zero PRR for the equity position.

PRR must still be calculated on the LIBOR leg.

Where a firm has a position in a credit default product that incurs only a specific risk charge, together with a position in the reference asset, the FSA may permit the two specific risk charges to be offset, provided that the credit events specified in the default product are to all intents and purposes the same as those specified for the reference asset.

Example 5: Credit default option + position in reference asset

Firm A holds option described in example 1.

Firm A is long £1m nominal XYZ Co. 8% notes 1999.

General market risk: 2 year PRA for relevant currency * mark to market value of bond.

Specific risk: nil

There may be other circumstances in which it is both legal and appropriate to recognise the hedging benefits of certain credit derivatives. **Firms are encouraged to discuss individual strategies with the FSA.**

Counterparty risk requirement

OTC credit derivatives, whether structured as swaps or options, give rise to counterparty risk. CRR for most credit derivative transactions will fall under rule 10-174: the appropriate part of Table 10-174(3) to be used in calculating the 'credit equivalent amount' should be determined by the nature of the reference asset.

Example 6: Credit default option

Firm A purchases from Firm B the option described in Example 1.

Credit equivalent amount = replacement cost + £50,000 [i.e. 0.5% of £1m]

Some firms may use credit derivatives to reduce their exposure to a counterparty. EU law does not permit the recognition of such hedging in all cases, but the FSA is prepared to consider on a case-by-case basis whether the protection provider may be substituted for the counterparty for the purposes of the CRR rules. **Firms wishing to investigate this possibility should contact the FSA.**

Large exposures

Exposures incurred in both buying and writing credit derivatives should of course be taken into account for the purposes of calculating a firm's large exposures requirement. Where a firm holds an asset together with a hedge that is recognised as such by the FSA, it may choose to calculate its large exposures capital requirement in terms either of the exposure to the underlying or of the exposure to the entity providing the protection. This is not an entirely free choice, however: firms must be consistent in how they view credit protection. For example, if the protection has been taken into account when calculating PRR, an exposure to the provider must be reflected for large exposures purposes.

For the purposes of internal and regulatory monitoring of large exposures, the exposure to both the reference asset and to the protection provider should be indicated.

Multiple name risk

Where a firm is exposed to issuer risk of more than one issuer, for example where writing a credit default derivative which pays out on the default any one of a number of specified instruments: in general PRR should be calculated with reference to the

aggregate of the specific risk weightings of the instruments in the reference basket (ie. on an additive basis).

However, in cases where the derivative instrument/credit linked note has been afforded a credit rating by a 'relevant agency' which accords with the definition of 'qualifying debt security' firms may apply to the FSA to use the relevant single specific risk weighting from Appendix 53.

Risk assessment models

In the light of the forthcoming CADII package of directives, firms may also wish to consider whether to approach the FSA for permission to use an appropriate risk assessment model as the basis for calculating regulatory capital requirements.

SPECIFIC RISK TREATMENT OF CREDIT DERIVATIVES

Introduction

The following guidance is to clarify the specific risk treatments applicable to 'plain vanilla' credit derivatives such as credit default products, total return swaps and credit-linked notes.

Where a firm has a position in a more complex credit derivative instrument for which no PRR treatment has been specified, the firm must immediately seek guidance from the FSA. Until an appropriate treatment has been determined a PRR of 100% of the current mark to market value of the position must be applied.

Default Events

The following guidance applies only in circumstances where the default events, as drafted under the terms of the credit derivative, match those relating to the underlying reference asset. If default events are different, no hedging benefit should be recognised.

Specific Risk

Specific interest rate risk is the risk that the price of a specific security will change relative to prices of securities generally. Such a change is generally attributable to a change in the perceived creditworthiness of the issuer.

Credit derivatives are represented as a notional long or short position in the specific risk of the reference asset. If premium or interest payments are due under the swap, these cashflows are represented as a notional position in a Zone A government bond with the appropriate fixed or floating rate coupon.

Netting

A firm may net long and short positions in the same equity, debt and derivative instruments (under Chapter 10 rule 10-83 for equities based instruments and rule 10-102 for interest-rate based products) before the specific risk charge is applied to the resultant net long or short position. **Instruments are considered to be the same where the issuer is the same, they have equivalent ranking in liquidation, and the currency, coupon and maturity are the same.** These netting criteria are taken from Annex I (Position Risk) of the Capital Adequacy Directive (“CAD I”)

Specific risk offset

Firms may net notional specific risk positions in reference assets resulting from credit derivative positions against actual positions in the reference asset or other notional positions created by other credit derivatives providing the conditions set out in rules 10-83 or 10-102 are met (see ‘Netting’ above).

Example 1

A firm holds a position of £10mn nominal of XYZ Ltd 6% 2004 bond. The firm has bought protection (short credit risk) on this bond with a £10mn notional credit default swap referenced to this bond. The maturity of the credit default swap is 2004.

Under rule 10-102(1) the firm may net the notional position in specific risk created as a result of the swap against the actual position in the bond leaving a flat position. Therefore no specific risk charge is incurred. As credit default products do not attract a general market risk charge, general market risk is calculated on the cash position only.

Example 2

A firm has sold protection (long credit risk) via a credit default swap on £5mn notional of ABC Ltd 8% 2000. It has backed out the risk by buying £5mn of protection on the same reference asset. Documentation relating to the two transactions is identical.

Again, under rule 10-102(2) the firm may net the long and short notional positions in the reference asset leaving a flat position. No specific risk charge is incurred.

Maturity Mismatch

Where a credit default product or credit linked note is of shorter maturity than the reference asset, a specific risk offset is allowed between the long and short specific risk positions. However, the unhedged period creates a forward position in specific risk of the reference asset. The net result is a single specific risk charge for the longer maturity position in the reference asset. This is the treatment agreed with the UK Supervisory Group on Credit Derivatives.

Note: This treatment does not apply to total return swaps, where no forward position in specific risk of the reference asset is recorded in cases of maturity mismatch because of the way the TRS resets, i.e. the TRS will compensate for movements in the market value which go beyond that of a

credit event (a CLN/CDS will only provide protection at maturity where there has been a credit event).

Example

A firm is holding £3mn DEF Ltd 8.5% 2003 bond. It hedges this position by entering into a credit default swap referenced to this asset but with maturity of 2002.

The notional position in specific risk resulting from the credit default swap may be netted against the actual position in the bond. However, after 2002 the position is unhedged. This results in a forward position in the specific risk of the reference asset. An appropriate specific risk charge should be applied to the longer maturity position in the reference asset from commencement of the transaction.

Asset Mismatch

Where a firm enters into a credit derivative hedge referenced to an asset other than the underlying asset they are seeking to hedge, there is basis risk between the reference asset and the underlying asset. Specific risk offsets are not available under the standard FSA rules in the case of an asset mismatch.

If a firm is hedging a long position in a credit default option with a short position, specific risk offsets are available only if the two notional positions in the reference assets meet the requirements of Rule 10-102(3).

Example

A firm hedges £3mn GHI Ltd 7% 2005 bond by buying protection via a credit default swap. The maturity of the swap matches that of the underlying asset, however the swap is referenced to GHI Ltd 10% 2005 bond.

The short notional position created as a result of the swap is not eligible for netting against the underlying position as it does not meet the netting criteria of rule 10-102. Unlike the situation with maturity mismatches where some netting benefit is recognised, two specific risk charges must be calculated – one on the underlying asset and one on the notional position.

ANNEX F
Amendments to IPRU(INV) 13

- A. In rule 13.5.2 number each sub-paragraph as (1), (2) and (3).
- B. In Table 13.6.2(2), under the heading "Special Limits", delete the second indented paragraph and replace with:
- "- (where any excess has lasted for more than 10 days)
that excess, or the total of such excesses,
must not exceed 600% of the *firm's* own funds."

- C. After rule 13.12.5 insert a new rule 13.12.5A:

"A *Category B firm* must treat as a liability in the calculation of its financial resources any amount by which the sum of 13.12.5(1) exceeds the product of 13.12.5(2)."

ANNEX G

Changes from SFA Board Notices referred to in the Table in Annex A
in designating the guidance contained in them

Appendix 62

~~Board Notice 292~~

NETTING

~~20 December 1995~~

GUIDANCE

**~~This Board Notice applies to all firms subject to the
counterparty risk requirement rules~~**

Introduction

~~This board notice supplements Board Notices 228 and 249 by giving guidance on the netting of counterparty exposures for purposes of the counterparty risk rules. ISD firms should note that whilst SFA wishes to allow netting from 1 January 1996, should the "Netting Directive" not be passed by the European Parliament prior to that date SFA may not be permitted to allow such netting for products covered by the Solvency Ratio Directive. SFA will keep firms informed of developments. This guidance will apply:~~

- ~~(1) from 1 January 1996 (or such later date as the "Netting Directive" shall be passed by the European Parliament) to firms which are subject to the Investment Services Directive (ISD) and Capital Adequacy Directive (CAD), and should therefore be read in the context of Board Notice 249; and~~
- ~~(2) upon the confirmation of Board Notice 228 which sets out the amendments to the current counterparty risk rules to be followed by Non-ISD firms (i.e. those firms which do not fall within the definition of "investment firm" in the ISD) who will continue to be subject to SFA's existing Chapter 3 financial rules.~~

Similar Types of Transactions

The rules set out the requirements to be met by firms before offsetting exposures in 'similar types of transactions' with a counterparty (i.e. being those transactions falling under a particular counterparty risk rule). The netting of exposures within a particular rule is to be applied on a first in first out basis. ~~SFA is presently considering cross-product netting and will issue guidance on this at a later date.~~

Derivative Transactions

Firms may offset the negative replacement cost on written OTC options against the positive replacement cost of OTC purchased options with the same counterparty. ~~This form of offset will be incorporated into rule X-174(6) at a later date.~~

General Waiver

~~SFA has granted until 1 March 1996 a waiver of the netting requirements where a firm wishes to offset transactions in derivatives listed on an exchange or cleared through a clearing house with a counterparty. After this date firms must comply with rule book requirements in order to net exposures to counterparties in exchange traded derivatives.~~

~~For repurchase and reverse repurchase, securities lending and borrowing and sale and buy back agreements SFA will give firms until 1 March 1996 to put in place the required independent legal opinions.~~

Contents of this Notice

~~The Schedule to this Notice contains Appendix X to the financial rules which will implement the CAD as set out in Board Notice 249 and which also applies to Board Notice 228.~~

Questions

~~Any questions regarding the contents of the Notice should be directed to Larry Aylward or John Paul Dryden of the Financial Risk Division (telephone 0171-378 9000).~~

~~**BY ORDER OF THE BOARD
W. NIXON
SECRETARY**~~

Appendix X – Guidance On The Netting Of Counterparty Exposures

Introduction

1. This appendix contains guidance on the requirements to be attained in order for firms to net counterparty exposures assessed under the following areas.

Subject
Cash against documents transactions
Free deliveries of securities
Repurchase and reverse repurchase, securities lending and borrowing and sale and buy back agreements
Derivative transactions
Other amounts owed to a firm arising out of trading book business

Scope

2. The guidance applies to any firm subject to the CRR rules and which takes advantage of the netting provisions contained therein.

Background

3. Agreements which can effect set-off of counterparty exposures exist in two forms—
 - (a) novation agreements (referred as netting by novation) which replace existing contracts with one new contract and therefore can only be used to cover similar transactions with payments in the same currency for the same value dates; and
 - (b) netting agreements which can be used to cover transactions of very different types.

The guidance below applies to both novation agreements and netting agreements.

Principles of Offset

4. Before offsetting exposures in similar types of transactions with a counterparty a firm must have a contractual netting agreement with that counterparty which—
 - (a) covers the transactions which the firm is seeking to net;
 - (b) creates a single obligation in each currency or a single obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances;
 - (c) does not include a walkaway clause; and
 - (d) is supported by written and reasoned independent legal opinions to the effect that, in the event of a legal challenge, the relevant courts would find the firm's exposure to be the single net amount mentioned in (b) above.

Statement of Law on Netting

5. The prerequisite of holding a netting agreement supported by an independent legal opinion in order to offset exposures is not required where the Financial Law Panel's (November 1993) Statement of Law on netting applies. This Statement of Law indicates that under English law rule 4-90 of the Insolvency Rules 1986 imposes a requirement for complete set-off of transactions between parties incorporated in England and Wales, provided the transactions are mutual (i.e. credits, debts or claims arise from dealings between the same parties and that the parties are acting in the same capacity). Furthermore, it indicates that set-off is mandatory, applies whether

or not there is any contractual entitlement to set-off and cannot be excluded by agreement between the parties.

6. As mentioned above mutuality is required in order for there to be complete set-off of transactions. Accordingly, firms are expected to have procedures in place to identify the counterparty and the capacity in which the counterparty is acting. Firms proposing to rely on the Statement of Law on netting must satisfy themselves of the appropriateness of such reliance and, where in doubt, obtain legal advice. It is important to note that the Insolvency ~~Rules~~ Rule 4.90 do not apply to building societies, statutory organisations generally, mutual societies, partnerships and individuals.

Legal Requirements

7. Legal opinions ~~must relate to the~~ will be needed for the:
 - law of the jurisdiction in which the counterparty is organised;
 - law of the jurisdiction in which any branch involved is located;
 - law that governs the agreement and, if different, the law that governs individual transactions pursuant to it; and
 - law that governs the legal status of the counterparty who is entering into transactions of the type which the firm is seeking to net.
8. Where a firm uses an industry standard agreement which contains netting/set-off clauses the firm may rely only on a legal opinion relating to the netting/set-off clauses in that standard agreement where no amendment has been made to the agreement which would materially affect these clauses and where the legal opinion addresses the capacity of counterparties of the type with which the firm wishes to contract, the contract type and the relevant jurisdictions.
9. Where a netting agreement provides that one or both parties may enter into transactions with each other under the agreement through any of its (or certain designated) branches, then all such branches included in the agreement will be considered to be located in relevant jurisdictions for the purpose of this guidance.
10. Where a netting agreement involves more than one jurisdiction, a legal opinion is required for each to the effect that the agreement creates a single obligation in each currency or a single obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances.
11. As mentioned above legal opinions should relate to the law of the jurisdiction in which the counterparty is organised (i.e. incorporated or resident). However, certain circumstances may arise where this requirement could be considered not to be applicable; for example where:
 - a firm has no assets or exposure in that jurisdiction;

- any judgement obtained in that jurisdiction against a firm would not be enforceable under any of the rules in the UK relating to the enforcement of foreign judgements; or
 - there are no other factors relating to that jurisdiction which would affect the ability of a firm to make net payments as contemplated by the netting agreement.
12. Where a firm believes that the law of the jurisdiction in which a counterparty is organised is not relevant, that point must be addressed in the legal opinion supporting the netting agreement. The ability to exclude the law of the jurisdiction in which a counterparty is organised does not extend to the netting of those off balance sheet exposures listed in the Solvency Ratio Directive⁴: the amendment to this directive (to permit netting) specifically requires this matter to be addressed in the legal opinion.

~~4 Off balance sheet products subject to the Solvency Ratio Directive (as per Annex III) include:~~

~~**Interest rate contracts**~~

~~**Foreign exchange contracts**~~

- ~~-single currency interest rate swaps~~
- ~~-Cross currency interest rate swaps~~
- ~~-Basis swaps~~
- ~~-forward foreign exchange contracts~~
- ~~-Forward rate agreements~~
- ~~-Currency futures~~
- ~~-Interest rate futures~~
- ~~-Currency options purchased~~
- ~~-Interest rate options purchased~~
- ~~-Other contracts of a similar nature~~
- ~~-Other contracts of a similar nature~~

-
13. It is recognised that, with certain aspects of the agreement, it may not be possible to obtain a definite opinion or that a positive opinion regarding enforceability of the netting agreement can only be obtained subject to certain assumptions and/or qualifications. Where qualifications are made, they should be specific and their effect adequately explained. In the same way, assumptions should be specific, of a factual nature (except in relation to matters subject to the law of a jurisdiction other than that covered by the opinion) and should be explained in the opinion.
14. Legal opinions on netting agreements must be obtained from independent legal advisers with sufficient expertise and experience in this area of law. Opinions from in-house counsel will not be acceptable. Where the regulator in

the jurisdiction of the counterparty is satisfied that the netting agreement is not enforceable under the laws of that jurisdiction, the netting agreement cannot be relied upon regardless of the opinions obtained by a firm.

Compliance with the Legal Requirements

15. It is the responsibility of firms to ensure that the legal requirements set out above are met (firms are to calculate CRR on the gross value of exposures to counterparties where this is not the case). Firms do not need to apply to ~~SFA~~ the FSA in order to net exposures. Similarly, legal opinions on netting agreements and the agreements themselves are not required to be submitted to ~~SFA~~ the FSA for approval. ~~SFA~~ The FSA will establish the existence of legal opinions and netting agreements when compliance with the above requirements is being monitored by ~~the Surveillance Division~~ its staff.
16. Firms are expected to put procedures in place to ensure that the legal characteristics of netting arrangements are kept under review in light of possible changes in the relevant law.
17. Firms are expected to maintain records demonstrating that, in relation to the legal requirements, the following considerations have been addressed:
 - the applicability of the netting agreement to the counterparties, jurisdictions and transactions involved;
 - the applicability of the opinions to the counterparties, jurisdictions and transactions involved;
 - where more than one jurisdiction is involved, the potential for conflicts in law;
 - all documentation is complete and still valid and that the agreement has been properly executed (i.e. that the acceptance of terms have been evidenced);
 - the nature and effect of any qualifications in the legal opinions and assessment that these do not impair the obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances; and
 - where an industry standard agreement is used upon which a generic legal opinion has been obtained, identification of those clauses which if altered during the course of negotiating the agreement would affect the right to offset. Internal legal counsel is to evidence review of these agreements to ensure that the effectiveness of the set off clauses has not been altered directly or indirectly by virtue of other clauses being added or deleted.
18. Firms are expected to hold a copy of the legal opinion and the agreement to which it relates.

19. Firms are to net exposures within a particular rule on a FIFO basis. Firms may net only current exposures and cannot net potential future exposures.

~~Board Notice 353~~

CROSS-PRODUCT NETTING

~~9 August, 1996~~

INFORMATION

~~THIS BOARD NOTICE APPLIES TO FIRMS WHICH ARE FINANCIALLY REGULATED BY SFA~~

Introduction

~~SFA~~ The FSA wishes to publicise that it will consider granting rule waivers in order to permit firms to take account of cross-product netting in the calculation of their Counterparty Risk Requirement (CRR) in instances where ~~SFA~~ the FSA regards it appropriate.

The current drafting of ~~SFA's~~ the FSA's Financial Rules for securities and futures firms allows 'similar' types of transactions to be netted (where those transactions are covered by a valid netting agreement, with a supporting legal opinion). In practice, 'similar' has been defined as all transactions which fall within a particular CRR Rule treatment. Thus, currently, for the calculation of CRR in relation to exposures to a counterparty which are covered by valid netting arrangements, a firm would be required to assess, for example, a net exposure for all derivative transactions with that counterparty and a separate net exposure for all repo type transactions with that counterparty.

~~Board Notices 292 and 293 which were published in December 1995, stated that 'SFA is currently considering cross-product netting'. Until a full review of the netting allowances in SFA's CRR Rules has been undertaken, SFA is willing to entertain applications for waivers. Waivers will be granted at SFA's discretion, though as a matter of general guidance, the following requirements must be met:~~

The FSA will consider granting waivers in accordance with SUP 8, though in general it will expect the following conditions to be met:

1. For the types of transaction which the firm is seeking to net, the firm must have the capability to monitor, and must in practice manage, the resultant exposures on a net basis.
2. All transactions which the firm is seeking to net must be covered by valid netting agreements and supported by legal opinions, in accordance with the requirements of ~~SFA~~ the FSA's Financial Rules; and
3. Where underlying netting agreements are linked by a master netting agreement, the legal opinion must address the enforceability of the netting arrangements in their entirety;

One factor that ~~SFA~~ the FSA will consider in assessing whether a particular applicant meets these requirements is whether the firm has had the use of its ACMP sanctioned for the purposes of calculating CRR.

~~Applications for Waivers~~

~~Applications for waivers should be made in writing with all pertinent details of product types and netting arrangements to Sarah Varney (0171 378 5758) or John Paul Dryden (0171 378 5756) of the Financial Risk Division.~~

~~Questions~~

~~Any questions regarding the contents of the Notice should be directed to Sarah Varney or John Paul Dryden, as above.~~

~~BY ORDER OF THE BOARD~~
~~W. NIXON~~
~~SECRETARY~~

Appendix 63

GUIDANCE ON CREDIT DERIVATIVES

THIS APPENDIX APPLIES TO ISD FIRMS WHICH TAKE, OR INTEND TO TAKE, POSITIONS IN CREDIT DERIVATIVE PRODUCTS

Board Notice 414

~~GUIDANCE ON CREDIT DERIVATIVES~~

~~THIS GUIDANCE APPLIES TO ISD FIRMS WHICH TAKE, OR INTEND TO TAKE, POSITIONS IN CREDIT DERIVATIVE PRODUCTS~~

17 April 1997

INTRODUCTION

Over the past few years, there has been an increasing amount of interest and activity in credit derivatives, a class of products that includes credit-linked notes, total return swaps and default options and swaps. For at least some of these products, the commodity being traded is 'pure' credit risk. Through these instruments firms are no longer seeking to contain a risk which is incurred as a by-product of their mainstream trading activity, but are increasingly moving towards trading that very risk. The FSA ~~SFA~~ ~~has always~~ ~~required~~ firms to operate robust internal control systems; the advent of credit derivatives highlights the need for increased vigilance in the assessment, monitoring and control of market risk, credit risk and operational risk. **The primary purpose of this Appendix Board Notice is to underscore the importance of internal control procedures, particularly in circumstances where firms are trading new risks, or new combinations of risk.**

In addition, this ~~Board Notice~~ Appendix gives some general guidance on capital issues. The non-homogeneity of products under the umbrella term 'credit derivatives' makes it difficult for ~~SFA~~ the FSA to write explicit rules which cover all circumstances. Furthermore, an apparently small change in contract specification might require a significant change in capital treatment. Matters are further complicated by constraints on regulatory capital treatment imposed by European Directives.

To date, ~~SFA~~ the FSA has provided guidance to firms on an ad-hoc basis, and it intends to continue with this practice for the time being. That said, ~~SFA~~ the FSA is able to give a flavour of the capital treatments by way of the brief explanations and examples below. This should not, however, be taken as a definitive guide. **Any firm which has positions in credit derivatives, or intends to acquire such positions, should seek advice from SFA the FSA on the capital to be set aside for regulatory purposes.**

INTERNAL CONTROL ISSUES

Most of the risks to which credit derivatives give rise are familiar, as the same types of risk are present in longer-established instruments. However, they may be present in different combinations in new credit products, and this can add challenges to the manner in which risk is measured, monitored and controlled. For this reason it is of particular importance that any firm engaging in credit derivatives, or one which is intending to undertake such activity, considers whether additions or amendments to established procedures and control routines are required in order to capture and monitor the particular combinations of risks inherent in the products they intend to trade.

The following remarks are not intended as an exhaustive review of the matters which firms may need to address in considering the control of their credit derivatives business, but are merely illustrative of some of the issues which are pertinent. While they relate primarily to credit default type products, many of the considerations will be equally applicable to other credit derivative structures. Firms should also note that procedures for the control of credit derivatives cannot be viewed in isolation: they must mesh seamlessly with the procedures in place for the control of other forms of risk.

New product approval

Before a firm enters into any new type of business, it must ensure that it has in place systems and controls that are adequate to record and monitor the risks of that business. Control issues should be addressed by the firm's senior management, although the level and nature of the controls to be considered during the new product approval process will depend on a variety of factors, including the type and volume of business that will be entered into.

Among the factors which should be considered during the new product process are the following -

- whether the new business falls within the risk appetite of the firm, as established by the Board or equivalent management body;
- an exact description of the type of products to be introduced;
- accounting policies (which firms may wish to discuss with their external auditors);
- valuation methodology, and systems for ensuring that this policy is adhered to;
- authority and level of knowledge of risk managers and/or independent price-checkers;
- format and content of risk reports;
- limits, and systems for measuring and monitoring usage of those limits;
- type of documentation to be used, and other legal risks;
- clearing and settlement procedures;
- adequacy of the firm's computer systems for representing the new transaction type(s);

- reliance on key staff;
- risks arising from the remuneration strategy.

Senior management should approve the procedures and controls and management at all levels must understand and enforce them.

Risk appetite

It is crucial that a firm understands the risks to which credit derivatives give rise, and that resulting exposures are consistent with the overall risk appetite of the firm, as approved by the Board or equivalent management body. At the highest level, firms will need to consider their objectives in using such instruments. Are they buying and selling credit protection in order to diversify or hedge their portfolio of credit risk? Are they offering credit protection to others, thereby incurring risks which may need to be hedged? Are they seeking to make a turn from buying and selling credit protection? Or, as is most likely, a mixture of all three? The level of control required will, as ever, be a function of the trading strategy.

Understanding the products

Although many of risks to which credit derivatives give rise are familiar, it is important to understand the significant differences between these instruments and more traditional products of a similar nature.

For example, many commentators have drawn parallels between credit derivatives and products such as guarantees or insurance. While some credit derivatives exhibit many of the characteristics of both of these instruments, it is important to recognise a credit derivative as a product in its own right with its own set of associated risks. An over-reliance on similarities between products can lead to the obscuring of genuine differences between their risk characteristics.

Many default options have an economic structure similar to that of guarantees: if issuer A defaults in the repayment on maturity of a bond held by Firm X, Firm X can immediately put the defaulted bond to Firm Y at par in exchange for full payment. It is tempting to see this as analogous to a first on demand guarantee, where on a default by the guaranteed party the guarantor pays the guaranteed party's debt as if it were its own.

However, there is a strong argument that the legal risk in the derivative transaction is greater than that in the guarantee, since guarantee documentation has been tested in the courts over centuries, whereas the default option documentation is as yet untried. It can therefore be argued that while the economic intent may be similar in the two products, there is greater risk engendered by following the credit derivative path rather than the well-trodden guarantee route.

Given that the market is still in a fairly early stage of development, and that structures and terminologies are not yet standardised, participants should be aware of the transactional risks involved and ensure that they have fully understood (and exchanged confirmation of) the exact commercial terms of the transactions entered into.

Credit approval

Firms will need to consider the mechanisms in place for approval of the acquisition of credit risk. Will the sale of credit protection be subject to appropriate levels of credit approval, and will the process be the same as that for other credit exposures the firm incurs? Is the approval process separate from the dealing function? Are those making the decisions fully aware of the particular risks of credit derivatives? It would plainly be dangerous for product originators, whose prime motivation will often be the provision of innovative financial engineering solutions for clients, to be committing the firm to acquiring risk, without the nature of that risk being fully understood, and consequently approved, by those responsible for the protection of the firm's assets. There may be a need for education of those making credit decisions in the peculiar risks inherent in credit derivatives, particularly if the decision to incur risk is truly to be kept separate (in management terms) from those who are trading it.

Mismatches and imperfect hedges

In documenting credit derivatives, firms should review the degree to which default criteria match in the reference asset and the derivative. In the simplest asset structures, mere failure to pay constitutes default; if this is matched in the derivative the credit hedge is clearly highly effective. If, alternatively, further conditionality is imposed in the default criteria of the derivative - for example, the payoff is triggered only when a payment has failed and this fact has become public and the price of the underlying has been affected by more than a certain amount - then the hedge is less effective.

Consideration should also be given to maturity mismatches. Where the underlying credit exposure continues beyond the maturity of the hedge, firms may wish to consider the appropriate exposure reporting treatment. For example, where the underlying credit risk is deteriorating, and default is considered probable, but not before the expiry of any protection held, is it prudent to consider the risk to be transferred at all? Arguably not only is the risk not transferred, but firms should be giving consideration to provisioning.

Where firms sell credit protection, the question of the firm's rights in a receivership or bankruptcy will be crucial. For example, if a firm receives an underlying bond when it is called under any protection sold, then it will clearly have rights in any eventual receivership. However, a structure where a firm merely undertakes to pay an amount to a protection buyer in the event of the default of the reference asset, and the protection seller acquires no rights in bankruptcy against the defaulting party, will have a wholly different risk profile.

The degree of correlation between the default of the reference asset and that of the protection seller must be considered. Where the two are highly correlated, it will plainly be inappropriate to regard the risk as effectively transferred. Would it be prudent to consider exposure to a sovereign issuer to be reduced by the purchase of protection from an entity located in the same country? Is protection sold by a subsidiary a valid hedge against a parent company exposure? (In the latter case firms may also wish to consider any legal restrictions which there may be on the support of parent companies by subsidiaries).

None of the foregoing is to say that firms should not enter in to imperfect credit hedges, merely that they should be aware of the risks involved in doing so, and ensure that these are reflected in the monitoring and review procedures applied.

Monitoring of credit exposures

A firm's systems must be capable of aggregating credit exposures arising from credit derivatives with other exposures to a given entity. Furthermore, systems must be capable of reflecting the "dual" credit risk exhibited by many credit derivatives: where protection is bought for an asset held in the firm's portfolio, the firm has credit exposure both to the issuer of the reference asset and to the protection seller. Similarly, where cash flows are swapped, a firm may acquire a dual risk, depending on the exact nature of the structure. Firms should ensure that they have monitoring systems which are capable of reflecting this dual risk, so that exposure to both the issuer of the reference asset and to the protection seller can be monitored.

Credit review and provisioning procedures

In considering the ongoing credit review of exposures, firms will again need to address the dual nature of the exposure to which most credit derivatives give rise. They will need to review both the financial strength of the underlying credit risk and the creditworthiness of the protection seller from whom protection has been bought. In this regard firms may wish to investigate fully the rights they have to financial information on the underlying credit risk and whether any restrictions in access to information would put a seller of protection at a disadvantage compared to a holder of the underlying credit risk, and whether any such disadvantage significantly alters the risk profile. Plainly where there is a lack of transparency, and firms may not be party to information which holders of the reference asset may receive, there will be a need for greater vigilance in monitoring.

Traditionally, securities houses have rarely become involved in "work outs". However, where firms become the ultimate bearer of the credit risk of a certain counterparty, they will need to consider whether they have the necessary expertise in insolvency to make the best recovery possible. While it can be argued that even defaulted instruments can be sold "at a price", such a sale may result in greater financial loss than if the firm managed the recovery itself.

Scenario testing

It is important that any firm which incurs significant trading risk undertakes a rigorous and comprehensive programme of scenario testing covering all major types of risk, including market risk, credit risk and operational risk. Routine scenario testing should be undertaken in order to aid the measurement and control of risks in 'normal' circumstances. In addition 'stress' scenarios should be designed to test the potential for losses under extreme conditions, or to highlight possible risk control problems that may arise. These should include -

- abnormal market movements;
- periods of inactivity or illiquidity; and
- the break-down of key assumptions.

Individual firms will need to devise tests which are meaningful to their particular situations; in each case the criteria should explicitly identify plausible events or influences to which the firm could be exposed. Of crucial importance in the case of credit derivatives is that the results should be capable of clear interpretation even where, by the very nature of the instruments, the distinction between market risk and credit risk becomes somewhat blurred. In addition, credit pricing is evolving as the derivatives market develops, and subjective judgements may need to be made in order to price or mark to market these instruments, which may in turn affect the performance of the hedge. Such judgements should be routinely reviewed and their potential effect included within the scenario testing.

The results of scenario testing should be regularly communicated to senior management, and to the Board or equivalent body, and should be reflected in the policies and limits set by management.

Reality testing

The essence of reality testing is the comparison of actual trading results with expected outcomes. Firms are familiar with the idea of checking whether their assumptions about the direction of markets have held, but have been slower to apply similar techniques to credit spreads, ratings migration and default.

Any firm which incurs credit risk in its trading activities should ensure that it has a mechanism to test whether, and to what extent, its assumptions have been robust. There should also be a recognised route for the results of reality testing to feed back into the process governing the way in which the firm limits its risk-taking activity.

REGULATORY CAPITAL TREATMENT

Some of the products which are by common consent termed credit derivatives are covered by ~~SFA's~~ the FSA's rules (for example, options on an individual bond or equity). Other instruments, however, show characteristics of a type not explicitly covered by the rules, and for these products ~~SFA~~ the FSA has in the past provided guidance on an ad-hoc, though consistent basis. Both the credit derivatives market, and indeed the international regulatory capital regime, are evolving, and ~~SFA~~ the FSA does not believe it is appropriate at this stage to propose rule changes to accommodate the full range of new products.

The following paragraphs outline the general approach which ~~SFA~~ the FSA will follow, and show the way in which capital charges might be calculated for some given examples of transactions. However, **any firm with a position in a credit derivative product should seek guidance on its treatment from ~~SFA~~ the FSA.** There is as yet little standardisation of products, and an apparently small difference in specification might require a significant change in capital treatment. Furthermore, ~~SFA~~ the FSA is constrained by the requirements of the Capital Adequacy Directive, and associated pieces of legislation; it is possible that what seems a common-sense approach could be illegal.

Mark to market

Valuation is fundamental to the question of capital adequacy, as it has a direct effect on firms' financial resources. ~~SFA~~ The FSA requires marking on a 'close-out' basis - a long

position should be valued at the bid side of the market, and a short position at the offered side. Where a product is illiquid, the bid-offer spread available in the market will tend to be wide, and this must be reflected in the mark to market value. Firms are also required to take account of factors such as the size of the position. For example, if the size is larger than that for which a market bid-offer spread would hold, the spread must be widened to take account of this.

Credit derivatives offer certain additional challenges to the valuation process, but ~~SFA~~ the FSA believes that the principles remain the same. There are many products commonly traded by authorised firms which, because of their peculiar characteristics, are complex to value, but which ~~SFA~~ FSA nonetheless requires to be marked to market. In all cases, the valuation must reflect the level at which a firm realistically expects to be able to liquidate the position. Where there is any uncertainty, the overriding principle is that of prudence.

Notwithstanding this, the reliability of the pricing process for some credit default products may leave regulators with a residual concern. For this reason, **a firm's proposed methodology for marking to market must be agreed with ~~SFA~~ the FSA**. In extreme cases, ~~SFA~~ the FSA may require extra buffers to be included in the valuation, and may even restrict any unrealised profit from inclusion in a firm's financial resources.

For the sake of clarity it should be noted that all credit derivatives must be marked to market, whether or not they are trading book positions, and that they must be marked on a close-out basis.

Trading book/non-trading book

~~The FSA~~ SFA believes that it is likely that most credit derivative transactions entered into by firms will be trading book items, and will therefore be subject to PRR and CRR. Some firms are aiming to develop a two-way market, and others have bought protection for specific assets or asset classes in their trading book. Where a credit derivative position is clearly not a trading book item, it will be subject to a liquidity adjustment of either 100% or 8% (depending on which method a firm uses to calculate its financial resources).

Position Risk Requirement

Most credit derivative products can be slotted into the standard calculation methodologies (i.e. equity methods 1-4, and interest rate methods 1-3). The PRR calculation is divided into two distinct parts, being 'general market risk' and 'specific risk'. Some credit default products may not give rise to general market risk; where this is the case, instruments are likely to incur only the specific risk component of the relevant PRR charge.

Example 1: Credit default option

Firm A purchases option from Firm B.

A Credit Event is defined in terms of the default of XYZ Co. 8% notes 1999. Should a Credit Event occur, Firm B will pay Firm A £1m against delivery of £1m nominal of XYZ Co. 8% notes 1999.

For firm A -

General market risk: Nil

Specific risk: PRA of reference asset * nominal amount

Where the default protection is embedded in a credit-linked note issued by a third party, it is likely that both general market risk and specific risk charges will apply. Since there is a dual issuer risk, two specific risk charges should be calculated.

Example 2: Credit-linked note

Firm A holds a note issued by ABC Co, maturity 5 years, coupon 8%.

Should a Credit Event occur, the note is terminated. The Credit Event is defined in terms of the default of a bond issued by a third party - XYZ Co.

General market risk: 5 year PRA for relevant currency * mark to market value of note.

Specific risk: (PRA ABC Co + PRA XYZ Co) * mark to market value of note.

A total return swap should be treated as two notional positions, representing respectively the interest rate leg, and a position in the reference asset.

Example 3: Total return swap

Firm A pays 3 months LIBOR and any price depreciation on 100 XYZ Co shares;

Firm B pays dividend and any price appreciation on 100 XYZ Co shares.

Firm A: short debt equivalent position at three months; long equity equivalent position in 100 XYZ Co.

Firm B: long debt equivalent position at three months; short equity equivalent position in 100 XYZ Co.

Firms are reminded that if they are in any doubt as to the appropriate PRR treatment for any position or exposure, they should seek guidance from ~~SFA~~ [the FSA](#).

Offset for capital adequacy purposes

The Capital Adequacy Directive allows the competent authorities to recognise certain offsets for general market risk, but requires that the specific risk charge is applied to gross positions.

Where a position in a credit derivative has been represented as a notional debt or equity position, it automatically becomes eligible for the netting provisions set out in 10-83 and 10-102.

Example 4: Total return swap + hedge

Firm A pays 3 months LIBOR and any price depreciation on 100 XYZ Co shares;

Firm B pays any price appreciation and dividends on 100 XYZ Co shares.

Firm A is short 100 shares in XYZ Co.

Firm A's long equity equivalent position arising from the swap may be netted with its short position, giving rise to a zero PRR for the equity position.

PRR must still be calculated on the LIBOR leg.

Where a firm has a position in a credit default product that incurs only a specific risk charge, together with a position in the reference asset, ~~SEA~~ the FSA may permit the two specific risk charges to be offset, provided that the credit events specified in the default product are to all intents and purposes the same as those specified for the reference asset.

Example 5: Credit default option + position in reference asset

Firm A holds option described in example 1.

Firm A is long £1m nominal XYZ Co. 8% notes 1999.

General market risk: 2 year PRA for relevant currency * mark to market value of bond.

Specific risk: nil

There may be other circumstances in which it is both legal and appropriate to recognise the hedging benefits of certain credit derivatives. **Firms are encouraged to discuss individual strategies with ~~SFA~~ the FSA.**

Counterparty risk requirement

OTC credit derivatives, whether structured as swaps or options, give rise to counterparty risk. CRR for most credit derivative transactions will fall under rule 10-174: the appropriate part of Table 10-174(3) to be used in calculating the 'credit equivalent amount' should be determined by the nature of the reference asset.

Example 6: Credit default option

Firm A purchases from Firm B the option described in Example 1.

Credit equivalent amount = replacement cost + £50,000 [i.e. 0.5% of £1m]

Some firms may use credit derivatives to reduce their exposure to a counterparty. EU law does not permit the recognition of such hedging in all cases, but ~~SFA~~ the FSA is prepared to consider on a case-by-case basis whether the protection provider may be substituted for the counterparty for the purposes of the CRR rules. **Firms wishing to investigate this possibility should contact ~~SFA~~ the FSA.**

Large exposures

Exposures incurred in both buying and writing credit derivatives should of course be taken into account for the purposes of calculating a firm's large exposures requirement. Where a firm holds an asset together with a hedge that is recognised as such by ~~SFA~~ the FSA, it may choose to calculate its large exposures capital requirement in terms either of the exposure to the underlying or of the exposure to the entity providing the protection. This is not an entirely free choice, however: firms must be consistent in how they view credit protection. For example, if the protection has been taken into account when calculating PRR, an exposure to the provider must be reflected for large exposures purposes.

For the purposes of internal and regulatory monitoring of large exposures, the exposure to both the reference asset and to the protection provider should be indicated.

Questions

~~Any questions regarding this Notice should be addressed to Rose Gibson, Financial Risk Division (Tel: 0171-378-5751).~~

~~**BY ORDER OF THE BOARD**~~

~~**W NIXON**~~

~~**SECRETARY**~~

Board Notice 482

~~GUIDANCE ON CREDIT DERIVATIVES~~

~~RULE CHANGE CONSULTATION DOCUMENT~~

~~THIS BOARD NOTICE APPLIES TO ALL ISD FIRMS~~

22 July 1998

Introduction

This Board Notice should be read in conjunction with the attached FSA Report of Consultation on Credit Derivatives which sets out the background to these policy proposals and details of the pre-consultation process undertaken with trade associations. Firms should be aware that FSA Banking Supervisory Policy Guidelines applicable to UK incorporated banks are to be published simultaneously.

Firms will recall that in April 1997 SFA published Board Notice 414: Guidance on Credit Derivatives – at a time when the UK credit derivatives market was nascent. The credit derivatives market has without doubt developed in the intervening period, but it is SFA's view that the policy which was detailed in Board Notice 414 remains appropriate and in particular, emphasis on the overarching importance of robust internal controls for firms which are dealing in such products. Firms will recall that Board Notice 414 gave guidance on (inter alia): new product approval processes including the importance of full consideration of legal risks (including netting and offset) and appropriate documentation; risk appetite; understanding the products; credit approval processes; mismatches and imperfect hedges; monitoring of credit exposures; credit review and provisioning procedures; scenario testing and reality testing. Further, it is repeated that **'any firm which has positions in credit derivatives, or intends to acquire such positions, must agree with SFA its regulatory valuation methodology and should seek advice from SFA on the capital to be set aside for regulatory purposes'**.

However, over the intervening period, SFA and FSA (former Bank of England) have, in informal consultation with ISDA, LIBA and the BBA, considered whether it would be appropriate to amend guidance given to date, or indeed to make rules changes. **Firms are referred to the attached FSA Report of Consultation on Credit Derivatives Board Notice for further detail on the background to the policy proposals contained in this Board Notice.** FSA Banking Supervisory Policy Guidelines applicable to UK incorporated banks are to be published simultaneously to this Board Notice. The Banking Guidelines are not attached, but may be obtained by application to the FSA Publications Department, 25 The North Colonnade, Canary Wharf, London

~~E14 5HS. Firms should note that credit derivatives policy of SFA and FSA/Bank of England is now more closely aligned than formerly and it is intended that this process of alignment will continue. In addition, it is clear that further careful consideration must be given to what development of the international regulatory capital regime is desirable.~~

~~Rule Change~~

~~The schedule to this Board Notice details a change to the CRR Rules applicable to OTC derivatives (Rule 10-174). Whilst this change came out a review of the regulatory treatment of credit default derivatives, **firms should note that the change is applicable to all OTC derivatives referenced on bonds**. The result of the change is that firms will be required to calculate a credit equivalent amount (credit exposure) with reference to the potential future “add-on” applicable to equity derivatives for derivatives referenced on bonds which do not meet the criteria for a “*qualified debt security*”. For derivatives referenced on bonds which are “*qualifying*” firms may continue to calculate CRR using the relevant interest rate “add-on”. Guidance~~

~~The following paragraph provides additional general guidance on the regulatory capital treatment of some credit derivatives. This is complementary to the guidance issued in Board Notice 414:~~

~~1. Multiple name risk~~

~~Where a firm is exposed to issuer risk of more than one issuer, for example where writing a credit default derivative which pays out on the default any one of a number of specified instruments: in general PRR should be calculated with reference to the aggregate of the specific risk weightings of the instruments in the reference basket (ie. on an additive basis).~~

~~However, in cases where the derivative instrument/credit linked note has been afforded a credit rating by a ‘relevant agency’ which accords with the definition of ‘*qualifying debt security*’ firms may apply to ~~SFA~~ the FSA to use the relevant single specific risk weighting from Appendix 53.~~

~~2. Risk assessment models~~

~~In the light of the forthcoming CADII package of directives, firms may also wish to consider whether to approach ~~SFA~~ the FSA for permission to use an appropriate risk assessment model as the basis for calculating regulatory capital requirements.~~

~~Contents of this Notice~~

~~This notice contains guidance on credit derivatives which is complementary to the guidance which SFA published in Board Notice 414.~~

~~In addition, this notice seeks to consult upon the rule change relating to the CRR treatment of OTC derivatives referenced on bonds. The rule drafting changes may be found in the schedule attached to this notice.~~

~~Costs of Compliance~~

~~Comments on the costs of compliance are sought from firms. SFA believes that the proposed change to the CRR rules may require some firms to incur costs as a result of systems changes. However, it is also SFA's view that, for the purposes of calculating potential credit exposure, application of the interest rate add-ons to derivatives on bonds which are not *qualifying debt securities* may not adequately reflect the specific risk of the reference asset (i.e. price movements in the underlying which would affect the derivative exposure during the close out period following a potential counterparty default).~~

~~Consultation Period~~

~~All comments relating to this Board Notice should be addressed in writing to the Secretary, the Securities and Futures Authority, at the above address, by 28 August 1998.~~

~~Firms are asked to note that FSA intends to implement the Banking Supervisory Policy Guidelines applicable to UK incorporated banks from 30 September 1998. It would be SFA's intention to issue confirmation of the rules changes proposed in this Board Notice shortly thereafter.~~

~~Questions~~

~~Any enquiries regarding the contents of this Notice should be addressed to: Sarah Varney Tel:(0171 378 5758) or Shane Henderson Tel:(0171 378 5735) of Complex Groups Division Policy Department.~~

~~**BY ORDER OF THE BOARD**~~

~~**W NIXON**~~

~~**SECRETARY**~~

[delete Schedule to Board Notice]

SPECIFIC RISK TREATMENT OF CREDIT DERIVATIVES

**~~SPECIFIC RISK TREATMENT OF
CREDIT DERIVATIVES~~**

~~CONSULTATION DOCUMENT~~

**~~THIS BOARD NOTICE APPLIES TO ISD FIRMS
WHICH ARE FINANCIALLY REGULATED BY
SFA~~**

~~16 August 1999~~

Introduction

~~SFA published its initial guidance to firms dealing in credit derivatives in Board Notice 414, issued in April 1997.~~

~~In the intervening period, SFA in conjunction with FSA (for UK incorporated banks), convened a UK Supervisory Group on Credit Derivatives, with a membership of some firms known to be active in this market and ISDA, LIBA and the BBA. The group considered the development of the market and technical expertise in this area, and in addition, issues relating to the regulatory capital treatment of these products.~~

~~Subsequently, in July 1998, SFA published consultation Board Notice 482 (an update to BN 414), together with the FSA Report of consultation on Credit Derivatives. At the same time, the FSA issued amended guidelines for banks. These documents demonstrate the alignment of SFA policy and guidelines for banks relating to credit derivatives and the development of policy within the current framing of the Basle Accord and European Directives.~~

~~**The primary purpose of this Board Notice**~~ **The following guidance** is to clarify the specific risk treatments applicable to 'plain vanilla' credit derivatives such as credit default products, total return swaps and credit-linked notes.

Where a firm has a position in a more complex credit derivative instrument for which no PRR treatment has been specified, the firm must immediately seek guidance from ~~SFA~~ the FSA. Until an appropriate treatment has been determined a PRR of 100% of the current *mark to market* value of the position must be applied.

GUIDANCE

Default Events

The following guidance applies only in circumstances where the default events, as drafted under the terms of the credit derivative, match those relating to the underlying reference asset. If default events are different, no hedging benefit should be recognised.

Specific Risk

Specific interest rate risk is the risk that the price of a specific security will change relative to prices of securities generally. Such a change is generally attributable to a change in the perceived creditworthiness of the issuer.

Credit derivatives are represented as a notional long or short position in the specific risk of the reference asset. If premium or interest payments are due under the swap, these cashflows are represented as a notional position in a Zone A government bond with the appropriate fixed or floating rate coupon.

Netting

A firm may net long and short positions in the same equity, debt and derivative instruments (under Chapter 10 rule 10-83 for equities based instruments and rule 10-102 for interest-rate based products) before the specific risk charge is applied to the resultant net long or short position. **Instruments are considered to be the same where the issuer is the same, they have equivalent ranking in liquidation, and the currency, coupon and maturity are the same.** These netting criteria are taken from Annex I (Position Risk) of the Capital Adequacy Directive ("CAD I").

Specific risk offset

Firms may net notional specific risk positions in reference assets resulting from credit derivative positions against actual positions in the reference asset or other notional positions created by other credit derivatives providing the conditions set out in rules 10-83 or 10-102 are met (see 'Netting' above).

Example 1

A firm holds a position of £10mn nominal of XYZ Ltd 6% 2004 bond. The firm has bought protection (short credit risk) on this bond with a £10mn notional credit default swap referenced to this bond. The maturity of the credit default swap is 2004.

Under rule 10-102(1) the firm may net the notional position in specific risk created as a result of the swap against the actual position in the bond leaving a flat position. Therefore no specific risk charge is incurred. As credit default products do not attract a general market risk charge, general market risk is calculated on the cash position only.

Example 2

A firm has sold protection (long credit risk) via a credit default swap on £5mn notional of ABC Ltd 8% 2000. It has backed out the risk by buying £5mn of protection on the same reference asset. Documentation relating to the two transactions is identical.

Again, under rule 10-102(2) the firm may net the long and short notional positions in the reference asset leaving a flat position. No specific risk charge is incurred.

Maturity Mismatch

Where a credit default product or credit linked note is of shorter maturity than the reference asset, a specific risk offset is allowed between the long and short specific risk positions. However, the unhedged period creates a forward position in specific risk of the reference asset. The net result is a single specific risk charge for the longer maturity position in the reference asset. This is the treatment agreed with the UK Supervisory Group on Credit Derivatives.

Note: This treatment does not apply to total return swaps, where no forward position in specific risk of the reference asset is recorded in cases of maturity mismatch because of the way the TRS resets, i.e. the TRS will compensate for movements in the market value which go beyond that of a credit event (a CLN/CDS will only provide protection at maturity where there has been a credit event).

Example

A firm is holding £3mn DEF Ltd 8.5% 2003 bond. It hedges this position by entering into a credit default swap referenced to this asset but with maturity of 2002.

the notional position in specific risk resulting from the credit default swap may be netted against the actual position in the bond. However, after 2002 the position is unhedged. This results in a forward position in the specific risk of the reference asset. An appropriate specific risk charge should be applied to the longer maturity position in the reference asset from commencement of the transaction.

Asset Mismatch

Where a firm enters into a credit derivative hedge referenced to an asset other than the underlying asset they are seeking to hedge, there is basis risk between the reference asset and the underlying asset. Specific risk offsets are not available under the standard ~~SFA-FSA~~ rules in the case of an asset mismatch.

If a firm is hedging a long position in a credit default option with a short position, specific risk offsets are available only if the two notional positions in the reference assets meet the requirements of Rule 10-102(3).

Example

A firm hedges £3mn GHI Ltd 7% 2005 bond by buying protection via a credit default swap. The maturity of the swap matches that of the underlying asset, however the swap is referenced to GHI Ltd 10% 2005 bond.

The short notional position created as a result of the swap is not eligible for netting against the underlying position as it does not meet the netting criteria of rule 10-102. Unlike the situation with maturity mismatches where some netting benefit is recognised, two specific risk charges must be calculated - one on the underlying asset and one on the notional position.

Cost of Compliance

~~Rule changes are not being introduced as a result of this Board Notice. This Notice provides guidance on the application of the current rules which are reflective of SFA's legal obligation to enforce the requirements of the European Directives.~~

Consultation Period

~~All comments relating to this Notice should be addressed in writing to The Secretary, the Securities and Futures Authority, at the above address, by 30th September 1999.~~

Questions

~~Any questions regarding the contents of this Notice may be directed to Barry Pope (0207 676 1824) or Peter Rose (0207 676 1606) of the Complex Groups Policy Department, FSA.~~

~~**BY ORDER OF THE BOARD**~~

~~**T ARMSTRONG**~~

~~**SECRETARY**~~

ANNEX H

Amendments to SUP 16, Annex 10R

After part 3 in Section 6 insert new part 4:

4 Table Accounting policies for financial reporting statements and audited annual financial statements

1.1.3		General rule
	(1)	Unless otherwise provided in the <i>rules</i> , and subject to (2) below, a <i>firm</i> must determine amounts included in respect of items shown in a <i>firm's</i> financial reporting statements and audited annual financial statements in accordance with this rule and the accounting principles and rules which the <i>firm</i> would apply if it were drawing up financial statements under the Companies Act 1985 including those accounting principles and rules contained in the United Kingdom Statements of Standard Accounting Practice (SSAPs) and Financial Reporting Standards (FRSs) effective at the relevant time.
		Substance over legal form
	(2)	A <i>firm</i> must include each item in its financial reporting statements and audited annual financial statements in such a way as to reflect the substance and not merely the legal form of the underlying transactions and balances.
		Trade date accounting
	(3)	A <i>firm</i> must use trade date accounting.
		Doubtful debts and liabilities
(4)	A <i>firm</i> must promptly make adequate provision for doubtful debts and accrue for all liabilities.	
	Provision for taxation	
(5)	A <i>firm</i> must make adequate provision for both current and deferred taxation; a partnership or sole trader may make a provision for taxation of an amount at least equivalent to the tax that would be payable if they had ceased business at the relevant balance sheet date. For this purpose, the definition of a sole trader in the glossary in IPRU(INV) 10 applies.	
	Securities lending	
(6)	A <i>firm</i> which is a lender of <i>securities</i> or physical commodities must record and value the <i>securities</i> or physical commodities lent as part of its own positions. For this purpose, the definition of a physical commodity in the glossary in IPRU(INV) 10 applies.	
	Foreign currency	
(7)	A <i>firm</i> must translate assets and liabilities denominated in currencies other than the reporting currency into the reporting currency using the closing mid-market rate of exchange, or, where appropriate, the rates of exchange fixed under the terms of related or matching forward contracts.	

In schedule 4, insert after paragraph 1(16) "(17) Article 4(1) of The Financial Services and Markets Act 2000 (Transitional Provisions and Savings)(Rules) Order 2001", and insert after paragraph 2(1) "(2) Article 11(1) of The Financial Services and Markets Act 2000 (Transitional Provisions and Savings)(Rules) Order 2001".

**CONDUCT OF BUSINESS SOURCEBOOK (AMENDMENT No 3)
INSTRUMENT 2001**

Powers exercised

- A. The Financial Services Authority alters the Conduct of Business sourcebook in the exercise of the powers listed in Schedule 4 to the Conduct of Business sourcebook (Powers exercised).
- B. The provisions of the Financial Services and Markets Act 2000 (the "Act") relevant to making rules and identified in paragraph A are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force immediately.

Amendment of the Conduct of Business sourcebook

- D. The Conduct of Business sourcebook is amended as set out in Annex 1 to this instrument.
- E. The transitional rules in the Conduct of Business sourcebook are amended as set out in Annex 2 to this instrument.

Citation

- F. This instrument may be cited as the Conduct of Business Sourcebook (Amendment No 3) Instrument 2001.

By order of the Board
15 November 2001

ANNEX 1

Amendments to the Conduct of Business sourcebook

In this Annex, where amendments are shown rather than described, underlining indicates new text and striking through indicates deleted text.

COB 3.2 Application: what?

COB 3.2.4R (2)(b) Amend as shown below:

- (b) COB 3.8.4R (1) (Non-real time financial promotions: ~~fair~~, clear, fair and not misleading) except if the financial promotion is exempt under 3.2.5R (7);

COB 3.2.5R (7) Amend as shown below:

~~a financial promotion in connection with a takeover or related operation~~
which is subject to the *Takeover Code* or the SARs (or exempted from complying with the *Takeover Code* or the SARs by ~~the rules of that Code, those rules,~~ or by a ruling of the *Takeover Panel*) or to the requirements relating to *takeovers or related operations* in another *EEA State*.

COB 3.8 Form and content of financial promotions

COB 3.8.19R Amend as shown below:

A provider firm must ensure that it does not *communicate* or *approve* a *specific non-real time financial promotion* relating to a *packaged product* and containing or offering advice on investments unless it discloses in the *financial promotion* that the *firm* is only able to give *advice on investments* to *private customers* about the *packaged products* of the *firm* or of its *marketing group* and (if it is the case) about *adopted packaged products*.

COB 3.9 Direct offer financial promotions

COB 3.9.5R (2) Amend as shown below:

A direct offer financial promotion must not relate to:

- (a) ~~an unregulated collective investment scheme;~~
(~~b~~) (a) a derivative; or
(~~e~~) (b) a warrant;

unless the *firm* itself has adequate evidence to suggest that the *investment* may be suitable for the *person* to whom the promotion is *communicated*.

COB 3.9.8R (2) After "January 2001 edition of", delete the comma and add "the "Guidance for subscribers" to"

COB 3.11 Unregulated collective investment schemes

COB 3.11.3G (2) Amend as shown below:

Firms are reminded that, even if an invitation or inducement is within COB 3 Ann 5, ~~then all relevant~~ other rules in this chapter may still apply, including in particular COB 3.9.5R (2) (a) (which prohibits the *communication or approval of direct offer financial promotions relating to unregulated collective investment schemes* except in specified circumstances).

COB 4.1 Client classification

COB 4.1.5R Insert the following new paragraph and renumber subsequent paragraphs:

- (3) If there is an agreement under (2) in relation to more than one *client* (C2) represented by C1, F may discharge any requirement to notify, obtain instructions or consent from, or enter into an agreement with each C2 by sending to, or receiving from, C1, a single communication which is expressed to cover each C2, except that:
 - (a) separate risk warnings under COB 5.4 (Customers' understanding of risk);
 - (b) confirmations under COB 8.1 (Confirmation of transactions); and
 - (c) *periodic statements* under COB 8.2 (Periodic statements)are required for each C2.

COB 5.3 Suitability

COB 5.3.9R(2) Amend as shown below:

An independent intermediary must not make a *personal recommendation* to a *private customer* to buy:

- (1)
- (2) a *packaged product* issued or operated by ~~an associate~~ a connected product provider if it ought reasonably to be aware of another generally available *packaged product* which could satisfy the needs and circumstances of the *private customer* as well as the connected *packaged product* (but see COB ~~5.3.11G~~ 5.3.10R).

COB 5.3.10R Amend as shown below:

- (1) COB 5.3.9R(2) does not apply to a *firm* acting as an *investment manager*.

- (2) In COB 5.3.9R(2), a *product provider* ("P") is connected to an *independent intermediary* ("I") if I is an *undertaking* and:
- (a) P and I are members of the same *group*; or
 - (b) P is a *qualifying holder* in I; or
 - (c) P and I have the same *qualifying holder*; or
 - (d) any other member of P's *marketing group* is connected to I in a way described in (a), (b) or (c).
- (3) In (2)(b) and (c), a *qualifying holder* in an *undertaking* is a *person* who:
- (a) has a *direct or indirect holding* in the *undertaking* which represents *10 per cent or more of its capital or voting power*; or
 - (b) has a *direct or indirect holding* in the *undertaking* which makes it possible to exercise a *significant influence over its management*.

5.3.11G Amend as shown below:

- (1) In complying with the requirements of COB 5.3.9R, an *independent intermediary* should have an adequate knowledge of and have regard to the *packaged products* available from the market as a whole.
- (2) *Firms* are reminded that, even if the 10 per cent limit in COB 5.3.10R(3)(a) has not been reached, P may still be connected with I if it can exercise a *significant influence over I's management*. For example, if three otherwise unconnected *product providers*, each with 9 per cent of an *independent intermediary's* capital, are acting in concert, they might each be connected with the *independent intermediary* if such influence exists.

COB 5.4 Customers' understanding of risk

COB 5.4.3R Amend as shown below

A firm must not:

- (1) make a *personal recommendation* of a transaction; or
- (2) act as a *discretionary investment manager*; or
- (3) *arrange (bring about) or execute* a deal in a *warrant* or *derivative*; or
- (4) engage in *stock lending activity*;

with, to or for a *private customer* unless it has taken reasonable steps to ensure that the *private customer* understands the nature of the risks involved.

COB 7.5 Best execution

COB 7.5.4R (2) Amend as shown below:

the *firm* has agreed ~~in writing~~ with an *intermediate customer* that it need not owe a duty of best execution to him, unless that *customer* is:....

COB 7.12 Customer order and execution records

COB 7.12.6E (1)(f) Amend as shown below:

any other instruction received by the *firm* from the *customer* with regard to the *execution* of the *customer order*. ~~(including the nature of the communication, for example, telephone, fax, letter, email).~~

COB 9.3 Client Money

COB 9.3.2R Amend as shown below:

The *client money rules* do not apply with respect to:

- (1) the *permitted activities* of a ~~life office~~ long-term insurer or a *friendly society*; or

ANNEX 2

Amendments to the Conduct of Business Transitional Rules

In this Annex, underlining indicates new text and striking through indicates deleted text.

COB Table TR1: COB Transitional Provisions:

1. 1.8 ETP4 R Amend as shown below

1.8	<i>ETP4</i>	R	<p>(1) An <i>ex-section 43 firm</i> will not contravene any of the provisions labelled <i>ETP4</i> in Table <i>COB TR 2</i> in relation to its section 43 business to the extent that, on or after <i>commencement</i>, it complies with (2).</p> <p>(2) For the purposes of <i>COB 4.1</i>, an <i>ex-section 43 firm</i> may treat its <i>client</i> (other than another firm) who was a <i>client</i> of the <i>firm</i> before <i>commencement</i> as a <i>market counterparty</i> in relation to its section 43 business until the date of expiry of the <i>transitional period</i> <u>a period of 12 months following <i>commencement</i></u>, by which date it must classify the <i>client</i> in accordance with <i>COB 4.1</i>.</p>	<p><i>commencement</i> to <i>commencement</i> plus 12 months</p>	<p><i>commencement</i></p>
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**Individual Pension Accounts (Handbook Amendment)
Instrument 2001**

Powers exercised

- A. The Financial Services Authority (the "FSA") amends the Conduct of Business sourcebook, the Supervision manual and the Glossary, in the ways indicated in Annexes A, B and C to this instrument in the exercise of the powers listed in Annex D to this instrument.
- B. The provisions of the Financial Services and Markets Act 2000 (the "Act") relevant to making rules and listed in Annex D are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force at the beginning of the day on which section 19 of the Act (General prohibition) comes into force.

Citation

- D. This instrument may be cited as the Individual Pension Accounts (Handbook Amendment) Instrument 2001.

By order of the Board
15 November 2001

Annex A

Amendments to the Conduct of Business sourcebook

COB 6.5 Content of key features and important information: life policies, schemes, ISA cash deposit components and stakeholder pension schemes

COB 6.5.21G In (6), delete the full stop and replace it with a semi-colon

Insert the following new provision after (6):

- (7) for an *individual pension account*:
 - (a) where the *key features* relate to a *stakeholder pension scheme* or *personal pension scheme* and the *firm* chooses to highlight, within *key features* or elsewhere, that the *investment* will be made through an *IPA*, a statement:
 - (i) identifying by name any *IPA eligible investments* which are to be or may be held as assets of the *stakeholder pension scheme* or *personal pension scheme*; and
 - (ii) indicating which of those assets will benefit from the Stamp Duty Reserve Tax exemption available to *IPAs*;
 - (b) where the *firm* is acting as an *operator* or distributor of a *regulated collective investment scheme* or *investment trust savings scheme* and elects to include within *key features* a statement that some or all of the *investments* are *IPA eligible investments*, an indication in respect of each such *investment* whether *pension scheme* members will benefit from the Stamp Duty Reserve Tax exemption available to *IPAs*.

Annex B

Amendments to the Supervision manual

SUP 15.8

Insert the following new provision after SUP 15.8.1R:

Individual Pension Accounts

15.8.2 R If a *firm* begins or ceases to administer *individual pension accounts*, it must notify the *FSA* as soon as reasonably practicable that it has done so.

Annex C

Amendments to the Glossary

In the *Glossary*, insert the following definitions in the appropriate alphabetical order:

Definition title	Definition wording
<i>individual pension account</i>	an account for the holding of <i>IPA eligible investments</i> operated by a firm in accordance with the Personal Pension Schemes (Restriction on Discretion to Approve) (Permitted Investments) Regulations 2001 (SI 2001/117).
<i>IPA</i>	<i>individual pension account</i>
<i>IPA eligible investment</i>	a type of investment specified in regulation 4.(6) of The Personal Pension Schemes (Restriction on Discretion to Approve) (Permitted Investments) Regulations 2001 (SI 2001/117).

Annex D

Powers Exercised

The following powers and related provisions in the Act have been exercised to make the rule in this instrument:

(1) section 138 (General rule-making power);

(2) section 156 (General supplementary powers).

The power in section 157(1) of the Act (Guidance) has been exercised to alter guidance in this instrument.

AUTHORISATION MANUAL (AMENDMENT NO 3) INSTRUMENT 2001

Powers exercised

- A. The Financial Services Authority amends the Authorisation manual in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (the "Act"):
- (1) section 156 (General supplementary powers);
 - (2) section 157(1) (Guidance);
 - (3) paragraph 17(1) of Schedule 1 to the Act (Fees); and
 - (4) paragraph 5(4) of Schedule 4 (Treaty Rights: Notice to Authority) (and sections 51(3) and (6) (Applications under this Part)).
- B. The provisions of the Act relevant to making rules and listed above are specified for the purpose of section 153(2) of the Act (Rule making instruments).

Commencement

- C. This instrument comes into force:
- (1) in relation to AUTH 1, 2, 3, 4 and 7, immediately; and
 - (2) in relation to AUTH 5, at the beginning of the day on which section 19 of the Act (The general prohibition) comes into force.

Amendments to the Authorisation manual

- D. The Authorisation manual is amended:
- (1) in accordance with Annex A to this instrument;
 - (2) by deleting the existing AUTH 1 Annex 1G, and replacing it with the material in Annex B to this instrument (AUTH 1 Annex 1G); and
 - (3) by inserting the provisions in Annex C to this instrument.

Citation

- E. This instrument may be cited as the Authorisation Manual (Amendment No 3) Instrument 2001.

Annex A Amendments to made text

- 2.7.12G In the final sentence, after " schemes are unregulated schemes.", insert:
"The process for applying for authorisation of a *collective investment scheme* is described in CIS 16 (Application and notification)."
- 3.6.4G After (3), insert:
"(4) In relation to *accepting deposits*, the *limitations* which may be applied for or imposed include a *limitation* that the *firm* may *accept deposits* from *wholesale depositors* only. A *firm* with such a *limitation* may receive less intensive supervision by the *FSA*, because of the reduced risk it poses to the *regulatory objective* of protecting *consumers*. However, the precise arrangements that would apply would be determined case by case and would be based on an assessment of the risks the *firm* posed to all four of the *regulatory objectives*."
- 3.8.2G(1) After "*threshold conditions*", insert:
"and certain additional conditions"
- 3.8.2G(1)(e) At end of the sentence, remove "." and insert ";"
After (e), insert:
"(f) Additional conditions apply to non-EEA insurers."
- 3.8.2G(2) Replace the existing text with the following:
"*Threshold conditions* 3,4 and 5 enable the *FSA* to assess the applicant in the light of the activities it wishes to carry on and, in particular, make it clear that suitability to carry on one *regulated activity* does not mean that the applicant is suitable to carry on all *regulated activities*. These *threshold conditions* do not apply to *Swiss general insurance companies*."
- 3.8.2G(4) Replace the existing text with the following:
"The application of the *threshold conditions* to *Swiss general insurance companies* was varied by the Financial Services and Markets Act 2000 (Variation of Threshold Conditions) Order 2001."
- 3.12.1G After "*incorporated company*", insert "*other than a limited liability partnership*"
- 3.12.2G Replace "[to be finalised]" with "1.3 R(1)"
- 3.12.3G(2) After "*IPRU(FSOC)*" insert "1.3 R (1)"

- 3.12.15G After "*authorised UK representative*", insert:
- "(see *COND 2.6 (Additional Conditions)* for the additional conditions which apply to non-*EEA insurers* and *SUP 15.4 (Notified persons)* for rules on notifications by *overseas firms*)"
- 4.1.1R (1) Delete "and" at the end of (1)
- (2) In (2), replace "." with ";", and insert "and" at end of sentence
- (3) After (2), insert:
- "(3) an applicant for a certificate under article 54 of the *Regulated Activities Order*."
- 4.3 For 4.3, insert:
- "4.3 Obligation to pay certification fees
- General
- 4.3.1R An applicant for a certificate under article 54 of the *Regulated Activities Order* must pay to the *FSA* the application fee specified in Part 6 of *AUTH 4 Ann 1R*.
- Due date and method of payment
- 4.3.2R The application fee must be paid:
- (1) by bankers draft, cheque or other payable order;
- (2) in full without deduction; and
- (3) on or before the date on which the application is made.
- 4.3.3G An application for an article 54 certificate will be treated as incomplete until the application fee has been paid."
- AUTH 4
Annex 1R After "Part 5 – Activity Groupings", insert:
- "Part 6 Application for a certificate under article 54 of the *Regulated Activities Order*
- The amount payable in relation to each application is £2,000."
- 5.3.2G(3) At end of the sentence, insert:

"For example, it will reflect any limitations or requirements which are included in the *firm's Home State* authorisation."

- 5.3.5G(1) Replace "(under paragraph 3(2), a" with "(under paragraph 3(2)). A"
- 5.3.6G In the second sentence, italicise "EEA State"
- 5.3.7G In the second sentence, replace "*firm's Home Sate*" with "*firm's Home State*"
- 5.3.8G (1) In the first and second sentences, replace "schedule" with "Schedule"
- (2) In the first sentence, italicise " authorisation"
- 5.3.9D(3)(b) Replace "AUTH 5.3.11Gbelow)" with "*AUTH* 5.3.11G below"
- 5.3.11G(1)(b) Replace " Corporate Authorisation department The Financial Services Authority 25 The North Colonnade Canary Wharf London E14 5HS" with:
- "Corporate Authorisation department, The Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS"
- AUTH 5 Ann 3G In the row for COB, before the full stop in column (2), add "(*COB* 1.2.1R(1))".
- In the row for COB, replace the text in column (3) with the following:
- "Where the activity:
- (a) would fall within the *overseas persons* exclusions in article 72 of the *Regulated Activities Order*; or
 - (b) would not be regarded as carried on in the *United Kingdom*; or
 - (c) is not carried on with or for a *client* in the *United Kingdom*;
- then only the following apply:
- (d) *COB* 3 (Financial promotion), but see the territorial scope in *COB* 3.3 (Where?);
 - (e) *COB* 5.5.7R and *COB* 5.5.8R (Overseas business); and
 - (f) *COB* 6.5, *COB* 6.7 and *COB* 6.8 (Content of key features, Cancellation and withdrawal, Insurance contracts – life and general) but only in relation to *long-term insurance business* carried on with a *customer* habitually resident in the *United Kingdom*.
- Otherwise, as column (2) (*COB* 1.4.3R.)"

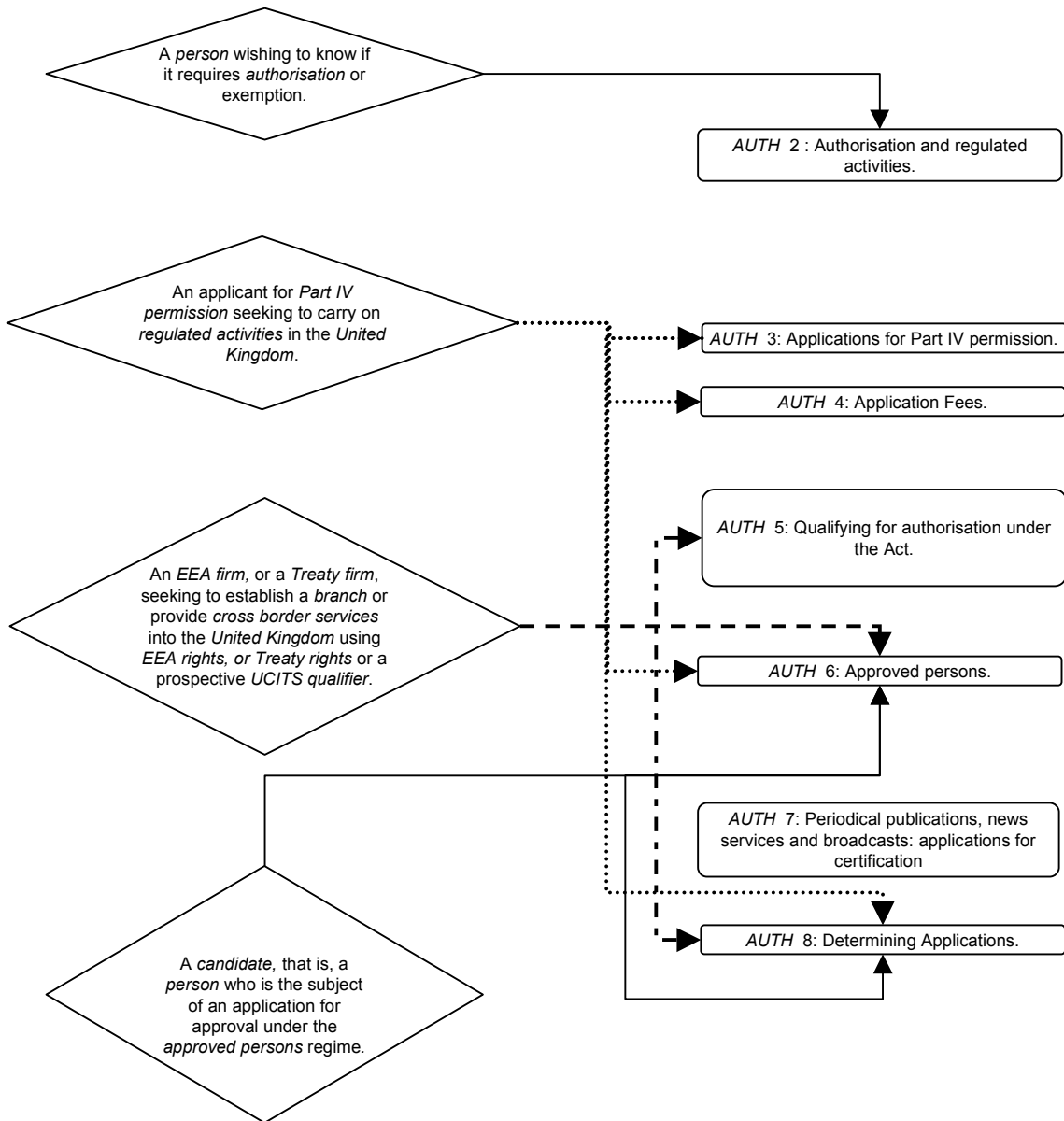
In the row for COMP, delete current wording in column (1) and (2) and replace with the following:

In column (1)

"Applies, except in relation to the *passport*ed activities of an *ISD investment firm* or a *BCD credit institution* (see the definition of "*participant firm*"). However, such a *firm* may be able to apply for *top-up cover* in relation to its *passport*ed activities (see *COMP 14* (Participation by EEA firms))."

In column (2):

"Does not apply in relation to the *passport*ed activities of an *ISD investment firm* or a *BCD credit institution* (see the definition of "*participant firm*"). Otherwise, *COMP* may apply, but the coverage of the *compensation scheme* is limited for non-UK activities (see *COMP 5*)."



Annex C

AUTH 7

Chapter 7

Periodical publications, news services and broadcasts : applications for certification

7

PAGE
1



7.1 Application and purpose

Application

- 7.1.1** G_{/1} This chapter applies to anyone involved in publishing periodicals, or in providing news services or broadcasts, who gives (or proposes to give) advice about *securities* or *contractually based investments* and who wishes to determine whether he will be carrying on the *regulated activity of advising on investments*.

Purpose

- 7.1.2** G_{/1} The purpose of this chapter is to provide *guidance* as to:
- (1) when a *person* involved in publishing periodicals, or in providing news services or broadcasts, requires *authorisation* to carry on the *regulated activity of advising on investments* (see ■ AUTH 7.3 (Does the activity require authorisation));
 - (2) If he does, whether he qualifies for the exclusion from that activity that applies to a periodical publication, a regularly updated news or information service or a television or radio service (see ■ AUTH 7.4 (Does the article 54 exclusion apply));
 - (3) If he does, whether his circumstances are an appropriate case for a certificate given by the *FSA* as conclusive evidence that he does qualify (see ■ AUTH 7.5 (When is it appropriate to apply for a certificate));
 - (4) how to apply for a certificate (see ■ AUTH 7.6.1G to ■ AUTH 7.6.5G); and
 - (5) how the *FSA* will use its power to give certificates (see ■ AUTH 7.6.6 G to ■ AUTH 7.6.10 G).
- 7.1.3** G_{/1} This *guidance* is issued under section 157 of the *Act*. The *guidance* represents the *FSA*'s views and does not bind the courts, for example in relation to an action for damages brought by a *private person* for breach of a *rule* (see section 150 of the *Act* (Actions for damages)), or in relation to the enforceability of a contract where there has been a breach of section 19 (The general prohibition) of the *Act* (see section 26 of the *Act* (Enforceability of agreements)). Although the *guidance* does not bind the courts, it may be of persuasive effect for a court considering whether it would be just and equitable to allow a contract to be enforced (see section 28(3) of the *Act*). Anyone reading this *guidance* should refer to the *Act* and to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544) (the *Regulated Activities Order*) to find out the precise scope and effect of any particular provision referred to in the *guidance* and should consider seeking legal advice if doubt remains. If a *person* acts in accordance with the *guidance* in the

circumstances contemplated by it, then the *FSA* will proceed on the footing that the *person* has complied with the aspects of the requirement to which the *guidance* relates.

7.2 Introduction

Exclusion for advice given in certain publications and services

7.2.1

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Advice is excluded by article 54 of the *Regulated Activities Order* from the *regulated activity of advising on investments* if :

- (1) the advice is given in a publication or service that is in one of three formats (see ■ AUTH 7.4.3 G and ■ AUTH 7.4.4 G); and
- (2) the principal purpose of the particular format is neither to give advice nor to lead to (or enable) certain transactions to be carried out (see ■ AUTH 7.4.5 G and ■ AUTH 7.4.10 G).

Certificate that the exclusion applies

7.2.2

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If a *person* would, but for the exclusion, be carrying on the *regulated activity of advising on investments*, and will be doing so as a business in the *United Kingdom* (see ■ AUTH 7.3), he may wish to apply to the *FSA* for a certificate that the exclusion applies (see ■ AUTH 7.6). However, a *person* does not need a certificate to get the benefit of the exclusion. In many cases it will be clear that the exclusion in article 54 applies and a certificate is not called for. A certificate may be appropriate, however, where the exclusion appears to apply but there may be an element of doubt. The granting of a certificate would remove any such doubt.

Certificates under the Financial Services Act 1986

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Certificates given under paragraph 25 of Schedule 1 to the *Financial Services Act 1986* (exclusion for periodical publications giving investment advice) do not have effect after 1 December 2001. Holders of such certificates must consider their position under the terms of the new exclusion. If a *person* considers that a certificate might be appropriate, a new application must be made.

7.3 Does the activity require authorisation?

Advising on investments

7.3.1

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Under article 53 of the *Regulated Activities Order*, advising a *person* is a specified kind of activity if :

- (1) the advice is given to the *person* in his capacity as an investor or potential investor, or in his capacity as agent for an investor or a potential investor; and
- (2) it is advice on the merits of his doing any of the following (whether as *principal* or agent) :
 - (a) *buying, selling*, subscribing for or underwriting a particular *investment* which is a *security* or a *contractually based investment*; or
 - (b) exercising any right conferred by such an *investment* to *buy, sell*, subscribe for or underwrite such an *investment*.

7.3.2

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Article 53 of the *Regulated Activities Order* contains a number of elements, all of which must be present before a *person* will require *authorisation*. For *guidance* on whether a *person* is carrying on this *regulated activity*, see ■ AUTH App 1 (Financial promotion and related activities [to be issued later]).

Carrying on the regulated activity by way of business

7.3.3

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Under section 22 of the *Act* (Regulated activities), for an activity to be a *regulated activity* it must be carried on 'by way of business'. There is power in the *Act* for the Treasury to change the meaning of the business element by including or excluding certain things. It has exercised this power (see the Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001 (SI No 2001/1177)). The result is that the business element differs depending on the activity in question. Where *regulated activities* carried on in relation to *securities* or *contractually based investments* are concerned, the business element is not to be regarded as satisfied unless a *person* carries on the business of engaging in one or more of the activities. This is a narrower test than that of carrying on *regulated activities* by way of business (as required by section 22 of the *Act*), as it requires the *regulated activities* to represent the carrying on of a business in their own right. This is the test which will apply to the *regulated activity* of *advising on investments*. ■ AUTH 2.3 (The Business element) and ■ AUTH 2.4 (Link between activities and the United Kingdom) provide further detail on this.

7.3.4

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In the *FSA's* view, for a *person* to be carrying on the business of *advising on investments* he will usually need to be doing so with a degree of regularity and for

commercial purposes – that is to say, he will normally be expecting to gain some kind of a direct or indirect financial benefit. But, in the FSA's view it is not necessarily the case that advice provided free of charge will not amount to a business. Advice is often given 'free' by a journalist or presenter, or in a publication or website, in the sense that no charge is made or commission received. For example, a newspaper may reply to readers' letters to generate goodwill or to generate a supply of further material that it can publish or a website that is 'free' to the user will be sponsored or paid for by advertising. In such cases, if *advice on investments* is given, then in the FSA's view the business of *advising on investments* is being carried on. In addition, non-commercial motives may be relevant in determining whether a *person* can be said to be carrying on the business of giving advice. For example, an investigative journal or journalist may occasionally feel that it is necessary to warn investors against the purchase of a particular investment because there are suspicions of fraud in connection with that investment. The FSA takes the view that, in such circumstances, the journal or journalist would not be regarded as carrying on the business of *advising on investments* as he would be acting to prevent crime rather than in the carrying on of a business.

Carrying on the regulated activity in the United Kingdom

7.3.5 G_{/1} Advice given in periodicals published from an establishment in the *United Kingdom* is regarded by the FSA as given in the *United Kingdom*. A similar approach is taken to advice given in, or by way of, a service provided from such an establishment.

7.3.6 G_{/1} In other circumstances, advice issued remotely may still be given in the *United Kingdom*. For example, the FSA considers that advice is given in the *United Kingdom* if :

- (1) it is contained in a non-UK periodical that is posted in hard copy to *persons* in the *United Kingdom*;
- (2) it is contained in a non-UK periodical (or given in or by way of a service) which is made available electronically to such *persons*.

7.3.7 G_{/1} But even if advice is given in the *United Kingdom*, the *general prohibition* will not be contravened if the giving of advice does not amount to the carrying on, in the *United Kingdom*, of the business of *advising on investments*. Also, the general prohibition will not be contravened if the exclusion for *overseas persons* in article 72 of the *Regulated Activities Order* (Overseas Persons) applies. That exclusion applies in relation to the giving of advice by an *overseas person* as a result of a 'legitimate approach' (defined in article 72(7)). In many cases where publications or services are provided from outside the *United Kingdom* it is likely that they will fall within the terms of this exclusion. For example, this will exclude any advice in a publication or service from being a *regulated activity* if it is given in response to an approach that has not been solicited in any way.

Exclusions and exempt persons

7.3.8 G_{/1} Finally, if a *person* is carrying on the business of *advising on investments* in the *United Kingdom*, he will not require *authorisation* if:

- (1) he is able to rely on an exclusion; in addition to the exclusions already mentioned (in articles 54 and 72 of the *Regulated Activities Order*), other exclusions that may be relevant are in Chapter XVII of Part II of the Order; or

- (2) he is an *exempt person* (see ■ AUTH 2.11 (What to do Now?)); since *persons* are exempt only in relation to specified *regulated activities*, his exemption must apply to the *regulated activity* of *advising on investments*.

Which person is required to be authorised?

7.3.9

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Many people may be involved in the production of a periodical publication, news service or broadcast. But if the *regulated activity* of *advising on investments* is being carried on so that *authorisation* is required, the FSA's view is that the *person* carrying on the activity (and who will require *authorisation*) is the *person* whose business it is to have the editorial control over the content. In the case of a periodical publication, this will often be the proprietor. But particular circumstances may vary so that the responsibility for content and editorial control rests with a freelance journalist rather than with the proprietor. In such cases it may well be that the journalist may properly be viewed as carrying on his own business, using the periodical publication as the vehicle for doing so – in which case it is likely to be the journalist alone who needs the *authorisation*.

7.3.10

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Similar principles apply to news services and broadcasts.



7.4 Does the article 54 exclusion apply?

The formats

7.4.1

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The exclusion applies to advice given in one of the following formats:

- (1) advice in writing or other legible form which is contained in a newspaper, journal, magazine, or other periodical publication;
- (2) advice in writing or other legible form which is given by way of a service comprising regularly updated news or information;
- (3) advice given in any service consisting of the broadcast or transmission of a television or radio programme.

7.4.2

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But the exclusion applies only if the principal purpose of the publication or service is neither to *advise on investments* (that is, *securities* or *contractually based investments*) nor to lead or enable *persons* to *buy, sell, subscribe for or underwrite securities* or *contractually based investments*.

Formats in writing or other legible form

7.4.3

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- (1) There are two specified formats for advice appearing in writing or other legible form.
- (2) The first is that of a newspaper, journal, magazine or other periodical publication. For these purposes it does not matter what form the periodical publication takes as long as it can be read. This will include, for example, a newspaper appearing as a hard copy or electronically on a website. It will also include any periodical published on an intranet site.
- (3) The second is that of a regularly updated news or information service. As with periodical publications, it does not matter how the service is accessed by, or delivered to, the user as long as it can be read. This will include, for example, a service provided through teletext, a fax retrieval system or a website (including websites that are used through handheld devices). The fact that it must be a 'regularly updated' service means that the provision of up-to-date news or information must be a primary feature of the service (for example, where it is likely to be of commercial value to the recipient). But, in the FSA's view, a news or information 'service' is not restricted to the giving of only news or information since this would not generally constitute the *regulated activity of advising on investments* (see ■ AUTH App 1 (Financial promotion and related activities)[to be issued later]). So the exclusion applies to services providing material in addition to news or information, such as comment or advice.

Television and Radio

7.4.4 G_{/1} The third specified format is for advice in any service consisting of the broadcast or transmission of television or radio programmes. This will encompass the transmission through cable of interactive television programmes. In the FSA’s view, ‘service’ in this context goes beyond any particular series of programmes broadcast or transmitted through a given medium. It refers instead to the administrative system (usually aimed at a particular audience) through which a range of different programmes is provided, for example any particular TV or radio channel. In the FSA’s view, it is unlikely that a TV or radio service will have one of the principal purposes that would prevent its being able to rely on the exclusion unless the complete service is designed to focus on financial or investment matters.

The principal purpose

7.4.5 G_{/1} The exclusion applies only if the principal purpose of the publication or service is neither :

- (1) to give advice on investments (see ■ AUTH 7.3.1G).
- (2) to lead or enable *persons* to *buy, sell*, subscribe for or underwrite *securities* or *contractually based investments*, or to exercise any rights conferred by *securities* or *contractually based investments* (abbreviated in ■ AUTH 7.4.9G and ■ AUTH 7.4.11G as ‘to engage in a relevant transaction’).

7.4.6 G_{/1} Any assessment of the principal purpose of a periodical publication, news service or broadcast needs to be carried out against the background that:

- (1) they all share the characteristic of being available over a sustained period and, within that period, appearing from time to time with a different content;
- (2) the same periodical publication will have many different editions;
- (3) the regular updating of the news or information service will produce differences in the material provided, comparing the content of the service as it appears at any one time with its content as it appears at any other; and
- (4) the programmes in a TV or radio service are bound to have a different content from each other.

7.4.7 G_{/1} To address this feature of variation in content, article 54 requires that the principal purpose of a publication or service is to be assessed by looking at the publication or service taken as a whole and including any advertisements or other promotional material contained in it. This requirement of an overall assessment of purpose or purposes goes beyond the content of any particular example of the publication or service (such as a particular edition or programme). It fixes instead on the characteristic content of the publication or service looked at over time. This judgment depends on the overall impression of content. One way of approaching this is to consider what an average consumer of a publication or service might expect to find when making a decision whether to buy a particular edition or to use the service.

7.4.8 G_{/1} Looking at the first disqualifying purpose set out in the exclusion, all the matters relevant to whether the *regulated activity of advising on investments* is being carried on must be taken into account (see ■ AUTH App 1.22 to ■ AUTH App 1 (Financial promotion and related activities [to be issued later])). If the principal purpose of a

publication or service is to give to *persons*, in their capacity as investors (or potential investors), advice as referred to in ■ AUTH 7.4.5 G(1), then the publication or service will not be able to benefit from this exclusion.

7.4.9

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For the second disqualifying purpose, the focus switches to assessing whether the principal purpose of a publication or service is to lead a person to engage in a relevant transaction or enable him to do so. This disqualifying purpose is an alternative to the first. So it extends to material not covered by the first. In this respect :

- (1) material in a publication or service that invites or seeks to procure *persons* to engage in a relevant transaction can be said to “lead” to those transactions even if it would not constitute the *regulated activity* of *advising on investments*; this includes, for example, material that consists of generic buy or sell recommendations, corporate brochures or invitations to invest in particular products or with a particular broker or fund manager; and
- (2) material enables *persons* to engage in a relevant transaction if it facilitates the transactions, for example by giving a user the forms that enable him to carry out relevant transactions; so this limb of the second disqualifying purpose would apply to the material providing an online dealing facility on an interactive website or to facilities for on-screen dealing through digital television.

In the *FSA’s* view, material will not lead or enable a *person* to engage in a relevant transaction where the material is intended merely to raise people’s awareness of matters relating to *securities* or *contractually based investments*.

7.4.10

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The test for determining the principal purpose of any publication which appears on a website, or of any news or information service which appears on a website, is no different from any other medium. An overall view will need to be taken of all the contents of the publication or service, including any features such as chatrooms, advertisements or other promotional material.

7.4.11

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In the context of the second disqualifying purpose, whether or not the presence of a hypertext link to another website indicates that the purposes of a publication or service include that of leading to relevant transactions (or enabling them to be entered into) will depend on all the circumstances. It will, in particular, be necessary to consider the form of the link and the content of the destination website. In the *FSA’s* view, the simple presence on a host publication or service of a hypertext link consisting only of the name or logo of another website is unlikely itself to indicate that a purpose of the host website is to lead to relevant transactions (or enable them to be entered into). But if more sophisticated links, such as banners or changeable text, contain promotional material inviting or seeking to procure persons to enter into relevant transactions, then those links will have to be weighed in the balance in determining the principal purpose of the publication or service hosting the link. The same applies if the host publication or service hosting the link itself contains material inviting persons to activate the link with a view to entering into relevant transactions.

7.4.12

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In reaching a view of the principal purpose of the publication or service as a whole, all the material that falls within either the first or second disqualifying purpose must be considered together.

Who can benefit from the exclusion?

7.4.13

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The *persons* who directly benefit from the exclusion will be the *persons* who would otherwise require *authorisation* (see ■ AUTH 7.3.9 G), that is, the *person* whose business it is to have editorial control over the content of the publication or service. The exclusion will apply regardless of the legal form of the *person* giving the advice so, for example, it will extend to *advice on investments* given by a *company* through its employees.



7.5 When is it appropriate to apply for a certificate?

7.5.1

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To decide whether the exclusion in article 54 applies, three assessments need to be made :

- (1) first, an assessment whether the vehicle for giving the advice is a newspaper, journal, magazine or other periodical publication, a service comprising regularly updated news or information or a service consisting of the broadcast or transmission of television or radio programmes;
- (2) second, an assessment of the purpose or purposes of any particular publication or service; and
- (3) third, an assessment of the relative significance of each purpose compared with any others.

7.5.2

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Because opinions may differ in circumstances close to the borderline, giving rise to doubt as to whether or not the exclusion applies, the *Regulated Activities Order* makes provision for a certification process. The purpose of this process is not to provide certification for every publication or service to which the exclusion in article 54 applies.

7.5.3

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In many cases it will be clear whether or not a publication or service benefits from the exclusion. A publication or service may provide reports on such a wide range of matters that it is not possible to say that it has any purpose other than to provide coverage of a wide range of matters. Alternatively, it may be clear that the principal purpose of a publication or service is something other than those specified in the article 54 exclusion. Examples of cases where, in the FSA's view, the exclusion is capable of applying include :

- (1) national or local newspapers providing the normal range of non-financial news and coverage of other matters (such as sports, arts and leisure) and which simply contain financial journalism (such as reports on particular investments or markets) as one element of their all-round coverage;
- (2) weekly or monthly journals aimed at a particular subject (such as computing or sport) but which have some coverage of, or promotional material relating to, investments and financial matters;
- (3) websites which provide financial news or information;
- (4) closed user group communication systems specialising in financial or investment matters; and
- (5) television or radio channels dedicated to consumer affairs which devote a small number of programmes to financial planning.

7.5.4

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It is only where there are grounds to think that there is a significant doubt as to the principal purpose of a publication or service that the question of whether or not to apply to the FSA for a certificate under article 54 of the *Regulated Activities Order* is expected to arise. For example, this may happen where a publication or service has several significant purposes and one of them is a disqualifying purpose referred to in the exclusion in article 54. It may on occasion be difficult to assess the relative importance of the purposes compared with each other, particularly given that over time there will be a variation in the content of the publication or service. In such cases, an application for a certificate would be appropriate.

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7.6 Applications for a certificate

Pre-application contact

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A *person* considering applying for a certificate should, before sending in any application, contact the Authorisation Enquiries Department of the *FSA* to discuss whether a certificate may be appropriate.

Form of application

7.6.2

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- (1) An application should be made by the proprietor of the relevant publication or service using a form which can be obtained from the Authorisation Enquiries Department of the *FSA*. The form asks for general information about the applicant and gives guidance notes on completion and other details of how the *FSA* can help.
- (2) An applicant will be asked to state his own view of the principal purpose of the publication or service. This should include an explanation why the applicant believes that he qualifies for the exclusion and why he believes that a certificate may be called for.
- (3) The applicant will be asked to define the extent of the publication or service for which he is seeking a certificate.
- (4) The applicant will be asked to supply material to demonstrate the content of the publication or service or, in the case of a new publication or service, its proposed content. For an existing publication or service, past samples should be supplied in the form most appropriate to the medium for which certification is sought. The samples should be chosen on the basis that they are representative of the publication or service as a whole and as it appears from time to time. The applicant will be asked to justify the selection of the particular samples as being representative. For a new publication or service, samples of proposed content should be supplied. These should be as comprehensive as possible.
- (5) The applicant will be asked to supply material to demonstrate that the principal purpose is not liable to change over the foreseeable future. This may, for example, include business plans, a statement of editorial policy and marketing literature.
- (6) The application must be accompanied by the application fee (see ■ AUTH 7.6.5 G).

Requests for further information

- 7.6.3 **G**_{/1} After an application is sent in, the *FSA* may, on occasion, need to obtain additional information from the applicant or elsewhere to enable it to process the application.

Time for processing applications

- 7.6.4 **G**_{/1} The *Act* does not specify a time limit for processing the application but the *FSA* intends to deal with an application as quickly as possible. The more complete and relevant the information provided by an applicant, the more quickly a decision can be expected. But on occasion it may be necessary to allow time in which the *FSA* can monitor the content of the service. This might happen where, for example, a service is in a form that makes record keeping difficult (such as a large website with a number of hypertext links).

Application Fees

- 7.6.5 **G**_{/1} The fee for an application for a certificate under article 54 of the *Regulated Activities Order* is £2,000 (see ■ AUTH 4 Annex 1R).

The FSA's approach to considering applications

- 7.6.6 **G**_{/1} The *FSA* will consider any application for a certificate on its merits.
- 7.6.7 **G**_{/1} Before it gives a certificate, the *FSA* must be satisfied that the principal purpose of the publication or service is neither of the purposes referred to in the exclusion (see ■ AUTH 7.4.5 G). If there is insufficient evidence, a certificate cannot be given.
- 7.6.8 **G**_{/1} The *FSA* will form an overall view as to the purpose (or purposes) underlying the publication or service. It will then determine whether the principal purpose is neither of those referred to in article 54 of the *Regulated Activities Order*. Because the possible range of subject matter covered by different publications or services is very wide it is not possible to apply standard tests. The *FSA* will form a judgment as to the overall impression created by the publication or service. For example, the proportion of advice, compared with other material in the publication or service, will be relevant in determining the principal purpose of the publication or service. But this will not necessarily be conclusive one way or the other. The purpose of a publication or service may still be to give advice even if only a small proportion of the space is devoted to advice as such. This might happen if, for example, a publication were marketed primarily on the basis that it contains advice on investments.
- 7.6.9 **G**_{/1} In reaching a view, the *FSA* will take into account both editorial and promotional material in the publication or service. It will also have regard to the stated purpose of the publication or service and to any other material relevant to its purpose.
- 7.6.10 **G**_{/1} Other factors relevant to an assessment of purpose or content of the publication or service may vary depending on the nature of the publication or service. For example, if a service is provided by a website, consideration of the content of the publication or service will take account of hypertext links and other features such as e-mail addresses, bulletin boards and chat rooms.

Grant of application

7.6.11

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If the *FSA* decides to grant the application it will issue a certificate. The certificate will normally be granted for an indefinite period. It will state what it is that the *FSA* considers constitutes the periodical or service in relation to which the *FSA* is satisfied that the exclusion in article 54 of the *Regulated Activities Order* applies. In many cases this will be self-evident. But it may sometimes be necessary to include further details in the certificate indicating what the certificate covers. For example, in the case of a large website, a distinct publication or service may form part of the website. In such a case a certificate may be given for that part only.

Refusal of application

7.6.12

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An application may be refused on the grounds that the *FSA* is not satisfied that the principal purpose of the publication or service is neither of those mentioned in article 54(1)(a) or (b) of the *Regulated Activities Order* (see ■ AUTH 7.4.5G). An application may also be refused on the grounds that the *FSA* considers that the vehicle through which advice is to be given is not a newspaper, journal, magazine or other periodical publication, a regularly updated news or information service or a service consisting of the broadcast or transmission of television or radio programmes. Where an application is refused, the *FSA* will issue a notice which will give a statement of the reasons for the refusal in that case. If the application is refused, the applicant, if he is an *unauthorised person*, will need to consider whether it is appropriate to continue to publish the periodical or provide the service without *authorisation* or exemption.

7.7 Post-certification issues

Ongoing monitoring

- 7.7.1** **G**_{/1} If a certificate is granted then, until it is revoked, it is conclusive evidence that the exclusion under article 54 of the *Regulated Activities Order* applies. A *person* to whom a certificate is given should notify the *FSA* of any significant changes to the purpose or nature of the content of the relevant publication or service. The *FSA* will need to keep the content of the publication or service in question under review.
- 7.7.2** **G**_{/1} An annual fee of £1,000 will be charged to meet the costs of ongoing monitoring (see ■ SUP 20 Annex 1R).

Revocation of certificate

- 7.7.3** **G**_{/1} The *FSA* may revoke a certificate at the request of its holder or on the *FSA*'s own initiative if the *FSA* considers that it is no longer justified. If the *FSA* revokes a certificate on its own initiative, it would normally expect to give advance notice to the holder of the certificate together with a statement of the reasons for the proposed revocation, and give the holder of the certificate an opportunity to make representations. Where a certificate is revoked, the holder of the certificate, if he is an *unauthorised person*, will need to consider whether it is appropriate to continue to publish the periodical or provide the service without *authorisation* or exemption.

Publication of details of certificate holders

- 7.7.4** **G**_{/1} The fact of a *person* holding a certificate granted under article 54(3) is information which may be of relevance to other *persons* (including investors or potential investors). For this reason, the *FSA* considers it appropriate that details of certificates granted under article 54(3) should be included in a list on the public record which the *FSA* is required to maintain under section 347 of the *Act* (The record of authorised persons, etc).

Further information

- 7.7.5** **G**_{/1} For further information contact the Authorisation Enquiries Department at the *FSA* (see ■ AUTH 1.9.2G).

TRAINING AND COMPETENCE SOURCEBOOK

(AMENDMENT No 2) INSTRUMENT 2001

Powers exercised

A. The Financial Services Authority amends the Training and Competence sourcebook in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (the "Act"):

(1) section 138 (General rule-making power)

(2) section 150(2) (Actions for damages)

(3) section 156 (General supplementary powers).

B. The provisions of the Act relevant to rules and listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

C. This instrument shall come into force at the beginning of the day on which section 19 of the Act (The general prohibition) comes into force.

Amendments to the Training and Competence sourcebook

D. The Training and Competence sourcebook is amended in accordance with the Annex to this instrument.

Citation

E. This instrument may be cited as the Training and Competence sourcebook (Amendment No 2) Instrument 2001.

By order of the Board
15 November 2001

ANNEX

TC INTERIM APPROVED EXAMINATION ANNEXES

The amendments are shown as follows:

Deletions : ~~Red—strike through~~

Amendments: **Yellow**

Annex 1R The interim approved examinations referred to in TC 2

Table 1 TC 2.1.4 R (1) (a) Employees engaging in advising on investments which are, and dealing with or for clients in, securities (other than stakeholder pension schemes or broker funds) and derivatives

Examination that must be passed before starting the activity		
KEY	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory module
1	Associateship - must include a pass in the Investment paper	Chartered Institute of Bankers
1	Associateship – must include a pass in the Investment paper	Chartered Institute of Bankers in Scotland
1	SFA Futures and Options Representative Examination plus Securities Representative Examination – Part 2 Certificate in Derivatives plus Certificate in Securities – Paper 2	Securities Institute
1	SFA Securities and Financial Derivatives Representative Examination Certificate in Securities and Financial Derivatives	Securities Institute
1	SFA Securities Representative plus Financial Derivatives Module Certificate in Securities plus Certificate in Derivatives – Paper 2	Securities Institute
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Chartered Financial Analyst	Association for Investment Management and Research
2	Examination	NIBE – SVV – the Dutch Institute for the banking, insurance and stockbroking industry

Examination that must be passed before starting the activity		
2	Module B(ii), Securities and Portfolio Management	Law Society of England and Wales
2	Ordinary and Senior Certificate	South African Institute of Financial Markets
2	Registered Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification – Class 1	Japanese Banking Association
2	Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification – Type 1	Japanese Securities Dealers Association
2	Secondary Examination	Analyst Association of Japan
3	SFA Registered Persons Examination – Section 1 (Regulation) Securities Institute Regulatory Paper	Securities Institute

Table 2 TC 2.1.4 R (1) (b) *Employees engaging in advising on investments which are, and dealing with or for clients in, securities (other than stakeholder pension schemes or broker funds) only*

Examination that must be passed before starting the activity		
KEY	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory module
1	Associateship - must include a pass in the Investment paper	Chartered Institute of Bankers
1	Associateship - must include a pass in the Investment paper	Chartered Institute of Bankers in Scotland
1	SFA Securities Representative Examination Certificate in Securities	Securities Institute
1	SFA Securities and Financial Derivatives Representative Examination Certificate in Securities and Financial Derivatives	Securities Institute
1	Diploma (including must include a pass in Regulation and Compliance paper)	Securities Institute
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Canadian Securities course plus Conduct and Practices Handbook	Canadian Securities Institute
2	Certificate	New Zealand Stock Exchange
2	Certificate in Financial Markets	Securities Institute of Australia
2	Certified European Financial Analyst	EFFAS Societies with accredited

Examination that must be passed before starting the activity		
		examinations
2	Chartered Financial Analyst (Level 1)	Association for Investment Management and Research
2	Diploma	Association of Belgian Financial Analysts
2	Diploma	The Swiss Stock Exchange
2	Diploma of Financial Markets	Securities Institute of Australia
2	Dealers Representative Examination	Singapore Exchange
2	Elementary, Intermediate and International Capital Markets courses	Korea Securities Training Institute
2	Examination	NIBE – SVV – the Dutch Institute for the banking, insurance and stockbroking industry
2	Examination	The French Society of Investment Analysts
2	General Certification Programme	ISMA/University of Reading
2	International Capital Markets Qualification (ICMQ) (including the Fixed Interest and Bond Markets Module)	Securities Institute/South African Institute of Financial Markets
2	Irish Registered Representatives Examination	Irish Stock Exchange/Dublin City University
2	Membership Examinations	Johannesburg Stock Exchange
2	Module B(ii), Securities and Portfolio Management	Law Society of England and Wales
2	Ordinary and Senior Certificate	South African Institute of Financial Markets
2	Promotore Finanziario Examination	Italian Exchange
2	Registered Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification – Class 1	Japanese Banking Association
2	Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification – Type 1	Japanese Securities Dealers Association
2	Secondary Examination	Analyst Association of Japan
2	Series 7 - General Securities Representatives Examination	National Association of Securities Dealers
2	Trainee Dealers Representatives examination	Kuala Lumpur Stock Exchange
3	SFA Registered Persons Examination – Section 4 (Regulation) Securities Institute Regulatory Paper	Securities Institute

Table 3 *TC 2.1.4 R (1) (c) Employees engaging in advising on investments which are, and dealing with or for clients in, derivatives only*

Examination that must be passed before starting the activity		
K E Y	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory module
1	Associateship - must include a pass in the Investment paper	Chartered Institute of Bankers
1	Associateship - must include a pass in the Investment paper	Chartered Institute of Bankers in Scotland
1	SFA Futures and Options Representative Examination Certificate in Derivatives	Securities Institute
1	SFA Securities and Financial Derivatives Representative Examination Certificate in Securities and Financial Derivatives	Securities Institute
1	Diploma (including Regulation and Compliance paper and Financial Derivatives paper)	Securities Institute
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	ACI Diploma	ACI
2	Chartered Financial Analyst	Association for Investment Management and Research
2	Derivatives Fundamentals course and Futures/Options Licensing course	Canadian Securities Institute
2	Diploma including passes in both the Australian Futures Trading and Options Trading papers	Securities Institute of Australia
2	Examination	NIBE – SVV – the Dutch Institute for the banking, insurance and stockbroking industry
2	Examination	Norwegian Society of Financial Analysts
2	Financial Derivatives paper of Diploma	Securities Institute
2	International Capital Markets Qualification (ICMQ) including passes in Futures, Options and other Derivative Products paper	Securities Institute/South African Institute of Financial Markets
2	Module B(ii), Securities and Portfolio Management	Law Society of England and Wales
2	Ordinary and Senior Certificate	South African Institute of Financial Markets
2	Registered Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification – Class 1	Japanese Banking Association
2	Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification – Type 1	Japanese Securities Dealers Association
2	Registered Representatives Examination	Sydney Futures Exchange
2	Secondary Examination	Analyst Association of Japan
2	Series 3 - National Commodity Futures Examination	National Futures Association

Examination that must be passed before starting the activity		
2	Singapore Exchange Futures Trading Test	Singapore Institute of Banking and Finance
3	SFA Registered Persons Examination – Section 4 (Regulation) Securities Institute Regulatory Paper	Securities Institute

Annex 2R The interim approved examinations referred to in TC 2

Table 1 TC 2.1.4 R (1) (d) *Employees engaging in managing investments*

Examination that must be passed within 30 months of starting the activity		
KEY	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory modules
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	Diploma (including Regulation and Compliance, Investment Analysis and either Fund Management or Private Client Investment Advice and Management papers) Diploma (must include a pass in Regulation and Compliance Paper)	Securities Institute
1	Fellow or Associate must include Investment paper E (post - May 1992 syllabus)	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Certificate in Investment Management (at least three papers passed by examination)	Society of Investment Analysts in Ireland
2	Certified European Financial Analyst	EFFAS Societies with accredited examinations
2	Chartered Financial Analyst (Level 1)	Association for Investment Management and Research
2	Chartered Member	Securities Analysts' Association of Japan
2	Investment Management Asset Allocation Qualification	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research

Examination that must be passed within 30 months of starting the activity		
2	Investment Practice version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Module B(ii), Securities and Portfolio Management	Law Society of England and Wales
2	Ordinary and Senior Certificates	South African Institute of Financial Markets
3	SFA Registered Persons Examination – Section 1 (Regulation) Securities Institute Regulatory Paper	Securities Institute
3	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research

Table 2 TC 2.1.4 R (1) (e) Employees engaging in managing investments in relation to venture capital investments only

Examination that must be passed within 30 months of starting the activity		
KEY	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory modules
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	Diploma (including Regulation and Compliance, Investment Analysis and either Fund Management or Private Client Investment Advice and Management papers) Diploma (must include a pass in Regulation and Compliance Paper)	Securities Institute
1	Fellow or Associate	Institute of Chartered Accountants in England and Wales
1	Fellow or Associate	Institute of Chartered Accountants in Ireland
1	Fellow or Associate	Institute of Chartered Accountants of Scotland
1	Fellow or Associate must include Investment paper E (post - May 1992 syllabus)	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	SFA Corporate Finance Representative Examination Certificate in Corporate Finance	Securities Institute

Examination that must be passed within 30 months of starting the activity		
2	Certificate in Investment Management (at least three papers passed by examination)	Society of Investment Analysts in Ireland
2	Certified Diploma in Accounting and Finance	Association of Chartered Certified Accountants
2	Certified European Financial Analyst	EFFAS Societies with accredited examinations
2	Chartered Financial Analyst (Level 1)	Association for Investment Management and Research
2	Chartered Member	Securities Analysts' Association of Japan
2	Diploma – Corporate Finance paper	Securities Institute
2	Investment Management Asset Allocation Qualification	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Investment Practice version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Module B(ii), Securities and Portfolio Management	Law Society of England and Wales
2	Ordinary and Senior Certificates	South African Institute of Financial Markets
2	Professional qualification which provides the particular discipline relevant to their responsibilities in relation to venture capital investments	
3	SFA Registered Persons Examination – Section 1 (Regulation) Securities Institute Regulatory Paper	Securities Institute
3	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research

Annex 3R The interim approved examinations referred to in TC 2

Table 1 TC 2.1.4 R (1) (f) *Employees engaging in advising on investments which are packaged products (other than broker funds or as in (g) or (h))*

Examination that must be passed within two years of starting the activity		
K E Y	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory modules
1	Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Associateship (post-August 1994 syllabus)	Chartered Institute of Bankers in Scotland
1	Certificate for Financial Advisers	Chartered Institute of Bankers
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	Diploma (including Private Client Investment Advice and Management paper)	Securities Institute
1	Fellow or Associate (life and pensions route only)	Chartered Insurance Institute
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Financial Planning Certificate	Chartered Insurance Institute
1	Initial Test of Competence	Institute of Chartered Accountants in England and Wales/Institute of Chartered Accountants in Ireland/Institute of Chartered Accountants of Scotland
1	Investment Advice Certificate	Securities Institute
1	Investment Paper (post-August - 1994 syllabus)	Chartered Institute of Bankers in Scotland
2	Investment paper from the Associateship	Chartered Institute of Bankers
2	Investment paper (pre - August 1994 syllabus)	Chartered Institute of Bankers in Scotland
2	Investment Planning Paper 2	Institute of Bankers in Ireland
2	Module B(i), Retail Branded/Packaged Products	Law Society of England and Wales
3	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
3	Certificate in Investment Planning – Paper 1	Chartered Institute of Bankers in Scotland
3	Financial Planning Certificate – Paper 1	Chartered Insurance Institute

Examination that must be passed within two years of starting the activity

3	Investment Advice Certificate – Paper 1	Securities Institute
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Table 2 TC 2.1.4 R (1) (g) **Employees** engaging in advising on investments which are *friendly society tax exempt policies* only

Examination that must be passed within two years of starting the activity

Interim approved examinations which meet the requirements of TC 2.4.5 R (2)

1	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
1	Certificate in Investment Planning – Paper 1	Chartered Institute of Bankers in Scotland
1	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
1	Investment Advice Certificate – Paper 1	Securities Institute

Table 3 TC 2.1.4 R (1) (h) *Employees* engaging in advising on investments which are *packaged products* (where the employee sells only *life policies* issued by a *friendly society* and is not reasonably expected to receive remuneration of more than £1,000 a year in respect of such sales)

No examination requirement

Table 4 TC 2.1.4 R (1) (i) *Employees* engaging in advising on investments in the course of *corporate finance business* only

Examination that must be passed within two years of starting the activity

K E Y	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory modules
1	SFA Corporate Finance Representative Examination Certificate in Corporate Finance	Securities Institute
1	SFA Securities Representatives Examination Certificate in Securities	Securities Institute
1	SFA Securities and Financial Derivatives Representative Examination Certificate in Securities and Financial Derivatives	Securities Institute
1	Diploma (including Regulation and Compliance, Investment Analysis and Fund Management)	Securities Institute

Examination that must be passed within two years of starting the activity		
	Diploma (must include a pass in Regulation and Compliance Paper)	
1	Fellow or Associate	Institute of Chartered Accountants in England and Wales
1	Fellow or Associate	Institute of Chartered Accountants in Ireland
1	Fellow or Associate	Institute of Chartered Accountants of Scotland
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Diploma – Corporate Finance paper	Securities Institute
2	Examination	NIBE – SVV – the Dutch Institute for the banking, insurance and stockbroking industry
2	Module B(ii), Securities and Portfolio Management	Law Society of England and Wales
2	Ordinary and Senior Certificates	South African Institute of Financial Markets
2	Registered Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification - Type 1	Japanese Securities Dealers Association
2	Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification - Class 1	Japanese Bankers Association
2	Secondary Examination	Analyst Association of Japan
3	SFA Registered Persons Examination – Section 1 (Regulation) Diploma (Regulation and Compliance)	Securities Institute
3	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research

Table 5 *TC 2.1.4 R (1) (j) Employees engaging in advising on investments which are (but not dealing in) securities (other than stakeholder pension schemes or broker funds) and derivatives. For employees engaging in advising in relation to venture capital investments only – see Annex 2R, Table 2.*

Examination that must be passed within two years of starting the activity

Examination that must be passed within two years of starting the activity		
KEY	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory modules
1	Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Associate or Fellow (life and pensions route only)	Chartered Insurance Institute
1	Certificate for Financial Advisers	Chartered Institute of Bankers
1	SFA Futures and Options Representative Examination plus Securities Representative Examination – Part 2 Certificate in Derivatives plus Certificate in Securities – Paper 2	Securities Institute
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	SFA Securities and Financial Derivatives Representative Examination Certificate in Securities and Financial Derivatives	Securities Institute
1	SFA Securities Representative Examination plus Financial Derivatives Module Certificate in Securities plus Financial Derivatives Module	Securities Institute
1	Diploma (including Regulation and Compliance, Investment Analysis and either Fund Management or Private Client Investment Advice and Management papers) Diploma (must include a pass in Regulation and Compliance Paper)	Securities Institute
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Financial Planning Certificate	Chartered Insurance Institute
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Initial Test of Competence	Institute of Chartered Accountants in England and Wales/Institute of Chartered Accountants in Ireland/Institute of Chartered Accountants of Scotland
1	Investment Advice Certificate	Securities Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Investment paper (post - August 1994 syllabus)	Chartered Institute of Bankers in Scotland
2	Chartered Financial Analyst	Association for Investment Management and Research
2	Examination	NIBE – SVV – the Dutch Institute for the banking, insurance and stockbroking

Examination that must be passed within two years of starting the activity		
		industry
2	Investment paper from the Associateship	Chartered Institute of Bankers
2	Investment paper (pre-August 1994 syllabus)	Chartered Institute of Bankers in Scotland
2	Investment Planning – Paper 2	Institute of Bankers in Ireland
2	Module B(ii), Securities and Portfolio Management	Law Society of England and Wales
2	Ordinary and Senior Certificates	South African Institute of Financial Markets
2	Registered Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification - Type 1	Japanese Securities Dealers Association
2	Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification – Class 1	Japanese Bankers Association
2	Secondary Examination	Analyst Association of Japan
3	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
3	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
3	Investment Advice Certificate – Paper 1	Securities Institute
3	SFA Registered Persons Examination – Section 1 (Regulation) Securities Institute Regulatory Paper	Securities Institute
3	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research

Table 6 TC 2.1.4 R (1) (k) *Employees engaging in advising on investments which are (but not dealing in) securities (other than stakeholder pension schemes or broker funds) only. For employees engaging in advising in relation to venture capital investments only – see Annex 2R, Table 2.*

Examination that must be passed within two years of starting the activity		
KEY	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory module
1	Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Associate or Fellow (life and pensions route only)	Chartered Insurance Institute
1	Certificate for Financial Advisers	Chartered Institute of Bankers
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	SFA Securities Representative Examination Certificate in Securities	Securities Institute
1	SFA Securities and Financial Derivatives Representative Examination Certificate in Securities and Financial Derivatives	Securities Institute
1	Diploma (including Regulation and Compliance, Investment Analysis and either Fund Management or Private Client Investment Advice and Management papers) Diploma (must include a pass in Regulation and Compliance Paper)	Securities Institute
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Financial Planning Certificate	Chartered Insurance Institute
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Initial Test of Competence	Institute of Chartered Accountants in England and Wales/ Institute of Chartered Accountants in Ireland/Institute of Chartered Accountants of Scotland
1	Investment Advice Certificate	Securities Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Investment paper (post - August 1994 syllabus)	Chartered Institute of Bankers in Scotland
2	Canadian Securities course plus Conduct and Practices	Canadian Securities Institute

Examination that must be passed within two years of starting the activity		
	Handbook	
2	Certificate	New Zealand Stock Exchange
2	Certificate in Financial Markets	Securities Institute of Australia
2	Certified European Financial Analyst	EFFAS Societies with accredited examinations
2	Chartered Financial Analyst (Level 1)	Association for Investment Management and Research
2	Dealers Representative Examinations	Singapore Exchange
2	Diploma	Association of Belgium Financial Analysts
2	Diploma of Financial Markets	Securities Institute of Australia
2	Elementary, Intermediate and International Capital Markets course	Korea Securities Training Institute
2	Examination	NIBE – SVV – the Dutch Institute for the banking, insurance and stockbroking industry
2	Examination	French Society of Investment Analysts
2	General Certification Programme	ISMA/University of Reading
2	Investment paper from the Associateship	Chartered Institute of Bankers
2	Investment paper (pre-August 1994 syllabus)	Chartered Institute of Bankers in Scotland
2	Investment Planning – Paper 2	Institute of Bankers in Ireland
2	International Capital Markets Qualification (including the Fixed Interest and Bond Markets Module)	Securities Institute/South African Institute of Financial Markets
2	Membership Examination	Johannesburg Stock Exchange
2	Module B(ii), Securities and Portfolio Management	Law Society of England and Wales
2	Ordinary and Senior Certificates	South African Institute of Financial Markets
2	Promotore Finanziano Examination	Italian Exchange
2	Registered Representatives Examination	Irish Stock Exchange/Dublin City University
2	Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification - Class 1	Japanese Bankers Association
2	Registered Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification - Type 1	Japanese Securities Dealers Association
2	Secondary Examination	Analyst Association of Japan
2	Series 7 – General Securities Representative Examination	National Association of Securities Dealers
2	Trainee Dealers Representative Examination	Kuala Lumpur Stock Exchange
3	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
3	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
3	Investment Advice Certificate – Paper 1	Securities Institute

Examination that must be passed within two years of starting the activity		
3	SFA Registered Persons Examination – Section 4 (Regulation) Securities Institute Regulatory Paper	Securities Institute
3	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Management and Research

Table 7 TC 2.1.4 R (1) (I) Employees engaging in advising on investments which are (but not dealing in) derivatives only

Examination that must be passed within two years of starting the activity		
K E Y	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory module
1	Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Associate or Fellow (life and pensions route only)	Chartered Insurance Institute
1	Certificate for Financial Advisers	Chartered Institute of Bankers
1	SFA Futures and Options Representative Examination Certificate in Derivatives	Securities Institute
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	SFA Securities and Financial Derivatives Representative Examination Certificate in Securities and Financial Derivatives	Securities Institute
1	Diploma (including Regulation and Compliance, Investment Analysis and either Fund Management or Private Client Investment Advice and Management papers) Diploma (must include a pass in Regulation and Compliance Paper)	Securities Institute
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Financial Planning Certificate	Chartered Insurance Institute
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Initial Test of Competence	Institute of Chartered Accountants in England and Wales/Institute of Chartered Accountants in Ireland/Institute of Chartered Accountants of Scotland
1	Investment Advice Certificate	Securities Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Investment paper (post - August 1994 syllabus)	Chartered Institute of Bankers in Scotland
2	ACI Diploma	ACI
2	Chartered Financial Analyst	Association for Investment Management and Research
2	Derivatives Fundamentals course and Futures/Options	Canadian Securities Institute

Examination that must be passed within two years of starting the activity		
	Licensing course	
2	Diploma including passes in both the Australian Futures Trading and Options Trading papers	Securities Institute of Australia
2	Examination	NIBE – SVV – the Dutch Institute for the banking, insurance and stockbroking industry
2	Examination	Norwegian Society of Financial Analysts
2	International Capital Markets Qualification (ICMQ) including a pass in Futures, Options and other Derivative Products paper	Securities Institute/South African Institute of Financial Markets
2	Investment paper from the Associateship	Chartered Institute of Bankers
2	Investment paper (pre-August 1994 syllabus)	Chartered Institute of Bankers in Scotland
2	Investment Planning – Paper 2	Institute of Bankers in Ireland
2	Module B(ii), Securities and Portfolio Management	Law Society of England and Wales
2	Ordinary and Senior Certificates	South African Institute of Financial Markets
2	Registered Representatives Examination	Sydney Futures Exchange
2	Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification – Class 1	Japanese Bankers Association
2	Registered Representative of Public Securities Examination (pre-April 1990)/Representative of Public Securities Qualification - Type 1	Japanese Securities Dealers Association
2	Secondary Examination	Analyst Association of Japan
2	Series 3 – Futures Representative Examination	National Futures Association
2	Singapore Exchange Futures Trading Test	Singapore Institute of Banking and Finance
3	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
3	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
3	Investment Advice Certificate – Paper 1	Securities Institute
3	SFA Registered Persons Examination – Section 1 (Regulation) Securities Institute Regulatory Paper	Securities Institute
3	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Management and Research

Annex 4R The interim approved examinations referred to in TC 2

Table 1 TC 2.1.4 R (1) (m) *Employees engaging in the activity of a broker fund adviser*

Examination that must be passed before starting the activity		
K E Y	1	Interim approved examinations which meet the requirements of TC 2.4.5 R (2)
	2	Interim approved examinations which meet the requirements of TC 2.4.5 R (2) with an appropriate UK regulatory module
	3	UK regulatory modules
1	G70 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Investment Management Asset Allocation Qualification	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
3	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
3	Certificate in Investment Planning – Paper 1	Chartered Institute of Bankers in Scotland
3	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
3	Investment Advice Certificate – Paper 1	Securities Institute
3	Regulation and Compliance paper of Diploma	Securities Institute
3	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research

Table 2 TC 2.1.4 R (1) (n) *Employees engaging in advising on syndicate participation at Lloyd's*

Examination that must be passed before starting the activity	
Interim approved examinations which meet the requirements of TC 2.4.5 R (2)	
Lloyd's Introductory Test	Lloyd's
Lloyd's Market Certificate	Lloyd's/Chartered Insurance Institute

Table 3 TC 2.1.4 R (1) (o) *Employees engaging in the activity of a pension transfer specialist*

Examination that must be passed before starting the activity	
Interim approved examinations which meet the requirements of TC 2.4.5 R (2)	
Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
Fellow or Associate by examination	Pensions Management Institute

Examination that must be passed before starting the activity	
Fellow or Associate including three pensions-related subjects as confirmed by the examining body	Chartered Insurance Institute
G60 paper of Advanced Financial Planning Certificate	Chartered Insurance Institute
Pensions paper of Professional Investment Certificate	Chartered Institute of Bankers

Annex 5R The interim approved examinations referred to in TC 2

Table 1 TC 2.1.4 R (2) (a) *Employees overseeing on a day-to-day basis operating, or acting as a trustee or depositary of, a collective investment scheme*

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity		
Stage 1 Industry awareness Stage 2 Regulatory knowledge Stage 3 Knowledge relevant to the role		
1	Certificate for Financial Advisers - Paper 1	Chartered Institute of Bankers
1	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	SFA Registered Persons Examination Certificate in Securities – Paper 2	Securities Institute
1	Company Secretarial Practice and Share Registration Practice (including the Regulatory module within the examination)	Institute of Chartered Secretaries and Administrators
1	Diploma	Securities Institute
1	Diploma - International Global Operations Management paper	Securities Institute
1	Diploma – Operations Management paper	Securities Institute
1	Fellow, Member or Associate	Chartered Institute of Bankers in Scotland
1	Fellow or Associate	Association of Corporate Treasurers
1	Fellow or Associate	Association of Chartered Certified Accountants
1	Fellow or Associate	Chartered Institute of Bankers
1	Fellow or Associate	Chartered Institute of Bankers in Ireland
1	Fellow or Associate	Chartered Institute of Management Accountants

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

1	Fellow or Associate	Chartered Institute of Public Finance Accountants
1	Fellow or Associate	Chartered Insurance Institute
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate	Institute of Chartered Accountants in England and Wales
1	Fellow or Associate	Institute of Chartered Accountants in Ireland
1	Fellow or Associate	Institute of Chartered Accountants of Scotland
1	Fellow or Associate	Institute of Chartered Secretaries and Administrators
1	Fellow or Associate	Pensions Management Institute
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Financial Planning Certificate - Paper 1	Chartered Insurance Institute
1	Investment Administration Qualification – Introduction to Securities and Investment module	Securities Institute
1	Investment Advice Certificate - Paper 1	Securities Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Member	Association of Accounting Technicians
1	Solicitor	Law Society of England and Wales/Law Society of Scotland/Law Society of Northern Ireland
2	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
2	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
2	Certificate in Company Secretarial Practice and Share Registration Practice (including the Regulatory module within the examination)	Institute of Chartered Secretaries and Administrators
2	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
2	Diploma – International Global-Operations Management paper	Securities Institute
2	Diploma – Operations Management paper	Securities Institute
2	Diploma – Regulation and Compliance paper	Securities Institute
2	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
2	Investment Advice Certificate – Paper 1	Securities Institute
2	Investment Administration Qualification – Regulatory Environment module	Securities Institute
2	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

2	Investment Regulation and Practice paper of the Associate Examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	SFA Futures and Options Representative Examination	Securities Institute
2	SFA Securities and Financial Derivatives Representative Examination	Securities Institute
2	SFA Securities Representative Examination	Securities Institute
2	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
3	Certificate in Company Secretarial Practice and Share Registration Practice (including the Regulatory module within the examination)	Institute of Chartered Secretaries and Administrators
3	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
3	Diploma - International Global Operations Management paper	Securities Institute
3	Diploma – Operations Management paper	Securities Institute
3	Investment Administration Management Award	Association of Unit Trusts and Investment Funds
3	Investment Administration Qualification – CREST Settlement module	Securities Institute
3	Investment Administration Qualification – Derivatives Operations/Exchange – Traded Derivative Administration module	Securities Institute
3	Investment Administration Qualification – Global Custody module	Securities Institute
3	Investment Administration Qualification – ISA and PEP Administration module	Securities Institute
3	Investment Administration Qualification – OEIC Administration module	Securities Institute
3	Investment Administration Qualification – PEP Administration module	Securities Institute
3	Investment Administration Qualification – Unit Trust Administration module	Securities Institute
3	A firm may use alternative methods of assessing the required level of knowledge and understanding at stage 3 only where the firm can demonstrate that none of the above examinations are appropriate.	

Annex 6R The interim approved examinations referred to in TC 2

Table 1 TC 2.1.4 R (2) (b) Employees overseeing on a day-to-day basis safeguarding and administering investments or holding of client money

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity		
	Stage 1 Industry awareness	
	Stage 2 Regulatory knowledge	
	Stage 3 Knowledge relevant to the role	
1	Certificate for Financial Advisers - Paper 1	Chartered Institute of Bankers
1	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	SFA Registered Persons Examination Certificate in Securities – Paper 2	Securities Institute
1	Company Secretarial Practice and Share Registration Practice (including the Regulatory module within the examination)	Institute of Chartered Secretaries and Administrators
1	Diploma	Securities Institute
1	Diploma – International Global Operations Management paper	Securities Institute
4	Diploma – Operations Management paper	Securities Institute
1	Fellow, Member or Associate	Chartered Institute of Bankers in Scotland
1	Fellow or Associate	Association of Chartered Certified Accountants
1	Fellow or Associate	Association of Corporate Treasurers
1	Fellow or Associate	Chartered Institute of Bankers
1	Fellow or Associate	Chartered Institute of Bankers in Ireland
1	Fellow or Associate	Chartered Institute of Management Accountants
1	Fellow or Associate	Chartered Institute of Public Finance Accountants
1	Fellow or Associate	Chartered Insurance Institute
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate	Institute of Chartered Accountants in England and Wales
1	Fellow or Associate	Institute of Chartered Accountants in Ireland
1	Fellow or Associate	Institute of Chartered Accountants of Scotland
1	Fellow or Associate	Institute of Chartered Secretaries and Administrators
1	Fellow or Associate	Pensions Management Institute
1	Fellow or Associate by examination	United Kingdom Society of Investment

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

		Professionals/Institute of Investment Management and Research
1	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
1	Investment Administration Qualification – Introduction to Securities and Investment module	Securities Institute
1	Investment Advice Certificate – Paper 1	Securities Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Member	Association of Accounting Technicians
1	Solicitor	Law Society of England and Wales/Law Society of Scotland/Law Society of Northern Ireland
2	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
2	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
2	Certificate in Company Secretarial Practice and Share Registration Practice (including the Regulatory module within the examination)	Institute of Chartered Secretaries and Administrators
2	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
2	Diploma – International Global Operations Management paper	Securities Institute
2	Diploma – Operations Management paper	Securities Institute
2	Diploma – Regulation and Compliance paper	Securities Institute
2	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
2	Investment Advice Certificate – Paper 1	Securities Institute
2	Investment Administration Qualification – Regulatory Environment module	Securities Institute
2	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Investment Regulation and Practice paper of the Associate Examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	SFA Futures and Options Representative Examination	Securities Institute
2	SFA Securities and Financial Derivatives Representative Examination	Securities Institute
2	SFA Securities Representative Examination	Securities Institute
2	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
3	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
3	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

3	Certificate in Company Secretarial Practice and Share Registration Practice (including the Regulatory module within the examination)	Institute of Chartered Secretaries and Administrators
3	Diploma - International Global Operations Management paper	Securities Institute
3	Diploma—Operations Management paper	Securities Institute
3	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
3	Investments Administration Management Award	Association of Unit Trusts and Investment Funds
3	Investment Administration Qualification – CREST Settlement module	Securities Institute
3	Investment Administration Qualification – Derivatives Operations/Exchange – Traded Derivative Administration module	Securities Institute
3	Investment Administration Qualification – Global Custody module	Securities Institute
3	Investment Administration Qualification – ISA and PEP Administration module	Securities Institute
3	Investment Administration Qualification – OEIC Administration module	Securities Institute
3	Investment Administration Qualification – PEP Administration module	Securities Institute
3	Investment Administration Qualification – Unit Trust Administration module	Securities Institute
3	Investment Advice Certificate – Paper 1	Securities Institute
3	A firm may use alternative methods of assessing the required level of knowledge and understanding at stage 3 only where the firm can demonstrate that none of the above examinations are appropriate.	

Annex 7R The interim approved examinations referred to in TC 2

Table 1 **TC 2.1.4 R (2) (c) *Employees overseeing on a day-to-day basis the following administrative functions in relation to managing investments:***

- (i) arranging settlement;
- (ii) monitoring and processing corporate actions;
- (iii) *client* account administration, liaison and reporting, including valuation and performance measurement;
- (iv) *ISA* or *PEP* administration;
- (v) *investment trust savings scheme* administration

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

Stage 1	Industry awareness	
Stage 2	Regulatory knowledge	
Stage 3	Knowledge relevant to the role	
1	Certificate for Financial Advisers - Paper 1	Chartered Institute of Bankers
1	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	SFA Registered Persons Examination Certificate in Securities – Paper 2	Securities Institute
1	Company Secretarial Practice and Share Registration Practice (including the Regulatory module within the examination)	Institute of Chartered Secretaries and Administrators
1	Diploma	Securities Institute
1	Diploma - International Global Operations Management paper	Securities Institute
1	Diploma – Operations Management paper	Securities Institute
1	Fellow, Member or Associate	Chartered Institute of Bankers in Scotland
1	Fellow or Associate	Association of Chartered Certified Accountants
1	Fellow or Associate	Association of Corporate Treasurers
1	Fellow or Associate	Chartered Institute of Bankers
1	Fellow or Associate	Chartered Institute of Bankers in Ireland
1	Fellow or Associate	Chartered Institute of Management Accountants
1	Fellow or Associate	Chartered Institute of Public Finance Accountants
1	Fellow or Associate	Chartered Insurance Institute
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate	Institute of Chartered Accountants in England and Wales
1	Fellow or Associate	Institute of Chartered Accountants in Ireland
1	Fellow or Associate	Institute of Chartered Accountants of Scotland
1	Fellow or Associate	Institute of Chartered Secretaries and Administrators
1	Fellow or Associate	Pensions Management Institute
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Financial Planning Certificate - Paper 1	Chartered Insurance Institute

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

1	Investment Administration Qualification - Introduction to Securities and Investment module	Securities Institute
1	Investment Advice Certificate - Paper 1	Securities Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Member	Association of Accounting Technicians
1	Solicitor	Law Society of England and Wales/Law Society of Scotland/Law Society of Northern Ireland
2	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
2	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
2	Certificate in Company Secretarial Practice and Share Registration Practice (including the Regulatory module within the examination)	Institute of Chartered Secretaries and Administrators
2	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
2	Diploma – International Operations Management paper	Securities Institute
2	Diploma – Operations Management paper	Securities Institute
2	Diploma – Regulation and Compliance paper	Securities Institute
2	Financial Planning Certificate - Paper 1	Chartered Insurance Institute
2	Investment Administration Qualification - Regulatory Environment module	Securities Institute
2	Investment Advice Certificate - Paper 1	Securities Institute
2	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	Investment Regulation and Practice paper of the Associate Examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
2	SFA Futures and Options Representative Examination	Securities Institute
2	SFA Securities and Financial Derivatives Representative Examination	Securities Institute
2	SFA Securities Representative Examination	Securities Institute
2	UK Regulation and Markets version of Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
3	Certificate in Company Secretarial Practice and Share Registration Practice (including the Regulatory module within the examination)	Institute of Chartered Secretaries and Administrators
3	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
3	Diploma – International Global Operations Management paper	Securities Institute
3	Diploma – Operations Management paper	Securities Institute
3	Investment Administration Management Award	Association of Unit Trusts and

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

		Investment Funds
3	Investment Administration Qualification – CREST Settlement module	Securities Institute
3	Investment Administration Qualification – Derivatives Operations/Exchange – Traded Derivative Administration module	Securities Institute
3	Investment Administration Qualification – Global Custody module	Securities Institute
3	Investment Administration Qualification – ISA and PEP Administration module	Securities Institute
3	Investment Administration Qualification – OEIC Administration module	Securities Institute
3	Investment Administration Qualification – PEP Administration module	Securities Institute
3	Investment Administration Qualification – Unit Trust Administration module	Securities Institute
3	A firm may use alternative methods of assessing the required level of knowledge and understanding at stage 3 only where the firm can demonstrate that none of the above examinations are appropriate.	

Annex 8R The interim approved examinations referred to in TC 2

Table 1 **TC 2.1.4 R (2) (d) Employees overseeing on a day-to-day basis the following *administrative functions* in relation to the *effecting or carrying out of life policies*:**

- (i) new business administration;
- (ii) *policy* alterations including surrenders and *policy* loans;
- (iii) preparing *projections*;
- (iv) processing *claims*, including pension payments;
- (v) fund switching

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

Stage 1	Industry awareness	
Stage 2	Regulatory knowledge	
Stage 3	Knowledge relevant to the role	
1	Certificate for Financial Advisers - Paper 1	Chartered Institute of Bankers
1	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	Certificate of Insurance Practice	Chartered Insurance Institute
1	SFA Registered Persons Examination Certificate in Securities - Paper 2	Securities Institute
1	Fellow, Member or Associate	Chartered Institute of Bankers in Scotland
1	Fellow or Associate	Association of Chartered Certified Accountants
1	Fellow or Associate	Association of Corporate Treasurers
1	Fellow or Associate	Chartered Institute of Bankers
1	Fellow or Associate	Chartered Institute of Bankers in Ireland
1	Fellow or Associate	Chartered Institute of Management Accountants
1	Fellow or Associate	Chartered Institute of Public Finance Accountants
1	Fellow or Associate	Chartered Insurance Institute
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate	Institute of Chartered Accountants in England and Wales
1	Fellow or Associate	Institute of Chartered Accountants in Ireland
1	Fellow or Associate	Institute of Chartered Accountants of Scotland
1	Fellow or Associate	Institute of Chartered Secretaries and Administrators
1	Fellow or Associate	Pensions Management Institute
1	Fellow or Associate by examination	United Society of Investment Professionals/Institute of Investment Management and Research
1	Financial Planning Certificate - Paper 1	Chartered Insurance Institute
1	Investment Administration Qualification - Introduction to Securities and Investment module	Securities Institute
1	Investment Advice Certificate - Paper 1	Securities Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Member	Association of Accounting Technicians
1	Solicitor	Law Society of England and Wales/Law Society of Scotland/Law Society of Northern Ireland
2	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
2	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity		
2	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
2	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
2	Investment Administration Qualification – Regulatory Environment module	Securities Institute
2	Investment Advice Certificate – Paper 1	Securities Institute
3	Certificate for Financial Advisers – Paper 2	Chartered Institute of Bankers
3	Certificate of Insurance Practice (life or pensions route)	Chartered Insurance Institute
3	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
3	Fellow or Associate (by examination)	Pensions Management Institute
3	Fellow or Associate (life and pensions route only)	Chartered Insurance Institute
3	Financial Planning Certificate – Paper 2	Chartered Insurance Institute
3	Initial Test of Competence	Institute of Chartered Accountants in England and Wales
3	Investment Advice Certificate - Paper 2	Securities Institute
3	Life assurance (735)	Chartered Insurance Institute
3	Life office administration	Chartered Insurance Institute
3	Module B(i), Retail Branded/Packaged Products	Law Society of England and Wales
3	Pensions administration	Chartered Insurance Institute
3	Pensions law, taxation and administration (740)	Chartered Insurance Institute
3	A firm may use alternative methods of assessing the required level of knowledge and understanding at stage 3 only where the firm can demonstrate that none of the above examinations are appropriate.	

Annex 9R The interim approved examinations referred to in TC 2

Table 1 TC 2.1.4 R (2) (e) *Employees overseeing on a day-to-day basis taking private customers through decision trees in connection with a stakeholder pension scheme*

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity	
Stage 1	Industry awareness
Stage 2	Regulatory knowledge
Stage 3	Knowledge relevant to the role

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

1	Certificate for Financial Advisers - Paper 1	Chartered Institute of Bankers
1	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	Fellow, Member or Associate	Chartered Institute of Bankers in Scotland
1	Fellow or Associate	Association of Chartered Certified Accountants
1	Fellow or Associate	Association of Corporate Treasurers
1	Fellow or Associate	Chartered Institute of Bankers
1	Fellow or Associate	Chartered Institute of Bankers in Ireland
1	Fellow or Associate	Chartered Institute of Management Accountants
1	Fellow or Associate	Chartered Institute of Public Finance Accountants
1	Fellow or Associate	Chartered Insurance Institute
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate	Institute of Chartered Accountants in England and Wales
1	Fellow or Associate	Institute of Chartered Accountants in Ireland
1	Fellow or Associate	Institute of Chartered Accountants of Scotland
1	Fellow or Associate	Institute of Chartered Secretaries and Administrators
1	Fellow or Associate	Pensions Management Institute
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Financial Planning Certificate - Paper 1	Chartered Insurance Institute
1	Investment Administration Qualification - Introduction to Securities and Investment module	Securities Institute
1	Investment Advice Certificate - Paper 1	Securities Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Member	Association of Accounting Technicians
1	Solicitor	Law Society of England and Wales/Law Society of Scotland/Law Society of Northern Ireland
2	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
2	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
2	Financial Planning Certificate – Paper 1	Chartered Insurance Institute

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

2	Investment Advice Certificate – Paper 1	Securities Institute
3	Certificate for Financial Advisers – Paper 2	Chartered Institute of Bankers
3	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
3	Fellow or Associate (by examination)	Pensions Management Institute
3	Fellow or Associate (pensions route)	Chartered Insurance Institute
3	Financial Planning Certificate – Paper 2	Chartered Insurance Institute
3	Initial Test of Competence	Institute of Chartered Accountants in England and Wales/ Institute of Chartered Accountants in Ireland/Institute of Chartered Accountants of Scotland
3	Investment Advice Certificate - Paper 2	Securities Institute
3	Module B(i), Retail Branded/Packaged Products	Law Society of England and Wales
3	A firm may use alternative methods of assessing the required level of knowledge and understanding at stage 3 only where the firm can demonstrate that none of the above examinations are appropriate.	

Annex 10R The interim approved examinations referred to in TC 2

Table 1 *TC 2.1.4 R (2) (f) Employees overseeing on a day-to-day basis the following administrative functions in relation to the operation of a stakeholder pension scheme:*

- (i) new business administration;
- (ii) receipt of or alteration to contributions;
- (iii) preparing *projections* and annual statements;
- (iv) administration of transfers;
- (v) handling claims, including pension payments;
- (vi) fund allocation and switching

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity		
	Stage 1 Industry awareness	
	Stage 2 Regulatory knowledge	
	Stage 3 Knowledge relevant to the role	
1	Certificate for Financial Advisers - Paper 1	Chartered Institute of Bankers
1	Certificate in Collective Investment Scheme Administration	Institute of Chartered Secretaries and Administrators
1	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
1	Fellow, Member or Associate	Chartered Institute of Bankers in Scotland
1	Fellow or Associate	Association of Chartered Certified Accountants
1	Fellow or Associate	Association of Corporate Treasurers
1	Fellow or Associate	Chartered Institute of Bankers
1	Fellow or Associate	Chartered Institute of Bankers in Ireland
1	Fellow or Associate	Chartered Institute of Management Accountants
1	Fellow or Associate	Chartered Institute of Public Finance Accountants
1	Fellow or Associate	Chartered Insurance Institute
1	Fellow or Associate	Faculty of Actuaries/Institute of Actuaries
1	Fellow or Associate	Institute of Chartered Accountants in England and Wales
1	Fellow or Associate	Institute of Chartered Accountants in Ireland
1	Fellow or Associate	Institute of Chartered Accountants of Scotland

All three stages 1, 2 and 3 of the approved examinations that must be passed within two years of starting the activity

1	Fellow or Associate	Institute of Chartered Secretaries and Administrators
1	Fellow or Associate	Pensions Management Institute
1	Fellow or Associate by examination	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Financial Planning Certificate - Paper 1	Chartered Insurance Institute
1	Investment Administration Qualification - Introduction to Securities and Investment module	Securities Institute
1	Investment Advice Certificate - Paper 1	Securities Institute
1	Investment Management Certificate	United Kingdom Society of Investment Professionals/Institute of Investment Management and Research
1	Member	Association of Accounting Technicians
1	Solicitor	Law Society of England and Wales/Law Society of Scotland/Law Society of Northern Ireland
2	Certificate for Financial Advisers – Paper 1	Chartered Institute of Bankers
2	Certificate in Investment Planning	Chartered Institute of Bankers in Scotland
2	Financial Planning Certificate – Paper 1	Chartered Insurance Institute
2	Investment Advice - Certificate – Paper 1	Securities Institute
3	Associate or Fellow	Faculty of Actuaries/Institute of Actuaries
3	Certificate for Financial Advisers – Paper 2	Chartered Institute of Bankers
3	Certificate of Insurance Practice (pensions route)	Chartered Insurance Institute
3	Fellow or Associate (by examination)	Pensions Management Institute
3	Fellow or Associate (pensions route)	Chartered Insurance Institute
3	Financial Planning Certificate – Paper 2	Chartered Insurance Institute
3	Initial Test of Competence	Institute of Chartered Accountants in England and Wales/Institute of Accountants in Ireland/Institute of Accountants of Scotland
3	Investment Advice Certificate - Paper 2	Securities Institute
3	Module B(i), Retail Branded/Packaged Products	Law Society of England and Wales
3	Pensions administration	Chartered Insurance Institute
3	Pensions law, taxation and administration (740)	Chartered Insurance Institute
3	A firm may use alternative methods of assessing the required level of knowledge and understanding at stage 3 only where the firm can demonstrate that none of the above examinations are appropriate.	

SUPERVISION MANUAL (AMENDMENT NO 5) INSTRUMENT 2001

Powers exercised

- A. The Financial Services Authority amends the Supervision manual in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (the "Act"):
- (1) section 138 (General rule-making power);
 - (2) section 156 (General supplementary powers);
 - (3) section 157(1) (Guidance);
 - (4) section 340 (Appointment).
- B. The provisions of the Act relevant to rules and listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force at the beginning of the day on which section 19 of the Act (The general prohibition) comes into force.

Amendment of the Supervision manual

- D. The Supervision manual is amended:
- (1) in accordance with Annexes A and B to this instrument; and
 - (2) by inserting the provisions in Annexes C, D and E to this instrument.

Citation

- E. This instrument may be cited as the Supervision Manual (Amendment No 5) Instrument 2001.

By order of the Board
15 November 2001

ANNEX A
SUP 3 (Auditors)

In this Annex, where amendments are shown rather than described, underlining indicates new text and striking through indicates deleted text.

SUP Transitional provisions In the first table of transitional provisions, insert the following new rows:

3A	<i>SUP 3.10</i>	R	<p>(1) Paragraphs (2) and (3) apply to the auditor of an <i>authorised professional firm</i>:</p> <p>(a) if that <i>firm</i> has an <i>accounting reference date</i> between 1 June 2001 and 30 November 2001 (inclusive); and</p> <p>(b) in relation to delivery of a client assets report on that <i>firm</i> for the period ending on that <i>accounting reference date</i>.</p> <p>(2) An auditor will not contravene <i>SUP 3.10.4R, SUP 3.10.5R, SUP 3.10.9R or SUP 3.10.10R</i> by delivering a report in the format required by the rules of the <i>firm's previous regulator</i> for client asset reports.</p> <p>(3) <i>SUP 3.10.7R</i> is changed so that the period for delivery of the report is the longer of:</p> <p>(a) four months from the <i>firm's accounting reference date</i>; and</p> <p>(b) the period permitted under the rules of the <i>firm's previous regulator</i>.</p>	From commencement for six months	<i>Commencement</i>
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3B	SUP 3.10.6R, SUP 3.10.7R	G	<p>Auditors affected by paragraph 3A are reminded that:</p> <p>(1) if the report has been delivered to the <i>firm's previous regulator</i> before <i>commencement</i>, it need not be delivered to the <i>FSA</i> (paragraph 7 of the transitional provisions in <i>GEN</i>); in this case, the first report to the <i>FSA</i> should cover a period ending not more than 53 weeks after the period covered by the last report to the <i>previous regulator</i>;</p> <p>(2) a report delivered after <i>commencement</i> should be submitted and addressed to the <i>FSA</i> in accordance with SUP 16.3.6R to SUP 16.3.13R; and</p> <p>(3) the auditor is free to fulfil its duty to deliver a report to the <i>FSA</i> by doing so before <i>commencement</i> (paragraph 3 of the transitional provisions in <i>GEN</i>).</p>	From <i>commencement</i> for six months	<i>Commencement</i>
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SUP 3.1.2R Amend the table as shown:

(1)	Category of firm	(2) Sections applicable to the firm	(3) Sections applicable to its auditor
(1)	<u>Authorised professional firm which is required by IPRU(INV) 2.1.2R to comply with chapter 3, 5, 10 or 13 of IPRU(INV) (Note 1)</u>	<u>SUP 3.1 – SUP 3.7</u>	<u>SUP 3.1, SUP 3.2, SUP 3.8 – SUP 3.10</u>
(2)	<u>Authorised professional firm not within (1) to which either or both of COB 9.1 (Custody) and COB 9.3 (Client money) applies, unless the firm is regulated by The Law Society (England and Wales), The Law Society of Scotland or The Law Society of Northern Ireland (Note 2)</u>	<u>SUP 3.1 – SUP 3.7</u>	<u>SUP 3.1, SUP 3.2, SUP 3.8, SUP 3.10</u>
(3)	<u>Authorised professional firm not within (1) or (2) which has an auditor appointed under or as a result of a statutory provision other than in the Act</u>	<u>SUP 3.1, SUP 3.2, SUP 3.7</u>	<u>SUP 3.1, SUP 3.2, SUP 3.8</u>

(4) (4)	<i>Bank or building society which in either case carries on designated investment business</i>	<i>SUP 3.1 – SUP 3.7</i>	<i>SUP 3.1, SUP 3.2, SUP 3.8, SUP 3.10</i>
(5) (2)	<i>Bank or building society which in either case does not carry on designated investment business</i>	<i>SUP 3.1 – SUP 3.7</i>	<i>SUP 3.1, SUP 3.2, SUP 3.8</i>
(6) (4)	<i>Insurer, the Society of Lloyd's, underwriting agent or members' adviser</i>	<i>SUP 3.1 – SUP 3.7</i>	<i>SUP 3.1, SUP 3.2, SUP 3.8</i>
(7) (3)	<i>Investment management firm, personal investment firm (other than a small personal investment firm), or securities and futures firm (Note 43)</i>	<i>SUP 3.1 – SUP 3.7</i>	<i>SUP 3.1, SUP 3.2, SUP 3.8 - SUP 3.10</i>
(8) (5)	<i>Small personal investment firm or, service company or authorised professional firm which, in each either case, has an auditor appointed under or as a result of a statutory provision other than in the Act (Note 2)</i>	<i>SUP 3.1, SUP 3.2, SUP 3.7</i>	<i>SUP 3.1, SUP 3.2, SUP 3.8</i>

Note ~~12~~ = This note applies in relation to an *authorised professional firm* which is required by *IPRU(INV)* 2.1.2R to comply with chapter 3, 5, 10 or 13 of *IPRU(INV)*. This chapter applies to such an *authorised professional firm* in row (1) (and its auditor) as if it were the *firm* were of the relevant *firm* type in the right-hand column of *IPRU(INV)* 2.1.4R.

Note 2 = In row (2):

(a) *COB 9.1* (Custody) is treated as applying only if (i) the *firm* safeguards and administers investments in connection with managing investments (other than when acting as trustee) or (ii) it safeguards and administers investments in relation to bonded investments;

(b) *COB 9.3* (Client money) is treated as applying only if the *firm* receives or holds client money other than under an arrangement where commission is rebated to the client;

but, if *COB 9.1* or *COB 9.3* is treated as applying, then *SUP 3.10* (Duties of auditors: notification and report on client assets) applies to the whole of the business within the scope of *COB 9.1* or *COB 9.3*.

Note ~~13~~ = This note applies in relation to an *oil market participant* to which *IPRU(INV)* 3 does not apply and in relation to an *energy market participant* to which *IPRU(INV)* 3 does not apply. In *SUP 3*:

(a) only *SUP 3.1*, *SUP 3.2* and *SUP 3.7* are applicable to such a *firm*;
and

(b) only *SUP 3.1*, *SUP 3.2* and *SUP 3.8* are applicable to its auditor;
and, in each case, only if it has an auditor appointed under or as a result of a statutory provision other than in the *Act*.

SUP 3.1.8G Amend the heading as shown:

Authorised professional firms ~~Auditors of firms of solicitors subject to SUP 3.10~~

SUP 3.1.8G Amend as shown:

A *firm* of solicitors is not required to comply with the *client money rules* (*COB 9.3*) and instead must comply with its *designated professional body's* rules (*COB 9.3.25R*). *SUP 3.10* is therefore modified for the auditor of such a *firm*, if it applies (see Note 2 to the table in *SUP 3.1.2R* and *SUP 3.10.2R*). This chapter applies to an *authorised professional firm* as set out in rows (1) to (3) of *SUP 3.1.2R*:

(1) a *firm* in row (1) is treated in the same way as its equivalent in row (7);

- (2) large parts of this chapter apply to a *firm* in row (2) and its auditor; the report on client assets under SUP 3.10 (Duties of auditors: notification and report on client assets) must cover compliance for the whole of the business within the scope of whichever of COB 9.1 and COB 9.3 is treated as applying; but there is no requirement for the auditor to prepare a report to the FSA on the firm's financial statements;
- (3) this chapter has limited application to a *firm* in row (3) and its auditor.

SUP 3.2.4G Amend as shown:

SUP 3.1.1R and *SUP 3.1.2R* limit the application of this chapter in relation to:

- (1) *authorised professional firms to which COB 9.1 (Custody) and COB 9.3 (Client money) do not apply or which are not required by IPRU(INV) 2.1.2R to comply with chapter 3, 5, 10 or 13 of IPRU(INV);*
- (2) *oil market participants, and energy market participants, to whom IPRU(INV) 3 does not apply;*
- (3) *small personal investment firms; and*
- (4) *service companies.*

Such a *firm* is not required, under this chapter, to appoint an auditor because *SUP 3.3* (Appointment of auditors) does not apply. If such a *firm* appoints an auditor under or as a result of a statutory provision other than in the *Act*, for example, under the Companies Act 1985, *SUP 3.7* (Notification of matters raised by auditor) and *SUP 3.8* (Rights and duties of all auditors) nevertheless apply to help the *FSA* discharge its functions under the *Act*.

Annex B
SUP 15 (Notification to the FSA)

SUP 15.8 Insert the following new rule:

15.8.3 **Insurers' commission clawback**

- R (1) An *insurer* must notify the *FSA* in respect of any *firm* (the "intermediary") as soon as reasonably practicable if:
- (a) any amount of *commission* due from the intermediary to the *insurer* in accordance with an indemnity commission clawback arrangement remains outstanding for four *months* after the date when the *insurer* gave notice to the intermediary that the relevant *premium* had not been paid; or
 - (b) any amount of *commission* due from the intermediary to the *insurer* as a result of either the cancellation of an investment agreement or overpayment of *commission* remains outstanding for four *months* after the date on which the *insurer* gave notice to the intermediary that cancellation or overpayment had occurred.
- (2) A notification in (1):
- (a) need not be given unless the total amounts outstanding under (1)(a) and (b) in respect of the intermediary exceed £1,000; and
 - (b) must give the identity of the intermediary and the amount of *commission* which remains outstanding.
- (3) In (1) an "indemnity commission clawback arrangement" is an arrangement under which:
- (a) an *insurer* pays *commission* to an intermediary before the date on which the *premium* is due under the relevant *investment agreement*; and
 - (b) the *insurer* requires repayment of the *commission*, if the *investment agreement* is terminated by reason of a failure to pay a *premium*.

Annex C

SUP chapter 18

18 Transfers of business

18.1 Application

- 18.1.1 G This chapter provides *guidance* in relation to business transfers.
- (1) *SUP* 18.2 applies to any *firm* or to any *member* of Lloyd's proposing to transfer the whole or part of its business by an *insurance business transfer scheme* or to accept such a transfer. *SUP* 18.2.31G to *SUP* 18.2.41G also apply to the *independent expert* making the *scheme report*.
 - (2) *SUP* 18.3 applies to any *firm* proposing to accept certain transfers of *insurance business* taking place outside the *United Kingdom*.
 - (3) *SUP* 18.4 applies to any *friendly societies* proposing to amalgamate under section 85 of the Friendly Societies Act 1992, to any *friendly society* proposing to transfer engagements under section 86 of that Act to another body and to any body (whether or not it is a *friendly society*) proposing to accept such a transfer. *SUP* 18.4 also provides *guidance* to those wishing to make representations to the *FSA* about an application for confirmation of an amalgamation or transfer.

- 18.1.2 G *Guidance* on *building society* transfers and mergers is given in *IPRU(BSOC)*.

INTRODUCTION

- 18.1.3 G *Insurance business transfers* are subject to Part VII of the *Act* and must be approved by the court under section 111. The Financial Services and Markets Act 2000 (Control of Business Transfers)(Requirements on Applicants) Regulations 2001 (SI 2001/[number to be inserted later]) also apply. These regulations set out minimum requirements for publicising schemes, notifying certain interested parties directly (subject to the discretion of the court), and giving information to anyone who requests it.
- 18.1.4 G An *insurance business transfer scheme* is defined in section 105 of the *Act* and the definition has been extended to transfers from *members* of Lloyd's to reflect the effect of the Financial Services and Markets Act 2000 (Control of Transfers of Business Done at Lloyd's) Order 2001(SI 2001/[number to be inserted later]). With certain exclusions (relating to some schemes approved under foreign legislation, some novations of reinsurance or some *captive insurers*), it includes, in broad terms, any scheme to transfer *insurance business* from one *firm* (other than a *friendly society*) or *members* of Lloyd's to another body (which may be a *friendly society*), if:
- (1)
 - (a) the transferor is an "UK authorised person" and the business is being carried on in one or more *EEA States*; or
 - (b) the business is reinsurance carried on in the *United Kingdom*; or
 - (c) the business is carried on in the *United Kingdom* and the transferor is not an *EEA firm*; and
 - (2) in each case, the transferred business will be carried on from an establishment in the *EEA*.

The business transferred may include liabilities and potential liabilities on expired *policies*, liabilities on current *policies* and liabilities on contracts to be written in the period until the transfer takes effect. The parties to schemes approved under foreign legislation or involving novations of reinsurance or a captive *insurer* can apply to the court for an order sanctioning the scheme.

- 18.1.5 G In the opinion of the *FSA*, a novation or a number of novations would constitute an *insurance business transfer* only if their number or value were such that the novation was to be regarded as a transfer of part of the business. A novation is an agreement between the *policyholder* and two *insurers* whereby a contract with one *insurer* is replaced by a contract with the other. In the opinion of the *FSA*, where an *insurer* agrees to meet the liabilities (this may include undertaking the administration of the *policies*) of another *insurer* by means of a reinsurance contract, including Lloyd's *reinsurance to close*, this would not constitute an *insurance business transfer* because the contractual liability remains with the original *insurer*, nor would an arrangement whereby an *insurer* offers to renew the *policies* of another *insurer* on their expiry date.
- 18.1.6 G Under section 112 of the *Act*, the court has wide discretion to transfer property and liabilities to the transferee and to make orders in relation to incidental, consequential and supplementary matters. In the opinion of the *FSA*, the court has the power in such cases and on such terms as may be appropriate, to transfer the benefit of reinsurance contracts protecting the transferred business and to make such amendments to the terms of those contracts as may be necessary to give effect to that transfer of benefit.
- 18.1.7 G Amalgamations of *friendly societies* and transfers of engagements from *friendly societies* to other bodies (whether or not *friendly societies*) are governed by part VIII of the Friendly Societies Act 1992 and Schedule 15 to that Act applies.

18.2 Insurance business transfers

PURPOSE

- 18.2.1 G Transfers enable *firms* to manage their affairs more effectively, both for their own benefit and for that of their *customers*. However they represent an interference in the contracts between a *firm* and its *customers*, unless the *customers* individually consent, and may also affect the rights of third parties. An important protection is the requirement for the consent of the court. Under section 110 of the *Act*, the *FSA* is entitled to be heard by the court. In deciding whether it should appear, the *FSA* will consider the potential risk to its *regulatory objectives* of the scheme compared to not implementing the scheme.
- 18.2.2 G The *FSA's regulatory objectives* include market confidence and the protection of *consumers*. Either or both of these might be impaired if a transfer were approved that led to loss, or perceived loss, to *consumers* or other market participants. On the other hand a transfer that led to improved security or benefits for *consumers* would promote the *FSA's regulatory objectives*. When considering a transfer, the *FSA* needs to take into account the interests of existing *consumers* of the transferee and of *consumers* remaining with the transferor as well as of those whose contracts are being transferred. The *guidance* in this section is intended to protect *consumers*. By so doing it promotes the market confidence objective.
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- 18.2.3 G Under section 5(2) of the *Act*, in considering what degree of protection may be appropriate for *consumers*, the *FSA* must have regard to their need for accurate information. Under *Principle 7*, a *firm* must pay due regard to the information needs of *clients* (the scope of the *Principle* is not precisely *consumers*). The extent and nature of the information provided to *consumers* about a proposed scheme will therefore be a factor for the *FSA* in determining its attitude to the scheme. For the court process to be an effective protection, *consumers* and others affected need to learn of the proposed transfer and receive sufficient information on the transfer and its effects in such a form as to enable them to decide if they are likely to be adversely affected, and whether they wish to be heard by the court. The information needed depends on the circumstances and cannot be precisely specified in advance but this chapter contains *guidance* aimed at ensuring that *consumers*, the *FSA* and the court receive adequate information.
- 18.2.4 G Under *Principle 11*, a *firm* must deal with the *FSA* in an open and cooperative way and disclose to the *FSA* appropriately anything relating to the *firm* of which the *FSA* would reasonably expect notice. This chapter contains *guidance* on the information that the *FSA* expects to receive from *firms* and *members* of Lloyd's in the context of *insurance business transfer schemes*.
- 18.2.5 G Under *Principle 6*, a *firm* must treat *customers* fairly (the scope of the *Principle* is not precisely *consumers*) and, under *Principle 8*, manage conflicts of interest fairly. A criterion for the *FSA* in considering a proposed scheme would be whether it appears that either *Principle* is not being followed. Transfers may have both positive and negative effects on individual *consumers*. In such circumstances it is for *consumers* to balance these effects and assess whether the proposed scheme as a whole is in their interests and whether to make representations to the court about the scheme. The *FSA*'s main concern then becomes to ensure that *consumers* have appropriate information and not to set its judgment over theirs.
- 18.2.6 G A scheme may have a material effect on the transferor or the transferee. The *FSA* will take any scheme into account in its future regulation of the *firms*, where it continues to regulate them. This could include, for instance, the exercise of own-initiative powers under section 45 of the *Act* to vary a *firm's Part IV permission*, for instance, by requiring a *scheme of operations* (*SUP 7* contains *guidance* on criteria for varying a *firm's Part IV permission*).
- 18.2.7 G For many transfers it is necessary to cooperate with *overseas regulators*. This section contains *guidance* on such cooperation.
- 18.2.8 G Section 86(8) of the Friendly Societies Act 1992 requires, where a transferee is a *friendly society*, that consent to accept the engagements is passed by special resolution in accordance with paragraph 7 of Schedule 12 to that Act. This section includes *guidance* about the information needed in these circumstances.
- 18.2.9 G Under section 109 of the *Act*, an *insurance business transfer scheme* must be accompanied by a *scheme report* in a form approved by the *FSA*. This section contains *guidance* on the form of a *scheme report*.
- 18.2.10 G Also under section 109 of the *Act*, the *scheme report* must be made by a *person* nominated or approved by the *FSA*. This section contains *guidance* on the procedures and general criteria that the *FSA* proposes to adopt for this purpose.
- 18.2.11 G The *FSA* has a duty under section 2(3) of the *Act* "to have regard to the need to use its resources in the most efficient and economic way". The extent to which (if at all) it examines and considers the details of a scheme and the resources it devotes to such consideration will depend on the potential risk to its *regulatory objectives*.
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PROCEDURE: INITIAL STEPS

- 18.2.12 G When an *insurance business transfer scheme* is being considered, the scheme promoters (including the transferor and, except possibly if it is a new *company*, the transferee) should discuss the scheme with the *FSA* as soon as reasonably practical, to enable the *FSA* to consider what issues are likely to arise, and to enable a practical timetable for the scheme to be agreed. The *FSA* will wish to consider material issues relating to *policyholder* rights (such as the reasonable expectations of with-profits *policyholders*) or *policyholder* security at the earliest opportunity. In any case the *FSA* will need time to:
- (1) consider the application, if an application by the transferee for a *Part IV permission* or a variation of *permission* is necessary (*AUTH* and *SUP* 6 provide *guidance* on this);
 - (2) seek information or approvals from other supervisors (where this applies);
 - (3) consider what skills are needed to make a proper report on the scheme and what criteria should therefore be applied to the choice of *independent expert*;
 - (4) consider whether the promoters' nominee for *independent expert* is suitable for approval or, if the *FSA* proposes to nominate someone, who the *FSA* should nominate; and
 - (5) consider whether to object to the scheme in the light of the report and other circumstances.

- 18.2.13 G The initial information on the scheme provided to the *FSA* under *SUP* 18.2.12G should include its broad outline and its purpose. The *FSA* will indicate to the promoters how closely it wishes to monitor the progress of the scheme, including the extent to which it wishes to see draft documentation.

INDEPENDENT EXPERT: QUALIFICATIONS

- 18.2.14 G Under section 109(2) of the *Act* a *scheme report* may only be made by a *person*:
- (1) appearing to the *FSA* to have the skills necessary to enable him to make a proper report; and
 - (2) nominated or approved for the purpose by the *FSA*.
- 18.2.15 G The general principles set out in *SUP* 5.4.8G, for suitability of a *skilled person*, apply also to the *independent expert*. The *FSA* expects the *independent expert* making the *scheme report* to be a natural person, who:
- (1) is independent, that is any direct or indirect interest or connection he has or has had in either the transferor or transferee should not be such as to prejudice his status in the eyes of the court; and
 - (2) has relevant knowledge, both practical and theoretical, and experience of the types of *insurance business* transacted by the transferor and transferee.
- 18.2.16 G For a transfer of *long-term insurance business* the *independent expert* should be an *actuary* familiar with the role and responsibilities of an *appointed actuary*.
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18.2.17 G For a transfer of *general insurance business* the *independent expert* should normally be competent at assessing technical provisions and the uncertainties of the liabilities they represent (such as an *actuary*). Exceptionally, where issues other than the ability of the transferee to meet the liabilities to be transferred are much more significant in assessing the likely effects of the scheme, this criterion might not be applied. In such a case the *independent expert* would be expected to take advice from an appropriately qualified practitioner about the adequacy of the financial resources of the transferee.

18.2.18 G The *independent expert* would not normally be expected to be knowledgeable:

- (1) about *general insurance business* if the business being transferred is *long-term insurance business* only; nor
- (2) about *long-term insurance business* if the business being transferred is *general insurance business* only;

but, where either the transferor or transferee is a composite, he should understand the relevance of the *general insurance business* to the security of the *long-term insurance business policyholders* and vice versa and may need to seek independent specialist advice.

INDEPENDENT EXPERT: APPOINTMENT

18.2.19 G The suitability of a *person* to act as an *independent expert* depends on the nature of the scheme and the *firms* concerned. On the basis of the preliminary information supplied by the scheme promoters (and any other knowledge it has of the circumstances and the *firms*), the *FSA* will consider what skills are needed to make a proper report on the scheme and what criteria should therefore be applied to the choice of *independent expert*. The *FSA* will inform the promoters of any such criteria it is minded to apply.

18.2.20 G Under section 107(2) of the *Act*, the application to the court may be made by the transferor or the transferee or both. As soon as reasonably practical, the intended applicant should choose their nominee for *independent expert* in the light of any criteria advised by the *FSA* and advise the *FSA* of their choice, unless the *FSA* wishes them to defer nomination or to make its own nomination. The notification should be accompanied by reasons why the party considers the nominee to be a suitable *person* to act as *independent expert*, together with relevant details of his experience and qualifications.

18.2.21 G The *FSA* may wish to have preliminary discussions with the nominee about the transfer to help the *FSA* determine whether he is suitably qualified to address issues arising from the transfer. The *FSA* will consider the suitability of the nominee and inform the *firm* that nominated him whether it approves him. Since the nature of the scheme is a factor in determining the suitability of the nominee, the *FSA* cannot approve a nominee before the broad outlines of the scheme have been determined. If the *FSA* rejects a nominee, it will normally inform him and, with the agreement of the nominee, the applicant of the reasons for the rejection.

18.2.22 G The *FSA* may itself nominate the *independent expert*, either where it indicates that a nomination is not required by the parties, or where it does not approve the parties' own nomination. In either case it will inform the promoters of its nominee.

18.2.23 G *Firms* should co-operate fully with the *independent expert* and provide him with access to all relevant information and appropriate staff.

CONSULTATION WITH OTHER REGULATORS

- 18.2.24 G The *guidance* set out in SUP 18.2.25G to SUP 18.2.30G derives from the requirements of the *Insurance Directives* and the associated agreements between *EEA regulators*. Schedule 12 of the *Act* implements some of these requirements.
- 18.2.25 G If the transferee is (or will be) an *EEA firm* (authorised in its *Home State* to carry on *insurance business* under the *Insurance Directives*) or a *Swiss general insurance company*, then the *FSA* has to consult the transferee's *Home State regulator*, who has 3 months to respond. It will be necessary for the *FSA* to obtain from the transferee's *Home State regulator* a certificate confirming that the transferee will meet the *Home State's* solvency margin requirements (if any) after the transfer.
- 18.2.26 G The transferor will need to provide the *FSA* with the information that the *Home State regulator* requires from *FSA*. This information includes:
- (1) the transfer agreement or a draft, with:
 - (a) the names and addresses of the transferor and transferee; and
 - (b) the *classes of insurance business* and details of the nature of the risks or commitments to be transferred;
 - (2) for the business to be transferred (both before and after reinsurance):
 - (a) the amount of technical provisions;
 - (b) the amount of *premiums* (in the most recent financial period); and
 - (c) for *general insurance business*, the *claims* incurred (in the most recent financial period);
 - (3) details of assets to be transferred;
 - (4) details of any guarantees (including reinsurance), whether provided by the transferor or a third party, to protect the provisions for the business transferred against deterioration; and
 - (5) the *states of the risks* or the *states of the commitments* being transferred.
- 18.2.27 G If the transferee is not (and will not be) *authorised* and will be neither an *EEA firm* nor a *Swiss general insurance company*, then the *FSA* will need to consult its insurance supervisor in the place where the business is to be transferred. The *FSA* will need confirmation from this supervisor that the transferee will meet his solvency margin requirements there (if any) after the transfer.
- 18.2.28 G If the transferor is an *UK insurer* and the business to be transferred includes business carried on from a branch in another *EEA State*, then the *FSA* has to consult the *Host State regulator*, who has 3 months to respond. The *FSA* will need to be given the information that the *Host State regulator* requires from it. This information should identify the parties to the transfer and include the transfer agreement or draft transfer agreement or a summary containing relevant information, and describe arrangements for settling *claims* if the branch is to be closed.
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- 18.2.29 G If the transferor is an *UK insurer* and the business to be transferred includes a *long-term insurance contract* (other than reinsurance) for which the *state of the commitment* is an *EEA state* other than the *United Kingdom*, then the *FSA* has to consult the *Host State regulator*. If the transferor is an *UK insurer* and the business to be transferred includes a *general insurance contract* (other than reinsurance) for which the *state of the risk* is an *EEA state* other than the *United Kingdom*, then the *FSA* must consult the *Host State regulator*. The *FSA* will need to be given the information that the *Host State regulator* requires from it. This information should identify the parties to the transfer and include the transfer agreement or draft transfer agreement or a summary containing relevant information. It would be helpful (especially for *long-term insurance business*) if a draft of the *scheme report* was also available. The consent of the *Host State regulator* to the transfer is required, unless he does not respond within 3 months.
- 18.2.30 G Where the transferor is an *UK-deposit insurer* and, following the transfer, it will no longer be carrying on *insurance business* in the *United Kingdom*, the *FSA* will need to collaborate with *regulatory bodies* in the other *EEA States* in which it is carrying on business to ensure that effective supervision of the business carried on in the *EEA* continues. The transferor should cooperate with the *FSA* and the other *regulatory bodies* in this process and demonstrate that it will meet the requirements of its regulators following the transfer.

FORM OF SCHEME REPORT

- 18.2.31 G Under section 109 of the *Act*, a *scheme report* must accompany an application to the court to approve an *insurance business transfer scheme*. This report must be made in a form approved by the *FSA*. The *FSA* would not expect to approve the form of a *scheme report* unless it complies with *SUP 18.2.33G* and would expect to approve the form of a *scheme report* that complies. *SUP 18.2.32G* and *SUP 18.2.34G* to *SUP 18.2.41G* provide additional *guidance* for the *independent expert*.
- 18.2.32 G There may be matters relating to the scheme or the parties to the transfer that the *FSA* wishes to draw to the attention of the *independent expert*. The *FSA* may also wish the report to address particular issues. The *independent expert* should therefore contact the *FSA* at an early stage to establish whether there are such matters or issues. The *independent expert* should form his own opinion on such issues, which may differ from the opinion of the *FSA*.
- 18.2.33 G The *scheme report* should comply with the applicable rules on expert evidence and contain the following information:
- (1) who appointed the *independent expert* and who is bearing the costs of that appointment;
 - (2) confirmation that the *independent expert* has been approved or nominated by the *FSA*;
 - (3) a statement of *independent expert's* professional qualifications and (where appropriate) descriptions of the experience that fits him for the role;
 - (4) whether the *independent expert* has, or has had, direct or indirect interest in any of the parties which might be thought to influence his independence, and details of any such interest;
 - (5) the scope of the report;
 - (6) the purpose of the scheme;
 - (7) a summary of the terms of the scheme in so far as they are relevant to the report;
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- (8) what documents, reports and other material information the *independent expert* has considered in preparing his report and whether any information that he requested has not been provided;
- (9) the extent to which the *independent expert* has relied on:
 - (a) information provided by others; and
 - (b) the judgment of others;
- (10) the people on whom the *independent expert* has relied and why, in his opinion, such reliance is reasonable;
- (11) his opinion of the likely effects of the scheme on *policyholders* (this term is defined to include *persons* with certain rights and contingent rights under the *policies*), distinguishing between:
 - (a) transferring *policyholders*;
 - (b) *policyholders* of the transferor whose contracts will not be transferred; and
 - (c) *policyholders* of the transferee;
- (12) what matters (if any) that the *independent expert* has not taken into account or evaluated in the report that might, in his opinion, be relevant to *policyholders'* consideration of the scheme; and
- (13) for each opinion that the *independent expert* expresses in the report, an outline of his reasons.

18.2.34 G The purpose of the *scheme report* is to inform the court and the *independent expert* therefore has a duty to the court. However reliance will also be placed on it by *policyholders*, by others affected by the scheme and by the *FSA*. The amount of detail that it is appropriate to include will depend on the complexity of the scheme, the materiality of the details themselves and the circumstances. For instance where it is clear that no-one will be adversely affected by the transfer, a simple explanation for this conclusion plus the details required by *SUP* 18.2.33G might be an adequate report.

18.2.35 G The summary of the terms of the scheme should include:

- (1) a description of any reinsurance arrangements that it is proposed should pass to the transferee under the scheme; and
- (2) a description of any guarantees or additional reinsurance that will cover the transferred business or the business of the transferor that will not be transferred.

18.2.36 G The *independent expert's* opinion of the likely effects of the scheme on *policyholders* should:

- (1) include a comparison of the likely effects if it is or is not implemented;
- (2) state whether he considered alternative arrangements and, if so, what;
- (3) where different groups of *policyholders* are likely to be affected differently by the scheme, include comment on those differences he considers may be material to the *policyholders*; and
- (4) include his views on:

- (a) the effect of the scheme on the security of *policyholders'* contractual rights, including the likelihood and potential effects of the insolvency of the *insurer*;
- (b) the likely effects of the scheme on matters such as investment management, new business strategy, administration, expense levels and valuation bases in so far as they may affect:
 - (i) the security of *policyholders'* contractual rights;
 - (ii) levels of service provided to *policyholders*; or
 - (iii) for *long-term insurance business*, the reasonable expectations of *policyholders*; and
- (c) the cost and tax effects of the scheme, in so far as they may affect the security of *policyholders'* contractual rights, or for *long-term insurance business*, their reasonable expectations.

18.2.37 G The *independent expert* is not expected to comment on the likely effects on new *policyholders*, that is, those whose contracts are entered into after the effective date of the transfer.

18.2.38 G For any mutual *company* involved in the scheme, the report should:

- (1) describe the effect of the scheme on the proprietary rights of members of the *company*, including the significance of any loss or dilution of the rights of those members to secure or prevent further changes which could affect their entitlements as *policyholders*;
- (2) state whether, and to what extent, members will receive compensation under the scheme for any diminution of proprietary rights; and
- (3) comment on the appropriateness of any compensation, paying particular attention to any differences in treatment between members with voting rights and those without.

18.2.39 G For a scheme involving *long-term insurance business*, the report should:

- (1) describe the effect of the scheme on the nature and value of any rights of *policyholders* to participate in profits;
- (2) if any such rights will be diluted by the scheme, how any compensation offered to *policyholders* as a group (such as the injection of funds, allocation of shares, or cash payments) compares with the value of that dilution, and whether the extent and method of its proposed division is equitable as between different classes and generations of *policyholders*;
- (3) describe the likely effect of the scheme on the approach used to determine:
 - (a) the amounts of any non-guaranteed benefits such as bonuses and *surrender values*; and
 - (b) the levels of any discretionary charges;
- (4) describe what safeguards are provided by the scheme against a subsequent change of approach to these matters that could act to the detriment of existing *policyholders* of either *firm*;

- (5) include the *independent expert's* overall assessment of the likely effects of the scheme on the reasonable expectations of *long-term insurance business policyholders*;
- (6) state whether the *independent expert* is satisfied that for each *firm* the scheme is equitable to all classes and generations of its *policyholders*; and
- (7) state whether, in the *independent expert's* opinion, for each relevant *firm* the scheme has sufficient safeguards (such as principles of financial management or certification by the *appointed actuary*) to ensure that the scheme operates as presented.

18.2.40 G Where the transfer forms part of a wider chain of events or corporate restructuring, it may not be appropriate to consider the transfer in isolation and the *independent expert* should seek sufficient explanations on corporate plans to enable him to understand the wider picture. Likewise he will need information on the operational plans of the transferee and, if only part of the business of the transferor is transferred, of the transferor. These will need to have sufficient detail to allow him to understand in broad terms how the business will be run. He would not normally be expected to assess the adequacy of systems and controls in detail.

18.2.41 G A transfer may provide for benefits to be reduced for some or all of the *policies* being transferred. This might happen if the transferor is in financial difficulties. If there is such a proposal, the *independent expert* should report on what reductions he considers ought to be made, unless either:

- (1) the information required is not available and will not become available in time for his report, for instance it might depend on future events; or
- (2) otherwise, he is unable to report on this aspect in the time available.

Under such circumstances, the transfer might be urgent and it might be appropriate for the reduction in benefits to take place after the event, by means of an order under section 112 of the *Act*. The *FSA* would wish to consider the fairness of any such reduction and section 113 allows the court to appoint an independent *actuary* to report to the *FSA* on any such post-transfer reduction in benefits.

NOTICE PROVISIONS

18.2.42 G Under the Financial Services and Markets Act 2000 (Control of Business Transfers)(Requirements on Applicants) Regulations 2001 (SI 2001/[number to be inserted later]), unless the court directs otherwise, notice of the application must be sent to all *policyholders* of the parties. It may also be appropriate to give notice to others affected, in particular to:

- (1) reinsurers of the transferor where it is proposed that benefits or liabilities under their contracts should pass to the transferee; and
- (2) anyone with an interest in the *policies* being transferred who has notified the transferor of their interest.

18.2.43 G The regulations referred to in *SUP* 18.2.42G require that notice of the application must be published in:

- (1) the London, Edinburgh and Belfast Gazettes; and
- (2) unless the court directs otherwise, in:

- (a) two national newspapers in the *United Kingdom*; and
- (b) in two national newspapers in any other *EEA State* that is the *state of the risk* or the *state of the commitment*.

Wider publication may be appropriate in some circumstances (especially if not all *policyholders* are sent notices).

- 18.2.44 G The regulations referred to in *SUP 18.2.42G* require that the *FSA* approves in advance the notices sent to *policyholders* and published in the press.
- 18.2.45 G Where a transfer involves *members* of *Lloyd's* as transferor or transferee, any notice requirements of the *Society* will also apply.
- 18.2.46 G The *FSA* is entitled to be heard by the court on any application for a transfer. A consideration for the *FSA* in determining whether to oppose a transfer would be its view on whether adequate steps had been taken to tell *policyholders* about the transfer and whether they had adequate information and time to consider it. The *FSA* would not normally consider adequate a period of less than six weeks between sending notices to *policyholders* and the date of the court hearing. Therefore it would be sensible, before requesting the court for a waiver of the publication requirements or the requirement to send statements direct to *policyholders*, to consult the *FSA* on its views about what waivers might be appropriate and what substitute arrangements might be made. The *FSA* will take into account the practicality and costs of sending notices to *policyholders* (especially for *firms* in financial difficulty), the likely benefits for *policyholders* of receiving notices and the efficacy of other arrangements proposed for informing *policyholders* (including additional advertising or, where appropriate, electronic communication). For instance, the *FSA* would be unlikely to object to a transfer on the grounds that *policyholders* had not been sent notices, if cover for the *policies* concerned had expired and the probability of them making a *claim* was so small as to make the sending disproportionately expensive (particularly if there had been additional advertising). A *firm* may not be able to send notices to some or all of its *policyholders*, because it does not have their address, or may not even know their identity. This situation is not uncommon for business written through brokers or other agents. In such a case, alternative ways of informing *policyholders* need to be considered.
- 18.2.47 G As the consent (or presumed consent) of the *Host State* is required for a transfer covering contracts for which another *EEA State* is the *state of the risk* (for *general insurance business*) or the *state of the commitment* (for *long-term insurance business*), it is advisable to obtain the consent of *regulatory body* in the *Host State* to any waiver of publication in that state. The approval of the court will still be required.

STATEMENT TO POLICYHOLDERS

- 18.2.48 G It would normally be appropriate to include with the notice referred to in *SUP 18.2.42G* a statement setting out the terms of the scheme and containing a summary of the *scheme report*. Ideally every recipient should understand in broad terms from the summary how the scheme is likely to affect him. This objective will be most nearly achieved if the summary is clear and concise while containing sufficient detail for the purpose. A lengthy summary or one that was hard to understand would not be appropriate. Regulations require the *scheme report*, the notice and the statement to be made available to anyone requesting them. The internet can be used for this purpose if it is suitable for the *person* making the request.
- 18.2.49 G Where the transferee is a *friendly society*, the notice should include information about the meeting at which a special resolution in accordance with paragraph 7 of Schedule 12 to the *Friendly Societies Act 1992* is to be voted on, including the date of the meeting, how notice of the meeting is to be given to members and the terms of the special resolution. After the meeting the *friendly society* should inform the *FSA* whether the special resolution has been passed. The court will also need to be informed, so an appropriate way of informing the *FSA* may be to include it in the affidavit to the court.

- 18.2.50 G The *FSA* should be given the opportunity to comment on the statement referred to in *SUP* 18.2.48G before it is sent, unless the *FSA* has informed the promoters in writing that it does not wish to do so.

FSA ASSESSMENT OF SCHEME

- 18.2.51 G The assessment is a continuing process, starting when the scheme promoters first approach the *FSA* about a proposed scheme. Among the considerations that may be relevant to both the depth of consideration given to, and the *FSA*'s opinion on, a scheme are:
- (1) the potential risk posed by the transfer to the *regulatory objectives*;
 - (2) the purpose of the scheme;
 - (3) how the security of *policyholders*' (who include *persons* with certain rights and contingent rights under the *policies*) contractual rights appears to be affected;
 - (4) how the scheme compares with possible alternatives, particularly those that do not require approval (whether by the court or the *FSA*);
 - (5) how *policyholders*' rights and reasonable expectations appear to be affected;
 - (6) the compensation offered to *policyholders* for any loss of rights or expectations;
 - (7) how for other *persons* (besides *policyholders*) who have an interest in *policies*, their rights and the security of those rights appear to be affected;
 - (8) the opportunity given to *policyholders* to consider the scheme, that is whether they have been properly notified, whether they have had adequate information and whether they have had adequate time to consider that information;
 - (9) the opinion of the *independent expert*;
 - (10) for a transfer that involves *members* of Lloyd's as transferor or transferee, the effect on the *Society*;
 - (11) the views of other *regulatory bodies* consulted in connection with the proposed transfer; and
 - (12) any views expressed by *policyholders*.
- 18.2.52 G The *scheme report* will be an important factor in the view the *FSA* forms on a scheme. The *FSA* will place considerable reliance on the opinions of the *independent expert* and the reasons for them. However it will form its own view taking into account other information and having regard to its *regulatory objectives*.
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- 18.2.53 G The *FSA* is likely to object to a scheme if it concludes that it is unfair to a class of *policyholders*, unless the *policyholders* of that class have approved the scheme on the basis of information the *FSA* considers clear and accurate. *Policyholders* are not required to vote on a scheme but would, for instance, normally vote on a demutualisation or on a scheme of arrangement under the Companies Act 1985. The *FSA* is also likely to object to a scheme if it concludes that it has a material adverse effect on *policyholders'* security. The *FSA* may wish to satisfy itself that questions of systems and controls are properly addressed. There may also be conduct of business issues, particularly if the market has not fully absorbed the impact of the scheme by its effective date. The *FSA* would seek to resolve such issues through discussion with the scheme promoters in advance of the application to the court for approval, giving them the opportunity to amend the scheme or documentation, or otherwise to allay the *FSA's* concerns. Scheme promoters should keep the *FSA* informed to allow this discussion.
- 18.2.54 G The *FSA* may exercise its other powers under the *Act*, if it considers this a more effective method of achieving its *regulatory objectives*.
- 18.2.55 G The *FSA* is not required under its *regulatory objectives* to object to a scheme merely because some other scheme might have been in the better interests of *policyholders*, if the scheme itself is not adverse to their interests. However there may be circumstances where treating *customers* fairly would require a *firm* to consider or to implement an alternative scheme.
- 18.2.56 G Where a transfer involves *members* of Lloyd's as transferor or transferee, the *FSA* will consult the *Society*. Where the business of a *syndicate* is being transferred, the transfer involves all *members* participating in the relevant *syndicate years*.
- 18.2.57 G Regulations require that copies of the application to the court, the *scheme report* and the statement for *policyholders* referred to in SUP 18.2.48G are also given to the *FSA*. This enables the *FSA* to consider these and determine whether it wishes to be heard by the court. It might assist the *FSA* if these items were given to the *FSA* in draft, in the first instance. This would enable:
- (1) the *FSA* to seek clarification before the documents were finalised; and
 - (2) if the promoters so choose, allow them to amend the scheme to meet any concerns of the *FSA*.
- 18.2.58 G For *long-term insurance business*, the affidavit evidence to the court would normally include copies of reports on the transfer by the *appointed actuaries* of both *firms*, which should be provided to the *FSA* at an early stage. SUP 4.3.17R(4) requires a *firm* to consult its *appointed actuary* about the likely effect of material changes in its business plans on rights and reasonable expectations of *long-term insurance business policyholders*. A transfer would be material unless the liabilities transferred were not material relative to the total liabilities of the *firm*. The advice on a transfer would normally be in the form of a formal report by the *appointed actuary*.
- 18.2.59 G The scheme promoters should advise the *FSA* about any material representations made to them in response to the *transfer scheme*. Where it is proposed that reinsurance arrangements should pass to the transferee under the scheme, the *FSA* should also be informed about the steps being taken to consult with, or seek the consent of, the reinsurers and the reactions received.
- 18.2.60 G The court is likely to wish to know the *FSA's* opinion on the scheme and, if the *FSA* does not intend to be heard, the affidavit may include a summary of the views expressed by the *FSA*. The applicants to the court should provide the *FSA* with a copy of all the affidavit evidence that they intend to submit to the court.
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18.3 Insurance business transfers outside the United Kingdom

PURPOSE

- 18.3.1 G Under section 115 of the *Act*, the *FSA* has the power to give a certificate confirming that a *firm* possesses any *required minimum margin*, to facilitate an *insurance business* transfer to the *firm* under overseas legislation from a firm authorised in another *EEA State* or from a *Swiss general insurance company*. This section provides *guidance* on how the *FSA* would exercise this power and on related matters.

FSA RESPONSE TO PROPOSAL

- 18.3.2 G Under cooperation agreements between *EEA regulators*, if it has serious concerns about the proposed transferee, the *FSA* should inform the *regulatory body* of the transferor within 3 months of the original request from that *regulatory body*. The *FSA* is not obliged to reply, but if it does not, its opinion is taken to be favorable. Although the protocol does not apply to Switzerland, the *FSA* is required to cooperate with the Swiss *regulatory body* and would apply similar principles to a proposed transfer from a *Swiss general insurance company*.
- 18.3.3 G The information that the *regulatory body* of the transferor is required to supply will normally be sufficient for the *FSA* to determine whether the transfer is likely to have a material effect on the transferee.
- 18.3.4 G If the effect of the transfer is not likely to be material and the *FSA* does not already have serious concerns about the transferee, the *FSA* can reply favorably.
- 18.3.5 G If the effect of the transfer may be material, the *FSA* will need to consider whether to request a *scheme of operations* or other information from the proposed transferee to assist in determining whether the likely effect of the transfer is such that the *FSA* should have serious concerns.
- 18.3.6 G If the effect of the transfer may have a material adverse effect on the transferee or the security of *policyholders*, the *FSA* will consider whether it is appropriate to exercise its powers under the *Act* to achieve its *regulatory objectives*.

18.4 Friendly Society transfers and amalgamations

PURPOSE

- 18.4.1 G It is for the committee of management of a *friendly society* to decide whether to recommend an amalgamation or a transfer of engagements to the society's members. This section provides some *guidance* on the procedures to be followed and the information to be provided to a *friendly society's* members so that they are appropriately informed before they exercise their right to vote on the proposals.

GENERAL CONSIDERATIONS

- 18.4.2 G *Friendly societies* are encouraged to discuss a proposed transfer or amalgamation with the *FSA*, at an early stage to help ensure that a workable timetable is developed. This is particularly important where there are notification requirements for supervisory authorities in *EEA States* other than the *United Kingdom*, or for an amalgamation where additional procedures are required.
- 18.4.3 G The *FSA* will want to satisfy itself that after an amalgamation or a transfer the business will be prudently managed and continue to comply with the *Principles*. It may therefore require prudential information to be provided. It may request prudential information at an early stage to provide itself with adequate time to assess the information.
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- 18.4.4 G For a transfer to another *friendly society*, if the conditions of 87(1) and 87(2) of the Friendly Societies Act 1992 are met a report is required from the *appropriate actuary* of the transferee to confirm that it will meet the *required minimum margin*. Where the conditions of 87(1) and 87(3) are met the *FSA* may require a report from the *appropriate actuary* of the transferee to confirm that it will have an excess of assets over liabilities.
- 18.4.5 G For a transfer of *long-term insurance business*, the *FSA* may, under section 88 of the Friendly Societies Act 1992, require a report from an independent *actuary* on the terms of the proposed transfer and on his opinion of the likely effects of the transfer on long-term *policyholder* members of either the transferor or (if it is a *friendly society*) the transferee. A summary is included in the statement sent to members (see *SUP* 18.4.13G) and the full report is required to be made available to anyone on payment of a reasonable fee. The general principles in *SUP* 18.2.32G to *SUP* 18.2.40G apply to the independent *actuary's* report.
- 18.4.6 G Under the Friendly Societies Act 1992 the *FSA* may not confirm a transfer of engagements unless it is satisfied that the transfer is in the interests of the members of each *friendly society* participating in the transfer (see *SUP* 18.4.25G(2)(b)). It will therefore ask that the participating societies' *actuaries* confirm that the transfer is in the interests of the members.
- 18.4.7 G Under the Friendly Societies Act 1992, members will normally have the opportunity to vote on a proposed transfer or amalgamation (*SUP* 18.4.11G and *SUP* 18.4.12G describe exceptions). A *friendly society* has to ensure that, before casting their votes, its members are clearly and fully informed of the terms on which the amalgamation or transfer of engagements is to take place and that they have all the information needed to understand how their interests will be affected. If the society's rules permit, delegates can vote except on an "affected members' resolution" under section 86. The *FSA* may not confirm an amalgamation or a transfer if it considers that information material to the members' decision was not made available to all the members eligible to vote.
- 18.4.8 G Amendments to a *friendly society's* registered rules may be necessary to permit a transfer to it. The *FSA* will need to be consulted in the usual way about registration of the appropriate rules. Similarly for an amalgamation, each of the amalgamating societies has to approve the memorandum and rules of the new society and the requirements of schedule 3 to the Friendly Societies Act 1992 have to be met. It will be necessary to allow adequate time for these processes.
- 18.4.9 G For an amalgamation the successor society, and for a transfer the transferee, may need to apply for *permission*, or to vary its *permission*, under Part IV of the *Act*. The *FSA* will need time before confirming a transfer to consider whether any necessary *permission* or variation should be given. If the transferee is an *EEA firm* or a *Swiss general insurance company*, then confirmation will be needed from its *Home State regulator* that it meets the *Home State's* solvency margin requirements (see *SUP* 18.4.25G(3)).
- 18.4.10 G It is likely that the information sent to members will include a statement explaining the reasons for the amalgamation or transfer and the choice of partner. Although this is not a statutory statement and not subject to *FSA* approval, the *FSA* will take the statement into account when considering whether to confirm the amalgamation or transfer. A *friendly society* will therefore find it helpful to consult the *FSA* about the content of such a statement.
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FSA DISCRETION

- 18.4.11 G The *FSA* has discretion under section 86(3)(b) of the Friendly Societies Act 1992 to allow a transferee society to resolve to undertake to fulfil the engagements of a transferor society by resolution of the committee of management, rather than by special resolution. Among the issues on which the *FSA* will wish to satisfy itself before exercising this discretion, are that the transfer will be in the interests of the members of both societies and that the transfer will not mean a change of policy by the transferee society. The *FSA* is unlikely to exercise this discretion unless the transferee is significantly larger than the business to be transferred.
- 18.4.12 G The *FSA* has discretion under section 89 of the Friendly Societies Act 1992 to modify some of the requirements for a transfer of engagements from a *friendly society*, on the application of a specified number of its members, if it is satisfied that it is expedient to do so in the interests of its members or potential members.

SCHEDULE 15 STATEMENT TO MEMBERS

- 18.4.13 G Schedule 15 to the Friendly Societies Act 1992 requires a statement to be sent to every member of a *friendly society* entitled to vote on a transfer or amalgamation. Among other matters this statement has to cover the financial position of the *friendly society* and every other participant in the transfer or amalgamation. The members should be provided with sufficient financial information about the respective financial positions of the participants to gain an understanding of the relative financial strengths and key features of the participants. The statement has to include a summary of any *actuary's* report under section 88, though the *FSA* may direct that the summary is to be provided separately if inclusion appears impractical.
- 18.4.14 G The financial information provided under *SUP* 18.4.13G would normally contain comparative statements of balance sheets at the same date, and include main investments, reserves and funds or technical provisions, with details of the number of members of each participant as at the balance sheet date and the *premium* income of the relevant fund of each participant during the financial year to which the balance sheet relates. *SUP* 18.4.15G to *SUP* 18.4.18G give further *guidance* on the financial information to be included.
- 18.4.15 G If the information relates to a position some time in the past, the information should state that there has been no significant change or include a clear description of the changes. Differences in accounting *policies* and reporting requirements could lead to the loss of some comparability between participants. Such differences and their estimated financial effects (if any) should be explained.
- 18.4.16 G The information should state whether any of the participants has any significant future capital commitments. The *FSA* will require it to state that the transfer of engagements or amalgamation will not conflict with any contractual commitment by a society, any *subsidiary* or any body jointly controlled by it and others.
- 18.4.17 G Brief details should be given of the date of the last actuarial valuation and the position revealed (surplus/deficit, *required minimum margin* and free assets) for each participant.
- 18.4.18 G The *FSA* may require confirmation from the auditors of either *friendly society* involved in the transfer or amalgamation about the reasonableness of any part of the information in the statement. For instance such confirmation would normally be required if the financial information relates to a date more than six months previously.
- 18.4.19 G The statement is required to include particulars of:
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- (1) any interest of the members of the committee of management in the amalgamation or transfer; and
- (2) any compensation or other consideration proposed to be paid to committee members or other *officers* of the society and to the *officers* of every other society or *person* participating in the amalgamation or transfer.

Under section 92 of the Friendly Societies Act 1992, any compensation must be approved by a special resolution, separate from any resolution approving other terms of the amalgamation or transfer. This enables members to vote on this as a separate issue.

- 18.4.20 G Under schedule 15 to the Friendly Societies Act 1992, the *FSA* may require the statement to include any other matter. The *FSA* would normally require inclusion of the terms on which the amalgamation or the transfer of engagements is to be made.
- 18.4.21 G The statement should be clearly separate from other information sent to members. It has to be approved by the *FSA* and if it is not in a self-contained document, the approved element should appear in a separate section.
- 18.4.22 G *SUP* 18 Ann 1G provides an example of the information for members required by Schedule 15.

CONFIRMATION PROCEDURES AND CRITERIA

- 18.4.23 G Under the Friendly Societies Act 1992:
- (1) when the members of a transferor society have approved the transfer of its engagements by passing a special resolution and the transferee has approved the transfer (by passing a resolution where the transferee is a *friendly society*); or
 - (2) when two or more societies have approved a proposed amalgamation by passing a special resolution;
- it, or they jointly, must then obtain confirmation by the *FSA* of the transfer. Notice of the application will need to be published in one or more of the London, Edinburgh or Belfast Gazettes and other newspapers as directed by the *FSA*. If the *FSA* confirms a transfer, then it will register the society's instrument of transfer after receiving an application on the appropriate form by the transferor society and the transferee. If the *FSA* confirms an amalgamation, it will register the successor society. All the property, rights and liabilities pass on the transfer date specified by the *FSA*.
- 18.4.24 G For a *directive friendly society*, if the transfer or amalgamation includes *policies* where the *state of the risk* or the *state of the commitment* is an *EEA State* other than the *United Kingdom*, consultation with the *Host State regulator* is required and *SUP* 18.2.25G to *SUP* 18.2.29G apply (for an amalgamation they apply as if the business of the amalgamating societies is to be transferred to the successor society). Paragraph 6(1) of Schedule 15 to the Friendly Societies Act 1992 requires publication of the application to the *FSA* for confirmation of an amalgamation or transfer and the *FSA* may require the notice of the application to be published in two national newspapers in the *Host State*.
- 18.4.25 G The criteria that the *FSA* must use in determining whether to confirm a proposed amalgamation or transfer are set out in schedule 15 to the Friendly Societies Act 1992. These criteria include that:
- (1) confirmation must not be given if the *FSA* considers that:
 - (a) there is a substantial risk that the successor society or transferee will be unable lawfully to carry out the engagements to be transferred to it;
-

- (b) information material to the members' decision about the amalgamation or transfer was not made available to all the members eligible to vote;
 - (c) the vote on any resolution approving the amalgamation or transfer does not represent the views of the members eligible to vote; or
 - (d) some relevant requirement of the Friendly Societies Act 1992 or the rules of any of the participating societies was not fulfilled (but it can modify some requirements and direct that certain failures may be disregarded, see *SUP* 18.4.12G and *SUP* 18.4.27G);
- (2) the *FSA* must be satisfied that:
- (a) the transferee or successor society will have any *permissions* necessary under Part IV of the *Act*;
 - (b) for a transfer, it is in the interests of the members of each *friendly society* participating in it (see *SUP* 18.4.6G); and
 - (c) for a *directive friendly society* where a transfer includes *policies* where the *state of the risk* or the *state of the commitment* is an *EEA State* other than the *United Kingdom*, the *Host State regulator* has been notified of the transfer and has consented or has not refused consent to the transfer; and
- (3) for a transfer, the transferee possesses the *required minimum margin* after taking the proposed transfer into account or, where it is not required to maintain a *required minimum margin*, possesses an excess of assets over liabilities (for a transferee that is a *Swiss general insurance company* or an *EEA firm*, this is evidenced by a certificate from its *home state regulator*).

18.4.26 G If *authorisation* or a *Part IV permission* is needed, the *FSA* will need to consider the application for *authorisation* or *permission* in the usual way. If the *authorisation* or *permission* is refused, confirmation cannot be given even if all the other criteria are met. As part of the *regulatory objective* to protect *consumers*, the *FSA* may consider whether an amalgamation is in the interests of members.

18.4.27 G The *FSA* may (as an alternative to refusing confirmation) direct the society or societies to remedy certain procedural defects in a proposed transfer or amalgamation, and after they have been remedied confirm the application. If it appears to the *FSA* that failure to meet a "relevant requirement" of the Friendly Societies Act 1992 or the rules of the *friendly society* could not be material to the members' decision, then it may direct that this failure is to be disregarded.

CONFIRMATION PROCEDURES: REPRESENTATIONS

18.4.28 G Any interested party has the right to make representations to the *FSA* about an application for confirmation of a transfer or amalgamation. This includes any *person* (whether a member of the *friendly society* or not) who claims that he would be adversely affected by the amalgamation or transfer. The *person* making the representations should state clearly why he or she claims to be an interested party and the ground or grounds to which the representations are directed.

- 18.4.29 G Written representations, or written notice of a *person's* intention to make oral representations, or both, are required to reach the *FSA* by the date published in the relevant *Gazettes* and other newspapers. Those giving notice of intent to make oral representations are advised to state the nature and general grounds of the oral representations they intend to make. *Persons* who make written representations but subsequently decide also to make oral representations are required, nevertheless, to give notice of that intention, in writing, to the *FSA* by the same date.
- 18.4.30 G The *FSA* will send copies of all written representations to the society(ies), and will afford them an opportunity to comment on the representations. It may consider the written representations and a society's response to them, before the date set for hearing oral representations. A synopsis of the written representations (probably in the form of a summary of each of the points made and the numbers of *persons* making each point) and a society's responses will be made available to those participating in the hearing. This is intended to inform those making oral representations of the points already being considered by the *FSA*.
- 18.4.31 G The *FSA* expects that any documents referred to in a society's comments will be made available by the society for inspection at its registered office and, if reasonably possible, at the venue of the hearing on the date of the hearing. However if a society applies to put documents which it considers to be sensitive to the *FSA* in confidence, the *FSA* will balance any disadvantage this might cause interested parties in making representations against the commercial damage that publication of the documents might cause, and may permit the documents or sensitive parts of them not to be available for inspection.

CONFIRMATION HEARING

- 18.4.32 G Interested parties may be represented and may make collective representations. Such arrangements should be notified to the *FSA* in advance to enable it to make appropriate arrangements.
- 18.4.33 G The hearing referred to in *SUP* 18.4.30G will be at a time and place that will be notified to the participants and will be conducted by *FSA* representatives. The hearing may last longer than one day and may be adjourned. The *FSA* will try to tell participants when they may expect to make their representations and when the society may be expected to respond.
- 18.4.34 G The *FSA* expects that oral hearings will be held in public though this is not required. At the start members of the general public and the press will be asked to wait outside while participants are asked if any of them has good reason to object to the admission of the general public or the press. Unless an objection by a participant is upheld by the *FSA* representatives, the press and the general public will then be admitted, within the limits of the space available. However, the *FSA* representatives may decide that parts of the hearing will be in private if that appears to them to be desirable.
- 18.4.35 G The procedure will be informal. All participants will be expected to speak concisely and avoid repetition. The *FSA* will, as far as practicable, help those who are not professionally represented. Those taking the hearing may question the participants. The sequence of events will normally be broadly:
- (1) any preliminary matters (such as the admission of the public or other procedural questions) will be dealt with;
 - (2) the chair of the hearing will introduce the proceedings;
 - (3) the society representatives will be invited to speak on the application, including a description of the events at the meeting at which the resolution to amalgamate or transfer was put to the members, a statement of the voting on the resolution, and any other matters which they wish to introduce at that stage;
-

- (4) the other participants will be invited to speak to their representations. The *FSA* expects to call them in order of a list arranged, so far as possible, by subject matter;
- (5) the society representatives will be invited to reply to, or comment on, the points made by the other participants; and
- (6) the other participants will be invited to comment on the society replies.

- 18.4.36 G The above procedure may be varied according to the circumstances at the hearing, and is intended only as a guide. The hearing may be adjourned if the *FSA* representatives consider that necessary to enable facts to be checked or additional information to be obtained.
- 18.4.37 G The *FSA* will not decide whether to confirm the transfer or amalgamation at the hearing. A copy of its written decision, including its findings on the points made in representations, will be sent to the society(ies) and to those making representations. It will also be available to any other *person* on request and may be published.
-

SUP 18 Annex 1G – Example of Schedule 15 statement

Transfer/Amalgamation of [Society A] to/with [Society B]

Proposed effective date:

Comparative financial positions

(a) Balance Sheet as at 31 December 20--

	Society A	Society B
ASSETS		
Land and buildings (4)		
Government securities		
Equities		
Other investments (6)		
Fixed assets		
Other assets		
Cash at bank and in hand		
	-----	-----
	-----	-----
LIABILITIES		
Benefit funds [technical provisions] (7)		
[Management fund]		
Other liabilities and provisions		
Reserve funds [Reserves] (8)		
	-----	-----
	-----	-----

NOTES

(1) The above figures are extracted from the audited accounts [unaudited accounts] of [Society A and Society B] for the year [period] ended:

(2) There has been no significant change in the financial position of the [participants] [except for].

(3) The future capital commitments of [the participants] are:
[None of [the participants] has any significant future capital commitments.]

(4) Land and buildings have been brought into account on the following bases:

(include statement of any differences in accounting policies and where material any estimated financial effects)

(5) Investments have been brought into account on the following bases:

(include statement of any differences in accounting policies and where material any estimated financial effects)

(6) Other investments comprise:

(include statement of any differences in accounting policies and where material any estimated financial effects)

(7) Benefit Funds [Technical Provisions] comprise:

(include statement of any differences in accounting policies and where material any estimated financial effects)

(8) Reserve Funds [Reserves] comprise:

(9) The membership at [] and premium income received during [] for each [participant] were:

(10) Brief summary of the financial position of each [participant] as shown in the last actuarial investigation:

(11) Summary of independent actuary's report under section 88 of the Friendly Societies Act 1992:

(12) The interests of committee members of the [participants] in the transfer [amalgamation] are:

(13) Proposed compensation to be paid to committee members and[/or] to other officers is:

(14) The terms of the transfer[amalgamation] are:

Annex D
SUP Schedule 5 (Rights of action for damages)

Schedule 5
Rights of actions for damages

G

1. The table below sets out the *rules* in *SUP* contravention of which by an *authorised person* may be actionable under section 150 of the *Act* (Actions for damages) by a *person* who suffers loss as a result of the contravention.
2. If a “Yes” appears in the column headed “For private person?”, the *rule* may be actionable by a “*private person*” under section 150 (or, in certain circumstances, his fiduciary or representative). A “Yes” in the column headed “Removed” indicates that the *FSA* has removed the right of action under section 150(2) of the *Act*. If so, a reference to the *rule* in which it is removed is also given.
3. The column headed “For other person?” indicates whether the rule is actionable by a *person* other than a *private person* (or his fiduciary or representative). If so, an indication of the type of *person* by whom the *rule* is actionable is given.

Actions for damages: Supervision manual

Chapter/ Appendix	Section/ Annex	Paragraph	Right of action under section 150		
			For private person?	Removed?	For other person?
All <i>rules</i> in <i>SUP</i> with the status letter “E”			No	No	No
3	8	All <i>rules</i> in the section	No	No	No
3	9	All <i>rules</i> in the section	No	No	No
3	10	All <i>rules</i> in the section	No	No	No
4	3	13	No	No	No
4	3	20	No	No	No
4	4	7	No	No	No
4	4	9	No	No	No
4	5	All <i>rules</i> in the section	No	No	No
10	All <i>rules</i> in sections SUP 10.1 to SUP 10.10		No	No	No
All other <i>rules</i> in <i>SUP</i>			Yes	No	No

Annex E
SUP Schedule 6 (Rules that can be waived)

Schedule 6
Rules that can be waived

G

The *rules* in *SUP* can be *waived* by the *FSA* under section 148 of the *Act* (Modification or waiver of rules), except for:

- (a) the *rules* in the transitional provisions relating to written concessions to the extent that those *rules* relate to other *rules* which cannot be *waived*;
- (b) the *rules* in *SUP* 3.8 to *SUP* 3.10 (Auditors) and the transitional *rules* relevant to those *rules* (and the *rules* in *SUP* 3.1 (Application) to the extent that those *rules* apply to an auditor rather than to a *firm*);
- (c) the *rules* in *SUP* 4.3 to *SUP* 4.5 (Actuaries) which apply to an actuary rather than to a *firm* (and the *rules* in *SUP* 4.1 (Application) to the extent that those *rules* apply to an actuary rather than to a *firm*);
- (d) the *rules* in *SUP* 10.2 to *SUP* 10.10 (Approved persons) (and the *rules* in *SUP* 10.1 (Application) to the extent that those *rules* apply or modify the *rules* in *SUP* 10.2 to *SUP* 10.10);
- (e) the following rules in *SUP* 13 (Exercise of passport rights by UK firms): *SUP* 13.5.1R, *SUP* 13.5.2R, *SUP* Ann 1R, *SUP* Ann 2R and *SUP* Ann 3R;
- (f) the *rules* in *SUP* 20 (Fees).

SUPERVISION MANUAL (AMENDMENT NO 6) INSTRUMENT 2001

Powers exercised

A. The Financial Services Authority amends the Supervision manual in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (the "Act"):

- (1) section 59 (Approval for particular arrangements);
- (2) section 138 (General rule-making power);
- (3) section 156 (General supplementary powers);
- (4) section 157(1) (Guidance);
- (5) section 182 (Notification);
- (6) section 340 (Appointment).

B. The provisions of the Act relevant to rules and listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

C. This instrument comes into force immediately.

Amendments to the Supervision manual

D. The Supervision manual is amended in accordance with the Annex to this instrument.

Citation

E. This instrument may be cited as the Supervision Manual (Amendment No 6) Instrument 2001.

By order of the Board
15 November 2001

Annex
Amendments to text already made

In this Annex, where amendments are shown rather than described, underlining indicates new text and striking through indicates deleted text.

SUP transitional provisions

In the first table of transitional provisions, amend the following rows as shown:

2	<i>SUP</i> 3.9 and <i>SUP</i> 3.10	R	<p>An auditor of a <i>firm</i> will not contravene a <i>rule</i> in <i>SUP</i> 3.9 or <i>SUP</i> 3.10 to the extent that:</p> <p>(1) a report submitted under that <i>rule</i> relates to a period which ended before <i>commencement</i> and was prepared in accordance with, <u>and submitted within the time permitted by,</u> a substantially similar pre-commencement provision (whether applicable to the auditor or the <i>firm</i> audited); or</p> <p>...</p>	From <i>commence- ment</i> for 2 years	<i>Commence- ment</i>
10	<i>SUP</i> 16.4.5R <i>SUP</i> 16.5.5R	R	<p>...</p> <p>(2) <i>SUP</i> 16.4.5R and 16.5.5R are modified so as to require a <i>firm</i> to submit the first relevant report:</p> <p style="padding-left: 40px;">(a) prepared as at any date falling within 4 <i>months</i> after <i>commencement</i>; and</p> <p style="padding-left: 40px;">(b) within 4 <i>months</i> of <i>commencement</i>; and</p> <p>if:</p> <p>...</p>	From <i>commence- ment</i> for four months	<i>Commence- ment</i>

In the first table of transitional provisions, insert the following new row:

3C	SUP 3.10	R	<p>(1) Paragraph (2) applies to an auditor of a <i>firm</i> if:</p> <p>(a) the last client assets report delivered to the <i>firm's previous regulator</i> covered a period ending between 1 and 31 December 2000 (inclusive); and</p> <p>(b) the period covered by the first client assets report on the <i>firm</i> delivered to the <i>FSA</i> ends on 30 November 2001.</p> <p>(2) An auditor will not contravene SUP 3.10 to the extent that any of the following apply:</p> <p>(a) the auditor delivers the first client assets report on the <i>firm</i> to the <i>FSA</i> within a period of 53 weeks plus four <i>months</i> after the end of the period covered by the last report delivered to the <i>firm's previous regulator</i>;</p> <p>(b) the first client assets report on the <i>firm</i> relates to compliance by the <i>firm</i> with the relevant pre-commencement provision;</p> <p>(c) the period covered by the second client assets report on the <i>firm</i> delivered to the <i>FSA</i> ends not later than 31 December 2002.</p>	From commencement for 13 months	Commencement
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SUP 3 Auditors

SUP 3.9.5R In row (13)(d), after "*IPRU(INV) 10-10R*", insert "(except *IPRU(INV) 10-10R(3)(m)* and (n))"

SUP 3.10.5R In rows (1) and (2), for "*COB 9*", substitute "*COB 9.1 to COB 9.4*"
 Insert a new row (4) as follows:

- (4) (if there has been a *secondary pooling event* during the period) the *firm* complied with the *rules* in COB 9.5 (Client money distribution) in relation to that pooling event.

SUP 9 Individual guidance

SUP 9.1.2G Amend as shown:

Individual *guidance* is *guidance* that is not given to persons or regulated persons generally or to a class of regulated person. It will normally be given to one particular person and relate to his own particular circumstances or plans. It may be oral or written. Individual *guidance* will not be published but may at the *FSA's* discretion be converted to general guidance and published in the *Handbook*. Written individual *guidance* will often be labelled as such.

SUP 10 Approved persons

- SUP 10.9.10R(1) In the last sentence, after "*designated investment business*" insert "other than *dealing in investments as principal*"
- SUP 10.9.11G At the end of the provision, insert "For the position in relation to proprietary traders, see SUP 10.9.13 G."
- SUP 10.9.12R(1) For "an activity which is not in relation to *designated investments*" substitute "*dealing in investments as principal* or an activity which is not *designated investment business*"

SUP 11 Controllers and close links

- SUP 11.3.9D After "If a Controllers Form B" insert ", or an Application to perform *controlled functions* under the *approved persons* regime (Form A in SUP 10 Ann 4D) in respect of a *governing function*,"
- SUP 11 Ann 4D (Controllers Form A) Amend question 1.05 as shown:
-
- (b) The conditions are:
- (i) the *firm* has permission to accept deposits ~~is a BCD credit institution~~;
 - (ii) the *controller* is either a *BCD credit institution* or the *parent undertaking* of a *BCD credit institution*; and
 - (iii) as a result of the proposed change in *control*, the *controller* would become a *parent undertaking* of the *firm*.
-

SUP 12 Appointed representatives

SUP 12.2.6G After "SUP 12.2.7G", insert "(1)"

SUP 12.2.7G Renumber SUP 12.2.7G as SUP 12.2.7G(1), and renumber paragraphs (1) to (4) as (a) to (d)

For "(1) to (3)" substitute "(a) to (c)".

Insert at the end:

- (2) If the *appointed representative* is an investment firm (see (3)), the business in (1) does not include the reception and transmission of orders on behalf of investors in relation to instruments covered by the *ISD* unless that activity is solely on behalf of another investment firm.
- (3) In (2), an "investment firm" is a *person* whose regular occupation or business is the provision of *core investment services* to third parties on a professional basis, other than a *person* to whom the *ISD* does not apply under article 2(2) of the *ISD*.

SUP 16 Reporting requirements

SUP 16.7.36R In the row of the table beginning "Quarterly Financial Return", after "(a)", add "or (b)"

SUP 17 Transaction reporting

SUP 17 Ann 5G In the table, under the heading "Iceland", insert "Iceland OTC market"

FSA 2001/64

COMPLAINTS SOURCEBOOK (REVOKING) INSTRUMENT 2001

The Financial Services Authority hereby revokes the Complaints Sourcebook Instrument 2001 made on 20 September 2001.

By order of the Board

15 November 2001

COMPLAINTS SOURCEBOOK INSTRUMENT 2001

- A. The Financial Services Authority makes the rules and gives the guidance in this instrument (“DISP”), except those provisions which are made exclusively by the Financial Ombudsman Service Limited, in the exercise of the powers listed in Schedule 4 to DISP (Powers exercised).
- B. The instrument shall come into force as follows: (1) DISP 1.5.4R – DISP 1.5.7R come into force on 1 April 2002; (2) the remainder of this instrument comes into force at the beginning of the day on which section 19 of the Act (the general prohibition) of the Financial Services and Markets Act 2000 (“the Act”) comes into force.
- C. The provisions of the Act relevant to making rules and listed in Schedule 4 to DISP (Powers exercised) are specified for the purpose of section 153(2) of the Act (Rule-making instruments).
- D. This instrument may be cited as the Complaints Sourcebook Instrument 2001.
- E. This Annex to this instrument (including its Schedules) may be cited as Dispute resolution: the Complaints sourcebook (or DISP).

By order of the Board

15 November 2001

ANNEX



Dispute resolution: Complaints



Contents

Transitional provisions

Text of DISP:

Introduction

1 Complaint handling procedures for firms

2 Jurisdiction of the Financial Ombudsman Service

3 Complaint handling procedures of the Financial Ombudsman Service

4 Standard Terms

Appendix 1: Relevant existing complaints

Appendix 2: Guidance on handling mortgage endowment complaints

Schedule 1: Record keeping requirements

Schedule 2: Notification requirements

Schedule 3: Fees and other required payments*

Schedule 4: Powers exercised

Schedule 5: Rights of action for damages

Schedule 6: Rules that can be waived

Derivations

Destinations

Handbook Modules

Transitional provisions

1 Table Transitional Provisions table

(1)	(2) Material provision to which transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1	<i>DISP</i> 1.2.15G	R	A firm must cease to use letter-headed paper or marketing literature which refers to its membership of a former scheme no later than 30 June 2002.	<i>Commencement</i> to 30.6.02	<i>Commencement</i>
2	<i>DISP</i> 1.5.4R – <i>DISP</i> 1.5.7R	R	A firm must include, in the first report which it submits to the FSA under <i>DISP</i> 1.5.4R in respect of the 1 April 2002 – 30 September 2002 reporting period, the total number of reportable complaints (that is, complaints subject to <i>DISP</i> 1.4 – <i>DISP</i> 1.6) which it has received but not closed by the beginning of that reporting period (including any such complaint which could be referred to the <i>Financial Ombudsman Service</i> as a relevant new complaint under the <i>Ombudsman Transitional Order</i>.	01.4.02 – 31.10.02	01.4.02

(1)	(2) Material provision to which transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
3	DISP 1.5.4R – DISP 1.5.7R	G	Transitional provision 2R requires a <i>firm</i> , in addition to complying with the reporting requirements in DISP 1.5.4R, to include in its first report under DISP 1.5.4R the total number of complaints subject to DISP 1.4 – DISP 1.6 which remain open at the beginning of that reporting period (that is, on 1 April 2002). This will enable the FSA to know how many complaints were carried forward into the first reporting period. (A <i>firm</i> is not required to provide a breakdown by category code or generic product type of the complaints carried forward at 1 April 2002, but must do so in respect of complaints received during the 1 April 2002 to 30 September 2002 reporting period and in respect of subsequent reporting periods.)	01.4.02 – 31.10.02	01.4.02
4	DISP App 1	R	Firms are subject to DISP App 1 in relation to relevant existing complaints.	From commencement	Commencement
5	DISP App 1	G	The Ombudsman Transitional Order makes special provision for the handling by FOS Ltd of "relevant existing complaints" (that is, complaints which the former schemes have partly completed at commencement). The arrangements for handling these complaints are set out in DISP App 1. (The handling of complaints which firms have partly completed at commencement is described at DISP 1.4.6R.)	From commencement	Commencement
6	DISP 2, DISP 3, DISP 5 and DISP App 1	R	In DISP 2, DISP 3, DISP 5 and DISP App 1, references to a "firm" or "firms" include unauthorised persons subject to the Compulsory Jurisdiction in accordance with the Ombudsman Transitional Order.	From commencement	Commencement

(1)	(2) Material provision to which transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
7	<i>DISP 2, DISP 3, DISP 5 and DISP App 1</i>	G	Under the <i>Ombudsman Transitional Order</i> , a <i>relevant complaint</i> is subject to the <i>Compulsory Jurisdiction</i> whether or not it is about a <i>firm</i> or an <i>unauthorised person</i> . <i>Unauthorised persons</i> are not subject to <i>DISP 1</i> , but references to "firm" in <i>DISP 2, DISP 3, DISP 5 and DISP App 1</i> include <i>unauthorised persons</i> subject to the <i>Compulsory Jurisdiction</i> in relation to <i>relevant complaints</i> , where applicable.	From commencement	Commencement
8	<i>DISP 1, DISP 2, DISP 3, DISP 4, DISP 5 and DISP App 1</i>	R	In relation to <i>relevant complaints</i>, references in <i>DISP 1, DISP 2, DISP 3, DISP 4, DISP 5 and DISP App 1</i> to an "eligible complainant" include a person who is to be treated as an <i>eligible complainant</i> in accordance with the <i>Ombudsman Transitional Order</i> and references to a complaint shall be construed accordingly.	From commencement	Commencement

COMPLAINTS SOURCEBOOK

DISPUTE RESOLUTION: COMPLAINTS

Introduction

Access for retail consumers to mechanisms for dealing with complaints about financial services *firms* is a key part of the regulatory regime. The *Act* gives the *FSA* the power to make rules relating to the handling of complaints by *firms* and provides for the establishment of an independent dispute resolution scheme (the *Financial Ombudsman Service*) to resolve complaints about financial services *firms* quickly and with minimum formality. The body established to administer and operate this scheme (the “scheme operator”) is the Financial Ombudsman Service Limited (“*FOS Ltd*”).

This module of the *FSA Handbook* contains the rules and guidance relating to the handling of complaints by *firms* and to the operation of the *Financial Ombudsman Service*. Responsibility for the rules relating to the *Financial Ombudsman Service* is shared under the *Act* between the *FSA* and the *FOS Ltd*, with those rules and other requirements written by the *FOS Ltd* being subject to approval by, or the consent of, the *FSA*.

Under the *Act*, the *Financial Ombudsman Service* comprises two jurisdictions:

- (a) The *Compulsory Jurisdiction* covers *firms* which are required to participate in the *Financial Ombudsman Service* in respect of complaints about activities specified by the *FSA* [and *unauthorised persons* subject to the *Compulsory Jurisdiction* in relation to *relevant complaints*];
- (b) The *Voluntary Jurisdiction* can cover financial services activities not included in the *Compulsory Jurisdiction*. Both *firms* and *unauthorised firms* can participate in the *Voluntary Jurisdiction* by contractual agreement with the *FOS Ltd* (in accordance with the *Standard Terms* – see below) and are known as *VJ participants*.

Although the authority to make the rules relating to the *Compulsory Jurisdiction* and the *Voluntary Jurisdiction* derives from different sections of the *Act*, the provisions have been co-ordinated to ensure that, wherever possible, they are identical.

Chapter 1: Complaint handling procedures for firms

These rules set out the complaint handling procedures which *firms* capable of giving rise to an eligible complaint under the *Compulsory Jurisdiction* (see Chapter 2) must establish. They are made by the *FSA* under section 138 of the *Act* and paragraph 13 of Schedule 17 to the *Act*. These rules, with some exceptions, are applied to *VJ participants* by contract via the *Standard Terms* set by the *FOS Ltd* (Chapter 4).

Chapter 2: Jurisdiction rules

These rules set out the scope of the *Compulsory Jurisdiction* and the *Voluntary Jurisdiction* of the *Financial Ombudsman Service*. They specify who can refer a complaint to the *Financial Ombudsman Service* and the time limits for doing so, as well as which activities are covered by the *Compulsory Jurisdiction* and the *Voluntary Jurisdiction*. The rules also set out the territorial scope of the *Financial Ombudsman Service*. They are relevant to consumers who may wish to refer complaints to the *Financial Ombudsman Service*; to firms which are subject to the *Compulsory Jurisdiction*; to *unauthorised persons* who are subject to the *Compulsory Jurisdiction* in relation to *relevant complaints*; to *VJ participants* and to the *Ombudsman* himself. The rules relating to the scope of the *Compulsory Jurisdiction* are made by the *FSA* (under section 226 of the *Act*); the rules relating to the scope of the *Voluntary Jurisdiction* are made by the *FOS Ltd*, with *FSA* approval (under section 227). The rules relating to the time limits for referring a complaint to the *Financial Ombudsman Service* are made by the *FSA* under paragraph 13 of Schedule 17 to the *Act* and are applied to *VJ participants* by contract via the *Standard Terms* set by the *FOS Ltd*.

Chapter 3: Complaint handling procedures of the Financial Ombudsman Service

These rules apply to the *Ombudsman*, to *firms*, and to *unauthorised persons* who are subject to the *Compulsory Jurisdiction* in relation to *relevant complaints*. They are also relevant to complainants. They set out how the *FOS Ltd* and, in particular, the *Ombudsman* will handle complaints under the *Financial Ombudsman Service*. For the purposes of the *Compulsory Jurisdiction*, they comprise the scheme rules and the costs rules (made by the *FOS Ltd*, with *FSA* consent or approval, under paragraph 14 of Schedule 17 and section 230 respectively) and rules made by the *FSA* on the kinds of loss or damage that can be compensated, including the maximum amount which can be awarded (s229). These procedural rules are applied to *VJ participants* via the *Standard Terms*.

Chapter 4: The Standard Terms

The *Standard Terms* are made, with *FSA* approval, by the *FOS Ltd* under paragraph 18 of Schedule 17 to the *Act* and are the contractual terms by which *VJ participants* participate in the *Voluntary Jurisdiction*.

Appendix 1: Relevant Existing Complaints

The *Ombudsman Transitional Order*, made by HM Treasury under sections 426-428 of the *Act*, extends the scope of the *Financial Ombudsman Service* to enable it to deal with complaints about pre-commencement business where these could have been handled by a former scheme ("*relevant complaints*") and makes special provision for the handling of these complaints.

It distinguishes between:

- (a) *relevant existing complaints* (ie complaints referred to, but not determined by, a former scheme (other than the *Personal Insurance Arbitration Service*) before commencement (see article 2 of the *Ombudsman Transitional Order*); and

- (b) *relevant new complaints* (ie complaints referred to the *Financial Ombudsman Service* after *commencement* which relate to a pre-*commencement* act or omission, in respect of which the *firm* was, immediately before *commencement*, subject to a *former scheme*) (see article 3 of the *Ombudsman Transitional Order*).

The Order enables the *FOS Ltd*, with only a few exceptions, to handle *relevant new complaints* in accordance with its new procedures, as set out in *DISP* 1 to 5 and these are covered in the main body of the *DISP* rules. Except as otherwise indicated, the term "complaint" in *DISP* 1 to 5 therefore includes a *relevant new complaint*.

However, the *Ombudsman Transitional Order* makes different provision for the handling of *relevant existing complaints* (ie complaints which the *former schemes* have partly completed at *commencement*). These complaints will be passed over to the *Financial Ombudsman Service* by the *former schemes* (except the *Personal Insurance Arbitration Service*) at *commencement* and the *Ombudsman Transitional Order* requires the *FOS Ltd* to complete the handling of these cases. However, it provides that the *Financial Ombudsman Service* must do this, in a significant number of respects, in accordance with the procedures of the relevant *former scheme*. The arrangements for dealing with these complaints are set out in *DISP* App 1. This describes the ways in which *relevant existing complaints* must be treated differently from other complaints dealt with under the *Financial Ombudsman Service*, but cross refers to the provisions in *DISP* 1 to 5, where appropriate. (*DISP* 1 explains how complaints which are partly completed by *firms* (as distinct from *former schemes*) at *commencement* are to be handled.)

Appendix 2: FSA's guidance on handling mortgage endowment complaints

DISP App 2 contains FSA's guidance to *firms* on handling mortgage endowment complaints..

Chapter 1

Complaint handling procedures for firms

1.1 Application and Purpose

Application

- 1.1.1** **R** _{/1} This chapter applies to every *firm* in respect of activities carried on from an establishment maintained by the *firm* (or its *appointed representative*) in the *United Kingdom*, except:
- (1) (a) a *firm* that is exempt under *DISP* 1.1.7R;
 - (b) a *UCITS qualifier*;
 - (c) an *authorised professional firm* in so far as its *non-mainstream regulated activities* are concerned; and
- (2) in relation to the *Society of Lloyd’s*, *members of the Society* and *managing agents*, *DISP* 1 applies subject to *DISP* 1.7 (the *Society of Lloyd’s*).
- 1.1.2** **G** _{/1} This chapter is also relevant to those who might wish to refer a complaint to the *Financial Ombudsman Service*.
- 1.1.3** **G** _{/1} *Firms* are responsible for ensuring their *appointed representatives’* compliance with *DISP* 1.
- 1.1.4** **G** _{/1} *VJ participants* are subject to *DISP* 1, except *DISP* 1.1.5R and *DISP* 1.5 (Record keeping and reporting), by contract under the *standard terms* (see *DISP* 4). *DISP* 1.2 applies to *VJ participants* only in relation to complaints about activities of the *VJ participant* specified in *DISP* 2.6.9R.
- 1.1.5** **R** _{/1} Except as otherwise specified, references to a “complaint” in this chapter include a complaint which is capable of becoming a *relevant new complaint*.
- 1.1.6** **G** _{/1} A complaint about pre-commencement investment business carried on by a *firm* which was regulated in respect of that business by a *recognised professional body* will be handled under the arrangements of that *professional body*, and is outside the scope of *DISP*.

Exemption

1.1.7 **R** _{/1} A *firm* which does not conduct business with *eligible complainants* and has no reasonable likelihood of doing so is exempt from *DISP* 1.2 – *DISP* 1.7, if it notifies the *FSA* in writing of this fact and that notice remains current, with effect from the date that notice is received by the *FSA*.

1.1.8 **R** _{/1} A notice under *DISP* 1.1.7R must be given:

- (1) by 28 February 2002, in which case it will remain current until 31 March 2003; or
- (2) before, or as soon as practicable after, the time of the *firm's* *authorisation* by the *FSA*, in which case it will remain current until the end of the *financial year* in which it is given; or
- (3) as soon as practicable after the *firm* ceases to conduct business with *eligible complainants*, in which case it will remain current until the end of the *financial year* in which it is given; or
- (4) in February of each *financial year* (beginning with February 2003), in which case it will remain current until the end of the next *financial year*.

1.1.9 **G** _{/1} A notice under *DISP* 1.1.7R will be renewable every 12 *months*.

End of exemption

1.1.10 **R** _{/1} A *firm* which is exempt under *DISP* 1.1.7R must notify the *FSA* if the conditions in *DISP* 1.1.7R no longer apply.

1.1.11 **G** _{/1} A *firm* to which the conditions in *DISP* 1.1.7R no longer apply is subject to *DISP* 1.2 – *DISP* 1.7.

Purpose

1.1.12 **G** _{/1} The purpose of this chapter is to set out the rules relating to the internal handling of complaints by *firms*, including the procedures which a *firm* must put in place; the time limits within which a *firm* must deal with a complaint; the records of a complaint which a *firm* must make and retain; and the requirements on a *firm* to report information about complaints to the *FSA*. This is to ensure that complaints are handled fairly, effectively and promptly, and resolved at the earliest possible opportunity, minimising the number of unresolved complaints which need to be referred to the *Financial Ombudsman Service*. This purpose is consistent with the *FSA's* consumer protection regulatory objective.

1.2 Internal complaint handling procedures: general requirements

Requirement to have internal complaint handling procedures

- 1.2.1** **R** _{/1} A *firm* must have in place and operate appropriate and effective internal complaint handling procedures (which must be written down) for handling any expression of dissatisfaction, whether oral or written, and whether justified or not, from or on behalf of an *eligible complainant* about that *firm's* provision of, or failure to provide, a financial service.
- 1.2.2** **G** _{/1} An *eligible complainant* is a *person* who would be eligible to refer a complaint to the *Financial Ombudsman Service*, as defined in *DISP* 2.4.
- 1.2.3** **G** _{/1} *Firms* are not obliged to restrict their internal complaint handling procedures to expressions of dissatisfaction from *eligible complainants*. They may, if they wish, also establish procedures for handling complaints from other customers.
- 1.2.4** **G** _{/1} The internal complaint handling procedures should provide for:
- (1) receiving complaints;
 - (2) responding to complaints;
 - (3) the appropriate investigation of complaints; and
 - (4) notifying complainants of their right to go the *Financial Ombudsman Service* where relevant.
- 1.2.5** **G** _{/1} When deciding what constitutes an appropriate complaint handling procedure (see *DISP* 1.2.1R), a *firm* should have regard to:
- (1) the type of business it undertakes;
 - (2) its size and organisational structure;
 - (3) the nature and complexity of the complaints it is likely to receive; and
 - (4) the likely number of complaints it will receive and have to investigate.
- 1.2.6** **G** _{/1} *DISP* 1.2.1R does not prevent the use of a third party administrator for the purposes of handling complaints.

1.2.7 **G**_{/1} In establishing their internal complaint handling procedures, *firms* may wish to take account of British Standard 8600:1999 “Complaints Management Systems - Guide to Design and Implementation”. This is available on request from the *FSA*.

1.2.8 **G**_{/1} The internal complaint handling procedures should enable complainants to make a complaint by any reasonable means (for example, letter, telephone, e-mail or in person).

Publicising the procedures

1.2.9 **R**_{/1} **A firm must:**

- (1) refer in writing to the availability of its internal complaint handling procedures at, or immediately after, the point of sale;
- (2) publish details of its internal complaint handling procedures, supply a copy on request, and supply a copy automatically to the complainant when it receives a complaint (unless the complaint is resolved by close of business on the next *business day*); and
- (3) display in each of its branches or sales offices to which *eligible complainants* have access a notice indicating that it is covered by the *Financial Ombudsman Service*.

1.2.10 **G**_{/1} The requirements in *DISP* 1.2.9R(1)-(3) relate to the internal complaints procedures required by *DISP* 1.2.1R.

1.2.11 **G**_{/1} In order to comply with *DISP* 1.2.9R(1), a *firm* may include reference to its complaint handling procedures in contractual documentation, for example, (where the *firm* is subject to the requirements in *COB*) in a *terms of business* letter, *key features document* or *client agreement*.

1.2.12 **G**_{/1} Where a complaint is also subject to the more detailed requirements in *DISP* 1.4 - *DISP* 1.6, the *firm* may send out a copy of its complaint handling procedures (as required by *DISP* 1.2.9R (2)) at the same time as the acknowledgement required by *DISP* 1.4.1R.

1.2.13 **G**_{/1} For the purposes of satisfying *DISP* 1.2.9R(2) a *firm* may wish to produce a leaflet which summarises its internal complaint handling procedures.

1.2.14 **G**_{/1} *Firms'* literature and correspondence relating to complaints should be in clear and plain language.

1.2.15 **G**_{/1} A *firm* may also, if it wishes to do so, disclose the fact that it is covered by the *Financial Ombudsman Service* by including the *Financial Ombudsman Service* logo in any marketing literature or correspondence directed at *eligible complainants*, provided that it does so in a way which is not misleading.

Particular matters for which procedures must make provision

1.2.16 **R**_{/1} **A firm's internal complaint handling procedures under *DISP* 1.2.1R must make provision for:**

- (1) complaints to be investigated by an employee of sufficient competence who, where appropriate, was not directly involved in the matter which is the subject of the complaint;
- (2) the *person* charged with responding to complaints to have the authority to settle complaints (including the offering of redress where appropriate) or to have ready access to someone who has the necessary authority; and
- (3) responses to complaints to address adequately the subject matter of the complaint and, where a complaint is upheld, to offer appropriate redress.

Providing compensation

- 1.2.17 **R** /1 Where a *firm* decides that redress is appropriate, a *firm* must provide a complainant with fair compensation for any acts or omissions for which it was responsible and comply with any offer of redress which the complainant accepts.
- 1.2.18 **G** /1 In deciding whether or not to accept a complaint and what would be appropriate redress, *firms* may wish to consider any relevant guidance published by the FSA, the *Financial Ombudsman Service* or by any of the *former schemes*.
- 1.2.19 **G** /1 Appropriate redress will not always involve financial redress. It may, for example, simply involve an apology. Where financial redress is deemed appropriate, it may include a reasonable rate of interest.
- 1.2.20 **G** /1 *DISP* App 2 contains *guidance* to *firms* on the approach to assessing financial loss and appropriate compensation in circumstances where a *firm* regards a complaint in relation to the sale of an endowment policy (which is sold for the purposes of repaying a mortgage) as justified.

Using the procedures

- 1.2.21 **R** /1 A *firm* must take reasonable steps to ensure that all relevant employees (including employees of *appointed representatives*) are aware of the *firm's* internal complaint handling procedures and must endeavour to ensure that they act in accordance with them.
- 1.2.22 **R** /1 A *firm* must put in place appropriate management controls and take reasonable steps to ensure that in complying with *DISP* 1.2.1R it handles complaints fairly, consistently and promptly and that it identifies and remedies any recurring or systemic problems, as well as any specific problem identified by a complaint.



1.3 Internal complaint handling procedures: additional requirements

- 1.3.1** G_{/1} *DISP 1.4-DISP 1.6* contain additional requirements, concerning time limits, record keeping and reporting and cooperation with the *Ombudsman*, for handling complaints, unless *DISP 1.3.3R* applies.
- 1.3.2** R_{/1} *DISP 1.4-DISP 1.6* also apply to any complaints that are capable of becoming *relevant new complaints*, unless *DISP 1.3.3R* applies.
- 1.3.3** R_{/1} *DISP 1.4 – DISP 1.6* do not apply:

 - (1) where the *firm* has taken reasonable steps to determine, and has determined, that the complaint:
 - (a) is not made by, or on behalf of, an *eligible complainant*; or
 - (b) does not relate to an activity of that *firm* which comes under the jurisdiction of the *Financial Ombudsman Service*; or
 - (c) does not involve an allegation that the complainant has suffered, or may suffer, financial loss, material distress or material inconvenience; or
 - (2) where the complaint has been resolved by close of business on the *business day* following its receipt.
- 1.3.4** G_{/1} Under the *Ombudsman Transitional Order*, a complaint received by a *firm* either before or after *commencement* is capable of becoming a *relevant new complaint*. A *firm* is expected to handle such complaints in accordance with *DISP 1*. However, where a *firm* has already received, but only partly completed the handling of, such a complaint by *commencement*, *DISP 1.4.6R* recognises that this may not always be practicable.
- 1.3.5** G_{/1} Financial loss includes consequential or prospective loss, in addition to actual loss. For example, a complaint may involve an allegation that the complainant may suffer financial loss which has not yet crystallised because of the type of product involved (for example, pensions, endowments etc).

1.4 Time limits for dealing with a complaint

Written acknowledgement within five business days

1.4.1 **R** ^{/1} A *firm* must send a written acknowledgement of a complaint within five *business days* of its receipt, giving the name or job title of the individual handling the complaint for the *firm* (together with details of the *firm*'s internal complaint handling procedures).

1.4.2 **G** ^{/1} A *firm* which is able to provide a *final response* within five *business days* of receipt of a complaint may combine its acknowledgement of the complaint with the *final response*. (For complaints which are subject to the FSAVC review, see *DISP* 1.4.15R to *DISP* 1.4.17G.)

1.4.3 **G** ^{/1} A *firm* should aim to resolve complaints at the earliest possible stage.

Final or holding response within four weeks

1.4.4 **R** ^{/1} A *firm* must, within four weeks of receiving a complaint, (unless *DISP* 1.4.7R or *DISP* 1.4.9R applies) send the complainant either:

- (1) a *final response*; or
- (2) a holding response, which explains why it is not yet in a position to resolve the complaint and indicates when the *firm* will make further contact (which must be within eight weeks of receipt of the complaint).

Final or other response within eight weeks

1.4.5 **R** ^{/1} A *firm* must, by the end of eight weeks after its receipt of a complaint, (unless *DISP* 1.4.7R or *DISP* 1.4.9R applies) send the complainant either:

- (1) a *final response*; or
- (2) a response which:

- (a) explains that the *firm* is still not in a position to make a *final response*, gives reasons for the further delay and indicates when it expects to be able to provide a *final response*; and
- (b) informs the complainant that he may refer the complaint to the *Financial Ombudsman Service* if he is dissatisfied with the delay and encloses a copy of the *Financial Ombudsman Service's* explanatory leaflet.

Complaints being dealt with at commencement

1.4.6 **R** Where, at *commencement*, a *firm* is still dealing with a complaint that is capable of being referred to the *Financial Ombudsman Service* as a *relevant new complaint*:

- (1) it may continue to try to resolve the complaint in accordance with its *pre-commencement* complaints procedures; but
- (2) it must, within eight weeks of *commencement*, send the complainant a response which satisfies *DISP 1.4.5R*, unless *DISP 1.4.7R* or *DISP 1.4.9R* applies)

Early resolution of complaints

1.4.7 **R** *DISP 1.4.4R* to *DISP 1.4.6R* do not apply if the complainant has already indicated in writing acceptance of a response by the *firm*, provided that the response informed the complainant how to pursue his complaint if he remained dissatisfied.

1.4.8 **G** *DISP 1.4.7R* recognises that a response by the *firm* will not necessarily be its *final response* but that it may, nonetheless, resolve the complaint.

Firms with two-stage complaints procedures

1.4.9 **R** Where, within eight weeks of receiving a complaint, the *firm* sends the complainant a written response which:

- (1) offers redress (whether or not it accepts the complaint) or rejects the complaint and gives reasons for doing so;
- (2) informs the complainant how to pursue his complaint with the *firm* if he remains dissatisfied;
- (3) refers to the ultimate availability of the *Financial Ombudsman Service* if he remains dissatisfied with the *firm's* response; and

- (4) indicates that it will regard the complaint as closed if it does not receive a reply within eight weeks;

the *firm* is not obliged to continue to comply with *DISP* 1.4.4R or *DISP* 1.4.5R unless the complainant indicates that he remains dissatisfied, in which case, the obligation to comply with *DISP* 1.4.5R resumes.

1.4.10

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If the complainant takes more than a week to reply to a written response of the kind described in *DISP* 1.4.9R, the additional time in excess of a week will not count for the purposes of the time limits in *DISP* 1.4.4R-*DISP* 1.4.6R.

1.4.11

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- (1) *DISP* 1.4.9R caters for the situation where a *firm's* complaints procedures provide for a complainant who is dissatisfied with the *firm's* response to refer the complaint back to the *firm* again or to the *firm's* head office before a *final response* is issued.
- (2) Such *firms* are subject to the time limits in *DISP* 1.4.4R to *DISP* 1.4.6R in the same way as any other *firm*. However, *DISP* 1.4.9R recognises that some complainants may never respond to a *firm* or may take a long time to do so.
- (3) Provided that the *firm* has sent a letter which complies with the conditions in *DISP* 1.4.9R within eight weeks of receiving the complaint:
- (a) if the complainant does not reply at all, the *firm* is not required to send a *final response*;
 - (b) if the complainant does not reply within eight weeks of the *firm's* letter, *DISP* 1.5.7R(3) enables the *firm* to treat the complaint as a closed complaint for the purposes of the reporting requirement in *DISP* 1.5.4R;
 - (c) if the complainant does reply (within or after eight weeks), the *firm* is required to continue to comply with *DISP* 1.4.5R, and the time limits in *DISP* 1.4.5R therefore resume. But *DISP* 1.4.10R allows the *firm* to discount, for the purposes of the time limits in *DISP* 1.4.4R to *DISP* 1.4.6R, any time in excess of a week taken by the complainant to reply.
- (4) The *FSA* expects that *firms* operating a two-stage complaints procedure will wish to provide complainants with easy access to the second stage of the process (for example, by referring complaints on to the next stage for them if they remain dissatisfied).

The final response

1.4.12

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When a *firm* sends a complainant its *final response*, the *final response* must:

- (1) inform the complainant that he may refer the complaint to the *Financial Ombudsman Service* if he is dissatisfied with the *final response* and that he must do so within six *months*; and

(2) enclose a copy of the *Financial Ombudsman Service's* explanatory leaflet (unless it has already done so under *DISP 1.4.5R(2)(b)*).

1.4.13

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Copies of the *Financial Ombudsman Service's* explanatory leaflet may be reproduced under licence or can be obtained from the *Financial Ombudsman Service*.

1.4.14

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Under *DISP 1.4.5R* and *DISP 1.4.6R*:

- (1) a complainant can refer his complaint to the *Financial Ombudsman Service* if he receives a *final response* with which he is dissatisfied or the *firm* has had at least eight weeks to resolve the complaint and has failed to do so in that time; the complainant may decide whether to give the *firm* more time before exercising any right he may have to refer a complaint to the *Financial Ombudsman Service*;
- (2) the six *month* time limit within which a complainant must refer a complaint to the *Financial Ombudsman Service* begins at the date when the *final response* is sent by the *firm*.

Complaints subject to the FSAVC review

1.4.15

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DISP 1.4.1R to *DISP 1.4.14G* and *DISP 1.5.1R* and *DISP 1.5.4R* do not apply where the complaint is subject to a review directly or indirectly under the terms of the policy statement for the review of specific categories of FSAVC business issued by the *FSA* on 28 February 2000.

1.4.16

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Where *DISP 1.4.15R* applies, the *firm* must, if the complainant remains dissatisfied on completion of that review, treat that expression of dissatisfaction as a complaint and comply with *DISP 1.4.1R-DISP 1.4.14G*, *DISP 1.5.1R* and *DISP 1.5.4R*.

1.4.17

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The effect of *DISP 1.4.15R* is to relieve the *firm* of the obligation to comply with the requirements and time limits for replying to complainants, and the record-keeping and reporting requirements in *DISP 1.5.1R* and *DISP 1.5.4R*, where a complaint is subject to the FSAVC review. However, if a complainant remains dissatisfied with the outcome of the review, *DISP 1.4.16R* requires the *firm* to treat this as a complaint and comply with these requirements just as it would in respect of any other complaint. *Firms* are therefore required to record and report such complaints only where they receive a complaint about the outcome of the review.

1.5 Record keeping and reporting

Making and retaining records of complaints

1.5.1 **R** ^{/1} A *firm* must make and retain records of complaints subject to *DISP* 1.4 – *DISP* 1.6 for a minimum period of three years from the date of its receipt of the complaint.

1.5.2 **G** ^{/1} The records required by *DISP* 1.5.1R are for the purposes of monitoring by the FSA and also to ensure that the *firm* is able to cooperate, as necessary, with the *Financial Ombudsman Service*. They should include:

- (1) the name of the complainant;
- (2) the substance of the complaint; and
- (3) any correspondence between the *firm* and the complainant, including details of any redress offered by the *firm*.

1.5.3 **G** ^{/1} *DISP* 4.2.3G covers record keeping by *VJ participants*.

Reporting complaints to the FSA

1.5.4 **R** ^{/1} A *firm* must provide the FSA, twice a year, with a report containing (for the relevant reporting period) information about:

- (1) the total number of complaints subject to *DISP* 1.4 – *DISP* 1.6 received by the *firm*, broken down according to the categories and in respect of each of the generic product types listed at *DISP* 1 Ann 1R which are relevant to the *firm*; and
- (2) the total number of complaints subject to *DISP* 1.4 - *DISP* 1.6 closed by the *firm*:
 - (a) within four weeks or less of receipt;
 - (b) within four to eight weeks of receipt; and
 - (c) more than eight weeks after receipt; and

(3) the total number of complaints subject to *DISP* 1.4 - *DISP* 1.6 outstanding at the end of the reporting period.

1.5.5

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Where a complaint could fall into more than one category, the complaint should be recorded in the category which the *firm* considers to form the main part of the complaint.

1.5.6

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For the purposes of *DISP* 1.5.4R:

- (1) the relevant reporting periods are from 1 April to 30 September and from 1 October to 31 March each year; and
- (2) reports are to be submitted to the *FSA* within one *month* of the end of the relevant reporting period.

Reporting: when is a complaint closed?

1.5.7

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For the purpose of *DISP* 1.5.4R(2), a closed complaint is a complaint:

- (1) where the *firm* has sent a *final response*; or
- (2) where the complainant has indicated in writing acceptance of the *firm's* earlier response; or
- (3) where *DISP* 1.4.9R applies, provided that the complainant has not responded to the *firm* within eight weeks of the written response referred to in that *rule*.

1.5.8

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Where a complaint is reported as closed under *DISP* 1.5.7(3) because the complainant has not replied to the *firm* within eight weeks of a written response which meets the requirements in *DISP* 1.4.9R, the *firm* may treat the date of that response as the date when the complaint was closed for the purposes of the reporting requirements in *DISP* 1.5.4(2).

Reporting: complaints subject to the FSAVC review

1.5.9

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Where a complaint is subject to the FSAVC review, the record keeping and reporting requirements in *DISP* 1.5.1R and *DISP* 1.5.4R apply only where the complainant is dissatisfied with the outcome of that review (under *DISP* 1.4.15R and *DISP* 1.4.16R).

Method of submission of reports

1.5.10

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A report under this section must be given or addressed, and delivered, in the way set out in *SUP* 16.3.6R - *SUP* 16.3.16G (General provisions on reporting), except that, instead of the *firm's* usual supervisory contact, the report should be given or addressed to [to be added later].

Notification of contact point for complainants

1.5.11

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For the purpose of inclusion in the public record maintained by the *FSA*, a *firm* must provide the *FSA*, at the time of its *authorisation*, with details of a single contact point within the *firm* for complainants and must notify the *FSA* of any subsequent change.

1.5.12

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The contact point can be by name, job title or department and may include, for example, a helpline telephone number.



1.6 Cooperation by firms with the Ombudsman

1.6.1

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A *firm* must cooperate fully with the *Ombudsman* in the handling of complaints against it.

1.6.2

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Cooperation with the *Ombudsman* includes, but is not limited to, producing requested *documents*, adhering to any specified time limits, attending hearings when requested to do so and complying promptly with any settlements or awards.

1.7 The Society of Lloyd's

- 1.7.1 **R** /1 The *Society* of Lloyd's must establish and maintain appropriate and effective procedures for handling complaints by policyholders against *members* of the *Society*, which comply with *DISP* 1.
- 1.7.2 **R** /1 *Members* of the *Society* of Lloyd's must, in complying with *DISP* 1, ensure that the arrangements which the *member* maintains are compatible with the procedures maintained by the *Society* in accordance with *DISP* 1.7.1R, so that, taken as a whole, the requirements of *DISP* are met.
- 1.7.3 **R** /1 The *Society* of Lloyd's must take reasonable steps to ensure that complaints by policyholders against *members* of the *Society* are dealt with under the procedures in *DISP* 1.7.1R and that *members* comply with the requirements of those procedures.
- 1.7.4 **R** /1 A complaint by a policyholder against a *member* of the *Society* of Lloyd's may not be referred to the *Financial Ombudsman Service* until after the internal procedures in *DISP* 1.7.1R have been completed or until after the end of eight weeks from receipt of the complaint, whichever is the earlier.
- 1.7.5 **R** /1 Notices under *DISP* 1.1.7R must be given to the *FSA* by the *Society* of Lloyd's on behalf of any *member* eligible for an exemption under that *rule*.
- 1.7.6 **R** /1 The *Society* of Lloyd's must notify the *FSA* if the conditions in *DISP* 1.1.7R no longer apply to a *member* who is exempt.
- 1.7.7 **R** /1 The report in *DISP* 1.5.4R must be provided by the *Society* of Lloyd's and must cover all complaints by policyholders against *members* falling with the scope of *DISP* 1.5.4R.
- 1.7.8 **G** /1 Each *member* of the *Society* of Lloyd's is individually subject to the *rules* in *DISP* 1 as a result of the *insurance market direction* given in *LLD* 6.2.1D under section 316 of the *Act* (Direction by Authority).
- 1.7.9 **G** /1 However, the *Society* of Lloyd's operates a two-tier internal complaints handling procedure, currently set out in the "Code for Underwriting agents: UK Personal Lines Claims and Complaints Handling". Under this procedure, complaints by policyholders against *members* of the *Society* are considered by the *managing agent* and then, if necessary, by the *Society* of Lloyd's in-house Complaints Department.

This procedure (and any procedure that may replace it) will be subject to the requirements in *DISP* 1.

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Members will individually comply with *DISP* 1 if and only if all complaints by policyholders against *members* are dealt with under the internal procedure established by the *Society* of Lloyd's for handling those complaints, provided that this procedure complies with *DISP*. Accordingly, certain of the obligations under *DISP* 1, for example the obligation to report on complaints received and the obligation to pay fees under *DISP* 5, must be complied with by the *Society* on behalf of *members*. *Managing agents* will not have to make a separate report to the *FSA* on complaints reported under *DISP* 1.7.7R.

1.7.11

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A members' adviser must establish and maintain effective arrangements for handling any complaint from a member of the Society of Lloyd's regarding advice given to the member in connection with the acquiring or disposing of syndicate participation.

1.7.12

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Complaints from *members* of the *Society* of Lloyd's regarding the activities of *members' advisers*, which cannot be resolved by the *members' adviser*, cannot be referred to the *Financial Ombudsman Service*. (See *LLD* (the Lloyd's sourcebook), for further information concerning complaints by *members* of the *Society* of Lloyd's.)

DISP 1 Ann 1R

Table

DISP 1 Ann 1R (see DISP 1.5.4R)
Complaint Categories

Firms are required to report the total number of complaints subject to DISP 1.4-1.6 received in respect of each of the generic product types listed, according to the categories below.

Generic Product Type*	
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Category	Total Number of Complaints	
	Private Individual	Small Businesses
Overcharging/incorrect charges		
Delay		
Other administrative errors		
Unsuitable or misleading advice		
Failure to carry out instructions		
Poor customer service		
Misleading advertising/product information		
Disputes over sums/amounts payable		
Switching/Churning (wrong advice to surrender one investment and take out another)		
Breach of customer agreement or contract		
Other		
Other		

*Generic Product Types
Free Standing AVC
Personal Pension
Stakeholder Pension
Mortgage Endowment
Other Endowment
Whole of Life
Permanent Health
Term Assurance
PEP/ISA
Unit Trust/OEIC
Investment Bond
Share/Derivative
Current Account
Deposit and savings accounts
Loan secured on land
Other loans
General insurance - motor
General insurance - property
General insurance - other
Other

Chapter 2

2

Jurisdiction of the Financial Ombudsman Service

2.1 Application and Purpose

Application

- 2.1.1** **R** _{/1} This chapter applies to the *Ombudsman*, to *firms* (except *UCITS qualifiers*) and to *VJ participants*.
- 2.1.2** **G** _{/1} It is also relevant to those who might wish to refer a complaint to the *Financial Ombudsman Service*.
- 2.1.3** **R** _{/1} A reference in this chapter to a "complaint" under the *Compulsory Jurisdiction* includes a *relevant new complaint*.
- 2.1.4** **G** _{/1} References in this chapter to "*firms*" are to be construed, where relevant, as including:
- (1) in accordance with the *Ombudsman Transitional Order*, *unauthorised persons* subject to the *Compulsory Jurisdiction* in relation to *relevant complaints*; and
 - (2) as a result of section 226 of the *Act*, *unauthorised persons* who were formerly *firms* in respect of complaints about acts or omissions which occurred at the time when they were *authorised*, provided that the *Compulsory Jurisdiction* rules were in force in relation to the activity in question.

Purpose

- 2.1.5** **G** _{/1} The purpose of this chapter is to set out the rules which govern the scope of both the *Compulsory Jurisdiction* and the *Voluntary Jurisdiction* of the *Financial Ombudsman Service*. They specify who may refer a complaint to the *Financial Ombudsman Service* and the time limits for doing so. They also set out which activities are covered by the *Compulsory Jurisdiction* and the *Voluntary Jurisdiction* and the territorial scope of the *Financial Ombudsman Service*.



2.2 Which complaints can be dealt with under the Financial Ombudsman Service?

Complaints (other than relevant new complaints)

2.2.1

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The following conditions will need to be satisfied before a complaint (other than a *relevant new complaint*) can be dealt with under the *Financial Ombudsman Service*:

- (1) the complainant must be an *eligible complainant* (see *DISP* 2.4);
- (2) the *firm* or *VJ participant* about which the complaint is made must be one which is subject to either the *Compulsory Jurisdiction* or the *Voluntary Jurisdiction*, as appropriate;
- (3) the activity to which the complaint relates must be subject to either the *Compulsory Jurisdiction* or the *Voluntary Jurisdiction*, as appropriate;
- (4) in relation to the *Compulsory Jurisdiction*, the act or omission complained of must have occurred at a time when the *rules* in *DISP* 2 were in force, in relation to the activity being complained about;
- (5) the *firm* or *VJ participant* must have failed to resolve the complaint to the satisfaction of the complainant within eight weeks of receiving it; and
- (6) the *firm* or *VJ participant* about which the complaint is made must:
 - (a) in the case of the *Compulsory Jurisdiction*, have been *authorised* under the *Act* at the time of the act or omission to which the complaint relates; or
 - (b) in the case of the *Voluntary Jurisdiction*, have been a *VJ participant* at the time of the act or omission to which the complaint relates or have agreed to let the *Financial Ombudsman Service* consider such complaints, and must not have withdrawn from being a *VJ participant* at the time when the complaint is referred to the *Financial Ombudsman Service*.

Relevant new complaints

2.2.2

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- (1) Article 3 of the *Ombudsman Transitional Order* provides that (subject to certain modifications) the *Compulsory Jurisdiction* applies to a *relevant new complaint*, provided that:
 - (a) the act or omission is that of a *person* who was, immediately before *commencement*, subject to a *former scheme*;

- (b) the act or omission occurred in the carrying on by that *person* of an activity to which that *former scheme* applied; and
 - (c) the complainant is eligible and wishes to have the complaint dealt with under the new scheme.
- (2) For the purposes of (1)(c), the *Ombudsman Transitional Order* enables the *Ombudsman*, if he considers it appropriate, to treat the complainant as eligible if he would have been entitled to refer an equivalent complaint to the *former scheme* in question immediately before *commencement*.
- (3) The *Ombudsman Transitional Order* enables *relevant new complaints* to be handled, as far as possible, under the *Financial Ombudsman Service* procedures, but provides for the rules of the *former schemes* to apply or be taken into account in certain circumstances.
- (4) The *Ombudsman Transitional Order* makes separate provision for the treatment of *relevant existing complaints*, as described in *DISP* App 1.

Dismissal of complaints without consideration of the merits

2.2.3

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Under *DISP* 3.3.1R(1), the *Ombudsman* may dismiss a complaint without considering its merits if he is satisfied that the complainant has not suffered, or is unlikely to suffer, financial loss, material distress or material inconvenience.



2.3 Time Limits for referral of complaints to the Financial Ombudsman Service

2.3.1

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- (1) The *Ombudsman* cannot consider a complaint (except as described in (2)) if the complainant refers it to the *Financial Ombudsman Service*:
 - (a) less than eight weeks after receipt of the complaint by the *firm* or *VJ participant*, unless the *firm* or *VJ participant* has already sent the complainant its *final response*; or
 - (b) more than six *months* after the date on which the complainant is advised by the *firm* or *VJ participant* in its *final response* that he may refer his complaint to the *Financial Ombudsman Service*; or
 - (c) more than six years after the event complained of or (if later) more than three years from the date on which he became aware (or ought reasonably to have become aware) that he had cause for complaint (but see *DISP 2.3.5R*).
- (2) The *Ombudsman* can consider complaints outside the time limits in (1)(b) or (c) when, in his view, the failure to comply with the time limits was as a result of exceptional circumstances or where he is required to do so by the *Ombudsman Transitional Order* (see *DISP 2.3.2G*).

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In relation to *DISP 2.3.1R* (1)(b) and (c), article 4(2) of the *Ombudsman Transitional Order* requires an *Ombudsman* to extend the time limit in respect of a *relevant new complaint* referred to the *Financial Ombudsman Service* not later than twelve *months* after *commencement*, so the time limit applying to the complaint is the same as that which would have applied under the *former scheme* in question as it had effect immediately before *commencement*.

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For the purposes of *DISP 2.3.1R*(2), an example of an exceptional circumstance might be where the complainant has been or is incapacitated or where the *firm* or *VJ participant* has failed, in its *final response*, to inform the complainant that he may refer his complaint to the *Financial Ombudsman Service* or that he must do so within six *months*.

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Under *DISP 5.6.1R* a *firm* or *VJ participant* is liable to pay a case fee in respect of *chargeable cases*. However, in some circumstances, the *Ombudsman* may conclude that a *firm* or *VJ participant* should have more time to resolve a complaint before a case fee is incurred (for example, where there has been delay in obtaining information from third parties or where the *Ombudsman* considers that the

complainant has not fully cooperated with the *firm* or *VJ participant* in the investigation of the complaint).

Exceptions for reviews of past business

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DISP 2.3.1R(1)(c) does not apply where:

- (1) the time limit has been extended under a scheme for review of past business approved by the Treasury under section 404 of the *Act* (Schemes for reviewing past business); or
- (2) the complaint concerns a contract or policy which is the subject of a review directly or indirectly under:
 - (a) the terms of the Statement of Policy on 'Pension transfers and Opt-outs' issued by the *FSA* on 25 October 1994; or
 - (b) the terms of the policy statement for the review of specific categories of *FSAVC* business issued by the *FSA* on 28 February 2000.



2.4 Who can refer a complaint to the Financial Ombudsman Service?

2.4.1 **R** /1 A complaint may be dealt with under the *Financial Ombudsman Service* only if it is brought by or on behalf of an *eligible complainant*.

2.4.2 **G** /1 *Eligible complainants* are those falling within one of the classes of *person* specified in *DISP* 2.4.3R; and

- (1) having a customer or potential customer relationship with a *firm* or *VJ participant* (as specified in *DISP* 2.4.7R and *DISP* 2.4.8R); or
- (2) having an indirect relationship with a *firm* or *VJ participant* (as specified in *DISP* 2.4.10R);

or, in relation to *relevant complaints*, those specified in the *Ombudsman Transitional Order* (see *DISP* 2.4.14G and *DISP* 2.4.15G and *DISP* App 1.3.1G).

Classes of person

2.4.3 **R** /1 (1) Subject to (2), a *person* is an *eligible complainant* if he is:

- (a) a private individual; or
- (b) a business, which has a group annual turnover of less than £1million at the time the complainant refers the complaint to the *firm* or *VJ participant*; or
- (c) a charity which has an annual income of less than £1million at the time the complainant refers the complaint to the *firm* or *VJ participant*; or
- (d) a trustee of a trust which has a net asset value of less than £1million at the time the complainant refers the complaint to the *firm* or *VJ participant*;

who satisfies the relevant criteria in *DISP* 2.4.7R – *DISP* 2.4.12R, and is not within (2).

(2) The following are not *eligible complainants*:

- (a) an individual, business, charity or trustee, who was an *intermediate customer* or *market counterparty* in relation to the *firm* in question at the time of the act or omission, and in respect of the activity, which is the subject of the complaint;
- (b) a *firm* or *VJ participant* whose complaint relates in any way to an activity which the *firm* itself has *permission* to carry on or which the *VJ participant* itself conducts, and which is subject to the *Compulsory Jurisdiction* or the *Voluntary Jurisdiction* of the *Financial Ombudsman Service*.

2.4.4 **G**_{/1} For the purposes of *DISP* 2, a business includes a *sole trader*, a *company*, an unincorporated body and a *partnership* carrying on any trade or profession.

2.4.5 **G**_{/1} If a *firm* or *VJ participant* is in any doubt about the eligibility of a business, charity or trust, it should treat the complainant as if it were eligible. If the complaint is referred to the *Financial Ombudsman Service*, the *Ombudsman* will determine eligibility by reference to appropriate evidence, such as audited accounts or VAT returns.

2.4.6 **G**_{/1} For the purposes of *DISP* 2.4.3R(1)(b), a subsidiary of a corporate group (as defined in section 262(1) of the Companies Act 1985) will be eligible only where the corporate group as a whole meets the turnover test.

Eligible complainants: customers

2.4.7 **R**_{/1} A *person* is an *eligible complainant* if:

- (1) he is or has been a customer of a *firm* or *VJ participant*;
- (2) the complaint arises out of matters relevant to his being or having been a customer of the *firm* or *VJ participant*; and
- (3) he falls into one of the classes of *person* in *DISP* 2.4.3R(1).

Eligible complainants: potential customers

2.4.8 **R**_{/1} A *person* is an *eligible complainant* if:

- (1) the complaint arises out of a *firm's* or *VJ participant's* actions or failure to act for the complainant in his capacity as a potential customer of the *firm* or *VJ participant*; and
- (2) he falls into one of the classes of *person* in *DISP* 2.4.3R(1).

2.4.9 **G**_{/1} *DISP* 2.4.8R is intended to enable a potential customer to use the *Financial Ombudsman Service* where the complaint involves an allegation that he has suffered or may suffer financial loss, material distress or material inconvenience as a result of a *firm's* or *VJ participant's* wrongful act or omission (for example, where, as a result of maladministration or illegal discrimination, a service has not been provided). A complaint about the legitimate exercise of a *firm's* or *VJ participant's* commercial

judgment may be dismissed by an *Ombudsman* without consideration of its merits under *DISP* 3.3.1R(11).

Eligible complainants: indirect complaints

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A *person* is an *eligible complainant* if:

- (1) he is not, and has not been, a customer or potential customer of the *firm* or *VJ participant* in relation to the subject matter of the complaint; and
- (2) he has a complaint against the *firm* or *VJ participant* which either:
 - (a) arises out of a relationship which he has with the *firm* or *VJ participant* as described in *DISP* 2.4.11R; or
 - (b) is derived from another *person* and which arises from any of the circumstances described in *DISP* 2.4.12R; and
- (3) he falls into one of the classes of *persons* in *DISP* 2.4.3R(1).

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The relationships with the *firm* or *VJ participant* relevant for *DISP* 2.4.10R(2)(a) are:

- (1) the complainant has given the *firm* or *VJ participant* a guarantee or security for a mortgage or loan; or
- (2) the complainant has relied in the course of his business on a cheque guarantee card issued by the *firm* or *VJ participant*; or
- (3) the complainant is the true owner or the *person* entitled to immediate possession of a cheque, or of the funds it represents, collected by the *firm* or *VJ participant* for someone else's account; or
- (4) the complainant is the recipient of a banker's reference given by the *firm* or *VJ participant*; or
- (5) the complainant is the holder of *units* in a *collective investment scheme* and the *firm* or *VJ participant* is the *operator* or *depository* of the *scheme*.

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The circumstances relevant for *DISP* 2.4.10R(2)(b) are:

- (1) that the complainant is a beneficiary under a trust or estate of which the *firm* or *VJ participant* is trustee or personal representative; or
- (2) that the complainant is a *person* for whose benefit a *contract of insurance* was taken out or was intended to be taken out; or

(3) that the complainant is a *person* on whom the legal right to benefit from a claim under a *contract of insurance* has been devolved by contract, statute or subrogation.

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DISP 2.4.12R(2) and(3) include, for example, employees covered by a group permanent health policy taken out by an employer, which provides in the insurance contract that the policy was taken out for the benefit of the employee.

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In respect of a *relevant new complaint*, where the complainant is not eligible in accordance with DISP 2.4, article 3(3) of the *Ombudsman Transitional Order* provides that the *Ombudsman* may, nonetheless, if he considers it appropriate, treat the complainant as an *eligible complainant* if he or she would have been entitled to refer an equivalent complaint to the *former scheme* in question immediately before *commencement*, provided that the complainant wishes to have the complaint dealt with under the new scheme.

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Article 3(4) of the *Ombudsman Transitional Order* provides that, in the case of a *relevant new complaint*, where the *former scheme* in question is the *Insurance Ombudsman Scheme*, a complainant is not to be treated as an *eligible complainant* unless:

- (1) he is an individual; and
- (2) the complaint does not concern aspects of a policy relating to a business or trade carried on by him.

Representatives of eligible complainants

2.4.16

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A complaint may be brought on behalf of an *eligible complainant*, or a deceased *person* who would have been an *eligible complainant*, by a *person* authorised by the *eligible complainant* or authorised by law.

2.4.17

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It is immaterial whether the *person* authorised to act on behalf of an *eligible complainant* under DISP 2.4.16R:

- (1) can satisfy any of the criteria applicable to the *person* under DISP 2.4.3R(1); or
- (2) has a claim of his own, or is acting for another *person* against the *firm* or *VJ participant*; or
- (3) is or was a customer or potential customer of the *firm* or *VJ participant*.



2.5 Which firms are subject to the jurisdiction of the Financial Ombudsman Service?

- 2.5.1** G_{/1} All *firms* are subject to the *Compulsory Jurisdiction* of the *Financial Ombudsman Service*. *VJ participants* are subject to the *Voluntary Jurisdiction* and to *DISP 2* to the extent specified in the *standard terms (DISP 4)*.
- 2.5.2** G_{/1} *Firms* may, however, be exempt from the requirements of *DISP 1* (Complaint handling procedures for firms) and *DISP 5 (Financial Ombudsman Service funding rules)*, if they qualify under *DISP 1.1.7R (Exemption)*.
- 2.5.3** G_{/1} *Members* of the *Society of Lloyd’s* are treated as *firms* for the purposes of the *Compulsory Jurisdiction* (including the *rules* in *DISP 1* relating to *firms’* complaints procedures) and are subject to *DISP 1* as a result of the *insurance market direction* given in *LLD 6.2.1D*, under section 316 of the *Act* (Direction by Authority). However, as set out in *DISP 1.7*, *members* will individually comply with *DISP 1* if and only if all complaints by policyholders against *members* are dealt with under the internal procedures established by the *Society of Lloyd’s* for handling those complaints, provided that these procedures themselves comply with *DISP 1*. Accordingly, certain of the obligations under *DISP 1*, for example, the obligation to report on complaints received, must be complied with by the *Society* on behalf of *members*.



2.6 To which activities do the rules apply?

The Compulsory Jurisdiction

2.6.1

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The *Ombudsman* can consider a complaint under the *Compulsory Jurisdiction* only if it relates to an act or omission by a *firm* in the carrying on of one or more of the following activities (unless the provision described in DISP 2.6.3G applies):

- (1) *regulated activities*;
 - (2) lending money secured by a charge on land;
 - (3) lending money (other than *restricted credit*);
 - (4) paying money by a *plastic card* (other than a *store card*);
 - (5) the provision of ancillary banking services (see DISP 2.6.6G);
- or activities ancillary to them (see DISP 2.6.2R).

2.6.2

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The activities in DISP 2.6.1R include any ancillary activities, including advice, provided by the *firm* in connection with those activities.

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Under article 3 of the *Ombudsman Transitional Order*, the *Ombudsman* can also consider a *relevant new complaint* under the *Compulsory Jurisdiction* where it relates to an act or omission of a *firm* which was, immediately before *commencement*, subject to a *former scheme*, provided that:

- (1) the act or omission occurred in the carrying on by that *firm* of an activity to which that *former scheme* applied; and
- (2) the complainant is eligible and wishes to have the complaint dealt with under the new scheme.

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The carrying on of an activity in DISP 2.6.1R includes offering, providing or failing to provide and administering or failing to administer a service in relation to the activities covered by that rule. This includes the manner in which a *firm* has administered its business, provided that the business is an activity subject to the jurisdiction of the *Financial Ombudsman Service*.

- 2.6.5 G /1 Complaints about acts or omissions by a *firm* include complaints about acts or omissions in respect of activities for which the *firm* is responsible (that is the activities of their *appointed representatives*).
- 2.6.6 G /1 For the purposes of *DISP* 2.6.1R(5), ancillary banking services include, for example, the provision and operation of cash machines and safe deposit boxes.
- 2.6.7 R /1 A complaint about an *authorised professional firm* cannot be handled under the *Compulsory Jurisdiction* of the *Financial Ombudsman Service* if it relates solely to a *non-mainstream regulated activity* and can be handled by a *designated professional body*.
- 2.6.8 G /1 A complaint about a *non-mainstream regulated activity* conducted by an *authorised professional firm* will be handled by the relevant *professional body*.

The Voluntary Jurisdiction

- 2.6.9 R /1 The *Ombudsman* can consider a complaint under the *Voluntary Jurisdiction* only if it is not covered by the *Compulsory Jurisdiction* and it relates to an act or omission in the carrying on of one or more of the following activities by a *VJ participant*:
 - (1) lending money secured by a charge over land;
 - (2) a financial services activity carried on after *commencement* and which had been covered by a *former scheme* in so far as the *VJ participant* was a member of that *former scheme*, in respect of that activity, immediately before the *commencement day*;

or an activity ancillary to it (see *DISP* 2.6.11R).
- 2.6.10 G /1 *DISP* 2.6.9R(2) enables complaints about *VJ participants* which, immediately before the *commencement day*, were members of one of the *former schemes* replaced by the *Financial Ombudsman Service* to be dealt with under the *Voluntary Jurisdiction*. This is in respect of the financial services activities for which the *VJ participant* was previously covered but excludes complaints which fall into the *Compulsory Jurisdiction* as *relevant complaints*. So the complaints which are covered by *DISP* 2.6.9R(2) are only those which arise out of acts or omissions occurring after the *commencement day*.
- 2.6.11 R /1 The activities in *DISP* 2.6.9R include any ancillary activities, including advice, provided by the *VJ participant* in connection with those activities.
- 2.6.12 R /1 A complaint subject to these rules which is not covered by the *Compulsory Jurisdiction* can be considered by the *Ombudsman* even though it relates to an act or omission that occurred before the *VJ participant* was participating in the *Financial Ombudsman Service*, and whether the act or omission occurred before or after the *commencement day*, either:

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- (1) if the complaint could have been dealt with under a *former scheme*; or
- (2) as a consequence of the agreement of the *VJ participant* in *DISP 4.2.5R*.

The provisions of *DISP 2.6.12R* are made under the power in section 227(13) of the *Act*. The section allows for a complaint relating to an act or omission occurring either before *commencement* or before the *VJ participant* joined the *Voluntary Jurisdiction* (or both) to be dealt with under the *Financial Ombudsman Service* provided the *VJ participant* agrees. The act or omission must, however, be one which could have been dealt with under a *former scheme*. Where complaints in this category are not already covered by the *Compulsory Jurisdiction* as *relevant complaints*, they can, therefore, be included in the *Voluntary Jurisdiction* under *DISP 2.6.12R*.



2.7 The territorial scope of the jurisdiction of the Financial Ombudsman Service

- 2.7.1 **R**_{/1} The territorial scope of the jurisdiction of the *Financial Ombudsman Service* covers complaints about the activities of a *firm*, an *appointed representative* or a *VJ participant* carried on from an establishment in the *United Kingdom*.
- 2.7.2 **G**_{/1} The territorial scope therefore covers *firms* (including *appointed representatives*) or *VJ participants* operating from a permanent place of business in the *United Kingdom*, including *incoming EEA firms* and *incoming Treaty firms* which qualify for *authorisation* under Schedule 3 (*EEA Passport Rights*) or Schedule 4 (*Treaty rights*) to the *Act*.
- 2.7.3 **G**_{/1} Complaints which concern business conducted by branches of *firms* or *VJ participants* outside the *United Kingdom* or by *EEA firms* operating in the *United Kingdom* on a services basis from outside the *United Kingdom* are not subject to the *Compulsory Jurisdiction* or the *Voluntary Jurisdiction* of the *Financial Ombudsman Service*.
- 2.7.4 **G**_{/1} A complaint can be dealt with under the *Financial Ombudsman Service* irrespective of whether the complainant lives or is based in the *United Kingdom*.

Chapter 3

Complaint handling procedures of the Financial Ombudsman Service

3.1 Application and Purpose

Application

- 3.1.1** **R** This chapter applies to the *Ombudsman* and to *firms*.
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- 3.1.2** **G** It is also relevant to those who might wish to refer a complaint to the *Financial Ombudsman Service*.
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- 3.1.3** **G** *VJ participants* are subject to the rules in this chapter by contract under the *standard terms* (see *DISP* 4).
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- 3.1.4** **R** Except as otherwise specified, references in this chapter to a "complaint" include a *relevant new complaint*.
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- 3.1.5** **G** References in this chapter to "*firms*" are to be construed, where relevant, as including:
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- (1) in accordance with the *Ombudsman Transitional Order*, *unauthorised persons* subject to the *Compulsory Jurisdiction* in relation to *relevant complaints*; and
 - (2) as a result of section 226 of the *Act*, *unauthorised persons* who were formerly *firms* in respect of complaints about acts or omissions which occurred at the time when they were *firms*, provided that the *Compulsory Jurisdiction* rules were in force in relation to the activity in question.
- 3.1.6** **G** The *Ombudsman Transitional Order* provides, with some exceptions (see *DISP* 2.2.2G (scope of *Compulsory Jurisdiction*), *DISP* 2.3.2G (time limits), *DISP* 2.4.14G and *DISP* 2.4.15G (*eligible complainant*) and *DISP* 3.8.2G (determinations), for *relevant new complaints* to be determined in accordance with the requirements of the *Financial Ombudsman Service*.
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Purpose

- 3.1.7** **G** The purpose of this chapter is to set out the way in which the *Financial Ombudsman Service* and, in particular, the *Ombudsman*, will operate to ensure that complaints may be resolved quickly and with minimum formality. It sets out the procedures for the investigation and consideration of complaints, including the circumstances in which a complaint may be terminated without consideration of its merits; the evidence which may be required or admitted; the provisions for fixing and extending time limits for different aspects of the proceedings; the factors which the *Ombudsman* will take into account in determining what is fair and reasonable;
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the types of loss or damage for which the *Ombudsman* can award compensation; the limits on awards and the costs that can be awarded.



3.2 The investigation and consideration of complaints by the Ombudsman

- 3.2.1** **R** /1 On receipt of a complaint (and subsequently if necessary) the *Ombudsman* must have regard to the following matters:
- (1) whether or not the complaint meets the criteria in *DISP 2.2* (Which complaints can be dealt with under the *Financial Ombudsman Service?*);
 - (2) whether or not the complaint is within the time limits in *DISP 2.3* (Time limits for referral of complaints to the *Financial Ombudsman Service*);
 - (3) whether or not the complainant is an *eligible complainant*; and
 - (4) whether or not the complaint is one which should be dismissed without consideration of its merits under *DISP 3.3* (Dismissal of complaints without consideration of the merits).
- 3.2.2** **G** /1 In the case of *relevant new complaints*, the *Ombudsman* will take account of the relevant criteria under the *Ombudsman Transitional Order*, referred to in *DISP 2.2.2G*, and will extend the time limits in *DISP 2.3*, as required under article 4(2) of the *Ombudsman Transitional Order* and described in *DISP 2.3.2G*.
- 3.2.3** **R** /1 Where the *firm* has not had the eight weeks provided for under *DISP 1.4.5R* to consider the complaint, the *Ombudsman* will refer the complaint to the *firm*, unless the *firm* has already issued a *final response*.
- 3.2.4** **R** /1 Where a *firm* fails to send a complainant a *final response* by the end of eight weeks, the *Ombudsman* may consider the complaint.
- 3.2.5** **R** /1 Where the *Ombudsman* considers that the complaint or the complainant may be ineligible under the jurisdiction rules (see *DISP 2* (Jurisdiction of the *Financial Ombudsman Service*)) he must give the complainant an opportunity to make representations before he reaches his decision and he must give reasons to the complainant for that decision and inform the *firm* of his decision.
- 3.2.6** **G** /1 *DISP 3.2.5R* applies without prejudice to a *firm's* right to raise the issue of eligibility subsequently.

- 3.2.7 **R** /1 Where the *firm* disputes the eligibility of the complaint or the complainant, the *Ombudsman* must give the parties an opportunity to make representations before he reaches his decision and he must give reasons to the parties for that decision.
- 3.2.8 **R** /1 Where the *Ombudsman* considers that the complaint may be one which should be dismissed without consideration of its merits, under *DISP* 3.3 (Dismissal of complaints without consideration of the merits), he must give the complainant an opportunity to make representations before he makes his decision. If he then decides that the complaint should be dismissed, he must give reasons to the complainant for that decision and inform the *firm* of that decision.
- 3.2.9 **R** /1 Where the *Ombudsman* considers that both the complaint and the complainant are eligible and that there is a reasonable prospect of resolving the complaint by mediation, he may attempt to negotiate a settlement between the parties.
- 3.2.10 **G** /1 The *Ombudsman* will attempt to resolve complaints at the earliest possible stage and by whatever means appear to him to be most appropriate, including mediation or investigation.
- 3.2.11 **R** /1 If the *Ombudsman* decides that an investigation is necessary, he will:

 - (1) during the investigation, give both parties an opportunity of making representations;
 - (2) send to the parties a provisional assessment, setting out his reasons and a time limit within which either party must respond; and
 - (3) if either party indicates disagreement with the provisional assessment within the time limit prescribed in *DISP* 3.2.11R(2), proceed to determination (see *DISP* 3.8 (Determination by the *Ombudsman*)).
- 3.2.12 **R** /1 The parties will be informed of their right to make representations before the *Ombudsman* makes a determination. If he considers that the complaint can be fairly determined without convening a hearing, he will determine the complaint. If not, he will invite the parties to attend a hearing. No hearing will be held after the *Ombudsman* has determined the complaint.
- 3.2.13 **R** /1 A party who wishes to request a hearing must do so in writing, setting out the issues he wishes to raise and (if appropriate) any reasons why he considers the hearing should be in private, so that the *Ombudsman* may consider whether the issues are material, whether a hearing should take place and, if so, whether it should be held in public or private.

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In deciding if there should be a hearing and, if so, whether it should be in public or private, the *Ombudsman* will have regard to the provisions of the European Convention on Human Rights.



3.3 Dismissal of complaints without consideration of the merits

3.3.1

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The *Ombudsman* may dismiss a complaint without considering its merits if he:

- (1) is satisfied that the complainant has not suffered, or is unlikely to suffer, financial loss, material distress or material inconvenience; or
- (2) considers the complaint to be frivolous or vexatious; or
- (3) considers that the complaint clearly does not have any reasonable prospect of success; or
- (4) is satisfied that the *firm* has already made an offer of compensation which is fair and reasonable in relation to the circumstances alleged by the complainant and which is still open for acceptance; or
- (5) is satisfied that the complaint relates to a transaction which the *firm* in question has reviewed in accordance with the regulatory standards for the review of such transactions prevailing at the time of the review, or in accordance with the terms of a scheme order under section 404 of the *Act* (Schemes for reviewing past business), including, if appropriate, making an offer of redress to the complainant, unless he is of the opinion that the standards or terms of the scheme order did not address the particular circumstances of the case; or
- (6) is satisfied that the matter has previously been considered or excluded under the *Financial Ombudsman Service*, or a *former scheme* (unless material new evidence likely to affect the outcome has subsequently become available); or
- (7) is satisfied that the matter has been dealt with, or is being dealt with, by a comparable independent complaints scheme or dispute resolution process; or
- (8) is satisfied that the subject matter of the complaint has been the subject of court proceedings where there has been a decision on the merits; or

- (9) is satisfied that the subject matter of the complaint is the subject of current court proceedings unless proceedings are stayed or sisted (by agreement of all parties or order of the court) in order that the matter may be considered under the *Financial Ombudsman Service*; or
- (10) considers that it would be more suitable for the matter to be dealt with by a court, arbitration or another complaints scheme; or
- (11) is satisfied that it is a complaint about the legitimate exercise of a *firm's* commercial judgment; or
- (12) is satisfied that it is a complaint about employment matters from an employee or employees of a *firm*; or
- (13) is satisfied that it is a complaint about investment performance; or
- (14) is satisfied that it is a complaint about a *firm's* decision when exercising a discretion under a will or private trust; or
- (15) is satisfied that it is a complaint about a *firm's* failure to consult beneficiaries before exercising a discretion under a will or private trust, where there is no legal obligation to consult; or
- (16) is satisfied that a complaint which involves or might involve more than one *eligible complainant* has been referred without the consent of the other complainant or complainants and the *Ombudsman* considers that it would be inappropriate to deal with the complaint without that consent; or
- (17) is satisfied that there are other compelling reasons why it is inappropriate for the complaint to be dealt with under the *Financial Ombudsman Service*.

3.3.2 G_{/1} Under article 5(2)(c) of the *Ombudsman Transitional Order*, the *Ombudsman*, in deciding whether a *relevant complaint* is to be dismissed without consideration of its merits, is to take into account whether an equivalent complaint would have been so dismissed under the *former scheme* in question, as it had effect immediately before *commencement*.

3.3.3 G_{/1} For the purposes of *DISP* 3.3.1R(4), offers of compensation include ex gratia payments.

3.3.4 G_{/1} In *DISP* 3.3.1R(5) the transaction could, for example, be a pension transaction which has been reviewed by the *firm* in accordance with the relevant regulatory standards. The *Ombudsman* may decide not to proceed with a complaint about the result of that review unless he considers that the standards or guidance published by the regulator did not address the particular circumstances of the case.

3.3.5 G_{/1} When deciding if it would be suitable for a complaint to be dealt with outside the *Financial Ombudsman Service* (*DISP* 3.3.1R(10)), the *Ombudsman* may consider whether, in view of a conflict of evidence, a fair resolution of the complaint could be achieved only through examination of the evidence by the courts.

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The *Ombudsman* may decide to proceed with a complaint which would otherwise be dismissed under *DISP* 3.3.1R(13), (14) or (15) if he considers that the complaint involves an allegation of negligence or maladministration.



3.4 Referral of a complaint to another complaints scheme for determination

3.4.1

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The *Ombudsman* may refer a complaint to another complaints scheme where he considers that it would be more suitable for the matter to be determined by that scheme and the complainant consents to the referral.



3.5 Evidence

3.5.1

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The *Ombudsman* may, in relation to the evidence which may be required or admitted when he considers and determines a complaint, give directions as to:

- (1) the issues on which evidence is required;
- (2) the extent to which the evidence required to decide those issues should be oral or written; and
- (3) the way in which the evidence should be presented to the *Ombudsman*.

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The *Ombudsman* may:

- (1) exclude evidence that would otherwise be admissible in a court of law or include evidence that would not be admissible in such a court;
- (2) where he considers it necessary or appropriate, accept information in confidence, so that only an edited version or (where this is not practicable) a summary or description is disclosed to the other party;
- (3) reach a decision on the basis of what has been supplied and take account of the failure by a complainant or a *firm* to provide information that an *Ombudsman* has requested; and
- (4) dismiss a complaint if a complainant fails to supply required information.

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The provisions in *DISP* 3.5.2R(1) follow the provisions of the Civil Justice Rules.

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For the purposes of *DISP* 3.5.2R(2), evidence which the *Ombudsman* may accept in confidence includes confidential evidence about third parties and security information.

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The *Ombudsman* may request a party to a complaint to provide evidence necessary for the determination of the complaint under section 231 of the *Act*. A failure to comply with the request can be dealt with by the court under section 232.



3.6 Time limits

- 3.6.1 **R** ^{/1} The *Ombudsman* may fix time limits and extend fixed time limits for any aspect of the consideration of a complaint by the *Financial Ombudsman Service*.
- 3.6.2 **R** ^{/1} If a *firm* fails to comply with a time limit, the *Ombudsman* may proceed to the next stage of consideration of the complaint and may, if appropriate, make provision for any material distress or material inconvenience caused by that failure in any award which he decides to make.
- 3.6.3 **R** ^{/1} If a complainant fails to comply with a time limit, the *Ombudsman* may either proceed to the next stage or dismiss the complaint.



3.7 Delegation of the Ombudsman's powers

3.7.1

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- (1) Only an *Ombudsman* may determine a complaint or decide the circumstances in which information may be disclosed under *DISP* 3.10.1R (3).
- (2) The *Ombudsman* may designate members of the staff of *FOS Ltd* to exercise any of the other powers of the *Ombudsman* relating to the reference, investigation or consideration of a complaint.
- (3) Where any *person* is so designated, *DISP* 2 - *DISP* 4 apply as if any reference to "the *Ombudsman*" included a reference to that *person*.

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The Chief *Ombudsman* will designate those members of staff of *FOS Ltd* who are to have these powers.

3.8 Determination by the Ombudsman

Opinion as to fairness and reasonableness

- 3.8.1** **R** /1 (1) The *Ombudsman* will determine a complaint by reference to what is, in his opinion, fair and reasonable in all the circumstances of the case.
- (2) In considering what is fair and reasonable in all the circumstances of the case, the *Ombudsman* will take into account the relevant law, regulations, regulators' rules and guidance and standards, relevant codes of practice and, where appropriate, what he considers to have been good industry practice at the relevant time.

- 3.8.2** **G** /1 In determining, in relation to a *relevant new complaint*, what is fair and reasonable in all the circumstances of the case and what amount (if any) constitutes fair compensation, for the purposes of section 229(2)(a) of the *Act* (money awards), the *Ombudsman* is required, under article 7(2) of the *Ombudsman Transitional Order*, to take into account:

- (1) what determination the *former Ombudsman* might have been expected to reach, and
- (2) what amount (if any) might have been expected to be awarded by way of compensation;

in relation to an equivalent complaint dealt with under the *former scheme* in question immediately before *commencement*.

The Ombudsman's determination

- 3.8.3** **R** /1 The *Ombudsman's* determination will include the following stages:
- (1) When a complaint has been determined, the *Ombudsman* will give both the complainant and the *firm* a signed written statement of the determination, stating the reasons for it.
- (2) The statement will invite the complainant to notify the *Ombudsman* in writing before the date specified in the statement whether he accepts or rejects the determination.

- (3) If the complainant notifies the *Ombudsman* that he accepts the determination within the time limit set, it is final and binding on both the complainant and the *firm*.
- (4) If the complainant either rejects the determination or does not notify the *Ombudsman* by the specified date that he accepts the determination, the complainant will be treated as having rejected the determination, and the *firm* will not be bound by it.
- (5) The *Ombudsman* must notify the *firm* of the complainant's response (or lack of response).

3.9 Awards by the Ombudsman

Money awards

- 3.9.1** **G**_{/1} As provided for under section 229 of the *Act* (Awards), if a complaint is determined in favour of the complainant, the determination may include:
- (1) a money award against the *firm* of such amount as the *Ombudsman* considers fair compensation for financial loss or for loss or damage of a kind specified in *DISP* 3.9.2R and subject to the maximum limit in *DISP* 3.9.5R; or
 - (2) a direction that the *firm* take such steps in relation to the complainant as the *Ombudsman* considers just and appropriate (whether or not a court could order those steps to be taken); or
 - (3) both of these.
- 3.9.2** **R**_{/1} Where the *Ombudsman* decides to make a money award, in addition to (or instead of) awarding compensation for financial loss, he may award compensation for the following kinds of loss or damage, whether or not a court would award compensation:
- (1) **pain and suffering; or**
 - (2) **damage to reputation; or**
 - (3) **distress or inconvenience.**
- 3.9.3** **G**_{/1} For the purposes of awards by the *Ombudsman*, financial loss includes consequential or prospective loss.
- 3.9.4** **G**_{/1} In determining, in relation to a *relevant new complaint*, what amount (if any) constitutes fair compensation for the purposes of a money award, the *Ombudsman* is required under article 7(2) of the *Ombudsman Transitional Order* to take into account what amount (if any) might have been expected to be awarded by way of compensation, in relation to an equivalent complaint dealt with under the *former scheme* in question immediately before *commencement*.

Limits on money awards

- 3.9.5** **R**_{/1} The maximum money award which the *Ombudsman* may make is £100,000.

- 3.9.6 G
/1 If the *Ombudsman* considers that an amount more than the maximum is required as fair compensation, then he may in addition recommend to the *firm* that it pays the balance.
- 3.9.7 G
/1 The *Ombudsman* may specify in his award that reasonable interest must be paid on the award (at the rate and from the date he states).
- 3.9.8 G
/1 For the purposes of calculating the monetary limit referred to in *DISP* 3.9.5R the amount of interest awarded does not form part of the award itself.
- 3.9.9 G
/1 The limit on the maximum money award has no bearing on any direction which an *Ombudsman* may make as part of a determination.

Costs

- 3.9.10 R
/1 **When the *Ombudsman* finds in a complainant’s favour, he may also award an amount which covers some or all of the costs which were reasonably incurred by the complainant in respect of the complaint.**
- 3.9.11 G
/1 It is not anticipated that awards of costs will be common, since in most cases complainants should not need to have professional advisers to bring complaints to the *Financial Ombudsman Service*.
- 3.9.12 R
/1 **The amount payable under the award of costs may, if the *Ombudsman* orders, bear interest at a reasonable rate specified in the order and from a date specified in the order.**
- 3.9.13 G
/1 For the purposes of calculating the monetary limit specified in *DISP* 3.9.5R, an award of costs does not form part of the award itself.

Complying with awards and settlements

- 3.9.14 R
/1 **A *firm* must comply promptly with:**
 - (1) any money award or direction made by the *Ombudsman*; and
 - (2) any settlement which it agrees at an earlier stage of the procedures.
- 3.9.15 R
/1 **The *Ombudsman* must maintain a register of each money award and direction made.**
- 3.9.16 G
/1 A money award registered in accordance with *DISP* 3.9.15R can be recovered or enforced through the courts under paragraph 16 of Schedule 17 to the *Act*.
- 3.9.17 G
/1 A complainant may enforce a direction by injunction or order in accordance with section 229(9) of the *Act* (Awards).

3.10 Dealing with information

3.10.1

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- (1) In dealing with any information received in relation to the consideration or investigation of a complaint, the *Financial Ombudsman Service* must have regard to the parties' rights of privacy.
- (2) Paragraph (1) does not prevent the *Ombudsman* disclosing information (either in full, or where he considers it necessary or appropriate under *DISP* 3.5.2R(2), in the form of an edited version or (where this is not practicable) a summary or description):
 - (a) to the extent that he is required or authorised to do so by law; or
 - (b) to the parties to the complaint; or
 - (c) in his determination; or
 - (d) at a hearing in connection with the complaint.
- (3) So long as he has regard to the parties' rights of privacy, the *Ombudsman* may disclose information to the *FSA* or any other body exercising regulatory or statutory functions for the purpose of assisting that body or the *Financial Ombudsman Service* to discharge its functions.

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Under article 11 of the *Ombudsman Transitional Order*, any information held by any *person* responsible for the operation of a *former scheme* in connection with the operation of a *former scheme* may be disclosed by that *person* (after *commencement*) to *FOS Ltd* or to an *Ombudsman* without contravening any restriction on disclosure of that information (imposed by statute or otherwise) to which that *person* was subject. But *FOS Ltd* or the *Ombudsman* is subject to any restrictions on disclosure (and exceptions) which would have applied to the former holder of that information.

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Article 11 of the *Ombudsman Transitional Order* does not, however, prevent the application of section 31(4A) of the Data Protection Act 1998. This provides for an exemption in respect of subject information provisions to the extent to which the application of those provisions to data would be likely to prejudice the proper discharge of the functions conferred under Part XVI of the *Act* (The *Ombudsman Scheme*).

Chapter 4

Standard terms



4.1 Application and Purpose

Application

4.1.1

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The *standard terms* apply to any *company, partnership*, individual practitioner or other business which has decided to be a participant in the *Voluntary Jurisdiction* (a *VJ participant*). They are fixed by *FOS Ltd* with the approval of the *FSA* in accordance with paragraph 18 of Schedule 17 to the *Act*.

Purpose

4.1.2

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The *standard terms* are the basis on which complaints will be dealt with and determined under the *Voluntary Jurisdiction*. They cover:

- (1) the rules and guidance for handling complaints (see *DISP* 4.2.2R to *DISP* 4.2.6R);
- (2) an indemnity for *FOS Ltd*, any member of its governing body, any member of its staff and any *person* acting as an *Ombudsman*, as permitted by paragraph 18(5) of Schedule 17 to the *Act* (see *DISP* 4.2.7R);
- (3) the *Ombudsman's* powers relating to determinations and awards (see *DISP* 4.2.8R);
- (4) the enforcement of a determination (see *DISP* 4.2.10R); and
- (5) the process for withdrawal by a *VJ participant* from the *Voluntary Jurisdiction* (see *DISP* 4.2.11R).

4.2 The standard terms

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- (1) For the purposes of the *standard terms*, a *company, partnership, individual practitioner or other business*, whether authorised or unauthorised, agreeing to participate in the *Voluntary Jurisdiction* of the *Financial Ombudsman Service* is known as a *VJ participant*.
- (2) In consequence of the agreement by the *VJ participant* to participate in the *Voluntary Jurisdiction*, the *standard terms* fix the basis on which complaints relating to relevant acts or omissions of the *VJ participant* are to be dealt with and determined.
- (3) Where the *standard terms* apply rules relating to the *Compulsory Jurisdiction* for the purposes of the *Voluntary Jurisdiction*, those are to be treated as part of the *standard terms*.
- (4) A *VJ participant* is subject to the *standard terms*, which may be amended or supplemented with the approval of the *FSA*.

Complaint handling procedures

4.2.2

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The rules and guidance contained in *DISP 1* (Complaint handling procedures for firms) will apply to *VJ participants* for the purposes of the *Voluntary Jurisdiction* as if they were *firms*, with the exception of *DISP 1.5* (Record keeping and reporting). *DISP 1.2* (Internal complaint handling procedures: general requirements) applies in relation to complaints about activities of the *VJ participant* specified in *DISP 2.6.9R*.

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DISP 1.5.1R contains a requirement for a *firm* in the *Compulsory Jurisdiction* to make and retain records of complaints subject to *DISP 1.4-DISP 1.6* for a minimum period of three years from the date of its receipt of a complaint. Although this requirement is not applied to *VJ participants*, they may need to keep records of complaints for sufficient time to enable them to provide the *Ombudsman* with necessary information in the event of a complaint being referred to the *Financial Ombudsman Service*. The requirement for reporting complaints to the *FSA* under *DISP 1.5.4R* is also not applied to *VJ participants*.

Jurisdiction of the Financial Ombudsman Service

4.2.4 **R** /1 The rules and guidance contained in *DISP 2* will apply for the purposes of the *Voluntary Jurisdiction*, with the exception of *DISP 2.6.1R - DISP 2.6.8G*.

4.2.5 **R** /1 By agreeing to participate in the *Voluntary Jurisdiction*, a *VJ participant* also agrees to complaints relating to activities covered by *DISP 2.6.9R* being dealt with under *DISP 2.6.12R*.

Complaint handling procedures of the Financial Ombudsman Service

4.2.6 **R** /1 The rules and guidance contained in *DISP 3* will apply to *VJ participants* for the purposes of the *Voluntary Jurisdiction* as if they were *firms* (except where their application to *VJ participants* is specifically excluded or necessarily inapplicable).

Liability

- 4.2.7 **R** /1
- (1) None of the following is to be liable in damages for anything done or omitted in the discharge, or purported discharge, of any functions in connection with the *Voluntary Jurisdiction*:
- (a) *FOS Ltd*;
 - (b) any member of its governing body;
 - (c) any member of its staff;
 - (d) any *person* acting as an *Ombudsman* for the purposes of the *Financial Ombudsman Service*.
- (2) Paragraph (1) does not apply:
- (a) where the act or omission is shown to have been in bad faith; or
 - (b) so as to prevent an award of damages made in respect of an act or omission on the ground that the act or omission was unlawful as a result of section 6(1) of the Human Rights Act 1998.

Determination and awards

4.2.8 **R** /1 If the *Ombudsman* determines a complaint under the *Voluntary Jurisdiction* in favour of the complainant, the determination may include:

- (1) a “money award”, that is, an award against the *VJ participant* of such amount as the *Ombudsman* considers fair compensation for financial loss or for loss or damage of a kind specified in *DISP* 3.9.2R that has been suffered, or may be suffered, by the complainant;
- (2) a direction that the *VJ participant* take such steps in relation to the complainant as the *Ombudsman* considers just and appropriate (whether or not a court could order those steps to be taken).

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DISP 4.2.8R gives the *Ombudsman* the same powers to make money awards and directions as he has, under section 229 of the *Act* (Awards), in relation to *firms* in the *Compulsory Jurisdiction*.

Enforcement of a determination

4.2.10

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The *Ombudsman's* determination, if accepted by the complainant within the time limit specified by the *Ombudsman*, will be binding on the *VJ participant* and final, and may be enforced in court by the complainant.

Withdrawal from the Voluntary Jurisdiction of the Financial Ombudsman Service

4.2.11

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A *VJ participant* may not withdraw from the *Voluntary Jurisdiction* of the *Financial Ombudsman Service* unless the *VJ participant*:

- (1) has submitted a written plan to *FOS Ltd* setting out its proposals for:
 - (a) notifying its existing customers of its intention to withdraw from the *Voluntary Jurisdiction*; and
 - (b) the handling of complaints against it prior to its withdrawal from the *Voluntary Jurisdiction*; and
- (2) the plan has been approved in writing by *FOS Ltd*; and
- (3) the *VJ participant* has paid the *general levy* for the year in which it withdraws and any other fees payable; and
- (4) *FOS Ltd* has agreed in writing the date on which the *VJ participant* may withdraw from the *Voluntary Jurisdiction* (which date is not to be earlier than six *months* from the date of approval of the plan).

Appendices



Appendix 1

Relevant Existing Complaints

1.1 Application and Purpose

Application

1.1.1 **R** This appendix applies to *firms*, to *FOS Ltd*, to the *Ombudsman* and to those who might wish to refer a complaint to the *Financial Ombudsman Service* in respect of *relevant existing complaints*.
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1.1.2 **G** References in this chapter to “*firms*” are to be construed, where relevant, as including:
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- (1) in accordance with the *Ombudsman Transitional Order*, *unauthorised persons* subject to the *Compulsory Jurisdiction* in relation to *relevant complaints*; and
- (2) as a result of section 226 of the *Act*, *unauthorised persons* who were formerly *firms* in respect of complaints about acts or omissions which occurred at the time when they were *firms*, provided that the *Compulsory Jurisdiction* rules were in force in relation to the activity in question.

Purpose

1.1.3 **R** *DISP 2* to *DISP 5* apply to *firms*, to the *Ombudsman* and to *FOS Ltd* in respect of *relevant existing complaints*, except as stated in this appendix.
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1.1.4 **G** The purpose of this appendix is to describe how *FOS Ltd* must handle *relevant existing complaints* (that is, the partly completed complaints which it inherits from the *former schemes* at *commencement* under the *Ombudsman Transitional Order*). Complaints which *firms* (as opposed to the *former schemes*) have partly completed at *commencement* will be handled as described in *DISP 1* (Complaint handling procedures for firms) (see, in particular, *DISP 1.4.6R*).
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1.1.5 **G** *Relevant existing complaints* will be referred by the *former schemes* to *FOS Ltd* for completion at *commencement*. Article 2 of the *Ombudsman Transitional Order* provides that *FOS Ltd* will complete the handling of these cases, but requires that, in a significant number of respects, it must do this in accordance with the requirements of the relevant *former scheme*.
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- 1.1.6** G_{/1} This appendix describes the ways in which *FOS Ltd* is required to treat these complaints differently from the other complaints which are subject to *DISP* 1 to 5. Apart from these exceptions, the rules in *DISP* 2 to *DISP* 5 and the statutory provisions in sections 225-234 of the *Act* apply as they do to other complaints.

1.2 Eligible complaint

- 1.2.1** G_{/1} (1) Article 2 of the *Ombudsman Transitional Order* requires that, irrespective of whether the conditions set out in section 226(2) of the *Act* are met (see *DISP* 2.2.1G), a complaint which:
- (a) was referred to a *former scheme* (other than the *Personal Insurance Arbitration Service*) at any time before *commencement*, by a *person* who was at that time entitled, under the terms of the *former scheme*, to refer such a complaint (whether described in that scheme as the making of a complaint, the referral of a dispute, the submission of a claim, or otherwise), and
 - (b) has not, before *commencement*, been rejected, withdrawn, settled or determined, by the *former Ombudsman* (whether by a substantive decision, or by closure of the case without a substantive decision);

- 1.2.1** G_{/1} is to be dealt with under the *Financial Ombudsman Service* (and not the *former scheme*).

(2) These complaints are described as *relevant existing complaints*.

- 1.2.2** G_{/1} Article 2 of the *Ombudsman Transitional Order* provides that a complaint is not to be treated as determined before *commencement* if the determination was, at *commencement*, subject to (or capable of being subject to) an appeal, a reference to arbitration or similar procedure.

- 1.2.3** G_{/1} The definition of a *relevant existing complaint* excludes complaints referred to the *Personal Insurance Arbitration Service* before *commencement*, which will be completed by the *Personal Insurance Arbitration Service*, not *FOS Ltd*. It also excludes complaints about pre-*commencement* investment business conducted by *firms* which were formerly authorised by a *recognised professional body*. These will be handled by the relevant *professional body*.

1.3 Eligible complainant

- 1.3.1** G_{/1} Under article 2(1)(a) of the *Ombudsman Transitional Order*, a *person* will be treated under the *Financial Ombudsman Service* as an *eligible complainant* in respect of a *relevant existing complaint*, if he was entitled, under the terms of the

former scheme, to refer such a complaint at the time when the complaint was referred to that scheme.

1.4 Time limits

- 1.4.1** G_{/1} Article 4(2) of the *Ombudsman Transitional Order* requires an *Ombudsman* to extend the time limits set under *DISP* 2.3.1R(1)(b) and (c) in respect of a *relevant existing complaint* where the effect of that extension is that the time limit applying to the complaint is the same as that which would have applied under the *former scheme* in question as it had effect immediately before *commencement*.

1.5 Determination of complaints

- 1.5.1** G_{/1} Article 5(2)(a) provides that *FOS Ltd's* power to specify in its scheme rules the matters to be taken into account in making determinations does not apply to *relevant existing complaints* (see *DISP* 3.8.1R).
- 1.5.2** G_{/1} Article 5(2)(c) requires the *Ombudsman*, in deciding whether a *relevant complaint* (including a *relevant existing complaint*) is to be dismissed without consideration of its merits under the scheme rules, to take into account whether an equivalent complaint would have been so dismissed under the *former scheme* in question, as it had effect immediately before *commencement*.
- 1.5.3** G_{/1} Article 6(1) disapplies, in respect of *relevant existing complaints*, the provisions in the *Act* relating to the criteria for determining complaints in section 228(2) and those relating to awards in section 229 (with the exception of those in section 229(8)(b) and paragraph 16 of Schedule 17 relating to the enforceability of money awards and those in section 229(9) and (10) relating to the enforceability of directions made by the *Ombudsman*). It also disapplies the provisions relating to costs awards in section 230, except to the extent referred to in *DISP* App 1.11.1G.
- 1.5.4** G_{/1} Apart from this, section 228 of the *Act* applies in relation to *relevant existing complaints* as it applies to other complaints which are subject to the *Compulsory Jurisdiction*.

1.6 Criteria for determining complaints

- 1.6.1** G_{/1} Article 6(2) provides that a *relevant existing complaint* is to be determined (so far as practicable) by reference to such criteria as would have applied to the determination

of the complaint by the *former ombudsman* under the *former scheme* in question immediately before *commencement* (provided that where the *former scheme* in question is the *FSA scheme*, the criteria are those which would have applied to the determination of the complaint by an *independent investigator* under that scheme at that time).

- 1.6.2** G_{/1} An exception is, however, made in respect of *relevant existing complaints* about former *IMRO* members inherited from the *Investment Ombudsman* under the *IMRO scheme* in order to reflect the way in which those complaints have been determined in practice under that scheme. The effect of article 6(2) and 6(11) taken together is that, as with all new complaints received after *commencement*, these will be determined according to what is, in the opinion of the *Ombudsman*, fair and reasonable in all the circumstances of the case and will be binding on both parties subject to the complainant's agreement.

1.7 Awards and remedies

- 1.7.1** G_{/1} The remedy that the *Ombudsman* can impose in determining a *relevant existing complaint* is limited by article 6(3) to such remedy as could have been included in a determination (whether described as a determination, award, recommendation or otherwise) made by the *former Ombudsman* under the *former scheme* in question immediately before *commencement*.

1.8 Extent to which awards are binding

- 1.8.1** G_{/1} Under article 6, except in the circumstances set out in *DISP* App 1.8.2G to *DISP* App 1.8.6G, the *Ombudsman* will, in respect of *relevant existing complaints*, provide the *firm* and the complainant with a written statement of his determination (including reasons) in accordance with section 228(3)-(9) of the *Act* (see *DISP* 3.8.3R) and if the complainant notifies the *Ombudsman*, within the time period specified, that he accepts the determination, it is binding on both parties and final.
- 1.8.2** G_{/1} Under article 6(7), where the *former scheme* in question was the *FSA scheme* and the *relevant existing complaint* was, at *commencement*, subject to arbitration in accordance with that scheme, the extent to which the determination of the complaint under the new scheme is binding and final depends on the terms of the arbitration. Where a complaint under the *FSA scheme* was not subject to arbitration at *commencement*, the determination of the case under the new scheme is not binding on the *firm* or the complainant. The requirements in section 228 (4)(c) and (5) to (7) of the *Act* do not apply in relation to the complaint.
- 1.8.3** G_{/1} Under article 6(8), where the *former scheme* in question was the *SFA scheme*:
- (1) if the *relevant existing complaint* has not been submitted to arbitration under that scheme, and would not have been *eligible* to be so submitted under that

scheme as it had effect immediately before *commencement* (disregarding any requirement for certification by the *SFA Complaints Bureau* that the complaint had not been resolved by conciliation), the determination of the complaint under the *Financial Ombudsman Service* is not binding on the *firm* or the complainant;

- (2) if the *relevant existing complaint* has been submitted to arbitration under the *SFA scheme*, or would have been eligible to be so submitted under that scheme as it had effect immediately before *commencement* (disregarding any such requirement), the determination of the complaint under the *Financial Ombudsman Service* is binding on the *firm* and the complainant and final, but if the complaint has been submitted to arbitration, the terms of arbitration are otherwise unaffected;

and the requirements in section 228(4)(c) and (5) to (7) of the *Act* do not apply in relation to the complaint.

1.8.4 G_{/1} Under article 6(9), where the *former scheme* in question was the *Building Societies Ombudsman Scheme* and the *relevant existing complaint* was, at *commencement*, subject to arbitration in accordance with that scheme, the extent to which the determination of the complaint under the *Financial Ombudsman Service* is binding and final depends on the terms of the arbitration (which remain unaffected), and the requirements in section 228(4)(c) and (5) to (7) of the *Act* do not apply in relation to the complaint.

1.8.5 G_{/1} Under article 6(10), where the *former scheme* in question was the *Building Societies Ombudsman Scheme* and the *firm* would have been relieved of its obligation to comply with a determination under that scheme if it had complied with conditions as to the giving of notice of its non-fulfilment of the obligations imposed by the determination, the determination of the complaint under the *Financial Ombudsman Service* is (notwithstanding section 228(5) of the *Act*) not binding on the *firm* if it complies with equivalent conditions. (This preserves the "publicity option" under the *Building Societies Ombudsman Act 1986* in respect of *relevant existing complaints*.)

1.8.6 G_{/1} The effect of article 6(2) and 6(11) taken together is that, where the *former scheme* in question was the *IMRO scheme*, the determination will be binding on both parties subject to the complainant's agreement, unless, before *commencement*, the complaint has been determined by a *former ombudsman* under that scheme and the *former ombudsman* has offered the complainant adjudication (see *DISP App 1.9.1G-1.9.2G*).

1.9 Complaints determined before commencement

1.9.1 G_{/1} Under article 8, where, before *commencement*, a *relevant existing complaint* has been determined by a *former ombudsman* under the *IMRO scheme* and that *former ombudsman* has offered adjudication:

- (1) if the matter is already subject to adjudication at *commencement*, the relevant provisions of the *former scheme* will continue to apply so far as practicable, with references to the *Investment Ombudsman* or "the Ombudsman" being read as references to *FOS Ltd* or an *Ombudsman*, as appropriate; or

- (2) if the matter has not been referred to adjudication before *commencement*, but the complainant accepts adjudication, *FOS Ltd* must appoint an adjudicator to determine the matter, and if the complainant agrees to the appointment of the adjudicator, the *firm* must concur in the reference to adjudication.

1.9.2 G_{/1} The relevant provisions of the *IMRO scheme* will apply, so far as practicable, as they would have applied to adjudication under that scheme, with references to the *Investment Ombudsman* or "the Ombudsman" being read as references to *FOS Ltd* or an *Ombudsman*, as appropriate.

1.9.3 G_{/1} Under article 9, where a *relevant existing complaint* has been determined before *commencement* by a *person* appointed as an arbitrator under the *SFA scheme*:

- (1) if, at *commencement*, that determination is the subject of an appeal, or an application for leave to appeal, under that scheme which has not been determined or withdrawn, the relevant provisions of that scheme will continue to apply to that appeal or application (and any ensuing appeal) so far as practicable;
- (2) if, at *commencement*, an application for leave to appeal against the determination was capable of being entertained under that scheme, the relevant provisions of that scheme will apply, so far as practicable, to the making of any such application for leave and any ensuing appeal, as they would have applied to an application for leave or an appeal before *commencement*.

1.9.4 G_{/1} *FOS Ltd* may appoint such *persons*, on such terms and for such duration, as it thinks fit to hear any appeal or application for leave to appeal made after *commencement* and references in the relevant provisions of the *SFA scheme* to the *SFA* or its Arbitration Secretariat will be read as references to *FOS Ltd*.

1.9.5 G_{/1} Under article 10, where a complaint has been determined before *commencement* under the *Building Societies Ombudsman Scheme*, and, at *commencement*, a case either has been stated with respect to that determination for the opinion of the High Court or Court of Session under section 84(5) to (7) of the Building Societies Act 1986 and no decision has been reached on the case or could be stated under those provisions, those subsections continue to apply as if they provided for the Court to direct that the complaint be dealt with under the *Financial Ombudsman Service* as a *relevant existing complaint*.

1.10 Enforceability of awards

1.10.1 G_{/1} Where the *Ombudsman* makes a determination which includes an award against a *firm* of compensation payable to the complainant, it is enforceable (under article 6(4)) in the same way as a money award made under the *Compulsory Jurisdiction*.

1.10.2 G_{/1} Where the *Ombudsman* makes a determination which includes a requirement for the *firm* to take any steps in relation to the complainant, it is enforceable (under article 6(5)) in the same way as a direction made under the *Compulsory Jurisdiction*.

1.11 Costs

- 1.11.1** G^{/1} Where the *former scheme* in question, as it had effect immediately before *commencement*, included provision for the award of costs, the *Ombudsman* may, under article 6(6), on determining the *relevant existing complaint*, award costs in accordance with that provision (irrespective of whether those costs were incurred, or relate to anything done, before or after *commencement*) and section 230(6) and (7) and paragraph 16 of Schedule 17 to the *Act* apply in relation to the enforcement of such an award of costs in the same way as they apply to awards of costs made under the *Financial Ombudsman Service* procedures.

1.12 Funding and fees

- 1.12.1** G^{/1} Under *DISP 5*, *firms* will be subject to case fees in respect of *relevant complaints*. If *FOS Ltd* deals with a *relevant existing complaint* against a *person* who is not *authorised* by the *FSA*, a special case fee will be charged (see *DISP 5 (Financial Ombudsman Service Funding Rules)*) and this will be recoverable as a debt to *FOS Ltd* in the same way as case fees relating to complaints about *firms*.

1.13 Time limits, record keeping and reporting requirements

- 1.13.1** G^{/1} The time limits, record keeping and reporting requirements in *DISP 1.4* (Time limits for dealing with a complaint) and *DISP 1.5* (Record keeping and reporting) do not apply to *firms* in respect of *relevant existing complaints* since these, by definition, will already have been referred to a *former scheme*.

1.14 Cooperation with the Ombudsman

- 1.14.1** R^{/1} *Firms* must comply with *DISP 1.6* (Cooperation by *firms* with the *Ombudsman*) in respect of *relevant existing complaints*.

Appendix 2

Handling Mortgage Endowment Complaints

2.1 Introduction

2.1.1 G_{/1} This appendix sets out the approach and standards which *firms* should use when investigating complaints relating to the sale of endowment *policies* for the purposes of achieving capital repayment of a mortgage. It is not intended to be comprehensive. It is primarily concerned with the assessment of whether the complainant may have suffered financial loss, and if so, how much that loss is, and therefore what amount a *firm* should consider offering by way of fair and appropriate compensation in circumstances where the *firm's* investigation of a complaint reveals:

- (1) the complainant has received negligent *advice on investments*; and
- (2) if this advice had not been negligent, either:
 - (a) the complainant would be unlikely to have acquired the endowment policy but instead would have taken out the same amount of loan on a repayment basis; or
 - (b) the complainant would have acquired an endowment mortgage for a shorter term.

2.1.2 G_{/1} There will also be cases where a *firm* will conclude after investigation that, notwithstanding its own failure to give compliant and proper advice, the complainant would nevertheless have proceeded with the endowment policy as sold, in which case no compensation will be due.

2.1.3 G_{/1} This appendix only addresses how *firms* should approach the assessment of loss and compensation where negligence on the part of the *firm* is established.

2.1.4 G_{/1} This appendix is relevant both to the obligations arising under the complaints handling *rules* contained in *DISP* 1.2 and to the *FSA's* approach to the supervision of *firms*.

2.1.5 G_{/1} This appendix is also relevant to complaints which the *Ombudsman* may investigate under the *Compulsory Jurisdiction* or *Voluntary Jurisdiction* of the *Financial Ombudsman Service* established under Part XVI of the *Act* (The *Ombudsman Scheme*).

2.1.6 G_{/1} Before proceeding to assess the extent of a complainant's financial loss, a *firm* will usually have completed the following stages:

- (1) gathering all relevant facts and information;

- (2) making a fair and objective assessment whether it has failed to comply with a relevant duty owed to the complainant; and
- (3) assessing whether any failure of duty by it was in the circumstances a material failure in the sense that if it had not occurred the complainant would have been likely to have acted differently.

2.1.7 G_{/1} If it is concluded that the complainant would have acted differently, the *firm* should proceed to assess any direct or consequential loss.

2.1.8 G_{/1} Nothing in this appendix relieves *firms* of the obligation to consider the particular facts and circumstances of each complaint and to consider whether the assessment of loss and compensation should, in the light of those facts and circumstances, be carried out on a different basis. If, however, the facts and circumstances make it appropriate to do so, the *FSA's* expectation is that *firms* will apply the approach and standards set out in this appendix, and where they do not, the *FSA* is likely to require them to demonstrate the adequacy and completeness of their alternative approach.

2.2 The standard approach to redress

2.2.1 G_{/1} If there has been a failure to give compliant and proper advice, or some other breach of the duty of care, the basic objective of redress is to put the complainant, so far as is possible, in the position he would have been in if the inappropriate advice had not been given, or the other breach had not occurred. In many cases, although it must be a matter for inquiry and assessment in each individual case, this position is likely to have resulted in the complainant taking a repayment mortgage with accompanying life cover, and this is the assumption which underpins the standard approach to redress.

2.2.2 G_{/1} Unless the contrary is demonstrated, it should be assumed that the complainant could have afforded the mortgage on a repayment basis.

2.2.3 G_{/1} The measure of any financial loss suffered by the complainant will be arrived at by:

- (1) comparing the complainant's current capital position with the position he would have been in had the loan been a standard repayment mortgage as at the date the *firm* decides to regard the complaint as justified; and
- (2) comparing the cost of the complainant's actual monthly outgoings and those he would have made had his loan been on a standard repayment basis as at the date the *firm* decides to regard the complaint as justified.

2.2.4 G_{/1} In some cases other factors may be included in the overall calculation, for example, if mortgage arrangement fees were waived by agreement on the occasion of the endowment *policy* being taken out.

2.2.5 G_{/1} If, on comparing the complainant's current endowment position with the repayment alternative, the *surrender value* of the endowment *policy* exceeds the amount of the capital which the complainant would have repaid through the repayment method, then, at the point of the assessment, the complainant has suffered no capital loss (but the complainant may suffer some compensatable consequential loss associated

with changing the mortgage arrangements to the repayment basis, see *DISP* App 2.3). Conversely, if the capital which would have been repaid on the repayment basis exceeds the *surrender value*, there is a capital loss represented by the difference between the two amounts.

- 2.2.6** G_{/1} If the complainant's endowment mortgage outgoings exceed the equivalent cost for the repayment method, the complainant should be compensated for the higher payments in addition to any loss on the *surrender value* and capital repaid comparison. This means, for example, that if the endowment arrangement has been more expensive, this may result in compensatable loss even though the capital repayment against surrender comparison may be favourable to the endowment.
- 2.2.7** G_{/1} If the total cost of the outgoings for the endowment calculation is less than that for the repayment calculation, the "savings" should be brought into account in assessing any overall loss unless it is unreasonable to do so.
- 2.2.8** G_{/1} It is unlikely to be reasonable to bring "savings" into account in circumstances where, at the time of the sale of the *policy*:
- (1) the complainant was advised or informed orally or in writing that he would have lower outgoings than would be the case under a repayment mortgage, whether or not the difference was quantified; and
 - (2) the complainant has dissipated those "savings" on the strength of this advice or information.
- 2.2.9** G_{/1} The circumstances in which it may be appropriate to take some or all of the "savings" into account are those where, subject to *DISP* App 2.2.7G, the complainant is of "sufficient means" so that it is reasonable for a *firm* to assume that the "savings" have contributed to those means.
- 2.2.10** G_{/1} Where it is otherwise reasonable for "savings" to be brought into account, determining whether or not a complainant is of sufficient means and, if so, to what extent the "savings" are to be brought into account, will have to be based on the facts of each individual case. It will be appropriate to require the complainant to provide adequate information to assist the *firm* in this task. Matters to be taken into account in this assessment may include:
- (1) the length of the remaining mortgage term;
 - (2) the complainant's current and prospective resources;
 - (3) the amount of the capital shortfall in proportion to the endowment outgoings balance.
- 2.2.11** G_{/1} Firms may adopt streamlined processes to assist them in individual assessments of "sufficient means", but will have to satisfy themselves that the complainant's position is nevertheless protected. Firms will need to ensure that the complainant is given an opportunity to make an informed choice whether to accept the streamlined process, that the process itself is transparent, and that the firm is satisfied that the outcome would be fair to complainants.
- 2.2.12** G_{/1} If a *firm* intends to make a deduction for all or any part of the lower endowment outgoings, the *firm* should explain clearly to the complainant in writing both how the "sufficient means" test has been satisfied, including details of the information taken into account in reaching the decision, and how the deduction has been arrived at. The letter should further inform the complainant that if he is unhappy with the

proposal to make a deduction, either in principle or as to the amount, he should give his reasons to the *firm*.

- 2.2.13** G_{/1} If a complainant puts forward a case that it would be unreasonable for a deduction to be made, the *firm* should reach a fair and objective determination on the facts of all relevant matters including those set out at *DISP* App 2.2.8G and *DISP* App 2.2.9G.
- 2.2.14** G_{/1} In recognition that *firms* may not wish, for practical reasons, to make individual assessments of “sufficient means”, *firms* may decide not to seek to bring into account any benefit to the complainant in assessing overall compensation.
- 2.2.15** G_{/1} It would not be unreasonable if a *firm* providing redress in these circumstances were to frame its offer of redress on the assumption that the complainant will agree to surrender the *policy*. However, *firms* should bear in mind that there may be circumstances where it is appropriate for the complainant to retain the *policy*, for example, where it is being retained as a savings vehicle.
- 2.2.16** G_{/1} If a complainant becomes aware that he has taken out the endowment *policy* on the basis of unsuitable advice and inadequate information, he should if necessary, after taking appropriate advice, take reasonable steps to limit his loss, and may in any subsequent *claim* be unable to recover for losses which are avoidable. The complainant may have to show that he has not delayed unreasonably since becoming aware of his loss. The reasonable costs and expenses the complainant may have incurred in limiting his loss are to be taken into account in assessing his compensation. These costs and expenses are likely to include the complainant taking advice on whether he should convert from an endowment to a repayment mortgage and incurring expenses in doing so, see *DISP* App 2.3.
- 2.2.17** G_{/1} The standard approach to redress can be illustrated by the following examples, which show how redress would be calculated in certain hypothetical but typical scenarios. (Because the examples are illustrative, round numbers have been used for “established facts” in each example. The payments should be taken as being made monthly: *firms* should not approximate by assuming that payments are made annually. If the complainant has benefited from MIRAS, the calculations should allow for the effect of MIRAS both on the endowment mortgage and the repayment comparison.)
- 2.2.18** G_{/1} Table Table of examples of typical redress calculations

Example 1	Capital shortfall and higher endowment outgoings
Example 2	Capital shortfall partially offset by lower endowment mortgage outgoings
Example 3	Capital shortfall more than offset by lower endowment mortgage outgoings
Example 4	Capital surplus more than offset by higher endowment mortgage outgoings
Example 5	Capital surplus partially offset by higher endowment mortgage outgoings
Example 6	Capital surplus and lower endowment mortgage outgoings
Example 7	Low start endowment mortgage

- 2.2.19** G_{/1} Table Example 1

EXAMPLE 1	
Capital shortfall and higher endowment mortgage outgoings	
<u>Background</u>	
Capital sum of £50,000	
25 year endowment <i>policy</i>	
Duration to date: 5 years	
Endowment <i>premium</i> per month: £75	
<u>Established facts</u>	
Endowment <i>surrender value</i>:	£3,200
Capital repaid under equivalent repayment mortgage:	£4,200
<i>Surrender value</i> less capital repaid:	(£1,000)
Cost of converting from endowment mortgage to repayment mortgage:	(£200)
<u>Total outgoings to date</u>	
Equivalent repayment mortgage (capital + interest + DTA life cover):	£21,950
Endowment mortgage (endowment <i>premium</i> + interest):	£22,250
Difference in outgoings (repayment – endowment):	(£300)
<u>Basis of compensation</u>	
In this example, the complainant has suffered loss because the <i>surrender value</i> of the endowment is less than the capital repaid and also because of the higher total outgoings to date of the endowment mortgage relative to the repayment mortgage. The two losses and the conversion cost are therefore added together in order to calculate the redress.	
<u>Redress</u>	
Loss from <i>surrender value</i> less capital repaid:	(£1,000)
Loss from total extra outgoings under endowment mortgage:	(£300)
Cost of converting to repayment mortgage:	(£200)
Total loss:	(£1,500)
Therefore total redress is:	£1,500

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Table Example 2

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EXAMPLE 2	
Capital shortfall partially offset by lower endowment mortgage outgoings	
<u>Background</u>	

EXAMPLE 2	
Capital sum of £50,000	
25 year endowment <i>policy</i>	
Duration to date: 5 years	
Endowment <i>premium</i> per month: £60	
<u>Established facts</u>	
Endowment <i>surrender value</i> :	£2,500
Capital repaid under equivalent repayment mortgage	£4,200
<i>Surrender value</i> less capital repaid under equivalent repayment mortgage:	(£1,700)
Cost of converting from endowment mortgage to repayment mortgage	(£300)
<u>Total outgoings to date:</u>	
Repayment mortgage (capital + interest + DTA life cover):	£21,950
Endowment mortgage (endowment <i>premium</i> + interest):	£21,350
Difference in outgoings (repayment – endowment):	£600
<u>Basis of Compensation</u>	
In this example, the complainant has suffered loss because the <i>surrender value</i> of the endowment is less than the capital repaid but has gained from the lower outgoings of the endowment mortgage to date. In calculating the redress the gain may be offset against the loss unless the complainant's particular circumstances are such that it would be unreasonable to take account of the gain.	
Redress if it is not unreasonable to take account of the whole of the gain from lower outgoings	
Loss from <i>surrender value</i> less capital repaid:	(£1,700)
Gain from total lower outgoings under endowment mortgage:	£600
Cost of converting to repayment mortgage:	(£300)
Net loss:	(£1,400)
Therefore total redress is:	£1,400
Redress if it is unreasonable to take account of gain from lower outgoings	
Loss from <i>surrender value</i> less capital repaid:	(£1,700)
Gain from total lower outgoings under endowment mortgage:	Ignored*
Cost of converting to repayment mortgage:	(£300)
Net loss taken into account:	(£2,000)

EXAMPLE 2	
Therefore total redress is:	£2,000
* In this example, and also in Examples 3, 7, 8 and 9, the complainant's circumstances are assumed to be such as to make it unreasonable to take account of <i>any</i> of the gain from lower outgoings.	

2.2.21

G Table Example 3

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EXAMPLE 3	
Capital shortfall more than offset by lower endowment mortgage outgoings	
<u>Background</u>	
Capital sum of £50,000	
25 year endowment <i>policy</i>	
Duration to date: 8 years	
Endowment <i>premium</i> per month: £65	
<u>Established facts</u>	
Endowment <i>surrender value</i> :	£7,300
Capital repaid under equivalent repayment mortgage:	£7,600
<i>Surrender value</i> less capital repaid:	(£300)
Cost of converting from endowment mortgage to repayment mortgage:	(£200)
<u>Total outgoings to date</u>	
Repayment mortgage (capital + interest + DTA life cover):	£34,510
Endowment mortgage (endowment <i>premium</i> + interest):	£33,990
Difference in outgoings (repayment – endowment):	£520
<u>Basis of Compensation</u>	
In this example, the complainant has suffered loss because the surrender value of the endowment is less than the capital repaid but has gained from the lower total outgoings of the endowment mortgage. In calculating redress the gain may be offset against the loss unless the complainant's particular circumstances are such that it would be unreasonable to take account of the gain.	
Redress if it is not unreasonable to take account of the whole of the gain from lower outgoings	
Loss from <i>surrender value</i> less capital repaid:	(£300)
Gain from total lower outgoings under endowment mortgage:	£520
Cost of converting to repayment mortgage:	(£200)
Net gain:	£20
Therefore, there has been no loss and no redress is payable.	
Redress if it is unreasonable to take account of gain from lower outgoings	

EXAMPLE 3	
Loss from <i>surrender value</i> less capital repaid:	(£300)
Gain from total lower outgoings under endowment mortgage:	Ignored
Cost of converting to repayment mortgage:	(£200)
Net loss taken into account:	(£500)
Therefore total redress is:	£500

2.2.22

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Table Example 4

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EXAMPLE 4	
Capital surplus more than offset by higher endowment mortgage outgoings	
<u>Background</u>	
Capital sum of £50,000	
25 year endowment <i>policy</i>	
Duration to date: 8 years	
Endowment <i>premium</i> per month: £75	
<u>Established facts</u>	
Endowment <i>surrender value</i> :	£7,800
Capital repaid under equivalent repayment mortgage:	£7,600
<i>Surrender value</i> less capital repaid:	£200
Cost of converting from endowment mortgage to repayment mortgage:	(£250)
<u>Total outgoings to date</u>	
Repayment mortgage (capital + interest + DTA life cover):	£34,510
Endowment mortgage (endowment <i>premium</i> + interest):	£34,950
Difference in outgoings (repayment – endowment):	(£440)
<u>Basis of compensation</u>	
In this example, the complainant has suffered loss because of the higher total outgoings to date of the endowment mortgage but has gained because the <i>surrender value</i> of the endowment is greater than the capital repaid. Since the sum of the loss and the conversion cost is greater than the gain, the redress is calculated as the difference between the two.	
<u>Redress</u>	
Gain from <i>surrender value</i> less capital repaid:	£200
Loss from total extra outgoings under endowment mortgage:	(£440)
Cost of converting to repayment mortgage:	(£250)

EXAMPLE 4	
Net loss:	(£490)
Therefore total redress is:	£490

2.2.23

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Table Example 5

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EXAMPLE 5	
Capital surplus partially offset by higher endowment mortgage outgoings	
<u>Background</u>	
Capital sum of £50,000	
25 year endowment <i>policy</i>	
Duration to date: 10 years	
Endowment <i>premium</i> per month: £75	
<u>Established facts</u>	
Endowment <i>surrender value</i> :	£11,800
Capital repaid under equivalent repayment mortgage:	£9,700
<i>Surrender value</i> less capital repaid:	£2,100
Cost of converting from endowment mortgage to repayment mortgage:	(£300)
<u>Total outgoings to date</u>	
Repayment mortgage (capital + interest + DTA life cover):	£46,800
Endowment mortgage (endowment <i>premium</i> + interest):	£47,500
Difference in outgoings (repayment – endowment):	(£700)
<u>Basis of compensation</u>	
In this example, the complainant has suffered loss because of the higher total outgoings to date of the endowment mortgage relative to the repayment mortgage. However the sum of this and the conversion cost is less than the complainant's gain from the difference between the <i>surrender value</i> of the endowment and the capital repaid. Thus no redress is payable.	
<u>Redress</u>	
Gain from <i>surrender value</i> less capital repaid:	£2,100
Loss from total extra outgoings under endowment mortgage:	(£700)
Cost of converting to repayment mortgage:	(£300)
Net gain:	£1,100
Therefore there has been no loss and no redress is payable.	

2.2.24

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Table Example 6

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Example 6	
Capital surplus and lower endowment mortgage outgoings	
<u>Background</u>	
Capital sum of £50,000	
25 year endowment <i>policy</i>	
Duration to date: 10 years	
Endowment <i>premium per month</i> : £65	
<u>Established facts</u>	
Endowment <i>surrender value</i> :	£10,100
Capital repaid under equivalent repayment mortgage:	£9,700
<i>Surrender value</i> less capital repaid:	£400
Cost of converting from endowment mortgage to repayment mortgage:	(£200)
<u>Total outgoings to date</u>	
Repayment mortgage (capital + interest + DTA life cover):	£46,800
Endowment mortgage (endowment <i>premium</i> + interest):	£46,300
Difference in outgoings (repayment – endowment):	£500
<u>Basis of compensation</u>	
In this example, the complainant has gained both because the <i>surrender value</i> of the endowment is greater than the capital repaid and because of the lower total outgoings of the endowment mortgage. These gains are larger than the cost of converting to a repayment mortgage. Thus no further action is necessary.	
<u>Redress</u>	
As there has been no loss, no redress is payable.	

2.2.25

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Table Example 7

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Example 7	
Low start endowment mortgage	
<u>Background</u>	
Capital sum of £50,000	
25 year endowment <i>policy</i>	
Duration to date: 10 years	
Endowment <i>premium per month</i> : starting at £35 in first year, increasing by 20% simple on each <i>policy</i> anniversary, reaching £70 after five years and then remaining at that level.	
<u>Established facts:</u>	
Endowment <i>surrender value</i> :	£8,200
Capital repaid under equivalent repayment mortgage::	£9,700

Example 7	
<i>Surrender value</i> less capital repaid:	(£1,500)
Cost of converting from endowment mortgage to repayment mortgage:	(£250)
<u>Total outgoings to date</u>	
Repayment mortgage (capital + interest + DTA life cover):	£46,800
Endowment mortgage (endowment <i>premium</i> + interest):	£45,640
Difference in outgoings (repayment minus endowment):	£1,160
Of this difference in outgoings, £800 arose in the five year period when the complainant was paying a low endowment <i>premium</i> .	
<u>Basis of compensation</u>	
In this example, the complainant has suffered loss because the <i>surrender value</i> of the endowment is less than the capital repaid but has gained from the lower total outgoings of the endowment mortgage. As in Example 3, in calculating redress the whole of the gain should be offset against the loss unless the complainant's particular circumstances are such that it would be unreasonable to do so. However, unlike Example 3, in a low start endowment mortgage the complainant may have chosen to pay a lower than usual <i>premium</i> in the early years (this would need to be established on the facts of the case). Where it has been established that the complainant chose to make lower payments, even if it is unreasonable to take account of the whole of the gain from total outgoings, the gain from paying a lower <i>premium</i> during the low start period is normally taken into account. In such cases the redress is calculated as the capital loss plus the conversion cost minus the total amount by which repayment mortgage outgoings would have exceeded the actual low start endowment mortgage outgoings during the five year low start period.	
Redress if it is not unreasonable to take account of the whole of the gain from lower outgoings	
Loss from <i>surrender value</i> less capital repaid:	(£1,500)
Gain from total lower outgoings under endowment mortgage:	£1,160
Cost of converting to repayment mortgage:	(£250)
Net loss:	(£590)
Therefore total redress is:	£590
Redress if it is unreasonable to take account of gain from lower outgoings	
Loss from <i>surrender value</i> less capital repaid:	(£1,500)
Gain from total lower outgoings during low start period of endowment mortgage:	£800
Cost of converting to repayment mortgage:	(£250)
Net loss taken into account:	(£950)
Therefore total redress is:	£950

Interest rates

- 2.2.26** G_{/1} In fixing a repayment comparator, it would be appropriate to have regard to the repayment quotation actually provided at the time of sale. If more than one repayment quotation was obtained, the comparison should be with the quotation which approximates most closely to the terms of the endowment mortgage actually taken. If a repayment quotation was not provided, or is not now available, it should be assumed that the interest rate for the repayment comparison is the same as that of the mortgage endowment arrangements. *Firms* will then need to replicate interest rate changes throughout the lifetime of the comparator mortgage.

Life cover

- 2.2.27** G_{/1} Unless after due inquiry there is clear evidence that the complainant with a mortgage endowment had no foreseeable need for life cover at the time the endowment arrangements were concluded, in the overall comparison between a repayment mortgage and an endowment mortgage the monthly outgoings under the repayment will include the premium for the decreasing term assurance that would have been required. This adjustment for the cost of life cover is only to be made if the *firm* is undertaking a comparison of monthly outgoings. It is not appropriate to deduct the cost of life cover from the capital loss calculation, as this would constitute double counting.
- 2.2.28** G_{/1} If a deduction is to be attributed to the provision of life cover, the appropriate approach is to assume that the complainant took out the insurance quoted in the alternative repayment quotation provided at the time of the sale. If the quotation is not available, the deduction should be at the rates that would have been quoted at the time.

2.3 Remortgaging

- 2.3.1** G_{/1} As already noted, the basic objective of redress is to put the complainant, so far as is possible, in the position he would have been in if the inappropriate advice or other breach had not occurred: for their part, the complainants should take such reasonable steps as they can to limit loss once they are informed of the position they are in because of the failure of advice at the time of sale.
- 2.3.2** G_{/1} In practice, it is likely to be appropriate for a complainant whose complaint has been upheld to convert to a repayment mortgage, whether or not there is financial loss to date. It will normally be possible for complainants to do so without incurring unreasonable cost. Conversion will of course mean that the complainant no longer has a *policy*.
- 2.3.3** G_{/1} *Firms* should therefore in the case of upheld complaints inform complainants that it is likely to be appropriate and necessary for them to convert to a repayment arrangement.
- 2.3.4** G_{/1} *Firms* should make it clear that they will bear the costs of conversion if the rearrangement is made with the existing lender and to the equivalent repayment mortgage. If a complainant is not willing to rearrange with the existing lender, then

the costs to be paid by the *firm* should normally be limited to those which would have been payable had the rearrangement been made with the existing lender and to the equivalent repayment mortgage. If it is not possible to rearrange with the existing lender, for example, if the lender has a closed book, the *firm* should pay all costs which are not unreasonable in completing the rearrangement with an alternative provider. Such costs might include an administration fee for changing the existing arrangement, redemption penalty, arrangement fee for the new mortgage and the reasonable cost of further advice if necessary.

- 2.3.5** G_{/1} If the “new” mortgage is, in fact, arranged at a lower interest rate than the existing loan, the benefit to the complainant should usually be disregarded, as it is always open to complainants to change their underlying mortgage arrangements at any time.
- 2.3.6** G_{/1} If the “new” mortgage is arranged at a higher interest rate than the existing loan, the increased payment should not normally be taken into account in calculating any payment to be made to the complainant.
- 2.3.7** G_{/1} If the complainant takes the opportunity to increase his loan on the occasion of the remortgage, the expenses which a *firm* pays by way of compensation should be paid by reference to the capital sum due under the “old” loan.
- 2.3.8** G_{/1} As stated, one aspect of the conversion process is the disposal of the endowment *policy*. The standard approach to assessing loss requires *firms* to calculate loss using the *surrender value*. However, once loss is established on this basis and *firms* move to deal with redress, they may wish to consider whether there is a role for the *policy*’s “market value” within the traded endowment *policy* (TEP) market.
- 2.3.9** G_{/1} A *firm* may arrange the sale of the endowment *policy* on the traded endowment market, provided the full implications of such a course of action are explained to the complainant and his express consent is obtained for the firm to arrange the sale. This includes informing the investor that he will continue to be the life assured under the *policy*. The complainant should be informed that such an arrangement may reduce or eliminate the amount of redress actually borne by the *firm*, but not so as to affect the amount of redress he receives.
- 2.3.10** G_{/1} In the event that a complainant is willing to pursue this option, a *firm* should first have assessed the complainant’s loss using the approach set out in this appendix, and the minimum amount the complainant should receive under such a sale arrangement is the sum representing the position the complainant should have been in under this appendix together with the reimbursement of remortgaging costs. In order to ensure the process does not delay the provision of redress, the *firm* must pay this minimum sum immediately the complainant agrees to the sale arrangement. To the extent that the net amount realised by the sale of the *policy* on the traded endowment market exceeds the total redress due to the complainant, this greater sum is to be paid to the complainant on completion of the sale. If the amount realised by the sale of the *policy* on the traded endowment market is less than the total redress due to the complainant, the *firm* will be responsible for the amount of the shortfall.
- 2.3.11** G_{/1} Table Example of assessment set out at 2.3.10

The following example illustrates the position:

Surrender value	£10,000	TEP value	£16,000
Loss calculated by standard approach	£5,000		

Remortgaging costs	£300		
Total	<u>£15,300</u>		
Complainant receives £16,000 all ultimately funded from the TEP sale.			
Surrender value	£10,000	TEP value	£13,000
Redress calculated by standard approach	£5,000		
Remortgaging costs	£300		
Total	<u>£15,300</u>		
Complainant receives £15,300, £13,000 ultimately funded from the TEP sale and £2,300 ultimately funded from the <i>firm</i> .			

2.4 Policy reconstruction

2.4.1 G_{/1} This section of this appendix is primarily concerned with circumstances where the term of the mortgage and associated endowment *policy* extend beyond the individual complainant's normal retirement age in circumstances where the *firm* regards a complaint as justified because the arrangement is not affordable in retirement; and this could have, and should have, been foreseen at the time of the advice.

2.4.2 G_{/1} Two sets of circumstances are examined at *DISP* App 2.4.3G to *DISP* App 2.4.13G. Although these are considered in isolation, *firms* should, as part of their investigation of all of the factors involved in the complaint, consider whether either set of circumstances should be considered in conjunction with those factors examined at *DISP* App 2.2G.

Case 1

2.4.3 G_{/1} If on enquiry it is found that no proper assessment of the complainant's post-retirement means had been undertaken at the time of *sale*, but if the likelihood had been that the complainant would have borrowed the same amount over a shorter term (up to retirement) using an endowment *policy* as a repayment vehicle, then an appropriate form of redress would be for the *policy* to be reconstructed with a shorter term.

2.4.4 G_{/1} Redress should in most cases be provided by meeting the cost of rearranging the *policy*, by way of a lump sum payment into the *policy* in respect of the higher rate of *premium* due from its inception. It may be appropriate in individual cases to take account of the lower *premiums* that the complainant will have paid to date. The *guidance* in *DISP* App 2.2, as to the circumstances in which this will be appropriate, will be relevant here.

- 2.4.5** G_{/1} If the *policy* extends beyond retirement age and the complainant is already retired, the *policy* should be reconstructed to a maturity date as at the accepted retirement date, with the *policy* proceeds becoming immediately payable. The costs are to be borne by the *firm*, subject to any lower outgoings adjustment.
- 2.4.6** G_{/1} *Firms* should consider whether the reconstruction would have tax implications for complainants (see *DISP* App 2.5.8G and *DISP* App 2.5.9G).
- 2.4.7** G_{/1} The reconstruction process deals with the situation to the date the *policy* is reconstructed. The complainant will generally be responsible for paying the increased *premiums* for the remaining term.
- 2.4.8** G_{/1} At the time the complainant is advised of the revised *premium*, he should as a matter of good practice be provided with a reprojection based on the prevailing *projection* rates, which will allow him to address any projected shortfall.
- 2.4.9** G_{/1} If it is not possible for a *firm* to reconstruct a *policy*, then it should offer the investor equivalent redress, for example, by paying a cash lump sum equivalent to the amount that would have been credited to a reconstructed *policy*.

Case 2

- 2.4.10** G_{/1} If a loan extending into retirement was on any basis not affordable, whether or not it is reconstructed to the retirement date, *firms* will need to consider whether, if proper advice had been given, the loan would have been taken out at all and, if not, consider what arrangements might now need to be made in order to reduce the amount of the complainant's borrowings.

Mismatched loans and policy terms

- 2.4.11** G_{/1} If a complaint is regarded as justified by the *firm* on the basis that the endowment *policy* maturity date extends beyond the mortgage term expiry date and the *firm* is responsible for this situation, the *policy* should be reconstructed so that it matures at the expiry of the mortgage term.
- 2.4.12** G_{/1} In these circumstances the *guidance* given elsewhere in *DISP* App 2.4 will apply as appropriate.

Examples

- 2.4.13** G_{/1} The following examples illustrate the approach to redress as described in this section.
- 2.4.14** G_{/1} Table Example 8

EXAMPLE 8

Term extends beyond retirement age and *policy* reconstruction

Background

45 year old male non-smoker, having taken out a £50,000 loan in 1998 for a term of 25 years. Unsuitable sale identified on the grounds of affordability and complaint raised on 12th *policy* anniversary.

It has always been the intention of the complainant to retire at State retirement age 65.

Term from date of sale to retirement is 20 years and the maturity date of the mortgage is 5 years after retirement.

Established facts

Established <i>premium</i> paid by investor on <i>policy</i> of original term (25 years):	£81.20
<i>Premium</i> that would have been payable on <i>policy</i> with term from <i>sale</i> to retirement (20 years):	£111.20
Actual <i>policy</i> value at time complaint assessed:	£12,500
Value of an equivalent 20-year <i>policy</i> at time complaint assessed:	£21,300
Difference in <i>policy</i> values at time complaint assessed:	£8,800
Difference in outgoings (20 year <i>policy</i> – 25 year <i>policy</i>):	£4,320

Basis of compensation

The *policy* is reconstructed as if it had been set up originally on a term to mature at retirement age, in this example, a term of 20 years. The difference in the current value of the *policy* actually sold to the complainant and the current value of the reconstructed *policy*, as if the *premium* on the reconstructed *policy* had been paid from outset, is calculated. The complainant has gained from lower outgoings (lower *premiums*) of the actual endowment *policy* to date. In calculating the redress, the gain may be offset against the loss unless the complainant's particular circumstances are such that it would be unreasonable to take account of the gain.

Redress generally if it is not unreasonable to take account of the whole of the gain from lower outgoings

Loss from current value of reconstructed <i>policy</i> less current value of actual <i>policy</i> :	(£8,800)
Gain from total lower outgoings under actual <i>policy</i> :	£4,320
Net loss:	(£4,480)
Therefore total redress is:	£4,480

Redress if it is unreasonable to take account of gain from lower outgoings	
Loss from current value of reconstructed <i>policy</i> less current value of actual <i>policy</i> :	(£8,800)
Gain from total lower outgoings under actual <i>policy</i> :	<i>Ignored</i>
Therefore total redress is:	<u>£8,800</u>
<u>Additional Information</u>	
<p>If the <i>policy</i> is capable of reconstruction, the complainant must now fund the higher <i>premiums</i> himself for the remainder of the term of the shortened <i>policy</i> until maturity. In this example the higher <i>premium</i> could be £111.20. However the <i>firm</i> should provide the complainant with a reprojection letter based on the reconstructed <i>policy</i> such that the actual monthly payment required to achieve the target sum could be even higher, say £130. The reprojection letter should set out the range of options facing the complainant to deal with the projected shortfall, if any.</p>	

2.4.15

G Table Example 9
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EXAMPLE 9	
Term extends beyond retirement age: example of failure to explain investment risks	
<u>Background</u>	

EXAMPLE 9

45 year old male non-smoker, having taken out a £50,000 loan in 1998 for a term of 25 years. Unsuitable sale identified on the grounds of affordability and complaint raised on 12th anniversary.

It has always been the intention of the complainant to retire at state retirement age 65.

Term from date of sale to retirement is 20 years and the maturity date of the mortgage is five years after retirement.

In addition, an endowment does not meet the complainant's attitude to investment risk and a repayment mortgage would have been taken out if properly advised.

Established facts

<i>Surrender value</i> (on the 25 year <i>policy</i>) at time complaint assessed:	£12,500
Capital repaid under repayment mortgage of term to retirement date (20 years):	£21,000
<i>Surrender value</i> less capital repaid:	(£8,500)
Difference in outgoings (repayment – endowment):	£5,400
Cost of converting from endowment mortgage to repayment mortgage:	£200

Basis of compensation:

The *surrender value* of the (25 year term) endowment *policy* is compared to the capital that would have been repaid to date under a repayment mortgage arranged to repay the loan at retirement age, in this example, a repayment mortgage for a term of 20 years. The complainant has gained from lower outgoings of the endowment mortgage to date. In calculating the redress, the gain may be offset against the loss unless the complainant's particular circumstances are such that it would be unreasonable to take account of the gain. The conversion costs are also taken into account in calculating the redress.

Redress generally

Loss from <i>surrender value</i> less capital repaid:	(£8,500)
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EXAMPLE 9	
Gain from total lower outgoings under endowment mortgage:	£5,400
Cost of converting to a repayment mortgage:	(£200)
Net loss:	(£3,300)
Therefore total redress is:	<u>£3,300</u>
Redress if it is unreasonable to take account of gain from lower outgoings	
Loss from <i>surrender value</i> less capital repaid:	(£8,500)
Gain from total lower outgoings under endowment mortgage:	<i>Ignored</i>
Cost of converting to a repayment mortgage:	(£8,700)
Therefore total redress is:	<u>£8,700</u>

2.5 Additional considerations

Introduction

- 2.5.1 G_{/1} This section addresses two issues which may be relevant to the standard redress for unsuitability cases, as well as some post-retirement cases upheld on the grounds of affordability.

Continuing life cover and other policy benefits

- 2.5.2 G_{/1} *Firms* will need to consider the importance for many complainants of having life assurance in place to ensure a mortgage is paid off in the event of death.
- 2.5.3 G_{/1} If a complaint is upheld and the *policy* is to be surrendered as part of the settlement, the *firm* should remind the complainant in writing that the life cover within the endowment will be terminated and that it may therefore be appropriate to take advice about the merits or otherwise of taking out a stand-alone *life policy* in substitution.
- 2.5.4 G_{/1} If a need for life assurance at inception has been established so that a deduction representing its cost has been made from the redress payable under *DISP* App 2.2.4G, the *firm* should advise the complainant that the *firm* would be responsible for paying any *premium* for an appropriate replacement *policy* which exceeds that used for calculating the deduction or alternatively will, where possible, provide the

cover itself at that cost. If it is not possible for the *firm* to provide the cover itself at the original cost, it may choose to discharge that obligation by the payment of an appropriate lump sum. Any such amount should enable the complainant to effect the cover at the original cost, with no additional cost in respect of increased age or deterioration in health. This option may be particularly relevant if the *firm* against which the complaint has been made is an independent intermediary which cannot itself provide the cover, although it may be possible for such a *firm* to arrange for the product provider to offer cover to the complainant at the original *premium* on payment by the independent intermediary of an appropriate lump sum to meet any increased cost.

- 2.5.5** G_{/1} *Firms* will not be responsible for any increased costs resulting from the complainant choosing another *product provider* or for increased *premiums* charged by another provider chosen by the complainant in respect of the risk now presented, for example, higher *premiums* charged by the other provider due to deterioration in health, unless the original *product provider* no longer writes new business and is unable to offer revised life cover on a decreasing term assurance basis.
- 2.5.6** G_{/1} There can be exceptional circumstances where, in order to retain suitable life cover, the endowment *policy* has to be retained and any additional costs will be the responsibility of the *firm* that sold the endowment *policy*.
- 2.5.7** G_{/1} The same considerations will apply to the establishment of the need for other *policy* benefits including critical illness cover, disability cover and waiver of *premium*.

Taxation

- 2.5.8** G_{/1} *Firms* will need to consider the likely taxation implications for complainants if *policies* are surrendered or reconstructed, or any form of underpinning or guarantee is given.
- 2.5.9** G_{/1} If there is potential tax liability for the complainant, it will be appropriate for *firms* to undertake in writing to the complainant to reimburse any tax payable, or which becomes payable, and make payment on production of appropriate evidence of the liability and payment having been made.

”Underpinning”

- 2.5.10** G_{/1} *Firms* proposing to offer arrangements involving some form of minimum underpinning or “guarantee” should discuss their proposals with the *FSA* and the Inland Revenue at the earliest possible opportunity (see *DISP* App 2.5.8G). The *FSA* will need to be satisfied that these proposals provide complainants with redress which is at least commensurate with the standard approaches contained in this appendix.

Reference to the guidance in firms’ complaints settlement letters

- 2.5.11** G_{/1} One of the reasons for introducing the *guidance* in this appendix is to seek a reduction in the number of complaints which are referred to the *Financial Ombudsman Service*. If a *firm* writes to the complainant proposing terms for settlement which are in accordance with this appendix, the letter may include a statement that the calculation of loss and redress accords with the *FSA guidance*,

but should not imply that this extends to the assessment of whether or not the complaint should be upheld. *Firms* should point out that if the complainant remains dissatisfied, he may refer the complaint to the *Financial Ombudsman Service*.

2.5.12**G**

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A statement under *DISP* App 2.5.11G should not give the impression that the proposed terms of settlement have been expressly endorsed by either the *FSA* or the *Financial Ombudsman Service*.

Schedules



Handbook Modules

Schedule1 Record keeping requirements

1 Table

G

The aim of the *guidance* in the following table is to give the reader a quick overall view of the relevant record keeping requirements.

It is not a complete statement of those requirements and should not be relied on as if it were.

2 Table

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
<i>DISP</i> 1.5.1R	Complaints subject to <i>DISP</i> 1.4– <i>DISP</i> 1.6.	Not specified, but see <i>DISP</i> 1.5.2G	On receipt	3 years

Handbook Modules

Schedule2 Notification requirements

1 Table

G

The aim of the *guidance* in the following table is to give the reader a quick overall view of the relevant requirements for notification and reporting.

It is not a complete statement of those requirements and should not be relied on as if it were.

2 Table

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<i>DISP</i> 1.1.7R	<i>Firm</i> qualifies for exemption	Confirmation that a <i>firm</i> does not do business with <i>eligible complainants</i> and has no reasonable likelihood of doing so	If the <i>firm</i> wishes to take advantage of the exemption in <i>DISP</i> 1.1.7R an annual renewal is required. See <i>DISP</i> 1.1.8R for timing of notice	N/A
<i>DISP</i> 1.1.10R	End of exemption	Confirmation that the conditions in <i>DISP</i> 1.1.7R no longer apply	Conditions in <i>DISP</i> 1.1.7R no longer apply	Not specified
<i>DISP</i> 1.5.4R	Complaints report	Details	– 30 September – 31 March each year	One <i>month</i>
<i>DISP</i> 1.5.11R	Single contact point	Details	At the time of authorisation or on subsequent change	Not specified
<i>DISP</i> 1.7.5R	<i>Member</i> of Lloyd's qualifies for exemption	Confirmation by the <i>Society</i> of Lloyd's that a specified <i>member</i> of Lloyd's does not do business with <i>eligible complainants</i> and has no reasonable likelihood of doing so	[As above]	N/A

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<i>DISP 1.7.6R</i>	End of exemption for <i>member</i> of Lloyd's	Confirmation by the <i>Society</i> of Lloyd's that the condition in <i>DISP 1.1.7R</i> no longer apply to a specified <i>member</i> of Lloyd's	Conditions in <i>DISP 1.1.7R</i> no longer apply	Not specified
<i>DISP 1.7.7R</i>	Complaints report by <i>Society</i> of Lloyd's	Details	– 30 September – 31 March each year	One <i>month</i>

Handbook Modules

Schedule3 Fees and other required payment

- 1 The table of fees and other required payments will be inserted in DISP at a later date.

Handbook Modules

Schedule4 Powers Exercised

1 Table

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- 1 The following powers and related provisions in the *Act* and in the *Ombudsman Transitional Order* have been exercised by the *FSA* to make the *rules* in *DISP*:
 - (1) Section 138 (General *rule*-making power)
 - (2) Section 156 (General supplementary powers)
 - (3) Section 226 (*Compulsory Jurisdiction*)
 - (4) Section 229 (Awards)
 - (5) Schedule 17 paragraph 13 (*FSA's* procedural *rules*)
 - (6) Article 15 (Record-keeping and reporting requirements relating to *relevant complaints*) of the *Ombudsman Transitional Order*.

- 2 The following power in the *Act* has been exercised by the *FSA* to give the *guidance* in *DISP*:
 - (1) Section 157(1) (*Guidance*)

- 3 The following powers and related provisions in the *Act* have been exercised by the *FOS Ltd* to make the *rules* in *DISP*:
 - (1) Section 227 (*Voluntary Jurisdiction*)
 - (2) Section 230 (Costs)
 - (3) Schedule 17 paragraph 8 (*Guidance*)
 - (4) Schedule 17 paragraph 14 (The scheme's *rules*)
 - (5) Schedule 17 paragraph 15 (*Fees*)
 - (6) Schedule 17 paragraph 18 (Terms of reference to the scheme)

2 Table

4	The powers to make <i>rules</i> relating to the new <i>ombudsman</i> scheme are shared between the <i>FSA</i> and the <i>Financial Ombudsman Service (FOS Ltd)</i> . <i>FOS Ltd's</i> rules are subject to <i>FSA</i> consent or approval. The rules made exclusively by <i>FOS Ltd</i> are:
---	--

3 Table

DISP 2	2.6.9R 2.6.11R
DISP 3	3.2.5R 3.2.7R 3.2.8R 3.2.9R 3.2.11R 3.2.12R 3.2.13R 3.3.1R 3.4.1R 3.5.1R 3.5.2R 3.6.1R 3.6.2R 3.6.3R 3.7.1R 3.8.1R(2) 3.8.3R 3.9.10R 3.9.12R 3.9.15R 3.10.1R
DISP 4	All rules

Handbook Modules

Schedule 5

Actions for damages for contravention under section 150 of the Act

1 Table

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1	The table below sets out the rules in <i>DISP</i> contravention of which by an <i>authorised person</i> may be actionable under section 150 of the <i>Act</i> (Actions for damages) by a <i>person</i> who suffers loss as a result of the contravention.
2	If a "Yes" appears in the column headed "For <i>private person</i> ?", the rule may be actionable by a " <i>private person</i> " under section 150 (or, in certain circumstances, his fiduciary or representative; see article 6(2) and (3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001 No 2256)). A "Yes" in the column headed "Removed" indicates that the <i>FSA</i> has removed the right of action under section 150(2) of the <i>Act</i> . If so, a reference to the rule in which it is removed is also give.
3	The column headed "For other person?" indicates whether the rule may be actionable by a <i>person</i> other than a <i>private person</i> (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of <i>person</i> by whom the rule may be actionable is given.

2 Table

Chapter/ Appendix	Section/ Annex	Paragraph	Right of action under s150			
			For Private Person?	Removed?	For Other Person?	
1 Complaints handling arrangements for <i>firms</i>	--	--	Yes	---	---	---
2 Jurisdiction rules	--	--	Yes	-	-	---

3	Complaints handling procedures of the <i>Financial Ombudsman Service</i>	--	--	Yes	---		---	
4	The <i>standard terms</i>	--	--	N/A	---			
5	Funding	--	--	Yes	---			

Handbook Modules

Schedule6 Rules that can be waived

G

- 1 No rules in DISP may be waived, other than DISP 1.5.4R, and DISP 1.4.1R to DISP 1.4.16R.

Handbook Modules

Dispute resolutions: Complaints sourcebook

Derivations

G

1. There is no table of derivations for this sourcebook.

Handbook Modules

Dispute resolutions: Complaints sourcebook

Destinations

G

1. There is no table of destinations for this sourcebook.

COMPENSATION SOURCEBOOK INSTRUMENT 2001

- A. The Financial Services Authority makes the rules and gives the guidance in this instrument in the exercise of the powers listed in Schedule 4 to the Annex to this instrument (Powers exercised).
- B. The instrument comes into force as follows:
- (1) COMP 14 (EEA firms) and A to E on this page come into force immediately;
 - (2) the remainder of this instrument comes into force at the beginning of the day on which section 19 of the Act (the general prohibition) of the Financial Services and Markets Act 2000 (“the Act”) comes into force.
- C. The provisions of the Act relevant to making rules and listed in Schedule 4 to the Annex to this instrument (Powers exercised) are specified for the purpose of section 153(2) of the Act (Rule-making instruments).
- D. This instrument may be cited as the Compensation Sourcebook Instrument 2001.
- E. This Annex to this instrument (including its Schedules) may be cited as the Compensation sourcebook (or COMP).

By order of the Board

15 November 2001

ANNEX



Compensation

COMP TP 1 Transitional Provisions

COMP 1 Introduction and Overview

- 1.1 Application, Introduction, and Purpose
- 1.2 The FSCS
- 1.3 Claimants
- 1.4 EEA Firms

COMP 2 The FSCS

- 2.1 Application and Purpose
- 2.2 Duties of the FSCS

COMP 3 The qualifying conditions for compensation

- 3.1 Application and Purpose
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- 3.3 Insurance

COMP 4 Eligible claimants

- 4.1 Application and Purpose
- 4.2 Who is eligible to benefit from the protection provided by the FSCS?
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- 5.2 What is a protected claim?
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COMP Contents

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COMP 8 Rejection of application and withdrawal of offer

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- 8.2 Rejection of application for compensation
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- 9.1 Application and Purpose
- 9.2 When must compensation be paid?

COMP 10 Limits on the amount of compensation payable

- 10.1 Application and Purpose
- 10.2 Limits on compensation payable

COMP 11 Payment of compensation

- 11.1 Application and Purpose
- 11.2 Payment

COMP 12 Calculating compensation

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 - 12.2 Quantification: general
 - 12.3 Quantification date
 - 12.4 The compensation calculation
 - 12.5 Quantification when the FSCS is seeking to secure continuity of insurance cover
 - 12.6 Quantification: trustees, personal representatives, agents, and joint claims
- 12 Annex 1 COMP 13 Ann 1R: Management Expenses Levy Limit

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- 13.2 General structure
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- 13.4 The FSCS's power to impose levies
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- 13.6 Compensation costs
- 13.7 Incoming EEA firms
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COMP 14 Participation by EEA Firms

- 14.1 Application and Purpose
- 14.2 Obtaining top-up cover
- 14.3 Co-operation between the FSCS and Home State compensation schemes
- 14.4 Ending top-up cover

COMP Sch 1 Record-keeping requirements

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COMP Sch 4 Powers Exercised

COMP Sch 5 Rights of action for damages

COMP Sch 6 Rules that can be waived

Compensation

Transitional Provisions

1 Table Transitional Provisions Table

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional Provision	(5) Transitional provision: dates in force	(6) Handbook Provisions coming into force
1	COMP 5	R	<p><u>Protected claims</u></p> <p>(1) <i>A claim for a protected deposit or under a protected contract of insurance includes a claim in respect of an article 9 default, subject to (2)</i></p> <p>(2) <i>A claim must be treated as a claim in relation to a protected contract of insurance under COMP 5.4.5R if the conditions in article 10((1)(a)–(d) of the compensation transitionals order are satisfied.</i></p> <p>(3) <i>A claim in connection with protected investment business includes a claim in respect of a pending application.</i></p> <p>(4) <i>Where the claim is in respect of an article 9 default or a pending application, the FSCS must apply the rules of the relevant former scheme, as they applied to the default before commencement, unless (2) applies.</i></p>	Indefinitely	<i>Commencement</i>

- (5) The rules of each *investment business compensation scheme* are amended so that references to the person managing the scheme are replaced by references to the *FSCS*.
- (6) The rules of the Friendly Societies Protection Scheme are amended so that:
- (a) references to the person managing the scheme are replaced by references to the *FSCS*; and
 - (b) References to functions conferred upon the Friendly Societies Protection Scheme Board are replaced by references to functions conferred upon the *FSCS*.
- (7) Where the default occurs after *commencement*, a *claim* for a *protected deposit* includes a *claim* that arose before *commencement* in respect of:
- (a) a deposit within the meaning of the Banking Act 1987; and
 - (b) a *claim* in respect of a protected investment within the meaning of section 27 of the Building Societies Act 1986.
- (8) Where the default occurs after *commencement*, a *claim* in connection with *protected investment business* includes a *claim* that could have been entertained under an *investment business compensation scheme* (provided that the person making the claim has not also made a *pending application* arising out of the same set of facts).

2	COMP 13.5R and COMP 13.6R	R	<p>Funding</p> <p>(1) The FSCS must give a <i>participant firm</i> which is a <i>professional firm</i> the following discount on the <i>specific costs levy</i> or <i>compensation costs levy</i> that it would otherwise have to pay:</p> <p>(a) 75%, if the levy is made between 1 December 2001 and 31 March 2002;</p> <p>(b) 25%, if the levy is made between 1 April 2002 and 31 March 2003;</p> <p>(c) 10%, if the levy is made between 1 April 2003 and 31 March 2004.</p> <p>(2) The FSCS must reallocate the amount of any discount to the other members of the relevant <i>contribution group</i>, in accordance with the relevant tariff basis in COMP 13.6.7R.</p>	Commencement – 31 March 2004	Commencement
3	COMP 134.6R and COMP 13.6.77	R	<p>Calculation of levies</p> <p>(1) Until 31 March 2002, the FSCS must calculate a <i>participant firm's</i> share of a <i>compensation costs levy</i> allocated to the insurance business <i>sub-scheme</i> in accordance with the provisions of the Policyholders Protection Act 1975 (including the provisions relating to net premium income).</p>	Commencement – 31 March 2002	Commencement

4	COMP 13.5.8R	R	<p>(2) In making the calculation under transitional provision 3R(1), the <i>FSCS</i> may assess a <i>participant firm</i> for its share of a <i>compensation costs levy</i> on any reasonable basis, if the <i>participant firm</i> has not provided the information required under the Policyholders Protection Act 1975, making such adjustments as seem appropriate in subsequent levies once the true figures are known.</p> <p>Grandfathered Firms</p> <p>COMP 13.5.8R (New participant firms) does not apply to a <i>firm</i> that becomes <i>authorised</i> at <i>commencement</i> under the Financial Services and Markets Act 2000 (Transitional Provisions) (authorised Persons etc.) Order 2001.</p>	Commencement – 31 March 2002	Commencement
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Forward to the Compensation Sourcebook

(This Forward to the Compensation Sourcebook does not form part of COMP.)

Forward

The Act requires the FSA to make rules establishing a scheme for compensating consumers when authorised firms are unable, or likely to be unable, to satisfy claims against them. The body established to operate and administer the compensation scheme is the Financial Services Compensation Scheme Limited (FSCS). By making rules that allow the FSCS to pay compensation to retail consumers and small businesses, focusing protection on those who need it most, the compensation scheme rules form an important part of the toolkit the FSA will use to meet its statutory objectives.

This module of the FSA Handbook contains the rules and guidance that allow the Financial Services Compensation Scheme Limited to pay claims for compensation or secure continuity of insurance when an authorised person is unable or likely to be unable to meet claims against it. The rules specify who is eligible to receive compensation and in what circumstances, how much compensation can be paid to a claimant; and how the scheme will be funded. The compensation rules, although of interest to consumers and authorised firms, do not in fact apply to either. The rules only apply to the FSCS.

The Sourcebook is divided into 14 Chapters covering all aspects of the scheme:

Chapter 1: Introduction and Overview

This chapter provides an introduction to the FSCS rules and a table of question and answers that may be of interest to consumers.

Chapter 2: The FSCS

This chapter gives the FSCS the duty to administer the compensation scheme. It also sets out the general conditions the FSCS must follow when administering the scheme such as having regard to the efficient and economic use of resources, the requirement to publish an Annual Report, and the duty to ensure consumers are informed about how they can make a claim. The rules in this chapter also require the FSCS to have in place procedures for dealing with complaints.

Chapters 3 The qualifying conditions for paying compensation

This chapter sets out the main qualifying conditions that must be satisfied before the FSCS can pay compensation to claimants or take steps to secure continuity of insurance. These are that a claimant is eligible to claim; the activity that gave rise to the loss is protected by the scheme; the firm against which the claim is being made is protected by the scheme; and that the claimant has assigned his rights to the scheme. Chapters 4-7 expand on the general conditions described in Chapter 3.

Chapter 4 Eligible claimants

This chapter specifies who is eligible to receive compensation or benefit from the continuity of insurance provided by the FSCS.

Chapter 5 What is a protected claim?

This chapter specifies the activities that are protected by the FSCS.

Chapter 6 Relevant persons in default

This chapter specifies the circumstances when a firm is in default, that is, when a firm is to be taken as being unable or likely to be unable to meet claims against it. The FSCS can only pay compensation, take steps to secure continuity of insurance, or provide assistance to an insurer in financial difficulties if the circumstances specified in Chapter 6 are met.

Chapter 7 Assignment of rights

This chapter enables the FSCS to make an offer of compensation conditional on the claimant assigning to it their rights to claim against the failed firm. If the FSCS recovers from the firm a greater sum than it has paid to the claimant, it must pay the balance to the claimant.

Chapter 8 Rejection of application and withdrawal of offer

This chapter allows the FSCS to reject an application for compensation or withdraw an offer of compensation in specified circumstances.

Chapter 9 Time limits on payment and postponing payment

This chapter requires the FSCS to pay a claim for compensation within a specified time unless specified conditions apply.

Chapter 10 Limits on the amount of compensation payable

This chapter specifies the maximum amount of compensation the FSCS can pay to a claimant, and the limits on the FSCS's duty to secure continuity of insurance for policyholders. Different limits apply depending on whether the claim is for a deposit, a claim on an insurance policy, or a claim in connection with an investment.

Chapter 11 Payment of compensation

This chapter specifies to whom the FSCS may pay compensation. In certain circumstances compensation may be paid to a person other than the claimant.

Chapter 12 Calculating compensation

This chapter specifies how the FSCS will calculate the amount of compensation it can pay to a claimant.

Chapter 13 Funding

This chapter allows the FSCS to make levies on authorised firms to fund the operation of the scheme, to pay compensation or secure continuity of insurance. It specifies how FSCS can make levies, how costs are to be allocated, the maximum the FSCS can levy in any particular period of time, and how sums recovered from failed firms are to be treated.

Chapter 14 Participation by EEA firms

This chapter sets out the way the FSCS deals with incoming EEA firms who may choose to top-up into the FSCS to supplement the compensation available from their home state scheme.

Chapter 1

Introduction and Overview



1.1 Application, Introduction, and Purpose

Application

1.1.1 G This chapter is relevant to:

01.12.01/001

- (1) the *FSCS*;
- (2) *eligible claimants*; and
- (3) *firms*.

1.1.2 G This sourcebook is principally relevant to the *FSCS*. It sets out the circumstances in which compensation may be paid, to whom compensation may be paid, and on whom the *FSCS* can impose levies to meet the costs of paying compensation (see in particular *COMP 3, 4, and 13*). It also describes how the *FSCS* is to calculate compensation in particular cases (see *COMP 12*).

01.12.01/001

1.1.3 G Claimants and their advisers will be particularly interested in the sections of this sourcebook which deal with eligibility for claiming compensation, the way that the *FSCS* calculates compensation, and how they can make a claim. For convenience, the relevant parts of this sourcebook are highlighted in a list of questions and answers in *COMP 1.3.3G*.

01.12.01/001

1.1.4 G *Firms* will be particularly interested in *COMP 13*, which deals with levies.

01.12.01/001

Introduction

1.1.5 G Under section 212 of the *Act* (The scheme manager), the *FSA* must establish a body corporate to exercise the functions that are conferred on that body corporate by Part XV of the *Act*, dealing with compensation. This body is the Financial Services Compensation Scheme Limited, a company limited by guarantee (*FSCS*).

01.12.01/001

1.1.6 G The *FSA* is also required, under section 213 of the *Act* (The compensation scheme), to make *rules* establishing a compensation scheme. These *rules* are set out in the remaining chapters of this sourcebook, and are directed to the *FSCS*, claimants and potential claimants, and *firms*.

01.12.01/001

Purpose

1.1.7 G The *FSCS* will only pay *claims* if a *firm* is unable or likely to be unable to meet *claims* against it because of its financial circumstances. If a *firm* is still trading and

01.12.01/001

has sufficient financial resources to satisfy a *claim*, the *firm* will be expected to meet the *claim* itself. This can, for example, be an amount the *firm* agrees with the claimant, or the amount of an *Ombudsman* award from the *Financial Ombudsman Service*.

1.1.8



01.12.01/001

COMP 1 consists of *guidance* which is aimed at giving an overview of how this sourcebook works. The provisions of COMP 2-14 cover who is eligible, the amount of compensation and how it might be paid, and the ways in which the activities of the FSCS are to be financed.

1.1.9



01.12.01/001

This sourcebook is one of the means by which the FSA will meet its *regulatory objectives* of securing the appropriate degree of protection for *consumers* and maintaining confidence in the *financial system*.

1.1.10



01.12.01/001

By setting up the FSCS and making *rules* that allow the FSCS to provide compensation at a level appropriate for the protection of retail *consumers* and *small businesses*, the FSA enables *consumers* to participate in the financial markets with the confidence that they will be protected, at least in part, should the *relevant person* with whom they are dealing be unable to satisfy *claims* against it.

1.2 The FSCS

1.2.1



01.12.01/001

While this sourcebook deals with the main powers and duties of the *FSCS*, it does not provide the complete picture. Other aspects of the operation of the *FSCS* are dealt with through the powers of the Financial Services Compensation Scheme Limited under company law (such as the power to borrow, to take on premises, etc.).

1.2.2



01.12.01/001

- (1) In addition, the *Act* itself confers certain powers upon the *FSCS*, such as a power under section 219 of the *Act* (Scheme Manager's powers to require information) to require *persons* to provide information. These powers are not, therefore, covered by this sourcebook.
- (2) Of specific relevance to the way in which the *FSCS* fulfils its responsibilities is the relationship between the *FSCS* and the *FSA*. This is covered in a Memorandum of Understanding which can be found on the *FSA* website www.fsa.gov.uk.



1.3 Claimants

1.3.1 **G**
01.12.01/001

The *FSCS* also provides information to claimants and potential claimants about the way the *FSCS* works and the procedures that need to be followed when making a *claim*. The *FSCS* can be contacted at 7th Floor, Lloyds Chambers, 1 Portsoken Street, London E1 8BN, or by telephone or fax (Tel: 020 7892 7300 or Fax: 020 7892 7301), or by e-mail (enquiries@fscs.org.uk).

1.3.2 **G**
01.12.01/001

Information about the operation of the *FSCS* and how to claim is also available from the *FSCS* website (www.fscs.org.uk).

1.3.3 **G**
01.12.01/001

Table Areas of particular interest to claimants (see COMP 1.1.3G). This Table belongs to COMP 1.3.3.

Q1	What do I need to do in order to receive compensation?	
A1	In order to receive compensation:	
	(1) you must be an <i>eligible claimant</i> ;	COMP 4.2–3
	(2) you must have a <i>protected claim</i> ;	COMP 5.2–5
	(3) you must be claiming against a <i>relevant person</i> ;	COMP 6.2.1R
	(4) the <i>relevant person</i> must be <i>in default</i> .	COMP 6.3
	In addition, if the <i>FSCS</i> requires you to do so, you must assign your legal rights in the claim to the <i>FSCS</i> .	COMP 7.2
	And you must bring your claim to the <i>FSCS</i> within a set time (normally within six years of the date on which your claim against the <i>relevant person</i> occurred).	COMP 8.2.3R–8.2.4R
	It is possible, in certain circumstances, for someone else to make a <i>claim</i> on your behalf.	COMP 3.2.2R
Q2	How much compensation will I be offered?	
A2	This depends on whether your <i>protected claim</i> is:	
	(1) a <i>claim</i> for a <i>protected deposit</i> , or	COMP 5.3
	(2) a <i>claim</i> under a <i>protected contract of insurance</i> ; or	COMP 5.4
	(3) a <i>claim</i> in connection with <i>protected investment business</i> .	COMP 5.5
	Different limits apply to different types of <i>claim</i> .	COMP 10.2.3R
Q3	How will the <i>FSCS</i> calculate the compensation that is offered to me?	
A3	Again, this will depend on whether your <i>protected claim</i> is a:	
	(1) a <i>claim</i> for a <i>protected deposit</i> , or	COMP 12.2.1R, 12.3.1R, and 12.4.1R

1

	<p>(2) a claim under a <i>protected contract of insurance</i>; or</p> <p>(3) a claim in connection with <i>protected investment business</i>.</p>	<p>COMP 12.2.1R, 12.3.2–4R, and 12.4.9R–12.5.2R</p> <p>COMP 12.2.1R, 12.3.5–6R, and 12.4.2–8R</p>
	<p>Certain types of <i>protected investment business claim</i> require the FSCS to use a particular method of calculation.</p>	<p>COMP 12.4.5–7R</p>
<p>Q4</p>	<p>What happens if an insurance undertaking is insolvent?</p>	
<p>A4</p>	<p>If you have a <i>long term insurance contract</i> with an insolvent <i>insurance undertaking</i>, the FSCS will first try to secure continuity of insurance for you.</p> <p>If the FSCS achieves this, you will not necessarily receive any cash, but you will continue to be insured (though possibly with lower benefits than before).</p> <p>You will receive cash compensation only if the FSCS cannot secure continuity of insurance cover or the cost of doing so would be unreasonable.</p> <p>If you have a <i>relevant general insurance contract</i> with an insolvent <i>insurance undertaking</i>, the FSCS will pay you cash compensation if it is unable to secure continuity of insurance cover or the cost of doing so would be unreasonable.</p> <p>If the <i>insurance undertaking</i> is in "financial difficulties", the FSCS may try to arrange for another <i>insurance undertaking</i> to take over the <i>business</i>, or provide the <i>insurance undertaking</i> with financial assistance to carry on business. If this occurs, you will not receive cash compensation, but your policy will continue (though possibly with lower benefits than before).</p>	<p>COMP 3.3, 11.2.3R, and 12.4.11R</p> <p>COMP 3.3R, 10.2.6R, 11.2.2R, and 12.5.1R</p> <p>COMP 3.3.1–2R, and 11.2.1R</p> <p>COMP 3.2.1–2R and 11.2.3R</p> <p>COMP 3.3.3–6R, 10.2.6–7R, and 11.2.3R</p>



1.4 EEA Firms

1.4.1

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01.12.01/001

Incoming EEA firms which are conducting *regulated activities* in the *United Kingdom* under a *BCD* or *ISD* passport are not required to participate in the *compensation scheme* in relation to those *passport activities*. They may apply to "top-up" into the *compensation scheme* if the level or scope of cover provided by the *incoming EEA firm's Home State* compensation scheme is less than that provided by the *compensation scheme*. This is covered by *COMP 14*.

1.4.2

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01.12.01/001

If an *incoming EEA firm* "tops-up", and then becomes insolvent, the *Home State* compensation scheme will pay compensation for *claims* up to the limit and scope of the *Home State* compensation scheme, with the *FSCS* paying compensation for the additional amount in accordance with the provisions in this sourcebook.

1.4.3

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01.12.01/001

The *DGD* and *ICD* require the *FSCS* to make arrangements with the relevant *Home State* compensation scheme regarding the payment of compensation (*COMP 14.3.1R*).

Chapter 2

2

The FSCS





2.1 Application and Purpose

Application

2.1.1 R This chapter applies to the *FSCS*.
01.12.01/001

Purpose

2.1.2 G In order to carry out its functions and put into effect the provisions set out in *COMP 3 - COMP 14* (which deal with determining whether compensation is payable, calculating the amount of compensation that should be paid, and making levies on *firms*), the *FSCS* needs to have a variety of powers. The purpose of this chapter is to set out these powers, and the restrictions upon them.
01.12.01/001

2.2 Duties of the FSCS

Administering the compensation scheme

2.2.1 **R** The FSCS must administer the *compensation scheme* in accordance with the *rules* in this sourcebook and any other rules prescribed by law to ensure that the *compensation scheme* is administered in a manner that is procedurally fair and in accordance with the European Convention on Human Rights.

01.12.01/001

2.2.2 **G** The FSCS may:

01.12.01/001

- (1) pay compensation to *eligible claimants* or secure continuity of insurance for *eligible claimants* when a *relevant person* is unable or likely to be unable to meet *claims* against it in accordance with the sourcebook; and
- (2) make levies on *participant firms*, in accordance with COMP 13 (Funding), to enable it to pay compensation, secure continuity of insurance, or meet the costs of discharging its functions under this sourcebook.

Information for claimants

2.2.3 **R** The FSCS must publish information for claimants and potential claimants on the operation of the *compensation scheme*.

01.12.01/001

Assistance to claimants

2.2.4 **R** The FSCS may agree to pay the reasonable costs of an *eligible claimant* bringing or continuing insolvency proceedings against a *relevant person* (whether those proceedings began before or after a determination of default), if the FSCS is satisfied that those proceedings would help it to discharge its functions under the requirements of this sourcebook.

01.12.01/001

Annual Report

2.2.5 **G** The FSCS must make and publish an annual report to the FSA on the discharge of its functions (section 218 of the *Act* (Annual report)).

01.12.01/001

Finance and resources

2.2.6

R

01.12.01/001

The *FSCS* must have regard to the need to use its resources in the most efficient and economic way in carrying out its functions under the requirements of this sourcebook.

Publication of defaults

2.2.7

R

01.12.01/001

The *FSCS* must take appropriate steps to ensure that potential claimants are informed of how they can make a *claim* for compensation as soon as possible after a determination has been made that a *relevant person* is *in default*, whether by the *FSCS* or the *FSA*.

Complaints

2.2.8

R

01.12.01/001

The *FSCS* must put in place and publish procedures which satisfy the minimum requirements of procedural fairness and comply with the European Convention on Human Rights for the handling of any complaints of maladministration relating to any aspect of the operation of the *compensation scheme*.

Chapter 3

The qualifying conditions for compensation

3



3.1 Application and Purpose

Application

3.1.1 **R** This chapter applies to the *FSCS*.

01.12.01/001

3.1.2 **G** It is also relevant to claimants.

01.12.01/001

Purpose

3.1.3 **G** The purpose of this chapter is to set out in general terms the conditions that must be satisfied before the *FSCS* can make an offer of compensation, or secure continuity of insurance cover, or provide assistance to an *insurance undertaking* to enable it to continue *insurance business*.

01.12.01/001

3.1.4 **G** The qualifying conditions for paying compensation are set out in greater detail in *COMP 4 – COMP 7*.

01.12.01/001



3.2 The qualifying conditions for paying compensation

3.2.1

R

01.12.01/001

The FSCS may pay compensation to an *eligible claimant*, subject to COMP 11 (Payment of Compensation), if it is satisfied that:

- (1) an *eligible claimant* has, for *claims* other than *claims* under a *protected contract of insurance*, made an application for compensation;
- (2) the claim is in respect of a *protected claim* against a *relevant person* who is *in default*;
- (3) where the FSCS so requires, the claimant has assigned the whole or any part of his rights against the *relevant person* or against any third party to the FSCS, on such terms as the FSCS thinks fit; and
- (4) in the case of a *claim* under a *protected contract of insurance*:
 - (a) it is not reasonably practicable or appropriate to take steps to secure continuity of insurance under COMP 3.3.1R and COMP 3.3.4R(1); or
 - (b) it would not be appropriate to take the measures specified in COMP 3.3.4R(2) to provide assistance to an *insurance undertaking* in financial difficulties.

3.2.2

R

01.12.01/001

The FSCS may also pay compensation to a *person* who makes a *claim* on behalf of another *person* if the FSCS is satisfied that the *person* on whose behalf the *claim* is made:

- (1) is or would have been an *eligible claimant*; and
- (2) would have been paid compensation by the FSCS had he been able to make the *claim* himself, or to pursue his application for compensation further.

PAGE
3

3.2.3

G

01.12.01/001

Examples of the circumstances covered by COMP 3.2.2R are:

- (1) when personal representatives make a *claim* on behalf of the deceased;
- (2) when trustees make a *claim* on behalf of beneficiaries (for further provisions relating to *claims* by trustees, see COMP 12.6.1 to COMP 12.6.7R);

- (3) when the donee of an enduring power of attorney makes a *claim* on behalf of the donor of the power;
- (4) when the Master of the Court of Protection makes a *claim* on behalf of a *person* incapable by reason of mental disorder of managing and administering his property and affairs;
- (5) when an *eligible claimant* makes a *claim* for compensation but dies before his *claim* is determined.



3.3 Insurance

Securing continuity of insurance cover

3.3.1 **R**
01.12.01/001

The FSCS must make arrangements to secure continuity of insurance for an *eligible claimant* under a *protected contract of insurance* which is a *long term insurance contract* with a *relevant person*, if:

- (1) the *relevant person* is the subject of any of the proceedings listed in COMP 6.3.3R(1)-(5); and
- (2) it is reasonably practicable to do so.

3.3.2 **R**
01.12.01/001

The arrangements contemplated by COMP 3.3.1R include arrangements to:

- (1) secure or facilitate the transfer of the *long-term insurance business* of the *relevant person in default* or any part of that business, to another *firm*; and
- (2) secure the issue of policies by another *firm* to *eligible claimants* in substitution for their existing policies.

Insurance undertakings in financial difficulties

3.3.3 **R**
01.12.01/001

Where a *relevant person* is an *insurance undertaking* in financial difficulties (see COMP 3.3.6R), the FSCS must take such measures for the purpose of safeguarding *eligible claimants* on such terms (including terms reducing or deferring payment of any liabilities or benefits provided under any *protected contract of insurance*) as it considers appropriate if, in the opinion of the FSCS at the time it proposes to take the measures, the cost is likely to be less than the cost of paying compensation under COMP 3.2.

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5

3.3.4 **R**
01.12.01/001

The measures contemplated in COMP 3.3.3R include measures to:

- (1) secure or facilitate the transfer of the business of the *relevant person* which consists of *carrying out contracts of insurance*, or any part of the business, to another *firm*; and

3.3.5



01.12.01/001

- (2) give assistance to the *relevant person* to enable it to continue to effect or carry out contracts of insurance.

Before the FSCS takes the measures described in COMP 3.3.3R for the purpose of safeguarding an *eligible claimant* in respect of a *protected contract of insurance* that is a long term insurance contract, it must:

- (1) reduce the *eligible claimant's* interest in the *protected contract of insurance* to 90% of the amount which would otherwise have been payable under the terms of the contract; and
- (2) reduce all *premiums* under the contract which have not fallen due before the time when the reduction is to take effect to 90% of the amount which would otherwise have been payable.

3.3.6



01.12.01/001

For the purpose of COMP 3.3.3R, a *relevant person* who is an *insurance undertaking* is in financial difficulties if:

- (1) it is in provisional liquidation; or
- (2) it has been proved, in any proceedings on a petition for the winding up of the *relevant person* under the Insolvency Act 1986 or the Insolvency (Northern Ireland) Order 1989 for the voluntary winding up of the *relevant person* (or in any analogous proceedings pursuant to the law of any other jurisdiction), to be unable to pay its debts; or
- (3) an application has been made to the court under section 425 of the Companies Act 1985 or Article 418 of the Companies (Northern Ireland) Order 1986 for the sanctioning of a compromise or arrangement proposed between the *relevant person* and its creditors or any class of them and the terms of the compromise or arrangement provide for reducing, or deferring payment of, the liabilities or the benefits provided for under any of the *relevant person's* policies; or
- (4) the FSA determines that the *relevant person* who is an *insurance undertaking* is likely to be unable to satisfy *protected claims* against it.

Chapter 4

Eligible claimants





4.1 Application and Purpose

Application

4.1.1 **R**
01.12.01/001

This chapter applies to the *FSCS*.

4.1.2 **G**
01.12.01/001

It is also relevant to those who may wish to bring a *claim* for compensation.

Purpose

4.1.3 **G**
01.12.01/001

The purpose of this chapter is to set out the types of *person* who are able to claim compensation or benefit from the protection the *FSCS* is able to provide. A claimant needs to be an *eligible claimant* to satisfy *COMP 3.2.1R(1)*.

4.2 Who is eligible to benefit from the protection provided by the FSCS?

4.2.1

R

01.12.01/001

Unless COMP 4.2.3R applies, an *eligible claimant* is any *person* who at any material time:

- (1) did not come within COMP 4.2.2R; or
- (2) did come within COMP 4.2.2R, but satisfied the relevant exception in COMP 4.3.

4.2.2

R

01.12.01/001

Table Table COMP 4.2.2R Persons not eligible to claim unless COMP 4.3 applies (see COMP 4.2.1R). This table belongs to COMP 4.2.1R

- (1) **Firms (other than a sole trader firm or a small business whose claim arises out of a regulated activity for which they do not have a permission)**
- (2) **Overseas financial services institutions**
- (3) **Collective investment schemes, and anyone who is the operator or trustee of such a scheme**
- (4) **Pension and retirement funds, and anyone who is a trustee of such a fund (except a trustee of a small self-administered scheme or an occupational pension scheme of an employer which is not a large company, large partnership, or large mutual association)**
- (5) **Supranational institutions, governments, and central administrative authorities**
- (6) **Provincial, regional, local and municipal authorities**
- (7) **Directors and managers of the relevant person in default. However, this exclusion does not apply if:**
 - (a) **the relevant person in default is a mutual association which is not a large mutual association; and**
 - (b) **the directors and managers do not receive a salary or other remuneration for services performed by them for the relevant person in default.**
- (8) **Close relatives of persons excluded by (7) above**
- (9) **Bodies corporate in the same group as the relevant person in default**
- (10) **Persons holding 5% or more of the capital of the relevant person in default, or of any body corporate in the same group**
- (11) **The auditors of the relevant person in default, or of any body corporate in the same group as the relevant person in default, or the appointed actuary of a friendly society or insurance undertaking in default**

- (12) *Persons who in the opinion of the FSCS are responsible for, or have contributed to, the relevant person's default*
- (13) *Large companies or large mutual associations*
- (14) *Large partnerships*
- (15) *Persons whose claim arises from transactions in connection with which they have been convicted of an offence of money laundering.*
- (16) *Persons whose claim arises under the Third Parties (Rights against Insurers) Act 1930*

4.2.3

R

01.12.01/001

A person who is a *small business* is an *eligible claimant* in respect of a *relevant general insurance contract* entered into before *commencement* only if the *person* is a *partnership*.



4.3 Exceptions: Circumstances where a person coming within COMP 4.2.2R may receive compensation

Deposits

4.3.1 **R**
01.12.01/001

A *person* is eligible to claim compensation in respect of a *protected deposit* if, at the date on which the *relevant person* is determined to be *in default*:

- (1) he came within category (14) of COMP 4.2.2R; or
- (2) he came within any of categories (1)-(3) of COMP 4.2.2R, and was not a *large company*, *large mutual association*, or a *credit institution*.

Long term insurance

4.3.2 **R**
01.12.01/001

A *person* other than one which comes within any of categories (7)-(12) and (15) of COMP 4.2.2R is eligible to claim compensation in respect of a *long term insurance* contract.

Relevant general insurance contracts

4.3.3 **R**
01.12.01/001

(1) A *person* falling within categories (1)-(4) of COMP 4.2.2R is eligible to claim compensation in respect of a *relevant general insurance contract* if, at the date the contract commenced he was a *small business*.

(2) Where the contract has been renewed, the last renewal date shall be taken as the commencement date.

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5

4.3.4 **R**
01.12.01/001

A *person* coming within category 14 of COMP 4.2.2R is eligible to claim compensation in respect of a *relevant general insurance contract* entered into before *commencement*.

4.3.5 **R**
01.12.01/001

A *person* who comes within category (16) of COMP 4.2.2R (a '*category 16 person*') is eligible to claim compensation if:

- (1) the *person* insured would have been an *eligible claimant* at the time that his rights against the insurer were transferred to and vested in the category 16 *person*; or
- (2) the liability of the *person* insured in respect of the category 16 *person* was a liability under a contract of employer’s liability insurance which would have been a *liability subject to compulsory insurance* had the contract been entered into after 1 January 1972 or (for contracts in Northern Ireland) 29 December 1975; or
- (3) the extent of the liability of the *person* insured in respect of the category 16 *person* had been agreed in writing by the insurer, or determined by a court or arbitrator, before the date on which the insurer is determined to be *in default*.

Liability subject to compulsory insurance

4.3.6

R

01.12.01/001

A *person* who comes within COMP 4.2.2R is eligible to claim compensation in respect of a *liability subject to compulsory insurance*.

Protected investment business

4.3.7

G

01.12.01/001

There are no exceptions to COMP 4.2.2R for *claims* made in connection with *protected investment business*.

Compensation

Chapter 5

Protected claims

5

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1





5.1 Application and Purpose

Application

5.1.1 R This chapter applies to the *FSCS*.

01.12.01/001

5.1.2 G It is also relevant to claimants.

01.12.01/001

Purpose

5.1.3 G The purpose of this chapter is to set out the various categories of *claim* for which compensation may be payable.

01.12.01/001

5.2 What is a protected claim?

5.2.1

R

01.12.01/001

A *protected claim* is:

- (1) a *claim* for a *protected deposit* (see COMP 5.3); or
- (2) a *claim* under a *protected contract of insurance* (see COMP 5.4);
or
- (3) a *claim* in connection with *protected investment business* (see COMP 5.5).

5.2.2

G

01.12.01/001

Where a *claim* is against a *relevant person* which is:

- (1) an *incoming EEA firm* which is a *credit institution* or *ISD investment firm*; or
- (2) an *appointed representative* of (1);

the categories of *claim* that are *protected claims* are modified in COMP 14.5. This is because the *DGD* and *ICD* provide that compensation may be available under the *firm's Home State* compensation scheme.

5.3 Protected deposits

5.3.1

R

01.12.01/001

A *deposit* is a *protected deposit* only if:

(1) the *deposit* was made with:

- (a) an establishment of a *relevant person* in the *United Kingdom*; or
- (b) a *branch* of a *UK firm* which is a *credit institution* established in another *EEA State* under an *EEA right*; and

(2) the *deposit* is not:

- (a) a bond issued by a *credit institution* which is part of the institution's capital, as set out in the Consolidated Banking Directive (Directive 2000/12/EC); or
- (b) a *secured deposit*; or
- (c) a *deferred share* issued by a *building society*; or
- (d) a *non-nominative deposit* (that is, a *deposit* made without disclosing the depositor's identity).

5.4 Protected contracts of insurance

5.4.1

R

01.12.01/001

A *protected contract of insurance* is:

- (1) (if issued after *commencement*) a *contract of insurance* within COMP 5.4.2R (Contracts of insurance issued after commencement)
- (2) (if issued before *commencement*) a *contract of insurance* within COMP 5.4.5R (Contracts of insurance issued before commencement)

Contracts of insurance issued after commencement

5.4.2

R

01.12.01/001

A *contract of insurance* issued after *commencement* which:

- (1) relates to a protected risk or commitment as described in COMP 5.4.3R;
- (2) is issued by the *relevant person* through an establishment in;
 - (a) the *United Kingdom*; or
 - (b) another *EEA State*; or
 - (c) the Channel Islands or the Isle of Man; and
- (3) is a *long-term insurance contract* or a *relevant general insurance contract*;

is a *protected contract of insurance*.

5.4.3

R

01.12.01/001

A risk or commitment is a protected risk or commitment for the purpose of COMP 5.4.2R(1) if:

- (1) in the case of a *contract of insurance* falling within COMP 5.4.2R(2)(a), it is situated in an *EEA State*, the Channel Islands or the Isle of Man;
- (2) in the case of a *contract of insurance* falling within COMP 5.4.2R(2)(b), it is situated in the *United Kingdom*;

5.4.4

R

01.12.01/001

(3) in the case of a *contract of insurance* falling within COMP 5.4.2R(2)(c), it is situated in the *United Kingdom*, the Channel Islands or the Isle of Man.

For the purpose of COMP 5.4.3R and COMP 5.4.5R(1)(b), the situation of a risk or commitment is determined as follows:

- (1) for a *contract of insurance* relating to a building or a building and its contents (in so far as the contents are covered by the same *contract of insurance*), the risk or commitment is situated where the building is situated;
- (2) for a *contract of insurance* relating to vehicles of any type, the risk or commitment is situated where the vehicle is registered;
- (3) for a *contract of insurance* lasting four months or less covering travel or holiday risks (whatever the class concerned), the risk or commitment is situated where the policyholder took out the *contract of insurance*; and
- (4) in cases not covered by (1) to (3):
 - (a) where the policyholder is an individual, the risk or commitment is situated where he has his habitual residence at the date when the *contract of insurance* commenced;
 - (b) where the policyholder is not an individual, the risk or commitment is situated where the establishment to which the risk or commitment relates is situated at the date when the *contract of insurance* commenced.

Contracts of insurance issued before commencement

5.4.5

R

01.12.01/001

(1) If the default of the *relevant person* occurs after *commencement*, a *contract of insurance* issued by a *relevant person* before *commencement* which is within COMP 5.4.5R(2) is a *protected contract of insurance*, provided that:

- (a) (unless it comes within (b)) it was a "United Kingdom policy at the beginning of the liquidation" for the purposes of the Policyholders Protection Act 1975;
- (b) if the *contract of insurance* is a contract of employers' liability insurance entered into before 1 January 1972 or (for contracts in Northern Ireland) 29 December 1975, and the *claim* was agreed after the default of the *insurer*, the risk or commitment was situated in the *United Kingdom* (as set out in COMP 5.4.4R).

(2) The *contracts of insurance* referred to in COMP 5.4.5R(1) are:

- (a) a *relevant general insurance contract*;
- (b) a *contract of insurance* within the *credit* class; and
- (c) a *long-term insurance contract*.

Contracts not evidenced by a policy

5.4.6

R

01.12.01/001

If it appears to the FSCS that a *person* is insured under a contract with an *insurance undertaking* which is not evidenced by a policy, and it is satisfied that if a policy evidencing the contract had been issued, the *person* in question would have had a *protected contract of insurance*, the FSCS must treat the contract as a *protected contract of insurance*.

Liabilities giving rise to claims under a protected contract of insurance

5.4.7

R

01.12.01/001

The FSCS must treat liabilities of an *insurance undertaking* which is *in default*, in respect of the following items, as giving rise to *claims* under a *protected contract of insurance*:

- (1) (if the contract has not commenced) *premiums* paid to the *insurance undertaking*; or
- (2) proceeds of a *long-term insurance contract* that has matured or been surrendered but have not yet been passed to the claimant; or
- (3) the unexpired portion of any *premium* in relation to *relevant general insurance contracts*; or
- (4) *claims* by *persons* entitled to the benefit of a judgement under section 151 of the Road Traffic Act 1988 or Article 98 of the Road Traffic (Northern Ireland) Order 1981.



5.5 Protected investment business

5.5.1

R

01.12.01/001

Protected investment business is:

- (1) *designated investment business* carried on by the *relevant person* with the claimant or as *agent* on his behalf;
- (2) the activities of the manager or *trustee* of an *AUT*, provided that the *claim* is made by a *holder*;
- (3) the activities of the *ACD* or *depository* of an *ICVC*, provided that the *claim* is made by a *holder*;

provided that the condition in *COMP 5.5.2R* is satisfied.

5.5.2

R

01.12.01/001

COMP 5.5.1R only applies if the *protected investment business* was carried on from:

- (1) an *establishment* of the *relevant person* in the *United Kingdom*;
or
- (2) a *branch* of a *UK firm* which is an *ISD investment firm* (including a *credit institution* which is an *ISD investment firm*) established in another *EEA State*, and the *claim* is an *ICD claim*; or
- (3) both (1) and (2).

Chapter 6

Relevant persons in default





6.1 Application and Purpose

Application

6.1.1 **R** This chapter applies to the *FSCS*.

01.12.01/001

6.1.2 **G** It is also relevant to claimants.

01.12.01/001

Purpose

6.1.3 **G** The purpose of this chapter is to specify the types of *person* against whom a claimant must have a *claim* in order to be eligible for compensation, and when those *persons* are “*in default*”. Generally, this occurs when they are insolvent or unable to meet their liabilities to claimants.

01.12.01/001

6.1.4 **G** To be eligible for compensation a claimant’s claim must be against a *relevant person in default*: see *COMP 3.2.1R(2)*.

01.12.01/001



6.2 Who is a relevant person?

6.2.1

R

01.12.01/001

A relevant person is a person who was, at the time the act or omission giving rise to the claim against it took place:

- (1) *a participant firm; or*
- (2) *an appointed representative of a participant firm.*

6.2.2

G

01.12.01/001

An incoming EEA firm, which is a credit institution or an ISD investment firm, and its appointed representatives are not relevant persons in relation to the firm's passported activities, unless it has top-up cover. (See definition of "participant firm").

6



6.3 When is a relevant person in default?

6.3.1 **R**
01.12.01/001

A *relevant person* is *in default* if:

- (1) (except in relation to an *ICD claim* or *DGD claim*) the *FSCS* has determined it to be *in default* under *COMP 6.3.2R*, *COMP 6.3.3R*, *COMP 6.3.4R* or *COMP 6.3.5R*; or
- (2) (in relation to an *ICD claim* or *DGD claim*):
 - (a) the *FSA* has determined it to be *in default* under *COMP 6.3.2R*; or
 - (b) a judicial authority has made a ruling that had the effect of suspending the ability of *eligible claimants* to bring *claims* against the *participant firm*, if that is earlier than (a).

6.3.2 **R**
01.12.01/001

Subject to *COMP 3.3.3R* to *COMP 3.3.6R*, the *FSCS* (or, where *COMP 6.3.1R(2)(a)* applies, the *FSA*) may determine a *relevant person* to be *in default* when it is, in the opinion of the *FSCS* or the *FSA*:

- (1) unable to satisfy *protected claims* against it; or
- (2) likely to be unable to satisfy *protected claims* against it.

6.3.3 **R**
01.12.01/001

The *FSCS* may determine a *relevant person* to be *in default* if it is satisfied that a *protected claim* exists (other than an *ICD claim* or *DGD claim*), and the *relevant person* is the subject of one or more of the following proceedings in the *United Kingdom* (or of equivalent or similar proceedings in another jurisdiction):

- (1) the passing of a resolution for a creditors' voluntary winding up;
- (2) a determination by the *relevant person's Home State regulator* that the *relevant person* appears unable to meet *claims* against it and has no early prospect of being able to do so;
- (3) the appointment of a liquidator or administrator, or provisional liquidator or interim manager;
- (4) the making of an order by a court of competent jurisdiction for the winding up of a company, the dissolution of a partnership, the

administration of a company or partnership, or the bankruptcy of an individual;

- (5) the approval of a company voluntary arrangement, a partnership voluntary arrangement, or of an individual voluntary arrangement.

6.3.4

R

01.12.01/001

For *claims* arising in connection with *protected investment business*, the FSCS has the additional power to determine that a *relevant person is in default* if it is satisfied that a *protected claim* exists, and:

- (1) the FSCS is satisfied that the *relevant person* cannot be contacted at its last place of business and that reasonable steps have been taken to establish a forwarding or current address, but without success; and
- (2) there appears to the FSCS to be no evidence that the *relevant person* will be able to meet *claims* made against it.

6.3.5

R

01.12.01/001

For *claims* arising in connection with *protected contracts of insurance*, the FSCS must treat any term in an *insurance undertaking's* constitution or in its *contracts of insurance*, limiting the undertaking's liabilities under a *long-term insurance contract* to the amount of its assets, as limiting the undertaking's liabilities to any claimant to an amount which is not less than the gross assets of the undertaking.

6

Compensation

Chapter 7

Assignment of rights

7

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1





7.1 Application

Application and Purpose

7.1.1 **R**
01.12.01/001

This chapter applies to the *FSCS*.

7.1.2 **G**
01.12.01/001

It is also relevant to claimants.

Purpose

7.1.3 **G**
01.12.01/001

The *FSCS* may make an offer of compensation conditional on the assignment of rights to it by a claimant. The purpose of this chapter is to make provision for and set out the consequences of an assignment of the claimant's rights.

7.2 How does the assignment of rights work?

- 7.2.1** **R** 01.12.01/001 The *FSCS* may make any payment of compensation to a claimant in respect of a *protected claim* conditional on the claimant assigning the whole or any part of his rights against the *relevant person*, or against any third party, or both, to the *FSCS* on such terms as the *FSCS* thinks fit.
- 7.2.2** **R** 01.12.01/001 If a claimant assigns the whole or any part of his rights against any *person* to the *FSCS* as a condition of payment, the effect of this is that any sum payable in relation to the rights so assigned will be payable to the *FSCS* and not the claimant.
- 7.2.3** **R** 01.12.01/001 The *FSCS* must make such recoveries as it reasonably can through the rights so assigned.
- 7.2.4** **R** 01.12.01/001 Unless compensation was paid under *COMP 9.2.3R*, if a claimant agrees to assign his rights to the *FSCS* and the *FSCS* subsequently makes recoveries through those rights, those recoveries must be paid to the claimant:
- (1) to the extent that the amount recovered exceeds the amount of compensation (excluding interest paid under *COMP 11.2.7R*) received by the claimant in relation to the *protected claim*; or
 - (2) in circumstances where the amount recovered does not exceed the amount of compensation paid, to the extent that a failure to pay any sums recovered to the claimant would leave a claimant who had promptly accepted an offer of compensation at a disadvantage relative to a claimant who had delayed accepting an offer of compensation (see *COMP 7.2.5R*).
- 7.2.5** **R** 01.12.01/001 The *FSCS* must endeavour to ensure that a claimant will not suffer disadvantage arising solely from his prompt acceptance of the *FSCS*'s offer of compensation compared with what might have been the position had he delayed his acceptance.
- 7.2.6** **G** 01.12.01/001 As an example of the circumstances which *COMP 7.2.5R* is designed to address, take two claimants, A and B.
- (1) Both A and B have a *protected investment business claim* of £60,000 against a *relevant person in default*. The *FSCS* offers both claimants £48,000 compensation (the maximum amount payable for such claims (*COMP*

10.2.3R). A accepts immediately, and assigns his rights against the *relevant person* to the FSCS, but B delays accepting the FSCS's offer of compensation.

- (2) In this example, the liquidator is able to recover assets from the *relevant person in default* and makes a payment of 50p in the pound to all the *relevant person's* creditors. If the liquidator made the payment before any offer of compensation from the FSCS had been accepted, A and B would both receive £30,000 each from the liquidator, leaving both with a loss of £30,000 to be met by the FSCS. Both *claims* would be met in full.
- (3) However, if the payment were made by the liquidator after A had accepted the FSCS's offer of compensation and assigned his rights to the FSCS, but before B accepted the FSCS's offer of compensation, A would be disadvantaged relative to B even though he has received £48,000 compensation from the FSCS. A would be disadvantaged relative to B because he promptly accepted the FSCS's offer and assigned his rights to the FSCS. Because A has assigned his rights to the FSCS, any payment from the liquidator will be made to the FSCS rather than A. In this case the FSCS has paid A more than £30,000 so the £30,000 from the liquidator that would have been payable to A will be payable in full to the FSCS and not to A.
- (4) B is able to exercise his rights against the liquidator because he delayed accepting the FSCS's offer and receives £30,000 from the liquidator. B can then make a *claim* for the remaining £30,000 to the FSCS which the FSCS can pay in full (see COMP 10.2.2R). B therefore suffers no loss whereas A is left with a loss of £12,000, being the difference between his *claim* of £60,000 and the compensation paid by the FSCS of £48,000.

Chapter 8

Rejection of application and withdrawal of offer

8

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8.1 Application and Purpose

Application

8.1.1 **R** This chapter applies to the *FSCS*.

01.12.01/001

8.1.2 **G** It is also relevant to claimants.

01.12.01/001

Purpose

8.1.3 **G** In some circumstances, it may be appropriate for the *FSCS* to reject an application for compensation, or withdraw an offer of compensation. The purpose of this chapter is to set out when those circumstances arise.

01.12.01/001



8.2 Rejection of application for compensation

- 8.2.1** **R** 01.12.01/001 If an application for compensation contains any material inaccuracy or omission, the *FSCS* may reject the application unless this is considered by the *FSCS* to be wholly unintentional.
- 8.2.2** **G** 01.12.01/001 A rejection under *COMP* 8.2.1R does not mean that the claimant cannot receive compensation. A rejected application may be resubmitted, with the appropriate amendments.
- 8.2.3** **R** 01.12.01/001 Unless *COMP* 8.2.4R applies, the *FSCS* must reject an application for compensation if the liability of the *relevant person* to the claimant has been extinguished by the operation of law, or the *FSCS* considers that a civil claim in respect of the liability would have been defeated by a defence of limitation at the earlier of:
- (1) the date the *relevant person* is determined to be *in default*; or
 - (2) the date the claimant first indicates in writing that he may have a claim against the *relevant person*.
- 8.2.4** **R** 01.12.01/001 For *claims* made in connection with *protected investment business*, the *FSCS* may disregard a defence of limitation where the *FSCS* considers that it would be reasonable to do so.



8.3 Withdrawal of offer of compensation

- 8.3.1** **R** 01.12.01/001 The *FSCS* may withdraw any offer of compensation made to a claimant if the offer is not accepted or if it is not disputed within 90 days of the date on which the offer is made.
- 8.3.2** **R** 01.12.01/001 Where the amount of compensation offered is disputed, the *FSCS* may withdraw the offer but must consider exercising its powers to make a reduced or interim payment under *COMP 11.2.4R* or *COMP 11.2.5R* before doing so.
- 8.3.3** **R** 01.12.01/001 The *FSCS* may repeat any offer withdrawn under *COMP 8.3.1R* or *COMP 8.3.2R*.
- 8.3.4** **R** 01.12.01/001 The *FSCS* must withdraw any offer of compensation if it appears to the *FSCS* that no such offer should have been made.
- 8.3.5** **R** 01.12.01/001 The *FSCS* must seek to recover any compensation paid to a claimant if it appears to the *FSCS* that no such payment should have been made, unless the *FSCS* believes on reasonable grounds that it would be unreasonable to do so, or that the costs of doing so would exceed any amount that could be recovered.

Chapter 9

Time limits on payment and postponing payment



9.1 Application and Purpose

Application

9.1.1 **R** This chapter applies to the *FSCS*.

01.12.01/001

9.1.2 **G** It is also relevant to claimants.

01.12.01/001

Purpose

9.1.3 **G** The purpose of this chapter is to ensure that compensation is paid to claimants as quickly as possible and that delays in paying compensation to claimants are kept to a minimum. The *FSCS* may postpone payment of compensation only in strictly limited circumstances.

01.12.01/001

9.2 When must compensation be paid?

9.2.1

R

01.12.01/001

The FSCS must pay a *claim* as soon as reasonably possible after:

- (1) it is satisfied that the conditions in COMP 3.2.1R have been met; and
- (2) it has calculated the amount of compensation due to the claimant;

and in any event within three months of that date, unless the FSA has granted the FSCS an extension, in which case payment must be made no later than six months from that date.

9.2.2

R

01.12.01/001

The FSCS may postpone paying compensation if:

- (1) in the case of a *claim* against a *relevant person* who is an *appointed representative*, the FSCS considers that the claimant should make and pursue an application for compensation against the *appointed representative's principal*; or
- (2) in the case of a *claim* relating to *protected investment business* which is not an *ICD claim*, the FSCS considers that the claimant should first exhaust his rights against the *relevant person* or any third party, or make and pursue an application for compensation to any other *person*; or
- (3) in the case of a *claim* relating to a *protected contracts of insurance*, the FSCS considers that the liability to which the *claim* relates or any part of the liability is covered by another *contract of insurance* with a solvent *insurance undertaking*, or where it appears that a *person*, other than the liquidator, may make payments or take such action to secure the continuity of cover as the FSCS would undertake; or
- (4) the *claim* is one which falls within COMP 12.4.5R or COMP 12.4.7R and it is not practicable for payment to be made within the usual time limits laid out in COMP 9.2.1R; or
- (5) the claimant has been charged with an offence arising out of or in relation to money laundering, and those proceedings have not yet been concluded.

9.2.3

R

01.12.01/001

Notwithstanding COMP 9.2.2R(2), the *FSCS* may pay compensation to a claimant in respect of assets held by a *relevant person* if an insolvency practitioner has been appointed to the *relevant person*, and:

- (1) the *FSCS* considers it likely that the insolvency practitioner would, in due course, return the assets to the claimant;
- (2) the claimant has agreed to be compensated for the assets on the basis of the valuation provided by the *FSCS*; and
- (3) the claimant has agreed, to the satisfaction of the *FSCS*, that his rights to the assets in respect of which compensation is payable should pass to it.

Chapter 10

Limits on the amount of compensation payable

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10.1 Application and Purpose

Application

10.1.1 **R** This chapter applies to the *FSCS*.

01.12.01/001

10.1.2 **G** It is also relevant to claimants.

01.12.01/001

Purpose

10.1.3 **G** In most cases it is appropriate for there to be a limit on the amount of compensation payable by the *FSCS* and that there should be some part of the *claim* which is not compensatable and for which the claimant must bear the loss. The purpose of this chapter is to set these limits out.

01.12.01/001

10.1.4 **G** The chapter also sets out the limit on the level of protection the *FSCS* must seek to secure when the *FSCS* is ensuring that there is continuity of insurance cover.

01.12.01/001

10.2 Limits on compensation payable

10.2.1 **R** The limits on the maximum compensation sums payable by the FSCS for *protected claims* are set out in COMP 10.2.3R.
01.12.01/001

10.2.2 **G** The limits apply to the aggregate amount of *claims* in respect of each category of *protected claim* that an *eligible claimant* has against the *relevant person*. Consequently, a claimant who has, for example, a *claim* against a *relevant person* for a *deposit* of £2,000, and for a further *deposit* of £1,500, will not receive 100% compensation on both *deposits*; instead he will receive £3,350 (100% of the first £2,000 and 90% of the next £1,500). Similarly, if a claimant receives more than one payment in respect of a claim on a *protected contract of insurance*, the claimant will only receive 100% of the first £2,000 of the total paid, and not 100% of the first £2,000 of each payment.
01.12.01/001

10.2.3 **R** Table **Table Limits**
01.12.01/001 This table belongs to COMP 10.2.1R

Type of claim	Level of cover	Maximum payment
Protected deposits	100% x first £2,000 90% x next £33,000	£31,700
Protected contract of insurance when the contract is a relevant general insurance contract	(1) Where the <i>claim</i> is in respect of a <i>liability subject to compulsory insurance</i> : 100% of <i>claim</i> .	Unlimited
	(2) Where the <i>claim</i> arises under the Third Party (Rights against Insurers) Act 1930, is in respect of a liability within COMP 5.4.5R(1)(b), and is in connection with an <i>Article 9 default</i> : 90% of the <i>claim</i> .	Unlimited
Protected contract of insurance when the contract is a long-term insurance contract	(3) In all other cases: 100% x first £2,000 90% of remainder of the <i>claim</i> .	Unlimited
	100% x first £2,000 At least 90% of the remaining value of the policy (including <i>future benefits</i> declared before the date the <i>relevant person</i> is determined to be <i>in default</i>).	Unlimited
Protected investment business	100% x first £30,000 90% x next £20,000	£48,000

10.2.4 **G** COMP 12 sets out the *rules* the FSCS will follow when calculating the amount of compensation payable.
01.12.01/001

10.2.5

G

01.12.01/001

COMP 12.4.1R and COMP 12.4.4R include further limits relating to *DGD claims* and *ICD claims* against certain *incoming EEA firms*. These reflect the *DGD* and *ICD*, under which compensation may be payable by the *incoming EEA firm's Home State* compensation scheme.

Continuity of insurance cover

10.2.6

R

01.12.01/001

The *FSCS's* duty to ensure continuity of cover for any *protected contract of insurance* which is a *long term insurance contract* extends only to ensuring that the claimant will receive 100% of the first £2000 and 90% of the remainder of any *future benefit* under his *contract of insurance*, subject to and in accordance with terms corresponding (so far as it appears to the *FSCS* to be reasonable in the circumstances) to those which have applied under the *contract of insurance*.

10.2.7

R

01.12.01/001

Any future *premiums* that the claimant is committed to paying under the policy will be reduced by an equivalent amount.

Compensation

Chapter 11

Payment of compensation

11

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11.1 Application and Purpose

Application

11.1.1 **R** This chapter applies to the *FSCS*.

01.12.01/001

11.1.2 **G** It is also relevant to claimants.

01.12.01/001

Purpose

11.1.3 **G** The *FSCS* will usually pay compensation direct to the claimant, but in certain circumstances it may be appropriate for the *FSCS* to pay compensation to someone other than the claimant, or to make reduced or interim payments. The purpose of this chapter is to set out when those circumstances arise.

01.12.01/001



11.2 Payment

To whom must payment be made?

11.2.1 **R**
01.12.01/001

If the *FSCS* determines that compensation is payable, it must pay it to the claimant, or as directed by the claimant, unless:

- (1) arrangements have or are being made to secure continuity of insurance under *COMP 3.3.1R* and *COMP 3.3.2R* or the *FSCS* is taking measures it considers appropriate under *COMP 3.3.3R* to *COMP 3.3.6R*; or
- (2) *COMP 11.2.2R* or *COMP 11.2.3R* applies.

11.2.2 **R**
01.12.01/001

Where a claimant has a *protected claim* arising out of the circumstances described in *COMP 12.4.5R*, the *FSCS* must pay any compensation to:

- (1) the trustee of an *occupational pension scheme*; or
- (2) a *personal pension scheme* or other *product provider*; or
- (3) both (1) and (2);

and not to the claimant, unless exceptional circumstances apply.

11.2.3 **R**
01.12.01/001

Where an *eligible claimant* has a *claim* under a *protected contract of insurance* against a *relevant person* that is in provisional liquidation or liquidation, the *FSCS* may, unless arrangements have or are being made to secure continuity of insurance under *COMP 3.3.1R* and *COMP 3.3.2R* or the *FSCS* is taking measures it considers appropriate under *COMP 3.3.3R* to *COMP 3.3.6R*:

- (1) make payments to or on behalf of *eligible claimants* on such terms (including any terms requiring repayment in whole or in part) and on such conditions as it thinks fit (subject to *COMP 10*); or
- (2) secure that payments (subject to *COMP 10*) are made to or on behalf of any such *eligible claimants* by the liquidator or

provisional liquidator by giving him an indemnity covering any such payments or any class or description of such payments.

Reduced or interim payments

11.2.4 **R**
01.12.01/001

If the *FSCS* is satisfied that in principle compensation is payable, but considers that immediate payment in full would not be prudent because of uncertainty as to the amount of the claimant's overall net *claim*, it may decide to pay an appropriate lesser sum in final settlement, or to make payment on account.

11.2.5 **R**
01.12.01/001

The *FSCS* may also decide to make a payment on account or to pay a lesser sum in final settlement if the claimant has any reasonable prospect for recovery in respect of the *claim* from any third party or by applying for compensation to any other *person*.

11.2.6 **R**
01.12.01/001

The *FSCS* may not pay a lesser sum in final settlement under *COMP 11.2.4R* and *COMP 11.2.5R* where the *claim* is a *DGD claim* or *ICD claim*.

Paying interest on compensation

11.2.7 **R**
01.12.01/001

The *FSCS* may pay interest on the compensation sum in such circumstances as it considers appropriate.

11.2.8 **R**
01.12.01/001

Interest under *COMP 11.2.7R* is not to be taken into account when applying the limits on the compensation sum payable in respect of a *claim* under *COMP 10*.

Compensation

Chapter 12

Calculating compensation

12

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1





12.1 Application and Purpose

Application

12.1.1 **R**
01.12.01/001

This chapter applies to the *FSCS*.

12.1.2 **G**
01.12.01/001

This chapter is also relevant to claimants, since it sets out how a *claim* will be quantified. (For the process of paying compensation, including the limits on the amount of compensation that can be paid, see *COMP 8 – COMP 11*).

Purpose

12.1.3 **G**
01.12.01/001

The purpose of this chapter is to set out the different ways in which the *FSCS* is to calculate compensation.



12.2 Quantification: general

12.2.1 **R**
01.12.01/001

The amount of compensation payable to the claimant in respect of any type of *protected claim* is the amount of his overall net *claim* against the *relevant person* at the *quantification date*.

12.2.2 **R**
01.12.01/001

COMP 12.2.1R is, however, subject to the other provisions of COMP, in particular those *rules* that set limits on the amount of compensation payable for various types of *protected claim*. The limits are set out in COMP 10.

12.2.3 **G**
01.12.01/001

Where a liability of a *relevant person* to an *eligible claimant* could fall within more than one type of *protected claim* (see COMP 5.2.1R), for example a *claim* in connection with *money* held by an *ISD investment firm* that is also a *credit institution*, the FSCS should seek to ensure that the claimant does not receive any further compensation payment from the FSCS in cases where the claimant has already received compensation from the FSCS in respect of that *claim*.

Overall net claim

12.2.4 **R**
01.12.01/001

A claimant's overall net *claim* is the sum of the *protected claims* of the same category that he has against a *relevant person in default*, less the amount of any liability which the *relevant person* may set off against any of those *claims* (see COMP 10.2.2G).

12.2.5 **G**
01.12.01/001

For the different categories of *protected claim*, see COMP 5 and COMP 10.2.3G.

12.2.6 **G**
01.12.01/001

In calculating the claimant's overall net *claim*, the FSCS may rely, to the extent that it is relevant, on any determination by:

- (1) a court of competent jurisdiction;
- (2) a trustee in bankruptcy;
- (3) a liquidator;
- (4) any other recognised insolvency practitioner;

and on the certification of any net sum due which is made in default proceedings of any exchange or clearing house.

12.2.7 **R**
01.12.01/001

In calculating the claimant's overall net *claim*, the FSCS must take into account any payments to the claimant (including amounts recovered by the FSCS on behalf of the claimant) made by the

relevant person or any other *person*, if that payment is connected with the *relevant person's* liability to the claimant.



12.3 Quantification date

Protected deposits

- 12.3.1** R For a *protected deposit claim*, the *quantification date* is the date the *relevant person* is determined to be *in default*, or the date the *protected deposit* was due and payable, if later.

01.12.01/001

Protected contracts of insurance

- 12.3.2** R For a *claim* under a *protected contract of insurance* that is a *long-term insurance contract*, the FSCS must determine as the *quantification date* a specific date by reference to which the liability of the *relevant person* to the *eligible claimant* is to be determined.
- 12.3.3** R For a claim under a *protected contract of insurance* that is a *relevant general insurance contract*, the FSCS must determine as the *quantification date* a specific date by reference to which the liability of the *relevant person* to the *eligible claimant* is to be determined.
- 12.3.4** R For a *claim* in respect of the unexpired *premiums* under a *protected contract of insurance* that is a *relevant general insurance contract* (see COMP 5.4.7R(3)), the *quantification date*, being the date by which the liability of the *relevant person* to the *eligible claimant* is to be determined, is the date the policy was terminated or cancelled.

01.12.01/001

01.12.01/001

01.12.01/001

Protected investment business

- 12.3.5** R For a *claim* made in connection with *protected investment business* which is not an *ICD claim*, the FSCS must determine a specific date as the *quantification date*, and this date may be either on, before or after the date of the determination of default.
- 12.3.6** R For a *claim* made in connection with *protected investment business* which is an *ICD claim*, the *quantification date* is the date the *relevant person* is determined to be *in default*.

01.12.01/001

01.12.01/001



12.4 The compensation calculation

Protected deposit with incoming EEA firm

12.4.1 **R**
01.12.01/001

If the claimant has a *DGD claim* against an *incoming EEA firm* which is a *credit institution*, the *FSCS* must take account of the liability of the *Home State* deposit-guarantee scheme in calculating the compensation payable by the *FSCS*.

Protected investment business: general

12.4.2 **R**
01.12.01/001

The *FSCS* may pay compensation for any *claim* made in connection with *protected investment business* which is not:

- (1) a *claim* for property held; or
- (2) a *claim* arising from transactions which remain uncompleted at the *quantification date*;

only to the extent that the *FSCS* considers that the payment of compensation is essential in order to provide the claimant with fair compensation.

12.4.3 **R**
01.12.01/001

The *FSCS* must not pay compensation for any *claim* in connection with *protected investment business* to the extent that it relates to or depends on:

- (1) a failure of investment performance to match a guarantee given or representation made; or
- (2) a contractual obligation to pay or promise to pay which the *FSCS* considers to have been undertaken without full consideration passing to the *relevant person* or in anticipation of possible insolvency; or
- (3) the mere fluctuation in the value of an *investment*.

12.4.4 **R**
01.12.01/001

If the claimant has an *ICD claim* against an *incoming EEA firm* which is an *ISD investment firm* (including a *credit institution* which is an *ISD investment firm*), the *FSCS* must take account of the

liability of the *Home State* compensation scheme in calculating the compensation payable by the *FSCS*.

Protected investment business: claims covered by the pensions review

12.4.5

R

01.12.01/001

If the claimant has a *claim* in connection with *protected investment business* relating to the fact that the claimant has:

- (1) while eligible or reasonably likely to become eligible to be a member of an *occupational pension scheme*, instead become a member of a *personal pension scheme* or entered into a *retirement annuity*; or
- (2) ceased to be a member of, or to pay contributions to, an *occupational pension scheme*, and has instead become a member of a *personal pension scheme* or entered into a *retirement annuity*; or
- (3) transferred to a *personal pension scheme* accrued rights under an *occupational pension scheme* which is not a defined contribution (money purchase) scheme; or
- (4) ceased to be a member of an *occupational pension scheme* and has instead (by virtue of such a provision as is mentioned in section 591(2)(g) of the Income and Corporation Taxes Act 1988) entered into arrangements for securing relevant benefits by means of an annuity;

the *FSCS* must take the steps set out in *COMP 12.4.6R*.

12.4.6

R

01.12.01/001

If *COMP 12.4.5R* applies, the *FSCS* must follow the Specification of Standards and Procedures issued by the *FSA* in October 1994, as supplemented and modified by subsequent guidance issued by the *FSA* (in particular, that of November 1996) (the ‘Specification’) in:

- (1) assessing whether a *relevant person* has complied with the relevant regulatory requirements;
- (2) assessing whether non-compliance has caused the claimant loss; and
- (3) calculating the amount of compensation due (where the *FSCS* may rely on calculations made by the *FSA* or any previous regulator of the *relevant person*);

unless the *FSCS* considers that departure from the Specification is essential in order to provide the claimant with fair compensation.

Protected investment business: FSAVC Review

12.4.7

R

01.12.01/001

Where a *claim* made in connection with *protected investment business* relates to an Additional Voluntary Contribution policy advised on or arranged by a *relevant person*, the FSCS must follow the FSAVC Review Model Guidance issued by the FSA in May 2000 (the "Guidance") in:

- (1) assessing whether the *relevant person* has complied with the relevant regulatory requirements;
- (2) assessing whether non-compliance has caused the claimant loss; and
- (3) calculating the compensation due (where the FSCS may rely on calculations made by the FSA or any previous regulator of the *relevant person*);

unless the FSCS considers that departure from the Guidance is essential in order to provide the claimant with fair compensation.

Protected investment business: excessive benefits

12.4.8

R

01.12.01/001

The FSCS may decide to reduce the compensation that would otherwise be payable for a *claim* made in connection with *protected investment business* that is not an *ICD claim*, if it is satisfied that:

- (1) there is evidence of contributory negligence by the claimant; or
- (2) payment of the full amount would provide a greater benefit than the claimant might reasonably have expected or than the benefit available on similar *investments* with other *relevant persons*; and

it would be inequitable for the FSCS not to take account of (1) or (2).

Protected contracts of insurance: liabilities subject to compulsory insurance

12.4.9

R

01.12.01/001

The FSCS must pay a sum equal to 100% of any liability of a *relevant person* who is an *insurance undertaking* in respect of a *liability subject to compulsory insurance* to the claimant as soon as reasonably practicable after it has determined the *relevant person* to be *in default*.

Protected contracts of insurance: general insurance

12.4.10

R

01.12.01/001

The FSCS must calculate the liability of a *relevant person* to the claimant under a *relevant general insurance contract* in accordance

with the terms of the contract, and (subject to any limits in COMP 10.2.3R) pay that amount to the claimant.

Protected contracts of insurance: long-term insurance

12.4.11 **R**
01.12.01/001

Unless the FSCS is making arrangements to secure continuity of insurance cover under COMP 3.3.1R and COMP 3.3.2R, the FSCS must calculate the liability of a *relevant person* to the claimant under a *long-term insurance contract* in accordance with the terms of the contract as valued in a liquidation of the *relevant person*, or (in the absence of such relevant terms) in accordance with such reasonable valuation techniques as the FSCS considers appropriate, and (subject to any limits in COMP 10.2.3R and to COMP 12.4.12R to COMP 12.4.14R) pay that amount to the claimant.

12.4.12 **R**
01.12.01/001

The FSCS must not treat any bonus provided under a *long term insurance contract* as part of the claimant’s claim unless it was declared before the beginning of the liquidation.

12.4.13 **R**
01.12.01/001

If the FSCS considers that the benefits or *future benefits* provided for under a protected *long term insurance contract* issued by a *relevant person* are or may be excessive in any respect, having regard to the *premiums* paid or payable and to any other terms of the contract, the FSCS must refer the contract to an actuary who is independent of the claimant and of the *relevant person in default*.

12.4.14 **R**
01.12.01/001

If the FSCS is satisfied, following the actuary’s written recommendation, that any of the benefits provided for under the contract are or may be excessive, it may treat the liability of the *relevant person* under the contract as reduced or (as the case may be) disregarded.

12.4.15 **R**
01.12.01/001

The FSCS may rely on the value attributed to the contract by the actuary when calculating the compensation payable to the claimant, or when securing continuity of cover.

12.4.16 **R**
01.12.01/001

For *claims* arising in connection with *protected contracts of insurance*, the FSCS must treat any term in an *insurance undertaking’s* constitution or in its *contracts of insurance*, limiting the undertaking’s liabilities under a *long-term insurance contract* to the amount of its assets, as limiting the undertaking’s liabilities to any claimant to an amount which is not less than the gross assets of the undertaking.



12.5 Quantification when the FSCS is seeking to secure continuity of insurance cover

12.5.1

R

01.12.01/001

In any period when the FSCS is seeking to secure continuity of cover for any policyholder of a *relevant person*, the FSCS must secure that 100% of the first £2,000 and 90% of the remainder of any *future benefit* under a *long term insurance contract* which would have fallen due to be paid to any policyholder during that period, is paid to the policyholder in question as soon as reasonably practicable after the time when the benefit in question would have fallen due under the contract (but subject to and in accordance with any other terms which would have applied under the contract).

12.5.2

R

01.12.01/001

A bonus provided under a *contract of insurance* is not a *future benefit* for the purposes of COMP 12.5.1R unless it was declared before the beginning of the liquidation.



12.6 Quantification: trustees, personal representatives, agents, and joint claims

Trustees

- 12.6.1** **R** 01.12.01/001 If a claimant’s *claim* includes a *claim* as trustee, the *FSCS* must treat him in respect of that *claim* as if his *claim* as trustee were a *claim* of a different *person*.
- 12.6.2** **R** 01.12.01/001 If a claimant has a *claim* as a bare trustee for one or more beneficiaries, the *FSCS* must treat the beneficiary or beneficiaries as having the *claim*, and not the claimant.
- 12.6.3** **R** 01.12.01/001 If any group of *persons* has a *claim* as trustees, the *FSCS* must treat them as a single and continuing *person* distinct from the *persons* who may from time to time be the trustees.
- 12.6.4** **R** 01.12.01/001 Where the same *person* has a *claim* as trustee for different trusts, *COMP* applies as if the *claims* relating to each of these trusts were *claims* of different *persons*.
- 12.6.5** **R** 01.12.01/001 Where the claimant is a trustee, and some of the beneficiaries of the trust are *persons* who would not be *eligible claimants* if they had a claim themselves, the *FSCS* must adjust the amount of the overall net *claim* to eliminate the part of the claim which, in the *FSCS*’s view, is a claim for those beneficiaries.
- 12.6.6** **R** 01.12.01/001 Where *COMP* 12.6.1R to *COMP* 12.6.5R apply, the *FSCS* must try to ensure that any compensation paid to the trustee:
- (1) is for the benefit of beneficiaries who would be *eligible claimants* if they had a *claim* themselves; and
 - (2) does not exceed the amount of the loss suffered by those beneficiaries.
- 12.6.7** **R** 01.12.01/001 Where a *person A* is entitled (whether as trustee or otherwise) to a *deposit* made out of a clients’ or other similar account containing money to which one or more *persons* are entitled, the *FSCS* must treat each of those other persons, and not *A*, as entitled to the part of

the *deposit* that corresponds to the proportion of the money in the account to which the other person is entitled.

Personal representative

12.6.8 **R**
01.12.01/001

Where a *person* numbers among his *claims* a *claim* as the personal representative of another, the *FSCS* must treat him in respect of that *claim* as if he were standing in the shoes of that other *person*.

Agents

12.6.9 **R**
01.12.01/001

If a claimant has a *claim* as agent for one or more *principals*, the *FSCS* must treat the *principal* or *principals* as having the *claim*, not the claimant.

Joint claims

12.6.10 **R**
01.12.01/001

If two or more *persons* have a joint beneficial *claim*, the *claim* is to be treated as a *claim* of the partnership if they are carrying on business together in partnership. Otherwise each of those *persons* is taken to have a *claim* for his share, and in the absence of satisfactory evidence as to their respective shares, the *FSCS* must regard each *person* as entitled to an equal share.

Foreign law

12.6.11 **R**
01.12.01/001

In applying *COMP* to *claims* arising out of business done with a *branch* or establishment of the *relevant person* outside the *United Kingdom*, the *FSCS* must interpret references to *persons* entitled as personal representatives, trustees, bare trustees or agents, or references to *persons* having a joint beneficial *claim* or carrying on business in partnership, as references to *persons* entitled, under the law of the relevant country or territory, in a capacity appearing to the *FSCS* to correspond as nearly as may be to that capacity.

COMP 13 Ann 1R: Management Expenses Levy Limit

1 This table belongs to *COMP* 13.5.2R

2 **Table**

Period	Limit on total of all management expenses levies attributable to that period
1 December 2001 to 1 April 2002	£4,209,000

Compensation

Chapter 13

Funding





13.1 Application and Purpose

Application

13.1.1 R
01.12.01/001

This chapter applies to:

- (1) every *participant firm*; and
- (2) the *FSCS*.

13.1.2 G
01.12.01/001

Firms which are not *participant firms* (such as certain types of *incoming EEA firms*, *service companies* and *ICVCs*) are not required to contribute towards the funding of the *compensation scheme*.

Purpose

13.1.3 G
01.12.01/001

The purpose of this chapter is to set out the requirements on *participant firms* to pay levies imposed by the *FSCS* to provide funding for its functions.

13.2 General structure

- 13.2.1** G Section 213(3)(b) of the *Act* requires the *FSA* to make rules to enable the *FSCS* to impose levies on *authorised persons* in order to meet its expenses. These expenses include in particular expenses incurred, or expected to be incurred, in paying compensation, borrowing or insuring risks.
01.12.01/001
- 13.2.2** G The *FSCS* may impose two types of levy: a *management expenses levy*, and a *compensation costs levy*. In the first three full years of the operation of the *compensation scheme*, the *FSCS* may impose an *establishment costs levy* as part of a *management expenses levy*. The *FSCS* has discretion as to the timing of the levies imposed.
01.12.01/001
- 13.2.3** G In calculating a *compensation costs levy*, the *FSCS* may include anticipated *compensation costs* for defaults expected to be determined in the 12 month period following the date of the levy. The total of all *management expenses levies* attributable to a financial year will be restricted to the amount set out on an annual basis in COMP 13 Ann 1R.
01.12.01/001
- 13.2.4** G In order to allocate a share of the amount to be funded by an individual *participant firm*, the funding arrangements are split into three *sub-schemes*: the accepting deposits *sub-scheme*, the insurance business *sub-scheme*, and the designated investment business *sub-scheme*. The business carried on by a *participant firm* determines into which *sub-scheme*, or *sub-schemes*, it falls.
01.12.01/001
- 13.2.5** G Within each *sub-scheme* there are one or more *contribution groups*. These relate to different types of activity carried on by *participant firms* within each *sub-scheme*. Within a *sub-scheme*, individual *participant firms* are allocated for funding purposes to one or more *contribution groups*, depending on their business activities. This meets a requirement of section 213(5) of the *Act* that the *FSA*, in making rules to enable the *FSCS* to impose levies, must take account of the desirability of ensuring that the amount of the levies imposed on a particular class of *authorised person* reflects, so far as practicable, the amount of claims made, or likely to be made, in respect of that class of person.
01.12.01/001
- 13.2.6** G Section 223 of the *Act* (Management expenses) prevents the *FSCS* from recovering, through a levy, any *management expenses* attributable to a particular period in excess of the limit set in *COMP* as applicable to that period. ‘Management expenses’ are defined in section 223(3) to mean expenses incurred or expected to be incurred by the *FSCS* in connection with its functions under the *Act*, except:
01.12.01/001

The management expenses levy

- (1) expenses incurred in paying compensation; and

- (2) expenses incurred as a result of the FSCS making the arrangements to secure continuity of insurance set out in COMP 3.3.1R and COMP 3.3.2R or taking the measures set out in COMP 3.3.3R and COMP 3.3.4 when a *relevant person* is an *insurer* in financial difficulties..

13.2.7

01.12.01/001

A *management expenses levy* under COMP may consist of three elements. The first is a *base costs levy* for the ‘base costs’ of running the *compensation scheme* in a financial year – that is, costs which are not dependent upon the level of activity of the *compensation scheme* and which therefore are not referable to any specific default. Included in this category are items such as the salary of the members of the board of the FSCS, the costs of the premises which the FSCS occupies, and its audit fees. The amount that each *participant firm* pays towards a *base costs levy* is calculated by reference to the *regulatory costs* paid by the *firm*. All *participant firms* are liable to contribute towards a *base costs levy*.

13.2.8

01.12.01/001

The second element of a *management expenses levy* is a *specific costs levy* for the ‘specific costs’ of running the *compensation scheme* in a financial year. These costs depend on the number of claims and types of default, and include the salaries of the staff of the FSCS and legal and other professional fees paid in respect of particular defaults. The specific costs are allocated to the *contribution group* or groups of which the *relevant person in default* was a member, or which is responsible for those costs under COMP, on the basis of the *protected claims* against that *person*. The FSCS may include in a *specific costs levy* the specific costs that the FSCS expects to incur (including in respect of defaults not yet declared at the date of the levy) during the financial year of the *compensation scheme* to which the levy relates. The amount that each *participant firm* pays towards the *specific costs levy* is calculated by reference to the amount of business conducted by the *firm* in each of the *contribution groups* to which the FSCS has allocated specific costs. Each *contribution group* has a separate ‘tariff base’ for this purpose, set out in COMP 13.6.7R. *Participant firms* may be exempt from contributing to the *specific costs levy*.

13.2.9

01.12.01/001

The third element of a *management expenses levy* is the costs of establishing the FSCS. The FSCS may impose an *establishment costs levy* only until the end of the third full financial year of operation of the *compensation scheme*. The amount that each *participant firm* pays towards the *establishment costs levy* is calculated on the same basis as the *base costs levy*, and all *participant firms* are liable to contribute.

13.2.10

01.12.01/001

The FSA intends to consult in January each year on the amount which it will set as the limit on the *management expenses* attributable to the forthcoming financial year of the FSCS.

The compensation costs levy

13.2.11

01.12.01/001

The *compensation costs levy* is made up of the *compensation costs* which the FSCS has incurred and has not yet recovered from *participant firms* (less any recoveries it has made using the rights that have been assigned to it), together with those *compensation costs* it expects to incur (including in respect of defaults yet to be declared) over the 12 months following the date of the levy.

13.2.12

01.12.01/001

Compensation costs are the costs incurred in paying compensation, securing continuity of long-term insurance and safeguarding eligible claimants when insurers are in financial difficulties. For funding purposes, these costs are allocated by the FSCS, and met by *participant firms*, in the same way as specific costs: see COMP 13.6.6R.

13.2.13 G
01.12.01/001

If a *participant firm* is a member of more than one *contribution group*, the total *compensation costs levy* and *specific costs levy* for that firm will be the aggregate of the individual levies calculated for the firm in respect of each of the *contribution groups*.

Incoming EEA firms

13.2.14 G
01.12.01/001

Incoming EEA firms which top up under the provisions of COMP 14 are *firms* whose *Home State* scheme provides compensation cover in the event that they are determined to be in default. Under COMP 13.7, the FSCS is required to consider whether *incoming EEA firms* should receive a discount on the amount that they would otherwise pay as their share of the levy, to take account of the availability of their *Home State* cover. The amount of any discount is recoverable from the other members of the *incoming EEA firm's contribution group*.

13.3 Exemption

- 13.3.1** **R** 01.12.01/001 A *participant firm* which does not conduct business that could give rise to a *protected claim* by an *eligible claimant* and has no reasonable likelihood of doing so is exempt from a *specific costs levy*, or a *compensation costs levy*, or both, provided that it notifies the FSCS of this fact and the notice remains current.
- 13.3.2** **R** 01.12.01/001 A notice under COMP 13.3.1R must be given:
- (1) by 28 February 2002, in which case it will remain current until 31 March 2003; or
 - (2) as soon as practicable after the time of its authorisation by the FSA, in which case it will remain current until the end of the financial year of the *compensation scheme* in which it is given; or
 - (3) as soon as practicable after it ceases to conduct business that could give rise to a *protected claim* by an *eligible claimant*, in which case it will remain current until the end of the financial year of the *compensation scheme* in which it is given; or
 - (4) unless (1) applies, in February of each financial year of the *compensation scheme*, in which case the notice will remain current until the end of the next financial year.
- 13.3.3** **G** 01.12.01/001
- (1) A notice under COMP 13.3.1R will be renewable every 12 months.
 - (2) The financial year of the *compensation scheme* is the twelve months ending on 31 March.
- 13.3.4** **R** 01.12.01/001 A *participant firm* which is exempt under COMP 13.3.1R must notify the FSCS as soon as reasonably practicable if the conditions in COMP 13.3.1R no longer apply.
- 13.3.5** **G** 01.12.01/001 A *participant firm* to which the conditions in COMP 13.3.1R no longer apply will then become subject to COMP 13.4, 13.6, and 13.8
- 13.3.6** **R** 01.12.01/001 If, during the course of a financial year of the *compensation scheme*, a *participant firm* ceases to conduct business that could give rise to a *protected claim* by an *eligible claimant* and notifies the FSCS of this under COMP 13.3.2R(3), it will be treated as a *participant firm* to which COMP 13.8.7R applies until the end of the financial year.

13.4 The FSCS's power to impose levies

General limits on levies

- 13.4.1** **R** 01.12.01/001 The FSCS may at any time impose a *management expenses levy* or a *compensation costs levy*, provided that the FSCS has reasonable grounds for believing that the funds available to it to meet relevant expenses are, or will be, insufficient, taking into account:
- (1) in the case of a *management expenses levy*, the level of the FSCS's anticipated expenditure in respect of those expenses in the financial year of the *compensation scheme* in relation to which the levy is imposed; and
 - (2) in the case of a *compensation costs levy*, the level of the FSCS's anticipated expenditure in respect of *compensation costs* in the 12 months following the levy.
- 13.4.2** **G** 01.12.01/001 The calculation of levies will also take into account previous levies, where funds raised in anticipation of meeting liabilities prove either more or less than the amount actually required.
- 13.4.3** **G** 01.12.01/001 The FSCS may impose one or more levies in a financial year to meet either its *management expenses* or its *compensation costs*. The FSCS may also impose interim levies, as part of its overall levy commitment. This flexibility allows the FSCS to phase its financing over the course of a financial year and thus avoid collecting levies from firms before the money is actually needed. The FSCS has committed itself in the Memorandum of Understanding with the FSA (the text of which can be found on the FSA website www.fsa.gov.uk) to publish regularly an indicative timetable for its levy procedures
- 13.4.4** **G** 01.12.01/001 The discretion over levying in COMP also gives the FSCS, if it thinks this appropriate, the ability to use third parties as its agents in raising and collecting the levies.

Limits on compensation costs levies on sub-schemes

- 13.4.5** **R** 01.12.01/001 The FSCS must not require a *participant firm* in the accepting deposits *sub-scheme* to pay a share of a *compensation costs levy* allocated to that *sub-scheme* to the extent that:

- (1) the share in question; plus
- (2) all previous amounts paid by the firm either as its share of levies allocated to that *sub-scheme*, or under the *Deposit Protection Scheme* (deducting from those amounts any amount refunded under COMP 13.4.17R - COMP 13.4.18R or by the *Deposit Protection Scheme*);

amounts to more than 0.3% of the firm's *protected deposits*.

13.4.6 **R**
01.12.01/001
The FSCS must not require a *participant firm* in the insurance business *sub-scheme* to pay a share of a *compensation costs levy* allocated to that *sub-scheme* in any financial year of the *compensation scheme*, to the extent that the share in question, together with all previous amounts paid by the *firm* as its share of *compensation costs levies* allocated to that *sub-scheme* in that financial year, amounts to more than 0.8% of the *participant firm's relevant net premium income*.

13.4.7 **R**
01.12.01/001
The maximum amount of *compensation costs* for which the FSCS can levy the designated investment business *sub-scheme* in any one financial year of the *compensation scheme* is limited to £400 million.

Levy for compensation costs paid in error

13.4.8 **R**
01.12.01/001
The FSCS may include in a *compensation costs levy* the costs of compensation paid by the FSCS in error, provided that the payment was made in good faith.

Management of funds

13.4.9 **R**
01.12.01/001
The FSCS must hold any amount collected from a *specific costs levy* or *compensation costs levy* to the credit of the *sub-schemes* and relevant *contribution groups*, in accordance with the allocation established under COMP 13.5.6R and COMP 13.6.2R.

13.4.10 **R**
01.12.01/001
Any funds received by the FSCS by way of levy or otherwise for the purposes of the *compensation scheme* are to be managed as the FSCS considers appropriate, and in doing this the FSCS must act prudently.

13.4.11 **R**
01.12.01/001
Interest earned by the FSCS in the management of funds held to the credit of a *contribution group* must be credited to that *contribution group*, and must be set off against the *management expenses* allocated to that *contribution group*.

13.4.12 **R**
01.12.01/001
The FSCS must keep accounts which show:

- (1) the funds held to the credit of each *sub-scheme* and relevant *contribution group*; and
- (2) the liabilities of that *sub-scheme* and relevant *contribution group*.

13.4.13 **R**
01.12.01/001

The FSCS may use the money collected from firms within one *sub-scheme* to pay *compensation costs* in respect of any *contribution group* within that *sub-scheme*, so long as it ensures that this is done without prejudice to the *participant firms* from whom the money has been collected.

13.4.14 **G**
01.12.01/001

COMP 13.4.13R means that, for example:

- (1) when crediting interest under COMP 13.4.11R, the FSCS should regard any money collected from one *contribution group* which has been used to pay the *compensation costs* of another *contribution group* within the same *sub-scheme* as standing to the credit of the first *contribution group*; and
- (2) the FSCS should not raise a levy under COMP 13.4.1R on a *contribution group* solely because, as a result of the FSCS's action under COMP 13.4.13R, there appear to be insufficient funds available to the credit of the *contribution group* to meet its expenses.

13.4.15 **R**
01.12.01/001

- (1) The FSCS may use any money held to the credit of one *sub-scheme* (the 'creditor *sub-scheme*') to pay compensation costs in respect of another *sub-scheme* (the 'debtor *sub-scheme*') if the FSCS has reasonable grounds to believe that this would be more economical than borrowing funds from a third party or raising a levy.
- (2) Where the FSCS acts in accordance with (1), it must ensure that:
 - (a) the creditor *sub-scheme* is reimbursed by the debtor *sub-scheme* as soon as possible;
 - (b) the debtor *sub-scheme* pays interest at a rate equivalent to the Bank of England's repo rate from time to time in force; and
 - (c) the amount lent by the creditor *sub-scheme* to the debtor *sub-scheme* is taken into account by the FSCS when considering whether to impose a *compensation costs levy* on the creditor *sub-scheme* under COMP 13.4.1R.

13.4.16 **R**
01.12.01/001

Unless COMP 13.4.17R applies, any recoveries made by the FSCS in relation to *protected claims* must be credited to the *contribution groups* to which the related *compensation costs* were allocated.

PAGE
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13.4.17 **R**
01.12.01/001

If the FSCS makes recoveries in relation to *protected claims* where the related *compensation costs* were allocated to the accepting deposits *sub-scheme*, or in relation to compensation paid out of a special contribution under the *Deposit Protection Scheme*, and if the FSCS refunds the recoveries under COMP 13.4.18R, it must ensure that, as far as possible, the recoveries are refunded to the *firms* that

contributed to the relevant *compensation costs levy* or special contribution (whether or not the *firms* are *participant firms* at the time that the recoveries are made).

13.4.18 **R**
01.12.01/001

If the FSCS has more funds to the credit of a *contribution group* than the FSCS believes will be required to meet levies on that *contribution group* for the next 12 months, it may refund the surplus to members or former members of the *contribution group* on any reasonable basis.

Adjustments to calculation of levy shares

13.4.19 **R**
01.12.01/001

The FSCS may adjust the calculation of a *participant firm's* share of any levy to take proper account of:

- (1) any excess, not already taken into account, between previous levies of that type imposed in relation to previous periods and the relevant costs actually incurred in that period; or
- (2) *participant firms* that are exempt from the levy under COMP 13.3; or
- (3) amounts that the FSCS has not been able to recover from *participant firms* as a result of COMP 13.4.5R or COMP 13.4.6R; or
- (4) amounts that the FSCS has not been able to recover from *participant firms* after having taken reasonable steps; or
- (5) COMP 13.5.8R (New *participant firms*), COMP 13.4.20R (Remission of levy) or COMP 13.7 (*Incoming EEA firms*); or
- (6) anything else that the FSCS believes on reasonable grounds should be taken into account.

Remission of levy

13.4.20 **R**
01.12.01/001

If a *participant firm's* share of a levy would be an amount so small that, in the opinion of the FSCS, the costs of collection would be disproportionate to the amount received, the FSCS may treat the *participant firm* as if the share amounted to zero.

13.5 Management expenses

Obligation on participant firm to pay

- 13.5.1** **R** *A participant firm must pay to the FSCS a share of each management expenses levy.*

01.12.01/001

Limit on management expenses

- 13.5.2** **R** *The total of all management expenses levies attributable to a particular period of the compensation scheme may not exceed the limit applicable to that period set out in COMP 13 Ann 1R.*

01.12.01/001

Participant firm's share

- 13.5.3** **R** *A participant firm's share of a management expenses levy consists of one or more of:*

01.12.01/001

- (1) a share of a *base costs levy*; and
- (2) a share of a *specific costs levy*; and
- (3) a share of an *establishment costs levy*.

- 13.5.4** **R** *The FSCS must ensure that each participant firm's share of a management expenses levy separately identifies the firm's share of the base costs levy, specific costs levy and establishment costs levy.*

01.12.01/001

Base costs levy

- 13.5.5** **R** *Unless COMP 13.4.19R applies, the FSCS must calculate a participant firm's share of a base costs levy by:*

01.12.01/001

- (1) identifying the *base costs* which the FSCS has incurred, or expects to incur, in the relevant financial year of the *compensation scheme*, but has not yet levied;

- (2) calculating the amount of the *participant firm's regulatory costs* as a proportion of the total *regulatory costs* relating to all *participant firms* for the relevant financial year; and
- (3) applying the proportion calculated in (2) to the figure in (1).

Specific costs levy

13.5.6 **R**
01.12.01/001

The FSCS must allocate any *specific costs levy* amongst the *sub-schemes* and relevant *contribution groups* in proportion to the volume of relevant costs arising from, or expected to arise from, claims in respect of the different activities represented by those *contribution groups*.

13.5.7 **R**
01.12.01/001

The FSCS must calculate a *participant firm's* share of a *specific costs levy* (subject to COMP 13.4.19R) by:

- (1) identifying each of the *sub-schemes* and relevant *contribution groups* within those *sub-schemes* to which the *participant firm* belongs, using the statement of business most recently supplied under COMP 13.6.11R;
- (2) identifying the *management expenses* other than *base costs* or *establishment costs* which the FSCS has incurred, or expects to incur, in the relevant financial year of the *compensation scheme*, allocated to the *contribution groups* identified in (1), but not yet levied;
- (3) calculating, in relation to each relevant *contribution group*, the *participant firm's* tariff base as a proportion of the total tariff base of all *participant firms* in the *contribution group*, using the statement of business most recently supplied under COMP 13.6.11R;
- (4) applying the proportion calculated in (3) to the figure in (2); and
- (5) if more than one *sub-scheme* or *contribution group* is relevant, adding together the figure in (4) for each *contribution group*.

New participant firms

13.5.8 **R**
01.12.01/001

A *firm* which becomes a *participant firm* part way through a financial year of the *compensation scheme* will not be liable to pay a share of a *specific costs levy* made in that year.

13.5.9 **G**
01.12.01/001

New *participant firms* will normally have relevant tariff bases of nil as at 31 December in the financial year preceding that in which they join, so that they will not be required to pay a share of a *specific costs levy* (or a *compensation costs levy*

because of COMP 13.6.6). COMP 13.5.8 means that that the FSCS does not have to estimate the tariff base of a new *participant firm*.

13.5.10**G**

01.12.01/001

Since a *firm* that becomes a *participant firm* in the course of a financial year of the *compensation scheme* will already be obtaining a discount in relation to the *base costs levy* and the *establishment costs levy* through the modified fee provisions of SUP 20.4.3, no rule is necessary in COMP for discounts on the *base costs levy* or the *establishment costs levy*.

Establishment costs levy**13.5.11****R**

01.12.01/001

The FSCS must calculate a *participant firm's* share of an *establishment costs levy* on the same basis as a *base costs levy* under COMP 13.5.5R.

13.5.12**R**

01.12.01/001

The FSCS may not impose an *establishment costs levy* after the end of the third full financial year of operation of the *compensation scheme*.

13.6 Compensation costs

- 13.6.1** **R** 01.12.01/001 The *compensation costs levy* is made up of *compensation costs* incurred by the *FSCS*, together with any *compensation costs* which can reasonably be anticipated as arising in the 12 months following the levy date, and which in each case have not already been subject to a levy.
- 13.6.2** **R** 01.12.01/001 The *FSCS* must allocate any *compensation costs levy* to the individual *sub-schemes* and relevant *contribution groups* in proportion to the volume of *compensation costs* arising from, or expected to arise from, claims in respect of the different activities represented by those *contribution groups*.
- 13.6.3** **R** 01.12.01/001 If a *participant firm* which is *in default* has carried on a *regulated activity* other than in accordance with a *permission*, the *FSCS* must allocate any *compensation costs* or *specific costs* arising out of that activity to the relevant *contribution group* which covers that activity.
- 13.6.4** **R** 01.12.01/001 If the *relevant person in default* is an *appointed representative*, the *FSCS* must allocate any *compensation costs* or *specific costs* arising out of a *regulated activity* for which his *principal* has not accepted responsibility to the relevant *contribution group* for that activity.
- 13.6.5** **R** 01.12.01/001 A *participant firm* (except one exempt under COMP 13.3) must pay to the *FSCS* a share of each *compensation costs levy*.
- 13.6.6** **R** 01.12.01/001 The *FSCS* must calculate a *participant firm's* share of a *compensation costs levy* on the same basis as a *specific costs levy* under COMP 13.5.6R, COMP 13.5.7R and COMP 13.5.8R.
- 13.6.7** **R** 01.12.01/001 When calculating a *participant firm's* share of a *compensation costs levy* or *specific costs levy* allocated to:
- (1) the accepting deposits *sub-scheme* or the insurance business *sub-scheme*, the *FSCS* must use the *contribution groups* and tariff bases as set out in the table in COMP 13.6.8R.;
 - (2) the investment business *sub-scheme*, the *FSCS* must use as the *contribution groups* and tariff bases the correspondingly numbered *activity groups* and tariff bases set out in part 7 of SUP 20 Ann 1R;

13.6.8

R

01.12.01/001

Table Table: Contribution Groups for the Accepting Deposits Sub-scheme and the Insurance Business Sub-scheme for the Financial Services Compensation Scheme (see COMP 13.6.7R (1))

SUB-SCHEME	CONTRIBUTION GROUP (REFERENCES TO A1, A2 ETC ARE TO THE FSA FEE BLOCKS)	LEGAL BASIS FOR ACTIVITY (references to articles are to articles of the <i>Regulated Activities Order</i>)	TARIFF BASE
Accepting deposits	A1 – deposit takers	<i>Accepting deposits</i> (article 5)	<i>Protected deposits</i> (see COMP 13.6.13R)
Insurance business	A3 – Insurance activities – General insurance	<i>Effecting contracts of insurance and/or carrying out contracts of insurance</i> (article 9) that are <i>general insurance contracts</i>	<i>Relevant net premium income</i>
Insurance business	A4 – insurance activities – Life Insurance	<i>Effecting contracts of insurance and/or carrying out contracts of insurance</i> (article 9) that are <i>long-term insurance contracts</i>	<i>Relevant net premium income</i>

13.6.9

G

01.12.01/001

Table Table: A summary of the relevant contribution groups and tariff bases for the investment business sub-scheme (see COMP 13.6.7R (2)).

SUB-SCHEME	CONTRIBUTION GROUP (REFERENCES TO A1, A2 ETC ARE TO THE FSA FEE BLOCKS)	LEGAL BASIS FOR ACTIVITY (references to articles are to articles of the <i>Regulated Activities Order</i>)	TARIFF BASE
Designated investment business	A7 – fund managers holding client money and/or assets	<i>Managing investments</i> (article 33), and either: (a) holding <i>client money</i> ; or (b) <i>safeguarding and administering investments</i> (article 36)	Funds under management
Designated investment business	A8 – fund managers not holding either client money and/or assets	<i>Managing investments</i> (article 33), but not: (a) holding <i>client money</i> ; or (b) <i>safeguarding and administering investments</i> (article 36)	Funds under management
Designated investment business	A9 – managers of an <i>AUT</i> , <i>ACDs</i> and <i>depositories</i>	Any of the following: (a) <i>establishing, operating or winding up a collective investment scheme</i> ; (b) <i>acting as a trustee of an authorised unit trust scheme</i> ; (c) <i>acting as a depository, or sole director of an open-ended investment company</i> (article 48)	Gross income

Designated investment business	A10 – dealing as principal	<i>Dealing in investments as principal</i> (article 12), but not: (a) dealing as principal in investments if the investments are <i>life policies</i> ; or (b) acting as a matched principal broker	Number of traders
Designated investment business	A11 – execution only brokers	Any of the following: (a) <i>dealing in investments as agent</i> (article 19); (b) <i>arranging (bringing about) deals in investments</i> (article 21(1)); (c) <i>making arrangements with a view to transactions in investments</i> (article 22(2)); (d) dealing as principal in investments where the investments are <i>life policies</i> (article 12); (e) acting as a matched principal broker; but without <i>permission to advise on investments</i> (article 52)	Commission income
Designated investment business	A12 – brokers (excluding execution-only brokers and corporate finance advisers) – holding either client money or assets	Any of the following: (a) <i>dealing in investments as agent</i> (article 19); (b) <i>arranging (bringing about) deals in investments</i> (article 21(1)); (c) <i>making arrangements with a view to transactions in investments</i> (article 22(2)); with <i>permission</i> to: (i) <i>advise on investments</i> (article 49); (ii) hold <i>client money</i> , and (iii) <i>safeguard and administer investments</i> (article 36)	Number of approved persons
Designated investment business	A13 – brokers (excluding execution only brokers and corporate finance advisers) – not holding either client money or assets	Any of the following: (a) <i>dealing in investments as agent</i> (article 19); (b) <i>arranging (bringing about) deals in investments</i> (article 21(1)); (c) <i>making arrangements with a view to transactions in investments</i> (article 22(2)); with <i>permission to advise on investments</i> (article 49); but not to (i) hold <i>client money</i> , and (ii) <i>safeguard and administer investments</i> (article 36).	Number of approved persons
Designated investment business	A14 – corporate finance advisory firms	<i>Permission</i> includes a requirement that the <i>firm</i> must not conduct <i>designated investment business</i> other than <i>corporate finance business</i>	Number of approved persons

Designated investment business	A15 – advisory only	<i>Advising on investments</i> (article 49), but not within A11 to A14	Number of <i>approved persons</i>
Designated investment business	A16 – pensions review	The <i>firm</i> was liable to pay the Pensions Review Levy to the <i>PIA</i> in 2001/ 2002	Percentage share of <i>PIA</i> 's 2001/ 2002 Pensions Review Levy

13.6.10 G
01.12.01/001

A *participant firm* may belong to more than one *sub-scheme*, and more than one *contribution group* within the same *sub-scheme*.

13.6.11 R
01.12.01/001

Unless exempt under **COMP 13.3.1R**, a *participant firm* must provide the *FSCS* by the end of February each year with a statement of:

- (1) the *contribution groups* to which it belongs; and
- (2) the total amount of business (measured in accordance with the appropriate tariff base or bases) which it conducted, as at 31 December of the previous year, in relation to each of those *contribution groups*.

13.6.12 R
01.12.01/001

If the information in **COMP 13.6.11R** has been provided to the *FSA* under other rule obligations, a *participant firm* will be deemed to have complied with **COMP 13.6.11R**.

13.6.13 R
01.12.01/001

Where a *participant firm* can identify that a *protected deposit* was made by a *person* who is not an *eligible claimant*, it may exclude the amount of that deposit from the tariff base, provided that it notifies the *FSCS* of the amount of the deposit so excluded and provides the *FSCS* with such information about the deposit as the *FSCS* may reasonably require.

13.6.14 R
01.12.01/001

Where a *participant firm* does not provide the statement required by **COMP 13.6.11R**, the *FSCS* may assess the firm for its share of the *compensation costs levy* or the *specific costs levy* on any reasonable basis (including on the basis of the statement for the previous year), making such adjustments as seem appropriate in subsequent levies once the true figures are known.

13.7 Incoming EEA firms

Levies for specific costs and compensation costs relating to the pension transfers and opt-outs review

13.7.1

R

01.12.01/001

If an *incoming EEA firm*, which is a *BCD credit institution* or *ISD investment firm*, is a *participant firm*, the *FSCS* must give the *firm* such discount (if any) as is appropriate on the share of any levy it would otherwise be required to pay, taking account of the nature of the levy and the extent of the compensation coverage provided by the firm's *Home State* scheme.

13.8 Payment of levies

13.8.1 **R** *A participant firm must pay its share of any levy made by the FSCS:*

01.12.01/001

- (1) in one payment; or
- (2) where the FSCS agrees, quarterly, at the beginning of each quarter, by direct debit agreement.

13.8.2 **G** The amount paid under a direct debit arrangement will be adjusted on a continuous basis to take account of interim levies and other adjustments made during the course of the financial year.

01.12.01/001

13.8.3 **R** *A participant firm's share of a levy to which COMP 13.8.1R(1) applies is due on, and payable within 30 days of, the date when the invoice is issued.*

01.12.01/001

13.8.4 **R** *If a participant firm does not pay its share of a levy as required by COMP 13.8.3R, it must thereafter pay additional administrative fees based on the amount outstanding at a rate of 5% over the Bank of England's repo rate from time to time in force accruing on a daily basis from the date on which the payment was due.*

01.12.01/001

13.8.5 **R** *If a participant firm does not pay its share of a levy subject to a direct debit agreement as required by COMP 13.8.1R(2), the entire amount of the levy becomes due and payable to the FSCS, and additional administrative fees are payable at the rate set out in COMP 13.8.4R.*

01.12.01/001

13.8.6 **R** *If a participant firm fails to make payment under COMP 13, the FSCS may:*

01.12.01/001

- (1) take steps to recover any money owed; or
- (2) refer the matter to the FSA so that the FSA may take whatever disciplinary action it considers necessary; or
- (3) do both (1) and (2).

13.8.7 **R** *If a firm ceases to be a participant firm part way through a financial year of the compensation scheme:*

01.12.01/001

- (1) it will remain liable for any unpaid levies which the FSCS has already made on the firm; and

- (2) the FSCS may make a levy upon it (which may be before or after the firm has ceased to be a *participant firm*, but must be before it ceases to be an *authorised person*) for the costs which it would have been liable to pay had the FSCS made a levy on all *participant firms* at the time of the levy on the *firm*.

Compensation

Chapter 14

Participation by EEA Firms

PAGE
1



14

14.1 Application and Purpose

Application

14.1.1 **R** This chapter applies to the *FSCS*.

15.11.01/001

14.1.2 **R** This chapter also applies to an *incoming EEA firm* which is a *credit institution* or an *ISD investment firm* (or both).

15.11.01/001

Purpose

14.1.3 **G** This chapter provides supplementary *rules* and *guidance* for an *incoming EEA firm* which is a *credit institution* or an *ISD investment firm*. It reflects the implementation of the *Deposit Guarantee Directive* and *Investors Compensation Directive*. This sourcebook applies in the usual way to an *incoming EEA firm* which is exercising *EEA rights* under the *Insurance Directives*. Such a *firm* is not affected by the *Deposit Guarantee Directive* or the *Investors Compensation Directive*.

15.11.01/001

14.1.4 **G** An *incoming EEA firm*, which is a *credit institution* or an *ISD investment firm*, is not a "*participant firm*" in relation to its *passport activities* unless it "*tops-up*" into the *compensation scheme*. This reflects section 213(10) of the *Act* (The *compensation scheme*) and regulation 2 of the *Electing Participants Regulations* (Persons not to be regarded as relevant persons). If an *incoming EEA firm* also carries on non-*passport activities* for which the *compensation scheme* provides cover, it will be a *participant firm* in relation to those activities and will be covered by the *compensation scheme* for those activities in the usual way.

15.11.01/001

14.1.5 **G** In relation to an *incoming EEA firm's passport activities*, its *Home State* compensation scheme must provide compensation cover in respect of business within the scope of the *Deposit Guarantee Directive* and *Investors Compensation Directive*, whether that business is carried on from a *UK branch* or on a *cross border services* basis.

15.11.01/001

14.1.6 **G** If the scope or level of cover provided by the *incoming EEA firm's Home State* compensation scheme is less than that provided by the *compensation scheme*, this chapter enables the *firm* to obtain *top-up cover* from the *compensation scheme* for its *passport activities* carried on from a *UK branch*, up to the *compensation scheme's* limits (set out in *COMP 10*). This reflects section 214(5) of the *Act* (General) and regulation 3 of the *Electing Participants Regulations* (Persons who may elect to participate). If the *firm* "*tops-up*" and then becomes insolvent, the *Home State* compensation scheme will pay compensation up to the limit and scope of the *Home State* compensation scheme, with the *FSCS* paying compensation for

15.11.01/001

the additional amount in accordance with the provisions in this sourcebook (*COMP* 12.4.1R and *COMP* 12.4.4R).

14.2 Obtaining top-up cover

- 14.2.1** **R** 15.11.01/001 An *incoming EEA firm* may, by notice in writing to the FSCS, elect to receive *top-up cover* from the *compensation scheme* if it falls within one of the categories prescribed in regulation 3 of the *Electing Participants Regulations* (Persons who may elect to participate).
- 14.2.2** **R** 15.11.01/001 An election under COMP 14.2.1R takes effect on the date when the FSCS notifies the *incoming EEA firm* that its election has been accepted.
- 14.2.3** **G** 15.11.01/001 A notice under COMP 14.2.1R should include details confirming that the *incoming EEA firm* falls within a prescribed category. In summary:
- (1) the *firm* must be a *credit institution* or an *ISD investment firm*;
 - (2) the *firm* must have established a *branch* in the *United Kingdom* in the exercise of an *EEA right*; and
 - (3) the scope and level of cover provided by the *firm's Home State* compensation scheme must be less than that provided by the *compensation scheme*.
- 14.2.4** **R** 15.11.01/001 When the FSCS accepts an application, it must allocate the *incoming EEA firm* to the *contribution group* (or groups) which seems to the FSCS to be most appropriate, taking into account the nature of the business for which the *incoming EEA firm* is seeking cover from the *compensation scheme*.
- 14.2.5** **R** 15.11.01/001 The FSCS must put in place and publish procedures to enable an appeal by an *incoming EEA firm* against a rejection by the FSCS of an election to receive *top-up cover* or a decision to allocate an *incoming EEA firm*, once the *firm's* election has been accepted, to a particular *contribution group*. Such procedures must satisfy the minimum requirements of procedural fairness and comply with the European Convention on Human Rights.



14.3 Co-operation between the FSCS and Home State compensation schemes

14.3.1



15.11.01/001

Where an *incoming EEA firm* obtains *top-up cover* under COMP 14.2, the FSCS must seek to establish with that *firm's Home State* compensation scheme appropriate procedures for the payment of compensation to claimants, following the principles set out in Annex II of the *DGD* or Annex II of the *ICD*, as appropriate.

14.4 Ending top-up cover

FSCS terminating top-up cover

- 14.4.1** **R** 15.11.01/001 The FSCS must terminate an *incoming EEA firm's top-up cover* where it is advised by the *firm's Home State regulator* or compensation scheme that the conditions in COMP 14.2.1R are no longer satisfied.
- 14.4.2** **R** 15.11.01/001 If an *incoming EEA firm* which has *top-up cover* fails to observe any of the *rules* in this sourcebook which apply to *participant firms*, the FSCS must notify the FSA and the *incoming EEA firm's Home State regulator*.
- 14.4.3** **R** 15.11.01/001 In cases where COMP 14.4.2R applies, the FSCS must co-operate with the *incoming EEA firm's Home State regulator* so that appropriate measures can be taken to ensure that the *incoming EEA firm* meets its obligations under this sourcebook.
- 14.4.4** **R** 15.11.01/001 If the *incoming EEA firm* fails to meet its obligations for a period of twelve months, the FSCS may terminate its *top-up cover*.

Resignation of an EEA firm from the compensation scheme

- 14.4.5** **R** 15.11.01/001 An *incoming EEA firm* which has *top-up cover* may terminate that *top-up cover* by giving six month's notice in writing to the FSCS.

Notice to customers

- 14.4.6** **R** 15.11.01/001 When an *incoming EEA firm's top-up cover* comes to an end under COMP 14.4.1R, COMP 14.4.4R or COMP 14.4.5R, it must inform all the clients of its *UK branch* no later than six weeks after the date that its participation ends that they are no longer protected by the *compensation scheme*, and of the level of compensation which is then available to them.
- 14.4.7** **R** 15.11.01/001 If an *incoming EEA firm* fails to comply with COMP 14.4.6R, the FSCS must inform the *firm's Home State regulator* of that fact.

14.4.8

R

15.11.01/001

The *FSCS* must bring the ending of an *incoming EEA firm's top-up cover* to the attention of the *incoming EEA firm's* clients by means of a public notice.

Schedules



Compensation

Schedule1 Record-keeping requirements

1 Table

<p>G</p> <ol style="list-style-type: none"> 1. The aim of the guidance in the following table is to give the reader a quick overall view of the relevant record keeping requirements. The Rules listed below apply only to FSCS (the scheme manager). 2. It is not a complete statement of those requirements and should not be relied upon as it were.
--

2 Table

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
COMP 13.4.12R	FSCS funding	Full details of the movement of funds within sub-schemes.	Ongoing requirement.	N/A

Compensation

Schedule2 Notification requirements

1 Table

<p>G</p> <ol style="list-style-type: none"> The aim of the guidance in the following table is to give the reader a quick overall view of the relevant requirements for notification and reporting. In all cases, other than those concerning Chapter 13 and Chapter 14, the notification rules in COMP apply only to FSCS (the scheme manager). It is not a complete statement of those requirements and should not be relied on as if it were.

2 Table

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
COMP 2.2.5R	Annual Report	Not specified in COMP – see Memorandum of Understanding (MoU) between FSA and FSCS	End of Financial Year	Not specified in COMP (see MoU)
COMP 2.2.7R	Default of relevant person	Not specified – although FSCS must take appropriate steps to ensure claimants are informed about how they can claim compensation	default of a relevant person	Not specified – but as soon as practicable after determining default
COMP13.3.2R	Right to exemption for specific costs and compensation costs levy	Notice that firm does not conduct business that could give rise to a claim on the FSCS and has no reasonable likelihood of doing so	In February each year or on the occasion of the firm’s authorisation or when it ceases conducting business with person eligible to claim on FSCS	As soon as practicable

COMP 13.3.4R	Loss of right to seek exemption from specific costs & compensation costs levy	Statement that firm no longer qualifies for exemption because it carries on business with persons eligible to claim on FSCS	Firm loses the right to claim the exemption.	As soon as practicable
COMP 13.6.11R	Levy base for participant firm	The contribution groups to which the participant firm belongs. The total amount of business (measured in accordance with the appropriate tariff bases, which it conducted as at 31 December of the previous year	The end of the calendar year (the occasion of 31 December every year beginning with 31 December 2001).	By end February
COMP 13.8	Participant firms compensation levy for the financial year	Amount of levy payable by the participant firm	The decision by the FSCS that it must impose a levy	30 days before the levy is payable
COMP 14.2.1R	Application by eligible inward passporting EEA firm to top-up into compensation scheme	That firm is qualifying incoming EEA firm. The sub-scheme(s) the firm wishes to participate in. Confirmation that the level or scope of cover offered by its home state scheme(s) is less than that available in the UK.	The firm's decision that it wishes to top-up into the UK scheme.	N/A

COMP 14.4.5R	Termination of top-up cover	Statement that incoming EEA firm is terminating top-up cover	Decision by firm to resign from FSCS	6 months notice
COMP 14.4.6R	Termination of inward passporting EEA firm's top-up cover into compensation scheme	The firm's resignation from the compensation scheme and the level of compensation available to clients of the firm's UK branch following its decision to resign from FSCS	Termination of firm's top-up cover	No later than six weeks after the end of the firm's participation in compensation scheme

Compensation

Schedule3 Fees and other required payments

1 Table

G

1. The rules in COMP 13 give FSCS (the scheme manager) the power to raise levies on participant firms in order to meet its expenses. The rules in COMP 13 do not specify the amount of any levy but do specify how a participant firm's share of a levy is to be calculated and any limit on the amount leviable by the FSCS is a particular period.

Compensation

Schedule4 Powers Exercised

1 Table

G	
1	<p>The following powers and related provisions in the Act and the Compensation Transitionals Order have been exercised by the FSA to make the rules in COMP:</p> <ol style="list-style-type: none">(1) Section 138 (General rule making powers)(2) Section 156 (General supplementary powers)(3) Section 214 (General)(4) Section 215 (Rights of the Scheme in relevant persons insolvency)(5) Section 216 (Continuity of long term insurance policies)(6) Section 217 (Insurers in financial difficulties)(7) Section 223 (Management Expenses)(8) Article 4 (Pending Applications) of the Compensation Transitional's Order(9) Article 6 (Post-commencement applications) of the Compensation Transitional's Order(10) Article 9 (Article 9 defaults occurring before commencement) of the Compensation Transitional's Order(11) Article 10 (Applications in respect of compulsory liability insurance) of the Compensation Transitional's Order(12) Article 12 (Applications under the new scheme) of the Compensation Transitional's Order
2	<p>The following powers in the Act have been exercised by the FSA to give the guidance in COMP:</p> <ol style="list-style-type: none">(1) Section 157(1) (Guidance)

Compensation

Schedule5 Rights of action for damages

1 Table

1. The table below sets out the *rules* in *COMP* contravention of which by an *authorised person* may be actionable under section 150 of the *Act* (Actions for damages) by a *person* who suffers loss as a result of the contravention.
2. If a “yes” appears in the column headed “For private person?”, the *rule* may be actionable by a “*private person*” under section 150 unless a “yes” appears in the column headed “Removed”. A “yes” in the column headed “Removed” indicates that the *FSA* has removed the right of action under section 150(2) of the *Act*. If so, a reference to the *rule* in which it is removed is also given.
3. In accordance with the Financial Services and Markets Act 2000(Rights of Action) Regulations 2001 (SI 2001/2256) a “private person” is:
 - i any individual, except when acting in the course of carrying on a *regulated activity*; and
 - ii any *person* who is not an individual, except when acting in the course of carrying on business of any kind;

but does not include a government, local authority or an international organisation.
4. The column headed “For other person?” indicates whether the rule is actionable by a *person* other than a *private person*, in accordance with those Regulations. If so, an indication of the type of person by whom the rule is actionable is given.
5. The vast majority of *rules* in *COMP* are *rules* to which the *FSCS* is subject. No right of action arises under section 150 for breach of these *rules*, as the *FSCS* is not an *authorised person*.

2 Table Table title (Omit row for untitled tables) row-graphic-table

Chapter/ Appendix	Section/ Annex	Paragraph	For pri- vate per- son?	Removed	For other per- son?
COMP 13	Funding (all rules)		Yes	No	No
COMP 14.4.6 R			Yes	No	No

Compensation

Schedule6 Rules that can be waived

1 Table

G

The *rules* in *COMP* cannot be *waived* by the *FSA*, except:

- (1) COMP 13.6.11R;
- (2) COMP 14.4.6R.

LLOYD'S SOURCEBOOK (AMENDMENT) INSTRUMENT 2001

Powers exercised

- A. The Financial Services Authority amends the Lloyd's sourcebook in the exercise of the powers in section 138 (General rule-making power) and section 157(1) (Guidance) of the Financial Services and Markets Act 2000 (the "Act").
- B. The provisions of the Act relevant to rules and listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force immediately.

Amendments to the Lloyd's sourcebook

- D. The Lloyd's sourcebook is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Lloyd's sourcebook (Amendment) Instrument 2001.

By order of the Board

15 November 2001

ANNEX

LLD 10.9.7G For “syndicate actuary” insert “*syndicate actuary*”

LLD15 Annex 5 In "R Auditors' report, 1 Table 1(1)", for “*LLD 15.5.1R(3)*” insert “*LLD 15.5.1R*”

**Special Guide for Small Friendly Societies
Instrument 2001**

Powers exercised

- A. The Financial Services Authority gives the guidance in the Annex to this instrument in the exercise of the power in section 157(1) of the Financial Services and Markets Act 2000.

Commencement

- B. This instrument comes into force immediately.

Citation

- C. This instrument may be cited as the Special Guide for Small Friendly Societies Instrument 2001.
- D. The annex to this instrument may be cited as the Special Guide for Small Friendly societies, or FREN.

By order of the Board
15 November 2001

ANNEX



Small Friendly Societies

- FREN 1** **FREN: Special guide for small Friendly societies**
 - 1.1 Application and purpose
 - 1.2 Parts of the Handbook applicable to small friendly societies

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Chapter 1

FREN: Special guide for small Friendly societies

1.1 Application and purpose

- 1.1.1**  This special guide is for small friendly societies.
- 1.1.2**  Its purpose is to guide small friendly societies to the particular parts of the *Handbook* which apply to them.
- 1.1.3**  A *friendly society* that is not subject to the *Insurance Directives* is often referred to as a *non-directive friendly society*. For the purposes of this guide it is referred to as a small friendly society.
- 1.1.4**  A Reader's Guide is also available that gives an introduction to the *Handbook* and is a key navigational aid for *Handbook* users. The Reader's Guide explains the format, layout and workings of the *Handbook*, including the status and definitions of its components such as directions, *rules* and *guidance*. A Reader's Short Guide is also available.



1.2 Parts of the Handbook applicable to small friendly societies

1.2.1 **G**
01.12.01/001

Small friendly societies should read applicable parts of the *Handbook* to find out what the detailed regulatory requirements for small friendly societies are. These parts are listed in the table below.

1.2.2 **G**
01.12.01/001

Table Table: Parts of the Handbook applicable to small friendly societies.

	Part of Handbook	Applicability to small friendly societies
High Level Standards	Principles for Businesses (<i>PRIN</i>)	This applies.
	Senior management arrangements, Systems and Controls (<i>SYSC</i>)	This applies.
	Threshold Conditions (<i>COND</i>)	This applies – except for <i>COND</i> 2.6.
	Statements of Principle and Code of Practice for Approved Persons (<i>APER</i>)	This applies to an <i>approved person</i> who performs a <i>controlled function</i> for a small friendly society.
	The Fit and Proper test for Approved persons (<i>FIT</i>)	This applies to an <i>approved person</i> who performs a <i>controlled function</i> for a small friendly society.
Business Standards	General provisions (<i>GEN</i>)	This applies.
	Interim Prudential sourcebooks (<i>IPRU</i>)	The following parts of the Interim Prudential sourcebook (Friendly societies) (<i>IPRU(FSOC)</i>) apply to small friendly societies: (a) <i>IPRU(FSOC)</i> 1 (Application) (b) <i>IPRU(FSOC)</i> 2 (Integrity, skill, care and diligence) (c) <i>IPRU(FSOC)</i> 3 (Management and control) (d) <i>IPRU(FSOC)</i> 4 (Financial prudence) – in this part sections 4.1 to 4.7 and 4.24 apply

	Part of Handbook	Applicability to small friendly societies
		<p>(e) <i>IPRU(FSOC) 5</i> (Prudential reporting) – the application depends upon the type of business (<i>long-term insurance business</i> or <i>general insurance business</i>) and whether the small friendly society is a <i>registered friendly society</i> or an <i>incorporated friendly society</i>; it does not apply to <i>flat rate benefits business friendly societies</i></p> <p>(f) <i>IPRU(FSOC) 7</i> (Definitions)</p> <p>Appendices to <i>IPRU(FSOC)</i></p> <p>(a) Appendix 1 (Long-term insurance business margin of solvency)</p> <p>(b) Appendix 2 (General insurance business solvency margin)</p> <p>(c) Appendix 4 (Asset valuation rules)</p> <p>(d) Appendix 5 (Liability valuation rules)</p> <p>(e) Appendix 6 (Balance sheet)</p> <p>(f) Appendix 7 (General insurance business: revenue account, other revenue account and additional information)</p> <p>(g) Appendix 8 (Long-term insurance business: revenue account and additional information)</p> <p>(h) Appendix 9 (Abstract of actuarial valuation) – this applies to incorporated small friendly societies with <i>Part IV permission to effect</i> or <i>carry out long-term insurance business</i></p> <p>(i) Appendix 10 (Prudential reporting forms)</p> <p>Annexes to <i>IPRU(FSOC)</i></p> <p>(a) Annex 1 (Guidance on corporate governance of friendly societies)</p> <p>(b) Annex 2 (Guidance on officers’ liability insurance)</p> <p>(c) Annex 3 Part I (Guidance on systems of accounting, control of business and inspection and report)</p> <p>(d) Annex 3 Part II (Guidance on systems of control over investments) A – sections 9 to 13 do not apply. B – sections 19 to 23 do not apply</p> <p>(e) Annex 3 – Attachments A to D</p> <p>(f) Annex 4 (Guidance on margins of solvency and the guarantee fund) – provides <i>guidance</i> to different categories of <i>friendly societies</i> and does not apply to <i>flat rate benefits business friendly societies</i></p>

	Part of Handbook	Applicability to small friendly societies
	<p>Conduct of Business sourcebook (<i>COB</i>)</p>	<p>(g) Annex 5 (Guidance on exemption from triennial valuation)</p> <p>(h) Annex 5 – Attachment</p> <p><i>Friendly societies</i> and their advisers may also wish to refer to <i>IPRU(INS)</i> Volume 3 (Guidance) which contains additional Guidance Notes and other material, such as 'Guidance for insurers and auditors on the Valuation of Assets Rules' and 'Dear Appointed Actuary' letters, that may be of assistance to them.</p> <p>The other IPRU sourcebooks do not apply.</p> <p>The following parts of <i>COB</i> are relevant to small friendly societies:</p> <p>(a) <i>COB</i> 1 (Application and general provisions)</p> <p>(b) <i>COB</i> 2 (Rules which apply to firms conducting designated investment business)</p> <p>(c) <i>COB</i> 3 (Financial promotion)</p> <p>(d) <i>COB</i> 4 (Accepting customers)</p> <p>(e) <i>COB</i> 5 (Advising and selling)</p> <p>(f) <i>COB</i> 6 (Product disclosure and the customer's right to cancel or withdraw)</p> <p>(g) <i>COB</i> 7 (Dealing and managing) – but is likely to have limited relevance to small friendly societies.</p> <p>(h) <i>COB</i> 8 (Reporting to customers) – but is likely to have limited relevance to small friendly societies.</p> <p>(i) <i>COB</i> 9 (Client assets) – in this part sections 9.1, 9.2 and 9.4 are relevant</p> <p><i>COB</i> 10 to <i>COB</i> 12 do not apply.</p> <p>This sourcebook is principally relevant to small friendly societies with <i>Part IV permission to effect contracts of insurance</i>. However, for societies that only <i>carry out contracts of insurance</i>, <i>COB</i> 6.8 will apply. These societies should note that <i>COB</i> 8 and <i>COB</i> 9 may be of relevance to them.</p> <p>Only the following parts of <i>COB</i> apply in relation to <i>general insurance business</i> and <i>pure protection contracts</i>: <i>COB</i> 1.1 to 1.4, <i>COB</i> 1.8, <i>COB</i> 3.1 to 3.5, <i>COB</i> 3.8.4 to 3.8.6, <i>COB</i> 3.14, <i>COB</i> 4.1.12 to 4.1.14 and <i>COB</i> 6.8. <i>COB</i> 6.7 applies in relation to <i>pure protection contracts</i> only.</p>

	Part of Handbook	Applicability to small friendly societies
<p>Regulatory Processes</p>	<p>Market conduct sourcebook (MAR)</p>	<p>MAR 1 (Code of Market Conduct) – this gives <i>guidance</i> on what does and does not amount to <i>market abuse</i>; this Code is relevant to all <i>persons</i> seeking <i>guidance</i> as to whether or not <i>behaviour</i> amounts to <i>market abuse</i>.</p> <p>MAR 2 (Price stabilising rules) – applies to all <i>firms</i> but is likely to have limited relevance to small friendly societies.</p> <p>MAR 3 (Inter-professionals conduct) – does not apply.</p> <p>MAR 4 (Endorsement of the Takeover Code) – this applies to every <i>firm</i> whose <i>permission</i> includes, or ought to include, any <i>designated investment business</i>, but is likely to have limited relevance to small friendly societies.</p>
	<p>Training and Competence sourcebook (TC)</p>	<p>TC 1 (Commitments) applies.</p> <p>TC 2 (Rules and guidance) applies in respect of <i>employees</i> engaged in advising on certain long-term insurance products (see the table at TC 2.1.4R).</p>
	<p>Money Laundering sourcebook (ML)</p>	<p>This applies to small friendly societies but not in respect of their <i>pure protection contracts</i> or in relation to <i>general insurance business</i>.</p>
	<p>Authorisation manual (AUTH)</p>	<p>This applies.</p> <p><i>AUTH</i> contains <i>guidance</i> on the <i>Act and Regulated Activities Order</i>. It explains, among other matters, the <i>FSA's</i> procedures for applications for <i>Part IV permission</i> for an applicant that is not already an <i>authorised person</i>.</p>
	<p>Supervision manual (SUP)</p>	<p><i>SUP</i> contains, and explains, provisions that relate to how the <i>FSA</i> will monitor <i>firms</i> for compliance with requirements imposed by or under the <i>Act</i>.</p> <p>The following parts of <i>SUP</i> apply to small friendly societies:</p> <ul style="list-style-type: none"> (a) <i>SUP</i> 1 (The <i>FSA's</i> approach to supervision) (b) <i>SUP</i> 2 (Information gathering by the <i>FSA</i> on its own initiative) (c) <i>SUP</i> 3 (Auditors) – in this part sections 3.1 to 3.7 apply; societies should note that sections 3.1, 3.2 and 3.8 apply to a <i>society's</i> external auditors (d) <i>SUP</i> 4 (Actuaries)

	Part of Handbook	Applicability to small friendly societies
	Enforcement manual (<i>ENF</i>)	<p>(e) <i>SUP</i> 5 (Skilled persons)</p> <p>(f) <i>SUP</i> 6 (Applications to vary and cancel Part IV permission)</p> <p>(g) <i>SUP</i> 7 (Individual requirements)</p> <p>(h) <i>SUP</i> 8 (Waiver and modification of rules)</p> <p>(i) <i>SUP</i> 9 (Individual guidance)</p> <p>(j) <i>SUP</i> 10 (Approved persons) – <i>SUP</i> 10.6.26R to <i>SUP</i> 10.6.29G provide for a special <i>controlled function</i> for small friendly societies (the <i>small friendly society function</i>). <i>SUP</i> 10.10 (Customer functions) does not apply in relation to <i>general insurance business</i> or <i>pure protection contracts</i></p> <p>(k) <i>SUP</i> 11 (Controllers and close links) – in this part sections 11.1, 11.2 and 11.9 apply</p> <p>(l) <i>SUP</i> 12 (Appointed representatives) – this part applies to a <i>friendly society</i> with <i>permission</i> to carry on <i>designated investment business</i> and which is considering appointing, has decided to appoint or has appointed an <i>appointed representative</i></p> <p>(m) <i>SUP</i> 15 (Notifications to the FSA)</p> <p>(n) <i>SUP</i> 16 (Reporting requirements) – in this part sections 16.4 to 16.7 do not apply; section 16.8 applies to societies with <i>permission</i> to effect or carry out <i>life policies</i></p> <p>(o) <i>SUP</i> 18 (Transfers of business)</p> <p>(p) Appendix 1 (Prudential categories and sub-categories)</p> <p>(q) Appendix 2 (Scheme of operations)</p> <p><i>ENF</i> describes the <i>FSA</i>'s policies and procedures for the exercise of its enforcement powers, and contains <i>guidance</i> on how those powers will be exercised. <i>ENF</i> applies to <i>firms</i>, <i>approved persons</i> and (in relation to some of the powers) other <i>persons</i>.</p> <p><i>ENF</i> applies to small friendly societies, except for the following parts:</p> <p>(a) <i>ENF</i> 4 (Intervention against incoming firms)</p> <p>(b) <i>ENF</i> 16 (Collective investment schemes)</p> <p>(c) <i>ENF</i> 18 (Disapplication orders against members of the professions)</p>

	Part of Handbook	Applicability to small friendly societies
Redress	Decision making manual (<i>DEC</i>)	<p>Societies should be aware of the following parts of <i>ENF</i>, although they may be of limited relevance:</p> <p>(a) <i>ENF</i> 14 (Sanctions for market abuse) – applies to any <i>person</i>, whether regulated or not, who may be the subject of a financial penalty or public statement on the basis that the <i>FSA</i> suspects the <i>person</i> is or has engaged in <i>market abuse</i></p> <p>(b) <i>ENF</i> 17 (Disqualification of auditors and Actuaries) – applies to auditors and <i>actuaries</i> of small friendly societies</p> <p>This applies.</p> <p><i>DEC</i> contains <i>guidance</i> on the <i>FSA</i>'s decision making, and other procedures for giving <i>statutory notices</i>. It also gives <i>guidance</i> on the <i>FSA</i>'s procedures for using its powers under certain Parts of the <i>Act</i>.</p>
	Dispute resolution: the Complaints sourcebook (<i>DISP</i>)	<p>This applies. All <i>firms</i> are subject to the <i>Compulsory Jurisdiction of the Financial Ombudsman Service</i>.</p> <p><i>DISP</i> 4 (Standard terms) – only applies to a <i>firm</i> which has decided to be a <i>participant</i> in the <i>Voluntary Jurisdiction</i> of the <i>Financial Ombudsman Service</i>.</p>
	Compensation sourcebook (<i>COMP</i>)	<p>This sourcebook is principally relevant to the <i>Financial Services Compensation Scheme Limited</i> (<i>FSCS</i>). It sets out the circumstances in which compensation may be paid, to whom compensation may be paid and on whom the <i>FSCS</i> can impose levies to meet the costs of paying compensation.</p> <p><i>Firms</i> will be particularly interested in <i>COMP</i> 13 (Funding) which deals with levies.</p>
Specialist Sourcebooks	Complaints Against the <i>FSA</i> (<i>COAF</i>)	<p>This sourcebook sets out the details of the <i>complaints scheme</i>. The <i>complaints scheme</i> applies in relation to complaints made about the way the <i>FSA</i> has carried out its functions under the <i>Act</i>.</p>
	Collective Investment Schemes sourcebook (<i>CIS</i>)	<p>The specialist sourcebooks do not apply.</p>
	Professional firms sourcebook (<i>PROF</i>)	
Lloyd's sourcebook (<i>LLD</i>)		

	Part of Handbook	Applicability to small friendly societies
Special Guides	Recognised Investment Exchange and Recognised Clearing House sourcebook (<i>REC</i>)	This does not apply.
	Special guide for Energy Market Participants (<i>EMPS</i>)	
	Special guide for small Friendly societies (<i>FREN</i>)	
	Special guide for Oil Market Participants (<i>OMPS</i>)	
	Special guide for Service companies (<i>SERV</i>)	
Schedules	Summary schedules	These apply, but only to the extent that the sourcebook or manual to which they relate applies.
	1. Record keeping requirements	
	2. Notification requirements	
	3. Fees and other required payments	
	4. Powers exercised in making the Handbook	
	5. Rights of action for damages	
	6. Rules that can be waived	
	7. Releases	
Glossary of definitions	This applies	
Index	This applies	

The Listing Rules

Copies may be obtained from:

The Financial Services Authority

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London E14 5HS

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Interim Permitted Persons Instrument 2001

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the powers and related provisions in:
- (1) article 12(1) of the Financial Services and Markets Act 2000 (Interim Permissions) Order 2001, SI No. 2001/3374 (“the Interim Permissions Order”);
 - (2) sections 138 (General rule-making power), 145 (Financial promotion rules), 149 (Evidential provisions) and 156 (General supplementary powers) of the Financial Services and Markets Act 2000 (the “Act”); and
 - (3) section 157(1) (Guidance) of the Act.
- B. Article 12(2) of the Interim Permissions Order is relevant to the exercise of the powers set out in paragraph A(2) and A(3) above because it provides that section 155 (Consultation) does not apply to the rules and guidance set out in this Instrument.
- C. The provisions listed above relevant to making rules are specified for the purposes of section 153(2) of the Act (Rule-making instruments).

Commencement

- D. This instrument comes into force:
- (1) to the extent it relates to a specific part of the Handbook: when that part comes into force or immediately, whichever is the later; and
 - (2) otherwise: when section 19 of the Act (The general prohibition) comes into force.

Citation

- E. This instrument may be cited as the Interim Permitted Persons Instrument 2001.
- F. The Annex to this instrument may be cited as Directions, rules and guidance for Interim Permitted Persons, or IPPS.

By order of the Board

15 November 2001

Annex: Directions, rules and guidance for Interim Permitted Persons (IPPS)

1. Handbook and other requirements for Interim Permitted Persons

1.1 Application and purpose

1.1.1 R *IPPS* applies to *interim permitted persons*.

1.1.2 G The purpose of *IPPS* is:

- (1) to make *rules* relating to the disclosure of their regulated status by *interim permitted persons*;
- (2) to direct, in accordance with article 12(1) of the *Interim Permissions Order*, that certain provisions of the *Handbook* that would otherwise apply to *interim permitted persons*:
 - (a) are not to apply; or
 - (b) are to apply to them as modified in the way specified in *IPPS*; and
- (3) to give ancillary *guidance* to *interim permitted persons* as to the application of the *Handbook* to them.

1.2 Disclosure of interim permitted person status

1.2.1 G The purpose of *IPPS* 1.2 is to prevent *clients* being misled about the extent to which the *FSA* has approved a *firm's* affairs.

REFERRING TO APPROVAL BY FSA – ALL INTERIM PERMITTED PERSONS

1.2.2 D The *FSA* directs that *GEN* 1.2 (Referring to approval by the *FSA*) is not to apply to an *interim permitted person*.

1.2.3 G Instead, *IPPS* 1.2.4 R makes provision for *interim permitted persons* about referring to approval by the *FSA* or *authorisation* for the purposes of the *Act*.

1.2.4 R

- (1) Unless required to do so under the *regulatory system*, an *interim permitted person* must ensure that neither it nor anyone acting on its behalf claims, in a public statement or to a client, expressly or by implication, that its affairs, or any aspect of them, have the approval of the *FSA* or that it is an *authorised person* for the purposes of the *Act*.
- (2) Paragraph (1) does not apply to statements by or on behalf of an *interim authorised person* that explain, in a way that is fair, clear and not misleading, that:
 - (a) the *firm* is an *interim authorised person*;
 - (b) the *firm* has *interim permission* to carry on a specific activity;
 - (c) an *authorisation order* has been made in relation to an *AUT* or *ICVC*;
 - (d) a *recognised scheme* has that status;

- (e) the *firm's approved persons* are deemed to be approved by the *FSA* for the purposes of section 59 of the *Act* (Approval for particular arrangements) pending determination of the *firm's* application for *authorisation*;
 - (f) the *firm* has been given express written approval by the *FSA* in respect of a specific aspect of the *firm's* affairs.
- (3) Paragraph (1) does not apply to statements by or on behalf of an *interim permitted person* who is not an *interim authorised person* that explain, in a way that is fair, clear and not misleading, that:
- (a) the *firm* is an *authorised person*;
 - (b) as appropriate:
 - (i) the *firm* has *permission* to carry on a specific activity; or
 - (ii) the *firm* has *interim permission* to carry on a specific activity;
 - (c) an *authorisation order* has been made in relation to an *AUT* or *ICVC*;
 - (d) a *recognised scheme* has that status;
 - (e) as appropriate:
 - (i) one or more of the *firm's approved persons* has been approved by the *FSA* for the purposes of section 59 of the *Act* (Approval for particular arrangements); and/or
 - (ii) one or more of the *firm's approved persons* is deemed to be approved by the *FSA* for the purposes of section 59 of the *Act* (Approval for particular arrangements) pending determination of the *firm's* application for *permission*;
 - (f) the *firm* has been given express written approval by the *FSA* in respect of a specific aspect of the *firm's* affairs.
- (4) Paragraph (1) applies with respect to the carrying on of both *regulated activities* and *unregulated activities*.

REQUIRED DISCLOSURES – INTERIM AUTHORISED PERSONS ONLY

- 1.2.5 R An *interim authorised person* who, in order to comply or to provide evidence of compliance with a provision (including a provision mentioned in *IPPS* 1.2.7 G) of the *Handbook*, discloses that he is authorised or regulated by the *FSA*, must also disclose that he is authorised or regulated on an interim basis only.
- 1.2.6 E (1) An *interim authorised person* should, in the circumstances mentioned in *IPPS* 1.2.5 R, disclose that he is “interim authorised under the Financial Services and Markets Act 2000” or “interim regulated by the Financial Services Authority” or “regulated by the Financial Services Authority as an interim authorised person” or use words to that effect.
- (2) Compliance with (1) may be relied on as tending to establish compliance with *IPPS* 1.2.5 R.
- (3) Contravention of (1) may be relied on as tending to establish contravention of *IPPS* 1.2.5 R.

- 1.2.7 G Table Non-exhaustive list of provisions about status disclosure

This table belongs to *IPPS* 1.2.5 R

Provision	Topic
COB 3.9.7 R (1)	Direct offer financial promotions
COB 4.2.10 R	)Terms of business
COB 4.2.15 E (2))
COB 5.5.3 R (3)	)Private customer designated investment business
COB 5.5.5 E 1(d))
COB 5.5.5 E 2(d))
COB 10.6.2 R	)Content of Scheme documents
COB 10.6.8E (1))

1.3 Application of Handbook to interim permitted persons

INTERIM PERMITTED PERSONS OTHER THAN INTERIM AUTHORISED PERSONS

- 1.3.1 G The *Handbook* applies to *interim permitted persons* who are not *interim authorised persons*, as set out in *IPPS*. Any *regulated activity* covered by their *interim permission* is *regulated activity* for the purposes of the *Handbook*.

INTERIM AUTHORISED PERSONS

- 1.3.2 G The *Interim Permissions Order* provides broadly that *interim authorised persons* are to be treated, unless otherwise provided, as *authorised persons* for the purposes of the *Act* and any provision made under the *Act* (see paragraph 5 of the Schedule to the *Interim Permissions Order*). As a result, the *Handbook* applies to *interim authorised persons* and any *regulated activity* in respect of which they are seeking *permission* is *regulated activity* for the purposes of the *Handbook*.

ALL INTERIM PERMITTED PERSONS

- 1.3.3 G The parts of the *Handbook* and their applicability to *interim permitted persons* are listed in *IPPS* 1.3.7 G. *Interim permitted persons* should read applicable parts of the *Handbook* to find out what the detailed regulatory requirements for them are. They should bear in mind that under *IPPS* 1.3.4 D they will, broadly speaking, for the purposes of working out which parts of the *Handbook* apply to them, be in the same regulatory category (including prudential category and sub-category) that they are expected to be in upon grant of their application. See *SUP* App 1 for an explanation of the prudential categories and sub-categories.
- 1.3.4 D The *FSA* directs that any special application or disapplication provisions in the *Handbook* are to apply to *interim permitted persons* as nearly as possible as if the application for *permission* which gives rise to the *interim permission* has been granted in the terms applied for, including as if the *requirements* and *limitations* applied for (or otherwise required to give effect to the terms of the application) have already been included in that *permission*.
- 1.3.5 G Where *FSA* has given an *interim permitted person* a *waiver* from a provision of the *Handbook*, the terms of that *waiver* are to be taken into account in determining the provisions of the *Handbook* that apply to that *interim permitted person*.
- 1.3.6 G The effect of the above is that, for example, an *interim authorised person* who has applied to be *authorised* as an *energy market participant* will be bound by the provisions of the *Handbook* to the extent that they are applicable to an *energy market participant* as described in *EMPS* (taking into account, in applying *EMPS*, any *waiver* granted by *FSA* in the exercise of its powers under section 148 of the *Act* (Modification or waiver of rules)).

This table belongs to *IPPS 1.3.3 G*

	Part of Handbook	Extent of application (subject to <i>IPPS 1.3.4 D</i>)
High Level Standards	Principles for Businesses (<i>PRIN</i>)	This applies.
	Senior management arrangements, Systems and Controls (<i>SYSC</i>)	This applies.
	Threshold Conditions (<i>COND</i>)	This applies.
	Statements of Principle and Code of Practice for Approved Persons (<i>APER</i>)	<p>(1) This applies.</p> <p>(2) Article 72 of the <i>Grandfathering Order</i> provides broadly, with some exceptions, that where at <i>commencement</i> a person (E) is performing a function for a person (A) under an <i>arrangement</i> entered into by A or by a contractor of A, then if E's continued performance of that function after <i>commencement</i> would require the approval of the FSA under section 59(1) or (2) (Approval for particular arrangements) of the <i>Act</i>, then that continued performance by E of that function after <i>commencement</i> is to be taken to have been approved by the FSA for the purposes of section 59.</p> <p>(3) Article 9 of the <i>Interim Permissions Order</i> provides broadly that E's transitional approval under the <i>Grandfathering Order</i> lapses at the latest when A's <i>interim permission</i> relating to the relevant <i>regulated activity</i> lapses.</p>
	The Fit and Proper test for Approved Persons (<i>FIT</i>)	This applies. See notes (2) and (3) relating to <i>APER</i> above.
	General provisions (<i>GEN</i>)	<p>(1) <i>GEN 1.2</i> (Referring to approval by the FSA) does not apply to <i>interim permitted persons</i>: see <i>IPPS 1.2.2 D</i>. Instead, <i>IPPS 1.2.4 R</i> makes provision about <i>interim permitted persons</i> referring to approval by the FSA or <i>authorisation</i> for the purposes of the <i>Act</i>.</p> <p>(2) The remainder of <i>GEN</i> applies.</p>

	Part of Handbook	Extent of application (subject to IPPS 1.3.4 D)
Business standards	Interim Prudential sourcebooks (<i>IPRU</i>)	This applies.
	Conduct of Business sourcebook (<i>COB</i>)	<p>(1) This applies.</p> <p>(2) <i>IPPS</i> 1.2.5 R makes special provision for required status disclosures by <i>interim authorised persons</i>. See also note (1) relating to <i>GEN</i> above.</p> <p>(3) Paragraph 6 of the Schedule to the <i>Interim Permissions Order</i> provides broadly that an <i>interim authorised persons</i> is not <i>authorised</i> for the purposes of sections 21(1) (Restrictions on financial promotion) and 25(2)(a) (Contravention of section 21) unless the communication invites an agreement the making or performance of which constitutes a <i>controlled activity</i> corresponding to a <i>regulated activity</i> covered by his <i>interim permission</i>.</p>
	Market Conduct sourcebook (<i>MAR</i>)	This applies.
	Training and Competence sourcebook (<i>TC</i>)	This applies.
	Money Laundering sourcebook (<i>ML</i>)	This applies.

	Part of Handbook	Extent of application (subject to IPPS 1.3.4 D)
Regulatory processes	Authorisation manual (<i>AUTH</i>)	<p>(1) This applies.</p> <p>(2) Article 8 of the <i>Interim Permissions Order</i> provides:</p> <ul style="list-style-type: none"> (a) that after <i>commencement</i>, an <i>interim permitted person</i> cannot withdraw his application for <i>permission</i> which gives rise to his <i>interim permission</i> without the consent of the <i>FSA</i>; (b) for the duration of <i>interim permission</i>, which ends broadly when the application process is determined and appeal rights are exhausted. <p>(3) Paragraph 2 of the Schedule to the <i>Interim Permissions Order</i> provides that for the purposes of section 20 (Authorised persons acting without permission) an <i>interim permission</i> is treated as having been given to him by the <i>FSA</i> under Part IV of the <i>Act</i>.</p> <p>(4) Paragraph 3 of the Schedule to the <i>Interim Permissions Order</i> provides that an applicant's <i>interim permission</i> is to be disregarded for the purposes of sections 38(2) (Exemption orders), 40(2) (Application for permission) and 42 to 44 (Giving permission, Imposition of requirements and Variation etc. at request of authorised person) of the <i>Act</i>.</p> <p>(5) Special provision is made for <i>approved persons</i> performing <i>controlled functions</i> for <i>interim permitted persons</i>: see explanation relating to <i>APER</i> above.</p> <p>(6) <i>Interim authorised persons</i> will be identified as such on the public register maintained by the <i>FSA</i>.</p> <p>(7) The Schedule to the <i>Interim Permissions Order</i> provides broadly that <i>interim authorised persons</i>:</p> <ul style="list-style-type: none"> (a) are to be treated, unless otherwise provided, as <i>authorised persons</i> for the purposes of the <i>Act</i> (see paragraph 5); (b) may still be <i>appointed representatives</i> (and hence may be treated as exempt from the <i>general prohibition</i> as a result of section 39(1) for the purposes of section 42(3)(a)) (see paragraph 7); and (c) are not to be treated as <i>authorised persons</i>, or are not to be treated as <i>authorised persons</i> for all purposes, under the exclusions provided for in articles 22, 29 and 72 of the <i>Regulated Activities Order</i> (which relate to certain transactions and arrangements entered or made with or through authorised persons) (see paragraphs 10-12).

	Part of Handbook	Extent of application (subject to IPPS 1.3.4 D)
	Supervision manual (<i>SUP</i>)	This applies. See also note (2) to <i>APER</i> above which is relevant to <i>SUP</i> and notes (2), (4) and (7)(b) to <i>AUTH</i> above which are relevant to <i>SUP</i> 6, <i>SUP</i> 7 and <i>SUP</i> 12.
	Enforcement manual (<i>ENF</i>)	This applies.
	Decision making manual (<i>DEC</i>)	This applies. See also note (2) to <i>AUTH</i> above.
Redress	Dispute resolution: Complaints sourcebook (<i>DISP</i>)	This applies.
	Compensation sourcebook (<i>COMP</i>)	This applies.
	Complaints against the FSA (<i>COAF</i>)	This applies.
Specialist sourcebooks	Collective Investment Schemes sourcebook (<i>CIS</i>)	(1) This applies. (2) However, the Schedule to the <i>Interim Permissions Order</i> provides broadly that <i>interim authorised persons</i> : (a) are not to be treated as <i>authorised persons</i> for the purposes of Chapter II (Restrictions on promotion) of Part XVII (Collective Investment Schemes) of the <i>Act</i> (see paragraph 8 of the Schedule); and (b) are not to be treated as <i>authorised persons</i> for the purposes of subsections (8) and (9) of section 272 (individually recognised overseas schemes) of the <i>Act</i> (see paragraph 9 of the Schedule).
	Professional firms sourcebook (<i>PROF</i>)	These apply.
	Lloyd's sourcebook (<i>LLD</i>)	
	Recognised Investment Exchange and Recognised Clearing House sourcebook (<i>REC</i>)	
Special guides	Special guide for Service companies (<i>SERV</i>)	This applies.
	Special guide for Energy Market Participants (<i>EMPS</i>)	This applies.
	Special guide for small Friendly societies (<i>FREN</i>)	This applies.
	Special guide for Oil Market Participants (<i>OMPS</i>)	This applies.

	Part of Handbook	Extent of application (subject to IPPS 1.3.4 D)
Schedules	Summary schedules	These apply.
	1. Record keeping requirements	
	2. Notification requirements	
	3. Fees and other required payments	
	4. Powers exercised in making the Handbook	
	5. Rights of action for damages	
	6. Rules that can be waived	
	7. Releases	
Glossary of definitions		This applies.
Index		This applies (when available).

2. Interpretation

2.1 GEN and Glossary apply

2.1.1 The General provisions (*GEN*) of the *Handbook* and the *Glossary* made under the Act apply in the interpretation of *IPPS*.

2.1.2 The terms in *IPPS* 2.1.3 are also defined for the purposes of *IPPS*.

2.1.3 Table Terms defined for the purposes of *IPPS*

This table belongs to *IPPS* 2.1.2 .

Definition	Definition text
<i>Grandfathering Order</i>	the Financial Services and Markets Act 2000 (Transitional Provisions) (Authorised Persons etc.) Order 2001, SI No. 2001/2636.
<i>interim authorised person</i>	an <i>interim permitted person</i> who is an <i>authorised person</i> only because he has an <i>interim permission</i> .
<i>interim permission</i>	a <i>Part IV permission</i> conferred by article 6 or 7(2) of the <i>Interim Permissions Order</i> .
<i>Interim Permissions Order</i>	the Financial Services and Markets Act 2000 (Interim Permissions) Order 2001, SI No. 2001/3374.
<i>interim permitted person</i>	a <i>person</i> who has an <i>interim permission</i> .
<i>IPPS</i>	Directions, rules and guidance for Interim Permitted Persons forming the Annex to the Interim Permitted Persons Instrument 2001.

Designation of Pensions Review Provisions Instrument 2001

1 Application and Purpose

Application

- 1.1 This instrument applies to *firms* which, immediately before *commencement*, were regulated by self regulating organisations or recognised professional bodies under the Financial Services Act 1986.

Purpose

- 1.2 Under the Financial Services Act 1986, reviews were set up concerning the sale of personal pension schemes between 29 April 1988 and 30 June 1994, and the sale of free standing additional voluntary contribution schemes between 29 April 1988 and 15 August 1999 (the "reviews").
- 1.3 So that the *FSA* can require *firms* to continue to conduct the reviews under the *Act* after *commencement*, the *Pensions Review Transitional Order* provides for the reviews to be treated as if they constituted a scheme under section 404 of the *Act* (Schemes for reviewing past business) (the 'deemed scheme'), and that the *FSA* can designate *pensions review provisions* for that purpose.

2 Designation under Article 3 of the Pensions Review Transitional Order

- 2.1 The *FSA* designates, under article 3 of the *Pensions Review Transitional Order*, the *pensions review provisions* listed in schedules 1 to 10 to this instrument.
- 2.2 Each of the *pensions review provisions* listed in the schedules is to have effect as a provision of an authorised scheme within the meaning of section 404 of the *Act*.
- 2.3 The *persons* to which designated provisions are to apply are those identified in the schedules.

3 Modifications of Pensions Review Provisions

- 3.1 For the purposes of the deemed scheme, in the *pensions review provisions* listed in the schedules to this instrument, references to the following are to be read as stated, unless the context requires otherwise:
- (1) "firm" or "member", as a *person* authorised under the *Act*;
 - (2) ombudsman arrangements or ombudsman schemes, as the arrangements in *DISP*;
 - (3) compensation arrangements, as the arrangements in *COMP* or in the *Compensation Transitional Order*; and
 - (4) the firm's regulator, as the *FSA*.

4 Miscellaneous

- 4.1 In this instrument, words and phrases in italics have the meanings given in the table contained on page 3 of this instrument.

4.2 Article 3 of the *Pensions Review Transitional Order* is specified for the purposes of section 153 (2) of the *Act* (Rule-making instruments).

5 Commencement

5.1 This instrument comes into force at *commencement*.

6 Citation

6.1 This instrument may be cited as the Designation of Pensions Review Provisions Instrument 2001.

By order of the Board

15 November 2001

Table

DEFINITION TITLE	DEFINITION WORDING
Act	the Financial Services and Markets Act 2000.
commencement	the beginning of the <i>commencement day</i> .
commencement day	the day on which section 19 of the <i>Act</i> (The general prohibition) comes into force.
COMP	the Compensation sourcebook.
Compensation Transitional Order	The Financial Services and Markets Act 2000 (Transitional Provisions, Repeals and Savings) (Financial Services Compensation Scheme) Order 2001 (SI 2001/2967).
DISP	Dispute resolution: the Complaints sourcebook.
firm	a <i>person</i> authorised under section 31 of the <i>Act</i> (Authorised persons).
FSA	the Financial Services Authority.
pensions review provision	<p>(as defined in the <i>Pensions Review Transitional Order</i>) any (or any part of any) enactment, subordinate legislation or other instrument or provision (including guidance in writing or other legible form) which (or to the extent that it) provides for, or relates to, the conduct of a review into, or the taking of other steps with respect to:</p> <p>(a) the selling, between 29 April 1988 and 30 June 1994, by persons who were at the time:</p> <p>(i) authorised persons under the Financial Services Act 1986; or</p> <p>(ii) appointed representatives of such persons (within the meaning of that Act); of rights in, or interests under, personal pension schemes; or</p> <p>(b) the selling, by such persons between 29 April 1988 and 15 August 1999, of rights in, or interests under, free-standing additional voluntary contribution schemes.</p> <p>In (a) and (b), references to "selling" rights or interests are to be construed in accordance with paragraph 27 (Interpretation) of Schedule 2 to the <i>Act</i>, but also include:</p> <p>(i) the giving of advice to acquire rights or interests; and</p> <p>(ii) the making of arrangements for another person to acquire, or with a view to another person acquiring, rights or interests.</p>
Pensions Review Transitional Order	The Financial Services and Markets Act 2000 (Transitional Provisions) (Reviews of Pensions Business) Order 2001 (SI 2001/2512)
person	(in accordance with the Interpretation Act 1978) any person, including a body of persons corporate or unincorporate (that is, a natural person, a legal person and, for example, a partnership, other than a limited liability partnership).

Schedule 1

Designated *pensions review provisions* applying to *firms* which, immediately before *commencement*, were members of the Personal Investment Authority Limited (PIA)

Description of Provisions (see notes 1 and 2)	Published by	Date Published or Made
Pension Transfers and Opt Outs Review of Past Business Part I: Statement of Policy	The Securities and Investments Board (SIB) (now known as the Financial Services Authority (FSA))	Oct 94
Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures	SIB	Oct 94
Regulatory Update 3	PIA	Oct 94
Pension Transfers and Opt Outs Review of Past Business Identifying Opt Outs and Non-Joiners: Model Guidance	SIB	Dec 94
Regulatory Update 7	PIA	Feb 95
Pension Transfer and Opt-Outs: Review of Past Business Statement of PIA's Policy	PIA	Feb 95
Pension Opt-Outs And Non-Joiners - Section 1 Guidance For Review Of Past Business	PIA	Apr 95
Regulatory Update 11	PIA	Jun 95
Transfers – Section 2 Guidance For Review Of Past Business	PIA	Jul 95
Redress Assessment – Section 3 Guidance For Review Of Past Business	PIA	Aug 95
Regulatory Update 13	PIA	Sep 95
Notes on the Pension Opt-Outs and Non-Joiners and Transfers Review Guidance For Review Of Past Business	PIA	Dec 95
Regulatory Update 16, including the accompanying Pensions Unit Bulletin	PIA	Jan 96
Specimen Calculations. Transfers - Loss Assessment Review Of Past Business	PIA	Jan 96
Specimen Calculations. Opt-Outs and Non-Joiners - Loss Assessment and Redress - Review Of Past Business	PIA	Apr 96
Regulatory Update 18	PIA	Mar 96
PI Insurance Effect of The Accord – Section 4 Guidance For Review Of Past Business	PIA	Mar 96
The Pensions Review Essential Steps	PIA	Mar 96
Regulatory Update 20, including the accompanying PIA Pensions Unit Bulletin	PIA	May 96
Regulatory Update 22	PIA	Aug 96
Regulatory Update 24	PIA	Sep 96
Regulatory Update 26, including the accompanying PIA Pensions Unit Bulletin	PIA	Nov 96
Simplifying the Pensions Review Part 1: Statement of Policy	SIB	Nov 96

Simplifying the Pensions Review Part 2: Guidance and Model Specification	SIB	Nov 96
Simplifying the Pensions Review Schedules to Part 2	SIB	Nov 96
Simplifying the Pensions Review: Amending Guidance	SIB	Jan 97
Simplifying the Pensions Review Statement of Policy	PIA	Jan 97
Regulatory Update 27, including the accompanying PIA Pensions Unit Bulletin	PIA	Jan 97
Regulatory Update 28, including the accompanying PIA Pensions Unit Bulletin	PIA	Feb 97
Pensions Review and Redress Programme – Redress by Guarantee: Criteria	SIB	May 97
Regulatory Update 29	PIA	Mar 97
Regulatory Update 31	PIA	May 97
Regulatory Update 33	PIA	May 97
Regulatory Update 39	PIA	Sep 97
Regulatory Update 41, including the accompanying PIA Pensions Unit Bulletin	PIA	Nov 97
Regulatory Update 42	PIA	Nov 97
Regulatory Update 46, including the accompanying PIA Pensions Unit Bulletin	PIA	Feb 98
Regulatory Update 47	PIA	Feb 98
Regulatory Update 53	PIA	Jul 98
Regulatory Update 54, including the accompanying Pensions Review bulletin	PIA	Aug 98
Pension transfers and opt outs review phase 2 - Policy statement	FSA/PIA	Aug 98
Pension Transfers and Opt Outs Review Phase 2 Guidance	PIA	Aug 98
Regulatory Update 56	PIA	Sep 98
Pension transfers and opt outs review phase 2: model guidance - Further information	FSA	Oct 98
Regulatory Update 57	PIA	Oct 98
Pensions Review bulletin No 1	FSA	Nov 98
Regulatory Update 60	PIA	Nov 98
Pensions Review bulletin No 2	FSA	Dec 98
Pension transfers and opt outs review phase 2: rebate-only cases - Policy statement and model guidance	FSA	Dec 98
Pension transfers and opt outs review Guidance for interim authorised firms on completion of the review	FSA	Jan 99
Phase 2 Return: Instructions for completion	FSA	Jan 99
Pensions Review bulletin No 3	FSA	Feb 99
Pensions Review bulletin No 4	FSA	May 99
Pension transfers and opt outs review phase 2: Optional Compliance Test for transfer cases – Policy statement and model guidance	FSA	Jul 99
Pensions Review bulletin No 5	FSA	Aug 99
Pension transfers and opt outs review phase 2: target date – Policy statement and model guidance	FSA	Sep 99
Pensions Review bulletin No 6	FSA	Nov 99
Pensions Review bulletin No 7	FSA	Dec 99

Pensions Review bulletin No 8	FSA	Feb 00
FSAVC Review Policy Statement	FSA/PIA	Feb 00
Regulatory Update 74	PIA	Feb 00
Pensions Review bulletin No 9	FSA	May 00
FSAVC Review Model Guidance	FSA	May 00
Pensions Review bulletin No 10	FSA	Jun 00
Regulatory Update 76	PIA	Jun 00
Pensions Review bulletin No 11	FSA	Aug 00
FSAVC Review Model Guidance Update	FSA	Aug 00
FSAVC Review Bulletin Issue No: 1	FSA	Sep 00
Pension transfers and opt outs review phase 2: Optional simplified approach to testing for Financial Viability of transfer cases – Policy statement and model guidance	FSA	Sep 00
FSAVC Review Bulletin Issue No: 2	FSA	Oct 00
Pensions Review bulletin No 12	FSA	Nov 00
FSAVC Review Bulletin Issue No: 3	FSA	Jan 01
Pensions Review bulletin No 13	FSA	Feb 01
FSAVC Review Model Guidance Update	FSA	Mar 01
Pensions Review bulletin No 14	FSA	May 01
Regulatory Update 89	PIA	May 01
FSAVC Review Model Guidance Update	FSA	May 01
FSAVC Review Model Guidance Update	FSA	Jun 01
Regulatory Update 92	PIA	Aug 01
Pensions Review bulletin No 15	FSA	Aug 01
FSAVC Review Bulletin Issue No: 4	FSA	Sep 01
Regulatory Update 94	PIA	Oct 01
Rule 7.2.4 - The Pensions Review - Re-calculating loss (and redress) for Phase 2 transfers – SERPS Adjustment	PIA	Oct 01
Pensions Review bulletin No 16	FSA	Nov 01
The Pensions Review: Recalculating Loss (and Redress) for Phase 2 Transfers – SERPS Adjustment Guidance	PIA	Nov 01
The Pensions Review: Recalculating Loss (and Redress) for Phase 2 Transfers – SERPS Adjustment Statement of Policy	PIA	Nov 01
FSAVC Review Bulletin Issue No: 5	FSA	Nov 01

Notes

1. Where the designation relates to a Regulatory Update published by PIA, the designation covers only those parts of the Regulatory Update that relate to the reviews.
2. Where not contained within the documents listed above, the economic assumptions published each February; May; August and November by the FSA (formerly known as the SIB) beginning in February 1995 and relevant to Appendix L of the SIB's Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures, are also designated.

Schedule 2

Designated *pensions review provisions* applying to *firms* which, immediately before *commencement*, were members of the Investment Management Regulatory Organisation Limited (IMRO)

Description of Provisions (see note 1)	Published by	Date Published
Pension Transfers and Opt Outs Review of Past Business Part I: Statement of Policy	The Securities and Investments Board (SIB) (now known as the Financial Services Authority (FSA))	Oct 94
Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures	SIB	Oct 94
<p>The following text contained in a letter signed by Robin D Clark entitled 'IMRO's Approach to Monitoring the Review of Past Pension Transfers and Opt Out Business ("The Review")</p> <ul style="list-style-type: none"> • <i>'Members should write to all complainants confirming that their complaint is being dealt with under the Review process. Members should advise complainants of the priority category in which they have been placed, an estimate of the time frame for completing the Review, and that their case can be referred to IMRO if they are dissatisfied with the outcome.'</i> • <i>'Please note that reference here to complaints or complainants includes Investors who may only have made enquiries.'</i> 	IMRO	25 Nov 94
Guidelines to IMRO Members in respect of the Review of Past Pension Transfer and Opt-out Business – Issue 1	IMRO	Nov 94
Pension Transfers and Opt Outs Review of Past Business Identifying Opt Outs and Non-Joiners: Model Guidance	SIB	Dec 94
Guidelines to IMRO Members in respect of the Review of Past Pension Transfer and Opt-out Business – Issue 2	IMRO	Dec 94
Pensions Review and Redress Programme – Redress by Guarantee: Criteria	SIB	May 97
Pension transfers and opt outs review phase 2 - Policy statement	FSA/PIA	Aug 98
Pension transfers and opt outs review phase 2 - Model guidance	FSA	Aug 98
Pension transfers and opt outs review phase 2: model guidance - Further information	FSA	Oct 98
Pensions Review bulletin No 1	FSA	Nov 98
Pensions Review bulletin No 2	FSA	Dec 98
Pension transfers and opt outs review phase 2: rebate-only cases - Policy statement and model guidance	FSA	Dec 98
Phase 2 Return: Instructions for completion	FSA	Jan 99
Pensions Review bulletin No 3	FSA	Feb 99
Pensions Review bulletin No 4	FSA	May 99
Pension transfers and opt outs review phase 2: Optional Compliance Test for transfer cases – Policy statement and model guidance	FSA	Jul 99
Pensions Review bulletin No 5	FSA	Aug 99
Pension transfers and opt outs review phase 2: target date – Policy statement and model guidance	FSA	Sep 99
Pensions Review bulletin No 6	FSA	Nov 99

Pensions Review bulletin No 7	FSA	Dec 99
Pensions Review bulletin No 8	FSA	Feb 00
FSAVC Review Policy Statement	FSA/PIA	Feb 00
Pensions Review bulletin No 9	FSA	May 00
FSAVC Review Model Guidance	FSA	May 00
Pensions Review bulletin No 10	FSA	Jun 00
Pensions Review bulletin No 11	FSA	Aug 00
FSAVC Review Model Guidance Update	FSA	Aug 00
FSAVC Review Bulletin Issue No: 1	FSA	Sep 00
Pension transfers and opt outs review phase 2: Optional simplified approach to testing for Financial Viability of transfer cases – Policy statement and model guidance	FSA	Sep 00
FSAVC Review Bulletin Issue No: 2	FSA	Oct 00
Pensions Review bulletin No 12	FSA	Nov 00
FSAVC Review Bulletin Issue No: 3	FSA	Jan 01
Pensions Review bulletin No 13	FSA	Feb 01
FSAVC Review Model Guidance Update	FSA	Mar 01
Pensions Review bulletin No 14	FSA	May 01
FSAVC Review Model Guidance Update	FSA	May 01
FSAVC Review Model Guidance Update	FSA	Jun 01
Pensions Review bulletin No 15	FSA	Aug 01
FSAVC Review Bulletin Issue No: 4	FSA	Sep 01
Pensions Review bulletin No 16	FSA	Nov 01
FSAVC Review Bulletin Issue No: 5	FSA	Nov 01

Note

1. Where not contained within the documents listed above, the economic assumptions published each quarter by the FSA (formerly known as the SIB) beginning in February 1995 and relevant to Appendix L of the SIB's Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures, are also designated.

Schedule 3

Designated *pensions review provisions* applying to *firms* which, immediately before *commencement*, were members of the Securities and Futures Authority Limited

Description of Provisions (see note 1)	Published by	Date Published
Pension Transfers and Opt Outs Review of Past Business Part I: Statement of Policy	The Securities and Investments Board (SIB) (now known as the Financial Services Authority (FSA))	Oct 94
Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures	SIB	Oct 94
Pension Transfers and Opt Outs Review of Past Business Identifying Opt Outs and Non-Joiners: Model Guidance	SIB	Dec 94
Simplifying the Pensions Review Part 1: Statement of Policy	SIB	Nov 96
Simplifying the Pensions Review Part 2: Guidance and Model Specification	SIB	Nov 96
Simplifying the Pensions Review Schedules to Part 2	SIB	Nov 96
Simplifying the Pensions Review: Amending Guidance	SIB	Jan 97
Pensions Review and Redress Programme – Redress by Guarantee: Criteria	SIB	May 97
Pension transfers and opt outs review phase 2 - Policy statement	FSA/PIA	Aug 98
Pension transfers and opt outs review phase 2 - Model guidance	FSA	Aug 98
Pension transfers and opt outs review phase 2: model guidance - Further information	FSA	Oct 98
Pensions Review bulletin No 1	FSA	Nov 98
Pensions Review bulletin No 2	FSA	Dec 98
Pension transfers and opt outs review phase 2: rebate-only cases - Policy statement and model guidance	FSA	Dec 98
Phase 2 Return: Instructions for completion	FSA	Jan 99
Pensions Review bulletin No 3	FSA	Feb 99
Pensions Review bulletin No 4	FSA	May 99
Pension transfers and opt outs review phase 2: Optional Compliance Test for transfer cases – Policy statement and model guidance	FSA	Jul 99
Pensions Review bulletin No 5	FSA	Aug 99
Pension transfers and opt outs review phase 2: target date – Policy statement and model guidance	FSA	Sep 99
Pensions Review bulletin No 6	FSA	Nov 99
Pensions Review bulletin No 7	FSA	Dec 99
Pensions Review bulletin No 8	FSA	Feb 00
FSAVC Review Policy Statement	FSA/PIA	Feb 00
Pensions Review bulletin No 9	FSA	May 00
FSAVC Review Model Guidance	FSA	May 00
Pensions Review bulletin No 10	FSA	Jun 00
Pensions Review bulletin No 11	FSA	Aug 00

FSAVC Review Model Guidance Update	FSA	Aug 00
FSAVC Review Bulletin Issue No: 1	FSA	Sep 00
Pension transfers and opt outs review phase 2: Optional simplified approach to testing for Financial Viability of transfer cases – Policy statement and model guidance	FSA	Sep 00
FSAVC Review Bulletin Issue No: 2	FSA	Oct 00
Pensions Review bulletin No 12	FSA	Nov 00
FSAVC Review Bulletin Issue No: 3	FSA	Jan 01
Pensions Review bulletin No 13	FSA	Feb 01
FSAVC Review Model Guidance Update	FSA	Mar 01
Pensions Review bulletin No 14	FSA	May 01
FSAVC Review Model Guidance Update	FSA	May 01
FSAVC Review Model Guidance Update	FSA	Jun 01
Pensions Review bulletin No 15	FSA	Aug 01
FSAVC Review Bulletin Issue No: 4	FSA	Sep 01
Pensions Review bulletin No 16	FSA	Nov 01
FSAVC Review Bulletin Issue No: 5	FSA	Nov 01

Note

1. Where not contained within the documents listed above, the economic assumptions published each quarter by the FSA (formerly known as the SIB) beginning in February 1995 and relevant to Appendix L of the SIB's Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures, are also designated.

Schedule 4

Designated *pensions review provisions* applying to *firms* which, immediately before *commencement*, were members of The Association of Chartered Certified Accountants (ACCA)

Description of Provisions (see note 1)	Published by	Date Published
Pension Transfers and Opt Outs Review of Past Business Part I: Statement of Policy	The Securities and Investments Board (SIB) (now known as the Financial Services Authority (FSA))	Oct 94
Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures	SIB	Oct 94
Pension Transfers and Opt Outs Review of Past Business Identifying Opt Outs and Non-Joiners: Model Guidance	SIB	Dec 94
The following text contained in a letter signed by H F Youngs entitled 'Review of Pension Transfers and Opt Outs from Occupational Pension Schemes': <i>'...where you have followed the compliance review route, it [the monitoring unit] will be looking at whether you have carried this out in accordance with SIB's guidance. In preparation for this, could you please complete the enclosed checklist for each case you are required to review. These should then be filed on the relevant client file...'</i>	ACCA	18 Apr 96
Pensions Review and Redress Programme – Redress by Guarantee: Criteria	SIB	May 97
Pension transfers and opt outs review phase 2 - Policy statement	FSA/PIA	Aug 98
Pension transfers and opt outs review phase 2 - Model guidance	FSA	Aug 98
Letter signed by A H Harding entitled 'Pensions Review – Phase 2' – Section headed 'Identification of cases'.	ACCA	Oct 98
Pension transfers and opt outs review phase 2: model guidance - Further information	FSA	Oct 98
Pension transfers and opt outs review phase 2: rebate-only cases - Policy statement and model guidance	FSA	Dec 98
Phase 2 Pensions Review – Further Guidance (enclosed with letter signed by K I Honnoraty entitled 'Pensions review – phase 2') – Section headed 'Compliance assessment'	ACCA	17 Jun 99
The following text contained in a letter signed by Karen Honnoraty entitled 'Pensions Review – Phase 2': <i>'This [a loss assessment] is a complex calculation which should be carried out by an approved actuary using the rates and assumptions specified by FSA.'</i>	ACCA	Issued when firms identified Phase 2 cases requiring loss assessment
FSAVC Review Model Guidance	FSA	May 00
FSAVC Review Bulletin Issue No: 1	FSA	Sep 00
FSAVC Review Bulletin Issue No: 2	FSA	Oct 00
FSAVC Review Bulletin Issue No: 3	FSA	Jan 01
FSAVC Review Model Guidance Update	FSA	Mar 01

FSAVC Review Bulletin Issue No: 4	FSA	Sep 01
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Note

1. In addition to the documents listed above, the economic assumptions published each quarter by the FSA (formerly known as the SIB) beginning in February 1995 and relevant to Appendix L of the SIB's Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures, are also designated.

Schedule 5

Designated *pensions review provisions* applying to *firms* which, immediately before *commencement*, were members of The Institute of Actuaries

Description of Provisions (see notes 1 - 3)	Published by	Date Published
Pension Transfers and Opt Outs Review of Past Business Part I: Statement of Policy	The Securities and Investments Board (SIB) (now known as the Financial Services Authority (FSA))	Oct 94
Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures	SIB	Oct 94
Pension Transfers and Opt Outs Review of Past Business Identifying Opt Outs and Non-Joiners: Model Guidance	SIB	Dec 94
Compliance Bulletin 7/95	The Institute of Actuaries	Dec 95
Pensions Review and Redress Programme – Redress by Guarantee: Criteria	SIB	May 97
Compliance Bulletin 4/97	The Institute of Actuaries	Aug 97
Compliance Bulletin 5/97	The Institute of Actuaries	Dec 97
Compliance Bulletin 4/98	The Institute of Actuaries	Jun 98
Compliance Bulletin 5/99	The Institute of Actuaries	Jun 99
Compliance Bulletin 6/99	The Institute of Actuaries	Jul 99
FSAVC Review Model Guidance	FSA	May 00
Pensions Review bulletin No 10	FSA	Jun 00
FSAVC Review Model Guidance Update	FSA	Aug 00
FSAVC Review Bulletin Issue No: 1	FSA	Sep 00
FSAVC Review Bulletin Issue No: 2	FSA	Oct 00
Compliance Bulletin 4/2000	The Institute of Actuaries	Nov 00
FSAVC Review Bulletin Issue No: 3	FSA	Jan 01
FSAVC Review Bulletin Issue No: 4	FSA	Sep 01
Regulatory Update 94	The Personal Investment Authority (PIA)	Oct 01
Compliance Bulletin 4/2001	The Institute of Actuaries	Nov 01
FSAVC Review Bulletin Issue No: 5	FSA	Nov 01

Notes

1. Where the designation relates to a Compliance Bulletin published by the Institute of Actuaries, the designation covers only those parts of the Compliance Bulletin that relate to the reviews.
2. Where not contained within the documents listed above, the economic assumptions published each quarter by the FSA (formerly known as the SIB) beginning in February 1995 and relevant to Appendix L of the SIB's Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures, are also designated.
3. Where the designation relates to a Regulatory Update published by PIA, the designation covers only those parts of the Regulatory Update that relate to the reviews.

Schedule 6

Designated *pensions review provisions* applying to *firms* which, immediately before *commencement*, were members of The Institute of Chartered Accountants in England and Wales (ICAEW)

Description of Provisions (see note 1)	Published by	Date Published
Pension Transfers and Opt Outs Review of Past Business Part I: Statement of Policy	The Securities and Investments Board (SIB) (now known as the Financial Services Authority (FSA))	Oct 94
Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures	SIB	Oct 94
Pension Transfers and Opt Outs Review of Past Business Identifying Opt Outs and Non-Joiners: Model Guidance	SIB	Dec 94
Simplifying the Pensions Review Part 1: Statement of Policy	SIB	Nov 96
Simplifying the Pensions Review Part 2: Guidance and Model Specification	SIB	Nov 96
Simplifying the Pensions Review Schedules to Part 2	SIB	Nov 96
Simplifying the Pensions Review: - Amending Guidance	SIB	Jan 97
Pensions Review and Redress Programme – Redress by Guarantee: Criteria	SIB	May 97
The following text contained in a letter signed by Peter Skelton entitled 'The Securities and Investment Board's (SIB) Review of Pension Transfers and Opt-Outs. Eighth Quarterly Return for the period up to 30 September 1997': <i>'...it should be noted that in order for the firm to indicate that their Review is complete, but subject to Professional Indemnity Insurers instructions, all priority case investors must be contacted to inform them that the Review has been carried out and the firm's conclusion.'</i>	ICAEW	1 Oct 97
Investment Business Gazette – Issue No. 25 – Section headed 'The SIB Pensions Review: Identification of Cases'	ICAEW	Feb 98
Pension transfers and opt outs review phase 2 – Policy statement	FSA/PIA	Aug 98
Pension transfers and opt outs review phase 2 – Model guidance	FSA	Aug 98
Pension transfers and opt outs review phase 2: model guidance – Further information	FSA	Oct 98
Pensions Review bulletin No 1	FSA	Nov 98
Pensions Review bulletin No 2	FSA	Dec 98
Pension transfers and opt outs review phase 2: rebate-only cases – Policy statement and model guidance	FSA	Dec 98
The following text contained in a letter signed by Peter Skelton entitled 'Pension Transfers and Opt Outs Review : Phase 2' : <i>'At its meeting in November, the Joint Investment Business Committee considered the case of those firms that had already carried out compliance reviews of Phase 2 files. It was decided that, where a file was, as a result, known to be non-compliant under the SIB (now FSA) requirements, it would not be correct to write to the client now and ask him if he wanted his file to be reviewed; with that knowledge, the firm must adopt the Phase 1 methodology and proceed to a loss assessment.'</i>	ICAEW	18 Dec 98
Pensions Review bulletin No 3	FSA	Feb 99

Pensions Review bulletin No 4	FSA	May 99
Pension transfers and opt outs review phase 2: Optional Compliance Test for transfer cases – Policy statement and model guidance	FSA	Jul 99
Pensions Review bulletin No 5	FSA	Aug 99
Pension transfers and opt outs review phase 2: target date – Policy statement and model guidance	FSA	Sep 99
The following text contained in a letter signed by Peter Skelton entitled 'Pension Transfers and Opt Outs Review : Phase 2' : <i>'The Financial Viability Test (FVT) (9-10) will require the services of an actuary (unless the work currently being undertaken by the FSA results in an acceptable means of simplification being found). When a case fails the FVT, then further actuarial costs will be incurred in calculating the potential loss for redress.'</i>	ICAEW	27 Sep 99
Pensions Review bulletin No 6	FSA	Nov 99
Pensions Review bulletin No 7	FSA	Dec 99
Pensions Review bulletin No 8	FSA	Feb 00
Pensions Review bulletin No 9	FSA	May 00
FSAVC Review Model Guidance	FSA	May 00
Pensions Review bulletin No 10	FSA	Jun 00
Pensions Review bulletin No 11	FSA	Aug 00
Pension transfers and opt outs review phase 2: Optional simplified approach to testing for Financial Viability of transfer cases – Policy statement and model guidance	FSA	Sep 00
FSAVC Review Bulletin Issue No: 1	FSA	Sep 00
FSAVC Review Bulletin Issue No: 2	FSA	Oct 00
Pensions Review bulletin No 12	FSA	Nov 00
FSAVC Review Bulletin Issue No: 3	FSA	Jan 01
Pensions Review bulletin No 13	FSA	Feb 01
FSAVC Review Model Guidance Update	FSA	Mar 01
Pensions Review bulletin No 14	FSA	May 01
FSAVC Review Model Guidance Update	FSA	May 01
FSAVC Review Model Guidance Update	FSA	Jun 01
FSAVC Review Bulletin Issue No: 4	FSA	Sep 01
Letter signed by Brian Manners entitled 'The Financial Services Authority's (FSA) Review of Free Standing Additional Voluntary Contributions (FSAVC) Policies' and accompanying document entitled 'Free Standing Additional Voluntary Contributions (FSAVC) Review - Instructions to firms for carrying out the Review'	ICAEW	25 Oct 01

Note

1. Where not contained within the documents listed above, the economic assumptions published each quarter by the FSA (formerly known as the SIB) beginning in February 1995 and relevant to Appendix L of the SIB's Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures, are also designated.

Schedule 7

Designated *pensions review provisions* applying to *firms* which, immediately before commencement, were members of The Institute of Chartered Accountants of Scotland (ICAS)

Description of Provisions (see note 1)	Published by	Date Published
Pension Transfers and Opt Outs Review of Past Business Part I: Statement of Policy	The Securities and Investments Board (SIB) (now known as the Financial Services Authority (FSA))	Oct 94
Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures	SIB	Oct 94
Investment Business Update – Issue No. 20 – Section headed ‘The SIB Review: Pension Opt Outs and Non Joiners’	ICAS	Jan 96
Simplifying the Pensions Review Part 1: Statement of Policy	SIB	Nov 96
Simplifying the Pensions Review Part 2: Guidance and Model Specification	SIB	Nov 96
Simplifying the Pensions Review Schedules to Part 2	SIB	Nov 96
Simplifying the Pensions Review: - Amending Guidance	SIB	Jan 97
Pensions Review and Redress Programme – Redress by Guarantee: Criteria	SIB	May 97
Investment Business Gazette – Issue No. 25 – Section headed ‘The SIB Pensions Review: Identification of Cases’	ICAS	Feb 98
Pension transfers and opt outs review phase 2 – Policy statement	FSA/PIA	Aug 98
Pension transfers and opt outs review phase 2 – Model guidance	FSA	Aug 98
Pension transfers and opt outs review phase 2: model guidance – Further information	FSA	Oct 98
Pensions Review bulletin No 1	FSA	Nov 98
Pensions Review bulletin No 2	FSA	Dec 98
Pension transfers and opt outs review phase 2: rebate-only cases – Policy statement and model guidance	FSA	Dec 98
The following text contained in a letter signed by A M Scott entitled ‘Review of Pension Transfers and Opt Outs – Phase 2’ – letter reference F0041/projplan/AMS: <i>‘At its meeting in November, the Joint Investment Business Committee considered the case of those firms that had already carried out compliance reviews of Phase 2 files. It was decided that, where files were, as a result, known to be non-compliant under the SIB (now FSA) requirements, it would not be appropriate to write to those clients now and ask if they wanted their files to be reviewed; in these cases, firms must adopt the Phase 1 methodology and proceed to a loss assessment.’</i>	ICAS	11 Dec 98
Pensions Review bulletin No 3	FSA	Feb 99
Appendix enclosed with letter signed by A M Scott headed ‘Review of Pension Transfers and Opt Outs – Rebate-Only Cases’ – letter reference F0039/ro/ph2rev/AMS – Section headed ‘No. 2 – December 1998’ - paragraph number (iv) ‘Loss assessment and redress calculations: A reminder’.	ICAS	29 Mar 99

Pensions Review bulletin No 4	FSA	May 99
Pension transfers and opt outs review phase 2: Optional Compliance Test for transfer cases – Policy statement and model guidance	FSA	Jul 99
Pensions Review bulletin No 5	FSA	Aug 99
Pension transfers and opt outs review phase 2: target date – Policy statement and model guidance	FSA	Sep 99
The following text contained in a letter signed by Nicola Saggi entitled 'Review of Pension Transfers and Opt Outs – Phase 2' – letter reference F0041/ph2ppsfup/NJB: <i>'The calculation of the Financial Viability Test (FVT) (9-10) will require the services of an actuary. When a case fails the FVT, then further actuarial costs will be incurred in calculating the potential loss for redress.'</i>	ICAS	11 Oct 99
Pensions Review bulletin No 6	FSA	Nov 99
Pensions Review bulletin No 7	FSA	Dec 99
Pensions Review bulletin No 8	FSA	Feb 00
Pensions Review bulletin No 9	FSA	May 00
FSAVC Review Model Guidance	FSA	May 00
Pensions Review bulletin No 10	FSA	Jun 00
Pensions Review bulletin No 11	FSA	Aug 00
Pension transfers and opt outs review phase 2: Optional simplified approach to testing for Financial Viability of transfer cases – Policy statement and model guidance	FSA	Sep 00
FSAVC Review Bulletin Issue No: 1	FSA	Sep 00
FSAVC Review Bulletin Issue No: 2	FSA	Oct 00
Pensions Review bulletin No 12	FSA	Nov 00
FSAVC Review Bulletin Issue No: 3	FSA	Jan 01
Pensions Review bulletin No 13	FSA	Feb 01
FSAVC Review Model Guidance Update	FSA	Mar 01
FSAVC Review Model Guidance Update	FSA	May 01
FSAVC Review Model Guidance Update	FSA	Jun 01
FSAVC Review Bulletin Issue No: 4	FSA	Sep 01
Letter signed by Sharon Jackson entitled 'The Financial Services Authority's (FSA) Review of Free Standing Additional Voluntary Contributions (FSAVC) Policies' and accompanying document entitled 'Free Standing Additional Voluntary Contributions (FSAVC) Review - Instructions to firms for carrying out the Review'	ICAS	2 Nov 01

Note

1. Where not contained within the documents listed above, the economic assumptions published each quarter by the FSA (formerly known as the SIB) beginning in February 1995 and relevant to Appendix L of the SIB's Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures, are also designated.

Schedule 8

Designated *pensions review provisions* applying to *firms* which, immediately before commencement, were members of The Institute of Chartered Accountants in Ireland (ICAI)

Description of Provisions (see notes 1 - 3)	Published by	Date Published
Pension Transfers and Opt Outs Review of Past Business Part I: Statement of Policy	The Securities and Investments Board (SIB) (now known as the Financial Services Authority (FSA))	Oct 94
Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures	SIB	Oct 94
Pension Transfers and Opt Outs Review of Past Business Identifying Opt Outs and Non-Joiners: Model Guidance	SIB	Dec 94
Simplifying the Pensions Review Part 1: Statement of Policy	SIB	Nov 96
Simplifying the Pensions Review Part 2: Guidance and Model Specification	SIB	Nov 96
Simplifying the Pensions Review Schedules to Part 2	SIB	Nov 96
Simplifying the Pensions Review: - Amending Guidance	SIB	Jan 97
The following text contained in a letter signed by A Bradshaw entitled 'The Securities and Investment Board's (SIB) Review of Pension Transfers and Opt-Outs. Eighth Quarterly Return for the period up to 30 September 1997': <i>'...it should be noted that in order for the firm to indicate that their Review is complete, but subject to Professional Indemnity Insurers instructions, all priority case investors must be contacted to inform them that the Review has been carried out and the firm's conclusion.'</i>	ICAI	1 Oct 97
Investment Business Gazette – Issue No. 25 – Section headed 'The SIB Pensions Review: Identification of Cases'	ICAI	Feb 98
Pensions Review bulletin No 1	FSA	Nov 98
Pensions Review bulletin No 2	FSA	Dec 98
Pensions Review bulletin No 3	FSA	Feb 99
Pensions Review bulletin No 4	FSA	May 99
Pension transfers and opt outs review phase 2: Optional Compliance Test for transfer cases – Policy statement and model guidance	FSA	Jul 99
Pensions Review bulletin No 5	FSA	Aug 99
Pension transfers and opt outs review phase 2: target date – Policy statement and model guidance	FSA	Sep 99
Pensions Review bulletin No 6	FSA	Nov 99
Pensions Review bulletin No 7	FSA	Dec 99
Pensions Review bulletin No 8	FSA	Feb 00
Pensions Review bulletin No 9	FSA	May 00
FSAVC Review Model Guidance	FSA	May 00
Pensions Review bulletin No 10	FSA	Jun 00

Pensions Review bulletin No 11	FSA	Aug 00
Pension transfers and opt outs review phase 2: Optional simplified approach to testing for Financial Viability of transfer cases – Policy statement and model guidance	FSA	Sep 00
Pensions Review bulletin No 12	FSA	Nov 00
Pensions Review bulletin No 13	FSA	Feb 01
Pensions Review bulletin No 14	FSA	May 01
Regulatory Update 94	The Personal Investment Authority (PIA)	Oct 01
Pensions Review bulletin No 16	FSA	Nov 01

Notes

1. Any provision which relates to the priority review – that is, the review required by the documents published by SIB in the above table – is designated so as to apply to Phase 2 of the review also.
2. Where not contained within the documents listed above, the economic assumptions published each quarter by the FSA (formerly known as the SIB) beginning in February 1995 and relevant to Appendix L of the SIB's Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures, are also designated.
3. Where the designation relates to a Regulatory Update published by PIA, the designation covers only those parts of the Regulatory Update that relate to the reviews.

Schedule 9

Designated *pensions review provisions* applying to *firms* which, immediately before *commencement*, were members of The Law Society

Description of Provisions (see note 1)	Published by	Date Published
Pension Transfers and Opt Outs Review of Past Business Part I: Statement of Policy	The Securities and Investments Board (SIB) (now known as the Financial Services Authority (FSA))	Oct 94
Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures	SIB	Oct 94
Council Statement – Document C	The Law Society Council	Jun 95 (amended Dec 96)
Simplifying the Pensions Review Part 1: Statement of Policy	SIB	Nov 96
Simplifying the Pensions Review Part 2: Guidance and Model Specification	SIB	Nov 96
Simplifying the Pensions Review Schedules to Part 2	SIB	Nov 96
Simplifying the Pensions Review: - Amending Guidance	SIB	Jan 97
Pensions Review and Redress Programme – Redress by Guarantee: Criteria	SIB	May 97
The following text contained in a letter signed by R A Butler entitled 'Pension Transfers and Opt Outs – Review of Past Business' – letter reference OSS/MIU/RAB: <i>'Completion of the review in this context [the deadline for completion of the review] should either be having informed clients that their transaction is compliant or they have not suffered any losses or in the case of redress being due, the case has been referred to the Solicitors Indemnity Fund.'</i>	Office for the Supervision of Solicitors	3 Nov 97
Pension transfers and opt outs review phase 2 - Policy statement	FSA/PIA	Aug 98
Pension transfers and opt outs review phase 2 - Model guidance	FSA	Aug 98
Pension transfers and opt outs review phase 2: model guidance - Further information	FSA	Oct 98
Council Statement – Document D	The Law Society Council	Oct 98
Pensions Review bulletin No 1	FSA	Nov 98
Pensions Review bulletin No 2	FSA	Dec 98
Pension transfers and opt outs review phase 2: rebate-only cases - Policy statement and model guidance	FSA	Dec 98
Pensions Review bulletin No 3	FSA	Feb 99
Pensions Review bulletin No 4	FSA	May 99
Pension transfers and opt outs review phase 2: Optional Compliance Test for transfer cases – Policy statement and model guidance	FSA	Jul 99
Pensions Review bulletin No 5	FSA	Aug 99
Pensions Review bulletin No 6	FSA	Nov 99
Pensions Review bulletin No 7	FSA	Dec 99

Pensions Review bulletin No 8	FSA	Feb 00
Pensions Review bulletin No 9	FSA	May 00
FSAVC Review Model Guidance	FSA	May 00
Pensions Review bulletin No 10	FSA	Jun 00
Council Statement on the Review of Free-Standing Additional Voluntary Contributions	The Law Society Council	Jul 00
Pension transfers and opt outs review phase 2: Optional simplified approach to testing for Financial Viability of transfer cases – Policy statement and model guidance	FSA	Sep 00
FSAVC Review Bulletin Issue No: 1	FSA	Sep 00
FSAVC Review Bulletin Issue No: 2	FSA	Oct 00
Pensions Review bulletin No 12	FSA	Nov 00
FSAVC Review Bulletin Issue No: 3	FSA	Jan 01
FSAVC Review Model Guidance Update	FSA	Jun 01
Pensions Review bulletin No 15	FSA	Aug 01
FSAVC Review Bulletin Issue No: 4	FSA	Sep 01
Council Statement on the Review of Free-Standing Additional Voluntary Contribution Policies (No. 2)	The Law Society Council	Oct 01
FSAVC Review Bulletin Issue No: 5	FSA	Nov 01

Note

1. Where not contained within the documents listed above, the economic assumptions published each quarter by the FSA (formerly known as the SIB) beginning in February 1995 and relevant to Appendix L of the SIB's Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures, are also designated.

Schedule 10

Designated *pensions review provisions* applying to *firms* which, immediately before *commencement*, were members of The Law Society of Scotland (LSS)

Description of Provisions (see note 1)	Published by	Date Published
Pension Transfers and Opt Outs Review of Past Business Part I: Statement of Policy	The Securities and Investments Board (SIB) (now known as the Financial Services Authority (FSA))	Oct 94
Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures	SIB	Oct 94
Simplifying the Pensions Review Part 1: Statement of Policy	SIB	Nov 96
Simplifying the Pensions Review Part 2: Guidance and Model Specification	SIB	Nov 96
Simplifying the Pensions Review Schedules to Part 2	SIB	Nov 96
Simplifying the Pensions Review: - Amending Guidance	SIB	Jan 97
Pensions Review and Redress Programme – Redress by Guarantee: Criteria	SIB	May 97
Pension transfers and opt outs review phase 2 - Policy statement	FSA/PIA	Aug 98
Pension transfers and opt outs review phase 2 - Model guidance	FSA	Aug 98
Pension transfers and opt outs review phase 2: model guidance - Further information	FSA	Oct 98
Pension transfers and opt outs review phase 2: rebate-only cases - Policy statement and model guidance	FSA	Dec 98
Letter signed by L H Cumming entitled 'Pension Transfers and Opt-Outs – Review of Past Business - GUIDANCE' – letter reference PPR.LHC.JW.F	LSS	22 Apr 99
The following text contained in a letter signed by L H Cumming entitled 'Pension Transfers and Opt-Outs – Review of Past Business – IMPORTANT INFORMATION' – letter reference PPR.LHC.JW.f: <i>'If a complete new business register is available this should be reviewed to identify all pension business between 29/4/88 and 30/6/94. All firms who were authorised to conduct investment business during this period, and who did not maintain a new business register for the whole period, must now write to every insurance company with whom they had an agency with during the review period and request lists of pension business transacted through their agency...'</i>	LSS	27 Jul 99
FSAVC Review Model Guidance	FSA	May 00
FSAVC Review Model Guidance Update	FSA	Aug 00
FSAVC Review Bulletin Issue No: 1	FSA	Sep 00
FSAVC Review Bulletin Issue No: 2	FSA	Oct 00
FSAVC Review Bulletin Issue No: 3	FSA	Jan 01
FSAVC Review Model Guidance Update	FSA	Mar 01
FSAVC Review Model Guidance Update	FSA	May 01
FSAVC Review Model Guidance Update	FSA	Jun 01
Letter signed by L H Cumming entitled 'Pension Transfers and Opt-Outs – Review of Past Business – Phase 2' – letter reference PPR.LHC.IH	LSS	16 Jul 01

FSAVC Review Bulletin Issue No: 4	FSA	Sep 01
Pensions Review bulletin No 16	FSA	Nov 01

Note

1. In addition to the documents listed above, the economic assumptions published each quarter by the FSA (formerly known as the SIB) beginning in February 1995 and relevant to Appendix L of the SIB's Pension Transfers and Opt Outs Review of Past Business Part II: Specification of Standards and Procedures, are also designated.

**GENERAL PROVISIONS AND GLOSSARY (AMENDMENT NO 3)
INSTRUMENT 2001**

Powers exercised

- A. The Financial Services Authority amends the General provisions and the Glossary in the exercise of the powers and related provisions listed in Schedule 4 to the General provisions (Powers exercised).
- B. The provisions of or under the Financial Services and Markets Act 2000 (the "Act") relevant to making rules and referred to above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force immediately.

Amendment of the General provisions and the Glossary

- D. The General provisions are amended in accordance with Annex A to this instrument.
- E. The Glossary is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the General Provisions and Glossary (Amendment No 3) Instrument 2001.

By order of the Board
20 December 2001

Annex A
Amendment of the General provisions

Insert, in the table of transitional provisions under the heading “Transitional provisions applying across the Handbook”, the following additional rows numbered 23 and 24:

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional provision	Transitional provision: dates in force	Handbook provision: coming into force
23	Every <i>rule</i> in the <i>Handbook</i> made by the <i>FSA</i>	R	<p><u>Dealing as principal by certain grandfathered firms</u></p> <p>(1) This paragraph applies to a <i>firm</i> which has <i>permission to deal in investments as principal</i> which:</p> <p style="padding-left: 20px;">(a) is subject to a <i>limitation</i> to the effect that the <i>firm</i>, in carrying on this <i>regulated activity</i>, is limited to entering into transactions in a manner which, if the <i>firm</i> was an <i>unauthorised person</i>, would come within article 16 of the <i>Regulated Activities Order (Dealing in contractually based investments)</i>; and</p> <p style="padding-left: 20px;">(b) it was treated as having, at <i>commencement</i>, as a result of article 6, 7, 8 or 9 of the <i>Financial Services and Markets Act 2000 (Miscellaneous Provisions) Order 2001 (SI 2001/3650)</i>;</p> <p style="padding-left: 20px;">unless the <i>firm</i> is an <i>ISD investment firm</i>.</p> <p>(2) The <i>rules</i> in the <i>Handbook</i> apply to, and in relation to, a <i>firm</i> in (1) as if:</p> <p style="padding-left: 20px;">(a) the <i>firm</i> does not have, and does not require, <i>permission to deal in investments as principal</i> or to <i>agree to carry on that regulated activity</i>;</p>	From 20 December 2001 until 19 December 2002	Various dates

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
			<p>(b) dealing as principal in a manner which is excluded under article 15 of the <i>Regulated Activities Order</i> (Absence of holding out etc) (and agreeing to do so) is not <i>designated investment business</i>;</p> <p>(c) dealing in investments as principal in a manner described in (1)(a) (and agreeing to do so) is an <i>unregulated activity</i> (and hence also not <i>designated investment business</i>);</p> <p>(d) <i>PRIN 3.2.1R(2)</i> does not apply; and</p> <p>(e) <i>SYSC 1.1.3R(2)</i> does not apply in relation to <i>SYSC 3</i>.</p>		
24	<p>Paragraph 23 and <i>guidance</i> in the <i>Handbook</i> other than in:</p> <ul style="list-style-type: none"> • <i>COND</i>; • <i>APER</i>; • <i>FIT</i>; • <i>AUTH</i>; • <i>PROF</i>; • <i>MAR 1</i> 	G	<p>(1) Paragraph 23 applies to banks, building societies, insurance companies and friendly societies which were not authorised under the Financial Services Act 1986 but which were grandfathered into <i>authorisation</i> under the <i>Act</i> with a limited <i>permission to deal in investments as principal</i>. These <i>firms</i> were able to carry on limited dealing as principal in both securities and contractually based investments without authorisation under paragraph 17 of Schedule 1 to the 1986 Act (Dealings as principal), and were not subject to conduct of business rules for such activities. <i>Firms</i> used the exemptions mainly for the purposes of treasury management.</p> <p>(2) Under the <i>Act</i>, the exemption for <i>contractually based investments</i> (article 16 of the <i>Regulated Activities Order</i> (Dealing in contractually based investments)) is not available to these <i>firms</i>, as they are <i>authorised persons</i>. Further, the <i>Handbook</i> treats <i>dealing in investments as principal</i> in relation to <i>securities</i> as <i>designated investment business</i>, even if it falls within the exemption in article 15 of that Order (Absence of holding out etc).</p> <p>(3) The transitional <i>rule</i> in paragraph 23 results in the <i>FSA's rules</i> applying to these <i>firms</i> as if their article 15 and 16 dealing as principal was not <i>designated investment business</i> nor a <i>regulated activity</i>, pending <i>FSA</i> consultation on the treatment of this activity under the <i>Handbook</i>. This transitional provision does not, for example, affect the application of:</p>	From 20 December 2001 until 19 December 2002	Various dates

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
			<p>(a) <i>rules</i>, such as most prudential <i>rules</i>, whose application is not dependent on the regulated status of this activity;</p> <p>(b) <i>Principle 3</i> (Management and control) and <i>SYSC 3</i> (Systems and controls) in a <i>prudential context</i> (<i>PRIN 3.2.3R</i> and <i>SYSC 1.1.5R</i>);</p> <p>(c) <i>Principle 4</i> (Financial prudence) and <i>Principal 11</i> (Relations with regulators) (<i>PRIN 3.2.3R</i>);</p> <p>(d) <i>SYSC 2</i> (Senior management arrangements), which continues to apply for dealing as principal within article 15 and 16 (<i>SYSC 1.1.3R(2)</i>);</p> <p>(e) the rules of <i>FOS Ltd</i> in <i>DISP</i>.</p> <p>(4) <i>Firms</i> to which paragraph 23 applies may also regard the <i>guidance</i> referred to in column (2) as being modified in the same way as the <i>rules</i> are modified under paragraph 23.</p>		

Annex B Amendment of the Glossary

Amend the following definitions as shown (underlining indicates new text, striking through indicates deleted text):

- industrial assurance policy* ~~a policy of industrial assurance, as defined in the Industrial Assurance Act 1923.~~
a contract of insurance on human life, premiums in respect of which are received by means of collectors, but excluding:
- (a) a contract of insurance, the premiums in respect of which are payable at intervals of two months or more;
 - (b) a contract of insurance, effected whether before or after the passing of the Industrial Assurance Act 1923 by a society or company established before the date of the passing of that Act which at that date had no contracts of insurance outstanding the premiums on which were payable at intervals of less than one month so long as the society or company continues not to effect any such contracts;
 - (c) a contract of insurance effected before the passing of the Industrial Assurance Act 1923, premiums in respect of which are payable at intervals of one month or more, and which have up to the passing of that Act been treated as part of the business transacted by a branch other than the industrial branch of the society or company; and
 - (d) a contract of insurance for £25 or more effected after the passing of the Industrial Assurance Act 1923, premiums in respect of which are payable at intervals of one month or more, and which are treated as part of the business transacted by a branch other than the industrial branch of the society or company, in cases where the relevant authority certified prior to 1 December 2001 under section 1(2)(d) of that Act that the terms and conditions of the contract is on the whole not less favourable to the assured than those imposed by that Act;
- in this definition:
- (i) “collector” includes every person, however remunerated, who, by himself or by any deputy or substitute, makes house to house visits for the purpose of receiving premiums payable on policies of insurance on human life, or holds any interest in a collecting book, and includes such a deputy or substitute;
 - (ii) “collecting book” includes any book or document held by a collector in which payments of premiums are recorded.
- insurance business transfer scheme* (a) a scheme, defined in section 105 of the Act, which is in summary: a scheme to transfer the whole or part of the business of an insurer (other than a friendly society) to another body;
- (b) a similar scheme to transfer the whole or part of the business carried on by one or more members of the Society or ~~former underwriting~~ former underwriting members that meets the conditions of article 4 of the Financial Services and Markets Act 2000 (Control of Transfers of Business Done at Lloyd's) Order 2001 (SI 2001/3626[~~number to be inserted later~~]).

regulated activity

...

which is carried on by way of business and relates to a *specified investment applicable to that activity* or, in the case of (l), (m), (n) and (o), is carried on in relation to property of any kind.

state of the commitment

(in SUP 18) (in accordance with paragraph 6(1) of Schedule 12 to the Act (Transfer schemes: certificates)) (in relation to a commitment entered into at any date):

- (a) if the *policyholder* is an individual, the State in which he had his habitual residence at that date;
- (b) if the *policyholder* is not an individual, the State in which the establishment of the *policyholder* to which the commitment relates was established at that date;

in this definition, "commitment" means (in accordance with article 2 of the Financial Services and Markets Act 2000 (Control of Business Transfers) (Requirements on Applicants) Regulations 2001 (SI 2001/3625~~[number to be inserted later]~~) any contract of insurance of a kind referred to in article 1 of the *First Life Directive*.

Lists of Investment Exchanges and Clearing Houses Instrument 2001

- A. The Financial Services Authority (the FSA) amends the Interim Prudential sourcebook for investment businesses, the Interim Prudential sourcebook for banks and the Glossary in the ways indicated in Annex A.
- B. The FSA makes this instrument in the exercise of the powers and related provisions in or under the Financial Services and Markets Act 2000 (the Act) listed in Annex B.
- C. The provisions of the Act relevant to altering rules and listed in Annex B are specified for the purpose of section 153(2) of the Act (Rule-making instruments).
- D. This instrument comes into force on 1 January 2002.
- E. This instrument may be cited as the Lists of Investment Exchanges and Clearing Houses Instrument 2001.

By order of the Board
20 December 2001

Annex A

Part 1

Changes to the Interim Prudential sourcebook for investment businesses

1.1 Replace Appendix 57 of IPRU(INV) 3 with the following:

Appendix 57

List of Exchanges and Clearing Houses Recognised for the purposes of IPRU(INV) 3

1 Exchanges recognised for the purposes of IPRU(INV) 3

- a. Any recognised investment exchange (see Appendix 33).
- b. Any designated investment exchange (see Appendix 33).
- c. Any regulated market (see SUP 17 Ann 5G).

2 Clearing Houses recognised for the purposes of IPRU(INV) 3

- a. Any recognised clearing house.
- b. Any of the following clearing houses:

- ASX Settlement and Transfer Corporation Pty Ltd (ASTC)
- Austrian Kontroll Bank (OKB)
- Board of Trade Clearing Corporation
- Cassa di Compensazione e Garanzia S.p.A (CCG)
- Commodity Clearing Corporation
- Emerging Markets Clearing Corporation
- FUTOP Clearing Centre (FUTOP Clearing Centralen A/S)
- Hong Kong Futures Exchange Clearing Corporation Ltd
- Hong Kong Securities Clearing Company Ltd
- Kansas City Board of Trade Clearing Corporation
- Norwegian Futures & Options Clearing House (Norsk Opsjonsentral A.S. (NOS))
- N.V. Nederlandse Liquidatiekas (NLKKAS)
- OM Stockholm Exchange
- Options Clearing Corporation
- Options Clearing House Pty Ltd (OCH)
- Sydney Futures Exchanges Clearing House (SFECH Ltd)
- TNS Clearing Pty Ltd (TNSC)

1.2 Replace Appendix 57 of IPRU(INV) 10 with the following:

Appendix 57

List of Exchanges and Clearing Houses Recognised for the purposes of IPRU(INV) 10

1 Exchanges recognised for the purposes of IPRU(INV) 10

- a. *Any recognised investment exchange* (see **Appendix 33**).
- b. *Any designated investment exchange* (see **Appendix 33**).
- c. *Any regulated market* (see *SUP 17 Ann 5G*).

2 Clearing Houses recognised for the purposes of IPRU(INV) 10

- a. *Any recognised clearing house*.
- b. Any of the following *clearing houses*:

ASX Settlement and Transfer Corporation Pty Ltd (ASTC)
Austrian Kontroll Bank (OKB)
Board of Trade Clearing Corporation
Cassa di Compensazione e Garanzia S.p.A (CCG)
Commodity Clearing Corporation
Emerging Markets Clearing Corporation
FUTOP Clearing Centre (FUTOP Clearing Centralen A/S)
Hong Kong Futures Exchange Clearing Corporation Ltd
Hong Kong Securities Clearing Company Ltd
Kansas City Board of Trade Clearing Corporation
Norwegian Futures & Options Clearing House (Norsk Opsjonssentral A.S. (NOS))
N.V. Nederlandse Liquidatiekas (NLKKAS)
OM Stockholm Exchange
Options Clearing Corporation
Options Clearing House Pty Ltd (OCH)
Sydney Futures Exchanges Clearing House (SFECH Ltd)
TNS Clearing Pty Ltd (TNSC)

Part 2

Changes to the Interim Prudential sourcebook for banks

2 Replace section 5 of Chapter BC of IPRU(BANK) with the following:

5 APPENDIX

5.1 Clearing houses and exchanges recognised for the purposes of Chapter BC of IPRU(BANK). (Counterparty exposures to CEDEL and Euroclear continue to attract a 20% weighting).

5.1.1 Exchanges

1 Any of the following:

- a) any “recognised investment exchange”;
- b) any “designated investment exchange”;
- c) any “regulated market”

in each case, as defined in the central Handbook Glossary (“the Glossary”, as amended from time to time).

5.1.2 Clearing Houses

2 Any of the following:

- a) any “recognised clearing house” as defined in the Glossary;
- b) any of the following clearing houses:

ASX Settlement and Transfer Corporation Pty Ltd (ASTC)
Austrian Kontroll Bank (OKB)
Board of Trade Clearing Corporation
Cassa di Compensazione e Garanzia S.p.A (CCG)
Commodity Clearing Corporation
Emerging Markets Clearing Corporation
FUTOP Clearing Centre (FUTOP Clearing Centralen A/S)
Hong Kong Futures Exchange Clearing Corporation Ltd
Hong Kong Securities Clearing Company Ltd
Kansas City Board of Trade Clearing Corporation
Norwegian Futures & Options Clearing House (Norsk Opsjonsentral A.S. (NOS))
N.V. Nederlandse Liquidatiekas (NLKKAS)
OM Stockholm Exchange
Options Clearing Corporation
Options Clearing House Pty Ltd (OCH)
Sydney Futures Exchanges Clearing House (SFECH Ltd)
TNS Clearing Pty Ltd (TNSC)

Part 3

Changes to the Glossary

3. In the *Glossary*, amend the definition of “designated investment exchange” with as shown (striking through indicates deleted text):

Definition title	Definition text
<i>designated investment exchange</i>	<p>any of the following investment exchanges:</p> <ul style="list-style-type: none"> American Stock Exchange Australian Stock Exchange Bolsa Mexicana de Valores Bourse de Montreal Inc Chicago Board of Trade Chicago Board Options Exchange Chicago Stock Exchange Coffee, Sugar and Cocoa Exchange, Inc Euronext Amsterdam Commodities Market Hong Kong Exchanges and Clearing Limited International Securities Market Association Johannesburg Stock Exchange Kansas City Board of Trade Korea Stock Exchange MidAmerica Commodity Exchange Minneapolis Grain Exchange New York Cotton Exchange New York Futures Exchange New York Stock Exchange New Zealand Stock Exchange Osaka Securities Exchange Pacific Exchange Philadelphia Stock Exchange Singapore Exchange South African Futures Exchange Tokyo International Financial Futures Exchange Tokyo Stock Exchange Toronto Stock Exchange

Annex B

Powers exercised

The following powers and related provisions in or under the Act have been exercised to alter rules under this instrument:

- Section 138 (General rule-making power)
- Section 149 (Evidential provisions)
- Section 156 (General supplementary powers)

The following power in the Act has been exercised to alter guidance under this instrument:

- Section 157(1) (Guidance)

**CONDUCT OF BUSINESS SOURCEBOOK (AMENDMENT No 4)
INSTRUMENT 2001**

Powers exercised

- A. The Financial Services Authority alters the Conduct of Business sourcebook in the exercise of the powers listed in Schedule 4 to the Conduct of Business sourcebook (Powers exercised).
- B. The provisions of the Financial Services and Markets Act 2000 (the "Act") relevant to making rules and identified in paragraph A are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force as follows:
 - (1) the amendments in Annex 1 come into force on 1 January 2002;
 - (2) the remainder of this instrument comes into force immediately.

Amendment of the Conduct of Business sourcebook

- D. The Conduct of Business sourcebook is amended as set out in Annex 1 to this instrument.
- E. The transitional rules in the Conduct of Business sourcebook are amended as set out in Annex 2 to this instrument.
- F. Schedule 1 to the Conduct of Business sourcebook (Record keeping requirements) is amended as set out in Annex 3 to this instrument.

Citation

- G. This instrument may be cited as the Conduct of Business Sourcebook (Amendment No 4) Instrument 2001.

By order of the Board
20 December 2001

ANNEX 1

Amendments to the Conduct of Business sourcebook

In this Annex, underlining indicates new text and striking through indicates deleted text.

COB 9.3 Client Money

COB 9.3.26R (2) Amend as shown below:

if regulated by the Law Society of Scotland, the Solicitors' (Scotland)
Accounts, ~~Rules 1997 and the Solicitors' (Scotland) Accounts Certificate, s~~
Professional Practice and Guarantee Fund Rules 1997 2001;

ANNEX 2

Amendments to the Conduct of Business Transitional Rules

In this Annex, underlining indicates new text and striking through indicates deleted text.

COB Table TR1: COB Transitional Provisions:

Amend as shown below:

1.12	<i>ETP7</i>	R	<p><u>Client money assets</u></p> <p>An <i>ex-section 43 firm</i> need not comply with the provisions labelled <i>ETP7</i> in Table <i>COB TR 2</i> in relation to its section 43 business until the expiry of a period of 12 months following <i>commencement</i>, provided it continues to comply with the requirements of the Grey Paper (version June 1999), as published by the <i>FSA</i>, relating to the segregation of money and other assets belonging to counterparties.</p>	<p><i>commencement</i></p> <p style="text-align: center;">to</p> <p><i>commencement</i></p> <p>plus 12 months</p>	<i>commencement</i>
1.15	<i>ETP9</i>	R	<p>Group business disapplication for <i>ex-IMRO firms</i> <u>and <i>ex-SFA firms</i></u></p> <p>(1) This paragraph applies to a <i>pre-N2 firm</i> which immediately before <i>commencement</i> was a member of <i>IMRO</i> or <i>SFA</i>.</p> <p>(2) <i>COB 1.3.1R</i> applies to a <i>pre-N2 firm</i> <u><i>an ex-IMRO firm</i></u> in (1) as if it provided as follows:</p> <p>"<i>COB</i> applies to <i>firms</i> with respect to the carrying on of:</p>	<p><i>commencement</i></p> <p>to 30 June 2002</p>	<i>commencement</i>

		<p>(1) <i>all regulated activities</i> except:</p> <p>(a) to the extent that a provision of <i>COB</i> provides for a narrower application; and</p> <p>(b) activities which fall within article 69 of the <i>Regulated Activities Order</i> (Groups and joint enterprises), notwithstanding, in respect of article 69, article 4 (4) of that Order (Specified activities: general: investment firms); and</p> <p>(2) <i>unregulated activities</i> to the extent specified in any provision of <i>COB</i>."</p> <p>(3) <u><i>COB 1.3.1R</i> applies to an <i>ex-SFA firm</i> in (1) as if it provided as follows:</u> <u>"<i>COB</i> applies to <i>firms</i> with respect to the carrying on of:</u></p> <p>(1) <u><i>all regulated activities</i> except:</u></p> <p>(a) <u>to the extent that a provision of <i>COB</i> provides for a narrower application; and</u></p> <p>(b) <u>in relation to all of <i>COB</i> other than <i>COB 7.13 (Personal account dealing)</i> and the <i>rules in COB</i> requiring records to be made and retained, activities which fall within article 69 of the <i>Regulated Activities Order</i> (Groups and joint enterprises), notwithstanding, in respect of article 69, article 4 (4) of that Order (Specified activities: general: investment firms); and</u></p> <p>(2) <u><i>unregulated activities</i> to the extent specified in any provision of <i>COB</i>."</u></p>		
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1.16	ETP9	G	<p>The purpose of <i>ETP 9</i> is to carry forward for <i>ex-IMRO firms</i> and <u><i>ex-SFA firms</i></u> the former regulatory treatment of intra-group investment business, which is carried on in conjunction with investment business for third parties. The effect of that treatment was that under the <i>IMRO</i> rulebook the rules did not apply to the business done for group companies which fell within the group business exemption in paragraph 18 of Schedule 1 to the Financial Services Act 1986. <u>The effect of that treatment under the <i>SFA</i> rulebook was that with the exception of the rules relating to compliance (of which the personal account dealing and record keeping rules are carried forward in <i>COB</i>) the conduct of business rules did not apply to the business done for group companies that fell within the group business exemption.</u> Effectively it was only the non-group third party element of the <i>ex-IMRO firm's</i> such <i>firms'</i> investment business that was subject to <i>IMRO's</i> rules <u>to the relevant rules</u>. <i>COB</i> would not have carried forward this group business disapplication for such <i>firms</i>, were it not for the introduction of <i>ETP 9</i>.</p> <p>Note that during the <i>transitional period</i> the <i>FSA</i> will be consulting on its proposals how this issue should be treated in <i>COB</i> after 30 June 2002.</p>	commencement to 30 June 2002	commencement
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COB Table TR2: COB provisions to which transitional relief attaches

Amend as shown below:

COB Rule	Rule Heading	Label		
		ETP	TTP	TSP
	Chapter 9 Client assets (whole chapter)	ETP5 <u>ETP 7</u>		
	9.3 Client money	ETP7		
9.3.89R		ETP1 <u>ETP6</u>		

Annex 3

Amendments to COB Schedules

In this Annex, underlining indicates new text and striking through indicates deleted text.

Schedule 1 Record Keeping Schedule

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
COB 7.12 3R and COB 7.12.6E (1)	Customer orders	Customer's name (or other designation)/ account number; date and time of receipt or decision by the firm to deal; who received the order or made the decision to deal; the designated investment; the number of/total value of the designated investment in <u>including</u> any price limit; whether sale or purchase; any other instructions received; and the nature of the communication of the <u>customer order</u>	When the order arises	3 years (after the date of completion of the transaction)

MARKET CONDUCT SOURCEBOOK (AMENDMENT NO 4) INSTRUMENT 2001

Powers exercised

- A. The Financial Services Authority amends the Market Conduct sourcebook in the exercise of the power in section 157(1) of the Financial Services and Markets Act 2000 (Guidance).

Commencement

- B. This instrument comes into force immediately.

Amendment of the Market conduct sourcebook

- D. The Market conduct sourcebook is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Market Conduct Sourcebook (Amendment No 4) Instrument 2001.

By order of the Board
20 December 2001

ANNEX

MAR 1.11.2G

Amend as shown (underlining indicates new text, striking through indicates deleted text):

..... The Treasury has prescribed all markets established under the rules of a UK RIE and the market known as OFEX as markets to which section 118 applies. ~~The following is a list of UK RIEs as at 19 July 2001~~ The prescribed markets, as at 5 December 2001, are:

(1) the markets established under the rules of the following (the UK RIEs):

(a) COREDEAL Limited;

(b) The International Petroleum Exchange of London Limited;

(c) Jiway Limited;

(d) LIFFE Administration and Management;

(e) The London Metal Exchange Limited;

(f) London Stock Exchange plc (including AIM);

(g) OM London Exchange Limited;

(h) virt-x Exchange Limited;

(i) virt-x plc;

(2) the market known as OFEX.

FEES (No. 2) INSTRUMENT 2001

Powers exercised

- A. The Financial Services Authority makes the rules and gives the guidance in this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (the "Act"):
- Section 156 of the Act (General supplementary powers);
 - Section 157(1) of the Act (Guidance);
 - Paragraph 17(1) of Schedule 1 to the Act (Fees).
- B. The provisions of the Act relevant to making rules and listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument shall come into force as follows:
- (i) paragraph D comes into force on 1 January 2002; and
 - (ii) paragraph E comes into force immediately.

Amendment of AUTH

- D. AUTH is amended by deleting AUTH 4 (including AUTH 4 Ann 1R) and replacing it with the provisions in the Annex to this instrument.

Amendment of SUP

- E. SUP is amended as follows:
- (i) delete the number of 6.3.21G and move the text so that it becomes the final sentence of SUP 6.3.20G;
 - (ii) renumber SUP 6.3.22G as SUP 6.3.21G;
 - (iii) insert the following new rule after SUP 6.3.21G:

"6.3.22 R If a *firm* applies for a variation of its *Part IV permission*, it must pay the fee specified in Part 3 of *AUTH 4 Annex 1R* in either of the following cases:

- (1) if the variation is granted, the business of the *firm* will fall within one or more fee blocks specified in Part 5 of *AUTH 4 Annex 1R* not applicable before the grant of the variation; or
- (2) any other circumstances specified in Part 3 of *AUTH 4 Annex 1R* apply."

Citation

F. This instrument may be cited as the Fees (No. 2) Instrument 2001.

By order of the Board
20 December 2001

ANNEX

Authorisation

Chapter 4

Authorisation Fees

4

PAGE
1



4.1 Introduction

Application

4.1.1



03.09.01/001

This chapter applies to:

- (1) every applicant for *Part IV permission* (including an *incoming firm* applying for *top-up permission*);
- (2) every *Treaty firm* that wishes to exercise a *Treaty right* to qualify for *authorisation* under Schedule 4 to the *Act* (Treaty rights) in respect of *regulated activities* for which it does not have an *EEA right*; and
- (3) an applicant for a certificate under article 54 of the *Regulated Activities Order*.

4.1.2



03.09.01/001

This chapter does not apply to:

- (1) an *EEA firm* that wishes to exercise an *EEA right*; or
- (2) an *ICVC*; or
- (3) a *UCITS qualifier*.

Purpose

4.1.3



03.09.01/001

The purpose of this chapter is to set out the requirements on applicants for *Part IV permission*, and *Treaty firms* qualifying for *authorisation* under Schedule 4 to the *Act* (Treaty rights), to pay fees.

Background

4.1.4



03.09.01/001






GEN 3 (FSA Fees – General Provisions) applies to fees required by this chapter.

4.1.5



03.09.01/001

Most of the detail of what fees are payable by applicants and *Treaty firms* is set out in ■ AUTH 4 Ann 1R, the provisions of which will vary from one financial year to another. Accordingly a fresh ■ AUTH 4 Ann 1R will come into force, following consultation, for each financial year.

- 4.1.6**  The rates set for authorisation fees represent an appropriate proportion of the costs of the FSA in processing the application or exercise of *Treaty rights*.
03.09.01/001
- 4.1.7**  Applications (and exercises of *Treaty rights*) are categorised by the FSA for the purpose of fee raising as complex, moderately complex and straightforward as identified in AUTH 4 Ann 1R. This differentiation is based on the *permitted activities* sought and does not reflect the FSA's risk assessment of the applicant (or *Treaty firm*).
- 4.1.8**  A potential applicant (or *Treaty firm*) has the opportunity to discuss its proposed application (or exercise of *Treaty rights*) with the FSA before submitting it formally (see ■ AUTH 3.9.1G). If an applicant (or *Treaty firm*) does so, the FSA will be able to use that dialogue to make an initial assessment of the fee categorisation and therefore indicate the authorisation fee that should be paid.
03.09.01/001
- 4.1.9**  See ■ AUTH 3.9 in relation to the procedures for making applications for *Part IV permission* and ■ AUTH 5 for procedures for the exercise of *Treaty rights* by *Treaty firms*.
03.09.01/001
- 4.1.10**  Authorisation fees are not refundable.
03.09.01/001

4.2 Obligation to Pay Authorisation Fees

General

- 4.2.1** **R** 03.09.01/001 A *person* to whom this chapter applies must pay to the FSA an authorisation fee for each application made (or exercise of a *Treaty right*), as set out in ■ AUTH 4 Ann 1R.

Amount

- 4.2.2** **R** 03.09.01/001 In respect of a particular application (or exercise) the authorisation fee referred to in ■ AUTH 4.2.1R is the highest of the tariffs set out in part 1 of ■ AUTH 4 Ann 1R which apply to that application (or exercise).
- 4.2.3** **G** 03.09.01/001 If an application (or exercise of a *Treaty right*) falls within more than one category, only one fee is payable. That fee is the one for the category to which the highest fee tariff applies.

Due date and method of payment

- 4.2.4** **R** 03.09.01/001 The sum payable under ■ AUTH 4.2.2R must be paid:
- (1) by bankers draft, cheque or other payable order;
 - (2) in full without deduction; and
 - (3) on or before the date on which the application is made (or notice of exercise is given).
- 4.2.5** **G** 03.09.01/001 An application for a *Part IV permission* will not be complete until the appropriate fee is paid, and the six month period for consideration will not start until that time (see further ■ AUTH 3.9.30G).

Modification for certain Treaty firms

- 4.2.6** **R** 03.09.01/001 If a certificate has been issued under paragraph 3(4) of schedule 4 to the *Act* in respect of an exercise of a *Treaty right*, no sum payable under ■ AUTH 4.2.2R.

4.2.7

R

03.09.01/001

If no certificate has been issued under paragraph 3(4) of schedule 4 to the *Act* in respect of an exercise of a *Treaty right*, the sum payable is as specified in Part 4 of ■ AUTH Ann 1R.

4

PAGE
5

4.3 Obligation to pay certification fees

General

4.3.1

R

15.11.01/001

An applicant for a certificate under article 54 of the *Regulated Activities Order* must pay to the FSA the application fee specified in Part 6 of ■ AUTH 4 Ann 1R.

Due date and method of payment

4.3.2

R

15.11.01/001

The application fee must be paid:

- (1) by bankers draft, cheque or other payable order;
- (2) in full without deduction; and
- (3) on or before the date on which the application is made.

4.3.3

G

15.11.01/001

An application for an article 54 certificate will be treated as incomplete until the application fee has been paid.

Authorisation fees payable in relation to the period from 1st January 2002 to 31 March 2002

Part 1 – Authorisation fees payable

1 Table

Application type (see Part 2)	Amount payable
(a) Straightforward	£2,000
(b) Moderately complex	£5,000
(c) Complex	£25,000

Part 2 – Complexity Groupings

2 Table Straightforward Cases

Activity grouping	Description
A.3	Friendly societies only
A.4	Friendly societies only
A.12	Advisory arrangers, dealers or brokers (holding or controlling client money and/or assets)
A.13	Advisory arrangers, dealers or brokers (not holding or controlling client money and/or assets)
A.14	Corporate finance advisers
A.15	Advisory only firms

3 Table Moderately Complex Cases

Activity grouping	Description
A.5	Managing agents at Lloyd's
A.7	Fund managers (holding or controlling client money and/or assets)
A.8	Fund managers (not holding or controlling client money and/or assets)
A.9	Operators, trustees and depositaries of collective investment schemes
A.10	Firms dealing as principal
A.11	Execution only arrangers, dealers or brokers

4 Table Complex Cases

Activity grouping	Description
A.1	Deposit acceptors

A.3	Firms conducting insurance activities subject only to prudential regulation (excluding friendly societies)
A.4	Firms conducting insurance activities subject to both prudential and conduct of business regulation (excluding friendly societies)

Part 3 – Variation of Permission Fees

- 5 The fee payable under SUP 6.3.22R is 50% of that payable under AUTH 4.2.2R.
- 6 There are no circumstances specified for the purposes of SUP 6.3.22R(2).

Part 4 – Authorisation Fees for Treaty Firms

- 7 If the Treaty firm wishes to undertake the permitted activities in question through its branch in the United Kingdom, the fee is 50% of the fee that would be payable under.
- 8 If the Treaty firm wishes to undertake the permitted activities in question by providing services in the United Kingdom, the fee is 25% of the fee which would be payable under.

Part 5 – Activity Groupings

- 9 The activity group definitions below reflect those published in CP111 in September 2001.

10 Table

Activity grouping	Fee-payer falls in the activity group if:
A.1 Deposit acceptors	<p>Its <i>permission</i> includes <i>accepting deposits</i> BUT DOES NOT include one or more of the following:</p> <ul style="list-style-type: none"> • <i>effecting contracts of insurance;</i> • <i>carrying out contracts of insurance.</i>
A.3 Firms conducting insurance activities subject only to prudential regulation	<p>Its <i>permission</i> includes one or more of the following:</p> <ul style="list-style-type: none"> • <i>effecting contracts of insurance;</i> • <i>carrying out contracts of insurance;</i> <p>BUT ONLY in respect of specified investments that are:</p> <ul style="list-style-type: none"> – <i>general insurance contracts;</i> or – <i>long-term insurance contracts other than life policies.</i>
A.4 Firms conducting insurance activities subject to both prudential and conduct of business regulation	<p>Its <i>permission</i> includes one or more of :</p> <ul style="list-style-type: none"> • <i>effecting contracts of insurance;</i> • <i>carrying out contracts of insurance;</i> <p>both in respect of <i>specified investments</i> including <i>life policies;</i></p> <ul style="list-style-type: none"> • <i>entering as provider into a funeral plan contract.</i>
A.5 Managing agents at Lloyd's	Its <i>permission</i> includes <i>managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's.</i>
A.6 The Society of Lloyd's	It is the <i>Society of Lloyd's.</i>

A.7 Fund Managers (holding or controlling client money and/or assets)	<p>Its <i>permission</i> includes <i>managing investments</i>; AND one or more of the following:</p> <ul style="list-style-type: none"> • <i>safeguarding and administering of assets (without arranging)</i>; • <i>arranging safeguarding and administration of assets</i>; • the ability to hold and/or control <i>client money</i>: <ul style="list-style-type: none"> – that is, there is no <i>requirement</i> which prohibits the <i>firm</i> from doing this; – and provided that the <i>client money</i> in question does not only arise from an agreement under which <i>commission</i> is rebated to a <i>client</i>.
A.8 Fund Managers (not holding or controlling client money and/or assets)	<p>Its <i>permission</i> includes <i>managing investments</i>; BUT NEITHER of the following:</p> <ul style="list-style-type: none"> • <i>safeguarding and administering of assets (without arranging)</i>; • <i>arranging safeguarding and administration of assets</i> <p>AND if it EITHER:</p> <ul style="list-style-type: none"> • has a <i>requirement</i> that prohibits the <i>firm</i> from holding and/or controlling <i>client money</i>; OR • if it does not have such a <i>requirement</i>, only holds/controls <i>client money</i> arising from an agreement under which <i>commission</i> is rebated to a <i>client</i>.
A.9 Operators, Trustees and Depositories of collective investment schemes	<p>Its <i>permission</i> includes one or more of the following:</p> <ul style="list-style-type: none"> • <i>establishing, operating or winding up a regulated collective investment scheme</i>; • <i>establishing, operating or winding up an unregulated collective investment scheme</i>; • <i>acting as trustee of an authorised unit trust scheme</i>; • <i>acting as the depository or sole director of an open-ended investment company</i>; <p>AND PROVIDED the <i>firm</i> is NOT one of the following:</p> <ul style="list-style-type: none"> • a <i>corporate finance advisory firm</i>; • a <i>firm</i> whose activities are limited to carrying out <i>corporate finance business</i>; • a <i>venture capital firm</i>.
A.10 Firms dealing as principal	<p>Its <i>permission</i> includes <i>dealing in investments as principal</i>; BUT NOT if one or more of the following apply:</p> <ul style="list-style-type: none"> • the above activity is carried on exclusively in respect of <i>life policies</i>; • the <i>firm</i> is acting exclusively as a matched principal broker; • the above activity is limited to acting as an <i>operator</i> of a <i>collective investment scheme</i>; • the <i>firm</i> is a <i>corporate finance advisory firm</i>; • the above activity is otherwise limited to carrying out <i>corporate finance business</i>.

<p>A.11 Execution-only arrangers, dealers or brokers</p>	<p>Its <i>permission</i> includes one or more of the following:</p> <ul style="list-style-type: none"> • <i>dealing in investments as agent;</i> • <i>arranging (bringing about) deals in investments;</i> • <i>making arrangements with a view to transactions in investments;</i> • <i>dealing as principal in investments</i> where the activity is carried on exclusively in respect of <i>life policies</i> or where the <i>firm</i> acts as a matched principal broker; <p>BUT NONE of the following:</p> <ul style="list-style-type: none"> • <i>advising on investments (except pensions transfers and pension opt-outs);</i> or • <i>advising on pension transfers and pension opt-outs.</i> <p>AND PROVIDED the fee-payer is NOT any of the following:</p> <ul style="list-style-type: none"> • a <i>corporate finance advisory firm;</i> • a <i>firm</i> for whom all of the applicable activities above are otherwise limited to carrying out <i>corporate finance business;</i> • a <i>firm</i> whose activities are limited to carrying out <i>venture capital business;</i> • a <i>firm</i> whose activities are limited to acting as an <i>operator, depository or trustee</i> of a <i>collective investment scheme.</i>
<p>A.12 Advisory arrangers, dealers, or brokers (holding or controlling client money and/or assets)</p>	<p>Its <i>permission</i> includes one or more of the following:</p> <ul style="list-style-type: none"> • <i>dealing in investments as agent;</i> • <i>arranging (bringing about) deals in investments;</i> • <i>making arrangements with a view to transactions in investments ;</i> • <i>dealing as principal in investments</i> where the activity is carried on as a matched principal broker; <p>AND AT LEAST one of the following:</p> <ul style="list-style-type: none"> • <i>advising on investments (except pension transfers and pension opt-outs);</i> • <i>advising on pension transfers and pension opt-outs;</i> • <i>advising on syndicate participation at Lloyd's.</i> <p>AND CAN HAVE one or more of the following:</p> <ul style="list-style-type: none"> • <i>safeguarding and administering of assets;</i> • <i>arranging safeguarding and administration of assets;</i> • the ability to hold and/or control <i>client money</i>: <ul style="list-style-type: none"> – that is, there is no <i>requirement</i> which prohibits the <i>firm</i> from doing this; – and provided that the <i>client money</i> in question does not only arise from an agreement under which <i>commission</i> is rebated to a <i>client</i>; <p>AND PROVIDED the fee-payer is NOT any of the following:</p> <ul style="list-style-type: none"> • a <i>corporate finance advisory firm;</i> • a <i>firm</i> for whom all of the applicable activities above are otherwise limited to carrying out <i>corporate finance business;</i> • a <i>firm</i> whose activities are limited to carrying out <i>venture capital business;</i> • a <i>firm</i> whose activities are limited to acting as an <i>operator</i> of a <i>collective investment scheme;</i> • a <i>firm</i> who otherwise meets the requirements to fall in the A.4 activity group.

A.13 Advisory arrangers, dealers, or brokers (not holding or controlling client money and/or assets)	<p>Its <i>permission</i> includes one or more of the following:</p> <ul style="list-style-type: none"> • <i>dealing in investments as agent;</i> • <i>arranging (bringing about) deals in investments;</i> • <i>making arrangements with a view to transactions in investments;</i> • <i>dealing as principal in investments where the activity is carried on as a matched principal broker;</i> <p>AND AT LEAST one of the following:</p> <ul style="list-style-type: none"> • <i>advising on investments (except pension transfers and pension opt-outs);</i> • <i>advising on pension transfers and pension opt-outs;</i> • <i>advising on syndicate participation at Lloyd's;</i> <p>BUT NEITHER of the following:</p> <ul style="list-style-type: none"> • <i>safeguarding and administration of assets;</i> • <i>arranging safeguarding and administration of assets;</i> <p>AND MUST EITHER</p> <ul style="list-style-type: none"> • have a <i>requirement</i> that prohibits the <i>firm</i> from holding and/or controlling <i>client money</i>; OR • if it does not have such a <i>requirement</i>, only holds/controls <i>client money</i> arising from an agreement under which <i>commission</i> is rebated to a client; <p>AND PROVIDED the fee-payer is NOT one of the following:</p> <ul style="list-style-type: none"> • a <i>corporate finance advisory firm</i>; • a <i>firm</i> for whom all of the applicable activities above are otherwise limited to carrying out <i>corporate finance business</i>; • a <i>firm</i> whose activities are limited to acting as an <i>operator</i> of a <i>collective investment scheme</i>; • a <i>firm</i> who otherwise meets the requirements to fall in the A.4 activity group.
A.14 Corporate finance advisers	The <i>firm</i> is carrying on <i>corporate finance business</i> .
A.15 Advisory only firms	<p>Its <i>permission</i> includes one or more of the following:</p> <ul style="list-style-type: none"> • <i>advising on investments (except pension transfers and pension opt-outs);</i> • <i>advising on syndicate participation at Lloyd's</i> <p>BUT MUST NOT include:</p> <ul style="list-style-type: none"> • any of the dealing/arranging activities used in defining the A.11 to A.13 activity groups above; <p>AND PROVIDED the fee-payer is NOT one of the following:</p> <ul style="list-style-type: none"> • a <i>corporate finance advisory firm</i>; • a <i>firm</i> for whom all of the applicable activities above are otherwise limited to carrying out <i>corporate finance business</i>; • a <i>firm</i> whose activities are limited to carrying out <i>venture capital business</i>; • a <i>firm</i> whose activities are limited to acting as an <i>operator</i> of a <i>collective investment scheme</i>.
A.16 Pensions review levy firms	It was liable to pay the Pensions Levy to the PIA in 2001/2002.

Part 6 – Application for a certificate under article 54 of the Regulated Activities Order

11 Table

1. The amount payable in relation to each application is £2,000.

**COMPENSATION SOURCEBOOK (CONFIRMATION AND AMENDMENT)
INSTRUMENT 2001**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the powers and related provisions listed in the revised version of Schedule 4 to the Compensation sourcebook (Powers exercised) which is attached to this instrument.
- B. The provisions of or under the Financial Services and Markets Act 2000 (the "Act") relevant to rules and referred to in that list are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force immediately.

Confirmation of COMP

- D. The Financial Services Authority notes that Schedule 4 to the Compensation sourcebook, which was made on 15 November 2001, did not list all the powers under which the Compensation Sourcebook Instrument 2001 was made.
- E. The Financial Services Authority therefore confirms and remakes the Compensation Sourcebook Instrument 2001 specifying all the powers which are listed in the revised version of Schedule 4 to the Compensation sourcebook which is attached to this instrument.

Amendment of COMP

- F. The Compensation sourcebook is amended as follows:
 - (1) in column (2) of transitional provision 3, replace "COMP 13.6.77" with "COMP 13.6.7R";
 - (2) replace Schedule 4 with the revised version of Schedule 4 attached to this instrument.

Citation

- G. This instrument may be cited as the Compensation Sourcebook (Confirmation and Amendment) Instrument 2001.

By order of the Board
20 December 2001

Compensation

Schedule4 Powers Exercised

1 Table

G

- 1 The following powers and related provisions in the *Act* and the Financial Services and Markets Act 2000 (Transitional Provisions, Repeals and Savings) (Financial Services Compensation Scheme) Order 2001 (“the *compensation transitionals order*”) have been exercised by the *FSA* to make the *rules* in *COMP*:
 - (1) Section 138 (General rule making power)
 - (2) Section 156 (General supplementary powers)
 - (3) Section 213 (The compensation scheme)
 - (4) Section 214 (General)
 - (5) Section 215 (Rights of the scheme in relevant persons insolvency)
 - (6) Section 216 (Continuity of long term insurance policies)
 - (7) Section 217 (Insurers in financial difficulties)
 - (8) Section 218 (Annual report)
 - (9) Section 223 (Management expenses)
 - (10) Article 4 (Pending Applications) of the *compensation transitionals order*
 - (11) Article 6 (Post–commencement applications) of the *compensation transitionals order*
 - (12) Article 9 (Article 9 defaults occurring before commencement) of the *compensation transitionals order*
 - (13) Article 10 (Applications in respect of compulsory liability insurance) of the *compensation transitionals order*
 - (14) Article 12 (Applications under the new scheme) of the *compensation transitionals order*
- 2 The following powers in the *Act* have been exercised by the *FSA* to give the *guidance* in *COMP*:
 - (1) Section 157(1) (Guidance)

CREDIT UNIONS SOURCEBOOK INSTRUMENT 2001

Powers exercised

- A. The Financial Services Authority makes the rules and gives the guidance in this instrument in the exercise of the powers listed in Schedule 4 to the Annex to this instrument (Powers exercised).
- B. The provisions of the Financial Services and Markets Act 2000 (the “Act”) relevant to making rules and referred to above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force on 1 July 2002.

Citation

- D. This instrument may be cited as the Credit Unions Sourcebook Instrument 2001.
- E. The Annex to this instrument (including its Schedules) may be cited as the Credit unions sourcebook (or CRED).

By order of the Board
20 December 2001

ANNEX



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Credit unions

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- 2.2 Structure
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CRED 17 Complaint handling procedures for credit unions

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App 1.1 This is the table referred to in CRED 2.2.2G.

CRED App 2 The Credit Unions sourcebook

App 2.1 Detailed contents of CRED

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CRED Sch 3 Fees and other required payments

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CRED Sch 5 Rights of actions for damages

CRED Sch 6 Rules that can be waived

CRED Sch 7 Consolidated schedule of releases

Credit unions

CRED Transitional Provisions

1 **G** Table Transitional Provisions

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1	Every <i>rule</i> in the <i>Handbook</i> relating to a <i>credit union</i>	R	Where a transitional provision in the <i>Handbook</i> refers to "commencement", in relation to a credit union it means "credit unions day".	From <i>credit unions day</i>	varies depending on rule concerned
2	As for 1	G	Where a <i>rule</i> applies to a <i>credit union</i> , its related transitional provision will also apply. The effect of paragraph 1 is to ensure that the transitional provision applies from <i>credit unions day</i> (and not from the earlier date of <i>commencement</i>).	As for 1	As for 1

Chapter 1

Introduction





1.1 The Credit Unions Sourcebook

- 1.1.1** 01.07.02/001 G Welcome to the *Credit Unions* sourcebook, known as *CRED* for short. *CRED* is *credit unions*' guide to the main *FSA Handbook*, which contains all of the *rules* and *guidance* for all regulated *firms*, including *credit unions*. It puts into effect the *FSA*'s commitment to provide *credit unions* with their own specialist sourcebook. The *Handbook* is a vast document and many parts of it are not relevant to *credit unions*. So we have tried to distil into *CRED* those parts of the *Handbook* which are most relevant. We believe that *CRED* contains enough information on what the *FSA* requires of *credit unions* to meet most of their day-to-day operational needs.
- 1.1.2** 01.07.02/001 G *CRED* does not encompass the requirements associated with any regulatory *permission* other than a *Part IV permission* to *accept deposits*. Other *permissions* are covered elsewhere in the *Handbook*. Thus, for example, a *credit union* seeking a *permission* to undertake *mortgage* lending would need to comply with the requirements in the specialist sourcebook on *mortgage* lending (*MORT*).
- 1.1.3** 01.07.02/001 G Every *credit union* is either a *version 1 credit union* or a *version 2 credit union*. The difference is that a *version 1 credit union* is subject to a *requirement* that it must not lend more than £10,000 in excess of a member's shareholding. *CRED* 14.5 (Applications to vary or cancel permission) describes how a *credit union* can switch between the two versions.
- 1.1.4** 01.07.02/001 G The approach we have taken in assembling the various chapters of *CRED* is as follows:
- (1) Where there are requirements that are specific to *credit unions* we have spelt these out in full. The chapters containing these requirements are Chapters 7 – 10 and Chapter 17.
 - (2) Where there are requirements in the *Handbook* relating to the day-to-day operations of a wider range of *firms* than *credit unions*, we have provided substantive *guidance* on the way in which those requirements should apply to *credit unions*. The relevant chapters are 3 – 6, 11, 12 and 14. It should be noted that in these chapters, the *guidance* refers to *rules* which exist elsewhere in the *Handbook* and which must be observed by *credit unions*.
 - (3) Where there are requirements in the *Handbook* covering to a wider range of *firms* than *credit unions*, but which do not relate to the day-to-day operations of *credit unions*, we have provided a brief summary of those requirements. In circumstances in which one of these chapters became relevant to a *credit union*, we would expect *credit unions* to access the full text in the *Handbook*. The relevant chapters are 13, 15 and 16.
 - (4) Where there are requirements in the *Handbook* that do not relate to *credit unions*, the relevant chapter of the *Handbook* has not been covered in *CRED*. The various other specialist sourcebooks and the Training and Competence manual (*TC*) are examples of this.

(5) The procedures for compensation (*COMP*) and for complaints against the *FSA* (*COAF*) have not been included.

1.1.5



01.07.02/001

It should be emphasised that in any circumstances in which a *credit union* has doubts concerning the *FSA*'s requirements as set out in *CRED*, reference should be made to the *Handbook*, and if necessary, in turn, to the *Act* and any relevant statutory instruments.

1.1.6



01.07.02/001

We have tried to make *CRED* as easy to navigate as we can. The Reader's Guide which follows explains how *CRED* is structured and how it relates to the *Handbook*.

1.1.7



01.07.02/001

The language used in *CRED* reflects the requirements of the main *Handbook*. Thus, in those parts of *CRED* which apply across the wider regulated community, the terminology used is that of the main *Handbook*. For example, in Chapter 3 (Principles for Businesses) reference is made to *firms*, *clients* and *customers*. Conversely, in those sections of *CRED* which are specific to *credit unions* (such as Chapters 7 – 10), terminology specific to *credit unions* is used.

Chapter 2

2

Reader's Guide

PAGE
1



2



2.1 What is this guide?

2.1.1





01.07.02/001


This guide is an introduction to the *Credit Unions* sourcebook (*CRED*). It describes the contents of *CRED*, where to find them and how to make use of them. This guide is a summary of salient points in the Reader's Guide to the *Handbook*.




2.2 Structure

- 2.2.1**  *CRED* is available on the Internet, on CD-ROM and on paper. Its structure and contents are the same in each medium.

01.07.02/001
- 2.2.2**  *CRED* follows the same structure as the *Handbook*, which consists of sourcebooks (providing sources of the FSA's requirements and *guidance*) and manuals (containing processes to be followed) arranged in groups according to their subject matter. A table of contents of the *Handbook* is provided at Appendix 1 to this sourcebook.

01.07.02/001
- 2.2.3**  Appendix 2 sets out the contents of *CRED*. These are the same as those of the *Handbook* except that those sourcebooks and manuals which are not relevant to credit unions have been omitted.

01.07.02/001
- 2.2.4**  Each sourcebook or manual has a reference code of two or more letters. This is usually a contraction or abbreviation of its title, for use in cross-references in the text and in the index. Thus, for example the *Credit Unions* sourcebook abbreviates to *CRED*, while the *Authorisation* manual abbreviates to *AUTH*.

01.07.02/001



2.3 Contents of CRED

2.3.1



01.07.02/001

CRED contains:

- (1) a list of transitional provisions;
- (2) the introduction to *CRED*;
- (3) this guide, which is a summary of the Reader's Guide in the *Handbook*;
- (4) the main text, with any annexes and appendices to it;
- (5) schedules of supplementary information.

2.3.2



01.07.02/001

Most chapters of *CRED* begin with an application provision. This explains to what types of *firm* or other *person*, or to *persons* carrying on what types of business, the chapter applies.

2.3.3



01.07.02/001

After the application provision, each chapter will normally contain a statement of purpose. This explains the objective of the provisions in the chapter: What standards is it intended to uphold? Does it reinforce one or more of the Principles for Businesses? What result does it aim at?



2.4 Status of provisions

2.4.1  01.07.02/001

CRED contains the same types of provision as the *Handbook*. Their status is indicated by icons containing the letters below. The precise legal status of any particular provision depends upon the terms of the *Act* and the particular power exercised to create that provision. Schedule 4 of the *Handbook* lists the powers used to make the various parts of the *Handbook*. So what follows is only an introduction.

Rules: R

2.4.2  01.07.02/001

The letter R is used to indicate general *rules* made under section 138 of the *Act* and specialised *rules* made under sections 140 to 147 and other powers. The legal effect of a *rule* varies, depending on the power under which it is made, and on the language used in the *rule* – is it mandatory language or not? Most of the *rules* in the *Handbook* create binding obligations on *firms* (that is, *authorised persons*). If a *firm* contravenes such a *rule*, it may be subject to enforcement action (see *ENF*).

2.4.3  01.07.02/001

The FSA Principles for Businesses are *rules*.

Evidential provisions: E

2.4.4  01.07.02/001

The letter E is used to indicate an *evidential provision*. This usually indicates a practice or procedure in relation to a *rule* which, if observed, will "tend to establish compliance" with the *rule* to which it relates. Conversely, failure to observe that practice or procedure will "tend to establish contravention" of the *rule* to which it relates. For example, CRED 4.3.11E indicates that a failure of a *credit union* to have an *internal audit function* would "tend to establish contravention" of the *rule* (described earlier in CRED 4.3.1G) that all firms should take reasonable care to establish and maintain such systems and controls as are appropriate to their business.

2.4.5  01.07.02/001

E is also used for paragraphs that make up the *Code of Practice for Approved Persons (APER 3)* made under section 64 of the *Act*. That code may be relied on so far as it tends to establish whether or not the conduct of an *approved person* complies with the *Statements of Principle for approved persons*.

Guidance: G

2.4.6  01.07.02/001

The letter G is normally used to indicate *guidance* given under section 157. The *guidance* in the *Handbook* relates to the operation of the *Act*, the *rules* in the *Handbook* and other matters. Most general *guidance* will be given through the

2.4.7

G

01.07.02/001

Handbook, but in certain cases, where the *guidance* is urgent or temporary, it will be published in a separate *Guidance Note*. Material published in vehicles other than it *Handbook* or *Guidance Notes*, for example in newsletters or on the *FSA's* website, is not *guidance* unless it says that it is.

Guidance may be used to explain the implications of other provisions, to indicate possible means of compliance, to recommend a particular course of action or arrangement, and for other purposes. Whatever *guidance* is used for, it is not binding on those to whom the *Act* and *rules* apply, nor does it have 'evidential' effect. It need not be followed in order to achieve compliance with the relevant *rule* or other requirement. So a *credit union* cannot incur disciplinary liability merely because it has not followed *guidance*. Nor is there any presumption that departing from *guidance* is indicative of a breach of the relevant *rule*. However, *credit unions* should at all times take care to ensure that where the *guidance* refers to, or describes *rules* in *CRED* or elsewhere in the *Handbook*, those *rules* are observed.

2.4.8

G

01.07.02/001

Guidance is generally designed to throw light on a particular aspect of regulatory requirements, not to be an exhaustive description of *credit unions'* obligations. If a *person* acts in accordance with *guidance* in the circumstances contemplated by that *guidance*, then the *FSA* will proceed on the footing that the *person* has complied with the aspects of the *rule* or other requirement to which the *guidance* relates.

2.4.9

G

01.07.02/001

Rights conferred on third parties (such as *credit union* members) cannot be affected by *guidance* given by the *FSA*. *Guidance* on *rules*, the *Act* or other legislation represents the *FSA's* view, and does not bind the courts, for example in relation to an action for damages brought by a *private person* for breach of a *rule*, or in relation to the enforceability of a contract where there has been a breach of *general prohibition* on carrying on a *regulated activity* in the *United Kingdom* without *authorisation*). A *person* may need to seek his own legal advice.

2.4.10

G

01.07.02/001

G is also used for the *FSA's* statement of the procedure for giving statutory notices under section 395 of the *Act* (see *DEC*), for the various statements of policy regarding use of the *FSA's* enforcement powers (see *ENF*), and to indicate the arrangements made by the *FSA* under paragraph 7 of Schedule 1 to the *Act* for the investigation of complaints arising in connection with its exercise of its non-legislative functions (see *COAF*).

Direction: D

2.4.11

G

01.07.02/001

The letter D is used to indicate directions and requirements given under various powers conferred by the *Act*, for example, directions under section 51(3) of the *Act* about the form and content of applications for *Part IV permission*. Directions and requirements are binding upon the *persons* or categories of *person* to whom they are addressed.



2.5 Numbering: Pages

2.5.1



01.07.02/001

Page numbers are not important in *CRED*. In the paper version, page numbering starts again at the beginning of each chapter. But each page of a chapter shows:

- (1) the reference code for the sourcebook or manual;
- (2) the number and title of the chapter; and
- (3) the number and title of the section of the chapter.

For example, the first page of Chapter 3 of the Supervision manual shows at the top, on the left 'SUP 3: Auditors' and on the right 'Section 1: Application'. In addition, each page of a chapter shows, at the foot of the page, the number of the last paragraph on the page.

2.5.2



01.07.02/001

Each page of an annex shows, at the top of the page, the reference code, number and title of the chapter to which the annex relates, and the number and status of the annex.

2.5.3



01.07.02/001

Each page of an appendix shows, at the top of the page, the reference code of the sourcebook or manual to which the appendix relates, and the number and title of the appendix.

2.5.4



01.07.02/001

Each page of *CRED* also shows, at the foot of the page, the number, month and year of the release with which the page was published (for example, *FSA Handbook: Release 003: October 2001*).

2.5.5



01.07.02/001

Both the electronic and the paper editions of the *Handbook* represent the text of *CRED* current at the date of the last release, including all amendments to that date.



2.6 Numbering: Contents

2.6.1



01.07.02/001

The main text of *CRED* is numbered as follows:

- (1) chapter 1 (2, 3 etc)
- (2) section 1.1 (1.2, 1.3 etc)
- (3) paragraph 1 (1.1.2, 1.1.3 etc)
- (4) sub-paragraph 1.1.1(1) (1.1.1(2), 1.1.1(3) etc)

2.6.2



01.07.02/001

Further sub-paragraphs are shown by (a), (b), (c) and so on, and then by (i), (ii), (iii) and so on. For example, the third paragraph of the second section of the first chapter in the Conduct of Business sourcebook, if it were a *rule*, would be *COB 1.2.3R*. If there were two further sub-paragraphs, it would be *COB 1.2.3R(1)(a)*.



2.7 Defined terms



2.7.1




01.07.02/001


Defined terms used in the text are shown in italic type. Where a word or phrase is in italics, its definition can be found in the *glossary* of definitions contained in *CRED*. This is an extract from the *Handbook Glossary*. Where a word or phrase which is shown in italics in one part of the text appears without italics in another part, it is meant to be given, where un-italicised, its ordinary natural meaning.




2.8 Schedules

2.8.1  *CRED* contains eight schedules as follows:
01.07.02/001


Transitional provisions

2.8.2  The list of transitional provisions in *CRED* modifies the general transitional provisions contained elsewhere in the *Handbook* to apply specifically to *credit unions*.
01.07.02/001


Schedule 1: Record keeping requirements

2.8.3  Schedule 1 provides a list of the detailed record keeping requirements in *CRED* and where they are to be found.
01.07.02/001


Schedule 2: Notification requirements

2.8.4  Schedule 2 provides a list of the detailed notification requirements in *CRED* and where they are to be found.
01.07.02/001

Schedule 3: Fees and other required payments

2.8.5  Schedule 3 provides a list of any fees and other payments for which a *credit union* with a *Part IV permission* may be liable under *CRED* and where details of them are to be found.
01.07.02/001

Schedule 4: Powers exercised in making the Handbook.

2.8.6  Schedule 4 specifies the powers given by the *Act* which the *FSA* has exercised in making the provisions in the sourcebook or manual.
01.07.02/001

Schedule 5: Rights of action for damages

2.8.7  Schedule 5:
01.07.02/001

- (1) gives *guidance* (where relevant) on the availability of rights of action to *private persons* under section 150 of the *Act*; and
- (2) lists the *rules* in *CRED*:
 - (a) to which rights of action under section 150(1) of the *Act*; and
 - (b) to which rights of action apply at the suit, not only of a *private person*, but of a *person* who is not a *private person*, in accordance with section 150(3), with a statement to whom the rights have been extended.

Schedule 6: Rules that can be waived

2.8.8



01.07.02/001

- (1) Schedule 6 specifies the *rules* in the sourcebook or manual (if any) which the *FSA* has power to waive or modify, and the section of the *Act* which gives the *FSA* that power in respect of the *rules* in question.

Schedule 7: Schedule of releases

2.8.9



01.07.02/001

- (1) The purpose of schedule 7 is to help *credit unions* keep track of amendments made to *CRED* since it was first published. It lists by serial number each release issued, its date of publication and its contents. The full text of each release is on the *FSA*'s website at www.fsa.gov.uk.



2.9 Glossary of Definitions

2.9.1

G
01.07.02/001

In addition to the links between defined terms and definitions in the electronic versions of the *Handbook*, *CRED* has a *glossary* of definitions. This lists the defined terms used in *CRED* and gives their meaning.

Chapter 3

3

The FSA's Principles for Businesses


PAGE
1




3.1 Application and purpose

3.1.1  This chapter applies to all *credit unions*.


01.07.02/001

3.1.2  The Principles for Businesses (*PRIN*) sets out, in a small number of high-level requirements, the basic obligations of all regulated *firms*. They provide a general statement of regulatory requirements, and the *FSA* considers that the Principles are appropriate expressions of the standards of conduct to be expected of all financial *firms* including *credit unions*. The purpose of this chapter is to provide additional *guidance* on the provisions of *PRIN* as they relate to *credit unions*.

01.07.02/001

3.1.3  *PRIN* 2.1.1R applies to all *credit unions*. Additional *guidance* on this *rule* is given in *CRED* 3.2.

01.07.02/001

3.1.4  In applying the Principles to *credit unions*, the *FSA* will be mindful of proportionality. In practice, the implications are likely to vary according to the size of the *credit union*.

01.07.02/001



3.2 The Principles

3.2.1



01.07.02/001

The table in *PRIN 2.1.1R* sets out the full text of the Principles. These are repeated below for ease of reference.

- (1) Integrity. A *firm* must conduct its business with integrity.
- (2) Skill, care and diligence. A *firm* must conduct its business with due skill, care and diligence.
- (3) Management and control. A *firm* must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
- (4) Financial prudence. A *firm* must maintain adequate financial resources.
- (5) Market conduct. A *firm* must observe proper standards of market conduct.
- (6) *Customers'* interests. A *firm* must pay due regard to the interests of its *customers* and treat them fairly.
- (7) Communications with *clients*. A *firm* must pay due regard to the information needs of its *clients* and *communicate* information to them in a way which is clear, fair and not misleading.
- (8) Conflicts of interest. A *firm* must manage conflicts of interest fairly, both between itself and its *customers* and between a *customer* and another *client*.
- (9) *Customers*: relationships of trust. A *firm* must take reasonable care to ensure the suitability of its advice and discretionary decisions for any *customer* who is entitled to rely upon its judgement.
- (10) *Clients'* assets. A *firm* must arrange adequate protection for *clients'* assets when it is responsible for them.
- (11) Relations with regulators. A *firm* must deal with its regulators in an open and cooperative way, and must disclose to the *FSA* appropriately anything relating to the *firm* of which the *FSA* would reasonably expect notice.

3.3 Consequences of breaching the Principles

3.3.1



01.07.02/001

The Principles are expressed in general terms. They are designed to be sensitive to individual circumstances and to be proportionate. Their practical implications for *firms'* conduct, organisation and resources will depend on the size of the *firm* and the business it undertakes. The Principles do not require small *firms* to act or be treated as if they were large.

3.3.2



01.07.02/001

However, being ready, willing and organised to abide by the Principles is a critical factor in applications for *authorisation* and whether a *credit union* is continuing to be fit and proper. Therefore, breaching a Principle makes a *credit union* liable to the FSA's disciplinary sanctions. The full provisions of how the FSA will use its powers in support of its enforcement functions under the *Act* are set out in *ENF 2*. The FSA will be proportionate in the use of its powers.

Credit unions

Chapter 4

Senior management arrangements, Systems and Controls

4

PAGE
1





4.1 Application and purpose

4.1.1 **R**
01.07.02/001

This chapter applies to all *credit unions*.

4.1.2 **G**
01.07.02/001

The purpose of this chapter is to provide further *guidance* to *credit unions* with a *permission to accept deposits* (see CRED 13.5) on the application of Senior management arrangements, Systems and Controls (SYSC), together with additional *rules* and *guidance* that are specific to *credit unions*.

4.1.3 **R**
01.07.02/001

SYSC applies to all *credit unions* in respect of the carrying on of their regulated activities and unregulated activities in a prudential context.

4.1.4 **G**
01.07.02/001

The purposes of SYSC are:

- (1) to encourage *directors* and *senior managers* to take appropriate practical responsibility for the *credit union's* arrangements on matters likely to be of interest to the *FSA* because they impinge on the *FSA's* function under the *Act*;
- (2) to reinforce *Principle 3*, under which all *firms* including *credit unions* must take reasonable care to organise and control their affairs responsibly and effectively with adequate risk management systems;
- (3) to encourage all *firms*, including *credit unions*, to vest responsibility for effective and responsible organisation in specific *directors* and *senior managers*.

4.1.5 **G**
01.07.02/001

SYSC contains a number of high level *rules* designed to have general application to all *firms*.

4.1.6 **G**
01.07.02/001

Specific *guidance* on how these *rules*, and the general *guidance* that accompanies them, apply to the particular circumstances of *credit unions* is set out below.

4.1.7 **G**
01.07.02/001

SYSC 3.1.2G(3) states that detailed requirements regarding systems and controls relevant to particular types of *firm* may be covered elsewhere in the *Handbook*. This chapter includes all such specific requirements for *credit unions*.



4.2 Apportionment of responsibilities

- 4.2.1** G Under SYSC 2.1.1R every *firm* is required to take reasonable care to maintain an appropriate apportionment of significant responsibilities among its *directors* and *senior managers*, so that it is clear who has those responsibilities and so the *firm* can be governed adequately.
01.07.02/001
- 4.2.2** G In order to comply with the requirements, a *credit union* will need to be clear who is responsible for which significant matters within the *credit union*.
01.07.02/001
- 4.2.3** G Among the significant responsibilities to be apportioned will be responsibility for:
01.07.02/001
- (1) finance;
 - (2) lending;
 - (3) arrears control;
 - (4) *money laundering* reporting;
 - (5) complaints handling.
- 4.2.4** G SYSC 2.1.3R requires that the actual task of apportioning significant responsibilities to different people must itself be allocated by the *credit union* to one or more individuals to carry out. The task of overseeing the establishment and maintenance of the *credit union's* systems and controls would normally be allocated to the same individual or individuals. However, it would be possible to allocate the overseeing function to different individuals as long as this was appropriate.
01.07.02/001
- 4.2.5** G Together these tasks are known as the *apportionment and oversight function*.
01.07.02/001
- 4.2.6** G An individual to whom a function is allocated under SYSC 2.1.3R will be performing the *apportionment and oversight function* (see CRED 6.3.8G) and an application must be made to the FSA for approval of the individual before the function is performed (see CRED 13.7).
01.07.02/001
- 4.2.7** G SYSC 2.1.4R requires that the *apportionment and oversight function* must be allocated to the *credit union's chief executive* where there is one. 'Chief executive' in this context means an *employee* who alone, or jointly with others, is responsible under the immediate authority of the committee of management for the conduct of the whole business of the *credit union*. In smaller *credit unions*, this would include any *manager* or *person* who is entrusted with the whole of the day to day running of the *credit union* even if the title 'chief executive' is not used.
01.07.02/001
- 4.2.8** G The *apportionment and oversight function* may be allocated to one or more members of the *credit union's* committee of management in addition to the *chief executive*, or where there is no *chief executive* (see also CRED 4.3.17G).
01.07.02/001

- 4.2.9** G
01.07.02/001 The allocation of the *apportionment and oversight function* to one or two individuals is likely to be appropriate for most *firms*, including many *credit unions*. However, it would be possible to allocate the function to every member of the *credit union's* committee of management as long as that allocation remained appropriate.
- 4.2.10** G
01.07.02/001 If the allocation is to more than one *person* they may perform the *apportionment and oversight function*, or aspects of the function, separately. So, for example, one individual may have specific responsibility for the apportionment of responsibilities, whilst somebody else may have specific responsibility for overseeing the establishment and maintenance of the *credit union's* systems of control.
- 4.2.11** G
01.07.02/001 Under SYSC 2.2.1R, all *credit unions* are required to maintain a record of the arrangements they have made to satisfy the requirements to apportion significant responsibilities and allocate the *apportionment and oversight function*. Where responsibilities have been allocated to more than one *person*, the record will need to show clearly how those responsibilities are shared or divided. These records must be retained for six years after being replaced by a more up-to-date record.
- 4.2.12** G
01.07.02/001 Most *credit unions* should be able to comply with the requirements of SYSC 2.2.1R by means of records they already keep for their own purposes (for example, job descriptions, organisation charts, committee constitutions and terms of reference).



4.3 Systems and Controls

General

- 4.3.1** **G**
01.07.02/001 SYSC 3.1.1R requires that every *firm*, including a *credit union*, takes reasonable care to establish and maintain such systems and controls as are appropriate to its business.
- 4.3.2** **G**
01.07.02/001 SYSC 3.1.1R is a high level *rule* which allows *firms* to put in place the systems and controls that are appropriate and effective for their particular circumstances. What is appropriate for a particular *credit union* will depend upon such matters as the nature, scale, and complexity of its business, the volume and size of its *transactions*, and the level of risk associated with its operations.
- 4.3.3** **G**
01.07.02/001 A small *version 1 credit union* will not be expected to have the same systems and controls as a large *version 2 credit union*.
- 4.3.4** **G**
01.07.02/001 SYSC 3.2 deals with the areas to be covered by systems and controls. *Guidance* on how this applies to *credit unions* is provided below.

Rules and evidential provisions


- 4.3.5** **R**
01.07.02/001 **A *credit union* must establish, maintain and implement an up-to-date business plan approved by the committee of management and supply a copy on request to the FSA.**
- 4.3.6** **G**
01.07.02/001 *Guidance* on business planning is given in CRED 4.3.61G - CRED 4.3.68G.
- 4.3.7** **R**
01.07.02/001 **A *credit union* must establish, maintain, and implement an up to date and fully documented policies and procedures manual, and supply a copy on request to the FSA.**
- 4.3.8** **G**
01.07.02/001 *Guidance* on documentation of policies and procedures is given in CRED 4.3.69G - CRED 4.3.71G.
- 4.3.9** **R**
01.07.02/001 **A *credit union* must establish, maintain and implement a fully documented system of control.**
- 4.3.10** **G**
01.07.02/001 *Guidance* on the documentation of systems of control is given in CRED 4.3.28G - CRED 4.3.31G.

4.3.11  01.07.02/001

- (1) A *credit union* should have an *internal audit function* (this may be either in house or outsourced to a third party).
- (2) Contravention of CRED 4.3.11E(1) may be relied on as tending to establish contravention of SYSC 3.1.1R (see CRED 4.3.1G).

4.3.12  01.07.02/001

Guidance on internal audit is given in CRED 4.3.50G – CRED 4.3.60G.

4.3.13  01.07.02/001

- (1) A *credit union* should ensure appropriate segregation of duties in order to minimise the risk of *financial crime* or contravention of requirements and standards under the *regulatory system*.
- (2) Contravention of CRED 4.3.13E(1) may be relied on as tending to establish contravention of SYSC 3.1.3R.

4.3.14  01.07.02/001

Guidance on segregation of duties is given in CRED 4.3.26G - CRED 4.3.27G.

Committee of management

4.3.15  01.07.02/001

Under Schedule 1 to the Credit Unions Act 1979, a *credit union* is required to have a committee of management. The committee of management should be competent to control the affairs of a *credit union*, and have an appropriate range of skills and experience having regard to the activities carried on by the *credit union*.

4.3.16  01.07.02/001

CRED 6.2 provides additional guidance for *credit unions* on the *Statements of Principle for Approved Persons* (see also APER 2.1.2P). In accordance with *Statement of Principle 7*, it is the responsibility of each individual member of the committee of management to understand, and ensure that the *credit union* complies with, the requirements of all the relevant Acts, secondary legislation, and *rules*.

4.3.17  01.07.02/001

As the *credit union's governing body*, the committee of management has responsibility for ensuring that the *credit union* complies with the requirements of SYSC 3.1.1R (see CRED 4.3.1G – CRED 4.3.2G). Accordingly, the committee of management has overall responsibility for the following matters:

- (1) to establish objectives and formulate a business plan;
- (2) to monitor the financial position of the *credit union*;
- (3) to determine and document policies and procedures;
- (4) to direct and coordinate the work of all *employees* and volunteers, and ensure that they are capable and properly trained;
- (5) to maintain adequate reserves;
- (6) to make provision for bad and doubtful debts;
- (7) to recommend a dividend on shares to members subject to the *credit union's* financial position;
- (8) to ensure that the *credit union* complies with all statutory and regulatory requirements;

(9) to ensure that the *credit union* complies with the requirements of its registered rules.

Where a committee of management has responsibility for these matters on a day to day basis (that is, they are not delegated to a *chief executive* or *manager*) it seems highly likely that each member of the committee would be performing the *apportionment and oversight function*, and would therefore require individual approval.

4.3.18 G The committee of management should meet at least monthly.
01.07.02/001

Organisation

4.3.19 G *Guidance* on organisational arrangements is located in SYSC 3.2.2G - SYSC 3.2.5G.
01.07.02/001

4.3.20 G A *credit union* should have clearly defined organisational arrangements and procedures. These arrangements and procedures should be properly documented.
01.07.02/001

4.3.21 G Those *credit unions* that do not have a permanent place of business or permanent full-time staff should take particular care to ensure that their organisational arrangements are robust and clear.
01.07.02/001

4.3.22 G The delegation of functions and tasks should take place within an appropriate framework. This should distinguish between those decisions reserved for the committee of management and those delegated to sub-committees, volunteers or *employees*.
01.07.02/001

4.3.23 G There should be arrangements to supervise delegation. This should include establishing appropriate reporting mechanisms and procedures for monitoring.
01.07.02/001

4.3.24 G Reporting lines should be clear and appropriate having regard to the nature, scale, and complexity of the *credit union* and its business.
01.07.02/001

4.3.25 G SYSC 3.2.4G specifically covers the issue of outsourcing. *Guidance* relevant to delegation within a *credit union* is also relevant to external delegation ("outsourcing"). A *credit union* cannot contract out its regulatory obligations, and remains ultimately responsible for any activities or functions that are outsourced. A *credit union* should therefore take reasonable care to supervise any outsourced activities, and obtain sufficient information to be able to assess the impact of outsourcing on its systems and controls.
01.07.02/001

4.3.26 G CREd 4.3.13E states that all *credit unions* should ensure appropriate segregation of duties. Duties should be segregated to prevent one individual from initiating, controlling, and processing a transaction (for example, approval and payment of an invoice).
01.07.02/001

4.3.27 G Responsibilities of connected *persons* (for example, relatives and other close relationships) should be kept entirely separate. Such *persons* should not hold key posts at the same time. Where this is unavoidable, a *credit union* should have a written policy for ensuring complete segregation of duties and responsibilities.
01.07.02/001

Documentation of systems of control

4.3.28



01.07.02/001

CRED 4.3.9R requires a *credit union's* system of control to be fully documented. The documentation helps the committee of management to assess if systems are maintained and controls are operating effectively. It also helps those reviewing the systems to ensure that the controls are those that have been authorised, and that they are adequate for their purpose.

4.3.29



01.07.02/001

The committee of management should determine the form of documentation to be adopted. Considerations should include the following:

- (1) It should be comprehensive. It should cover all material aspects of the operations of the *credit union*.
- (2) It should be integrated. Separate elements of the system should be cross referred so that the system can be viewed as a whole.
- (3) It should identify risks, and the controls established to manage those risks. The controls should be identified and their purpose defined so that their effectiveness can be evaluated.
- (4) There should be named *persons* or posts for each control function, and alternatives in case of absence.
- (5) It should state how the operation of the control is evidenced. Evidence might include signatures, records and registers, retention of control *documents*.
- (6) It should be unambiguous. Instructions should be clear and precise, avoiding expressions such as "normally" and "if possible".
- (7) It should be practical. The separate elements should have a practical role in the review and improvement of systems.
- (8) It should be up to date. There should be an accurate description of the function that the control is to address. When changes are made to the function, the appropriate systems of control need to be updated and documented at the same time.
- (9) The committee of management should, from time to time, seek confirmation that the systems of control are being complied with.

4.3.30



01.07.02/001

Documentation should not be restricted to "lower level" controls applied in processing transactions, but should also cover "high level" controls including:

- (1) powers to be exercised only by the committee of management, and powers delegated to others;
- (2) the purpose, composition and reporting lines of sub-committees, and *senior managers* to whom responsibilities are delegated;
- (3) the specific roles and responsibilities of individual *officers*;
- (4) the timing, form and purpose of meetings of the committee of management and sub-committees, and the way in which policies and decisions are recorded and their implementation monitored.

4.3.31



01.07.02/001

The documentation of IT controls should be integrated within the overall documentation of a *credit union's* system of control.

Accounting records and systems

- 4.3.32** G SYSC 3.2.20R requires that a *credit union* takes reasonable care to make and retain adequate records of all matters governed by the *Act*, secondary legislation under the *Act*, or *rules* (including accounting records). These records must be capable of being reproduced in the English language and on paper.
01.07.02/001
- 4.3.33** G A *credit union* should have appropriate systems in place to fulfil its obligations with respect to adequacy, access, periods of retention, and security of records.
01.07.02/001
- 4.3.34** G The main reasons why a *credit union* should maintain adequate accounting and other records are:
01.07.02/001
- (1) to provide the committee of management with adequate financial and other information to enable them to conduct its business in a prudent manner on a day-to-day basis;
 - (2) to safeguard the assets of the *credit union* and the interests of members and *persons* too young to be members (see CRED 7.3.2G);
 - (3) to assist *officers* of the *credit union* to fulfil their regulatory and statutory duties in relation to the preparation of annual accounts;
 - (4) to provide the committee of management with sufficient timely and accurate information to assist them to submit the information required or requested by the *FSA*.
- 4.3.35** G When forming their opinion of whether the accounting and other records are adequate, the committee of management should satisfy themselves that they capture and record on a timely basis, and in an orderly fashion, every transaction. They should provide sufficient information in respect of each transaction to explain:
01.07.02/001
- (1) its nature and purpose;
 - (2) the asset or liability, actual and contingent, which arises (or may arise) from it;
 - (3) the income or expenditure, current and deferred, which arises from it.
- 4.3.36** G The committee of management must be satisfied that the records are maintained in an integrated and orderly manner to disclose, with reasonable accuracy and promptness, the state of the business at any time.
01.07.02/001

Compliance

- 4.3.37** G SYSC 3.2.6.R requires all *credit unions* to take reasonable care to establish and maintain effective systems and controls for compliance with all regulatory requirements (in other words, the relevant Acts, secondary legislation, and *rules*) and for countering the risk of *financial crime*.
01.07.02/001
- 4.3.38** G *Guidance* on compliance is located in SYSC 3.2.6R - SYSC 3.2.9G.
01.07.02/001
- 4.3.39** G SYSC 3.2.8R is unlikely to be relevant to a *credit union* as it is relevant only to *firms* carrying on *designated investment business*.
01.07.02/001
- 4.3.40** G Some important compliance issues include:
01.07.02/001

- (1) insurance against fraud and dishonesty;
- (2) arrangements for the prevention, detection and reporting of *money laundering*;
- (3) establishing and maintaining a satisfactory system of control;
- (4) keeping proper books of account;
- (5) computation and application of profits;
- (6) investment of surplus funds;
- (7) capital requirements;
- (8) liquidity requirements;
- (9) limits on shares and loans;
- (10) maintenance of membership records;
- (11) submission of financial reports to the regulator;
- (12) *approved persons* regime;
- (13) payment of regulatory fees.

Management information

4.3.41 G *Guidance* on management information is located in SYSC 3.2.11G – SYSC 3.2.12G.

4.3.42 G *A credit union* should maintain information systems to enable the committee of management to direct and control the *credit union's* business effectively, and to provide the information required by the *FSA*.

4.3.43 G The committee of management should be satisfied that:

- (1) the information available is sufficient for the proper assessment of the potential risks for the *credit union*, and in order to determine its need for capital and liquidity;
- (2) the information available is sufficiently comprehensive to provide a clear statement of the performance and financial position of the *credit union*;
- (3) management information reports are prepared with sufficient frequency;
- (4) sufficient attention is focused on key factors affecting income and expenditure and that appropriate performance indicators are employed;
- (5) actual performance is compared with planned and prior performance.

4.3.44 G In forming a view on whether the management information system is sufficiently comprehensive, the committee of management should consider whether, where relevant, the substance of reports provides a clear statement of:

- (1) the capital position;

- (2) the liquidity position;
- (3) profits and losses, assets and liabilities, and flow of funds;
- (4) loans, arrears, and provisions.

4.3.45 G The matters listed in *CRED* 4.3.44G should be compared against limits, ratios and other parameters set by the committee of management, as well as regulatory requirements.

01.07.02/001

Information for the FSA

4.3.46 G Information reported to the *FSA* should be accurate and timely. *Credit unions* are required to complete returns as set out in *CRED* 14.10, and submit them within the specified timetable. Returns should be reviewed prior to their submission to the *FSA* at a sufficiently senior level. The review should check for consistency between different returns, between various tables on the same return, and between information prepared for the committee of management.

01.07.02/001

Personnel

4.3.47 G *Guidance* on *employees* and agents is located in *SYSC* 3.2.13G - *SYSC* 3.2.14G.

01.07.02/001

4.3.48 G A *credit union* should identify present and future staffing requirements (including volunteers and paid staff) and make appropriate plans for their recruitment and training.

01.07.02/001

4.3.49 G A *credit union* should have appropriate systems and controls in place to satisfy itself as to the suitability of its staff, including the competence and honesty of such staff. Any assessment of suitability should take into account the nature of the position and the level of responsibility that the individual would hold.

01.07.02/001

Internal Audit

4.3.50 G *CRED* 4.3.11E states that an *internal audit function* should oversee the internal audit process.

01.07.02/001

4.3.51 G *Guidance* on internal audit and audit committees (otherwise known as the supervisory committee) is located in *SYSC* 3.2.15G - *SYSC* 3.2.16G.

01.07.02/001

4.3.52 G Depending upon the scale and nature of the *credit union's* activities, it may be appropriate for the audit committee to delegate the task of monitoring the effectiveness and appropriateness of its systems and controls to an *employee* or other third party.

01.07.02/001

4.3.53 G The purposes of an internal audit are:

01.07.02/001

- (1) to ensure that the policies and procedures of the *credit union* are followed;
- (2) to provide the committee of management with a continuous appraisal of the overall effectiveness of the control systems, including proposed changes;

4.3.54



01.07.02/001

- (3) to recommend improvements where desirable or necessary;
- (4) to determine whether the *internal controls* established by the committee of management are being maintained properly and operated as laid down in the policy, and comply with relevant Acts, secondary legislation, *rules*, policies and procedures;
- (5) to ensure that accounting records are prepared promptly and accurately, and that they are in order;
- (6) to assess whether financial and operating information supplied to the committee of management is accurate, pertinent, timely, and complete.

The *internal audit function* should develop an audit plan, covering all aspects of the *credit union's* business. The audit plan should identify the scope and frequency of work to be carried out in each area. Areas identified as higher risk should be covered more frequently. However, over a set time frame (likely to be one year) all areas should be covered. Care should be taken to avoid obvious patterns of checking.

4.3.55



01.07.02/001

The internal audit work programme should include items such as:

- (1) verification of cash (counting and reconciliation) without prior notification;
- (2) *bank* reconciliation (checking records against *bank* statements);
- (3) verification of passbooks or account statements;
- (4) checking for compliance with policies and procedures;
- (5) checking for compliance with relevant Acts, secondary legislation and *rules*;
- (6) checking minutes and reports of the committee of management and other sub-committees for compliance, and assessing regularity and completeness;
- (7) checking loan applications;
- (8) verification of the *credit union's* assets and *investments*.

4.3.56



01.07.02/001

The key elements of a satisfactory system of internal audit include the following:

- (1) Terms of reference. These should be specified with precision and include, amongst other things, scope and objectives of the audit committee and the *internal audit function*, access to records, powers to obtain information and explanations for *officers*, and reporting requirements. These should be approved by the committee of management.
- (2) Risk analysis. Key risks in each area of the *credit union's* business should be identified. The adequacy of the specific controls put in place to address those risks should be assessed.
- (3) Internal audit plan. This should be developed on the basis of the risk analysis.
- (4) Detailed programmes. These should be based on the internal audit plan, together with the controls and their objectives specified in the control documentation. Each programme should be comprehensive, specifying the frequency with which the various parts of the programme are to be carried out and how the work is to be performed.

- (5) Working papers. These should be maintained to evidence who performed the work, how it was controlled and supervised, and to record the conclusions reached. They should be cross referenced to reports made and action taken.
- (6) System of reporting. Formal reports should be submitted at the completion of each aspect of programmed work, stating the areas covered together with any recommendations and conclusions reached.

4.3.57 G The *internal audit function* should be independent of all of the functions it inspects.

01.07.02/001

4.3.58 G The committee of management should be satisfied that the status and reporting relationship of the chair of the audit committee is sufficient to maintain the independence and objectivity of the function.

01.07.02/001

4.3.59 G The qualifications, experience and training of individuals performing the *internal audit function* should be adequate in relation to its objectives.

01.07.02/001

4.3.60 G The committee of management should be satisfied that the *internal audit function* is being properly carried out. In order to review the overall effectiveness of the *internal audit function* it should consider the following:

01.07.02/001

- (1) the adequacy and scope of planning;
- (2) the adequacy and scope of work performed in relation to the plans and programmes;
- (3) the regularity and level of reporting on matters arising from the inspections;
- (4) the disposal of points and recommendations raised, and reasons for the rejection of any major points;
- (5) a review of the overall effectiveness of the *internal audit function*.

Business planning

4.3.61 G CRED 4.3.5R requires that a *credit union* maintains a current business plan.

01.07.02/001

4.3.62 G *Version 2 credit unions* should submit a copy of their business plan to the FSA. A *version 2 credit union* making any significant changes to the business plan should provide the FSA with a copy of the amended plan as soon as possible after it has been adopted.

01.07.02/001

4.3.63 G *Guidance* on business strategy is located in SYSC 3.2.17G.

01.07.02/001

4.3.64 G The committee of management should have a satisfactory planning system to provide a framework for growth and development of the *credit union*, and to enable it to identify, measure, manage and control risks of regulatory concern.

01.07.02/001

4.3.65 G The business plan should cover a period of three years from the current financial year.

01.07.02/001

4.3.66 G The planning system should be defined clearly, documented appropriately, and planning related tasks and decision making responsibilities allocated clearly within the *credit union*.

01.07.02/001

4.3.67 G The conclusions, recommendations, projections and assumptions set out in the business plan should be supported by analysis, based on adequate data, and properly documented for comparison with actuals.
01.07.02/001

4.3.68 G The committee of management should consider the range of possible outcomes in relation to various risks.
01.07.02/001

Documentation of policies and procedures

4.3.69 G CRED 4.3.7R requires that a *credit union* maintains a manual of its policies and procedures.
01.07.02/001

4.3.70 G *Version 2 credit unions* should submit a copy of their policy and procedures manual to the FSA. A *version 2 credit union* making any significant changes to their policies or procedures should provide the FSA with a copy of the amended manual as soon as possible after it has been adopted.
01.07.02/001

4.3.71 G The policy and procedures manual should cover all aspects of the *credit union's* operations, including matters such as:
01.07.02/001

- (1) cash handling and disbursements;
- (2) collection procedures;
- (3) lending - including large *exposures* (see CRED 10.1 - CRED 10.5);
- (4) arrears management (see CRED 10.2.8G - CRED 10.2.9G);
- (5) provisioning (see CRED 10.5);
- (6) liquidity management (see CRED 9);
- (7) financial risk management (see CRED 7);
- (8) *money laundering* prevention (see CRED 12);
- (9) internal audit (see CRED 4.3.50G - CRED 4.3.60G);
- (10) information technology (see CRED 4.3.31G);
- (11) business continuity - otherwise known as disaster recovery (see CRED 4.3.72G - CRED 4.3.74G);
- (12) marketing;
- (13) training;
- (14) connected *persons* and managing conflicts of interest (see CRED 4.3.27G);
- (15) complaints handling (see CRED 17).

Business continuity

4.3.72 G *Guidance* on business continuity is located in SYSC 3.2.19G.
01.07.02/001

4.3.73

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01.07.02/001

A *credit union* should put in place contingency arrangements to ensure that it could continue to operate and meet its regulatory requirements in the event of an unforeseen interruption that may otherwise prevent the *credit union* from operating normally. (For example, if there was a complete failure of IT systems or if the premises were destroyed by fire).

4.3.74

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01.07.02/001

Business continuity arrangements should be reviewed and tested regularly in order to ensure their effectiveness.

Credit unions

Chapter 5






Threshold conditions

5

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1



5.1 Application and purpose

- 5.1.1**  This chapter applies to all *credit unions*. It also applies to any *person* seeking to become *authorised* as a *credit union*.
01.07.02/001
- 5.1.2**  The purpose of this chapter is to provide additional *guidance* to *credit unions* on the basic requirements that all *credit unions* must meet if they are to be allowed to carry on a *regulated activity*.
01.07.02/001
- 5.1.3**  Schedule 6 to the *Act* sets out the *threshold conditions* for *authorisation*. *COND* contains *guidance* for all *firms* on the *threshold conditions*.
01.07.02/001
- 5.1.4**  In order to become *authorised* under the *Act* all *firms* must meet the *threshold conditions*.
01.07.02/001
- 5.1.5**  The *threshold conditions* must be met on a continuing basis by *credit unions*. Failure to meet one of the conditions is sufficient grounds for the exercise by the *FSA* of its power. *ENF 1* provides an overview of the range and purpose of these powers, the *FSA*'s approach to enforcement and the structure of the Enforcement manual.
01.07.02/001

5.2 The Conditions

5.2.1



01.07.02/001

Schedule 6 to the *Act* and *COND* set out the *threshold conditions* in full. They are:

- (1) *Threshold condition 1: Legal status.* This sets out a number of conditions for legal form. A *credit union* by definition will comply.
- (2) *Threshold condition 2: Location of offices.* A regulated *UK credit union* must have its head office and registered office in the *United Kingdom*. This requirement is aimed at ensuring that *firms* are organised in a way that can be effectively supervised.
- (3) *Threshold condition 3: Close links.* This condition requires the *FSA* to be satisfied that it can effectively supervise a *firm*, taking into account the structure of the *group* to which it belongs or the other *firms* to which it has *close links*. This will have little relevance to *credit unions* because of the way they are constituted.
- (4) *Threshold condition 4: Adequate resources.* The adequate resources condition has a wide meaning. The *FSA* will interpret the term 'adequate' as meaning sufficient in terms of quantity, quality and availability, and 'resources' as including all financial resources, non-financial resources and means of managing its resources; for example, capital, provisions against liabilities, liquidity and human resources. Detailed financial resources and systems requirements for *credit unions* can be found in *CRED 4*, *CRED 8*, and *CRED 9*. The *FSA* will consider whether a *credit union* is ready, willing and organised to comply with these requirements when assessing if it has adequate resources for the purposes of this *threshold condition*.
- (5) *Threshold condition 5: Suitability.* Essentially, this condition requires the *FSA* to be satisfied that a *credit union* is 'fit and proper' to be *authorised* and permitted to carry on the relevant activities. It will therefore have regard to all relevant matters. These will include whether there are any indications that the *credit union* will not be able to meet its debts as they fall due, and whether the *credit union* has taken reasonable steps to identify and measure any risks of regulatory concern. It will also include the *credit union's* connection with any *person*.

5.2.2



01.07.02/001

The first two *threshold conditions* prescribe objective criteria to be satisfied – there is no room for judgment on the part of the *FSA*. *Threshold condition 4* and *threshold condition 5* set new formal conditions for *credit unions*. In both cases, what is required will depend upon such matters as the size of the *credit union* and the activities it wishes to carry on.

5.2.3



01.07.02/001

Where a *credit union* may no longer meet the *threshold conditions* (see *ENF*) the *FSA* will make further enquiries. This might include the provision of a report by a *skilled person* or the *FSA* exercising its formal enforcement powers. In any situation where the *FSA* may need to consider the use of its powers as a result of the failure of

a *credit union* to meet one of these conditions, the *FSA* will have regard to the principles underlying the *FSA*'s approach to the use of these powers. These principles include transparency, proportionality and consistency.

5.2.4

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01.07.02/001

The *FSA* has the power to vary a *credit union*'s *Part IV permission* on its own initiative (see *ENF 3.2*), if it appears to the *FSA* that the *credit union* is failing, or is likely to fail, to satisfy the *threshold conditions* (see *ENF 3.5*).

Credit unions

Chapter 6

The Approved persons regime

6

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1





6.1 Application and purpose

6.1.1 R 01.07.02/001 This chapter applies to all *credit unions* and *approved persons*. It also applies to *applicants* seeking to become *authorised* as a *credit union*.

6.1.2 G 01.07.02/001 The purpose of this chapter is to provide *guidance* on the provisions concerning *approved persons* as they relate to *credit unions*.

6.1.3 G 01.07.02/001 The full provisions are to be found in the following sourcebooks or manuals of the *Handbook*:

- (1) The Statements of Principle and Code of Practice for Approved Persons (*APER*)
- (2) Fitness and Propriety (*FIT*)
- (3) *Authorisation* manual (*AUTH*)
- (4) Supervision manual (*SUP*)
- (5) Enforcement manual (*ENF*)

6.1.4 G 01.07.02/001 *Guidance* on all the provisions of the manuals concerning *approved persons* is provided below, but the following points summarise the key parts of the proposals:

- (1) *FSA* has specified various functions which are seen as key to the operation of a *credit union* and which are referred to as *controlled functions*.
- (2) A *controlled function* may be performed only by a *person* who is a fit and proper *person* to perform the *function* to which the approval relates.
- (3) The purpose of these provisions is to complement the regulation of *credit unions* themselves.
- (4) The manuals provide full details concerning all aspects of the application process, the criteria for assessment, the range of *controlled functions* and disciplinary action.



6.2 The Statements of Principle of Code of Practice for Approved Persons (APER)

6.2.1



01.07.02/001

The purpose of this section is to provide a guide to the *Statements of Principle and Code of Practice for Approved Persons (APER)* – which are issued for the *guidance of approved persons* in the conduct of their functions and follows the structure of the statements and code.

Introduction

6.2.2



01.07.02/001

APER 1.1 provides that APER applies to *approved persons*.

6.2.3



01.07.02/001

APER 1.2 explains that section 64(2) of the *Act* provides that if the *FSA* issues *Statements of Principles* it must also issue a code of practice for the purpose of helping to determine whether a *person's* conduct complies with these *Statements of Principle*. The code has been issued for that purpose. It also sets out some guiding principles concerning the application of the *Statements of Principle* and the *Code of Practice for Approved Persons*. *Statements of Principle* 1, 2, 3 and 4 apply to all *approved persons* performing a *controlled function* for a *credit union*, and *Statements of Principle* 5, 6, and 7 apply to those approved to perform *significant influence functions*. All *controlled functions* performed for a *credit union* are *significant influence functions* (APER 1.2.4G).

The Statements of Principle

6.2.4



01.07.02/001

APER 2.1 sets out the seven *Statements of Principle* which apply to *approved persons*. These are all designed to ensure that *approved persons* undertake their roles efficiently and with integrity. All seven *Principles* may apply to *approved persons* performing functions for *credit unions*.

6.2.5



01.07.02/001

The table in APER 2.1.2P sets out the full text of the *Statements of Principle*. These are repeated below for ease of reference.

- (1) An *approved person* must act with integrity in carrying out his *controlled function*.
- (2) An *approved person* must act with due skill, care and diligence in carrying out his *controlled function*.
- (3) An *approved person* must observe proper standards of market conduct in carrying out his *controlled function*.

- (4) An *approved person* must deal with the FSA and with other regulators in an open and cooperative way and must disclose appropriately any information of which the FSA would reasonably expect notice.
- (5) An *approved person* performing a *significant influence function* must take reasonable steps to ensure that the business of the *firm* for which he is responsible in his *controlled function* is organised so that it can be controlled effectively.
- (6) An *approved person* performing a *significant influence function* must exercise due skill, care and diligence in managing the business of the *firm* for which he is responsible in his *controlled function*.
- (7) An *approved person* performing a *significant influence function* must take reasonable steps to ensure that the business of the *firm* for which he is responsible in his *controlled function* complies with the regulatory requirements imposed on that business.

Code of Practice for Approved persons

6.2.6



01.07.02/001

APER 3.1 provides an introduction to the *Code of Practice for Approved Persons* and provides *guidance* on its operation. The key points for those involved with *credit unions* are as follows:

- (1) An *approved person* will be in breach of a *Statement of Principle* only where his conduct was deliberate or where his standard of conduct was below that which would be reasonable in the circumstances.
- (2) All the *Statements of Principle* may apply to *approved persons* performing a *controlled function* for a *credit union*.

Factors relevant to Statements of Principle

6.2.7



01.07.02/001

APER 3.2 - APER 3.3 set out factors to be taken into account in determining whether or not an *approved person's* conduct complies with the *Statements of Principle*. Since all *controlled functions* relevant to *credit unions* are *significant influence functions*, all these factors are relevant to *credit unions*.

6.2.8



01.07.02/001

APER 4.1 – APER 4.7 set out the seven *Statements of Principle* in turn, and provide *guidance* on conduct which, in the opinion of the FSA, does not comply with each of the *Statements of Principle* or, in the case of APER 4.3, conduct which will tend to show compliance with the relevant *Statement of Principle*.

Enforcement procedures

6.2.9



01.07.02/001

Details of the disciplinary measures which may be taken against *approved persons* are located in ENF 11 – ENF 13. *Approved persons* should note that disciplinary action may be taken either for their personal misconduct or for conduct which results in a *credit union* breaching any provisions to which it is subject.



6.3 Approved persons

6.3.1



01.07.02/001

The purpose of this section is to provide a guide to those parts of the Supervision manual (*SUP*) concerning *approved persons* as they apply to *credit unions*, and follows the structure of that manual. This section should be read in conjunction with *SUP* 10.

Introduction

6.3.2



01.07.02/001

SUP 10.1.1R - *SUP* 10.1.26G provides an introduction to the application of the *approved persons* regime. The effect of the *rules* is that a *credit union* must apply to the *FSA* for the approval of one or more individuals to perform the functions which are known as *controlled functions*. In broadest outline these *controlled functions* are roles which enable an individual to exert significant influence on the conduct of the *credit union's* affairs. A complete list of these functions is set out in *SUP* 10.4.5R, although not all of these are relevant to *credit unions*. This guide concentrates only on the *controlled functions* which are relevant for the majority of *credit unions*. The largest *credit unions* should consider whether a wider range of *controlled functions* is relevant to them.

Purpose of the regime

6.3.3



01.07.02/001

SUP 10.2 outlines the purpose of the direct regulation of individuals which is to supplement the regulation of *credit unions* themselves. Individuals will need to be approved to undertake tasks which are key to the operation of a *credit union*.

Controlled functions

6.3.4



01.07.02/001

SUP 10.3 provides, in this context, that a function is a *controlled function* only when it is undertaken by a *credit union* in relation to a *regulated activity*. *Controlled functions* fall within two groups. The *significant influence functions* describe the roles performed by the *governing body* and *senior managers* of the *firm* who exert a significant influence over the *regulated activities* of the *firm*. The *customer functions* describe the roles of individuals who deal with *customers* or with the property of *customers*. These *customer functions* do not extend to activities in relation to accepting *deposits* or general insurance and therefore will not be relevant to *credit unions* with *permission* for *accepting deposits* only.

Specification of functions

6.3.5

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01.07.02/001

SUP 10.4 specifies all the *controlled functions* and provides that its requirements apply only in relation to the performance of the *controlled functions* for which an individual is approved.

6.3.6

G

01.07.02/001

The complete list of all *controlled functions* is located in SUP 10.4.5R. *Guidance* on those *controlled functions* most likely to be relevant to *credit unions* is provided below:

6.3.7

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01.07.02/001

SUP 10.6: the *governing functions*:

(1) SUP 10.6.4R: the *Director function*

This is the function of acting in the capacity of a *director* of a *credit union*.

(2) SUP 10.6.8R: the *non-executive director function*

It is unusual for a *credit union* to appoint *non-executive directors* as such. But this function would include membership of a *credit union's* supervisory committee and any other committee which scrutinises the approach of executive management, the *credit union's* performance, and its standards of conduct.

(3) SUP 10.6.11R: the *chief executive function*

Acting in the capacity of *chief executive*, whether or not using that title. This role includes anyone having the responsibility, alone or jointly with one or more others, under the immediate authority of the committee of management, for the conduct of the whole of the business.

6.3.8

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01.07.02/001

SUP 10.7: the *required functions*:

(1) SUP 10.7.1R: the *apportionment and oversight function*. The apportionment of responsibilities (see CRED 4.2 and SYSC 2.1.1R).

The function of dealing with apportionment of responsibilities under SYSC 2.1.1R, and of overseeing the establishment and maintenance of systems and controls under SYSC 3.1.1R.

(2) SUP 10.7.13R: the *money laundering reporting function*.

The function of acting in the capacity of the *money laundering reporting officer* of a *credit union*.

6.3.9

G

01.07.02/001

SUP 10.8: the *systems and controls functions*:

(1) SUP 10.8.1R the *finance function*

The function of acting in the capacity of a *senior manager* with responsibility for reporting to the committee of management in relation to its financial affairs.

(2) SUP 10.8.3R: the *risk assessment function*

The function of acting in the capacity of a *senior manager* with responsibility for reporting to the committee of management on the setting and controlling of its risk exposure.

(3) SUP 10.8.6R: the *internal audit function*

The function of acting in the capacity of a *senior manager* with responsibility for reporting to the committee of management in relation to its adherence to internal systems and controls, procedures and policies.

6.3.10 G
01.07.02/001

SUP 10.9: the *significant management functions*:

These *controlled functions* will only apply to the *credit union* if the functions are not being performed by a member of the committee of management and the *credit union* has followed the *guidance* in SUP 10.9.3G.

6.3.11 G
01.07.02/001

SUP 10.11: gives guidance on forms and procedures relating to *approved persons*.

6.3.12 G
01.07.02/001

Table The following are the forms that will most commonly be needed by credit unions.

Form A	SUP 10 Ann 4D	Application to perform <i>controlled functions</i> under the <i>approved persons</i> regime.
Form B	SUP 10 Ann 5R	Notice to withdraw an application to perform <i>controlled functions</i> under the <i>approved persons</i> regime.
Form C	SUP 10 Ann 6R	Notice of ceasing to perform <i>controlled functions</i> .
Form D	SUP 10 Ann 7R	Notification of changes in personal information or application details.

Copies of these forms may be obtained from the *FSA* website or from the Individual Vetting and Approval Department.

6.3.13 G
01.07.02/001

SUP 10.12 outlines procedures concerning the application for approval and withdrawing an application for approval. Applications should be made by the *credit union* and not by individual applicants. Details are provided concerning the procedure that *FSA* will adopt when granting or refusing applications.

6.3.14 G
01.07.02/001

SUP 10.13 outlines procedures concerning changes to an *approved person's* details. Where changes to an *approved person's* role involve the *person* performing one or more different *controlled functions* from those for which they have been given approval, then a new application must be made to *FSA*. This will be for approval to perform the new *controlled functions*.

6.3.15 G
01.07.02/001

SUP 10.14 points readers in the direction of frequently asked questions and answers, in particular which part of the *FSA* to approach with any questions which remain unanswered.



6.4 Assessing fitness and propriety

Purpose

6.4.1  01.07.02/001

The purpose of this section is to set out and describe the criteria that the *FSA* will consider when assessing the fitness and propriety of a *person* in respect of whom an application is being made for approval to undertake a *controlled function* under the *approved persons* regime (*SUP 10*). The criteria specified here will also be used to assess the continuing fitness and propriety of *persons* who have already been approved.

Background

6.4.2  01.07.02/001

- (1) *FIT 1.2* explains that the *FSA* may grant an application for approval for a *person* to perform a *controlled function* only if it is satisfied that the *candidate* is fit and proper to perform the *controlled function* to which the application relates.
- (2) It also indicates that the *FSA* may withdraw its approval if it considers that an individual is no longer fit and proper to perform the *controlled function* to which the approval relates.

Assessing fitness and propriety

6.4.3  01.07.02/001

FIT 1.3 explains that the *FSA* will have regard to a range of factors when assessing the fitness and propriety of a *person* to perform a particular *controlled function*, but that the most important criteria will be the *person's*:

- (1) honesty, integrity and reputation;
- (2) competence and capability; and
- (3) financial soundness.

6.4.4  01.07.02/001

FIT 2.1 – FIT 2.3 provide further details of the criteria referred to in *CRED 6.4.3G* and the primary matters which *FSA* will take account in assessing them.

Chapter 7

Investment and borrowing

7

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1





7.1 Application, purpose and interpretation

7.1.1 **R**
01.07.02/001

This chapter applies to all *credit unions*.

7.1.2 **G**
01.07.02/001

- (1) The *rules* and *guidance* contained in this chapter are designed to address risks that can arise from the structure of a *credit union's* balance sheet.
- (2) These risks include the risk that a *credit union's* income is not sufficiently large to cover its funding, operational and other costs, and the risk that a *credit union* may not be able to renew or replace wholesale funding at an affordable rate.

7.1.3 **R**
01.07.02/001

For the purposes of this chapter:

- (1) the maturity of a *security* or loan is the last or only date on which it shall be repayable by or under its terms; and
- (2) surplus funds means funds not immediately required for a *credit union's accepting deposits, lending and ancillary purposes*.



7.2 Investment

Types of investment

7.2.1

R

01.07.02/001

Subject to the general limitations on its powers contained in the Credit Unions Act 1979 and to the limitations contained in *CRED 7.2.2R – CRED 7.2.3R* below, a *credit union* may invest its surplus funds and funds serving liquidity purposes only in the following types of *investment*:

- (1) *deposits* or loans to a *UK domestic firm* with *Part IV permission to accept deposits*;
- (2) *deposits* or loans to an institution which is authorised in any other *EEA State* to *accept deposits*;
- (3) sterling-denominated *securities* issued by the government of any *EEA State*;
- (4) fixed-interest sterling-denominated *securities* guaranteed by the government of any *EEA State*, provided that any guarantee is unconditional in respect of the payment of both principal and interest on those *securities*.

7

Maturity investment

7.2.2

R

01.07.02/001

Any *securities* invested in, or loans made, in accordance with *CRED 7.2.1R* by a *version 1 credit union* must have a maturity date of not more than 12 *months* from the date on which the *investment* is made.

7.2.3

R

01.07.02/001

Any *securities* invested in, or loans made, in accordance with *CRED 7.2.1R* by a *version 2 credit union* must have a maturity date of not more than five years from the date on which the *investment* is made.

Cash in custody of officers

7.2.4

R

01.07.02/001

Surplus funds not invested by a *credit union* in accordance with CRED 7.2.1R – CRED 7.2.3R must be held as cash in the custody of *officers* of the *credit union*.

Investment conditions no longer satisfied

7.2.5

R

01.07.02/001

Where under CRED 7.2.1R – CRED 7.2.3R above, a *firm* or another institution ceases to satisfy the conditions necessary for a *credit union* to invest with it or lend to it, and any funds of a *credit union* are with that *firm* or other institution, the *credit union* must take all practicable steps to call in and realise that loan within three *months* of that cessation, or, if that is not possible, as soon after the end of that period as possible.

Transactions between credit unions

7.2.6


G


01.07.02/001

A *credit union* may accept a loan from another *credit union* (section 10(1) of the Credit Unions Act 1979). However, although a *credit union* is a *UK domestic firm* with *Part IV permission* to *accept deposits* (CRED 7.2.1R(1)), it cannot issue shares to another *credit union* (section 5(1) and (2) of the Credit Unions Act 1979) or otherwise *accept deposits* from another *credit union* (Section 8(1) of the Credit Unions Act 1979). *UK banks* and *building societies* may *accept deposits* from a *credit union*.





7.3 Funds held on trust for persons too young to be members


7.3.1  **Nothing in CRED 7.2.1R – CRED 7.2.3R applies to funds held on trust as mentioned in section 9(2) of the Credit Unions Act 1979.**
01.07.02/001


7.3.2  Section 9(2) of the Credit Unions Act 1979 requires that *deposits* held on trust for *persons* too young to be members should be kept in a fund apart from the general funds of the *credit union* and invested only in the manner specified by statute.
01.07.02/001

Borrowing


7.3.3  **The borrowing of a *version 1 credit union* must not exceed, except on a short-term basis, an amount equal to 20% of the total shareholding in the *credit union*.**
01.07.02/001


- 7.3.4**  (1) The borrowing of a *version 1 credit union* should not exceed an amount equal to 20% of the total shareholding in the *credit union* at the end of more than two consecutive quarters.
01.07.02/001
- (2) Contravention of CRED 7.3.4E(1) may be relied on as tending to indicate contravention of CRED 7.3.3R.

7.3.5  A *version 2 credit union* may borrow from any of the sources permitted under section 10 of the Credit Unions Act 1979 subject to the restrictions contained in that section.
01.07.02/001

7.3.6  **Subordinated debt obtained by a *credit union* and forming part of its capital (see CRED 8.2.1R) does not count towards the borrowing limits under CRED 7.3.3R.**
01.07.02/001

Financial risk management policy statement

7.3.7  **A *version 2 credit union* must establish, maintain and implement an up-to-date financial risk management policy statement approved by the committee of management.**
01.07.02/001

7.3.8  This policy should address both interest rate and funding risk. It should cover aggregate limits on holdings of *investments* and borrowings from sources other than members. It should deal with avoidance of funding concentrations (both source and
01.07.02/001

time-band concentrations) and should detail the organisational arrangements, systems and controls in respect of these matters.

7.3.9

G

01.07.02/001

A *credit union's* committee of management should review and approve its financial risk management policy at least once a year, and more frequently if necessary, especially in light of significant changes in business.

7.3.10

R

01.07.02/001

A *version 2 credit union* must send to the FSA a copy of its financial risk management policy statement as soon as is reasonably practicable after approval by the committee of management.

Chapter 8

Capital requirements

8

PAGE
1





8.1 Application and purpose

8.1.1

R

This chapter applies to all *credit unions*.

01.07.02/001

8.1.2

G

It amplifies *Principle 4* under which a *firm* must maintain adequate financial resources and the *threshold condition* that a *firm's* resources must be adequate in relation to the *regulated activities* that it carries on.

01.07.02/001

8.1.3

G

The purpose of setting capital requirements is to ensure that a *credit union* has an appropriate level of capital available to absorb unexpected losses.

01.07.02/001

8.1.4

G

The capital and net worth requirements set out in this chapter represent the minimum requirements that a *credit union* must comply with. A *credit union* should decide for itself the amount of capital that it needs to hold over and above these minimum standards proportionate to its scale of operations and its risk profile.

01.07.02/001

8.1.5

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The *FSA* may require a *credit union* to hold minimum amounts of capital greater than those set out below where it considers that particular circumstances make that appropriate.

01.07.02/001

8.2 Components of capital

8.2.1

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01.07.02/001

- (1) The following are included in the meaning of 'capital' for the purposes of this chapter:
 - (a) audited reserves;
 - (b) interim net profits;
 - (c) subordinated debt meeting the requirements set out at *CRED* 8.2.1R(4);
 - (d) initial capital.
- (2) Audited reserves are audited accumulated profits or losses, or both, retained by a *credit union* after payment of tax and dividends. Reserves also include other realised gains and gifts of capital - for example from a sponsoring organisation.
- (3) Interim net profits are interim profits net of tax and anticipated dividends.
- (4) To be included in the calculation of capital, subordinated debt must meet the following conditions:
 - (a) the maturity of the loan must be not less than five years from the date on which the loan is made;
 - (b) the subordination provisions provide that the claims of the subordinated creditors rank behind those of all unsubordinated creditors including the *credit union's* shareholders;
 - (c) to the fullest extent possible creditors waive their rights to set off amounts they owe the *credit union* against subordinated amounts owed to them by the *credit union*;
 - (d) the only events of default are non-payment of any interest or principal under the debt agreement or the winding-up of the *credit union*;
 - (e) the remedies available to the subordinated creditor in the event of default in respect of the subordinated debt are limited to

- petitioning for the winding up of the *credit union* or proving for and claiming in the liquidation of the *credit union*;
 - (f) the subordinated debt must not become due and payable before its stated final maturity date except on an event of default complying with (d);
 - (g) the terms of the subordinated debt must be set out in a written agreement or instrument that contains terms that provide for the above conditions;
 - (h) the debt must be unsecured and fully paid up.
- (5) Initial capital is a *credit union's* capital at the time it is given *Part IV permission to accept deposits*, but this does not apply in cases where the *credit union* is treated as having such a *permission on credit unions day*. Initial capital consists of a *credit union's* assets less its liabilities other than the liabilities set out in *CRED 8.2.1R(1)(a)-(c)*.

8.2.2 R Negative reserves and any interim net losses must be deducted from capital.

01.07.02/001

8.2.3 R The amount of any subordinated loan counting towards a *credit union's* regulatory capital must, over its final four years to maturity, be written down by 20% of the amount of the loan per year. (See Table 8.2.4R.)

01.07.02/001

8.2.4 R Table Writing down subordinated loans over final four years
This table belongs to *CRED 8.2.3R*

01.07.02/001

Years to maturity	Amount of loan counting towards capital
More than 4	100%
Less than and including 4 but more than 3	80%
Less than and including 3 but more than 2	60%
Less than and including 2 but more than 1	40%
Less than and including 1	20%



8.3 Version 1 credit unions

Requirement to maintain positive net worth

- 8.3.1** **R**
01.07.02/001 **A *version 1 credit union* must at all times maintain a positive amount of capital.**
- 8.3.2** **G**
01.07.02/001 *CRED 8.3.1R* means that the sum of the items set out at *CRED 8.2.1R(1)(a)-(c)* must produce a positive figure, so that a *credit union's* assets will at all times exceed its non-capital liabilities.
- 8.3.3** **G**
01.07.02/001 *CRED 8.3.1R* implements the principle that every pound saved by a depositor with a *credit union* should always be worth at least a pound.
- 8.3.4** **G**
01.07.02/001 *CRED 10.5.1R* and *CRED 10.5.2R* mean that bad and doubtful debts must be taken into account in establishing whether a *credit union* is maintaining a positive amount of capital.

Building reserves

- 8.3.5** **R**
01.07.02/001 **A *version 1 credit union* must establish and maintain a general reserve.**
- 8.3.6** **R**
01.07.02/001 **If, at the end of any year of account, the amount in its general reserve stands at less than 10% of its total assets, such a *credit union* must transfer to its general reserve at least 20% of its profits for that year (or such lesser sum as is required to bring the amount in its general reserve up to 10% of its total assets).**
- 8.3.7** **R**
01.07.02/001 **For the purposes of *CRED 8.3.5R* 'profits' means the profits resulting from the operations of a *credit union* in the year of account in question after deduction of all operating expenses (including payment of interest) and after making provision for the depreciation of assets, for tax liabilities and for bad and doubtful debts, but before the payment of any dividend.**
- 8.3.8** **R**
01.07.02/001 **A *credit union* may not transfer from its general reserve where its general reserve stands at less than 10% of its total assets.**

Minimum initial capital

8.3.9 R **A version 1 credit union must have initial capital of at least £1,000.**

01.07.02/001

8.3.10 G For the meaning of 'initial capital' see CRED 8.2.1R(5) above.

01.07.02/001

8.3.11 G For the relationship between registration and *authorisation* see CRED 13.2.1G. The purpose of CRED 8.3.9R is to establish for these *credit unions* a minimum amount of capital at *authorisation*, out of which early expenses may be defrayed. It should be noted that the requirement in CRED 8.3.9R does not affect a *credit union's* obligations to meet the other capital requirements that apply to it. The ability of a *credit union* to comply on a continuing basis with the other capital requirements that apply to it will be a central factor for consideration in any application for *authorisation*.

01.07.02/001

Capital requirement for version 1 credit unions wishing to lend amounts of more than £5,000 in excess of the borrowing member's shareholding.

8.3.12 R (1) **A version 1 credit union must not make a loan of an amount greater than £5,000 in excess of the borrowing member's shareholding unless it has a capital to total assets ratio of at least 5%.**

01.07.02/001

(2) **A credit union which is owed by a member a total amount greater than £5,000 in excess of that member's shareholding must maintain at all times, while such an amount is outstanding, a capital to total assets ratio of at least 5%.**

8.3.13 G CRED 10.5.1R and CRED 10.5.2R mean that bad and doubtful debts must be taken into account in establishing the capital to assets ratio.

01.07.02/001

Capital requirements for large version 1 credit unions

8.3.14 R **A version 1 credit union with total assets of more than £5 million or a total number of members of more than 5,000, or both, must maintain at all times a capital to total assets ratio of at least 5%.**

01.07.02/001

8.3.15 G CRED 10.5.1R and 10.5.2R mean that bad and doubtful debts must be taken into account in establishing the capital to assets ratio.

01.07.02/001

8.3.16 R (1) **A version 1 credit union with total assets of more than £10 million or a total number of members of more than 10,000, or both, must maintain at all times a risk-adjusted capital to total assets ratio of at least 8%.**

01.07.02/001

(2) **'Risk-adjusted capital' has the same meaning as in CRED 8.4.1R – CRED 8.4.2R (Risk-adjusted capital requirements for version 2 credit unions).**

8.4 Version 2 credit unions

8.4.1

R

01.07.02/001

(1) A *version 2 credit union* must maintain at all times a risk-adjusted capital to total assets ratio of at least 8% unless CRED 8.4.3R applies.

(2) Risk-adjusted capital is calculated as follows:

Capital + (provisions – balance of the net liability of borrowers where their loans are 12 *months* or more in arrears – 35% of the net liability of borrowers where their loans are 3-12 *months* in arrears).

8.4.2

R

01.07.02/001

In calculating risk-adjusted capital:

- (1) the maximum net figure for provisions (after deduction of the stipulated amounts for loans in arrears) that can be included is 1% of total assets;
- (2) 'provisions' includes specific provisions and general provisions; and
- (3) *mortgage* loans and provisions in respect of *mortgage* loans must not be included in calculating the loan balances to be deducted from, and the provisions to be added to, the amount of capital.

Minimum initial capital

8.4.3

R

01.07.02/001

A *version 2 credit union* must have initial capital of at least £5,000.

8.4.4

G

01.07.02/001

For the meaning of 'initial capital' see CRED 8.2.1R(5).

8.4.5

G

01.07.02/001

For the relationship between registration and *authorisation* see CRED 13.2.1G. The purpose of CRED 8.4.3R is to establish for these *credit unions* a minimum amount of capital at *authorisation*, out of which early expenses may be defrayed. It should be noted that the requirement in CRED 8.4.3R does not affect a *credit union's* obligations to meet the other capital requirements that apply to it. The ability of a *credit union* to comply on a continuing basis with the other capital requirements that apply to it will be a central factor for consideration in any application for *authorisation*.

Credit unions

Chapter 9

Liquidity

9

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1





9.1 Application, purpose and interpretation

9.1.1 **R**
01.07.02/001

This chapter applies to all *credit unions*.

9.1.2 **G**
01.07.02/001

This chapter amplifies *Principle 4* under which a *credit union* must maintain adequate financial resources and the *threshold condition* for *permission* that a *credit union's* resources must be adequate in relation to the *regulated activities* that it carries on.

9.1.3 **G**
01.07.02/001

A central feature of *credit union* business is maturity transformation. That is taking short term *deposits* (in the form of share accounts) from members and making comparatively long-term loans. It is important, in order to maintain confidence and protect members, that a *credit union* has adequate liquid assets (liquidity) to enable it to fulfil members' withdrawal requests within expected timeframes.

9.1.4 **G**
01.07.02/001

The liquid assets held by a *credit union* should be sufficient to meet its day-to-day business needs and to provide an appropriate cushion in the event of pressure arising from unexpected events.

9.1.5 **R**
01.07.02/001

'Unattached shareholding' means the amount by which the member's savings with the *credit union* exceeds the amount which, under the terms of section 7 of the Credit Unions Act 1979, he cannot withdraw at all or he cannot withdraw without first of all obtaining the permission of the committee of management of the *credit union*.

9.1.6 **G**
01.07.02/001

- (1) Under section 7 of the Credit Unions Act 1979, if a withdrawal of shares would reduce the member's savings with the *credit union* to less than his total liability (including contingent liability) to the *credit union* whether as borrower, guarantor or otherwise then:
 - (a) if there is a loan to the member which is treated as under section 11A of the Credit Unions Act 1979, the withdrawal is not permitted; and
 - (b) in any other case, the withdrawal is permitted only at the discretion of the committee of management of the *credit union*.
- (2) 'Unattached shareholding' is intended to refer to that portion of a member's savings the withdrawal of which is not restricted by section 7.

9.1.7 **R**
01.07.02/001

'Total relevant liabilities' means the sum of:

- (1) unattached shareholdings in the *credit union*; and
- (2) liabilities (other than liabilities for shares, and *deposits* held on trust for *persons* too young to be members of the *credit union*)

with an original or remaining maturity of less than three *months* (including overdrafts and instalments of loans).



9.2 General requirements

- 9.2.1** **R**
01.07.02/001 *A credit union must hold liquid assets of an amount and composition that is prudent and appropriate to the scale and nature of its business, having regard to material risks, including the risk of a sudden adverse cash flow, with a view to enabling it to meet its objective.*
- 9.2.2** **R**
01.07.02/001 *A credit union must establish, maintain and implement an up-to-date liquidity management policy statement approved by the committee of management and designed to ensure its compliance with CRED 9.2.1R.*
- 9.2.3** **R**
01.07.02/001 *A version 2 credit union must send to the FSA a copy of its liquidity management policy statement as soon as is reasonably practicable after approval by the committee of management.*
- 9.2.4** **G**
01.07.02/001 *The responsibility for ensuring that a credit union can meet its obligations as they fall due rests with the credit union's management.*
- 9.2.5** **G**
01.07.02/001 *A credit union should be able to satisfy the FSA on a continuing basis that it has a prudent liquidity management policy and adequate management systems in place to ensure that the policy is adhered to.*
- 9.2.6** **G**
01.07.02/001 *The liquidity management policy statement of a credit union should set out the credit union's objectives for liquidity, the limits within which liquidity should be maintained, and the types of liquid assets which the credit union should hold.*
- 9.2.7** **G**
01.07.02/001 *A credit union's committee of management should review and approve its liquidity management policy statement at least once a year, and more frequently if necessary, especially in light of significant changes in business.*
- 9.2.8** **G**
01.07.02/001 *Where a version 2 credit union has borrowed wholesale funds, the maturity of such funds and the risk of their not being able to be refinanced should be taken into account in the formulation of the credit union's liquidity management policy statement.*



9.3 Minimum liquidity requirements

- 9.3.1** G
01.07.02/001 The liquidity requirements set out in *CRED 9.3.2R – CRED 9.3.5R* are minimum requirements and are subject to the overarching requirement of *CRED 9.2.1R*.
- 9.3.2** R
01.07.02/001 A *credit union* must at all times hold liquid assets of a value equal to at least 5% of its total relevant liabilities.
- 9.3.3** R
01.07.02/001 A *version 1 credit union* must further hold enough liquid assets to ensure that on no two consecutive quarter ends is the level of the *credit union's* liquid assets below 10% of its total relevant liabilities.
- 9.3.4** R
01.07.02/001 Of the *deposits* held by a *credit union* on trust for *persons* too young to be members, the amount held as liquid assets must at all times be equal to at least 5%.
- 9.3.5** R
01.07.02/001 Of the *deposits* held by a *version 1 credit union* on trust for *persons* too young to be members, the amount held as liquid assets must not be below 10% on two consecutive quarter ends.
- 9.3.6** G
01.07.02/001 *CRED 9.3.4R – CRED 9.3.5R* reflect the fact that section 9(2) of the Credit Unions Act 1979 requires that *deposits* held on trust for *persons* too young to be members should be kept in a fund apart from the general funds of the *credit union* (see *CRED 7.3.2G*).
- 9.3.7** R
01.07.02/001 For the purposes of *CRED 9.3.2R – CRED 9.3.5R*, only those assets shall count as liquid which can be realised for cash at short notice, and within at most eight *days*.
- 9.3.8** R
01.07.02/001 For the purposes of calculating the ratio of a *credit union's* liquid assets to its total relevant liabilities (in *CRED 9.3.2R – CRED 9.3.5R*), assets shall be valued at the amount for which they could be realised within eight *days*.
- 9.3.9** E
01.07.02/001 (1) For the purposes of calculating the ratio of a *credit union's* liquid assets to its total relevant liabilities (in *CRED 9.3.2R – CRED 9.3.5R*), the *securities* referred to in *CRED 7.2.1R – CRED 7.2.3R* should be valued on the basis that they could be realised at par minus the following discounts (whether or not this is the case in fact):

 - (a) maturity less than 1 year – Zero;
 - (b) maturity 1 to 5 years – 5%.

(2) Compliance with CRED 9.3.9E(1) may be relied on as tending to indicate compliance with CRED 9.3.8R (the 8-day realisation-value rule).

9.3.10



01.07.02/001

An asset maturing on a non-business *day* should be regarded as maturing on the succeeding *business day*.

9.3.11



01.07.02/001

For the purposes of clarity, funds serving liquidity purposes may be invested in the manner set out in CRED 7.1.4R – CRED 7.1.9R provided that the resulting assets satisfy the relevant requirements of this chapter.

Credit unions

Chapter 10

Lending

10

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1





10.1 Application and purpose

10.1.1

R

This chapter applies to all *credit unions* carrying on lending activity.

01.07.02/001

10.1.2

G

This chapter seeks to protect the interests of *credit unions*' members in respect of loans to members. *Principle 4* requires *credit unions* to maintain adequate financial resources and Chapter 8 sets out the FSA's detailed capital adequacy requirements in respect of *credit unions*.

01.07.02/001

10.2 General requirements

- 10.2.1** **R** *A credit union must establish, maintain, and implement an up-to-date lending policy statement approved by the committee of management that is prudent and appropriate to the scale and nature of its business, having regard to the limits outlined in CRED 10.3 – CRED 10.4.*
01.07.02/001
- 10.2.2** **R** *A version 2 credit union must provide the FSA with a copy of its lending policy statement as soon as is reasonably practicable after approval by the committee of management.*
01.07.02/001
- 10.2.3** **G** *A principal purpose of credit unions' business is the accumulation of members' savings to provide a fund out of which loans are provided for the benefit of the members. Credit unions may often in practice have less scope to minimise credit risk through the exercise of discretion than some other lenders. It is therefore important that a credit union has a carefully considered and effective lending policy statement.*
01.07.02/001
- 10.2.4** **G** *CRED 4.3.7R requires a credit union to maintain a manual of its policies and procedures. This should include the policy and procedure for making loans.*
01.07.02/001
- 10.2.5** **G** *The credit union's committee of management should review and approve its lending policy at least once a year, and more frequently if necessary (for example if there is an escalating arrears problem), especially in the light of significant changes in business.*
01.07.02/001
- 10.2.6** **G** *The lending policy should consider the conditions for and amounts of loans to members, individual mandates, and the handling of loan applications.*
01.07.02/001
- 10.2.7** **G** *A credit union should have clear arrangements for dealing with loans to officers, staff and connected persons (for example, relatives and other close relationships) to prevent conflicts of interest.*
01.07.02/001
- 10.2.8** **G** *A credit union should have a documented arrears management policy, setting out the procedures and process for dealing with borrowers who fall into arrears. This should be reviewed regularly and promptly in the light of experience.*
01.07.02/001
- 10.2.9** **G** *A credit union should have a clear, robust and effective approach to handling arrears and be able to satisfy the FSA on a continuing basis that it has adequate management and control systems in place to monitor arrears.*
01.07.02/001
- 10.2.10** **G** *A credit union should ensure that loan assets are valued correctly in their accounts. A provisioning policy relating to problem loans and arrears cases should be clearly defined and documented covering the circumstances in which provisions are to be made.*
01.07.02/001






10.3 Lending limits

- 10.3.1** **R** *A version 1 credit union must not lend for a period of more than three years where unsecured and seven years where secured.*
01.07.02/001
- 10.3.2** **R** *A version 1 credit union must not lend more than £10,000 in excess of the borrowing member's shareholding. A credit union must maintain a capital to total assets ratio of at least 5% when making a loan to any member of an amount greater than £5,000 in excess of that member's shareholding.*
01.07.02/001
- 10.3.3** **R** *A version 2 credit union must not lend for a period of more than five years where unsecured and fifteen years where secured.*
01.07.02/001
- 10.3.4** **R** *The maximum amount that a version 2 credit union may lend is £10,000 in excess of the borrowing member's shareholding or 1.5% of total shares in the credit union in excess of the borrowing member's shareholding, whichever is the greater.*
01.07.02/001
- 10.3.5** **G** *The lending limit requirements set out above are maxima. A credit union should have adequate systems for recording and controlling all potential exposures. The capital requirements for version 1 credit unions and version 2 credit unions in respect of lending are set out in CRED 8.3 – CRED 8.4, including the FSA's requirements in respect of calculating risk-adjusted capital.*
01.07.02/001

10.4 Large exposures

- 10.4.1** **R** For the purposes of this section, a large *exposure* is defined as an individual net liability to the *credit union* which meets both of the following criteria:
01.07.02/001
- (1) it is at least £5000;
 - (2) it is at least 10% of the value of the *credit union's* total capital.
- 10.4.2** **R** An individual large *exposure* must not exceed 25% of the *credit union's* capital. In no circumstances may the aggregate total of all large *exposures* exceed 500% of the *credit union's* capital.
01.07.02/001
- 10.4.3** **R** The aggregate total of all large *exposures* must not exceed 300% of capital without a *credit union* pre-notifying the *FSA*.
01.07.02/001
- 10.4.4** **G** For the purposes of large *exposures* the maximum net liability of a *credit union* with assets of £500,000 and 8% capital would be £10,000 subject to *CRED* 10.4.2R and *CRED* 10.3.4R.
01.07.02/001
- 10.4.5** **G** For a *credit union* with assets of £1million and 10% capital the maximum net liability would be £25,000.
01.07.02/001
- 10.4.6** **G** Excessive *exposure* (large loans to an individual borrower and in aggregate) by a *credit union* can create a concentration of risk on the balance sheet and increase a *credit union's* vulnerability to bad debt. This can lead to a strain on capital and solvency. While this risk cannot be eliminated, it can be contained by limits and controlling the extent to which *credit unions* commit themselves to large *exposures*. Therefore the large *exposure* limits set the maximum sum that may be loaned to any one member as a percentage of reserves to prevent concentration. All *credit unions* should set and document their own large *exposure* policy limits to avoid concentration of risk. It is the committee of management's responsibility to monitor large *exposures*. The policy should be reviewed on an annual basis (or more frequently where required).
01.07.02/001

10.5 Provisioning



- 10.5.1**  **A *credit union* must make adequate provision for bad and doubtful debt.**
01.07.02/001
- 10.5.2**  **A *credit union* should make specific provision in its accounts for bad and doubtful debts of at least the amounts set out below:**
01.07.02/001
- (1) 35% of the net liability to the *credit union* of borrowers where the amount is more than three *months* in arrears; and
 - (2) 100% of the net liability to the *credit union* of borrowers where the amount is more than 12 *months* in arrears.
- 10.5.3**  (1) A *credit union* should maintain a general provision for bad and doubtful debts of at least 2% of its other loan assets.
01.07.02/001
- (2) Contravention of CRED 10.5.3E(1) may be relied on as tending to establish contravention of CRED 10.5.1R.
- 10.5.4**  In order to comply with the requirements of CRED 10.5.1R – CRED 10.5.3E it follows that it will be necessary for a *credit union* to review its provisioning requirements frequently (that is, at least *monthly*).
01.07.02/001
- 10.5.5**  A *credit union* should make it its business to know its *customers* and, in conjunction with its auditor, make a judgement on the degree of risk of non-payment attached to loans that are in arrears. Provisioning should reflect that judgement.
01.07.02/001

Chapter 11


Conduct of Business




11.1 Introduction

- 11.1.1**  The Conduct of Business sourcebook (*COB*) sets out *rules* and *guidance* for *firms* on how they should conduct their business with their *customers*.
01.07.02/001
- 11.1.2**  The *rules* and *guidance* set out in *COB* mainly apply to *designated investment businesses* and, as stated in *COB* 1.3.2G(2), have limited application to *deposits*.
01.07.02/001


11.2 Financial promotion

11.2.1  The only part of COB that sets out *rules and guidance* on *deposits* other than a *cash deposit ISA* is that relating to *financial promotion* in COB 3. *Financial promotion* is defined as an invitation or inducement to *engage in investment activity*.


01.07.02/001

11.2.2  *Financial promotions* can be *real time* or non-real time. A *real time financial promotion* is *communicated* in the course of a personal visit, telephone conversation or interactive dialogue. A non-real time *financial promotion* is not a *real time financial promotion*. It includes a *financial promotion* made by letter, e-mail or contained in a newspaper, journal, magazine, other periodical publication, website, television or radio programme or teletext service.

01.07.02/001

11.2.3  Where a *financial promotion* relates to a *deposit* (other than a *cash deposit ISA*) only certain parts of COB 3 apply. These are COB 3.1 – COB 3.5 and COB 3.8.4R to COB 3.8.6G and COB 3.14.

01.07.02/001

11.2.4  In addition to the limited application of COB 3, a number of exemptions from the *rules and guidance* on *financial promotions* are listed in COB 3.2.5R. Some exemptions are particularly relevant to *credit unions* namely exemptions (2), (4) and (5):

01.07.02/001

- (1) Exemption (2): A *financial promotion* which can lawfully be *communicated* by an unauthorised communicator without approval.
- (2) Exemption (4): A "one off" non-real time *financial promotion* or a "one off" solicited *real time financial promotion*. If the conditions set out in (a) to (c) are satisfied, a *financial promotion* is to be regarded as "one off"; if not, the fact that any one or more of these conditions is met is to be taken into account in determining if a *financial promotion* is "one off", but a *financial promotion* may be regarded as "one off" even if none of the conditions are met; the conditions are that:
 - (a) the *financial promotion* is *communicated* only to one recipient or only to one group of recipients in the expectation that they would engage in any *investment* activity jointly;
 - (b) the identity of the product or service to which the *financial promotion* relates has been determined having regard to the particular circumstances of the recipient;
 - (c) the *financial promotion* is not part of an organised marketing campaign.
- (3) Exemption (5): A *financial promotion* which contains only one or more of the following:
 - (a) the name of the *firm*;

- (b) the name of an *investment*;
- (c) a contact point (address including an e-mail address, telephone or facsimile number);
- (d) a logo;
- (e) a brief, factual description of the *firm's* activities;
- (f) a brief, factual description of the *firm's* fees;
- (g) a brief, factual description of the *firm's investment* products;
- (h) the price or yield of *investments* and the charges.

11.2.5



01.07.02/001

Despite the limited application of COB to *deposits* and the exemptions mentioned in CRED 11.2.4G, COB 3.2.8G(1) reminds *firms* that *financial promotions* (including those which are exempt) may be subject to more general *rules* including Principle 7 (*Communications with clients*) SYSC 3 (Systems and controls) and COB 2.1.3G (Clear, fair and not misleading *communication*)).

11.2.6



01.07.02/001

The requirement on a *firm* under COB 3.8.4R(1) is that it should be able to show that it has taken reasonable steps to ensure that a non-real time *financial promotion* is clear, fair and not misleading. This is supported by an *evidential provision* (COB 3.8.5E):

- (1) A *firm* should take reasonable steps to ensure that, for a non-real time *financial promotion*:
 - (a) its promotional purpose is not in any way disguised or misrepresented;
 - (b) any statement of fact, promise or prediction is clear, fair and not misleading and discloses any relevant assumptions;
 - (c) any statement of opinion is honestly held and, unless consent is impracticable, given with the consent of the *person* concerned;
 - (d) the facts on which any comparison or contrast is made are verified, or, alternatively, that relevant assumptions are disclosed and that the comparison or contrast is presented in a fair and balanced way, which is not misleading and includes all factors which are relevant to the comparison or contrast;
 - (e) it does not contain any false indications, in particular as to:
 - (i) the *firm's* independence; or
 - (ii) the *firm's* resources and scale of activities; or
 - (iii) the scarcity of any *investment* of service;
 - (f) the design, content or format does not disguise, obscure or diminish the significance of any statement, warning or other matter which the *financial promotion* is required by this chapter to contain;
 - (g) it does not include any reference to approval by the FSA or any government body, unless such approval has been obtained in writing from the FSA or that body (see also GEN 1.2 (Referring to approval by the FSA));

- (h) it does not omit any matters the omission of which causes the *financial promotion* not to be clear, fair and not misleading; and
 - (i) the accuracy of all material statements of fact in it can be substantiated.
- (2) (a) Compliance with COB 3.8.5(1) may be relied on as tending to show compliance with COB 3.8.4(1).
- (b) Contravention of COB 3.8.5(1) may be relied on as tending to show contravention of COB 3.8.4(1).

Chapter 12

Money laundering





12.1 Introduction

What is Money laundering?





12.1.1



01.07.02/001

Money laundering is the process by which *persons* attempt to conceal the true origin and ownership of the proceeds of criminal activity. Anyone successfully ‘laundering’ these proceeds will ultimately be able to provide an apparently legitimate cover for their source of income. There are many ways that *money laundering* might occur in a *credit union*, for example where members offer large lump-sum payments which are not part of their normal payment pattern or they may make numerous small payments for shares so that the total of each *deposit* is unremarkable, but the total of all the credits is significant. Reluctance to provide normal information when opening an account (even when taking account of the financially disadvantaged nature of some potential *credit union* members) should alert staff to a potential *money laundering* situation.

12.2 Money laundering and the FSA

- 12.2.1**  The *Act* gives the *FSA* a 'reduction of *financial crime*' objective and explicit powers in relation to *money laundering* for the first time. These are the power to prosecute for breaches of the *Money Laundering Regulations* and the power to make and enforce regulatory *rules* on *money laundering*.
01.07.02/001
- 12.2.2**  The *Money Laundering* sourcebook (*ML*) *rules* and *guidance* apply to *credit unions* unless the text makes clear that they do not (for example, *ML8* on *sole traders* and *professional firms*).
01.07.02/001
- 12.2.3**  This chapter of *CRED* offers some short additional *guidance* to *credit unions* to help them understand what *ML* expects of them in relation to some specific aspects of *ML*, namely:
- (1) identification of the *client* (*ML3*);
 - (2) external reporting (*ML4*);
 - (3) using national and international findings and material deficiencies (*ML5*); and
 - (4) compliance monitoring and record keeping (*ML7*).
- 12.2.4**  This additional *guidance* is not a substitute for, and should be read in conjunction with, the requirements contained in the relevant parts of *ML*.
01.07.02/001



12.3 Identification of the client

12.3.1



01.07.02/001

ML 3.1.1G - ML 3.1.9R establish a duty on *relevant firms* to carry out the identification of *clients*. *ML 3.1.3R* makes clear that *relevant firms* must not, in general, carry out *relevant regulated activities*, or agree to do so, for a *client* or potential *client* unless the *firm* has taken reasonable steps to check that *client's* identity. That requirement applies to any *person* engaged in, or who has had contact with the *firm* with a view to engaging in, any *transaction* with that *firm*:

- (1) on his own behalf; or
- (2) as agent for or on behalf of another.

In the case of (2), the *firm* has to enquire into the identity of both *persons*, unless an exception enables it to focus solely on the *person* it is actually in contact with.

12.3.2



01.07.02/001

In the *credit union* context, in order to ensure that the *person* is who they say they are, the following information should be obtained:

- (1) a true name and name used;
- (2) correct permanent address, including postal code; and
- (3) date of birth.

12.3.3



01.07.02/001

Ideally, the true name or names used should be verified by reference to a *document* obtained from a reputable source which bears a photograph. There is obviously a wide range of other *documents* that members might produce as evidence of their identity. It is for each *credit union* to decide the appropriateness of such *documents* in the light of other security procedures operated when an account is opened.

12.3.4



01.07.02/001

In addition to the name verification, it is important that the current permanent address should also be verified. Some means of verifying address are:

- (1) checking the voters' roll; or
- (2) making a credit reference agency search; or
- (3) requesting sight of a recent utility bill, local authority tax bill, *bank* or *building society* statement (originals); or
- (4) checking a local telephone directory (not as a primary check).

12.3.5



01.07.02/001

ML 3.1.5G - ML 3.1.7G recognise that there will be exceptional circumstances when the potential member is unable to produce the normal *documents* to confirm their identity. In these circumstances a *credit union* can accept a letter from *persons* in a position of responsibility such as teachers, social workers, doctors, ministers of religion, hostel managers and solicitors as evidence of identity. The *credit union*

still has the responsibility to satisfy itself that the *person* applying for membership is who they say they are (*ML 3.1.3R*).

12.3.6



01.07.02/001

ML 3.2 sets out a number of exceptions to the requirement upon *firms* to establish the identity of the *client*. These exceptions apply in principle to *credit unions*, but the only one which is likely to be relevant to the *credit union* context is that described in *ML 3.2.4R*. That *rule* establishes that the identification requirements need not apply if the source of funding of a *transaction* is an account held by a *client* with a *firm* which itself is subject to the requirements laid down in *ML*. In the *credit union* context this, for example, would mean that funds arriving in a member's account which originated from an account held with a *bank* or *building society* need not be subject to the *customer* identification requirements set out in *ML 3.1.3R*. However, none of these exceptions applies if the *firm* knows or suspects that the *client* is engaged in *money laundering*.



12.4 External Reporting

12.4.1

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01.07.02/001

Firms should take reasonable steps to ensure that any report of *money laundering* reported to the *MLRO* is swiftly consulted. Having consulted the information available, if the *MLRO* suspects a *person* has been engaged in *money laundering*, he should report promptly to the National Criminal Intelligence Service (*NCIS*).

12.4.2

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01.07.02/001

In the *credit union* context the committee of management may consider it appropriate to have a standing item covering *money laundering* on the agenda of their monthly meeting to ensure procedures are regularly reviewed.



12.5 Government and Financial Action Task Force findings

12.5.1

01.07.02/001



ML 5.1.2R requires *firms* to take reasonable steps to ensure that they obtain and make proper use of any government or *Financial Action Task Force* findings. This information will be published on the *FSA* website. *Firms* are required to access this information.

12.5.2

01.07.02/001



It is acknowledged that many *credit unions* do not have direct access to the Internet. Where this is the case, they will need to make arrangements for a volunteer to access the website on a regular basis, as a minimum every six *months*. Many *credit unions* will have members who are foreign nationals or have overseas links. For those *credit unions* it is important that they keep abreast of the *Financial Action Task Force* findings of inadequacy concerning the approach to *money laundering* of individual countries or jurisdictions so that these can be taken into account in their decisions and arrangements.

12.6 Compliance Monitoring

12.6.1

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01.07.02/001

ML 7.2.2E sets out that, in accordance with SYSC 3.2.6R, *firms* should take reasonable care to establish and maintain appropriate systems and controls. In the context of the *financial crime* objective, this should include requirements for, at least, annually:

- (1) a report from the *MLRO*;
- (2) a review of the *firm's* compliance with *ML*;
- (3) assessing the impact of any new findings under *ML 5*;
- (4) a review of the number of *money laundering* reports made by staff.

In the case of *credit unions*, the committee of management should consider the *MLRO's* report and take any action necessary to remedy deficiencies identified.



12.7 Record keeping

12.7.1



01.07.02/001

ML 7.3.2R requires *firms* to make and keep for specified periods records in relation to evidence of identity; records of *transactions* with *clients*; records of internal and external reports made; and records of suspicions of any *money laundering* not reported to *NCIS*. In the *credit union* context, it is important to note that *ML 7.3.2R* requires a *credit union* which has concluded that a member is financially excluded (under *ML 3.1.5G – ML 3.1.7G*) to make and keep a record of the reasons for doing so.

Chapter 13

Registration and Authorisation





13.1 Application and purpose

13.1.1



01.07.02/001

This chapter applies to:

- (1) a *person* applying, or considering applying, to the FSA to become a *registered only credit union*;
- (2) a *person* applying, or considering applying, to the FSA to become *authorised as a credit union* with a *Part IV permission* to accept deposits; and
- (3) a *candidate*, but only as a matter of general relevance.

13.1.2










01.07.02/001

This chapter gives *guidance* about:

- (1) what it means to become a *registered only credit union* and a *credit union* with a *Part IV permission* to accept deposits;
- (2) the application procedures for *persons* wishing to become a *registered only credit union* and a *credit union*;
- (3) the procedures by which an applicant can obtain approval for *persons* to perform *controlled functions* under the *approved persons* regime; and
- (4) the FSA's decision making procedures for *Part IV permission* and *approved persons* applications.



13.2 Introduction

- 13.2.1**  01.07.02/001 Registration and becoming *authorised* as a *credit union* are two distinct statutory processes. The Credit Unions Act 1979 sets out the statutory requirements for registration and the *Act* sets out the statutory requirements relating to *authorisation*. The *FSA* would normally expect these two processes to be undertaken simultaneously as part of a single combined application. However where appropriate, the *FSA* is willing to consider granting registration before making a decision about *authorisation* where the applicant would find this helpful. Where the *FSA* grants registration before making a decision about *authorisation*, there can be no assumption on the part of applicants that the *FSA* will grant a *Part IV permission*.
- 13.2.2**  01.07.02/001 The *Authorisation* manual (*AUTH*) explains in full the circumstances in which *authorisation* is required, the *authorisation* process and the *FSA*'s powers in relation to *authorisation*.
- 13.2.3**  01.07.02/001 An applicant for a *Part IV permission* must apply in writing in the manner directed, and with the information required, in the application pack provided by the *FSA*.
- 13.2.4**  01.07.02/001 The application pack, which is modular, contains some general forms applicable to all applicants and some specific to *credit union* applicants. The application pack also contains a set of explanatory notes about the information required and on how to complete the forms.
- 13.2.5**  01.07.02/001 Applications should be accompanied by the relevant application fees set by the *FSA* for registration and *authorisation* (see *Schedule 3*).
- 13.2.6**  01.07.02/001 The *FSA* is committed to an interactive application process. Applicants are encouraged to contact the *FSA*'s Credit Union team at an early stage to discuss their plans and proposed application. In any event, applicants are expected to discuss their plans with the *FSA*'s Credit Union team before making a formal application. In some circumstances, it may be appropriate for the *FSA* to hold a pre-application meeting with an applicant.
- 13.2.7**  01.07.02/001 (1) The application pack and accompanying explanatory notes are available on www.fsa.gov.uk or from the Corporate Authorisation department of the *FSA*. To contact the Corporate Authorisation department:
- (a) telephone on 020 7676 1000; or
 - (b) write to the Corporate Authorisation department at The Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS; or
 - (c) email corporate.authorisation@fsa.gov.uk.

- (2) Copies of all current *guidance* are available from the *FSA* website www.fsa.gov.uk or through the *FSA*'s Publication Enquiries department on 020 7676 3298. The *FSA* will review its *guidance* from time to time and may need to amend or withdraw published or written *guidance* in the light of changing circumstances, developing business practices or case law.



13.3 What does registration mean?

13.3.1



01.07.02/001

The registration process leads to the formation of a *registered only credit union*, as an *industrial and provident society*, under the Credit Unions Act 1979. On registration, it becomes a *body corporate* with limited liability.

13.3.2



01.07.02/001

Registration does not allow a *registered only credit union* to undertake *deposit-taking* activities. Whether or not *accepting deposits* is a *regulated activity* under the *Act* depends on the use to which the *money* is put. The activity is caught if *money* received by way of *deposit* is lent to others or if any other activity of the *person* accepting the *deposit* is financed wholly (or to a material extent) out of the capital, or interest on, *money* received by way of *deposit*.

13.3.3



01.07.02/001

Where the *FSA* has granted registration before making a decision about *authorisation*, the *registered only credit union* must become *authorised* under the *Act* (see *CRED 13.5 – CRED 13.8*) before it can undertake the activity of *accepting deposits*.



13.4 Process for registration

13.4.1

01.07.02/001



For registration, applicants must demonstrate to the satisfaction of the *FSA* that the statutory conditions set out in section 1 of the Credit Unions Act 1979 will be fulfilled. *CRED 13 Annex 1* contains a table listing these statutory conditions. The application pack contains the relevant forms for registration and explanatory notes on how to complete the forms.

13.4.2

01.07.02/001



Where the *FSA* has agreed to consider granting an application for registration before making a decision about an application for a *Part IV permission*:

- (1) it will look to make its determination within three *months* of receipt of the application. Where information or *documents* required to be submitted as part of the application are not provided, or the *FSA* requires additional information, it may take longer to complete this process;
- (2) it may want to meet with the applicant as part of the registration process although, normally, it would not expect to do so;
- (3) the applicant may withdraw its application for registration (and *Part IV permission*) at any time before the application for registration is granted or refused, by giving written notice to the *FSA*.

13.5 What does authorisation involve?

- 13.5.1** G
01.07.02/001
- An applicant seeking to carry on the activity of *accepting deposits* (a *regulated activity*) must seek *authorisation* by way of a *Part IV permission* (so called because the relevant provisions are contained in Part IV of the *Act*). For the purposes of the legislation, members' shares in a *credit union* are considered to be *deposits* (in the same way that shares in a *building society* are considered to be *deposits*).
- 13.5.2** G
01.07.02/001
- Whilst there is a single *deposit-taking permission*, *applicants* will need to decide whether to apply to be a *version 1 credit union* or a *version 2 credit union*.
- 13.5.3** G
01.07.02/001
- An applicant for *Part IV permission* must also obtain approval by the FSA of *persons* who perform one or more *controlled functions*. The *approved persons* regime and *controlled functions*, as they apply to *credit unions*, are explained in CRED 6.
- 13.5.4** G
01.07.02/001
- The FSA's *Authorisation* manual (*AUTH*) explains in full the circumstances in which *authorisation* is required, the *authorisation* process and the FSA's powers in relation to *authorisation*. The key chapters of *AUTH* for a *person* applying, or considering applying, to the FSA to become a *credit union* with a *Part IV permission to accept deposits* are:
- (1) *AUTH 3: Applications for Part IV permission;*
 - (2) *AUTH 4: Authorisation fees;*
 - (3) *AUTH 6: Approved persons;* and
 - (4) *AUTH 8: Determining applications.*



13.6 Process for Part IV permission

13.6.1

01.07.02/001



The nature of the information and *documents* requested by the *FSA* for a *Part IV permission*, in the application pack, or in subsequent requests, will be proportional to the risks posed by *firms*. For instance, in the case of *credit unions*, the risks posed by an applicant seeking *permission* to carry out the activities of a *version 2 credit union* will normally be greater than those of an applicant seeking to become a *version 1 credit union*.

13.6.2

01.07.02/001



The *FSA* will typically require the following information from all applicants as a minimum:

- (1) a business plan which describes the *regulated activities* and any unregulated activities which the applicant proposes to carry on, the management and organisational structure of the applicant and details of any proposed outsourcing arrangements;
- (2) appropriately analysed financial budget and projections which demonstrate that the applicant expects to comply with the relevant financial resources requirements applicable to *credit unions* (see *CRED 5.2.1G(4)*, *CRED 8* and *CRED 9*);
- (3) details of the systems to be used, and the controls to be put in place, for the running of the *credit union* (see *CRED 4.3*);
- (4) details of the individuals to be involved in the running of the *credit union*, particularly those performing one or more *controlled functions* for whom *approved persons* status will be required (see *CRED 6.3*); and
- (5) a statement from two *directors* of the applicant's committee of management confirming, to the best of their knowledge, the completeness and accuracy of the information supplied.

13.6.3

01.07.02/001



The *FSA* will begin its formal process of consideration once it has received an application made using the application pack. During this process, the *FSA* may consider it appropriate to ask for additional information, undertake additional lines of enquiry or seek verification from third parties of the information provided to it by the applicant. The *FSA* will normally want to meet with the applicant's management team, in their own area, to discuss their application. As part of its assessment, the *FSA* will consider whether the applicant is ready, willing and organised to comply with the regulatory requirements to which it will be subject if it is granted *Part IV permission* to carry on the *regulated activities* referred to in its application.

13.6.4

01.07.02/001



As part of its application for *Part IV permission*, an applicant may wish to apply for certain *limitations* or *requirements* (see *AUTH 3.6*, *AUTH 3.7* and the application pack). Applicants applying to be a *version 1 credit union* will need to apply for the

appropriate *requirement* to define the scope of its *Part IV permission* (details of which are given in the application pack).

13.6.5



01.07.02/001

The FSA may decide to grant an application for *Part IV permission* subject to *limitations* or *requirements*. For example, the FSA:

- (1) can impose *limitations*, for example, to limit the number of *customers* from whom the *credit union* can *accept deposits* during an initial period of operation; this might be used where, for example, a *credit union's* systems are not yet adequate to be able to process a high volume of transactions; and
- (2) the FSA can impose *requirements*, for example, to restrict the scope of a *credit union's Part IV permission* to carry on *regulated activities* or require a *credit union* to submit financial returns more frequently than normal (see AUTH 3.7).

13.6.6



01.07.02/001

Where the FSA decides to impose *limitations* or *requirements* not requested by the applicant, these will be discussed with the applicant, and the applicant will be informed in writing and given the opportunity to make representations before the FSA reaches a final decision.

13.6.7



01.07.02/001

An applicant which has been granted a *Part IV permission* by the FSA is *authorised*. The FSA will inform the *applicant*, in writing, of the effective date of the *authorisation*. A *credit union* should not commence its *regulated activities* before receiving this written notice. When a *credit union* is *authorised*, a general description of the activities it has been *authorised* to carry on will be recorded in the *FSA Register* which will be accessible by the public.

13.6.8



01.07.02/001

If a *Part IV permission* is given, the FSA will expect the *credit union* to operate in accordance with its business plan. *Credit unions* are advised to discuss any problems with commencing a *regulated activity* with their usual supervisory contact at the FSA. If the FSA consider it appropriate to vary or cancel a *credit union's Part IV permission* (see ENF 3 and ENF 5), it will discuss the proposed action with the *credit union* and ascertain its reasons for not commencing or carrying out the *regulated activity*, or activities, concerned as described in its application.

13.6.9



01.07.02/001

The FSA has six *months* from the date of receipt of a completed application to make its determination about whether to grant a *Part IV permission*. However, where the FSA receives an application in respect of a *Part IV permission* which is incomplete, it has up to 12 *months* to make its determination. This provides time for the applicant to provide the FSA with the information required to complete the application.



13.7 Applying for approved persons status

- 13.7.1** **G**
01.07.02/001 The *approved persons* regime and the *controlled functions* that apply to *credit unions* with a *Part IV permission to accept deposits* are explained in more detail in *CRED 6.3*.
- 13.7.2** **G**
01.07.02/001 An applicant for *Part IV permission* must take reasonable care that it has applied in respect of all *persons* who will be performing *controlled functions* for approval by the *FSA*. A *person* cannot commence performing a *controlled function* until it has been approved by the *FSA*. Applicants planning to outsource the performance of one or more *controlled functions* should discuss the *approved persons requirements* with their usual supervisory contact at the *FSA*.
- 13.7.3** **D**
01.07.02/001 An applicant for *Part IV Permission* must complete Form A (included as part of the *FSA's* application pack) when applying for approval of a *person* to perform a *controlled function*.
- 13.7.4** **G**
01.07.02/001 The *FSA's* application pack includes explanatory notes on how to complete the *approved persons* forms.
- 13.7.5** **G**
01.07.02/001 The *FSA* has to process complete *approved person* applications within three *months* of receipt, but it will aim to come to a decision more quickly than this whenever circumstances allow. Where the *FSA* has to request additional information, the elapsed time from receipt of the application to determination may be more than three *months* to make a determination about the application.
- 13.7.6** **G**
01.07.02/001 The *FSA* may grant an application only if it is satisfied that the *candidate* is a fit and proper *person* to perform the *controlled function* stated in the application form. The criteria used by the *FSA* in making this judgement are covered in *CRED 6.4*. Responsibility lies with the applicant to satisfy the *FSA* that the *candidate* is fit and proper to perform any *controlled function* applied for.
- 13.7.7** **D**
01.07.02/001 Until an application for approval has been determined by the *FSA*, the applicant must inform the *FSA* of any significant change to the information given in Form A immediately.
- 13.7.8** **G**
01.07.02/001 An application for approval can be withdrawn by the applicant at any time by notifying the *FSA*, using Form B. The applicant must have the consent of the *candidate* before withdrawing an application for approval.



13.8 The FSA's decision making procedures

13.8.1  01.07.02/001

The FSA's decision making procedures in relation to *authorisations* under the *Act* (that is, *Part IV permissions* or approval of a *person*) are set out in *AUTH 8*. The FSA will, to the extent appropriate, apply similar procedures to the registration process.

13.8.2  01.07.02/001

Decisions which fall within the scope of *CRED 13* are taken either by the FSA's *Regulatory Decisions Committee (RDC)* or by internal staff procedures within the FSA by the FSA's staff at an appropriate level of seniority.

13.8.3  01.07.02/001

Where FSA staff recommend:

- (1) the refusal, or proposed refusal, of:
 - (a) an application for *Part IV permission*; or
 - (b) an application for approval under the *approved persons* regime; and
- (2) the granting or proposed granting of an application for *Part IV permission* subject to a *limitation* or *requirement* which was not applied for by the applicant;

the decision has to be referred to the *RDC*. The status, composition and operating procedures of the *RDC* are explained in *AUTH 8.2* and *DEC 4*.

13.8.4  01.07.02/001

Where an applicant's case has been referred to the *RDC*, and the *RDC* decide to give a *warning notice* to the applicant, or in the case of applications for approval under the *approved persons* regime, to all *interested parties*, the applicant can make written and oral representations to the *RDC*. Where the *RDC* decides not to grant an application, the FSA will inform the applicant or, in the case of applications for the approval of individuals under the *approved persons* regimes, all *interested parties* in writing. There is scope, in such circumstances, for the applicant to refer the FSA's decision to the *Tribunal* before a final decision is made about a case. The status and procedures for referring cases to the *Tribunal* are explained in *AUTH 8.3* and *DEC 5*.

13.8.5  01.07.02/001

Decisions which may be taken by internal staff procedures include:

- (1) decisions to grant an application for *Part IV permission* on the terms applied for; and
- (2) decisions to grant an application for approval under the *approved persons* regime.

13.8.6  01.07.02/001

The FSA's internal staff procedures are intended to ensure that decisions will, so far as possible, be taken by FSA staff with a good knowledge and understanding of the application concerned, the relevant risks to the FSA's *regulatory objectives* and

other relevant factors in the general context of the application. These internal staff procedures are also designed to ensure that decisions made are subject to appropriate individual oversight.

Annex 1: Requirements of Registration

1 Table The requirements of registration under the Industrial and Provident Societies Act 1965, as set out in the Credit Unions Act 1979 and referred to in CRED 13.4.1G.

REQUIREMENT	SECTION OF THE RELEVANT ACTS
That the purposes of the society are those, and only those, of a credit union.	Credit Unions Act 1979, s.1(2)(a)
the promotion of thrift among the members of the society by the accumulation of their savings	Credit Unions Act 1979, s.1(3)
the creation of sources of <i>credit</i> for the benefit of the members of the society at a fair and reasonable rate of interest	Credit Unions Act 1979, s.1(3)
the use and control of the members' savings for their mutual benefit	Credit Unions Act 1979, s.1(3)
the training and education of the members in the wise use of <i>money</i> and in the management of their financial affairs	Credit Unions Act 1979, s.1(3)
That admission to membership of the society is restricted to individuals all of whom fulfil a specific qualification which is appropriate to a credit union (the 'common bond' between members).	Credit Unions Act 1979, s.1(2)(b)
following a particular occupation	Credit Unions Act 1979, s.1(4)
residing in a particular locality	Credit Unions Act 1979, s.1(4)
being employed in a particular locality	Credit Unions Act 1979, s.1(4)
being employed by a particular employer	Credit Unions Act 1979, s.1(4)
being a member of a bona fide organisation or being otherwise associated with other members of the society for a purpose other than that of forming a society to be registered as a credit union	Credit Unions Act 1979, s.1(4)
residing in or being employed in a particular locality	Credit Unions Act 1979, s.1(4)
being currently in receipt of a continuing and regular contractual payment arising from employment by a particular employer	Credit Unions Act 1979, s.1(4)
being currently in receipt of a continuing and regular contractual payment arising from employment by particular employers in a particular area	Credit Unions Act 1979, s.1(4)

<p>being currently in receipt of a continuing and regular payment arising from participation in the provision of a public service of a particular nature, or of particular services associated with such participation</p>	Credit Unions Act 1979, s.1(4)
<p>residing in a particular locality, or being a member of a bona fide organisation or group of organisations (or otherwise having a continuing and active association with one or more of such organisations) existing within that locality for a purpose other than that of forming a society to be registered as a credit union</p>	Credit Unions Act 1979, s.1(4)
<p>any other qualifications as approved by the <i>FSA</i></p>	Credit Unions Act 1979, s.1(4)
<p>That the rules of the credit union are in a form as agreed by the <i>FSA</i> and provide for all matters required by the legislation.</p>	Credit Unions Act 1979, s.4(1) and Schedule 1
<p>That the registered office of the credit union is in Great Britain.</p>	Credit Unions Act 1979, s.1(1)(c)
<p>That a suitable name is chosen for the credit union.</p>	Credit Unions Act 1979, s.3
<p>for credit unions with their registered office in England or Scotland their name must always include the words 'Credit Union' and have 'Limited' as the last word in the name</p>	Credit Unions Act 1979, s.3(1) and 3(4)
<p>for credit unions with their registered office in Wales their name may use 'undeb credyd' instead of 'Credit union' and 'cyfyngedig' instead of 'Limited'</p>	The Welsh Language Act 1993, s.28 and 29
<p>That the credit union has at least 21 members.</p>	Credit Unions Act 1979, s.6(1)
<p>only individuals can be members of a credit union</p>	Credit Unions Act 1979, s.5(1)
<p>an individual is not a member of a credit union unless he holds at least one fully paid-up share in that credit union</p>	Credit Unions Act 1979, s.1(6)
<p>That on registration there will be in force, in relation to the credit union, a policy of insurance against fraud.</p>	Credit Unions Act 1979, s.15

Credit unions

Chapter 14

Supervision

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1

14





14.1 The FSA’s approach to supervision

Application and purpose

- 14.1.1** G This section and *SUP 1* apply to all *credit unions*.
- 01.07.02/001
14.1.2 G This section is a summary of *SUP 1*.
- 01.07.02/001
14.1.3 G The *Act* requires the *FSA* to ”maintain arrangements designed to enable it to determine whether *persons* on whom requirements are imposed by or under this *Act* are complying with them” (paragraph 6(1) of Schedule 1 to the *Act*).
- 01.07.02/001
14.1.4 G The design of these arrangements is shaped by the *regulatory objectives*. These are set out in section 2 of the *Act* (The Authority’s general duties) and are:

 - (1) maintaining confidence in the *financial system*;
 - (2) promoting public understanding of the *financial system*;
 - (3) securing the appropriate degree of protection for *consumers*; and
 - (4) reducing the extent to which it is possible for a business to be used for a purpose connected with *financial crime*.
- 01.07.02/001
14.1.5 G In designing its approach to supervision, the *FSA* has had regard to the principles of good regulation set out in section 2(3) of the *Act*. In particular, the *FSA*’s regulatory approach aims to focus and reinforce the responsibility of the management of each *credit union* to ensure that it takes reasonable care to organise and control the affairs of the *credit union* responsibly and effectively, and develops and maintains adequate risk management systems. It is the responsibility of management to ensure that the *credit union* acts in compliance with its regulatory requirements. The *FSA* will have regard to the principle that a burden or restriction should be proportionate to the benefits which are expected to result from it.

The FSA’s risk based approach to supervision

- 14.1.6** G The purpose of taking a risk-based approach to supervision is to focus the *FSA*’s resources on the mitigation of risks to its *regulatory objectives*, and to have regard to the need to use the *FSA*’s resources in the most efficient and economic way. The approach to risk assessment of *credit unions* is based on both the impact of such risks were they to crystallise and the probability of their doing so.

Tools of supervision

14.1.7 G
01.07.02/001

In order to meet the *regulatory objectives* and address identified risks to those objectives, the FSA has a range of supervisory tools available to it.

14.1.8 G
01.07.02/001

The FSA classifies these tools under four headings:

- (1) diagnostic: designed to identify, assess and measure risks;
- (2) monitoring: to track the development of identified risks, wherever these arise;
- (3) preventative: to limit or reduce identified risks and so prevent them crystallising or increasing; and
- (4) remedial: to respond to risks when they have crystallised.

14.1.9 G
01.07.02/001

The FSA uses a variety of tools to monitor whether a *credit union* remains in compliance with regulatory requirements. These tools include:

- (1) desk-based reviews;
- (2) liaison with other agencies or regulators;
- (3) meetings with management and other representatives of a *credit union*;
- (4) on-site inspections;
- (5) reviews and analysis of periodic returns and notifications;
- (6) reviews of past business;
- (7) use of auditors;
- (8) use of *skilled persons*.

14.1.10 G
01.07.02/001

The FSA also uses a variety of tools to address specific risks identified in *credit unions*. These tools include:

- (1) making recommendations for preventative or remedial action;
- (2) setting individual *requirements*;
- (3) giving individual *guidance* to a *credit union*;
- (4) varying a *credit union’s permission*.

14.1.11 G
01.07.02/001

For further discussion of the FSA’s regulatory approach, see Publications on the FSA website: in particular, “A new regulator for the new millennium” and “Building the new regulator progress report 1”.



14.2 Information gathering by the FSA on its own initiative

Application and purpose

- 14.2.1** 01.07.02/001 G This section and *SUP 2* apply to all *credit unions*.
- 14.2.2** 01.07.02/001 G The section is a summary of *SUP 2*.
- 14.2.3** 01.07.02/001 G Achieving its *regulatory objectives* involves the *FSA* informing itself of developments in *credit unions*. The *Act* requires the *FSA* to monitor a *credit union's* compliance with requirements imposed by or under the *Act*. For this purpose, the *FSA* needs to have access to a broad range of information about a *credit union's* business.
- 14.2.4** 01.07.02/001 G The *FSA* receives information through a variety of means, including regular reporting by *credit unions*. This section is concerned with the methods of information gathering that the *FSA* may use on its own initiative.
- 14.2.5** 01.07.02/001 G *SUP 2.1.5G* states that the *FSA* has statutory powers, including:

 - (1) to require the provision of information;
 - (2) to require reports from *skilled persons*;
 - (3) to appoint investigators; and
 - (4) to apply for a warrant to enter premises.
- 14.2.6** 01.07.02/001 G The *FSA* prefers to discharge its supervisory functions by working in an open and cooperative relationship with *credit unions*. The *FSA* will look to obtain information in that way unless this will not achieve the necessary results, in which case it will use its statutory powers.

Information gathering by the FSA on its own initiative: background

- 14.2.7** 01.07.02/001 G *SUP 2.2.1G* states that failure to cooperate with the *FSA* makes a *credit union* liable to regulatory sanctions, including discipline under the *Act*. But this:

 - (1) is not a criminal offence;
 - (2) cannot lead to a *person* being treated as if in contempt of court.
- 14.2.8** 01.07.02/001 G When the *FSA* obtains confidential information using the methods of information gathering described in *SUP 2*, it is obliged to treat that information as confidential

and will not disclose it without lawful authority, for example the consent of the *person* from whom that information was received.

Information gathering by the FSA on its own initiative: cooperation by credit unions

14.2.9 G
01.07.02/001

SUP 2.3.1G sets out the various methods of information gathering that the FSA will use on its own initiative which require the cooperation of *credit unions*:

- (1) supervision visits on a regular or sample basis;
- (2) meetings at the FSA’s offices or elsewhere;
- (3) provision of information or *documents*.

14.2.10 G
01.07.02/001

The FSA expects to be able to give reasonable notice to a *credit union* when it seeks information, *documents*, meetings or access to business premises. On rare occasions, however, the FSA may make unannounced visits.

14.2.11 G
01.07.02/001

SUP 2.3.3G – SUP 2.3.4G state how the FSA considers that a *credit union* should cooperate in providing access to its *documents* and personnel:

- (1) make itself readily available for meetings as reasonably requested;
- (2) give access to any records, files, tapes or computer systems which are within its possession or control, and provide any facilities that are reasonably required;
- (3) produce specified *documents*, files, tapes, computer data;
- (4) print information which is held on computer or microfilm or otherwise convert it into a readily legible *document*;
- (5) permit copying of *documents* or other material on its premises at its reasonable expense;
- (6) answer truthfully, fully and promptly all questions which are reasonably put to it.

14.2.12 G
01.07.02/001

SUP 2.3.5G states that a *credit union* must permit access, with or without notice, during reasonable business hours to its business premises in relation to the discharge of the FSA’s functions under the *Act*. It must also take reasonable steps to ensure that others, such as agents and suppliers under *material outsourcing* arrangements permit such access to their business premises.

”Mystery Shopping”

14.2.13 G
01.07.02/001

Representatives or appointees of the FSA (which may include individuals engaged by a market research firm) may approach a *credit union* in the role of potential members. This is known as ”mystery shopping”. The FSA expects that any ”mystery shopping” it arranges will be conducted in accordance with the Market Research Society Code of Practice. (See SUP 2.4.1G – SUP 2.4.4G).



14.3 Auditors

Application and purpose

14.3.1  01.07.02/001

This section and *SUP 3* apply to all *credit unions* and their external auditors appointed under *SUP 3.3*.

14.3.2  01.07.02/001

This section is a summary of *SUP 3*, and sets out *guidance* on the role auditors play in the *FSA*'s monitoring of *credit unions*' compliance with the requirements and standards under the *regulatory system*.

Appointment of auditors

14.3.3  01.07.02/001

SUP 3.3.2R states that a *credit union* must:

- (1) appoint an auditor to undertake the duties and responsibilities set out in *SUP 3.8* (summarised in *CRED 14.3.22G* – *CRED 14.3.31G*);
- (2) notify the *FSA*, without delay, when it is aware that a vacancy in the office of auditor will arise or has arisen, giving the reason for the vacancy;
- (3) appoint an auditor to fill any vacancy in the office of auditor which has arisen;
- (4) ensure that the replacement auditor can take up office at the time the vacancy arises or as soon as is reasonably practicable after that; and
- (5) notify the *FSA* of the appointment of an auditor, advising the *FSA* of the name and business address of the auditor appointed and the date from which the appointment has effect.

14.3.4  01.07.02/001

A *credit union* is also under an obligation to appoint an auditor under the Friendly and Industrial and Provident Societies Act 1968, but a single auditor may be appointed for both purposes.

Auditors' qualifications

14.3.5  01.07.02/001

SUP 3.4 sets out *rules* and *guidance* aimed at ensuring that the auditor of a *credit union* has the necessary skill and experience.

14.3.6  01.07.02/001

SUP 3.4.2R states that before a *credit union* appoints an auditor, it must take reasonable steps to ensure that the auditor has the required skill, resources and

experience to perform his functions under the *regulatory system* and that the auditor is eligible under Friendly and Industrial and Provident Societies Act 1968.

14.3.7 G 01.07.02/001 SUP 3.4.5R states that a *credit union* should have regard to whether its proposed auditor has expertise in the relevant requirements and standards, and possesses or has access to appropriate specialist skill. The *credit union* should seek confirmation of this from the auditor concerned.

14.3.8 G 01.07.02/001 A *credit union* must not appoint as auditor a *person* who is disqualified by the FSA under section 345 of the *Act* (Disqualification) from acting as an auditor either for that *credit union* or *credit unions* in general.

14.3.9 G 01.07.02/001 If it appears to the FSA that the auditor of a *credit union* has failed to comply with a duty imposed on him under the *Act*, it may disqualify him under section 345 of the *Act*.

14.3.10 G 01.07.02/001 SUP 3.4.7R states that a *credit union* must take reasonable steps to ensure that an auditor, which it is planning to appoint or has appointed, provides information to the FSA about the auditor’s qualifications, skills, experience and independence in accordance with the reasonable requests of the FSA.

14.3.11 G 01.07.02/001 To enable it to assess the ability of an auditor to audit a *credit union*, the FSA may seek information about the auditor’s relevant experience and skill.

Auditors’ independence

14.3.12 G 01.07.02/001 If an auditor is to carry out his duties properly, he needs to be independent of the *credit union* he is auditing, so that he is not subject to conflicts of interest.

14.3.13 G 01.07.02/001 SUP 3.5.2R requires a *credit union* to take reasonable steps to ensure that the auditor it appoints is independent of the *credit union*.


14.3.14 G 01.07.02/001 If a *credit union* becomes aware at any time that its auditor is not independent of the *credit union*, it must take reasonable steps to ensure that it has an auditor independent of the *credit union*. The *credit union* must notify the FSA if independence is not achieved within a reasonable time.

14.3.15 G 01.07.02/001 The FSA will regard an auditor as independent if his appointment or retention does not breach the ethical guidance in current issue from the auditor’s recognised supervisory body on the appointment of an auditor in circumstances which could give rise to conflicts of interest.

Credit unions’ cooperation with their auditors


14.3.16 G 01.07.02/001 SUP 3.6.1R states that a *credit union* must cooperate with its auditor in the discharge of his duties under that chapter.

14.3.17 G 01.07.02/001 In complying with SUP 3.6.1R, a *credit union* should include giving a right of access at all times to the *credit union’s* accounting and other records, in whatever form they are held, and *documents* relating to its business. A *credit union* should allow its auditor to copy *documents* or other material on the premises of the *credit union* and to remove copies or hold them elsewhere, or give him such copies on request.

14.3.18  Section 341 of the *Act* (Access to Books etc) provides that an auditor of a *credit union* appointed under SUP 3.3.2R:


01.07.02/001

- (1) has a right of access at all times to the *credit union's* books, accounts and vouchers; and
- (2) is entitled to require from the *credit union's officers* such information and explanation as he reasonably considers necessary for the performance of his duties as auditor.


14.3.19  *Credit unions* and their *officers* and *managers* are reminded that, under section 346 of the *Act* (Provision of false or misleading information to auditor or *Actuary*), knowingly or recklessly giving false information to an auditor appointed under SUP 3.3.2R constitutes an offence in certain circumstances, which could render them liable to prosecution. This applies regardless of whether an auditor is also appointed under the Friendly and Industrial and Provident Societies Act 1968.

01.07.02/001

Notification of matters raised by auditor


14.3.20  A *credit union* should consider whether it should notify the *FSA* in accordance with CRED 14.9.3G if it expects or knows its auditor will qualify its report on the audited financial statements or add an explanatory paragraph.

01.07.02/001


14.3.21  A *credit union* should consider whether it should notify the *FSA* in accordance with CRED 14.9.3G if it receives a written *communication* from its auditor commenting on *internal controls*.

01.07.02/001


Rights and duties of all auditors

14.3.22  The auditor of a *credit union* has various rights and duties to obtain information from the *credit union*.


01.07.02/001

14.3.23  SUP 3.8.2R states that an auditor of a *credit union* must cooperate with the *FSA* in the discharge of its functions under the *Act*.

01.07.02/001

14.3.24  The *FSA* may ask the auditor to attend meetings and to supply it with information about the *credit union*.


01.07.02/001

14.3.25  SUP 3.8.4R states that an auditor of a *credit union* must give any *skilled person* appointed by the *credit union* all assistance that that *person* reasonably requires.


01.07.02/001

14.3.26  SUP 3.8.5R states that the auditor must be independent of a *credit union* in performing his duties in respect of that *credit union*.

01.07.02/001

14.3.27  SUP 3.8.6R states the auditor must take reasonable steps to satisfy himself that he is free from any conflict of interest from which bias may reasonably be inferred. He must take appropriate action where this is not the case.

01.07.02/001

14.3.28  Within the legal constraints that apply, the *FSA* may pass on to an auditor any information which it considers relevant to his function. An auditor is bound by the confidentiality provisions set out in Part XIII of the *Act* (Public record, disclosure of information and cooperation) in respect of confidential information he receives from a *credit union* or other *person*. An auditor may not pass on confidential information without lawful authority.

01.07.02/001

14.3.29 G
01.07.02/001

Auditors are subject to regulations made by the Treasury obliging them to report certain matters to the *FSA*. An auditor does not contravene any duty by giving information or expressing an opinion to the *FSA*, if he is acting in good faith and he reasonably believes that the information or opinion is relevant to any function of the *FSA*. These provisions continue to have effect after the end of the auditor’s term of appointment.

14.3.30 G
01.07.02/001

SUP 3.8.11R states that an auditor must notify the *FSA* without delay if he:

- (1) is removed from office by a *credit union*; or
- (2) resigns before his term of office expires; or
- (3) is not re-appointed by a *credit union*.

14.3.31 G
01.07.02/001

SUP 3.8.12R states that if an auditor ceases to be, or is formally notified that he will cease to be, the auditor of a *credit union*, he must notify the *FSA* without delay:

- (1) of any matter connected with his ceasing which he thinks ought to be drawn to the *FSA*’s attention; or
- (2) that there is no such matter.




14.4 Skilled persons

Application and purpose


14.4.1  This section and *SUP 5* apply to all *credit unions*.

01.07.02/001

14.4.2  The purpose of this section is to summarise *SUP 5*, which gives *guidance* on the *FSA's* use of the power in section 166 of the *Act* (Reports by *skilled persons*).


01.07.02/001

The FSA's power

14.4.3  *SUP 5.2* explains that the *FSA* may, by giving written notice, require a *credit union* to provide it with a report by a *skilled person*.


01.07.02/001

Policy on the use of skilled persons

14.4.4  *SUP 5.3* explains the *FSA's* policy on the use of *skilled persons*. The *FSA* will have regard to all relevant factors, including the circumstances of the *credit union*, the availability of alternative tools and the cost implications for the *credit union* (which would have to pay for the services of the *skilled person*).


01.07.02/001

Appointment and reporting process

14.4.5  *SUP 5.4* explains the appointment and reporting process. The *FSA* will send to a *credit union* a notice requiring it to provide a report by a *skilled person*, and give written notification of the report's purpose, scope, and timetable. The *FSA* will normally seek to agree with the *credit union* in advance which *skilled person* (whether accountant, lawyer or other *person* with relevant skills) will make the report.

01.07.02/001

Duties of a credit union

14.4.6  *SUP 5.5.1R* and *SUP 5.5.5R* set out what is required in the contract between the *credit union* and the *skilled person*.

01.07.02/001

14.4.7  *SUP 5.5.11R* states that a *credit union* must provide all reasonable assistance to the *skilled person*.

01.07.02/001

Confidential information privilege

14.4.8

G


01.07.02/001

SUP 5.6 explains what confidentiality provisions apply when the FSA passes on relevant information to a *skilled person*.



14.5 Applications to vary or cancel Part IV permission

Application and purpose


14.5.1  This section and *SUP 6* apply to all *credit unions* with a *Part IV permission* that wish to;

01.07.02/001

- (1) vary their *Part IV permission*; or
- (2) cancel their *Part IV permission* and end their *authorisation*.


14.5.2  This section is a summary of *SUP 6*.

01.07.02/001

14.5.3  This section explains:


01.07.02/001

- (1) how a *credit union* can apply to vary or cancel its *Part IV permission*;
- (2) the additional procedures that apply to a *credit union* that needs to wind down its business over a long time period (usually more than six *months*);
- (3) how the *FSA* assesses those applications.

14.5.4  A *version 1 credit union* that wishes to become a *version 2 credit union* will need to apply to vary its *Part IV permission*.

01.07.02/001

Introduction


14.5.5  A *credit union authorised* under Part IV of the *Act* (*Permission* to carry on *regulated activities*) has a single *permission* granted by the *FSA*, which contains a description of the activities the *credit union* may carry on, including any *limitations*.

01.07.02/001


Applications for variation of permission

14.5.6  A *credit union* may apply to the *FSA* to vary its *Part IV permission*.

01.07.02/001


14.5.7  *SUP 6.3.15D* states that the application must be in writing and addressed and delivered in the way set out in *SUP 15.7.4R – SUP 15.7.6R* (summarised in *CRED 14.9.19G*).

01.07.02/001


14.5.8  A *credit union* is advised to discuss its application with the Credit Union team at the *FSA* before submission, particularly if it is seeking a variation of *permission* within a

01.07.02/001


short time scale. It is also advised to include as much detail as possible with its application. A *version 1 credit union* that wishes to become a *version 2 credit union* will typically need to supply information on the matters referred to in CRED 13.6.2G.

14.5.9  The FSA, as soon as possible after receipt of an application, will advise the *credit union* of any additional information which is required as part of its application. The amount of information that the FSA will require will vary depending on the nature of the variation.


01.07.02/001

14.5.10  The FSA may refuse the application if it appears that the interests of members would be adversely affected if the application were to be granted.


01.07.02/001

14.5.11  The FSA may vary or impose *limitations* or *requirements* on a *credit union's permission*.


01.07.02/001

14.5.12  The FSA has six *months* to consider a completed application, or 12 *months* if the application is incomplete.

01.07.02/001


14.5.13  Within these time limits, however, the length of the process will vary according to the complexity of the variation requested.

01.07.02/001

14.5.14  At any time after receiving an application and before determining it, the FSA may require the applicant to provide additional information or *documents*. The circumstances of each application will dictate what additional information or procedures are appropriate.

01.07.02/001

Applications for cancellation of permission


14.5.15  If a *credit union* with a *Part IV permission* applies to the FSA, the FSA may cancel its *permission*.

01.07.02/001


14.5.16  The FSA may refuse such an application if it appears that:

01.07.02/001


- (1) the interests of members, or potential members, would be adversely affected; and
- (2) it is desirable in the interests of members or potential members for the application to be refused.

14.5.17  SUP 6.4.5D states that if a *credit union* wishes to cancel its *permission*, it must write to the FSA giving the reasons and the date on which the *credit union* has ceased or expects to cease carrying on *regulated activities*. The *credit union* must explain the full circumstances of its application.


01.07.02/001

14.5.18  SUP 6.4.5D states that a *credit union's* application for cancellation of its *permission* must be given to a member of, or addressed for the attention of, the Corporate Authorisation Resignation team at the FSA.

01.07.02/001


14.5.19  The *credit union's* usual supervisory contact at the FSA will, however, be responsible for all day-to-day contact with the *credit union* and for assessing the application.


01.07.02/001


14.5.20  When it receives this application, the Corporate Authorisation Resignation team will send the *credit union* a written acknowledgement. This acknowledgement will


01.07.02/001

explain the cancellation process and detail the information required as part of the application.


14.5.21  The FSA may request confirmation from the *credit union* that there are no unresolved, unsatisfied or undischarged complaints against the *credit union* from a member.
01.07.02/001


14.5.22  SUP 6.4.14G states that it is an offence for a *person* knowingly or recklessly to give the FSA information that is false or misleading. If necessary a *credit union* should take appropriate professional advice when supplying information required by the FSA.
01.07.02/001

14.5.23  The FSA may require additional information, including professional advice where it considers this appropriate.
01.07.02/001


14.5.24  The FSA will usually not cancel a *credit union's permission* until the *credit union* can demonstrate that it has:

- (1) ceased carrying on *regulated activities*;
- (2) repaid all shares and *deposits*;
- (3) discharged, satisfied or resolved complaints against the *credit union*.


14.5.25  In deciding whether to cancel a *credit union's permission*, the FSA will take into account all relevant factors in relation to business carried on under that *permission*, including those set out in SUP 6.4.22G.
01.07.02/001

14.5.26  If the FSA has granted an application for cancellation of *permission* and withdrawn a *credit union's* status as an *authorised person*, it will retain certain investigative and enforcement powers in relation to the *credit union*, including those set out in SUP 6.4.23G.
01.07.02/001


14.5.27  The FSA has six *months* to consider a completed application or 12 *months* if the application is incomplete.
01.07.02/001


14.5.28  Within these time limits, however, the length of the process will vary according to the complexity of the circumstances.
01.07.02/001

Ending authorisation

14.5.29  If the FSA cancels a *credit union's permission*, leaving it without *permission* to carry out a *regulated activity*, the FSA is required to withdraw the *credit union's* *authorisation*.
01.07.02/001

Additional guidance

14.5.30  SUP 6 Annex 4G provides additional *guidance* for a *credit union* winding down (running off) its business.
01.07.02/001

14.5.31  If a *credit union* requires a long term period (usually in excess of six *months*) in which to wind down (run off) its business, it will usually be appropriate for it to apply for a variation in its *permission*.
01.07.02/001

- 14.5.32** G A *credit union* should discuss its plans with its usual supervisory contact at the *FSA*.
- 14.5.33** 01.07.02/001 G The *FSA* may vary a *credit union's permission* to impose a *limitation* on accepting new *deposits*.
- 14.5.34** 01.07.02/001 G The annexes to *CRED 15* provide tables setting out the *FSA's* enforcement powers, including those to cancel or suspend registration, vary or cancel *permission* and withdraw *authorisation*.



14.6 Individual requirements


Application and purpose

14.6.1  This section and *SUP 7* apply to all *credit unions*.

01.07.02/001

14.6.2  This section is a summary of *SUP 7*.

01.07.02/001

14.6.3  The *FSA's Handbook* primarily contains provisions that apply to all *credit unions*. However, the *FSA* may judge it necessary or desirable to impose additional *requirements* on a *credit union* or amend the activities it has *permission* to undertake. Doing so enables the *FSA* to take account of a *credit union's* individual circumstances and assists the *FSA* in meeting its *regulatory objectives*.

01.07.02/001

The *FSA's* powers to set individual requirements on its own initiative


14.6.4  The *FSA* may vary a *credit union's Part IV permission* on its own initiative where:

01.07.02/001

- (1) one or more of the *threshold conditions* is, or is likely to be, no longer satisfied;
- (2) it is desirable in order to protect members.


14.6.5  If the *FSA* exercises its powers, it will do so by issuing a *supervisory notice*.

01.07.02/001

14.6.6  A *credit union* may refer this decision to the *Financial Services and Markets Tribunal*.


01.07.02/001

Criteria for varying a *credit union's* permission

14.6.7  The *FSA* expects to maintain a close working relationship with *credit unions* and expects that routine supervisory matters can be resolved by issuing *guidance*. However, the *FSA* may seek to vary a *credit union's permission*:

01.07.02/001

- (1) if it is appropriate to act formally so that enforcement action can be taken if necessary;
- (2) so that a *credit union* can comply without breaking agreements with third parties.

14.6.8  The *FSA* may seek to vary on its own initiative a *permission* if risks are presented by:

01.07.02/001

- (1) a *credit union's* management, business or *internal controls*;
- (2) its involvement in new products or selling practices;
- (3) a change in its structure, activities or strategy.

14.6.9



01.07.02/001

The following are some of the *requirements* or *limitations* that may be imposed:

- (1) submission of reports;
- (2) maintenance of prudential limits;
- (3) submission of business plan;
- (4) limitation of activities;
- (5) maintenance of financial resources.

14.6.10



01.07.02/001

The *FSA* will seek to give reasonable notice of intent to vary a *permission* and to agree an appropriate time scale with the *credit union*. However, the *FSA* may act immediately if that is necessary to protect members.



14.7 Waiver and modification of rules

Application and purpose

14.7.1 
01.07.02/001

This section and *SUP 8* apply to all *credit unions* that wish to apply for, or to consent to, or have been given a modification of or *waiver* of the *FSA's rules*.

14.7.2 
01.07.02/001

This section is a summary of *SUP 8*, and explains how the regime for the *waiver* or modification of *rules* works.

Introduction

14.7.3 
01.07.02/001

The *FSA* may, on the application or with the consent of a *credit union*, direct that certain *rules*:

- (1) are not to apply to the *credit union*; or
- (2) are to apply to the *credit union* with such modifications as may be specified.

14.7.4 
01.07.02/001

SUP 8.2.7G includes a table of the types of *rules* which may be *waived* and Schedule 6 identifies those *rules* in *CRED* that can be *waived*.

Applying for a waiver

14.7.5 
01.07.02/001

SUP 8.3.1G states that the *FSA* may not give a *waiver* unless it is satisfied that:

- (1) compliance would be unduly burdensome or would not achieve the purpose for which the *rules* were made;
- (2) the *waiver* would not result in undue risk to *persons* whose interests the *rules* are intended to protect.

14.7.6 
01.07.02/001

SUP 8.3.3D states that if a *credit union* wishes to apply for a *waiver*, it must do so in writing to its usual supervisory contact at the *FSA*. The application must include:

- (1) the name and *FSA* reference number of the *credit union* making the application, and a contact point for the *credit union* on the application;
- (2) the reference number of the *rule* to which the application relates;
- (3) a clear explanation of the *waiver* that is being applied for and the reasons why the *credit union* wants it;

- (4) details of any special requirements, for example if the *credit union* needs a decision urgently, or if there is a specific period for which the *waiver* is required;
- (5) relevant facts that support the *credit union's* application;
- (6) the *credit union's* reasons for considering that the conditions in CRED 14.7.5G are satisfied;
- (7) any reasons, with reference to CRED 14.7.13G, why the *credit union* believes that it would be inappropriate or unnecessary to publish the *waiver*.

14.7.7 G
01.07.02/001 The FSA will acknowledge applications and seek to reply within 20 working *days*, though this may take longer if further information is required.

14.7.8 G
01.07.02/001 The FSA may impose conditions on a *waiver* including extra reporting requirements.

14.7.9 G
01.07.02/001 If the FSA decides against the *waiver*, it will give its reasons.

14.7.10 G
01.07.02/001 If the FSA considers that the *waiver* should apply to a number of *credit unions*, it will inform them that the *waiver* is available. To take advantage of the *waiver*, they will only have to give their written consent rather than making a formal application.

Notification of altered circumstances relating to waivers

14.7.11 G
01.07.02/001 SUP 8.5.1R states that if a *credit union* becomes aware that a *waiver* is no longer relevant or appropriate, it must notify the FSA immediately.

Publication of waivers

14.7.12 G
01.07.02/001 The FSA is bound to publish a *waiver*, unless it is inappropriate or unnecessary. If the FSA publishes a *waiver*, it will not publish details of why a *waiver* was required or any of the supporting information given in a *waiver* application.

14.7.13 G
01.07.02/001 In deciding whether or not to publish, the FSA will take into account whether:

- (1) it will be prejudicial to the commercial interests of the *credit union*;
- (2) it relates to a minor matter that does not affect a third party and is unlikely to be of interest to other *credit unions*.

14.7.14 G
01.07.02/001 If the FSA decides upon publication, it will give the *credit union* the opportunity of avoiding this by withdrawing its application.

Varying waivers

14.7.15 G
01.07.02/001 If a *credit union* wishes the FSA to vary a *waiver*, it should follow the procedures in SUP 8.3.3D (summarised in CRED 14.7.6G).

Revoking waivers

14.7.16 G
01.07.02/001

The *FSA* may revoke a *waiver* if it is no longer appropriate. This may take effect immediately, if that is necessary to prevent undue risk to members.

14.7.17 G
01.07.02/001

Where revocation is not immediate, the *FSA* will give written notice, with a reasonable period (usually *28 days*) in which to make representations. After considering any representations the *FSA* will give written confirmation of its decision.

14.7.18 G
01.07.02/001

Where the revocation is immediate, the *FSA* will also give the *credit union* the opportunity to make representations. After considering these, it will either confirm the revocation or seek the *credit union's* consent to a new *waiver*.

Decision making

14.7.19 G
01.07.02/001

The *waivers* regime will be overseen by a staff committee of the *FSA*.



14.8 Individual guidance

Application and purpose

- 14.8.1
G
This section and *SUP 9* apply to all *credit unions* and *persons* generally.
- 14.8.2
G
This section is a summary of *SUP 9*.
- 14.8.3
G
This section explains how a particular *person* may seek from the *FSA guidance* that relates to its own particular circumstances or plans.

01.07.02/001
01.07.02/001
01.07.02/001

Making a request for individual guidance

- 14.8.4
G
Requests may be either oral or written.
- 14.8.5
G
Requests for individual *guidance* should be directed to the *credit unions* usual supervisory contact at *FSA* in the first instance. A written request will be necessary where the issue is complex or significant. A *credit union* should have taken reasonable steps to analyse the issue before approaching the *FSA*.
- 14.8.6
G
The *FSA* will aim to respond quickly and fully to reasonable requests, but complex or novel issues may take more time. *Credit unions* should try to make allowance for this.

01.07.02/001
01.07.02/001
01.07.02/001

Giving individual guidance to a credit union on the FSA's own initiative

- 14.8.7
G
The *FSA* may issue individual *guidance* to *credit unions* on its own initiative where it is appropriate to do so.
- 14.8.8
G
An example of this is where general *guidance* in the *Handbook* does not fit the *credit union's* particular circumstances or more detailed *guidance* is required.

01.07.02/001
01.07.02/001

Reliance on individual guidance

- 14.8.9
G
SUP 9.4 explains what reliance can be placed on individual *guidance*.
- 14.8.10
G
If a *person* acts in accordance with current individual written *guidance* in the circumstances contemplated by that *guidance*, then the *FSA* will proceed on the footing that the *person* has complied with the aspects of the *rule* or other requirement to which the *guidance* relates.

01.07.02/001
01.07.02/001

14.8.11 G
01.07.02/001

Rights conferred on third parties cannot be affected by *guidance* given by the FSA. *Guidance on rules*, the *Act* or other legislation represents the FSA’s view, and does not bind the courts; a *person* may need to seek his own legal advice.

14.8.12 G
01.07.02/001

The extent to which a *person* can rely on individual *guidance* to him will depend on many factors. These could include, for example, the degree of formality of the original query and the *guidance* given, and whether all relevant information was submitted with the request. Individual *guidance* is usually given in relation to a set of particular circumstances which exist when the *guidance* is given. If the circumstances later change, for example, because of a change in the circumstances of the *person* or a change in the underlying *rule* or other requirement, and the premises upon which individual *guidance* was given no longer apply, the *guidance* will cease to be effective.

14.8.13 G
01.07.02/001

If the circumstances relating to individual *guidance* change it will be open to a *person* to ask for further *guidance*.



14.9 Notifications to the FSA

Application and purpose

14.9.1 G
01.07.02/001

This section and *SUP 15* apply to all *credit unions* in relation to both *regulated activities* and *unregulated activities*.

14.9.2 G
01.07.02/001

This section is a summary of *SUP 15*, which sets out:

- (1) *guidance* on the type of event or change in condition which a *credit union* should consider notifying to the *FSA*;
- (2) *rules* on events and changes that a *credit union* must notify;
- (3) *rules* on the core information that a *credit union* must provide;
- (4) *rules* requiring a *credit union* to ensure that information provided to the *FSA* is accurate and complete.

General notification requirements

14.9.3 G
01.07.02/001

SUP 15.3.1R states that a *credit union* must notify the *FSA* immediately it becomes aware, or has information which reasonably suggests, that any of the following has occurred, may have occurred or may occur in the foreseeable future:

- (1) the *credit union* failing to satisfy one or more of the *threshold conditions*; or
- (2) any matter which could have a serious adverse impact on the *credit union's* reputation; or
- (3) any matter which could affect the *credit union's* ability to continue to provide adequate services to its members and which could result in serious detriment to a member; or
- (4) any matter in respect of the *credit union* which could result in serious financial consequences to the *financial system* or to other *firms*.

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23

14.9.4 G
01.07.02/001

Principle 11 requires a *credit union* to deal with the *FSA* in an open and cooperative way and to disclose what the *FSA* would normally expect to be disclosed.

14.9.5 G
01.07.02/001

Compliance with *Principle 11* includes giving notice of:

- (1) any proposed restructuring, reorganisation or expansion which would have a significant impact on the risks run by the *credit union*;

- (2) any significant failure in the *credit union's* systems or controls, including those reported by the *credit union's* auditor;
- (3) any proposed action that could result in a material change to a *credit union's* capital adequacy or solvency.

14.9.6 G
01.07.02/001

The period of notice given depends on the event, although the FSA expects a *credit union* to discuss relevant matters with it at an early stage before making commitments.

14.9.7 G
01.07.02/001

SUP 15.3.11R states that a *credit union* must notify the FSA of the following immediately:

- (1) a significant breach of *rule* or Principle;
- (2) breach of requirement imposed by the *Act*, regulations or order;
- (3) the bringing of a prosecution for, or a conviction of, any offence under the *Act* involving the *credit union*, members of its committee of management, *officers*, *employees* or *approved persons*.

14.9.8 G
01.07.02/001

SUP 15.3.15R states that a *credit union* must also notify the FSA immediately of the following:

- (1) civil proceedings against the *credit union* where the claim is significant to its resources or reputation;
- (2) action against the *credit union* under section 71 or 150 of the *Act* (actions for damages);
- (3) the *credit union* is prosecuted for, or convicted of, any offence involving fraud or dishonesty or any penalties are imposed upon it for tax evasion.

14.9.9 G
01.07.02/001

Notification should include details of the matter and an estimate of the likely financial consequences.

14.9.10 G
01.07.02/001

SUP 15.3.17R states that a *credit union* must notify the FSA immediately of the following events, if significant:

- (1) fraud by an *officer* against members;
- (2) fraud committed against the *credit union*;
- (3) irregularities in accounting or other records;
- (4) serious misconduct by *officers* concerning honesty or integrity.

14.9.11 G
01.07.02/001

In determining whether a matter is significant, a *credit union* should have regard to:

- (1) the size of any monetary loss;
- (2) reputational loss to the *credit union*;
- (3) weaknesses in the *credit union's internal controls*.

14.9.12 G
01.07.02/001

SUP 15.3.21R states that a *credit union* must notify the FSA of any legal steps involving the insolvency, bankruptcy or winding up of the *credit union*.

Core information requirements

- 14.9.13** G 01.07.02/001 *SUP* 15.5.1R, *SUP* 15.5.4R and *SUP* 15.5.6R state that a *credit union* must provide the *FSA* with notice of:
- (1) change in name;
 - (2) change in address;
 - (3) change in legal structure.

- 14.9.14** G 01.07.02/001 Similar obligations to those in *CRED* 14.9.13G are imposed by existing *credit union* legislation.

Inaccurate, false or misleading information

- 14.9.15** G 01.07.02/001 *SUP* 15.6.1R states that a *credit union* must take reasonable steps to make sure that information given to the *FSA* is factually accurate and complete.

- 14.9.16** G 01.07.02/001 *SUP* 15.6.4R states that a *credit union* must notify the *FSA* if it realises that information already provided may be false, misleading, incomplete or inaccurate.

- 14.9.17** G 01.07.02/001 *SUP* 15.6.7R states that it is an offence to provide such information knowingly or recklessly.

Form and method of notification

- 14.9.18** G 01.07.02/001 *SUP* 15.7.1R states that a *credit union* should provide notification in written English, preceded by oral notification if the matter is urgent or significant.

- 14.9.19** G 01.07.02/001 *SUP* 15.7.4R and *SUP* 15.7.5R state that the notification should be addressed to the *credit union's* usual supervisory contact at the *FSA* using one of these methods:

- (1) by post to the *FSA's* address;
- (2) self delivery to *FSA's* address (and obtaining time-stamped receipt);
- (3) electronic mail;
- (4) hand delivery to the *credit union's* usual supervisory contact at the *FSA*;
- (5) fax number to the *credit union's* usual supervisory contact at the *FSA*, followed by submission by one of the methods in *CRED* 14.9.19G (1) – (4).

- 14.9.20** G 01.07.02/001 *SUP* 15.7.10R states that notification should be within the period specified by the particular *rule*. If no period is specified, the *credit union* should act reasonably in deciding when to notify.



14.10 Reporting requirements

Application and purpose

14.10.1 G
01.07.02/001

This section, *SUP 16.7.1G – SUP 16.7.4G*, and *SUP 16.7.15AR – SUP 16.7.15DR* apply to all *credit unions*.

14.10.2 G
01.07.02/001

This section is a summary of those parts of *SUP* that apply to every *credit union*.

14.10.3 G
01.07.02/001

In order to discharge its functions under the *Act*, the *FSA* needs timely and accurate information about *credit unions*.

General provisions on reporting

14.10.4 G
01.07.02/001

SUP 16.3.6R – SUP 16.3.13R state that a report must:

- (1) be in writing;
- (2) give the *credit union's FSA* reference number;
- (3) be given to or addressed for the attention of the *credit union's* usual supervisory contact at the *FSA*;
- (4) be delivered to the *FSA* by one of the methods in *SUP 15.7.5R* (summarised in *CRED 14.9.19G*).

Quarterly return

14.10.5 G
01.07.02/001

SUP 16.7.62R states that a *credit union* must submit a quarterly return.

14.10.6 G
01.07.02/001

Table This table belongs to *CRED 14.10.5G*

Content of report	Form	Frequency	Due date
Key financial data	QR	Quarterly	One month after quarter end

Annual return

14.10.7 G
01.07.02/001

SUP 16.7.62R states that a *credit union* must submit an annual return.

14.10.8 **G** Table This table belongs to CRED 14.10.7G
01.07.02/001

Content of report	Form	Frequency	Due date
Annual audited financial statement	AR	Annually	Seven <i>months</i> after financial year end

Credit unions

Chapter 15

Enforcement

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1



15

15.1 Application and purpose

15.1.1

G

01.07.02/001

This chapter contains *guidance* on the investigation and enforcement powers available to the FSA, and its approach to the use of those powers, in respect of :

- (1) *registered only credit unions*;
- (2) *credit unions*, with respect to their activities of *accepting deposits*; and
- (3) *approved persons of credit unions*, as set out in CRED 6.


15.1.2


G

01.07.02/001


The FSA's effective and proportionate use of its investigation and enforcement powers plays an important role in the pursuit of its *regulatory objectives*.


15.2 Investigation and enforcement powers


15.2.1  The *FSA*'s investigation and enforcement powers are provided for in the Industrial & Provident Societies Act 1965, the Industrial & Provident Societies Act 1968, the Credit Unions Act 1979 and the *Act*.
01.07.02/001

15.2.2  For ease of reference:
01.07.02/001

- (1) Annex 1 to this chapter (*CRED 15 Annex 1*) contains a table of the *FSA*'s investigation and enforcement powers under the Industrial & Provident Societies Act 1965, Industrial & Provident Societies Act 1968 and the Credit Unions Act 1979; and
- (2) Annex 2 to this chapter (*CRED 15 Annex 2*) contains a table of the main relevant investigation and enforcement powers under the *Act*, showing where they are considered in the Enforcement manual (*ENF*).

15.2.3  Some of the *FSA*'s powers listed in *CRED 15 Annex 1* are similar to the powers listed in *CRED 15 Annex 2*. For example, the *FSA* has information gathering and investigation powers under both the Industrial & Provident Societies Act 1965, as extended by the Credit Unions Act 1979, and the *Act*. These different powers enable the *FSA* to investigate and enforce the different requirements imposed on *registered only credit unions* and *credit unions* by legislation.
01.07.02/001

15.2.4  In appropriate circumstances, the *FSA* may need to consider which power to use, and whether to use powers, from one or more of the Acts. The appropriate power or powers will vary according to the circumstances of the case. Where the *FSA* is exercising its investigation and enforcement powers, it will normally explain to the *registered only credit union*, *credit union*, individual or other *persons* concerned under which power, or powers, it is acting.
01.07.02/001

15.2.5  However, it is the responsibility of *registered only credit unions*, *credit unions* and individuals, or other *persons* connected to them to ensure that their actions comply with the requirements of the legislation and, for *credit unions*, the *FSA*'s rules, at all times. *Registered only credit unions*, *credit unions* and those involved with them can contact their usual supervisory contact at the *FSA* about the use of the *FSA*'s investigation and enforcement powers.
01.07.02/001



15.3 The FSA’s approach to the use of its investigation and enforcement powers

15.3.1



01.07.02/001

There are a number of principles underlying the FSA’s approach to the exercise of its investigation and enforcement powers in relation to *registered only credit unions* and *credit unions*:

- (1) the effectiveness of the regulatory regime depends to a significant extent on the maintenance of an open and cooperative relationship between the FSA and the management of *registered only credit unions* and *credit unions*;
- (2) the FSA will seek to exercise its investigation and enforcement powers in a manner that is transparent, proportionate and consistent with its publicly stated policies; and
- (3) the FSA will seek to ensure fair treatment when exercising its investigation and enforcement powers. For example, the FSA’s decision making process for regulatory enforcement cases generally gives an opportunity for both written and oral representations to be made, and also provides for a facility for mediation in certain disciplinary cases.

15.3.2



01.07.02/001

The investigation and enforcement powers available to the FSA form part of the regulatory toolkit it will use to meet its *regulatory objectives* of protecting *consumers*, promoting public awareness, maintaining confidence in the *financial system* and reducing *financial crime*. Where a *credit union*, or an individual, has failed to comply with the requirements of the Industrial & Provident Societies Act 1965, the Industrial & Provident Societies Act 1968, the Credit Unions Act 1979, the *Act*, the FSA’s *rules*, or other relevant legislation (for example, the Criminal Justice Act 1993 and the *Money laundering Regulations* 1993), it may be appropriate to deal with this without the need for formal disciplinary or other enforcement action.

15.3.3



01.07.02/001

The proactive supervision and monitoring of *credit unions*, and an open and cooperative relationship between *credit unions* and their supervisors, will, in some cases where a contravention has taken place, lead the FSA to decide against taking formal disciplinary action. However, in such cases, the FSA will expect the *credit union*, or the individual, to act promptly to take the necessary remedial action, agreed with its supervisors, to deal with the FSA’s concerns. If the *credit union*, or the individual, does not do this, the FSA may take investigation or enforcement action in respect of the original contravention.

15.3.4



01.07.02/001

Where the FSA has concerns about a *registered only credit union*, a *credit union*, or an individual, it will normally discuss its concerns with them before considering the use of its investigation and enforcement powers.



15.4 The FSA’s policies and procedures for taking enforcement action

15.4.1  01.07.02/001

The FSA’s enforcement powers are exercised in, and reviewed by, the criminal courts, the civil courts and the *Tribunal*. For example, the FSA has power to prosecute particular offences in the criminal courts, it may seek to obtain *injunctions* in the civil courts, and its powers to impose disciplinary sanctions under the *Act* are subject to referral to the *Tribunal*.

15.4.2  01.07.02/001

The FSA’s enforcement powers in the Industrial & Provident Societies Act 1965, the Industrial & Provident Societies Act 1968, the Credit Unions Act 1979 and the *Act* can be grouped into three broad categories, based on the type of procedure that applies to their use. The three broad categories are:

- (1) regulatory enforcement powers, which the FSA must exercise by administration notice procedures;
- (2) civil enforcement powers, which the FSA must exercise by making application to the civil courts; and
- (3) criminal prosecution powers, which the FSA must exercise by bringing proceedings in the criminal courts.

15.4.3  01.07.02/001

When the FSA exercises its regulatory enforcement powers, the administration notice procedure it must follow varies depending on the type of action to be taken and the provisions of the relevant legislation.

- (1) If the FSA is using its regulatory enforcement powers under the *Act*, it must give the reasons and various notices required by the *Act* and, in all cases, allow the *person* receiving the notice an opportunity to make representations. The FSA’s decision making procedures for notices to be given by the *Act* are set out in *DEC*. *CRED 16* provides an overview of *DEC*.
- (2) If the FSA is using its regulatory enforcement powers under the Industrial & Provident Societies Act 1965, the Industrial & Provident Societies Act 1968 and the Credit Unions Act 1979, it will have regard to the Principles set out in *CRED 3* and will, so far as appropriate, provide a process that is consistent with that in *DEC*.

15.4.4  01.07.02/001

When the FSA uses its civil enforcement powers and criminal prosecution powers under the relevant legislation, it must follow the procedures of the civil and criminal courts.

15.4.5  01.07.02/001

- (1) If the FSA is considering using its regulatory enforcement, civil enforcement or criminal prosecution powers under the *Act*, it will apply the policies on the use of those powers set out in *ENF*.

-
- (2) If the *FSA* is considering using its regulatory enforcement, civil enforcement or criminal prosecution powers under the Industrial & Provident Societies Act 1965, the Industrial & Provident Societies Act 1968 and the Credit Unions Act 1979, it will, to the extent appropriate, apply the policies on the use of similar powers under the *Act* (as set out in *ENF*).

Annex 1: Enforcement Powers

1 Table Table of powers available under Industrial and Provident Societies legislation and the Credit Union Act 1979

SUBJECT	SECTION OF THE RELEVANT ACTS
CANCELLATION OR SUSPENSION OF REGISTRATION	
Power to cancel the registration of a credit union	Industrial & Provident Societies Act 1965, s.16 as applied by Credit Unions Act 1979, s.20(1)
Power to suspend the registration of a credit union	Industrial & Provident Societies Act 1965, s.17 as applied by Credit Unions Act 1979, s.20(1)
INSOLVENCY PROCEEDINGS	
Provision of information: when a credit union is in receivership	Industrial & Provident Societies Act 1965, s.43
Provision of information: when a credit union is subject to a creditors' voluntary liquidation	Industrial & Provident Societies Act 1965, s.59
INFORMATION GATHERING AND INVESTIGATION POWERS	
Power to require information from individuals who are, or have been, officers of a credit union	Industrial & Provident Societies Act 1965, s.48 extended by Credit Unions Act 1979, s.17(1)
Power to appoint an investigator to look into the affairs of a credit union	Industrial & Provident Societies Act 1965, s.49 extended by Credit Unions Act 1979, s.18(1)
AUDITING OF ACCOUNTS	
Power to require the financial accounts of a credit union for past years to be audited	Industrial & Provident Societies Act 1965, s.9(c)
SUSPENSION OF OPERATIONS	
Power to issue a Direction suspending the operations of a credit union	Credit Unions Act 1979, s.19
Power to vary or revoke a Direction suspending the operations of a credit union	Credit Unions Act 1979, s.19
COMPULSORY WINDING UP	
Power to petition the court for the winding up of a credit union	Credit Unions Act 1979, s.20(2)
PROSECUTION OF CRIMINAL OFFENCES	
Power to prosecute offences under the Industrial & Provident Societies Act 1965, Industrial & Provident Societies Act 1968 and the Credit Unions Act 1979	Credit Unions Act 1979, s.28

Annex 2: Enforcement Powers

1 Table

This table gives the main location in the Enforcement manual where *guidance* appears on the powers referred to in the *Act* list below.

This is an edited version of the table given at *ENF 1* Annex 1G.

2 Table Table of powers referred to in the Enforcement manual

SUBJECT	PART AND SECTION OF THE ACT	ENFORCEMENT MANUAL LOCATION
VARIATION AND CANCELLATION OF PERMISSION AND WITHDRAWAL OF AUTHORIZATION OF CREDIT UNIONS		
Duty to withdraw <i>authorisation</i>	Part III, s.33	<i>ENF 5</i>
Variation and cancellation on the <i>FSA's</i> own initiative	Part IV, s.45	<i>ENF 3</i> (Variation), <i>ENF 5</i> (Cancellation)
Prohibitions and restrictions	Part IV, s.48	<i>ENF 3.3.10G</i>
PROHIBITION OF INDIVIDUALS		
Power to make a prohibition order	Part V, s.56	<i>ENF 8</i>
WITHDRAWAL OF APPROVAL FROM APPROVED PERSONS		
Power to withdraw approval from <i>approved persons</i> of <i>credit unions</i>	Part V, s.63	<i>ENF 7</i>
DISCIPLINARY POWERS AGAINST APPROVED PERSONS		
Public statements of misconduct	Part V, s.66	<i>ENF 11</i> and <i>ENF 12</i>
Financial penalties	Part V, s.66	<i>ENF 11</i> and <i>ENF 13</i>
INFORMATION GATHERING AND INVESTIGATION POWERS		
Power to require information from <i>credit unions</i>	Part XI, s.165	<i>ENF 2.3.2G – ENF 2.3.7G</i>
Power to require <i>credit unions</i> to provide a report by a <i>skilled person</i>	Part XI, s.166	<i>ENF 2.3.8G – ENF 2.3.11G</i>
Power to appoint <i>persons</i> to carry out general investigations into <i>credit unions</i> .	Part XI, s.167	<i>ENF 2.3.12G – ENF 2.3.13G</i>
Power to appoint <i>persons</i> to carry out investigations in particular cases involving a <i>person</i> or a <i>credit union</i>	Part XI, s.168	<i>ENF 2.3.14G – ENF 2.3.15G</i>
Powers of investigators appointed under s.167	Part XI, s.171	<i>ENF 2.4.2G – ENF 2.4.5G</i> and <i>ENF 2.4.10G – ENF 2.4.12G</i>
Additional powers of investigators appointed as a result of s.168(1) or (4).	Part XI, s.172	<i>ENF 2.4.6G – ENF 2.4.7G</i> and <i>ENF 2.4.10G – ENF 2.4.12G</i>
Powers of investigators appointed as a result of s.168(2)	Part XI, s.173	<i>ENF 2.4.8G</i> and <i>ENF 2.4.10G – ENF 2.4.12G</i>

Information and documents: supplemental provisions relating to investigators appointed under s.167 or s.168.	Part XI, s.175	ENF 2.4.10G – ENF 2.4.12G
Entry of premises under warrant	Part XI, s.176	ENF 2.15.1G – ENF 2.15.4G
DISCIPLINARY POWERS AGAINST CREDIT UNIONS		
Public censure	Part XIV, s.205	ENF 12
Financial penalties	Part XIV, s.206	ENF 13
DISQUALIFICATION OF AUDITORS APPOINTED BY CREDIT UNIONS		
Disqualification of auditors for failure to comply with a duty imposed under the <i>Act</i> .	Part XXII, s.345	ENF 17
ORDERS AGAINST DEBT AVOIDANCE		
Provisions against debt avoidance: the right to apply for an order .	Part XXIV, s.375	ENF 10.9 and ENF 10.10
INJUNCTIONS AGAINST PERSONS		
<i>Injunctions</i> for breach of a relevant requirement	Part XXV, s.380	ENF 6.3, ENF 6.5 and ENF 6.6
RESTITUTION		
Power to apply to court for a restitution order	Part XXV, s.382	ENF 9
Power to require restitution	part XXV, s.402	ENF 9
PROSECUTION OF CRIMINAL OFFENCES		
Power to prosecute offences under the <i>Act</i> and subordinate legislation	Part XXVII, s.401	ENF 15
Power to prosecute other offences	Part XXVII, s.402	ENF 15

Chapter 16

Decision making



16.1 Application and Purpose

16.1.1


01.07.02/001

The Decision Making manual (*DEC*) gives *guidance* on the *FSA*'s decision making and other procedures for giving statutory notices under the *Act*, including rights to make representations and procedures for referral to the *Tribunal* and, in certain circumstances, access to mediation (as explained in *DEC* Appendix 1). It also gives *guidance* on the *FSA*'s procedure for using its powers under Part XXV of the *Act* (*Injunctions* and restitution) and to prosecute criminal offences. It is relevant to every *credit union*.

16.1.2


01.07.02/001

Section 395 of the *Act* (The *FSA*'s procedure) requires the *FSA* to publish a statement of its procedure for the giving of statutory notices. The purpose of *DEC* is to fulfil this obligation.

16.2 Introduction

16.2.1



01.07.02/001

The Decision making manual (*DEC*), together with the other manuals described below, constitute the regulatory processes block of the *Handbook*. The other manuals are:

- (1) the *Authorisation* manual (*AUTH*) which sets out the relationship between the *FSA* and applicants for *Part IV permission* (amongst others);
- (2) the *Supervision* manual (*SUP*) which sets out the relationship between the *FSA* and *authorised persons* (referred to in the *Handbook* as *firms*); and
- (3) the *Enforcement* manual (*ENF*) which describes the *FSA*'s enforcement powers under the *Act* and sets out its policies for using these powers.

16.3 Guidance on DEC

DEC 1

16.3.1



01.07.02/001

DEC 1 describes the application and purpose of DEC and provides an introduction to the manual. That introduction explains that the *Act* designates certain notices as *warning notices*, *decision notices* or *supervisory notices* (together called '*statutory notices*') for which there are certain specified procedures, actions and protections. DEC 4 explains which decisions are to be taken by the *Regulatory Decisions Committee (RDC)* and which are subject to *executive procedures*. In relation to regulatory decisions which are not subject to *statutory notices*, the FSA's general policy is that regulatory decisions should be taken at a level of seniority which is appropriate to the decision having regard to the following:

- (1) significance of the decision for those affected by it;
- (2) the complexity of the relevant considerations;
- (3) the alternatives;
- (4) the extent to which the factors of the case may be disputed;
- (5) the novelty of the decision in the light of stated policy and established procedure.

16.3.2



01.07.02/001

The FSA expects that most decisions will be made by individuals accountable through line management to the Board within the management structure of the FSA.

DEC 2

16.3.3



01.07.02/001

DEC 2 describes the procedure for issuing a *warning notice* or a *decision notice*. DEC 2 Annex 1G sets out the circumstances in which the *warning notice* and *decision notice* procedures apply. Examples of such notices are:-

- (1) when the FSA is proposing or deciding to refuse an application for *Part IV permission*;
- (2) when the FSA is proposing or deciding to cancel a *Part IV permission* otherwise than by request;
- (3) when the FSA is proposing or deciding to make a *prohibition order* against an individual;

(4) when the FSA is proposing or deciding to withdraw approval from an *approved person*.

DEC 3

16.3.4  01.07.02/001

DEC 3 explains the procedures that apply in the case of *supervisory notices*. The circumstances giving rise to *supervisory notice* procedures are set out in DEC 3 Annex 1G. There is an example of such circumstances when the FSA is exercising its *own-initiative power* to vary a *Part IV permission*.

DEC 4

16.3.5  01.07.02/001

DEC 4 explains the distribution and decision making responsibilities between the RDC and *executive procedures*.

16.3.6  01.07.02/001

Examples of matters to be decided by the RDC include:

- (1) refusal of an application for *Part IV permission*;
- (2) *limitation*, variation or restriction of a *Part IV permission*;
- (3) refusal or withdrawal of *approved person* status;
- (4) exercise of the FSA’s powers to impose a financial penalty or public censure on any *person*.

16.3.7  01.07.02/001

Examples of matters to be decided by *executive procedures* include:

- (1) imposing a *requirement* to submit regular reports;
- (2) imposing a *requirement* to submit a business plan;
- (3) establishing or varying prudential limits, for example on capital or liquidity.

16.3.8  01.07.02/001

It explains (DEC 4.2.1G – DEC 4.2.19G) the status, composition and operating procedures of the RDC, and the way in which *executive procedures* will be conducted (DEC 4.3.1G – DEC 4.3.19G).

16.3.9  01.07.02/001

It also sets out the various procedures open to *persons* for making representation to the FSA (DEC 4.4.1G – DEC 4.4.14G).

DEC 5

16.3.10  01.07.02/001

DEC 5 covers references to the *Tribunal*, publication and service of notices.

Chapter 17

17

Complaint handling procedures for credit unions

PAGE
1



17.1 Application and Purpose

- 17.1.1** **R** **01.07.02/001** This chapter applies to all *credit unions*.
- 17.1.2** **G** **01.07.02/001** This chapter replaces *DISP 1* (Complaints Handling Procedures for firms), which does not apply to *credit unions* (*DISP 1.1.1R*).
- 17.1.3** **G** **01.07.02/001** This chapter is also relevant to *eligible complainants* who might wish to refer a complaint to the *Financial Ombudsman Service*.
- 17.1.4** **G** **01.07.02/001** *DISP 2 – DISP 5* (which cover jurisdiction, procedures and funding of the *Financial Ombudsman Service*) apply to *credit unions*.
- 17.1.5** **G** **01.07.02/001** The purpose of this chapter is to set out the *rules* relating to the internal handling of complaints by a *credit union*, including:
- (1) the procedures which a *credit union* must put in place;
 - (2) the time limits within which a *credit union* must deal with a complaint;
 - (3) the records of a complaint which a *credit union* must make and retain; and
 - (4) the requirements for a *credit union* to report information about complaints to the *FSA*.
- 17.1.6** **G** **01.07.02/001** This is to ensure that complaints are handled fairly, effectively and promptly, and are resolved at the earliest possible opportunity, thereby minimising the number of unresolved complaints which need to be referred to the *Financial Ombudsman Service*. This purpose is compatible with the *FSA's consumer* protection statutory objective.

17.2 Internal complaint handling procedures: general requirements

17.2.1 **R** *A credit union must establish, maintain and implement appropriate and effective internal complaint handling procedures (which must be written down) for handling any expression of dissatisfaction whether oral or written, and whether justified or not, from or on behalf of an eligible complainant about that credit union’s provision of, or failure to provide, a financial services activity.*
01.07.02/001

17.2.2 **G** *An eligible complainant is a person who would be eligible to refer a complaint to the Financial Ombudsman Service. The term is defined for all firms in DISP 2.4, but guidance for credit unions is provided at CRED 17.3 below.*
01.07.02/001

17.2.3 **G** *Credit unions are not obliged to restrict their internal complaint handling procedures to expressions of dissatisfaction from eligible complainants. They may, if they wish, also establish procedures for handling complaints from other persons.*
01.07.02/001

17.2.4 **G** *The internal complaint handling procedures should provide for:*
01.07.02/001

- (1) receiving complaints;
- (2) responding to complaints;
- (3) the appropriate investigation of complaints;
- (4) notifying complainants of their right to go to the *Financial Ombudsman Service*, where relevant.

17.2.5 **G** *When deciding what constitutes an appropriate complaint handling procedure, a credit union should have regard to:*
01.07.02/001

- (1) the type of business it undertakes;
- (2) its size and organisational structure;
- (3) the nature and complexity of the complaints it is likely to receive; and
- (4) the number of complaints it is likely to receive and have to investigate.

17.2.6 **G** *A credit union is not prevented from using a third party administrator (for example, an outside organisation) for the purposes of handling complaints.*
01.07.02/001

17.2.7 **G** *In establishing their internal complaint handling procedures, credit unions may wish to take account of British Standard 8600:1999 “Complaints Management Systems – Guide to Design and Implementation”. This is available on request from the FSA.*
01.07.02/001

17.2.8 **R**
01.07.02/001

A credit union must:

- (1) refer in writing to the availability of its internal complaint handling procedures when, or as soon as possible after, a *person* is admitted as a member or juvenile depositor;
- (2) publish details of its internal complaint handling procedures, supply a copy on request and supply a copy automatically to the complainant when it receives a complaint (unless the complaint is resolved by close of business on the next business day); and
- (3) display at its registered office a notice that it is covered by the *Financial Ombudsman Service*.

17.2.9 **G**
01.07.02/001

In order to comply with CRED 17.2.1R, a *credit union* may include reference to its complaint handling procedures in documentation supplied to members, for example its membership pack or the first piece of correspondence sent to a member or juvenile depositor after he joins the *credit union*.

17.2.10 **G**
01.07.02/001

A *credit union* may also, if it wishes to do so, disclose the fact that it is covered by the *Financial Ombudsman Service* by including the *Financial Ombudsman Service* logo in any marketing literature or correspondence directed at members or juvenile depositors, provided that it does so in a way which is not misleading.

17.2.11 **R**
01.07.02/001

A credit union's internal complaint handling procedures must make provision for:

- (1) complaints to be investigated by a suitable *person* (*officer, director* or member of staff of the *credit union*) who, where appropriate, was not directly involved in the matter which is the subject of the complaint;
- (2) the *person* charged with responding to complaints to have the authority to settle complaints (including the offering of redress where appropriate) or to have ready access to someone who has the necessary authority; and
- (3) responses to complaints to address adequately the subject matter of the complaint and, where a complaint is upheld, to offer appropriate redress.

17.2.12 **R**
01.07.02/001

Where a *credit union* decides that redress is appropriate, it must provide a complainant with fair compensation for any acts or omissions for which it was responsible and comply with any offer of redress which the complainant accepts.

17.2.13 **R**
01.07.02/001

A *credit union* must take all reasonable steps to ensure that all *relevant persons* (whether *officers, directors* or volunteers) are aware of the *credit union's* internal complaint handling procedures and must endeavour to ensure that they act in accordance with them.

17.2.14 **R**
01.07.02/001

A *credit union* must put in place appropriate management controls and take reasonable steps to ensure that it handles complaints fairly,

consistently and promptly, and that it identifies and remedies any recurring or systemic problems, as well as any specific problem identified by a complaint.

17.2.15 
01.07.02/001

The internal complaint handling procedures should enable complainants to make a complaint by any reasonable means (for example by letter, telephone, or in person).

17.2.16 
01.07.02/001

A *credit union's* correspondence and literature relating to complaints should be in clear and plain language.

17.2.17 
01.07.02/001

The *FSA* will take account of the size and nature of the *credit union* in applying the requirements.

17.2.18 
01.07.02/001

In deciding whether or not to accept a complaint and what would be appropriate redress, *credit unions* may wish to consider any relevant *guidance* published by the *FSA* or the *Financial Ombudsman Service*.

17.2.19 
01.07.02/001

Appropriate redress will not always involve financial redress. It may, for example, simply involve an apology. Where financial redress is deemed appropriate, it may include a reasonable rate of interest.

17.3 Eligible complainants

17.3.1



01.07.02/001

The definition of *eligible complainant* in DISP 2.4 applies for the purposes of this chapter.

17.3.2



01.07.02/001

The FSA regards the general definition of *eligible complainant* as meaning, in the *credit union* context:

- (1) those having a direct relationship with the *credit union*:
 - (a) members, potential members and former members of the *credit union*;
 - (b) juvenile depositors, potential juvenile depositors and former juvenile depositors of the *credit union*.
- (2) those having an indirect relationship with the *credit union*:
 - (a) businesses with a turnover of less than £1million (where, for example, the business has guaranteed a member's loan); if in doubt a *credit union* should assume that the business is eligible;
 - (b) beneficiaries of those having a direct relationship with the *credit union* (where, for example, a *person* has been nominated to receive property on a *person's* death).
- (3) the representatives of those having a direct or indirect relationship with the *credit union* (where, for example, a *person* is acting on behalf of a deceased member).

17.4 Internal complaint handling procedures: additional requirements

17.4.1

R

01.07.02/001

The additional requirements in *CRED 17.5 – CRED 17.7* (on time-limits, record-keeping; reporting and cooperation with *Ombudsman*) do not apply:

- (1) where the *credit union* has taken reasonable steps to determine, and has determined, that the complaint:
 - (a) is not made by, or on behalf of, an *eligible complainant*; or
 - (b) does not relate to an activity of that *credit union* which comes under the jurisdiction of the *Financial Ombudsman Service*; or
 - (c) does not involve an allegation that the complainant has suffered, or may suffer, financial loss, material distress or material inconvenience; or
- (2) where the complaint has been resolved by close of business on the business day following receipt.

17.4.2

G

01.07.02/001

DISP 2.6 sets out the activities which come under the jurisdiction of the *Financial Ombudsman Service*, as follows:

- (1) *regulated activities*;
- (2) lending *money* secured by a charge on land;
- (3) lending *money* (other than *restricted credit*);
- (4) paying *money* by a *plastic card* (other than a *store card*);
- (5) the provision of ancillary banking services.

17.4.3

G

01.07.02/001

Financial loss includes indirect or future loss, in addition to actual loss. For example, a complaint may involve an allegation that the complainant may suffer financial loss which has not yet occurred.

17.5 Time limits for dealing with a complaint

- 17.5.1** **R** 01.07.02/001 A *credit union* must send a written acknowledgement of a complaint within five business days of its receipt, giving the name or job title of the *person* handling the complaint within the *credit union* (together with details of the *credit union's* internal complaint handling procedures).
- 17.5.2** **G** 01.07.02/001 A *credit union* that is able to provide a *final response* within five business days of receipt of a complaint may combine its acknowledgement of the complaint with the *final response*.
- 17.5.3** **G** 01.07.02/001 A *credit union* should aim to resolve complaints at the earliest possible stage.
- 17.5.4** **R** 01.07.02/001 By the end of eight weeks after its receipt of a complaint, the *credit union* must send the complainant either:
- (1) a *final response*; or
 - (2) a response which;
 - (a) explains that the *credit union* is still not in a position to make a *final response*, gives reasons for the further delay and indicates when it expects to be able to provide a *final response*; and
 - (b) informs the complainant that he may refer the complaint to the *Financial Ombudsman Service* if he is dissatisfied with the delay and encloses a copy of the *Financial Ombudsman Service's* explanatory leaflet.
- 17.5.5** **R** 01.07.02/001 When a *credit union* sends a complainant its *final response*, the *final response* must:
- (1) inform the complainant that he may refer the complaint to the *Financial Ombudsman Service* if he is dissatisfied with the *final response* and that he must do so within six *months*; and
 - (2) enclose a copy of the *Financial Ombudsman Service's* explanatory leaflet (unless it has already done so).
- 17.5.6** **G** 01.07.02/001 Copies of the *Financial Ombudsman Service's* explanatory leaflet may be reproduced under licence or can be obtained from the *Financial Ombudsman Service*.

17.5.7

G

01.07.02/001

Under CRED 17.5.4R and CRED 17.5.5R:

- (1) even if the *credit union* has failed to resolve the complaint within eight weeks, the complainant may decide to give the *credit union* more time before exercising any right he may have to refer a complaint to the *Financial Ombudsman Service*; and
- (2) the six *month* time limit within which a complainant must refer a complaint to the *Financial Ombudsman Service* begins at the date when the *final response* is sent by the *credit union*.

17.6 Record Keeping and Reporting

17.6.1 **R** **A credit union must make and retain records of complaints (except those referred to in CRED 17.4.1R) for a minimum period of three years from the date of its receipt of a complaint.**

01.07.02/001

17.6.2 **G** **The records required are for the purposes of monitoring by the FSA and also to ensure that the credit union is able to cooperate, as necessary, with the Financial Ombudsman Service. These should include:**

01.07.02/001

- (1) the name of the complainant;
- (2) the substance of the complaint; and
- (3) any correspondence between the credit union and the complainant, including details of any redress offered by the credit union.

17.6.3 **R** **A credit union must provide the FSA, on an annual basis, with a report containing (for the year ending 31 March) information about:**

01.07.02/001

- (1) the total number of complaints received by the credit union (except those referred to in CRED 17.4.1R) broken down according to the categories and in respect of each of the generic product types listed at DISP 1 Annex R which are relevant to the credit union; and
- (2) the number of complaints closed by the credit union within:
 - (a) eight weeks of receipt; and
 - (b) more than eight weeks after receipt.
- (3) the total number of complaints outstanding at the end of the reporting period.

17.6.4 **G** **Where a complaint could fall into more than one category, the complaint should be recorded against the category that the credit union considers to form the main part of the complaint.**

01.07.02/001

17.6.5 **R** **For the purposes of CRED 17.6.3R, reports are to be submitted to the FSA within one month of the end of the relevant reporting period.**

01.07.02/001

17.6.6 **G** **The reports will form part of a credit union's quarterly return.**

01.07.02/001

17.6.7
01.07.02/001

R

For the purposes of making reports under *CRED* 17.6.3R, a closed complaint is a complaint:

- (1) where the *credit union* has sent a *final response*;
- (2) where the complainant has positively indicated acceptance of the *credit union's* earlier response; or
- (3) where the complainant has failed to revert to the *credit union* within eight weeks of the *credit union's* most recent letter.

17.6.8
01.07.02/001

G

The address to which reports should be sent is: The *FSA*, 25 The North Colonnade, Canary Wharf, London, E14 5HS

17.6.9
01.07.02/001

R


For the purpose of inclusion in the public record maintained by the *FSA*, a *credit union* must provide the *FSA*, at the time of its *authorisation*, with details of a single contact within the *credit union* for complainants, and in its quarterly return must notify the *FSA* of any subsequent change.

17.6.10
01.07.02/001


G

The contact point can be by name or job title and may include, for example, a telephone number.

17.7 Cooperation by credit unions with the Ombudsman

17.7.1  **A credit union must cooperate fully with the Ombudsman in the handling of complaints against it.**

01.07.02/001

17.7.2  Cooperation with the *Ombudsman* includes, but is not limited to, producing requested *documents*, adhering to any specified time limits, attending hearings when requested to do so and complying promptly with any settlements or awards.

01.07.02/001

Appendices





Appendix 1 Contents of the Handbook

1.1 This is the table referred to in CRED 2.2.2G.

1.1.1 Table

01.07.02/001

	Sourcebook or manual	Reference code
High Level Standards	Principles for Businesses	PRIN
	Senior Management Arrangements, Systems and Controls	SYSC
	Statements of Principle and Code of Practice for Approved Persons	APER
	The Fit and Proper test for Approved persons	FIT
	General provisions	GEN
Business Standards	5 Interim Prudential sourcebooks	IPRU
	Conduct of Business	COB
	Market conduct, including:	MAR
	Code of Market Conduct	
	Price stabilising rules	
	Inter-professional conduct	
	Training and Competence	TC
Regulatory Processes	Money laundering	ML
	Authorisation	AUTH
	Supervision	SUP
	Enforcement	ENF
Redress	Decision making	DEC
	Dispute resolution: Complaints	DISP
	Compensation	COMP
Specialist sourcebooks	Complaints against the FSA	COAF
	Collective investment schemes	CIS
	Credit unions	CRED
	Professional firms	PROF
	Lloyd's	LLD
	Mortgages	MORT
	Recognised investment exchanges and Recognised clearing houses	REC

	United Kingdom Listing Authority	UKLA
Schedules:		
Transitional provisions		
Summary schedules:		
1. Record keeping requirements		
2. Notification requirements		
3. Fees and other required payments		
4. Powers exercised in making the Handbook		
5. Rights of action for damages		
6. Rules that can be waived		
7. Releases		
Glossary of definitions		
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Appendix 2 The Credit Unions sourcebook

2.1 Detailed contents of CRED

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01.07.02/001

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3.3	Consequences of breaching the Principles
4	Senior management arrangements, systems and controls
4.1	Application and purpose
4.2	Apportionment of responsibilities
4.3	Systems and controls

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5		Threshold conditions
	5.1	Application and purpose
	5.2	The Conditions
6		The Approved persons Regime
	6.1	Application and purpose
	6.2	The Statements of Principle of Code of Practice for Approved Persons (APER)
	6.2.2	Introduction
	6.2.4	The Statements of Principle
	6.2.6	Code of Practice for Approved persons
	6.2.7	Factors relevant to Statements of Principle
	6.2.9	Enforcement procedures
	6.3	Approved Persons
	6.3.2	Introduction
	6.3.3	Purpose of the regime
	6.3.4	Controlled functions
	6.3.5	Specification of functions
	6.4	Assessing fitness and propriety
	6.4.1	Purpose
	6.4.2	Background
	6.4.3	Assessing fitness and propriety
7		Investment and borrowing
	7.1	Application, purpose and interpretation
	7.2	Investment
	7.2.1	Types of investment
	7.2.2	Maturity investment
	7.2.4	Cash in custody of officers
	7.2.5	Investment conditions no longer satisfied
	7.2.6	Transactions between credit unions
	7.3	Funds held on trust for persons too young to be members
	7.3.3	Borrowing
	7.3.7	Financial risk management policy statement
8		Capital requirements
	8.1	Application and purpose

8.2	Components of capital
8.3	Version 1 credit unions
8.3.1	Requirement to maintain positive net worth
8.3.5	Building reserves
8.3.9	Minimum initial capital
8.3.12	Capital requirement for version 1 credit unions wishing to lend amounts of more than £5,000 in excess of the borrowing member's shareholding
8.3.14	Capital requirements for large version 1 credit unions
8.4	Version 2 credit unions
8.4.3	Minimum initial capital
9	Liquidity
9.1	Application, purpose and interpretation
9.2	General requirements
9.3	Minimum liquidity requirements
10	Lending
10.1	Application and purpose
10.2	General requirements
10.3	Lending limits
10.4	Large exposures
10.5	Provisioning
11	Conduct of Business Sourcebook (COB)
11.1	Introduction
11.2	Financial promotion
12	Money Laundering
12.1	Introduction
12.1.1	What is Money laundering?
12.2	Money laundering and the FSA
12.3	Identification of the Client
12.4	External Reporting
12.5	Government and Financial Action Task Force findings
12.6	Compliance Monitoring
12.7	Record keeping
13	Registration and Authorisation
13.1	Application and purpose
13.2	Introduction
13.3	What does registration mean?
13.4	Process for registration
13.5	What does authorisation involve?
13.6	Process for Part IV permission
13.7	Applying for approved persons status
13.8	The FSA's decision making procedures
<i>Ann 1</i>	Requirements of Registration [table]
14	Supervision
14.1	The FSA's approach to supervision
14.1.1	Application and purpose
14.1.6	The FSA's risk based approach to supervision

	14.1.7	Tools of supervision
14.2		Information gathering by the FSA on its own initiative
	14.2.1	Application and purpose
	14.2.7	Information gathering by the FSA on its own initiative: background
	14.2.9	Information gathering by the FSA on its own initiative: cooperation by credit unions
	14.2.13	"Mystery Shopping"
14.3		Auditors
	14.3.1	Application and purpose
	14.3.3	Appointment of auditors
	14.3.5	Auditors' qualifications
	14.3.12	Auditors' independence
	14.3.16	Credit unions' cooperation with their auditors
	14.3.20	Notification of matters raised by auditor
	14.3.22	Rights and duties of all auditors
14.4		Skilled persons
	14.4.1	Application and purpose
	14.4.3	The FSA's power
	14.4.4	Policy on the use of skilled persons
	14.4.5	Appointment and reporting process
	14.4.6	Duties of a credit union
	14.4.8	Confidential information privilege
14.5		Application to vary or cancel Part IV permission
	14.5.1	Application and purpose
	14.5.5	Introduction
	14.5.6	Applications for variation of permission
	14.5.15	Applications for cancellation of permission
	14.5.29	Ending authorisation
	14.5.30	Additional guidance
14.6		Individual requirements
	14.6.1	Application and purpose
	14.6.4	The FSA's powers to set individual requirements on its own initiative
	14.6.7	Criteria for varying a credit union's permission
14.7		Waiver and modification of rules
	14.7.1	Application and purpose
	14.7.3	Introduction
	14.7.5	Applying for a waiver
	14.7.11	Notification of altered circumstances relating to waivers
	14.7.12	Publication of waivers
	14.7.15	Varying waivers
	14.7.16	Revoking waivers
	14.7.19	Decision making
14.8		Individual guidance
	14.8.1	Application and purpose
	14.8.4	Making a request for individual guidance

	14.8.7	Giving individual guidance to a credit union on the FSA's own initiative
	14.8.9	Reliance on individual guidance
14.9		Notifications to the FSA
	14.9.1	Application and purpose
	14.9.3	General notification requirements
	14.9.13	Core information requirements
	14.9.15	Inaccurate, false or misleading information
	14.9.18	Form and method of notification
14.10		Reporting requirements
	14.10.1	Application and purpose
	14.10.4	General provisions on reporting
	14.10.5	Quarterly Return
	14.10.7	Annual Return
15		Enforcement
	15.1	Application and purpose
	15.2	Investigation and enforcement powers
	15.3	The FSA's approach to the use of its investigation and enforcement powers
	15.4	The FSA's policies and procedures for taking enforcement action
	<i>Ann 1</i>	Enforcement Powers [table – powers available under Industrial and Provident Societies legislation and the Credit Unions Act 1979]
	<i>Ann 2</i>	Enforcement Powers [table – powers referred to in ENF]
16		Decision making manual (DEC)
	16.1	Application and purpose
	16.2	Introduction
	16.3	Guidance on DEC
	16.3.1	DEC 1
	16.3.3	DEC 2
	16.3.4	DEC 3
	16.3.5	DEC 4
	16.3.10	DEC 5
17		Complaints handling procedures for credit unions
	17.2	Internal complaint handling procedures: general requirements
	17.3	Eligible complainants
	17.4	Internal complaint handling procedures: additional requirements
	17.5	Time limits for dealing with a complaint
	17.6	Record keeping and reporting
	17.7	Co-operation by credit unions with the Ombudsman

Schedules



Credit unions

Schedule1 Record keeping requirements

G

1 Table

The aim of the *guidance* in the following table is to give the reader a quick overall view of the relevant record keeping requirements.

It is not a complete statement of those requirements and should not be relied on as if it were.

2 Table Record keeping requirements

Handbook reference	Subject of reference	Contents of record	When record must be made	Retention period
CRED 4.2.11G	Apportionment of significant responsibilities	Record of arrangements and how responsibilities are shared.	Immediately	6 years
CRED 12.2.3G	<i>Money Laundering</i>	Reference to <i>ML 7</i> in relation to compliance and record keeping.	On-going in accordance with <i>ML 7</i>	5 years from dates specified in <i>ML 7.3</i>
CRED 12.7.1G	<i>Money Laundering</i>	Specifies retention periods in relation to evidence of identity etc.	On-going	As per <i>ML 7</i>
CRED 17.6.1R	Complaints Handling	Specifies retention period of complaints.	From date of receipt	3 years

Credit unions

Schedule2 Notification requirements

G

1 Table

The aim of the *guidance* in the following table is to give the reader a quick overall view of the relevant requirements for notification and reporting.

It is not a complete statement of those requirements and should not be relied upon as if it were.

2 Table Notification requirements

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
CRED 4.3.5R	Business plan	Copy of business plan.	Upon request	As soon as reasonably practical
CRED 4.3.7R	Policies and procedures manual	Copy of policies and procedures manual. Wide range of detail as specified as guidance in Chapter 4.	Upon request	As soon as reasonably practical
CRED 4.3.9R	Documented system of control	Systems of control.	Upon request	As soon as reasonably practical
CRED 7.1.18R	Financial risk Management Policy	Statement of financial risk management policy.	On conversion to version 2	Upon request to convert to version 2
CRED 6.3.12G	<i>Approved Persons</i>	Application to perform a <i>controlled function</i> . Notice to withdraw application. Notice of ceasing to perform.	When applicable	Asap Asap Within 7 days of cessation
CRED 9.3.3R	Liquidity	Notification of changes in application details. Liquidity Management Policy Statement for <i>version 2 credit unions</i> .	After adoption and/or review or amendment	Asap As soon as reasonably practical
CRED 10.3.1R – CRED 10.3.2R	Lending Policy	Current lending policy statement.	After adoption and/or review or amendment	As soon as reasonably practical

CRED 10.5.5G	Large <i>Exposures</i>	Limits on large <i>exposures</i> to avoid concentration of risk.	Upon request	As soon as reasonably practical
CRED 12.6.1G	<i>Money Laundering</i>	Report from <i>MLRO</i> .	Upon request	As soon as reasonably practical
CRED 14.5.3G	Appointment of Auditors	Notification of vacancy of auditor. Notification of appointment of auditor.	As applicable	Immediately
CRED 14.5.21G	Matters raised by auditors	Possible notification to the <i>FSA</i> of any written <i>communication</i> from its auditor commenting on internal controls.	When relevant	Immediately
CRED 14.5.30G	Duties of auditors on ceasing to audit a <i>credit union</i>	Notification of his removal by the <i>credit union</i> . Resignation before his term in office expires. Is not re-appointed by a <i>credit union</i> .	When applicable	Immediately
CRED 14.5.31G	Duties of the auditors on ceasing to audit a <i>credit union</i>	Notification of any matter connected with cessation of duties that should be drawn to the <i>FSA</i> 's attention or that there is no such matter.	When applicable	Immediately
CRED 14.9.11G	Notification of altered circumstances relating to a <i>waivers</i>	Specifies the reference point the <i>credit union</i> must refer to if a <i>waiver</i> is no longer relevant or appropriate.	When applicable	Immediately
CRED 14.11.3G	General notification	<i>Credit union</i> at risk of: Failure to satisfy <i>threshold conditions</i> ; Reputation at risk; Services to members at risk; Any matter that may result in serious financial consequences.	When applicable	Immediately
CRED 14.11.5G	General notification	Any proposed re-organisation that may have a significant impact. Failure in systems or controls. Material change to capital adequacy or solvency.	As soon as the <i>credit union</i> is aware	At an early stage
CRED 14.11.7G	General notification	Breaches of <i>rules</i> or <i>principles</i> , statutory requirements or the prosecution or conviction of any of the committee of management.	As soon as the <i>credit union</i> is aware	Immediately

CRED 14.11.8G	General notification	Significant civil proceedings, action for damages against the <i>credit union</i> or prosecution or conviction of the <i>credit union</i> .	As soon as the <i>credit union</i> is aware	Immediately
CRED 14.11.10G	General notification	Fraud, irregularities and misconduct.	As soon as the <i>credit union</i> is aware	Immediately
CRED 14.11.12G	General notification	Legal steps involving insolvency, bankruptcy or winding up.	As soon as the <i>credit union</i> is aware	As soon as possible
CRED 14.11.13G	Core information requirements	Change in name, address or legal structure.	As soon as the <i>credit union</i> is aware	Immediately
CRED 14.11.16G	Inaccurate, false or misleading information	Notification that information already provided is incorrect.	As soon as the <i>credit union</i> is aware	Immediately
CRED 14.12.5R	Quarterly Return	Quarterly return form.	End of quarter	1 month after quarter event
CRED 14.12.7R	Annual Return	Annual Return.	End of financial year	7 months after financial year end
CRED 17.6.3R	Complaints	Number of complaints received.	Year ending 31 March	30 April
CRED 17.6.9R	Record Keeping & Reporting	Change in <i>credit union</i> contact for complaints handling.	As appropriate	Via the next quarterly return

Credit unions

Schedule3 Fees and other required payments

G

1 Table

There are no requirements for fees or other payments in *CRED*.

Credit unions

Schedule4 Powers exercised

G

1 Table

The following powers and related provisions in the *Act* have been exercised by the *FSA* to make the rules in *CRED*:

- (1) Section 138 (General rule-making power);
- (2) Section 149 (Evidential provisions); and
- (3) Section 156 (General supplementary powers).

The following power in the *Act* has been exercised by the *FSA* to give *guidance* in *CRED*:

- (1) Section 157(1) (Guidance).

Credit unions

Schedule5 Rights of actions for damages

G

1 Table

The table below sets out the *rules* in *CRED* contravention of which by an *authorised person* may be actionable under Section 150 of the *Act* (Actions for damages) by a *person* who suffers loss as a result of the contravention.

If a "Yes" appears in the column headed "For private person?", the *rule* may be actionable by a "private person" under section 150 (or, in certain circumstances, his fiduciary or representative). A "Yes" in the column headed "Removed" indicates that the *FSA* has removed the right of action under Section 150(2) of the *Act*. If so, a reference to the *rule* in which it is removed is also given.

The column headed "For other person?" indicates whether the *rule* is actionable by a *person* other than a *private person* (or his fiduciary or representative). If so, an indication of the type of *person* by whom the *rule* is actionable is given.

2 Table Actions for damages: Credit unions sourcebook

Chapter / Appendix	Section / Annex	Paragraph	Right of action under section 150		
			For private person?	Removed?	For other person?
All <i>rules</i> in <i>CRED</i> with the status letter 'E'.			No	No	No
All other <i>rules</i> in <i>CRED</i> .			Yes	No	No

Credit unions

Schedule6 Rules that can be waived

G

1 Table

The *rules* made in *CRED* can be *waived* by the *FSA* under section 148 of the *Act* (Modification or waiver of rules).

CRED includes *guidance* on *rules* made in other parts of the *Handbook*. Reference should be made to those parts of the *Handbook* concerning *waiver* of those *rules*.

Credit unions

Schedule 7 Consolidated schedule of releases

1 Table

This schedule will list by serial number each release containing amendments made to *CRED* since it was first published. Since *CRED* is being published for the first time, there are no entries in this schedule.

**CREDIT UNIONS SOURCEBOOK
(CONSEQUENTIAL AMENDMENTS) INSTRUMENT 2001**

Powers exercised

- A. The Financial Services Authority amends the Supervision manual, the Complaints sourcebook and the Glossary in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (the "Act"):
- (1) section 138 (General rule-making power);
 - (2) section 149 (Evidential provisions);
 - (3) section 156 (General supplementary powers);
 - (4) section 157(1) (Guidance); and
 - (5) section 340 (Appointment).
- B. The provisions of the Act relevant to rules and listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force on 1 July 2002.

Amendments to SUP, DISP and the Glossary

- D. The Supervision manual, the Complaints sourcebook and the Glossary are amended in accordance with:
- (1) Annex A to this instrument (Amendments to SUP, DISP and the Glossary); and
 - (2) Annex B (Forms QR and AR).

Citation

- D. This instrument may be cited as the Credit Unions Sourcebook (Consequential Amendments) Instrument 2001.

By order of the Board
20 December 2001

Annex A
Amendments to SUP, DISP and the Glossary

In this Annex, where amendments are shown rather than described, underlining indicates new text and striking through indicates deleted text.

Supervision manual

SUP 3.1.2R Insert the following new row in the table:

Category of firm		Sections applicable to the firm	Sections applicable to its auditor
(5 A)	<i>Credit union</i>	<i>SUP 3.1- SUP 3.7</i>	<i>SUP 3.1, SUP 3.2, SUP 3.8</i>

SUP 16.1.3R Amend the rows for SUP 16.4 and SUP 16.5, and for SUP 16.7, as shown:

16.1.3 R Table Application of different sections of SUP 16

(1) Sections	(2) Categories of firm to which section applies	Applicable rules and guidance
<i>SUP 16.4 and SUP 16.5</i>	All categories of <i>firm</i> except: (-a) a <i>credit union</i>; (a) an <i>ICVC</i> ;	Entire sections
<i>SUP 16.7</i>	<u><i>Credit union</i></u> <u><i>Bank,....</i></u>	<u><i>SUP 16.7.62R to 16.7.63R</i></u>

SUP 16.4.1G Amend as shown :

16.4.1 G The effect of *SUP 16.1.1R* is that this section applies to every *firm* except:

~~(-1) a *credit union*;~~

(1) an *ICVC*;

....

SUP 16.5.1G Amend as shown :

16.5.1 G The effect of SUP 16.1.1R is that this section applies to every *firm* except:

(-1) a credit union;

(1) an ICVC;

....

SUP 16.7.5G Insert the following new row at the beginning:

Firm category	Applicable rules and guidance
<i>Credit union</i>	SUP 16.7.62R to SUP 16.7.63R

SUP 16.7 After SUP 16.7.61G, insert the following new heading and rules:

Credit unions

16.7.62 R A *credit union* must submit reports to the FSA in accordance with, and in the same format as, the forms contained in SUP 16 Ann 13R, as set out in SUP 16.7.63R.

16.7.63 R Table: Financial reports required from a credit union (see SUP 16.7.62R)

Content of report	Form	Frequency	Due date
Key financial data	QR	Quarterly	One <i>month</i> after quarter end
Annual audited financial statement	AR	Annually	Seven <i>months</i> after financial year end

SUP App 1 1.3.1G Insert an additional row in the appropriate alphabetical position, and amend Note 2, as shown:

Prudential categories (Note 1)	Applicable prudential requirements (Note 2)	Prudential sub-categories
<u><i>Credit union</i></u>	<u><i>CRED 7, 8, 9, and 10</i></u>	<u><i>Version 1 credit union</i></u> <u><i>Version 2 credit union</i></u>
Note 2 = Only the requirements in the Interim Prudential sourcebooks, and LLD₂ and <u><i>CRED</i></u> are listed in the column. Requirements in other parts of the <i>Handbook</i> will also apply.		

Complaints sourcebook

DISP 1.1.1R Amend as shown:

This chapter applies to every *firm* in respect of activities carried on from an establishment maintained by the *firm* (or its *appointed representative*) in the *United Kingdom*, except:

(1)(a) a *firm* that is exempt under *DISP* 1.1.7R; or

(b) a *UCITS qualifier*; or

(c) an *authorised professional firm* in so far as its *non-mainstream regulated activities* are concerned; or

(d) a *credit union*; or

(2) in relation to the Society of Lloyd's and members of the Society and managing agents, *DISP* 1 applies subject to *DISP* 1.7 (The society of Lloyd's).

DISP 1.1.4G Renumber the existing provision as (1) and insert the following new paragraph:

“(2) *Rules and guidance* relating to complaints handling by *credit unions* are contained in *CRED* 17.”

Glossary

Delete the existing definition of “credit union”

Insert the following new definitions in the appropriate alphabetical position:

<i>credit union</i>	a body corporate registered under the Industrial and Provident Societies Act 1965 as a credit union in accordance with the Credit Unions Act 1979, which is an <i>authorised person</i> .
<i>registered only credit union</i>	a body corporate registered under the Industrial and Provident Societies Act 1965 as a credit union in accordance with the Credit Unions Act 1979, which is not an <i>authorised person</i> .
<i>version 1 credit union</i>	a <i>credit union</i> whose <i>Part IV permission</i> includes a <i>requirement</i> that it must not lend more than £10,000 in excess of a member's shareholding; in this definition a "member's shareholding" means any shares held by a member of the <i>credit union</i> within limits set by section 5 of the Credit Unions Act 1979.
<i>version 2 credit union</i>	a <i>credit union</i> which is not a <i>version 1 credit union</i> .

Annex B
Forms QR and AR

After SUP 16 Ann 12 G, insert:

Sup 16 Ann 13R: Forms QR and AR



CREDIT UNION QUARTERLY RETURN

for quarter ended [] / [] / []

Name [] Credit Union Limited

Register No []

Meetings of Officers during the quarter

- Board of Directors/Committee of Management
Credit/Loans Committee
Supervisory/Internal Audit Committee

Number of Meetings [] [] []

Fidelity Insurance (Section 15 Credit Unions Act 1979)

Did the Credit Union maintain in force during the period of this quarterly return a policy of insurance complying with the requirements of section 15 of the Credit Unions Act 1979 ?

Enter YES or NO []

Membership

Number of members at end of quarter

Table with 3 columns: Ordinary, Non-qualifying, Juveniles

Affiliation

The Credit Union is affiliated to

[]

Management Reports

- (i) During this quarter, have all the reports required by the registered Rules of the Credit Union been made ?
(ii) Have any financial statements been prepared since completion of the previous Quarterly Return ?

Enter YES or NO []

Enter YES or NO []

BALANCE SHEET

at quarter ended on / /

Assets

	£
Fixed assets	<input type="text"/>
Investments	<input type="text"/>
Juvenile deposits	<input type="text"/>
Members' loans	<input type="text"/>
less: Provision for doubtful debts	()
Credit Union Loans	<input type="text"/>
Cash and Bank balances	<input type="text"/>
Other assets (<i>specify</i>) 	<input style="width: 100%; height: 100%;" type="text"/>
.	
.	
.	
Total Assets	<input type="text"/>

Liabilities

	£
Shares	<input type="text"/>
General Reserve	<input type="text"/>
Other reserves	<input type="text"/>
Juvenile fund	<input type="text"/>
Credit Union Loans	<input type="text"/>
Bank loans	<input type="text"/>
Bank overdrafts	<input type="text"/>
Other liabilities (<i>specify</i>) 	<input style="width: 100%; height: 100%;" type="text"/>
.	
.	
.	
Profit / (Loss)	<input type="text"/>
Total Liabilities	<input type="text"/>

REVENUE ACCOUNT

Income

	This quarter	Year to date
	£	£
Entrance fees	<input type="text"/>	<input type="text"/>
Loan Interest	<input type="text"/>	<input type="text"/>
Bank Interest	<input type="text"/>	<input type="text"/>
Credit Union Loan Interest	<input type="text"/>	<input type="text"/>
Grants and Donations	<input type="text"/>	<input type="text"/>
Other Income (<i>specify</i>)	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>
.		
.		
.		
Total Income	<input type="text"/>	<input type="text"/>

Expenditure

	This quarter	Year to date
	£	£
Officers and staff	<input type="text"/>	<input type="text"/>
Audit	<input type="text"/>	<input type="text"/>
Occupancy	<input type="text"/>	<input type="text"/>
Printing, etc.	<input type="text"/>	<input type="text"/>
Bank Charges	<input type="text"/>	<input type="text"/>
Credit Union Loan Interest	<input type="text"/>	<input type="text"/>
Insurance	<input type="text"/>	<input type="text"/>
Bad debts written off	<input type="text"/>	<input type="text"/>
Bad Debt Provision	<input type="text"/>	<input type="text"/>
Other Expenditure (<i>specify</i>)	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>
.		
.		
.		
Total Expenditure	<input type="text"/>	<input type="text"/>

CASH FLOW STATEMENT

Receipts

	This quarter £	Year to date £
Share receipts	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
Loan repayments:		
Capital	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
Interest	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
Other receipts (<i>specify</i>)	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>
...		
...		
Total receipts	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>

Payments

	This quarter £	Year to date £
Shares repaid	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
Loans to members	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
Management expenses	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>
Other payments (<i>specify</i>)	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>
...		
...		
Total payments	<input style="width: 100%;" type="text"/>	<input style="width: 100%;" type="text"/>

Juvenile Deposits

	£
Fund at start of quarter	<input style="width: 100%;" type="text"/>
Add New deposits	<input style="width: 100%;" type="text"/>
Interest on fund	<input style="width: 100%;" type="text"/>
Deduct Deposits withdrawn	(<input style="width: 100%;" type="text"/>)
Administration charge	(<input style="width: 100%;" type="text"/>)
Fund at end of quarter	<input style="width: 100%;" type="text"/>

Credit Union Loans

	This quarter £	Year to date £
Loans to other credit unions		
Payments		
Receipts		
Loans from other credit unions		
Receipts		
Payments		

Analysis of loans in arrears (after write-offs) at end of quarter

	Over 1 month up to 3 months	Over 3 months up to 6 months	Over 6 months up to 12 months	Over 12 months	Total
Number					
Amount	£	£	£	£	£

Total amount of loans more than 1 month in arrears as a percentage of total loans outstanding

	%
--	---

Loans in arrears considered to be irrecoverable

Number

Amount £

Loans in arrears refinanced or rescheduled

Number

Amount £

Changes in Personnel - please give details of changes in the Board of Directors/Committee of Management and other Officers since the submission of the last quarterly return. Also include any changes in private address of current personnel.

Name
(Please state title
Mr, Mrs, Miss etc.)

Address
(Please state full postal address
including post code)

Office **On/Off** **Training received** **Date of change**

					/ /
					/ /
					/ /
					/ /
					/ /
					/ /
					/ /
					/ /
					/ /
					/ /
					/ /
					/ /
					/ /
					/ /
					/ /

Verification

Cash and Bank balances at end of quarter

Enter YES or NO

Has all cash been banked as per the Credit Union's policy document and its policy of insurance?

I, _____, a member of _____, *
hereby certify that I have counted the 'Cash in custody of officers', and found the total to be in agreement with the figure shown below; and reconciled the figure for 'Cash at Bank' as shown below with the bank statements.

Insert whether a member of the Supervisory or Internal Audit Committee or other office. The Treasurer or Assistant Treasurer should **not make the verification.*

Cash in custody of officers (as per books of account)
£ <input type="text"/>

Cash at Bank (as per books of account)
£ <input type="text"/>

<input type="text"/>
Signature*

<input type="text" value="/ /"/>
Date

Signatures - One signatory should be the Treasurer, the Chair or the Secretary (no deputies); and the second signatory should be the Chair of the Supervisory Committee/Internal Audit, or one of his/her deputies.

	Signature and Name	Contact phone no.	Date
President or Chair/ Treasurer/Secretary	<input type="text"/>	<input type="text"/>	<input type="text" value="/ /"/>
Chair of Supervisory /Internal Audit Committee	<input type="text"/>	<input type="text"/>	<input type="text" value="/ /"/>



Annual Return for a Credit Union
 Industrial and Provident Societies Acts 1965 to 1978
 Credit Unions Act 1979

PUBLIC RECORD

Form AR 20

If the details above are incorrect please amend clearly

Year Ended

The Credit Union's year end was

/ /

Other Accounts

Has the Credit Union issued to its members other accounts made up for the period (or any part thereof) covered by this return

Yes / No

(delete as appropriate)

Common Bond

The nature of the common bond is

Section 15 Insurance

Did the Credit Union maintain in force during the period of this return a policy of insurance complying with the requirements of section 15 Credit Unions Act 1979?

Yes / No

(delete as appropriate)

Affiliation

The Credit Union is affiliated to

<i>For Official Use</i>						
	Date Received	Accounts	Fee Paid	Ack'd.	Ab.	Ex.
1st	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
2nd	<input type="text"/>					

BALANCE SHEET

at / / (year end)

				Note	£		[prior year end]	
					£	£	£	£
Fixed assets	...	...	...	2	A	<input type="text"/>		<input type="text"/>
Investments	...	...	...	3	B	<input type="text"/>		<input type="text"/>
Investments - juvenile depositors	...	...	...	5(b)	C	<input type="text"/>		<input type="text"/>
Balance due from members for loans						<input type="text"/>		<input type="text"/>
Secured	...	...	...	4(a)	D	<input type="text"/>		<input type="text"/>
Unsecured	...	...	...	4(a)	E	<input type="text"/>		<input type="text"/>
<i>Less: Provision for doubtful debts</i>	...	...	...	4(b)	F	(<input type="text"/>)		(<input type="text"/>)
					G	<input type="text"/>		<input type="text"/>
Cash and bank balances	...	...	...	10(c)	H	<input type="text"/>		<input type="text"/>
Other debtors (including interest due)	...	...	...		I	<input type="text"/>		<input type="text"/>
Prepaid expenses	...	...	...		J	<input type="text"/>		<input type="text"/>
Other assets (specify)	...	...	...		K	<input type="text"/>		<input type="text"/>
TOTAL ASSETS	...	...	...		L	<input type="text"/>		<input type="text"/>
Capital and reserves						<input type="text"/>		<input type="text"/>
Share capital	...	...	...	6(b)	M	<input type="text"/>		<input type="text"/>
General reserve	...	...	...		N	<input type="text"/>		<input type="text"/>
Other reserves (specify)	...	...	...		O	<input type="text"/>		<input type="text"/>
Appropriation account	...	...	...		P	<input type="text"/>		<input type="text"/>
					Q	<input type="text"/>		<input type="text"/>
Juvenile depositors fund	...	...	...	5(a)	R	<input type="text"/>		<input type="text"/>
Loans						<input type="text"/>		<input type="text"/>
Bank loans	...	...	...	7	S	<input type="text"/>		<input type="text"/>
Bank overdrafts	...	...	...	10(c)	T	<input type="text"/>		<input type="text"/>
Credit union loans	...	...	...	7	U	<input type="text"/>		<input type="text"/>
					V	<input type="text"/>		<input type="text"/>
Other liabilities						<input type="text"/>		<input type="text"/>
Expenses and interest payable	...	...	...		W	<input type="text"/>		<input type="text"/>
Interest to juvenile depositors	...	...	...		X	<input type="text"/>		<input type="text"/>
Taxation	...	...	...		Y	<input type="text"/>		<input type="text"/>
Others (specify)	...	...	...		Z	<input type="text"/>		<input type="text"/>
					AA	<input type="text"/>		<input type="text"/>
Applications	...	...	...		BB	<input type="text"/>		<input type="text"/>
TOTAL RESERVES AND LIABILITIES	...	...	...		CC	<input type="text"/>		<input type="text"/>

REVENUE ACCOUNT

for the year ended / /

							£	[prior year] £
Income						Note		
Entrance fees	...	...	...	...		A	<input type="text"/>	<input type="text"/>
Total interest receivable	...	...	...	...		8(a) B	<input type="text"/>	<input type="text"/>
Bad debts recovered previously written off	...					C	<input type="text"/>	<input type="text"/>
Administration charge - juvenile deposits	...					5(c) D	<input type="text"/>	<input type="text"/>
Profit on investment sales	...	...	...	...		E	<input type="text"/>	<input type="text"/>
Other income								
Grants	...	...	...	...		F	<input type="text"/>	<input type="text"/>
Donations	...	...	...	...		G	<input type="text"/>	<input type="text"/>
Other (<i>specify</i>)	...	...	...	...		H	<input type="text"/>	<input type="text"/>
Total income	...	...	...	...		I	<input type="text"/>	<input type="text"/>
<i>less:</i>								
Expenditure								
Administration expenses	...	...	...	...		9(a) J	<input type="text"/>	<input type="text"/>
Depreciation - fixed assets	...	...	...	...		2 K	<input type="text"/>	<input type="text"/>
Bad debts written off	...	...	...	...		L	<input type="text"/>	<input type="text"/>
Provision for doubtful debts	4(b)	...	...	...		M	<input type="text"/>	<input type="text"/>
Loan interest payable:								
Bank loans (<i>including overdrafts</i>)	...					N	<input type="text"/>	<input type="text"/>
Credit union loans	...	...	...	...		O	<input type="text"/>	<input type="text"/>
Loss on investment sales	...	...	...	...		P	<input type="text"/>	<input type="text"/>
Other outgoings (<i>specify</i>)	...	...	...	...		Q	<input type="text"/>	<input type="text"/>
Total expenditure	...	...	...	...		R	<input type="text"/>	<input type="text"/>
Profit /(loss) for year before taxation	...	...	...	...		S	<input type="text"/>	<input type="text"/>
<i>less: taxation</i>	...	...	...	...		T	<input type="text"/>	<input type="text"/>
Profit after tax: transferred to appropriation account	...	...	...	...		U	<input type="text"/>	<input type="text"/>
(Loss) after tax: transferred to general reserve	...	...	...	...		V	<input style="font-size: 0.8em; vertical-align: middle;" type="text" value="("/>)	<input style="font-size: 0.8em; vertical-align: middle;" type="text" value="("/>)

APPROPRIATION ACCOUNT

for the year ended / /

Profit after tax: transferred from revenue account	...	...	...	£	A <input style="width: 80px;" type="text"/>
Compulsory transfer					
<i>to</i> general reserve	...	...		B	(<input style="width: 80px;" type="text"/>)
<i>from</i> general reserve	...	...		C	<input style="width: 80px;" type="text"/>
Voluntary transfer					
<i>to</i> general reserve	...	...		D	(<input style="width: 80px;" type="text"/>)
<i>from</i> general reserve	...	...		E	<input style="width: 80px;" type="text"/>
Net transfers	...	...	...	F	<input style="width: 80px;" type="text"/>
Amount available for distribution	...	...		G	<input style="width: 80px;" type="text"/>
Applications					
Dividend at	...	<input style="width: 40px;" type="text"/> %	...	H	(<input style="width: 80px;" type="text"/>)
Rebate of interest at	...	<input style="width: 40px;" type="text"/> %	...	I	(<input style="width: 80px;" type="text"/>)
Donations	...	<input style="width: 40px;" type="text"/> %	...	J	(<input style="width: 80px;" type="text"/>)
Total applied	...	...	...	K	(<input style="width: 80px;" type="text"/>)
Percentage applied	...	<input style="width: 40px;" type="text"/> %	...		
Transfer					
<i>to</i> other reserves	...	...		L	(<input style="width: 80px;" type="text"/>)
Balance unapplied	...	...	...	M	<input style="width: 80px;" type="text"/>
Appropriation account balance at beginning of year	...	...	...	N	<input style="width: 80px;" type="text"/>
Voluntary transfer					
<i>to</i> general reserve	...	...		O	(<input style="width: 80px;" type="text"/>)
<i>to</i> other reserves	...	...		P	(<input style="width: 80px;" type="text"/>)
<i>from</i> other reserves	...	...		Q	<input style="width: 80px;" type="text"/>
Net transfers	...	...	...	R	<input style="width: 80px;" type="text"/>
Applications					
Dividend at	...	<input style="width: 40px;" type="text"/> %	...	S	(<input style="width: 80px;" type="text"/>)
Rebate of interest at	...	<input style="width: 40px;" type="text"/> %	...	T	(<input style="width: 80px;" type="text"/>)
Donations	...		...	U	(<input style="width: 80px;" type="text"/>)
Other applications (<i>specify</i>)	...		...	V	(<input style="width: 80px;" type="text"/>)
Total applied	...	...	...	W	(<input style="width: 80px;" type="text"/>)
Balance unapplied	...	...	...	X	<input style="width: 80px;" type="text"/>
Appropriation account balance at end of year	...	...	...	Y	<input style="width: 80px;" type="text"/>

RESERVES
for the year ended / /

General reserve

Beginning of year A
 (Loss) after tax: transferred from revenue account B () ()

Compulsory transfers

from appropriation account

where general reserve is less than 10% total assets
 the lower of either
 20% profit after tax per revenue account or
 10% total assets less general reserve at beginning of year C

to appropriation account

where general reserve is more than 20% total assets
 general reserve at beginning of year less 20% total assets D () ()

Voluntary transfers

from appropriation account E
to appropriation account F () ()
from other reserves G

End of year H

Other reserves

Beginning of year I

Transfers

to general reserve J () ()
from appropriation account K
to appropriation account L () ()

End of year M

General reserve at end of year as a percentage of total assets N

Profits after tax as a percentage of average total assets O

Applied profits after tax as a percentage of average total assets P

CASH FLOW STATEMENT

for the year ended / /

	Note	£	£	[prior year]	
				£	£
Operating activities					
Entrance fees	A				
Interest received	B				
Bad debts recovered	C				
Administration of juvenile deposit fund	D				
Expenses paid	E	()		()	
Loans made to members	F	()		()	
Repayment of members' loans	G				
Grants received	H				
Other (<i>specify</i>)	I				
Net cash inflow/(outflow) from operating activities			J		
Returns on investments and servicing of finance					
Interest paid	K	()		()	
Dividends and other distributions	L	()		()	
Other (<i>specify</i>)	M				
Net cash inflow/(outflow) from returns on investments and servicing of finance			N		
Taxation					
Tax paid			O	()	()
Investing activities					
Purchase of fixed assets	P	()		()	
Sale of fixed assets	Q				
Purchase of investments	R	()		()	
Sale of investments	S				
Other (<i>specify</i>)	T				
Net cash inflow/(outflow) from investing activities			U		
Net cash inflow/(outflow) before financing			V		
Financing					
Share capital received	W				
Share capital withdrawn	X	()		()	
Loans received	Y				
Loans repaid	Z	()		()	
Other (<i>specify</i>)	AA				
Net cash inflow/(outflow) from financing			BB		
Increase/(decrease) in cash and bank balances	10		CC		

NOTES TO THE FINANCIAL STATEMENTS

1. Principal accounting policies

Basis of accounting

The Credit Union is registered under the Industrial and Provident Societies Act 1965. The financial statements have been prepared under the historical cost accounting rules in accordance with the Industrial and Provident Societies Acts 1965 to 1978 and the Credit Unions Act 1979. Applicable accounting standards have been followed.

Fixed assets

Fixed assets are stated at cost. Depreciation of fixed assets is charged by equal annual instalments commencing with the year of acquisition at rates estimated to write off their cost less any residual value over their expected useful lives as follows:

Freehold offices years

Leasehold offices Over period of lease

Office equipment years

Investments

These are stated at cost, less provision for permanent diminution in value where necessary.

Subsidiary companies

The Credit Union has no subsidiary companies.

Provision for doubtful debts

This is made in accordance with guidance issued by the Registry of Friendly Societies.

Amount of interest

Interest receivable on loans and other investments and payable on loan made to the Credit Union are accrued.

Juvenile depositors

The amounts received by the Credit Union for juvenile depositors are held in a trust fund for those depositors and are excluded from the Revenue account and the statement of cash flow except to the extent of a charge for the administration of the trust fund.

1. Principal accounting policies *(continued)*

Other

Any other material matters should be set out below, or if insufficient space, a separate sheet should be attached to this page.

2. Fixed assets

	Freehold Offices £	Leasehold Offices £	Office Equipment £	Other £	Total £
Cost					
Beginning of year					
Additions					
Disposals					
End of year					
Depreciation					
Beginning of year					
Charge for year					
Elimination in respect of disposals					
End of year					
Net book amount					
End of year					
Beginning of year					

Name of computer system/bureau (if any)

3. Investments

(a) Building societies and other investments

	Beginning of year £	End of year £	Change in year £	Change in prior year £
Building societies				
Shares				
Deposits				
Other investments				
Investments at cost				
/less: provision for permanent diminution in value				
Investments				

(b) Details of other investments held during the financial year

Investment	Date of purchase	Amount £
Total		£

4. Loans

(a) Loans to members

Amount

Beginning of year
 New loans
 Interest on loans (less rebates)
 Loan repayments including interest and transfers of share capital
 Bad debts written off
 End of year

£	[Prior year] £
<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>
<input type="text" value="()"/>	<input type="text" value="()"/>
<input type="text" value="()"/>	<input type="text" value="()"/>
<input type="text"/>	<input type="text"/>

Number

Beginning of year
 New loans
 Loans repaid
 Loans written off
 End of year

Number	[Prior year] Number
<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>
<input type="text" value="()"/>	<input type="text" value="()"/>
<input type="text" value="()"/>	<input type="text" value="()"/>
<input type="text"/>	<input type="text"/>

Loans to members as percentage of total assets

	[Prior year]
<input type="text"/> %	<input type="text"/> %

Secured and unsecured loans

Beginning of year
 End of year
 Largest loan above shareholding made during year
 Longest repayment period for loans made during year

	Secured Loans £	Unsecured Loans £
Beginning of year	<input type="text"/>	<input type="text"/>
End of year	<input type="text"/>	<input type="text"/>
Largest loan above shareholding made during year	<input type="text"/>	<input type="text"/>
Longest repayment period for loans made during year	<input type="text"/> months	<input type="text"/> months

Interest rates charged on loans during the year

Normal rate
 Maximum rate
 Minimum rate

% per month
<input type="text"/>
<input type="text"/>
<input type="text"/>

4. Loans [continued]

(b) Provision for members' doubtful debts

Changes in year

	General £	Specific £	Total £
Beginning of year	<input type="text"/>	<input type="text"/>	<input type="text"/>
Increase/(decrease) in provision	<input type="text"/>	<input type="text"/>	<input type="text"/>
Amounts written off in year	(<input type="text"/>)	(<input type="text"/>)	(<input type="text"/>)
End of year	<input type="text"/>	<input type="text"/>	<input type="text"/>

Provision for members' doubtful debts

as a percentage of

average total assets

total loans at year end

		[Prior year]
average total assets	<input type="text"/> %	<input type="text"/> %
total loans at year end	<input type="text"/> %	<input type="text"/> %

Analysis of loans in arrears (after write offs)

	Up to 3 months	3 to 6 months	6 to 12 months	Over 12 months	Total
Number	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Amount	£ <input type="text"/>	£ <input type="text"/>	£ <input type="text"/>	£ <input type="text"/>	£ <input type="text"/>

Loans in arrears (after write offs) as a percentage of total loans outstanding

	[Prior year]
<input type="text"/> %	<input type="text"/> %

Loans in arrears refinanced

	Number	Amount	[Prior year]	Number	Amount
<input type="text"/>	<input type="text"/>	£ <input type="text"/>	<input type="text"/>	<input type="text"/>	£ <input type="text"/>

5. Juvenile deposits

(a) Fund

	Number of depositors		Amount £
Beginning of year	<input type="text"/>	Beginning of year	<input type="text"/>
New deposits	<input type="text"/>	New deposits (and interest distributed)	<input type="text"/>
Deposit accounts closed	(<input type="text"/>)	Deposits withdrawn	(<input type="text"/>)
End of year	<input type="text"/>	End of year	<input type="text"/>

(b) Investments

	£
Beginning of year	<input type="text"/>
Purchased during year	<input type="text"/>
Sold during year	(<input type="text"/>)
Profit/(loss) on transactions	<input type="text"/>
End of year	<input type="text"/>

(c) Distribution

	£
Interest on investments	<input type="text"/>
Profit/(loss) on transactions	<input type="text"/>
Administration charge	(<input type="text"/>)
Total available for distribution	<input type="text"/>

The distribution will be (was) made to depositors on / /

6. Members and Share Capital

(a) Members

	Qualifying members	Non-qualifying members	Total members
Beginning of year	<input type="text"/>	<input type="text"/>	<input type="text"/>
Added during year	<input type="text"/>	<input type="text"/>	<input type="text"/>
Ceased during year	(<input type="text"/>)	(<input type="text"/>)	(<input type="text"/>)
End of year	<input type="text"/>	<input type="text"/>	<input type="text"/>

The percentage of members not qualifying under the common bond was %

(b) Share Capital

	Amount £
Beginning of year	<input type="text"/>
Received during year	<input type="text"/>
Withdrawn during year	(<input type="text"/>)
Transferred during year	(<input type="text"/>)
End of year	<input type="text"/>

7. Borrowings

	Amount outstanding at end of year £	Due for repayment on	Interest rate %	Name of organisation
Bank loans	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Total	£ <input type="text"/>			
Credit union loans	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Total	£ <input type="text"/>			

Borrowings represents % of share capital

8. Income

(a) Interest receivable

	£	[Prior year] £
Loans to members	<input type="text"/>	<input type="text"/>
Investments	<input type="text"/>	<input type="text"/>
Bank deposits	<input type="text"/>	<input type="text"/>
Credit union loans	<input type="text"/>	<input type="text"/>
Total interest receivable	<input type="text"/>	<input type="text"/>
Yield on average total assets	<input type="text"/> %	<input type="text"/> %

(b) Loans to credit unions in accordance with section 10(1) Credit Unions Act 1979

Name of Credit Union	Date of Loan	Amount of Loan £	Interest rate %	Interest receivable £
<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>	<input style="width: 100%; height: 100%;" type="text"/>
Total		<input type="text"/> £	Total	
			<input type="text"/> £	

9. Expenditure and Staff

(a) Administration expenses

	£	[Prior year] £
Expenses of directors/committee members	<input type="text"/>	<input type="text"/>
Honoraria to officers	<input type="text"/>	<input type="text"/>
Other staff - remuneration	<input type="text"/>	<input type="text"/>
- expenses	<input type="text"/>	<input type="text"/>
Auditors' remuneration	<input type="text"/>	<input type="text"/>
Costs of occupying offices	<input type="text"/>	<input type="text"/>
Printing and stationery and advertising	<input type="text"/>	<input type="text"/>
Bank charges	<input type="text"/>	<input type="text"/>
Fidelity insurance	<input type="text"/>	<input type="text"/>
Other insurance	<input type="text"/>	<input type="text"/>
Other expenses (<i>specify</i>)	<input type="text"/>	<input type="text"/>
Total administration expenses	<input type="text"/>	<input type="text"/>
Administration expenses as a percentage of average total assets	<input type="text"/> %	<input type="text"/> %

9. Expenditure and Staff *[continued]*

(b) Number of paid employees of the credit union as at year end

		[Prior year]
Full time	<input type="text"/>	<input type="text"/>
Part time	<input type="text"/>	<input type="text"/>

10. Cash and Bank Balances

(a) Banks

The Credit Union's bankers are

(b) Analysis of changes in cash and bank balances

	£	[Prior year] £
Beginning of year (net of overdrafts)	<input type="text"/>	<input type="text"/>
Increase/(decrease) per cash flow statement	<input type="text"/>	<input type="text"/>
End of year (net of overdrafts)	<input type="text"/>	<input type="text"/>

(c) Analysis of cash and bank balances

	Beginning of year £	End of year £	Change in year £	Change in prior year £
Cash	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Bank balances	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Bank overdrafts	()	()	<input type="text"/>	<input type="text"/>
Total	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

AUDITORS' REPORT

to the members of the credit union

We have audited the financial statements on pages 2 to 16 which have been prepared under the accounting policies set out on pages 7 and 8.

Respective responsibilities of the committee of management and auditors

As described on page 19 the committee of management is responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to the credit union.

Basis of Opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the committee of management in the preparation of the financial statements, and of whether the accounting policies are appropriate to the credit union's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material mis-statement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

Registered Auditor	
Signature	Name &
<input type="text"/>	<input type="text"/>
Name (block capitals)	Address of firm
<input type="text"/>	<input type="text"/>
Name of contact at firm	
<input type="text"/>	
Tel. no.	Date
<input type="text"/>	<input type="text" value=" / /"/>

Lay Auditors	
Signature	<input type="text"/>
<input type="text"/>	<input type="text"/>
Name (block capitals)	<input type="text"/>
<input type="text"/>	<input type="text"/>
Occupation	<input type="text"/>
<input type="text"/>	<input type="text"/>
Address	<input type="text"/>
<input type="text"/>	<input type="text"/>
Date	Date
<input type="text" value=" / /"/>	<input type="text" value=" / /"/>

OTHER REPORTABLE ITEMS

Committee of Management and other Officers of the Credit Union

The names and addresses of the committee of management and other officers of the credit union

as at / / (end of financial year) according to the Register of

Members and Officers were as follows:

Name (BLOCK CAPITALS)	Post Held	Address and postcode (BLOCK CAPITALS)	Year of birth
Committee of Management			
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

Money Laundering Officer

Is a money laundering officer in post?

Delete as appropriate

Name (BLOCK CAPITALS)	Post Held	Address and postcode (BLOCK CAPITALS)	Year of birth
Loans/Credit Committee			
Supervisory/Internal Audit Committee			

Statement of committee of management's responsibilities

The committee of management are required under credit union legislation to prepare financial statements, for each financial year, which give a true and fair view of the state of affairs of the credit union at the end of the financial year, and of the income and expenditure of the credit union for the year ended on that date.

In preparing these financial statements they are required to:

- select suitable accounting policies and apply them consistently;
- make reasonable and prudent judgements and estimates;
- state whether accounting standards have been followed, and give details of any departures; and
- prepare the financial statements on a going concern basis unless in their view the credit union will be unable to continue in operation.

They are also responsible for:

- keeping proper accounting records;
- maintaining a satisfactory system of control over the accounting records and transactions;
- safeguarding the credit union's assets; and
- taking reasonable steps for the prevention and detection of fraud and other irregularities.

Statutory compliance with Credit Unions Act 1979

Did any shareholding exceed the maximum permitted during the financial year? *[S. 5(3)]*

Did any amount borrowed by the credit union at any time during the year exceed in the aggregate one half of the total paid-up share capital? *[S. 10(1)]*

Did any juvenile depositor at any time during the year have a balance in excess of the statutory maximum? *[S. 9(1)]*

Did the rate of interest charged at any time during the year exceed the statutory maximum? *[S. 11(5)]*

Were all members individuals above the age of sixteen? *[S. 9(1)]*

Has the Credit Union held, purchased or taken on lease in its own name any land for a purpose other than conducting its business thereon? *[S. 12(1)]*

Are all juvenile deposits kept apart from the general funds of the credit union and invested only in "narrower range" investments under the Trustee Investments Act 1961? *[S.9(2)]*

Is any person directly or indirectly concerned in the management of the credit union an undischarged bankrupt or a person convicted on indictment of any offence involving fraud or dishonesty? *[S. 27]*

Fidelity Insurance (Section 15 Credit Unions Act 1979)

Policy issued by

Aggregate value of share subscriptions and deposits received and not repaid at relevant date

Date of inception of policy or last renewal

Amount of cover in respect of:
a. any one claim

Date of expiry of policy

b. all claims made in any one year

Date of next renewal of policy

Relevant date

Were any claims made on the policy during the period covered by the return ?

In accordance with the requirements of the Friendly and Industrial and Provident Societies Act 1968, the financial statements on pages 2 to 16 and the other reportable items on pages 1 and 18 to 20, which together comprise the annual return of the credit union, were approved by the committee of management on

and signed on its behalf by:

	Signature	NAME in BLOCK CAPITALS
Member of the committee of management	<input type="text"/>	<input type="text"/>
Member of the committee of management	<input type="text"/>	<input type="text"/>
Secretary of the credit union	<input type="text"/>	<input type="text"/>